Novus Capital Markets Research

Trains and boats and planes

17 March 2011

This week's blog – on the subject of cars – is prompted by the fact that, walking round the streets of London and driving round Devon I have seen very few of the new '11' registration plates which came in at the start of the month. Methinks the SMMT's hopes for a bumper March may be disappointed.

Buying them: a new car is expensive (you pay a lot of money for an asset that immediately depreciates) and, in the context of hugely improved technology and reliability, easily postponed. Car sales collapsed in the recession, rebounded under the car scrappage scheme, but are once again running below year-earlier levels. Current low levels of consumer confidence do not point to a bounce in car sales.

Making them: as a rough generalisation, we don't make cars any more; we assemble them. That puts parts of UK production at risk when, as now, imports of parts (from Japan) are likely to be curtailed or halted. Three quarters of the cars that we assemble are for export (and a similar number of the cars that we drive are imported). Car output also plummeted in the recession but, boosted by a strong rebound in the global economy, vehicle production is up 15% in the last year, according to today's figures from the SMMT. Exports are up 27% and the trade deficit on cars is on its way to being eliminated.

Running them: motorists don't need telling that pump prices are at record levels. In fact they have risen every week for over six months, boosted by a combination of oil prices at $110 a barrel (from less than $80 a year ago), VAT at 20% and an extra 2.76p on fuel duties. The Government inherited plans to increase duties by 1p a litre in real terms every year. The Treasury may not be able to come up with a sensible design for a fair fuel stabiliser in next week's Budget but you can be sure the Chancellor will use the windfall that he has received from higher oil prices to backtrack on this year's duty increase.

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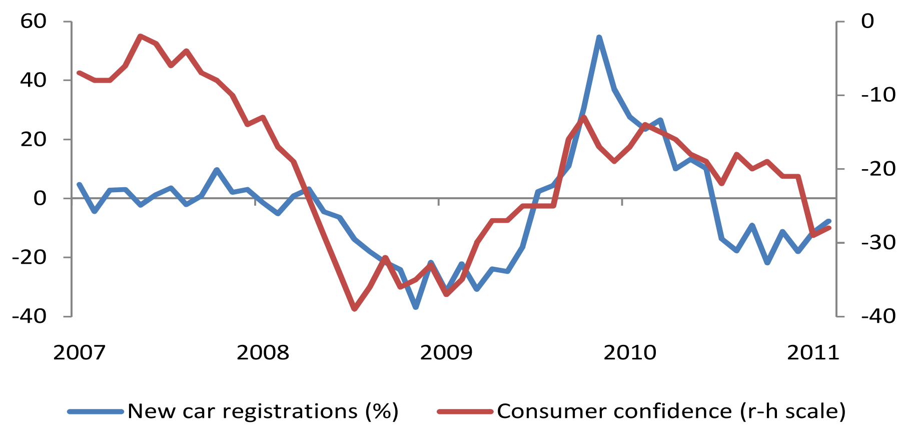
Buying them

New car sales collapsed in the recession. On ONS data new car registrations fell 21.7% in 2008 (Dec/Dec) and in early 2009 the decline had accelerated to nearer 30%. The response of the then Labour Government was to introduce, in the Budget of March 2009, a car scrappage scheme, under which ten-year old cars could be traded in for new with a £2k discount, half of which would come from the 'Government' (the tax-payer). The scheme was launched in May 2009 and ran until March 2010. In all, funding was made available for up to 400k cars to be scrapped.

The positive effects of the scrappage scheme became evident by around the middle of 2009 when sales started to rise in y/y terms. By the end of the scheme in March 2010 sales growth was running at over 25% (although for 2009 as a whole sales were down 6.8%). Now that the scheme has ended and the temporary boost from scrappage has run its course, new car registrations are down again. According to the Society of Motor Manufacturers and Traders (SMMT), sales have fallen in y/y terms for eight successive months. In the latest month (February) sales were down 7.7% overall with private car sales (which excludes fleet sales) down 26.7%. The SMMT is hoping for better in March with the introduction of the 11-plate. On current levels of consumer confidence, it may not get it (Chart 1).

Chart 1: New car registrations (% y/y)



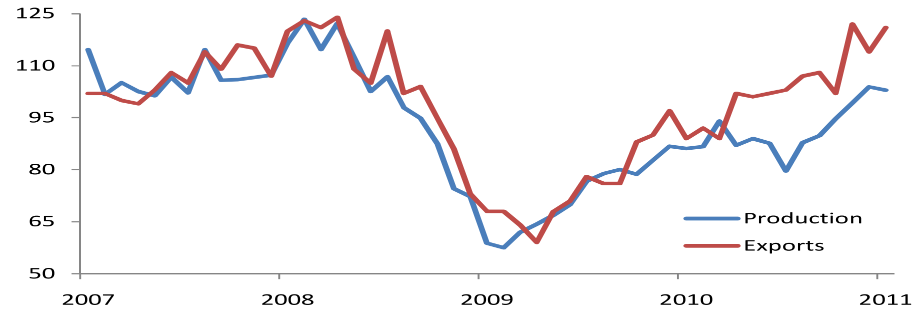
Source: ONS, SMMT, GfK

Making them

The face of the UK car industry has changed radically over the years. Most of it is now under foreign ownership as overseas companies have taken over failing British manufacturers and as the Japanese in particular have opened production facilities here. One fall-out from this process is that the UK is now less of a manufacturer of cars and more of an assembler as many parts are imported directly from overseas and then assembled into cars on UK production lines. A consequence of this can be seen in the aftermath of the earthquake and tsunami where production of parts in Japan has been affected or even halted. Any shortfall in deliveries of parts would then affect UK car production. The reverse effect is true for UK car component manufacturers such as GKN which supply the Japanese domestic market.

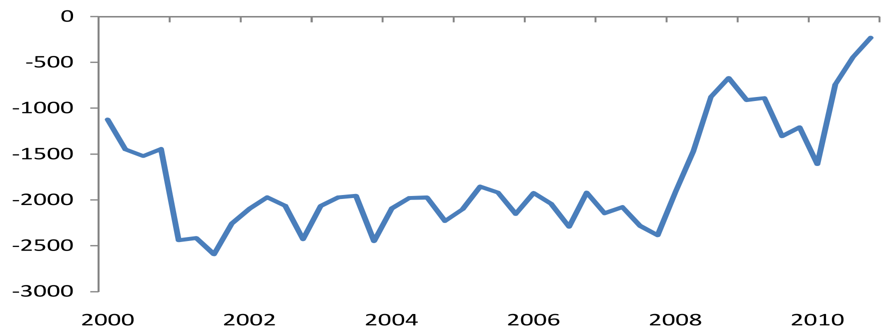
UK car production took a huge hit in the recession. Between February 2008 (the peak) and February 2009 (the trough) output more than halved as factories and production lines were closed for extended periods. Since then output has climbed steadily and is almost back at the levels of 2007 though, like many areas of production, it is still some way off the pre-crisis peak. Exports, which fell in tandem with output in the recession, have come back more strongly and are just shy of pre-crisis levels (Chart 2). In the last three months alone vehicle exports have risen 15% such that by 10q4 the deficit on vehicles was well on its way to being eliminated (Chart 3). On SMMT estimates (published today) car output rose 15% in the year to February and exports were up 27%. Overall something like three quarters of UK car production is now exported (and a similar number of the cars that we buy are imported).

Chart 2: UK production and export of motor vehicles (2006 = 100)



Source: ONS

Chart 3: UK trade balance in motor vehicles (£m)

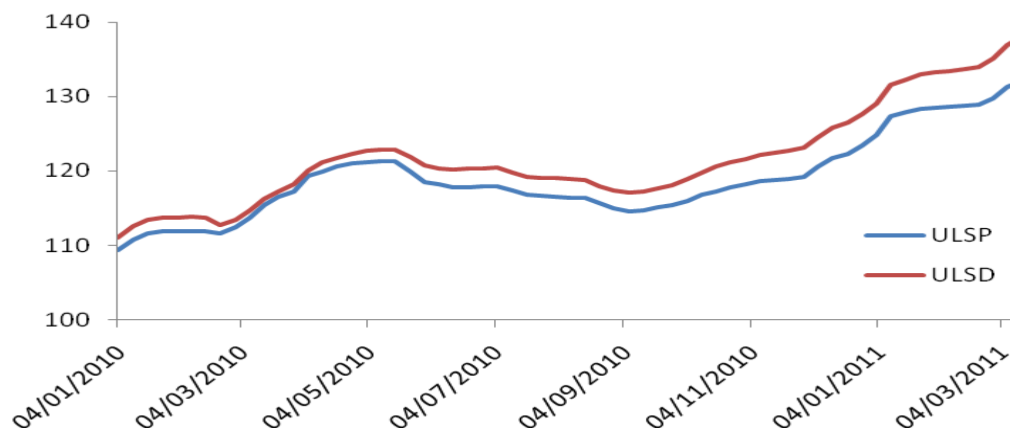


Source: ONS

Running them

Week by week pump prices hit new record levels. This week petrol prices averaged 132.18p/litre and diesel averaged 138.25 (Chart 4). They have risen every week since last September, a run of 27 weeks and are now 14.5% up on the last year in the case of petrol and 19% for diesel.

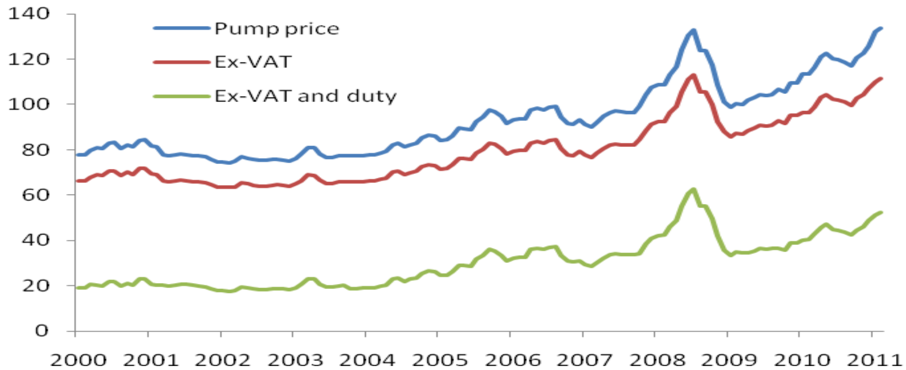
Chart 4: Weekly fuel costs (pence/litre)



Source: DECC

As a result of the hike in VAT to 20% in January and the increase in fuel duty from 58.19 to 58.95 pence/litre, VAT and duty combined currently account for more than 80p (>60%) of the pump price (Chart 5). In the last year taxes account for nearly half of the increase in pump prices, 7.6p out of 16.7p for petrol and 8.5p out of 22p for diesel (Table 1).

Chart 5: The make-up of the pump price (diesel)



Source: DECC

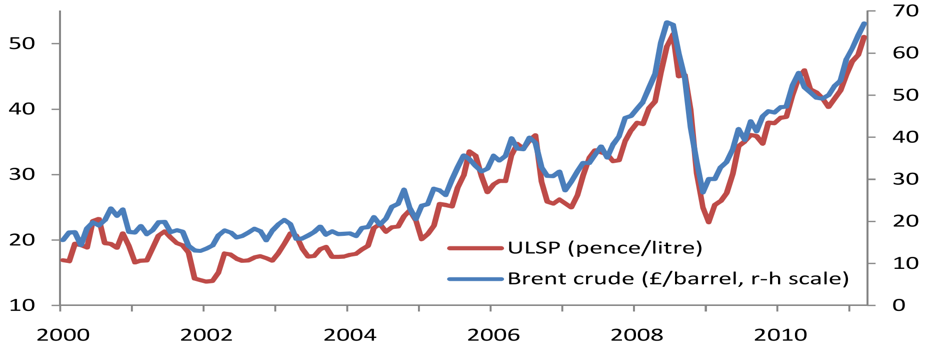
Table 1: The make-up of the pump price

Pence/litre		Ex-taxes	Duty	VAT	Pump
Petrol	14.3.11	51.20	58.95	22.03	132.18
	15.3.10	42.08	56.19	17.20	115.46
	change	9.12	2.76	4.83	16.72
Diesel	14.3.11	56.26	58.95	23.04	138.25
	15.3.10	42.71	56.19	17.31	116.21
	change	13.55	2.76	5.73	22.04

Source: DECC

At the same time as fuel taxes have been increased the price of oil has been on a rising trend. A year ago Brent crude was selling at just under $80 a barrel compared with $110 currently. Over the same period sterling has risen against the dollar but even so the sterling price, which is closely correlated with the ex-tax price of fuel (Chart 6) has risen from about £52 a barrel to around £67 currently. Over the same period the ex-tax price of petrol has risen from about 42p/litre to 51p while that of diesel has risen from around 43p to 56p.

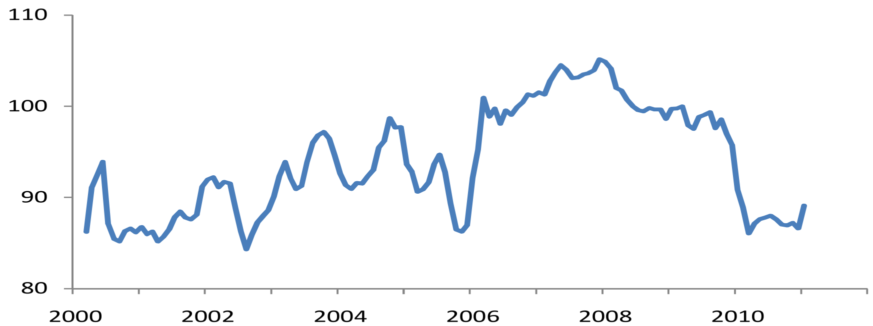
Chart 6: Oil prices and the ex-tax price of petrol



Source: DECC

Against this background it is no surprise that retail sales of petrol have barely picked up over the last year and are languishing a long way below pre-crisis levels (Chart 7).

Chart 7: Retail sales of petrol (volume, 3m average)



Source: ONS

The present Government inherited a 1p/litre rise in fuel duty, which had been implemented on 1 April 2010, and a commitment to raise duties by another 1p/litre on 1 October and 0.76p/litre on 1 January 2011. The coalition Government has implemented these proposals, raised VAT to 20% and also retained the previous Government's commitment to increase fuel duties by 1p/litre in real terms each year from 2011 to 2014.

The Chancellor asked the OBR to examine the case for a fair fuel stabiliser. Under this proposal duties are allowed to take some of the strain of (temporary) fluctuations in the price of crude, rising when global prices are low/falling and falling when, as now, global prices are high/rising. In this way the motorist would be spared some of the pain of high global oil prices (or, more accurately, the pain would be shared with all tax-payers, whether they are motorists or not). The OBR Report estimated that a £10 a barrel increase in the price of oil benefited the public finances by £2.4bn in the first year. In the last 12 months the price of a barrel of oil has increased by nearly £15 (nearly $30 a barrel, some of which has been offset by a rise in sterling against the dollar), which means that the public finances will have gained around £3½bn from the higher oil price.

The OBR Report found that any short-term benefits would be offset by other effects in the wider economy and concluded that there was little reason to support a fair fuel stabiliser. Nevertheless, the Treasury is still working on the scheme. Whether they are able to come up with something in time for next week's Budget remains to be seen but, at the very least, we can expect the Chancellor to use the windfall that he has received from higher oil prices to rescind the 1p duty increase that has been announced for April.

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