

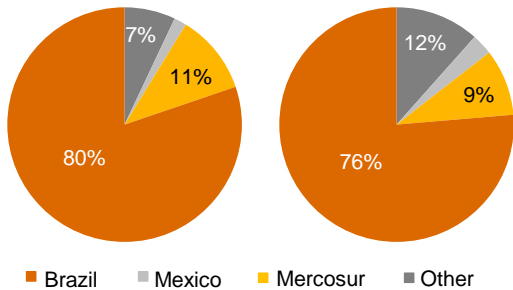
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Policy changes for Brazil's auto sector Decree 7,567 aims to bolster local industry

Superficially, a 30% hike in sales tax rates on imported vehicles should slow their rise in the Brazilian market. However, already high levels of investment in Brazil's auto sector and Mercosur and Mexican exemptions will limit the market impact, but serve to slow the rise of Chinese imports.

Brazil: Light Vehicle Sales by Source
2010 vs. 2011 YTD



Source: ANFAVEA, Autofacts Analysis

Growing share of imported vehicles

Although the overall Brazilian light vehicle market is up 7.5% 2011 YTD, the market has seen a 1.6% decrease in demand for domestically built cars. Because domestic cars account for 61.5% of the domestic light vehicle market, this decline has held domestic light vehicle sales growth to a modest 1.2%. The driver of overall market growth has been imports, with YTD total import sales up 34.7%, with imported cars (up 43.2%) leading the way.

Tax change from government

On September 15th, the Brazilian government announced Federal Decree number 7,567. The decree has a dual purpose – to reduce demand for imports and to encourage local manufacturing and export growth. The headline change is the 30% increase across the board in Federal Excise Tax (IPI) rates on certain imported vehicles and auto parts. In fact, the increased IPI rates apply

regardless of the vehicles being imported or resold. The rate rise will increase vehicle prices by 25-28%. Importantly, local manufacturers meeting certain requirements will benefit from tax reductions that negate the IPI increase. Requirements include 65% local content, a commitment to local R&D and the onshoring of six out of 11 production processes outlined in the decree. For the purposes of calculating the level of local content, the decree expressly mentions that parts imported from Mercosur and Mexico should be considered locally produced goods.

Impact of tax hike likely to be muted

While the policy change has made headlines, the plan's true impact will likely be muted. As noted, Mercosur and Mexico are excluded from the measure. Vehicles imported from North America, Europe and Asia will be affected the most, with the rise of Chinese vehicle sales the most worrying for Brazil's policy makers. Chinese makers have succeeded in gaining 3.3% market share after being in the market just over a year.

While the decree is also designed to bolster and encourage local investment by global automakers in Brazilian facilities, it is likely that most manufacturers with plans for future Brazilian capacity have already declared their investments. The decree requirements will undoubtedly improve the quality of those investments. By 2017, Autofacts expects 2.2 million units of incremental light vehicle capacity to be added to Brazil. This increase consists of a 1.2 million unit upgrade at existing facilities in the 2011-2017 timeframe and nearly one million units of capacity represented by six all new assembly plants.