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BMI Industry View

The medium-term outlook for Iranian auto production remains cautiously optimistic, reflecting the temporary deal reached between the US and major powers over the future of its nuclear programme in November 2013. **BMI**'s Country Risk team's *core view remains that talks will continue over the coming years, with the potential for a long-term agreement to be found, although we cannot preclude a breakdown in talks over the coming quarters, which could unleash a Western military response. Over the very near term, there is the chance that the* six-month interim arrangement agreed in November 2013, which expires on July 20 2014, could be extended by an additional six months should both parties agree.

Data reported by Iran's IRNA news agency in January 2014 suggest that there is cause to be less bearish in our estimate for 2013 full-year vehicle production. For the first 10 months of the Iranian calendar year, ending March 21 2014, the industry produced 576,663 units, down 10.5% from the previous year.

We consequently believe there is good reason to upgrade our production estimate for 2013, while the return of French carmaker Renault, and the potential for others to follow suit, creates significant upside potential for at least the early part of 2014. This supports our forecast for a return to positive production growth of at least 10% for passenger cars in 2014, although this will be subject to revision based on sanction developments.

Based on a poor first half of 2013 and perceived ongoing headwinds, we had previously projected a 50% decline in vehicle output for the calendar year 2013 (January to December), as based on OICA reporting periods. We believe that the moderation in the output contraction over the Iranian year so far can be attributed to the return of some models to the country's line-up as national manufacturers source domestically produced parts, as well as the ramping up of production of the 'national cars', such as **Iran Khodro Company's (IKCO)** Runna. As such, we have upgraded our output estimate for 2013 to a 28% contraction.

Looking ahead, the temporary deal reached with the P5+1 group to ease sanctions on the country provides the opportunity for a number of international carmakers to return to the market and restore at least some lost output. With the initial deal in place for just six months, while a more long-term solution is negotiated, we would expect the most significant uptick to be in the early part of the year until we know more regarding the future beyond the six-month period.

Early signs are promising, as Renault has already recommenced shipments of parts for its Tondar model for assembly in the country. At present the shipments are 'very low' in numbers, according to Renault's head of Asia Pacific (including the Middle East), Gilles Normand. However, it is a step towards normalising operations in the country. Fellow French carmaker PSA Peugeot Citroen has also signalled its intent to return.

Looking forward, although it is still unknown how long these companies will be able to remain operational in the country, we would expect them to make the most of their time, eventually ramping up output in what Normand called 'a window of opportunity for the next six months'. There is potential for other carmakers which previously had operations in the country to return, as Kia Motors, which had a tie-up with Saipa, is also reportedly monitoring the situation.

In a further encouraging development, in December 2013 it was reported that more than US$1bn in foreign direct investment has been approved for Iran's automotive manufacturing industry, according to the head of the Organisation for Investment, Economic and Technical Assistance of Iran, Behrouz Alishiri. Some US $300mn has already been invested. The government wants to turn Iran into an automobile production hub by extending legal support and special privileges to overseas investors. Alishiri says the government will provide a long-term plan to the Iranian automobile sector to help find reliable foreign investors.

In 2013, local car producer **Saipa** remained the dominant player on the Iranian new car sales market, selling 237,724 units, according to figures on the Focus2Move website. This equated to a market share of nearly 40%. Saipa manufactures Iran's most popular car, the Pride.

In second place is French carmaker **Peugeot**, on 181,051 units (30% share), followed by **Iran Khodro Company** on 102,051 (17%).

In fourth and fifth place were **Renault** (45,221; 7.5%) and Chinese automaker **Chery** (23,610; 3.9%)

SWOT

Iran Auto Industry SWOT

Strengths	▪ The largest car-producing market in the Middle East. ▪ Domestically developed engines, as well as vehicles, reduce the country's reliance on imports. ▪ Growing middle class that should provide high demand for new cars over the medium term.
Weaknesses	▪ Local parts and components manufacturers face capacity constraints, which will mean greater reliance on foreign imports in car assembly. ▪ Production likely fell over 2013.
Opportunities	▪ Should a permanent deal on Iran's nuclear programme be reached and sanctions ended, then we would expect the domestic economy to grow rapidly over the medium term, which in turn would boost demand for new cars. ▪ As Iran's car sector grows, it will increasingly rely on outsourcing for parts and components. ▪ Agreements with Chinese manufacturers brings new business partnerships and uses for capacity.
Threats	▪ Should talks between Iran and the West collapse in 2014, then the country would remain subject to US trade sanctions, which would continue to cut the country off from international investment. ▪ Political instability remains a key concern for the whole Iranian economy.

Political

Political SWOT Analysis

Strengths	▪ Since the overthrow of the Pahlavi family in 1979, there has been some reduction in the level of political corruption, while wealth distribution has improved marginally. ▪ The Revolutionary Guard and Basij militia are fiercely loyal to the supreme leader, helping to maintain social stability.
Weaknesses	▪ The country has one of the poorest human rights records in the region, and authorities do not hesitate to quell dissidents. A number of journalists and anti-government protesters are being held in custody. ▪ While decision-making ultimately rests with the supreme leader, the regime is heavily fragmented, and consensus is hard to reach. ▪ Widespread perceptions of electoral fraud during the course of June 2009's presidential elections have damaged the regime's legitimacy in the eyes of many Iranians.
Opportunities	▪ The Majlis (parliament) is more than just a rubber stamp; the move by 150 parliamentarians (out of 290) to hold former president Mahmoud Ahmadinejad accountable for his handling of the economy in March 2012 is a positive indication that checks exist. ▪ The victory of moderate cleric Hassan Rouhani in Presidential elections in June 2013 is leading to a significant improvement in relations with the West.
Threats	▪ Despite progress in nuclear talks, the prospect of further US and EU sanctions and the possibility of a military strike by the US or Israel cannot be dismissed entirely. ▪ Youth unemployment is high. ▪ The strong influence of the Revolutionary Guards within the political and economic arena may present a challenge to reform over the long term.

Economic

Economic SWOT Analysis

Strengths	▪ Iran has the world's second largest proven oil reserves after Saudi Arabia, and the world's second largest proven gas reserves after Russia. ▪ Oil and gas aside, Iran is rich in other resources and has a strong agricultural sector.
Weaknesses	▪ Local consumption of hydrocarbons is rising rapidly; this, coupled with ageing technology in the sector, will have a negative impact on its oil and gas exporting capacity. ▪ International sanctions discourage foreign oil companies from bringing much-needed technical knowledge and equipment to maintain oil output levels.
Opportunities	▪ The gas sector remains underdeveloped, and there is considerable room to maximise this source of revenue. ▪ A growing population, combined with a shortage of housing, provide opportunities for investment in residential construction.
Threats	▪ A decline in global oil prices would have a marked impact on the economy. Although an Oil Stabilisation Fund exists to protect the economy at times of weaker oil prices, it has increasingly been used to fund government overspending and could be close to empty. ▪ Capital flight could continue, particularly should negotiations on the nuclear programme fail.

Business Environment

Business Environment SWOT Analysis

Strengths	▪ The Foreign Investment Promotion and Protection Act gives some protection to foreign investors and now allows relatively good terms for the repatriation of profits. ▪ Although stifled in the years since the Islamic Revolution, Iranians have traditionally been renowned for their entrepreneurial skills - a factor that is potentially a strong pull for foreign investors.
Weaknesses	▪ Progress on the privatisation front remains slow despite some recent encouraging signs. ▪ Foreign firms are currently unable to own Iran's hydrocarbon resources. The resultant 'buy back' deals offer less advantageous terms than those elsewhere, limiting hopes of new investment.
Opportunities	▪ As part of the fourth five-year development plan 2005-2009, the government ended tax and customs concessions afforded to the country's quasi-statal bonyads, or foundations.
Threats	▪ UN, US and EU sanctions on Iran's banking and energy sectors are making it very difficult for foreign companies to undertake financial transactions with Iranian entities, and much riskier to invest in the hydrocarbon sector. ▪ Central bank supervision of charitable funds will be stepped up sharply after it emerged that a number of these funds had collapsed due to indiscriminate lending practices.

Industry Forecast

Production

Table: Iran Automotive Production, 2011-2018

	2011	2012f	2013f	2014f	2015f	2016f	2017f	2018f
PRODUCTION: Vehicles, units	1,648,505	991,847	610,120	666,096	787,457	968,907	1,060,133	1,148,876
PRODUCTION: Vehicles, units, % chg y-o-y	3.1	-39.8	-38.5	9.2	18.2	23.0	9.4	8.4
PRODUCTION: Passenger cars, units	1,413,276	871,997	538,170	591,987	710,384	887,981	976,779	1,064,689
PRODUCTION: Passenger cars, units, % chg y-o-y	3.4	-38.3	-38.3	10.0	20.0	25.0	10.0	9.0
PRODUCTION: Passenger cars, % of total domestic vehicle unit production	85.7	87.9	88.2	88.9	90.2	91.6	92.1	92.7
PRODUCTION: Commercial vehicles, units	235,229	119,850	71,950	74,109	77,073	80,926	83,354	84,188
PRODUCTION: Commercial vehicles, units, % chg y-o-y	1.2	-49.0	-40.0	3.0	4.0	5.0	3.0	1.0
PRODUCTION: Commercial vehicles, % of total domestic vehicle unit production	14.3	12.1	11.8	11.1	9.8	8.4	7.9	7.3

e/f = BMI estimate/forecast. Sources: OICA, UN Comtrade

Data reported by Iran's IRNA news agency in January 2014 suggest that there is cause to be less bearish in our estimate for 2013 full-year vehicle production. For the first 10 months of the Iranian calendar year, ending March 21 2014, the industry produced 576,663 units, down 10.5% from the previous year. Over the first 11 months of the current Iranian year, auto production rose to 656,990 vehicles. The country made 557,013 sedans, which accounted for 84% of the total output in the reported period. The country produced 93,183 vans, 6,324 trucks, 379 autobuses and 92 minibuses in the same period, reports Shata. The report added that Iran made 80,476 vehicles from January 21 to February 19, of which 68,107 were sedans. During this period, the country made 11,713 vans, 607 trucks, 38 autobuses and 11 minibuses.

We consequently believe there is good reason to upgrade our production estimate for 2013, while the return of French carmaker Renault, and the potential for others to follow suit, creates significant upside potential for at least the early part of 2014. This supports our forecast for a return to positive production growth of at least 10% for passenger cars in 2014, although this will be subject to revision based on sanction developments.

Based on a poor first half of 2013 and perceived ongoing headwinds, we had originally projected a 50% decline in vehicle output for the calendar year 2013 (January to December), as based on OICA reporting periods. We believe that the moderation in the output contraction over the Iranian year so far can be attributed to the return of some models to the country's line-up as national manufacturers source domestically produced parts, as well as the ramping up of production of the 'national cars', such as **Iran Khodro Company's (IKCO)** Runna. As such, we have upgraded our output estimate for 2013 to a 28% contraction.

Looking ahead, the temporary deal reached with the P5+1 group to ease sanctions on the country provides the opportunity for a number of international carmakers to return to the market and restore at least some lost output. With the initial deal in place for just six months, while a more long-term solution is negotiated, we would expect the most significant uptick to be in the early part of the year until we know more regarding the future beyond the six-month period.

Early signs are promising, as **Renault** has already recommenced shipments of parts for its Tondar model for assembly in the country. At present the shipments are 'very low' in numbers, according to Renault's head of Asia Pacific (including the Middle East), Gilles Normand. However, it is a step towards normalising operations in the country. Fellow French carmaker PSA Peugeot Citroen has also signalled its intent to return. Having been one of Iran's leading foreign brands before sanctions were tightened, a return to the market for Peugeot would help to offset the ongoing slump in the group's European business.

Indeed, looking to the longer term, the resumption of business in Iran could be a lifeline for the PSA Group. The country had been Peugeot's second-largest market after France before the sanctions. As a result of such a significant market being removed from its operations, CFO Jean-Baptiste de Chatillon said the company has been losing EUR10mn a month in operating profit. Combined with the slowdown in Europe, this saw the PSA group post an operating loss of EUR510mn in H113, following a EUR1.5bn loss in 2012.

Although it is still unknown how long these companies will be able to remain operational in the country, we would expect them to make the most of their time, eventually ramping up output in what Normand called 'a window of opportunity for the next six months'. There is potential for other carmakers which previously had operations in the country to return, as Kia Motors, which had a tie-up with Saipa, is also reportedly monitoring the situation.

This period of increased international activity will be backed by domestic carmakers ramping up output of their own models, which are increasingly targeting the export market - also in need of a boost since sanctions hit. In the first nine months of the Iranian year, exports fell 88.9% year-on-year (y-o-y) to just 4,824 units. Shipments were largely limited to three main markets - Iraq with 2,542 units, Azerbaijan with 1,147 units and 612 vehicles exported to Egypt.

Here too there is upside potential, however, as Saipa has announced that production of its Taiba car grew 74.7% y-o-y in the first 10 months of the Iranian year on the back of increased exports, and more markets have recently been added. In 2012, the model passed the Euro 4 tests allowing it to be sold in Ukraine. In January, it was granted permission to be sold in Russia, which will also open up the Kazakhstan and Belarusian markets through their customs union. As a result, Saipa is aiming to export 20% of its output a year by 2016.

As a result of the country's depleted production, imports show the only sign of positive growth in the market, rising 49.2% y-o-y in the first nine months to 44,647 units. The bulk of imports, some 33,899 units, came from the UAE, which is a traditionally strong re-export market for the region. Interestingly, however, one of the next biggest import sources was China with 7,099 units. This supports **BMI**'s long-held view that, as Chinese carmakers look to diversify their overseas growth markets, the Middle East will become a key region.

Among domestic automakers, **Iran Khodro Company** (IKCO) is also likely to benefit from the potential return of its former partner, although the domestic carmaker had been making progress in producing its own components for models such as the Peugeot 206 following the French firm's withdrawal. Local production of Peugeot models in September and October 2013 topped 10,000 units a month for the first time in three years. According to data from the Iran Vehicle Manufacturers Association, the Peugeot Pars claimed second place in terms of output in October 2013, with 10,533 units produced. In total, we still forecast a 50% decline in vehicle production in 2013, however.

Indeed, there remains a great deal of 'wait and see' sentiment in the industry, until the full details of future operating in the Iranian market have been made clear. South Korea's **Kia Motors**, which had a partnership with domestic producer **SAIPA** until it withdrew from the market in 2010, said it will wait for more information before commenting. Germany's Daimler, which used to have a 30% stake in a diesel engine joint venture with IKCO before starting to cut back its Iranian business in 2010, said it will 'closely monitor' the situation, but has no plans to return to the market.

In a further encouraging development, in December 2013, it was reported that more than US$1bn in foreign direct investment has been approved for Iran's automotive manufacturing industry, according to the head of the Organisation for Investment, Economic and Technical Assistance of Iran, Behrouz Alishiri. Some US $300mn has already been invested. The government wants to turn Iran into an automobile production hub by extending legal support and special privileges to overseas investors. Alishiri says the government will provide a long-term plan to the Iranian automobile sector to help find reliable foreign investors.

Iranian vehicle production ended calendar year 2012 down 40% on the previous year, and registered a similar decline for the Iranian year ending March 20 2013. Although the latter months of the Iranian year showed signs of improvement with year-on-year declines shrinking, **BMI** believes there are still too many risks to manufacturing - not least the shortage of capital and Western sanctions - to expect a full recovery in the current year.

New opportunities have also arisen in the form of an agreement reached in March 2014 between Saipa and Chinese automaker Chongqing Changan Automobile Co. to manufacture cars jointly, reports ISNA. Under the agreement, two models of car will be manufactured by Saipa's subsidiary Saipa Kashan. This subsidiary has the capacity to make 180,000 cars on a yearly basis. Meanwhile, 502,273 cars were produced in Iran in the first three quarters of the current Iranian calendar year, which commenced on March 21. In addition, the Iranian government intends to reduce car import tariffs to zero in two year period, according to a member of the Iranian parliamentary Industries and Mines Committee, Ali Ali-lou. The move is expected to enhance domestic production and make the auto industry competitive with its counterparts across the globe.

Further long-term upside potential comes from a new plant in the planning stages due to open in 2015. According to ISNA reports, the plant will have an annual production capacity of 5mn units and will produce the first fully national car to be sold for US$10,000-12,000. If this projected capacity is correct, **BMI** believes it will be incredibly ambitious to achieve and as such we have not factored this full total into our forecasts. We have raised our outlook for 2015 and beyond to take new capacity into account, but await confirmation of the new plant's projected capacity.

Sales

Table: Iran Automotive Sales, 2011-2018

	2011	2012f	2013f	2014f	2015f	2016f	2017f	2018f
SALES: Vehicles, units	1,590,000	1,030,995	711,000	782,100	821,205	886,901	966,723	1,063,395
SALES: Vehicles, units, % chg y-o-y	6.5	-35.2	-31.0	10.0	5.0	8.0	9.0	10.0

Source: BMI

Information on latest sales data is more difficult to obtain. However, **BMI** surmises that sales will move largely in line with domestic production over the forecast period, ending at around 925,000 units by 2018. Much will depend on how the talks between Iran and the major powers progress over early 2014. Should sanctions be permanently eased, then there is scope for more rapid growth in new car sales as the Iranian economy - especially its key oil sector - regains access to the world's markets.

However, if the talks fail and new sanctions are imposed, then the future of the few remaining international carmakers - such as Renault - still operating in Iran would be called into question.

Turning to the macroeconomic backdrop within the country, **BMI** forecasts Iran's economy to expand by 2.8% and 3.4% in real terms in 2014 and 2015, respectively, from an estimate of a 3.5% contraction in 2013. Iran and the 5+1 powers (the United States, Russia, China, France, Britain and Germany) clinched an interim deal on the Islamic Republic's nuclear programme on November 24, including gains of approximately US$7bn in sanctions relief. This will result in an improved outlook for exports, as well as increased confidence among investors and consumers. In addition, we see macroeconomic management improving significantly during the presidency of Hassan Rouhani, which will lead to a gradual decline of price pressures over the coming years. Encouragingly for the auto sector, we see private consumption and fixed investment as the major drivers of growth in 2014 and 2015.

Trade

Vehicle exports from Iran fell 94.3% y-o-y for the first five months of the Iranian year, which started March 21 2013, according to Iranian news agencies. **BMI** believes there are a number of reasons for this, making it difficult for domestic producers to rectify the situation in the near term. The biggest cause is the parallel slump in production, brought about by the withdrawal of several international carmakers from their local assembly agreements.

The decline in production outline above is perhaps the biggest driver of the decline in production. Combined with this is the fact that sanctions are also hitting imports, which means more output is required to accommodate the domestic market. Although imports of fully built cars are not actually included in the latest round of US sanctions, which took effect in July, carmakers have still chosen to suspend exports to the country. However, a lack of reliable sales data makes it hard to judge to what extent domestic models are filling the void left by imports.

Iran's major export market for its cars remains Iraq, despite occasional reports of Iraq trying to ban Iranian-built cars on sometimes spurious grounds, such as poor quality standards. Indeed, Iraq was the largest market for Iranian cars in the six months of the current Iranian year started March 21, according to a report by the Iraqi Customs Department in October 2013. The report showed that the Iraqi share of Iranian sedans equalled 59.2% in the reported period, while Azerbaijan and Egypt were second and third with a share of 13.5% and 9.2% respectively, ISNA reported. Iran exported 2,218 sedans worth US$16mn during the period.

While this may have contributed to the drop in exports, the decline is not totally negative. IKCO has turned to a domestic assembly line in Iraq, which is due to have an annual production capacity of 30,000 units, reducing the need to export to the country. Industry-wide, however, Iraq accounted for over 90% of exports in the previous Iranian year and this will be a big loss to offset.

Carmakers have sought new markets to expand their export operations, however. In September 2013, IKCO announced it will begin exporting the Samand, Runna and Soren models to Tunisia. The company plans to ship 100,000 units by 2014 and will use the country as a base for exports to Libya and Algeria.

IKCO has already expanded exports to Ukraine and Kazakhstan in the current year to date. According to CEO Javad Najmeddin, after shipping 95% of exports to Iraq in the last Iranian year, Kazakhstan, Venezuela, Turkmenistan and Ukraine were the main export markets for the first quarter of the current year.

Passenger Vehicles

In 2013, local car producer **Saipa** remained the dominant player on the Iranian new car sales market, selling 237,724 units, according to figures on the Focus2Move website. This equated to a market share of nearly 40%. Saipa manufactures Iran's most popular car, the Pride.

In second place was French carmaker **Peugeot**, on 181,051 units (30% share), followed by **Iran Khodro Company** on 102,051 (17%).

In fourth and fifth place were **Renault** (45,221; 7.5%) and Chinese automaker **Chery** (23,610; 3.9%)

According to Focus2Move, the total number of light passenger vehicles 'produced and shipped to dealers in Iran' over 2013 stood at 601,407 units, up by 17% year-on-year (y-o-y).

Table: Iran - Top 5 Best-Selling Manufacturers

Manufacturer	Sales	Market Share (%)
Saipa	237,724	39.5
Peugeot	181,051	30.0
Iran Khodro	102,051	17.0
Renault	45,221	7.5
Chery	23,610	3.9

Source: Focus2Move

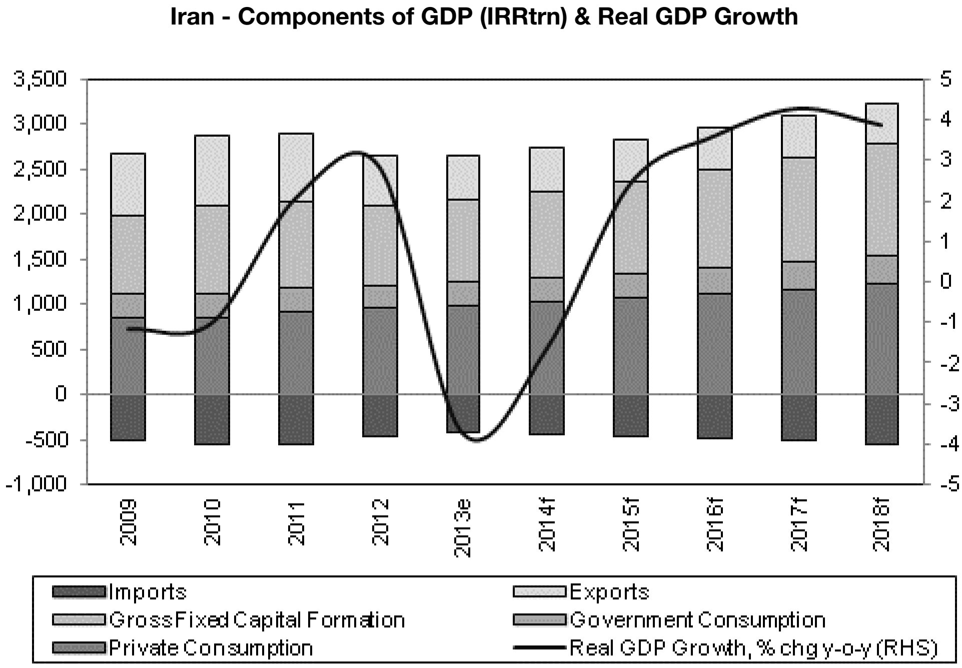
Macroeconomic Forecast

Economic Analysis

BMI View:*We project Iran's economy to expand by 2.8% and 3.4% in real terms in 2014 and 2015, respectively, from our estimate of a 3.5% contraction in 2013. Improving relations with the West and better macroeconomic management, coupled with low base effects, will lead to an improved outlook for exports and increased business and consumer confidence. That said, the macroeconomic outlook will remain highly susceptible by developments in negotiations on the nuclear programme.*

We forecast Iran's economy to expand by 2.8% and 3.4% in real terms in 2014 and 2015, respectively, from our estimate of a 3.5% contraction in 2013. Iran and the 5+1 powers (the United States, Russia, China, France, Britain and Germany) clinched an interim deal on the Islamic Republic's nuclear programme on November 24, including gains of approximately US$7bn in sanctions relief (*see 'Interim Nuclear Deal: Key Implications', November 25 2013*). This will result in an improved outlook for exports, as well as increased confidence among investors and consumers. In addition, we see macroeconomic management improving significantly during the presidency of Hassan Rouhani, which will lead to a gradual decline of price pressures over the coming years. We see private consumption and fixed investment as the major drivers of growth in 2014 and 2015.

Private Consumption And Fixed Investment Driving Growth



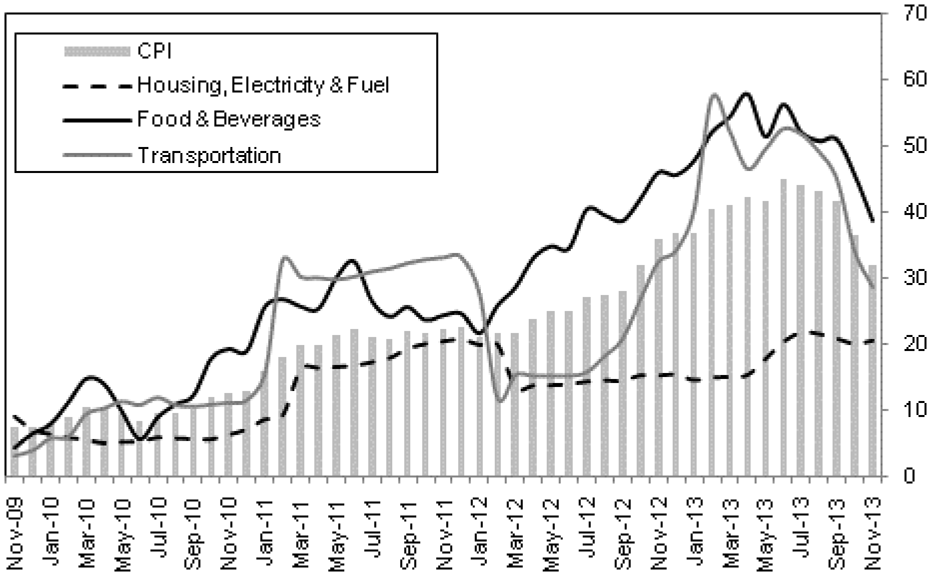
Source: BMI, United Nations. F=BMI Forecasts

Private Consumption Outlook

We project private consumption to increase by 4.0% in 2014 and 5.0% in 2015, compared to our estimate of 3.0% growth in 2013. A combination of high base effects, improving macroeconomic conditions and the government's efforts to tackle inflation will ensure that consumer price index inflation (CPI) gradually declines over the coming quarters. We forecast the headline inflation print to average 26.0% in FY2014/15 (fiscal year running from 21 March 2014 - 20 March 2015), from our projection of 35.0% in FY2013/14. In addition, improving relations with the West and Rouhani's pledge for macroeconomic reform will contribute to increasing investors' and consumers' confidence.

Inflationary Environment Improving Gradually

Iran - Components Of CPI, % chg y-o-y



Source: BMI, Central Bank of Iran

This is not to say, however, that private consumption growth will accelerate drastically over the coming quarters. We expect fiscal policy to be contractionary in FY2014/15 (*see below*), and we do not expect private sector activity to increase at a rapid pace as long as the outcome of nuclear talks remains uncertain. This will ensure that unemployment levels - which currently stands around the 20% level according to unofficial estimates - will remain relatively elevated for the foreseeable future.

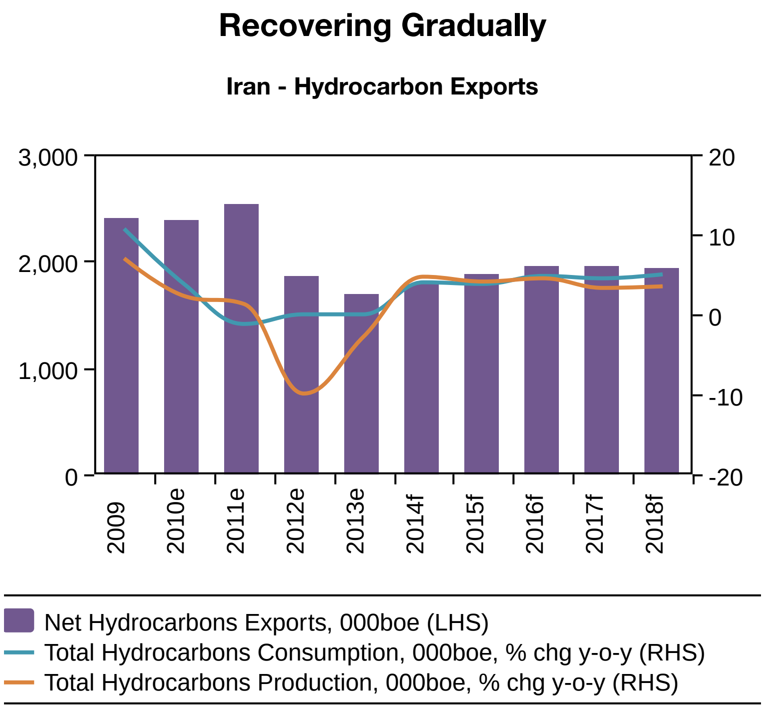
Government Spending Outlook

The government will undertake a relatively contractionary fiscal policy in FY2014/15, as the administration seeks to trim an elevated budget deficit. That said, we do not expect cuts in areas such as healthcare, public services and education to be too radical, as Tehran seeks to maintain public support to its rule. We project government consumption increasing by 1.5% and 3.0% in 2014 and 2015, respectively.

Fixed Investment Outlook

Growth in gross fixed capital formation has been significantly hampered by international sanctions, an opaque business environment and a challenging macroeconomic picture over the past few years. The improving macroeconomic environment and renewed business confidence will in our view contribute to an uptick in investment over the coming quarters, and our Infrastructure and Construction research team sees real growth in the construction industry returning to positive territory as a result. Recent developments have also seen renewed interest by foreign in the Iranian market. As an illustration, German pharmaceutical major Merck said on December 31 2013 that it is considering partnering an Iranian drugmakers to manufacture drugs in the country, while Finland-based Outotec, which provides technologies and services for the metal and mineral processing industries, revealed interest to invest in Iran's iron-ore and pelletising development projects on December 27.

That said, a measure of caution is to be warranted. For one, we do not expect a significant uptick in foreign investment until a longer-term agreement on the nuclear programme is found. Moreover, the continuation of banking and hydrocarbon sanctions will limit investment by domestic companies. We forecast fixed investment expanding by 5.0% in 2014 and 6.0% in 2015, respectively.



Source: BMI

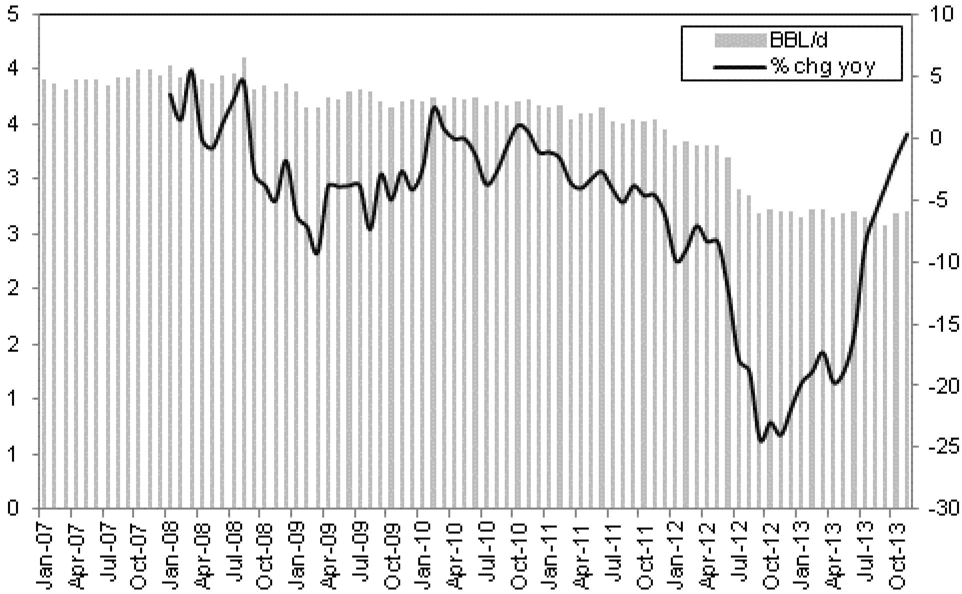
Net Exports

Iran's external position will remain weak over the coming quarters. We see total exports declining by 1.0% in 2014 and 2.0% in 2015, compared to our estimate of a 11.0% decline in 2013. Much of the improvement will result from improving oil exports - which accounted for 85.0% of total exports in 2010.

According to the International Energy Agency, oil production increased by 0.4% y-o-y to 2.71mn bbl/day in November 2013, having declined an average of 11.7% y-o-y over the first 11 months of 2013. The recent interim deal on nuclear sanctions offers a measure of optimism whereby several international companies are reportedly discussing with Iranian officials a potential return of investments should the sanctions be relieved. In addition, we note that the deal could provide an easing of the ban on European shipping insurance for Iranian oil, which would result in a slight increase of oil exports from Iran to major customers like India and South Korea to at least the level permitted under current the sanctions regime. That said, we remain cautious about the prospects for Iranian energy exports in 2014, given that a significant easing of oil sanctions would only come as part of a broader, final settlement, which would in our view be at a minimum 6-12 months away.

Oil Production On The Mend

Iran, Oil Production, Million Barrels per Day (LHS), % chg y-o-y



Source: IEA, BMI

The fall in value of the rial and international sanctions have resulted in a sizeable decline in total imports over the past few quarters. Although the value of the rial will remain volatile over the coming quarters (*see 'IRR: Nuclear Talks Triggering Volatility In 2014', December 11 2013*), a gradual appreciation in the open market coupled with an uptick in economic activity will lead to a return to import growth in 2014, which will offset the improvement in the outlook for exports. We forecast total imports expanding by 5.0% in 2014 and 6.0% in 2015, from our estimate of a 10.0% contraction in 2013.

Risks To Outlook

The macroeconomic outlook will remain highly susceptible by developments in negotiations with the West on the country's nuclear programme over the coming years. We see three potential scenarios in negotiations. One sees talks continuing without key developments over the next 24 months, another a major breakthrough within 6 to twelve months, and a third a breakdown in talks within the same time frame (see 'US - Iran Talks: Three Scenarios', October 1). Should the second or third scenario play out, this could prompt us to significantly revise our forecasts.

Table: Iran - Economic Activity								
	2011	2013	2013e	2014f	2015f	2016f	2017f	2018f
Nominal GDP, IRRbn 1,2	5,598,126	6,715,880	8,923,880	11,528,456	13,832,654	16,299,152	18,677,770	21,208,475
Nominal GDP, US$bn 1,2	527.3	550.6	435.3	466.7	628.8	679.1	849	964
Real GDP growth, % y-o-y 1,2	3	-1.9	-3.5	2.8	3.4	3.5	4.2	4.2
GDP per capita, US$ 1,2	6,991	7,204	5,621	5,948	7,911	8,441	10,427	11,705
Population, mn 3	75.4	76.4	77.4	78.5	79.5	80.5	81.4	82.4

Notes: [e] BMI estimates. [f] BMI forecasts. [1] Year Begins in March (Iranian calendar). Sources: [2] UN/BMI; [3] World Bank/UN/BMI.

Industry Risk/Reward Ratings

Middle East And North Africa Risk/Reward Ratings

The aim of **BMI**'s industry risk/reward ratings system for the automotive industry is to show the rewards and the risks that carmakers operating in a particular region - in this case Middle East and North Africa (MENA) - may face. The unique system assesses crucial factors, such as sales and output growth, international trade, market size and location, and the level of market competition, in addition to taking into account a country's economic and political backdrop. The ratings system allows analysts to fully expound the potential advantages and disadvantages of investing in MENA car markets, and offers an overall comparison of the key markets in the region.

There has been no change among the top five markets. Indeed, if anything, Saudi Arabia has tightened its grip on the top spot with an increase in its Autos Market rating on the back of a positive forecast revision and, subsequently, its overall rating. Moreover, there is potential for further improvement as the nascent vehicle production industry develops, which could see the market consolidate its leadership for some time to come.

Kuwait, Israel, Qatar and the UAE stay in second to fifth spot respectively, as the strength of the Gulf Cooperation Council (GCC) states, which claim four of the top five places, remains a notable theme. There is little to distinguish between them in terms of regulation of the automotive market, with the GCC determining customs regulations. Coupled with robust sales forecasts, this market openness keeps these states at the top of the table.

Second-placed Kuwait, for example, scores highly for demand and a stable market, but still lacks production. Qatar and the UAE are fourth and fifth, with little between them in terms of their overall ratings. Both are highly attractive autos markets, with some of the strongest demand for new cars in the region over recent years and similarly positive forecasts. Moreover, demand in these markets is weighted towards high-end models, boosting the overall value of new cars sold.

Splitting the GCC states is Israel, ranking third. While it is also lacking large-scale production, it scores highly for its business environment and is also gaining a reputation for innovation in the industry. However, its score has fallen slightly for this quarter as 'green' taxes threaten sales by pushing up the cost of car ownership.

The first big move in the ratings comes at sixth place, where Iran has moved up from ninth previously. Its Autos Market score has risen as the extension of our forecast period to 2018 now includes what should be a period of relative recovery for the market, which has resulted in an improved average five-year forecast. It still has the lowest Country Risk score of any market in the ratings, but potential progress with sanctions on the back of a temporary nuclear deal could prove positive in this respect in future ratings.

Bahrain has also moved up, albeit just one place, to seventh on the back of an improved average sales forecast for the new five-year forecast period. We still believe, however, that high levels of car ownership mean it is likely to enjoy lower levels of growth than some of the other markets that are coming from a lower base. That said, while the market is relatively small, it is open and highly competitive.

Swapping places with Bahrain is Oman, which has dropped to eighth with a slight drop in its Country Risk rating impacting its overall score. Despite this decline, which was mostly on the back of a reduction in its ratings for long term monetary policy and policy continuity, its autos market is still reasonably attractive. Like other GCC states, it offers strong demand and relative stability but no domestic production.

One of the other bigger moves is a drop for Lebanon from sixth to ninth. A considerable reduction in its Country Risk score as the situation in neighbouring Syria worsens has dragged on its overall rating. Its Autos Market score has remained stable, however, as the market still offers niche opportunities, such as the preference for smaller vehicles.

Iraq, Tunisia and Egypt have exchanged places in 10th, 11th and 12th, although with only slight changes in score. Iraq has moved up from 12th to 10th with a slight upward revision of its Auto Market rating as relative stability continues to drive sales growth. It is also attracting considerable investment in the commercial vehicle segment, which should intensify competition.

Tunisia has fallen one place to 11th, but with no change in score. It still has notable risk related to political tensions, which is the same for Egypt in 12th place. Egypt has seen a drop in Autos Market score as its five-year average sales forecast has been impacted by the political instability.

Morocco has climbed two places to 13th with a solid increase in its Autos Market rating, thanks to a projected increase in vehicle ownership and a favourable five-year average forecast. It is also one of the more stable North African countries and has attracted production investment from major brands such as **Renault**.

This jump from Morocco means Jordan has slipped to 14th, although its score has not changed. Like Lebanon, it is exposed to a certain amount of risk from neighbouring Syria and a lacklustre economy has impacted the sales outlook. Algeria has also fallen one place to 15th with a drop in its Autos Market score as its average five-year sales forecast and GDP per capita projections are lower than the previous round-up.

Unsurprisingly, given their heightened instability, Libya and Syria remain anchored to the bottom of the table in 16th and 17th place respectively. As well as their particularly low scores for risk given the political situation in both countries, Libya also has the worst Autos Market score of any markets in the table. We expect private consumption growth in the country to remain below potential over the forecast period, while there is also an increasing threat to the new car sales market posed by imports of older used cars.

Table: BMI Industry Risk/Reward Ratings - Middle East And North Africa Autos

	Rewards			Risks				
	Autos Market	Country Structure	**Industry Rewards**	Market Risks	Country Risk	**Risks**	**Autos BE Rating**	Regional Ranking
Saudi Arabia	43.3	69.7	**52.6**	75.0	69.7	**72.4**	**58.5**	1
Kuwait	33.3	88.1	**52.5**	75.0	66.4	**70.7**	**57.9**	2
Israel	31.7	86.5	**50.9**	75.0	68.4	**71.7**	**57.1**	3
Qatar	26.7	89.5	48.6	75.0	68.0	71.5	55.5	4
UAE	28.3	80.4	**46.6**	75.0	64.7	**69.8**	**53.5**	5
Iran	56.7	42.6	**51.7**	75.0	31.1	**53.0**	**52.1**	6
Bahrain	25.0	75.8	**42.8**	75.0	69.5	**72.3**	**51.6**	7
Oman	25.0	73.9	42.1	85.0	56.7	70.9	50.8	8
Lebanon	21.7	84.0	43.5	80.0	47.4	63.7	46.4	9
Iraq	30.0	64.0	41.9	60.0	50.7	55.3	45.9	10
Tunisia	21.7	61.5	35.6	85.0	50.6	67.5	45.2	11
Egypt	40.0	34.3	**38.0**	75.0	49.0	**62.0**	**45.2**	12
Morrocco	40.0	25.2	**34.8**	75.0	52.2	**63.6**	**43.4**	13
Jordan	18.3	64.0	34.3	70.0	53.6	61.8	42.6	14
Algeria	30.0	36.6	**32.3**	65.0	50.0	**57.5**	**39.9**	15
Libya	5.0	71.5	28.3	65.0	45.7	55.3	36.4	16
Syria	25.0	54.0	35.1	25.0	42.6	33.8	34.7	17

Source: BMI; Scores out of 100, with 100 highest.

Company Profile

Company News Alert

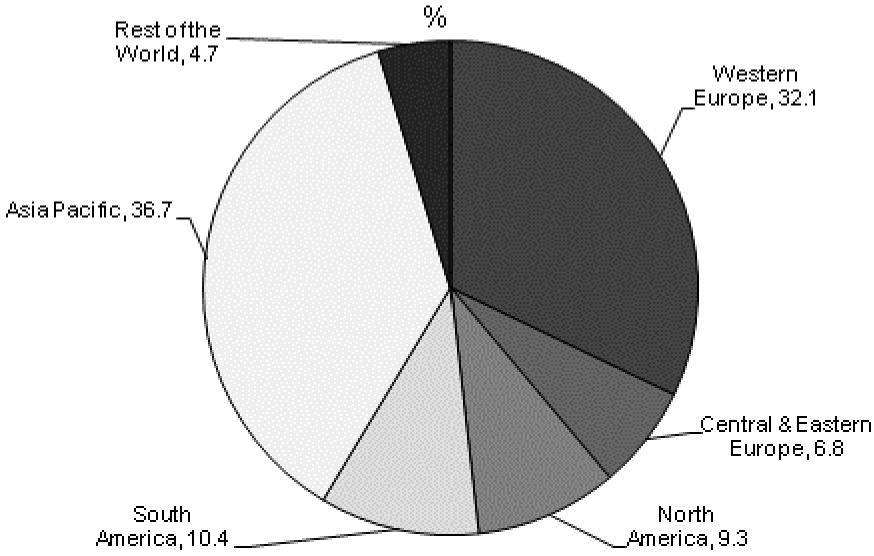
German carmaker **Volkswagen** (VW) will be further expanding on its presence in the Middle East in 2014 as it looks to build on a solid performance in the region in 2013. **BMI** sees the region as becoming increasingly important to the group's ambitions of becoming the world's biggest carmaker by 2018, but currently VW has admitted it needs to at least double its regional market share.

In 2013, VW sold around 14,000 units in the Middle East, up 30% from 2012. According to VW Middle East managing director Thomas Milz, this is the result of two years of investing heavily in the region, in everything from showrooms to service centres and training staff. However, Milz also said that the company has a market share in the Middle East of 2-3% and needs to double that.

Based on data for 9M13 (latest available covering all regions) the Rest of the World division, which includes the Middle East, was one of the fastest growing, although this is from a small base being the lowest volume of any of the regional divisions. However, with sales in bigger markets such as Europe and South America sliding, markets with high growth potential increase in importance, particularly as VW's deadline for global leadership of the autos market gets nearer.

RoW Is Small But Strategically Important

VW Sales By Region 9M13 (% of total volume sales)



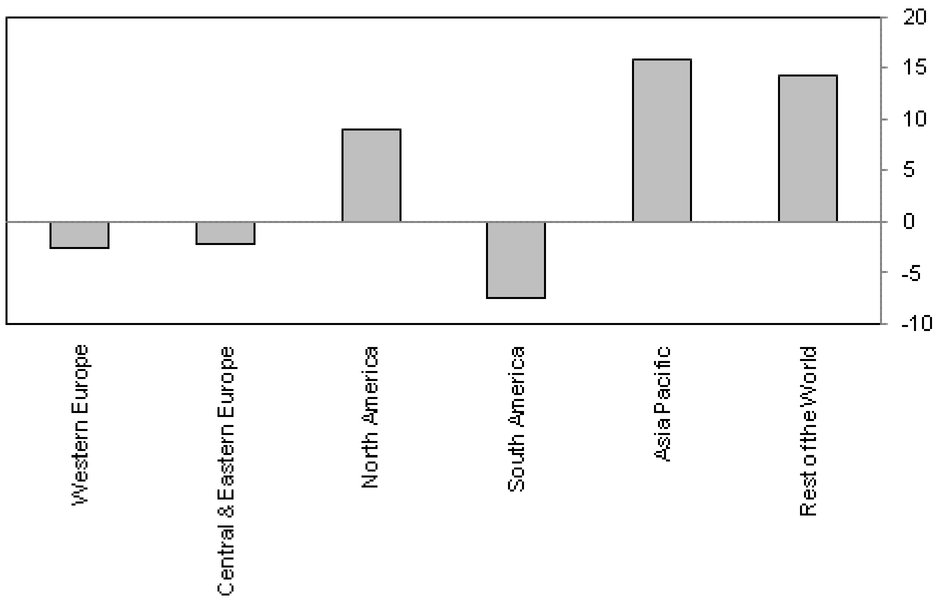
Source: VW

The Middle East is a prime market for tapping given **BMI**'s view that volume brands are gaining popularity in the region and this explains why the company is keen to have a bigger share sooner rather than later. Competition is already fierce, with **Toyota Motor** claiming at the beginning of 2013 that it held a 43% market share in the Middle East and almost the same level of penetration as in its domestic market, while **Renault** has been making headway among the European brands *(see 'Product And Expansion Strategy Paying Off For Renault', April 22 2013).*

Plans include expanding the company's sales and service network in some of its biggest markets such as the UAE, with plans to add new facilities in Dubai, Sharjah and Fujairah, as well as some of its highest growth markets such as Qatar, where sales rose 58% in 2013. Products will also be central to the growth strategy, as the Golf R model comes to the region. Looking at the longer term, VW also plans to launch a seven-seater SUV 'in one or two years', according to Milz, which again fits **BMI**'s long held view that SUVs will continue to be a growth driver in the region.

Timely Growth Outside Of Europe

VW Sales Growth By Region 9M13 (% chg y-o-y)



Source: VW

In addition to its stand alone brand, however, **BMI** believes the VW group has an advantage in its premium brands. The enduring popularity of luxury cars in the region, particularly in the markets of the Gulf Co-operation Council (GCC), will see **Audi** and **Porsche** making no small contribution to the group's growth in the region, as well as its global targets (*see 'Audi And Porsche Contribute To VW's Global Vision', July 16 2013*). In the first 11 months of 2013, Porsche reported growth of 18.1% year-on-year for its Asia Pacific, Africa and Middle East division, while Audi aims to double its Middle East sales by 2020.

BMI has previously highlighted that Europe is no longer the primary global driver of sales for most premium autos companies, and growth in other regions more than offsets the slowdown from Europe. The Middle East has been one such region for VW and its subsidiaries, and if this can be sustained as the European market begins a tentative recovery, it will bode well for the group's global plans.

Iran Khodro Company (IKCO)

Company Overview

IKCO is the largest auto manufacturer in Iran and was established in 1963. The firm also has foreign production facilities, including sites in Azerbaijan, Belarus and Venezuela.

When production of the Hillman Hunter ceased in the UK in 1979, Peugeot Citroën, by then in control of Chrysler's former operations in Europe, began negotiations to sell the rights of the brand and the manufacturing plant to IKCO. The agreement was sealed in 1985 and the production line at Linwood, Scotland, was dismantled and shipped to Iran. As part of the deal, Peugeot Citroën also sold 65,000 engines to Iran.

The company's product line is at present complemented by the Peugeot 405 model in a number of variants and the 206, launched in 1990 and 2001 respectively. The former has local parts integration close to 80%, while the 206 is exported by Peugeot in CKD form. An indigenous version of the 405, the model RD, a 405 body fitted with the Paykan engine and drive-shaft, is also being assembled. The range was further enhanced in 1997 by the Pars model, a revamped 405, and later in 2001 by the Samand, another local project, also known as the national car or X7, which uses the 405 Powertrain.

In 1992, IKCO bought from Volkswagen (VW) Argentina machinery to build the Avenger 1.6-litre engines, which powered the Argentine version of the Avenger as well as VW's 1,600 and 1,800 models, up to 1990.

IKCO separated its commercial vehicle division from the passenger car unit, creating IKCO Diesel. The unit, formerly Khavar Industrial Group, began its activities in 1959 assembling Mercedes-Benz trucks under licence and is now in charge of the production of IKCO's heavy industrial vehicles, trucks, buses, and minibuses, as well as the Paykan light utility vehicle (LUV). In 2002, Russia's GAZ exported a batch of 500 CKD-kits of the GAZel truck model in seven variants for assembly by the unit, thus resuming a cooperation project, which included the construction of an assembly line in Tehran's suburbs, which was suspended in late 1999.

IKCO is working intensively to expand its foreign markets, which bring in much-needed hard currency. In February 2014, IKCO exhibited a range of its models - including the Runna, Soren and Samand -in the Turkmenistan capital of Ashkhabad as part of a showcase of Iranian products to its northern neighbour. According to a company press release, 'Turkmenistan is considered as one of IKCO's most important target markets and consistent presence in such exhibitions can stabilize the position of the company in this market'.

In recent years, IKCO has concentrated on expanding its own ranges, as opposed to those it produces under license to other manufacturers. The latest models unveiled include a new version of the Samand, a wheelchair-accessible Samand, the R90 station wagon, and a next-generation minivan powered by LNG.

Strategy

In November 2013, IKCO said that it had registered a 53% increase in production during September 23-November 21. The company's average daily output reached 1,530 cars in the reported period, compared with the average output of 1,000 vehicles a day in the first half of the current Iranian year started March 21, according to a report on the Islamic Republic News Agency. From October 23 to November 21, IKCO's production jumped 25% year-on-year to 35,000 vehicles. Growth in production is expected to continue and is likely to touch an average of 1,800 cars daily. The increase in production was attributed to the government's ongoing efforts to revive the auto industry.

In September 2013, it was reported that IKCO is looking to increase production of the nationally developed Runna model, which has been one of its best-sellers since its launch in late 2012. The Runna is one of only three models to have increased output on a year-on-year (y-o-y) basis this year, as the industry tries to cope with the withdrawal of international partners, a shortage of components and the need to satisfy more domestic demand as imports drop.

Production of the Runna rose 728% y-o-y in August and 1607% y-o-y in the first five months of the Iranian year starting March 21, although the model is relatively new and still building volumes. Nevertheless, as a national model it is less reliant on input from international companies and is demonstrating the self-sufficiency required of such models. Indeed, the only other model to register positive growth in production for the five-month period is the Saipa Tiba.

Although exact figures are not available, reports from the Fars News Agency suggest that the Runna accounted for 35% of IKCO's sales in August, but only 8% of production over the first five months, and this has prompted an increase in production of the model. Despite BMI's forecast for a 49% decline in industry-wide production in 2013, IKCO's goals should be aided by the fact it also plans to produce the model at its overseas plants in Belarus, Azerbaijan, Egypt, Syria, Senegal and Venezuela.

Having a model in demand could help ICKO's domestic targets, however, as it is aiming to produce 1,500 cars a day, as is fellow automaker Saipa, according to the Ministry of Industry, Mines and Trade. How successful this will be without backing from former foreign partners remains to be seen and even if achieved for the remaining months of the year, it would leave output down on the previous year. Focussing on 'national cars' with largely domestic content does provide upside potential, however.

In August 2013, IKCO stated that it is to design and develop two of five new platforms to be built as part of a 15-year vision for the development of the Iranian car industry, according to Javad Soleymani, the company's vice-president in product and quality. Soleymani said the company would start working on one of the platforms in 2013. The company would manage the process with support from the technology employed in the existing platforms, while IKCO engineers would be in charge of the design and development, Soleymani said.

In April 2013 IKCO announced it is planning to manufacture 550,000 cars in the current Iranian year without support from foreign sources. The company plans to manufacture passenger cars, such as the Runna and Samand cars and the Bardo pick-up. The company has put the daily production of 2,000 sets of cars on its agenda, with parts and components from Iranian part makers, said Hossein Najari, IKCO's vice-president for production.

In March 2013, IKCO, together with Saipa, pledged to reduce prices 10-22% after President Mahmoud Ahmadinejad ordered Iran's two major domestic carmakers to reduce end prices, otherwise car import duties will be cut by 10%.

In February 2013, IKCO announced it is planning to design and manufacture 1,600cc versions of the XUM engine in the near future. The move is in line with the carmaker's aim to improve the performance of its cars. The fuel economy of the engine would increase to 6 litres/100km, according to IKCO Vice President for Quality and Product Development Mir Javad Soleimani. Soleimani said that the current XUM, which has a capacity of 1,900cc, would power Peugeot Pars sedans soon, as well as the Peugeot 405 and some other IKCO products.

Soleimani said that production of IKCO brand cars had accelerated 30% this year, compared to a rise of 17% when the company first laid out its strategic plan four years ago. He said: 'We have focused on IKCO brand and at the same time have planned talks with foreign partners for some new cars to be produced beside IKCO cars,' adding that Tondar 90 pick-up, Tondar passenger car enjoying automatic transmission and Tondar facelift would be produced following the recent talks held between IKCO and Renault.

He said establishing new ties with new partners is a crucial strategy for IKCO. 'Two years ago, IKCO studied 20 foreign carmakers to see the possibility of building up new ties to produce SUV and A, B, C and D segment cars, however, three of them have been elected and discussions are going on in between.'

He added: 'These cars will be locally assembled from CKD packs, however local part supply is our priority and for this we have held talks with Asian and European partners which is close to be a deal.'

IKCO ranked second among Iran's top 400 companies this year, which ends on March 19 2012, according to the Industrial Management Institute in February 2013. It is the top employer in Iran, with 53,806 workers.

IKCO expects sales and exports to its main markets in Russia, the Middle East, South America and Africa to 'boom' 45%, reported to RFE/RL in August 2012, This is thanks to interest in its domestically made and designed 'national' car, the Runa, unveiled in 2009. IKCO is also confident about its revamped sedan model, the Samand, which is exported to Russia via an assembly plant in Belarus and also made in Iraq. IKCO intends to adopt new marketing strategies in an effort to export 16% of its output in the coming three years and enhance its global market share. IKCO's ambitious export plans could be buoyed by the rapid development of alternative fuel vehicles, which may find a niche in markets where there is demand for green cars.

IKCO plans to make and sell 50,000 units of the Samand sedan, equipped with its 'national diesel engine', by 2013, according to Iran Khodro Powertrain's CEO Mohammad Zali. The engine meets Euro-V standards, and will enter large-scale production in 2013. The carmaker has manufactured 23 units of the engine until now and fitted three of the manufactured engines in its own cars for necessary tests.

IKCO intends to export 10,000 units of the Samand sedan to Russia. The domestically designed Samand will be equipped with engines that meet Euro IV emissions standards, according to the company's vice-president for exports, Abdulazim Sa'dian. Cargoes of Samand completely knocked-down parts will be transported to the company's assembly line in Belarus from July 22 and will then be exported to Russia.

IKCO is likely to export 15,000 cars to Russia, Kazakhstan, Turkmenistan and Belarus by the end of the current Iranian calendar year, said the company's managing director, Javad Najmeddin, in March 2012. He said 2,000 cars out of its export target are expected to be manufactured at a production facility in Belarus. IKCO aims to export 12% of its total output to various countries in the next Iranian calendar year and eventually export 20% of its output. IKCO currently exports 7% of its total production.

IKCO is also stepping up production of its own engines as it claims to be nearer self-sufficiency. IKCO currently produces 300 units a day of the EF7 engine, which is available in dual-fuel, petrol and diesel. It hopes to increase this to 500 units a day and according to IKCO's vice-president of production, Hossein Najari, total production should have reached 120,000 units by the end of the Iranian year ending March 2013.

The engines are also geared toward the availability of compressed natural gas in the country, with 70% of the engines compatible with the gas. IKCO has also been improving the fuel-efficiency of its vehicle range to help its export strategy.

According to Iran's Minister of Industries, Mining and Trade, Mehdi Ghazanfari, Iran intends to manufacture around 3mn cars and plans to export 1mn of them by 2025. Ghazanfari revealed that Iran produced approximately 1.6mn cars in the last Iranian year ended March 19 2012 out of which 55,000 cars were exported in the same period. IKCO will be a big part of this push as one of the country's largest manufacturers.

IKCO has also worked on its self-developed vehicle range. In June 2012, it launched the Runna, which is the company's second 'national car' model and follows the Samand, launched in 2003. It will also unveil the country's first domestically made diesel car in 2012. The car's diesel engine meets Euro V standard requirements and would be suitable for D-segment cars like the Samand, Soren and Dena. The company intends to mass produce diesel passenger cars in less than two years.

IKCO plans to enter the Tunisian auto market by exporting 700 units of the Runna, Soren and Samand sedans to the country. The move follows a series of agreements reached by the Iran-Tunisia Joint Economic Cooperation Commission, according to

Abdolazim Sadian, IKCO deputy CEO for export and international affairs. The company has exported more than 6,000 units of the Peugeot 206 SD to Tunisia through the sales network of Peugeot in recent years.

IKCO is negotiating with design consultant companies for its first B segment platform, with an agreement expected to be finalised soon, according to IKCO CEO Javad Najmeddin. He added that the platform's primary components will be designed and developed by IKCO, while the company's parts manufacturers will be responsible for the smaller components. Production of the first car on the new platform is scheduled in 2014, Najmeddin added. IKCO plans to develop two new platforms for the B and D segments at a cost of about US$6.5mn. IKCO is expected to manufacture 10 new cars on the platforms by 2021.

Saipa Diesel

Company Overview

Saipa Diesel is Iran's second-largest commercial vehicle manufacturer, 79.3% owned by Saipa Automobile Manufacturing Company. It began operations in 1963 under an agreement with the US's Mack Trucks, but the licence came to an end following the revolution of 1979. It signed a licence agreement to produce Volvo trucks in 1985, which revived the company's fortunes after years of uncertainty. It has since signed an agreement with Renault Trucks. Among its subsidiaries are Iran Kaveh Saipa - which manufactures trailers and truck bodies - and Kavek Khodro Saipa, a parts and components supplier.

The firm plans to increase truck exports to Angola in the near future. Iraq remains one of the country's main target markets. New export markets for the company include Algeria, Ukraine, Yemen, Turkmenistan, and Azerbaijan.

Operational Data

- Year established: 1963

Societe Annonyme Iranienne de Production Automobile (Saipa)

Company Overview

Saipa is the second-largest auto manufacturer in Iran. The company was founded in 1966 as the Citroën Production Association, and in 1968 began to manufacture the Citroën Dyane model, a replacement version of the popular 2CV. In 1977, Saipa introduced the Renault 5 model in two and four-door variants. By 1985, Saipa also produced the Nissan Junior LUV equipped with a 2.0-litre engine, complemented in 1990 by a 2.4-litre model. This was followed, in 1993, by the Renault 21 mid-range passenger car.

Some years later, Saipa concluded an agreement with Kia Motors to manufacture the Pride in four models, and in 1999 sealed a deal with PSA Peugeot Citroën to produce the Xantia. In 2002, an indigenous redesign of the Pride was launched, known as the 141 model. By that time, local parts integration reached 85% for the Junior LUV and 81% for the Pride. In the 1990s, Saipa merged with Iran Kaveh, since then renamed Saipa Diesel, and Zamyad, and in 1999 acquired a majority stake in Pars Khodro.

The Iranian government has control over the company through IDRO, an agency of the Ministry of Industry and Mines. In 1998, Saipa listed on the Tehran Stock Exchange as a first step towards privatisation. The majority 14.3% stake in private hands belongs to the Bahman Group, which is also engaged in autos manufacturing, under licence from Mazda, through Bahman Auto.

Exports represent a small stream of income. Azerbaijan, Iraq, Egypt, Syria, and Sudan were the group's main export destinations. The company's commercial vehicle subsidiary Zamyad is one of Iran's largest truck producers. The Saipa Group is Iran's largest vehicle manufacturer. Its most popular passenger car is the Pride, which was developed by South Korea's Kia.

Saipa has also opened a new car assembly line in Homs, Syria, where the Saipa 132 model will be manufactured under the name Emesa. The total investment for the project was US$46mn, of which 85% was contributed by Saipa and the remaining 15% by a private company, Hamshoo.

In May 2011, Saipa launched a new US$350mn facility in Kashan. The factory will have an annual production capacity of 150,000 vehicles. It will make the Tiba range, Iran's first domestically designed and built vehicles.

The Iranian Privatisation Organisation reportedly sold 260mn shares in the company in May 2011, representing a 2.5% divestment.

In March 2013, Saipa, together with IKCO, pledged to reduce prices 10-22% after former President Mahmoud Ahmadinejad ordered Iran's two major domestic carmakers to reduce end prices, otherwise car import duties would be cut by 10%.

Saipa is the second-largest employer in Iran, with a workforce of 43,000, according to the Industrial Management Institute in February 2013.

In March 2014, Saipa signed a deal with Chinese automaker C**hongqing Changan Automobile Co.** to manufacture cars jointly, according to a report by ISNA. Under the agreement, two models of car will be manufactured by Saipa's subsidiary **Saipa Kashan**. This subsidiary has the capacity to make 180,000 cars on a yearly basis.

Regional Overview

Middle East And North Africa Overview

The growth of domestic vehicle production is a trend **BMI** will be watching closely in the Middle East and Africa in 2014. While a production industry has been gathering momentum in North Africa for some time through plants in Egypt, Algeria and Morocco, it is the moves to produce in the markets of the Gulf Co-operation Council (GCC) which are grabbing attention. Following the opening of **Isuzu**'s plant in Saudi Arabia in 2012 and tentative plans for it to be joined by **Jaguar Land Rover** (JLR), the news that a sports car have been developed in the UAE throws open more opportunities in the high-consumption GCC states.

Compete Or Complement In The GCC?

The unveiling of the **Devel** Sixteen sports car, developed and produced in Dubai, marks the first vehicle production project for the UAE. With full-scale domestic vehicle production beginning recently in Saudi Arabia, **BMI** believes that the Sixteen could herald a similar path for the UAE, which would see the two GCC states either compete or complement in terms of their production segments.

Firstly, it is worth noting that the Sixteen will be produced in small volumes. Rashi Al Attar, vice president of Defining Extreme Vehicles Car Industry, said the company does plan to open a plant in Jebel Ali. However, he also emphasised the highly customised nature of the model's production, which suggests niche production in small volumes. This would already contrast with the volume production of mass market models such as **Isuzu**'s pick-up trucks in Saudi Arabia. Even JLR plans to produce 50,000 Land Rovers a year if its project goes ahead.

On the other hand, there are elements of the Sixteen project which would lend themselves to developing a larger production industry in the UAE. According to Al Attar, the Jebel Ali plant will use locally produced parts and components, and only the tyres will not be produced in Dubai. This would be an incredible boost for the local supplier segment, developing the potential to serve a larger production industry.

We believe this would particularly be the case for the raw material providers. The Sixteen's chassis is built from carbon fibre and aluminium and the body work is also carbon fibre. As more and more premium brands focus on using lighter materials to achieve better fuel economy, the presence of suppliers in this field would be an attraction, as in Saudi Arabia where the opening of a new aluminium complex was a plus for JLR (*see 'Vehicle Production Is Boost For Industrialisation', December 14 2012*).

The UAE's own aluminium production potential has just been given a boost by an agreement to invest US $5bn in a bauxite mine in Guinea, which is one of the world's largest producers of bauxite, the raw material for aluminium (*see 'Diversification Plan Gathers Steam', November 27 2013*). This supply of raw materials, alongside a supplier segment developed on the back of a sports car project, mean that rather than seeing the UAE and Saudi Arabia start to compete for production projects, there is potential for specialisation.

The UAE has become a haven for high-end luxury brands, with **Ferrari** choosing Abu Dhabi for its 'Ferrari World' attraction centre and **Audi** planning to base its biggest workshop worldwide in Dubai. It could be fitting, therefore, if the industry specialised in production of high-end cars, while Saudi Arabia produces bigger volumes. Until the Sixteen's limited edition run starts in 2014, however, the domestic sector's capabilities are still unproven.

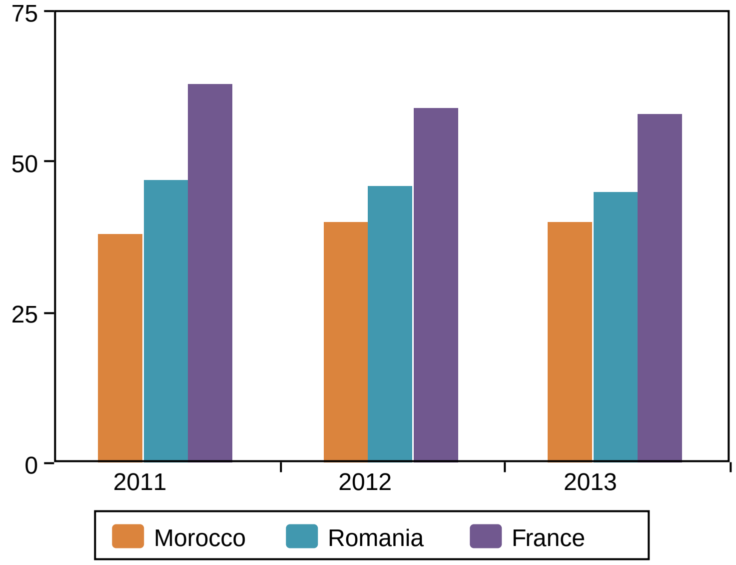
North Africa Becoming A Viable Alternative

While the GCC is just testing the water in terms of production, the slightly more established North African markets could start to become more than just a low-cost manufacturing hub for the local region. For example, **BMI** believes that **Renault-Nissan**'s second production line at its plant in Morocco will improve the group's flexibility to respond to market dynamics and will provide options when an alternative to other export-oriented plants is required.

Indeed, the plant's expansion has been controversial, facing opposition in France, where it is seen as 'delocalising' production. The geographical position, however, makes it an attractive choice for an export base for both the Middle East and North Africa and Europe, with some 95% of output currently going to export markets. Low labour costs increase the competitiveness of these exports and also mean the plant has been considered as an alternative when other facilities have faced disruption.

Closing The Gap

BMI Autos Risk/Reward Ratings By Country



Notes: Scores are 1-100, with 100 most attractive based on an aggregate of Country Rewards, Market Rewards, Industry Risk and Country Risk. Source: BMI

In March 2013, a wage dispute at the **Dacia** plant in Romania forced a temporary stoppage in production. At the time, the Tangier plant was suggested as an option if the labour action became protracted. Although that situation was quickly resolved, **BMI** has warned in the past that such pay demands could start to erode the competitiveness of the Romanian plant and the country's auto sector in general (*see 'Wage Dispute May Deter Further Investment', March 21 2013*), possibly playing into the hands of the newly expanded Moroccan facility.

At the time of the dispute, Dacia vice president Constantin Stroe said a worker at the Moroccan plant earned just 54% of a Romania worker's salary. This has been part of the argument for expanding the Tangier facility to increase production of low-cost Dacia models. Renault's country director for Morocco, Jacques Prost, said that 'this type of car can only be done in this type of factory'.

If the Moroccan plant is more competitive than the Romanian plant, then it certainly has the advantage over Renault's French factories, given the issues of competitiveness that the country's manufacturing sector as a whole have faced. We believe this is a necessary element of flexibility for the Renault group to have on standby, as the downturn in Europe has weighed on its performance and overcapacity has been an issue industry-wide.

Still Cautious On Iran

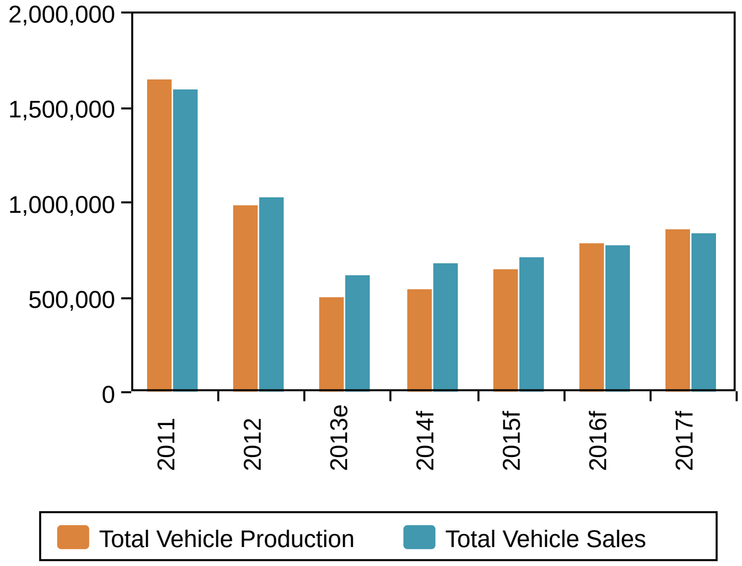
Although we have been highlighting developing manufacturing bases, there is also cause to monitor the region's biggest vehicle producer - Iran. With a deal to ease sanctions on Iran's auto sector, amongst other industries, due to come into force on January 20, carmakers have already been considering their plan of action - not least France's **PSA Peugeot Citroen**. Having been one of Iran's leading foreign brands before sanctions were tightened, a return to the market for Peugeot will help to offset the ongoing slump in the group's European business.

In the longer term, however, the resumption of business in Iran could be a lifeline for the PSA group. The country had been Peugeot's second-largest market after France before the sanctions. As a result of such a significant market being removed from its operations, CFO Jean-Baptiste de Chatillon said the company has been losing EUR10mn a month in operating profit.

Iran Khodro (IKCO), is also likely to benefit from the potential return of its former partner, although the domestic carmaker had been making progress in producing its own components for models such as the Peugeot 206 following the French firm's withdrawal (*see 'So Far So Good For IKCO', July 30 2012*). Production of Peugeot models in September and October 2013 topped 10,000 units a month for the first time in three years.

Long Road To Recovery

Iranian Vehicle Production And Sales (CBUs)



Notes: Renault/ IVMA/BMI

However, there is still a great deal of 'wait and see' sentiment in the industry, until the full details of operating in the market have been made clear. South Korea's **Kia Motors**, which had a partnership with domestic producer **SAIPA** up until it withdrew from the market in 2010, said it will wait for more information before commenting. Germany's **Daimler**, which used to have a 30% stake in a diesel engine joint venture with IKCO before starting to cut back its Iranian business in 2010, said it will 'closely monitor' the situation, but has no plans to return to the market. Either way, **BMI** believes it will take a long time to recover from the slump in output, partly caused by the sanctions.

Global Industry Overview

In our last update of the year, we will not only be looking at how key markets are likely to end the year, but also look at projections for 2014. On the whole, it is looking like a better year for many markets that have struggled in 2013, while those that have enjoyed more rapid growth are likely to stabilise. All in all, it should be a better year for the industry.

Table: Passenger Car Sales November 2013 (CBUs)

	Last Month	Monthly Sales	% chg y-o-y	YTD Sales	% chg y-o-y	BMI End-2013 Sales	BMI Full-year Growth Forecast (2013, % chg y-o-y)	BMI End-2014 Sales	BMI Full-year Growth Forecast (2014, % chg y-o-y)
Core Europe	November	710,712	0.3	338,926	-1.9	8,939,993	-1.8	8,992,379	0.6
Eastern Europe	November	64,049	3.3	681,931	-1.4	744,906	-1.0	772,230	3.7
Japan	November	378,597	16.7	4,203,069	-1.1	4,686,640	2.5	4,714,760	0.6
United States	November	1,245,325	8.9	14,239,897	8.4	15,681,560	8.2	16,248,215	3.6
Canada	November	133,860	6.5	1,630,076	4.0	1,754,982	4.7	1,801,522	2.7
Brazil	November	223,748	-4.1	2,504,507	-3.1	2,765,994	-3.0	2,738,334	-1.0
India*	November	201,520	-10.2	1,639,535	-5.3	2,601,426	-3.0	2,757,511	6.0
China	November	1,696,278	16.1	16,151,800	15.1	17,633,538	13.8	19,432,158	10.2
Turkey	November	64,117	23.0	563,456	19.0	667,536	20.0	694,237	4.0
Russia **	November	231,982	-3.5	2,512,965	-6.8	2,602,879	-6.5	2,524,793	-3.0

* year-to-date is financial y-t-d, full year forecast is Apr-Mar 2014 **AEB data (includes LCVs, therefore, forecast now includes LCVs)

Source: BMI, Trade associations

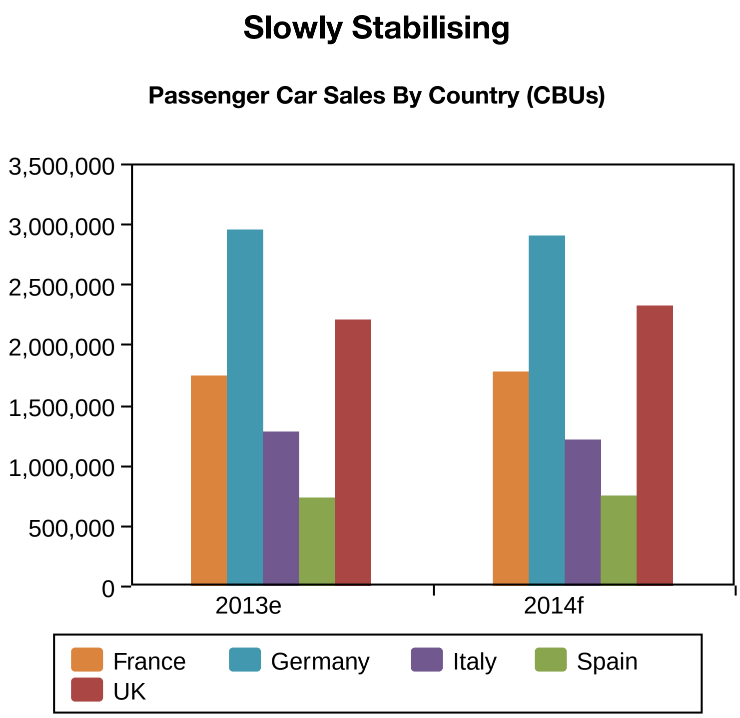
Europe On Road To Recovery

Our view that many markets in Europe would start to bottom out toward the end of 2013 is playing out, with November's passenger car sales showing a 0.3% year-on-year (y-o-y) increase for our Core Europe grouping (France, Germany, Italy, Spain, UK), and growth of 3.3% for Eastern Europe.

Strengthening sales in a number of Western European markets have prompted slight upward revisions to our year-end estimates for 2013, resulting in an expected 1.9% contraction for the Core Europe group. A resurgence in Spanish sales has been a key driver of this growth, with a 15.1% y-o-y increase in November, following growth of 28.5% y-o-y and 34.4% y-o-y in September and October respectively. Sales for 11M13 are now firmly in positive territory, up 2.1% y-o-y and we expect 3.0% growth for the full year.

The UK has also continued its strong showing for the year, with sales up 9.9% y-o-y for 11M13 following a 7.0% increase in November. In Italy, while the market is still contracting, the declines are moderating each month, which is a promising sign. November sales fell 4.5% y-o-y, taking the 11M13 contraction to 7.7% y-o-y.

Looking ahead, we believe Italian private consumption will remain weak, which will still weigh on big ticket purchases such as cars. That said, we believe the y-o-y declines will continue to moderate and we forecast a 5.1% contraction for 2014. France should also see a better year, largely on the back of pent-up demand following four consecutive years of declining volumes. Although consumer sentiment is expected to remain relatively weak, we forecast growth of 2.0%, to 1.78mn units, which would still leave the market below its 2009 peak of 2.30mn units.



Notes: CCFA/VDA/ACEA/INE/Ministerio Del Interior/Department For Transport

In the markets of our Eastern Europe grouping there are also signs of progress, although there are still some clear underperformers such as Romania, Bulgaria and Slovakia. These have been outweighed for the year-to-date by markets such as Estonia, with sales up 7.9% y-o-y in November and 14.1% y-o-y for 11M13, to result in solid positive growth for the sub-region in November and a decline of just 1.4% y-o-y for 11M13. Poland, too, is staging a healthy recovery, which has prompted an upward revision to our 2013 forecast. We now expect Poland to end the year with growth of 6.0%, on the back of an improving private consumption picture. Such performances mean we expect the group to end the year with sales down just 1.0% in 2013.

In 2014, there will be some cautious consumer sentiment remaining. We expect those markets that are currently struggling to retain some weakness, with contractions forecast again for Bulgaria (4.5%) and Slovakia (0.2%). However, Estonia will continue to be an outperformer, although growth is forecast to slow to 10.0% in 2014, while Poland's steady recovery should be sustained with 5.0% growth. Czech sales should also return to positive growth of 3.0%, which will be a boost given the size of the market.

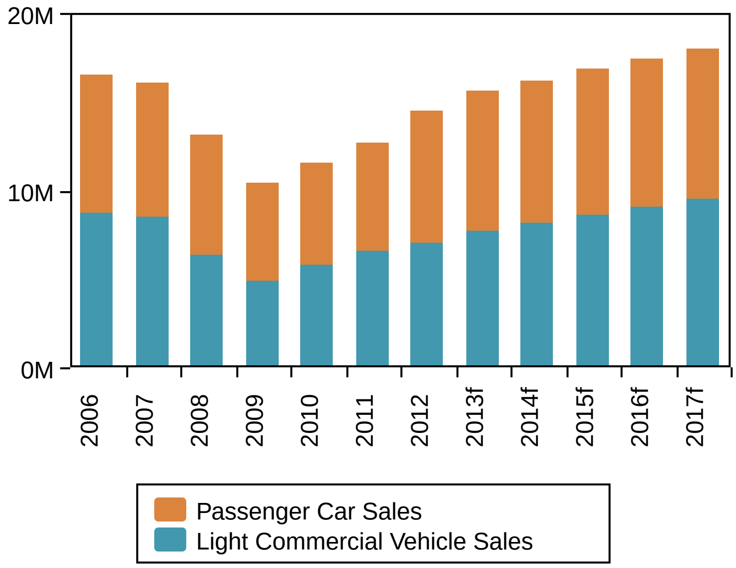
Tax Hike Skews Japan's Outlook; US Hits Sweet 16

The announcement that the Japanese consumption tax will be raised in March 2014 is impacting the passenger car market in the latter months of 2013 and is likely to do so heading into 2014. Growth of 16.7% y-o-y in November, following 18.4% y-o-y growth in October reflects not only a natural improvement in consumer sentiment, but also front-loading of purchases before the tax hike. Although the market is still down 1.1% y-o-y for 11M13, we expect this level of monthly growth to take the market into positive territory in December to end the year up 2.5%.

We expect this trend of purchases being brought forward to continue into Q114, as consumers look to beat the introduction of the higher tax. The reverse is likely to be true following the tax hike, however, with sales expected to tail off in the months immediately after. With sales expected to be strong earlier in the year, but dropping off later, we forecast very marginal growth of 0.6% for 2014.

Returning To Normal

US Light Vehicle Sales By Segment (CBUs)



Notes: US Dept of Transport/BMI

US light vehicle sales in November remained on course to meet **BMI**'s forecast of 8.2% growth to 15.68mn units for 2013. Thanksgiving promotions and a weekend to end the sales month contributed to growth of 8.9% y-o-y, taking 11M13 growth to 8.4% y-o-y. **BMI** believes this is likely to be the last year of such substantial growth, however, as the market gets nearer to its natural 16mn units mark and the first signs of inventory build-up pose a risk to growth in 2014.

The light truck market is still the key driver of growth, up 11.8% y-o-y in November and 11.3% y-o-y for 11M13. Looking ahead, positive data from the residential housing sector, as part of an increasingly bullish macroeconomic picture, suggests that the truck segment will carry this growth into 2014 (*see 'Weekly Data Analysis: Positive Housing, Manufacturing And Consumer Data', December 2*). We forecast 5.3% growth in light truck sales in 2014, which is still robust by historical standards, despite representing a slowdown from current levels.

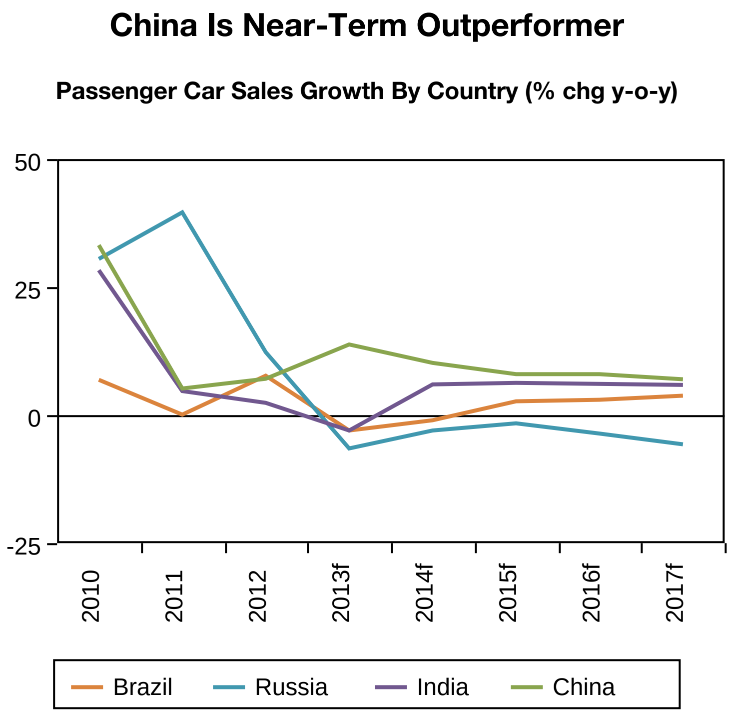
We also expect slightly slower growth of 2.0% for the passenger car segment in 2014, following estimated growth of 6.5% in 2013. Again, this is reasonable by pre-recovery standards and we expect one of the areas driving this growth to be the premium segment. An improving economy and a raft of new model launches should make 2014 a good year at the higher end of the segment, particularly as the US is still one of the major global markets for the leading German luxury brands, looking to offset the European slump.

China Is BRIC Bright Spot

As Chinese passenger car sales surge on the back of healthy economic indicators to end 2013 on a high, we believe the positive sales momentum will spill over into early 2014. According to the China Association of Automobile Manufacturers, passenger car sales in November 2013 rose 16.3% y-o-y, to 1.7mn units. This has brought car sales for 11M13 to 16.15mn units, an increase of 15.1% y-o-y, prompting us to upgrade our 2013 forecast to 13.8% growth, to 17.6mn units, from 11.0% previously.

However, we remain firm on our sector slowdown view for 2014 (*see 'Sector Slowdown View Pushed To 2014', September 13*). As China's current stimulus-driven growth gives way in the latter part of 2014, this will hurt consumer sentiment and negatively impact car sales. Therefore, we maintain a relatively conservative forecast of 10.2% in 2014, although this is still considerable growth.

It is certainly a better outlook than that of the other BRIC markets. India's passenger vehicle segment has declined throughout the financial year, which began in March, most recently posting a 10.2% y-o-y decline in November. We believe growth will pick up in FY14/15, but until then market sentiment remains depressed.



Notes: National Association of Motor Vehicle Manufacturers (Anfavea)/AEB/SIAM/CAAM

Car sales in Brazil are looking particularly weak, as the expected Q413 uptick following a poor Q3 tempered by high base effects from 2012, did not materialise. November sales fell 6.6% y-o-y, dragging 11M13 sales down 3.1% y-o-y. **BMI** expects this market weakness to continue into December, and we have accordingly revised down our 2013 sales forecast to a 3.0% decline, from the 2.0% contraction previously forecast.

As the broader slowdown in consumer spending in Brazil impacts the passenger car segment, we forecast a further 1.0% decline in 2014. We believe the ongoing deterioration in the country's consumer story, combined with the government's tax incentive schemes expiring by the end of 2013, will impact the segment. Upside risk to this forecast comes from a potential change in autos leasing regulations, which would aim to encourage banks to issue more car lease agreements.

After being a BRIC state mainstay, Russia now appears to be running out of steam. Light vehicle sales declined 3.6% y-o-y in November, to 231,982 units, taking sales for 11M13 to a decline of 6.4% y-o-y, to 2,513,163 units. We believe that the country's weak consumer story is increasingly impacting the segment, and forecast a 6.5% decline in the passenger car segment for 2013 and a 7% decline in light commercial vehicle sales.

Despite earlier announcements of car loan subsidy scheme, which came without a timeframe, we expect any such programme to have a limited impact compared to the growth seen under the previous subsidy programme, as the wider consumer story is weaker. Indeed, we forecast a 3% decline in the passenger car segment and a 2.4% drop in LCV sales in 2014 on the back of the ongoing deterioration in consumer sentiment.

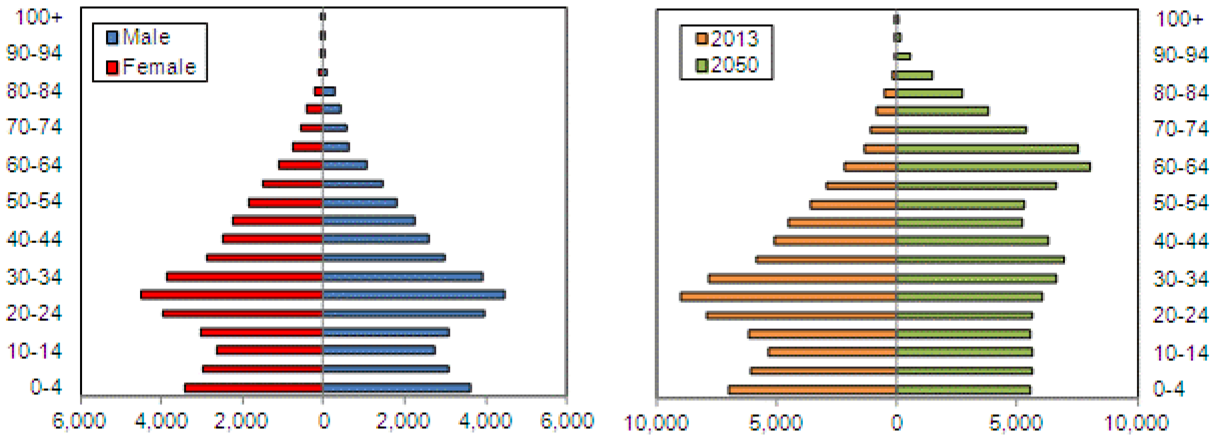
Demographic Forecast

Demographic analysis is a key pillar of **BMI**'s macroeconomic and industry forecasting model. Not only is the total population of a country a key variable in consumer demand, but an understanding of the demographic profile is key to understanding issues ranging from future population trends to productivity growth and government spending requirements.

The accompanying charts detail Iran's population pyramid for 2013, the change in the structure of the population between 2013 and 2050 and the total population between 1990 and 2050, as well as life expectancy. The tables show key datapoints from all of these charts, in addition to important metrics including the dependency ratio and the urban/rural split.

Population Pyramid

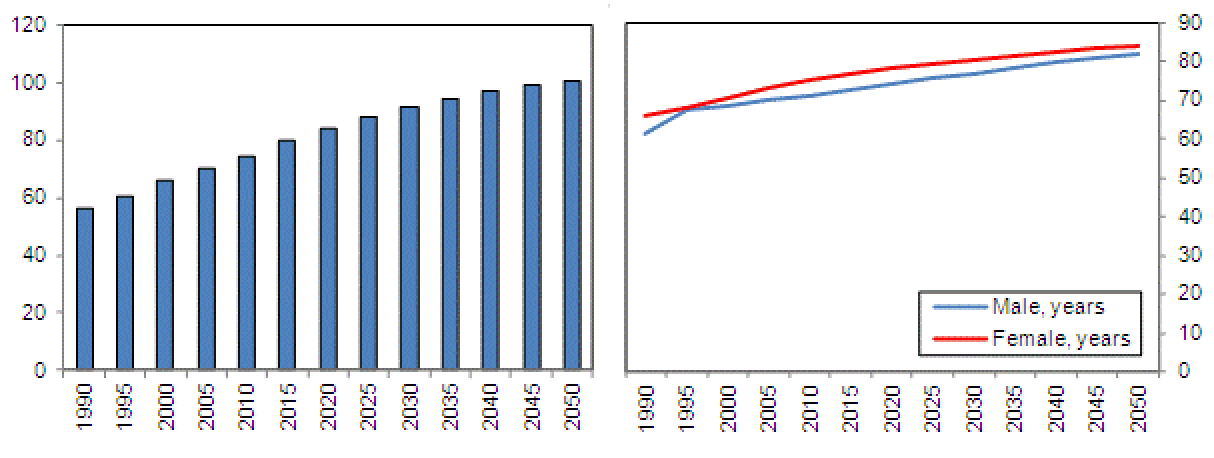
2013 (LHS) And 2013 Versus 2050 (RHS)



Source: World Bank, UN, BMI

Population Indicators

Population (mn, LHS) And Life Expectancy (years, RHS), 1990-2050



Source: World Bank, UN, BMI

Table: Iran's Population By Age Group, 1990-2020 ('000)

	1990	1995	2000	2005	2010	2013e	2015f	2020f
Total	56,362	60,468	65,911	70,152	74,462	77,447	79,476	84,149
0-4 years	9,313	7,568	6,317	5,484	6,556	7,034	7,146	6,751
5-9 years	8,906	8,983	7,552	5,477	5,416	6,046	6,507	7,117
10-14 years	7,325	8,837	8,981	7,155	5,613	5,357	5,488	6,494
15-19 years	5,823	6,885	8,801	9,248	7,216	6,124	5,644	5,467
20-24 years	4,698	5,222	6,932	9,143	8,994	7,904	7,068	5,596
25-29 years	4,054	4,429	5,316	6,859	8,705	8,978	8,727	6,998
30-34 years	3,536	3,901	4,443	5,202	6,521	7,789	8,485	8,650
35-39 years	3,031	3,393	3,886	4,693	5,210	5,858	6,497	8,410
40-44 years	2,123	2,888	3,372	4,113	4,833	5,057	5,263	6,431
45-49 years	1,621	1,956	2,857	3,421	4,033	4,495	4,758	5,193
50-54 years	1,527	1,469	1,930	2,801	3,245	3,605	3,896	4,665
55-59 years	1,393	1,396	1,431	1,767	2,638	2,933	3,110	3,788
60-64 years	1,140	1,265	1,322	1,336	1,640	2,159	2,500	2,986
65-69 years	899	995	1,146	1,258	1,279	1,379	1,551	2,340
70-74 years	507	717	826	1,056	1,130	1,129	1,143	1,369

Iran's Population By Age Group, 1990-2020 ('000) - Continued								
	1990	**1995**	**2000**	**2005**	**2010**	**2013e**	**2015f**	**2020f**
75-79 years	269	344	509	654	803	858	877	902
80-84 years	136	147	203	347	413	482	528	598
85-89 years	49	56	66	113	173	198	217	290
90-94 years	11	14	17	22	39	54	64	85
95-99 years	2	2	3	3	5	7	9	16
100+ years	0	0	0	0	0	1	1	1

e/f = BMI estimate/forecast. Source: World Bank, UN, BMI

Table: Iran's Population By Age Group, 1990-2020 (% of total)								
	1990	**1995**	**2000**	**2005**	**2010**	**2013e**	**2015f**	**2020f**
0-4 years	16.52	12.52	9.58	7.82	8.80	9.08	8.99	8.02
5-9 years	15.80	14.86	11.46	7.81	7.27	7.81	8.19	8.46
10-14 years	13.00	14.61	13.63	10.20	7.54	6.92	6.90	7.72
15-19 years	10.33	11.39	13.35	13.18	9.69	7.91	7.10	6.50
20-24 years	8.34	8.64	10.52	13.03	12.08	10.21	8.89	6.65
25-29 years	7.19	7.32	8.06	9.78	11.69	11.59	10.98	8.32
30-34 years	6.27	6.45	6.74	7.42	8.76	10.06	10.68	10.28
35-39 years	5.38	5.61	5.90	6.69	7.00	7.56	8.18	9.99
40-44 years	3.77	4.78	5.12	5.86	6.49	6.53	6.62	7.64
45-49 years	2.88	3.23	4.33	4.88	5.42	5.80	5.99	6.17
50-54 years	2.71	2.43	2.93	3.99	4.36	4.65	4.90	5.54
55-59 years	2.47	2.31	2.17	2.52	3.54	3.79	3.91	4.50
60-64 years	2.02	2.09	2.01	1.90	2.20	2.79	3.15	3.55
65-69 years	1.59	1.65	1.74	1.79	1.72	1.78	1.95	2.78
70-74 years	0.90	1.19	1.25	1.50	1.52	1.46	1.44	1.63
75-79 years	0.48	0.57	0.77	0.93	1.08	1.11	1.10	1.07
80-84 years	0.24	0.24	0.31	0.50	0.55	0.62	0.66	0.71
85-89 years	0.09	0.09	0.10	0.16	0.23	0.26	0.27	0.34
90-94 years	0.02	0.02	0.03	0.03	0.05	0.07	0.08	0.10
95-99 years	0.00	0.00	0.00	0.00	0.01	0.01	0.01	0.02

Iran's Population By Age Group, 1990-2020 (% of total) - Continued

	1990	1995	2000	2005	2010	2013e	2015f	2020f
100+ years	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00

e/f = BMI estimate/forecast. Source: World Bank, UN, BMI

Table: Iran's Key Population Ratios, 1990-2020

	1990	1995	2000	2005	2010	2013e	2015f	2020f
Dependent ratio, % of total working age	94.7	84.3	63.6	44.4	40.4	41.1	42.1	44.6
Dependent population, total, '000	27,416	27,664	25,621	21,569	21,427	22,544	23,530	25,965
Active population, % of total	51.4	54.3	61.1	69.3	71.2	70.9	70.4	69.1
Active population, total, '000	28,946	32,805	40,290	48,583	53,035	54,903	55,946	58,184
Youth population, % of total working age	88.2	77.4	56.7	37.3	33.2	33.6	34.2	35.0
Youth population, total, '000	25,543	25,388	22,850	18,116	17,586	18,436	19,141	20,363
Pensionable population, % of total working age	6.5	6.9	6.9	7.1	7.2	7.5	7.8	9.6
Pensionable population, total, '000	1,872	2,276	2,770	3,454	3,842	4,108	4,390	5,602

e/f = BMI estimate/forecast. Source: World Bank, UN, BMI

Table: Iran's Rural And Urban Population, 1990-2020

	1990	1995	2000	2005	2010	2013e	2015f	2020f
Urban population, % of total	56.3	60.2	64.0	67.6	68.9	69.4	69.7	70.6
Rural population, % of total	43.7	39.8	36.0	32.4	31.1	30.6	30.3	29.4
Urban population, total, '000	31,749	36,424	42,211	47,394	51,333	53,726	55,362	59,374
Rural population, total, '000	24,613	24,045	23,700	22,759	23,129	23,722	24,114	24,774

e/f = BMI estimate/forecast. Source: World Bank, UN, BMI

Methodology

Industry Forecasts

BMI industry forecasts are generated using the best-practice techniques of time-series modelling and causal/econometric modelling. The precise form of model we use varies from industry to industry, in each case being determined, as per standard practice, by the prevailing features of the industry data being examined.

Common to our analysis of every industry is the use of vector autoregressions. Vector autoregressions allow us to forecast a variable using more than the variable's own history as explanatory information. For example, when forecasting oil prices, we can include information about oil consumption, supply and capacity.

When forecasting for some of our industry sub-component variables, however, using a variable's own history is often the most desirable method of analysis. Such single-variable analysis is called univariate modelling. We use the most common and versatile form of univariate models: the autoregressive moving average model (ARMA).

In some cases ARMA techniques are inappropriate because there is insufficient historic data or data quality is poor. In such cases we use either traditional decomposition methods or smoothing methods as a basis for analysis and forecasting.

BMI mainly uses OLS estimators and in order to avoid relying on subjective views and encourage the use of objective views, **BMI** uses a 'general-to-specific' method. We mainly use a linear model, but simple non-linear models, such as the log-linear model, are used when necessary. During periods of 'industry shock', for example when poor weather conditions impede agricultural output, dummy variables are used to determine the level of impact.

Effective forecasting depends on appropriately selected regression models. We select the best model according to various different criteria and tests, including but not exclusive to:

- R^2 tests explanatory power; adjusted R^2 takes degree of freedom into account.
- Testing the directional movement and magnitude of coefficients.
- Hypothesis testing to ensure coefficients are significant (normally t-test and/or P-value).
- All results are assessed to alleviate issues related to auto-correlation and multi-collinearity.

BMI uses the selected best model to perform forecasting.

Human intervention plays a necessary and desirable role in all of our industry forecasting. Experience, expertise and knowledge of industry data and trends ensure that analysts spot structural breaks, anomalous data, turning points and seasonal features where a purely mechanical forecasting process would not.

Sector-Specific Methodology

A number of principal criteria drive our extrapolations and forecasts for each autos variable.

- **Production And Sales**

At a general level, we approach our forecasting from both a micro and a macro perspective, assessing the expansion plans of relevant multinationals/indigenous firms, while also taking account of the prevailing economic outlook. In this latter respect, our projections for macro variables such as industrial output, private consumption, government investment, monetary policy and GDP growth play a key role.

Figures for production are derived from a generic source (thereby ensuring maximum comparability between country data-sets), and include all vehicles with four wheels or more. For sales, we rely on data from government agencies and national automobile associations. Unless otherwise stated, sales numbers include domestically produced and imported vehicles, but not exports. The sector's contribution to GDP is projected by taking the US dollar production value as a proportion of nominal GDP, using our own macroeconomic and demographic forecasts.

- **Auto Imports And Exports**

These variables are mainly calculated at the micro level, using individual company reports. Changes in government policy, particularly with regard to tariffs and quotas, also have a significant bearing.

Sources

Aside from government departments and official company reports, we rely on the International Organization of Motor Vehicle Manufacturers (OICA), other established think tanks, institutes, and international and national news agencies.

Risk/Reward Ratings Methodology

BMI's Risk/Reward Ratings (RRR) provide a comparative regional ranking system evaluating the ease of doing business and the industry-specific opportunities and limitations for potential investors in a given market. The RRR system divides into two distinct areas.

Rewards

Evaluation of sector's size and growth potential in each state, and also broader industry/state characteristics that may inhibit its development. This is further broken down into two sub categories:

- Industry Rewards (this is an industry-specific category taking into account current industry size and growth forecasts, the openness of market to new entrants and foreign investors, to provide an overall score for potential returns for investors).
- Country Rewards (this is a country-specific category, and the score factors in favourable political and economic conditions for the industry).

Risks

Evaluation of industry-specific dangers and those emanating from a state's political/economic profile that call into question the likelihood of anticipated returns being realised over the assessed time period. This is further broken down into two sub categories:

- Industry Risks (this is an industry-specific category whose score covers potential operational risks to investors, regulatory issues inhibiting the industry, and the relative maturity of a market).
- Country Risks (this is a country -pecific category in which political and economic instability, unfavourable legislation and a poor overall business environment are evaluated to provide an overall score).

We take a weighted average, combining industry and country risks, or industry and country rewards. These two results provide an overall Risk/Reward Rating, which is used to create our regional ranking system for the risks and rewards of involvement in the autos industry in a particular country.

For each category and sub-category, each state is scored out of 100 (100 being the best), with the overall Risk/Reward Rating a weighted average of the total score. As most of the countries and territories evaluated are considered by **BMI** to be 'emerging markets', our rating is revised on a quarterly basis. This ensures that the rating draws on the latest information and data across our broad range of sources, and the expertise of our analysts.

In constructing these ratings, the indicators in the table below have been used. Almost all indicators are objectively based. Given the number of indicators/datasets used, it would be inappropriate to give all sub-components equal weight. The weighting given is described in the table.

Table: Automotive Risk/Reward Ratings Indicators And Weighting Of Indicators

Indicator	**Weighting, %**
Rewards	70, of which
Industry Rewards	65, of which
Vehicle ownership, % of population	10
Total vehicle stock, mn	10
Total production	10
Production growth, five-year forecast average	10
Total vehicle sales	10
Sales growth, five-year forecast average	10
Country Rewards	35, of which
Urban/rural split	10
Rigidity of employment	10
Labour costs	10
GDP per capita, US$	10
Risks	30, of which
Industry Risks	50, of which
Regulatory environment	10
Competitive landscape	10
Country Risks	50, of which
Corruption	10
Bureaucracy	10
Market orientation - openness	10
Legal framework	10
Long-term monetary risks	10
Long-term external risks	10
Long-term financial risks	10
Long-term policy continuity	10

Source: BMI