Global Auto & Equipment Finance Report 2018

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White Clarke Group is the market leader in software solutions and business consultancy to the automotive and equipment finance sector for retail, fleet and wholesale. White Clarke Group solutions enable end-to-end credit processing and administration to streamline business practice, cut operational cost and deliver outstanding customer service. White Clarke Group has a 25-year track record of leadership and innovation in finance technology, consultancy and new market entry. Clients value White Clarke Group's industry knowledge, market intelligence and innovation.

The company employs approximately 600 finance and technology professionals, with offices in the USA, UK, Canada, Australia, Austria, Germany, India and China.

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FOREWORD

By Brendan Gleeson, group chief executive officer, White Clarke Group

The analysis in this year's White Clarke Group Global Auto and Equipment Finance Report provides an encouraging vision of the industry for 2018.

Industry leaders consulted for this report have provided a broadly positive outlook, with expectations of growth throughout the globe.

Our analysis shows that economic growth is supporting new business development worldwide, from Asia Pacific to North America.

This generally positive message does include pockets of uncertainty, such as concerns about the impact of Brexit on UK markets, the impact of slowing auto sales in the US, challenging economic circumstances in some Latin American countries and geo-political tensions surrounding the Korean peninsula.

However, even here there is a recognition that growing consumer and business awareness of the benefits of asset finance will increase penetration levels in many markets and deliver growth that can outpace wider economic performance.

While perspectives differ by region and country, the industry is ready to make the best of the opportunities that are available during 2018.

Two critical global issues identified in this year's report are digitalization and the impact of compliance and regulation requirements.

Compliance and regulation sits at the heart of the finance market and is identified as a challenge in every region around the world, ranging from fundamental changes to tax law in India, to new open banking rules in Europe and a more business-friendly approach to regulation in the US.

Digitalization provides significant opportunities for the development of new services that serves as a win/win for the financial services industry, offering benefits to consumers and streamlining business processes for finance companies.

The challenge is to deliver these services through robust mechanisms, which are secure, scalable and flexible.

For those who ignore the evolution, the consequences could be extremely costly.

As this year's report notes, 'Digital Darwinism' will see the strongest companies thrive by adapting to this changing and dynamic market.

It will be an exciting journey and we look forward to supporting you as the year progresses.




Executive summary

NORTH AMERICA

- The auto and equipment finance industry expects a strong start to the first few months of 2018 as momentum from a solid 2017 performance is carried into the New Year.
- Tax reforms will form the foundation for growth in 2018 and both auto and asset finance companies have responded positively to the new legislation.
- Changes in leadership at the Consumer Financial Protection Bureau give an indication of a new industry-friendly approach that should bode well for finance companies that serve US consumers.
- US equipment finance sector new business volume reached new highs during 2017 as it exceeded $100 billion
- The National Automobile Dealers Association (NADA) expects new car and light truck sales to decline slightly during 2018. Overall, a total of 16.7 million new cars and light trucks will be sold in 2018, compared to 17.1 million in 2017. This has been widely anticipated after years of record sales related to post-recession pent-up demand.
- Despite a forecasted fall of around 4% in auto sales, it will still be the fourth highest year on record.
- There is disagreement about any threat posed by sub-prime lending, particularly in the auto sector. While the US Federal Reserve Bank warns of rising delinquencies, industry experts argue that the industry is robust and point to latest research showing a fall in sub-prime auto originations.

SOUTH AMERICA

- Most economies that make up Latin America are likely to see growth accelerate in 2018.
- Research from Alta Group Latin American Region picks out Mexico, Colombia and Chile as markets showing particularly strong leasing growth.
- There is a trend away from finance leases to operating leases as independent finance companies continue to dominate the market.
- The total value of leasing portfolios across Latin America is an estimated $55.6 billion for the full year 2016, up 4.3% on 2015.
- 95% of the whole leasing portfolio in the LAR is concentrated among the 100 largest leasing companies.
- Two countries, Chile and Mexico, supplied the vast majority of leasing portfolio growth (78%) among nations that recorded an increase in market size, with Colombia accounting for an additional 16%. In total, portfolio growth was nearly USD$4 billion.
- Overall growth in Latin America has been curtailed by declines in some countries, particularly Venezuela, which saw the biggest drop in leasing portfolio size by value at 25% to $286.6m. Brazil, the largest economy in South America, also saw a double-digit drop in its leasing portfolio value (10.7%) to $7.3bn.
- An ongoing change in the market for 2018 is the trend for banks to exit the market and for independents to move in.
- A dramatic shift in multinational investment in the leasing industry has seen a retreat from US banks, with European companies taking up market share.

ASIA PACIFIC

- The Asia Pacific region has trade growth opportunities despite its many geopolitical problems.
- Outside the Korean peninsula, there appears to be a “business as usual” approach, even if concerns remain high about the impact of tensions with North Korea.
- The Chinese economy is forecast to grow by 6% in 2018, supported by favorable Chinese government policies.
- Sector growth has also fueled competition, which is pressuring yields and undermining lessors’ underwriting discipline.
- There were more than 8,000 equipment leasing companies operating in China in 2017, a 15% annual increase.
- China is well-established as the world’s largest new car market, but the scale of its appetite for fresh metal will be challenged by a burgeoning used car market.

- In India, the introduction of the Goods and Service Tax (GST) in July 2017 consolidated India's indirect tax regime into a single tax and had an impact on every area of the economy.
- Verified industry data is still absent from the market, although the creation of the Asset Finance Association of India in 2017 to represent the interests of the leasing industry should improve the authenticity of data.
- In Australia, more than half of Australian businesses expect the political environment to impact their ability to grow during 2018.
- The proportion of Australian businesses saying they are operating with outdated assets doubled in 2017 to 22.4%.
- In Japan, Prime Minister Shinzo Abe kept his substantial majority in last year's snap election and the strong mandate paves the way for ongoing political change.
- While consumer confidence is strong, in 2018 the Japanese economy is set to decelerate, with experts at Focus Economics predicting GDP growth of 1.2%.
- The Japanese leasing market reflects the challenging outlook. The overall value of lease transaction volumes fell during 2017, although some sectors saw an increase in demand.

EUROPE

- Auto and equipment finance companies are striking a positive tone in their predictions for 2018, despite ongoing challenges.
- The Biannual European Leasing Survey, based on information collected from Leaseurope's Member Associations on their national leasing markets, reveals that total leasing volumes in Europe were €164.3 billion in the first half of 2017, an increase of 10.5% compared to the same period a year ago.
- European vehicle finance new business rose 9.8% and equipment finance rose 12% during the first half of 2017.
- The market is heavily influenced by a small number of major economies, with the EU5 (France, Germany, Italy, Spain, UK) accounting for 65% of vehicle and equipment new business in H1 2017.
- Following 6% growth in 2017, the leasing sector in Germany is confident about prospects for 2018.
- The German Council of Economic Experts is predicting a 5.1% increase in equipment investment during 2018.
- In Germany, around 40% of all newly-registered road vehicles are now leased. Vehicle leasing increased 6% in 2017.
- The UK enters its last year full year as a member of the European Union with a positive outlook, but there are challenges ahead.

- The UK's car market is traveling in the opposite direction to neighboring economies, with sales down nearly 5% last year; further declines are expected in 2018.
- Legislation will have a significant impact on the European auto and equipment finance market in 2018, including the General Data Protection Regulation, which becomes enforceable from May 25, 2018, while open banking regulation in the form of the second EU Payment Services Directive 2 (PSD2) also comes into force this year.
- Uncertainty over diesel caused by changing political attitudes is undermining vehicle demand as consumers wait for a clearer picture of the future, which could affect residual values for current assets.
- Diesel uncertainty could be a positive for the finance industry, as consumers shy away from long-term ownership of assets.
- Central and Eastern Europe offer a promising potential market for generating additional growth in 2018, with analysis indicating the leasing market is worth €17 billion.

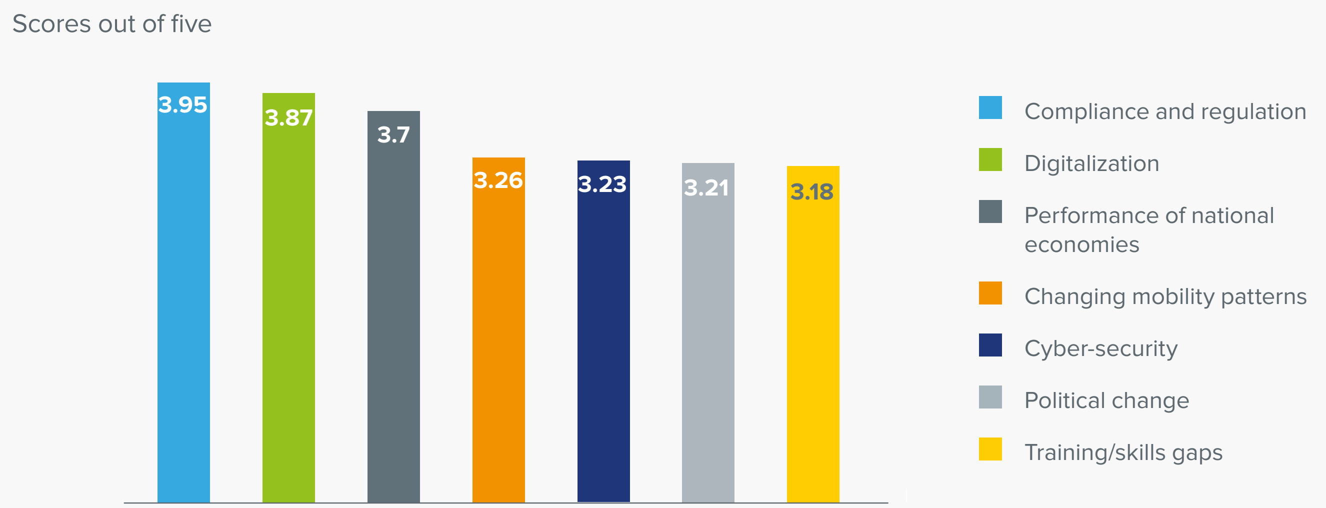
Industry adapts to digitalization challenge

Digitalization is one of the biggest issues currently facing the global auto and equipment finance sector, according to industry leaders.

The introduction of digital services has the potential to transform the finance market by providing new ways of serving customers, managing risk and sourcing funding.

Its potential is so great that digitalization was ranked second only to legal and regulatory issues in a survey of industry leaders carried out by Asset Finance International.

Most important issues facing the auto and equipment finance industry in 2018



Source: Asset Finance International
Notes: 1=least important, 5=most important

Digitalization can drive efficiencies and improve customer service through consistent, automated, reliable processes that require minimal human involvement.

Examples can range from the use of chatbots in the customer service process through to automated risk analysis that scans a wide range of market data, removing the need for customers to provide extensive personal or financial details before being approved for finance.

The Internet of Things and cloud computing will play a significant part, as assets are increasingly able to communicate with finance companies to provide critical information about usage, condition, location and a range of other factors that can drive efficiencies within the business.

For many companies, adapting to this new market will be a challenge, as there are significant barriers to overcome, ranging from technical hurdles to new business processes.

However, as the research shows, the industry recognizes the importance of embracing change to remain relevant in a digital economy.

Brian Solis, a principal analyst at Altimeter Group, studying disruptive technology and its impact on business, uses the term “Digital Darwinism” to describe the importance of businesses embracing change.

For the auto and equipment finance industry, those that are quickest to adapt to the new way of doing business will thrive, while others may struggle to survive

He said: “Digital Darwinism is the evolution of consumer behavior when society and technology evolve faster than your ability to adapt.”

For the auto and equipment finance industry, those that are quickest to adapt to the new way of doing business will thrive, while others may struggle to survive.

Eero Tölö, senior economist at the Bank of Finland, said: “Traditional financial participants are facing new competition.

“On the one hand, major technology giants have begun to provide services designed primarily for payments but partly also for lending, while on the other hand fast-growing fintech start-ups are out to peck the most delicious titbits off banks’ plates, spurred by feather-light cost structures and new ways of thinking.

“The steps taken in various segments of the sector in recent years signal a more profound shake-up of financial sector structures.”

Major banks are responding to the digitalization challenge. For example, Swedbank has opened its doors to work with fintechs and developers by launching a new open banking platform.

Swedbank’s open banking platform will provide third parties safe and secure access to bank systems and customer accounts when they have given permission.

As a first-step, it has created a ‘sandbox’ environment where partners can test their new ideas with the bank.

Emma Heimonen, head of digital innovation at Swedbank, said: “Innovative capability and co-operation capacity combined with high delivery rates are crucial factors for us to succeed in the digital paradigm shift.

“Our ambition is to select good ideas that come from all the testing and co-innovation that goes on.

“This is a great opportunity for entrepreneurs that want to create fantastic customer value.”

Digitalization transforms a business, it transforms the basis of competition, it changes the dynamic and the relationship with the customer

Richard Jones
managing director, Black Horse

This is a view shared by Richard Jones, managing director of Black Horse in the UK and chairman of the UK Finance and Leasing Association.

He believes finance companies should embrace open API technologies that allow a wide range of software used by industry suppliers and their customers to integrate with their own systems to start the finance process.

Jones said: “Digitalization transforms a business, it transforms the basis of competition, it changes the dynamic and the relationship with the customer. It allows innovation and it provides an explosion in the amount of data that you suddenly acquire from your customers.

“All of these things are going to change our market. The key for me is to have the right technology platforms so I can deal with every single one of those if I needed to.

“Open API technologies allow you to plug-and-play any part of your sales process and fundamentally change it. When you design an online car and car finance buying journey, it’s not the same as the physical one. You have to think about it quite differently.”

This includes completing online purchasing, carrying out identity checks and verification or dealing with queries, all without ever meeting the customer.

Jones said: “None of this is possible if you haven’t got the right technology in the first place and, as lenders, this is something we’ve all got to get our heads around. It will lead to a lot more collaboration between lenders and software distribution businesses.”

Kirstine Wilson, head of strategic development, Siemens Financial Service, Commercial Finance, said that the trend to digitalizing and automating production processes and service models is driving change among customers and that benefits the finance sector.

She said: “Digitalization and automation contribute to accelerated equipment technical obsolescence and replacement cycles in some sectors.

“Lessors, therefore, need to keep a very close eye on industry dynamics, asset trends as well as the volatility of underlying equipment values securing the lease, in order to offer commercially sustainable financing packages.

“As a result of accelerated technological development, over the last few years, there has been significant growth in the availability of and interest in, the idea of paying for business outcomes, rather than paying to use the technology that the acquirer believes will produce beneficial outcomes.”

Finance and technology are being combined into an integrated value proposition where the solution provider offers organizations the possibility of paying for expected business outcomes, such as productivity improvements, optimized uptime, precise performance gains, cost reduction or reduced energy usage.

Wilson added: "Being able to pay for business outcomes transforms the reliability of financial planning. Not only are costs more transparent, the risk of technology obsolescence, capital commitment, and so on are avoided."

In Europe, the biggest driver of digitalization in 2018 will be the arrival of new regulations that open the door for a flood of innovative new services.

Under the revised EU Payment Services Directive (PSD2), which must be applied in national legislation from January 2018, all banks must provide third parties with account access and transaction data if the customer wishes.

In Europe, the biggest driver of digitalization in 2018 will be the arrival of new regulations that open the door for a flood of innovative new services

Daniel Bailey, executive director of Arkle Finance, said: "PSD2 and open banking should provide much wider access to critical information previously owned and reserved for banks."

Tölö added: "Digitalization has found its way into the core of banking. A growing number of crowdfunding and peer-to-peer lending platforms provide funding and investment opportunities exclusively via the internet.

"Although still holding a rather small market share in most countries and being primarily designed for high-risk funding, the new forms of funding are growing rapidly. For example, the Chinese peer-to-peer lending market has already reached a volume of $66.9 billion."

Measures initiated by the Finnish authorities in response to the digitalization of financial intermediation include the Crowdfunding Act, which clarifies the legal status and regulation of crowdfunding participants.

Richard Ryan, a partner at Invigors, said digitalization is the greatest opportunity for the auto and equipment finance market in 2018, adding that growth could come from the use of artificial intelligence and machine learning, big data, smart assets and connected vehicles.

Despite the accelerating digitalization developments in auto and equipment finance markets, there are significant risks associated with innovations, particularly when it comes to cyber-security.

During 2017, hundreds of millions of customers' records were lost in data breaches around the world, affecting a number of global brands.

Experts believe that this momentum will continue throughout 2018, increasing pressure on finance companies to ensure their systems are secure, despite being more open.

According to Tölö, it is vital that authorities keep track of the structural changes and respond appropriately to advances in digitalization.

The new General Data Protection Regulation in the EU is designed to achieve this, with tougher standards for data security and bigger penalties for businesses when breaches occur.

Blockchain provides one way to provide a secure record of transactions that can combat fraud by having an irrefutable record of every record change held at several, independent data centers.

Last year, Daimler and Landesbank Baden-Württemberg (LBBW) jointly used blockchain technology to execute a €100 million financial transaction, while Bank of Montreal, CaixaBank, Commerzbank and Erste Group have teamed up with IBM to build a new global platform for trade finance which is based on blockchain technology.

According to the US Equipment Leasing & Finance Foundation, emerging technologies including artificial intelligence and machine learning, the Internet of Things and blockchain, are beginning to take hold and may help drive future growth.

Digital verification systems are also becoming more sophisticated, using technology ranging from fingerprint and facial recognition to automated scanning of a customer's digital footprint to search for patterns of fraudulent behavior that might otherwise go unnoticed.

Bailey said security would be one of the biggest challenges facing the industry in 2018, adding that an increasing incidence of technology-related crime and fraud could impact the industry's processing costs.

Altimeter's Solis argues that success in digitalization will be driven by 'digital change agents', who lead business change from within.

He said: "Although digital transformation is one of the biggest trends in business today and companies are investing heavily in new technologies and innovations, many still do so as a grassroots effort driven by expert individuals — digital change agents — across the organization."

He believes change agents can rise from anywhere in the organization and often begin as digital advocates — employees who introduce or promote new digital ideas or products — and can eventually progress to experienced transformers.

Solis added: "To garner support across the organization, change agents quickly realize that they must acquire basic change-management skills if they are to secure cross-functional collaboration and leadership support.

"Without support, digital change agents may become disenchanted and lose morale and seek to take their expertise and passion elsewhere."

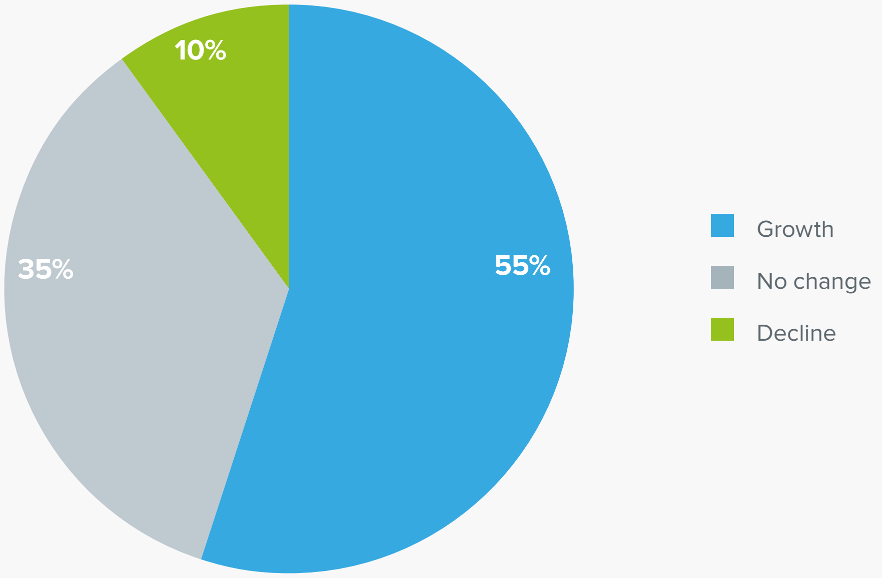
Industry confident of growth in 2018

The majority of auto and equipment finance companies are predicting growth in 2018.

According to recent reader research carried out by Asset Finance International, 55% of respondents predict that market conditions for their organization will improve in 2018.

A further 35% expect conditions to stay the same and only 10% expect conditions to worsen, with the majority of those based in the UK, where confidence continues to suffer as the country takes an uncertain path towards Brexit and its split from the European Union.

Expectations of global auto and equipment finance industry performance 2018



Source: AFI

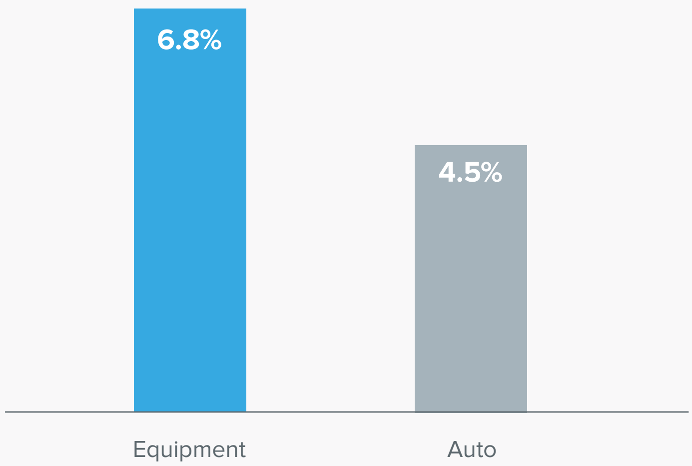
Confidence is highest in the equipment finance sector, with 50% of executives predicting growth, while 37% of executives in auto finance agree, although this was from a smaller sample of respondents.

Overall, equipment finance executives predict growth of 6.8%, although this varies depending on the country of the respondent, with China leading the way with growth of 10% expected on average, followed by the US (7.8%), while countries including Germany, UK and Australia predict growth of 5%.

Expectations of growth in auto finance are lower, at an average of 4.5%, with substantial variations by country. In the UK, overall growth of 2% is predicted, but several respondents anticipate a decline of around 2%. Expectations of growth are based on increasing market share and improving levels of finance penetration.

Growth of 2% in auto finance is also predicted in the US, although some companies expect a static market, while China is expected to grow by 10%.

Expected global average auto and equipment finance growth 2018



Source: AFI

Respondents pointed to a range of challenges facing the industry, including the importance of differentiation in an increasingly digitized finance environment, where personal service is more difficult to highlight.

Daniel Bailey, managing director at Arkle Finance, warned of fintechs providing "highly effective vanilla products", which could "homogenize finance and bury the benefits of properly deployed and well-thought-out asset finance solutions".

However, there are also dangers in delaying action, with David Betteley, director at Marknad, warning against trying to maintain the status quo and moving too slowly to embrace the changes currently affecting the market and the opportunities they provide.

Barry Lau, managing director of Constellation Capital, pointed to strong global liquidity markets and intensified levels of competition with new market entrants fighting against established players.

According to Jason Hurwitz, head of strategic initiatives at Aldermore, this includes the return of large high-street banks to markets they exited during the financial crisis, which is absorbing market share.

In its 2018 Outlook report on finance and leasing companies, Fitch Ratings says the market will be relatively stable.

This reflects modest leverage across most sub-sectors, adequate liquidity profiles, and the generally muted impact of rising interest rates in certain regions.

However, it points to weakening asset quality and residual values across many asset classes, in addition to regulatory environment uncertainty.

It reports that most finance and leasing companies are better capitalized than before the financial crisis, given more conservative leverage policies.

This should serve as a structural tailwind to offset tougher portfolio credit profiles.

The commercial finance sector outlooks are mostly stable as there are still opportunities for outsourcing ownership of assets like aircraft, commercial fleets and trucks.

Financial technology (fintech) is likely to play an increasingly important role in financial services globally in 2018, it says, increasing market efficiency but also introducing potential competitive disruption, although the real impact will be felt beyond 2018.

Key factors impacting sector outlooks are:
Auto lending and leasing: the primary drivers of weaker credit performance are likely to be declines in used vehicle prices and the seasoning of 2013-2015 auto loan vintages, which Fitch believes were characterized by weaker underwriting standards.

Aircraft leasing: the overall market for commercial aircraft benefits from the strong growth of global air traffic, moderate fuel prices and largely stable airline credit fundamentals.

Railcar leasing: weak freight car prices are likely to continue to pressure railcar residual values and lessor profitability into 2018, but declines should moderate.

NORTH AMERICA

Auto and equipment finance industry predicts growth ahead

The auto and equipment finance industry expects a strong start to the first few months of 2018 as momentum from a solid 2017 performance is carried into the New Year.

Base indicators all point in the right direction, with the labor market approaching full employment, wage growth, rising consumer confidence and increasing business investment, particularly in certain sectors of the economy.

The introduction of tax reforms led by Donald Trump's administration have benefited the industry in a number of ways and provided additional impetus to economic growth.

The National Automobile Dealers Association (NADA) is celebrating the success of its campaign to retain an amendment preserving 100% deductibility of interest on floor plan loans in the new bill.

Mark Scarpelli, 2017 NADA chairman said: "Preserving floor plan deductibility was one NADA's top priorities for tax reform. [It] will help preserve auto sales, dealership jobs and tax revenue for our state and local governments."

U.S. Bancorp, parent company of U.S. Bank, has announced investments in several strategic projects as a result of the tax reform package.

This includes a special $1,000 bonus for nearly 60,000 employees, an increase in the minimum wage for hourly employees, enhancements to employees' healthcare offerings and new investment in strategic projects focused on digital and mobile.

Andy Cecere, president and chief executive officer, U.S. Bancorp, which has $459 billion in assets, said: "We believe that tax reform is positive for the US economy because it provides an immediate opportunity to benefit our employees, our communities and our customers."

David Mirsky, chief executive officer, Pacific Rim Capital, forecasts strong business conditions to continue until the middle of 2018 when he expects a slowing of the business cycle, which could even lead to a recession in 2019.

He added: "The things that can derail our happy situation are mostly the political division that our media is promulgating.

"If the anti-Trump forces manage to force something as extreme as impeachment, it would be very negative for the economy. I think that is unlikely, barring unforeseen circumstances (or actions)."

David Pohlman, COO Great America, said: "I am relatively optimistic. The business community believes we will get some change and if we do the economy will move forward."

An additional initiative that may benefit the auto and equipment finance industry relates to leadership changes at the Consumer Financial Protection Bureau.

The agency was set up after the financial crisis to oversee consumer lending regulation and has taken strong action in the auto lending market in the past, most notably handing out an $80 million penalty to Ally Financial over allegations of discriminatory pricing of auto loan deals to ethnic minority consumers.

Last year, CFPB director Richard Corday announced his resignation and named Leandra English, newly appointed deputy director of the agency, as its head until the Senate confirmed his replacement.

However, President Trump then stated that White House budget director Mick Mulvaney would take up the post with immediate effect.

Chris Stinebert, president & chief executive officer of the American Financial Services Association (AFSA), said: "Mulvaney's appointment as acting director will ultimately ensure a smooth transition to a permanent director, nominated by the President, who will carry on the priorities of the administration.

"In his role as budget director, as well as having served on the House Financial Services Committee, director Mulvaney has demonstrated that he understands the need for effective and fair regulation.

"Nowhere is that balanced approach more needed than at the CFPB, an agency that has all too often regulated by press releases.

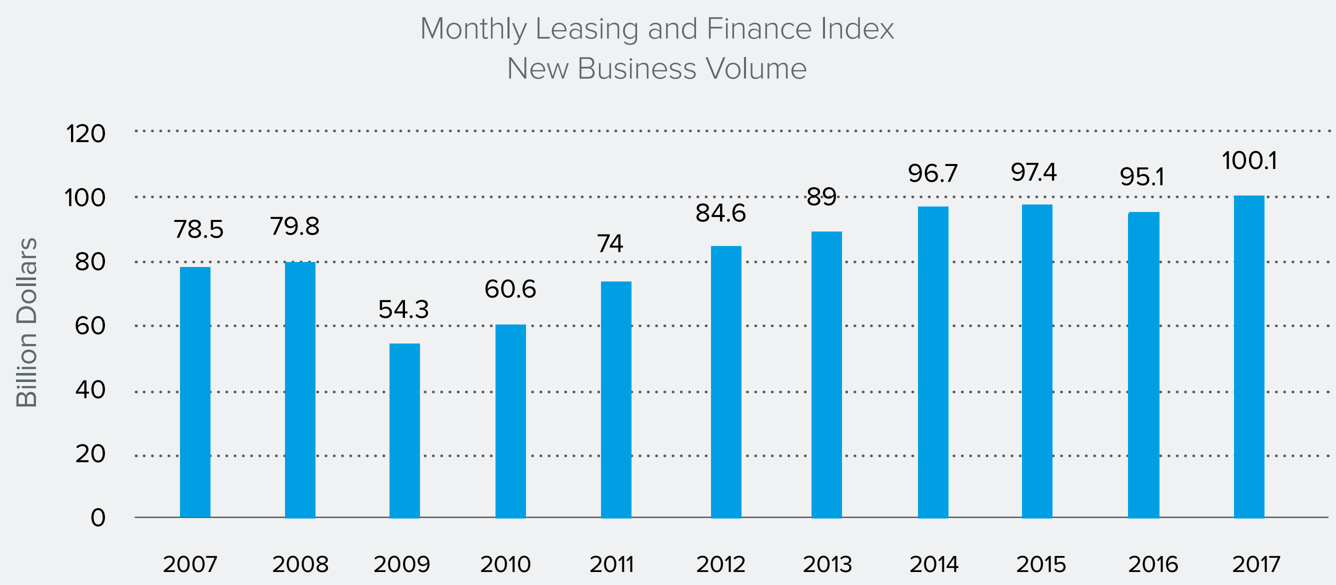
"AFSA believes that Mulvaney will lead the CFPB in a fashion that gives financial services providers clear guidelines as opposed to guesswork and allows them to better serve their customers."

The new approach will not be certain until there is clarity over who will prevail in leading the CFPB. While a federal judge denied a request for a temporary restraining order to block Mulvaney from serving as acting director, English maintains she is the lawful acting director.

However, these signs of progress are building industry confidence that the momentum for growth from 2017 will be maintained during 2018.

Last year, cumulative new business volume in the US equipment finance industry was up by 4%, according to data from the Equipment Leasing and Finance Association (ELFA) and for the first time, new business exceeded the $100 billion threshold.

US equipment finance sector growth 4%



Source: ELFA MLFI-25 (2017 figures include data up to August 2017 - the 2017 full year figure is an estimate)

National Federation of Independent Businesses chief economist Bill Dunkelberg said company owners were much more positive about the economic environment, suggesting a long-term view.

He added: “Consumer sentiment surged based on optimism about jobs and incomes, an encouraging development as consumers account for 70% of GDP.”

Investment in equipment and software is projected to expand 9.1% in 2018, according to the Equipment Leasing and Finance Foundation’s Equipment Leasing & Finance U.S. Economic Outlook.

The annual investment growth projection is well above the estimated 5.2% growth rate experienced in 2017.

Ralph Petta, president of the Foundation and President and CEO of the Equipment Leasing and Finance Association, said: “This forecast for higher-than-expected growth in capital equipment investment is indeed good news. Business conditions appear favorable heading into the new year. Equipment finance organizations we talk to are bullish about 2018 growth projections for the industry."

Consumer demand powers auto finance growth

The National Automobile Dealers Association (NADA) expects new car and light truck sales to decline slightly during 2018, but still remain one of the highest years on record.

Overall, a total of 16.7 million new cars and light trucks will be sold this year, compared to 17.1 million in 2017.

However, 2017 NADA chairman Mark Scarpelli said the forecast is indicative of a stable, healthy market for new vehicles.

He said: "We expect 2018 to be a robust year. Every dealer in America, myself included, would be thrilled with a seasonally adjusted annualized rate of above 16 million.

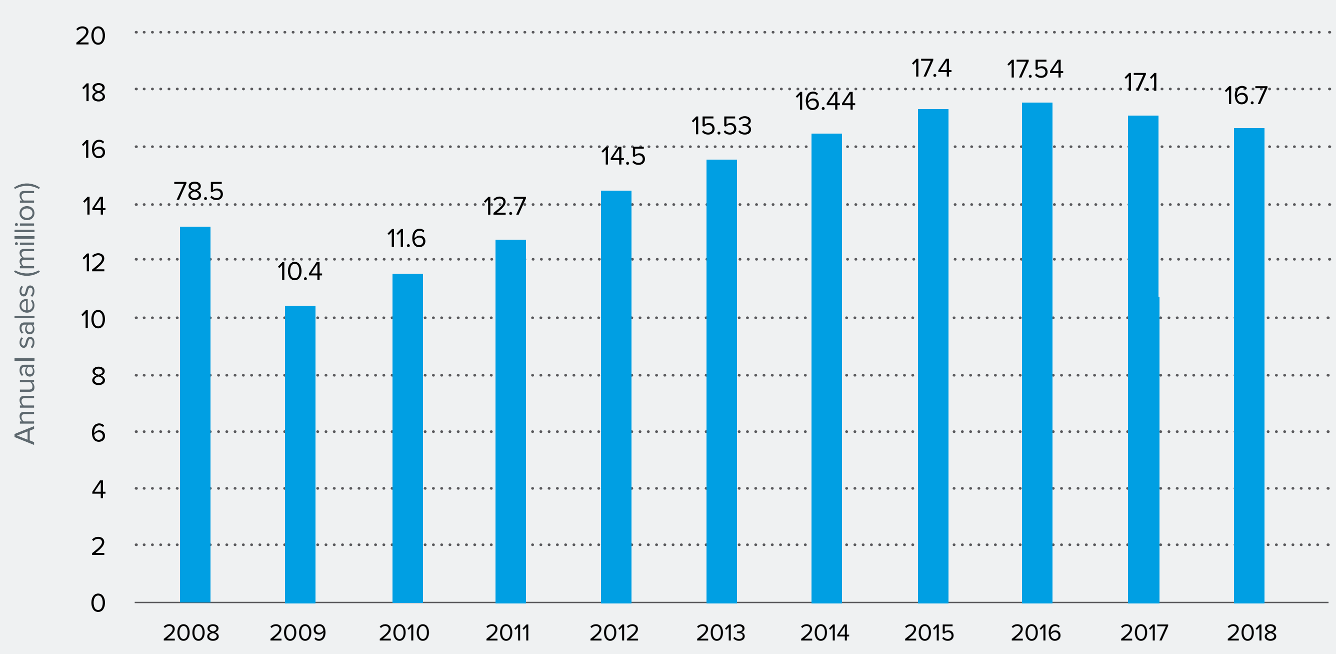
"We are looking at a stable market where demand – particularly for light trucks, SUVs and crossovers – continues to be very healthy.

"The inventories that we're carrying in our showrooms are aligning very well with what our customers are looking for.

"This is a very positive forecast."

While the forecast predicts a fall of around 4%, it will still be the fourth highest year on record for auto sales.

US Annual Light Vehicle Sales



Source: NADA

According to NADA senior economist Patrick Manzi, the vehicle segment mix will continue to favor light-truck sales.

Last year, light-trucks accounted for nearly 64% of sales and that is likely to grow to 65% in 2018.

Manzi added that the overall economic outlook for 2018 remains strong with projected gross domestic product (GDP) growth at 2.6%, average employment growth around 180,000 jobs per month, and the price for regular-grade gasoline at around $2.50 per gallon.

Outlining some areas of concern, Manzi said rising interest rates, ever-increasing loan terms and higher vehicle transaction prices could lead to slower, but still strong, sales pace in 2018.

In addition, NADA forecasts that new-car dealerships will retail 15.3 million used vehicles in 2018, compared to around 15.1 million in 2017. The total used-vehicle market will exceed 40 million retail sales in 2018.

Manzi said: “The influx of off-lease vehicles returning to dealerships is likely to put pressure on new-vehicle sales.

“However, the mix of these late-model vehicles will favor light-trucks more than past years and should be more in line with present consumer demand.”

Although official concerns have been raised about increasing loan terms and levels of sub-prime debt, industry experts say there is little evidence to support claims that the market is showing signs of stress.

According to the US Consumer Financial Protection Bureau (CFPB), 42% of auto loans made in 2017 carried a payback term of six years or more, compared to just 26% in 2009.

In recent years, loans of six years or longer have had default rates that exceeded 8%, whereas shorter-term loans have had default rates closer to 4%.

In addition, in the US the average length of vehicle ownership is approximately 6.5 years.

The US Federal Reserve Bank argues delinquencies in auto lending are on the rise and it says the sub-prime sector is starting to show signs of stress.

Wilbert van der Klaauw, senior vice-president at the New York Fed, said: “Examining the auto loan market more closely revealed notable differences between auto finance and auto bank lenders.

“Delinquency rates among auto finance lenders are considerably higher and rising, especially for sub-prime borrowers, in part reflecting differences in underwriting standards.”

The Federal Reserve analysis suggests auto finance companies continue to hold more than 70% of sub-prime auto loans.

However, Experian is countering predictions of an imminent auto finance crisis with research showing the market is gaining strength and stability, with sub-prime originations at a record low.

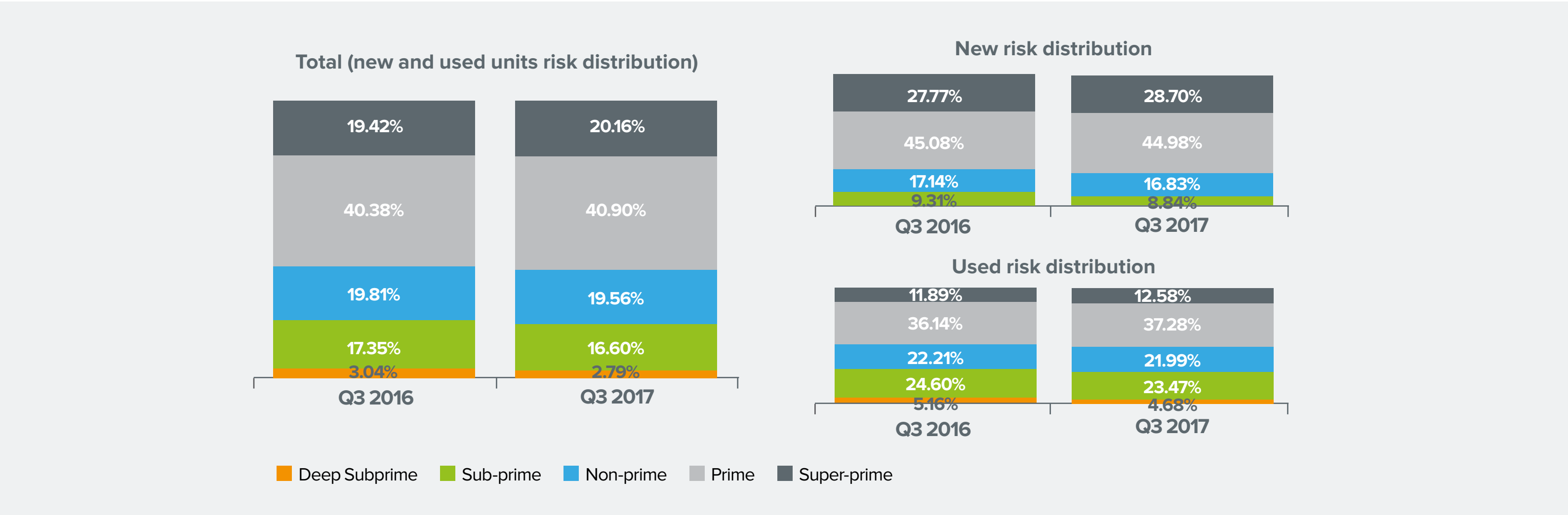
Although sub-prime finance showed substantial growth during the first three quarters of 2017, Experian's Q3 State of the Automotive Finance Market report shows prime consumers grabbed the lion's share of the total finance market (40.9%), while super-prime buyers showed the largest increase, reaching 20.16% market share.

Conversely, the number of consumers outside prime notably decreased, hitting the lowest total finance market share on record since 2012.

Melinda Zabritski, senior director of automotive finance for Experian, said: "For some time now, the story has been focused incorrectly on the rise in sub-prime lending. But the data over the last several quarters has shown that the entire market is growing, not just sub-prime.

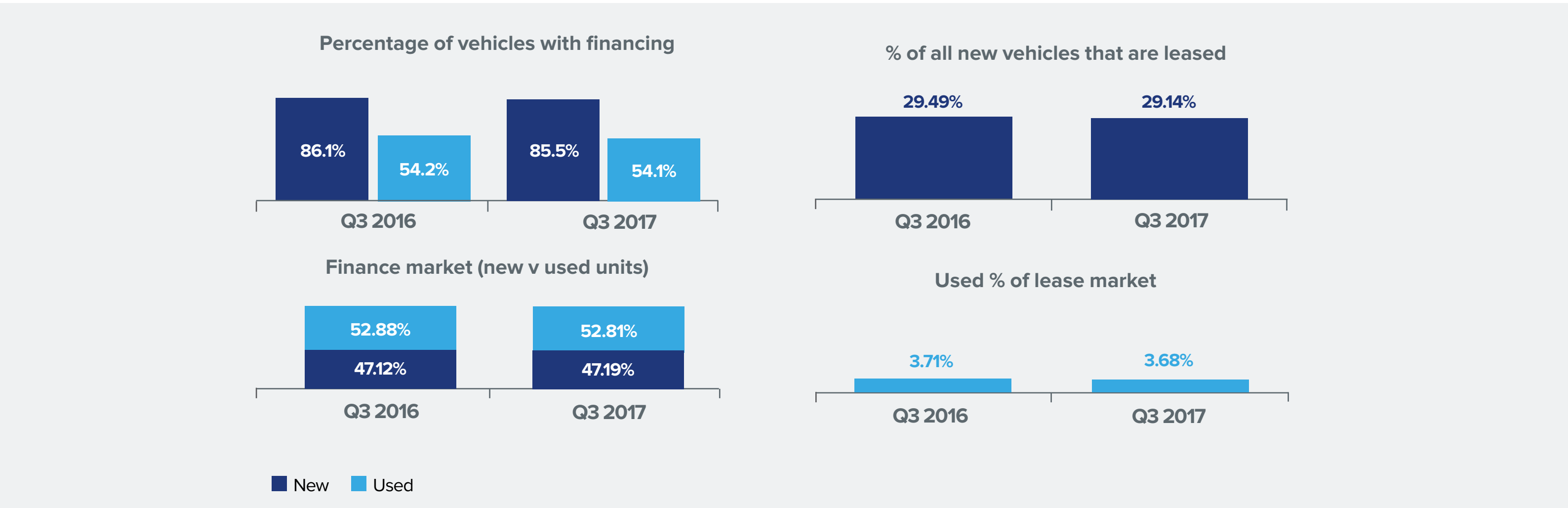
"The market turning more prime is an encouraging trend. It indicates that industry professionals are using data and analytics as part of the lending process, and consumers are taking a more active role in managing their credit before buying a car."

Total finance (loan & lease) and used market reach record low for sub-prime while prime continues to grow



Source: Experian Automotive

Automative financing: snapshot of how and what consumers are financing



Source: Experian Automotive

South America

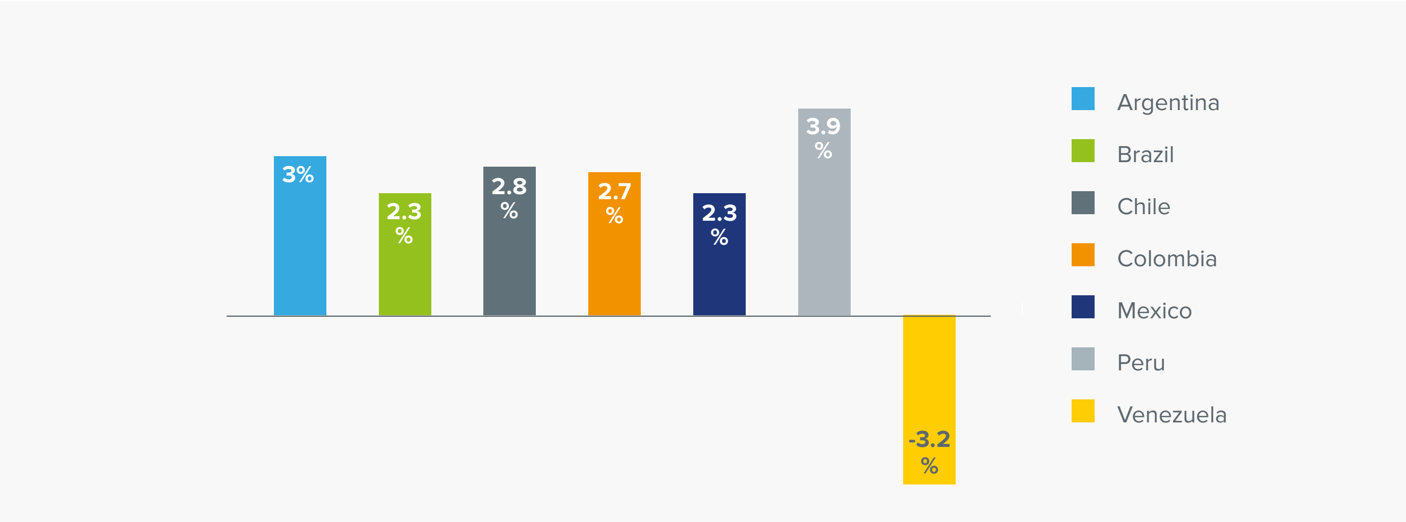
Rise of the independents

Most of the economies that make up Latin America are likely to see growth pick up in 2018, but there are risks to this outlook, according to experts.

Focus Economics reports that most countries except Venezuela are likely to see growth.

This includes the five key economies of Brazil, Chile, Colombia, Mexico and Peru, which make up around 95% of the leasing market by value.

Predicted economic growth 2018



Source: Focus Economics

Economic growth is the foundation of long-term growth in leasing, so overall this paints a positive picture for the region.

Esteban Gaviria, Bancolombia Leasing chief executive, is expecting a good year in the Colombian market in 2018 due to a recovering economy and stronger demand for financing, including leasing.

Gaviria said: “Issues regarding an estimated increase in investments related with the country’s infrastructure modernization program, and fueled by an expansionary monetary policy, make us foresee a good year, in which our expectations for portfolio growth are set in the 10% area, with new businesses growing at a 20% pace.”

Real estate, both commercial and residential, is expected to keep on being the prime asset for the Colombian leasing industry.

However, Gaviria said new legislation promoting investment in clean energy highlights this as “an enormous opportunity” for the leasing industry in 2018.

Threats to growth include new accounting standards being rolled out that could become a hurdle for companies struggling with the new rules.

Gaviria said: “The ability of leasing companies, almost all merged with the parent banks, to maintain their offering based on asset knowledge and asset management skills, will be a key factor for the industry to survive by differentiating itself from the loan offering.

“Moreover, presidential elections to be held in the first quarter might have a negative impact on the economy, but we expect that once the election process is concluded it might recover its dynamism.”

For countries which host manufacturing facilities for US companies, there is also the risk that US President Donald Trump could introduce policies that discourage outsourcing to other countries to generate more jobs at home.

The experience of Venezuela shows how external factors can impact on a country’s economy. The country relies on oil for 95% of its export revenues, so the falling price of oil on the global markets has led to ongoing economic and political upheaval.

Future leasing growth

Research from Alta Group Latin American Region picks out Mexico, Colombia and Chile as markets with particularly strong leasing growth, while Brazil is showing renewed progress due to the fact that operating leases in the form of renting agreements (locação) are taking the place of the finance lease business.

Alta expects the trend for a move away from finance leases to operating leases to continue as independents dominate the market.

Rafael Castillo-Triana, Alta Group Latin American Region chief executive, added: “Technology is bringing challenges and opportunities.

“Capital is flowing and profitability is one of the major issues on the agenda. We have a very bright landscape today and I hope it will be that way for the future.

"Several countries are in government transitions or elections, which normally reduce demand for capital goods, in particular construction equipment and similar.

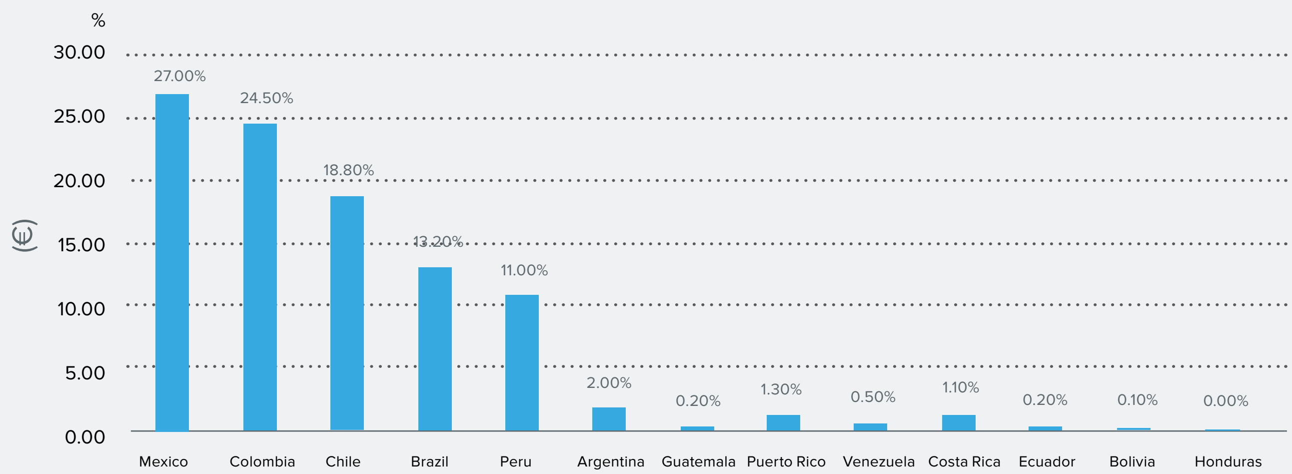
"On the other hand, exports are expected to rise, fueled by the return to market of commodities buyers, particularly from China. That will increase volume in transportation equipment and Information technology."

Research from Alta Group Latin American Region shows the total value of the leasing portfolios across Latin America at an estimated $55.6 billion for the full year 2016, up 4.3% on 2015.

This is the second year in a row that the leasing industry has outpaced the region's economic performance.

Most of the value in the leasing portfolio is concentrated in Brazil, Chile, Colombia, Mexico and Peru.

Share of value of leasing portfolio 2016



Source: Alta Group Latin American Region

Its analysis also shows that about 95% of the whole leasing portfolio in the LAR is concentrated in the 100 largest leasing companies.

Two countries, Chile and Mexico, accounted for the vast majority of leasing portfolio growth (78%) among countries that recorded an increase in market size, with Colombia accounting for an additional 16%. In total, growth was nearly USD$4 billion.

Castillo-Triana said: "Mexico has experienced a profound transformation of the structure of its players, while it has managed to grow.

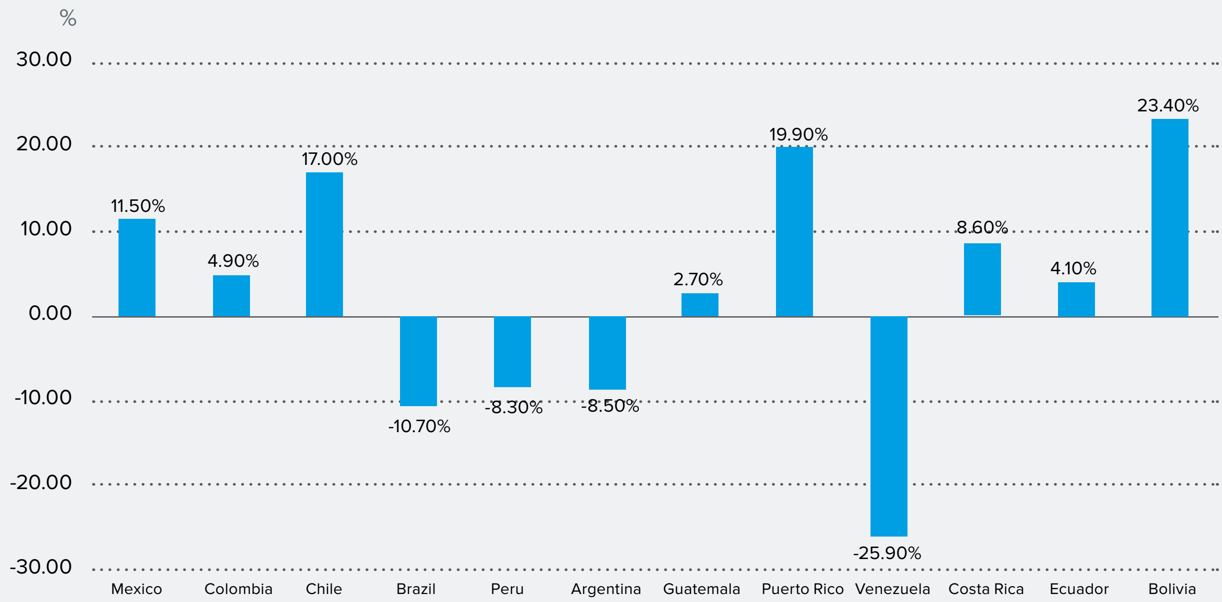
"Mexico is a good benchmark of the features that we can, in general, observe in the region, while bank lessors are leaving the space, independents are taking care of the business."

However, this growth was offset by declines in other countries, including the key economies of Brazil and Peru, while falls in Argentina and Venezuela also had a substantial impact, slashing overall growth to USD$2.3 billion.

Venezuela saw the biggest drop in leasing portfolio size by value, dropping 25% to $286.6m.

Brazil, the largest economy in South America, also saw a double-digit drop in its leasing portfolio value, by 10.7% to $7.3bn. There have been consistent drops in the size of Brazil's leasing portfolio for the past three years.

Latin American leasing portfolio growth 2015–2016



Source: Alta Group Latin American Region

Castillo-Triana describes Brazil's leasing industry as a "spoiled brat", which has seen favorable tax treatment since 1973.

While many other countries changed their approaches, with taxation changes forcing innovation with alternative financing methods, Brazil never did because it was too easy to maintain the status-quo.

Castillo-Triana said: "A lot of talent went away. If you do the same thing every day and there is no incentive for innovation, you walk away and start in a different business. Leasing is not fun in Brazil.

"We have seen a lot of emigration of talent."

Despite seeing a reduction in leasing portfolio size in Brazil, it has shown some areas of business growth as operating leases in the form of renting agreements (locação) are taking the place of the finance lease business (arrendamento mercantil).

Castillo-Triana said banks and financial institutions in Brazil are now migrating from equipment leasing into other forms of equipment financing, such as secured loans with pledges and guarantee trusts (alienação fiduciaria).

In Brazil, there is also an emerging industry of non-regulated operating lessors.

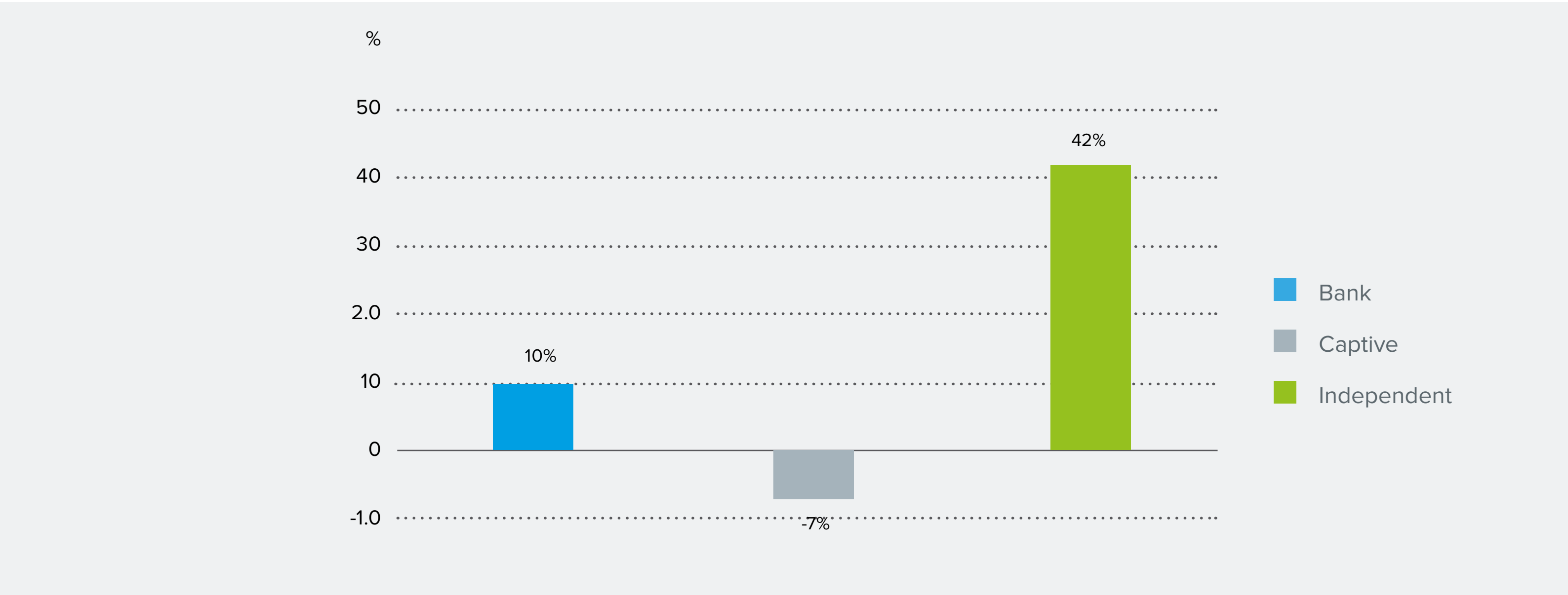
Castillo-Triana said: "We have seen that to the point where currently in the 25 largest companies in the LAR we have two Brazilian non-regulated operating lessors."

While Argentina also saw its leasing portfolio size drop by 8.5%, Castillo-Triana believes it is coming back from a "dark age" of minimal investment and could soon play a key role in the region's new leasing business volume.

However, the gap between Argentina and the lead players is still very large.

There is no doubt that Mexico is the outlier. It has become the largest country in terms of leasing portfolio, new business and prospects for overall economic growth.

Portfolio growth by type of company (2015-2016)

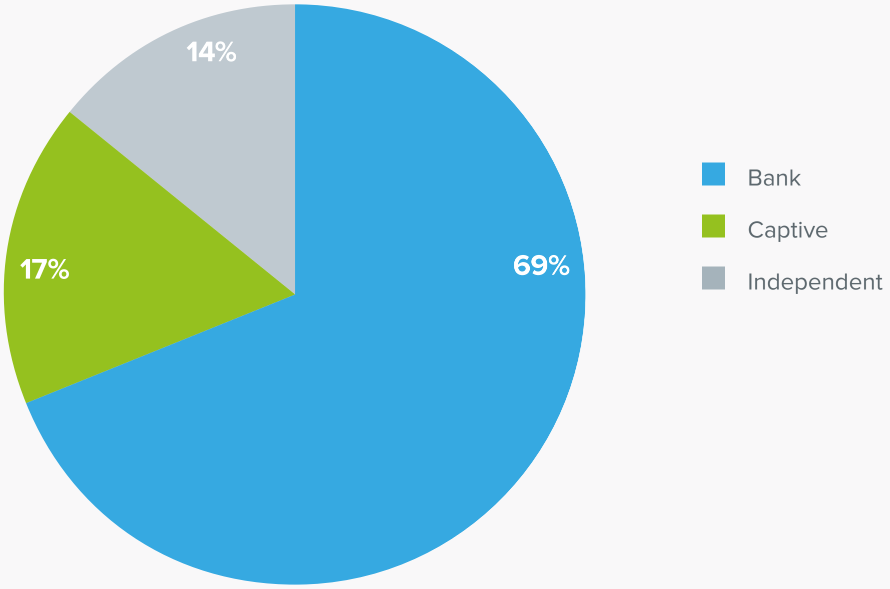


Source: Alta Group Latin American Region

An ongoing change in the market in LAR that will continue in 2018 is the trend for banks to exit the market and for independents to move in.

These independents are companies owned by a combination of family businesses, private equity and investment funds. The independents specialize in operating leases, rather than finance leases, so the rise of the independents explains a reduction in finance leases across the Latin American market.

LAR market by share of sector (2015-2016)



Source: Alta Group Latin American Region

The LAR has seen independents grow by 42% between 2015 and 2016, taking share from the main banks, which have still seen growth, but at a much lower rate of 10%. The big losers are the captive finance houses that have seen a 7% reduction in market share because of the independents growing so rapidly.

Castillo-Triana said: "The industry has realized that to be a starring player in leasing, it is no longer necessary to be a bank or belong to a bank.

"Excessive regulations are basically focusing on the banking system and asphyxiating it. This has made them more risk averse and seen them migrating out of growing markets like financing capital goods, which is the engine of any economy."

Castillo-Triana said the good news is that regulators are opening the door to independent companies that are being held accountable, so they can be measured in terms of efficiencies and corporate governance.

The huge growth from independent finance is also down to abundant access to capital in the last three to four years.

Several private equity funds and institutional investors are betting on the LAR leasing industry, particularly in countries like Brazil, Chile, Colombia, Costa Rica, Mexico and Peru.

Castillo-Triana said the 7% reduction in captives can be explained by a combination of a decline in sales-type leases in the region and a growing tendency of manufacturers and vendors to outsource their customer financing to independent companies.

Captives are most concentrated in the two largest economies, Brazil and Mexico.

Within the 100 largest leasing companies in the LAR, there are only 14 captives (eight in Mexico, three in Brazil, one in Argentina, one in Colombia and one in Costa Rica).

Castillo-Triana: "The few captives that were operating were US-backed. However, when we look now, the main source is now China, not the US.

"This is because two Chinese banks have acquired some Latin American banks."

Alta LAR 100

Alta collects data on the 100 largest leasing companies in the LAR and it shows that Colombia's Bancolombia retained its position as the biggest player in the region in 2016, the latest year for which full-year data is available.

The business increased its portfolio by value from USD$4.5bn to USD$5.1bn or 13.3%. It has been the market leader in the LAR since 2012, when it displaced Banco Itauleasing from Brazil.

One of the most dramatic changes in the last 12 months has been Banco Itau Chile skyrocketing up the list from 40th place into 6th position. Itau acquired Corpbanca, a Chilean banking conglomerate owning banks with leasing companies in Chile and Colombia.

The merger of these two large banks in Chile resulted in its portfolio size increasing by 470% from USD$350 million to create a USD$2bn business.

Mexico's Unifin Financiera also saw a big boost in business, moving from 17th place to 8th in the top 100 with an impressive 69% boost in its portfolio from USD$1bn to USD$1.7bn. Unifin Financiera launched a very successful IPO some years ago and this has fed a very aggressive organic growth strategy.

Volkswagen Leasing sustained one of the largest drops in the past 12 months, moving from 6th place all the way to outside the top 20 at 21st place. This has seen its portfolio in the Mexican market drop from USD$1.9bn down to USD$986 million.

Castillo-Triana said: "Overall sales of Volkswagen were affected in Mexico and the US due to the emissions scandal.

"The company then reduced deals until they managed to clean their image. At the same time, some other players grew faster."

From within the top 20, Mexico's Caterpillar Credito saw some of its market share eroded, moving from 11th place last year down to 14th position, with its portfolio falling from USD$1.3bn to USD$1.2bn.

BBVA Leasing in Mexico also dropped from 12th to 18th place this year with its portfolio dropping from USD$1.3bn to USD$1bn.

The top 10 companies in the Alta LAR 100 are represented by companies originating from Colombia, Mexico, Peru and Chile. This mirrors the general positioning in the overall portfolio leasing sizes by country.

For a full listing of ALTA LAR100 companies, visit
http://thealtagroup.com/lar-100-report-2017/

ALTA LAR100 Top 20

Ranking 2015	Ranking 2016	Company	Country	Portfolio 2015 (USD$000)	Portfolio 2016 (USD$'000)
1	1	Bancolombia	Colombia	4,492,904.60	5,058,899.61
2	2	NR Finance De Mexico	Mexico	3,739,196.43	3,708,284.94
7	3	Davivienda	Colombia	1,835,495.94	2,668,682.21
3	4	Banco Credito Del Peru	Peru	2,803,606.08	2,474,045.82
4	5	Banco Santander Chile	Chile	2,157,814.33	2,187,121.34
40	6	Banco Itau Chile	Chile	350,286.60	1,996,209.26
5	7	Banco De Chile	Chile	1,933,895.26	1,990,886.70
17	8	Unifin Financiera	Mexico	1,022,827.35	1,726,778.70
8	9	Banco De Occidente	Colombia	1,540,874.41	1,682,555.45
9	10	Arrendadora Inbursa	Mexico	1,516,643.56	1,669,004.11
14	11	BCI - Credito E Inversiones	Chile	1,227,737.20	1,577,509.37
10	12	BBVA -Banco Continental	Peru	1,481,092.72	1,563,666.96
18	13	Localiza	Brazil	1,014,009.25	1,497,791.17
11	14	Caterpillar Crédito	Mexico	1,306,661.86	1,232,320.07
15	15	Banco Corpbanca	Colombia	1,101,013.68	1,178,858.81
21	16	BBVA Colombia	Colombia	912,762.07	1,135,425.76
22	17	Ford Credit	Mexico	893,984.51	1,110,191.64
12	18	BBVA Leasing	Mexico	1,279,609.72	1,038,385.40
19	19	Banco Del Estado	Chile	945,560.32	1,031,120.20
16	20	Scotiabank	Peru	1,084,959.28	999,332.58

Europe leads multinational investment

The last 12 months have seen a dramatic shift in multinational investment in the leasing industry in the LAR. A retreat from US banks has seen European companies take up that market share.

US banks used to represent 15% of the market but a number of strategic withdrawals have since reduced this share to 11%.

European investment has gone from 18% to more than one-quarter of the market (28%).

It is still clear that the majority of ownership of lessors remains in the hands of Latin American investors, but their share declined from 64% to 58%.

New entrants are coming from Japan, China and the Middle East, so there is now a lot more international interest in the market.

Castillo-Triana said: "US Leasing International was one of the most important players in the leasing industry from a North American perspective in the LAR.

"US Leasing International's exit a few years ago was followed by other American companies like AT&T Capital that previously had ambitions to become real multinationals.

"They opened spaces to other players. We see French, Spanish, German and some UK banks investing in Latin America, taking up the space left by the US companies that migrated. In a way, they are eating the lunch that the American's left."

Castillo-Triana said that while most may think that, culturally, the European banks may be a closer fit with Latin American banks, the actual management style in the LAR is predominantly one of a US slant.

He said: "You will find an amazing predominance of US management style within the Latin leasing companies.

"That has created a bit of a cultural clash between the European banks and those in the LAR.

"The Germans are particularly fascinated with the lack of discipline and lack of order they are finding in Latin America."

Regulations

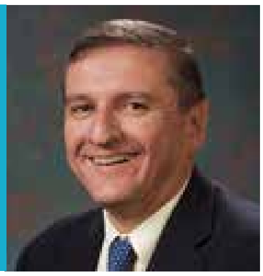
It's imperative that in a developing country, people have access to credit. However, regulation in the banking industry across the LAR has created a reduction in financial penetration.

The Alta Group has observed that regulations keep affecting the performance of Latin American lessors in interesting ways.

Castillo-Triana describes the regulations as creating a loss of dynamism and an "analysis paralysis" culture.

Banks feel constrained by ratios between required capital and risk-weighted assets, and few of them have decided to drill down and understand risks associated with the leasing business

Rafael Castillo-Triana
The Alta Group



He said: "Banks feel constrained by ratios between required capital and risk-weighted assets, and few of them have decided to drill down and understand risks associated with the leasing business.

"For that reason, we anticipate that their market share will continue to drop."

Most of the fastest growing players in countries like Brazil, Colombia, Chile and Peru are non-regulated commercial companies.

The space in leasing abandoned by banks and non-bank financial institutions has been taken over by more dynamic, commercial company players who understand equipment lifecycles, productivity and secondary markets, while also developing capabilities for delivering financing solutions.

Castillo-Triana said: “These players enjoy little to no regulatory supervision, but tend to become more transparent as they require more sophisticated funding sources.”

The case of Mexico is especially interesting. While the country deregulated the leasing business in 2006 and created “non-regulated financial institutions” (SOFOMS, or Sociedades Financieras de Objeto Multiple), over the years these companies became more and more regulated on their sidelines.

These companies were subject to consumer protection regulations and monitoring by the Mexican Financial Consumer Defense Commission (CONDUSEF).

Many regulations emerged from this government body. These companies were also subject to Anti Money Laundering Compliance, supervised by the National Banking and Securities Commission, which requires internal certifications, periodic reports of customers (“Know Your Customer” routines), reports of suspicious activities, etc.

All companies issuing securities subject to public offering also became regulated by the National Banking and Securities Commission.

Castillo-Triana said: “As a normal development, the reaction to asphyxiating regulatory interference has been the migration of most of the active lessors from the financial systems.

“Alta has been watching how many of the key lessors are ceasing to be regulated SOFOMs, while others just transformed their legal structure from SOFOMs to SAPIs to become open companies, suitable for growth in capital markets, but relinquishing their former privilege to be treated as financial institutions.”

ASIA PACIFIC

Growth beckons amid geo-political tensions

The Asia Pacific region has trade growth opportunities but also many geo-political problems.

One of the influencers for business prospects can be seen as the US vision for trade in the region, according to Paul Errington, chief executive officer of Hong Kong-based Connaught Finance.

US president Donald Trump held a high-profile visit to the region last year, visiting Japan, China, South Korea, Vietnam and the Philippines, where he attended the ASEAN Summit Conference.

There are still few details about how the Trump administration's policy of 'America First' will manifest itself in action during 2018, but the president has already withdrawn the US from the Trans-Pacific Partnership (TPP), a trade agreement between Australia, Brunei, Canada, Chile, Japan, Malaysia, Mexico, New Zealand, Peru, Singapore and Vietnam.

However, as the American position in Asia declines, so the Chinese position rises.

Errington said: "China already has its own trade program in place; the Regional Comprehensive Economic Partnership (RCEP).

"America is playing directly into the hands of China, which encourages multinational trade agreements, whereas America is looking for only bi-lateral agreements. Unfortunately, not many nations are stepping up for such agreements at the moment.

"Overall, the 'unknown' Trump vision in Asia is expected to have little impact on business growth in the region, as China's economy continues to grow, as does its influence in the region."

Locally, there are other issues, too, that will or could impact business growth, such as tensions with North Korea, the South China Sea territorial disputes and the military junta government of Thailand going to elections in 2018.

Errington warned that the North Korean situation will impact foreign investments into South Korea during 2018, as confidence over stability is put in question.

However, outside of the Korean peninsula, there appears to be a "business as usual" approach, even if concerns remain high.

"Generally, we are expecting a positive growth to the economy in Asia Pacific," said Errington.

"The automotive industry is ever-increasing in China, but Singapore will drop off drastically as the government implements a 'no new cars' policy from February 2018 (only a small market of 600,000 cars in 2016, while China has 172 million).

"The mining industry in the Philippines and Indonesia will be set to grow after some clarifications on trade regulations for both countries. Infrastructure will be one of the largest growth sectors, in our opinion, along with logistics."

China – the regional powerhouse

The Chinese economy continues to show an energy and dynamism that most countries can only envy, never mind match.

GDP is forecast to grow more than 6% in 2018.

A combination of robust domestic consumption and a recovery of exports have kept the economy growing, according to the World Bank, which signaled a rebalancing of the Chinese economy from investment to consumption as state-backed investment slowed.

According to Fitch Ratings, Chinese leasing companies continue to benefit from the authorities' supportive stance towards the sector's development, which broadly offsets risks associated with rapid growth, intensified competition and increased industry and system-wide leverage.

Its sector outlook for 2018 is stable.

The government has introduced a series of policies to support the growth of the leasing sector in recent years, with the aim of improving funding diversity and accessibility for small businesses. These efforts are likely to continue in 2018, Fitch Ratings says.

Leasing subsidiaries of financial institutions and manufacturers will also continue to receive capital and funding support from their parents, which should allow them to take advantage of growth opportunities without placing a strain on their capitalization or funding profiles.

Independent lessors also have strong opportunities for growth but a higher risk appetite and are likely to continue to face greater challenges in terms of capitalization and funding. As such, Fitch Ratings' sector outlook on independent lessors is negative.

Fresh capital for independent lessors is less readily available, and aggressive growth that exceeds internal capital generation will increase these lessors' leverage and weaken their credit profile, unless they have a viable capital replenishment plan.

Fitch adds that independent lessors, particularly the smaller, less-established ones, are also the most likely to face an increase in funding costs or a shortage of funding availability because of the heightened scrutiny on shadow-banking activities.

These lessors are more reliant on non-loan credit - such as wealth-management and trust products - than larger lessors that receive funding support from parents.

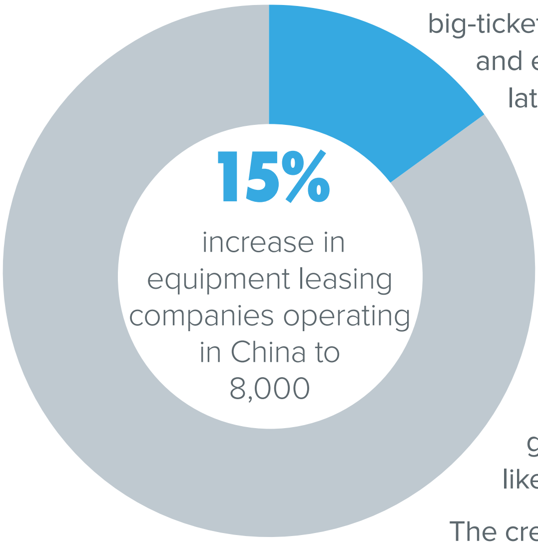
Favorable government policies, while supporting sector growth, have also fueled competition, which is pressuring yields and margins, and undermining lessors' underwriting discipline.

Lessors with higher risk appetite, especially more aggressive independent lessors, may start loosening underwriting standards as they pursue greater market share, potentially creating future asset-quality problems.

Jonathan L. Fales a director with Alta Group, the global equipment leasing and finance consulting firm, describes the Chinese leasing and finance industry as highly segmented, and lacking a single association to speak on behalf of the industry as a whole.

This has impeded the development of important tax and asset ownership policies that could accelerate equipment financing volumes and expand the industry.

Without these changes, Fales, foresees the industry morphing into two groups: big-ticket/China Bank Regulatory Commission-licensed lessors in one corner and everyone else in the other, with fintechs playing a large role in the latter group.



Data reported at last year's China Leasing summit indicated more than 8,000 equipment leasing companies were operating in 2017, a 15% increase on 2016, despite funding issues and lack of reliable credit information.

Fales added that the Chinese leasing industry is about to change.

He said: "If a unified leasing association is created with the aim of representing all facets of the industry in constructive talks with government ministries, the pace of equipment financing growth is likely to accelerate."

The creation of new businesses has tripled in the country since reforms in 2014 and this has had a substantial impact on domestic demand, including car sales.

For example, new car sales to the end of October rose 4.1% year-on-year to 22.9 million, while China is becoming a world-leader in demand for electric vehicles, with sales of around 500,000 last year.

China is now well established as the world's largest new car market, but the scale of its appetite for fresh metal will be challenged by a burgeoning used car market.

Up to this point, the supply of used cars has been limited. The new car market only took off in 2009, when sales stimulus packages pushed registrations up 53% to 10.3 million units; and even then many of those domestically-produced cars struggled to remain reliable, and therefore desirable, beyond their third birthday.

But the influx of European and US manufacturers has raised production quality, and with it the prospect of an enormous used car market.

In other major car markets around the world, used car sales outstrip new registrations by at least 2.5 times, and it will be interesting to see whether drivers continue to buy new cars from domestic and mid-market manufacturers, or whether the large supply of second-hand cars will cannibalize new car sales.

India – a year of change

The dust is starting to settle on a tumultuous year for business in India, including the finance and leasing sector, and this is affecting the outlook for 2018.

The introduction of the Goods and Service Tax (GST) in July 2017 consolidated India's indirect tax regime into a single tax, and had an impact on every area of the economy.

GST has caused changes in lease structures, business models and required companies to re-evaluate the way leasing business has been undertaken in India

Nidhi Bothra, executive committee member, Asset Finance Association, India

Nidhi Bothra, executive committee member of the Asset Finance Association of India, said: "GST has caused changes in lease structures, business models and required companies to re-evaluate the way leasing business has been undertaken in India."

Some asset classes, for example, will no longer have input credits available, and a host of technical issues are forcing companies to review their leases.

"Transition to GST will cause the growth in leasing volumes to slow down," said Bothra.

The leasing industry also faces the challenge of new accounting standards (Ind AS 116) which will bring the country into line with IFRS 16 and see operating leases appear on corporate balance sheets from April 2019.

The off-balance sheet treatment was a powerful factor in businesses deciding between operating leases and finance leases, and its elimination "will also have an impact on the growth of new business volumes in India," said Bothra.

New business volumes had been growing steadily, she added, with new players entering the leasing market and signing sizeable business.

Bothra added: "The growth in new business volumes in 2016-17 will be around 20%, although this growth rate will be difficult to achieve in 2017-18."

Verified industry data is still absent from the market, although the creation of the Asset Finance Association of India last year to represent the interests of the leasing industry should improve the authenticity of data.

The economy is forecast to grow by 7.4% in 2018, according to the Asian Development Bank.

In the automotive sector, this is nudging India's light vehicle market towards the 4 million sales mark, with cars accounting for about 80% of sales and light commercial vehicles for about 20%.

The new GST, which can add as much as 28% to the price of a new car, has not brought down prices as much as expected, according to LMC Automotive, with the new car market showing percentage growth of more than 10% in 2017.

Australia – stronger growth ahead

Green lights flicker encouragingly across the economy in Australia.

GDP was forecast to grow by 2.9% in 2017-18, inflation of 1.8% is below the Reserve Bank of Australia's medium-term target of 2.5%, and interest rates of 1.5% support investment.

Employment figures are heading in the right direction, labor costs remain subdued, and the government deficit is forecast to become a surplus by 2020-21.

According to KPMG, 17 of 20 industry sectors grew in Q2 of 2017, with the finance and insurance services sector the largest industry in the economy, accounting for 9.7% of gross value added, followed by construction (8.1%), health care and social assistance (7.4%) and mining (7.4%).

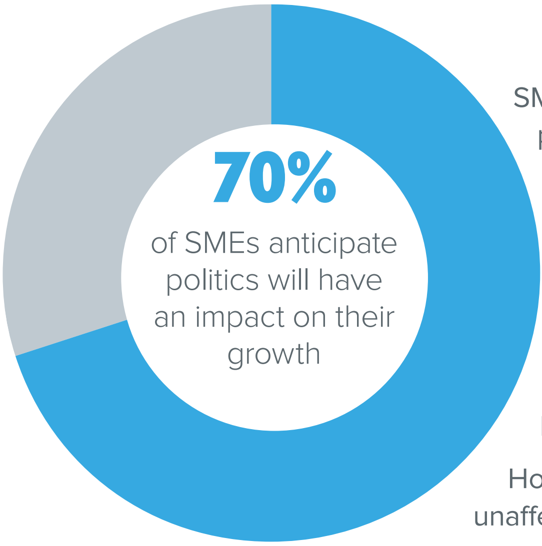
Guy Debelle, deputy governor of the RBA, said Australia is now well positioned to reap the benefits of investment spending that has reached historical highs in the past decade, particularly in the mining and LNG sector.

Sharp rises in commodity prices, most notably coal and iron ore, fueled the investment, and although prices have subsequently fallen, they remain at levels above those forecasts when the investment decisions were commissioned, said Debelle.

He said: "Since the peak in 2012/13, investment spending in the resource sector has declined as projects have been completed. As they have been completed, production has been ramped up and we are now seeing the benefits of that with large increases in resource exports."

However, political issues are likely to have an impact in 2018.

More than half of Australian businesses expect the political environment to impact their ability to grow during 2018, new research has warned.



SMEs and businesses in the electricity, gas and water sector are particularly sensitive to the political environment, according to Alleasing.

Around 80% of businesses in these sectors expect some political impact on their business in the coming 12 months.

Alleasing's Equipment Demand Index reveals that, overall, 70% of SMEs anticipate politics will have an impact on their growth, suggesting more than one million of Australia's two million SMEs believe they will be affected.

However, the majority of larger businesses (69%) say they expect to be unaffected by political issues in the country.

Alleasing said that political decisions around managing the impact of climate change, migration, employment regulations and taxation can have a big impact and drive investment decisions.

Daniel Blizzard, chief executive at Alleasing, said: "Our research shows that politics is impacting different businesses in different ways.

"For SMEs, confidence is critical. On a national scale, the political impasse in the energy sector is clearly impacting business sentiment. Our research also shows political nervousness in the finance sector, with 66.7% of businesses stating that politics will have an impact on their operations."

The headline Index result found that nearly 27% of all businesses planned to make asset acquisitions in the final quarter of 2017, down slightly from nearly 29% in the previous quarter.

Although businesses are planning acquisitions, the number who say they are operating with assets they consider outdated and are hindering productivity, doubled in 2017 from 11.6% in January to 22.4%.

Blizzard added: "When businesses under-invest in their equipment they are often left with unproductive or less efficient technology.

"If this trend continues, Australian businesses will lose out to their competitors, particularly as many businesses across the globe continue to update their technology at a rapid pace."

Japan – global growth planned

Prime Minister Shinzo Abe kept his substantial majority in October's snap election and the strong mandate paves the way for ongoing political change.

He is on track to becoming the longest-serving prime minister in Japan's history and is expected to take a more assertive approach to foreign policy, in particular with North Korea, threatening to add further strain to tensions in the region.

His domestic policies will be focused on boosting long-term growth, which could include the introduction of a controversial sales tax hike in 2019.

While consumer confidence is strong, the economy is set to decelerate, with experts at Focus Economics predicting GDP growth of 1.2% in 2018

While consumer confidence is strong, the economy is set to decelerate, with experts at Focus Economics predicting GDP growth of 1.2% in 2018.

The leasing market reflects the challenging outlook. The value of lease transaction volumes from April to September 2017 was 2,273.5 billion yen (USD$20 billion), a decrease of 6.3% compared with the same period in 2016, according to the Japan Leasing Association.

Factory equipment was up 14.7% and construction equipment was up 14.8%, but other key sectors declined.

Information and communication equipment (1% down), office equipment (2% down), industrial equipment (17.9% down), transport equipment (1.8% down), medical equipment (3.6% down), and commercial and service equipment (5.6% down) have shown negative growth respectively.

The OECD reports that while Japan has become increasingly integrated into global value chains, especially in Asia, the benefits of international trade are concentrated in large firms, as few small and medium-sized enterprises export goods, thus contributing to the large labor productivity gap between large and small firms.

EUROPE

Finance key to growth in uncertain times

Auto and equipment finance companies are striking a positive tone in their predictions for 2018.

While there are significant challenges ahead, ranging from Brexit and its impact on economic growth, to business changes required to adapt to new legislation, there is an underlying view that this plays to the industry's strengths.

Finance is an essential ally in uncertain times, as it enables consumers and companies to adapt to changing environments and smooth short-term financial shocks with long-term financial planning.

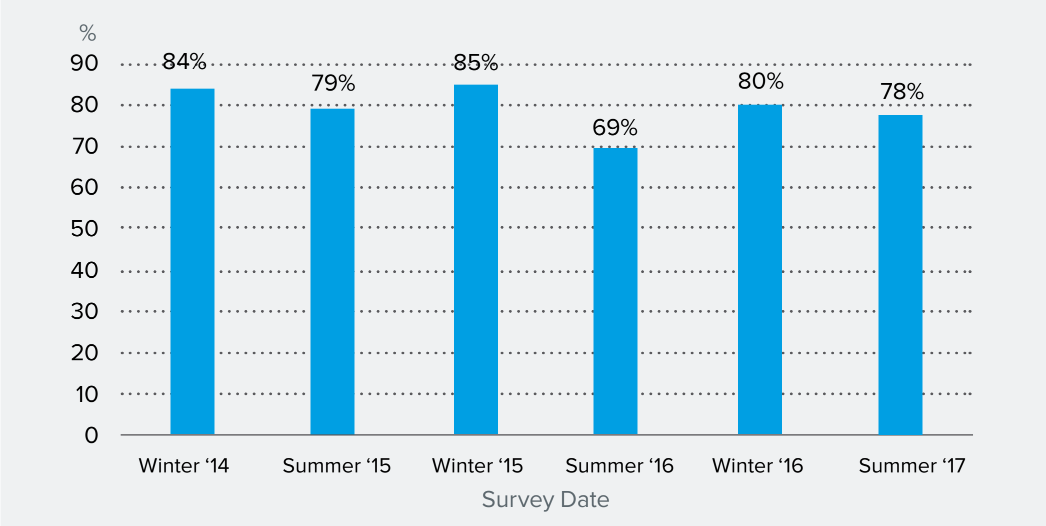
This means that the proportion of spending covered by finance has been increasing, leaving industry leaders confident about the future, despite uncertainty ahead.

For example, the most recent Leaseurope/Invigors European Business Confidence Survey showed a continuing positive outlook for the European leasing business during the second half of 2017 and into 2018.

Of those surveyed, 78% expected new business volumes to increase for full-year 2017, with only 5% expecting a decline, while more than half predicted a rise in net profits.

Invigors EMEA Partner Richard Ryan said: “Recent elections across Europe do not appear to have dented sentiment in the European leasing market, which is driven by increasing economic growth and continued access to liquidity. This seems likely to continue for the immediate future as economic growth in most European countries is forecast to further strengthen.”

Proportion of companies expecting increase in new business in next six months



Source: Leaseurope/Invigors

This optimism has been reflected in the industry’s performance according to Leaseurope’s latest figures, covering the first half of 2017.

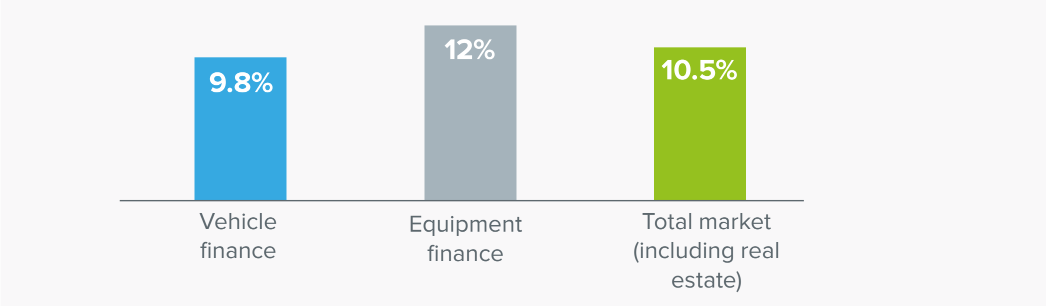
The Biannual European Leasing Survey, based on information collected from Leaseurope’s Member Associations on their national leasing markets, reveals that total leasing volumes in Europe were €164.3 billion in the first half of 2017, an increase of 10.5% compared to the same period a year ago.

Growth was observed across all main asset categories.

Vehicle leasing expanded by 9.8%, albeit at a somewhat slower rate compared to the first half of 2016, while equipment leasing volumes increased by 12.0%. New business volumes in real estate leasing grew by 12.3%.

Leaseurope’s senior adviser in statistics and economic affairs, Jurgita Bucyte, said: “The double-digit increase in new business volumes in the first half of 2017 clearly indicates that the leasing industry has been able to sustain its growth seen since 2014.”

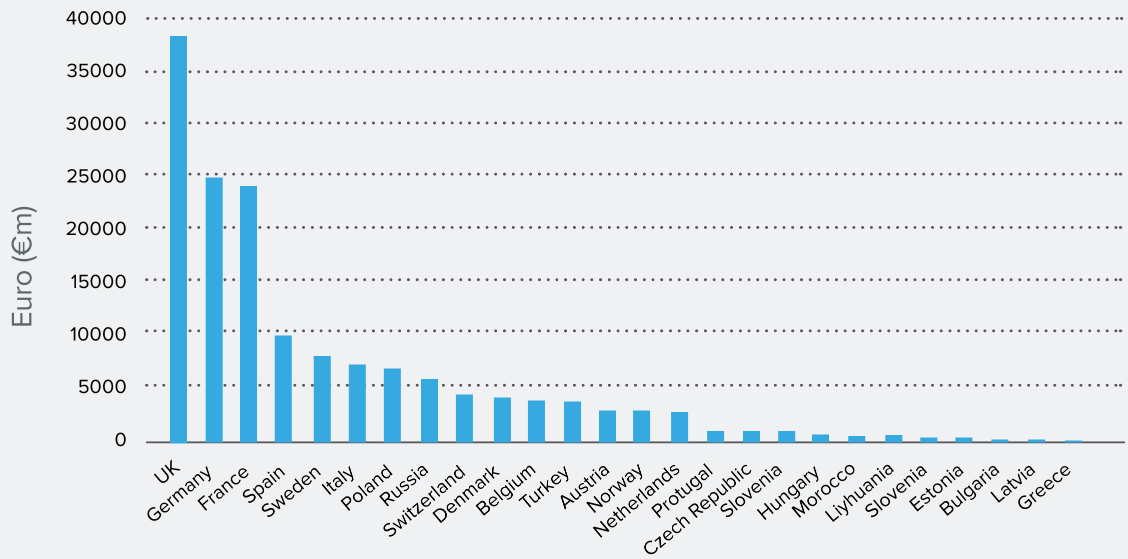
European leasing market new business growth H1 2017



Source: Leaseurope

These figures suggest strong momentum that will be carried into the early part of 2018, although the market is heavily influenced by a small number of major economies, with the EU5 (France, Germany, Italy, Spain, UK) accounting for 65% of vehicle and equipment new business in H1 2017.

European leasing market H1 2017 – equipment and vehicles new production (€ million)



Source: Leaseurope

Therefore, the fortunes of these economies in the next year will have the most impact on the performance of the European auto and equipment finance sector, particularly France, Germany and the UK.

Kirstine Wilson, head of strategic development at Siemens Financial Services, Commercial Finance, said: “The equipment leasing market is fundamentally driven by each individual country’s underlying level of capital expenditure and the extent to which leasing has established itself as a widely accepted financing alternative to relationship bank lending.

“Mature leasing economies in Europe, with high levels of leasing penetration and lower levels of forecasted capital expenditures, are likely to see a slower growth in leasing – as future increases will be driven mainly by the development of capital expenditure in those countries.

“Steps amongst the major industry trade bodies to further increase the adoption of leasing, through raising awareness of its benefits, continue but will take time to take effect.”

Germany plans for growth

Following 6% growth in 2017, the leasing sector in Germany is confident about prospects for 2018, according to the German Leasing Association (BDL).

Last year, leasing companies financed €67 billion euro’s worth of business in the real estate, machinery, vehicles, IT equipment and other assets segments.

Whereas overall investment in equipment rose 2.3% in Germany, equipment leasing increased by 6.5% to €57.3 billion.

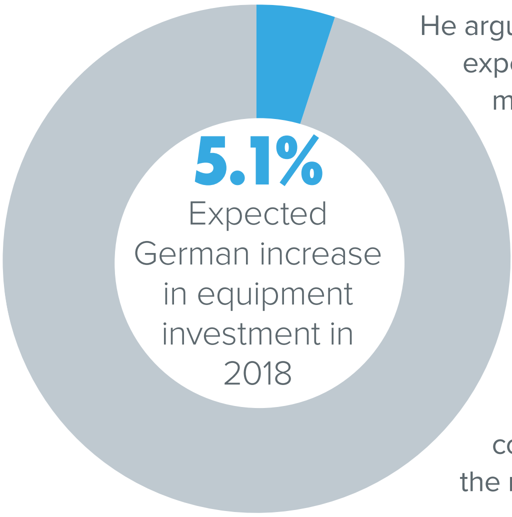
This means that the overall share of the equipment investment market accounted for by leasing has increased to 24.1%.

Kai Ostermann, president of the German Leasing Association, said: “We have every reason to be satisfied with this result.

“Leasing activity continues to outstrip the overall rate of economic growth, and has once again shown itself to be a powerful driver of investment in Germany.”

This upbeat mood is only slightly dampened by factors such as low interest rates.

Osterman said persistently low rates of interest are having a markedly adverse effect on incomes and expenses and this, in turn, is hampering the ability of the leasing sector to serve German businesses as an efficient investment partner.



He argues this partnership will be critically important during 2018 if, as expected, the upswing in the German economy continues to gain momentum, and brings about an increase in overall investment activity.

The German Council of Economic Experts is predicting a 5.1% increase in equipment investment during 2018.

Ostermann said: “Given the healthy state of the economy, and the prevailing positive outlook, our politicians may be tempted to ignore the pressing need to create conditions that will encourage companies to invest.

“The outgoing coalition government didn’t view this as a priority, and considerations of this kind clearly didn’t figure to any significant extent in the recently failed ‘Jamaica Coalition’ negotiations.

“We will continue to urge politicians in general, and the governing parties in particular, to set in place improved framework conditions for investment.”

His priority list matches that of auto and equipment finance companies throughout Europe, with a requirement for red tape to be reduced and a tax framework that is fit for purpose.

Specifically, for Germany, he also called for an overhaul of the fiscal depreciation tables, which haven’t been updated in 15 years, and are therefore “out of step with actual technological life cycles”.

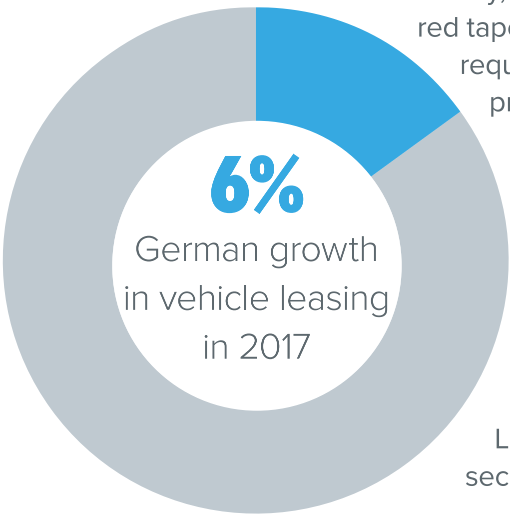
Ostermann added: “The ordinary useful life of assets acquired by companies is nowadays much shorter than allowed for in these tables, not least because of digitalization and the pace of change being dictated by ‘Industry 4.0’.

“We feel the time has come for the reintroduction of the declining balance method of depreciation. It reflects the change in the value of an investment over time more accurately than the straight-line depreciation method. That means costs are distributed more realistically over the useful life of the asset, and this frees up liquidity for new investments. In short, it relieves companies of financial pressure.”

Regulatory reform: reducing the administrative overhead

A further concern of the German leasing industry that will be echoed in other European countries relates to regulatory requirements.

The BDL believes that the regulators should take greater account of the low levels of risk associated with leasing transactions.



Ostermann said: "First, we feel leasing companies should be decoupled from the new requirements that the Financial Supervisory Authority has imposed on large banks.

"Secondly, we want to see an overall reduction in the amount of regulatory red tape the leasing sector has to comply with. For example, many of the requirements leasing companies are expected to meet regarding the provision of documentation and information are extremely burdensome without being of any practical value."

In Germany, vehicle leasing is the main engine for growth, with passenger cars and commercial vehicles accounting for 77% of all leasing business transacted, according to 2017 figures.

Around 40% of all newly-registered road vehicles are now leased. Vehicle leasing increased 6% in 2017.

Leasing companies have also increased their share of the machinery sector, with new business up 4.5%.

While the leasing of office equipment, computers, servers and IT systems stagnated last year, this follows a sharp contraction in earlier years and indicated a more positive outlook for IT leasing.

Ostermann says: "On the one hand there has been long-term erosion in the price of hardware, while on the other the process of migration to the Cloud remains ongoing."

Real estate accounted for just under 2% of all new leasing business transacted.

German leasing market 2017	
New leasing business	€58.5 billion (+5.7 %)
Hire purchase	€8.5 billion (+10.4 %)
Equipment leasing	€57.3 billion (+6.5 %)
Real-estate leasing	€1.2 billion (-20.4 %)
Overall leasing penetration rate	16.1 %
Penetration rate in equipment segment	24.1 %
Leasing-Segment Trends	**Year-on-year comparison with 2016**
Vehicles	+6.3 %
Production machinery	+4.5 %
Office equipment, IT systems	+0.3 %
Information and signaling systems, "Other products"	+2.2 %
Aircraft, watercraft and rail vehicles	+126.6 %

Source: Federal Association of German leasing companies

UK positive outlook as challenges grow

The UK enters its last year full year as a member of the European Union with a positive outlook, but there are challenges ahead.

The shadow of Brexit looms large over almost every debate about the future of the auto and equipment finance sector, particularly when it comes to securing a good trade deal with its former partners.

Positive progress at the end of 2017 buoyed the industry, particularly regarding a deal on the final bill the UK will pay on its departure.

Furthermore, companies are adapting to the new environment and looking at what opportunities it can bring.

This is especially the case among new businesses that are likely to be first in line for finance to fund growth.

Hitachi Capital Business Finance research shows that new businesses were almost four times as likely to predict growth in the final quarter of 2017 as businesses that have been trading longer.

In addition, its latest research was the third consecutive quarter that the proportion of new businesses predicting growth had risen, with more than half (54%) predicting a positive outlook, compared to 38% for all SMEs.

The Hitachi Business Barometer suggested that the age of an SME, not its size, has a direct bearing on business confidence.

Businesses anticipating growth in the next three months: Young small businesses (trading for less than five years) compared to the SME national average

	Q2 2017 (Pre-General Election)	Q2 2017 (Post-General Election)	Q3 2017	Q4 2017
Small businesses trading for less than five years:				
% predicting expansion in the next three months	44%	46%	50%	54%
All SMEs:				
% predicting expansion in the next three months	35%	33%	39%	38%

Source: Hitachi Business Barometer

Gavin Wraith-Carter, managing director at Hitachi Capital Business Finance said: “Brexit has dominated the business headlines for much of this year and there has been a watchful eye on how major corporates will react.

“Over the course of 2017, our research has shown the SME sector to have a relatively bullish attitude to Brexit, many see opportunity from uncertainty and are also looking to launch new services and open up new markets; this at a time when many larger businesses are reacting to the latest Brexit developments in a more cautious way.”

This also suggests that small businesses will be key to driving business growth during 2018.

He said: “Many are digitized and still evolving their service lines and customer footprint and are more agile in being able to adapt to a changing market environment.

“This is positive for the economy at large, but it means 2018 will be a year when small business finance will be even more sharply under the spotlight. If younger enterprises are to be growth drivers, then their ability to secure the right kind of funding, when they most need it, will become vital not just to the vibrancy of the small business sector, but also the general health of the broader economy as well.”

Finding growth segments and increasing the penetration levels of finance will be key as the economy is only likely to show modest growth during 2018.

This means that maintaining business confidence will remain important, so a prompt trade deal with the EU will be beneficial, while any improvements in the UK’s productivity levels would be incentives for businesses to invest.

Andy Hart, head of Investec Asset Finance, said: “Overall we see healthy demand for asset finance likely to continue as businesses invest to increase productivity and remain competitive.”

He believes gently rising interest rates will mean continued liquidity, although competition will keep the pressure on margins.

Hart adds: “Slower economic growth is likely to put some pressure on affordability for some customers. We are likely to see greater regulatory scrutiny, particularly around affordability in motor finance. The Bank of England has signaled that it is uncomfortable over the growth of unsecured consumer lending, particularly for motor vehicles.

“It seems very likely that the BoE will take action to tighten lending standards, but the motor finance industry should be in good shape to embrace industry-wide change, building on significant development and professionalization of the industry over the last few years.”

This is a view echoed by the British Vehicle Rental and Leasing Association, which says in its 2018 Industry Outlook Report that the UK auto leasing industry is ready to embrace opportunities in the months ahead.

Despite what the industry sees as an increasingly hostile tax regime, and uncertainty surrounding diesel vehicles, terrorism and the regulatory environment, in addition to Brexit, BVRLA members are upbeat.

BVRLA chief executive, Gerry Keaney said: “The Government published an Industrial Strategy outlining its ambition to see the UK become the world’s most innovative nation by 2030. Our industry will help deliver this by embracing new technologies, not only relating to vehicle design and build, but also the way we interact with customers, operate fleets and use data.

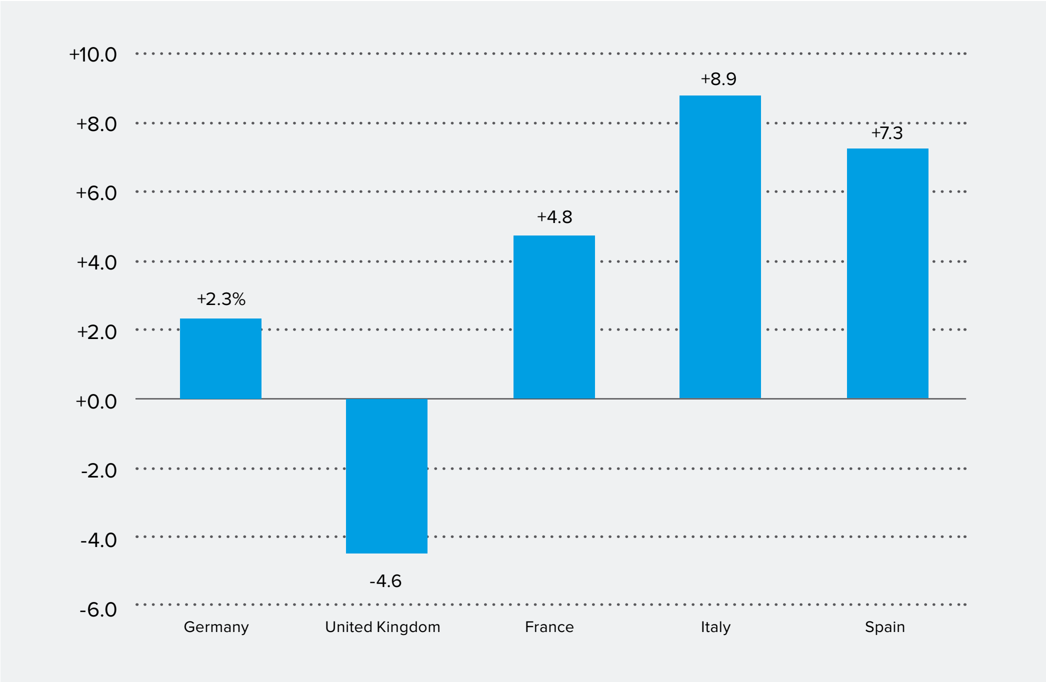
“As an increasing number of customers move from vehicle ownership to usership, our members will be ready to meet their needs; providing the expertise to guide customers and businesses to the right transport solution, considering affordability, sustainability and cost-effectiveness.

"BVRLA members know their customers, understand their products and are experts in combining the two in the safest, most sustainable and cost-effective way. This is why they are now collectively responsible for almost five million vehicles– that's 1-in-8 cars, 1-in-5 vans and 1-in-5 trucks - licensed on UK roads."

This increase in penetration of finance and leasing will play a key role in the growth of the industry this year, as vehicle sales are likely to continue their decline following years of strong growth since the recession.

The UK's car market is traveling in the opposite direction to key rivals, with sales down nearly 5% last year; further declines are expected in 2018.

EU new car sales – % change 2016-2017



Source: ACEA (year to end October 2017)

Roger Skinner, chief executive of the Maxxia Group, said: "Consumer debt in the UK is starting to hurt and is going to start impacting on retail sales, particularly large ticket items.

"We have seen an overheated new car market for several years, and my prediction for 2018 is that we shall see the new car market slow down compared to the last few years. However, we would see this as a 'normalized' new car market."

Legislation a key EU challenge in 2018

New legislation will have a significant impact on the auto and equipment finance market in 2018 in several areas.

The arrival of the General Data Protection Regulation promises to shake-up industry processes and create business disruption.

It brings enhanced consumer rights and tougher penalties when companies breach regulations and aims to give control back to citizens and residents over their personal data.

It becomes enforceable from May 25, 2018 and does not require national governments to pass any enabling legislation, so it immediately becomes applicable in all EU countries including the United Kingdom.

According to the European Commission, personal data is “any information relating to an individual, whether it relates to his or her private, professional or public life. It can be anything from a name, a home address, a photo, an email address, bank details, posts on social networking websites, medical information, or a computer’s IP address.”

Importantly, in addition to data protection legislation, automated individual decision-making, including profiling, is made contestable.

Citizens will have the right to question and fight decisions that affect them that have been made on a purely algorithmic basis.

There is also a legal obligation to notify the authorities of data breaches within 72 hours of the breach and individuals if their personal data has been affected.

Non-compliance poses a greater operational risk for many businesses, as infringements are punishable by fines of up to €20m or 4% of the company’s total worldwide annual turnover, whichever is higher.

Data security will continue to be a key factor as the industry further embraces digitalization

With data breaches becoming increasingly common, companies are being warned of the potential financial consequences from legal action taken by the authorities and by consumers whose data has been exposed.

Data security will continue to be a key factor as the industry further embraces digitalization.

Other legislative changes that will have an impact during 2018 range from accounting changes set out in IFRS 16, which will be mandatory from January 2019, to open banking legislation enforced through the second EU Payment Services Directive 2 (PSD2), a Europe-wide regulation that requires European banks to make it easier to share customer transaction and account data with third parties, at the request of the customer.

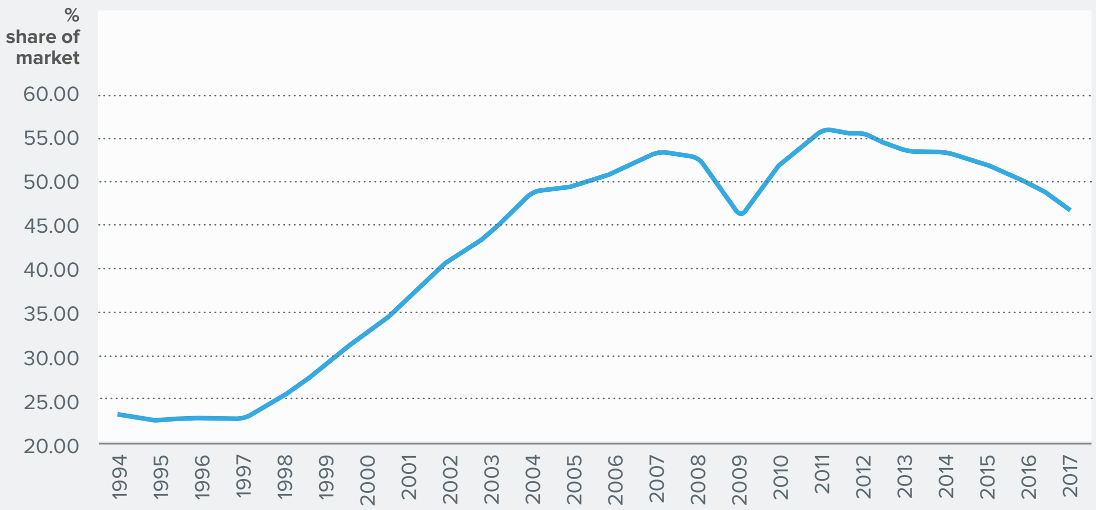
Additional challenges for auto finance companies include changing political attitudes to diesel fuels, which have dominated auto sales in Europe for decades.

Amid growing concerns about the impact of diesel fumes on the health of urban populations, governments throughout Europe are now introducing legislation that discourages the fuel.

Initiatives range from fuel tax rises for diesel in France to increases in company car taxation for UK business drivers from this year.

This uncertainty is undermining vehicle demand as consumers wait for a clearer picture of the future and it could affect residual values for current assets.

Diesel share of EU passenger car registrations 1994-2017



Source: ACEA (2017 estimated figure)

However, according to the British Vehicle Rental and Leasing Association, diesel uncertainty could be a positive for the finance industry, as consumers shy away from long-term ownership of assets.

Its 2018 Industry Outlook report said: “Diesel dominance of the commercial vehicle market will not change yet. Uncertainties around air quality measures will drive more people towards renting and leasing. 2018 will be the year of the in-depth fleet review.”

Tex Gunning, chief executive officer, LeasePlan, said: “LeasePlan has seen stable prices for its vehicles across Europe throughout the year, with no discernible impact from diesel regulations, which are very localized and focused on older models.”

LeasePlan’s fleet turns over every three to four years, so the company retains exposure to only the latest and cleanest diesel models. More than 99% of LeasePlan’s diesel fleet is Euro 5/6, so it argues that it is well-positioned to adapt to any changes in regulation which can take significant time to be implemented.

Gunning added: “LeasePlan also benefits from a pan-European network and can mitigate localized declines in the pricing of 3-4-year-old cars by leveraging cross-country pricing arbitrage opportunities. In addition to providing a source of risk mitigation, better exploitation of these cross-country arbitrage opportunities within Europe has the potential to drive meaningful profit enhancements across a significant portion of the vehicles sold by LeasePlan each year.”

Industry looks East for growth

Eastern Europe is a promising potential market for generating additional growth in 2018.

Experts indicate the leasing market in Central and Eastern Europe is worth €17 billion, making it an attractive potential investment to tap into future economic development.

Last year, Erste Group and De Lage Landen International announced they were establishing a strategic alliance for their vendor financing and leasing activities in Central and Eastern Europe.

A memorandum of understanding outlined a potential transfer of DLL Hungary entities into Erste Bank Hungary, or one of its entities, to take place during early 2018.

The new partnership will target growth in the vendor finance market in Austria, Bosnia and Hercegovina, Croatia, Czech Republic, Hungary, Macedonia, Montenegro, Romania, Serbia, Slovakia, and Slovenia.

Karin Schmidt-Mitscher, head of Erste Group's commercial real estate and leasing business, said: "Erste Group has been investing in Central and Eastern Europe for almost two decades now and has seen a growing demand in leasing and vendor financing.

"The overall estimated potential of this market is above €17 billion. By joining forces with DLL, one of the world's largest leasing companies, we have the ambition to build new direct client relations and expand our portfolio. Furthermore, we will benefit from its know-how and vast network of global relationships."

Erste Group is a leading financial services provider in the eastern part of the EU, with 47,000 employees serving more than 16 million customers in seven countries, covering Austria, Czech Republic, Slovakia, Romania, Hungary, Croatia, Serbia).

Marc Dierckx, chief financial officer of DLL, said: "DLL has a clear interest in geographic expansion, growth and finding new ways to provide our vendor partners with access to markets where we do not have a physical presence.

"The planned alliance will allow DLL to leverage Erste Group's extensive network and capabilities throughout Central and Eastern Europe. Most importantly, DLL vendor partners will gain access to competitive pricing and support in the countries where Erste has capabilities."

Conclusion

There are clear signs that 2018 is set to be a transformational year for the auto and equipment finance industry.

Digitalization will start to change the business landscape as companies adopt increasingly automated processes in response to customer expectations.

At the same time, new legislation, such as the second Payment Services Directive, will create new opportunities for digital innovation while the General Data Protection Regulation will increase the severity of consequences for getting it wrong.

Together this mix of push and pull in digital finance will change start to change the shape of auto and equipment finance during 2018.

But who is leading that change?

According to Altimeter, in its report on digital change, companies need agents for change who operate from a strategic manifesto to guide them in their digital transformation efforts.

This includes embracing being a catalyst, combining resources with other agents for change in the business and learning to speak the language of the C-suite, who may need encouragement and guidance in accepting a different way of thinking.

The challenge of persuading senior colleagues to accept change in a risk-averse business environment may be challenging, but it is a crucial part of a new business dynamic, where companies need to adapt or face an increased risk or failure or decline.

While companies face individual national and regional trends, the path towards digitalization is a global force that will bring changes to the auto and equipment finance sector across borders and continents to bring about truly global change.

Technology may provide a platform, but change will be driven by senior managers and employees with the vision and commitment to succeed.

As Brian Solis, principal analyst at Alitmeter and author of The Digital Change Agent's Manifesto, says: "That's part of the misnomer about digital transformation. It's more of a human story than it is about digital."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