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Ruble Devaluation May Save Russian Car Production

By Delphine d'Amora

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A man entering a dealership selling Lada cars, produced by the Russian AvtoVAZ. Russian car sales plunged 17.3 percent in June, compared with 2013.

While the ruble devaluation has devastated car sales and much else over recent months, it has simultaneously served one of the state's long-term aims: to localize car production in Russia.

The president of AvtoVAZ, Russia's largest car producer, on Thursday announced plans to increase domestic production from an already hefty 84 percent of all components to 90 percent.

"Increasing the localization of production is the main trend for me," AvtoVAZ president Bo Andersson told journalists at the ongoing Innoprom industrial trade fair in Yekaterinburg, Prime reported.

With special government agreements with automakers to expire in 2019, and customs duties on imported cars to decline from 25 to 15 percent in the coming years due to Russia's accession to the World Trade Organization, it had appeared that localizing production in Russia would lose its cost-cutting appeal.

But the decline in the ruble exchange rate has come to save the day for Russian car production. "Localization is the key way to control costs and to remain competitive on the market," said Vladimir Bespalov, an analyst at VTB Capital.

VTB Capital expects the ruble to continue to depreciate over the coming years. So too does Russia's Economic Development Ministry, which in its base forecast has predicted the exchange rate will gradually rise to between 38.3 and 39.3 rubles to the dollar in 2017, ITAR-Tass reported.

"If production is not localized, this will inevitably either put pressure on costs or will force the producers to increase prices, which will make them less competitive," Bespalov said.

The devaluation has also, of course, had its negative impact, playing a role in the market's collapse of 17.3 percent in June and with 7.6 percent over the past six months compared to the same periods in 2013, according to the Association of European Business.

Joint venture Ford Sollers, which handles all production of Ford vehicles in Russia, has been one of the hardest-hit this year, with sales falling 53 percent this June compared to last year and 39 percent since January.

Nonetheless, a Ford Sollers spokeswoman on Thursday affirmed the company's continuing commitment to the market, as well as its intentions to increase local production.

"In addition to supporting the local Russian supplier industry, this also will help reduce the impact of fluctuations in exchange rates," the spokeswoman said. Ford already has three domestic production plants, where 99 percent of the vehicles sold in Russia are built, she added.

The abrupt market decline has served to demonstrate the extent to which controlling costs relies on localized production, Bespalov said: "Part of the decline in the market which we saw, for example, in the second quarter of this year, was related to [foreign] producers trying to increase prices, which consumers were not ready for."

For Ford, AvtoVAZ and other major sellers such as GM and Volkswagen, localization has more than just economic sense behind it. These companies in 2010 signed agreements with the Russian government by which they promised to localize at least 60 percent of their production and to establish production capacity of at least 350,000 units within the country in exchange for exemptions from customs duties on the imports of car parts.

These agreements produced a vital change on the market. "Practically all the leading car manufacturers came to the country and organized production, trying to fulfill their agreements on localization," said Sergei Udalov, executive director of automotive industry analytics agency Autostat.

These agreements expire in 2019. Meanwhile, Russia will be lowering its current 25 percent tariff on imported cars to 15 percent by 2020 in order to comply with WTO regulations following its accession in 2012.

The coincidence of these factors, both of which will diminish the economic incentive of localizing production, has led to concerns that foreign producers could flee abroad in 2020.

"If no supportive measures are taken, with the decrease in import tariffs and the privileges on delivering parts being canceled, a reverse trend is possible," Udalov said.

A report published by Roland Berger Strategy Consultants in May predicted that, in the absence of additional government subsidies, production in Russia would become unprofitable for many foreign producers under the new conditions.

"About 40 percent of the foreign cars produced in Russia are under threat of being replaced by imports," the report said. Those most at risks of fleeing are companies that produce less than 25,000 units a year in Russia, the analysts found, adding that the loss of this business would cause crises in regions such as Kaliningrad, Lipetsk and Vladivostok, where the automotive industry is king.

But according to VTB Capital's Bespalov, this is precisely where the ruble will do its part — if devaluation continues, the cost of importing and producers' fear of sudden fluctuations will compel them to center their production in Russia.

Along with the advantages of a falling ruble, Russia is also benefiting from the labor of the major car companies in recent years. Obliged to localize by their agreements, these companies have worked to arrange production of high-quality parts in Russia — an effort that is now coming to fruition.

Thanks to the business of these companies, Russian suppliers are expected to continue to grow over the coming years with further component suppliers arriving from abroad to launch their own production facilities in Russia, Bespalov said.

Renault already produces more than 70 percent of its parts in Russia, excluding only engines and transmissions, which are to be produced within the country as well in the near future, the company's press service said.

As conditions in Russia improve, even foreign companies who did not sign these agreements have localized, Bespalov said. Hyundai, for instance, never made an agreement with the government, but has nonetheless localized about 50 percent of production in Russia.

Underlying the move to localize is a confidence that, although car producers are seeing difficult times, Russia is still a promising and underserved market with an appetite for about 2.5 million cars a year.

"We are confident in our chosen strategy. We believe Russia has the potential to become the leading new car market in Europe in the upcoming years," Ford Soller's spokeswoman said.

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