MONEY LOSERS: *A bleak economy keeps buyers away*

BRAZIL

STUCK IN A RUT

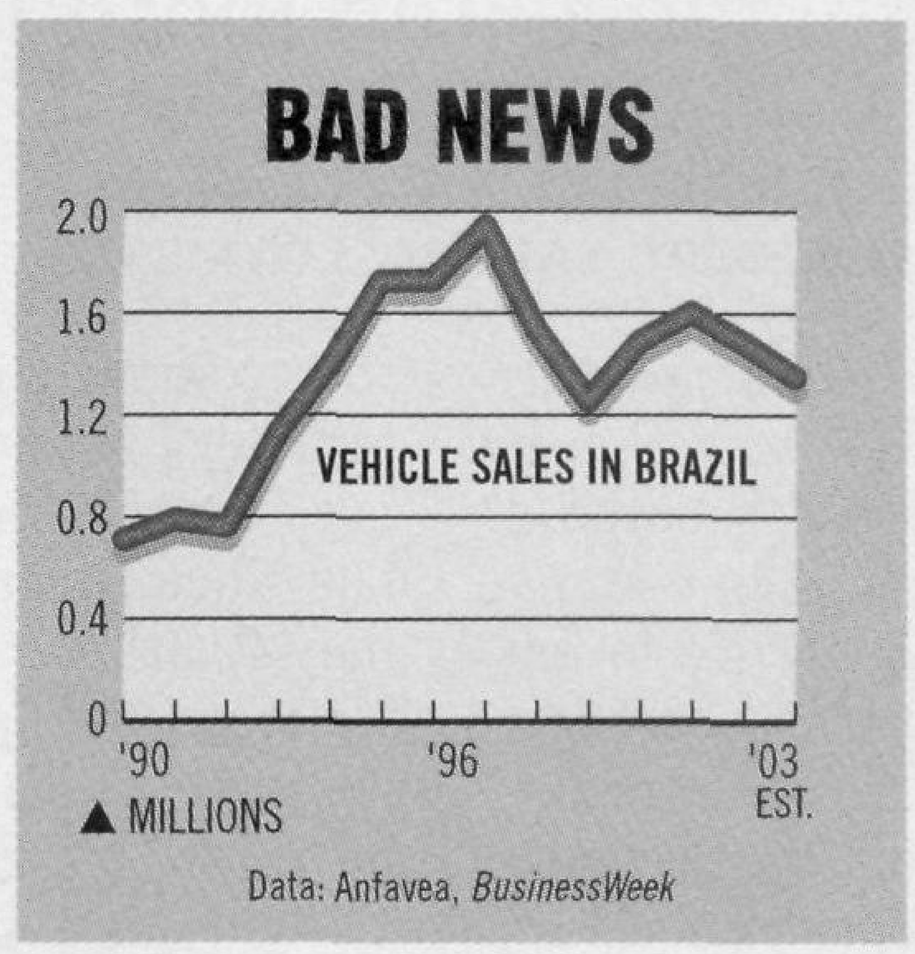
Can Brazil's auto industry stop spinning its wheels?

Working with such a dark palette, there was no way for Walter Wieland to paint a pretty picture. So when the president of General Motors Corp.'s Brazilian subsidiary met with journalists recently, he stuck to the facts: Sales of GM models are flagging and the company's local plants are operating at 60% capacity. Said Wieland: "2003 will be remembered as the most difficult year since the industry set up in Brazil."

At least Wieland is not alone. His colleagues at Brazil's other long-established carmakers—Volkswagen, Ford, and Fiat—along with newcomers such as Renault and Honda, are also gritting their teeth as they steer through a deep sales rut. Even the most optimistic predictions put Brazilian sales of cars, trucks, and buses at 1.4 million this year—a 30% decline from their peak of 2 million in 1997. What's wrong? The economy. The "spectacle of growth" promised by President Luiz Inácio Lula da Silva, who took office in January, has yet to materialize. High interest rates will hold down expansion to just 1.5% this year, while unemployment has surged to a record 13%. With the future uncertain, Brazilians are putting off any big-ticket purchases. "While people are afraid of losing their jobs, they won't change their car," says João Batista Simão, president of the GM distributors' association.

All this is bad news for auto makers who were counting on emerging markets like Brazil to rev up profits in the coming decades. The market's potential seemed limitless in the early- to mid-1990s, when Brasília knocked down import barriers and tamed inflation. Suddenly, Brazilians had money to spend—but not on the outmoded, second-rate models that had been rolling off local assembly lines.

Carmakers thought they had discovered a new El Dorado and began plowing money into new factories. Big money: The Brazilian auto industry association, Anfavea, figures that auto makers have sunk nearly $30 billion into Brazil since 1995. Overall production capacity now stands at 3.2 million vehicles a year—more than double last year's sales. No wonder Renault scrapped plans to build a new world car at its plant in Paraná, inaugurated in 1999. "There are too many marques," says Ricardo Carvalho, Anfavea president and a director at VW in Brazil. "So far nobody is talking about leaving, but the future is very uncertain."



The crisis is hitting foreign carmakers' profits. While none breaks out figures by country, Volkswagen cited "substantial" losses in Brazil as a key contributor to falling profits in the first half of 2003. Market leader VW claims manufacturers in Brazil are operating at a negative margin of 5%: That means they're losing money on each vehicle they sell.

So far this year, Brazil's carmakers have held back on massive layoffs—a costly undertaking given the country's generous labor laws. Instead, nearly all manufacturers have instituted overtime bans, flextime, and reduced working weeks. In July, Fiat placed 1,000 workers on compulsory leave; Ford and Renault did likewise with 2,800 workers each. VW announced plans to eliminate 4,000 jobs on July 22, but quickly backtracked after labor representatives at its biggest plant reminded the company it was bound by a no-cuts pledge until 2006. "If Volkswagen dares to disrespect the agreement, we won't be talking about strikes. They can get ready for war," warns José Lopez Feijóo, president of the auto workers' union in the São Paulo industrial belt. VW proposes spending more than $100 million on a job-creation scheme modeled on a project that seeded more than 170 new companies in the vicinity of VW's home town of Wolfsburg. The company eventually hopes to transfer the excess workers to these new jobs, but the union is balking.

Carmakers have also turned to the government for relief. After much lobbying, on Aug. 5 officials agreed to knock four percentage points off one of several taxes applied to purchases of new vehicles for a period of four months. But other levies mean the government still pockets between 22% and 45% of a car's price, depending on the engine size. Although the industry welcomed the reduction as a way to clear up inventories, any hopes of a sustained rebound lie with the economy. And that is looking worse by the day.

By Jonathan Wheatley in São Paulo

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