Overseas Market Information

Automobile Industry in Malaysia

(Continued from previous issue)

Business Environment Ranking

BMI's revised Business Environment Ranking for the automotive industry sees Malaysia falling to join 13th place with Hong Kong going into the final quarter of the year, on a composite score of 31. This is four points lower than in our last report, due to a substantial decrease in our production forecast for the next five years, which has reduced the country's CBU output potential. The Government's new auto policy could see an improvement in regulatory scores in future to lift the market in the rankings. However, a high level of vehicle ownership compared with the rest of the region, coupled with lingering protectionist policies, continue to reduce the scope for new market entrants.

Table : Asia-Pacific Business Environment Ranking

Country	*Economics - LT Risk*	*Politics - LT Risk*	*CBU Output Growth*	*Vehicle Ownership/ Penetration*	*Potential Regulation*	*Competitive Environment*	*Composite Score*
Australia	9	10	3	1	10	9	42
Vietnam	3	3	10	9	8	8	41
India	5	9	8	10	8	3	38
China	7	3	8	9	6	4	37
Singapore	10	9	1	6	8	2	36
South Korea	10	7	3	2	8	6	36
Thailand	6	5	4	6	7	6	34
Indonesia	4	4	3	9	7	7	34
Pakistan	4	3	4	9	6	7	33
Taiwan	8	8	1	3	5	7	32
Philippines	3	4	7	2	7	7	30
Japan	6	10	3	1	9	1	30
Malaysia	**8**	**6**	**2**	**4**	**6**	**5**	**31**
Hong Kong	5	5	1	8	7	5	31

LT Economic Risk : Based on BMI Country Risk Service Long-Term Economic Risk Rating. **LT Political Risk** : Based on BMI Country Risk Service Long-Term Political Risk Rating. **CBU Output Growth** : Based on BMI forecasts for 200 CBU production. **Vehicle Ownership/Penetration Potential** : Based on saturation of market. **Regulation** : Based on BMI Business Environment Rankings, Foreign Direct Investment and Industry Regulations. **Competitive Environment** : Based on level of existing market competition. **Composite Score** : Unweighted total of preceding six scores. **Re Rank** : Highest composite score = most attractive auto sector environment within the Asia/Pacific region; lowest composite score = least attractive.

(Source : BMI research)

Economics - Long-Term Risk

Malaysia will continue to boast one of the most open, investment-friendly economies in Southeast Asia. The export of basic electronic components, made in the local branch plants and subsidiaries of Western manufacturing companies, will remain the main pillar of Malaysia's economic growth.

CBU Output Growth

Malaysia's production of CBU is expected to rise by 7.06% over the forecast period to 2010, which means Malaysia's output growth is well below average for the region and the market therefore received a ranking of two from a possible 10.

Vehicle Ownership/Penetration Potential

This measures the opportunity for market growth based on the market's vehicle ownership as a percentage of the population. Around 20.19% of the population own a car in Malaysia, while the regional average is 16.45%. Based on this, Malaysia scores four out of 10.

Regulation

This is a reflection of the regulatory environment in the market. Malaysia scores slightly above average due to its investor friendly regulations. However, deferment of adherence to AFTA tariff regulations remains an issue. Malaysia, therefore, received six out of 10.

Competitive Environment

The competitive environment category measures the opportunity for new market entrants, based on existing manufacturers and brands in the country. Despite increasing numbers of car makers launching production activities in Malaysia, some major manufacturers are still absent, leaving opportunity for extra competition. The market scores five out of 10.

Industry Forecast Scenario

Table : Malaysia Autos Sector - Historical Data & Forecasts (CBUs unless otherwise stated)

	2003	*2004*	*2005*	*2006f*	*2007f*	*2008f*	*2009f*	*2010f*
Total Production (CBUs)	350,000	471,975	563,408	488,300	502,949	518,037	533,579	549,586
Total Production (US$ bn)*	3.8	4.0	4.5	3.9	4.0	4.1	4.3	4.4
Total Production (MYR bn)	14.5	15.1	17.0	14.8	15.2	15.7	16.2	16.6
Cars (CBUs)	325,000	370,475	445,092*	390,640	402,359	414,430	426,863	439,669
Commercial Vehicles (CBUs)	25,000	101,500	118,316*	97,660	100,590	103,607	106,716	109,917
Total sales (CBUs)	405,100	487,605	551,042	481,500	500,760	530,806	567,961	613,399
Total sales (US$ bn)*	5.3	5.6	6.0	5.3	5.5	5.8	6.2	6.7
Total sales (MYR bn)*	20.0	21.3	22.8	20.1	20.8	22.1	23.7	25.6

e/* = BMI estimate, f = BMI forecast. *(Source : OICA, Malaysian Automotive Association & BMI estimates)*

Restrictions on hire purchase loans and festive periods have resulted in a fall in monthly new vehicle sales in Malaysia, taking the total for the year to date down further. Around 35,563 units were sold in October, down 37% from the same month in 2005 and 17% lower than September's sales. The year to date total of 417,966 units is 11.3% lower than the sales of 465,106 units achieved by October 2005.

According to data from the Malaysian Automotive Association (MAA), passenger cars accounted for 26,571 units, with commercial vehicles contributing the remaining 8,992 units. Broken down by origin, national brands accounted for 23,938 units, down 64.7% from 39,441 in October 2005. Non-national brands sold 11,625 units, down from 17,316 units. Although both sides lost out, this shows national brands' share of sales falling from 81% to 65% over the year, despite the aim of the NAP to create a strong domestic industry.

The Government is looking to the current incumbents to increase production, while rationalizing models in order to streamline the industry. However, production for the month was also down from 41,288 units to 29,586 units in October. Production for the first 10 months of the year combined fell from 466,172 units in 2005 to 428,937 units.

BMI had initially expected a year-end rally to support sales in line with our full-year forecast of 568,742 units. This now looks unattainable, although the freezing of interest rates at Bank Negara Malaysia's last three policy meetings, coupled with the view that the current rate of 3.50% will be held until 2007, suggests that there will be no further squeeze on borrowing and consumers may feel more comfortable in undertaking major purchases.

We now believe sales of around 481,500 are more realistic, reflecting a 12% y-o-y decline from 2005. Our production forecast of 568,742 units was optimistic, given the continuing downturn over the year to date, so we have revised our forecast to a 13% drop to 488,300 units. We retain our view, however, that this will be a temporary slide until the industry has adapted to the NAP, although we still do not expect production growth to rise about 2-3% for the next five years.

Trade

Table : Malaysia Autos Sector - Historical Data & Forecasts (CBUs unless otherwise stated)

	2003	*2004*	*2005*	*2006f*	*2007f*	*2008f*	*2009f*	*2010f*
Automotive Exports*	14,850	21,922	28,176	37,987	52,351	69,690	80,144	89,761
Auto exports (value, US$ bn)*	0.2	0.2	0.3	0.5	0.7	1.0	1.4	1.6
Auto exports (value, MYR bn)	0.6	0.9	1.2	1.7	2.4	3.3	4.5	5
Auto imports*	78,125	98,515	109,310	125,492	146,187	166,147	187,939	210,492
Auto imports (value, US$ bn)	1.7	2.2	2.6	3.2	4.1	4.8	5.5	6.2
Auto imports (value, MYR bn)	6.5	8.5	9.8	11.4	13.5	15.6	17.9	20.1
Balance (US$ bn)	-1.6	-2.0	-2.3	-2.7	-3.4	-3.8	-4.1	-4.6
Balance (MYR bn)	-5.9	-7.5	-8.6	-9.7	-11.1	-12.3	-13.5	-15.1

e/f = BMI estimate/forecast. *(Source : OICA, Malaysian Automotive Association & BMI estimates)*

After deferring the introduction of the full AFTA benchmark tariff of 5% for some time, the NAP has reduced the tax rate for ASEAN passenger car CBUs by 20% to 40%, while the duty on non-ASEAN CBUs has been cut by 5% to 30%. Excise Duty on completely knock down (CKD) kits has fallen from between 80% and 200% to between 75% and 125%. Meanwhile, the ASEAN Common Effective Preferential Tariff scheme sees the duty on vehicles with at least 40% ASEAN content reduced from 15% to 5%.

However, Mr. Naris Chaiyasoot, Director General of Thailand's Fiscal Policy Office, claims that Malaysia's demand that all manufacturers register for approval on imports acts as a non-tariff barrier, which does not comply with AFTA. He added that although the lowering of Malaysia's import tariffs would have some effect on Thai exports, the impact would be minor as many manufacturers already have bases in both countries.

The issue has escalated, with Thailand's Fiscal Policy Office refusing to reduce the import duty on vehicles from Malaysia, claiming that its ASEAN neighbour still has non-tariff barriers in place, which contravene the AFTA agreement. As a result, Thailand will retain the existing 20% Duty on Malaysian vehicles for now. If this issue is not resolved swiftly, it could have serious consequences for regional trade.

However, despite the dispute, Thailand's exports of vehicles, parts and accessories to its ASEAN neighbour rose by 11.6% y-o-y in the year to August. The value of total automotive exports to Malaysia increased from US$441 million in the first eight months of 2005 to US$492.6 million, with CBUs accounting for US$52.4 million. Full-year exports for 2005 reached US$653.9 million, of which vehicles contributed US$56.7 million. The results confirm Malaysia's position as the fourth-largest market for Thai automotive goods, behind Australia, Japan and Indonesia.

Exports are still likely to play more of a role in the strategies of manufacturers, if over-production is to be avoided. In particular, national producers **Proton** and **Perodua** will need to find alternative markets as their market share continues to dwindle at home. Domestic car company **Naza** has already been actively expanding its reach, launching its own-branded 1.1-litre compact car in April 2006, which it intends to export. This would make Naza, Malaysia's third car maker, to export domestically built cars. **BMI** had expected a considerable recovery of around 28.5% in 2005, with shipments of 28,176 units. We believe this level of growth will slow to 12% by the end of the period under review to 2010.

The import market is likely to witness considerable activity over the forecast period as the Government brings the industry in line with its ASEAN counterparts but struggles to retain some protective measures. Lost revenue from import tariffs will be offset by a rise in Excise Duties to as much as 250%. **BMI** believes that this will be the key to restraining imports in what could threaten to become a market-flooding scenario. We forecast consistent growth of around 11-13% for the remainder of the forecast period, surpassing the 200,000-unit mark by 2010.

Economic Contribution

Table : Malaysia Autos Sector - Historical Data & Forecasts (CBUs unless otherwise stated)

	2003	*2004*	*2005*	*2006f*	*2007f*	*2008f*	*2009f*	*2010f*
GDP (US$ bn)	104	118.5	130.8	149.9	168.4	190.5	209.7	227.2
Contribution to GDP* (%)	3.7	3.4	3.6	3.7	3.9	4.1	4.3	4.5
Total stock of passenger cars* (mn)	4.5	4.7	5.0	5.2	5.4	5.6	5.8	6.1
Car ownership (% of population)*	18.2	18.8	19.4	19.9	20.3	20.9	21.4	22.0
Population (mn)	24.4	24.9	25.3	25.8	26.2	26.7	27.1	27.5
Sectoral employment* (mn)	41.8	43.6	45.2	46.7	48.2	49.7	51.2	52.4

f = BMI forecast, * BMI estimates. *(Source : OICA, Malaysian Automotive Association)*

Macroeconomic Forecast Scenario

Moderate Slowdown Ahead - Due to the effects of the global monetary tightening cycle and high energy prices, which will weigh on demand for Malaysia's exports, we anticipate a slowdown in the second-half of the year. Consequently our 2006 GDP forecast for Malaysia is 5.4%, despite a strong Q106 performance. Going forward, a slower global economy will continue to hurt the export industry and will limit growth to 5.2% in 2007. While this is a concern, a lower rate of inflation should help support domestic demand next year.

The Malaysian economy grew by 5.9% y-o-y in Q206, up from 5.5% in the previous quarter, despite a deceleration in external demand, the main driver of economic growth. The effects of a slowdown in export growth to 5.4% y-o-y in Q206 from a revised 7.3% in Q106 were accompanied by a slowdown in import growth to 7.7% y-o-y from 10.8% in Q106, which helped to limit its impact on GDP. Growth was also supported by a 6.6% y-o-y increase in consumption expenditure, compared with 6.1% in Q106. Concerns over growth do exist, however, with easing external demand posing the biggest downside risk. The US is poised for a slowdown on the back of a cooling housing market and, although September's core US CPI rose by 0.2% month-on-month (m-o-m) from August, on a yearly basis it is closer to 3%, well above the 1-2% comfort range indicated by Fed policymakers. This suggests that one more 25 basis point (bp) rate hike to 5.25% in 2006 may be on the cards, hurting consumption levels in Malaysia's primary export market.

Fearing the worst, Malaysia is turning to Europe, hoping that strong growth in the region will translate into increased demand for its hi-tech goods. In Q2006, the eurozone exhibited growth at an annualized rate of 3.6%, its best performance in six years. The continent proved to be a major export destination for Malaysia in Q106, with annual growth in exports of almost 14%, compared with 12% to China and 9% to the US. Continued growth in Europe should ensure sustained demand from the region. However, it is unlikely that European imports will be able to fill the gap in demand caused by a downturn in the US economy, especially if Germany, Europe's biggest economy, is hit with a 3% rise in VAT next year. Indeed a deceleration in Malaysia's industrial production, to 5.0% y-o-y in August from 6.7% in July, indicates that manufacturers are wary of the effects of a slowdown in external demand, which has been intensified by a strong ringgit (relative to the start of the year), and which will hurt the country's vital export industry.

(Source : EEPC Singapore Office)

(To be continued in the next issue)