Overseas Market Information

Automobile Industry in Malaysia

Executive Summary

A continuing decline in Malaysia's new vehicle sales – down 11.3% year-on-year (y-o-y) as of October 2006 – suggests that there is little hope of a return to growth in the remainder of the year. Indeed, BMI's Malaysia Automotives Report includes a revised forecast, which projects sales of around 481,500 units in 2006, down 12% y-o-y. Production will also take a downward turn, despite the Government's attempts to encourage the current incumbents to increase output, while rationalizing models in order to streamline the industry. Production for the first 10 months of the year combined fell from 466,172 units in 2005 to 428,937 units.

There is still cause for optimism in the market, however. 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. Moreover, national manufacturer **Proton** may have finally found the international partner needed to raise its game. The Malaysian Government has revealed that it is in talks with France's **PSA Peugeot Citroen** regarding a potential strategic alliance. Proton entered into an initial agreement with PSA in September, signing a letter of intent to work together in areas such as joint vehicle development and sourcing of components.

Malaysia's business environment still provides cause for concern, however. The country has fallen to joint 13th place in **BMI's** Business Environment Ranking for the automotive industry in the Asia Pacific region. This is largely due to a substantial decrease in our production forecast for the next five years, which has reduced the country's completely built unit (CBU) output potential rating. Meanwhile, 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. Not all manufacturers have been deterred from their plans for the country, however, with **Hyundai** announcing plans to begin production of a sports utility vehicle (SUV) in Malaysia next year.

International car makers continue to grow in influence in Malaysia. In October, national brands accounted for sales of 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 National Automotive Policy (NAP) to create a strong domestic industry. Proton's approach of forming ties with the big names could prove to be the best possible solution, but it is unlikely that the national firm will regain its dominance of earlier years in the face of international competition.

Malaysia Auto Industry SWOT

Strengths

- Ties with other ASEAN markets are strengthening all the time through AFTA-induced tariff reductions, which will provide advantages for carmakers basing themselves in Malaysia
- The market continues to attract investment from major car makers, with Hyundai pledging in October 2006 to expand its locally-built range.

Weaknesses

- The national industry is in decline, with Proton posting a loss in market share of 4% (to 30%) and Perodua remaining static (on 25%) in 2005
- Protectionist measures are still barring new entrants, particularly Chinese manufacturers such as Geely

- Car ownership levels are relatively high at one car for every four people, compared with one in 30 in neighbouring Thailand and Indonesia.

Opportunities

- Toyota has commenced exports from Malaysia, becoming the first carmaker to benefit from export incentives offered under Malaysia's new National Automotive Policy (NAP)
- Proton also stands to benefit from new incentives linked to investment, as the company plans to spend MYR 5 bn on R&D over the next five years, helping to retain a strong national player
- The national manufacturer should also regain some ground in the market through partnerships with Chery and PSA Peugeot Citroen.

Threats

- Malaysia's trade dispute with Thailand over non-trade barriers in the automotive industry could hamper the export projects of major car makers
- Burgeoning capacity levels of around 700,000 units could result in a supply glut
- Thailand's 'Detroit of Asia' strategy threatens other manufacturing bases in the region; the country plans to invest THB 10 bn in achieving output of one million vehicles by 2006.

Malaysia Economic SWOT

Strengths

- During the past four decades, Malaysia has transformed itself from a commodities-dependent backwater into a major world source for electronics and computer parts
- Malaysia is the world's largest producer of rubber, palm oil, pepper and tropical hardwoods, and is also a net exporter of crude oil. All this provides a solid platform for economic growth.

Weaknesses

- Malaysia's relative insulation from global energy price shocks is being eroded. It is now possible that within the next five years Malaysia will become a net importer of oil
- Malaysia's economic openness can be as much of a burden as a benefit, since it confers a high degree of vulnerability to global growth and capital flows.

Opportunities

- The opportunity for private-sector-led growth will improve if the Government sticks to its pledge this year to conduct its biggest ever divestment of state shareholdings as it seeks to raise money to plug a yawning budget deficit
- Malaysia's move to a managed float exchange rate should allow the central bank to stabilize the ringgit at a competitive level against its trading partners.

Threats

- Wages are higher in Malaysia than in a number of its competitors, such as China and Vietnam, which could be a long-term hindrance to economic expansion. To maintain competitive edge, Malaysia needs a steady stream of inward investment
- Export competitiveness could be eroded if the exchange rate is allowed to appreciate rapidly, and inflation continues to rise.

Malaysia Business Environment SWOT

Strengths

- Standards of corporate governance have improved greatly in Malaysia since the Asian financial crisis - more so, in fact, than in many neighbouring countries
- Foreign companies, or at least foreign manufacturing companies, looking to do business in Malaysia will continue to be welcomed with open arms - with the Government offering lavish tax breaks and concessions.

Weaknesses

- State subsidization of prices will remain a peripheral but persistent part of daily economic life in Malaysia
- Doing business in Malaysia will always, to some extent, mean dealing with the politically well-connected
- Big construction projects - and big contracts for foreign construction firms - are unlikely to be as much of a priority for Malaysia's Government as they were under the previous administration of former Prime Minister Mr. Mahathir Mohamad.

Opportunities

- The opportunity to invest in Malaysian state assets could improve. The Government, if it sticks to its word, will soon conduct its biggest ever divestment of state shareholdings
- Malaysia is eager to compete globally in banking and although it currently lacks a domestic champion, with ten main institutions in the market, bank consolidation is a strong possibility.

Threats

- The waterways and shipping lanes that surround Malaysia will continue to pose the threat of piracy and terrorism
- Malaysia is at risk, conceivably, of losing out to China in the race for foreign investment. Penang, once the pillar of Malaysia's electronics industry, has seen an exodus of foreign firms, with Seagate, Motorola and Solectron all shifting production to elsewhere in Asia.

Regional Market Overview

The Asia Pacific region has been emerging in recent years as a real force in the automotive industry, both in terms of acting as a production base and providing manufacturers with relative untapped markets. Many car makers have shifted production operations from traditional US and Western European locations to Asian countries with lower costs.

The markets of the Association of South-East Asian Nations (ASEAN) have become prominent and are expected to account for 13% of Asia's total vehicle output by 2011, compared with 7% at present according to industry data. In 2005, output from the four major markets of the region – Thailand, the Philippines, Indonesia and Malaysia – surpassed 2.3 million units, and is projected to exceed 3 million by the end of our forecast period in 2010.

Thailand is the leading production base in the ASEAN bloc, accounting for output of 1.125 million units in 2005. As the world's second-largest producer of pick-up trucks and a flourishing export base, thanks largely to Government incentives, the country is set to continue attracting foreign investment and was expected to exceed output of 1 million units in 2005. That milestone had already been passed by November 2005. The country's importance as a hub has been underlined by a series of projects by multinational car makers.

Honda, for example, has revealed plans to consolidate its parts operations in Thailand under one new subsidiary. The company has invested THB 1.28 billion in **Asian Parts Manufacturing Company**, which will produce parts for Honda models built in Asia (including Oceania), Europe and Japan. Due to become operational in June 2007, the new business will employ 200 people. The venture is a response to the growing demand for body parts in Honda's global production operations. Establishing a single parts unit will reduce costs and improve delivery efficiency, while the existing **Honda Asian Parts Centre** in Chachoengsao will continue in its role of managing Honda's global parts supply network and acting as a regional sourcing and logistics centre.

Nissan Motor, meanwhile, has set up a base for the export of automotive parts in Laem Chabang, Thailand. The unit, which will be operated by local subsidiary **Siam Nissan Trading**, will source parts from 94 Thai suppliers, to be shipped to Nissan production plants in 110 countries. The centre will become operational in January 2007, supplying body panels and roof assemblies for the Tiida compact car to countries where the model is assembled, including Mexico. Further parts will be added to the range in the future, as the base is expected to become Nissan's second-largest export base outside Japan.

The Philippines is also enhancing its position as a production hub, with **Toyota** choosing the country as the base for its largest transmission production base outside Japan. Exports will play a large role in the development of the Philippines auto industry, as the Government has recently introduced a vehicle export programme. The country has also played a part in vehicle innovation, as **Ford** became the first company in April 2006 to roll out a flex-fuel vehicle in the Philippines, with the launch of a Focus model powered by either gasoline, ethanol or a mixture of the two.

The Philippines Government is promoting the use of coco-biodiesel, sugarcane ethanol and jathropa biodiesel as alternatives to conventional fuel, as the country aims to reduce its dependence on imported oil. Indeed, the Government is offering tax breaks and other incentives to manufacturers that invest in hybrid development.

A raft of new assembly licences awarded to international manufacturers has increased Malaysia's annual production capacity to 700,000 units, although this has raised the question of over-capacity in a market of under 500,000 units. In 2005, actual output totaled just 563,408 units. A report published by Malaysia's Ministry of International Trade & Industry (MITI) in July 2006, outlines the Government's aim to create an automotive industry centred on two strong national manufacturers under the National Automotive Policy (NAP). The domestic giants will be 'complemented' by overseas producers, possibly with local partners. The Government is looking to the current incumbents to increase production, while rationalizing models in order to streamline the industry. As a result, the component sector is expected to become more efficient, largely due to the merging of companies, while output grows and the sector becomes more integrated into the global industry.

Overseas manufacturers have not be deterred from investing in local production, however, as Hyundai plans to begin production of an SUV in Malaysia next year, through local importer **Hyundai-Sime Darby Motors**. The model is yet to be revealed, although Hyundai currently imports the Tuscon compact SUV and Santa Fe crossover SUV. The announcement was made as Hyundai-Sime Darby launched its latest domestically produced vehicle, the Getz 1.4-litre model. Producing the Getz in Malaysia has enabled the company to reduce the price of the model by over MYR 10,000 from the imported version of MYR 58,000.

In Indonesia, some industry figures are understandably concerned about the impact of reduced tariffs on the country's domestic industry. The Indonesian Finance Ministry has finalized the second round of tariff reductions for imported automotive products, on its way to achieving AFTA obligations by 2010. The new structure will apply to vehicles between 1,500cc and 3,000cc, with tariffs falling from 70% to 60%. By 2010, tariffs on all CBUs must be lowered to 40% in all categories. Manufacturers in Indonesia produced 530,000 vehicles in 2005 and imported 75,000 from other Southeast Asian countries and 15,000 from outside of the region. However, Gaikindo, the Indonesian Automotive Producers Association, estimates that local car makers will only be able to produce 500,000 units in 2006, due to increasing operating costs and growing competition from imported vehicles.

Despite this, **General Motors** is mulling the prospect of re-opening its production plant in Indonesia. The plant, with an annual production capacity of 15,000 units, has been idling since March 2005. The project is a notable show of confidence in Indonesia, which has witnessed a contraction in the automotive market over the year to date, as a result of escalating interest rates and a Government policy to double fuel prices in October 2005. GM is carrying out a feasibility study in order to determine the level of investment and models to be produced at the plant, which is due to re-open in 2007.

Outside of the ASEAN trade bloc, the two major forces are China and India. China's rapid growth in recent years led the China Federation of Machinery Industry to forecast a 20% y-o-y increase in output in 2005, to over 6 million units, which would have toppled Germany from its position as the world's third-largest automotive producer. In fact, China produced 5.71 million units, up 12.6% y-o-y. China's production segment is supported by an equally burgeoning component industry, with many international parts manufacturers planning to expand, based on the rapid growth of CBU production in China.

Indeed, US car maker Ford has announced plans to spend US$ 2.6 billion on the procurement of parts and equipment from China for its global production. Following a Q3 loss of US$ 5.8 billion for its global operations, Ford is looking to cut back on costs and has suggested that China will play an increasing role in its restructuring plans. This level of spending is twice the US$ 1.3 billion invested by Ford since its arrival on the mainland in 2001, and Ford Executive Chairman Mr. William Clay Ford Jr. has confirmed that further investment for China is on the cards.

India was the world's fastest-growing auto market in 2004 and has established a position as a popular production and export base due to its low operation costs. India was responsible for output of around 1.7 million (four-wheeled) vehicles in 2005-06, around 14% of which was exported. By 2010, we expect the country's annual output to exceed 3 million units, as its export potential is further developed.

Table : Asia-Pacific Autos Production – Historical Data & Forecasts (CBUs unless otherwise stated)

	2003	*2004*	*2005*	*2006f*	*2007f*	*2008f*	*2009f*	*2010f*
Australia	408,186	405,314	388,985	396,764	404,699	410,770	418,984	427,361
China (mn)	4.444	4.910	5.710	6.566	7.551	8.684	10.160	12.192
Hong Kong	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a
India (mn)	1.264	1.277	1.699	2.042	2.332	2.662	3.035	3.436
Indonesia	322,044	408,311	524,930*	556,000	585,200	605,050	626,983	652,061
Japan (mn)	10.286	10.617	10.799	10.993	11.213	11.577	11.810	12.046
Malaysia	**350,000**	**471,975**	**563,408**	**546,505**	**562,900**	**574,158**	**585,641**	**603,210**
Pakistan	105,280	152,529	200,160	246,341	253,334	266,011	279,311	293,278
Philippines	53,777	70,728	113,000*	149,000	156,500	175,280	196,313	215,944
Singapore	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a
S. Korea (mn)	3.177	3.469	3.699	3.948	4.181	4.268	4.354	4.440
Taiwan	386,686	430,814	446,345	348,879	359,345	370,125	384,930	400,327
Thailand	763,000	928,081	1.125 mn	1.215 mn	1.313 mn	1.418 mn	1,531 mn	1.653 mn
Vietnam	43,000	32,500	33,800	38,400	88,800	139,200	189,600	257,856

f = forecast, **BMI estimate,* *n/a = not available.* *(Sources : OICA, BMI research)*

In terms of sales, the regional market is expected to expand further as more developed markets in the West saturate. According to industry data, vehicle sales in the ASEAN countries alone are expected to account for 4.4% of global sales by 2010. In China, sales are slowing slightly following a feverish couple of years in 2003 and 2004. However, sales in excess of 8.8 million units are still forecast for 2010. In 2005 vehicle sales reached 5.76 million units. Domestic sales have been largely boosted by the removal of import quotas under WTO obligations.

In contrast, the more developed market of South Korea is facing sluggish domestic demand, based on reasonably high car ownership. Sales on the home market fell by 17% in 2004, although South Korean manufacturers offset this poor performance with a 41.7% increase in export sales. Domestic demand is expected to pick up, however, in the region of 30% by 2010. The upswing began in 2005 as domestic sales rose 4.3%, with exports again boosting sales with growth of 19.1%.

Table : Asia-Pacific Autos Sales – Historical Data & Forecasts (CBUs unless otherwise stated)

	2003	*2004*	*2005*	*2006f*	*2007f*	*2008f*	*2009f*	*2010f*
Australia	909,811	955,229	988,269	1.038 mn	1.079 mn	1.158 mn	1.243 mn	1.333 mn
China (mn)	4.390	4.878	5.760	6.451	7.096	7.805	8.430	8.852
Hong Kong	30,306	34,717	34,028	34,436	34,849	35,267	35,691	36,119
India (mn)	1.159	1.251	1.055	1.150	1.253	1.379	1.544	1.730
Indonesia	354,331	483,295	533,841	341,913	364,821	386,710	409,913	426,309
Japan (mn)	5.828	5.820	5.852	5.854	5.942	6.060	6.181	6.366
Malaysia	**405,100**	**487,605**	**551,042**	**568,742**	**602,866**	**639,038**	**677,380**	**718,023**
Pakistan	103,606	140,738	200,893	235,528	249,659	264,638	279,633	293,616
Philippines	92,336	88,075	97,603	103,947	110,681	119,536	129,099	139,426
Singapore	113,797	131,222	145,058	153,241	158,534	165,909	171,839	178,098
S. Korea (mn)	1.318	1.093	1.142	1.222	1.303	1.388	1.479	1.568
Taiwan	361,878	422,232	446,477	334,858	344,904	355,251	369,461	384,239
Thailand	533,176	626,000	703,432	713,983	749,683	809,657	874,430	944,385
Vietnam	63,264	64,131	52,264	43,787	46,689	51,450	59,808	67,465

f = forecast, **BMI estimate.* *(Sources : OICA, BMI research)*

Japanese companies tend to dominate the competitive landscape in Asia, with Toyota taking the lead in its domestic market, many of the ASEAN countries, Singapore and Taiwan. One of the keys to its success is a varied product portfolio, which includes small cars and sedans through to the pick-up trucks that form the backbone of the International Innovative Multi-purpose Vehicle (IMV) programme. In the rapid growth market of India, however, it is **Maruti Suzuki** that claims over half of the passenger car market. Suzuki also leads the passenger segment in neighbouring Pakistan, accounting for over 58% of sales and continuing the Japanese hold on the Asian region.

The increasingly valuable Chinese market, however, is a different story, with German giant **Volkswagon** (VW) fighting it out with US major GM through respective joint ventures. Volkswagon took the lead in 2004, but GM hit back in 2005 increasing sales at its Chinese joint ventures by 35% to 665,390 units, resulting in a top-ranking market share of 11.2%.

(Source : EEPC Singapore Office)

(To be continued at next issue)