



A white paper from The
Economist Intelligence Unit

ASEAN automotive: Looking to 2015

Contents

Executive summary	2
Overview: The automotive sector after the AEC	5
Thailand: Out in front	9
Indonesia: A new auto hub	13
Malaysia: Losing protection	17
Philippines: Looking for a roadmap	21
Vietnam: Last chance?	25
Singapore: Office space?	29
Brunei: No rich pickings	31
Cambodia: High hopes	33
Laos: One for the long term	35
Myanmar: Opening up	37
ASEAN attractions: an EIU ranking	39
How we calculated the rankings	42

Executive summary

The ASEAN region is becoming a major focus for automotive investment as the end-2015 deadline for economic integration approaches.

At the end of 2015, the ten members of the Association of South-East Asian Nations (ASEAN) intend to form the ASEAN Economic Community (AEC), further liberalising trade and increasing economic cooperation. The challenges of pulling together this disparate group of countries—from wealthy Singapore or Brunei to impoverished Laos and Myanmar—are immense. There is a high chance that the end-2015 deadline will be missed. Nevertheless, companies are already gearing up for the opportunities and threats that the AEC will bring. Vehicle-makers in particular now see this region as a focus of their global strategies.

While previous investment favourites such as Brazil and Russia are proving disappointing, the ASEAN nations offer what seem to be fairly certain growth prospects for the auto industry. The ten nations already boast total vehicle sales of around 3.6m units; over the next five years that is likely to rise by one-third to around 5.3m, according to Economist Intelligence Unit forecasts. Indonesia offers particularly strong prospects. Over the next five years, its vehicle sales are likely to rise by around 12% a year on average to overtake those of Thailand, and the long-term prospects are even better.

The question facing automakers is how to distribute their investment across the region in order to take advantage of falling tariff barriers, and the decline in non-tariff barriers. Governments in the ten nations are trying to woo investment, in some cases by offering tax breaks and other support for investment. Given the huge investments involved, however, vehicle-makers will also be looking at the long-term attractions of each market, as well as any barriers to investment.

This report outlines what ASEAN integration will mean for the region's automotive industry and the strategies that various vehicle-makers, and their suppliers, are using to benefit from freer trade. It also assesses the pros and cons of each market:

- **Thailand**, known as the “Detroit of the East”, has long been the region’s auto hub, owing to its reliable energy supply and staunchly pro-business economic policies. The military government, which seized control in May, is hastening to reassure investors that they are still welcome. Thailand has a better-educated labour force than neighbouring Myanmar, Laos and Cambodia, and its economy is five times bigger than those three countries’ combined.
- **Indonesia** offers the region’s largest population, at around 250m, combined with a fast-growing economy. That is already driving rapid growth in car ownership, prompting the government to introduce measures to cool the market. Nevertheless, automotive production is also rising rapidly, and could soon overtake that of Thailand. The government is supporting development through tax breaks under the Low-cost Green Car Programme.
- **Malaysia** is the only ASEAN country with an indigenous auto industry, in the form of carmakers Proton and Perodua. The country also offers a stable political and business environment. Market growth is not strong, however, and Proton in particular is struggling against rising imports. Further investment will be needed as competition intensifies, and the government is currently wooing Chinese businesses.
- **The Philippines** has the region’s second-largest population, and population growth, combined with rising incomes, is driving rapid growth in car sales. Vehicle-makers are still waiting for a government development policy, however, to bolster its faltering auto industry.
- **Vietnam** has already built up a sizeable auto industry on the back of a “Thailand+1” strategy adopted by some vehicle-makers. The country offers a stable base to reach the smaller ASEAN nations, as well as a business-friendly government. Its vehicle market is fairly small, but is growing rapidly.
- **Singapore** is the only ASEAN vehicle market that is steadily shrinking, as the authorities try to tackle pollution and congestion. Nevertheless, its status as a global trading hub, its developed business environment, and its supply of skilled labour make it a natural headquarters for the region’s auto industry.
- **Brunei, Cambodia, Laos and Myanmar** are unlikely to attract much automotive investment in the short term, but will become attractive target markets. They are at very different stages of development, with oil-rich Brunei primarily of interest to luxury German carmakers, while mass-market carmakers are eyeing the long-term prospects of impoverished, but populous, Myanmar.

In order to quantify the comparative advantages of each country, this report uses Economist Intelligence Unit data and forecasts to draw up a ranking covering four areas: current position, future prospects, business environment and cost-competitiveness.

Current position	Market potential	Business environment	Competitiveness	Overall
Thailand	Indonesia	Malaysia	Indonesia	Indonesia
Indonesia	Philippines	Thailand	Vietnam	Thailand
Malaysia	Vietnam	Philippines	Thailand	Philippines
Philippines	Thailand	Indonesia	Philippines	Malaysia
Vietnam	Malaysia	Vietnam	Malaysia	Vietnam

The rankings suggest that Indonesia is likely to overtake Thailand as the region's auto hub in the long term, with investment already being funnelled into the country. Yet the costs of moving established factories and supply chains mean that this shift will happen only gradually. Until then, Thailand—currently the only net vehicle exporter in the ASEAN region—is likely to be the main beneficiary, as the AEC starts to take shape.

Overview: The automotive sector after the AEC

The AEC could help to boost competition and remove barriers in the automotive sector, but the impact will be gradual.

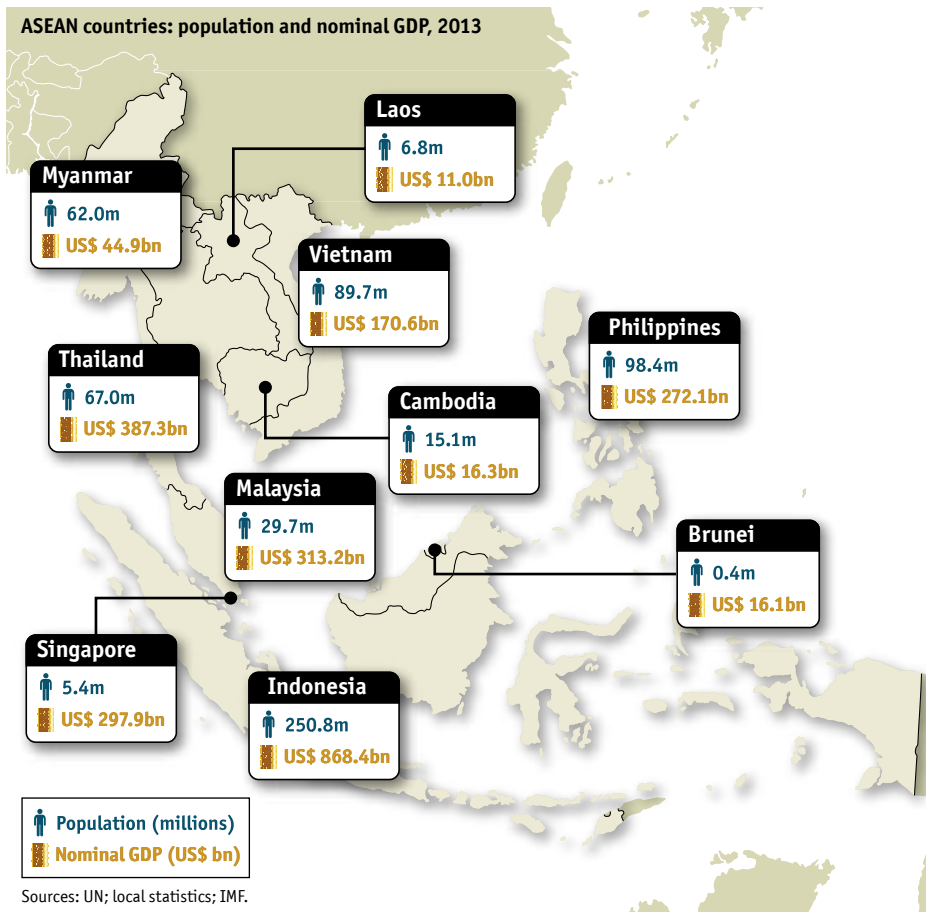
At the end of next year, the member states of the Association of South-East Asian Nations (ASEAN) intend to form the ASEAN Economic Community (AEC). Their aim, closer economic integration in a vast and diverse region, is a work in progress and The Economist Intelligence Unit expects many of the policy deadlines to be missed. Yet the AEC's impact on the automotive sector will be sizeable, as tariff barriers drop and competition increases in the region's automotive markets.

More than 600m people live in the ten member countries of ASEAN (Thailand, Myanmar, Laos, Vietnam, Malaysia, Singapore, Indonesia, the Philippines, Cambodia and Brunei). In the majority of member states, rates of car ownership are still very low. Nonetheless, if considered as a single unit, the ASEAN region is already the world's seventh-largest automotive market.

In most member countries incomes will continue to rise rapidly over the coming years. All except Brunei, Malaysia and Singapore are either yet to approach or are already in the US\$3,000-10,000 per head income bracket, in which car ownership grows about twice as quickly as incomes. ASEAN will therefore continue to grow rapidly as a consumer market for vehicles.

It will also gain in importance as a production base for the world's biggest car manufacturers, especially from Asia, but also the US and the EU. The market is sizeable, growing rapidly and wedged between Asia's fastest-growing automotive markets, China and India. ASEAN's geographical location, further trade liberalisation and its ambition to create a common market underpin its attractiveness as a manufacturing platform, including for cars and motorcycles.

The AEC, due to be launched on December 31st 2015, is an important step towards greater economic integration. The idea is to transform a vast and



disparate region into an EU-style economic area with free movement of goods, services, investment and skilled labour, and a freer flow of capital.

Effect on auto trade

The AEC will have an impact on the region's automotive sector but is unlikely to transform it. The competitive landscape is a complex web of numerous metrics, including infrastructure, business environment, tax incentives, labour costs, geographical location and market size. The production networks, dominated by Japanese manufacturers, have been built over decades. The sunk cost of these investments is significant, and the relocation of existing production facilities is likely to be limited.

In terms of automotive tariff barriers, the countries in the ASEAN region have already been working towards free trade, although there will be a marginal effect. Thailand, for example, exports around 40% of the vehicles it produces, and currently faces tariff barriers of up to 5% within the ASEAN region. These tariffs will be removed as the AEC takes shape, with a slight effect on competition in the region.

The biggest obstacles to greater intra-regional trade and production, however, are non-tariff barriers, which affect both vehicles and components. According to the Asian Development Bank, the incidence of non-tariff barriers in the automotive sector is high in terms of additional taxes and charges, as well as technical regulations (Singapore), automatic import licensing (Brunei and Malaysia) and non-automatic import licensing (Indonesia and the Philippines).

While member states have long acknowledged this as a problem, non-trade barriers remain notoriously hard to eliminate, not least because they vary greatly in nature, from customs surcharges to technical product requirements. The ASEAN Secretariat is currently in the process of drawing up a list of non-tariff barriers to determine which need to be dealt with first, and under what measures.

The AEC signifies the arrival of a more level playing field, less protectionism and greater competition. However, it is one step in a long process rather than the end point. It remains unclear to what extent entrenched interests, economic nationalism and a lack of institutional and regulatory harmony will continue to stand in the way of greater economic integration. Much will depend on political will. But even if non-trade barriers were to disappear overnight, for many poorer ASEAN countries it will take decades to build a competitive production platform for cars that can compete with the region's largest producers, Indonesia and Thailand.

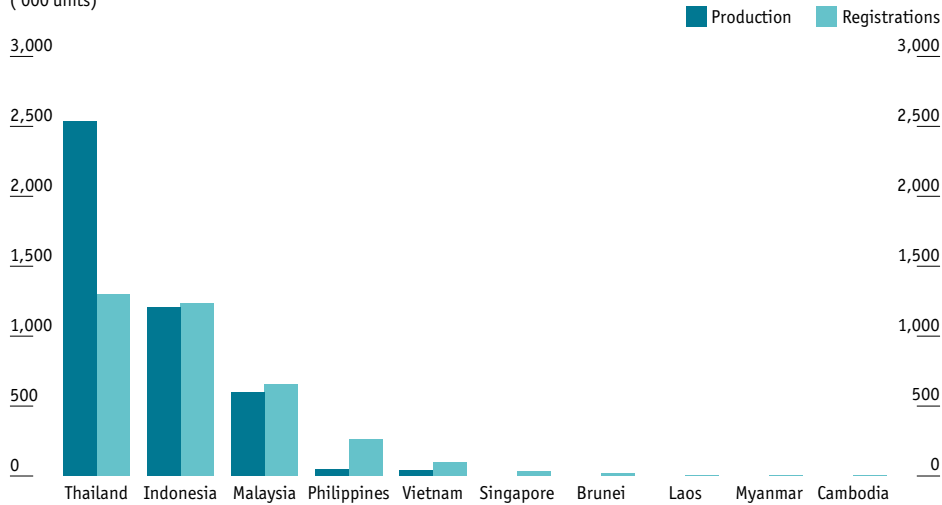
Jostling for position

Together these two nations account for more than four-fifths of ASEAN's automotive production. In 2013 Thailand accounted for 55% of cars produced in the economic bloc, followed by Indonesia (27%), Malaysia (14%), Vietnam (2%) and the Philippines (2%). In the short term, the AEC will not alter this hierarchy. Thailand, hailed as the "Detroit of the East", exports more cars than the rest of ASEAN combined (2.5m units in 2013) and is likely to see exports rise as barriers fall.

Indonesia's economy is growing quickly, however, and its potential market for cars is vast. Over time it will become both the biggest producer and biggest consumer of cars in the region. Thailand's domestic market is less dynamic than Indonesia's, and despite industry's inertia, this could weigh against it in the long term. Malaysia, the third-largest producer, is likely to suffer under AEC. Foreign firms in the country need to enter joint ventures with local partners, which has produced uncompetitive national champions, Proton and Perodua. More competition will challenge their dominance.

More generally, in the medium-to-long term, the creation of a more level playing field in the region is likely to challenge the position of the big established players (Toyota and Honda), while favouring smaller players such as Suzuki,

Vehicle production and registrations, 2013
('000 units)



Source: National statistics, International Organisation of Motor Vehicle Manufacturers (OICA).

Mitsubishi and Isuzu, as well as new market entrants. Increased competition and fewer barriers to entry will reduce the power of established firms in taking retaliatory action against smaller players who are seeking to increase production capacity. The opportunity for growth in those market participants will therefore be significantly improved.

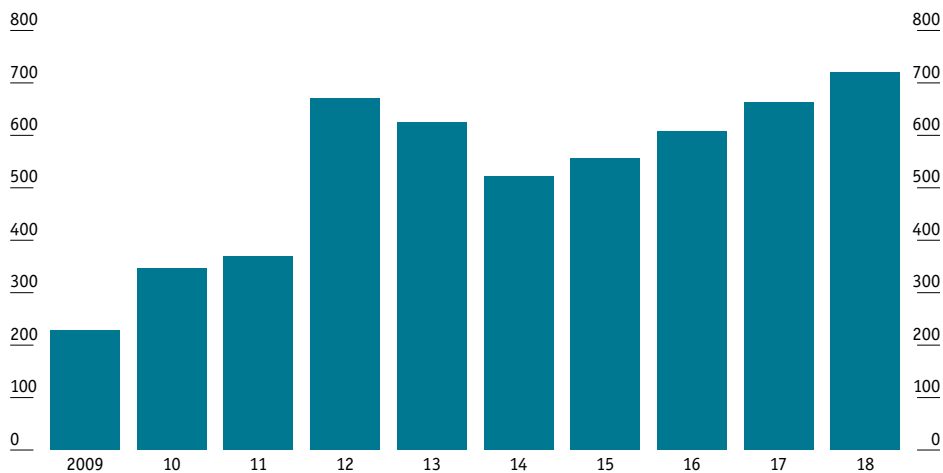
Thailand: Out in front

Will falling ASEAN trade barriers help or hinder the world's eighth-largest vehicle producer?

Thailand is one of the most important car-producing countries within the ASEAN region, and is likely to be one of the nations most affected by deeper economic integration in the region next year. At present, however, international trade pales into insignificance compared with domestic politics, after the military coup in May this year. The political turmoil is causing similar upheaval in the automotive market, with sales over the first half of this year falling by 30%. That is making it harder for carmakers to plan their strategy ahead of next year's ASEAN integration.

Thailand's current position as the "Detroit of the ASEAN region" is not in doubt. The country occupies a strategic geographic location for export across the wider ASEAN region, but the flourishing of its automotive sector is not solely down to its position on the global map. Successive years of considerable government support

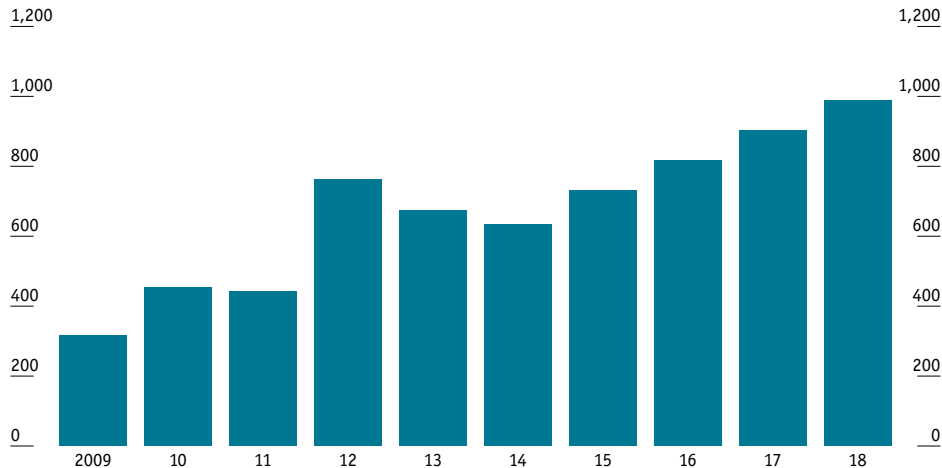
Thailand: passenger car registrations
('000)



Source: The Economist Intelligence Unit

Thailand: commercial vehicle registrations

('000)



Source: The Economist Intelligence Unit.

have helped, which has resulted in the emergence of a regulatory regime that is favourable towards automotive production. Thailand is now the region's only net vehicle exporter.

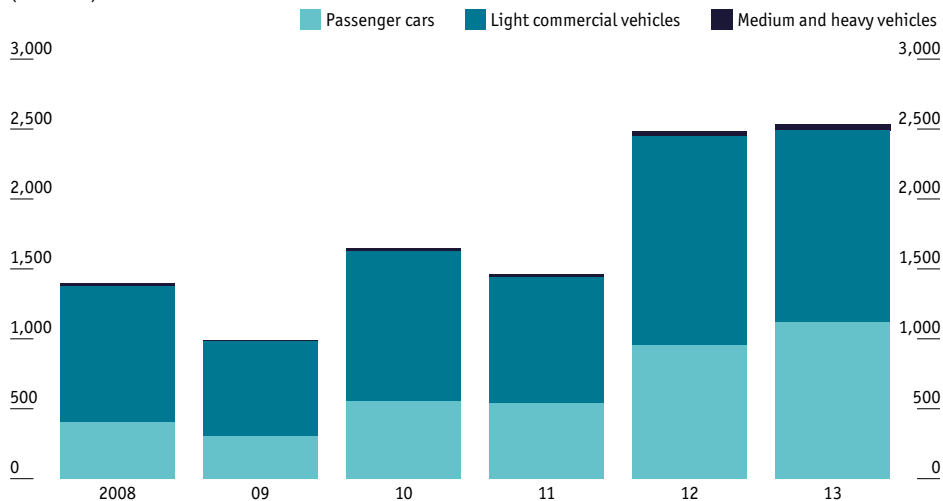
Part of this regime involves attracting foreign investors by allowing them to enjoy majority shareholdings in vehicle-assembly facilities, as well as giving them freedom to source vehicle parts from other countries. Local production is further incentivised via the imposition of a more punitive excise and import tax regime for wholly assembled vehicle imports—which are subject to a tariff of 80%, compared with an average tax of just 30% for auto parts. The terms of the ASEAN Free-Trade Area provide even more favourable conditions; exports of Thai auto parts and vehicles are subjected to a maximum tariff of 5% within the ten-member bloc.

The upshot of these efforts is the creation of a market that is keenly regarded by many of the world's biggest carmakers and is largely self-sufficient, with local production covering more than 95% of local demand. Approximately 2.5m vehicles were produced in Thailand last year, of which 1.4m were commercial vehicles and 1.1m were passenger cars. Of this total, 40% were destined for foreign markets, primarily neighbouring countries within Southeast Asia.

Politics and weather

The expansion of Thailand's auto sector has not been smooth, however. Severe flooding across parts of central and northern Thailand in 2011, which inflicted widespread devastation and resulted in over 800 deaths, disrupted the automotive supply chain, causing a large number of factory closures. The floods set back both domestic demand and local production capacity. Production fell by 11% in 2011, and the shortage of Thai-made parts caused problems for carmakers worldwide, particularly Japanese ones.

Thailand: vehicle production
(’000 units)



The problems were short-lived, with production rebounding by 67% in 2012 and 4.3% in 2013. Both Ford and Nissan opened new plants in Thailand in 2012 and 2013, respectively, and the likes of General Motors (GM), Ford, Volvo, Mercedes-Benz and BMW have now reignited plans to build new factories and expand capacities at existing ones. Honda plans to open a new US\$644m plant in 2015, with capacity to produce 420,000 vehicles per year, while Volkswagen is seeking approval for a 100,000 capacity plant near the port of Bangkok. If approval is forthcoming, that plant could open around 2019, beefing up the German company’s presence in the region.

Just as car production has started to return to pre-flood levels, however, a second, more recent event, continues to cause uncertainty. In May of this year a military junta, the National Council for Peace and Order, staged a successful military coup, on the back of two days of failed talks with political leaders. It took until mid-June for the junta to outline its (vague) political plans, which include appointing an interim government in October and drafting a new constitution. With a return to democracy not now expected until 2016 at the earliest, Thailand’s economy is on course for years of weak economic growth. Economist Intelligence Unit forecasts put GDP growth for this year at around 1.9%, from 2.9% in 2013 and 6.5% in 2012.

The knock-on effect for car manufacturers has run deep. At the beginning of August, GM claimed that it was struggling in Thailand’s auto market, owing to weak demand resulting from the political crisis, tough competition from dominant Japanese competitors and currency uncertainty. Toyota, meanwhile, is forecasting a 31% drop in sales this year. Data published by the Federation of Thai Industries (FTI) show that auto sales fell by 30.4% year on year in June, to 73,799 units, although the conclusion of a government funded first-car subsidy scheme in

2012 has also had a role to play in dampening sales.

With a stable political environment unlikely to materialise in the short term, passenger car registrations are likely to suffer, although we forecast a return to positive growth in 2015 (at 6.6% year on year). A more pressing question is whether political forces will stymie the planned launch of the ASEAN Economic Community (AEC) in December 2015. It may also add some uncertainty to carmakers' own investment plans.

A secure future under the AEC?

For most of the ASEAN region's Japanese car producers—Toyota, Isuzu, Nissan, Mitsubishi and Honda—all of whom have dominated the market for decades, the benefits of the AEC are likely to be significant. Combined with a slight weakening of exchange rates, the lowering of tariff and non-tariff barriers are likely to bolster exports.

Competition within the Thai market will intensify, however. Toyota could see its Thai market share slip under pressure from rising imports (indeed this already seems to be happening). The introduction of the AEC could give its smaller Japanese rivals an advantage, as well as European producers keen to make more of an impact in a country where Japanese producers hold close to an 80% share of the passenger car market.

However, Thailand's car making infrastructure is showing signs of age and underinvestment, made worse by a lack of investment in the energy supply needed to power a productive auto manufacturing network. The downturn in domestic sales could also lead to tighter margins in the auto sector, further dampening future investment. Rising wages in Thailand may also undermine the country's competitiveness—although they may also draw in much-needed skilled labour from elsewhere.

For the short term, however, the AEC is unlikely to alter the current hierarchy of auto production. Thailand accounted for 55% of cars produced in the ASEAN economic bloc in 2013, followed by Indonesia (27%) and Malaysia (14%). The country's high proportion of localisation, its use by car manufacturers as a "mother plant" and its more sophisticated production network, should see it at the forefront of ASEAN car production for some time to come.

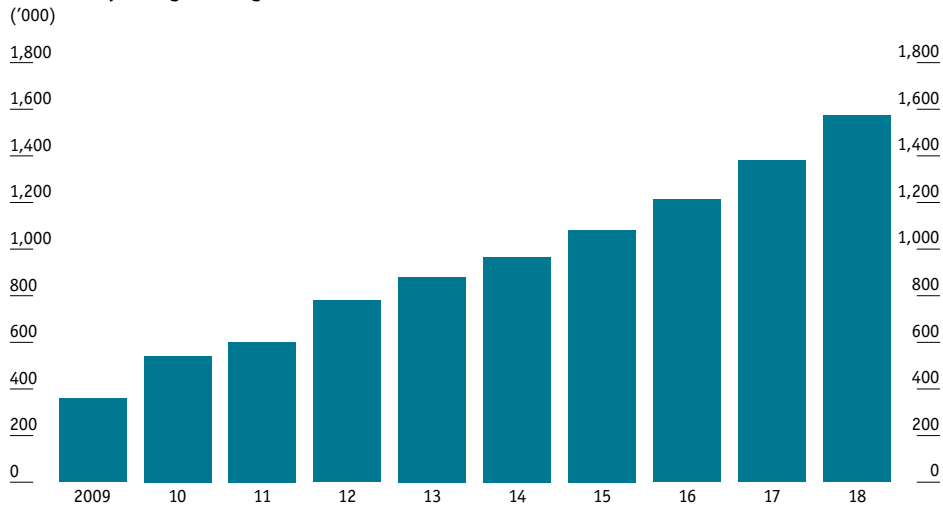
Indonesia: A new auto hub

Can Indonesia’s auto industry benefit from falling trade barriers, or will it focus on the domestic market?

Indonesia is the world’s fourth most populous nation with some 250m inhabitants. But its car ownership rate remains quite low, at around 80 vehicles per 1,000 inhabitants. This is well below ownership rates in Malaysia and Thailand, and one of the lowest in Asia. Until recently, auto sales had been stagnant, depressed by low incomes and sluggish economic growth, especially compared with neighbouring Asian Tigers. In the past five years, however, annual unit sales have more than doubled. Total vehicle sales are expected to reach 1.2-1.3m units this year, probably surpassing Thailand for the number one spot in Southeast Asia.

Indonesia is not just a fast-growing auto market, however. Under the leadership of the president, Joko Widodo, the country is aiming to become the leading economy in Southeast Asia. The auto industry is a major contributor of

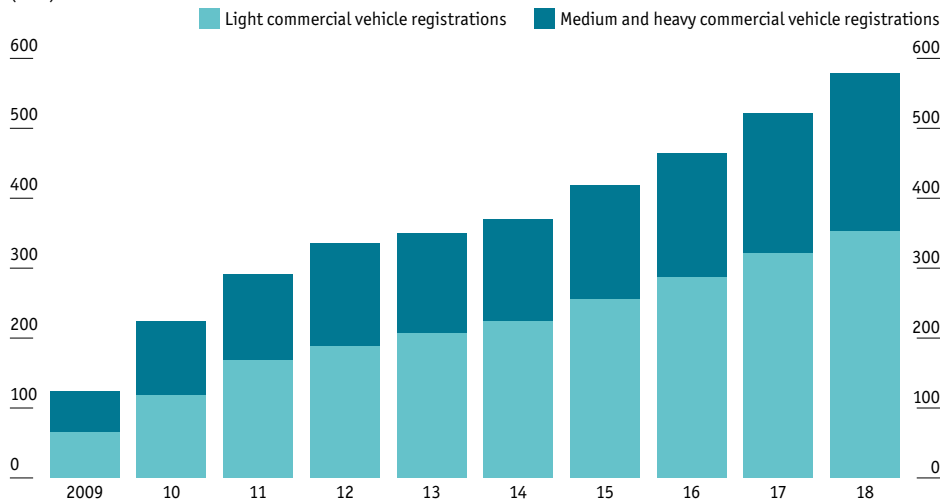
Indonesia: passenger car registrations



Source: The Economist Intelligence Unit.

Indonesia: commercial vehicle registrations

('000)



Source: The Economist Intelligence Unit.

tax revenue and a key driving force behind Indonesia's rapid economic expansion. And after attracting massive investment over the past two years, the auto industry is looking confidently to next year, when the ASEAN Economic Community (AEC) will be created.

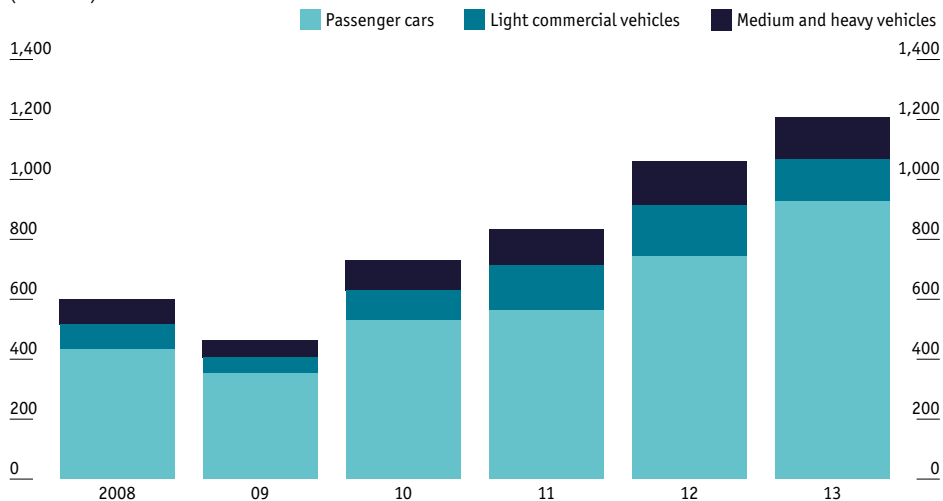
International automakers awoke to the Indonesian market's potential several years ago. Japanese automotive companies have been present there for a while—Toyota still owns over one-half of the passenger car market, and Japanese manufacturers collectively sell close to 90% of all cars in Indonesia—but they are being joined by an increasing number of US, European, Korean and even Chinese carmakers.

General Motors (US), which withdrew from Indonesia in 2005, is investing US\$150m into reopening its old facility in Bekasi, West Java, in order to produce seven-seat sports utility vehicles (SUVs) for the local market. Ford (US), Hyundai (South Korea), Tata (India) and Geely (China) have already made or are planning to make substantial new investments into Indonesia. Volkswagen already runs a plant in Cikampek assembling 5,000 vehicles a year, but has been toying with the idea of building another, bigger plant, once conditions are right.

The home market

Most of these carmakers are there to feed domestic demand. Their heavy investment will shield the domestic auto industry from foreign competition once trade barriers across ASEAN countries start to come down. Indonesia already has the capacity to produce around 2m vehicles a year at highly competitive prices, which will keep imports down.

Indonesia: vehicle production
(’000 units)



Source: International Organisation of Motor Vehicle Manufacturers.

Sales are expected to double again, at least, by 2019, and touch the 3m mark. Some 96% of the country’s consumers say that they are eager to get behind the wheel of a private vehicle, compared with the average of 77% worldwide, according to Nielsen, a market research company. In Indonesia, car ownership is a major status symbol, which prompts car buyers to plump for the most expensive vehicle they can afford. Fully 94% of Indonesians who already own a car want to upgrade their vehicle whenever their finances allow it, the highest percentage in the world.

Last year, sales were also boosted by the introduction of subsidies under the low-cost green car (LCGC) programme, which aims to improve the environment and position Indonesia as an eco-car producer. The programme eliminates the luxury tax on certain fuel-efficient and low emissions vehicles. Daihatsu (Japan), which is partly owned by Toyota, has been highly successful in selling environmentally-friendly small cars in the first six months of 2014, achieving 30% sales growth and a nearly 10% market share.

In the short term, automotive sales growth may moderate. Higher interest rates—and the resultant slower economic growth—may dampen demand, but it is likely to be a temporary dip. The Economist Intelligence Unit expects GDP growth to slow to 5.4% this year, before returning to over 6% from 2015 onwards. Moreover, during his successful presidential election campaign this summer, Mr Widodo pledged to eliminate fuel subsidies over the next four years. The subsidies currently cost around US\$18bn annually, while benefiting middle-class motorists instead of the poor farmers for whom they were originally intended.

The policy balance

The elimination of fuel subsidies may prove a blessing in disguise for the domestic automotive market. Some potential car owners have been discouraged by the

poor state of the country's infrastructure and huge traffic jams in the capital, Jakarta, and other major cities. Phasing out fuel subsidies may relieve some of the congestion in the near term, whereas the money saved could boost budgets for desperately needed road construction and infrastructure improvement.

The government's challenge, after all, is to balance competing trends: it needs to allow for the expansion of the automotive industry (and therefore demand) while also minimising the effects of pollution and congestion. The LCGC initiative is clearly intended to achieve this, while also allowing producers to carve out a specialism. Indonesia's other challenge, after all, will be to translate its status as the largest regional automotive market into a massive increase in auto exports.

Indonesia's export success is not assured, even under the increasingly favourable tariff regime created by the AEC starting next year. Other countries— notably Thailand, Malaysia and the Philippines, not to mention China—also have their eye on ASEAN car markets. True, Indonesia's exports of fully built up vehicles have nearly doubled since 2008, and are expected to hit the 200,000 unit mark in 2014. Yet contrast this total with the level of motor vehicle exports from Thailand, the current regional hub. Its unit exports hit the 1m mark in 2012 and measured 1.1m last year. Indonesia has a long way to go.

Malaysia: Losing protection

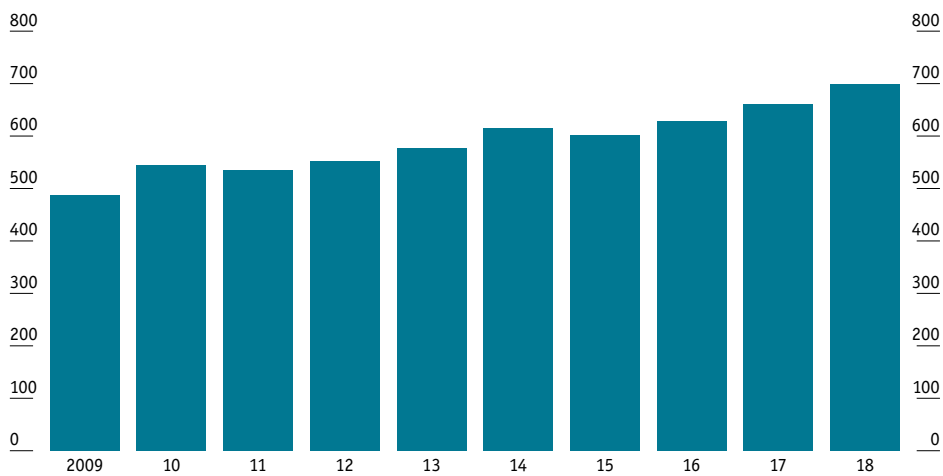
Malaysian carmakers seek opportunities in ASEAN integration, but may end up losing out.

Malaysia is the only ASEAN country to boast an indigenous auto industry. As the ASEAN Economic Community (AEC) comes into being on December 31st 2015, motor vehicle markets across Asia will become liberalised, opening up opportunities but also removing protective barriers from previously sheltered national markets. The two Malaysian marques, Proton and Perodua, are looking for strategies to position themselves for the new business environment.

In May, Dr Mahathir Mohamad, Malaysia’s 88-year-old former prime minister, was appointed chairman of Proton Holdings Bhd, the first national automaker which he helped to found while in office in 1983. Dr Mahathir was also opposed to the takeover of the often-troubled Proton by one of several global automakers with whom the company had partnered over the years. However, his first act as the top man at Proton has been to pen an agreement with Zhejiang Geely Holding

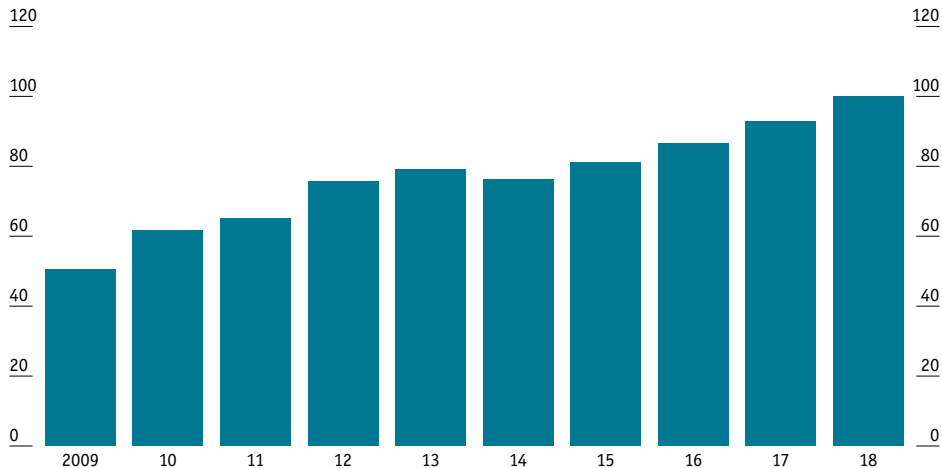
Malaysia: passenger car registrations

('000)



Source: The Economist Intelligence Unit.

Malaysia: commercial vehicle registrations
('000)



Source: The Economist Intelligence Unit.

Group, a leading Chinese automaker. The partnership is still evolving, and may involve selling more Proton vehicles in the Chinese market, as well as producing Geely proprietary vehicles in Malaysia, under the Proton nameplate.

Perodua, meanwhile, unveiled plans to invest M\$600m (US\$188m) into a new engine plant in western Negeri Sembilan State, in partnership with Daihatsu Motor (Japan). Construction will start in September and when completed, the plant will have the capacity to make 140,000 engines per year. Daihatsu, which owns a minority stake in Perodua, already has a transmission plant in Negeri Sembilan, in which Perodua holds a 10% share.

Indeed, Daihatsu and its parent company Toyota would have been market leaders in Malaysia, if it weren't for the protection afforded to domestic producers. In theory, they should benefit as the ASEAN market opens up, but in fact they may see some fierce competition from smaller Japanese rivals such as Suzuki, Isuzu and Mitsubishi. That is because ASEAN has free-trade agreements (FTAs) with countries outside the association, including China, India, New Zealand and Japan. As a result, vehicles made in Japan by smaller carmakers will be treated equally to cars made in Thailand and Indonesia by larger Japanese producers.

Ceding positions

As things now stand, Perodua is still a market leader in Malaysia, controlling just over 30% of overall unit sales. Proton holds slightly more than one-fifth of the market. The current owner of Proton, DRB-Hicom, is a major vehicle importer into Malaysia. The marques it distributes include Mitsubishi, Honda, Audi and Suzuki, as well as Isuzu, Mitsubishi and Mahindra commercial vehicles. Together with Proton, its vehicles hold over 50% of the market.

However, both domestic manufacturers have been suffering market share

Malaysia: vehicle production
(‘000 units)



Source: International Organisation of Motor Vehicle Manufacturers.

declines. Even as vehicle sales rose by 12% in April, Perodua and Proton suffered falling sales and, correspondingly, market share declines. Both companies have a rocky road ahead, especially since our forecast calls for a modest decline in unit sales in their domestic market in 2015, reflecting tighter monetary policies by Bank Negara Malaysia (BNM, the central bank).

Another factor that could curb vehicle sales later this year and into early next year is the proposed replacement of the sales and services tax with a lower goods and services tax (GST), which will go into effect on April 1st 2015. The sales levy will go down from 10% to 6%, reducing car prices. Since domestic vehicles are in the lower end of the price range, delayed buying will likely fall heavily on Proton and Perodua. In the second half of next year, moreover, car buyers may hold back once again, waiting for the new trade agreement to take effect.

Proton troubles

Dr Mahathir has already complained about Malaysian motorists for their refusal to support the national manufacturer. But Proton has been plagued by poor quality and backward engineering and styling, while its prices have not been competitive with Japanese imports. It controlled more than one-half of the domestic market in the early 2000s, but now even its current, much reduced market share would have been even lower had the government not supported it by special measures, such as requiring taxi owners to buy Proton vehicles.

Perodua has performed better, which allowed it to become Malaysia’s market leader. But when pitted against global manufacturers in export markets, its vehicles have also been found wanting. Perodua UK announced in June that it

stopped importing the Myvi subcompact after selling just 120 vehicles in Britain in 2013.

Whether teaming up with Geely would solve the problem for Proton remains to be seen. Chinese companies have deep pockets, but they have not been eager to invest in Malaysia. Cumulative direct investment from China stands at around US\$1bn, while Malaysia's investment into China has been more than six times as large. During his recent visit to China, the prime minister, Datuk Seri Najib Tun Razak, called on China to boost investment into Malaysia, especially in light of bilateral trade volumes that have been expanding by over 18% a year over the past decade and a half. But another question is whether Geely could come to terms with Proton which, under Dr Mahathir's tutelage, has been remarkably uncooperative with its previous partners.

If all goes well, then a link-up with a Chinese company should serve Proton well. As well as its strong position in the world's biggest auto market, Geely's additional advantage is its ownership of Volvo, the Swedish passenger car manufacturer. The two companies are starting to develop vehicles jointly, using the Swedish company's technology, engineering and design acumen. If Proton could plug into this partnership, Dr Mahathir hopes that it would greatly improve the quality and attractiveness of its vehicles and recapture some of its lost market share at home, while mounting an export drive into other ASEAN countries.

On the face of it, such plans should dovetail with Geely's ambitious international strategy. In addition to becoming the first Chinese automaker to snare a major global automotive brand, Geely has emerged as a top Chinese automotive exporter as well, vying for the honour with Chery. Malaysia's automotive market is small by Chinese standards: the Malaysian Automotive Association expects vehicle sales to reach 670,000 this year, compared with 20m in China. But Malaysia is a gateway to the AEC, which with its 600m-plus inhabitants, low car ownership rates and rapid economic growth, should become one of the most important automotive markets of the next decade.

Philippines: Looking for a roadmap

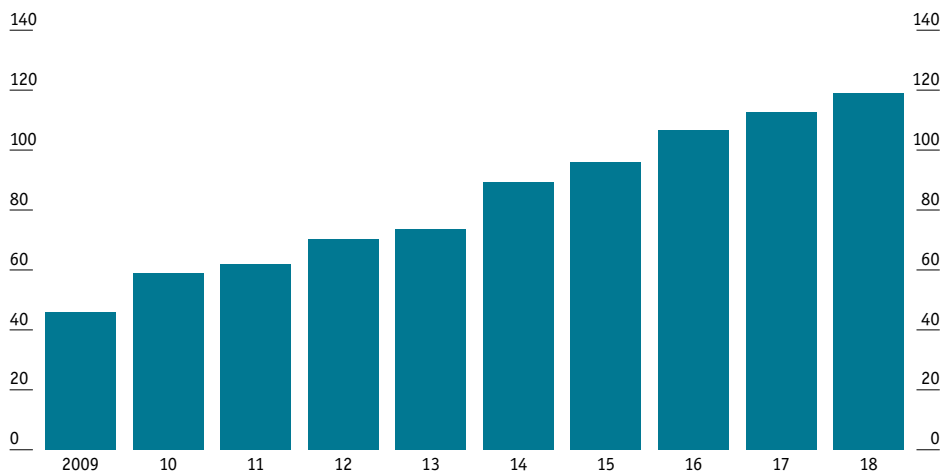
Automakers in the Philippines are still waiting for an industry development policy to help them plan ahead.

While Indonesia is forging ahead with its low-cost green car programme and Malaysia unveils its new national automotive programme, the Philippines' automotive industry still awaits a major policy framework for the sector. Already delayed by over two years, the "roadmap for the development of the Philippine automotive industry" will replace the decade-old Motor Vehicle Development Programme (MVDP). But given that the latter has largely failed in its aim of encouraging a rise in auto exports, will the roadmap do any better?

Under the MVDP, a 1% tariff applies to completely knocked-down (CKD) vehicles imported by MVDP-registered participants. CKDs of alternative-fuel vehicles enter duty-free, as well as all CKD cars from Japan and from the other ASEAN countries. The Philippines also extends zero duty treatment on importation of capital equipment, spare parts and accessories by motor vehicle manufacturers

Philippines: passenger car registrations

('000)



Source: The Economist Intelligence Unit.

registered with the Board of Investments, as well as prohibiting the importation of used motor vehicles.

The MVDP, however, has failed miserably to encourage local automotive production. In 2013 the Philippines produced only 52,000 vehicles, compared with 2.5m in Thailand, 1.2m in Indonesia and 600,000 in Malaysia. That is partly down to the smaller domestic market in the Philippines, with annual registrations around one-half those in Malaysia and one-quarter of those in Indonesia or Thailand. But the Philippines also produced fewer cars than Vietnam, which has a smaller market.

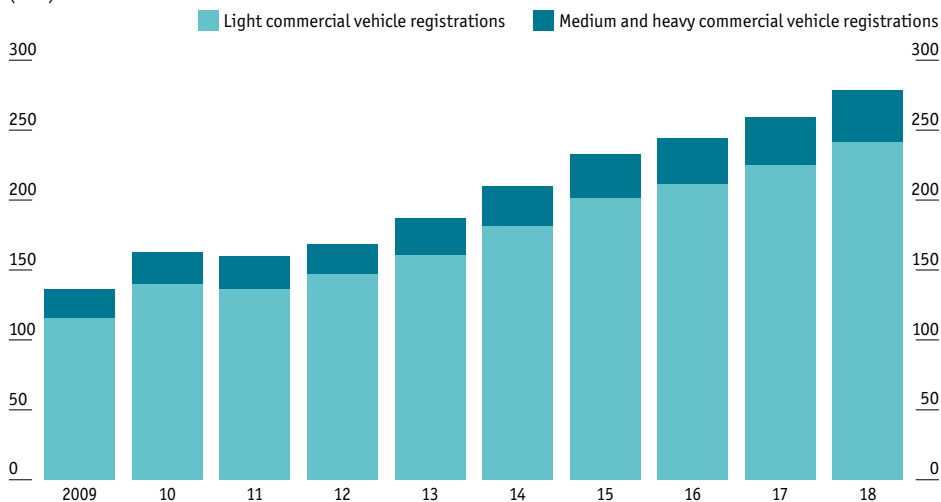
The Philippines market is also among the fastest-growing and local carmakers are not getting enough of that growth. Toyota Motor Philippines dominated the market, accounting for 41% of sales in 2013, followed by Mitsubishi Motors (24%), and Honda, Ford and Isuzu (on 7% each). Yet locally assembled vehicles have been losing market share to so-called completely built up (CBUs) automobiles imported from South Korea and other ASEAN countries, such as Thailand and Indonesia.

According to the Philippine Automotive Competitiveness Council (PACCI), two-thirds of new vehicles registered in 2013 were imports. The official figures are lower than that, but it is widely acknowledged that the government of the president, Benigno Aquino III, has had little success in curbing smuggling.

Cost factors

The squeeze on local production may be down to several factors. PACCI blames other countries' fiscal support for CBU imports, which are thus less costly to produce than locally-assembled cars. But the Philippines also suffers from an inadequate pool of makers of critical vehicle parts, which forces local assemblers to buy elsewhere.

Philippines: commercial vehicle registrations
('000)



Source: The Economist Intelligence Unit.

As a result, local components account for only 23% of the total manufacturing cost of a car made in the Philippines, compared with 67% of the local cost of a car manufactured in Thailand. The Philippines also imports 49% of the parts used in making each car from Thailand. Thai automakers, on the other hand, buy only 7% of a car's components from the Philippines.

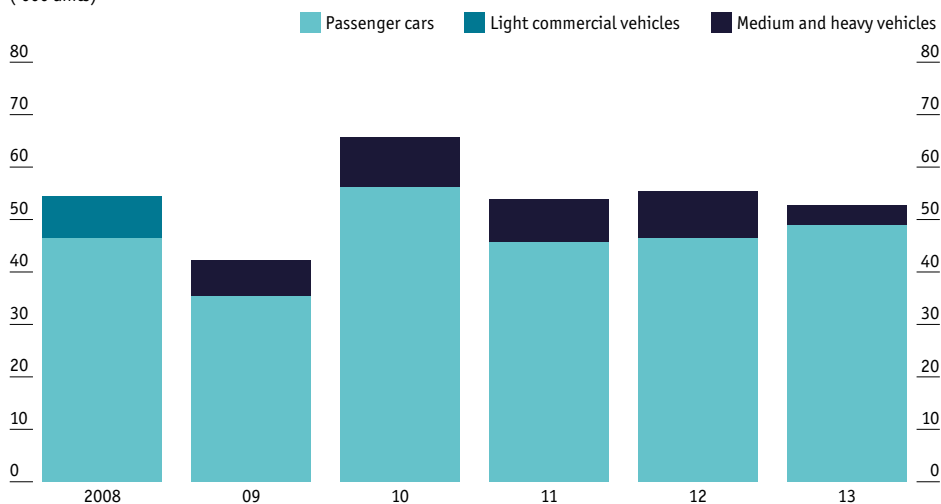
Demand is expected to grow stronger in the coming years, as incomes rise. The Philippines is, after all, the second most populous country in Southeast Asia, with a population of close to 100m. Although per capita income is low, at US\$2,300, there is a fast-expanding middle class, spawned by robust economic growth in recent years. Vehicle sales rose by 26% in the first seven months of 2014, according to the Chamber of Automotive Manufacturers of the Philippines, and are expected to maintain much of that momentum for the next few months.

Japanese automakers already producing cars in the Philippines are quick to see these opportunities. Toyota announced in January that it planned to invest around P500m (US\$11.4m) in 2014 to increase its output at its assembly plant in Santa Rosa, just south of Manila. The company will use the new investment to install two additional painting robots, expanding the plant's capacity to 40,000 units from 35,481 units in 2013. In addition, Toyota aims to increase the local content of the Vios, its best-selling passenger car in the Philippines, by using 15 local stamping parts for the first time.

Mitsubishi, meanwhile, has bought another Santa Rosa plant previously closed by Ford of the US, closing down its own smaller facility as part of a medium-term expansion plan in the Philippines. Suzuki recently opened a motorbike plant, while Nissan Motor Corp established a new marketing company in the Philippines to introduce new models, strengthen branding, marketing and sales.

A roadmap is not vital to attract further investment, therefore, but it might be

Philippines: vehicle production
('000 units)



Source: International Organisation of Motor Vehicle Manufacturers.

useful if the industry is to export as well as mop up local demand. According to the Department of Trade and Industry (DTI), the much awaited roadmap will address weaknesses such as the dearth of a local parts-maker and create the conditions to allow the Philippines to move from a CKD assembly hub to full automotive manufacturing.

This is likely to include fiscal support and more incentives for local assemblers and motor vehicle parts manufacturers to gear up for ASEAN expansion. Although details are still unclear, these seem likely to be limited to carmakers producing over 40,000 units a year, some of them destined for export. PACCI has also been lobbying for non-fiscal measures, such as increased curbs on smuggling of used imported vehicles, and clearing the roads of old, unsafe automobiles to expand the market. While the lobbying continues, however, the roadmap has still failed to appear.

Vietnam: Last chance?

A SEAN integration threatens Vietnam’s auto industry, which has never lived up to its early promise.

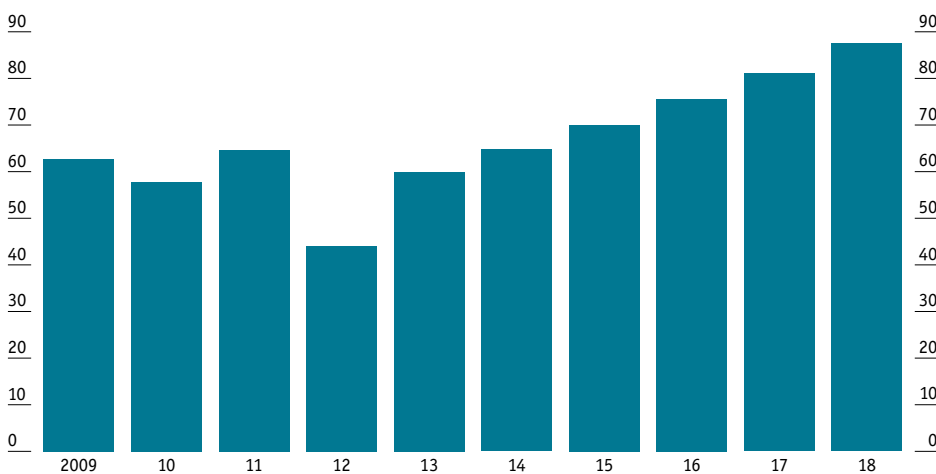
Having been slow in promoting domestic auto production, Vietnam is now playing catch-up ahead of the imminent tariff reductions mandated under the ASEAN Free Trade Agreement (AFTA). The question is whether it can salvage its auto industry before 2018, and whether it is even going about it the right way.

Vietnam is still sometimes styled as a “second China”, but its auto industry, at least, is a very long way from matching the achievements of its northern neighbour. In the first five months of the year, auto sales in Vietnam jumped by more than one-quarter, and the Vietnam Automobile Manufacturers’ Association (VAMA) envisions sales of 125,000 units for the year as a whole. But even accounting for Vietnam’s much smaller population, car sales in relative terms are still less than 10% of those in China.

Local production, meanwhile, is the lowest of Asia’s main vehicle-producing

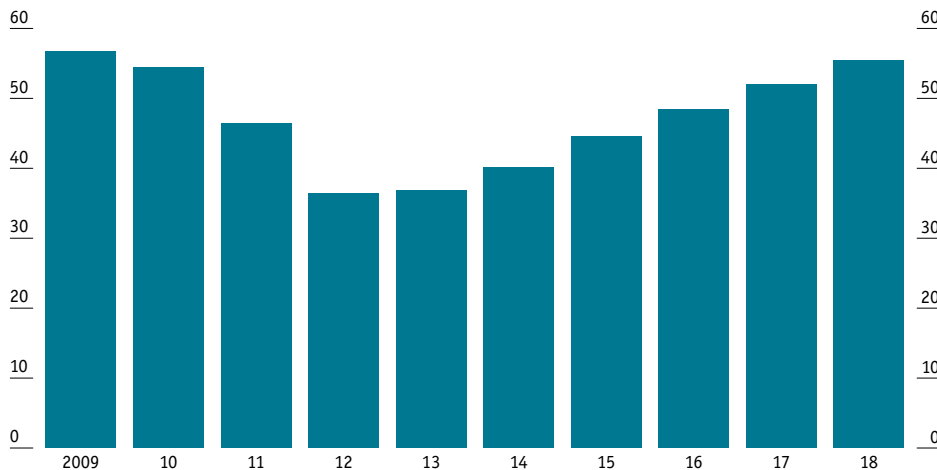
Vietnam: passenger car registrations

(’000)



Source: The Economist Intelligence Unit.

Vietnam: commercial vehicle registrations
(‘000)



Source: The Economist Intelligence Unit.

countries, at just 40,920 vehicles in 2013, according to the International Organisation of Motor Vehicle Manufacturers (OICA). Although the tally rose by 1% last year compared with 2012, Vietnam has still not made back the ground lost in 2011, when output plummeted along with sales.

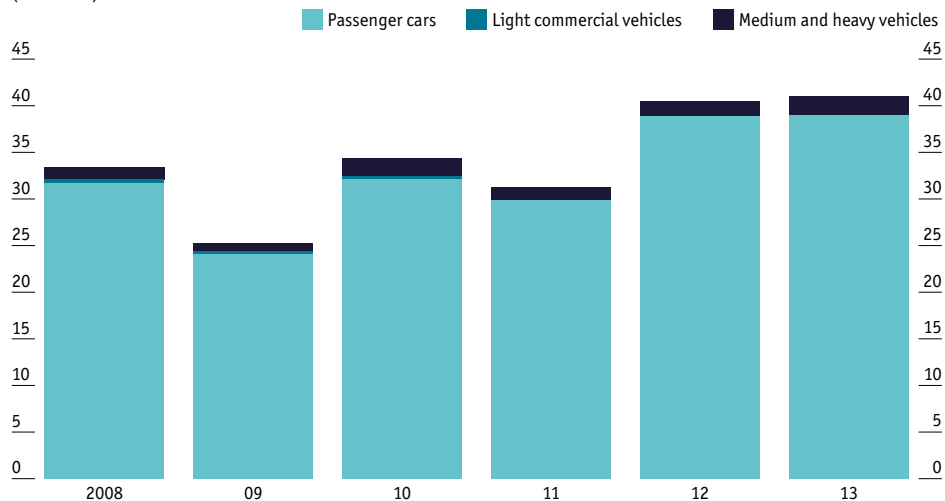
Early promise

This is a disappointment given that a decade ago Vietnam looked set to become a player in the regional auto industry, helped by the economic reforms in 1986. It was not only the fourth-largest automotive market in Southeast Asia, but it offered low labour costs that were very attractive to international automakers looking to build production bases in the region. Many vehicle-makers adopted a Thailand +1 policy that saw them build satellite plants in Vietnam.

Japanese automakers were especially interested in outsourcing production to Southeast Asian countries, in order to escape expensive domestic labour, as well as a persistently overvalued yen. Both domestic manufacturers and foreign companies entering Vietnam through sole proprietorship and joint ventures boosted production and assembly capacity to 100,000 units currently. This is capacity that is now severely underused.

Some of the blame lies with the desultory domestic market. In the seven years to 2011, Vietnam's automotive sales quadrupled, reaching 165,000 units. Then the effects of the global financial crisis of 2008-09 started to seep in, as did the imposition of import tariffs and a steep vehicle registration tax. Even last year, after a 20% year-on-year bounce, VAMA's 19 members reported sales of less than 97,000 vehicles. Toyota (Japan) has been consistently the largest seller, even though it was overtaken in May by Truong Hai Auto Corp., a local company which assembles motor vehicles from imported components.

Vietnam: vehicle production
(’000 units)



Source: International Organisation of Motor Vehicle Manufacturers.

While Vietnam lost its lustre, Thailand, and increasingly Indonesia, have been steadily growing their domestic markets and attracting investment from major global automakers. Both countries not only have annual domestic sales of over 1m units, but have become export hubs for parts, as well as fully assembled vehicles. Even Malaysia, while providing protection for its two domestic marques, is getting into the game.

Delayed reaction

Vietnam, with its very modest domestic sales, is further hampered by government policies. It lacks the free-trade zones (FTZs) that Thailand has used to lure automotive investment. And unlike in China, where the government developed a comprehensive policy to attract foreign investors into its auto industry through joint ventures and has stuck to it over the past two decades, the government in Hanoi has changed its mind repeatedly in terms of the overall direction of strategy.

It originally wanted Vietnam to win a regional niche as a producer of light lorries, tankers and other commercial vehicles. However, that policy became increasingly unviable as competition from players in China and India became tougher, offering lower labour costs via partnerships with market leaders such as Cummins and General Motors (USA), Daimler (Germany) and Volvo Trucks (Sweden). As a result, the Ministry of Industry and Trade in Vietnam decided several years ago to switch emphasis to larger passenger cars and sports utility vehicles (SUVs).

Since then, policy has focused partly on protectionism. Imported components are subject to a 20% tariff in order to protect local companies. Even so, the

components industry remains underdeveloped, and local content ranges from just 5% to 25% of locally assembled vehicles.

The government also provides protection to local assemblers in the form of a 60% import tariff on fully assembled vehicles. This limits imports, but the cost advantages abroad are such that around 40,000 vehicles are still imported annually, mainly from South Korea and China, despite being subject to stiff tariffs. Vehicles made in Thailand are becoming even cheaper, with so many automakers investing into new facilities there to achieve economies of scale.

Moreover, under the terms of AFTA, Vietnam's tariffs on all finished vehicles will have to be gradually eliminated by 2018. The government is therefore planning to cut consumption taxes and registration fees sharply by early 2015, in order to boost domestic sales. At the same time, it hopes to increase the domestic output of assembled vehicles by eliminating tariffs on imported components. Even so, the final decline of Vietnam's automotive industry may well occur before then, since the prospect of zero tariffs is already impacting investment decisions by major automakers.

While the departure of large producers may not in itself be a huge blow, their small and medium parts suppliers, most of them low-tech and labour-intensive, create tens of thousands of jobs. Given the intense competition within the AFTA region, they would inevitably go out of business once the major producers leave. To avoid that, the government needs to decide on its focus, and direct policy towards promoting those parts of the industry that will remain viable in a post-tariff era.

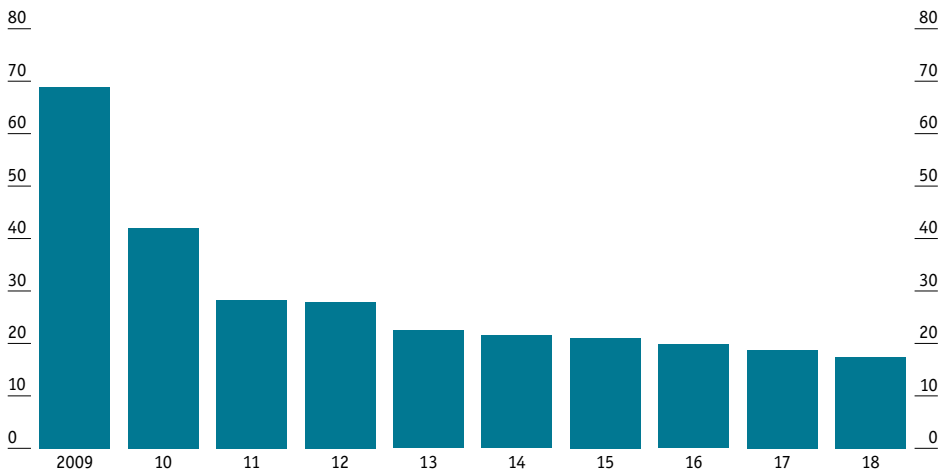
Singapore: Office space?

Singapore cannot compete on auto production, but it is well-placed as an ASEAN headquarters.

Although Singapore has no car manufacturing, it serves as a good springboard for what is likely to be the next group of emerging car markets in Southeast Asia, namely Indonesia, Thailand and Malaysia. As the region’s richest market, it offers a secure business environment and a fast-growing economy. Business executives are happy to be based there, as they oversee the development of ASEAN markets.

Late last year, for example, General Motors (GM) announced that it was shifting the bulk of its non-Chinese international operations from the Chinese city of Shanghai to Singapore. The US carmaker first established its Asia-Pacific headquarters in Singapore back in 1993, only to move to Shanghai 11 years later, when the Chinese car market took off. Now it is back, with a new office that will employ 120 staff working across sales and marketing, product planning and communications not just for ASEAN markets but also for Africa, India, South Korea

Singapore: passenger car registrations
(’000)



Source: The Economist Intelligence Unit.

and the Middle East. Staff will also manage Chevrolet’s European operations, as well as GM’s luxury Cadillac brand.

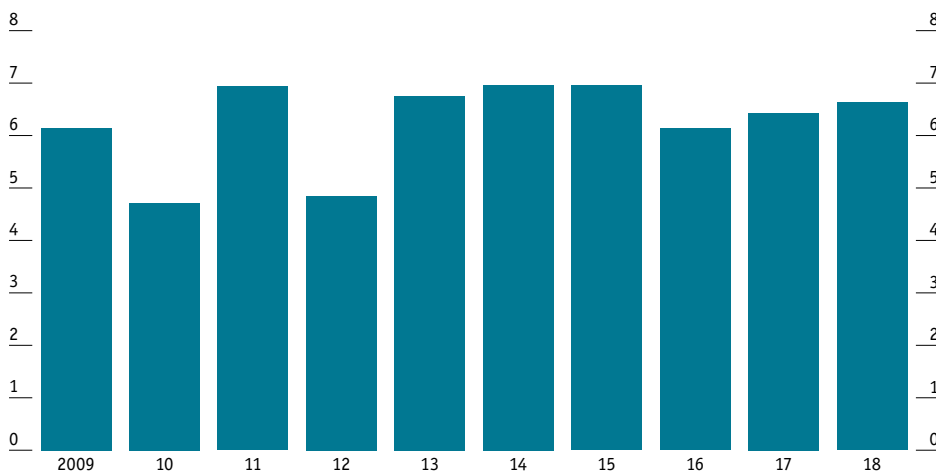
Singapore’s automotive parts and accessories industry is also growing, with particularly the manufacture and design of high-technology automotive components. These include ignition control modules and pressure sensors for original equipment manufacturers, as well as replacement parts. Japanese companies in particular often manufacture parts in Singapore for import to Japan.

As for the local market, it is supplied solely by imports. It is, however, one of the most depressed auto markets in the world. According to the Land Transport Authority (LTA), new-car registrations plunged by 19.5% in 2013, to 22,472 units. This was the sixth consecutive year of decline, and means that new-car registrations are now at less than one-fifth of their peak in 2006, when they reached 117,100. This largely reflects the government’s decision to halve allowable growth in Singapore’s car fleet to 1.5% (effective from 2009).

The government controls demand via Certificates of Entitlement, which have to be renewed every ten years, as well as other fees and levies, including an Additional Registration Fee (ARF). The government has also tightened up on car loans in an effort to subdue the market. A road-pricing scheme, meanwhile, is designed to reduce car usage. As a result, owning a car is extremely expensive. Perhaps surprisingly, however, buyers have responded to the difficulties in buying a car by opting for luxury models. Daimler, maker of Mercedes cars, is the market leader, with its German rival BMW in second place.

There are also some rare opportunities for electric vehicles here, with low emission cars qualifying for a large rebate on the ARF. In August, this prompted BMW to team up with Greenlots, a US charging company, to develop a Singapore charging network. The venture should support the rollout of BMW’s ground-breaking i-series of electric cars, as they enter the ASEAN market for the first time.

Singapore: commercial vehicle registrations
(’000)



Source: The Economist Intelligence Unit.

Brunei: No rich pickings

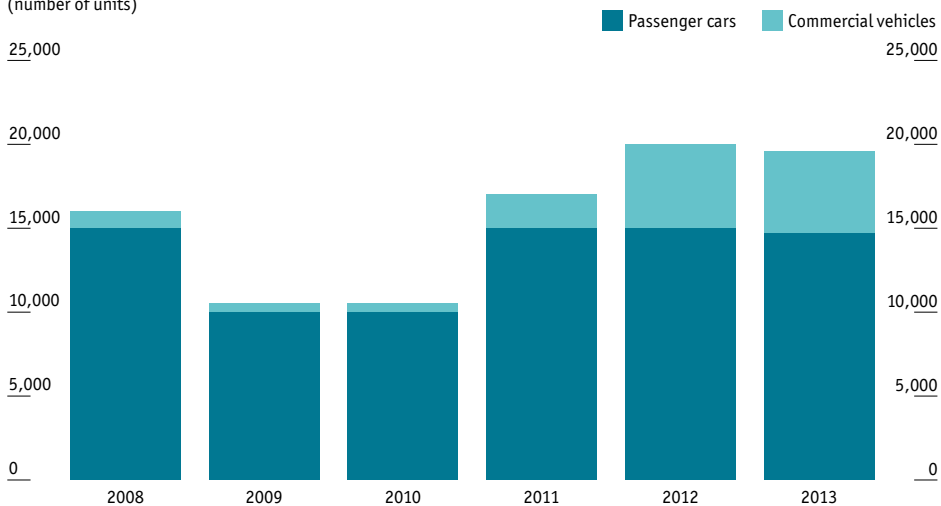
Brunei is extremely wealthy, but its small market is unlikely to get much bigger.

The Sultanate of Brunei, along with Singapore, stands out in the ASEAN grouping as a rich cousin among poor nations. In fact, it is one of the richest countries in the world: its per capita GDP on a purchasing power parity basis stood at US\$71,210 in 2013, similar to that of the United Arab Emirates.

Unlike Switzerland, however, Brunei is small, with a population of less than 430,000, and it is entirely dependent on oil and gas, which provides nearly two-thirds of its GDP and 90% of exports. Despite oil wealth, the auto market is tiny. In 2012 car sales recovered from a financial crisis-related dip after 2008 and returned to levels last seen six years ago. In 2013 auto sales reached 18,642 units, marginally higher year on year.

Contrary to stereotypes, the rich subjects of the Sultan of Brunei are not all driving Rolls Royce cars. Solidly middle class Toyota is a perennial leader in sales,

Brunei: vehicle registrations
(number of units)



Source: OICA (International Organisation of Motor Vehicle Manufacturers).

with just over 4,000 units sold last year, of which only 5% were upmarket Lexus vehicles. The rest of the market is divided up by other economic producers from Asia, namely Kia, Suzuki and Hyundai. The upmarket segment, including German premium marques, constitutes less than 10% of total sales. Moreover, sales of new luxury vehicles were hurt last year by a plethora of second-hand vehicles on the market. Finally, Malaysia's two brands, Proton and Perodua, sold less than 650 vehicles between them, even though ethnic Malay constitute a majority of Brunei's population.

A downturn in the oil and gas business has been responsible for a contraction of GDP in recent quarters. It is unlikely that output and prices will rebound in the near term, and the government has developed plans to diversify the economy away from the resource sector. With a substantial budget surplus, measuring some 20% of GDP, it has plenty of funds to finance infrastructure projects, such as the Sungai Kebu bridge in the capital, which will cost US\$115m. Building more roads could spur auto sales in future years, and the start of the ASEAN common market in 2015 could gradually reduce the price of imported autos by eliminating automatic import licensing. Vehicles manufactured and assembled in other ASEAN countries, such as Thailand and Indonesia, will be favourably impacted, as will direct imports from Japan, South Korea and China, which have free trade agreements with the bloc.

On the other hand, spurring economic growth, a recent IMF report asserts, would require structural reforms, which include reducing and even eliminating fuel subsidies. This could negate the positive impact of free trade across ASEAN and keep automotive sales in check—at least until economic growth picks up again.

Cambodia: High hopes

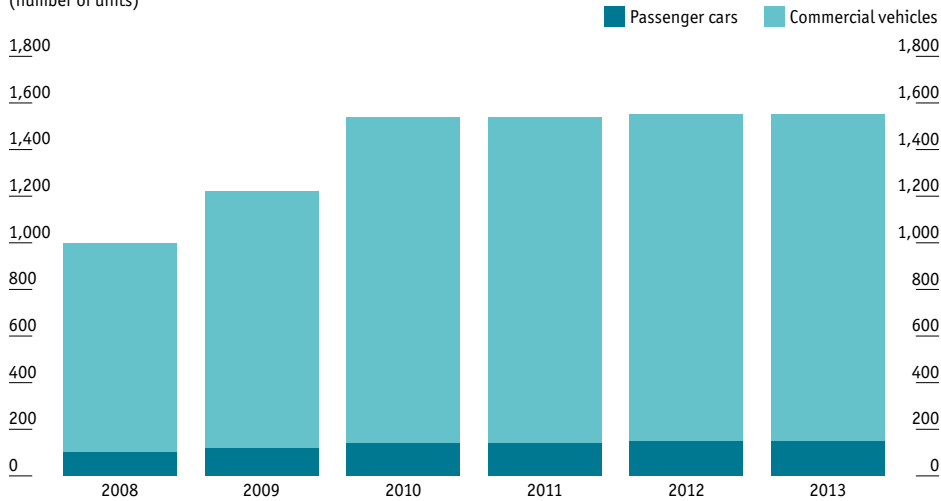
Cambodia has managed to attract a few auto investments, but wants many more.

The Cambodian automotive market remains extremely small. Annual sales measure around 20,000 vehicles, with new cars representing just 10% of this number. The country's 15m people are poor and young, as it still bears the scars of the murderous Khmer Rouge rule in the mid-1970s. More than one-half of the population is under 25 years of age, and more than 20% live in poverty. At the same time, income inequality is massive, leaving room for a small elite. Reflecting these trends, Rolls Royce opened a showroom in Phnom Penh, the capital, earlier this year.

Still, for all the enduring economic and political problems, growth has been robust, even by the standards of the fast-growing Southeast Asia region, measuring over 7% a year in 2011-13. Per capita GDP has been climbing, albeit slowly, and has reached US\$2,700. Growth is being spurred by investment, especially from China, which last year accounted for nearly one-quarter of all foreign direct investment (FDI) into the Cambodian economy. Cambodia is also benefiting from the strength of the economic recovery in the US, which takes one-third of its exports, mainly commodities, textiles and garments.

The government expects the flow of FDI to pick up after the ASEAN Economic Community is inaugurated in 2015. The nascent auto industry could benefit. So far, there have been few investments into automotive production, but a handful of international and domestic companies have set up shop. For example, Hyundai has been assembling vehicles locally for over two years. It expects annual production to reach 800 units. Two years ago, a UK-based auto engineering company, BIW, concluded a more ambitious agreement with ACICA Automotive to build a factory to produce a low-cost vehicle for the local market, as well as for other low-income ASEAN countries. Total investment in the project was set at US\$2bn.

Cambodia: vehicle registrations
(number of units)



Source: OICA (International Organisation of Motor Vehicle Manufacturers).

Finally, earlier this year, Heng Company, a Cambodian design firm, introduced the first Cambodian car, EV-2014, a small all-electric vehicle capable of going 40 miles per hour and priced at less than US\$10,000. These may all be small-scale projects, but the government sees them as the start of something bigger. It has high hopes of enticing luring international automakers from neighbouring Thailand, where production costs are rising, and from Vietnam, where they suffer from logistical and political problems. Building a sizeable auto market in Cambodia will, however, take many years of work.

Laos: One for the long term

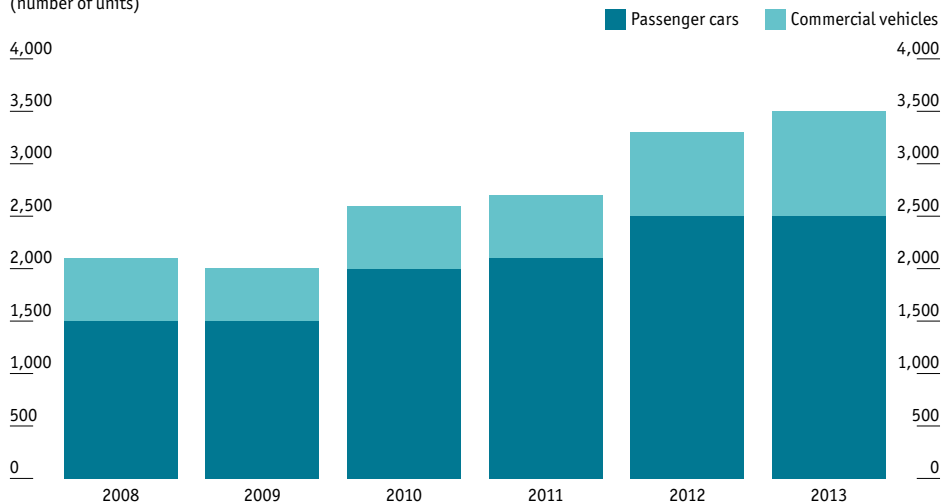
Auto sales are tiny and locals poor, yet Laos offers one of the world's fastest-growing economies.

Laos remains on the list of the United Nations Development Programme's least-developed countries, but its economic growth over the past quarter of a century has been nothing short of spectacular. Growth is still coming from a low base, but in 2013 it measured 8.3%, one of the fastest rates in the world. Per capita GDP increased to US\$3,100 last year.

In 2013, Laos became the last member of ASEAN to join the World Trade Organisation, a process that has already triggered a number of much needed economic reforms and will open up new opportunities for the export sector. Exports are still dominated by agricultural and mining commodities. Thailand, China and Vietnam account for two-thirds of all exports.

A poor, landlocked country with a small population of under 7m, Laos is unlikely to become a major market for global automakers any time soon. Although new

Laos: vehicle registrations
(number of units)



Source: OICA (International Organisation of Motor Vehicle Manufacturers).

car sales are projected to increase fourfold over the next decade, in 2013 they were estimated at less than 3,500. The market is dominated by South Korea's Hyundai and Kia, with Toyota, the leader in most other Southeast Asian markets, only a distant third. Nine out of ten cars sold in Laos last year, moreover, were used vehicles, most of them Japanese and very old.

A few other carmakers are moving in, however, hoping to get in on the ground floor. Nissan and Mazda see Laos and other markets in Indochina as their natural preserves, while Ford and General Motors (GM) have also entered the market. GM opened its largest dealership in the region in Vientiane, the capital, in April 2013. The dealership is a joint venture with Maignom Auto Group, a local player, and the partners invested some US\$40m in the project.

Next year's inauguration of the ASEAN Economic Community is likely to provide yet another spur to economic growth in Laos, at least over the medium term. However, in order to stimulate automotive sales, the government will not only need to boost personal incomes, but to embark on major road construction and infrastructure projects. That is a work in progress.

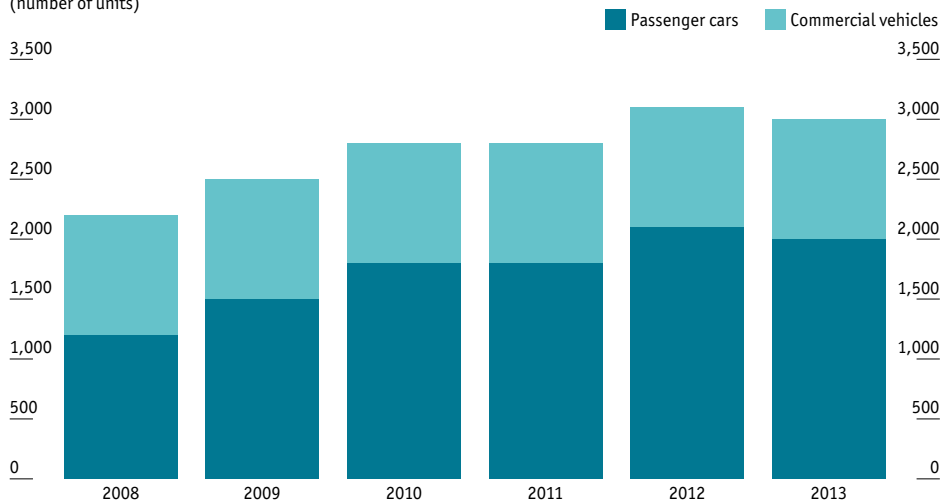
Myanmar: Opening up

As Myanmar emerges from political isolation, investor interest is rising.

In a country of some 60m people, Myanmar had fewer than 300,000 passenger cars on the road at the start of 2013, almost all of them used and many several decades old. Not only is this the poorest member of ASEAN, with per capita GDP of US\$1,700 and annual incomes averaging around US\$250, it had been in self-imposed political isolation and under international economic sanctions until the government began gradual liberalisation in 2010.

Since sanctions were lifted, a steady flow of foreign investment followed, targeting the local food-processing industry and the energy sector, as well as export-oriented garment and high-tech industries. A small but vibrant middle class started to emerge. In 2013 some 100,000 used cars were sold, boosting the number of vehicles on the road by one-third. Last October, the ban on importing

Myanmar: vehicle registrations
(number of units)



Source: OICA (International Organisation of Motor Vehicle Manufacturers).

new cars, originally imposed in order to reduce the outflow of foreign exchange, was lifted on a limited basis.

So far, new car sales have been extremely modest. The total number sold by end-2014 is unlikely to exceed 25,000. The motorcycle remains a favourite mode of transportation, with more than 2m two-wheelers plying rural roads outside Yangon, the former capital and the country's largest city.

Nevertheless, major car makers are starting to move into the market. Japanese producers, who traditionally dominate markets in Southeast Asia, are in the forefront, and lower-end producers, such as Mazda and Suzuki, are setting up dealership and customer service outlets in Yangon. Chinese manufacturers BAIC and Dongfeng also see Myanmar as an opportunity to compete on equal footing with more established brands. Finally, Tata and other Indian carmakers may have a leg up in Myanmar, both because they offer cheaper cars and because they have a historic link with Myanmar.

The impending arrival of the ASEAN free market will eventually reduce tariffs on automotive imports, and may encourage some automakers and parts producers to set up local assembly operations. Economic integration with ASEAN partners is also likely to speed up the emergence of an indigenous middle class that is conscious of status.

Not surprisingly, Daimler, the maker of Mercedes-Benz, became one of the first automakers earlier this year to set up a dealership. Look below the top of the market, however, and price reductions as a result of freer trade are unlikely to make much difference to demand. A new car, even a cheaper one selling for less than US\$10,000, will not be within the reach of ordinary people in Myanmar for years to come.

ASEAN attractions: an EIU ranking

Which of the ASEAN countries is best-placed to attract automotive investment?

Thailand is currently by far the biggest vehicle producer in the ASEAN region, as well as the biggest exporter, but will it retain its position over the next few years as the market opens up? The introduction of the ASEAN Economic Community (AEC) is likely to result in even more competition between Thailand and Indonesia in their quest to become the region's main car manufacturing hub.

Indonesia has the benefit of being a high-growth market, with a large pool of low-cost labour that is already starting to attract investment from companies such as General Motors (US). Other countries will also jostle for position. Malaysia has made overtures to China as it seeks to shore up the position of its two indigenous carmakers. Vietnam is trying to improve its business environment, while the Philippines is (slowly) drafting an auto development policy.

To assess which of these countries is most likely to attract automotive investment over the next few years, we used Economist Intelligence Unit forecasts to draw up rankings for the five major automotive producers in the region. The rankings use data and forecasts to assess their attractions in four key areas:

- Current position, as demonstrated by vehicle market size and production levels.
- Growth potential, which covers our forecasts for household incomes and vehicle registration growth, combined with data on current car stocks (to allow for pent-up demand).
- The business environment, drawing on the EIU's business environment rankings, risk ratings and our assessment of the government's attitude to foreign investment.
- Competitiveness, using our forecasts for unit labour costs, exchange rates, and our rating for the availability of skilled labour.

A fuller discussion of the criteria and the data used is available on page 42.

Thailand scores highly on the first of these four criteria, as might be expected from its current position as the “Detroit of the East”. But the rankings show that carmakers are right to be looking at Indonesia, which leads in terms of growth potential and competitiveness. The Philippines also offers attractions, particularly in terms of its market potential and low labour costs. Malaysia has the soundest business environment, but loses out in terms of market potential and competitiveness, while Vietnam is simply too small a market to justify much investment.

Overall, Indonesia scores highest on most of these criteria. Any shift in production is unlikely to be rapid, however, with Thailand still best-placed to benefit from the market opening in the short term. The amount of investment

Current position	Growth potential	Business environment	Competitiveness	Overall
Thailand	Indonesia	Malaysia	Indonesia	Indonesia
Indonesia	Philippines	Thailand	Vietnam	Thailand
Malaysia	Vietnam	Philippines	Thailand	Philippines
Philippines	Thailand	Indonesia	Philippines	Malaysia
Vietnam	Malaysia	Vietnam	Malaysia	Vietnam

and management energy already sunk into the country will weigh in its favour, given the costs of uprooting supply networks. Many vehicle-makers have already adopted a “Thailand+1” policy, which means they will serve the market by means of a mother plant in Thailand and one additional plant in Cambodia, Laos, Vietnam or Myanmar. In the automobile industry this has, to date, meant producing in Vietnam, the richest of these four countries, where around 100,000 units were produced in 2013 (equal to 2% of total production in ASEAN). With its market growing rapidly, Vietnam may continue to attract small-scale production projects.

Over the wider region, however, the economic advantages of basing production within Indonesia’s fast-growing market will lure some vehicle-makers away from Thailand. How swiftly they make the necessary investments depends partly on political progress in making the AEC a reality and partly on supply chains within individual companies, in particular the Japanese producers that dominate both Indonesia and Thailand. Countries may also be able to find market niches where they can be competitive. Indonesia’s Low-cost Green Car Programme, for example, is intended to position the country as a base for low-emission vehicles, although Malaysia and Thailand also have their eyes on that specialism.

There is also an opportunity to carve out a niche when it comes to automotive components, and this is an area where the smaller countries, such as Vietnam, the Philippines, or even Cambodia can compete. Japanese producers, for example, have spent years building up their investment in production networks across the ASEAN region, which allows them to take advantage of each country’s relative

strength in producing parts for use at different stages in the assembly line. Thailand, for example, is primarily used as a base for production of diesel engines, stamping parts, plastic/resin parts, steering columns and finished vehicles, while Indonesia is used to produce transmissions and ball joints, and Malaysia rolls out engine computers and steering links.

The lowering of trade barriers (both formal and informal) within the AEC will make it easier for such components to be exported and imported as needed, but will also lead to greater competition that could threaten existing producers. The same is true in vehicle manufacturing, with imports already rising rapidly in several markets in the region. Malaysia would seem to be particularly vulnerable here, with the rising production in Indonesia likely to lead to even fiercer competition for Malaysia's indigenous carmakers, Proton and Perodua. Even the latter's Japanese ownership may not protect it for long from the market forces that are emerging as the ASEAN region moves towards economic integration.

How we calculated the rankings

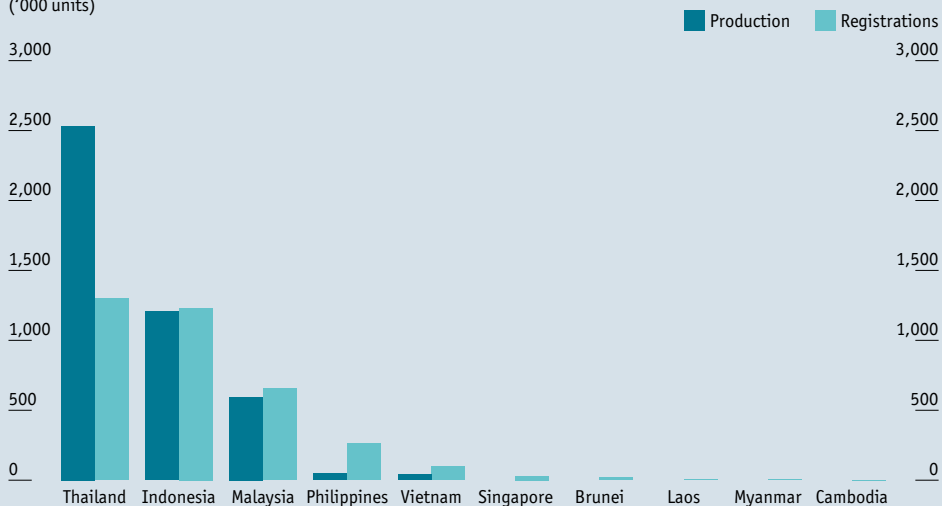
The Economist Intelligence Unit ranked the five major vehicle producing countries in the ASEAN region using data and forecasts from our Market Indicators and Forecasts service, grouped under four headings:

Current position

- Series used: car and commercial vehicle registrations and production in 2013.
- Sources: local automotive associations, national data.

Despite the setbacks caused by 2011's flooding and the more recent political turmoil, Thailand was by far the biggest producer and exporter in 2013, and inertia means it may prove hard to dislodge. The costs of uprooting production and supply chains may well outweigh the benefits in the short term. In the long term, vehicle-makers will want to locate production near the biggest markets. In 2013, that was Thailand, but Indonesia is almost certain to overtake it this year.

Vehicle production and registrations, 2013
('000 units)

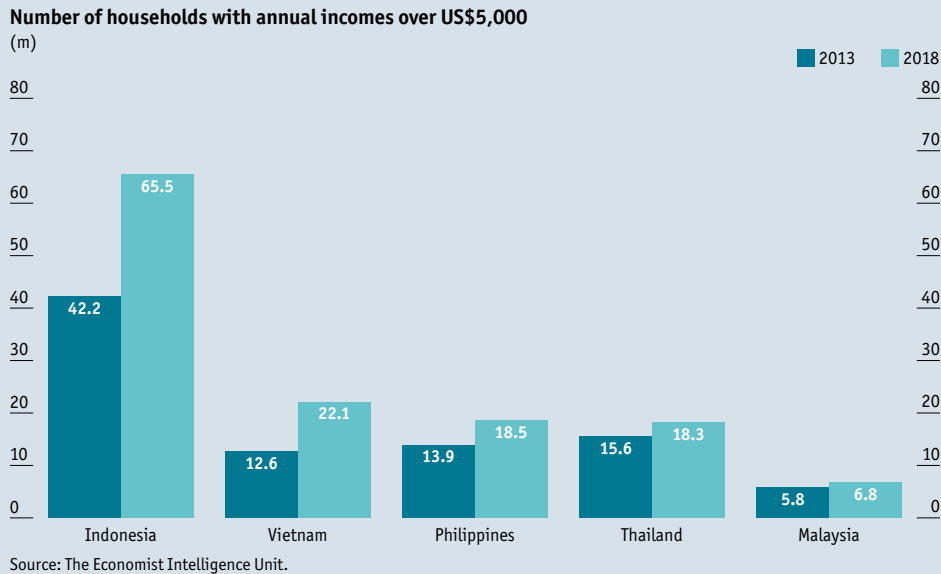


Source: National statistics, International Organisation of Motor Vehicle Manufacturers (OICA).

Growth potential

- Series used: Number of households with income over US\$5,000 in 2018, vehicle registration growth 2014-18, car stock per 1,000 people in 2013.
- Sources: The Economist Intelligence Unit forecasts, World Bank Development Indicators.

Indonesia is far from the wealthiest country in the ASEAN region, but its economy and car market are growing rapidly. It is also the most populous country, with 250m people compared with Thailand's 67m. As a result, we expect the number of households with annual income over US\$5,000 (enough to contemplate car ownership) to expand rapidly to around 65m in 2018. Combine this with Indonesia's current low car stocks, and that leaves room for a huge surge in demand. Indeed, the government's task is to manage that demand carefully, in order to extract the maximum economic benefit while minimising the resulting pollution and congestion.



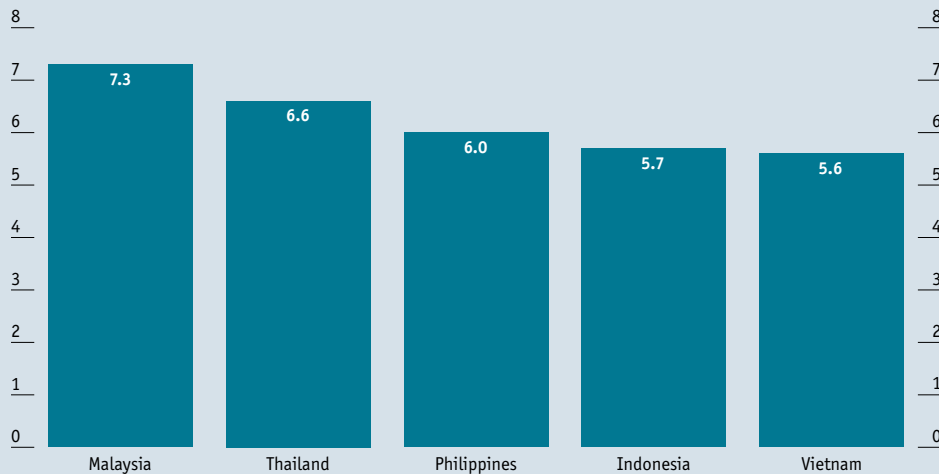
Business environment

- Series used: EIU business environment rankings, EIU risk rating, EIU rating for government policy towards foreign investment, all 2013.

- Source: The Economist Intelligence Unit.

Malaysia, as the wealthiest country out of the five compared, offers the best business environment. Its infrastructure is more developed, as are its financial markets. There is also a fair degree of political stability, a distinct advantage over Thailand, where May saw another military coup. For that reason, Malaysia also has the lowest risk rating. When it comes to attitudes to foreign investors, however, Malaysia's history of protectionism means that it does lose out to Vietnam, where the government has made positive efforts to attract foreign direct investment.

EIU business environment ranking, 2013
(score out of 10)



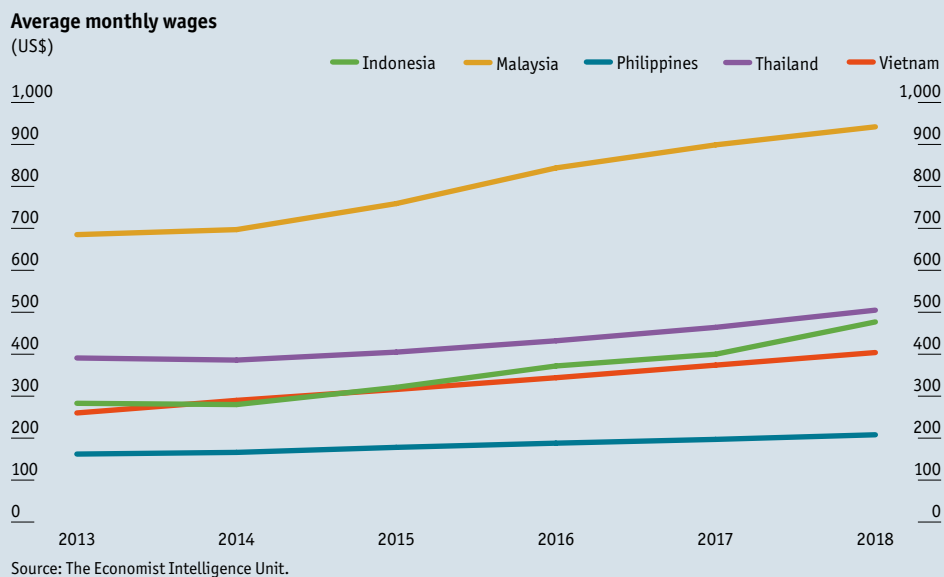
Source: The Economist Intelligence Unit.

Competitiveness

- Series used: Exchange rates, average monthly wages, EIU rating for availability of skilled labour, all 2014-18 forecasts.

- Source: The Economist Intelligence Unit.

The main problems facing Thailand’s automotive industry are rising wages and a shortage of skilled labour. That caused tensions in June, when the military junta launched a crackdown on illegal labour, only to backtrack as thousands of foreign workers left. The arrival of the AEC should help to alleviate some of these constraints, by facilitating the free flow of skilled labour. The AEC blueprint outlines measures, including the recognition of qualifications, the removal of bureaucratic hurdles for visas and employment passes, and increased co-operation among universities. Even so, Indonesia offers a more plentiful labour supply than Thailand, while the Philippines offers the lowest labour costs. Malaysia, meanwhile, has seen wages rise rapidly and may also suffer from a rising currency over the next five years, which will make its exports less competitive.



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LONDON

20 Cabot Square
London
E14 4QW
United Kingdom
Tel: (44.20) 7576 8000
Fax: (44.20) 7576 8500
E-mail: london@eiu.com

NEW YORK

750 Third Avenue
5th Floor
New York, NY 10017
United States
Tel: (1.212) 554 0600
Fax: (1.212) 586 1181/2
E-mail: newyork@eiu.com

HONG KONG

6001, Central Plaza
18 Harbour Road
Wanchai
Hong Kong
Tel: (852) 2585 3888
Fax: (852) 2802 7638
E-mail: hongkong@eiu.com

GENEVA

Rue de l'Athénée 32
1206 Geneva
Switzerland
Tel: (41) 22 566 2470
Fax: (41) 22 346 93 47
E-mail: geneva@eiu.com