Q1 2012

www.businessmonitor.com

VIETNAM

AUTOS REPORT

INCLUDES BMI'S FORECASTS

ISSN 1749-0286

Published by Business Monitor International Ltd.

VIETNAM AUTOS REPORT Q1 2012

INCLUDING 5-YEAR FORECASTS TO 2016

Part of BMI's Industry Report & Forecasts Series

Published by: **Business Monitor International**

Copy deadline: October 2011

Business Monitor International
85 Queen Victoria Street
London, EC4V 4AB
UK
Tel: +44 (0) 20 7248 0468
Fax: +44 (0) 20 7248 0467
Email: subs@businessmonitor.com
Web: http://www.businessmonitor.com

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Executive Summary

New vehicle sales in Vietnam have risen by 2% year on year (y-o-y) over the first eight months of 2011 to reach 70,650 units, according to data from the Vietnam Automobile Manufacturers Association (VAMA). This figure includes both domestically produced vehicles plus those imported into the country by VAMA members. On the import side, the number of completely built units (CBUs) imported into the country over the Jan-Aug period rose by 30% y-o-y to reach 42,000, according to a September 2011 report on the AutomotiveWorld website. The value of imported cars increased by 32% y-o-y to US$782mn. This comes despite efforts by the government to curb imports in favour of developing the domestic industry.

Looking at the monthly data, new vehicles sales reached 9,518 units in August 2011, up 9.8% y-o-y, compared with 8,671 units in August 2010, according to the VAMA. During the same month, passenger car sales increased by 54% y-o-y to 4,201 units, which helped to overturn a negative month-on-month (m-o-m) trend from the past several months. Commercial vehicle sales were down 24% y-o-y to 3,164 units in August.

There has been something of a slowdown in the monthly growth rate in sales figures for the entire new vehicle sector. As of May 2011, new vehicle sales were up by 11% y-o-y. By August, they slowed to 2% y-o-y. Against this backdrop, **BMI** is happy to maintain its 2011 new vehicle sales forecast of 118,824 units for now, but we caution that there may be slight downside risks to this forecast should the downward trend in m-o-m sales resume.

The country is still dogged by high inflation, with the CPI at 18% as of September 2011, and a weak currency, which may act as a demand suppressant over the rest of the year. Moreover, the car industry remains heavily taxed, with taxes reportedly accounting for some 60% of the value of a new car in Vietnam at present. One glimmer of hope for the autos industry was a report in the Vietnam Investment Review magazine during August 2011 that the Ministry of Finance is considering plans to revise the special consumption tax levied on vehicles, a move which may see certain types of vehicles exempted from taxation in the future. No concrete proposals had been tabled as this report was being compiled in October 2011.

Among local producers, the leading domestic automaker remains **Truong Hai Auto Joint Stock Co** (Thaco), which sold 2,677 cars in September. The company has sold a total of 23,413 cars over the Jan-Sep 2011 period, with a market share of almost 29% of new vehicle sales year-to-date. In second place is **Toyota Vietnam**, which has sold 22,106 vehicles year-to-date, with a market share of 27.4%

In May 2011, the Vietnam Today website reported that the head of Thaco, Tran Ba Duong, stated that constant changes to domestic tax policy continue to cause problems for local automakers. As part of discussions with Deputy Prime Minister Hoang Trung Hai, Tran called for consistency in tax levels, which would allow carmakers to invest for the future and prepare for the onset of competition following the slashing of import tariffs to zero by 2018. Tran also called for further government support to help develop the burgeoning local spare parts industry.

For his part, Deputy PM Hoang praised Thaco’s recent work and also said that the government would be looking favourably on Quang Nam province’s proposal to develop a new autos manufacturing centre within the Chu Lai open economic zone.

Name change for Vidamco

In September 2011, **General Motors Company** (GM) announced that it would be changing the name of its Vietnamese operation from **Vidamco** to **GM Vietnam**. At the same time, the company announced that it would now be selling all of its cars under the **Chevrolet** brand, with production and sales of **Daewoo** branded cars to stop immediately. The company will continue to provide after-sales care and spare parts for owners of Daewoo cars.

GM Vietnam plans to launch three new Chevrolet models in Vietnam before the end of the year and to upgrade its dealer network and service centres. According to the company, Chevrolet sales were up by 40% over the first eight months of the year.

As of September 2011, GM Vietnam had sold 7,353 CBUs year-to-date with a market share of 9.1%. This puts the company in third place in the Vietnamese market, behind Thaco and Toyota Vietnam. The company’s best-selling model is currently the compact Cruze, which has sold 2,009 CBUs in the year to September 2011.

SWOT Analysis

Vietnam Autos Industry SWOT	
Strengths	▪ Low rate of vehicle ownership provides more opportunity for sales growth. ▪ Low labour costs.
Weaknesses	▪ Fluctuations in import tariffs on completely built units (CBUs) bring instability to the market. ▪ Increased special consumption tax (SCT) on locally produced vehicles puts pressure on domestic manufacturers.
Opportunities	▪ Ford Motor's largest ever contract in the country will boost the local production and parts industry. ▪ The market shows diversity, with growth in both the premium and small car segments.
Threats	▪ A return to higher import tariffs has started to reduce sales growth after an initial surge prior to the new rates. ▪ Despite government efforts to develop the component sector, growth may still be hindered by a lack of enough domestic CBU production to absorb output.

Vietnam Political SWOT	
Strengths	▪ The Communist Party of Vietnam remains committed to market-oriented reforms and we do not expect major shifts in policy over the next five years. The one-party system is generally conducive to short-term political stability. ▪ Relations with the US have witnessed a marked improvement, and Washington sees Hanoi as a potential geopolitical ally in South East Asia.
Weaknesses	▪ Corruption among government officials poses a major threat to the legitimacy of the ruling Communist Party. ▪ There is increasing (albeit still limited) public dissatisfaction with the leadership's tight control over political dissent.
Opportunities	▪ The government recognises the threat that corruption poses to its legitimacy, and has acted to clamp down on graft among party officials. ▪ Vietnam has allowed legislators to become more vocal in criticising government policies. This is opening up opportunities for more checks and balances within the one-party system.
Threats	▪ Macroeconomic instabilities in 2010 and 2011 are likely to weigh on public acceptance of the one-party system, and street demonstrations to protest economic conditions could develop into a full-on challenge of undemocratic rule. ▪ Although strong domestic control will ensure little change to Vietnam's political scene in the next few years, over the longer term, the one-party state will probably be unsustainable. ▪ Relations with China have deteriorated over recent years due to Beijing's more assertive stance over disputed islands in the South China Sea and domestic criticism of a large Chinese investment into a bauxite mining project in the central highlands which could potentially cause large-scale environmental damage.

Vietnam Economic SWOT	
Strengths	▪ Vietnam has been one of the fastest-growing economies in Asia in recent years, with GDP growth averaging 7.2% annually between 2000 and 2010. ▪ The economic boom has lifted many Vietnamese out of poverty, with the official poverty rate in the country falling from 58% in 1993 to 20% in 2004.
Weaknesses	▪ Vietnam still suffers from substantial trade, current account and fiscal deficits, leaving the economy vulnerable to global economic uncertainties. The fiscal deficit is dominated by substantial spending on social subsidies that could be difficult to withdraw. ▪ The heavily managed and weak currency, the dong, reduces incentives to improve the quality of exports, and also serves to keep import costs high, thus contributing to inflationary pressures.
Opportunities	▪ WTO membership has given Vietnam access to both foreign markets and capital, while making Vietnamese enterprises stronger through increased competition. ▪ In spite of current macroeconomic woes, the government will continue to move forward with market reforms, including privatisation of state-owned enterprises and liberalisation of the banking sector. ▪ Urbanisation will continue to be a long-term growth driver. The UN forecasts the urban population will rise from 29% of the population to more than 50% by the early 2040s.
Threats	▪ Inflation and deficit concerns have caused some investors to re-assess their hitherto upbeat view of Vietnam. If the government focuses too much on stimulating growth and fails to root out inflationary pressure, it risks prolonging macroeconomic instability, which could lead to a potential crisis. ▪ Prolonged macroeconomic instability could prompt the authorities to put reforms on hold as they struggle to stabilise the economy.

Vietnam Business Environment SWOT	
Strengths	▪ Vietnam has a large, skilled and low-cost workforce, which has made the country attractive to foreign investors. ▪ Vietnam's proximity to China and South East Asia, and its good sea links, make it a good base for foreign companies to export goods to the rest of Asia and beyond.
Weaknesses	▪ Vietnam's infrastructure is still weak. Roads, railways and ports are unable to cope with the country's economic growth and growing linkage with the rest of the world. ▪ Vietnam remains one of the world's most corrupt countries. Its score in Transparency International's 2010 Corruption Perceptions Index was 2.7, placing it in 22nd place in the Asia-Pacific region.
Opportunities	▪ Vietnam is increasingly attracting investment from key Asian economies, such as Japan, South Korea and Taiwan. This offers the possibility of the transfer of high-tech skills and knowhow. ▪ Vietnam is pressing ahead with the privatisation of state-owned enterprises and the liberalisation of the banking sector. This should offer foreign investors new entry points.
Threats	▪ Ongoing trade disputes with the US and the general threat of American protectionism remain a concern. ▪ Labour unrest remains a lingering threat. A failure by the authorities to boost skill levels could leave Vietnam a second-rate economy for an indefinite period.

Global Overview

Industry Trend Analysis – Economic Woes Weigh On Car Demand

Domestic and international economic pressures are likely to be the overriding theme for the performance of new car sales in all major markets globally for 2011 and 2012. Broadly speaking, the picture looks mixed in 2012, as the poor economic outlook will dent demand in most markets while a combination of favourable base effects and improved vehicle supplies will aid in recovery in the other markets.

Table: Passenger Car Sales (Units), Jan-August 2011

	Last Month	Monthly Sales	% chg y-o-y	Sales YTD	% chg y-o-y	2011 Sales[f]	2011 Sales Growth (% y-o-y)[f]	2012 Sales[f]	2012 Sales Growth (% y-o-y)[f]
Core Europe	August	522,900	10.0	6,621,287	-2.8	9,743,624	-3.4	10,045,354	3.1
Eastern Europe	August	59,968	4.2	498,900	-1.3	803,845	-1.8	848,593	5.5
Japan	August	273,273	-2.6	2,198,476	-28.2	3,017,209	-28.4	3,236,989	7.3
United States	August	509,108	2.1	4,246,407	9.3	6,058,543	5.0	6,179,714	2.0
Canada	August	60,772	8.2	474,713	-0.2	694,435	-2.0	702,768	1.2
Brazil	August	236,172	-0.7	1,880,253	11.7	2,918,961	8.4	3,119,105	6.9
India*	August	144,516	-10.0	743,275	-1.3	2,822,872	12.0	3,079,753	9.1
China	August	1,041,584	3.3	8,640,000	4.9	14,448,000	5.0	17,120,880	18.5
Turkey	August	38,875	-7.9	372,139	37.9	601,545	17.9	662,854	10.2

*f = forecast, * refers to financial year starting April 2011. Source: Individual Industry Associations, BMI*

Developed Slowdown

- Year-on-year (y-o-y) growth of 10% in the our Core Europe grouping (Germany, France, the UK, Spain and Italy) during August has done little to change our forecast of a cumulative 3.4% contraction in the region by end-2011 and a modest 3.1% growth in 2012. With more than a fifth of Spain's workforce out of employment (as of June 2011) and the Italian economy stalling under a debt burden, the increasing weakness in the German, French and UK markets – the previous outperformers – give us reason to expect that H211 is likely to be significantly worse than H111. Although we have downgraded our growth forecasts for each of the bloc's major economies, including France, Germany, Italy and Spain in 2012, we expect 3% growth in new car sales in the region to mostly come on the back of favourable base effects. There are downside risks to this forecast if Italy’s and Spain’s new car markets enter 2012 during a contraction. A Greek default could further hit confidence and bank lending in the region.

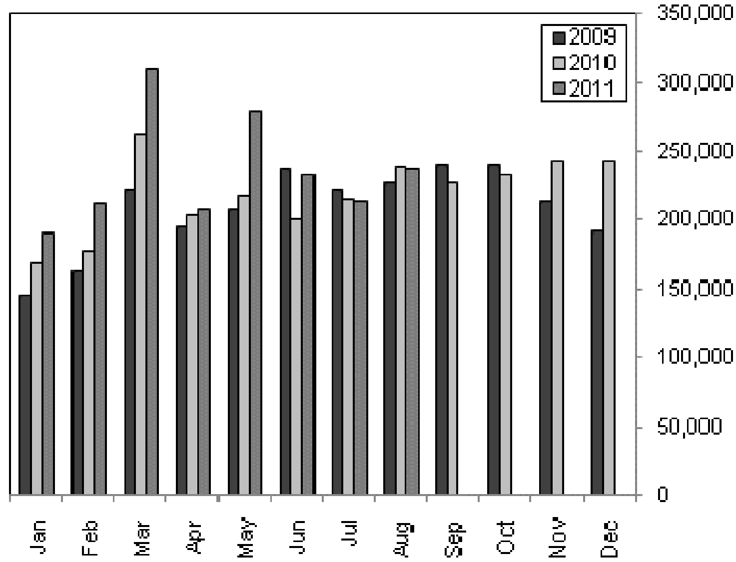
- A host of factors, ranging from the ongoing shortage of some passenger car models from leading Japanese brands and Hurricane Irene, which closed some dealerships towards the end of the month, were held responsible for anaemic 2.1% y-o-y growth in US car sales in August. We expect broader economic pressures and the renewed fiscal stimulus to weigh heavily on consumers' minds. We believe 2011 US autos sales growth will therefore be limited to 5%. We do not believe that the US is headed into recession in 2012, but in line with our view of a weak consumer segment, we expect new car demand to grow at an unimpressive 2% during the year.

Domestic Troubles

Demand in some of the major EMs has fallen victims to domestic economic pressures and government regulation.

The Regulatory Damage

Brazil Passenger Car Sales (Units)



Source: Anfavea

In Brazil, a combination of inflationary trends, rising lending rates and import restrictions saw new car sales contract for a second consecutive month in August. But **BMI** expects demand to slow further during the remainder of the year amid fears that debt problems in Brazil could be on the rise and the fact that the average rate of interest on consumer lending stood at 47% as of May this year. Both factors mean that current credit conditions in the country are simply unsustainable. Moreover, with inflation passing 7% y-o-y in August, we believe that the market is set for more modest 6.9% growth in new car sales in 2012.

- Similar inflationary pressures and the consequent increase in the running costs of vehicles in India prompted Indian consumers to demand 10% fewer cars in August this year compared with the same period last year. Sales in the first five months of the financial year (April to July) contracted 1.3%. While this puts downside pressures on our forecast of 12% growth in the current financial year, we are adopting a 'wait and see' approach ahead of the upcoming festival period, which traditionally spurs sales. In 2012, we see demand growing a more modest 9.1%.

Slowdown: Blame It On Outsiders

- China's slowing from rapid growth in previous years continues. Car sales in August were up only 3.3% y-o-y compared with 6.7% in July, putting eight-month sales up 4.9% y-o-y, in line with our expectations of full-year growth of 5%. This is largely owing to the outside threat of a double-dip scenario in the US, which would significantly impact Chinese exports and the wider economy, plus the ongoing effects of the withdrawal of car sales incentives. For 2012, we are forecasting real GDP growth of 8.1%, which should take vehicle sales growth up 18.5%.

- Growth in the emerging European countries (comprising Bulgaria, the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Romania, Slovakia and Slovenia) will rest entirely on the strength of economic growth in Western Europe, although favourable base effects could add some upside risks to vehicle demand. With consumers refusing to take on new debt and the economic recovery looking very fragile, a 1.3% y-o-y contraction in the sales of new cars during the January to August period closely align with **BMI**'s expectations of a 1.8% y-o-y fall in the full-year figure. After four consecutive years of contraction in the new cars market, we believe that the emerging Europe market should return to positive territory in 2012 with modest 5.5% growth.

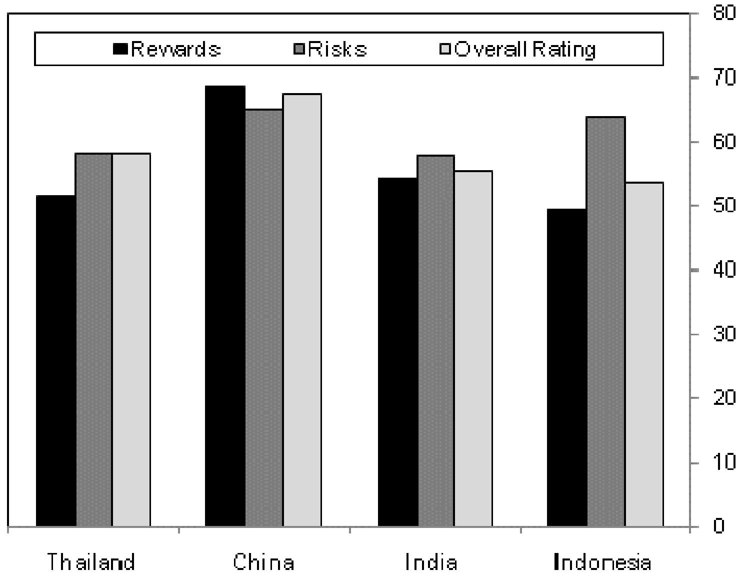
Regional Overview

Industry News – Thai Floods Threaten Regional Car Sales

As Thailand's position as a regional production and export hub in the autos sector has become more prominent, the risk that events such as the recent flooding in the country will impact not just domestic production and sales but also neighbouring export markets has increased. Several major carmakers based in the country have been forced to stop production owing to disruptions in the supply chain and there is currently no timeframe for normal operations to resume.

Playing To Strengths

Scores From BMI's Risk/Reward Ratings By Country



Scores out of 100, with 100 highest. Source: BMI

Honda Motor's plant in Ayutthaya has been closed since October 4, halting production of the Jazz small car, which is exported to around 30 countries. This is the second blow for the plant this year, after restricted supplies from Japan following the March earthquake and tsunami meant that its exports fell 11% in H111 and the company is on course to post its first contraction in exports in 14 years.

Toyota Motor has also shuttered its three production plants, which are not affected by flooding themselves, but are impacted by the lack of parts from suppliers hit by the disaster. A decision on whether to re-open is due to be made on October 15, but at the moment the company cannot say to what degree output will be affected as it is unknown how long the conditions will last.

Toyota has a combined annual production capacity of 650,000 units at the three plants and in September it suggested it might begin production of subcompacts in Thailand for export as a move to avoid the strengthening yen. Its exports, most of which are currently shipped to Australia, Brunei and Singapore, accounted for 53% of its total production of 630,000 units in 2010. With total industry sales in Australia and Singapore already lower on a year-on-year basis, disruption to one of the markets' major brands would worsen the outlook. Toyota claims it has enough stock to fulfil orders for at least a month.

Ford Motor's strategy of raising local content in its vehicles has forced the carmaker to close its **AutoAlliance Thailand** (AAT) plant in Rayong for at least two days due to affected supplies from Ayutthaya. Ford's dealers are in a position to go ahead with business as usual, while Ford's ASEAN president Peter Fleet says the company will be evaluating the situation to decide when to restart production.

Ford, which rolled out its new Ranger pick-up in September, announced at the beginning of October that it will source local content to the value of US$2bn per year from Thailand. This will start when its new plant, also in Rayong, becomes operational in 2012, although sourcing will include purchases by AAT. While high levels of local content are often encouraged to increase competitiveness and support the local supplier segment, events such as this highlight the risk to such a strategy.

Isuzu Motors has halted production of its pick-up trucks until at least October 14, which will impede its attempts to fulfil an already growing backlog of orders. Isuzu has announced plans to spend THB7.3bn (US$233.9mn) on a new plant to increase production of its new D-Max range of pick-ups, as it is already struggling to meet pent-up demand for the existing model.

Although it is too soon to say how the closures will impact our forecasts for production, the flood's effects on suppliers will also pose a downside risk to production in other countries for some companies. Toyota's regional production strategy means that parts from Thailand are used by plants in other ASEAN countries. Indeed, Thailand's significance to the regional industry has been underlined by a source from **Toyota Motor Thailand**, quoted in The Nation, who said that the situation is worse than after the Japanese disaster, which only required a reduction in output rather than a full closure.

Business Environment Ratings

The aim of **BMI**'s Business Environment Rating system for the automotive industry is to show the rewards and the risks that carmakers operating in a particular region – in this case Asia Pacific – may face. The unique system assesses crucial factors, such as sales and output growth, international trade, market size and location, and the level of market competition, in addition to taking into account a country's economic and political backdrop. The ratings system allows analysts to fully expound the potential advantages and disadvantages of investing in Asian car markets, and offers an overall comparison of the key markets in the region.

The ratings have changed slightly against the backdrop of the global economic slowdown, as some markets have proved better equipped to cope than others. Australia now leads the regional rankings, with a much higher score of 70.1 out of a possible 100, compared with 65.3 in the last ratings. The developed nature of the country means that Australia is at a disadvantage due the near-saturation status of its autos market, which reduces growth potential. On the other hand, a high GDP increases purchasing power, while market risks are reduced by low levels of corruption and a strong legal framework. This is reflected in the market's high score for its low risk. Its Country Rewards score has also risen from 66.7 to 87.2.

China has now fallen to second, although its overall score has risen from 66.5 to 67.7. The market's highest scores are still for its production and sales growth potential, based on **BMI**'s forecasts up to 2013, although signs of a slowdown in the market have been evident. Even though a low level of vehicle ownership can look tempting in terms of possible growth, the low score for country structure (caused by the large gap that exists between wealthy towns and poorer rural areas) acts as a clear restriction on potential penetration. In terms of China's macroeconomic environment, a healthy long-term political and economic outlook ensures strong scores for Country Risk.

A country held back by an autos market on the brink of saturation is South Korea, which has stayed in third place with 66.8 out of 100, up from 64.2. Historically poor labour relations weigh on the country's overall rating, although long-term political and economic stability reduce the risks. The score for Country Rewards has risen this year from 52.2 to 65.8. Free trade agreements add to South Korea's sound regulatory environment, although there is room for improvement if a deal with the US can be ratified.

Japan stays in fourth with an overall rating of 61.1, up from 60.6 in the previous ratings. The risks associated with a developed market still exist, however. Just as Australia and South Korea suffer in the ratings due to their developed statuses, a saturated market also weighs on Japan's ratings. While the country scores well in terms of Country Risk, with low levels of corruption and a sound legal framework that have bumped up the market's overall score, the autos industry is nearing full capacity, and this consequently reduces production growth potential, while the high level of vehicle ownership restricts possible sales growth. Labour costs are also high, which adds to the cost of expanding production.

Moving up to fifth is Thailand, which has benefited from an improved country risk score, taking its overall rating to 58.3. A number of new export-oriented investment projects have raised the country's production growth potential for the next five years, despite the current downturn, while several existing free trade agreements have increased the reach of investors. Government incentives for manufacturers producing low-emission vehicles have boosted Thailand's regulatory environment score, along with good labour relations and trade relationships.

India is now down to sixth with a slightly lower score of 55.4, as a reduction in its Country Rewards rating drags on the Rewards category. India shares the same pros and cons as China, ranking highly in terms of high production and sales growth potential, but with a low score for country structure (again caused by a large gap between wealthy urban and poorer rural areas), which acts as a restriction on future penetration rates. However, the country's regulatory environment rating is bolstered by the government's efforts to encourage 'green' motoring, as well as a number of free trade agreements which are supporting the country's bid to become a regional export hub.

The Philippines has moved up to seventh, although its overall score is down marginally from 54.6 to 54.0. The market offers only average sales and production growth potential according to **BMI**'s five-year forecast. Although the market is dominated by Japanese brands, the competitive landscape is still far from saturated by carmakers and could still provide opportunities for new entrants, while the country also scores well for its regulatory environment. In terms of Country Risk, solid scores for long-term economic and political risk should assure investors.

Indonesia, which has fallen to eighth with 53.9, compared with 56.2 previously, is the region's largest passenger car market and as such will always have an appeal for investors. Low labour costs and a competitive environment with room for new players increase Indonesia's attractiveness, as do its recently upgraded regulations on intellectual property rights (IPRs), which boost its regulatory environment rating. The country's risks act as a hindrance however, with low scores for corruption, bureaucracy and the legal framework. The Country Rewards score has fallen from 47.5 to 36.3, taking its score for limits to potential returns down from 53.5 to 49.5.

Malaysia follows in ninth position with a rating of 52.6, up slightly from 50.2, although there is room for improvement in terms of the country's regulatory environment. While the country is a leading light of the ASEAN trade bloc, which has made it a popular choice for regional production activities in the autos sector, there is potential for greater things if a proposed free trade agreement with the US is finalised. In terms of the market itself, production growth potential receives an average rating, while potential sales growth is low in comparison with its peers.

Taiwan, which has climbed to 10th on 49.4 points, paints a similar picture to Japan, in that its macroeconomic environment is sound, with high scores for long-term economic risk and low corruption.

However, autos production is set to fall over **BMI**'s five-year forecast period, while projected sales growth is also minimal. The country receives an above-average rating for its regulatory environment, although links with China may arouse concerns over IPRs.

Singapore has climbed one place to rank 11th with a rating of 48.5, compared with 45.2 in the previous year, with an increase in its Country Rewards score from 76.5 to 90.1. Singapore, along with Thailand, has the highest number of free trade agreements in force for any Asian market. However, in industry terms, the lack of domestic production facilities and the imposition of vehicle quotas, which restrict potential sales growth, weigh on the market's overall rating. Nevertheless, Singapore has climbed three places since our first ratings were produced.

Vietnam stays in 12th place. A newly liberated autos market has witnessed stellar growth, and according to the above-average rating for its potential over the next five years, sales growth should be maintained. Its highest score is for Industry Risk, which stands at 85.0. Its Country Risk score has also risen from 49.8 to 51.5, taking its total score for risks up to 68.2. Vietnam is still a country we would expect to see climb the ratings in future, particularly if its vehicle tariff policy becomes more consistent.

This leaves Hong Kong, which suffers from a lack of local automotive production, in 13th place on 46.6, although this is an improvement from its previous score of 42.9. The country scores highly for its long-term economic and political risk and regulatory environment and indeed, its Country Reward score has risen from 72.0 to 87.4. However, with these scores near to the maximum achievable, and with little prospect of vehicle production on the horizon to raise Hong Kong's score for that criterion, the market is unlikely to climb much further in the ratings in the foreseeable future.

Rounding out the rankings on 38.9, down from 42.4, is Pakistan, which is held back by low production growth potential and an average rating for sales growth. However, as a signatory to the Trade Related Intellectual Property Rights Agreement (TRIPS) under the auspices of the WTO, the country's regulatory environment scores well. A number of free trade agreements also contribute to this criterion, although forming FTAs with non-Asian countries would improve this rating further. Despite low marks for bureaucracy and corruption, the market does score well for its long-term economic risk and policy continuity.

Table: Business Environment Ratings – Auto Industry Asia Pacific

	Rewards			Risks				
	Industry Rewards	**Country Rewards**	**Rewards**	**Industry Risks**	**Country Risks**	**Risks**	**Autos Risk/ Reward Rating**	**Regional Ranking**
Australia	58.3	87.2	68.4	80.0	68.2	74.1	70.1	1
China	81.7	44.9	68.8	65.0	65.2	65.1	67.7	2
South Korea	63.3	65.8	64.2	75.0	70.4	72.7	66.8	3
Japan	51.7	76.6	60.4	50.0	75.4	62.7	61.1	4
Thailand	53.3	48.3	51.6	60.0	56.4	58.2	58.3	5
India	68.3	28.2	54.3	60.0	55.8	57.9	55.4	6
Philippines	50.0	46.1	48.6	75.0	58.0	66.5	54.0	7
Indonesia	56.7	36.3	49.5	75.0	52.9	63.9	53.9	8
Malaysia	40.0	61.2	47.4	60.0	69.7	64.8	52.6	9
Taiwan	35.0	50.0	40.3	70.0	71.5	70.8	49.4	10
Singapore	11.7	90.1	35.3	55.0	86.0	70.5	48.5	11
Vietnam	**45.0**	**26.8**	**38.6**	**85.0**	**51.5**	**68.2**	**47.5**	**12**
Hong Kong	10.0	87.4	37.1	55.0	82.9	68.9	46.6	13
Pakistan	31.7	25.2	29.4	75.0	47.0	61.0	38.9	14

Scores out of 100, with 100 highest. Source: BMI.

The Autos Business Environment Rating is our principal rating. It is comprises two sub-ratings, 'Rewards' and 'Risks', which have a 70% and 30% weighting respectively. In turn, the 'Rewards' rating comprises Industry and Country elements, which have weightings of 65% and 35% respectively. These are based upon specific industry growth and size dynamics within the market, and the broader economic and socio-demographic environment of the country. The 'Risks' rating is comprised of Industry Risks and Country Risks, each of which has a 50% weighting. These are based on a subjective evaluation of industry regulation and competitive issues particular to that market, and the industry's broader Country Risk exposure, which is based on **BMI**'s proprietary Country Risk Ratings. The ratings structure is aligned across all 14 industries for which **BMI** provides Business Environment Ratings methodology, and is designed to enable clients to consider each rating individually or as a composite, with the choice dependant on level of exposure to the industry in each particular state. For a list of the data and indicators used, please consult the appendix located at the back of the report.

Macroeconomic Forecast Scenario

Growth To Moderate Despite Improvement In Net Exports

BMI View: *Vietnam's real GDP growth figure came in slightly better than expected at 5.7% y-o-y in Q211. However, we expect economic activity to continue to moderate in H211, and we see this as a positive sign that government efforts to iron out macroeconomic imbalances in the economy remain on track. Despite incipient evidence of a narrowing trade deficit, we warn that global economic headwinds remain a downside risk to external demand. Accordingly, we are projecting real GDP growth to remain subdued at 6.0% for 2011 (below the government's target of 6.5%), but we predict growth of 6.5% in 2012.*

Vietnam's real GDP growth figure came in slightly better than expected at 5.7% y-o-y in Q211. However, leading indicators suggest that economic activity should continue to moderate, and we see this as a positive sign that government efforts to iron out the country's macroeconomic imbalances remain on track. Prevailing economic headwinds in the US and eurozone should continue to act as a dampener on external demand. This in turn suggests that production activity in the manufacturing sector and other export-based industries should remain depressed in H211. Furthermore, lending rates, which have surged to around 25.0-27.0% as a result of the State Bank of Vietnam's (SBV) aggressive monetary tightening in recent months, suggests that gross fixed capital formation (GFCF) growth would remain subdued in H211. Although the SBV has cut its reverse repurchase rate by 100bps from 15.00% to 14.00% on July 4, we see the move as an attempt to ease liquidity in the banking system rather than a signal for further rate cuts. We note that the SBV's benchmark policy rate (refinance rate) remains unchanged at 14.00% and we expect the rate to remain on hold through 2011.

Growth Slows In Construction And Agricultural Sectors

According to figures published by the General Statistics Office, output in the agricultural sector has slowed to multi-year lows of just 1.8% y-o-y in Q211, compared to 2.0% in Q111. Meanwhile, growth in the construction sector also witnessed a significant slowdown from 7.0% y-o-y in Q111 to 4.2% y-o-y in Q211. We believe that exorbitant lending rates due to aggressive monetary tightening by the central bank were mainly responsible for stemming growth in the construction sector. Indeed, construction and infrastructure companies have complained about having to cope with higher debt servicing costs due to their capital-intensive structure. Tight credit conditions may have prompted commercial banks to adjust their loan portfolios towards higher-return industries over the agricultural sector. Given that the agricultural sector accounts for a significant 18.4% of nominal GDP, we note that high lending rates should continue to depress agricultural production and, in turn, broader economic growth this year.

Private Consumption Remain Resilient In 2011

Retail sales have moderated considerably since November 2010, when the SBV initiated its monetary tightening cycle. Retail sales growth slowed from 32.5% in November 2010 to 22.6% in June, indicating that monetary tightening has dampened private consumption growth. Nonetheless, retail sales remain at double-digit growth rates, indicating that private consumption growth remains resilient. This supports our view that private consumption will remain resilient on the back of robust labour market conditions and rising wages in Vietnam. Public spending cuts and a subdued outlook on GFCF growth due to high lending rates mean that domestic demand will continue to moderate.

Narrowing Trade Deficit To Help Cushion Slowdown In Domestic Demand

Following a significant 8.5% devaluation in the Vietnamese dong in February 2011, we are finally beginning to see incipient signs of a narrowing trade deficit. Trade export growth accelerated to 23.5% y-o-y in June from 14.6% in May, while imports growth slowed to 16.2% y-o-y from 20.5% in May. The latest trade figures showed a smaller trade deficit of US$0.4bn in June (the smallest deficit since August 2010) compared to US$1.4bn in May, relieving concerns that further deterioration in the trade balance would lead to another devaluation. Industrial production, which provides a reliable gauge for export orders, also indicates that demand for exports remained resilient. Industrial production growth has begun to pick up in recent months, rising from 11.8% y-o-y in April 2011 to 17.0% in June.

Although we are optimistic that trade exports are beginning to show signs of strength, we caution that global economic headwinds in the US and eurozone remain a downside risk to external demand. Nonetheless, trade imports, which are beginning to slow on the back of moderating domestic demand and a slowdown in the broader economy, should help reduce the trade deficit over the coming months. We remain optimistic that an improvement in net exports would help cushion the impact of a slowdown in domestic demand, while headline economic growth should continue to moderate throughout the year. Looking ahead to 2012, we expect the SBV to ease monetary policy in light of moderating inflation and this should support a pickup in economic growth. Accordingly, we are maintaining our real GDP growth forecast of 6.0% for 2011, followed by a pickup towards 6.5% in 2012.

Table: Vietnam – Economic Activity

	2008	2009	2010	2011e	2012f	2013f	2014f	2015f
Nominal GDP, VNDbn [2]	1,485,038.0	1,658,389.0	1,953,223.3	2,379,025.2	2,783,319.1	3,152,968.4	3,547,056.7	3,972,115.8
Nominal GDP, US$bn [2]	89.8	92.8	101.9	115.5	136.6	159.2	184.3	211.8
Real GDP growth, % change y-o-y [2]	6.3	5.3	6.8	6.3	7.2	7.2	7.2	7.2
GDP per capita, US$ [2]	1,041	1,063	1,153	1,294	1,515	1,749	2,004	2,282
Population, mn [3]	86.2	87.3	88.4	89.3	90.2	91.1	92.0	92.8
Industrial production index, % y-o-y, ave [1,2]	13.6	6.7	14.1	10.0	15.0	16.0	17.0	16.0
Unemployment, % of labour force, eop [2]	4.7	6.0	5.0	6.0	5.0	5.0	5.0	5.0

Notes: [e] BMI estimates. [f] BMI forecasts. [1] at 1994 prices; Sources: [2] General Statistics Office. [3] World Bank/BMI calculation/BMI.

Industry Forecast Scenario

Table: Vietnam Autos Sector – Historical Data And Forecasts

	2009	2010	2011e	2012f	2013f	2014f	2015f	2016f
Total Production (CBUs)	33,689	37,199	40,322	43,872	48,170	52,805	57,789	63,252
Total Sales (CBUs)	119,460	112,224	118,824	126,562	138,656	159,496	181,478	206,597
Total Imports (CBUs)	76,300	53,100	47,790	49,988	52,338	54,798	57,428	60,184
Imports (value, US$bn)*	-76,300	-53,100	-47,790	-49,988	-52,338	-54,798	-57,428	-60,184

*Figures are for complete knocked-down kits/completely built units, f = forecast, * estimate. Sources: VAMA*

Sales

Vietnam's new vehicles market is characterised by fluctuating tariffs, which often make it hard to identify sales patterns. Sales of domestically produced vehicles were affected by an increase in vehicle ownership tax in 2008. After the tax doubled to 10%, the Vietnam Automobile Manufacturers Association (VAMA) reported that average sales for the last four months of that year dropped by around half compared with the first eight months of 2008. The registration tax was raised again on January 1 2009 to 12% in Hanoi and 15% in Ho Chi Minh City. Furthermore, the special consumption tax (SCT) was increased on April 1, bringing a return to the days of prohibitively high vehicle prices in the country.

New vehicle sales fell by 6% y-o-y in 2010 with VAMA attributing the decline to the ongoing effects of the economic crisis. A further deterrent to sales was the country's ever-changing tariff regime.

New vehicle sales in Vietnam have risen by 2% year on year (y-o-y) over the first eight months of 2011 to reach 70,650 units, according to data from the Vietnam Automobile Manufacturers Association (VAMA). This figure includes both domestically produced vehicles plus those imported into the country by VAMA members. On the import side, the number of completely built units (CBUs) imported into the country over the Jan-Aug period rose by 30% y-o-y, to reach 42,000 CBUs, according to a report on the AutomotiveWorld website. The value of imported cars increased by 32% y-o-y to US$782mn. This comes despite efforts by the government to curb imports in favour of developing the domestic industry.

Looking at the monthly data, new vehicles sales reached 9,518 units in August 2011, up 9.8% y-o-y, compared with 8,671 units in August 2010, according to the VAMA. During the same month, passenger car sales increased by 54% y-o-y to 4,201 units, which helped to overturn a negative month-on-month (m-o-m) trend from the past several months. Commercial vehicle sales were down 24% y-o-y to 3,164 units in August.

There has been a slowdown in the monthly growth rate in sales figures for the entire new vehicles sector. As of May 2011, new vehicle sales were up by 11% y-o-y. By August, they had slowed to 2% y-o-y. Against this backdrop, **BMI** is happy to maintain its 2011 new vehicle sales forecast of 118,824 units, but we caution that there may be slight downside risks to this forecast should this downward trend in m-o-m sales continue.

The country is still dogged by high inflation, with the CPI at 18% as of September 2011, and a weak currency, which may act as a demand suppressant over the rest of the year. The car industry remains heavily taxed, with taxes reportedly accounting for some 60% of the value of a new car in Vietnam at present. One glimmer of hope for the autos industry was the news in August 2011 that the Ministry of Finance is reportedly making plans to revise the special consumption tax levied on vehicles, a move which may see certain types of vehicles exempted from taxation. No concrete proposals had been tabled as this report was being compiled in October 2011.

New Regulations To Hit Small Importers

New rules aimed at reducing the number of vehicles imported into Vietnam are likely to see many smaller unauthorised importers close down as the government looks to address the industry's trade deficit and promote local production. Despite previous efforts by the government to curb vehicle imports, an underdeveloped production industry means that imports remained strong in the early months of 2011.

The new regulation, which was due to come into effect on June 26, will require importers of cars with fewer than nine seats to provide documentation stating that they are authorised dealers for foreign carmakers. They will also be required to operate customer service divisions for the imported models. This will greatly reduce the number of importers, according to the director of car dealer **Tradoco**, Pham Huu Tam, who also said that only 11 joint ventures will meet the requirements. Smaller dealers may be forced to become sales agents or close completely. Vehicle imports in the first four months of 2011 rose 71% to 14,330 units, according to the Ministry of Industry and Commerce. In value terms, growth was even more pronounced, up 88% to US$185mn.

BMI still believes that more needs to be done to encourage domestic production before attempting to slash imports. Total production accounts for little under one-third of total sales, leaving the country well behind its regional peers in the ASEAN bloc, which can largely serve their domestic and export demand. Industry policy in Vietnam tends to be more restrictive than other countries that have promoted production in certain vehicle segments either through investment or purchase incentives.

Production

Vietnam's domestic autos production capability could be set for a considerable boost thanks to plans to create a national industry hub in the Chu Lai Economic Zone. The aim of the project is to increase the scale of domestic production in order to make the sector more competitive when import tariffs are eliminated under the ASEAN Free Trade Agreement in 2018. Regardless of the agreement's impact, **BMI** believes the Vietnamese autos sector has been struggling to compete with its regional peers for some time and that such a move would have been necessary at some point to win investment.

In a positive development for the project, it has piqued the interest of major South Korean carmakers **Hyundai Motor** and **Kia Motors**. Hyundai has already committed to an agreement with local company **Truong Hai Automobile**, which will act as the company's exclusive distributor in the country. Hyundai will also set up an engine production plant with an annual production capacity of 10,000 engines for the domestic market in the initial phase, followed by an expansion to 50,000 to accommodate exports to China, after 2015.

Kia is in negotiations with the economic zone's management regarding a project to produce 100,000 cars per year from 2015. This would be a considerable boost to local production, as **BMI** expects total industry output will be just shy of 60,000 units by 2015. There will be requirements placed on Kia and any other carmakers planning similar projects. Within the first year of operation, each company must achieve a local content rate of 47% and allocate at least 70% of output to export. By the time the factory is running at full capacity, output should contain 60% local content.

The government has set localisation rates before, which were not met by the industry due to a lack of new investment in the supplier segment. A target of 25% local content was set for 2005, due to rise to 30% by 2007. However, the Ministry of Finance estimated that by 2004, the level of local content in vehicles was just 2-10%.

This time, the government and the authorities of Quang Nam province, where the economic zone is based, are backing the industry with a package of investment incentives. The Quang Nam authority has suggested exempting land for such projects from leasing fees for the lifespan of the project, although the Ministry of Finance has instead suggested an exemption for the construction period plus the following 11 years. Quang Nam has also proposed a raft of tax breaks including an extension of the 10% corporate tax rate from the usual 15 years for companies in the economic zone to 30 years, as well as delaying import and luxury taxes for five years between 2015 and 2019.

BMI believes such measures are necessary to show investors that the government and local authorities are serious about establishing a viable industry hub. When tariffs are removed in accordance with the terms of AFTA in 2018, Vietnam will be competing with countries which have established and proven industry policies in place, such as Thailand, already dubbed ‘the Detroit of Asia’, as well as Indonesia and Malaysia, which are up-and-coming alternatives.

Although the government has tried to increase domestic production in the industry before, particularly by raising import tariffs on vehicles, there has been little in the way of rewards for companies which have chosen to invest. This is reflected in the 'Rewards' section of **BMI**'s Industry Risk/Reward Ratings for the autos sector in Asia, where Vietnam scores far below its neighbours in terms of the industry rewards on offer.

There is a sense of urgency now, as the Ministry of Industry and Trade believes the country will need 70,000-100,000 passenger cars per year by 2016-2020 and if local factories cannot step up capacity to meet demand and become more competitive by the time tariffs are dropped in 2018, smaller companies will be out of business.

Market Overview

The country's autos industry is still in its infancy as producers typically import complete knock-down kits (CKDs), which are assembled and sold domestically. The domestic parts sector is small at present, although the government is making it a priority. Given rapid economic growth in the region, there is significant development potential for the industry, especially as less than 1% of the population owns a car. In recent years, significant hurdles have appeared, not least a drastic change to the tax regime.

The increase in consumption tax stems from concerns that manufacturers are not investing heavily enough in the domestic parts industry. By 2005, the government wanted to achieve a minimum 25% localisation of parts, increasing to 30% by 2007. Yet, in 2004, the Ministry of Finance estimated that the proportion of locally made parts in domestically sold vehicles ranged from 2-10%. This is a significant gap, and could largely be attributed to the continued import of CKDs.

Table: New Vehicle Sales By Top 10 VAMA Members (CBUs)

	2009	2010	% chg, y-o-y	Market Share (%)
Toyota Motor	30,109	31,135	3.0	27.7
Truong Hai Auto	21,167	26,047	20.0	23.2
Vinamotor	15,284	12,274	-20.0	10.9
GM Daewoo	14,200	9,685	-32.0	8.6
Vinaxuki	8,680	9,002	4.0	8.0
Ford Motor	8,286	6,475	-22.0	5.8
Visuco (Suzuki)	2,669	3,242	21.0	2.9
Honda Motor	4,215	3,140	-26.0	2.8
Mercedes-Benz Vietnam	3,399	2,827	-17.0	2.5
VinaStar (Mitsubishi)	3,666	2,492	-32.0	2.2

Source: Vietnam Automobile Manufacturers Association

Only four of the top 10 locally producing carmakers posted positive growth in 2010, although the competitive landscape remained largely the same. **Toyota Motor** retained its lead with growth of 3%, down on the 34% growth of Q110 and 29% of H110. **Visuco** again achieved the best growth of the top 10 manufacturers with a 21% rise in sales, though this was down from 72% in H110. **Hino Motor** registered the worst sales of all 16 local manufacturers with a 44% decline.

Table: New Vehicle Sales By Top 10 VAMA Members (CBUs)

	Q110	Q111	% chg, y-o-y	Market Share (%)
Toyota Motor	7,128	7,637	7.0	27.4
Truong Hai Auto	3,946	7,225	83.0	25.9
GM Vietnam	1,881	2,628	40.0	9.4
Ford Motor	1,214	1,986	64.0	7.1
Vinamotor	2,597	1,941	-25.0	7.0
Vinaxuki	1,987	1,831	-8.0	6.6
Honda Motor	467	1,098	135.0	3.9
Visuco (Suzuki)	560	1,041	86.0	3.7
VinaStar (Mitsubishi)	339	604	78.0	2.2
Mercedes-Benz Vietnam	474	592	25.0	2.1

Source: Vietnam Automobile Manufacturers Association

There was a positive development for the local industry in March 2011, as a Vietnamese producer overtook Toyota in volume sales for the first time. **Truong Hai Auto**, which produces vehicles for South Korea's **Kia Motors** among others, registered growth of 29.9% y-o-y in March to 3,085 units. This compares with 2,357 units sold by Toyota in the month. The Japanese brand held onto the lead for Q1, although its lead was cut to just 412 units as Truong Hai achieved growth of 83% y-o-y for the quarter, compared with 7% for Toyota. This may have something to do with Toyota's prominence in the MPV segment, which saw sales fall again in March (-20%), despite strong growth in the first two months.

As of September 2011, the leading domestic automaker remains Truong Hai, which sold 2,677 cars in September. The company has sold a total of 23,413 cars over the Jan-Sep 2011 period, with a market share of almost 29% of new vehicle sales in the year to date. In second place is Toyota, which has sold 22,106 vehicles in the year to date, with a market share of 27.4%.

In third place is **GM Vietnam**, with a 9.1% market share (7,353 vehicles sold in the year to date), followed by **Ford Motor** on 7.5% (6,058) and truck maker **Vinaxuki** on 7% (5,786).

Industry Developments

With vehicle imports set to surge when tariffs are removed under the ASEAN Free Trade Agreement (AFTA) in 2018, Vietnam's Ministry of Industry and Trade (MOIT) is looking to make the domestic industry competitive in the meantime. **BMI** sees an underdeveloped supplier segment as a major area of concern, which will be addressed through higher import tariffs on parts that can be made domestically. Higher rates are also applied to vehicles imported as completely built units.

In order to facilitate the sector's development, MOIT proposed in June 2010 that investment projects for the autos industry should be given preference. **BMI** believes that the Vietnamese industry is trapped in a vicious cycle where carmakers are reluctant to invest in production without a well developed supplier base and suppliers, for their part, want to see growth potential in vehicle assembly before investing.

To help break the cycle and encourage domestic parts production, MOIT is proposing a zero per cent tariff on imported products and materials used in manufacturing components. The ministry is also requesting that the National Assembly consider a special 50% cut in VAT on trucks, buses and products that will improve the fuel efficiency and environmental credentials of vehicles.

The government made moves earlier in 2010 to limit imports. Measures considered included reducing the number of ports that imported vehicles could pass through and restricting access to foreign currency loans for imports. The VAT rate has been returned to 10% after it was cut in half in 2009 to kick-start sales.

When the floodgates open in 2018, **BMI** expects Asian brands to have the best opportunities. Tariffs on vehicles with fewer than nine seats from other AFTA signatories will be scrapped, while parts will be subject to a lower 5% tax, and tariffs on parts from China and South Korea will also be reduced to 5% under respective FTAs. Non-Asian brands based in these countries could also benefit, although in a downside risk for Vietnam, this could lead to increased investment in existing production facilities in other Asian countries.

In May 2011, the VietNamNet Online Newspaper reported on the MOIT’s current drafting of an automotive strategy for the 2020-2030 period. According to the report, the Vietnamese government is looking to develop its autos industry in a similar way to that pursued by Thailand, whereby local production and supplier ratios are increased and sizeable engineering centres are developed.

At present, the number of local parts used in car assembly is very low, with Suzuki having a localisation ratio of 3% and Ford 2%, according to VietNamNet Online. This is far below the current targeted ratio of 50%. Moreover, foreign manufacturers are yet to make a significant investment in transferring modern technologies to Vietnam.

The government wants local suppliers to provide 50-60% of all the necessary car parts for domestic production by 2020. Whether this can be achieved in such a short time, especially given a still-uncertain tariff backdrop, remains to be seen.

Passenger Cars – Forecast & Analysis

Table: Vietnam Autos Sector – Historical Data And Forecasts

	2009	2010	2011e	2012f	2013f	2014f	2015f	2016f
Production – cars	31,684	32,805	36,315	39,438	42,988	47,286	51,921	56,905
Sales – cars (incl. SUVs/MPVs)	62,723	57,778	58,934	61,880	66,212	74,157	82,315	91,369

*Figures are for complete knock-down kit/completely built unit assembly, f = forecast, * estimate. Sources: VAMA*

BMI expected the MPV/SUV segment to drag on overall passenger segment sales in 2010, owing to the higher special consumption tax (SCT) on these vehicles, and this happened. Segment sales were down 13% compared with a contraction of just 3% for passenger cars. We expect the overall passenger segment to continue to underperform in terms of growth compared with the commercial vehicle segment while the higher tax on MPVs and SUVs is still in place

While we still expect this to be the case in 2011 as a whole, sales in Q111 were helped by an uptick in consumer confidence, reflected in a 47% y-o-y increase in passenger car sales. The SUV/MPV segment, also recovered dramatically in Q1 with sales up 34% y-o-y. This was mostly due to a surge in January after which the segment contracted again during the quarter.

Segment Developments

Japanese automaker **Mazda Motor** will start production and sales of its Mazda2 subcompact car in Vietnam in October 2011, with manufacturing operations based at a facility in Núi Thành. The plant, owned by the automaker's local distributor **Vina Mazda Automobile Manufacturing**, is expected to produce approximately 2,000 units of the car annually. Mazda aims to strengthen its position in emerging markets through local production as part of its medium- and long-term strategies, according to Global Marketing and Sales Chief Yuji Nakamine.

In April 2011, Toyota Vietnam announced that it was recalling nearly 66,000 units of its Fortuner and Innova models, following the discovery, by a local engineer, of several technical faults surrounding the cars' seats, wheel alignment and braking systems. The company has been criticised for its initial response to the crisis, when it appeared to downplay the seriousness of the technical faults. The 'whistle-blower' engineer, Le Van Tach, also alleged that he had been threatened by colleagues after exposing the technical defects.

In a further blow for the company, Toyota Vietnam announced in April 2011 that it would have to cut local production by 70% between the end of April and June, citing a lack of available parts from Japan following the devastating earthquake and tsunami of March 2011.

In April 2011, Ford Vietnam announced the start of production of the Fiesta model at its Hai Duong plant, which has an annual capacity of 14,000 units. The locally produced Fiesta will be priced from VND542mn-VND606mn.

Malaysian **Tan Chong Motor** is the latest company from an emerging market to expand globally, a trend that **BMI** expects will be a feature of the autos sector over our forecast period to 2015. The company's wholly owned subsidiary, **ETCM**, is planning to acquire a 74% stake in **Nissan Vietnam** from Danish **Kjaer Group**, and is negotiating a joint venture (JV) with Nissan regarding the business. Tan Chong says that this completes its Indochina strategy in coverage terms.

In addition to being Nissan's exclusive passenger car and light commercial vehicle distributor in Malaysia, the group has recently been given responsibility for Cambodia and Laos. Tan Chong says a JV with Nissan in connection to expanding its Vietnam business would target ‘a key ASEAN emerging market’. Nissan has already started local assembly of its Grand Livina MPV through **Vietnam Motors** as it looks to increase its market share while avoiding rising import tariffs.

The Livina is an important part of Nissan's product strategy for South East Asia, as MPVs are popular. However, it is risky in Vietnam, where MPVs carry a higher SCT.

Nissan has previously blamed high import tariffs on imported vehicles for its relatively low market share of less than 1% in Vietnam, which led to the decision in 2009 to go ahead with investment in the plant, despite the global downturn. Nissan COO Toshiyuki Shiga referred to Vietnam as ‘one of the key automobile markets’, and this was marked with the opening of two new dealerships in April 2010 to accommodate its new models.

Commercial Vehicles – Forecast & Analysis

Table: Vietnam Autos Sector – Historical Data And Forecasts

	2009	2010	2011f	2012f	2013f	2014f	2015f	2016f
Sales – commercial vehicles	56,737	54,446	59,891	64,682	72,444	85,339	99,164	115,228

*Figures are for complete knock-down kit/completely built unit assembly, f = forecast, * estimate. Sources: VAMA*

The commercial vehicle (CV) segment contracted 4% in 2010, which in relative terms outperformed the overall market decline of 6%. There may be hope for the CV segment going forward with the reduction in import tariffs on trucks. We expect the CV segment to perform better over the coming years as the market corrects itself.

The Ministry of Finance introduced a new tax regulation to reduce the rate on imported trucks, under WTO commitments. On trucks under five tonnes, the rate was cut to 30%. For the 5 to 10-tonne segment, the rate was lowered from 55% to 25% and for 10 to 20-tonne segment, the rate fell from 30% to 25%. All reductions were effective from January 1 2011.

Data for Q111 suggests the tariff reductions took effect. CV sales rose 16% y-o-y for the quarter and according to VAMA, the 6% growth in March alone was usual for the segment at that time of year. Companies traditionally return to buying new vehicles following the Tet holiday period (Vietnamese New Year). This was better reflected in the m-o-m growth in commercial vehicle sales of 32% for March. It also aligns with **BMI**'s view that the CV segment will outperform in the full year.

Segment Developments

In June 2011, Truong Hai Auto announced that it has opened a new bus manufacturing facility in central Quang Nam Province. The VND600bn facility has a capacity of 1,500 CBUs per year and will produce 18-80 seat buses. Initial production will be aimed at the domestic market, but Truong Hai is hopeful that it can start exporting vehicles to other ASEAN nations during 2012.

Chinese commercial vehicle manufacturer **Anui Jianghuai Automobile** (JAC) began its international expansion in April 2010 by starting construction on a JV plant in Vietnam, China Daily has reported. China's second largest truck maker, based in Hefei in the eastern province of Anhui, will mostly produce medium- and light-duty trucks with its unnamed Vietnamese partners at the plant, the newspaper quoted the company's chairman, Zuo Yan'an, as saying. It will be JAC's first facility outside China.

JAC's Vietnamese plans come after it signed a US$293mn agreement with US truck maker **NC2** to jointly manufacture and sell trucks and parts in China with an eye on particular markets for export. NC2 is itself a JV between carmaker **Navistar International** and manufacturing conglomerate **Caterpillar**.

The overseas plans will help JAC more than double its exports to 15% of total output by the end of China's 12th five-year plan in 2015 and is part of an expansion programme that may also see a production plant built in Brazil. JAC exported 6-7% of the 322,000 units it produced in 2009 to South East Asia, the Middle East and Latin America. The truck maker expects to produce 400,000 units in 2010 and plans to ramp up output to 1mn units by the end of 2015. Traditionally one of China's leading vehicle exporters, JAC's revenue reached US$3bn in 2009.

Suppliers – Analysis

The domestic spare parts and components sector in Vietnam is small at present, although the government is making it a priority. Given rapid economic growth in the region, there is significant development potential for the industry. The Ministry of Industry and Trade is looking to make the domestic industry more competitive. **BMI** believes that the parts segment needs to be better developed in order to attract vehicle producers to invest in the country. There are signs that the situation is improving, with Germany's **Bosch Group** opening a new plant to serve as a regional base for push-belt production, but to create a vehicle production hub a wider range of suppliers is needed.

One further move to boost domestic part production is the imposition of higher import tariffs on parts that can be made domestically. **BMI** believes that the Vietnamese industry is in danger of being trapped in a vicious cycle where carmakers are reluctant to invest in production without a well-developed supplier base yet suppliers want to see growth potential in vehicle assembly before investing. The government wants local suppliers to be providing 50-60% of all the necessary car parts for domestic production by 2020.

In September 2011, local newspaper VnExpress Sunday reported that manufacturers of car components in Vietnam producing 15 ‘priority’ products will be entitled to tax benefits and encouraging credit policies from the government. Producers will also be offered support in terms of technology, infrastructural development, human resource training and land leasing. The automotive industry will also receive assistance from the Industry and Trade Ministry to achieve its production target of 361,000 cars per year by 2020, which will fulfil 65-68% of domestic demand.

Bosch investment a positive

In August 2011, German automotive components supplier **Robert Bosch** announced that it will now spend US$132.6mn on its gasoline systems factory in Vietnam by 2015, rather than the US$73mn originally allocated. This will enable the company to double its annual production capacity for push belts used in the production of Continuously Variable Transmissions (CVT) from 1.6mn to 3.2mn by 2015. According to **Robert Bosch Vietnam**'s managing director, Vo Quang Hue, the investment will increase the German firm's share of the CVT market, which it expects to grow in line with the country's auto sector.

While Bosch has made sure of strengthening its position in the leading Asian emerging markets (EMs) such as China and India, it has also been investing in some of the smaller markets, focusing on product range as much as geography. Although Vietnam is not currently a major production base for the region, it has become Bosch's production and research and development (R&D) hub for certain products in South

East Asia and has now secured double the original investment intended, while a move into new product areas has resulted in the acquisition of a Taiwanese supplier.

Although **BMI** still believes Vietnam is a work in progress as far as its vehicle production industry goes, with annual output of fewer than 40,000 units, the factory, which opened in April 2011, will give Bosch the chance to be an early mover in the country and serve larger high-growth markets such as China and Japan through exports. **BMI** also sees positive opportunities in the government's plans to create a national industry hub in the Chu Lai Economic Zone. The aim of the project is to increase the scale of domestic production in order to make the sector more competitive when import tariffs are eliminated under the ASEAN Free Trade Agreement in 2018.

Another plus point for Bosch's chosen product range in Vietnam is that its push belts fit a range of vehicles, from small cars up to SUVs, and both petrol and hybrid engines. Ongoing issues with tariffs and taxes for various vehicle types will therefore have less impact if it can supply producers of a range of a vehicle types. The company's plans to invest in new technology to produce its own components will also contribute to increased competitiveness. Bosch has been increasingly focused on becoming more self-sufficient in Vietnam, opening its first software and engineering centre for the South East Asian region in the country in May 2011.

BMI sees Bosch's expansion in EMs, and Asia in particular, as a positive move, which will reduce its exposure to more mature European markets. The company posted a 24% y-o-y increase in sales to EUR47.3bn (US$64.1bn) in 2010, marking a complete recovery to the pre-crisis level of 2007, but was reliant on the European market for nearly 60% of its total revenue. Bosch's Asian sales rose 43% to EUR11bn, which increased the region's contribution total sales to 23% and has clearly encouraged the German firm to continue with this expansion strategy.

Japanese automotive and industrial brakes supplier **Akebono Brake Industry** has announced plans to form a joint venture (JV) with **Akebono Brake Astra Indonesia** and **Astra Otoparts** in Vietnam to produce motorcycle disc brakes and master cylinders for Japanese automakers. The JV, **Akebono Brake Astra Vietnam** (AAVH), will be set up in Hanoi in November 2011 with an investment of nearly JPY130mn (US$1.6mn). AAVH, which is scheduled to become operational in July 2012, will serve the rising demand in growing markets, increase revenue and reduce risks by expanding manufacturing operations geographically.

Company Monitor

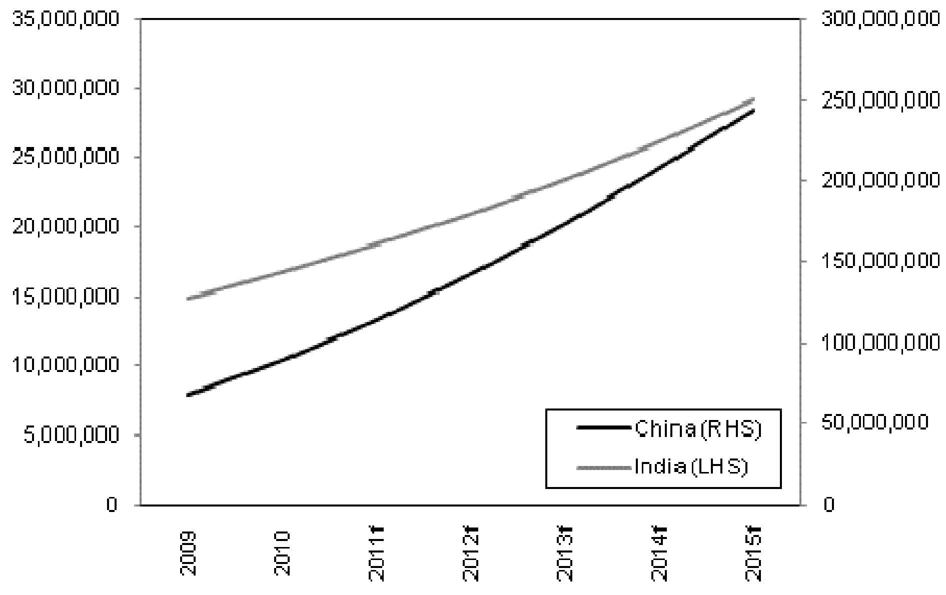
Japanese tyre manufacturer **Bridgestone** has announced record investment of JPY300bn (US$3.94bn) for 2012, as it looks to meet increasing demand from emerging markets (EMs). The investment will also help the company consolidate its leadership of the global tyre market, ahead of French rival **Michelin**, which has announced its own aggressive investment strategy.

Second-Hand Demand

The investment is part of Bridgestone's mid-term business plan for 2012-2016, as revealed by CFO Akihiro Eto. He said that EM demand for tyres is outstripping supply and Bridgestone plans to expand its capacity to meet that demand as soon as possible. One of the key areas of focus for expansion is China, where the slowdown in new vehicle sales is not a problem for tyre producers.

Old And New In Demand

Total Passenger Car Fleet (CBUs)



f = BMI forecast; Source: World Bank

Industry players say tyre sales in China could grow around 30% in 2011, despite projections for much slower vehicle sales following the record sales of 2010. This is because there is also a growing used car segment, expected to grow at three times the rate of its new car counterpart over the next five years, which is generating demand for replacement parts, including tyres. Similarly in India, the sudden increase in the cost of owning and running a new car means industry players expect the second-hand market to more than double in size by 2015.

This rising car ownership is a factor in China's rapidly growing demand for replacement tyres, which is backed by **BMI**'s forecasts for car ownership per 1,000 people to grow an average of 21% over the next five years. As a result, the industry expects tyre sales in China to grow at 10 times the global growth rate.

In August, Bridgestone announced plans to expand its plant in Tianjin to increase its output of passenger car radial tyres. When the expansion is complete in July 2012, the plant will have the capacity to produce 25,300 tyres per day, up 60% from its current daily rate. Particular emphasis will be placed on production of its 'ECOPIA' branded tyres, which contribute to the improved fuel efficiency of a vehicle. According to Eto, EMs will contribute 30% of Bridgestone's total sales of fuel-efficient tyres by 2016, compared with less than 20% currently.

Outside of Asia, Bridgestone is looking to expand its operations in Costa Rica by investing US$70mn in the country over the next five years and making it a base for its new Latin American financial services centre. Highlighting the importance of Costa Rica for its overall regional strategy, Bridgestone revealed in June 2011 that its new centre will help improve financial services for the company in the entire Latin American region. Meanwhile, its investment at the Heredia manufacturing facility will help expand its manufacturing presence in the country and follows a US$18mn investment in a spring factory in Turrialba in 2007.

Back in 2009, Bridgestone revealed it was to increase its exports from Costa Rica to the US. However, its mid-term plan also includes fresh investment for its US operations. The company will expand the annual production capacity of its plant in Aiken, South Carolina to increase production of passenger car radial tyres and light truck radial tyres, with investment of around US$211mn. The expansion will increase the plant's daily output by 8,000 tyres to 37,750 by Q315.

A brand new US plant, also in Aiken Country, will be built to produce tyres for construction and mining vehicles. The US$970mn plant is a response to a projected increase in global demand for such products, particularly in North, Central and South America, according to Bridgestone. Tyre production is expected to begin in H114, with full completion of the project slated for 2020.

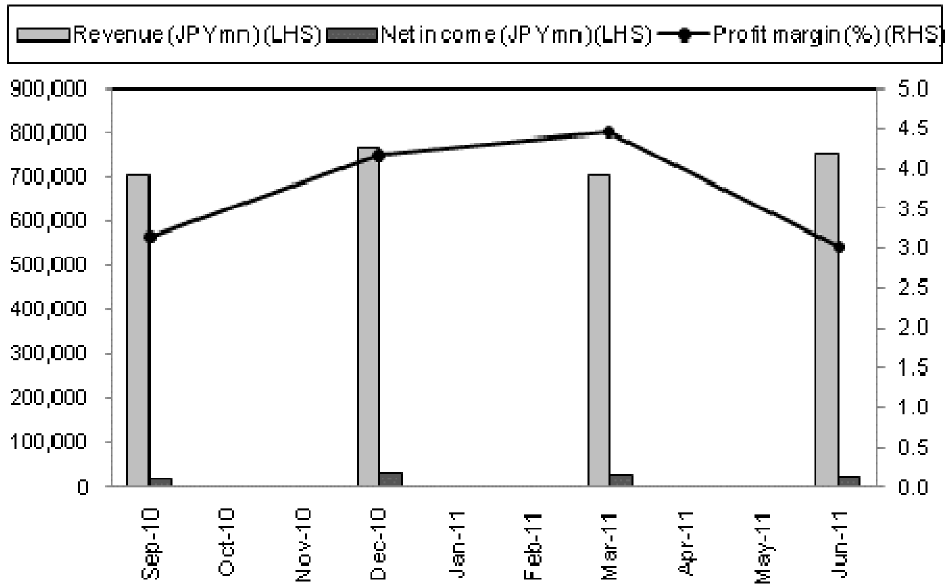
Addressing The Threats

Investment in North America suggests Bridgestone's capital expenditure plans are not all EM-driven. Nevertheless, the increased EM focus should contribute to lower costs, as the company looks to improve its profit margin, which fell from 4.45% in the quarter ending March 2011, to 3.02% at the end of June 2011, despite higher revenues.

Indeed, any increased overseas operations, in emerging or developed states, will reduce Bridgestone's exposure to the strong yen, which has already forced several Japanese carmakers to rethink their production strategies. In addition to improving the competitiveness of its products, however, it will also improve the time to market of Bridgestone's output as its investment projects are targeting the areas where the demand is.

Counting The Cost

Bridgestone Quarterly Financial Results



Source: Bloomberg

All of these factors contributing to improved competitiveness are crucial to holding off the likes of Michelin. With net sales of EUR17.9bn (US$24.5bn) in 2010, is the world's second biggest tyre maker behind Bridgestone, which booked revenue of JPY2.861trn (US$34.6bn) in the same period. Michelin's better-than-expected performance came on the back of its well-balanced exposure in developed and emerging markets (EMs).

Moreover, Michelin has also earmarked a US$2.56bn spending plan for major capacity expansion projects in China, India and Brazil. Michelin has indicated that it will be looking to corner demand in the premium tyre segment, which aligns with the broader outperformance of the luxury vehicle segment in the overall new vehicle market. Industry experts estimate that sales of luxury vehicles in Europe during H111 were almost twice the levels seen during the same period last year, while premium sales in emerging markets continue to be bolstered by rising incomes.

Headwinds For All?

However, there are risks to the plans of both Bridgestone and Michelin, as well as the wider supplier segment - namely weakening demand and increasing input costs. Although there is still demand in EMs thanks to growing used car segments, there have also been reports of drivers switching to retreading rather than replacing tyres in India, where rubber consumption has fallen behind production, according to the Cochin Rubber Merchants Association. If this trend gathers momentum it will eliminate a potential growth area.

Europe is also a major concern and Michelin has already said it could put the brakes on its production and expansion plans if global economic conditions continue to deteriorate. Michelin CEO Michel Rollier estimates that unsold inventories could cost the company up to EUR20mn (US$27.3mn) each day. It has already increased its European tyre prices between 4% and 7.5% this year, to make up for nearly 75% of the EUR1.5bn increase in costs owing to higher raw material prices.

Risks aside, Bridgestone aims to increase its annual sales to JPY3.6trn (US$47.2bn) by 2012, with planned capital expenditure of JPY250bn (US$3.28bn) per year until 2016.

Company Profiles

GM Vietnam (formerly Vidamco)

Market Position

In 2008, Vidamco was in fourth place in the market with sales of 11,036 units and a share of 10%, almost double the share claimed in 2006. This was the result of a 45.6% increase in sales from 2007.

The company's sales for 2009 were up by 29% and its market share had also risen, to 11.8%.

In H110, the company's sales were down 11% to 4,401 units, taking its market share down to 8.75%. By the end of September, its share had slipped again slightly to 8.2%, on the back of a 30% drop in sales for the nine-month period.

For the whole of 2010, sales were down 32%, to 9,685 units.

As of September 2011, GM Vietnam had sold 7,353 CBUs year-to-date for a market share of 9.1%. This puts the company in third place in the Vietnamese market. The company’s best-selling model is currently the compact Cruze, which has sold 2,009 CBUs in the year to September 2011.

New Products

In September 2011, GM announced that it would be changing the name of its Vietnamese operations from Vidamco to GM Vietnam. At the same time, the company announced that it would now be selling all of its cars under the Chevrolet brand, with production and sales of Daewoo branded cars to stop immediately. The company will continue to provide after-sales care and spare parts for owners of Daewoo cars.

GM Vietnam plans to launch three new Chevrolet models in Vietnam before the end of the year, with a plan to upgrade its dealer network and service centres as well. According to the company, Chevrolet sales were up by 40% over the first eight months of the year.

Company Data

- No. of employees: 580
- Year established: 1993

Mercedes-Benz Vietnam

Market Position

Mercedes-Benz Vietnam (MBV)'s sales for 2008 fell almost 7% y-o-y to 2,119 units, taking the firm's share of the market down to 1.9%. In Q109, MBV sold 712 cars, 432 of which were sold in March alone. The Q1 total was a 48.45% improvement y-o-y, with sales up 200% compared with February. In H109, MBV was the only one of the top 10 manufacturers to post positive growth, with sales up 28% to 1,451 units, for a market share of 3.03%. MBV posted the highest growth of the top 10 manufacturers in 2009 as sales ended the year up 60% to 3,399 units.

For 2010, sales were down 17% y-o-y to 2,827 units.

As of September 2011, MBV had sold 1,722 vehicles on the Vietnamese market, for a market share of 2.4%. This places it in eighth place.

New Products

To celebrate the 125th anniversary of Mercedes-Benz in 2011, MBV announced a range of promotions, including the payment of 5% of the registration fees for a new Mercedes-Benz car and the provision of a low 12.5% interest loan (for the first year) for buyers of new C-Class, E-Class and GLK models.

The carmaker is also looking for a local partner to invest in a new Mercedes-Benz dealership to be located in central Hanoi. As of mid-2011, MBV operated six Autohaus dealerships (that cover both sales and service) five city showrooms (sales only) and two workshops (service only). MBV wishes to increase the number of Autohaus dealerships to 10 by the end of 2012, targeting major provincial cities such as Can Tho and Vinh Long.

In April 2010, MBV expanded its alternative fuel range with the launch of the Mercedes S400 hybrid saloon. The company claims the addition of the lithium-ion battery pack, the first in an MBV model, reduces fuel consumption by 20% and increases power by 10%. Vietnam's tax system will influence sales, as the import tariffs, luxury car tax and VAT take the price of the S400 over VND4.41bn (US$210,000).

The new SLS AMG ‘super sports car’ was also unveiled in April, but with worldwide production already sold out, numbers in Vietnam will be limited.

Company Data

- Annual production capacity: 4,000 units

BMI Methodology

How We Generate Our Industry Forecasts

BMI's industry forecasts are generated using the best-practice techniques of time-series modelling. The precise form of time-series model we use varies from industry to industry, in each case being determined, as per standard practice, by the prevailing features of the industry data being examined. For example, data for some industries may be particularly prone to seasonality, ie seasonal trends. In other industries, there may be pronounced non-linearity, whereby large recessions, for example, may occur more frequently than cyclical booms.

Our approach varies from industry to industry. Common to our analysis of every industry, is the use of vector autoregressions. Vector autoregressions allow us to forecast a variable using more than the variable's own history as explanatory information. For example, when forecasting oil prices, we can include information about oil consumption, supply and capacity.

When forecasting for some of our industry sub-component variables, however, using a variable's own history is often the most desirable method of analysis. Such single-variable analysis is called univariate modelling. We use the most common and versatile form of univariate models: the autoregressive moving average model (ARMA).

In some cases, ARMA techniques are inappropriate because there is insufficient historic data or data quality is poor. In such cases, we use either traditional decomposition methods or smoothing methods as a basis for analysis and forecasting.

It must be remembered that human intervention plays a necessary and desirable part of all our industry forecasting techniques. Intimate knowledge of the data and industry ensures we spot structural breaks, anomalous data, turning points and seasonal features where a purely mechanical forecasting process would not.

Automobile Industry

There are a number of principal criteria which drive our extrapolations and forecasts for each auto variable:

Production And sales
At a general level, we approach our forecasting from both a micro angle and a macro perspective, assessing the expansion plans of relevant multinationals/ indigenous firms, while also taking account of the prevailing economic outlook. In this latter respect, **BMI** projections for macro variables such as industrial output, private consumption, government investment, monetary policy and GDP growth play a key role.

Figures for production are derived from a generic source (thereby ensuring maximum comparability between country data-sets), and include all vehicles with four wheels or more. For sales, we rely on data from government agencies and national automobile associations. Unless otherwise stated, sales numbers include domestically produced and imported vehicles, but not exports.

The sector's contribution to GDP is projected by taking the US dollar production value as a proportion of nominal GDP, using **BMI**'s own macroeconomic and demographic forecasts.

Auto Imports And Exports
These variables are predominately calculated at the micro level, using individual company reports. Changes in government policy – particularly with regard to tariffs and quotas – also have a significant bearing.

Sources

Aside from government departments and official company reports, we rely on the International Organization of Motor Vehicle Manufacturers (OICA), other established think tanks, institutes, and international and national news agencies.