Published by:
Creamer Media's
RESEARCH CHANNEL
AFRICA

REAL ECONOMY INSIGHT
AUTOMOTIVE

JULY **2019**

CREAMER MEDIA'S
ENGINEERING NEWS

creamer media

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Real Economy Insight 2019:

AUTOMOTIVE

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The weak macroeconomic conditions battering the South African economy have slowed demand for new vehicles, as consumers' disposable income is under pressure and business confidence has fallen to worrying lows.

With the exception of 2017, new-vehicle sales have been on a downward slope for the past five years and declined to 552 190 units in 2018 (2017: 557 703). Sales continued to fall in each of the first three months of 2019, with January sales decreasing by 7.40%, February sales by 6.50% and March sales by 3.10%. The declining trend came to a halt in April, when the market surprised on the upside, aided by exceptional growth in the export market.

Domestic sales increased by 0.70% year-on-year to 36 794 units in April, while export sales numbers gained by a significant 53.80% to 33 090 vehicles.

Last year, 351 139 South African-made left- and right-hand-drive vehicles were shipped worldwide, an improvement of 13 058, or a gain of 3.86%, compared with the 338 096 vehicles exported in 2017.

South Africa-based automakers have now set their sights on export sales of close to 400 000 units in 2019. To put this into perspective, South Africa exported only about 25 000 vehicles in 1998. Exports have increased sharply in the past two decades, spurred on by the incentives-based support programme that government introduced in 1995.

Europe is the dominant region for South African vehicle exports, accounting for two-thirds of all exported vehicles. In 2018, South Africa exported 233 772 vehicles to Europe, a 22.71% increase on the previous year. Asia is the second-biggest export market, with 50 277 vehicles having been shipped to Asian countries in 2018, which was 4.83% less than in 2017.

North America was previously South Africa's third-largest export partner, but this market has been affected by with the phasing out of the BMW 3 Series exports to the US. Exports of the 2 Series have been replaced by the BMW X3, which will instead focus on Europe. A total of 13 037 South African-manufactured vehicles were exported to North America in 2018, compared with 43 393 units in the previous year.

The African market was South Africa's third-largest vehicle export region in 2018 and has recorded noteworthy

Changing composition of South African vehicle exports

	2014	2015	2016	2017	2018	Change 2018/2017
Africa	61 015	41 431	21 505	21 848	23 988	+9.80%
Asia	34 031	34 929	46 665	52 827	50 277	+4.80%
Australasia	14 608	22 946	22 735	25 125	22 767	-9.40%
Central America	600	496	410	812	1 511	+86.10%
Europe	116 064	173 883	196 727	190 503	233 772	+22.70%
North America	48 136	53 606	52 024	43 393	13 037	-70%
South America	2 484	6 554	4 750	3 588	5 787	+61.30%
Total	276 936	333 845	344 816	338 096	351 139	+3.90%

Source: Naamsa

growth, following a number of years of sharp decline. In 2018, export sales to Africa increased by 9.79% to 23 988 units, which the National Association of Automobile Manufacturers of South Africa (Naamsa) says suggests that demand from the rest of Africa has stabilised and is starting to recover. Export sales to Africa reached 61 015 units in 2014, dropping to 41 431 units in 2015 and to 21 848 units in 2017.

The Mercedes-Benz C-Class, which is manufactured in East London, is South Africa's biggest vehicle export, followed by the Ford Ranger, which is manufactured in Silverton, Pretoria, and the BMW X3, which is assembled in Rosslyn, north of Pretoria.

With a weak domestic market for vehicles, automotive companies are expected to intensify their supply efforts for export markets. There is uncertainty about Brexit – Britain's leaving the European Union (EU) – considering the block's importance to South African exporters. Should the UK leave the EU without a deal, automotive imports will face a 10% tariff, which could prove to be fatal for South African vehicle exports to the UK.

Another obstacle to export growth, particularly in Africa, is that many countries on the continent permit the importation of thousands of used vehicles. Africa, however, is vital to the South African industry's aim of increasing production volumes. Naamsa expects the African market to expand from the current 1.20-million new cars and commercial vehicles to two-million vehicles in five to ten years.

Automotive sector: A key economic contributor

* The automotive industry contributes 6.90% to gross domestic product (4.40% manufacturing and 2.50% retail).
* The industry accounts for 30.10% of the country's manufacturing output and for 13.90% of total exports and is the fifth-largest of all 104 exporting sectors.
* Vehicles and components are exported to 149 international markets.
* The sector employs 110 000 people in vehicle and component production.

Source: Naamsa

Exports are forecast to increase to 384 150 units in 2019 and to 400 200 units in 2020.

MANUFACTURING AND COMPONENTS

South Africa manufactured an estimated 610 854 units in 2018 and this is forecast to expand domestic production by 6.18% to 648 650 vehicles in 2019. The country contributed 0.64% of global new-vehicle production in 2018, up from 0.62% in 2017. South Africa was ranked fifteenth in the world with regard to light commercial vehicle production – largely bakkies – in 2018, with a market share of 1.24%.

Compared with the world's tier-one automotive producers, which each manufacture more than 1.50-million vehicles a year, South Africa is a relatively unimportant automotive producer, but government has an aspirational target of capturing 1% of global output, resulting in production of between 1.30-million and 1.50-million units by 2035.

Seven original-equipment manufacturers (OEMs) – BMW Group South Africa, Ford Motor Company of Southern Africa (FMCSA), Isuzu Motors South Africa, Mercedes-Benz South Africa (MBSA), Nissan South Africa, Toyota South Africa Motors (TSAM) and Volkswagen South Africa (VWSA) – have light-vehicle assembly plants in South Africa.

The major local vehicle manufacturers invested a record R8.17-billion in the sector in 2017, and followed this up with an investment of R7.24-billion in 2018. These figures reflect investment projects by the major vehicle manufacturers in terms of the Automotive Production and Development Programme (APDP) and projected higher levels of production for export markets.

The CEOs of the seven automotive OEMs pledged in October 2018 to invest a combined R40-billion over the coming five years, as part of President Cyril Ramaphosa's $100-billion investment drive. These investments will bring new model tooling, advanced manufacturing technology and additional localisation of parts to South African shores.

Some of the recent major investment announcements include a R3-billion investment by Japanese vehicle manufacturer Nissan to prepare its Rosslyn plant, in Pretoria, for production of the Navara pick-up. Assembly will start in November next year and will add to the current production of the NP300 one-ton bakkie and the NP200 half-ton bakkie. Last year, MBSA announced that it would invest €600-million, or about R10-billion, to expand its manufacturing plant, in East London, and equip it for the future.

The large South African OEMs – all subsidiaries of global automakers – are manufacturing under the newly approved and revised APDP, which provides guidance and stability for the industry up to 2035.

The APDP consists of interrelated mechanisms to incentivise local manufacture, including the Automotive Investment Scheme, which is a cash grant for qualifying capital investment in plant and equipment. The APDP was intended to come to an end in 2020 but Cabinet approved the extension of the APDP in November 2018 from 2021 to 2035. The extension includes amendments to support the South African Automotive Masterplan (SAAM).

The SAAM is the newly developed strategic plan for the long-term development of the automotive industry and the APDP will now operate within the framework of this masterplan. The masterplan focuses on market optimisation, regional market development, localisation, infrastructure development, industry transformation and technology, as well as associated skills development.

The SAAM aims to double employment in the sector to 224 000 jobs by 2035, from 112 000 currently, and position South Africa to account for 1% of global vehicle production by that date. To achieve the 2035 target, the domestic market will have to grow at a compound annual growth rate of at least 4.50% for passenger vehicles, 3.50% for light-commercial vehicles and 3% for medium- and heavy-commercial vehicles.

The new automotive industry framework places local content at the centre of any future support for the industry, with government having set a target of raising local content from less than 40% currently to 60% by 2035. Currently, VWSA has the highest local content of all vehicle manufacturers in South Africa, at about 45%. Without high-value-added-type component projects, however, such as engine production, it is unlikely that OEMs will reach 60% local content. The APDP allows automakers to build extra parts and export them to earn additional benefits; therefore, manufacturers do not need to use all the parts in their vehicles. South Africa-based manufacturers can create suppliers to produce large numbers of parts for their parent companies abroad.

That should benefit the country's component supplier industry. South Africa is already a strategic supplier of catalytic converters to the world, and by value, this component category is the dominant component export each year. In 2017, the country exported catalytic converters worth R18.70-billion, engine parts worth R3.77-billion, and tyres worth R2.52-billion.

REGIONAL DEVELOPMENT

OEMs believe that a regional market in sub-Saharan Africa is central to the sustainability of the South African automotive industry. Through the African Association of Automotive Manufacturers (AAAM), South African OEMs are pushing for three, possibly four, vehicle production centres on the continent as part of a pan-African automotive deal. These include South Africa, Nigeria, Kenya and possibly Ethiopia. South Africa could, for example, produce bakkies, while Kenya could possibly assemble trucks and buses. The Kenya and Nigerian new-vehicle markets have the potential to develop to the same level as South Africa's, at about 600 000 new vehicles sold a year.

"If we do not get Africa right as a combined market, we can say goodbye to the South African [automotive assembly] industry in the next ten years. South Africa is symbiotically linked to the future of Africa," AAAM CEO Thomas Schaefer, who is also the CEO of VWSA, has said.

AUTOMOTIVE 'DISRUPTION'

The automotive industry is heading into restructuring and the landscape will significantly change in the next two decades. Much of the industry "disruption", so described by Toyota South Africa's Andrew Kirby, stems from changes to drivetrain technologies.

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New powertrain technologies, such as battery electric vehicles (BEVs), plug-in hybrids and fuel-cell electric vehicles (FCEVs), are making headway, putting pressure on the traditional internal combustion engine (ICE).

Advisory firm KPMG's latest 'Global Automotive Executive Survey' report forecasts that multiple drivetrain technologies will co-exist for some time and that the mix will vary from country to country. Executives participating in the survey believe in a fairly even split of BEVs (30%), hybrids (25%), FCEVs (23%) and ICEs (23%) by 2040.

According to the survey, consumers are not yet ready for fully alternative drivetrain technologies, with hybrids the number-one choice for a consumer's next car choice, followed closely by ICEs.

The KPMG report notes that Western Europe's influence in the global automotive manufacturing industry will shrink from 15% to less than 5% by 2030, while China is becoming the leading nation in terms of battery electric mobility.

These global market trends, coupled with new domestic changes under a new regulatory regime that starts in 2021, are resulting in the South African industry undergoing its "biggest disruption" since the introduction of the Motor Industry Development Plan in 1995.

The industry has to find a unique, local way of dealing with changes, particularly transformation and supply chain management. Naamsa believes that the South African motor industry is on the cusp of a growth spurt, but much of its future success relies on how successful it is in establishing a regional African market.

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