Chapter 5

Economic impact on Malaysia automotive industry in 1997

Sales volume of automobile is regarded as barometer of economy. There are direct correlation between automobile sales volume and economy indicators in Malaysia. Some of the obvious economy indicators affecting the automobile sales in 1997 are GDP (Gross Domestic Product), currency exchange, real interest rate, and financing policy.

GDP growth and financing policy

In first half of 1997, GDP remained strong at 8.5% and moderated to 7.1% in second half of 1997. CPI (Consumer Price Index) contained at 2.8% in first half of 1997 and increased moderated to 2.5% at second half of 1997. In second half of 1997, there was a sharp decline in exchange rate, -35.1% against USD. Besides, there was sharp decline in stock market at –44.8% and loan growth moderated to 26.5% at end December against 30.4% at end-June 1997. Generally, there was weak market sentiment and confidence towards end of 1997. The decline in Ringgit in the final quarter of 1997 reflected weak market sentiment, influenced by regional developments and market perception that the financial system would be adversely affected by the fall in stock value and the potential decline in property prices as well as expectations of higher interest rates. (BNM, 1997)

During the final quarter of 1997, the Government put in place a package of macroeconomic stabilisation measures. These measures centred on the further tightening of monetary policy, maintaining fiscal prudence, restoring external trade balance through the deferment of a number of large non-critical projects and the strengthening of the financial system. With this tight monetary policy, finance companies were unable to provide end financing for automotive purchase. Even if the finance company did give loan financing, lower low amount and extreme high interest rate were deteriorated to sales. These were some of the main reasons causing sales of automobile started to drop in November 1997. Refer to table 13 for total vehicle registered in Malaysia.

As interest rate continued to increase, monetary restraint policy was adopted in September 1997 to contain inflationary pressures arising from the ringgit depreciation as well as to discourage capital outflows. The 3-month interbank rate, which is BNM's policy rate, had been raised in several steps from 7.55% in mid-September 1997 to 8.7% at end-1997. The high shorter-term interest rates reflected the tight liquidity conditions in the market more so the smaller financial institutions. Furthermore, with increased uncertainties in the financial market, there was a flight to quality of retail deposits placed with these smaller institutions towards the end of 1997 and in early 1998.

From second half of 1997 to first half of 1998, the major obstacle to sales increase in domestic automotive market is the difficulty in obtaining end-financing. Interest rates, which have been creeping up, had also impacted car sales. From the initial 7% as August 1995, rates climbed to 8% in October 1997 and to 10-11% in December 1997. Regardless of the rising interest rate, the sales of automobile continue to rise till November. However, it increased with slower pace as compared with the same period in 1996. When Interest rate at the highest in December, the sales of automobile dropped drastically from a high of 31933 in November to 20346 in December. Refer to table 13 and chart 1.4 in Appendix A.

In addition, in March 1997, Bank Negara had directed all financial institutions to limit their lending to non-productive sectors of the economy, which included the motor industry. Taking heed, banks and finance companies have adopted more stringent lending policies and lower percentage of end financing. This resulted in lesser loans being given out for the purchase of cars. This can be seen from the declining trend of loan availability on purchase of transport vehicles by finance company, only 1.35% of total loans by banking system was allocated to purchase of transport vehicles in forth quarter of 1997. Refer to table 11 in Appendix A.

Exchange Rate

For 1997 as a whole, the ringgit recorded a depreciation of 31.4% against the composite basket of currencies of Malaysia's major trading partners. The depreciation of the ringgit was pronounced against all major currencies, ranging between 25-35%. Against the green back, the ringgit depreciated by 35%. Against the pound sterling, the ringgit depreciated by 33.7%. The relatively moderate decline of the ringgit against the Japanese yen by 27.3% reflected mainly the weakening of the yen against the United States dollar in the wake of the weak economic activity and financial sector problem in Japan. (page 55-56, BNM, 1997)

Due to the unfavorable currency exchange rate, increase of duties on foreign luxury cars and inflation rate, most of the non-national car companies had increased their price started from forth quarter of 1997. As show in table 9, Toyota and Mercede Benz had increased the car prices started from forth quarter. The sales volume of non-national car such as Nissan, and Toyota, Honda, BMW, and Mercede Benz started to decline in October / November, as shown in chart 1.3 in Appendix A. National car companies such as Perodua, Proton and USPD trying to hold on to their price to attract more customers. Nevertheless, the sales of Proton car started to decline in November as well. At the initial stage, automobile companies might not be affected by the currency exchange rate due to advance inventory order placed and served as cushion for a few months. However, automobile industry was impacted when currencies exchange crisis carried on to 1998.

Meanwhile, investors had dumped their motor stocks on Kuala Lumpur Stock Exchange which by the end of 1997 were trading at 70% to 85% below their January prices. Should sales remain bleak, motor stocks on the KLSE will remain underweight.

Impact felt by automobile industry and Proton

Prior to the currency and financial crisis, Automotive industry is one of the sectors that showed an impressive performance in 1997. Despite the erosion of wealth, demand for new cars continued to remain strong in the first nine months of 1997. Sales of passenger cars and commercial vehicles declined drastically by 9.8% and 34.1% respectively in the

last quarter of 1997 (increased by 22% and 26.7% respectively in the first nine months of 1997). Car sales declined towards the end of the year when BNM tightened the hire-purchase guidelines for the purchase of passenger cars by lowering the credit ceiling from 75% to 70% and shortening the repayment period to not more than five years. In addition, demand was affected by the imposition of higher import duties and tight liquidity in the banking system. Despite these developments, the assembly of motor vehicles recorded a higher growth of 21.2% while the production of motor vehicle parts and accessories moderated to 0.3% in the fourth quarter of 1997 (16.7% and 8.7% respectively in the first nine months of 1997). The sharp moderation in production of motor vehicles only occurred in December when its growth slowed down to 13.5% from 28.6% in November 1997. In addition, the assembly of motorcycles and scooters declined by 15.2% in the fourth quarter (an increase of 26% in the first nine months of 1997). Consequently, growth in the transport equipment industry as a group moderated sharply to 10.7% in the fourth quarter (15.5% in the first nine months of 1997), contributing to the sharp moderation in output to 14.2% for the year as a whole. (pg 13, BNM 1997)

Although the automotive industry recorded higher passenger car sales of approximately 308,000 units in 1997 when compared to 276,000 units in 1996, the change in the economic environment and the negativity in the market in early 1998 had begun to affect the automotive sector and the passenger car total industry volume then dropped. The drop which began towards the end of the year is due to new regulatory measures and guidelines on hire-purchase, a downward review of the financing ceiling and review of loan repayment period. This tightening of liquidity has led to a significant decrease in sales.

Since the demand of vehicles had dropped and cost of production gone up with the weaker ringgit, most of the car companies undertook a major across-the-board austerity drive with drastic overhead reductions towards lowering the breakeven point of each company. Direct and indirect costs have been cut by 30% minimum. They are now doing things mostly in-house, thereby reducing as much as possible any contracting and dependence on contract workers and expatriates. Capital expenditure has been drastically

reduced, deferred or cancelled. There had been a comprehensive review on the need to incur capital expenditure, however small the amounts.

Proton began to feel the impact of economy crisis in December 1997. Despite the steep decline in sales experienced in the last month of 1997, Proton models distributed by EON and USPD continued to dominate the market in 1997. The company's share of the passenger car market was maintained at 64%, same as 1996.

To counter the effects of the economic downturn, major across-the-board austerity drive was undertaken by Proton at both the company and group levels. Aimed both at conserving cash and lowering capital expenditure, the cost-cutting programme has been implemented aggressively to sustain operations. Keeping costs low was now crucial for the survival of motor companies. The cost cutting exercise was implemented in late 1997 and carried on to 1998, the worst hit year for Proton. Detail of what Proton and EON had done during this difficult year will be covered in next chapter.