

The Automotive Industry in Eastern Central Europe

Due first and foremost to foreign investment, the automotive industry in most of the countries of Eastern Central Europe has emerged as an important economic factor. German automotive parts suppliers have seized the opportunity to produce there at lower cost, as well as to take advantage of local sales potential.

General industry trends

Production patterns. The automotive industry – automobile makers and parts suppliers alike – has become one of the main forces driving economic growth in the new EU countries of Eastern Central Europe. This is especially true of the Czech Republic, Hungary and Slovakia, where automobile production accounts for 15 % or more of total manufacturing output. In Slovenia and Poland, where the figure is closer to 9 %, the automotive industry's role in the manufacturing sector is substantially smaller.

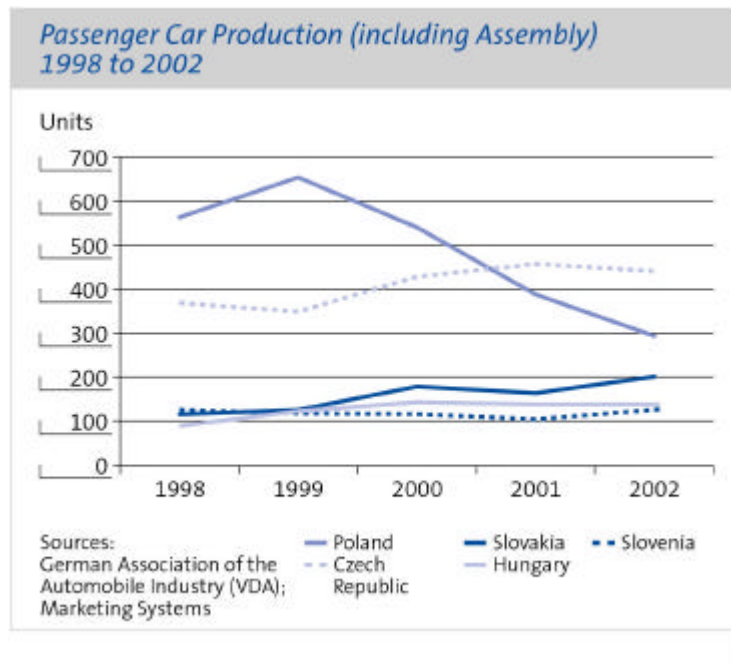
The growth of the automotive industry in these countries is closely linked to the strategies of the big international automobile makers, which have either taken over existing production facilities in the region or set up new ones. Their objective is not merely to supply these increasingly attractive markets, but also to export to neighbouring countries by exploiting the comparative cost advantages.

Along with the auto manufacturers, many large and medium-sized parts suppliers – especially German ones – have invested in these countries, directly supplying the local automotive industry. At the same time, local companies there are often interlinked with German plants in production alliances, since producing in these countries means a cheaper supply of parts. In view of the continuing pressure on prices exercised by the big automakers, parts suppliers welcome the possibility of being able to cut costs while maintaining the same level of quality.

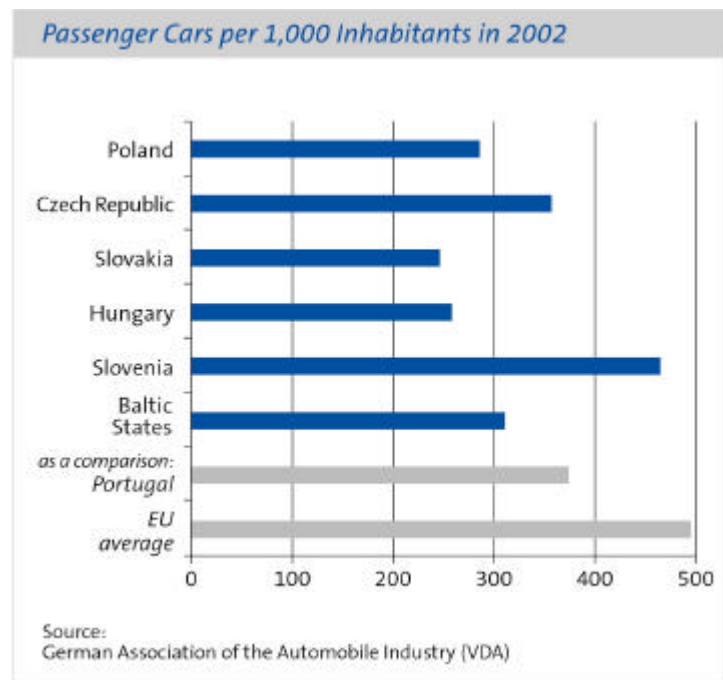
Automobile production in the countries of Eastern Central Europe continues to display an upward trend, though not a steady one, as can be seen from the graph above on page 2, which covers the years 1998 to 2002. The Polish market in particular has slipped into a severe crisis. Production has undergone a drastic decline; the number of new registrations has likewise dropped. Tax hikes and problems at *Daewoo* have both played a major part in this process.

In the Czech Republic, too, the number of units produced in 2002 fell, while the level of production in Hungary stagnated. Conversely, the upward trend in Slovenia and Slovakia experienced only a brief hiatus.

One of the key characteristics of the sector is that production in each country tends to be completely or almost completely in the hands of only one or two manufacturers. This applies to the Czech Republic (*Skoda*) as well as to Slovakia (*VW*) and Slovenia (*Renault*). In Poland, automobile production is essentially synonymous with *Fiat* and *Opel*, while *Suzuki* and *Audi* jointly dominate production in Hungary.



Trends in demand. Demand for passenger cars in Eastern Central Europe in recent years has risen markedly. However, the density of automobile ownership varies substantially from one country to another. The highest level is found in Slovenia, with 465 cars per 1,000 inhabitants. The figure for other countries is distinctly lower, in part falling considerably below the EU average (see graph below).

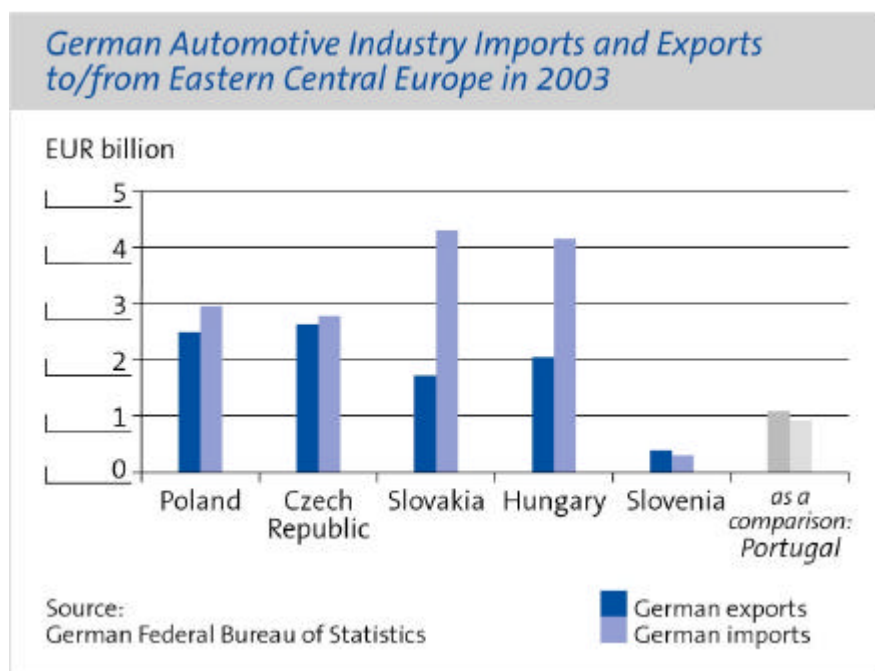


In all of these countries, minis and compact cars dominate the registrations, making up some 55 % of the total. A further 32 % fall into the lower medium-range category. Owing to local income levels, we do not expect to see any significant change in demand structures during the foreseeable future.

Foreign trade trends

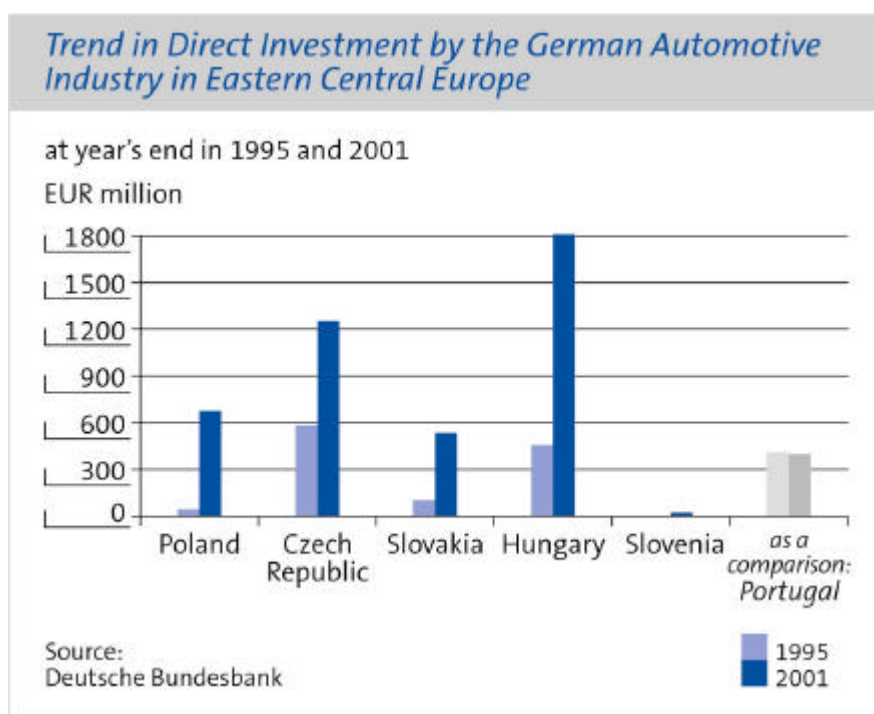
As a market for high-end German cars, the countries of Eastern Central Europe are of only limited significance. Only Poland, which accounts for some 54,000 units, and Hungary, with approximately 36,000, figure appreciably in the German export statistics.

However, that a lively trade nevertheless takes place in both directions (see graph) is due to the fact that bilateral commerce involves not just vehicles but auto parts too. Given the strong presence of German parts suppliers in the new EU member states, it comes as no surprise that German imports from these countries outweigh the exports of German manufacturers in the opposite direction. This is particularly true of Hungary and Slovakia, which have emerged as important locations for parts producers and assembly operations.



Direct investment

German automobile and automotive parts makers were among the first to invest in these countries. This investment partly went into existing companies (takeovers, joint ventures), and partly involved the establishment of new plants. Investment by automotive parts suppliers was mainly aimed at supplying the carmakers already manufacturing in these countries, as well as at securing low-cost exports to Germany as a means of cushioning the price pressure exerted by carmakers.



Hungary and the Czech Republic have for many years been the preferred targets for German direct investment (see graph). The Czech manufacturer *Skoda* was taken over by *Volkswagen* as early as 1991, while its subsidiary *Audi* chose to have its Audi TT model line assembled in Hungary. VW is also active in Slovakia, where *VW Slovakia* is currently the only company making cars in the country.

For German parts makers, too, the Czech Republic and Hungary have thus far been the investment targets of choice. Very recently, they have been joined by Slovakia. Many companies are actually represented by subsidiaries and affiliates in a number of countries. The heavy presence of German auto parts makers, as well as a whole host of important companies from other car-making countries, means that most automotive subcontractors in Eastern Central Europe are now foreign-owned.

Medium-term prospects

Major new projects. The importance of the automotive sector in the countries of Eastern Central Europe seems set to keep growing. Nor will its importance be confined to improving these countries' balance of trade: it will also serve as a motor for technological development in other important industries. The introduction of new manufacturing technologies and systems and the training of skilled workers and executives will, on the whole, have a positive impact.

New operations in various countries have been announced, and these are likely to bring new dynamism to the sector. The decision of a Franco-Japanese consortium consisting of *Toyota* and *PSA Peugeot Citroën (TPCA)* to build a car factory in the Czech Republic for producing a compact car surely augurs well for the future of the already important Czech car industry. In total, EUR 1.5 billion will be invested for the production of a projected 300,000 units.

PSA is also building a EUR 700 million-car plant in Slovakia, in which some 300,000 are to be manufactured starting in 2006. Likewise in Slovakia (or possibly in Poland), *Hyundai* plans to EUR 1.1 billion-production facility. *VW* has announced plans for producing a new delivery vehicle in Poland, as well as its T5; plant capacity will reach 150,000 by 2005.

Parts suppliers ratchet up their presence. German car manufacturers already enjoy a strong position in the countries of Eastern Central Europe. Moreover, over a hundred German auto parts makers are present in the region, some with several plants. Especially in light of the major projects now in the pipeline, the parts suppliers are sure to expand their presence in these countries: in spring 2003, an IKB survey of some 200 of these companies revealed that Eastern Central Europe would be the main target of their foreign investment plans in coming years.

Huge sales potential. Regardless of the difficult economic situation in recent years, their relatively low levels of automobile ownership mean that Germany's eastern neighbours still offer great potential for growth. Owing to its large population, Poland represents a particularly attractive market. A gradual increase in automobile density to the current level of Portugal (see again the graph below on page 2), for example, would imply demand for 3.4 million cars. Just as in other countries, as incomes rise, demand for larger cars will increase at the expense of compact models. Of course, this will be a very slow process.

New markets in the East. Manufacturing in the countries of Eastern Central Europe is doubly attractive inasmuch as they can serve as a base for supplying subsequent candidates for EU succession (Croatia, Bulgaria, Romania) as well as countries further to east (Russia, Belarus, Ukraine). These countries likewise harbour major potential for growth, albeit initially limited to minis and compacts. Here, Bulgaria and Croatia already have relatively high levels of car ownership (327 and 312 per 1,000 inhabitants, respectively), while Romania (with 176) and Ukraine (with 135) still have considerable catching up to do. Furthermore, a number of countries in Southeastern and Eastern Europe already feature in the strategic plans of carmakers and parts producers as possible production locations.

On the whole, the German automobile industry – which is already benefiting greatly from its presence in Eastern Central Europe – will continue to profit from the ongoing process of adjustment and integration. Most of the companies which have already taken the plunge and invested in the new EU member countries have had a positive experience, though not always without initial difficulties. For those German supplier companies that are still holding out, the accession of these countries to the EU is likely to reduce their reluctance to invest.

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