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PANORAMA

Automotive Sector Central Europe

COFACE ECONOMIC PUBLICATIONS

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The automotive sector plays an important role in the CEE's economic activity. Thanks to low labour costs, the educated workforce, geographical proximity to Western European markets, tax incentives and the stabilising legal environment, CEE countries have become attractive destinations for investment by global car manufacturers.

The automotive sector contributes to the economic growth of CEE and has a sizeable share in the region's economy. As an employment sector, it provides 850,000 jobs - a 2.5 % share of total employment. Our Panorama focuses only on car manufacturers in CEE countries where significant volumes of cars are produced: the Czech Republic, Hungary, Poland, Romania, Slovakia and Slovenia. There are, in total, 33 car plants in these countries, manufacturing engines, personal cars, commercial vehicles and buses. The CEE region has been able to attract FDIs thanks not only to attractive labour costs and its geographical proximity to Western Europe, but also its educated workforce and the improving business climate which is more favourable for investors. Despite these strong foreign direct investment (FDI) inflows, only two CEE countries figure in the list of the world's 20 biggest vehicle producers. If last year's total car production from the 6 countries covered by our analysis (the Czech Republic, Hungary, Poland, Romania, Slovakia and Slovenia) were combined, they would equal the amount manufactured in India – the world's 6th largest car manufacturer.

Despite the economic deterioration noted in several emerging economies, the automotive sector in the CEE region has been generating fairly dynamic sales growth. This mirrors the improved prospects of the sector's main external market, the Eurozone, where a significant share of CEE automotive production is shipped. Since the 1990's, the CEE region has been benefitting from FDIs in its domestic car plants. Some of these plants became sites for manufacturing and assembling foreign brands. However two local brands, Czech Skoda and Romanian Dacia, have been able to survive in the competitive global market.

Although the increased volumes in car production sales are confirmed by hard data, the automotive sector is not risk-free. Many CEE economies are dependent on foreign trade. This huge dependence on exports is positive during a period of booming demand but can be negative when markets are deteriorating. Although rebounding private consumption in CEE economies makes this addiction to external markets less of a danger, it still remains a crucial factor given that the prevailing share of the CEE's automotive production is sent abroad. Despite improved economic prospects, consumers are still cautious in their purchasing decisions and expectations of sizeable discounts are an important criterion in their brand selection process. At the same time, growth in car registrations is not only a result of increased demand for vehicles but also due to self-registrations affected by car manufacturers and their dealers. With these latest developments and improving domestic prospects, is the CEE automotive sector still reliant on foreign demand?

DOSSIER

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"The automotive sector is a strong driver for CEE economies. Countries have been able to attract significant FDI amounts which resulted in more than doubled vehicle production in the region in last ten years. However Slovakia, the Czech Republic and Romania were the most successful in that area where car production tripled or even quadrupled. Although Poland was also supposed to join this exclusive group, its vehicle production has been gradually decreasing after 2008 bringing the level of manufacturing in 2014 to the same as ten years before."

1 THE CEE* AUTOMOTIVE SECTOR IS MOVING FASTER - BUT RISKS REMAIN

The CEE automotive sector has expanded, with strong FDIs

The automotive industry is an important pillar of Central and Eastern European economies. It has long traditions but the sector's growth potential was disrupted during the communism era. Following the region's break-away, most domestic car brands were unable to expand on their own. However the CEE automotive sector remained attractive for global automotive players. At the beginning of the 1990's, pioneering investments to purchase existing car plants included Volkswagen in Czechoslovakia's Skoda, Renault in Slovenia's Revoz and Fiat in Poland's FSM. Low labour costs, the educated workforce, geographical proximity to Western European markets, tax incentives and the stabilising legal environment, all contributed to making the CEE attractive to foreign investors. Most were brownfield investments by global automotive corporations to increase manufacturing capacities for their own brands. Nevertheless, two local names remained in the game and received a new lease of life - namely Czech Skoda and, more recently, Romanian Dacia.

During the course of last year, nearly 90 million vehicles were produced worldwide. Although a growth in car production in the CEE region was recorded, only two Eastern European countries managed to enter the list of the top world's 20 biggest vehicle producers – the Czech Republic and Slovakia. The worldwide rankings are led by manufacturers from Asia, North America and EU-15[1] countries, while the CEE share amounted to 4% in 2014. The most spectacular increase in car production in recent years was recorded in China, where the level has grown from 2.3 million units in 2001, to 23.7 million in 2014 (a rise of over 900% during the period).

Chart 1:
Major producers of vehicles (passenger cars and commercial vehicles, in millions of units, 2014)

China	23.72
USA	11.66
Japan	9.77
Germany	5.91
South Korea	4.52
India	3.84
Mexico	3.37
Brazil	3.15
Spain	2.40
Canada	2.39
Russia	1.89
Thailand	1.88
France	1.82
UK	1.60
Indonesia	1.30
Czech Rep	1.25
Turkey	1.17
Iran	1.09
Slovakia	0.99
Italy	0.70

Source: OICA

* CEE = Central European Economies
[1] EU-15: Austria, Belgium, Denmark, Finland, France, Germany, Greece, Ireland, Italy, Luxembourg, Netherlands, Portugal, Spain, Sweden, United Kingdom.

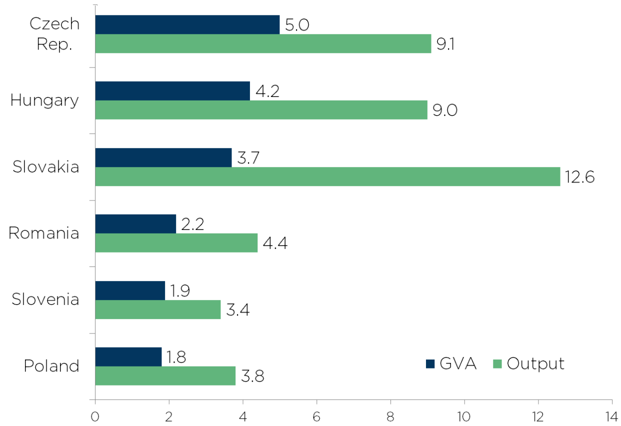
While last year's statistics show a fair growth in world vehicle production (up by 2.6% compared to 2013), automotive output has been fluctuating in recent years. The global financial crisis impacted the ability of households and businesses to purchase cars. In 2009, global car production fell by 13% compared to 2008, down to 61.8 million units. Production in the European Union decreased by 17.3%, to 15.2 million vehicles, while in the US it plummeted by 34%, to 5.7 million. Emerging economies have stepped into the driver's seat in the global automotive market, with China becoming the main producer, as well as the main buyer, of cars in recent years. The US market[2] has rebounded and is generating positive growth dynamics but its past deterioration, including the insolvency of its flagship automotive manufacturing location, Detroit, is a reminder that pre-crisis levels have not been reached.

An important contributor to the economic growth of CEE countries

Although, within a global perspective, only 4% of cars were produced in CEE countries last year, the importance of the automotive sector for the region is high. In 2014, 3.6 million vehicles were produced in Eastern Europe, equating to 21% of total EU production. The manufacturing of vehicles, trailers, semi-trailers and other transport equipment provides around 850,000 jobs in the CEE region. It also makes a sizeable contribution to the overall performance of the economy. The most important examples are Slovakia and the Czech Republic where, respectively the automotive sector accounts for 32%, 22% of total manufacturing production value. This also translates into substantial input into the overall manufacturing output of these economies, with 12.6% and 9.1%, respectively.

Chart 2 illustrates the automotive sector's share of gross added value (GVA), alongside the total manufacturing outputs in CEE economies. Differences between GVA and manufacturing output can be seen in most Eastern European countries. As summarised by the IMF, this is a result of the dominant role of car assemblies within the automobile industry. Assemblies account for only a small share of added value, as the central focus of added value creation has shifted to auto parts suppliers.

Chart 2:
Automotive sector*: share of gross added value and total manufacturing output (%, 2013)



* Manufacturing of vehicles, trailers, semi-trailers and other transport equipment

Note: Data on Poland uses Coface's estimates, due to unavailability of official figures for 2013

Source: Eurostat

Chart 3:
Total vehicle production (personal cars and commercial vehicles, in thousands of units)

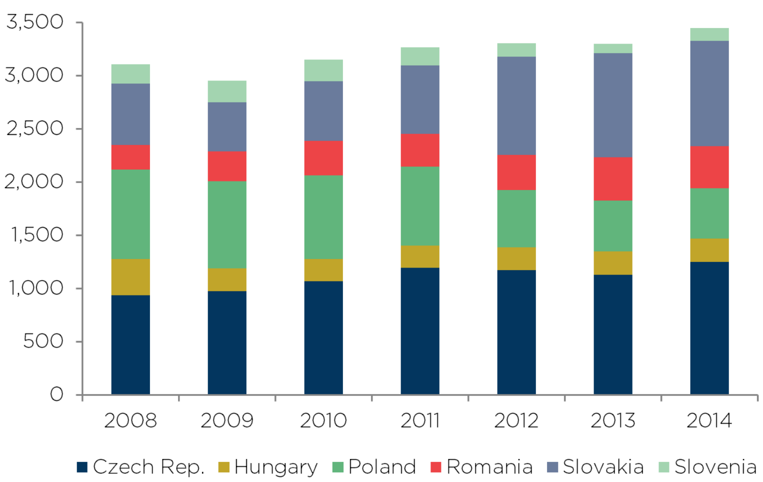
		Czech Rep.	Hungary	Poland	Romania	Slovakia	Slovenia
Production	2008	946.6	346.1	952.8	245.3	575.8	197.8
	2014	1,251.2	227.0	593.9	391.4	993.0	118.6
	2014 (2008=100%)	132%	66%	62%	160%	172%	60%

Source: OICA, own calculations

[2] Details of the US automotive market can be found in the Coface Panorama on the US car sector, published in April 2015.

Vehicle production in the CEE is dominated by two countries, with the Czech Republic and Slovakia combined accounting for nearly two-thirds of the region's total car production. The biggest economy in Eastern Europe, Poland, produced 600,000 cars last year - less than half of the quantity produced in the Czech Republic. Production in Poland has been gradually decreasing, leading to overcapacities, especially in personal vehicle manufacturing. Recent investments to expand the capacity of car manufacturers have mainly been in the Czech Republic, Hungary, Romania and Slovakia. Although production in the CEE is dominated by the manufacturing of passenger cars, Poland benefits from a significant share of the production of commercial vehicles. Whereas this sub-sector represented 1% of the total share in other CEE countries, it accounted for 25% in Poland last year. Several brands of commercial vehicles are produced in Poland. These include Scania buses, MAN buses and heavy trucks, a domestic brand of Solaris[3] buses (which has successfully expanded to many foreign markets) and last, but not least, military vehicles through the Polish company Jelcz. Light vehicles account for the biggest share of commercial vehicle production. Volkswagen has been producing its Caddy and Transporter models in Poland for worldwide markets for more than 10 years. Moreover, the producer has begun construction of a new plant in Poland, for the next generation of Volkswagen Crafter. The new facility is expected to start production in late 2016, generating employment for 3,000 workers.

Chart 4:
Personal car production (in thousands of units)



Source: OICA

The level of vehicle production in recent years was subject to internal demand in CEE economies but was even more dependent on the global performance of the automotive market. The latter fluctuated when it was negatively impacted by two major economic occurrences - the global financial crisis and the double dip recession in the Eurozone. Challenged by the deterioration in demand, along with weak consumer and business confidence indicators, car registrations slumped during the crisis years. Many car manufacturers were obliged to implement cost optimisation processes, while trying to retain their market share. This created manufacturing opportunities for locations with attractive labour costs, such as CEE countries. Indeed, when compared to vehicle production in the EU-15, which has still not yet returned to the levels recorded in 2008, total vehicle production in the CEE exceeded its 2008 levels by 10% last year.

When breaking down CEE vehicle output, differences in production levels can be seen in certain countries. While the Czech Republic, Slovakia and Romania showed significant increases in car manufacturing, production dropped in other Eastern European economies. Countries can either be winners, or victims of demand for particular car brands and models - as well as being subject to the decisions of their head companies on the production levels in different factories.

Production dominated by personal cars

Within the 6 CEE countries covered by our analysis, there are a total of 33 car manufacturing plants. Their production is dominated by Western European brands, often from Germany, France and Italy. The CEE region is also attractive for Asian manufacturers, such as Hyundai, Toyota and Suzuki. The majority of production concerns passenger cars, although three countries also manufacture heavy commercial vehicles. Only one - Poland - produces light commercial vehicles (at its Volkswagen plant). There are also engine assemble plants which are used for locally produced cars and sent to foreign factories. As an example, Toyota engines and gearboxes assembled in Poland are used in factories all over the world.

While some local brands of heavy vehicles and buses have been able to address foreign markets, domestic producers of personal cars have been less successful in remaining on the market, or in creating new brands that could be expanded to overseas. However there are two strong exceptions, namely Czech Skoda and Romanian Dacia. These two brands have been re-dynamised, thanks to FDIs made by Volkswagen and Renault.

[3] Solaris is a producer of city, intercity and special-purpose buses, as well as low-floor trams. Since the start of production 1996, over 12,000 vehicles have already left the factory and are now available in 29 countries.

Skoda, a brand with long traditions, has created a wide selection of car models which are not only popular in the Czech Republic, but also in foreign markets. In 2014, Skoda's global sales exceeded 1 million units, of which 967,000 were sold on foreign markets and 70,000 were sold on its domestic market. Skoda's local production in 2014 amounted to 736,000 units, as some production was moved to neighbouring Slovakia and to emerging markets where a growing proportion of the middle classes is generating solid demand. As such, factories are also located in China, India and Russia.

The popularity of Skoda's cars is growing. Global sales increased by 13% in 2014 compared to the previous year. Its Octavia and Fabia models remain customer favourites. As the brand strengthens its solid position in Western Europe, it is also increasing its focus on prospective markets. In 2013, China became Skoda's biggest country market, with a total of 227,000 deliveries. Over the coming years, Skoda plans to increase its worldwide sales to at least 1.5 million vehicles annually. To achieve this objective, a strategy has been implemented to introduce a new or revised model on average every six months.

Romanian Dacia became a brand of the Renault Group in 1999. Since then it has been increasing its market share. High growth dynamics were especially noted during the 2008-2010 crisis years, thanks to new models and its ability to offer quality budget cars. Sales dynamics remain impressive. More than 511,000 cars were produced last year, while annual sales increased by 19%. The Romanian Mioveni plant has a capacity of 350,000 vehicles per year. Most of this production is for foreign markets, with 93% of the plant's output in 2013 destined for export. Dacia's foreign manufacturing sites include locations in India, Colombia and Morocco. The brand currently offers 6 models, including its best-seller, the Logan, with sales of 1.4 million cars since 2004. Of the 5.5 million Dacia cars produced during the last 46 years, 3.2 million were manufactured in the last 10 years.

A variety of brands are manufactured in CEE factories. They include a range running from small city cars such as the Volkswagen Up, Toyota Aygo and Peugeot 108, to premium models such as the Audi TT, Mercedes CLA, Volkswagen Touareg, Audi Q7 and bodies for Porsche Cayenne. VW's Slovakian plant is to be further expanded for the production of bodies for Bentley Bentayga.

Chart 5:
Automobile assembly and engine production plants in CEE countries

Country	Manufacturers	Brands	Types produced					Total number of plants
			Engine	PC	LCV	HV	Bus	
Czech Rep.	Tedom, TPCA, Tatra, Volkswagen, Sor, Hyundai, Iveco	Toyota, Peugeot, Citroen, Tatra, Skoda, Sor, Hyundai, Iveco	✓	✓		✓	✓	8
Hungary	Suzuki, Volkswagen, Daimler, GM	Suzuki, Audi, Mercedes-Benz	✓	✓				4
Poland	Fiat, Solaris, GM, Toyota, Volkswagen, Volvo, Jelcz	Fiat, Lancia, Alfa Romeo, Solaris, Opel, MAN, Volkswagen, Scania, Ford, Volvo, Jelz	✓	✓	✓	✓	✓	14
Romania	Roman, Renault, Ford	Roman, Dacia, Ford	✓	✓		✓	✓	3
Slovenia	Renault	Renault		✓				1
Slovakia	Volkswagen, PSA, Hyndai	Volkswagen, Audi, Porsche, Skoda, Seat, Peugeot, Citroen, Kia	✓	✓				3

Notes: PC – personal car, LCV – light commercial vehicle, HV – heavy vehicle, TPCA – Toyota/PSA joint venture

Source: ACEA

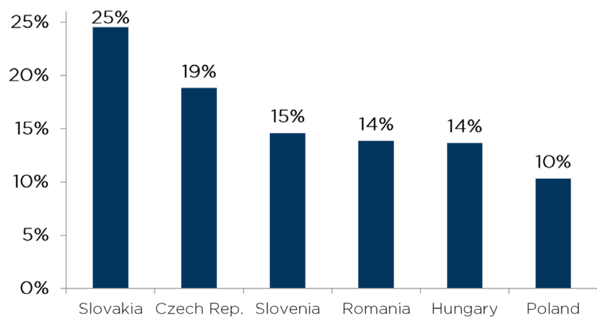
Strong export exposure

Both domestic brands and foreign manufacturers are mainly producing for export markets. Vehicle exports thus account for a significant share of the CEE's foreign trade, making its economies dependent on demand from external markets. Export destinations are dominated by European Union countries, which receive approximately 85% of the CEE's vehicle exports. Slovakia and Romania are the most strongly positioned on countries outside the EU. 26% of Slovakia's road vehicle exports are shipped outside the EU, with 4% going to the US market and 7% to China. Romania sends 28% of its vehicle exports outside the EU, with a relatively high proportion to the Turkish market.

With the improved prospects in the Eurozone and other European countries, the demand for vehicles has been growing. Lower oil prices, subdued inflation, better perspectives on the labour market and growing consumer confidence, have all contributed to increased car sales in many European markets. On the other hand, large emerging economies are slowing down. While the Chinese market still generates double digit growth in car sales, the recession in Russia, its depreciated currency and high inflation, have translated into a decrease in disposable consumer income. Car purchases are among the many items to suffer a contraction in sales. During the first five months of 2015, car sales in Russia dropped by 38% compared to to the same period last year. This occurred despite the fact that the Russian government offered subsidised auto loans and allowed consumer leasing in the second quarter, after a used-car rebate programme initiated last year failed to ignite sales. The ruble lost around half of its value against the US dollar last year, inflating the cost of cars - most of which are either manufactured abroad, or produced in Russia from imported parts. Some car manufacturers, such as Seat, are exiting the Russian market, GM has closed its assembly line and is reducing its offer, while Volkswagen is limiting the amount of manufacturing. According to the Association of European Businesses, car sales in Russia will contract by 24% this year, following a drop of 10% last year. This is bad news for car manufacturers, who expected to benefit from the market of 140 million potential consumers and the growing middle class. In 2014, there were a total of 2.5 million cars and light commercial vehicles sold in Russia.

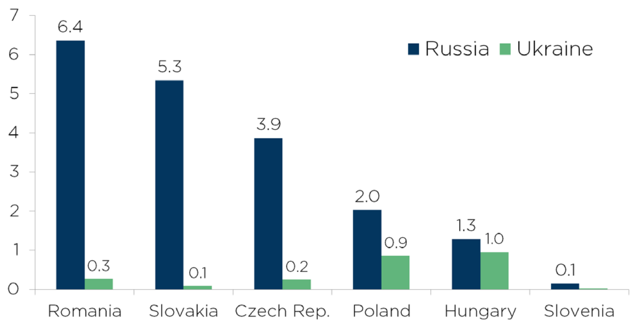
The deterioration of the Russian market has affected vehicle exports from CEE countries. In 2013, Slovakia had the highest share in the region's total vehicle exports to Russia, at nearly 7%. At the end of 2014, Slovakia's car exports to Russia decreased by 21%, while the slump was even deeper in Poland, where they decreased by 52%. Higher export volumes to Western Europe have compensated for lower Russian demand, but overall export potential is mitigated by a slowdown of this trade destination.

Chart 6:
Share of road vehicle exports in total exports



Source: Eurostat

Chart 7:
Share of exports to Russia and Ukraine in total road vehicle exports

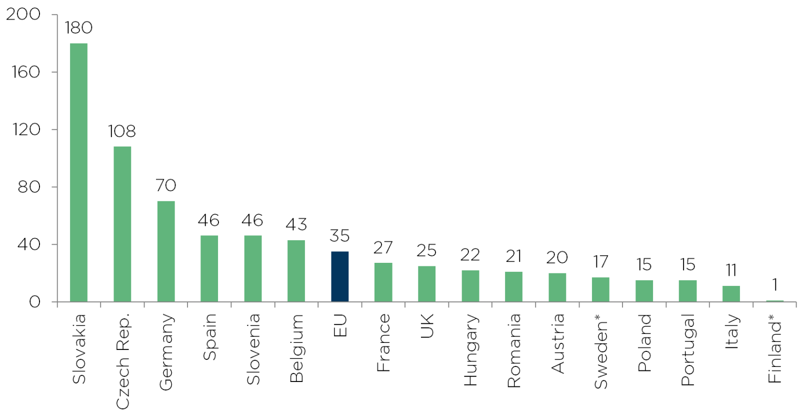


Source: Eurostat

The regional countries with the highest level of export exposure are Slovakia and the Czech Republic. These two countries have the highest number of vehicles produced per 1,000 inhabitants, 180 and 108, respectively. Domestic car with saturation, however, is much lower.

The only CEE country that exceeds the EU average in terms of passenger car registrations per 1,000 inhabitants is Slovenia, where the car density is 518. In the Czech Republic and Slovakia there are 448 and 337 cars registered per 1,000 inhabitants. The region's lowest ranking in terms of car registrations is Romania, with just 224 cars. This further confirms the fact that CEE economies are strongly dependent on the performance of their trading partners and external demand for vehicles.

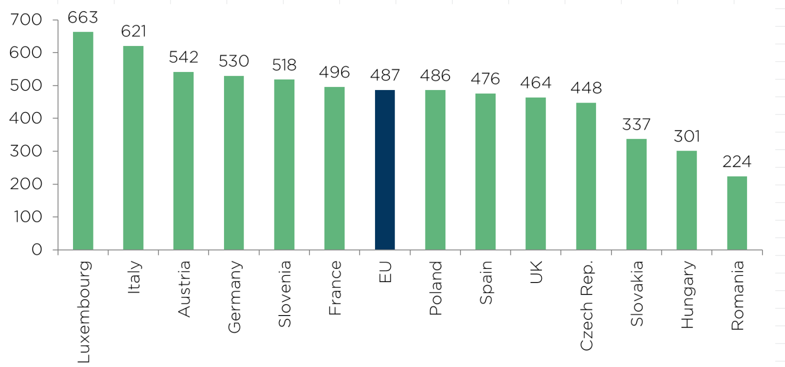
Chart 8:
Motor vehicle production per 1,000 inhabitants (2013)



* only production of cars available in 2013

Source: Eurostat, ACEA

Chart 9:
Registered passenger cars per 1,000 inhabitants (2012)



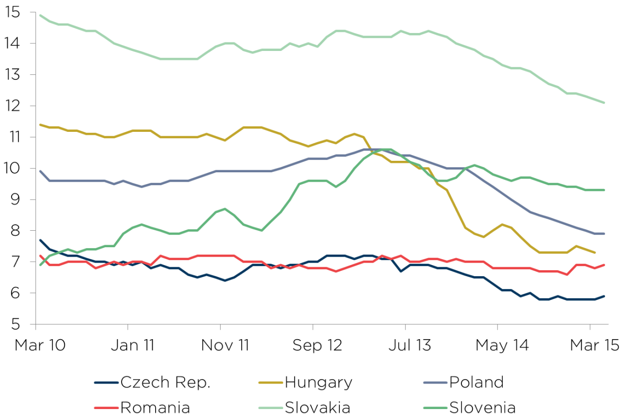
Source: Eurostat

Improving internal demand supports domestic vehicle sales

Economic growth in CEE economies has been shifting from net exports to internal demand. The driving force behind this is household consumption, supported by positive developments in the labour markets of most CEE countries. Unemployment rates have lowered in many cases, while wages have increased. Moreover, positive price trends for consumers have been recorded, with low inflation (or even deflation) in some economies, as well as much lower oil prices compared to recent years. Last but not least, households have become more optimistic, leading to a higher propensity to spend money.

Does it mean that rebounding private consumption will have a positive effect on car sales dynamics? Faced with the deterioration of Russian and Ukrainian markets, could domestic demand for cars compensate for the contraction in these export destinations? Or could it even lead to CEE vehicle production no longer being dependent on foreign demand and, as a consequence, mitigation against the risks of impacts from the economic activities of external markets?

Chart 10:
Unemployment rates (%)

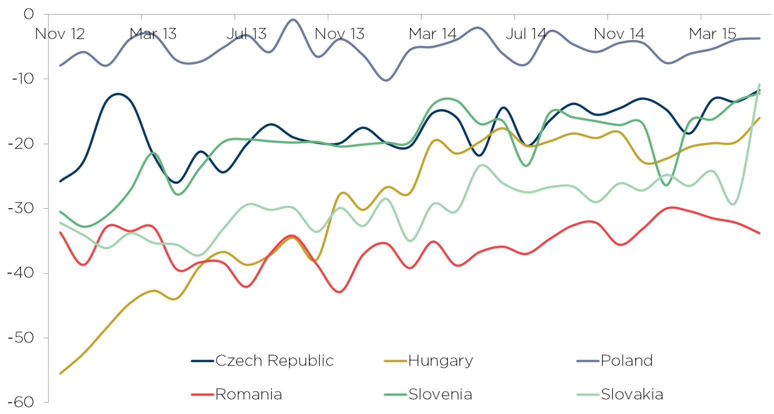


Source: Eurostat

First and foremost, households are more willing to spend money when they are certain that they have stable employment. Positive trends on the labour market have continued and unemployment rates are currently close to the levels recorded 6 years ago (except for Slovenia[4]). Unemployment levels in the Czech Republic, Poland and Hungary[5] are even lower than they were in mid-2009. With this and the increase in wages experienced, households see the improvements in the labour market as sustainable. The propensity to spend is supported by rising consumer confidence indicators and the improved assessments of households' financial situations in the near future is breaking historic levels. Moreover, consumers are more willing to make major purchases of durable goods, including passenger cars. These purchasing decisions often need to be supported by incurring loans, which remain relatively attractive thanks to the environment of low interest rates.

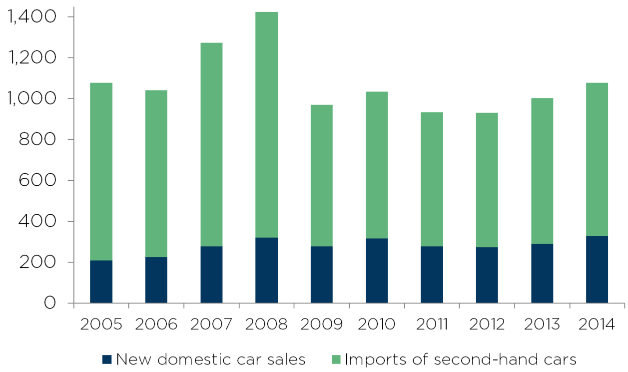
[4] In mid-2009, Slovenia's unemployment rate was the lowest among all CEE economies covered by the analysis. However it climbed to 9.3% in April 2015, compared to 6% in June 2009.
[5] The largest fall in unemployment rate was recorded in Hungary, where it fell by a quarter, from 9.9% in June 2009 to 7.3% in March 2015. However, this it is partly a result of substantial public work programs and changes in calculations of the labour force staying outside the country.

Chart 11:
Consumer sentiment survey - major purchase over the next 12 months



Source: Eurostat

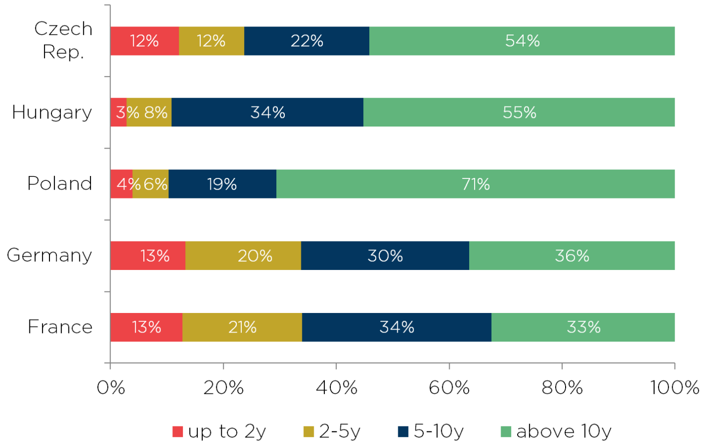
Chart 13:
New domestic car sales and imports of second-hand cars – Poland (in thousands of units)



Source: ACEA, PZPM

On the other hand, in many cases cars are still considered as luxury goods which not all households can afford. According to SILC[6] data, in most CEE economies the percentage of individuals unable to afford a personal car is decreasing, but this problem still concerns some households. This is especially apparent in Hungary, where the share rose from 20.4% in 2008, to 24.6% in 2013, as well in Romania where the share reached the highest level in the entire EU, with 39.2%. It should be also noted that the average age of vehicles is higher in CEE countries than in Western Europe. In most CEE economies, purchasers mainly acquire second hand vehicles and the average age of a personal car is over 10 years. These second hand cars are not only purchased from rotation on the domestic market but also from an inflow of used cars from abroad, mainly from Western Europe. While this situation is not beneficial for car manufacturers, it brings opportunities for spare parts producers.

Chart 12:
Passenger cars by age



Source: Eurostat

The Polish example confirms that more people have decided to purchase second-hand, rather than new cars. Imports of vehicles significantly increased after Poland joined the European Union in 2004, peaking in 2008 when exchange rates positively affected purchases in hard currencies. In 2008, Poland imported more than 1.1 million second-hand cars. Following a contraction, these imports began to rise again in 2011, reaching 750,000 in 2014. Sales of new domestic cars have also been increasing since then, reaching 328,000 in 2014. This accounted for 30% of the total increase in car stock in Poland.

Poland's passenger car registrations grew by 12.9% in 2014, compared to the previous year. However, several other CEE countries enjoyed even higher growth dynamics, namely: Croatia (+22.3%), Romania (+21.6%), Hungary (+20.2%), Lithuania (+19.3%), Latvia (+17.1%) or the Czech Republic (+16.7%). This compares with passenger car registrations in the entire European Union, which grew by 5.6% last year. The EU registration growth was mainly supported by the dynamics of emerging EU countries (the 13 countries that have joined EU since 2004) which grew by +14.2%, compared to +5% reached by EU-15 countries.

Dynamics of car sales are supported not only by the growing number of households with sufficient incomes, but also by companies which have increased their car fleets thanks to improved economic conditions leading to higher demand for their products and services. Company vehicles include passenger cars for management staff and sales representatives, as well as commercial vehicles needed to satisfy growing demand. Sales of the latter have been growing rapidly in recent months. Thanks to improving internal and external prospects with the CEE's main trading partner, the Eurozone, companies have been experiencing increased economic and business activity.

[6] Statistics on Income and Living Conditions (SILC) survey by Eurostat.

The Eurozone rebounded from a double-dip recession last year and is speeding up its growth this year (1.5% for 2015 according to Coface's forecast). The Eurozone's recovery is an important contributor to sales of commercial vehicles, as besides strengthening the foreign trade of CEE countries, CEE companies have been providing more carriage services within the Eurozone. CEE countries are able to offer reasonably priced road transportation services (with lower labour costs than in the Eurozone) and can send employees abroad for weeks at a time.

Better internal prospects in CEE economies, along with attractive financing conditions for households and business, are supporting domestic car sales. Nevertheless, although this is positively contributing to sales, it is not sufficient to make the CEE automotive sector independent from foreign demand. Having been so exposed to exports, the risks from deterioration on foreign markets cannot be avoided. Only higher domestic growth could mitigate them. The Russian market, which represents a minor share of the region's export structure, is not significantly impacting the performance of the overall sector, particularly as Western Europe, the core external market, has started to generate a more optimistic picture.

Chart 14:
Vehicle registration dynamics

	2014/2015			Jan-Apr 2015 / Jan-Apr 2014		
	PC	**LCV**	**HCV**	**PC**	**LCV**	**HCV**
Czech Rep.	16.7%	12.8%	7.5%	22.1%	38.8%	11.2%
Hungary	20.2%	39.6%	-2.3%	13.3%	27.6%	46.0%
Poland	12.9%	7.6%	-8.2%	-4.4%	15.8%	19.7%
Romania	21.6%	14.1%	22.0%	9.0%	12.3%	44.5%
Slovakia	9.5%	10.9%	-5.5%	1.2%	29.9%	43.0%
Slovenia	4.8%	3.7%	29.4%	12.4%	-13.4%	23.3%
EU	5.6%	11.3%	-6.1%	8.2%	13.1%	17.0%
EU-15	5.0%	11.2%	-6.6%	8.4%	12.8%	16.0%
EU-13	14.2%	12.3%	-3.5%	5.5%	16.2%	21.7%

Notes: PC – personal car, LCV – light commercial vehicle, HCV – trucks of 16t and over, EU-13 – EU Member States who have joined the EU since 2004

Source: ACEA

2 CONCLUSION

The automotive sector plays an important role in the CEE's economic activity. Thanks to low labour costs, the educated workforce, geographical proximity to Western European markets, tax incentives and the stabilising legal environment, CEE countries have become attractive locations for investments by global car manufacturers. Despite these strong automotive FDI inflows, only two CEE countries figure in the list of the 20 biggest vehicle producers. If the last year's car production, for the 6 countries covered by our analysis (the Czech Republic, Hungary, Poland, Romania, Slovakia and Slovenia) were combined, they would equal the amount manufactured in India – the world's 6th largest car manufacturer. FDIs also supported the renewal of brands by Czech Skoda and Romanian Dacia, who have both become significant participants in the global car manufacturing market.

The manufacture of vehicles and transport equipment has a measurable effect on the outcome of CEE economies. For some of the region's countries, such as Hungary, the Czech Republic and Slovakia, the sector represents around a tenth of their total output. It also generates a significant number of jobs, employing over 850,000 workers in the 6 countries covered by our analysis in 2013. This strong exposure brings with it risks in case of a deterioration of demand for vehicles. This particularly applies to foreign demand, as the majority of CEE car production is destined for external markets. However the current stance shows that the Eurozone - the main export market - is rebounding and generating improved prospects. Due to the sector's global exposure, the performance of other external markets is also important for the financial results of Skoda and Dacia, as well as for other car manufacturers. While the Chinese market still generates fair growth in sales, despite its economy slowing down, the market closer to the CEE region, Russia, is falling into recession this year. Lower disposable household income and the deterioration of business activities, is translated into a slump of demand for new vehicles.

While faced with unclear situations on some external markets, positive developments can be seen from the domestic side. Rising private consumption in most CEE economies is supported by a number of factors. These include the improving situation on the labour market, rising consumer confidence, subdued inflation, oil prices still much lower than experienced in previous years and low interest rates supporting loans. The higher propensity to spend is resulting in more dynamic car sales in CEE economies. Consumers are not only households, but also companies expanding their fleets of passenger cars and commercial vehicles. Commercial vehicles have been generating high sales dynamics, thanks to improved business prospects both internally in the CEE and externally, with the Eurozone showing clearer signs of speeding its recovery (Eurozone GDP growth of 1.5% is forecast for this year). The increased demand for commercial vehicles is a positive message, especially for Polish manufacturing plants, as significant volumes of light commercial vehicles are produced there.

Higher volumes of car sales do not directly translate into materially higher profitability. CEE plants are involved in the global automotive market - and particularly in Europe, which is suffering from overcapacities, with Ford, GM, PSA and Volvo having closed plants in Western Europe over the last two years. Thanks to their more attractive labour costs and their geographical proximity, CEE factories seem to secure, although decisions of particular car manufacturers on production levels, or even changing locations, could potentially hurt them. It should also be noted that a high level of car registrations are so called 'self- registrations', i.e. selling cars for the brand itself, or its dealers. Many of these vehicles are new cars in dealers' stocks, used as demos or sold as young used cars at a sharp discount. Even in a case of totally new orders for cars, clients, especially corporate buyers, have been able to benefit from sizeable discounts.

Although increasing internal demand from the CEE is supportive, its growth is not sufficient to make the region's automotive sector independent from foreign demand. Having been so exposed to exports, the risks from deterioration on foreign markets cannot be avoided. Higher domestic growth potential could mitigate these risks. Russia's minor share within the region's vehicle exports structure does not significantly impact the sector's overall performance especially with improved Eurozone prospects. It should also be noted that high growth dynamics cannot be endlessly continued, due to eventual saturation of the market. While companies may be able to regularly renew or increase their fleet, households often keep cars for a longer duration, or purchase ones from the second-hand market due to financial constraints.

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