OPPORTUNITIES FOR SRI LANKAN RUBBER BASED VALUE ADDED PRODUCTS IN AUSTRALIA

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1. BACKGROUND

As with numerous manufacturing industries in Australia, the Natural Rubber Product Manufacturing industry facing stiff competition from imports. Local manufacturers are finding it increasingly difficult to competition from imports. Local manufacturers are finding it increasingly difficult to compete on prices. Meanwhile, demand from major markets such as the Motor Vehicle Manufacturing industry is weakening. Industry revenue is expected to decline at an annualized 0.5% over the five years through 2015-16, However, industry revenue is expected to grow by 0.9% over 2015-16, to reach $865.3million.The current-year revenue increase is being driven by growth in export markets caused by depreciations in the Australian dollar. The industry manufactures a range of rubber products, from rubber washers to the rubber belts used in car engines. Over 60.0% of domestic demand for these products is expected to be met by imported products over 2015-16. Domestic manufacturers have struggled to compete with foreign imports over the past five years, as imported products are often produced by large foreign companies with greater economies of scale and lower operating costs. Industry firms have increasingly aimed to maintain profit margins and avoid direct competition with foreign imports by focusing on specialty and customized products that are made to order. Despite this, many enterprises have been forced out of the industry over the past five years as fierce price competition from imported products has made their businesses unviable. The industry is expected to suffer as domestic automotive manufacturing winds down over the next five years. This trend is expected to result in heavy revenue declines in the first half of the next five-year period. Many companies that service automotive manufacturing companies are expected to exit the industry over the next five years. However, the industry will benefit from strong construction activity and an improvement in the competitiveness of domestic manufacturing due to a weak Australian dollar. However, the benefits of increased construction activity will not be enough to instigate long-term growth, and the industry is expected to continue its structural decline over the next five years. Industry revenue is forecast to decline by an annualized 2.6% over the five years through 2020-21, to reach $ 759.5 million.

Trade Weighted Index

The value of the Australian dollar influences how competitive the industry is in international markets. When the Australian dollar appreciates, industry products become more expensive in international markets, while imports become cheaper. A lower Australian dollar presents an opportunity for the industry to regain domestic market share from imports and improve export sales. The trade-weighted index is expected to decline over 2015-16.

Demand from Manufacturing

The manufacturing sector is a large market for industry products. Key buyers include motor vehicle and machinery manufacturers that use rubber hoses, belts and other industry products as intermediate inputs. Demand from manufacturing is expected to decline over 2015-16, representing a threat to industry revenue.

Consumer Sentiment Index

The rubber products manufactured by the industry are varied and are often used in homes. As a result, general economic conditions affect demand. When consumer sentiment is higher, household consumer sentiment is expected to improve over 2015-16.

World Price of Rubber

The world price of rubber affects industry costs and the relative competitiveness of rubber with substitute materials. Higher rubber prices can increase industry revenue, but can also have the reverse effect as customers will often switch to cheaper substitute products if these costs are passed downstream. If higher purchase costs are absorbed by industry operators, then these firms face reduced profit margins. The world price of rubber is forecast to decrease marginally over 2015-16.

2. MARKET ANALYSIS

The Natural Rubber Product Manufacturing industry has been under pressure from import penetration and high wage costs. However, the industry has had some positive developments in trading conditions. Significant declines in the world price of rubber over the past five years have provided some relief to the industry and supported profit margins. An increase in construction activity has also provided some growth in the domestic market and supported industry revenue. Meanwhile, depreciations in the value of the Australian dollar since 2012-13 have boosted export competitiveness and are expected to drive an industry revenue increase of 0.9% over 2015-16.Overall,industry revenue is expected to decline at an annualized 0.5% over the five years through 2015-16,to reach $865.3 million. Enterprise numbers have declined significantly over this period as business have struggled to compete with foreign imports.

Industry players have faced mixed profit conditions over the past five years. Significant declines in world rubber prices have supported industry profit margins by reducing purchase costs. This has relieved some pressure on profitability, but the effect has been limited by stiff price competition from imports manufactured in countries with lower operating costs, such as China. While purchase costs have fallen, most of the savings have had to be passed on downstream. Overall, profit margins have increased marginally over the past five years. Industry operators have struggled to reduce staff numbers as industry revenue has declined. While the industry is facing strong pressure to cut costs due to foreign imports, wages have increased as a share of industry revenue over the past five years. Part of the problem is the small size of industry operations and the comparatively high requirement for labour in the production of customized natural rubber products. Almost 90.0% of industry firms are operated as sole traders or have fewer than 20 employees, making cutting staff a difficult task if a company wants to retain production capabilities.

Motor Vehicle Manufacturing

Demand for industry products is driven by the consumption of rubber goods in a range of sectors, including automotive manufacturing, the automotive aftermarket, building construction and improvement applications, and the retail sector. Automotive production has struggled over the past five years, and manufacturers have increasingly depended on component imports rather than domestically made parts. Higher fuel prices over much of this period have shifted consumer preferences towards smaller, more fuel-efficient vehicles, as opposed to the medium-to large vehicles commonly produced in Australia. In addition, vehicle import tariffs have been progressively reduced over the past decade. The decline in automotive production has negatively affected domestic automotive component makers, including industry firms that manufacture rubber belts, seals, hoses and washers. Domestic automotive manufacturers now require fewer products, and some are also purchasing cheaper imported rubber belts, seals, washers and hoses to compete with imported vehicles. It is generally not worthwhile for Australian automotive component manufacturers to export Asian countries (where an increasing proportion of the world's cars are being built), largely due to major differences in production costs. Growth in the stock of consumer motor vehicles has increased demand for replacement rubber automotive components. Australia's population has grown rapidly over the past five years. This has coincided with the presence of more cars on Australian roads than ever before, which has expanded the market for replacement parts such as belts and hoses.

3. IMPORTS AND COMPETITION

Globalization has opened up export markets through lower tariffs and better logistics. Natural rubber product manufacturers have increasingly relied on exports which have grown as a share of industry revenue over the past decade. Exports mostly consist of products that have patent protection, which prevents competition with foreign firms. Other exports are sent to neighboring countries (most notably New Zealand), where many domestic firms have a presence and choose to supply their products from a single factory located in Australia. As a result, total exports are estimated to grow by an annualized 1.1% over the five years through 2015-16.Despite depreciation in the Australian dollar since 2012-13, imports are forecast to grow over the five years through 2015-16.Import penetration mainly affects homogeneous products that can be mass produced. Australian operators do not have the same scale as competitors in the United States, Japan and China. Industry players that manufacture products that compete directly with mass-produced imports from these countries must compete with their lower marginal costs, and as a result face significant price competition. This has led to most industry operators focusing on niche markets are less affected by competition from abroad and benefit from being close to customers, allowing adjustments to be made quickly.

Industry Outlook

The Natural Rubber Product Manufacturing industry is expected to continue its long term decline over the next five years. Industry revenue is projected to fall by 4.8% over 2016-17 and 5.2% over 2017-18, contracting as the industry loses key customers in the Motor Vehicle Manufacturing industry. Industry revenue is forecast to decline at an annualized 2.6% over the five years through 2020-21, to reach $759.5million.Enterprise numbers are forecast to decline at an annualized 2.0% over the next five years. Several businesses are expected to exit the industry following the cessation of Australian automotive manufacturing and continued growth in import penetration. However, growth in the construction sector will assist demand over the next five years, as residential, commercial and industrial construction investment increases. A weak Australian dollar is also expected to provide the industry with some relief as it makes domestically manufactured goods more competitive in international and domestic markets. Manufacturing demand is expected to remain weak, with flow-on effects from declining motor vehicle and motor vehicle part manufacturers that supply the mining sectors is also expected to weaken over the period, as the booming growth of mineral sand resources industries subsides.

Profit and Industry participation

Industry profitability is forecast to remain mostly stable over the next five years, dipping as car manufacturing ceases but returning to its long –term trend from 2017-18 onwards. The closure of most of the affected industry firms, which is expected to happen soon after local car manufacturing stops, will boost industry profitability, as exiting companies are likely to be ones that are performing poorly. Meanwhile, employment and wages are expected to fall over the next five years as a share of industry revenue due to difficulties in reducing labour requirements in the industry. Imports are expected to increase their share of domestic demand as local operators avoid direct competition by focusing on niche and customized products. Natural rubber input prices are forecast to continue declining over the next five years, which will likely improve profit margins but drag down revenue as some of the savings are passed on downstream, in the form of reduced prices.

International Trade

The Australian dollar is forecast to remain comparatively weak over the five years through 2020-21, after depreciations in the past five years. Industry operators are expected to improve their production efficiency to remain competitive and take advantage of new export opportunities. However, the lower Australian dollar is expected to have a slightly muted effect on industry trade as domestic firms do not have a slightly muted effect on industry trade as domestic firms do not have the scale to compete with overseas companies, limiting the markets in which industry operators can take advantage of a weaker dollar. Exports are forecast to increase at an annualized 0.1% over the next five years, while imports are anticipated to grow at an annualized 1.9%.The low competitiveness of downstream industries in the manufacturing sector will also affect the Natural Rubber Product Manufacturing industry and may result in further offshoring of downstream industries. When local manufacturers move offshore, they are anticipated to source rubber products from foreign firms that operate closer to the new production facilities, reducing demand for industry products.

4. DEMAND FOR RUBBER BASED PRODUCTS

The fortunes of the industry's product segments are highly dependent on changes in demand from downstream industries. Products sold to growing sectors such as mining and construction have gained industry revenue share over the past five years. Meanwhile, products sold to declining industries, including many in manufacturing have been losing share.

Rubber Belting

Rubber belting is the largest product segment in the industry, accounting for almost half of all industry revenue. Rubber belts are frequently used as inputs for automotive manufacturing and repair. Rubber conveyor belts also makeup a large portion of this product segment. Products are often sold to manufactures, and mining and materials handling companies. This segment has remained largely stable as a share of industry revenue over the past five years. While automotive manufacturing demand has declined, mining and materials handling companies have increased demand for products in this segment. Steady demand from passenger car and truck repair companies has also helped stabilize this segment as a share of industry revenue.

Sponge and Foam Rubber

Sponge and foam rubber is expected to account for 6.5% of industry revenue over 2015-16.The industry's customized sponge and foam rubber products are used in the construction of household furnishings, automotive upholsteries and pillows. This product segment has declined as a share of revenue over the past five years, due to rising competition from imports and reduced demand from automotive manufacturing companies.

Rubber Tubes, Pipes and Hoses

Rubber tubes and hoses are expected to make up 8.2% of industry revenue over 2015-16.Products in this segment are used in various manufacturing industries including rubber hoses for automotive manufacturing. Products in this segment are also used as protection for plastic or metal piping. This segment has increased as a share of industry revenue over the past five years due to stronger declines in other segments.

Other Products

Other products produced by the industry include customized natural rubber products made under commission. These products include a variety of small specialized products such as door stops or protective guards for furniture items. These products are usually highly specialized and made upon request. As a result this segment has faced less import competition from mass-produced natural rubber products. This segment has increased as a share of industry revenue over the past five years.

Demand for Rubber Products in the Automotive Market

Motor vehicle manufactures are a key market for industry products. This market demands rubber hoses seals, washes and belts, in addition to rubber foam used to make seating and interior trim. Motor vehicle manufactures have declined as a share of industry revenue over the past five years due to weak motor vehicle production in Australia. Almost all automotive production is expected to cease over the next five years, significantly reducing this market as a source of industry revenue.

Demand for rubber products will suffer as domestic automotive manufacturers downsize in response to increased competition from abroad. Demand from motor vehicle and motor vehicle parts manufacturers is expected to decline heavily over the two years through 2017-18,following announcements that the remaining three domestic car manufacturers will close their Australian production facilities over this period. The loss of demand from this key market will reduce the volume of natural rubber products consumed.

5. IMPORT OF RUBBER PRODUCTS INTO AUSTRALIA

Imports are at a high level and estimated to account for 61.8% of domestic demand in 2015-16.Imports are high because foreign manufacturers benefit from lower production costs and expensive supporting supply chains. Over the past five years there has been significant growth of imports from China and the United States, which account for over a third of imports. Imports are estimated to increase at an annualized 2.9% over the five years through 2015-16.Imports have grown over the past five years as industry operators continue to lose out to lower priced products made by foreign manufacturers. Downstream demand from manufacturers has declined as many have begun sourcing rubber inputs from cheaper countries, as they too themselves compete with the import of manufactured merchandise. This increase in import penetration has been a result of the strong Australian dollar over much of the past five years, making imported products competitive in the domestic market.

Value of Imports

Year	Value AU $ Millions
2012-13	1,022.5
2013-14	1,074.9
2014-15	1,100.1
2015-16	1,112.3

Custom Tariff

There is a maximum general import tariff rate of 5% on products manufactured in this industry. Tariffs have been falling over the past couple of decades as the government has reduced trade restrictions in a bid to become more closely integrated into global trade. Over the past five years, an increasing number of countries are exempt from tariffs due to a number of new free trade agreements and other bilateral trade agreements. This low level of tariff protection is reflected in the high level of imports in this industry. Some manufacturers servicing the automotive sector receive minor forms of indirect assistance from the Government in terms of grants and export facilitation schemes. For example, the automotive Transformation scheme (ATS) is running from 2011 to 2020, and includes a sizeable sum in aid to a wide variety of manufacturers and suppliers within the automotive sector.

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