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Editor: Gerry Conover**Please contact us at**
feedback@carsmartnews.com

Dear Subscribers,

This week included the media preview of the 2006 Detroit auto show, several days of non-stop reviews and presentations by most of the world's principal automakers. If this wasn't enough, GM shareholder Kirk Kerkorian's chief advisor, Jerry York, outlined his own prescription for GM corporate health – notions not terribly appreciated by senior GM execs. There is other news, too. Please read on.

Jerry York's Prescription for GM

When Kirk Kerkorian bought close to 10% of GM's outstanding common stock, the industry took notice. But before Mr. K made his investment, he took notice of the analysis and opinions of his chief advisor, Jerry York.

Following military service (Mr. York is a West Point grad), Mr. York went to work for GM...and then Ford...and then Chrysler...and then IBM...then back to Chrysler...and finally for Mr. Kerkorian.

Mr. York's auto industry credentials go beyond whom he worked for. He and Hal Sperlich brought Ford's rejected "Ohio" program to Chrysler where it became the Dodge Caravan and its siblings – the most popular minivan family in the world.

Mr. York's plan for improving GM's fiscal health – cut the dividend by half, reduce executive and management salaries in a sliding scale, close plants, and 'chuck' a couple of marketing divisions – have gotten wide publicity in the popular media. These are the kinds of things Mr. York implemented during his participation in Chrysler's and IBM's turnarounds; they're not magic. They're part of a long list of options GM has to consider.

GM vice-chairman Bob Lutz didn't think much of Mr York's suggestions. It is his view that the steps GM has underway – renegotiation of hourly health benefits, structured plant closing and capacity reductions, and pricing policy revisions are on the right track to get GM's sick North American operations back on track.

Mr. York said two things that were widely overlooked by the popular media – perhaps because they required too much thought to interpret.



These two observations are the underpinnings of a realistic recovery plan and can serve as on-going metrics for success.

First, Mr. York addressed GM's cash "burn rate" – the rate at which continuing losses eat away at GM's cash pile. His review of GM's financial results for the first nine months of 2005 showed a worldwide corporate net loss of \$3.8 billion. For automotive operations alone the net loss was \$6.0 billion, the bulk of which was in North American Operations.

For the nine-month period, cash flow from automotive operations, excluding "non-recurring" items, was \$6.6 billion negative. There were 273 calendar days in the first nine months of 2005, so GM's cash burn rate was \$24 million per day.

Mr. York estimates that GM had about \$25 billion of cash and quick-sale assets available at the end of the nine month period – \$15 billion of balance sheet cash, plus \$11 billion from the sale of half of GMAC less the net of several other smaller adjustments.

❖ **The available \$25 billion, at the current cash burn rate of \$24 million per day, would keep GM going for just over a thousand days, or about three years.**

This assumes conditions remain the same as they were in the first nine months of 2005. If conditions get worse, the thousand days would contract and if conditions get better, the thousand days would expand.

Second, Mr. York called for a sense of urgency, a "crisis mode", for GM's leadership. One of the reasons he recommended executive and management pay cuts was to bring home the sense of urgency up and down the chain of command.

❖ **GM CFO Fritz Henderson later noted that he was already operating in crisis mode, but was not about to panic. Bob Lutz warned that any significant compensation cuts in executive ranks would likely lead to a "talent drain" with many key, needed executives taking off for other, safer industries like logistics or electronics.**

❖ **When all the smoke cleared, we ended up with a much better idea of where Mr. Kerkorian wants GM to go – and what he or Mr. York may insist that the GM Board of Directors order should either of them get a seat on that Board. Whether this would be constructive or disruptive will become clearer when GM reviews its 2005 financial results later this month. GM has already said it will not give an outlook for 2006.**

GM's Rejoinder

GM said in response to Mr. York's suggestions that it expects to realize about \$4 billion in savings in 2006 of the previously identified targeted savings of \$7 billion -- comprised of \$6 billion in structural costs and \$1 billion in material costs.

As part of the next phase of cost-cutting, GM said it is now aiming to lower its global structural costs as a percentage of revenue to 25% in 2010 from the current level of about 34%.

GM said new products will help its turnaround. About 29% of GM's North American sales volume in 2006 is expected to come from recently launched cars and trucks, as well as upcoming new models. By 2007, GM, which introduced a new pricing strategy this week in a move to reduce its reliance on incentives, said it expects more than 30% of its sales volume to come from the new vehicles.

- ❖ **GM's R&D budget has been increased by \$1 billion this year and despite the financial constraints, Bob Lutz said it would be a mistake not invest in new products and technologies.**

Detroit Auto Show Roundup

Every major automaker that does business in North America (and one that doesn't – yet) convened in Detroit for the annual North American International Auto Show. Although no longer the only motor show sanctioned by the OICA for North America, (Chicago, Los Angeles and New York pass around another sanction annually) it's still the place where the major product and business announcements are made and where some very large deals are negotiated among companies.



We won't try your patience by recounting the details of the several dozen new cars, trucks and concepts that were revealed in Detroit during the media preview week. You've read about them in the popular and trade press. With 6,800 journalists reporting, the news is impossible to avoid. We prefer instead to get to the important industry trends indicated by them.

- ❖ **Overall, many very beautiful cars and trucks...a lot of concentration of customer wants and needs...pricing rationalization...with "Big 2½" technology at least one generation behind Europe and Japan.**

Crossovers are Big...

The expected onslaught of new crossover utility vehicles – two-box utility vehicles with more ground clearance (and available 4WD/AWD) on a unitized (or car) platform – were shown by each of the "Big 2½."



Ford went berserk with two of its own offerings and another from Mazda. All are derived from the mid-size Mazda6 platform and are further additions to the passel of ten vehicles that Ford plans to take off the Mazda6.



Three of these four CUVs are built on the same platform and one is not. Which CUV isn't part of the family? Answer next week.

The Ford edge goes into Ford brand dealerships, while Lincoln-Mercury stores will get the Lincoln MKX ("Mark X" according to Ford product chieftains). Mazda dealers will enjoy the Mazda CX-7 which has unique appearance from the parent Ford Motor Company duo.

- ❖ **There is nothing yet on a Mercury brand derivative – but there are two more major US auto shows yet to come in February and April.**

GM's Buick brand showed a crossover "concept" – the Enclave – which we understand will be a 2007½ production model. Enclave is well-executed, neat, clean, concise...and boring.



Chrysler unveiled its 2007 Jeep Compass crossover which gets its underpinnings from the Dodge Caliber C-class car (the Neon's replacement). Compass could follow Caliber into worldwide sales.

...So Are SUVs – with Japanese and Korean Automakers

While American car companies are trying to convince customers that their "crossover" utility vehicles are "friendly" and "comfortable", Asian automakers are labeling their crossovers as "SUVs" to convey the notion that they are "rough and ready" and "off-road capable" (even if the latter is limited).

Acura's RDX prototype is built on Honda's "all-new global light truck platform" which we understand is further derived from the Honda Civic. It "represents the forward thinking that will be seen in the next generation of Acura light trucks," according to John Mendel, senior vice president of Acura auto operations.

- ❖ **Regardless of its dainty heritage, RDX has the tools to play in the dirt. It features a 2.3L I-4 turbocharged engine and Acura's Super Handling All-Wheel Drive (SH-AWD). Acura management says RDX is "designed to redefine the entry premium SUV segment."**



Hyundai's Santa Fe, which is loosely based on its Sonata platform, enters a new generation. Santa Fe has been Hyundai's "SUV" since its inception, although we did hear one executive utter the term "CUV" when discussing the little truck. With its 3.3L V-6 engine, Santa Fe will nonetheless be priced under the Honda Pilot competitor (comparably equipped).

Toyota and Nissan Reveal New “Bread-and-Butter” Cars

Toyota launched its sixth-generation Camry in Detroit as did Nissan with its Sentra. The Camry, the best-selling car in America four years running and eight of the past nine years, is completely new for 2007. The exterior has a visual impact that departs from the upright style of its predecessor. The new shape has a long, high-visibility cabin. The wheelbase is longer and track is wider, with the wheels pushed toward the extremes of the car's four corners.

In addition to 2.4L I-4 and 3.5L V-6 gasoline engines, Toyota is making its Hybrid Synergy Drive available in the 2007 Camry. It consists of gasoline and electric power sources that are complementary and produce a combined 192 horsepower.

- ❖ **Camry's hybrid system consists of a 2.4L I-4 Atkinson-cycle engine (which generates 147 hp) coupled to a continuously variable transaxle. The small electric motor produces an additional 45 hp. An ultra-small inverter with a specially designed compact battery completes the system.**



The all-new, sixth-generation 2007 Nissan Sentra represents an advancement for Nissan's popular compact sedan. Built on Nissan's new global “C” platform, the 2007 Sentra has an all-new 2.0L I-4 engine, and either a standard six-speed manual transaxle or Nissan's Xtronic CVT.

The interior features a 60/40 split-fold rear seat, optional hidden trunk storage compartment and optional integrated overhead compact disc holder. Leather seating and Nissan's “Intelligent Key” passive remote keyless entry system are also available. Power door locks and windows, side-impact

curtain air bags and air conditioning are standard.

The 2007 Sentra goes on sale in fall 2006 and with an MSRP starting around \$15,000.

- ❖ **Why do these two cars matter? Their combined sales in 2005 were 651,000 units or more than twice as many cars and trucks as delivered by Volkswagen in the US and only a shade under Ford Division's car sales for 2005. Anything really new can see as much as a 10% volume “bump” – that'd be over 700,000 upa total.**

Hybrid-Electric Vehicles – GM Catches Up – Sort Of

Not three years ago, GM pshawed hybrid-electric vehicles (HEVs) as mere passing fancies. The real energy savings it said were to come from fuel-cell electrics (FCEVs) – into which GM has poured hundreds of staff and millions of development dollars at two labs (one in upstate New York, the other in Germany).

As the deadline for an affordable FCEV slipped from 2010 to 2015 and now is looking more like 2020, GM finally got on-board with the HEV wave. At least you would think so from GM's marketing rhetoric.

At last year's Detroit auto show, GM showed a disconnected gaggle of mild hybrids (those which add a little more power to an internal combustion engine for passing or hill-climbing; and may have a stop-start feature for idling at traffic lights) and one full hybrid (the vehicle can run on electricity alone for short periods). Since then, GM and DCX (later joined by BMW) entered into an agreement to develop a "Two-Mode" full hybrid.

GM has decided to scatter these disparate offerings across many of its platforms and brands to appear, at least, to be a player with Toyota and Honda and Ford in the HEV sweepstakes for customers' hearts, minds and dollars.

For example, the Saturn Vue crossover will get the mild hybrid for 2006 as a power and torque booster for startup and passing acceleration. A 5% fuel economy improvement in both city and highway fuel economy test modes is forecast by GM.

Big trucks (Chevy Tahoe, GMC Yukon and Cadillac Escalade) will be available in 2008 with the Dual-Mode Hybrid from the tripartite development program. It will be mated with GM "Gen IV" small block V-8. GM says this rig will see a 15% improvement in composite fuel economy.



Saturn Vue Green Line hybrid layout

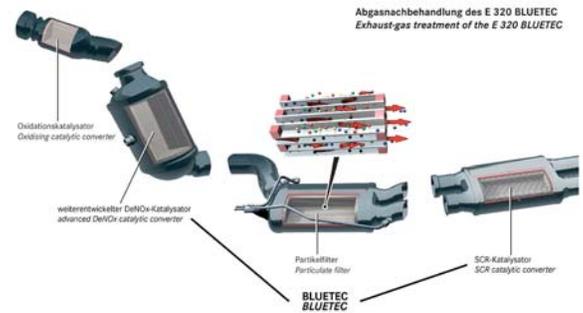
- ❖ **GM has two strategies underlying this plan. First, it is putting hybrid powertrains in a lot of big trucks where it has a fuel economy problem – the biggest improvement gains come in "big vehicle" segments. GM followed the same strategy when it applied its Advanced Fuel Management (aka displacement-on-demand) variable displacement system first to big trucks.**
- ❖ **GM's second strategy is price-driven. While the premium for Dual-Mode may reach \$6,000, the price uplift for the Saturn mild hybrid will be only around \$2,000 – "\$4,000 less than a typical hybrid." So GM is saying it will offer customers a choice – varying degrees of fuel savings at varying prices.**

Diesels – Why, Sure

The Mercedes Car Group blew the roof off Cobo Hall (figuratively, of course) with the announcement that it had a proper car diesel engine that was sufficiently clean to be sold in all 50 states in America. The importance of this is that Mercedes has found technological solutions to dealing with the California Air Resources Board's proclivity to diddle with its air quality regulations with a principal goal of effectively outlawing diesels in The Golden State.

Mercedes' 3.2L V-6 CDI models are claimed by their maker to be the cleanest diesels in the world and to consume 20% to 40% less fuel than their gasoline counterparts. Both the E 320 BLUETEC (expected 35 mpg) and the Vision GL 320 BLUETEC (expected 25 mpg) will be the most economical vehicles in their respective segments in the US.

- ❖ **BLUETEC is a modular concept, which combines various technologies aimed at minimizing emissions. Passenger cars equipped with this technology incorporate an oxidizing catalyst and a particulate filter as well as "DeNOx" (nitrogen oxide-reducing) systems.**
- ❖ **BLUETEC was also shown in a Jeep Grand Cherokee engineering study vehicle. More to come?**



Mercedes Not Alone – Honda Wants in on the Diesel Action

Honda is working hard to bring a four-cylinder diesel engine to the United States. "The US is our most important market and our top priority for diesels," according to Motoatsu Shiraishi, president of Honda R&D.

Bringing a diesel to America is more important to Honda than expanding the number of diesel engines it sells in Europe. Honda offers two diesel engines in Europe, a 2.2L I-4 and a 1.7L I-4.

The company aims to be selling diesels in North America by the end of the decade, but has not yet determined if diesels will first be offered on cars or trucks here.

Japan has similar emissions standards as the United States for diesels, and eventually the US-made diesel engine could also be used in Japan.



- ❖ **Toyota and Nissan also sell small diesels in Europe – and Toyota's diesel emission control system there looks to be as good as Mercedes' BLUETEC.**
- ❖ **GM and Ford offer I-4 and V-6 diesels in Europe, but seem to have little if any development work underway to bring them to North America.**
- ❖ **Ford did allege a diesel for its HEV concept Reflex, but showing neither an engine nor any performance data suggests to us that the diesel HEV is at best a research curiosity.**

Cool Premium Car Concepts

Not all the action at the NAIAS was centered on CUVs or fuel efficiency improvements. Ford and DCX showed three exceptionally well-done concept cars for premium market segments.

Chrysler turned out an Imperial concept loosely connected to the Chrysler 300/Dodge Magnum platform. Taking many design cues from Maybach (offered by a DCX sister car division), the Imperial's most prominent design features were a European-style boat-tail and "suicide doors" wherein the rear doors are hinged at the rear to open forward.



Aston Martin's Rapide concept adds a real rear seat and two more doors to the A-M Vantage coupe. Aston's six-foot-five design director could sit comfortably and exit effortlessly.

- ❖ **The execution of the "stretch" and the elegance of the craftsmanship lead us to declare Rapide as our "Best in Show."**

The Lincoln brand showed a Volvo-S80-derived concept – called MKS ("Mark S") that could easily be the replacement for the 35-year-old Lincoln Town Car. MKS has not yet been approved for production, but action on this could come in the first or second quarter of 2006.



MKS has what is becoming the usual collection of premium car features – a panoramic glass roof, Bluetooth connectivity for one's personal communications and entertainment toys, LED adaptive headlamps and passive remote keyless entry. The navigation system is claimed to also include Internet connectivity for downloading a variety of information.

- ❖ **MKS is powered by a 4.4L V-8 engine driving through a six-speed automatic transmission and a driveline featuring "intelligent" all-wheel drive.**
- ❖ **Ford doesn't have a 4.4L V-8 in its powertrain stable – but long-time premium engine development partner Yamaha does.**

Production Luxury, Too

The long awaited new Lexus LS made its debut in Detroit. As indicated by a number of design concept cars preceding it, the 2007 LS-460 made a lot of people say "wow." Shown in a long-wheelbase model (SWB to come in a few months), the LS-460 typified luxury.

The LS platform maintains a balance between ride comfort and responsive handling. The redesigned multilink suspension system includes an electronic power steering system and a next-generation vehicle dynamics integrated management system.

No slouch in the “get up and go” department, the LS will be powered by a new 4.6 L V-8 engine producing 380 hp and 370 lb-ft of torque. Combined with an eight-speed automatic transmission, a world-first, the LS-460 will 0-60 mph in less than 5.5 seconds.

Lexus didn't go too deeply into the features portfolio of the LS – which is expected to be rich – but based on our experience in Tokyo recently we expect to see adaptive cruise control and some form of advanced backup and/or parking aid. We don't expect night vision or adaptive headlamps. There will be more on this after the New York Auto Show in April.



Lexus LS-460. Is that a “Bangle bump?”



One of the better surprises at the Detroit auto show was a totally revised GL-Class SUV from Mercedes, replacing the civilian version of its boxy Galendewagen military truck. The previous model G-Class was essentially the German army's notion of a big jeep with an S-Class interior and seats, and re-tuned mechanicals.

The seven-seater premium off-roader offers what Mercedes claims to be excellent handling on and off-road, spacious occupant accommodation, and the comfort of a luxury sedan.

The optional PRE-SAFE safety system is a first in its market segment. Mercedes' DISTRONIC radar-assisted proximity control system which maintains distance to the vehicle ahead is also an option.

Special off-road features such as downhill speed regulation, hill-start assist and off-road ABS assist the GL-Class driver off road. The “Off-Road Pro” engineering package with two-speed transfer case and differential locks allows the GL to handle extreme off-road terrain.

❖ **The modified AIRMATIC air suspension increases the ground clearance to a maximum of twelve inches where required, and raises the fording depth to almost 24 inches.**

Adaptive headlamps, a cornering light function and a high-pressure cleaning system are standard on high-series GL-Class.

The optional rear-seat entertainment system features 7-inch LCD monitors in the back of the front head rests, a DVD player, TV tuner, remote control and connection for games consoles or a digital camera.

❖ **The GL-Class will be built alongside the Mercedes M-Class and R-Class at DCX's Tuscaloosa, AL, assembly plant.**

Let's Go Fast!

The Dodge Challenger concept and Chevy Camaro concept "pony" cars have had way too much exposure in the popular media. These "pony" cars are, however, large enough to be "horses."

Challenger is based on the Chrysler LX rear-drive, making the concept car very long and wide (the wheelbase is six inches longer than the Plymouth Barracuda and first-generation Challenger). It is powered by a Hemi engine.



Camaro is a different case. Rumor has it that GM has resurrected development of its earlier-cancelled Zeta rear-wheel drive platform in a new configuration called "Zeta light" – the first embodiment was too big and heavy to suit Bob Lutz's vision for next-gen global RWD cars.

Camaro looks a lot like the 2006 Corvette and Cadillac XLR, leading us to think Camaro might have been derived from the two-seater production platform. Looking at selected dimensional data suggest this is not the case – nor is Camaro related to the Opel Insignia concept, the only vehicle based on the first Zeta architecture that was ever shown.

- ❖ **Could the Camaro concept – rumored for 2009 production – be atop the next architecture for Corvette? And others? It does use the 'Vette LS2 6.0L engine and driveline.**

A little more urbanely, Audi showed its new S6, a performance model on the A6 architecture, with a 5.2L V-10 engine (420 hp) that traces it heritage back to the Lamborghini Gallardo super-premium sports car.

- ❖ **200 hp per ton – 0-60 mph is a little over five seconds – ahhh!**

CHEVROLET CAMARO CONCEPT

	<u>Camaro Concept</u>	<u>2006 Corvette</u>	<u>"Zeta" Opel Insignia</u>
Dimensions (in)			
Overall Length	186.2	174.6	189.1
Wheelbase	110.5	105.7	114.8
Overall Width	79.6	72.6	75.4
Overall Height	53.0	49.0	55.7
Front Track	63.8	62.0	65.6
Rear Track	63.3	61.0	65.6
Engine	<u>Corvette LS2</u>	<u>Corvette LS2</u>	<u>2004 Corvette</u>
- Displacement (L)	6.0	6.0	
- Power (hp)	400	400	344
- Torque (lb-ft)		400	

Industry News

Toyota Sees Hyundai as a Threat

Toyota claims to be afraid of complacency, competition, and success itself. But Hyundai is creeping up toward the top of Toyota's list. "Our main competitors in North America are Honda, Nissan and Hyundai – and Hyundai is the one we are very carefully watching," said Yukitoshi Funo, chairman of Toyota Motor Sales USA.

Hyundai has raised its profile as a study by J.D. Power showed Hyundai quality good enough to match the best Japanese brands.

Hyundai now sells more cars than Volkswagen, Mazda and Subaru in the United States. It expects sales to rise more than 10% this year to over 500,000 units, in an overall market that will be either stagnant or shrinking slightly.

Hyundai's path to success has been modeled closely on Toyota's strategy of striving for top quality with competitive prices and appealing to a broad range of customers with a wide range of products.

Funo added that Toyota would not and could not compete with Hyundai on price and would instead, focus on building its brand and value. "Our costs aren't as low as Hyundai's. We don't want to compete on their terms," he said.

Hyundai indicated that it didn't see itself as a big threat to Toyota. "They're a very successful company," said Bob Cosmai, CEO of Hyundai Motor America. "We have a long way to go," he said.



Yukitoshi Funo

Fiat Auto Profit in 2006

While in Detroit for the North American International Auto Show, Fiat SpA's CEO said that its Fiat Auto unit would post a profit in 2006 and meet or beat its target of a €317 million trading loss in 2005.

Fiat Auto has been narrowing its losses from a trading loss of €822 million in 2004 and a €302 million trading loss in the first nine months of 2005.

❖ **Marchionne is trying to make Fiat Auto profitable by cutting costs and establishing alliances with other automakers such as Ford and Tata Motors.**

Supplier Insights

Continental AG and ZF to Supply Hybrid Drive to VW

Continental AG in a joint venture with ZF Friedrichshafen will supply Volkswagen with a hybrid drive module. ZF will supply the electric motor, the clutch and the dual-mass flywheel, while Continental Automotive Systems will be responsible for the power electronics.



Continental has separately agreed on a strategic partnership with Volkswagen for the development of power electronics for future hybrid projects.

- ❖ German automakers have been pushing diesels as their best fuel-efficiency alternative but now find they need to form partnerships to bring hybrid-powered models to market as well.

Lear Takes a \$342 Million Write-Down

Lear will take a goodwill impairment charge of \$342 million for its automotive interiors business due to a worsening outlook for operations. In addition, expensive labor contracts could force Lear to move at least some production offshore.



Lear disclosed the goodwill write-down for the auto interiors business in a filing with the Securities and Exchange Commission.

- ❖ The charge reflects "a deterioration of the commercial outlook for this segment" and will use up substantially all the goodwill left to the unit. This follows a \$670 million goodwill write-down for the unit in October 2005.

The latest goodwill impairment charge and deferred tax asset valuation would hurt net income, assets and shareholder equity for the 2005 fourth quarter and full year.

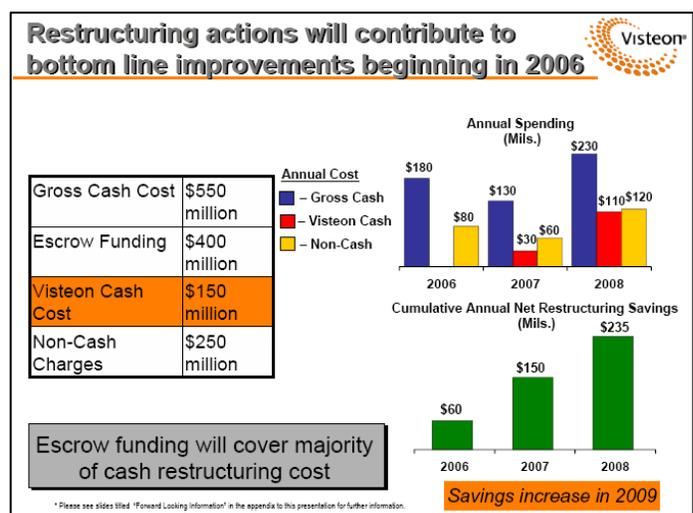
- ❖ The write-down for the interiors group comes after General Motors announced in November the elimination of 30,000 jobs, numerous plant closings, and a reduction in annual production by about a million vehicles.
- ❖ Lear is in "cahoots" with Wilbur Ross to buy out Collins & Aikman, combine it with Lear's interiors group, and float the new company on the stock market to achieve a tidy profit.

Visteon Plans \$800 Million Restructuring

Visteon plans an \$800 million three-year restructuring including closing up to 23 facilities. The company expects non-cash charges of about \$250 million, with \$400 million reimbursable under an escrow agreement with Ford, and a cash cost to Visteon of \$150 million.

Over the next several months, Visteon will close factories in Mexico, Puerto Rico and Buffalo, NY. It will also put six other plants up for sale. Visteon will try to restore the remaining plants to profitability. All of the facilities will be fixed, sold or closed.

Visteon wants to address eleven plants in 2006, seven in 2007, four in 2008 and one in 2009. The costs are likely to come from severance and benefits, contract terminations, production transfers and for impairment about facilities and equipment.



Visteon at the end of September completed a restructuring agreement with Ford, sending numerous unprofitable facilities back to Ford and cutting ties to 18,000 UAW hourly workers.

- ❖ **The deal with Ford reduced Visteon's annual revenue by about 40% as it reduced the company's reliance on Ford business and narrowed its focus to interiors, climate control and electronics where most of its new business comes from.**

Spotlight on China

China is World's 2nd Largest Auto Market

Almost six million vehicles were sold in China in 2005, more vehicles than in Japan, making China the world's second largest auto market after the United States. If imports of 160,000 are excluded, China is still number three.

Chinese vehicle sales last year rose 14% from 2004 to 5.8 million units of China-made products. Sales of vehicles in 2006 – including cars, buses and trucks – are expected to grow 10% to 15% to between 6.4 million and 6.6 million units.

Sales of passenger vehicles, including cars and SUVs, jumped 21% to nearly 4 million units, bouncing back from a “lackluster” rise of 15% in 2004. In 2003, sales almost doubled.

The stronger performance in 2005 was partly due to healthy sales in secondary markets in the inland provinces where personal incomes are just starting to grow.

- ❖ **North America and Europe should have such auto sales growth “problems.”**