13 August 2019
Article

German recession fears, should we blame the Chinese car market?

The current slowdown of the German economy is closely linked to problems in the automotive sector. What role does China play in all of this?

Content

The German economy appears to be stuck between solid domestic fundamentals and external risks. The industrial slowdown is beginning to have an impact on the domestic economy while the entire economy seems to be flirting with recession.

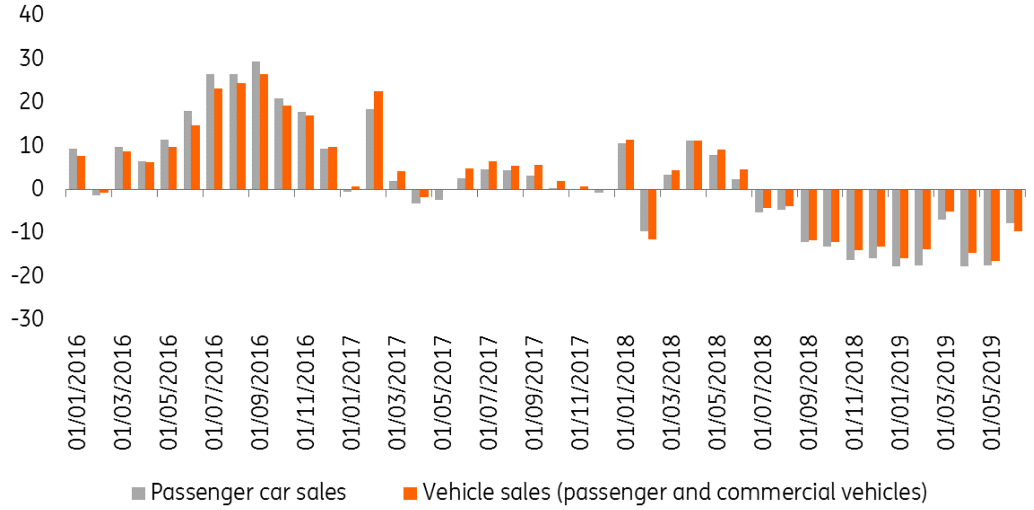
Cars have been and will continue to play an important role in this situation but despite the multitude of explanations for the problems in the automotive sector, surprisingly one of them is China. Understanding recent developments in the Chinese automotive market is an important piece of the puzzle to comprehend the outlook of the German automotive market.

From WLTP to the US-China trade conflict

The delayed introduction of the new emissions standard - the worldwide light vehicles test procedure, or WLTP - and delays in complying with these new standards led to severe disruptions in the German automotive production and delivery. The US-China trade war and the subsequent slowdown of the Chinese economy are also considered to be responsible for Germany's car problems.

But data shows a more nuanced picture. In 2018, vehicle sales in China dropped by some 3% YoY, while passenger car sales dropped by more than 4% - the first decrease in over twenty years. However, German car manufacturers saw their sales increase by 2%.

New vehicle sales have dropped 13 months in a row



Source: Refinitiv Datastream

Direct impact of the trade conflict on the German automotive sector

The Chinese market is the most important market for the majority of German car manufacturers. In 2018, almost one-quarter of all cars sold in China were German. BMW and Daimler sold more than one-third of their total car sales in China. For Volkswagen, the share is even bigger - 40%.

Looking ahead, things aren't looking too good for German car manufacturers. New car sales in China have fallen for 13 months in a row, a slump which started in the second half of 2018 when the trade war between China and the US began to heat up.

> In 2018, almost one-quarter of all cars sold in China were German. BMW and Daimler sold more than one-third of their total car sales in China

As a result, US customs duties on Chinese goods worth 250 billion US dollars (with 300 billion US dollars to follow on 1 September) and Chinese customs duties on US goods worth 110 billion US dollars, car and car parts from China have been taxed at 27.5 percent in the US since July 2018, while China has temporarily increased customs duties on US vehicles from 15 to 40 percent. However, China has removed these additional tariffs now, so US autos are subject to China's standard tariff rate of 15%.

According to media reports, BMW and Mercedes car exports from the US to China have suffered due to the tariff hikes, which is probably why BMW has started to manufacture locally in China to circumvent car tariffs in China on car imports.

Given that some German car manufacturers actually export US-produced cars to China, there has been a clear and direct impact of the trade conflict on the German car industry. Having said that, the larger impact seems to be coming indirectly from lower Chinese consumer confidence.

Structural factors and shift in the Chinese automotive market

Another factor, which is well-known in Europe and has probably weighed more heavily on sales in recent months is the switch to the new emission standard. By July 2020, all light vehicles in China need to comply with the China 6a emission standard, based on European and US regulations. But many provinces rushed ahead and made the new standard mandatory a year earlier to comply with environmental protection campaigns.

In Europe, the impact of adapting to this new standard placed a huge strain on the passenger car market last year such that new passenger car registrations fall more sharply (in absolute terms) than during the global financial crisis. Although car dealers have substantially discounted prices for China 5-standard vehicles before the deadline, consumers were reluctant, probably waiting for passenger cars with the new emission standard instead. Automotive retail sales only surged in June, with car dealers offering heavy price reductions. The destocking of China 5-emission standard vehicles might be responsible for lower orders from dealers too. But with the new standard now in place, a rebound in car sales might be round the corner.

> Forecasts of the Chinese car market have assumed low ownership rates projecting plenty of growth potential in the coming years, but it's quite possible that this growth potential will be impaired by ride-hailing and/or car-sharing

The tax incentives expiring for small cars at the end of 2017, which lasted three years, is also likely to continue to have an impact on the Chinese market, as car purchases were brought forward.

Alongside cyclical developments, there are also structural changes in the Chinese automotive market affecting German car sales. China is already the largest ride-hailing market in the world, with over 459 million customers and a turnover of around 53 billion dollars. In the US, there are currently 66 million users generating 49 billion dollars in turnover. To put things into perspective, one-third of the Chinese population already uses alternative mobility solutions, while in the USA the figure is around 20 percent and in the EU it is just 18 percent - a trend, which is likely to grow in the coming years. Admittedly, it's impossible to tell whether users are exclusively using ride-hailing or whether it is complementary to still owning a car.

So far, forecasts of the Chinese car market have assumed low ownership rates projecting plenty of growth potential in the coming years, but it's quite possible that this growth potential will be impaired by ride-hailing and/or car-sharing.

Another structural change is the transition towards electric car production and sales, which the Chinese government is supporting. Indeed, sales of electric cars in China are still going strong, increasing by 50 percent in the first half of 2019 compared to 1H18, but the subsidies in this segment will also be phased out between 2020 -2021.

The biggest threat to German automotives is...

So, we think the current crumbling of the Chinese car market appears to be a simultaneous combination of cyclical factors, one-off effects and structural changes.

And for the German economy, it's not actually the trade conflict which is most concerning but the structural shifts in the Chinese automotive market, which could turn out to be one of the biggest threat in the years ahead.

Carsten Brzeski
Chief Economist ING Germany
+49 69 27 222 64455
carsten.brzeski@ing.de

Iris Pang
Economist, Greater China
+85 22 848 8071
iris.pang@asia.ing.com

Inga Fechner
Economist, Germany, Austria
+49 69 27222 66131
inga.fechner@ing.de