

# How Will US Import Tariffs Affect Global Auto Industry?

Atradius Economic Research – January 2019

## Summary

- The world's automotive sector is already straining under the weight of US tariffs on steel and aluminium
- US manufacturers are reporting unplanned costs and many are facing radical restructuring and competition for local suppliers to replace international supply chains
- Manufacturers worldwide have reported supply chain disruption. Workers have been laid off. Car sales have slowed and many auto companies are facing slashed profits and increased credit risks.
- To help mitigate the effects of US tariffs, global manufacturers are increasingly focusing on local suppliers and markets. But until these supply chains are developed, the manufacturers will face a rocky road.

## Global overview

The global automotive sector has recovered impressively from the wide-ranging impacts of the 2008 financial crisis. After eight years of sustained improvement, the industry saw record-breaking revenues for both carmakers (USD 2,335 billion) and suppliers (USD 620 billion) in 2017, which translates to compound annual growth of approximately 5.7% since 2009. However, a number of developing trends now threaten to arrest this upward momentum.

In Europe, the collapse of the Turkish currency has coincided with the continued-threat of fallout from Brexit. At the same time, the European Central Bank has announced that it will end its super-stimulus program by the end of the year, which should tighten consumer spending in major markets such as Germany. Meanwhile, the latest economic statistics from China show that GDP growth has slowed to its lowest level since the recession, and car sales have

fallen through the third quarter of 2018. We can attribute a significant portion of this slowdown to the protectionist initiatives that the Trump administration has implemented over the past year.

After releasing a Section 301 report, which claimed that China was engaging in discriminatory policies that represented a restrictive influence on US commerce, the government imposed a 25% import tariff on approximated USD 34 billion worth of Chinese industrial goods in July. As the bilateral trade war escalated, a 10% tax was placed on an additional USD 200 billion worth of products at the end of September; these rates will rise to 25% by the start of 2019, if US stipulations are not met. Billions of dollars worth of Chinese auto parts are included in this new tariff list.

China is far from the only country to feel the consequences of the Trump administration's new

administration's new initiatives. Following months of uncertainty surrounding the dissolution of NAFTA, the US, Canada, and Mexico were finally able to put pen to paper on a reconfigured US-Mexico-Canada Agreement (USMCA) that replaced the former trade agreement. While the deal does represent a welcome nod towards stability, it will raise new challenges for auto companies across the region. The USMCA introduces a new *rule of origin* which requires 75% of all parts used in auto manufacturing in the region to come from North American companies (a 22% rise on the previous requirement). Additionally, it levies a 2.5% minimum wage tariff on auto assembly.

However, these effects will pale in comparison to the potential impacts of the 25% tariff on imported cars and auto parts that was proposed by President Trump back in July. The Commerce Department is currently heading up a Section 232 report investigating whether the US auto industry's reliance on imports represents a threat to national security. If the agency rules in favor of tariffs, as it did back in May with the steel and aluminum tariffs, then the global auto industry will be severely compromised.

### Germany

German OEMs produce about 1.6 million cars in the US alone, of which about 600,000 to 800,000 are sold in the US. Many related Tier 1 suppliers also operate inside the US. Currently, these outsourced manufacturers are dealing with the impact of steel and aluminium tariffs, which worked to drive up operating costs. While these companies will not be affected by an auto parts tariff, German OEMs also export an additional 500,000 vehicles to the US. These units would feel the impact of any added levies.

However, luxury car manufacturers should be in a better position to manage added costs as their main segments are typically more willing to accept price increases. That being said, German or other European suppliers that are currently exporting parts to the US will likely face a significant reduction in profitability as a result of the new tariffs, as many US-based importers may decide to switch to local suppliers. Moving forward, these foreign suppliers could pose a substantial credit risk, especially those businesses that already have a poor liquidity situation.

### US

Regardless of the final results of the Section 232 report, US car manufacturers have already begun to experience supply chain disruptions because of existing steel and aluminum tariffs. Adding tariffs on auto parts significantly increases the cost component. Auto manufacturers have cultivated complex and highly sophisticated global sourcing networks that encompass everything from semi-finished products to components and raw materials.

Their current vendors are all vetted for quality, accuracy, and timeliness. Replacing these suppliers with onshore alternatives would mean a radical restructuring that could take 5-10 years. Many companies could become a significant credit risk over the long term.

In recent testimony to the Senate Finance Committee a representative from Honda North America stated that the existing Section 232 steel tariffs have added millions of dollars in unplanned costs for the company. While Ford CEO Jim Hackett admitted that if tariffs continue then the automaker could see losses of more than USD 1 billion over the next couple of years due to massive increases in US steel prices. The company has already phased out several imported car models from its US lineup.

Rising prices for steel and aluminum could negatively impact businesses profitability and cash generation, especially for Tier 1 and Tier 2 producers. These trends will only be exasperated if the additional 25% auto industry tax is enforced. CAR studies estimate that this tax could result in a 2-million unit reduction in vehicles sold and a total job loss of more than 700,000 across the sector, probably leading to increasing insolvencies. From a consumer perspective, the tariffs could add as much as USD 6,400 to the cost of a USD 30,000 vehicle in the US which would increase monthly payments by up to USD 120. Repair and maintenance costs would also increase in lockstep.

While the auto resale market should see a nice bump in volume as many consumers are priced out of the new car market we could also see a more rapid move to shared auto options. Development of the auto of the future may also see a positive bump in investment as more streamlined local manufacturing facilities will grow in importance and the entrance of non-traditional auto companies in the development of connected, electric, autonomous and updateable vehicles will drive continued investment.

### Canada

Canada's auto industry accounts for 23% of the country's manufacturing trade, and motor vehicles and auto parts are their second most lucrative export behind energy products. Almost 96% of the sector's annual production went to US buyers last year. The country's tit-for-tat escalation of steel tariffs has caused layoffs in the local steel manufacturing sector while auto-parts makers who import steel from the US have found it more difficult to procure raw materials at cost. As these tariffs deepen over the new year, these companies may find themselves facing significant liquidity issues.

These factors illustrate just how important the signing of USMCA was to locally based automakers, and how devastating an additional 25% auto import tariff could prove. Such a tariff could cause many outsourced automakers to reconsider their local operations. If the tariff is imposed, it could prove to be a critical area for credit risk assessment. For the time being, the USMCA rule of origin could mean an increase in local parts and automotive manufacturing.

### Japan

Japan's largely export-driven economy is built around its USD 100 billion auto industry (3% of the Japanese GDP). In 2017, over 4 million vehicles were exported to the US, a figure that represents about 40% of the country's total auto exports. Japan differs from other major auto exporters in that a large portion of vehicles sold in America are already manufactured in the US. However, like other auto manufacturers, components are sourced from a myriad of suppliers both in the US and abroad. Subcontractors and suppliers are likely to be hit hard and the higher costs could pose a significant financial toll on small and mid-sized auto related companies, increasing their credit risk.

Auto-related suppliers have also begun to feel the pinch of rising steel and aluminum costs. This year, Toyota group supplier Aisin stated that their costs had risen by an additional ¥1 billion due to the added cost of sourcing materials to its US production facilities. Denso, another Toyota supplier with manufacturing facilities in the US has claimed that their costs could increase by ¥2 billion over the years.

China has become an increasingly lucrative market for Japanese auto companies. In 2017, sales to the region totaled 1.52 million only 7 million short of US sales figures for the year. Companies such as Toyota are also looking to ramp up their Chinese-production. The increasing synergy between these two Pacific nations may help to soften the blow if any additional US tariffs go into effect. However, if tariffs lead to further weakening in Chinese consumption, this mitigating effect may be negated.

### Mexico

USMCA restrictions could prove more problematic for the Mexican auto industry. In 2017, 75% of Mexico's exports consisted of light vehicles sold in the US. Currently, only 5 locally based automakers meet the 75% rule of origin requirement. Manufacturers will also have to account for an additional stipulation which states that 40%-45% of final assembly must be done by workers earning an average wage of at

least USD 16 an hour. We predict that most companies in the country will be willing to pay the additional 2.5% duty in order to avoid this sort of drastic increase in overhead. These additional costs will probably be folded into the list price of exported vehicles. In the medium-term we should see an increase in new contracts made with OEMs to meet the regional content of vehicle production requirements.

### China

China's auto industry is largely independent of the US market, but Chinese car part producers exporting to the US will feel the pinch of the escalating trade war. US imports currently account for only 1% of the vehicles sold in China. However, US manufacturers still export more than USD 10 billion worth of related automotive products to the country. Increasing trade tensions between the two countries has caused these manufacturers to lower their profit estimates. However, the Chinese government has worked to mitigate these rising costs, by lowering import duties for non-US vehicles and auto parts by 10% and 4% respectively.

China has also taken steps to invite investment opportunities for overseas car manufacturers. The country is loosening restrictions on joint ventures for the electric vehicles sector this year. The country has also announced plans to open up the commercial vehicles market by 2020 and the passenger cars market by 2022. This should help to stabilize the Chinese auto industry even if further US tariffs are implemented.

### South Korea

South Korea's auto industry contributes an estimated 10% to the country's GDP and employs almost 2 million people across the sector. In 2017, 33% of all South Korean car exports were made to the US, at an overall estimated valuation of USD 16 billion. However, South Korea has some degree of protection against any further auto tariffs as many of their major manufacturers such as Hyundai (50%) and Kia (64%) produce a large portion of their US output in the United States. Kia also produces a further 300,000 units in Mexico which means that the company should enjoy additional protections under the USMCA.

Still, the US represents a large portion of South Korean exports and any tariffs in this respect would be impactful. The relatively small size of the South Korean car market means that the country cannot hope to make up any future deficits through future

US car imports. Currently, only 13% of car imports to the country come from the US. Another factor to take into account is that local suppliers will feel the effects of increased parts and raw material tariffs if a large portion of their exports are to US-based facilities. These rising costs could pose a threat to the liquidity and future operating capabilities of these firms.

South Korea has worked to mitigate these threats by expanding their presence in other markets such as China (1.15 million units sold in 2017) and the EU (1 million units sold). As far as the US goes, there is some hope that a new independently agreed Free Trade deal could help to exempt South Korea from further auto tariffs, however the country will likely have to accept some limitations to its export capabilities in the future.

## **Disclaimer**

This report is provided for information purposes only and is not intended as a recommendation or advice as to particular transactions, investments or strategies in any way to any reader. Readers must make their own independent decisions, commercial or otherwise, regarding the information provided. While we have made every attempt to ensure that the information contained in this report has been obtained from reliable sources, Atradius is not responsible for any errors or omissions, or for the results obtained from the use of this information. All information in this report is provided 'as is', with no guarantee of completeness, accuracy, timeliness or of the results obtained from its use, and without warranty of any kind, express or implied. In no event will Atradius, its related partnerships or corporations, or the partners, agents or employees thereof, be liable to you or anyone else for any decision made or action taken in reliance on the information in this report or for any consequential, special or similar damages, even if advised of the possibility of such damages.

Copyright Atradius N.V. 2019  
Atradius N.V.  
David Ricardostraat 1 · 1066 JS  
P.O. Box 8982 · 1006 JD  
Amsterdam  
The Netherlands  
Telephone: +31 20 553 9111  
Fax: +31 20 553 2811