Synchronised sinking – vehicle sales forecast updated; industry outlook remains negative

SCOPE Scope Ratings

We have updated our forecast for light vehicle sales for 2020 and now expect a steep decline of 9% in unit volumes worldwide. Key to the marked slump is the expected impact from the coronavirus pandemic, which mainly affects Chinese and European light vehicle markets.

Our outlook for the automotive industry remains at negative and the expected deceleration of unit sales volumes in 2020 only strengthens this view.

We have updated our forecast for light vehicle sales (passenger cars, SUVs, CUVs, pick-up trucks) for 2020 and now expect a steep decline of 9% in 2020 worldwide. This implies a drop of 8m global unit sales.

We see a sharp correction in China (-10%), assuming the Chinese government will put in place some vehicle purchase incentives, and significantly worse for Western Europe (-19%) – and even worse for Europe, east and west (-21%). Our previously cautious stance on the US market now includes the potential effects of consumer confidence, which may lead to lower discretionary spending and eventually to a more significant decline of the US market (-8.5%). For economies dependent on crude oil/natural gas prices such as Russia, we now foresee a market contraction of over 50% in 2020.

We continue to consider global auto markets to have peaked in 2017 for various reasons (see our 2020 Automotive Outlook here). Our negative view on the sector's developments was exacerbated by the spread and effects of the coronavirus pandemic, which has led to a virtual standstill of economic activity in some European countries, notably Italy, reduced consumer confidence, and the risk of second-round effects (lower employment, lower business confidence) affecting the demand for light commercial vehicles.

Supply chain disruptions in 2020 should exceed the effects we have observed in the autumn of 2018, when the new WLTP emission standard was introduced and supply chains were in turmoil.

The suspension of production with the resumption of normal production will take time. We do, however, caution that a rebound in demand in the second half in 2020 depends on whether the capacity of the *entire* automotive supply chain can accommodate the hoped-for spike in demand for light vehicles once the coronavirus is under control. Although capacity utilisations at the OEM level suggest there is sufficient spare capacity, this might not be true for very efficiently run automotive suppliers. Short-term shortages of components will still be an issue once the pandemic is behind us.

Governmental incentivisation of vehicle purchases may only pull forward demand, as observed in 2009/10 with various scrappage schemes following the financial crisis and with the different variations of the Chinese vehicle purchase tax.

In our view, the current pandemic will have the biggest impact on consumer confidence, including a hesitation to embark on large-ticket purchases until the pandemic is resolved.

Analyst

Werner Stäblein
+49 69 6677389 12
w.staeblein@scoperatings.com

Editor

Matthew Curtin
+33 1 8626 1554
m.curtin@scopegroup.com

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Scope Ratings GmbH

Lennéstraße 5
10785 Berlin

Phone +49 30 27891 0
Fax +49 30 27891 100

info@scoperatings.com
www.scoperatings.com

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China's deceleration to be worse than envisaged

We went into 2020 already expecting further deceleration in the Chinese market. The spread of the coronavirus, including the shutdown of production facilities and the spill-over effects on the economy, has made the picture even worse for the largest single market for light vehicle sales.

In January, passenger car sales in China were down 18% year-on-year, followed by a virtual disappearance of the market in February (decline of 92% year-on-year). The year-on-year decline in the Chinese market could reach 30%-35% in the first quarter of 2020.

The effects of the coronavirus have spread far beyond its epicentre in Wuhan, which itself accounts for about 8% of light vehicle production and about 4% of light vehicle sales, according to China's Passenger Car Association. Sales statistics for the first two months of the year suggest that Chinese consumer sentiment has clearly worsened.

While we see a normalisation of light vehicle sales in the second half of 2020, we do not expect the coronavirus' full effects to be compensated for later in the year. Consequently, we expect a year-on-year decline of 10%.

We believe the assumption of a sharp recovery in second half of 2020 should not rest on the erroneous idea that the entire supply chain will have the capacity to produce those 'extra' vehicles later in the year. While the capacity utilisation at Chinese OEMs is fairly low, at around 75% in 2019, we cannot reasonably assume that the automotive supply chain is likewise running at these low levels. The capacity for final assembly is most likely the easiest one to scale up to accommodate higher demand later in the year for OEMs, assuming demand recovers, as the number of shifts can be changed.

Looking through the supply chain, including the capacity utilisation on the supply side, is difficult (let alone that auto suppliers rarely publish these numbers). Knowing that auto suppliers are very much used to a high degree of efficiency and that Chinese OEMs' capacity utilisation was running below those of the US (80%-85% before the pandemic) and Europe, the premise of a rebound assumes that the entire auto supply chain was running at a low capacity utilisation prior to the pandemic. We do not follow that thought process and instead believe that capacity restraints among automotive suppliers (spare capacity is used up quickly once demand rebounds) will eventually be the restraint for Chinese OEMs. Keeping in mind that 100% capacity utilisation is not an efficient way to run mass production of vehicles and components, the headroom to accommodate a strong rebound of light vehicle sales is limited in the second half of 2020.

In our eyes, a recovery of demand in the Chinese market is likewise linked to governmental purchase incentives once the crisis is behind us. One lever used by the Chinese central government in the past was a reduction in vehicle purchase tax. In addition, the central government may consider increasing licence plate quotas in certain cities/provinces. Depending on a conceivable new quota, possibly even with an increase of licence plates for vehicles with internal combustion engines, we would view any such quota move to have limited effects on light vehicle sales, lifting annual demand by about 1%.

Governmental stimulus such as a variation of the vehicle purchase tax is a double-edged sword, as previously observed in China. Changes in vehicle purchase tax would only pull forward demand, in our view, with a subsequent 'pack-back' in later periods.

The recovery we foresee for China in 2021 is strongly linked to governmental policies in 2020: The higher the subsidisation and artificial boost to light vehicle sales in 2020, the lower the recovery in 2020. For the time being, we expect a mild recovery of 3% year-on-year in 2021.

Europe to be hit the hardest

The expected development for the European market in 2020 must be viewed in conjunction with its recent past. In 2019, the western European market was broadly stable. Based on data published by the European Automotive Manufacturers Association, registrations in key European markets rose by 1% in Germany (+5% in H1 2019), 1.9% in France (-1.8% in H1 2019), 0.3% in Italy (-3.5% in H1 2019), but declined in Spain by 4.8% and in the UK by 2.4%.

The modest growth in 2019 marked the sixth consecutive year of passenger car registration growth in the EU, with the western European market almost reaching its pre-crisis (2007) level. While this appears backward-looking, we want to highlight that car registrations in western Europe in 2019 have already been supported by the de-stocking of inventory related to the introduction of the Worldwide Harmonised Light Vehicle Test Procedure (WLTP) in September 2018. Further support in the German market came from trade-in bonuses, environmental bonuses and various discounts and incentives for older diesel vehicles. While exact data is not available, we also believe that all car OEMs have incentivised the sale of high-CO2-emitting vehicles before the CO2 emissions legislation comes into effect in 2020.

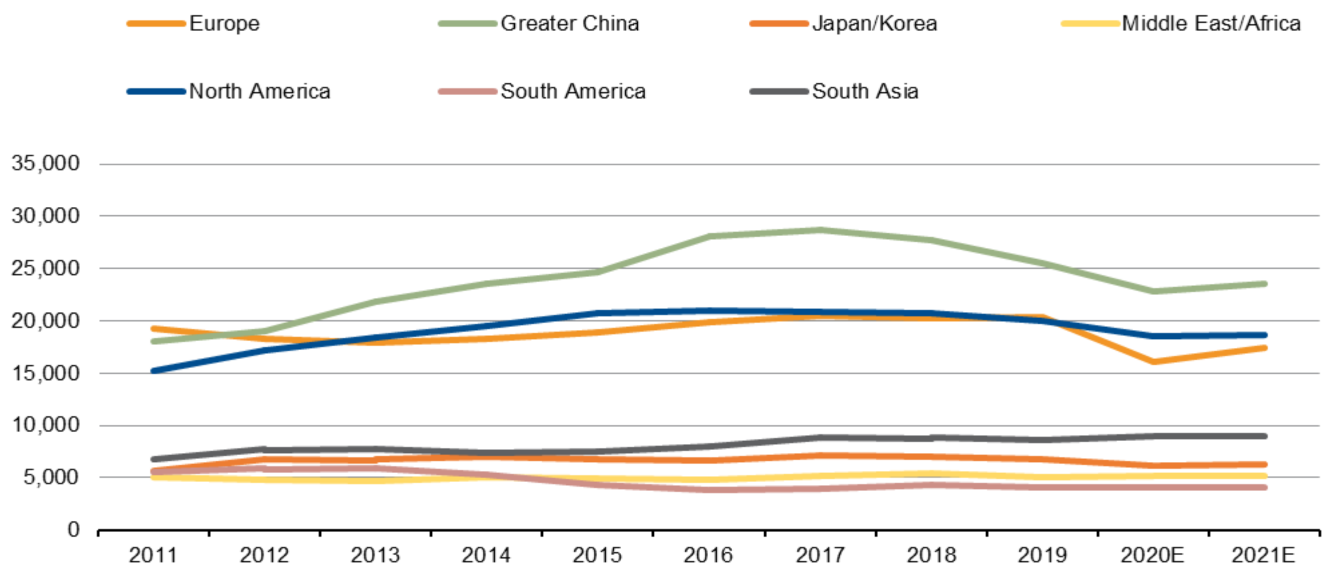
In our view, 2019 vehicle sales in Europe were already inflated by effects unlikely to be repeated in 2020, but the coronavirus has made our previous expectation of a decline of 3% redundant.

We now expect the western European market to drop by almost 3m units (or 19%) in 2020. Much of the decline will be related to Germany, where we expect no special incentives in 2020, as well as Italy and Spain. This forecast includes a massive decline of light commercial vehicles typically used by small enterprises, as we believe the replacement of those vehicles is postponed in view of the difficulties that some smaller enterprises may face in terms of funding and business.

A key market in eastern Europe that will add to the woes in Europe is Russia. The sharp decline in oil prices and the high dependence of Russia's economy on crude oil/gas exports should have a massive impact on light vehicle sales. While the Russian market has already diminished in size (1.8m units in 2019 after 2.5m in 2014 and 2.8m in 2013), we see the risk of a further deterioration by 0.8m units in 2020.

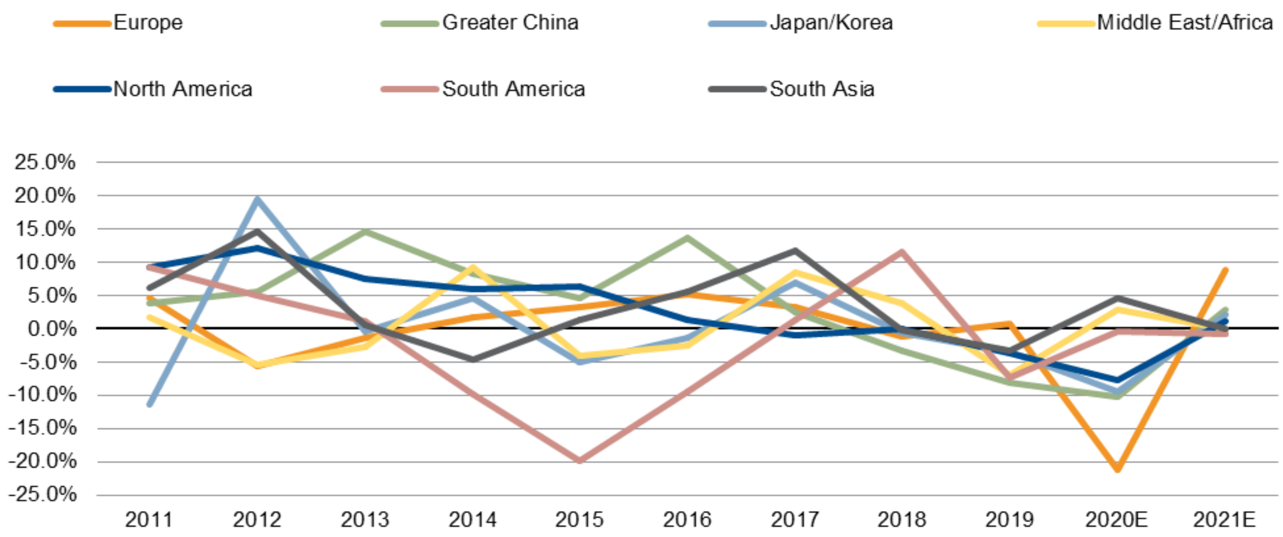
Unit volume sales is, of course, a function of appealing products, availability of financing, disposable income and, most importantly, OEM purchase incentives. According to Autodata, average incentives in Europe moved to EUR 5,000/vehicle in late 2019, up from about EUR 3,000/vehicle. This is another indication that the starting point for the current crisis is an inflated market supported by factors including low interest rates, high incentivisation, and a favourable economic environment (low unemployment and high business/consumer confidence). We would not expect car OEMs to compromise lending practices and underwriting standards to support vehicle sales and believe the pro-cyclical nature of the lending cycle will now move to 'risk on' for consumer financing, eventually leaving its mark on light vehicle sales in the region.

Figure 1: Global automotive sales volumes (thousands of units)



Source: LMC Automotive, Scope Ratings

Figure 2: Global automotive sales (growth rates year-on-year)



Source: LMC Automotive, Scope Ratings

Scope Ratings GmbH

Headquarters Berlin
Lennéstraße 5
D-10785 Berlin

Phone +49 30 27891 0

Frankfurt am Main
Neue Mainzer Straße 66-68
D-60311 Frankfurt am Main

Phone +49 69 66 77 389 0

Paris
1 Cour du Havre
F-75008 Paris

Phone +33 1 8288 5557

London
Suite 301
2 Angel Square
London EC1V 1NY

Phone +44 20 3457 0444

Madrid
Paseo de la Castellana 95
Edificio Torre Europa
E-28046 Madrid

Phone +34 914 186 973

Milan
Via Paleocapa 7
IT-20121 Milan

Phone +39 02 30315 814

Oslo
Haakon VII's gate 6
N-0161 Oslo

Phone +47 21 62 31 42

info@scoperatings.com
www.scoperatings.com