Economic Research

GLOBAL AUTOMOTIVE

September 2018

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BUMPY ROAD AHEAD

EXECUTIVE SUMMARY

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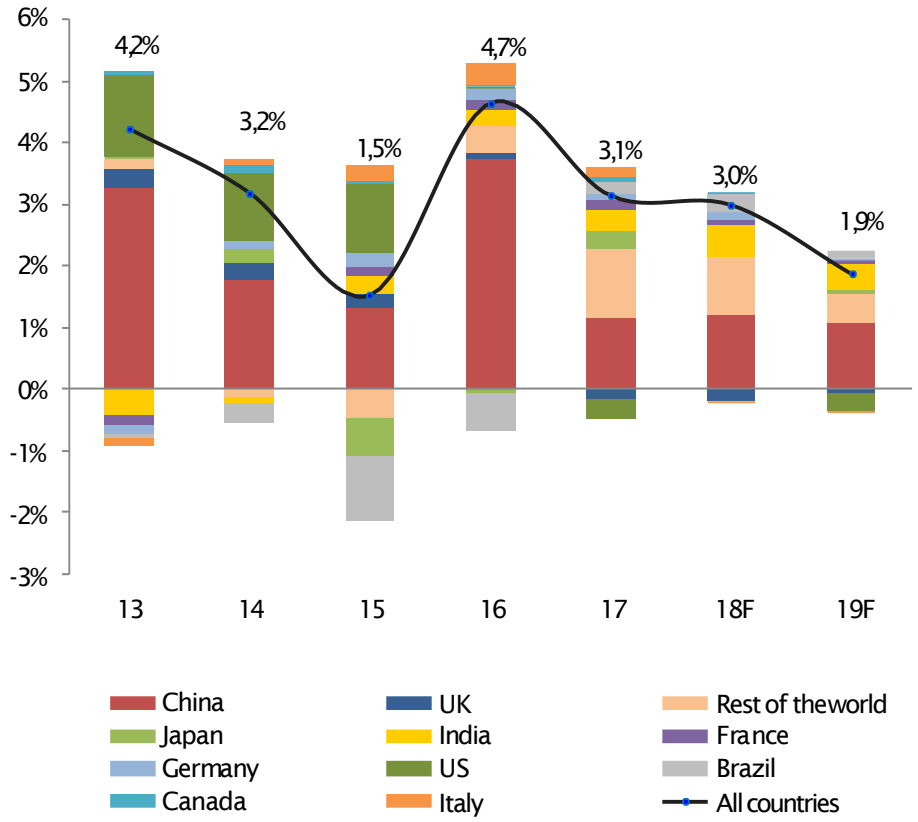
- The automotive market is set to grow by +3.0% in 2018 compared to +3.1% in 2017 and to slow down to +1.9% in 2019, with new vehicle registrations expected to exceed 100mn units in 2019, worldwide.
- Medium-term prospects remain favorable, with annual sales to reach 110 million units by 2022 mainly driven by the demand in China and to a lesser extent India.
- However, for manufacturers and suppliers, transition to electric vehicle and protectionism are leading to greatly increased uncertainty and rising costs, notably inputs costs, relocation of production and upheaval of supply-chains.
- Some car makers will be forced to dedicate CAPEX to meeting short term challenges and therefore not be able to deploy the significant amounts required to take advantage of opportunities stemming from the future of mobility.

Chart 1 Contributions to Growth in Global Vehicle Sales (in pp)



Sources: OICA, IHS, Bloomberg, Allianz Research

Photo by Chuttersnap on Unsplash

100mn

Vehicle sales in 2019

GLOBAL AUTOMOTIVE BUMPY ROAD AHEAD

- **A positive global market: Driven by demand from China and India after two years of growth (+ 3% in 2018 and + 1.9% in 2019), new vehicle registrations are expected to exceed 100mn units in 2019, worldwide.**

- **Short-term yet high-pressure for manufacturers and suppliers: Transitioning to electric vehicle and the protectionism increase are two challenges weighing down on their financial prospects and their ability to invest in future mobility markets.**

The global automotive market continues to grow, with still favorable medium-term prospects mainly driven by the demand in EM.

After a healthy eight year recovery-time and a still dynamic first half in 2018, the automotive market is set to grow by +3.0% in 2018 compared to +3.1% in 2017 and to slow down to +1.9% in 2019. Worldwide vehicle sales will reach 99.7mn in 2018. They will cross the 100mn unit threshold in 2019 with 101.6mn annual sales despite some hurdles that will impede additional sales in different countries. They are the following: (i) the decelerating economic momentum (Asia, Europe) (ii) the global tightening of financial conditions that will raise borrowing costs for households (iii) the renewed tensions on some currencies that will penalize the demand from importing countries (iv) growing second-hand markets (in China, the U.S., the U.K.) that will maintain the price differential with new vehicles and continue to surpass new-vehicle deliveries in most mature markets (where the ratio of used-vehicle to new-vehicle sales stand between 2 and 2.5).

Asia will lead the way as the largest contributor to sales growth, thanks to China and India generating together more than 55% and 75% of the additional global sales, respectively in 2018 and 2019. China is on course to strengthening its position as the world's largest automotive market, despite a slight downshift in new registrations. These are expected to increase by + 4% in 2018 and + 3.5% in 2019, after a CAGR of + 8.6% between 2012 and 2017 to 29.2mn in annual sales. India, for now, should maintain its position of 4th place in the global automotive market, with new vehicle registrations increasing by + 12% in 2018 (to 4.5mn units) and + 9% in 2019 (4.9mn units), before reaching the podium in 2020. Japan, after experiencing several years of a volatile market, should stabilize in 2018 before a small increase in 2019 (+1%) to 5.2mn units.

Europe will follow, thanks to decelerating, yet still increasing sales in the E.U., specifically in the German and French markets, with the U.K. and Italy as key exceptions, and to the strong performance in the Eastern countries, boosted by the rebound in Russia and double digit growth in smaller markets. Germany continues to host Europe's largest market with 3.9mn units in 2018 (+3%) and almost 4.0mn in 2019 (+1%); still lower than the peak reached in 2009. After 3 years of a steady recovery-time (+5.6% cagr over 2015-2017), in 2018, France is to regain the historical high, reached in 2009, with

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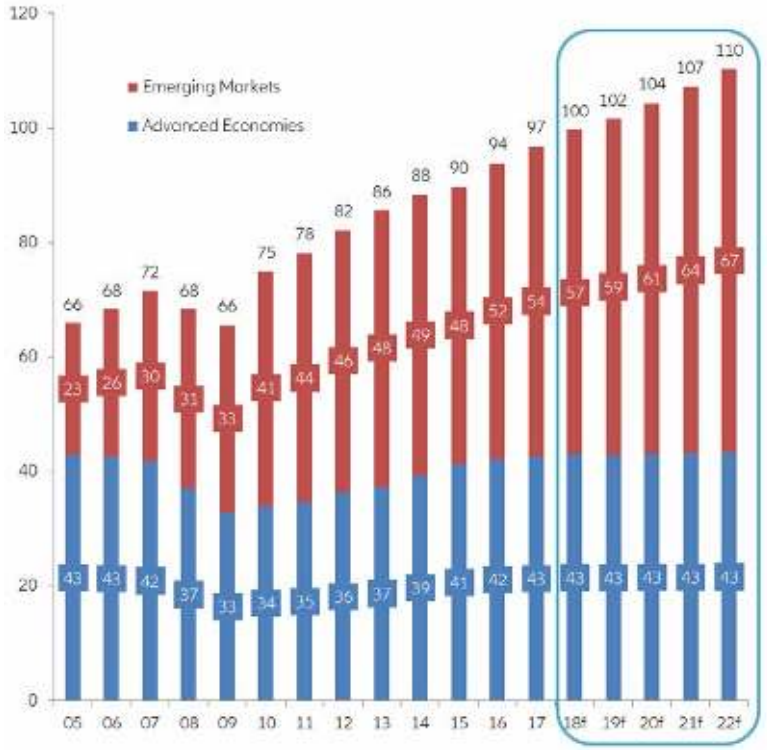
2.7mn (+4%) before 2.8 in 2019 (+2%). On the other hand, Italy should post experience a small decline (-1%) both in 2018 and 2019, and continue to register a lot less new vehicles than in 2007 (2.8mn) despite four consecutive years of a strong rebound between 2013 and 2017 (+11.4% cagr). The U.K. will continue to be a key exception, with a set of declines in registrations due to diesel taxation, air-quality plans, waning consumer purchasing power and Brexit-related uncertainties. In our central scenario of a last minute agreement, we expect a decrease of -6% in 2018 and -3% in 2019 (after -5% in 2017) for new car sales that will push them down to 2.8mn in 2018 and less than 2.7mn in 2019, compared to the highest sales of 3.1mn in 2016.

In this context, the U.S. market will remain key - as the second largest market with more than 18% of global sales - however its contribution to the increase in global sales will mainly come from the recovery of the Brazilian market. Currently, the U.S. market should reach a plateau in 2018 at 17.6mn units, just slightly down from the high level reached in 2016 at 17.9mn units, before a moderate decrease in 2019 (-1.5% to 17.3 min).

Medium-term prospects remain favorable at global level, with annual sales to reach the 110 million threshold by 2022. Despite the slower pace expected in the short term, two key factors should support the markup to new records in the next five years.

First, let's talk about the unsatisfied needs for mobility around the world. Despite the impressive number of more than 1300mn vehicles in use worldwide, there is a huge disparity between countries and numerous markets that are still posting a (very) low motorization rate, with the lowest averages at 60 per 1000 inhabitants in Africa/Middle East, 100 per 1000 in Asia and 200 per 1000 in South America, compared to more than 800 per 1000 inhabitants in North America and 600 in Western Europe, as is the case for three major countries—Brazil (210), China (120) and India (25). With this in mind, we expect to see emerging markets with positive economic forecasts and a growing middle-class. All in all, annual sales in emerging markets should increase by +13mn in 2022, compared to 2017. We expect, a noticeable extra +6mn to +35mn vehicles in China (i.e. 34% of global sales), and +2mn to +6mn in India (i.e. almost 6% of global sales), with the potential to double the market size in the next ten years when reaching 8mn units.

Chart 2 Global Vehicle Sales Medium-term forecasts (in million)



Sources: OICA, Oxford Economics, Allianz Research

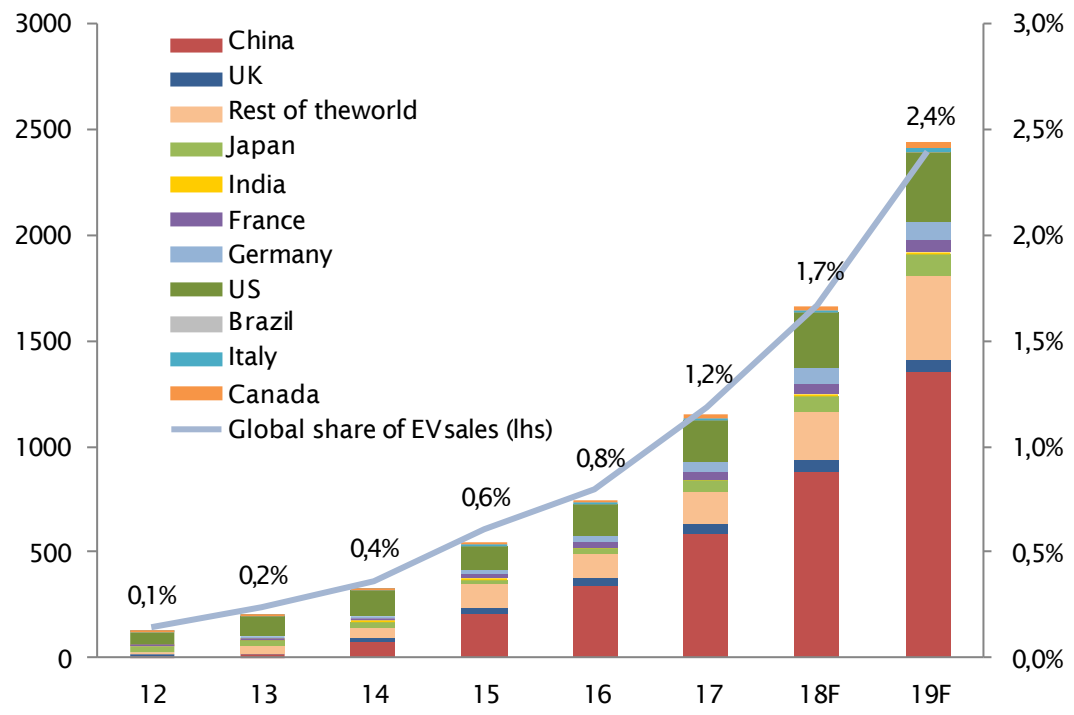
Second, let's address the needs and appetite for replacement in mature markets. We believe that mature markets should no longer be a strong foundation for growth in global sales, posting at best a moderate increase by 2022, but we still expect them to remain broadly stable at around 43 million vehicles per year. Here are three points that support this point of view: (i) the natural need for replacement, coming with the size and average age of the fleet of vehicles in use. The purchase of replacement vehicles accelerated in recent years as households previously postponed purchasing after the global financial crisis. Yet, since 2010, the growth in the number of vehicles in use (more than 250mn) still exceeds the growth in new sales in Europe, meaning that the average vehicle age remains high (with a use/sales ratio exceeding fourteen years). (ii) The consumer's appetite for innovation and new technology and services, as seen with the commercial success of Sport Utility Vehicles (SUVs) globally (+14% in H1 2018 to almost 15mn units) and the Advanced Driver Assistance Systems (ADAS). (iii) The environmental needs arising from both consumer demand and public authority restrictions, through regulation and standards, that are driving up the electric vehicle (EV) market.

The transition to EV has become increasingly challenging in the short term for automakers. They are entering a critical phase, because the timing and costs of adapting to a large variety of specific market contexts, notably regulations, can be challenging and the end of diesel is arriving faster than expected.

The global EV market is enjoying a strong double-digit momentum. Global EV sales surpassed 1mn units for the first time in 2017 (+54% after +38% in 2016) and will keep on posting record annual sales in 2018 after another staggering increase (+45%), as well as in 2019 (+46%) when approaching the threshold of 2.5mn. Thanks to this rapid expansion, the worldwide fleet of EV will climb from 3.1mn in 2017 to 4.7mn in 2018 and more than 7.2mn in 2019.

However, this growth still only comes from few countries, particularly China, and EV market shares remain limited with a large dispersion across countries, reflecting in practice the state of policy support and regulatory frameworks. China is by far the largest contributor to growth, with more than half of global EV sales, followed by the U.S. It now has a larger EV market than the U.S. and Europe combined and the set of policy measures in place, in terms of subsidies and regulation, will guarantee its leadership position. Yet, almost all the mature markets are expected to explode with double-digit growth

Chart 3 Global EV Sales (in thousand)



Sources: IAE-EVI, EAFO, Allianz Research

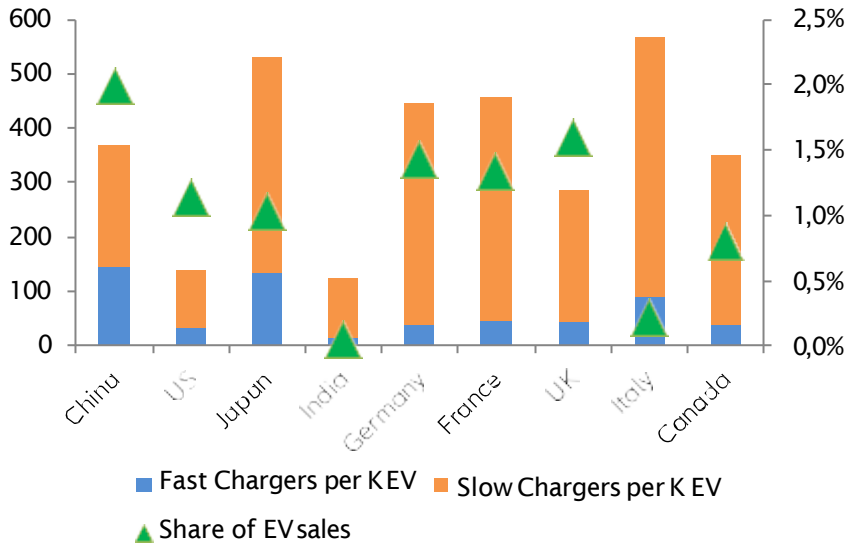
in EV sales in the coming two years. We foresee annual EV sales to exceed 320K units in the U.S. and 100K units in Japan by 2019. The European countries will reach 400K units in 2018.

Despite this momentum, EV market shares will remain low for the short term, totaling less than 1.7% of global sales in 2018 and 2.4% in 2019, from 1.2% in 2017. The same is true at the country level, since most countries were posting a lower than 1.5% market share for EV in 2017, with only a few key exceptions such as the U.K. (1.6%), China (2%), Sweden (4.6%) and Norway (31%). In China, the adoption rate at the national level mainly results from strong sales in a limited number of large cities such as Beijing and Shanghai. Norway stands out as the world's most advanced market of electric cars in terms of sales shares since 2011 and the first market to have reached a critical mass.

In the case of Norway, where policy support has been a key factor for EV deployment, and conversely in the Netherlands, where a shift in the incentive system lead to a trend reversal in EV sales in 2016 (-44%) and 2017 (-55%), both show that EV success continues to be dependent on two critical features that limit the EV expansion to a small set of countries and keep it dependent on all kinds of policy support, and thus vulnerable to any changes.

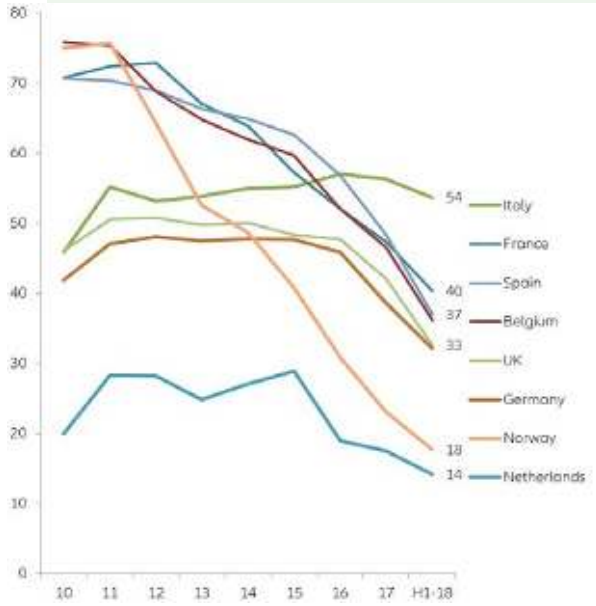
Constraint 1: The charging infrastructure. Households use private charging stations at home and at the workplace, but access to publicly accessible charging stations, particularly along major road networks, is an important factor in increasing EV sales. At a global level, the number of charging stations continues to increase, with 430,151 installations after a double-digit growth (+37% in 2017 after +71% in 2016). However, this rate is not enough to significantly increase the concentration of stations, still at 374 chargers per 1000 EV on average in 2017 (compared to 340 in 2015). Moreover almost 3 out of 4 publicly accessible charging stations have slow charging outlets, while fast and ultra-fast chargers are essential to increasing the consumer appetite for EVs by enabling long distance travel and optimizing installation in cities with land availability constraints, notably in China. More importantly, the installation of charging stations is highly different from one country to another, with almost three-quarters of the world's stock of chargers in China as of end-2017 (213K chargers) – even if other countries have accelerated the de-

Chart 4 Charging Infrastructure and Share of EV Sales



Sources: IAE-EVI, Allianz Research

Chart 5 Market share of Diesel in new registrations (in %)



Sources: ACEA, Allianz Research

ployment of charging stations last year (+39% in Germany, +24% in the U.S., +21% in the U.K. compared to +51% in China) and most often announced their ambition to support large-scale infrastructure.

Constraint 2: The value proposition of EVs (too expensive for most households). Battery cost, which, despite a strong decrease since 2010, is now being reduced at a much slower pace and continues to be the main reason for the higher prices of EVs in comparison with internal combustion engine vehicle (ICEs). Further battery cost reductions are expected with increased production, but even if simultaneously the battery performances continues to improve, the role of financial incentives, such as subsidiesand tax exemptions, remains crucial for individuals deciding on purchasing an EV.

Consequently, the accelerated end of diesel and the tightening of regulations are adding pressure on automakers, by forcing them to adapt faster and more cost-effectively. The decline in Diesel's market share started after the VW emission scandal in 2015 and recently accelerated throughout Western Europe where diesel accounts for more than half of new car registrations. This has been the case for more than a decade but dropped below -40% in H1 2018 regionally and below 33% in Germany and the U.K. This trend was accentuated when a wave of announcements were made by national/local authorities about ICE vehicle bans, access restrictions and intentions to end sales/registrations of new ICEs. This had a significant impact on suppliers specializing in diesel car parts, who were forced to endure drastic adjustments, including job losses and potential insolvencies. At the same time, this weakening demand for diesel has been benefiting ICEs more than EVs because of their value proposition (and the low oil price context that reduced the operating-cost advantage of EVs). The latter is an extra matter of complexity for automakers since they are facing an acceleration of regulatory constraints linked to the implementation of new standards and threats of financials penalties.

In Europe, the result of this was the transition into the Worldwide Harmonized Light Vehicle Test Procedure (WLTP) that came into play September 1St. The obligation for all new carregistrations to meet tougher emission standards created short-term turbulences on production and sales. Consequently, modifications of models were costly and there was a (temporary) stop in production, and accelerating sales with significant discounts to wholesalers and retailers up to September for non-compliant models. There is yet another more difficult challenge in sight— compliance in 2020 with EU rules governing CO2 emissions with the ultimate threat of a penalty of EUR95 per gram exceeding the target. In China, this is the New Energy Vehicle (NEV) credit scheme that set a minimum requirement for the car industry, in terms of production of new energy vehicles, with a system of EV credit that can be obtained by producing and importing EVs, and purchasing NEV credits from other manufacturers.

For manufacturers, both challenges (in Europe and China) already pushed a faster roll-out of new mod-

Chart 6 Bilateral Net Balance in Trade in Automotive (USDbn, 2017)

Surplus in green, Deficit in red. Example: China (line 3) has a trade deficit with Germany (column 5). Conversely Germany (line 5) has a trade surplus with China (column 3)

Partner	Brazil	Canada	China	France	Germany	India	Italy	Japan	Korea	Mexico	Russia	Spain	Turkey	UK	US	RoW	World
Brazil		-5	-844	-262	-935	-150	-366	-839	-1 026	-300	185	-111	-50	-162	-1 292	7 034	876
Canada	5		-56	-62	-3 250	-140	-341	-4 768	-2 324	-3 829	39	-133	-90	-871	7 613	-295	-8 502
China	844	56		143	-21 506	1 370	-1 238	-8 046	-1 175	725	1 410	-40	533	-4 412	3 759	26 111	-1 467
France	262	62	-143		-7 634	-160	-694	-1 231	-540	-48	305	-4 138	-1 467	1 864	92	-2 941	-16 412
Germany	935	3 250	21 506	7 634		149	6 666	3 811	3 613	-1 678	3 927	-170	2 486	22 789	22 701	27 784	125 403
India	150	140	-1 370	160	-149		112	-351	-1 394	598	-1 332	-1 113	-1 013	-1 115	-61	7 483	13 895
Italy	366	341	1 238	694	-6 666	-112		-610	-593	-22	283	-2 648	-1 794	253	5 028	-1 014	-5 256
Japan	839	4 768	8 046	1 231	-3 811	351	610		697	3 124	3 363	1 170	735	2 021	49 036	49 788	121 969
Korea	1 026	2 324	1 175	540	-3 613	1 394	593	-697		1 910	2 461	742	689	751	17 614	20 089	46 288
Mexico	300	3 829	-725	48	1 678	-598	22	-3 124	-1 910		72	-389	-89	139	61 528	1 769	61 148
Russia	-185	-39	-1 410	-305	-3 927	1 332	-283	-3 363	-2 461	-72		-293	-230	-852	-514	-3 472	-17 532
Spain	111	133	40	4 138	170	1 113	2 648	-1 170	-742	389	293		208	3 487	676	6 606	16 718
Turkey	50	90	-533	1 467	-2 486	1 013	1 794	-735	-689	89	230	-208		1 731	1 036	4 738	6 152
UK	162	871	4 412	-1 864	-22 789	1 115	-253	-2 021	-751	-139	852	-3 487	-1 731		6 763	-7 451	-27 626
US	1 292	-7 613	-3 759	-92	-22 701	61	-5 028	-49 036	-17 614	-61 528	514	-676	-1 036	-6 763		10 017	-165 078
RoW	-7 034	295	-26 111	2 941	-27 784	-7 483	1 014	-49 788	-20 089	-1 769	3 472	-6 606	-4 738	7 451	-10 017		-146 483
World	-876	8 502	1 467	16 412	-125 403	-13 895	5 256	-121 969	-46 288	-61 148	17 532	-16 718	-6 152	27 626	165 078	146 483	

Sources: UNCTAD, Allianz Research

els compliant with the regulatory targets. This will weigh on associated costs (R&D, industrial deployment, marketing, etc.) and push for flexible platforms, since there are no certainties at this stage on the winning engine in the medium term, whether it be fully-electric, hybrid, plug-in hybrid or another one.

The increase of instability on international trade adds more unpredictability to financial expectations, corporate strategies and investments.

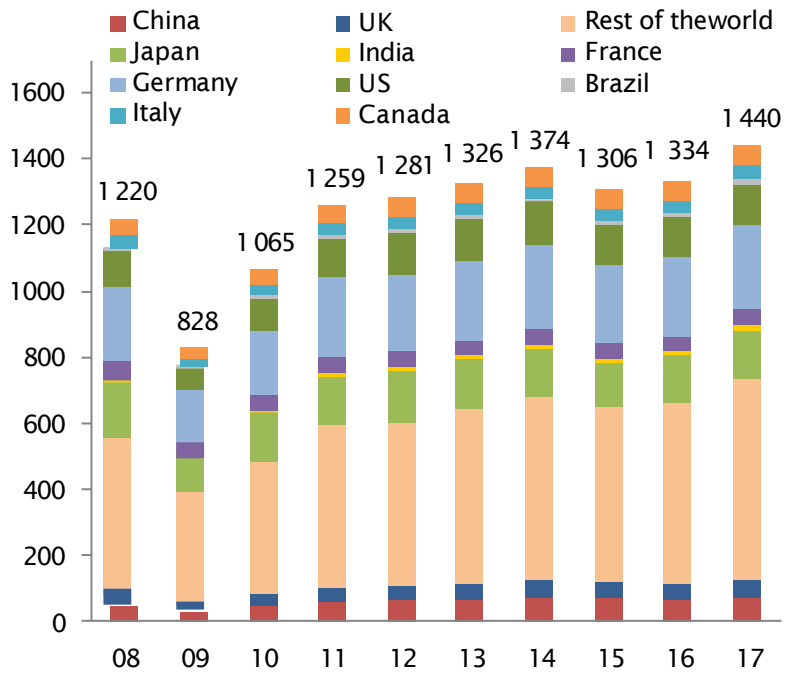
Brexit-related uncertainties continue to threaten the Western European automotive sector specifically, since the U.K. is both a significant market for exporters and a major hub. After a -5% slump in 2017, we expect sales to decline by another -6% in 2018 and -3% in 2019 in our central scenario of a last minute Brexit agreement. This will push the annual new sales down to 2.8mn in 2018 and less than 2.7mn in 2019, from a high of 3.1mn in 2016, suggesting that the U.K. would lose one rank in the Western European market and fall to third place behind Germany and France. Yet, a hard Brexit scenario has the potential for a perfect storm. Not only because auto exports totaled USD51.9bn in 2017 (10% of British exports) and auto imports totaled USD79.5bn, but also since:(i) almost 80% of the cars sold in the U.K. are imported, notably 66% from the EU (ii) the local-based auto industries import three times more components from the EU than they export to the EU; (iii) the domestic production, which amounted to 1.7mn units in 2017, despite a -3% decline for the first time in nine years, is at 80% dedicated to exports, including 50% to the EU (iv) local-based foreign automakers have key positions, notably the Japanese Toyota, Honda and Nissan (40% of total production). Uncertainties on the Brexit outcome have already impacted investments in the sector, with a decline of -33% in 2017 and -46% in H1 2018 to less than GPB350mn.

The major turbulence comes from multiple initiatives of the Trump administration.
Sanctions on Iran have had a very limited impact. From a global point of view, there has mainly been a (temporary) loss of a promising market for all automakers since new registrations reached 1.7mn units in 2017 (i.e. 1.7% of global sales meaning just slightly less than the South Korean market).

U.S. steel and aluminum duties have a stronger impact. First directly, since metals represent more than half of the components in a vehicle: the increase in imports tariffs to 25% and 10% respectively for steel and aluminum mechanically drives up the input costs for the US-based manufacturers continuing to import metals. On average enacted tariffs on metals already increased by about USD250 the cost of producing a new car in the US. For the local manufacturers, this will be at the expense of the margin for the entry-level cars, on which the price competition is intense, and the consumer for the higher-level/premium cars. Secondly, by being the starting point for tariff escalation with China on a variety of parts and components used on US-based assembly lines. This will continue to drive up the cost of the US vehicle, while the latter already approaches USD35000 in average and is pushing vehicles loans to record levels.

Trade agreement renegotiations and (threats of) additional trade barriers targeting the auto sector is a double shock of uncertainty. President Trump has directly targeted the automotive sector with his objective

Chart 7 Global Exports in Automotive (USDbn)



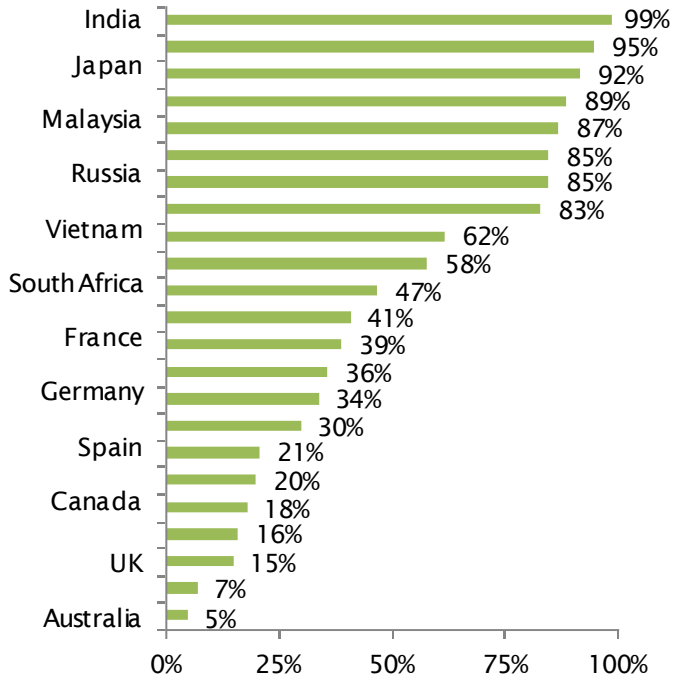
Sources: UNCTAD, Allianz Research

of rebalancing the U.S. trade balance and supporting domestic production. Firstly, the U.S. is by far the world's largest auto importer (USD291bn), accounting for 20% of the total, registering significant deficit in net trade (USD165bn). Secondly, President Trump initiated a national security investigation into automotive imports, using section 232 of the Trade Expansion Act of 1962, and bilateral actions with trade partners of the automotive sector on tariff issues (customs duties) as well as on non-tariff questions (local sourcing, labor costs) as seen in the outcome of the negotiations with Mexico. The still on-going negotiation with the EU and escalation in trade barriers with China is a double concern.

The first uncertainty is on level of trade. Global exports of vehicles represent 9% of global trade of goods (6.5% of global trade of goods and services). Total exchanges reached a record high in 2017, after an increase of (+8%) USD1,439bn, and came at 68% from automobiles and 32% from auto parts. Top exporters are Germany (USD252bn), Japan (144), the U.S. (127), Mexico (101) and China (72), while top importers are the U.S. (USD291bn), Germany (126), U.K. (79) and China (73). However, key concerns are for the top 3 imbalances in trade between: US-Mexico (USD62bn deficit), US-Japan (49) and US-Germany (23).
Negotiations with Germany has a specific complexity since they need to involve the EU while all EU members do not have the same kind of exposure in their trade with the U.S. when it comes to the automobile industry— apart from the U.K., Germany is the only European manufacturer massively exporting (resp. importing) to (and from) the U.S., mostly premium cars. The tariff differential was the starting point for discussions with US cars imported to the EU subject to 10% tariffs versus 2.5% the other way (not to mention the 25% tariff for pickup and truck vehicle imports to the U.S.). That being said, lowering tariffs could remain a favorable option for German manufacturers, but it may not increase the interest of European consumers for US vehicles, poorly adapted to local needs, since it would disadvantage European manufacturers in their trade with other countries with which they would have to adjust tariffs in application of WTO rules.
One risk is the 20-point increase in US import tariffs on imported vehicles from Europe. This would increase the average price of a European car imported to the U.S by EUR6.5K, decrease the number of cars imported by 270K and generate a shortfall of around EUR10bn for the European automotive industry, the year after the new tariffs are introduced (i.e. 1.5% of total European vehicle exports). Another risk is a trade escalation scenario with China, who has already retaliated to the U.S. tariffs by increasing tariffs for US-made vehicles to 40%, making them less competitive. Both risks would further limit global trade in automobiles, already expected to decelerate to +5.5% in 2018 and +4.8% in 2019 to USD1,600bn in 2019.

The second uncertainty is for implementation strategies and supply-chain interconnections, because most operators are global players who produce and export in and from several countries. They have established global or regional wide network of parts and vehicle assembly plants. The variety of business models, brand by brand, deeply complicates the negotiations at government levels. German automakers are the best example: In 2017, they exported around 494k cars from Germany to the U.S. and produced

Chart 8 Percentage of locally-produced cars on total sales



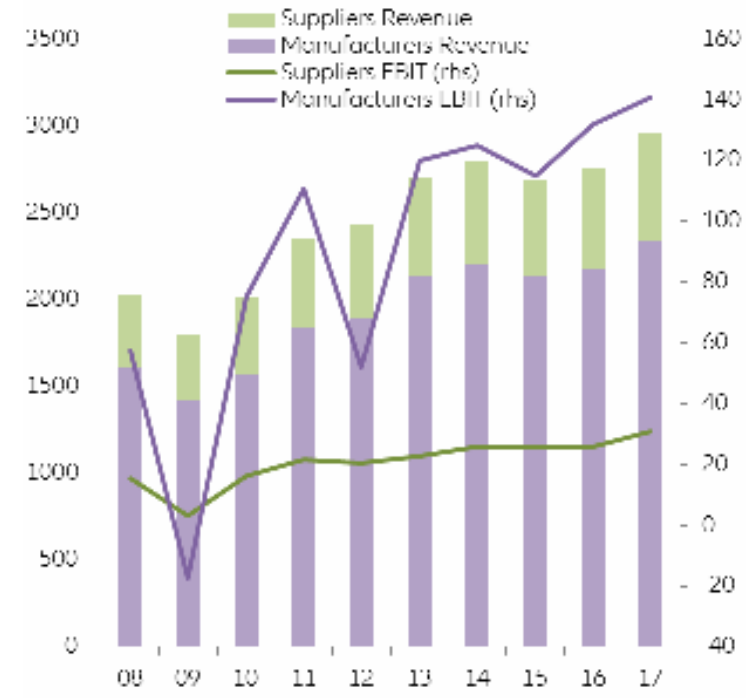
Sources: JATO, Allianz Research


Photo by Alexander Popov on Unsplash

more than 800K cars in the U.S. while more than half of this US-based production was exported (430K cars), notably to Asia. At the same time, German manufacturers have major differences in terms of US-based production with, for example, major production plants for BMW and Mercedes, specifically for SUVs that are exported to China, and for Daimler's Mercedes, which is the largest US-heavy-truck manufacturer, while none of VW Group's premium-brand, such as Porsche and Audi, has production capacity in the U.S.

All the announcements resulted in adaptation costs (higher input costs in the U.S. and Mexico, lower expectation of exports for cars targeted by higher tariffs). On-going negotiations have *wait-and-see* attitude costs that are unfavorable for investment decisions. Finally, the outcome of those on-going negotiations will generate additional adaptation costs, since corporations will continue fine-tuning their business models, eventually brand by brand, meaning more or less reshuffling for current production hubs and supply chains. One objective will be maintained, and that is to optimize production (entry-level cars in low-labor costs plants), possibly with more local-based production in specific cases. One new and proactive objective could be to avoid further protectionist policies, possibly by creating factories in markets that should be less targeted by tariff threats, notably in the emerging ASEAN or South Asian markets.

Chart 9 Revenue and EBIT (USDbn)



Sources: Bloomberg, Allianz Research

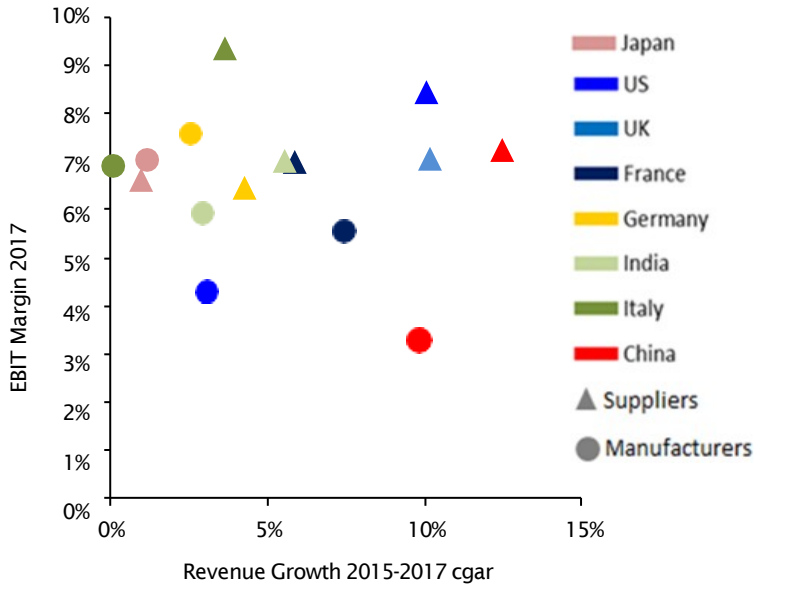
Margin of the sector will most likely weaken, while the industry must continue massively investing to benefit from the future of mobility/automobiles.

The automotive sector probably reached a high point in its cycle in 2017. The automotive sector registered eight years of recovery-time since the collapse of the global market that led most automotive players to severe financial difficulties and large scale bankruptcies, particularly in the U.S. (GM and Chrysler). In 2017, the global amount of revenue reached record highs at USD2,335bn for manufacturers and USD0,620bn for suppliers, as demonstrated in our panel of the top 60 listed manufacturers and the top 100 listed suppliers. For both, this corresponds to a +5.7% cagr increase since the 2009 slump. Same story for the operating profits with EBIT totaling USD140bn for the

manufacturers and USD31bn forthe suppliers in 2017, meaning an operating margin (EBIT margin) on local currencies, on average of 5% for manufacturers and 7.2% for equipment manufacturers. We expect operating margins to weaken in the face of adaptation costs of short-term challenges and to continue presenting disparities between countries, notably due to the differences in business models (shares of premium segment versus low cost segment and shares on EV production). Subsequently, manufacturers will continue pressuring suppliers to reduce their spread in the operating margin.

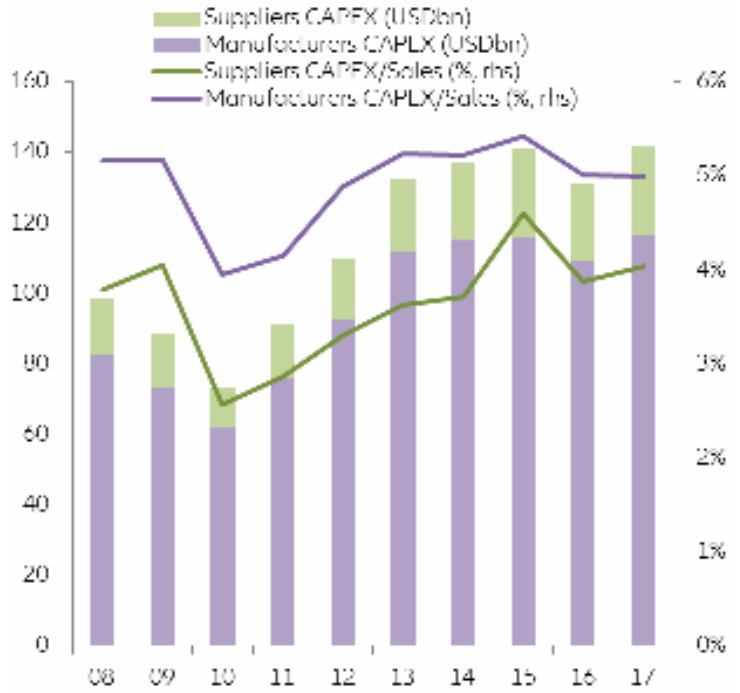
CAPEX under closer watch. CAPEX totaled USD140bn in 2017 – a new record high after rebounding +8% in absolute terms when cumulating manufacturers and suppliers. In relative terms, however, the intensity of the effort has already reached a plateau since 2016, with a ratio of CAPEX to global sales at 4.8% in 2017 compared to a high at 5.3% in 2015. We expect a decrease in profit margin expectations to revive debt-sustainability concerns for some industry players and force them to reduce/postpone part of their long-term investment plan. This context is less supportive for mergers and acquisitions (both cross and inner-sectors), but more favorable for all types of cooperation and partnerships, such as joint ventures and strategic alliances. The risk, otherwise, is to lose ground in the competition for autonomous vehicles and more broadly all the new growth markets related to mobility, while they concentrate revenue prospects.

Chart 10 EBIT Margin Suppliers vs Manufacturers



Sources: Bloomberg, Allianz Research

Chart 11 CAPEX



Sources: Bloomberg, Allianz Research

Maxime Lemerle

FOCUS: China's ambition to become the automotive worldwide center

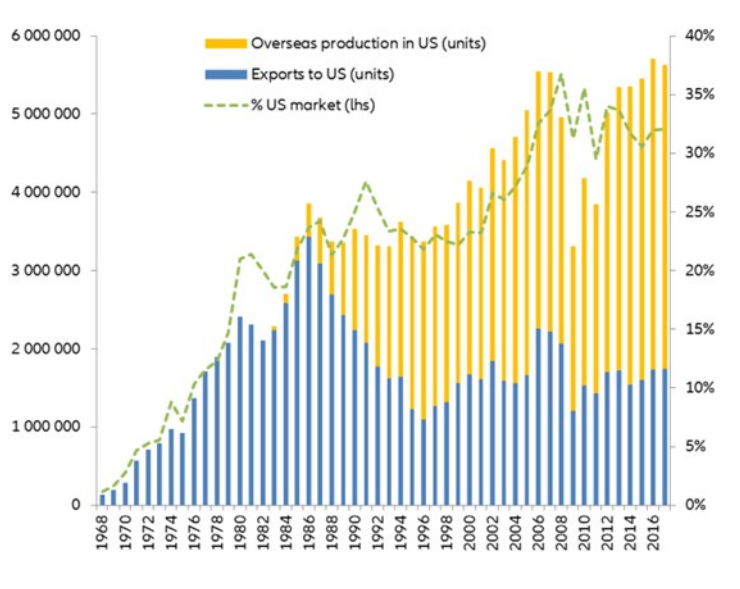
China has already been leading the automotive market in terms of annual sales since 2008. In 2008, new car registrations in China surpassed new car registrations in the U.S., the world's former leader of the automobile market, and has continued growing ever since. It reached a new record in 2017 and accounts for more than a third of global vehicle sales since 2016 (compared to 18% for the U.S.). Based on the still-low equipment rate in the country, especially in rural areas, and demographically, such as the growing middle-class, China's leadership will strengthen in the coming years. In other words, the Chinese automotive market remains pretty young compared to mature markets like the fleet, currently at around 200mn units and the second-hand market, currently at 12.4mn units despite a +19% surge in 2017, but it will continue to massively grow and has tremendous potential.

China also has the world's biggest automotive factories, with many JVs and foreign manufacturers, but is not a key exporter and importer. Domestic production of automobiles reached 29mn units in 2017 (24.8mn passenger cars and 4.2mn commercial vehicles) thanks to more than 100 companies. Yet, more than 95% of this production is sold in China. Foreign brands, either imported or locally-produced, represent more than 55% of domestic sales of passenger cars and dominate the upper- and high-end sales, while domestic brands concentrate on the low end. Exports are on the upside, but so far remain limited to 1mn units (USD72bn in 2017). The same is true for imports: they reached USD74bn in 2017 but should benefit from the reduction of import duties from 25% to 15%.

Thanks to the EV transition, the next step is to become a global player with global champions, as the Japanese did in the 90's. (see chart 12). China already has the largest EV market both in terms of sales and fleet, with local brands such as BAIC, BYD, JAC and Geely accounting for more than 70% of sales, while creation of EV startups continue, partnerships with digital giants (e.x. Baidu, Alibaba and Tencent) to explore mobility solutions are increasing and more than half of the capacity production of Lithium-ion batteries are in China.

All the latest measures dedicated to both boosting EV production and competition (NEV scheme, relaxing foreign ownership restrictions, etc.) as well as forcing the Chinese brands to join forces might be the crucial turning point needed to becoming strong enough to start exploring international markets.

Chart 12 Japanese Success Story in the US



Sources: JAMA, Allianz Research

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