BREXIT: IMPACTS ON THE UK AUTOMOTIVE SECTOR

PWC AUTOFACTS®, BREXIT MONITOR

THE BRITISH AUTOMOTIVE CONTEXT

In absolute terms, the British new car market is the second largest in the EU+EFTA region with a total sales of more than 2.63 million cars in 2015. Since 2011, the market has seen impressive growth of +35.7%. For 2016, Autofacts expects new car registrations to increase less strong than in past years by only +1.8% to more than 2.67 million cars. However, a slowdown of the market has been expected for a couple of years, and the first signs are visible – coinciding but not necessarily caused by the Brexit vote and consequences. In the month of June, new car registrations posted their first decline after 51 months of consecutive monthly year-over-year growth at -0.8% to 1.4 million units.

From an assembly perspective, the UK was ranked the fourth biggest automotive manufacturing location within the EU in 2015. On a global scale, the UK was the 13th largest automotive producer worldwide in the same year. Since 2009, assembly volume has increased by more than 54% until 2015. Production is expected to grow by +8.5% year-on-year in 2016, to a total of 1.81 million units, which is equivalent to pre-crisis volume levels of 2003 and 2004.

RECENT IMPACTS OF BREXIT ON THE BRITISH AUTOMOTIVE INDUSTRY

The UK leaving the EU is not a single act but rather a process with a period of political meetings, negotiations and uncertainty. The process started in June 2016 with the popular vote to leave the EU. Prime Minister Theresa May has announced to activate Article 50 of the Lisbon Treaty by March 2017, making the referendum legally binding and starting the official negotiations to leave the EU, but mostly concerning the post-Brexit relationships with the EU. The formal negotiation period is assumed to end after two years in March 2019, whereby it is likely that negotiations about the future relationship of the UK and the EU will continue even longer.

Brexit is also impacting the British automotive industry: Firstly, as a reaction to the Brexit referendum and the political struggles, the British pound has experienced a sharp fall to the lowest exchange rate in 30 years, which has both positive and negative effects. A positive effect is that exports have become more price-competitive which is supportive for production in the UK. The adverse effect is the increasing cost of imported goods. This has already forced one manufacturer to increase its new car prices in order to stay profitable, while other automakers have warned that this step might be inevitable for them. New car sales in 2017 are still expected to remain broadly stable with a minor growth of +0.5%. In 2018 and 2019, however, new car sales could decrease to estimated sales of 2.61 million and 2.45 million units, mainly due to the uncertainty of the outcome of the Brexit negotiations. By 2020, sales are forecasted to increase further by +9.0% to 2.67 million cars, on the back of increased car parc renewal due to sharper regulations and new technology.

Secondly, UK-based manufacturers have benefited from the strength of domestic demand in recent years as well as the full integration of the UK into the EU and its single market. In addition, it has profited from relationships to other key markets of the automotive industry, such as North America and China: In 2015, four out of five cars (77.3%) assembled in the UK were sold abroad. Thereof, 57.5% have been exported to the European Union which makes the EU the biggest export market for UK-built cars this corresponds to a value share of 52.8% or 14.6 billion Euro of UK's total automobile exports to the EU according to ACEA.

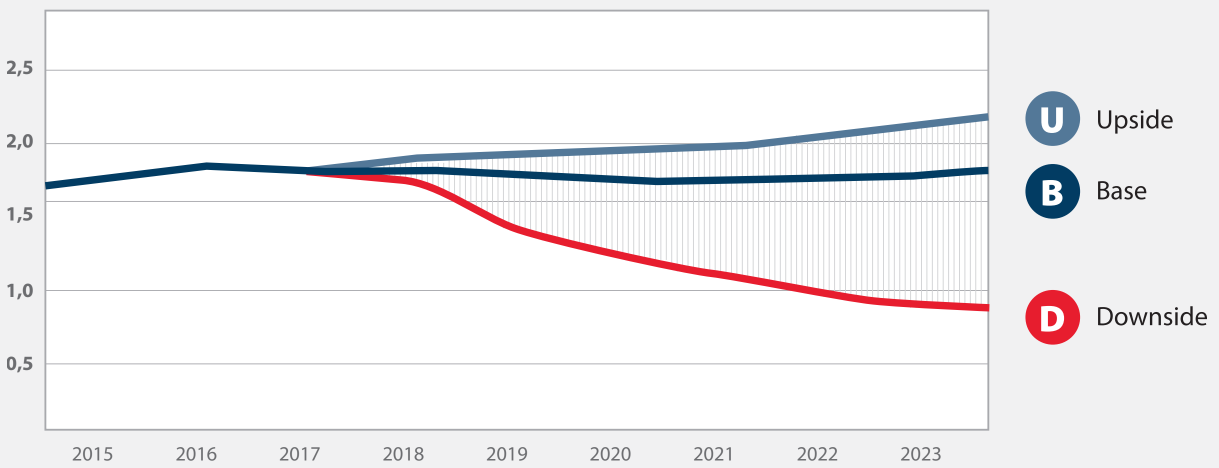
POTENTIAL SCENARIOS AND THEIR IMPACT ON THE AUTOMOTIVE SECTOR

Autofacts have analysed three different scenarios – EEA membership, a bespoke bilateral deal and a no-access agreement. In the first scenario, the UK will become an EEA member. The access to the single market of the European Union would be assured, without directly imposed EU taxes or tariffs. Exports and imports would be the same as before the leaving of the UK. But at the same time, as the UK would still have to follow EU regulations and contribute to the EU budget, but with less influence on politics and legislation than before, this scenario does not coincide with the objectives of the Brexiteers. These paradox consequences make an EEA membership less likely from a political standpoint. The second scenario, the bespoke bilateral deal, is expected to offer limited access to the single market and consequently at the cost of adopting relevant EU regulations. Further, additional expenses in terms of trade barriers and tariffs are likely to be established. Such a deal would offer a greater independence from EU regulations.

If the EU and the UK will not reach an agreement within the two years of official negotiations, the EU treaties expire, and trade would follow only the basic set of WTO (World Trade Organization) rules. The impact of this third scenario on the automotive sector would be tremendous. Tariffs and trade barriers would significantly increase the cost of trade flows between the EU and the UK. Besides difficult access to the single market for car exports, the supply chain could be in disarray. Therefore, the competitiveness of the UK automotive industry would be impacted negatively.

WHAT THE FUTURE OF THE LIGHT VEHICLE ASSEMBLY COULD LOOK LIKE

UK: LIGHT VEHICLE ASSEMBLY SCENARIOS (MILLIONS) *Source: Autofacts Analysis, Autofacts 2016 Q4 Forecast Release*



An upside scenario would assume that the UK will keep its access to the EU single market. Therefore, manufacturers continue to invest into existing plants, dealerships and labour force of the UK automotive industry. Auto manufacturers remain committed to the UK as an automotive production hub. By 2022, light vehicle assembly is forecasted to exceed the 2 million unit mark under this scenario. The base scenario assumes that the UK loses its unlimited access to the single market but is able to negotiate bespoke bilateral agreements with European governments. The OEMs are expected to make no additional investments, but to keep the current status quo. In the time period between 2016 and 2022, UK light vehicle assembly is expected to decrease to 1.71 million units in 2022 before recovering slightly. The downside scenario - with the outcome of trade according to the rules of the WTO - assumes manufacturers would not only stop investments but also disinvest in order to avoid the increasing costs of trade barriers and tariffs. In particular, this could mean the closure of plants and dealerships as well as layoffs on all levels of the automotive value chain. As most global manufacturing groups still show excess capacities in other European production facilities, production determined for consumption in the European market can be (at least partially) shifted to the EU mainland. This could lead to a second crisis of the British automotive industry and a sharp decline of output to less than 1 million units by 2022 – depending on manufacturer's decisions on volume re-allocation.

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