ANNEX I

CARS 2020 Process – Economic situation of the European automotive industry

Similarly to most European industries, the automotive sector has been strongly affected by the unprecedented economic crisis which stroke Europe. Last years have been marked, in most of the EU countries, with a rigorous introduction of far-reaching austerity measures and a struggle to regain positive economic growth. In parallel, sizable efforts were made in order to stem growing rates of unemployment and falling consumers' confidence. In spite of recent signals indicating that the EU economy is slowly coming out of contraction, GDP of the Euro zone fell by 0.4% in 2013 and the GDP of the entire EU rose by 0.1%.

Overview of the situation of vehicle manufacturers, suppliers and dealers

Adverse economic situation created unfavourable conditions for almost all European industry sectors not sparing vehicle manufacturers. Five consecutive years (2008 – 2012) of significant sales and registration declines in Europe brought the automotive sector back to the volumes of the year 1995, almost a quarter lower comparing to peak numbers of the year 2007. Falling sales have affected vehicle manufacturers in Europe in an inhomogeneous manner. Volume producers with a product range focused on small and medium size cars were most heavily impacted. Upon those companies a strong pressure for cutting costs has been built resulting in several restructuring operations across Europe (PSA, Ford, GM and FIAT). Performance of premium brands has been considerably better mostly due to a possibility to compensate worse results in Europe by externalising their sales to third markets.

Year 2013 has brought further declines to already very low sales levels in Europe, however, these were not as dramatic as in previous years. Grim forecast predicting contraction of the European automotive market by another 4% has not been fulfilled and, mostly due to remarkable growth in the last four months (on average, over 6% per month), it closed 2013 with a moderate decline of 1.7%. The noticeable positive trend of the last trimester of 2013 and a very good first half of 2014 (+6.5%) spurs optimism for a sustainable recovery in 2014 (2% according to Global Insight).

A similar picture can be seen for L-category vehicles. Sharp declines of around 13% of sales volumes in 2012 propelled by falling consumers' confidence put manufacturers in a challenging position. Year 2013 did not bring long sought reverse of a trend; instead sales fell by additional 14% in comparison to previous year.

Likewise, sales of commercial and heavy duty vehicles have been strongly impacted by deteriorating economic situation. It has led to a significant fall of new registrations across Europe in 2012 bringing the market to its historically low volumes and resulted in only a very slight growth in 2013. However, emerging signs of an improvement of an economic situation fuel expectations of approaching increases of sales in 2014.

A decrease of production output of vehicles across the EU in 2012 was a direct implication of falling sales. Growing sales to third countries could not compensate for the loss on the domestic market, aggravating the problem of extensive overcapacities present both at specific plants' and at companies' level. A capacity utilisation rate of 75-80%, widely considered as a sustainable level for vehicle manufacturing plants, is hardly achieved by several Europe based companies raising concerns about possible further restructuring. This might result in a permanent loss of production capacities and reduction of employment not only at the manufacturing sites but also over the entire supply chain. Despite contracting demand on the European market in 2013, the production levels of light duty vehicles grew by 0.8% to almost 16 000 000 units.,

Difficult situation of the vehicle manufactures has also presented a challenge for others market players. Suppliers of the automotive plants have been severely impacted by the outbreak of the financial crisis in the end of the last decade. This forced them to embark on reorganization processes leading to higher flexibility in terms of the utilisation of production capacities, diversification and more effective management of a workforce. At present moment, major suppliers appear to be less susceptible, however not immune, to the consequences of falling production volumes of vehicles successfully externalising their operations to other markets. Nevertheless, in cases where production of components takes place in close proximity to manufacturing plants, reduction of volumes will inevitably lead to a loss of workforce in a specific region. Similarly, smaller suppliers, showing to a lesser extent a possibility to diversify their sales or to follow vehicle manufacturers during a re-location, will be more exposed to insolvencies and, in consequence, will be more prone to take downsizing actions

On the other side of the value chain, lower sales volumes put dealers and repair sector in an unfavourable position. Faced with falling profits and a lack of possibilities to externalise sales to other geographical locations, in several EU countries over 50% of dealers reported losses and signalised in many cases emerging liquidity problems.

Adverse economic situation is regarded as a major but not an ultimate source of falling sales and registration volumes in Europe. Structural societal changes including demographics or alteration of mobility needs shape in a number of ways the demand for vehicles. Growing number of people living in urban areas as well as progressing aging of the population combined with a constant improvement of public transport and high congestion result in a gradual replacement of a mobility based on personal vehicles with other modes of transport. Emerging reluctance to car ownership and falling distances covered annually can be partly explained on the economic grounds (for example, due to increased fuel prices or high unemployment among young people), however, raising consumers' awareness and availability of alternative mobility solutions seem to reinforce the downward trend.

Development of trade with third markets and its impact on the European automotive industry

Deteriorating situation on the European market has forced EU vehicle manufacturers to search business opportunities outside Europe. Emerging economies, in particular BRIC countries as well as the US and Turkey have become major sources of growth and profit for majority of European companies. Technical superiority and strong brand image, hallmarks of the European products, enabled EU exporters to successfully gain market shares in third countries creating a substantial export surplus (almost €128 billion for the sector in 2013). The position of the majority of European vehicle manufacturers seems currently unchallenged. However, growing competition from local producers and protectionism practiced by several countries require further efforts both on the manufactures' and regulators' sides.

Out of approximately 15 million cars produced on a yearly basis in Europe, around one third (4.7 million in 2013) is exported outside the EU. Traditionally, the biggest trading partner for vehicles is the US with a positive trade balance of around €19 billion and €10 billion for vehicles and parts respectively. The vast majority of almost 800,000 units exported to the US in 2013 belonged to a premium segment. Some independent impact studies performed have estimated that a finalisation of the on-going discussions under the Transatlantic Trade and Investment Partnership (TTIP) with a full elimination of tariffs and a reduction of 10% of non-tariff barriers (NTBs) could contribute to a further increase of sales to the US up to 70% during the period 2017-2027.

China, with a €25 billion positive trade balance is the second most important external market for the European manufacturers. Being by far the world's leading automotive market, China has recently become the main source of profit and growth for several European companies. In parallel to heavy investment in increasing local production capacities, vehicle manufacturers continue to export significant volumes of cars, almost solely from the high-end, premium segment. Imports from China in 2013 constituted about 12% of the total imports of vehicles and parts, however, this number is expected to rise in the future.

The third biggest EU trade partner in the automotive sector is Japan. European exports to Japan are dominated by premium cars while imports tend to be more focussed on entry and mid-level vehicles. Japan has had a traditional surplus in trade of vehicles to the EU, but this trend has been reversed in 2012 and 2013. It is unclear if this is a sustainable trend. In the case of parts and components, the EU trade balance with Japan is negative. The European Commission is currently in the process of negotiating an FTA with Japan. In the motor vehicle sector the objective of the negotiations is to tackle the existing NTBs, which hamper market access for European manufacturers and to increase regulatory harmonisation (based on UN Regulations), in order to facilitate market access and cut unnecessary costs. The successful conclusion of the FTA depends, among others, on satisfactory progress in dismantling NTBs and on the agreement on a set of disciplines regarding NTBs.

Restructuring and effects on employment

Difficult situation in the European market urged a need for further cost-cutting activities and improvement of efficiency. This, in several cases, meant involvement in deeper restructuring processes which inevitably led to reductions in employment. In a first phase of the crisis (2008-2009) most of the restructuring took place upstream of the vehicle manufacturing plants with only three European plants terminating their operations (a Saab Automobile plant in Trollhattan, Sweden; a General Motors factory in Antwerp, Belgium; and a Fiat plant in Termini, Italy). Year 2012 brought new announcement of major restructuring including closure of PSA plant in Aulnay, Ford manufacturing facility in Genk and internal reorganization of FIAT plants. In parallel, however, several European companies including major automotive suppliers, announced creation of new workplaces in response to growing demand on global markets. In total, it is estimated that only around 11,000 jobs were lost in the automotive industry Europe in the course of 2012.

In 2013, despite uncertain economic situation and a bleak outlook for a swift recovery, only one vehicle manufacturer decided to stop production in one of its plants - Opel in Bochum. On the other hand, some companies have reacted through internal competitiveness plans (e.g. Renault and PSA), which have been negotiated with the unions, and which will allow for more flexibility in the management of the workforce and will ensure continued activity and employment for the future. Nevertheless, several vehicle manufacturers have embarked on deep internal restructuring activities including Renault, Volvo Trucks and Volvo cars, Daimler Trucks, PSA) and Honda. Major restructuring events have also taken place within the suppliers' segment. Johnson Controls has decided to terminate production in a plant in Czech Republic. Similarly, Goodyear closed its manufacturing facility in France. Unsurprisingly, job creation in the sector was significantly smaller comparing with occurred job destruction. Following announcements of Jaguar Land Rover, Audi, BMW, Ford Skoda and Iveco, new posts will be created in the nearest future.

It must be remembered that each job destruction activity triggers a ripple effect throughout the entire supply chain. It is estimated that each place in a manufacturing plant is responsible for a creation of around three additional posts upstream the supply chain. Therefore, restructuring cases mentioned above should be seen in a wider context including a cumulative impact of redundancies on the European economy.

Improving economic conditions and raising consumers' confidence seem to indicate that the worst period of the crisis has been overcome and the market has bottomed out, however, it is not expected that it will reach 2007 levels in the nearest future. Further restructuring activities cannot be excluded, however, it is expected they will not be as far reaching as those which happened in the course of 2012 and 2013.