Light vehicle sales forecast updated; subsidies insufficient to avoid massive drop

Scope Ratings

We have updated our forecast for global light vehicle sales in 2020 and incorporated the effects of the spread of the Covid-19 pandemic in the US, South America, and South Asia. We have also slightly revised down our 2020 baseline forecast for light vehicle sales (passenger cars, SUVs, CUVs, pick-up trucks) in other regions, in line with recently updated economic data. We are now looking at a decline of 20% in global unit sales compared with our previous forecast of a drop of 15-20%. This translates into a decline of 18m units in 2020 and reduces the size of the global light vehicle market to levels not seen since 2010. Our outlook for the automotive industry remains negative.

The largest share of our downward volume revisions reflects market conditions in the US and Europe. Both markets will shed about one quarter of volume in 2020 vs. 2019. The question of whether the global light vehicle market had peaked in 2017 is now behind us (see our 2020 Automotive Outlook **here**).

China's car market has shown a sequential improvement in light vehicle sales since April 2020, we see the gradual bounce-back of demand primarily supported by vehicle purchase incentives offered by local Chinese regions. The effects of vehicle purchase incentives may fade in the second half of 2020 and despite the demand rebound since April 2020, we continue to expect a significant decline in the Chinese market of 12% this year compared with 2019, the third consecutive year of declines in light vehicle sales.

The US market should suffer from a considerable drop in fleet sales in 2020, notably fleet sales to car rental companies representing 17%-18% of the market before the Covid-19 crisis. Car rental companies depend heavily on passenger traffic at airports and business. The drastic impact of travel restrictions and lockdowns on airline traffic will force rental companies to downsize their fleets considerably. In addition, the expiry of government support programs – short-time schemes, additional unemployment benefits - and uncertainty about the economic outlook should limit overall demand for new cars.

Demand in Europe in the second half of this year will get a boost from environmental purchase subsidies introduced in various countries, notably Germany and France, aimed at stimulating demand for electric vehicles including fully-electric (BEV) and plug-in hybrids (PHEV).

The increased governmental stimulus for electric vehicles should lead to a pull-forward of demand for BEVs/PHEVs and should support H2 sales. The magnitude of the pre-buy/pay-back effect in 2020/2021 depends on whether original equipment manufacturers (OEMs) can meet demand. We understand that car makers are partly sold out on their BEV capacity in 2020 as production of the new vehicles is still ramping up, with more capacity to be added in 2021.

As we have argued before, we do not believe that the effect of plant closures (limited product availability) can be made up for by increasing the final assembly volume in the post-lockdown period given the capacity constraints across the sector's supply chain.

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GDP forecasts suggest deepest recession in post-war era

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As of the latest update in July 2020, our sovereign team expects a global decline of GDP by 4.5%, which would represent the sharpest global economic contraction of the post-war era. This is expected to be followed by recovery of 5.8% growth in 2021. Under a stressed economic scenario, global growth in 2020 might contract by 7.3%, with a sluggish recovery next year of 3.7%. Results across baseline and stressed scenarios are summarised in the below **Figure 1**. The baseline scenario assumptions include that a renewed increase of the virus spread in H2 2020 in advanced economies is assumed to be "manageable" in most such nations. Renewed virus transmission impedes the economic recovery, but recovery continues in most cases, even if at a more gradual pace or with moderate interruption to growth later in the year. We assume only selective second-round economic restrictions, though with more intensive measures in some countries such as the UK and US. Most nations do not return to full lockdown. This scenario is similar to a "check mark" or "wing-shaped" global recovery with a decelerating recovery slope after the speedy pick-up in activity of recent months.

Figure 1: Scope Ratings baseline forecasts (July 2020)

Country/region	Real GDP growth							
		Baseline scenario				Stressed scenario		
	2019E	2020F (July)	Diff. from Apr.	2021F (July)	Diff. from Apr.	2020F (July)	2021F (July)	Medium-run potential
Euro area	1.2	(9.1)	↓ 2.6	5.9	↑ 1.4	(12.7)	2.7	1.3
Germany	0.6	(5.5)	↓ 0.3	3.2	↓ 0.1	(8.8)	0.9	1.2
France	1.5	(11.0)	↓ 4.7	7.2	↑ 3.1	(14.8)	5.7	1.2
Italy	0.3	(10.0)	↓ 2.5	7.5	↑ 3.0	(12.8)	1.6	0.7
Spain	2.0	(12.5)	↓ 4.5	7.0	↑ 2.5	(17.0)	2.5	1.7
United Kingdom	1.5	(10.4)	↓ 7.1	8.8	↑ 7.0	(12.4)	3.7	1.5
Russia	1.3	(6.8)	↓ 3.5	4.0	↑ 1.7	(10.1)	3.2	1.5
Turkey	0.9	(4.2)	↓ 3.2	5.8	↑ 2.8	(6.7)	3.3	3.9
United States	2.3	(7.5)	↓ 4.0	6.0	↑ 3.9	(12.0)	2.5	<2.0
China	6.1	1.3	↓ 2.7	6.4	↑ 0.4	0.3	5.7	5.0
Japan	0.7	(6.0)	↓ 2.0	3.0	↑ 1.1	(9.0)	1.0	<1.0
World	2.9	~ (4.5)	↓ 4.0	~ 5.8	↑ 1.8	~ (7.3)	~ 3.7	-

Negative growth rates denominated in parentheses. Source: Scope Ratings GmbH forecasts, Haver analytics. More details in Scope's Q3 2020 Sovereign Update: Covid-19 pandemic's economic impact: gradual and uneven global recovery with significant risks still on the horizon

Stress scenario captures second round of Covid-19 spread

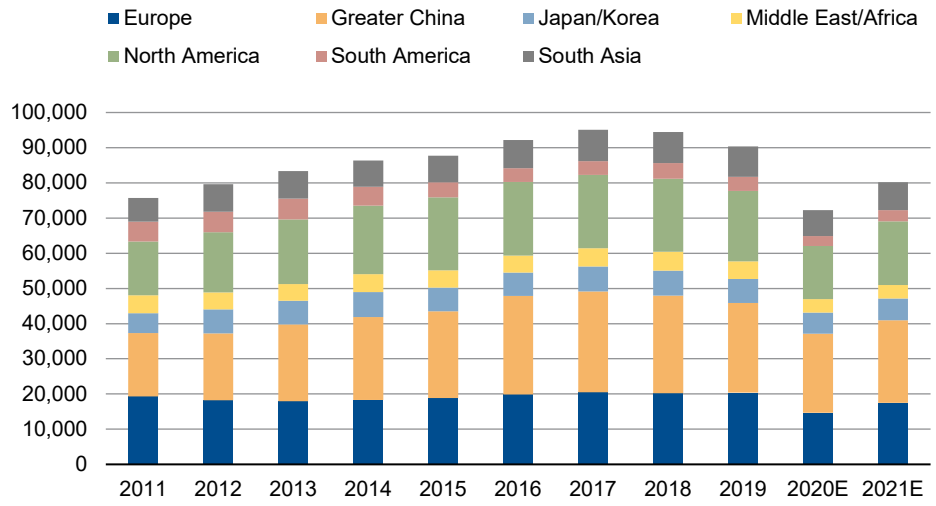
Under the stressed scenario assumptions, a second round of coronavirus cases and activity in Europe and the US forces countries to reimpose highly disruptive full or partial lockdowns by Q3 or Q4 2020, with a double-dip economic contraction extending into prolonged economic weaknesses over 2021. This scenario could reflect the postponed mass availability of vaccine(s) and/or effective therapeutics with coronavirus remaining a prime restriction to "normal economic conditions" through 2021. This is akin to a W-shaped recovery outcome with, on top, severely weakened economic conditions in 2021.

Revised forecasts for important automotive regions

Light vehicle sales to drop to levels not seen since 2010

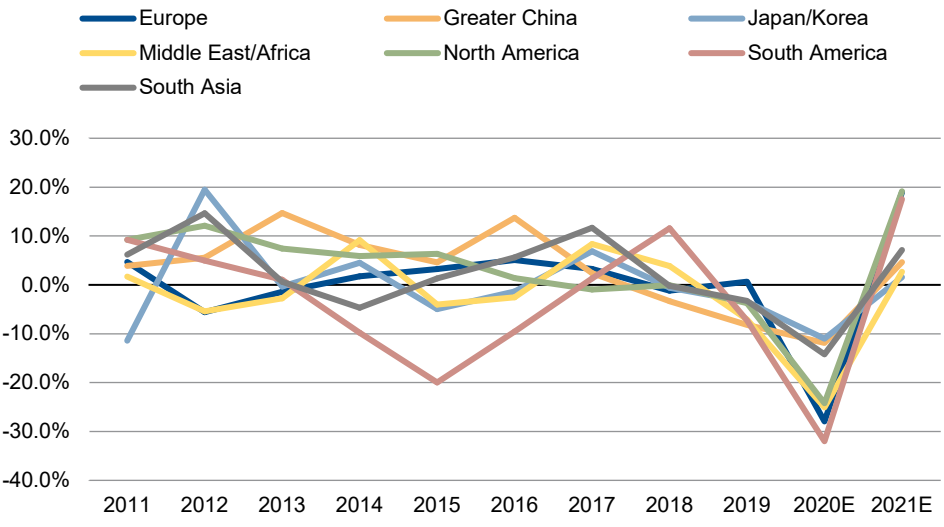
We have revised lower the expected volume of light vehicle sales in 2020 by about 3m units mainly due to the weaker US (forecast lowered by 1.4m units) and European markets (forecast lowered by 1.2m units). We are now looking for a global unit-volume decline of light vehicle sales of 20% in 2020 to 72m units. This would place global light vehicle volumes at levels from 2010, the first year of the economic recovery after the economic and financial crisis of 2008-2009.

Figure 2: Global light vehicle sales



Source: LMC Automotive, Scope Ratings GmbH, numbers are in thousand units

Figure 3: Global light vehicle sales growth year-on-year



Source: LMC Automotive, Scope Ratings GmbH

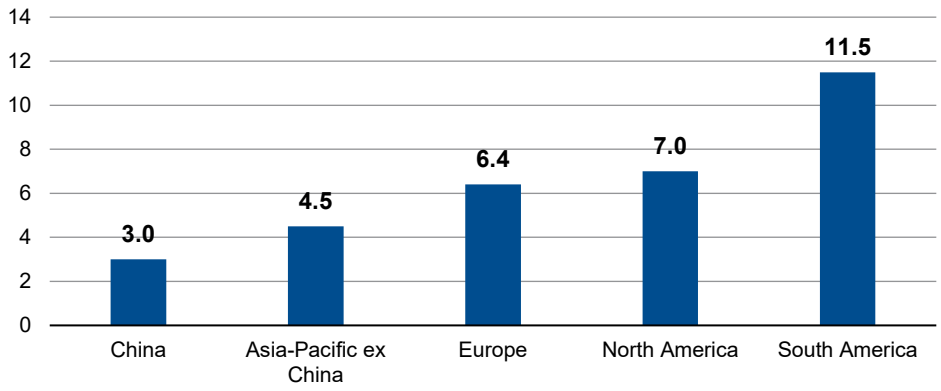
Lockdowns and social distancing effects

Our auto sector forecasts capture the effects of lockdowns and other measures such as plant closures in the H1 across geographic regions. The spread of Covid-19 across the globe was not simultaneous. Non-medical measures aimed at mitigating the transmission of the virus through policies such as physical distancing and closure of public venues (schools, universities, churches, bars, and other venues) have likewise been implemented with a time-lag worldwide.

Effect of plant closures not recoverable

Automotive plants were closed for several weeks (April and May) and final vehicle assembly was affected differently across regions, partly due to measures to curb the spread of coronavirus such as physical distancing but also through component shortages, with supply chains disrupted for several weeks. Assessing the health of the automotive supply chain, including capacity utilisation on the supply side, is difficult, acknowledging that auto suppliers rarely publish the relevant data. Knowing that auto suppliers are used to a high degree of efficiency and that OEMs' capacity utilisation was running below those (80%-85% before the pandemic), the premise of a rebound assumes that the entire auto supply chain was running at low capacity utilisation prior to this pandemic. We do not follow that logic. Instead, we believe that capacity restraints among automotive suppliers (spare capacity is used up quickly once demand rebounds) will eventually be a restraint for OEMs in addition to weak underlying demand. 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 in light vehicle sales is limited in the second half of 2020. As we have argued before, we do not believe that the effect of plant closures - limited product availability - can be made up by simply increasing the final assembly volume in the post-lockdown period.

Figure 4: Average time of automotive plant closures in weeks by region

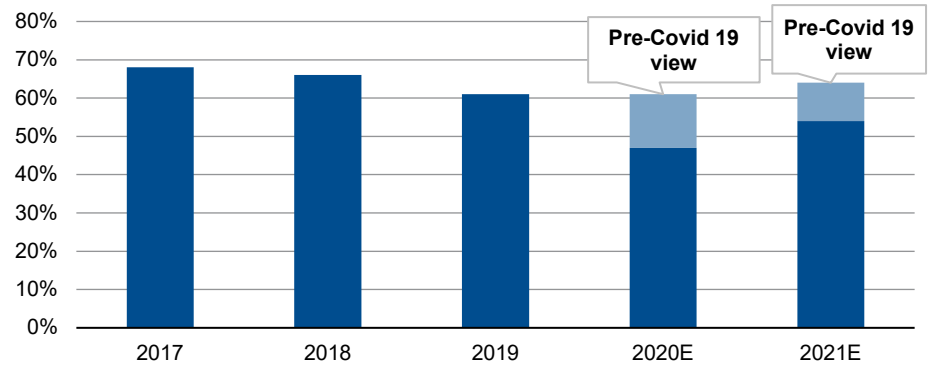


Source: LMC Automotive

Capacity underutilisation in the industry to increase

Capacity utilisation among parts suppliers may sometimes run at levels of OEMs but this may not be true for the most efficiently managed automotive suppliers. The capacity along the supply chain would have to allow for the supply of extra volumes of components to make up for the output lost from plant closures. We doubt that important players in the auto supplier industry can simply expand their capacity quickly to accommodate a short-lived heightened demand for their components. The most recent estimates about production capacity at the OEM level suggest that utilisation will drop levels below 50% with only a gradual improvement in 2021 assuming that the expected recovery in global light vehicle sales materialises. The effect of low fixed-cost absorption through lower capacity utilisation will leave its mark on operating profits in 2020 and 2021.

Figure 5: Capacity utilisation at OEM level pre-Covid 19 and post-Covid 19



Source: LMC Automotive

China – first in the crisis, first out but severe declines in 2020

China's 2Q20 figures suggest improvement from 1Q20

Our forecast for China remains unchanged. The spread of the coronavirus in the region, including shutdown of production facilities and spill-over effects on the economy, have led to a drop in car sales of 42% year-on-year in Q1 according, to the China Association of Automobile Manufacturers (CAAM). Demand has picked up in April (+4.4% y-o-y) with further acceleration in May (+13.4% y-o-y), June (+11.6% y-o-y) and July (+16% y-o-y). The rebound of demand in China in Q2 was mainly supported by various subsidy programs and vehicle purchase incentives from local governments. Various purchasing incentive programs for every type of vehicle (internal combustion and electric) were put in place in more than 20 regions of the country.

Purchase incentives to be followed by pay-back in 2H20

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 taxes tends only to pull forward demand rather than create extra demand, with a subsequent pull-back in later periods. The recovery we foresee for China in 2020 and into 2021 is linked strongly to governmental policies in 2020: the higher the subsidy and, with it, an artificial boost to light vehicle sales in 2020, the slower the recovery in 2021. The effects of vehicle purchase incentives may likewise fade in the second half of 2020 and, despite the demand rebound since April 2020, we expect a significant decline of the Chinese market of 12%, the third consecutive year of declines in light vehicle sales.

Europe to be hit the hardest after record levels in 2019

Developments in 2020 also a reflection of the recent past

Understand the severe slump in the European car market this year is possible only by recognising the impact of increasingly artificially sustained growth in the years running up to the pandemic. The European market had shown modest growth in 2019, the sixth consecutive year of passenger registration growth in the EU. The western European market had almost reached pre-crisis (2007). Such growth reflected the favourable economic environment (low unemployment and high business/consumer confidence) including low interest rates. Unit volume sales are, 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 the market ahead of the Covid-19 crisis was quite simply inflated.

Social distancing from large-ticket spending expected

The European market was severely affected by the lockdowns and other coronavirus-containment measures that led to the closure of car dealers, vehicle registration offices and vehicle assembly plants across the region. The European market, notably the western European part of it, is mature and primarily driven by replacement demand. Large-ticket discretionary spending for items such as cars will likely be negatively affected for quite some time. The economic knock-on effects of the pandemic are mitigated by various governments' fiscal stimulus across the region and liquidity/loan assistance programs. However, we believe consumers' interest in big-ticket discretionary spending will remain subdued for as long as the economic outlook, including elevated unemployment rates, remains uncertain. In other words, physical distancing is very likely to be followed by more durable "psychological distancing" towards big-ticket purchase such as new cars. Consumers are likely to opt instead for increased precautionary savings until the pandemic is perceived to have been resolved with an effective vaccine.

EU car market down 40% in 1H20

The most recent data provided by ACEA show that the EU car market (EU, EFTA, UK) declined by 40% in the H1. The drop in volume in June (-24%) was sequential improvement from the Covid-19 months of May (-60%), April (-84%), and March (-56%). One interesting observation was the 1.2% y-o-y improvement in new car registrations in the French market in June 2020 reflecting the subsidy program that the French government has put in place for the purchase of vehicles with low local emissions. In the first half of 2020, however, the French was still down 39%.

Effects of "green" vehicle subsidies in 2H20 possible

Demand for new vehicles in Germany in H2 should reflect the auto sector support program approved in June 2020. The reduction of value-added tax by 3 percentage points (from 19% to 16%) benefits all types of vehicles (internal combustion, plug-ins, battery-electric) while the increased direct purchase subsidies for electric vehicles ('innovation bonus') should likewise support increased sales of plug-in hybrids and fully battery-powered vehicles (BEVs). The purchase subsidies for PHEV and BEV in Germany are limited until Dec. 2021. Similar to the environmental bonus system introduced in France, the purchase subsidy is higher for vehicles with lower retail prices. For instance, the full environmental bonus of EUR 9k (from 3k before) is granted for BEV purchases with list prices below EUR 40k (in France: EUR 7k for list price of less than EUR 45k). Purchase subsidies for PHEVs are lower and government grants for vehicles with higher list prices (above EUR 40k in Germany and EUR 40k-65k in France) are likewise reduced. The environmental subsidy schemes passed by the German and French governments should mainly support vehicles of European players such as PSA Group (the maker of Peugeot and Opel cars), Renault SA and Volkswagen AG with PHEVs and BEVs at price points below EUR 40k-45k in their product range. Tesla's Model 3, for instance, retails at EUR 43k in its standard range version and would not qualify for the full environmental bonus in the German market – unlike Volkswagen's new ID.3 that retails starting at EUR 36k. Nor would Tesla's Model X, retailing at EUR 86k for the standard version, though cars in that price category benefit from the temporary VAT reduction.

Pull-forward effect from environmental bonus schemes

The increased governmental stimulus for electric vehicles should lead to a pull-forward of demand for BEVs/PHEVs and should support higher unit sales numbers in 2020. The magnitude of the pre-buy/pay-back effect in 2020/2021 depends on the car OEMs capacity to deliver fully electric vehicles. We understand that car makers are effectively sold out on their BEV capacity in 2020 as these new vehicle types are still in their ramp-up phase with more capacity to be implemented the future. Volkswagen's ID.3, for instance, has waiting times of several months. The new fully electric ID.4-SUV will only become available in early 2021, potentially with initial limited availability due to the usual gradual ramp-up of vehicle assembly for new vehicles. While availability of BEVs appears limited for most consumers, we believe that an elevated demand for PHEV's (no

limitations on availability, lower wating times) at the sub-EUR40k price point should provide some impetus for vehicle unit sales until the end of the year.

PHEV/BEV in strong demand during the peak of pandemic

Demand for electrically chargeable (ECVs) vehicles was strong in Q2, with 53% growth across the EU. ECVs have reached a share of 7.2% of all registered vehicles in the quarter, compared with 2.4% in the full year of 2019, primarily driven by PHEVs. In view of the governmental stimulus programs to become available from the second half of the year 2020, the share of ECVs in the overall market mix should increase further.

Western Europe enters downturn from peak levels Jan. and Feb. declines don't show the full picture

We have revised down our estimate for the European light vehicle market, despite the governmental stimulus programs, and now expect a decline of 28%. The severe economic impact of the measures governments across the region have taken to curb the spread of Covid-19 should leave their marks on new vehicle demand. Our forecast for Europe includes a massive decline in sales of light commercial vehicles typically used by SMEs, as we believe that business owners will delay the replacement of those vehicles given difficult funding and business conditions.

US: market drops almost to 2009 levels

Second-round effects to leave mark on U.S. car market

We have slightly lowered our light vehicle forecast for the U.S. market down to 12.9m units (vs 14.2m units before) translating into a market decline of 24% y-o-y. Even without the current pandemic, we have been cautious on volume developments for the US in 2020. The record-high filing of 6.6m initial jobless claims in early April 2020 reported by the US Bureau of Labor Statistics has abundantly terminated the jobs growth in the US of the past decade, with an unemployment rate that had reached a 50-year low. While the US Senate has passed a USD 2trn coronavirus aid package to help workers and businesses, we do not see the effect of this stimulus programme as quickly feeding through to light vehicle sales. Uncertainty about the containment of the coronavirus in the country with risks of an outbreak of a "second wave", the expiry of important government support programs, such as additional unemployment benefits ,should remain a drag on auto demand until the end of the year.

Fleet sales important reason for decline in the U.S.

An important reason for the expected drop of the U.S. market by almost on fourth are drastically reduced fleet sales (sales to rental car companies, government agencies and commercial businesses). Fleet sales averaged around 17%-18% of total light-vehicle vehicle sales in the years before 2020 representing a unit volume of about 3.0m vehicles annually. Slightly more than half of fleet sales (around 1.7m units in 2019) of OEMs were done with large rental car companies. The Big 3 auto OEMs General Motors Co., Ford Motor Co. and Chrysler (part Fiat Chrysler Automobiles Inc.) account for more than 50% of cars in rental fleets. The high dependence of car rental companies on airport locations and drastically lower air traffic volumes have led to serious difficulties for car rental companies exemplified by the Chapter 11 filing of Hertz in May 2020. Car rental companies usually have buy-back agreements with the respective car OEMs, i.e. car OEMs take back the vehicles from car rental firms after a pre-determined period. As car rental companies will have to adjust and downsize their fleet sizes, demand for new vehicles to be in-fleeted will be significantly lower than the number of vehicles returned under buy-back agreements with OEMs. In a sense, the future of the US light vehicle market partly hinges on the developments in air passenger traffic. For now, the outlook for a considerable rebound of passenger traffic – in the air and at airports - remains bleak, indirectly affecting light vehicle demand.

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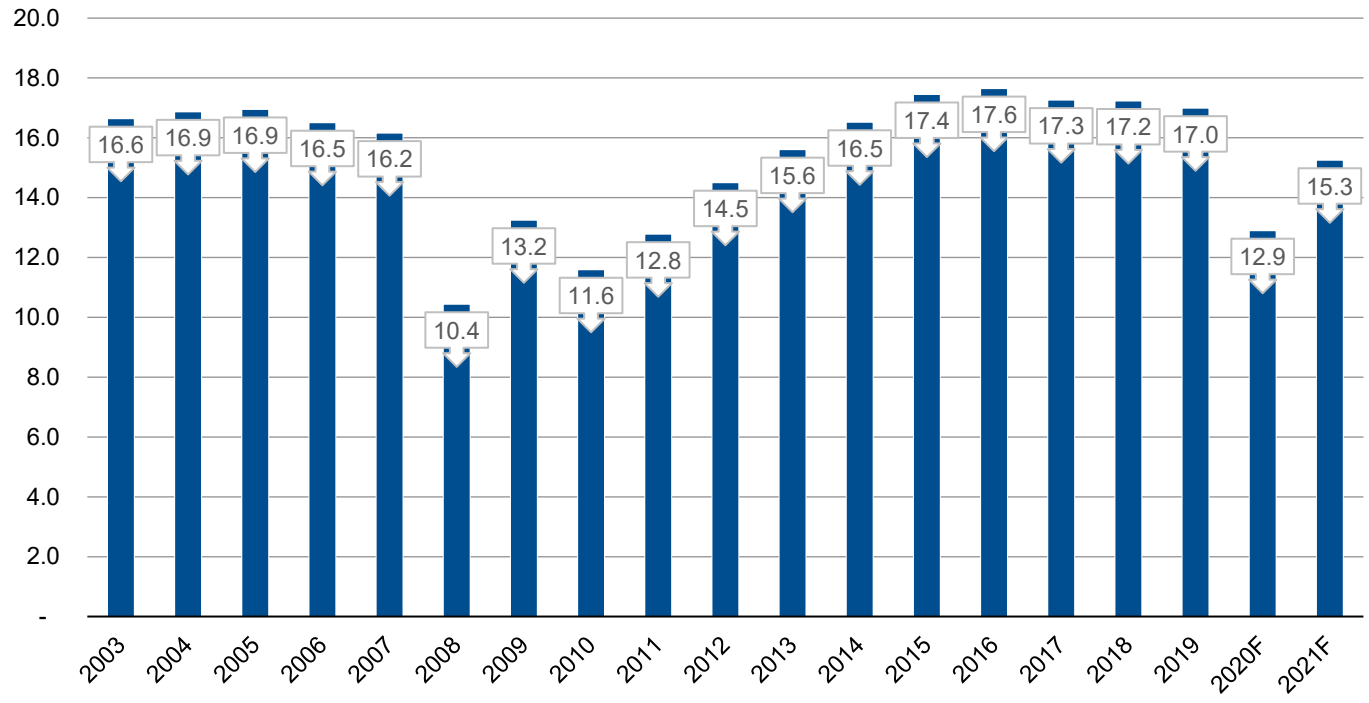
Historic data in the US good example to explain stimuli

The US market provides a good boilerplate to analyse the likely effects of car purchase incentive schemes if any such industry-specific fiscal stimuli were enacted in addition to the broad schemes currently being rolled out by a broad number of countries worldwide. In 2009, the year of largest drop in US GDP during the global financial crisis, light vehicle sales increased from 10.4m to 13.2m. Keeping in mind that light vehicle sales were supported by a special government stimulus programme ("cash-for-clunkers") similar to the purchase incentive scheme introduced in Germany at that time ("Abwrackprämie"), one can easily see the "pay-back" from these programmes one year later. The US market dropped to 11.6m units in 2010, the year when US GDP accelerated after the crisis. The same phenomenon will, in all likelihood, be observed across all regions and markets worldwide if auto-specific stimulus programmes are put in place. We believe that any such pull-forward of demand will only leave its negative markers on vehicle sales numbers one year later.

Figure 6: Light vehicle sales in the US (in millions units)



Source: LMC Automotive, Scope Ratings GmbH

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