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Special Report
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Quarterly Snapshot: The Automotive Sector

In this special report, IBISWorld analyses the key trends and events affecting the automotive sector over the past three months

> The change in fortunes for the industry was fuelled by a slump in new car sales to the domestic market

Following record numbers of registrations in 2017, the brakes have been applied to the automotive sector, with investment plummeting and new car sales slipping as Brexit pressures rev up. Numerous manufacturers have stated their concerns regarding just-in-time production, parts sourcing and exports. Diesel vehicle production has faced particularly strong pressure, as city-wide bans loom and health and emissions scandals continue to plague the fuel, while the road ahead does look far clearer for alternatively fuelled and self-driving vehicles. Government investment in the latter is expected to hasten innovation in this market, whilst opportunity is also expected to arise as Harley Davidson struggles with the effects of EU-US tariffs.

Production downshift

According to the Society of Motor Manufacturers and Traders (SMMT), approximately 1.7 million cars were manufactured in 2016, which was the highest total recorded since the start of the century, before starting to slide in 2017. This trend continued in 2018, with total number of cars manufactured dropping by 6.3% in the first quarter of 2018 when compared with the first quarter of the previous year. Although approximately eight in 10 cars produced in the United Kingdom are exported, the change in fortunes for the industry was fuelled by a slump in new car sales to the domestic market, as elevated inflationary pressures forced UK households to hold back on big-ticket purchases, while Brexit-related uncertainties also caused business to reduce spending. The manufacture of diesel cars bore the brunt of this decline, fuelled by public confusion over UK government policy on diesel vehicles, as some cities and local authorities are considering bans on older diesel cars (see IBISWorld report C29.100). Bad press publicity revealing the highly polluting nature of diesel vehicles also contributed to the fall. In June 2018, emission tests that make it impossible for motor vehicle manufacturers to cheat revealed that almost all diesel car models launched in Europe since the 'dieselgate' scandal remain highly polluting. This test uses a beam of light to analyse the exhaust plumes of a car as it passes and uses automatic number plate recognition to link the measurement to a specific model. Similarly, a research study published by researchers at the University of Oxford and the University of Bath in June 2018 showed that diesel vehicles cause 88% of the £6 billion annual damage to people's health from car and van exhaust emissions in the United Kingdom.

The number of cars manufactured in the United Kingdom increased in April for the first time in 2018, and this trend was maintained in May. As a result, IBISWorld estimates the total number of cars produced in the United Kingdom increased by 2% in second quarter of 2018 when compared with the same quarter in

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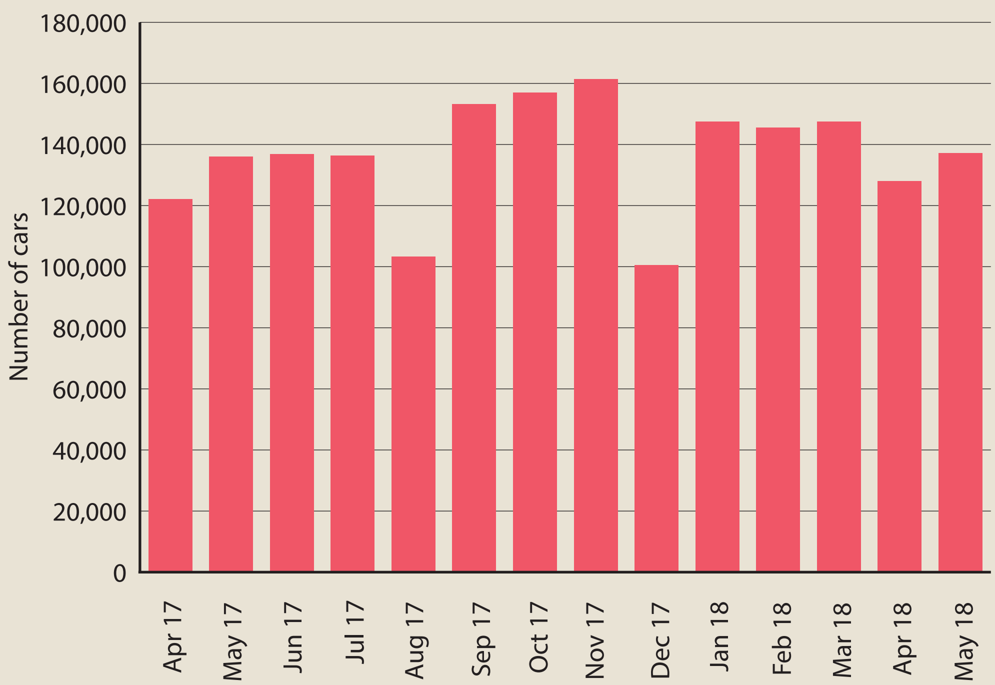
2017, to approximately 400,000 cars. Several manufacturers ramped up production to deliver a number of new models, which contributed to the increase. Sales to the domestic market also increased during the first two months of the year, as the squeeze on household spending budgets eased with inflationary pressures starting to fade. However, businesses continued to remain cautious when spending on new vehicles, which restricted both the increase in sales to the domestic market and the growth in car production in the second quarter. In addition, export sales, especially to the European Union, declined and curtailed growth in car production. The looming threat that diesel vehicles could be banned from cities across Europe following Germany's highest administrative court in Leipzig ruling in favour of upholding bans introduced by lower courts in February is expected to have been partly responsible for the fall. The increase in production was also partially attributable to lower production levels in April and May 2017, due to the timing of Easter in 2017 and manufacturers scaling back production for new model introductions. Therefore, although conditions rebounded in the second quarter of 2018, IBISWorld does not expect car production volumes to improve steadily over the coming months.

Investment plunges

According to the SMMT, investment plummeted in the first six months of 2018 to just £347.3 million, compared with £647 million in the same period in 2017, as investor confidence has been crushed by uncertainties regarding the UK's future relationship with the European Union after the transitional deal comes to an end in December 2020. Fears that the United States will increase the tariff on passenger cars imported from the European Union from the current level of 2.5% to 20% also contributed to this decline. In June 2018, Nissan Motor Manufacturing (UK) Ltd

Monthly Car Production Volumes



SOURCE: SOCIETY OF MOTOR MANUFACTURERS AND TRADERS

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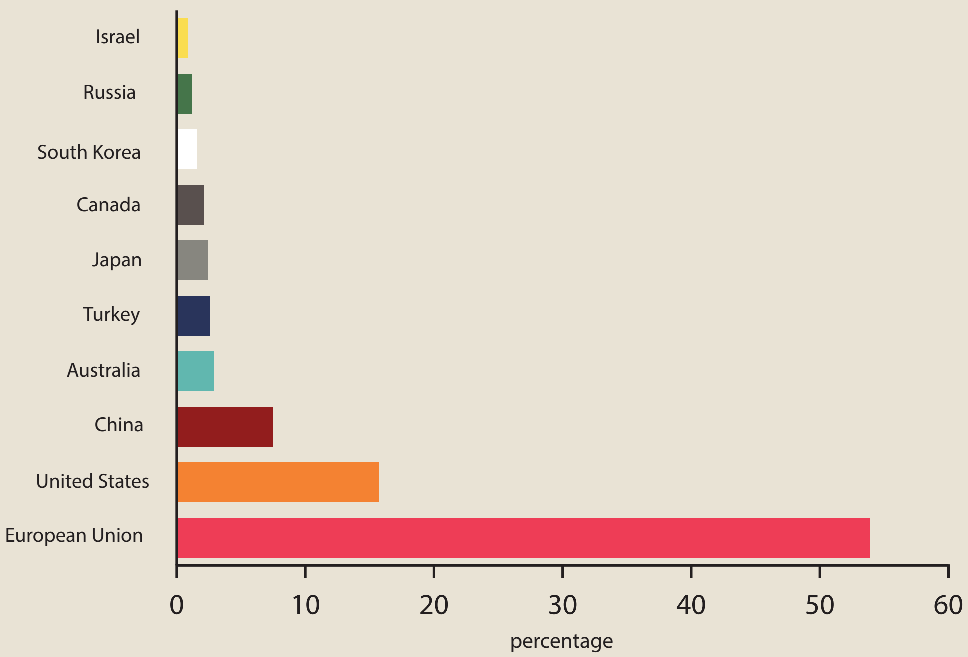
became the latest player to announce that it will put all future investment decisions on hold until more clarity is provided on the UK's future relationship with the trading bloc. Over 50% of the industry's exports are destined to the European Union. Therefore, a no-deal Brexit, whereby the United Kingdom exits the European single market and customs union, will severely hamper motor vehicle exports to the European Union, as vehicles manufactured in the United Kingdom will attract import tariffs. Such changes would also inflate production costs, force manufacturers to raise selling prices and disrupt the industry's supply chain as it is highly globalised, with less than 50% of the average motor vehicle produced in the United Kingdom being made from domestic parts. Many manufacturers rely on just-in-time production, where motor vehicle parts are sourced from all over the European Union and often delivered to production lines with few hours to spare. For instance, in June 2018, The Financial Times revealed that Honda only stored enough parts to keep its Honda Civic production line in Swindon in operation for just 36 hours. Operators have also told MPs that every 15 minutes of customs delays could cost them up to £850,000 a year.

Uncertainties regarding Britain's future relationship with the European and lacklustre demand conditions also resulted in many firms announcing job cuts in the second quarter of 2018. For instance, in April 2018, it was reported that Jaguar Land Rover Automotive plc, the largest player in the Motor Vehicle Manufacturing industry, was planning to cut 1,000 jobs in the West Midlands owing to a reduction in demand. During the same month, Nissan Motor Manufacturing (UK) Ltd also announced plans to cut hundreds of jobs at its Sunderland plant, which is the largest car factory in the United Kingdom, due to a fall in demand for its diesel vehicles. Meanwhile, in June 2018, Jaguar Land Rover, announced that it will move all production of its Land Rover Discovery

UK Car Exports 2017
Destination



SOURCE: SOCIETY OF MOTOR MANUFACTURERS AND TRADERS

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model range from its Solihull plant in the United Kingdom to a facility in Slovakia, which is likely to result in further job cuts. However, the Solihull plant will be converted to manufacture electric and hybrid cars, which the company will switch to making from 2020. The Slovakian site is the firm's first major non-UK manufacturing facility and gives its first real opportunity to produce models at scale outside of the United Kingdom. The company has previously warned about the repercussions of the United Kingdom leaving the European Union without a favourable trade deal on its manufacturing operations, which require access to the trading bloc for components and exports, and industry experts believe that the company will shift more work to Slovakia in the coming years if the United Kingdom is unable to secure a favourable trade deal. In June 2018, BMW also warned that it will be forced to close UK plants if the company is unable to import components from the European Union in a reliable and timely manner after Brexit. In July 2018, Jaguar Land Rover announced that it will have to rethink its £80 billion investment plan if the United Kingdom leaves the European single market.

Concerns regarding the future relationship with the European Union once the transitional deal comes to an end have also started to stifle demand for motor vehicle components manufactured in the United Kingdom (see IBISWorld report C29.300), as European motor vehicle manufacturers are being advised to avoid using components manufactured in the United Kingdom. In June 2018, the Dutch government issued advice to all manufacturers in the Netherlands, warning that they may lose free trade access if a significant part of the vehicle has been manufactured using components from the United Kingdom. The threat arises because EU 'rules of origin' stipulates that at least 55% of a motor vehicle's components should be sourced from within the European Union in order for a manufacturer to benefit from EU trade agreements that are currently in place between the European Union and other countries across the globe. Leaving the European single market and customs union will result in components produced in the United Kingdom no longer being counted towards this minimum requirement.

The road ahead

Although the Motor Vehicle Manufacturing industry has endured many challenges, it has not been all doom and gloom for the industry during the second quarter of 2018. Demand for hybrid and electric vehicles, also known as alternatively fuelled vehicles (AFVs), continued to record double-digit growth. For instance, sales of hybrid and plug-in cars in the United Kingdom recorded a staggering 36.1% year-on-year growth in volume terms in May 2018, according to the SMMT. Similarly, demand for electric buses has grown strongly across the globe as governments are being heavily criticised for poor urban air quality, providing an opportunity for firms that focus on manufacturing electric buses. Alexander Dennis Ltd, the UK's largest bus and coach manufacturer, started producing electric buses in 2016 and has expanded rapidly to become the European market leader with more than 170 vehicles operating the United Kingdom alone.

Meanwhile, funds channelled towards the manufacture of AFVs continued to rise, even though investment in the overall industry fell sharply during the first half of 2018. In June 2018, Jaguar Land Rover unveiled plans to invest £13.5 billion over the next three years, marking a 26% increase over the £10.7 billion invested in the past three years. Similarly, investment directed towards the development of autonomous vehicles also increased, as the UK seeks to become a world leader in self-driving cars. In June 2018, the UK government awarded £25 million to six project teams that will research and test autonomous vehicles on highways and on trials of remote-control parking, a move that the UK's automotive minister believes will lead to driverless cars reaching production within the next decade.

In addition, the 25% tariff imposed by

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the European Union on all US-made motorcycles exported to Europe from June 2018 is also likely to benefit Triumph Motorcycles Ltd and the wider Motorcycle Manufacturing industry in the United Kingdom (IBISWorld report C30.910), as the company is the largest player in the industry, with a market share of over 80%. This is primarily because the tariff will significantly increase prices of Harley Davidson motorcycles in the European Union and make Triumph motorcycles a more attractive alternative. Harley Davison is currently the largest player in the Motorcycle Sales and Repair industry (IBISWorld report G45.400), having sold 39,773 motorcycles in Europe in 2017, with approximately 5,500 of these expected to have been sold in the United Kingdom. Harley Davidson has already warned that it will increase the price of its motorcycles in the European Union by US$2,200 on average (approximately £1,667) and announced that it will move production capacity out of the United States as a result.

IBISWorld Industry reports used in this special report:

C29.100 - Motor Vehicle Manufacturing in the UK
C29.300 - Motor Vehicle Parts & Accessories Manufacturing in the UK
C30.910 - Motorcycle Manufacturing in the UK
G45.111 - New Car & Light Motor Vehicle Dealers in the UK
G45.400 - Motorcycle Sales and Repair in the UK

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