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To the point!

Cross-Asset- and Strategy-Research

Germany’s auto industry looking for ignition

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Simple and pain-free exits from the crisis seem unlikely

The negative headlines from Germany's automotive giants keep rolling in. First, Volkswagen broke a previously sacrosanct taboo: factory closures and layoffs are no longer off the table. Shortly thereafter, two other German giants followed suit. Mercedes-Benz and BMW have lowered their profit forecasts. Deep pessimism reigns in the stock market (see Fig. 1).

A drumroll of bad news

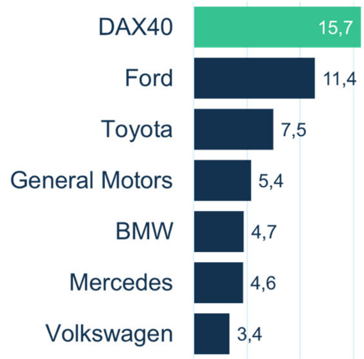
A Bouquet of Problems

After the diesel scandal, where several German carmakers were found to have manipulated emissions tests, many believed things couldn't get any worse. Now they are. Last week Germany's Minister for Economic Affairs, Robert Habeck, convened an automotive summit. Expecting quick and simple solutions from it would have been naive. The situation is too complex and the problems are too multifaceted:

Decline in Sales. Demand is weak. Car sales in Europe plummeted by 18% in August compared to the previous year. In Germany, the drop was even 28%. And for electric vehicle sales cratered by more than 40%. The rise in interest rates is adding fuel to the fire: nearly half of new car purchases in Germany are financed through credit or leasing. Expensive German cars become less affordable.

Model Lineup. In the world's largest car market, China, Volkswagen and its peers are falling behind due to the rapid shift to e-mobility. While the three major German carmakers still hold about 20% market share for internal combustion engines, a mere 6% of all electric vehicles in China come from their factories. Given that these "Big 3" sell between 30 and 40% of their vehicles in China, this trend severely hampers their profitability.

Fig. 1: P/E Ratios 2024



Bloomberg (23.9.2024), LBBW Research

Cost Discipline. The cost structure no longer matches the declining revenues. Overcapacity and low utilization rates are driving up the cost per unit. It is unlikely that manufacturers will be able to avoid some painful cuts.

Regulations. As it stands, German carmakers, particularly Volkswagen, are set to miss the European Union's CO_2 fleet targets. To add insult to injury, they could thus face billions in fines as early as next year.

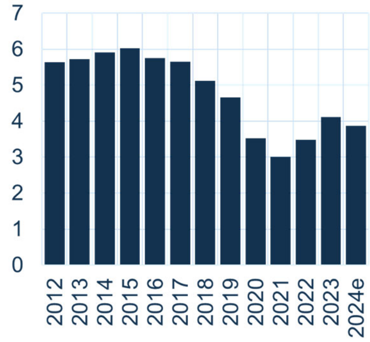
Fickle Subsidy Policies. The German government abruptly ended generous subsidies for electric cars in January 2024, which continues to harm electric vehicle sales to this day.

What is needed now. and what is not

Robert Habeck is right when he says that carmakers must first address their partly self-inflicted problems. How this aligns with his desire to avoid factory closures is unclear. Unfortunately, consolidation seems inevitable. Today, almost a third fewer cars are built in Germany than a decade ago (see Fig. 2). Still, the public sector's haphazard sectoral policies have also contributed to the problem. If the promotion of electric vehicles had been more consistent and the expansion of the charging network more advanced, the e-sales slump might have been less severe. Expensive cash for clunkers incentives are not a suitable solution. Too often they provide windfall gains to well-off households.

The instinctive call for state subsidies does not do justice to the structural nature of the challenge. More creative thinking is needed. More systematic incentives could result from, for example, increasing the fuel tax (and finally abolishing the outdated diesel tax privilege), and using the revenue to aggressively expand the charging infrastructure. This would boost sales of electric vehicles. Now is the time for ingenuity: if you have good ideas beyond old-fashioned subsidies, please send me a message!

Fig. 2: Motor vehicle production in Germany (Million units)



Source: International Organization of Motor Vehicle Manufacturers, LBBW Research. 2024 estimate by LBBW Research based on VDA half-year data.

Carmakers made mistakes. So did the state.