

Article | 22 October 2024

TRANSPORT & LOGISTICS

Europe's auto parts manufacturing sector remains under pressure

Europe's automotive sector is under pressure, and we expect that to continue for the rest of the year. We could see a turning point in 2025, but the full picture isn't yet clear. Lower rates and other policy measures will likely play a supportive role



Tabor Mobile car dealership in Kehl, Germany

The European auto sector hit by negative headlines

The European automotive sector has been hit by a succession of negative headlines over the past few months, starting with the second-quarter earnings season and continuing into September. The negative news flow included downward revisions of previous full-year 2024 targets and some idiosyncratic developments with major European car markets and manufacturers. Most of the bad news came from Germany, with a significant drop in new registrations in August and September and negative news flow around three German auto manufacturing majors – Volkswagen, BMW and Mercedes.

Sales growth could reduce further this year

After a strong rebound in light vehicle sales in 2023, the pace of car sales growth slowed in the first half of this year, which was in line with our expectations. Nevertheless, all three major

regional car markets, China, the United States and the European Union, delivered growth during the first half of 2024, notably +4.4% Year-on-Year in Europe (including the EU, UK and EFTA area), +2.1% YoY in the United States and +6.1% in China.

We envisage a deceleration in car sales during the second half of the year as consumer demand continues to be more muted following the buoyant post-Covid phase. The mixed economic environment with elevated, although declining, interest rates and political and policy uncertainties in multiple prominent geographies aren't helping either.

Used cars are more attractive again

Furthermore, used cars have become more attractive again after prices started to drop following better stock positions. Taking this industry backdrop into account, in August we reduced our global car sales growth expectations to +1.8% for FY24. However, given the sales statistics in August and September and announcements made by various industry participants over the past few weeks, that forecast may prove optimistic, with market growth ending up in the 0% to +1% territory.

We expect production volumes to fall in the second half of 2024

We expect production dynamics to be weak in the second half of this year due to high inventories in the United States and a slowdown in the Electric Vehicle (EV) adoption process in Europe. We anticipate that production volumes will drop by mid-single digits in the second half of this year.

For the full year of 2024, we now anticipate that car manufacturing volumes will decline by low single-digit percentages compared to the flat or slightly positive growth we anticipated earlier this year. We believe that this expected contraction in production volumes will impact auto parts manufacturers' revenue and earnings.

Car manufacturers under greater spotlight

As we have already indicated, the second-quarter results season was mixed for the auto sector, with multiple revisions of initial full-year targets. In our view, car manufacturers have been more affected than car parts manufacturers by the changes in the car market environment this year, including less buoyant EV sales. We believe that one reason for this was a strong comparative base for the major Original Equipment Manufacturers, which benefited from a very favourable commercial and pricing environment in previous years.

Now that the demand overhang has been cleared, these OEMs do not enjoy the same pricing power and will have to rely on operational efficiencies to sustain their current relatively high

margins.

Auto parts manufacturers feeling the heat

We believe that auto parts manufacturers have not experienced the same favourable pricing environment as OEMs in the recent past and have initiated some of the cost-cutting initiatives earlier, putting them in a relatively more defensive position margin-wise. In fact, their guidance revision during the 2Q24 season was relatively measured and not wholesale.

An overall sector weakness

However, the overall sector weakness has also been asserting itself regarding European auto parts manufacturers, with major players like ZF Friedrichshafen (ZFF) and Forvia releasing downward FY24 guidance revisions in late September.

To put things into perspective, ZFF did not change its 4.9-5.4% FY24 EBIT margin guidance during the second quarter earnings release on 1 August but revised it down sharply to 3% to 4% on 27 September, less than two months later. We expect more adjustments to the FY24 targets for auto parts manufacturers during the third-quarter earnings season.

Slowdown of the electrification process a major drag

The electrification process has slowed in Europe and the US this year, although it's more resilient in China. There are several reasons for that, including saturation in the early adoption buyers category, lack of infrastructure, the ending of government incentives for consumers in Germany, and prices remaining elevated for electric vehicles against more constrained customer buying power.

Against that weak backdrop, it's worth noting that hybrid cars have been enjoying something of a renaissance this year. Several manufacturers have introduced new plug-in hybrid electric vehicles (PHEVs) to respond to current consumer preferences.

A weak third-quarter 2024 earnings season

After recent negative headlines and guidance adjustments by the European OEMs, we expect that the 3Q24 earnings season will also have a soft tone for European auto parts manufacturers. They might use this occasion to reduce and calibrate their targets further for the full year. While the second half of 2024 is shaping up to be soft and probably weaker than we expected even right after the recent 2Q24 reporting season, we feel that the current year is a transition one where the electrification surge experiences a sharp slowdown before resuming growth at a more modest pace, with more balanced multi-platform car sales, including ICEs, hybrids and BEVs, potentially in the next couple of years.

Outlook for 2025 also coming into focus

With expectations for the third quarter and, indeed, the second half of 2024 being managed significantly lower, we believe the outlook for 2025 is becoming increasingly relevant. For now, we expect a stabilisation in the global auto market volume next year, with some positive aspects more likely than a sharp negative downturn; the expected lower interest rate backdrop in the United States and Europe should provide a tailwind for consumer sentiment.

A reliance on policy support

In the US, for example, 83% of new cars are financed by lease or loans. At the same time, visibility is still limited for next year, and we feel that auto markets in key geographies may have to rely on some policy support in order for constructive scenarios for the year to materialise. Such policy measures could potentially include new EV subsidies in Europe, including Germany, tailwinds from the economic stimulus measures in China or some supportive measures after the US elections.

Policies will be decisive in a pivotal year for European automotive industry

Policies have a directive impact on the car industry and its outlook for 2025 amid the historical shift to EVs. The pace of change logically also impacts part-suppliers. As EVs are not on par yet in many situations, policies drive the market forward and impact its composition, especially in the run-up to 2025, which will be a critical year. It's all about trade and especially climate policy. What's the current state of play here? And what's the impact on the outlook for 2025?

- After a lengthy investigation about market-distorting government support, EU member states agreed on import tariffs on Chinese EVs. Additional tariffs on top of the 10% previously in place [range from 17% for BYD to 35% for SAIC](#). The outcome is already much of a compromise given the dependence on Chinese supplies and the Chinese car market, especially for the German brand.
- The higher tariffs won't stop Chinese brands from making inroads in Europe, but rather, they will speed up initiatives to produce more locally. The higher barriers provide time and some room to manoeuvre for car makers but won't change the direction of travel and will likely delay the downward trend in EV prices for consumers. In 2024 around 25% of the EVs sold in the EU are built in China. This includes a majority of Western brands such as Tesla (+7.8% tariff increase),

Volvo (18.8% tariff increase) and BMW (20.7% tariff increase). **Under these stated policies, European brands will likely still need to introduce more affordable EVs in 2025 (see below), while the rise of Chinese brands will slow but will, nevertheless, continue.**

- **Most impactful in the short term are the 2025 CO₂ targets.** European car manufacturers are forced to comply with a limit of 93.6 grams per km for the average production by 2025. [In 2023 the industry average was just 111 grams per km](#), and in 2024, the EU share of battery EVs (BEVs) in EU new car sales only slipped from 14% to barely 13% in the first three quarters of 2024. Although the increasing share of hybrids contributes to lower emissions, the BEV-share should surpass the hurdle of 20% in order to meet the industry target the BEV share, which means a huge leap forward. The billions of potential looming fines combined with deteriorated finances sparked discussion in the European Commission, although a [review is formally only scheduled for 2026](#).
- As one of the cornerstones of Europe's 'Fit for 55' climate deal, we don't expect the 100% ban on ICE cars by 2035 to be lifted by then, flexibility on the target for 2025 – such as a delay to 2026 – could be on the cards. This would mean that BEV sales will ramp up gradually. Nevertheless, BEV share is expected to catch up again in 2025 after a sluggish 2024. To what extent this will happen is also dependent on fiscal support. Electric cars are not yet suitable for many drivers, and people are still waiting for more affordable models. In order to support low new vehicle sales and meet the CO₂ targets, the reintroduction of fiscal support to reach short-term targets could be possible in an important country like Germany. Another measure to facilitate the uptake would be to adopt a phase-out target for company cars, which represent a large share of new car sales in countries.

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