CO2 targets are the key question for European car makers at the start of 2025

The most important question for European car markets at the start of the year is whether the ambitious EU CO2 targets for 2025 will remain in place. The industry is already struggling with a raft of challenges while demand for electric vehicles is stalling. But car makers also need to push ahead to remain competitive

The European car industry is not on track to reach its 2025 CO2 target

In the final months of 2024, the CO2 debate within the industry and the European Parliament intensified amid a challenging market environment and looming trade tariffs. Car manufacturers are required to meet the average of 93.6 grams per kilometre* for all new car deliveries in the EU in 2025, progressing towards zero emissions by 2035. However, the European Environmental Agency (EEA) has shown that the average for 2023 was 106.4 grams per kilometre. Moreover, stagnating battery electric vehicle (BEV) sales throughout 2024 indicate minimal progress since then. The share of BEV sales in the EU is projected to reach around 14% in 2024. The figure should exceed 20% in 2025 to hit the target.

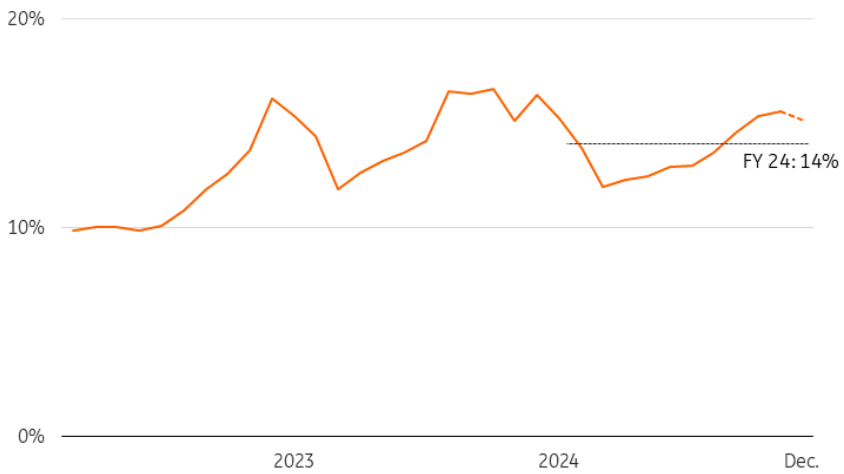
If car manufacturers fail to comply with the objective, they will face fines of €95 per gram of CO2 per unit exceeding the limit, potentially amounting to several billion euros in penalties, given the

over 10 million new deliveries annually.

*According to the world harmonised light vehicle test procedure WLTP

EU's share of battery electric car sales struggled to grow in 2024

Share of electrified cars in European new car registrations (EU), three month rolling average



Source: ACEA, ING Research

Most car makers face a significant gap and will struggle to comply

Most car makers with a significant market share in Europe are nowhere near the 2025 CO2 target, which means action is required. Volvo is the only large car maker and market player which has managed to comply with the target, aside from the EV-only manufacturer Tesla and smaller Chinese companies. Volkswagen and Ford face the largest challenge to meet the goal.

Four options to deal with the challenge

If the current rules remain in place, car manufacturers have four options to deal with the challenge. None of them seems popular as they all come at significant costs:

- Push battery EV (BEV) sales by introducing more affordable models and lowering prices. Most of the reduction should be achieved by BEVs. However, this eats into already lower profits from BEVs.
- Reduce conventional car (ICE) production and produce more plug-in hybrid electric vehicles (PHEV) and conventional hybrids (HEV)*
- Pay the fines (€95 per gram exceeding the 94 gram/CO2 target per unit)
- Buy CO2 credits from car makers that already comply with the target (Tesla, Volvo). In practice, this comes down to partnering with these players to get to a lower figure on a joint basis.

In practice, we are likely to see a combination of these strategies, with a significant emphasis on

boosting BEV sales.

*However: From 2025, the EU will significantly reduce the so-called utility factors, which is the share of electric driving that regulators use for calculating CO2 emissions of PHEVs. From 2027, the utility factors of plug-in hybrids will be fully aligned with how they are driven in the real world.

Multiple challenges for car makers trigger calls for flexibility and early policy review

Car makers such as VW, BMW and Mercedes currently face a challenging cocktail of lower margins, falling market share in China, new competition from new battery-only players such as BYD and low car and EV sales in their European home market. The regulatory obligation to meet EU CO2 targets in 2025 only adds to that. Lower margins on BEVs are deterring companies from pushing harder from the supply side, as they also face large investment programmes and operational restructuring to transition to BEVs.

Industry urges reconsideration of plans and policy makers seem open for discussion

The industry association ACEA advocates for greater flexibility and rescheduling the regular review to an earlier date (currently set for 2026). It highlights a lack of demand as the most pressing issue, alongside the development of charging infrastructure. The cost of new BEVs is still not comparable to conventional internal combustion engine (ICE) cars for many middle class private drivers. While policymakers could choose to promote BEVs, several countries, including Germany, France, and the Netherlands, are opting to phase out incentives instead. Meanwhile, discouraging conventional cars through mileage charges is not very popular, and this does not help to boost BEV demand.

At the start of the new European Commission, Ursula von der Leyen announced she would chair a 'strategic dialogue' on the future of the European car industry, this January. Additionally, the European Competitiveness Council urged the EC to review the 2025 CO2 target. The announced restructuring at Volkswagen at the end of 2024, due to market conditions and excess capacity, further fuelled the discussion.

A complicating factor for policymakers is that the bloc is far from self-sufficient in EV battery cell supplies and has become even more dependent on China in recent years (85% at the end of 2023 up from 80% two years earlier). Europe aims to produce up to 90% of its used batteries locally to become more self-sufficient, but it lacks a plan to rapidly increase domestic production.

With BEV production needing to rise sharply in 2025, more sourcing from Asia will be required. Coupled with the struggles car manufacturers face and the significant direct and indirect impact of the industry on employment and economic contribution, this could lead the EU to permit regulatory flexibility or even delay the 2025 CO2 target.

Postponing or waiving targets would buy car makers time, but won't help their structural position

It's clear that car makers face unprecedented challenges in the green transition. That said, the targets are not completely out of reach which T&E also shows. And the overarching goal of achieving 100% zero emissions by 2035 is likely to remain intact.

While short-term interests may advocate for an alternative approach, it is clear that the path

forward involves transitioning to EVs sooner rather than later. Ultimately, this means that short-term pain will lead to long-term gain.

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