Emerging Markets
18 June 2020

CEE automotive industry

Accelerating challenges

Jakub Seidler
Chief Economist, Czech Republic
Prague +420 257 47 4432
jakub.seidler@ing.com

Piotr Popławski
Senior Economist, Poland
Warsaw +48 22 820 4078
piotr.poplawski@ing.pl

Peter Virovacz
Senior Economist, Hungary
Budapest +36 1 235 8757
peter.virovacz@ing.com

Valentin Tataru
Economist, Romania
Bucharest +40 31 406 8991
valentin.tataru@ing.com

Dmitry Dolgin
Chief Economist, Russia
Moscow +7 495 771 7994
Dmitry.Dolgin@ingbank.com

Petr Krpata, CFA
Chief EMEA FX and IR Strategist
London +44 20 7767 6561
petr.krpata@ing.com

Contents

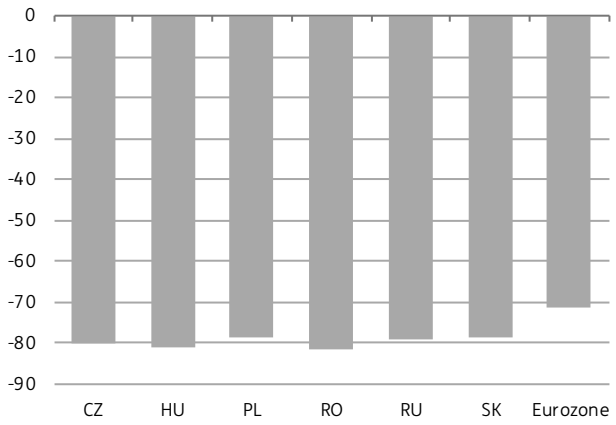
Executive Summary

The automotive segment globally will be significantly affected by the Covid-19 crisis and Centre and Eastern Europe (CEE) is no exception as some CEE countries are heavily dependent on this industrial segment. Although some of these countries introduced car subsidies (even before the Covid-19 outbreak), what matters more for the CEE region that exports a large part of its auto production is the recent EU/German scrappage scheme. But given its focus on electric cars subsidies, it will provide only limited help to the CEE automotive sector as electric cars are only gradually being produced there. Benefits to the region coming from potential supply-chain disruptions seem less clear and we do not see any strong evidence for that just yet. As such, the Covid-19 crisis might accelerate challenges for the sector, which were already apparent before the coronavirus outbreak.

Hit like other industries, but the recovery may be longer lasting

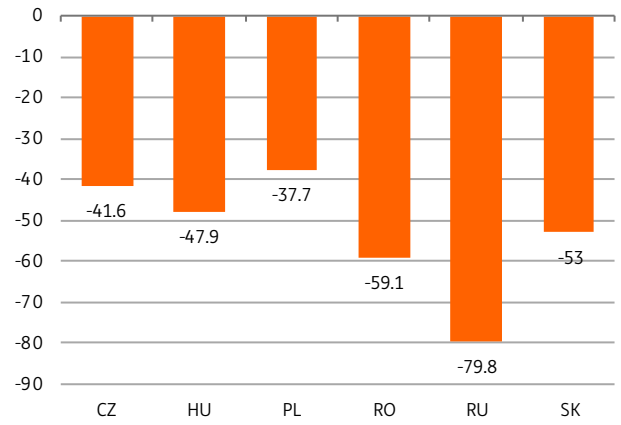
The global automotive segment has been significantly hit by the Covid-19 crisis, seeing double-digit declines of new car-sales registrations across Europe, but also a double-digit fall in car production in the latest months due to the shutdown in car factories (Figure 1), which outpaced the lowest monthly fall during the Global Financial Crisis in 2008/2009 (Figure 2). This is not so much different to other segments of economies, which had to be closed due to restrictive measures against the Covid-19 pandemic. However, as the car sector is being more cyclical, and is also currently facing structural changes due to the stricter emission regulation, its recovery might be more long-lasting and with the potential for long-term structural changes.

Fig 1 Fall in car production in Apr 2020 (% YoY)



Source: ING, local statistical offices

Fig 2 Highest monthly YoY fall of the car production in GFC



Source: ING, local statistical offices

Some CEE countries are highly dependent on the auto industry

The CEE region experienced a similar path to the rest of the word with respect to the main variables related to the car segment, with a significant decline in both sales and production of cars in April. As the dependency of some CEE countries on the automotive is high (around 13% of GDP in Slovakia, 10% in Romania, and slightly below 10% in Czechia and Hungary) and has a high export share, the future of the industry is crucial for those countries. In contrast, Poland and Russia are less vulnerable (see Figure 3 and 4).

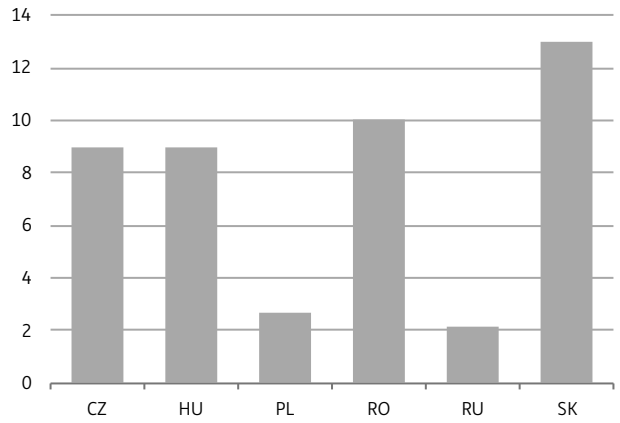
This is also the reason why the Visegrad Group of countries (called V4: CZ, PL, SK, HU) sent an open letter to EU institutions to support the industry, which in the V4 countries alone directly employs 650,000 people and more than 1.3 million (which is 4.5% of the total workforce) when accounting also indirect jobs. It also represents nearly one-fifth of EU total vehicle production.

The form of the German scrappage scheme not so beneficial for CEE

As Germany decided not to restart the scrappage scheme for the typical combustion engines, and only increased its grant for electric vehicles, the prior expectations that German support of the automotive would transmit into CEE countries has disappeared.

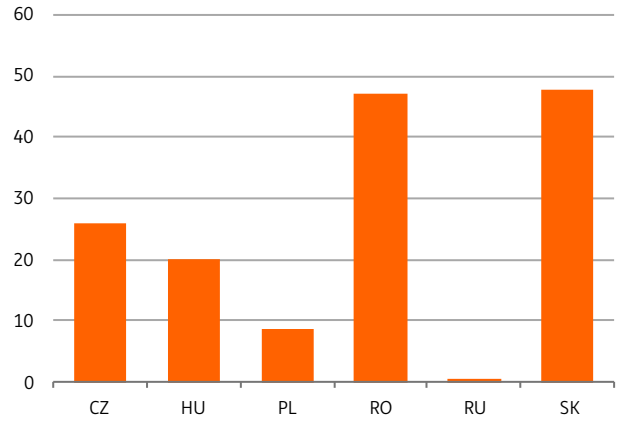
This is because the electric vehicles represent only a single-digit percentage share in most of the EU countries and the production capacities in the CEE region related to electromobility remains limited (and fairly uneven), though being gradually enhanced in the last year or so. As such, the electromobility support on the European level will not provide a significant positive shock for the CEE automotive sector as a whole. On the individual countries level, Slovakia followed by Hungary may benefit the most given its larger electromobility-production share, while Romania and Russia less so.

Fig 3 Automotive's share of GDP (%)



Source: ING, local statistical offices

Fig 4 Automotive's share of exports (%)



Source: ING, local statistical offices

Premature to expect beneficial supply-chain disruptions for CEE

The debate about potential supply chains disruption after the Covid-19 outbreak, which might potentially lead to the de-globalization and a move of some of the production capacity from Asia closer to Europe (potentially to the CEE region) seems to be premature in our view. As the automotive segment is in distress, the first impact phase will be clearly negative for the region as indicated by the already announced postponement of auto industry-related investments in Hungary and Romania.

Moreover, the potential benefits from relocating production towards the CEE region is not straightforward. The most important car market in the years to come will remain China. Should European automotive remain under pressure due to the combination of the Covid-19 crisis and the emission regulations, we can hardly expect any positive twist for the CEE region. As such, risks related to the future of the automotive segments in Europe and the CEE region have even intensified with the current Covid-19 crisis. See also How will the automotive industry recover from Covid-19?

In the country section below, we look in detail into individual CEE countries. In particular, we look at (1) the importance of the automotive industry for each country; (2) the local Scrappage /support scheme (if it exists); (3) the impact of supply-chain disruptions; (4) Covid-19 impact on investments in the automotive segment; (5) potential benefit from scrappage in EU/Germany; and (6) other considerations

Jakub Seidler, Petr Krpata

Country Detail

Czech Republic

Background: Car production represents the most important industrial and export segment in the Czech Republic, having more than a 25% share in total Czech exports. In 2019, 1.4 million cars were produced in the Czech Republic, which makes it a country with one of the highest car production per capita in the world, after Slovakia. There are three main car manufacturers: Škoda Auto (64% share), Hyundai Motor Manufacturing Czech (22% share) and Toyota Peugeot Citroën Automobile (14% share).

While automotive alone represents around 6% of GDP, due to the significant supply-chains linked to the industry, the total share of the automotive for the Czech economy might represents around 9% of GDP. As such, the importance of the segment is one of the highest among countries in the regions, with more than 90% of the produced cars being exported, mainly to Germany. As such, the German scheme scrappage would be an important pro-growth factor for the industry.

Scrappage scheme: There was a hope that the potential Germany or the EU scrappage schemes would help Czech car-makers (as was the case during the Global Financial Crisis (GFC) in 2008/09), but the recent German government decision to focus mostly on electric cars will be of a limited positive impact on the Czech auto industry. This is because with more than 90% of produced cars exported, the scrappage scheme abroad (mainly in Germany) is more relevant than any local incentives. As for the domestic scene, the institute of scrappage is active in the Czech legislation, being approved in 2009, though not used actively, but it is not currently debated. Even the subsidies for the electric cars are quite limited at this point, being focused only on companies and on not households. In addition, there is a price limit for subsidies at CZK1.25m (EUR47,000 equivalent). The subsidy starts from 20-40%, based on the size of the company. Given these limitations, the share of electric cars or plug-in-hybrids in new car registrations was just limited at around 0.5% in 2019. January-May 2020 figures show an increase to 0.83% due to Skoda's Citigo and Superb plug-in-hybrid.

Impact of supply-chain disruptions: No clear evidence yet.

Covid impact on investments: so far, the car producers plans announced before Covid-19 were not publicly changed. However, as the automotive industry is affected by the crisis, this will likely lead to some cost-reduction actions later this year. It is already clear that employment decreased by around 3% YoY among larger industrial companies. Though the short-term negative impact will be concentrated on agency workers, employment in the automotive sector will most likely decline further.

Benefit from scrappage in EU/Germany: The Czech car-makers had been fairly late to start the electromobility production, with Skoda auto introducing its first plug-in-hybrid model for Skoda Superb only in 2019. And the recently introduced small city-car Škoda Citigo-e iV is produced in Slovakia, not in the Czech Republic. However, the recent information suggests a slightly faster move towards electromobility, as Skoda's pure electric car Enyaq iV will start to be produced in the Czech Republic later this year and also other car-makers have moved towards electromobility, with TCPA Toyota Yaris and Hyundai hybrid Tuscon and electric/hybrid Kona.

Jakub Seidler

Hungary

Background: The Hungarian automobile industry produces about 5% of GDP. It employs 4% of total workers in the country. Most cars and car parts are produced by German companies (VW Group and Daimler), and 90% of the production is exported. While relevance of the local automotive is around 5% GDP, including spill-overs, the automotive industry, might represents around 9% of GDP, though the share in gross value added is lower for the Hungarian automotive industry: it still heavily relies on the import of inputs. As such, it is likely that disruptions on global value chains and a significant fall in demand will hit Hungary at an above average level as the majority of the work done is assembly, without R&D or marketing.

Scrappage scheme: Families with three or more children are eligible for up to HUF2.5m (which may be equivalent to a maximum 50% of the price of the vehicle) for the purchase of vehicles that seat at least seven passengers under the "big-family car subsidy" scheme which launched on 1 July 2019. It is a non-repayable grant. The government also subsidizes the purchase of EVs. According to Ministry data, subsidies of some HUF3bn supported the purchase of 2,800 EVs since the scheme was rolled out in 2016. The government has increased its subsidy for purchases of new electric cars from HUF1.5m to HUF2.5m in 2020, and also introduced a decreasing scheme for subsidies for more expensive cars. The maximum HUF2.5m subsidy is only valid for electric car purchases not exceeding HUF11m. There is a degressive scheme, so the subsidy for electric cars in the HUF11-15m price range is only HUF0.5m, but there is no subsidy for vehicles costing HUF15m or more. As a new element, taxi operators may obtain an even higher subsidy covering up to 55% of the cost of new electric vehicles priced at no more than HUF15m. The programme was launched on 15 June with a budget of HUF5bn and was fully depleted within 36 hours having 2000 applications.

Impact of supply-chain disruptions: Hungarian plants are unique from different points of view. Some car elements/parts or cars in the supply chain are only made in Hungary. Some car-makers have special plants (like a special paint shop or body and tool production lines). If the future means stronger centralization and having more parallelism in production, Hungary can see a drop in the "power ranking" within the supply chains. On the other hand, companies set up a strong relationship with local universities for getting supply of a labour force with the exact knowledge. So, packing up and leaving won't be just about the factory, but it would be a material sunk cost taking into consideration their respective participation in the education system.

Covid impact on investments: Several investment plans remained in the pipeline by Audi but as VW prepares a 20% cut in investment activity, Hungary might be on the wrong end of this decision. Mercedes-Benz AG is building a new press plant at the Kecskemét site, thus increasing the flexibility of global production network of the whole company group. It was announced after Covid-19 hit. Pioneering in the field of the digitisation of material processing, the new plant is expected to start production in 2022, by which time the entire Kecskemét plant will operate in a carbon-neutral way. However, BMW postponed its investments due to the Covid-19 outbreak.

Benefit from scrappage in EU/Germany: Audi, the German car-maker, has a flagship factory in Hungary when it comes to electric powertrains and EVs (Audi E-tron is built in Győr). The Japan car-maker Suzuki has moved to produce only mild hybrid cars. As for now, no electric powertrain or EV built in Kecskemét by Daimler (Mercedes-Benz), but the factory is flexible, so within a year it can be changed without any further major investment. Last but not least, the now PSA member Opel has no electric powertrain production in Szentgotthárd, just regular engines.

Peter Virovacz

Poland

Background: The Polish economy and its export structure are one of the most diversified among the CEE economies. The reliance on the automotive sector is also one of the lowest in the region. The automotive sector in Poland represents just 2.7% of GDP and slightly above 10% of total industrial production, which is one of the lowest dependencies in the region. Due to its lower importance, there is no debate about the scrappage in Poland.

Scrappage scheme: A scrappage scheme was neither discussed at a local level, nor expected to be introduced, though some debate started last year.

Impact of supply-chain disruptions: Polish manufacturers are likely to be affected by supply-side disruptions in the euro area similarly to CEE counterparts. However, Poland thrives on internal demand in the euro area. It might therefore benefit if large countries introduce new fiscal measures to boost their demand to offset potential disruptions. Producers of furniture are a good example – substantial exports, high reliance on core EU internal demand, but relatively low reliance on foreign supply chains. During the US-China trade wars, Poland showed substantial resilience to the global slowdown largely owing to this factor.

Covid impact on investments: Large investments may be curbed / delayed primarily in the energy sector. Elsewhere investment propensity was weak even before the pandemic. We are yet to see if any major existing activity in the automotive sector is to be permanently slashed. Factories mostly halted production during the peak of the pandemic, but due to a lack of demand, as there was no enforced lockdown in industry.

Benefit from scrappage in EU/Germany: In the short term this is unlikely, apart from the general fiscal impact. The long-run impact is dubious. Poland hosts the biggest factory producing electric batteries in Europe but may lose on lower demand for parts in the other segments, eg, ICE combustions.

Other: Companies from related fields (eg, tyre producers) managed to return production at levels similar to those prior to the pandemic. They move to Asian markets, where the demand seems to have rebounded. However, they face substantially lower margins.

Piotr Popławski

Romania

Background: Germany is the largest export partner for Romania with a 22.9% share of total exports. Around two-thirds of the total exports are automotive-related. Hence, automotive-related exports to Germany account for about 15% of Romanian exports, representing roughly 10% of Romania's GDP and employing approximately 90,000 people. Romania belongs also to the mostly exposed countries in terms of GDP share, which is around 10 % and exports of the automotive consists of almost 50%, as in Slovakia.

Scrappage scheme: There are two active schemes, which explains the relatively higher proportion of electric cars in the new car registrations of 3.8%:

1) RABLA Clasic: for traditional engines and hybrid engines without plug-in: a c.EUR1,200 voucher is given for each car older than 8 years. The voucher can be used only to purchase a new car with emission norms of maximum 140g CO_2/km. There are different extra-bonuses offered on top of this voucher, depending on different conditions such as buying a new car with emissions < 105g CO_2/km, buying an LPG car or buying a non-plug-in hybrid. So in theory the total voucher value + bonuses could reach c.EUR2,200.

2) RABLA Plus: for 100% electric AND plug-in hybrids. The voucher value differs in this case, ranging from c.EUR4500 for non-hybrid plug-in with emissions <50g/km to EUR10k for 100% electric cars.

Impact of supply-chains disruption: Not observed yet.

Covid impact on investments: Dacia cancelled an EUR100m investment for increasing production capacity by 15%.

Benefit from scrappage in EU/Germany: There are no plans to build an electric vehicle in Romania anytime soon, which means that benefits stemming from support of the electric vehicles across EU will miss Romania's automotive sector. Ford Puma is the first hybrid vehicle manufactured in the Romania.

Other: Being a low-cost producer, Dacia benefited after the 2008-09 crisis. This time could be different, as consumers are more and more incentivised to switch to EVs, which was not the case 10-12 years ago. But all in all, we would expect the company to still perform well with its low cost cars during these times. Ford on the other hand is producing a more premium vehicle in Romania – Ford Puma. The premium segment could take a stronger hit, but there are two factors which we think mitigate this: (1) the compact SUVs are exactly what the market wants lately; and (2) Puma production started only in October 2019 so there is not much downside potential from here.

Valentin Tataru

Russia

Background: The share of Russian automotive to GDP is relatively small, as Russia is not focused on car manufacturing. The share of the automotive industry is 2.1% of GDP (which is significantly smaller than the majority of its CEE counterparts - as per Fig 3) and form only 0.5% of total exports. This is divided to passenger cars exports (0.3%) on the one hand, and trucks, buses and auto parts (0.2%) on the other hand. Automotive industry employs less than 0.5% of Russia's labour force.

Government demand support measures: The government initiated a 'cash for clunkers' scheme in 2010-2011, but then suspended it. The renewed scrappage programme was introduced in 2014 and has been prolonged every year since then. After the Covid-19 outbreak, the government changed the rules, and now those who have a car older than 6 years (previously, it was 10 years) may apply for 'cash for clunkers' or 'trade-in' programmes. The average compensation varies within 700-1200 USD. On average, it covers approximately 5-12% of a new car's cost. In addition to the discount, the dealership may provide the owner with better conditions and/or discounts when buying a new car. As for electric cars, if the vehicle satisfy the requirements (one of them production being localized), the producer company may use the programme

Impact of supply-chain disruptions: Russia's automotive industry is vulnerable due to a high dependency on imports. According to ASM Holding estimates, except for Hyundai, AutoVaz, Renault and Chinese Haval, localization of production in automotive industry is on average 40%. As a result, the companies' inventories have been depleted during the lockdown. For example, in April Peugeot, Citroen and Opel suspended their production until mid-May. Currently, 'Avtotor' in Kalinigrad plant is suspending the assembly of BMW cars since mid-June till the end of the month due to the lack of components.

Covid impact on investments: Nissan decided to cut the number of models from 69 to under 55, closing the Datsun model production. Some other producers started to re-arrange their investment strategies. Still, car-makers do not panic. Recently Volkswagen entered into a special investment contract, under which it pledges to invest RUB61.5bn (USD0.9bn) in the Russian automotive industry over the next eight years.

Benefit from scrappage in EU/Germany: Electric cars are exempt from 'luxury tax', used for cars worth over RUB3m. Electric car owners in Moscow are allowed to use city parking free of charge. Electric car producers have may have some tax incentives, if their production may be considered innovative, which includes (1) Exemption from 20% VAT in R&D and intellectual property, (2) Simplified accounting of R&D expenses, (3) Accelerated depreciation of fixed assets used in scientific and technical activities, (4) Various tax incentives (including exemption from income tax on targeted financing) etc.

Other: The government upgraded the program of preferential car loans for cars made in Russia worth up to RUB1.5m (approximately USD22,000) since 1 June 2020. The programme also provides a 10% discount (25% for the Far East region and 25% for electric cars in any region) for families with at least one child under the age of 18, workers in heath industry and 'trade in' programme participants. The renewed list of participants include: Lada, UAZ, Kia, Hyundai, Volkswagen and Renault.

The drop in car manufacturing in Russia narrowed from -80% YoY in April to -45% YoY in May, and the dynamic of new car sales also improved from -72% to -52%. However, the path to full recovery may be hampered by the deterioration in the household income trend. According to the recent polls, the share of households able to afford a car dropped from 21% to 16-19%.

Dmitry Dolgin

Slovakia

Background: Slovakia is the country with the highest share of produced car per capita, with 1.1m cars produced last year. There are four main car-makers in Slovakia with a relatively evenly distributed production share among the first three car-makers of around 350,000 cars per year: Volkswagen, KIA, and PSA. The fourth produced is Jaguar Land Rover. The share of automotive in industrial production is the highest in the region, around 13% of GDP, and almost 50% of industrial production. The similarly high share has automotive in Slovakia's total exports.

Scrappage scheme: Local scrappage is not being debated, though it was introduced during the 2009 crisis for 10-year old cars with a possible maximum support of EUR2,000 (as a combination of government and car producers' subsidy). This programme supported the liquidation and buying of around 40,000 cars with government costs of EUR55m. Based on the latest information, the Slovak government is not considering the scrappage scheme renewal, instead trying to focus on other forms of support. However, Slovakia introduced a new subsidy for new electric vehicles since December 2019 for both households and companies. Pure electric vehicles received a support of EUR8,000, while plug-in-hybrid EUR5,000, with limit on prices of electric cars at EUR 50 thousand. The final amount reached EUR5m and supported a purchase of less than 1,000 cars. A new wave of support was introduced in May

Impact of supply-chain disruptions: The battery maker InoBat is to enter Slovakia with a EUR1bn investment next year, to be able to produce 240,000 batteries in a four-year horizon. The motivation behind this is to reduce the dependence on China, which might represent around 75% of world capacity for car batteries.

Covid impact on investments: Despite the difficult situation after Covid-19 outbreak, Kia recently announced a new assembly line in Slovakia for unspecified electric model of C-segment. However, the potential consolidation in the sector might be further announced as a result of the market situation, which underlined the last year's Volkswagen decision to reduce its workforce in Slovakia.

Benefit from scrappage in EU/Germany: Compared to its peers, Slovakia started earlier with electric car production. The Volkswagen e-up! has been installed in Slovakia since 2013. Škoda Citigo-e iV and Seat Mii Electric have joined last year. The Peugeot e-208 has been produced at the PSA Group's Trnava plant since last year. Including Plug-in-hybrids, also Kia Ceed, Porsche Cayenne or VW Touareg is presented in the Slovakia. As such, Slovakia might benefit the most from the subsidies for the electro mobiles introduced this year and seems to be more prepared in terms of heterogeneity of production and its focus on electromobility.

Jakub Seidler

Disclaimer