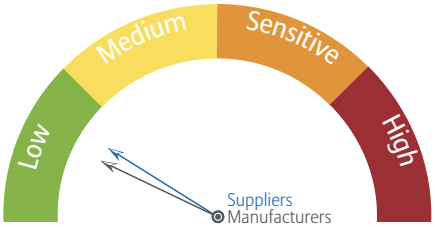
Automotive in the US

Growth Sputters



Automotive Non-Payment Risk
(Q2 2017)

- **Auto loans defaults have been surging, putting a dent in credit lending and sales**
- **Swelling inventories contribute to declining profit margins for car manufacturers**
- **The US remains one of the global leaders in innovation, especially battery technology patents**

Sales running out of gas

We expect the US automotive market to shrink by -2.5% in 2017 and -1.8% in 2018. In the aftermath of the global financial crisis, strong sales volumes were driven by the availability of cheap credit and lax lending conditions. With tighter monetary policy, the access to motor financing is becoming more restrictive, leading to a slowdown in consumer demand. New car loan origination has cooled off, as borrowers have started to default. Headwinds hampering new vehicle sales will also come from the booming used-car market. Growing volumes of off-lease vehicles will lead to downward pressure on pricing in the next years, leading to declining consumer demand for new vehicles. The policy changes proposed by the Trump Administration (e.g. border adjustment tax) add uncertainty to the industry's outlook.

Inventory glut will eat into margins

The average EBIT margin of US manufacturers was below average of the sample countries. In 2016, they earned an EBIT margin of 4.0%. On the contrary, suppliers achieved average EBIT margin of 6.0%. We expect margins to deteriorate because of an inventory glut. When consumer demand slipped and inventories started rising, manufacturers cut prices and increased incentives for car dealers. This, in turn, will cause margins to plummet. Mounting pressure on production capacity has already led some manufacturers to announce plans to lay off workers. US manufacturers and suppliers continue to be industry leaders when it comes to capital expenditure, behind Japan and Germany.

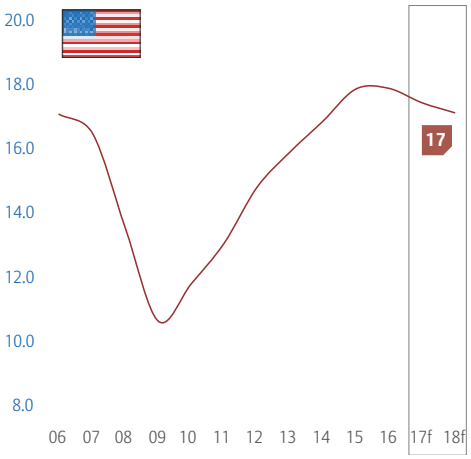
One of the global leaders in innovation and strategic investments

In 2015, R&D volumes amounted to EUR16.8bn, following Germany with EUR37.0bn and Japan with EUR29.4bn US industry players lead the field in battery technology. Between 2010-2015, they secured 29% of worldwide patents, before Japan (23%) and Germany (15%). Between 2012-2017, volume of M&A deals in ICT totaled USD2.1bn, following China and Germany. In May 2016, Ford, General Motors, and Microsoft invested USD253 mn in Pivotal Software, a cloud-based software startup. The former two had previously launched Ford Pass, an innovative consumer experience platform. In August 2017, Ford announced that it will launch production of electric cars in China, in a joint venture with Anhui Zotye Automobile. It already operates JVs in China, with Changan Automobile and Jiangling Motors.

California ahead of the curve

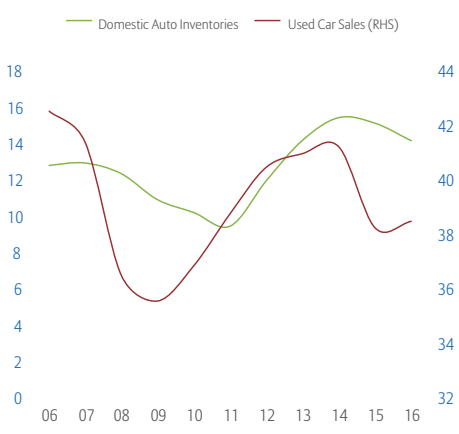
Government support for electric driving in the US is below average compared to the countries in our panel. Electric vehicle adoption varies greatly across states, with California being in the pole position. Alongside a zero-emission vehicle scheme and tax incentives, they just proposed the California Electric Vehicle Initiative (CEIV), which would provide point-of-sale rebates to buyers of electric cars (up to USD7,000, while also eliminating the need to file rebate applications with the state). The vast majority of fast chargers can be found in metropolitan areas such as San Francisco and San Jose. Other states such as Georgia, Oregon, and Washington are also catching up. ■

Chart 1 New Vehicle Registrations
(in million)



Sources: OICA, IHS, Euler Hermes forecasts

Chart 2 Used-Car Sales & Inventories in the US
(in million)



Sources: Edmunds Media, US Bureau of Economic Analysis

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