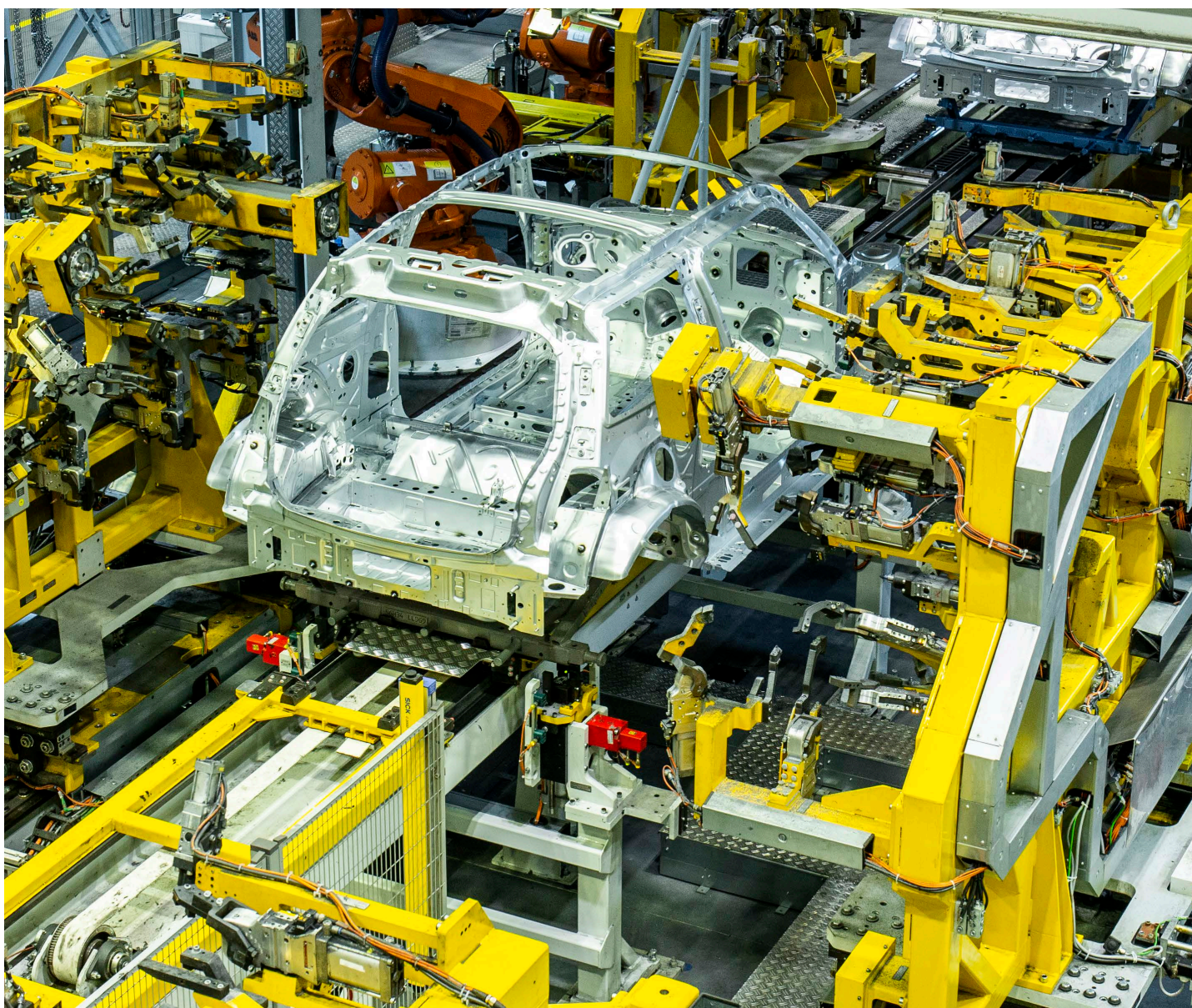


RISKS AND OPPORTUNITIES

UK AUTOMOTIVE TRADE IN A POST-COVID WORLD



SMMT's second trade report examines the 2019 UK automotive trade performance; the impact the Covid-19 outbreak is having on the automotive sector, both globally and in the UK; and the importance of an ambitious free trade agreement with the EU and future trade policy recommendations.

CONTENTS

3	LETTER FROM THE CEO
4	EXECUTIVE SUMMARY
6	CHAPTER 1: UK AUTOMOTIVE TRADE IN 2019
14	CHAPTER 2: IMPACT AND RESTART
20	EXPORT SUMMARY
22	CHAPTER 3: UK AUTOMOTIVE TRADE BEYOND LOCKDOWN
30	RECOMMENDATIONS
32	ANNEX - DATA SOURCES





LETTER FROM THE CEO

SMMT's second annual trade report is published at a time of extreme uncertainty for the global automotive industry as it faces the exceptional challenge of the coronavirus pandemic. The impact on society has been unparalleled and for many, tragic, while the shock to the economy and industry has been devastating.

Yet, beyond the pandemic, other more familiar challenges remain; ongoing trade tensions, environmental pressures, technology shifts and, for the UK and our closest trading partners, Brexit and the looming end of the transition period. The outcome of these negotiations will be fundamental to our sector's ability to recover from the chaos wrought by Covid-19 – and to its long-term viability.

UK Automotive is built on firm foundations with a rich heritage of innovation and cutting-edge engineering. It is agile, flexible and fundamentally competitive, with world-leading levels of efficiency. In 2019 the sector generated more than £100 billion in total trade for the third consecutive year, highlighting its role as a global trading powerhouse, and held the lead as Britain's biggest exporter of goods by a considerable margin. Exporting vehicles, engines and components to more than 150 countries worldwide across all continents, the sector is key to the UK's international trade agenda and supports thousands of highly skilled, high value jobs across all regions.

The vast majority of UK-produced automotive goods exported overseas are destined for the EU and some seven out of 10 vehicles bought by UK consumers come from factories in the bloc. Securing a comprehensive free trade agreement with our largest trading partner is paramount. The sudden imposition of tariffs, just as the sector strives to restart and recover from the current crisis, would be catastrophic. Furthermore, if we are to retain the preferential trade we currently enjoy with other key markets around the world after the transition period ends, and capitalise on future global growth, we need deals with these other countries agreed in parallel.

How quickly automotive recovers from the shock of the pandemic will be decisive for Britain's overall recovery and future prosperity, global influence and reputation. As well as potentially creating further skilled jobs, the sector can lead the world in technological development and drive the transition to a zero-carbon economy.

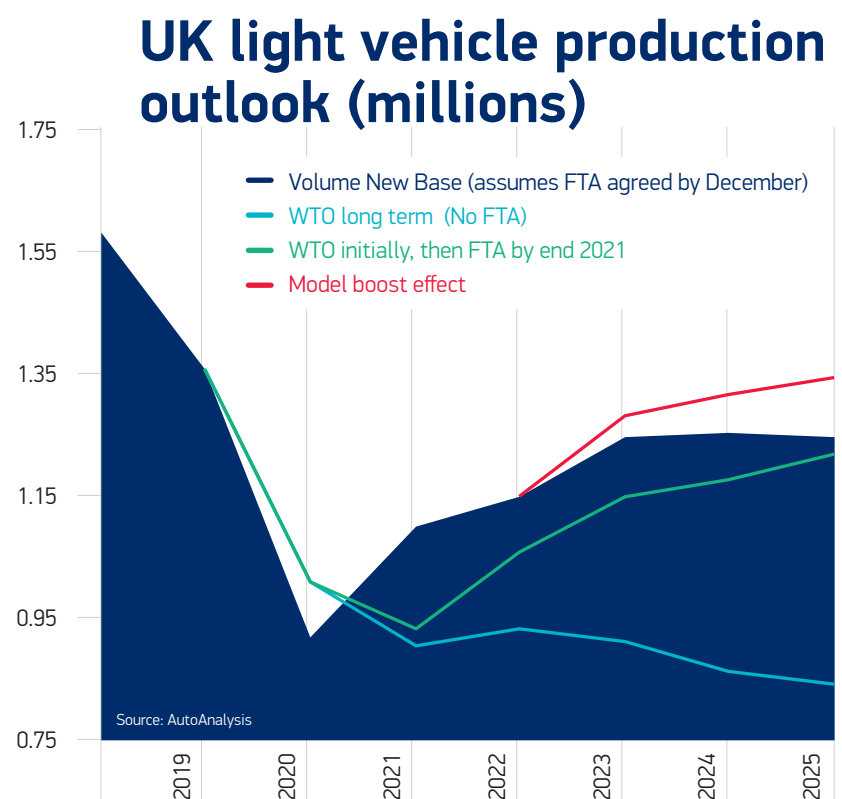
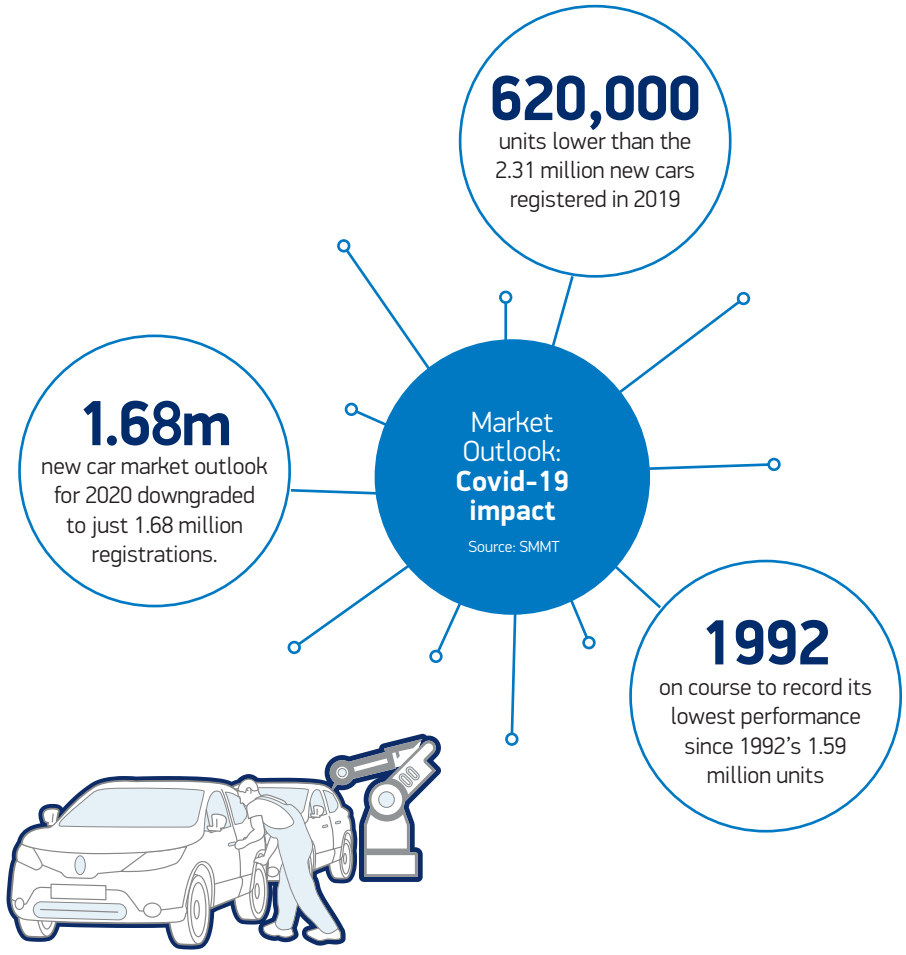
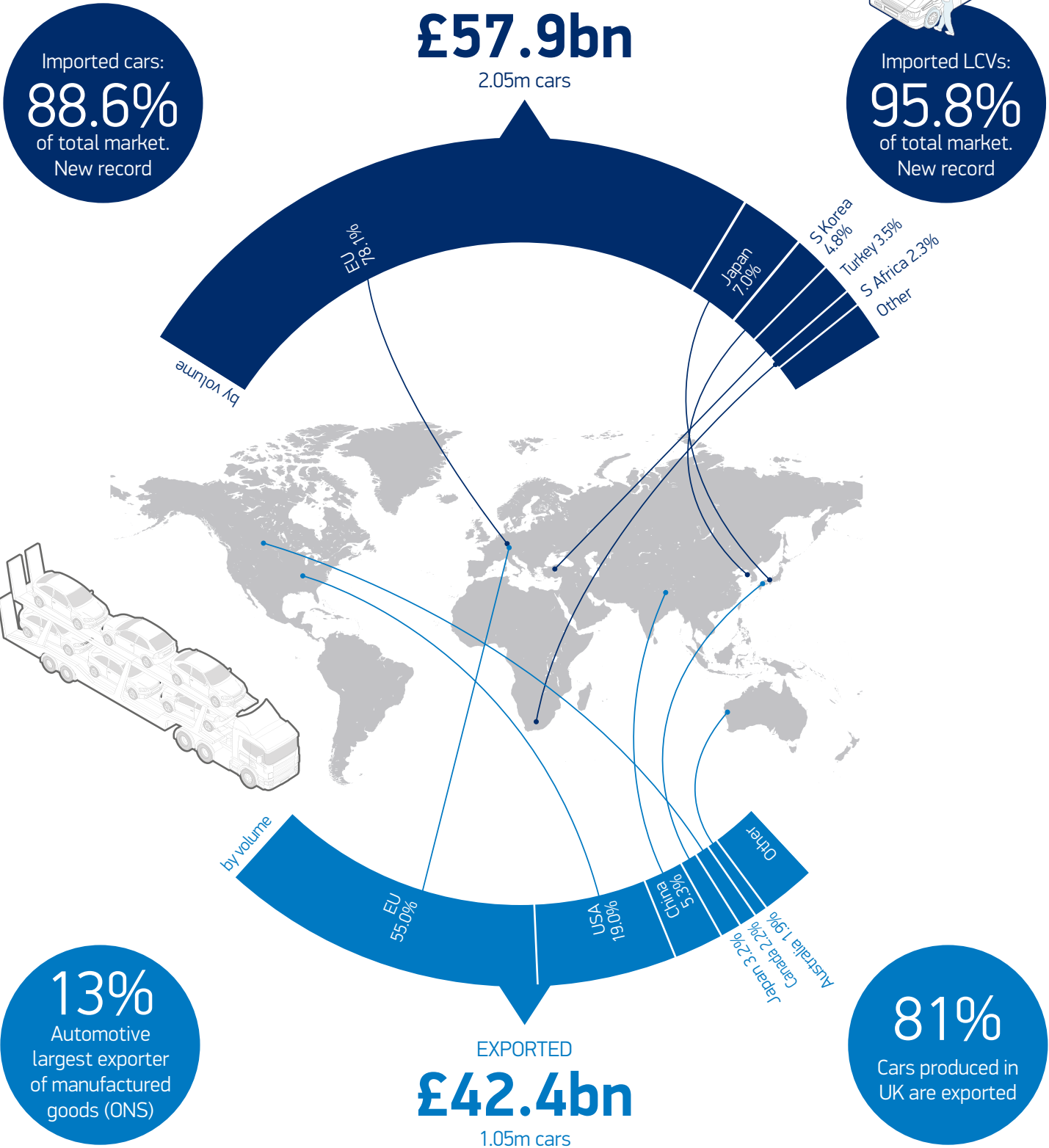
As the coronavirus crisis begins to dial back and government helps to nurture the nation back into economic growth, it is UK Automotive that can be an engine room of success. The next few months will be critical for determining its future. This report sets out a comprehensive analysis of the sector, the value it creates for the economy and its importance to future trade. Providing a detailed picture of future growth markets and the UK's current ability to serve them, it sets out key recommendations to help policymakers and industry grow existing trade relationships and unlock new markets – keeping this vital sector at the heart of the UK's future trade strategy.

A handwritten signature in blue ink, appearing to read 'MH', with a long horizontal line extending to the right.

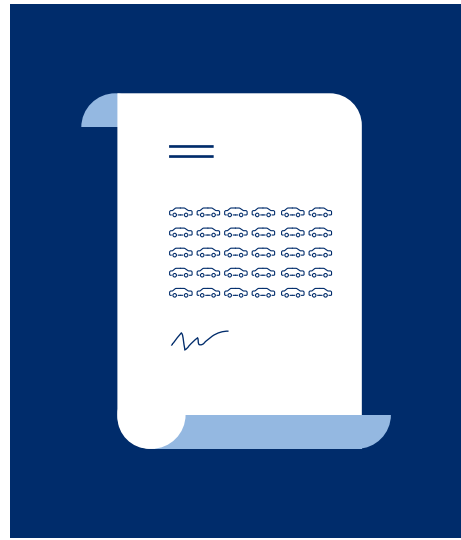
Mike Hawes Chief Executive

The Society of Motor Manufacturers and Traders (SMMT)

2019 HIGHLIGHTS: £100BN AUTOMOTIVE TRADE FOR THIRD CONSECUTIVE YEAR



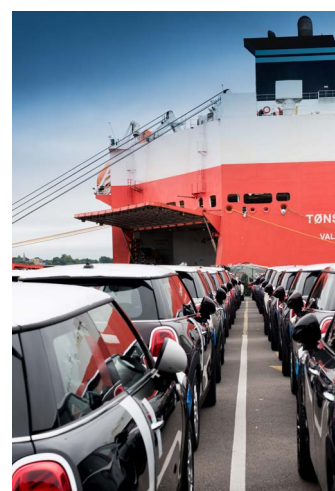
TEN RECOMMENDATIONS FOR GOVERNMENT AND INDUSTRY



- 01 PLACE AUTOMOTIVE AT THE FOREFRONT OF A LONG-TERM TRADE STRATEGY
- 02 SECURE AMBITIOUS DEALS WITH KEY TRADING PARTNERS
- 03 DEFUSE INTERNATIONAL TRADE TENSIONS
- 04 A TRADE AGENDA BACKED BY UK AUTOMOTIVE BUSINESSES
- 05 DELIVER ON BUSINESS MARKET ACCESS NEEDS
- 06 CAPTURE GLOBAL GROWTH
- 07 FACILITATE BUSINESS-FRIENDLY CUSTOMS PROCESSES
- 08 BUILD FLEXIBILITY AND RESILIENCE
- 09 ALIGN UK TRADE AND AUTOMOTIVE INDUSTRIAL STRATEGY AMBITIONS
- 10 SUPPORT THE INDUSTRY'S RECOVERY FROM COVID-19 DISRUPTION

UK AUTOMOTIVE TRADE IN 2019

- UK automotive trade was worth more than £100 billion for the third consecutive year.
- The sector retained its position as the UK's largest exporter of industrial goods despite increasingly challenging business conditions and a widening sectoral trade deficit amounting to £15.5 billion.
- The share of imported cars and commercial vehicles hit a new record, representing 88.6% of all UK registrations, while EU car producers and suppliers remained the preferred trading partner for the UK's consumers, manufacturers and importers.
- Unprecedented surplus for trade in engines shows the strength of domestic industry in this market segment.



TOTAL AUTOMOTIVE TRADE

Before the outbreak of Covid-19 forced the industry into an abrupt halt, the UK automotive sector remained a major catalyst of international trade exchanges.

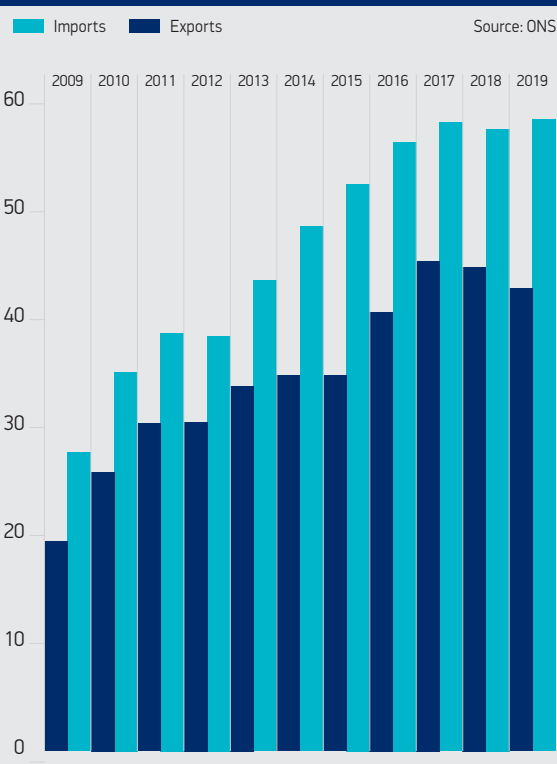
In 2019, the total value of trade generated by import and exports of motor vehicles, parts and components amounted to just over £100 billion. Trade in automotive products remained stable – with a decrease of just £1.1 billion compared with 2018 – and passed the £100 billion mark for the third consecutive year (ONS).

Despite increasingly challenging international trade conditions, the sector retained its role as the UK's largest exporter of industrial goods. Exports of UK motor vehicles, parts and components were worth £42.4 billion, amounting for 13.0% of all manufactured goods exports and 6.0% of the UK's total exports, including services (ONS).

However, although the overall value of automotive trade remained almost unchanged in 2019, the commercial balance saw a substantial deterioration. The automotive trade deficit increased from £12.7 billion to £15.5 billion, a 22.0% annual increase. The highest deficit for the sector since 2016 comes from a £0.8 billion increase in the value of automotive imports, while the value of UK automotive exports decreased by almost £2 billion (ONS).

The record-breaking value of automotive imports enables unparalleled choice for UK consumers and efficiency gains for domestic manufacturers. The slowdown in exports is a result of a combination of weak demand, as well as global trade and industrial challenges.

CHART 1 Total automotive by trade value (£100 million)



EXPORTS OF UK FINISHED VEHICLES

A widening sectoral trade deficit is not surprising, considering that a slowdown in exports has had significant repercussions on an industry that has consistently shipped the vast majority of its entire production to overseas markets..

In 2019, the UK automotive sector remained firmly export-focused, with 81.0% of UK-built cars and 58.9% of domestically-produced commercial vehicles (CVs) shipped abroad.

However, both cars and CVs saw the total number of exported units decline. The volume of cars destined for overseas markets dropped to 1.05 million vehicles, down by -14.7%. Exports of UK-built CVs declined by -8.7% on a year-on-year basis, with 46,000 exported units.

Weakened consumer and business confidence, slower demand in key export markets, growth in overseas capacity of some UK manufacturers, and a shift from diesel across Europe, are some of the major factors contributing to this bearish trend.

Notwithstanding these considerable headwinds, road vehicles remained by far the UK's most valuable exported industrial commodity, worth almost £38.4 billion and accounting for 10.5% of all the UK's merchandise exports (HMRC).¹

The automotive sector's economic relevance is measured by it maintaining the lead position as the UK's main exported commodity. This is in spite of three years of decline in overseas shipments and an increasingly hostile trading environment, with 47 new harmful interventions implemented worldwide affecting the trade of motor vehicles – including new tariffs, import substitution schemes and potentially trade-distortive export support measures (Global Trade Alert).

¹ ONS and HMRC trade data differs slightly due to different methodologies, see Annex on Data Sources

CHART 2 UK vehicle production for export market by volume

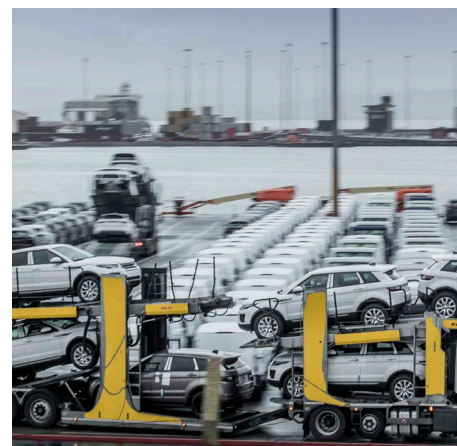
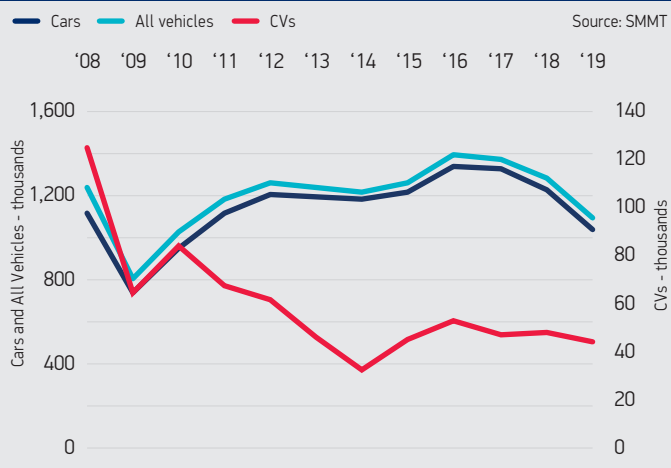
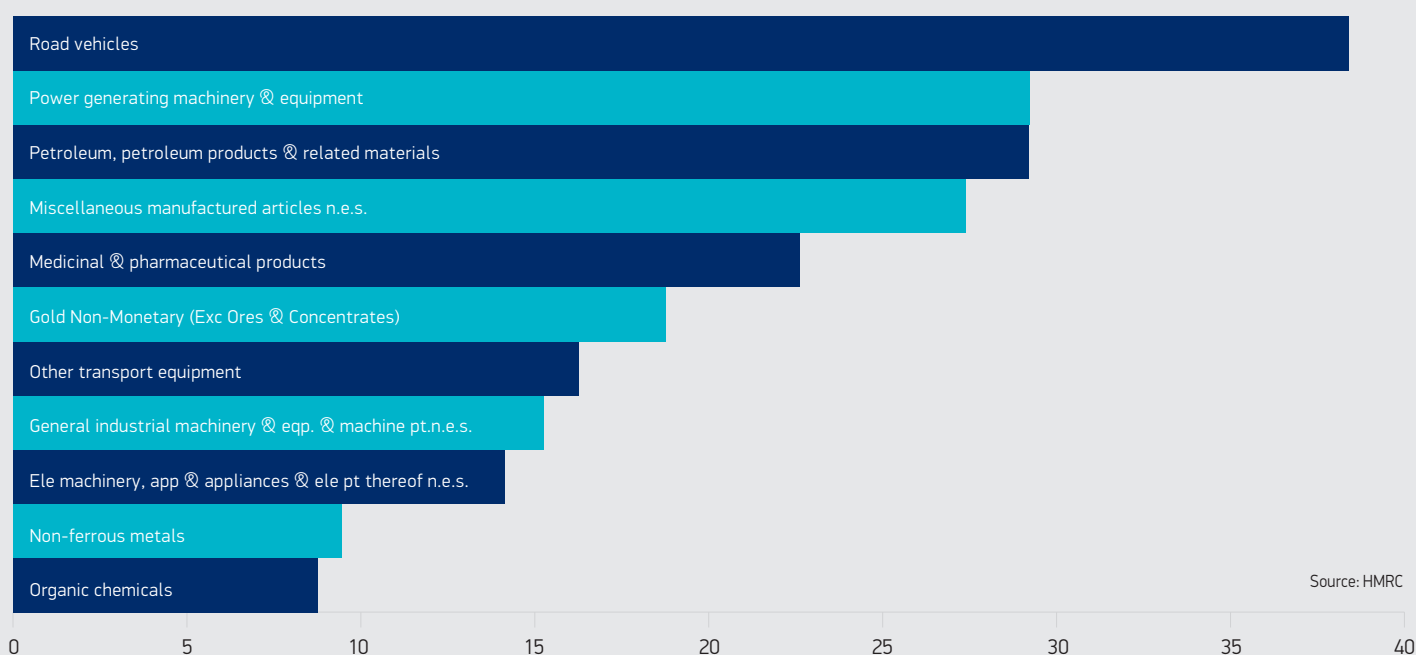


CHART 3 Top 10 UK goods exports 2019 (value) £100 million



The general slowdown in exports was driven by a decrease in overseas shipments of UK volume and premium vehicles, which constitute the vast majority of the sector’s manufacturing portfolio. In contrast, exports of luxury and sports vehicles to high-value markets confirmed a greater level of resilience to declining global demand. UK small volume manufacturers (SVMs) exported more than 25,000 units in 2019, with this industry segment registering a second consecutive year of sustained growth.

Combined, the larger European region (including EU and non-EU countries) and the Americas received 82.7% of all UK cars destined abroad, while the Asian markets’ share decreased from 14.8% to 13.6%.

The EU remained the dominant export destination for UK-built volume vehicles. The EU also received the highest share of UK premium vehicle exports, although this market segment distributed its goods more evenly across the European, the Americas and Asian regions compared with volume manufacturers. The Americas and Asian markets were the top export destination by volume for SVMs (SMMT).

Road vehicles remained by far the UK’s most valuable exported industrial commodity, worth almost £38.4 billion.

CHART 4 UK car exports by type (volume)

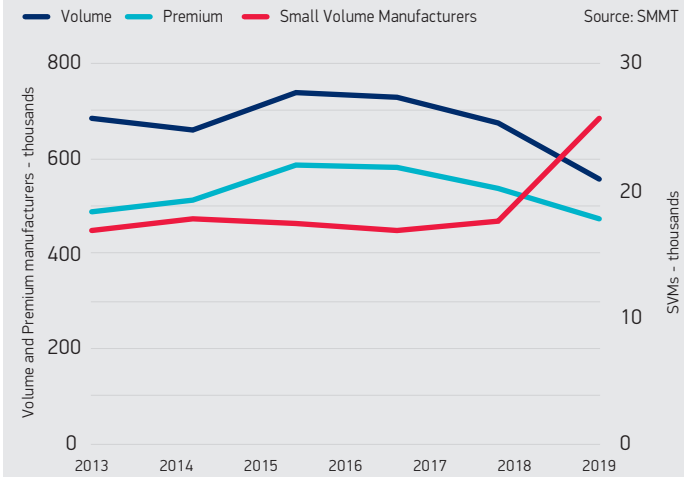


CHART 5 UK 2019 car exports by destination (volume)

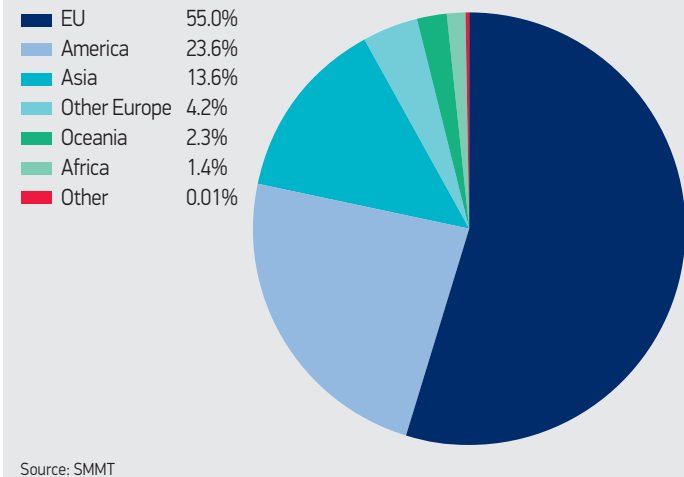
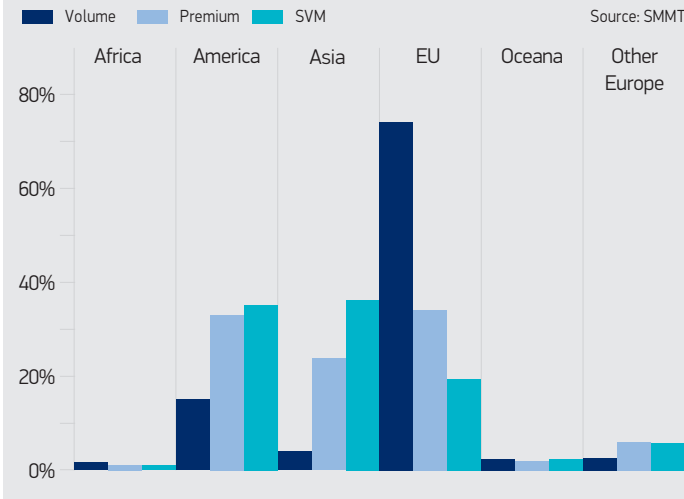


CHART 6 Export destination by vehicle type



The world's four biggest economies remained the main export markets for UK cars. In line with the general trend, manufacturers of volume and premium vehicles saw their exports decrease to the EU, USA, Japan and China, while SVMs' sales increased. Canada gained three positions to become the fifth-biggest export destination for UK-built cars. Ukraine and Israel were the only export markets to expand among the top 10 and replaced Turkey and Switzerland as the main neighbouring Euro-Mediterranean export destinations outside of the EU.

Despite a decrease in the volume of car shipments, both the EU and the USA saw a significant increase in their relative weight as UK carmakers' preferred export destinations. The EU received 55.0% of all UK exported cars, up by 2.4% year-on-year, while the US accounted for 19.0% of UK car exports, with a 1.1% relative growth compared with 2018.

The decrease in exports to Asian markets was mainly due to a sustained decline in shipments of UK-built cars to China for the third consecutive year, a decrease in car exports to Japan and a -52.3% drop in exports to South Korea (SMMT). In value terms, the slowdown in exports to Japan was the first since 2014, while the value of UK car exports to Korea decreased for the first time since the conclusion of the EU-Korea FTA in 2011 (HMRC).

IMPORTS OF FINISHED VEHICLES

The share of imported cars and light commercial vehicles (LCVs) in the UK's domestic market hit new heights last year.

Imported LCVs represented a record-breaking 95.8% of UK's new registrations. The higher volume of imported LCVs was the main driver of a 2.4% annual increase for the UK's van market, with more than 13,000 additional imported LCVs compared to 2018. Growth in LCVs imports was likely the result of UK buyers wishing to switch to the latest low emission models to comply with clean air zone requirements, and to meet demand brought about by the rise of online shopping and corresponding deliveries (SMMT).

For passenger cars, despite a -2.3% decrease for the UK's new car market and a third consecutive year of decline in the absolute number of units shipped to the UK, imported cars represented 88.6% of all UK registrations, up 0.7 percentage points over 2018, the highest share on record (SMMT).

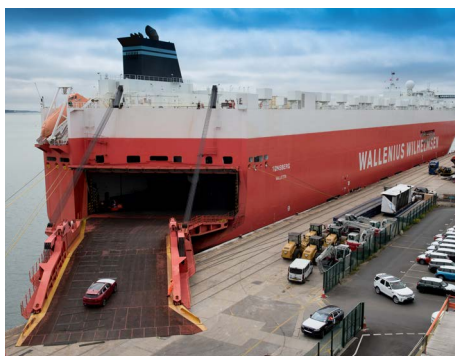


CHART 7 Top 10 car export destination by volume (Thousands)

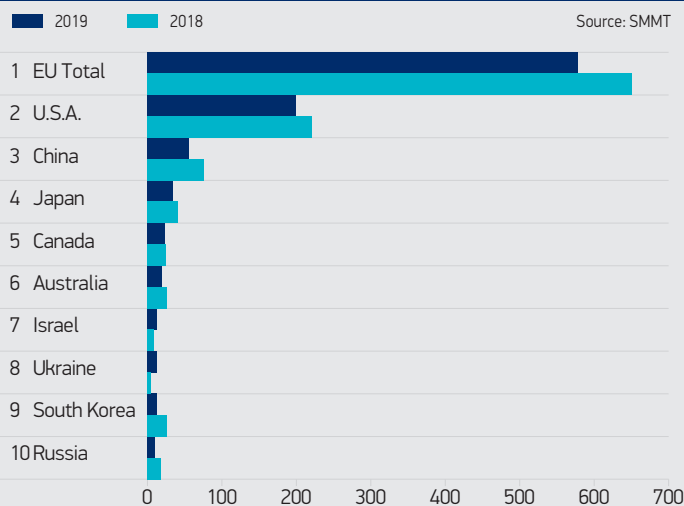


CHART 8 UK registrations of imported LCVs by volume

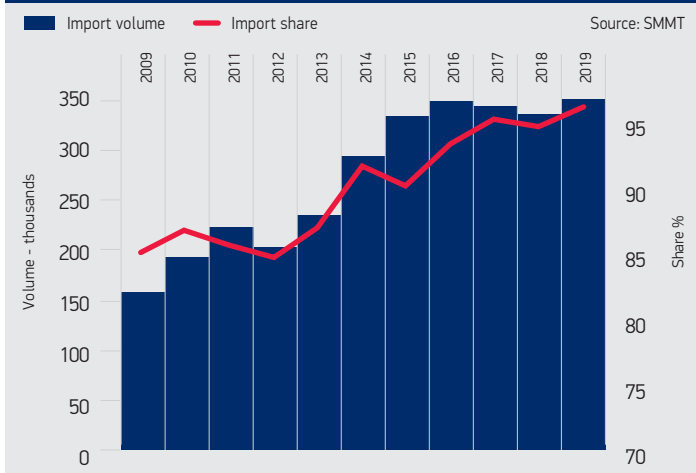


CHART 9 UK registrations of imported cars by volume

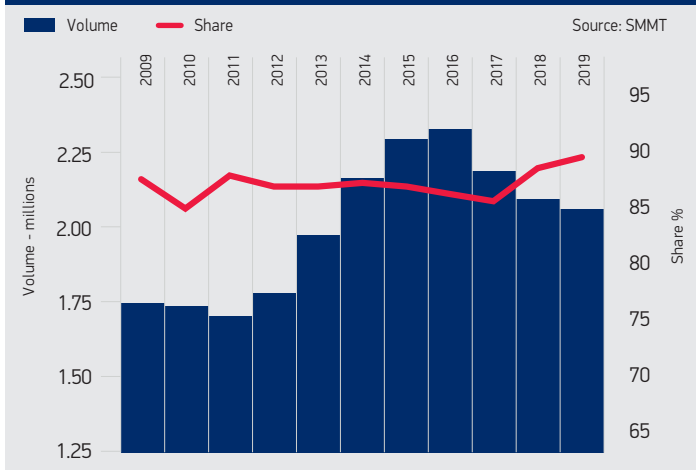
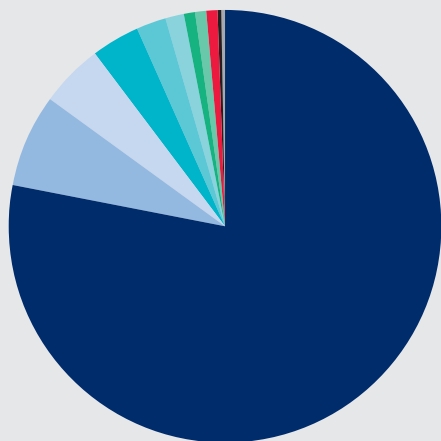


CHART 10 Imported car registrations by origin 2019 (volume)

EU	78.1%
Japan	7.0%
South Korea	4.8%
Turkey	3.5%
South Africa	2.3%
USA	1.5%
China	0.8%
Morocco	0.8%
India	0.7%
Thailand	0.2%
Others	0.3%



Source: SMMT

The EU remains the dominant trading partner in terms of car imports, with almost 1.6 million units shipped to the UK, covering 78.1% of all new imported car registrations, up 0.3% over the previous year (SMMT).

Considering individual EU member states, the UK new car market showed a decline in shipments from Germany, with almost 56,000 fewer German-made cars registered in 2019. However, Germany remained by far the top EU car exporter to the UK, with almost 700,000 newly registered units. Spain consolidated its position as the second-biggest EU import market, with almost 285,000 cars shipped to the UK and an annual uplift of more than 45,000 cars. UK-built vehicles lost their position as second-biggest source of cars for the domestic market and are now third behind Germany and Spain. Imports from France, Romania and Austria increased by more than 7,000 units each (SMMT).

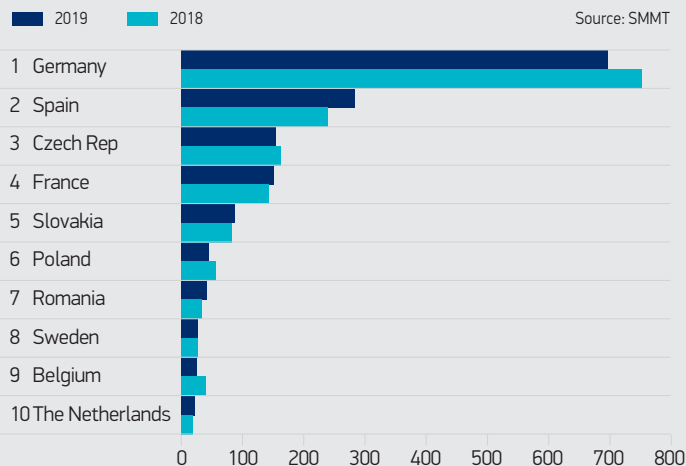
Japan consolidated its position as the second-biggest exporter of cars to the UK behind the EU, with 144,000 units shipped to the UK, an uplift of more than 8,000 vehicles. Cars of Japanese origin covered 7.0% of all new registered vehicles imported into the UK, a 0.5% increase compared to 2018 (SMMT).

ENGINES TRADE

Trade in petrol and diesel engines was worth £3.7 billion in 2019, with a -10.1% decrease in value over 2018. The slowdown was mainly driven by a continuous decline of engine imports.

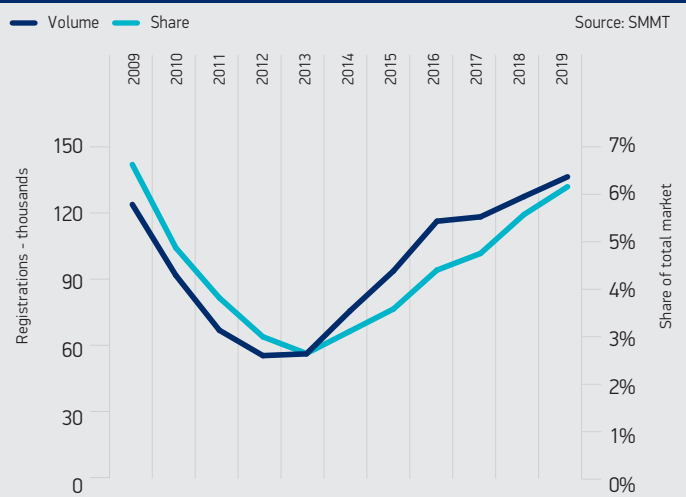
Contrary to other market segments, trade in engines continues to register a significant trade surplus. Despite a slight decline in the value of exported UK engines, the surplus hit a record-breaking £2 billion.

CHART 11 UK new car registrations - top 10 originating from EU* (Thousands)



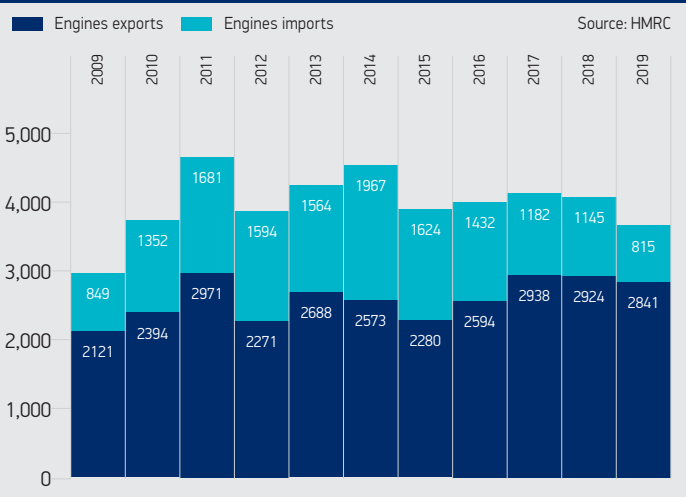
Source: SMMT

CHART 12 UK new car registration - originating from Japan (volume)



Source: SMMT

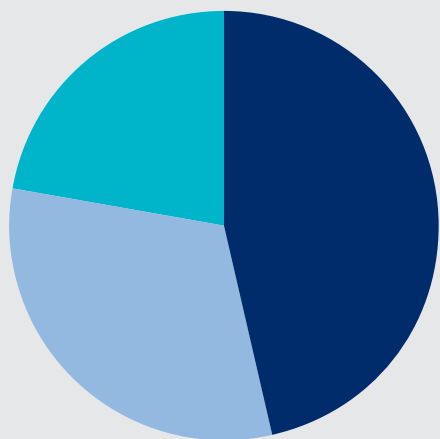
CHART 13 Total engine trade value (£ millions)



Source: HMRC

CHART 14 UK engines exports 2019 (Value)

EU	46.6%
Turkey	31.3%
ROW	22.1%



Source: HMRC

The UK remains an engine manufacturing powerhouse for the broader European automotive supply chain. The combined value of engine exports to the EU and Turkey was more than £2.2 billion in 2019, covering 77.9% of engine exports, up by 2.7%. The increase was driven by a 3.2% uplift in the value of engine exports to EU markets, now worth more than £1.3 billion. The share of exported engines' value directed to Turkey remained stable (31.3%) (HMRC).

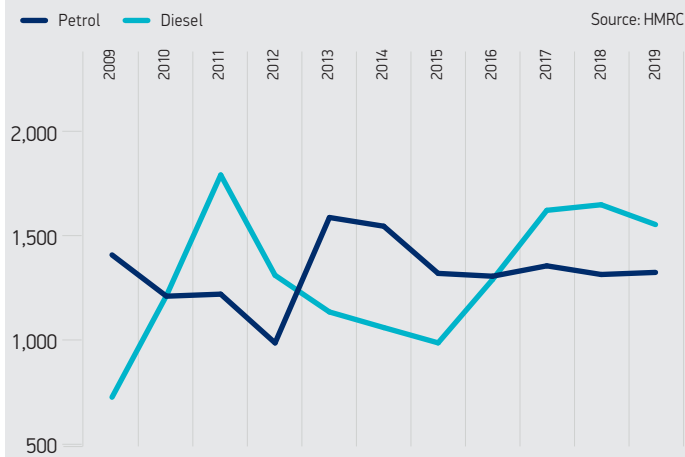
Exports of diesel engines were worth more than £1.5 billion for the third consecutive year, despite a -5.7% drop. The value of petrol engine shipments overseas flattened at £1.3 billion.

On the import side, the value of shipments of engines to the UK from markets overseas declined by -28.7% to a total £815 million, the lowest value since 2001 (HMRC). Engine imports show a sustained downward trend since 2014. Imports from the EU decreased by -42.4%, while the value of imports from extra-EU countries increased by 26.6%, led by the doubling of the value of shipments from Japan.

Reshoring engine production by one major UK original equipment manufacturer (OEM) and the competitiveness of UK engine producers are likely to be the key drivers of this drop in the imports' value. The UK's downward trend in domestic car manufacturing and the slowdown in demand for diesel engines might also be contributing factors.

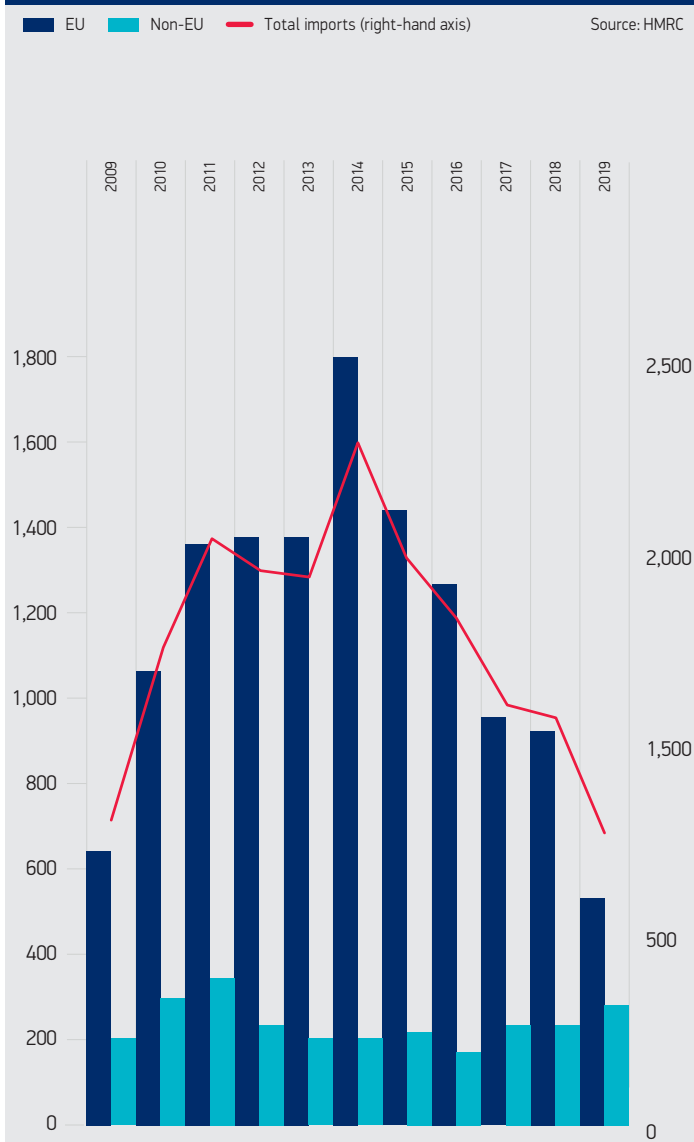
The UK remains an engine manufacturing powerhouse for the broader European automotive supply chain

CHART 15 Engines exports by engine type (value) (£ millions)



Source: HMRC

CHART 16 Imports of engines (£ millions)



Source: HMRC

TRADE OF PARTS AND COMPONENTS

After five years of continuous growth, the total value of trade in automotive parts and components slightly decreased by -3.4% in 2019, falling just below £18 billion.

Both imports (-2.9%) and exports (-4.8%) of parts and components registered a slowdown. Given the large share of imports over the total value of trade in parts and components, the decline resulted in a -1.5% reduction of the trade deficit for this crucial industry segment, now standing at £7.8 billion.

Exports of UK parts passed the £5 billion mark for the third consecutive year, despite the decrease in shipments both to EU and non-EU destinations. Shipments to the EU were valued at £3.5 billion, while exports to the rest of the world were worth £1.5 billion.

EU suppliers remained the dominant trading partner of UK OEMs and automotive importers. Despite a small -1.8% decline in value terms, imports of EU parts and components were worth more than £10 billion for the third year in a row. Imports from the rest of the world amounted to £2.4 billion, with an annual decrease of -7.0%.

Exports of UK parts passed the £5 billion mark for the third consecutive year

CHART 17 Total trade of parts and components (Value) £ billion

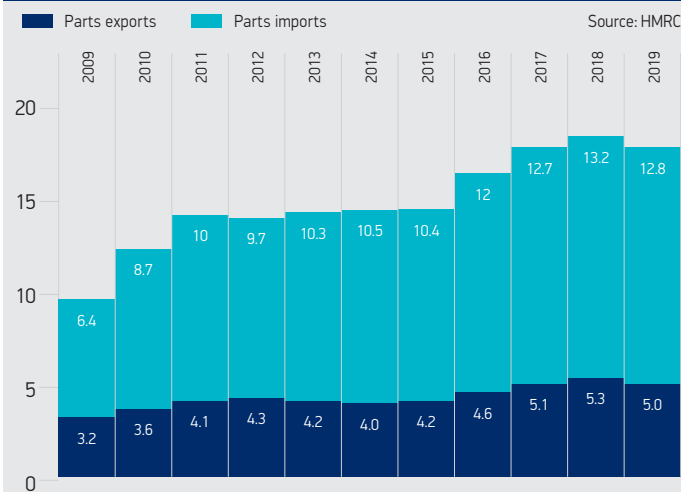


CHART 18 Exports of parts, accessories and components (£ billions)

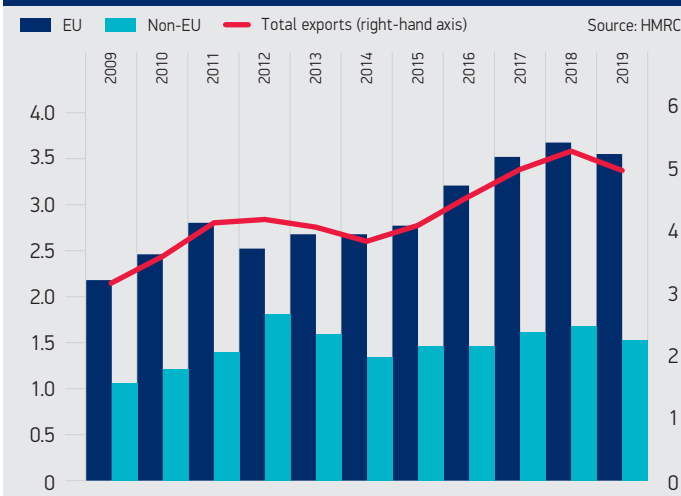
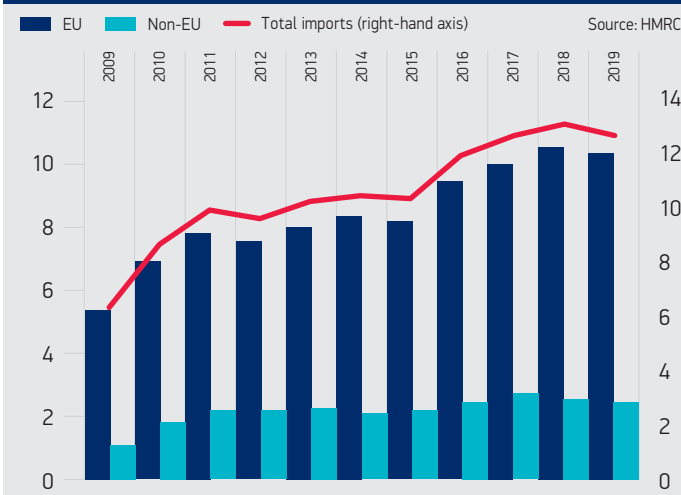


CHART 19 Imports of parts, accessories and components (£ billions)



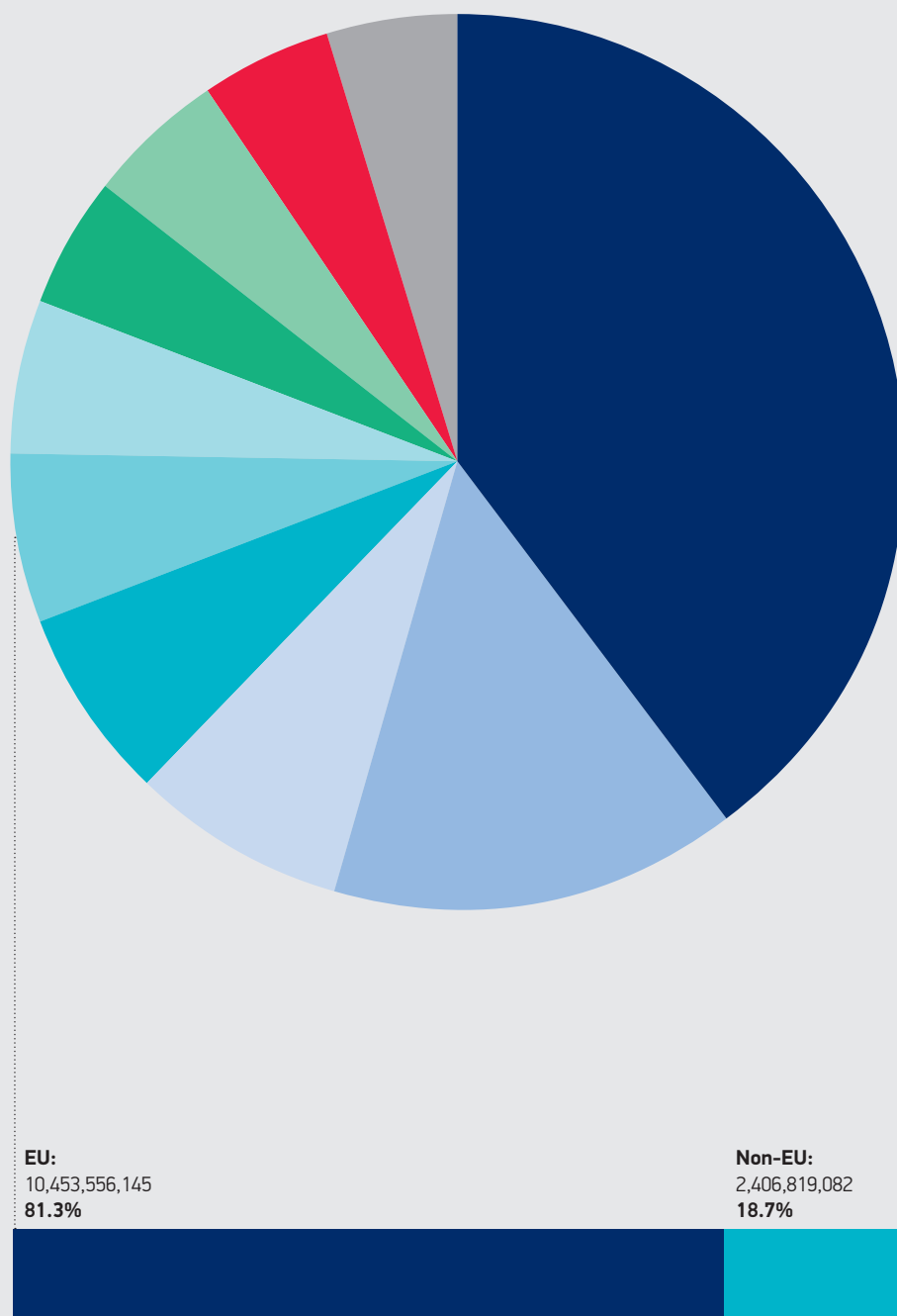
Thanks to a 6.1% increase in the value of shipments of parts and components, the US overcame China and Japan to become the second-biggest import market after the EU. A break-down analysis of top import markets, including individual EU member states, sees Germany topping the ranking with exports worth more than £4 billion, followed by France and Poland.

Resuming a trend brusquely halted by the explosion of the Covid-19 pandemic at the beginning of 2020 requires a robust restart of a highly integrated international supply chain. In the short term, this is likely to be the greatest challenge faced by the UK automotive industry since the end of the Second World War. However, even greater challenges loom ahead to secure the sector's viability in the medium-term and ensure the UK automotive industry will thrive in the future. Many of these challenges will demand ambitious trade policy solutions.

Chart 20 Top-10 UK imports markets for parts, accessories and components in 2019

Rank	Import Market	£ (Values)	% Total
1	Germany	4,038,893,120	31.4%
2	France	1,500,367,162	11.7%
3	Poland	777,637,185	6.0%
4	Italy	710,466,121	5.5%
5	Spain	621,342,556	4.8%
6	Czech Republic	567,599,719	4.4%
7	United States	497,208,488	3.9%
8	China	496,353,344	3.9%
9	Belgium	479,143,214	3.7%
10	Japan	458,093,718	3.6%

Source: HMRC





COVID-19: IMPACT AND RESTART

- The Covid-19 outbreak has wreaked havoc on the global economy and international trade.
- Global and UK automotive industries halted as governments worldwide enforced economic and social lockdowns to combat the pandemic.
- Financial support and job-retention schemes are crucial to keep businesses operational, but the stimulus packages might be needed to support demand as short-term sales and production forecasts remain uncertain.

IMPACT ON GLOBAL ECONOMY AND TRADE

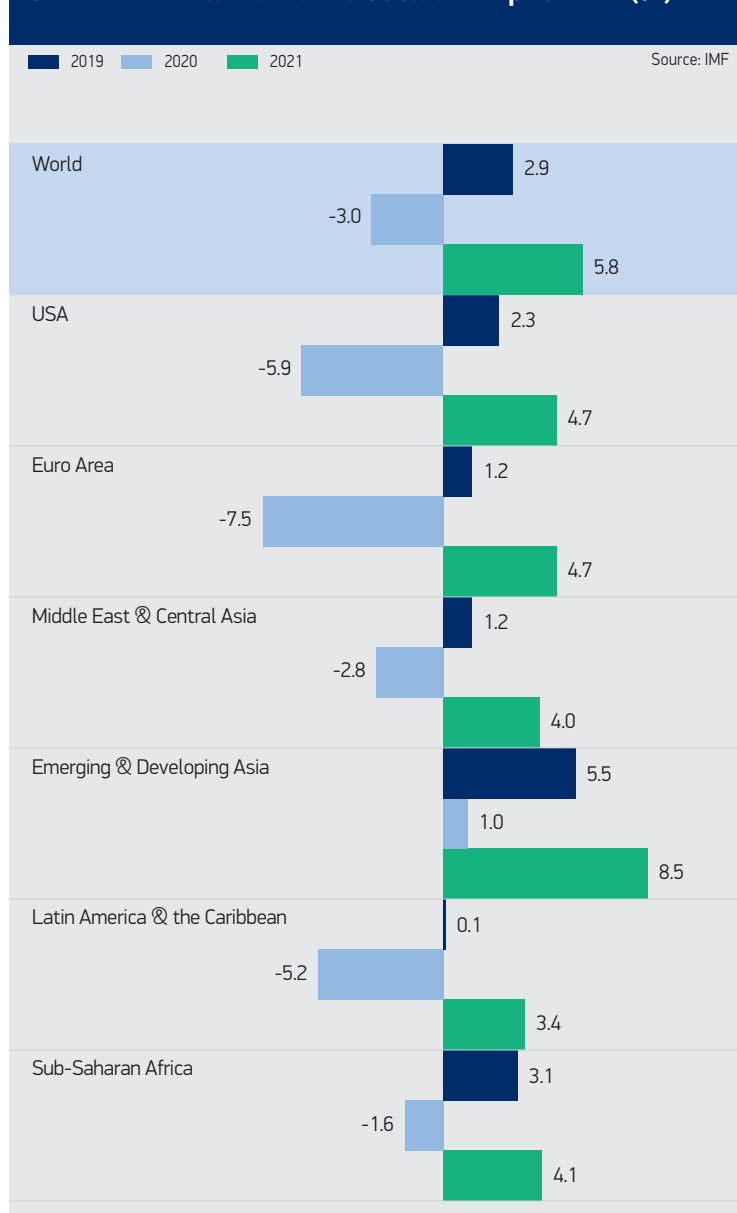
The coronavirus pandemic has gravely affected the global economy and is posing unprecedented challenges for international trade, supply chains and businesses of all sizes. The Covid-19 outbreak triggered extraordinary lockdowns across the world, resulting in a global shock to supply and demand. Businesses and factories were forced to close, citizens were confined to their homes, while commodities, currencies and stock markets plunged. Overall economic activity collapsed around the world at the onset of an unprecedented synchronised downturn.

The fallout from the pandemic looks to be one of the biggest shocks in generations. The economic backdrop has deteriorated rapidly and the global economy is already in a recession. GDP growth expectations have turned negative in most countries. The recent forecast from the International Monetary Fund (IMF) predicts that the world economy will shrink by -3.0% this year, a far bigger contraction than the -0.1% experienced in 2009. The IMF projects that the UK economy will see its economy contract by -6.5% this year – the biggest slump since 1921. Other European countries will experience similar contractions, with Italy shrinking by -9.1% and Spain by -8.0%. Referring to the fight against the pandemic as ‘The Great Lockdown’, the IMF also pointed out that the recession could be even deeper than its central forecast if the coronavirus pandemic causes even lengthier shutdowns around the world in the coming months.

To try and support economies reeling from government-enforced economic and social lockdowns aimed at combating the outbreak, governments and central banks around the world have unleashed unprecedented amounts of fiscal and monetary support.

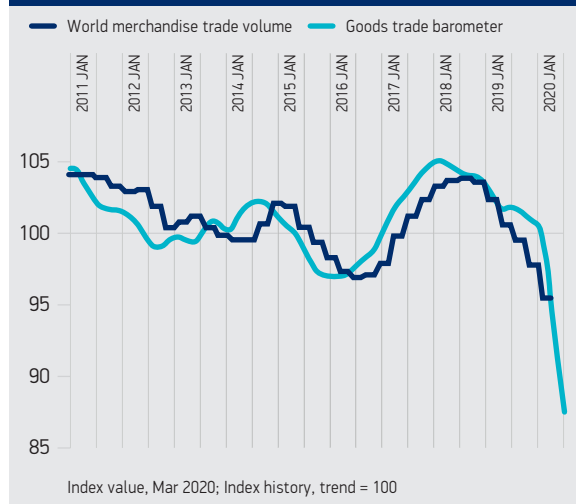
International trade is not immune from the fallout and is set to drop precipitously in the first half of 2020 as coronavirus wreaks havoc on global supply chains and consumer demand. Global trade is projected to fall by between -13.0% and -32.0% this year, according to the latest WTO projections. The WTO’s quarterly goods trade barometer, which provides real-time information on the trajectory of world merchandise trade relative to recent trends, slumped to 87.6 in Q1 2020, on a scale where anything below 100 indicates a downturn. The reading was the lowest value on record since the indicator’s launch in July 2016, suggesting a sharp contraction in world trade extending into the second quarter of 2020. Shipments of automotive products were the weakest of all, owing to collapsing car production and vehicle demand in major economies.

CHART 21 World Economic Outlook - April 2020 (%)



The pandemic has affected international trade exchanges that were already suffering from a significant deterioration in the global trade environment even before the outbreak. The volume of world merchandise trade shrank by -0.1% in 2019, marking the first annual decline since the global financial crisis in 2009, according to the WTO. At the heart of the 2019 slowdown were trade tensions between the US and China, resulting in the world's two biggest economies ramping up tariffs on each others' goods. If US-China trade tensions flare-up again and uncertainty over the UK's future trading relationship with the EU continues, these factors could damage the recovery from the current Covid-19 crash and exacerbate the impact.

CHART 22 WTO Goods trade barometer



While the long-term effects of Covid-19 on the industry are difficult to predict, the latest indicators and forecasts do provide some insight into the scale of the challenge ahead.

IMPACT ON THE GLOBAL AUTOMOTIVE INDUSTRY

The effects of Covid-19 have had an equally seismic impact on the automotive industry. The crisis has significantly hurt liquidity, supply, production and demand. Initial concerns over disruptions to supply chains in China were quickly pivoted to large scale shutdowns of assembly plants and car dealerships globally, impacting their tier 1, tier 2 and tier 3 suppliers. Similarly, production and vehicle sales dropped abruptly in most countries, causing the industry to come to a grinding halt. As a result, already wafer-thin margins in a highly competitive sector came under pressure, leading to sharp falls in revenues for most car manufacturers and suppliers around the world. Some of the most affected regions are major production hubs and home to critical links in the sector's highly intertwined global supply chain.

There is no doubt that the Covid-19 crisis has emerged as the single biggest risk factor facing the automotive industry for many years. It has piled intense additional pressure on an already stressed industry. International trade tensions, Brexit uncertainty that caused an investment freeze, lack of clarity over the future trade environment and more onerous emissions regulations, combined with the transformation to electrification and digitalisation, among other issues, were already weighing heavily on the industry.

While the long-term effects of Covid-19 on the industry are difficult to predict, the latest indicators and forecasts do provide some insight into the scale of the challenge ahead. The latest available data indicated that global light vehicle registrations in April fell by -47.5% to 3.8 million units (compared with 7.2 million a year ago), according to JATO Dynamics. This represents the largest year-on-year monthly decrease since 1980, surpassing even the global financial crisis in November 2008, which saw a -25.0% decline in registrations. April's results mean that in the first four months of 2020, the global light vehicle market has witnessed a -32.0% decline compared with the same period in 2019 – a decline that nobody in the industry would have anticipated just a few months previously.

As countries relax strict lockdown measures, there are some timid encouraging signs for the global automotive industry. In particular, car registrations in China, the world's largest automotive market, rose for the first time in almost two years in April as pent-up demand unleashed by the lifting of lockdowns gave the struggling sector a boost. However, the rebound came after registrations tumbled -79.0% in February and by -43.0% in March, and the market remains on course for a third consecutive annual decline in registrations.

For countries at the height of the crisis at the time of writing, a rebound in automotive demand remains unpredictable. In Europe, registrations plunged -78.0% in April following a -52.0% decline in March as lockdowns were introduced across Europe. April recorded double-digit declines in all European markets, with Italy down almost -98.0%, the UK down more than -97.0%, Spain down -96.0%, France down -89.0% and Germany down -61.0%, according to ACEA data. Meanwhile, in the US, new passenger car and light truck registrations plummeted by -47.9% year-on-year in April. These monthly declines resemble, or are even worse than, those seen during the industry downturn in 2008 and 2009. However, at that time, production and public life did not largely come to a halt.

Germany's economy is very reliant on the auto industry and car dealerships were one of the first businesses able to reopen on 20 April. Registrations in the EU have dropped about -40.0% during the first four months, in a sign that a full recovery will take some time. However, dealerships have now reopened in most EU markets and automakers have started reopening plants, fuelling hopes that April will mark the trough, followed by a recovery similar to that in China.

IMPACT ON UK AUTOMOTIVE

Closer to home, it has been a similar story for the UK's car market, which all but ground to a halt in April. New car registrations plunged by more than -97.0% as just 4,321 new cars were registered, after car showrooms were told to close as part of attempts to limit the spread of the virus. The performance compared with 161,064 registrations in the same month last year, and was the weakest since 1946 when the UK was emerging from war and resources were still rationed – highlighting the historic extent to which pandemic restrictions have hit the industry and the wider economy. In May, new car registrations fell -89.0% as 'click and collect' services, allowed from mid-month, enabled some movement in the market. However, with 163,477 fewer registrations than in the same month last year, the performance still marked the lowest May since 1952. In the first quarter of 2020, the overall UK new car market was down -43.0%, with 487,878 cars registered. Similarly, the UK new light commercial vehicle (LCV) market declined -86.2% in April as just 3,387 LCVs joined UK roads, (21,217 fewer than in the same month last year). In May, the UK new LCV market fell -74.1%, with the majority of vehicles delivered to fleets running food distribution, home delivery, utilities, broadband and emergency services operations.

Meanwhile, car production fell to its lowest level since the Second World War in April, down -99.7%. Output for both the domestic and overseas markets was severely curtailed in the month, with just 152 cars built for export and 45 for customers in the UK. The month was exceptional even when compared with a particularly weak April 2019, when volumes fell -44.5% year-on-year due to temporary shutdowns as manufacturers sought to mitigate the impact of an expected end-March 2019 Brexit.

SHORT-TERM SALES AND PRODUCTION OUTLOOK

At a global level, analysts continue to revise their forecasts downward in the face of the fallout and growing uncertainty, even as the global automotive industry stirs to life again. LMC Automotive, which closely tracks automotive registrations and production trends, said it expects global light vehicle sales to fall -21.6% to 70.8 million units in 2020, from prior estimates of a circa -12.0% drop. LMC also estimates global light vehicle production to drop -20.2% to 71.0 million units in 2020, with the biggest disruption coming in the first half of the year. Both registrations and production are expected to bounce back by around 15.0% or more in 2021, however, factors that could temper optimism include a loss in consumer confidence, fear of a second wave of infections and a lack of urgency to buy new cars, especially if appropriate incentives are not put in place.

The outlook for the UK new car market is equally uncertain. Demand levels are expected to be weak, given the broader weak economic setting, low consumer and business confidence and, in most cases, constrained cash flow. Some consumers may have accrued savings during the lockdown but whether vehicle purchases are then a priority is unclear. There could be increased demand for personal transport, especially with public transport likely to face severe pressures from social distancing, but we could also see changes in working habits – such as increased working from home, and less desire to travel for some time.

SMMT's latest new car market outlook for 2020 has downgraded previous expectations to just 1.68 million registrations. This puts the sector on course to record its lowest performance since 1992's 1.59 million units, below the levels seen during the financial crisis, and some -27.0% or 620,000 fewer units than the 2.31 million new cars registered in 2019. The results in April were collected with dealerships temporarily shut and the country in an enforced 'lockdown', making it very difficult to determine the outlook. Despite this, the BEV market is expected to double in 2020 to 77,300 units as new model introductions bolster the market. Meanwhile, the outlook for the LCV market is a decline of -28.0% in 2020 to 263,210 units. In 2021, registrations are expected to recover by 30.4% to 343,290 units year-on-year.

Concerning production, the UK automotive industry's immediate future looks challenging. An initial assessment commissioned by SMMT of the potential impact of these shutdowns suggests that annual UK car production could fall below one million units in 2020, which would represent lower volumes than in 2009 and possibly a third lower than expected in January pre-crisis.

CHART 23 New car registrations

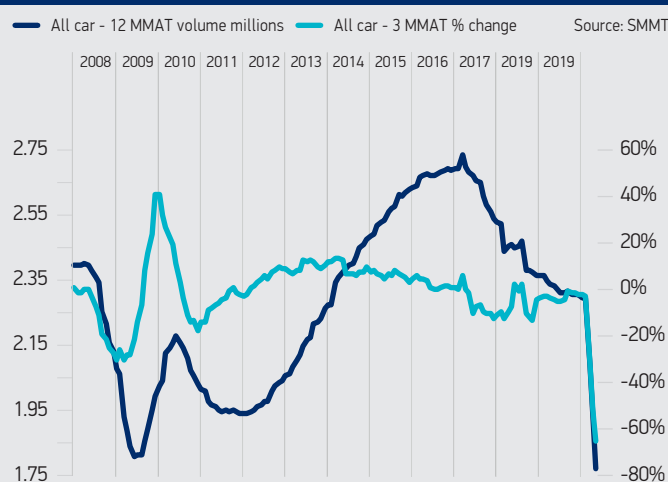
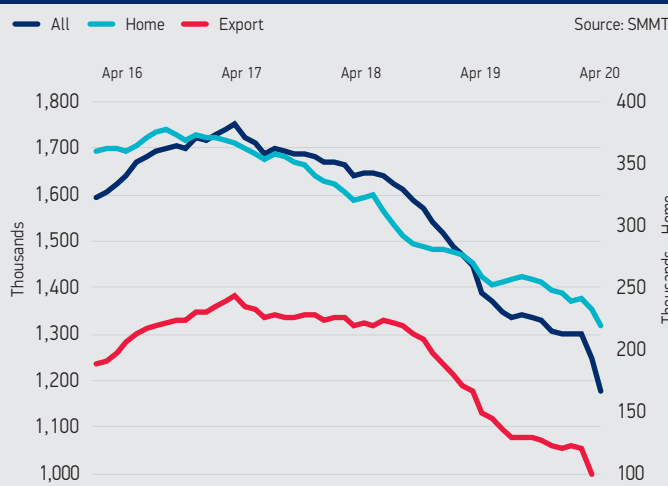


CHART 24 Car production - rolling year



START-UP POST COVID-19

By the time of publication, most UK vehicle production plants are expected to be back up and running again following the Covid-19 related shutdowns. The industry has worked hard to develop new protocols and working practices to better ensure that social distancing measures can be adhered to as much as possible, and that the workforce can return safely.

The pace at which plants can ramp up production is dependent on a variety of factors, including new productivity rates, security of supply chain and of course demand levels.

The new productivity rates will depend upon how much the production process has to vary due to Covid-19 mitigation issues – for example, changing the plant physically to increase social distancing; amending working practices determining the number of people working at a station/ process at any one time; the line-speed; start/end of shift protocols; and break times. Many vehicle production plants have had to change more than 100 different individual work processes.

Suppliers must also undertake all these measures, but because they are smaller and lack the resources of large multinationals, their restart may be more challenging. Covid-19 is likely to lead to increased consolidation in the sector, as suppliers seek to rationalise footprints, overheads and cost bases.

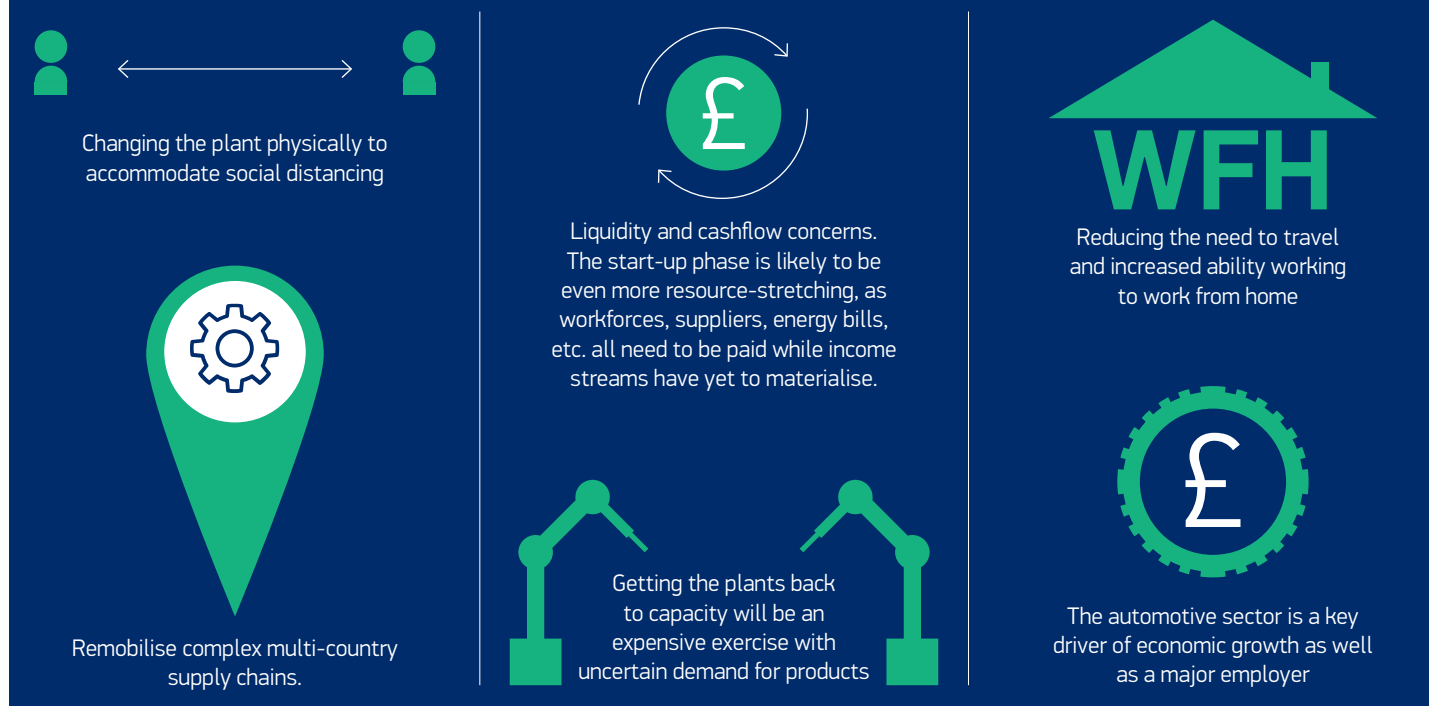
The pace at which plants can ramp up production is dependent on a variety of factors, including new productivity rates, security of supply chain and, of course demand levels.



Moreover, restart and rebound will depend on how quickly the industry can remobilise complex multi-country supply chains. Countries that have been heavily impacted by the outbreak – particularly China, Western-European countries, Japan and South Korea – account for a significant share of global automotive manufacturing. China's Hubei province, the pandemic's epicentre, is one of the country's key automotive production centres. A resurgence of cases in any of these automotive production hubs coupled with potential new lockdowns could have widespread impacts on the whole industry.

As OEMs restart production, many suppliers facing liquidity issues may succumb to market conditions. This can cause potentially large disruptions and have dire consequences across the global automotive manufacturing ecosystem. Suppliers with an exclusive focus on the automotive sector are likely to be most affected, while suppliers with a diversified customer base might be better placed to restart operations immediately, particularly if they are also servicing industries that have expanded during the pandemic outbreak. This is why, in addition to support for automotive suppliers from governments around the globe, it is likely that OEMs will directly intervene both financially and with management support to secure weaker links in their supply chain.

FACTORS WHICH NEED TO BE CONSIDERED AT THE START OF THE RECOVERY



The financial implications of the Covid-19 crisis, with plants idled for weeks, if not months, have been severe. The start-up phase is likely to be even more resource-stretching, as workforces, suppliers, energy bills, etc. all need to be paid while income streams have yet to materialise. The measures the government put in place to protect workforces and businesses have been unprecedented, but industry is likely to need further support, such as access to finance and greater flexibilities with some of the measures. This will include the UK's Coronavirus Job Retention Scheme as workers come back and volumes build up.

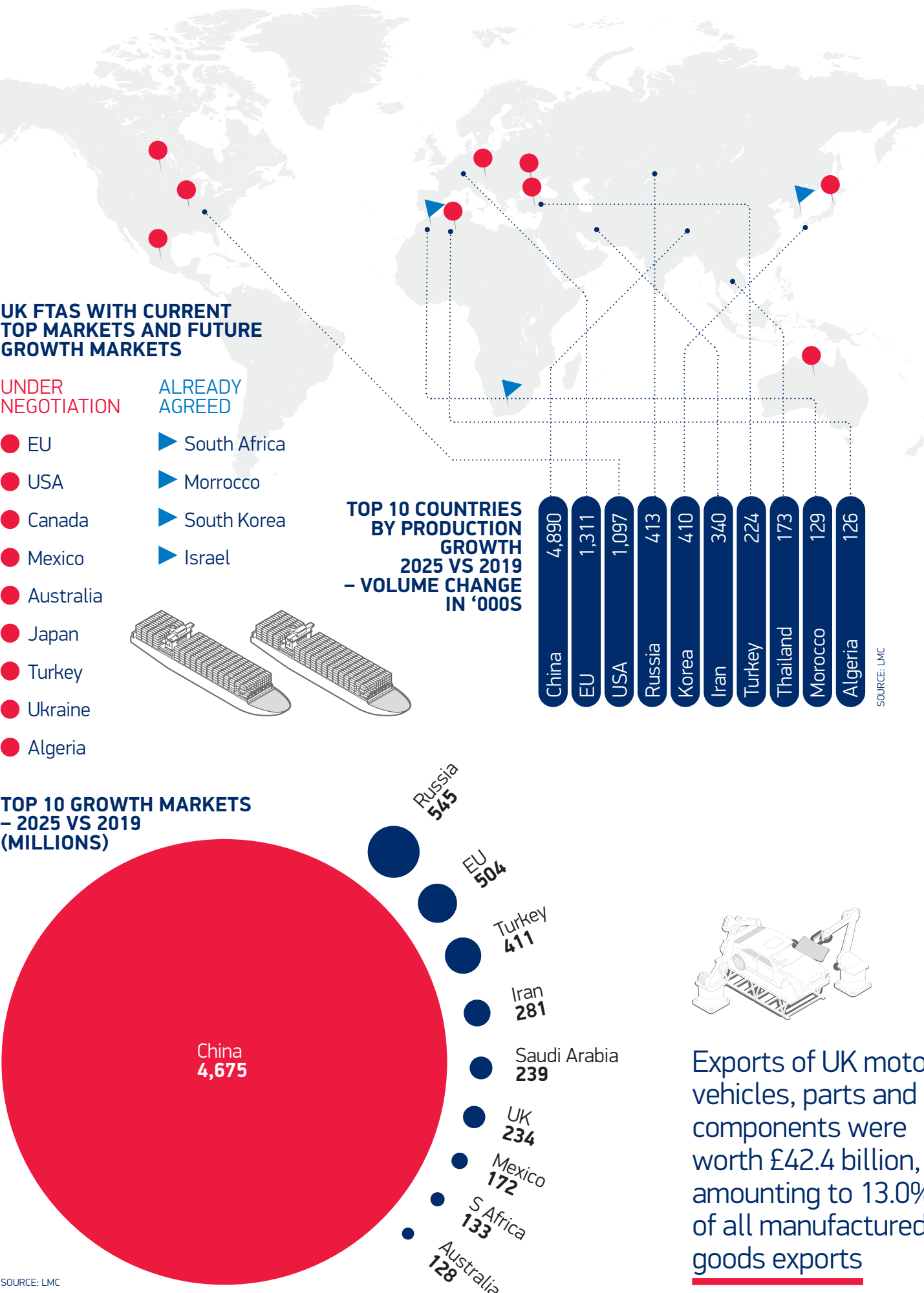
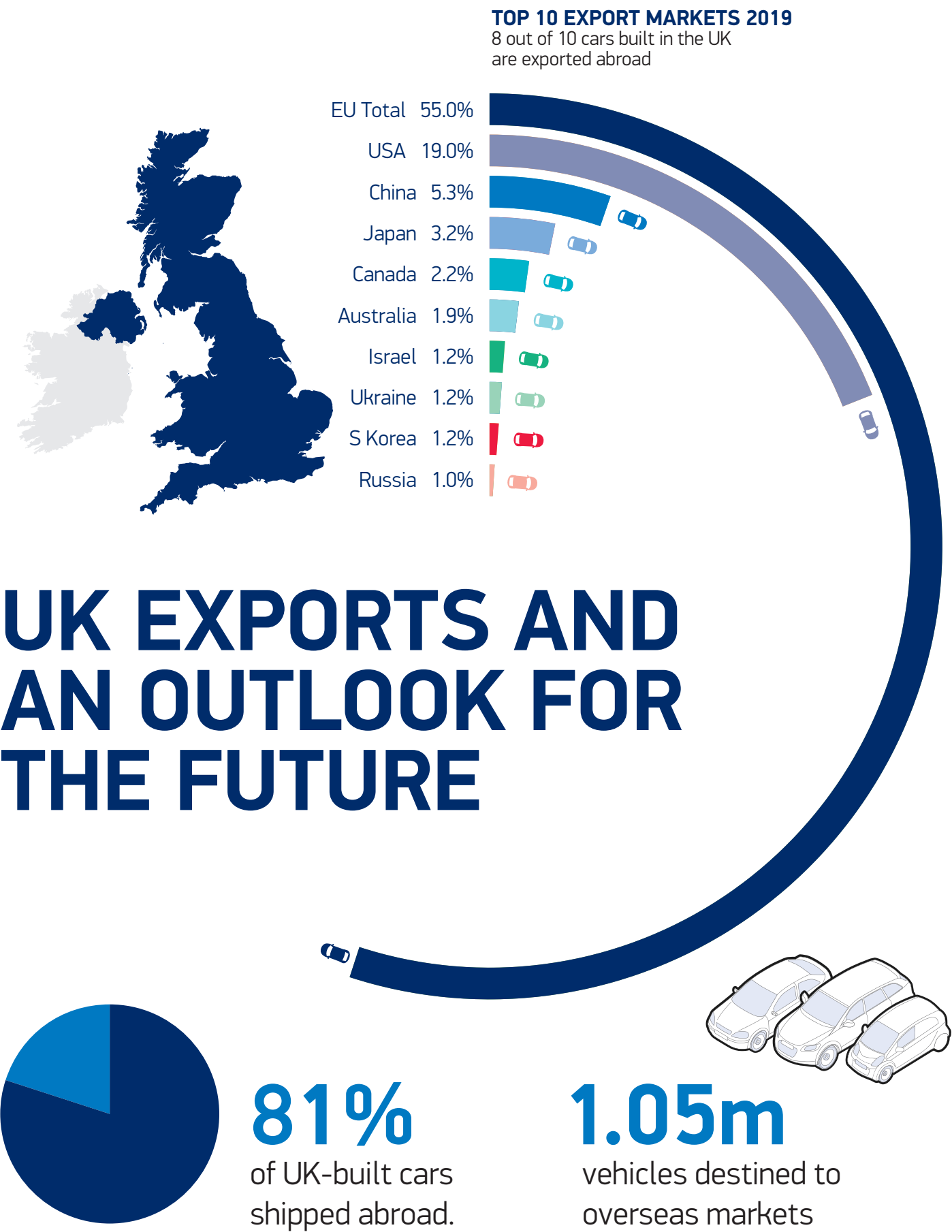
The success of this scheme during the crisis suggests the measures should be kept in place for as long as needed to restart the industry. However, the UK could also consider maintaining a similar mechanism beyond Covid-19, following international best practices such as the German *kurzarbeit*.

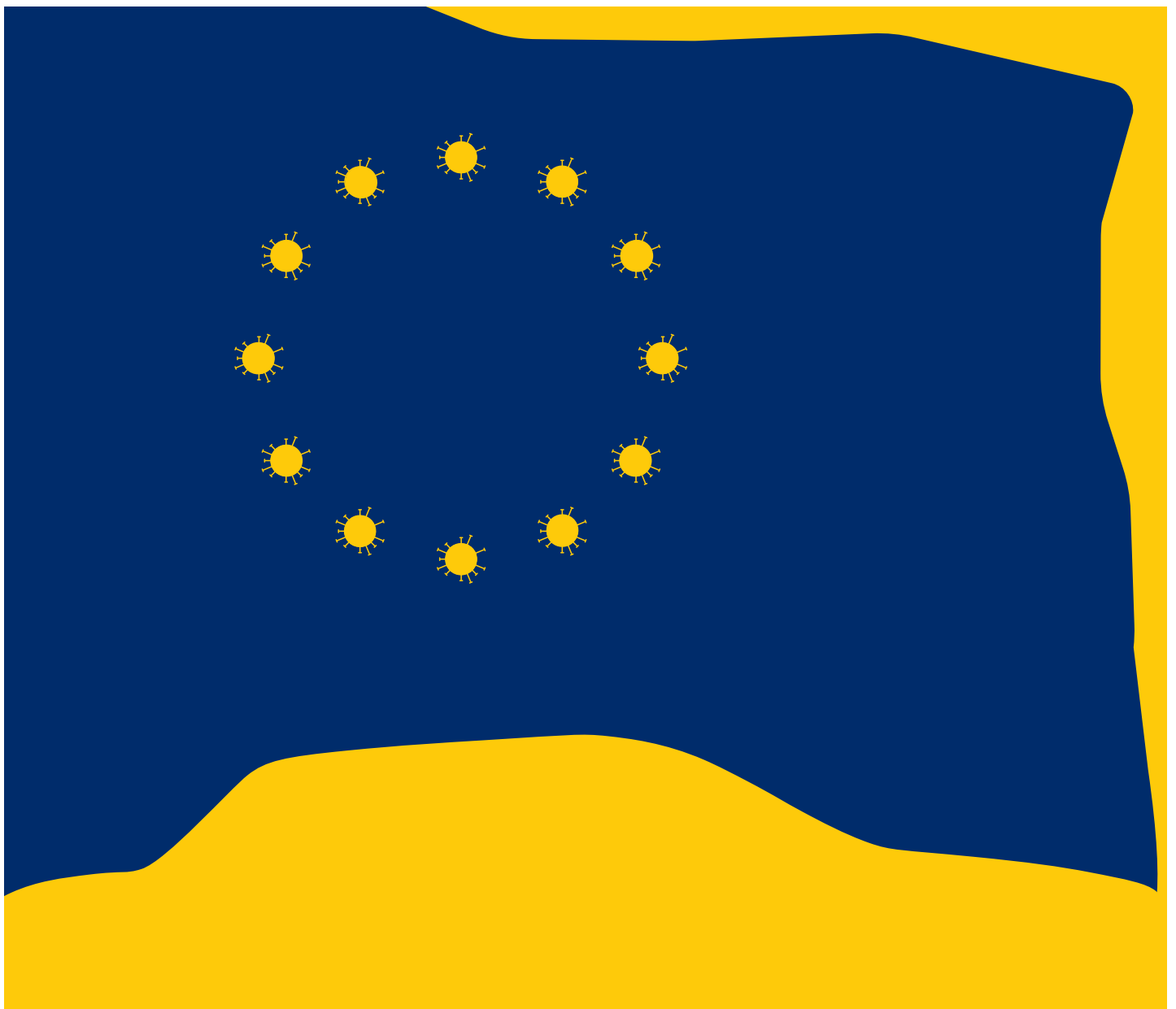
Regardless of support measures to keep businesses operational, getting the plants back to capacity will be an expensive and pointless exercise without demand for products. While some orders will need to be fulfilled, the state of demand is far from clear. The global recession will likely have left many without jobs or reduced means to pay for a new vehicle. Others may still be unwilling to make big-ticket purchases until they have a clearer picture of the longer-term health of the economy. The impacts of Covid-19 on travel are also unclear, given a likely increase in demand for personal transport over using public and

shared services, – countered a by reduced need to travel at all, given increased working from home, for example.

During the last recession in 2009 the UK, alongside most other markets, introduced stimulus measures to kick-start the market. Today, such measures are already in place in China and South Korea, and most other markets, such as Germany and France, are looking at levers to help boost new vehicle demand, unlock consumer spending and help restore the auto sector, supporting the jobs and wealth it creates. In the UK, the auto sector supports more than 820,000 jobs, and has an economic value of over £300 billion – or 3% of UK GDP. This value also doesn't reflect the myriad sectors which feed into automotive: steel, glass, plastics, textiles, advertising and financial. Those jobs also support the wider economy and bring in significant tax revenues to the government. New cars also bring environmental and safety benefits to the overall fleet.

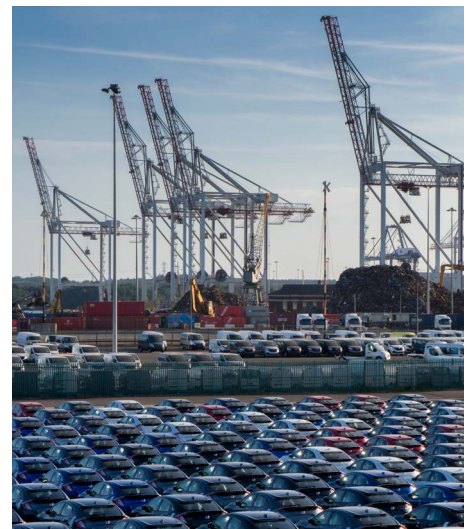
The automotive industry is essential for the global economy and increasing prosperity. In many countries, the automotive sector is a key driver of economic growth as well as a major employer. Trouble in this industry will lead to serious challenges for the state of the global economy. To overcome these challenges, support for vehicle manufacturers, suppliers and robust short-term measures are crucial. However, more is required for the medium and long term. Governments and companies will need to prepare for what comes after surviving the acute phase of the pandemic. The question will shift from how to manage the crisis, to its longer-term impacts and its potential effects on the future of the industry.





UK AUTOMOTIVE TRADE BEYOND LOCKDOWN

- The UK automotive industry can successfully overcome the impact of the Covid-19 crisis, but its long-term viability will largely depend on concluding an ambitious free trade agreement with the EU, its largest trading partner.
- UK automotive exporters are reasonably well positioned to capture global growth in the next five years, but significant efforts are needed to ensure that the UK's future trade policy can effectively support the sector.
- Business-driven risk-mapping can help address supply chain vulnerabilities, but inward-looking trade policies are unlikely to build resilience.



AGREEING A TRADE DEAL WITH THE EU

The immediate issue for the industry is overcoming Covid-19 – restarting factories safely and evaluating demand. The UK must also quickly secure its long-term preferential trading arrangements with the EU, our largest and closest trading partner, before exploring growth potential around the world and putting measures in place to ensure UK-based plants are best placed to capitalise on it.

Compared with the 2008 global downturn, after which the UK automotive industry began a robust expansive phase, the sector is now unlikely to return to pre-crisis production levels as quickly. Instead, the economic shock linked to Covid-19 and related lockdowns is likely to result in a readjustment of sales and production volumes. However, while a sectoral adjustment is the most likely outcome of the pandemic globally, the long-term outlook will depend largely on the outcome of trade negotiations with the EU.

In this context, overcoming the pandemic emergency is the most urgent priority, but not the decisive factor in securing the sector's long-term viability. Pre-Covid19, UK light vehicle (car and LCV) production was expected to be 1.34 million units in 2020. In mid-March, just ahead of vehicle plant closures, output was expected to fall -15.7% to 1.15 million units. As the sector begins to emerge from shutdown, output is likely to be well below a million units (circa 925,000 units), or down a third on 2019's pre-pandemic output, resulting in lost value of up to £12.5 billion year-on-year.

Despite the severe impact of the pandemic on the UK automotive industry, the sector has the potential to return to production volumes of more than 1.1 million units from 2021 – if a tariff-free trade agreement with the EU is concluded. A deal with the EU is the essential precondition to avoid the pandemic's shock developing into a medium-term structural adjustment with a considerable downsizing of UK automotive manufacturing.

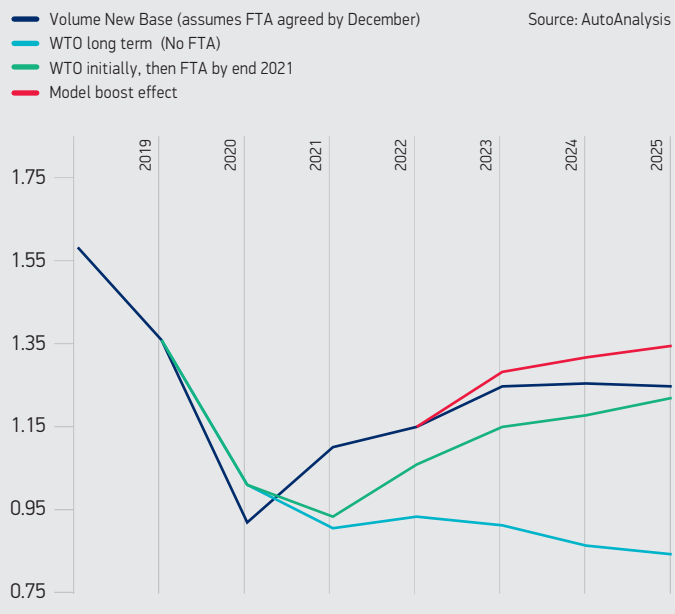
Considering a baseline scenario with a deal agreed by December 2020, ending the UK's transition period with the EU without a preferential trade deal is expected to cut UK production by a further 200,000 units in 2021 compared with the 1.1 million units produced if a deal is agreed, and leave it some 400,000 units lower in 2025 when compared with the 1.25 million units expected to be produced with a deal in place.

The EU is the UK's largest trading partner and currently the world's second largest market after China for new cars. Leaving without a deal would leave UK-built cars facing a 10% tariff cost and vice versa. Tariffs would transcend into a price increase of almost £3,000 on the average UK exported car to the EU, a £2,000 price increase on UK vans exported to the EU and a price increase of £1,800 on cars and vans imported from the EU, if fully passed on to UK consumers. Additional customs duties, costs and complexity would significantly disrupt sourcing of parts and components from the EU.

Some manufacturers have already publicly stated that leaving without a deal would undermine the viability of their UK operations and encourage them to put future inward investment elsewhere. However, reaching an ambitious deal would boost the UK's attractiveness as a production centre of new models, unlock new investment and see production climb to more than 1.35 million units by 2025.

If leaving without an agreement looks likely at the end of 2020, it could lead to a push to focus UK production on exports and possibly lift volumes altogether by almost 100,000 units as manufacturers looked to

CHART 25 UK light vehicle production outlook (millions)



export volumes ahead of tariffs being imposed. But, thereafter volumes would be expected to fall – being almost a fifth or nearly 200,000 units lower in 2021, moving to a third lower in 2025 compared with a baseline deal scenario. Volumes in 2025 would be more than 400,000 units lower compared with a tariff-free deal, and a loss of over 1.45 million units over the six year outlook. This would amount to some £40 billion of lost production value over the six years to 2025.

There would be no net benefits from the impact of tariffs on domestic producers or currency exchange fluctuations. The introduction of tariffs could potentially boost output for the UK market at some plants where they would be advantaged by imports facing tariffs, and potentially from manufacturing groups using UK plants to make models for domestic buyers. However, given the impact of tariffs on automotive products exported to the EU, and noting that exports are typically much larger than output for the domestic market, the net impact is still likely to be restrictive to the future of UK manufacturing.

Leaving the EU without a deal would also likely have an impact on sterling, making exports appear more attractive to overseas markets and domestically produced cars more attractive in the UK market. However, given the global nature of the auto industry such measures may be offset by higher costs of imported raw materials and components, as well as consumers facing higher costs for imported goods.

GLOBAL MARKET OUTLOOK TO 2025

Given the importance of exports to UK manufacturing plants, the global outlook for vehicle demand is key to the success of UK output. Covid-19 has had a huge impact, notably in the short term, but and will continue to have a longer term impact. Yet growth in global vehicle demand is still expected. This section sets out where that is likely to be and explores the UK's potential to benefit from future growth.

The automotive sector was already engaging in a radical overhaul before Covid-19. Products were evolving rapidly, with increased electrification of powertrains, enhanced connectivity and a move to autonomous vehicle technology. Vehicle use was also shifting, with populations increasingly

living in cities and major conurbations, moving away from individual vehicle use and into shared transport.

While Covid-19 might have put a temporary halt to some of these trends, others might accelerate in the aftermath of the crisis and impacts may also be longer term. It remains imperative that the UK automotive sector continues to attract inward investment, deliver the types of products consumers demand and adjust to this new business environment.

The global outlook data presented below is taken from LMC (www.lmc.com), based on their May outlook.

At the start of 2020, the global new car market was expected to show a very modest -0.4% dip on 2019 levels to 75.8 million units, as the subdued economic setting was expected to soften demand further. In the UK, ongoing uncertainty about the economic impact of exiting the EU and concerns, in particular for automotive companies, about likely increases in costs to consumers through new barriers to trade and possible supply constraints, could have a negative effect on future sales. The global outlook to 2024, however, was still positive, with the total marketplace set to grow by more than 10 million units, or 13.5%, to 86.4 million units.

The latest May view suggests the global market will show a -21.7% or 16.5 million unit decline – the equivalent of more than seven times the size of the UK market last year – to 59.5 million units in 2020. Demand is still expected to recover and be fairly ‘V’ shaped in appearance to 2025, rising by 10.4% to 83.9 million units. However, it is still some five million units lower than expected pre-Covid-19 by 2024, pointing to a structural readjustment of the whole industry and right-sizing of the global car market. Globally, a return to pre-Covid sales levels is expected by 2023.

The post-Covid-19 long-term outlook suggests still significant potential for the automotive industry in the future and for UK plants to supply into it. The breakdown of the growth shows a strong focus in volume terms in Asia, but also to a smaller degree in Europe, the Middle East and Africa. The near-term declines are focused in Asia, North America and the EU.

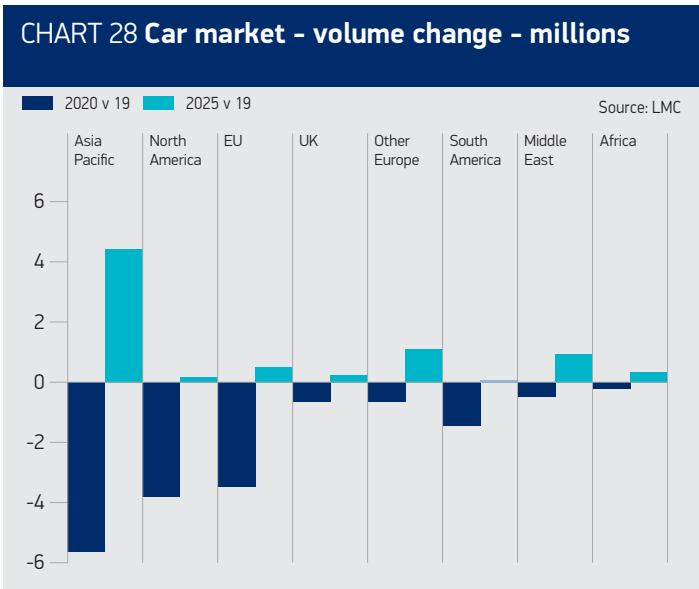
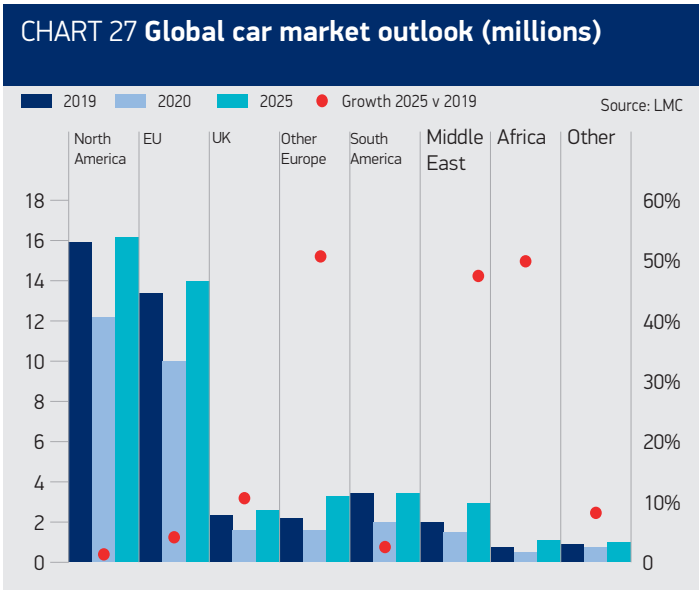
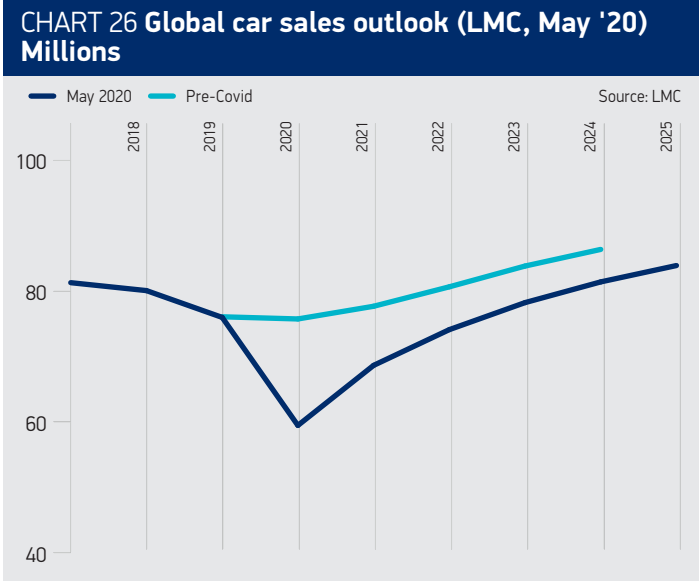
By 2025, the Asian market is expected to have grown by almost 4.5 million units in 2019, to 39.4 million units, a rise of 12.8%. This represents some 56.0% of the total world’s growth over this period. China is the key driver of this, with an expected 4.7 million unit rise (more than the overall Asian increase). Japan and India, meanwhile, are both expected to decline between 2019 and 2025.

The car market in the EU is expected to rise by a modest 3.7% in 2025, compared with 2019, although this does represent more than a half a million unit rise. Other European markets (excluding the UK) are expected to rise by more than 50%, or 1.1 million units, by 2025 to 3.3 million, supported by strong growth in Russia and Turkey.

The Middle East is forecast to see 47.2% growth, from more than 900,000 units to 2.9 million – with Iran, Saudi Arabia and the UAE anticipated to make some of the biggest gains. Africa is expected to record a 50% increase in registrations, amounting to almost 370,000 units, to 1.1 million.

North America, meanwhile, is expected to grow by just 1.0%, reflecting a -0.3% decline in the US car market over the period, which offsets growth in other markets, notably a 172,000 unit rise in Mexico.

Considering its current export portfolio, the UK automotive industry is in a reasonably good position to capture future global automotive growth.



The UK has a very strong export focus on the EU – notably for the volume manufacturers, with almost three-quarters of their exports going there. It is also the largest export market for premium brands, accounting for just over a third of their exports and almost 20% for small volume manufacturers (SVMs), which is understandable given it is the second largest market overall after China, and the UK's closest in terms of proximity.

Many of the volume manufacturers with plants in the UK have other factories in their global portfolio, and tend to use these to supply 'local' global markets, rather than their UK facilities, for example, Asian plants supplying into Asian markets. The SVMs, which only operate UK plants, have an export spread closer to the global sales picture. Meanwhile, UK production-centric premium manufacturers are also becoming increasingly global – with both Jaguar Land Rover and MINI operating plants in China, as well as other European operations.

The SVMs and premiums also have global reach already, so could clearly benefit from overall growth in those global markets, more so than the volume manufacturers. However, the UK could be a good base for increasing exports to the growth markets in Eastern Europe and possibly to other right-hand drive vehicle markets such as Australasia, the Indian continent and parts of Africa (acknowledging most plants can already easily switch between the two, but some economies of scale may accrue from focusing on such markets).

The SVMs and premiums already have an export share on a par with or above global market shares for Africa, North America, the EU and Eastern Europe. The proportion of their exports to Asia is low compared with the Asian market's global share, even though it is the largest market for SVMs, the third largest for premiums, and that their products are high-end compared with the usual smaller, cheaper cars prevalent in those markets.

2025 CAR PRODUCTION OUTLOOK

While overall production volumes closely follow sales, by region they are quite different, reflecting the historical location of plants. The chart below shows expected production growth by region from 2019 to 2020 and 2025. It also compares the change in volumes between production and sales volumes by region in 2025 vs 2019.

The chart shows Asia dominates growth in both output and sales, but also that its output is expected to exceed sales, suggesting the region is likely to be a net exporter over this period. The EU and North America also expect to see production growth outweigh sales, which either reflects increased supply to the domestic markets or rising exports.

Provided that an ambitious deal with the EU is concluded, growth in the EU should be positive for UK suppliers, given its potential for increased opportunities and its proximity.

CHART 29 UK export focus, by producer type

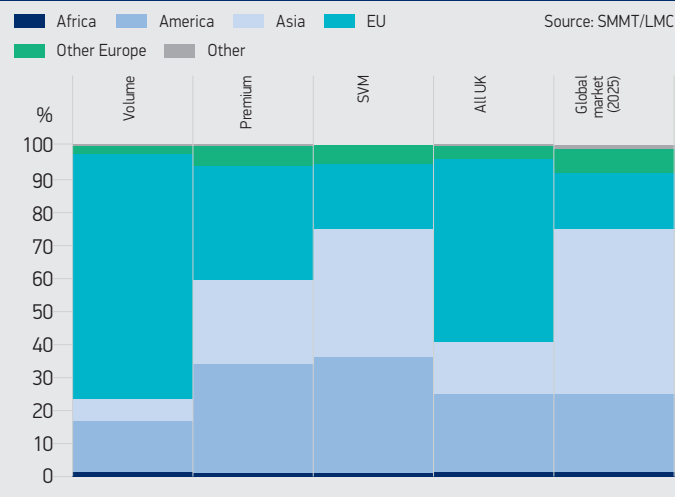


CHART 30 Global car production outlook (millions)

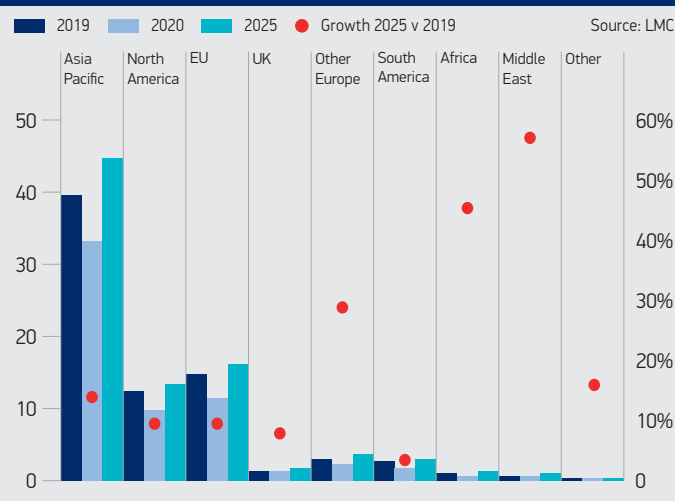
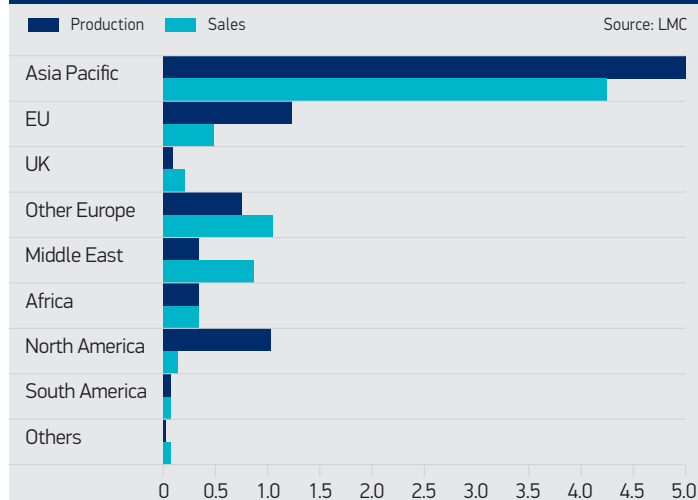


CHART 31 Volume changes 2025 vs 2019 (millions)



CVs OUTLOOK TO 2025

As with cars, the market outlook for light commercial vehicles (LCVs) suggests a similar sharp downturn in 2020, followed by recovery. The chart below shows both the global and EU markets, given the EU is the key export market for UK built LCVs, accounting for 94.6% of exports in 2019 (SMMT).

Global LCV sales are expected to fall by -21.1% in 2020, according to LMC, a drop of more than three million units on 2019, but then to recover to some 10.3%, or almost 1.5 million units, above 2019 levels by 2025. A similar 13.1% gain by 2025 on 2019 levels is forecast for the EU, although the 2020 downturn is due to be more severe, down -28.2%.

The EU is expected to account for around 16% of the global growth in LCV sales in 2025, compared with 2019 levels. Turkey and Russia will help other European markets see growth of more than 80%, or 200,000 units, to account for 13.7% of global growth. The Middle East and Africa should also see strong growth rates, albeit from low bases. China, again, is key to global growth, expecting a quarter of a million-plus rise in sales by 2025.

Global LCV production is expected to show a very similar decline to sales in 2020, down -22.0%, with slightly more modest growth by 2025, up 7.9% or 1.1 million units. The EU is expected to see LCV output decline by -32.3% in 2020, but also still be -5.3% down on 2019 levels in 2025. This reflects declining output in Spain, Germany and Italy, which more than offsets strong growth in Poland. The UK is expected to see output double to some 100,000 units in 2025 compared with 2019 levels, on the back of the PSA plant at Luton and also the new LEVC electric van.

Notable growth in manufacturing output is also expected in the rest of Europe, up by more than 40% or some quarter of a million units, largely on the back of strong growth in Turkey. China, Mexico, the USA and South Africa are also expected to show strong volume growth by 2025 from 2019 levels, with Iran and Egypt also showing strong growth, albeit from smaller volume base. This is likely to result in increased international competition for UK manufacturers as well as in new opportunities for UK suppliers of engines and parts for LCVs.

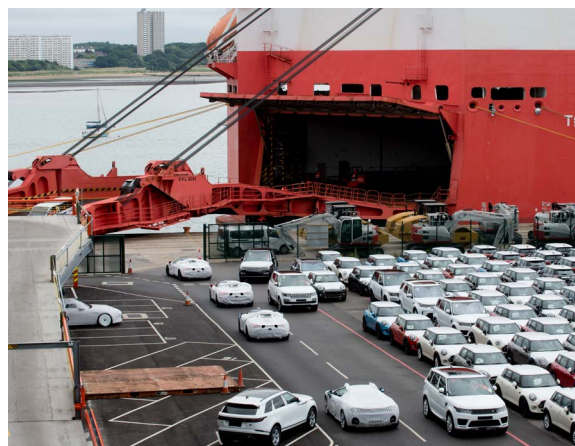
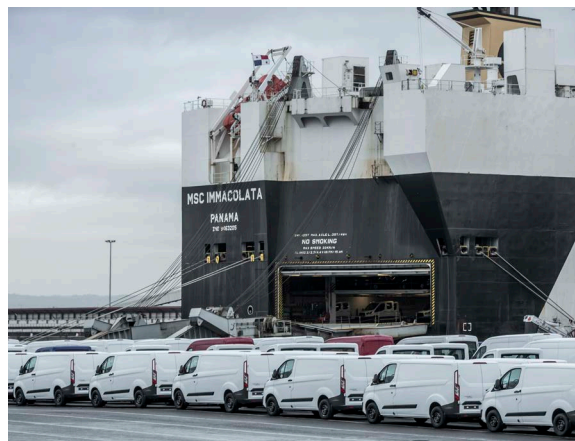
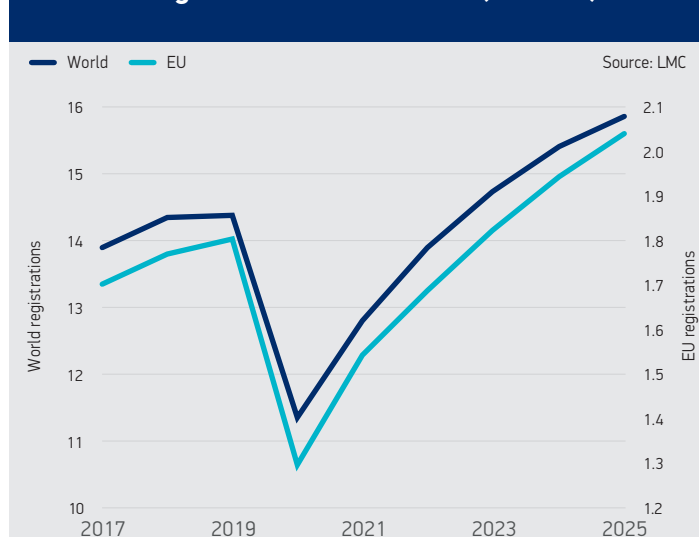


CHART 32 Light van market outlook (millions)



The EU is the key export market for UK built LCVs

UK TRADE POLICY AND GROWTH MARKETS

While the current sector's export portfolio allows the UK automotive industry to be reasonably well positioned to capture global growth, only very significant efforts on the part of the UK government will ensure that the country's future trade policy can support the global outreach of the UK's largest exporter of manufactured goods.

Excluding its domestic market, the UK automotive industry currently benefits from preferential treatment on cars exported to four out of the nine biggest car growth markets, namely the EU, Turkey, Mexico and South Africa. At the time of writing, only South Africa will surely have a free trade agreement in place with the UK at the end of the transition period.

The EU is the largest growth market with which the UK currently shares a preferential trade relationship. The EU is expected to growth by more than half a million units from 2019 levels by 2025.

The conclusion of an ambitious trade deal with the EU would still be insufficient to avoid new trade barriers following the UK's withdrawal from the continental bloc, but it would allow UK-built cars to be eligible for zero-tariff treatment to access the world's third largest car growth market, as well as the second largest growth market for LCVs.

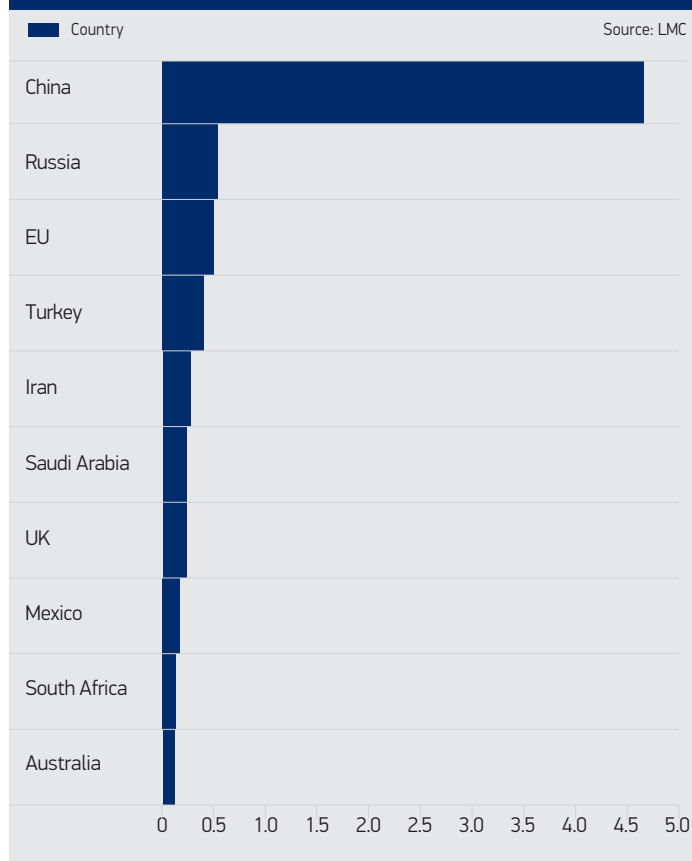
In the absence of a deal with the EU, the UK would not be able to secure a new trade agreement with Turkey, the second largest car growth market with which the UK currently has a preferential trade relationship in place. Being in a customs union with the EU, Turkey would not be in a position to sign a new deal with the UK if there is no similar arrangement in place between the EU and the UK. As in the case of car exports to the EU, UK-built cars and LCVs would face a 10% tariff upon import into Turkey. In addition, the absence of a new FTA would severely undermine UK engine businesses as privileged suppliers of Turkish car and LCV manufacturers.

With regard to Mexico, replicating the existing deal would allow UK-built cars to avoid WTO-level tariffs of between 15% and 50%.

It is interesting to note that the new free trade agreements currently being pursued by the UK with new trading partners are with markets that are generally not expected to see the strongest global growth – namely the US, Australia and New Zealand, although these markets do remain pivotal to the UK auto sector.

Regardless of an anticipated -0.3% decrease in car sales by 2025 compared with 2019 levels, the US is a major export destination for UK-built cars, notably for the premium and small volume manufacturers. Honda also exported more than 70% of Civic exports there in 2019, but with the UK's plant to close by 2021 there will likely be no volume manufacturer exporting there by 2025.

CHART 33 Top 10 growth markets 2025 v 2019 (millions)



Australia and New Zealand have long-standing ties with the UK and are set to see strong market growth out to 2025. Further, with the removal of the Australian car production plants, these markets are fully serviced by imports.

However, the most notable issue is that the UK neither has trade agreements in place today, nor plans to negotiate preferential deals in the next future, with four out of the six biggest car growth markets – including with China and Russia, which are by far the world's biggest growth markets in the medium term.

Traditionally, China, Russia, Iran and, to a lesser degree, Saudi Arabia, present considerable market access obstacles and particularly challenging non-tariff barriers. To support sales in these markets, the UK government does not necessarily need to launch trade negotiations, which would prove challenging from a political perspective, as well as impractical while negotiating with other major trading partners at the same time.

In the first place, promotion of UK products in all growth markets should be encouraged and adequately funded, in line with UK's global competitors.

It is also critical for the UK to put in place an efficient market access unit tackling trade barriers worldwide and supporting UK businesses operating in these markets. This unit should substitute and improve upon the EU Market Access Advisory Council, the market access body to which both the UK government and businesses have lost access since the UK's withdrawal from the EU.

In light of this new situation, systems have already been put in place to ensure UK businesses can directly flag market access restrictions via an online portal. Although allowing UK traders to report barriers in third countries is critical, the functions of the UK market access unit should not be limited to administering or prioritising reported barriers.

Building up relationships with the authorities in key growth markets should top the UK's future trade agenda and lead to the establishment of shared policy and regulatory engagement processes to minimise any differences between respective regulatory approaches and ensure UK exporters have sufficient transparency and lead-times to meet rules, regulations, standards or policies adopted in those key trade markets.

Given the UK has the largest number of SVMs in the world and a focus on premium and luxury products, we also need to be mindful that rules and regulations in other countries may not consider the unique nature of these products. Over the years, strong engagement with the EU has ensured suitable provisions and sufficient lead times are in place to enable low volume producers to compete alongside larger companies with more resource and global reach. This process is also ongoing in China, but more can be done to broaden this approach to other markets, especially once we lose the relationship and support of the EU in such processes.

For SVMs, it is critical to minimise obstacles to export, given the impossibility for manufacturers of luxury vehicles to diversify production to avoid entry barriers.

On the other hand, to support UK manufacturers with direct investment in challenging growth markets, the UK could seek new or enhanced bilateral investment treaties. These agreements might also help promote the UK as an automotive investment hub for new international investors.

Finally, the UK should spare no effort in supporting global trade rules and restoring confidence in international organisations such as the WTO. At a time of unprecedented global challenges, the ongoing crisis of the multilateral trading system paves the way for new trade restrictions that might severely undermine the industry's ability to access growth markets, particularly with trading partners with which the UK will not negotiate preferential trade agreements in the near future.

For SVMs, it is critical to minimise obstacles to export

SUPPLY CHAINS POST-COVID

Redesigning global supply chains and automotive business models following the shock of the pandemic is a topic likely to dominate the agenda of businesses and policy-makers worldwide for years.

At present, it is difficult to draw definitive conclusions about the sector's resilience and its ability to return to standard levels of production soon after restart.

However, even in the event of a speedy return to pre-Covid-19 sales and production levels, the inability of the automotive sector to remain operational during a severe global downturn is an issue that must be addressed.

The crisis has laid bare the impossibility for the UK industry to reach its customers through its traditional distribution channels when car dealers are forced to close. A wider adoption of click-and-collect purchasing mechanisms or a larger utilisation of online selling platforms could have partially mitigated the immediate impact of the outbreak. China's car sales rebound could be an indication that where customers are more familiar with digital sales channels, vehicle sales could quickly unlock the sector's manufacturing capabilities.

In addition, weaknesses in the sector's business model would have been exposed even if the outbreak was successfully contained and lockdowns were limited to some automotive manufacturing hubs – such as China's Hubei province. As already experienced after the 2011 tsunami in Japan, when the entire automotive industry was discovered to be dependent on processing of raw materials carried-out near Fukushima, it is likely that the global automotive industry would have suffered significant disruptions also in this scenario.



While it is important to understand and identify the vulnerabilities of the complex supply chain, solutions might be less obvious, in particular if re-shoring or near-shoring is proposed by policy-makers worldwide as a silver bullet against external shocks.

The impact of prolonged disruption to international supply chains is considerable if OEMs are forced to seek domestic alternatives to imported materials. Such alternatives often do not exist or are not cost competitive.

Dependency on raw materials highly concentrated in specific locations is almost unavoidable, but in some cases there might be limited possibilities for diversification. An example could be the supply of cobalt, a key material for the manufacturing of electric batteries. Today, cobalt extraction is largely concentrated in the Democratic Republic of Congo, but Australia – a prospective UK preferential trading partner – could scale up production in the future and become an alternative supplier. The same applies for rare earths, raw materials that are relatively abundant but that are mainly extracted and processed in China for a great variety of industries, including automotive.

For automotive parts and sub-assemblies, reducing the diversity of supply is unlikely to be the right answer. Instead, what would ensure the future success of the automotive sector is to build flexibility and resilience into the supply chain, along with cost efficiency.

The success of the automotive industry depends on access to a diverse and competitive supply chain. Purchasing decisions will remain largely linked to suppliers' capabilities, capacities, qualities, costs and ability to deliver. On its own, location is unlikely to become a decisive factor in business decisions, unless costs associated with long-distance suppliers are not duly factored into purchasing decisions. Purchasing decisions will likely continue to be based on total landed cost.

In this sense, on-shoring or near-shoring could be a sensible business decision if the cost of gross failure of parts with long logistics chains is much higher than when locally sourced.

Also, a shorter supply chain could be advisable if a long chain slows the ability of a supplier to make an engineering change to improve features or functions according to customer demand. The same applies if long supply chains have an impact on the automotive sector's agility to change product configurations or provide greater choices for consumers.

However, long supply chains are not necessarily fragile by default. For example, the UK automotive industry was able to continue manufacturing for several weeks after the outbreak in China, because the distance meant key parts produced in Hubei were still in transit to the UK when the Chinese province started enforcing strong lockdown measures. If the epidemic started much closer to the UK, the impacts would have probably been more immediate.

In this regard, should governments worldwide resort to inward-looking reshoring policies aimed at forcing automotive businesses to repatriate production, these programmes would be unlikely to build resilience or secure the long-term competitiveness of domestic industries. In addition, aggressive localisation incentives could distort international trade and production patterns, to the detriment of smaller countries unable to offer similar incentives. Continued commitment to long-established multilateral trade rules on issues such as forced localisation would give mid-sized economies a better chance to participate to global supply chains.

As for the UK, strengthening the suppliers' base and ensuring their participation in current regional and global supply chains and also in innovative production systems and supply chains, will be one of the key challenges for the future of the sector and UK trade policy.

Where UK or global automotive businesses identify a clear vulnerability in their supply chains, the UK should strive to offer them a competitive alternative to diversify production. At the same time, the UK could support domestic suppliers looking to reduce vulnerabilities by diversifying customers and export markets. The focus should be on partners that are likely to significantly increase car production in the next five years.

A fundamental question to consider is what sort of a supply base the government and the industry want in the future to support the economy and help suppliers retool for the future. Financial support for capital expenditure, R&D and upskilling are likely to be decisive factors in accelerating the modernisation of the domestic supply chain. Finally, a faster upgrade to automation of UK automotive manufacturing could improve the chances of securing additional investment in the domestic supply chain. Automation could prove decisive in reducing health risks during the recovery phase after the end of the pandemic and give a competitive edge to the UK when in competition with labour-intensive markets to secure new investment. Greater connectivity, industry 4.0 and digital manufacturing will also provide more supply chain transparency and create opportunities for risk mitigation.

Top 10 markets by production growth

Rank	Market	Volume change '000s	%
1	China	4,890	23.3%
2	EU	1,311	8.9%
3	USA	1,097	14.7%
4	Russia	413	27.1%
5	South Korea	411	11.5%
6	Iran	341	58.1%
7	Turkey	225	22.8%
8	Thailand	173	18.2%
9	Morocco	129	41.7%
10	Algeria	126	122.8%

RECOMMENDATIONS FOR GOVERNMENT AND INDUSTRY

1

PLACE AUTOMOTIVE AT THE FOREFRONT OF A LONG-TERM TRADE STRATEGY

→ As the UK's largest exporter of industrial goods, any UK trade policy needs to have the automotive industry at its centre.

→ This will support the government's own ambitions of positioning the UK as a leading nation in global trade and secure economic certainty for key automotive hubs in regions outside London such as the North East and West Midlands.

→ Failure to secure trade deals which work for UK Automotive will reduce the chances to increase UK exports' contribution to the national GDP and hamper the UK's position as a leading exporter of industrial goods.

→ With a new generation of automotive vehicles and technologies on the horizon, government and industry should work together to understand the conditions that are needed to position the UK as a leading nation of automotive production.

2

SECURE AMBITIOUS DEALS WITH KEY TRADING PARTNERS

→ The conclusion of an ambitious free trade agreement with the EU is the essential pre-condition to ensure the long-term viability of the sector and boost the UK's attractiveness as a production centre of new models.

→ It is critical to ensure as few new barriers as possible are introduced to trade between the UK, the EU and the wider Euro-Mediterranean region. Regional supply chains are highly integrated and should be protected in the UK to maintain a competitive domestic market and preserve the majority of key UK automotive exports. Securing a new trade deal with Turkey will be instrumental to achieving this objective.

→ Retaining existing trading terms for preferential access to major markets beyond the EU is crucial to open up new commercial opportunities for the UK business community, preserving consumer choice and encouraging foreign direct investment. The conclusion of a new trade agreement with Japan would foster a 40-year long industrial partnership and bolster confidence in the UK's position as a major automotive manufacturing hub.

3

DEFUSE INTERNATIONAL TRADE TENSIONS

→ Government should explore all avenues to protect Automotive and those sectors relevant to the supply chain from international trade disputes.

→ Trade tensions, which have risen significantly over recent years, threaten the multilateral trading system and risk disrupting trade flows of raw materials and automotive products.

→ With disruption already occurring as a result of the impacts of Covid-19 and the subsequent slowdown of the global economy, increased effort must be made to ensure unnecessary barriers to trade do not arise.

→ Government should spare no effort in supporting global trade rules and restoring confidence in international organisations such as the World Trade Organisation. A strong multilateral trading system remains the best insurance against trade-restrictive policies that might be adopted worldwide in response to the Covid-19 crisis.

4

A TRADE AGENDA BACKED BY UK AUTOMOTIVE BUSINESSES

→ As a major exporting market, future UK trade strategies must receive the buy-in of UK automotive businesses. Transparent government trade ambitions, the publication of bilateral trade mandates and ensuring consistent formal business engagement structures are necessary measures to secure business buy-in.

→ Collaboration between government and industry should be channelled through the Automotive Sector Panel Expert Trade Advisory Group to ensure government utilises automotive business expertise, as experienced exporters of goods, to inform the UK's trade strategy. In this context, the need to preserve confidentiality in trade negotiations should not prevent meaningful engagement with all relevant industry stakeholders.

5

DELIVER ON BUSINESS MARKET ACCESS NEEDS

→ Government should encourage the growth of trade by examining and removing existing market access barriers which negatively affect trade between the UK and its key trading partners.

→ Given the complexities of trade policy, and the policy priorities of UK Automotive, government must secure an effective operational market access team, led by the Department for International Trade, but working closely with officials from the Department for Business, Energy and Industrial Strategy, the Department for Transport and other relevant departments.

→ It is more important than ever that government champions the UK's leading role in UNECE discussions, especially in light of new and emerging technologies.

→ Where possible, the mutual recognition of equivalent automotive regulations could deliver a large gain for UK automotive companies.

6

CAPTURE GLOBAL GROWTH

→ Trade negotiations with the US and the replication of existing agreements with Mexico and Canada could strengthen already solid trade relations and offer new growth opportunities.

→ Government and industry should explore the markets where the potential for meaningful access improvements for UK exporters may be the greatest, with a focus on key growth markets such as China.

→ The launch of trade negotiations with Australia and New Zealand would also be a step in the right direction to improve market access to significant growth markets.

→ To support UK automotive brands with manufacturing capacity or significant commercial presence in growth regions, the UK government could seek new bilateral investment treaties and ensure support via its diffused network of regional Trade Commissioners and commercial attachés.

→ For small volume manufacturers, it is critical to minimise obstacles to export in key growth markets, given the impossibility for manufacturers of luxury vehicles to diversify production to avoid entry barriers. This can also be achieved by ensuring rules and regulations in other countries duly consider the unique nature of these products.

→ SMMT and DIT's GREAT campaign team should continue to strengthen their working relationship to foster automotive trade promotion in key growth markets worldwide.

7

FACILITATE BUSINESS-FRIENDLY CUSTOMS PROCESSES

→ Building on close collaboration with major trading partners, the government should guarantee efficient trade facilitation measures which avoid costly delays at the border.

→ Continuing to share relevant customs data and intelligence between trading partners, especially between the UK and EU, will be one mechanism to maintain the free flow of goods at the border.

→ Sufficient infrastructure must be in place to support the UK's international trade agenda. Assessments need to continue to be undertaken to understand capacity issues to avoid a bottleneck on 1 January 2021.

→ An innovative and non-burdensome customs environment is needed to support UK importers and exporters. The system should streamline customs procedures, minimise costs and remove onerous authorisation procedures.

8

BUILD FLEXIBILITY AND RESILIENCE

→ UK automotive businesses should identify and map vulnerabilities in their existing business model. Innovative distribution and sales channels and the diversification of customers and export markets could mitigate future risks.

→ Diversification of sourcing and processing of raw materials can be supported by the future UK's trade policy agenda, although dependency on raw materials highly concentrated in specific locations is almost unavoidable.

→ Businesses should adequately factor-in risks and costs stemming from long and less agile supply chains.

→ Inward-looking policies forcing re-shoring should be avoided. Instead, government should support automation, R&D, upskilling and re-tooling to offer a competitive alternative.

9

ALIGN UK TRADE AND AUTOMOTIVE INDUSTRIAL STRATEGY AMBITIONS

→ UK trade ambitions must sensibly align with the mission statements set out by the joint government-industry Automotive Council, as well as reflect the Grand Challenges detailed in government's Industrial Strategy.

→ Reflecting the desires of both government and industry, UK Automotive has a valuable contribution to make beyond the traditional policy areas, from mobility services to artificial intelligence and data, privacy and cybersecurity.

→ Government and industry should strengthen cross-departmental collaboration to ensure efforts to support industrial and economic prosperity in the regions are being delivered according to the UK's strategic interests and in a sustainable manner for UK trade.

10

SUPPORT THE INDUSTRY'S RECOVERY FROM COVID-19 DISRUPTION

→ Immediate support for automotive businesses to restart UK manufacturing, incentivise consumer demand and aid UK economic recovery is a necessary intervention by the government.

→ It is important that support mechanisms work for the whole automotive industry, from production through to retail and aftermarket.

→ Longer-term support should allow UK Automotive to maintain its pre-Covid-19 international competitiveness and, in this regard, government should take note of aid provided by European governments to their domestic industries.

ANNEX: DATA SOURCES

SMMT has used three key sources for the trade data – ONS, HMRC and our own SMMT data sets. The two government sources are used for value of exports and imports. They use slightly different classifications and approaches, but the overall difference is relatively small in this context. We have used ONS data for the headline figures and HMRC data for country specific information (which is not available from the ONS data). SMMT data is used for volumes of vehicle production destined for export and new registrations by origin.

For more information on SMMT data and for additional data please contact aisdata@smmt.co.uk.

The ONS data uses the change in ownership balance of payments methodology, whilst HMRC uses physical movement of goods.

The ONS data uses SIC29 and covers all motor vehicles, including engines and parts and accessories. The ONS data gives both home and export details and a split between EU and non-EU.

See <https://www.ons.gov.uk/economy/nationalaccounts/balanceofpayments/bulletins/uktrade/previousReleases> for data and

<http://www.siccodesupport.co.uk/sic-division.php> for SIC29 definition.

The HMRC data uses HMRC codes and for the purposes of this report certain codes in 87 (motor vehicles and parts and accessories) and 84 (engines). The detailed codes are given below. The HMRC data can be analysed at country level, so offers greater granularity.

<https://www.uktradeinfo.com/Statistics/BuildYourOwnTables/Pages/Home.aspx>

Vehicle registration and production forecasts

Global market and production outlook is based on LMC Automotive Limited's May outlook – see

www.lmc.com for more details.

UK light duty vehicle production outlook is based on AutoAnalysis's view in June, see

www.autoanalysis.co

AA's production outlook for the EU is also available to SMMT members – please see

<https://www.smmt.co.uk/vehicle-data/production-outlook/> for more details.

UK new car and van registrations outlook are produced by SMMT each quarter – see

<https://www.smmt.co.uk/category/vehicle-data/new-car-van-forecasts/>

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