There may be trouble ahead…

The latest book in our Bite-Size Brexit range is now published! 'Carmageddon?: Brexit & Beyond for UK Auto' looks at the manufacturing industry at the heart of the issues around Brexit, with the industry's sophisticated just in time and other major logistical challenges.

The book, edited by Professor David Bailey, Professor Alex De Ruyter, Neil Fowler and John Mair, brings together a wide spectrum of industry experts and world-renowned auto industry figures, providing a real perspective on Brexit at the raw edge. Contributors include leading auto analysts, top automotive journalists, politicians and academics.

Today, we are delighted to share Ian Henry's contribution to the book. Ian Henry is the Owner and Managing Director of AutoAnalysis and Visiting Professor at the Centre for Brexit Studies.

Enjoy…

There may be trouble ahead…

Car production in the UK for the 11 months to November 2019 was just over 1.23m units1, a fall of 14.5 per cent year-on-year. The full year figures (due out at the same time as this book was published) will likely be around 1.32m.

The November fall was actually 16.5 per cent, due in part to scheduled shutdowns at some vehicle plants in anticipation of the UK leaving the EU without a deal on October 31. Disappointing sales of old models and planned model changeovers (e.g. the Nissan Juke switch to a new model led to zero output for several months in 2019) did not help the production environment last year. As well as declining production volumes, the vehicle manufacturing sector had – according to the Society of Motor Manufacturers and Traders SMMT – borne Brexit-related costs and contingency measures valued at more than £500m. Such is the economic cost, so far, of Brexit, and it had not even been done by November.

Brexit will, however, soon be ‘done’, at least in the sense of the UK legally leaving the EU’s institutions. Following the Conservatives’ general election victory – barring any unforeseen, last minute turn-of-events – the UK will leave the EU on January 31, 2020. It will then enter the transition period which is due to last until December 31, 2020. Unless this is extended by agreement, the UK’s departure from the EU will be complete.

What happens in 2021?

The crucial issue for the automotive manufacturing sector is what will be trading environment come January 1, 2021. This is due to be negotiated during the transition, but negotiations are unlikely to start before March and would need to be complete by October to stand a chance of being ratified by the end of the year. In terms of the automotive industry, it needs to know whether there will be tariffs on exported vehicles and components? What will the regulatory environment be? And how secure or stable will be the in-bound supply chains on which UK vehicle factories depend for their just-in-time deliveries?

The UK government says it has time during 2020 to complete a comprehensive free-trade agreement, although most independent trade policy analysts – and the EU – say this is impractical. A ‘bare bones’ free trade agreement is said to be possible, but what this would entail and how it would affect the automotive sector is unknown.

What we can be sure of is that in the absence of a zero tariff, zero quota and technological alignment agreement, the UK’s vehicle manufacturing sector will face additional costs. Its basic economic model will be undermined; and for vehicles sold in the most price-competitive segments, these additional costs risk sending the programmes concerned into a downward spiral from which recovery may be impractical.

In the corresponding chapter in the first edition of this book, we explained that the costs of tariffs for UK exports would be around £3bn a year. The actual costs will vary with production volumes achieved and whether European consumers continue to buy UK vehicles if import tariffs are applied, and whether EU factories continue to source UK-made components if they too are subject to import tariffs.

As production and exports fall – as they are likely to do with tariffs imposed – the costs borne by the industry will also fall. But this is far from good news.

Tariffs will hit demand

The real damage will come from loss of value at the factory gate. Fewer vehicles made means lower economic output – and the risk of job losses, shifts being cut, or factory futures being placed at risk.

Calculations by AutoAnalysis undertaken for the SMMT make clear the scale of this risk. A hard Brexit – taken as 10 per cent tariffs applied at the port of entry on the landed price of UK-made vehicles when they arrive in the EU – would hit EU demand for UK-made vehicles.

We calculate that 1.5m vehicles would be lost from otherwise expected UK production from 2020 through to 2024; and, taking into account the different mix of vehicles involved, from Opel Astras through to Rolls Royces, the loss of economic value at the factory gate would be nearly £43bn, or more than £8bn a year on average.

This would be not far off 20 per cent of the value of vehicle production in a 'typical' pre-Brexit year. The actual impact will vary from company to company and factories, such as Vauxhall Ellesmere Port or Toyota at Burnaston, which ship the overwhelming majority of their output to the EU, will be most severely hit by the tariff burden.

By contrast, Jaguar Land Rover (JLR) and Mini, which are less than 30 per cent dependent on the EU for their exports, will be relatively less impacted by EU tariffs. Their much bigger worry would be if the US increased tariffs on vehicle imports, currently just 2.5 per cent, to a possible 25 per cent.

One of the many unanswered (or unknown unknown) Brexit questions is whether such a move by the US administration would impact the UK once it left the EU. The real worry for UK vehicle production in the event of a hard Brexit, with EU tariffs levied, is whether this turns out to be a permanent situation, or merely a temporary problem, and in this case, for how long?

Government support required

Recent discussions with senior industry executives make it clear how much of the UK vehicle production sector will be uneconomic with a permanent imposition of 10 per cent tariffs on exports to the EU. In the event of tariffs being imposed, vehicle manufacturers will look for significant government support while they adjust to the new economic order. For some factories, there may be no time; for example, PSA has made it clear that its provisional decision to allocate some – but not all – of the production of the next Astra to Ellesmere Port was dependent on the nature of the Brexit deal; this is widely believed to mean that tariffs would make the plant uneconomic for exporting to the EU.

Although PSA could make Ellesmere Port into a CKD plant making a range of models for the UK market, such an approach would run counter to recent industry practice. We expect that a hard Brexit from January 1, 2021 would lead to closure of the Ellesmere Port factory very speedily.

The UK is already losing the Honda plant (officially for global reasons, as opposed to Brexit) and a much reduced production line-up at Nissan (the Infiniti range has finished, and the X-Trail will not come to the UK). These programmes alone mean a minimum permanent loss to UK production of 225-250,000 vehicles a year.

The possible closure of Ellesmere Port, and with the economics of production for the other plants (especially the remaining Japanese factories) undermined, , would see UK vehicle production will fall further. The expected negative impact and implications of Brexit are especially unfortunate given the potential which the UK vehicle manufacturing sector still has today. Despite Brexit uncertainty, the new Vivaro has gone into production at Luton (including Peugeot, Citroen and Opel versions, for export), the electric Mini is now in production at Oxford, the Aston Martin DBX SUV is in trial build in a new factory in Wales, and JLR’s Castle Bromwich plant is being reconfigured to make electric vehicle (EVs), starting with the replacement for the XJ.

Before the Brexit referendum was even a gleam in David Cameron's eye, UK car production was heading towards 2m units a year. Now it is running at around 1.3m units a year, with the risk of output falling below 1m a year. Of course, the decline in UK output is not entirely due to Brexit, as the diesel issue, problems in China and disappointing sales of many UK-made models have all contributed to the decline in production.

However, Brexit's cost and practical impacts should not be underestimated. Additional production costs of £3bn a year and £8bn a year in lost economic value creation are sums which any industry would struggle to bear unscathed. Given the global headwinds battering UK vehicle production, we can expect further major challenges for this once thriving, but now troubled, sector.

'Carmageddon?: Brexit & Beyond for UK Auto' is available NOW, in paperback and digitally, here.