



How will China's yuan devaluation impact the auto industry?

By Martin Kahl

Stock markets, financial investors and foreign companies relying on China for sales or production have been reeling in the wake of the shock decision by China's central bank to devalue the yuan. On 11 August 2015, the People's Bank of China (PBoC) lifted the daily fixing rate of the country's currency against the US dollar by 1.9%, resulting in a 1.8% devaluation of the yuan against the dollar which, according to Natixis, was the currency's biggest one day move since July 2005 when the government first introduced the exchange rate reform.

As analysts pore over the underlying reasons behind the devaluation, and look to understand what impact it will have, especially when combined with the country's general economic

slowdown, vehicle manufacturers, luxury goods makers and tech companies in particular have begun reacting to falling stocks in the hours and days since the news broke.

An expected surprise

The PBoC's move on 11 August may have come as a surprise internationally, but a move of some kind by China's authorities was far from unexpected. The government needs to stimulate growth and boost the country's ailing economy. Exports fell 8.3% in July, and growth reportedly stands at around 6.8%, an enviable figure compared to most other developed economies, but still below the 7% forecast by the government for 2015, and the slowest it has been for 25 years. Earlier double-

digit growth figures may now be a thing of the past; according to Patrick Artuc, Chief Economist at Natixis, "Our estimate of Chinese potential growth in the 2020s comes to 3% per year."

China's currency had been appreciating for several years, and over the last year, the government has been employing measures to reverse this. The BBC reports that the currency has dropped by about 3% throughout 2015. The concurrent loss of foreign exchange reserves has served to mask depreciation.

A stock market crisis in June and July, which culminated in the country's worst daily fall on the markets since 2007, was calmed by the China Securities and Regulatory Commission (CSRC) saying it would buy shares, while the PCoB



central bank injected reportedly billions of dollars into the markets, amongst other measures.

Furthermore, there is speculation that the devaluation is linked to China's moves to secure the yuan's position as a global reserve currency alongside the US dollar, Japanese yen, British pound and the Euro in the list of Special Drawing Rights (SDR) currencies.

Relatively minor, but symbolic

The significance of the devaluation therefore needs to be weighed up. "At 1.9% the size of the move itself was relatively minor, especially compared with other emerging markets, and certainly is not enough to provide a sudden boost in competitiveness to

exports," says Anna-Marie Baisden, Head of Autos Analysis at BMI Research. "Symbolically, however, it carries more weight as it was the first such move since 1993 and is a sign that the government is changing its currency policy. As for how it is being managed, it is worth noting that the PBoC stated on 11 August that this would be a one-off move, but then set the yuan reference rate weaker again for the second day running, which means their policy is unpredictable at the moment."

Nonetheless, the suddenness of the devaluation looks to have taken by surprise the many global companies which have become accustomed to, reliant on and at the mercy of China's recent high levels of growth.

Impact on the automotive industry

China is the world's largest single country new car market and despite a slowdown, its market is still growing faster than other major markets; the impacts of the devaluation, therefore, could be felt particularly hard by the global automotive industry.

Shortly after the currency devaluation, GM issued the following statement: "General Motors' primary approach to managing foreign exchange risk has been to employ a natural hedge by building vehicles for sale in each of our major markets. In China, we believe that this approach, along with a well-established local supply chain, mitigates a majority of the risk associated with the devaluation of the yuan. We believe that our exposure is limited and manageable, and do not expect that the devaluation will have a material impact on the company's financial performance. We continue to expect strong results in China will be sustained through the remainder of the year."

A statement from BMW, reported by *Bloomberg*, said: "Current business developments in China present us and other automobile manufacturers with challenges we foresaw a long time ago."

The country's slowing economy - and the accompanying slowdown in vehicle sales - has already begun taking its toll on foreign OEMs operating in China. [Jaguar Land Rover's fall in sales in China - down by a third in the April to June quarter - was blamed for the drop in net profit at parent company Tata Motors.](#) As a result, JLR has cut its sales and production targets, and reduced the local prices of its Jaguar and Land Rover products. This follows earlier price cuts by other OEMs, including Ford, GM, SAIC and VW.

[Ford, which has just appointed Joseph Liu, formerly Executive Vice President of Shanghai GM, as Vice President, Marketing, Sales & Service \(MSS\) at Ford China,](#) was reported by *Reuters* to have suggested that although it remains "bullish" on China, it would balance supply with demand if the Chinese market experienced a "prolonged period of recessions."

How concerned should those foreign OEMs be that have become reliant on China for a significant portion of their global sales? "This is the latest in a line of big concerns for OEMs regarding China," says BMI's Baisden. "Sales growth was already expected to be slower this year in line with the economy, but this was accelerated as people channelled money into the stock market instead of cars and then lost out in the market downturn in June. Now the devaluation, which will make imported goods more expensive, means foreign brands are at a distinct disadvantage compared to their domestic counterparts in a weakened market, and this is already being reflected in share prices - VW, BMW and GM all fell markedly [on 11 August]."

How much impact the devaluation itself will have on foreign OEMs producing cars in China depends on the production models they have in place. So far, it's had little impact on the foreign OEMs, says Huu-Hoi Tran, Director, Automotive Sector at KPMG in China. "Major players produce their cars already in China and have covered their cost in renminbi (yuan). Currently, revenues are expected to fall, but on the other hand, OEMs will spend less on car production."

Large OEMs have their own currency hedging programmes, which will soften currency exchange volatility, adds Tran. Baisden agrees, noting the added importance of local content. "If they have a strong local supplier network and are spending on parts and components in China, this helps to reduce the exposure to foreign currency moves. If not, they are likely to see costs rising for imported inputs. Repatriated profits will also be lower and this is where companies reliant on China for income will really feel it."

Commenting ahead of the 11 August depreciation, Andrew Bergbaum, a Managing Director at AlixPartners, said: "China continues to be the main engine of the growth in the automotive industry, but now at a slower rate. Despite the economy growing at an average of 6.8% per year, vehicle sales are expected to rise only by 4.1% per year. The slow-down will therefore increase price pressure in the Chinese vehicle market

and put a squeeze on the margins. With China expected to provide nine out of the 19 million unit growth in the next seven years, this shift will have wide reaching effects."

Impact on the domestic market

Whilst the devaluation has become a headline topic in the international press, it remains to be seen what impact this will have on the domestic market, and on the country's car market in particular. "Given the economic conditions and earlier clampdown on luxury spending, buyers themselves already seem to be of the mindset that value for money is now a bigger concern than buying something that is a status symbol," says Baisden. "As a result, we're seeing domestic brands faring much better than imported brands for the year so far. The devaluation will just serve to strengthen this advantage for Chinese brands as imported vehicles become more expensive. This is going to be much more of a big deal for international brands and their investors."

Buyers of premium cars will be hit particularly hard, says KPMG's Tran. "Foreign OEMs with a high share of imported premium cars need to be cautious, as the devaluation of the yuan will make imported cars in the long run more expensive for Chinese customers."

In a Natixis research note, Patrick Artus, Chief Economist, Alicia Garcia Herrero, Chief Economist for Asia Pacific and Evariste Lefeuvre, Chief Economist of Natixis North America, wrote that a yuan depreciation will help improve the situation of the mid and downmarket Chinese industry. "However, rising inflation will curb consumption. But this effect will be attenuated by the deflationary environment in China. Also, there will be less incentive for industry to move upmarket due to the real appreciation of the exchange rate; in particular, there could be no more incentive for the modernisation of SOEs (state owned enterprises)."

What happens next?

According to Artus, Garcia Herrero and Lefeuvre, if the Chinese authorities now allowed capital outflows to cause

a substantial depreciation of the yuan, we could in the short-term see larger capital outflows from China and a significant trade-weighted depreciation of the yuan as a trend.

Should this lead to China entering into a "currency war" to improve its cost competitiveness, write the Natixis economists, we can expect more expansionary monetary policies, in China and, in reaction, in the countries competing with China, leading to a depreciation of those countries' currencies against the dollar and the euro and a fall in long-term interest rates; and difficulties for the industries of countries competing with China, hence a decline in those countries' exchange rates, and an improvement in the situation of Chinese industry, and hence probably a rise in commodity prices.

More questions than answers

China's government officials rarely reveal publicly what they are thinking, and while making headlines internationally, this move has something of a calculated, controlled air about it. Nonetheless, because of that 'poker face' approach, the devaluation - and its impact on the automotive industry - raises a whole host of questions, not least of which are:

- What impact will the devaluation have on those regions which have aligned themselves with China for trade (many African nations, Brazil) and aid (Africa, Asia)?
- Is the Chinese economy being stabilised at a level we should consider the new normal?
- Were foreign companies - and automotive OEMs in particular - naive to think that China's high growth rates could go on forever?
- Can the automotive industry continue to rely on China for a significant portion of its vehicle sales - or is the party over?

The answers to these and many other questions will become clear in the weeks and months that follow the Chinese currency's sharpest devaluation in the last 20 years.



CE? Yes, says the auto industry

*International CES 2015 underlined the rapid convergence of consumer electronics (CE) and automotive technology. **Martin Kahl** asked several key automotive industry stakeholders why they hold this consumer electronics show in such high regard*

The convergence of consumer electronics and automotive technology is undeniable – and unstoppable. The car can no longer be the Internet black spot that it has for so long been; consumers will not accept it, OEMs are doing everything they can to enable connectivity, and a host of third parties are lining up to identify and exploit its commercial potential, from infotainment providers to insurance companies and even national and regional authorities.

Every year, International CES, the consumer electronics show held in January in Las Vegas, becomes steadily more ‘automotive’. Indeed, the 2015 edition hosted ten OEMs over a floor space reportedly 20% larger than in 2014 – and there were many more Tier 1 automotive suppliers exhibiting

than in previous years. The event, which in 2015 welcomed a record 176,676 visitors, enjoys widespread mainstream media coverage and most of the column inches about CES 2015 highlighted the developments in automotive technology; not just connected cars and autonomous drive technology, but also the car’s place within the Internet of Things, over the air (OTA) software updates, data analytics, cyber security and data protection, wearable tech and voice and gesture control.

With a calendar of automotive trade shows to choose from, why is CES so attractive to the automotive industry? “The amount of automotive technology here is tremendous, and it grows every year,” says Walter Sullivan, Head of Elektrobit’s new Innovation

Lab in San Jose. “The difference between here and the Detroit Auto Show is that the focus of the car companies here is on the technology that’s in the car. At the Detroit Auto Show, it’s more about the car itself – the design of the car and the efficiency of the powertrain.”

Ironically, adds Martin Schleicher, Vice President Strategy and Key Partnerships at Elektrobit Automotive, it’s also easier to meet German customers at the Las Vegas event than to drive across Germany to visit them. “Everybody we want to work with, and everybody we do work with, is here. Even though we’re not a consumer facing company, this show gives us the opportunity to meet and talk to our customers. We can engage with all of those car companies.”



Elektrobit Mercedes-Benz S-Class Simulator, CES 2015

“We participate in several trade shows throughout the year, but from a pure customer engagement standpoint, CES is probably the most valuable trade show to be at,” says Sullivan. “And being here as an exhibitor also shows your state of the art in terms of technology, what you’re doing, and your innovations. Our being here has been very well received by our customers,” adds Schleicher.

Broadcom is a regular at CES; it is also a founding member of the OPEN Alliance, a special interest group (SIG) established to encourage wide-scale adoption of Ethernet-based automotive applications. “Five years ago, we had no interaction with car customers in general and no reason to talk to them, because we didn’t do automotive products and they didn’t care what we made. Now we see the exact opposite happening,” Scott McGregor, President and Chief Executive of Broadcom, tells *Megatrends*. “CES is a very important show for us. We have quite a number of the major automotive manufacturers coming to talk with us here at the show, to discuss taking the technology you see here for the living room and understanding how to get that into the car. Why should you settle for lower quality content in your car than you have in your living room?”

CES is also a major event in the calendar for infotainment supplier Harman, which hosts a booth at the event highlighting its home

entertainment and automotive technologies. “CES has become our biggest automotive show,” says Dinesh Paliwal, Harman’s Chairman, President and Chief Executive. “We go to Geneva, Shanghai, Frankfurt and other shows, but this is the biggest because almost every automaker is here. Every automaker has spent time with us and we have all our infotainment and car audio and our software suite of services fully in demonstration mode here. At other shows, we may not have as much space to do that.”

Although popularly known as the show where tech giants launch new phones and tablets, drones and ever-higher

definition TVs and curved screens, look more closely and you’ll find the tech behind the tech. Michigan-headquartered TRW has traditionally been viewed as a safety company, supplying products that consumers cannot see and hope to never use, like airbags and other safety equipment. In recent years, it has broadened its electronics technology offerings to include not only advanced driver assistance systems (ADAS) technology that ties in with everyday consumer features and benefits that drivers use, like Adaptive Cruise Control - and it’s looking to the future with a suite of semi- and fully-autonomous drive solutions.



TRW’s stand at CES highlighted the supplier’s suite of semi- and fully-autonomous drive technologies, under the slogan “Automated driving starts with safety”



“As we move into automated driving, the automated driving systems use those safety building blocks that are TRW’s area of expertise,” explains Andy Whydell, the company’s Director Product Planning for Global Electronics. “But this isn’t something that you use once a year or hope to never use, it’s something you want to use every day. So the products that we’re working on are going to be interacting much more than ever with consumers.” CES, he says, is a way for TRW to communicate directly with consumers and show them some of the technologies it is developing. “It’s also an opportunity for us to listen and get some ideas. And as we get further down the road into automated driving, we need to get an understanding of what people are looking for and what their expectations are.”

Tim Yerdon, Global Director of Innovation and Design at Visteon, describes the place of a supplier of automotive electronics technology as being positioned somewhere between the automotive industry and the consumer electronics industry. He likens it to three cogs moving at different speeds: “The auto industry is spinning on a four-year cycle. The consumer electronics wheel spins about eight times faster, and every six months or so there is usually a new product out. We are somewhere in the middle. We have to mesh this and take the best of the consumer world into

automotive, and ensure the expected levels of robustness and reliability.

“We are building in headroom with the microprocessor and the electronics in order to future proof some of these products,” says Yerdon. Visteon claims to be the number 1 supplier of displays, number 2 in driver information and number 3 in cockpit electronics. “In terms of display technology, we have had programmes where, over the three-year development cycle, the display spec has changed four times to higher-resolution displays. This of course affects other graphics and processing speeds. We are really starting to get much better at the prediction side of future proofing technology, and tying that hardware future proofing together with the

potential for over the air software updates.”

If the show hadn’t already secured its place in the global automotive industry events calendar, then the 2015 edition of CES, the ‘car electronics show,’ did just that. With cars on the stands of non-traditional automotive companies – Intel had a Jaguar F-Type, Panasonic hosted the unexpected appearance of the Tesla Model X – CES 2015 became the world’s most car-focused non-car show. There might be a case for a separate ‘automotive CES,’ but that’s a selfish automotive insider’s view; a key part of the show’s attraction to OEMs and suppliers is the wide range of offerings at the show, and the wider CE industry’s emphasis on the car’s place within the Internet of Everything.



“We have to take the best of the consumer world into automotive, and ensure the expected levels of robustness and reliability” - Tim Yerdon, Visteon

COMMENT:

Tumbling fuel prices - buy now, pay later

By Martin Kahl

How do you tell the people filling up their cars at your local fuel station that the attractive low prices aren't as great as they might think?

Tumbling oil prices over the last six months, culminating in [OPEC's decision to maintain a production ceiling of 30 million barrels](#), are effectively flooding the market with cheap oil - a decision that has seen crude tumble from over US\$100 a barrel earlier in the year to a five-year low of below US\$70. Great news if you're out of gas right now - but check out the newspaper headlines as you walk from the pump to the checkout.

[The surprise decision by the oil cartel came in the same week as Black Friday, which is being credited with helping OEMs report strong November US sales.](#) The ever-decreasing number on the gas station price boards that those new vehicle buyers passed on the way to the dealerships had a major impact on their vehicle purchase decisions: as fuel prices fall, sales of larger vehicles rise. Full size pick-up sales are up by around 4.3%, according to Kelley Blue Book's Alec Gutierrez.

Cheap oil, and by extension cheap fuel, though, are seen as a positive for the economy. Spend less on fuel, spend more on shopping. Spend less at the pump, spend more on a new, bigger car.

New SUVs and pick-ups are the most efficient they have ever been. That will

“ The spend-now-worry-later approach overlooks the impact on the invest-now-benefit-later strategy employed by those developing alternative technologies in anticipation of potentially unaffordable fossil fuel costs

be of some comfort to those using current fuel prices to guide their buying decision; rapid dips in oil prices are usually followed by rapid spikes in oil prices, meaning that big sedan / pick-up / SUV might be a more expensive proposition longer term, if not already by this time next year.

There's confusion right across the energy sector. Fast-flowing oil is good news for refineries and pipeline suppliers, but ratings agencies are looking at downgrading the oil companies. Equities markets are riding the oil rout, but commodities have been hit hard. Gold has fallen and rebounded; we've seen copper slide to a four-year low; and currencies have been hit. As the *FT's* John Auther points out, cheap oil means strong dollar, and strong dollar usually means hard times for emerging markets. Russia's unusually frank admission that it expects to slide into recession next year was the result of a sinking ruble, economic sanctions and the falling oil price.

Still, the Fed isn't worried. Stanley Fischer, Vice Chairman of the US Federal Reserve, and New York Federal Reserve President William C. Dudley have welcomed the lower oil prices; they're good for business, they say, as everyone will be better off and will spend, not save that extra cash.

The spend-now approach sees an instant boost to the economy; but the spend-now-worry-later approach overlooks the impact on the invest-now-benefit-later strategy employed by those developing alternative technologies in anticipation of potentially unaffordable fossil fuel costs. The unexpected decline in pump prices has hit the cost side of that equation hard. Those who expected to see a return on investment in US shale extraction and natural gas will be wondering when they will see their money.

Tell that to the smiling folks walking out of the fuel station kiosk.

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