

Automotive update Spring 2022



Sector overview

The Automotive industry has experienced a challenging couple of years. Demand for vehicles remains strong but output has stalled due to the ongoing supply chain constraints. Last year several vehicle manufacturers were forced to temporarily shut down production due to global shortages of semi-conductors and further production suspensions have been announced in recent weeks due to supply chain instability created by the crisis in Ukraine.

Restrictions on the availability of new vehicles has resulted in increased demand for used vehicles and a rapid increase in their value. Despite facing showroom closures and a rapid shift to operating remotely, dealerships have reported record results on the back of strong consumer demand and price inflation. They do however acknowledge that uncertainty remains given the reduced availability of new vehicles and increasing inflationary pressures.

Recovery may now be slower than expected and businesses need to remain flexible to adapt to the changing market dynamics given the uncertainty that remains across the automotive value chain.

Economic data

Q1 2022 SMMT data shows that the UK produced nearly 100,000 less vehicles in the first 3 months of this year than Q1 2021 with March being the weakest for 13 years. S&P Global Mobility have also downgraded its global light production forecasts for 2022 and 2023.

April new car registrations fell 15.8% to 119,167 units, diesel vehicles saw the largest decline (52%) but demand for battery electric vehicles (BEV's) increased 40.9% with electrified vehicles accounting for 27.9% of all new car registrations (SMMT)

Used car transactions rose 11.5% in 2021 with 7,530,956 units sold but still down 5.5% on pre-pandemic 5 year average with Q2 2021 seeing 2.1m transactions. Demand for BEV's rose 119.2% though 96.6% of all used car sales were either petrol or diesel vehicles. (SMMT)

Production delays have increased new car lead times considerably with certain vehicles taking up to 12 months to be delivered.

Autotrader have reported that 1 in 5 'nearly new' cars sold were selling for more than their new equivalents.

Prices for palladium (used in catalytic converters) and nickel (required for battery manufacturing), rose to record levels with the latter being suspended on the LME after prices rose to over \$100,000 per ton.

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Strengths

- > **Demand for alternative fuel vehicles** continues to gather pace with Government policies further driving this trend. As supply issues are not expected to ease in the short term it would appear manufacturers will focus on diverting materials to prioritize the manufacture of electric models.
- > **The Electric Vehicle Strategy** recently published by the government has committed £1.6bn for the expansion of the UK charging network aiming for a minimum of 300,000 charging points by 2030 (There are just over 30,000 currently). Alongside this they have passed new legislation that comes into effect later this year and requires all fast-charging stations to have 99% reliability.
- > **Recent Investment in UK Manufacturing** provides positive steps to secure the future of the UK automotive industry.
 - > **Envision AESC** announced plans to build a \$1bn 'Gigafactory' as part of a partnership with Nissan and Sunderland City Council to support electric car battery production.
 - > **BritishVolt** have started production of its electric car battery factory in Northumberland having received £100m of investment from the UK government via its Automotive Transformation fund.

Challenges

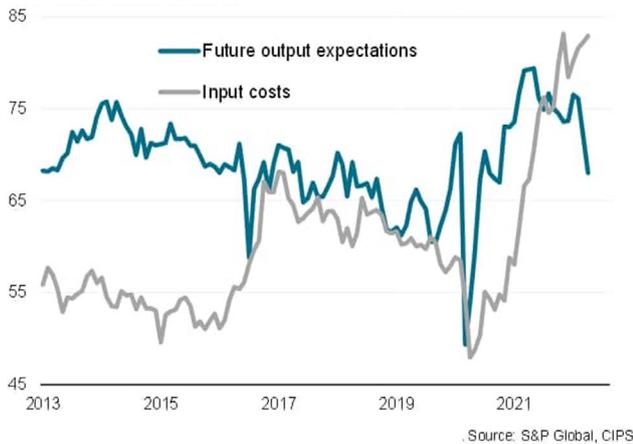
- > **Declining Consumer confidence** as disposable income is further reduced by rising living costs, price inflation, rising fuel prices and increased national insurance contributions. The cost-of-living squeeze may deter some consumers from big ticket purchases such as cars.
- > **Supply chain constraints** look to continue with manufacturers struggling to source key parts. The semiconductor shortages show little sign of easing and vehicle supply is expected to remain constrained. The financial fragility of some suppliers remains a major risk for automakers. This continued pressure has meant a need to adapt trading models to keep factory lines running and look to move their parts supply closer to home.
- > **The Russian/Ukraine crisis** has led to a number of OEMs (original equipment manufacturers) announcing that they have suspended operations and car shipments from Russia and this has exacerbated the logistical and supply chain difficulties. Ukraine is a key hub for automotive manufacturing due to cheaper labour and proximity to European car factories. They serve as key manufacturers of wire harnesses and produce around 50% of the world's supply of Neon gas which is required for semiconductor production.
- > **Strict 'zero covid' restrictions** in major Chinese cities such as Shanghai have hindered production of auto parts as factories are closed. Automotive manufacturers such as BMW have had to temporarily shut down its plants. Chinese Media has suggested that by the end of April only 70% of Shanghai enterprises were restarting production.
- > **Brexit:** Despite a tariff free, quota free deal there has still been an increased cost burden from the additional administration. Going forward manufacturers will need to adapt their supply chains to comply with the new 'Rules of Origin' which stipulates that at least 40% of the value of parts in a finished vehicle is produced within the UK/EU. This rises to 45% in 2023 and 55% by 2027. This poses a potential problem given the requirement for all new vehicles to be electric by 2030.

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Underwriting approach

- > Case by case underwriting approach remains in place with each business to be assessed on their own individual financial merits.
- > Up to date financial information remains critical as will understanding how they are adapting to the supply chain issues and inflationary price pressures. Some caution may be required on buyers with heavy import/export reliance.

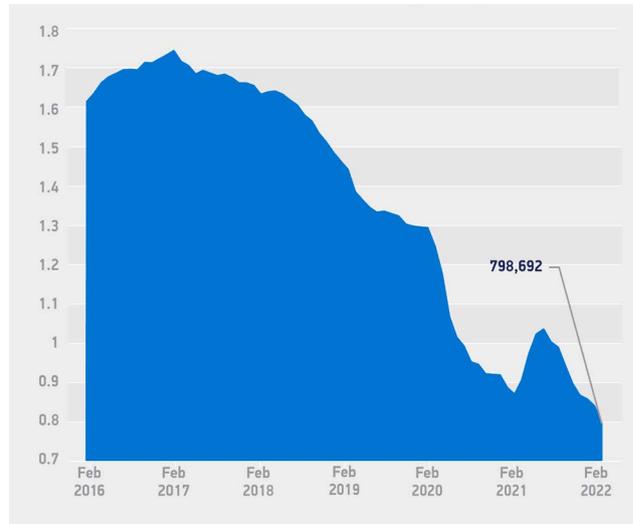
UK PMI survey: input cost inflation and expected output



UK PMI survey data reported a slowdown in the pace UK economic growth during April, as demand for goods and services fell and raw materials, energy prices and wages increased.

SOURCE - <https://ihsmarkit.com/research-analysis/uk-economic-growth-slows-in-april-as-outlook-darkens-and-inflation-pressures-mount-Apr22.html>

Car output - rolling years totals (millions)



SOURCE - https://www.smm.co.uk/wp-content/uploads/sites/2/Car-output_rolling-year-totals-February-2022.png

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