Automotive News

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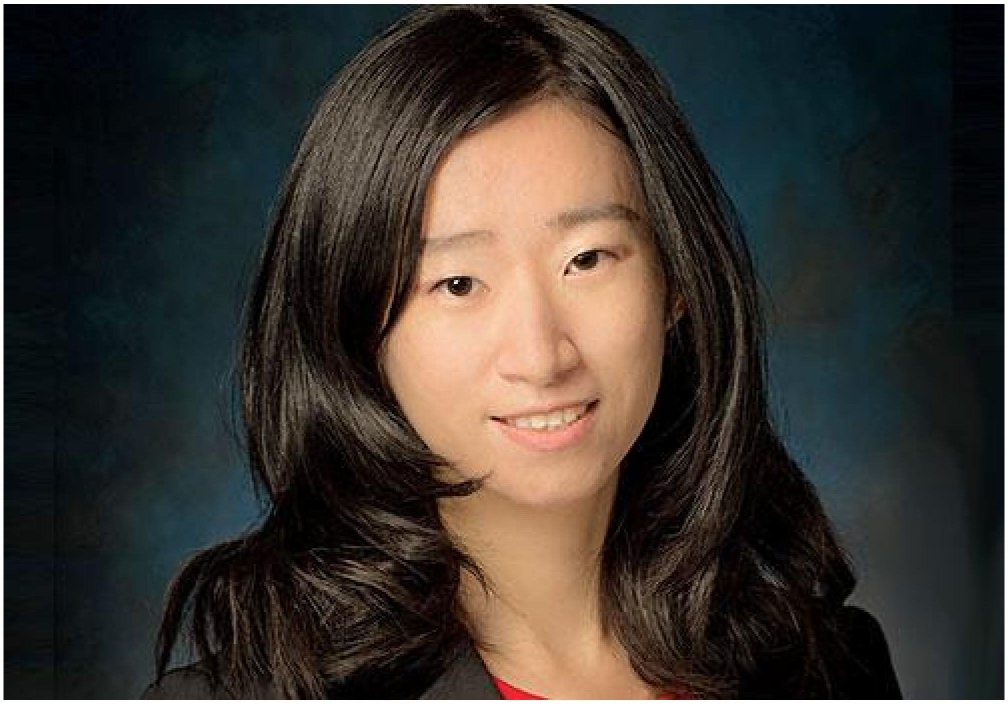
China trade war: Assessing the casualties



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Since the first round of the new China tariffs became effective, automotive suppliers have been scrambling to determine bottom lines, apply for exemptions, look for ways to mitigate exposure, renegotiate contracts and investigate fundamental restructuring.

In reaction to the trade war, Chinese suppliers without a U.S. footprint are generally looking to relocate their production lines to Mexico and Southeast Asia.

Even before the Trump-imposed tariffs took effect, many Chinese suppliers were already evaluating their options to move certain low-skilled factory work out of China to avoid increasing Chinese labor costs.

The tariffs have served to accelerate this process.

Many suppliers reacted quickly by undertaking studies to assess where they could move production to best mitigate the impact of tariffs. The findings are clear: Labor costs in the U.S. are on average four times higher than in Mexico and many Southeast Asian countries.

Until Chinese suppliers can substantially lower their labor costs by using advanced manufacturing techniques, it makes more sense to move production to those sites.

Chinese suppliers that are considering moving production to the U.S. or expanding existing plants in the U.S. face difficulty in filling jobs due to the historically low unemployment rate and the lack of skilled blue-collar workers.

From the U.S. perspective, small and medium-size U.S. suppliers that depend on imports from China will likely have no choice but to cut staff to survive the trade war.

While some higher-tier suppliers that have achieved a global footprint and domestic production will have little difficulty enduring the trade war, increased costs resulting from the tariffs will place a significant and harmful burden on small and medium-size lower-tier suppliers.

Where U.S. suppliers are unable to absorb the higher costs or pass the costs on to the consumer, their only options will be to institute layoffs, move overseas or close plants.

Threat to survival

"The coldest winter for our business is coming," say many Chinese suppliers who rely heavily on exports. If a 25 percent tariff is implemented at year end, many Chinese suppliers won't survive.

A series of shutdowns of Chinese factories will likely occur, causing significant disruption in the entire automotive supply chain.

With limited viable options for alternative supplier sourcing for vehicles under production or development, U.S. suppliers will be negatively impacted by the volatility of the supply chain.

A sharper-than-expected China slowdown will eventually have detrimental effects on the U.S. automotive industry.

China is an important market for U.S. automakers. In 2017, 20 percent of all U.S. automobile exports went to China. In the same year, American passenger vehicles sold in China accounted for 12.3 percent of all passenger vehicles sold in China.

China has been General Motors' largest retail market for six consecutive years. Tesla derives a fifth of its revenue from the Chinese market.

China's economic outlook is already clouded by softening domestic growth, tightening of credit and now, a full-blown trade war. A slowdown of the Chinese economy means decreased demand for American vehicles. In fact, GM, Ford and Fiat Chrysler have lowered their full-year profit forecasts due to escalating tariffs.

The automotive industry is no stranger to the cyclical nature of the world economy. Just as there are cycles in automotive demand, there are cycles in the trade frictions between countries.

To survive — and even thrive — under the headwinds of tariffs, every supplier will need to reconsider and rebalance its globalization and localization strategy to properly diversify its risk and exposure under the new norm.

Keep investing

Considering the cyclical nature of the world economy, U.S. and Chinese companies would be wise to continue investing in each other.

Chinese suppliers should continue investing in the U.S. and/or expand their existing U.S. footprint through mergers, acquisitions and greenfield investments. The U.S. continues to offer one of the most business-friendly environments in the world.

Although the Foreign Investment Risk Review Modernization Act was recently signed into law by President Donald Trump, and many Chinese companies are worried that the increased government scrutiny will jeopardize their investments, it is expected that U.S. regulators will continue to clear transactions from private-sector companies that don't involve sensitive technology, infrastructure or personal data.

At the same time, U.S. suppliers should not miss out on China's continuing growth and loosening restrictions. China is scheduled to lift foreign ownership restrictions on manufacturing companies by 2022, with restrictions on electric-car makers to be removed as soon as this year.

There are also many other laws and regulations under discussion in the Chinese government aimed at deepening the reform, further opening Chinese markets and leveling the playing field. U.S. businesses would be wise to take advantage of these new policies to gain market share in the single-largest consumer market in the world.

It's easy to start a war, but never easy to stop one. Automotive suppliers need to be prepared to be in this trade war for the long haul.