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AUTOMOTIVE

Luxury automakers facing uncertainty, rising costs due to latest tariffs

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The BMW X3 is now assembled in China due to tariffs. Image credit: BMW

By SARAH RAMIREZ

With trade tensions continuing to escalate between the United States and both China and Japan, luxury automakers in the U.S. and abroad are likely to take a hit.

Earlier this month, China announced plans to impose additional tariffs on $75 billion worth of U.S. exports, including a 25 percent duty on U.S. cars slated to go into effect in December. Meanwhile at the G7, the U.S. and Japan tentatively agreed to forestall additional tariffs on Japanese automotive exports to the U.S.

"These tariffs are hitting the brands that build in the U.S. and export to China, regardless of whether it's an American brand or one from Europe," said David Undercoffler, editor in chief of Autolist, San Francisco. "BMW, Mercedes-Benz and Ford have been hit particularly hard since together they make up about 77 percent of all vehicles exported from the U.S. to China.

"Trade with Japan is much different in the auto sector than it is with China for a huge number of complicated reasons," he said. "Japan is open to moves by the U.S. to reduce the current trade deficit most of which is made up of autos and auto parts so long as it doesn't mean slapping massive 25 percent tariffs on car exports, since that could tilt Japan's economy towards a recession."

Tariff repercussions

Instigated by U.S. President Donald Trump, the U.S.-China trade war began in 2018, with both countries trading tariff increases on a variety of products.

At the time, the president proposed tariffs that would reach up to 25 percent, placing a significant toll on foreign exporters and the customers in the U.S. who desire foreign cars (see story).

From October 2018 to March 2019, vehicle exports to China fell from $5.9 billion to $4.1 billion, according to *The Washington Post*. This accounted for a 4 percent drop in overall U.S. automotive exports.

China is an important market for Tesla. Image courtesy of Tesla

China's commerce ministry announced that as of December 15, tariffs will increase to 25 percent on vehicles and 5 percent on auto parts exported from the U.S.

"At 25 percent, 232 tariffs stand to cost our industry 2 million sales annually and 117,000 dealership jobs," said Howard Hakes, chairman of the American International Automobile Dealers Association, in a blog post. "AIADA continues to work with manufacturers in D.C. to push back against the argument for these tariffs and ensure they never see the light of day."

For this next round of vehicle tariffs, U.S. automakers will not be the only ones impacted. In addition to the luxury automakers that manufacture cars in Europe, many American-made vehicles include foreign parts, so tariffs would still increase production costs stateside.

In recent years, German automakers BMW and Mercedes-Benz have ramped up their manufacturing footprint in the American south.

This spring, Mercedes revealed that it will be producing an upcoming Maybach sport utility vehicle in an Alabama plant.

According to *Automotive News*, this will be the most expensive passenger vehicle manufactured in the United States, with an estimated starting price of $200,000. Based on the GLS, the car is expected to be available starting next year (see story).

"BMW currently builds most of its X crossovers globally in the U.S., and last year China gobbled up about a third of those exports," Mr. Undercoffler said. "Ironically, Trump's tariffs can encourage more Chinese assembly of vehicles that were previously built in the U.S.

"This is the case with BMW's X3, which is now assembled in South Africa and China, partially because of tariffs imposed last year," he said.

Among American automakers, luxury electric vehicle manufacturer Tesla is also likely to see struggles because of the tariffs.

Reuters reports that Tesla will raise prices in China effective Aug. 30, earlier than initially planned due to a weakened yuan. The automaker is also reportedly considering a second price increase in China this December, once the newest duties take effect.

"Unlike most U.S. automakers that sell in China, Tesla doesn't currently build any vehicles there," Mr. Undercoffler said. "An assembly plant is currently being built, but until it's online, Tesla is subject to stiff tariffs on its cars since they're imported.

"China is also crucial to Tesla because it's become an EV-friendly market that Tesla badly needs to make up waning U.S. demand," he said.

According to Frost & Sullivan, China is likely to account for 55 percent of all electric vehicle sales this year. In comparison, 21.2 percent of EVs will be sold in the Americas the second largest market share and the rest of the Asia-Pacific region is responsible for only 4.2 percent of EV sales (see story).

These tariffs also come at a time when Chinese consumers have a growing appetite for luxury vehicles.

Frost & Sullivan's "China Luxury Car Market, Forecast to 2025" found that 10 percent of the 24 million passenger vehicles sold in China in 2017 were luxury models. The report predicts that the luxury segment will dominate more than 60 percent of Chinese market share by the year 2025.

Mercedes, Audi and BMW are the most popular luxury passenger vehicles in China, with a combined 68.8 percent of market share across SUVs and sedans last year. European automotive original equipment manufacturers lead the luxury car market in China (see story).

Mercedes is one of the most popular car brands in China. Image credit: Mercedes-Benz

In the meantime, luxury automakers need to prepare for the impact that possible tariffs may have on sales in the U.S.

According to a 2018 survey from Autolist, 65 percent of consumers expect car prices to climb if auto tariffs come to fruition. Forty-one percent of car shoppers would choose to purchase a pre-owned vehicle if tariffs increased car costs.

Based on reports, if automakers choose to pass on increased costs to consumers, prices could rise by up to 20 percent a difference of thousands of dollars (see story).

"As tariffs begin to impact pricing, consumers tend to gravitate toward the best deals in terms of price, or even delay purchases, especially of big ticket items like automobiles, in the hope that prices will come back down in the near future," said David VanAmburg, managing director at the ACSI, Ann Arbor, MI.

Automotive uncertainty

Besides China, Mr. Trump has also threatened other trading partners with automotive import tariffs on vehicles and parts.

In May, the Trump administration cited national security concerns as justifications for proposed 25 percent tariffs, drawing criticism from automakers in the U.S. and elsewhere. As U.S. automakers become less competitive, the Commerce Department believes this is diminishing their capacity for innovation, thereby impairing national security.

The tariff decision was postponed for a six-month period as the White House attempts to negotiate trade deals with the European Union and Japan (see story).

"Many Japanese automakers have significant manufacturing and assembly operations in North America and have for decades," Mr. Undercoffler said. "That gives Japan and its automakers a key bargaining chip; they can point to the tens of thousands of U.S. jobs these facilities have created as a sign of these companies' commitment to the U.S. economy and a reason for the U.S. not to increase tariffs on those vehicles built in Japan."

Later in May, Mr. Trump threatened a 5 percent tariff policy on Mexico before changing course. Had the policy taken effect, it could have impacted luxury automakers such as BMW, who recently opened a new factory in Mexico (see story).

As the trade war with China continues, automakers are reevaluating their production plans.

"Most brands already have a production footprint in China, not because of Trump's tariffs but due to China's longstanding requirement that any foreign automaker looking to build a factory in China must do so in partnership with a local Chinese company," Autolist's Mr. Undercoffler said. "So those automakers that can are increasing production in those facilities or looking for how they can shift U.S. production to other plants globally in order to avoid the tariffs on U.S.-made goods in another ironic byproduct of Trump's tariffs they're potentially pushing production out of the U.S.

"It's important to remember, however, that moving production anywhere is extraordinarily expensive and time-consuming, and could potentially affect an automaker's global production plans for decades," he said. "So to a degree, there will be brands that hope to ride out these tariff storms and eat the short-term costs and effects rather than make very consequential production moves."