
LMC AUTOMOTIVE

# Alert

## Auto impact of US tariff threat on imports from Mexico

4 June 2019

# Situation and Executive Summary

- The US plans to impose a 5% tariff on all imports from Mexico, starting on 10 June. The duty will increase by 5% every month, until reaching a cap of 25% in October and will remain in place until Mexico implements measures to significantly reduce the amount of illegal immigration across the US-Mexico border. President Trump is using the authority to invoke such tariffs under the International Emergency Economic Powers Act of 1977, citing national security.

- In 2018, a total of $372 billion in goods and services were imported from Mexico, while the US exported $299 billion to Mexico. Completed vehicles and auto parts from Mexico accounted for $93 billion, or 25% of the total, while vehicles and parts to Mexico amounted to $22 billion, or 7% of the total.

- Approximately 40 different models are built in Mexico and sold in the US, totalling an expected 2.7 million units in 2019, or 16% of all Light Vehicles sold in the US. Bodystyle distribution is fairly even, with 36% of imports being SUVs, 33% Cars and 28% Pickups.

- According to the Center for Automotive Research, 16% of parts used in US assembly plants come from Mexico, including 70% of critical wire harnesses. Many of these parts can cross the US-Mexico border as many as four times, as parts or sub-assemblies, so the impact reaches far beyond fully finished vehicles.

- If a tariff of 5% is imposed, but lasts only one month, we believe that the industry could absorb the average $1,700 price increase on the models and parts imported from Mexico. With the tariff rising by 5% in each passing month, however, prices to consumers would be impacted more significantly, thus lowering vehicle volume and pushing consumers to either hold off on purchases or shift to the used car market.

- Given the Car-heavy element of the Mexican imports, a temporary tariff could result in further production cuts in Mexico, reducing some of the current concerns over high inventory levels. Light Vehicle production in Mexico is expected to be flat in 2019, at 3.9 million units, or 23% of North American volume. As a reference, we expect that volume to grow to 4.5 million units, or 25% of North American production by 2026.

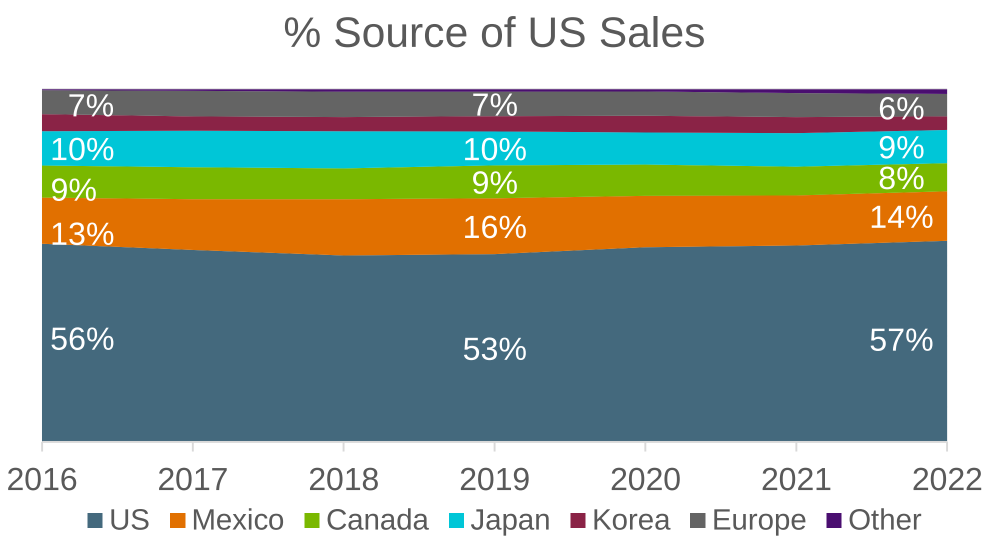
- A sustained period at the 25% tariff level would have a potentially devastating impact on the auto industry. Prices on models imported from Mexico could increase by an average of $8,500 and when factoring in parts for assembly in the US, the average price of all vehicles sold in the US could rise by as much as $2,500-3,000. Such a substantial increase could lower sales by 500,000-1.5 million units annually.

- A prolonged period of tariffs on Mexican imports would likely push Mexico into recession and could also threaten a recession in the US. Our partner Oxford Economics estimates that the tariff would cut GDP growth by at least 0.7 ppt in 2020.

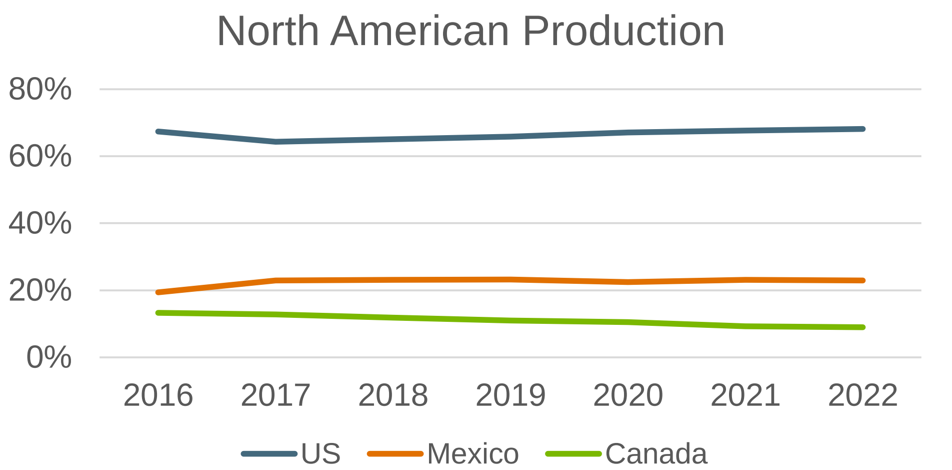
- The timing of new tariffs and related uncertainty could not come at a worse moment for the auto industry as it continues the process of restructuring for the longer term and furthers its investment into electrification and autonomous technologies. While this may be an unconventional tactic used to bring Mexico to the table on illegal immigration, it could also lead to an increase in auto manufacturing in the US. Given the unpredictable nature of the Trump administration, we estimate the probability of the tariff being imposed at 50%.

# Sourcing Analysis

Given the substantial manufacturing footprint and investment, the US still dominates supply of vehicles to the US market, though it is set to decline from 56% in 2016 to a projected 53% this year. Mexico is the second-largest source of sales, at 16%, so the tariff risk is considerable, covering Cars, SUVs and Pickups in near equal proportions. Looking ahead, we are already expecting a slight pullback in Mexico's share of US sales to 14% by 2022. Canada and Japan are both hovering at around 10%, followed by Europe at 7%.




Mexico's share of North American production has increased from 19% in 2016 to 23% this year, something that may have contributed to the Trump administration's new tariff position, alongside the publically stated stance on immigration. Over the next couple of years, we expect Mexico's share to remain relatively flat, though capacity and volume are likely to increase as BMW, Mercedes-Benz/Nissan, GM and Toyota all increase capacity in Mexico. During the same period, the US is expected to grow to 68% of production in the region, from 66% in 2019.



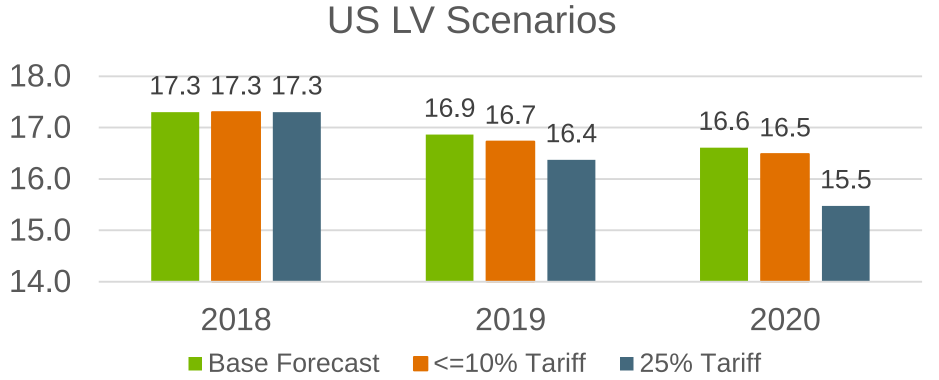



Source: LMC Automotive

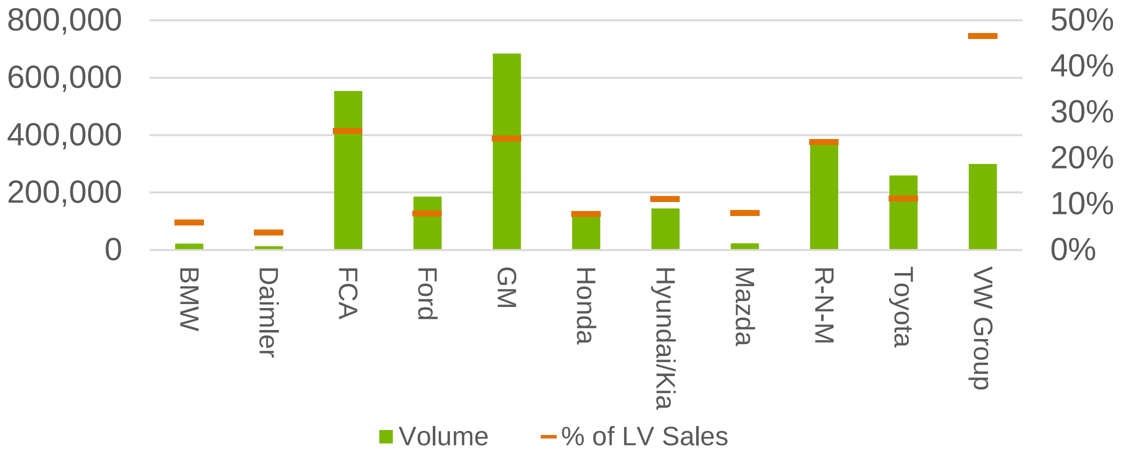
# Market Outlook and Risks

Without any tariff activity, the US Light Vehicle market is expected to decline by 2.5% to 16.9 million units in 2019, then contract by a further 1.5% in 2020 to 16.6 million. A 10% tariff lasting for up to three months would result in a potential price increase of $3,500 on Mexican-sourced sales and a corresponding spread of $1,200 across the industry, including the impact from parts. This would lower demand in the US by an expected 140,000, or nearly 1%, this year, with some carryover impact into 2020.

A longer span during which the tariff reaches 25% would have a more devastating impact, with prices on Mexican-made vehicles increasing by $8,500 and the industry average rising by roughly $2,500-3,000, with parts factored in. Prices at this level would likely reduce demand by nearly 500,000 units in 2019 and by an estimated 1.1 million in 2020 (-7%). Consumers would likely delay or suspend purchase decisions, or shift to the used car market.




At the OEM level, VW Group carries the highest risk as a percentage of US sales, as an estimated 47% of its 2019 sales are sourced from Mexico – significantly higher than the 16% industry average. Both GM and FCA also have sizeable volume at risk, owing to heavy SUV and Pickup production. Detroit's Big Three make up 53% of the volume imported from Mexico. Pickups are three of the top five models at risk, and the Ram Pickup line is the highest volume vehicle in jeopardy from tariffs. Excluding Tesla, Subaru and Volvo, virtually every major OEM has some degree of risk.




**Top 5 Imported Models - Mexico**

| Model | 2019F Volume |
|---|---|
| Ram 1500/2500/3500 | 245,548 |
| Toyota Tacoma | 238,493 |
| Nissan Sentra | 210,649 |
| Chevrolet Silverado | 200,297 |
| Jeep Compass | 165,880 |

Source: LMC Automotive

# About LMC Automotive

LMC Automotive is the premier automotive forecasting company and has an exclusive focus on the industry and an understanding of the dynamics that drive it. With offices in Oxford, Detroit, Shanghai, Bangkok and representation in Germany, Brazil, Japan and Korea, we combine more than 30 years of experience in macroeconomics and demand analysis, with a global network of ground-level, intelligence-gathering expert analysts creating unique perspectives and insights. We help our clients make sense of what is happening today, while planning for tomorrow.

LMC's principal area of activity is the global forecasting of vehicle sales, production and powertrain and coverage is provided of both Light and Heavy Vehicles.

The automotive industry is facing an extraordinarily rapid period of technology evolution, particularly in the area of alternative propulsion systems. LMC is taking the lead in the analysis of the impact of these changes and is unique in offering several services that specifically forecast future demand and production for hybrid, electric and fuel cell powered vehicles.

Our core services include:

- **Global Automotive Production Forecast** (*monthly)* by model, plant, platform, SOP/EOP with a 7-year forecasting horizon
- **Global Automotive Sales Forecast** *(monthly)* by model, bodytype with a 12-year forcasting horizon
- **Global Light Vehicle Powertrain Forecast** *(quarterly)* by model, engine (IC, BEV, etc), transmission, driven wheels with a 7-year forecasting horizon
- **Global Hybrid & EV Forecast** *(quarterly)* sales by model and propulsion system with a 12-year forecasting horizon; optional **Battery & eMotors Module** (model level, xHEV technologies)

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forecasting@lmc-auto.com

lmc-auto.com

Oxford +44 1865 791737
Detroit +1 248 817-2100
Bangkok +662 264 2050
Shanghai +86 21 5283 3526