Prospects

Aperiodic – no. 24/274 – 17 October 2024

The point of view

China in the face of protectionism

After a suspenseful wait, the European Union has maintained its decision to impose higher import tariffs on Chinese electric vehicles (EVs), with the least cooperative manufacturers facing tariffs as high as 45.3%. This is a setback for China, which was hoping that a combination of carrot (promised investment in Europe) and stick (retaliation and reprisals) would deter the EU. Various approaches and official visits over the past few months – notably to Spain, where Prime Minister Pedro Sanchez afterwards came out in opposition to higher tariffs – have failed to bear fruit.

Bad news for Chinese carmakers

Just five countries (Germany, Hungary, Malta, Slovakia and Slovenia) voted against the decision; twelve, including Spain and Sweden, abstained; and ten, including France, Italy and Poland, voted in favour: **a divided Europe, but not divided enough to put a stop to these measures China was so keen to avoid. For the time being, the European Commission has rejected all the Chinese government's proposals**, starting with its proposed minimum price of €30,000, which the Commission deemed too low, as well as the introduction of a quota system. The precedent of solar panels, which were subject to similar measures between 2013 and 2016, no doubt played its part in this decision: quotas did nothing to prevent the EU's Chinese competition from laying waste to the European solar panel industry.

While the United States and Canada had already taken turns to announce much heftier tariffs (100% for both countries), their share of total Chinese EV exports remains marginal. By contrast, in 2023 the European Union absorbed one third of all Chinese EV exports, worth a total of $12.8 billion.

For Chinese EV makers, the timing could not be worse: between January and August they racked up record losses of $20 billion as a result of weak domestic demand and less buoyant than expected exports, prompting manufacturers to wage an intense price war in an effort to shift their stock. The upshot is that export prices have fallen by around 12% since the beginning of the year.

Meanwhile, **domestic prices have fallen by as much as 17%.** The China Automobile Dealers Association says only 27% of automobile dealers turned a profit in the first half of 2023, compared with 50% in 2021. Market weakness and the price war have added to the inflationary pressure that has been affecting China for over a year now, fuelling hopes of a fiscal support package eagerly awaited by Chinese markets and economic agents.

How much leeway does China have?

China's initial response was swift: it announced that importers of brandy – which includes cognac – would have to put down security deposits with the Chinese customs authorities. However, charges will only be levied if the government approves a hike in import tariffs – potentially to as high as 35% – on these products.

In reality, the only European country affected by this move is France, with total cognac exports of $1.1 billion in 2023. Unlike the European Union's substantiated accusations, based on a comprehensive report assessing the amount of state subsidies received by Chinese vehicle manufacturers, the allegations made by China, which sees itself as a victim of dumping by French winemakers, are difficult to discern. France has already said it intends to file a complaint with the WTO – a long-winded process that rarely pays off.

China has also reiterated that investigations into pork and pork products (notably offal) as well as dairy products are ongoing and said it has not ruled out raising import tariffs on combustion vehicles with large engine capacities, this time targeted at German manufacturers.

Another option available to China is to leverage its promised investments in a number of European countries. There is no shortage of planned projects, which include a Dongfeng production site in Italy, an assembly line for Chery-branded cars in Barcelona, and battery plants in Germany and France. With the commissioning of the Barcelona assembly line already delayed by a year, it would come as no surprise if China were to backtrack on other announcements. **But there is one country that might escape Chinese retaliation: Hungary, long seen by China as source of tension and division within the EU**.

Hungary is currently the main catalyst for Chinese investment in Europe, precisely around the electric vehicle value chain. While Turkey, which has a vehicle export deal with the EU, was also at one time seen as a Trojan horse for gaining access to the European market, the country's decision to also impose 40% tariffs on Chinese EVs could prompt Chinese manufacturers to rethink their plans. And this mistrust goes both ways: China's Ministry of Commerce has asked manufacturers to be careful about what technology and assets they transfer, particularly to India and Turkey. A planned BYD facility in the Izmir region with a production capacity of 150,000 vehicles a year for an initial investment of around $1 billion could end up consisting of nothing more than assembly lines.

Lastly, Mexico – a new gateway to the United States for Chinese products – has also indicated that it would like to reduce its reliance on China. With the US election approaching, another win for Donald Trump could potentially pave the way for tighter controls on the origin of imports, particularly those from third-country markets (Mexico and Vietnam) that are increasingly acting as intermediaries, helping China circumvent tariff and non-tariff barriers put in place by the United States.

☑ **Our opinion –** *China's hard-fought negotiations to avoid additional import tariffs on its EVs are further evidence – if any were needed – of how much is at stake in this decision. With its domestic market in difficulty and reacting strongly to each new announcement by the authorities, signalling a degree of agitation, China had been banking on the export sector to take up the slack. Manufacturers, who have been waging an intense price and technology war, believed that the associated losses and margin squeezes would be temporary and that they would be able to balance their books by winning market share in foreign markets. This would be a much more difficult task if they were to be cut off from European markets.*

However, China is not out of the game just yet. For one thing, negotiations are ongoing. The European Commission rejected an initial proposal consisting of a combination of quotas and minimum prices on the basis that it did not do enough to protect the single market from what the Commission sees as unfair competition. But China might come back to the table with another offer, specifically around prices. While higher import tariffs will certainly erode the price competitiveness of Chinese EVs, it will not eliminate it entirely: with entry-level prices starting at around €30,000 before any increase in tariffs, some models are still more affordable than those made by European manufacturers.

In the 1980s, the United States took a very dim view of Japanese cars and trucks invading American roads and forced Japanese manufacturers to set up shop on US soil. A similar strategy could also enable China to reposition itself in Europe, with an additional benefit: it would create competition between European countries vying for the associated investment, thus stoking further dissension. As we have seen, European countries have been extremely divided over this issue, with Germany in particular expressing strong opposition. By directly and immediately targeting a product that is only exported by France, seen as a key country in favour of import tariffs within the European Union, China is showing that it will not hesitate to exploit different countries' offensive interests. If the investigation into dairy products proceeds through to its conclusion, it will penalise Denmark and the Netherlands, both of which voted in favour of import tariffs, and Spain, which abstained despite heavy pressure from China.

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