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China has changed its policy to further open up its automotive market that will benefit foreign luxury vehicle automakers

China has pledged to further open up its automotive market, as declared by China's President XI in early April, at the opening ceremony of the Boao Forum for Asia Annual Conference 2018, by lowering import tariffs and easing controls on foreign ownership in an automotive JV in China. The objective is to accelerate the development and transformation of the Chinese automotive industry by bringing more technologically advanced automakers, especially for EVs, and creating more intense competition in this market. However, foreign luxury vehicle automakers and spare parts manufacturers seem to be the ultimate winners of such policy and market change.

Lower import tariffs will make import vehicles, in particular, foreign luxury vehicles, more competitive on the Chinese market: upsides on their market share in China

China is by far the world's largest car market for the 9th consecutive year, with 29 million motor vehicles sold in 2017 – including 25 million passenger cars and 4 million commercial vehicles - accounting for more than 30% of world's sales. Chinese automotive market remains highly attractive to all automakers across the globe.

Foreign vehicle brands predominate in China, with 14 million passenger cars sold in 2017, accounting for 56% of the market, while only 11 million Chinese brands passenger cars were sold during the year. The most important foreign car brands active in China come from Germany, Japan and America.

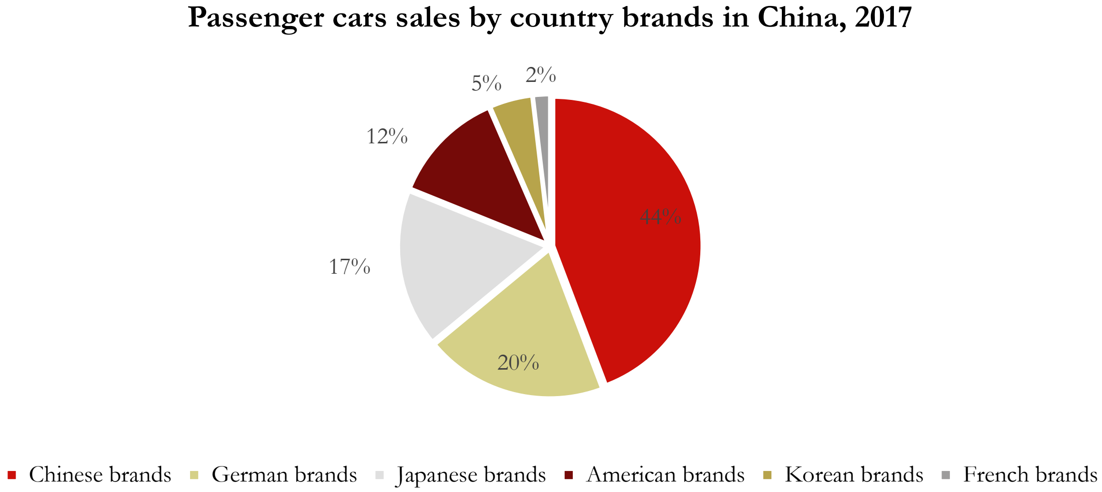

Figure 1. Passenger car sales by country brands in China, 2017

If we look into the vehicle price segments proposed by the automakers in the Chinese market, we find that Chinese automakers mainly focus on the low-to-medium-end market, with more than 80% of the Chinese brands vehicles priced (MSRP[1]) at less than 120 thousand Yuan (about 19 k$), as shown in the figure below. While the JV OEMs in China target the medium-end market, the luxury premium vehicle market is almost dominated through imports by foreign luxury automakers, where nearly half of the imported vehicles are high-emission and high-end with engine above 2.5 liters.

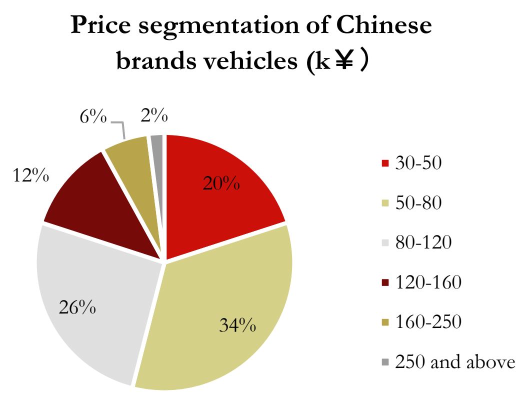

Figure 2. Price segmentation of Chinese brands vehicles (k￥)

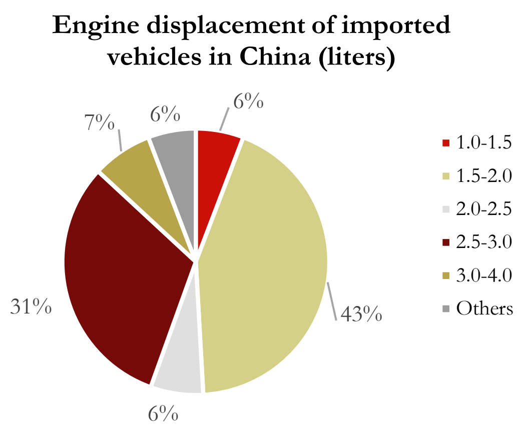

Figure 3. Engine displacement of imported vehicles in China (liters)

[1] : Manufacturer's Suggested Retail Price

In 2017, China has imported 1.2 million motor vehicles in total, mostly passenger cars, showing an increase of 16% YoY. On the top 10 imported vehicles brands, nine have experienced growth in 2017 compared with 2016.

Table 1. Top 10 imported vehicles brands in China in thousand units

Rank	Brands	2017	2016	YoY
1	BMW	187	172	9%
2	Mercedes-Benz	184	156	18%
3	Lexus	135	107	26%
4	Toyota	84	75	12%
5	Porsche	71	64	11%
6	Land Rover	69	57	22%
7	Lincoln	65	36	79%
8	Volkswagen	59	34	73%
9	Audi	49	57	-13%
10	Mini	36	31	17%

The aggregated imported vehicle value (CIF[2]) is 342 billion Yuan (about 54 B$) in 2017 according to China Customs, an increase of 16% YoY. The average CIF per vehicle is 276 thousand Yuan (about 44 k$), to which there are import tariffs, consumption tax, VAT and margins that should be added to finally reach MSRP (Manufacturer's Suggested Retail Price) in China, normally representing 80% to 150% extra to CIF value, depending on import tariffs, value-added tax (VAT) and consumption tax.

Hereafter we explain how the cut of import tariffs influences the after-tax price of imported vehicles in China, as promised by president Xi, at the opening ceremony of the Boao Forum for Asia Annual Conference 2018 in early April, that China's car import tariffs will be significantly lower.

How import tariffs influence the after-tax price of imported vehicles?

Historically, China's auto import tariffs have been adjusted several times, from 220% in 1986 before joining the WTO, to the current level at 25%.

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[2] CFI (Cost Insurance Freight) is an incoterm used in national accounts to define the cost of a commercial exchange. It includes the regular transaction price of the good, plus the cost of packing, freight, insurance in transit to destination.

The after-tax price of an imported vehicle includes the CIF value, import tariffs, value-added tax (VAT) and consumption tax, for which, in respect to WTO rules, China applies identical VAT and consumption tax to both domestic and imported products.

To promote energy-efficient vehicles, the consumption tax is proportional with the engine displacement of the vehicle, from 0% for battery electric vehicles up to 40% for high-emission vehicles with an engine displacement of more than 4.0 liters.

Tax calculation formulas for imported vehicles are given as follows:

Import Tariffs (I)	$\text{CIF Value} \times \text{Import Tariff Rate (25\%)}$
Consumption Tax (C)	$(\text{CIF} + \text{I}) \times \text{Consumption Tax Rate (Depending On Engine Displacement)}$
VAT	$(\text{CIF} + \text{I} + \text{C}) \times \text{VAT Rate (17\%)}$

A consolidated tax rate can be determined based on the formulas described previously:

$$\text{Consolidated tax rate} = \frac{(\text{Import tariff rate} + \text{Consumption tax rat} + \text{VAT rate} + \text{Tariff rate} \times \text{VAT rate})}{1 - \text{Consumption tax rate}}$$

Thus, the after-tax price of an imported vehicle can be deduced as follows:

$$\text{After tax price} = \text{CIF Value} \times (1 + \text{Consolidated Tax Rate})$$

In order to assure the stability and to protect the domestic automotive industry, the import tariffs would not be sharply changed. We estimate that the import tariffs on auto import would probably drop to 15%, reaching the same level as in the EU.

Taking the examples of a BMW X3 and a Mercedes-Benz GLE, which are among the most popular imported vehicles in China, we illustrate in the following table how the change on import tariff rate impacts the after-tax price of the imported vehicle:

Table 2. BMW X3 and Mercedes-Benz GLE price comparison in different import tariff rates

	BMW 2018 X3 sDrive 30i 2.0L		**Mercedes-Benz GLE 350 4MATIC 3.5L**	
Tariff rate (%)	**25%**	**15%**	**25%**	**15%**
CIF Value (￥)	268 695		344 610	

Import Tariffs (￥)	67 174	40 304	86 153	51 692
Consumption Tax (￥)	17 677	16 263	143 588	132 101
VAT (￥)	60 103	55 295	97 640	89 828
After-tax Price (￥)	**413 649**	**380 557**	**671 990**	**618 230**
Price discount (￥)	**33 092**		**53 759**	
Price discount rate (%)	8%		8%	
MSRP (Manufacturer's Suggested Retail Price, ￥)	498 000		858 000	

The after-tax price discounts in average 8% in the condition of a 10% drop in tariff rate. Thus, the higher the imported vehicle CIF is, the more important price discount in absolute value the car will benefit. Luxury imported vehicles will embrace a significant reduction in after-tax price in absolute value, making them more attractive to Chinese high net worth consumers, that helps to improve the market share of high-end foreign brands in the Chinese market.

More foreign luxury automakers, seeing their market share growing, are likely to set up manufacturing plants in China, especially for electric vehicles, under the circumstances of foreign ownership restriction remove

The restriction of foreign ownership in Joint Venture in the automotive industry was initially enacted in 1994 in the document < Automotive Industry Policy 汽车工业产业政策 > and then in 2004 in another document < Automotive Industry Development Policy 汽车产业发展政策 >, that limited to 50% of foreign capital in automotive Joint Venture in China. There are today 25 automotive JVs in China formed between Chinese domestic and foreign automakers. Their shareholder structure is shown in the table here-below.

Table 3. Automotive JV in China

Joint Venture	Chinese automaker	Foreign automaker
Dongfeng-Honda 东风本田	Dongfeng 东风 – 50%	Honda 本田 – 50%
Dongfeng-Nissan 东风日产	Dongfeng 东风 – 50%	Nissan 日产 – 50%
Dongfeng-Renault 东风雷诺	Dongfeng 东风 – 55%	Renault 雷诺 – 45%
Dongfeng-PSA 东风标致雪铁龙	Dongfeng 东风 – 50%	PSA 标致雪铁龙 – 50%

Dongfeng-Yueda-Kia 东风悦达起亚	Dongfeng 东风 – 25% Yueda 悦达 – 25%	Kia 起亚 – 50%
GAC-Fiat 广汽菲亚特	GAC 广汽 – 50%	Fiat 菲亚特 – 50%
GAC-Honda 广汽本田	GAC 广汽 – 50%	Honda 本田 – 50%
GAC-Mitsubishi 广汽三菱	GAC 广汽 – 50%	Mitsubishi 三菱 – 50%
GAC-Toyota 广汽丰田	GAC 广汽 – 50%	Toyota 丰田 – 50%
Changan-Ford 长安福特	Changan 长安 – 50%	Ford 福特 – 50%
Changan-Mazda 长安马自达	Changan 长安 – 50%	Mazda 马自达 – 50%
Changan-PSA 长安标致雪铁龙	Changan 长安 – 50%	PSA 标致雪铁龙 – 50%
Changan-Suzuki 长安铃木	Changan 长安 – 51%	Suzuki 铃木 – 49%
Foton-Daimler 福田戴姆勒	BAIC 北汽 – 50%	Daimler 戴姆勒 – 50%
Beijing-Hyundai 北京现代	BAIC 北汽 – 50%	Hyundai 现代 – 50%
Beijing-Benz 北京奔驰	BAIC 北汽 – 51%	Daimler 戴姆勒 – 49%
FAW-GM 一汽通用	FAW 一汽 – 50%	GM 通用 – 50%
FAW-Toyota 一汽丰田	FAW 一汽 – 50%	Toyota 丰田 – 50%
FAW-Volkswagen 一汽大众	FAW 一汽 – 60%	Volkswagen 大众 – 40%
NAVECO 南京依维柯	SAIC 上汽 – 50%	Fiat 菲亚特 – 50%
SAIC-Volkswagen 上海大众	SAIC 上汽 – 50%	Volkswagen 大众 – 50%
SAIC-GM-Wuling 上汽通用五菱	SAIC 上汽 – 50% Wuling 五菱 – 16%	GM 通用 – 34%
BMW-Brilliance 华晨宝马	Brilliance 华晨 – 50%	BMW 宝马 – 50%
Chery-Jaguar Landrover 奇瑞捷豹路虎	Chery 奇瑞 – 50%	Jaguar Landrover 捷豹路虎 – 50%
JAC-Volkswagen 江淮大众	JAC 江淮 – 50%	Volkswagen 大众 – 50%

Foreign ownership restriction in JV structure has protected the domestic automakers but limited interests of foreign players in the world's biggest market. Porsche and Tesla, the two important luxury automakers are still manufacturing their vehicles abroad and then export them to China. Aware of this issue, China has pledged to ease controls on foreign ownerships in an automotive JV in China, as promised by

President Mr. XI in early April, at the opening ceremony of the Boao Forum for Asia Annual Conference 2018. The objective is to accelerate the development and transformation of the Chinese automotive industry by bringing more technologically advanced automakers, especially for EVs, and creating more intense competition into this market. China has clearly shown its strong wish to engage reforms in the automotive sector. Just one week after the declaration of the president Mr. XI, NDRC released specific legal texts, stating that:

- Before the end of 2018, foreign capital restriction will be totally removed in an automotive JV manufacturing electric vehicles or special purpose motor vehicles.
- Before the end of 2020, foreign capital restriction will be totally removed in an automotive JV for traditional commercial vehicles.
- Before the end of 2022, foreign capital restriction will be totally removed in an automotive JV for traditional passenger vehicles.

The American luxury EVs automaker, Tesla, who was looking for Chinese partners to set up a JV in China, will now have the opportunity to take the adventure alone in the country. Porsche, the German luxury automaker, with current sale volume around 72 000 vehicles per year in China, said that they would not consider manufacturing in China without a sale volume reaching 100 000 vehicles per year. The line will be easily crossed in the coming years with a probable drop of 10% on import tariffs, strongly stimulating the sales of such luxury vehicles. Porsche would also consider to set up directly a factory alone now, manufacturing their pure EV, Mission E, to compete with Tesla in the world's biggest market.

Foreign automotive spare parts manufacturers will be the ultimate winner of such market change

Luxury vehicle automakers usually work with the world top and technologically advanced foreign automotive spare parts manufacturers for their latest innovative technology, and good and reliable product quality. Sales increase of luxury vehicles in China will positively impact the business of those manufacturers, through the growing demands on both the foreign market related to the export volume to China, or on the Chinese market, in the case where the automaker is currently manufacturing in China.

China imports today 5% of its total sold vehicles: 1.2M imported vehicles with 44 k$ in average per vehicle in CIF value. Assuming that the drop of 10% on import tariffs will translate into 2% to 5% additional luxury vehicle sale in the Chinese market, the increase of related luxury vehicle spare parts market will be valued between 20 B$ to 50 B$ for those manufacturers.

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