



German auto industry

Further measures are necessary to overcome the diesel crisis

August 4, 2017

Author

Eric Heymann
+49(69)910-31730
eric.heyman@db.com

www.dbresearch.com

Deutsche Bank Research Management
Stefan Schneider



The results of the “diesel summit” are an interim solution at best. In view of the current negative sentiment towards diesel engines, diesel cars will stand a chance in the medium to long term only if the auto industry credibly demonstrates that it can keep emissions below the legal thresholds in real driving situations and in (almost) all weather conditions. If carmakers do not succeed in this endeavour, customers will increasingly turn away from diesel cars, as they fear excessive residual value losses or stricter regulation.

The German auto industry is used to praise and success. Now, however, it is fiercely criticised from numerous sides: the media, politicians, consumer protection organisations, customers, NGOs and other stakeholder groups. The damage to its reputation and credibility stems from the diesel scandal and more recent allegations that German car producers had made illegal cartel-like agreements, for example on certain vehicle specifications. In addition, the relations between the auto industry on the one hand and politicians and public authorities on the other are thought to have become uncomfortably close over time. From the vantage point of the critics, the close connections nurtured the recent scandals or even caused them in the first place.

The charges against the auto industry are serious indeed. During the next few months, the relevant authorities will need to examine the cartel allegations. Corporate managers will need to spend much of their time on this issue, too. In the short term, however, the really important issue for both carmakers and car owners is the future of the diesel engine. The results of the recent “diesel summit” at Berlin have brought some clarity on this issue.

In principle, politicians have a number of instruments at their disposal to deal with the fact that many diesel cars’ emissions exceed the legal limits. The decision by the Stuttgart administrative court shows that (regional) bans of diesel cars are ultimately an option. Bans are obviously a serious measure, which will hit drivers in particular. Of course, carmakers are keen as well to prevent driving bans or a patchwork of regionally different rules, which might scare customers away and weigh on the residual values of diesel cars.

Most recently, the discussion focussed on the question whether a – comparatively cheap – software update will be sufficient to ensure that diesel engine emissions stay below the legal limits and prevent driving bans or whether more expensive hardware updates will be necessary. The “diesel



summit” concluded that the “small solution” is sufficient for now; roughly five million diesel cars are to receive a software update.

Software updates probably only an interim solution

However, this is probably only an interim solution. In view of the current negative sentiment towards diesel engines, diesel cars will stand a chance in the medium to long term only if the auto industry credibly demonstrates that it can keep emissions below the legal thresholds in real driving situations and in (almost) all weather conditions. If carmakers do not succeed in this endeavour, customers will increasingly turn away from diesel cars, as they fear excessive residual value losses or stricter regulation. Moreover, a number of stakeholder groups and politicians will continue to call for lowering the emissions of diesel engines until the legal limits are respected on the road. Initial responses by NGOs are pointing in this direction. Admittedly, diesel engines are an ideological issue for some NGOs, which are against (diesel) cars on principle.

Nevertheless, the market share of diesel engines is likely to decline even if the car industry meets all environmental thresholds. Clean diesel cars will become more expensive in comparison to petrol-fuelled engines. In addition, the price difference between diesel cars and alternative fuel cars will decline. This means that diesel cars will become less attractive especially in the volume segment. Nevertheless, many European customers, particularly those who drive a lot for business purposes, will stay true to diesel engines, which are efficient and relatively cheap to run, as diesel benefits from lower tax rates in most EU countries. During the first half of 2017, c. 46% of all new car registrations in western Europe were for diesel cars. While this is a decline by 4 pp in a year-on-year comparison, diesel cars are still miles ahead of alternative fuel cars. Remember that diesel car engines are not very popular outside Europe.

One positive outcome of the diesel summit is that the participants did not introduce state subsidies for the purchase of modern diesel cars. Car purchases should not be subsidised on environmental grounds anyway, regardless of the fuel type. Subsidies are not a very effective and efficient measure to realise either environmental or economic goals, and they raise social-policy questions as well. Moreover, under the costs-by-cause principle future costs should be borne by the car industry. It remains to be seen whether and to what extent the companies can successfully pass on higher expenses to the customers.

Economic framework conditions will reduce negative impact from stricter regulation

While German carmakers are currently suffering from damage to their reputation and credibility, they are nevertheless in good financial shape and generate high profits. This will make it easier for them to bear higher expenses in the coming months and years. However, car sales in the US, in China and in the UK have recently slowed. Moreover, it remains to be seen how many buyers decide against a German car in the coming months on the grounds of the recent scandals and crises. So far, any shifts at the global level have been limited. But as the protracted crisis in the financial sector (which I have experienced first-hand) has shown, credibility and trust are particularly important commodities for companies.



German auto industry

© Copyright 2017. Deutsche Bank AG, Deutsche Bank Research, 60262 Frankfurt am Main, Germany. All rights reserved. When quoting please cite "Deutsche Bank Research".

The above information does not constitute the provision of investment, legal or tax advice. Any views expressed reflect the current views of the author, which do not necessarily correspond to the opinions of Deutsche Bank AG or its affiliates. Opinions expressed may change without notice. Opinions expressed may differ from views set out in other documents, including research, published by Deutsche Bank. The above information is provided for informational purposes only and without any obligation, whether contractual or otherwise. No warranty or representation is made as to the correctness, completeness and accuracy of the information given or the assessments made. In Germany this information is approved and/or communicated by Deutsche Bank AG Frankfurt, licensed to carry on banking business and to provide financial services under the supervision of the European Central Bank (ECB) and the German Federal Financial Supervisory Authority (BaFin). In the United Kingdom this information is approved and/or communicated by Deutsche Bank AG, London Branch, a member of the London Stock Exchange, authorized by UK's Prudential Regulation Authority (PRA) and subject to limited regulation by the UK's Financial Conduct Authority (FCA) (under number 150018) and by the PRA. This information is distributed in Hong Kong by Deutsche Bank AG, Hong Kong Branch, in Korea by Deutsche Securities Korea Co. and in Singapore by Deutsche Bank AG, Singapore Branch. In Japan this information is approved and/or distributed by Deutsche Securities Inc. In Australia, retail clients should obtain a copy of a Product Disclosure Statement (PDS) relating to any financial product referred to in this report and consider the PDS before making any decision about whether to acquire the product.