LOS ANGELES
Daily Journal
www.dailyjournal.com

TUESDAY, JULY 12, 2016

PERSPECTIVE

Britain's Exit and the Auto Industry

By Jonathan Michaels

The sanctity of the European Union — a sovereign pack architected in the 1950s to prevent another flare-up of extreme nationalism that led to two World Wars — was called into serious question last month, when Britain voted to secede from the EU.

Frustrated by a perceived imbalance in immigration and economic regulation, Britain opted to go it alone, leaving the remaining 28 members wondering if an exodus is the right solution. The 2015 Greece debt crisis tested everyone's faith in the entire European experiment, and now that Britain has voted to leave, other powerhouses like France and Germany are white-boarding the same.

Even if the EU is not teetering on the verge of collapse, Britain's exit has proven it to be a brittle system, dotted with criticisms from nearly all sovereign members. While some may think the system is too big to fail, most held the same opinion of the Soviet Union before it toppled in 1991, proving that no political sisterhood is immune from collapse.

Regardless of whether the EU will fall, Britain's exit is certain to have a cascading effect on economies and industries around the globe. Perhaps hardest hit will be the automotive sector, which will suffer mightily under the weight of the falling pound and new European tariffs that are sure to be imposed.

The British pound closed out last week at a U.S. dollar exchange rate of $1.28 — a 30-year low — and most economists in the know are forecasting financial parity with the dollar by the end of the year, or early 2017 at the latest. A weak pound means falling profits for manufacturers who sell in Britain, and for dealer groups, such as Penske Automotive Group and Group 1 Automotive, who have retail stores there. Penske, who has 94 dealerships in Britain, witnessed a 20 percent stock beating since news of the exodus broke.

Of even greater concern is the near-certainty of new tariffs to be imposed by the EU on cars exported from Britain. The U.K., Europe's second largest car market, produces 1.7 million cars annually, with 58 percent of them being shipped to EU nations, resulting in an annual export of some 27 billion pounds. EU member nations, a status that Britain no longer maintains, enjoy friction-free trading among members in the automotive industry.

New York Times

Workers assemble convertibles and sedans along the Mini Cooper assembly line in Oxford, England.

The flow of cars in the opposite direction is even more drastic. Of Britain's 2.6 million new cars sold annually, 2.2 million are imported, and mostly from EU countries. A retaliatory British-imposed tariff against EU nations would dramatically impact consumer prices and automaker profits.

Most expect the EU to impose a 10 percent tariff on Britain's automotive exports, and that Britain will do the same against EU member countries, resulting in an automotive market that will be out-of-round for years to come.

The impact of Britain's exit will hardly be contained to the land of right-handed vehicles, with carmakers around the globe feeling the impact. While many consider traditional British vehicles to be just that — British — the truth is that most U.K. automakers have been rolled up into other automotive juggernauts. Mini and Rolls- Royce are owned by BMW, Jaguar and Land Rover are owned by India's Tata Motors, and Bentley is owned by Volkswagen. The result of this, of course, is that these manufacturers will take a double hit has they are taxed on importing and exporting their own cars across Britain's borders.

Tata Motors, who owns Jaguar and Land Rover, sustained a 12 percent drop in the price of its stock the day after the Brexit news was announced — its biggest fall since 2012, wiping out $2.5 billion in the company's market capitalization in just 24 hours. And it gets worse for the Indian company's two luxury car makers.

Prior to leaving the EU, Britain had negotiated a deal with the European Parliament whereby Jaguar and Land Rover vehicles were subjected to a much less onerous fuel economy target by 2020. With Britain leaving, that deal is now in jeopardy, leaving open the question of whether the two carmakers will need to modify their vehicle lineup (at great expense), or face stiff financial penalties for not complying with the standardized fuel economy targets.

And it is not just traditional British line-makes that will be hit. Nissan is the country's second-largest auto producer, with a production run of 475,000 units, followed by Toyota, who builds 190,000 in the U.K. annually. Honda and GM also have production facilities in England, with GM's facility the most likely to be shut down given the uncertainty swarming the nation. It remains to be seen who will leave, but currently all four automakers export the majority of their English- made vehicles to the EU, subjecting them to the hefty new EU tariffs that are certain to come.

German carmakers will also be hard hit. According to the German Association of the Auto Industry, the U.K. is the biggest single export market for German automakers, and about half of England's new car registrations are German nameplates. So BMW, Volkswagen, Audi and Mercedes should be in a panic over what will become of their profits.

Britain's departure from the EU will sting for a while, but the real question is whether the EU will remain a sustainable unit moving forward. The quick answer is that the song will remain the same, but deep thinkers are not so quick to agree. German Chancellor Angela Merkel recently issued a statement of concern that Britain could be just the first of several nations to pull out of the alliance, citing rank dissatisfaction among members over migration and economic disparity.

The centralization of a common economic unit, the euro, which is subscribed to by 19 of the remaining 28 member countries, certainly makes the conversation more dynamic — particularly with certain countries lagging behind the economic engines of Germany and France. Regardless of what happens with the rest of the EU, the global economy will have to travel down a long and windy road in dealing with Britain's recent decision, with much uncertainty and economic fallout sure to come.

Jonathan Michaels *is the founding member of MLG Automotive Law, APLC, which specializes in representing clients in the automotive industry. You can reach him at (949) 581-6900 or jmichaels@mlgautomotivelaw.com*