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Short-term Risk is Reduced for the French Automotive Sector, but Profound Changes are Ahead

- **The automotive sector has been upgraded to the best risk category**
- **Private buyers are returning to the car market, driving up sales of new vehicles, which are expected to increase by 5.6% in 2016**
- **Risks to be monitored in the longer term as French added-value is falling**
- **Internationalization of production and R&D seems to be an inevitable outcome**

The Automotive Sector Considered Low-Risk in the Short-Term

The French automotive sector is being strengthened by household consumption which has recovered due to the fall in unemployment and new financing methods. Sales of new vehicles increased from January to July and Coface predicts a 5.6% increase in 2016, followed by a smaller one, between 1.5% and 2.5%, in 2017.

For these reasons, the French automotive sector has been upgraded to the "low risk" category, but with reservations about the fragility of second- and third-tier equipment manufacturers. Currently, only two sectors of activity (automotive and retail) out of 12 reviewed have this best short-term sector assessment.

Constrained Internationalization is Gaining Momentum

More broadly speaking, the French automotive industry is at a turning point. While France has undeniable strengths in terms of engineering, standard of living and ability to adapt to change, it is losing in terms of competitiveness. The sector's added value fell by 29% between 2008 and 2014, while that of French industry increased 3%. For the equipment manufacturers, this is also reflected by the erosion of the trade surplus. The automakers have had to reduce unit costs per vehicle, by choosing job cuts and wage and hiring freezes, to cope with a fall in sales in the domestic market and therefore under-utilization of their factories.

Will internationalization address these problems? With a narrow market, comprised mainly of economy-range vehicles, France cannot provide the required levels of profitability. Companies are encouraged by the vigor of sales cars worldwide, especially in emerging countries, and are internationalizing their client portfolio. As an example, the first-tier equipment manufacturers that have been able to bounce back now have an operating margin of around 7.8%, 2 percentage points more than the automakers.

Another trend that must be taken into account is that both automakers and equipment manufacturers are establishing R&D centers in low-cost markets, after a phase when they relocated their production or assembly activities. At this stage, most of this function is concentrated in France, but the transfer of R&D activities to emerging countries could eventually gather momentum. The fundamental factor behind this phenomenon is the appearance of local automotive clusters that include automakers, equipment manufacturers and subcontractors specialized in logistics, engineering and IT.

NORTH AMERICA MEDIA CONTACT: Sue Hinton – sue.hinton@coface.com - +1 212 389 6484