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# Research Global

## Buckle up for EU-China trade tensions

- There is a high probability that the EU will increase the tariff on Chinese electric cars, but there are also good arguments why that might not lead to a large-scale trade war.
- The EU Commission has rung alarm bells over a doubling of the EU-China trade deficit over the past three years and in October 2023 launched an anti-subsidy probe into Chinese battery energy vehicles (BEVs).
- We find it likely that EU will raise the tariff on imports of Chinese BEVs from 10% to around 20-25% when the investigation is concluded (by November this year). China will likely retaliate and potentially hurt specific smaller European sectors a lot. However, we think they will be careful not to scare of foreign companies more broadly and thus will choose a moderate overall response.
- Trade tensions are likely to be a rising topic since China has become a leader in a long list of green products such as BEVs, batteries and solar panels – products that will see high European demand in coming years and where EU aims to de-risk from China.

### EU anti-subsidy investigation on Chinese EVs

In September 2023 EU Commission President Ursula von der Leyen *revealed* the launch of an anti-subsidy on Chinese BEVs stating that the “*the global market is flooded with cheaper electric vehicles*” with prices “*kept artificially low*” owing to “*huge state subsidies*” from the Chinese government. **The Commission has until November to conclude the investigation, but it seems to have decided in advance. The Commission says in the *formal notice* of the anti-subsidy investigation that it has found evidence of subsidies from the Chinese government that have injured the EU’s industry (see box 2) and that prices on Chinese BEV are typically 20% lower than EU-made models.** The EU Commission stresses that the term injury refers both to actual injury *as well as a threat* of injury or retardation of the establishment of an industry. Hence, even if it is found that Chinese subsidies do not cause injury today, then tariffs can be introduced if the Commission believes that EU industry will be damaged in the future.

### Outcome of the investigation likely to be higher tariffs

**We expect the outcome of the investigation will be an increase in tariffs on Chinese BEVs to levels around 20-25%.** The EU Commission usually initiates anti-subsidy investigations following complaints by companies, but this investigation is based on the Commission’s own initiative. The EU has a 10% tariff on BEVs imported from China while the United States has a 27.5% tariff. China has a *tariff on BEVs* imported from the EU at between 15% and 25% (depending on characteristics) so there is room for the EU to increase tariffs just to match Chinese tariff rates. The case is strengthened by EU seeing the BEV sector as strategic as well as having a strategy of de-risking from China, i.e. reduce dependence. With the auto sector employment being 8.5% of EU’s manufacturing employment, a large chunk of Europe’s traditional industry is also at stake.

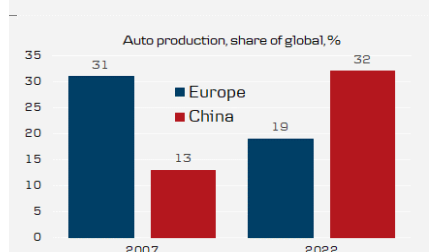
EU-China trade deficit more than doubled from 2020 to 2022 but declined in 2023



Source: Eurostat, Danske Bank

Note: 2023 data cover January to November plus forecast for December

China and Europe have switched places as global auto makers



Source: ACEA, auto

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## China to retaliate – but response may be moderate

China will likely retaliate and potentially hurt specific smaller European sectors a lot. However, we think they will be careful not to scare of foreign companies more broadly and thus will choose a moderate overall response. Hence, a large-scale trade war is not immediately at sight even though China’s immediate response to the investigation was one of defiance, and the Chinese Commerce Ministry *called it* blatant protectionism. The strong exports, China said, was *not* due to huge state subsidies but a highly competitive supply chain. The question is how strongly they will react to an actual tariff hike by EU. It is not unusual to see a strong verbal response by China but only a smaller-scale response that hurts a small sector but potentially by a lot. In a dispute with Australia, China put high tariffs on Australian wine, which had a significant effect on Australia’s wine exports to China but not on the aggregate economy.

## EU largest receiver of Chinese made EVs

EU imports of BEVs from China have increased significantly over the past three years from EUR 0.8 bn in 2020 to EUR 9.0 bn in 2023 (Jan-Nov). In the same period, exports to China from the EU were broadly unchanged leading to a big EU deficit in the EV trade with China (see left chart below). At the same time EU has by far been the biggest taker of EVs from China compared to other regions. The **EU Commission argues that the low tariffs on BEVs from China compared to other countries have a pull effect of Chinese BEVs towards the EU**. Another reason for Chinese EV exporters aiming for the European market is probably a faster rise in EV penetration compared to other regions and on top of this the rising US animosity towards China is making the US market less attractive for Chinese companies.

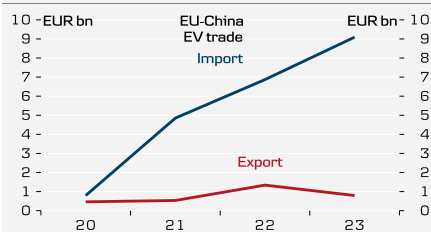
Surging imports from China explains the recent rise in the trade deficit



Source: Eurostat, Danske Bank

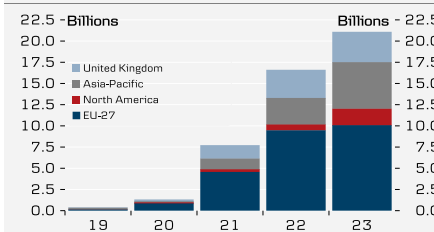
Note: 2023 data cover January to November plus forecast for December

EU imports of Chinese-made EVs skyrocket



Source: Eurostat. Note: 2023 is Jan-Nov

EU by far the biggest receiver of Chinese-made EVs



Source: UN Comtrade. Note: 2023 is Jan-Sep

## EU-China trade deficit historically large

The European Union has had a trade deficit vis-à-vis China for decades. This is nothing new, but from 2020 to 2022 the trade deficit in goods more than doubled from EUR 183 bn to EUR 396 bn – equivalent to 2.5% of GDP. The rise in the trade deficit from 2020 to 2022 was due to a large rise in imports as exports continued its trend growth. Monthly data released until November 2023 show that the trade deficit decreased to EUR 273 bn, and we expect the full-year 2023 to end at EUR 300 bn which is 25% smaller than in 2022. **Yet, the 2023 trade deficit will still be large in a historical perspective, and the deficit continued to increase on electric vehicles thereby increasing the risk of EV import tariffs** (for an overview of the different electric vehicle categories see Box 1).

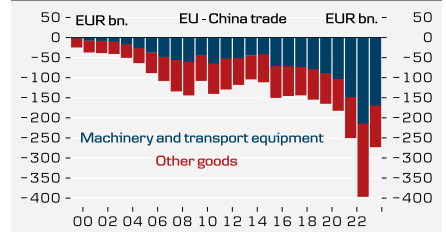
### Box 1: Categories of new energy vehicles (NEW)

- **Electric vehicle (EV):** Any vehicle powered primarily by electricity
- **Battery electric vehicle (BEV):** An electric vehicle solely powered by an electric battery
- **Hybrid electric vehicle (HEV):** A vehicle powered by both an electric and a combustion engine
- **Plug-in hybrid electric vehicle (PHEV):** A vehicle powered by a combustion engine and an electric engine charged from an external socket
- **Mild hybrid electric vehicle (MHEV):** A vehicle powered by both an electric and combustion engine but incapable of electric-only driving
- **Fuel cell electric vehicle (FCEV):** An electric vehicle powered by chemical energy

## Trade deficit on critical goods for the EU increases the likelihood of trade tensions

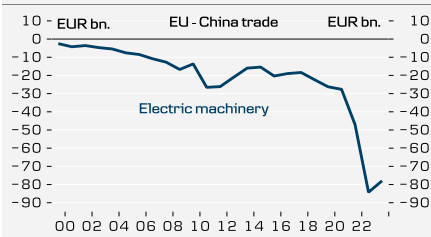
The EU trade deficit vis-à-vis China is mainly due to goods that are critical for key EU priorities like the green transition and digitalisation which increases the risk of trade barriers. The primary product category responsible for the trade deficit is “machinery and transport equipment” which accounted for 62% of the annual deficit in 2023. This category consists mainly of electrical machinery, telecommunications, and office equipment. Electrical machinery explained 29% of the total deficit in 2023 and its deficit tripled from 2020 due to a large increase in imports of solar panels, semiconductors, batteries, and electric motor parts. The trade deficit on batteries itself was 8% of the total trade deficit in 2023 and semiconductors including solar panels was 7%.

### The trade deficit is especially due to machinery and transport equipment



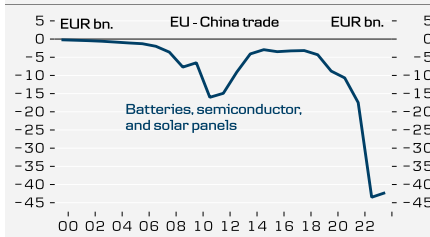
Source: Eurostat. Note: 2023 is Jan-Nov

### Deficit on electrical machinery has tripled since 2020...



Source: Eurostat. Note: 2023 is Jan-Nov

### .. mainly due to batteries, semiconductors, and solar panels



Source: Eurostat. Note: 2023 is Jan-Nov

## Trade tensions here to stay but no large-scale trade war immediately in sight ....

With the EU likely to increase protection in areas where it sees a strategic importance in the future (see box to the right) and at the same time has a trade deficit with China, **EU-China trade tensions are likely to be with us for a long time and it cannot be ruled out it will develop into an actual trade war at some point.**

Recently, China initiated its own anti-dumping investigation into EU brandy, which looks a lot like a warning shot to the EU especially affecting French brandy brands. France is known to be a key initiator of the EU investigation whereas Germany has been less supportive as German companies worry about potential repercussions in the Chinese market. A recent *paper* by the European think tank Bruegel highlighted that China could also file anti-subsidy investigations into sectors where EU has recently scaled up subsidies in its de-risking drive, such as for semiconductors.

### .... as China wants to attract foreign investments not least from the EU

A mitigating factor is that China wants to attract foreign investments and not least from the EU. That points to an only moderate retaliation. With the US being increasingly protectionist towards China, and the relationship being very strained, China needs a tolerable relationship with EU to not have to fight on too many fronts. A too harsh response could be the last drop for European companies that are considering what to do with their China investments in the future. Also, Chinese EV companies will likely be able to live with a 20-25% tariff as their actual cost and technology advantage is bigger than that. Auto supplier Forvia said at a convention in Las Vegas, that Chinese companies have a 10.000 euro *cost advantage*. For lower-cost BEVs costing 20.000-30.000 euros for the importer, Chinese cars can still be competitive even with a 25% tariff.

### De-risking initiatives from the EU

- **Critical Raw Materials Act (2023):** focused on bolstering EU's critical raw materials capacities. Part of the Green Deal industrial Plan
- **Net-Zero Industry Act (2023):** targeted towards enhancing the competitiveness of EU's strategic net-zero technologies. Part of the Green Deal industrial Plan
- **Green Deal Industrial Plan (2023):** focused on positioning EU's net-zero industry in the lead - for instance via protecting the Single Market against unfair trade
- **European Chips Act (2022):** aimed at strengthening the semiconductor industry in the EU

Source: The EU Commission

## The lesson from the solar panel industry scares the EU

The surge in BEV imports from China brings back memories of the **solar panel industry that emerged in Germany in the early 2000s but became completely decimated due to cheaper Chinese imports**. Back in 2012 and 2013 the EU Commission failed to reach a consensus on solar panels due to *fears* of Chinese retaliations. This time consensus is much stronger and electric vehicles are a cornerstone of the EU's strategic focus on *green transition and technology* as internal combustion engine vehicles will be phased out by 2035. So, the likelihood of increased tariffs is high due to the sector's strategic importance for the EU in terms of innovation, value added and employment.

## European BEVs made in China will also be hit by import tariff

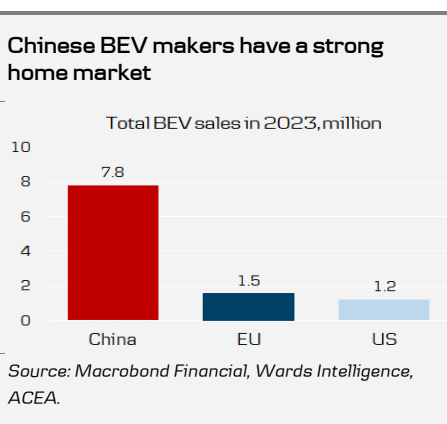
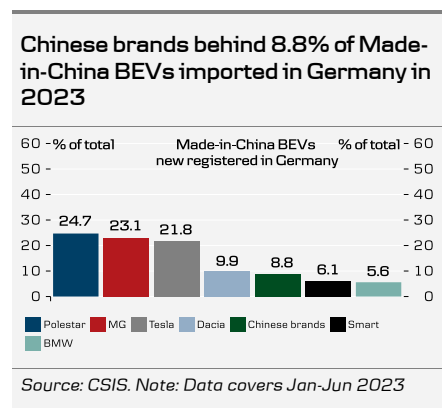
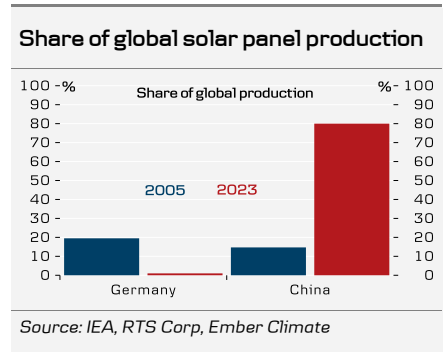
In the foreign trade statistics that the Commission refers to goods produced by foreign companies in China, such as cars from Renault, BMW and Tesla, count as imports from China to the EU. So, when European car manufacturers produce cars – or parts of them – in China and ship them to the EU the trade deficit increases. During the first half of 2023, only 8.8% of new BEVs from China imported to Germany were from “pure” Chinese companies. Conversely, Tesla, Chinese-owned European brands, and joint ventures between European and Chinese firms accounted for the vast majority. However, this does not decrease the risk of a higher tariff. The EU Commission expects the share of EV sales from Chinese companies to rise to 15% in 2025 and is concerned the market share will keep rising if Chinese companies dump prices due to overcapacity in the home market, insufficient domestic demand and state support.

The Commission's notice also imply that it **does not matter whether Chinese subsidies hurt EU companies or not. What matters is whether it hurts industry within the EU**. Hence, the fact that potential subsidies are also given to European companies in China does not help in this regard because it adds to the threat that the BEV production moves to China. A recent business *survey* by the German Chamber of Commerce in China showed that especially the German auto sector is still investing in China. 63% of German auto companies said they would increase investments in the coming years.

## China might not be the culprit behind the price war on EVs

While the EU is concerned over Chinese overcapacity, it is not clear that overcapacity is to be found in China's BEV sector among the companies that currently export to Europe. The Chinese EV industry is characterised by *a flood of companies* (China has 150 car brands) with strong polarisation where the most successful ones are producing close to capacity while the many less successful ones have lots of spare capacity. However, the companies with spare capacity are not the companies selling on the European market. Hence, the current price war on the European market does not seem triggered by overcapacity in China but by fierce competition amid lower costs with Tesla being the main “perpetrator”. China's economic slowdown and weak demand are not the obvious reason since Chinese EV sales have been one of the areas where growth was strong with a lift in sales within China from 6.9 million EVs in 2022 to 9.5 million in 2023, an increase of 37%.

Finally, it is not obvious that China is dumping prices and flooding Europe with cheap cars as the Commission argues. Dumping takes place when products are sold at a lower price in the export market than the domestic market. But the Chinese brands entering Europe these years are actually sold at *higher prices* in Europe than in China. The cheapest car coming from China is a *Dacia Spring* imported by French car maker Renault.



Nevertheless, it is fair to worry about what the overall overcapacity means for the future development as some of the unsuccessful companies are likely to go bankrupt leaving their production lines open for sale to companies that make the cut in the consolidation of the sector in the coming years. There is also a big overcapacity in the ICE auto sector where production lines may be adjusted for production of EVs in the years ahead. China itself has expressed concern over overcapacity in the EV industry and criticized local governments for allowing too big investments. China’s central bank also recently said financing to overcapacity sectors would be tightened.

**Box 2: Excerpts from the EU Commission’s notice**

“The Commission has found evidence, among others, of various grants, provision of loans, export credits and credit lines provided by State-owned banks or bonds underwritten by State-owned banks and other financial institutions at preferential terms, provision of preferential export insurance; income tax reductions and exemptions, dividend tax exemption, import and export tax rebates; VAT exemptions and rebates; and government provision of goods (such as raw and input materials as well as components) and services for less than adequate remuneration.”

“It is therefore foreseeable that the subsidised imports of the product concerned could continue to negatively affect the Union industry’s economic situation... Indicate the likelihood of substantially increased imports in the near future... Furthermore, the Commission found evidence that there is sufficient freely disposable capacity in the People’s Republic of China and that there is an imminent and substantial increase in such capacity which does not appear to be absorbable by other markets.”

“The evidence at the disposal of the Commission also shows that that the prices of the subsidised imports are significantly lower compared to the prices of the Union industry, thereby depressing prices or preventing price increases which otherwise would have occurred and, consequently, placing significant pressure on Union sales, market shares and profit margins...This is especially relevant in a context where the Union industry will need to achieve higher volumes of sales in the BEV market to absorb the heavy investments it needs to spend to remain competitive in the transition to full electrification.

Source: [https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=OJ:C\\_202300160](https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=OJ:C_202300160)

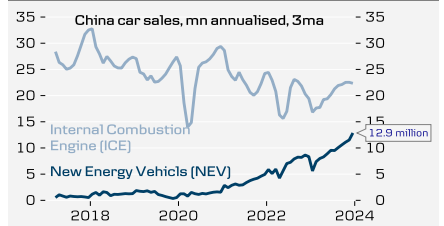
**Backdrop: China’s road to world’s largest car exporter and its impact on EV prices**

China’s economic model has been efficient in driving technological development and innovation. China now leads research in 37 of 44 future technologies (according to the Australian think tank ASPI) and in 2023 it ranked number 12 out of 132 countries in the Global Innovation Index developed by the World Intellectual Property Organization. One of its accomplishments has been to become leader in several green sectors and the BEV space is one of them (see more in box 2 below on how China became a leader in electric vehicles). The flip side, is that it has happened through a lot of help by the state (see below), created wasteful investments along the way and tended to lead to overcapacity and price wars. As mentioned above the solar industry is a key example.

Over the past three years, China has moved from exporting very few cars to becoming the world’s largest car exporter overtaking Japan in 2023. Last year China’s vehicle exports increased a whopping 64%. This is partly thanks to rising EV exports and foreign companies increasingly placing production of new energy vehicles in China. As mentioned, the biggest jump has been to Europe, which is the destination of half of China’s EV exports.

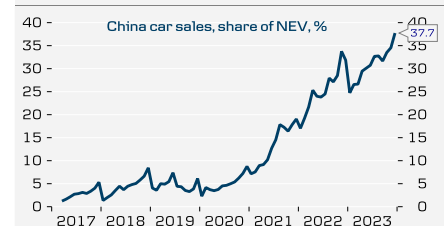
In China’s home market a fierce price war broke out last year, which ironically was started by an American company when Tesla in January decided to slash prices in China (as well as in Europe and the US). It forced Chinese competitors to follow suit. Tesla has since cut prices further, and started 2024 announcing yet another price cut. The price war alongside continued subsidies for EV purchases has expanded the Chinese EV market

**Chinese EV sales have moved steadily higher in 2023**



Source: Macrobond Financial, CAAM

**Chinese EV sales – share of total**



Source: Macrobond Financial,

strongly in 2023 with now close to 40% of new cars sold being an EV. While Tesla has the best-selling model in China, the Chinese company BYD has many different models and sits solidly on the biggest market share selling 36% of all EVs in China. In Q4 2023 it even became the *bestselling* global EV company overtaking Tesla.

## Appendix: How China became an EV leader

**China's growth model is characterized by a combination of the invisible hand of markets and a visible and often heavy hand** provided by the state to guide and support development. It is close to the 'developmental state' model also seen during the rise of Japan, Singapore, Taiwan, and South Korea, where industrial policy played a key role in developing and upgrading specific industries in their early phases (see for example *World Bank: Some lessons from the East Asian Miracle* and *Catch-up and learning in Taiwan: The role of industrial policy*). Yet, it is also to some extent inspired by *early American tech development* of products like *microchips*, internet and GPS that came out of defence and space research supported by the state decades ago. Industrial policy in China has been geared towards both catching up in certain technologies (like microchips) and at leapfrogging in others by aiming to identify future technologies (like EVs) and put lots of money and R&D behind it.

**For decades electrical vehicles have been designated a strategic industry** where China aimed to leap frog and move to the technological frontier while Western auto companies were still busy focusing on R&D within traditional internal combustion engine (ICE) cars. As early as 2001 EV technology was introduced as a priority science research project in China's Five-Year Plan and in 2007 the industry got a boost from the country's new minister of science and technology, Wan Gang, who had worked for Audi in Germany for a decade and was a big fan of EVs. On top of leap-frogging considerations, the sector is also seen as crucial in China's green transition where electrification as well as switching to green sources for electricity are key levers. The BEV industry was one of 10 industries highlighted in China's Made-in-China 2025 industrial policy blueprint launched in 2015. China's global ambitions were made clear in 2017 when they rolled out the "Mid-to Long-Term Automotive Industry Development Plan" outlining that China would aim for global influence and that Chinese automakers rank among top 10 of the world's largest auto makers by 2025.

**China's support through industrial policies has many tentacles** and include lower costs for financing, energy and land, investments in companies by local governments and/or state venture capital funds, industrial tech parks etc. It is difficult to quantify, though. The development of strategic industries in China is typically an interplay between the private sector and the state. The state has also indirectly supported the EV sector by providing demand through for example *shifting to public electric buses* across the country in the 2010s and demanding taxis to be *EVs* in big cities etc. Often state subsidies are gradually reduced once a sector matures, and companies can compete without support. Finally, China has supported and planned the development of the whole supply chain for EVs and now have some of the world's best and biggest *battery suppliers such as CATL and BYD*, with global market shares of 37% and 16%, respectively.

**China's EV sector also benefits from lower costs for skilled labour** relative to its' Western peers. Some of the state support as well as low-cost benefits also apply to foreign auto companies, which makes it attractive for them to increasingly place EV production in China. This has been the case with Tesla's giga-factory built in Shanghai in 2019, which is *Tesla's most efficient plant* and main production site for exports. All of its Model 3 cars for Europe are made in China and Tesla is responsible *for 39% of EV exports from China to Europe*.

### Made-in-China 2025 strategic sectors

Below is a list of the key sectors identified as strategic in the Made-in-China 2025 strategy launched in 2015 (China no longer uses the name but the strategy is still in place):

1. Energy-saving vehicles
2. Information technology
3. High-end numerical control machinery and automation
4. New materials
5. Aerospace and aviation equipment
6. Electrical equipment
7. Biomedicine and high-performance medical apparatus
8. Rail equipment
9. Agricultural equipment
10. Maritime engineering equipment and high-tech vessel manufacturing

*In 2020 China also named new energy industry and energy conservation as a strategic emerging industries (Xinhua).*

Sources: China Briefing, Xinhua.

## Disclosure

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