Will China roll over the European auto industry?

Chinese automakers are gaining market share both at home and abroad, placing pressure on European manufacturers. A renewed export wave of new energy vehicles (NEVs) into the EU has has triggered a protectionist shift with stricter FDI screening and new tariffs. This rising trade friction forces both Chinese and German automakers to overhaul their global strategies.

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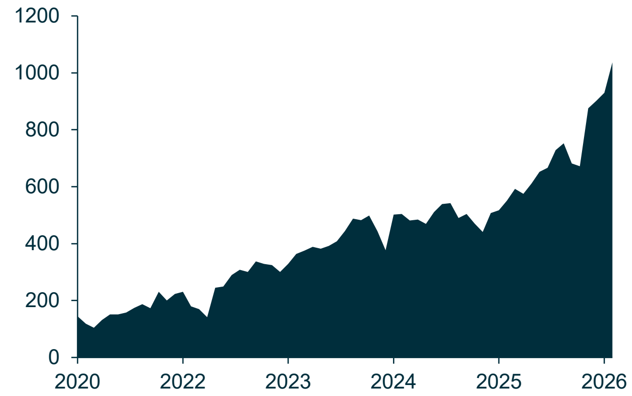
The domestic squeeze and the export imperative...

The defining feature of the Chinese automotive sector over the past two years has been intense "involution", a period of destructive competition marked by relentless price wars and severe excess capacity. In the first half of 2026, domestic vehicle sales declined by 3.2% year-on-year, constrained by sluggish consumer confidence and the broader economic drag of the property downturn. Concurrently, the phase-out of domestic purchase subsidies has exacerbated the pressure on manufacturers.

This excess capacity is the hangover effect of large-scale, fragmented industrial policy. For years, provincial and municipal governments heavily subsidized local EV supply chains to meet regional economic targets, resulting in a fractured landscape that peaked at nearly 500 EV makers. As domestic demand cooled and central subsidies were phased out, automakers slashed prices to survive, severely compressing profit margins across the sector. The situation became so acute that suppliers faced skyrocketing accounts payable, and dealerships began classifying zero-kilometer vehicles as "used" to circumvent manufacturer price floors.

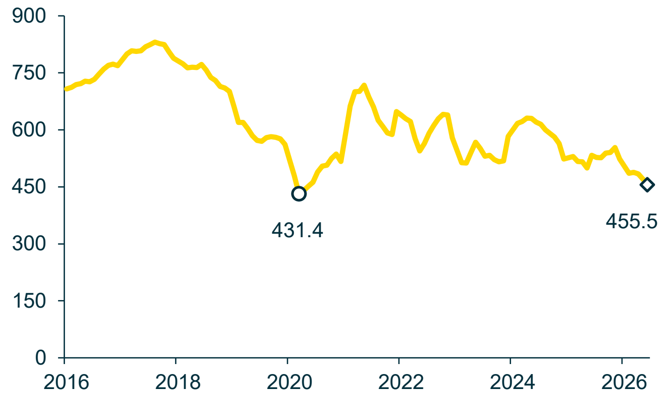
Faced with shrinking margins and surplus production at home, Chinese original equipment manufacturers (OEMs) have pivoted aggressively outward. Exports surged 65.6% in 2026 H1, with New Energy Vehicle (NEV) shipments more than doubling (Chart 1 and 2). This export imperative has transformed Chinese manufacturers from regional players into a formidable global force, putting immense pressure on legacy automakers, particularly German firms that relied heavily on the Chinese market for volume and profitability.

Chart 1 - While car exports surge to record highs...
Monthly auto export, thousand cars



Source: China Association of Automobile Manufacturers (CAAM), Commezbank Research

Chart 2 - ...profits plummet to a post-pandemic low
12-month rolling sum, CNY bn



Source: National Bureau of Statistics (NBS), Commerzbank Research

...Prompting Beijing to rein in the involution...

Recognizing that destructive competition undermines the sector, Beijing has pivoted toward market consolidation and high-quality development. The overhaul of China's Pricing Law targets cutthroat competition by banning below-cost sales. This intervention aims to halt price wars, forcing automakers to compete on technology and brand value.

To shrink excess capacity, the Ministry of Industry and Information Technology (MIIT) is revoking manufacturing licenses of chronic "zombie" automakers. Regulators are also using revised Company Law provisions to bypass local protectionism and liquidate unviable entities. Furthermore, tighter entry thresholds eliminate low-tech assembly plants, while a 60-day supplier payment mandate protects supply chain liquidity.

However, excess capacity elimination will remain gradual. Though we expect total light vehicle production to contract in 2026, new model launches remain the primary growth driver, adding 3.8mn units. This production contraction is not driven solely by market consolidation through retired model or market exits, which accounts for a 2.2mn decline. Instead, production adjustments on existing models drive a larger 3.1 million unit drop (Chart 3).

Chart 3 - Relentless new launches slow capacity cleanup
China's light vehilcle production, mn cars

Source: CAAM, Commerzbank Research

Concurrently, the central government has calibrated its demand-side incentives. Starting this year, the decade-long full 10% purchase tax exemption for NEVs has been halved to a 5% rate, with the maximum tax break capped at CNY15k (~$2200). In addition, it shifted the trade-in subsidies from a fixed cash amount to a percentage-based system. Consumers scrapping an old car for a new NEV now receive a 12% subsidy, capped at CNY20k. For example, a buyer of an CNY80k budget NEV receives only CNY9.6k today, compared to a flat CNY20k in 2025. This structural change prevents price wars by incentivizing automakers to compete on quality rather than relying on heavily discounted cheap models to drive sales.

However, local governments remain reluctant to allow unprofitable regional champions to fail, complicating the central government's efforts to restructure the industry. Nevertheless, these domestic regulatory shifts suggest that while the sheer volume of Chinese exports may stabilize, the surviving competitors will emerge stronger, more technologically advanced, and more formidable on the global stage, directly challenging German automakers' core value propositions.

Table 1 - China auto policy shifts to curb involution

Policy	Changes	Intended outcome
Pricing & Market Regulation	Issued guidelines prohibiting below-cost dumping and deceptive pricing, increasing scrutiny via joint regulator cost investigations	Curb price wars, stabilize margins, and shift competition toward product quality and innovation
Battery Export VAT Rebates	Value-added tax export rebates for battery products were reduced from 9% in 2025 to 6% in 2026.	Curtail indirect subsidies for low-price exports, discouraging aggressive export abroad
Capacity Management	Regulators ramped up production-consistency checks and enforced directives to shorten supplier payment terms to protect vendors.	Eliminate inefficient capacity and ensure supply chain financial health
NEV Purchase Tax Exemption	The full exemption of up to CNY30k in 2025 halved to a CNY15k maximum in 2026	Accelerate market consolidation by weeding out uncompetitive firms reliant on tax breaks
Trade-in & Scrappage Subsidies	Transitioned from a flat RMB 20,000 cash rebate in 2025 to stricter, tightened terms and conditions.	Deter aggressive discounting on budget EVs, incentivize the purchase of higher-quality vehicles, and protect brand equity
Our Verdict: While these policy shifts will not eliminate excess capacity overnight, they will steadily compress the survival space for financially fragile automakers, gradually consolidating the market and forcing remaining industry leaders to compete on operational efficiency and technology		

Source: State Council, NDRC, SAMR, Commerzbank Research

...While Europe hardens its defenses...

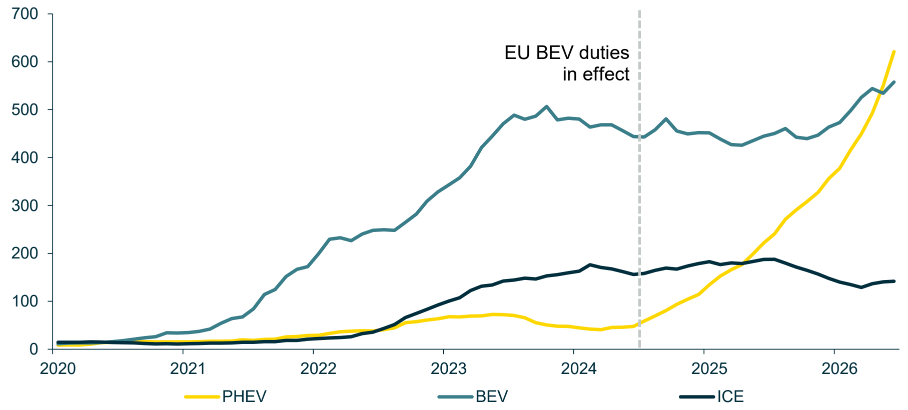
The influx of Chinese vehicles, particularly plug-in hybrids (PHEVs) following the earlier tariffs on battery-electric vehicles (BEVs), is likely to trigger a renewed defensive response from the EU (Chart 3). Sentiment towards Chinese competition is hardening across the bloc, driven by intense lobbying from domestic automakers facing capacity underutilization and potential job losses.

The European Commission is expected to launch an anti-subsidy investigation into Chinese PHEVs in Q3 2026. Provisional duties could be applied by late 2026 or early 2027. While the final tariff range for PHEVs is anticipated to be lower than the maximum 45.3% levied on BEVs, it will still represent a significant barrier.

Beyond tariffs, the EU's flagship **Industrial Accelerator Act (IAA)** represents a structural shift toward protectionism. The IAA mandates stringent "Made in EU" requirements for public procurement and introduces rigorous restrictions on foreign direct investment in strategic sectors. These measures are designed to ensure that the European industrial base captures the value of the green transition, explicitly excluding Chinese imports from qualifying as EU-origin equivalent. Even previously welcoming member states, such as Hungary, are increasing regulatory scrutiny on Chinese greenfield investments under new political leadership.

Chart 4 - Chinese hybrids flood Europe post-BEV tariffs

China's passenger car exports to the EU in thousand cars, 12-month rolling sum



Source: General Administration of China Customs (GACC), Commerzbank Research

PHEV = Plug-in hybrid electric vehicle, BEV = Battery electric vehicle, ICE = Internal combustion engine vehicle

Will the strategy work?

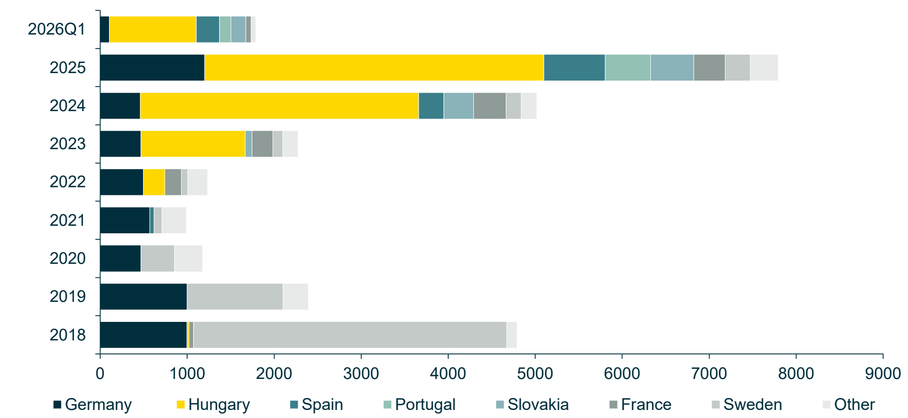
The European strategy aims to force Chinese automakers to transition from an export-heavy model to localized European manufacturing, theoretically leveling the playing field for domestic OEMs. Chinese firms are already adapting. Some are pursuing greenfield investments in Eastern Europe (Chart 5), though these projects are facing increased regulatory scrutiny over labor and environmental practices. Others are opting for "asset-light" joint ventures, taking over underutilized or shuttered European factories, such as the revitalization of facilities in Spain, to circumvent import tariffs and integrate into the local supply chain.

However, localizing production in Europe presents significant challenges for Chinese firms. They must navigate a higher cost environment, rigorous corporate governance standards, and the loss of the deeply integrated supply chain advantages they enjoy at home. Furthermore, Beijing has quietly tightened scrutiny over outward automotive investment, wary of technology leakage.

For European automakers, this localization push is a double-edged sword. While it may reduce the immediate price advantage of imported Chinese vehicles, it ensures that highly competitive Chinese brands will become permanently embedded within the European industrial ecosystem. The pressure on German and European OEMs is not dissipating. It is merely shifting from the docks to the domestic factory floor. To survive, European carmakers must accelerate their own technological transitions, particularly in software and battery efficiency, or risk losing their home market to localized Chinese competitors.

Chart 5 - Chinese automotive FDI shifts to Eastern Europe and Iberia

China's FDI in key European countries, USD mn



Source: China Cross-Border Monitor (CBM), Commerzbank Research

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