SRI FLASH

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Northern European countries ambivalent on WTO approach to free trade

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- This summer saw moves in several sectors to get their governments, with some success, to bring in protectionist measures to combat competition from some countries accused of dumping and infringing WTO rules. This issue is of interest, as we see it, because in most cases, it is not fully assumed: the response to this intense competition, underpinned by deliberate subsidy mechanisms on the part of southern countries, often involves an accumulation of regulatory layers from the most ardent defenders of free trade.
- Four telling examples emerged this summer, in four particular sectors. These are characterised by: 1/ a declining trend in northern countries due to the maturity of markets, accelerated by a significant crisis impact: automotive and steel, and 2/ original growth, spurred by powerful and vital public support measures in the northern states: biofuels and renewables. For each of the sectors, there have been calls for border taxes.
- These examples clearly illustrate the ambiguous relationship that exists, with globalisation, between northern economies and the other economic powers, be they developed or not. This often manifests itself indirectly; with hard-to-identify non-tariff measures that can just as easily cause distortion (see WTO report on world trade in 2012).
- In recent years, under the guise of environmental protection, state intervention has often been characterised by a form of protectionism, which is intrinsically at odds with free trade rules, as defined by the WTO. State intervention often takes its cue from a wish to re-establish a competitive balance for sectors subject to environmental regulations that substantially undermine their competitive edge. Indeed, many will remember the aborted attempts (these moves periodically resurface in Europe) to put in place a carbon tax at the border, as a way of restoring the balance for electricity-intensive sectors facing additional costs as a result of the carbon quota trading system. Now, doubtless because of the unusual length of the economic crisis but also probably with shifting political currents in some countries, the focus is on safeguarding jobs in sectors where neither the demand nor the margins warrant maintaining so much production capacity. Little wonder, then, that governments are trying, particularly in such a fragile economic climate, to come to the aid of businesses and jobs, even though this may been seen as little more than fig leaves.

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BIOIFUELS: biodiesel producers looking to resist exports from Argentina and Indonesia.

Having obtained from the European Union in 2008 a tax on US and then Canadian biodiesel, on the grounds of anticompetitive practices (the cause being the tax credit applied to biodiesel blending in diesel in North America), European producers have this time been taking on competition from Argentina and Indonesia. According to the European Biodiesel Bureau, which launched the offensive, the price of soya and palm oil (raw materials in biodiesel) from these two countries exceed those of imported biodiesel in Europe. The eurObserv'ER barometer, published in August, largely confirms this claim that European biodiesel production is suffering from the decline in raw material imports, particularly for soya from Argentina, but also for prices, which defy all competition, for the finished product from these two countries. This is evidenced by the fact that European biorefineries have capacity utilisation rates of under 40% and European biodiesel imports now represent one-fifth of the market and have increased by 25% in three years. Spain, which has been hard hit by this competition, has reacted by closing its borders to Argentine biodiesel since April 2012, in retaliation for the nationalisation of YPF (a significant proportion of the biodiesels and ethanols sold in Spain by Repsol had previously come from YPF). It has also lodged a complaint with the WTO for violation of international trade rules.

RENEWABLES: Europe and US take on China

The US is gearing up, in September, to impose tariffs on imports of Chinese windtowers, ranging from 20.85% to 72.69% depending on the producers. In 2011, the US imported $222m worth of windtowers from China and now accuses the country of selling them at a loss in order to gain a rapid foothold in the US market. Nacelles, blades and other components are not concerned by these measures.

With the US having already imposed tariffs, in May 2012, ranging from 31% to 250% depending on the manufacturer, for solar panels produced in China, European groups, led by EU ProSun, won their case with the European Commission, which said it would conduct a probe into the commercial practices of Chinese solar power equipment makers. Brussels now has 15 months to gauge if these practices are unfair and, if necessary, impose sanctions. European producers of solar panels, particularly in Germany, are suffering as a result of the price slump orchestrated by Chinese players. Chinese domination of the industry is evidenced by a number of figures: seven out of the world's top ten players in the solar panel sector, i.e. nearly two-thirds of world production, are Chinese. Ironically, prices have fallen so sharply (around 50% in a year), that the Chinese manufacturers themselves have been making a loss since 2007 and have record overcapacity. As a result, investors are rushing to exit the sector, with inventories at 1 year, and Chinese groups' sales are 90% focused on Europe (€21bn in Chinese exports in 2011, i.e. 60% of total Chinese exports) or the US, which is already affected by the crisis and the broad-based revisions to public support mechanisms. Despite this, the Chinese government is intent on continuing the price war, with Trina Solar and Yingli Solar raising their delivery volumes by nearly 40% and 49% respectively. This overcapacity is allowing Chinese groups to offer equipment priced 60-90% below what their western counterparts are offering. But Germany is still ambivalent regarding the introduction of retaliatory measures at the border as it fears, rightly enough, that this could be accompanied by an upward drift in prices, thus making network parity a more distant prospect.

AUTO: France takes action against South Korean imports

France has asked the European Commission to investigate the free-trade agreement between South Korea and the EU on the grounds that there is a sharp imbalance in favour of South Korea. Some

400,000 vehicles were exported from South Korea to Europe, i.e. 40% more in H1 12 than in H1 11 and only 73,000 imported. Note also that European tariffs for small vehicles, initially 10%, were lowered to 8.3% as of the agreement, then to 6.7% at 1 July 2012. They are due to drop to 0% in 2016.

In this way, France wants to protect its domestic industry, but imports from South Korea are not what it thinks are. Of the 400,000 vehicles sold by Hyundai and Kia, barely half actually originate from South Korea, the rest being produced by the two groups in eastern Europe. In contrast, Renault sells vehicles produced by its Renault Samsung Motor subsidiary in South Korea for around 10,000 units in H1 and Opel is the biggest importer with 103,000 Chevrolet vehicles registered in Europe but produced in Korea.

As for other sectors, if the request is approved by the EU, it will undertake a detailed probe and, in the event of a proven imbalance, could apply sanctions and review the agreement. Other manufacturers, including Fiat and VW, have also warned Europe about the risks of forging similar agreements with India and Japan. Discussions are under way.

STEEL: Russian WTO entry poses increased threat to western European steel groups

Russia joined the WTO on 22 August and may now import as much steel as it likes into the European Union. With overcapacity estimated at 50 or 60Mt, this prospect will not be welcomed by European steel makers, particularly ArcelorMittal which is in talks with the Belgian and French governments and with the unions to close its blast furnaces in Liège and reduce its production at the Florange facility. Fortunately, the market is not in good shape anywhere; the Russian steel industry is using only 60% of the quotas to which it was entitled prior to its entry into the organisation.

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1/ Peer comparison method: valuation multiples for the company in question are compared with those of a sample of companies in the same sector, or with a similar financial profile. The sample average acts as a valuation benchmark, to which the analyst can, where necessary, apply discounts or premiums resulting from his/her perception of the company's specific features (legal status, growth outlook, profitability, etc.).
2/ NAV method: Net asset value is an assessment of the market value of the assets on a company's balance sheet using the method that the analyst deems most relevant.
3/ Sum of the parts method: this method involves valuing each of the company's businesses separately using the most appropriate valuation methods for each, and then adding them together.
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