THE WATCH

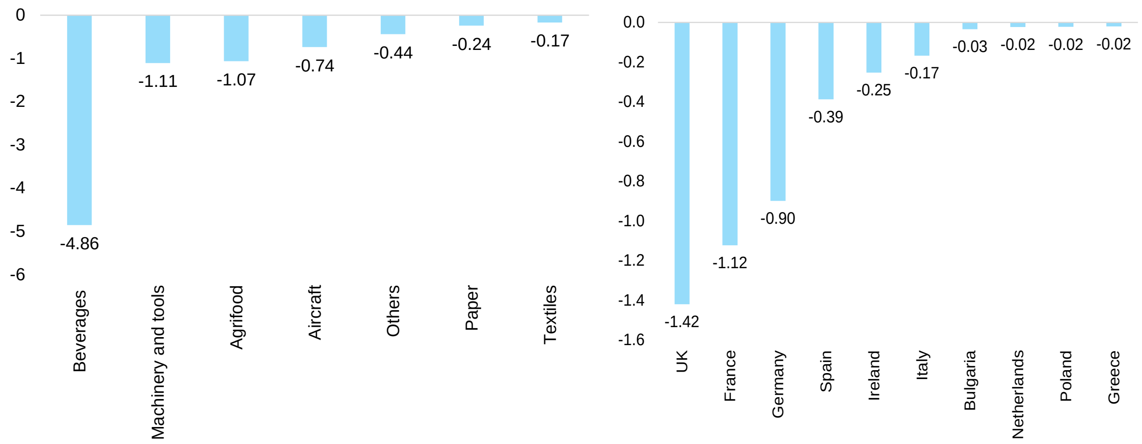
03 October 2019

U.S. and EU trade tensions: A tougher stance ahead

U.S. retaliatory tariffs on EU imports (WTO ruling on Airbus subsidies): France and Italy to be most impacted

- The World Trade Organization (WTO) authorized on October 2nd the U.S. to impose tariffs on EU imported goods to cover an estimated annual loss of USD7.5bn in compensation for illegal state aid provided to aircraft maker Airbus SE. The ruling marks the resolution of a 15-year dispute over the EU's subsidies for Airbus.
- The U.S. published a list of close to 100 products that will be taxed more starting from October 18th.
- We have calculated that in total EUR37bn of EU goods are targeted, the equivalent of 8% of total EU exports to the U.S.[1]. The goods taxed are mainly aircrafts, agri-food, beverages, machinery, paper and textiles.
- Aircrafts will be taxed at 10% compared to 0% previously while the other products will be taxed at 25% compared to an average of close to 4%. However, as this represents around 1.5% of total US imports, the impact on the total US import tariff is deemed negligible (less than +0.1pp from the current 8%).
- We estimate the total impact on EU GDP growth at less than -0.1pp with an estimated global loss of annual exports of USD8.6bn. Looking at sectors, the biggest export losses will be registered in beverages (USD4.9bn) followed by machinery (USD1.1bn), agri-food (USD1.1bn) and aircraft (USD0.7bn). The top 5 most impacted countries are the UK (USD1.4bn), France (USD1.1bn), Germany (USD0.9bn), Spain (USD0.4bn) and Ireland (USD0.3bn). In GDP growth terms, this would mean around -0.1pp for the UK and less for the others.

Figure 1 - Most impacted products and countries vs estimated annual export losses (in USDbn)



Sources: ITC, WTO, Allianz Research

[1] https://ustr.gov/sites/default/files/enforcement/301Investigations/EU_Large_Civil_Aircraft_Final_Product_List.pdf

- The EU had filed its own WTO complaint against Boeing Co. in 2004, but as the U.S. began its case nine months earlier, Washington will be able to punish Europe first. Talks between the two trade partners to resolve the dispute have so far been unfruitful. Brussels is planning to retaliate with duties ranging from USD11-20bn of U.S[2]. The WTO is expected to give its decision in March 2020.

What's next? U.S. tariffs on EU car imports in mid-November: Germany and the UK are most exposed

- We give 55% probability that the U.S. will now turn its trade policy focus to Europe as President Trump has criticized the ECB policy, Germany and the EU overall several times. Moreover, potentially new protectionist measures targeting China are rather limited as the most recent tariffs will have a direct impact on the US consumer.
- Hence, the decision of imposing U.S. tariffs on car imports (currently taxed at 3% from the EU) is expected to come mid-November. At this time, we expect President Trump to announce that the U.S. aims to implement a 10% tariff (from a range of 10%-25%) on imported European cars (EUR48bn from the EU out of the EUR260bn of total imported cars by the US) in the absence of noticeable progress on the U.S.-Europe trade deal.
- What could be the impact?
  EU growth would be hit by -0.1pp (for 10% US import tariffs). Germany would be hit the hardest in terms of export losses and given the weakness of its automotive sector, we expect the recession in the industrial sector to continue in early 2020. Hence, a technical recession could easily materialize even if it is not our central scenario; in terms of GDP growth, Finland, Germany and Sweden would be the most exposed.
  - If the U.S. were to impose 10% tariffs on its EU car imports in November
    Aggregate export losses for the EU would be EUR4bn per year.
    The increase in the U.S. average tariff will be very limited (+0.2pp from above 8% currently) which is still far from a situation of trade war that we define by an average US import tariff above 12%[3].
  - If tariffs are further hiked to 25%:
    The total export loss for the EU would be EUR12.5bn per year.
    Germany would be hit by more than -0.3pp of real GDP growth per year pushing it closer to full blown recession.
    The U.S. average tariff would go up by +0.5pp.

We expect a correction in the European equity markets which will comfort the ECB in cutting the deposit rate in Q1 2020 and increasing the QE size (from the current EUR20bn per months to EUR30bn).

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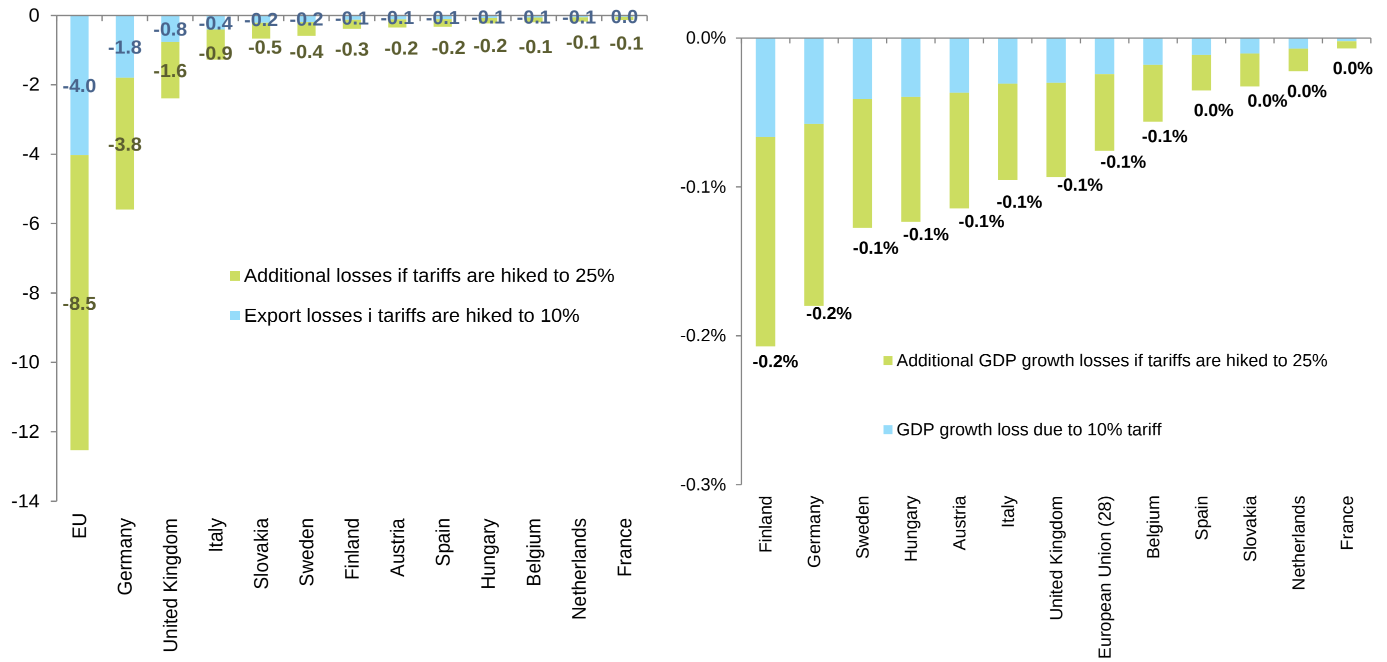
[2] https://europa.eu/rapid/press-release_IP-19-2162_en.htm
[3] Cf. page 4
https://www.eulerhermes.com/content/dam/onemarketing/euh/eulerhermes_com/erd/publications/pdf/20190919TheView-Liberal-cycleCOMPRESSED.pdf

Figure 2 – Expected annual export losses by country from higher U.S. import tariffs on cars (EURbn and pp of real GDP growth)

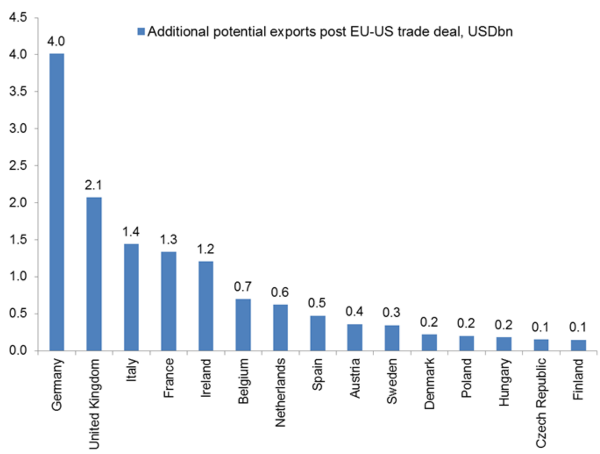


Sources: ITC, WTO, Allianz Research

Would a US-EU trade deal be a game changer?

- We don't expect a trade deal with the U.S. to be signed during the current mandate of the European Commission (40% probability). The U.S. is currently negotiating with Europe for a trade deal. While some concessions were made by the European Commission over the summer (namely on beef), there doesn't seem to be sizeable progress.
- Even if a trade deal is signed, similar to the CETA one where more than 95% of goods are duty-free, the potential positive impact looks rather limited. Not higher than +0.1pp on real GDP growth as the weighted average import tariffs between the two are already low: below 2% for the US import tariff and 3% for the EU one as half of the imports between the two are duty-free.
- In total, the EU would export USD14bn more products per year while the U.S. would export USD11bn.
- The top five sectors expected to benefit the most are chemicals, machinery, vehicles, electronics and agri-food.
- In terms of EU countries, Germany (USD4bn), the UK (USD2.1bn), Italy (USD1.4bn), France (USD1.3bn) and Ireland (USD1.2bn) are expected to benefit the most.

Figure 3 – Additional potential exports post an EU-U.S. trade deal, USDbn



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Ana Boata
+33 (0) 1.84.11.48.73
Ana.BOATA@eulerhermes.com

Georges Dib
+33 (0) 1 84 11 33 83
Georges.dib@eulerhermes.com

Aisha Salih

Director of Publications: Ludovic Subran, Chief Economist

Euler Hermes Allianz Economic Research

1, place des Saisons | 92048 Paris-La-Défense Cedex | France

Phone +33 1 84 11 35 64 |

A company of Allianz

http://www.eulerhermes.com/economic-research

research@eulerhermes.com