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Trade Wars – is the EU next in line?

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- **Attention has been focussed on the trade conflict between the US and China ...**
- **... though President Trump has hinted that he is considering imposing tariffs on imports of cars and vehicle parts from Europe**
- **If imposed, European car production and exports would drop, with a knock-on effect on other sectors that rely on the car industry**
- **As the price elasticity for cars is relatively high, European GDP growth could be 0.2-0.3% lower**
- **Besides this direct impact, there will be an indirect impact that will hurt all countries involved in the conflict, and could potentially be around the same size as the direct impact**
- **Considering that there will be significant damage to the US as well, it seems unlikely that these tariffs will be imposed, but President Trump might want to keep the threat alive as leverage in negotiations**

Introduction

The negotiations between the US and China have stolen the headlines when it comes to global trade tensions. Still, President Trump has repeatedly scorned Germany's huge current account surplus, the US's large bi-lateral deficit in trade in cars, and the low level of imports of US agricultural products by European countries. In this research note we answer a number of questions about the trade dispute between the US and EU and assess what the potential damage to both countries could be. We do this in a Q&A format.

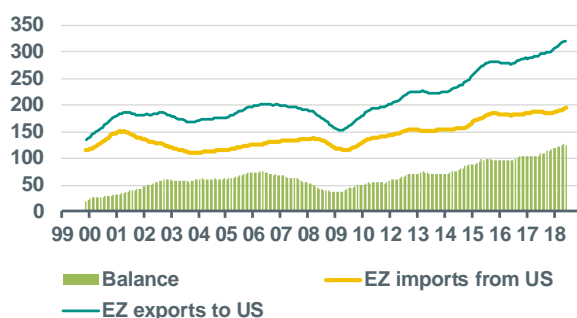
What tariffs have been imposed on US-EU trade so far?

Steel and aluminium and a number of US products. At the end of May 2018, President Trump exercised his presidential authority under Section 232 of the Trade Expansion Act of 1962 to impose a 25 percent tariff on US steel imports and a 10 percent tariff on US aluminium imports from the EU. Section 232 authorizes the President of the United States, through tariffs or other means, to adjust the imports of goods or materials from other countries if it deems the quantity or circumstances surrounding those imports to threaten national security. Subsequently, the EU retaliated by implementing tariffs (so-called 'rebalancing

measures') on a list of products imported from the US, worth around EUR 2.8bn, which is equal to merely 1% of total imports from the US. The EU imposed a 25% tariff on imports of steel and steel products, some agricultural products and products such as whiskey, peanut butter and clothing and shoes from the US.

Eurozone trade with the US ...

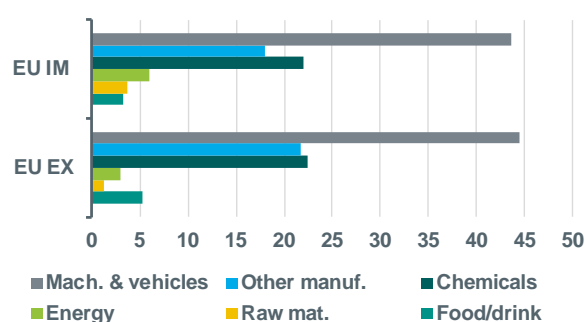
EURbn, 12M sum



Source: Thomson Reuters Datastream, ABN AMRO Group Economics

... and the main product groups

Share in total exports/import EU to/from US, %



Source: Eurostat

Are further tariffs on the agenda?

Possibly. The US started a Section 232 investigation into the imports of cars and vehicle parts on 23 May 2018. The US Commerce Department submitted its report and recommendations to President Trump on Sunday 17 February 2019. The details of this report have not been disclosed. According to the provisions of Section 232 investigations, President Trump will have 90 days after the presentation of the report to decide whether or not he will take action. This sets the deadline on 22 May 2019. The European Union has said that it would react in a swift and adequate manner if Trump follows through on his threat to impose duties on EU cars and auto parts. The 28-nation bloc has prepared retaliatory tariffs totalling EUR 20bn (approximately \$22.7 billion) of US goods.

The Section 232 investigation reflects that there is a big imbalance in trade in cars and vehicle parts. As the graphs above and below show, bilateral trade between the EU and US is dominated by the broad product group machinery and vehicles. Also, the largest imbalance in trade between the EU and US is in trade in cars and motor vehicles. In 2017, the EU exported EUR 38bn worth of motor vehicles to the US, while it imported only EUR 6.5bn. This means that the cover ratio (ratio of exports over imports) is almost 6. The EU's bilateral trade surplus in vehicle *parts* is almost EUR5bn, with a cover ratio of over 2.5.

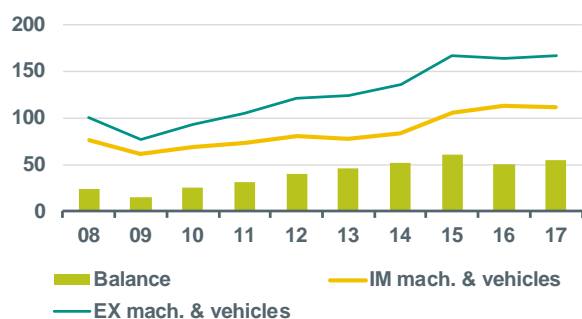
Are the US and EU negotiating about trade?

They have agreed to do so, but talks have not yet begun. On 25 July 2018, US President Trump and EC president Juncker agreed that the US and EU would work together towards zero tariffs, zero non-tariff barriers, and zero subsidies on non-auto industrial goods. Also, the countries agreed to work together to reduce barriers and increase trade in services, chemicals, pharmaceuticals, medical products as well as soy beans. The agreement further states that the EU wants to import more LNG from the US to diversify its energy supply. Trump and Juncker

agreed to focus on a limited range of areas where results could be realistically achieved quickly and without entering areas of significant sensitivity for either side. This is why the joint agenda does *not* include cars, agriculture (sensitive for the EU) or public procurement (sensitive for the US). The US and EU set up an Executive Working Group (EWG) to take the joint agenda forward. The EWG is co-chaired by EU Commissioner for Trade Cecilia Malmström and US Trade Representative Robert Lighthizer. Both sides also agreed to refrain from any measures that would go against the spirit of their agreement while work on this joint agenda is ongoing. This would therefore imply that the US would not impose any Section 232 measures, and therefore neither on EU cars and car parts.

Trade in Machinery and vehicles...

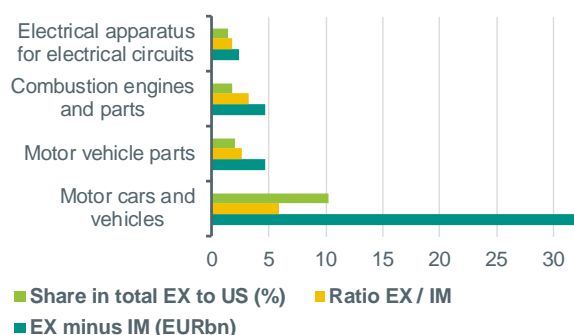
EU exports to / imports from US, EURbn



Source: Eurostat

...and its main parts

Various indicators



Source: Eurostat

Has progress been made between the US and EU on trade?

No. On 30 January 2019, the EWG published an interim report (see [here](#)). Since the start of the negotiations, some timelines had been set, working groups had been formed and mutual intentions had been formulated. Recent comments by President Trump clearly indicate that he thinks that it is going much too slowly. Also, Ms Malmström recently mentioned to the press that a lack of trust between Washington and Brussels was hampering the possibility of a broad trade deal and that the focus should remain on only a limited number of items. Finally, recent reports in the press have indicated that talks will be delayed as European leaders do not agree on the matter. The only concrete, measurable, results so far seem to be that the EU's imports of soy beans from the US rose by 114% yoy between 1 July 2018 and 27 January 2019. That said, the EWG report emphasises that any action by the US to impose tariffs or quotas on EU exports of cars and car parts as a result of the ongoing Section 232 investigation would be hugely disruptive to this work programme, and would effectively block further progress on key elements. It would also be counter to the commitment made by the US in July "not to go against the spirit of this agreement" while work in the EWG is ongoing. The application of restrictions on trade of automobile products would in any event lead to the suspension of negotiations over industrial tariffs.

What will be the impact on the eurozone economy of car tariffs?

Sizeable. To begin with there will be a direct impact. Import tariffs on European car and vehicle part exports to the US will have the impact of a supply shock, meaning

that they will lift car prices in the US and depress the volume of sales.

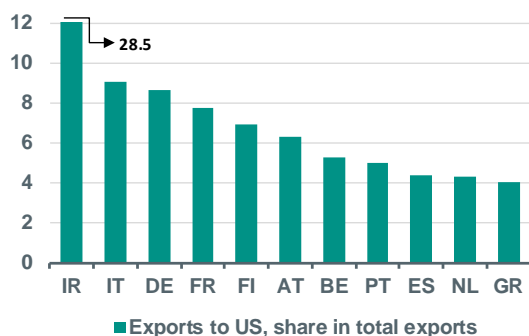
Consequently, European car exports and production will drop, which will also have knock on effects on other sectors that rely on the initial sectors impacted.

Measuring the impact of tariffs is complicated by the fact that the European and US car industries are highly integrated. According to the European Automobile Manufacturers Association (EAMA), EU-owned automobile manufacturers account for more than 25% of total US car production, while more than half of these cars are exported from the US, also partly to the EU.

As a rule of thumb we can assume that around half of the 25% tariff on passenger cars and vehicle parts will be passed on to consumers, car prices in the US would rise by approximately 10-12% (which is roughly in line with estimates by the US Center of Automotive Research). As the price elasticity for cars is relatively high (most academic studies find elasticities of around 2 to 3, although varying per type or brand of car), US demand for European cars could drop by approximately 25%. Considering the share of cars and vehicle parts in total EU exports to the US (around 12%) and the share of export to the US in total extra-EU exports (around 20%) this means that (all else the same) European GDP growth could decline by approximately 0.1%. On top of that, there will be an impact on the entire supply chain and some automotive related services. If we take this into consideration the impact on EU GDP growth could rise to around 0.2-0.3%. The eurozone countries that potentially will be affected the most are the leading car producing countries Germany, Spain and France.

Exports to the US individual eurozone countries ...

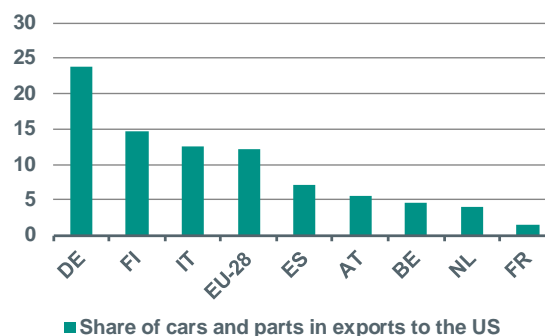
Share in total exports, %



Source: Thomson Reuters Datastream, ABN Amro Group Economics

... and the share of cars and car parts in EX to the US

Share of cars and vehicle parts in total exports to the US, % (top-eight)



Source: Various national statistics Bureaus, OEC, ABN Amro Group Economics, Eurostat

Besides the direct impact there will be an indirect impact. As in the case of the trade dispute between the US and China, a large part of the economic impact of an escalation of the trade conflict between the US and the EU would be through the channel of financial market sentiment and business confidence. This type of damage of the trade conflict would probably be felt roughly equally in the EU and the US. While it is hard to measure these indirect effects they can significantly hurt domestic demand, particularly if the tariffs on cars and vehicle parts are considered to be a next step in a larger trade war that will escalate further. On top of that, an escalating trade war between Europe and the US would create uncertainty about the overall post-World War II international order, including NATO cooperation.

Consequently, investment and production decisions could be postponed or cancelled. Moreover, negative wealth effects stemming from deteriorating financial market sentiment will also weigh on domestic demand. Overall, the direct impact could potentially have roughly the same size as the direct impact.

What will be the impact on the US economy of car tariffs?

Noticeable, but probably more limited than the impact on the eurozone. As mentioned above a large part of the economic impact of trade wars is via the channel of financial market sentiment and business confidence. This damage would roughly be the same in all countries involved in the conflict. On top of that, the integrated nature of global car production could also impact US producers and employment in the US car industry. US tariffs on imported cars could theoretically result in higher demand for domestically-produced cars, but tariffs on car components could raise the prices of domestically-produced cars, which could counteract this. As things stand, there is an oversupply of used cars flooding the market, and any imposition of tariffs would likely hasten a consumer shift from new to used cars.

How likely is it that tariffs will be imposed?

It seems unlikely, given the damage it could do to the US economy. The pattern so far is that President Trump uses tariffs – real or threatened – as a bargaining chip. The lack of progress in negotiations between the US and EU may convince him that he needs to keep the threat of tariffs alive. However, there is quite some resistance within the US against the imposition of tariffs on cars and car parts. Since the start of the Section 232 investigation, multiple members of Congress have raised concerns about this investigation. Moreover, the US motor vehicle industry has voiced strong opposition to tariffs. Also, Congress has introduced some bills to curtail the authority of the US President to restrict US imports by using the Section 232 more generally. These look unlikely to pass this side of the 2020 presidential elections, although any actual imposition of tariffs could galvanise support for the bills.

Conclusion

Very little progress has been made in the trade negotiations between the EU and US and President Trump is becoming increasingly impatient. For now, he appears to be using the threat of tariffs on imports of European cars and vehicle parts to create leverage in upcoming negotiations. Indeed, the direct and indirect damage of these tariffs to the European car industry and overall economy would be sizeable. Considering that there is strong resistance in the US against tariffs on imports of cars and vehicle parts and that the US motor vehicle industry and overall economy would be hurt significantly as well, it seems unlikely that these tariffs will be imposed – and this is without considering retaliatory measures the EU would impose. Still, we would not be surprised if President Trump kept the threat alive in his communication for a while.

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