M.M.WARBURG & CO
BANK

ECONOMIC SITUATION AND STRATEGY

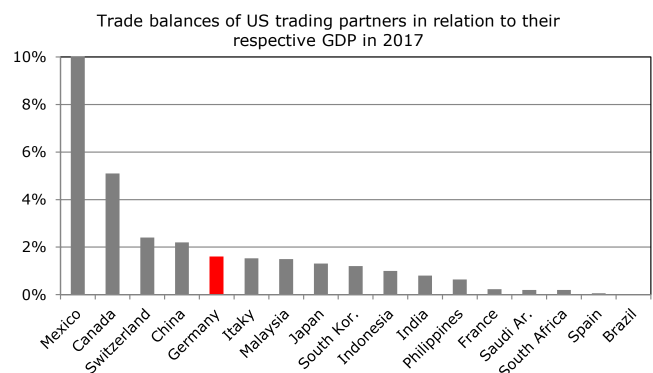
June 15, 2018

Stakes for Germany in trade war with US?

The differences between Donald Trump and his country's most important trading partners (besides China) again came to light at the G7 summit last weekend in La Malbaie, Canada. At first, it looked as if the summit might be a surprising success – Trump spoke of "great meetings and relationships" with the other leaders – but tensions grew after his departure for Singapore. Trump withdrew consent to the joint communiqué after Canadian Prime Minister Justin Trudeau made comments critical of Trump at the concluding press conference. In addition, the US president again threatened to impose tariffs on automobiles.

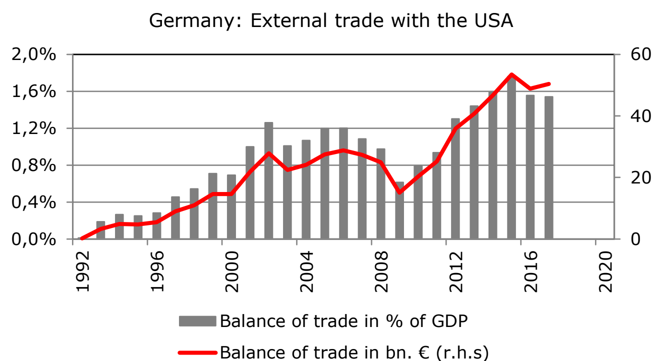
As in the case of the tariffs on steel and aluminum, the US president is again arguing that these measures are necessary to avoid endangering national security. Using this line of argument, the US president can decide at his own discretion to implement trade barriers and does not need the approval of Congress despite provisions to the contrary in the US Constitution. Even though we do not believe that Trump wants actually and permanently to limit trade, it appears the US president does do what he says he will. One should therefore not dismiss the threat of tariffs on automobiles as nothing but a scare tactic.

What countries have especially close trade ties to the United States and could be affected more than average by tariffs and other trade restrictions? The United States had a trade deficit of almost USD 800 billion in 2017, equivalent to 4% of US gross domestic product (GDP). Trump's simple, but economically incorrect, calculation is that without foreign trade, the deficit would drop to zero and the US economy would grow significantly faster. However, he fails to consider that without trade, the United States would also lose jobs and purchasing power. The United States had its largest deficits in the exchange of goods last year with China (USD 376 billion), Mexico (USD 71 billion), Japan (USD 69 billion), and Germany (USD 64 billion). To be able to judge the potential growth effects, one must set the trade balances of US trading partners in relation to their respective economic power. The situation then looks especially threatening by far for Mexico, followed by Canada, Switzerland, China, and Germany.



A look at the trade statistics shows how and where the German economy is vulnerable. Taking into account imports and exports, China has displaced the United States as Germany's most important trading partner since 2015, but the United States is still the most important market for German exports. Goods worth EUR 111.5 billion were exported to the United States in 2017, which represented 8.7% of total exports. On the other hand, goods worth EUR 61.1 billion were imported (5.9% of total imports). The German trade surplus with the United States of EUR 50.4 billion equaled 1.5% of German GDP. On the (unrealistic) assumption

that Germany were to stop trading with the United States while trade with all other countries remained unchanged, German GDP growth would consequently turn out a nominal 1.5 percentage points lower than it was in 2017. The nominal growth rate would drop from 4.1% to 2.6%, and the real growth rate from 2.5% to about 1%. Even though these considerations greatly simplify reality, they do show what risk a potential trade war with the United States would entail for Germany.



Only five sectors accounted for more than 70% of German exports to the United States in 2017. Automobiles are by far the most important export from Germany to the United States (USD 27 billion, or 24% of all exports to the US), followed by machinery (USD 23 billion, or 20%), pharmaceuticals (USD 13 billion, or 12%), electrical technology (USD 10 billion, or 9%), and optical products (USD 9 billion, or 8%). Of Germany's total trade surplus with the United States of USD 50 billion, the automobile sector alone accounts for USD 20 billion. It is no wonder that this is a thorn in Trump's side and he views tariffs on automobiles as an appropriate means of motivating Germany and Europe to make trade policy concessions. If exports to the United States are considered in isolation, the pharmaceutical sector might even suffer more from trade restrictions than the automobile industry. That is because "only" 12% of total automobile exports go to the United States, while the number is 17% in the case of pharmaceutical producers.

Because of the great importance that US trade has for the German economy, politicians should not try to continue waiting the problem out. Instead, they should propose concrete solutions to the United States. For example, one could offer to completely remove the 10% import duty on automobiles produced in the United States. If Trump is actually against protectionism and for fair and free trade, he should welcome this step and in return lift the 2.5% US duty on European passenger vehicles. Ideally, the duties on SUVs, amounting to 25% on imports into the United States and about 15% on imports into the euro zone, would also be lifted. The result would be motor vehicle trade on a level playing field, so that future development of the trade balance in this sector would solely express demand, undistorted by tariffs, on the part of buyers in the United States and the euro zone. Ideally, such a political proposal might even lead to further reduction of duties in other economic sectors. More free trade would also lead to more growth in the United States as well as in the euro zone and the rest of the world.

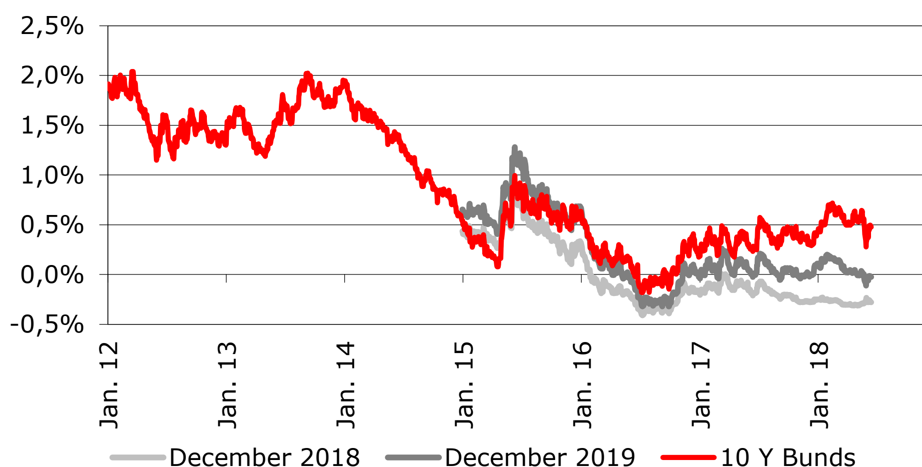
But it remains to be seen, of course, how the Trump administration would actually react to a "disarmament proposal" in the trade conflict. If he sees himself primarily as a dealmaker who keeps the promises made to his voters, he might well agree to such an idea. But if what matters to him is "America first" and a new world order in which allies are viewed as new competitors, such a proposal would not be enough for him, and he would raise further demands. Then, however, everyone would know where one stands with him. European politicians should understand that they have a "partner" in Donald Trump, who does not fit the European concept of an elder statesman, but rather wants impulsively to implement his own ideas. One will not reach agreement with this US president by following the long-practiced deliberateness of European politics. Also Europe will need a different political style in the future.

Weekly outlook for June 18-22, 2018

	Jan.	Feb.	Mar.	Apr.	May	June	Release
DE: Producer prices, m/m	0.5%	-0.1%	0.1%	0.5%	0.4%		June 20
DE: Producer prices, y/y	2.1%	1.8%	1.9%	2.0%	2.6%		June 20
DE: PMI, manufacturing - flash	61.1	60.6	58.2	58.1	56.9	56.5	June 22
DE: PMI, services - flash	57.3	55.3	53.9	53.0	52.1	52.5	June 22
EUR19: PMI, manufacturing - flash	59.6	58.6	56.6	56.2	55.5	55.1	June 21
EUR19: PMI, services - flash	58.0	56.2	54.9	54.7	53.8	54.0	June 22
EUR19: Consumer confidence - flash	1.4	0.1	0.1	0.3	0.2	0.1	June 22

MMWB estimates in red

Chart of the Week: The ECB's dilemma



This week could not have been more suspenseful from the standpoint of monetary policy. Two top-level decisions were on the agenda in the United States and the euro zone. While the Federal Reserve has lowered its key interest rate for the seventh time since the trend reversal in December 2015, the European Central Bank (ECB) is having great trouble just ending its asset purchase program. Although it reduced the monthly purchase total from EUR 60 billion to EUR 30 billion in January in view of good economic development last year and announced a possible end for September, the closer we get to that month, the greater the ECB's dilemma becomes. Recently weaker economic data from the euro zone and additional political fireworks (including conflicts with the United States regarding trade policy and Iran as well as the new Italian government's antics) suggest the program should be continued for a while, while the recent rise of prices and the ECB's goal of finding a way back to a normal cycle of interest rate increases argue for ending asset purchases soon. The decision ultimately reached is certainly an attempt to master this balancing act. The quantitative easing program will continue to the end of this year, but will end then. In addition, monthly purchases will decrease from EUR 30 billion to EUR 15 billion as of October. The ECB has also ventured for the first time to specify an end date for its zero interest rate policy. Accordingly, the key interest rate might be raised for the first time after summer 2019. The ECB is optimistic because the inflation rate is nearing its target of 2%. Inflation forecasts for this year and next have been raised correspondingly from 1.4% to 1.7%. ECB President Mario Draghi has furthermore expressed optimism that the core inflation rate will also increase towards the end of the year. He emphasizes that all decisions are subject to the condition of a sustainably higher inflation rate in the euro zone. However, the real question is how sustainable the outlined inflation scenario is, since the current inflation rate of 1.9% is largely due to base effects in the energy sector that will dissipate over the summer.

Market data overview

Stock marktes	As of 15.06.2018 11:19	Change versus 08.06.2018 -1 week	14.05.2018 -1 month	14.03.2018 -3 months	29.12.2017 YTD
Dow Jones	25175	-0,6%	1,1%	1,7%	1,8%
S&P 500	2782	0,1%	1,9%	1,2%	4,1%
Nasdaq	7761	1,5%	4,7%	3,5%	12,4%
DAX	13111	2,7%	1,0%	7,1%	1,5%
MDAX	27249	2,2%	2,3%	6,1%	4,0%
TecDAX	2938	4,7%	5,9%	9,7%	16,2%
EuroStoxx 50	3531	2,4%	-1,0%	4,1%	0,8%
Stoxx 50	3115	1,9%	-0,7%	4,3%	-2,0%
SMI (Swiss Market Index)	8664	1,8%	-3,7%	-2,3%	-7,6%
Nikkei 225	22852	0,7%	-0,1%	4,9%	0,4%
Brasilien BOVESPA	71421	-2,1%	-16,2%	-17,0%	-6,5%
Russland RTS	1128	-1,3%	-6,2%	-9,8%	-2,3%
Indien BSE 30	35547	0,3%	0,0%	5,1%	4,4%
China Shanghai Composite	3023	-1,4%	-4,8%	-8,2%	-8,6%
MSCI Welt (in €)	2142	1,4%	3,5%	6,9%	5,2%
MSCI Emerging Markets (in €)	1126	0,4%	-0,6%	-1,6%	0,4%
Bond markets					
Bund-Future	163,14	274	500	520	146
Bobl-Future	131,67	28	89	107	6
Schatz-Future	112,01	-2	15	14	4
3 Monats Euribor	-0,32	0	1	1	1
3M Euribor Future, Dec 2017	-0,30	-4	0	0	0
3 Monats $ Libor	2,34	1	1	20	65
Fed Funds Future, Dec 2017	2,19	3	-3	9	0
10 year US Treasuries	2,93	-2	-8	11	52
10 year Bunds	0,40	-5	-21	-19	-3
10 year JGB	0,04	-1	-1	0	-1
10 year Swiss Government	-0,02	-4	-12	-5	10
US Treas 10Y Performance	558,25	-0,2%	0,3%	-0,9%	-4,0%
Bund 10Y Performance	611,46	0,2%	1,8%	1,6%	0,7%
REX Performance Index	481,24	-0,4%	0,5%	0,6%	0,1%
US mortgage rate	0,00	0	0	0	0
IBOXX AA, €	0,84	-3	-2	11	16
IBOXX BBB, €	1,59	-6	8	25	35
ML US High Yield	6,40	-10	-7	-10	25
JPM EMBI+, Index	784	-0,8%	-1,7%	-3,9%	-6,3%
Convertible Bonds, Exane 25	7501	0,0%	0,1%	2,6%	1,4%
Commodities					
CRB Spot Index	450,94	0,2%	1,7%	1,1%	4,3%
MG Base Metal Index	363,27	-0,8%	3,2%	4,1%	1,3%
Crude oil Brent	75,34	-1,7%	-3,3%	16,4%	13,1%
Gold	1300,01	0,2%	-1,5%	-1,9%	-0,3%
Silver	17,22	2,7%	3,4%	4,0%	1,2%
Aluminium	2262,25	-1,5%	-2,3%	9,4%	0,3%
Copper	7173,00	-2,1%	4,6%	3,2%	-0,5%
Iron ore	65,56	1,3%	-3,0%	-9,9%	-8,0%
Freight rates Baltic Dry Index	1433	3,0%	-2,9%	22,6%	4,9%
Currencies					
EUR/ USD	1,1611	-1,2%	-3,1%	-6,1%	-3,2%
EUR/ GBP	0,8737	-0,5%	-0,8%	-1,4%	-1,6%
EUR/ JPY	128,29	-0,3%	-2,3%	-2,6%	-5,0%
EUR/ CHF	1,1563	-0,1%	-3,4%	-1,2%	-1,2%
USD/ CNY	6,4204	0,2%	1,3%	1,6%	-1,3%
USD/ JPY	110,63	1,0%	0,9%	4,0%	-1,8%
USD/ GBP	0,75	0,9%	2,3%	5,0%	1,8%

Carsten Klude
+49 40 3282-2572
cklude@mmwarburg.com

Dr. Rebekka Haller
+49 40 3282-2452
rhaller@mmwarburg.com

Martin Hasse
+49 40 3282-2411
mhasse@mmwarburg.com

Dr. Christian Jasperneite
+49 40 3282-2439
cjasperneite@mmwarburg.com

Bente Lorenzen
+49 40 3282-2409
blorenzen@mmwarburg.com

Julius Böttger
+49 40 3282-2229
jboettger@mmwarburg.com

This information does not constitute an offer or an invitation to submit an offer, but is solely intended to provide guidance and present possible business activities. This information does not purport to be complete and is therefore not binding. The information provided should not be considered a recommendation to purchase financial instruments individually, but serves only as a proposal for a possible asset allocation. The opinions expressed herein are subject to change without notice. Where statements were made with respect to prices, interest rates or other indications, these solely refer to the time when the information was prepared and do not imply any forecasts about future development, particularly regarding future gains or losses. In addition, this information does not constitute advice or a recommendation. Before completing any deal described in this information, a product-specific consultation tailored to the customer's individual needs is required. This information is confidential and exclusively intended for the addressee described herein. Any use by parties other than the addressee is not permissible without our approval. This particularly applies to reproductions, translations, microfilms, saving and processing in electronic media as well as publishing the entire contents or parts thereof.

This analysis is freely available on our website.