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## MACRO UPDATE: TRADE TALKS, BREXIT TURMOIL

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#### TRADE: MORE GOOD NEWS THAN BAD NEWS

Whereas the US and China are both playing hardball in what are – hopefully – the latter stages of their contentious trade talks, US President Trump has delayed his decision about punitive tariffs on car and car part imports from the EU, Japan and others by up to six months. Trade tensions are bad. The assertion of Trump and his Commerce Department that car and car part imports pose a threat to US national security seems odd, to put it very mildly. Still, the two separate pieces of news over the last eight days, disappointment on US-China and relief on US-EU trade issues, are on balance a modest positive. We see five reasons for that:

1. EU-US trade matters most. It is by far the biggest single bilateral trade flow in the world. Counting exports and imports of goods and services, US-EU bilateral trade exceeded that between the US and China in 2018 by more than 70%. Seen from a US mercantilist angle, the gap is even starker. In 2018, the US exported more than three times more to the EU (\$576bn) than to China (\$180bn). If the EU had to, it could hit back hard at the US.
2. Trump's hesitation to impose tariffs on car and car part imports from the EU strengthens our view that he would have little political support in the US for a trade war against the EU. Unlike China, the EU is not seen as a geostrategic rival. While the argument "China stole our jobs" seems to go down well in parts of the US, the argument that "European car companies are stealing your job" would not sell well around the German-owned car plants in Tennessee, Alabama and South Carolina, to name the obvious ones. Soybean farmers in the key primary state of Iowa may also not be amused if the EU were to curtail its soybean purchases from the US in response to US car tariffs.
3. A six month reprieve for Europe (and Japan) moves the decisive stage of negotiations much closer to the US election season. Our key call remains that Trump will want to campaign for re-election by boasting "I created jobs" rather than "I am waging trade wars that hurt others even more than they hurt us". Later this year, he may see more reason to compromise than now.
4. In a similar vein, unexpectedly strong US GDP growth in Q1 may have encouraged Trump to take a hard line on trade issues with China now. However, if US growth decelerates to a still healthy but less buoyant 2.3% pace later this year, as we expect, the risk that trade war damage may cause a visible dent to US economic performance will likely loom larger.
5. The mere passage of time may help a little. The longer we talk about trade risks, the less could any particular outcome shock us. While impediments to trade are a persistent drag on the long-run growth potential of countries, the short-term impact depends on the damage to confidence. The risk of a disruptive shock to confidence – the fear factor – should recede somewhat over time.

Trade tensions will remain with us for quite a while. With luck, the US and China may make progress when Xi Jinping and Donald Trump meet at the G20 summit on 28-29 June in Osaka. US and EU talks could make headlines over the autumn – or earlier if Trump chooses to up the ante. But on balance, the reprieve of up to six months between the US and the EU supports the call that global manufacturing could turn up again during the second half of the year. The Chinese stimulus, which is already in the pipeline but only starting to show up in some data, will add to that.



### **BREXIT: CORBYN WALKS OUT, MAY LEAVES, BORIS RUNS**

The Brexit sands are shifting again. Conservative-Labour talks for a Brexit compromise have apparently broken down after six weeks with little to show for. UK Prime Minister Theresa May has announced she will set out her departure date next month irrespective of whether Brexit is sorted or not. Brexiteer Boris Johnson, a fan favourite among grass roots Conservatives, has announced he will run for Conservative leadership and thus Prime Minister. On balance, these developments reduce the chance that the Brexit mess could be resolved soon, that is by the end of June before the new EU parliament meets on 2 July. The newsflow also casts some doubt over our base case that parliament will eventually back one of the softer options for UK-EU trade during the summer and pass the Withdrawal Agreement shortly thereafter. May will probably now turn to parliament to begin a process of indicative voting on the various options for the future UK-EU relationship. The precise nature of such votes and whether May will try this before the planned vote on the Brexit Withdrawal Bill – due the week commencing 3 June - remain open questions.

As May has failed to get Brexit over the line so many times, MPs might simply decide to wait to see what the new Conservative leader and Prime Minister might bring to the table and vote down the Withdrawal Agreement again in early June. Furthermore, as the Conservatives are bitterly divided over Brexit, Labour MPs could decide to make life even harder for the government by voting against potential solutions that could sort Brexit out soon in the hope it will raise the chance of a collapse of government that could trigger snap election. The one potential upside is that, fearing that the next Prime Minister could be a Brexiteer such as Boris Johnson, parliament might be incentivised to vote for the Withdrawal Agreement – this is the one sure fire way of taking a hard Brexit off the table. The Withdrawal Agreement, which contains the Irish backstop, would commit the UK to a customs union style arrangement as the bare minimum for the future relationship. Any further agreement would need to be practically equivalent to this or more comprehensive. The UK is due to leave the EU at the end of October. Our key concern is that the risk that the UK could waste the next six months. This tilts the risk of a hard Brexit – which we put a 20% - a little to the upside. Come late October, the EU may be much less willing to grant the UK a further extension than it was in April. Still, as a hard Brexit only has minority support among the British population and in the British parliament, it remains a somewhat unlikely outcome.



## MACRO NEWS

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