

# The Economic Outlook: What a European Slowdown Means for Freight Stakeholders



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# Questions, questions, questions



Source: Getty Images

## Question 1:

*How are trade tensions affecting the Eurozone economy?*

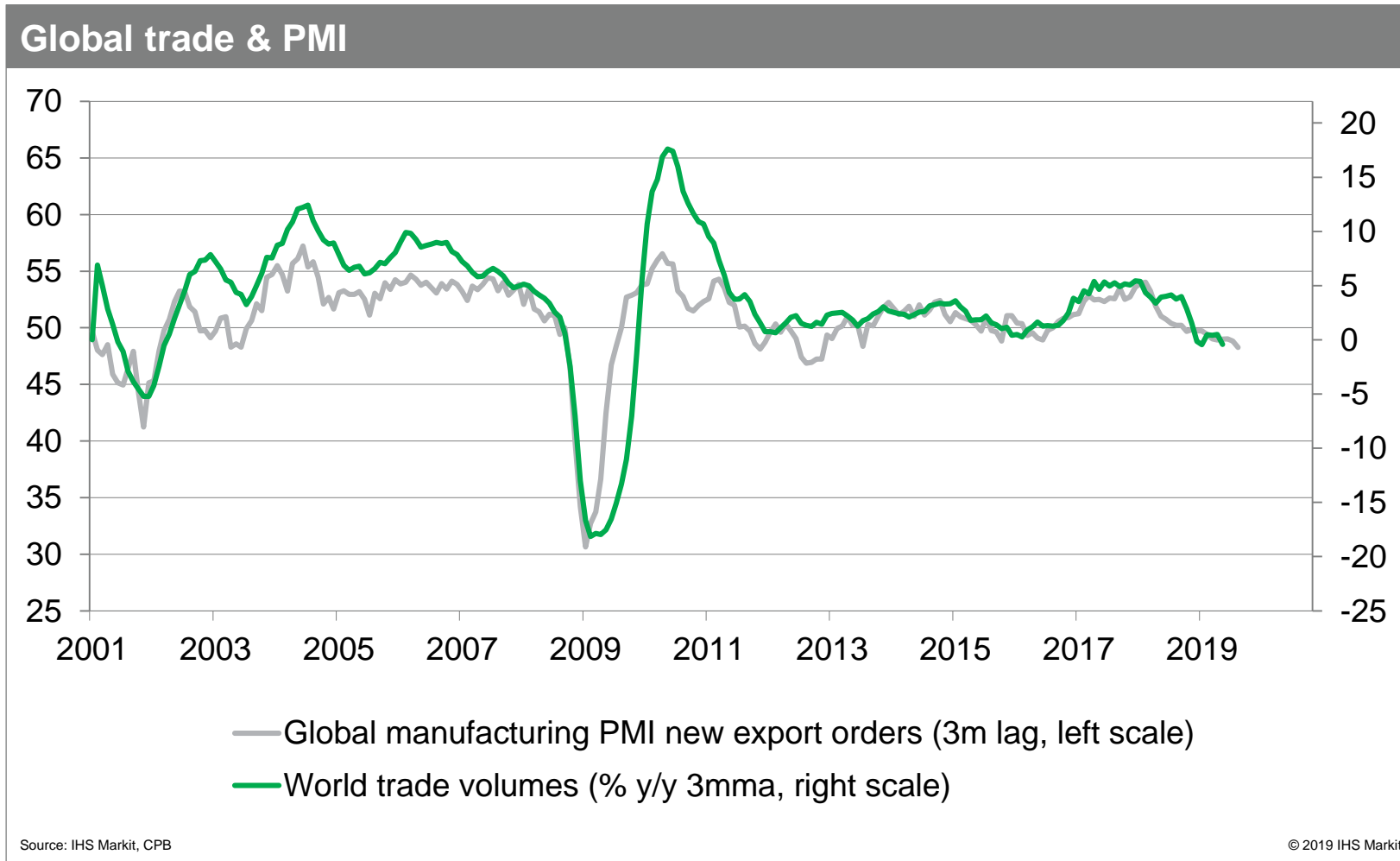
## Question 2:

*Will the external sector become more supportive?*

## Question 3:

*What risks are there in place?*

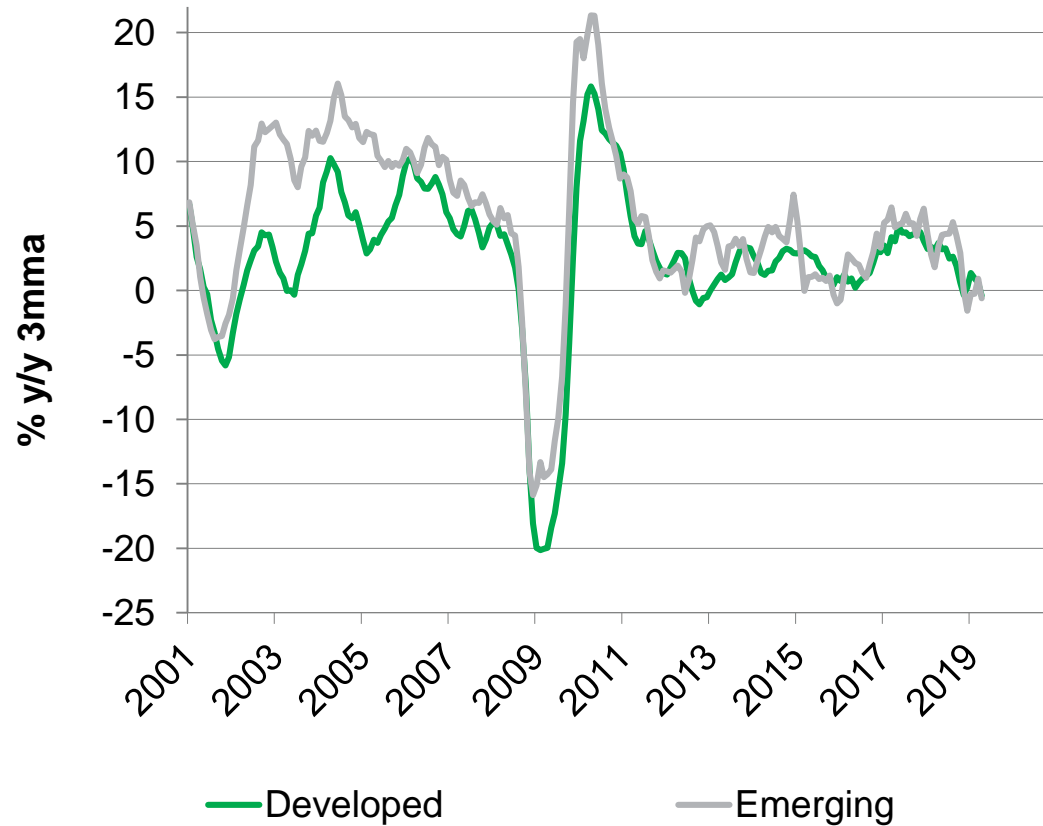
# Manufacturing PMI's export orders points to weak global trade



- IHS Markit's global manufacturing PMI new export orders sub-index is usually a reliable guide to world trade dynamics.
- The PMI data lead the “hard” trade data by around three months and data releases are more timely.
- New exports orders have contracted for the 11<sup>th</sup> consecutive month in August.
- The decline in new export orders in August was the sharpest since early 2013.

# The softening in trade momentum has been broad-based

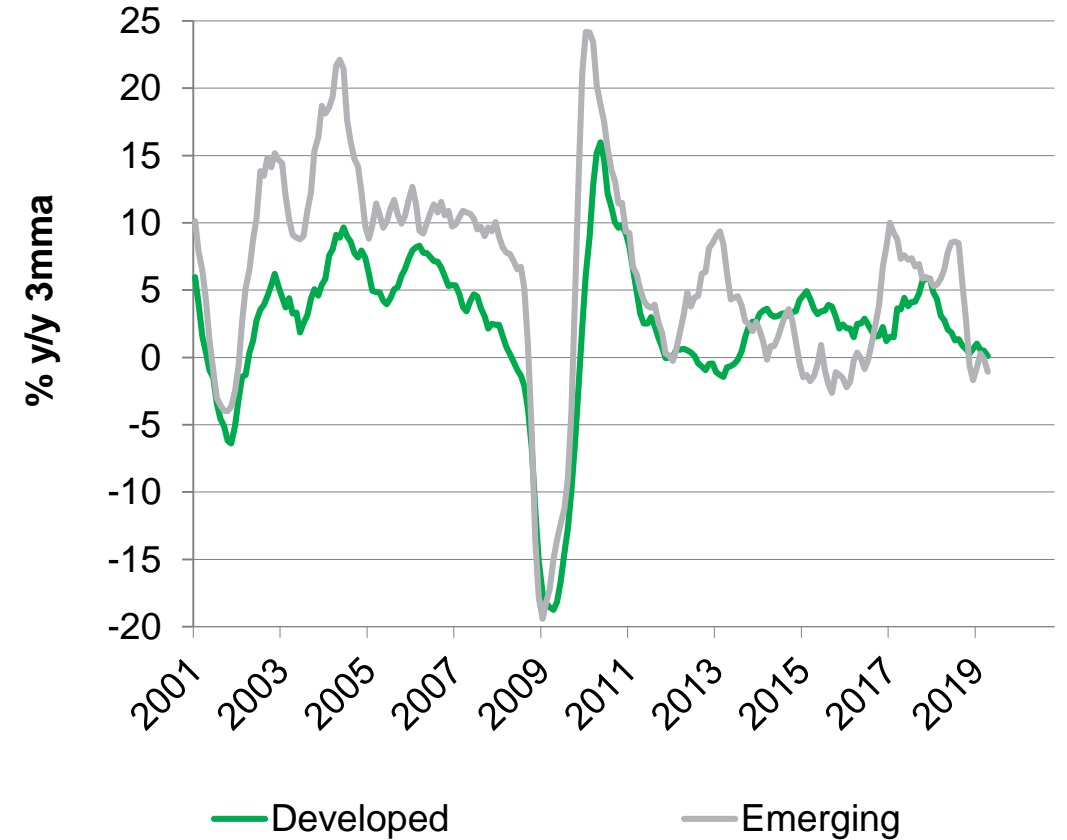
Global trade: export volumes



Source: CPB

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Global trade: import volumes

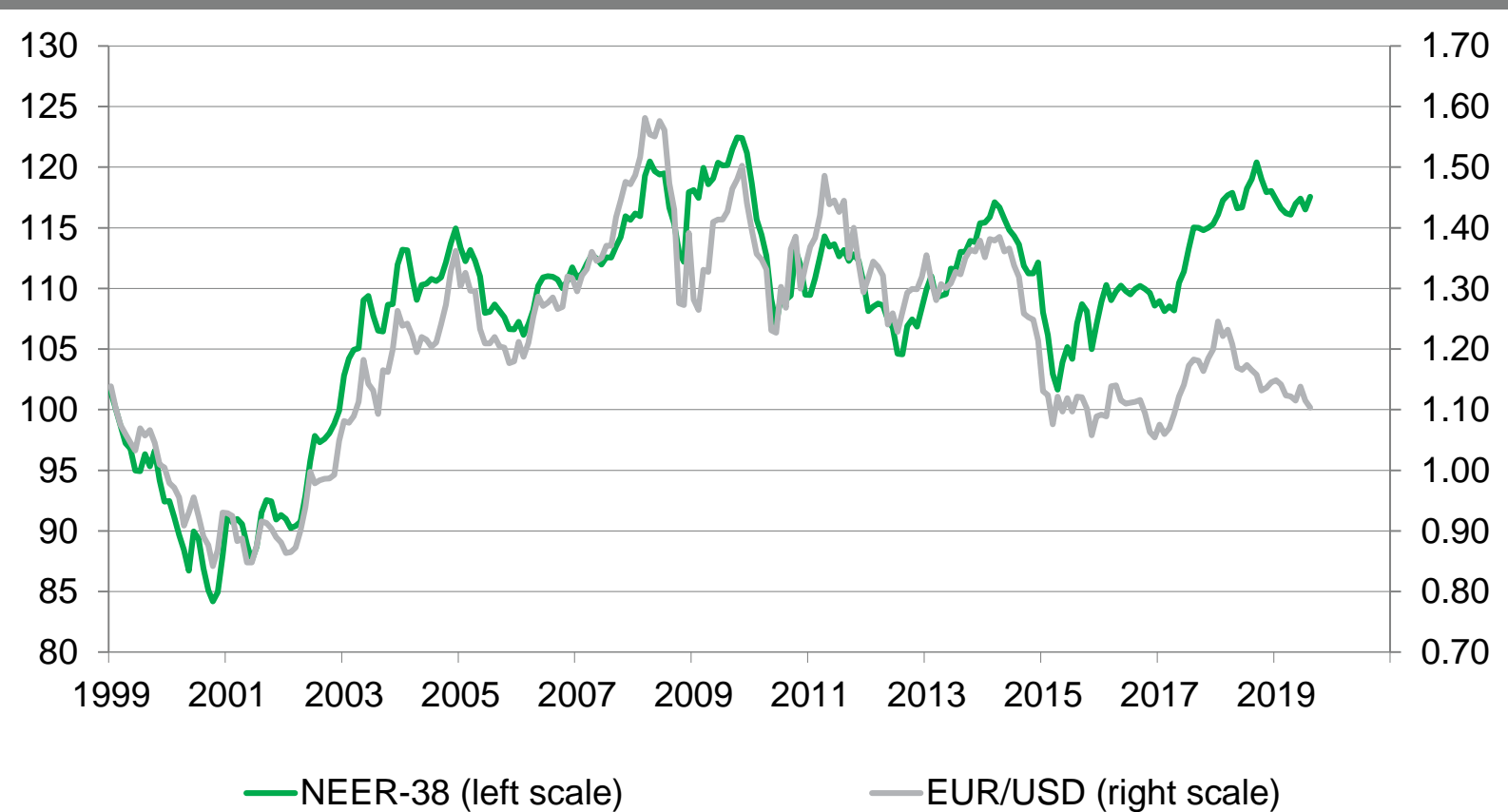


Source: CPB

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# Emerging markets turmoil led to an appreciation of the trade-weighted euro

Euro strong on a trade-weighted basis

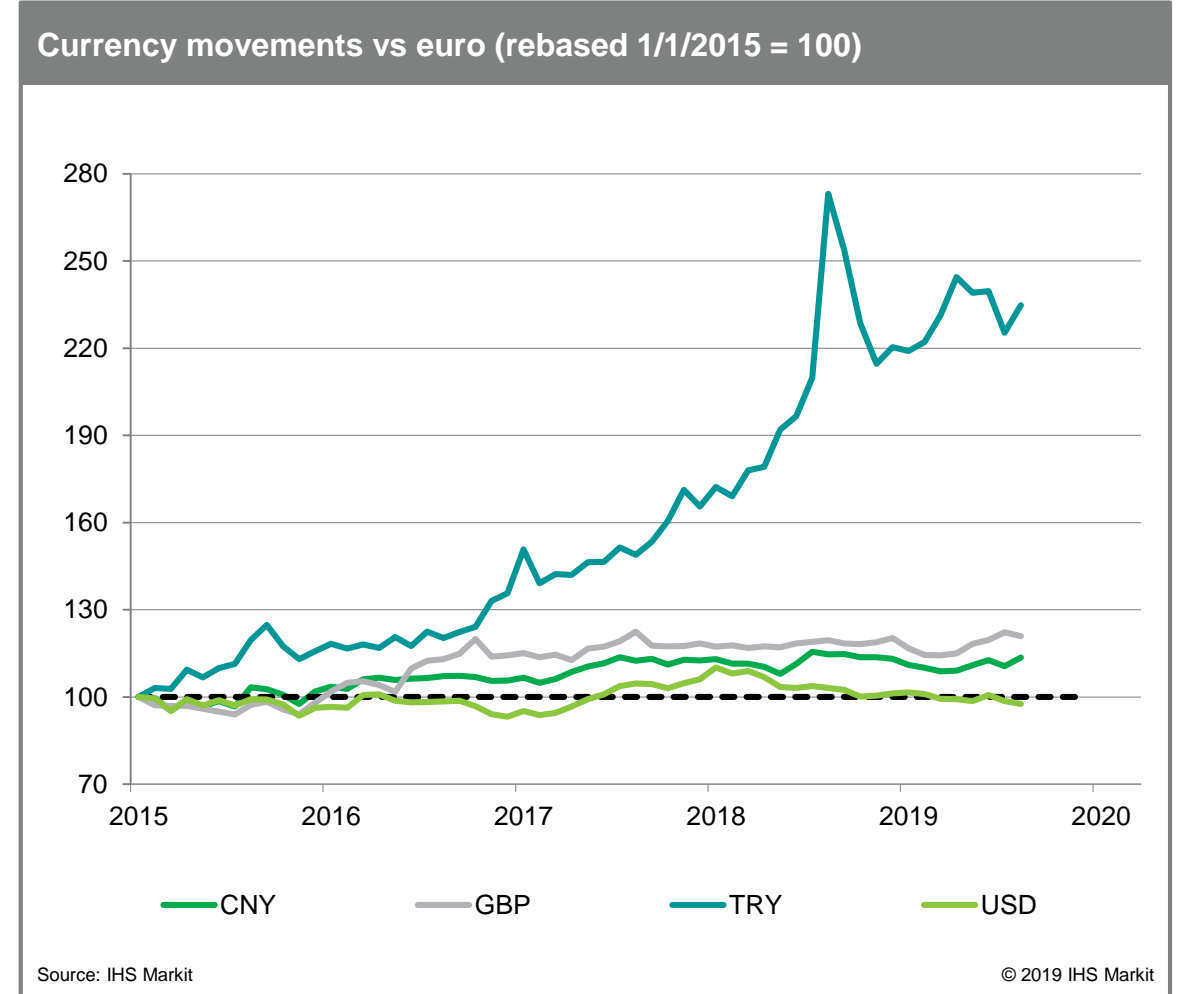
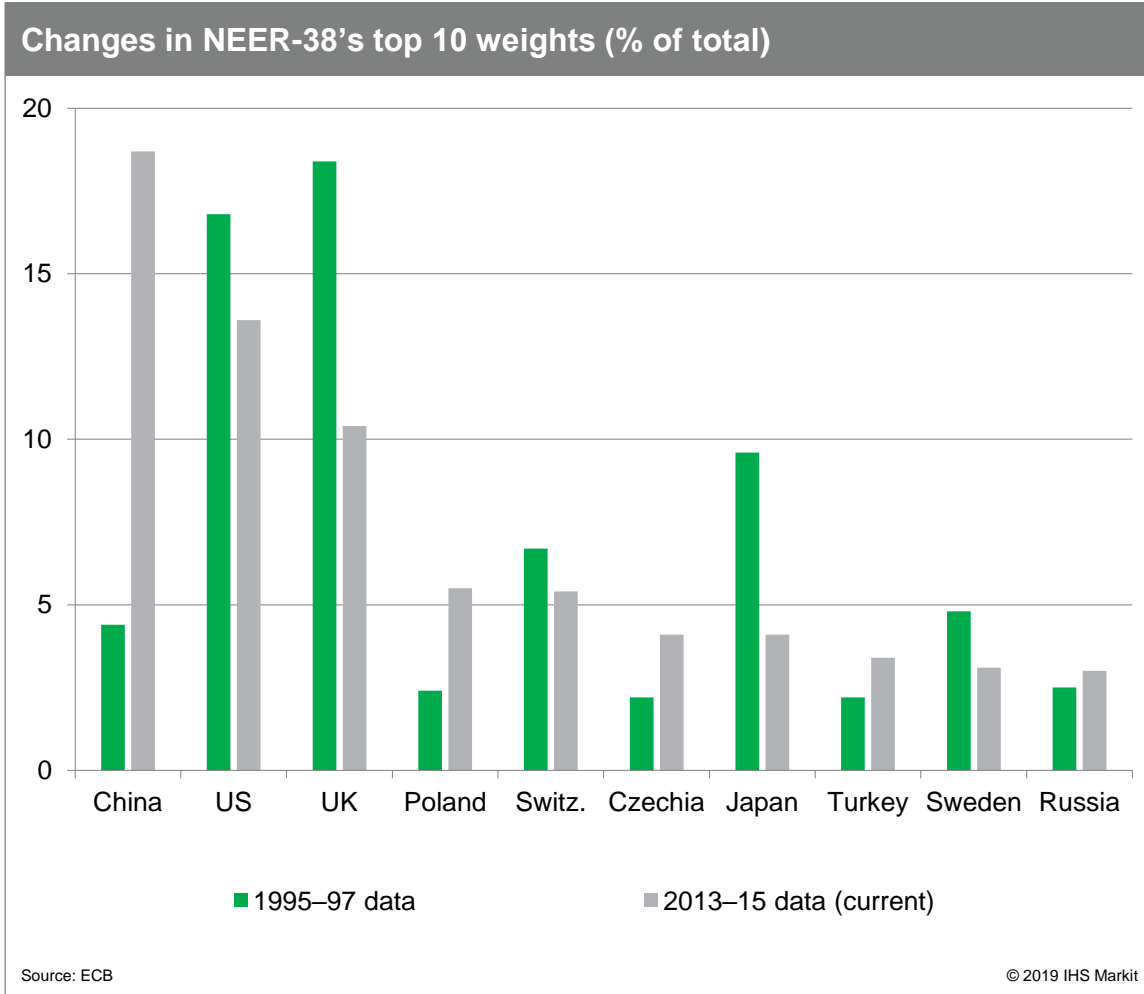


Source: Eurostat

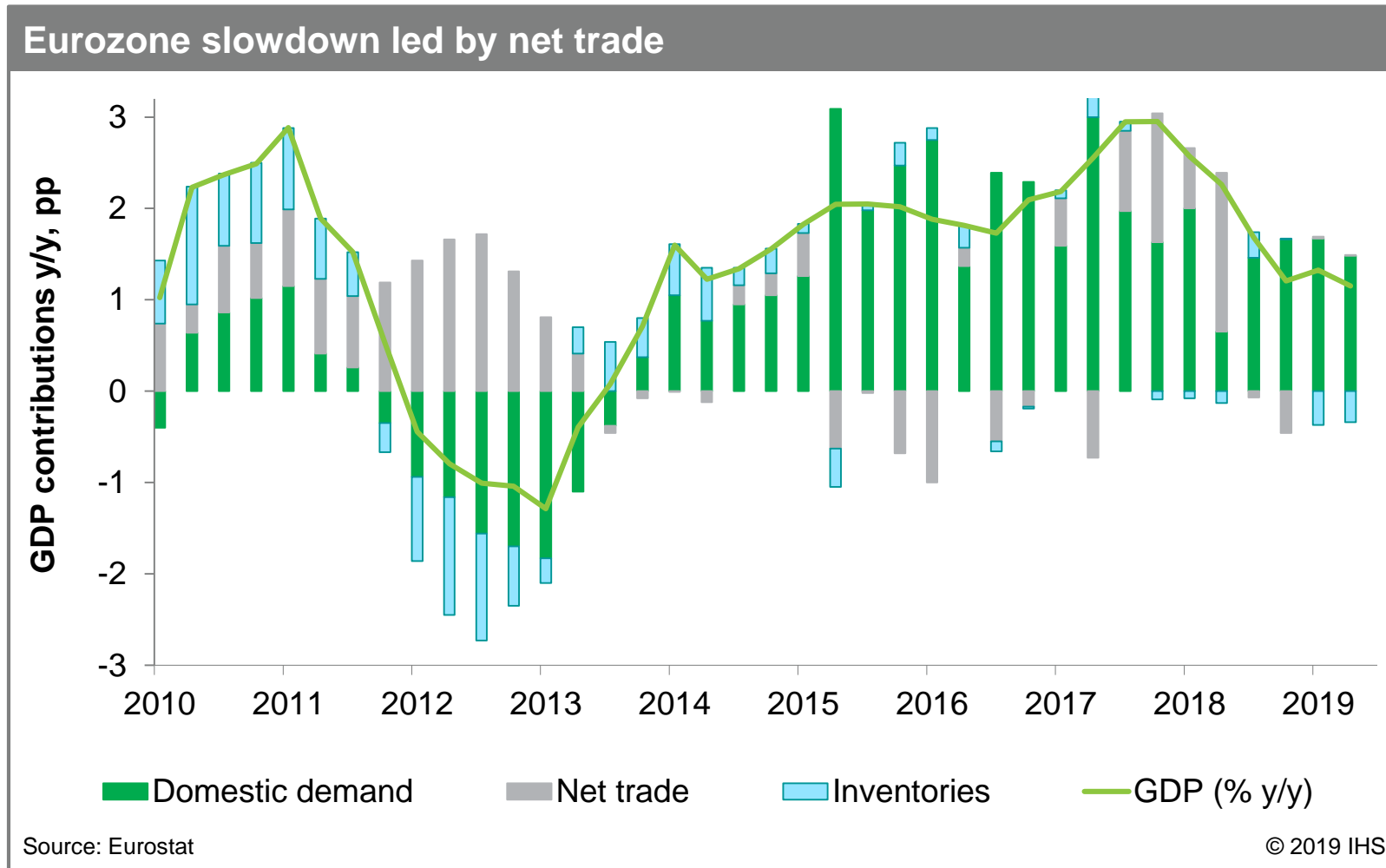
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- The stable relationship between the EUR/USD rate and the NEER-38 broke down from spring 2015.
- Despite the weak EUR/USD rate, in autumn 2018 the euro reached its strongest level in almost a decade on a trade-weighted basis.
- The NEER-38 fell back from its late 2018 highs during the early part of this year, but it has started to reappreciate more recently.

# Changes in trade weights reflect increased EM importance



# Softer exports are hitting Eurozone growth

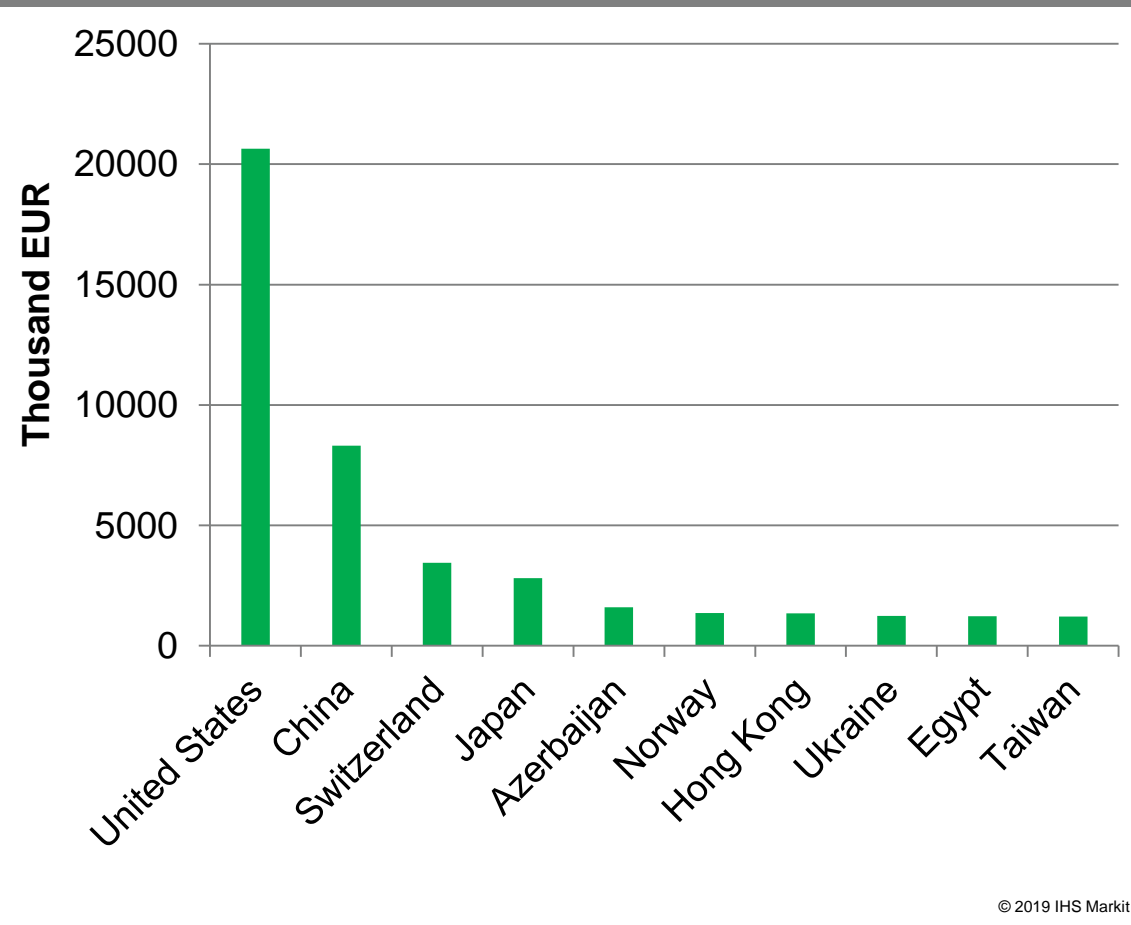


- Q2 2019's GDP growth rate of just 1.2% y/y was the joint weakest for more than five years.
- The swing in net trade contributions led the slowdown initially, primarily due to softer exports: down from 5.3% to 2.8% y/y in the four quarters to Q2 2019.
- The more persistent the export weakness, the bigger the potential spillovers to domestic demand.

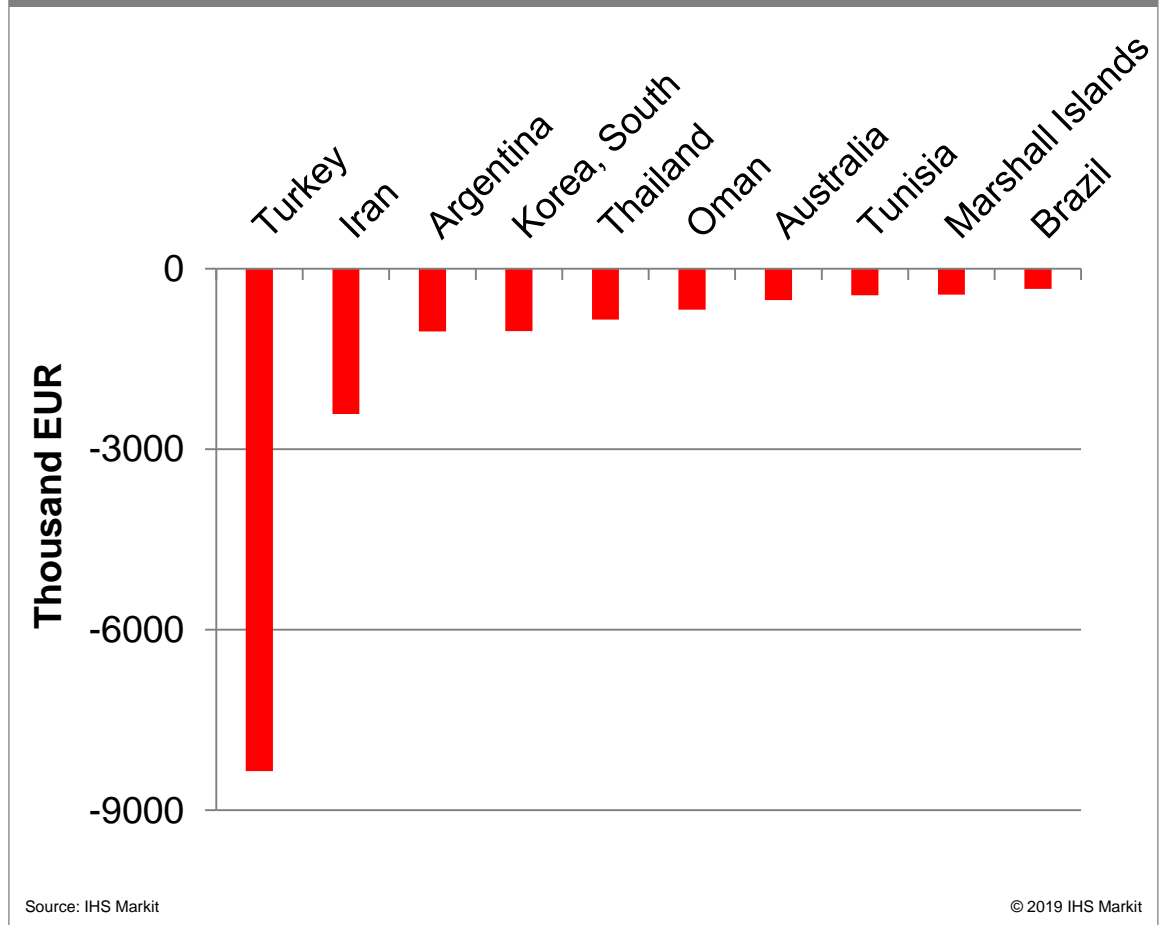


# Emerging markets have been an important drag on EU exports

Top 10 countries showing strongest growth in 19H1

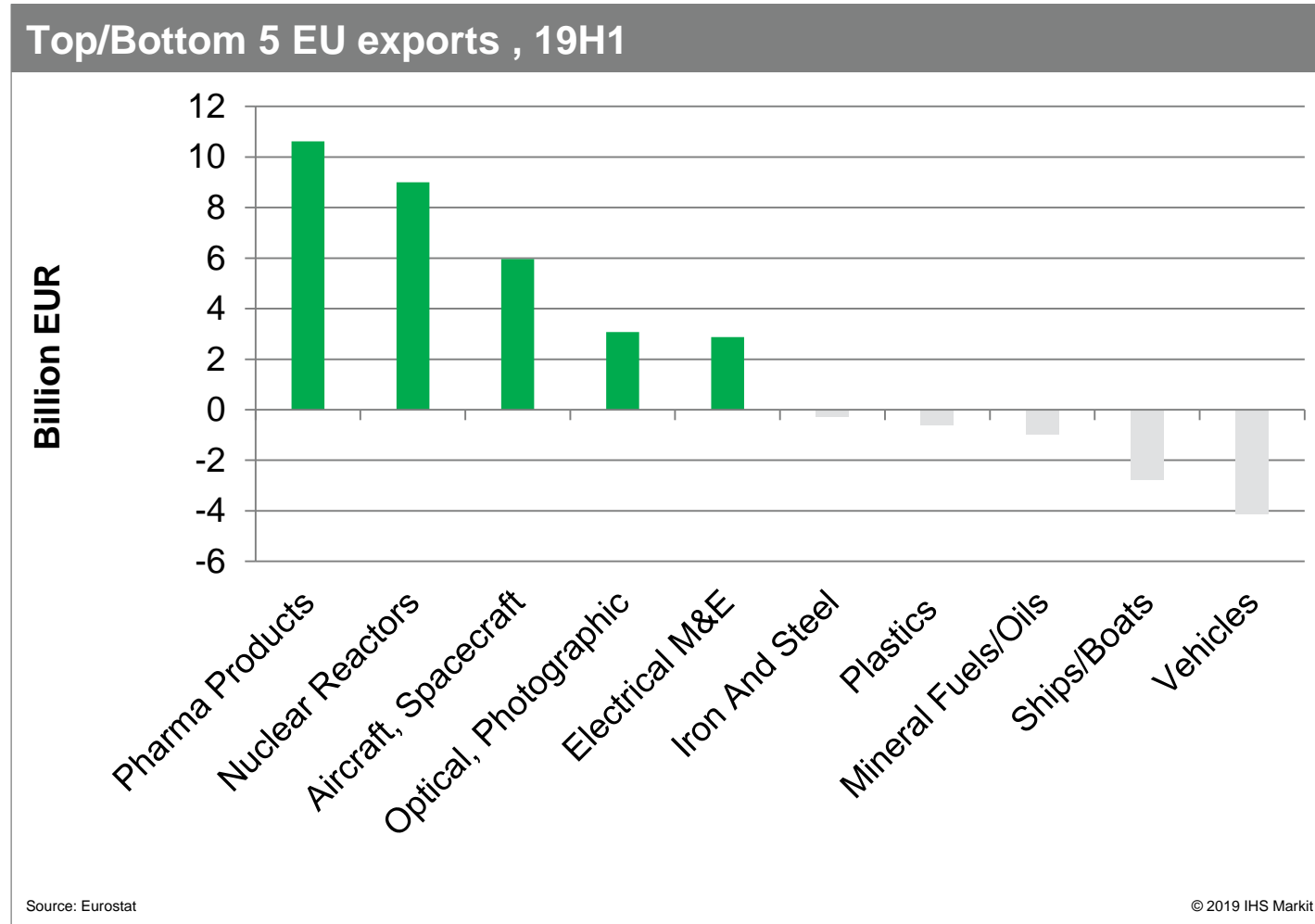


Top 10 countries showing strongest falls in 19H1





# EU exports by products



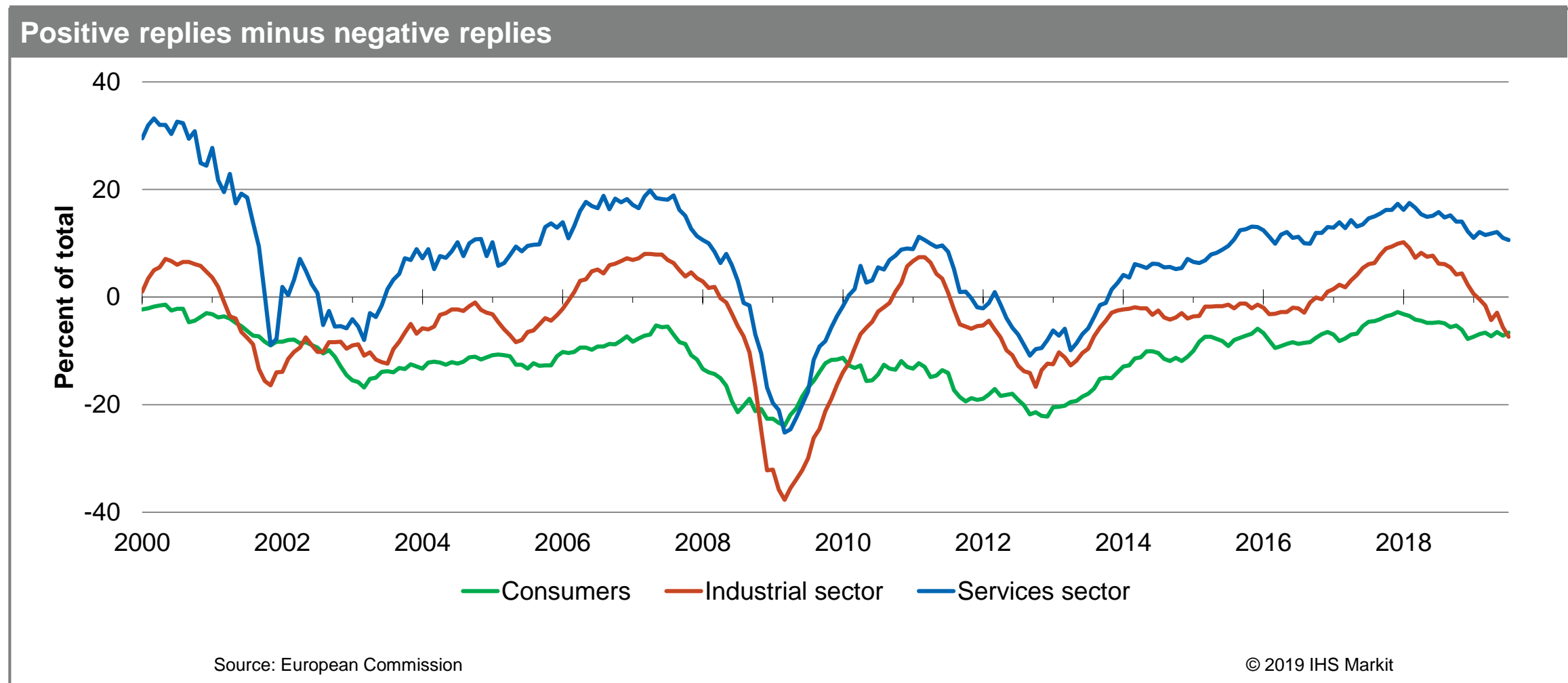
- Exports of pharma have been boosted by regulatory changes, while the FTA with Japan may have had a slight positive impact.
- On the other hand, exports of autos were a major drag.

## Key points on US-China trade war

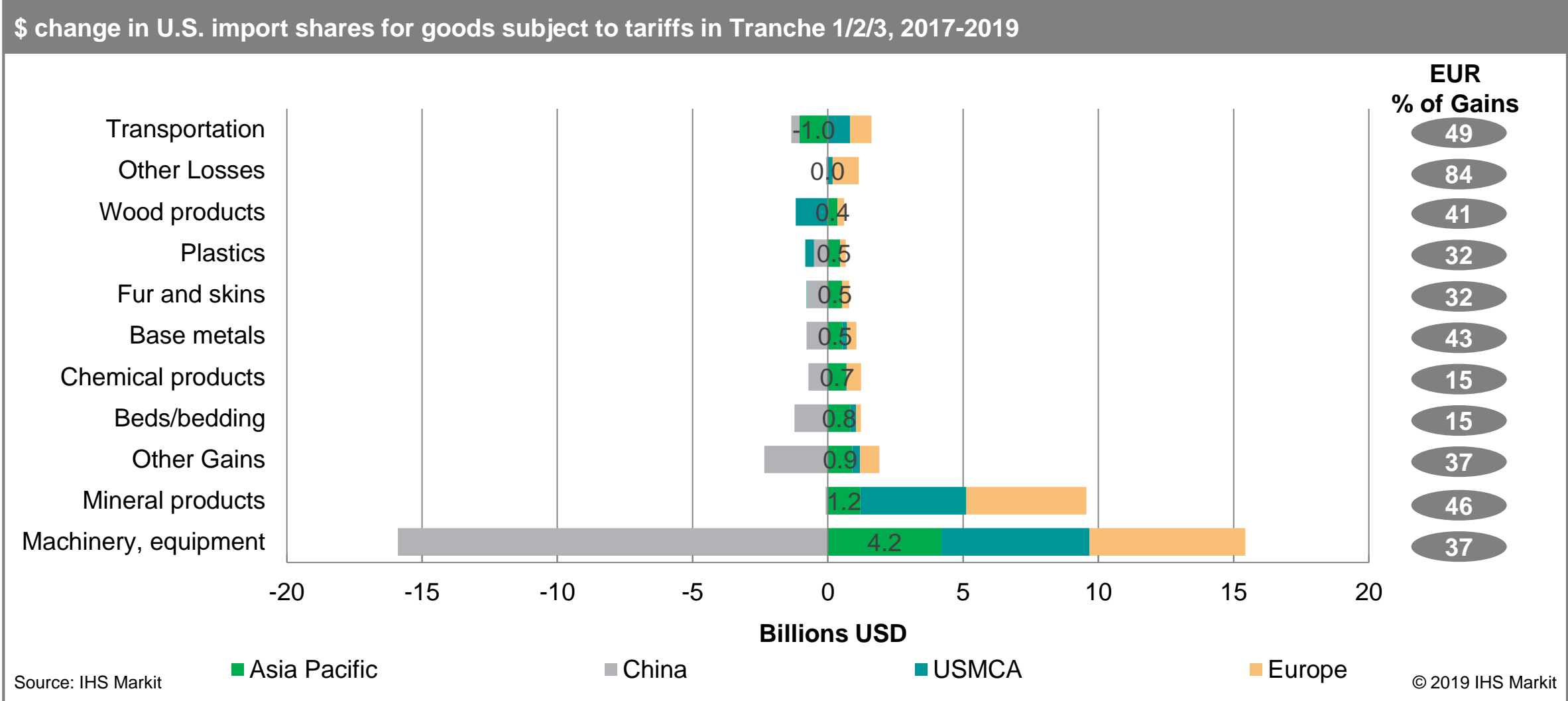
- Direct impact of the announced tariffs on **China** is not severe in near-term
- Tariffs will not just hurt China, due to its key role in global supply chain
- Beijing does not want a trade war, but cannot backdown due to domestic politics
- Complete abandonment of industrial policy and state-owned sector subsidy is a no-go for China
- Despite RMB crossing the 7 CNY/USD line, Beijing will likely keep RMB stable in the near-term, but could adopt a weak RMB policy if trade negotiation completely breaks down
- In the **US**, new and increased tariffs on imports from China are expected to boost consumer prices and the cost of capital, restraining consumer spending, business fixed investment, and GDP.
  - As a result, the outlook for real GDP growth has been lowered by an average of 0.1 percentage point annually in the years 2020-23.
- Trade uncertainty has driven the Fed to cut interest rates.

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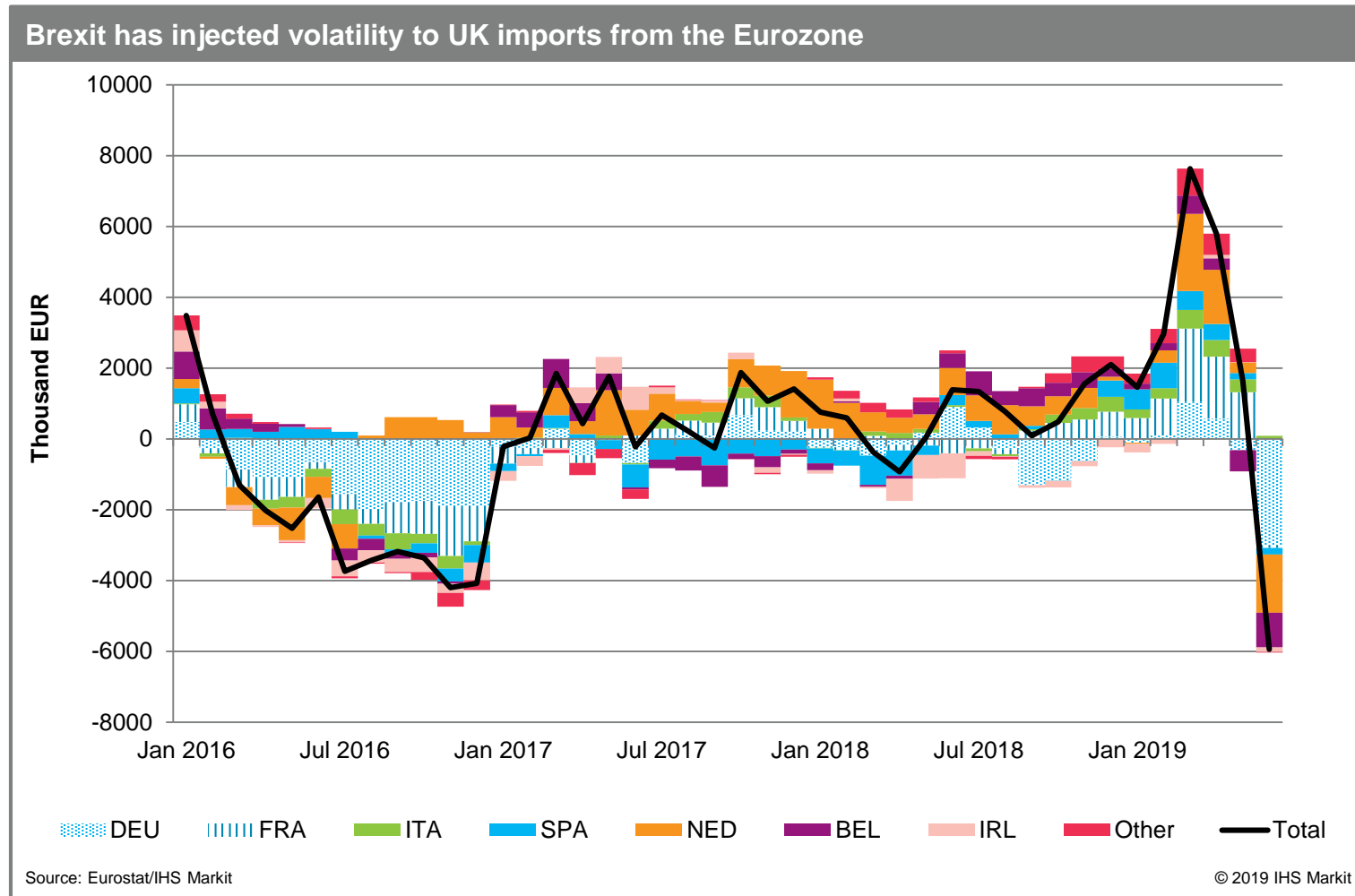
# Trade tensions are weighing down on Eurozone business confidence



# Tariffs also create substitution effects, which could be positive for Europe

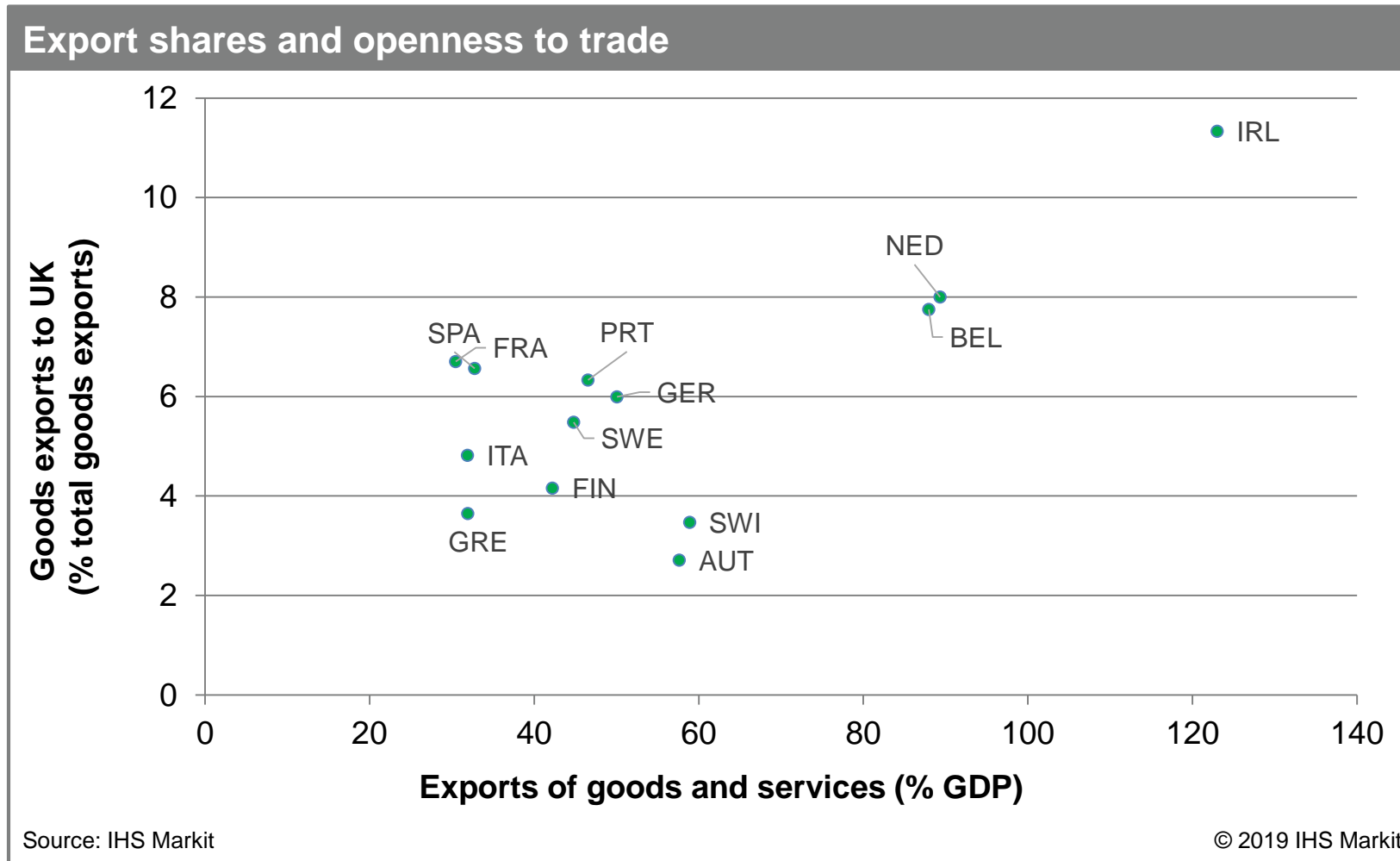


# Brexit concerns add to trade uncertainty



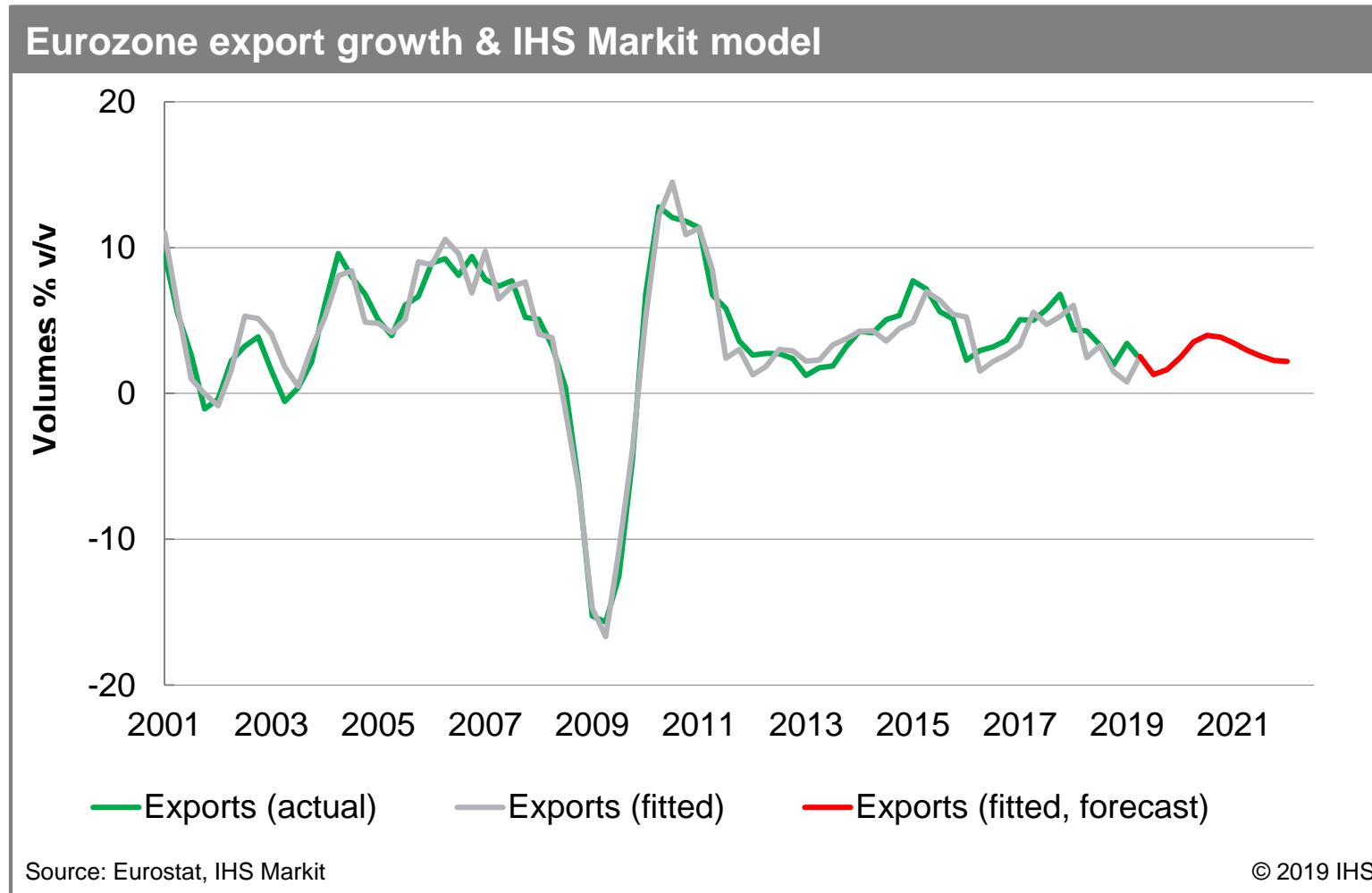
- Eurozone exports to the UK jumped at the start of 2019 driven by stockpiling.
- But there was a large correction in May as the deadline was extended.
- German exports to the UK has been particularly weak mainly, but not exclusively, driven by autos.

# Trade exposures to the UK



- Trade linkages to the UK vary across the EU.
- Ireland has much the highest share of total goods exports going to the UK and is very “open”.
- The same applies to the Netherlands and Belgium.
- Types of goods exported also matter: German autos (and linked economies) are vulnerable to a severe adverse shock to the UK household sector.

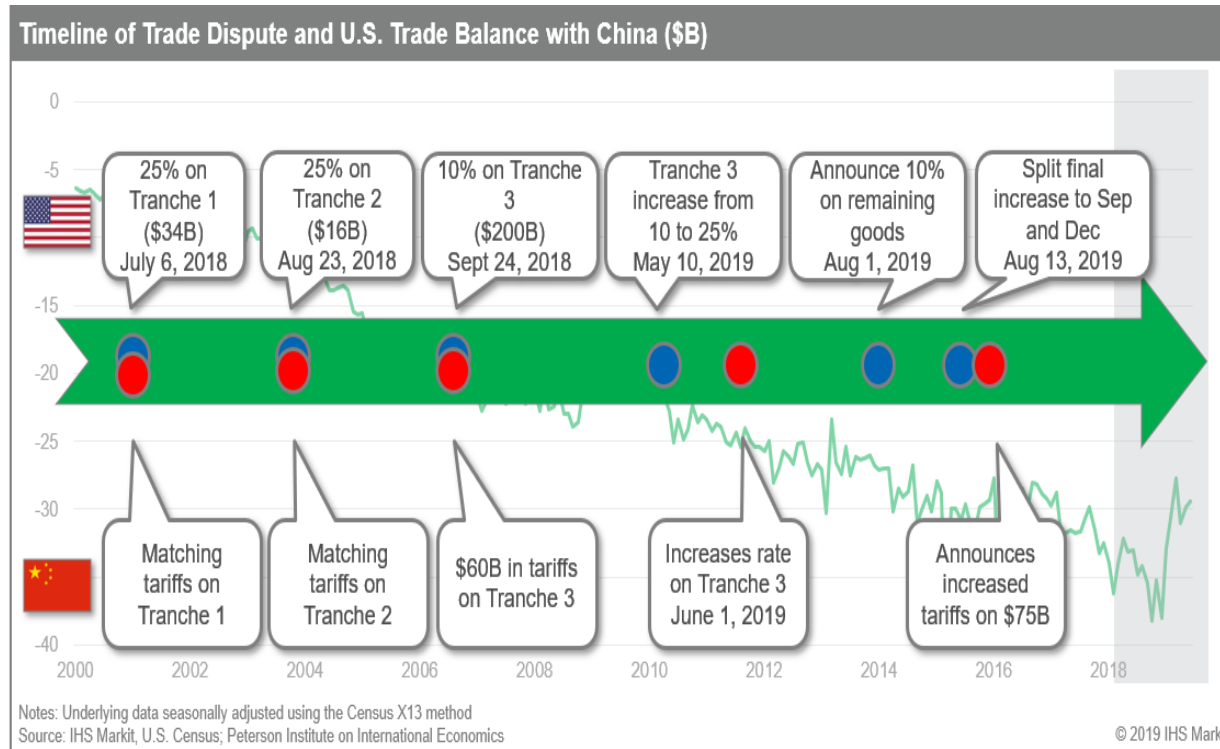
# Export model signals modest improvement but risks are on the downside



- IHS Markit's export model is driven by our forecasts of domestic demand growth in the eurozone's ten key trading partners, plus expected movements in the trade-weighted euro.
- The model suggests a modest rebound from early 2020 though the upturn will fail to reach the prior cycle peaks.
- Risks are to the downside given potential adverse news on protectionism (e.g. auto and parts tariffs).



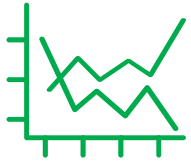
# Risk: Intensification of the trade-war, with the EU directly targeted



- Tariffs related to the dispute around Airbus/Boeing subsidies may be announced in September.
- US proposed 100% tariffs on USD25bn of EU imports, including cheese, wine, olive oil, etc.
- Decision on US Section 232 25% tariffs on autos expected in November.
- US/China negotiation will restart in October but progress will be difficult.
- Rising trade tensions would intensify the global economic slowdown already underway.

# Risk: A global recession may lead to a further deceleration in trade

## Typical recession triggers not present (yet)



### Supply shocks

- Supply curbs drive up oil and other commodity prices
- This raises the cost of production and crimps household real incomes



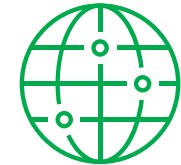
### Financial stress

- Bubbles burst, asset prices correct, adverse wealth effects
- Tightening of banks' credit conditions



### Policy problems

- Restrictive central bank policy to bear down on inflation and expectations
- Pro-cyclical fiscal contraction worsens a downturn



### Geopolitical factors

- Military conflicts, social upheaval
- Populism, protectionism
- Persistent high uncertainty

## Risk: We expect the UK and the EU to reach a deal but the probability of a “no-deal” Brexit has increased

- Although the UK government’s current policy course increases the probability of a no-deal Brexit by default, our baseline scenario assumes that the UK parliament will still be likely to prevent such a move.
- There are many potential timeframes and paths to a deal, but we assume that the agreement will ultimately be defined by the guiding principles of the Political Declaration that accompanied the Withdrawal Agreement:
  - Free-trade agreement for goods, and specific sector agreements for UK service providers to access the single market.
  - It will fall short of the “frictionless arrangements” that the UK currently enjoys as part of the customs union and single market.
  - Principle of equivalence underpins the agreement covering trade in services.
- The economic consequences of a no-deal Brexit would be significant in the UK but they will also be felt in the EU-27.

# Conclusion: Global trade conditions are likely to remain under pressure during the next year, with plenty of risks

## What to watch in 2019 H2:

- WTO Airbus decision (September)
- Brexit deadline (October)
- Draghi leaves ECB (October)
- US auto tariff decision (November)

**Good luck!**



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