THIS MONTH'S TOPIC

European equities: what impacts in the event of a tariff war with the United States?

IBRA WANE, Equity Strategy

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The essential

While the threat of a large-scale Sino-US tariff war appears to be receding, the US could now switch its focus to its trade deficits with the European Union. With this in mind, we wanted to find out which European equities, in terms of country, sector or individual companies, would be hardest hit by a trade conflict. A review of the indice showed that 20% of aggregate sales of MSCI Europe companies were to the US, vs. 14% for the MSCI US in the other direction. In the event of a conflict, the US would therefore be less exposed, but both sides would definitely lose out. And while the European Automobiles & Components are generally singled out, other sectors such as Capital Goods, Food, Beverages & Tobacco or Healthcare which are even more exposed to the US could therefore prove at risk.

A possible lull in the Sino-US conflict

While growth in international trade volumes plunged last year[1], driven down in particular by the Chinese economic slowdown and protectionist US rhetoric, the **markets are now keeping a nervous eye** on initial signs of a **take-off in China** and headway on Sino-US **tariff negotiations**.

On both fronts, a lull appears to have been forming in recent weeks in the rebound in PMI and retail sales figures in China, and in recent high-level Sino-US meetings. However, **some caution is in order**, as 2019-2020 growth targets for Chinese GDP are barely over 6%, and as there appear to be some ulterior motives in tariff negotiations between the two superpowers. Even so, this lull, combined to the soothing language from central banks, has played a clear part in the market rally so far this year.

Out of the frying pan, into the fire

For an investor in European equities, however, it would be premature to consider that most trade risks have been resolved, given US tariff temptations and Brexit uncertainties.

With an improvement now looming on the Sino-US front, **the US** may now shift its gaze to its bilateral deficits with **the European Union** (EU). Following Donald Trump's scathing words regarding the BMW and Mercedes crowding Fifth Avenue and the raising of customs tariffs on European steel and aluminium, the Commission president, **Jean-Claude Juncker, met with Trump last July** and a **truce** was then concluded, pending further negotiations. Meanwhile, the US commerce secretary raised the bar in mid-February, presenting Trump with a report suggesting that **imported cars** "threatened national security"; this gave the president 90 days, i.e., until mid-May, to make a decision. And in early April, the US also raised again the issue of public subsidies to **Airbus**. On the other side of the Atlantic, on 15 April the European Commission got a green light from the EU Council of Ministers to negotiate a **new trade agreement with the US**. The EU trade commissioner, Cecile Malmström, will be in charge of negotiations with the US trade representative, Robert Lighthizer. Talks will deal solely with manufacturing tariffs, to the exclusion of agriculture, services, access to public procurement and protection of investments.

[1] *Falling from +5.0% in the first quarter of 2018 to 1.4% in the fourth quarter on a year-on-year basis.*

Meanwhile, after three years of foot-dragging, a **no-deal Brexit** could automatically trigger customs duties as provided under WTO rules. The duties would vary from one product to the next and would amount, for example, to 10% in Automobiles & Components.

Both the UK and continental Europe would take a big hit, as the UK exports 631,000 vehicles annually to the 27 other EU countries (81.5% of UK output is exported, of which 51% to the EU), and the EU almost 1.8 million vehicles to the UK (12% of their total production and 32% of their exports). As the average price of a new vehicle in Europe, excluding VAT is about €25,000, WTO customs duties would raise their cost by 10%, or €2500. As cars have a high price elasticity of demand, this could result in a 10% decline in sales of the models involved.[2]

Who would be hit the hardest?

In the event of a tariff war, who would be hit the hardest? On a macroeconomic level, various national and international bodies have already provided some useful indications.

According to the **European Commission**, for example, although the bilateral trade relationship, strictly speaking, is structurally in the EU's favour, a broader view, including services, investments and repatriated profits, shows far greater balance, with a slight surplus in the US's favour in both 2017 and the past decade (2007-2017)[3]. Meanwhile, the **Bank of England** has estimated that a global trade war – in which the entire world raised tariffs by about 10 percentage points – would subtract about 2.5% from global GDP growth over three years. Looking at Brexit alone, in a report last November, the **UK government**[4] estimated that, in the event of a no-deal Brexit, UK GDP could decline by 8% in the long term (i.e., about 15 years) compared to its initial trajectory. According to various forecasters, the UK could hover around recession territory in 2020, rather than achieving the 1.4% currently forecast. Last but not least, in a recent article of the **ECB Economic Bulletin** on "the economic implications of rising protectionism, a euro area and global perspective"[5] the authors estimated that "*the impact so far were expected to remain contained, however, large negative effects could materialise if trade tensions were to escalate further*".

Our approach focused on equity markets is less academic and more practical. Our concern is, above all, to distinguish which countries, sectors or individual companies in Europe would be the most exposed if customs tariffs were to be raised. To do so, we listed the geographical exposure of various indices and sub-indices concerned. This filter is, of course, oversimplified. To make it complete, we would have to include not just sales but also purchases and production done abroad. Similarly, the net exposure thus calculated should be compared to the margins of each entity under consideration. The impact, for example, of a net duty of 2% of sales would depend on the entity's margin. Be that as it may, this first filter does provide some useful indications and should simplify any complementary research.

We will look in particular at how exposed **European equities are to the US**. In **two boxed insets**, we will deal with **Automobiles & Components**, a sector that regularly makes headlines, and **EU-27 exposure to the UK** in the event of a no-deal Brexit.

The US accounts for 20% of the aggregate sales of MSCI Europe companies...

Chart 1 shows that **sales to the US** average **20%** of MSCI Europe companies aggregate turnover. In the other direction, sales to Europe account for **14% of MSCI US** aggregate turnover, of which 12% for the EU alone. In the event of a tariff war, the US would therefore be less exposed than Europe. But it would still be heavily exposed and would also lose out if the conflict were to fester.

However, Europe's US exposure varies widely from one country to another, from Portugal's 2% to Switzerland almost 30%. There is less dispersion in the MSCI Europe's Big Four – Germany, France, UK, and Switzerland – which together account for 73% of Europe's market cap. Their US exposure ranges from 16% to 30% and averages 22% (weighted by their MSCI Europe weights).

As **Switzerland** is not in the EU, and as the **UK** is a special case (due, among other things, to Brexit and its status as a close ally of the US) among the Big Four, **Germany** and its famous premium cars, **looks most heavily exposed**.

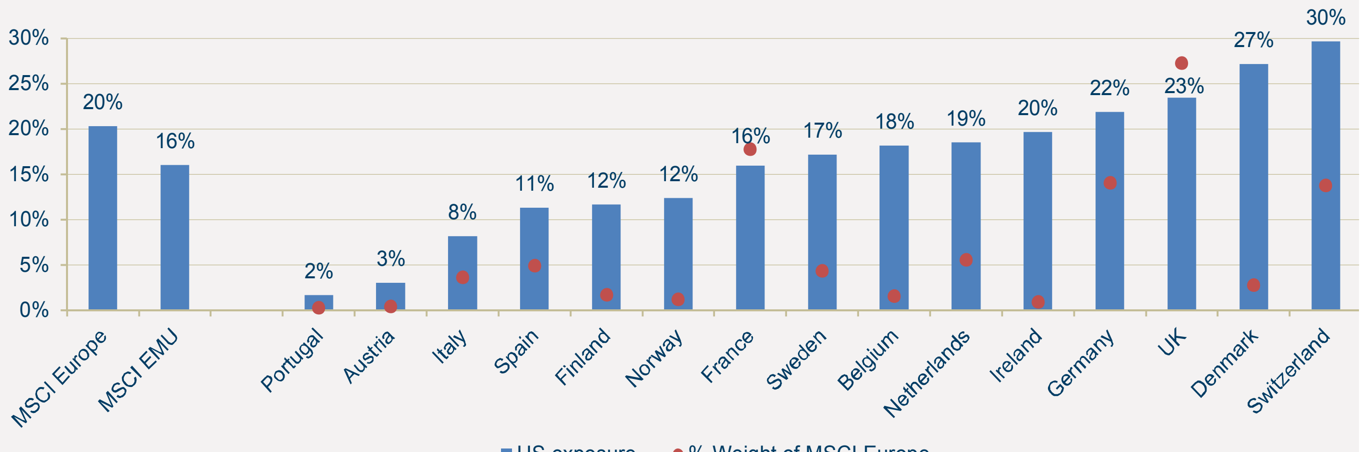
[2] *Some examples: Honda Civic, Toyota Corolla, Land Rover Evoque, Nissan Juke and Qashqai, Mini in the EU-27 and 90% of models sold in the UK.*

[3] *Liberalization of tariffs on industrial goods between the United States of America and the European Union: An economic analysis http://trade.ec.europa.eu/doclib/docs/2019/february/tradoc_157704.pdf*

[4] *EU Exit long-term economic analysis, November 2018, rapport disponible sur www.gov.uk/government /publications*

[5] *Article from V. Gunnella and L. Quaglietti published as part of the ECB Economic Bulletin, Issue 3/2019*

1/ MSCI European indices, Sales exposure to the US in % of total



Source: Factset, Amundi Research

…. and close to 40% in some sectors!

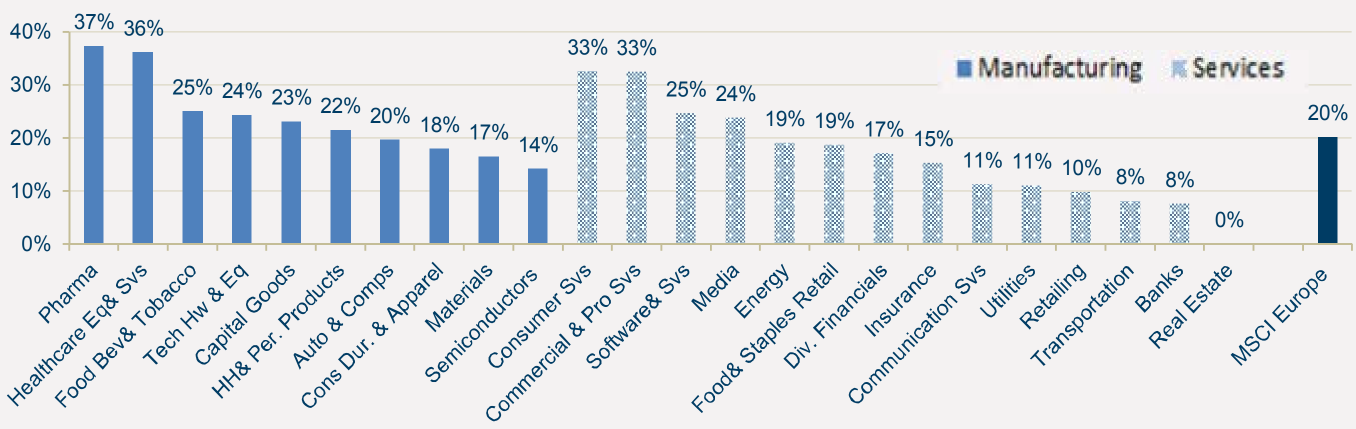
However, a more detailed look at the MSCI Europe (see chart 2), shows that, with 20% of its sales in the US, **the European auto sector is merely average.** Despite what you may have heard, it is far from being the most heavily exposed in the US. While it would take a hit from higher customs tariffs – the US is the key market for German automakers, after China[6] -- **other sectors are also at risk**.

We are thinking in particular of Pharmaceuticals and Healthcare Equipment, 37% and 36% of whose sales, respectively, go to the US. What's more, with elections coming up, we are certain to see the ritual campaigning over drug prices and healthcare in general. As these sectors are in normal times regarded as defensive, they may doubly disappoint if the US and Europe also engage in a tariff war.

Four other industrial sectors are also more prominent than Automobiles & Components – Food, Beverages & Tobacco; Tech Hardware, **Capital Goods and Household & Personal Products,** with their US sales ranging from 22% to 25% of their total.

In chart 2, we isolated services. Although some of them[7] are heavily exposed to the US, they come under a different approach as they would appear to be at little risk of customs tariffs, though, in an aggressive trade war, they could be affected by many non-tariff barriers, such as standards, certifications, legal protectionism, and extraterritoriality of US law.

2/ MSCI Europe by industry: sales exposure to the US in % of total



Source: Factset, Amundi Research

[6] *The US is the second-largest market after China, but ahead of Germany for BMW and Mercedes, and the third after China and Germany for the VW group.*
[7] *Such as customer services (hotels and restaurants) or business services (temp workers, etc.)*

Healthcare and Capital Goods companies are generally the most exposed

Beyond the European sector average, it is also worth going one notch further on a national level. Once again, German Automobiles & Components (18%) are no more exposed than Food in Switzerland (30%); Pharmaceuticals in France (32%), the UK (35%) and Switzerland (41%); and medical equipment in Germany (46%). These sector scores are led by national champions such as Nestlé, Novartis, and Sanofi, which makes us wonder about which individual companies are the most heavily exposed.

For example, the two tables below list the **MSCI Europe's 30 manufacturing companies** with the heaviest US exposure in relative terms (as a percentage of total sales) and in absolute terms (in millions of euros of sales).

In this first **Top 30**, the percentage of **sales to the US ranges from 32% to 84% and averages 47%**, vs. 20% for the MSCI Europe. These are **large caps but not necessarily giants**. Their median size, in fact is €13bn in sales, of which €6bn in the US. By sector, **Healthcare** (12 out of 30) and **Capital Goods** (12) have the **lion's share**, far ahead of Food, Beverages & Tobacco (2) and other sectors. Of the latter, **there is only one auto sector group, Fiat**, which, as a result of its 2014 takeover of Chrysler, now makes 56% of its sales in the US. With the exception of some Fiat 500 models (38K in 2017) and a handful of Ferraris (2518 in 2017), 98% of Fiat's US sales are Chryslers. So, the group has very little tariff exposure.

Top 30 European Manufacturing Stocks Exposure to the US (relative)

Rank	Company Name	Country	Classification	US Revenue 2018 (Mn Euros)	US Revenue 2018 (% of total)
1	Ashtead Group	UK	Capital Goods	3,512	84%
2	Ferguson	UK	Capital Goods	13,965	80%
3	Fresenius Medical Care	Germany	Health Care Equipment & Services	9,788	59%
4	Meggitt	UK	Capital Goods	1,380	59%
5	Fiat Chrysler	Italy	Automobiles & Components	62,099	56%
6	Bunzl	UK	Capital Goods	5,046	49%
7	UCB	Belgium	Pharma Biotech & Life Sciences	2,266	49%
8	Novo Nordisk	Denmark	Pharma Biotech & Life Sciences	7,310	49%
9	Smith & Nephew	UK	Health Care Equipment & Services	1,995	48%
10	Roche Holding	Switzerland	Pharma Biotech & Life Sciences	23,238	47%
11	BAE Systems	UK	Capital Goods	8,718	46%
12	Melrose Industries	UK	Capital Goods	4,400	45%
13	Lonza Group	Switzerland	Pharma Biotech & Life Sciences	2,157	45%
14	Smiths Group	UK	Capital Goods	1,595	44%
15	EssilorLuxottica	France	Consumer Durables & Apparel	2,925	39%
16	GlaxoSmithKline	UK	Pharma Biotech & Life Sciences	13,543	39%
17	British American Tobacco	UK	Food Beverage & Tobacco	10,725	39%
18	Grupo ACS	Spain	Capital Goods	14,200	39%
19	Skanska	Sweden	Capital Goods	6,457	39%
20	Assa Abloy	Sweden	Capital Goods	3,017	37%
21	Novartis	Switzerland	Pharma Biotech & Life Sciences	14,885	34%
22	Husqvarna	Sweden	Consumer Durables & Apparel	1,353	34%
23	Brenntag	Germany	Capital Goods	4,235	34%
24	Sanofi	France	Pharma Biotech & Life Sciences	11,540	33%
25	Philips	Netherlands	Health Care Equipment & Services	6,050	33%
26	Siemens Healthineers	Germany	Health Care Equipment & Services	4,458	33%
27	Kerry Group	Ireland	Food Beverage & Tobacco	2,190	33%
28	Air Liquide	France	Materials	6,905	33%
29	AstraZeneca	UK	Pharma Biotech & Life Sciences	6,137	33%
30	Rolls-Royce	UK	Capital Goods	5,698	32%

Because of their sheer size, most European champions do have heavy footprints in the US, but their relative exposure is actually rather ordinary

The second table ranks companies on the basis of their US sales in millions of euros. Thirteen of them, which are highlighted in red, are also in the previous rankings, such as Fiat-Chrysler and Roche.

However, in this second Top 30, **the profile of new entrants (Daimler, VW, Nestlé, etc.) is quite different** – their **median size is four times greater** (€51bn in total sales, vs. €13bn), but their **relative exposure is far lower** (22% vs. 47%) and is closer to the MSCI Europe as a whole (20%). Given their sheer size, it is no surprise to find **most European giants** on this list, such as BMW, Continental, Daimler, Michelin and VW in Automobiles & Components, as well as Airbus, BASF, LVMH, L'Oréal, Nestlé, Siemens and Unilever.

By sector, **this second Top 30 if far more diversified** given that, in addition to Capital Goods (8) and Healthcare (7), it also includes Automobiles & Components (6), Food, Beverages & Tobacco (3), Materials (3), Household & Personal Products (2) and Luxury Goods (1).

Top 30 European Manufacturing Stocks Exposure to the US (absolute)

Rank	Company Name	Country	Classification	US Revenue 2018 (Mn Euros)	US Revenue 2018 (% of total)
1	Fiat Chrysler	Italy	Automobiles & Components	62,099	56%
2	Daimler	Germany	Automobiles & Components	41,152	25%
3	Volkswagen	Germany	Automobiles & Components	31,856	14%
4	Nestle	Switzerland	Food Beverage & Tobacco	23,920	30%
5	Roche Holding	Switzerland	Pharma Biotech & Life Sciences	23,238	47%
6	BMW	Germany	Automobiles & Components	16,088	17%
7	Siemens	Germany	Capital Goods	16,012	19%
8	Novartis	Switzerland	Pharma Biotech & Life Sciences	14,885	34%
9	Grupo ACS	Spain	Capital Goods	14,200	39%
10	BASF	Germany	Materials	14,062	22%
11	Ferguson	UK	Capital Goods	13,965	80%
12	ArcelorMittal	Luxembourg	Materials	13,792	21%
13	GlaxoSmithKline	UK	Pharma Biotech & Life Sciences	13,543	39%
14	Sanofi	France	Pharma Biotech & Life Sciences	11,540	33%
15	LVMH	France	Consumer Durables & Apparel	11,207	24%
16	Anheuser-Busch InBev	Belgium	Food Beverage & Tobacco	11,120	24%
17	British American Tobacco	UK	Food Beverage & Tobacco	10,725	39%
18	Bayer	Germany	Pharma Biotech & Life Sciences	9,793	25%
19	Fresenius Medical Care	Germany	Health Care Equipment & Services	9,788	59%
20	Airbus	Netherlands	Capital Goods	9,428	15%
21	BAE Systems	UK	Capital Goods	8,718	46%
22	Continental	Germany	Automobiles & Components	8,646	19%
23	Unilever	UK	Household & Personal Products	8,305	16%
24	Volvo	Sweden	Capital Goods	8,246	22%
25	Novo Nordisk	Denmark	Pharma Biotech & Life Sciences	7,310	49%
26	Schneider Electric	France	Capital Goods	7,044	27%
27	Air Liquide	France	Materials	6,905	33%
28	Michelin	France	Automobiles & Components	6,818	31%
29	L'Oreal	France	Household & Personal Products	6,649	25%
30	Skanska	Sweden	Capital Goods	6,457	39%

To sum up

Given the extent of reciprocal links between the US and the EU, both would be losers in a trade conflict. Although on a pure trade basis Europe is most heavily exposed, when services, investments and repatriation of profits are factored in, the relationship is almost perfectly in balance and perhaps even to the US's advantage. Even so, given that goods are more easily taxed than services, Europe would be the first to bear the brunt of increased tariffs. While European Automobiles & Components already appear to have been convicted by a jury of tweets, this is not the sector with the heaviest US exposure and, moreover, has many counter-arguments in its defence. However, other sectors – including healthcare, capital goods, and food, beverages & tobacco – which are less subject to media hype but also have large US footprints, are worth greater attention and a more in-depth review.

Automotive sector: A usual suspect which is worth a second look

Although singled out on a regular basis, German **automotive champions don't just export to the US**; they also have a very heavy manufacturing footprint in the US itself and are a big employer in the southern states, which traditionally vote Republican.

Taken as a whole, the three German auto groups – VW, Mercedes and BMW – **in 2017 had a sales-to-local manufacturing ratio** (i.e., the number of vehicles produced locally divided by the number of total cars registered) of **61%** in the US and as much as **115% in the case of BMW**.

As a matter of fact, BMW has been on the ground in the US since 1994, and its **largest plant in the world** is located in Spartanburg, South Carolina; this is also its only plant producing all of its large SUVs, from the X3 to the X7.

At the other extreme, with a sales-to local manufacturing ratio of just 21% in the US (of which 38% for the VW brand, but 0% for Audi and Porsche), **the VW group is behind its peers**. However, as NAFTA is still largely valid (now renamed USMCA), this is offset by its heavy manufacturing footprint in Mexico, which gives it a ratio of 75% for all three NAFTA countries. However, to avoid alienating US decision-makers, VW has announced that it will ramp up its **Chattanooga, Tennessee**, plant, hire an additional 1000 persons there, and invest $800m to produce its **future electric VW.**

2017 (000'0)	US Production	US Sales	US coverage rate	Mexico Production	Total Production ALENA	ALENA Sales	ALENA coverage rate	ALENA plants	Main models
VW Group	**130**	**624**	**21%**	**600**	**730**	**972**	**75%**	Chattanooga (Tennessee)	VW Passat, SUV VW Atlas, future electric VW.
VW	130	340	38%	520	650	602	108%		
Audi	-	227	-	80	80	278	29%	Puebla (Mexico)	VW Tiguan, Golf, Jetta, New-Beetle, Audi Q5
Porsche	-	55	-	-	-	65	-		
Mercedes	**287**	**372**	**77%**	**0**	**287**	**442**	**65%**	Tuscaloosa (Alabama)	GLE, GLS, Classe C
BMW-MINI	**405**	**353**	**115%**	**0**	**405**	**421**	**96%**	Spartanburg (South Carolina)	World exclusive from the X3 to the X7
BMW	405	306	132%	0	405	360	113%		
MINI	-	47	-	-	-	60	-		
Big 3 German	**22**	**1,349**	**61%**	**600**	**1,422**	**1,835**	**77%**		

Brexit: A limited challenge for the EU's 27 companies, a much bigger one for UK companies

In addition to a tariff war with the US, the EU could soon be facing another trade problem if the UK were to split off from it without an agreement, as this would automatically trigger tariffs provided under WTO rules. To compare the challenges for equity markets, we used the same set of indicators as for the US.

Regarding the EU-27, the problem should be of a lesser extent than for the US as the aggregate UK sales of the MSCI Europe ex-UK is just 5.7%, or three times lower than US sales (17.3%).

However, the UK's dependence on the EU-27 is far greater (at 16.7% of aggregate sales of the MSCI UK) and almost the same as US sales (23.4% of the aggregate sales of the MSCI UK).

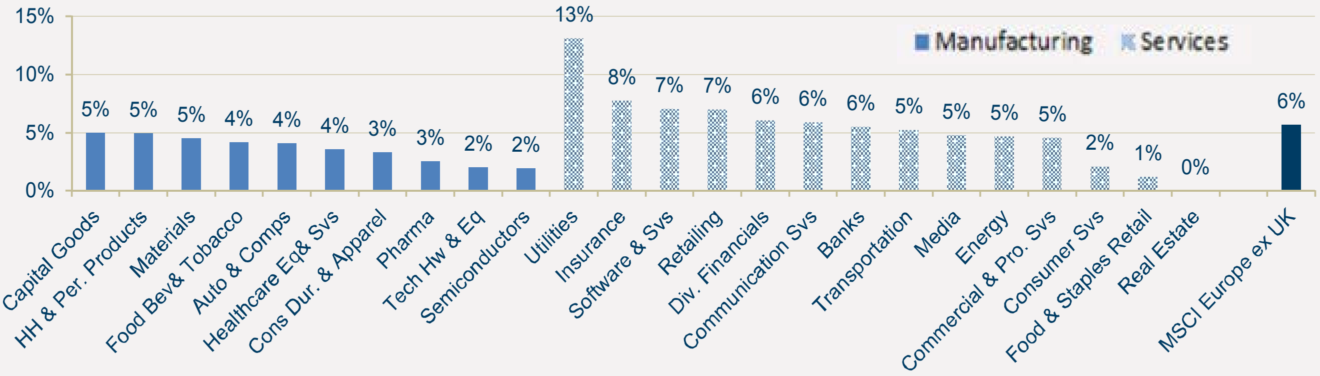
This relatively low dependence of the EU 27 on the UK also shows up by sector (table 3). Just one sector, Utilities, makes more than 10% of its sales in the UK. And even this percentage comes with the caveat that gas and electricity suppliers are, by essence, local players, whether through organic growth or acquisitions.

Looking back at our distinction between manufacturing and services, with the former being more easily taxable and the second more vulnerable to non-tariff barriers, we find that **none of the 10 industrial sectors exceed 5% exposure in the UK**, while seven of them range between 20% and 37% vis-à-vis the US.

Individual companies, however, may have far heavier UK exposure. Tables 4 and 5 on the next page sum up UK exposure for all sectors combined. The first Top 30 companies are ranked by percentage of total sales and the second in terms of absolute value. Average exposure of the first top 30 surges to 21.5% from 5.7% for the companies on the whole, a far more impactful figure. By country, there are many German (7), Nordic (6), Spanish (6) and Irish (5) companies, but few French ones (3), although it's true that Getlink (the ex-Eurotunnel) unsurprisingly dominates the rankings, at 50% of its sales. Alongside manufacturing companies (7) are many services companies, in finance (9) and utilities (7).

The second ranking (table 5) sums up the 30 non-UK companies with the **heaviest absolute UK exposure**. Out of these 30 companies, 11 were already been included in the relative rankings. The 19 others include **most European champions** (Allianz, BASF, Nestlé, Siemens, Total, Unilever, etc.), and in particular Automobiles & Components giants (VW, Daimler, BMW, Renault, Peugeot, Fiat-Chrysler), with average sales of **€80bn**. Even so, in relative terms, these 19 champions are far less exposed to the UK, at **6.1% on average vs. 22.2%** for the other 11.

3/ MSCI Europe ex-UK by industry: sales exposure to the UK in % of total



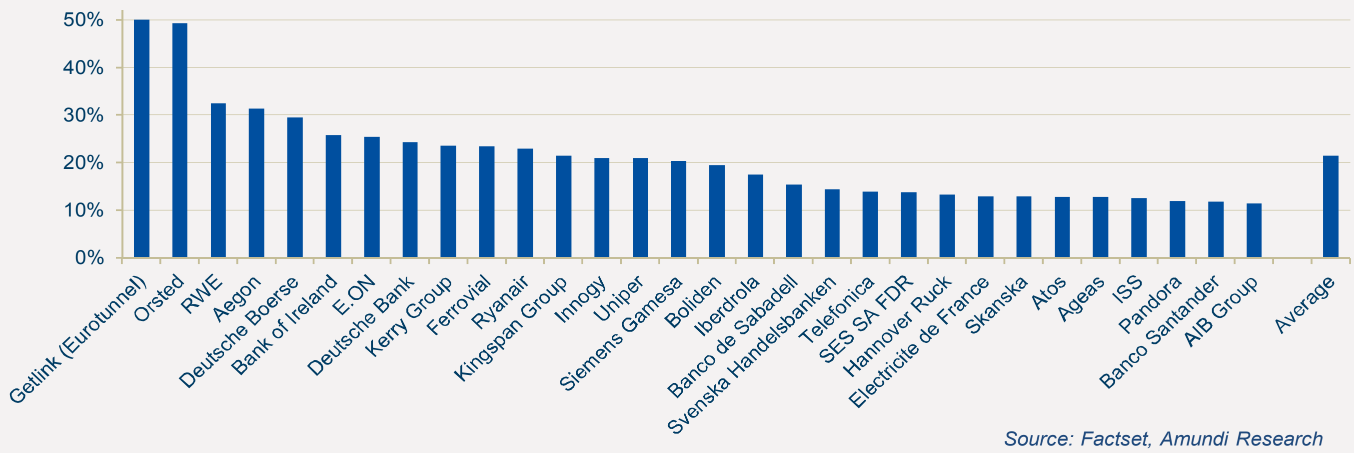
Source: Factset, Amundi Research

These 30 companies are mainly from Germany (13) or France (8), ahead of Spain (3), Italy and Switzerland (2), Denmark and the Netherlands (1).

All in all, after more than 45 years of living together, the UK has formed a large number of links with the rest of the EU. In the event of a hard Brexit, there will be a temporary leap into the unknown, followed, ultimately, by long negotiations that will also cover services. Given both sides' mutual interests and neighbourly relations, this should ultimately lead to **reasonable compromises**.

4/ Top 30's Companies exposed to the UK (relative terms)

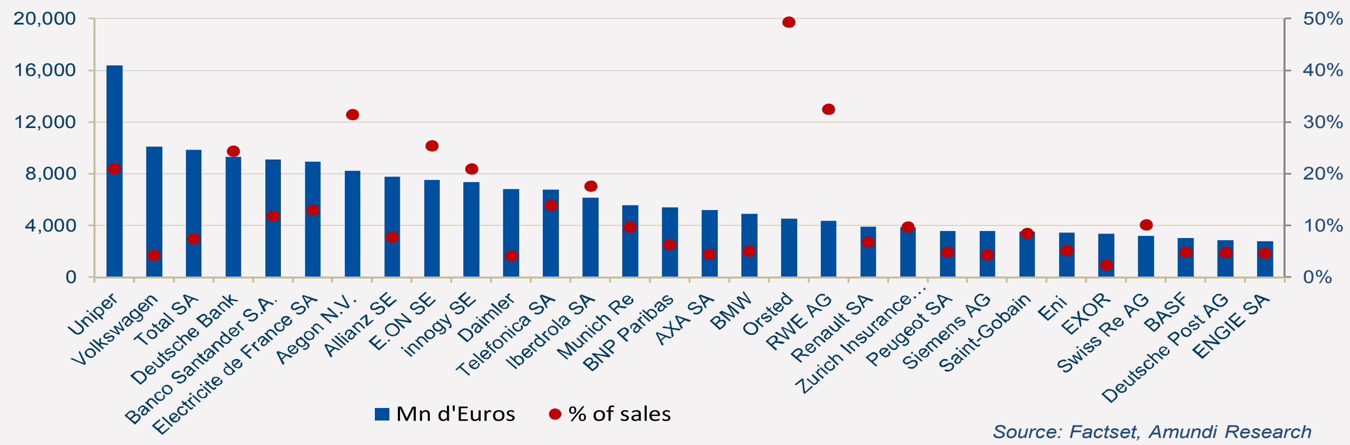
European non-UK stocks relative exposure to the UK (% of total Sales)



Source: Factset, Amundi Research

5/ Top 30's Companies exposed to the UK (absolute terms)

European non-UK stocks exposure to the UK (classified by UK Sales in Mn Euros)



Source: Factset, Amundi Research

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