THE WEEKLY EZ ECONOMIC MONITOR

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German net exports probably rose in Q4, but we can't make sense of the import price deflator.

Slowing growth in China has been a drag on German exports, but weakness in the U.K. is the key story.

The trade truce between the EU and the U.S. is still holding, but a confrontation is brewing.

Net Exports *Probably* Boosted German GDP Growth in Q4

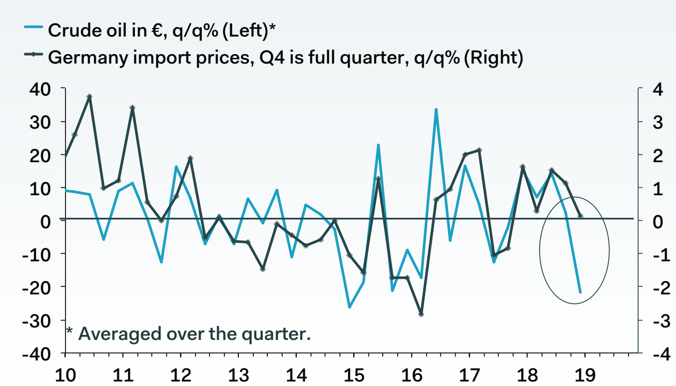
German exports flatlined for most of 2018, driving the trade surplus down by 7.3% amid still-solid growth in imports. That said, the data suggest that net exports made a strong finish to the year. The seasonally adjusted trade surplus rose to a six-month high of €19.4B in December, from €18.9B in November, lifted by a 1.5% month-to-month increase in exports, offsetting a 1.2% gain in imports. The nominal trade surplus jumped 6.4% quarter-on-quarter in Q4, partially reversing the 11.6% crash in the third quarter. Auto exports dived in Q3 because the introduction of new EU emissions regulations disrupted the entire automotive industry.

Crucially, the *real* trade surplus also appears to have increased in Q4, by a solid 4.5%, though we can't quite make sense of the monthly import price deflator. With oil prices down just over 20% quarter-on-quarter, we had been expecting a large fall in import prices and, by extension, a boost to *real* imports. *Usually, real net exports suffer in quarters with big declines in the oil price*. In Q4 2018, however, import prices *increased* by 0.1% quarter-on-quarter, showing few signs of the slump in oil prices. Assuming that these data are left unrevised, our estimate suggests that net trade boosted GDP growth in Q4, rebounding from a crash in Q3. ***In total, though, we still think next week's advance GDP estimate will be underwhelming, posting a mere 0.1% increase, up only slightly from the 0.2% fall in Q3***.

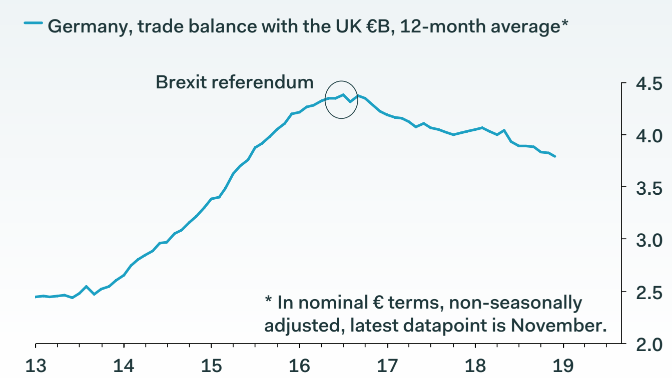
Why has Germany's trade surplus fallen?

Weakness in China has borne the brunt of the blame for the reversal in German exports, but the detailed data tell a slightly more nuanced story. To the extent that a slowdown in China is a drag on *global* manufacturing and trade, an export-sensitive economy like Germany will be at the front of the line to take the hit. The *bilateral* trade data with China, however, look solid enough. Growth in nominal exports to China has slowed, but it was still robust at about 10% year-over-year at the end of last year. This pace was comfortably ahead of growth in imports, with the result that Germany's trade deficit with China *narrowed* last year. Note, though, that the

WHAT HAPPENED TO Q4 IMPORT PRICES IN GERMANY?



BLAME A WEAK U.K. FOR A LOWER TRADE SURPLUS IN GERMANY



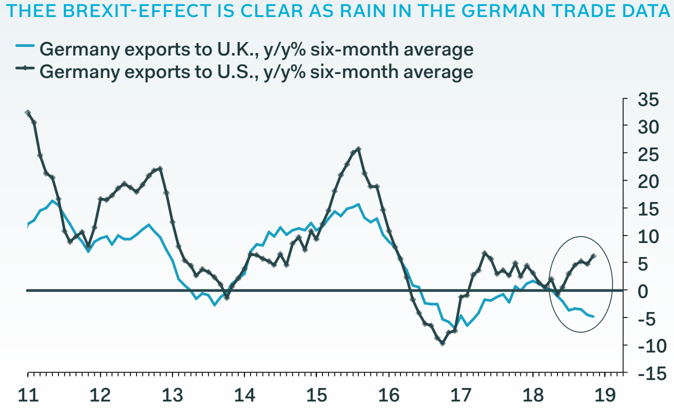
weaker EURCNY was a big driver of this improvement, especially in the final six months of the year.

By contrast, the decline in Germany's aggregate trade surplus has mainly been driven by a steadily falling advantage with the U.K., and more recently, to a lesser extent, weakening net trade with France. The smoothed surplus with Britain has been slipping and sliding since the Brexit referendum. As a share of nominal GDP, it peaked at just over 1.5% in the middle of 2016, but has now dwindled to about 1.2%.

These are nominal data, so it is safe to say that the 26% rise in EURGBP since the beginning of 2016 is the main driver of this shift. ***But that just goes to show that the one-off hit to German competitiveness following the Brexit referendum has been a big drag on export revenues.*** In addition, the slowdown in U.K. *inflation-adjusted* growth also is a challenge. Real consumers' spending across the Channel was growing at 3% year-over-year coming into the referendum, but has now slowed to about 1.5%.

The problem of slower growth in the U.K. becomes even more apparent if we compare German exports to the U.S. and U.K. Our next chart shows that export growth to the U.S. is now accelerating, in contrast to the deteriorating trend in exports to the U.K. This divergence will persist through Q1, at least, as Brexit uncertainty increases. *But if we are right that a favourable transition deal eventually will be reached, growth in exports to the U.K. should accelerate later this year.* In addition, with the trade-weighted euro now *falling* slightly year-over-year, exports to the U.S. also should continue to grow.

THEE BREXIT-EFFECT IS CLEAR AS RAIN IN THE GERMAN TRADE DATA



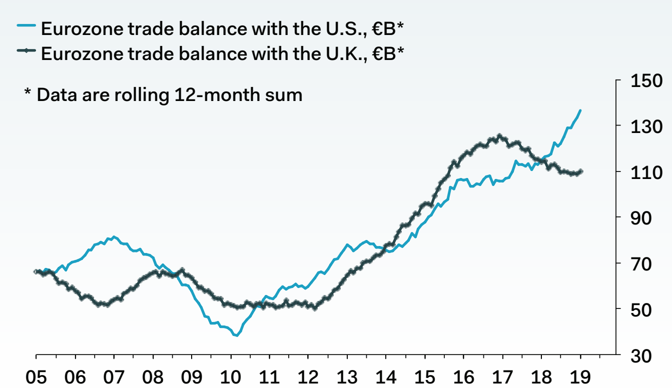
Are tariffs on EU cars the next trade-war move?

We have received questions from readers about whether the U.S. will drag Europe into the trade wars by hitting the car sector with tariffs. *The actions of Mr. Trump are anyone's guess, and risks are rising.* The EU pulled a trick last year when Jean-Claude Juncker agreed with the U.S. president that neither party would impose tariffs on each others' markets while negotiations are taking place. *Few institutions are better at dragging out negotiations than the EU, but the U.S. is losing patience.*

Last week, U.S. Ambassador to the EU, Gordon Sondland, said that "there have been a lot of talks, but nothing of substance." The EU has pledged to buy more LNG and soybeans from the U.S., but it is virtually impossible for the Commission to force through such a shift, at least not quickly. *In any case, for a U.S. president using bilateral trade data as a scorecard for success, the data suggest that action is needed.*

The Eurozone's trade surplus with the U.S. is hitting new highs, and if we are right that German exports to the U.S. will push on this year, it could be a red rag to the bull currently occupying the White House. In the short run, ongoing negotiations with China, and the fact that opening a new front with the EU would hurt the stock market, probably will stay Mr. Trump's hand. *But based on recent evidence, a confrontation is brewing, and the EU will have to come up with* something *to kick the can down the road, for a second time.*

THAT CHART THE EU DOES NOT WANT MR. TRUMP TO SEE



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THIS WEEK IN BRIEF

Note: "**D**" prefix denotes Datanotes for these releases.

Monday, February 11

- **No significant data released**

Tuesday, February 12

- **No significant data released.**

Wednesday, February 13

- **D: Industrial Production, Eurozone (12) 11:00 CET**

We think industrial production slipped **0.5%** month-to-month in December, leaving the year-over-year rate unchanged at -3.2%. Weakness in Spain, Italy and a huge fall in Ireland probably were the main drivers of the fall. **Consensus: 0.4%**.

Thursday, February 14

- **France, Unemployment (Q4) 07:30 CET**

The ILO unemployment rate in France probably fell to **9.0%** in Q4, marginally lower than the 9.1% rate in Q3. We think it will fall to about 8.8% in the next six months. **Consensus: 9.1%**.

- **D: Advance GDP, Germany (Q4) 08:00 CET**

We think real GDP in Germany rose **0.1%** quarter-on-quarter in Q4, rebounding slightly from a 0.2% decline in Q3. The year-over-year rate likely slipped to 0.7%, from 1.2% in the previous quarter. We don't see details in this report, but we suspect that investment and consumers' spending remained subdued. **Consensus: 0.1%.**

- **D: GDP, Second Estimate, Eurozone (Q4) 11:00 CET**

It will be a close call, but we are betting on a downward revision, from the advance estimate of 0.2% quarter-on-quarter, to **0.1%**, slightly slower than the 0.2% in Q3. This forecast also implies that we think the year-over-year rate slipped to 1.1%, just 0.1pp lower than the first estimate. Weakness in Germany and Italy were the key drivers of the subdued growth. **Consensus: 0.2%**.

- **D: Employment, Eurozone (Q4) 11:00 CET**

We think headline employment growth in the Eurozone slowed to **1.1%** year-over-year in Q4, 0.2pp slower than in Q3. This report is an advance estimate, and these data often are revised, so we have to take the headline with a pinch of salt. We are confident, however, that growth in employment is now slowing as a lagged response to slower GDP growth through most of last year. We think the headline will dip below 1% in the next two-to-three quarters. **Consensus: N/A**.

Friday, February 15

- **D: Car Registrations, EU 27 (1) 11:00 CET**

New car registrations in the EU probably were **flat** year-over-year in January, rebounding from an 8.4% plunge in December. The hangover from the pre-WLTP surge in sales is still weighing on demand, but we think growth will recover further growth in the first part of the year. **Consensus: N/A.**

- **D: Trade Balance, Eurozone (12) 11:00 CET**

The headline seasonally-adjusted trade surplus in the Eurozone probably increased to **€17.0B** in December from €15.1B in November, boosted by jumps in French and German exports. The trend in the euro area's trade surplus has deteriorated in the past 12-to-18 months, but we think it will stabilise in the next six months. **Consensus: €16.3B.**

PANTHEON EUROZONE FINANCIAL CONDITIONS DASHBOARD

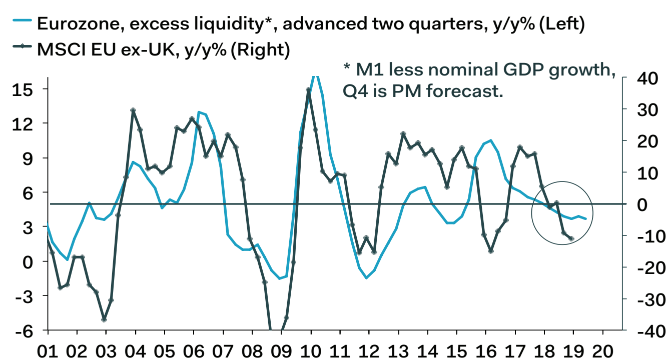
Market	Valuation*	Six month change, %	y/y, %
Eurostx 50	-1.0	-8.7	-5.9
Dax 30	-0.8	-12.3	-10.0
CAC 40	-0.7	-8.6	-2.5

* P/E ratios in standard deviations from 10y average (>1.5 = expensive, <-1.5 = cheap)

Bonds	Curve**	Six month change, bp	y/y, bp
GER (10-2)	-3.7	-28.6	-64.6
FRA (10-2)	-3.3	-12.5	-40.4
ITA (10-2)	-1.7	+44.9	-7.3

** Curve in standard deviations from its 10y average (>1.5 = historically steep, <-1.5 = historically flat)

EUROZONE EXCESS LIQUIDITY VS MSCI EU (EX UK)



EZ equities continue to edge higher, though we doubt that February will be as good as January. The recent dovish tilt by global central bankers will help, but excess liquidity continues to signal only modest returns.

PANTHEON'S EUROZONE ECONOMIC FORECASTS (GDP: REAL GDP Q/Q%)

GDP			
Q3 18	0.2	2016 year:	1.8
Q4 18 forecast	0.1	*2017 year:*	*2.5*
Q1 19 forecast	0.4	*2018 year:*	*1.8*
Q2 19 forecast	*0.3*	*2019 year:*	*1.2*
Q3 19 forecast	*0.2/0.3*	*2020 year:*	*1.1*

CPI y/y, %		Unemployment, %	
January	1.4%	November	7.9%
February	*1.2%*	*December*	*7.9%*
March	*1.0%*	*January*	*7.9%*
April	*1.4%*	*February*	*7.9%*
May	*1.3%*	*March*	*7.9%*