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Europe may win if tariff war persists

With its reliance on exports, US chemicals will be very vulnerable to retaliatory tariffs. Europe, meanwhile, has sprung into action on defense and infrastructure spending

Paul Hodges New Normal Consulting

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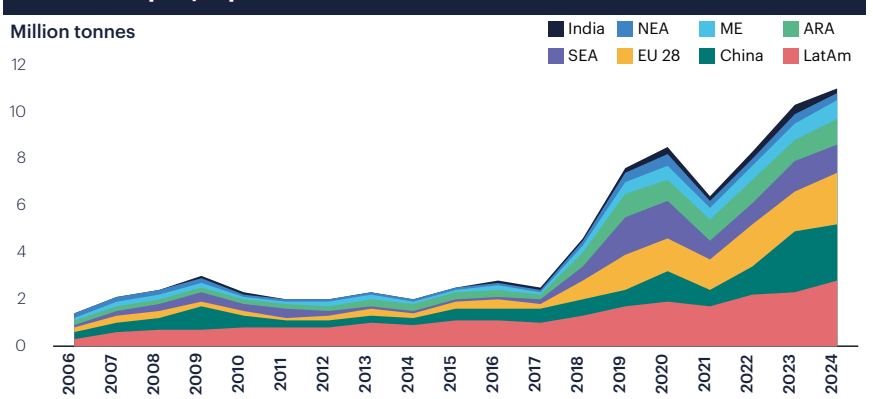
Donald Trump was very clear about his core economic policy before the election, when he argued that "To me, the most beautiful word in the dictionary is tariff".

At the time, many argued that either (a) "he doesn't really mean it" or that (b) tariffs were only "a negotiating tool from the world's greatest deal-maker". Unsurprisingly, however, it turns out that he did mean it. Also unsurprisingly, the EU has already worked out that US polymer exports could be a good target for retaliation, with a potential 25% tariff on polyethylene (PE) being discussed as part of the package.

The chart highlights the potential scale of any tariff war, based on Trade Data Monitor data. It shows the vast expansion of US ethylene-based exports since the shale revolution began in 2018. They are up more than three-fold on a net basis, from 3.6 million tonnes in 2017 to 15.3 million tonnes last year. And Europe has seen the largest increase in imports, in both tonnes and percentage. Volume has risen more than five-fold from 0.5 million tonnes to 3.1 million tonnes, with PE exports leading the charge. They account for 2 million tonnes of the increase, highlighting the rationale for the EU's proposed retaliation.

US PE new export/import trade 2006-2024



Source: pH Report, Trade Data Monitor

US PE producers may suffer more

Unfortunately, this imbalance means US producers stand to suffer if the trade war goes ahead. President Trump is of course right that global trade has been increasingly unbalanced since 2008's subprime crisis. But this is not because of trade with America's traditional allies in North America and Europe. Rather, it is due to major policy mistakes in China and the US:

- China responded to the crisis by ramping up export-based manufacturing, and its 'subprime on steroids' property bubble to keep people employed
- The US responded to the crisis with major stimulus programs, to keep asset prices and consumption moving ahead

It will be very hard, if not impossible, for US producers to find alternative markets. They will therefore have to pay the tariff cost if they want to export

As a result, China's export surplus is now >1.5% of global GDP, double 2007's level. The US deficit is essentially its mirror image, at a deficit of 1.5%. Essentially, the tariff war is therefore trying to treat symptoms rather than causes.

The real issue is the structural imbalances in world trade created by these Chinese and US policies. Trade, after all, balances on a global basis, not bilaterally between individual countries. And on a structural basis, the core problems are easy to describe:

- China has become addicted to unrealistic

GDP growth targets, which it meets by debt-fuelled, export-led growth in manufacturing

- The US has become addicted to debt-fuelled consumer-led growth, so its household and national debt has risen to unsustainable levels

These problems have built up over the past 20 years, and so tackling them is never going to be easy. But unfortunately, the tariff war is likely to make the situation worse, rather than better, as it will not tackle the structural issue. Instead it will inevitably reduce supply and create inflationary pressures. As JP Morgan has already warned:

"There is about a 40% chance of a US recession this year and a risk of lasting damage to the country's standing as an investment destination if the administration undermines trust in US governance."

Chemicals perspective

From the chemical industry perspective, the tariff war also adds to the existing problems created by overcapacity. And it is particularly bad news for US producers. If Europe goes ahead with its reciprocal tariffs on PE and other products, it will be very hard, if not impossible, for US producers to find alternative markets for their product. They will therefore have to pay the tariff cost if they want to export.

A further problem is that the history of wars, including trade wars, suggests that they are seemingly easy to start – but very difficult to end. There is also a clear risk of further tariff increases, if both sides dig in for a long battle.

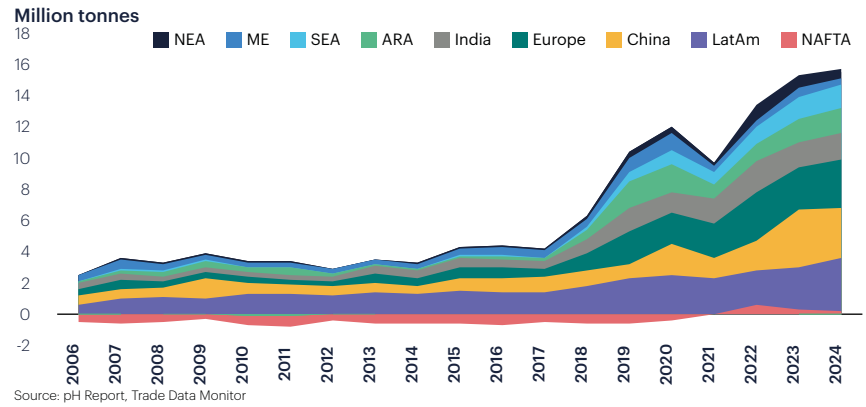
Nobody denies that trade is currently unbalanced. But rebalancing it requires an agreement with China to replace its export-focused manufacturing strategy with a new focus on increasing its own domestic consumption. Its per capita disposable household income averaged just $7500 for urban residents in 2024. Rural residents averaged only $3200. So there is plenty of scope to redirect production to the local population, given the political will.

Similarly in the US, policymakers need to move away from their current reliance on stimulus policies. The national debt has been on an unsustainable path for years, and now totals $107,000 per citizen, and $323,000 per taxpayer. As a result, interest payments on the debt are crowding out other expenditure. Last year, they were higher than either Defence or Medicare. Only Social Security is now higher.

Of course, tackling these fundamental and long-lasting problems in China and the US is a lot harder that signing executive orders to establish new tariff barriers. But doing nothing simply risks increasing today's over-capacity problem.

In turn, the cost to the petrochemical industry in terms of lost revenue and lower margins will continue to increase. And ironically, it may well be that the main positive aspect of a tariff war will be in Europe. It is already starting to create the 'once-in-a-lifetime' shock that was needed to force through long-needed structural change.

US ethylene eqivalent trade flows 2006-2024



Source: pH Report, Trade Data Monitor

And ironically, it may well be that the main positive aspect of a tariff war will be in Europe

Developments in Germany provide the key evidence for this statement. Back in 2009, Angela Merkel's government introduced the 'debt brake' to restrict annual budget deficits to just 0.35% of GDP. As a result, German infrastructure – which used to be the envy of the world – has started to (literally in some cases) fall apart. Now, however, and to the surprise of almost everyone, the incoming Merz government has pushed through major change.

€500bn will now be available for infrastructure spend over the next 12 years, including €100bn for climate change measures. Even more importantly, given Russia's invasion of Ukraine, all defence spending above 1% of GDP will be exempt from the debt rule. As analysts TS Lombard have noted, the scale of this spending exceeds both the transformational post-War Marshall Aid Plan, and the post-1989 Reunification programme after the fall of the Berlin Wall.

Merz himself has acknowledged the importance of this catalyst, when citing fears that the US could pull back from defending Europe. Similar fears have been expressed in Brussels, where they have led the European Union to allocate €800bn to defence spending over the next 4 years.

They have also had a wider political impact, with the UK, France and Germany now agreeing to combine in a 'coalition of the willing' to resist Russian aggression. This coalition now includes 31 countries including Canada, Australia and Turkey. Nobody would have thought that any of these developments would be possible at the beginning of the year. There is therefore a clear risk, from a US perspective, that the net impact of the tariff war will be to increase domestic inflation and reduce economic growth.

Tariff war may boost Europe

It may well also provide Europe with the incentive to overcome its reluctance to change. One sign of this paradigm shift is the increasingly enthusiastic adoption of the Clean Industrial Deal. It was originally sponsored by industry association CEFIC, and is now official EU policy. This is a potentially very powerful move towards a more local-for-local economic model. And it offers the opportunity for more widespread adoption of renewable energy and recycling, as part of policies to promote regional and national security.

Equally important is that from a European perspective, the tariff war has broken the psychological barrier that stopped Europe moving into a more protectionist mode. Essentially, it has opened Pandora's Box. It will now be much easier to increase any retaliatory tariffs, and the range of products affected. And on a global basis, the tariff war risks accelerating the move away from globalisation, and directly harming the export-dependent US producers it was theoretically meant to "protect".

Unfortunately, therefore, US producers may well find that the tariff war creates more problems than it solves. And European producers may end up seeing major benefits. Local demand is clearly set for major expansion as a result of the German and EU spending. And competition will move to a more 'local-for-local' basis as tariffs remove the basis for globalisation. We may even see Europe thanking President Trump for helping to 'Make Europe Great Again!'. ■

Paul Hodges is chairman of New Normal Consulting and NiTech Solutions, and the Advisory Board for Infinity Recycling. He publishes The pH Report and writes the ICIS Chemicals & the Economy Blog.