HOUSE VIEW

ONE AGAINST ALL AND ALL AGAINST ONE

BancaMarch

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Barely two months into his term and Donald Trump has managed to fall out with pretty much everyone: blackmail with tariffs, threatening his allies, flirting with Russia to achieve a ceasefire in Ukraine, and even snubbing all his partners... he has even threatened to leave NATO. It has shattered the foundations on which the West was rebuilt after World War II, the Trump having become the very antithesis of the 'all for one, and one for all' motto of The Three Musketeers, reneging on such virtues as honour, loyalty and comradeship that the US was supposed to share with its allies. Instead of behaving with the propriety and dignity expected of the leader of the world's most powerful nation, like Monsieur de Tréville for the Musketeers, he seems more inclined to curry favour with Putin, much like Milady de Winter did for Cardinal Richelieu.

When it comes to trade policy, Trump has begun to dish out tariffs left, right and centre, unleashing chaos in the process. First it was China, on which he slapped 20% tariff hikes 16 days into his term. That was soon followed by similar measures against Canada and Mexico, which he then went back on and, as if that were not enough, as of 2 April, he is readying measures against the so-called "dirty 15" list of countries—which happen to include the EU—against which he will administer the so-called 'reciprocal tariffs'. What he claims to be doing, at least on paper, is to equalise tariffs, although he has also threatened to include in his tariff hikes own taxes that the countries charge, such as VAT, in order to calculate the "optimal" tariff level. So as we wait on tenterhooks to see what unfolds next week, it is important to have some perspective on what happened during Trump 1.0, as some of the measures he initially announced did not ultimately go ahead, or were subsequently withdrawn. The tariff war of his first term can be split into three main blocks:

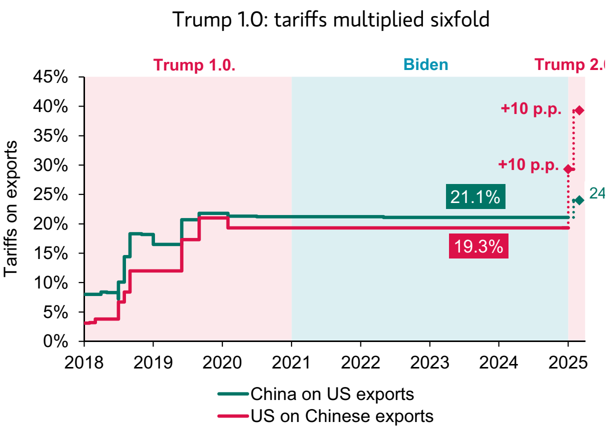
1. China, the country most affected, saw its tariffs increased sixfold, with no U-turn (Figure 1).

2. However, Mexico and Canada managed to renegotiate NAFTA in November 2018. After a gruelling process and almost a year of tariffs, they finally achieved tariff exemption on steel and aluminium from May 2019.

3. The impact of tariffs on EU exports was limited—only 3.5% of total sales to the United States. Ultimately, Trump did not carry out his threat of a 100% tariff on wine and certain French products, nor for that matter the 25% tax on cars, which would certainly have hurt Europe.

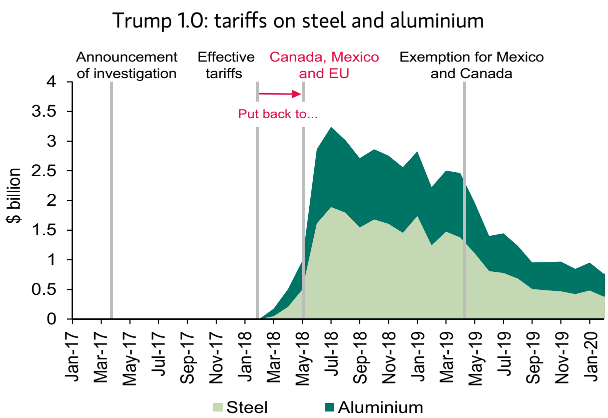
1. WITH CHINA THERE WAS NO U-TURN

Sources: Peterson Institute and Banca March



2. US WITHDREW TARIFFS ON CANADA AND MEXICO

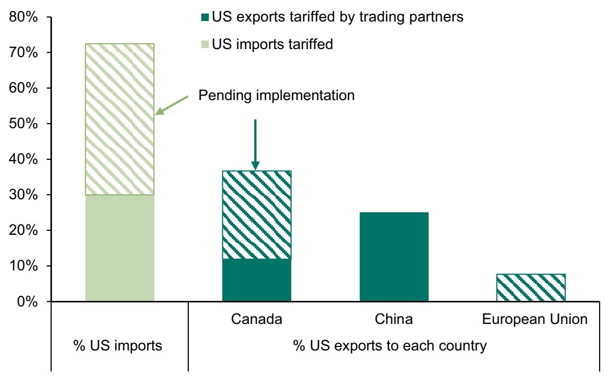
Sources: USITC and Banca March



Past experience leads us to believe that perhaps Trump has gone too far in his statements, that sanity will ultimately prevail, and that some of the draconian measures he has announced will be reversed, or at least dialled down. If the US administration does not back down, 70% of the products imported into the US will be affected, causing a severe shock to economic growth and inflation.

3. TRUMP HAS PROPOSED TARIFFS ON 70% OF ITS IMPORTS.

Sources: International Trade Administration and Banca March.



Moreover, Trump has less room for manoeuvre during this second term than was the case during Trump 1.0, because the public deficit currently stands at 6.6%—as opposed to 2.9% in 2016—, so realistically he won't be able to use tax cuts to offset the negative effect of the tariffs, as indeed he did during his first term, when he cut the top corporate rate from 35% to 21%.

Nor should we ignore the early signs of trouble for Wall Street. North American households are highly sensitive to the performance of equities, in which they hold 26% of their wealth, the highest level since Q2 2021. And the top 10% of households—which account for 39% of all shares held—are responsible for almost half of total consumption, so a prolongation or deterioration of the current situation would affect household spending and undermine the popularity of the current president.

Thus, while it is impossible to tell whether Trump will press ahead with his current strategy, we believe he will at least dial down his policies.

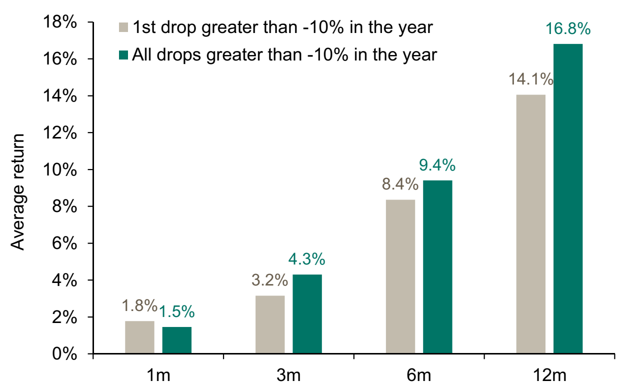
Meanwhile, Trump's obstinacy over MAGA has generated such distrust in Europe that it has triggered a rebound effect, known as a MEGA (Make Europe Great Again), given that now Europe has been getting much cosier with the UK than was previously the case and by setting up a common defence system, they have become more united than ever: it will even offer favourable financing conditions for those countries with less fiscal wiggle room. However, while the "Re-Arm Europe" programme will have a sizeable budget equivalent to 4.5% of the EU's GDP, each state will have to self-finance more than 80% of the funds needed.

In our view, it is Germany that really stands to benefit from this situation because of its low indebtedness (debt to GDP ratio of 63%, compared to 88% for the wider euro area), making it genuinely able to undertake new investment programmes. Moreover, after five years of stagnation, the new government has moved swiftly and already has an additional €500 billion set aside for infrastructure investment, to be spent over the next 12 years. This will mobilise 11.6% of GDP, boosting German growth by a further 0.6 pp per year. And let's not forget, if the current ceasefire in Ukraine leads to a more lasting agreement, this would lead to a reconstruction phase for which an investment of around €500 billion is estimated.

All things said, while the situation is volatile right now, and with little political visibility, we believe it is important to stay constructive when it comes to risk. It's best to keep our gaze on the mid-term horizon and not get blinkered, in the knowledge that, just as the sell-off began with Trump's surprising outbursts, the S&P 500 will begin to rally soon enough for equally capricious and unpredictable reasons. As the figure shows, following dips of 10% and in the absence of a recession, it is normal for the market to rally.

4. S&P 500: PERFORMANCE FOLLOWING CORRECTIONS OF -10% IN THE ABSENCE OF RECESSION 12 MONTHS LATER

Sources: Bloomberg and Banca March



Despite the challenging outlook, there will be no economic derailment and we should keep our feet firmly on the ground and, much like brave musketeers, draw our swords to fight on.

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IMPORTANT REMARK: