

## Talking point

### Brexit: German automotive and pharmaceutical industries hit the hardest

July 1, 2016

Following the UK referendum, Brexit will also leave traces on German industry. After all, 7.5% of all German exports went to the UK in 2015, making it Germany's third most important export market after the United States and France. The automotive and pharmaceutical industries are likely to be hit the hardest by Brexit. This is because the UK accounts for 12.8% and 10.5%, respectively, of these two industries' total exports. In addition, they both generally have an above-average export ratio. The UK referendum is likely to have an impact on individual companies' investment decisions and German companies' UK pricing structures in the short term.

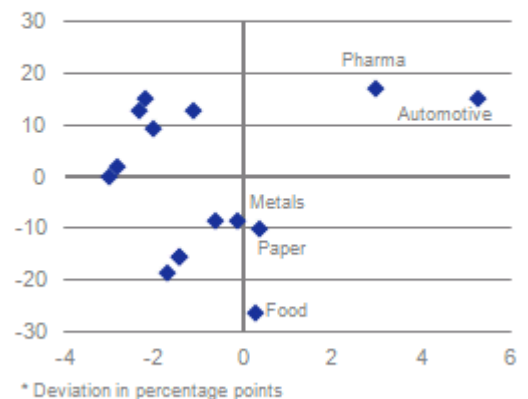
Following the UK referendum on the country's exit from the EU, we have lowered our GDP growth forecast for 2017 for the UK, Germany and the EU as a whole. In addition, we expect sterling to depreciate against the euro as well as other currencies. In 2015, the UK was Germany's third most important export market after the United States and France, accounting for 7.5% of all German exports of goods, up from 6.1% in 2010. This shows that the UK has grown in importance as a market for German exporters over the last few years, aided by the weak euro, which depreciated against sterling (GBP) by 15% between 2010 and 2015.

What industrial sectors in Germany are likely to be affected the most strongly by the (expected) weaker growth of the UK economy and the probable depreciation of GBP? To answer this question from a macroeconomic point of view, we have calculated the proportion of individual manufacturing sectors' exports to the UK in their total exports. In addition, we consider the export ratio at the sector level. The first chart tracks the deviations in both variables from the average for manufacturing as a whole in the individual sectors; an export ratio of 49.7% was recorded for total manufacturing in 2015.

Accordingly, the top right quadrant contains those sectors which send a particularly high share of their exports to the UK and simultaneously have an above-average percentage of export business. Both criteria apply to the automotive industry as well as the pharmaceutical industry. This suggests that these two sectors are likely to bear the brunt of Brexit. 12.8% of the German automotive industry's exports went to the UK (number 2 after the United States) in 2015. At the same time, the total export ratio of this industry came to 64.9%. In the pharmaceutical industry, the UK accounted for 10.5% of all exports (number 3), while the export ratio was no less than 67% last year.

#### Brexit: Automotive and pharma are affected most

X: deviation from avg. UK export share by German sector; Y: deviation from avg. total export ratio\*



\* Deviation in percentage points

Sources: Federal Statistical Office, Deutsche Bank Research



Over the last few years, UK demand has provided significant economic support for both sectors. In 2015, nominal exports of the automotive industry in Germany exceeded the level recorded in the pre-crisis year of 2008 by just under 70%, with the pharmaceutical industry recording a figure of as much as 195% in the same period.

The possible slowdown in UK growth comes at an unfortunate point in time for the automotive industry as even without Brexit demand for passenger cars in the United Kingdom would have passed its cyclical peak in 2016/17. The expected appreciation of the euro against sterling will make German exports to the UK more expensive. The factories operated by German OEMs and components suppliers in the UK must now pay more for their imports. The negative economic fallout from Brexit for the German pharmaceutical industry should be softened by the relatively low price elasticity of demand for pharmaceutical products.

### Some German industries set to emerge unscathed

The bottom right-hand quadrant of the chart contains those sectors whose exports are characterised by a large UK portion but which generally have a below-average export ratio (food and paper industries). Conversely, the top left hand quadrant is composed of sectors with an export ratio (far) in excess of the mean for manufacturing. However, the UK is less important for them as a market (e.g. electrical engineering, mechanical engineering, chemicals, other transport equipment). These sectors will therefore remain less affected. Obviously, companies in the chemical, metal, rubber, plastic and electrical engineering industries will also be indirectly affected by Brexit in that they supply a relatively large portion of their output to the automotive industry in Germany.

Given the uncertainty surrounding the upcoming Brexit process, it is difficult to quantify the economic impact on German industrial sectors. In the short term, there is clearly no reason to panic as the Brexit negotiations will extend over a protracted period of time and the UK will remain a member of the EU until they have been completed. However, the UK referendum is likely to exert an influence in the short term on individual companies' investment decisions and German companies' UK pricing structures as well as currency hedging. What is more, cross-border supply chains are likely to be realigned over the next few months.

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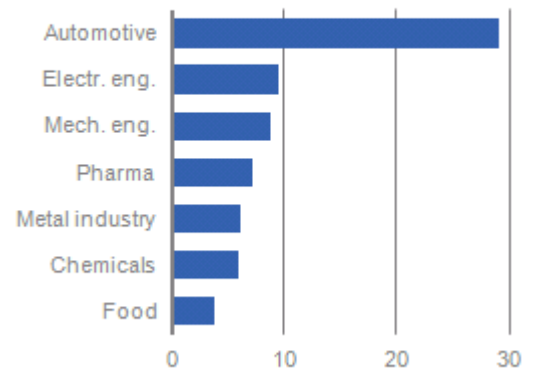


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## German automotive industry leads exports to the UK

German exports to the UK by sector, 2015, EUR bn



Source: Federal Statistical Office

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