**BOX 1**

**POTENTIAL IMPACT OF THE US TARIFFS ON CAR IMPORTS FROM THE EU ON THE LITHUANIAN ECONOMY**

Tensions regarding the US and EU trade relations appear to be rising again. Having conducted an investigation, in February 2019 the US Department of Commerce decided that car imports pose a threat to the US national security as they impair the country’s production base and military readiness. Such decision renewed discussions that the US may amp up the pressure on the EU and even start applying 25% tariff on car imports from the EU. Meanwhile, the EU states declare their intention to avoid escalating the trade conflict. However, if the US increases the import tariffs, the EU would be prepared to retaliate. The US is the EU’s main export partner of cars and their parts (see Chart A). As a small open economy Lithuania is dependent on foreign demand trends, therefore, it is important to assess how a potential escalation of the conflict could affect our economy.

**The largest share of the EU exports of cars and their parts goes to the US.**

Chart A. EU exports of cars and their parts outside the EU in 2018 (by trade partner)

**More than two thirds of goods of Lithuanian origin are exported to the EU.**

Chart B. Exports of goods of Lithuanian origin, excluding mineral products, in 2018 (by country)

The new trade restrictions could have only a minor direct impact on the Lithuanian exports; however, it could increase production costs of the Lithuanian companies. The Lithuanian car industry is poorly developed, and the share of exports of these goods is relatively small – land vehicles and their parts account for only 1.4% of total exports of goods of Lithuanian origin and 0.5% of GDP, thus, this type of impact is very weak. Still, higher prices of imported intermediary goods could increase production costs of Lithuania’s companies and adversely impact competitiveness of exporters. The impact on the Lithuanian economy would hinge on which US imports the EU would increase tariffs. According to current estimates, such impact would still be low, since imports from the US account for only 2.8% of the total imports of the Lithuanian goods.

**However, it is likely that the escalation of US-EU trade conflict would mostly affect Lithuania through weaker demand in the euro area.** Lithuania exports 42% of all goods of Lithuanian origin to the euro area and another 31% to other EU states (see Chart B). Euro area is also the main export market...
for commercial road transport services, and this sector is rapidly expanding in Lithuania (see Chart C).

Transport sector performance is dependent on trade volumes in the EU, therefore, slower growth of trade volumes could hurt the sector’s further development. However, despite high significance of the car industry in individual euro area countries, for example, Germany, the direct impact of further trade conflict escalation on the main Lithuania’s export markets would probably be also relatively small. According to the IMF assessment\(^1\), if the US imposed tariffs of 25% on imports of cars from other countries and these countries retaliated, the euro area would not be directly adversely impacted in the first three years, since it would be able to direct its production to other regions. The euro area would feel a slight negative impact after three years, since the US manufacturers would have adapted to changes by then, i.e. replaced car parts currently imported from the euro area with the local production. In the long term, the direct negative impact on the euro area economy would be minor. However, according to the IMF assessment, the indirect impact on the euro area, stemming from worsened expectations, increased uncertainty, tension in financial markets and tighter financing conditions, could significantly surpass the direct impact of the trade conflict. Moreover, the negative impact could be strengthened by the disruption of global value chains. IMF estimates that, in contrast to the scenario without the imposition of additional tariffs, the total direct and indirect impact on the euro area economy over the next few years could account for a production drop of up to 0.5%, and in the long term – of up to 0.06%. Weaker euro area growth would have an adverse impact on the Lithuanian export trends. The impact on the Lithuanian economy could be similar to the overall impact on the euro area economy.

The share of exports of transport services in Lithuania’s GDP continues to increase.

Chart C. Dynamics of the exports of transport services and the share of the employed in the transport sector

Lower expectations and slightly higher prices could curb domestic demand growth, albeit only slightly. Confidence indicators of Lithuanian companies remain at high levels, however, if the trade conflict heats up and fears about a slowdown in foreign demand does not abate, business and consumer expectations would probably worsen (see Chart D). As a result, Lithuanian companies may be inclined to postpone investment, whereas households could limit their consumption. Higher prices of imported goods could contribute to higher inflation and negatively affect the growth of household consumption.

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\(^1\) IMF World Economic Outlook, October 2018: Challenges to Steady Growth.