COMMERZBANK

Economic Research

Economic Briefing

Trump's tariff hammer

3 February 2025

Bernd Weidensteiner [AC]
Dr. Christoph Balz [AC]

Table of contents

Trump implements his tariff threats	1
Canada: What have they done to deserve this?	2
Mexico: a risk for the automotive industry	3
How are trading partners reacting?	4
EU: tariffs ahead	4
Who pays the tariffs?	5
USA: The rule book goes out the window	5

President Trump is imposing punitive tariffs on Canada, Mexico and China. Canada and Mexico, in turn, have announced counter-tariffs. Trump also wants to impose tariffs on the EU, which could happen "pretty soon". There is a risk of an escalating international trade war that would weaken the global economy and increase inflation.

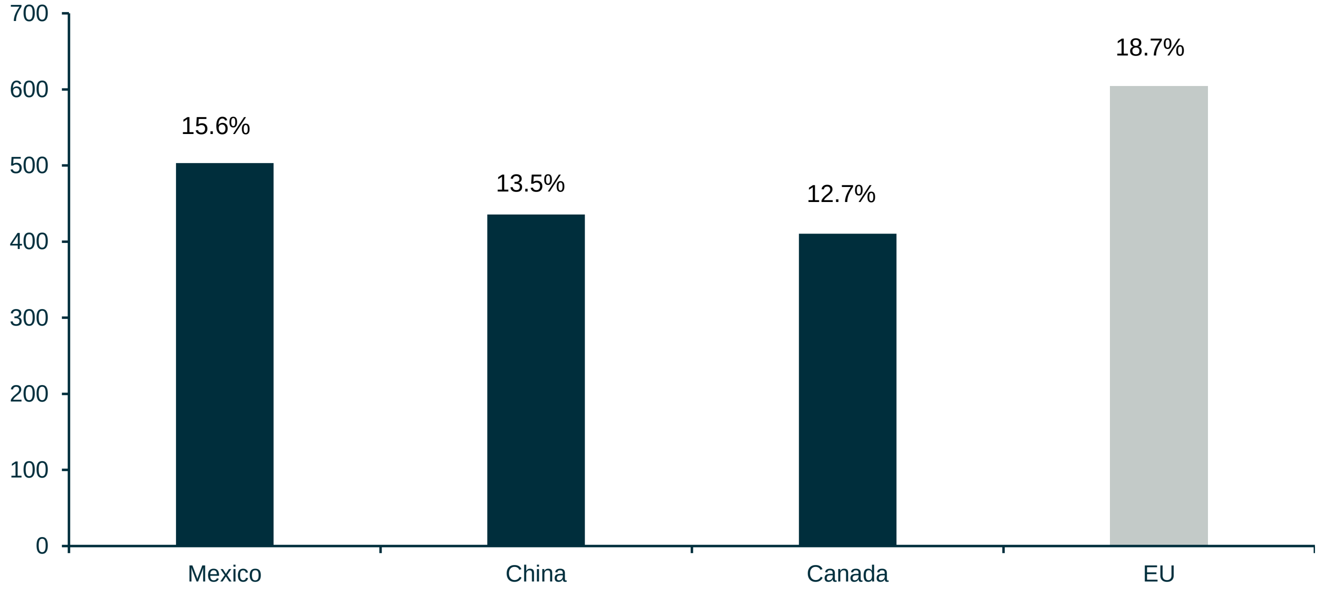
Trump implements his tariff threats

US President Trump has declared a **national emergency** due to the "extraordinary threat posed by illegal aliens and drugs, including deadly fentanyl" and imposed tariffs on countries he blames for it. Starting tomorrow, the US will impose tariffs of 25% on imports from Canada and Mexico and 10% on imports from China. These tariffs will be in addition to any existing tariffs. A reduced rate of 10% will apply to energy imports from Canada. Further tariffs on imports of computer chips, medicines, steel, aluminum, copper, oil and gas are in the pipeline and could be imposed from mid-February. Tariffs on imports from the EU "will definitely come," said Trump, without being more specific.

Mexico and Canada, which are linked to the US by a free trade agreement, account for almost 30% of American imports. China supplies a further 13.5%. This means that a large proportion of US imports would be subject to punitive tariffs (Chart 1). This makes this round of tariffs significantly larger than the measures taken during Trump's first term in office. Hopes that Trump would not implement the threats he made during the election campaign have thus been dashed. However, we **did not share** these hopes in any case.

Chart 1 - Trump takes aim on wide segments of US imports

US goods imports, various countries/regions, 12 months up to November 2024 in billion dollars. Percentages: share of total US goods imports



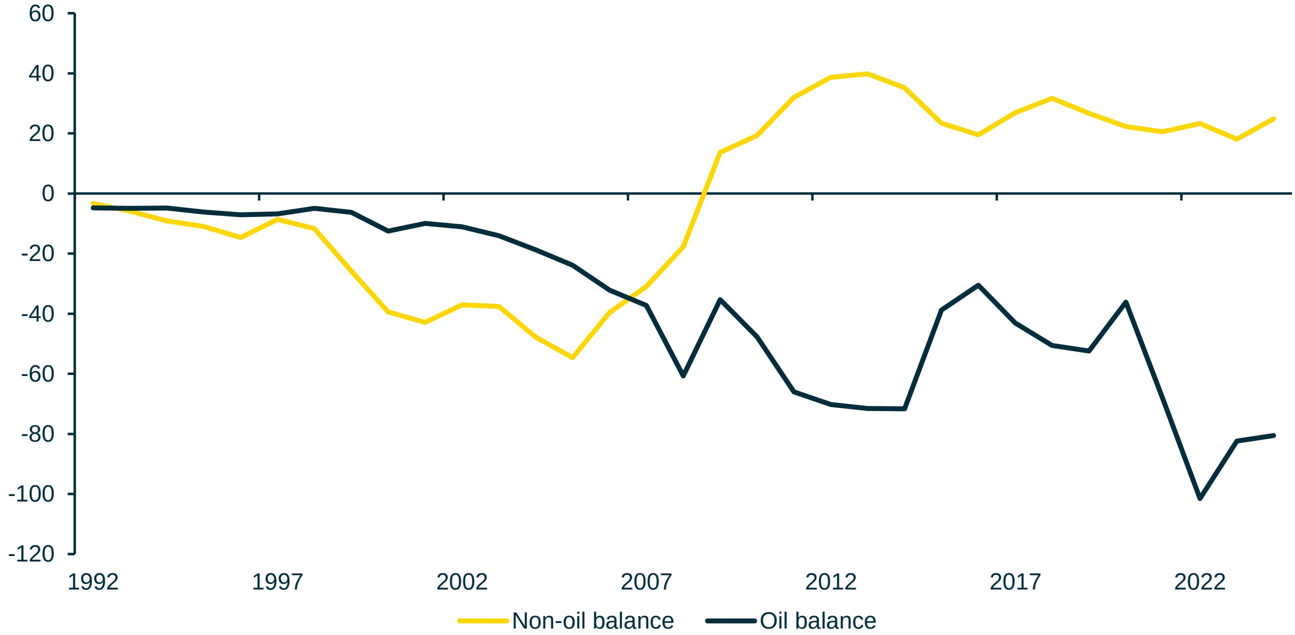
Source: US Bureau of the Census, Commerzbank Research

Canada: What have they done to deserve this?

Canada has been a close ally of the United States and one of its most important trading partners for decades. Although the country has a trade surplus with the US of around $60 billion, this is due entirely to the high US imports of Canadian oil, where the Americans have a deficit of $80 billion. Canada mainly supplies relatively "heavy" crude oil to the refineries of the Midwest (almost 3 million barrels per day). These refineries are designed for Canadian crude oil types, as is the pipeline network in this region. This also explains why Donald Trump only imposes a 10% tariff on oil imports from Canada; this is obviously to reduce economic damage to the US.

Chart 2 - If oil is excluded, the US has a trade surplus with Canada

US goods trade balances vis-a-vis Canada, annual data (2024: up to November), in billion dollars



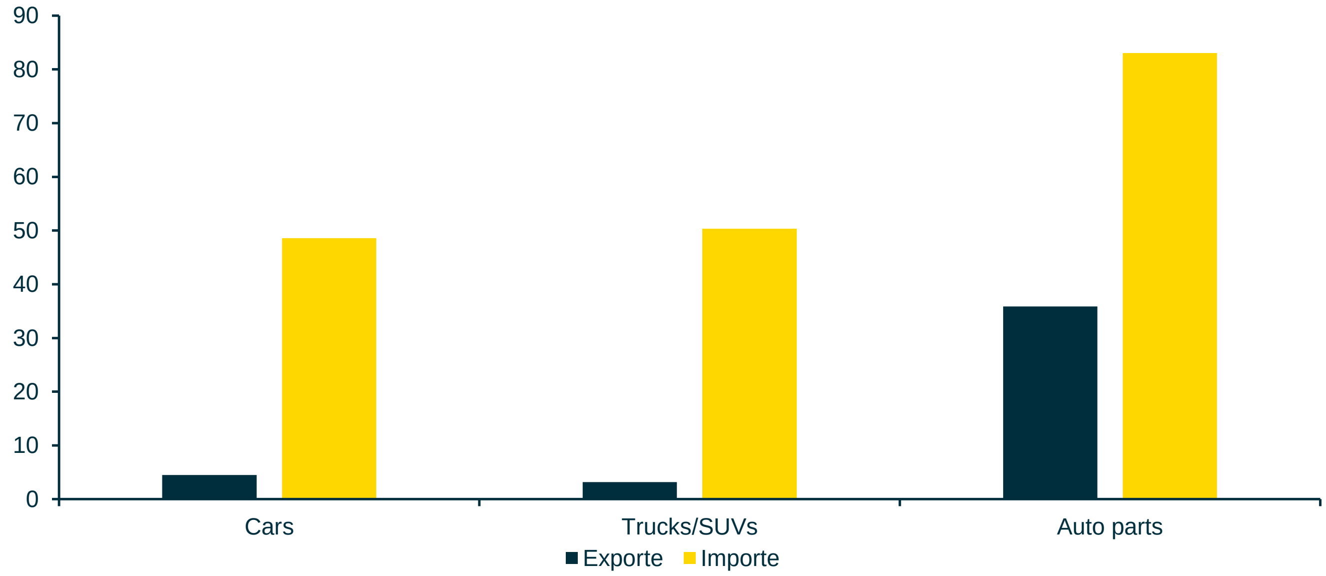
Source: US Census Bureau, Commerzbank Research

Mexico: a risk for the automotive industry

Countless automotive companies and suppliers have set up in Mexico, relying on permanently low tariffs in the North American Free Trade Agreement zone (now the USMCA). Many of these are subsidiaries of American manufacturers. The plants in Mexico are tightly integrated into the US automotive industry's production and supply chains. According to industry sources, components are transported back and forth across the border multiple times as they pass through the various stages of the value chain. It seems hardly possible to quickly reorganize the production chains. The affected carmakers are therefore likely to face significantly higher input costs. Not least, a high level of bureaucracy is to be expected in order to collect the tariffs in the case of such closely intertwined production chains.

Chart 3 - Auto industry: Mexico as America's workbench

US exports to and imports from Mexico, autos and auto parts, 12 months to November 2024, in billion dollars



Source: US Bureau of the Census, Commerzbank Research

How are trading partners reacting?

Canada has announced a 25% tariff on US imports worth 155 billion Canadian dollars. Starting tomorrow, it will initially affect American products such as orange juice, peanut butter, wine, spirits, beer, coffee, household appliances, clothing, shoes, motorcycles, cosmetics, and pulp and paper. The second phase will begin in three weeks and will include products such as cars and trucks, steel and aluminum products, certain fruits and vegetables, aerospace products, beef, pork, dairy products, recreational vehicles and recreational boats.

Mexico's President Sheinbaum has also stated that retaliatory tariffs will be imposed. Details are to be announced later today, Monday.

China announced that it would challenge President Trump's move at the WTO and take other countermeasures, but without specifying which measures would be taken and without explicitly threatening to impose retaliatory tariffs. The official statement also left the door open to talks between Washington and Beijing. It is possible that China will hold back to avoid an escalating trade war with the US. After all, the Chinese government urgently needs to focus on the economic problems in its own country. At the same time, the problem of fentanyl imports, which Trump cited as the reason for the tariffs on China, should be relatively easy to solve. A more detailed analysis on the impact on China can be found **here**.

EU: tariffs ahead

The EU is already indirectly affected by the tariffs that have been imposed, because many companies from Europe produce in Canada, Mexico and China for the US market. This applies in particular to the German automotive industry. Added to this is the general uncertainty among companies, as basic parameters that were once considered incontrovertible no longer apply. With the foreseeable tariffs on imports from the EU, the currency union would then also be directly affected.

How should the EU best react to the new US trade policy? One starting point is Donald Trump's apparent transaction-oriented approach: if you offer him something, he might refrain from imposing overly drastic tariff increases. In the short term, the EU could commit to importing more liquefied natural gas (LNG) from the US. This could be used in particular to replace the still high supplies from Russia, which would in any case be in line with the aim of better enforcing sanctions against Russia. The EU could reduce various tariffs. For example, a 10% tariff is levied on the import of cars from the US, whereas the US only charges a 2.5% tariff on such vehicles. And finally, the EU could commit to higher defense spending, which is in its interest anyway.

However, the risk is that Trump apparently wants to impose tariffs first and only then negotiate. The EU will therefore hardly be able to avoid retaliatory measures, which increases the risk of escalation.

Who pays the tariffs?

The importer pays the tariff initially. It is not so easy to say who ultimately bears the costs: if the importers can pass on the tariff increases in full to their customers, then the Americans foot the bill. In this case, the tariffs are nothing more than a discriminatory sales tax (discriminatory because domestic products and importers from countries not affected by the tariff measures are not burdened) on domestic consumption. However, the US government hopes that Mexican, Canadian or Chinese exporters will be forced to lower their prices in order to continue selling their products. A stronger dollar, if the tariffs remain in place for a longer period, could also reduce the inflationary effects, but work against the purpose of the tariffs. After all, a stronger dollar would make US exports more expensive on the world market. The effect on the trade deficit would be significantly dampened. In any case, such drastic tariffs, which affect large parts of US foreign trade, are associated with considerable inefficiencies.

Even Donald Trump now recognizes that the tariffs could imply "pain" for Americans. However, he added on his social media platform: “BUT WE WILL MAKE AMERICA GREAT AGAIN, AND IT WILL ALL BE WORTH THE PRICE THAT MUST BE PAID.” (original in capital letters).

USA: The rule book goes out the window

It is noteworthy that Trump is targeting close allies in particular, while the major geopolitical rival China is getting off comparatively lightly. The Chinese reaction already shows that they have no interest in an escalation. Apparently, they would rather watch how the US deals with its allies.

From the US point of view, at least from an economic perspective, there are no more allies, only rivals. In such an environment, the US feels constrained by the rules that have been established in the decades following World War II (not least at the instigation of the Americans). However, an escalating global trade war is likely to produce only losers.

And even if the crisis is quickly resolved and the tariffs are lifted, a considerable amount of trust will have been lost. Companies will think twice about continuing to spend money on investment projects – some of which have a horizon of well over 10 years – in Mexico or other countries. After all, it seems that one can no longer rely on the spirit and letter of signed trade agreements. This may be, of course, an intended consequence of Trump's policy. However, it will also be accompanied by considerable adjustment pains for US industry.

Whether Trump, supported by the enormous US domestic market, will be successful depends above all on how high the costs of the trade conflict will be for Americans. In the short term, a significant slump in the stock markets would be the best way to change his mind. So far, the markets have reacted negatively, but only to a limited extent.

Analysts

Bernd Weidensteiner AC
Senior Economist
+49 69 9353 45625
bernd.weidensteiner@commerzbank.com

Dr. Christoph Balz AC
Senior Economist
+49 69 9353 45592
christoph.balz@commerzbank.com

This report was completed 3/2/2025 09:47 CET and disseminated 3/2/2025 09:47 CET.

This document has been created and published by the Group Research department (GM-R) within the Group Management division of Commerzbank AG, Frankfurt/Main or Commerzbank's non-US branch offices mentioned in the document.

Analyst Certification (AC): The author(s), denoted by AC at the beginning of this report, individually certifies that the views expressed in this report accurately reflect their personal views about the subject securities and issuers; and no part of their compensation was, is, or will be directly or indirectly related to the specific recommendation(s) or views expressed by them contained in this document.

It has not been determined in advance whether and in what intervals this document will be updated. Unless otherwise stated current prices refer to the most recent trading day's closing price or spread which may fluctuate.

Conflicts of interest

Disclosures of potential conflicts of interest relating to Commerzbank AG, its affiliates, subsidiaries (together "Commerzbank") and its relevant employees with respect to the issuers, financial instruments and/or securities forming the subject of this document valid as of the end of the month prior to publication of this document*:

Please refer to the following link for disclosures on companies included in compendium reports or disclosures on any company covered by Commerzbank analysts: **https://commerzbank.bluematrix.com/sellside/Disclosures.action***

*Updating this information may take up to ten days after month end.

Disclaimer

This document is for information purposes only and has been prepared for recipients who, like professional clients according to MiFID II, have the experience, knowledge and expertise to understand information related to the financial markets. The document does not take into account specific circumstances of any recipient and the information contained herein does not constitute the provision of investment advice. It is not intended to be and should not be construed as a recommendation, offer or solicitation to acquire, or dispose of, any of the financial instruments and/or securities mentioned in this document and will not form the basis or a part of any contract or commitment whatsoever. Investors should seek independent professional advice and draw their own conclusions regarding suitability of any transaction including the economic benefits, risks, legal, regulatory, credit, accounting and tax implications.

The information in this document is based on public data obtained from sources believed by Commerzbank to be reliable and in good faith, but no representations, guarantees or warranties are made by Commerzbank with regard to accuracy, completeness or suitability of the data. Commerzbank has not performed any independent review or due diligence of publicly available information regarding an unaffiliated reference asset or index. The opinions and estimates contained herein reflect the current judgement of the author(s) on the date of this document and are subject to change without notice. The opinions do not necessarily correspond to the opinions of Commerzbank. Commerzbank does not have an obligation to update, modify or amend this document or to otherwise notify a reader thereof in the event that any matter stated herein, or any opinion, projection, forecast or estimate set forth herein, changes or subsequently becomes inaccurate.

In order to address potential conflicts of interest Commerzbank's Research department operates independently of other business units of the bank. This is achieved by way of physical and administrative information barriers and separate reporting lines as well as by written internal policies and procedures.

This communication may contain trading ideas where Commerzbank may trade in such financial instruments with customers or other counterparties. Any prices provided herein (other than those that are identified as being historical) are indicative only, and do not represent firm quotes as to either size or price. The past performance of financial instruments is not indicative of future results. No assurance can be given that any financial instrument or issuer described herein would yield favourable investment results. Any forecasts or price targets shown for companies and/or securities discussed in this document may not be achieved due to multiple risk factors including without limitation market volatility, sector volatility, corporate actions, the unavailability of complete and accurate information and/or the subsequent transpiration that underlying assumptions made by Commerzbank or by other sources relied upon in the document were inapposite.

Commerzbank and or its affiliates may act as a market maker in the instrument(s) and or its derivative that has been mentioned in our research reports. Employees of Commerzbank and or its affiliates may provide written or oral commentary, including trading strategies, to our clients and business units that may be contrary to the opinions conveyed in this research report. Commerzbank may perform or seek to perform investment banking services for issuers mentioned in research reports.

Neither Commerzbank nor any of its respective directors, officers or employees accepts any responsibility or liability whatsoever for any expense, loss or damages arising out of or in any way connected with the use of all or any part of this document.

Commerzbank may provide hyperlinks to websites of entities mentioned in this document, however the inclusion of a link does not imply that Commerzbank endorses, recommends or approves any material on the linked page or accessible from it. Commerzbank does not accept responsibility whatsoever for any such material, nor for any consequences of its use.

This document is for the use of the addressees only and may not be reproduced, redistributed or passed on to any other person or published, in whole or in part, for any purpose, without the prior, written consent of Commerzbank. The manner of distributing this document may be restricted by law or regulation in certain countries, including the United States. Persons into whose possession this document may come are required to inform themselves about and to observe such restrictions. By accepting this document, a recipient hereof agrees to be bound by the foregoing limitations.

Additional notes to readers in the following countries:

Germany: Commerzbank AG is registered in the Commercial Register at Amtsgericht Frankfurt under the number HRB 32000. Commerzbank AG is supervised by both the German regulator, Bundesanstalt für Finanzdienstleistungsaufsicht (BaFin), Graurheindorfer Strasse 108, 53117 Bonn, Marie-Curie-Strasse 24-28, 60439 Frankfurt am Main and the European Central Bank, Sonnemannstrasse 20, 60314 Frankfurt am Main, Germany.

United Kingdom: This document is not for distribution to retail customers and has been issued or approved for issue in the United Kingdom by Commerzbank AG, London Branch, which is authorised and regulated by Bundesanstalt für Finanzdienstleistungsaufsicht (BaFin) and the European Central Bank. Authorised by the Prudential Regulation Authority. Subject to regulation by the Financial Conduct Authority and limited regulation by the Prudential Regulation Authority. Details about the extent of our regulation by the Prudential Regulation Authority are available from us on request.

United States: This research report was prepared by Commerzbank AG, a company authorized to engage in securities activities in Germany and the European Economic Area (EEA). Commerzbank AG is not a U.S. registered broker-dealer and is therefore not subject to U.S. rules regarding the preparation of research and associated rules pertaining to research analysts. This document is not for distribution to retail customers. Any distribution of this research report to U.S. investors is intended for “major U.S. institutional investors” in reliance on the exemption from registration provided by Rule 15a-6(a)(2) of the U.S. Securities Exchange Act of 1934, as amended (the “Exchange Act”). Any U.S. recipient of this research report seeking to effect transactions to buy or sell securities, or related financial instruments based upon the information provided in this research report, may only do so through a Financial Industry Regulatory Authority (FINRA) registered broker-dealer. Commerz Markets LLC (CMLLC) is a U.S. registered broker-dealer and wholly owned subsidiary of Commerzbank AG. Commerzbank AG is a registered derivatives swap dealer with the Commodity Futures Trading Commission (CFTC), in accordance with the Dodd-Frank Wall Street Reform and Consumer Protection Act. U.S. Person(s) and related Dodd-Frank relevant investors seeking to effect transactions in non-security based swaps based upon the information provided in this research report, may only do so through a CFTC registered swap dealer.

Canada: The information contained herein is not, and under no circumstances is to be construed as, a prospectus, an advertisement, a public offering, an offer to sell securities described herein, solicitation of an offer to buy securities described herein, in Canada or any province or territory thereof. Any offer or sale of the securities described herein in Canada will be made only under an exemption from the requirements to file a prospectus with the relevant Canadian securities regulators and only by a dealer properly registered under applicable securities laws or, alternatively, pursuant to an exemption from the dealer registration requirement in the relevant province or territory of Canada in which such offer or sale is made. Under no circumstances is the information contained herein to be construed as investment advice in any province or territory of Canada and is not tailored to the needs of the recipient. In Canada, the information contained herein is intended solely for distribution to Permitted Clients (as such term is defined in National Instrument 31-103) with whom Commerzbank AG and/or Commerz Markets LLC deals pursuant to the international dealer exemption. The information contained herein is not permitted to reference securities of an issuer incorporated, formed or created under the laws of Canada or a province or territory of Canada, as Commerzbank AG and Commerz Markets LLC operates under the international dealer exemption pursuant to National Instrument 31-103. No securities commission or similar regulatory authority in Canada has reviewed or in any way passed upon these materials, the information contained herein or the merits of the securities described herein and any representation to the contrary is an offence.

European Economic Area: Where this document has been produced by a legal entity outside of the EEA, the document has been re-issued by Commerzbank AG, London Branch for distribution into the EEA. Commerzbank AG, London Branch is authorised and regulated by Bundesanstalt für Finanzdienstleistungsaufsicht (BaFin) and the European Central Bank. Authorised by the Prudential Regulation Authority. Subject to regulation by the Financial Conduct Authority and limited regulation by the Prudential Regulation Authority. Details about the extent of our regulation by the Prudential Regulation Authority are available from us on request.

Switzerland: This document is generally not for distribution to retail clients. Neither this research report nor the information contained herein should be regarded as personal recommendations for transactions in financial instruments within the meaning of the Financial Services Act.

Singapore: This document is furnished in Singapore by Commerzbank AG, Singapore branch. It may only be received in Singapore by an institutional investor, an accredited investor or an expert investor as respectively defined in section 4A of the Securities and Futures Act, Chapter 289 of Singapore (“SFA”) pursuant to section 274 or section 275 (as applicable) of the SFA. Nothing in this document constitutes accounting, legal, regulatory, tax, financial or other advice and/or recommendations to the recipient of this communication. Further, the communication/information provided herein does not constitute a “financial advisory service” within the meaning of the Financial Advisers Act, Chapter 110 of Singapore (“FAA”) and therefore, the regulatory requirements and duties that may be owed to a client pursuant to or in connection with the FAA are not applicable to the recipient in connection with this communication. Recipients are advised to seek independent advice from their own professional advisers about the information contained discussed herein.

Japan: This information and its distribution do not constitute and should not be construed as a "solicitation" under the Financial Instrument Exchange Act (FIEA) of Japan. This information may be distributed from Commerzbank international branches outside Japan solely to "professional investors" as defined in Article 2(31) of the FIEA and Article 23 of the Cabinet Ordinance Regarding

Commerzbank Offices

Frankfurt	**London**	**New York**	**Singapore**
Commerzbank AG	Commerzbank AG	Commerz Markets LLC	Commerzbank AG
DLZ - Gebäude 2, Händlerhaus	PO BOX 52715	225 Liberty Street, 32nd floor,	128 Beach Road
Mainzer Landstraße 153	30 Gresham Street	New York,	#17-01 Guoco Midtown
60327 Frankfurt	London, EC2P 2XY	NY 10281-1050	Singapore 189773
Tel: + 49 69 136 21200	Tel: + 44 207 623 8000	Tel: + 1 212 703 4000	Tel: +65 631 10000