



## Trump's shock and awe strategy

If the US does impose tariffs on Canada and Mexico over the weekend, these are intended to force political concessions from those countries. However, tariffs could soon also be increased for economic reasons. We describe our understanding of US trade policy and highlight risks.

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### Trump is initially using tariffs as leverage on immigration, ...

For Donald Trump, there are a number of reasons for imposing tariffs. Firstly, they are intended to combat “unfair trade practices” (also known as trade deficits). Secondly, they are used to generate revenue, for example to finance tax cuts. And thirdly, tariffs are a tool in practically all other disputes to force the other side to make concessions.

In the first days of his presidency, the third motive was the main focus. Trump threatened to impose tariffs to combat illegal immigration to the US. After all, border security is the number one issue for many of his voters. Several countries were targeted:

- Last weekend, the **Colombian** government initially refused to allow deportation flights from the US to land. Trump responded by threatening an immediate tariff of 25%, which would increase to 50% in a week. Since the US is Colombia's most important export market, the Colombian government, according to the White House, responded by caving in, causing Donald Trump to refrain from implementing the threatened punitive measures.
- According to press reports, there are growing signs that Trump could take action against **Canada** and **Mexico** this weekend. Shortly after his inauguration, Trump had suggested a 25% tariff on imports from Mexico and Canada, with a possible date of February 1. He justified this by saying that these countries were not doing enough to combat the flow of migrants and drugs such as fentanyl into the US. The threatened additional 10% customs duty on imports from **China** was justified by the fact that China supplies chemicals that are used to produce fentanyl to Mexico.

### ...but soon also as a remedy for the trade deficit

While these threatened measures were pursuing non-economic goals, the fight against the high trade deficit is likely to come to the fore soon. The fact that Trump has held back so far may also be due to the fact that some of the legal bases for imposing tariffs require prior investigations. Accordingly, Trump has instructed the relevant authorities to submit reports by April 1 on unfair trade practices by other countries, currency manipulation, discriminatory foreign taxes and technology transfer practices. They are also to propose measures to reduce the considerable US trade deficit. Based on the analyses available in April, Trump will then have a wide range of options for targeting individual countries, industries or entire groups of countries.

### What is on the horizon?

In recent days, the following tariff plans in particular have been making headlines:

- The new Treasury Secretary Bessent seems to favor a general tariff that starts at 2.5% and is raised by 2.5 percentage points each month until a maximum rate of, say, 20% is reached. A general tariff of this kind would limit evasive action – such as the rerouting of Chinese exports destined for the US via Vietnam – and also take account of the revenue motive that Trump repeatedly cites.
- Trump himself thought 2.5% was much too low and talked about tariffs on selected products. “We’re going to look at pharmaceuticals – drugs – we’re going to look at chips and semiconductors, and we’re going to look at steel and some other industries,” he said. He also called for tariffs to be imposed on copper and aluminum produced abroad.
- Even without direct government action, Congress is already targeting China. For example, some members of Congress have already introduced a bill in the Senate and House of Representatives (with the support of Democrats) to withdraw China's status as a “Permanent Normal Trade Relations.” According to the bill, a 100% tariff would be imposed on goods from China classified as strategic, and a minimum tariff of 35% would be levied on the rest. A robust approach against China has bipartisan support.

So far, there has been little concrete information regarding action against the EU. However, Trump repeatedly addresses the high US deficit in bilateral trade. In Davos, he recently said that the EU was treating the US “very, very unfairly, very badly”. He has repeatedly targeted Germany, and in particular the German automotive industry. This means that tariffs against the EU remain possible. This applies all the more since the EU itself is also tending towards protectionism instead of pragmatically seeking a deal with Trump.

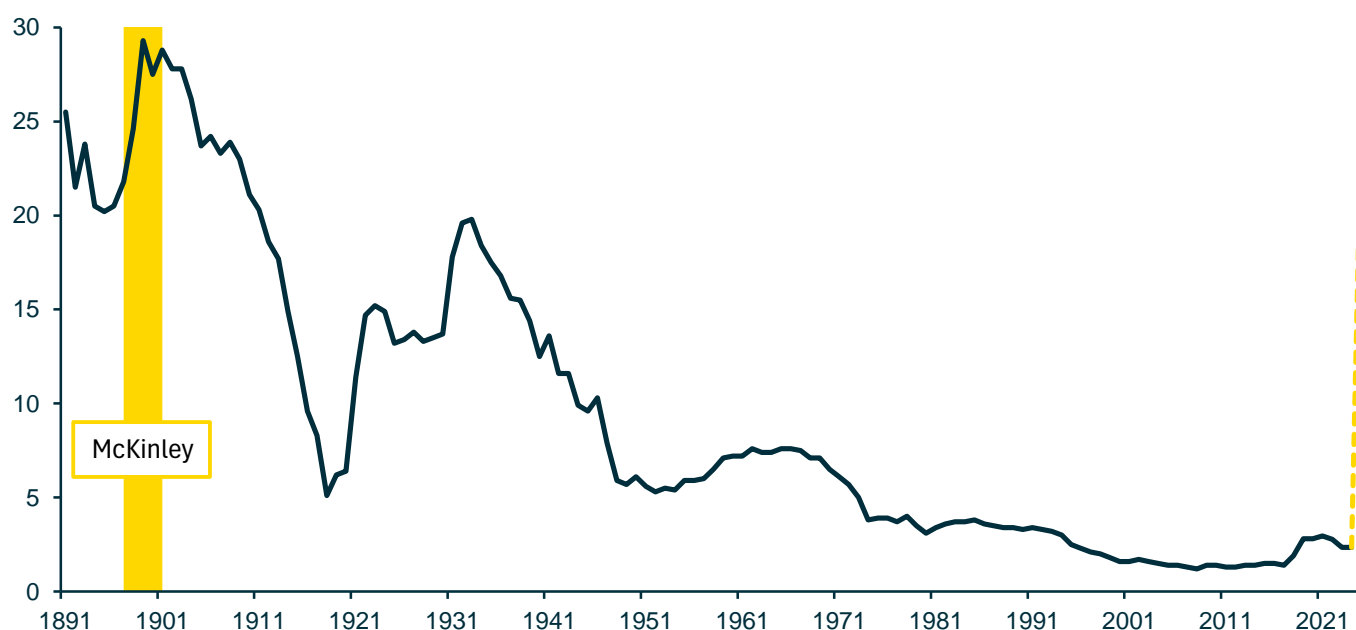


## USA says goodbye to free trade

Despite the tariff increases in Trump's first term and a few more under Biden, the US still has a low-tariff economy overall. The effective tariff – i.e. tariff revenues as a percentage of total import value – is currently 2.3%. Two-thirds of goods still enter the country duty-free. If Trump implements his tariff plans, the system of relatively free trade established after the Second World War would be over. A general tariff of 25% would take the US back to the 19th century. It is no coincidence that Donald Trump regards President McKinley as a great role model. Under McKinley's leadership from 1897 to 1901, US tariffs reached their peak (Chart 1).

**Chart 1 - US tariffs: back to the 19th century?**

Effective tariff rate (duties collected in % of total imports), annual data



Source: USTR, Census, Commerzbank Research

## “New” trade policy...

In doing so, Trump is obviously pursuing a ‘shock and awe’ strategy. The aim is to paralyze the opponent and break their will to fight by using overwhelming power and spectacular actions. As in the conflict with Colombia, this is intended to bring quick successes. These are also necessary from Trump's point of view, since he only has a limited amount of time available. He can currently take advantage of the fact that the domestic opposition is still disorganized and that the trade partners have not yet adjusted to the new administration. In addition, his options for action could be limited in two years if the Republicans lose their narrow majority in one of the two chambers in the 2026 midterm congressional elections, which is likely given that the president's party often loses congressional seats in midterm elections. In addition, Trump's second term ends in four years without the possibility of re-election.

## ...is to make US manufacturing great again, ...

With his trade policy, Trump wants to make the manufacturing sector the growth engine of the economy again. This is because it is seen as a driver of innovation and should thus indirectly boost the economy as a whole. In addition, there are strategic reasons for a renaissance of manufacturing: against the background of looming conflicts with China and Russia, the development of a strong industrial base also has a deterrent effect. This is because it could be quickly converted to defense production in an emergency, which is not so easy if the production base is no longer sufficiently available. And finally, the longing for a strong industry also has nostalgic reasons. In the past, this sector provided well-paid jobs for Americans without higher education, making it a driving force behind the American dream.

Behind tariff walls, this “golden age” is to be resurrected. The investment uncertainty abroad triggered by an unpredictable tariff policy is certainly intentional. After all, the aim is to persuade foreign companies to set up plants in the US.



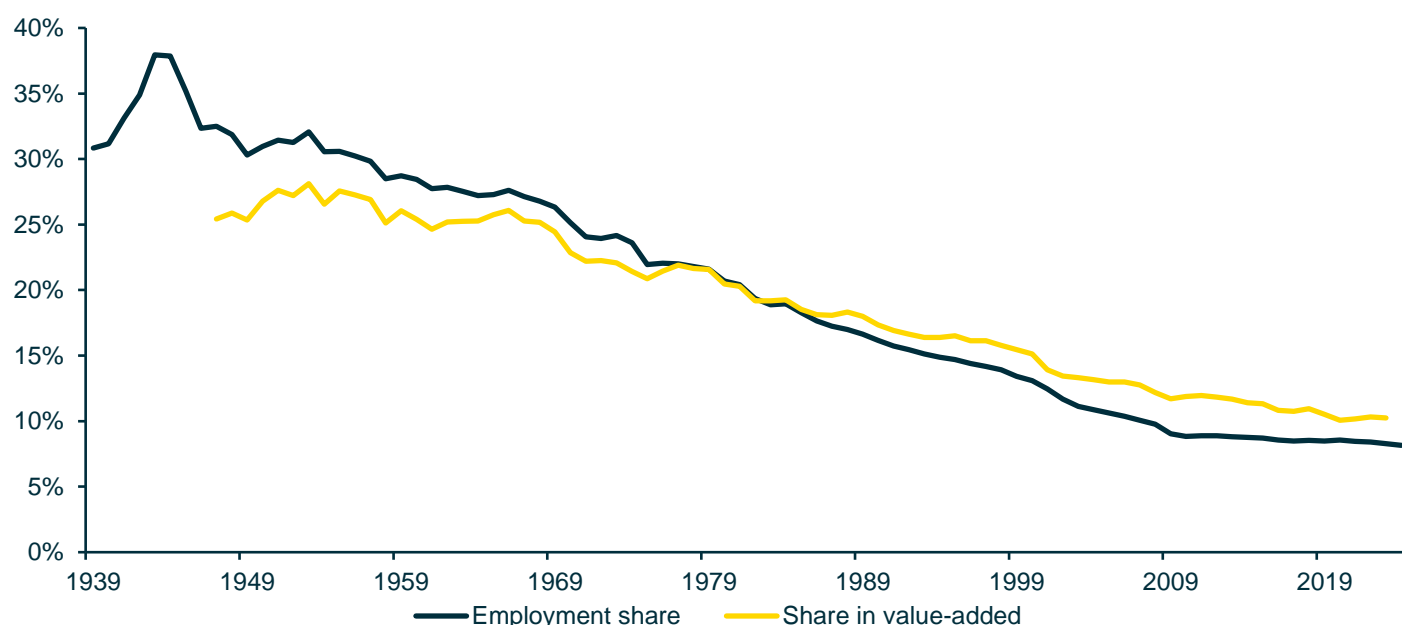
## ... but has little prospect of success,...

The relative decline of manufacturing is not unique to the US, however, nor did it only begin when China entered the world market with allegedly unfair means. The share of the manufacturing sector in US economic output fell fairly steadily from 29% in 1950 to 10% most recently. The share of manufacturing employment peaked at almost 40% during the Second World War and is now down to just 8%. Even if the US were to succeed in balancing its trade by increasing domestic production, the share of value added by industry would only rise to around 13-14%, i.e. roughly the level at the beginning of the 21st century.

However, this would hardly increase economic output, but rather come at the expense of other sectors. After all, the US economy is already operating close to capacity, and the unemployment rate is very low at 4.1%. In order to significantly increase industrial production, workers would have to be transferred from other sectors to manufacturing, especially if the planned mass deportation of undocumented immigrants were to reduce the labor force in any case. Thus, high tariff walls would probably not primarily increase real gross domestic product, but rather push up inflation in the US.

### Chart 2 - The times of the US as an "industrial country" are over

Manufacturing share of non-farm employment and of GDP, annual data in %



Source: BEA, BLS, S&P Global, Commerzbank Research

## ... and could cause major damage

With his shock strategy, Trump is likely to harm the US in the longer term. If Trump does impose tariffs on imports from Canada and Mexico in the short term despite the USMCA free trade agreement, many partners will question the value of agreements with the US.

At the same time, other countries will be incentivized to expand trade among themselves to compensate for the loss of markets in the US. The trade agreement between the EU and the Mercosur countries in South America is aimed in this direction. According to the World Bank, international trade as a percentage of GDP increased in 72% of countries between 2016 and 2023. In the US, by contrast, foreign trade has become less important. In the longer term, the US faces the threat of marginalization in international trade, which will slow productivity and growth.

## What can Europe do?

The US administration appears determined to pursue its objectives with robust methods. The question is how the EU can best respond to the new US trade policy. One approach could be to take the apparently transaction-oriented approach of Donald Trump: if he is offered something, he might refrain from raising tariffs too drastically. In particular, we see the following possibilities:

- In the short term, the EU could commit to importing more liquefied natural gas (LNG) from the US. This could be used 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.



According to Eurostat, the EU imported almost 16 bn m<sup>3</sup> of LNG from Russia in the 12 months to November 2024 (these imports have remained relatively constant at this relatively high level since 2022). During the same period, 34 bn m<sup>3</sup> were imported from the USA.

- The EU could reduce various tariffs. For example, a 10% tariff is levied on imports of passenger cars from the US, whereas the US only charges a 2.5% tariff on such vehicles. This would create the level playing field that Trump has been calling for.
- Finally, higher defense spending is necessary for Europe's own interests. This would meet one of Trump's demands. In addition, higher imports of defense equipment from the US could be promised.

However, all these measures would only moderately reduce the US's high deficit in goods trade with the EU (currently around \$230 billion a year). It would be more important to boost domestic demand in the EU, which would also increase the demand for imports. Given the current growth differentials between the US and the EU, no significant reduction in the bilateral deficit can be expected otherwise. At least the EU could gain time with the above-mentioned concessions.



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