



The consequences of Mr. Trump's tariffs

On Wednesday, Donald Trump announced massive tariff increases on US imports. We analyse possible reactions by the EU and the effects on growth, inflation and the ECB.

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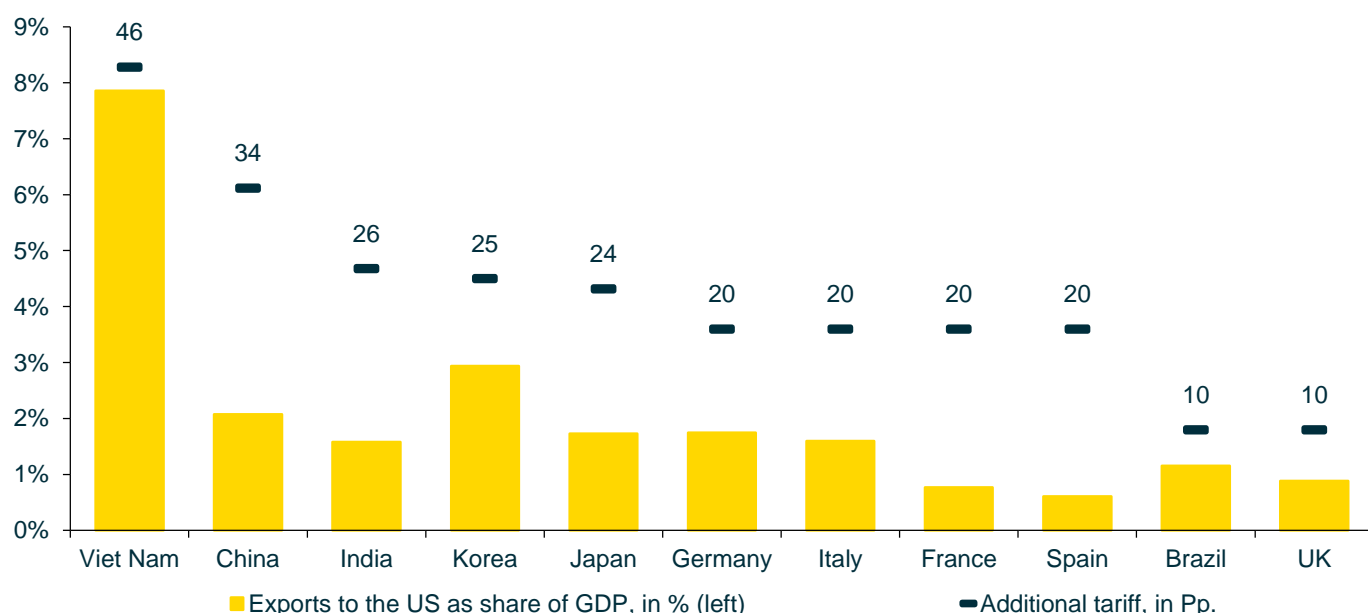
Who will be hit by Mr. Trump's tariff hammer?

In principle, Trump's so-called reciprocal tariffs affect imports from almost all countries. The US administration is already raising the general tariff rate by 10 percentage points on 5 April for all goods not originating from Canada or Mexico. However, there are exceptions for some products such as pharmaceutical products, chemicals, fossil fuels and semiconductors, which account for about a fifth of US imports (see our [Economic Briefing](#) for a more detailed explanation). On April 9, the reciprocal tariffs will then be raised from 10 percentage points to a specific tariff for each partner country (Chart 1).

Depending on the level of this specific tariff rate and the share of direct goods exports in domestic production, the economies of the US trading partners will be affected to different degrees. Among the major trading partners, Viet Nam and South Korea are likely to be particularly hard hit. The tariff on goods from Vietnam will be increased by 46 percentage points, and a considerable share of this country's economic output is exported to the US. Among the developed economies, South Korea is particularly dependent on the US market. Germany and Italy are in the middle of the pack in this regard. The additional tariff of 20% is somewhat lower than that on deliveries from Asian countries, and direct exports of goods from Germany (and Italy) account for 'only' just under 2 per cent of GDP.

Chart 1 - Which countries are hit by the tariffs?

Additional tariff in percentage points, domestic value added in direct goods exports to the United States as share of total domestic value added in % as of 2019 (right),



Source: OECD, White House, Commerzbank-Research

How will the EU react?

At a press conference on Thursday morning, the European Union (EU) announced a firm but level-headed response. The EU is also counting on negotiations. In an initial reaction, EU Commission President Ursula von der Leyen regretted the US tariffs and emphasized the negative consequences for the global economy. However, she seems to want to keep the door open for negotiations. She also sees significant defects in the world trade system and agrees with President Trump that *'others are taking unfair advantage of the current rules'*. She stresses the EU's willingness to negotiate. Accordingly, a delegation is to fly to Washington in the near future. The delegation is likely to be equipped with offers such as tariff reductions, a simplification of standards and joint investments



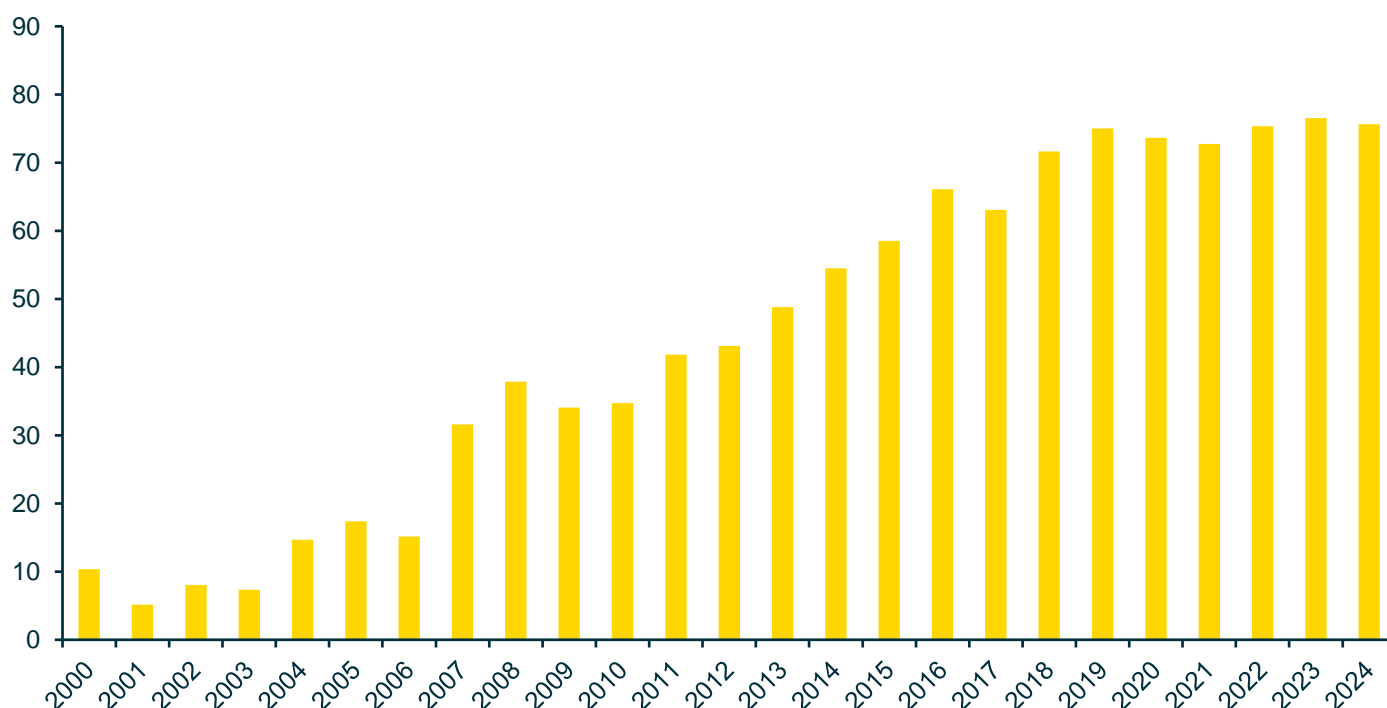
in security. However, von der Leyen also underlined that the EU is prepared to take further countermeasures. The EU has various measures at its disposal:

(1) Conventional countermeasures primarily include counter-tariffs on imports from the US. On 14 April, the first package of counter-tariffs in response to the US tariffs on steel and aluminum is to come into force. Another package, which will probably be significantly larger, will be worked out in detail during the ongoing negotiations. However, the EU is likely to refrain from imposing counter-tariffs on intermediate goods and raw materials that are important for industry. The European Commission can impose this independently.

(2) Anti-coercion instruments will only be activated if there is no prospect of success in negotiations with the Trump administration. Brussels could then take measures such as restricting the EU market for US companies or increasing taxation on US companies. This could also affect American tech companies and online service providers. Finally, the EU could also target trade in services. The Americans have a surplus of around 75 billion dollars in this area (Chart 2).

Chart 2 - Unfair! US has a services trade surplus with the EU

US services trade balance with EU, annual data in billion dollars



Source: Census, S&P Global, Commerzbank Research

Is Trump willing to make a deal with the EU?

The outcome of the negotiations will also depend on the extent to which the US economy itself is affected by an intensified trade conflict. The immediate reaction of the financial markets indicates that there are fears of major damages.

The erratic and confrontational economic policy destroys the basis for planning and causes companies and consumers to hold back. In addition, the foreseeable price increases reduce consumers' real income, which is likely to curb consumption accordingly. And companies are also suffering from the increase in the price of primary products. Retaliatory measures by trading partners could also close foreign markets for American exports.

Whether companies will relocate production on a large scale to the US as compensation is rather questionable. In view of the U-turns in US tariff policy, which sometimes take place every few days, it is almost impossible to predict what will apply in four or five years' time, when such production facilities would start operations.

In view of these risks, we already scaled back our growth forecast for 2025 from 2.3 per cent to 2.0 per cent a few weeks ago and now see a roughly one-third probability of a recession. That said, our baseline scenario remains that the US economy will continue to



expand, albeit at a slower pace. After all, it has still significant momentum, and the financial situation of consumers and businesses remains good on the whole.

We also assume that the EU will achieve at least a partial success in the negotiations in the medium term, not least because of the negative consequences for the US economy that are likely to become increasingly visible. In addition, Trump could sell EU concessions well in the media and mitigate the negative consequences of tariffs on the US economy. In our baseline scenario for the coming years, some sector-specific tariffs, such as those on cars, will remain in place. However, the EU's reciprocal tariff of 20% on all goods could be reduced over the coming months.

What does this mean for the euro area and the ECB?

However, this would still result in a significant increase in tariffs on euro area exports to the US, weighing on the economy. For example, tariffs on China during Trump's first presidency noticeably reduced Chinese exports. It is true that some countervailing effects [1] are likely to mitigate the impact on the economy as a whole. However, we expect that the tariffs alone will push down eurozone GDP by up to 0.3% in our baseline scenario, with the EU negotiating a successful outcome and sectoral tariffs remaining in place.

The weaker economy also suggests lower inflation. In addition, companies whose access to the US market is restricted are likely to increasingly push their products onto European markets. This increases supply in this country and reduces price pressure. This is also likely to at least offset the price-driving effect of possible counter-tariffs.

Both the economic damage and the low price pressure increase the likelihood that the ECB will cut key rates further. This applies despite the great uncertainty associated with Trump's tariffs. We therefore continue to expect the ECB to cut interest rates twice more in the coming months.

[1] The following effects should somewhat mitigate the burden of the US tariffs on the German economy. For example, some export goods may be diverted to the domestic market or to other countries. In addition, EU goods will become relatively cheaper on the US market compared to Chinese, Japanese or South Korean goods, as higher tariffs will be imposed on the latter. Finally, EU goods could become cheaper than US products on the world market, as the competitiveness of the US economy will suffer from higher prices for intermediate products. ([back to text](#))



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This report was completed 4/4/2025 07:28 CEST and disseminated 4/4/2025 07:28 CEST.

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