US tariffs vs. German fiscal policy – who wins?

Dr. Ralph Solveen AC

Following the trade agreement between the EU and the US, tariffs on US imports from the EU will be significantly higher than before Donald Trump took office. Although this will slow down German exports to the US, it will not prevent the generally expected upturn in the German economy. This is because the new German government's expansionary fiscal policy and the ECB's interest rate cuts will more than offset this negative effect. For the rest of the eurozone, the net effect of higher tariffs, lower ECB interest rates, and national fiscal policy is less clear.

Higher US tariffs ...

Last weekend, the EU Commission and the US government agreed on a trade deal. Under this deal, most shipments from the EU to the US will be hit with a 15% tariff. Aluminum and steel, as well as related products, will still be taxed at 50%, while some goods like aircraft and aircraft parts, certain chemicals, and generic drugs can be imported into the US without tariffs (see also **here**).

... slow down German exports to the US

According to our estimates, the effective average tariff rate on US imports from Germany will be 12.8% based on these agreements. This would be significantly higher than when Donald Trump took office in January this year and also slightly higher than in May, the last month for which official figures on the effective tariff rate are available (title chart).

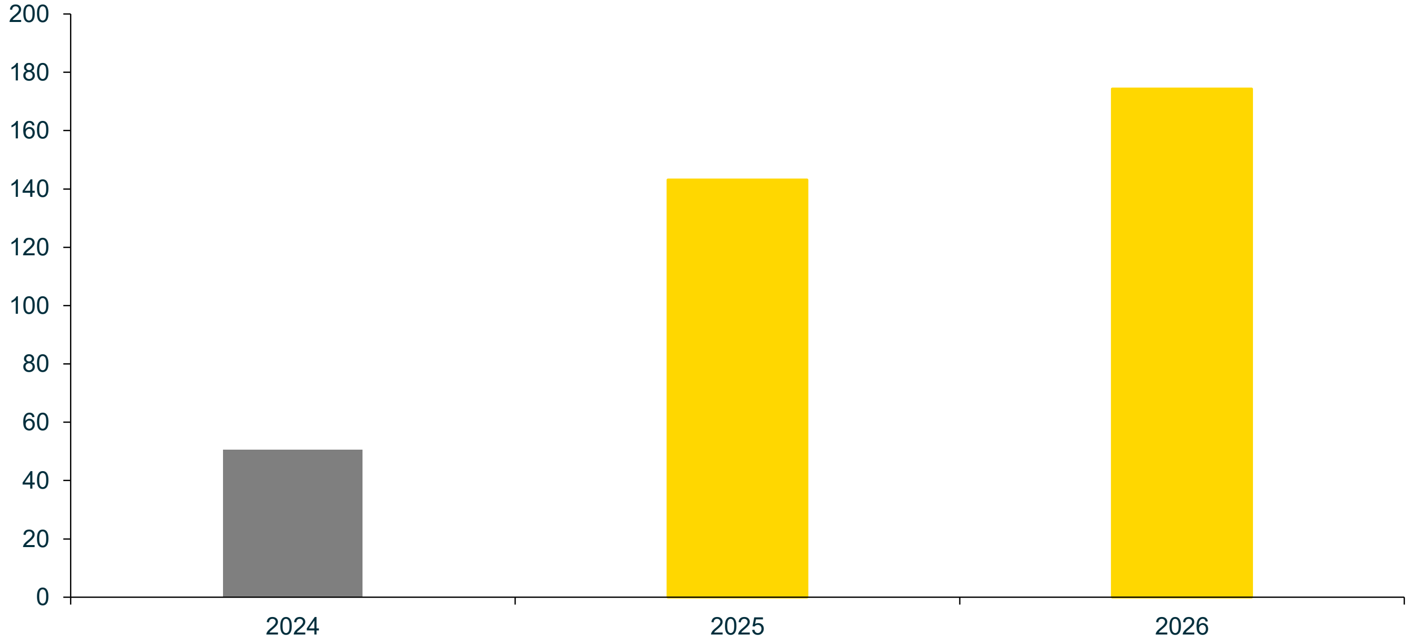
This significantly higher tariff clearly makes it much more difficult for German companies to access their most important export market, thereby slowing German exports to the US. Based on experience from Trump's first term in office, when he imposed high tariffs on imports from China in particular, price-adjusted German exports are likely to be between 20% and 25% lower in two years than they would have been without these changes. This is likely to reduce real GDP by up to 0.4% on its own. With demand from China also weakening at the same time, exports to countries outside the EU are likely to slow down the German economy.

However, fiscal policy is providing a massive boost to the economy ...

However, this is unlikely to halt the gradual recovery of the German economy. This is because the burden of higher tariffs is being offset by a number of expansionary factors. First and foremost among these is the massive shift in German fiscal policy. After all, new borrowing on the federal level next year, including various special-purpose funds, is expected to be almost €124 billion higher than in 2024 (Chart 1). This corresponds to just under 3% of GDP. Assuming that the states will at least partially use the leeway opened up to them by the amendment to the constitution [1] to increase their deficits, this will result in a fiscal stimulus of a good 3% of GDP for 2025 and 2026 combined.

Chart 1 - Federal government will ramp up its deficit

Budget deficit of the federal level, in bn Euro; 2025 and 2026 according to the budget drafts



Source: German ministry of finance, Commerzbank Research

According to current plans, the majority of the increase in the deficit is to occur in the current year. However, the budget for this year will probably not be approved until September at the earliest, meaning that a considerable portion of the additional expenditure planned for 2025 will probably not be incurred. This means that, contrary to the plans of the Ministry of Finance, the majority of the fiscal stimulus is likely to take effect only next year.

… and more than outweighs the tariff effect …

The extent of this effect depends on many uncertain factors: How much will the deficit increase in 2025, and how much of this increase will occur in 2026? To what extent will significantly stronger government demand drive up prices, so that the “real” effect of higher spending is less than its nominal increase? To what extent will higher government spending boost private sector demand, e.g., because defense companies invest in expanding their production capacities in view of the looming stronger government demand?

The actual stimulus provided by fiscal policy to the economy is likely to be significantly smaller than the increase in nominal spending, particularly due to the price-driving effect of significantly higher government spending. However, very extreme assumptions would have to be made for the boost from fiscal policy to offset the negative effects of higher tariffs. Rather, the net effect of the two factors is likely to be clearly positive and boost growth by at least half a percentage point in the coming year.

… further bolstered by the ECB's rate cuts

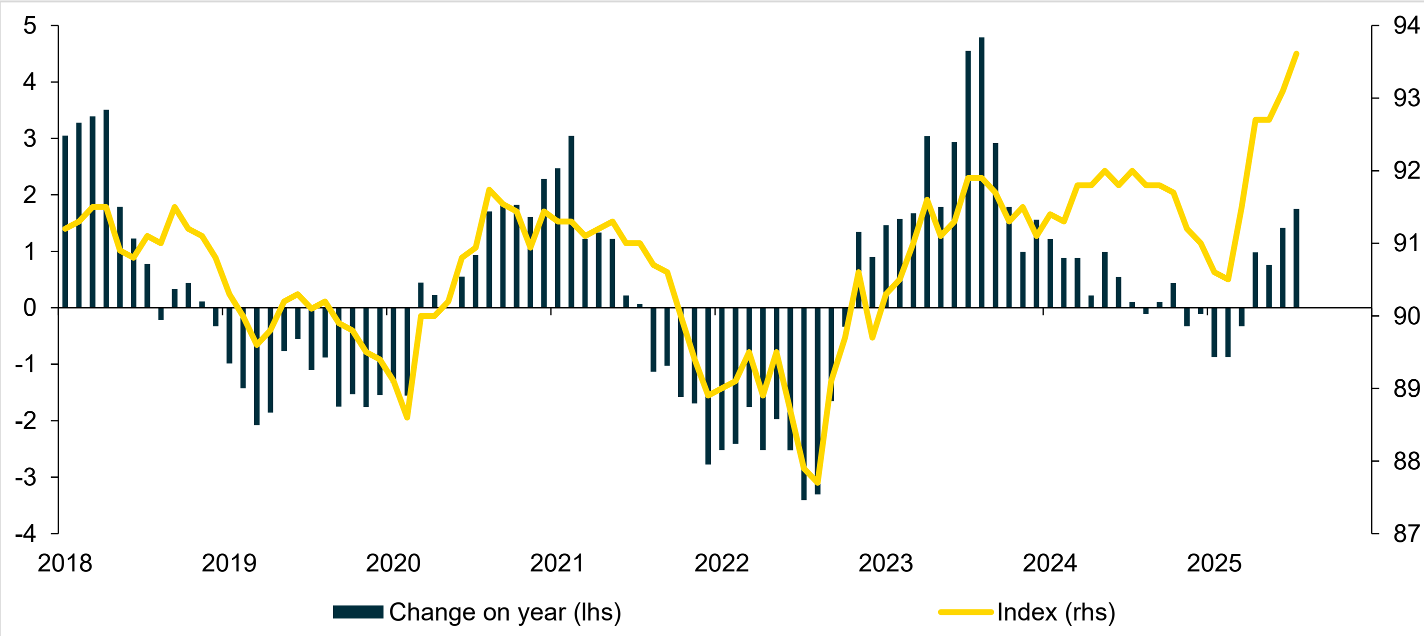
In addition, the interest rate cuts implemented by the ECB since summer 2024 are likely to increasingly take effect. Here, too, the extent of the stimulus and the exact timing of its onset are uncertain. Various studies have come to very different conclusions. However, it is generally assumed that it will take some time for the effects of an interest rate cut to fully feed through to the real economy. Consequently, the positive impact of monetary policy on the economy is likely to increase in the coming months, thereby boosting the economy.

And the stronger euro?

Discussions about the growth prospects for the German economy often refer to the recent strengthening of the euro, which is said to reduce the competitiveness of German products on the world market and thus weigh on exports and the economy as a whole. The focus is usually on the exchange rate against the US dollar, against which the euro has appreciated by a good 10% since the beginning of the year. However, the euro has not appreciated nearly as strongly against other currencies, and the strength of the euro since the beginning of the year follows a period of pronounced weakness – including against the US dollar – in the second half of last year. As a result, the indicator of the German economy's price competitiveness – the real external value of a fictitious D-mark – has risen quite significantly in recent months, pointing to a decline in the competitiveness of German products. However, according to our estimates, the indicator was less than 2% higher in July than a year ago, which is by no means an unusual movement (Chart 2). The resulting dampening effect on the economy is therefore likely to be rather limited.

Chart 2 - Only limited headwind from the FX market

Indicator of the price competitiveness of the German economy, 1999Q1=100 and change on year in percent



Source: Bundesbank, S&P Global, Bloomberg, Commerzbank Research

Conclusion: Positive drivers outweigh negative factors for the German economy...

The bottom line remains that the expected stimulus from monetary and fiscal policy will more than offset the negative effects of higher US tariffs on the German economy in the coming year, and even the slightly stronger euro will not fundamentally alter this positive net effect. We therefore expect the German economy to grow noticeably again in the coming year, at 1.4%, for the first time in quite some time. However, two points should be noted when interpreting this figure: First, 1/4 of a percentage point of this growth rate is attributable to the fact that there will be more working days in Germany in the coming year than in 2025. The internationally standard growth rate adjusted for working day effects is therefore likely to be correspondingly lower. Second, there are no signs as yet that the German government's additional spending will noticeably improve the medium to long-term growth prospects for the German economy. Instead, there is a risk of a flash in the pan fueled by new debt, which will ultimately leave nothing but massively higher debt.

... unlike for many other eurozone countries

However, because of this flash in the pan, the German economy will no longer be at the bottom of the eurozone growth rankings next year, but will instead be somewhere in the middle. This is because the net effect of the factors discussed above for Germany is significantly less favorable in most other eurozone countries. It's true hat, for many economies, exports to the US are less important than for the German economy, so the higher US tariffs will have less of an impact on their economies. However, no other eurozone country will pursue such an expansionary fiscal policy as Germany in the coming year. On the contrary, some countries, such as France and Italy, will even have to reduce their deficits, which will be made more difficult by rising interest rates. In addition, industry accounts for a much smaller share of value added in many countries, and this capital-intensive sector is likely to benefit most from the ECB's interest rate cuts. We therefore expect slightly stronger growth of 1.2% for the eurozone next year, after 1.0% this year. However, if Germany is excluded, the growth rate is likely to be even slightly lower than in the current year.

[1] The federal states are now allowed to have a "structural" deficit in their Budgets – i.e., adjusted for cyclical effects – corresponding to 0.35% of GDP. Previously, they were required to have a structurally balanced budget. (Back to text)

Analysts

Dr. Jörg Krämer AC
Chief Economist
+49 69 136 23650
joerg.kraemer@commerzbank.com

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

This report was completed 1/8/2025 07:22 CEST and disseminated 1/8/2025 07:22 CEST.

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.

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