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EcoFlash

EU-US Trade Deal: A Damage Limitation Success

Presidents Trump and Von der Leyen announced yesterday from Scotland that a trade agreement had been reached. Is it a good deal? Political commentators and many editorialists mostly say no. The stock market reaction says yes. Our take: the deal is at the better end of the spectrum of what could realistically be achieved. Importantly, it removes the risk of a trade war escalation in the world's largest trade relationship, and creates a more predictable environment for firms on both sides of the Atlantic to operate in.

Commentators have been talking of surrender or even outright defeat. This is a misreading of the situation. The deal negotiated by the EU has better terms (see Box) than all negotiated so far by countries with a trade surplus with the US. It contained economic damage rather than expanding it. And it conceded nothing that cannot be alleviated by ongoing domestic policy improvements. Given the imbalance created by EU's continued critical dependency on the US security umbrella, that's nothing to apologise for.

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This was not a classic trade negotiation where the parties seek to expand trade between each other via balanced lowering of trade barriers, even though the European Commission initially envisionned it as such. It was an exercise in resisting regulatory coercion and limiting economic damage in a context where the US had made the unilateral and sovereign policy decision to replace revenue from domestic taxes by taxes on imports.

Let's not forget that President Trump kicked off the negotiations arguing the EU's VAT was a tariff that needed to be dropped off and significantly reduced, and that its tech regulations and digital services taxes were also unacceptable. Ditto for a large number of EU phytosanitary and other safety regulations acting as powerful non-tariff barriers. The EU held firm and made no concessions in these areas.

As to economic damage, most economic modelling of the impact of US tariffs makes clear that 1) the biggest negative impact, particularly in the short term, comes from uncertainty; and 2) GDP growth (of both parties) is more adversely impacted in case of retaliation. Embarking on a prolonged standoff would have been triply harmful to the EU economy:

- by prolonging uncertainty,

- by leading to an even higher level of tariffs while negotiations continued, putting Europe at a disadvantage over other exporters to the US, i.e. at risk of losing market share of a likely shrinking pie.

- by raising the costs of the goods and services that the EU imports from the US and would have been tariffed in the event of a standoff, thereby potentially strengthening the hand of the hawks on the ECB's Governing Council instead of allowing it to deliver a more supportive stance.

Despite this not being a classic "barrier-lowering" trade negotiation, the EU still secured "zero for zero" tariff reductions in a meaningful list of sectors (indeed airplanes and components are among the top traded goods between the US and EU). No other trade deal having reached so far contains similar provisions on this scale.

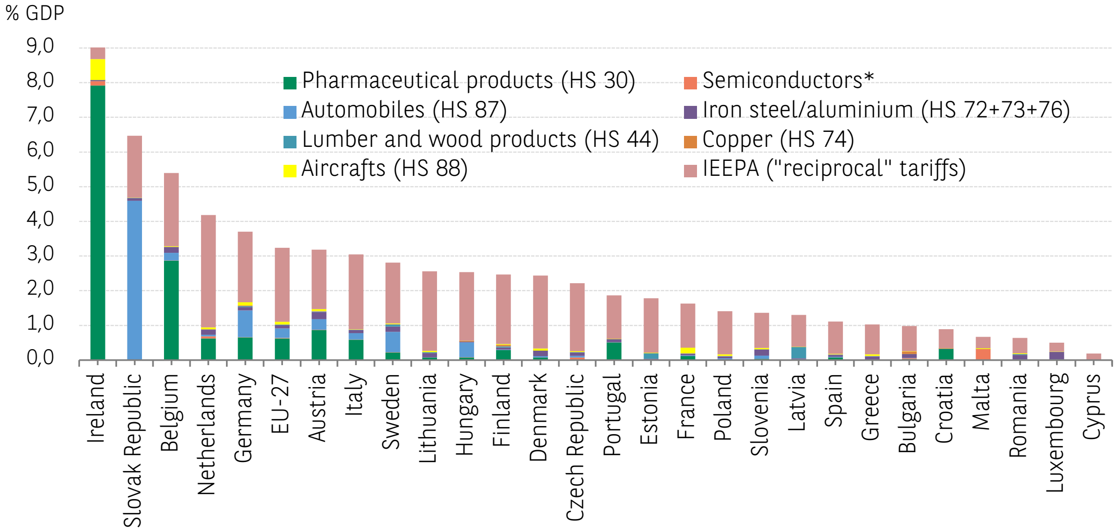
Getting a deal over the line allows all EU economic agents to move on safely in the knowledge that a broader trade war (that could have expanded to services) has been averted. It also allows EU policymakers to refocus fully on the domestic (both national and intra-EU) reform agenda that will matter so much more to EU growth in the medium to long term.

The deal is still undoubtedly a negative shock compared to the tariff level that prevailed at the start of the year (with the effective tariff rate roughly multiplied by 10), but with exports to the US being less than 3% of EU GDP, it will be a manageable one. Importantly, the 15% cap on sectoral tariffs protects the few economies for which sectors subject to specific "section 232" tariffs at much higher level would have been very impactful (see chart). And it has turbo-charged the EU's efforts to negotiate trade deals with new counterparts, which will benefit the EU's economy over the medium to long term.

Key Terms
(based on announcements on July 27)

- Single 15% tariff rate across for vast majority of EU exports products, including cars, pharmaceuticals, semiconductors; 15% is a ceiling, no stacking, all inclusive (ie, includes pre-existing tariffs).
- ”Zero for zero” tariffs on a number of strategic products including aircrafts and components; certain chemicals, certain generics, semiconductor equipments, and certain agricultural products, natural resources and critical raw materials. Work will continue to add more products to this list. No unilateral tariff reduction.
- On steel and aluminium, the two sides will work together to reduce global overcapacity (ie, put pressure on China). Tariffs will be cut and a quota system put in place.
- Non tariff EU commitments: EU will replace Russian gas and oil by significant purchases of US LNG and nuclear fuels (to the tune of $250 / year over the next 3 years); the EU will purchase US AI chips and significant amounts of US military equipment. EU will invest an extra $600 bn in the US over the next 3 years (EU FDI flows to the US amounted to $200bn in 2024).

Exports to the US



Source: Eurostat, BNP Paribas

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The references above correspond to Harmonized System codes maintained by the World Customs Organization.

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