US increases pressure on trade negotiations in a make it or break it moment

The US hits the EU and Mexico with 30% tariffs starting 1 August – despite speculation of an imminent trade deal with the former. With retaliation delayed and talks ongoing, the next three weeks will be crucial. But even a deal may not bring lasting certainty to global trade

President Trump's announced 30% tariffs on the EU and Mexico starting on 1 August

After numerous countries had already received tariff letters from America, it was finally the EU and Mexico's turn on 12 July. According to the letters sent by US President Donald Trump, a new 30% tariff will apply to European and Mexican goods entering the US. Only 24 hours earlier, there had been speculation about a possible trade deal between the EU and the US that might be announced over the weekend. Clearly someone jumping the gun. Instead of the principle trade deal, a 30% tariff letter landed in the mailbox and shows that the US administration is increasing the pressure. This is something that shouldn't come as a complete shock. The US administration has long signalled a tougher stance on the EU than on other trading partners. Comments like "the EU is nastier than China" have set the tone. So, while the timing may have caught some off guard, the message fits the pattern.

And it's too early to panic anyhow. There are still nearly three weeks left to reach an amicable agreement. And let's not forget that the EU was already threatened with a 50% tariff as of 1 June. We have given up speculating about any longer-term strategies in these trade negotiations. What the letters of the last days, and in particular the letters to the EU and Mexico, show is that we are nearing a make-it-or-break-it moment. The letters show that the US administration is increasing the pressure to reach some kind of deals. Whether negotiators are close to or still far away from reaching such a deal remains unclear. In any case, there are three ways how this latest letter wave can end: i) the new pressure leads to tangible results; ii) tariffs lose their fear factor as the US administration will eventually budge at the risk of losing face; or iii) we are entering a fully-fledged trade war. The theoretical fourth option of postponing beyond 1 August looks highly unlikely and politically not very attractive for the US administration.

Why the EU is waiting until the beginning of August to retaliate

On Sunday, the European Commission confirmed that it intended to continue holding back its first countermeasure package worth €21 billion for 90 days planned in response against US tariffs on EU steel and aluminium imports. This was in response to 9 July, the original deadline for suspending the reciprocal tariffs that had been raised since April. The fact that the EU's countermeasures have now also been postponed to 1 August is only logical. Why strike back now if the counter-tariffs were also held back before?

Don't forget that so far, only the 1 August deadline is legally binding and officially recorded in an Executive Order. Everything else – especially what's circulating on social media – still leaves plenty of room for negotiations. And in today's world, three weeks is a very long time.

How the EU could react

The weekend letter will now clearly put pressure on the EU to increase their negotiation offers. In fact, the EU has several options in these trade talks. Option one is to step up purchases from the US. Think of the ill-famous soybeans and LNG from seven years ago but also military equipment as part of the European strategy to increase defense spending (even though Europe will have a hard time selling to its own electorate that tax payers money will be spent on US military equipment). Option two is to actually reduce tariffs, eg, on US cars or US agricultural products, or to reduce non-tariff trade hurdles like quality standards for US cars. Option three are export bans on strategically important products for the US. Think of European pharmaceuticals and medicine that currently is not produced in the US – the European version of the Chinese magnesium. The fourth and final option would be to go into outright retaliation with either increasing tariffs on US goods or the nuclear option in trade: tariffs on digital services but also tighter regulations on US tech firms.

Let's be clear, the final option would lead to a fully-fledged trade war between the US and Europe and we can only repeat our earlier view that there are no winners in trade wars, only losers.

Against this background, the EU will increase its efforts to find an agreement with the US administration but there are red lines. Think of lower tariffs and standards for US agricultural products. At the same time, a 30% US tariff rate will not go unanswered from the EU. The European problem, however, is that the more pressure the US administration will put on the EU the higher the likelihood that the united European line will crack.

The Art of the Un-deal: US trade promises on shaky ground

Some have come up with the label 'strategic uncertainty', trying to describe the never-ending trade and tariff saga of the US administration. We have stopped speculating about the whether or not there is a longer-term strategy. We only know that financial markets seem to have grown numb, while at the same time the tariff threat is still for real. In the European case, a 30% universal tariff could shave off some 0.4pp of GDP growth, pushing the European economy back to the brink of recession. And this is not even counting the toll the tariff uncertainty since April will be taking on investment decisions.

And even though we have stopped speculating, you want to hear a base case scenario from us. Here it is: we still expect some kind of deal before 1 August that will bring a universal tariff of 10% and sectoral tariffs of between 20% and 25% for the EU. As a result, the EU would be facing an effective US tariff rate of close to 20%. Is this a conviction call? No.

To make things even more complicated, even a deal wouldn't mark the end of the tariff saga. First of all, don't forget that trade deals are not written on a one or two-pager but normally consist of hundreds of pages. Negotiations don't last weeks but rather months and years. Therefore, any "big, beautiful deal" that might be reached over the next weeks will not come with a guarantee that it will last. Whether it holds for weeks, months, or years depends entirely on the whims of the US administration. In today's trade landscape, nothing can be taken for granted. Global trade is only going to become more volatile. The search for new trade partners – like between the UK and India, or the Comprehensive Economic Partnership Agreement (CEPA) announced over the weekend between the EU and Indonesia – is a clear sign of this.

Donald Trump's letter to the EU is not a love letter but also not a hate letter. It's a letter to increase pressure in the ongoing negotiations. The next days and weeks will tell whether Europe is willing and able to compromise to the US liking. In any case, the letters of the last week suggest that a make-it-or-break-it moment in the tariff saga is getting closer.

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