Thursday 6 February 2025

Trump's trade tariffs: political strategies and economic consequences

In this additional update, we interpret President Trump's international political strategy and the economic impact of international import tariffs and trade restrictions.

Last weekend, US President Donald Trump pushed for the imposition of import tariffs on goods from Canada, Mexico and China. Mexican products would be taxed with a 25% import tariff. This would also apply to Canadian products, with the exception of energy, where a 10% tariff would be imposed. Meanwhile, the initially announced US import tariffs on Canadian and Mexican goods have been suspended for a month in exchange for border protection agreements with both countries.

The announced import tariffs on Chinese goods apply for now. That country is subject to a 10% tariff increase on all goods on top of existing tariffs. At the same time, President Trump announced that the EU will be next.

The threat of import tariffs

President Trump aims to achieve a number of things with import tariffs. In doing so, there is a substantial difference between the effect of threatening import tariffs and actually implementing them. The threat of import tariffs is mainly part of broader international negotiation strategies and can thus be seen as an important means of pressure. By threatening to impose import tariffs, the US president is creating bargaining space for political gain, as he has previously shown in 'negotiations' with Panama and Colombia in recent weeks.

The situation with Mexico is another good example. After Trump announced import tariffs, a conversation took place between him and Mexican President Claudia Sheinbaum. As a result of that conversation, among other things, 10,000 Mexican military personnel will guard the US-Mexican border. A message that Trump, who in his election campaign insisted on stopping Mexican immigrants, could proudly present to voters.

Actual economic effects

The rationale behind actually instituting import tariffs, is a theoretical stimulation of their own economy. The underlying reason Trump and his team see for justifying these import tariffs is what they see as the lopsided trade balance between the US and the countries concerned. By taxing imports of goods from abroad more, the alternative, domestic production ('US First'), becomes more attractive. In theory, in the long run, this stimulates national production of goods and creates job growth. However, the question is whether this will work out in practice and what the collateral consequences will be.

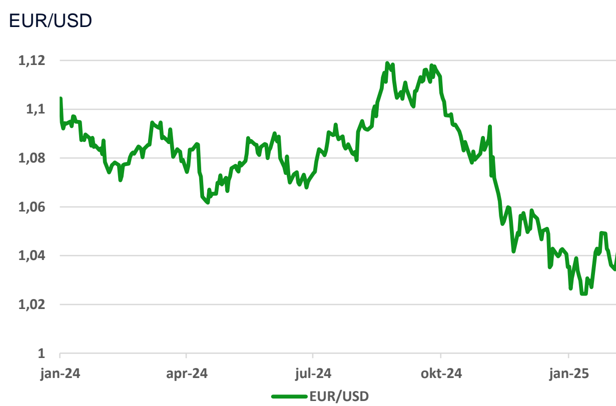
For Americans, the short-term economic impact of such import tariffs is mainly visible in higher costs of products imported by the US. And this while the alternative of (an increase in) domestic production of these goods does not just take off. The very reason some products are imported is because they can be made cheaper and/or more efficiently elsewhere in the world. The higher cost of import duties will inevitably lead to an increase in inflation. In addition, an increase in inflation will be fought by the US central bank - the Federal Reserve (FED) - with interest rate hikes. These interest rate hikes are an additional brake on economic growth, as they discourage investment, and are precisely contrary to Trump's desire for interest rate cuts in favour of economic growth and more investment.

Since Trump's election the US dollar has strengthened significantly. This is because the market expects that due to the economic policies pursued, including import tariffs, interest rates in the US will fall less quickly than in Europe, for example. Financial markets are thus ignoring Trump's call for the Fed to cut interest rates faster. A justified reaction, as the central bank has an independent position

and a mandate to fight inflation. So the Fed's policy should be politically independent. FED chairman Powell has also indicated he will not heed Trump's call.

Dollar appreciated significantly

EUR/USD



Source: LSEG Eikon

Impact of the new China-US trade war

While Canada and Mexico have seen their announced import tariffs suspended for now, China is now facing Trump's tariffs from 10 February onwards. In response, China has already announced a package of countermeasures. For instance, import tariffs of 15% will be maintained on coal and LNG, and 10% on US oil and farm machinery. In addition, Chinese authorities have announced export restrictions on rare metals. Finally, the Chinese government has announced it will file a complaint with the World Trade Organisation (WTO).

The direct impact of these duties on oil markets is likely to be limited. In China, US oil accounted for less than 2% of imports by 2024, or an average of 194 thousand barrels per day (kb/d). In the current context of a well-supplied oil market, Chinese buyers will have little trouble buying oil elsewhere. At the same time, Sino-US oil trade accounts for only 1.5% of US oil exports. Despite the buyers' market, the measures will not have a major impact on US oil exports given its low market share.

Tariffs on LNG will have a bigger impact for Chinese buyers. In 2024, China imported 4.4 million tonnes of LNG[1] from the US. This volume accounts for 5.5% of Chinese LNG imports and 5% of US LNG exports. US producers will have little trouble finding new buyers, considering the current tightness in the LNG market. In the short term, the import tariff will push up gas prices in China. However, the long-term impact will be limited as trade routes realign. US LNG carriers will increasingly move towards Europe while LNG from the Middle East will meet the demand of Chinese buyers.

The impact of possible trade restrictions with Mexico & Canada

If the threat of a trade conflict between the US and Mexico or Canada becomes a reality, there will be a stronger impact on the physical trade of oil and gas than is the case with China. In 2023, 60% and 11% of US crude oil imports came from Canada and Mexico, respectively. In particular, refineries in the mid- and northwestern US are highly dependent on oil imported from Canada

Canadian oil is "heavier" than oil from US soil, meaning it is more viscous and has a higher sulphur content. Refineries that use Canadian oil are set up for these properties, so switching to "lighter" US

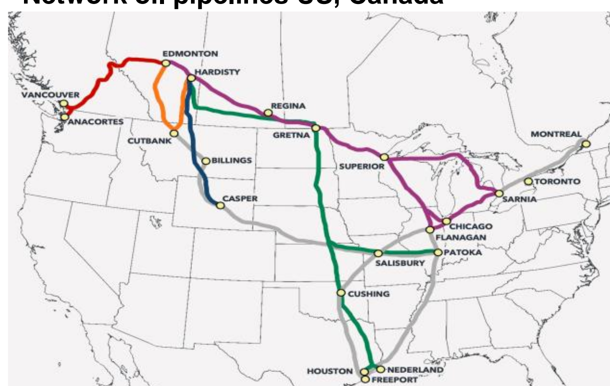
[1] The conversion ratio for LNG from tonnes to cubic metres depends on a number of factors such as temperature and the chemical composition of the gas. Existing conversion ratios for 1Mt LNG range from 1.26 bcm to 1.40 bcm. This means that China's imports of US LNG in 2024 were between 5.5 bcm and 6.2 bcm.

oil is not easily possible. At the same time, refineries in these areas have little access to other sources of heavy oil, so the impact of tariffs will be felt most by these companies.

The US South, where virtually all Mexican oil imports go, typically has access to flexible maritime oil supplies. As a result, the impact of tariffs on Mexican oil will be more limited. Still, it leads to an increase in uncertainties in supply lines and increased purchasing rates of these refineries. Their higher cost leads to an advantage for refiners in the Middle East and Asia in particular. Refineries that can process heavier oils, while US refiners' margins come under pressure. Higher fuel prices in the US, especially for petrol for which the US is a net importer, therefore seem inevitable at the time these import duties take effect.

For diesel, the price impact will be felt mainly in Europe, with the US as the main supplier. Market traders on the other hand will react more positively. They benefit from volatility and uncertainties in the market. All in all, tariffs will push up the price of oil and oil products in the US. This disadvantages the competitiveness of US industrial sectors.

Network oil pipelines US, Canada



Source: Canada Association of Petroleum Producers

The impact of tariffs will also be felt in Canada and Mexico. 96% of Canadian oil production takes place in the western part of the country. Until May 2024, pipeline capacity to the coast was limited, leaving 97% of oil exports destined for the US. Thanks to the construction of the *Trans Mountain Expansion* pipeline, exports to the Asian market have grown. With a capacity of 890 kb/d, this pipeline can cover just under a quarter of Canada's oil exports. US tariffs on Canadian oil will therefore still hit Canadian oil producers hard. Moreover, Canada depends on the US for internal, or national, oil transportation. Indeed, the only pipeline to transport oil from Western to Eastern Canada runs through the US. This means that trade restrictions on oil between the two countries will also have a price driving effect for (Western) Canadian oil in Eastern Canada.

Mexican refineries have also suffered from a lack of investment for years, making them unable to refine Mexico's heavy oil. As a result, although more than half of Mexican oil exports are destined for the US, Mexico was 93% dependent on the US for refined petroleum products by 2023. Therefore, trade restrictions on oil products will: (1) weaken the revenue model of Mexican crude oil, which is already in question; and (2) push up the price of refined oil products in Mexico.

Also, a trade dispute between the US and its neighbours will affect gas markets. Although the US is a net gas exporter, it imports a significant amount of natural gas. In 2023, 9% of total US gas demand was met by imports. Virtually this entire volume (99.5%) came from Canadian soil. This gas is imported by pipeline, making sales to other regions impossible in many cases. Unlike oil consumers, buyers of Canadian gas do have access to other (domestic) gas markets. Nevertheless, import tariffs on Canadian gas will apply upward pressure on US gas prices.

Net US gas exports to Mexico in the first half of 2024 averaged 175 million cubic metres per day (mcm/d), which would add up to 65 billion cubic metres (bcm) on an annual basis. This volume accounts for 30% of US gas exports and 74% of Mexican gas demand. Some of this volume is re-exported from Mexico in the form of LNG. All in all, the economic impact of (reciprocal) import tariffs on the mutual gas market would be large.

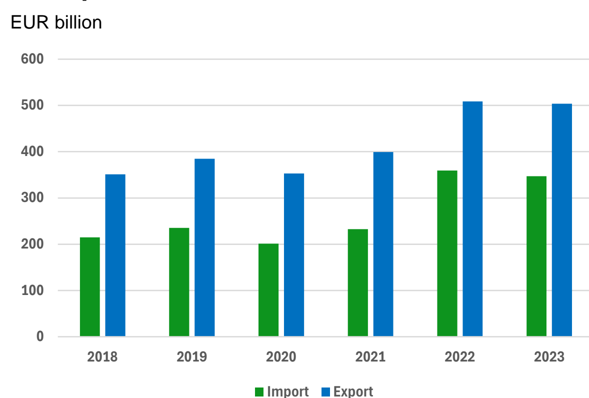
European economic dependencies on the US

Trump has not yet made any concrete statements on the extent of (possible) import tariffs on goods from the EU. However, it is no secret that the negative trade balance between them is a thorn in Trump's side. The left-hand chart below shows that the EU has been exporting far greater value of goods to the United States than it imports for years. In 2023, the export value of goods from the EU to the US was over EUR 500 billion. In contrast, European imports from the US included a value of nearly EUR 350 billion. In other words, the US trade deficit in 2023 was about EUR 150 billion.

Looking at the Dutch situation, we see just the opposite picture. Where the EU records a plus, the Netherlands has been looking at a minus on its mutual trade balance with the Americans for years. The Netherlands' negative trade balance with the US is largely explained by our function as an international transit country. For example, many goods destined for the European market enter through the port of Rotterdam. This Dutch role in international trade logically makes us extra vulnerable to the effects of US import tariffs directed against the EU and the tariffs or otherwise trade restrictions that the EU imposes in return

Wide plus on EU - US trade balance

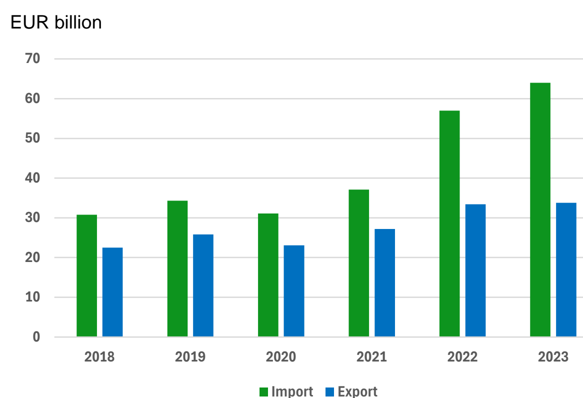
EUR billion



Source: Eurostat

But the situation is reversed for the Netherlands

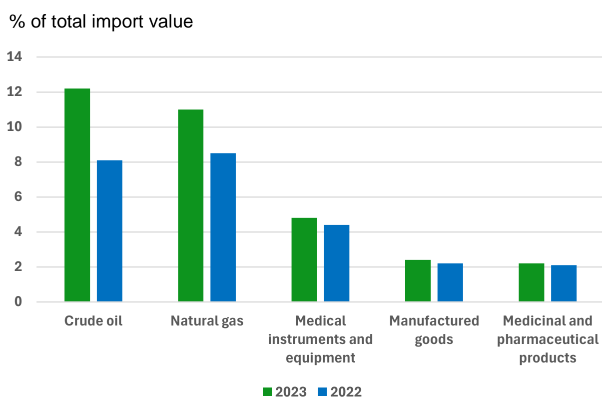
EUR billion



Source: CBS

Netherlands vulnerable as transit country

While goods imports represent a financial outflow, import value, mainly for transit countries like the Netherlands, actually also generates economic value in the form of economic activity (jobs). Therefore, the sum of export and import value is also an important measure of the economic value mutual trade offers a country. The total value of EU-US trade in goods (imports plus exports) was around EUR 850 billion in 2023. This is roughly equivalent to 5% of GDP in the EU. In the Netherlands the total value of trade in goods with the US was almost EUR100 billion. This translates to a volume as large as almost 10% of Dutch GDP.



Source: CBS

Finally, the trade balances between the US and the EU and the Netherlands show a sharp increase in both import and export value after 2021. This increase is largely explained by two factors. First, from 2022 onwards the global economy gained momentum after the corona pandemic. In addition, large parts of Russian pipeline supplies of natural gas to the EU fell in 2022. As a result, the EU entered the global LNG market to meet its natural gas demand. Since 2022, large parts of the EU's LNG imports have come from the United States. From the chart above, we can see that the total import value of crude oil and natural gas in 2023 was more than 20% of the entire import value from the US.

All in all, the Netherlands is particularly vulnerable to a possible trade war between the EU and the US. This is partly because of the Netherlands' function as an international transit country, and partly because of its increased dependence on supplies of US natural gas and oil due to the energy crisis.

Trump has also set his sights on other oil-producing countries

Under Biden, sanctions against Russian oil – especially shipping it – were significantly strengthened just before his resignation. If Trump decides to continue and strictly enforce the sanctions, this will further hit Russian oil exports. Currently, there is suspicion – especially in India – among buyers that Trump will enforce sanctions less strictly, allowing Russian oil to be bought through so-called bypass routes. A strict(er) enforcement of sanctions may result in Indian buyers also having to look for non-Russian oil. Should Trump indeed (partially) loosen the reins, the long-term impact of the sanctions will be limited. Russia will be able to find buyers relatively easily, limiting the impact on global supply.

At the World Economic Forum, the president demanded that OPEC+ should lower the cost of oil. A production increase from OPEC+ would push down the price of oil, which would also hit the sales of Russian producers. OPEC+ had already announced to phase out their production limitation from April 2025, theoretically fulfilling Trump's demands with their intentions. However, it remains to be seen whether OPEC+ will actually increase production from April, given a lower oil price will hurt their state revenues. On the other hand, there are noises from Trump and his ministers about possible sanctions on Iran and Venezuela. US sanctions on these countries' oil industries would in turn have a price-increasing effect.

The uneasy relationship between Trump and oil prices

So far, the impact of Trump's first two weeks on energy markets has been fairly limited. Oil prices reacted faintly to the announcement of import tariffs on Canada and Mexico, despite significant trade flows. Reciprocal import tariffs between China and the US also have little impact on oil prices due to low trade volumes. On top of that, OPEC+'s reaction also calmed markets by reaffirming its intended policy on production increases from March last week.

The difficulty of US presidents regarding oil prices lies in the dilemma that voters are very sensitive to (too) high fuel prices. Many a US president - including Trump - has called for lower oil prices, especially in the run-up to elections. At the same time, the US is the world's largest oil producer. This oil production comes about through the efforts of hundreds of commercial parties. In recent years, these companies have increasingly focused on cash flow and profitability of their exploration activities. In other words, they only produce if it makes economic sense. Too big a price drop will make projects less profitable or unprofitable, halting production growth, or even reducing production

So it is looking for an equilibrium price where US oil producers as well as consumers (read voters) are satisfied. This does not necessarily have to be a price where the rest of the international market sees this equilibrium price. In particular, major oil producers Saudi Arabia and Russia not only have a strong opinion on this, but also a big influence on it through OPEC+. At the same time, the second-largest consumer - China - also has an important role regarding the price of oil in the form of degree of economic growth.

European import dependence on natural gas

A bigger impact is seen in gas markets, although this can only be attributed to Trump's policies to a limited extent at the moment. In particular, higher gas demand from Europe due to colder weather and the need for more LNG imports is currently supporting TTF gas prices. Yet potentially for Europe, there is greater price risk here than with oil. This is mainly explained by the fact that the diversification options for oil are a lot bigger than for gas. European gas production has been under pressure for years. In addition, supplies of Russian pipeline gas have been cut to almost zero, and European leaders would like to get rid of dependence on Russian LNG sooner rather than later. In this, European leaders and Trump may be able to find common ground in the short term. Trump wants Europe to buy more LNG from the US, and the EU has a big task to fill gas supplies in time - and at a not-too-high rate - for the winter of 2025/26.

At the same time, almost half of European LNG imports already come from the US. A further increase would make dependence on US gas unjustifiably high, similar to the situation a few years earlier when Europe was very dependent on Russian natural gas. So while more LNG imports may be a win-win for the short term, Europe also benefits from caution and diversification of suppliers when it comes to the longer term

Finally, we have seen many business activities, or investments on behalf of business activities, related to renewable energy move to the US due to the Inflation Reduction Act subsidies, made available in the previous presidential term by Joe Biden. Donald Trump has put many of the support measures in favour of renewable energy 'on hold'. This potentially presents opportunities for Europe. A level playing field is something the European, and certainly the Dutch, industry has been advocating for some time. You create such a level playing field partly by lowering costs in Europe, in addition to relaxing laws and regulations. Yet higher costs in the US can also help to narrow the price gap between the continents. However, whether it is a favourable development for the energy transition in general can be questioned.

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