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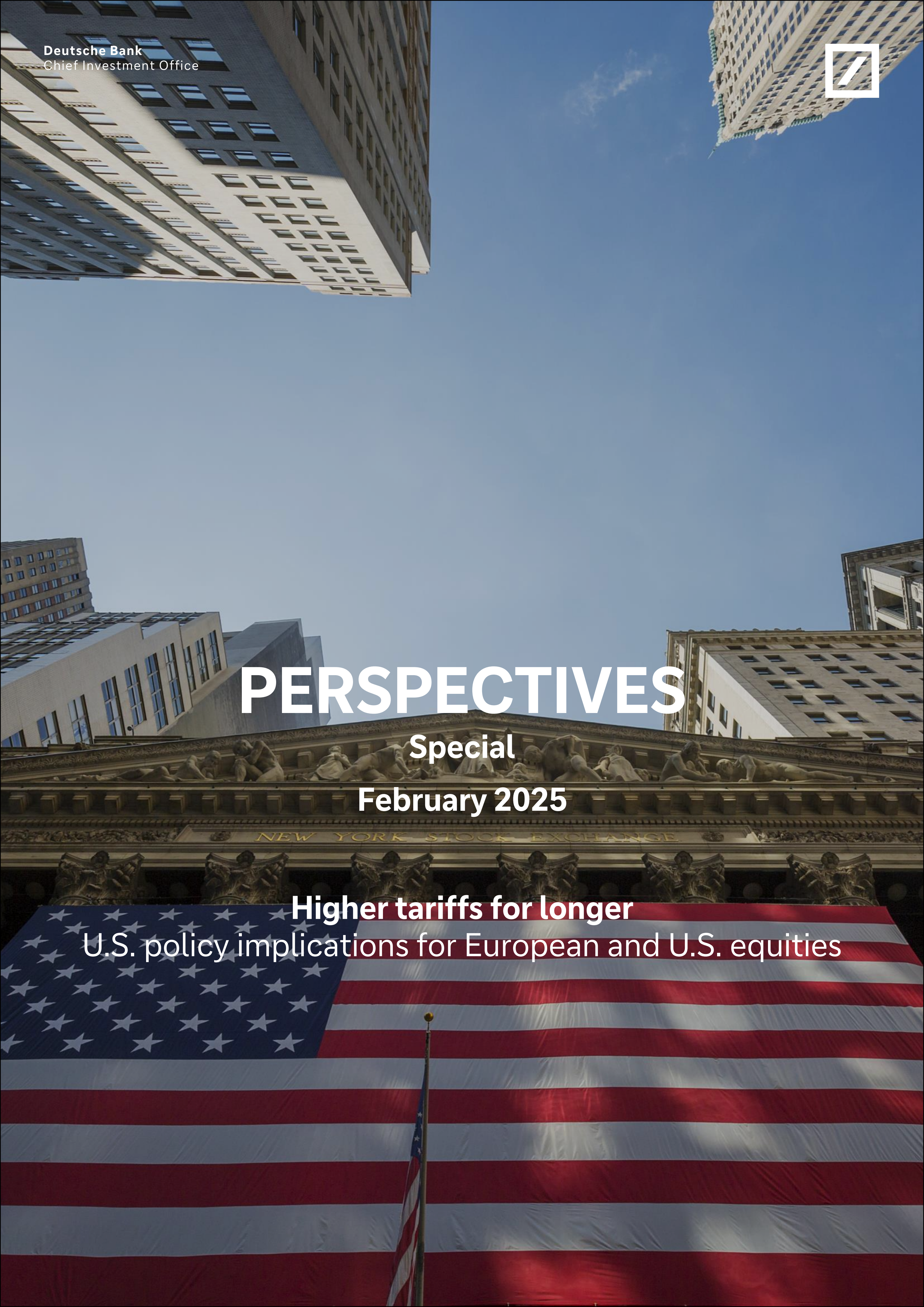

PERSPECTIVES

Special

February 2025

Higher tariffs for longer
U.S. policy implications for European and U.S. equities

Introduction

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We are only in the fourth week of Donald Trump's second U.S. presidency and markets have already been confronted with a wide range of import tariff announcements from the self-proclaimed "Tariff Man". These have triggered heterogeneous reactions across asset classes and added to uncertainty about future U.S. moves and possible retaliation from targeted trading partners. Given the erratic nature of Trump's announcements, leading to a high degree of speculation about his likely future actions, and the variety of possible endgames, markets have been volatile and are likely to remain so for the time being. After all, the trade war episode (2017-2019) of Trump's first presidency taught us that trade wars are not fought in a single battle, but with multiple rounds and a constant back-and-forth. As such, we believe that a dispassionate analysis of the aims of Trump's tariff policy is warranted to separate the noise surrounding the announcements from what may be more enduring elements laying the groundwork for investor guidance – with a focus on European and U.S. equities as a starting point.

- "Trade war 2.0" is on. We argue against the idea that the U.S. administration is simply using tariffs as a bargaining chip, setting out the reasons why higher tariffs will be implemented and remain in place for longer.
- Focus on the run-up to April 1, when the Congressional Budget Office (CBO) update of fiscal outlook and policy actions under Trump's "America First Trade Policy" are due, setting the framework for U.S. policymakers' decisions on both fiscal and trade policies in the coming years.
- Tariffs have only a limited effect on the aggregate earnings of S&P 500 and STOXX 600. However, risk premiums will ebb and flow with a varying intensity of tariff news and actions, inducing stock price volatility.
- Certain sectors, and individual stocks, are more exposed to direct tariff effects. Automobiles and Basic Resources stand out. Health care and industrial imports to the U.S. may also be targeted by tariffs, but listed companies should cope well with the effects.

Contents

01

What has happened so far

Trump's 2024 campaign threats	• A 10-20% tariff on all imports and a 100% tariff on cars made outside the U.S. • A 60% tariff on Chinese goods and 100% tariffs on BRICS countries if they challenge the dominance of the U.S. dollar.
January 20	• The White House issues the "**America First Trade Policy**" memorandum, which outlines measures to reduce trade deficits, address unfair trade practices, and enhance U.S. industrial and economic security. Each of the four sections details specific investigations and policy reviews, with findings and recommendations from the designated agencies **due by April 1, 2025**.
February 1	• Trump signs an executive order imposing a 25% tariff on all goods imported from Mexico and Canada (10% on Canadian oil and gas). • An additional 10% tariff on imports from China and a promise to take similar action against "unfair" trade practices by European trading partners.
February 4	• Tariffs on Mexico and Canada due to go into effect are delayed for 30 days after Mexico's President Sheinbaum and Canada's Prime Minister Trudeau promised measures to combat crime and tighten border controls. • China responds by imposing tariffs of 15% on coal and LNG imported from the U.S. and 10% on crude oil, agricultural machinery, and some car models. In addition, export controls are imposed by China on metals such as tungsten, tellurium and germanium, and antitrust proceedings will be launched against Alphabet, the parent company of Google.
February 10	• Trump signs an executive order imposing a 25% tariff on steel and aluminium imports (effective from March 12) applied universally, eliminating previous country-specific exemptions. • Furthermore, Trump threatens to impose reciprocal tariffs on any country that has imposed tariffs on U.S. imports. • Japan requests an exemption from the 25% tariffs on steel and aluminium. • Trump indicates that his advisors will develop plans for sectoral tariffs over the next four weeks.
February 13	• China imposes additional tariffs of 10-15% on 80 U.S. products, including agricultural goods and technology components and adds several U.S. companies to a list of "unreliable entities". • According to U.S. Republican House Speaker Mike Johnson, tariff exemptions could be considered by President Trump possibly including pharmaceutical and automotive industries. • The White House issues a memorandum directing its staff to develop a "**Fair and Reciprocal Plan**" for trade that would match other countries' tariffs, taxes, and non-tariff barriers, such as regulatory requirements, subsidies, and exchange rate policies. There is no hard deadline in the memo, as the plan is to be submitted only after the "America First Trade Policy" memorandum is submitted to the president, due on April 1.
February 14	• At the **Munich Security Conference**, trade wars and punitive tariffs are criticized by politicians. European Commission President Ursula von der Leyen states that tariffs would fuel inflation and impact workers, businesses, and the middle class on both sides of the Atlantic. • President Trump says **tariffs on automobile imports** would be coming „maybe around April 2", the day after the report on the "America First Trade Policy" memorandum is due.

Investors vividly recall the first trade war that began in late 2017, when Donald Trump's trade policies introduced significant volatility to the markets. Since the U.S. election in November, market participants have been bracing for similar tariff headlines. Despite the constant tariff-related news flow, prediction markets currently price only a 51% chance that Trump will impose large tariffs in his first six months, down from 69% on February 2. Apparently, investors believe that Trump’s bark is worse than his bite.

Possibly this perception is due to the fact that Canada and Mexico got their tariffs postponed quickly after signalling willingness to make concessions. This may explain the muted market response to the announced tariffs, with European and U.S. stock markets at or close to their all-time highs.

02 Aims of Trump's tariff policy

Looking at Trump's quick decision to delay tariffs on Canada and Mexico, and the recently reported intentions of Japan and Australia to negotiate exemptions, one might be tempted to conclude that Trump's tariff threats are all just a “storm in a teacup”, intended to strengthen his negotiating position on issues such as replacing multilateral trade agreements with arrangement renegotiated on a bilateral basis where the U.S. has more leverage.

So, the question is: Is Trump's call for higher tariffs merely a means of exerting pressure to get his way on international negotiations ("threatening through tariffs") that will erratically shift from one pole to the other in a matter of days, or should higher import tariffs be seen as the ultimate goal of Trump's foreign policy? We believe that for the new U.S. administration, higher tariffs reflect a threefold combination of strategic, protectionist, and structural aspects and are therefore set to remain. Hence, **we anticipate a “higher for longer” tariff regime**.

On January 20, the White House issued the "**America First Trade Policy**" memorandum, which outlines measures to reduce trade deficits, address unfair trade practices, and enhance U.S. industrial and economic security – with findings and recommendations from the designated agencies **due by April 1, 2025**. Each of the **four sections** details specific investigations and policy reviews, and covering all three aforementioned aspects of Trump’s tariff policy aims:

- **Section 1 – Unfair Trade Practices**: Investigates and adjusts tariffs on imports that harm U.S. industries, including reviews of tariffs, trade agreements, currency manipulation, and anti-dumping.
- **Section 2 – China Relations**: Covers trade compliance, intellectual property, and unfair practices, and assesses the economic and security risks associated with trade with China.
- **Section 3 – Economic Security**: Focuses on protecting the industrial base, counterfeiting risks and import adjustments.
- **Section 4 – Tax and Procurement**: Covers foreign tax policies, customs revenue, and procurement implications.

Strategic bargaining chip

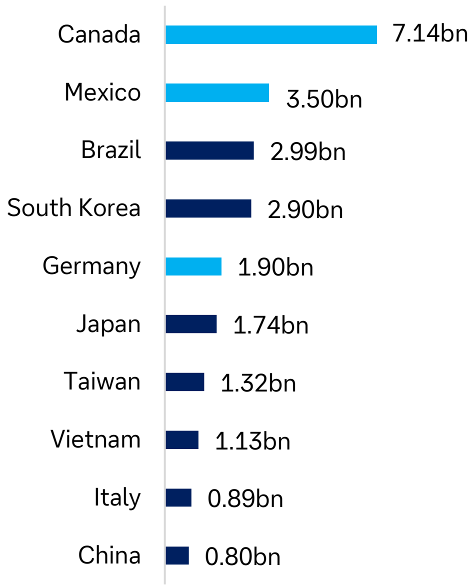
Regarding recent tariff threats against Mexico and Canada, the new U.S. Treasury Secretary Scott Bessent has argued that they were targeted at securing action by those governments on non-trade issues such as immigration and illegal drug trafficking. As the tariff hikes against both countries have only been delayed and are by no means cancelled, the next few weeks will be an opportunity for all sides to find a solution that enables the politicians involved to save face while limiting the potential economic damage or, ideally, preventing it altogether.

After all, the stakes for the U.S. economy are high as well, since Mexico and Canada are its top single trading partners, with comparatively small trade deficits. While Trump may seek bilateral deals, Canada and Mexico are likely to focus their efforts on an agreement based on the existing USMCA free trade agreement. Signed by the three countries during Trump's first term, this came into force in 2020 and is due to be renegotiated in 2026. A possible compromise could be an early renegotiation of the agreement.

Protectionist tool

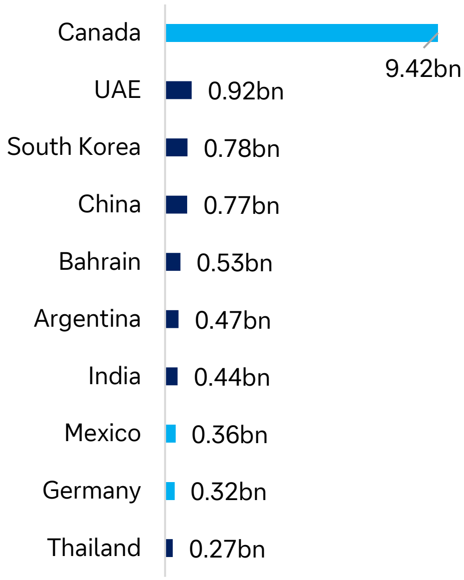
A key element of Trump's campaign was his plan to protect certain U.S. industries from "unfair" trade practices and to safeguard strategic security interests. The reinstated **25% tariffs on steel and aluminium imports** are an example for the latter as the two metals are vital components in many industries, including transportation, construction, and packaging. Unlike the tariffs imposed in 2018 during Trump's first term, which were later largely reversed, this time the new tariffs also affect intermediate steel and aluminium products. In 2024, the U.S. imported steel from 79 countries and aluminium from 89 countries for a total value of just over USD49bn, with Canada by far the most important supplier, exporting USD7.1bn worth of steel and USD9.4bn worth of aluminium to the U.S. Within Europe, Germany is the largest supplier with steel and aluminium exports to the U.S. amounting to USD1.9bn and USD0.3bn, respectively (figure 1 and 2). While 25% tariffs would be annoying, they would certainly not be catastrophic, as, for example, only 4% of Germany's total steel exports are shipped to the U.S.

Figure 1: Top 10 steel exporters to the U.S. (2024)



Source: U.S. International Trade Administration, Deutsche Bank AG. Data as of February 14, 2025.

Figure 2: Top 10 aluminium exporters to the U.S. (2024)

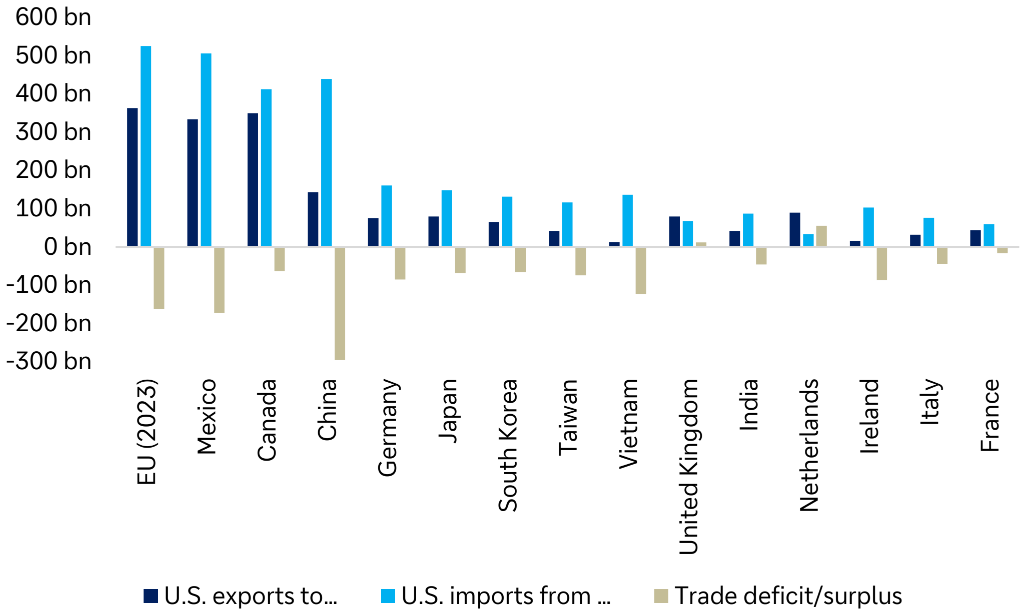


Source: U.S. International Trade Administration, Deutsche Bank AG. Data as of February 14, 2025.

On possible retaliatory measures, the EU Commission said there was no need to react as no official notification had been received. In Trump's first term in 2018, he imposed import tariffs on EU steel and aluminium shipments worth USD6.6bn. The EU retaliated with tariffs of its own on USD2.9bn of U.S. products, and tariffs on a further USD3.8bn of U.S. imports which were due to take effect three years later, but were not imposed after President Joe Biden took office.

In terms of possible negotiations, it is worth considering the **EU's significant bargaining chips**. In 2023, total bilateral trade in goods & services between the U.S. and the EU reached USD1.6 trillion, with a total trade deficit on the U.S. side of USD54bn, representing only 3% of total trade between the two blocs. Total bilateral trade in goods amounted to USD888bn, with the EU exporting USD525bn of goods to the U.S. and the U.S. exporting USD363bn to the EU, resulting in a U.S. deficit in trade in goods of USD162bn (figure 3). The interesting part is trade in services. Total bilateral trade in services reached USD718bn, with the EU exporting USD305bn to Europe and the U.S. USD413bn. Thus, in services, the deficit of USD108bn is on the EU side, probably strengthening its negotiating position.

Figure 3: Top 15 U.S. trading partners (goods only, USD, 2024)



Source: U.S. Census Bureau, Deutsche Bank AG. Data as of February 14, 2025.

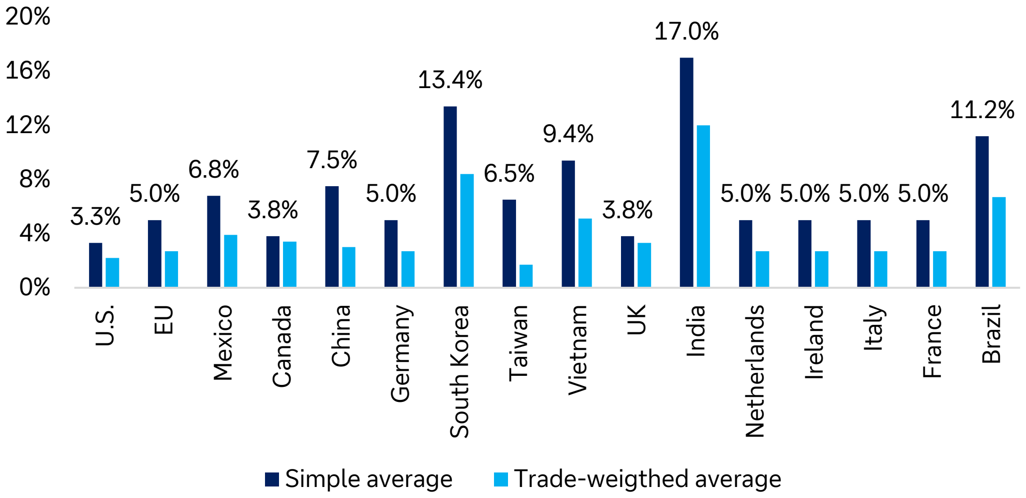
Structural financing tool

On the fiscal revenue aspect of tariffs, it seems reasonable to assume that the Trump administration will structurally rely on revenue from "taxes" on imports as a source of financing over the next four years, e.g. to (partially) fund tax cuts for the private sector, such as those included in the Tax Cut and Jobs Act (TCJA). Recently, Treasury Secretary Bessent stressed the urgent need to extend Trump's 2017 TCJA, saying that allowing it to expire at the end of this year would trigger a USD4 trillion additional tax burden [over 10 years] for businesses and individuals that could "crush" the U.S. economy.

While the final tariff mix will only be determined in what are likely to be tough, mostly bilateral negotiations, it is fair to assume a sustained increase of the average import tariff rate. According to the U.S. Census Bureau, the U.S. imported around USD3 trillion worth of goods in 2023 (i.e.

excluding services, which are unlikely to be Trump's main focus). Accordingly, increasing the average import tariff by 1 ppt would generate additional revenue of just over USD30bn per year. Hence, tripling the average import tariff rate from currently 3.3% (figure 4) to 10% – a scenario that according to analysts seems possible – would generate additional annual revenues of approximately USD200bn, all else equal.

Figure 4: Average import tariff rates of the U.S. and its most important trading partners (2024)



Note: The U.S. has free trade agreements with Canada, Mexico and with South Korea that eliminate nearly all tariffs between the member countries.
Source: U.S. Census Bureau, WTO, Deutsche Bank AG. Data as of February 14, 2025.

In its January update, the Congressional Budget Office (CBO) projects that the expiration of the TCJA on December 31, 2025, will result in additional annual revenues of about USD400bn in 2026 and beyond. In contrast, the clear intention of Trump and Bessent is to make the TCJA permanent. To partially finance the gap, spending cuts of up to USD2 trillion over the next ten years, or an average of USD200bn per year, have been discussed in the House of Representatives. Much of the savings would come from capping federal subsidies for Medicaid. At the same time, however, the administration plans to increase spending on border security and defence, reducing the net savings.

And this is where the envisaged higher tariff regime comes in – likely a mix of a substantial increase in tariffs on imports from China, targeted higher tariffs on Europe, and possibly a base tariff across the board, perhaps with separate treatment for Canada and Mexico as the US's most important individual trading partners. Assuming that the tariff mix would raise sufficient funds, it is reasonable to expect a deficit close to the CBO projection of around 5.5% in 2026.

However, if the Trump administration was forced to make concessions on one or both sides (e.g., on tariffs due to effective countermeasures by affected trading partners and/or on spending cuts due to mounting social and political pressure at home), the only way out would be a debt-financed offset, all else equal.

The **next regular CBO update of the nation's fiscal outlook** (informing lawmakers and the public about the state of federal finances, such as the national debt, deficits and economic conditions) is expected to be one of the key tools that policymakers in Washington will rely on to make fiscal policy decisions in the coming years. **Therefore, given the importance for markets, we would advise investors to pay close attention to the upcoming CBO update on April 1 – especially considering that potential policy actions under the "America First Trade Policy" plan are also due on the same day.**

Trump's "Fair and Reciprocal Plan"

The memorandum issued by the White House on February 13 instructs its staff to develop a plan for reciprocal trade actions that would match other countries' tariffs, taxes and non-tariff barriers, such as regulatory requirements, subsidies and exchange rate policies. No hard deadline is set – only after the "America First Trade Policy" memorandum is submitted to the President, due on April 1 – but the White House Office of Management and Budget (OMB) is instructed to submit a report within 180 days, i.e. by August 12, suggesting an extensive timeframe for delivery.

The initial scope of the plan is very broad, covering not only tariffs but also taxes (including value-added taxes (VAT), extraterritorial taxes on US companies) and non-tariff barriers (regulatory requirements, subsidies and exchange rate policies). It's important to note that while the U.S. does not have a federal VAT system, so imported goods currently enter the country VAT-free, VAT is common practice in EU countries – with an EU-wide minimum VAT rate of 15% and effective rates ranging from 17-27%. Analysts estimate that a reciprocal plan that establishes VAT on U.S. imports could have more than five times the impact on the U.S. average effective tariff rate compared to a plan that focuses only on tariff gaps. A plan that included other non-tariff barriers could raise it even more.

Given the combination of a long lead time and its broad scope, this suggests that the reciprocal tariff plan may also be aimed at negotiation rather than pure implementation. While President Trump has supported a reciprocal tariff plan since his first term in office and appears to be serious about aligning tariff rates, the broad scope of the plan suggests a maximalist starting position aimed at gaining concessions from trading partners, while its long lead time is likely intended to create room for negotiation.

The broad scope of the reciprocal plan has also led to some speculation that the across-the-board tariff that President Trump discussed during his campaign may no longer be seen as the most feasible scenario. Recent comments by Trump and White House advisor Peter Navarro also point in this direction. While this is by no means a certainty, the focus on the reciprocal plan seems to reduce the risk of an across-the-board tariff being proposed in the near future.

03

Equities: Implication of import tariffs for stock markets

Tariffs can affect stocks through multiple channels, impacting (1) earnings, (2) financing costs, and (3) valuations.

Earnings

Direct effects

- Negative: Companies that rely on importing goods or intermediate products from abroad may face higher costs due to tariffs. The extent to which these squeeze profit margins depends on the company's ability to pass these costs on to customers. This ability is influenced by factors such as demand elasticity, brand power, and the level of competition in the market. For instance, companies with strong brand loyalty and less price-sensitive customers may be able to increase prices without significantly reducing demand. Conversely, companies in highly competitive markets with price-sensitive customers may struggle to pass on these costs, leading to reduced profit margins.
- Positive: On the other hand, companies that produce goods domestically without intermediate products from abroad are unaffected by higher import costs. These companies may benefit from increased demand as their products become relatively cheaper compared to imported goods. Additionally, they may gain a cost advantage over competitors that rely on imports, potentially increasing their market share and profitability.

Indirect effects

Tariffs can also lead to higher overall prices in the economy, as companies pass on increased costs to consumers. This can reduce total demand, as consumers may be able to afford fewer goods and services. The extent of this impact depends on the duration of the tariffs. If tariffs remain in place for an extended period, the negative effects on earnings may become more pronounced, as sustained higher prices could lead to a prolonged reduction in consumer spending.

Financing Costs

Central banks may respond to rising inflation, driven by higher prices due to tariffs, by not cutting interest rates as much as investors currently expect or even raising rates to combat inflation. Higher interest rates can lead to increased bond yields, raising the cost of borrowing for companies. As a result, companies may face higher financing costs, which can reduce their profitability and limit their ability to invest in growth opportunities.

Valuations

Higher financing costs and bond yields increase the cost of capital for companies. This can weigh on stock valuations, as future earnings streams must be discounted at a higher rate. This effect is mathematically larger for companies that are not profitable yet. Investors may also demand a higher risk premium for stocks due to the uncertainty associated with trade policies. This increased risk premium can further depress stock valuations, as investors require greater compensation for the perceived higher risk.

We point out that the overall effect on the stock market will depend on the duration and extent of the tariffs, as well as the ability of companies to adapt to the changing economic environment. Given the manifold transmission channels and the absence of detailed tariff numbers we can only make estimates for the overall effect of tariffs on the stock markets.

Impact on aggregate earnings in the U.S. and Europe limited

We think that tariffs will have a negative effect on aggregate earnings in the U.S. and in Europe. However, the magnitude appears likely to be relatively small. For the U.S., analysts estimate that a 5 ppts increase in the U.S. tariff rate from currently ca. 3% would reduce the 2025 S&P 500 EPS estimate only by roughly 1-2%. However, this does not consider the non-linear impact of tariffs and also does not account for the potential strengthening of the U.S. dollar, which would be an additional drag on index EPS.

For Europe-wide indices like the STOXX 600, the impact of a higher tariff level could be somewhat larger, given that companies generate around 60% of their revenues outside Europe.

On the impact of U.S. tariffs on imports, we note that only approximately 25% of total revenues of European large caps come from the U.S. The share of their total revenues that is generated by selling goods imported into the U.S. is only 7% because companies produce goods for the U.S. market locally. Revenues from locally-produced goods make up 10% of total sales. 9% of total sales come from services in the U.S.

On this point, we note that 30% of STOXX 600 assets including production facilities are nowadays in the U.S., compared to 18% in 2012. This gives European companies the option to shift some production to the U.S. and mitigate exposure further. Companies with a significant U.S. footprint also benefit from Trump's focus on high economic growth, potential tax cuts, and deregulation.

Another quarter of total revenues comes from emerging markets of which roughly half is generated in China. Hence, European stocks may also feel the impact of U.S. tariffs on China.

A weaker Euro to the rescue?

The drag on European earnings could be reduced by a depreciation of the Euro. This is because European EPS estimates tend to rise with a falling Euro, given the global exposure of European companies. This is because repatriated earnings become more valuable in euro terms. Therefore, the 6% weakening of the Euro against the U.S. dollar has had a cushioning effect against higher tariffs (figure 5).

However, fundamental earnings are only one driver of stock markets; valuations also react. Historically, European stock prices were positively correlated with the euro, and euro weakening was typically associated with weaker global growth. Hence, it came with a rise in the risk premium, offsetting the translation effect of foreign earnings.

Further we note that many investors in the European equity market are dollar-based, meaning they lose out if the Euro depreciates unless they hedge their currency exposure. Hence, they may reduce their appetite for European stocks, driving stocks down instead of up.

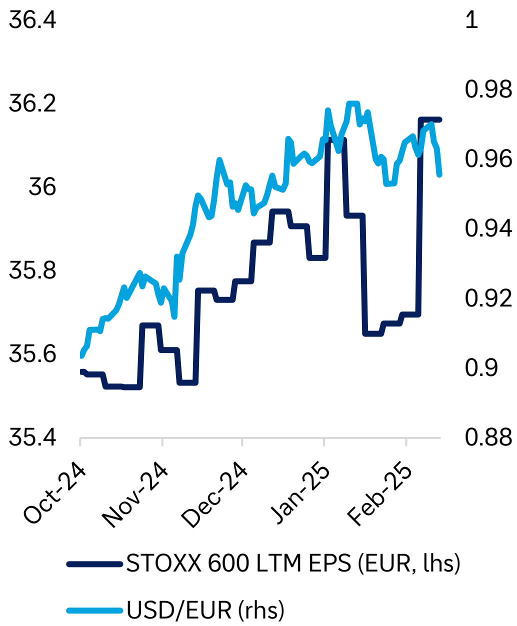
Due to these factors, the total effect of a weaker Euro is less than clear-cut.

Valuation effect is dominating

In light of the relatively small negative effect on aggregate earnings, the valuation effect of tariffs seems more relevant. The key question is whether current uncertainty around trade will significantly drive down stock multiples.

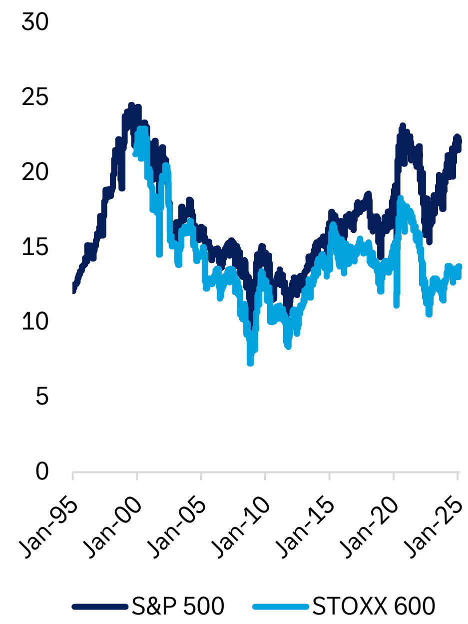
Here we highlight the different starting levels of U.S. and European valuations. The S&P 500 is trading at valuations last seen during the pandemic and the DotCom bubble years ago, while the European market appears relatively cheap and under-owned (figure 6). Hence, valuations provide a larger buffer against price downside in Europe than in the U.S.

Figure 5: European EPS have risen alongside the USD



Source: LSEG Datastream, Deutsche Bank AG. Data as of February 14, 2025.

Figure 6: NTM P/E ratios



Source: LSEG Datastream, Deutsche Bank AG. Data as of February 14, 2025.

U.S. equities might become more susceptible if investors interpret these tariffs as a signal to reevaluate their assumptions about the risks the U.S. administration is prepared to take regarding growth and inflation. Then, risk premiums could increase more broadly. However, we think Trump will de-escalate if stock markets signal concerns about too harsh trade interventions.

Digging deeper: country and sector levels

Given differences in the economies and the sector weightings of their indices, some European country indices are more exposed to global trade than others. Therefore, they are more exposed to tariffs i.e. frictions in global trade. Generally, the beta of equity returns to world trade growth is higher for European markets than for the U.S., with the highest beta in emerging markets. In Europe, the Nordics (OMX) and Germany (DAX, MDAX) are most vulnerable. In contrast, the British FTSE 100 has a low beta to world trade, due to its composition; the UK is a services-oriented economy and could be exempt from tariffs due to its trade balance with the U.S. Similarly, the SMI has historically been more insulated with a low beta to world trade growth. It is also a defensive index, and Swiss exports tend to be inelastic due as they comprise largely of technologically-advanced products, particularly pharmaceuticals.

04

EU product groups most at risks to be targeted

The U.S. administration has indicated that it plans to hike the tariffs on **automobile** imports from Europe. Automobile imports are a natural choice because (1) the volumes of imports are high (in 2023, total imports of automobiles from Europe amounted to USD59bn), (2) the auto industry is important to the domestic U.S. economy in terms of value added and employment, (3) the price-elasticity of demand is sufficiently high, meaning that customers are likely to consider buying a locally produced car, assuming they get relatively cheaper, and (4) tariffs on autos are already in place, which means that they can be increased without a lengthy bureaucratic process, and are lower than the respective EU tariffs.

Specifically, the EU levies a weighted average tariff of c. 10% on automobiles imported from the U.S., while the U.S. imposes a tariff of only 2.6% on those imported from the EU, making the European automobile manufacturers the most likely target for discretionary protectionist U.S. import tariffs. Certainly, the EU could anticipate this and offer a reduction of own tariffs to reach a trade deal with the U.S.

Medical and pharmaceutical product imports also strike us as a potential tariff target. The volume of imports from the EU is enormous at USD99bn in 2023. Also, the U.S. has a large domestic pharmaceutical industry and products from foreign competitors are subject to very low tariffs. However, the demand elasticity is relatively low in the space given patent protection amongst other factors.

The third candidate that shows similar characteristics to automobiles is the product group **electrical and industrial machinery and equipment**. The U.S. imported USD67bn of goods of this group in 2023. However, demand elasticity seems also low as incompatibilities of machinery make substitution more difficult, particularly in the case of replacement purchases.

05

Stock market sectors in focus

We assess the impact of tariffs on associated equity index sectors in the following tables. We point out that the member companies of the respective equity index sector are not representative for the industry in the economy, as only a small number of firms are publicly listed. Also, these companies are most often multinational corporations running production facilities in the U.S. This allows them to mitigate exposure to tariffs. Further, they hold significant pricing power and can push costs through to their customers.

European sectors in focus

Automobiles and Parts

- Many European auto OEMs and suppliers have shifted production facilities to Mexico, Canada, and the U.S. in recent years, relying on free movement across North American borders. Unfinished components often cross these borders multiple times. Hence, the sector would be particularly harmed by the proposed tariffs on Canada and Mexico. However, the degree to which auto companies are negatively affected varies significantly. Some European truck OEMs have over 70% of their North American production in Mexico and would therefore be extremely exposed.
- Further we note that if additional tariffs on car imports from Europe were put in place as signalized by Trump, European luxury car brands, which import up to 100% of their U.S. sales from Europe, may be at greatest risk. However, these companies have high pricing power to pass costs to customers and mitigate the margin squeeze.
- The automobile sector also faces a double whammy as China has announced retaliatory tariffs on U.S.-made vehicles with combustion engines above 2.5L. These include SUVs produced by some European brands in the U.S. for the Chinese market. Intense competition may make it difficult for the companies to pass these costs to customers. As such, profits from China could decline.
- We note that the sector has only a 2% weight in the STOXX 600 Index. As such it is simply too small to derail the overall index.

Healthcare

- The European healthcare sector generates over 40% of its total revenues in the U.S., with some companies having up to 70% exposure. However, the companies have significant production capacities in the U.S. Pharmaceutical companies, the sector heavyweights, generate only 15% of total sales by selling goods imported into the U.S. Medtech companies have a higher exposure at 25%
- European pharma companies also benefit from healthy margins, allowing them to absorb additional costs more easily. However, due to the low demand elasticity for pharmaceutical products, these companies would likely pass on any increased costs to customers, further straining already low healthcare affordability in the U.S. Consequently, there is a strong argument for exempting the healthcare sector from tariffs.

Luxury

- The luxury industry generates nearly all of its U.S. revenues from imported goods, accounting for close to 20% of total revenues. For instance, the wine and spirits segment generates 35% of its total sales in the U.S., with 95% of these products produced in the EU. Despite these dependencies, the sector does not appear to be significantly at risk, as the luxury segment is characterized by low demand elasticity. In some cases, the industry even exhibits positive price elasticity, where demand increases as prices rise.

Basic Resources

- The sector's revenue exposure to the U.S. is relatively small, at around 10% of total sales. The impact of the new tariffs will depend on the reaction of global prices at the London Metal Exchange (LME) and premiums for local steel and aluminium. Since their announcement, the LME benchmark price for aluminium has declined, as investors anticipate a potential drop in global metal demand amid a possible second trade war. Meanwhile, the U.S. Midwest premium, which is added to global prices at the LME, has risen to its highest level in over two years due to the tariffs. Higher local prices could lead to demand deterioration in the U.S., as the extra costs are likely to be passed on to end consumers. This could further weigh on global demand for metals, which is already low, with China struggling to revive its economy.

Capital Goods

- The sector's revenue exposure is slightly above average at ca. 25%. However, only 8% of revenues are generated by selling imported goods. The majority of sales are made by selling local to local. Additionally, at ca. 4%, services also make up a noteworthy share.
- Given low substitutability of industrial product, we think the capital goods sector will cope well with higher tariffs. The bigger risks to the sector's outlook are potential adjustments of fiscal spending and a drop off in hyperscalers' investments into data centers and electricity infrastructure.

U.S. sectors in focus

Healthcare

- The pharmaceutical and medical device industries rely extensively on imports from China. These are already subject to relatively high tariffs which were introduced by the Biden administration to counter lower quality products.
- With GLP-1 drugs having garnered significant attention last year, heavily supporting the performance of the pharmaceutical industry (one of the highest performing subsectors within the Healthcare sector), potential Trump tariffs on Europe may lead to lower sales projections for the drug given substantial manufacturing presence in Europe.
- However, while major drug developers do benefit from their multinational operations which hedge them against excessive tariff impact from one region, the impact from tariffs would likely still be negative overall since it is not as easy to ramp up domestic production given the highly regulated and complex nature of the U.S. healthcare and insurance landscape.

Energy

- The oil, gas and consumables sector makes up about 93% of the Energy subsector making it the most significant contributor to the performance of the sector. The U.S. derives over 70% of its crude oil imports from Mexico and Canada and tariffs may mean an additional price increase of USD0.50-USD1.00/gallon paid by the end consumer.
- The current administration's goal could be to produce more oil domestically which might ultimately lower prices in the long-term. However, the market is saturated and there are a low incentives to do so because of the higher costs of drilling and the problem for domestic producers that additional oil supply might put downward pressure on prices in the long-term. While there are short-term headwinds for the sector depending on the extent of tariffs imposed, there may be more of a neutral impact in the medium term.

Consumer Staples

- A third of the Consumer Staples sector is made up of the distribution & retail subsectors. The grocery and wholesale subsector has been witnessing trends of decelerating EPS over the years and any additional tariffs would put a dent on their already slim margins, meaning they pass on costs to consumers.
- For the beverages subsector, the impact may not be too profound given the fact that most of the beverages consumed are produced domestically, although there are downward trends in using domestically produced raw materials for production (e.g. as of 2021, less than 70% of wine was domestically produced, vs. up to 89% about 30 years prior).

Real Estate

- On the real estate front, there would be higher construction costs arising from the higher spend on lumber and building material imports due to tariffs on Canada and Mexico.
- Combined with the high mortgage rates and lower supply of existing housing inventory, the residential real estate sector may not be well positioned to benefit in the case of excess tariffs.
- The logistics real estate sector may be more shielded in the short to medium term as the industry has had an excess of supply in the recent years (which was in response to cover for pandemic era shortages) and may not be as affected by rising costs of construction materials.

Consumer Discretionary

- The resilient labour market combined with the wealth effect has seen the U.S consumer spend more on luxury and 'wants-based' items despite the stubborn post-pandemic inflationary environment. Higher tariffs could strain the target segment (luxury clothing imports, sporting goods, etc..) due to higher prices.
- However, luxury goods are not the most market elastic (i.e. marginal increase in prices are less likely to disengage an ultra-wealthy consumer). The extent of the tariffs and subsequent retaliation will affect the performance of this subsector due to the potential for shifting target consumer dynamics.

Technology

- The sector is affected by U.S. tariffs on imports from China. It could also be impacted if the EU decides to go after Big Tech at some point.
- Tariff exposure is currently concentrated in the hardware and equipment segments. The production of hardware such as smartphones, notebooks, tablets, or monitors is still largely based in China.
- Overall, 20% of the sector's total production is China-based. Analysts estimate the hit to EPS from 10% tariff hike at 2.5% of EPS for the whole sector. Without mitigation measures, IT hardware companies could be 2-3x more exposed.
- Mitigation is possible via: tariff exemption requests, shipping via third party countries like Vietnam, raising prices.

06

Conclusion

At the start of his second term in office, U.S. President Donald Trump launched his "trade war 2.0". We argue against the idea that the U.S. administration is simply using tariffs as a bargaining chip. Instead, we have set out the reasons why tariffs could be implemented and remain in place for some time.

Given the threefold approach of Trump's tariff policy, which combines a strategic negotiation aspect, a protectionist aspect and a structural financing aspect, we expect the process of shaping a tariff mix to be a lengthy one. Moreover, tit-for-tat tactics and retaliation from targeted trading partners are likely to trigger multiple rounds of negotiations.

Investors may thus be in for a wild ride over the next few months, if not years, with a steady and noisy flow of tariff-related news. This will increase the volatility of equity markets, which are already trying to understand a range of other issues e.g. the consequences of China's AI model DeepSeek, the rise of AI in general, and elevated political uncertainties.

We would advise investors to pay close attention in the run-up to April 1, when two important reports are expected to be released – the next regular CBO update of the nation's fiscal outlook and the potential policy actions under Trump's "America First Trade Policy" plan, setting the framework for policymakers to make decisions on both fiscal and trade policies in the coming years.

Although S&P 500 and STOXX 600 aggregate earnings are unlikely to be significantly affected by new tariffs, risk premiums will ebb and flow with the varying intensity of tariff news and actions, inducing stock price volatility. During the first trade war, stock markets experienced several setbacks following tariff escalations. We expect this pattern to be repeated (figure7).

Certain sectors are more vulnerable to a higher tariff regime given their exposure to global trade. These will experience higher price volatility. We highlight the sectoral risks but also point to recovery potential if negotiations lead to a trade deal.

Figure 7: The S&P 500 was sensitive to trade-related news during trade war 1.0

Source: LSEG Datastream, Deutsche Bank AG. Data as of February 14, 2025.

Glossary

BRICS is an intergovernmental organization consisting of ten countries — Brazil, Russia, India, China, South Africa, Egypt, Ethiopia, Indonesia, Iran and the United Arab Emirates.

The **DAX** is a blue-chip stock-market index consisting of the 40 major German companies trading on the Frankfurt Stock Exchange; other DAX indices include a wider range of firms.

Earnings per share (EPS) are calculated as a companies' net income minus dividends of preferred stock all divided by the total number of shares outstanding.

EUR is the currency code for the euro, the currency of the Eurozone.

The **FTSE 100** Index tracks the performance of the 100 major companies trading on the London Stock Exchange.

The **London Metal Exchange (LME)** is a major centre for industrial metals trading.

The **MDAX** tracks the performance of the 50 largest companies following the DAX stocks on the Regulated Market.

NTM stands for next twelve months in the context of earnings and thus price/earnings ratios.

OMX is a Swedish financial services company.

Price/earnings (P/E) ratios measure a company's current share price relative to its per-share earnings. In this context, **LTM** refers to last twelve months' earnings.

The **S&P 500** Index includes 500 leading U.S. companies capturing approximately 80% coverage of available U.S. market capitalization.

The **Stoxx Europe 600** is a broad-based index looking at various sizes of companies across 17 European countries.

The **Swiss Market Index (SMI)** includes 20 large and mid-cap stocks.

USD is the currency code for the U.S. dollar.

The **value added tax (VAT)**, also known as goods and services tax (GST), is a tax that is based on increasing the value of a product or service at each stage of production or distribution.

Appendix

Historical performance

Performance	14.2.2020 – 14.2.2021	14.2.2021 – 14.2.2022	14.2.2022 – 14.2.2023	14.2.2023 – 14.2.2024	14.2.2024 – 14.2.2025
S&P 500	16.4%	11.9%	-6.0%	20.9%	21.7%
Nasdaq Composite	44.8%	-2.2%	-13.3%	32.6%	25.8%
Eurostoxx 50	-3.8%	10.0%	4.3%	11.1%	13.7%
FTSE 100	-11.1%	14.3%	5.6%	-4.8%	15.3%
2-Year U.S. Treasury	2.6%	-1.9%	-2.0%	3.8%	4.7%
10-Year U.S. Treasury	6.6%	-4.3%	-12.1%	-0.6%	2.7%

Source: Deutsche Bank AG, Bloomberg Finance L.P., LSEG Datastream; Data as of February 14, 2025.

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