Analysis

How will the trade war hit the economy?

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The United States has set extensive barriers to trade and trade policy uncertainty has increased. A trade war triggered by the proposed increases in import tariffs could, in model-based scenarios, weaken the level of output globally by some 0.5%. The impacts on the euro area economy could be larger. In contrast, the impacts of a trade war on euro area inflation would remain relatively modest. The full impact of the tariffs is subject to a number of uncertainties. None of the parties seem to benefit from a trade war, and reaching a balanced solution in negotiations would be the best outcome for everyone.



Threat of a significant increase in import tariffs

The threat of a trade war is again casting a shadow over the outlook for the global economy. This is due to the objective of the new US administration to protect domestic production from foreign competition by imposing additional tariffs. Threats of tariffs are also used as a means for obtaining various concessions from trading partners.

The United States is an important trading partner to many countries, also to the EU. In 2023, the EU exported EUR 503 billion of goods to the US market, while importing EUR 347 billion. The trade surplus in goods is balanced out by the deficit in services. In 2023, the EU exported EUR 319 billion of services to the US while importing EUR 427 billion.[1] The EU's most important export goods to the United States are chemicals, machinery and transport equipment, and the most important goods imported from the US are extracts (incl. natural gas), chemicals, crude oil and machinery.[2]

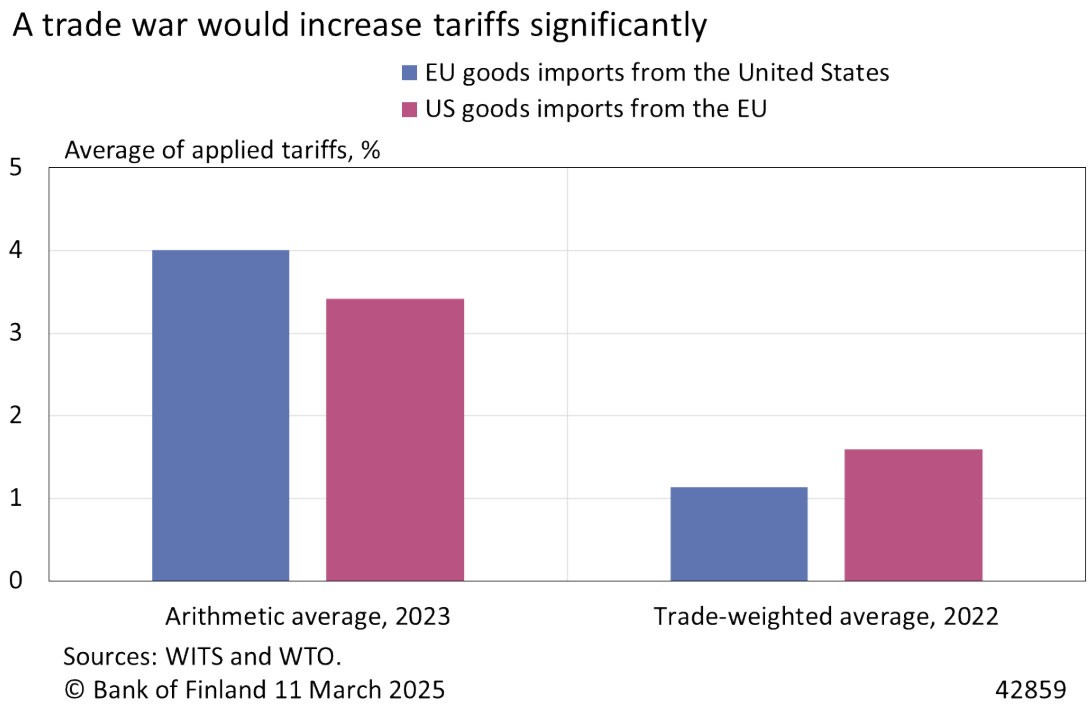
Since January, President Trump's second administration has imposed tariffs on imports from Mexico and Canada, and an additional tariff of 20% on imports from China. China and Canada have introduced retaliatory tariffs on US imports. As of 12 March, the United States will implement a 25% tariff on aluminium and steel imports. There have also been calls for additional tariffs on EU imports and more extensively on imports from all the countries whose import restrictions President Trump's administration considers to be larger than the corresponding import restrictions imposed by the United States. The US administration is currently analysing the trade policies of other countries and, based on these analyses, more announcements on tariffs are

expected. President Trump's administration considers as trade restrictions not only tariffs and exchange rate manipulation, but also, among other things, value-added tax, which is exceptional. If the United States imposes additional tariffs, other countries are expected to impose retaliatory tariffs.

If a trade war were to materialise, it would increase the tariffs on EU-US trade significantly. Figures for 2023 show that EU goods imports from the United States were subject to a 4% tariff on average, and US imports from the EU to a tariff of some 3.5% on average (Chart 1). The actual tariffs are, however, significantly smaller on average, as EU-US trade in goods subject to high tariffs is smaller. In EU-US goods trade, the trade-weighted average of the tariffs was only around 1% based on the situation in 2022 (Chart 1).[3] Indeed, there is no absolute figure for the average tariffs on EU-US trade.[4]

On average, higher tariffs are applied to both EU imports from the United States and on US imports from the EU in the case of, for example, textiles and clothes (approximately 8–9%) and agricultural products (approximately 6%).[5] Regarding individual products, the tariffs can even be much higher. For example, in many agricultural product groups, the tariffs on EU imports from the United States are on average different from those on US imports from the EU. A subject of debate has been the tariffs on cars, which for EU imports from the United States were 10% at the beginning of 2025, and the tariff on US imports from the EU was only 2.5%. The European Commission estimates that the tariffs in EU-US trade are overall well balanced.[6]

Chart 1.



The data available on the tariffs on US-China trade is more limited. Following the trade war in 2018–2020, the tariffs remained high, and tariffs agreed within the context of the WTO are no longer providing a correct picture of the level of tariffs. The trade-weighted average of US tariffs on Chinese imports is estimated at approximately 10–19%, based on the situation in 2023.[7,8]

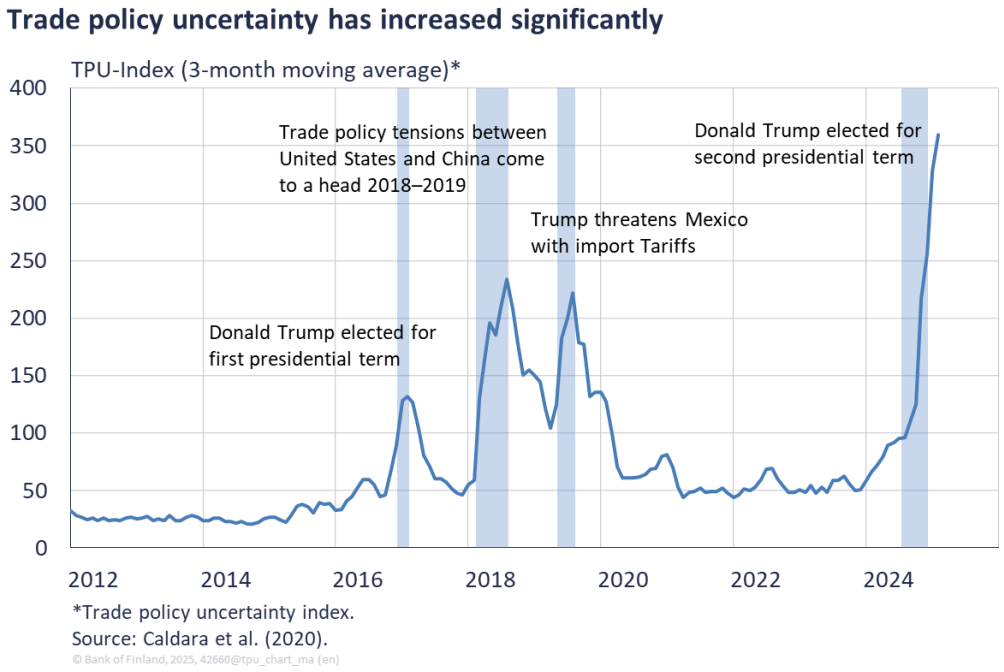
In addition to tariffs, there are also other barriers to trade. Their importance in trade policy has increased due to the generally weaker protection provided by tariffs. Other trade barriers may also include measures other than trade policy tools; i.e. measures whose purpose is to protect public health and the environment or otherwise regulate the markets.[9] This may also include EU regulations and strong restrictions on genetically modified crops, which in practice considerably hamper the import of US agricultural products into the EU.[10]

The price of imports is influenced also by the exchange rate. The real USD/EUR exchange rate, a measure of the euro area's price competitiveness relative to the United States, has depreciated by a quarter since spring 2014, when the euro area monetary policy stance started to ease relative to the United States. This means that the euro area's price competitiveness relative to the United States has improved. When estimating the impacts on prices, the size of exchange rate movements cannot, however, be compared directly with the changes in tariffs.

Elevated uncertainty triggered by a trade war could hit investment and risk premia

The planned import tariffs, if implemented, would push up the prices of the imported products subject to the tariffs and would decrease US imports from the countries in question. In addition to the direct impacts of the import tariffs, the threat of a trade war itself could increase economic agents' uncertainty over the future and weaken economic growth. In particular, uncertainty over the level and extent of the import tariffs, the possible retaliatory tariffs and the actual impact on prices may postpone companies' investment decisions and raise financing costs due to higher risk premia. That is, uncertainty reduces investment and pushes up risk premia, which has an adverse impact on total output and also indirectly affects inflation. These effects could, in the worst case, turn out to be even larger than the direct economic impacts of the import tariffs.

Chart 2.



The increase in uncertainty triggered by a trade war can be measured with, for example, the trade policy uncertainty index (TPU), constructed from newspaper articles in the United States (Chart 2)[11]. The index reached a record high during the US presidential elections in November 2024, and in subsequent months it has remained exceptionally high. The previous time the TPU index increased nearly as strongly was during Donald Trump's first presidential term, when trade policy tensions rose between the United States and its trading partners.

The historical correlations between the TPU index and macroeconomic variables, such as investment and risk premia, can be used for estimating the impacts of uncertainty. According to our calculations, a rise in uncertainty that increases the TPU index by 100 points reduces investment already in the same quarter by some 0.5%.[12, 13] Correspondingly, a similar increase in uncertainty raises risk premia in developed economies by approximately 0.04 percentage points and in emerging economies by as much as 0.12 percentage points.

Based on the recent increase of some 250 points in the TPU index, we can therefore form a rough estimate of the economic impacts of the uncertainties related to the threatening trade war and use the estimate to calibrate the model simulations presented in the following chapter. Our estimates show that, in the short term, uncertainty may reduce investment in all the examined economies by approximately 1.25% and raise risk premia in developed economies by some 0.1 percentage points and in emerging economies by approximately 0.3 percentage points.

It is important to remember, however, that one cannot escape estimation uncertainty even when estimating the impacts of uncertainty itself. The confidence intervals calculated for our estimates are fairly wide as the estimates are based on historical data – which are available only to a very limited extent. The figures presented here are, however, our best empirical estimate of the impacts of trade policy uncertainty on investment and risk premia.

A trade war would weaken output globally

The economic impacts of the import tariffs and of the increase in uncertainty resulting from the threat of a trade war can be estimated using an extensive macroeconomic model of the global economy. Chart 3 presents the macroeconomic effects of a possible trade war. The scenarios are based on the Global Integrated Monetary and Fiscal Model (GIMF), developed by the IMF (see Kumhof et al. 2010).[14]

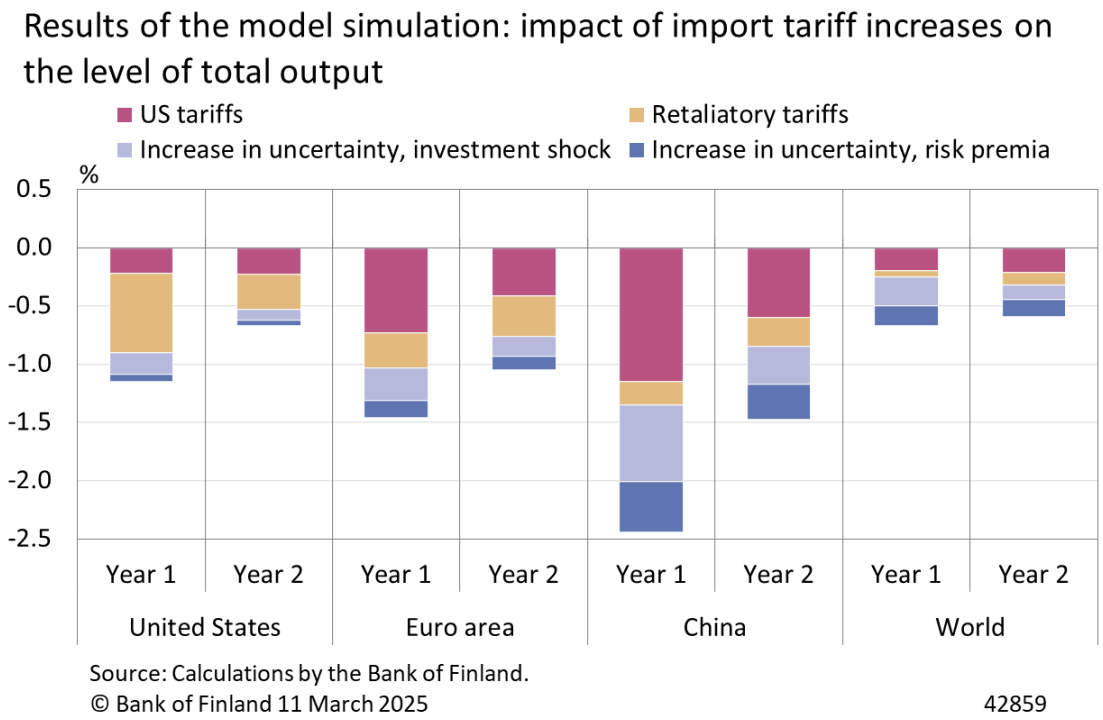
First, we examine the impacts of the increases in US import tariffs imposed on the euro area and China.[15] The examined additional tariffs are 25% on imports from the euro area and 20% on imports from China. Next, the euro area and China are expected to impose symmetric retaliatory tariffs on the US. Moreover, the increase in uncertainty described in the previous section will weaken investment and raise private sector risk premia.[16] The impacts are for the first two years, but the longer-term impacts are fairly similar to the impacts in the second year. The calculations are not forecasts; they describe possible scenarios. Uncertainty concerning the implementation and size of the tariffs is high. The calculations do not assume any discretionary fiscal stimulus measures to alleviate the negative impacts on growth.[17]

Based on scenario calculations, a trade war could, if it materialised, weaken the level of total output globally by some 0.6% (Chart 3). The economic impacts would be larger in the euro area (scenario: first year −1.5% and second year −1.1%) and in China (scenario: first year −2.4% and second year −1.5%). The impacts on the US economy would also be significant (scenario: first year −1.2% and second year −0.7%). At the same time, trade policy tensions would strengthen the US dollar slightly relative to the other currencies, which would alleviate somewhat the impacts of the US tariffs on the relative prices of the export goods of the euro area and China.

Tariffs and retaliatory tariffs (Chart 3, reddish and ochre bars) seem to explain most of the negative economic impacts. The scenario assumes that the euro area and China will impose retaliatory tariffs on goods from the United States. As a result, some of the negative impacts on, for example, the euro area, will be offset by growth in its share of exports to China (trade diversion). The retaliatory tariffs placed by China and the euro area will raise the prices of US products in these countries relative to the products of other countries. This will have significant repercussions for US exports and, consequently, for the country's economic growth.

In addition to the direct impacts of the tariffs, the increase in uncertainty would have negative growth effects in the scenario, especially in China (Chart 3, light and dark blue bars)[18]. The direct impacts of the tariffs will be most heavily felt in foreign trade, whereas uncertainty in the scenario will hit investment, in particular. In emerging economies, the effects of uncertainty on the economy will be even more pronounced, as in China, for example, investment plays a major role in economic growth, and risk premia typically rise more readily in emerging economies.

Chart 3.



The import tariffs will have a direct impact on the prices of imported goods and therefore on inflation. The impact on inflation will be fairly subdued, however, both globally and in the euro area, so the monetary policy response to inflation will also remain modest. The trade barriers imposed by the United States will reduce the demand for imported goods in the US, and world market prices will decrease slightly as a result. In the model calculations, the retaliatory tariffs, in turn, will slightly push up the prices in tariff-imposing regions, such as the euro area. The overall impact on prices will depend on pricing power in different product categories and on the extent to which businesses are able to pass on the tariffs into the prices of their products.[19]

Besides being affected by the tariffs, headline inflation will also be affected by the increase in uncertainty that will weaken economic growth. In the model simulations, higher uncertainty will slightly weigh on the euro area inflation. On the other hand, the adverse effects of trade tensions on production chains may also push up the prices of intermediate goods and therefore increase price pressures. Based on the ECB's recent contacts with non-financial companies, the effects of the tariffs on inflation are spread fairly evenly in terms of their price-raising and price-decreasing impact (Maruhn et al. 2025), with the net effect being close to zero. The majority of euro area companies estimated that the tariffs would have little or no impact on inflation. What companies were concerned about, however, were the negative effects of increased price competition on prices.

Extent of uncertainty and allocation of tariffs significant in terms of economic impacts of a trade war

Besides the Bank of Finland, other institutions, too, have recently used macroeconomic models for studying the impacts of tariffs on the global economy. The most important studies include those by the Peterson Institute of International Economics (PIIE) (McKibbin et al. 2024, 2025a and 2025b) and the analysis in the IMF's World Economic Outlook from October 2024. Both the PIIE and the IMF analyses are based on global macroeconomic models, as is our analysis presented in this article. All of the PIIE analyses are based on the same model and the IMF analysis on the GIMF model we also use in this article's analysis.

In the IMF analysis, the United States, the euro area and China each impose a 10% tariff on each other. The United States also imposes a 10% tariff on the rest of the world. The PIIE analyses examine a wide range of various tariff scenarios. As with the tariff scenarios, the different analyses also diverge somewhat from each other in terms of model assumptions[20].

The results of the different tariff scenarios are presented in Table 1. In the PIIE model, the impacts on the euro area have not been modelled separately, so for the PIIE scenarios the table shows the impacts on Germany instead of those on the euro area. Of the PIIE analyses, we will examine the scenario in which the United States imposes a 10% tariff on all countries and these respond with equivalent retaliatory tariffs (Table 1, scenario 2). According to our impact assessment, the trade war will have a greater effect on total output than suggested by the IMF and PIIE calculations. The key difference is that we assume higher additional tariffs for the euro area (25%) and China (20%).

Contrary to our calculations, in the IMF analysis the impacts of the tariffs are most heavily felt in the second and, in some cases, only in the third year after imposition. This is due to the fact that, in the IMF model, trade policy uncertainty only eases after the third year. The PIIE analysis excludes trade policy uncertainty, and this is one of the factors explaining why it suggests, except for the United States, a significantly smaller tariff impact on investment and output than the other assessments.

The PIIE analysis points to smaller tariff impacts on Germany than our calculations for the euro area. This reflects – in addition to the exclusion of uncertainty and the smaller assumed tariff increases – trade diversion in response to tariffs, i.e. redirection of trade from trade-war economies to other economies. The PIIE scenario assumes that the United States imposes tariffs on all countries, which will lead to greater trade flows between other economies and stronger losses in market shares for US exporters. In this scenario, trade diversion would generate gains for the euro area economy, which would mitigate the effects of the trade war compared with our

scenario.

Results of the model simulation under different tariff scenarios

Source	Scenario	United States		Euro area/ Germany		China		World	
		Year 1	Year 2	Year 1	Year 2	Year 1	Year 2	Year 1	Year
		Impact of tariffs (%) on the level of total output							
Calculations by the authors	See text	-1.2	-0.7	-1.5	-1.1	-2.4	-1.5	-0.7	-0.
McKibbin et al. (2024)	See text	-0.4	-0.9	-0.1	-0.1	0	-0.1	-	-
IMF (2024)	See text	-0.3	-0.6	-0.4	-0.7	-0.6	-0.8	-0.3	-0.
McKibbin et al. (2024)	10% US tariff on the rest of the world	-0.1	-0.4	-0.1	-0.1	-0.3	-0.2	-	-
McKibbin et al. (2024)	60% US tariff on China	0	-0.1	0	+0.1	-0.9	-0.9	-	-
McKibbin et al. (2024)	60% reciprocal US–China tariffs	-0.1	-0.4	0	+0.1	-0.8	-1.2	-	-
McKibbin et al. (2025a)	10% reciprocal US–China tariffs	-0.1	-0.1	-	-	-0.2	-0.2	-	-

As in our assessment, the impacts of the tariffs on inflation are also minor in the IMF analysis, both in the euro area and globally. The PIIE analysis results in higher inflationary impacts for the United States and China.

President Trump's previous tariffs were largely borne by US households and businesses

The economic impacts of the tariffs imposed by Donald Trump during his first presidential term have been subject to extensive analysis, and the related findings can also provide some indication of the potential effects of the new tariffs. The more fully the tariffs are passed on to import prices, the more detrimental they are to the tariff-imposing country (Feenstra 2004). In 2018–2019, the United States imposed steel and aluminium tariffs on a number of countries, along with tariffs on solar panels and washing machines. It also introduced tariffs on a wide range of products from China, particularly on machinery and equipment. Research literature on the repercussions of these tariffs suggests that the costs were ultimately borne by US households and businesses.

For example, the tariffs raised the price of steel in the United States and increased employment in steel production. According to the PIIE estimates, however, the price of each job created was as much as USD 650,000, paid by US steel users in the form of more expensive domestic steel (Hofbauer and Jung, 2018).

Amiti et al. (2019) and Cavallo et al. (2021) find evidence that the entire cost of the tariffs fell on US import firms and households. According to Cavallo et al. (2021), Chinese exporters did not lower their dollar prices by much, despite the depreciation of the yuan renminbi, meaning that the costs of the tariffs were largely borne by US firms and households. The Chinese goods affected by the tariffs were differentiated goods for which substitutes are difficult to locate. Retaliatory tariffs, on the other hand, largely focused on agricultural commodities that can be more easily sourced from other countries, forcing the producers to carry a larger share of the burden from the retaliatory tariffs. In fact, the United States decided to provide assistance to farmers when, in particular, soybean exports to China came to a halt.

Changes in exchange rates also contributed to reducing the impacts of the tariffs on the US trading partners' exports. Jeanne and Son (2024) estimate that the tariffs imposed by the United States on China in 2018–2019 accounted for as much as two thirds of the depreciation of the yuan renminbi in that period and about a fifth of the appreciation of the US dollar. Khalil and Strobel (2024) argue that trade policy uncertainty in itself drives US dollar appreciation, thereby weakening the impact of tariffs.

Although research literature finds that the tariffs imposed during Trump's previous presidency were detrimental to the US economy, there can also be justifications for tariffs in some cases. Import tariffs may lower the world market prices of the affected products and thus improve the tariff-imposing country's terms of trade (export prices relative to import prices).[21] Moreover,

infant industries may require protection against foreign competition for some time in order to develop and advance. This argument in favour of import tariffs has, however, also long been criticised in research literature (Baldwin, 1969). For example, Melitz (2005) demonstrates that import quotas may, also in the case of infant industries, be more advantageous than import duties and that the disadvantages of production subsidies are generally even smaller as they do not distort consumption. National security, which the United States has used as a rationale for steel and aluminium tariffs, may also be a valid reason for protectionism (Brander, 1986).

From the perspective of an individual economic area, import tariffs can indeed generate gains through better terms of trade or progress in a specific industry. However, this may lead to an undesirable equilibrium in which economic areas impose import tariffs on each other in order to improve own terms of trade (Johnson, 1953–1954). Bagwell and Staiger (1999) establish that a trade agreement between trading partners can improve the efficiency of both economies compared with a situation where individual countries impose import tariffs to improve their own position. In its agreements, the WTO applies the principle of reciprocity, i.e. the member countries will make mutual, equal changes in tariffs when increasing or decreasing them. In addition, the WTO's most-favoured-nation (MFN) principle ensures that all member countries receive equal treatment in trade relations, which prevents discrimination and promotes fair competition. The principle of reciprocity helps in maintaining balanced terms of trade conditions and, together with the principle of MFN, serves to deliver efficient trade policy outcomes (Bagwell and Staiger, 1999).

Conclusions

Although the imposition of import tariffs may in some cases be beneficial from the perspective of an individual economy or industry, it will likely lead to retaliatory tariffs by the country's trading partners. Based on the calculations presented in this article, the import tariffs envisaged by the United States and the trade war triggered by them would be detrimental to all parties involved and would weaken the level of global output by more than 0.5%. In addition to direct trade effects dampening output, the increase in trade policy uncertainty would weaken the investment outlook for businesses. The overall economic implications will depend on a number of factors, such as the magnitude of the increase in uncertainty, the impact of the tariffs on the terms of trade, and the extent of trade diversion. In the light of economic research literature, a trade agreement based on reciprocity under the principles of the WTO would be the most effective solution to the trade war.

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Notes

1. See European Commission (2025). ↑
2. Statistical sources: WITS and WTO. The data are based on WTO Multilateral Trade Negotiations (MTN) Categories, and they are for the year 2022. ↑
3. The source of the average tariffs on EU-US trade is World Trade Organisation (WTO) data, classified in accordance with the WTO Multilateral Trade Negotiations categories. All the conclusions and analyses presented in this article and based on WTO data are the responsibility of the authors and do not necessarily represent the views of the WTO. ↑
4. See also European Commission (2025). ↑
5. The figures are arithmetic averages of the tariffs applied to the product groups based on the situation in 2023. ↑

6. The Peterson Institute for International Economics estimates that US tariffs on Chinese exports are on average 19.3% and Chinese tariffs on US exports are on average 21.1%. See Bown (2023). ↑
7. The Economist Intelligence Unit estimates that the average tariff rate (WATR) against imported Chinese products is 10.3%. The estimate is lower than that of the Peterson Institute, which is due to the fact that the actual tariff rates are lower owing to business lobbying, exemptions and trade substitution. See Economist Intelligence Unit (2024). ↑
8. See UNCTAD (2025). ↑
9. See e.g. USTR (2023). ↑
10. The TPU index measures the frequency of joint occurrences of trade policy and uncertainty terms across major US newspapers. The index is described in more detail in Caldara et al. (2020). ↑
11. For estimating the impacts of uncertainty on investment and risk premia, we used several structural vector autoregressive (SVAR) models. We assumed that the increase in uncertainty has a negative impact on investment and a positive impact on risk premia by setting sign restrictions on the contemporaneous effects of the uncertainty shock. For estimating the models, we used, in addition to the TPU index, data on private investment and risk premia in the economic regions of interest. ↑
12. TPU index rose by some 100 points, for example, when President Trump was elected for his first term. ↑
13. We use a six-region version of the GIMF model, with the regions being the euro area, Japan, China, other emerging Asia, the United States, and remaining countries. The calibration of foreign trade in our version of the model is based on 2019 statistics. In our modelling, EU tariffs are approximated with euro area tariffs. Estimates of the impacts of a trade war on Finland's economy are presented in the article by Juvonen, Silvo and Viertola (2024). ↑
14. The revenue from tariffs is expected to be used in full for reducing public debt. ↑
15. In the model, uncertainty is described based on the impacts presented in the section above, with a shock that reduces investment by 1.25% in the countries party to the trade war and a global rise in private sector risk premia. The growth in risk premia is assumed to be 0.3 percentage points in the emerging economies and 0.1 percentage points in the developed economies. The shocks are assumed to ease gradually with a duration coefficient of 0.5. ↑
16. In the modelling, monetary policy is allowed to respond in accordance with its policy rule. ↑
17. Higher risk premia (dark blue bars) will raise financing costs for companies, and this will further reduce investment. ↑
18. For example, in the 1980s, tariffs imposed by the United States seem to have raised the prices of motorcycles by the full amount of the tariff, but the impact on the prices of trucks was considerably smaller (Feenstra, 2004). This difference has been explained by increased production of trucks in the United States in response to the tariff and by the temporary nature of the tariff on motorcycles. ↑
19. In the PIIE model, tariff revenue is used to reduce the US federal budget deficit, and in the IMF model it is transferred back to households. According to McKibbin et al. (2024), the ↑

assumption will have some effect on the results. In the IMF model, trade policy uncertainty will push down investment in the United States and the euro area by about 4%, and elsewhere by about half of this. Uncertainty is assumed to ease after the third year. The PIIE model does not account for uncertainty.

20. An improvement in the terms of trade means that the economy's export prices increase relative to import prices. ↑

Keywords

EU, import tariffs, trade war, USA