Macro Note

Eurozone: Economy holds up better-than-expected in 2Q; EU-US trade deal waiting to be finalized; ECB in wait-and-see mode

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Global Economics & Markets Research
GlobalEcoMktResearch@uobgroup.com
www.uob.com.sg/research

Lee Sue Ann
Economist
Lee.Sueann@uobgroup.com

- The European Union (EU) continues to work with the US to finalise a Joint Statement, as agreed on 27 Jul, where both EU head Ursula von der Leyen and US President Donald Trump struck a deal on tariffs. The centerpiece is a 15% baseline tariff on almost all European exports to the US, except for steel, aluminum and pharmaceuticals.
- The EU-US trade deal may have helped avoid a deeper trade conflict, but the ongoing uncertainty and increased costs for EU exporters, as well as weakening external demand are likely to keep economic growth subdued through the rest of the year. We have nonetheless revised out forecasts for Eurozone GDP growth to 0.9% (from 0.5% previously), and 1.1% (from 1.0% previously) for 2025 and 2026, respectively.
- The European Central Bank (ECB) is expected to take a cautious and data-dependent approach. At this juncture, we expect a 25-bps cut at the next ECB meeting on 11 Sep, and we see the ECB cutting again by 25 bps in Oct or Dec. We recognize that the ECB is approaching the end of its current rate cutting cycle; but much depends on how tariffs, growth and inflation evolve.

The European Union (EU) continues to work with the US to finalise a Joint Statement, as agreed on 27 Jul, when both EU head Ursula von der Leyen and US President Donald Trump struck a deal on tariffs. The EU-US trade deal was announced at Trump's luxury golf course in western Scotland after an hour-long meeting.

This comes after months of negotiations, and just days before the 1 Aug deadline when Trump threatened to impose steep levies on European goods had an agreement not been reached. Both the EU and the US are each other's largest trade partners and account for 1/3 of all global trade. In 2024, two-way trade in goods and services reached nearly $2 trillion. The US ran a $235.6bn goods trade deficit with the EU. Pharmaceuticals, car parts and industrial chemicals were among Europe's largest exports to the US.

Key takeaways:

The centerpiece is a 15% baseline tariff on almost all European exports to the US, except for steel, aluminum and pharmaceuticals. That compares with the 10% baseline 'reciprocal' tariff rate but is materially lower than the 20% rate that Trump imposed, and later paused, on 'Liberation Day', as well as the 30% rate in Trump's Letter to Von der Leyen.

Steel and aluminum will still be taxed at 50%, dashing the hopes of both these industries in the bloc.

The 15% tariff also applies to autos (down from the 27.5% rate introduced in Apr). This will bring relief for the bloc's auto sector, employing around 13 million people.

Semiconductors and pharma products will also be taxed 15%. However, ongoing US 'section 232' investigations into semiconductors and pharma products, which could lead to US tariff increases, are set to report findings in two weeks' time. According to von der Leyen, these will be dealt with 'on a separate piece of paper'.

The EU also committed to buy $750 billion of liquefied natural gas, oil and nuclear fuels from the US over three years – to replace Russian energy sources. The EU will also pledge $600 billion more in additional investments in the US over the course of Trump's second term.

Both partners will adopt 'zero for zero' tariffs on aircraft (and parts), certain chemical and agriculture products, and various raw materials. A full list has yet to be finalised.

How has the US responded?

- In a statement announcing the agreement, the White House described it as "fundamentally rebalancing the economic relationship between the world's two largest economies". It will open up market access and re-establish a positive long-term relationship between the two economies, it said.

- Meanwhile, the EU announced earlier this week (4 Aug) that it will suspend for six months its planned countermeasures against the US' tariffs, which were set to take effect 7 Aug.

How have European leaders responded?

- German Chancellor Friedrich Merz welcomed the agreement, saying it avoids "an unnecessary escalation in transatlantic trade relations".

- French Prime Minister Francois Bayrou called the deal a "dark day" for Europe, saying the bloc had caved in to the US president with an unbalanced deal that spares US imports from any immediate European retaliation.

- French trade minister, Laurent Saint-Martin, criticised the EU's handling of the negotiations, saying the bloc should hit back in what he saw as a power struggle initiated by Trump.

- EU Trade Commissioner Maroš Šefčovič said it was the "best deal we could get under very difficult circumstances".

- Wolfgang Niedermark, a board member of the Federation of German Industries trade body, called the deal "an inadequate compromise" with the EU "accepting painful tariffs".

- Benjamin Haddad, France's European affairs minister, said: "The trade agreement … will bring temporary stability to economic actors threatened by the escalation of American tariffs, but it is unbalanced.

- Dutch Foreign Trade Minister Hanneke Boerma said the deal was "not ideal" and called on the commission to continue negotiations with Washington.

What happens next?

- As of 1 Aug, the US will apply this maximum tariff on the vast majority of EU exports.

- Negotiations are ongoing about wine and spirits, according to EU officials. This will be welcome news for Irish distilleries and will mean extra lobbying from Europe's greatest winemakers in France, Italy, Germany, Spain and Portugal. But negotiations will require weeks and perhaps months.

- Agriculture remains protected from US imports that do not comply with EU rules. But the EU has eliminated tariffs on some agrifoods it cannot source itself including some nuts, some processed fish and pet food. It is also increasing the quota on bison allowed into the EU at a favoured tariff.

- The next step is a joint statement, similar to that of the UK's in early May, which must then be turned into legal text. This process could take two months, if the UK's experience is anything to go by.

- At the same time, Trump is expected to sign a series of executive orders putting the deal into legal effect in the US.

- It will not be binding in the EU which will have to create a legal instrument or international agreement to bring it into force. This means involving the European Parliament and all national parliaments, and it could take weeks.

- As it is, Von der Leyen described the deal as a "framework" agreement. "Details have to be sorted out, and that will happen over the next weeks," she said.

- Much of the technical details of the agreement are yet to be finalised, and implementation will depend heavily on business investment decisions rather than EU-level policy.

- Note that the European Commission has bloc-wide competency to make policy and sign deals on trade so no one country can veto the US deal. France's protests are seen as political and are not expected to derail the deal.

- The deal creates a division on the island of Ireland, as traders in Northern Ireland can sell into the US on a 10% tariff rate, courtesy of the UK deal, while their neighbours in Ireland will be hit with the 15% rate. The disparity will make for difficult diplomatic conversations over guarantees to maintain stability on the entire island in the Good Friday agreement, which had already been rocked by the fallout from Brexit, when customs arrangements involving Northern Ireland became a huge headache for EU and UK negotiators.

Potential implications:

Trump called the deal "the biggest deal ever made", while von der Leyen said "it's a big deal. It's a huge deal".

Indeed, had an agreement not been reached, the outcome would have been an increase in US tariffs to 30%, and EU counter-tariffs targeting EUR93bn worth of US products. In this regard, the deal brings some certainty about the new reality of permanently higher tariffs.

Still, current trade barriers are much higher than before Trump took office in 2025, and hence, the economic costs are substantial. In all, the tariffs will apply to 70% of EU exports worth around EUR380bn a year, making European goods even less competitive than they were before. Logically, this would likely first result in a fall in corporate profits for companies that manufacture in Europe; followed by a rise in unemployment rates across Europe.

The Eurozone economy grew by 0.1% q/q in 2Q25, according to preliminary estimates. While the reading was slightly better than expected, country-level data from the bloc's largest economies indicate that US tariffs are starting to weigh. The slowdown follows an unexpectedly strong first quarter, when the economy grew by 0.6%. Among the largest economies, both Germany and Italy contracted by 0.1% q/q, while France surprised to the upside with 0.3% growth, driven largely by inventory accumulation.

The deal may have helped avoid a deeper trade conflict, but the ongoing uncertainty and increased costs for EU exporters, as well as weakening external demand are likely to keep economic growth subdued through the rest of the year. We have nonetheless revised out forecasts for Eurozone GDP growth to 0.9% (from 0.5% previously), and 1.1% (from 1.0% previously) for 2025 and 2026, respectively. We see some resilience in the Eurozone economy stemming from a more expansionary fiscal policy, especially in Germany; but also from signs of growth in domestic demand, which should help cushion some of the impact from tariffs as Europe's dependence on export-led manufacturing falls.

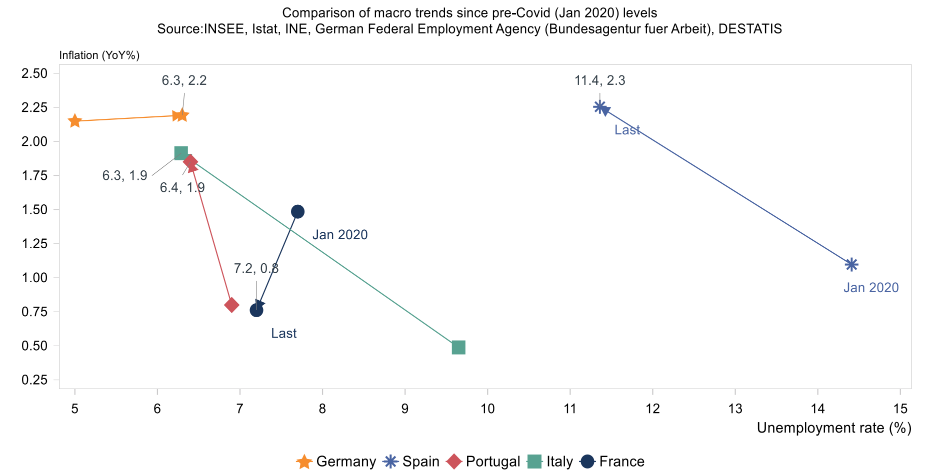
The European Central Bank (ECB) is expected to take a cautious and data-dependent approach. At this juncture, we expect a 25-bps cut at the next ECB meeting on 11 Sep, and we see the ECB cutting again by 25 bps in Oct or Dec. We recognize that the ECB is approaching the end of its current rate cutting cycle; but much depends on how tariffs, growth and inflation evolve.

Official Sources:

- EU-US trade deal explained
  https://ec.europa.eu/commission/presscorner/detail/en/qanda_25_1930
- Fact Sheet: The United States and European Union Reach Massive Trade Deal
  https://www.whitehouse.gov/fact-sheets/2025/07/fact-sheet-the-united-states-and-european-union-reach-massive-trade-deal/

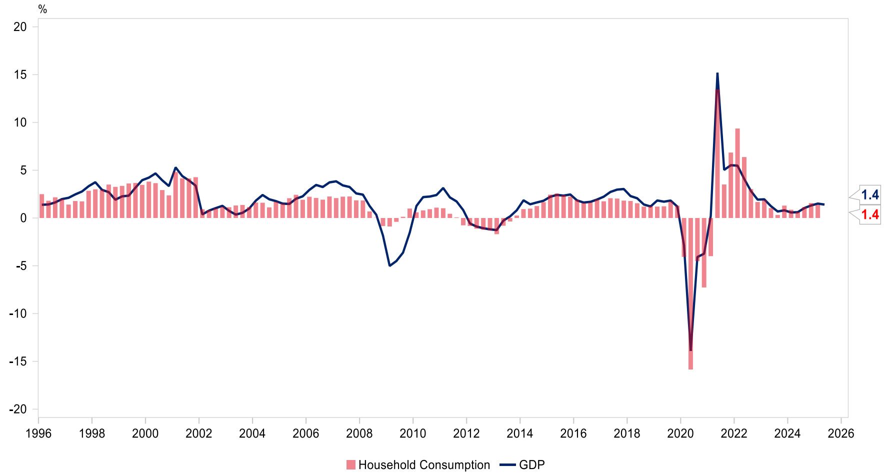
Key Euro Area countries: Unemployment rate and inflation

Source: Macrobond, UOB Global Economics & Markets Research



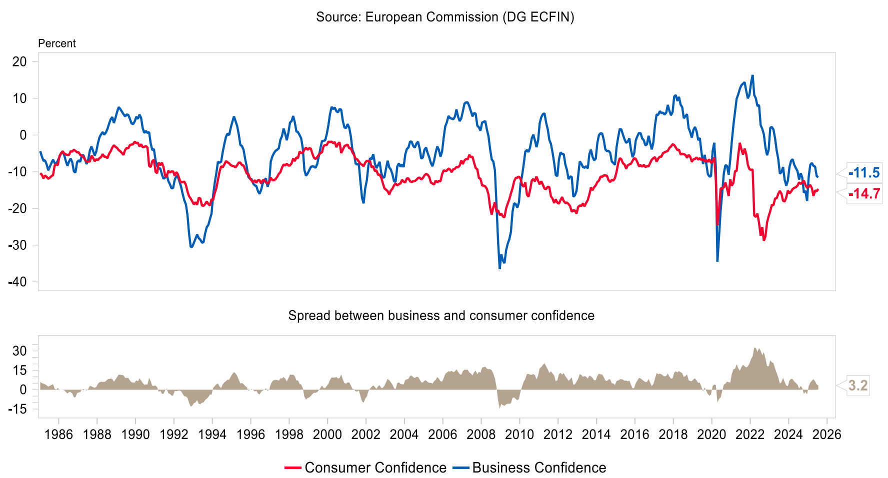
Household consumption to support economic growth

Source: Macrobond, UOB Global Economics & Markets Research



Euro Area: Consumer and business confidence

Source: Macrobond, UOB Global Economics & Markets Research



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