Trade War – ACT II

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Following days of uncertainty and mixed messages, both from other Cabinet members and from the President himself, President Trump confirmed that 25% tariffs on imports from Canada and Mexico – plus an additional 10% on imports from China – go into effect on March 4th. The news has sent global equity markets into a tailspin.

Notably, President Trump confirmed these tariffs at a press conference announcing a planned $100 billion of investments in the United States by Taiwan Semiconductor Corporation. Upon questioning, he stated that Canada and Mexico will "have to build their car plants, frankly, and other things, in the United States, in which case they have no tariffs."[1] President Trump also signaled that tariffs for other countries will be imposed on April 2nd. There will be intense focus on the President's imminent address to the joint session of Congress on March 4th at 9pm ET. Perhaps President Trump will lay out exceptions and offramps to the current tariffs . . . or perhaps he will prepare the country for a protracted battle with promises of a brighter future.

Making sense of it all

While President Trump's initial justification for tariffs on Canada, Mexico, and China is related to border security and fentanyl, it is clear that his "America First" platform aims to dramatically alter trading relationships across the globe. At a fundamental level, he sees the existence of a U.S. trade deficit as prima facie evidence that unfairness exists in these trading relationships. While one could ascribe a method to his current approach – such as starting hard to pull back later, creating tactical unpredictability, setting a precedent for the EU and others, or putting Canada, Mexico, and China in competition to see who will offer the best deal – it may simply be that President Trump envisions a favorable outcome from wielding the largest sledgehammer. His desire to generate revenue through tariffs to fund tax cuts, while secondary to the goal of bringing jobs back to the U.S., also features prominently.

Is the President overestimating U.S. economic resiliency?

Weak data and survey measures in the U.S. punctuated late February/early March, which include falling consumer confidence and rising weekly initial unemployment claims. The Atlanta Fed GDPNow estimate for Q1 GDP tumbled into contractionary territory over the past week.[2] Tariffs are not the only disruption impacting the economy. DOGE spending cuts and layoffs will have an ongoing impact. Even AI proliferation is a slow-moving disruption that is likely causing a degree of caution among the workforce.

Based on a low unemployment rate combined with February stock market record highs, President Trump may be overestimating the ability of the U.S. economy to absorb shocks. Prior downturns have demonstrated that the labor market can reverse quickly, particularly now that the buffer of excess job openings has eroded. Currency markets may also be signaling a less-than-robust U.S. position as the Canadian dollar has not breached its February lows relative to the U.S. dollar, and the Japanese yen has recently strengthened considerably. The strengthening yen could add another element of market risk if the "yen carry trade" (borrowing cheaply in yen to invest in U.S. markets and elsewhere) begins to unwind and reverse. The U.S. economy began the year in a stable but not stalwart position. A modest economic shock can be absorbed, but bracing for multiple large ones is considerably more precarious.

[1] President Trump, 3/3/2024, speaking at a press conference
[2] www.atlantafed.org/cqer/research/gdpnow

The U.S. domestic pushback is coming

While President Trump believes he has a mandate for dramatic changes, several counterbalancing realities are also important. Republicans, as a starting point, generally lean toward free trade and will likely only support the President's tariff agenda so far. The Republican majority in the House is the slimmest in almost 100 years, so the extent to which tariff revenue plays into budget negotiations may set important bounds. Business leaders such as Ford's CEO are already making public remarks about the "devastating" consequences of these tariffs. Layoff announcements would be the point at which pushback gathers strength and the narrative around tariffs takes a decidedly negative turn domestically. This development is likely to occur in a matter of weeks, not months. Indeed, President Trump could provide a roadmap that includes an offramp to tariffs at any time.

Response and Outlook

Canada and China have announced retaliatory tariffs and Mexico's President has indicated that theirs will also be announced soon. So far, the response by all three countries has been restrained, which makes sense given that tariffs cause near-term damage to the economy of both parties. Our belief is that President Trump may take the U.S. (and world) economy to the edge but reach trade deals before going over it. That said, there is great uncertainty at the edge. Moreover, in the case of economic impacts from tariffs, the edge may be upon us more precipitously than President Trump believes.

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