Ameriprise Financial

Economic Views Brief

Russell T. Price, CFA | Chief Economist
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Examining the Trump tariff threat

The magnitude and immediacy of tariff actions recently announced by the Trump Administration are unprecedented. This makes estimating their economic impact and the path ahead that much more difficult and furthers the uncertainty surrounding the situation. Currently, market participants do not have traditional and well-understood economic principles to evaluate, but rather, the near-term path is heavily reliant on the very uncertain next steps of a handful of individuals.

Key Takeaways

- Tariffs recently announced by the Trump Administration are unprecedented in the modern era. The magnitude and speed at which they are being implemented also adds to the potential economic disruption of the actions.
- We estimate the tariffs, as currently imposed and proposed could cut U.S. real GDP growth by 1.0% to 2.5% over the next 12-months with a similar gain in inflation.
- Despite the denials of various administration officials, we still believe there is an opportunity for the tariffs to be trimmed in coming weeks and months via individual country agreements.

Simply examined, the sharp increase in tariffs would raise prices for imported goods significantly, reducing consumer demand. Retaliatory tariffs would also be expected to reduce demand for U.S. exports. Lower import values would partially offset these negatives since imports are a subtraction from Gross Domestic Product (GDP).

Many domestic businesses would also likely see lower aggregate demand, thus potentially leading to pressure on employment over the intermediate-term. Any benefit to domestic production and employment from "reshoring" would likely take years, assuming the tariffs remain in place.

Overall, we estimate that the tariffs, as currently imposed and proposed, would reduce U.S. real Gross Domestic Product (GDP) by 1.0% to 2.5% this year (mostly in the second half) with a similar gain in inflation. The wide estimation range reflects the uncertainty regarding the Trump administration's next steps and potential actions from Congress. At this early stage, we believe a recession is not necessarily guaranteed, but the unprecedented nature of the situation and its ongoing uncertainty has already led financial markets to respond as if that were a foregone conclusion – which itself is likely to add to the pull-back in consumer sentiment and spending.

The President has stated his tariff objectives are to bring back U.S. manufacturing capabilities and the related jobs lost to foreign competitors over decades. Generating revenue (tariffs are paid to the federal government) to offset the debt /deficit impact of extending the personal income tax cuts enacted under 2017's Tax Cuts and Jobs Act (TCJA) is also a key consideration for the administration.

In our view, such goals would be better addressed via a gradual implementation of tariffs, thus allowing domestic businesses adequate time to adjust their supply chains.

Estimated Cost of Tariffs (in billions)

Decline in imports:	Average Tariff rate: 10%	15%	20%	25%
0%	$267	$401	$534	$668
10%	$240	$361	$481	$601
20%	$214	$321	$427	$534
30%	$187	$280	$374	$467

Table source: Census Department trade figures and AEIS estimates.

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As was long telegraphed and eagerly anticipated, on April 2nd the Trump Administration unveiled a significant round of tariffs affecting practically every nation on earth. The announced actions were much more comprehensive and widespread than expected, but there were also some carve-outs.

The carve-outs for key products covered under the United States, Mexico, Canada Agreement (USMCA) as well as pharmaceuticals, semiconductors, cooper, and lumber should reduce the negative growth and inflation consequences of the tariffs and, overall, make them relatively more economically digestible (but still very difficult).

Given the significant number of moving pieces in this transformation of the global trading scheme, uncertainty remains very high. The "negotiating tactics" view of the situation is quickly fading. However, we still believe there is plenty of room for significant tariff cuts to be negotiated, cuts that could potentially affect a significant percentage of imports over the months ahead.

Q: What is a tariff?

A: A tariff is a tax on imported goods that is paid to the federal government. The importing entity is responsible for paying the tax, which makes procuring goods or services from certain countries incrementally more expensive. This is meant to encourage the importer to either find a domestic source of supply or a source from a different country. However, supply chains, particularly in the manufacturing sector – can take significant time to adjust.

Q: How significant are the tariffs that have been imposed?

A: In 2024, the U.S. imported goods with a value of $3.261 trillion, or about 11.2% of U.S. GDP. We estimate that excluding the carve-outs as noted above, would bring the value of the goods affected by the tariffs to $2.67 trillion. Applying a 20% average tariff on this value would equate to tariffs of $534 billion. However, the higher costs are likely to reduce demand. As such, based on the calculations shown in the table on page one, we believe a decline in imports of approximately 20% could be achieved, and at an average tariff rate of 20%, the total cost would be about $427 billion, or about 1.8% of GDP.

The very material tariff values announced also seem to be structured to incentivize "deals". Although various administration officials have stressed that the tariffs are permanent, the President has indicated an openness to negotiation on an individual country basis. Ultimately, we believe signs of such negotiations and resulting tariff rate cuts could reverse some of the present concerns over their negative influence on economic activity and corporate earnings, thus offer room for a partial rebound in financial markets.

Q: What does the inflationary impact look like?

A: On an annualized basis, we estimate that, using the same formula as above could boost the Consumer Price Index (CPI), i.e., inflation, by 1.0% to 1.8% for a full year. But lasting tariff implementations would likely require congressional approval and legislation. Republicans have very slim majorities in the House and Senate, although officials from auto-intensive states would likely balk at the tariffs being made permanent, in our view.

Q: Who ultimately bears the cost of the tariffs?

A: Most of the added cost is likely to be added to the final cost of the good, thus leaving consumers with the tab. This would depend, however, on the pricing power for various goods. The price of a small toy going from $4.00 to $5.00 would likely go unnoticed, so the volume sold may not change much. For a washing machine, automobile, television, or other big-ticket item, however, an added 20% would likely be prohibitive for consumers without a material degradation in sales volumes.

Other avenues of tariff cost absorption include: a stronger U.S. dollar, tighter profit margins for the exporter and /or importer and /or retailer. Re-sourcing suppliers would be a very long endeavor, especially in such industries as autos, auto parts, appliances, energy commodities, heavy equipment, and certain farm goods amongst others.

Q: What type of economic impact might the tariffs have?

A: Over the near term, the tariffs could have their greatest impact via border disruptions as some businesses could seek to delay shipments in hopes the tariffs are revoked sooner rather than later. If so, some U.S. manufacturing operations may need to temporarily shut-down, particularly in the auto industry. If so, it would likely put considerable pressure on the President to reverse course.

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Q: Could the tariffs become permanent?

A: The Trump administration has significant leeway to impose near-term rates but lasting trade agreement changes would require Congressional legislation, in our view. The President is posturing that the tariffs will be permanent, but the stated objectives suggest a different story, in our opinion. With Mexico and Canada, for instance, the President has said he wants greater cooperation on border control issues related to immigration and drug flows. We believe these are reasonable and attainable objectives for all.

Q: Should investors sell into any near-term market weakness?

A: When or if agreements are reached, we believe markets can rebound, thus leaving those that try to “time” these events with underperformance relative to a “hold” strategy.

Overall, we believe the U.S. economy currently stands on solid fundamentals, most notably solid consumer and corporate balance sheets. Such conditions bode well for longer-term economic prospects in our view and should offer support to conditions even as tariffs entice significant headwinds over the intermediate-term. Extreme tariff policies, however, could yet be strong enough to pull the economy into what we believe would be a short, shallow downturn. Admittedly, our “short and shallow” viewpoint is partially based on an assumption that more rational heads prevail, sooner rather than later. We believe there is a strong possibility that some tariffs are trimmed-back, or in some cases eliminated. That may be inconsequential, however, if markets ‘price-in’ a recession beforehand.

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Ameriprise Financial
1441 West Long Lake Road, Suite 250, Troy, MI 48098
Telephone: 248.205.5808
For additional information or to locate your nearest branch office, visit ameriprise.com.

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