Market Perspectives - Impact of New Tariffs

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TURTLE CREEK
WEALTH ADVISORS

TRUMP'S NEW TARIFFS: ECONOMIC IMPACTS, TRADE TENSIONS, AND UNCERTAINTY AHEAD

Over the past weekend, President Trump announced that through executive action he was planning to impose 25% additional tariffs on all imports coming from Mexico and Canada and 10% additional tariffs on all imports coming from China. Energy resources from Canada will see tariff rates of only 10% (the US currently imports roughly 20% of daily oil consumed from Canada). These tariffs are expected to go into effect on Tuesday Feb 4, however the tariffs on Mexico have already been paused for a month based on negotiations.

- The primary rationale given by the Administration for the new tariffs is the leverage it believes it will give the United States in stopping illegal immigration and the importation of fentanyl and other dangerous narcotics. White House aides argue that the tariffs can come down when fentanyl levels are lower, but once tariffs go up, they are hard to cut.
- Secondary justifications for the tariffs given were the impact of illegal immigration on wages, social services, crime, terrorist entry into the U.S., and human trafficking, as well as the President's desire to "level the playing field" with regard to international trade.
- It's estimated that the tariffs will raise an approximately $150bn of new tariff revenue on an annual basis and is the fiscal equivalent of a 10-11 percent increase in the corporate tax rate.
- Gross trade (imports plus exports) makes up 67% of Canada's GDP, 73% of Mexico's GDP, and 37% of China's GDP. Gross trade makes up 24% of U.S. GDP, while the United States' total trade deficit is roughly -3% of GDP, hence the desire to level the playing field.
- In the short-term, this action is likely to lead to increased volatility in the financial markets as well as higher long-term interest rates and lower stock valuations. The longer-term impact will be a function of how long the tariffs remain in place, how our trading partners respond (they are threatening their own increased tariffs) and whether the President is simply using these as negotiating tools and thus backs off them once he gets what he wants.
- Broader implications of these tariffs for inflation are difficult to assess due to:
  - the potential of U.S. consumers to switch to lower cost domestically produced goods if available;
  - currency market fluctuations;
  - the duration of the tariffs put in place.
- At the margin, this should encourage more domestic production of goods in the United States and a stronger US dollar.
- To justify imposing these tariffs, President Trump invoked the International Economic Emergency Powers Act (IEEPA) which has not previously been used in this context. Trump's use of IEEPA brings significant legal liability since the provisions have never been used or challenged previously. It's believed that impacted parties will bring a legal challenge to the tariffs.
- It's likely that the Fed will see the tariffs as inflationary all else being equal, which could mean fewer Fed rate cuts than the 1-2 currently expected in 2025.

The bottom line is that the imposition of tariffs at this level was not fully anticipated (many saw this as a bluff/negotiating tactic by the President when first announced), so the near-term impact will be negative. However, the President, who has said there will be short term pain, is known to change his course of action on things quickly, especially if the economy is suffering. So, while we'll see some near term volatility, the real longer-term impact is yet to be known.