RATHBONES

THE EMPEROR'S NEW TARIFFS

REVIEW OF THE WEEK
7 APRIL 2025

MARKETS ARE TUMBLING FAST IN RESPONSE TO US TARIFFS THAT WILL UPEND GLOBAL TRADE. PERHAPS MORE DANGEROUS THAN THE POLICY ITSELF IS JUST HOW SILLY IT MAKES THE ADMINISTRATION LOOK.

In the lead up to 2 April – dubbed 'Liberation Day' by US President Donald Trump – markets were positioned for some pain from higher tariffs on trade. What they weren't ready for was for Trump to do the economic equivalent of walking to the rostrum with no clothes on.

Rather than targeted tariffs on specific countries that could be used as negotiating leverage, Trump unveiled breathtaking increases on virtually all trade and at levels that were much higher than anticipated. The US will tariff all imports at 10%, and all countries that have a 'trade surplus' with the US (i.e. that send the US more goods than the US sends to it) will be hit with much higher punitive tariffs. When you tot them all up, we estimate that the average US tariff is set to soar from 3% to 23% virtually overnight. As you can see from the chart, that level hasn't been seen since the early 20th century.

Stock markets dropped with everyone's jaws. The S&P 500 fell more than 10% in just two days. That has happened on only three other occasions: the 2020 COVID fall, the Global Financial Crisis and Black Monday 1987. This selling has continued on Monday, with Asian markets down significantly and the FTSE 100 trading 5% down as of writing.

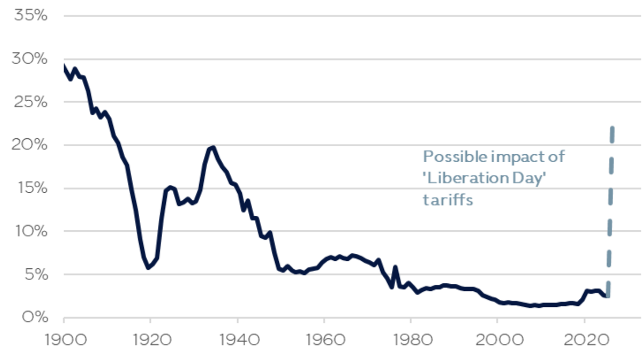
The new tariffs are a huge increase in taxes – contrary to what Trump and his Cabinet often argue, tariffs are a tax – and a large spanner in the spokes of global trade. The White House says $600 billion a year will be raised over the next 10. If correct, that's the equivalent of about 2% of the American GDP. Capital Economics thinks it will be higher at roughly $700bn a year, or a whopping $7 trillion. Even the lower number ranks as one of the largest tax hikes of all time. It's hard to know what the real cost will be until we're years down the line, however. This is going to completely scramble business supply chains, international relations and people's buying decisions. The knock-on effects from these first-order effects are endless.

What's perhaps worse than the tariffs themselves is the nonsensical reasoning behind the policy and its implementation. **You could make arguments for protecting your domestic production**, despite it being a more expensive alternative, for national security reasons or to protect a nascent industry that would be crushed by established foreign competitors. You may want to ensure your local employers aren't undercut by foreign businesses that exploit their staff, or by countries that make themselves cheaper by keeping their currency artificially low. But Trump's tariffs aren't doing any of this.

Trump's tariffs aren't being targeted at those who are hustling the US or imposing tariffs and other barriers – or that's not how they've been determined. They have been calculated based solely on whether a nation sends more goods to the US than it receives in reciprocal imports. Often, that's because the US wants and likes the products! Or uses them as inputs to other, more valuable products that the US sells elsewhere. The size of each nation's new tariff is exactly half of the ratio of this difference in trade. So Chinese exports to America minus American exports to China divided by Chinese exports is 0.67. Half of that gives you America's new tariff on China of 34%.

That makes no sense at all. Neither does the administration's implicit goal of completely eliminating all trade deficits with other countries. Some nations are better at making or growing certain things than the US and it makes sense to buy from them. Meanwhile, those countries may not have need of what America is selling (or may prefer to buy US services

AVERAGE US TARIFFS SET TO SOAR



instead). American producers may get more if they sell to another country instead. And it doesn't take into account services exports with those countries, which are often sizeable. It's almost as if the Trump White House thinks services (which are intangible) are irrelevant, despite them accounting for about a third of all US exports and 80% of US employment.

Trump's tariff policies have a sort of 'return to bartering' vibe that is a backward step for the global economy.

Should I sell?

So what happens next? First off, the selling is likely far from finished. Like the tolling of a huge bell, unusually big market moves vibrate through everything. They can wrongfoot many investors, especially those who have borrowed heavily to buy stocks and other assets. As the market moves against them, they are forced to sell to provide cash to avoid their brokers foreclosing on them. That pushes prices lower and can spark further waves of selling in a feedback loop.

However, this doesn't mean it will go on forever and it certainly doesn't mean you should sell your investments. It's best to be calm when others are losing their heads. Bonds are providing good ballast to stock market losses, with their prices rising as investors swap stocks and other risky assets for safe haven developed world government bonds.

While the new tariffs have meaningfully changed the investment landscape, we see no grounds for a financial crisis. Inflation is higher than target, but not worryingly so, and central banks have plenty of space to cut their interest rates to support economies and keep the financial system lubricated if required.

Meanwhile, the US economy is coming off a strong run. This makes it more likely that US growth decelerates, rather than moves into full-blown reverse. Economic analysis we've seen estimates the tariffs could reduce US GDP growth by 1-1.5 percentage points (its current longer-term trend growth is 2.0%). And while the tariffs will hamper trade for all nations, recent announcements of big government spending packages in Europe and China (the other two legs of the global economy) should provide a counterweight to the US. That should support global demand for goods and services and hopefully avoid a nastier downturn. Analysis of the effects of US tariffs on UK and European GDP is in the region of 0.5 of a percentage point.

As we've been saying for months (years?) American rising unemployment – and economic data that tends to anticipate it – is the measure to watch to stay alert for a global recession (which is when stock markets get hit hard). So far, it's still low at 4.2% and indicators don't imply that it will worsen in the next six months or so. We will be watching this and other signals of worsening financial conditions closely in the weeks and months to come.

Will mercurial Trump reverse the tariffs?

It's a dictum that Trump tends to use the stock market as a gauge of presidential performance. Well, he has in the past. If that still holds, a sustained drop in stock markets may force him to reverse course – especially if opinion polls and allies start to slide as well.

It seems hard to see Trump backing away from the tariffs and surviving without losing all credibility. Although, we concede that Trump's ability to turn on a dime and secure enough leverage or profile to appear the winner is endlessly underestimated. Trump has made them such a central part of his platform and has been such a central figure in creating them that it will be hard for him to call them the bad ideas and poor implementation of lackeys. He could still try!

Treasury Secretary Scott Bessent has looked particularly green in interviews given since the announcements. He's a difficult fall guy though, considering it's pretty apparent that he wasn't in the room when they were agreed on (there are reports that he was ejected from the discussions several times in the lead-up). The main champions of the tariff agenda appear to be senior counsellor Peter Navarro and Commerce Secretary Howard Lutnick. Both are steadfast in their support of the tariffs even as 'First Buddy' Elon Musk criticised the move – there are rumours that he will soon leave his position at the Department for Government Efficiency (DOGE), although he has denied this. We will have to see what happens.

But these fractures show the political pressure that will be piling up on the White House lawn. Republican lawmakers will be apoplectic. High-profile Texas Senator and long-time Trump ally Ted Cruz has already condemned the tariffs and warned of a Republican "bloodbath" at the midterm elections in November 2026 if the tariffs usher in recession. There are bipartisan moves in Congress to challenge the President's tariffs and how he has implemented them. These are on strong ground, to be fair, although they will need a super-majority in both houses to pass it. The chance of that seems vanishingly small.

As we've already laid out, tariffs are a tax. Under the US constitution, the power of taxation lies exclusively with Congress, not with the President. So how can Trump unilaterally raise taxes like this, we hear you ask. Well, the constitution vests foreign policy in the hands of the President. Over time, tariffs have been used as a sort of *sanction* against foreign countries that invade others or do things the US doesn't like, i.e. they've been thought of more as a tool of foreign policy rather than a tax. Presidents have also used tariffs to defend industries in times of crisis – using emergency powers to raise barriers to protect jobs. Congress has allowed both of these uses and effectively delegated this to the President in many pivotal moments of the past 50-odd years.

Now, there is one school of argument that this is illegal. That Congress cannot delegate its powers of taxation to the executive, at least, not without strong guidance and parameters. In the past couple of years, the Supreme Court has ruled in several cases that many regulators had overstepped their bounds in terms of what they could do without explicit congressional authority. Would they rule in a similar fashion when the person potentially overstepping their bounds is the man at the very top of the executive? You can almost hear the stampede of lawyers rushing to file suits objecting to the tariffs on this 'non-delegation doctrine'.

At heart, the US has found itself in this quandary because it has, over time, created a much stronger presidency than was envisaged in the original constitution. The President has wide powers to act unilaterally in times of national emergency. This is helpful when it comes to natural disasters – it means the federal government can act quickly and decisively to send aid to those who need it. However, those powers have been worded so loosely that it's virtually impossible for anyone – including Congress – to object to what the President considers an 'emergency'.

For now, Trump remains in the driver's seat. But Congress, if it wants to, can reassert its power. And the Supreme Court remains a wild card.

*If you have any questions or comments, or if there's anything you would like to see covered here, please get in touch by emailing **review@rathbones.com**. We'd love to hear from you.*