Market View
Economics and Strategy

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Started from the bottom, now we're… where with tariffs?

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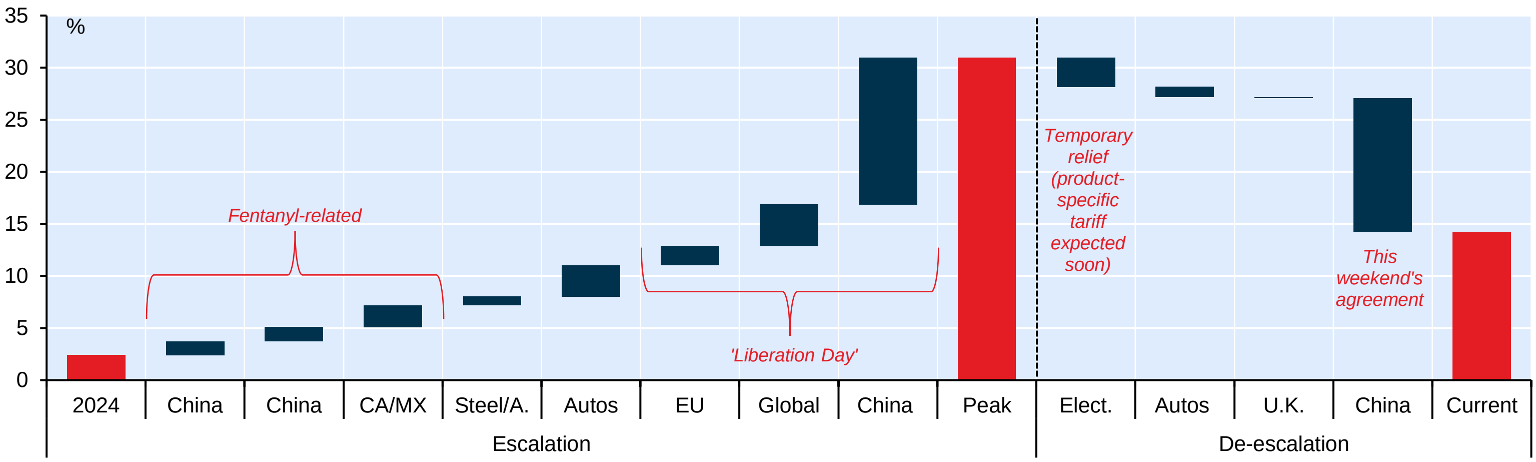
The 'beautiful deals' are starting to roll in, just as the White House had promised. On Friday, we looked at the U.S. / U.K. **agreement in detail** and concluded that tariffs were set to be negotiated down, but not away entirely. Moreover, the changes to U.K. trade policy would have very little impact from a U.S. inflation perspective, and we would need to see significant de-escalation in levies on Chinese imports to really 'move the needle'. Well, the highly anticipated bilateral talks took place this weekend, and both nations have significantly reduced their tariffs on one another (for 90 days, at least). The U.S. will reduce levies on Chinese products to 30% (over a 100-percentage point reduction), and China will lower their reciprocal duties an equal amount to 10% for the time being as the two countries set a three month 'deadline' to work towards a broader agreement.

So, where do we stand today? At it's peak (i.e., post- 'Liberation Day'), the U.S. average effective tariff rate (AETR) stood at an egregious 125-year high of ~30%. After this weekend's agreement and earlier, relatively modest tariff relief announcements, the AETR has been halved to just under 15%. *Lower* tariffs are not to be confused with *low* tariffs, however. And even after more bilateral agreements are struck over coming weeks/months, low tariffs will still be a thing of the past as the administration will retain a material degree of protectionism. For the Fed, this 90-day deal will do little to change their stance in the near-term. Upside inflation and downside growth risks may have moderated, but prevailing tariffs are still consistent with a material disruption to the economy per most trade models (Chart 2). Whether the inflation or growth channel is more affected remains uncertain, which will keep the Fed standing pat until greater clarity emerges. The prevailing market narrative had been that even with higher inflation, the Fed would shift towards easing later this year as the employment side of their mandate takes priority. There's clearly less anxiety today, expectations for Fed easing moderating further. We still expect tariffs and ongoing uncertainty to take a toll, and we'd lean against stripping out cuts any further… even if expectations for inflation aren't exactly where the Fed would like (Chart 3).

Chart 1: It's been a tariff-induced roller coaster ride – here's a breakdown of developments thus far

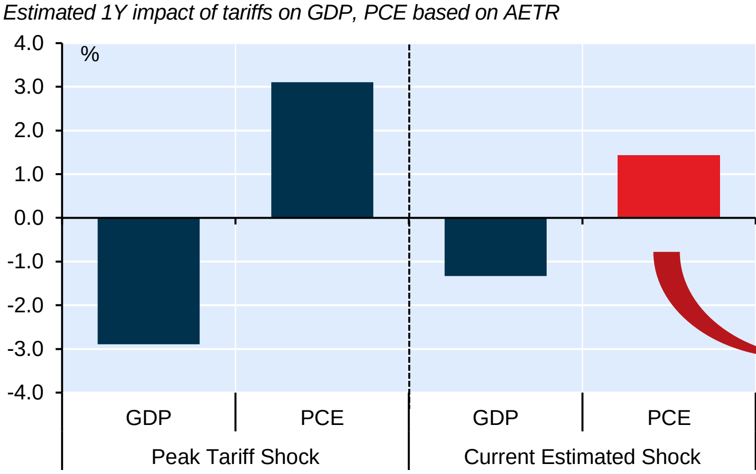
Contributions to the U.S. average effective tariff rate (AETR), decomposed by baseline rate and (de)-escalations from geography- and product-specific levies



Source: NBC, U.S. Census, Bloomberg | Note: Using 2024 trade weights by country / HS2 code; 'CA/MX' refers to Canada & Mexico, and includes the impact of USMCA carveouts; 'Global' refers to the 10% baseline tariff implemented on all trading partners; 'Elect.' refers to the reprieve on certain electronic products; De-escalation in autos as it relates to parts, non-stacking policies

Chart 2: Growth and inflation risks down, but not out

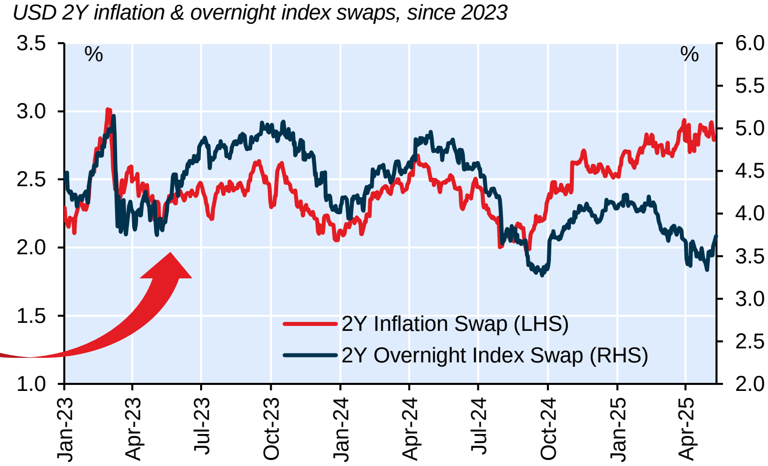
Estimated 1Y impact of tariffs on GDP, PCE based on AETR



Source: NBC, Bloomberg, Yale, Federal Reserve | Note: 'Shock factors' are derived from avg of Bloomberg (via Fed) and Yale estimates on tariff impacts & applied to Chart 1 AETRs

Chart 3: Inflation swaps and OIS are telling different stories

USD 2Y inflation & overnight index swaps, since 2023



Source: NBC, Bloomberg

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