Global Macro Research - Insight

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#US / #Politics / #Fiscal policy

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What would Trump do? 1.Trade

Trump's ability to implement tariff changes using executive orders makes trade one of the most unpredictable and potentially disruptive areas of his policy platform.

Key Takeaways

- Former President Donald Trump has made clear that higher, broader tariffs are at the centre of his trade policy. Key proposals include a 10% baseline tariff on all US imports, and a 60% tariff on Chinese goods.
- As Trump's first term demonstrated, the office of president holds broad powers to introduce tariffs through executive orders, meaning Congress is unlikely to be able to act as a block.
- Economically, tariffs are best thought of as a tax, or as a negative supply shock. They could put upward pressure on inflation and downward pressure on activity. Monetary policy would probably have to be looser in the end, while any attempt to tighten policy in response to the initial inflation pressures could bring the Fed and Trump into conflict.
- Trump continues to focus on goods trade deficits as a key indicator of how well a trading relationship is functioning. Based on this, a number of major US trading partners beyond China, including the EU, Japan and Mexico, could be vulnerable to additional tariffs.
- Against this backdrop, some countries will likely be in a comparatively strong position. These include India and some southeast Asian countries, which could benefit from reshoring away from China in the event of increased trade tensions.

In the first of our notes looking at former President Donald Trump's policy platform, we focus on trade. Trump's proposals represent one of the more significant areas of policy risk owing to their potential macro and market impact and ability to be implemented without congressional approval.

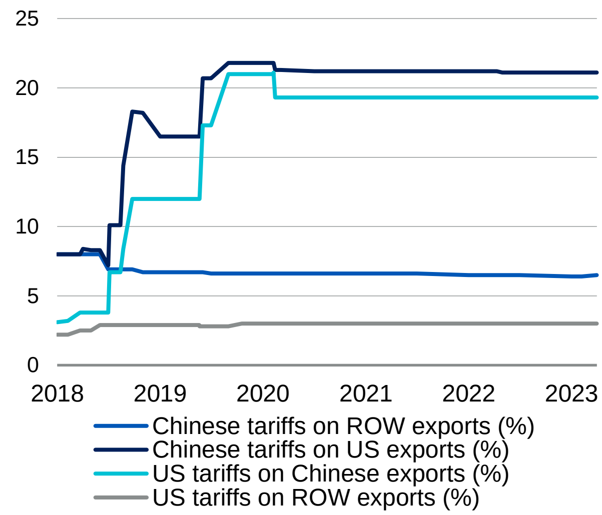
Threatening tariffs is a signature Trump policy

Throughout his first term, Trump utilised tariffs to correct perceived trade imbalances, protect and develop domestic production and strategic industries, project a tough foreign policy stance against geopolitical rivals and force countries to start negotiations on a range of issues.

These consisted mainly of broad tariffs on steel and aluminium imports, and additional tariffs on a broad range of Chinese goods. Indeed, average US tariffs on Chinese exports increased sixfold over the course of this trade spat and have largely remained in place during Joe Biden's presidency (see Figure 1).

In a second-term Trump administration, the greater scale of his tariff ambitions, and their likely volatile application, will create greater uncertainty.

Figure 1: Tariffs, particularly on US-China trade, increased markedly under Trump and are still in place



Source: abrdn, Peterson Institute, March 2024

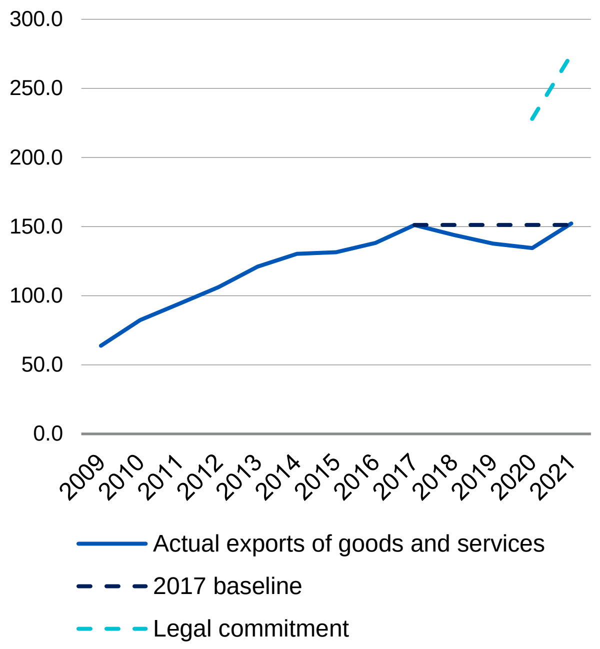
Trump's first-term tariffs did not meet their objectives

Though Trump continues to advocate for a tariff-based approach to trade policy, his first-term initiatives have garnered mixed results.

The headline US trade deficit remained large throughout his presidency, with sector and trade partner specific tariffs not reducing this macro imbalance.

The bilateral trade deficit with China did narrow. However, it remained large, and the partial adjustment was accompanied by rising trade shortfalls with other economies as trade was redirected by tariffs.

Figure 2: China did not purchase any of the additional $200 billion of US exports it had committed to under the phase one trade deal



Source: abrdn, Peterson Institute, March 2024

Tariffs raised domestic prices for affected goods and may have acted as a drag on the US economy. A 2023 report from the US International Trade Commission found that US importers bore nearly the full cost of tariffs introduced by Trump. It estimated that prices increased by about 1% for each 1% increase in the tariffs on steel, aluminium and Chinese-made goods.

While domestic production of many products subject to tariffs increased, price rises resulted in higher costs for downstream industries and may have lowered aggregate US growth and employment.

Tariffs also appeared to hurt equity markets, which fell in each day that new measures were announced (see Figure 3).

Figure 3: The 2018-19 trade war was a disruptive force in markets

Date	Event	Stock market return on day of announcement
22 Jan 2018	US imposes tariffs on solar panels and washing machines	0.75%
28 Feb 2018	US imposes steel and aluminium tariffs	-1.07%
22 March 2018	China announces retaliatory tariffs	-2.57%
29 May 2018	US announces 25% tariff on some Chinese goods	-1.00%
15 June 2018	China announces retaliatory tariffs	-0.10%
19 June 2018	US announces tariffs on Chinese goods	-0.41%
2 Aug 2018	China announces retaliatory tariffs	-0.59%
6 May 2019	US announces tariffs on Chinese goods	-0.41%
13 May 2019	China announces retaliatory tariffs	-2.58%
1 August 2019	US announces tariffs on Chinese goods	-1.00%
23 August 2019	China announces retaliatory tariffs	-2.64%

Source: abrdn, NBER, March 2024

Campaign commitments suggest Trump will go further than in his first term

Over the course of the campaign so far, Trump has made several policy commitments on trade.

- A 60% tariff on Chinese goods exported to the US, as well as revoking China's most favoured nation trade status.
- A complete ban on imports of key categories of Chinese-made goods like electronics, steel and pharmaceuticals.
- A baseline 10% tariff on all US imports. Higher tariffs would be introduced if a country is found to have "unfair trading practices against the US".
- A Trump Reciprocal Trade Act, which would impose reciprocal tariffs on overseas goods if tariffs on US products are higher than those imposed by the US.

The exact tariffs proposed at this stage are perhaps less important than the clear direction of travel they suggest. Under a Trump presidency, tariffs will be higher and broader, potentially significantly so.

If implemented, these policies are likely to be disruptive

According to a study published by Oxford Economics, the imposition of a 60% tariff on Chinese goods would add 1.2ppts to US annual inflation in the year implemented. The impact of this implicit tax hike alongside an assumed sell-off in financial markets drives a 1ppt decline in GDP compared to baseline assumptions. Their modelling suggested this would lead to over 700,000 job losses. These shocks would persist into the long term as productivity suffers.

Trump's trade adviser Robert Lighthizer has acknowledged that economic disruption is likely but has argued the national security benefits are worth the cost. However, it is not clear that the president would be willing to tolerate an economic and market fallout on the scale of the Oxford Economics modelling.

The shock would be unevenly felt across the economy. The sectors expected to be most affected include motor vehicles, other transport equipment and machinery, reflecting their high trade intensity and deep integration in global supply chains. By contrast, some sectors will see smaller hits to output, or even increased activity, such as textiles and electronics, as tariffs make domestic production more competitive.

Higher tariffs would also present challenging policy questions for the Fed

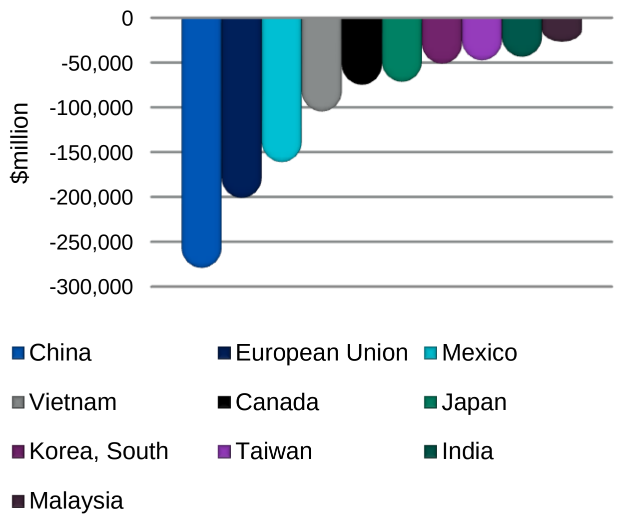
This potential negative supply shock would lead to an uncomfortable combination of higher short-term inflation, and weaker short-term and long-term growth and employment. These dynamics could motivate looser policy in the end, although a period of high inflation would limit and delay the degree of any easing. Any move to outright tighten monetary policy could exacerbate tensions between the Federal Reserve and Trump.

Goods trade deficits will matter

During Trump's first term, the balance of trade in goods was often used as a proxy to determine whether a country conducted its trade with the US in a 'fair' manner. Generally, the higher the trade deficit, the greater likelihood of retaliatory action from the US.

Trade deficits are therefore likely to be used as a partial justification for the introduction of higher tariffs on Chinese goods. US trading partners including the EU, Mexico, Japan and Vietnam would also risk becoming the focus of additional tariffs.

Figure 4: Goods trade balances show a number of major US trade partners could be at risk of additional tariffs



Source: abrdn, US Department of Commerce, April 2024

Trump's comments on the campaign trail indicate Mexico will be a particular focus, both because of immigration concerns and the rise in Chinese investment. The threat of tariffs to gain policy concessions on these two points is extremely likely. The trade agreement between the US, Mexico and Canada (USMCA) – though negotiated by Trump – is unlikely to act as a significant constraint, with Trump likely to either seek to renegotiate the deal to address perceived areas of concern or threaten to withdraw entirely.

Despite Trump's commitment to universal tariffs, a sector-specific approach is likely in most cases

Although Trump's campaign commitments advocate for universal tariffs, his speeches indicate that he does have a sector-specific focus, except for China. Tariffs on automotive imports are likely, with risks for European and Japanese carmakers.

Trump has been a vocal critic of electric vehicles, arguing that the frequent presence of Chinese companies in their supply chain undermines the US economy.

Areas where executive orders are possible will represent the greatest risk

Trump's first term demonstrated his clear preference for introducing tariff changes through executive orders. This removes the need for congressional approval and speeds up the pace of change, creating risk of significant market volatility.

Generally, Trump can use executive orders to introduce tariffs when there is a national security justification or evidence that the tariff is corrective. Therefore, it is more likely that he is able to introduce a 60% tariff on Chinese goods than a 10% baseline tariff on all imports without congressional approval.

Not all countries will see a Trump presidency as a risk

The possible return of Trump is likely to represent an opportunity for other countries, particularly if they can insulate themselves from the bulk of the tariff increases. India may be in a strong position in this regard. With a relatively low US trade deficit and a foreign policy that increasingly distances itself from China, it is less likely to be singled out than some other large emerging markets.

Southeast Asian countries, though at risk of being subject to tariffs themselves, may benefit from private sector reshoring away from China.

Tarriff levels may be subject to rapid change if used as a negotiating tool

In Trump's first term, tariffs, or the threat of their introduction, were frequently used as a negotiating tool. It is possible that he will adopt this approach again, though he will likely do so on a case-by-case basis – more likely when the rationale for introducing tariffs relates to a single issue, for example obtaining immigration concessions from Mexico.

This aspect of Trump's trade policy will bring substantial uncertainty. Not only do tariffs risk being introduced without warning, but they could well be withdrawn, or reduced in the same manner. However, the imposition of tariffs with the intention of gaining concessions could potentially lessen their negative impacts should these negotiations be successful.

Some level of retaliation is highly likely

The international response is likely to vary by country. However, it is extremely unlikely that, in the event of the introduction of significant new tariffs, there would be no retaliatory response by any major US trading partner.

China and the EU are likely to respond with some increase in tariffs without directly matching US measures. Indeed, the impact of tariffs introduced on Chinese goods in 2018-19 was partially offset by depreciation of the renminbi against the dollar. A repeat of this trend would reduce the need for Chinese retaliation beyond sending political signals. Others, like Mexico, are more likely to attempt to make policy concessions.

The likelihood of additional tariffs on traditional US allies, particularly the EU and Japan, could also lead to a wider deterioration in cooperation. The risk will be particularly high for multilateral initiatives designed to address climate change as well as supply chain derisking initiatives, given Trump's preference for onshoring and bilateral arrangements.

Subsidies to protect US consumers may be introduced

Should any tariffs introduced by Trump or in retaliation to his policies result in price increases, fiscal support is likely to be introduced for affected industries. This was the case during Trump's first term when $23 billion in direct aid payments were issued to farmers affected by retaliatory tariffs.

This would lessen the negative impact of the prices increases domestically but would at least partially offset the revenue raised by the tariffs themselves.

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