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Trade War 2.0: Analysing the implications of Trump's second-term tariffs

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President Trump's second term has ushered in a sweeping series of tariff measures that have reshaped the global trade landscape. Since his January 2025 inauguration, Trump has implemented a multi-pronged tariff strategy targeting key trading partners. The most significant measures include a 25% tariff on steel and aluminium imports and a new "reciprocal" tariff system designed to match or counter perceived unfair trade practices by other nations.

The first country specific tariffs to be announced were 25% tariffs on all goods imported from Canada and Mexico (with a 10% rate for Canadian energy exports), but both countries secured a one-month pause after agreeing to enhanced border security measures and drug trafficking prevention efforts.

At the end of February, Trump announced that he will proceed with the tariffs on the US's neighbours on the 4th of March. At the same time, he imposed an additional 10% tariff on Chinese imports, adding to the already implemented 10% tariff on the 4th of February.

The response from affected countries has been swift but measured. The EU has promised "firm and proportionate" retaliation against steel and aluminium tariffs while maintaining a relatively conciliatory stance on broader trade negotiations. China has implemented limited countermeasures affecting approximately $14 billion of US imports, showing notably more restraint than previous trade disputes.

Financial markets relatively unfazed

Financial markets initially demonstrated remarkable resilience in the face of escalating trade tensions. The S&P 500 rallied to near-record highs, climbing within 0.1% of its previous peak, while the Dow Jones Industrial Average and Nasdaq also posted strong gains. This positive market sentiment was supported by strong corporate earnings reports that exceeded expectations and robust US economic fundamentals, including a healthy job market.

However, since then, sentiment has deteriorated on concerns about the state of the US economy and uncertainty around the Trump administration's swift and far-reaching efforts to reduce the size of the fiscus by shuttering US Aid programmes, closing down departments, and firing staff across the public sector. Trump's decision to go ahead with the tariffs on Canada and Mexico and additional tariffs on China are likely to add to the volatility of financial markets until it becomes apparent what the impact on the US and global economy is likely to be.

Historical precedents from 2018 have shown tariffs imposed in Trump's first presidency had a limited inflationary impact. However, the extent and geographical reach of the tariffs on the table and already implemented are likely to have a more profound impact than those experienced in his previous term.

Economic concerns prevail

While markets have remained relatively buoyant, there are several concerns about the potential economic impact of the tariff measures, namely the inflation risk, growth impact and labour market effects.

The Tax Foundation estimates the 10% tariff on Chinese imports alone could add $172 to the average US household's tax burden. Inflation expectations have increased sharply, with the latest University of Michigan one-year inflation expectation figures showing that consumers expect inflation to be 4.3% one year out compared with an estimated 3.3%. That is well above the Fed's targeted 2% and likely to add to the US Federal Reserve's caution in reducing interest rates.

Supply chain disruptions could increase production costs, particularly in the automotive sector. They could also hinder growth and lead to a possible slowdown in global trade volumes. The risk of retaliatory measures would negatively affect US exports and its broader economy. However, Trump has warned countries that think of striking back: F* Around and Find Out (FAFO).

The labour market may come under stress as companies shift from relying on cheaper foreign workers to more expensive domestic labour, with job losses in the export-oriented sectors a real possibility.

Mitigating factors that may mute tariff impacts

Our analysis suggests that the economic impact of these tariffs may be less severe than many observers fear for several key reasons:

- ➢ Currency adjustment effects

  The depreciation of affected currencies like the Canadian Dollar and Mexican Peso, combined with the strengthening of the USD, has already created a natural buffer against tariff impacts. This currency movement effectively reduces the net cost increase for foreign exporters selling to the US market.

- ➢ Price flexibility

  Historical evidence suggests that exporters often absorb a portion of tariff costs by reducing their prices, limiting the pass-through to end consumers. This was observed during the 2018 tariff implementation when inflation remained notably subdued.

- ➢ Domestic substitution

  The US economy has significant capacity to increase domestic production in response to higher import costs. This substitution effect could stimulate local manufacturing and employment, partially offsetting the negative impacts of reduced trade.

- ➢ Trade composition

  China represents about 15% of total US imports, limiting the overall exposure to any single trading partner. Furthermore, as a net importer, the US maintains significant leverage in trade negotiations, as retaliatory measures from trading partners would likely have a more severe impact on their own economies.

Navigating tariff outcomes

Against this backdrop, investors can minimise investment risks by considering the following:

- Focus on companies with a strong US domestic market presence and flexible supply chains
- Monitor sectors with significant exposure to international trade
- Consider opportunities in domestic US manufacturers that may benefit from import substitution
- Maintain diversification across sectors and asset classes to manage potential volatility

While tariffs present legitimate concerns for global trade and economic growth, the market's relatively sanguine response reflects valid mitigating factors and adaptation mechanisms within the global economy. The combination of currency adjustments, price flexibility, and domestic substitution opportunities suggests that the economic impact may be more moderate than expected over time.

Glacier Research would like to thank Philip Short for contributing to this week's *Funds on Friday.*

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