For the US, Trump's 'beautiful' tariffs are in the eye of the beholder

We've downgraded our outlook for the US as the threat of recession is real unless President Trump backtracks quickly on tariffs or the Fed rapidly cuts interest rates. Neither seems likely in the near term

Beautiful? Donald Trump described this portrait of him as 'truly the worst'.

Trump's tariffs are a tool to achieve three objectives

President Donald Trump sees "beautiful" tariffs as a tool to achieve three objectives:

1. A diplomatic weapon to change the behaviour of foreign nations.
2. An incentive for manufacturing reshoring to the US.
3. A way of raising revenue to fund future tax cuts for households and corporates.

The announcement of a 10% minimum tariff that jumps to 25% for some products and then rises steeply to 145% for the majority of Chinese exports may, over time, reap benefits for the US economy and American workers. In the near term, though, it means the US economy faces a very challenging and likely economically damaging transition period.

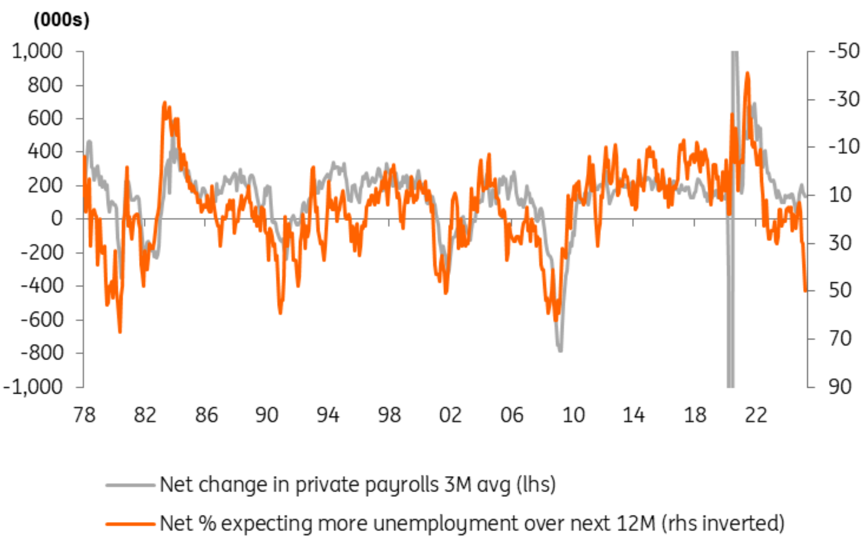
If trade deals are done then there is less scope for broader tax cuts

Financial markets have delivered their verdict, and the steep falls in equity and bond prices and heightened volatility suggest deep unease. Although tariffs have enhanced security at the Mexican and Canadian borders, they have also sparked resentment, leading to retaliatory tariffs and some instances of consumer boycotts against American products and services. For example, there has been a noticeable drop in Canadian flight bookings to the US.

At the same time, labour costs and the costs of constructing a new US plant, including transport and energy logistics, means that outside of high value-added, highly automated sectors, it is questionable how much reshoring will be delivered within the next couple of years. It may be cheaper in many instances to stick with foreign production centres and either absorb the costs within profit margins or pass higher costs on to customers.

With regards to the revenue-raising ability of tariffs, it appears the Administration is looking at around $600-700bn per year, which may cover the cost of the extension of Trump's 2017 tax cuts that are set to sunset at the end of this year. However, taxpayers are not going to notice any change in their pay packets from this – it merely prevents a 2026 tax rise. Any additional tax cuts – not taxing tips and lower corporation tax (likely achievable) plus not taxing social security and overtime pay (less likely) – will not be felt until 2026 at the earliest. Of course, if deals are done and tariffs are scaled back, then there will be less fiscal headroom to deliver broader tax cuts.

Households are worried about spending power, stock market falls and the risk of losing their job



Source: Macrobond, ING

Growth headwinds intensify on multiple fronts

The concern over tariffs has led to a pre-emptive surge in auto, electronic and other big-ticket item sales in late March and early April, but the concern for upcoming months is that US consumers now face three major headwinds:

- The erosion of spending power as goods prices jump (and by extension, some services, such as insurance and repair).
- A rapidly cooling jobs market (ISM employment metrics contracting, Federal government lay-offs, quits rates pointing to wage growth slowing to 3%).
- Falling equity markets and bond prices will involve negative wealth effects that predominantly deter higher-income households from spending.

So far, investment is holding up and should do enough to prevent a negative first-quarter GDP print, but the heightened economic uncertainty and falling equity prices mean businesses are likely to be reluctant to put money to work, so we expect that to cool noticeably. At the same time, government spending is set to slow markedly thanks to the cuts instigated by the Department of Government Efficiency (DOGE).

Net trade will be a big drag on first-quarter GDP growth due to companies ramping up imports to get ahead of tariffs. In the second quarter, that will be less of a story, but reciprocal tariffs and consumer boycotts of US products remain a threat to export growth subsequently. Putting this together, we now look for full-year 2025 growth of 1.4% and 2026 growth of 1.1%, down from our previous forecasts of 2.1% and 1.6%, respectively.

Significant rate cuts from the summer

As for inflation, goods prices will inevitably increase, and we expect headline inflation to rise above 4%. We will also see some service prices rise too, such as insurance, but the shelter components, which account for 35% of the inflation basket by weight and more than 40% for core inflation, will come under downward pressure later in the year.

Rising unemployment and hurting household finances mean landlords won't be able to keep pushing rents up 5%. The Cleveland Fed's measure of national new rent agreements is already falling in year-on-year terms, and given the transmission mechanism, we think the Fed will become increasingly comfortable with the view that inflation will be back towards 2% by the end of 2026.

Fed Chair Jerome Powell has already indicated that he sees the threat of more persistent inflation and weaker growth ahead, but having delivered 100bp of rate cuts already, and with little sign of financial system stress, the Federal Reserve is prepared to "wait and see." We think the Fed will start cutting meaningfully from the third quarter and expect 125bp of cuts.

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