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U.S. Chartbook – Tariffs Edition – February 2, 2025

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Trump and the U.S. Economy: Downside Risks Materialize

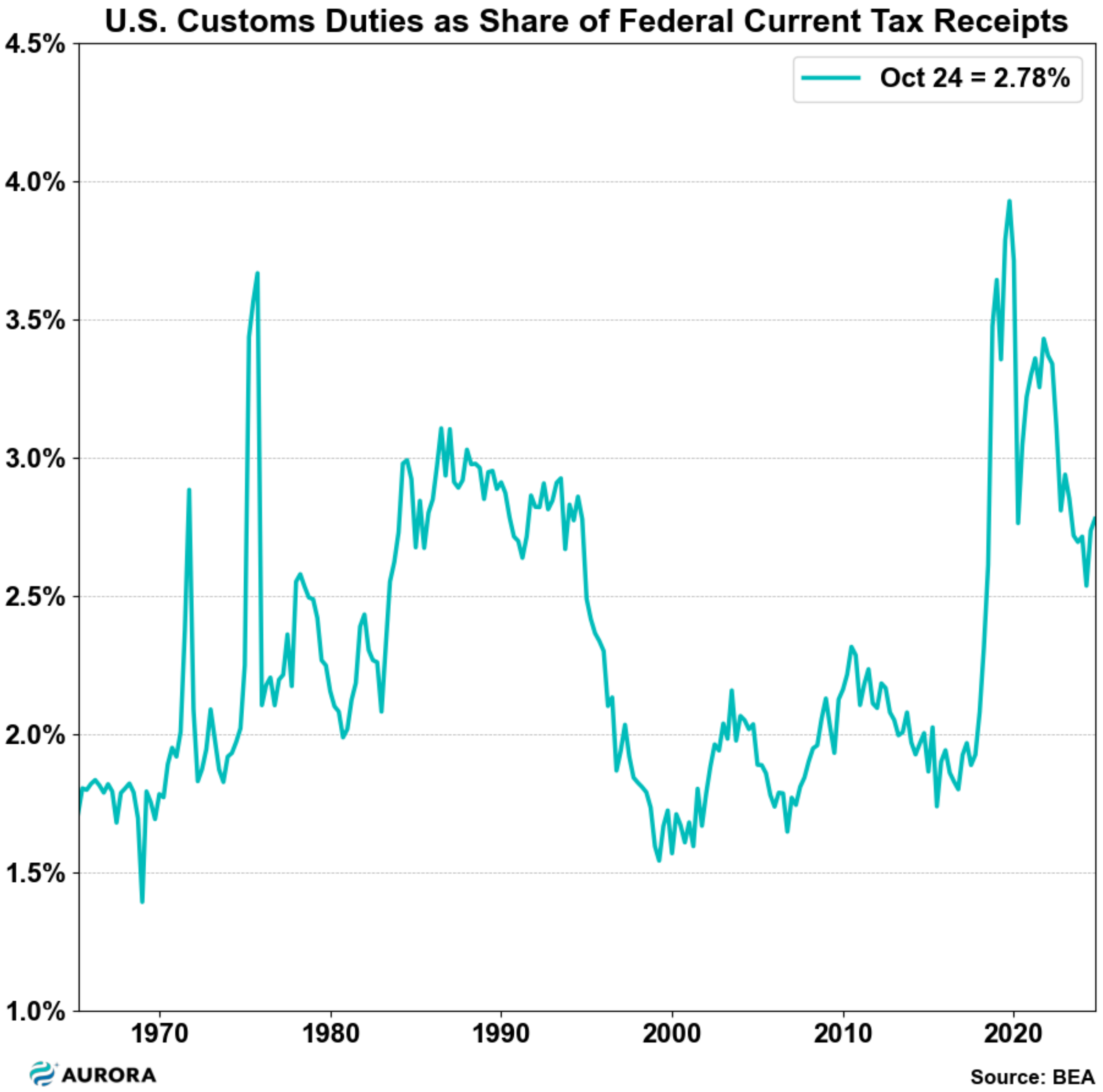
- Aside from immigration restrictions, three macro-significant actions took place since Trump took office:
  i. A spat with Colombia showed Trump in deal-maker mode: the president threatened tariffs, travel bans, and financial/banking sanctions, and then backed down once he got what he wanted.
  ii. A funding freeze memo by the OMB would probably have caused a recession had it not been blocked and then rescinded.
  iii. Finally, tariffs imposed on Canada, China, and Mexico are a macro-significant, inflationary supply shock with positive revenue implications. (basically a tax hike)
- We view these developments as leading to slower growth and higher inflation. Our base case sees Canada and Mexico tariffs reduced over the next 6 months as part of a USMCA renegotiation.
- The Fed will have to respond, and we continue to expect no cut before May. Hikes this year are not out of the question.
- In the short run, these developments are bad for equities, bad for short-term rates, ambiguous on the 10-year, and good for USD.

Upcoming Events

Feb 03	ISM Manufacturing
Feb 04	JOLTS Release
Feb 07	Payrolls
Feb 12	CPI Release
Feb 27	GDP Release
Feb 28	PCE Release
Mar 03	ISM Manufacturing
Mar 07	Payrolls
Mar 11	JOLTS Release
Mar 12	CPI Release
Mar 19	**FOMC Meeting**
Mar 27	GDP Release

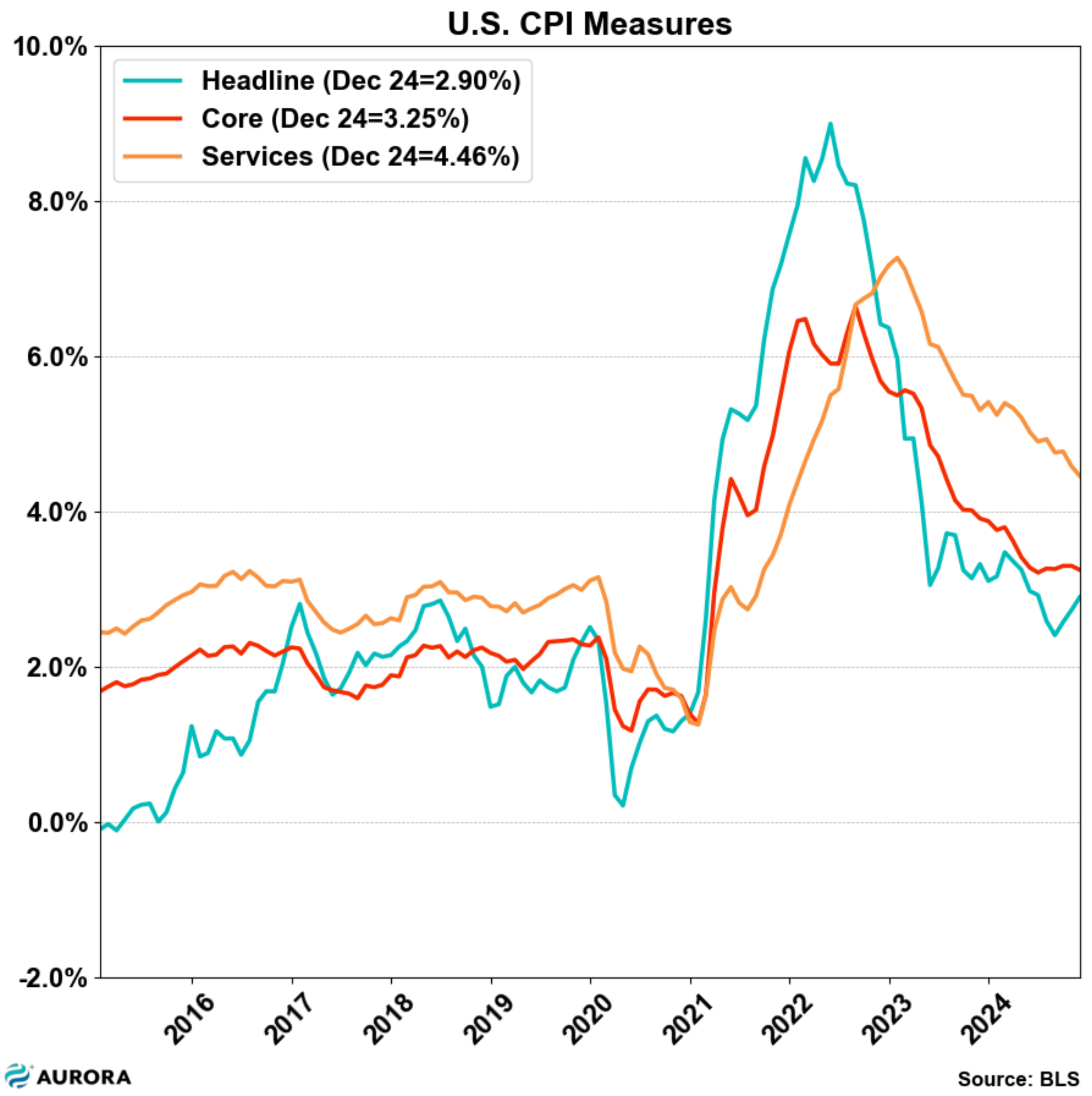
Canada/China/Mexico: Tariffs as an End in Themselves

- On Saturday, U.S. President Donald Trump announced a 25% tariff on all Canadian good ex-energy and all Mexican goods.
- A 10% tariff was imposed on Canadian energy goods and all Chinese goods.
- The tariffs account for around half of U.S. imports and will dramatically increase customs revenue.
- They will be inflationary (estimates are of about 70bps of PCE) and harm growth and U.S. competitiveness—most Canadian and Mexican imports are resources and intermediate goods.
- Both countries will implement counter-tariffs.
- Countries and corporates will try to negotiate with the Trump administration for exemptions—essentially an accelerated version of the USMCA renegotiation conducted under duress.
- Our base case sees most MX/CA tariffs lifted within 6 months, probably on a gliding scale.



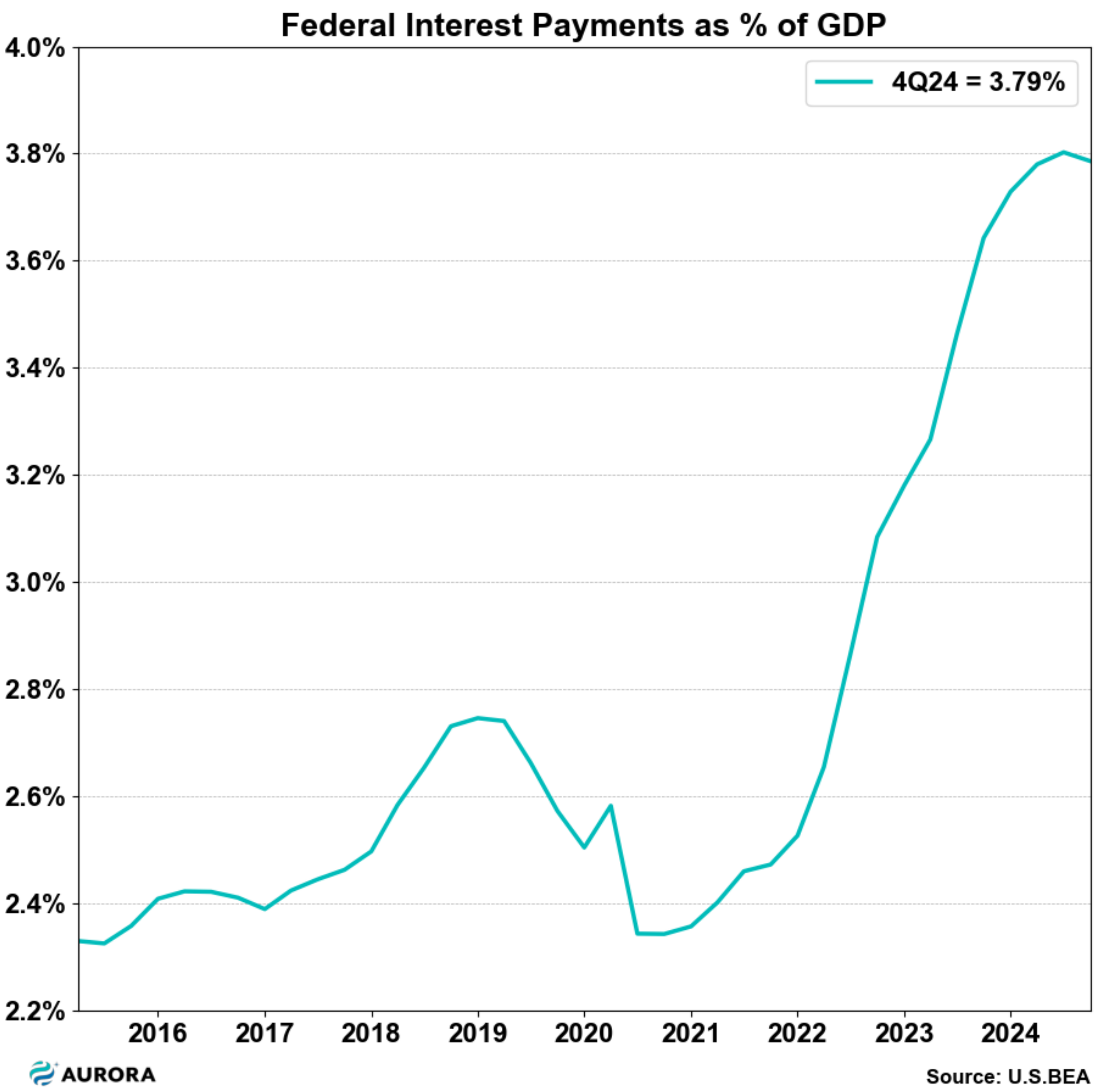
The Fed has to react—and the reaction is hawkish

- Though the December print was on the softer end of expectations, core inflation remains about 30-40bps above the Fed's comfort level.
- Headline is (i) the Fed's formal target and (ii) important for inflation expectations. It will undoubtedly be hit by the tariffs, as energy, food, and goods prices adapt.
- In his press conference last week, Powell insinuated that the FOMC would wait to see the effect of tariffs before acting.
- We find this hard to believe. A majority (see [Dec minutes]) already thinks trade and immigration policy are inflationary and warrant higher rates.
- A minority led by Christopher Waller claim that tariffs will not be inflationary and further cuts are coming.
- The hawks have it for now: we view no action between now and May and see the March meeting as a flashpoint for a hawkish surprise.



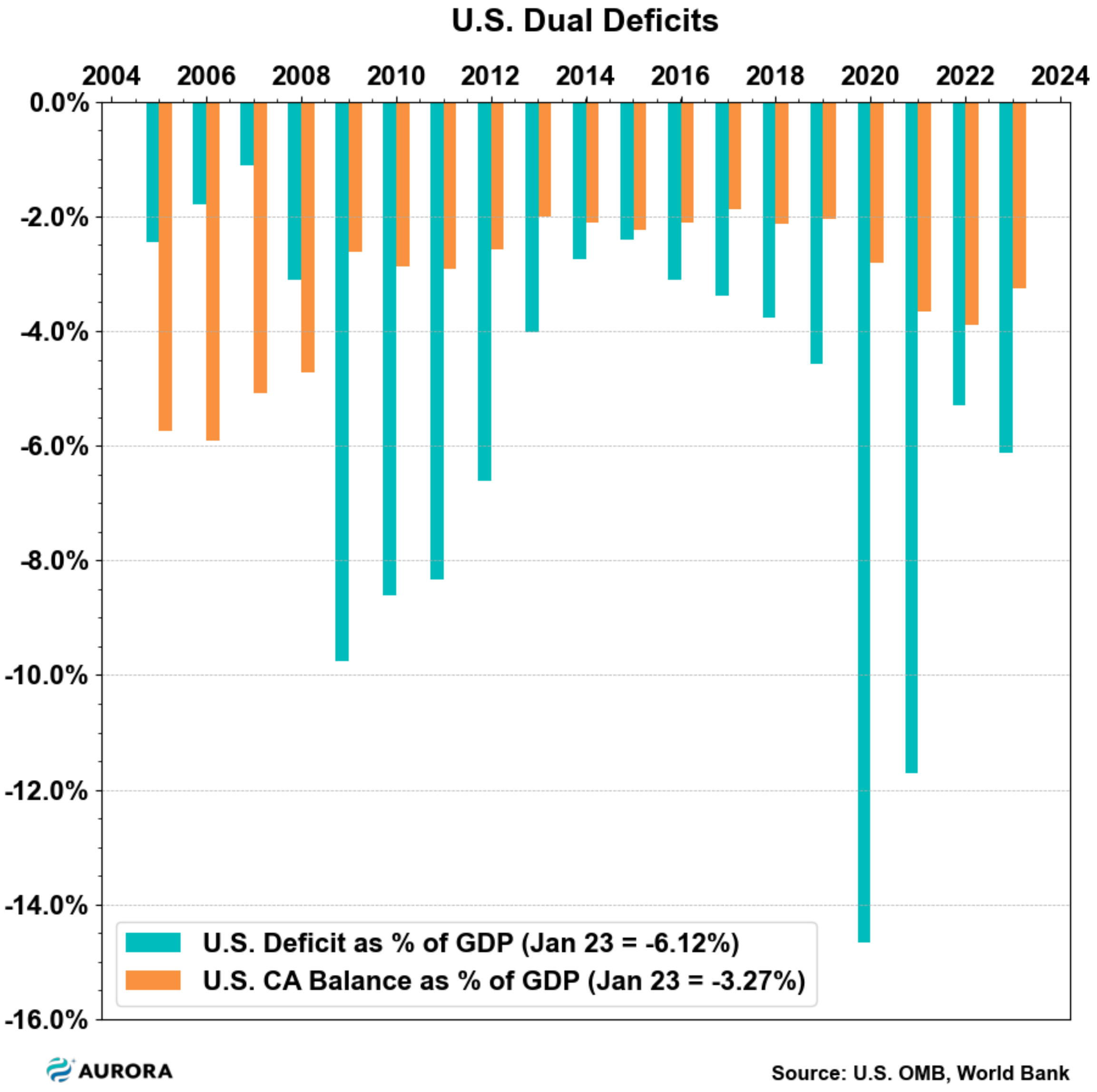
Fiscal risks will dominate in Q2

- Higher rates have become a problem for the federal government, which is spending an increasing part of its budget on interest.
- Here, the tariffs have an ambiguous effect: inflationary pressures and the Fed reaction are bearish, while slower growth and higher tariff revenues are bullish.
- As a reminder, the Treasury has already hit the debt ceiling and will now have to run down the TGA to make payments until Congress acts.
- We still expect Congress to pass a mildly expansionary budget, but its headroom will be limited if 10-year rates pick up.
- In our view, higher rates represent the single most important risk to the administration's agenda—and to continuing U.S. economic outperformance.



The Long Run: Trump Viewed from Abroad

- The Colombia kerfuffle last weekend ended up being macroeconomically insignificant for both countries.
- But it could prove to be an episode with significant long-term consequences.
- In particular, Trump's threat to impose financial and banking sanctions over a seemingly unrelated matter (the manner of deportation flights) raises serious question about the U.S.'s role as nexus of global finance.
- Though there is no ready alternative to the USD, we would expect neutral countries to continue diversifying their reserves into gold and alternative currencies.
- This poses additional risks for the U.S. treasuries market, though we expect these to materialize slowly over the coming years.
- U.S. fiscal problems are far more pressing, and domestic bondholders may well rebel before foreign demand wanes meaningfully.



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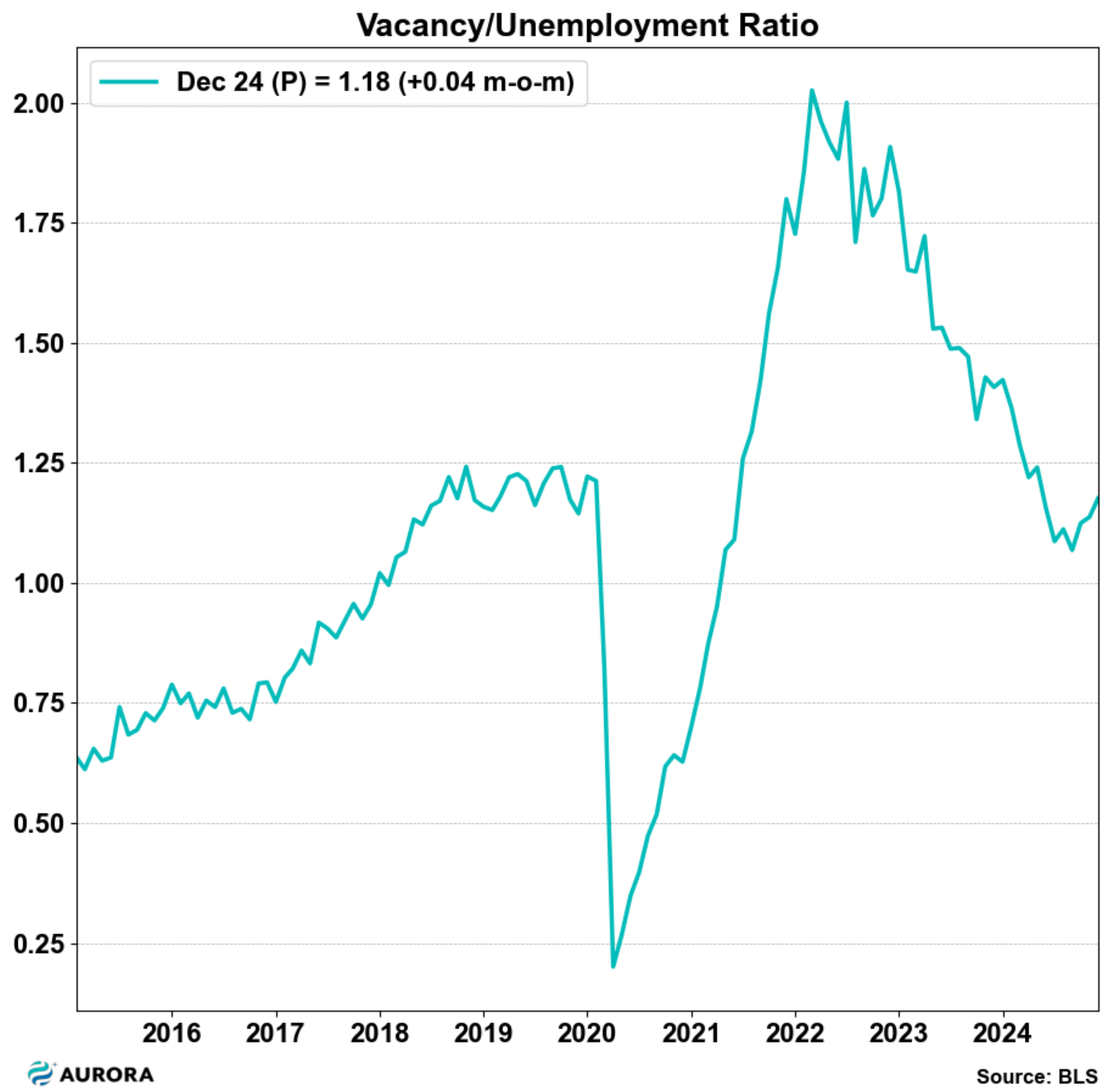
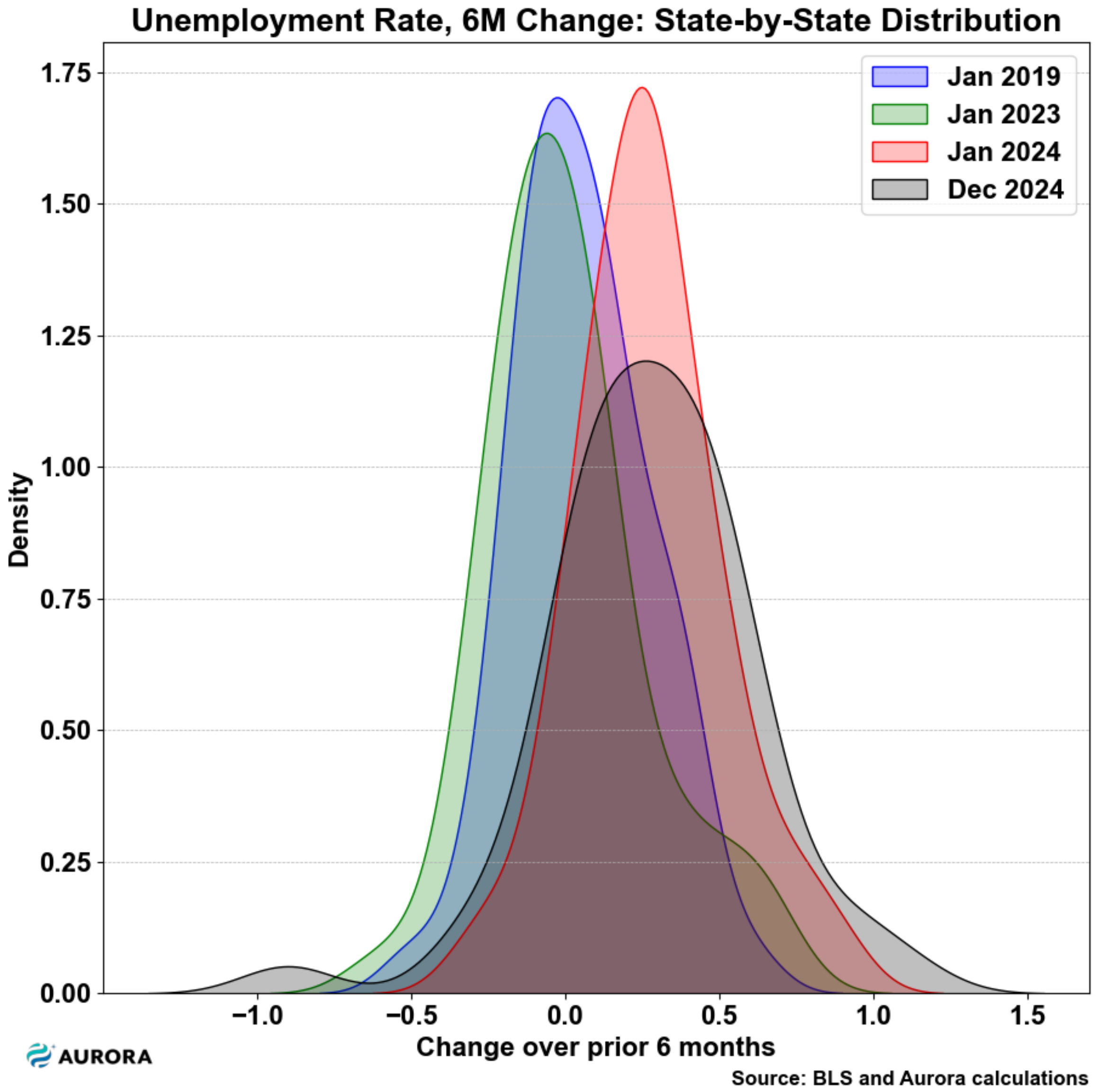
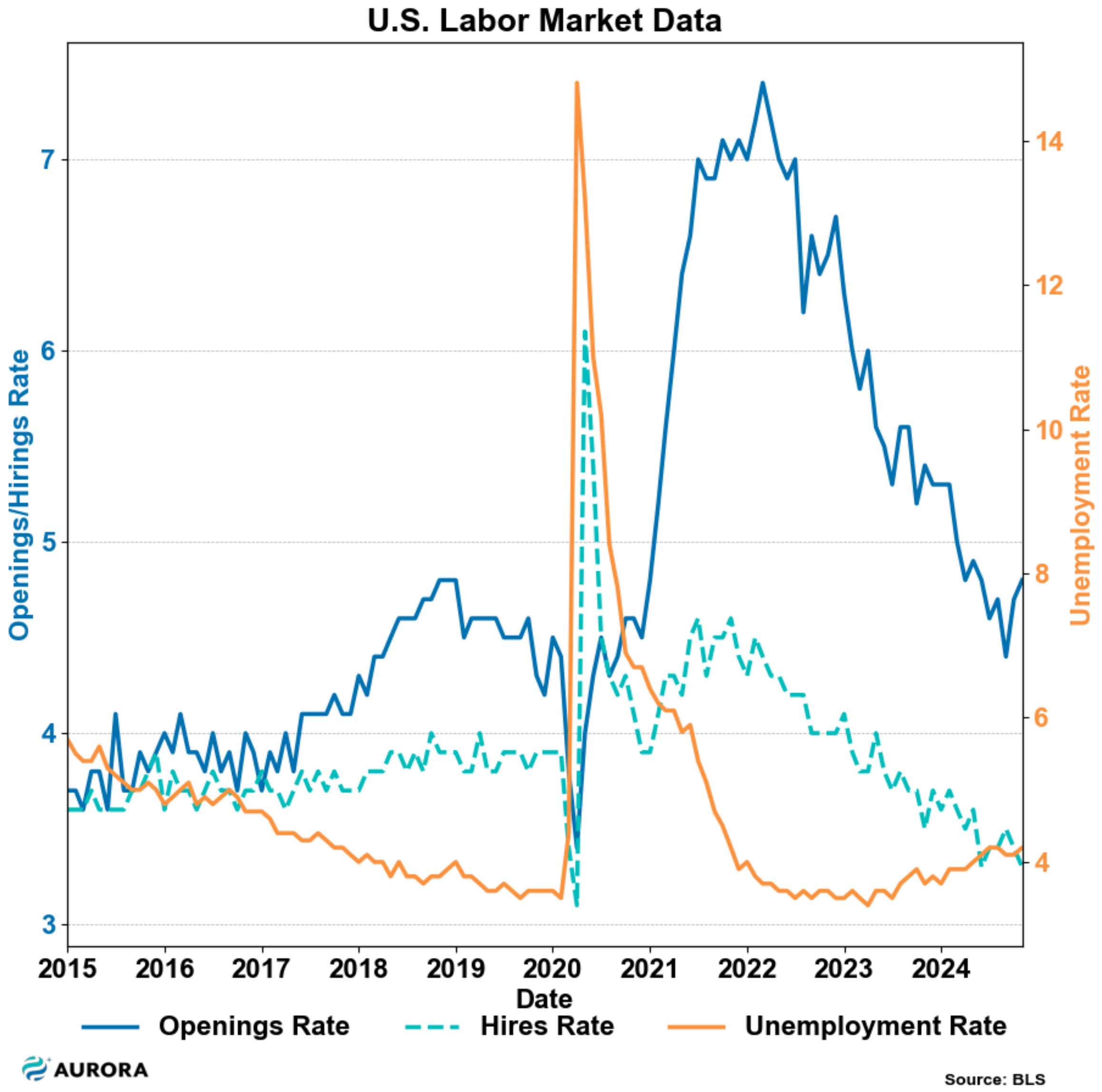
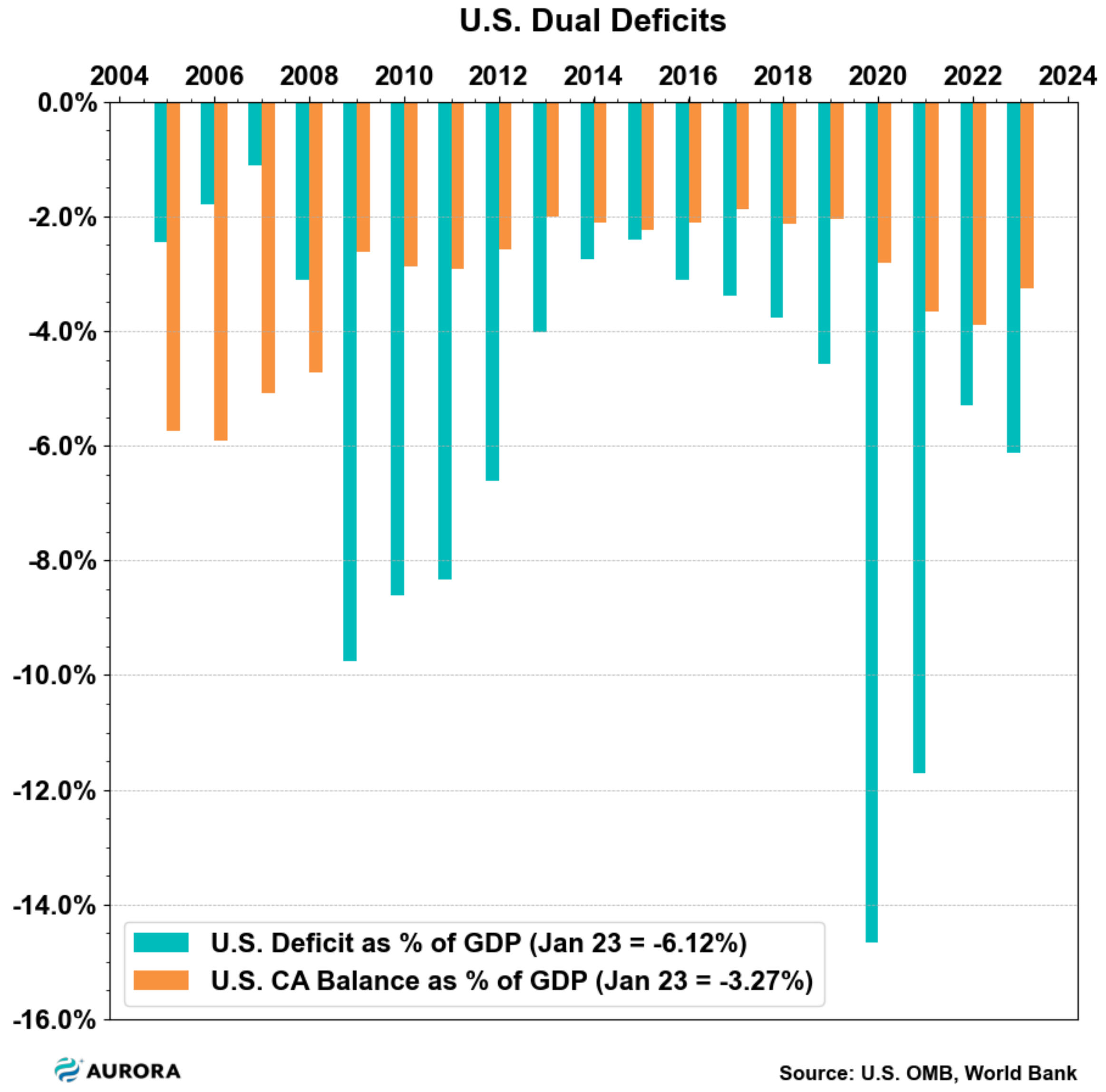


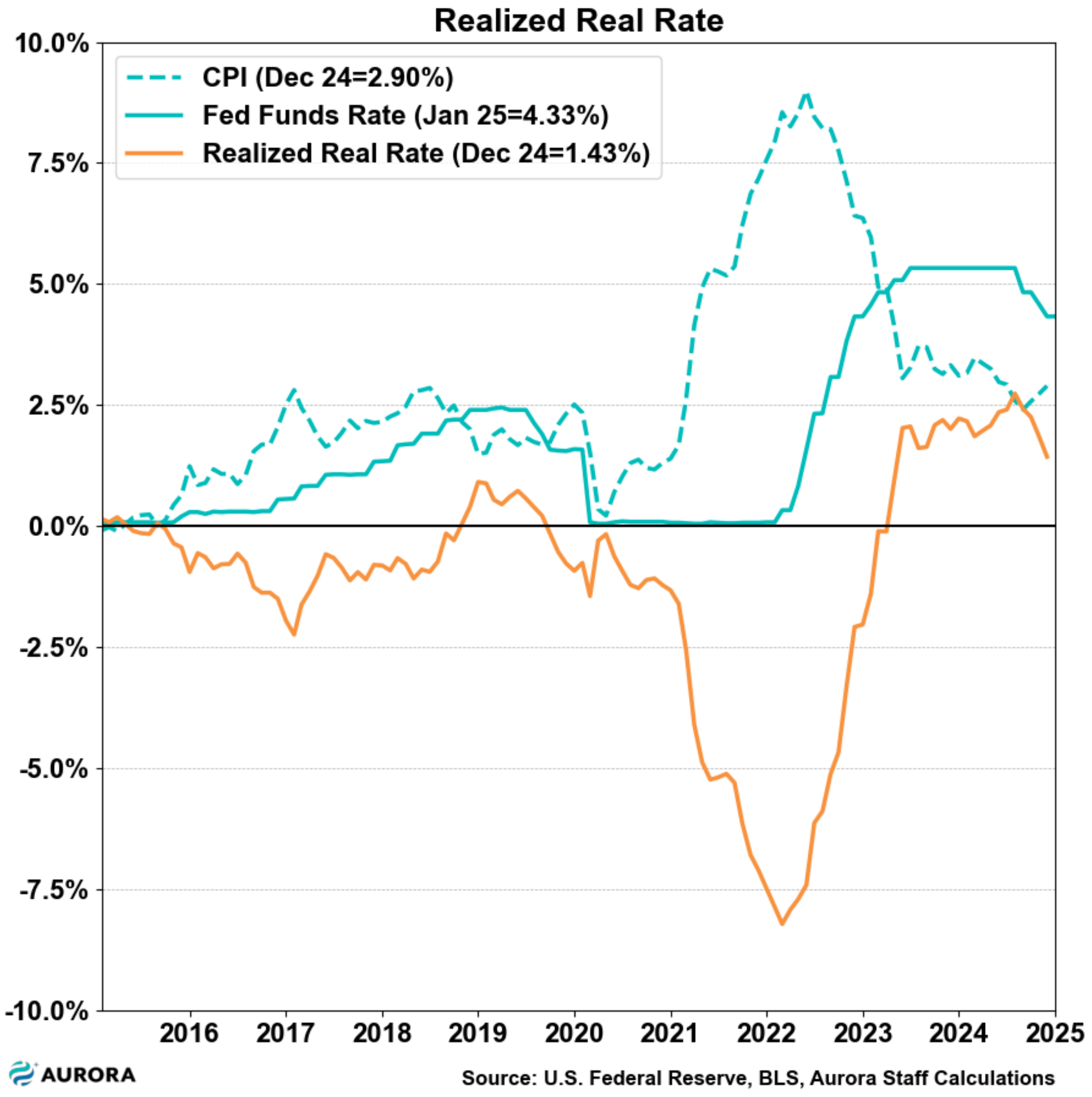
1b. Labor Market Continued



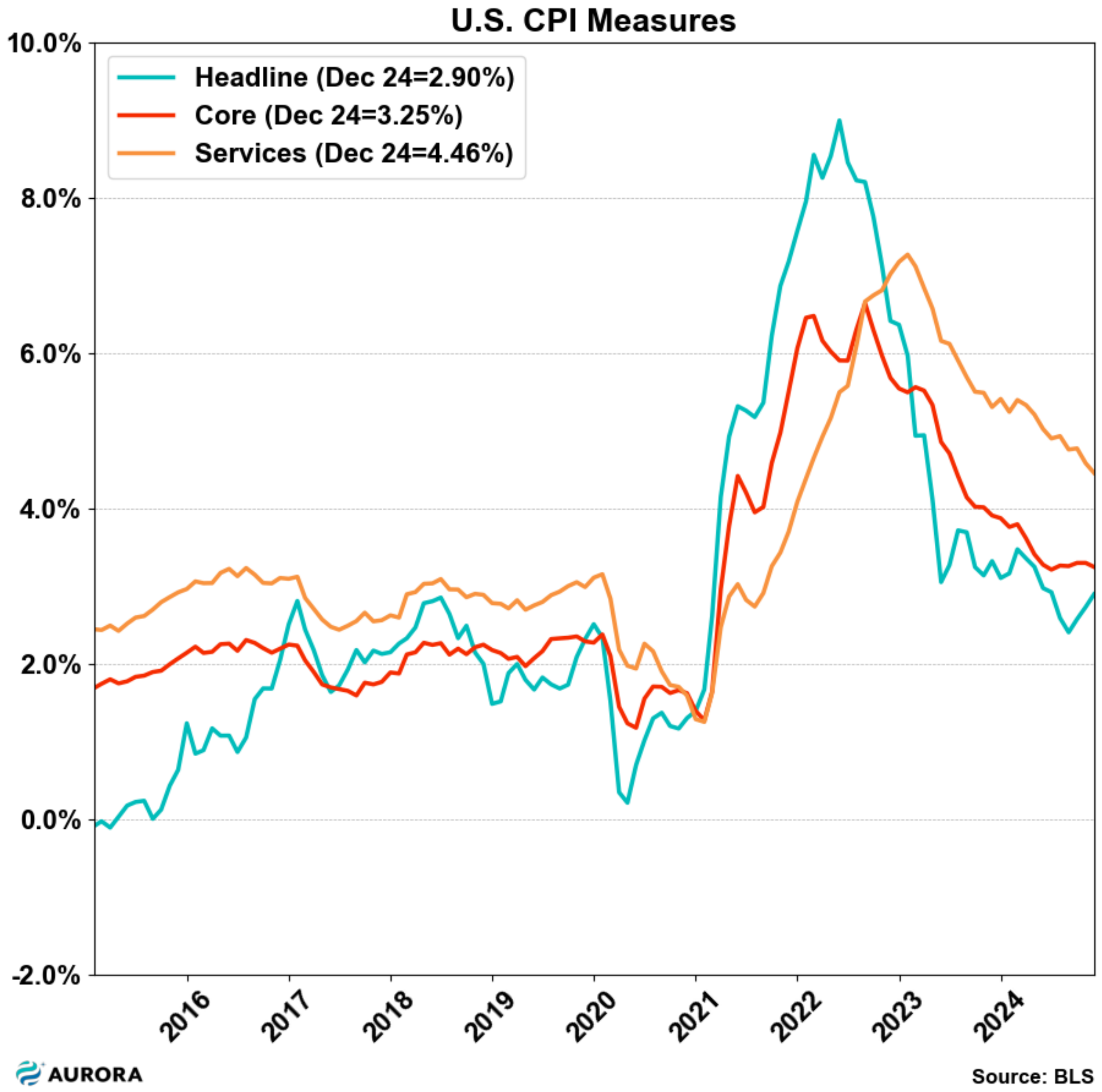


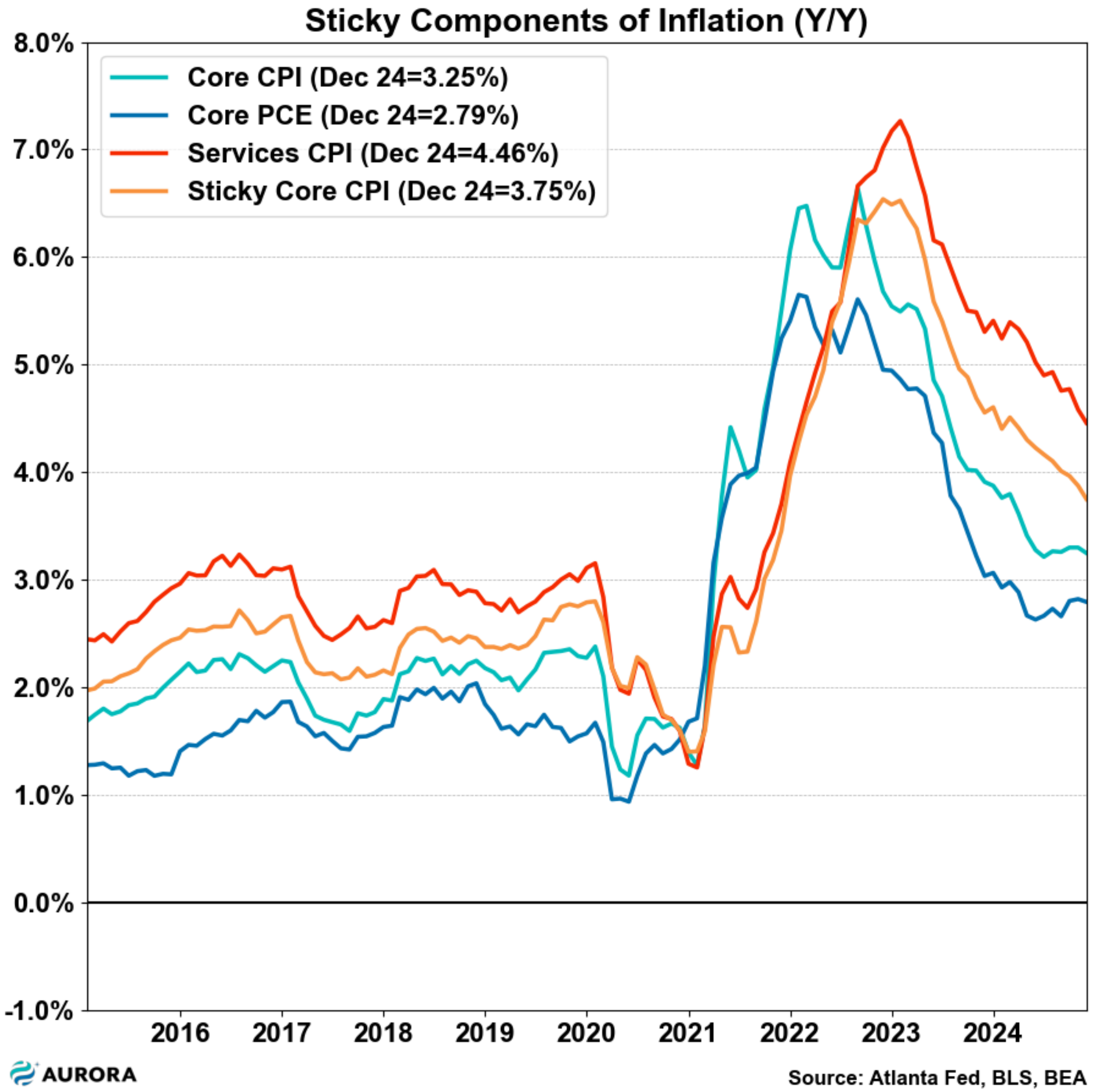
1c. Policy Overview



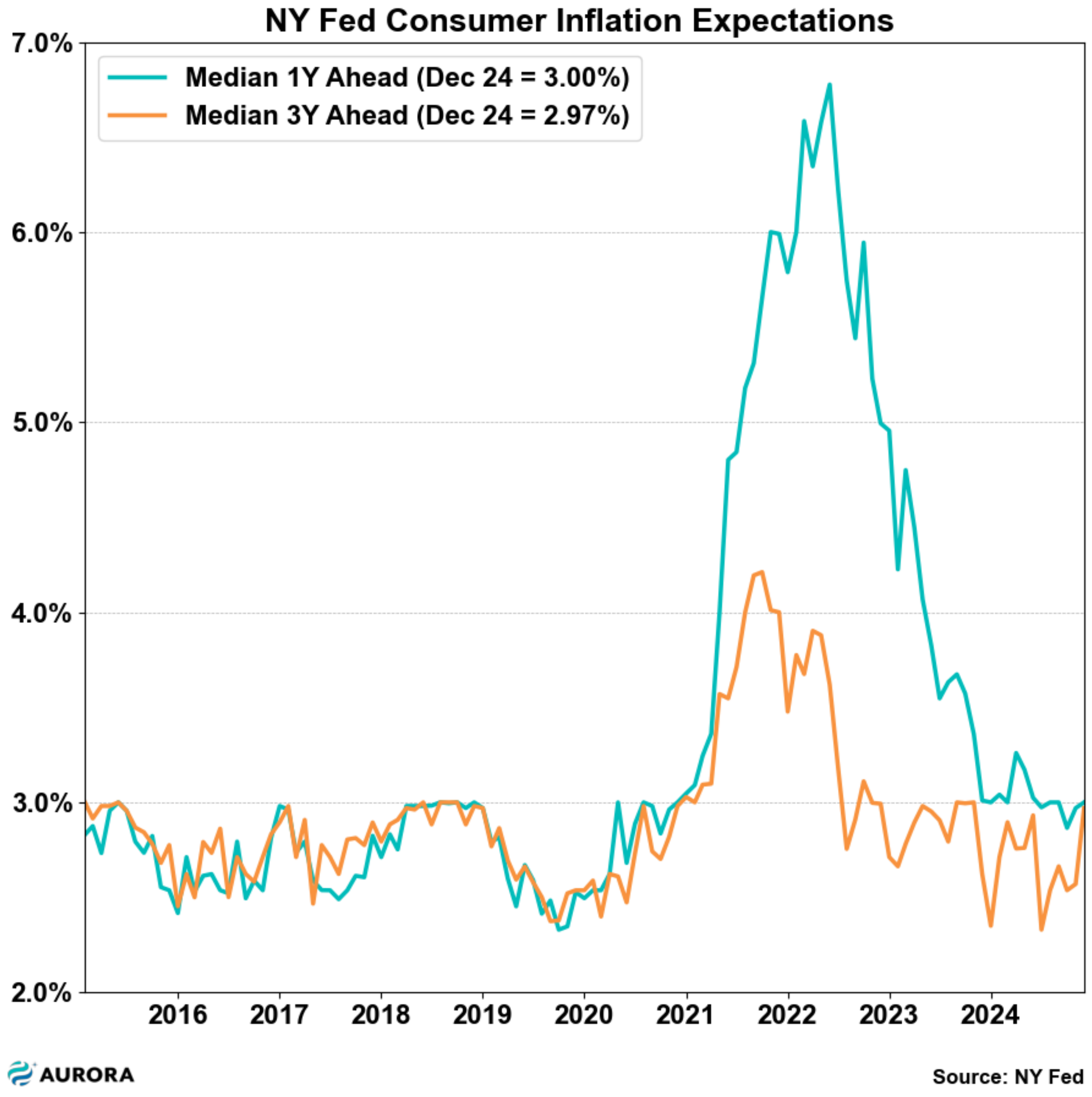


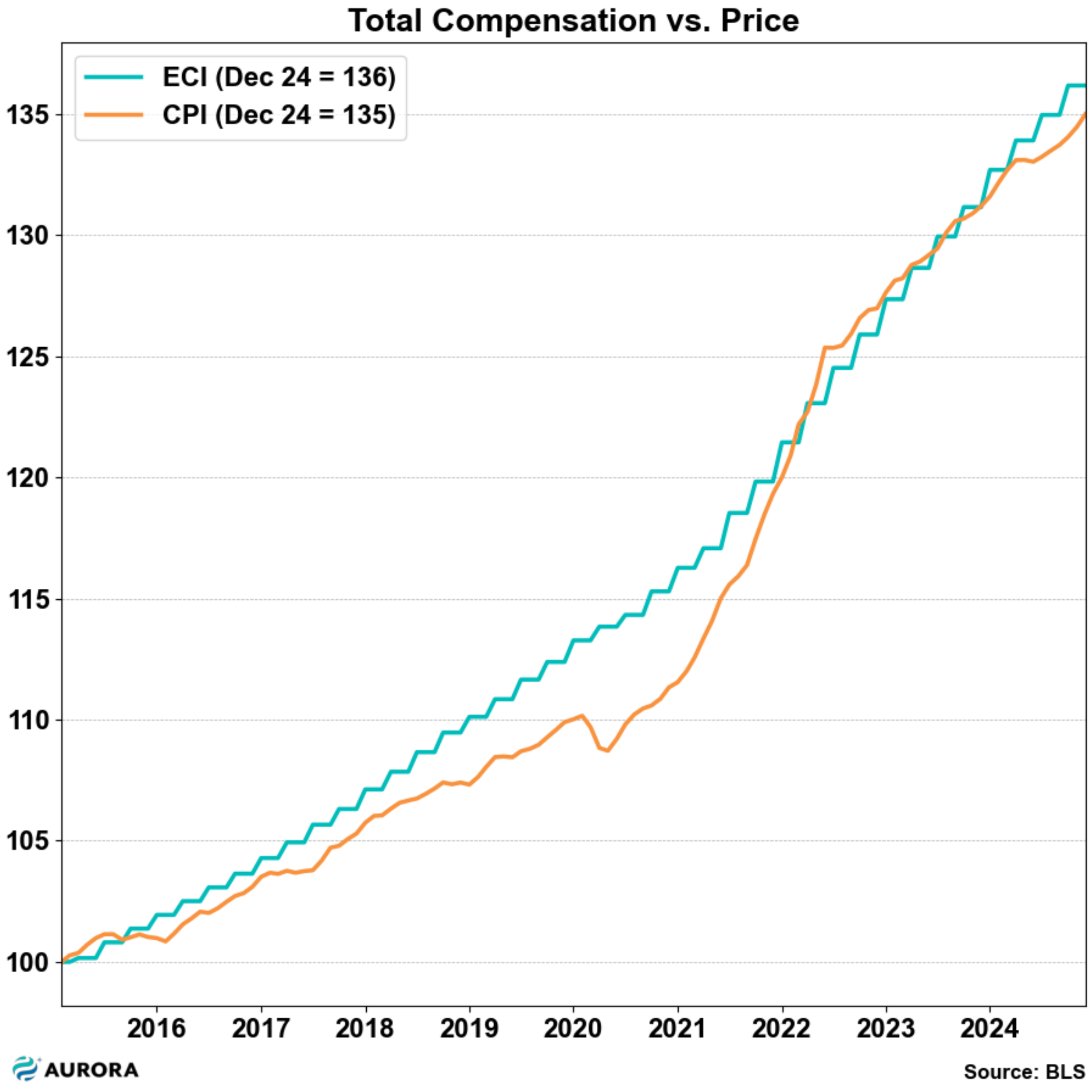
2a. Inflation



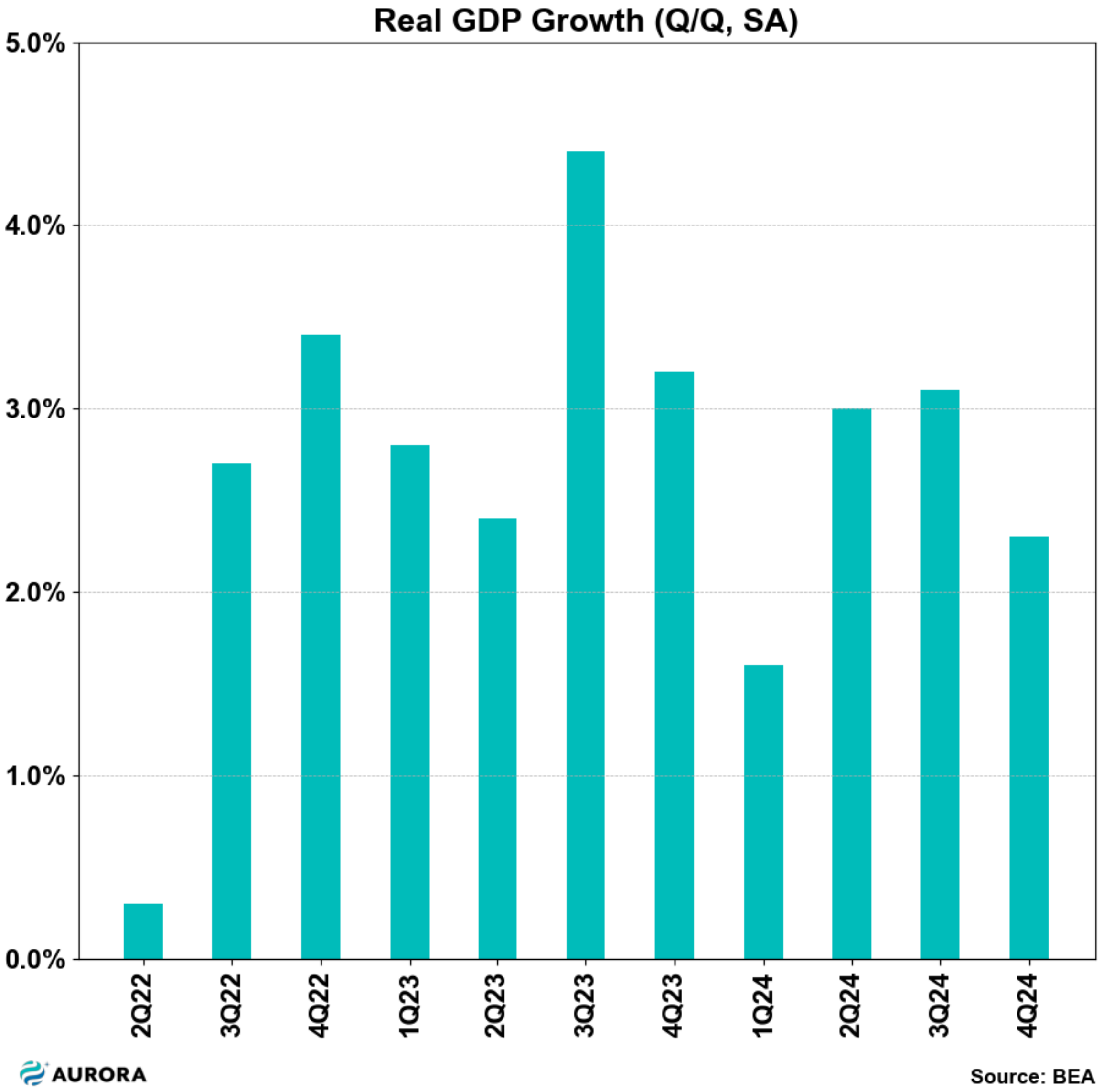


2b. Inflation





3a. GDP


Real GDP Growth (Q/Q, SA)
5.0%
4.0%
3.0%
2.0%
1.0%
0.0%
2Q22
3Q22
4Q22
1Q23
2Q23
3Q23
4Q23
1Q24
2Q24
3Q24
4Q24
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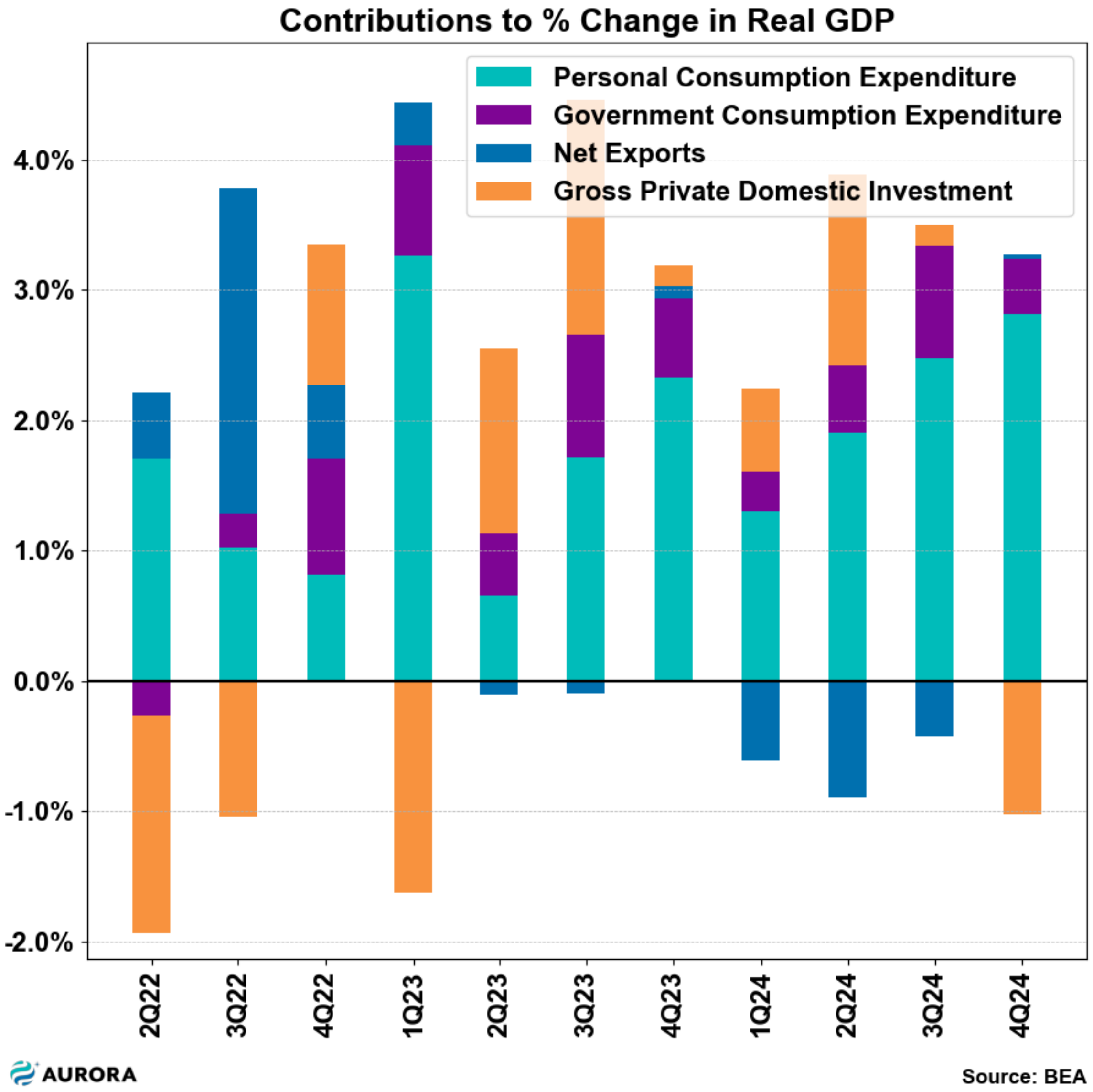
Source: BEA


Contributions to % Change in Real GDP
Personal Consumption Expenditure
Government Consumption Expenditure
Net Exports
Gross Private Domestic Investment
4.0%
3.0%
2.0%
1.0%
0.0%
-1.0%
-2.0%
2Q22
3Q22
4Q22
1Q23
2Q23
3Q23
4Q23
1Q24
2Q24
3Q24
4Q24
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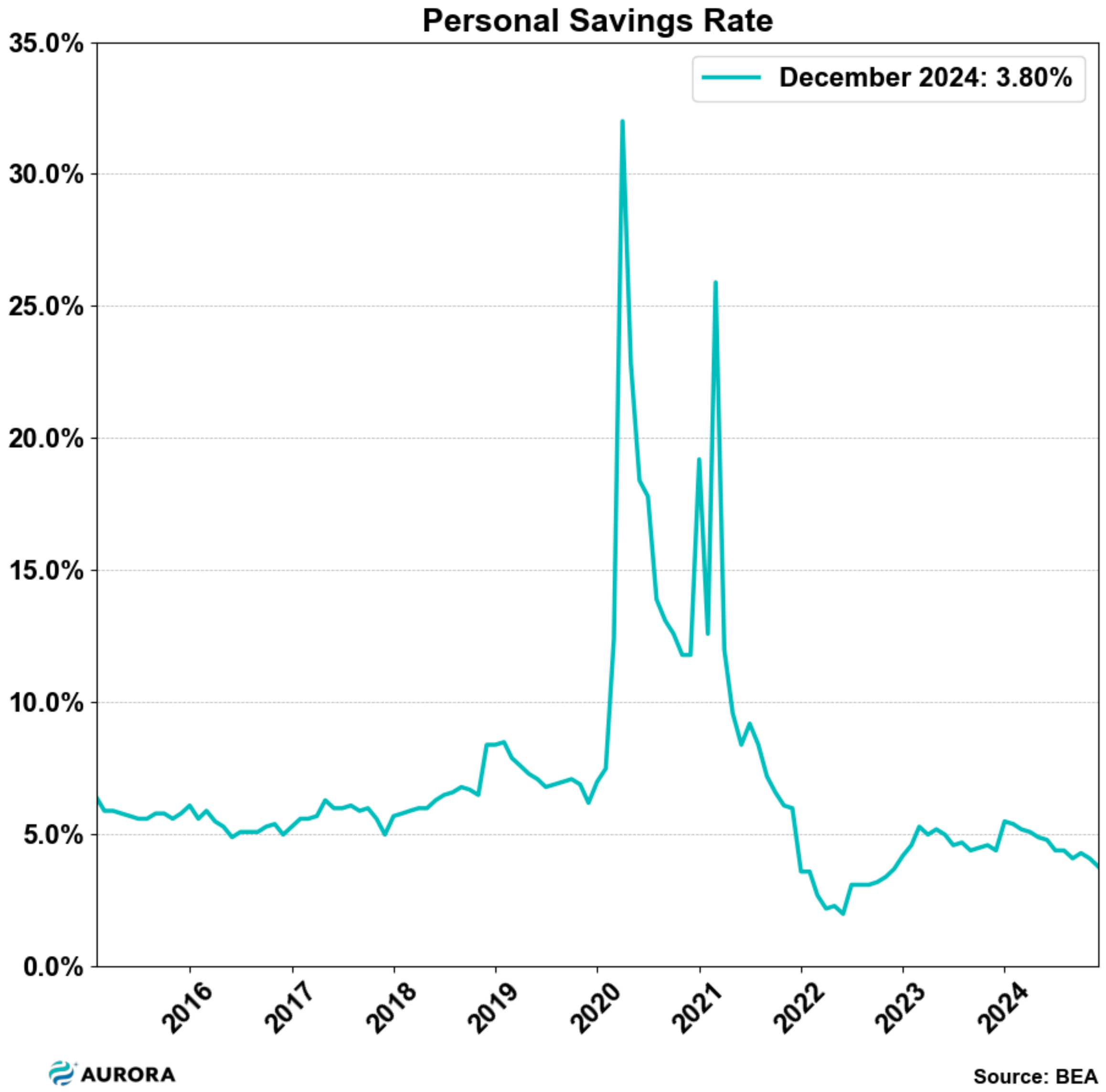
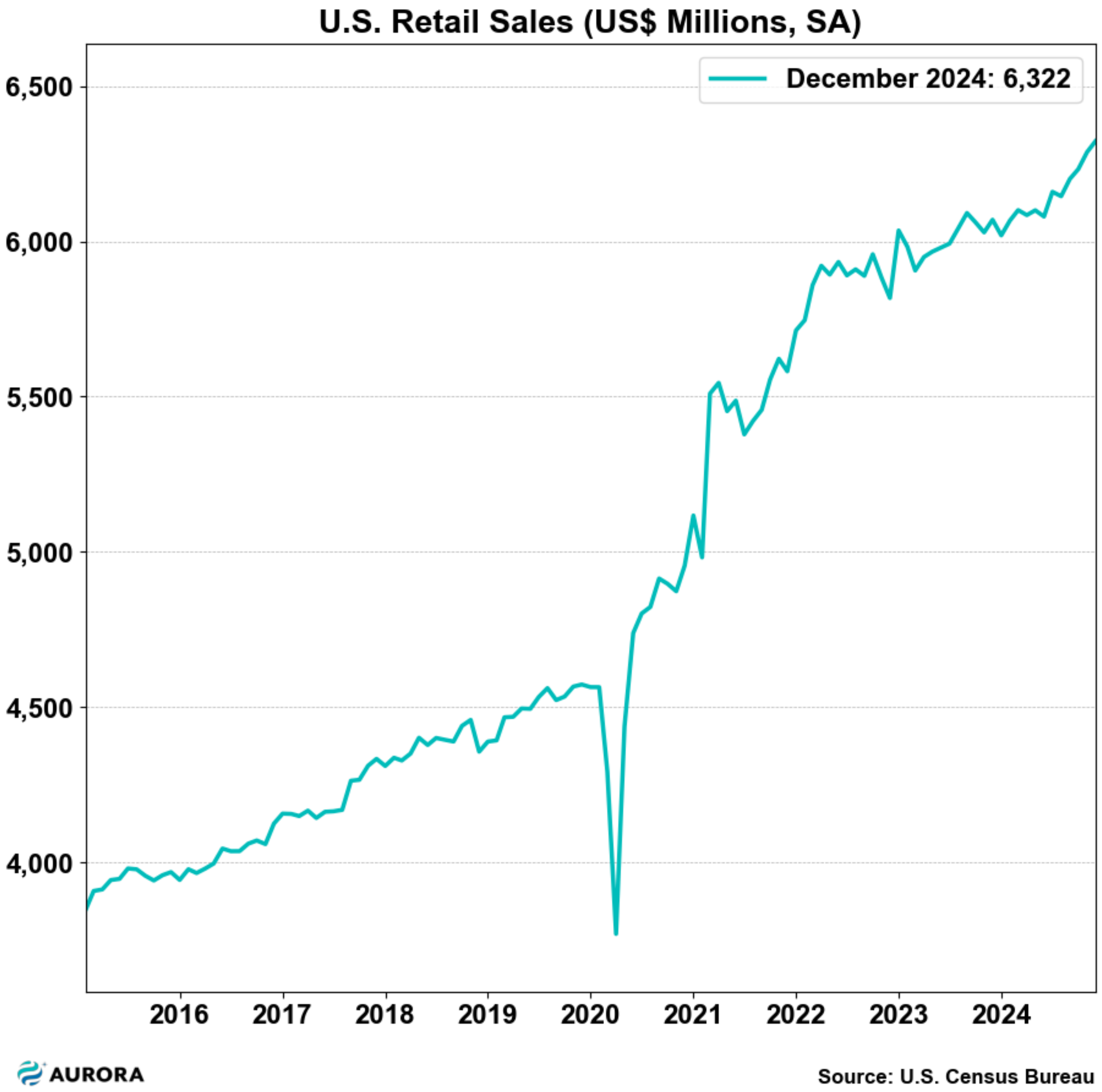
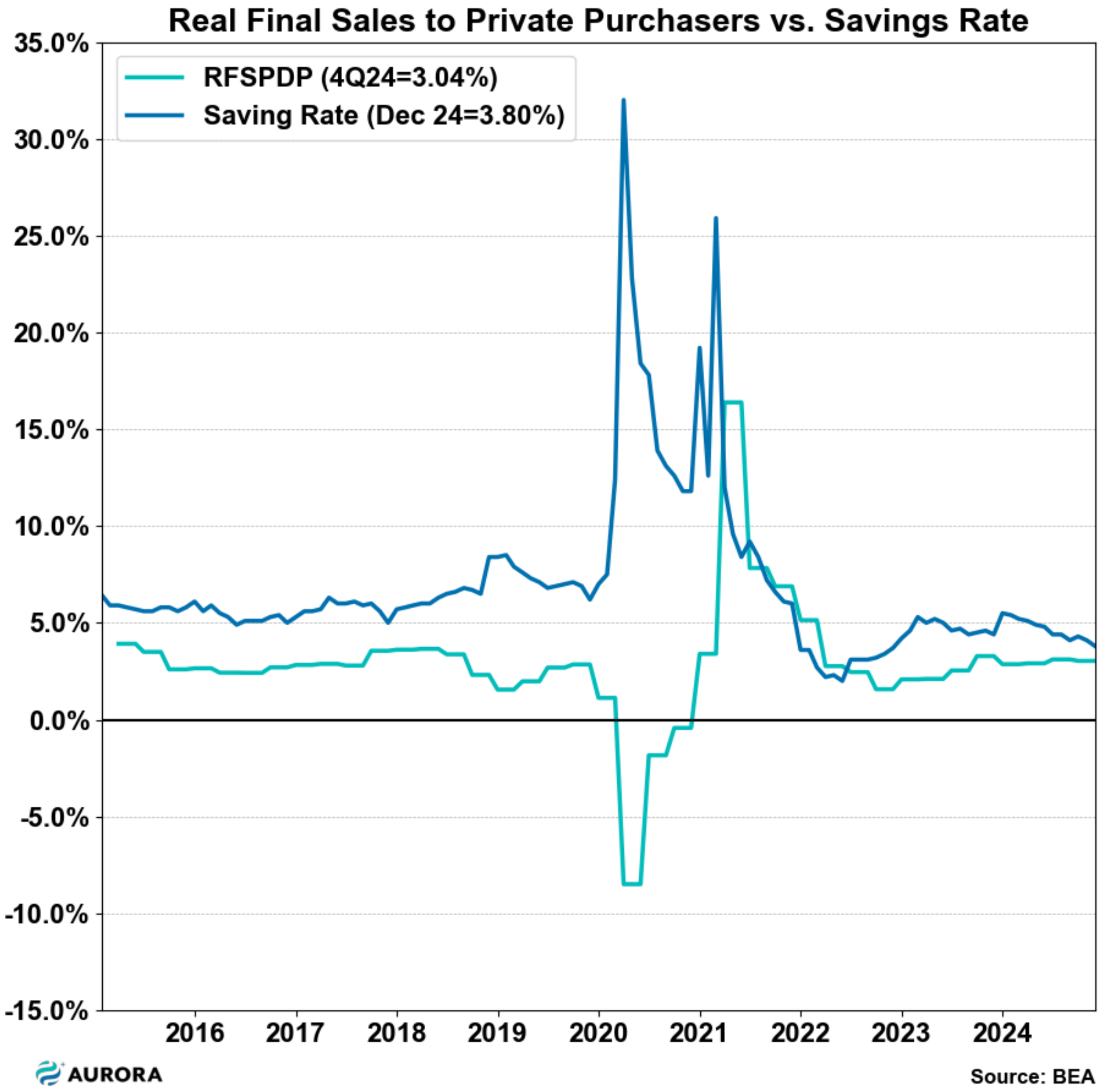
Source: BEA

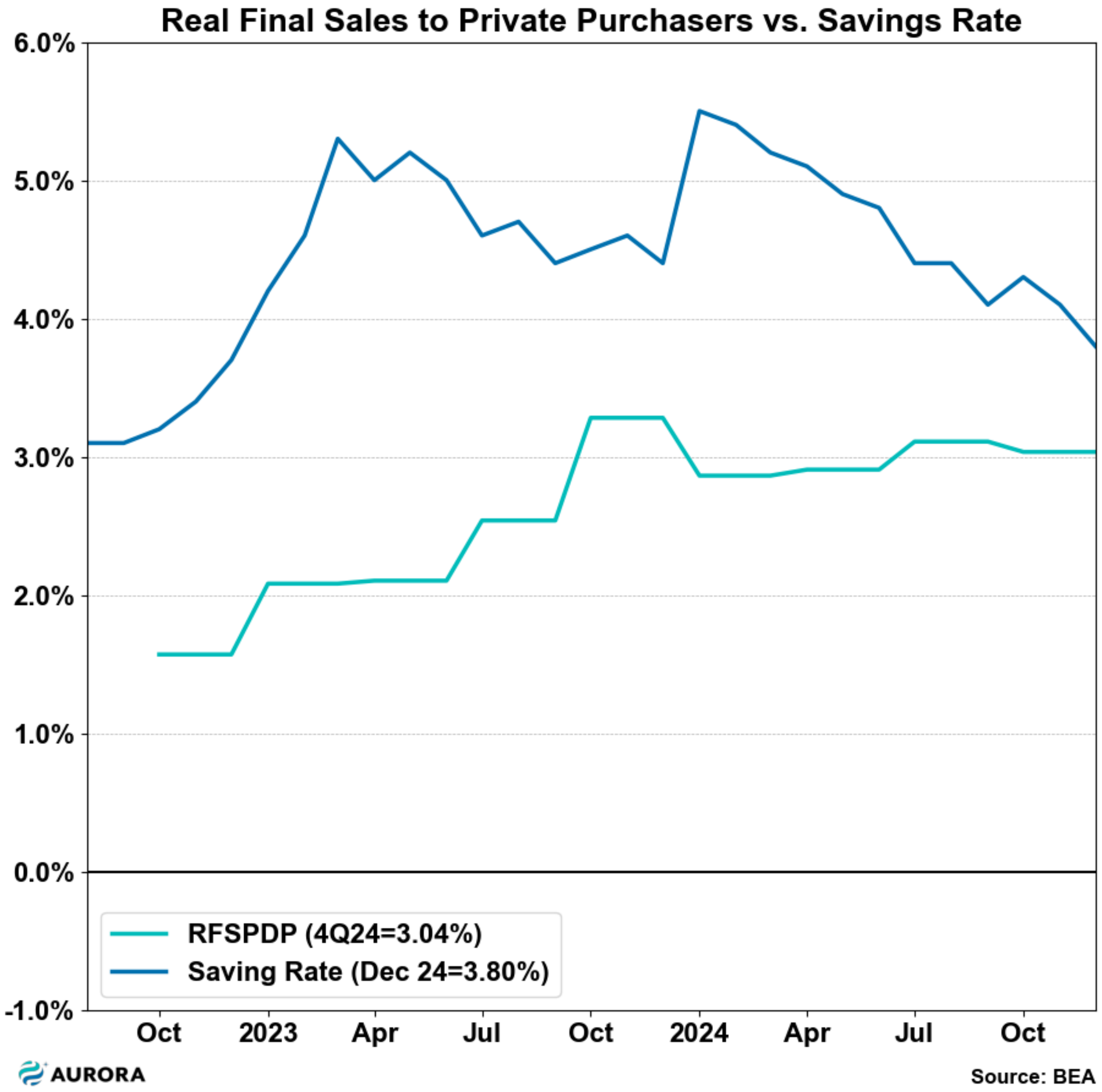
4a. Consumption



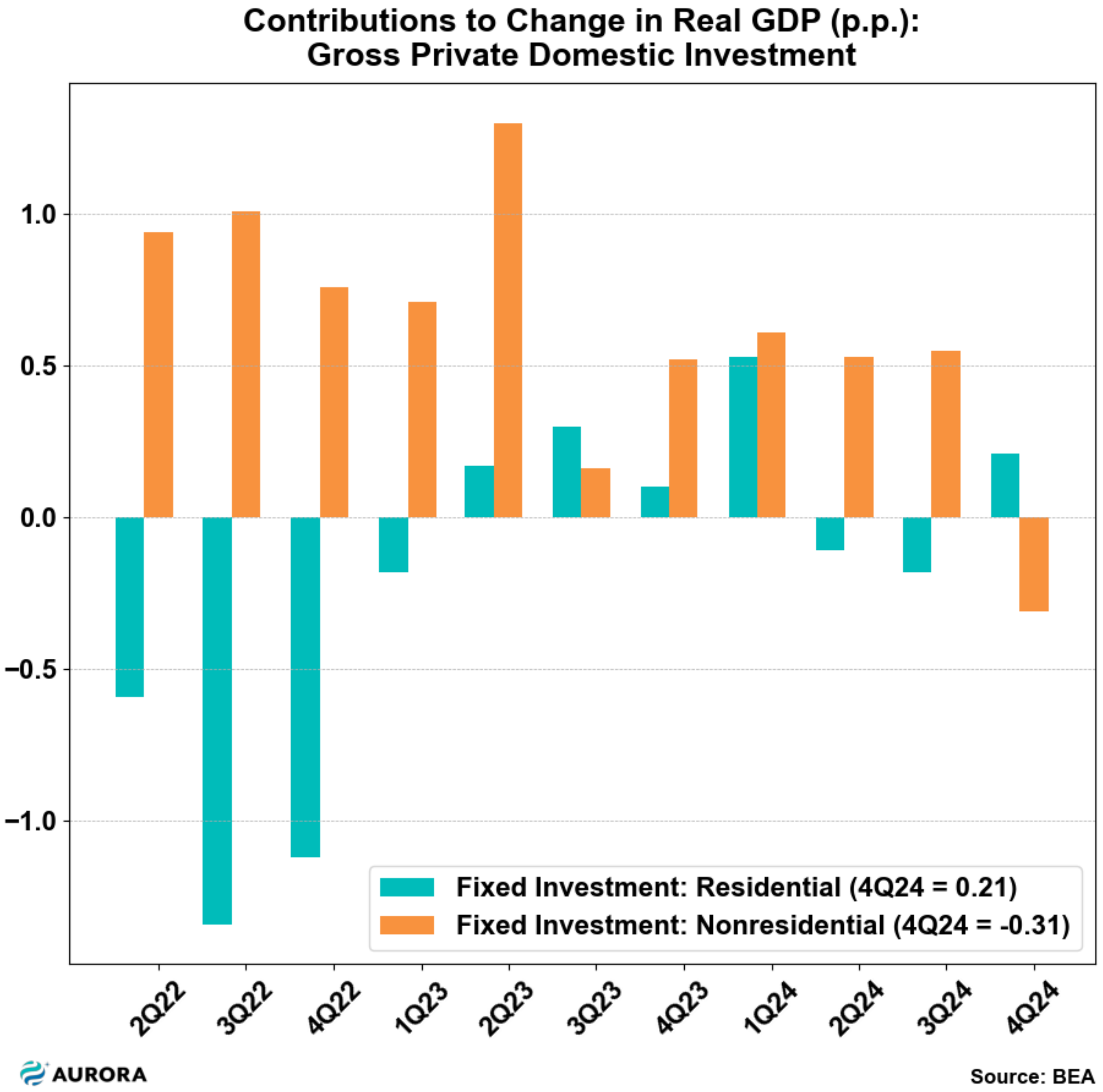


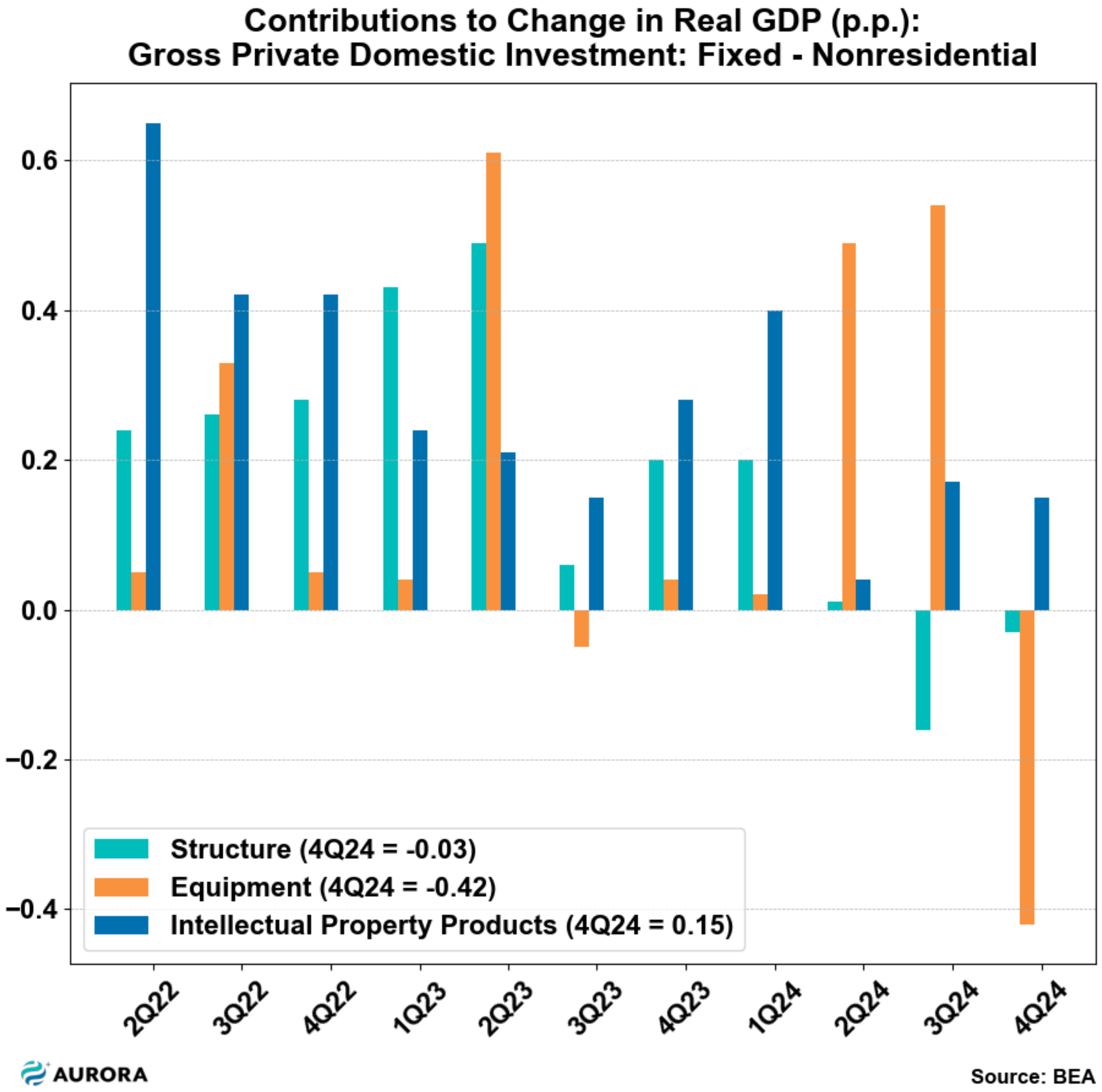
4b. Consumption



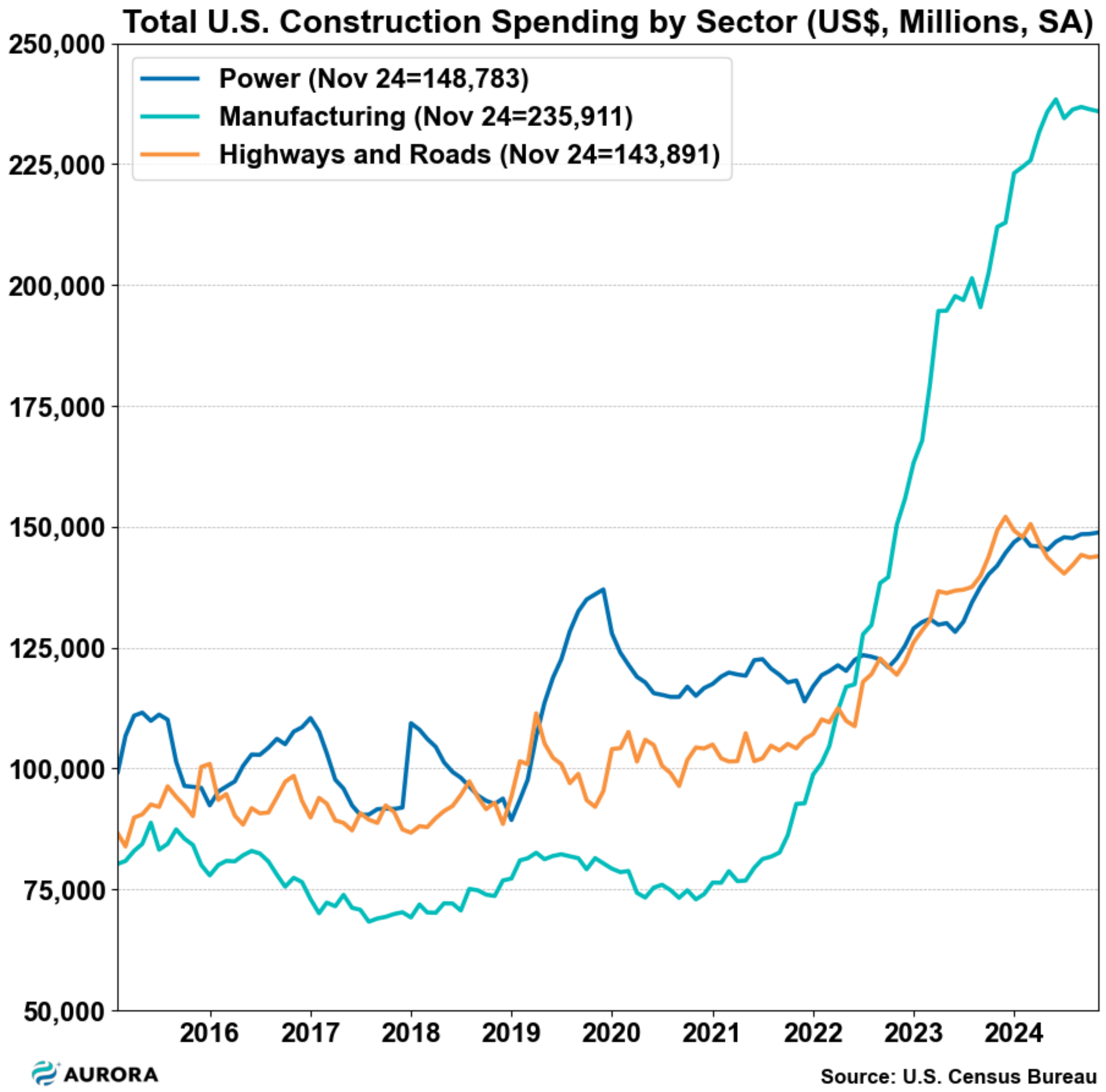


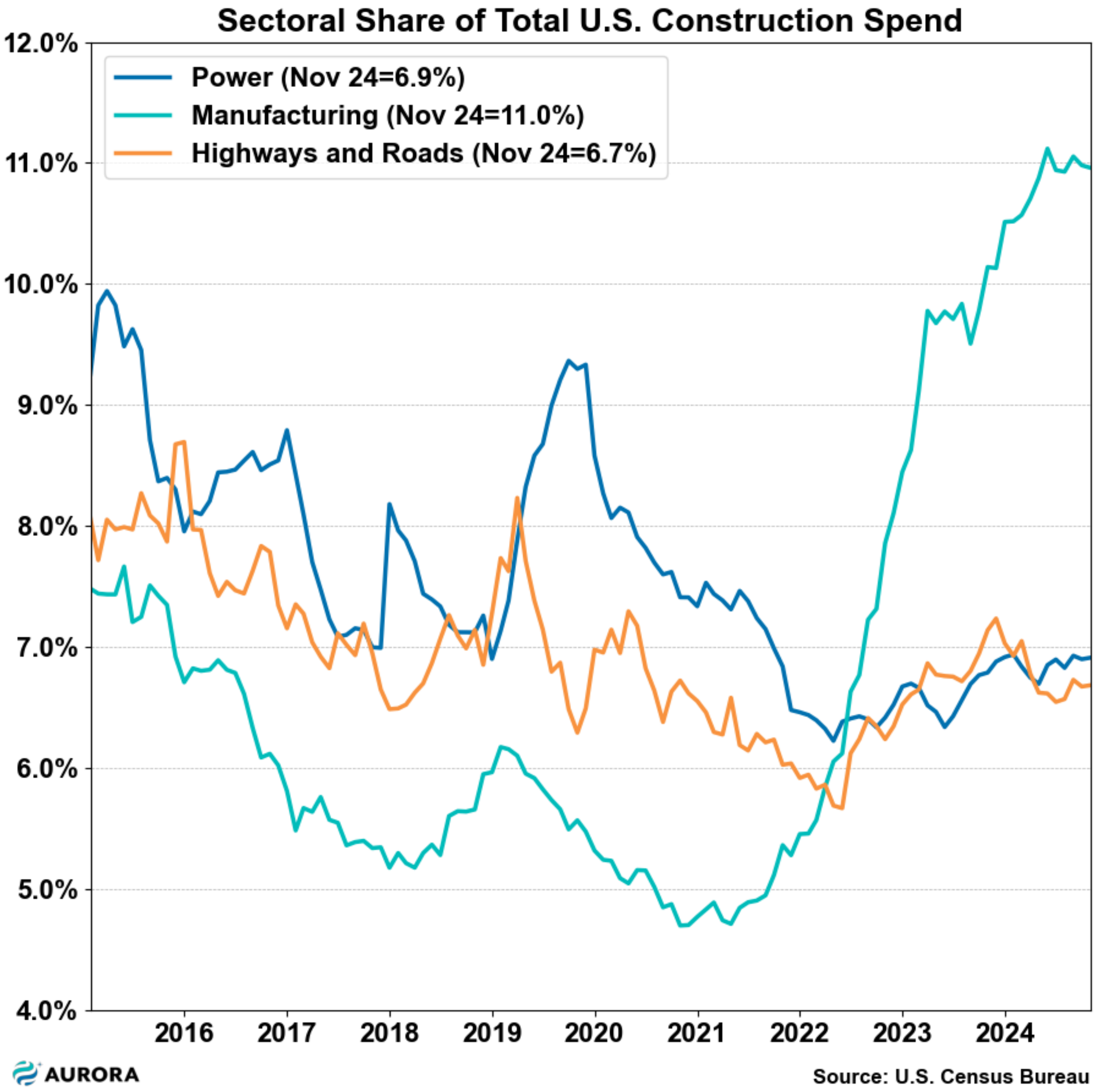
5a. Investment contributions to GDP



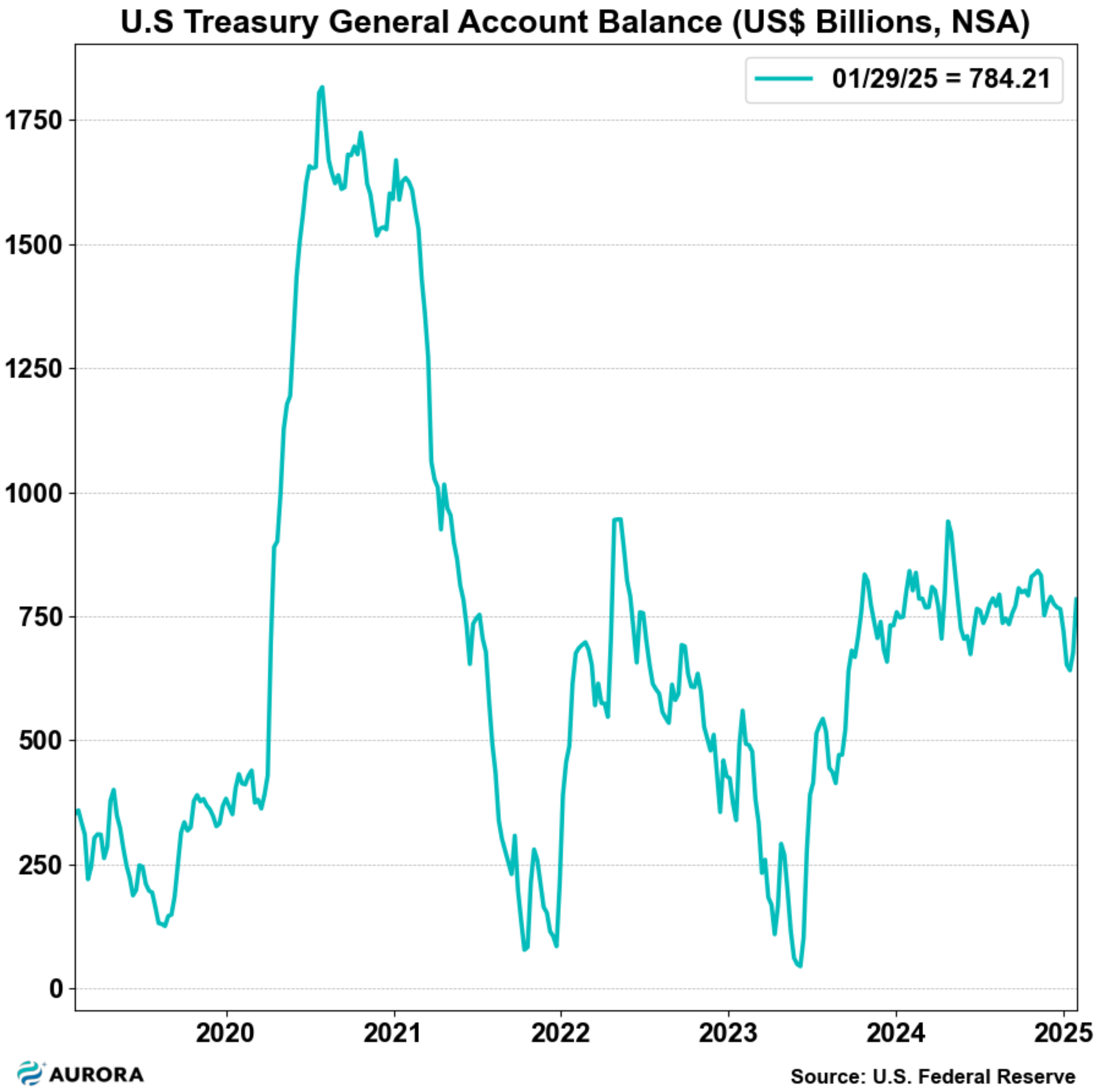


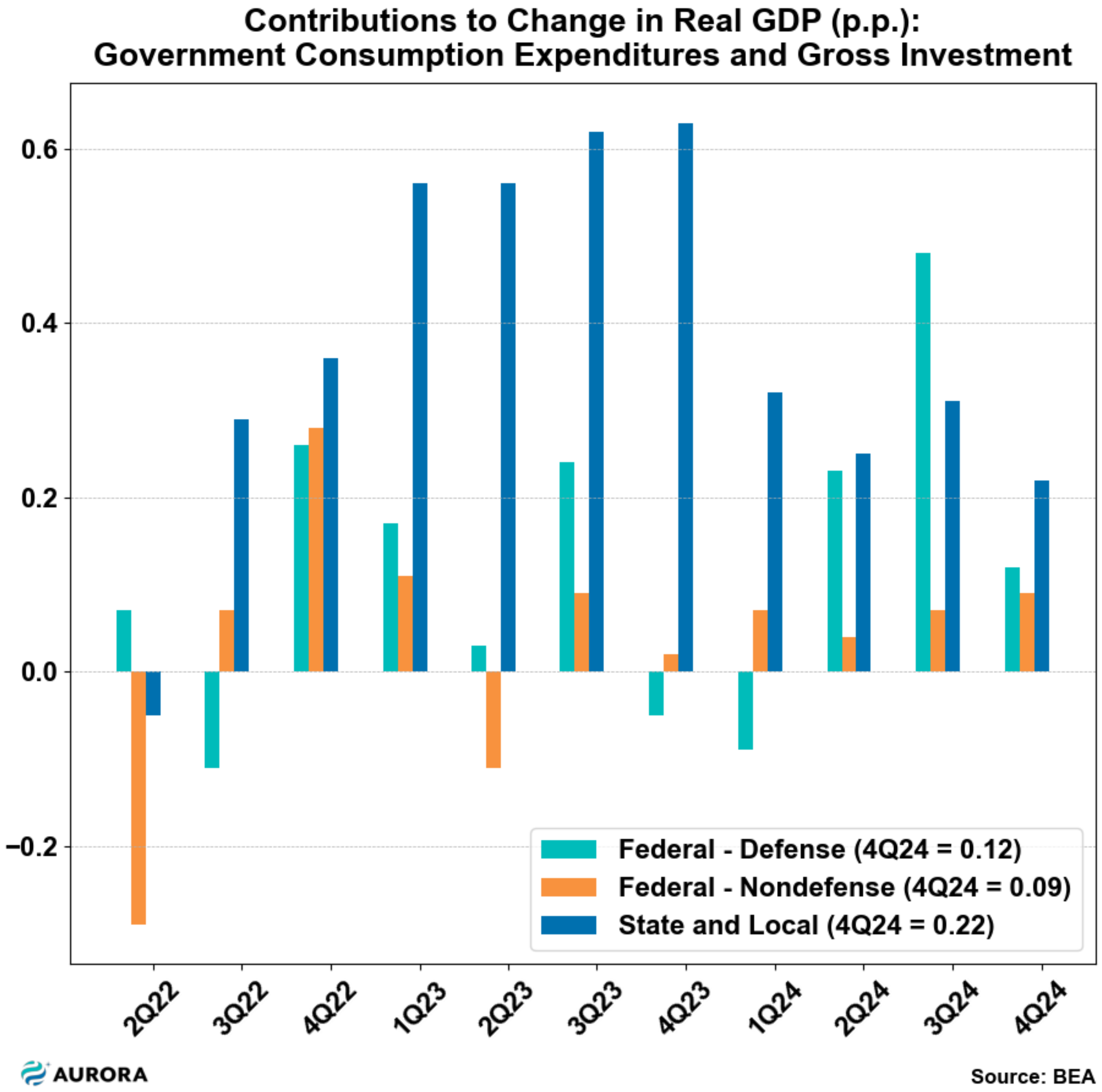
5b. Construction Spending



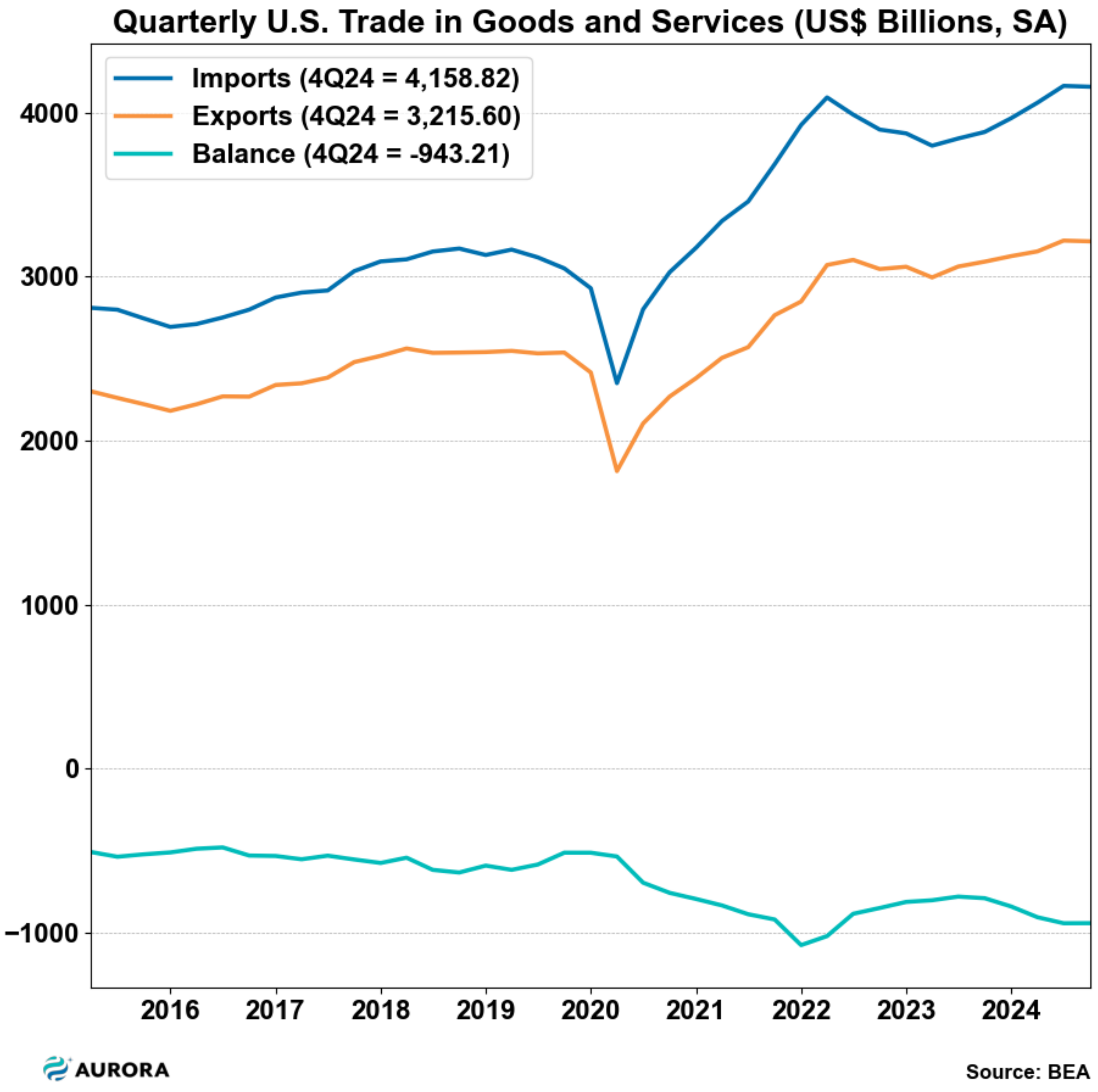


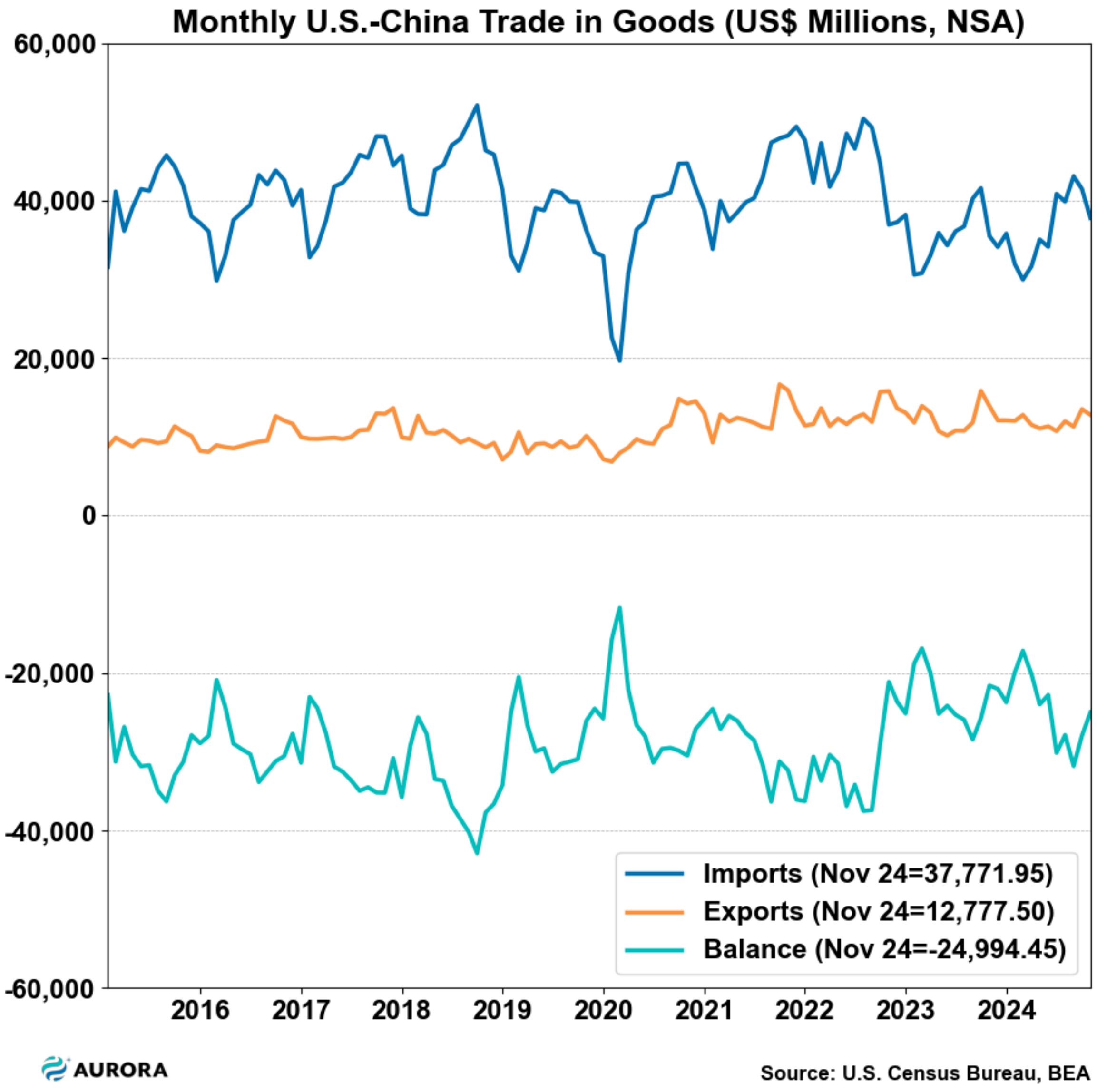
6. Government Spending



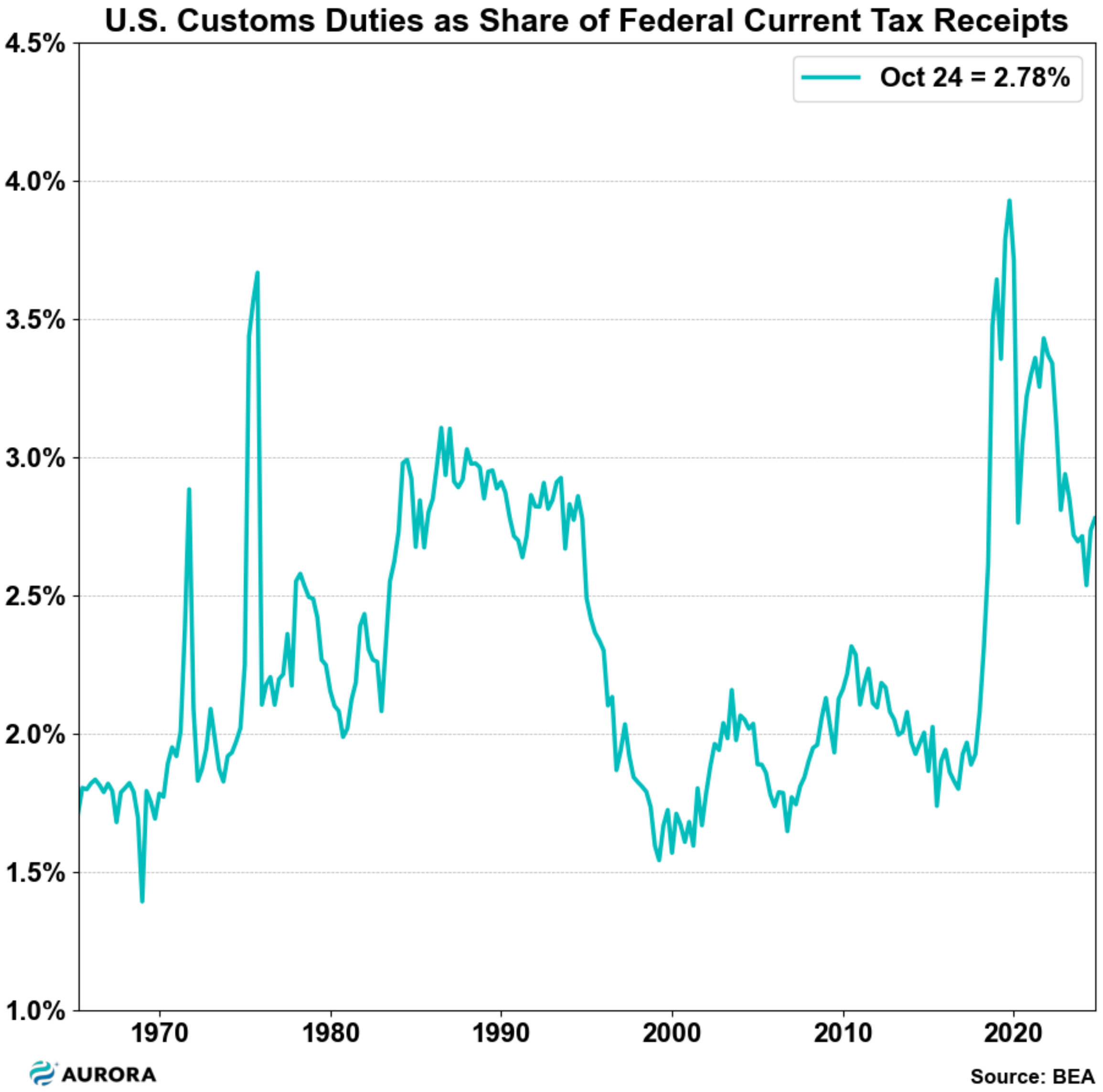


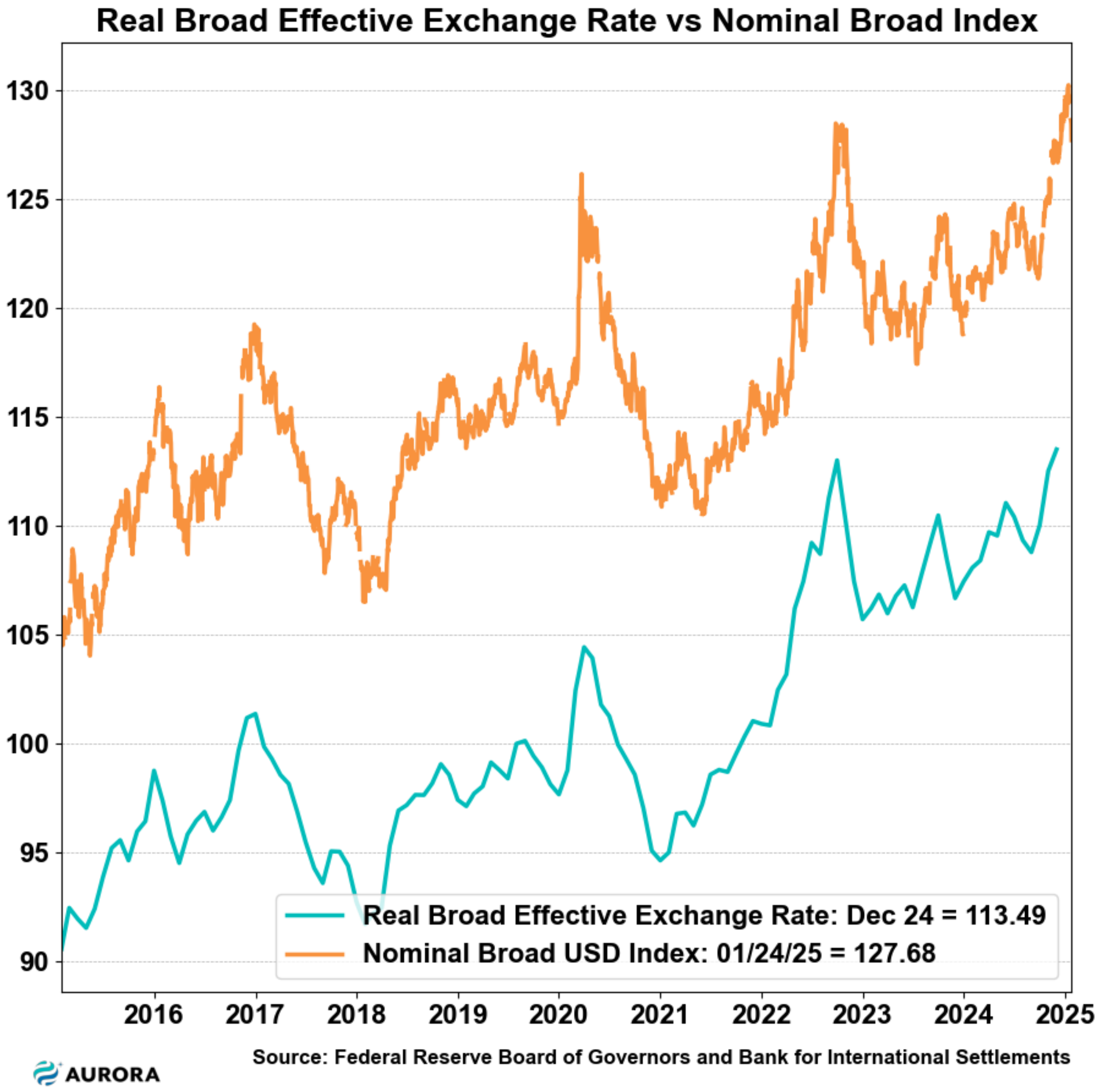
7a. International Trade



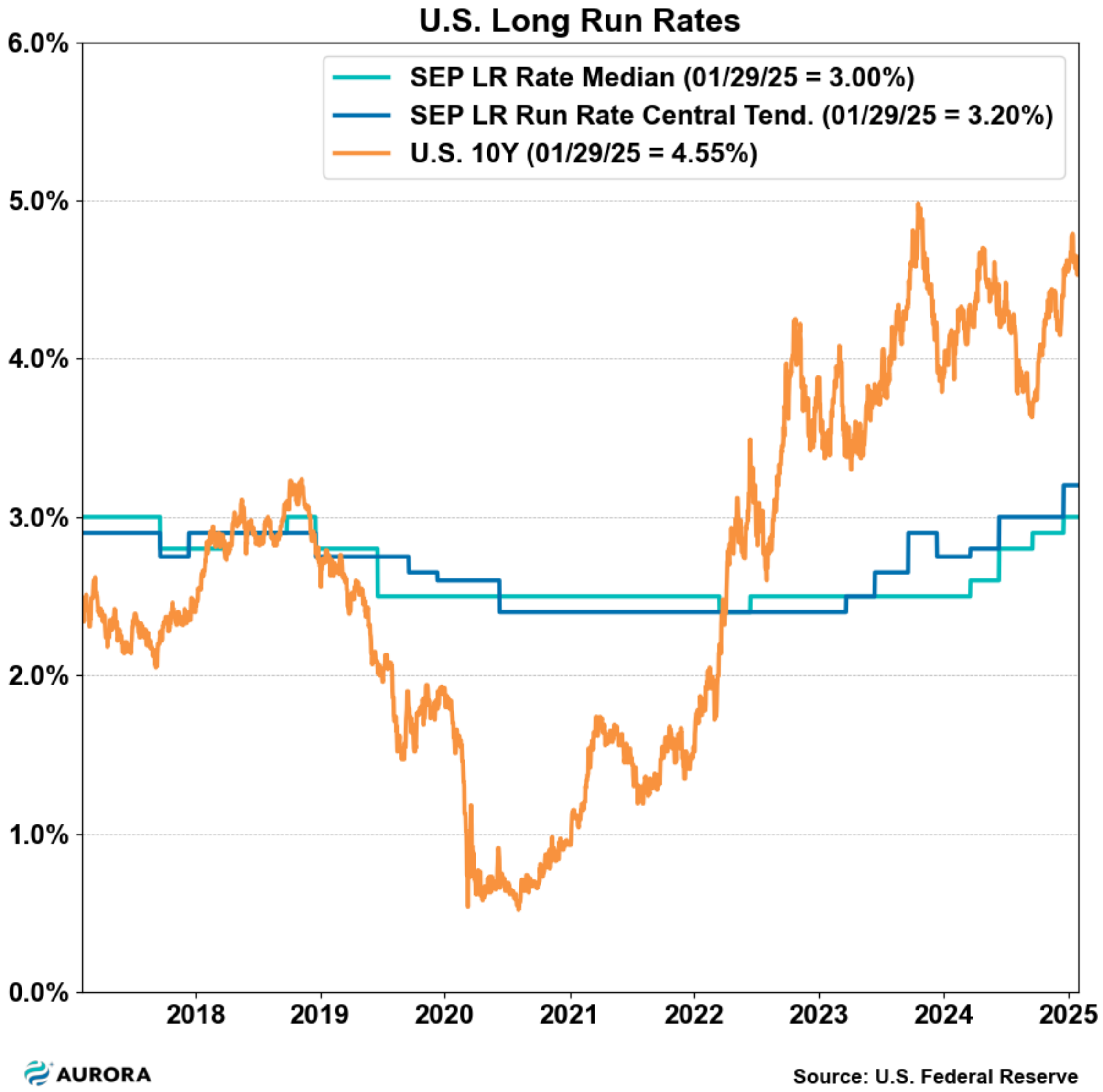


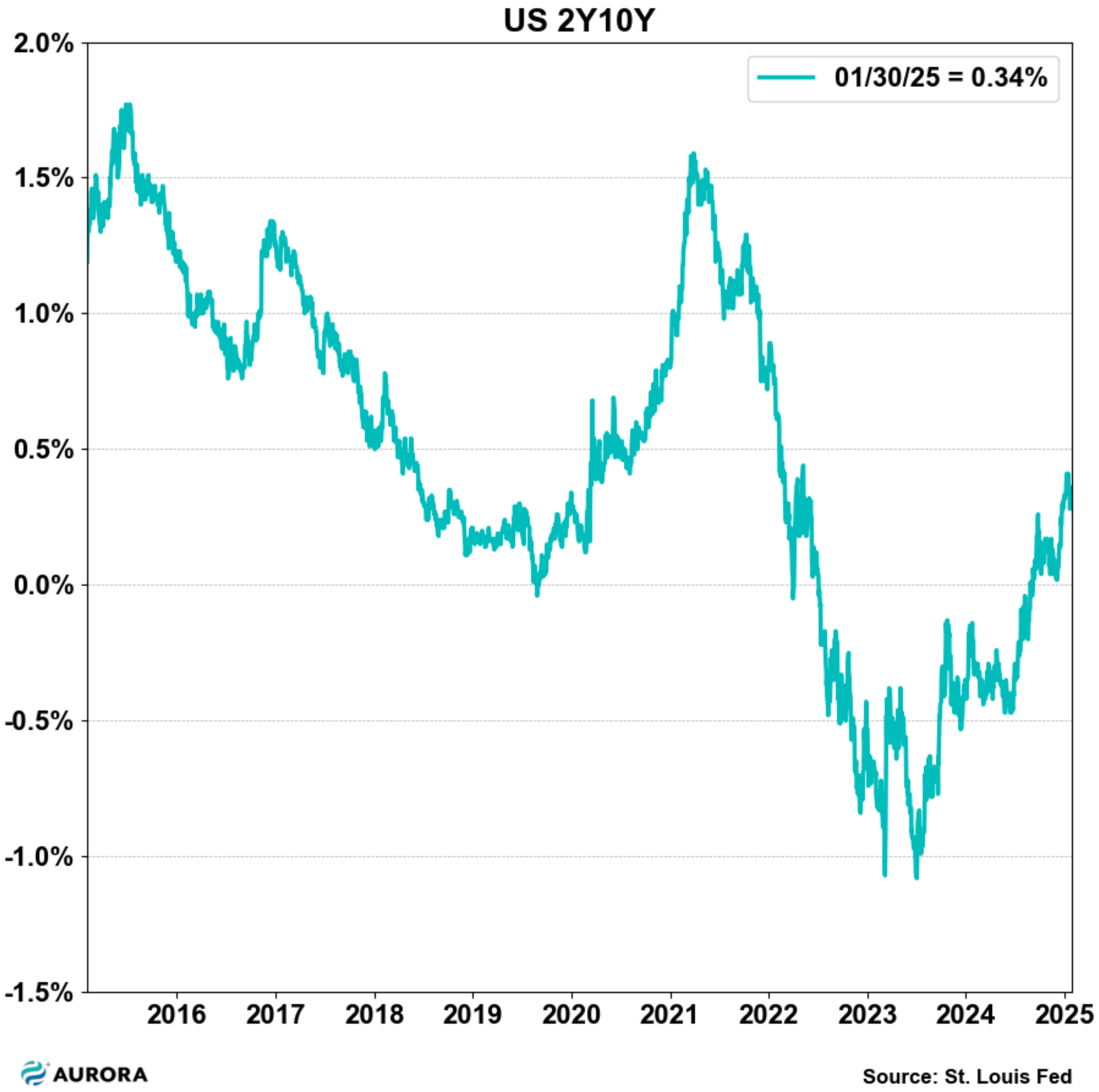
7b. International Trade





8a. Financial Markets





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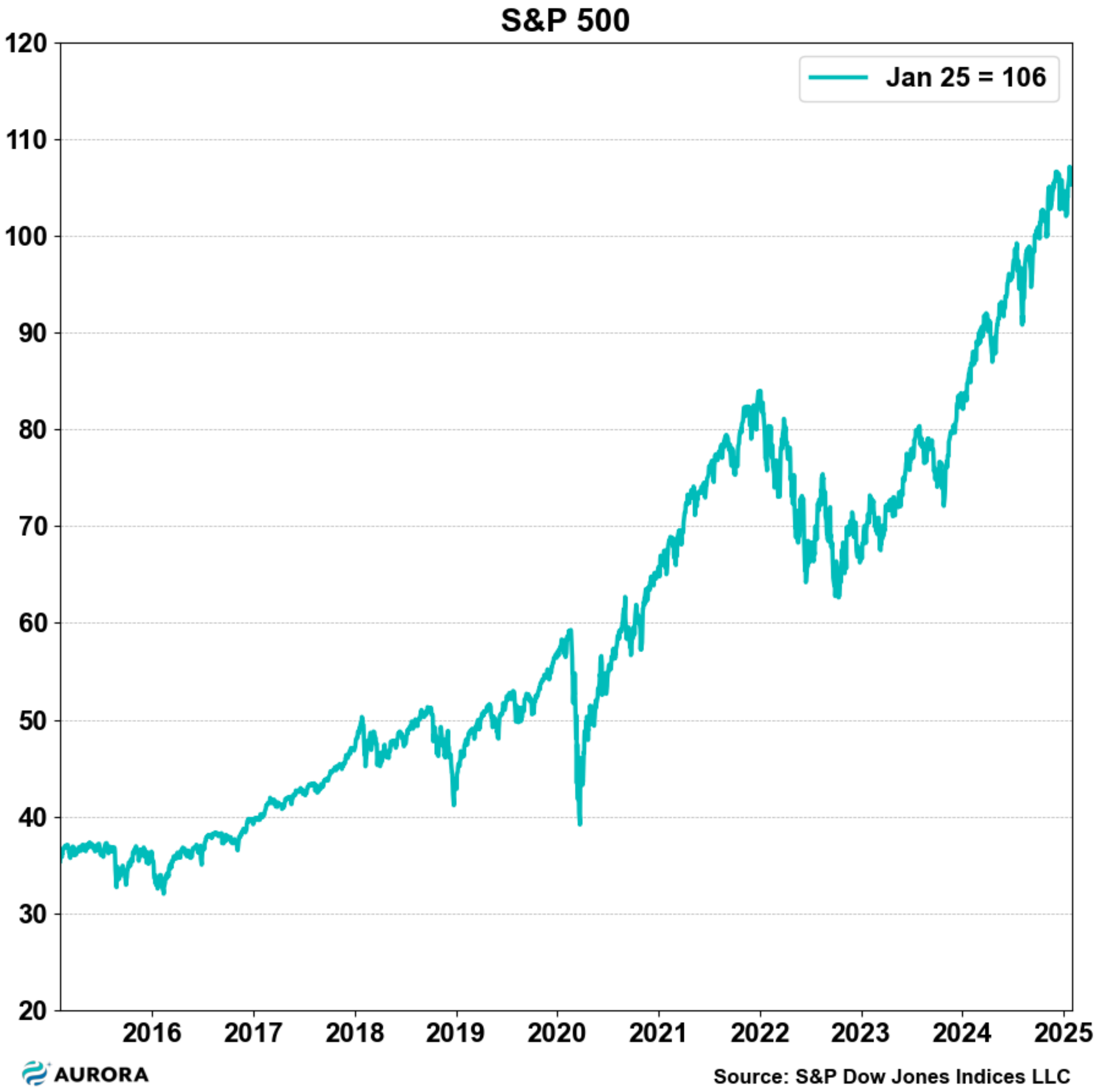
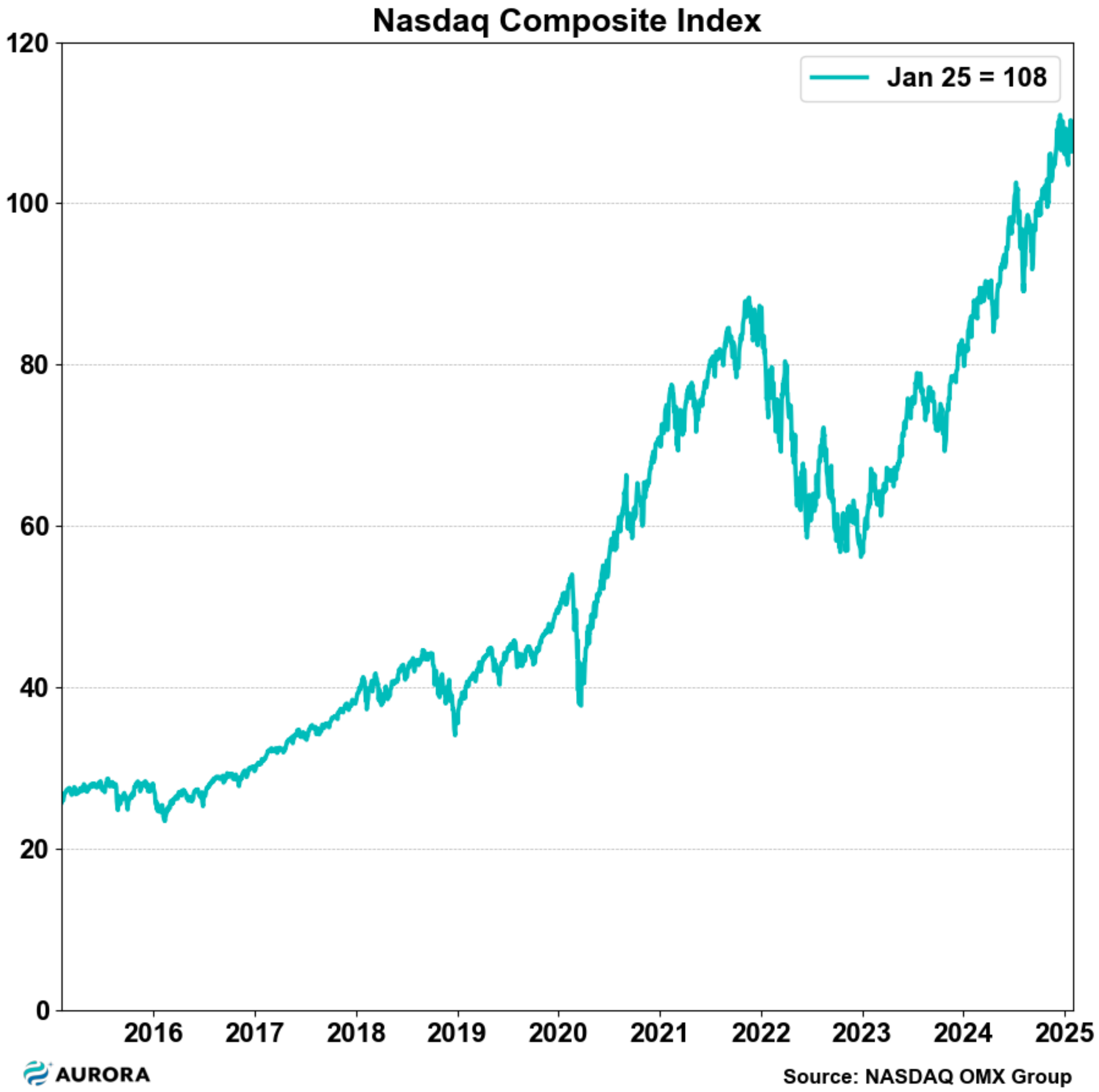
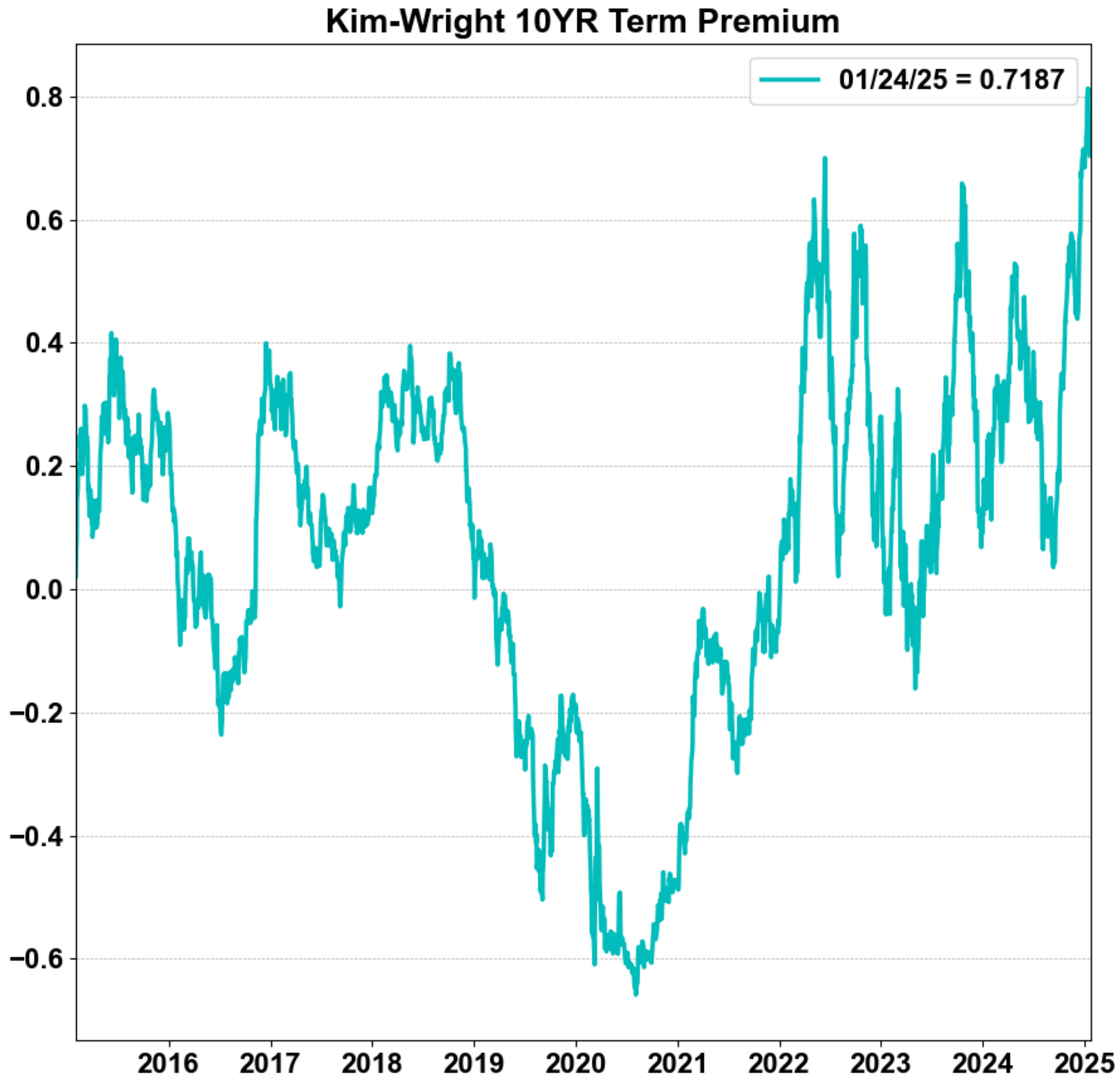




8c. Financial Markets



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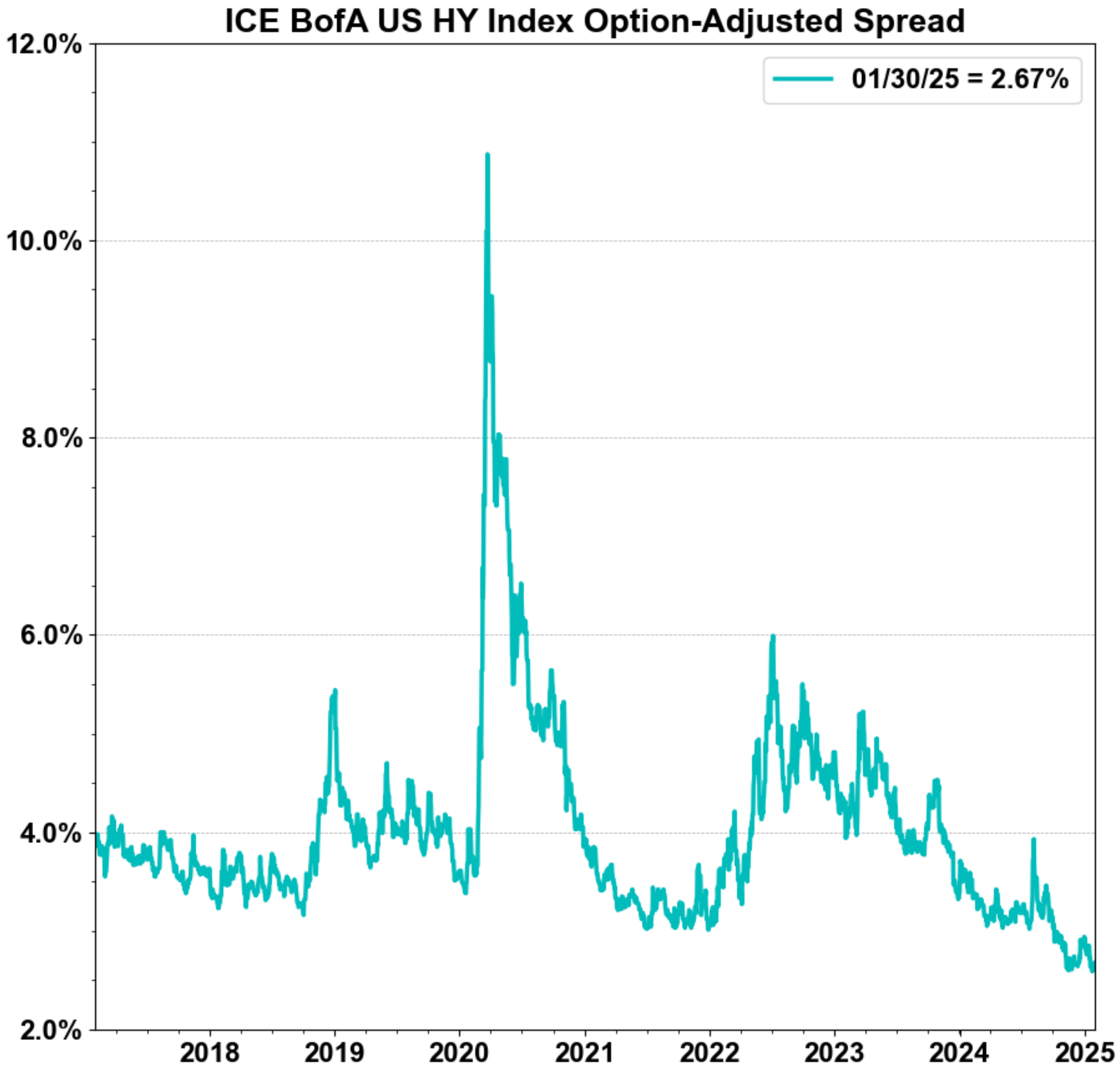
Source: U.S. Federal Reserve



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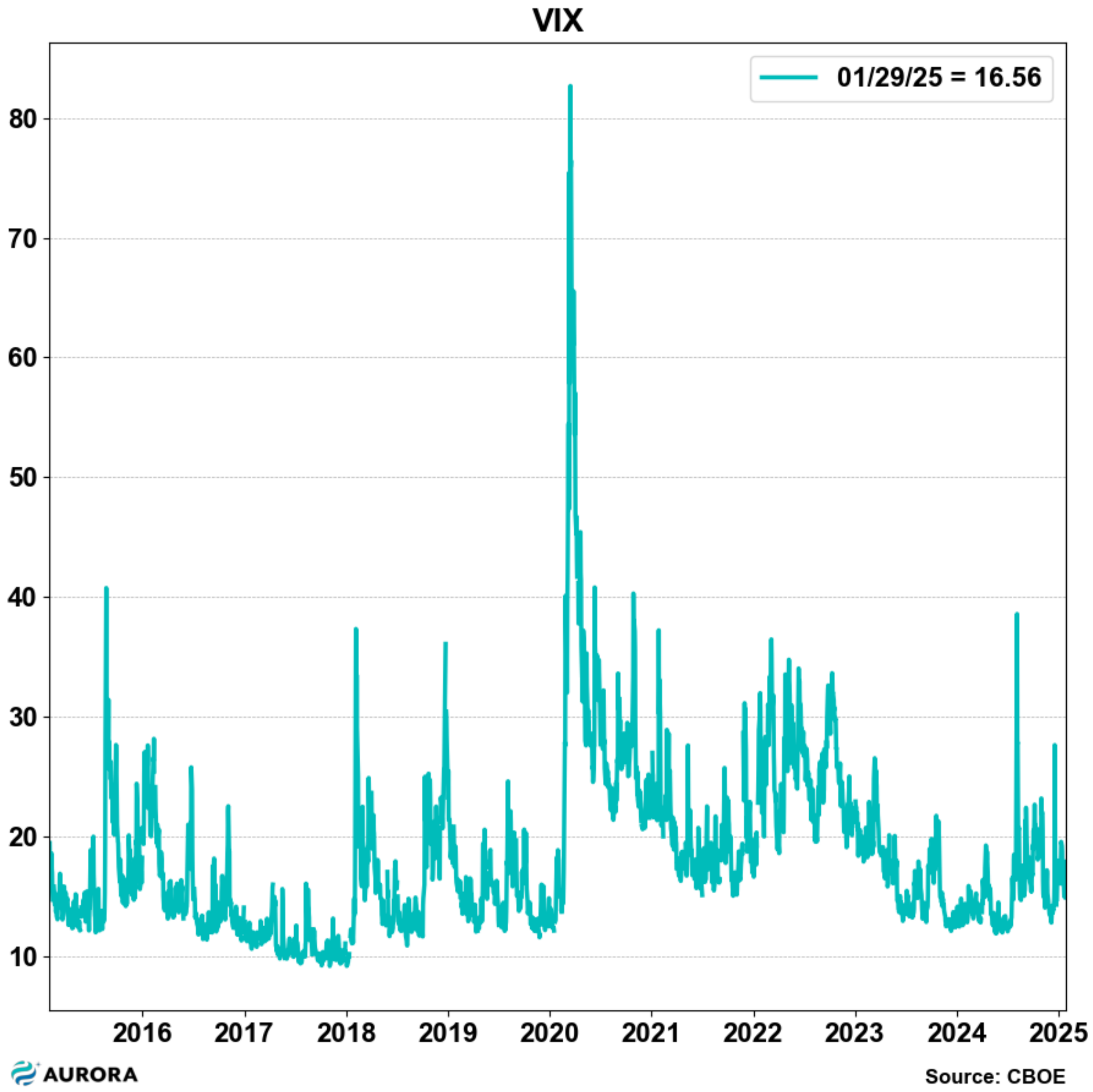
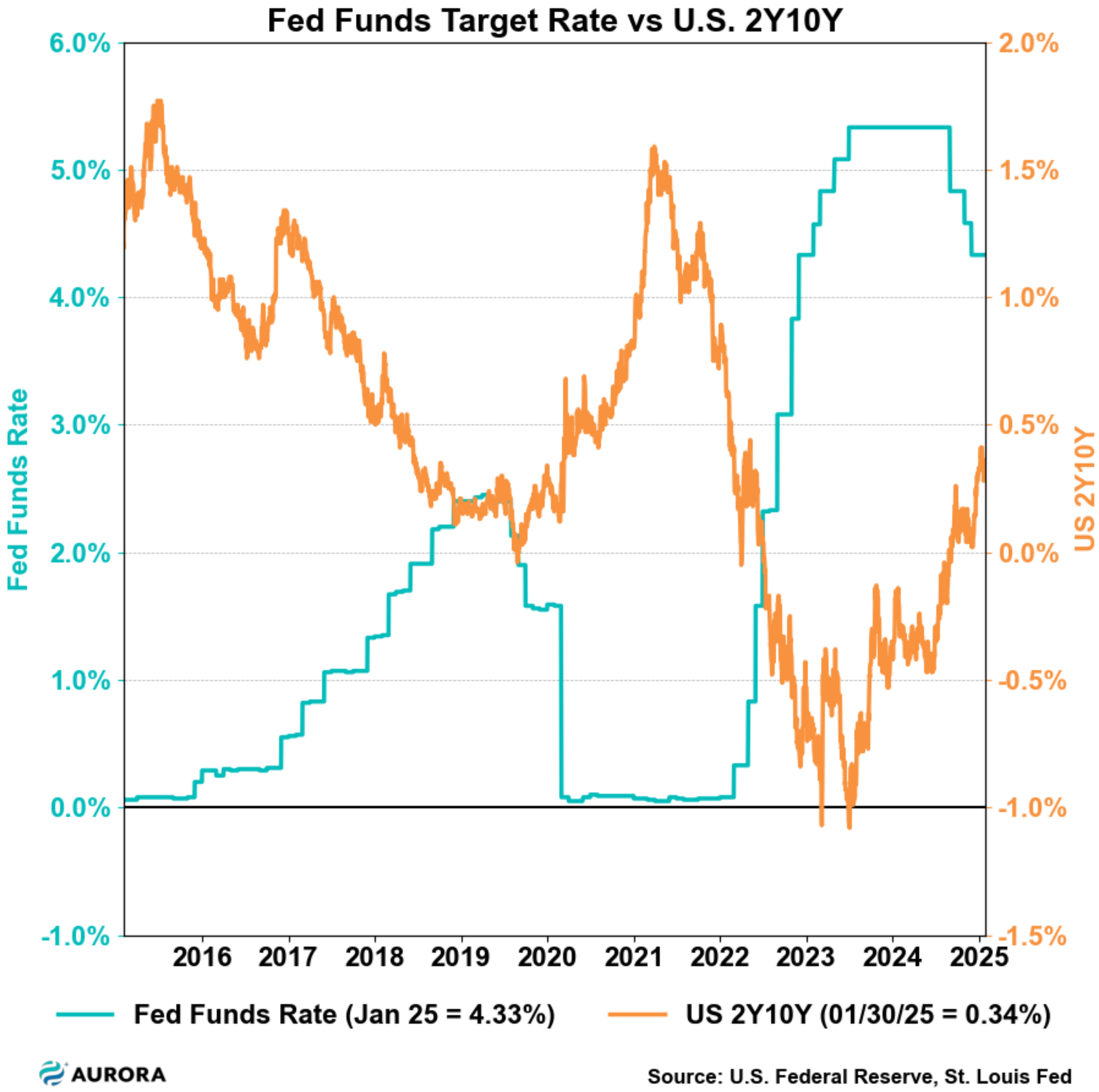
Source: ICE Data Indices

8d. Financial Markets





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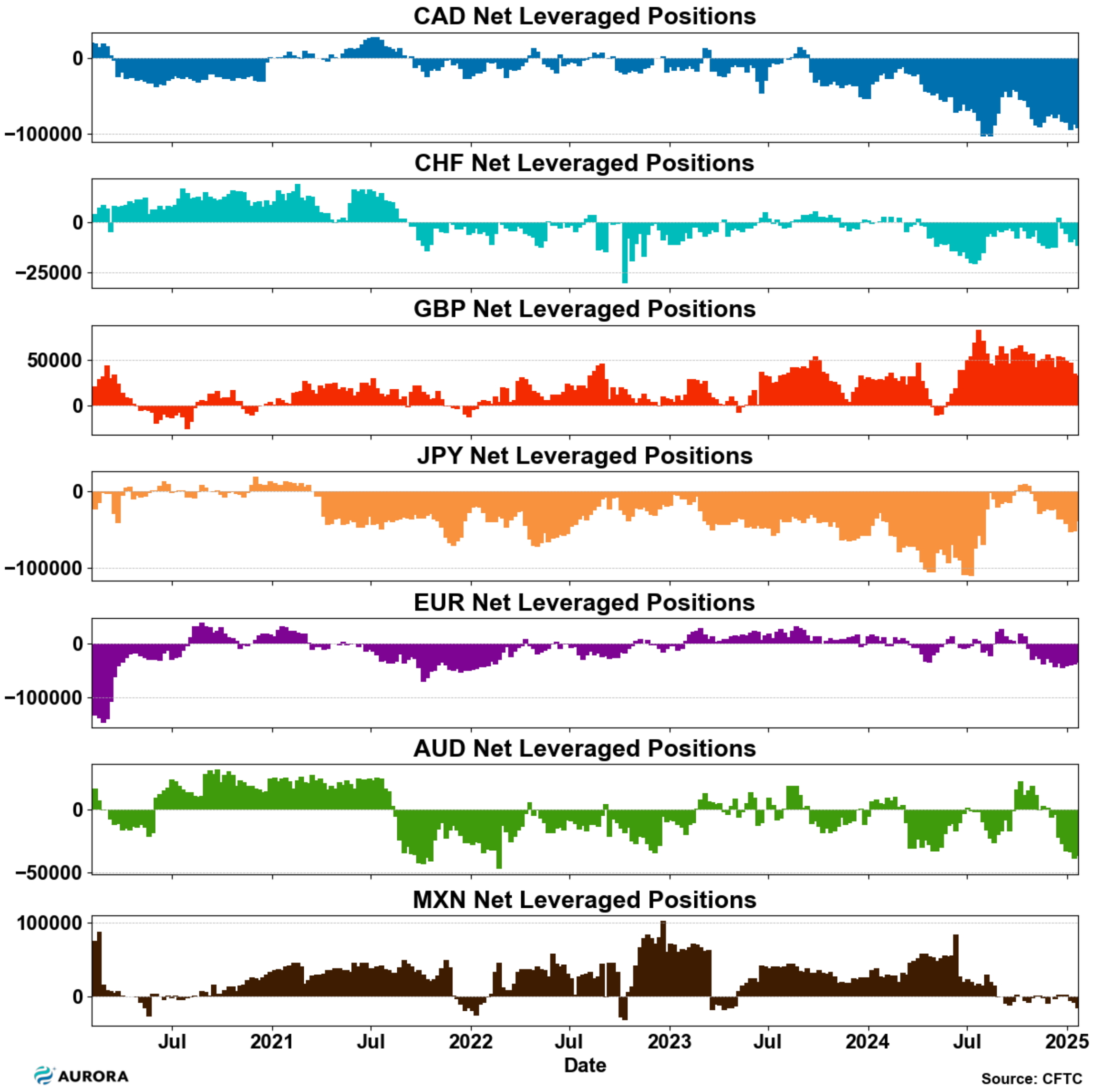

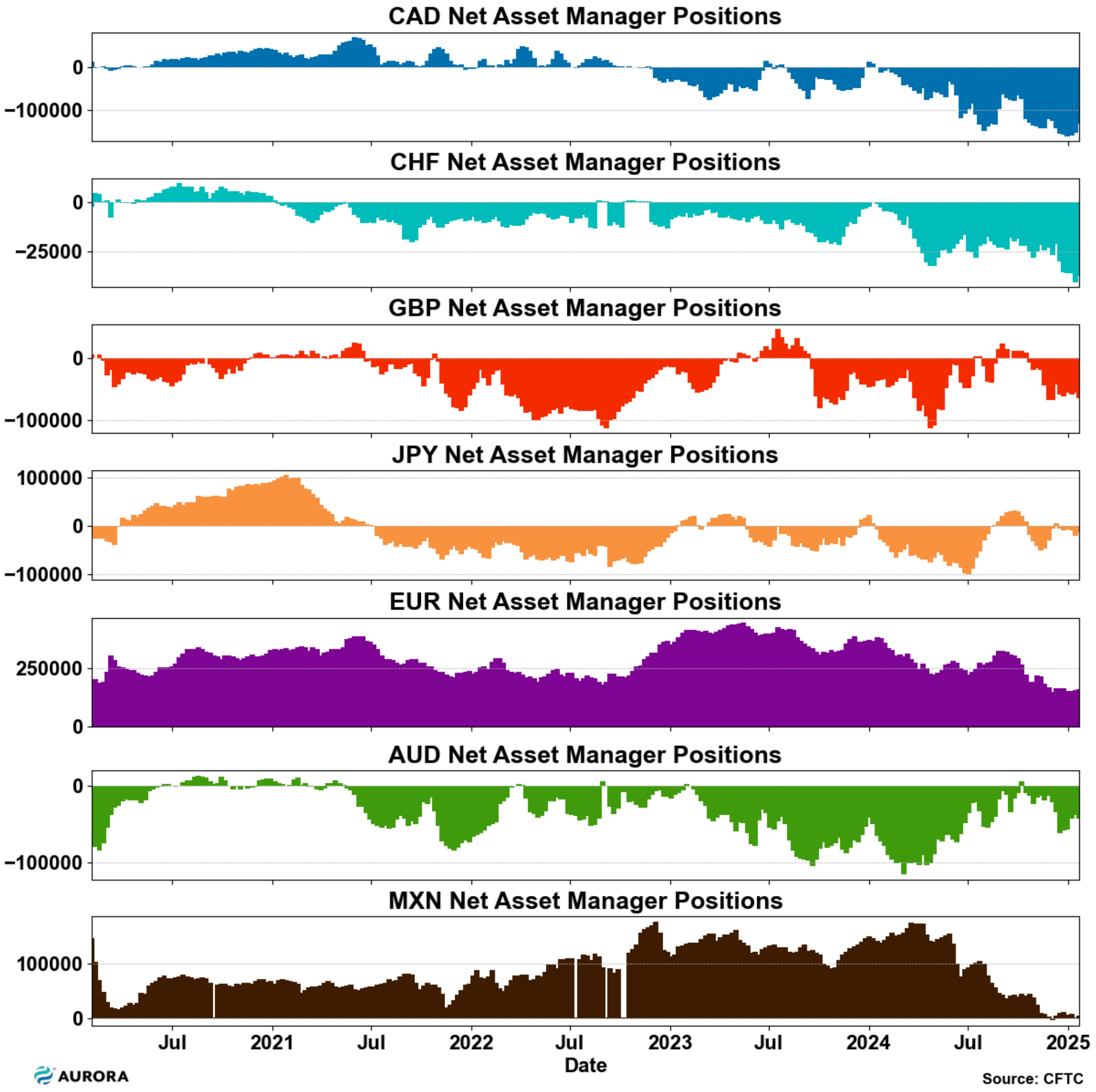

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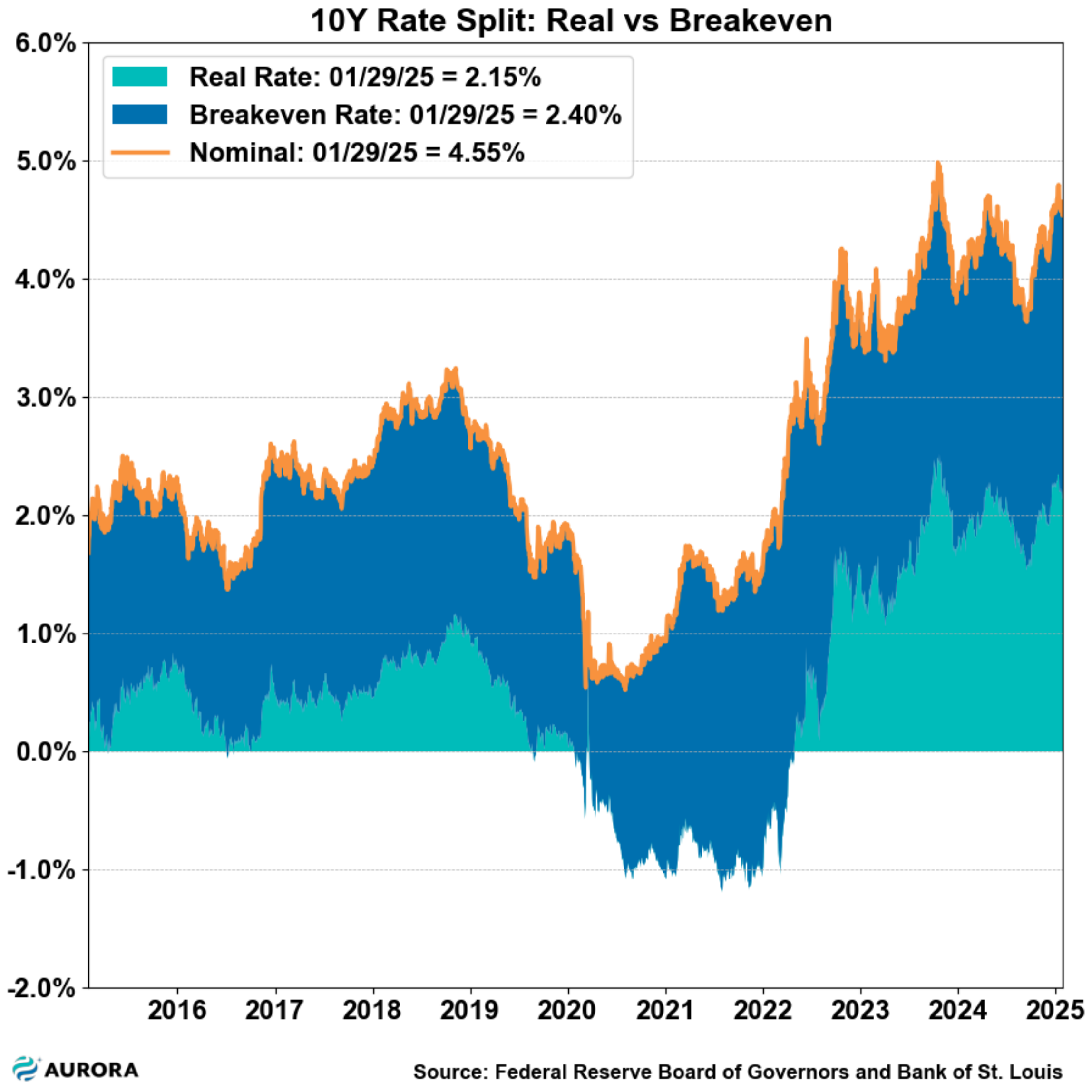
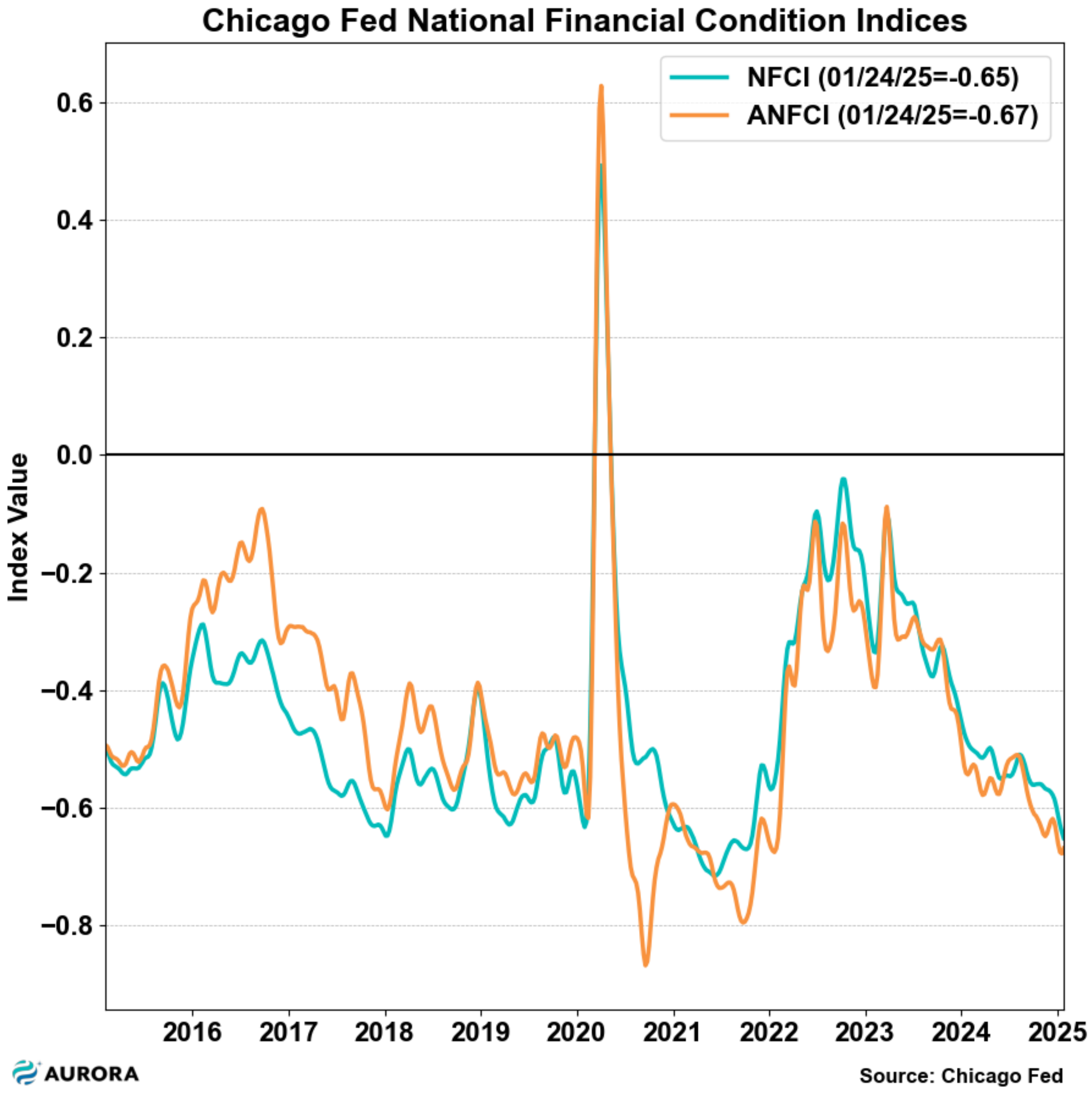
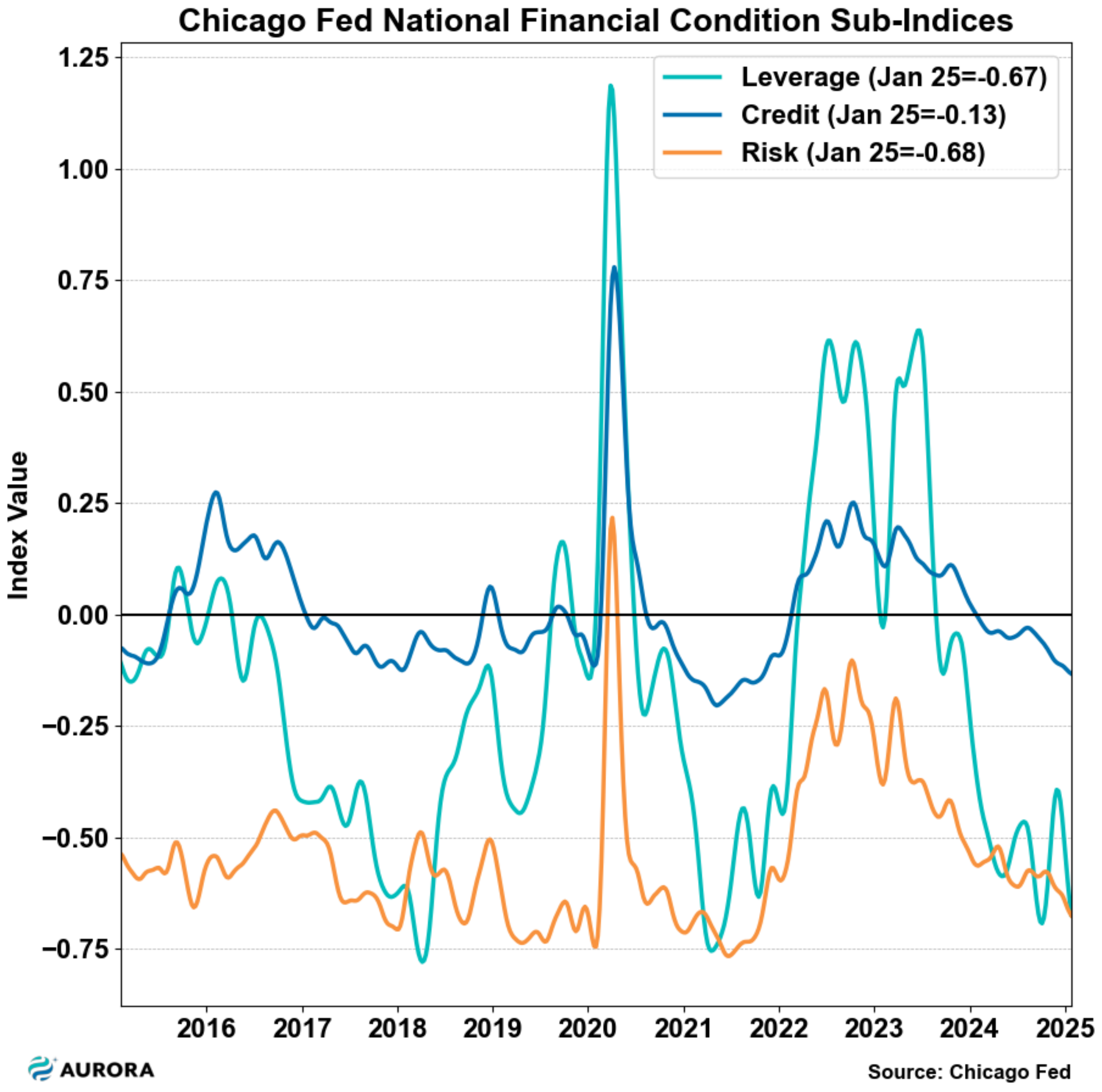


9a. Financial Condition Indicators





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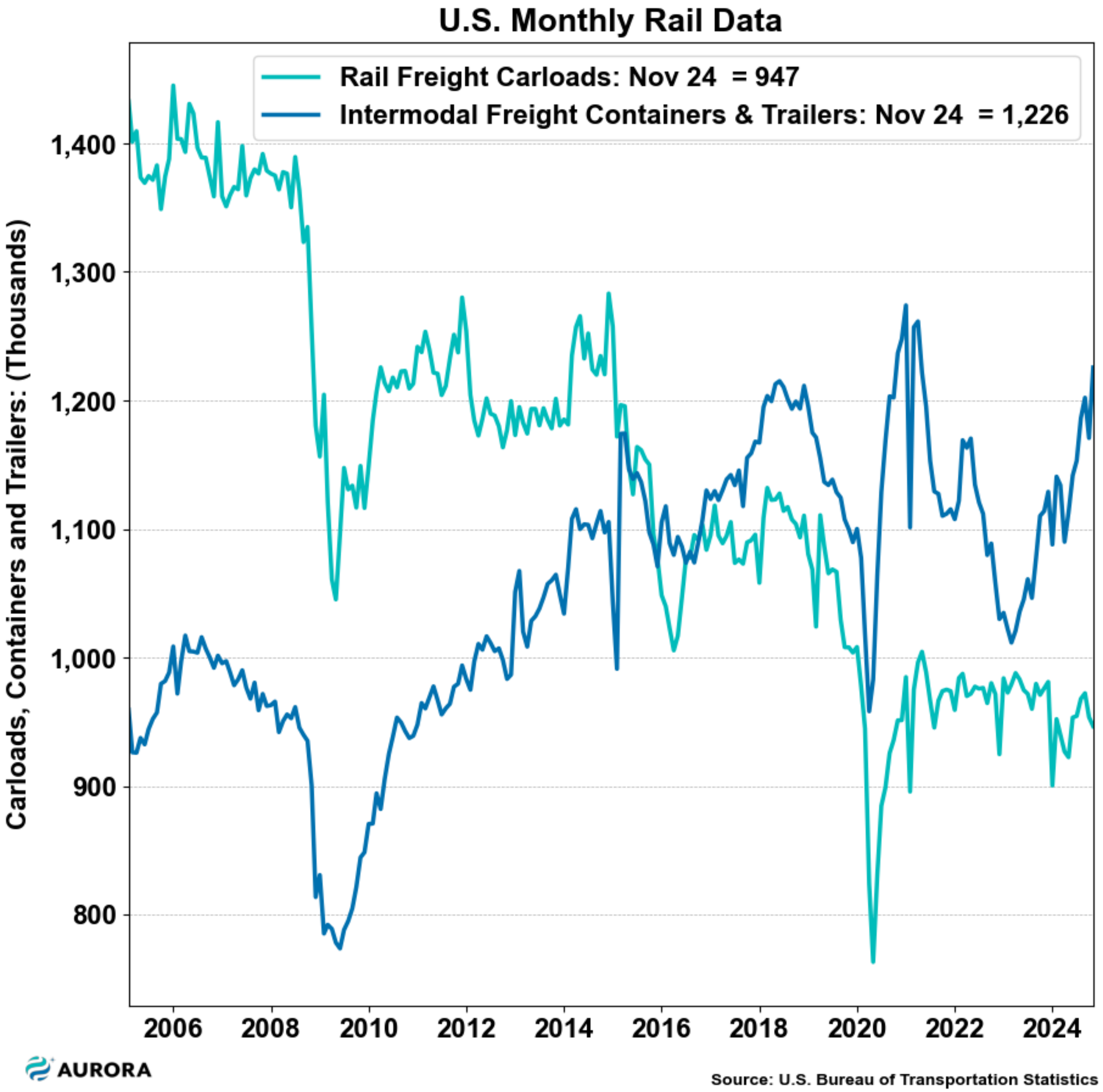
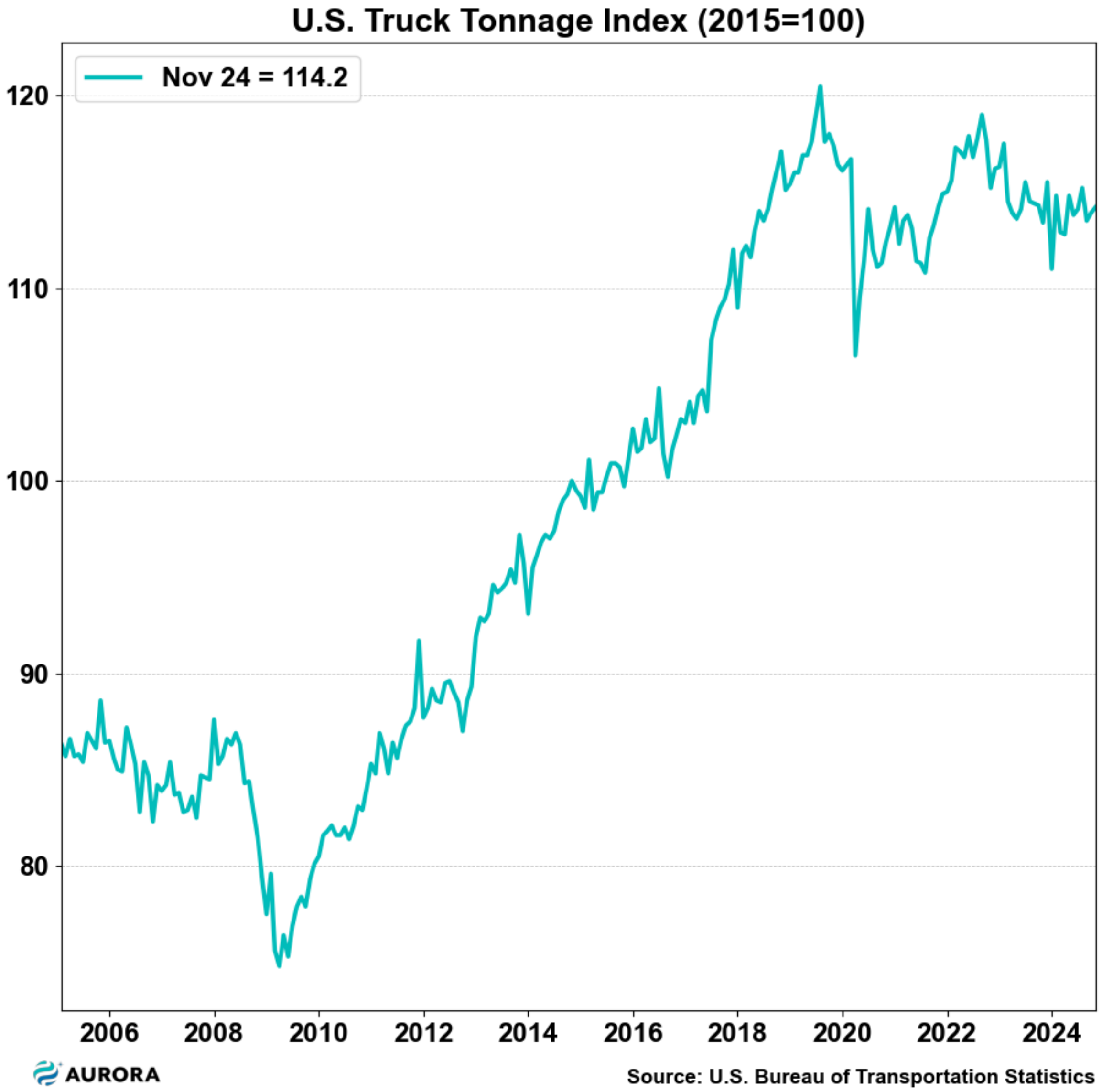
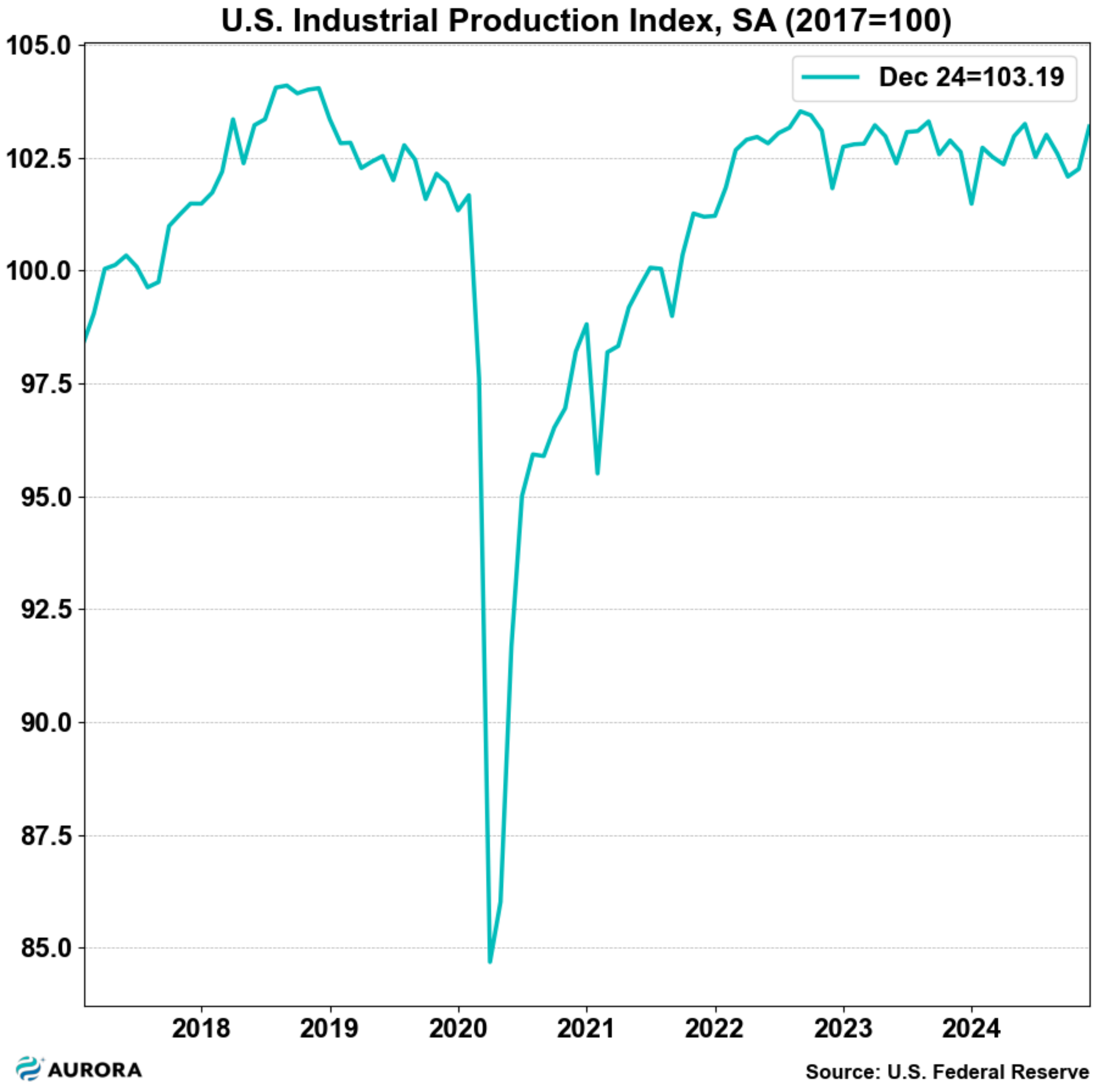
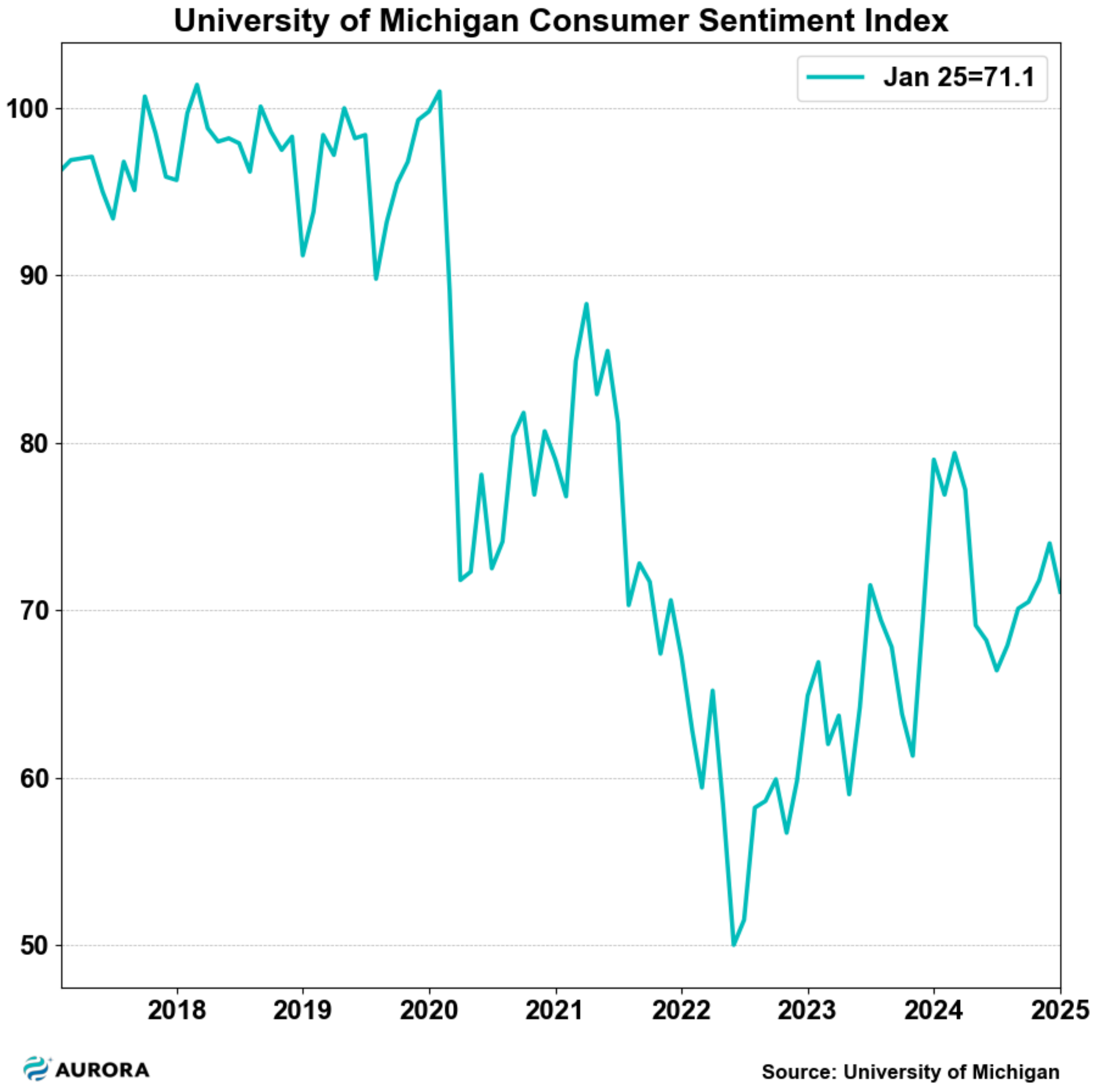




9c. Other Economic Indicators





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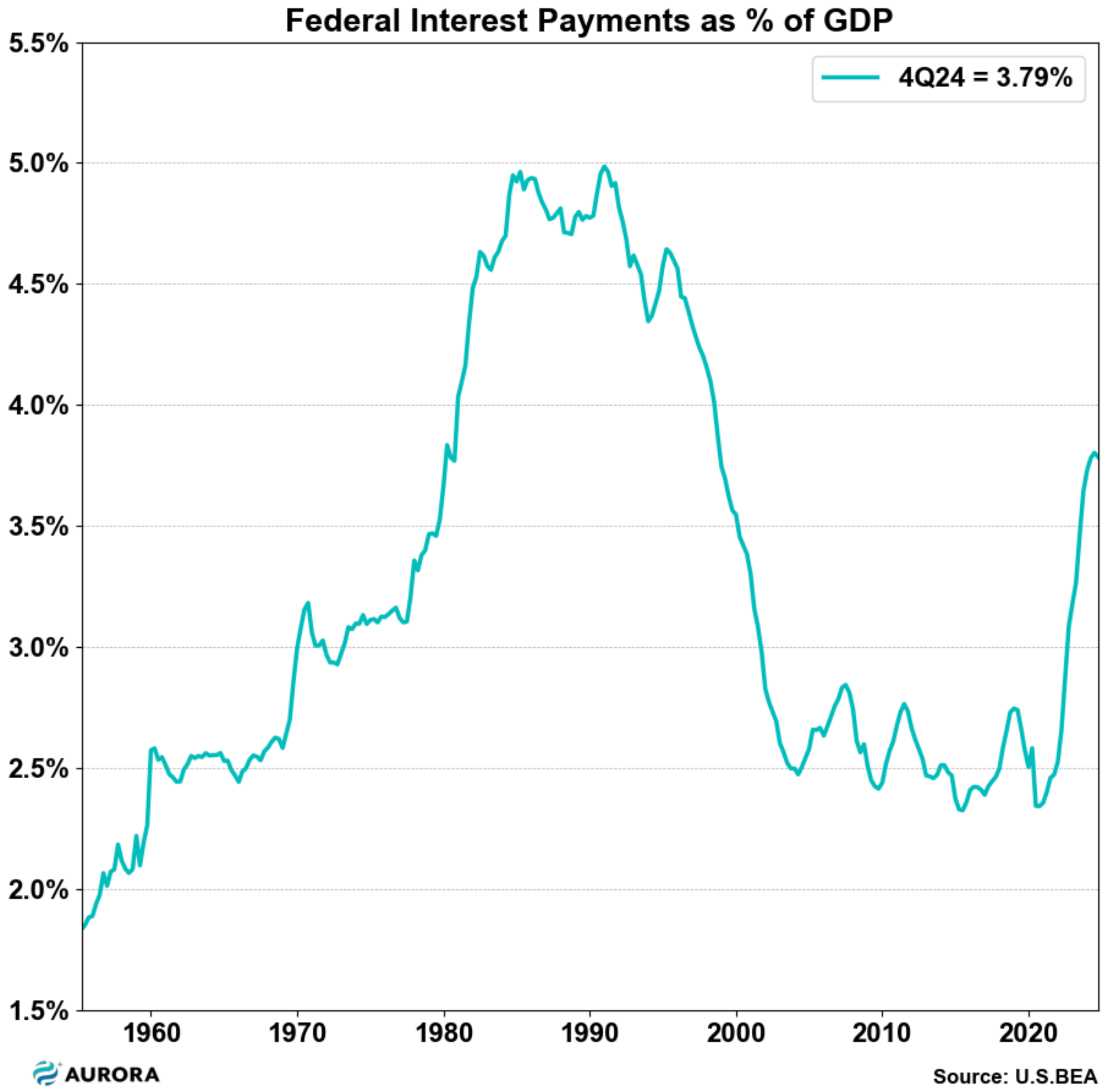

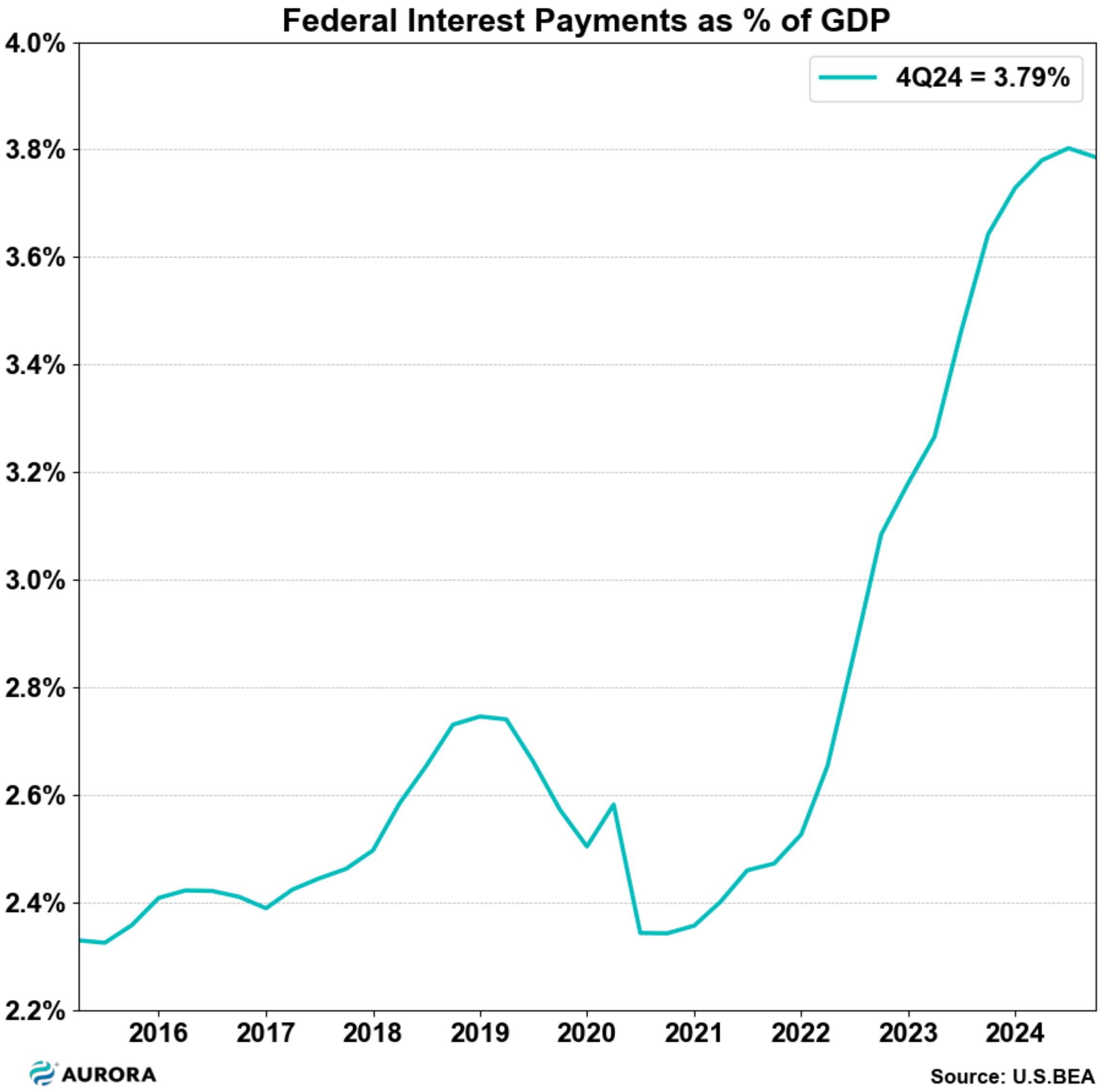

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