Goldman Sachs Exchanges

Tariffs: What's ahead and why it matters

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Allison Nathan: Does the recent tariff rhetoric suggest that we're entering a global trade war, and what could that mean for economies and markets? I'm Allison Nathan, and this is Goldman Sachs Exchanges. Today I'm joined by Kamakshya Trivedi, our Head of Global Foreign Exchange, Interest Rates, and Emerging Markets Strategy Research, Alec Phillips, our Chief Political Economist, and Joseph

Briggs, who co-leads the global economics team within Goldman Sachs Research.

Joseph and Alec are here with me in New York, and Kamakshya is in London.

So Alec, as we sit here on Wednesday morning, we have seen an absolute slew of tariff announcements over the past week. They just keep coming. It's been very hard to keep track of. As we sit here today, we are waiting for more details on what could be a reciprocal tariff, and those details might actually be out by the time this podcast sees the light of day. I think it would be useful just to start with catch us up, what is happening with tariffs at this point?

Alec Phillips: Right. So a lot has happened, and a lot more has been announced that hasn't yet happened. Starting with Inauguration Day, I think as we went into Inauguration Day, a lot of our clients had an expectation that you were going to have a bunch of big tariff announcements. Instead, on Inauguration Day, we got a memo that had all sorts of recommendations and studies and reports due by April 1st.

And so, what that seemed to suggest is that actually we're going to get a reprieve for a couple of months where maybe we wouldn't have some of those big announcements. And then, of course, actually that day, President Trump said, but by the way, Mexico and Canada tariffs starting February 1st. So all of a sudden, that April 1st date looked a little less relevant. He also then proposed the 10 percent on China, which he seemed to shy away from the first day, but then the second day of the new administration said, no, yes, we're going to do China, 10 percent on February 1st as well.

We get to February 1st. Obviously, we saw, what happened. He proposed, the tariff, formally on all three countries. And then, of course, we got the deal. And for Canada and Mexico, those tariffs were pushed off by a month to March 4th. For China, they were implemented. And so that was actually a pretty big change, and it happened pretty early.

Our expectation going into it had been that we would get China tariffs pretty early and that we would not get any of those other tariffs. So in that sense, it went according to what we were imagining. I will say in the moment, it certainly didn't feel like it was going along with expectations.

So that's what we got there. We then saw steel and aluminum tariffs just announced. Uh, those don't take effect for another month, but I don't think that that's really a negotiating tactic. I think that that's just time to implement and so on. So those seem pretty real. The effect there is smaller. You know, we already had steel and aluminum tariffs from the first administration. They had carved out so many exemptions to those that they didn't have that much of an impact. But now, those exemptions all go away. The aluminum tariff goes from 10 percent to 25 percent.

Not as big of a deal there, but clearly still impactful. And so now we're waiting for the next round of stuff. And potential reciprocal tariff announcement coming as soon as today. Possible tariffs on the EU, et cetera, et cetera. So there's a lot more still to come.

Allison Nathan: I want to ask you more about that reciprocal tariff, but before I do, just give us a little context. A lot of us have in our mind the trade war in 2018, 2019 in Trump's first term. So, as you're sitting here, how does this compare to that? Is it faster? Is it bigger? How would you contextualize it?

Alec Phillips: Yes, both, right? In terms of faster the thing I will point out is that if you look at the rise in the effective tariff rate on imports from China during Trump's first term. So the entire so-called trade war with China, it ended up being around a 10 percentage point increase. And then the other big tariff that we got at that point was on steel and aluminum, which then we had a lot of exemptions to. If you look at what has happened in the last couple of weeks, we got a 10 percent across the board tariff on imports from

China that actually covers more than all of the imports that were covered during the entire first term, and we got steel and aluminum tariffs with no exemptions and a higher tariff rate on aluminum. So you take the entire trade war or whatever you want to call it from the first term, you compress it into two weeks, and we just got that.

But the amazing thing is that if you then look at the kind of the commentary around this and the media coverage, the market commentary for that matter. The commentary is the trade war was avoided because we didn't do tariffs with Canada and Mexico. So on the one hand, this is actually already a lot more than we saw, or it’s, I should say, equivalent to what we saw in the first term.

On the other hand, it's as if the bullet has been dodged so far because nothing really serious, quote, unquote has happened. But of course, I think everybody is still expecting a lot more to happen. And so you could argue, maybe expectations were already just so high for additional tariffs coming in, that so far what we've seen doesn't seem that surprising.

I'm sure there will be another, and KT may have the other side of this that maybe there are some places where expectations aren't that high and that not that much has been priced. But certainly from sort of the media and public perspective, it seems like people are already condition to expect a lot of tariff announcements.

Allison Nathan: And Kamakshya, would you agree with that? When you think about the market reaction so far, have you been surprised or are there places where you think, you know, this is being priced more or less?

Kamakshya Trivedi: Yeah, I think it's fair to say that when you look at it on a broad basis, you take the currency markets, for example, which are the place where you should see the impact most directly because currencies can offset the tariff impact to some extent by shifting relative prices. You did see, you know, when Canada and Mexico tariffs were imminent. The broad dollar moved up a percent and a half. So to the question that we often get “are all the tariffs already priced? Is it all already reflected in market pricing?” The short answer to that is no. You can see that the dollar did strengthen a percent and a half. You did see the euro weaken. You did see equities fall and the bond curve flatten as well. But it is true that there were places where perhaps a lot more was expected. Like Alec mentioned, a good example is China. China was a place where I think we and a lot of others expected much more significant tariffs and the 10 percent was seen as a little bit of a smaller increase than people were expecting and so Chinese markets in fact started moving up already.

I think there's also another layer here I think that the back and forth that you have seen a little bit that Alec described has also meant that people are unwilling to price the full impact straight away when the announcement happens or when the tariffs go into effect.

And so what that tells you is that the longer they stay in place, the more likely it is that the market impact with will build over time. It might also be that the retaliatory impacts become bigger. So for example in China's case, the retaliation has been seen as somewhat more constrained.

They haven't allowed the currency to move that much. Their retaliatory measures are less than proportionate. But the longer they stay in place on China If you get that second additional 10 percent as well, you might see a bigger response. So from both those senses, you might get a bigger impact the longer they stay in place.

Allison Nathan: And, Alec, I think the big question on a lot of people's mind is whether this reciprocal tariff is really going to be the big tariff. There's been so much discussion about a universal tariff. Do you think that this replaces a universal tariff, or do you think there's still a chance that we get a very extreme scenario like that?

Alec Phillips: Yeah, I mean, that is in theory the silver lining of the reciprocal tariff. Now, I will say, you know, Trump talked about something called the Reciprocal Trade Act, which is essentially a legislative version of the reciprocal tariff during his first term.

And if you look at the way he described the reciprocal tariff last week, he actually said, “I'm going in this direction instead of an across-the-board tariff”. I'm paraphrasing, but that was essentially what he meant. I think the question, though, is you know, four weeks into the new term. Is this really the final step on tariff policy, and do we then not see any further tariff announcements? I think most people would say probably not. And so, you know, it could be that for now, this is sort of the replacement for the across-the-board tariff, but it doesn't mean that we won't still see additional discussion of that. And it doesn't I don't think it means that that risk is off the table. In terms of our kind of expectations. We have always assumed that the across-the-board tariff was a clear risk, but not the baseline. And I'd say even with a reciprocal tariff, I think that would probably still be our assumption, just because there's a long way to go here. And we haven't even gotten to the big question around tariffs, which is this fiscal idea, right?

So it's not just about negotiation or about protecting certain industries. It might also be about generating revenue. And that I think right now is still very much an open question. But, if it turns out that Congress is looking for a lot more budgetary savings because they've got this big fiscal package and Trump is worried about trying to deal with all of that, then we could see the focus shift back to that sort of universal tariff or other tariff ideas.

And then outside of the universal tariff, the other clear risk is this idea of critical imports or, you know, big sectoral tariffs on different things. And Trump has mentioned that now several times, and I think something on that is probably coming.

Allison Nathan: Interesting. Yes, there is a lot of uncertainty, we recognize that. If we take all of the different tariffs that have kind of been announced and you think are likely to be implemented, and your best guess on this reciprocal tariff, ultimately that can go in a lot of ways as well, you know, what would be the net effect on the effective tariff rate. What do your numbers show?

Alec Phillips: So, if you take everything that we've sort of imagined in our, you know, baseline, so you've got China focused tariffs, the ones that were already announced and implemented, plus another 10 points on top of that, which we think probably at some point does come, So called critical imports, The steel and aluminum, et cetera, you end up having something like a four point increase in the effective tariff rate.

If you add the reciprocal tariff on top of that, and it, this depends a lot on how they actually implement this and structure it, but you've got another point or two on top of it. The risk scenario on the reciprocal tariff is that Trump has talked a lot about value added taxes over the years and in particular, he has focused on the fact that the EU Has more than a 20 percent in most countries value added tax. And if they ended up including that in the calculation, then you would have a much bigger tariff increase. That would be something like another 10 points. So actually, in many ways similar. to the across-the-board tariff in terms of the impact. Right now we're talking about sort of mid-single digits in terms of the increase in the effective tariff rate, but obviously the risk scenario is toward the higher end.

Allison Nathan: Joseph, let me bring you into the conversation. If we get this mid-single digit increase in the effective tariff rate what would be the implications for growth? And it will differ between the economies at stake. Talk us through some of the economic implications of some of these higher tariffs.

Joseph Briggs: Yeah, absolutely. I'd say that when I look at the baseline scenario that Alec outlined and reasonable perturbations around it, I would characterize the impact as manageable. On the growth side of things, tariffs impact the economy in several different ways. Tighter financial conditions and increased uncertainty can slow investment.

Higher prices can slow real income growth, thereby creating headwinds to consumer spending. And you do see the net trade effects where a lower import demand from the U S tends to boost GDP in the US but weigh on activity elsewhere. Under the roughly five percentage point increase in the tariff rate baseline, we would expect that growth in the US would probably slow by a quarter point or so. We've been somewhat hesitant to incorporate this drag into our forecast, mostly because we haven't seen financial conditions tighten that much in response to tariff announcements so far. And furthermore, some of the more pro-growth parts of Trump's agenda should provide offsets that leave the net impact on GDP somewhat, somewhat neutral.

We do expect bigger headwinds in China. They have been the target of most of the hawkish trade news recently. We have seen 10 percentage point tariffs already implemented. As Alec mentioned, we're expecting another 10 percentage points. And under that scenario, we expect that growth this year will probably be about 70 basis points lower than it would have been otherwise.

For other economies, there's not really a big direct growth impact. Most of the impact is going to come from this trade policy uncertainty channel. The idea here is that if you're a German exporter and you're seeing growth slow in China, and you're worried about tariffs on the EU, then you're probably not going to be scaling up, hiring or undertaking large capital investments until you have clarity around the business environment that you're going to be operating in.

And so, during the last trade war, we saw that this type of dynamic slowed growth in the euro area probably by about a point. We expect that a similar dynamic is going to play out this time. It's a reason why the day after Trump's election, we took down our European growth forecast by half a point and are still forecasting a well below consensus pace of growth of 0.7 percent in the euro area this year. And so this is going to be the main channel that has bite in other economies. The last point to make is that the critical goods imports, will have some impacts on companies or countries that are highly exposed to them, namely economies like Canada. But, again, the direct impact from my perspective looks pretty small right now.

Allison Nathan: The focus really seems to be on inflation, and whether these tariffs are going to make the problematic inflation even worse. What are you finding in terms of inflation impacts of the tariffs that we think are most likely and the more extreme scenario that Alec laid out.

Joseph Briggs: Tariffs definitely have a direct impact on inflation, higher import costs are ultimately largely going to be passed on to the consumers. It's why we have taken our core PCE inflation forecast in the US up to 2.6 percent by the end of this year, despite the fact that if we didn't have tariffs, we'd probably be expecting the core inflation converges back towards target, maybe a touch above at 2.1 percent. And so there will be a moderate uplift to prices in the US. In other economies, the two things to watch are how countries retaliate and then how currencies move. I'm sure KT will have a lot more to say on currency impacts later on, but so far, we haven't seen a lot of very aggressive retaliation announcements. Other economies have been somewhat hesitant to match dollar for dollar. Retaliation has been targeted to specific strategic goods. And so if we remain in this scenario where we're not actually seeing import or tariffs on imports to other countries from the US, then you're not seeing the large direct price increases, and the impact on inflation will largely be driven by currency depreciation.

I actually see a case where tariffs could be net disinflationary in other economies, mostly because we do expect a moderate slowdown in growth. And at the same time, if we do see some of the Chinese export supply being reallocated to other major economies because of the pullback in US demand, then this could be worth a few tenths of downward pressure on core inflation in places like the euro area.

Allison Nathan: Interesting. If you're sitting here at the Fed and you have potential growth impacts and potential inflation impacts, how are they weighing this and what do we expect from here from the Fed, given this uncertainty?

Joseph Briggs: I think the tariffs are a reason why the Fed will be cautious, and this has been definitely reflected in the recent rhetoric we've heard most recently from Chair Powell yesterday. Our baseline forecast is still for two cuts this year, one more cut in 2026. That being said, if we do see tariffs drive prices too much higher above our current forecast for 2.6 percent core PCE inflation, then the Fed will become a little bit concerned about inflation spilling back into aid, inflation expectations, wage growth.

And as a result, I think it does strengthen the case, uh, for the Fed remaining on hold for longer. Especially since growth in the US continues to, to run at a very healthy pace, and we're expecting that this will continue despite tariffs. So to summarize, it is slightly hawkish for, for the Fed, but, uh, if we're only seeing core inflation rise to 2.6 percent and underlying inflation is cooling, I do think that the Fed will be able to cut this year. For other economies, the impact, I think, is more clearly dovish. You're not getting much of an inflation impact, and there should be a growth drag. This should definitely strengthen the case for cuts in other economies, particularly major exporters like the euro area and Canada.

Allison Nathan: And Kamakshya, just going back to you, is that what you're seeing reflected in market pricing at this point?

Kamakshya Trivedi: So, yeah if you think, go back to the weekend around when Canada and Mexico tariffs looked imminent, it wasn't just that the dollar strengthened against the Canadian dollar or against the Mexican peso. The euro fell quite meaningfully as well. And I think it partly fell for some of the reasons that Joseph was just describing.

The idea that, A, there's likely to be more tariffs to come. So it was taken as a signal that the euro area could be up next, but that even if the euro area is not a direct target of upcoming tariffs, the increase in trade uncertainty, the fact that it's disinflationary for the euro area, and the fact that there's limited space in the euro area to respond from a fiscal standpoint meant that interest rates might come down even more in the euro area relative to other parts of the world.

And so that rate differential between the U. S. and the euro area widens in that eventuality. It stays wide. And that, again, puts more downward pressure on the Euro itself. So that's certainly something we saw even when Europe was not directly the target of tariffs around that weekend. But as we've been hearing from Alec, we think this is still, there's more news to come.

So while I don't think all of this is priced and you know, you see that in the kind of back and forth that you're seeing in the announcements and the back and forth that you are seeing in currency markets, we think there's more coming and this is still an early act in this play. And as we go further, we will see more of these impacts being priced. But certainly the early acts give us an indication of which direction that is going in.

Allison Nathan: And how are investors, well, how are you observing investors responding to all of this uncertainty at this point? Are you seeing hedges, or less activity or it's just business as usual until we get more information?

Kamakshya Trivedi: I think there's a few different things. I mean, it's fair to say, yes, I mean, there's already a little bit of investor fatigue from all the tariff headline ping pong that has been that has been going on. I'd highlight three things, you know, first, I think some investors, you know, I think are trying to be super nimble, super responsive, have sort of short-dated exposures, add them when the market relaxes about some of these risks.

So things like dollar upside, buying volatility. But the challenge with those exposures is that you kind of have to monetize them and reload them very quickly. And being super nimble is easier said than done. I think the other strategy that you're seeing a lot of people kind of revert to is to acknowledge that, look, predicting these events and these announcements and when exactly they happen is hard.

And by the way, even in 2018-19, we saw the biggest market impacts just when those announcements did happen. And so if you don't have an edge exactly on when this is coming out, it's hard to be sort of too positioned for that. And so you anchor your market views to your broader distribution of outcomes.

Our broader, view as Joseph outlined is still a pretty benign one. We expect solid growth. We expect inflation to be declining. And so people are positioning for long equity views, but having hedges, like you mentioned, particularly for dollar upside against things like the euro, things like the CAD, because in the event that you get that deep tariff tail, we think there's a lot more that those things can move.

So certainly kind of pairing any sort of long risk position, long equity position with dollar upside, I think is a key part managing the portfolio. I think the other thing you're also seeing is people diversifying their equity exposures more.

Now, diversification is always a good thing, but it might particularly help in this case because if some of the worst tariff tails, the risk that Alec mentioned, are avoided, that's going to be good for equities, but it might be more good for equities outside the U.S. where some of these risks are beginning to be priced in euro area, China, where valuations are also a little bit more compelling. And then I think the final thing people are doing, is basically just staying away, like trying to find areas of the market in the macro universe that are not affected by the day-to-day tariff headlines.

We're seeing people more engaged in places like Japan and Japanese fixed income where they're getting more convinced about the fact that policy rates can move higher for longer using more and EM carries strategies and places where there is more room for managed currencies to deliver you a sort of income stream that is not related to the day-to-day vol in tariff headlines. I think those are some of the, the strategies people are using.

Allison Nathan: Alec let's close with you. Obviously, we've talked about the fact that there is still tremendous uncertainty. What are you watching? Are there key dates, key announcements? What are you watching in the coming weeks?

Alec Phillips: I think there's basically going to be something just about every week. I think I'm right in saying we've had some discussion between President Trump and the press, more or less every day since inauguration. And more of those days than not, I think have included some tariff discussion. So there's going to be a lot of news. I think the things from here, so obviously reciprocal tariff and what we see on that in the very near term, I think there's a clear risk that at some point fairly soon, could be next week, could be the next few weeks, we see some kind of announcement on an EU focused tariff. Trump has said that in the next four weeks, he will make an announcement on some of the sectoral tariffs. And then of course we have this April 1st deadline in the original trade memo where you're going to have a lot of recommendations from the Treasury, from the US Trade Representative, from the Department of Commerce on all kinds of different trade issues, including how to structure a universal tariff, what else to do with regard to China, the phase one trade deal, whether there are new tariffs that should be announced there.

So for as much as right now, it feels like there's a lot going on. I think the stuff that we're seeing right now is still more in the negotiation leverage phase of it, and we're kind of getting into what I would think of as the second phase, which is the sort of more protecting domestic industries focused on certain products, et cetera.

And then the big question is do we get into the, what I think would be the final phase, which is you know, using tariffs for revenue, broader economic adjustment, et cetera.

We've always assumed we would have those first two phases. The question is whether we get to that final one. And I think April 1st, we'll probably find out more around that.

Allison Nathan: So basically, we'll be sitting on the edge of our seat every single day as this unfolds.

Alec Phillips: That's right. And not just on trade, because don't forget, we've got a lot of other, issues to worry about, too. Fiscal, immigration, regulatory, etc. So there's a lot going on.

Allison Nathan: Absolutely. Alec, Joseph, and Kamakshya, thanks so much for joining us.

Alec Phillips: Thanks.

Joseph Briggs: Thank you, Allison.

Kamakshya Trivedi: Thank you.

This episode was recorded on Wednesday, February 12, 2025. I'm Allison Nathan. Thanks for listening.

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