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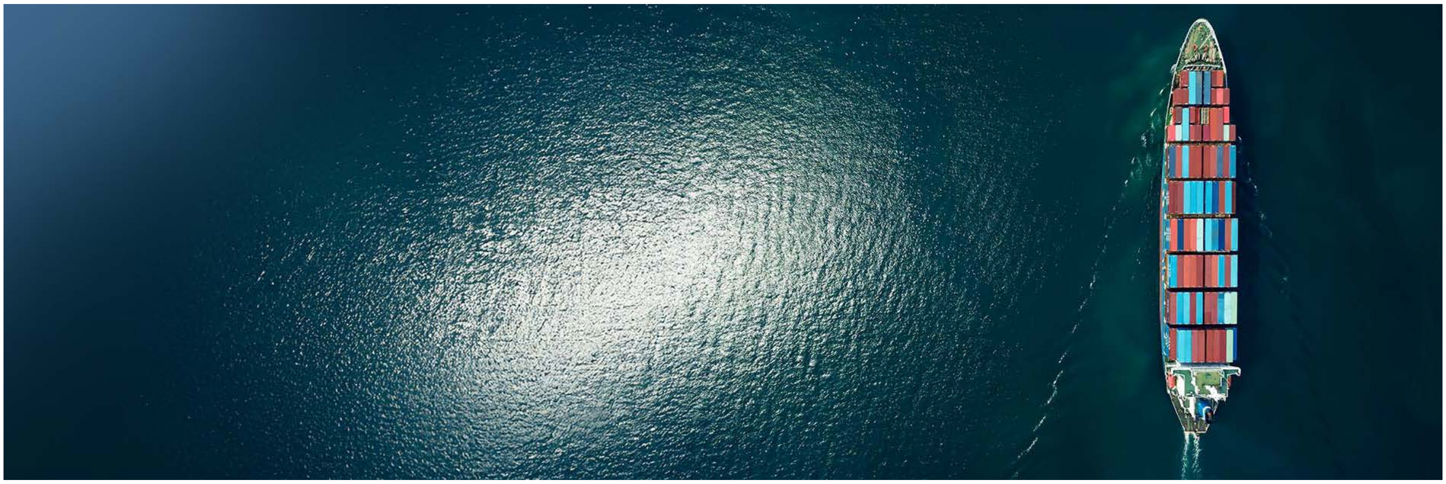

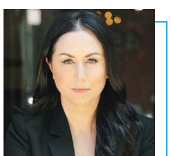

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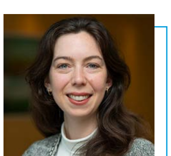

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Tariffs explained: Assessing the global economic impact

The much-anticipated "Liberation Day" on April 2 provided investors with more details on the direction of U.S. trade policy under the Trump administration. Despite hopes of a more moderate approach, the tariffs were worse than expected, raising the prospect of lower economic growth, higher inflation and interest rate cuts. U.S. equity markets sold off sharply on the news, exacerbating a year-to-date decline for the S&P 500 Index. European and Asian markets also fell.

A lasting scenario with tariffs on the high end of initial proposals could tip the U.S. toward a recession. Retaliatory tariffs and counter retaliatory tariffs from the U.S. remain a concern.

A key caveat is whether tariffs are being used as a bargaining tactic. We suspect that the newly announced numbers are an opening salvo for negotiations and won't likely serve as a roadmap of what tariffs could be in six to 12 months. Still, current rhetoric and near-term economic implications make us cautious. It is still too early to draw definitive conclusions about the impact on economic growth and inflation, given the broad spectrum of sectors and countries impacted by the new policies.

Timeline on tariff announcements

Date	Country/sector	Action
January 20	Canada, Mexico, EU	President Donald Trump threatens tariffs on Canada, Mexico and EU.
February 1	China, Canada, Mexico	Trump orders tariffs on China (10%) and Canada and Mexico (25%) as of Feb. 4.
February 3	Canada, Mexico	Trump announces tariffs on Canada and Mexico will be delayed by a month.
February 4	China	Tariffs on China take effect, and China retaliates with its own tariffs and export controls.
February 10	Steel, aluminium	Tariffs on steel and aluminium announced (25%) as of March 12.
February 25	Copper	Trump requests an investigation into whether copper imports are a national security threat.
February 26	EU/autos	Trump threatens tariffs on autos from EU.
March 1	Lumber	Trump requests an investigation into whether lumber imports are a national security threat.
March 4	China, Canada, Mexico	Tariffs on Canada and Mexico (25%), and 10% additional tariffs on China takecome into effect.
March 4	Canada	Trump threatens further tariffs in response to Canada''s retaliatory tariffs.
March 6	Canada, Mexico	Trump adjusts tariffs on Canada and Mexico to minimize disruption to auto industry.
March 24	Venezuela	U.S. imposes secondary tariffs of 25% on any country that imports Venezuelan oil or gas.
March 25	Autos	U.S. imposes 25% tariffs on imported vehicles and parts.
April 2	Global	U.S. to impose a 10% baseline tariff on all imports. These are slated to take effect on April 5. Separately, higher tariff rates on countries with which the U.S. has large trade deficits to take effect April 9.

Source: Capital Group. As of April 2, 2025.

1 What are President Trump's tariff goals?

The latest tariff announcements from the Trump administration signal a significant shift in U.S. posture toward global trade. Initially, tariffs focused on foreign policy, border security and drug trafficking, but recent proposals emphasize protectionist measures to address trade imbalances that the administration believes are unfair. In his April 2 tariff order, Trump declared "foreign trade and economic practices have created a national emergency."

Besides correcting perceived unfavorable trade dynamics, other goals have emerged, such as increasing tariff revenue to offset the cost of planned tax cuts.

Decoding tariffs: Motivations and implications

Decoupling: Shift supply chains and reduce reliance on certain countries

Potential impacts
High, persistent

Countries: China

Industries:
Tech, energy, industrial materials, pharma, biotech, aircraft

Rebalancing: Reduce trade deficits and boost domestic production

Potential impacts
Medium, persistent, mixed

Countries: China, EU, Japan, South Korea, Vietnam, India, Mexico, Canada, Brazil

Industries:
Autos, steel, aluminum, agriculture, food, chemicals, consumer electronics, pharma, luxury, defense, energy, oil

Negotiating: Use economic pressure to achieve policy outcomes

Potential impacts
Low, temporary

Countries: China, Mexico, Canada, EU, Japan, Latin America

Industries:
Autos, steel, agriculture, consumer electronics, construction machinery, minerals, defense, energy, semiconductor equipment

Funding: Generate revenue to fund budget priorities

Potential impacts
High, persistent

Countries: May be a broadly applied universal tariff

Industries:
Consumer goods, autos, industrials; price effects and margin pressure across industries

Sources: Capital Group, American Compass. As of March 5 2025.

This four-quadrant graphic describes the motivations and implications of recent tariffs announced by the U.S. These four motivations will serve an important role in how the story plays out. For instance, tariffs used for negotiating purposes are unlikely to persist over long periods. Conversely, tariffs that are part of a larger decoupling process could be here to stay.

2 How effective will tariffs be in achieving these goals?

Tariffs can contribute to the geopolitical goals of decoupling, negotiating and generating revenue (although they are effectively a regressive tax), but rebalancing might be harder to achieve.

The U.S. trade deficit represents a balance between domestic and international production, savings and investment. In the short term, the trade balance might see some improvement, but over time, exchange rates, interest rates and relative prices adjust to balance savings, investment and production.

Ultimately, tariffs are more likely to reduce the volume of trade with a given country without altering the overall trade balance itself. For example, although U.S. imports from China significantly decreased in 2018 and 2019, this decline was largely compensated by increased imports from other countries.

3 How will tariffs impact economic activity and markets?

Analyzing the effects of U.S. tariffs is difficult, as the impact will largely depend on specifics, such as the goals, products involved, new rates and any possible exemptions. There are also the potential policy responses from other countries, including retaliation, bilateral trade deals and potentially lowering trade barriers to ease restrictions on U.S. companies in global markets. Finally, modeling the impact of tariffs relies heavily on various assumptions and potential policy responses in each country.

Here is a broad overview in which to think about the possible impact:

Growth: Tariffs generally act like a negative supply shock, raising the price level and limiting growth through various mechanisms. These mechanisms can cause companies to postpone their investments and reduce household purchasing power.

The extent of these negative impacts on growth will depend on several factors, including the duration of the higher tariffs, the nature of retaliatory and counter-retaliatory actions, the efficiency of tariff collection and the feedback effects in global financial conditions.

Looking back at President Donald Trump's first term, U.S. GDP growth still averaged 2.7% from 2017 to 2019, despite the trade war. However, this might have been because tariffs did not end up being significant. U.S. customs duties collected doubled between 2017 and 2019, but the increase only accounted for 0.2% of GDP at the time.

Inflation: Raising the cost of imported goods could lead companies to pass those prices onto consumers. These tariffs may reduce international competition, giving domestic producers more runway to raise prices themselves, exacerbating inflation pressures. A common estimate is that 30% to 50% of the cost will be passed onto consumers, though the rate may be higher for products with fewer substitutes.

Whether this translates into sustained inflation depends on the Federal Reserve's response to this price level shock. Fed officials could overlook a one-time price increase caused by higher tariffs, but if core inflation moves too far from the central bank's target, it could justify postponing rate cuts.

The dollar: According to economic theory, the dollar should be stronger in the short term because of changing trade dynamics from tariffs (greater demand for the U.S. dollar, lower demand for international currencies) and the likelihood of a more hawkish Fed, in response to inflation uncertainty. A key question for the Fed's response will be if tariffs generate a one-off price level shock or whether it changes inflation expectations and encourages a Fed response. Current volatility in the dollar likely reflects the lack of clarity on tariffs and their impact on both U.S. and international growth. However, in the longer term, tariffs may reduce U.S. growth prospects and lead to lower real interest rates, both of which would tend to weaken the dollar.

Historical analyses show varied economic outcomes. A National Bureau of Economic Research study found that during the 2018 U.S.–China trade war, announcements of U.S. tariffs on China resulted in a stronger dollar, especially against the Chinese yuan (CNY). However, it is unclear how much of the CNY weakness was due to the tariffs or a pseudo retaliation against the U.S., allowing the CNY to weaken. Overall, empirical evidence suggests the impact of tariffs on the home country's currency is mixed, showing short-term positive effects.

4 Does Trump have the legal authority to keep raising tariffs?

The newly announced reciprocal tariffs invoke the authority of the International Emergency Economic Powers Act (IEEPA), the National Emergencies Act and the Trade Act of 1974, based on a declared emergency related to "large and persistent annual U.S. goods trade deficits." Other tariffs have been implemented with a stated intent of combatting emergencies related to illegal immigration and illicit drugs.

Using these measures to impose tariffs is unprecedented and will likely face legal challenges, but courts have generally deferred to the president on tariffs and national security. During Trump's first term, some tariffs were temporarily blocked, but none were reversed by the courts. Congress could also move to rein in the executive branch's power to unilaterally implement tariffs, although no such actions were taken under the first Trump administration. Senators Chuck Grassley and Maria Cantwell introduced bipartisan legislation on April 3 that would require congressional approval for new tariffs, but it remains to be seen if the measure goes anywhere.

What might change Trump's view on tariffs is public opinion. In the past, retaliatory tariffs from China, the EU and others have targeted specific products from those districts in the U.S. with strong political influence on the administration. A severe market reaction could also impact the president's decisions, although Trump has previously demonstrated he is comfortable with short-term market pain to achieve his goals.

5 What will be the impact on regions and sectors globally?

Regional tariffs

Regional	Policies	Potential Impact
Canada and Mexico	25% tariffs imposed on goods not compliant with USMCA. Exempted from further reciprocal tariffs.	• The U.S. accounts for around 80% of Mexican and Canadian exports, while Mexico and Canada each account for around 15% of U.S. imports. The U.S. is reliant on specific imports, including horticulture from Mexico and energy from Canada. • Canada has announced retaliatory tariffs, while Mexico has said it will communicate with the U.S. government before making any announcements. • Mexico and Canada stayed out of the limelight on April 2, but it seems likely that a review of the U.S.–Mexico–Canada Agreement (USMCA), scheduled for 2026, could be advanced sooner.
China	34% additional tariffs announced on April 2 on top of previously implemented 20% tariffs.	• Exports to the U.S. account for approximately 15% of China's total exports, and so the impact may not be as large as it once would have been. • The U.S.–China trade war of 2018 resulted in slower Chinese economic growth, CNY depreciation and stock market declines for China, although the country managed to sustain its global export share and trade surplus in subsequent years.
EU	20% reciprocal tariff announced on April 2	• In addition to the tariffs announced April 2, the EU could also be affected by steel and aluminum duties, as well as auto tariffs.
Asia ex-China	Tariffs vary by country, as of April 2. Here are some notable ones: Vietnam 46% Taiwan 32% Japan 24% India 26% South Korea 25% Thailand 36% Indonesia 32% Malaysia 24%	• The U.S. consistently runs a significant trade deficit in the region, and some Asian economies impose higher tariff rates on U.S. imports compared to the tariffs the U.S. places on them. • Many Asian countries have strong linkages to global trade, including China's supply chains. The newly industrialized, export-oriented economies (such as Taiwan, South Korea and Singapore) appear to be the most vulnerable.

Sector tariffs

Sector	Policies	Date	Potential Impact
Steel and aluminium	Aluminum tariffs raised from 10% to 25%. Aluminum and steel will be excluded from further reciprocal tariffs. Previous exemptions eliminated for Argentina, Australia, Brazil, Canada, EU, Japan, Mexico, South Korea, Ukraine and U.K.	In effect since March 12	• Trump has stated that existing exemptions, like quotas and free trade agreements, were being exploited by countries with excess steel and aluminum, such as China, undermining their original intent. • The EU and Canada are likely to be the most exposed, followed by Mexico, Brazil, South Korea and South Africa. • May be positive for U.S. steel producers, who can raise prices due to reduced competition. Could be negative for aluminum consumers, the automobile or construction sectors for example, as the U.S. is heavily dependent on aluminum imports. • A second order impact would be inflationary. Steel demand is impacted by highly interest-sensitive industries (autos, construction and manufacturing). • Uncertainties around tariffs may also lead to cautious capital expenditure (capex), dampening demand for steel and aluminum.
Copper	Exempted from reciprocal tariffs	Report due by November 22, 2025	• Trump has ordered an investigation into copper imports, citing copper's role in defense, infrastructure and emerging technologies. • The U.S. is heavily reliant on copper imports, with over half of its consumption needs imported. • Chile, Canada and Peru are likely to be the most exposed if tariffs are imposed.
Timber, lumber	Exempted from reciprocal tariffs	Report due by November 26, 2025	• As with copper, Trump has ordered an investigation into whether reliance on timber and lumber imports represent national security risks. • Will likely raise costs for the U.S. construction industry. • Canada should face the greatest impact if tariffs are imposed, followed by the EU, China, Vietnam, Brazil, Chile and Mexico.
Autos	25% tariff imposed on April 2, but exempted from further reciprocal tariffs	Announced in executive order March 25	• The auto sector has already been hit by tariffs on Mexico and Canada. Only around 50% of cars sold in the U.S. are manufactured in the U.S., with the rest coming from Mexico, Canada, Asia and Europe. • Having already moved a great deal of parts inventory across borders in advance, there are few effective mitigation efforts open to auto companies, other than hiking prices.

Sector tariffs

Sector	Policies	Date	Potential Impact
Agricultural products	Subject to reciprocal tariffs	Announced April 2	• Asia generally imposes higher tariffs on agricultural products, which would be politically difficult for Asia to lower in any negotiations.
Oil and gas	Exempted from reciprocal tariffs	Suggested mid-February but not yet imposed	• Trump has suggested that oil and gas tariffs might encourage domestic production through higher domestic prices. However, it is unclear how much it would increase U.S. production due to a mismatch between the light oil produced domestically and the heavy oil required by many U.S. refineries. • Canada is the most exposed if tariffs are imposed, followed by Mexico.
Pharmaceuticals	Exempted from reciprocal tariffs	Suggested that it could be announced along with lumber tariffs	• Imposing tariffs within the pharmaceutical (pharma) industry is a major divergence from the past. Since 1994, the U.S. and its trading partners have agreed to reciprocal tariff elimination for pharma products and chemicals used in drug production. • Pharma supply chains are very global, and it is unclear how "made in the USA" will be defined. • Tariffs on medicines would likely raise drug prices, exacerbating drug shortages. • Tariffs are likely to hurt generic companies, which struggle to pass on costs, as they already have thin margins. Most generic drugs are imported, with India and China being major suppliers. • The EU, Singapore, Switzerland, India and China are among pharma-product exporters that could see reprieve, though it remains to be seen if there will be further tariffs.
Semiconductors	Exempted from reciprocal tariffs	Suggested that it could be announced along with lumber tariffs	• Trump has threatened to tariff semiconductors "in the very near future," but given that semiconductors are the backbone of the modern digital economy, and the U.S. currently lacks local alternatives to replace imports, these tariffs could be inflationary. • The supply chain is incredibly complex and global, so there are some workarounds companies could potentially use. • Emerging markets in Asia (including China, Taiwan, Malaysia, Vietnam, Thailand and Korea) and the EU are likely to be the most impacted. Many of these countries avoided tariffs during the 2018–2019 trade war, but this is unlikely to happen again.

Assessing what's next

Altogether, we expect an ongoing process, with recalibrations to many of the enacted tariffs. Initially, we may see higher tariffs in the near term, though lower in the long run, depending on the industry or national domicile. Fortunately for corporate firms, many have a healthy financial position with historically high margins. Some companies will experience a rise in input costs, though the severity of such increases remain in flux.

Under a scenario where tariffs are lasting and severe, such input costs could rise to a level that causes firms to cut capital expenditure, reduce head count or even cause a recession. Retaliatory tariffs are a key risk we're eyeing. Lastly, if the proposed tariffs persist, we could see a downgrade of earnings estimates now that the initial rates are more punitive than expected.

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