Trump's Tariffs: Emboldened to Hit His Base

- **Pres. Trump's new threat to impose 10% tariffs on USD 300 bn of US imports of goods from China takes the US-China trade spat into new territory where the White House now appears prepared to impose increased and visible costs directly on its voting base.**
- **The immediate macroeconomic impact of the 10% tariffs would be limited in both the US and in terms of spillovers into Canada: the tariffs would reduce real GDP growth in 2020 by about 0.14 percentage points (ppts) in the US and 0.11 ppts in Canada. However, there is a risk that the knock-on effects on business activity and consumer confidence could be more substantial than we have currently estimated.**

FURTHER ADVENTURES IN TRUMPONOMICS

President Trump ended a month-long pause in his escalating trade tensions with China through an announcement via Twitter yesterday that he intends to impose on September 1 a new set of tariffs of 10% on the remaining USD 300 bn of annual US imports from China that have not already been subjected to new tariffs by his administration. Though this new salvo in the US-China trade spat would follow through on threats Pres. Trump made a few months ago, we have thought it unlikely that he would levy fresh tariffs on the remaining half of US goods imports from China: to this point, the White House's tariffs have been specifically designed to avoid directly affecting the prices of bread-and-butter goods that households buy on a daily basis (chart 1). This new round of tariffs would imply immediate price increases on key consumer products, such as toys, sports gear, games, clothing, and shoes, which are important to Pres. Trump's voting base in the run-up to the Christmas buying season (chart 2, next page). Recent polls imply that Americans increasingly understand that US businesses and families—not China—are bearing the burden of Pres. Trump's tariffs. Moreover, tariffs don't just dent the purchasing power of US households: they also crimp the large share of the money spent on goods made in China that boomerangs its way back into the pocketbooks of American companies and consumers through integrated supply chains and the retail networks that sell Chinese-made goods in the US (chart 3, next page).

THE TWITCHING TWITTER FINGER

The timing of Pres. Trump's tweets was likely driven by two immediate developments rather than being a methodical step in some grand geopolitical plan:

- First, the Fed's interest-rate cut on Wednesday appears to have both frustrated and emboldened the President. On the one hand, the 25 bps reduction in the fed funds target rate was less than the "big cut" Pres. Trump wanted and Chair Powell's communication of a "hawkish-neutral" stance implied that it may not be the beginning of a long cycle of interest-rate adjustments. On the other hand, the Fed's move seems to have enabled the President to ratchet up further his tariff battle with China as the Fed showed it was less data dependent and more trade-policy dependent than it had

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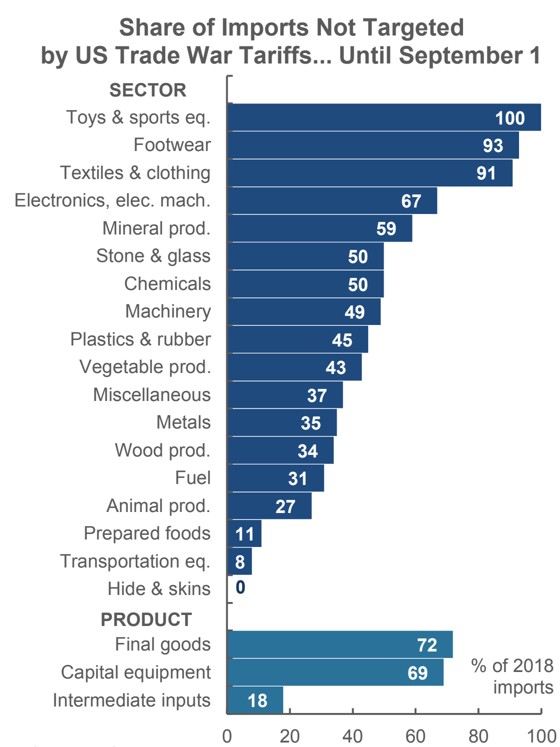
Chart 1



Sources: Scotiabank Economics, PIIE.

previously claimed. The hawkish-neutral slant to Chair Powell's communications was possibly too subtle to curb the moral hazard implicit in cutting rates in response to the trade and growth uncertainties generated by the White House itself; and

- Second, reports on the re-start of US-China trade talks imply that Beijing may be dragging its feet to draw out negotiations until after the November 2020 election in the hope of concluding talks with a new, more rational US President.

STILL HOPEFUL THE BARK IS WORSE THAN THE BITE

Given the *ad hoc* and reactive timing of this new threat, there remains some doubt that Pres. Trump will follow through on these new 10% tariffs on September 1. We continue to expect that the trade dispute between Washington and Beijing will not intensify further through the remainder of 2019 as US consumers react to the possibility of higher costs, but our conviction has obviously weakened in the wake of this week's events. We recognize that these latest tweets are different from past threats. This time around, Pres. Trump is reported to have ignored a request from Treasury Secretary Mnuchin and USTR Lighthizer to first issue a warning to China. Moreover, in contrast with past threats, yesterday's tweets don't contain a possible off-ramp should talks between now and September 1 go well—as was the case for Mexico in May. Regardless of whether Pres. Trump makes good on his threat, it represents another step that makes normalization of US-China trade relations through a comprehensive deal more, rather than less, difficult to achieve.

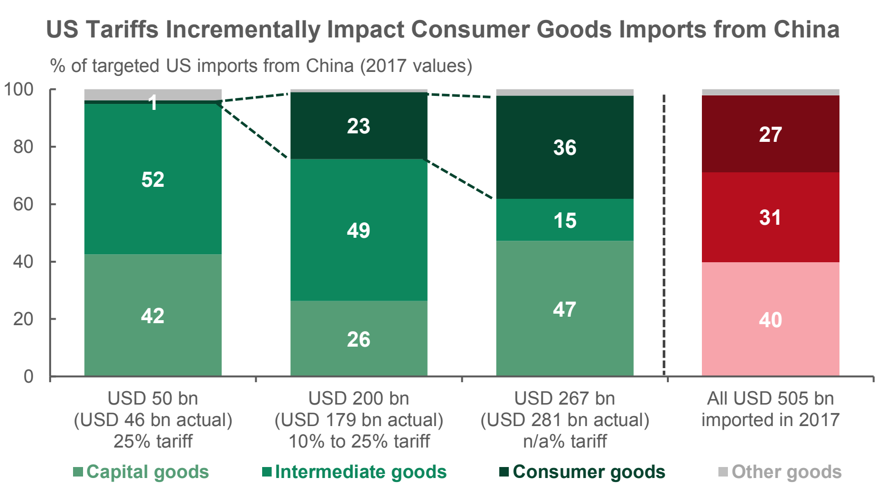
QUANTIFYING THE COSTS IF TRUMP FOLLOWS THROUGH

In the remainder of this note we revisit the macroeconomic scenarios for the US and Canada on the possible intensification of Pres. Trump's tariffs that we published in Scotiabank Economics' *Q3 Global Outlook*. In light of this week's developments, we add an assessment of the likely impact of the new threat of 10% tariffs starting September 1 (see tables 1 and 2 and charts 4 to 9, next pages).

- **Scenario 1 (+10% tariff on USD 300 bn of US imports from China)** considers the impact of Pres. Trump making good on his tweet threat to impose a 10% tariff on the remaining USD 300 bn of US imports from China that haven't already been hit by new taxes under his special powers on trade. In the US, real GDP growth would be 0.14 ppts lower in 2020 relative to our baseline, while both inflation and the fed funds rate would be virtually unchanged. In Canada, real GDP growth would be 0.11 ppts lower in 2020, while inflation and the Bank of Canada's (BoC's) overnight rate would not be materially affected. Though the immediate macroeconomic impact of these new 10% tariffs would be relatively limited, their longer-term effect on business activity and consumer confidence could be more pronounced than we have reflected in our model.

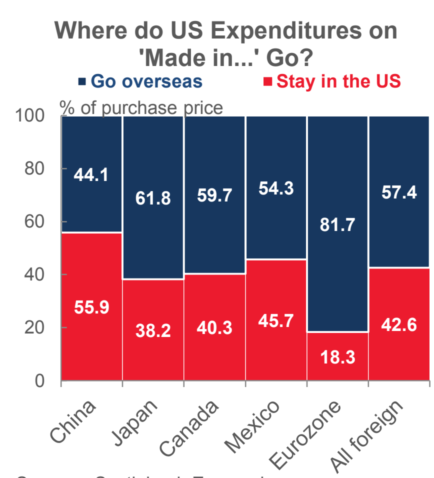
- **Scenario 2 (+25% tariff on USD 300 bn of US imports from China)** reflects a further escalation of the China-US trade war during Q3-2019 in which the US raises the September 1 tariffs from 10% to 25% on USD 300 bn of US imports from

Chart 2



Sources: Scotiabank Economics, US ITC, International Trade Centre, USTR.

Chart 3



Sources: Scotiabank Economics, Federal Reserve Bank of San Francisco.

China, thereby inducing 25% retaliatory tariffs from China on all of its imports from the US. This would weaken USD GDP growth by a cumulative 0.5 ppts during 2019–20 and prompt an additional 25 bps rate cut by the Fed in 2020 compared with our *Q3 Global Outlook*'s baseline projection of 3 x 25 bps in cuts in 2019 (see chart 6). US inflation would be affected only slightly in this scenario. In Canada, the Sino-US dispute translates into a reduction in GDP growth of 0.28 ppts in 2020 relative to our latest forecast. Inflation is little affected, nor is the BoC's policy rate.

- **Scenario 3 (+25% tariffs on all US imports including those from Canada and Mexico)**, Pres. Trump goes beyond his spat with China to launch an all-out trade war with the rest of the world that features 25% tariffs on imports from all countries. Given otherwise still-solid fundamentals in the US economy, it would take this scorched-earth trade war to push the US into recession: the US economy would contract by 0.7% in 2020. The Fed would be forced to cut the fed funds target rate by 100 to 125 bps beyond the 75 bps in cuts during 2019 already programmed in our baseline forecasts. Under this global trade-war scenario, Canada also falls into a deep recession that sees GDP contract by 1.6% in 2020. This sharp downturn forces the Bank of Canada to cut its policy rate to its effective lower bound by end-2020.

Table 1

US Trade War Scenarios Macroeconomic Projections		
US	**2019**	**2020**
Real GDP (annual % change)		
Baseline	2.50	1.60
China (current + 10% on USD 300 bn)	2.43	1.46
China (25% tariff on all)	2.33	1.26
Global trade war	1.31	-0.71
Core PCE (annual % change)		
Baseline	1.60	1.90
China (current + 10% on USD 300 bn)	1.60	1.89
China (25% tariff on all)	1.60	1.87
Global trade war	1.65	1.71
Fed Funds Rate (%, eop)		
Baseline	1.75	1.75
China (current + 10% on USD 300 bn)	1.71	1.68
China (25% tariff on all)	1.65	1.57
Global trade war	1.13	0.57

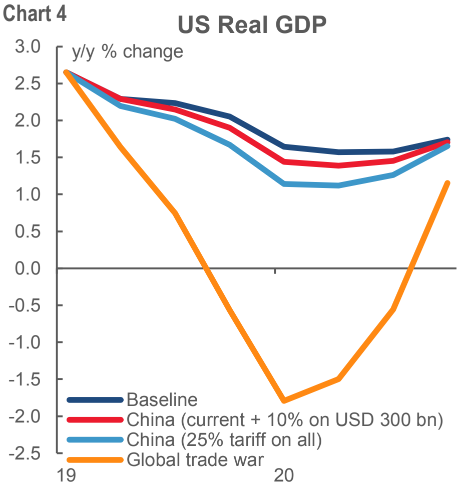
Source: Scotiabank Economics.

Table 2

US Trade War Scenarios Macroeconomic Projections		
Canada	**2019**	**2020**
Real GDP (annual % change)		
Baseline	1.40	2.00
China (current + 10% on USD 300 bn)	1.37	1.89
China (25% tariff on all)	1.33	1.72
Global trade war	0.46	-1.62
Core inflation (annual % change)		
Baseline	2.00	2.00
China (current + 10% on USD 300 bn)	2.00	1.97
China (25% tariff on all)	2.01	1.93
Global trade war	2.20	1.03
BoC Overnight Rate (%, eop)		
Baseline	1.75	1.75
China (current + 10% on USD 300 bn)	1.73	1.69
China (25% tariff on all)	1.71	1.61
Global trade war	1.26	-0.16

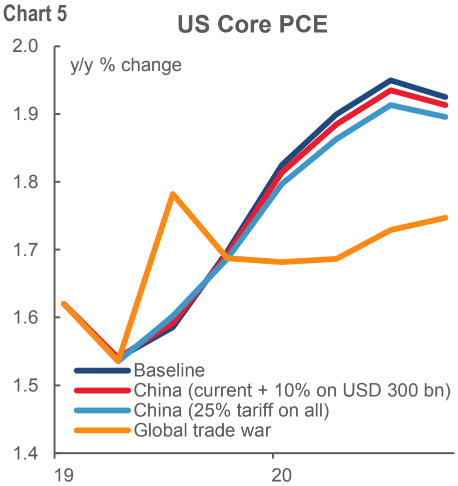
Source: Scotiabank Economics.

Chart 4



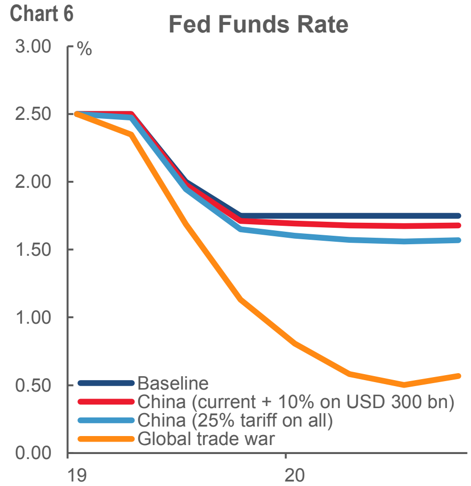
Source: Scotiabank Economics.

Chart 5



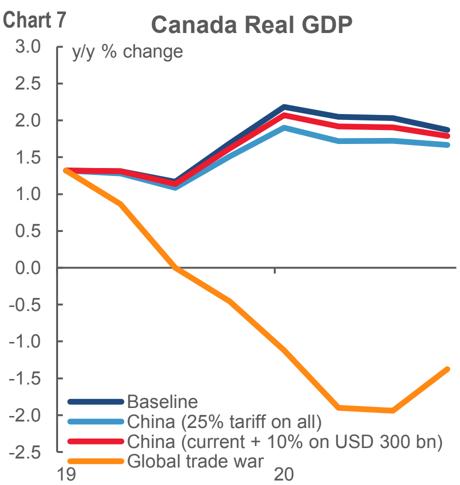
Source: Scotiabank Economics.

Chart 6



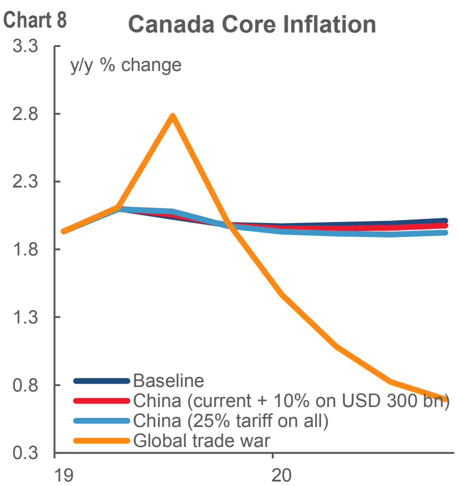
Source: Scotiabank Economics.

Chart 7



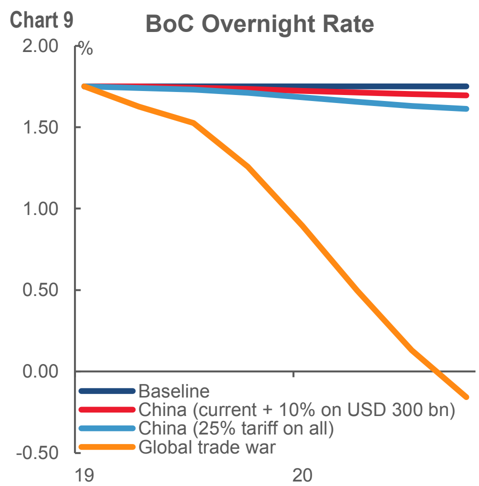
Source: Scotiabank Economics.

Chart 8



Source: Scotiabank Economics.

Chart 9



Source: Scotiabank Economics.