Comerica Economic Alert

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Tariffs Up, Inflation Up, Growth Down

- **The government raised tariffs on goods imports from most trading partners on April 2.**
- **The tariffs will help American manufacturers who compete against imports, but also raise costs for manufacturers who use foreign components, for service-providing businesses, and for consumers.**
- **The net effect of tariffs will be slower growth and more inflation.**
- **Comerica Economics will lower our 2025-2026 real GDP growth forecast and raise the inflation forecast to account for the impact of higher tariffs.**
- **The tariff hike drove U.S. equities into a correction on April 3, penalizing growth stocks more than value and defensive stocks. Treasury yields fell as investors fled risky assets for the safety of Treasuries.**

President Trump on April 2 announced that American importers of foreign goods will pay incremental tariffs of 10% to 50% on imports from most major trading partners. Canada and Mexico were not included, since the government already raised tariffs on goods imports that aren't covered by the USMCA trade deal. The 25% auto import tariffs also will be implemented as pledged. Tariff increases in the second Trump administration likely amount to a roughly 25% tax increase on the $3.3 trillion of U.S. annual goods imports, equivalent to a tax hike of 2%-3% of U.S. GDP. That's equivalent to more than doubling the amount of money the government collects in corporate income taxes.

If tariffs stay in effect as announced, foreign sellers will likely absorb some of the cost, as will American importers. But even so, the higher tariffs will likely cause inflation in 2025 to be 2-3% higher than it would have been without the tariffs, and inflation in 2026 to be 1-2% higher than it would have been otherwise.

Tariffs' effects will vary across sectors. Tariff hikes will help U.S. manufacturers that compete against foreign imports by allowing them to charge higher prices, gain market share, or both. But many manufacturers also use substantial amounts of imported goods as inputs, and so whether individual manufacturing businesses will benefit or be hurt will vary. Service-providing businesses, which account for a majority of employment and GDP, are all net purchasers of goods and so will pay higher prices from tariffs, as will consumers. And exporting industries like agriculture, energy, technology, entertainment, and aerospace will bear the brunt of foreign retaliation. In aggregate, the tax revenues and price increases from tariffs will leave less disposable spending power in consumer pockets, weighing on economic growth and hiring in the rest of 2025.

The tariffs' long-term effect will depend on whether businesses and consumers see them as temporary or permanent policy shifts. Businesses that expect them to be permanent are more likely to build a new factory or expand a business that is profitable because of tariffs than businesses that see the tariffs as a short-term tactic to pressure America's trading partners to cut barriers to U.S. exports. Similarly, consumers who think the tariffs will eventually be reversed are more likely to delay purchases of houses, cars, or other big-ticket items than consumers who expect them to be permanent.

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The reaction of foreign trading partners will matter, too. Escalating tariffs and trade barriers caused a collapse in world trade in the early 20th century and contributed to the Great Depression as countries attempted to protect domestic markets for domestic producers ("beggar thy neighbor"). So far, most U.S. trading partners are threatening retaliation toward the U.S., but don't seem to be discussing trade barriers toward the rest of the world. If that changes it would be bad news.

The near-term picture for U.S. growth is very muddy. There was a huge drag on real GDP in the first quarter from surging imports as companies front-ran tariffs, partially offset by a precautionary runup in inventories. Also, new car and truck sales surged to the highest since 2021 in March as buyers rushed to complete purchases before prices rose. Separate from trade policy, the U.S. saw big temporary headwinds in January from the LA wildfires and winter storms across the South, and DOGE cuts lowered government outlays. Accounting for these crosswinds, the economy likely contracted in the first quarter. Stripping out the effect of swings in the trade deficit, inventories, and government spending, trend private economic activity likely grew in the first quarter, but at a slower pace than in 2024.

Comerica Economics will mark down the 2025 real GDP forecast to 1.7% in our April forecast from 2.5% in our February forecast, accounting for the drag from tariffs on spending, as well as the deterioration of consumer and business sentiment in recent months. In the other direction, growth in the rest of 2025 should see a tailwind as the jump in the trade deficit unwinds. Consumer and business sentiment could recover in the second half of 2025 if the national conversation turns away from tariffs and trade war and toward the tax cuts that the tariffs might help fund.

The Fed doesn't have great tools to respond to the tariff hike, which will add to inflation but weaken growth. Chair Powell has said he sees higher inflation from tariffs as likely to be "transitory." Comerica forecasts for the Fed to reduce their policy rate a quarter percent in 2025 with a single cut in July. But it is easy to imagine scenarios in which a deteriorating economy forces the Fed to cut by considerably more, or in which inflation gets considerably worse and forces the Fed to hike.

U.S. equities opened sharply lower on April 3 as markets priced in the larger-than-expected tariffs. The S&P 500 Index fell into correction territory (meaning a decline of more than 10%), with larger declines in growth stocks than value stocks. The yield on the 10-year Treasury bond fell to around 4.0% and was the lowest since October 2024. The dollar appreciated against the offshore Chinese yuan, but fell against the euro, Mexican peso, and Canadian dollar. Commodity futures were mixed, pricing in a mix of higher import costs and lower demand.