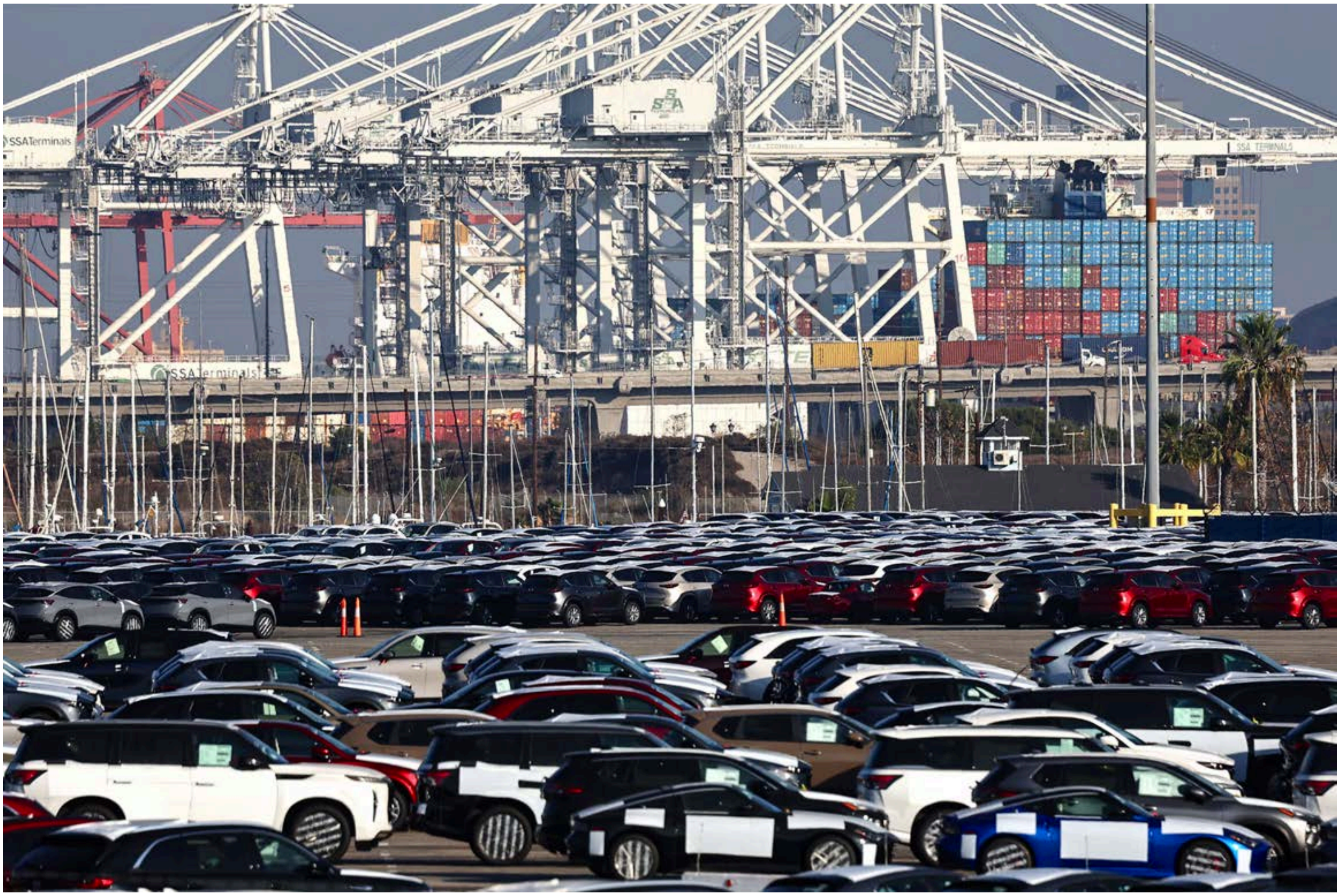

Imported autos are now subject to President Trump's 25% tariff. (MARIO TAMA/GETTY IMAGES)

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# Why the Tariff Damage Can't Be Undone

President Trump's tariff shock is forcing a reassessment by countries on how to respond and pushing investors to revise assumptions about profit margins, investments, and inflation.

By Reshma Kapadia Follow

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The scope, speed and magnitude of the Trump administration's tariff blitz left investors with a lot of questions. But one point came through crystal clear: The post–World War II global world economic order is no longer.

That is forcing a reassessment by countries on how to respond and pushing investors to reassess long-held assumptions about profit margins, investments, and inflation.

President Donald Trump on Wednesday unveiled a sweeping set of tariffs on top of other tariff-related moves in recent weeks that created uncertainty for companies and investors. But the 10% tariffs, effective April 5, and another set of country-specific tariffs—as high as 49%—on countries that the administration singled out for trade deficits with the U.S. were far higher than expected.

Capital Economics estimates that the average tariff is set to jump from about 2% last year to just over 20%—drawing comparisons to the Smoot-Hawley tariffs that deepened a recession in the 1930s. The tailspin in stocks, with the S&P 500 index shaving $2.5 trillion in market value in one day, underscored the shock. Economists warned that the tariffs could push the U.S. into stagflation, hitting growth and pushing prices higher.

Trump's latest tariff salvos aim to narrow the country's $1.2 trillion trade deficit in goods, which he describes as a national emergency. He is wielding tariffs as a powerful tool against both friends and foes in hopes of raising billions in revenue and bringing manufacturing jobs and production of critical goods back to the U.S.

While the administration may intend to negotiate these tariffs down, Michael Medeiros, macro strategist at Wellington Management, said the magnitude and way these tariffs were created have eroded trust among U.S. allies.

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"Though some countries might look to make concessions, the probability of successful negotiations has gone down versus Trump 1.0. Trust in U.S. institutions has been coming down, and those concerns have now been accelerated," said Medeiros. He said it's showing up in the market, with the dollar weakening despite the increase in tariffs—the largest in a century—which should have the opposite impact.

"Trump has taken the hatchet to trade with practically every major U.S. trading partner," said Eswar Prasad, former head of China research at the International Monetary Fund and currently an economics professor at Cornell University and senior fellow at Brookings Institution. "Trump is setting off a new era of protectionism that will reverberate worldwide and signals the end of a period when barriers to cross-border trade were falling and boosting global trade integration."

China responded Friday by announcing 34% tariffs on all U.S. imports, starting April 10, matching the level the U.S. hit it with in its latest move. Beijing also expanded export controls and added almost a dozen U.S. firms to its "unreliable entities list," restricting sales, and initiated new anti-dumping probes on medical devices. In a statement, the Ministry of Finance described the U.S. move as a "typical unilateral bullying practice."

Canadian Prime Minister Mark Carney vowed to match Trump's 25% tariffs on autos. If more countries follow Canada, which has taken a more aggressive stance with a "buy Canadian" movement, the next phase of the trade battle could turn into rounds of retaliation.

It could also make countries more hospitable to working with one another—at a time China has been trying to repair relationships with Europe and increase sales to other parts of the world.

Investors were left scrambling. "It's the unknown unknowns that can lead to severe confidence shocks," BofA Securities' Savita Subramanian told clients. She said that if stagflation is the concern, companies helped by inflation and higher nominal interest rates, with less global exposure, stable earnings, and dividends, may be the safer route within the S&P 500.



Uncertainty about the terms for trade negotiations, as well as wariness of the sustainability of any deal, could make officials less inclined to rush to Mar-a-Lago or Washington, D.C. While Trump has indicated he wants to meet with Chinese leader Xi Jinping, analysts say there hasn't been the prerequisite meetings even of cabinet officials with their counterparts.

The retaliation from China came bigger and faster than some analysts expected. "They are going hard and strong, and daring Trump to up his tariffs as he said he would do if countries retaliated," said Arthur Kroeber, head of research at Gavekal.

Trump posted his response on Truth Social Friday: "CHINA PLAYED IT WRONG, THEY PANICKED – THE ONE THING THEY CANNOT AFFORD TO DO!"

Europe, which got hit with 20% tariffs in this latest round, is already increasing military and infrastructure spending, and that could help offset a tariff hit. China's higher tariffs could force Beijing to bolster its gradual fiscal support to stabilize its economy.

The calculus is different for others like Vietnam, which relies on exports for almost half of its gross domestic product and is facing 46% tariffs. Countries that rely on the U.S. for security, like Japan, South Korea, and Taiwan, might also be more willing to negotiate. Indeed, Trump highlighted vows from Japan's SoftBank Group and Taiwan Semiconductor Manufacturing to invest billions in the U.S.

Indian officials have also been looking for a bilateral trade deal—and Kroeber sees India as likely to negotiate to lower its tariff rate. Success would make it more competitive with China and make it an even more attractive manufacturing alternative.

Over the medium to longer term, Trump's tariff and trade policy will likely accelerate the move to diversify supply chains, emphasize regionalization over globalization, and invest in becoming more self-reliant. The trend began in Trump's first term and was kicked into higher gear amid the supply-chain disruptions of Covid 19 and Russia's attack on Ukraine.

But given the uncertainty and increasing costs of inputs, companies may rethink where they allocate long-term capital. "These tariffs plus associated uncertainties provide more incentives to build around the U.S., not in the U.S.," says Mary Lovely, who focuses on U.S.-China relations at the Peterson Institute of International Economics.

Ironically, the uncertainties and "everything, everywhere" approach to tariffs could give China an edge, as countries where companies tried to diversify to—such as Vietnam and Thailand—face hefty tariffs. That could make these countries less desirable alternatives to China, with some companies possibly opting to stay put, given the uncertainty of where policy could head next.

"We will see a strengthening of Chinese trade with Europe, and China acting as the U.S. did post–World War II as the country with some money and ability likely to help the likes of Vietnam, Malaysia and Indonesia as we see a reordering of trade flows," says Cheryl Smith, an economist at Trillium Asset Management.

But even for the companies that look to bring back some of their manufacturing, such change moves at a glacial pace, even if the administration is able to speed up permitting for U.S. factories.

"The economic disruption is going to be longstanding. If Covid taught us anything, supply chains are extremely complex and difficult to rearrange overnight," Smith says. "It isn't a supply chain for a bakery but for computers and chips, with billions of investments and sunk costs."

This reordering of trade also means that a global structure based on uber-efficient supply chains may be a thing of the past. "The whole system efficiency goes down, and because it becomes a fragmented market, economies of scale will come down," says Jerry Wu, a fund manager on Polar Capital's Asia and emerging markets team.

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