Friday 7 February 2025

focus

Tariffs: Trump Card or Bluff?

President Trump campaigned on tariffs, and in his first two weeks he came out swinging, announcing new tariffs on Mexico, Canada, and China. Although tariffs on Mexico and Canada were quickly deferred, they are clearly a key part of Trump's playbook. The will-he, won't-he nature of Trump's trade policies creates a challenging environment for businesses and markets, with the rules of engagement unclear and subject to rapid change. Uncertainty and volatility are likely to remain features of the Trump presidency.

FORSYTH BARR

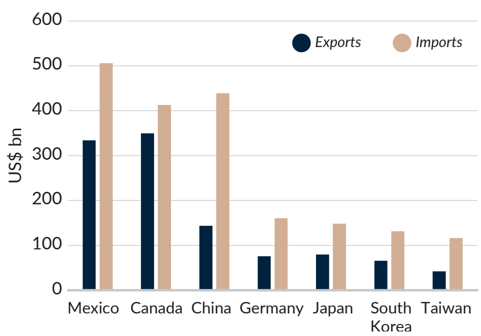
...Economists generally view tariffs as doing more harm than good...

One of President Trump's key election promises was to introduce sweeping tariffs on the United States' trading partners — and he has delivered.

In his first week back in office, after Colombian President Petro refused to allow US aircraft carrying Colombian deportees to land, President Trump imposed an immediate 25% tariff on Colombian imports, which he threatened to raise to 50% in a week. Colombia swiftly relented and agreed to accept deported migrants. The tariffs were lifted, but the episode clearly underscored President Trump's readiness to use tariffs as a negotiation tool.

On 1 February, President Trump signed executive orders imposing tariffs on the US' three largest trading partners: Mexico, Canada, and China. The order included a 25% tariff on all Mexican and Canadian imports, except Canadian energy (oil, natural gas, and electricity), which was to be taxed at 10%. An additional 10% tariff was levied on all Chinese goods. These tariffs would have raised US tariffs to the highest level since 1946.

UNITED STATES' LARGEST TRADING PARTNERS (2024)



Source: US Census Bureau, Forsyth Barr analysis

President Trump's administration justified the tariffs under the International Emergency Economic Powers Act, citing national security concerns — primarily illegal immigration and fentanyl trafficking through Canada and Mexico, plus China's supply of ingredients used to manufacture fentanyl.

While these tariffs were set to take effect within days, both Mexico and Canada secured a 30-day delay by agreeing to strengthen border security and enter negotiations on security, drugs, and trade. The additional tariffs on Chinese goods are now in effect.

Tariffs: A tax on businesses and consumers

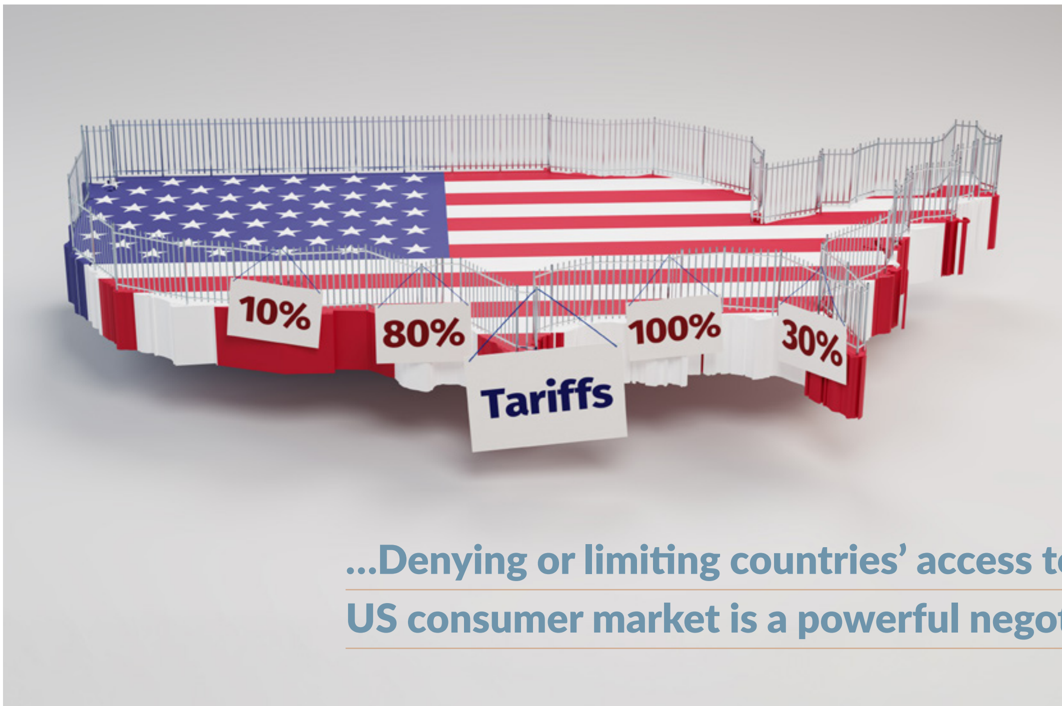
Tariffs are taxes on imported goods, designed to make foreign products more expensive and encourage consumers to buy local. Trump asserts that foreign companies, not US consumers, will bear the cost — this is not accurate.

In practice, tariffs are paid by the importer when goods enter the country. Importers then have three choices: (1) negotiate better deals with suppliers (often difficult), (2) absorb the cost (which eats into profits), and/or (3) pass the cost onto consumers.

The impact will vary depending on competition (e.g. the availability of substitute products) and demand elasticity (i.e. how sensitive consumers are to price increases). Historically, the burden has fallen predominantly on consumers. Tariffs would lift the price US households pay for many everyday goods, including fresh fruit, vegetables, electronics, and cars.

What is President Trump hoping to achieve?

Economists generally view tariffs as doing more harm than good. While they may offer protection



...Denying or limiting countries' access to the giant US consumer market is a powerful negotiating tool...

to certain domestic industries, they tend to reduce competition, push up prices, and slow economic activity.

Other countries have signalled that if the US does impose tariffs, they will retaliate with their own tariffs on US goods, which would impact US exports. Many political analysts view President Trump's tariff strategy as a tool of political leverage rather than economic policy – possibly explaining his readiness to drop tariffs when countries meet his demands.

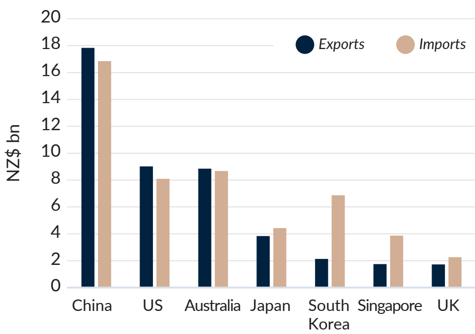
The US is the largest economy in the world, and it is dominated by consumers. In fact, the US consumer market is larger than the entire Chinese economy – the world's second-largest economy. Denying or limiting countries' access to the giant US consumer market is a powerful negotiating tool. Using this leverage to negotiate trade and border security deals with Mexico and Canada could well be President Trump's primary aim rather than pushing up prices for US households (voters!).

Is New Zealand vulnerable?

New Zealand is a small, open economy. While New Zealand isn't in President Trump's crosshairs and likely ranks low on his priority list, during his campaign, he did threaten a blanket 10% tariff on all imports. New Zealand's trade with the US has grown significantly in recent years. It now accounts for around 12% of our total exports and has been one of our fastest-growing markets. In 2024, we exported about $2.6 billion of meat and over $1 billion of dairy products to the US – both of which directly compete with US producers.

More broadly, any trade war would likely hurt New Zealand, even if we're not directly involved. A slowdown in our trading partners' economies due to tariffs would likely reduce demand for our exports.

NEW ZEALAND'S KEY TRADING PARTNERS (2024)



Source: Statistics NZ, Forsyth Barr analysis

Trump: The volatility machine

President Trump's tariff announcements shook stock, bond, and currency markets. The impacts lessened once tariffs imposed on Mexico and Canada were deferred.

The debate among political and market commentators is focused on the extent to which tariffs are a negotiation tool, or part of President

...tariffs typically raise prices and dampen economic activity...

Trump's long-term economic strategy. More protectionist trade policies seem likely, but how far the US — and other countries — will go is difficult to predict.

A major challenge for economies and markets, irrespective of the ultimate policies enacted, is uncertainty. Lack of policy clarity makes it hard for businesses to plan and invest. Consumers also might become more cautious if the economic outlook becomes less clear. Uncertainty over tariffs could be nearly as damaging as tariffs themselves.

When President Trump was elected, there was optimism around a more growth and business-friendly agenda. But, while the prospects of lower tax rates and deregulation are generally supportive, not all of his policies are necessarily business friendly.

At a macroeconomic level, tariffs typically raise prices and dampen economic activity. More broadly, President Trump's unconventional and unpredictable style — including sudden policy shifts, unexpected executive orders, and criticism of the Federal Reserve (often communicated via social media) — heightens overall uncertainty. Regardless of whether President Trump's impact on markets is ultimately a net positive or negative, one thing is likely: he will amplify volatility along the way.

If at any time you want to discuss investment options and opportunities, your Forsyth Barr Investment Adviser is available to provide you advice and assistance.

0800 367 227

forsythbarr.co.nz