

Self-styled 'Tariff Man' shocks Wall Street with tariffs

The end to self-delusion?



Adrian Bott
@Cavalorn



'I never thought leopards would eat MY face,' sobs woman who voted for the Leopards Eating People's Faces Party.

4:18 AM · Oct 16, 2015 · Twitter Web Client

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It's been fairly frequently remarked that markets seemed to believe that Donald Trump would do all the stuff that markets liked, and none of the things that markets don't like. Well, we now know how that turned out.

As a reflection of just how suddenly Wall Street analysts have had to scramble to adjust to reality, Standard Chartered's (presumably pre-written) *Sunday Macro Strategy* note said that "broader tariff concerns have come off the boil slightly as Trump appears heavily focused on domestic issues in his first few weeks". Whoops.

But StanChart's aren't the only optimistic analysts to have had their weekends ruined by Trump doing pretty much exactly what Trump has long said he would do (to be fair, even Trump's Treasury secretary seems to have been surprised).

Below are some chunks of the investment notes that have landed in Alphaville's inbox since the news broke. We'll update this post as more ~~copium~~ research arrives. At least Rabobank's Philip Marey doesn't mince his words:

Perhaps the pundits who have been thinking that we could take Trump's tariff threats with a grain of salt, should actually start listening to what Trump says, instead of clinging to self-delusional interpretations.

A sellside round-up

JPMorgan's chief US economist Michael Feroli seems to be in shock, noting that "risks to the US outlook economic [sic] escalated materially over the weekend", but declining to update his forecasts or even put rough numbers on the potential impact:

Given the uncertainties around the implementation of these tariffs, we are holding off from making changes to our forecast. As we have noted on several occasions . . . qualitatively tariffs should push up prices and depress growth. Even the president appeared to acknowledge this, writing this morning "WILL THERE BE SOME PAIN? YES, MAYBE (AND MAYBE NOT!)." The magnitude of these adverse growth and inflation effects will depend on whether and how long higher tariffs persist, which retaliatory and counter-retaliatory measures are put in place, the effectiveness of tariff collections, feedback effects from global and financial conditions, and other considerations. Even if tariffs are called off tomorrow, the increase in policy uncertainty will be hard to put back in the bottle. For the Fed, the weekend's developments will likely reinforce their inclination to sit on the sidelines and to remain below the radar as much as possible.

Feroli's colleagues Bruce Kasman, Jahangir Aziz and Joseph Lupton later sketched out some broader points, such as how this was likely to plunge both Mexico and Canada into a recession and could lift the US inflation rate by 1 percentage point "or greater".

They also noted almost plaintively that Trump seemed to be moving towards "a materially different US policy mix than is built into our 2025-26 outlook":

Is this a business friendly administration?

We believe model estimates for the impact of sharp tariff increases on US growth are very limited in guiding the path ahead. While awaiting clarity on actual policies, it is important to emphasize that this weekend's announcements point towards a materially different US policy mix than is built into our 2025-26 outlook.

The tariffs announced this weekend are not only larger, but different in nature than the actions incorporated in our baseline forecast. In concentrating large tariff increases on Canada and Mexico the negative supply shock that results is likely to have far bigger spillovers to the US.

The actions taken this weekend also threaten to dismantle a multi-decade free-trade agreement. Beyond the rising cost of moving goods across borders it will disrupt established supply-chains and depress North American business sentiment, heightening the risk of nonlinearities not captured in economic models.

Deutsche Bank's George Saravelos was also taken aback by the speed, the scope and the breadth, despite having previously cautioned that markets were being a bit blithe about the trade war risks. His emphasis below:

... We consider the announcements to be at the most hawkish end of the protectionist spectrum we could have envisaged. The speed of implementation (Tuesday 12:01am EST), the scope (all goods are covered, including small parcel goods previously exempted) and the breadth (approximately 44% of total US imports) are all aggressive. It is especially notable that energy imports from Canada are in scope. Even if at a reduced rate of 10%, that the administration is willing to impose tariffs on energy pushes back against the market narrative that cost-of-living considerations would act as a restraint. The macroeconomic implications of such tariffs are likely to be wide-ranging and materially disruptive, especially outside of the US.

Second, the market needs to structurally and significantly reprice the trade war risk premium. We have been writing for a while that the market was underpricing these risks. We have also been warning about the negative read-across tariffs on Canada — America's closest ally — would imply for the rest of the world. By our estimates, the market was roughly pricing the equivalent of a 5% universal tariff being enacted in coming months, equivalent to a 30bps "hump" in the US inflation curve. The announcements this weekend are roughly *three times larger* with reasonable passthrough assumptions, i.e., we would expect a 1% US headline inflation impact if tariffs are sustained. These tariffs are also roughly *five times as large* as the cumulative sum of trade actions taken under the first Trump administration measured in terms of average tariff increases. For Canada and Mexico, we see this trade shock — if sustained — as being far larger in economic magnitude than that of Brexit on the UK and would expect both countries to enter a recession in coming weeks.

Goldman Sachs was definitely more on the optimistic side. It had previously estimated that tariffs of these kinds would increase core US inflation by 0.7 percentage point and shave 0.4 percentage point off economic growth, but the investment bank admits it will probably have to revamp its forecasts “in light of the new tariff details”:

1. President Trump signed executive orders imposing a 25% tariff on imports from Mexico, a 25% tariff on imports from Canada apart from energy, which would face a 10% tariff, and a 10% tariff on imports from China. These tariffs would apply above and beyond existing tariffs. While the details of products eligible for the lower energy tariff have not been released, we expect it to cover oil, gas, and electricity. A Federal Register notice is likely to be published with implementation details, including specific product codes eligible for the lower rate.

2. The White House has highlighted a “retaliation clause” in the executive orders that states that should one of the countries “retaliate against the United States in response to this action through import duties on United States exports . . . or similar measures, the President may increase or expand in scope the duties imposed under this order to ensure the efficacy of this action.” While this is a clear warning against retaliation, it has no automatic effect.

3. The tariffs are scheduled to take effect at the start of Feb. 4. With only two days before implementation, the tariffs look likely to take effect, though a last-minute compromise cannot be completely ruled out. The White House fact sheet on the tariffs and the executive orders highlight fentanyl and immigration as the motivation for the tariffs, but there are no explicit criteria provided for lifting them beyond cooperation on and an improvement in the immigration and fentanyl situations. In light of their potential economic effects and the fact that the White House has set general conditions for their removal, we think it is more likely that the tariffs will be temporary but the outlook is unclear.

4. We previously estimated that a sustained 25% tariff on imports from Canada and Mexico would increase the effective US tariff rate by 7pp, implying a 0.7% increase in US core PCE prices and a 0.4% hit to GDP. The 10% tariff on energy products reduces the impact slightly. Our economic forecast already assumes a roughly 20pp tariff on imports from China, boosting core prices by around 0.3%. We expect to update these estimates and our forecast in the light of the new tariff details.

Morgan Stanley reckons the impact on growth and inflation will be more meaningful, cutting growth by as much as 1.1 percentage points, and is clinging on to the hope that the US courts will stymie Trump's tariffs.

— Our economists expect that fully implemented tariffs would have meaningful consequences. A recession in Mexico becomes the base case. US Inflation could be 0.3 to 0.6pp higher vs baseline over the next 3-4 months (putting headline PCE inflation at 2.9% to 3.2%) and US growth could be -0.7 to -1.1pp lower vs baseline over the next 3-4 quarters (putting real GDP growth at 1.2% to 1.6%). We see a similar or larger growth drag than the 100bps hit to Asia and China's growth in 2018-19. *(Note: Independent of the outcome Tuesday we maintain the assumption that tariff increases on imports from China and some European goods will manifest over the course of the year.)*

— Full implemented tariffs with staying power don't appear to be in the price of key markets: A bullish scenario for UST duration, as weaker growth expectations increase demand beyond short maturities; meaningful USD strength relative to MXN & CAD; US equities may come under pressure, and services should outperform consumer goods.

— If tariffs are implemented with meaningful product exceptions, or a quick resolution appears likely, the economic and market effects could be far more muted. In this event, we see impacts concentrated in certain key sectors, possibly those that have already been under pressure from ongoing tariff risks. If it's clear that the tariffs are limited or temporary, it could act as a clearing event for some Consumer Discretionary Goods stocks that have been weighed down by this risk.

— If tariffs are avoided or delayed further, there would be no change to the broader economic outlook. USD could weaken on pricing out some tariff risk, and in US equities consumer discretionary as well as broader cyclical stocks could lead.

— US courts are a wildcard: The president invoked authority under IEEPA to levy these tariffs. There's debate among legal scholars about how this law can be used. Hence investors should keep an eye on the possibility of court challenges and injunctions.

Barclays' Michael McLean sees three potential scenarios here, and reckons that the courts are more than a "wild card", assigning a 45 per cent chance that they block Trump's tariffs.

1. Tariffs take effect (45% probability): One scenario is the tariffs take effect as scheduled. If the tariffs take effect on Tuesday, we think there could be a prolonged trade war because we do not see an obvious near-term off ramp. The criteria outlined by President Trump for removing the tariffs is ambiguous. There is no clear metric on what Canada and Mexico would need to do regarding fentanyl, migration, or trade deficits to secure removal of the tariffs. Plus, these issues likely cannot be mitigated overnight. We see the rationale for these tariffs as primarily political, and we think the tariffs remain in place until the White House can sell concessions or commitments from Mexico and Canada as material enough to score a political win. This could take a while, adding uncertainty about how long the tariffs may last.

In our view, the administration believes it has more leverage than Canada and Mexico in a trade war because a significantly greater share of Canadian and Mexican exports go to the US than the US imports from Canada and Mexico. 78% of Canadian exports are to the US, but imports from Canada only account for 14% of total US imports. 80% of Mexican exports are to the US, but imports from Mexico only account for 15% of total US imports.

2. Trump backs down (10% probability): We think there is a small chance that Trump could back down before Tuesday, notwithstanding any legal challenges. The executive orders could be a strategy to escalate pressure on Canada and Mexico in order to deescalate, giving negotiators two more days to find a resolution. Trump said that he would hold calls on Monday morning with the leaders of Canada and Mexico, but downplayed expectations of a resolution.¹⁰ The February 4 effective date could be interpreted as purposefully giving time for an offramp. We think it is more likely that the February 4 date was chosen to give Customs and Border Protection (CBP) time to prepare to begin collecting the tariffs. One could also argue that the pushback on the administration may become too strong to ignore given the breath of the tariffs. Already, business trade groups like the US Chamber of Commerce (see [statement](#)) and organized labor (e.g., United Auto Workers, United Steel Workers) have come out against the tariffs on Mexico and Canada.

We acknowledge that President Trump's most recent comments suggest he is not inclined to change course. On Sunday, Trump [accused](#) "the Fake News Wall Street Journal and Hedge Funds" as opposing tariffs because they are "controlled by China, or other foreign or domestic companies." See other comments by President Trump defending the tariffs ([here](#) and [here](#)). Vice President JD Vance has also made [comments](#) suggesting that the administration likely will not back down, posting on X to "Buckle up!" In our view, it would be hard to see how Trump could completely reverse course at this point and maintain the credibility of his tariff threats with other foreign countries in the future. Various outside groups (e.g., auto industry, home builders, farm bureau) had lobbied unsuccessfully for exemptions, and even some Republicans in Congress had expressed concerns (with no avail) to the White House about the impact of tariffs on farm states.

What is most striking to us is that Trump's actions conflict with the process and timeline the President himself set forth in his January 20th presidential memorandum on American First Trade Policy and with comments by his Commerce Secretary-designate and Treasury Secretary during their Senate confirmation hearings on the path forward with tariffs. Even if Trump backed down, the Rubicon arguably has been crossed, and there is no guarantee that these tariffs may not come back in the future.

3. Courts stop the tariffs (45% probability): In our view, the most likely way that the tariffs do not take effect is if a court issues a temporary, emergency injunction that pauses their implementation. Trump's use of IEEPA is unprecedented, opening it up for legal challenge. We understand that this concern has been voiced within the administration. The tariffs could be vulnerable because they are not narrowly targeted to address the fentanyl emergency, which is given as the justification.

While we have high conviction that the administration likely will be sued over the tariffs, we have less conviction about how a federal court might rule. A temporary court injunction, thereby leading to a protracted process as a challenge works its way through the courts, is very plausible. While we think ultimately the president's authority likely would be upheld (federal courts have upheld the constitutionality of Congress's delegation of tariff authority to the executive branch, and tariffs have survived legal challenges), it would delay implementation and could forestall other uses of IEEPA to invoke tariffs until legal challenges are resolved.

DB's Saravelos also highlights legal challenges as a potential issue, but points out that the Trump administration still has many other ways to impose sanctions if it wants to:

Given the highly expansive use of presidential authority under the IEEPA, impacted parties are highly likely to seek an immediate temporary injunction, similar to the restraining order on federal spending last week. The use of National Emergency powers has not been tested in this way before, so it is highly uncertain what the court reaction might be. The next few days will be a major test of presidential power and potentially cause additional market volatility. Still, even if an injunction is granted, President Trump also holds authority to impose tariffs over multiple other executive avenues, as per our analysis of the trade memo that was released on the first day of the Administration.

Some analysts — like Academy Securities’ Peter Tchir — remain optimistic that this is *still* more of a threat, arguing that the tenuous link to fentanyl smuggling constitutes a way for affected countries to get off Trump’s shitlist. Here’s Tchir:

... This round seems to have a “built-in” off-ramp, just by fighting fentanyl harder.

Bottom line is that the combination of currency shifts and the potentially short-lived nature of these tariffs seem unlikely to result in big shifts in supply chains, and with both the exporter and importer taking some short-term pain (under the assumption it will be short-lived), there could be very little impact on the consumer.

I’m prepared to be wrong about this, but I think that is the outcome, at least in the next few weeks and even months.

The big question is how adversely markets react to all this.

The dollar is already up sharply, Asian stocks are down US equity futures are looking a bit sickly, and even crypto has puked across the board. Even \$TRUMP — which actually climbed a little last night — is now down over 13 per cent over the past 24 hours, extending its rout from the January high to 75 per cent.

However, the main trading sessions (ie the US one) have yet to start, so it we don't really know what markets will make of this quite yet. Goldman's chief US equity strategist David Kostin estimates that there is a "near-term" downside risk of a 5 per cent drop, but seems worried that this might be optimistic "if investors are forced to reassess the fundamental outlook".

Large tariffs pose downside risk to our S&P 500 earnings estimates and return expectations. If company managements decide to absorb the higher input costs, then profit margins would be squeezed. If companies pass along the higher costs to its end customers, then sales volumes may suffer. Firms may try to push back on their suppliers and ask them to absorb part of the cost of the tariff through lower prices. We estimate that every 5pp increase in the US tariff rate would reduce S&P 500 EPS by roughly 1-2%. As a result, if sustained, the tariffs announced this weekend would reduce our S&P 500 EPS forecasts by roughly 2-3%, not taking into account any additional impact from major financial conditions tightening or a larger-than-expected effect of policy uncertainty on corporate or consumer behavior. Our economists describe the outlook as unclear but believe there is a substantial probability that the tariffs on Canada and Mexico will be temporary.

Our FX strategists believe tariffs would also lead to further dollar strength, although this should have a limited impact on aggregate S&P 500 earnings. In total, S&P 500 companies derive 28% of revenues outside the US. Our top-down earnings model suggests that, holding all else equal, a 10% increase in the trade-weighted USD would reduce S&P 500 EPS by roughly 2%. S&P 500 companies report less than 1% of revenues explicitly from each of Mexico and Canada.

In addition to downside risk to earnings, rising policy uncertainty will likely weigh on equity valuation multiples.

The US Economic Policy Uncertainty Index jumped on Friday to 502, a top percentile reading relative to the last 40 years. The historical relationship between policy uncertainty and the S&P 500 Equity Risk Premium suggests that the recent uncertainty increase should reduce the forward 12-month P/E multiple by about 3%, holding all else constant.

Some investors have expressed the concern that tariffs might lead to higher interest rates, weighing further on equity valuations.

Our economists believe that upside risk to inflation will likely cause a short-term increase in yields, particularly on the short end of the curve. However, they expect that ultimately the downside risk to the economic growth outlook posed by trade conflict will prevent a major increase in long-term yields.

Combining these modeled EPS and valuation sensitivities suggests near-term downside of roughly 5% to S&P 500 fair value if the market prices the sustained implementation of the newly-announced tariffs. To the extent investors believe the tariffs will be a short-lived step toward a negotiated settlement, the equity market impact would be smaller. In contrast, equities would fall further if investors view the latest tariff announcements as signals increasing the probability of additional escalation. While equity investor positioning has declined from the extreme levels reached in December — our Sentiment Indicator now registers a moderate +0.6 standard deviations above neutral — elevated economic and earnings growth expectations underscore the potential downside risk to stocks if investors are forced to reassess the fundamental outlook.

DB's Saravelos is sceptical that a nasty market reaction might deter Trump, and notes that we don't have a full grasp of the retaliatory measures yet, which can cause further legs down.

The magnitude of the market reaction itself and the extent to which the Trump administration proves responsive to it. Note that the President sounded dismissive of the market reaction in comments to the press corp on Friday night, as well as a social media post this morning, yet the market has been assuming an embedded “Trump put” in the S&P. As per our scenario analysis, we expect USD/CAD to trade potentially to as high as 1.50 after the market open (a +3% move) with larger moves in USD/MXN given the inadequate risk premium priced in. In China, the onshore market is closed due to the Lunar New Year holidays until Wednesday 5th of February complicating things. The absence of an anchor from the daily USDCNY fix and/or liquidity operations will create additional pressure on the authorities and may encourage the markets to test all-time highs on USDCNH at 7.36. The market will be closely watching official-sector behaviour. A EUR/USD move closer to parity would fully capture the risk premium around these tariffs according to our framework, without any euro-specific tariffs on top.

Beyond FX, a tariff war should be interpreted as a combination of fiscal tightening (a consumption tax) and a negative supply shock. It is therefore clearly negative for equity markets. The fixed income response is more complicated given opposing inflationary/growth drivers. It is crucially dependent on the market’s assumption on offsetting fiscal easing. Tariffs, though, should clearly lead to widening interest rate differentials between the US and the rest of the world given the negative hit on the latter is going to be bigger: for context, trade of impacted goods as a share of GDP is 45% in Mexico, 33% in Canada and only 9% in the US.

... **The response from affected countries and “tit-for-tat” escalation.** Canada has already announced reciprocal tariffs of 25% on \$155bn of US goods with a staggered implementation period and with the country having the greatest scope to retaliate given more balanced trade with the US. During the announcement, PM Trudeau confirmed that President Trump has not met with him since inauguration day, implying that there are no high-level communications. With the US Executive Order already embedding a cross-retaliation provision, there is an immediate question mark on whether this is activated. Both China and Mexico have also threatened retaliation but with no firm announcements yet. This leaves some space for de-escalation, but with a negative time decay: the longer time goes by without signs of constructive engagement and retaliation from the other countries, the longer these tariffs are likely to be assumed to be permanent — and by extension the more negative the market reaction.




Even Saravelos can't help but end his report on a hopeful note though. Alphaville's emphasis below:

To conclude, given the magnitude of the economic impact involved, we hesitate to assume that the announced tariffs will be permanent. On the flipside, we have long been arguing that the market has been severely under-estimating revenue-raising considerations, and this will incentivize the administration to have tariffs in place ahead of the US budget negotiations in coming months. We expect the market reaction to at least in part shape the US reaction function, and this will be a reflexive learning process both for markets and the Administration in coming days. Irrespectively, the most long-lasting impact is likely to be a structurally more elevated tariff risk premium in coming months impacting all of America's trading partners.

Rabobank's Marey is having none of this, arguing that markets can't be blithe about the threat any longer.

Trump has made an end to the self-delusion in markets, the media and in politics that his tariff threats should be taken with a grain of salt. It has taken him only three weeks since his inauguration to raise tariffs on Canada, Mexico and China. Meanwhile, he is threatening sectoral tariffs by mid-February and an EU-wide tariff later. And we should not forget his campaign promise to put 60% tariffs on Chinese imports, only one sixth of that has now been implemented. The Trump tariffs are here and more are coming.

Oh sorry, Alphaville just saw that Anthony Pompliano is going to put out a newsletter on how all this teeth-gnashing is wrong. Stand down folks, crisis averted.


Anthony Pompliano   




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Four truths about tariffs:

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2. Tariffs lead to lower prices for American consumers.
3. Tariffs create American jobs.
4. Tariffs lead to lower income taxes.

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