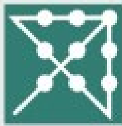

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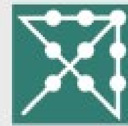

November 13, 2024

Morning Briefing

Trump Tariffs 1.0 & 2.0

Check out the accompanying chart collection.

Executive Summary: The new tariffs likely under Trump 2.0 could be means to great ends for the US by increasing the US's trade negotiating leverage—or they could backfire and cause a trade war that curtails global economic growth, which is not our expectation. Eric explains the opportunities and risks. … Also: Melissa reviews the US's tariff-related developments under the Trump 1.0 and Biden administrations and discusses Trump's plans for Mexico. … And: Joe assesses how S&P 500 companies fared last quarter in aggregate and by sector. It was another quarter for the record books, he reports, and Q4 looks poised to continue the momentum.

US Trade I: Tariffs, Solution or Risky Gambit? Tariffs are meant to raise revenue and protect the competitiveness of domestic industries. In President Trump's ideal scenario, tariffs offset lower tax revenues and prevent the federal deficit from widening, while also providing him with leverage to negotiate more favorable bilateral deals. Tariffs can backfire as a means to these ends, however, as retaliation from trading partners can decrease total imports and exports, dragging on government revenues and hurting domestic exporters.

One of the major risks to our Roaring 2020s outlook is a trade war that reduces global economic growth. That's not a likely scenario, but it could have large impacts. The Smoot-Hawley Tariff of 1930 led to the Great Depression and plunged the stock market into the Great Crash (see Chapter 2 of *Predicting the Markets*).

In short, what Trump's final trade policies will look like is uncertain at this point, but it's never too early to consider the potential impacts:

(1) *Revenues*. Tariffs raised $84 billion in customs duties over the 12 months ended September (*Fig. 1*). That represents 1.6% of total federal receipts (*Fig. 2*). That's a fraction of what taxes on individual income ($4.9 trillion, 49% of total), payrolls ($1.7 trillion, 34%) and corporations ($530 billion, 11%) bring in.

(2) *Proposed tariffs*. The proposed 60% tariffs on all Chinese imports and 20% on the rest

of the world are likely intended to be used as bargaining chips rather than revenue raisers. The leverage may be used, for example, to prevent Chinese goods from circumventing tariffs through other nations.

The tariff rate on Chinese imports (and China's rate on US exports) was roughly 20% last year, per the *Peterson Institute for International Economics*, before President Biden raised tariffs again in September (more on that below). So assuming the rate is now 30%, Trump's most hawkish proposal only doubles the status quo. Here's some back-of-the-envelope math: Imports from China were only $438 billion over the 12 months ended September. Adding back the $100 billion or so that comes through other countries' borders, and assuming no loss in trade volumes, a 60% tariff would raise $323 billion. That's just 6.6% of total federal receipts.

A blended 60% tariff rate on China and 20% tariff on the rest of the world comes out to a roughly 26% tariff rate. That would bring in around $1.1 trillion of revenue, based on current import volumes (*Fig. 3*). That would offset lowering the corporate tax rate from 21% to 15%. But for context, it would just about equal the government's net interest expense, leaving the primary budget deficit unaffected (*Fig. 4*).

(3) *Economic impacts*. We're less worried about the inflationary impact of tariffs than about the deflationary impact that would result from a slowdown in global growth. The global economy slowed before the pandemic as Trump's first trade war kicked off in 2018. That's when our Global Growth Barometer, which is based on an index of raw industrials prices and the price of oil, peaked and started to fall (*Fig. 5*). Global industrial production growth also had turned negative before the pandemic hit (*Fig. 6*).

We're hoping that tariffs will be used as a tool to negotiate better deals, and to protect key industries with national security and economic importance like semiconductors. We think it's unlikely that tariffs can raise a meaningful amount of revenues that somehow shrink the deficit—that would have to come from spending cuts.

Our biggest fear is that a trade war slows the global economy. We still don't think that's likely, however. That prospect is included in a scenario to which we ascribe only a 20% subjective probability, a geopolitical and/or domestic debt crisis. Additionally, we see 55% odds of our Roaring 2020s scenario and 25% of a 1990s-style meltup of the stock market.

US Trade II: Tracking Tariffs. The Tax Foundation's June 2024 *Tariff Tracker* reviews the tariffs imposed by the Trump 1.0 and Biden administrations, illustrating their profound global

impacts on output for a wide range of manufacturing industries as well as prices paid by US households for consumer goods.

The Trump administration initiated tariffs on goods such as steel, aluminum, washing machines, solar panels, and various Chinese imports. Most of these remained in force under Biden, with adjustments that lowered impacts on imports from Europe and raised them on those from China.

Since the tariffs were imposed in March 2018, imports of affected goods have declined, most steeply from China. But reduced imports from China were largely offset by increased trade with other nations. (See Tax Foundation chart titled "Imports Subject to Section 301 Tariffs Remain below Pre-Trade War Levels").

Let's take a walk down tariff memory lane and evaluate the contribution of different types of tariffs to the roughly $79 billion in total tariffs imposed under these trade policies (based on trade values when implemented and excluding retaliatory tariffs):

(1) *Section 301 under Trump: Chinese imports ($77 billion).* Section 301 tariffs on Chinese imports account for $77 billion of the US's $79 billion tariff total, with China's retaliatory measures impacting over $106 billion of American exports.

In March 2018, Trump imposed tariffs on up to $60 billion in Chinese goods, starting with $50 billion at 25%, adding a 10% tariff on $200 billion more in September, and later raising that to 25%. A 15% tariff on $112 billion followed in September 2019 and was reduced to 7.5% in December 2019. Further tariffs were paused under a "Phase One" deal.

(2) *Section 301 under Biden ($3.6 billion incremental).* In May 2024, Biden completed a mandatory review of the Section 301 tariffs and not only retained them but also imposed new rates of 25%-100% on $18 billion of imports for an additional tax increase of $3.6 billion (see White House *Fact Sheet*).

The following is an abbreviated list of the increases in Section 301 tariff rates imposed under Biden. These increases apply to a small share of the total $70 billion-plus collected in tariffs under Section 301 and are not a comprehensive list of all products subject to it. But the list helps to give a sense of where the Section 301 rates stand and what industries Biden targeted.

Current Section 301 tariffs applied to Chinese steel and aluminum products were raised

from the current average of 7.5% to an average of 22.5%. (Imports of Chinese steel and aluminum are also subject to the Section 232 tariffs discussed below.)

Additionally, the tariff rate on semiconductors increases from 25% to 50% by 2025; electric vehicles from 25% to 100% in 2024; lithium-ion EV batteries from 7.5% to 25% in 2024; lithium-ion non-EV batteries from 7.5% to 25% in 2026; battery parts from 7.5% to 25% in 2024; natural graphite and permanent magnets from 0% to 25% in 2026; certain other critical minerals from 0% to 25% in 2024; solar cells from 25% to 50% in 2024; ship-to-shore cranes from 0% to 25% in 2024; syringes and needles from 0% to 50% in 2024; certain personal protective equipment from 0%-7.5% to 25% in 2024; and rubber medical and surgical gloves from 7.5% to 25% in 2026.

Tariff increases in 2024 took effect in September (with exclusions for solar equipment retroactive to January 1). The United States Trade Representative provided for a comment period, which resulted in a few modifications to the above outlined *here*.

(3) *Section 232: Steel and aluminum ($2.7 billion)*. Tariffs on steel, aluminum, and derivative goods now contribute $2.7 billion in tariffs annually, while retaliatory measures from affected countries target over $6 billion in US exports.

In March 2018, President Trump imposed global tariffs of 25% on steel and 10% on aluminum. In 2020, he expanded them to cover derivatives of these metals.

Several countries secured exclusions or quotas: Australia, Brazil, South Korea, and Argentina obtained exemptions, while tariffs were lifted for Canada and Mexico by May 2019. In 2021-22, the Biden administration transitioned to tariff-rate quotas for the EU, Japan, and the UK, allowing limited imports at zero tariffs but maintaining rates on excess quantities.

(4) *WTO dispute with the EU*. Under Trump, after a nearly 15-year dispute, the World Trade Organization (WTO) authorized the US to impose up to 100% tariffs on $7.5 billion of EU goods. Starting in October 2019, the US set a 10% tariff on aircraft and 25% on agricultural and other products from the EU. In 2021, however, the Biden administration struck a five-year suspension agreement on these tariffs.

(5) *Section 201: Solar panels and washing machines*. In January 2018, Trump imposed tariffs on washing machines for three years and on solar panels for four. The Tax Foundation excludes these from its tariff totals given the broad exemptions and small

magnitudes.

Washing machine tariffs, extended through early 2023, have expired. Biden extended the solar panel tariffs through 2026, with temporary exemptions for imports from four Southeast Asian nations. In 2024, Biden removed exemptions for bifacial solar panels and ended temporary Southeast Asian exemptions.

Technical note: A 2019 Congressional Research Service *FAQ* noted that Congress has sole authority over regulating foreign commerce and previously has authorized the president to adjust tariffs through trade laws, including Section 232 (if quantities of imports or circumstances pose a threat to US national security) and Section 301 (if a trading partner is violating trade policies or engaging in unreasonable practices, e.g., China).

US Trade III: Trump 2.0 on Mexico. "Donald Trump is poised to smash Mexico with tariffs," was the title of a November 7 *article* in *The Economist*. Although Trump's Mexican tariff threats are easy to dismiss as bluster, the implications for Mexico are real. Even partial implementation of his policies could have lasting effects on trade and migration across North America.

Here's more:

(1) *Trump's Mexican agenda*. If Mexico does not curb illegal migration into the US, Trump 2.0 has said that he will immediately impose a 25% tariff on all Mexican imports. At a rally on November 4, Trump said that his first phone call as president would be to Mexican President Claudia Sheinbaum: "I will impose tariffs if [Mexico doesn't] stop this onslaught of criminals and drugs coming into our country."

(2) *Mexican fallout*. Mexico heavily benefits from trade with the US, which accounts for 83% of its exports—roughly a third of its GDP. A 25% tariff on its goods would hit hard, raising prices in the US and risking a recession in Mexico. During Trump's first term, Mexico thrived under tariffs imposed on China, attracting American companies looking for alternatives. However, now those same companies are pausing their investments in Mexico, fearing the potential consequences of further US protectionism.

(3) *USMCA concerns*. Even if Mexico avoids the blanket tariffs, the US-Mexico-Canada Agreement (USMCA)—a deal Trump himself negotiated—could be in jeopardy. Trump has hinted that as president he would revisit the agreement in 2026, particularly due to frustration over Chinese "backdooring" in Mexico. Recent changes to Mexico's judicial

system could also breach the USMCA, putting it at risk.

(4) *Migrant demands*. Trump demands that Mexico accept “safe third country” status for migrants, a stance Mexico has firmly rejected. This, along with the potential for US action against Mexican gangs involved in drug trafficking, could force Mexico into a corner.

Strategy: Record-High S&P 500 Quarterly EPS in Q3. With 92% of the S&P 500 companies having reported September-quarter results through midday Tuesday, the S&P 500’s “blended” quarterly EPS, which is composed of a mix of actuals for companies that have reported and estimates for those that haven’t, is $62.61. That’s a record high, and for a second straight quarter (see our *web pub* “S&P 500 Quarterly Metrics”). The 8.1% surprise from the consensus Q3 mean at the time of each company’s report is an acceleration from Q2’s 4.7% beat (*Fig. 7*). Q3’s blended actual EPS is also up from a consensus forecast of $60.96 at the start of the month before reporting season began (*Fig. 8*).

With 8% of the companies left to report, the S&P 500’s blended y/y earnings growth rate for Q3 is 7.2%. Q3 marks the fifth straight quarter of positive earnings growth for the S&P 500, though it’s down from Q2’s rate, when growth peaked at 10-quarter high of 11.3% y/y. On a proforma same-company basis, S&P 500 earnings rose 8.6% y/y in Q3, which is also a deceleration from 13.2% in Q2.

Joe also puts the S&P 500’s 11 sectors under his analytical lens. Below are his remarks on the sectors’ Q3 results just reported and current EPS growth expectations for Q4 up ahead:

(1) *Q3 sector EPS growth.* While the S&P 500’s earnings growth rate has slowed sequentially q/q in Q3, many sectors continued to deliver rising earnings. While Information Technology fell a hair short of its Q4-2023 record-high EPS, these four sectors hit that mark in Q3-2024: Communication Services, Consumer Discretionary, Consumer Staples, and Utilities.

Eight sectors recorded positive y/y earnings growth in Q3, down from nine sectors in Q2. Among the laggards, Boeing’s strike vectored the Industrials sector toward its first y/y earnings decline since Q4-2020; Energy’s earnings fell at a double-digit percentage rate for the fourth time in five quarters; and Materials’ posted its ninth straight quarter of declining earnings.

Here’s how the sectors have stacked up so far on a proforma basis: Communication

Services (25.5%), Information Technology (17.0), Utilities (15.6), Health Care (14.6), S&P 500 ex-Energy (11.3), Consumer Discretionary (10.9), S&P 500 (8.6), Financials (8.5), Consumer Staples (3.7), Real Estate (1.3), Industrials (-5.7), Materials (-7.2), and Energy (-25.9).

(2) *Q4 EPS growth expectations remain strong.* There has been increasing chatter about Q4-2024 EPS expectations declining at a faster rate than in recent quarters, but consensus y/y growth expectations are holding up well. Since 1993, the S&P 500's Q4 EPS has exceeded Q3's two-thirds of the time, but we believe it will miss slightly in Q4 even as Boeing's employees return to work (*Fig. 9*).

On a positive note, seven of the S&P 500 sectors are expected to record double-digit y/y percentage earnings growth in Q4. That's up from five doing so from Q1- to Q3-2024 and is the highest since Q4-2021, when eight sectors easily did so due to the pandemic-depressed year-earlier earnings in Q4-2020.

Here's how the sectors' consensus quarterly proforma earnings growth rate forecasts look now for Q4-2024: Communication Services (22.1%), Financials (17.3), Information Technology (14.6), Health Care (14.5), S&P 500 ex-Energy (12.6), Consumer Discretionary (12.3), Utilities (11.3), Real Estate (10.4), S&P 500 (10.0), Materials (3.2), Consumer Staples (-0.1), Industrials (-1.9), and Energy (-24.8).

Calendars

US: Wed: Headline & Core CPI 0.2%m/m/2.4%y/y & 0.3%m/m/3.3%y/y; MBA Mortgage Applications; API Weekly Crude Oil Inventories Williams; Logan. Thurs: Headline & Core PPI 0.2%m/m/2.3%y/y & 0.3%m/m/2.9%y/y; Initial Claims 222k; Crude Oil Inventories & Gasoline Production; IEA Monthly Report; Powell; William; Barkin. (FXStreet estimates)

Global: Wed: France Unemployment Rate 7.3%; Australia Unemployment & Participation Rates 4.1%/67.2%; Mann; Bullock; Jones. **Thurs:** Eurozone GDP 0.4%q/q/0.9%y/y; Eurozone Industrial Production -1.2%m/m/-1.6%y/y; Eurozone Employment Change 0.2% ; Spain CPI 0.6%m/m/1.8%y/y; Japan GDP & Price Index 0.2% & 2.9%; Japan Industrial Production 1.4%; China Retail Sale 3.8%y/y; China Industrial Production 5.5%y/y; China Unemployment Rate 5.1%; ECB Publishes Account of Monetary Policy Meeting; Schnabel; Baily; De Guindos; Mauderer. (FXStreet estimates)

US Economic Indicators

NFIB Small Business Optimism Index (*link*): “With the election over, small business owners will begin to feel less uncertain about future business conditions,” noted Bill Dunkelberg, NFIB’s chief economist. “Although optimism is on the rise on Main Street, small business owners are still facing unprecedented economic adversity. Low sales, unfilled jobs openings, and ongoing inflationary pressures continue to challenge our Main Streets, but owners remain hopeful as they head toward the holiday season.” The Small Business Optimism Index (SBOI) rose for the second straight month from 91.2 in August to 93.7 last month, which matched July’s reading, which was the highest reading since February 2022. The SBOI was at 88.5 in March—which was the lowest level since December 2012. The index remains below its 50-year average of 98.0 for the 34th consecutive month. In October, nine of the 10 components rose during the month, while plans to increase employment was flat at 15%. Of the 10 components, expect economy to improve (+7ppts to -5%) posted the biggest gain in October, followed by sales expectations (+5 to -4) and capital outlay plans (+3 to 22). The remaining components posted gains between 1 and 2 ppts: now good time to expand (+2ppts to 6%), current inventory (+2 to -2%), expected credit conditions (+2 to -6), current job openings (+1 to 35), plans to increase inventories (+1 to -2), and earnings trends (+1 to -33). Inflation (23%) remained the single most important problem for small business owners in October, with quality of labor (20), taxes (16), and cost of labor and government regulations (both at 8%) once again rounding out the top five. The net percentage of owners *raising selling prices* slipped to 21% in October from 22% in September after falling from 27% in June to 20% in August, while a net 26% plan price hikes in the next three months, up from 25% in September and August; it was at 33% in March. Turning to *compensation*, a net 31% reported raising compensation in October, down from 38% in June, while a net 23% plans to raise compensation in the next three months, unchanged from September though up from 18% in July.

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