April 2, 2025

# Morning Briefing

## Tariffs Are Messy

*Check out the accompanying chart collection.*

**Executive Summary:** With so much focus in the media on how the Trump tariffs can be expected to affect the US economy, Melissa today discusses how they'll likely affect other countries. Surprisingly, China may be less vulnerable than initially assumed, while the US's two North American neighbors may bear the brunt of the pain. … Also: What if the tariffs trigger a global recession? The US might outperform the rest of the world's economies in that case; it's better positioned to do so for several reasons. … And: Joe's data on analysts' estimate revisions for S&P 500 companies in aggregate suggest investors will be treated to better-than-expected Q1 earnings, possibly representing double-digit y/y growth.

**Global Tariffs I: Liberation Day's Main Event.** This *Morning Briefing* is dated April 2, Trump's "Liberation Day," the date on which the administration will unveil further tariff plans and the effective date of some already announced. While we wrote this the day before, in between April Fool's Day pranks (no, YRI is not really moving to Bali), we expect the administration's April 2 announcements will be no joke for global economies.

The challenge of assessing the risk that Trump 2.0 tariffs pose to individual nations is complicated by the intricate web of intraregional trade among nations, by China's rerouting US-bound goods through other nations to circumvent direct trade restrictions, and by the compounding effect of "stackable" tariffs, i.e., multiple layers of duties, which can significantly inflate costs. For instance, a steel auto part manufactured in China and shipped to the US could face a net tariff rate of 70% (20% for China's goods, 25% for steel, and 25% for autos). However, Melissa's research has found that, surprisingly, China might be less vulnerable to US tariff pain than Canada and Mexico for several reasons.

For instance, that would be the case if the White House's Liberation Day announcements include another "stackable" global tariff of 10% on all imports to the US. A 2024 analysis noted in several White House tariff press releases suggests that a global 10% tariff would grow the U.S. economy by $728 billion, create 2.8 million jobs, and raise real household incomes by 5.7%. However, it would likely reduce global economic growth, jobs, and household income by similar scale. Outside the US, Mexico and Canada would face the largest GDP losses from a 10% tariff on non-commodity imports to the US, an OECD analysis found. In comparison, China would suffer the least, followed by Japan, the Eurozone, and India.

Trump has also mentioned possible tariffs on copper, which could impact major global copper exporters like Chile, Peru, Indonesia, Australia, and Mexico.

The main event in the April 2 announcements is bound to be more details on reciprocal tariffs, aimed at reducing the US global trade deficit. These tariffs could be tailored to specific countries or industries or applied broadly in the form of the 10% global tariff (see our February 12 *Morning Briefing* for more on reciprocal tariffs).

To set the scene for Liberation Day, let's review the timeline of key Trump 2.0 tariff announcements so far:

(1) *China 20% tariff.* On February 4, Trump invoked the International Emergency Economic Powers Act to implement a 10% tariff on Chinese goods, raising it to 20% by March 3.

(2) *Canada & Mexico 25% tariff.* On February 1, Trump imposed a 25% tariff on goods from Canada and Mexico, with a 10% exception for Canadian energy products. On March 6, tariffs were scaled back to non-USMCA (United States–Mexico–Canada Agreement) goods, with an April 2 deadline for adjustments.

(3) *Steel & aluminum 25% tariffs.* On February 11, Trump reinstated the 25% steel tariffs and raised aluminum tariffs to 25% (up from 10%), effective March 12. Exemptions from previous agreements were eliminated.

(4) *Autos 25% tariff.* On March 26, the White House announced that beginning April 2, vehicles and car parts from other countries would face a 25% tariff. USMCA-compliant auto parts will remain tariff-free for now.

**Global Tariffs II: Impact of China Goods Tariff.** Despite the US's increased tariffs, the impact on the Chinese economy has been relatively muted so far. China's fiscal and monetary stimulus policies, along with currency depreciation, are likely to buffer the economic effects of US tariffs, reducing their impact on China's growth. Also, Trump 2.0 tariffs are incremental to legacy tariffs that have reshaped trade relations, reducing China's exposure to the US. So Trump 2.0's 20% tariff on all made-in-China goods may have a smaller effect than widely expected, at least initially.

Here’s more:

(1) *Legacy tariffs*. The US had already imposed significant tariffs on China before Trump 2.0. By January 2023, the US statutory average tariff rate was 19.3%, covering 66.4% of US imports from China, according to the Peterson Institute of International Economics.

(2) *Diminishing trade share*. The US is continuing to diversify its trade relationships over time, which entails reducing its reliance on Chinese imports. This shift will likely alter the US–China economic balance and lessen mutual dependency.

**Global Tariffs III: Canada & Mexico Bracing for Impact.** Recent research suggests that the broad tariffs on Canada and Mexico will have a more substantial impact than those on China. Brookings estimates that a 25% tariff on all goods from these countries could reduce their y/y GDP growth by over 1ppt. Other modelers have reached similar conclusions.

However, two factors mitigate these effects: First, Brookings did not consider the 10% lower tariff for Canadian energy, which accounts for about a third of Canada’s exports to the US. Second, the analysis assumes that all goods from Canada and Mexico are affected, but tariffs currently apply only to non-USMCA goods.

By April 2, all goods may fall under the 25% tariff except for Canadian energy, which remains subject to the 10% rate. This poses a significant problem for both Canada and Mexico, as the US is both countries’ largest export market.

Brookings modeled the impacts of a blanket 25% tariff, finding a substantial economic shock to both countries. Unlike the incremental China tariffs, there were no pre-existing tariffs on imports from Canada and Mexico. Additionally, Brookings observed that cross-border supply chains will exacerbate the tariff impact.

Brookings’ key findings include:

(1) *GDP Impact*. Canada and Mexico could lose around 1.15ppts of y/y GDP growth due to the 25% tariff. Job losses are projected at 278,000 for Canada and 1.4 million for Mexico.

(2) *Export declines.* Exports from Canada to the US could contract by 9%, while Mexico’s exports could shrink by nearly 14%. Exports across several sectors in both countries are expected to decline, including electronics, mining, and automotive.

**Global Tariffs IV: Targeting China Dumping to Reshore Steel & Aluminum.** The reinstatement of the 25% steel and aluminum tariffs, while removing exemptions, is focused on countering China's global dumping of excess steel and aluminum. China's overproduction has contributed to the decline of domestic production in the US.

Countries that previously had been granted exemptions—including Argentina, Australia, Brazil, Canada, Japan, Mexico, South Korea, the EU, Ukraine, and the UK—will now feel the impacts. If the tariffs succeed in curbing China's overproduction, global steel and aluminum prices are expected to rise.

Here are the potential effects:

(1) *China*. As the primary target of these tariffs, China's surplus steel and aluminum production should affect global prices less than before. China's steel, priced more for competitiveness than profit for its mills, was nearly half the cost of US steel, according to the US International Trade Commission as of September 2024. This pricing strategy has effectively pulled global prices down to approximately 75% of US prices.

(2) *Canada*, which accounted for 22.5% of US steel imports through September 2024, will also be impacted. Despite Canada's imposition of tariffs on Chinese steel, China's prices have stayed competitive, which has sparked the push for incremental US tariffs.

**Global Tariffs V: Impact on the Global Auto Industry.** The US auto industry is facing new challenges with the 25% tariffs now imposed on auto parts. Of the 16 million cars purchased by Americans, only 25% of the content is made in America. The remaining 75% will be subject to these tariffs, aimed at reducing the US trade deficit in automobile parts, which was $93.5 billion as of 2024.

Top sources of auto imports to the US include Mexico, Japan, South Korea, Canada, and Germany. These tariffs will have a far-reaching impact on the global auto industry.

**Global Tariffs VI: An American Sneeze Would Go Viral.** We recently raised our stagflation odds (which includes the possibility of a recession) for the US to 45%. The prospect of a growth slowdown from a global trade war is exacerbated by the lack of a "policy put" from the Federal Reserve and/or Trump 2.0 to support the stock market. Stocks have been hooked on stimulus and bailouts to stem crises since 2008. Americans, particularly retired Baby Boomers, have also been hooked on asset gains boosting their wealth and therefore spending. Now with falling stock prices and declining real economic activity, risk-averse consumer and business purchasing behavior could very well drag the economy into a slump.

However, European stock markets are still holding up better this year than the US market. The German Dax is up 13% ytd and near record highs, while the S&P 500 is down more than 4% and near correction territory. The UK's FTSE 100 is up 4.5% and also near record highs. China's CSI 300 is up 1.8% ytd and 8.6% over the past year. Seemingly, investors believe that the rest of the world can hold up amid a US downturn that is increasingly being priced into the stock market.

As it turns out, there's some recent precedent for this. During the dotcom bust, US real GDP growth fell from 4.8% and 4.1% in 1999 and 2000, respectively, to 1.0% and 1.7% over the next two years. Chinese growth rose from 7.7% in 1999 to above 8.0% over the next two years and 10% by 2023. While German real GDP fell to 0.0% and contracted by 0.7% in 2002 and 2003, the UK continued to grow at an annual pace of 2.0% or more throughout 2001-03 (*Fig. 1*).

The dotcom bust had a vibe similar to that of today's economy. A few preemptive Fed cuts and above-trend productivity growth were accompanied by a massive build up in hardware spending and broadband capacity that ended up outpacing demand. Bloated tech valuation multiples collapsed.

However, none of that would be the cause of a possible downturn this year. If the US enters a recession because investment stalls under uncertainty and real wages get depressed by tariffs and a weaker labor market, then foreign export-heavy economies would be crushed. Germany's manufacturing sector already struggling to compete with China, and the UK economy is essentially dealing with stagflation (*Fig. 2* and *Fig. 3*). The European Central Bank and the Bank of England have less room to cut interest rates than the Fed does, and fiscally Europe is more frugal (notwithstanding the recent infrastructure funding announcements).

Meanwhile, the US is at full employment, is a net energy exporter, and has a dynamic and flexible services-driven economy. Despite the US's worrisome federal debt dynamics, China's current bout of deleveraging is so extreme that it may take years (if not decades) to fully clean out. China's current situations has similarities to Japan's Lost Decades given the two countries' similar demographics.

In short, we think the US would outperform the rest of the world in the event of a tariffinduced recession. That’s why we are maintaining our Stay Home (versus Go Global) bias, recommending that managers of global portfolios overweight US stocks.

**Strategy: Another Strong Earnings Surprise on Tap for Q1.** Joe has been tracking the quarterly earnings forecast for S&P 500 companies collectively each week since the data series started in Q1-1994. Each reporting season brings a typical playbook: Industry analysts cut their estimates gradually until the final month of the quarter, when some companies warn of weaker results. The combination of falling forecasts for companies that have underperformed earlier expectations, steady forecasts for those holding good news close to their vests, and insufficient estimate increases so close to reporting time to balance out the lowered expectations invariably creates an “earnings hook” pattern in the charted estimate/actual data as reported earnings exceed the latest estimates—i.e., a positive earnings surprise.

In other words, the final month of quarters usually sets the stage for better-than-expected earnings reports. When earnings forecasts fall sharply during the tail-end of a quarter, earnings surprises are typically smaller. Will Q1-2025 prove true to form? Joe believes so. Below, he digests the consensus’ final outlook for the index’s Q1 EPS and earnings growth rate ahead of the earnings season:

(1) *Q1 estimate revision a touch deeper than usual.* At the end of March, the S&P 500’s consensus Q1-2025 EPS estimate of $60.11 was down 4.3% from $62.82 at the start of the quarter in January (*Fig. 4*). Downward revisions activity has been relatively quiet in recent weeks. Indeed, nearly all of Q1’s decline occurred in the first half of February during the peak of the Q4 earnings season. Since then, the consensus Q1-2025 estimate has drifted just 0.8% lower.

While the 4.3% decline in the Q1 estimate over the course of the quarter is the biggest such drop in five quarters, it’s only marginally worse than the 3.2% drop for Q4-2024—which in turn was nearly spot on the post-pandemic average decline of 3.3% since Q1-2022. Viewed from a broader perspective, Q1’s 4.3% drop compares to an average 3.9% decline over the 124 quarters since consensus quarterly forecasts were first compiled 30 years ago.

This “not-too-cold” revisions activity implies yet another strong earnings surprise will be reported in Q1. In fact, S&P 500 companies have reported an aggregate earnings beat in 62 of the 64 quarters since the Great Financial Crisis, missing only in Q1-2020 and Q4-2022. With the typical earnings hook, we’re forecasting that Q1-2025’s final EPS and growth rate will be $63 and 11.4%, respectively.

If our forecast comes to pass, Q1 would mark a second straight quarter of double-digit percentage earnings growth for the S&P 500. It hasn't posted a double-digit growth string in 10 quarters, since Q1-2022 ended a string of five quarters of double-digit growth following the pandemic.

(2) *S&P 500 earnings growth streak to reach seven quarters.* Analysts expect the S&P 500's earnings growth rate to be positive on a frozen actual basis for a seventh straight quarter following three consecutive y/y declines through Q2-2023. They expect 6.3% y/y growth in Q1-2025, compared to 13.8% in Q4-2024, 8.2% in Q3-2024, 11.3% in Q2-2024, and 6.6% in Q1-2024 (*Fig. 5* and *Fig. 6*). On a pro forma basis, they expect Q1 to represent a sixth straight quarter of positive y/y earnings growth, up 8.0% y/y (*Fig. 7*). These compare with 9.1% in Q3-2024, 13.2% in Q2-2024, and 8.2% in Q1-2024.

## Calendars

**US: Wed:** ADP Employment Change 105k; Factory Orders 0.5%; Total Vehicle Sales 15.9mu; MBA Mortgage Applications; Kugler. **Thurs:** Merchandise Trade Balance $123.0b; Initial Claims 225k; ISM NM-PMI 52.0; S&P Global C-PMI & NM-PMI 53.5 & 54.3; Cook; Jefferson. (FXStreet estimates)

**Global: Wed:** Japan NM-PMI 49.5; China Caixin NM-PMI 51.6; Schnabel; Lane. **Thurs:** Eurozone, Germany & France C-PMIs 50.4, 50.9 & 47.0; Eurozone, Germany & France NM-PMIs 50.4, 50.2 & 46.6; UK C-PMI & NM-PMI 52.0 & 53.2; Eurozone PPI 0.1%; ECB Monetary Policy Meeting Accounts; Japan Household Spending 0.5%m/m, -1.7%y/y; Schnabel. (FXStreet estimate)

## US Economic Indicators

**US Manufacturing PMI** (*link*): The ISM M-PMI in March contracted for the first time this year, as tariff concerns depressed businesses and raised costs. March's *M-PMI* dipped to 49.0 from 50.3 in February and 50.9 in January. It was at 46.9 in October—which was the lowest level since December 2023. Meanwhile, ISM's *price measure* jumped to the highest level since June 2022, accelerating from 62.4 in February to 69.4 in March; it was at a recent low of 48.3 in September. According to ISM, the *overall economy* continued its expansion for the 59th month after a one-month contraction in April 2020. (A manufacturing

PMI above 42.5 over a period of time generally indicates an expansion of the overall economy.) *New orders* (to 45.2 from 48.6) contracted for the second successive month, following three straight months of expansion, to its weakest reading since May 2023, while *production* (48.3 from 50.7) dipped below 50.0 after two months above. Prior to January's 52.5 reading, this measure was in contraction territory, below 50.0, for eight straight months. *Inventories* (53.4 from 49.9) moved from liquidation to accumulation last month. *Suppliers' deliveries* (53.5 from 54.5) remained slow last month—a reading above 50 indicates slower deliveries. Meanwhile, the employment (44.7 from 47.6) measure fell deeper into contractionary territory—falling to a six-month low.

**JOLTS** (*link*): Job openings sank in February on concerns that rising uncertainty regarding tariffs could impact labor demand. Job openings dropped 194,000 to 7.568 million (vs consensus estimate of 7.610 million), while January's level was revised slightly higher to 7.762 million from the initial estimate of 7.740 million. *By industry*, the largest declines were recorded in retail trade (-126,000), finance & insurance (-80,000), leisure & hospitality (-61,000), wholesale trade (-56,000), and health care & social assistance (-46,000), while the biggest gains were in professional & business services (134,000), construction (22,000), and transportation, warehousing, and utilities (18,000). There were 1.1 available jobs for each unemployed person for the fifth successive month. This ratio was at a recent high of 2.0 during July 2022. *Separations* include quits, which are generally voluntary separations initiated by employees—serving as a measure of workers' willingness or ability to leave jobs. *Total quits* have been on a downtrend since peaking at 4.5 million during spring 2022, falling to 3.2 million in February, little changed from its recent low of 3.0 million in November.

**Construction Spending** (*link*): Construction spending beat expectations in February, as lower mortgage rates boosted single-family activity. *Total construction* spending jumped 0.7% in February, more than double the 0.3% expected gain, following a downwardly revised 0.5% decline in January, first reported as a 0.2% shortfall. *Private construction* investment climbed 0.9%, with *residential* investment jumping 1.3% as *single-family* building rebounded 1.0%, while multi-family units were unchanged during the month. Investment in *nonresidential* structures rose 0.4%, led by solid gains in religious (4.2%) and amusement & recreation (2.6) building. *Versus a year ago*, *total* construction spending rose 2.9%, while *private* construction spending climbed 2.0%, with *nonresidential* construction rising 2.5% and *residential* building increasing 1.6%. *Public construction* investment jumped 6.0%, led by double-digit gains in commercial (53.1%), amusement & recreation (20.4), and health care (14.8) structures.

## Global Economic Indicators

**Global Manufacturing PMIs** (*link*): "Global manufacturing growth remains weak at the end of opening quarter," was the headline of the March report. The *JP Morgan Global M-PMI* continued to hover around the breakeven point of 50.0—slipping to 50.3 in March, after increasing from 49.6 in December to 50.1 in January and 50.6 in February. The report noted that *four of the PMI sub-components* had either a negative or less positive impact on its level—with production and new orders slowing in growth, while employment and stocks of purchases fell slightly. *Supplier delivery times* showed a slight positive contribution. *By country*, it was a mixed bag. Downturns in both *Japan* and the *UK* were steep, while output in the *US* declined after expanding the first two months of the year. There was encouraging news in both the *Eurozone* and *Asia (excluding Japan)*: The former showed an increase in factory output for the first time in two years as companies experienced improved domestic demand, while the latter showed production growth in mainland China reached a four-month high, while India, Vietnam, Thailand, and Taiwan also showed expansion. *By sector*, production rose in both the *consumer* and *intermediate* goods industries, though contracted for the ninth time in ten months in the *investment goods* category. *Turning to prices*, input costs rose at a rate close to February's two-year high, with part of the increase passed through in the form of higher selling prices—which reached its highest reading since June 2024.

**Eurozone CPI** (*link*): The *Eurozone CPI* is expected to ease to 2.2% y/y in March, slowing from 2.3% in February and from January's recent peak of 2.5%. It bottomed at 1.7% during January 2024—which was the lowest rate since April's 2021. Meanwhile, the *core CPI* is expected to be at 2.4% in March, down from 2.6% in February and a steady 2.7% rate from last October to this January. The headline and core CPIs are down sharply from their recent peaks of 10.6% in October 2022 and 5.7% in March 2023. *Looking at the components*, the *services* rate is forecast to slow for the third month from 4.0% in December to 3.4% by March. The rate for *food, alcohol & tobacco* is expected to accelerate for the second month, from 2.3% in January to 2.9% in March, while the *non-energy industrial goods* rate is expected to fluctuate between 0.5% and 0.6% for the sixth straight month. Among the four *largest Eurozone countries*, the CPI yearly rate for Germany is expected to slow to 2.3% in March, from 2.8% in December and January, while France's March rate is expected to match February's 0.9% rate—which is half the 1.8% rates recorded during December and January. Spain's CPI is expected to ease to 2.2% from 2.9% the first two months of this year, while Italy's is forecast to jump to 2.1% from 1.7% during January and February.

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