BLU Daily Meeting

February 3, 2025

Trump Trade War 2.0 and its Market Implications

Key Takeaways:

- **Tariffs and Market Reactions:** Recent US tariffs caused volatility in stocks, yields, and FX markets, weakening the Canadian dollar, euro, and Mexican peso. Retaliatory measures could prolong tensions, with Canada's political landscape adding uncertainty.
- **Global Economic Growth Risks:** US GDP could fall by 0.5% if tariffs persist, with supply chain disruptions worsening the impact. China faces a similar GDP hit, while escalating trade restrictions may deepen the global slowdown.
- **US Tariffs Motivation and Strategy:** Debate continues on whether tariffs are a negotiation tool or a long-term strategy. Some see them as leverage on immigration and fentanyl, while others argue they aim to close the US budget deficit. Political considerations could shape outcomes more than economic rationale.
- **Tariffs, Fed Policy, and the Dollar:** The Fed may cut rates if inflation remains low. Short-term uncertainty supports a stronger dollar, but declining global trust in the US could trigger a structural dollar downturn.
- **Equities, Trade Policy, and Global Shifts:** Uncertainty over tariffs is as damaging as the tariffs themselves, increasing downside risks for equities. The focus will shift from Mexico and Canada to China and the EU, with broader trade tensions reinforcing the transition to a multipolar world. As a result, volatility around the issue of tariffs is far from resolved.

Quick recap

The BCA strategists discussed the recent tariffs announced by President Trump and their potential impact on growth in various countries, including the US economy. They also analyzed the motivations behind the imposition of tariffs, the implications of the US's trade negotiations with Canada and Mexico, and the potential impact of tariffs on the stock market, the dollar, and bonds. The conversation ended with a discussion on the political implications of Trump's trade policies and the shift towards a multipolar world.

Summary

Discussing Tariffs and Market Impact

Mathieu led a discussion on the recent tariffs announced by President Trump, focusing on their impact on the market. He noted the volatility in stocks, yields, and the forex market, with the Canadian dollar, euro, and Mexican peso experiencing declines. Mathieu then asked a question about the potential increase in tariffs due to retaliatory measures from Canada and Mexico. Marko suggested that the likelihood of the conflict prolonging due to Canada's inability to make a deal is a problem, given the upcoming election in May. He also mentioned the risk of Prime Minister Justin Trudeau's Liberal party rejecting a deal for the sake of the country.

Tariffs' Impact on Global Economic Growth

Mathieu initiated a discussion about the potential impact of tariffs on GDP growth in the US, Canada, Mexico, and China. Peter estimated that US real GDP could fall by around half a percentage point relative to baseline scenarios if the tariffs persist, with potential supply chain disruptions adding to the impact. Jing added that the direct impact of a 10% tariff increase on China's economy could shave off about half a percentage point of GDP this year, with potential secondary impacts if the trade war triggers a global economic slowdown. Arthur pointed out that Chinese US importers have already doubled their tariffs, making the situation more significant than just a 10% increase.

US Tariffs: Motivations and Strategies

The strategists then discussed whether these tariffs were simply a negotiation tool or if they will last longer. Arthur and Dhaval discussed the motivations behind the imposition of tariffs by the US, with Dhaval emphasizing that the tariffs are a tool to secure American safety and national security. Dhaval also noted that there is an off-ramp for the tariffs if the US can convince other countries that progress has been made on immigration and Fentanyl. Irene disagreed, suggesting that the tariffs are a strategy to close the budget deficit and raise more revenue. Peter and Gary also disagreed, stating that the tariffs are not about border or drugs when it comes to Canada, and that the data does not support the US's claims. Peter and Garry expressed concerns about the US's approach to trade, viewing it as a win-lose proposition rather than a mutually beneficial arrangement. Mathieu ranked countries based on their vulnerability to the US's actions, with Germany and Japan being next on the list. Marko emphasized that the US is holding strong cards and that the negotiations are more about political victory than revenue. He suggested that the balance between negotiations and revenue-raising would be crucial for asset markets.

Tariffs, Fed, and Dollar Discussion

Mathieu initiated a discussion about the potential impact of tariffs on the market and the Fed's response. Ryan suggested that the Fed would likely react to inflation data, potentially leading to a 25 basis point cut if inflation remains low. Mathieu then shifted the discussion to the dollar, asking if it was near a peak or if the rising uncertainty would continue to push the greenback higher. Peter argued for buying the dollar in the short due to the potential worsening of the trade war. However, we warned that the decreasing trust toward the US could ultimately lead the dollar lower. Hence, he argued in favor of short-term dollar bullishness followed by a soon-to-start structural bear market. Chester generally agreed and recommended selling the dollar on strength. Marko, however, favored buying the CAD due to the potential for a trade deal with the US.

Tariffs, Equities, Trade Policy, and Global Shift

Mathieu expressed uncertainty about the stock market's future, questioning whether the market is bound to fall due to tariffs or if it can continue to rise in light of the robust state of the US economy. Peter discussed the potential impact of tariffs on the US economy, suggesting that uncertainty over trade policy could be as damaging as the tariffs themselves. He also expressed concern that the US might end up in a recession. Marko and Jonathan debated the political implications of Trump's trade policies, with Marko emphasizing the need to consider material constraints and Jonathan arguing that Trump's political incentives have changed since his first term. Jonathan also agreed that material constraints are what matters, but that the key such constrain is the stock market. Hence, at current valuations, risks were still high that equities had significant downside. Ultimately, the US may already be backtracking on Mexican tariffs, but the real threat to global growth are tariffs on China, the EU, and universal tariffs; those questions have not been resolved and it will take time to do so. Garry also highlighted that the increased uncertainty in the global environment is at odds of the low risk premia offered by assets, hence, he remains conservatively positioned. The conversation ended with Marko emphasizing the shift towards a multipolar world and the need to adapt to the distribution of power around the world.