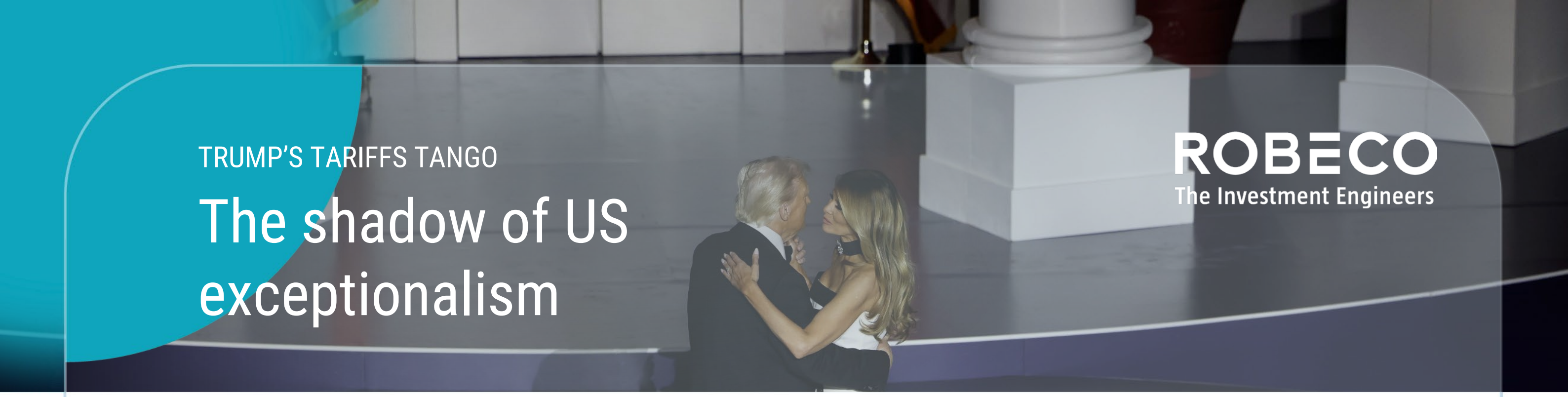

TRUMP'S TARIFFS TANGO

The shadow of US exceptionalism

- China reacts to new 104% tariff, thereby adding retaliation to US retaliation
- Analysis shows tariffs cannot conceptually work in the way they are intended
- Probability of Atlas Adrift stagnation scenario upgraded from 30% to 45%.

Wednesday 9 April is another momentous day for US trade policy and financial markets as the Trump reciprocal tariffs have gone into effect. Things are moving fast on the policy plane as a tit-for-tat dynamic is unfolding, with China now having to cope with a 104% tariff on its exports to the US, after it was slapped with another 50% tariff rate on top of the 34% original reciprocal tariff rate announced on 'Liberation Day'' on 2 April. It was a retaliation against China's retaliation. Now, China has again retaliated on this retaliation. It's dizzying.

The so-called 'Liberation Day' increasingly feels like a chokehold for markets. At the time of writing, the S&P 500 had lost more than 20% from its February peak. Bill Ackman, a hedge fund manager and supporter of Trump in his 2024 campaign, said that he assumed "economic rationality would be paramount". As things stand, rationality seemingly hasn't prevailed – at least on three fronts.

Trade deficit is the shadow of US *exceptionalism*

First, as many economists have pointed out, trade balances are the result of savings/investments ratios, not of trade policy. Actions undertaken by domestic actors (consumers, producers) matter as much as the actions of foreign entities. China's accession to the WTO in 2001 certainly posed a negative shock to the US trade balance by lowering global demand for US exports, aggravated by an undervaluation of the renminbi and state aid to Chinese exporters.

However, it is also true that easy US monetary and fiscal policy, strong foreign demand for US assets, a resulting low cost of capital and strong domestic wealth effects all led to US domestic demand outstripping domestic supply, deepening the US trade deficit. This deepening trade deficit is primarily the shadow of US exceptionalism.

Time inconsistency of stated tariff goals

Second, Trump's tariff policy is internally inconsistent, as tariffs can't be effectively used as both a negotiating tool and a tax revenue tool simultaneously. It's either luring companies back into the US to rebuild the US manufacturing base and forcing other countries to lower their tariff rates in exchange, or it means sticking to tariffs as an important revenue source, like the US pursued in the late 19th century.

ARTICLE APRIL 2025

Marketing material for professional investors, not for onward distribution

Peter van der Welle
Strategist, Robeco Investment Solutions

An erroneous execution worsening a conceptual flaw

Third, the details of Trump's tariff policy contain conceptual flaws. The reciprocal tariffs that some 60 countries now have to deal with have nothing to do with reciprocity. as they are clearly in excess of the tariffs that countries are levying the US on its exports. This excessive, retaliatory punch is the result of establishing the reciprocal tariff rate to be equal to the ratio of the bilateral trade balance a country has with the US as a percentage of imports from that country.

Only in theory (and using strong assumptions) would such a tariff rate equalize bilateral trade balances and see the US at least break even with other countries, aligning with a stated policy goal of Trump. Moreover, the formula used to calculate the reciprocal tariffs is not only conceptually dubious, but also contains a crucial error as applied in practice by the Trump administration. If this error had been spotted before 2 April, it would have left the reciprocal tariffs about four (!) times lower than they actually are.

The administration referred to a study by Cavallo (2021) to validate the numerical assumptions underpinning the formula – but the author himself pointed out on X that they apparently mixed up the numbers shown in his study. [1] The elasticity of import prices with respect to tariffs should be about one (actually 0.945), not 0.25 as the administration states, the latter being the price elasticity of *retail* prices with respect to tariffs, not *import* prices.

US exceptionalism thrown into disarray

Elements like these have quickly eroded trust in US policy making, paving the way for rising doubts about US exceptionalism, which was still the leading market narrative going into 2025. In our Expected Returns 2025-2029, 'Atlas Lifted'', released last September, we wrote that "investors should not take US exceptionalism for granted" [2] as we saw other regions potentially starting to catch up with the US in coming years. We pencilled in a below steady-state return for US equities.

The lack of economic rationality shows how much of the current US policy stance is rooted in ideology. That reduces the odds of a swift climbdown by the administration and lowers the level of a 'Trump put' to come to the rescue for financial markets.

The disruption in global trade that is building now shows that the tectonic plates of the global economy are about to shift. Our medium term bear case, 'Atlas Adrift', has come to the fore. In this scenario we foresaw an accelerating transition towards a multipolar world, creating stagflation. [3] We have upgraded the probability of this scenario now from 30% to 45%.

[1] Tariff Pass-Through at the Border and at the Store: Evidence from US Trade Policy - American Economic Association
[2] "Atlas Lifted" Expected Returns 2025-2029, p. 113
[3] See Atlas Lifted Expected Returns 2025-2029, p. 9

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