EDITORIAL

"RECIPROCAL" TARIFFS ARE BAD FOR WORLD GROWTH AND WORSE FOR THE US

Last week, the Trump administration announced tariffs against the entire world which, added to those of previous weeks, will raise the average external tariff of the United States to 22%, compared with 2.5% at the end of 2024. Financial markets have reacted extremely badly, and suggest even more serious fears for US growth than for global growth. Many unknowns remain, but this scenario is the most plausible. For the United States' trading partners, it would be better to resist the temptation to escalate and instead to double down on strengthening the engines of domestic growth. Europe is particularly well placed to do this..

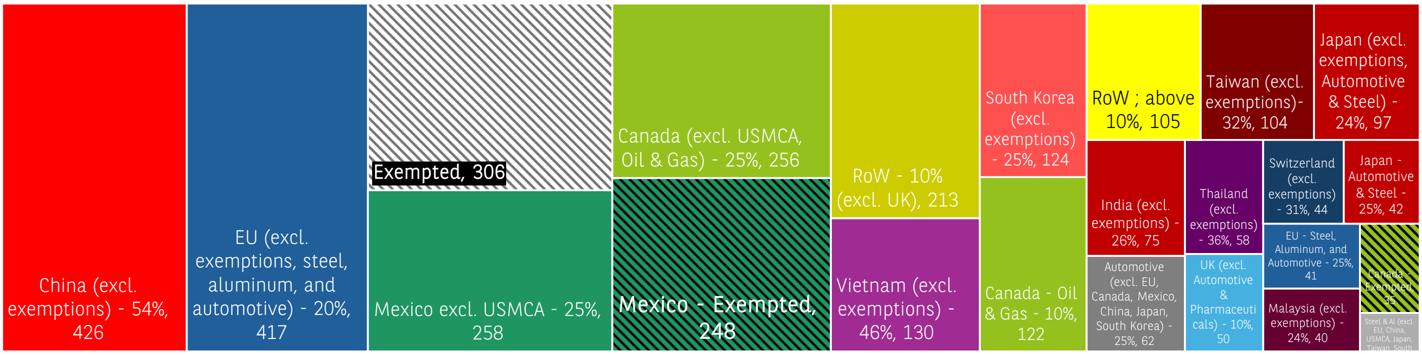
Let's recapitulate the key facts: after imposing ad hoc tariffs on Canada, Mexico and China, and 25% tariffs on all steel and aluminum imports, as well as on automobiles, on April 2 President Trump announced tariffs on the entire world (minus Belarus, Cuba, North Korea and Russia) ranging from 10% for the lucky ones to 49% for Lesotho. Contrary to what their official name suggests, these tariffs are not reciprocal but simply based on the size of the US bilateral trade deficit relative to imports. Together, these measures raise the average tariff on US imports to around 22%, from 2.5% at the start of the second Trump mandate (and 1.7% at the start of his first). Less than 20% of all US trade is now Trump-tariff-free. Poor countries and Asian countries are hit hardest, in particular China, whose exports to the US will now be taxed at 74% (potentially rising to 99% if the 25% tariffs on importers of Venezuelan oil are activated. *See chart 1*).

The reaction from markets was unambiguously bad: stock markets around the world plunged, as did oil and other growth-dependent asset prices, while sovereign bonds rallied. The moves were of a magnitude similar to those seen at the onset of the COVID lockdowns. Plainly, markets fear the so-called reciprocal tariffs will trigger a global trade war and recession. Consistent with the results of most macroeconomic models that have sought to estimate the impact of global tariffs such as those unleashed on April 2[1], markets also seem to expect the US economy to be hit hardest: the US dollar (which typically appreciates in global risk-off events) weakened sharply in the 48 hours following the announcement, and US stock markets underperformed[2]. Lower oil prices and long-term rates will be welcome by US consumers, but the former will further weaken the domestic oil industry, while much higher corporate bond yields, if sustained, will challenge the whole corporate sector.

Many unknowns remain. Speaking on the heels of the "reciprocal" tariffs announcement, Treasury Secretary Bessent argued that these tariffs provide much wanted certainty, in that they constitute a ceiling—provided trade counterparts do not retaliate. But nobody knows what scope there is to negotiate these tariffs down, nor on what basis, since there is plainly no discernible logic behind the "reciprocal" tariff rates. President Trump will be the one calling the shots, but he has said both that his tariffs were here to stay and that he would be open to revise them down if countries make him "phenomenal" offers. Moreover, more tariffs have yet to be announced: on copper, lumber, pharmaceutical products, and semi-conductors. An equally big unknown is how other countries will react. China has already retaliated with 34% tariffs on all US imports. Over 50 countries have allegedly reached out to the Trump administration since "Liberation Day" to try and negotiate a deal. The EU and the UK are considering their options. This uncertainty greatly amplifies the deleterious impact of the tariffs themselves, as households and businesses alike will be putting off any important economic decisions. The longer it lasts, the more persistent the damage will be.

1 See for example Conference Board, PIIE, Yale Budget Lab, Kiel Institute
2 See this week's Revue des marches

US TARIFF OFFENSIVE — TARIFF RATE (%); VALUE OF 2024 IMPORTS (USD BN)



Striped boxes represent Exemptions, which accounted for USD 588 bn of imports in 2024 i.e. 18% of the total - Exemptions = USMCA, Copper, Minerals, Pharmaceuticals, Semiconductors. This chart exclusively covers tariffs decided since 20 January 2025.

CHART 1

SOURCE: CENSUS BUREAU, MAISON-BLANCHE, BNP PARIBAS ECONOMIC RESEARCH.
DATAVIZ: ANIS BENSAIDANI

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How will it impact the US economy? The Trump administration's view is that these tariffs are essential to bring industrial jobs back[3], that they will therefore benefit workers, improve real wages, and will not cause inflation because foreigners will bear the burden of the tariffs. They also believe the tariffs will generate trillions of US dollars that will help fund tax cuts and reduce the US public debt. On the other hand, mainstream economists, and the Chair of the Federal Reserve, believe that the tariffs will lower growth and increase inflation. How much is hard to say. But in the case of the 2018 tariffs, various studies estimate about 60% of the cost increase was borne by US consumers[4]. Estimates of the extra costs of the Trump II tariffs for US households range from USD 1,500 to USD 2,100 per year[5]. Steel prices, including from domestic producers, have already gone up by 30% following the 25% tariffs imposed just weeks ago. As far as growth is concerned, apart from the uncertainty shocks described above, the USD 6 trillion in the value of the US stock market is bound to have a chilling negative wealth effect on the 58% of US households who own stocks, with many critically depending on them to fund their retirement. As a result, most forecasters –ourselves included—see higher odds of a US recession in the near term. In the longer run, as tariffs encourage capital allocation to less efficient producers, US productivity growth, which has been the envy of the world, is bound to fall. So will the pace at which the US economy can grow without excessive inflation. As to reducing public debt, the new tariffs imposed year-to-date could raise USD 3.3 trillion over the next 10 years, based on 2024 imports. But to the extent the Trump Administration's stated goal to reduce imports is met, then the revenue boost will be lower.

How should Europe and the rest of the world respond? Politics and public opinions call for strong retaliation. Yet, we know from history where such a posture led in the 1930s (*see the Kindelberger spiral*). Modern macroeconomic models confirm that outcomes are worse for all parties with retaliation. Of course, these assume that both the original and retaliatory tariffs remain in place. As ever, a case can be made to "escalate to de-escalate", i.e., to encourage the US to walk back the original tariffs. EU officials have noted that such moves do not need to be contained to trade in goods. Indeed, the US large surplus in exports of services, and its dependency on foreign capital inflows, can be seen as potential pressure points. This is a high-risk strategy with strong potential to back-fire.

While negotiations are ongoing, there will be calls to support the most directly impacted sectors, and providing such support makes sense to cushion the blow in the near term and hence strengthen the negotiators' hand (in the EU, care would need to be taken to maintain a reasonably level playing field across member states).

But ultimately, if the US does succeed in reducing its trade deficit (a big if, unless significant macroeconomic adjustments occur), economies that have relied extensively on US demand as a source of growth will need to find alternative ones. They will be tempted to look for other export markets, as China did very successfully since 2018. But unless the surplus economies grow their own domestic demand, this will be a zero-sum-game, or worse. As such, the EU is right to have warned China not to flood its markets with discounted goods and to contemplate safeguard measures. But it must go further and support its own domestic demand. Providentially, the single-market deepening and investment plans recommended by Mario Draghi last year and embraced by the EU Leadership since—across defense, infrastructure, energy and climate—will do precisely that, on a scale that far exceeds the US bilateral trade deficit (c. USD 230 bn in 2024). It's time to execute, using all the policy levers—fiscal, industrial, and monetary that the EU is fortunate to have at its disposal.

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3 We are skeptical this will happen, as argued here Will Tariffs Bring Industrial Jobs Back to America? See also Disentangling the Effects of the 2018-2019 Tariffs on a Globally Connected U.S. Manufacturing Sector
4 Cf for example The Impact of the 2018 Trade War on U.S. Prices and Welfare | NBER
5 Sources include the Peterson Institute for International Economics, the Tax Foundation, and the Yale Budget Lab, among others.