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How Trump's trade tariffs are likely to affect the US economy

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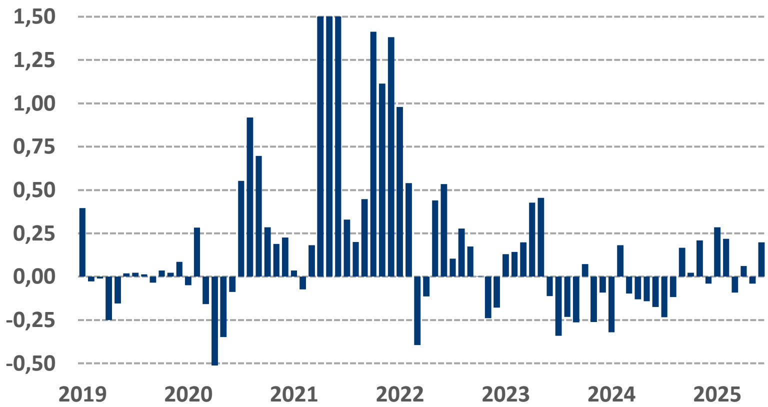
The US economy will undoubtedly be affected in various ways by Trump's new import tariffs. Inflation is likely to accelerate on the back of dearer tradables. Economic activity could be dampened by less efficient use of productive resources. And the business environment may well be hindered by heightened uncertainty about trade policy.

While the implementation of reciprocal tariffs has been delayed in many cases, potentially casting doubt on the course of this new trade war, the fact is that US import tariffs are now at their highest level in decades, but their full effects on the economy are yet to become apparent.

On one hand, recent customs revenue data clearly shows that new tariffs are already being levied on imports. The effective tariff rate is estimated to have risen 9 percentage points to date, with annual revenue from this source projected in June to total USD 320 billion (revenue from tariffs reached USD 29 bn in July alone). Despite the unprecedented shock, however, its stagflationary effects do not appear to have materialized fully so far.

Inflation is still displaying benign dynamics and continues to converge to the Fed's target of 2%, but the June data began to show a clearer impact of the tariffs on prices, with core goods inflation accelerating again after three months of low readings (Figure 1).

Figure 1: CPI – Core Goods (MoM)



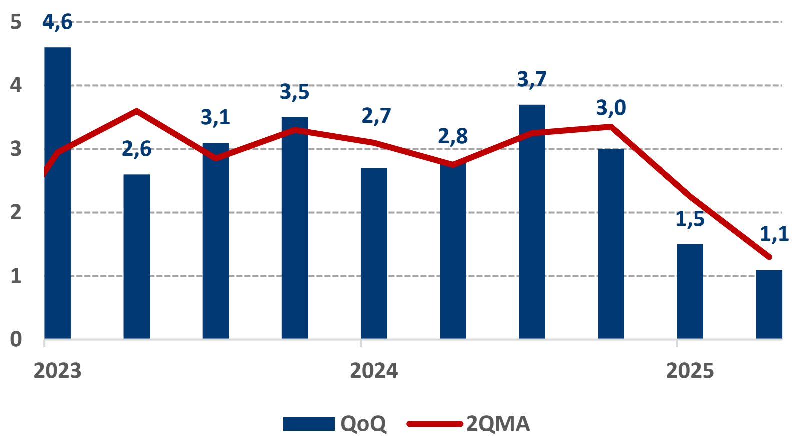
Source: BOCOM BBM, BLS

Prices of some imports, such as household utilities, rose significantly, while others, such as automotive vehicles, surprised in the opposite direction. Alongside the lower impact than expected on goods prices, services also helped keep headline inflation in check, and a decrease in US tourism drove down airfares and hotel rates.

Still, uncertainty persists regarding the size of the future rise in inflation. Data for the 2018-19 trade war shows retailers passing on most of the increase in tariff costs between four and six months after they were imposed, which suggests that higher price increases may materialize in the third quarter of this year. On the other hand, US companies' profit margins are currently about 60% higher than they were in 2018-19, enabling them to absorb a higher proportion of their extra tariff-related costs.

Economic activity remains resilient, with GDP growth reaching 1.25% in annualized terms in the first half of the year, although there were incipient signs of moderation. Final sales to domestic consumers rose only 1.1% on an annualized basis in the second quarter, down from 1.5% in the first quarter and 3.3% in the second half of 2024 (Figure 2). Similarly, non-residential investment ticked up only 1.9% in the second quarter in annualized terms, after soaring 10.3% in the first quarter.

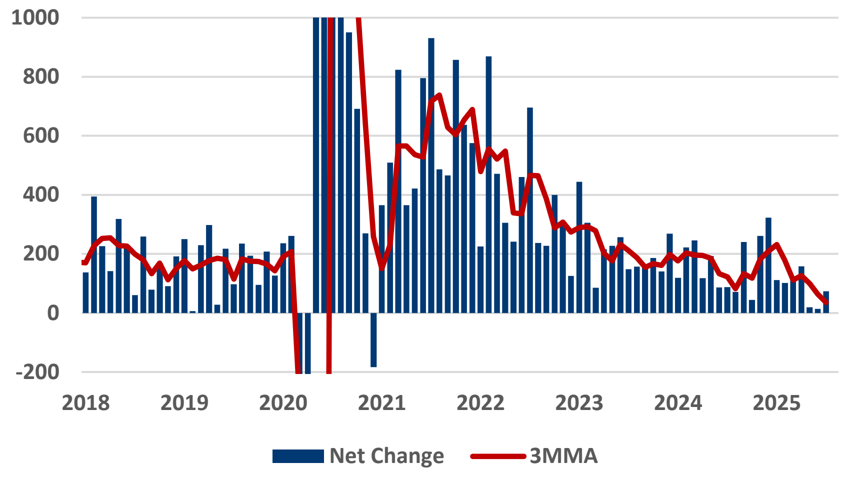
Figure 2: GDP - Final Sales to Domestic Consumers



Source: BOCOM BBM, BEA

Clearer signs of deceleration came from the labor market, which had been strongly dynamic until June. The recent trajectory of job creation displayed a significant change: the three-month moving average was revised down from 150,000 to 64,000 in June, and reaching 35,000 in July, well below the level seen before the pandemic (Figure 3). However, it should be noted that the performance of the labor market has been volatile, and that this was only the first weaker set of data after many months of robust job creation.

Figure 3: Labor Market - Nonfarm Payroll Change



Source: BOCOM BBM, BLS

The overall data points to a slowdown, but, so far, the deceleration appears to be milder than initially feared. Other factors, such as high corporate profitability, may be offsetting the negative effect of the tariffs on economic activity. In the first quarter, S&P 500 company earnings surpassed the five-year and ten-year averages, and 82% of the companies that had previously reported earnings beat market expectations in the second quarter. AI infrastructure implementation and government stimulus measures may help explain these results.

In sum, the effects of the tariffs on both US inflation and economic activity are expected to become more evident over the coming months. With regard to the Brazilian economy, meanwhile, the materialization of a more inflationary outlook and slower GDP growth in the US will offer both opportunities and risks.

ECONOMIC FORECASTS	2020	2021	2022	2023	2024	2025F	2026F
GDP Growth (%)	-3.3%	4.8%	3.0%	2.9%	3.4%	2.3%	1.5%
Inflation (%)	4.5%	10.1%	5.8%	4.6%	4.8%	5.1%	4.1%
Unemployment Rate (eoy ,%)	14.2%	11.1%	7.9%	7.4%	6.2%	6.5%	7.0%
Policy Rate (eoy, %)	2.0%	9.3%	13.8%	11.75%	12.3%	15.00%	12.0%
External Accounts							
Trade Balance (US$ bn)	36	42	52	92	66	62	73
Current Account Balance (US$ bn)	-25	-40	-42	-28	-61	-65	-55
Current Account Balance (% of GDP)	-1.7%	-2.4%	-2.2%	-1.3%	-2.8%	-3.0%	-2.4%
Fiscal Policy							
Central Government Primary Balance (% of GDP)	-9.8%	-0.4%	0.5%	-2.1%	-0.4%	-0.5%	-0.7%
Government Gross Debt (% of GDP)	86.9%	77.3%	71.7%	74.4%	76.1%	80.3%	85.1%