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Reciprocal tariffs

Investment Event | 3 April 2025

President Trump has announced 10% baseline tariff on all trade partners with additional reciprocal tariffs on a broad swathe of economies

The US average tariff rate is set to return to levels not seen since before WWII, potentially representing a significant headwind to US and global growth

Despite the announcement, policy uncertainty is set to remain elevated, implying continued volatility in investment markets

This points to an agile approach to managing portfolios. That means selectivity and portfolio resilience across geographies, asset classes, and factors

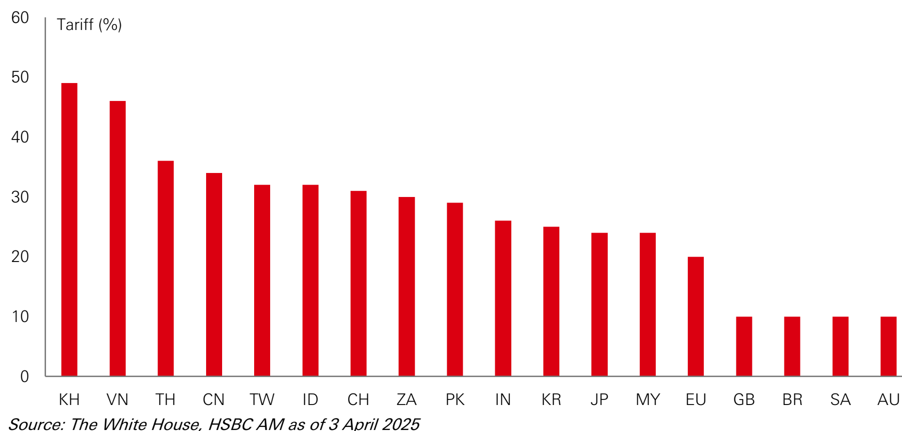
The big reveal

The US administration announced a package of "reciprocal" tariffs on its trade partners. The level of tariffs varies across countries, reflecting:

- The country in question's tariffs on imports from the US
- The US administration's judgement on the extent to which a country's non-tariff barriers, such as Value-Added Tax (VAT), limit its imports of US products.

Based on these factors, the US authorities have estimated an effective tariff rate that each country charges on imports from the US. The US will now charge a tariff equivalent to half of the effective tariffs imposed on the US by other economies, subject to a minimum 10% US import tariff. Figure 1 details the new tariffs that will be applied to a selection of economies. The global baseline 10% tariff will take effect at 00:01 ET on Saturday 5 April with the higher country-specific tariffs implemented at 00:01 ET on 9 April.

Figure 1: Announced US import tariffs for selected economies



Source: The White House, HSBC AM as of 3 April 2025

For China, these additional tariffs come on top of the 20% tariff increases already announced this year. However, Mexico and Canada have not been included in the reciprocal arrangements. At this point, they remain subject to the 25% tariffs on non-USMCA compliant goods (10% in the case of energy and potash). Once the US deems Mexico and Canada have adequately dealt with the US's concerns over fentanyl and illegal immigration into the US, the tariff rate on non-USMCA compliant trade will be reduced to 12%.

President Trump noted autos and auto-parts would not be charged the reciprocal tariffs but will be subject to the 25% tariff previously announced for the sector, which comes into effect on 3 April. Semi-conductors, pharmaceuticals, copper and lumber are excluded from the reciprocal regime but could be subject to sector-specific tariffs following investigations by the US authorities.

While the tariffs vary by country and there are some notable exclusions, this marks a dramatic shift in US economic policy that, if implemented in its entirety, pushes the average US tariff to levels not seen since before WWII. President Trump has left the door open to negotiation, but has also said any retaliatory action by other countries could result in further action by the US.

Economic considerations

Who will ultimately bear the cost of these tariffs is unclear and depends on the duration the tariffs are in place, how exchange rates move, the price elasticity of the products in question and, relatedly, the pricing power of firms. It also depends on fiscal and monetary policy responses. Nonetheless, we can say this is likely to be a significant economic shock for many countries, not least the US itself. The tariffs will inevitably put upward pressure on US inflation and downward pressure on US growth by introducing additional costs into supply chains and squeezing households' real income.

Aside from the direct impact of tariffs, we also need to consider the impact on business and consumer confidence, which can create additional headwinds to growth. Prior to the announcement, consumer confidence had faltered, and consumers had become more concerned about labour market prospects (Figure 2).

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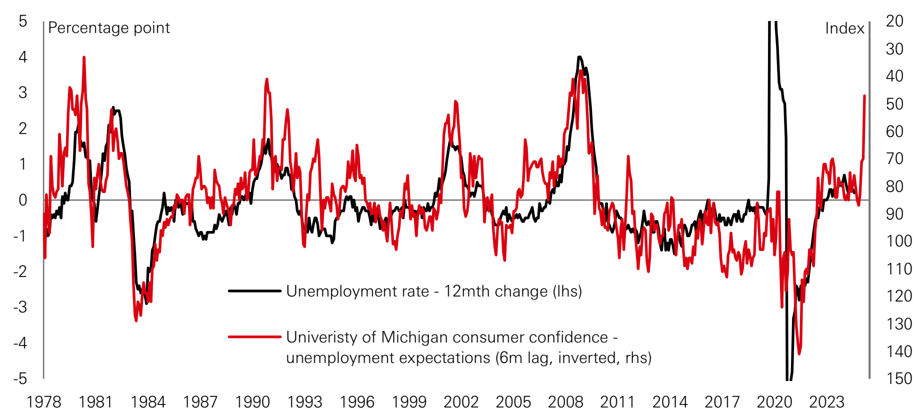
If this concern persists, the economy is at risk of negative feedback loops taking hold – slower growth begets weaker confidence, which worsens growth conditions, further undermining confidence. In such a scenario, growth would be weaker than forecasters currently assume.

Figure 2: Consumer unemployment expectations & change in the unemployment rate



Source: Macrobond, HSBC AM as of 3 April 2025

Globally, the impact of US tariffs will vary by economy, given the wide variation in duties applied. For those economies subject to the 10% charge, such as the UK, Brazil and Saudi Arabia, among others, the impact is likely to relatively limited. But other economies where tariffs are set to increase by 20-plus percentage points will clearly face more disruption, but the ultimate impact will also depend on fiscal and monetary policy responses, which are unclear at this stage.

Overall, barring an intense round of negotiations that results in a reversal of some of the announced tariff increases, global growth looks set to be materially lower than previously expected. In the case of the US, some economic models suggest we could see growth drop below 1% y/y later in 2025 or in early 2026. At the same time, US inflation could peak at close to 4.0%. This leaves the Federal Reserve in a bind. The market is pricing just over three 25bp cuts for the remainder of 2025 and a further cut in 2026. The risk in the near term is that the Fed feels compelled to be more cautious about cutting rates until it is confident that inflation expectations are well anchored. However, further ahead, it could end up cutting by more than priced in, as growth disappoints and the labour market likely weakens.

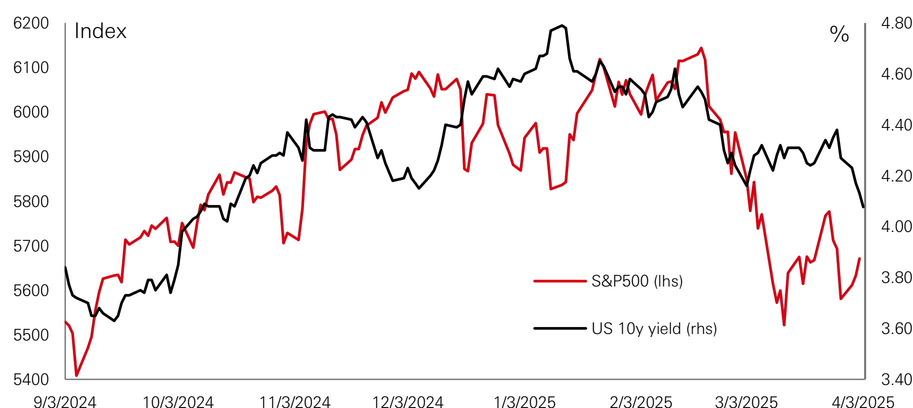
Market implications

Investors had been steeling themselves for April 2nd, the so-called "liberation day". And there's been a whiff of stagflation in market pricing over recent weeks; higher market volatility, lower US stock prices, and sticky long term interest rates (Figure 3). Meanwhile, the US dollar has been broadly weaker, and credit spreads have been rising. But after yesterday's tariff announcement, what happens next in investment markets?

The collective anxiety within the investment community ahead of the announcement shouldn't be confused with the idea that the new "reciprocal tariffs" are already priced-in. While it's true that US stocks have materially underperformed other global and emerging markets in 2025 so far, this move merely removed the hubris around US exceptionalism – the consensus view at the start of the year.

It means that the tariffs, any policy retaliation, and the economic consequences, will significantly impact investment market dynamics. In the vernacular, this is known as a "grey rhino"; investors were well aware that the rhino was there, but they just didn't know if, or when, it would charge.

Figure 3: US 10y Treasury yield & S&P500

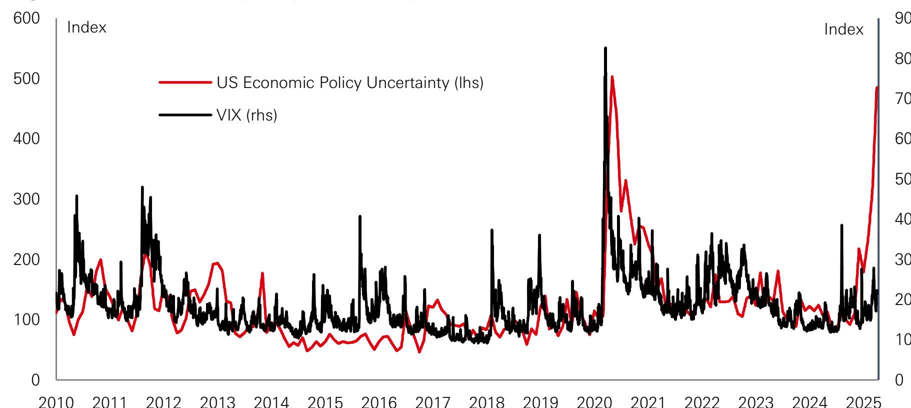


Source: Macrobond, HSBC AM as of 3 April 2025

Policy uncertainty is now structurally elevated. Some analysts had opined that "policy certainty" would return after the latest announcements. They reckoned that households, businesses, and investors would fine-tune their behaviour to a new reality. And, after a period of adjustment, everything would settle down. This perspective was always questionable, especially in the context of the size of tariffs announced yesterday.

Going forward, uncertainty is set to be a feature of investment markets, and not a bug. That's partly because the US administration has shown a willingness to re-negotiate or escalate tariffs. If investors can't be sure where tariffs will settle, it is hard to speculate on GDP and profits effects. While economic policy uncertainty is unlikely to remain at current levels, it may prove to be structurally higher, which implies more volatile markets than investors have been used two for most of the post-GFC period (Figure 4).

Figure 4: US economic policy uncertainty & VIX



Source: Macrobond, HSBC AM as of 3 April 2025

The economic effects of the tariff announcements are hard to gauge. Economic theory tells us that tariffs act as a tax, lowering growth and raising inflation (see above for our tentative assessment). But a precise estimate of these effects is very hard to make in real-time. Issues like consumers and households finding substitutes for tariffed goods, or private sector hoarding pre-implementation could delay impacts in economic data. Nor do economists know if yesterday's announcements will be fully implemented, or the shape of any retaliation.

More prosaically, the new tariffs take us another step away from the "rules-based global order" of the 1990s and early 2000s. But what the new equilibrium for the global trade system looks like remains very unclear. Investors will have to contend with high uncertainty about the new global trade regime in this different, multi-polar world.

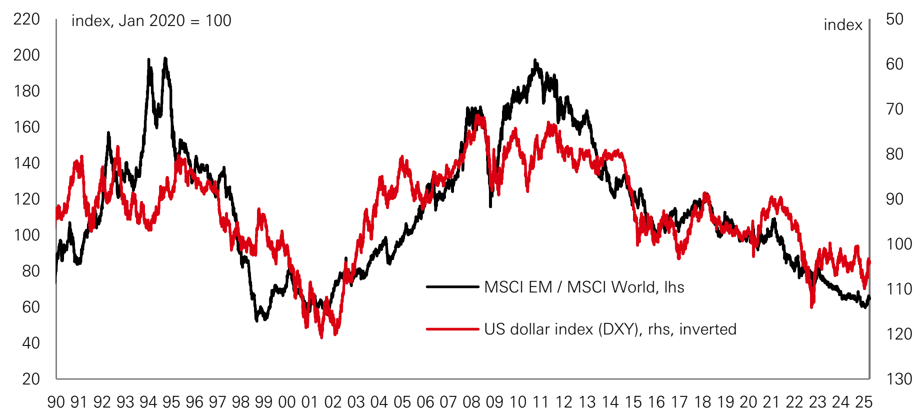
The aura of US growth invincibility, which was wrapped up in investors' notion of US exceptionalism, has been broken. So far, hard data on GDP and profits have held up. But the issue for financial markets is more about faltering investor confidence. US GDP and profits forecasts were already being downgraded before yesterday's tariff announcement. That process now looks set to accelerate. After recent weakness, US stocks have cheapened, with the S&P 500 trading on 20.5x and the NASDAQ on 25x. At these levels, some investors might be tempted to "buy the dip". The challenge with this idea is that policy uncertainty and the stagflation-lite news simultaneously lower profits expectations and market ratings. And sticky inflation postpones a pre-emptive easing by the Fed, which could've acted as a stock market shock absorber.

In terms of international effects, President Trump has set reciprocal tariffs according to the bilateral trade deficit. Can rest of the world stocks still outperform in the face of large-scale US tariffs? There were already signs that recent profits upgrades in Europe and China were slowing. And history suggests that when the US economy sneezes, the rest of the world catches a cold.

Investors need to consider three additional, important factors in the current environment. First, the emergence of new domestic policy initiatives, especially in Europe and China. These "policy puts" can support stock market performance, especially at a time when the valuations are on the cheap side of long run norms. For example, we expect that the cumulative effect of domestic policy initiatives will lift Chinese nominal GDP in 2025, after a couple of years of slowing. That's an important turning point, both for corporate profits, and investor psychology. And the emergence of viable investment themes in China tech or European defence helps sustain growth investors' interest too.

Second, will be the reaction of the US dollar. On the face of it, a stronger US dollar could offset some tariff effects. But much of the policy rhetoric from the White House has emphasised a preference for a weaker dollar. In markets, tariff announcements and rumours now foster short term dollar weakness (or at least no longer prompt outright strength).

Figure 5: Relative MSCI Emerging Market performance & USD



Source: Macrobond, HSBC AM as of 3 April 2025

Historically, a weaker dollar acts as a policy stimulus for the rest of the world, easing financial conditions and supporting global trade. Phases of emerging stock market leadership (such as the early 2000s BRICs mega trend) tend to go hand-in-hand with a weaker greenback (Figure 5). A weaker dollar today may persuade the White House that policy has been effective enough, but also create a way forward for the rest-of-world stock markets.

Third, how will trade flows and supply chains be diverted, or how quickly they can be re-adjusted? Many Emerging and Frontier Markets, especially Vietnam, benefitted strongly from a re-routing of trade from China in President Trump's first term. But globally-implemented tariffs could make a repeat of this strategy difficult.

How do recent events change the AM house view?

Our AM house view has emphasised two distinct scenarios since the end of 2024. First, a baseline scenario of "spinning around" envisaged elevated policy uncertainty driving higher market volatility, with adverse – though relatively mild – consequences for growth, profits, and inflation. Second, an alternative, downside scenario where growth and profits "topple over". Investment portfolios have been calibrated with both scenarios in mind, but with our principal attention on "spinning around".

If fully implemented alongside retaliatory measures, yesterday's announcement could bring our alternative scenario more vividly into play. However, given the numerous uncertainties at the current juncture, it's important to take some time to consider that assessment.

High policy uncertainty continues to point to an agile approach to managing portfolios. Of course, that means diversification and a selective approach that builds portfolio resilience across geographies, asset classes, and factors. Areas like the UK gilt market, high-quality credits, quality equity allocations, infrastructure, and actively-managed emerging market exposures continue to appeal.

We would also emphasise the importance of tactical portfolio management, either using convex strategies, hedge fund allocations, or active currency management (short dollar-yen, for example). These are important measures when recession risk and market downside risk are rising. And if sticky inflation means that global government bonds are a less reliable portfolio hedge.

Finally, we would highlight the importance of actively-managed private markets within a total portfolio approach, especially an asset class like private credit. We see this as a useful return driver for portfolios, and a complement to liquid market betas. Plus, an allocation to alternatives for the long run also provides investors with a way to side-step some of the emotional challenges of owning liquid assets through today's volatile and unpredictable times.

We will communicate any further adjustments to investment views in due course.

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