Trend Macrolytics, LLC
Donald Luskin, Chief Investment Officer
Thomas Demas, Managing Director
Michael Warren, Energy Strategist

MACROCOSM

Tariffs are Taxes. This is a Tax Hike.

Tuesday, March 4, 2025
Donald Luskin

There's already incipient weakness this quarter, and inflation risk. This is not good.

[This report has been corrected since its first publication this morning. Please see the note at the end.]

We've been saying two things about tariffs all year. *Tariffs are taxes*. And *wait and see*.

And last week we also said we were beginning to get worried about risks to growth (see "The Other Trump Effect: Uncertainty" February 25, 2025). We might have been right on that.

With President Donald J. Trump's imposition of 25% tariffs on $413 billion of annual US imports from Canada (except for energy goods at 10%) and $506 billion from Mexico, *that's a tax hike of $207.5 billion per annum* (see "They Called His Bluff on Tariffs" February 2, 2025). *Here's our hot take. More to come*.

We will have to wait and see who exactly ends up paying those taxes, or the taxes on the retaliatory tariffs to come. The "tax incidence" of tariffs is hard to determine. *But they are taxes, and tax hikes are bad for growth*. This we know.

We'll have to wait and see how long the tariffs last after potential challenges. The statute used to justify them, 1977's International Emergency Economic Powers Act, does not mention tariffs, and calls for congressional consultation that has not occurred.

We'll have to wait and see if the tariffs are inflationary. They weren't in the previous rounds of Trump tariffs in 2018 and 2019 (see "How Much Do Tariffs Matter?" January 28, 2025). But these are larger and more sudden. It's a special concern because, based on our monetarist model, *inflation is likely to head somewhat higher already* (see "What you're not hearing about where inflation is heading, and what it means" February 21, 2025).

Tariffing Canada's energy goods would seem to be a mistake if Trump's mission is to deliver relief from the affordability crisis of the last three years, considering that oil is a key and salient consumption item where the cost to consumers could actually be reduced. It's probably no coincidence that *OPEC announced yesterday it would, at long last, relax its long-*

Update to strategic view

US MACRO, US STOCKS, FEDERAL RESERVE, OIL: Trump imposed 25% tariffs on Canada and Mexico, amounting to a $230 per annum tax hike. Possible inflation effects will be on top of what our model expects will be a rising inflation environment this year. Tariffs on Canadian energy goods are being offset by OPEC relaxing its production quotas, driving global crude benchmarks lower. Fed expectations have shifted from inflation concerns to growth concerns, with three cuts now expected this year. Signs of economic weakness have already been materializing with the Atlanta Fed's GDPNow estimate calling for outright contraction in Q1. We see more recession risk now than at any time since the pandemic depression. Trump finds himself with these tariffs, as with Ukraine, having walked away from the table. His approval is barely holding, but stocks are trading just below where they were before the election. Will Trump listen to that feedback?

[Strategy dashboard]

Copyright 2025 Trend Macrolytics LLC. All rights reserved. This document is not to be forwarded to individuals or organizations not authorized by Trend Macrolytics LLC to receive it. For information purposes only; not to be deemed to be recommendations for buying or selling specific securities or to constitute personalized investment advice. Derived from sources deemed to be reliable, but no warranty is made as to accuracy.

standing production quotas. Global and domestic crude benchmarks are lower, despite the Canada disappointment.

After the presidential election, the Fed became very worried about the possible inflationary effects of possible tariffs (see "On the December Jobs Report, and How The Fed is Trumping Itself" January 10, 2025). But as of this writing, market-based expectations for the future path of the funds rate have relaxed considerably – now calling for three rate cuts this year, up from just one, three weeks ago – suggesting that the real issue here isn't inflation, but rather recession. *Indeed, we're seeing more recession risk than we've seen at any time since the pandemic depression*, even across all those years when the consensus was positive a recession was just around the corner.

At the same time, the Atlanta Fed's GDPNow real-time GDP estimator suddenly flipped negative on Friday, and worsened yesterday, now calling for a contraction in Q1 of 2.8% at an annual rate. That's based almost entirely on January data. So wait and see. But it's striking.

- Ironically, the biggest contributor to the estimated contraction quarter-to-date is "net exports," the difference between imports and exports – that is, the trade deficit, which now stands at an all-time record (with all of Trump's 2018 and 2019 tariffs still in place, plus former president Joseph R. Biden's new ones).
- It's worth noting that the trade data used in the Atlanta estimate is as of December. GDPNow, by construction, is an extrapolation to the entire quarter of data as it comes in throughout the quarter. Fair enough. But in this critical instance, the extrapolated data occurred entirely outside the quarter in question.

Trump is now, with these tariffs, in the same position that he finds himself with respect to Ukraine. He has angrily walked away from the negotiations. We have no idea what his purpose is. Is it to end the negotiations? Or is it to hope his counterparties will come back to the table, begging for them to be resumed? If the latter, will they? Not so far. Maybe they will.

As of this writing early in the morning, US equities are trading just below where they stood the day before Trump was elected. They traded slightly lower on January 13. In that sense, *this isn't exactly a panic. But it's not a good report card*, and it's a report card that Trump seems to care about, at least as a point of pride.

Also as of this writing, Trump's daily approval rating is hanging in there at the fail-safe point of 50%. It has never dipped below 50% so far since he took office. With the increasingly thick atmosphere of uncertainty we are seeing, and deterioration in some key economic indicators, we'll see if that lasts. And we'll see what he does to adjust course if it doesn't.

[Correction: This report has been corrected to recognize a differential 10% tariff on Canada's energy goods. As originally published, we said the 25% tariff on other goods would apply to them, as well. We were stupidly relying

Contact TrendMacro

On the web at
trendmacro.com

Donald Luskin
Dallas TX
214 550 2020
don@trendmacro.com

Thomas Demas
Charlotte NC
704 552 3625

tdemas@trendmacro.com
Michael Warren
Houston TX
713 893 1377
mike@trendmacro.energy

[About us]

AI podcast version

Click here to listen to an informal podcast version of this report made entirely by artificial intelligence. member – AI can be funky. This is still experimental. Check it out and let us know what you think.

on the White House "fact sheet" that said the 25% tariff applied to "ALL products coming into the United States" [capitalization in original] Thanks to a sharp-eyed client and friend for drawing our attention to our error].

Bottom line

Trump imposed 25% tariffs on Canada and Mexico, amounting to a $230 per annum tax hike. Possible inflation effects will be on top of what our model expects will be a rising inflation environment this year. Tariffs on Canadian energy goods are being offset by OPEC relaxing its production quotas, driving global crude benchmarks lower. Fed expectations have shifted from inflation concerns to growth concerns, with three cuts now expected this year. Signs of economic weakness have already been materializing with the Atlanta Fed's GDPNow estimate calling for outright contraction in Q1. We see more recession risk now than at any time since the pandemic depression. Trump finds himself with these tariffs, as with Ukraine, having walked away from the table. His approval is barely holding, but stocks are trading just below where they were before the election. Will Trump listen to that feedback?