

What a Difference a Day Makes

Yesterday's announcement on reciprocal tariffs was much more aggressive than expected, essentially doubling our initial forecast. The average effective tariff rate for goods entering the US is now approximately 20%. Tariffs can be much higher than that figure on some bilateral instances while the *minimum* rate has been set at 10%.

In the short term, this shock suggests an even larger price level jump and real GDP hit. Moreover, to the extent that global trade flows slow, there will likely be additional negative effects on economic output. Yet, it is too soon to tell whether yesterday's actions will lead to a recession because President Trump's transactional, dealmaking approach could lead to lower tariffs relative to the current proposed rates.

Moreover, the economy has proven to be remarkably resilient in the face of numerous shocks over the past several years — from Fed tightening, to surging inflation, to the regional banking crisis and a brief bear market in equities. Additionally, GOP passage of a budget reconciliation bill potentially around midyear could provide another prop to growth. Thus, we do not want to be overly pessimistic.

Considering the degree of uncertainty currently gripping policymaking and financial markets, the Fed is likely to remain on hold, at least in the short term. We continue to project two 25 basis point rate cuts at the September and December meetings. If the Fed is on the sidelines, then Chair Powell is going to have to dissuade strong expectations of midyear rate cuts.

In terms of numbers, we have lowered our real GDP forecast one percentage point while revising up our inflation forecast one percentage point. The unemployment rate is likely to move up, too.

As for financial markets, long end treasury rates are likely to go down more because recession fears will trump stagflationary concerns. Ultimately, the inflation rate will move substantially lower, too.

SMBC Nikko US Economics Outlook			
% YoY	2025 Forecast	Previous Forecast	Post-Tariff Shock
Real GDP	1.4%	2.4%	-1.0%
CPI	3.5%	2.5%	1.0%
Core CPI	3.8%	2.8%	1.0%
Unemployment	4.5%	4.1%	0.4%
UST 10-Year	3.75%	4.25%	-0.50%

Source: SMBC Nikko

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