Research
Economy Watch

7 April 2025

Trump's Terrifying Tariffs!

- **Market turmoil as tariffs surprise**
- **US consumer will be hit hard**
- **Global growth under pressure**
- **Uncertainty the real killer**
- **Awful timing for RBNZ decision**

The actions of one President Donald Trump simply beggar belief. In a matter of days one man has almost single-handedly knocked the world economy off its pedestal. Disruptors are a necessary part of both economic and social evolution. They are invaluable at leading change when society is stuck in the status quo. But what we are witnessing right now is simply something else!

While the implications of the US Government's tariff approach are staggering, perhaps what is more bothersome is that Trump's actions are forcing us all to re-evaluate the role of the United States in the world. The US has for many decades been seen as an anchor when global shocks have hit. Even when the US has been at the centre of those shocks, the world has turned to it, and its Federal Reserve, to provide guidance and stability. That's a key reason why the USD typically appreciates in times of global shock and uncertainty no matter its source. The fact that the USD has weakened this time around, notwithstanding a bounce late last week, is a clear sign it has lost some of its mana.

Moreover, the US has been seen as the defender of democracy, rules-based systems and free trade. And, to cap things off, the US constitution has been held up as something that would prevent concentration of power. In its simplest sense Congress has the power to pass laws, the President administers the laws, and the judiciary has the power to interpret and enforce the laws.

Rightly or wrongly, the rest of the world is currently wondering what is going on in this space. A concern that was first raised when President Trump initially utilised the National Emergencies Act to impose tariffs on Canada and Mexico.

We do not pretend to be experts on the US constitution nor its law-making process but we can report that there exists as much concern in financial markets about the process driving current decision as the decisions themselves. In short, the US now has a major credibility issue.

This credibility issue was intensified when details as to how the tariffs were calculated was made public. In short, the bigger your trade surplus with the US, as a ratio of the exports you send there, the bigger the effective tariff you are accused of placing on the US. In New Zealand's case the US suggested our effective tariff on their exports to New Zealand was 20%. No matter how you measure our actual tariffs and non-tariff barriers this seems nonsense. Fortunately, the US then halved the estimated amount before settling on a 10% tariff rate for New Zealand.

Incidentally, if you happen to run a deficit with the US they do not voluntarily agree to compensate you in a symmetrical fashion but, rather, they simply impose a 10% tariff on you for good measure.

We have always argued that for New Zealand the biggest risks around tariffs were not the direct effects but the indirect effects. This remains our view.

In the first instance, the impact of tariffs will fall most heavily on the US consumer. The prices of imported goods will rise and be passed onto the consumer. Some global suppliers may absorb some of these costs through lower margins but, ultimately, there will be a significant number of goods for which there is no immediate substitute so cost increases will be a direct impost on US citizens. In the longer run the US hopes its producers may substitute for what is currently imported but this will take time and such production is still likely to come at a higher price than is the case for imported goods now.

So, initially, at least, higher inflation for the US and lower growth. Federal Reserve Governor Jerome Powell has already warned of the initial price effects and cautions, rightly in our view, that inflation could persist for some time. If so, this means interest rates in the US are likely to be higher than would otherwise be the case further denting US growth. Trump's response to this was "cut interest rates, Jerome, and stop playing politics".

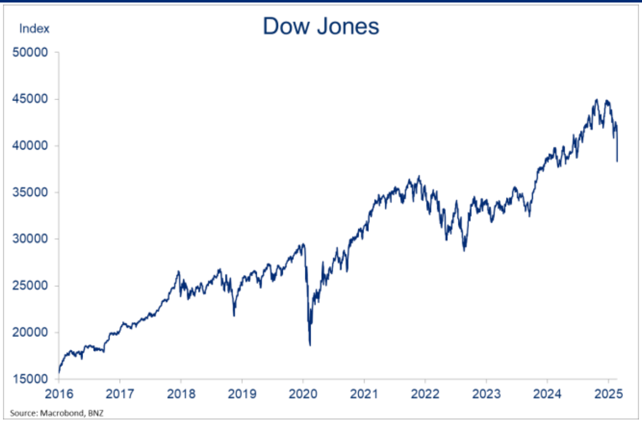
Slower US growth is bad news for all but the potentially worse news is the negative impact it might have on suppliers of goods to the United States. This is particularly problematic for New Zealand as we export a disproportionate amount of our goods to developing Asia, the economies of which, especially China, are facing the highest tariffs. Weaker Asian growth means weaker New Zealand growth.

But the real game changer will be if other nations start applying tit-for-tat tariffs on the United States. Already the Chinese have announced a 34 percentage point increase in tariffs on US goods. It seems like the European Union will not be too far away from doing something similar. This can only add further to inflationary pressures in the countries that impose the tariffs and further impede global growth.

For a country such as New Zealand there is no point in playing this game. Imposing higher tariffs on imported goods would, like everywhere else, add to domestic inflation and weaken growth. There is nothing to gain.

So the global growth environment is now fragile. The sense of this fragility becomes self reinforcing when market pricing starts to reflect the concerns. Take for example the huge declines in equity markets around the planet. Not only does this add to uncertainty but it creates wealth effects that further diminish consumer spending. Ironically, US consumer spending is significantly influenced by its equity market performance because a decent chunk of household wealth in the US is held in that form. In New Zealand's case our relatively low holding of international equities will cushion the blow albeit that our exposure has risen aggressively since the establishment of Kiwisaver.

Ouch!



But is doesn't end here. Uncertainty in and of itself is a major constraint on business fixed capital formation (investment). We would expect the investment component of the national accounts data of many countries to take a hit. The US may be an exception here if investment in domestic businesses rises. In New Zealand's case we already have a business community that is facing into excess spare capacity, margin pressure and local political uncertainty. The last thing it needs now is this tariff fiasco. We fear that our current forecast pick up in economic activity may yet be further delayed.

The uncertainty takes many forms:

- What will be the tariff responses around the world?
- How much will it really affect prices and volumes?
- Will there be positive substitution effects for some countries that end up delivering benefits?
- Is this the end of the US as the economic cornerstone of the world's economy?
- Will China take up that mantle?

But perhaps the biggest uncertainty of all is, are these imposed tariff measures sustainable? Will the legislature or Congress eventually provide the moderation that one might expect of them? What will happen to the support of the current government when the expected economic downturn in the United States takes hold? Will the shape of Congress change following the mid-term elections? And, is this policy path sustainable when President Trump finally departs the Oval Office?

Who knows?! But what is clear is that the United States will be viewed through a very different lens for a very long time.

From a New Zealand perspective, we are going to have to be more reactive to events than proactive in our analysis of the economy. Understanding risk will take precedence over a fraught forecasting process. Nothing is a given including the extent and the duration of the tariffs currently imposed on us. And for specific products substitution effects on both exports and imports will be important to understand and measure. For example, higher tariffs on competing exporters of meat and wine might aid these sectors. And because Asian exporters now have less access to the US they might redirect product at discounted rates to our shores?

Probably the best we can say is that there is a clear risk we need to downgrade our growth expectations but there is two-way risk for inflation. One thing's for sure, unintended consequences and unexpected reactions will come thick and fast. Take for example, OPEC+'s decision to increase oil supply. Oil prices have slumped, which adds a clear disinflationary pulse to the world, generally, and New Zealand specifically. But what was the motivation here? Some say it was to appease Donald Trump who was demanding lower oil prices. Others have a more conspiratorial view in suggesting that OPEC is lowering prices to a level that will make US drilling costs seem prohibitively high.

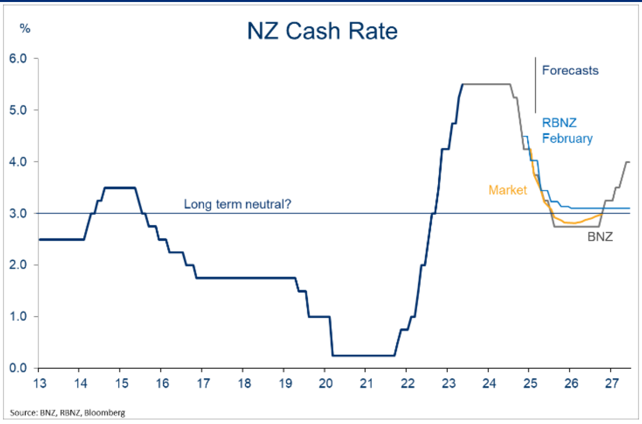
So what does the Reserve Bank of New Zealand do with this on Wednesday? It's hard to believe they will have any greater clue as to what is around the corner than do we or anyone else. And this is not a simple modelling exercise that can be run in the manner that some shocks might provide. Indeed, to start with this is yet another supply shock, and we know from recent past experience that central banks are not well placed to deal with such things.

In our opinion, the best thing that the Bank could do is to keep a very steady hand on the tiller. This means following through with the 25 basis point cut it had suggested when it met back in February.

Where things might well change is in the rhetoric about where to next. Surely the Bank must acknowledge what is going on now and the uncertainty this brings. In so doing, we would not be surprised if its musings about where to next were left wide open. Were this the case we would not read the text as indicating the Reserve Bank thought it had done enough just that it was acknowledging that it would use the time between now and the May Monetary Policy Statement to try to make sense of what is going on.

As you would know, we have been picking a 2.75% low in the cash rate for almost two years now. One of the reasons why we kept to our non-consensus view was the fear that the tariff news out of the States could only be bad. We'd not really pondered it being quite so tempestuous, but we feel our fears have been vindicated. It is our over-riding view that what we are seeing presents a big headwind to growth no matter where it all finally ends up. On this basis we see no reason to change our view at this juncture but, like everyone else, we will be watching the evolution of this nightmare very closely, mindful that while it may argue for higher interest rates it could, yet, also present some downside risk. For the record, domestic financial markets have certainly taken on board the downside risk in finally pushing the expected OCR track sub 3.0%.

Market reprices lower

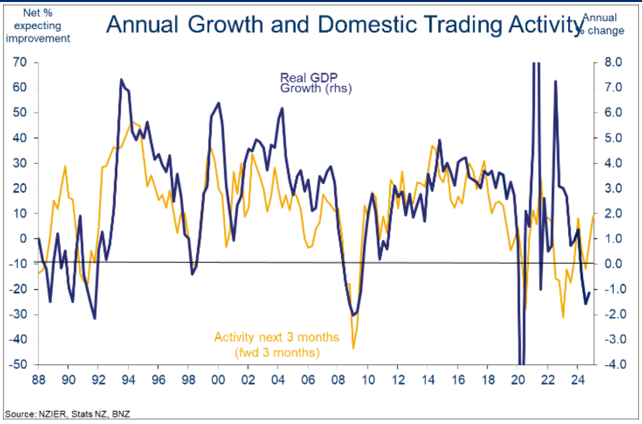


There are other data out during the week. Some might say who cares? And they may well have a point but we would still argue that some focus on domestic affairs is still warranted.

On Tuesday is NZIER's March Quarter Quarterly Survey of Business Opinion (QSBO). We will be looking for further signs the economy is, or at least was, on the mend. The QSBO does not contain the same insights into the agriculture sector as does the ANZ business survey so it may appear a little weaker than last week's ANZ offering given that agriculture and commodity prices are the driving forces of New Zealand's current economic progress.

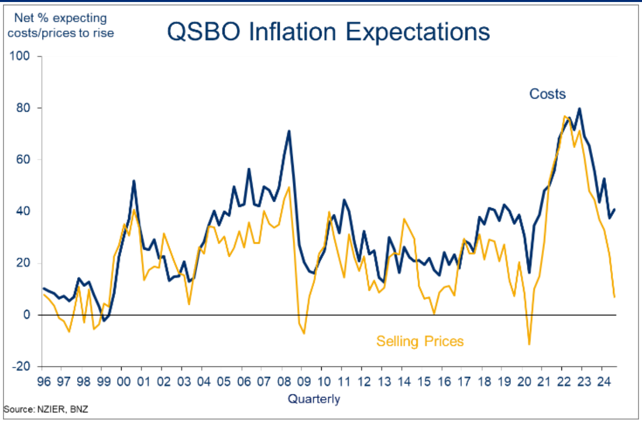
Any signs in this survey that own activity is not pushing higher would be worrying. Seasonal adjustment of this series has been fraught with danger given the noise in the data over the last few years but, to the extent we can adjust appropriately, we'd be hoping for a seasonally adjusted own activity indicator of at least +10 to be consistent with our forecast modest growth rebound.

More confidence please



Of real interest will be the pricing intentions series. The ANZ and QSBO series have been moving in diametrically opposite directions, QSBO down and ANZ up. The former says the RBNZ has nothing to worry about, the latter suggests a little bit of nervousness is warranted. We are hoping the QSBO stays true to form.

Can this be sustained?



On Friday we get the March BNZ-Business New Zealand Performance of Manufacturing Index (PMI) followed up with the Performance of Services Index (PSI) on Monday. The PMI has sprung into positive territory over the last two months while the PSI has returned to a sub 50 position. The composite index suggested economic growth pushing up to around 2.0%. We hope to see more of the same.

If either the QSBO and/or the PMI/PSI combination suggest a weakening in growth we will be very concerned given that these surveys will be reflective of pre-tariff expectations and experiences.

Keep an eye out for HLFS Working Age Population on Wednesday. Our view is that net migration inflows are troughing and that, consequently, the labour supply will start to grow more rapidly than the Reserve Bank has assumed. With labour demand still weak, and the QSBO should reinforce this, the population data should provide some support to our view that the unemployment rate will end up higher than the Reserve Bank currently forecasts. This, in turn, will help keep downward pressure on labour cost inflation, CPI inflation and the cash rate.

Talking of the CPI, Statistics New Zealand will announce changes to the CPI weights on Thursday. Depending on the details, this has the potential to affect CPI forecasts for the year ahead at the margin.

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