Bank of Nassau
SINCE 1982

Weekly Economic Flash

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"I am a tariff man, standing on a tariff platform."

President William McKinley

Markets should brace for more tariff headlines in the coming days. With the US-Iran conflict still raging, we suspect markets may just give a collective shrug to yet another round of tariffs. They shouldn't, though, as tariffs would add to the uncertain inflation outlook.

Background

Recall that after the Supreme Court ruled back in February that President Trump's reciprocal tariffs were illegal, the administration pledged to replace them with tariffs that would be justified by USTR investigations and thus harder to overturn. Until those investigations were completed, the administration quickly announced a temporary 10% global tariff under Section 122 of the Trade Act of 1974. Those tariffs were found to be illegal by the US International Trade Court back in June. However, because they are set to expire at the end of this week, the decision was not appealed to the Supreme Court.

New Tariffs Ahead

Reports suggest the administration is poised to announce a slew of new tariffs soon. Recall that the USTR opened a Section 301 investigation back in March into goods made with forced labor. The USTR announced the preliminary results in June and identified 59 countries as well as the 27 members of the European Union as having failed to counteract trade in goods produced by forced labor. It also issued the likely tariff rates for those countries. However, in order for those tariffs to kick in, the USTR must first issue its final report.

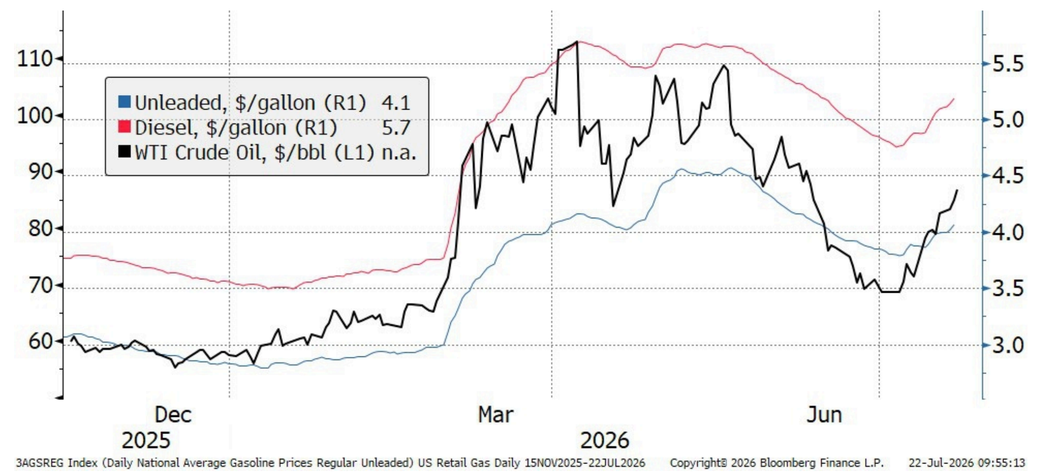
The Yale Budget Lab estimates the current average tariff rate at 12.1%, then falling to 9.8% when the Section 122 tariffs expire. If the threatened Section 301 tariffs go into effect, it estimates that the average tariff rate would rise to 12.8%. Of note, there is a separate Section 301 investigation regarding industrial excess capacity that remains ongoing. This also poses upside risks to the average tariff rate. Inflation appears to have peaked in May but these tariffs will cloud the outlook.

US CPI, % y/y

Economic Implications

According to the Yale Budget lab, the tariffs announced so far this year will add about 0.3 ppt to headline inflation. If the Section 301 tariffs are fully implemented, it estimates that the impact would more than double. With inflation still running high (and with growing upside risks due to the renewed surge in energy prices), this simply adds to inflation risks ahead. In terms of household budgets, the Yale Budget Lab estimates average household costs of $550 per annum currently and rising to $1100 when the Section 301 tariffs go into effect. Herein lies the stagflationary risks of an energy shock: household budgets get squeezed from rising fuel prices, which in turn leads to reduced consumption of other goods.

US Retail Fuel Prices



Policy Implications

The new tariffs would come at a time when energy prices are rising again due to renewed hostilities between the US and Iran. Crude oil prices are the highest since early June and are still rising. Same goes for retail gasoline prices in the US.

As a result of the growing inflation risks, the Fed is likely to remain in hawkish mode. After the better than expected June CPI data, Fed Chair Warsh pointedly said that "There might be some who look at this morning's data and say, 'Well, mission accomplished, everything is swell.' That is not my view." The FOMC meets next week and we expect another hawkish hold. For now, the Fed can focus on its price stability mandate. If tariffs and rising energy prices lead to a slowdown in the US economy, the policy dilemma emerges. That said, the US economy remains much more resilient than most expected at the start of this year and so we see steady rates from the Fed in H2.

US Rates