Citi Wealth

Investment Strategy *Bulletin*

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US Hikes Import Taxes Ten-Fold to Deglobalize

Shock and awe

The Trump administration's April 2 tariff announcements surprised the market with their scale and their breadth. Our best estimate is that full delivery of these tariffs would increase 2024's effective tariff rate by 10X, to nearly 25% - meaningfully higher than the 10-15% range being discussed by the investment community before the announcement. Our best estimate is that these policies would generate a $750 billion increase in US taxes in the year ahead, amounting to a fiscal tightening of 2.5% of GDP. The effects from such a large spike in import taxes, if not negotiated away, has the potential to wipe out US GDP growth in 2025. Even still, the extent of trade retaliation, additional tariffs, and legal challenges is yet to be seen.

Market reactions: the first 24 hours

Global equities plummeted in the overnight trading session as investors reduced risk and the selling followed through the trading day on Thursday. The large-cap S&P 500 closed down 4.6% on the day and the small-cap Russell 2000 fell more than 6.5%. Bond yields fell across the world with investors flocking to safe havens amid rising fears of recession. Credit spreads continued to widen, though have only returned to late 2023 levels. Perhaps most notable is the move in FX markets. The US dollar has traded sharply weaker versus other major currencies, a striking reversal of the "American exceptionalism" narrative that dominated most post-election analysis. We view these extreme market reactions as a rational response to policies that will present significant headwinds to growth and confidence in the near term.

Tariff next steps

This week's announcements were only the beginning of a critical phase of tariff negotiation and implementation. As of today, broad-based 10% tariffs will be imposed on April 5, and more targeted measures will take effect on April 9. In theory this opens up a window for major trading partners to negotiate with the US. However, we are skeptical that global leaders will immediately rush to offer aggressive concessions. The administration has also promised further tariff announcements covering semiconductors and pharmaceuticals, which could further ratchet tariff rates for countries like India, Ireland, Switzerland, and key chipmaking nations in Asia.

Earnings on our radar

Even if the tariff-induced volatility calms, the near-term calendar is packed with equity catalysts as 1Q25 reporting season kicks off on Friday, April 11. While the earnings releases may be history, companies will have an opportunity to update the analyst community on their forward guidance and tariff mitigation strategies. We believe the tone and content of earnings calls will be infinitely more important than the results from the first three months of this year. We are particularly worried that some firms will pull guidance completely amid the uncertainty, leaving analysts in the dark about the trajectory for sales and profits over coming quarters. It is hard for us to imagine how companies will be able to reassure investors while the policy environment and growth backdrop are evolving so quickly. Without a meaningful amendment to April 2nd's tariff plan, profits could be wiped out for this year.

Bottom Line

Even at significantly lower prices than we first delivered the message to wait to add to risk, we are reiterating that same advice. Given the heightened uncertainty on growth, policy, and earnings, we expect that even high-quality equities will remain under pressure in the near term. Investors who are holding on to hope of a swift rescue from monetary or fiscal policy support will likely be disappointed. In fixed income, we are increasingly concerned about a deterioration in credit and prefer short duration bonds and cash to long duration Treasuries.

Ring Fencing the US from Competition

With the largest one-day drop in the US equity market since 2022, readers will know that financial markets did not cheer after President Trump's "liberation day" tariff announcement. We have several observations to consider for the economy and portfolio allocations in the future.

1) US equity markets are falling much more than the world at large. This reflects investor positioning after the grand outperformance of US shares last year (+19 percentage points) and initial optimism that US policy would further support routine US growth outperformance. Instead, by curtailing foreign supplies, the US is effectively reducing its non-inflationary growth potential, at least over the short run. (As we write, US equities are off 8% for the year, while non-US equities are up 6%).

2) A slowdown in US imports will soon have a negative impact on foreign economies, but the US has taken a great deal of the pain on itself by raising tariffs on every trading partner all at once. To some extent, economies from China to the EU will stimulate domestic demand and seek new trade accords away from the US. **While foreign economies might harm themselves with their own tariff increases, retaliation across the world will be solely focused against US interests**. As the initial shock of the new tariffs is felt, the US dollar and related assets have justifiably underperformed.

3) **The Trump Administration seeks to reshape the US economy**, with goods production paramount. As we've discussed previously in our March 29, 2025 Bulletin, a rise in manufacturing output won't necessarily result in higher employment in goods-producing industries given a perpetual rise in automation (see **FIGURE 1**). US industries that use foreign inputs employ far more workers than goods-producing industries (see **FIGURE 2**).

4) The high-income US economy is fully employed and asset wealthy despite a chronic trade deficit since 1974. **The world economy has not evolved for every country to have a balanced trade account with every other.** Relative growth rates matter. Relative advantage in producing particular products means "self-sufficiency" drives have generally harmed growth. While non-tariff barriers are important, the "reciprocal" tariff calculation bears resemblance to the actual tariffs on US exports for most countries (see **FIGURE 3**). Therefore, it may be hard for many countries to bargain for lower tariffs.

5) **US firms have benefited from globalization more than most others, producing wherever most cost efficient and selling wherever demand is strongest.** As the US trade deficit expanded, so did the US market cap share of the world (see **FIGURE 4**). While there will be some areas of concentrated damage to foreign firms, we see US firms bearing the

brunt of the tariff and retaliation impact. It is unclear at this point how much of the tariff impact US firms will pass on in terms of higher prices or instead absorb in the form of profit declines. If sustained, we believe the large and expanding tariffs are enough to completely erase S&P 500 EPS growth this year. In response, US employment and investment growth will also slow in the current year even as the economics of "onshoring" production improves.

6) With the increase in tariffs well ahead of any moderate net income or corporate tax cuts next year, **US fiscal policy will now be net tighter than an unchanged tax baseline.**

7) **A fiscal tightening supports the US Treasury market.** Many routinely question the US budget deficit trajectory. The US administration has chosen a dramatically higher import tax to finance the US government, similar to a broader VAT used by others.

8) **The Fed will likely wait for price spikes to be passed on to consumers and observe how demand responds before easing monetary policy.** The tariffs are not recurring monetary inflation. Easing into an inflation rate above target will be difficult for the Fed, but the FOMC will likely argue that a deterioration in labor markets will offset the rise in the future. We believe short-term interest rates will have difficulty falling much further unless the US economy spirals down with far more negative impact than cuts to trade and inventories.

9) **Despite an 11% decline in the S&P 500, the two-year return for large cap US equities is still a strong 33%.** One could expect opportunities to arise as markets grasp to price in forward impact on the economy and profits. As we highlighted recently, US software shares have fallen as much as US retailers despite far more negative tariff impact for the latter. **When equities with higher-quality balance sheets and profitability suffer in great sympathy with vulnerable cyclicals, opportunities arise** (see **FIGURE 5**).

FIGURE 1: US manufacturing production vs manufacturing employment

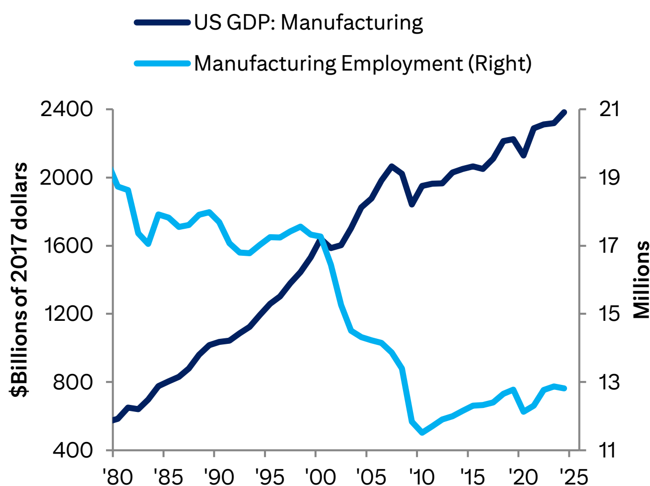
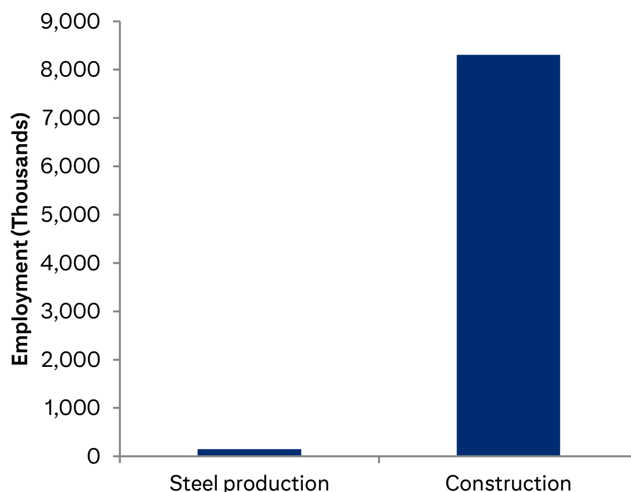


FIGURE 2: US steel industry employment vs construction

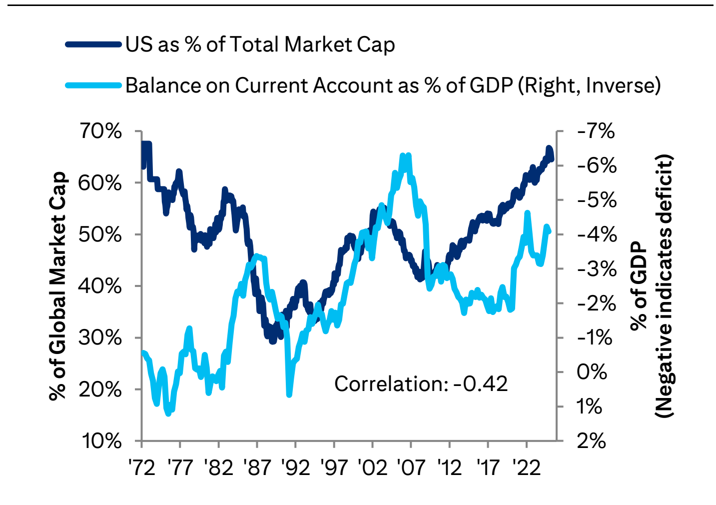


Source: Haver Analytics as of March 31, 2025.

FIGURE 3: US reciprocal tariff rates and import levels for key trade partners

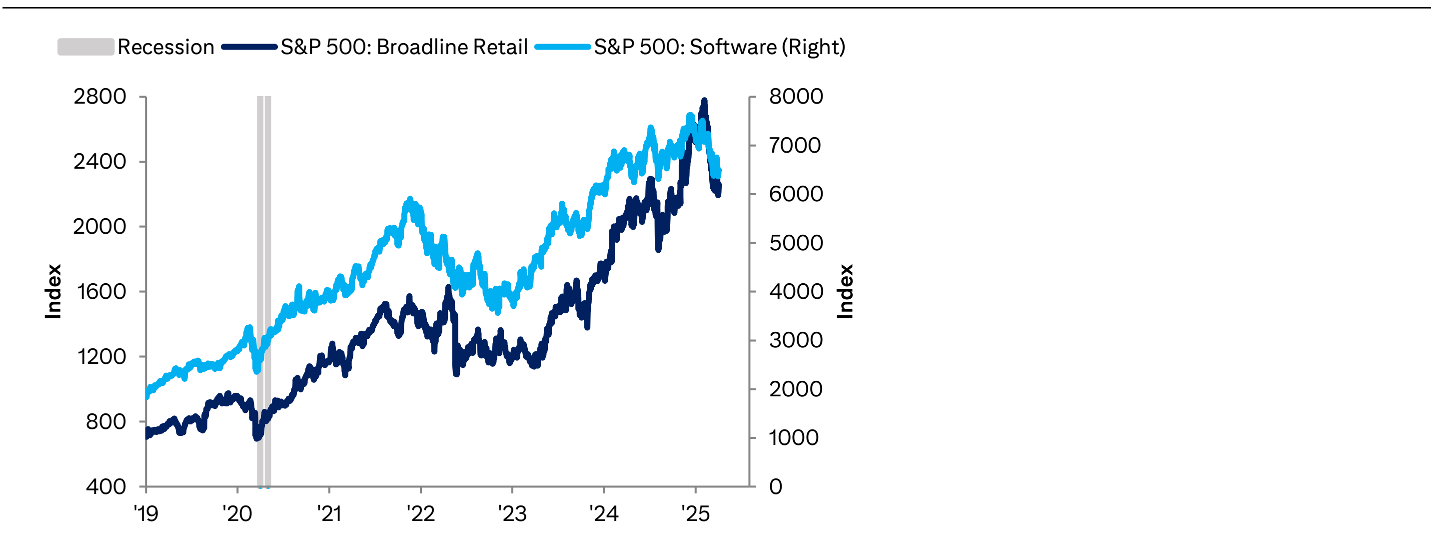
Top 10 US Trade Partners (%)			
Trade Partner	Trade Partner's Effective Tariff Rate on US	US Tariff Rate Announced by President Trump	Exports to US ($BB)
China	7.13	54	575.69
Euro Area	1.50	20	504.32
Mexico	5.17	25	459.18
Canada	1.08	25	446.62
Japan	3.90	24	154.45
Vietnam	2.85	46	135.88
South Korea	14.39	25	120.86
India	9.45	26	90.99
United Kingdom	0.69	10	64.75
Thailand	6.19	36	63.01

FIGURE 4: US share of world equity market vs current account deficit as % of GDP



Source: The World Bank and Haver Analytics as of March 31, 2025. Indices are unmanaged. An investor cannot invest directly in an index. They are shown for illustrative purposes only and do not represent the performance of any specific investment. Index returns do not include any expenses, fees or sales charges, which would lower performance. Past performance is no guarantee of future results. Real results may vary.

FIGURE 5: US software vs retailers



Source: Haver Analytics as of April 2, 2025. Indices are unmanaged. An investor cannot invest directly in an index. They are shown for illustrative purposes only and do not represent the performance of any specific investment. Index returns do not include any expenses, fees or sales charges, which would lower performance. Past performance is no guarantee of future results. Real results may vary.

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Bond credit quality ratings		Rating agencies	
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Investment Grade			
Highest quality	Aaa	AAA	AAA
High quality (very strong)	Aa	AA	AA
Upper medium grade (Strong)	A	A	A
Medium grade	Baa	BBB	BBB
Not Investment Grade			
Lower medium grade (somewhat speculative)	Ba	BB	BB
Low grade (speculative)	B	B	B
Poor quality (may default)	Caa	CCC	CCC
Most speculative	Ca	CC	CC
No interest being paid or bankruptcy petition filed	C	D	C
In default	C	D	D

1 The ratings from Aa to Ca by Moody's may be modified by the addition of a 1, 2, or 3, to show relative standing within the category.
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