MARKET UPDATE

Gauging the Potential Macro Impact of Tariffs

April 11, 2025

An Eventful 10 Days in the 2025 Tariff Tempest

To say it was an eventful week or so in world trade policy would be a sizable understatement. Mid last week, US President Donald Trump announced a collection of "Liberation Day" tariffs on imports from around the world—the most sweeping hike since the 1930 Smoot-Hawley Tariff Act. What followed was several dizzying days of rhetoric, reciprocal tariffs and generally sleepless times for policy watchers.

At midday on Wednesday, April 9, Trump announced that he would pause the reciprocal tariffs for 90 days to provide time for negotiations with a long list of trading partners. What remained in place, was the broad-based 10% Liberation Day tariffs across many countries. China, the notable exception, seems to be in the sharpest focus of the trade war. As of April 10, the US tariff on Chinese imports stood at 145%; on April 11, China raised its levy on US imports to 125%.

Capital markets wrestled mightily to assess the fast-paced series of announced tariff measures and their impacts on the macroeconomic picture, markets, industries and companies. Aside from a furious rally when many tariffs were paused, global equities slumped, credit spreads have generally widened and the VIX index of US equity market volatility has stayed at lofty heights compared with earlier in 2025.

What All This Means for the Macroeconomic Outlook

The back and forth over specific tariff measures remains very fluid, but if the 10% universal tariffs stay in place, we think those policies, combined with cuts in US domestic spending and government jobs, would reduce growth in 2025 US GDP to 0.5%–1.0%, with a substantial chance of recession. Our forecast for core CPI is 3.8%.

We think the impending tariffs on top of recent economic data skew risks clearly to the downside going forward. The starting point for the US economy is strong, and if labor income continues to outpace inflation the US economy won't collapse. If inflation expectations remain anchored, we expect 75 basis points in Fed interest-rate cuts this year, possibly more.

While it appears for now that the most severe tariffs are unlikely to go into effect outside of China, we still think more tariff-policy changes are coming. Even if they don't, damage has been done. Businesses and households are likely to pull back on investment and spending given the policy uncertainty, which will slow growth.

The tariff impact certainly isn't limited to the US. The European Union announced a 90-day pause of its retaliatory tariffs on many US goods on April 10. Still, the hit to growth is likely to be substantial versus a pre-tariff scenario. The euro area is again expected to face low growth or even recessionary risks from the effect of tariffs and undermined confidence. We expect the European Central Bank to cut policy rates to below 2% this year.

China has been preparing for higher tariffs since 2018, but the scale of these levies will hurt its economy; the direct exposure of US exports to China's GDP is 3%. US consumers may still bear a cost, because China is America's primary consumer importer. China seems set to launch stimulus to offset the drag of tariffs. For the rest of Asia, even the added 10% tariffs will likely slow growth, and policy uncertainty will likely reduce the appetites of consumers and businesses for spending and investment. This could generally more than offset the positive effects of trade diversion to other Asian countries.

The Key Variable Is Volatile: How Long and How High for Tariffs?

It's clear that attempts to judge the type, timing and magnitude of tariff measures are far short of precise. But given how wildly the overall tariff picture has been swinging, it's prudent to lay out potential scenarios for the next three months. They range from a general breakdown in negotiations to an optimistic path. In the table on the following page, we sketch out storylines for a baseline scenario, an upside scenario and a downside scenario of how tariff negotiations might evolve.

How the Tariff Tempest Could Turn Out: Three Scenarios

Scenario	How Things Could Play Out Over the Next 90 Days
Upside Scenario	The US quickly reaches agreements with important trading partners: Europe, Canada and Mexico for example. Negotiations with other countries proceed well enough to give us confidence that the reciprocal tariffs won't be imposed. Dialogue with China improves and we go back to the originally announced tariffs, with the hope that those will eventually be reduced, too.
Baseline Scenario	Some negotiations are resolved, and some make enough progress that Trump announces further pauses in tariffs. It's doubtful that 75 bilateral agreements will be reached, but if negotiations are going well enough to push back the reciprocal tariffs again, that should be enough. US/China tensions cool: no resolution is reached, but dialogue continues and at least a partial delay in the massive China tariffs is achieved.
Downside Scenario	Negotiations (ex-China) proceed slowly, with notable tension in US/Europe discussions. More product-based tariffs may be enacted and/or Trump may "suspend the suspension" if negotiations go badly with a particular country. With China, large moves in the CNY exchange rate would be a bad sign. So would an absence of dialogue: if there's no discussion, there can be no resolution.

Current estimates do not guarantee future results.
As of April 11, 2025
Source: AllianceBernstein (AB)

Of course, tariffs are only part of what will determine the path of the US economy—and other economies. Many variables will come into play, though for now tariffs are the biggest factor. While there's a lot of uncertainty around that variable right now, if we had to put a number on the potential outcomes for the US economy at this juncture, we'd assign a 20% chance to "all is well," a 50% chance to a slowdown and a 30% chance to a recession.

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