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US Tariff Policy Signals New Era of Protectionism

- US announces higher-than-expected trade tariffs
- Market reaction was clearly risk-off but still manageable
- Uncertainty is here to stay. As with previous announcements, Trump could still dilute, delay or remove tariffs, with the floor open for negotiations

Global financial markets entered a risk off mode on Thursday following the announcement of sweeping new US tariffs, which mark the most significant shift in American trade policy in almost a century. “Reciprocal tariffs” on several countries were significantly bolder than market expectations, ushering in new uncertainty.

The new US trade framework imposes a baseline 10% tariff on all imports, effective April 5. Additionally, certain countries—including the EU—will face higher "reciprocal" tariffs, effective April 9, aimed at mirroring the perceived treatment of American exports abroad. For the EU, this translates to an additional 20% levy on goods entering the US. Some country specific rates are as high as 50%, with Asia bearing much of the brunt of the highest rates.

The White House has framed the policy as a bid to restore American manufacturing strength and reduce trade deficits. However, markets are increasingly concerned that these measures could ignite a broader global trade war at a fragile moment for the global economy.

Initial market reaction

This marks the most aggressive step toward protectionism by the US since the 1930s. While the long-term effects remain uncertain, the immediate market reaction underscores fear of slower global growth, disrupted supply chains, and rising consumer prices.

Equity markets are down this morning: -1.6% for the Eurostoxx 50, -1.2% for the Stoxx 600, China's CSI dropped 0.6%, and futures on the US foresee a drop of +/-3%. The US is clearly more affected than other markets.

Gold has been propelled to a record high, reflecting heightened investor anxiety. Other safe-haven assets like the Japanese yen and the Swiss Franc also gained.

US and European government bonds rallied, pushing yields lower.

The 10-year UST yield fell to 4.05% this morning from around 4.20% twelve hours ago. The 2-year yield has fallen more modestly.

The prospect of tariffs had been stoking stagflation fears in the world's largest economy but now, investors are clearly more worried about the impact they will have on economic growth rather than prices. While tariffs will be inflationary, US inflation expectations, as measured by the 5y5y inflation swap rate, saw a drop from 2.4% to 2.3% last night, to reach the lowest level since 2022.

A risk-off move was also evident on European government bond markets, with the German 10y falling to 2.65% from 2.72% yesterday evening. A "positive" is that the move into Govies has been orderly and has not led to intra-European spreads widening.

Credit markets are also seeing some pressure and credit default swaps continue widening, but we remain far from stressed levels.

The dollar has weakened against a broad basket of currencies, suggesting continued repatriation by foreign investors—a trend already visible over the past month. So far, there is no evidence that the outflows are hurting the Treasury market, which continues to perform well relative to equities and credits.

A few factors will determine the dept of a potential slowdown in the US

Market-financing feedback loop: The downturn could be amplified if volatility in financial markets spills over into tighter corporate liquidity. However, this kind of "doom loop" seems less likely now than in previous cycles. The banking sector remains healthy, and corporate liquidity buffers are at record highs—offering resilience against tighter lending standards and reduced funding access.

Employment and household behaviour: If weaker capex translates into job losses, we could see a vicious cycle: falling employment leads to more cautious households, reducing sales, squeezing earnings and margins, and ultimately leading to further job losses. There are early signs of labour market weakening but it is premature to conclude that the labour market is deteriorating in a recessionary way.

International Response

The EU has already signaled it is preparing countermeasures. European Commission President Ursula von der Leyen said Brussels is finalising a new set of retaliatory tariffs, building on an existing EUR 26 billion response to earlier US measures on steel and aluminum. She emphasised that the EU will also take steps to protect key industries vulnerable to global supply shifts and a flood of cheap exports —particularly from China and other exporters likely to redirect goods away from the US market. There is the risk that EU actions could expand to target services, for example, with steeper digital services taxes.

More than 20% of EU exports go to the US, according to Eurostat, the bloc’s statistics office. That compares with 13.2% for the UK and 8.3% for China.

The EU country most affected is Germany, which exports EUR 161 billion to the US. Its carmakers were hit with a 25% US tariff rate. Italy exports EUR 65 billion.

Key sectors of the French economy—such as luxury goods, wine, and automotive exports—are likely to be impacted. French President Emmanuel Macron is scheduled to meet with business leaders today to assess potential fallout.

The UK, which has spent weeks working on a trade deal with the US to avoid the full impact of the level of tariffs introduced, was hit with a 10% levy. It has said it will try to negotiate further with the US.

Looking Ahead

While the US has left the door open for negotiation—indicating that reciprocal tariffs could be reduced if countries align more closely with the US—it remains unclear how global leaders will respond. The biggest risk is that other countries are unwilling to negotiate, leading to a full-blown trade war.

As with previous announcements, the next days may be filled with statements from Trump that remove, extend, or delay tariffs. The revenue impact of these tariffs will quickly enter the tax cut debate, which could mitigate the negative market impact of this announcement.

Markets are increasingly convinced that the Fed will respond to the tariffs by lowering interest rates. At present, markets are pricing in a total of 83bp in rate cuts for this year—fully pricing in three cuts (July, September, and December). Since markets began worrying about a tariff-induced recession in early February, rate expectations have shifted down considerably. Expectations for ECB support have also increased and markets are now pricing three further rate cuts for the remainder of the year.

For investors, the situation remains fluid. We are closely monitoring developments and will continue to assess the implications for portfolios, global markets, and the broader economic landscape. As always, we encourage clients to stay diversified and remain focused on long-term objectives.

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