GLOBAL PERSPECTIVES

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"LIBERATION DAY" TARIFFS: AN UNPRECEDENTED BREAK WITH FREE TRADE

The April 2nd "Liberation Day" tariff announcements represent what The Economist has called "America's total abandonment of the world trading order and embrace of protectionism" and "the most profound, harmful, and unnecessary economic error of the modern era." Financial markets recognized the risk posed by disruptive US policies earlier this year but were nonetheless shocked by both the scale and chaotic implementation of these measures, including that the rates were determined based on a spurious formula that does not in fact correspond to tariff rates charged against us by these countries. The S&P 500's immediate 13% plunge over the following four trading days reflects the market's grave assessment of this policy shift.

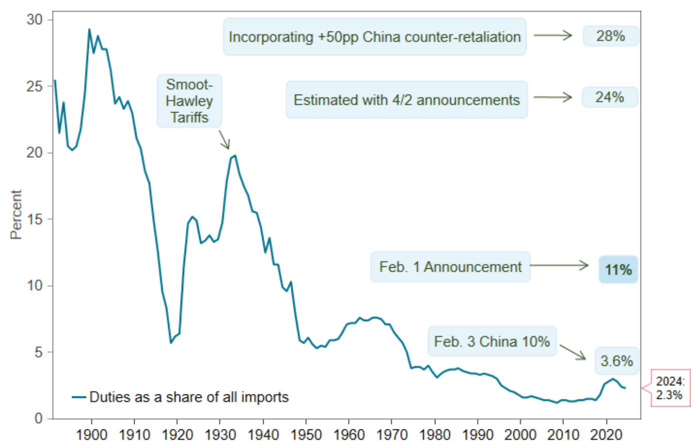
The April 2nd tariff package included:

- "Reciprocal" tariffs targeting virtually all US trading partners
- Differentiated rates: 34% on China, 27% on India, 24% on Japan, and 20% on the European Union
- A minimum 10% tariff on all target nations, with even higher punitive rates for certain smaller economies

When combined with existing trade barriers, China initially faced a staggering 65% effective tariff rate. Canada and Mexico were temporarily spared, and the new measures won't compound existing industry-specific tariffs (such as the 25% levy on automobiles), America's overall tariff rate was projected to rise to 24%—exceeding even the notorious Smoot-Hawley tariffs of the Great Depression era. But subsequent measures by President Trump have pushed tariffs on China to 104% on most goods, which will raise America's overall tariff rate to 28% (**Figure 1**).

FIGURE 1

Where Is America's Average Tariff Rate Headed?



Sources: GW&K Investment Management, EvercoreISI, JP Morgan, US International Trade Comission, and Macrobond.

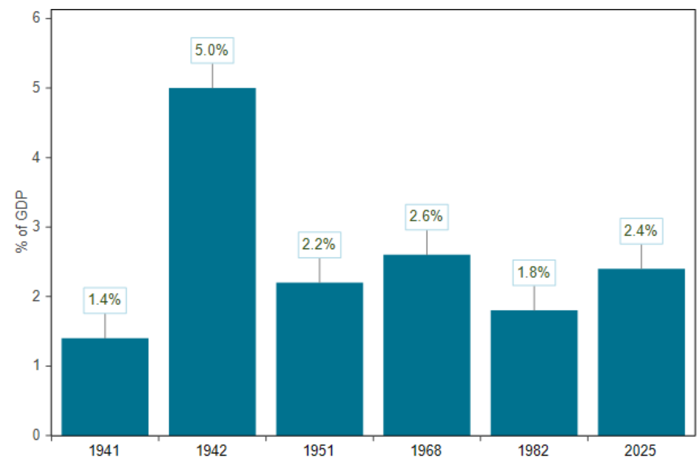
Liberation Day tariffs were projected to bring America's average tariff rate to 24%, but the recent hike in tariffs on China would push that to 28%, well above the level of the infamous Smoot-Hawley tariffs.

ECONOMIC IMPACT: THE ARITHMETIC OF AN IMPENDING DOWNTURN

For all their complexity, the economic consequences of these tariffs follow a straightforward calculation. US goods imports constitute approximately 11% of GDP, and the average effective tariff rate has jumped by roughly 26 percentage points. With most of these increased costs expected to pass through to consumers, the drain on spending power could surpass 2.5% of GDP—effectively one of the largest tax increases in American history, exceeding anything since the Revenue Act of 1968 that preceded the 1969-70 recession (**Figure 2**).

FIGURE 2

Large US Tax Hikes (% of GDP)



Sources: JP Morgan and Tax Foundation

US tariff hikes announced this year would be the largest tax increase on US households and business since the Revenue Act of 1968 which preceded the 1969-70 recession.

To put this in perspective:

A typical US recession involves a GDP contraction of about 2 percentage points from peak to trough.

- The US economy grew at a healthy 2.8% last year
- With a tariff-induced drag of 2% of GDP, many economists now project "stall-speed" growth of approximately 1%
- This anemic growth rate leaves the economy highly vulnerable to external shocks that could trigger an outright contraction

INFLATION COMPLICATIONS: A NEW DILEMMA FOR THE FEDERAL RESERVE

Beyond threatening growth, these tariffs create a significant inflation challenge. Higher import prices could push inflation toward 4% in coming quarters, severely complicating the Federal Reserve's efforts to achieve its 2% target. This has created a policy dilemma for Chair Jerome Powell, who indicated last Friday that the Fed remains hesitant to cut rates until it better understands the tariffs' impact.

Powell emphasized the Fed's commitment to preventing temporary tariff-induced price increases from becoming persistent inflation—a stance that suggests rate cuts may require clear evidence of economic deterioration first. This cautious approach could inadvertently increase recession risks as the economy absorbs the tariff shock.

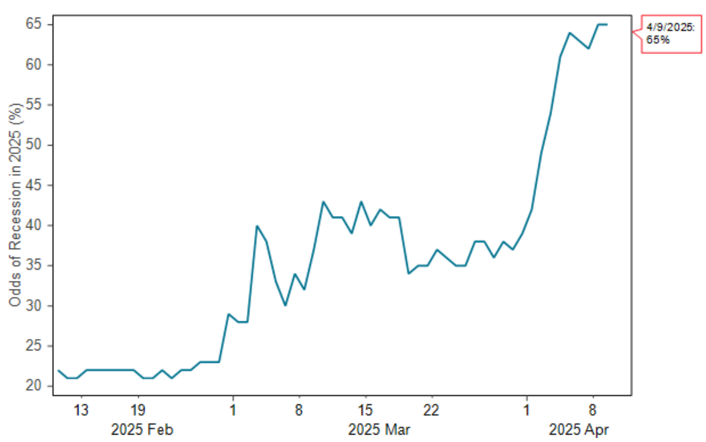
MARKET EXPECTATIONS AND RECESSION PROBABILITIES

The probability of a recession has surged across multiple measurements:

- J.P. Morgan's economics team now assigns a 60% probability to a global recession
- The Polymarket prediction market shows a crowd-sourced recession probability of 63%, up dramatically from 20% in mid-February (**Figure 3**)

FIGURE 3

Recession Odds Have Surged: Polymarket Contract on "US Recession in 2025"



Sources: GW&K Investment Management, Bloomberg, Polymarket, and Macrobond

According to the Polymarket prediction market, crowd-sourced odds of a US recession in 2025 have surged to above 60% since Liberation Day tariffs were announced.

- First-quarter growth has already downshifted, with the Atlanta Fed's GDP tracker showing a contraction of -0.3% annualized

These recession concerns align with deteriorating survey data, as both consumer and business sentiment weakened considerably in early 2025 on tariff anxieties. Key indicators include surveys from the Conference Board, University of Michigan, and the CEO Confidence Index, all of which are likely to decline further as concerns intensify about rising prices, falling profits, reduced investment, and potential job losses.

LABOR MARKET VULNERABILITIES AND SUPPLY CHAIN DISRUPTIONS

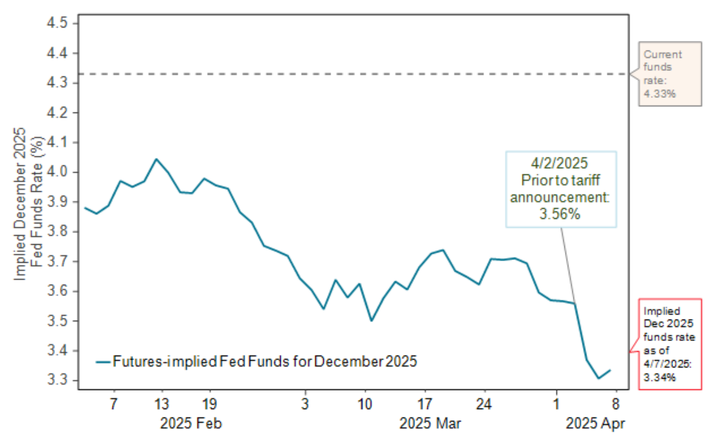
The labor market enters this challenging period from a position of relative strength, having added an average of 152,000 jobs monthly in Q1 amid historically low layoffs. However, with tariffs scheduled to take effect on April 9th, the second and third quarters will likely bear the brunt of the negative impacts.

Of particular concern is the potential for rapid supply chain disruption. As international vendor relationships suddenly become unprofitable, companies will be forced into hasty adjustments, contract cancellations, and potentially significant layoffs. These supply chain fractures could amplify the already substantial economic drag from reduced consumer spending power.

Meanwhile, financial markets are positioning for a more aggressive monetary policy response, with 2-year Treasury yields falling 10 basis points this month to 3.76%. Fed funds futures now price in at least four rate cuts this year—a sharp increase from the fewer than two cuts expected in mid-February (**Figure 4**). However, these would likely be "bad cuts"

FIGURE 4

Post-Liberation Day, Futures Have Priced in One More Fed Rate Cut for 2025



Sources: GW&K Investment Management, Bloomberg, and Macrobond

Fed funds futures are now pricing in about four rate cuts this year, compared to only two that were expected in mid-February.

responding to economic weakness rather than "good cuts" driven by naturally moderating inflation.

POLITICAL UNCERTAINTY AND GLOBAL RETALIATION

The final critical variable is whether the President will modify his stance given the severe market reaction. While he has suggested openness to reducing tariffs if other nations offer "phenomenal" concessions, other reports indicate he intends to stay the course, believing tariffs will ultimately repatriate jobs to America.

Regardless of potential policy adjustments, substantial damage has already been inflicted on confidence in both the US economy and the global trading system. China's swift retaliation measures with 84% tariffs on US exports likely presages similar responses from other trading partners, potentially extending beyond goods to services exports as well.

OUTLOOK: LONG-TERM CONSEQUENCES EVEN IF POLICIES MODERATE

Even the partial and modest tariff reversals that many economists anticipate will leave investors confronting a fundamentally altered global trade landscape. The enduring negative effects on global growth and inflation prospects appear inevitable, challenging policy makers, businesses, and investors to navigate an economic environment that has been made significantly more uncertain by this abrupt policy shift.

As the international trade architecture built over decades undergoes this stress test, market participants must prepare for prolonged volatility and potentially significant structural changes to global supply chains, inflation dynamics, and growth trajectories in the quarters and years ahead.

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