



Market Commentary

Trump's tariff tango

A Mag7 problem....or a MAGA problem?

Key points:

- Investors head to the exits after Trump's tariffs barrage. In FX markets, Liberation Day also saw investors dump the dollar.
- In our estimate, with the average global tariff at approximately 18%, we are thinking that US growth will slow to around 1% for the next several quarters, with inflation rising back to 5%.
- In Europe, we also see prospects for slower growth and higher prices, as the EU retaliates.
- We doubt that the ECB nor the Fed will be able to deliver much by way of monetary easing to help cushion the blow.
- While there is short-term hysteria around tariffs, the hope may be that this will give way to medium-term acceptance. However, the long-term outlook remains extremely unclear.

4 April 2025 (London) – Risk aversion pushed equities weaker and bonds stronger this week, in the wake of Trump's Liberation Day tariff announcements. Although there had been plenty of hype ahead of 2nd April, it appears that many investors had maintained a complacent view, in the hope that the President's bark would prove worse than his bite.

Yet, what was delivered was a complex array of tariffs at various rates on a global basis, which has triggered investor concerns with respect to the prospective impact these measures will have, both on growth and inflation.

In our analysis, we estimate the average global tariff at approximately 18%, and on this basis, we think that US growth will slow to around 1% for the next several quarters, whilst inflation jumps to approximately 5%.

In this case, we continue to believe that it will be hard for central banks to respond by easing rates, and therefore the rally in bond yields that we have seen, appears overdone in our assessment.

Reflecting on the Federal Reserve, Powell is moving into his last 12 months in office and knows that Trump will likely blame him, regardless of what he does or doesn't decide to do. However, as he ponders his legacy, we suspect that he will be wary of ending up with the mantle of the Fed Chair who lost control of inflation not only once, but twice, during his tenure in office.

In that case, we think the Fed will do nothing for the foreseeable future, as long as there is not a large rise in unemployment, which could trigger recession fears. But with some growth in US manufacturing jobs starting to occur, plus a slowing in immigration, which reduces the available slack in the labour market, we think that unemployment may only tick marginally higher over the next few months.

In Europe, we also see prospects for slower growth and higher prices, as the EU retaliates to Trump's tariffs. As in the US, we doubt that the ECB will be able to deliver much by way of monetary easing. With 65bps of cuts priced until the end of the year, we remain sceptical of this pricing. With fiscal policy being eased in the EU, this is likely to offset the need for monetary accommodation. From this standpoint, there is a sense that a fiscal response is the appropriate one to a supply shock, such as tariffs.

In this way, we may also expect other countries with fiscal space to look to deploy this, to cushion the negative impacts that are set to manifest. In this respect, there is something of a question as to how quickly spending measures can be deployed in a way that they can support growth, though there is an appreciation that monetary policy is the wrong tool to be deploying at the current point in time.

Elsewhere in Europe, the highlight of the week was the French court ruling, banning Marine Le Pen from running for office for the next five years. This potentially rules her out of a tilt at the 2027 Presidency.

However, a Paris appeals court will rule on Le Pen's verdict next summer and moreover, you might have thought that French judges would have learned from the US example that using the courts to try to block a popular Presidential candidate can easily end up just driving more sympathy and support in their direction.

Additionally, Le Pen has the pretext to bring down the French government and trigger new Parliamentary elections this summer. These are elections her party could well win, with Bardella potentially the next Prime Minister of the French Republic. On this basis, we continue to be wary of French OATs and continue to favour Italy BTPs on a relative spread basis.

In contrast to the Eurozone, the UK situation is more challenged in that the country lacks any fiscal space. Domestic inflation is problematically high and may rise further in a trade war, even if the UK has managed to stay away from the fray, with a US tariff rate of only 10%.

We strongly sense that the Bank of England would like to cut rates if it can, and a window may present itself at the May MPC meeting, ahead of the April CPI release. However, we think that cutting rates in the UK would be a policy error and that CPI will be up around 4% this summer.

In Japan, there was disappointment at an elevated tariff, when policy officials had been hoping for more favourable treatment by the US administration. Ultimately, we won't be surprised to see Japanese tariffs reduced, given the desire in Washington to maintain a close relationship with Tokyo, and considering Japan's strategic importance to the US, as it faces up to China.

In this respect, it is clear that the US would like to see a stronger yen, and this is a point which policymakers in Japan would also agree with. This being the case, and with growth and interest rate differentials narrowing, so we see scope for the yen to rally further in the weeks ahead.

In FX markets, Liberation Day saw investors dump the dollar, with the greenback dropping against nearly all currencies in developed markets. In part, this is discounting a weaker US growth outlook and the end of US growth exceptionalism.

Additionally, we would also cite shifts in capital flows, as global investors retrench from US stocks in favour of those closer to home. Aside from the yen, we are wary of chasing FX moves against a backdrop of elevated uncertainty, though we would also note that there may be a number of EM currencies that could be exposed to an unwind of carry trades, plus adverse trade and global growth developments.

In that context, we would continue to highlight the Colombian peso and Thai baht as potentially vulnerable. We have also added a short position in South African rand, which we feel has held up much better than expected.

Spreads in credit widened in sympathy with other risk assets, although price action was more muted relative to equities. The big question in credit, which investors now face, is whether a growth slowdown could morph into a recession and, in this case, a default cycle.

In this respect, we see balance sheets in Investment Grade credit looking relatively robust, and we would save our concerns for the more leveraged and lower quality part of the credit market, in areas such as private debt.

A widening in spreads in the coming days and weeks may represent an opportunity to lift CDS hedges and add exposure. However, we would like to feel more confident that we have seen the worst of the down move in equities, before this is the case.

Looking ahead

There is a sense that now the US tariff announcements are behind us, so as newsflow settles, we may hope that market volatility may abate. Once this appears to be the case, we may have attractive entry levels to add to short rates positions, in anticipation that central banks will push back against market expectations of forthcoming monetary easing. However, short-term price action in equities is uncertain.

Over the past six months, we have witnessed US investors routinely buying the dip each time the equity market has come under pressure, and the same may hold true in the coming days. However, there may be a

point when enthusiasm to add to stocks starts to wane, particularly noting that leveraged trackers such as the 3x S&P now trades at a price below where it sat at the end of 2021.

In this case, a deeper correction could be warranted, especially should it become clear that central banks won't be rushing to the rescue. Indeed, in this respect, we have often been asked to comment on the notion of a Fed (or Trump) put on stock indices.

Yet when we discuss this idea with central bankers, it is clear that markets would need to fall a lot more than they have for this idea to attract any real attention. In a sense, the real Fed put would kick in on a jump in US unemployment to 5% or were credit markets to seize up. Otherwise, it would take the S&P to fall well below 5,000, before a tightening in financial conditions were to cause the Fed to feel compelled to act. It should also be noted that, as for Trump supporters, few of these are actually stock owners.

Indeed, it tends to be Democrats these days who own equities more widely, and this can highlight how relatively disinterested the US administration seems to be in talking up stocks at the moment. On that note, it was interesting to hear Scott Bessent this week characterise recent price action in stocks as a Mag7 problem and not a MAGA problem.

Looking further ahead, we expect that ultimately, the US administration will pivot away from tariffs via executive orders, to a universal tariff legislated through Congress, which we might assume will sit at 10%, but which will only be enacted much later this year.

In this regard, there may be a hope that short-term hysteria around tariffs will give way to medium-term acceptance, and this could augur for an improved outlook into 2026. In this context, if the US economy bounces back next year, then Trump, Musk, and colleagues will no doubt be congratulating themselves on having managed to enact change to Make America Great Again.

However, this is only one possible scenario that could play out and there is an alternative narrative –that the US administration has been guilty of an unprecedented exercise in self-harm, with the damage done to the US economy needing years to be unwound.

For sure, the long-term outlook is extremely uncertain. What we feel we can be more confident about in the short term is that inflation is going to rip. Consequently, if markets overplay the recession narrative and expect too many rate cuts, then there should be money to be made on the other side of the trade.

Notes to Editors

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