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DoubleLine's Take on the Reciprocal Tariffs

Bill Campbell | April 2025

On April 2, 2025, President Donald Trump announced reciprocal tariffs on all countries across the globe. The tariffs start with a baseline of 10%, meaning that is the lowest rate that any country can achieve under the new reciprocal tariff structure. In addition to the baseline, higher reciprocal tariffs have been charged on most countries. The administration for the time being has allowed a few carveouts for sectors such as pharmaceuticals and semiconductors, but overall, these tariffs have surprised market participants to the high side of what was expected, with the global average rate in the range of 18.3% to 23% depending on how sectoral exemptions are handled.

Risks to the Tariff Outlook

The intention of these tariffs has not been clearly articulated. Are they to be tools to bring manufacturing back to the U.S., increase U.S. exports, achieve other objectives or a combination of goals? Estimates of revenues from the reciprocal tariffs are in the range of $600 billion to $650 billion. So, are reciprocal tariffs to be understood primarily as a new revenue source for the government? Or are they primarily to serve as leverage to renegotiate bilateral trading deals with countries around the globe? These questions give rise to uncertainty around how long these tariffs will be in place. The longer they stand, the greater the risk to the global economy.

Few nations have been sitting idle in the face of these tariffs, and many have come out with retaliatory measures. In addition to what was outlined in my February paper, "Assessing Trump Trade Policy: A Year of Rolling Tariffs, Macro Unknowns and FX Volatility," retaliatory measures have included:

- Canada on April 3 introduced 25% tariffs on U.S. vehicles and components deemed by Ottawa to be non-compliant with the Canada-United States-Mexico Agreement (CUSMA) while earmarking all tariff revenue to support Canadian auto workers. This targets politically sensitive U.S. industries in Republican-leaning states, mirroring strategies used in prior trade disputes.

- Beijing has mimicked the 34% U.S. reciprocal tariffs, imposing the same markup on American goods entering China. In addition, Beijing restricted exports of seven rare earth elements critical for advanced technologies, including samarium (used in aerospace/defense), gadolinium (MRI components), and terbium (electronics).

- The European Union (EU) has proposed a two-phase retaliatory strategy against U.S. tariffs, targeting $28 billion in American imports, with measures designed to pressure politically sensitive industries.

The response of the White House to these retaliatory measures remains to be seen. In his first term, President Trump reacted to China's retaliatory tariffs by piling on more tariffs. When China imposed tariffs on U.S. products such as soybeans and agricultural products in 2018, the president doubled down on tariff threats, directing the U.S. trade representative to consider $100 billion in additional duties. The first Trump administration also pursued a tit-for-tat strategy, escalating tariffs on $34 billion worth of Chinese goods in July 2018 and later proposing 10% duties on $200 billion in additional goods. If President Trump were to take a similar approach today, such actions would worsen the outlook for global growth.

One potential bright spot, albeit likely temporary, is the carveout for certain sectors from the reciprocal tariffs, mainly pharmaceuticals, semiconductors, lumber and energy. Although this might appear to be a positive development, I think it's likely that the White House will implement specific tariffs targeting these sectors later this year. This raises additional risks to the economic outlook as such sectoral tariffs would likely be additive to the reciprocal tariffs already announced.

Contours of the Reciprocal Tariffs Target the EU and Asia

Viewed by regions, a targeting of Asia and Europe compared to North and South America becomes clear. The larger Asian countries are on the receiving end of very high reciprocal tariff rates, with China at 34% (in addition to the 20% already in place, bringing the increase in tariff rates to 54% this year), Vietnam at 46%, Taiwan and Indonesia at 32%, South Korea at 25%, Japan at 24% and Malaysia at 24%, to name a few. Europe was hit with a 20% reciprocal tariff rate starting on April 9. By comparison, the South American countries Argentina, Brazil, Chile, Colombia, Ecuador, Peru, Paraguay and Uruguay face the 10% baseline tariff. Canada and Mexico were left off the reciprocal tariff model, although they remain subject to the tariffs already in place.

In his first administration, President Trump took a very hawkish stance toward China, a posture he appears to be continuing today. Asia has grown in global importance in goods manufacturing, ranging from products at the low end of added value (e.g., textiles) to the high end (e.g., semiconductors). In a rare instance of bipartisanship, Washington views China not only as an economic threat but also as a national security concern. The strategy of harshly targeting Asia is likely part of the administration's objective to contain China and not allow goods produced there to be re-exported via a regional neighbor into American markets. Prior to the start of Trump 2.0, the U.S. government had been focused on bringing manufacturing back to the States in a policy referred to as "near-shoring." The regional contours of the reciprocal tariffs suggest that this policy might remain on the agenda.

Economic Implications of the Tariffs: Higher Near-Term Inflation and Lower Growth

Tariffs will almost certainly have an inflationary impact in the near term as input prices on producer imports and prices of imported finished goods are marked up under these new import duties. There has been some discussion that producers and importers would be able to absorb the tariffs in their margins, but margins have been shrinking. It is more likely that producers and importers will pass at least a portion of the price increases to the end consumer. In addition, currency depreciation against the U.S. dollar was thought in some corners to help offset the impact of tariffs. The dollar, however, has weakened on the recent decline in U.S. growth prospects, removing this potential offset for foreign exporters. As an aside, I would expect that continued foreign currency strength against the dollar would exacerbate the price impact of tariffs, as producers would have additional costs to either absorb or pass through. Such an outcome would further accelerate U.S. inflation as imports become still more expensive in addition to tariff increases.

The longer tariffs remain in place, the more they will negatively impact growth. As discussed above, it is likely that price increases will be passed to consumers and end users. All else being equal, this will reduce consumption. Firms are facing margin pressures from the slowing growth outlook, the new tariff regime and uncertainty around future policies. This will delay capital spending plans by firms and constrain investment. Furthermore, if the squeeze on margins persists, corporations will eventually cut payrolls. The uncertainty about the employment outlook will also keep consumers cautious in the near term, another growth headwind.

The United States has benefited from large inflows of foreign savings over the past several decades, helping to boost domestic growth and markets. The new trade policy risks causing foreign investors and companies to pull back on their investments in the U.S. In addition, foreign governments might restrict companies, state pensions and sovereign wealth funds from investing in the U.S. Such moves have already come from China. French President Emmanuel Macron has similarly asked EU companies not to invest in the U.S. Escalatory actions like these will further dampen the outlook for U.S. and global growth.

The Federal Reserve finds itself in a difficult position, confronted with the "choose your poison" necessity of balancing its dual mandates of price stability and full employment with the possibility of higher inflation coinciding with a weaker labor market. Fed Chair Jerome H. Powell in remarks on April 4 suggested that the Fed would have to take a wait-and-see approach to cutting interest rates, citing concerns about the outlook for prices. Due to higher inflation risks presented by the tariffs in the near term, the Fed is likely to keep official short-term interest rates on hold until the labor market weakens. Once layoffs start to rise, the Fed will likely start to cut rates, perhaps in increments of 50 basis points.

If I could provide unsolicited advice to the administration, it would be to delay the implementation of the current tariffs in order to conduct a series of negotiations with nations around the world to reduce their tariffs and nontrade barriers. Many nations appear willing to reach out to have these meetings. Notable examples are the recent trade talks between the U.S. and governments of Mexico, Vietnam and India. President Trump could reverse much of the current deterioration in sentiment and potentially get the world into a more open trading environment with lower or no trade barriers or tariffs through this type of strategy. The longer the current hawkish trade and tariff policy remains in place, the greater the risk of durable economic damage.

Market Reactions to Tariffs

Many markets traded significantly lower in the wake of the reciprocal tariff announcement, playing out much as expected given the dramatic change in global trading relationships. Dimming global growth expectations will continue to form a headwind to the outlook for corporate earnings growth and margins. Without a dramatic shift in policy (as described in the preceding paragraph), DoubleLine supports defensive portfolio positioning, favoring higher-quality credit, U.S. Treasuries and Agency mortgage-backed securities, a strategy we have followed for the past quarter.

Rates markets in developed countries have been rallying, as expected given the economic disruptions being the predominant concern. We continue to favor the front end to the belly of the Treasury curve – in other words, Treasuries with tenors ranging from one to seven years. Market expectations of Fed cuts being pulled forward show the concern of a much larger growth contraction by markets than had been anticipated before the reciprocal tariff announcement.

If trade disputes give rise to an escalating series of more tariffs and countertariffs, called "layering," the Fed will very likely remain on hold longer than markets expect. By deferring easing until later this year, the Fed could find itself in the position of needing to implement larger cuts. This should support steepening of the Treasury curve. DoubleLine remains cautious on longer-duration Treasuries (durations of 10 years or more) as the fiscal outlook for the United States appears set to deteriorate. The new budget appears to be stimulative and does not meaningfully address the areas of entitlements and overall contributors to the precarious levels of deficit spending and debt issuance. We are expressing this in a steepener trade on the Treasury curve by overweighting the two-year Treasury and underweighting the 30-year Treasury.

Interestingly, the dollar has weakened despite falling global growth expectations. To understand this behavior a little better, let's break dollar exchange rates into buckets. The strength of the yen and Swiss franc reflects their status as safe-have currencies. On the other hand, the euro strength likely signals regime change with respect to the large amount of European capital that was invested in the U.S. over the past decade and a half when euro rates were negative. Now, some of this capital might be exiting the U.S. in a repatriation trade to Europe due to uncertainty around Washington policies. The strong emerging markets (EM) FX performance reflects, in my view, a continuation of the unwind of the U.S. exceptionalism trade.

That said, the global growth shock from tariffs will likely feed through markets and economies to reduce global growth. That likely would be negative for EM FX if the current tariff trajectory is not reversed. Longer term, the large foreign investment in the U.S. is at risk due to the large changes in U.S. policy (tariff and geopolitical). DoubleLine expects dollar weakness to be a structural theme after global markets digest the current tariff shocks. I have been writing for several years about an emergent move away from the dollar standard to a multipolar standard for trade and payments. This evolution is likely to advance in the coming years. ■

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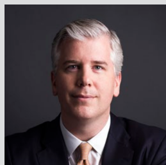

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