

# outlook

A Financial Newsletter / Spring 2025

The tariff and trade situation is changing rapidly.

## Not All Tariffs Are Created Equal

Everyone I talk to is concerned with a possible trade war. President Trump's threat to impose 25 percent tariffs on Canada and Mexico caught many people by surprise. After all, they are our two largest trading partners. US businesses were particularly concerned because, after the United States–Mexico–Canada Agreement (USMCA) replaced NAFTA (the North American Free Trade Agreement) in 2020, each country laid out their supply chains based on the new agreement. US manufacturers gained access to lower wages in Mexico and lower commodity prices in Canada. Everyone is benefiting from USMCA, but the benefits aren't equal. Trump recently started talking about reciprocal tariffs and equal trade.



Bob Hofmann  
President

As I stated in my last newsletter, Trump is negotiating in public. If we look at the numbers, trade can't be equal among these three countries. For instance, Canada has a population of 40 million, while Mexico has 130 million. Even

if we combine Canada and Mexico, the US population of 340 million is significantly larger. With a trade deficit of \$63 billion, Canada lacks the population size to substantially impact the trade imbalance. Mexico has a \$172 billion trade deficit with the US, and although more populous than Canada, it is less wealthy. Canada has a median income of \$70,500, the median income is only \$12,000 in Mexico. Moreover,

Canada's GDP is \$2.2 trillion, while Mexico's is only \$1.8 trillion. To put it in perspective, California's GDP is a little over \$4 trillion, and its population is slightly smaller than Canada's at 39 million. When we compare Mexico and Canada to the US, which has a median income of \$77,040 and a GDP of \$29.2 trillion, we understand why trade imbalances exist. Canada and Mexico are too economically small to reduce our trade deficit significantly. If I know this, Trump and his economic team also would have known this. This is why I believe Trump is just negotiating in public. His starting price is unrealistically high when he negotiates, but he knows that. Cooler heads will ultimately prevail, and Canada and Mexico will make minor concessions. Trump will declare victory and end up getting some of what he wants. Does Trump truly want enhanced border security from Canada and Mexico? Time will tell, but whatever deal emerges, I don't expect our trade deficits with Canada and Mexico to be materially impacted.

If the proposed tariffs on Canada and Mexico stick, they'll be inflationary. For instance, the number one vehicle sold in the US is the Ford F150. If we have a 25 percent tariff on aluminum and steel, the metal cost alone will increase the F150's price by \$400. Cars and trucks are more than just steel and aluminum. After adding all the other components sourced from Mexico and Canada, analysts predict your next car, truck, or SUV is projected to increase by \$3,000 or more if these tariffs go through. In 2024, the US imported approximately 3.6 million vehicles from Canada and Mexico. For GM, about one-

third of its cars come from our neighboring countries, and it's about 25 percent for Ford. The F150 Lariat has already increased in price by 55 percent over the last five years! The base price of a Ford F150 over the same timeframe is about 30 percent higher. Ford sources about 90 percent of its steel from the US, but 75 percent of high-quality aluminum comes from Canada. The increased prices have slowed sales of this popular pickup.

When it comes to China and the EU, the picture is different. China and the EU can't match US economic might individually, but they surpass us when you combine them. China has a GDP of \$18.8 trillion, the EU a GDP of \$19.4 trillion. They also have a population advantage, with 1.4 billion people in China and 449 million in the EU. However, people in China and the EU aren't as wealthy, with median incomes of \$4,801 and \$19,995, respectively. Regardless, their economic might is impressive—with a combined GDP of \$38.2 trillion, they can certainly move the needle and help reduce our massive trade deficits. Last year, China's trade deficit with the US was \$295.4 billion, and \$216 billion in the EU. These countries have the economic might to reduce our trade deficits if they find the political will.

If a trade war does occur, everyone will lose, including the US. With trade deficits of \$63 billion in Canada, \$172 billion in Mexico, \$216 billion in the EU, and \$295 billion in China, the US has a lot less to lose than our trading partners do. This leads me to believe that calmer heads will prevail, and Trump will ultimately reduce the trade deficit with the EU. When it comes to China, I'm not so optimistic because when you have a dictator in place who values his regime and power over his own people, it's impossible to predict how one man will act.

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China is currently handling the trade war through diversification. With a population of 1.4 billion, it has many jobs to fill. A median salary of \$4,801 gives China a huge advantage because it can produce goods for a lot less than most countries do. As US imports have fallen due to Trump's tariffs, China has exported more to other nations. For instance, dozens of garment factories have closed in Indonesia due to an influx of cheap Chinese fabrics. China floods markets with cheap goods, and local producers can't compete on price. Indonesia, which is the largest economy in Southeast Asia, lost roughly a quarter-million jobs in the textile industry over the last couple of years. It's predicted that another half-million are at risk in 2025, which would destroy one out of every four jobs in the textile industry. This strategy isn't new. From 1999 to 2011, the US sent many manufacturing jobs to China, and it became known as the great "China Shock." This shock wave wiped out about 2.4 million US jobs. China devastated the US steel industry before the first round of Trump tariffs. In 2018, Trump imposed a 25 percent tariff on steel coming from China, and now Chinese steel accounts for only 1.8 percent of total American steel imports. Countries all over the world use tariffs to protect jobs and industries, and they can be very effective. The cost is undeniable; higher inflation ensues, so the American consumer will pay the price. In some cases, maybe it's worth the price. However, it's hard to find the wisdom in blanket and reciprocal tariffs.

Now let's discuss the deficit. In 2024, the US ran a deficit of \$1.8 trillion, which was \$138 billion, or between 7 and 8 percent more than in 2023. In 2024, the US economy grew by 2.8 percent. If our debts continue to outgrow our economy, it's a bad sign, and if left unchecked, our overall debt could spiral out of control. Our total debt is currently \$35.5 trillion and growing. When evaluating overall debt, you must do so in a relative way. The largest economy in the world can certainly afford to borrow more than a smaller country such as Canada can. After all, it's the strength of our economy that backs our debt. The way to look at

our debt in a relative way is to calculate our debt-to-GDP ratio. We currently have a 122 percent debt-to-GDP ratio. Comparatively, here are some other developed countries and how they stack up according to debt to GDP:

■ France	112%
■ Germany	63%
■ UK	98%
■ Japan	251%
■ Spain	104%

Although the US comes in slightly higher than most of these countries, I'd argue that we have the economic strength to warrant the higher debt load. However, our trajectory of deficits exceeding economic growth is unsustainable. Sometime soon, we'll need to get our financial house in order.

Treasury Secretary Scott Bessent has a plan to try to improve our economic outlook. It's called the 3-3-3 plan. Politicians scrutinize and criticize every plan, and this plan is no exception. The first "3" relates to cutting the budget deficit to 3 percent of GDP by the end of Trump's four-year term. The second "3" relates to growing our economy by 3 percent a year through deregulation and other pro-growth policies. The third "3" relates to increasing energy production by adding three million barrels of oil daily. Increasing oil production will help bring down energy prices, which are a main contributor to inflation. Medicare, Medicaid, Social Security, and defense spending are the biggest drivers of our federal spending problem. It's unlikely these major areas of the budget will be reduced in a meaningful way.

Bessent apparently received inspiration for his 3-3-3 plan from the late Japanese Prime Minister Shinzo Abe, whose "three arrows" plan sought to utilize monetary policy, fiscal stimulus, and structural reforms to battle stubborn deflation and a stagnant economy. Will Bessent's plan work? Only time will tell.

If the trade war escalates, the Fed must come to the rescue. In the last Fed meeting on March 19, 2025, Fed Chair Jerome Powell kept interest rates unchanged. Powell said, "Our policy is in a good place to react to what comes." He also assured us that our

economy would remain solid based on what he called "hard data." However, the Fed did lower its US GDP outlook, expecting a modest 1.7 percent increase in 2025. That's down from December's 2.1 percent forecast. The Fed can't make any decisions until it knows both what tariffs are in place and how they will impact our economy. The Fed isn't in the business of predicting what Trump will do, but now it has seen the plan. In creating policy, the Fed is very data-dependent and reactive, not predictive. Its backward-looking approach may cause it to fall behind the curve, and it certainly won't be the first time. If the Fed is late to react, it will simply have to make larger interest rate cuts to make up for its policy delay.

The tariff and trade situation is changing rapidly. We'll continue to communicate our thoughts on the effects on markets and the economy. In the meantime, if you would like to review your overall allocation and financial plan or discuss how to put additional cash to work, please get in touch with your Roffman Miller Investment Advisor. On behalf of our whole team, thank you for your trust and confidence.

*Bob Hofmann, President*

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