



# Trump's tariff policy as a warning sign for the global economy

Exclusive report for ACATIS Investment: Prof. Dr. Dr. h.c. Lars P. Feld, University Freiburg and Walter Eucken Institute

On 2 April 2025, President Trump announced extensive tariffs that would affect countries around the world. Tariffs were supposed to rise to 64% for China, 27% for India, 24% for Japan and 20% for the European Union (EU). The minimum tariff would be 10%, and automotive tariffs of 25% would remain. After China announced retaliatory tariffs of 34% on American goods and export controls for rare earths, the US government increased the tariffs for China to 104%. Differently from China, the EU has been more reticent in its response by imposing several targeted tariff increases, and similar to Japan, it has also proposed to lower industrial tariffs to zero. The imminent trade war ends the old global order that was characterised by multilateral relations, globalisation and economic interests. The new world order is dominated by nationalism, protectionism and moralization, and it is geared towards conflict.

The US tariff policy has caused turbulence in financial markets. Share prices fell across the globe. And they continue to fall at the time this text is written. The DAX lost about 15 percent between 3 April 2025 and 7 April 2025; it subsequently recovered somewhat but is still 10 percent below the starting value. The S&P 500 also lost about 10 percent in five days, while the Hang Seng lost over 12 percent. The oil price is at the lowest level since the beginning of 2021; since the tariff announcement by Donald Trump, Brent crude oil fell from 75 dollars to 60 dollars a barrel. Bond markets are also feeling the effect. Yields for the 10-year government bonds of G7 states, which had started to decline, rose again immediately after the tariff announcement; having said that, Germany still enjoys its status as a safe haven for global investors.

It is not clear where this will all end. What seems clear, however, is that the American president is resolved to maintain his tariff policy, even if this will trigger a serious recession for the US and the entire world, and which could be extremely damaging to the US economy. There are many indications that this will be the case.

It is not clear what this means for financial markets. Because there is the possibility of another financial crisis.

The amount of the tariffs that was calculated by the US government is based on a simple calculation, according to which the US trade deficit with a country is divided by the imports from that country. The aim seems to be to reduce the trade deficit to zero. Economically speaking, this is very stupid, because the American commer-

cial balance sheet is already compensated to a great degree within the current account balance due to primary incomes, which are determined by cross-border interest, dividend and licensing income. American companies do big business overseas. An added factor is that a current account deficit must be accompanied by a surplus in the capital account. The US is attractive for investors and it is able to finance its relatively higher consumption using capital from abroad. If the current account balance is forced to be balanced with tariffs, capital inflows from abroad would cease. It is difficult to imagine what this would mean for the yields of American government bonds, or for the US' exorbitant privilege of being the global reserve currency.

China also cannot afford a financial crisis. Structurally speaking, the Chinese economy is vulnerable due to its demographic trends, its high private and government debt and the strongly export-oriented economic policy. Recently, the Chinese prime minister announced that the banks that suffered greatly during the real estate crisis would be recapitalised, and that the central government would take over the debt of local governments. Domestic consumption should be increased. Therefore the new US trade policy comes at a bad time for China.

The same applies to the member states of the European currency union. The announcement of significantly higher debts by the coalition partners of the future German government have driven up the yields of 10-year government bonds. This was not good news for highly-indebted governments in the Eurozone, such as Italy and France. While the current developments have the effect of reducing German yields, that is not true for the yields of much more vulnerable member states.

Now much will depend on the central banks, which are on alert in the face of these developments. It might be necessary for the main central banks to coordinate their activities in the short term. However, flooding the market with liquidity during a time of rising inflation could lead to very uncomfortable side effects.

Prof. Dr. Dr. h.c. Lars P. Feld