

Goldman Sachs Exchanges

How tariffs will impact the US economy

**David Mericle, Chief US Economist, Goldman Sachs
Research**

**Allison Nathan, Senior Strategist, Goldman Sachs
Research**

Date of recording: March 10, 2025

Allison Nathan: As tariffs go from idea to reality, what might be the actual implications for the US economy? I'm Allison Nathan and this is Goldman Sachs Exchanges.

Today I'm joined by David Mericle, our Chief US Economist in Goldman Sachs Research. He joins me over the phone from Doha. David, welcome back to Exchanges.

David Mericle: Thanks, Allison. Great to be back.

Allison Nathan: So, David, there are so many tariff headlines coming at us. Help us cut through all of this. Where does the picture stand now and how has that changed from your prior expectations?

David Mericle: Sure. The tariffs that are now in effect

raise the US' effective tariff rate by somewhere around three percentage points between election day and inauguration day. That's more or less what we were expecting. So, the tariffs that have already taken effect are not necessarily larger. But we have raised our expectations for what will eventually come into place.

Some of that was just seeing that they were willing to go ahead initially with these tariffs on Canada and Mexico and pulling them back. Some of it is commentary from President Trump and others in the administration that has made us think that a tariff on critical imports and a meaningful reciprocal tariff are probably also coming, maybe something on autos. And that all of this is going to wind up adding up to a more substantial increase than we expected.

So actually, just last week we raised our tariff expectations. We had been expecting a four to five percentage point increase in the effective tariff rate. Now we're expecting that it will all add up to about a 10-percentage point increase in the effective tariff rate. So, that would be a larger increase in the effective tariff rate than we had anticipated before the new administration took office.

Allison Nathan: So, let's talk about the macro implications. Is inflation, which has been so much in focus, becoming a bigger concern off the back of all of this?

David Mericle: If there were no tariffs this year, we would expect inflation to fall, if you look at the Fed's preferred core PCE measure, from 2.65 at the moment to something like 2.1 percent by the end of the year. Now, under our prior, more moderate tariff assumptions, we thought maybe instead of falling to the low twos, inflation would stay at something more like the mid twos for the duration of the year.

Our new larger tariff assumptions have a meaningful impact. They imply that instead we'll see a bit of a pickup and we'll wind up just short of three percent. In principle, even with the larger magnitude of the tariff increase, we're still talking about a one-time impact on the price level.

Although, one thing we're learning that's different than say 2019, the last time President Trump in his first term raised tariffs, is that the public is extremely alert to tariff increases. And as a result, you've seen a jump in some

measures of inflation expectations.

I still don't think this is as dangerous as, say, in a 2022-like environment where inflationary expectations are going up, not because people are being bombarded with news about tariffs, but because they're actually experiencing high, broad-based inflation. But it is, I think, a little bit of a surprise relative to what I might have expected several months back just how focused businesses and consumers are on tariffs. And I would say at the very least, this is something to keep an eye on, the risk of the tariffs sparking broader price increases.

Allison Nathan: And what about the risk that we see a hit to growth? I'm hearing the word stagflation a lot these days. How concerned are you that we could be in a stagflationary environment?

David Mericle: So, we have revised our inflation forecast up for the year and our growth forecast down for the year. So, directionally that would be the effect of tariffs. Higher inflation. Lower growth. I think using that word, at least in a US context, where most people have in mind when they hear stagflation, what we experienced back in the 1970s, a

very weak labor market and very high, eventually, double digit inflation. Comparing what we're expecting, even larger tariffs to do to that period seems to me inappropriate. So, I think that the terminology is probably a little bit misleading. But the effect of the larger tariffs is to push inflation higher and growth lower.

Allison Nathan: So, what are we expecting for growth at this point then?

David Mericle: So, we just cut our 2025 GDP forecast on the Q4/Q4 basis from 2.2 percent to 1.7 percent. So, we took off half a percentage point to reflect the larger impact of tariffs. Which hit economic activity through a few channels. First, just a tax-like effect on real, disposable income. And consequently, on consumer spending. Second, we've tended to see a tightening in financial conditions around tariffs. It's been a lot less extreme than it was in Trump's first term, especially scaled to the size of the tariff increase. But we have seen some sell off in the equity market for example.

And third, I think the uncertainty that tariffs introduce are probably going to have a larger effect discouraging business

investment than I would have thought a couple of months ago when it looked like the tariffs would be smaller in total and more narrowly focused on China.

Allison Nathan: What about the risk of outright recession? Has it risen?

David Mericle: We raised our 12-month recession probability from 15 percent to 20 percent. It's a pretty small increase. And the thinking there was the increased risk is ultimately a consequence of policies that the White House is choosing to impose. And so, they can always choose to stop imposing those policies. Or even reverse them if the economic data come in too weak.

If we get the impression that they're moving ahead with even larger tariffs than we now expect, or if the White House just signaled that it's really committed to its policies, even in the face of weaker economic data, either of those developments might imply that the recession probability is higher.

Recently, President Trump was asked about the risk of recession in the context of these policies and maybe

somewhat surprisingly he said that he didn't really want to talk about that or think about that rather than just maybe saying more strongly, "Well, we wouldn't let it come to that or we don't think it's going to come to that."

So, in general, I think one gets the impression that the White House is willing to pursue policies that might imply more economic and political risk than it was willing to in its first term. Back in the first term, even at a time when no one was really that worked up about high prices or high inflation, when inflation was quite low, even then they seemed to be pretty alert to the risk that higher tariffs that raise prices could antagonize the public. And they held back on the largest round of consumer-focused tariffs. This time around I do think there's a little bit more willingness to take those sorts of risks. But we'll see how big that turns out to be.

Allison Nathan: That does feel like a big surprise, David, doesn't it? I mean, we keep hearing that people think Trump is the stock market president. But he's sending different signals, as you just said, to that end.

David Mericle: Yeah. I think that's right. That both

President Trump and all members of the cabinet have kind of signaled a willingness to take larger risks than the first time around. That President Trump has said that people might have to bear with him. That there might be some adjustment period. And that was part of the thinking in penciling in larger tariff increases. And I think it does highlight that the risks around even what we have, which at 10 percentage points would be much larger in the first term, that the risks around even our new forecast are two sided.

Allison Nathan: So, where does this leave the Fed? Obviously, market expectations of Fed cuts have moved pretty widely over the last 18 months. But recently, have begun to shift again towards more cuts. Where do we think things are headed?

David Mericle: Sure. In December and January, we generally thought that market pricing was too hawkish for a variety of reasons. For one thing, we thought if President Trump does only do moderate tariffs, we think there is enough underlying disinflationary pressure that inflation could come down to something where they might deliver so-called normalization cuts, moving back in the direction

of neutral as inflation gets lower.

We also thought that the probability of hikes was a lot lower than the market was implying. That people were being a little bit too quick to forget the lesson of 2019 when tariffs triggered what were called insurance cuts where the Fed felt the need to push back preemptively against a potential weakening of the economy in response to the impact of and the uncertainty created by tariffs.

Now, the market has actually gone from being priced for a kind of flat path in the low fours to penciling in three cuts for the year. I would say we haven't made any change to our forecast. We still have two cuts this year and one cut next year. But our thinking about what would get you there has certainly changed.

It's still possible that you would get normalization cuts on the back of lower inflation if tariffs come in smaller than we're currently expecting. But I do think they would have to be smaller. With our new baseline of a 10-percentage point increase in the effective tariff rate, we think that means inflation actually runs closer to three percent, despite those offsetting disinflationary pressures. And

that's just too high for the Fed to be cutting because they've had success on inflation.

Even if we all feel like we have a decent sense of what the tariffs are worth and even if we still feel like the underlying inflation trend is lower, three percent would be too high for normalization cuts. So, I think the way to interpret what the market is now pricing is instead as 2019-style insurance cuts. I think that's possible. I would emphasize that with inflation expectations as measured in consumer surveys now quite a bit higher than they were before all of this tariff talk began, the bar for the Fed to deliver insurance cuts is going to be higher than it was in 2019.

2019, we didn't really see that much evidence that the economy was weakening. They went ahead and cut anyway. This time, I think they're going to need more supportive evidence in the form of weaker business and consumer confidence, weaker hard data, weaker financial market performance, some combination of all of that.

I wouldn't say that the high level of inflation expectations means they can't deliver insurance cuts if things get bad enough. But I do think you would need more substantial

evidence of that because it is going to be an awkward question for any central banker to answer, “Why are you cutting rates when inflation expectations are moving higher?”

So, the bar is higher. But the risks are clearly higher as well. We have a number of tariffs that we think would raise the effective tariff rate substantially. Those tariffs would affect many, many countries. Most of which would likely retaliate to some degree against US exports. So, it’s a possibility there are two paths to cuts. But if we do see larger tariffs imposed, I think that the more plausible path would become the insurance cut scenario.

Allison Nathan: So, are you basically saying that the risks to our mainline scenario of three cuts that we’ve held for a while now is tilted towards the more hawkish side?

David Mericle: In the very near term, I would say the Fed’s preference is probably just to stay out of all of this. That is more or less what they’ve communicated. That they’re not going to be in a position to make important decisions when there’s so much uncertainty.

Since Chair Powell said that at the January meeting, we probably had, if anything, more policy uncertainty in the intervening period than anyone could have imagined. So, I'm sure their preference is until things calm down a little bit, until they have a sense of what the White House is going to do, they would really rather not be adjusting the policy stance.

So, in the near term, I think that's where we are. In the medium term, I think it depends on the impact of the tariff policies on the economy. And I could see them delivering cuts later this year, we still have a couple penciled in, if those effects wind up being as negative or more negative than we think and if we get a string of data points that raises some worry that left to its own devices, the economy might weaken more than the Fed wants. That was the scenario that led them to deliver cuts in 2019. A thought that they should prevent things from kind of continuing to get worse on their own by intervening and providing a bit of accommodation.

Allison Nathan: Even if some of the tariffs end up being lower than we're currently expecting and some of the tail risk is removed, is the uncertainty alone that's come up a

number of times in our conversations, obviously we're all very focused on the uncertainty, is that enough to do economic damage? How do you think about that as an economist?

David Mericle: I think it is. You know, there was a debate around this in 2019. And we actually took the other end of it. The narrative in markets and at the Fed at the time was that trade policy uncertainty was causing businesses to hold back on investment in a big way that was pushing the US economy potentially to the brink of recession and that we really needed these rate cuts to make sure that things didn't go that far.

And our own research suggested directionally, logically, all of this makes some sense. But kind of exaggerating the consequences.

This time, I do think the uncertainty is more serious for investment and hiring decisions for two reasons. The first kind of simple, straightforward reason is just that the tariffs being proposed are much larger. And in fact, the tariffs already in effect, even, are larger than in the first Trump Administration. This second reason is a little bit

more subtle. We showed in a recent analysis looking at industry winners and losers from the tariffs, that US industry and Chinese industry don't overlap that much. US manufacturers don't use that many Chinese inputs in their own production. And they generally don't compete in the same output markets with Chinese producers.

On top of that, back then you only had one foreign government to worry about retaliating. And it largely retaliated against the manufacturing sector, at least retaliating in a big way. This time around, none of that is true anymore. If the White House does ahead with some of these broader tariffs, for example, a tariff on critical imports or the proposed reciprocal tariff would affect a lot of countries, then far more US businesses would be affected on the input side, on the output side, or by potential foreign retaliation. Now they have to worry about retaliation from any of many foreign governments. And that retaliation could even stretch beyond the manufacturing sector to affect services first.

So, yes, I do think. I was a skeptic last time around. But I do think the uncertainty is potentially more problematic this time.

Allison Nathan: So, what are you watching most closely from here to determine the impact of tariffs on the US economy and whether we're going to need to make more adjustments?

David Mericle: After the Canada/Mexico tariffs, which I imagine were probably a surprise to most people, I think we're kind of resetting. And I would say, most of the data we have at hand, even the survey data, is probably a little bit out of date at this point. So, I would certainly think that after the latest round of tariff threats, you see some step down in business confidence next month. That's one thing that I'll look at.

Many of the business surveys also have questions about capital spending expectations. That would be the most obvious, straightforward channel through which tariffs could have an immediate effect on the economy. So, that's something I'll look at too.

Having said that, the survey data or the soft data have not been particularly reliable over the course of the last few years. I would want to see some confirmation of that in the

hard data as well. I think it's reasonable to think that all of the policy uncertainty, especially the trade policy uncertainty, but I would also throw into the mix some of the proposed government spending cuts, that those could affect both business investment and hiring. So, we'll be watching closely the hiring numbers. And particularly exposed I would say, would be the two sectors, healthcare and government, that have accounted for such a disproportionate share of hiring over the last couple of years. Exposed not through uncertainty about trade policy, but uncertainty about government spending. So, that's what I would look for on the hiring side.

And then we'll also be watching closely the business investment numbers. I'm a little bit concerned there, even apart from the tariffs, because over the last few quarters, business investment growth has not been very good. In Q4, it was outright negative, Q4 of last year. And in Q2 and Q3 it looked okay. But the numbers were flattered by Boeing finally being able to ship out a bunch of planes. If you take that out, actually, over the last few quarters, we're starting from a fairly mediocre place on business investment. And now all of a sudden, companies have quite a bit to worry about. So, we'll watch that carefully too.

I would say all of this should be viewed in perspective. We had a big post-election jump in business confidence. We are still at least prior to the latest round of tariff threats, we were still at a level that although it was below the post-election peak optimism, it was above pre-election levels. And it was certainly above the levels of the last couple of years when many companies have feared recession.

I would also say that while it's perfectly reasonable to think that tariff uncertainty and policy uncertainty more broadly could deter investment, it's probably the case that fear of a looming recession, which was on many businesses minds for a few years, probably deterred as much, if not more, investment. So, I'm not sure in an absolute sense we're in a bad place just yet. But, you know, certainly I do think you could start seeing some of these uncertainty effects materialize in coming months, either on the hiring side or the capital spending side. So, that's what we'll be most focused on.

Allison Nathan: Interesting. David, thanks so much for your time. And safe travels this week.

David Mericle: Thanks, Allison.

Allison Nathan: This episode of Exchanges was recorded on Monday, March 10th. I'm Allison Nathan. Thanks for listening.

The opinions and views expressed in this program may not necessarily reflect the institutional views of Goldman Sachs or its affiliates. This program should not be copied, distributed, published, or reproduced in whole or in part or disclosed by any recipient to any other person without the express written consent of Goldman Sachs. Each name of a third-party organization mentioned in this program is the property of the company to which it relates, is used here strictly for informational and identification purposes only, and is not used to imply any ownership or license rights between any such company and Goldman Sachs. The content of this program does not constitute a recommendation from any Goldman Sachs entity to the recipient, and is provided for informational purposes only. Goldman Sachs is not providing any financial, economic, legal, investment, accounting, or tax advice through this program or to its recipient. Certain information contained in this program constitutes “forward-looking statements”,

and there is no guarantee that these results will be achieved. Goldman Sachs has no obligation to provide updates or changes to the information in this program. Past performance does not guarantee future results, which may vary. Neither Goldman Sachs nor any of its affiliates makes any representation or warranty, express or implied, as to the accuracy or completeness of the statements or any information contained in this program and any liability therefore; including in respect of direct, indirect, or consequential loss or damage is expressly disclaimed.

This transcript should not be copied, distributed, published, or reproduced, in whole or in part, or disclosed by any recipient to any other person. The information contained in this transcript does not constitute a recommendation from any Goldman Sachs entity to the recipient. Neither Goldman Sachs nor any of its affiliates makes any representation or warranty, express or implied, as to the accuracy or completeness of the statements or any information contained in this transcript and any liability therefor (including in respect of direct, indirect, or consequential loss or damage) are expressly disclaimed. The views expressed in this transcript are not necessarily those of Goldman Sachs, and Goldman Sachs is not

providing any financial, economic, legal, accounting, or tax advice or recommendations in this transcript. In addition, the receipt of this transcript by any recipient is not to be taken as constituting the giving of investment advice by Goldman Sachs to that recipient, nor to constitute such person a client of any Goldman Sachs entity. This transcript is provided in conjunction with the associated video/audio content for convenience. The content of this transcript may differ from the associated video/audio, please consult the original content as the definitive source. Goldman Sachs is not responsible for any errors in the transcript.