TARIFF WATCH: RISING RISKS TO GROWTH AND JOBS

March 2025

The latest round of tariffs discussed could bring the effective tariff rate to a level not seen since the 1940s.[1] If these tariffs become part of a lasting policy, especially amid continued uncertainty about future trade measures, we could see meaningful impact on the US economy.

What happened?

The Trump administration may move forward with a 25% tariff on goods from Canada and Mexico (with a 10% tariff on Canadian energy imports) and is imposing an additional 10% tariff on imports from China. These measures together would bring the effective tariff rate to ~11.8%, an increase of ~9% since the start of the new administration.

How could tariffs impact growth and inflation?

Estimates are uncertain, but the effects could be impactful. Based on the 2018–19 experience, a 1pp increase in the effective tariff rate might increase core inflation by as much as 0.1% and decrease US gross domestic product (GDP) growth by as much as 0.2–0.3% for some time. Importantly, tariffs' impact on GDP occurs to a significant extent due to the uncertainty created for businesses and households, which dampens business investment and consumption growth. This means that trade policy uncertainty — already much higher than it was in 2018–19 — can have a negative impact on GDP growth even if tariffs implementation is suspended or rolled back, once announced. The direct impact on GDP — e.g., via higher prices of imports squeezing consumer spending — is also critical.

How will tariffs impact the labor market?

Without offsetting stimulus, tariffs might increase the unemployment rate, depending on their extent and the uncertainty they create. A common rule-of-thumb is that the unemployment rate rises by half the impact on GDP growth. This means the rise in the effective tariff rate due to new tariffs on China, Mexico and Canada might result in a 1pp rise in the unemployment rate, if there is no offsetting stimulus. That said, risks might be greater as labor market changes tend to be non-linear. For instance, a 0.5pp increase in the unemployment rate from its recent lows historically precedes a larger rise in unemployment (and a recession) in the US.

[1] The effective tariff rate is tariff revenue divided by total imports.

Is the US at risk of recession?

We previously estimated US recession risks to be relatively low, at 20%. Whether the US is now at greater risk of recession depends on future growth-friendly policies. Without fiscal support beyond the extension of the 2017 tax cuts, the large rise in the effective tariff rate seen so far, especially if met with retaliation from trade partners, would increase the probability of a small US GDP contraction within 12 months closer to 40–50%.

What are the implications for markets?

To some extent, the market had already priced a moderate increase in tariffs, but not more severe scenarios. Equities are likely to remain volatile, but their overall direction will also depend on any growth supporting policies that have yet to be announced by the US and others, as well as longer-term drivers such as artificial intelligence.

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For more, see our full report: **Q&A: US Tariff Risks**.

The report includes potential Federal Reserve moves and an analysis of countries most at risk.

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