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Analysis of today
Assessment of tomorrow

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Tariff Impact May Be Significantly Lower Than Feared, Even Inexistent

The consensus narrative is that tariffs act as a drag on economic growth by increasing costs, disrupting trade flows, and reducing efficiency.

There are many reasons to criticise tariffs from a commercial and political perspective, but the recent announcements of the Trump administration are less protectionist tools than negotiation weapons to level the playing field; he uses tariffs as a geopolitical shield to reduce the current negative impact that American producers suffer from unfair trade practices and the cost of illegal immigration and drug trafficking.

The United States' 2024 trade deficit soared to $918.4 billion for goods and services—a whopping 17% rise from 2023, when the deficit was $784.9 billion— and it was the largest annual trade deficit since 2021. For goods alone, the deficit hit a record $1.2 trillion, 14% higher than in 2023.

No. This condition is not a fatality. It comes from years of building a global trade system that assumed that all nations could sell freely to the United States, while those same exporting nations imposed larger tariffs and created larger legal and fiscal trade barriers to restrict American imports.

According to the 2023 International Trade Barrier Index, the countries with the highest tariff and trade barrier scores were India, Russia, Indonesia, Thailand, and Egypt. China and Brazil also ranked poorly, placing 77th and 79th.

Additionally, the European Union's net effective tariffs against the United States were much larger than those imposed by the U.S. ING Research notes that "the EU tariff rate is 10% compared to 2.5% in the US for cars, and there is approximately a 3.5 percentage point difference for average tariffs on food and beverages. Additionally, tariffs on chemicals are on average 1 percentage point higher in the EU than in the U.S."

Furthermore, in a recent Financial Times article, Mario Draghi, ex-president of the ECB, mentioned that the IMF calculates that Europe's internal barriers equate to tariffs of 45% for manufacturing and 110% for services.

A rise of protectionism

The world has been living through a rise of protectionism in the past decade, and the United States has suffered a large increase in its trade deficit due to these mounting trade burdens. It is time to balance things.

Trump tariffs are designed as negotiation tools to eliminate the burdens imposed on American exporters, and because of it, the economic impact may be lower than what international bodies and banks estimate.

The Federal Reserve Bank of Boston assumes that a 60% tariff on China and a 10% tariff on the rest of the world could add 1.4 to 2.2 percentage points to core PCE inflation in a partial equilibrium scenario (assuming no substitution or demand changes).

A more modest 25% tariff on Canada and Mexico plus a 10% tariff on China might raise inflation by 0.5 to 0.8 percentage points. The OECD and IMF share this view, estimating a loss of global GDP of 0.5% to 1% for the United States.

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On inflation, tariffs may only cause a price increase if goods affected are produced entirely outside of the United States and the demand for them is completely inelastic. Few goods have those characteristics.

Additionally, tariffs have been announced on sectors and countries that have two distinct features: they have a large overcapacity and need to sell their excess capacity to the United States to avoid a working capital challenge.

Therefore, I believe that most countries will negotiate a better trade agreement with the United States, which is the goal of the Trump administration, or absorb most or all the tariff impact on their margins because they need to maintain the large surplus with America to survive.

Tariffs do not cause inflation

The monetary factor is the most relevant. Inflation is always a monetary phenomenon. Elevated government spending leads to a rise in the money supply, which in turn results in a loss of the currency's purchasing power.

However, tariffs do not lead to more units of currency in the system, nor do they cause a rise in money supply or increase the velocity of money; instead, they tend to have the opposite effect.

If tariffs have any impact, it is to slow down money velocity in parts of the economy. Thus, tariffs do not cause inflation unless producers have unlimited pricing power and the amount of currency in the system rises dramatically. None of those two factors occur today.

Tariffs could make some individual prices rise for a short period of time, but competition and local production would offset the effect in little time. However, tariffs cannot cause an increase in aggregate prices and drive further price rises in subsequent years, which is what inflation, CPI, and PCE measure: the annualised gain in aggregate prices.

Only a rising money supply, resulting from increased government currency issuance through unsustainable spending, can have this impact.

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Tariffs do not cause inflation because they do not lead to a rise in money supply and money velocity. In fact, the potential GDP impact that some analysts estimate means that money velocity and supply may decline.

Even the ECB president, Christine Lagarde, stated that "U.S. tariffs could lower demand for EU exports and redirect excess capacity from China into Europe, which could push inflation down" (12th March 2025).

She is inadvertently admitting the logic behind Trump's tariffs. Global producers need the US trade surplus to address their excess capacity. In the absence of government negotiations, producers will likely absorb most tariffs.

The external enemy excuse

The main challenge of using tariffs as a tool to level the playing field is that some of the United States' trading partners will not accept a negotiation and will use the external enemy excuse to increase protectionism further.

For example, in the European Union, political leaders may refuse to reduce trade barriers, hidden tariffs, and taxes and blame all their problems on Trump.

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Some governments would rather inflict economic hardship on their citizens than reverse their interventionist measures. However, the Mexican president, Ms Sheinbaum, has been the most pragmatic and

rapidly understood that this is a negotiation.

She immediately took measures to address illegal immigration and drug smuggling, successfully delaying the imposition of tariffs.

The world needs to continue trading with the United States, the richest and largest economy, so it is very likely that the alleged impact of tariffs will be quickly forgotten as negotiations conclude and trade imbalances are resolved.

The worst tariffs against citizens are overspending, printing money, and destroying the purchasing power of the currency. We have a global opportunity to eliminate the hidden and effective tariffs imposed against free trade by other economies and make trading simpler and more efficient.

Everyone will benefit after the media frenzy ends and negotiations lead to a better trading environment for all producers— Americans and global ones.

There are other reasons why libertarians and free market defenders should criticise tariffs, but we should not fall for the false idea that they will cause inflation.

Inflation is always a monetary phenomenon, and in the absence of monetary easing, tariffs will likely have an exceedingly limited impact on aggregate prices. Furthermore, if the US government really takes care of the deficit by cutting spending, money supply and velocity will slow down.