Tomorrow's Affairs
Analysis of today
Assessment of tomorrow

By: Emre Alkin

Trump's Tariff Policies and Their Impact on Inflation

Since the early 2000s, inflation has been a stubborn problem that economies have tried to resolve. This is mainly generated by expanding public spending and increasing the money supply—an approach we are not yet able to escape. However, with Trump, a new phase is approaching that could reignite inflation.

All available data indicates that Trump's high tariffs are reintroducing inflationary pressures. According to the Office of the U.S. Trade Representative (USTR), the tariffs have caused a noticeable decline in imports from China.

For example, import volumes in the electronics and automotive sectors have decreased by approximately 10-15%. However, this has also resulted in an additional cost of about $37.5 billion for products coming from China.

According to Wiley & Sons' 2024 report, these cost increases have driven up prices of electronics and automotive products by 10-15%, which is a substantial rise by Western standards.

This report was released way before Trump's magic touch (!) to the world economy. Today the costs are rising every day.

The IMF's October 2024 report states, "Trade policies and costly tariffs can push inflation higher again and threaten long-term economic sustainability." In this context, tariffs and market expectations have led to the short-term risk of rising inflation, which has become a critical factor shaping the Fed's interest rate policies.

It's also known that Americans have been spending over $100 billion monthly on dining out after the pandemic. We understood the reason through a recent study: in the U.S., "cheap" restaurant meals are more affordable than grocery shopping. However, there's significant debate about the quality of this food.

Dependence on Imports and Sectoral Risks

The U.S.'s high import dependence on China and India increases economic vulnerability and risks due to the tightening of tariffs.

According to the U.S. Department of Commerce, imports of automotive parts from China accounted for about 18% of total imports at the end of 2023.

In electronics, this ratio reaches 23%. Inflation and rising costs could lead to disruptions in supply chains, especially in the automotive and electronics sectors.

The automotive industry relies on China for 12% of its total production in 2024, and disruptions in the supply chain could cause prices to rise by 15-20%.

> Imports of rare earth elements account for nearly 60% of the supply and are controlled mainly by China and Indonesia

The U.S. also continues to depend on imports for pharmaceuticals and other strategic products, as well as energy.

According to the U.S. Energy Department's November 2024 data, energy imports meet about 14% of total energy consumption.

Imports of rare earth elements, crucial for U.S. defence and technological manufacturing, account for nearly 60% of the supply and are controlled mainly by China and Indonesia. This dependence raises questions about the long-term sustainability of tariffs.

Fed's Interest Rate Policy and Economic Transformation

Now, let's turn to the consequences of Trump's tariff war, which began with a lack of knowledge on monetary policy.

Recall that the Fed's leadership, aiming to support economic growth, considered lowering the policy interest rate from 5% at the end of 2024 to around 2-3%.

The IMF's October 2024 report warned that "a low-interest rate policy might support growth but could also increase risks of financial bubbles and inflation."

Even the expectation of a rate decrease alone stirred markets. The anticipation of low rates sparked a surge in housing and consumer loans, with reports indicating a 15% increase in mortgage usage and total credit reaching $3.8 trillion in 2024.

This temporarily boosted economic activity. Trump is now trying to claim credit for this, but it's not directly related.

> Persistently low interest rates also exert downward pressure on the dollar's global value

Harvard Business Review experts warn that, in the long run, a low-interest policy can lead to asset bubbles and undermine financial stability. It's evident even today with excessive price hikes in stock and housing markets.

We don't have to be an expert to see this reality. These developments show that the U.S. economy is heavily financialised, carrying significant risks of a financial crisis if bubbles burst. In a previous article, I discussed this danger in detail for Tomorrow's Affairs' readers.

Persistently low interest rates also exert downward pressure on the dollar's global value, which raises the prices of imported goods and fuels inflation again—particularly affecting the costs of strategic items like energy and rare earths.

Political and Market Dynamics

All these developments could have serious political consequences. Analyses in Foreign Affairs suggest that the resurgence of inflation would heighten economic anxieties among voters, complicating government actions.

Pressuring the Fed to cut interest rates is akin to pouring gasoline on a fire - Emre Alkin

Unfortunately, such outcomes might lead countries to adopt more protectionist policies. Market volatility could also rise sharply. The threat of high inflation and financial instability is likely to lead to downward revisions of growth forecasts.

In summary, tariff increases and high costs raise inflation, while it appears that Trump's understanding of the Marshall-Lerner condition is limited.

When dependence on imports is high for certain products, and short-term import substitution isn't feasible, devaluing the national currency doesn't help. Moreover, imposing high tariffs on essential imports exacerbates inflation.

Türkiye has been making this mistake since 2014. Today, it faces high inflation and deindustrialisation.

If this continues, the U.S. will remain in a current account deficit in the medium term and also face inflation. Pressuring the Fed to cut interest rates is akin to pouring gasoline on a fire.