MARKETS & FINANCE

Wall Street's Response to More Tariffs: Been There, Done That

Automakers and the peso fell. The Dow industrials hit a record.

By Sam Goldfarb Follow

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General Motors' Ramos Arizpe plant in Mexico. PHOTO: DANIEL BECERRIL/REUTERS

Wall Street isn't thrilled about the return of Donald Trump's tariff threats. But traders are hardly panicking either.

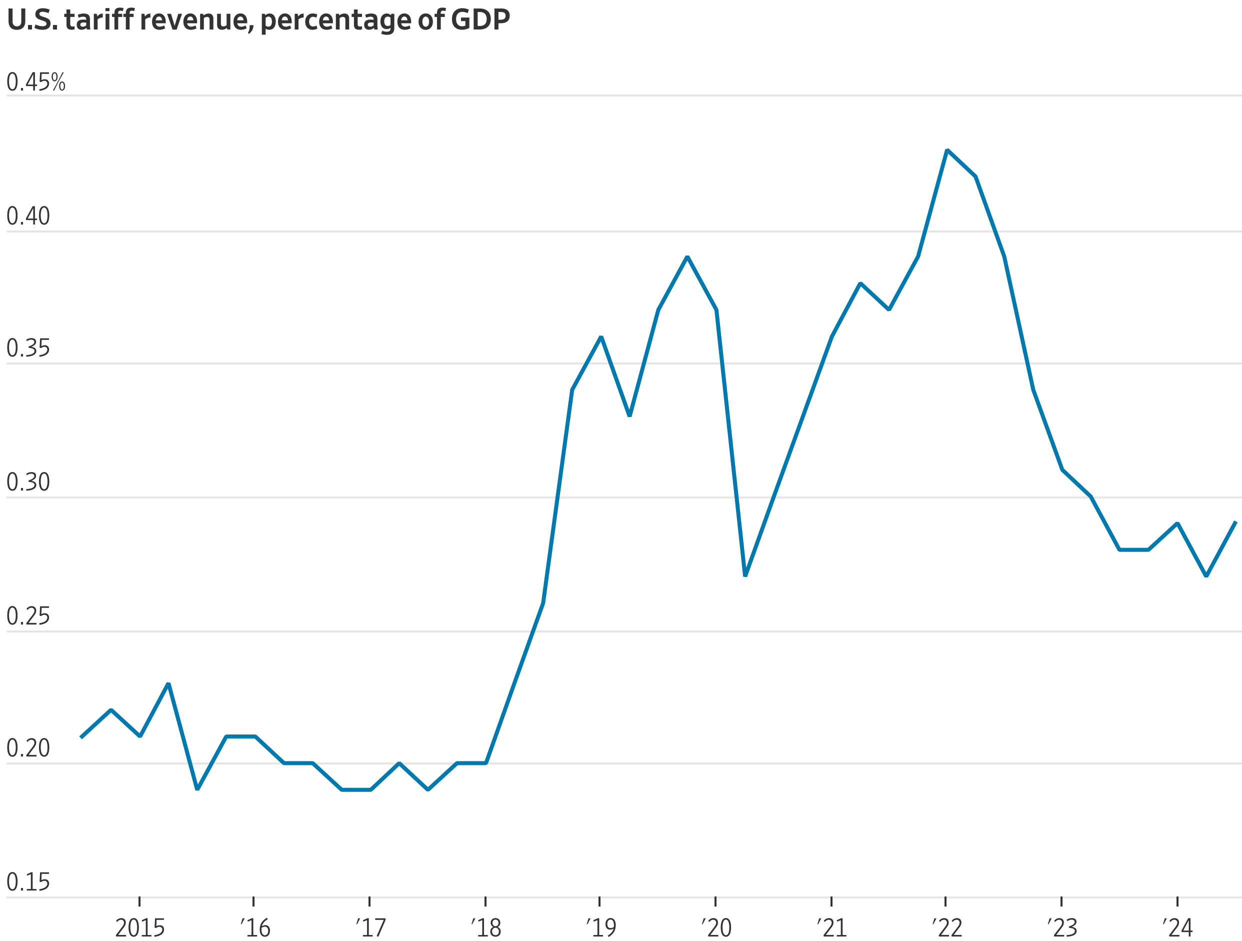
Shares of automakers were hit hard this week after the president-elect promised to levy hefty tariffs on imports from Canada and Mexico on his first day in office, along with additional tariffs on Chinese goods. Canadian railroad companies slumped, while Mexican and Canadian currencies weakened against the U.S. dollar.

Even so, broad indexes of stocks pushed higher, with the Dow Jones Industrial Average climbing to yet another record on Tuesday.

Some investors said they had learned lessons from the craze for trading Trump's social-media posts that followed his first electoral win. Back then, Trump often sparked big swings in stocks, commodities and currencies with surprise broadsides—only for the moves to unwind when negotiations progressed, he de-escalated, or workarounds mitigated the biggest threats to the economy or corporate profits.

The result was heightened volatility and higher tariffs on Chinese imports in particular. But stock returns over Trump's entire four years in office proved robust. This time, investors have been heartened by Trump's pick of Scott Bessent as Treasury secretary. He is a seasoned investor viewed by many as a potentially moderating influence on the president.

"The market is constantly trying to ask itself: What will happen and what is just posturing?" said Michael Antonelli, a managing director at Baird. "It's very reminiscent of the 2016 to 2020 time period."



Source: Commerce Department via Federal Reserve Bank of St. Louis

Taking Trump's words at face value, investors have more to fear from his trade policies now. His newly proposed 25% tariffs on imports from Canada and Mexico—the U.S.'s two largest trading partners—would add 0.8 percentage point to a key inflation gauge next year if just half of the costs are passed on to consumers, according to a Deutsche Bank analysis.

During the recent presidential campaign, Trump repeatedly said he supports across the board tariffs on imported goods, suggesting that those could be as high as 20% on imports from most countries and much higher than that on Chinese imports. Such tariffs, Trump argued, could revive domestic manufacturing and be an important source of revenue for the government.

That rhetoric marked a shift from his first term, when Trump talked more often about using tariffs as a cudgel to get other countries to lower their own trade barriers.

Many investors, though, said they believe that Trump's tariff threats should still be mostly viewed as a negotiating tool. Trump, they added, is promising tariffs on Canadian and Mexican imports explicitly as a tactic to reduce the flow of drugs and immigrants into the country.

Analysts at Goldman Sachs this week were among those drawing parallels to an episode in 2019, when Trump promised escalating tariffs on Mexico, also for the purpose of stopping illegal border crossings. About a week later, those planned tariffs were canceled when the U.S. and Mexico reached an agreement to stem the flow of migrants. The two countries, along with Canada, reached a trade agreement in 2020 that made relatively small changes to the North American Free Trade Agreement, which Trump had called "a nightmare."

Trump did more than just talk about tariffs during his first administration. By the end of the term, he had imposed levies on about $380 billion of goods, mostly from China, according to the Tax Foundation.

China retaliated against Trump's 2018 tariffs in part by buying far fewer U.S. soybeans. Prices fell 20% as China turned to Brazilian farmers instead. The next year U.S. farmers planted soybeans on roughly 15% less acreage. The Trump administration responded with new subsidies for farmers, but farm bankruptcies still swelled. The U.S. and China halted their trade-war escalations in 2020. That led to a rebound in trade between the two countries, though China fell short of its targets for purchasing U.S. exports.

"Trump and the people around him feel like they were vindicated in the first term," said Andy Laperriere, head of U.S. policy research at Piper Sandler. "In some areas, especially China, I think we're going to see very significant tariffs."

Trump's first-term trade battles were often overwhelmed by other factors driving markets. Stocks slumped in 2018 when those conflicts escalated, but that was also a year when the Federal Reserve was raising interest rates. The next year, trade tensions were still high, but stocks surged as the Fed pivoted to cutting rates.

Now the Fed is cutting rates again, and investors are generally happy with the economy. Many are hopeful that increased trade frictions under Trump will be more than offset by other parts of his agenda, including plans to extend tax cuts.

Some investors simply find it hard to believe that Trump would follow through on measures that would boost consumer prices after voters' discontent with inflation helped power his victory.

The driving political force of the day is, "It's inflation, stupid," said Keith Lerner, co-chief investment officer at Truist Advisory Services.

—Ryan Dezember contributed to this article.

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