MetLife Investment Management

Trade War is Hell

April 9, 2025

Waking Up to A New Reality — Recession

There are tariffs, there are reciprocal tariffs and then there are these proposed tariffs. As the “reciprocal” tariffs do not have any factual basis, there is no obvious solution to the announced tariffs and no agreed-upon starting point for negotiation. As such, one takeaway may be that these tariffs may not be meant to serve as a basis for negotiations. They may not be the means to an end, they may be the end.

Given there is no sign that the Administration is rethinking the announced policies (and absent any successful legal challenges), we are making a number of significant changes to our economic outlook that reflect our expectations for changes in consumer and corporate behavior, trade accounting and government spending. Specifically, we now expect a recession in 2025 and are making the following adjustments to our 2025 economic outlook:

2025 Real GDP Growth – New: 0.0%
2025 Real GDP Growth – Previous: +2.3%

We now expect at least two quarters of negative growth beginning in Q2 2025. After a short-lived bounce in consumer activity as consumers attempt to get in front of tariff-driven price increases, economic uncertainty and equity market volatility and/or an equity wealth effect should combine to prompt increases in the personal savings rate resulting in lower consumer spending and layoffs resulting from that decrease in activity. Corporate investment is likely to follow a similar pattern with some companies able to invest to avoid tariffs, but with larger investments likely put on hold until the new order sorts itself out. The result should be a significant slowing in real economic activity. Acting as a partial offset will be a reduced level of trade (the large deficit is, after all, the rationale for these tariffs) and increased government spending on unemployment benefits and other measures of consumer support.

2025 Inflation – New: 3.1%
2025 Inflation – Previous: 2.8%

Price adjustments will likely show higher inflation with tariffs adding to inflation pressures but weakened demand should act to limit overall price increases.

2025 Policy rate change – New: -100bp
2025 Policy rate change – Previous: -50bp

The Federal Reserve finds itself between a rock and a hard place. The Administration has been vocal about their desire for the Federal Reserve to ease policy by reducing interest rates and have pointed to recent market actions related to tariffs as justification. Chairman Powell is unlikely to be swayed by these arguments as the market movement has been caused by the policy actions of the Administration. Actions to offset the market response to these policies could encourage more actions that disrupt the real economy and/or financial markets. As a consequence, we look for the Federal Reserve to act, but we expect its actions to lag behind the evidence of a significant weakening in the economy — for example, evidence that the unemployment rate is moving decisively towards 5%.

2025 US Treasury 10-year yield – New: 3.75%
2025 US Treasury 10-year yield – Previous: 4.25%

We are revising down our 10-year yield forecast to reflect lower growth and that the forecast tariff-driven inflation increase is temporary in nature. We continue to believe that longer-term neutral rates are above 4%.

Damaged Goods

Even if there is a near-term resolution of the tariff and other trade issues, damage has been done to the economy and to consumer expectations. It is also unlikely that markets will rebound fully meaning that for the large cohort of workers approaching retirement and for those workers striving toward home ownership, the boost in the savings rate prompted by this volatility may be sustained.

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