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# Brunetti View 2

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## A year of Maga economics

It is probably the biggest experiment in unconventional economic policy that we have seen in a rich industrialized country in recent decades.

And it is certainly the most significant macroeconomic event of this year. With the aim of leading the economy – immediately – to unprecedented growth, hardly a stone was left unturned in US economic policy this year. However, most economists believe that the methods and instruments used to achieve this were completely unsuitable.

Although the policy mix was actually designed to achieve large growth gains as quickly as possible, the US economy remains remarkably sluggish.

As we discussed in the last issue of «View,» the populist expansion strategy was thwarted by the massive uncertainty created by the almost daily policy changes. As a result, the unusual policy mix weakened growth practically from the outset. If this policy is maintained, it is also likely to have a substantial negative impact on the medium-term growth momentum of the US economy.

## Tariffs as the main player

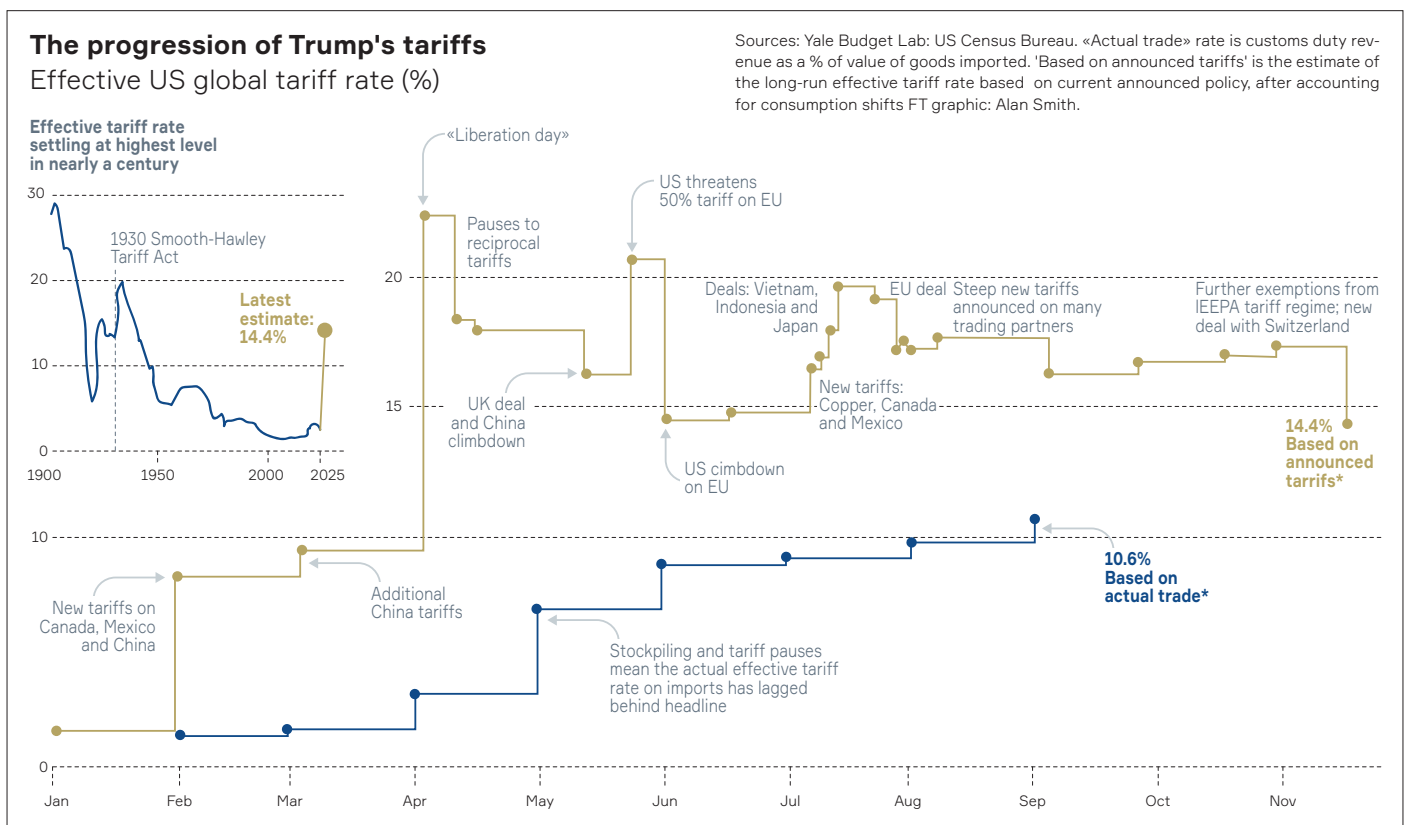
One policy area clearly stands out: trade policy. Tariffs are, so to speak, the symbol of Trump's economic policy, and he emphasized during his election campaign how important he considers significant tariff increases to be. And whatever one may think of this, the administration has delivered on its promise in this regard.

The Financial Times chart, which is updated regularly, shows the impressive trajectory that US trade policy has taken since the new administration took office.

The small graph in the upper section of the image traces the history of average US tariffs since the beginning of the 20th century.

In response to the high costs of the ill-fated protectionist measures of the interwar period (symbolized by the Smoot-Hawley Tariff Act), there was a significant rethink after the end of World War II. As part of the reorganization of global economic institutions, the US led the joint efforts of industrialized countries to dismantle trade barriers as far as possible.

Average tariffs were therefore gradually reduced, reaching a very low level of close to zero percent in this millennium. Donald Trump abruptly ended this wave of liberalization in world trade this year.



Tariffs shot back up to the level seen at the end of World War II in a very short time. The large chart in the figure traces this spectacular development in the current year in more detail.

After some initial tariff increases in the first quarter, the shock of Liberation Day – with its original title – came at the beginning of April. From this peak, tariffs have since been reduced somewhat, with some ups and downs, but are currently still at a very high average of just under 15%.

Incidentally, the most recent event noted here is the so-called “tariff deal” with Switzerland.

This development is also remarkable because such a protectionist trade policy is diametrically opposed to fundamental recommendations of economics.

Economists debate many things, but there is remarkable agreement on the harmful effects of tariffs. There are various arguments for this, but the basic reasoning is very simple.

Firstly, the (international) division of labor is the basis of prosperity (imagine a self-sufficient Switzerland) and secondly, trade only takes place if both parties benefit from it. The US administration's argument makes it clear that it does not accept or understand these two premises.

If it considers every bilateral trade deficit to be problematic and wants to bring the production of as many goods as possible back to the US, then it is effectively embarking on the immensely expensive and inefficient path toward self-sufficiency.



And if it repeatedly insists that trade with certain countries is at the expense of the US, then it believes that foreign trade is a zero-sum game and that one party's gain is another's loss. However, this is a fundamental misunderstanding, because no one can be forced to trade, and exchange therefore only takes place if both sides benefit; it is a positive-sum game that increases the size of the pie overall, and it is therefore not a question of distributing an existing pie.

Against this backdrop, it is economically undisputed that imposing tariffs is harmful and that the US administration is doing itself and its country a monumental disservice by sticking to them.

The political-economic problem with this is that the costs of tariffs are mainly long-term. In the short term, they are attractive because they appear to protect domestic production while also generating government revenue.

However, the costs are mainly felt in the longer term because value chains have to be reorganized and become less efficient, and the workforce is deployed less productively.

This significantly reduces future growth potential. One negative effect, however, can already be felt in the short to medium term, namely the rise in goods prices.

## Threat of inflation (loss of purchasing power)

This brings us to the second particularly noteworthy effect of Trump's policy mix. Virtually all of the measures threaten to fuel inflation.

The first is the trade policy described above. A large portion of the tariffs is usually passed on to customers. It is clear to see that this has already begun in the US, with consumers increasingly complaining about the falling affordability of goods subject to high tariffs. But the sharp restrictions on migration are also leading to wage pressure and thus price increases due to the increasing shortage of labor.

Fiscal policy is having the same effect through tax cuts combined with continued exceptionally high government spending.

And to make matters worse, the administration is constantly attacking the US Federal Reserve and demanding drastic interest rate cuts.

These attacks undermine the independence of the central bank, which is crucial for price stability, and any further interest rate cuts would also have an inflationary effect. Overall, all elements of this policy mix are driving up prices, and it is therefore no surprise that, despite the economic slowdown, US inflation, and core inflation in particular, remain stubbornly at 3%.

Rising inflation expectations also signal that this trend has probably not yet peaked.

## ... and Switzerland?

As is well known, Switzerland was particularly hard hit by the US tariff hammer. Accordingly, slumping goods exports led to weak GDP growth in the second quarter and a significant decline in the third.

As a country heavily dependent on exports, Switzerland cannot escape such a foreign trade shock. On a positive note, however, an agreement is now emerging that should lead to a reduction in tariffs from a stratospheric 39% to a still high 15%. The key factor here is that Switzerland is likely to face a similar burden to the EU, which will reduce additional displacement effects at its expense.

Accordingly, a slight recovery in the outlook can be expected, and the slump in GDP in the third quarter may not signal the start of a recession after all.

In general, the latest reactions from the US administration show that there is a growing realization that tariff policy increases prices, reduces the affordability of goods for US households, and thus increasingly undermines the government's popularity.

It is therefore quite conceivable that protectionist measures will be scaled back somewhat in the near future, which could significantly brighten the outlook for the global economy.

However, given the US administration's inconsistency this year, this remains a fragile hope for the time being.

## About the author of the Brunetti View

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