Economic view

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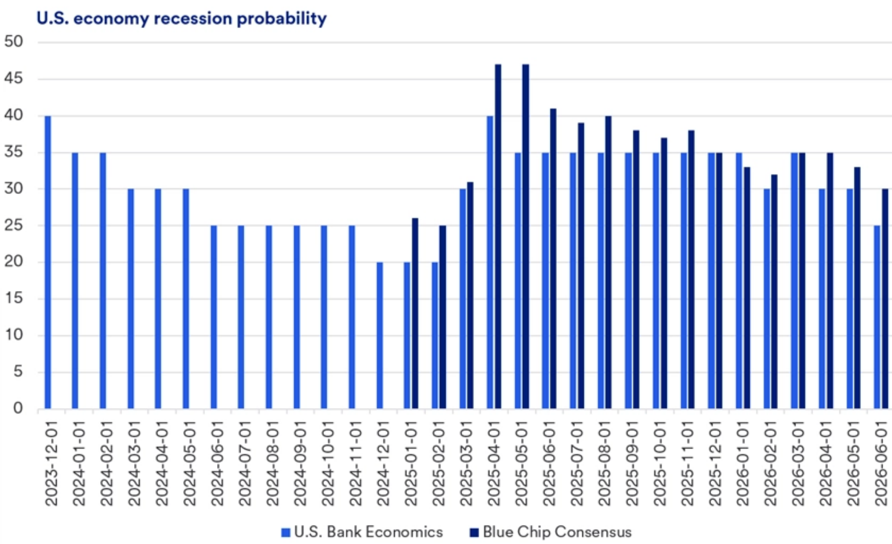
From the desk of Chief Economist Beth Ann Bovino

The tariff shock fades, but the trade map shifts

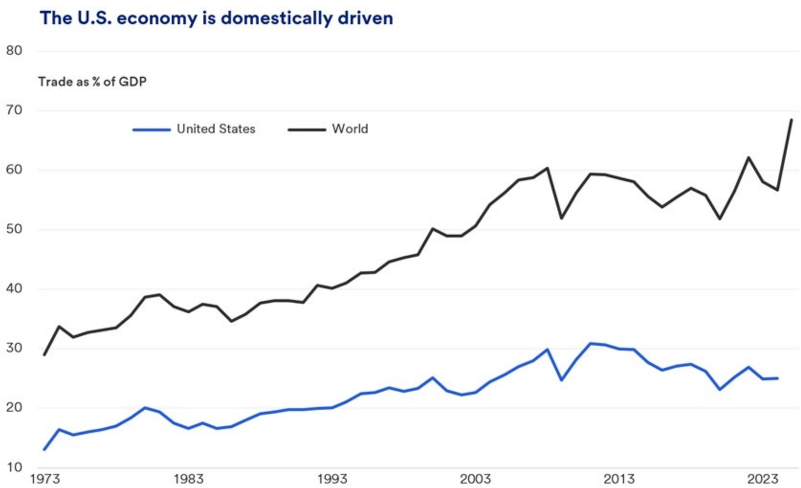
It's been 15 months since "Liberation Day" and we've seen multiple swings along the way. After the announcement, the effective tariff rate (ETR) was expected to climb to at least 20% – almost 10 times the 2024 rate of 2.25%. At the time, Blue Chip Consensus Economic Indicators placed the probability of recession over the following 12 months at 47%, as markets feared an escalating trade war. Once U.S.-China escalating tensions took a few steps back in May 2025, our recession risk held at around 35% through the rest of the year.



Source: U.S. Bank Economics, Blue Chip Consensus Economic Indicators

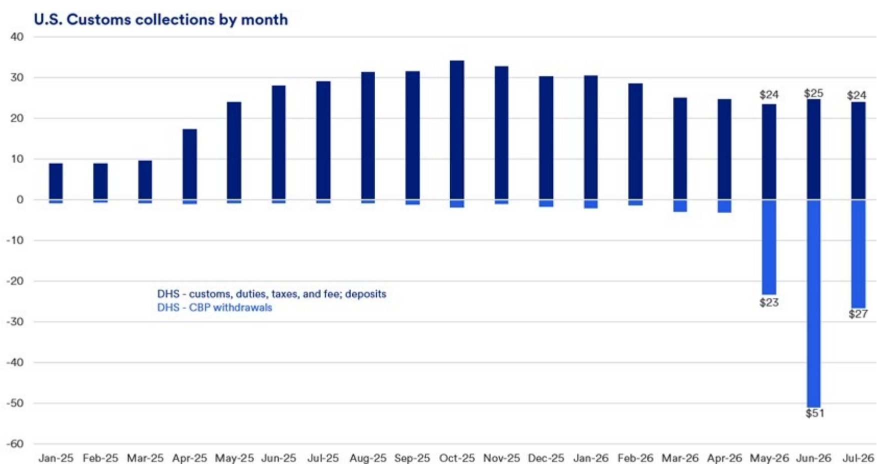
Despite the heightened uncertainty in 2025, we expected tariff-related costs to sting economic growth but not shatter the expansion. We believe this still holds today. The tariff shock on its own was not enough to cause recession. [LG1.1]

Because the U.S. economy is mostly domestic – about 75% of activity is domestically driven versus roughly 40% globally – we thought the near-term growth hit on the U.S. would be modest. Still, the inflation nudge from tariffs gave the Fed one more reason to keep a hawkish lean on monetary policy. Going forward, the key question is whether firms, both domestic and abroad, absorb the cost, pass it through, or rethink sourcing altogether.



Source: U.S. Bank Economics, World Bank

And some of the expected larger pass-throughs never began. Carve-outs, delays, and renegotiations meant the ETR was much lower when all was said and done. Then the Supreme Court struck down the Trump administration's International Emergency Economic Powers Act (IEEPA)-based tariff policy in February. Now refund checks are leaving the U.S. Treasury, with tariff refunds more than offsetting tariff collections for the third straight month.



Source: U.S. Bank Economics, U.S. Census Bureau

The tariff tax did add to inflation pressure, but we saw it as a one-off level increase that would eventually normalize. Based on inflation data today, the core goods price change is trending lower, with most of the tariff costs passed through to consumers now over. We estimate the ETR to settle at 7.5%, much lower than what was initially anticipated. But tariff rates are still three-three times higher than in 2024, adding to affordability constraints. And are now even worse, as war-related energy price pressures further weaken household purchasing power.

While it seems that the tariff war is largely behind us, longer-term ramifications need to be considered. The tariff war has nudged other countries to find different partners. The UK and India signed a trade agreement in July 2025, the EU and India reached a free trade agreement this January, and the EU also signed a landmark deal with Mercosur, creating a free-trade zone covering about 700 million consumers. We are watching whether this becomes a one-off scramble or a more durable shift away from U.S.-centered trade design.

As others deepen trade ties, the U.S. government is pursuing other options to increase tariffs, such as Section 301 of the Trade Act of 1974 to reimpose tariffs of up to 12.5 ppts around 60 economies, offsetting the 10% tariff the Supreme Court deemed unlawful. Dependence on U.S. technological innovation will likely keep foreign markets open to trade with the U.S. for some time. But the U.S. could be on shaky ground in the future, with China's technological advancements on its heels.

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