

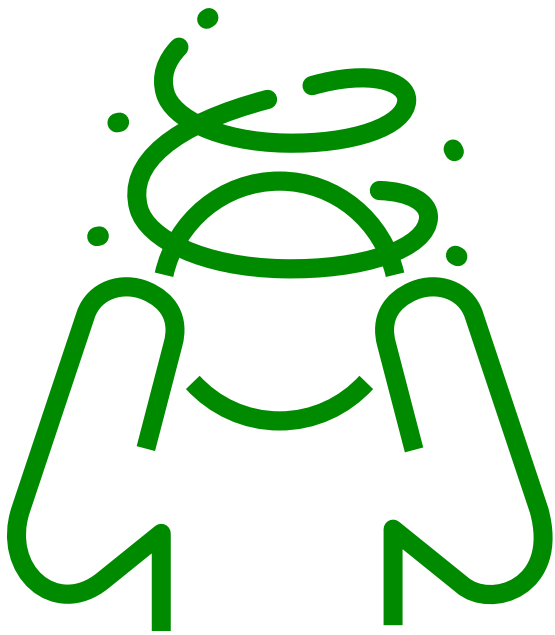
The First 100 Days: Dazed and Confused

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It's been a whirlwind for forecasters, reminding me of the pandemic days when we were reviewing forecasts every couple of weeks to catch up to policy announcements without a historical reference for what was going to come next.

But we've learned a lot in the first 100 days:



The first is that tariffs will remain the economic weapon of choice on a scale greater than anything in recent history.

The second lesson is that regardless of whether the Administration back-peddles on initial tariff threats, the goal remains the same:

1. Create more production independence, particularly within strategic sectors like technology, chemicals, resources and industrial materials.
2. And, I believe, there's an end goal to have a permanently higher tariff regime at around 10% based on the initial results with the UK and China.

That base tariff rate is used as our forecast benchmark.

Why does 10% look reasonable?

It's low enough to be partially absorbed within the supply chain to limit the pass-through to consumer prices. And It's a revenue raiser for the government. The U.S. is the only OECD country without a national sales tax, which would be wildly unpopular . But under the guise of fairness to American workers, this tactic works by impacting only 14% of the economy (i.e. the share of imports), and consumers don't generally pay the full amount. In contrast, a sales tax is highly observable by consumers by being reflected on every shopping receipt of daily transactions. If imports held constant, it would generate up to \$3 trillion in government revenues over the next decade to fund spending and tax cut initiatives.

But that still means forecasts have been broadly downgraded in the near term on the combination of DOGE cuts, tariff hikes, and a higher and more uncertain operating cost environment for many businesses.

The Result of the First 100 Days

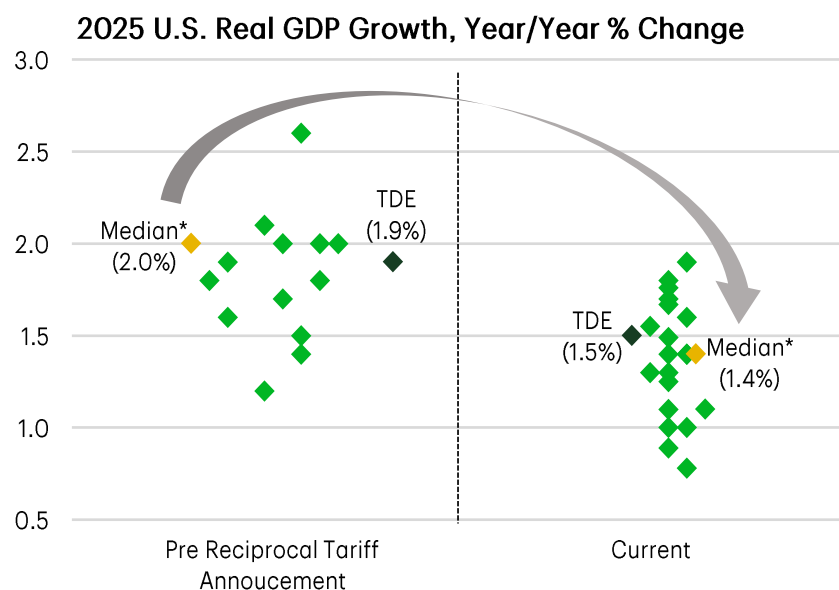
Let's start with the forecasts, where consensus does not yet reflect the 90-day tariff-truce between China and the U.S., but our figure does.

Following the April 2nd Liberation Day tariffs, a universal 40-60 basis point downgrade hit economic growth. The tariff-pause with China was certainly a positive development that will improve estimates, particularly among those with technical recessions. But the theme of downgrades relative to last quarter will hold.

Looking objectively at the situation:

1. Tariffs at 30% on China are higher than pre-Trump days, including a 54% de-minimus rate that was zero. Listening to a retailer on the news who imports educational toys from China, he expressed it succinctly by saying: the only reason to get excited about a 30% price hike is when it used to be 145%. Last year it was zero.
2. A 25% tariff remains on steel, aluminum and autos.
3. There's a laundry list of section 232 investigations underway on semiconductors, copper, lumber, pharmaceuticals, trucks and processed critical minerals. President Trump has even indicated that movies can make the list, underpinning an administration that is still highly prone to unpredictability and a high appetite to press the boundaries.

So there's optimism that the administration is inching towards their goal posts, but the business environment embeds a lot of uncertainty and additional costs. And although the market is behaving as if there's a deal with China, there's not. There's only an agreement to work on a deal, and many things can go wrong with two tough negotiators.



Source: Bloomberg, TD Economics. Last Observation: May 6th, 2025.

*Consensus includes larger U.S. banks and other key contributors.

Tariffs Hit Staggering Level Relative to History

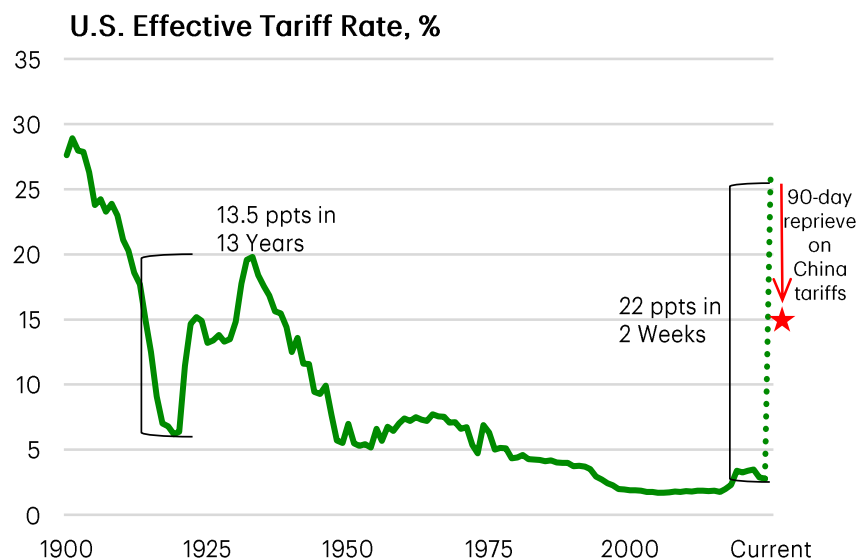
Here's the picture that speaks to the higher cost environment and forecast downgrades.

Many analysts refer to the Smoot-Hawley period in the early 1930s as the prior peak in the level of tariffs. But the rate of change matters more than the level.

In just a couple weeks there was a 22-percentage point jump in import tariffs, far more than the entire decade in the 1920s and early 1930s. This figure is calculated after the 90-day reciprocal pause, which still had tariffs on China at 145%, as well as 25% on global steel, aluminum and auto tariffs.

The deal with the UK didn't change the math, it represents only 3% of US trade. But the temporary reprieve with China at 30% did make a difference.

Even so, the U.S. effective tariff rate has still risen by 12 percentage points, marking a price shock for importing businesses in a very short period. And the level at 15% globally, is not much lower than the peak period during 1933.



Source: Bureau of Economic Analysis, TD Economics.

The Clock Is Ticking Down: Disruptions Caused By Policies

The de-escalation with China is telling us that the Trump administration is paying attention to headlines and market sentiment.

The economic impacts were quickly broadening, spanning shipment disruptions to consumer choices. And if there was ever any doubt on whether President Trump cares about market moves, that was cleared up when he advised the world to: "Better go out and buy stocks"!



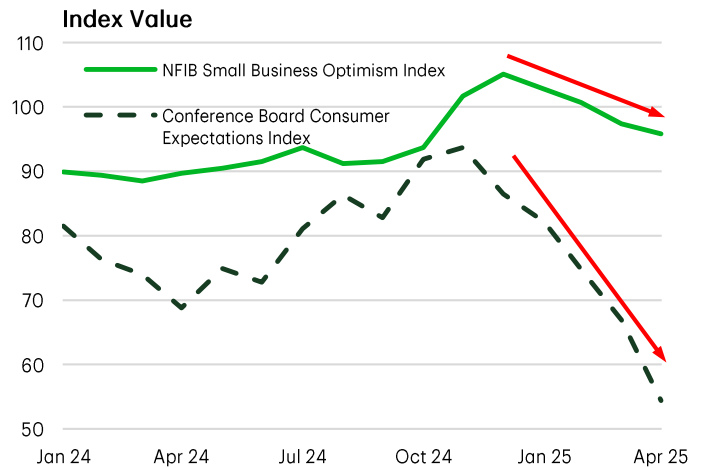
Tick...Tock...U.S. Businesses And Consumers Show Angst

The top graph must be making the administration nervous and speaks to the importance of turning around overall sentiment before it manifests in the hard data.

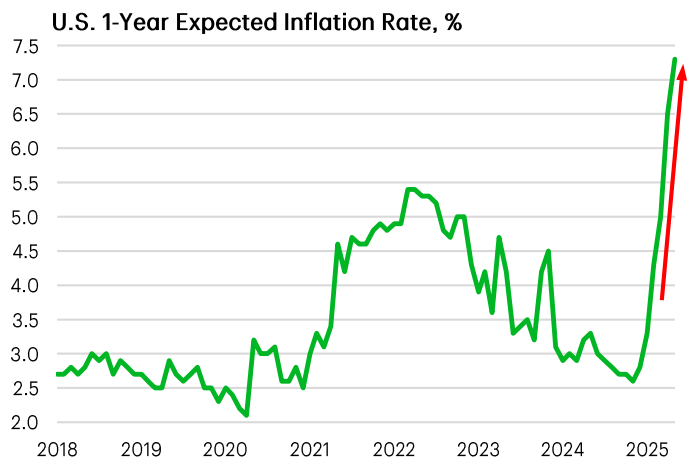
It hasn't yet because it's too early. The hard data is just starting to capture April outcomes, where survey periods may only extend to mid-month. Any large-scale shift in firm behaviors will be transmitted in the following months.

But so far, the data is solid, particularly where it matters most – the job market. It pumped out a 3-month pace of 155K jobs, which is more than sufficient to hold the unemployment rate steady. This is also why the Federal Reserve has noted the importance of watching sentiment, but not reacting with a policy response until there's a direct correlation to the hard data.

The graph below will be trickier for them to interpret. It shows a jump in inflation expectations one year ahead that's greater than during the pandemic. The same picture exists for expectations that are 5 years ahead. The Fed would pay more attention to this metric, but again, prefers the wait-and-see approach by monitoring the hard data.



Source: Conference Board, NFIB, TD Economics. Last Observation: April 2025.



Source: TD Economics. Last observation: May 2025.

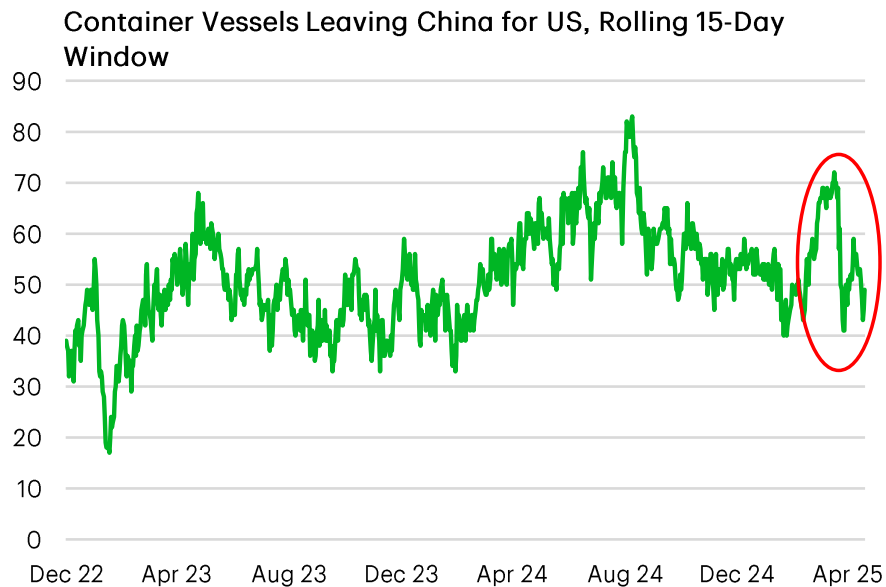
Tick...Tock...Tariffs Immediately Altered Shipments

Here is one piece of hard data that could define an acute risk to future inflation.

Daily data of container shipments from China leaving for the US show a collapse in the days following the tit-for-tat tariff escalation in early April. Anything that wasn't already on a ship and at sea following April 9th would have been tariffed at 145%. No surprise, this immediately locked up supply.

Shortly after, Walmart and Target CEOs sent out warnings of supply chain upheaval and empty store shelves. Meanwhile, the Federal Reserve's Beige Book cited firms already receiving notices from suppliers that costs would be increasing. That survey captured business responses within 10 days of the Liberation Day tariff announcement.

This signals that time is of the essence to get ahead of the inflation data because households have long memories when it comes to their cost of living.



Source: Bloomberg, TD Economics. Last observation: May 19th, 2025.

Isolate China? A Hard Nut To Crack for Trump Administration

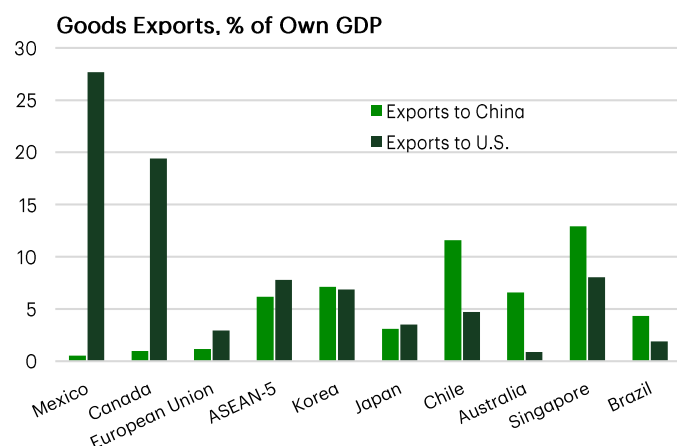
Despite the 90-day reprieve on China, we must be careful in getting too excited. A quick deal will be tough.

China has deep economic ties. The graph on the left shows each country's exports to China and the U.S. as a share of their GDP. Outside of North America, several countries have near equal or higher reliance on China than they do on the US. Some regions, like Brazil, even stand to gain from the trade war escalation, because China has shifted purchases to them for soybeans and other agricultural products.

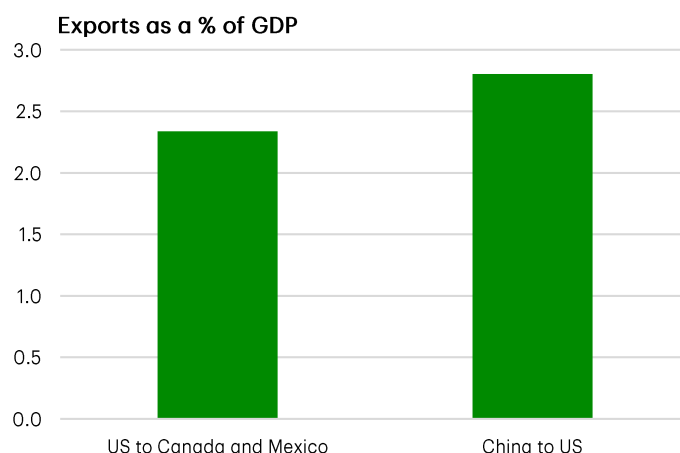
These relationships will complicate negotiations and the U.S. attempt to ring-fence China, whether it's for steel and aluminum, AI chips or other strategic targets. We're already seeing this play out. For the UK to not pay U.S. steel and aluminum duties, it agreed to ensure supply chain security via the ownership of relevant production facilities. This was legal-speak targeted at isolating China from the supply chain. China has already warned the UK that agreeing to this condition could be met with retaliation. This offers a good example of how countries will be caught trying to serve two masters for their export market.

As for how much pain China can take from a trade war...a lot.

The graph on the right shows that they have similar reliance on exports to U.S., as the U.S. has with Canada and Mexico. By logical extension, if the U.S. feels it has leverage over Canada and Mexico because its economy inherits less pain from tariffs, China can argue the same when it comes to the U.S.



Source: IMF, TD Economics.



Source: US Census Bureau, Haver Analytics, TD Economics.

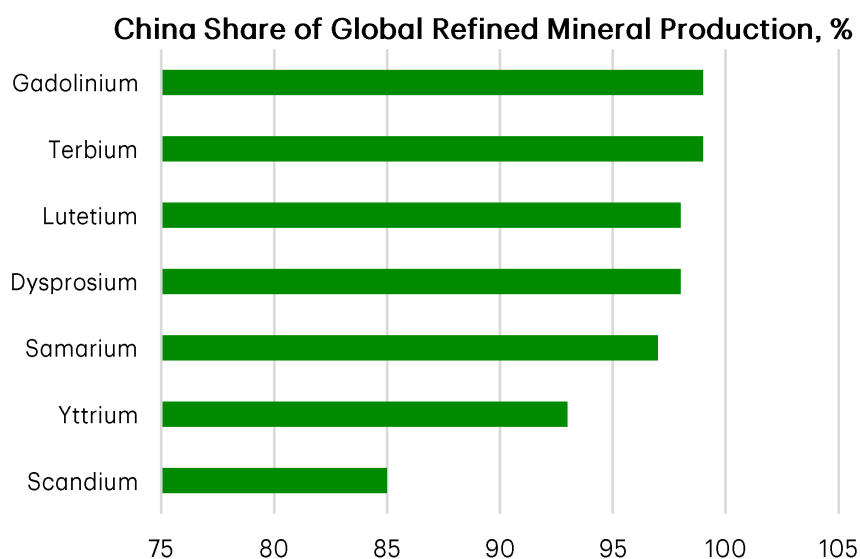
China's Critical Minerals Leverage

This is one reason why we rarely see China blink. The other reason is captured in this graph showing China's control of key rare earth minerals.

As part of the 90-day truce, reports indicate China will loosen export controls that were part of its retaliation response in April. China's restrictions applied to seven medium and heavy rare earths where they have a near full monopoly. In contrast, China was strategic to not impose restrictions on rare earths where there was sufficient diversity in supply from other countries.

The ones shown in this graph are needed for equipment production in aerospace, energy, military and autos. All areas of strategic importance to the U.S., which is the ultimate argument on why the Trump administration wants to pivot away from China.

But that's a long-game strategy and China knows it.



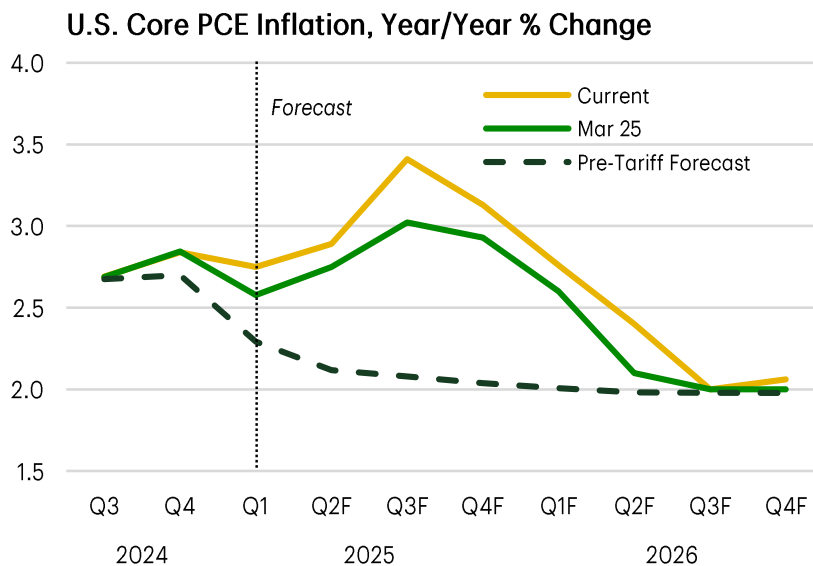
Source: Bloomberg, TD Economics.

An Inflation Lift Still The Base Case

Despite some 11th hour deals and market optimism, the fluid environment still places the balance of risks toward a lift in inflation by the third quarter, as the lagged effects get captured from higher import costs.

As an example of lags, there was a lot of optimism with the restraint shown within April's U.S. CPI inflation data. This was partly because vehicle prices were flat to down on the lagged effect of dealership deals to unload the stockpile of inventories. However, the Manheim used car index was strong in April, jumping nearly 3% in a single month. It takes about two months for that data to first make an appearance within the CPI methodology, putting us into June for the first transmission of tariff impacts on this industry.

Simply put, the U.S. won't be able to fully insulate itself from a 12-percentage point lift in tariffs until deals occur with their big import markets of China, Canada, Mexico and the EU. These account for three-quarters of their trade. The longer it takes to finalize these deals, the greater the risk that inflation won't abate in time to leave the memories of voters ahead of the 2026 mid-term elections, which creates a strong motivation for the Trump team to get it done.

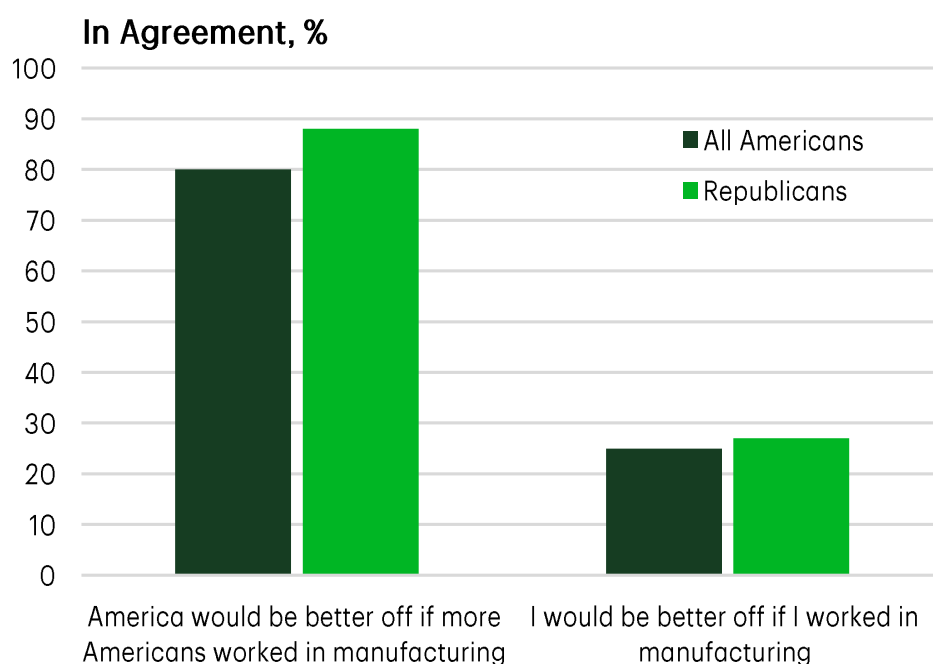


Source: Bureau of Economic Analysis, TD Economics.

Manufacturing Is the American Dream! Isn't It?

And let's face it, most people really only care about how changes affect them and their family.

When it comes to convincing Americans that higher prices are needed to create more manufacturing jobs, the argument gets you only so far in influencing the mindset. Although most Americans agree that more people should work in domestic manufacturing, it just shouldn't be them! In other words, it's a good job for you, but not me.



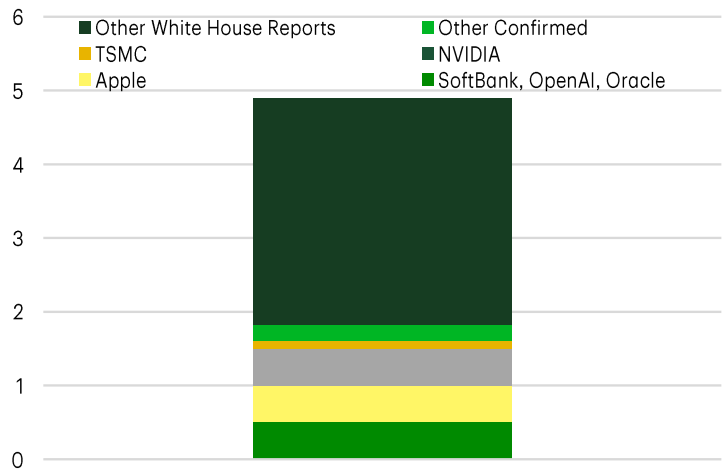
Source: Cato Institute 2024 Trade and Globalization National Survey, TD Economics.

Rotation of Investment? Some Evidence of Corporate Intent

This picture is further complicated with an administration pointing to \$5 trillion in investments flowing into America because of its tariff policy. They may have a harder time convincing the Average Joe who has less visibility on this statistic.

This data is pulled from the White House website and doesn't represent immediate commitments, but rather over a 4-to-5 year period. This is further nuanced by commitments that are not all net new, alongside somewhat nebulous commitments by nations, like the UAE, Japan and Saudi Arabia. For instance, Japan's \$1 trillion commitment includes the purchase of U.S. steel by Nippon Steel, where the administrations in both countries agreed to note it as an investment rather than a takeover.

2025 Investment Announcements, Trillions



Source: White House, Company websites, TD Economics.

Regardless, it's safe to say there's an investment boost happening on the margin, but it's over a multi-year timeframe with amounts that are likely exaggerated.

It's not 100% obvious how much will have significant flow-through to economic activity and whether Americans can see the benefit on a large enough scale to buy their patience.

Take the GM announcement a few weeks ago that's moving a production shift on pick-up trucks from Ontario to Indiana. In doing so, they cited just 25 new jobs, with most of the new jobs going to temporary workers and overtime hours. GM also cited a significant scaling back in investment dollars to preserve capital.

Obviously those 25 workers will appreciate their new jobs, as will the temporary hires, but it's not of a scale that's meaningful to our employment or consumer profiles, particularly if truck prices rise due to tariffs.

Is This Trump's Rope A Dope Strategy? Take a Beating And Come Out Swinging

Which leads to this sequence of events underpinning our forecast assumptions requiring a dialing back in negative influences and a dialing up on the growth drivers as time presses on this year.

Our GDP forecast in 2026 is placed at 2%, which is currently higher than consensus of 1.5%. Recent events have offered some hope that we'll get there, but there's still a long way to the finish line. Tariff stability is needed so that proposed tax cuts and other legislation has a better chance of creating a pro-growth tailwind into 2026.

Most forecasters embed the growth inhibitors from DOGE and tariffs, but not necessarily the growth accelerators, because they remain less defined in scope and timing.

As we get into the next couple of quarters, I'm betting forecast revisions will start going in a positive direction with upgrades to the consensus.

Discussions are on going with the Senate next up to bat, but some elements of the House Bill are shown for guidance. Our forecast embeds a 20-basis point lift to 2026 GDP growth as a placeholder for tax cuts, but this requires tariffs to not cannibalize the benefits. In the absence of significant trade deals, the cost of living could rise by as much as \$3000 per year. In addition, longer dated yields are rising on financial market angst over both tariff uncertainty and the fiscal trajectory. The government will need to get both within their comfort zone.

Deregulation is happening simultaneously, but the impact on the economy tends to boost investment further out in the forecast horizon. And of course, we have these assumptions because there is a time constraint: Mid-term elections.

Tariff Trauma

- Next 60-90 days requires trade deals = frameworks
- Most important: China and EU; USMCA still on deck
- Deal: Export controls, commitments to buy US products, tariff reductions, limit trade diversion, >US business market access

Tax Cuts: Beyond Extending TCJA

- Eliminate taxes on overtime pay & tips + car loan interest deduction
- Raise standard deduction by \$4,000 for people aged 65+ and increase child tax credit to \$2,500 (currently \$2,000)
- Increase SALT deduction

Deregulation And Pro-Tech Agenda

- Ten-for-one deregulation order = removing barriers
- Open federal lands to oil & gas exploration, eliminate freeze on LNG export applications, repealing Biden's climate EO's & EV mandates
- Ending SEC crypto lawsuits, rolling back AI regulations

Eye On The Prize: November 2026 Elections

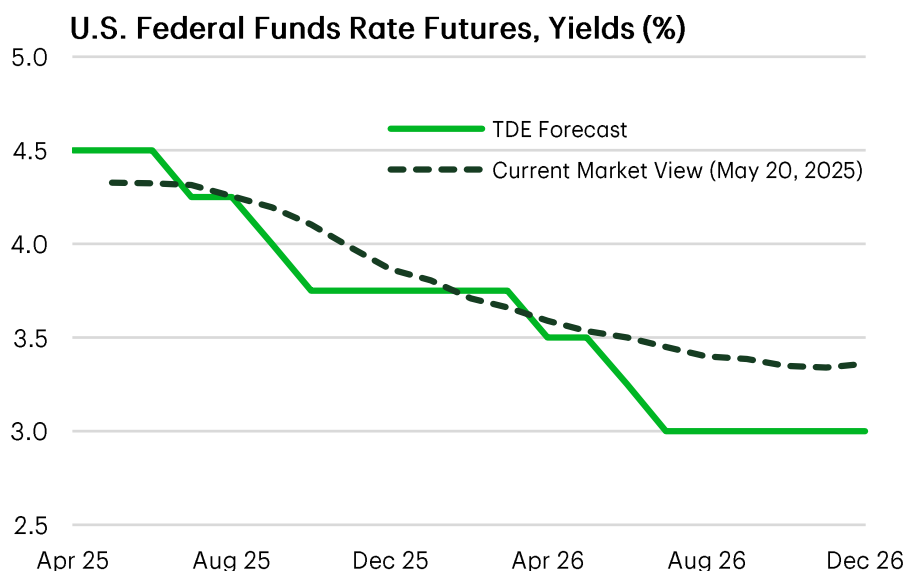
Will The Federal Reserve Be Caught In A Bind?

This sequence of events also has the benefit of achieving lower interest rates.

The policy rate is holding high at 4.50% after 100 basis points in cuts last year. At this level, it's still restrictive to the economy. Last year, the Fed cut proactively to stay ahead of economic momentum. But that strategy switched to a “wait and see” stance once tariffs came into place.

The prospect of a higher unemployment rate and rising inflationary pressures is the worst combination for a central bank with a dual mandate to anchor both. We've penciled in three rate cuts for this year, the first occurring in the third quarter once sufficient tariff risks recede. However, this is a highly fluid forecast that will require adjustment if our sequence of events don't fall into place.

In 2026, the expectation is for the Federal Reserve to return the policy rate to a neutral stance of 3% with an economy growing at around 2% and inflation risks abating. The market largely shares that view. However, we admit this depicts a perfect landing with a landing strip shrouded in thick fog.



Note: Monthly data. Source: Bloomberg, TD Economics.

Building Optimism

The final message is that there are some budding signs of optimism amidst a concrete jungle.

Optimism rests with the art of the deal. Developments with China a couple weeks ago provide some promise that the U.S. can pull itself back from the brink to reset trade relationships in a more reasonable fashion. But the road ahead will have twists and turns that will need to be quickly navigated to let the growth dynamics dominate in 2026.



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