Resolution Foundation

Trump Tariff Turmoil

The impact of higher US tariffs and the risk of a global recession

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President Trump's tariff announcements have taken a wrecking ball to the global system of international trade, pushing US tariff rates back to early 20th century levels. Following the suspension of 'reciprocal' tariffs, the UK's exposure to automotive and possible "major" pharmaceutical tariffs, means we are set to be affected by more than many other countries, with the notable exception of China. But as well as the direct impacts of the tariffs, President Trump's approach to policy making has led to huge uncertainty about the 'new normal' for tariffs. This uncertainty has triggered wild swings in financial markets and could lead to a global recession, affecting the UK economy through lower confidence and tighter financial conditions, exacerbating the trade impact.

What does all this mean for UK living standards? Tariffs are almost always a lose-lose policy, so there will be damage to the British economy. This is not least because the US is our largest single trade partner with around £60 billion of goods exports (or around 2 per cent of national income) under threat. Recent scenario analysis from the OBR suggests a 20-percentage-point increase in US tariffs across the board would take around 0.5 per cent off UK GDP, rising to around 0.8 per cent if trading partners retaliate in kind. In the OBR scenario, inflation is also higher than in its baseline forecast. But falls in global commodity prices – particularly oil – are likely to mean that inflation could actually turn out to be lower. This could be reinforced by lower import prices from trade previously destined for the US being diverted to the UK. Lower inflation, combined with lower demand, suggest the Bank of England is likely to respond by cutting rates more quickly than previously planned.

Impacts on this scale would not represent a huge crisis, but it would still be a blow to an economy that slowed in the second half of last year. But the consequences won't be felt evenly. The automotive sector is particularly in the firing line: this is the largest industry exporting to the US, directly employing around 260,000 people, and faces punitive 25 per cent tariffs. More generally, the tariff announcements are bad news for UK manufacturing jobs which are disproportionately in the middle-upper part of the wage distribution, and concentrated in areas outside of London. So this is particularly bad news for the Government's ambitions to improve living standards in all parts of the country. Furthermore, despite expectations that the Bank of England will cut policy rates more quickly, the Government's borrowing costs have risen. If they settle at a higher level, this is likely to wipe out much of the Government's fiscal 'headroom' – a 1 percentage point rise is all that would be needed to wipe out the thin margin from the Spring Statement. All this makes it imperative for the Government to accelerate efforts to boost growth including through industrial policy and by bringing down trade barriers elsewhere, including with the EU.

The risk of a global recession has risen following recent announcements of higher trade tariffs

Donald Trump's 'Liberation Day' and subsequent tariff announcements have dialled US tariff policy back to early 20th century levels, and will undoubtedly disrupt global trade. The President initially unveiled tariff rates based on the scale of US bilateral trade *deficits*, with some of the largest 'reciprocal' tariffs reserved for some of the world's poorest countries. This initially had the UK as one of the least-affected countries, given that, according to its own data, the US had a trade *surplus* with Britain of $11.9 billion in 2024, putting us 229th among 233 countries and territories. But now that 'reciprocal' tariffs have been paused, the UK look likely to be more affected than most, at least in the short term, thanks to our exposure to the higher (25 per cent) automotive tariffs, expected "major" tariffs on pharmaceuticals and a universal rate of 10 per cent on most other trade.

But as well as the direct impacts of the tariffs on trade, President Trump's approach to policy making has created huge uncertainty about where the situation is heading. It's clear now that tariff announcements are part of a negotiating position (tariffs on Canada and Mexico were redrafted at the eleventh hour following hasty concessions). And whether the situation escalates beyond a US-China trade 'war' into a full-blown global one will depend on the extent of retaliatory tariffs, which are now the subject of negotiation.

This uncertainty itself is increasing the chances of a global recession. Global stock markets have tanked, oil prices have fallen sharply and credit markets are showing early signs of distress even after the reciprocal tariffs were paused. This volatility has also prompted a rise in the cost of UK Government borrowing – with 30-year yields rising to their highest level since 1998 – and threatens to provide a headwind to growth through lower confidence and tighter financial conditions, on top of the impact of tariffs on trade.

Higher tariffs and market volatility will slow the UK economy, providing another unwelcome headwind to living standards growth

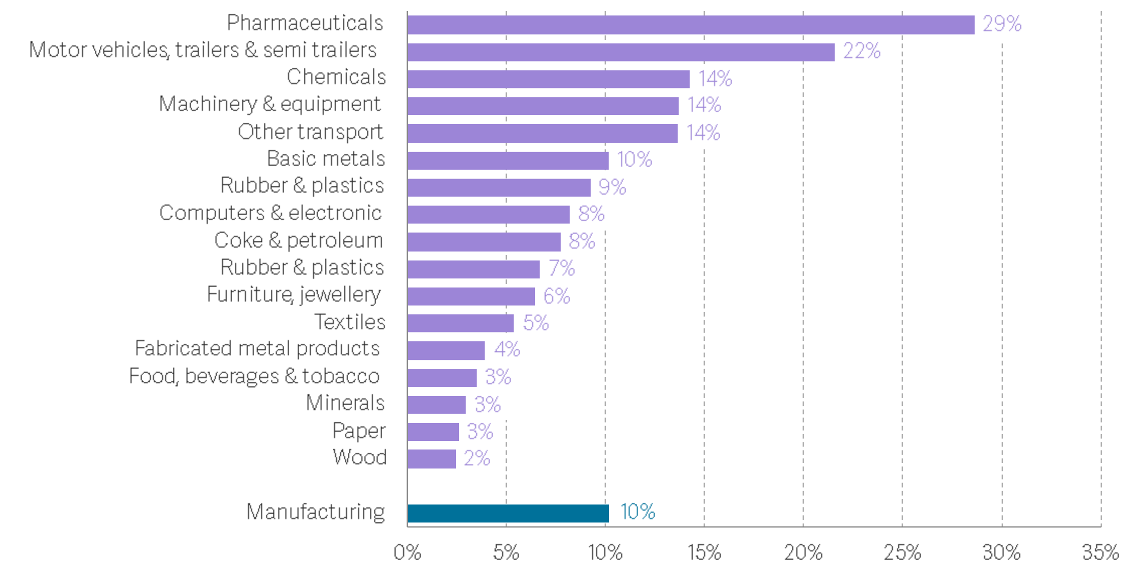
In most cases, tariffs are a 'lose-lose' policy, so the UK is unlikely to emerge from this unscathed. This is not least because the US is the country which the UK has the largest trade flows with (even if the EU is a much larger trading partner overall). Trade flows with the US were around £300 billion in 2023 with around £60 billion of goods exports (about 2 per cent of the UK's national income) under threat from higher trade barriers. In addition to goods exports that will be directly subject to tariffs (the UK's £126 billion in services exports are not covered by tariffs), and tighter financial conditions, global supply chains – in which we are deeply integrated – will be disrupted, amplifying the impact on the UK. Scenarios from the Office for Budget Responsibility (OBR), the Government's independent official forecaster, suggest that the implementation of tariffs equivalent to 20 per cent additional US tariffs on all goods would take around 0.5 per cent off UK GDP, rising to 0.8 per cent if countries retaliate in kind. An impact of this scale probably wouldn't represent an economic crisis, but would certainly be a blow to an economy that slowed sharply in the second half of last year.

In the OBR's scenarios there is also some bad news on inflation – with tariffs pushing CPI up by around 0.6 percentage points relative to the Spring Statement forecast in its most severe scenario. But with large falls in global commodity prices – particularly oil – and with the Government suspending import tariffs on many items rather than imposing them, it seems more likely that developments so far will, if anything, put downward pressure on inflation. This could be reinforced by lower import prices as trade previously destined for the US is diverted to the UK, reducing prices. If that were to happen it would be good news for consumers and, together with lower demand, suggests the Bank of England may be able to cut rates more quickly than previously planned to keep inflation on track to meet the 2 per cent target. This is consistent with falls in short-term market interest rates which are closely linked to expectations for official interest rates, and which are also act as the relevant reference rate for pricing mortgages. Despite this, the cost of government borrowing has increased. This is worrying because an increase of around 1 percentage point in gilt yields would be enough to wipe out the Government's fiscal 'headroom' from the Spring Statement.

Tariff pain will be concentrated on the tradable-goods sector, particularly car production

Even if the overall scale of the economic impacts turns out to be modest, exposed sectors will be hit much harder. Most exposed is the car industry. This is the largest single category of goods exports to the US, accounting for around a third of all such exports. Here, the 25 per cent tariffs on passenger vehicles will be a worry for around a quarter of a million British workers directly involved in manufacturing cars. More worryingly, more than one-fifth (22 per cent) of the total value added of the UK car sector ultimately depends on demand from the US, as shown in Figure 1. This suggests that the impact of tariffs could be disproportionately large with such a high proportion of all the sector's value added dependent on the US.

Figure 1 **UK pharma and car production is heavily dependent on US markets**
Proportion of UK manufacturing value added ultimately imported by the US: 2019

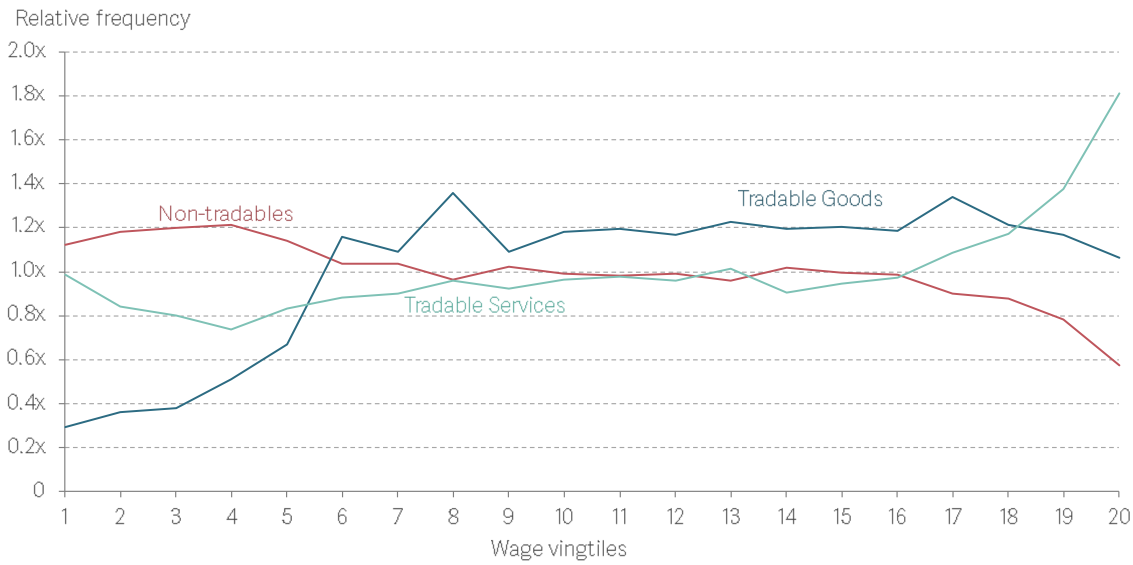


Source: RF analysis of OECD TiVA.

Stepping back, a trade war will hit manufacturing of tradable goods. This is the sector which produces goods for global markets, and includes pharmaceuticals as well as many other high-valued-added industries. This heaps more pressure on a sector that has been performing particularly poorly recently. As shown in our previous work, jobs in this sector are disproportionately in the upper-middle part of the wage distribution (Figure 2), with many of these jobs in South Wales, the West Midlands and Sunderland. So this is a blow for the Government's ambitious plan to improve living standards in all parts of the country.

Figure 2 **Manufacturing jobs are concentrated in the upper-middle part of the wage distribution**

Relative frequency of total jobs in non-tradables, tradable goods and tradable services appearing in each vingtile of the wage distribution: UK



Notes: Industries are separated into goods and services according to the standard ONS classification, and into tradable and non-tradable according to the categorisation in B Broadbent et al., The Brexit Vote, Productivity Growth and Macroeconomic Adjustments in the United Kingdom, mimeo., 2020. Wage vingtiles are calculated using gross weekly wages in the LFS. Workers in the three types of industry are assigned to and counted in each vingtile. The counts are divided by 5 per cent of the total number of workers in the corresponding type.
Source: Analysis of ONS, Subnational Trade in Services data tables and Regional Trade in Goods Statistics dis-aggregated by smaller geographical areas; Labour Force Survey.

Policy should protect living standards from the threat of higher tariffs

With the shock from higher tariffs likely to slow growth (to the detriment of living standards), and to disproportionately hit good jobs outside of London, there is a strong case for the Government to intervene to reduce the impact. Indeed, it's likely that we will see temporary support for the worst-affected industries. But funding such policies could be challenging given the rising cost of government borrowing. This means that it's unlikely that large-scale fiscal support would be possible under the current fiscal rules. Finally, these developments strengthen the case for the Government to go further in its attempts to boost growth. The focus should be on measures to boost dynamism and reduce trade barriers. Here, the Government can use its industrial policy to can be part of the answer here (see, for example, recent RF proposals). In addition, there is now an even stronger case for working to bring down trade barriers with other trade partners, particularly the EU.