Intelligence MEMOS

From: Glen Hodgson

To: Trade and International Policy

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Re: **The Many Risks of Trump's Economic Policies, and the Best Canadian Response**

Donald Trump is a "transformational" president, but most likely not in a good way. The risks and impacts of the president's often incoherent economic policies are becoming ever more apparent. Let's focus on three areas of critical importance to Canadians: tariffs, fiscal policy, and monetary policy.

Mr. Trump's chaotic tariff approach has attracted the most attention so far. There are three apparent over-arching objectives, which have evolved but not changed. Tariffs are intended to provide negotiating leverage, to induce investment flows toward the United States, and to generate government revenue. Despite all the bluster, the only definitive result is a jump in the revenues.

Meanwhile, after a spell of moderation in the wake of April's "Liberation Day," there has been a near-daily parade of new extreme announcements and deadline threats.

What are the results so far? At a macro level there is growing global and bilateral trade damage, and heightened stagflation risk that continues to unfold. Framework deals were announced with the UK and Vietnam, along with a de facto truce with China, which has shown it has its own cards to play. Countries that stand up to Trump's threats have appeared to do better than those that cower, but there's still a long way to go. The Trump team has learned that it's hard to negotiate nearly 200 meaningful bilateral trade deals simultaneously, so it appears to be focusing actual negotiations on a few larger trade relationships (notably Canada, Mexico, Japan and the EU) and assigning an arbitrary US tariff rate in many other cases, largely in line with the Liberation Day levies.

On the home front, Mr. Trump's massive new fiscal bill does a "reverse Robin Hood" by essentially taking from the poor to give to the rich (or from the young to the old, or the innovative to the established). The bill strips funding from programs largely used by less advantaged Americans (Medicaid, food aid, student loans), as well as green investment subsidies, to pay for $4.5 trillion in permanent tax cuts over a decade mainly for higher income Americans. The bill also signals a US retreat from the clean energy transition, leaving China to dominate the field. A further $3 trillion will be added to public debt over a decade, accelerating an eventual day of reckoning on the U. government's large and growing stock of debt, rising debt service burden, and even the status of the greenback as a reserve currency.

Despite brave talk about fiscal prudence and not tampering with a valued social program like Medicaid, nearly all Republican members of the House and Senate ultimately fell in line to pass the bill. The negative ripple effects from the spending cuts have already begun. Rural hospitals are notably exposed because of their heavy Medicaid reliance. Financial costs will be downloaded to states and there will many other social costs. The ripple effect will extend all the way to the mid -term elections in November 2026, when control of the House and perhaps the Senate will be in play.

Monetary policy is another wild card, with Federal Reserve independence under threat. Mr. Trump's verbal assaults on Fed Chair Jerome Powell have built in recent days as he demands a policy rate cut to 1 percent. And he is publicly preparing for one of his acolytes to replace Powell, whose term ends next May. But Mr. Trump ignores two basic monetary policy realties: that the Fed's job – alongside maximum employment – is to keep the inflation genie in the bottle, and that markets, not policymakers, ultimately determine interest rates beyond the policy rate, and, therefore, borrowing costs.

Where does this leave Canada? On tariffs, there is little choice but to negotiate in good faith and hope the United States respects whatever deal is reached. Prime Minister Carney and team have been smart not to escalate and to let the negotiations unfold. The government was criticized for giving up the digital tax so quickly, but it was unfortunately timed and was unlikely to survive the negotiations in any event (The EU quietly abandoned its own DST this week).

We can only hope that Mr. Trump's need for a big win will keep the negotiations on track and Canada can emerge with as few US tariffs in place as possible, allowing our still-integrated economies to operate to mutual advantage.

On fiscal policy, it will be critically important for Canada to demonstrate to financial markets that we indeed have a credible plan to restore solid fiscal management. Otherwise, we could be pulled into the vortex of a US federal debt burden that risks spiralling out of control. And on monetary policy, preserving Bank of Canada independence based on the well-established 2 per cent inflation anchor has arguably never been more important.

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