Scotiabank

GLOBAL ECONOMICS

INSIGHTS & VIEWS

October 31, 2024


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# The Costs of Trade Policy Uncertainty

- **The outcome of the U.S. presidential race remains a coin-toss. Given former President Trump's focus on trade policy in this campaign and the ongoing threat of tariffs that are central to his economic platform, trade policy uncertainty is almost certain to rise should he win.**
- **Using a trade policy market volatility index, we measure the economic effects of trade-related uncertainty stemming from a potential second Trump presidency. Trade-related uncertainty spiked significantly during his first term, and remains a major source of uncertainty going into next month's election.**
- **Continued trade policy uncertainty under a potential second Trump term, mirroring the elevated levels seen during his first term, could see the level of U.S. GDP a full percentage point weaker at the end of his term relative to a scenario in which there is no rise in uncertainty, with important spillovers effect on the Canadian economy.**
- **This projected loss of output is attributed solely to trade policy uncertainty and is separate from the impact of actual policy measures that could be implemented under Mr. Trump, like tariffs, tax cuts, and deportations. Those measures, particularly tariffs, are inflationary, whereas trade-related uncertainty on its own is disinflationary as it weakens demand and investment.**

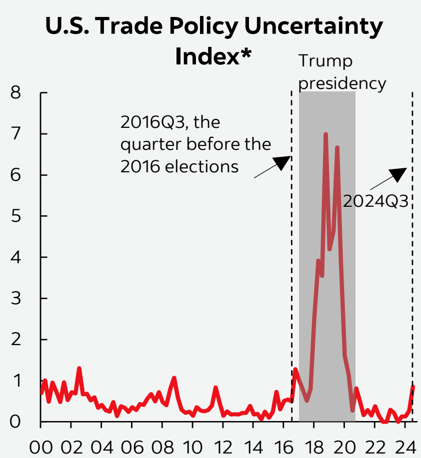
The outcome of the U.S. presidential election is highly uncertain. A number of economists, including **us**, have analyzed the potential consequences of a VP Harris or former President Trump win. This note focuses on an under-analyzed aspect of the post-election environment: trade policy uncertainty. Given pronouncements by both candidates, it is evidently clear that Mr. Trump's approach on trade would be more disruptive and create more uncertainty. This uncertainty was a feature of his first term in office (chart 1) and is likely to be a feature of a second term should he win. According to a Financial Times **article**, a potential future secretary of state for Trump noted: "Predictability is a terrible thing. Of course, the other side wants predictability. Trump is not predictable and we Americans like it."

According to Adam S. Posen **writing** for Foreign Affairs, this marks a departure from conventional presidential bids—a strategy emphasizing uncertainty over broad macroeconomic stability. He warns that "The Trump approach, in contrast, weaponizes uncertainty. But uncertainty is a difficult weapon to control, and it will backfire on whoever wields it too widely."

In this note, we set out to quantify the economic impact of this uncertainty. We use the equity market volatility (EMV) **trade policy index**—a specific subindex of the EMV index that captures volatility tied to trade policy uncertainty. This index is constructed based on monthly counts of occurrence of specific terms related to trade policy uncertainty from eleven major U.S. newspapers, and it aligns closely with the widely used market volatility index, the VIX, and volatility of returns on the S&P 500.

Leading up to the 2016 election, this index began to rise as Trump's election promises emphasized protectionist trade policies (chart 1 again). As Trump took office in 2017 and began implementing his trade agenda, including withdrawing from the Trans-Pacific Partnership, renegotiating NAFTA, and touting and imposing tariffs, this index rose to historic highs and remained elevated for the duration of his presidency, particularly during the height of trade tensions with China. Given its relatively stable behaviour before 2016, we consider this index a good proxy for the "Trump uncertainty effect."

**Chart 1**

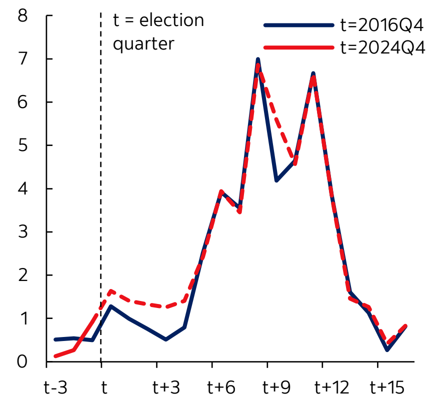



* Trade policy category of the EMV tracker.
Sources: Policyuncertainty.com.

Trade remains a major source of uncertainty in the lead up to the upcoming U.S. election. Major trading partners are preparing for the possibility of new tariffs on all imports into the U.S.—initially proposed at 10% and more recently suggested to rise to 20% across the board, with a possible 60% tariff on Chinese goods. Given the negative economic and inflation consequences of the application of broad-based tariffs, we do not view it as a given that he will implement these tariffs as aggressively and broadly as he is currently suggesting. Will he impose tariffs or not? If he does, how and when would they be applied? These are two major uncertainties to be confronted if Mr. Trump wins the election. We already see this uncertainty reflected in the trade policy EMV index which has shot up to 0.9 as of 2024Q3, almost double its level in the quarter prior to the 2016 election, consistent with a heightened protectionist rhetoric.

**Chart 2**

**Trade Policy Uncertainty Index Before and During Trump Presidency**

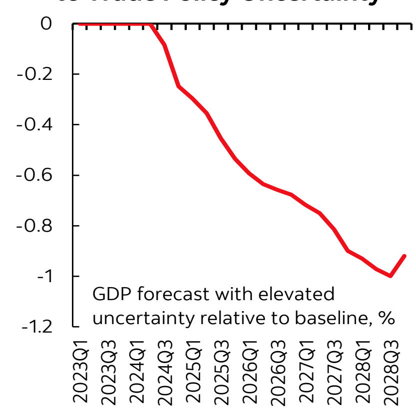



Sources: Scotiabank Economics, Policyuncertainty.com

Elevated trade policy uncertainty comes at an economic cost. We had looked into this issue in his first term by empirically estimating the impact of trade policy uncertainty in the Scotiabank Global Macroeconomic Model (SGMM). At the time, we estimated that if the sharp rise in trade policy uncertainty persisted through the presidential term, it would have lowered the level of U.S. GDP by 0.8% in 2020 relative to a scenario where uncertainty was at its historical average. Results also showed that this uncertainty would have a significant effect on the Canadian economy through trade, exchange rate, risk premia, and financial wealth channels, resulting in a level of Canadian GDP that is 0.7% weaker in 2020 relative to a no uncertainty scenario. In this note, we replicate the index's behaviour from Trump's first term starting 2025Q1 through 2028Q4 (chart 2). Due to the higher starting point in 2024Q3 relative to 2016Q3, we let the index hover slightly above its early 2017 levels in the first half of 2025. Running our SGMM model with this profile for the trade policy uncertainty index generates a forecast for U.S. real GDP that is weaker than our baseline forecast which is based on a stable trade policy uncertainty index (chart 3), with a peak impact of a 1% loss in economic output in 2028Q3. Canada's GDP would also be 0.7% weaker at the end of his term. Real GDP for both countries would continue to rise in this scenario, but less so than would be the case with less uncertainty. This result is consistent with the drag on economic activity resulting from elevated market volatility, a challenging investment climate, and constrained business planning amid unpredictable policy shifts.

**Chart 3**

**Projected Loss of U.S. GDP Due to Trade Policy Uncertainty**




Source: Scotiabank Economics.

This projected loss of economic output, stemming solely from trade policy uncertainty, should be viewed separately from the broader economic impact of a potential second Trump presidency. We realize the paradox here: GDP and inflation are weaker as uncertainty rises because of concerns about a tariff impact that would be inflationary. Should Mr. Trump only threaten tariffs, the impact on activity would be in line with the findings of this note. Should he move forward with the broad range of policies in his platform, including tariffs, the net impact on inflation would **clearly be positive**.

October 31, 2024