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Tariffs, Deficits, and Trump's Second-Term Economic Gamble[1]

As we head deeper into 2025, the Trump administration has begun executing on what it calls the "3-3-3+" economic plan, a blend of fiscal, monetary, and trade policies designed to fundamentally reshape America's economic trajectory by 2028. Proposed originally by Treasury Secretary Scott Bessent and later expanded by President Trump, this agenda centers around four primary objectives:

- reducing the federal budget deficit to 3% of GDP
- sustaining 3% annual GDP growth
- increasing domestic oil production by 3 million barrels per day
- reshoring critical manufacturing sectors.

While these goals may sound technocratic or abstract, the strategies used to achieve them, including a sweeping tariff regime, aggressive debt refinancing, spending cuts, and a push to revive U.S. industrial capacity are already reverberating across the markets, labor force, and the world.

Understanding the Fiscal Backdrop: Why This Plan Exists[2,3]

To fully grasp the implications of this economic overhaul, it's important to understand the context. The U.S. federal government currently runs a budget deficit of approximately $1.9 trillion for fiscal year 2025, representing 6–7% of GDP, well above the historical peacetime norm of 2–3%. This shortfall stems from a structural imbalance between spending and revenue. On the spending side, mandatory programs like Social Security, Medicare, and Medicaid continue to expand due to demographic shifts and rising healthcare costs. Discretionary spending which covers defense, infrastructure, education, and other annual appropriations remains elevated, while net interest on the debt has surged in recent years due to both higher debt levels and rising interest rates. Total federal debt now stands at approximately $35 trillion, with an average interest rate of ~4.2%, translating to annual interest payments of over $1.4 trillion. Even more pressing, $9.2 trillion of that debt matures in 2025, with 70% due before the end of June. Much of it was issued at lower rates, around 3.2%, and refinancing at today's ~4.0% yields will push borrowing costs even higher, widening the deficit further. On the revenue side, the government continues to rely primarily on income, payroll, and corporate taxes, supplemented by other sources such as tariffs.

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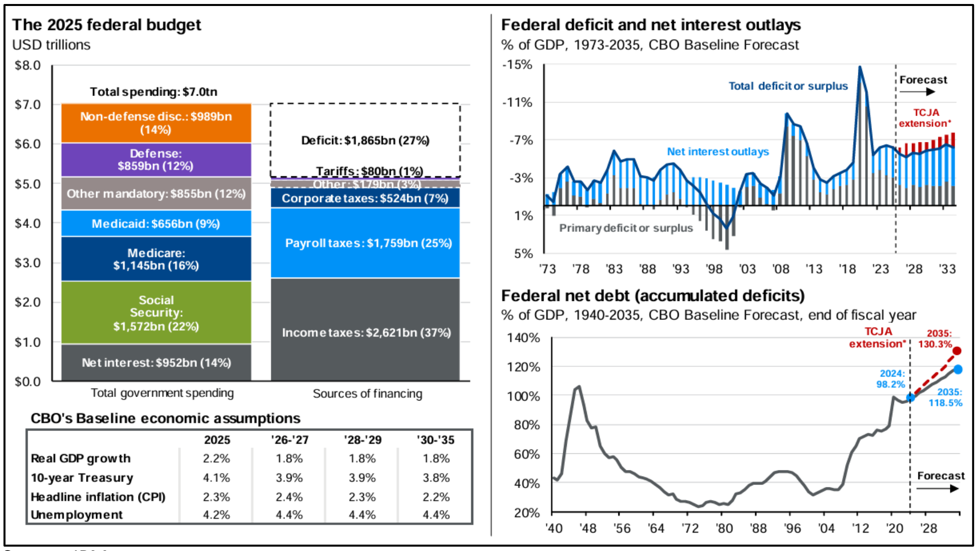
[1] Source: https://www.wsj.com/opinion/bessents-3-3-3-economic-growth-plan-and-the-5-4-3-threat-treasury-secretary-nominee-387250a8
[2] Source: Bloomberg Economic data. Data access 4.4.25
[3] Source: https://www.jec.senate.gov/public/vendor/_accounts/JEC R/debt/Monthly%20Debt%20Update.html?utm_source=chatgpt.com

Federal Finances



	2025	'26-'27	'28-'29	'30-'35
Real GDP growth	2.2%	1.8%	1.8%	1.8%
10-year Treasury	4.1%	3.9%	3.9%	3.8%
Headline inflation (CPI)	2.3%	2.4%	2.3%	2.2%
Unemployment	4.2%	4.4%	4.4%	4.4%

Source: JPMorgan

The Trump administration's fiscal strategy addresses the growing debt challenge on several fronts:

1. **Refinancing the Debt**: The administration seeks to refinance maturing debt into longer-term Treasuries, ideally at lower interest rates. This approach depends partly on the Federal Reserve's willingness to cut rates, something uncertain in the current economic climate. However, significant market turbulence, particularly a sharp drop in equities, could also pressure rates downward.

2. **Cutting Government Spending**: A key goal is reducing federal expenditures, particularly within non-defense discretionary budgets. This includes eliminating up to 300,000 federal jobs through the newly established Department of Government Efficiency (DOGE).[4]

3. **Tariffs as Revenue and Strategy**: Most controversially, the strategy revives and expands the use of tariffs, not just as a geopolitical tool, but as a central revenue source and a mechanism for reshoring key manufacturing industries deemed vital to national security.

The Refinancing Puzzle: Why Interest Rates Matter So Much[5]

The plan to refinance federal debt might seem straightforward, but its success depends on movements in long-term interest rates, particularly the 10-year Treasury yield. While the Fed's benchmark policy rate influences short-term lending, it's the 10-year yield that determines the government's cost to borrow at scale. As of now, that yield hovers around ~4.0%, which is higher than the rate on much of the debt that

[4] Source: JPMorgan Asset Management Dr. Kelly Tarriff update webinar. 4.3.25.
[5] Source: Bloomberg Economic data. Data access 4.4.25

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needs to be rolled over. If rates remain elevated, the refinancing operation will do little to improve the deficit and might worsen it altogether.

To materially lower borrowing costs, the Trump administration is banking partially on rate cuts from the Federal Reserve, and partially on an equity market sell-off. However, the Fed has grown more cautious, with recent projections indicating fewer cuts than the market had anticipated. In December 2024, the average Fed projection suggested three cuts in 2025. By March, that number fell, with only two Fed officials expecting three or more cuts and four expecting none at all. Realistically, even a 1% reduction in the Fed Funds Rate might only bring the 10-year yield down by 50–75 basis points, far short of the drop needed to generate substantial debt savings. To reduce the average yield on new debt to around 3.5%, which would save an estimated $238 billion annually, would require three or more (25 bps) rate cuts or a significant flight to safety via a broader market sell-off, which would not come without its own economic costs.

Spending Cuts and the Limits of DOGE

Cutting federal spending is a core pillar of the “3-3-3+” plan, but early actions have revealed just how limited this lever might be in practice. DOGE’s push to eliminate 250,000–300,000 federal jobs would save about $30 billion annually, assuming an average salary of $100,000 per worker. But that figure is a mere fraction of the $1.9 trillion deficit. Lawmakers have floated more aggressive ideas, like $2 trillion in cuts over a decade, primarily targeting Medicaid, state transfers, and other federal programs, but these proposals face steep political resistance and are not yet law. The immediate impact of DOGE’s cost-cutting is more symbolic than structural, though it is already having a chilling effect on institutions and sectors reliant on federal grants and loans, as many of the loans have been canceled or postponed this year.

The Return of Tariffs—Now Bigger Than Ever[6,7]

Perhaps the most controversial component of the Trump plan is the reintroduction and expansion of tariffs. In his first term, Trump’s trade war peaked at around $100 billion in annual tariff revenue with a global average rate of 10%. This time around, the administration is aiming for average effective tariffs closer to 25%, which could bring in $500–700 billion annually. But these gains come with significant trade-offs. Estimates suggest that tariffs could raise core inflation by 4–5% this year, shave 1.2 percentage points off GDP growth, and increase the unemployment rate to 4.7%. These effects are already felt in the markets, where consumer confidence is waning, hiring plans are being paused, and prediction markets are now placing U.S. recession odds at 52% for the year.

[6] Source: https://www.wsj.com/livecoverage/trump-tariffs-trade-war-stock-market-04-02-2025/card/DDimAeALjEnHu30XFvw6
[7] Source: JPMorgan Asset Management Dr. Kelly Tarriff update webinar. 4.3.25.

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What makes the new tariff policy even more opaque is the method of calculation. Instead of relying on actual foreign tariff rates or WTO standards, the Trump administration appears to be basing tariffs on bilateral trade deficits. For example, the European Union is facing what effectively amounts to a 39% tariff, derived from the size of the U.S. trade deficit with Europe—even though the EU's average tariff on American goods is only about 5%. Many economists argue this approach misrepresents the nature of trade imbalances. Much of the U.S. trade deficit with the EU isn't the result of unfair barriers, but rather structural differences: the U.S. is primarily a services-driven economy that imports low-cost goods, while the EU is a more export-oriented manufacturing economy. The baseline global tariff of 10% takes effect on April 5, with additional country-specific increases, targeting China, Germany, India, and Mexico set to roll out just four days later.

BMW's Predicament: A Case Study in Tariff Shock[8,9]

To see how this plays out in practice, consider the example of BMW's 3 Series sedans. These vehicles are built in Mexico by a German automaker and imported into the U.S., previously subject to just a 2.5% duty. Under the new tariff regime, that rate jumps to 27.5%, a combination of the 10% global baseline and an additional 17.5% penalty on Mexico and Germany. For a $47,000 car, this adds nearly $13,000 in tariffs. BMW, for now, has committed to eating the cost through May, but they estimate a $1 billion impact this year. The South Carolina plant that could have absorbed production is already at capacity, leaving the company to decide between price hikes, production shifts, or reducing U.S. inventory. This example underscores the blunt force of these tariffs and how quickly abstract economic policy can hit real-world bottom lines.

Economic Growth or Stagflation?[10]

Trump's broader vision requires sustained 3% GDP growth to cover increases in the GOPs proposed spending plan, tax cuts, and to help stabilize debt ratios, but the data increasingly points in the opposite direction. The economy is entering a soft patch. The Fed's own projections show weakening growth, a rise in unemployment, and persistent inflationary pressures, hallmarks of a stagflationary environment. The tariff expansion is likely to exacerbate this, as is the administration's approach to immigration. A sharp slowdown in both legal and unauthorized immigration could reduce the U.S. working-age population by as much as 800,000 annually, further straining labor markets and consumption. Despite this, wage inflation remains muted due to job insecurity and overall economic softness.

[8] Source: https://www.bmwblog.com/2025/03/12/bmw-na-mexico-tariff-price-protection/?utm_source=chatgpt.com
[9] Source: Joshua Brown LinkedIn Post. 03.03.25
[10] Source: JPMorgan Asset Management Dr. Kelly Tarriff update webinar. 4.3.25.

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The GOP Budget Math[11]

In the face of internal party disagreements, Congress has yet to pass a full spending bill, partly due to disagreements within the Republican party. Still, recent budget resolutions give a glimpse of where fiscal policy might be heading. Last week, the House locked in annual deficits of around $2 trillion for the next decade. Meanwhile, the Senate went further, proposing an additional $6 trillion in deficit spending on top of that. If enacted, these plans could push the federal deficit well beyond its current $1.9 trillion level, potentially increasing it by a range of $500 billion to $1 trillion annually. That would move the deficit closer to 8%from about 6% of GDP today, a level rarely seen outside of major wars or economic crises. According to the Committee for a Responsible Federal Budget, total federal debt under these proposals could rise by $45 to $60 trillion by 2055 levels comparable to some of the most inflationary eras in recent history.

Our Take: Can It Work?

Putting all the pieces together, a rough estimate shows that even under optimistic assumptions, the deficit reduction plan falls short of closing the gap. At the high end, tariff revenue could generate up to $700 billion annually, assuming none of the proposed tariffs are negotiated downward. If rates fall enough to bring 10-year yields down to 3.5%, that could save another $238 billion per year in interest costs. Cuts from the newly created Department of Government Efficiency (DOGE) might add another $30 to $100 billion in savings, depending on how permanent and widespread they are. Altogether, that's a potential deficit reduction of up to $968 billion per year. But subtracting that from the current $1.9 trillion deficit still leaves nearly $1 trillion in annual red ink. And that assumes all goes to plan. It doesn't account for the cost of making the Trump tax cuts permanent, the added spending from recent budget resolutions, or future economic shocks. In other words, it takes a series of best-case scenarios just to reduce the deficit by half, let alone bring the national debt meaningfully down. Assuming Trump can pull this off, the chart shows how the federal deficit, as a share of GDP, could change over 30 years under different GDP growth rates.

Deficit Elimination Timeline (with $968B recurring savings and 4% spending growth)

Nominal GDP Growth	Outcome	Time to Eliminate $1T Deficit
0.0%	GDP flat, deficit **grows as % of GDP**	❌ Never
1.5%	GDP grows slower than spending	❌ Never
2.0%	GDP grows, but still slower than spending	❌ Never
2.5%	GDP nearly keeps pace with spending	❌ Never (deficit shrinks slowly)
3.0%	GDP growth starts outpacing spending	⚠️ ~25–30 years (slow decline)
3.5%	GDP grows faster than spending	✅ ~20–25 years (deficit eliminated)

Source: Gitterman Asset Management

[11] Source: https://www.crfb.org/blogs/whats-senates-concurrent-fy-2025-budget

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It assumes a future administration enacts $968 billion in recurring annual savings through tariffs, interest rate reductions, and federal workforce cuts.

Key assumptions:

- The starting deficit is $1 trillion, after applying the $968B in savings to today's ~$1.9T shortfall.
- Federal spending grows 4% per year, in line with historical averages.
- The $968B in savings repeats every year without fading.

The result: At growth rates below 3%, the deficit remains large or even grows as a percentage of GDP. Only at 3.5% GDP growth does the deficit meaningfully shrink, potentially reaching balance within 20 to 25 years.

All of this is an attempt to transform the United States into an industrial economy in an era defined by services, software, and networks. That transformation may be politically appealing but economically misguided. Manufacturing output has risen over the past two decades, but with fewer jobs, thanks to automation and globalized supply chains. Trying to reverse the natural evolution of the economy could prove deeply disruptive, and futile. Economist Raymond Vernon's product life cycle theory explains why mature industries eventually migrate production to lower-cost regions, and trying to fight this tide may only raise prices and reduce competitiveness.[12] Although we understand the reasoning. What the U.S. gained in shareholder returns over the last decade, it forfeited in industrial strength. Core sectors like steel, aluminum, and shipbuilding were hollowed out by decades of indifferent trade policy. In Trump's view, this erosion isn't just economic, it's a national security risk. Victory in World War II, after all, owed as much to America's industrial might as its military strategy. Today, that once-formidable industrial base has decayed, while China has built the kind of manufacturing base that once defined U.S. power. The administration argues that tariffs do more than retaliate against unfair trade practices, they're a tool to rebuild domestic industry. By raising the cost of imports, tariffs aim to shift production back home and restore resilient supply chains anchored in the U.S.[13]

We are skeptical. Not necessarily because the objectives are wrong, fiscal discipline and domestic resilience are important, but because the tools that are used may worsen the very problems they're trying to fix, it's a high-risk plan. Inflation is rising, growth is slowing, and markets are rattled by policy uncertainty. If the administration doesn't pivot soon, either via a trade deal or more market-friendly policies, the next major economic narrative could be one of recession and retrenchment. Trump has until

[12] Source: https://www.thecarsonreport.com/post/the-end-of-american-exceptionalism-trump-s-tariff-policy
[13] Source: https://www.csis.org/analysis/liberation-day-tariffs-explained

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September to show progress before midterm pressures take over. Whether he adapts or doubles down remains to be seen.

What does this mean for Markets?[14]

In a market environment this volatile, offering short-term guidance feels futile, what's written in ink today may be obsolete by tomorrow. Policy headlines are whiplash-inducing, and the range of potential catalysts is dizzying: tariff retaliation announcements, Trump abruptly pivoting from pressure to negotiation, a surprise Fed rate cut, tax cut legislation stalling (or failing), a poor Treasury auction on April 10 (the largest of the year), disappointing earnings from Nvidia, or geopolitical shocks out of Ukraine or the Middle East. Any of these events could rewrite the market narrative overnight.

Still, we can try to frame the current landscape. What's clear is that policy uncertainty is the dominant variable, and neither the so-called *Trump Put* nor the *Fed Put* appear likely to activate in the near term. Soft economic data is showing cracks, but hard data—especially jobs and consumer spending—remains resilient, which may provide a floor under the next leg lower in U.S. equities. A possible turning point could come in the form of a headline-grabbing trade deal or framework, particularly with a G7 country like the UK. That would give investors a way to "look through" the tariffs aimed at the EU and Japan and refocus on growth potential.

What Is the Market Consensus?

The Market currently assumes that:

- A *Trump Put* exists somewhere between 5,000 and 5,300 on the S&P 500, implying that if stocks fall within that range, Trump will back off the tariffs or introduce market-friendly policies.
- The U.S. will outperform globally in nearly all scenarios, thanks in part to the recent reset in TMT (Tech, Media, Telecom) valuations.
- The *Fed Put* will be triggered no later than the June FOMC meeting, with the central bank stepping in to offset any excessive downside risk.

[14] Source: "Tactical Tariff Thoughts": A Must-Read April 2 Primer From JPMorgan's Trading Desk | ZeroHedge

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Do we Agree With Consensus?

Not exactly. Here's why:

- On the Trump Put: Trump believes he can remake the global trade and manufacturing order quickly—and he's likely more tolerant of equity market pullbacks than the Street assumes. If a Trump Put exists, its strike price may be well below 5,000. The willingness to shock the system appears deliberate, with an eye toward pushing rates down to refinance federal debt without worsening the deficit.
- On the Fed Put: The Fed remains boxed in. With unemployment at 4.2% and inflation still elevated (CPI at 2.8%), it's difficult to justify rate cuts. The Fed is unlikely to step in unless unemployment climbs closer to 5.0%, and even then, if inflation remains sticky, policy action will be constrained. If anything, the Fed Put may not activate until Q3 or beyond.

Until there is clear direction on trade, ideally in the form of a credible framework rather than shifting headlines the market will remain choppy and sentiment fragile. This is an environment defined not by fundamentals, but by policy roulette.

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