Fed warns economic risks rising because of tariff hikes

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7 May 2025

As expected, the US Federal Reserve kept interest rates on hold at its meeting yesterday but expressed concern that the tariff hikes of the Trump administration will lead to both higher inflation and rising unemployment.

In his prepared remarks to a press conference, Fed chair Jerome Powell said: "If the large increases in tariffs that have been announced are sustained, they are likely to generate a rise in inflation, a slowdown in economic growth, and an increase in unemployment."

Powell said that while the "risks of higher unemployment and higher inflation appear to have risen," the current stance of monetary policy left the central bank "well positioned to respond in a timely way to potential economic developments."

Those words of reassurance were somewhat undermined by other parts of his opening remarks.

The Fed, at least officially, operates under a dual mandate to ensure price stability and maximum employment.

But as Powell acknowledged, "we may find ourselves in the challenging scenario in which our dual mandate goals are in tension"—that is, both prices and unemployment are on the rise.

In response to a question, Powell said the US was still a "healthy economy" but was "shrouded in some very downbeat sentiment."

He noted in his opening remarks that surveys of households and businesses had reported a "sharp decline in sentiment and elevated uncertainty about the economic outlook," but it remained to be seen how these developments would affect future spending and investment.

As yet, he said on numerous occasions, the effects had not yet shown up in the data and the Fed had to adopt a "wait and see" stance.

"We think we're in the right place to wait and see how things evolve," Powell said. "We don't feel like we need to be in a hurry. We feel like it's appropriate to be patient."

Elaborating on this theme throughout his press conference, Powell said: "It's not a situation where we can be preemptive because we actually don't know what the right response to the data will be until we see more data."

The criticism of this "data dependent" stance, which has been made in the past and will no doubt be raised again, is that it is like driving by looking in the rear vision mirror as data coming in reflects past developments, not what is underway at present.

The present situation is that tariff hikes, which Powell acknowledged were "significantly larger than anticipated," have thrown investment planning and business decisions into disarray.

Companies are already reporting significant declines in their expected revenue. Ford has said it expects to take a $1.5 billion hit and Apple expects one of almost $1 billion.

The supply chains of potentially thousands of companies have been thrown into chaos as firms face massive increases in their cost structure. With shipments at ports on the West Coast already showing a decline of as much as 30 percent, there have been warnings that empty shelves may well become a phenomenon, accompanied by sharp price rises.

The *Financial Times* noted that while demand in the US economy had broadly remained "robust" since the start of the year, "surveys have indicated that businesses and consumers are deeply concerned about how Trump's levies will affect their respective prospects."

Guy LeBas, a strategist at the financial services firm Janney Montgomery Scott told the FT: "I can't recall a time when the Fed has upgraded both growth and inflation risks quite so starkly."

As far as the data are concerned, the GDP figures for the first quarter showed an annual contraction in the US economy of 0.3 percent. This has largely been dismissed as a kind of statistical anomaly because of the surge in imports as firms tried to stock up in anticipation of tariff hikes.

This view was countered in an opinion piece in the *Wall Street Journal* which warned that the US GDP decline was an "ominous sign."

It took issue with the statement by the Bureau of Economic Analysis which said the decline in GDP primarily reflected an increase in imports "which are a subtraction in the calculation of GDP."

The two authors said the decline was not a statistical artifact. The GDP number was down because "America produced less, not because it imported more."

The decline in GDP appeared to have been "largely the product of the massive uncertainty that the Trump administration's trade policy has created as it wreaked havoc on supply chains and global commerce. Since most of the tariffs have yet to go into effect, the negative growth for the first quarter is simply a warning of much worse to come if the administration doesn't call off its trade war."

If the tariffs proceeded, the likelihood was that "the US and most of the world will fall into recession in 2025."

Wall Street was up slightly in the wake of the Fed decision. But this was mostly because of the announcement that trade talks will be held between leading US and Chinese officials in Geneva over the weekend. It lost some momentum in response to the Fed's assessment that the risks of higher inflation and increased unemployment had risen.

If the discussions between Trump and incoming Canadian Prime Minister Mark Carney earlier this week are anything to go by, little movement on the 145 percent tariff on China can be expected.

When asked if there was anything Carney could say to convince him to lift the tariffs against Canada, Trump replied "no," insisting "there's no reason for us to be subsidising Canada."