

US Supreme Court decision on tariffs – Key Takeaways

Key Messages

1. The Supreme Court of the United States (SCOTUS) struck down the Trump administration's reciprocal tariffs. Over the weekend, President Trump already executed a new plan to reimpose tariffs, increasing global tariffs by 10% under Section 122.
2. In our view, the potential for less-than-full IEEPA tariff replacement or more consumer-friendly tariff composition tilts inflation risks to the downside and economic growth risks to the upside.
3. The biggest mispricing appears to be for bond yields as the Supreme Court decision poses a significant risk to the US fiscal outlook. We maintain our 12-month target of 4.25% for the 10-year US government bond yield. Even if we keep the 4.25% assumption, there remains considerable upside from current levels. Accordingly, we recommend avoiding longer-maturity US bonds.
4. We see little reason to change our current stance on US equities as the decision does not impact our core thesis. We remain Neutral on the US market as the S&P 500 should continue to struggle from the capex-monetization fears induced-underperformance of AI heavyweights. Within US equities we prefer cyclical sectors which should enjoy an ongoing tailwind from earnings and fiscal stimulus.

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The Supreme Court decision and the outlook for tariffs. The Supreme Court of the United States struck down the Trump administration's reciprocal tariffs in a 6-3 decision, ruling that the International Emergency Economic Powers Act (IEEPA)'s authorization of "regulation" of trade did not allow for its taxation. They did not address refunds. Lower courts will have to determine how this will work. This decision may also call into question the future of trade deals that the administration had previously struck with other countries.

Over the weekend, President Trump already executed a new plan to reimpose tariffs, increasing global tariffs by 10% under Section 122. This should slightly decrease the effective tariff rate that the US charges, relative to IEEPA levels. These tariffs can however rise over time, as Section 122 authorizes tariffs of up to 15% for a maximum period of 150 days.

The impact on the economy: The potential for less-than-full IEEPA tariff replacement or more consumer-friendly tariff composition tilts inflation risks to the downside and growth risks to the upside. This is our base scenario at this stage. In the event of full replacement there would be little change on the inflation outlook but temporary downward pressure on economic growth.

Stephan Kemper

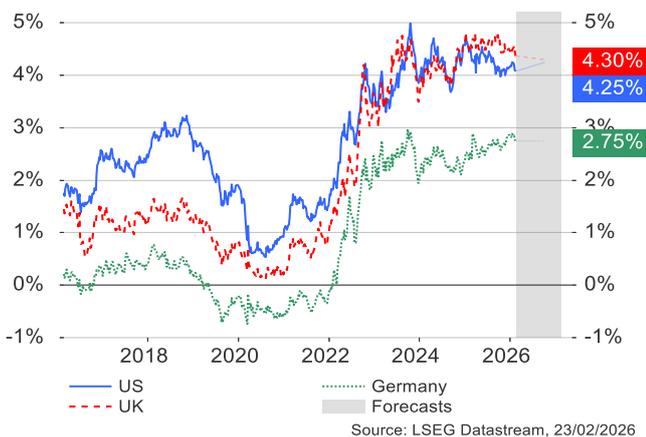
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Higher risks for the US bond markets: The biggest mispricing appears to be for bond yields. The elevated level of fiscal stimulus—driven by both likely large tariff refunds (about USD130 bn over time, we estimate) and potentially lower tariffs moving forward—poses a significant risk to the US fiscal outlook. We believe IEEPA tariffs amounted to roughly 0.6% of GDP annually, and their removal would make an already challenging fiscal outlook even more precarious.

In such an environment, it is difficult to justify the recent 4% yield level on the 10-year government bond. The potential GDP growth is estimated at around 1.80% with a 2% inflation target. To that we must add a bond risk premium, estimated at 0.5%. That is why we maintain our 12-month target of 4.25% at this stage. The risk that the bond premium will rise further is high. Even if we keep the 4.25% assumption, there remains considerable upside from current levels (see chart below). Accordingly, we recommend avoiding longer-maturity US bonds.

CHART 1: BOND YIELD OUTLOOK



USD outlook unchanged: The repeal of IEEPA should, in theory, be USD-negative for three reasons. First, with a key revenue stream adversely affected, investors are likely to once again question the sustainability of the US fiscal deficit and demand a higher premium to hold USD assets.

Second, lower tariffs reduce the incentive to invest in the United States, which should be reflected in a weaker USD valuation. Third, lower tariffs should bolster global trade and growth. Regarding the yield differential, we still expect the Fed to cut rates twice, while the ECB should remain on hold. The recent stronger-than-expected US employment data and the fact that the core personal consumption expenditure inflation rate has remained higher than expected have somewhat lowered the probability of those rate cuts by the Fed. We will monitor this closely.

Little impact on equities:

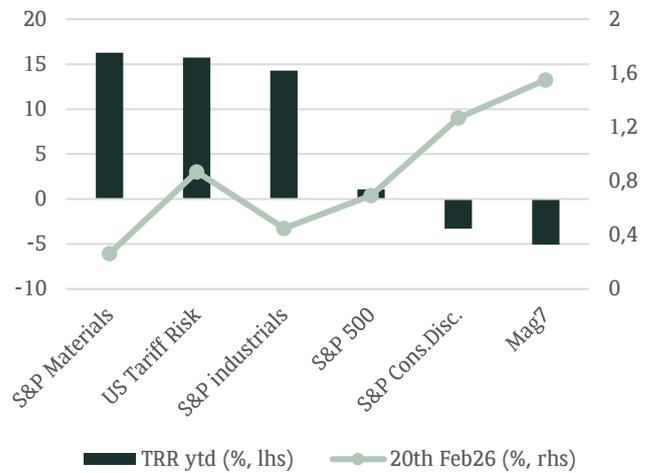
The equities clearly breathed a sigh of relief on Friday after the SCOTUS-ruling on tariffs was announced. This relief was somewhat short-lived though as markets quickly realized that the ruling might not change much in the near term and will rather increase uncertainties again. Donald Trump is not known for avoiding a fight or giving up easily. Indeed, over the weekend he imposed a 15% global tariff on foreign goods under Section 122 (increased from 10%) which will take effect on 24 February. The new announcement will keep overall tariffs broadly unchanged. Since they're limited to 150 days however, companies are now confronted with fresh uncertainties. The details of the final tariff-landscape, most likely involving Sections 232 and 301, are unclear and subject to great uncertainties. It is too early to judge what this might mean for corporate investment decisions but it is unlikely to encourage companies to accelerate them. Another area of vagueness concerns the question about potential tariff refunds. Since the SCOTUS has not decided on that question, legal disputes will continue as those companies affected by the tariffs are trying to recoup as much as USD 170 billion in tariffs they've already paid. While we don't predict the eventual outcome of those cases, we would note that the runway towards a final decision is likely to be long.



An anticipated decision? Looking at the companies most affected, we feel that sector wise it was Materials, Industrials and Consumer Discretionary. However, with the decision announced, the outcome appears already well reflected in US equity markets. Year-to-date, Industrials and Materials have significantly outperformed broad indices. Indeed, price action from Friday seems to confirm that narrative as the market was led by US mega caps while tariff repeal beneficiaries lagged.

No changes in equity allocations: We see little reason to change our current stance on US-equities as the decision is not impacting our core thesis, which we discussed in the latest [Equity Focus titled „Who needs to be afraid](#). We remain Neutral on the US market as the S&P 500 should continue to struggle from the capex monetization fears-induced underperformance of AI heavyweights. Within US equities we prefer cyclical sectors which should enjoy an ongoing tailwind from earnings and fiscal stimulus.

CHART 2: BASED ON PERFORMANCE, THE RULING WAS HARDLY A SURPRISE



Source: BNP Paribas, Bloomberg

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