

Flash Economics

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Donald Trump will continue to take surprising measures; will financial markets get used to it?

Since he took office, Donald Trump has continuously surprised observers with his announcements of very high tariffs, massive curbs on immigration, tax policy announcements and attacks on public research centres and universities.

The announcements, followed in several cases by an about face, have had a destabilising effect on financial markets. But one might wonder whether financial markets participants will start to ignore Donald Trump's positions, given their volatile nature, with the increasing conviction that the spectacular announcements will not be followed through (as per the now famous TACO: 'Trump always chickens out')

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Donald Trump will not stop making destabilising announcements

An important part of Donald Trump's strategy is to make spectacular announcements:

- Very high tariffs, of up to 145% on imports of Chinese products, up to 50% on steel and aluminium imports, and up to 25% on car imports;
- Massive curbs on immigration, cancellation of the right of asylum, suspension of the refugee protection system;
- A highly expansionist budget, adding at least \$330 billion a year to the US public deficit, with the extension of the Tax Cuts and Jobs Act, tax-free tips and overtime, and tax credits for interest paid on car loans;
- In the 'Big Beautiful Bill', section 899 provides for a 10% tax on income earned in the United States by residents of countries with distorting policies (such as a targeted tax on digital services);
- Deep cuts in federal budgets supporting public research bodies (NIH, NSF, NASA, etc.) and universities, despite the central role played by these bodies and by American universities in making the United States an attractive destination for students and researchers, and in the development of new technologies in the United States (one out of every two unicorns in the United States was created by an immigrant).

It is unlikely that Donald Trump will stop wishing to surprise financial markets and other countries, and it is therefore **likely that he will continue to make spectacular announcements**.

As a result, **markets are questioning the credibility of his announcements. Does Donald Trump systematically amend the extreme policies he has previously announced**, as he has done with tariffs (reduced to 30% for China and 10% for other countries)?

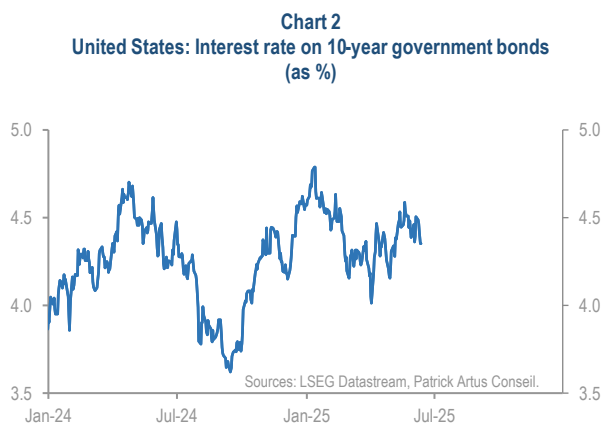
The **TACO theory** (Trump always chickens out) has emerged, which explains that Donald Trump systematically backtracks on announcements of tariffs, tax plans, etc.

Is the destabilising effect on financial markets easing?

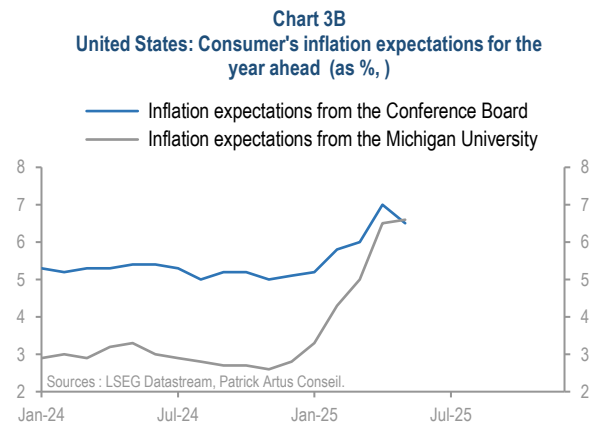
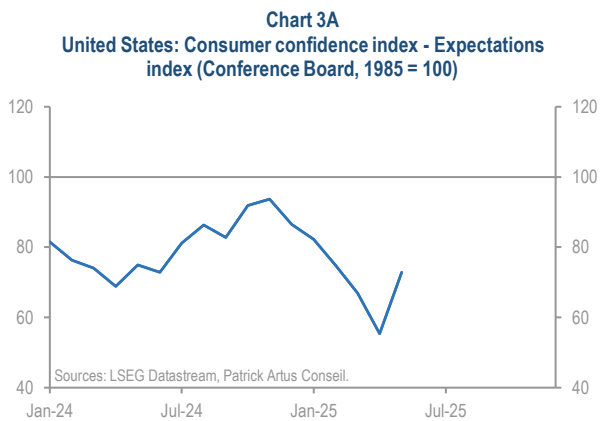
Chart 1 shows recent trends in the S&P 500 index.



Chart 2 shows the recent trend in the **10-year interest rate on US public debt**.



- **The stock market index initially fell sharply** with the announcement of very high tariffs and the expectation of inflation and recession that these tariffs generated (Charts 3A/B);



It then recovered, and **did not react to the announcement, at the end of May 2025, of 50% tariffs on steel and aluminium and a tax** on the income of companies, investors and households from countries presumed to implement distortions (regulatory, tax) to the detriment of the United States.

- **The 10-year interest rate initially fell sharply** (in anticipation of a sharp slowdown in growth), **then rose steeply** (in anticipation of inflation resulting from tariffs) **and then stabilised at around 4.40%-4.50%**, despite further surprising announcements concerning tariffs and taxation of non-residents.

Summary: the markets are buying the TACO hypothesis (Trump always chickens out)

As much as financial markets (equities and fixed income) reacted violently to Donald Trump's announcements when he first took office, they seem to have become indifferent to his announcements (on tariffs and taxation of non-residents) since the beginning of May.

Are markets right to believe that Donald Trump will systematically backtrack on his aggressive policies?

We do not believe that high tariffs are sustainable for the US economy because of their inflationary effect and their negative impact on consumption.

But two major risks remain:

- **That the very high public deficit** will push up long-term interest rates and that this increase in long-term interest rates will penalise the equity market;
- **That the tax on the income of non-residents**, particularly Europeans, provided for in section 899 of the Finance Bill, will actually be implemented. This would considerably slow capital inflows into the United States, leading to a sharp rise in long-term interest rates and a sharp slowdown in growth both necessary to reduce the external deficit, and ultimately resulting in a sharp drop in the equity market.

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