# Flash Economics

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# Protectionism, inflationary in countries with an external deficit, deflationary in countries with an external surplus

The world may be on the verge of a wave of protectionism initiated by the United States, and in particular taking customs duties to levels not seen since the Smoot-Hawley Tariff of 1930 (the rate of customs duty on all exports in the United States was 19.8% after the Smoot-Hawley Tariff, it fell below 10% with the signing of the GATT in 1947, it fell further until 2008, and it is now 20.6% with the customs duties introduced by Donald Trump).

For countries with large external deficits (the United States in particular), the main effect of tariffs is to drive up the price of imported products, and they are therefore inflationary (especially as there is little substitutability between imports and domestic production).

For countries with large external surpluses (e.g. the euro zone and China), the main effect of customs duties is to reduce exports, and therefore output, and so lower inflation.

Today, it is therefore reasonable, for example, to fear inflation in the United States and recession, with low inflation, in Europe.

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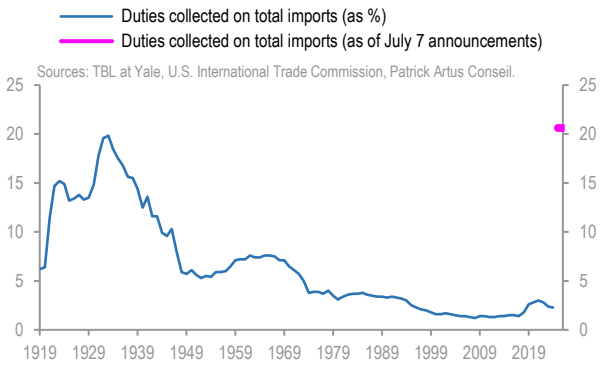
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## Protectionism is back

Significant customs duties have reappeared in the United States. Tariffs on US imports overall are now 20.6%, but many countries are applying high tariffs (India, with an average tariff of 17%, China, with a tariff of 33% on imports from the US). In contrast, the European Union is now applying an average tariff of only 5% on overall imports.

The tariffs applied by the United States, calculated on overall imports, are shown in Chart 1.

Chart 1
United States: Duties collected on total imports (as %)




One can see that these customs duties are the highest since the Smoot-Hawley Tariff of 1930, whereas after signing of the GATT in 1947 and until 2008, the customs duties that tax imports to the United States fell continuously.

## The effect of tariffs on countries differs depending on whether they have an external deficit or an external surplus

We compare the United States, the euro zone and China. Charts 2a/b/c show a major difference between the United States and the other countries: the United States has a trade deficit, while the other two countries (regions) have a trade surplus.

Chart 2A
United States: Trade balance in goods and services (monthly data, USD bn)

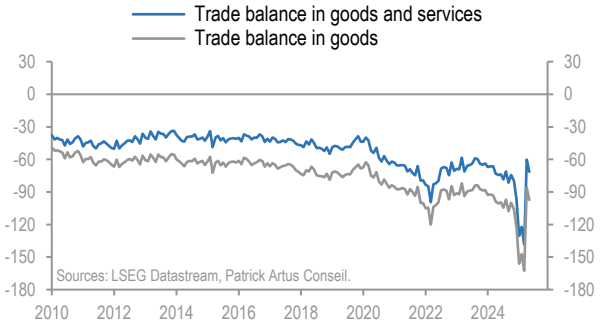



Chart 2B
Euro zone: Trade balance in goods and services (monthly data, USD bn)

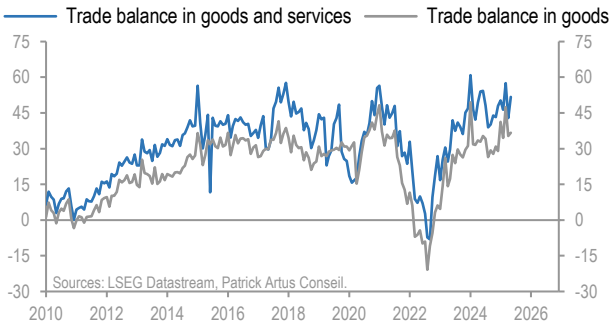



Chart 2C
China: Trade balance in goods and services (monthly data, USD bn)



**When a country has a large external deficit** (its imports are much greater than its exports), **the dominant effect of customs duties is to raise the price of imported products, and therefore domestic prices**.

**For the United States, entering into a situation of generalised protectionism therefore entails the risk of a rise in (underlying) inflation, Chart 3**.

**Chart 3**
**United States: Core inflation**
**(CPI excl. food and energy, Y/Y as %)**




**When a country has a large trade surplus** (exports are much higher than imports), **the dominant effect of customs duties is to weaken exports**.

The risk associated with Europe and China entering a situation of generalised protectionism is **therefore that of weaker growth** (**Charts 4a/b**).

**Chart 4A**
**Euro zone: Real GDP (Y/Y as %)**




**Chart 4B**
**China: Real GDP (Y/Y as %)**




## Summary: what is to be feared today in the United States or in Europe?

We have seen that, given the difference in the trade balance picture, the onset of generalised protectionism would lead above all to **a rise in inflation in the United States and a drop in growth in Europe,** and therefore also to a fall in inflation in Europe. Inflation and low growth in Europe would lead to a very expansionary monetary policy; the persistence of high inflation in the United States should lead to a fairly restrictive monetary policy, unless the Federal Reserve reacts mainly to growth and little to inflation in the future.

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