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Weekly Commentary

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How tariffs could impact liquidity

In finance and economics, it can seem like there is an index for everything. The sheer amount means that the better ones can be overlooked. One example is the Global Economic Policy Uncertainty Index, created by three economics professors, Scott Baker, Nick Bloom and Steven Davis. Prominent among its factors are text searches of several newspapers for articles that contain "economic" or "economy," "uncertain" or "uncertainty." Not surprisingly, it has skyrocketed since Donald Trump was elected president. The academics don't give reasons why, but clearly the emerging trade war is the main culprit. Last week the administration imposed 25% tariffs on Canada and Mexico, and tariffs of 20% on China before carving out autos from the tariffs and all goods covered by the United States-Mexico-Canada Agreement (USMCA), which is roughly half of all trade between the three countries. The US economy seems to be solid. The February nonfarm payrolls report came in just a hair under expectations, at 151,000 added jobs versus expectations of 160,000. But expectations are everything. If consumers and business start to tighten belts or face higher prices from tariffs, an economic slowdown could be on the horizon.

What does this mean for the liquidity space? Namely, the Federal Reserve. If the trade war weighs on the US economy, policymakers might take the fed funds target rate lower. We will know more after the Federal Open Market Committee meets next week, especially from the updated Summary of Economic Projections. The officials will have two important inflation data points this week with the release of CPI and PPI for February. However, even with rate cuts, we believe yields on liquidity product across the industry will still be attractive.

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