Dutta's Economic Daily
Stagflation fears likely overblown

Neil Dutta

That 70s show?

There has been a lot of talk about stagflation. I get it. Tariffs represent a negative supply shock. We had a lot of negative supply shocks in the 1970s.

It's still early but a few points of distinction.

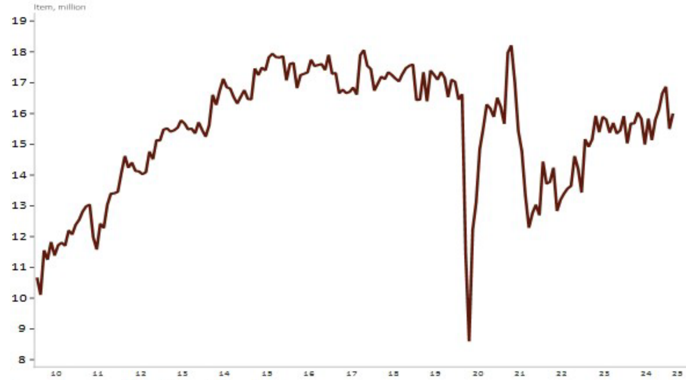
- First, we just spent the last year talking about a productivity boom — not exactly the preconditions for stagflation.
- Second, oil prices are falling, which is not what we saw in the 70s.
- Third, interest rates have been falling with five year breakevens down about 8bps since February 20.

For now, it feels like the weakness in growth will take the pressure off of inflation.

US auto sales up slightly, tariff threat looms

- February saw a modest 3.2% m/m increase in US vehicle sales, reaching an annualized rate of 16 million units. This figure fell slightly short of the 16.1 million units predicted. While seasonally adjusted sales showed improvement from January's weather-impacted performance, the rebound was considered relatively weak, likely due to the anticipation of rising car prices. Unadjusted sales totaled 1.22 million units, a 0.7% dip compared to February of the previous year.
- Within the market, light truck sales saw a marginal 0.1% y/y increase and comprised 82% of total sales. Passenger car sales, conversely, experienced a 4.4% y/y decline. Affordability remains a concern, particularly with the rise in auto financing rates at the start of the year.

Pretty weak bounce in auto sales
(Total light vehicle retail sales, SAAR, Million units)



Source: Renaissance Macro Research, Macrobond

- However, these rates are expected to decrease in the coming months, aligning with the recent drop in US Treasury yields. This positive development is countered by a significant emerging challenge: the proposed 25% tariffs on Canada and Mexico. These tariffs represent a negative supply shock, poised to further inflate auto prices and decrease sales volumes, acting as a substantial headwind for the sector.

Tariff war with neighbors: A losing proposition for all

- A recent report by PIIE analyzes the potential economic fallout from proposed US tariffs on Canada and Mexico, and their retaliatory responses. In early 2025, then-President Trump threatened 25% tariffs on most Canadian and Mexican imports (excluding Canadian energy, facing a 10% tariff), citing concerns about fentanyl, illegal immigration, and trade imbalances. Canada and Mexico announced retaliatory tariffs in kind, with Canadian Prime Ministerial hopeful Mark Carney vowing to "stand up to a bully." Although the tariffs were reportedly paused for negotiations, Trump implemented additional tariffs on China, triggering reciprocal measures. These tariffs would heavily impact key import sectors. From Mexico, transport equipment, fruits and vegetables, electronics, and machinery would be hardest hit. Canadian imports facing the greatest impact include wood products, metals, fuels, food products, and transport equipment. Canada and Mexico announced retaliatory tariffs in kind, with Canadian Prime Ministerial hopeful Mark Carney vowing to "stand up to a bully."

- The study uses the G-Cubed model to simulate the economic impact of a scenario where the US imposes 25% tariffs on all imports from Canada and Mexico, and they reciprocate. The model assumes these tariffs are permanent. The key finding is that retaliation exacerbates the negative economic consequences for all three countries. While US-only tariffs negatively impact real GDP and increase inflation in all three nations, the retaliatory tariffs amplify these effects.

- Specifically, compared to a scenario with only US tariffs, retaliation further shrinks the US economy by nearly 0.5% relative to baseline forecasts by 2027. However, the damage to Canada and Mexico is significantly greater, with their economies contracting by 2.3% and 3.4% relative to baseline by 2027-28 and 2032-33, respectively. Inflation also rises more sharply in all three countries under retaliation, with spikes of 3-4 percentage points in Canada and Mexico in 2025. By 2028, the price level in Canada is 5.2% higher and in Mexico 8.7% higher than baseline.

- The report concludes that tariffs are ineffective in addressing fentanyl and immigration issues, and are more likely to necessitate negotiations. While retaliation might appear politically appealing, the analysis demonstrates it would worsen the economic damage for all parties involved

Pretty weak bounce in auto sales

(Total light vehicle retail sales, SAAR, Million units)

Source: Renaissance Macro Research, Macrobond