Tariffs, the Economy and Market Turbulence -- What Does It Mean for Banks?

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Agenda

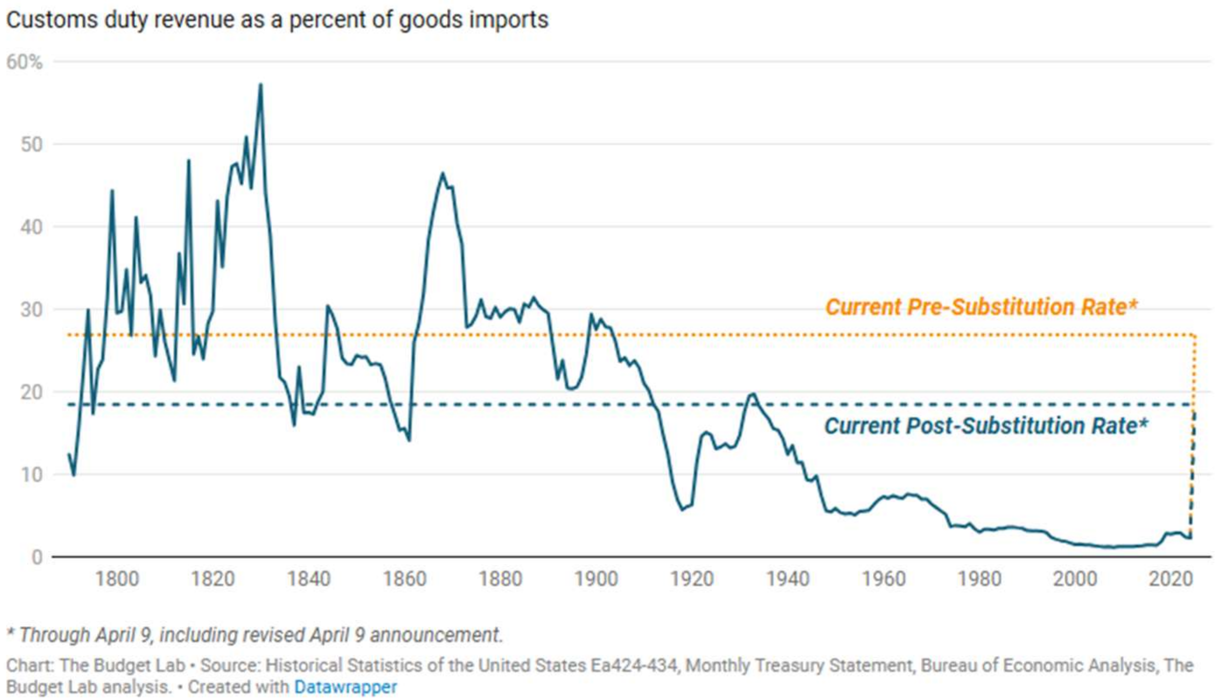
- What just happened with tariffs and markets?
- Where do we go from here?
- What does it mean for banks?
- Discussion/questions

US Administration policy mix -- expected near-term impact on US economic growth and inflation

- Growth positive
  - Deregulation
- Growth negative
  - Fiscal policy -- (#1 priority)
  - Tariffs/reindustrialization – revenue source – so expect them to be permanent
  - Immigration
  - Energy

- Lower inflation
  - Tighter fiscal policy (until H2 2025 tax cuts)
  - Deregulation
- Higher inflation
  - Immigration
  - Tariffs
  - Dollar deprecation

Announced tariff rates > Smoot-Hawley



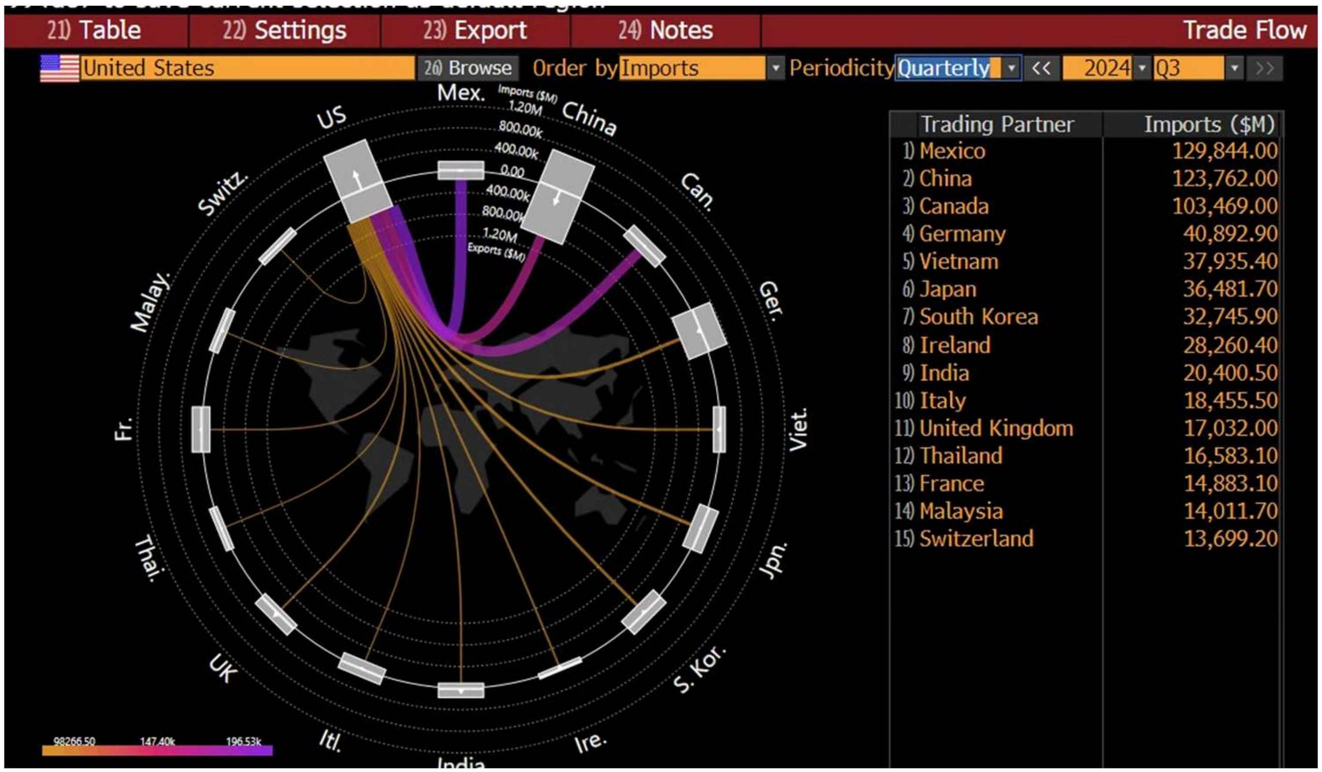
US tariff recap … as of this week…

- 10% baseline tariff on all US imports in effect
- 25% steel and aluminum tariffs
- 25% auto tariff
- 145% tariff on most imports from China
- 25% tariff on most imports from Canada and Mexico (USMCA compliant goods exempt)

China, Canada and EU have all imposed tariffs on US exports in response.

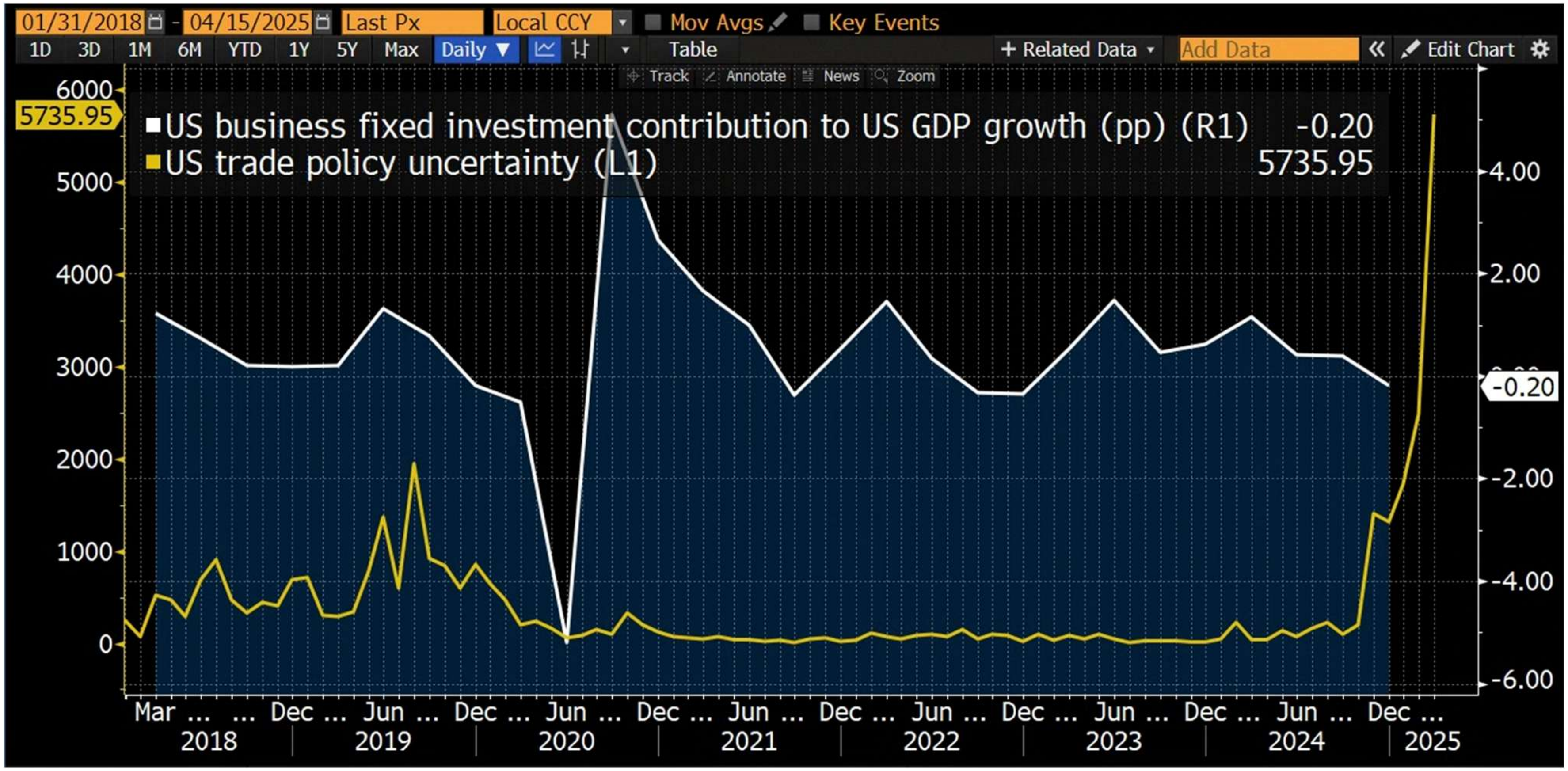
https://budgetlab.yale.edu/research/fiscal-and-economic-effects-revised-april-9-tariffs

Total US international trade $1.3 trillion ($851 billion in imports and $500 billion in exports); US is world's largest service exporter at ~$1 trillion

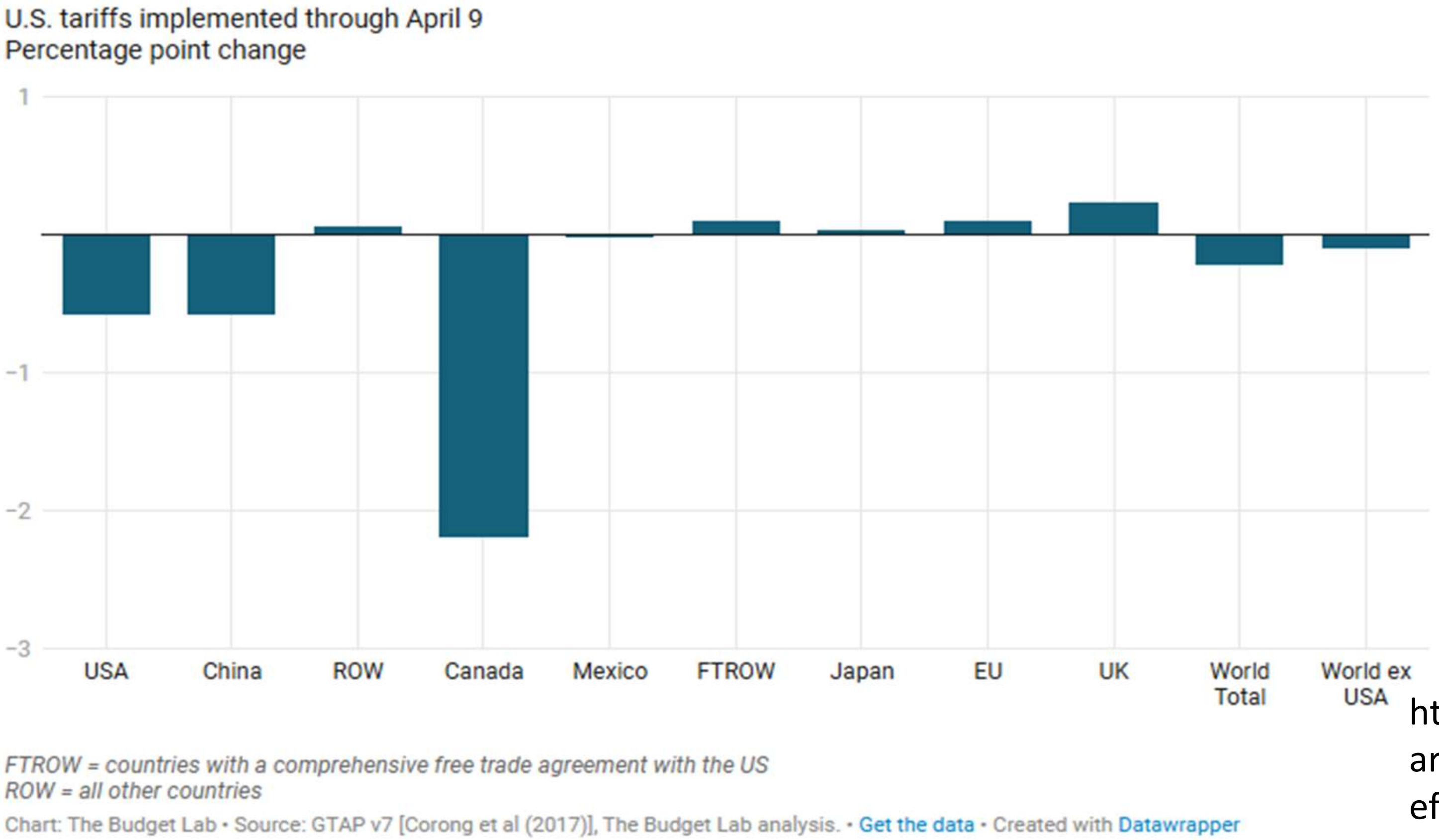


Trading Partner	Imports ($M)
1) Mexico	129,844.00
2) China	123,762.00
3) Canada	103,469.00
4) Germany	40,892.90
5) Vietnam	37,935.40
6) Japan	36,481.70
7) South Korea	32,745.90
8) Ireland	28,260.40
9) India	20,400.50
10) Italy	18,455.50
11) United Kingdom	17,032.00
12) Thailand	16,583.10
13) France	14,883.10
14) Malaysia	14,011.70
15) Switzerland	13,699.20

Trade policy uncertainty suggests lower investment and US GDP growth



Estimated long-run change in real GDP from 2025 tariffs



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Tariffs about revenue? National security? US jobs?

- $5.8 trillion US tax cut package working its way forward for H2 2025. Some in the Administration may want to assume that tariffs are part of payfors to fund the coming tax cut package.

- White House advisor Navarro stated this month that the tariffs could raise $600 billion per year in revenue, adding to the $100 billion expected from auto tariffs. Over a 10-year horizon, that is an estimated $6 trillion in US government revenue.

- So if tariffs were mostly borne by foreign exporters/producers, theoretically trading partners would pay for coming US tax cuts. Such a development would be fiscal stimulus to the US economy that is delivered without a deterioration in the US fiscal position.

- Corporate profit margins and firms' ability to sell goods elsewhere will determine who absorb tariffs/increased USG taxes. Expect tariff leakage with companies moving production from high tariff countries to other countries subject to the 10 percent baseline US tariff.

- Still all suggests a White House intent to make tariffs a more permanent source of US government revenue. For this reason, expect tariffs to endure as an economic policy (despite the havoc they are causing).

Tariffs are a tax

- Tariffs either
  - reduce foreign and/or US corporate profits; or
  - reduce consumers' real income through higher prices and inflation.
- To reindustrialize the US needs investment – but economic policy uncertainty is high and increased foreign investment mathematically is inconsistent with narrowing trade imbalances.
- Trust is earned over long periods, but discussions about US territorial expansion and raising revenue abroad is eroding international investors' trust in the US.
- More US fixed investment also is likely to imply higher savings/weaker consumption and higher US interest rates.

Too many priorities; no clearly articulated economic plan

- Which can lead to policy inconsistencies
  - Less immigration/aging demographics vs creating more US manufacturing jobs when already near full employment
  - Lower trade deficits vs increased foreign capital inflows/investment to fund reindustrialization
  - More US capital/fixed investment vs lower interest rates
  - Strengthen US government fiscal position through tariffs vs lower inflation/lower interest rates
  - Drill baby drill (O&G cap-ex) vs lower oil and gas prices to reduce inflation
  - Need to improve government finances vs recession risks and subsequent tax cuts
  - Sell-off in US financial markets won't hurt lower income Americans.

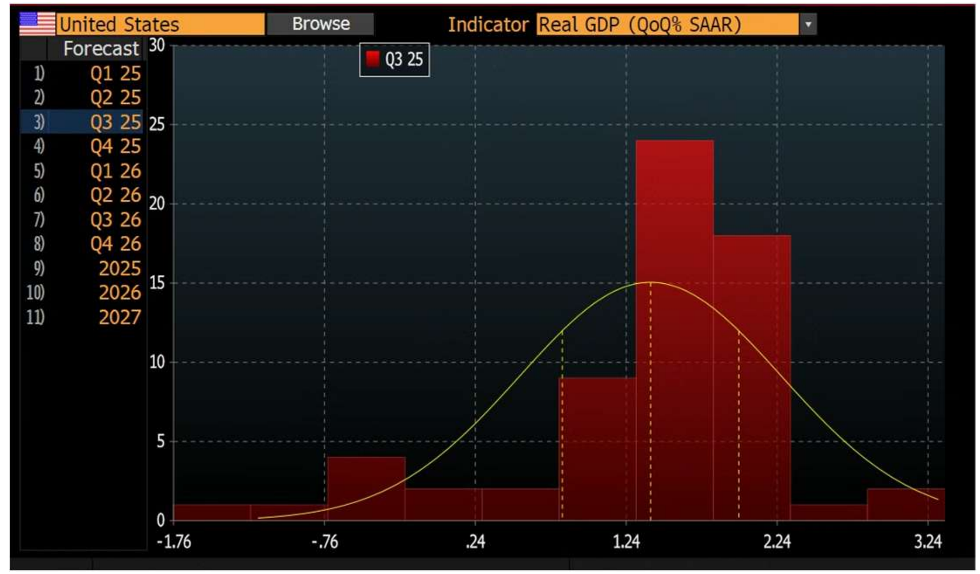
Financial crisis coming into view

- Multiple problems unfolding.
  - $10 trillion negative asset price shock and associated deleveraging to act as credit default trigger.
  - Macroeconomic forecasts and expectations for US economic policy too optimistic; large investor portfolio shifts still to come.
  - Erosion of the USD global reserve currency status and Treasury market. Some foreign official sector push back on tariffs via the Treasury market.
  - Global money market liquidity fine now, but over time tariffs will begin to act as unexpected drain in the global financial system.
  - No credible US official sector put/policy support.

2025 US economic growth still over-estimated, economy decelerating and recession risks rising

	2025	Q1	Q2	Q3	Q4
Now	1.8%	1.0%	1.5%	1.6%	1.8%
Mar 25 survey	2.0%	1.2%	1.5%	1.7%	1.8%
Feb 25 survey	2.3%	2.2%	2.0%	1.9%	2.0%
Jan 25 survey	2.2%	2.1%	2.0%	2.0%	2.0%
Dec 24 survey	2.1%	1.9%	2.0%	2.0%	2.0%
Nov 24 survey	2.0%	1.8%	1.9%	2.0%	2.1%
Oct 24 survey	1.8%	1.7%	1.9%	2.0%	2.1%

Consensus forecast from Bloomberg survey for US GDP growth



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Economists' near-term US inflation expectations < the bond market

- March Bloomberg consensus forecasts puts Q2 US CPI at 2.8%, significantly below fixed income markets (high at 4%).

- Inflation derivatives market (one year inflation swap) puts 2025 CPI at ~3.3%

- Short dated Treasury inflation protected securities (TIPS) suggested 2025 CPI at ~4%.

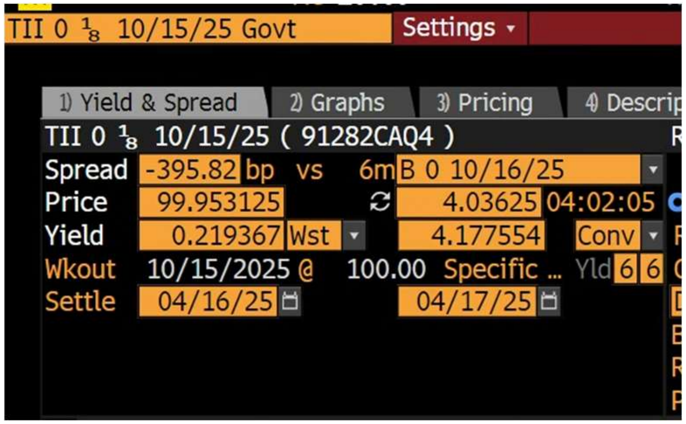
- 60/40 portfolio does not work well when inflation > 3%. Big investment portfolio shifts should come.

United States | Browse | Consumer Prices (YoY%) | Yearly | Quarterly

Q1 25 Actual 2.7 | Q1 25 Forecast 2.8

	Q1 25	Q2 25	Q3 25	Q4 25	Q1 26	Q2 26	Q3 26	Q4 26
Median	2.8	2.8	3.2	3.2	3.0	2.8	2.6	2.5
Mean	2.8	2.9	3.2	3.2	2.9	2.8	2.6	2.5
Bloomberg Weighted Average	2.8	2.9	3.4	3.3	3.1	2.9	2.7	2.5
High	3.5	3.9	4.2	4.6	4.4	4.5	4.2	3.1
Low	2.3	2.3	2.3	2.3	1.9	1.9	1.8	2.1
Responses	57	57	57	57	54	53	47	4
Mar. Survey	2.8	2.8	3.1	3.0	2.8	2.6	2.5	
Feb. Survey	2.8	2.7	3.0	2.8	2.7	2.6	2.5	

Contributors (57)	As of	Q1 25	Q2 25	Q3 25	Q4 25	Q1 26	Q2 26	Q3 26	Q4 26
Comerica	04/11/25	2.8	3.1	4.2	4.6	4.4	4.0	3.1	
Julius Baer	04/08/25	2.7	3.8	4.0	3.6	3.2	2.2	2.0	2.1
JPMorgan Chase	04/11/25	2.7	3.2	4.0	3.8	3.3	3.8		



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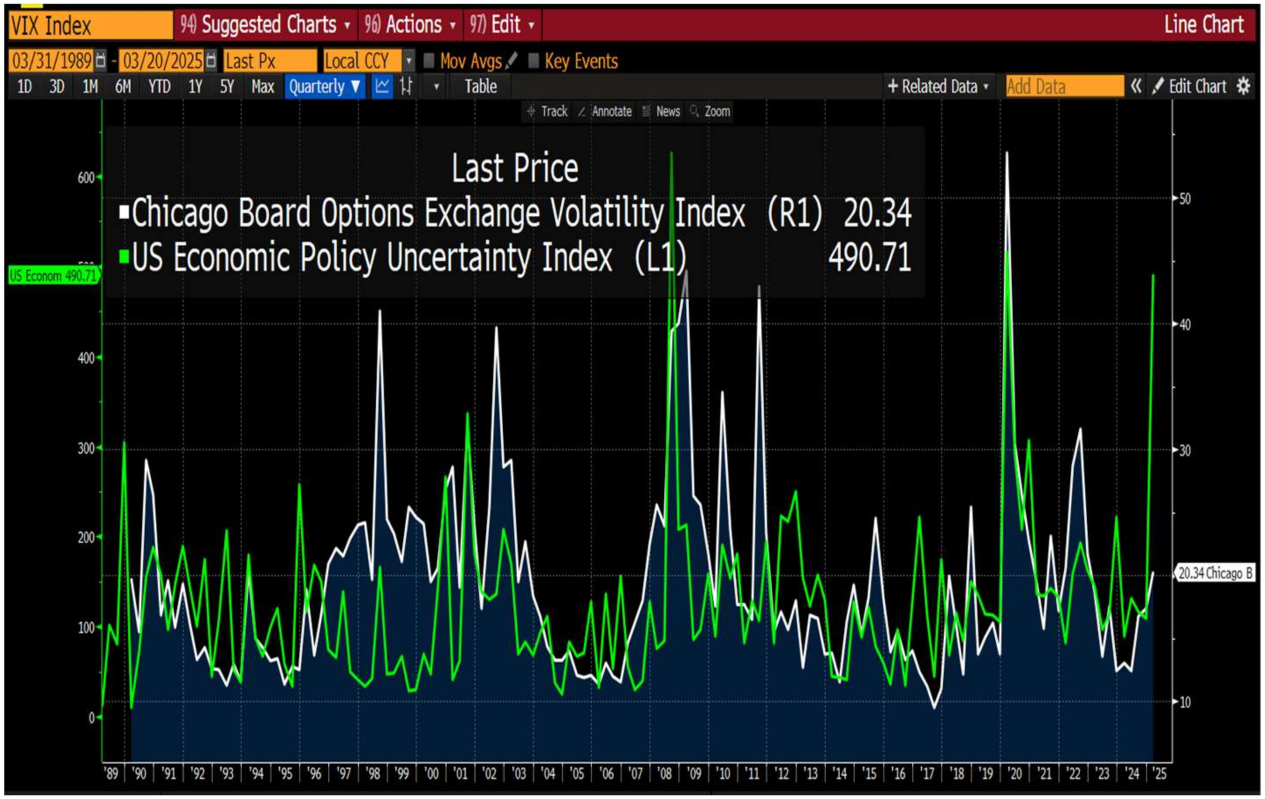
April 2 became "volatility liberation day" because risk so significantly mispriced in markets

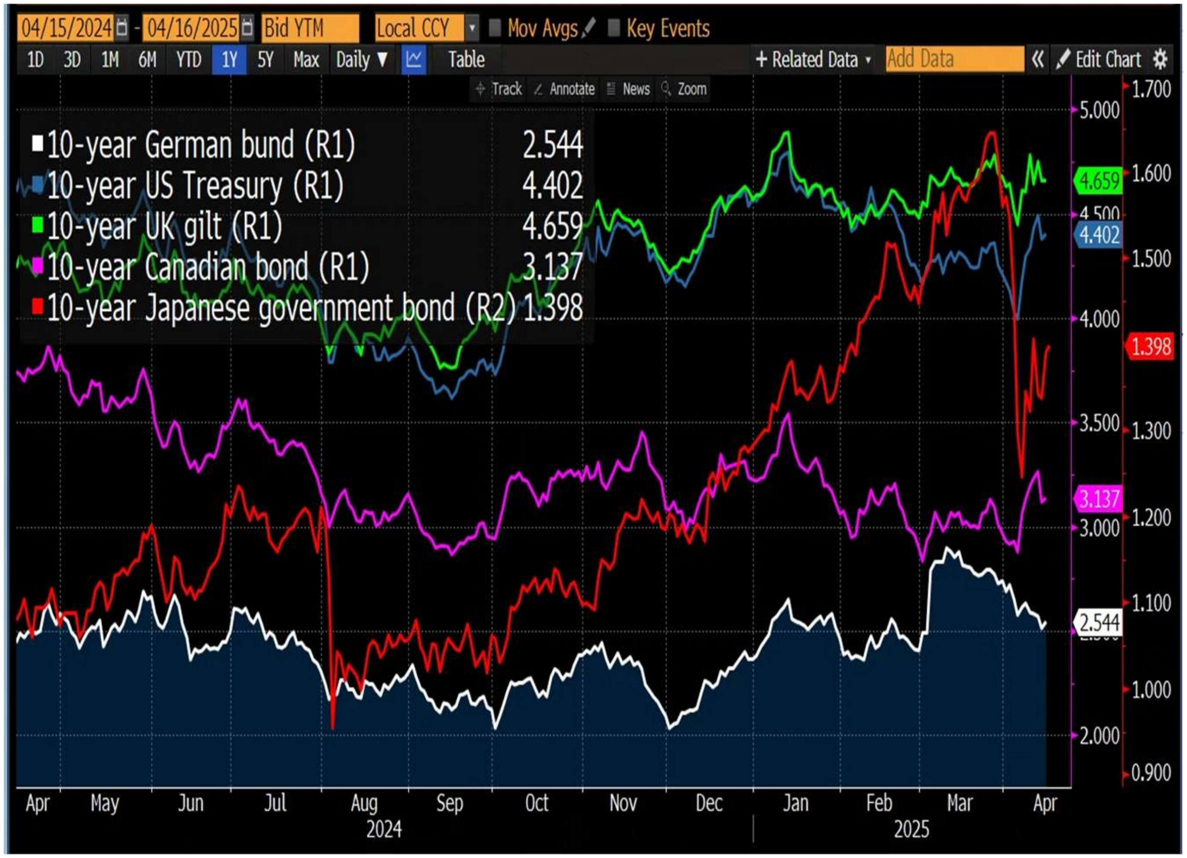
- Equity market volatility was too low for level of US economic policy uncertainty.

- High yield corporate bond spreads were ~3%, vs 2.5% historic low and 5.5-6% avg

- Process of portfolio reallocation unlikely to be complete.



Post tariff price action in German bunds vs Treasuries notable: bunds new safe haven?



Move in USD vs gold over last two years meets IMF definition of currency crisis

- Foreign central banks are buying gold given use of financial sanctions.
- China figuring out what to do with large US dollar balances; maybe not invest in US?
- Inflation expectations rising with growth in US Treasury debt stock.
- Central bank/macroeconomic policy credibility and <u>trust is the only thing that backs a fiat currency.</u> Does the US still have it?

Risk of a US capital account crisis growing

- Capital account crises are when sudden foreign capital outflows trigger a sharp decline in the value of the currency and higher interest rates -- sometimes also pressuring a country's banking system.

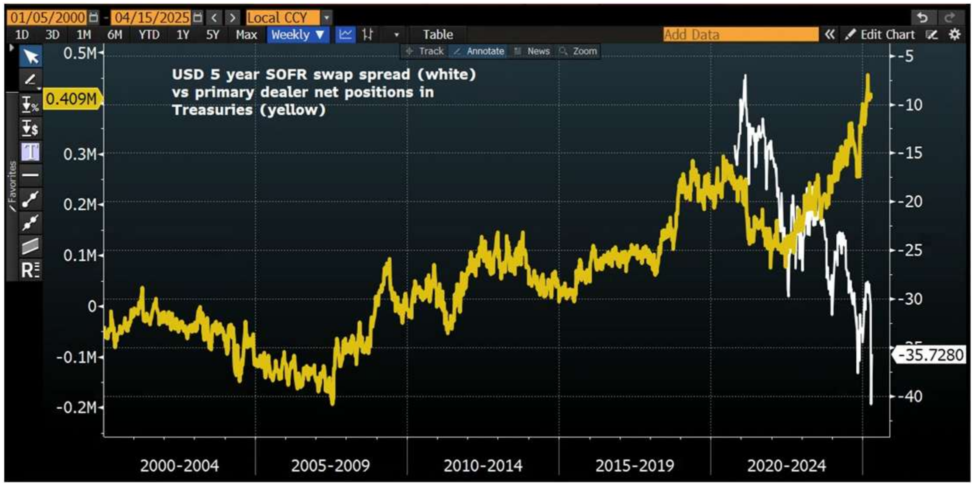
- Out of an international sample of 18 capital account crises in emerging markets, 8 were triple crises (a triple crisis is one that involves currency, government debt and the banking sector) and 7 were double crises.

- The magnitude of fx depreciation relates to crisis scope -- average depreciation in a single or twin crisis is around 25%, while average depreciation in a triple crisis is about 50% -- with implications for inflation.

- Historically capital account crises last 3 to 18 quarters; median length is 8 quarters.

No credible official sector policy support in view

- Monetary policy options limited.
  - No Fed put; stagflation is the hardest macro scenario for any central bank. Don't expect Fed rate cuts; cuts could be counterproductive. Fed facilities at high interest rates can't reflate/ are unhelpful.
  - QE to stabilize Treasury market risks USD depreciation. Fed still currently in QT mode until May FOMC.
  - Fed credibility at risk; Powell to step down in May 2026, but de-facto shadow Fed chair coming this fall?
- Fiscal policy options also limited.
  - US Treasury debt buybacks are not a credible tool.
  - Administration plans to cut taxes in H2 2025 may trigger an adverse bond market reaction, increasing long-term interest rates.
  - SLR relief for banks much touted, but unlikely to help Treasury market and crowds out loan growth. Hedge fund swap spread widener trades may have exacerbated move.



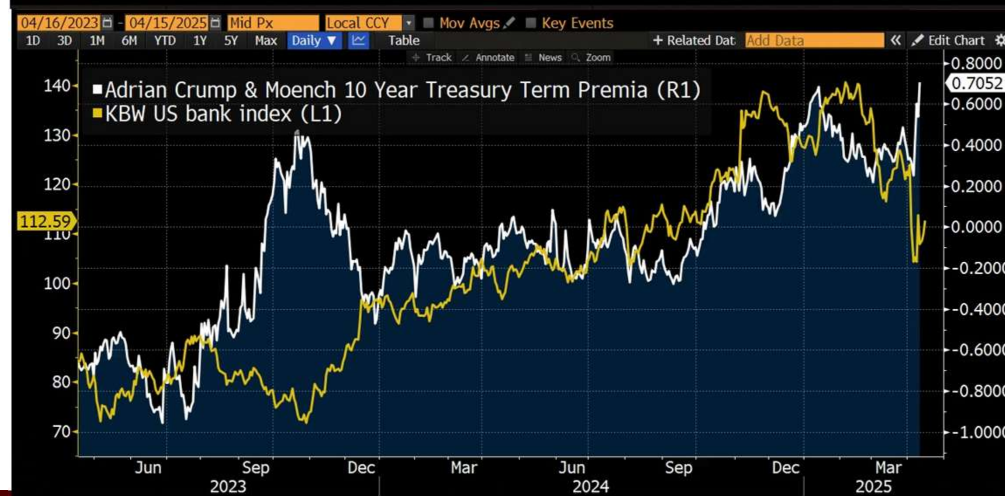
Alternative scenarios …

- It gets better
  - US economic policy approach changes/more consultative approach taken.
  - US fiscal stimulus can be delivered in H2 2025 without back up in US interest rates.
  - Q1 economic data initially aren't so bad, and household and business sentiment improves; US financial conditions ease.
  - Banks are strongly encouraged to buy Treasuries.

- It gets worse
  - Tariff war is prelude to growing risk of real geopolitical conflict.
  - Further shocks to confidence in US economic policy occur.
  - Capital controls imposed.

What does this mean for banks?

- 10-year Treasury term premium (chart) has pivoted from long-run trend – beginning a structural rise. Term premium was at a peak during 1980s stagflation.
- In the prior ultra-low rate environment, many US banks chased NII through higher duration and more rate volatility (agency MBS) and took EVE risk.
- Lagged impacts of interest rate risk still a likely headwind for some banks. Use of HTM really should be limited.
- Automatic stabilizers plus 2025 tax cuts = government budget deficit 10%+ of GDP is possible. 10-year Treasury yield is likely to rise in H2 2025 due to heavy Treasury issuance/supply.
- Consider obtaining some term funding (2-3 years).
- Resist the temptation to go beyond a duration of 2-3. Evaluate short-dated TIPS as an income booster.



What does this mean for banks?

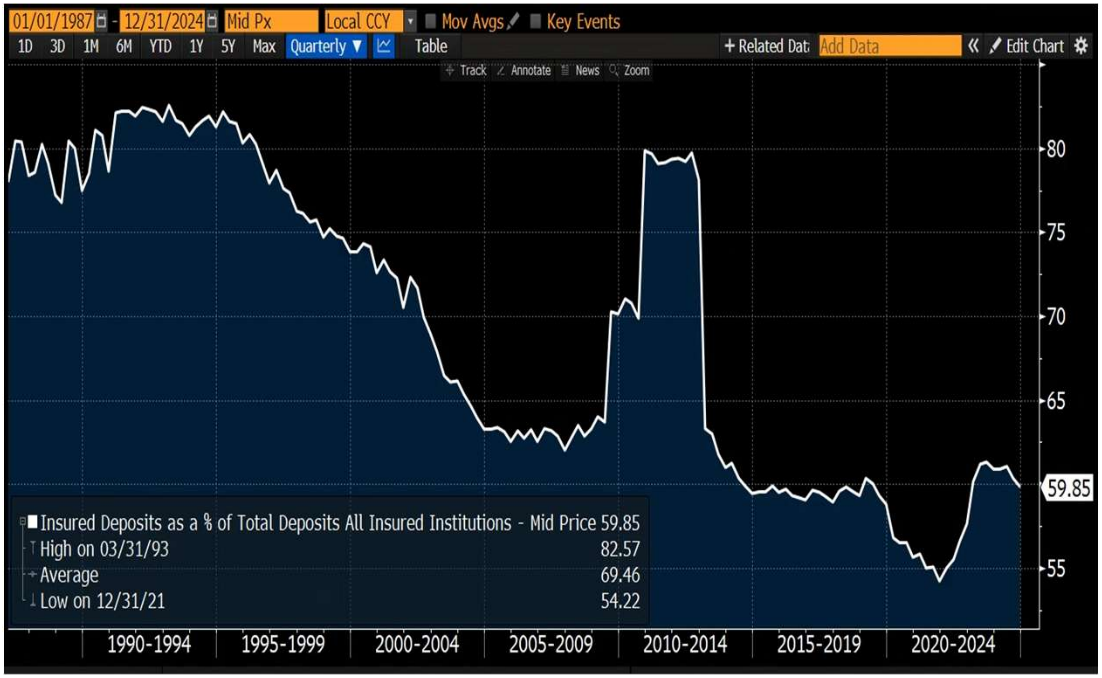
- Remember bank strategies that worked in the past may not work well now because official sector interventions may not work due to reduced policy credibility.
- Banks need to maintain strong liquidity and limit interest rate risk/market risk sensitivity.
- Superior capital is also helpful in this environment. Credit events will begin to emerge; stregthen workout function.
- Appropriate loan pricing is particularly essential vs loan volume in this environment.
- Stress test for a 6% 10-year Treasury yield and stagflation.
- Regulation is not risk management. Financial regulation has history of financial repression; it will happen again.

Note Financial repression is when governments implement policies to channel to themselves funds that in a deregulated market environment would go elsewhere – generally as a form of debt reduction.

- Avoid agency MBS (as agency MBS are basically short interest rate vol, privatization would create uncertainty and they are out of favor with the Fed)
- Be careful on US muni bonds as federal income tax exemption may be repealed to raise USG tax revenue.
- Economic scenarios used for Q4 2024 CECL were overly optimistic. Adjustments will be needed, weighing on bank earnings.

What does this mean for banks?

- Last period of US stagflation, the share of insured deposits much higher.
- Deposit pricing competition was less intense as Reg Q/deposit pricing caps did not change until the late 1980s.
- In late 2024, US bank equity was fully priced for significant deregulation and optimistic earnings. In 2023, decline in bank equity prices contributed to uninsured deposit runs.



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What does this mean for banks?

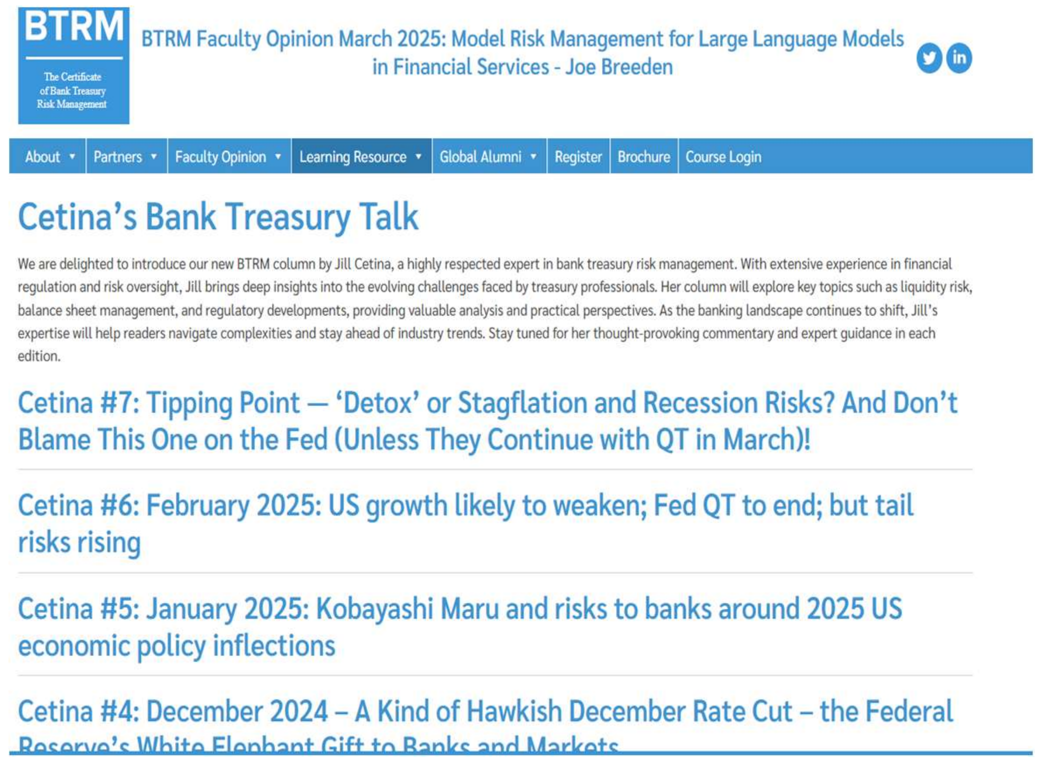
- Any bright spots? Yes, significant and attractive opportunities given fx volatility in international correspondent banking.

- Look for foreign and US banks teaming up to offer FDIC insured foreign currency deposits to retail customers with low deposit yields and earning nice spread with main risk being AML/KYC/BSA.

  - Far less risky than crypto/stablecoin offerings at banks.

  - In the US, the FIS platform permits US banks to offer multi-currency deposits.

Questions/discussion



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