Trump's trade war took a stunning bite out of the US economy, and it's the strongest evidence yet that he's shooting himself in the foot

Bob Bryan
Business Insider, 26 Oct 2018

- The US economy grew at an annualized rate of 3.5% in the third quarter, according to Friday's report on gross domestic product.
- The GDP report also showed major distortions because of President Donald Trump's tariffs on Chinese goods and metals.
- Trade took a major bite out of growth, dragging the GDP growth figure down by 1.78 points, the worst number in 33 years.
- It appears that companies also built up inventories in a rush to import goods before they were subject to tariffs.

There's mounting anecdotal evidence that President Donald Trump's trade war is causing trouble for the US economy and businesses. But Friday's report on third-quarter gross domestic product may be the best hard evidence yet that the tariffs are causing major disruptions in the economy.

GDP rose at an annualized rate of 3.5% in the third quarter. But the contribution of net exports of goods and services - the measure of how much trade added or subtracted to GDP growth - was a dismal -1.78 percentage points.

- It was the largest negative contribution to GDP growth for trade in 33 years; in the second quarter of 1985, trade subtracted 1.91 points.
- In other words, if trade were a net neutral, neither adding to nor subtracting from GDP growth, third-quarter GDP growth would have been a dynamite 5.3%.
- If trade had matched its average contribution since 2015, a 0.33-point drag, GDP growth would have come in at 5%.

Uncertainty over trade policy may have also contributed to muted growth in capital expenditures by businesses. Nonresidential fixed investment - spending on large-ticket items like equipment - added only 0.12 points to GDP growth, the lowest in seven quarters, while overall fixed investment was a 0.04-point drag, the worst in 10 quarters.

Companies have said that this uncertainty and the possibility that tariffs will push up costs elsewhere could result in decreased capex spending.

But the tariffs may have also helped prevent the GDP report from coming in softer than expected. Similar to the second quarter's sudden surge in exports (mostly soybeans), inventories surged in the third quarter and added 2.09 percentage points to the GDP growth figure.

Michael Feroli, an economist at JPMorgan, surmised that many businesses imported goods before they were hit by tariffs, helping to boost the inventories number.

"This may have reflected front-loading of imports (which increased at a 9.1% rate) ahead of scheduled tariff increases - imports which then end up temporarily in stockpiles," Feroli said.

That could mean companies rushed to import goods from China that were about to get hit by tariffs, stockpiling those items before they got more expensive.

But the sudden inventory build is unlikely to last. Ian Shepherdson, the chief economist at Pantheon Macroeconomics, said that the huge drag from trade might lessen slightly going forward but that the counterbalancing inventory build was even more likely to reverse.

"Trade likely will be a drag in Q4, though much less than Q3," Shepherdson tweeted on Friday. "But there's zero chance inventories will repeat their Q3 add, so jointly they'll be a drag on growth."

The GDP report follows a series of surveys and anecdotal evidence from companies suggesting the tariffs are causing trouble.

The Federal Reserve's latest Beige Book, a collection of interviews with business executives from each of the Fed's 12 regional banks, was chock-full of concern about possible costs from the tariffs. And many major corporations, including Tesla and 3M, have estimated that the tariffs will add tens of millions of dollars to their costs going forward.