Appalachian Highlands Economic Update

The Trouble with Tariffs

Taylor P. Stevenson, Ph.D. • Department Chair and Associate Professor of Economics

I will begin by expressing my uncertainty to what the tariffs are attempting to accomplish. It is looking more and more that the tariffs as presented on April 2 were intended as an opening offer in a negotiation. If that is the case, the end game may be lower tariffs across the board which would be good for both domestic consumers and domestic exporting firms. Domestic production and exports to foreign countries would increase over time. Alternatively, if the goal is protectionism, the tariffs would result in a wealth transfer from domestic consumers to domestic producers. It is possible that domestic manufacturing and employment could increase but no one argues that consumers will be better off, especially in the short term.

The market system in which we operate is predicated on the coordination of activity of resource owners, producers and consumers. The information required to coordinate economic activity is transmitted through prices of resources, goods and services. Any tax that is placed on any market, tariff or otherwise, distorts that information and changes activity of economic decision-makers both home and abroad. It is nearly impossible to predict the unintended consequences that the price distortions will have over time. In 2008, the housing market crash which was a direct result of the price distortions in the mortgage market but had the indirect impact of high unemployment in the market for carpenters. Young people had made the decision to devote their time to carpentry in response to artificially high demand for carpenters and about 17 percent subsequently lost their jobs. The price/wage signal was distorted by policy. While it is unclear what we may have "too many" or "too few" of in response to the tariffs, it is surely true that there will be a distortion in price signals that would result in widespread economic inefficiency.

The tariffs imposed in 2018, 25 percent tariff on steel and 10 percent on aluminum, were justified by arguments related to national security. The results of the steel tariffs have been an increase of about 1,000 jobs in the steel industry (82,500 in 2017 and 83,600 in 2023) at an estimated welfare cost of over $1 billion per month to consumers. I should note that there is the obvious blip in economic activity in the interim with the recession brought on by COVID restrictions and also that I am skeptical of the estimations of the welfare loss. Even so, the results of those tariffs are difficult to defend, ex post.

Another issue that may be a problem is the susceptibility to Rent-Seeking activity. Rent-seeking is the practice of using government legislation or regulation to create artificial transfers of wealth toward existing producers in an industry. Tariffs and import quotas can produce similar results. This is not a new practice. The satirical "Candlestick Makers Petition" written by Frederic Bastiat in 1845 illustrates the irreconcilability of protectionist policy and the public welfare. In the petition Bastiat suggests that candlestick makers face unfair competition from a foreign entity, the sun, and that it should be law that all openings into buildings be blocked. Just think of all the jobs that could be created in the candle making industry and the prosperity that would follow. We have already observed carve outs for some products and industries. The authority to transfer wealth is sure to attract lobbying efforts that are by nature unproductive.

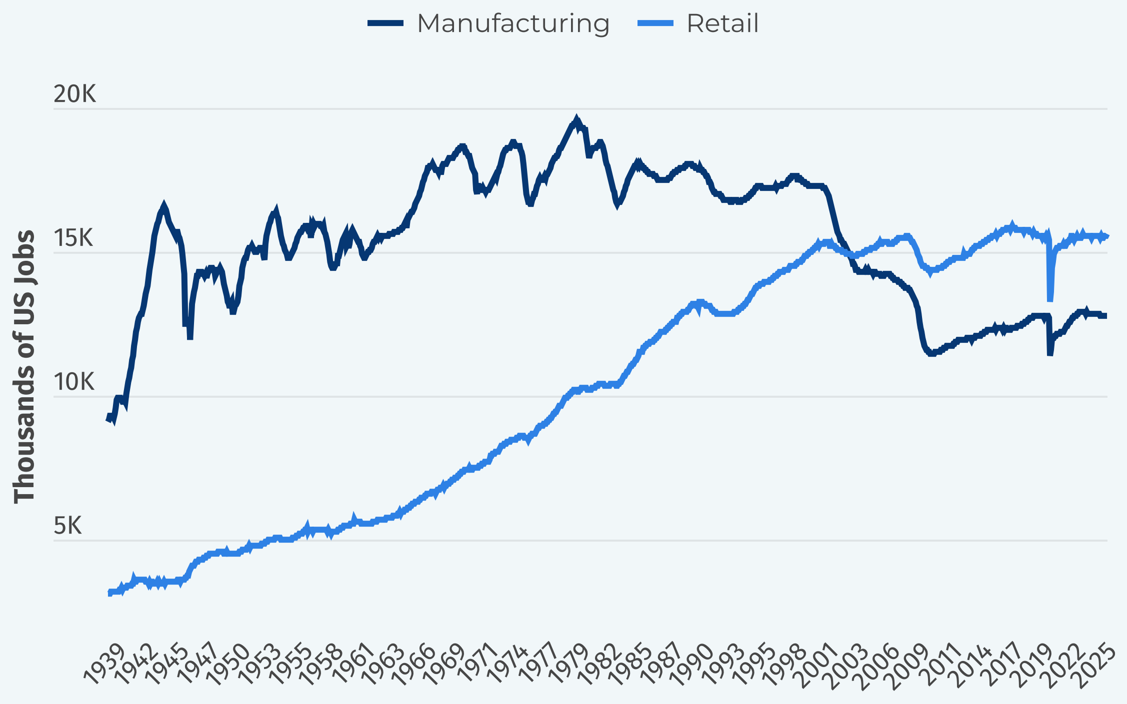
Yet another critique is the Hayekian pretense of knowledge. That is, there is a limitation to human understanding and therefore a limited ability to manage complex systems with a high degree of precision. The problem then is the assertion that a small group of individuals can engineer a solution to a problem within a complex system that has emerged as a result of human action and not human design. Hayek was presenting arguments against central planning, but the same logic applies to any economic policy. I think it would be fair to say that I have little confidence in the ability of anyone in the federal government to bring about their intended results without any side effects.

To be sure, my thoughts are focused on tariffs alone and do not take into account other foreign policy considerations. It will be quite interesting to see what comes out of the policy negotiations and what the real impacts of the tariff policy will be.

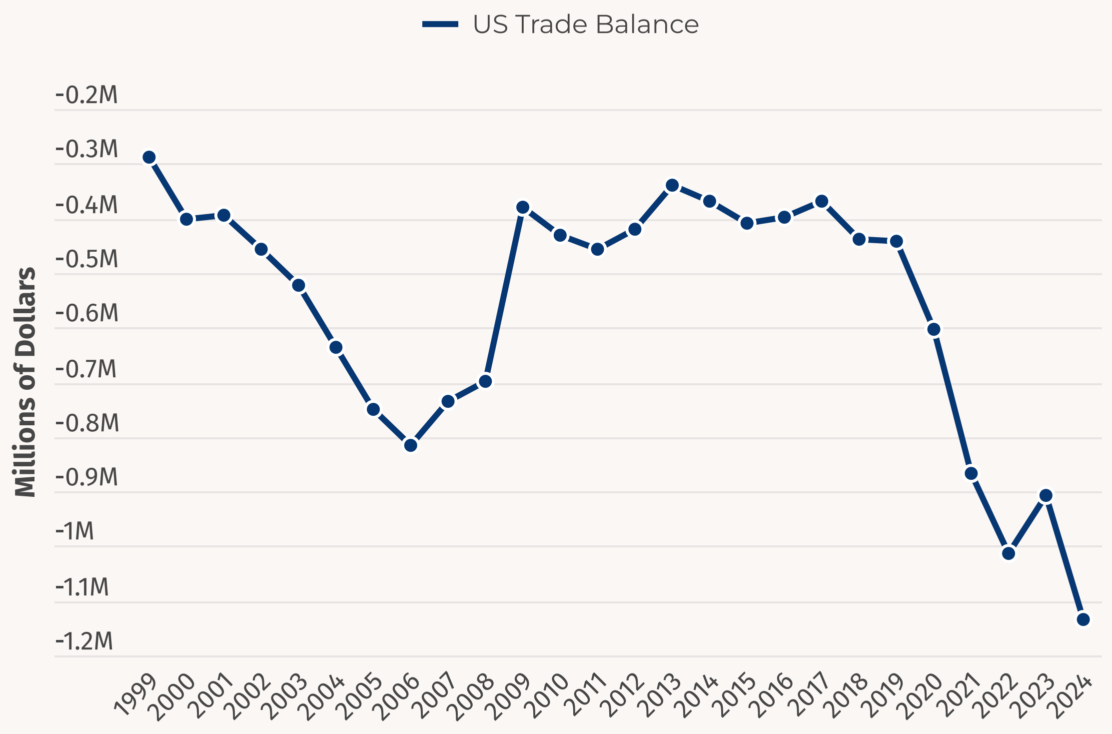
The New Tariff in Town

Joseph Newhard, Ph.D. • Associate Professor of Economics

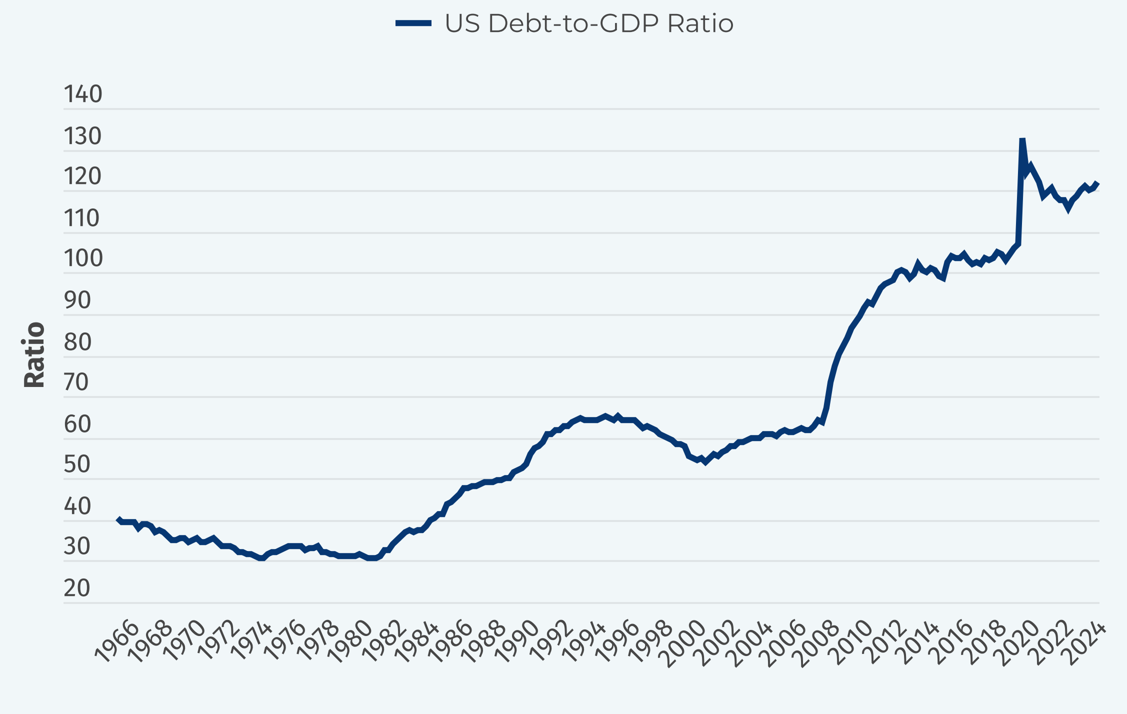
President Trump has levied what may be the largest tariffs package in US history, exceeding the Smoot-Hawley Act of 1930 that some economists blame for prolonging the Great Depression. Not only are the new tariff rates high but they will affect a large proportion of goods given that the value of imports tripled from 5% of GDP in 1970 to 15% today. Economists generally argue that countries maximize their prosperity by embracing free trade and in fact US real GDP per capita has increased by 65% since NAFTA was signed in 1994. However, millions of Americans say they haven't seen the prosperity that was promised by globalization. The number of Americans working in manufacturing fell from a peak of 19.5 million in 1979 to 12.7 million today despite population growth of 120 million. As a percentage of the workforce, manufacturing is a quarter of what it was after World War II due to both capital flight and automation. The United States lost 91,000 factories in the NAFTA era. Many of these jobs have been replaced by the "gig economy," food services, and retail jobs. When trade barriers are eliminated between two countries, capital flows to where wages are lowest while workers migrate to where wages are highest. Both processes depress wages in the higher income country until eventually the wages of both countries are equalized.



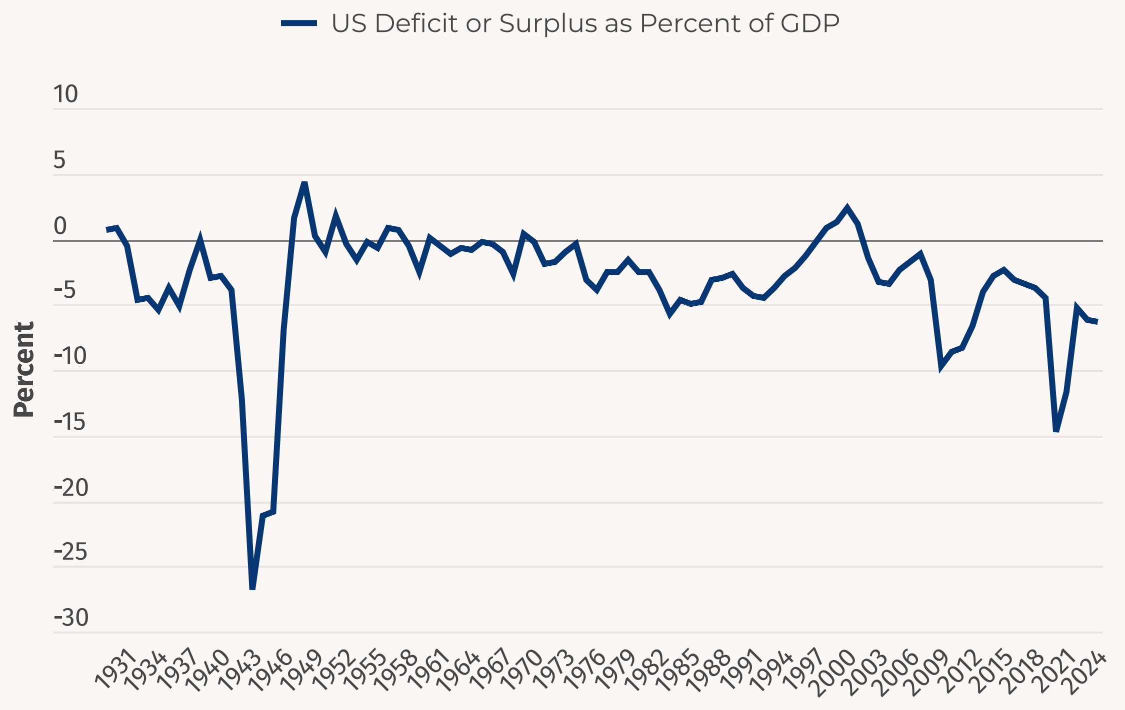
As a means of tackling the fiscal deficit, the tax revenue will be squandered if Congress increases spending or cuts taxes elsewhere by an equivalent amount. The federal government may also be overestimating tax revenue by not fully accounting for the decrease in the quantity demanded of imported goods due to tariffs. Another shortcoming of the tariffs is the lack of legislative durability. With Congress granting the president the power to impose tariffs, they are easy to create but also easy to terminate. If a tariff is the only reason it makes sense to relocate production to the United States, businesses must have confidence that it will remain in place in the long run before investing billions of dollars into domestic production. Some experts believe that the tariffs could be a bargaining tactic with the goal of eliminating tariffs on US exports. Implications to this effect from the White House undermine the tariffs as protectionism. President Trump calls the tariffs retaliatory, noting for example high Canadian tariffs on meat, dairy and grains, while also demanding other concessions. However, the longer the tariffs continue, the more difficult they will be to reverse. Revived or strengthened industrial groups will lobby for their preservation. History shows that trade liberalization is a long process.



Tariffs were the main source of federal revenue in the 19th century which saw immense economic growth. Today, the debt-to-GDP ratio is on an unsustainable trajectory, but tariff revenue could help prevent an inflationary debt crisis. President Trump argues that the tariffs will generate hundreds of billions of dollars in additional revenue and attract capital investment to grow the economy. There is also a national security argument for self-sufficiency in the production of steel, semiconductors, and pharmaceuticals. If tariffs succeed in reviving American industry, revenue could rise as the tax base grows. However, growth could take years or decades. Higher prices and reduced purchasing power will be immediate and jarring. Negative real economic data could pressure the government to abandon tariffs long before new investments are made. There is also evidence that tariffs on intermediate goods destroy jobs in industries that use them as inputs. Tariffs will drive up prices of goods that are made in the United States like trucks, even if the manufacturing of their components relocates here. Lastly, no amount of protectionism will bring Canadian potash mines or Costa Rican banana farms to the US; producers and consumers will simply have to pay higher prices for these goods.

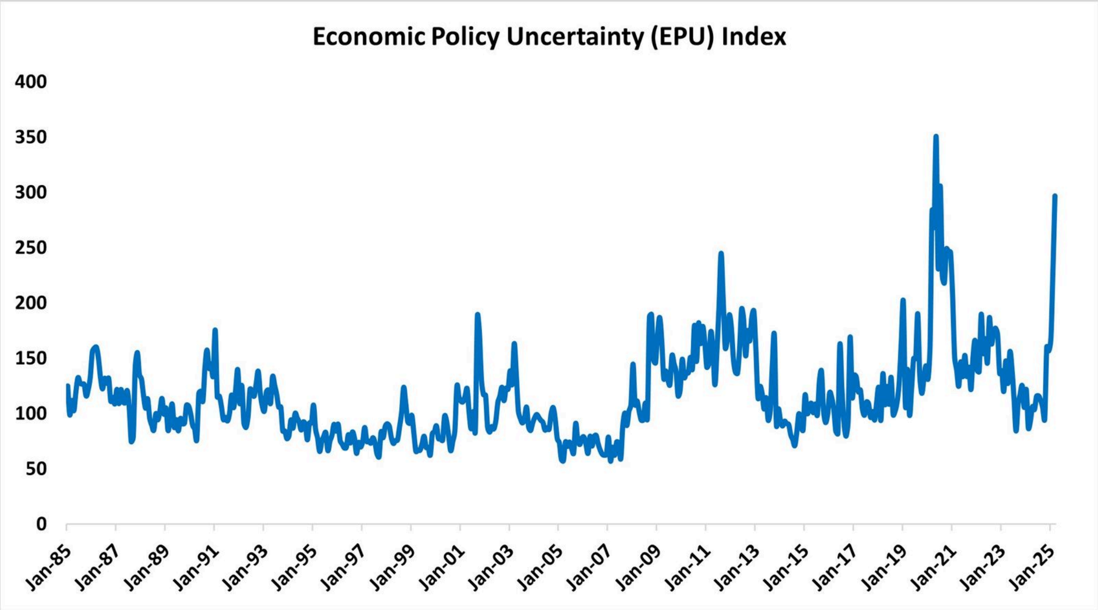


Despite the risks, there is a demand for change. The warnings that purchasing power may not rise fall flat for workers who have seen no improvement under free trade and free immigration and who now struggle to buy a home and raise a family. Today, a majority of households report living paycheck to paycheck, the fertility rate is below the replacement level, millions of young adults have dropped out of the labor force, and a greater percentage of them live with their parents than during the Great Depression. Yet after decades of integration with the North American and global economies, these taxes will be a bitter pill to swallow for an economy powered by consumption and debt. Trading partners will also suffer, and their job losses and retaliatory tariffs will reduce demand for US exports. Every policy creates winners and losers, and this campaign represents the pendulum swinging back from capital to labor. Only time will tell if it succeeds in growing the economy and raising real wages. Avoiding an inflationary debt spiral may depend on it.



Tariffs and the Macroeconomy

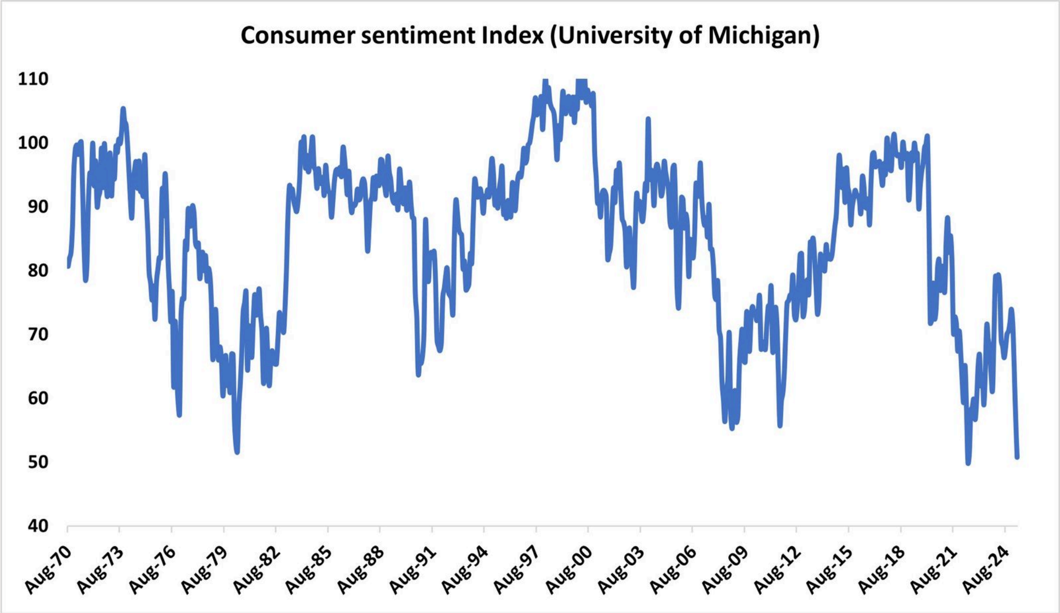
Dr. Aryaman Bhatnagar, Ph.D. Assistant Professor of Economics



Theme of the Day: Uncertainty

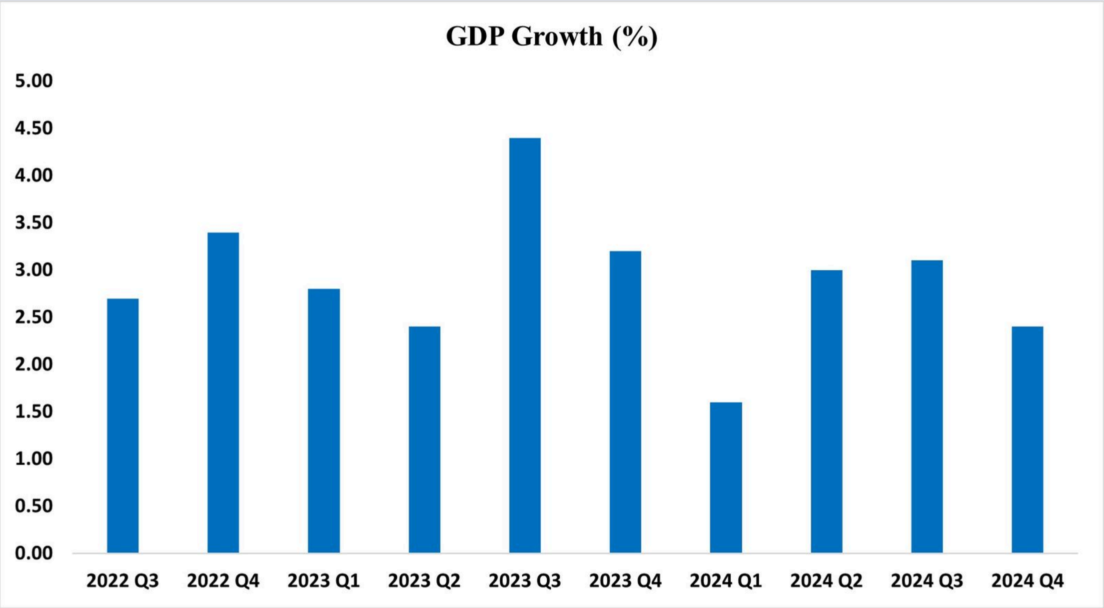
Over the last few weeks and months, tariff talks have dominated all the headlines. As of mid-April, the effective tariff rates in the United States have shot up to levels not seen since the second world war. What could be the possible ramifications of these tariffs for the macroeconomy?

Uncertainty remains the defining feature of the current economic climate. Will the administration go through with the announced tariffs? Will they be modified or maybe completely rolled back? Will other countries retaliate? Will the tariffs be accompanied by tax cuts? At the moment, nobody has an answer to any of these questions because economic (specifically trade) policy appears to be extremely unpredictable and incoherent. The Economic Policy Uncertainty (EPU) index has soared to three times the historical average. The only other time period where the index crossed this level was during the Covid crisis.



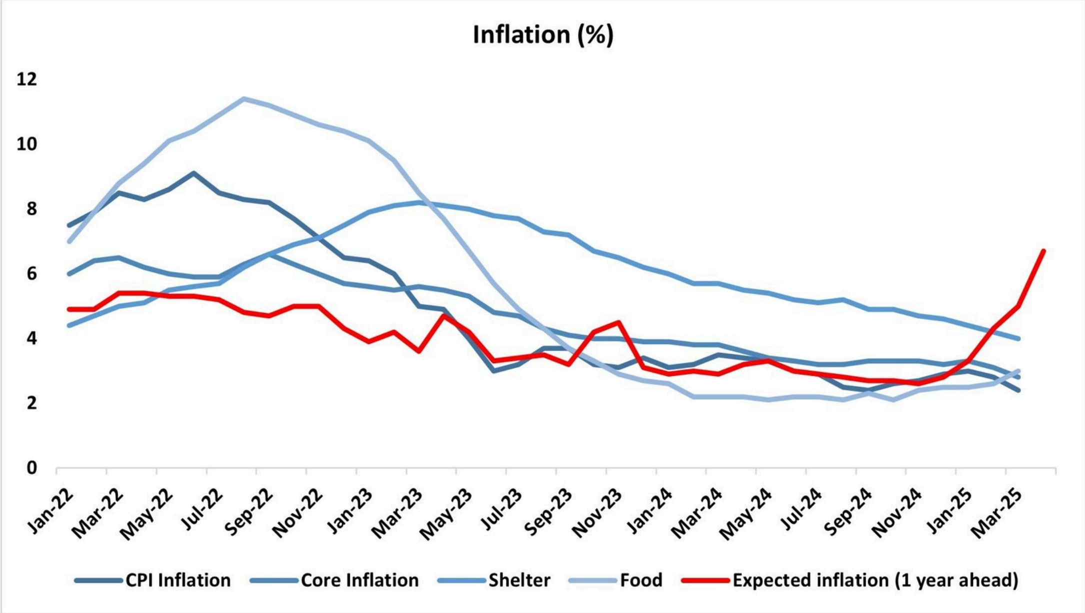
Low on Confidence

As one would expect, the widespread uncertainty has led to a drastic fall in consumer confidence. The consumer sentiment index has rapidly declined since the end of last year and plummeted to 50.8 in April 2025. This is now the second lowest value for the index since the series began in 1970. Other surveys such as the NY Fed survey of consumer expectations as well the Conference Board consumer confidence index also reflect a similar decline.



Growth Slow-Down?

High uncertainty and low confidence are usually accompanied by a growth slowdown. Most data points suggest that this may happen for at least the first half of 2025. Consumer spending has already moderated, recording -0.3% in January and +0.4% in February this year. While this is partly due to consumers being cautious regarding the upcoming tariff pressures, it may also be due to the fact that excess savings buildup during the pandemic has now been depleted. In addition to this, imports in the first quarter have risen substantially as importers try to get ahead of potential tariffs. Finally, the cuts in government spending are also expected to weigh down economic growth in 2025.



Inflation Expectations Shoot Up

After spiking to record heights in 2022, inflation has steadily come down towards the target over the last two years. As of March 2025, CPI inflation slowed down to 2.4%, the lowest since the pandemic. More importantly, core inflation, which excludes food and energy, also fell to 2.8% in March. This is the first time since March 2021 that core inflation has fallen below 3%.

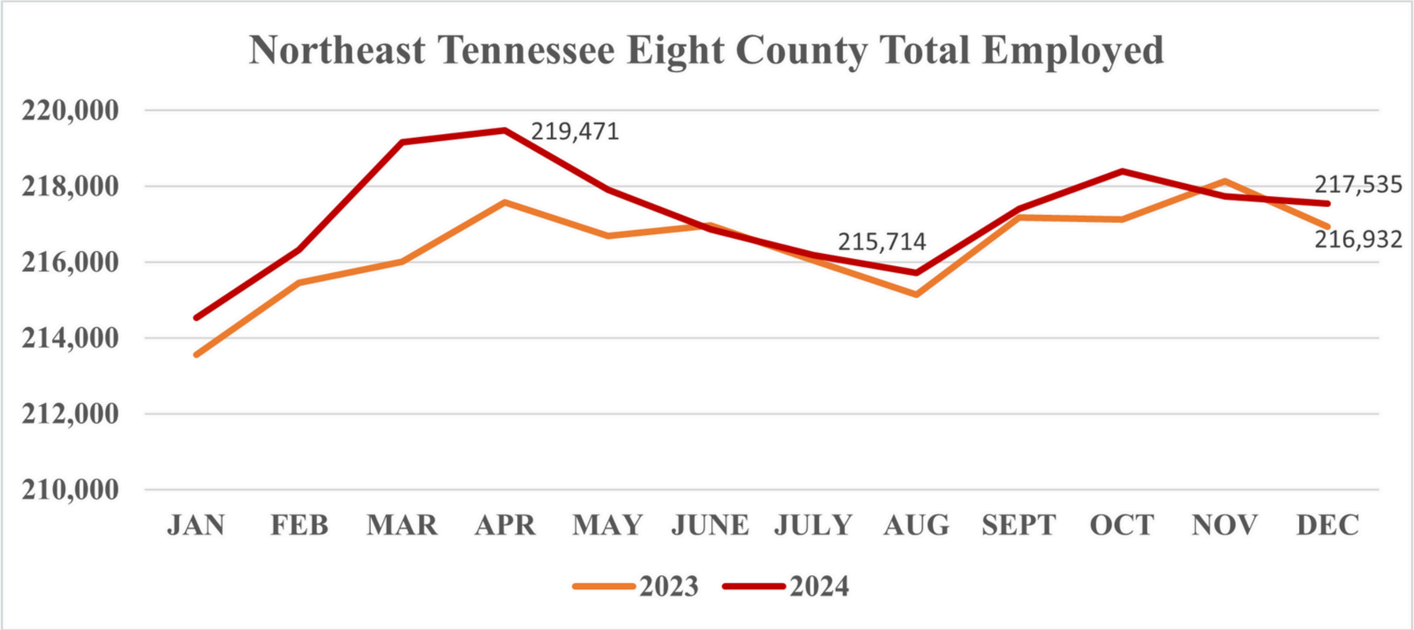
However, while inflation has continued its downward trend over the last few months, expected future inflation has shot up. The one-year ahead expected inflation, as measured by University of Michigan's consumer survey, has already spiked from 2.8% at the end of last year to 6.7% as of April 2025. This remains a major concern for the Fed as inflation expectations often turn out to be a self-fulfilling prophecy. Fortunately, long term expectations are still anchored around the 2% target and would be a key variable to watch out for over the coming months.

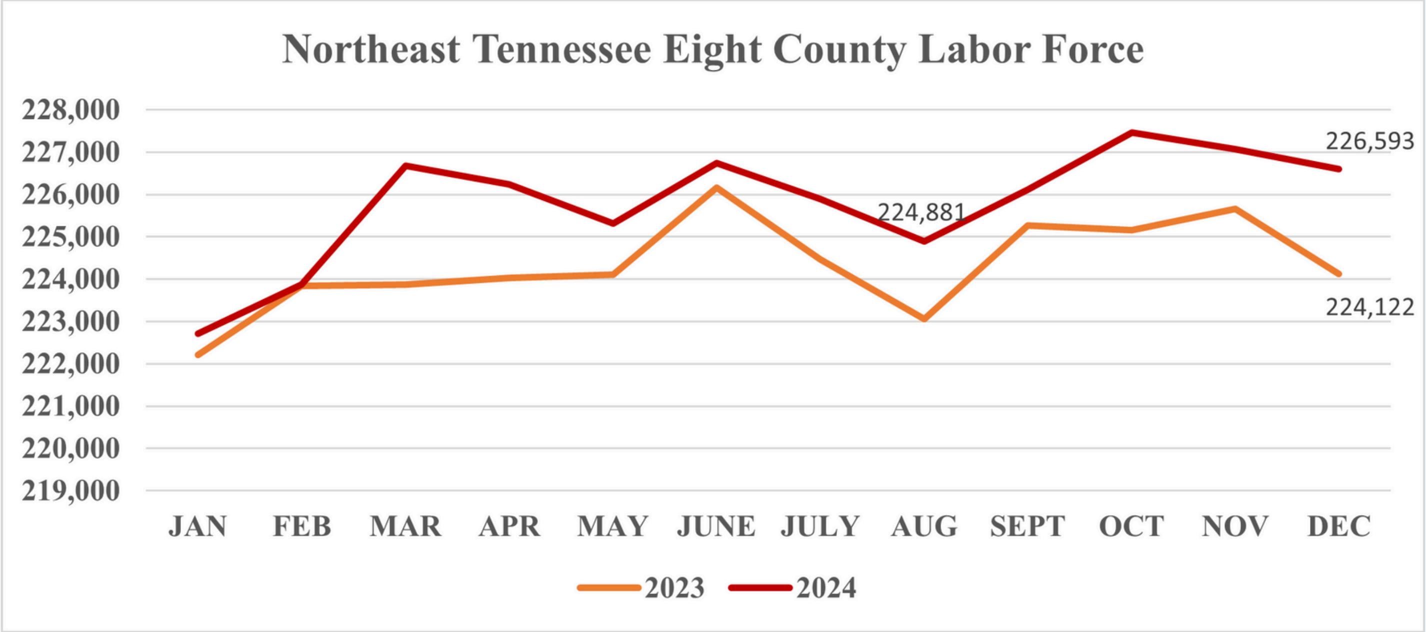
Summary

Overall, the US economic outlook would depend critically on future policy choices. This would include not just decisions regarding tariffs but also the future path of fiscal policy, immigration, and regulation. As mentioned by the Fed Chair, Jerome Powell, these are "fundamental policy changes" which could have wide-ranging long-term impacts for the US as well as the global economy.

Labor & Unemployment

Dr. Jon L. Smith, Ph.D. • Director, Bureau for Business & Economic Research

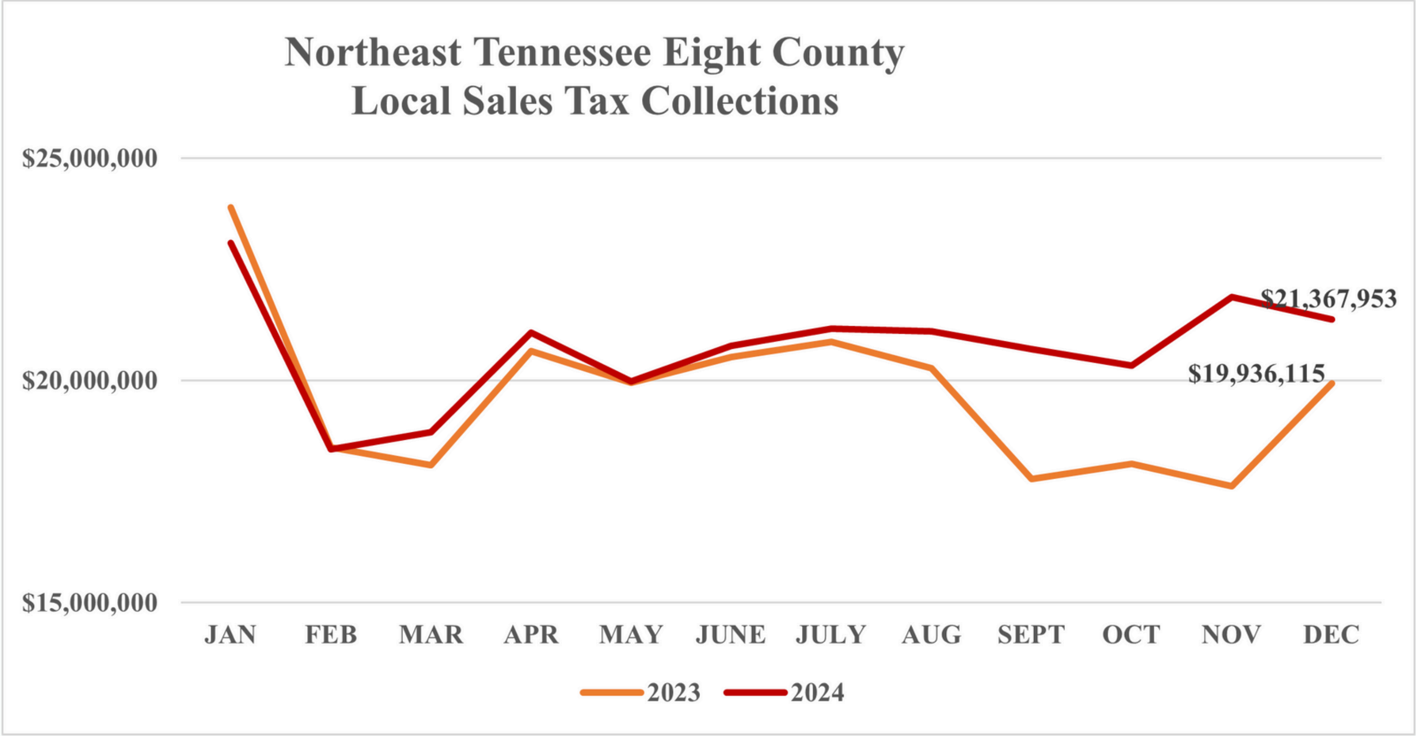




Employment & Labor Force

On April 18 of 2024, the Bureau of Labor Statistics issued significant revisions to the seasonally unadjusted county Local Area Unemployment Statistics for the years 2016 to 2024. These statistics show that the eight-county region's 2024 employment levels reached a low point in August of 2024 with employment levels falling from their peak of 219,471 in April to 215,714. However, by December of 2024 employment levels had rebounded to 217,535, a negligible increase of 0.8 percent. Preliminary results for January and February show further increases for early 2025.

The regional labor force showed movements similar to the eight-county employment levels, a low point in August of 2024 with the labor force levels falling to 224,881 rebounding to 226,593 in December of 2024. Eight county unemployment have edged up from 3.67% in January of 2024 to 4.0% in December.



Sales Tax

The eight county region's local sales tax collections have shown year-over-year increases over the last half of 2024. Based on the Tennessee Department of Revenue reported county collections, 2024 fiscal year's total nominal local sales tax collections for the eight county region ending in December were approximately 5.3% higher than collections in 2023, a strong showing.

Summary

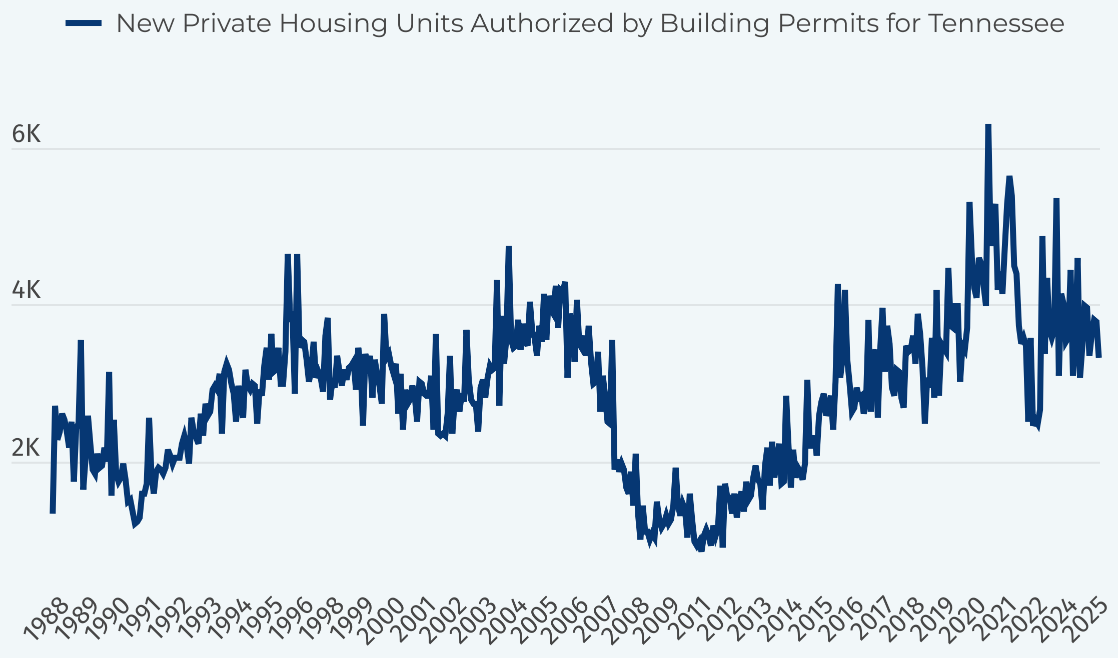
The last quarter of 2024 was a period of stability for the eight county region in terms of labor and employment data. Local sales tax revenue showed strong improvement, exceeding collections for the same period in 2023. Generally speaking, the region seems to have rebounded from the ravages of Hurricane Helene although there is still considerable work to be done in the impacted counties.

However, there is a note of caution in the business community with regard to possible significant policy changes at the federal level. While there is considerable uncertainty regarding changes in tariff levels, it should be noted that most models of the national economy indicate that the imposition of wide ranging tariff should result in price increases, often in unexpected products. For example, one expects that steel tariffs will result in increases in automobiles and construction costs. However, prices in steel forks, pots and pans and small appliances will be unexpected but inevitable. Until there are clear indications regarding the final policy decisions, a troublesome level of uncertainty will make it difficult to plan for the future.

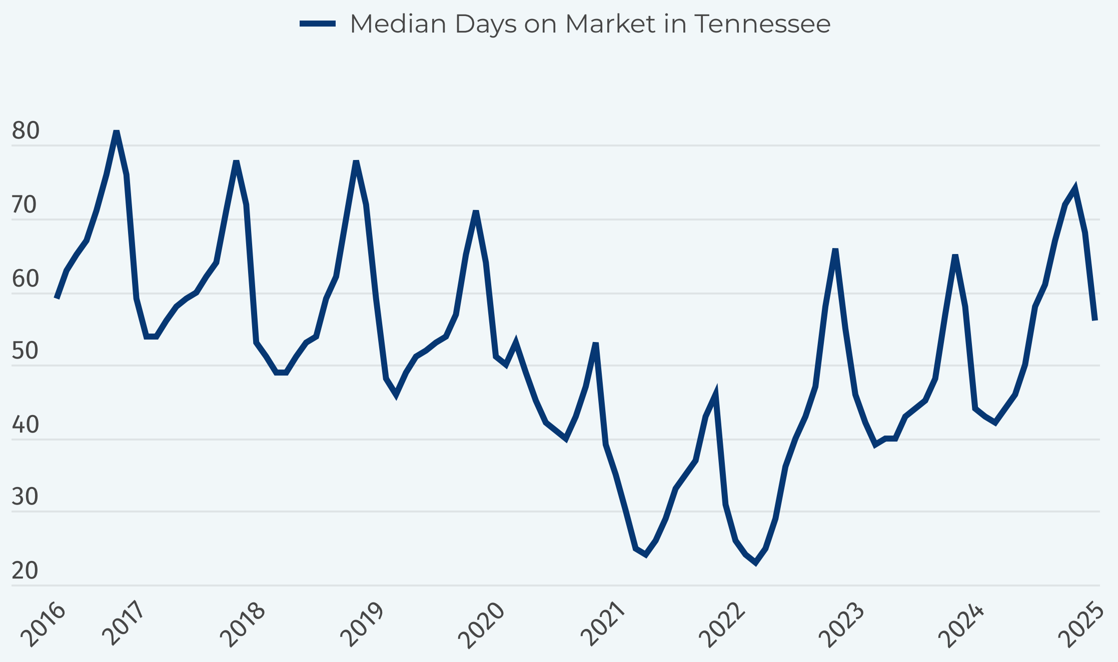
Housing Market

Joseph Newhard, Ph.D. • Associate Professor of Economics

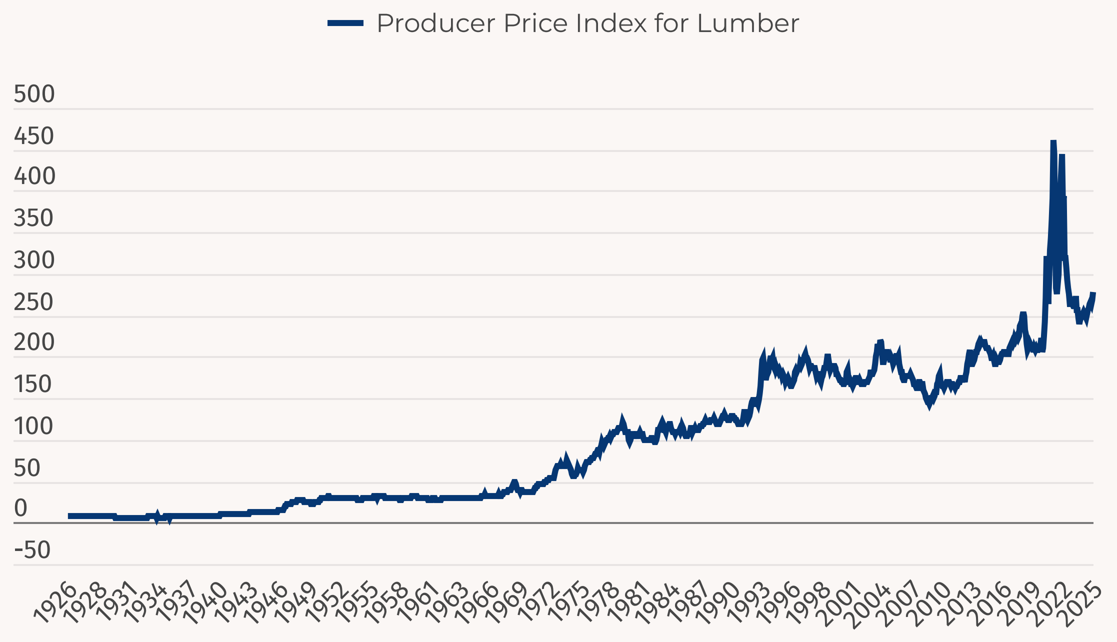
A combination of increased supply, especially of new construction, and depressed demand is increasing inventory as measured by both listing counts and months of inventory, and price growth is weak. Tennessee's active listing count is the highest for any March since 2017. A median of 56 days on the market takes us back to 2019. Median listing price for the state has been flat for three years. This reflects the extent to which Tennessee aggressively built homes in the past several years as the population grew by 217,000 from 2020 to 2023. Housing starts were at a robust 3,300 for the state in February, continuing to help Tennessee make up for the lack of home building that occurred following the Federal Reserve-orchestrated crash in home construction after 2007. As of February, The United States has an 8.9-months supply of new homes and a 3.5-months supply of existing homes. Overall, the South has returned to close to a balanced market while supply remains constrained in other regions. Homeowner equity is down only $900B from the peak to $34.7T, and only 2% of mortgages are underwater, accounting for 1.099 million homeowners.



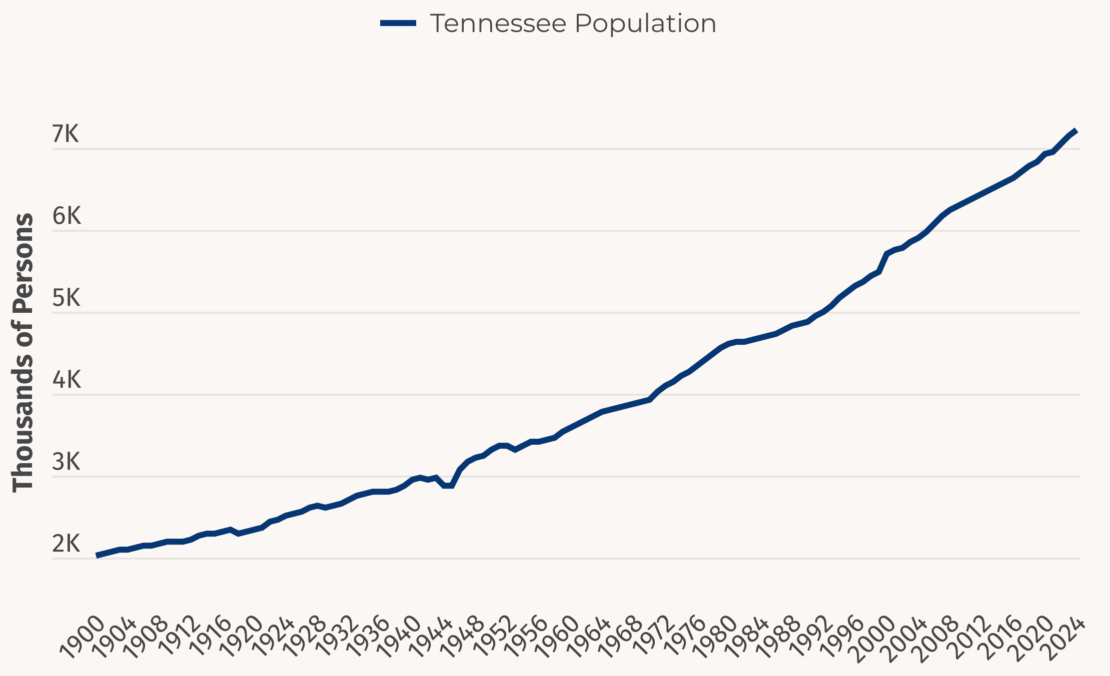
Northeast Tennessee continues to lag the state in terms of housing supply with a listing count for our combined MSA half of what it was eight years ago and down one-third from 2018, the last year that it was considered a balanced market. Listings bottomed out at 342 in February 2022 and are up 270% since then. Don Fenley of NETAR writes that active inventory in March was up 29% year-over-year, noting an average reduction of $30,687 from the original listing price for sold homes. Despite this, prices are up slightly, with the Johnson City MSA seeing a median listing price of $385,000 in March. The region saw a median price of $320,000. Despite increasing supply, we are still in a seller's market and most sellers are patient enough to wait a couple months for the best price. The lock-in effect is expected to sustain for a couple years, so supply will continue to rely heavily on new construction. The Johnson City MSA saw 83 housing units authorized by building permits in February, above the monthly average of 46 going back ten years. Note that the home prices being reported are highly misleading; around the country, builders are providing incentives on the backend to maintain high comps. This is a significant distortion in the data for a market where new construction is filling in the gap for frozen existing homes sales.



The new tariffs, if they remain in place, will increase home construction costs by an average of $9,200 per home according to the National Association of Home Builders (NAHB), leading to higher prices and less construction. However, just about all homebuilding materials already faced tariffs before 2025. The United States levies import duties on steel and aluminum products, lumber, cement, plywood, steel concrete rebar, iron and steel pipe, quartz, wood moulding and millwork products, prestressed concrete steel wire, steel nails, hand tools, wood flooring and ceramic tiles, washing machines and other appliances, shelving units, solar panels, steel sinks, wooden cabinets and vanities, and quartz countertops. In 2021, while overseeing an historic erosion in housing affordability, President Biden doubled the tariff on Canadian lumber from 9% to 18% over the protests of the NAHB. President Trump had done the same, raising the tariff to 20% in 2017 before lowering it to 9% in late 2020. However, he recently exempted Canadian lumber from the new tariffs, holding the rate steady at the current 14.5%. To aid new home construction and to reduce wildfire risk, President Trump also signed an executive order opening up 59% of national forest land to logging including large tracts of the Cherokee National Forest.



The Boyd Center at the University of Tennessee forecasts that the Tennessee population will grow a further 12.6% from 2022 to 2040, adding 890,000 residents, for a total of 7,940,000. Yet they forecast only 3.7% growth for the Johnson City MSA and 2.4% growth for the Kingsport MSA during this 18-year period, adding a combined 13,000 residents for all five Tennessee counties. They observe that the population growth of 23,840 from 2020 to 2023 for our combined MSA exceeds the net migration of 22,948 seen in the entire decade from 2010 to 2020. Our average annual net migration increased from 2,295 to 7,947. We accounted for 11% of Tennessee population growth in the past few years compared to 5.8% in the previous decade. However, the projections assume that growth peaked in 2022, and these forecasts assume a steady drop-off in the number of new residents year after year with growth turning negative for our MSAs in the 2030s. 70% of the state's population growth is projected to occur in the Greater Nashville development district. Unlike some other states, Tennessee has demonstrated a willingness to build new homes as demand rises.



Final Thoughts

Home prices have doubled in the past ten years. This is not unprecedented, and history tells us to generally expect continued price increases. In every year from 1975 to 1989, the median price of new single-family homes at least doubled from ten years prior. Appreciation peaked in 1980 when prices were 176% higher than in 1970. There was no correction; first-time buyers simply had to pay more for housing than their parents after years of stagflation. Median household income increased 140% in that ten-year period, but home prices still outpaced wage growth. This seems to be true for most asset classes including land, stocks, silver, and gold. The cause is always the same: devaluation of the dollar through chronic deficit spending and money printing, but this time wages in 2025 are up only 32% in ten years. Instead, the new money is concentrating in the hands of holders of wealth and investors are spending much of it on acquiring existing homes that working families would have bought. This has allowed prices to diverge from incomes. While imbalances between supply and demand can produce price volatility in the short run, under fiat currency the long-run trend for hard assets is real price growth. Housing is just one more example of the income and wealth transfers that are facilitated by the Federal Reserve through monetary inflation.

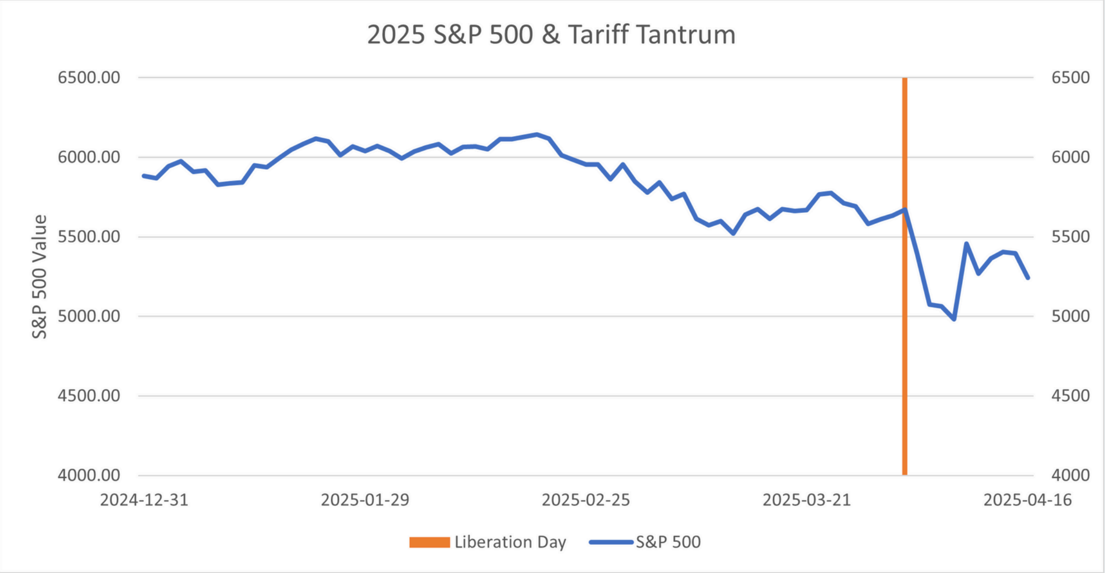
The Financial Market's Tariff Tantrum

William J. Trainor • John H. Poteat Chair of Banking, Professor of Finance, and Director of the Center for the Study of Finance

What is a tariff? It's a tax, tariffs are not implemented against other countries, they are implemented against other countries goods. Thus, a tariff against China is not a tax on China per se, but a tax on anyone who imports anything made in China, currently at 145%. Before any product can leave the port of entry, the tariff must be paid, not by China, but by the importer or even you if you bought something directly from China.

From a theoretical economic perspective, tariffs will shift production and misappropriate resources to produce goods in places that are less efficient in using resources to produce the most goods. Yes, this includes labor.

What is the exact mechanism that caused the financial markets to lose approximately $10 trillion in market value to deal with a $1 trillion trade deficit? First off, the term "deficit" has a negative connotation suggesting you are behind. However, if there is a trade "deficit" there must be a capital surplus. In essence, we are literally and figuratively trading paper (dollars), for goods. Currently, many countries citizens or businesses elect to invest in the U.S. rather than using the dollars they earn from selling to the U.S. to buy U.S. goods. This capital surplus supplies more wealth to the U.S. to invest in new products and technologies, think A.I. and other high-tech products.



The equity markets do not like increasing tariffs. Tariffs increase the cost of goods resulting in higher prices, reduced profit margins, and reduced sales. The market decline is because the discounted value of future earnings is now reduced. In the market's estimation, a $100 company is now only worth $90.

Uncertainty also plays a role. Not only are the expectations of future earnings lower, but because of the uncertainty surrounding the tariffs, the required return from investors increases. For example, if $10 of earnings is expected next year and you want to earn 10%, this is currently worth $9.09 (1/1.1). If you now require a 12% return due to the uncertainty of what those earnings will be, the expected $10 next year is now only worth $8.93 today, ($10/1.12). Now think of these values in trillions instead of the $10 I have used here. The "Tariff Tantrum" has resulted in a $10 trillion loss in market capitalization, i.e. stock values.

Above is a simplified explanation of why the financial markets have fallen dramatically. There is now the expectation of fewer products being sold at higher prices with lower profits from each item sold. The uncertainty about the magnitude of these future earnings adds to the decline due to the increase in the required return on stocks. The reality is more complicated, but in a nutshell, this is why your 401k is not what it once was.

Most of this may go away and tariffs may end up being lower in the end, but the uncertainty may linger. The value of the market was already quite lofty by most metrics. The tariffs ended the idea that all would be economically calm and predictable going forward.

Dr. Trainor discusses tariffs with WJHL