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In today's note, we discuss possible next steps for the Trump administration tariff proposal. We think the White House has three options – stay the course, negotiate, and pause (a variation on the negotiation option). We explain why we believe the negotiation option makes the most sense but also may deliver limited meaningful changes. Congress also has options but lacks the political will to enact them. The courts could also provide options for companies impacted by the tariffs.

- **Next Steps on Tariffs** – Market and political pressure continues to mount on President Trump to change the tariff policy which would set a 10% global tariff and impose higher tariffs on countries that have high trade surpluses with the U.S. We are skeptical that political pressure will force his hand since Congress lacks the political will to block his emergency declaration or change the trade laws. Market pressure might have more success, as there could still be a "Trump put." Investors may have mispriced the put, but we think it is still there.
  - **As Mr. Trump weighs his options, we think he has three choices:**
    1. **Stay the course** – Mr. Trump believes in his gut that tariffs will work and remake the American economy. He views this as his legacy, which might be more important to him than a few thousand points on the indices.
    2. **Negotiate** – This is the art of the deal. He would leave the 10% baseline tariffs in place but negotiate with countries and trading blocks to lower the higher tariffs. This seems like a likely outcome, but it could have limited economic impacts. Trade deals with small economies like Vietnam and Cambodia might be relatively easy to achieve, but they won't move the needle economically. New arrangements with large and impactful economies like China and Europe will take time. They have their own domestic political considerations which could complicate negotiations and limit potential outcomes. Also, this path could be rocky for the markets since it is likely to include threats of retaliation, especially with the largest trading partners.
    3. **Pause** – This is a variation of option 2 (negotiate), under which the administration would delay the implementation of the new tariffs while negotiations take place with trading partners. It faces the same challenges as the "negotiate" option and might achieve only limited changes. Also, adopting this approach might make it look like Mr. Trump capitulated, which is something he will try to avoid at all costs.
  - **Congressional options** – Currently, Congress lacks the political will to block the Trump administration's global tariff plan, despite press reports congressional Republicans are panicked over the potential economic damage that the tariffs might cause and concerns being expressed by constituents. Congress has two options, but both would face a presidential veto. It is highly unlikely Congress could muster the two-thirds majority vote needed to

override a veto. Even if every Democrat voted to override a veto (a precarious assumption since we think some progressive Democrats support the tariffs), over 70 House Republicans and 13 Senate Republicans would need to defy the White House and incur the wrath of the Trump base. We doubt that many Republicans would take that chance – at least for now. If Congress considers taking action to block the new tariffs, it has two basic options:

    1. Block Mr. Trump's emergency declaration under the International Emergency Economic Powers Act (IEEPA)
    2. Amend the trade laws and claw back the authority granted to it under the Constitution to "regulate commerce with foreign nations" and to "lay and collect Taxes, Duties, Imposts and Excises …"

  - **The Courts** – There are reasonable arguments to be made that Mr. Trump overstepped his authority under IEEPA. Also, The Supreme Court has taken a more limited view of Congress's authority to delegate its constitutional powers to the Executive Branch. Congress has delegated significant authority to the President, allowing him to set tariffs. Although IEEPA does not specifically mention tariffs, some will make the argument that Congress gave up too much of its power and in doing so, it violated the Constitution. These arguments might have merit, but we think it could take the courts some time to adjudicate any litigation on the matter.
  - **USTR on the Hill this Week** – Markets could get some additional clarity on the Trump administration's policy and strategy this week, as U.S. Trade Representative Jamieson Greer will testify before the Senate Finance Committee on Tuesday and before the House Ways and Means Committee on Wednesday.

- **Reconciliation Hiccup Could Weigh on the Markets** – The House might vote this week on the latest version of a budget resolution. Equity markets might react negatively if the House decides to either delay the vote until after Easter or, worse, vote down the budget blueprint. Over the weekend, the Senate passed its budget resolution, which differs from the House-passed resolution. As a reminder, a budget resolution is a prerequisite for any reconciliation bill (the legislative process being used to extend the Tax Cuts and Jobs Act of 2017 (TCJA or Trump tax cuts)).
  - Budget hawks in the House oppose what they see as gimmicks in the Senate's budget resolution, which would open the door to fewer spending cuts than what this faction wants. When the House passed its budget resolution in March, the budget hawks voted for the plan even though they wanted more than the $2 trillion in cuts ($1.5 trillion in mandatory spending cuts) called for in that plan. Although House Speaker Mike Johnson (R-Louisianna) successfully kept most of the budget hawks on board with the House budget plan, this might be a bridge too far for some of them. Most Republicans want to avoid being seen as an impediment to President Trump's agenda, so they might vote for the budget resolution in order to "keep the process moving forward." The angst over the lack of deficit reduction in the Senate budget resolution, however, might cause some budget hawks to split with the leadership this time.
  - Investors have been expecting quick action to extend the Trump tax cuts. We have thought Speaker Johnson's goal of passing a reconciliation bill by Memorial Day was ambitious and may have fueled overly optimistic assumptions by investors. A delay in the vote to pass a budget resolution could provide a check on the market's expectations.

- If Congress ultimately passes a bill that includes fewer spending cuts than what the budget hawks want, that could lead to demands for other actions to reduce the deficit, which could come from increased revenues. Investors have focused on the potential elimination or reduction of Inflation Reduction Act tax credits, but other options could be on the table including:
    1. Allowing the top individual income tax bracket to reset from 37% to 39.6%
    2. Creating a new tax bracket for individuals earning more than $1 million per year
    3. Increasing the corporate income tax rate to 22% - 25%
    4. Creating a cap on the corporate State and Local Tax (SALT) deduction similar to the individual SALT cap (which we expect will be raised).
- We do not view these tax hikes as a base case, but the odds of them being enacted certainly would increase if Congress opts for fewer spending cuts. Developments this week could suggest to investors that they have been underestimating such an outcome.

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