Tariff uncertainty to persist with recent court ruling

From MacKay Shields™

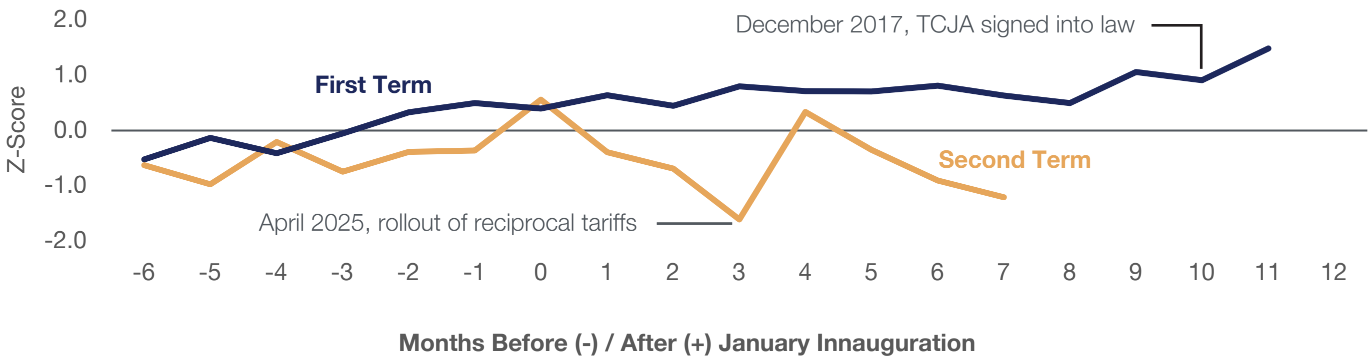
- **A federal Appeals Court decision has cast doubt on the legality of tariffs related to fentanyl trafficking as well as broad-based "reciprocal" tariffs.**
- **The decision suggests continued uncertainty regarding trade policy, in terms of the ultimate scope and level of tariffs. This uncertainty stems from questions over when and how the Supreme Court will ultimately rule in the case, and what other tariff authorities the administration might use if necessary.**
- **The court ruling also has implications for deficits and Treasury supply, as tariff revenue can provide an important offset to recent fiscal policy decisions. In our view, renewed uncertainty over tariff revenue – including potential refunds for duties already paid - has contributed to upward pressure on 30-year bond yields.**

On Friday August 29, a federal Court of Appeals upheld by a 7-4 vote a prior decision by the U.S. Court of International Trade that certain recent tariffs are not authorized by the International Emergency Economic Powers Act (IEEPA). The court decision covers tariffs on Canada, Mexico and China related to fentanyl trafficking and the "reciprocal tariffs" that were announced in April and only recently came into effect. The court's decision does not affect sectoral tariffs related to steel, aluminum, copper, autos and auto parts under Section 232 of the Trade Expansion Act of 1962.

The Court of Appeals has allowed the IEEPA tariffs to remain in effect until October 14. Assuming the administration appeals the decision, the Supreme Court could review the petition at the start of its annual term and issue an expedited decision next month. It is also possible that the Supreme Court stays the recent decision beyond October 14, allowing tariffs to remain in effect while it considers a ruling by the end of its term next summer.

How the Supreme Court will ultimately rule is very much in doubt. The majority decision by the Court of Appeals holds that IEEPA lacks explicit language granting the president tariff authority, in contrast to other statutes that clearly delegate tariff authority from Congress to the executive branch. Still, the Supreme Court has taken an expansive view of presidential power in recent years and may agree with the dissenting Court of Appeals judges who argued that IEEPA's language empowering the president to "regulate…importation" encompasses tariffs as a regulatory tool.

Figure 1. Manufacturing firms' capital investment plans during initial months of trump administrations
Median across surveys



Source: Manufacturing firm surveys from the Federal Reserve Banks of Dallas, Kansas City, New York, Philadelphia, Richmond. TCJA: Tax Cuts and Jobs Act. Through August 2025.

In our view, the recent tariff ruling raises several issues. First, until the Supreme Court weighs in, the current state of play reduces the administration's bargaining leverage in trade deals, potentially even where deals have been completed. For example, while the U.S. and European Union have reached an agreement on a wide-ranging trade deal, that deal must still go through a legislative approval process in Europe. While that process has been fast-tracked, it may now be delayed until there is legal clarity on the IEEPA tariffs. If the Supreme Court ultimately agrees with lower court rulings, the EU may seek to change the terms of the deal, especially as the deal has proven quite unpopular across the EU. Other countries may also seek to renegotiate deals.

Second, the dampening effect of tariffs on business and household sentiment as captured in a range of surveys is unlikely to dissipate, and overall tariff-related uncertainty may actually linger for longer. This is because a sustained reduction in tariff rates is unlikely to result from the Court of Appeals' decision. Even if the Supreme Court were to agree with the recent ruling, tariffs will remain an important economic tool of the administration. As stated by the President and other administration officials, tariffs can be used to wring concessions from trade partners, they generate significant near-term revenue, and they are a key component of the agenda to revitalize manufacturing and re-shore jobs. Importantly, the administration can rely on a number of other authorities to implement tariffs on a country-or sector-specific basis:

- Section 338 of the Tariff Act of 1930 allows the president to implement tariffs of up to 50 percent on all goods from a country on the grounds of discrimination against U.S. commerce. While a 30-day waiting period is required, Section 338 tariffs can otherwise be launched at the president's discretion.[1]
- Section 122 of the Trade Act of 1974 allows for fifteen percent tariffs for up to 150 days at full presidential discretion.
- Section 301 of the Trade Act of 1974, under which the U.S. Trade Representative can implement tariffs against other countries following investigations into discriminatory tariffs.[2]
- Product-specific tariffs aimed at safeguarding a sector that is seeing a surge in foreign competition or protecting against a national security threat.[3]

While these fallback authorities are available, some require investigations and public comment periods that take months, suggesting a potential pause in tariff implementation if IEEPA tariffs are struck down. As such, uncertainty over tariff policy, including their effects on supply chains and prices, may extend well into next year. This uncertainty may continue to weigh on business hiring and investment decisions. As seen in the chart above, manufacturing firms have generally reported weak investment intentions this year. This stands in contrast to solid capital investment intentions during President Trump's first term, when tariffs followed a well-defined legal process and were more constrained in scope and level.

Related to uncertainty, the Court of Appeals decision raises questions for firms' inventory management strategies. Many firms may decide to hold off on imports for the time being, presuming that the Supreme Court will make a final decision on the legality of IEEPA tariffs before long. In this event, goods imports in categories impacted by IEEPA may decline in the near term, as firms instead rely heavily on existing inventories.

Another key issue is fiscal. Should the Supreme Court ultimately rule against IEEPA tariffs, importers could seek refunds on duties already paid. Estimates suggest this could already total $100 billion or more. The current state of play also increases uncertainty around future tariff revenue that is seen as an important offset to the deficit impact of recent fiscal policy measures.

Figure 2. Treasury 2S/30S yield curve slope

Source: Bloomberg, through September 2.

Investors appear concerned both about fiscal implications of the recent court decision and the broader uncertainty over trade policy. Financial markets reacted immediately to the appeals court decision once markets opened after the Labor Day holiday. Equities declined and the VIX rose, while 30-year Treasury yields briefly touched five percent, with the 2s/30s curve steepening to its widest since 2021. The global backdrop to curve steepening should also be noted; across many developed markets, including Japan, the United Kingdom and France, renewed investor focus on long-term debt sustainability has put upward pressure on long-dated government bond yields in recent weeks.

1. Some trade law scholars view Section 338 as obsolete and superseded by more recent legislation such as the Trade Act of 1974.

2. The U.S. Trade Representative's 2018 finding of discriminatory Chinese trade practices would allow for rapid implementation of tariffs to replace the "fentanyl" and "reciprocal" tariffs against China.

3. Current steel, aluminum and copper duties have their roots in national security tariffs implemented during Trump's first term in office.

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