Insight INVESTMENT

GLOBAL MACRO RESEARCH
TRADE WARS 2025

JUNE 2025

BNY | INVESTMENTS

EXECUTIVE SUMMARY

- The new US trade regime is reshaping global economic and market outlooks. Tariffs are being used as leverage in negotiations, to address trade deficits and to encourage domestic manufacturing. Additionally, tariffs are now viewed as a means to generate fiscal revenue and to counter China's economic ascent.
- After taking office, the new US administration initially focused on Canada, Mexico, and China. It began with a 10% tariff on Chinese goods, which shortly increased to 20%, and declaring a national emergency to impose 25% levies on Mexico and Canada despite the USMCA agreement. On 2 April, the administration announced a base tariff of 10% on most imported goods and "reciprocal tariffs" on 57 countries, aiming to rebalance trade deficits. Auto tariffs of 25% were also implemented immediately.
- Amid market turmoil and economic forecast downgrades after the announcement, the US paused the rollout of reciprocal tariffs for 90 days, with China being a notable exception. On 12 May, the US and China then agreed to reduce tariffs temporarily, providing some relief. However, many tariffs remain in force, with more expected on products like pharmaceuticals and semiconductors.
- There remains significant uncertainty about what happens after the initial pause comes to an end, and also whether sectoral tariffs will be introduced on items like copper, lumber, pharmaceuticals, and semiconductors. It even appears that tariffs could be introduced on specific companies to force domestic production.
- Smaller, open economies like Vietnam face potentially huge economic headwinds without tariff relief. Sectoral tariffs, such as those on autos, semiconductors, and pharmaceuticals, further exacerbate the impact, especially for countries in Southeast Asia.
- Tariffs are likely to be a significant headwind for growth, for both the US and its trading partners. This is driven by the direct trade impact and via confidence. Even if reciprocal tariffs remain paused and the confidence impact dissipates, there is likely to be a long-term impairment of growth.
- It is not clear that risk assets are pricing in this scenario, and the policy response so far appears insufficient. To see a significant change to the economic impact, we need one of the following:
  - significant Fed cuts, which are unlikely before unemployment rises given the current inflation outlook;
  - a significant change of policy on tariffs, which seems very unlikely before we see real economic pain; or
  - an offsetting fiscal impulse, such as tax cuts, subsidies, or other support for affected industries, which seems the most likely scenario.

  In the meantime, we see downside risks to risk assets as the economic impact feeds through over the summer.
- With growth slowing, we expect wider deficits, with steeper yield curves, particularly in the US. The Fed will likely be slow to react due to inflation risks until unemployment picks up, but should then accelerate the easing cycle, causing US rates to underperform initially but potentially catch up later.
- Risks of capital reallocation away from the US may leave to the US dollar struggling to maintain its lofty valuation, potentially entering a long-term bear market, although in the short term, a cautious Fed and higher yields relative to the rest of the world are likely to provide some support.

TARIFFS: WHAT ARE THEY GOOD FOR?

President Trump has historically favoured protectionist economic policies for several reasons, though this new tariff regime is on a far greater scale than the tariffs introduced during his first term. Given the rapidly changing policy environment, it is useful to consider why specific tariffs are being used to assess whether they are likely to be permanent or temporary.

EMPOWERING NEGOTIATIONS

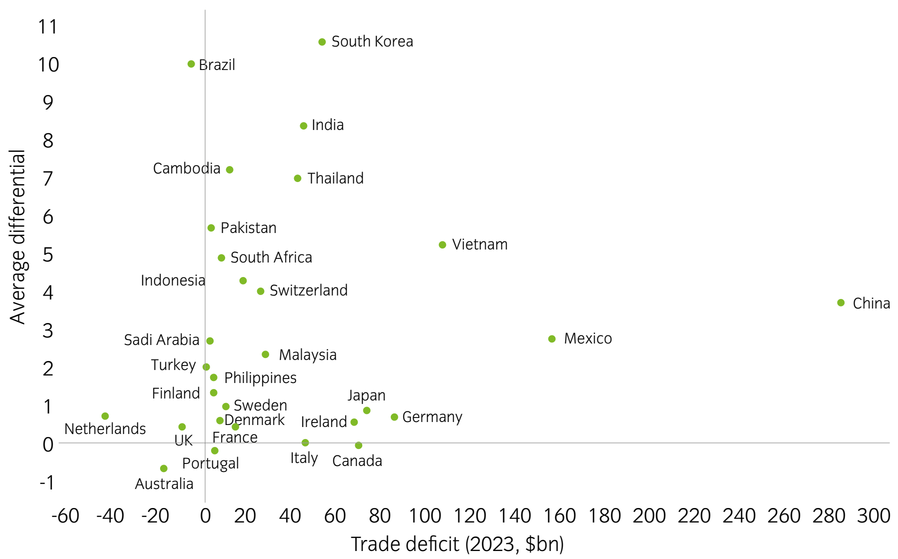
In some cases, the use of tariffs is merely intended to be a negotiating tactic to achieve other goals, such as border security. So far, the governments in targeted countries have mostly conceded to President Trump's demands. The key for foreign leaders is to determine what the US actually wants and to decide whether their country can afford to comply, or if trade retaliation makes more sense.

REBALANCING AND RESHORING TRADE

A core policy for the new administration is the focus on the US rebuilding its manufacturing capacity for national security reasons, and this ideology now extends beyond just President Trump. The war in Ukraine has made this view even more prevalent given the timescales needed for the US to restock military equipment. There is also political support from a large part of the population to rebuild the US manufacturing base, and that is only plausible behind a barrier of tariffs.

Tariffs targeting individual countries or specific sectors with a goal of rebalancing trade appear open to negotiation, with the US seeking to level the playing field. Key to this is a reduction of tariffs and non-tariff barriers in the targeted country, along with agreements to buy more US goods to close any trade gap. China, Mexico, Vietnam, and the EU are the countries/blocs with which the US has the largest trade deficits, but countries such as South Korea, India, and Thailand are also firmly in focus given their higher average tariff rates (see Figure 1).

Figure 1: Bilateral trade deficit and average most-favoured nation tariff differential 2024[1]



[1] Source: Insight and Bloomberg. Data as at 30 April 2025. The "Most Favored Nation" (MFN) tariff principle ensures that all World Trade Organization (WTO) members receive the same tariff treatment on imports from a given country, unless a preferential trade agreement exists.

An alternative method of combatting trade imbalances involves targeting specific sectors and products, rather than geographical regions. This strategy was employed during President Trump's first term and has continued in 2025 with tariff announcements on the auto industry, steel and aluminium. The president has also spoken about potentially targeting copper, semiconductors and pharmaceuticals.

RAISING REVENUE

President Trump has previously stated that tariffs at around 10% are useful for raising revenue rather than changing trade balances, so it is reasonable to assume that the baseline tariff of 10% announced in April aims to serve this purpose. This 10% base tariff level now appears unnegotiable. Theoretically, tariff revenue could supplement fiscal income to allow tax cuts in other areas, such as the "One Big Beautiful" tax bill which is expected to decrease federal tax revenue by around $4.5trn between 2025 and 2034.

THWARTING CHINA

There is broad bipartisan support in the US to block the rise of China. This consensus underlies the strategy of significantly impacting China through tariffs. Although tariffs were framed as a response to the fentanyl crisis, the core purpose is clearly to counter China's economic ascent. This strategy extends to encouraging third-world economies to divert their trading routes away from China in exchange for preferential treatment with the US, reflecting a potential negotiating tactic. Mexico and Vietnam have been singled out as countries best suited for this shift. The US-China relationship presents a complex array of foreign policy challenges. Among the critical issues are economic tensions and the theft of intellectual property, Chinese military aggression in the Indo-Pacific region, the security of Taiwan, China's relationship with Russia and its efforts to spread its influence globally.

TARIFFS: THE OPENING BARRAGE AND SUBSEQUENT DE-ESCALATION

THE POST INAUGURATION SCUFFLE

After taking office, the Trump administration initially focussed on Canada, Mexico and China. On 1 February, a 10% tariff was placed on Chinese goods, effective from 4 February, and this was then raised to 20% on 4 March. In addition, a national emergency was declared, granting the president emergency powers which enabled the implementation of 25% levies on both Mexico and Canada, despite the US-Mexico-Canada agreement (USMCA). This was justified on the basis that an influx of migrants and drug trafficking (notably fentanyl) represented a national security and public health crisis.

These initial tariffs were designed to force both Canada and Mexico to better control their borders with the US. The Mexican government deployed troops on the border and cracked down on fentanyl trafficking, with a series of arrests, drug seizures and lab raids. In Canada, border enforcement was increased and the government appointed a 'fentanyl czar' to work with US authorities to accelerate the dismantling of fentanyl production and trafficking rings. This saw the US adjust its position on 2 April, when it was confirmed that USMCA-compliant imports could continue to enter the US duty free.

LIBERATION DAY

On 2 April, 'Liberation Day', the US administration shifted its focus to the rest of the world, with a broad range of trade measures enacted via executive order[2]:

- A permanent base tariff of 10% on most imported goods, effective from 5 April, aimed at rebalancing trade, reshoring production, and raising revenue.
- 'Reciprocal tariffs' on 57 countries, effective from 9 April. These tariffs were not reciprocal in the sense of matching other countries' tariffs or trade barriers. Instead, they were calibrated to be half the US bilateral trade deficit divided by US imports from that country. The EU faced a 20% tariff, China an additional 34% (bringing total tariffs on China to 54%, close to a campaign promise of 60%), Japan 24%, Vietnam 46%, and so on. The primary goal of these tariffs is to rebalance trade deficits, but they are open to negotiation for those countries willing to agree to measures that reduce their bilateral trade deficit with the US.
- Auto tariffs of 25%, effective immediately. These tariffs are probably permanent as they aim to reshore auto production, but exemptions appear to be negotiable.

MAXIMISING STRATEGIC PRESSURE ON CHINA

On 10 April, China placed retaliatory tariffs on US goods and filed a complaint with the World Trade Organization. In response, the US increased its reciprocal tariffs.

In this escalation phase, it was clear that the new tariff regime was meticulously crafted to exert maximum pressure on China. The direct tariffs imposed were so high that they rendered trade nearly impossible for Chinese firms. Moreover, it strategically targeted efforts by Chinese companies to reroute exports away from China. For instance, Vietnam and Cambodia had been extensively utilised by Chinese firms to reroute shipments since 2018. Additionally, poor African countries that previously benefited from tariff-free exports of clothing and textiles to the US under the African Growth and Opportunity Act (AGOA) faced significant tariffs. Lesotho faced a 50% tariff, while Madagascar faced a 47% tariff. Chinese companies had heavily invested in the textile and apparel industries in countries like Lesotho and Ethiopia to take advantage of this agreement.

STEPPING BACK FROM THE BRINK: A TEMPORARY DE-ESCALATION

In the face of market turmoil and downgrades to economic forecasts, as well as US corporate executives expressing alarm at the consequences, the US administration started to back away from maximalist economic conflict with the rest of the world all at once. On 9 April the US announced that it would pause the roll out of reciprocal tariffs for 90 days, delaying the implementation date to 8 July 2025, with China the notable exception. However, even for China, some electronic and technology-related products were excluded from the reciprocal tariffs, including semiconductors and digital storage devices.

On 12 May, the US and China issued a joint statement following a meeting in Switzerland. The US reduced its reciprocal tariffs on Chinese goods to 10% from 145% for 90 days, this was combined with a 20% 'fentanyl levy' to give a tariff rate of 30%. China reduced its tariffs on US goods to 10% for the same period.

[2] https://www.whitehouse.gov/presidential-actions/2025/04/regulating-imports-with-a-reciprocal-tariff-to-rectify-trade-practices-that-contribute-to-large-and-persistent-annual-united-states-goods-trade-deficits/

BEYOND THE FRONT LINE: NON-TARIFF BARRIERS

In addition to the headline tariffs, both the US and China have introduced a range of non-tariff barriers to make trade more difficult.

US: non-tariff barriers on China

- Closing the tariff exemption for small packages: There has been bipartisan agreement in the US that the de minimis exemption, which allowed packages worth less than $800 to enter the US tariff free, was overly generous and outdated. With effect from 1 May, de minimis parcels from China and Hong Kong have been subject to either a 120% ad valorem duty or a flat rate per item of $100 (rising to $200 from 1st June). This change will directly challenge the business models of companies reliant on Chinese manufacturing and shipping to the US, including direct-to-consumer Chinese brands, marketplace platforms, and many small firms in China, the US and third-party countries. As with other tariffs and supply shocks, the macro impact is broadly negative for growth at the margin, and inflationary in the US. Trade route re-direction will mitigate this to some extent.
- **Port fees:** The Office of the US Trade Representative will increase port fees on Chinese ship operators from 14 October. Rates will start at $50 per ton, rising to a plateau of $140 per ton in April 2028. There will also be a fee for non-Chinese operators using Chinese-built ships.

This is likely to result in a gradual re-routing of Chinese ship operators and Chinese built ships to non-US destinations where possible. At the margin there will be an upwards effect on inflation, more so for low value-to-weight commodities.

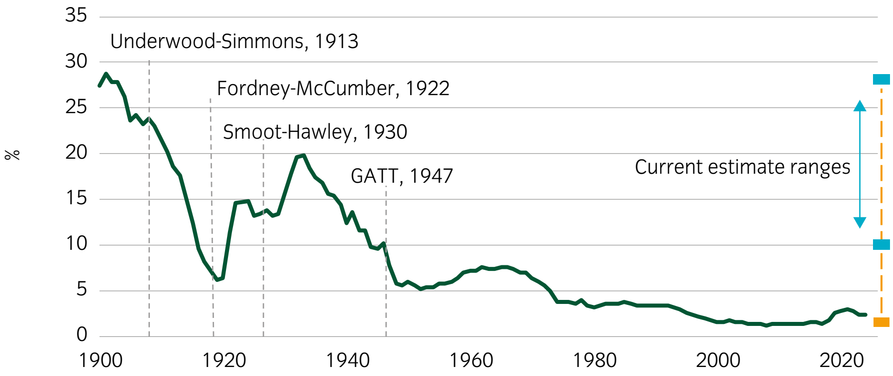
China: non-tariff barriers on the US

- **Expanding the Unreliable Entity List and Export Control List:** China has added 29 US companies to its Unreliable Entities List, and 43 companies to its Export Control List. The Unreliable Entities List includes US-based drone, defence and biotech companies, and restricts import and export activities as well as investment and personnel entry. The Export Control List prohibits exporting items or services for both civil and military applications and include aerospace, logistics and defence firms. Some of these measures have been suspended as part of the 12 May de-escalation.
- **Critical minerals:** China has placed export controls on 12 critical minerals so far this year, including those required for key defence equipment, computers and telecoms. Chinese exporters of these critical minerals now require licences from the Chinese Ministry of Commerce. It is possible that the US can re-route supply lines to go via third-party countries, but this will result in production delays and additional costs. Should this escalate to an outright export ban for these minerals, there will be a significant supply shock for the world outside of China. Production of many high-tech products would need to be idled, and shortages would start to occur. While some alternative sources could be eventually be developed, this process would require a multi-year timeframe.

NAVIGATING THE PAUSE

There were various estimates for the total effective tariff rates introduced in the initial announcement. The Budget Lab, a policy research centre at Yale University, estimated that the original announcement would see consumers face an average tariff rate of 28%, the highest since 1901[3]. Although reciprocal tariffs are paused, the minimum tariff of 10% now gives us a wide potential range, well above the pre-election US tariff rate of around 1.5%. As we can see in Figure 2, this is a radical new regime for global trade, with US tariffs expected to be higher than at any point since the early part of the last century.

Figure 2: Putting the new tariff regime into historical context[4]



Yale's Budget Lab have done some work on where US tariffs would settle if the current pause continued in perpetuity[5], and concluded that would result in US tariffs averaging 15.4%. Incorporating the impact of trade substitution would see the average tariff rate decline to around 14% (see Table 1).

Table 1: The Budget Lab estimates of US trade tariffs in a perpetual pause[6]

		Import share		Average effective tariff	
	Effective tariff	Pre-substitution	Post-substitution	Pre-substitution	Post-substitution
China	33.2%	14%	6%	4.5	2.0
Canada	17.2%	13%	15%	2.2	2.6
Mexico	14.7%	15%	17%	2.3	2.5
Rest of the world	11.0%	58%	62%	6.4	6.8
Total		**100%**	**100%**	**15.4**	**14.0**

Quite clearly, even this relatively optimistic scenario would be expected to have a significant economic impact on both the US and its trading partners.

[3] Source: Bloomberg, Insight, as at 24 April 2025.
[4] Source: https://budgetlab.yale.edu/research/state-us-tariffs-april-15-2025
[5] Source: https://budgetlab.yale.edu/research/state-us-tariffs-may-12-2025
[6] Source: https://budgetlab.yale.edu/research/state-us-tariffs-april-15-2025

WHAT TO EXPECT IN THE MONTHS AND YEARS AHEAD

TARIFFS AND TRADE DEALS

With the reciprocal tariffs delayed until 8 July, bar China, that date is clearly in focus. There is obviously considerable uncertainty around whether the US will stick to this date or extend it further, and this may vary by country. The 90-day de-escalation with China will then shift into focus unless there is progress between the two countries.

Sectoral tariffs for items such as copper, lumber, pharmaceuticals, and semiconductors are still forthcoming. Due to their importance and the lack of immediate US spare capacity, these sectors are either still under Section 232 investigation or are likely to be so[7].

The current pause is an extremely limited period of time for countries to negotiate trade deals, although the agreement reached with the UK provides hope that further agreements can be reached relatively quickly, especially for those countries where background negotiations have been underway for some time. US Treasury Secretary Scott Bessent has stated that the US is negotiating trade deals with 17 major trading partners but has not yet engaged with China. He expects some of these trade deals to be announced imminently, with 80% to 90% "wrapped by the end of the year".

We outline our thoughts on the current status of negotiations with the major US trade partners in Table 2.

Table 2: Potential trade deals

Country	Total trade (2024, $bn)	Reciprocal tariff	Outlook	Current situation
EU	961.3	20%	●	After a slow start to negotiations President Trump threatened to raise tariffs to 50% from 1 June, but postponed this after a call with European Commission chief, Ursula von der Leyen. EU trade chief, Maros Sefcovic, has stated that "import taxes are unjustified", and that the "EU will not be pushed into an unfair trade deal". A proposal to remove all tariffs on industrial goods has been rejected by the US. The EU has also offered to buy more US goods such as liquefied natural gas and soybeans. The EU is planning to share a paper with proposals to reduce trade and non-trade barriers and boost investment into the US. If talks fail, the EU is reported to be planning a €100bn package of retaliatory tariffs.
Mexico	771.8	0% / 25%	●	President Trump used powers provided to him during periods of national emergency to impose 25% tariffs on goods from Canada and Mexico despite the USMCA. These tariffs will be removed once US demands on immigration and drug trafficking are met. Mexican President Claudia Sheinbaum has stated that she intends to defend the USMCA as "one of the best trade agreements in history". This agreement ends in 2036 but is due for review in July 2026 when it can be extended for a further 16 years. US/Mexican relations are likely to normalise with time.
Canada	703.6	0% / 25%	●	Canada and the US have experienced a combative dialogue in recent months with President Trump stating that Canada has nothing the US wants and that it should become the 51st US state. A meeting took place between President Trump and Prime Minister Mark Carney on 6 May, with both stating that changes were needed to the USMCA. Major talks are expected "soon", but US/Canada relations are severely strained. There is speculation that the US would seek greater control over Canada's relationship with China in a renegotiated USMCA.

● Trade deal already annouced ● Trade deal already possible ● Trade deal likely to take some time ● Trade deal very difficult

[7] Section 232 of the Trade Expansion Act of 1962 authorises the US president to adjust imports of goods or materials if they are deemed a threat to national security, either through tariffs or by other measures.

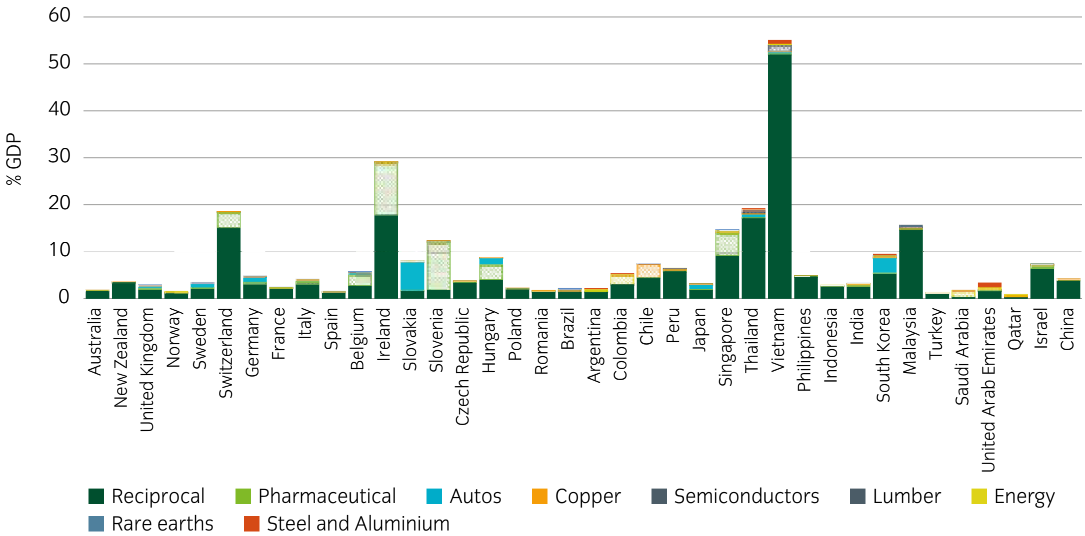
Country	Total trade (2024, $bn)	Reciprocal tariff	Outlook	Current situation
China	604.3	30%		China has been the primary target of US trade policy, resulting in a tit-for-tat escalation in tariffs. A meeting in Switzerland between the two sides saw some thawing in relations, with both sides agreeing to reduce their tariffs for a 90-day period. Although both sides are committed to further talks any trade deal is likely to complex and take a considerable amount of time. Trump has stated that any trade deal with China must be "fair" and that he will lower tariffs on China "at some point".
Japan	233.1	24%		Expected to be an early deal, with reports that Japan is aiming for June as a target date. This would build on the US-Japan Trade Agreement and Digital Trade Agreement that were struck during Trump's first term. Japan is focused on removing all tariffs between the two countries, including the 25% tariffs on autos, and tariffs on steel and aluminium.
South Korea	204.0	25%		US Treasury Secretary Scott Bessent described initial talks in late April as "very successful", immediately moving to technical talks. Bessent stated that "South Korea came early, and they brought their A-game". President Han Duck-soo has stated that the "government will try to find a win-win" with a focus on three key areas: trade balance, LNG and shipbuilding. Korea is the second largest shipbuilder in the world and Trump has previously talked about cooperation in this sector. Han has also stressed the debt it owes to the US for the 1950-1953 Korean War.
Vietnam	151.1	46%		Negotiations are underway, with Trade Minister Nguyen Hong Dien stressing the country is ready to address US concerns and asking corporates to be "proactive" in buying US goods in order to help the negotiations. An application for "market economy" status in 2024 was rejected by the Commerce Department which deemed that the government had too much control over domestic prices and production, while subsidising companies that compete with US firms. These issues are likely to be key to talks.
UK	140.8	10%		On 8 May the UK and US announced the first post-tariff trade deal. Accordingly, the UK will be allowed to export 100,000 cars to the US at a 10% auto tariff, and the UK will open up its ethanol, beef, machinery and agricultural markets. US tariffs on UK steel and aluminium were reduced to zero. The two countries have agreed to work on a digital trade deal. The 10% baseline tariff will remain.
India	128.0	27%		Vice President JD Vance has stated that a US-India deal would be "amongst the first deals", with President Trump indicating that talks with India are "going great." On tariffs he stated "They'll drop it to nothing. They've already agreed". Trade discussions were already under way before recent events. In a joint statement issued on 13 February, both sides agreed to expand bilateral trade to $500bn by 2030. This would come as part of a "mutually beneficial, multi-sector Bilateral Trade Agreement" with the first tranche to be finalised by "fall 2025". Sectoral talks are to take place in May. The US is seeking better access for agricultural goods which could prove problematic, but India is likely to commit to greater purchases from the US, such as oil and defence.
Brazil	86.1	10%		Finance Minister Fernando Haddad has stated that negotiations are underway, with meetings being held for over five weeks and now shifting to the terms of an understanding.
Singapore	99.1	10%		Singapore and the US already have a bilaterial free trade agreement, but negotiations are underway to strengthen this, with Singapore seeking concessions on pharmaceuticals and chips.
Switzerland	92.9	31%		Swiss Confederation President Karin Keller-Sutter has stated that the US is planning "privileged" trade negotiations with 15 countries, including Switzerland. Talks seem at an early stage, with Keller-Sutter stating that Switzerland had been assigned a specific contact person but few further details.
Thailand	83.0	36%		Thailand is a priority country for trade negotiations and the US has stated its focus is on reducing import tariffs, dismantling non-tariff trade barriers, curbing currency manipulation, and addressing industrial and labour subsidies. Initial talks, planned for the 23 April, were postponed due to criminal investigations being undertaken on a number of American citizens and for the US to conduct an investigation into certain exports. Thailand has offered to increase imports of US goods, including aircraft, reduce import duties, remove non-tariff barriers and introduce stricter inspections on goods shipped to the US to prevent counterfeiting. Another concern from the US side is Chinese companies establishing Thai export facilities to avoid tariffs.
Malaysia	80.4	24%		On 24 April, Malaysian Minister of Finance, Tengku Zafrul Aziz, led a delegation to the US to meet with US Secretary of Commerce Howard Lutnick and US Trade Representative Jamieson Greer. Zafrul has stated that key issues are reducing tariffs, non-tariff barriers, especially in agriculture and the aggregate level of the trade surplus. He is also aiming for zero tariffs on exports to the US.

ASSESSING THE ECONOMIC IMPACT

SMALLER, OPEN ECONOMIES WILL BE MOST VULNERABLE

From an economic perspective, the impact of tariffs is significantly influenced by the size of a country's export market relative to its aggregate GDP. For instance, while both China and Vietnam are major exporters to the US, the effect on Vietnam's GDP is substantially greater due to its relatively small and open economy. Without some tariff relief, Vietnam's economy is likely to face devastation. Certain countries also face a greater exposure to sectoral tariffs which have either been introduced or could be introduced in the months ahead.

Figure 3: GDP exposure to tariffs by country[8]



POTENTIAL IMPACT OF SECTORAL TARIFFS ON US TRADING PARTNERS

- **Autos:** On 3 April 2025, the US imposed a 25% tariff on imported cars, with a 25% tariff on non-USMCA compliant auto parts from 3 May 2025. USMCA-compliant vehicles and auto parts from Canada and Mexico are partially exempt, with tariffs only applicable to the non-US content of the vehicles. Canada and Mexico will be shielded by the USMCA agreement for now, and the UK's new trade framework will allow 100,000 cars to be exported to the US each year at a 10% tariff level. This leaves Japan and South Korea as the two countries most exposed. Slovakia stands out within the EU, with the country producing over one million cars in 2024, having benefited from years of investment from manufacturers including Volkswagen, Kia and Peugeot.
- **Semiconductors:** For semiconductors the impact will fall most heavily on Malaysia, Taiwan, Vietnam and Thailand, all of which mostly escaped tariffs during the first Trump presidency. In Vietnam, the government has a national strategy to become a leading semiconductor hub by 2030 and has recently announced a $500m investment in a national chip fabrication plant, which will design, produce and package chips. South Korea has announced a $23bn support package for its semiconductor industry. Thailand established the National Semiconductor and Advanced Electronics Industry Policy Committee of Thailand in late 2024 to help increase investment in semiconductors and advanced technologies.
- **Pharmaceuticals:** Trump has stated that he will announce "major" tariffs on pharmaceuticals "soon" and has signed an executive order asking the FDA to "reduce the amount of time it takes to approve domestic pharmaceutical manufacturing plants". The order also directs the FDA to increase fees for and inspections of foreign manufacturing plants. If tariffs are put on pharmaceuticals, then Singapore, Ireland, Switzerland and Slovenia will be most impacted (this could vary if specific pharmaceuticals are targeted). A further executive order, signed on 12 May, aims to reduce the cost of drugs in the US, which could help to close the US trade deficit on pharmaceutical goods via lower prices if successful.

[8] COMTRADE. Data as at 1 May 2025.

Southeast Asia appears most vulnerable to sectoral tariffs

Aggregating the potential impact of sectoral tariffs shows that Southeast Asia could be heavily impacted – including Malaysia, Taiwan, Singapore, South Korea, Vietnam and Thailand. Canada and Mexico are heavily dependent on the protections provided by the USMCA.

Figure 4: Aggregate impact of sector specific tariffs[9]

Country	Pharmaceuticals	Semiconductors	Steel/aluminum/ copper	Automobiles and auto parts	Total %-pts of GDP
Mexico	0.0%	0.5%	0.3%	8.8%	9.7%
Malaysia	0.0%	4.0%	0.1%	0.1%	4.2%
Canada	0.3%	0.1%	0.9%	2.8%	4.0%
Taiwan	0.1%	3.0%	0.2%	0.4%	3.6%
Singapore	3.2%	0.3%	0.0%	0.0%	3.5%
South Korea	0.2%	0.5%	0.3%	2.3%	3.2%
Vietnam	0.0%	2.6%	0.2%	0.4%	3.1%
Thailand	0.0%	1.8%	0.2%	0.4%	2.4%
Switzerland	1.8%	0.0%	0.0%	0.0%	1.8%
Japan	0.2%	0.1%	0.0%	1.2%	1.6%
EU	0.7%	0.0%	0.1%	0.3%	1.2%
South Africa	0.0%	0.0%	0.3%	0.5%	0.9%
Israel	0.3%	0.6%	0.0%	0.0%	0.8%
India	0.3%	0.1%	0.0%	0.1%	0.5%
United Kingdom	0.2%	0.0%	0.0%	0.2%	0.5%
United Arab Emirates	0.0%	0.0%	0.4%	0.0%	0.4%
Brazil	0.0%	0.0%	0.3%	0.0%	0.3%
China	0.0%	0.1%	0.0%	0.1%	0.2%
Australia	0.1%	0.0%	0.1%	0.0%	0.1%

THE IMPACT ON GROWTH

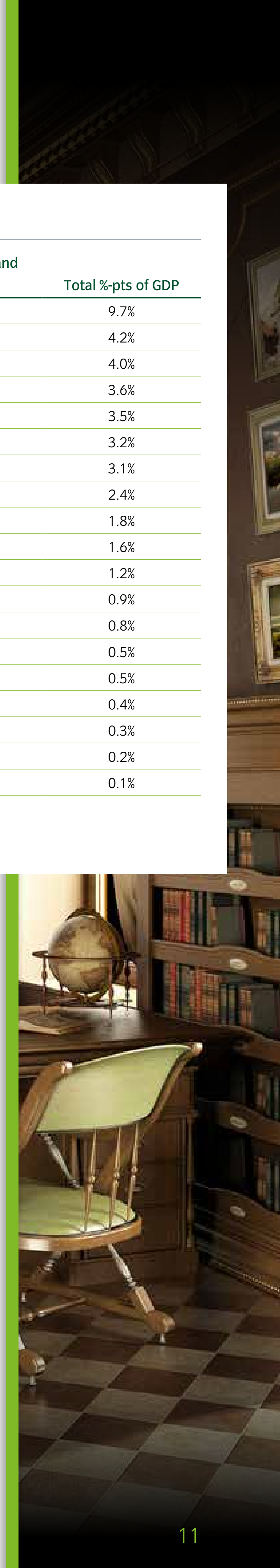
Trade channel impact

The most direct impact of tariffs on growth in exporting markets can be assessed by examining the proportion of GDP (or GVA) exposed to the US. We can then multiply this by the change in average tariffs, and the elasticity of demand can be considered to determine how the burden is ultimately split between producers and consumers. We can also estimate the impact on the US given retaliation from China. We have not accounted for elasticity of demand, implicitly setting it at 1, whereas academic studies typically suggest a lower figure.

In Figure 5 we outline two scenarios, the first assuming that tariffs remain on pause, and the second that we revert to the full level of reciprocal tariffs that were in place before the recent pause (including Chinese counter tariffs). In the first scenario, the effective tariff rate is around 15%-17%, while in the second scenario the effective tariff rate is 25%-27%, up from around 2.5% in 2024.

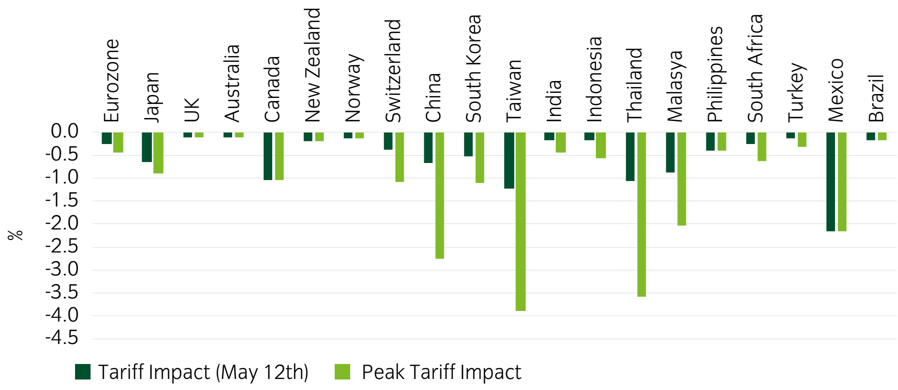
The impact is negative across the board, regardless of scenario.

In the worst-case scenario, where tariffs revert to pre-pause levels, China has a negative growth impact of -2.7%, with Thailand and Malaysia also deeply impacted at -3.6% and -2%, respectively. Within developed economies we estimate -0.9% for Japan and -0.44% for eurozone. The impact on the US is at -0.69% but this only takes account of Chinese retaliation, not the potential retaliation from other major trade partners, such as Canada.



[9] Source: USITC (NAICS 3361, 3362, 3363), World Bank, JP Morgan Strategic Research, published May 2025.

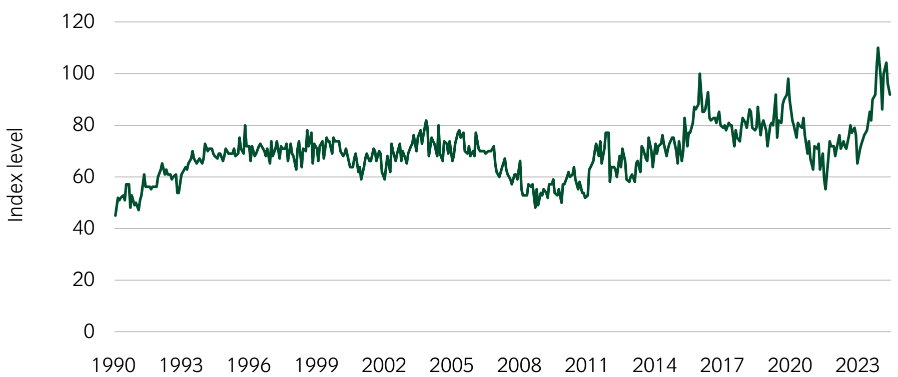
Figure 5: Growth impact of tariff announcements (Exposure US % GDP * Tariff change)[10]



Confidence channel impact

The uncertainty and noise around the new tariff regime is bewildering, making it difficult for economic participants, especially smaller firms, to keep track of the current position and how things may change. This level of chaos is likely to have a considerable impact on the economy as consumers and firms push out business decisions and investment. We can already see this coming through in forward looking data, such as the NFIB measure of uncertainty among small businesses (see Figure 6), which has risen to levels above the peak reached during the pandemic.

Figure 6: The NFIB Small Business Uncertainty Index is at historically extreme levels[11]

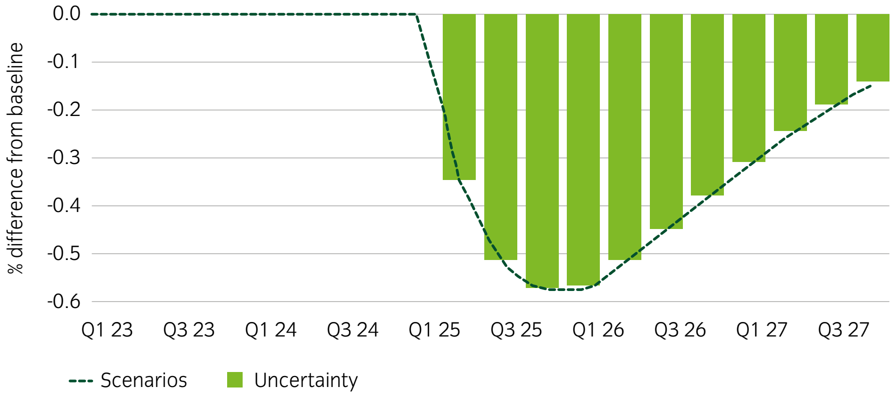


Forecasting the impact of uncertainty is inherently challenging due to the unpredictability of confidence and animal spirits. Additionally, it is difficult to estimate how long uncertainty will prevail, as the impact on growth tends to wane the longer it continues. Some investment decisions become increasingly critical and can no longer be postponed. Given the scale of the shock, it seems reasonable to believe the impact will be of comparable scale to the previous trade war in 2018, where GDP growth fell by 3% in the US, although the rapid bounce back in equity markets may help to contain the fallout.

Modelling an uncertainty shock of 2.5 standard deviations projects a minimum impact to US growth of -0.6% relative to baseline (see Figure 7). Performing the equivalent model for other countries gives a minimum impact of -0.21% for the eurozone, -0.55% for the UK, and -0.59% for China. However, China is expected to rapidly recover to -0.14% due to the planned stimulus by the authorities.

[10] Source: Insight and Bloomberg. Data as at 15 May 2025.
[11] Source: Insight and Bloomberg. Data as at 30 April 2025.

Figure 7: Modelled impact of uncertainty on US growth[12]

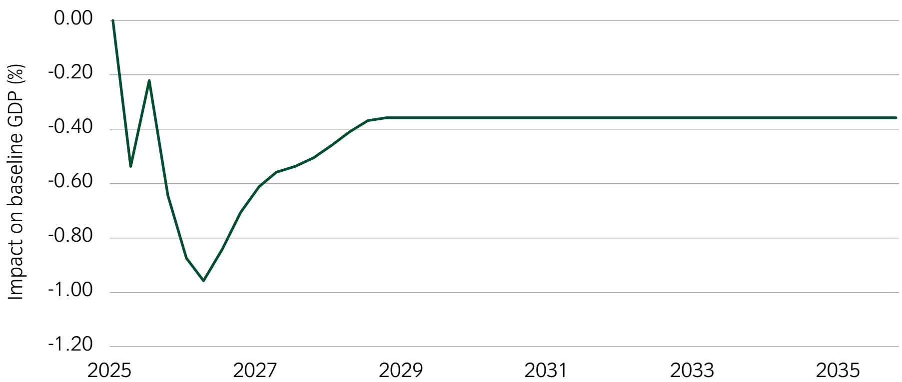


Barclays looked explicitly at the uncertainty impact for the EU and UK and concluded that the impact would be -1.1% and -1.3% respectively over 2025 and 2026[13].

Aggregating the growth impact

Aggregating the trade and confidence impacts, it's clear that the impact on growth is likely to be meaningfully negative for both the US and its trading partners. Although the confidence channel should dissipate over time, the direct trade channel impact could have a permanently impact. The Budget Lab modelled this and concluded that even if the current tariffs are paused in perpetuity, it would permanently impair US growth by around 0.36% per annum vs the baseline scenario (see Figure 8).

Figure 8: The direct trade impact could permanently impair US growth vs baseline forecasts[14]



INFLATION IMPACT

The impact of tariffs on the US is complex. While higher tariffs clearly increase import costs in the short term, margin compression may partially mitigate the pass-through to consumer prices. On the other hand, weaker growth will have a dampening effect on inflation, though not as quickly and we are also likely to see substitution away from higher tariff countries.

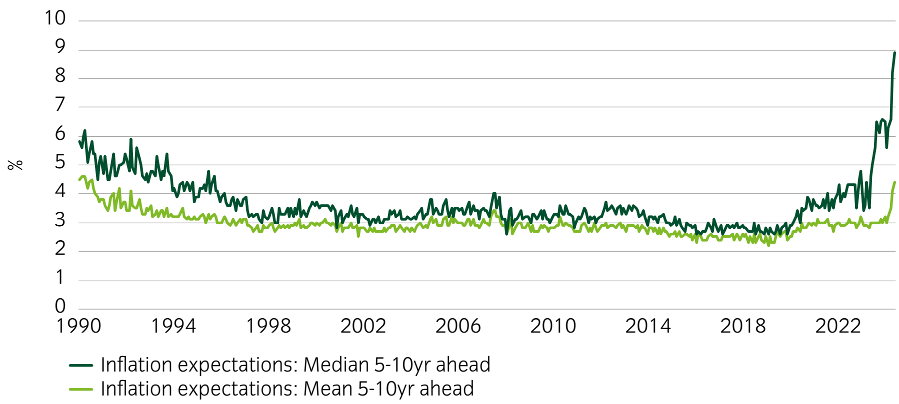
To get a sense of how corporates are expecting to deal with tariffs, we can reference a recent survey by the Dallas Fed, published by the Apollo Academy (see Figure 9). This shows that in the US, although corporates are planning to deal with tariffs in a variety of ways, passing cost increases to customers is the most prevalent response, especially for manufacturing firms. This would suggest a substantial impact on inflation, at least in the short term.

[12] Source: Bloomberg BECO, and Insight, as of April 2025.
[13] Source: Barclays Research, published April 2025.
[14] Source: https://budgetlab.yale.edu/research/state-us-tariffs-may-12-2025

Figure 9: Dallas Fed survey suggests firms are planning to pass tariff-related costs on to consumers[15]

Given all of the headlines on tariffs, it is perhaps unsurprising that long-term consumer expectations on inflation are surging, well beyond anything seen during the post pandemic period of high inflation. Inflation expectations appear to be becoming de-anchored, and ought to be very concerning to the Federal reserve.

Figure 10: University of Michigan expected inflation rate[16]



For the rest of the world, the negative impact on growth will be a dominant driver of inflation, assuming a widespread global trade war doesn't break out. Oil prices have fallen on the expectation of lower global demand, and this will be rapidly passed through to prices, while a weaker US dollar will further dampen inflation in some economies. There is also the potential for downward pressure on goods prices as a result of redirected trade flows, if China tries to dump excess production on the rest of the world.

[15] https://www.apolloacademy.com/how-are-firms-responding-to-higher-tariffs/
[16] Source: Insight and Bloomberg. Data as at 30 April 2025.

IMPLICATIONS FOR MARKETS

- Risk assets are not clearly pricing in the likely impact on growth, and the policy response so far has been insufficient to counter the negative headwinds facing the global economy. To see a significant change in the outlook, we need one of the following:
  - **Significant Fed cuts:** This is unlikely before unemployment rises, given the current inflation outlook and expectations.
  - **A significant change in tariff policy:** Although the easing in tensions between the US and China is welcome, reducing the overall effective tariff rate back to pre-trade war levels seems very unlikely before significant economic pain, given the current ideology in the White House.
  - **Offsetting fiscal impulse:** This could include tax cuts, subsidies, or other support for affected industries. This seems the most likely scenario, so keep an eye on the budget bill going through Congress.
- In the meantime, we see downside risks to equities and credit as the economic impact feeds through over the summer.
- With growth slowing, we expect wider deficits, with steeper yield curves, particularly in the US. The Fed will likely be slow to react due to inflation risks until unemployment picks up, but should then accelerate the easing cycle, causing US rates to underperform initially but potentially catch up later.
- Risks of capital reallocation may see the US dollar struggling to maintain its lofty valuation, and we could potentially be at the start of a long-term bear market for the US dollar. In the shorter term, a cautious Fed and higher yields relative to the rest of the world are likely to provide some support.

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IMPORTANT INFORMATION

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