23 May 2025

Global Political Drivers | Tariff Grid

TRUMP TARIFF MATRIX: DEAL OR NO DEAL? RoW IMPACT

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- Amid market jitters (EU today), Trump 2.0's first two trade deals (UK, China) illuminate the tariff path ahead
- More 'Phase 1' deals (e.g., Japan, India, Korea, Mexico) are surely coming . . .
- . . . and surprises too (à la "The Apprentice"). Our Trump tariff matrix sets out our framework of biggest winners & losers in a Deal vs No Deal scenario

Key judgments

- Ahead of the decisive countdown in the RoW race to strike deals, we rank countries by the difficulty of dealmaking and the costs of a 'no deal' outcome.
- The US-UK deal provides a compass for these judgments – both to measure White House tariff concessions (e.g., on Section 232 tariffs) – and for countries weighing relative losses in their negotiating calculations, as in a game of musical chairs . . .
- . . . in which Trumpian geo-economic transactionalism prevails over alliances – and relative power considerations over purely economic outcomes.
- Among EM, India and South Korea are well placed to offer concessions for deals, as is (eventually) Mexico, though Vietnam faces a more difficult task.
- The EU also has to jump through Trump-imposed hoops, while Japan's prospects are boosted by its being the biggest foreign holder of US Treasurys.
- Prepared to withstand more pain, China 'wins' no matter what – or does it?

Trump Tariff Grid: Deal or No Deal? RoW impact

	Deal*	No Deal
EU	-1	-1
Japan	+1	-1
China	+1	0
Vietnam	-1	-2
Mexico	+1	-2
Taiwan	+1	-2
South Korea	+2	-1
India	+2	-1
Brazil	0	0

	Scale
Good	+2
	+1
Status quo	0
	-1
Bad	-2

*Deal scores = how easy it is for country/region to offer concessions for a 'Phase 1' deal. No Deal scores = economic hit to country/region.
Source: GlobalData TS Lombard.

Contents

Trump tariffs, RoW scramble

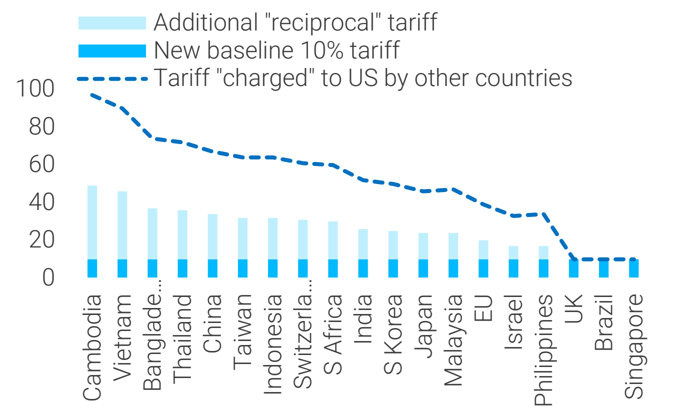
Deal or no deal? The arrival of Trump 2.0's first two trade agreements (UK, China) has reshaped the race for the rest of world (RoW) to secure new tariff deals.

The US-UK deal is the framework in principle for other RoW deals. Setting aside the well-documented, often scathing critiques on both sides of the Atlantic of this first Trump 2.0 trade deal – produced at a time when both sides needed a "win" – this narrow, low-ambition pact nonetheless deserves greater attention (outside the UK) than it has gotten for the following two reasons:

1. It showcases the **first concrete details of which tariffs the White House is willing to lower (notably, the 25% strategic sector tariffs** on steel/aluminium, auto/auto parts and – in the future – pharma, chips, critical minerals and lumber/timber, once the results of their Section 232 investigations are made public); and
2. US Trade Representative (USTR) Jamieson Greer has highlighted that his office will use **this deal as a template** to structure forthcoming deals with other trading partners (for more sectoral details of the US-UK deal, see the box below).

Trump's Liberation Day tariff scheme is set to return by 9 July if deals are not made

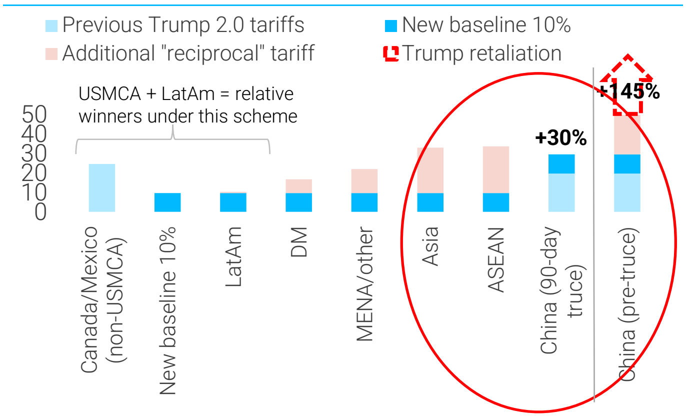
% "reciprocal" tariff rates for select countries



Sources: White House, GlobalData TS Lombard.

While Asia is the hardest hit by Trump's "reciprocal" tariffs, new deals = new winners/losers

% average "reciprocal" tariff rates by region*



Sources: White House, GlobalData TS Lombard.

By contrast, the US-China trade truce – applauded by markets, after a round widely seen as having been won by Beijing – has also been underrated, if for a separate reason: its negative impact on RoW exporters. Prior to the announcement of the current 90-day US-China trade truce, other export-oriented economies (primarily Asian), though unhappy with Trump's 10% baseline tariff, could still look forward to potentially picking up US market share from a suddenly uncompetitive China reeling from the US' de facto trade embargo. Given the ongoing trade truce, however, that calculus too has been reset. As a result, RoW exporters are faced with the unenviable choice of offering more concessions to the Trump administration to secure a deal or face a potential double whammy ahead: the loss of their US market share not only from higher additional "reciprocal" tariffs from the end of Trump's first 90-day pause in July, but from the potential for China to make a 'Phase 1.5' deal with the US the following month.

Changing Trumpian rules of the game
Liberation Day tariffs: Deal or No Deal guidelines (as of 22 May)

1. Trump's two overlapping 90-day pauses both expire in Q3/25 – setting up the RoW dash for new trade deals:

a. **Return of "reciprocal" tariffs** is projected for **9 July** 12:01 am Eastern Time (ET); and

b. **The US-China truce** is projected to last through 12 August ET before expiring.

2. US-UK framework 'Phase 1' deal is a template for RoW dealmaking.

- The White House is looking for **'quick win' deals** with low-hanging fruit that both sides can agree to ahead of the July deadline, similar to Trump 1.0's US-China **'Phase 1'** deal (signed Jan 2021).
- **Team Trump is willing to lower strategic sector tariffs** with key trading partners, including zero-tariff quotas (on steel/aluminum, as in Trump 1.0) and lower-tariff quotas (on autos/auto parts), as the UK deal illustrates.
- **Closing the 'back door' of other countries to Chinese transshipment** is a priority.
- While Trump is determined to keep a **baseline 10% global tariff** on all trading partners (ex-USMCA), **US courts will have the last word on this** in lawsuits that are now mushrooming. Policymakers – and investors – should take this into account.

US-UK 'Phase 1' deal: Top points

1. **Trump baseline 10% global tariff a 'non-negotiable'**

2. **US concessions on strategic sector tariffs:**
   - **Steel/aluminum**
     -Zero-tariff-rate quota for a fixed volume to be determined in future talks
     -Anti-China transshipment/ownership conditions
   - **Pharma**
     -If/when US imposes 'strategic' tariffs, UK to get similarly 'preferential' treatment
   - **Auto**
     -First 100,000* UK vehicles imported to the US to receive a preferential 10% tariff rate

3. **UK concessions to US agriculture**
   - **Beef:** Removal of UK's 20% tariff within a quota of 1,000mt; new duty-free quota of 13,000mt
   - **Ethanol:** Removal of UK's 19% import tariff; new duty-free quota of 1.4bn* liters

*These numbers close to present actual trade volumes

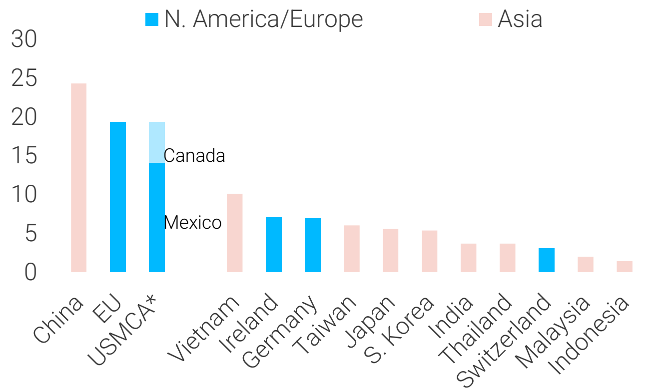
3. RoW must also race China to a deal

- The US-China truce incentivizes other exporters (primarily Asian rivals) to offer more concessions to the Trump administration.
- Failure to do so could lead to bruising consequences for RoW exporters that fail to ink a deal, with a possible double-whammy ahead in Q3/25: both additional "reciprocal" tariffs levied on their exports to the US and a US-China Phase 1.5 deal.
- While the US-China trade truce could still fizzle into a new round of tit-for-tat trade retaliation, US trading partners that can secure deals will be doubly rewarded vs their peers by preferential access to the US market and the lifting of the fog of market uncertainty.

As in a game of musical chairs, each country's ability to secure a deal with Trump will likely hinge on where they stand relative to each other when the music stops playing. For those left without chairs by the end of the first 90-day pause, one of Trump's saving graces is that few things are written in stone. Doors slammed shut can suddenly reopen; a chair taken away today could reappear a few days, weeks or months later.

"Dirty 15": US' top 15 trade deficits by country/region

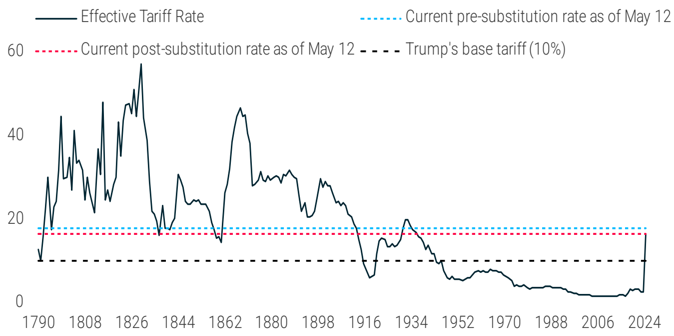
% of total goods deficit in 2024



Sources: BEA, US Census Bureau, FRED, GlobalData TS Lombard.

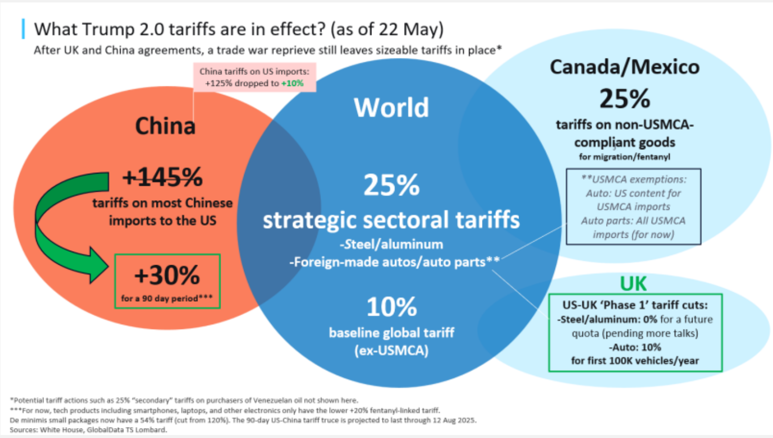
Even with the two 90-day tariff pauses, US tariff hit is unprecedented for modern times

Effective tariff rate = customs duty revenue % goods imports



Sources: Statistical Abstract of the US, Monthly Treasury Statement, BEA, Yale Budget Lab, GlobalData TS Lombard

Trump 2.0 trade war: Current landscape



Trump method vs madness

Analysts naturally seek to identify patterns and motives shaping the strategic vision of states that will inform policy choices. When it comes to Trump 2.0, this analytical habit has been criticized as "sanewashing" – that is, imputing rhyme and reason where there is no such thing – and, therefore, a poor basis for forecasting. One possible corrective is to posit, as a guide to the future, the *negation* of strategy. This approach to making sense of Trump 2.0 led us to the Geopolitical Counter-Revolution label. Reversing the radical departure from traditional US foreign policy involved in America's post-WW2 global power projection through alliance systems, Trump has overturned that coherent strategy by opting for a purely transactional approach.

Trump's reaction against old grand strategies and alliance systems can range from indifference to aversion. In the post-war system, the US struggle against world communism led it to throw open its market to allies sheltered under its security umbrella. Trump denounces all that. As he declared at the first formal meeting of his full cabinet in February – "the European Union was formed to screw the United States". Such vehemence towards Europe in particular highlights the risk of a no deal outcome with the EU at the end of the 90-day "reciprocal" tariff pause on 8 July – although Japan also fits Trump's view of allies taking advantage of the US.

A topical example of the new transactionalism is Trump's visit to leading Gulf monarchies last week. Denouncing values-based foreign policy, Trump traded supply of US technology (such as advanced AI chips and civil nuclear power) to these wealthy petrostates in return for their commitments to invest large sums in the US. The same spirit flashed in Trump's latest (19 May) phone call with Putin, whose foreign policy aide Yuri Ushakov reported afterwards that Trump became emotional on the subject of the potential for US-Russia economic partnership.

Commentary on AI chip supply to Gulf states has pointed out how this style of random-walk transactionalism flies in the face of the paramount strategic goal of containing China, which is already deeply embedded in GCC economies. On this view, Trump will end up dealing similarly with China itself. That would mean haggling out some re-heat of the December 2019 Phase 1 deal, without a coherent longer-term vision – whether along the lines of the Biden administration's "small yard, high fence" or anything else. Trump's championing of the Golden Dome project fits this non-strategy in the sense that the envisaged impregnable air defence – absolute invulnerability – would make the threat of China's relative power moot (at least from an isolationist perspective).

A different "sanewashing" argument holds, on the contrary, that the struggle against China remains paramount. This view rests on the realist school of geopolitics. As re-stated in a new article by one of this school's most prominent voices, John Mearsheimer, conventional economic criticism of Trump's tariff storm and trade wars as being counter-productive misses the point. As he puts it: "*economists tend to privilege a state's absolute gains, not its relative gains, which is to say they largely ignore the balance of power*." On this view, the economic 'madness' of negative sum is, rather, the method. Glossing Mearsheimer, the Serbian American economist Branko Milanovič writes: "*the national security requirement, as seen by the US political elite, is that the costs imposed on China (in terms of slower growth rate, delayed technological development etc.) be greater than the equivalent costs to the United States*."

One obvious objection to this view is Trump's hostility to the traditional US security establishment. Another might be that Trump's commitment to reviving industrial employment in the US motivates his policy regardless of how delusional it may turn out to be. For forecasting purposes, however, the conscious intent of policy may not matter so much. Since the objective near-term impact of the tariff campaign is lose-lose, regardless of how far this is the intention, the default calculation for countries weighing the merits of striking 'Phase 1' deals with the Trump administration is to include a comparison of their losses with those of other US trading partners. At any rate, this is the perspective consistent with the realist school of geopolitical and geo-economic analysis, For example, the UK government – having, in effect, swallowed Trump's mercantilism in its pioneering trade deal with the US – now claims that the UK is in a better position than any other country".

Trump Tariff Grid: Deal or No Deal? RoW impact

The 'Tariff Grid' below summarizes our views on relative winners and losers from the binary scenario of Deal or No Deal, as set up by Trump 2.0's two overlapping 90-day tariff pauses. In this heat map, we assign scores on a scale from -2 to + 2 reflecting our judgments on each scenario.

In the **Deal** scenario, we score the countries/regions in our universe of coverage by **how easy it will be** for each of them to strike a quick-win 'Phase 1' deal with Trump (aka all the low-hanging fruit that both sides can agree on) ahead of the expiry of the relevant 90-day pause in question. We assume that all difficult structural issues that cannot be agreed on will be kicked into ongoing or future negotiations for a 'real' Phase 2 deal ahead.

In the **No Deal** scenario, we score the countries/regions by how hard-hit they will be if they fail to meet Trump's deadline. This heat map summary page is followed by separate sections on each of our coverage regions explaining our views in key bullet points, detailed grids and additional commentary where relevant.

Trump Tariff Grid: Deal or No Deal? RoW impact

	Deal*	No Deal
EU	-1	-1
Japan	+1	-1
China	+1	0
Vietnam	-1	-2
Mexico	+1	-2
Taiwan	+1	-2
South Korea	+2	-1
India	+2	-1
Brazil	0	0

Scale	
Good	+2
	+1
Status quo	0
	-1
Bad	-2

*Deal scores = how easy it is for country/region to offer concessions for a 'Phase 1' deal. No Deal scores = economic hit to country/region.
Source: GlobalData TS Lombard.

Developed Markets

EU

- All the economic ingredients for a 'Phase 1' EU-US deal are in place
- But tail risks for Trump to take it past the brink are fattening
- Of our two "no-deal" scenarios, the crucial factor to monitor may be China

Following Trump's tweet of a possible 50% tariff on the EU starting 1 June, a preliminary deal along the lines we highlighted in early April (see: EU readies for 'Negotiation Day') is still our base case; but whether it comes by the 8-9 July deadline is another matter. The EU has much to offer to the US that Trump has long asked for. Big 'wins' there for the taking include more imports of US energy and defence equipment, higher defence spending (see Germany last week edging towards the 5% target), and perhaps some "choreographed" offers of greater manufacturing FDI into the US. Strategic sector tariffs will remain a sore point, but if the EU can secure significant tariff reductions to zero-tariff quotas (at any rate, more than the UK settled for), this is likely something the bloc can live with.

That said, the tail risk of US playing brinkmanship and delaying a deal has fattened, in the wake of the 90-day US-China truce. After virtually capitulating on China, Trump may now wish to extract more from the rich EU. Escalation risk is compounded by the pronounced anti-EU sentiment repeatedly expressed by Trump, Vance and other members of the administration. In a previous rhetorical sally against the EU, Trump denigrated the bloc as "nastier than China" in many respects for US trade. We flagged this risk in last week's GMM: more aggressive rhetoric and brinkmanship to the last minute are now more likely (evident in Trump's 50% tariff tweet), as is the scenario in which there is no deal by that deadline.

When it comes to a potential no-deal outcome, the premises on which such a situation develops and how long it lasts are crucial to determining the economic impact. Bearing in mind constant Trump 2.0 zigzags, **we sketch out two scenarios below (for more details and policy implications, see the grid table below):**

1. **Mild (little to no EU tariff retaliation).** This scenario would entail blowing past the 8-9 July deadline without a deal, but shortly thereafter, a partial reversal takes place, offering a sense of de-escalation (e.g. in the form of a few sector carveouts, broader tariff reductions or some agreement in principle). This does not elicit EU Commission retaliation or just a very limited response (e.g., reinstating the small tariff response to the original Trump steel/aluminium tariffs on a temporary basis). In the most benign version of this Mild scenario, Trump would reverse himself almost immediately, similar to his brief imposition of full 25% fentanyl/migration tariffs on USMCA partners Canada and Mexico for three days (4-6 March) before scaling that back to exclude USMCA-compliant goods. So long as talks show progress, a Mild scenario could stretch from a few weeks into months; but if negotiations hit a rough patch, the situation could quickly flip to a Severe scenario (below).

2. **Severe (escalatory EU tariff retaliation).** No real progress is achieved and the EU decides to trigger retaliation as per its list of countertariffs, covering €95bn of US exports. This would still be less than the value of EU exports tariffed by the US (€389bn), but it would have meaningful implications for monetary and fiscal policy. Meanwhile, the EU threat of targeting US digital and financial services – a "nuclear option" – would come to

the fore. **For Team Trump to green-light weeks to months of bruising trade war escalation with the EU, two conditions would likely need to be in place**:

- Trump secures a new Phase 1b deal with Beijing, after inking a flurry of other deals with other top US trading partners (Japan, Mexico, Canada, USMCA)
- US bond markets would have to be stable to rising.

Should these conditions be in place, Trump – despite squandering his initial honeymoon period waging trade war on the world – may well have replenished his political capital sufficiently to indulge his pet grudge against Europe and initiate a lengthy trade war with the EU. The counter-argument to this is that structural fundamentals for both conditions (e.g., the AI chip/tech war, in the first instance and the surging US fiscal deficit, exacerbated by Trump's sweeping tax cut bill, in the second) are trending in the wrong direction. Even if this second 'lose-lose' scenario materializes, it may eventually make pragmatic dealmaking more likely than not in the end. Before that occurs, however, the EU could tilt back towards China in its trading relationship, although reviving the Dec 2020 EU-China investment agreement would still face serious political obstacles, starting with China's effective support for Russia's war in Ukraine.

Grid	Deal	No deal	
		Mild	Severe
Tariff outlook	● "Reciprocal" tariffs (+10%) eliminated in exchange for more US LNG/farm goods purchases + NATO spending pledges ● "Global" 10% duty sticks, but with more carve-outs for special manufacturing and electronics ● Strategic sector tariff reductions or zero-tariff quotas likely; framework agreements to include auto, steel/aluminium, pharma	● Full "reciprocal" tariffs (20%) imposed temporarily, quickly followed by partial rollbacks ● EU decides not to retaliate or just activate its tariff response to original Trump 1.0 steel/ aluminium duties ● Talks continue, with some progress	● Full "reciprocal" tariffs (20%) imposed for an extended period ● EU escalates retaliation on goods trade ● Potential for retaliation on US export services increases (e.g., Big Tech, financial services)
Investment	● EU Commission "choreographs" the coordination of higher manufacturing FDI to US		● Capex pause due to worsening growth outlook and ECB hawkishness ● Hardest hit sectors: Manufacturing, logistics, real estate
Fiscal policy	● Promises to raise defence spending across EU member states to a target above 3% (already virtually discounted) could lead to a fresh rise in EU bond yields ● Promises to increase US military equipment procurement	● Member states ready stimulus to support sectors hit by tariffs, but don't deploy	● Member states deploy stimulus to tariff-hit sectors including revamping furlough schemes ● Accelerated talks about EU defence (similar to NGEU programme), with

			joint borrowing funding grants, to occur
Monetary policy	● Cuts below 2% rate become harder, as easing bias softens thanks to better growth outlook ● One more cut in September is still possible ● End of passive QT to accommodate higher military spending. Potential for some "defence QE" to manage EGB yields.	● One more cut in September to 1.75% terminal rate more likely, with a live easing bias due to lingering uncertainty ● Potential talks of passive QT slowdown	● Debate over whether to ease intensifies as retaliation + fiscal support implies higher EA inflation too ● Easing bias to stay, but there is potential for an extended pause before more cuts as ECB assesses activity and inflation data ● End of passive QT and launch of "defence QE" to directly lower EU funding costs.
Strategic sector tariffs	**Steel/aluminum:** Some tariffs remain; but an agreement in principle could be struck to allow reduced tariffs or zero-tariff quotas if back doors are shut to Chinese transshipment ● Tweaks will be needed to the EU's carbon border adjustment mechanism to let US firms off the hook	● Tariffs remain, but do not preclude an eventual Phase 1 deal ● Trump 1.0 sector tariffs imposed starting in 2018 were not lifted until Biden took office in 2021	● Tariffs remain, exacting an up to €28bn toll on EU exports, given 4x the volume of derivative products included this time around vs Trump 1.0's trade war
	Auto: An agreement for reduced tariff to zero-tariff quotas could be reached – aided by the EU's zero-tariff offer – if future growth is capped ● While the EU has a 10% tariff vs a 2.5% US tariff on EU sedans/SUV imports, Trump has railed against high EU VAT taxes too	● Germany hit hardest as the country represents nearly two-thirds of EU auto exports ● The US accounted in 2024 for just over one-fifth of EU auto exports totalling over €38bn ● Automakers with USMCA plants (e.g., VW, BMW) could see a reprieve once Trump scales back regional tariffs	
	Other (chips, pharma, critical minerals): Preferential access (e.g., zero-tariff quotas or reduced tariffs) to be granted, though details will hinge on sector tariffs when/if imposed	● Pharma tariffs of 25% are the EU's biggest concern, as this was the bloc's top export to the US in 2024 totalling €117bn ● Ireland, Belgium, Denmark and Germany to be the hardest hit in this scenario	
Geopolitics	Détente with Trump could involve accommodating some US demands on Chinese transhipments and ownership – and facilitates cooperation with the US on the Ukraine war endgame, reducing risk premia.	Amid intensified 'strategic sovereignty' rhetoric, EU makes overtures to China to irk Trump.	EU's China overtures pursued more seriously. Tensions with US complicate Ukraine war endgame, heighten risk premia – especially in CEE countries.

Japan

- Japan's deal prospects are boosted by its being the biggest foreign holder of US Treasuries
- But July elections are complicating talks
- Failure to reach a deal would rattle both Asian and US bond markets

	Deal	No deal
Tariff outlook	● Japan's role as the largest foreign holder of US Treasuries at a time of volatile bond markets will help to facilitate a Phase 1 deal ● Tokyo is keen to eliminate tariffs for strategic sectors (auto/auto parts, steel) but will need to settle for a reduction or lower-tariff quotas instead ● Increased purchases of US goods (LNG, soy, corn) plus lower tariffs on US rice to give Trump "wins" and offset Japan's current No. 8 rank in the 'Dirty 15'	● Full "reciprocal" tariffs at 24% to hit not just Asian but also US bond markets, especially after the US lost its final triple-A bond rating this month ● Retaliation via FX and consumer boycotts ● Significant hit to the Japanese auto sector; the US is Japan's top market for auto exports and accounted for 30% of vehicle exports in 2024
Investment	● More auto and chip investment in US, coupled with tighter rules on chip exports to China	● Reduced purchase of US assets ● Domestic investment slows
Fiscal policy	● Fiscal spending conditional on July election ● Small scale measures to support consumers and tariff-hit sectors	● External threat to help push for greater fiscal expansion even if election results in a hung parliament
Monetary policy	● BoJ to resume monetary policy normalization (hiking) in Q4/25 ● Intervention to manage FX and rise in long end yields	● BoJ hiking cycle over ● FX weakness actively encouraged to support exports
Strategic sector tariffs	**Steel/aluminum:** Zero-tariff quotas likely	Tariffs remain
	Auto: Tiered tariff system. Bulk of existing vehicle exports on a low tariff rate. More FDI into US likely.	Tariffs increase
	Other (chips): Mix of tariffs and incentives to bring manufacturing to the US and to close down loopholes of advanced chipmaking equipment exports to China	Politically expedient carveouts for certain sectors (consumer electronics/batteries etc).
Geopolitics	● Japan to maintain economic relations with China while ratcheting up defence spending	● Japan forced to engage in greater regional alliance and economic partnership building ● Tokyo may lean neutral rather than towards Washington ● Defence spending surges
Other	● July election critical to negotiations ● Deal unlikely to be ratified before a new Diet is formed	● Access to US market critical for Japan Inc which is being squeezed by China competition in all other markets. High tariffs would hit margins lowering competitiveness

EM

Brazil: Small signs of progress towards a deal

- Brazil is well placed to reach a deal with the US . . . if Team Trump prioritizes it
- US ethanol exports will be a top sticking point, even though Brazil's small overall trade deficit with the US should facilitate talks
- Brazil will continue to pursue closer China ties under Lula's multipolar vision

Brazil is not a top priority for the Trump administration; but negotiations are advancing. Unlike other countries that imposed retaliation measures on Trump tariffs and Brazil's own past tit-for-tat tariffs in Trump 1.0's trade war, the Lula government this time around has made a concerted effort not to rock the boat. So far, this strategy has been a success and Brazil has remained off the Trump administration's list of targets for tougher measures, even as President Lula (back home after another successful China trip last week) continues to pursue closer ties with Beijing.

Brazil, like the UK, has consistently posted trade deficits with the US over the past decade – putting it in the rare category of big EMs (alongside Argentina and Saudi Arabia) that are outside of the "Dirty 15" countries with which the US ran a big trade deficit in 2024. To sum up our more detailed review of US-Brazil bilateral goods trade, Brazil imports manufactured and semi-manufactured goods from the US, while its main exports to the US are commodities, including crude oil, beef and coffee, and semi-manufactured goods (notably steel). Brazil imports aircraft turbines and other components used to manufacture airplanes – which in theory are products that Trump would like to continue to export to Brazil.

Table 1: Brazil-US trade – top exports/imports
US$bn

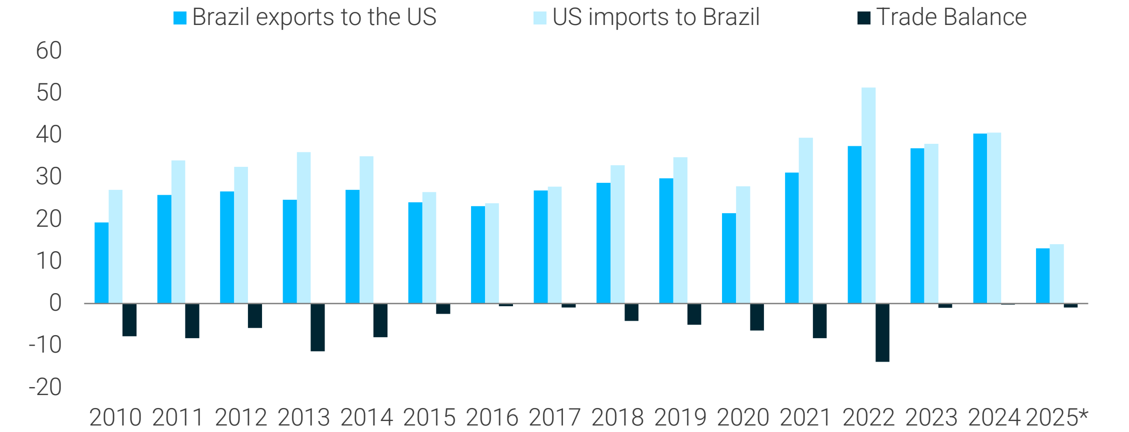
Top US exports to Brazil (2024)	US$	Top Brazil exports to the US (2024)	US$
Aerospace products and parts	6.1bn	Crude oil	5.83bn
LNG	1.66bn	Semi-finished steel	3.5bn
Crude oil	1.45bn	Coffee	1.85bn
Diesel	1.44bn	Wood pulp	1.55bn
Naphtha	1.43bn	Non-alloy pig iron	1.42bn
Bituminous coal	1.34bn	Airplanes	1.42bn
Ethylene polymers	578.8mn	Gasoline	966mn
Lubricants	570.8mn	Frozen beef	885mn
Polyethylene	500mn	Frozen orange juice	637mn
Fertilisers	475mn	Bulldozers	520mn
Sodium hydroxide	471mn	Front-end loaders	503mn

Source: Comexstat.

We believe Brazil's small trade deficit with the US, combined with the profile of US exports to Brazil, will pave the way to a deal. **If, however, the two countries are unable to reach an initial deal at the end of the 90-day "reciprocal" tariff pause, it will have a limited impact on Brazil – unless other countries gain significant advantages** from their 'Phase 1' deals with Trump.

Historically, Brazil has a small trade deficit with the US

US$ bn



Source: Comexstat.

While several bilateral meetings have already been held, the timing of a deal remains uncertain. In one positive sign, Finance Minister Fernando Haddad met with US Treasury Secretary Scott Bessent for the first time earlier this month, even though this meeting was not specifically arranged to discuss the tariffs imposed by the US on Brazil earlier this year, Haddad described the meeting as "excellent". More importantly, officials from Brazil's Trade Ministry have also been holding regular meetings with their counterparts in Washington, and are working to not only reach a consensus regarding the tariffs, but to strengthen ties between the two nations by finding common ground on economic issues that are of key importance to both governments. **Although the schedule for the next bilateral meeting has not yet been made public, President Lula was invited to participate in next month's G7 meeting (15-17 June) in Canada, where he could potentially meet President Trump for the first time.**

Ethanol will be a central issue in the trade talks. Brazil and the US have a long history of bilateral ethanol trade and both sides have used tariffs to protect their respective industries over past decades, in part because it is a sensitive issue for each country's agriculture caucuses. Since 2011, Brazilian ethanol has largely entered the US tariff free, while the tariff on imports of US ethanol into Brazil has fluctuated. The tariff fell to zero in 2022, then got raised to 16% in 2023 and subsequently bumped to 18% in 2024 – where it has remained. This has created a point of tension with the Trump administration, which is seeking to deliver some wins for American farmers in its broader trade negotiations.

However, completely dropping or eliminating the ethanol import tariff (as the UK did in its framework deal with the US) might not be politically viable for President Lula right now. This is because cane mills in northeastern Brazil – a core base of support for Lula's Workers' Party – would likely protest the move since the bulk of US imports are typically directed to this region. With large corn ethanol projects expanding into the northeast region, the Lula government will need to carefully evaluate its next move. These plants include a flexible mill in Alagoas state, which has installed corn-ethanol capacity at its sugarcane mill, allowing it to produce ethanol year round. Likewise, Paraguayan ethanol firm Inpasa is expected to start operations of its corn-ethanol plant in Balsas Maranhão state shortly and also has plans to install a mill in western Bahia. Fuel distributor PetroBahia also announced a plant in western Bahia. Both plants would be sufficient to supply the state's demand for the biofuel. And next year, Brazilian bioenergy firm BrasBio is expected to begin operating its corn ethanol plant in Piauí state.

One possibility would be for the two countries to negotiate tariff-free quotas both for US ethanol imports to Brazil and for Brazilian steel and aluminium exports to the US. Another possibility is the gradual phase-in of lower tariffs for additional imports above a fixed quota over a period of years. **We believe that a trade deal between the two countries will need to include increased access for US ethanol to the Brazilian market, but whether the Lula government can convince the White House to accept its proposed solution is another matter.**

In the best-case scenario, Brazil and the US will increase cooperation in critical minerals. Even with the temporary truce in the US-China trade war, the US will continue to seek to diversify its own critical minerals supplies. As a mining giant, Brazil is already an important supplier of key energy-transition metals, but the country has also emerged as a **potential supplier of lithium and rare earth elements**.The U.S. Geological Survey (USGS) recently revised its estimates of the latter category **– raising Brazil to second place (from third place previously)** with 21mn tonnes in estimated rare earth reserves – behind only China which dominates both global reserves and production. Brazil is also the leading global supplier of **niobium** and has the second biggest reserves of **graphite** (after China). **Any agreement that aims to expand Brazilian production to supply the US would be an important step forward in bilateral relations** and potentially allow for continuity with a core Biden policy imperative: the ongoing buildout of alternative critical mineral supply chains to China to supply the West.

Brazil is eager to attract investment from the US and is also launching a plan to attract global tech companies to Brazil to invest in data centres. This plan is the country's first concerted "powershoring" push, which seeks to capitalize on Brazil's cheap, abundant renewable power, which is needed to operate large data centres. The government plans to publish a Presidential Decree in coming weeks that would offer **import-tariff exemptions on any equipment needed for the installation of the data centres that is not produced in Brazil**. Haddad has promised that the bill would speed up the implementation of some elements of the tax reform, benefiting data centre investments. The reform offers tax exemptions to services exports from Brazil. On his recent trip to the US, Haddad met with companies including Amazon and NVIDIA to discuss these plans. These efforts underscore Brazil's efforts to attract investment from across the globe, as part of its broader foreign policy of strategic non-alignment. Local media reports that China's ByteDance is considering investments in its first Brazil data centre are a case in point.

Grid	Deal	No deal
Tariff outlook	● A deal between the US and Brazil will involve increased access for US ethanol to Brazil and Brazilian steel to the US ● Brazil is likely to agree to a quick Phase 1 deal despite Trump's insistence on a 10% baseline tariff, but would need some US concession in return	● Brazilian ethanol exports to California and exports of sustainable aviation fuel (including to Lanzajet's plant in Georgia). Steel and aluminium exports will also fall
Investment	● The US and Brazil could strengthen critical minerals partnerships, bolstering investment in Brazilian mining. ● Brazil is hoping to attract US$350bn+ in investment in data	● Brazil will continue to boost its ties with China and Chinese investments in Brazil will grow. ● ByteDance is reportedly mulling a 300-900MW data centre project in Brazil; other Chinese tech giants (i.e. food delivery behemoth Meituan) are also stepping up FDI plans

	centres over the next 10 years, starting with US Big Tech firms; while a Finance Ministry plan to exempt data centres from income + import taxes is a positive sign, it will hinge on data centre legislation being crafted by the government.	● Brazil will be under greater pressure to attract investment from Europe and the Middle East, but it will still court US FDI from individual investors.
Fiscal policy	Brazil will continue to struggle to meet its fiscal targets	
Monetary policy	Rates on hold until yearend	
Strategic sector tariffs	● **Steel/aluminium:** The two countries will negotiate a tariff-free quota for Brazilian steel and aluminium exports. Previously, Brazil was entitled to export 3.5mn tonnes of steel to the US tariff free.	Brazilian steel and aluminium exports to the US will decline by around $1.5bn/yr; Brazil will impose tariffs to protect its own steel industry.
	● **Ethanol:** Brazil will negotiate a tariff-free quota for US ethanol. Previously, Brazil offered a 750mn t/y tariff-free quota.	Brazilian ethanol exports to the US will decline, but this will not have a significant impact on the industry as Brazil exported just US$200mn of ethanol to the US last year.
Geopolitics	● Brazil will strengthen ties with the US while still pursuing closer ties with other BRICS and the Middle East, in line with Lula's multipolar vision	● Brazil will continue to court investment projects from individual US firms, while growing its ties with China and Europe as part of its multilateral agenda
Other: US-China talks	● Brazilian industry will be less exposed to competition from imported manufactured Chinese goods during the 90-day US-China trade truce ● US agricultural exports to China need to be monitored, as a potential US-China deal similar to the Phase 1 deal could cut Chinese purchases of Brazilian soy, corn and animal protein.	● Brazil will see increased imports from China, but could also boost some exports to the US. ● Brazil will continue to seek to diversify its agricultural exports, particularly to markets in Asia, such as Japan, South Korea and Vietnam.

East Asia

China: Paper tigers and a phase 1.5 deal

- Beijing wins round 1, bumpy de-escalation to +20-30% tariffs on track
- Phase 1.5 deal is possible, China is amenable to investing in the US and managing exchange rates
- No deal would lead to greater stimulus and prove positive for domestic demand

Tariffs on China went up 145% and have now dropped to 30%, with an additional 24% subject to a 90 day pause. The rapid tariff reversal vindicates Beijing's trade war playbook. America has been shown as a "paper tiger". China, the only country to effectively retaliate and the sole nation to negotiate in a neutral country, has raised its global standing. Looking beyond the propaganda and geopolitical victory, we expect a bumpy process of negotiation that leaves the permanent tariff rate in the 20-30% range (our longstanding forecast). A phase 1.5 deal could include provisions on FX, investment and tech.

There is little pressure on Xi Jinping to rush into a deal. A 30% tariff rate would eventually equate to a 0.9 ppt hit to GDP; however, in the near-term trade re-routing and frontloading (Chart 1) are actually delivering a positive impulse to growth. Accelerated fiscal stimulus in H1/25 is also helping power a weak cyclical recovery, one that we think will continue.

Putting a floor on the most important bilateral relationship in the world is an objective of PRC leaders. While many in Beijing believe economic and technological cold war is already underway it is better to hug your enemy closer or, put differently, engage in asymmetric decoupling. Prior to Liberation Day, China sent clear signals in favour of negotiation and has continued to advocate for dialogue throughout the escalation in tariffs.

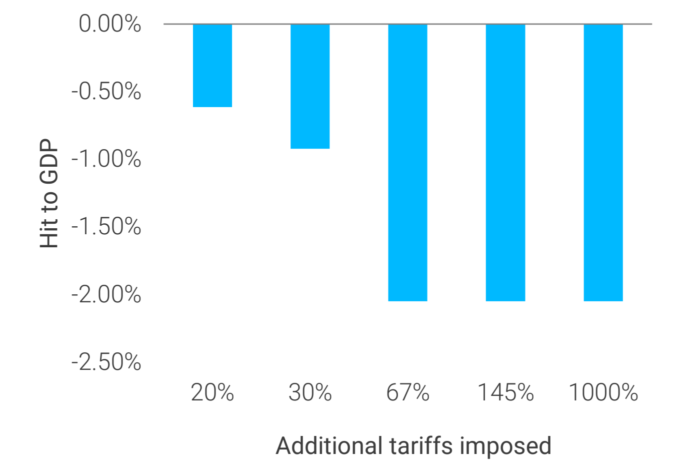
The China offering is likely to be a combination of:

- Opening of select industries to foreign investment (part of an existing PRC policy)
- Purchase of US goods
- FDI into America (Wanted by PRC corporate and politicians)

Frontloading and re-routing help exports

Sources: CEIC, GlobalData TS Lombard.

Hit to GDP will be offset



Sources: CEIC, GlobalData TS Lombard.

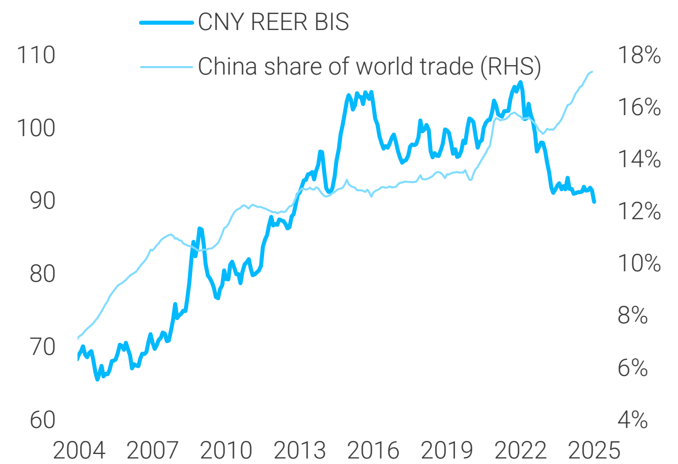
- Implicit agreement on FX (Xi wants a strong RMB)
- Cooperation on fentanyl precursor trade reduction

Many of the points listed above align with longer-term political-economic objectives. The RMB is an interesting case, Xi has made clear that USDCNY is a policy target. That objective has limited the scope for monetary easing post-Covid. A joint agreement containing tacit FX commitment would cause RMB appreciation and allow much-needed acceleration in PBoC policy support. Given China's large REER devaluation, this would be unlikely to materially damage export competitiveness, especially if EUR, JPY, and KRW, face similar agreements (see chart below left). Finally, as the Phase 1 deal highlighted, China may not need to follow any conditions beyond the scope of Trump's term in office. All of which clears the way for a limited deal to be struck.

In return China will want more than just tariff reduction. Areas of interest include; access to the US market for exports and manufacturing investment, ability to purchase advanced technology, and recognition of geopolitical spheres of influence (Taiwan/South China Sea). These conditions appear amenable to Trump but China hawks will fight on all three. Deal prospects will hinge on the balance of power in Washington between the national security lobby and Trump/Wall St aligned staffers. The President wants to negotiate which suggests hawks will have to compromise.

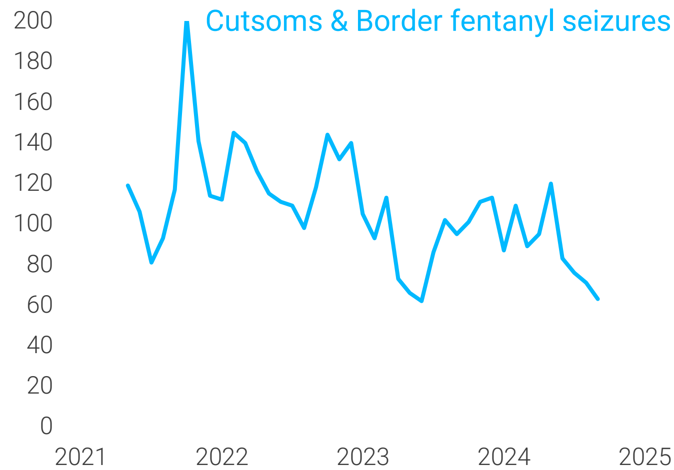
The 90-day pause lasts through 12 August. There are two key signposts to gauge negotiation progress as the date approaches. The first is **Fentanyl.** Beijing has made significant efforts to reduce output and exports of pre-cursors. Customs and border seizures of fentanyl have fallen in recent months (chart 4), possibly due to Mexican and Chinese efforts. The **TikTok** deal is the other key signpost. Trump has repeatedly pushed back a legal deadline. Continued delays or a soft agreement (anything that leaves the algorithm in ByteDance's control) are all positive for US-China relations. Taken together we expect a limited Phase 1.5 deal to be done over the coming months. As for the reverse scenario, the most likely way another escalatory bout in the trade war would materialize is through the **tech war.** The latest tensions that flared up over the US' new rule banning use of Huawei's Ascend AI chip "anywhere in the world" (language eventually deleted following Beijing's fury just days after the US-China truce was reached) underscores the potential for acrimony ahead – all the more so as the AI race fires up in new and unexpected directions.

RMB can appreciate



Sources: CEIC, GlobalData TS Lombard.

Fentanyl could be an off-ramp



Source: Customs and Border Protection.

<table>
<tr><th>Grid</th><th>Deal</th><th>No deal</th></tr>
<tr><td>Tariff outlook</td><td>● 10% baseline tariffs stick
● 20% tied to fentanyl could be reduced first before being removed
● 24% "paused" then gradually reduced
● End result is +20-30% on top of pre-existing Trump 1.0-Biden tariffs
● Resumption and update of Trump 1.0 Phase 1 purchases likely (farm, oil & gas, manufactured goods)</td><td>● Tariffs finish in the 50% range
● Politically expedient carveouts permitted for certain consumer goods and manufacturing inputs</td></tr>
<tr><td>Investment</td><td>● Low security risk sectors encouraged to invest in US
● Chinese automakers could potentially invest if they adopt a US tech stack
● Opening of financial, telecoms and biotech potentially offered</td><td>● Curtailment of US physical and financial investment into China and related assets
● Financial decoupling in strategic sectors could gain more traction</td></tr>
<tr><td>Fiscal policy</td><td>● Fast start to spending continues. Infrastructure and consumption the main focus
● Additional bond quota of RMB 0.5-1 trn in H2/25</td><td>● Beijing forced to more expansive fiscal policy
● Additional spending of 1% of GDP ● Funds spent on infrastructure and household support</td></tr>
<tr><td>Monetary policy</td><td>● Less pressure on RMB allows PBoC to loosen policy
● 10 bps rate cut, 50 bps RRR cuts</td><td>● PBoC remains accommodative to facilitate fiscal easing
● RMB weakness limits scope for outright rate cuts</td></tr>
<tr><td rowspan="3">Strategic sector tariffs</td><td colspan="2">Steel/aluminium: Tariffs to remain, given longstanding US concerns about Chinese excess overcapacity and Chinese transshipment to other countries. Beijing unlikely to retaliate, rare earth option held in reserve</td></tr>
<tr><td>Auto: Softened stance on auto parts. Vehicle tariffs to remain</td><td>In addition to continuing or higher tariffs on auto/auto parts, a focus on further shutting down re-routing options could ensue</td></tr>
<tr><td colspan="2">Other (chips, pharma, critical minerals): Both high and low tech national security sectors to face high tariff barriers on the US side and tit-for-tat export controls on Beijing's side
● Beijing will chafe at stringent US chipmaking + AI chip export controls which will remain a constant irritant in the bilateral relationship</td></tr>
<tr><td>Geopolitics</td><td>● Tariff turmoil creates opportunity to shift global perception of China
● Europe is the main prize. Expect continued efforts to restart the Comprehensive Agreement on Investment though China's support of Russia remains a big sticking point
● Outbound manufacturing investment will remain strong. EU periphery and large EMs preferred</td><td>● Higher bilateral tariffs would put China on the defensive. Beijing would likely seek to ensure access to global markets ex-US ● Outbound manufacturing investment will remain strong. EU periphery and large EMs preferred</td></tr>
</table>

Other	● China will seek wins beyond tariff reduction. These could include tech and geopolitics ● Beijing not averse to implicit currency agreement. Explicit statements on controlling FX are possible. But Japan's history and domestic political sentiment make a quantitative RMB target hard to tolerate.	● Escalation beyond trade conflict to economic and financial spheres a key risk ● Maritime showdowns and military drills in East Asia's four geopolitical flashpoints (Taiwan Strait, Korean Peninsula, South China Sea, East China Sea) have surged in the past year; a further breakdown in trade will exacerbate these tensions

Korea

- **Spot presidential election (3 June) to limit tariff negotiation time**
- **Keen US interest in chips and ships to help pave the way to a Phase 1 deal**
- **Failure to reach a deal, if prolonged, could provoke a highly disruptive break, with cascading geopolitical ripples on the Korean Peninsula – and global markets**

Grid	Deal	No deal
Tariff outlook	● 10% baseline tariff~~s~~ remains but additional "reciprocal" tariffs (+15%) paused or removed in exchange for Trump "wins" (e.g., more market access, farm/energy purchases) ● Strategic sector tariff reduction frameworks (steel, autos, chips) in place to cap future growth ● Tighter controls on Chinese transshipments + chipmaking tools ● A 'Phase 2' deal (renegotiations of the US-Korea FTA, potentially) to kick off and include a focus on non-tariff barriers (e.g., beef import restrictions, drug pricing policies, digital rules)	● Full "reciprocal" tariffs of 25% puts Korean exporters at a disadvantage with regional rivals, especially if other peer countries secure a Phase 1 deal first ● While 25% tariffs are lower than China's current tariff rate (30%), Chinese exporters still have an advantage over Korean exporters if tariffs remain at this level ● Consumer boycott of US products; the US is Korea's top overseas supplier of food products (e.g., beef, corn, wheat, fruit)
Investment	● New investments in US LNG, shipbuilding, auto and semiconductors	● Increased investment in transhipment hubs if no deal persists for one or more quarters
Fiscal policy	● Additional budget of 0.5% of GDP passed. Opposition candidate Lee Jae-myung if elected will add further stimulus ● Lee leads polling by 10-20 pts	● Bigger stimulus. Size of fiscal package determined by tariff rate

Monetary policy	● Two 25bps cuts in 2025 ● FX intervention to limit KRW appreciation/depreciation	● Three 25bps cuts in 2025 ● Support of KRW depreciation
Strategic sector tariffs	**Steel/aluminum:** Tariffs reduced to allied-nation level, with zero-tariff quotas likely	Tariffs remain
	Auto: Tiered tariff system. Bulk of existing vehicle exports allowed on a low tariff rate, with a cap on future growth. US onshoring encouraged for Hyundai and other EV battery manufacturers, but uncertainty over reduction in Biden's clean energy tax credits could delay FDI.	●Tariffs remain; more domestic support likely (e.g. EV consumer subsidies, tax incentives) ● In 2024, the US was South Korea's biggest auto export market, accounting for nearly half of its sales abroad.
	Other (chips, pharma, critical minerals): Carrots and sticks to encourage cooperation in critical sectors, especially chips and ships. The US is South Korea's biggest pharma export market, so a framework agreement on pharma could also be included in a deal.	● Politically expedient carveouts for certain sectors likely (e.g, consumer electronics, batteries)
Geopolitics	● Seoul will continue policy of cakeism where possible ● Reality and perception of declining US influence in Asia will stabilize Seoul-Beijing ties ● Defence spending and regional FDI to increase ● Though difficult, a Trump-Pyongyang deal to limit nuclear proliferation, if it materializes, could be supported by Lee as President	● US risks highly disruptive break with key Asian ally ● Pressure to reduce US soldiers deployed in Korea ● Increased pressure to abrogate component of KORUS defence treaty that allows US control of Korean troops under certain wartime conditions ● Seoul could pursue nuclear arms for deterrence
Other	● June 3rd election limits time for negotiations before 90-day pause expires ●Lee Jae-myung is highly likely to win the election; Lee and his DP party are traditionally in favour of engagement with the PRC and North Korea	● Access to US market critical for Korea Inc which is being squeezed by Chinese competition in all other markets. High tariffs would hit margins lowering competitiveness

Taiwan

- Taiwan – ranked No. 7 in the 'Dirty 15' – faces more hurdles to ink a deal vs peers
- But TSMC is key to Trump's AI chip ambitions, making a deal more likely than not
- Failure to achieve a deal would pose existential risk to Taiwan economy and security

<table>
<tr><th>Grid</th><th>Deal</th><th>No deal</th></tr>
<tr><td>Tariff outlook</td><td>● Taiwan has offered zero tariffs and more US LNG purchases (i.e. lifting its imports from 10% to 30% of the total)
● Other defence, farm and industrial purchases could be added to shrink the US deficit with Taiwan
● Closing down Chinese transshipments and AI chipmaking export loopholes to be part of the deal</td><td>● Full "reciprocal" tariffs at 32% to put Taiwan at a disadvantage to Japan (24%), South Korea (25%) and China (30%) under the Trump tariff scheme, especially if the other countries strike a Phase 1 deal first
● US is Taiwan's top export market, accounting for nearly one-quarter of foreign sales in 2024
● Limited retaliation via FX depreciation and re-direction of weapons purchases</td></tr>
<tr><td>Investment</td><td>● TSMC has already pledged an additional US$100bn in new chip investments in the US but new FDI announcements could come from TSMC suppliers and other electronics/industrial firms
● A possible TSMC-Intel partnership to help get Intel foundry back on track could be part of a deal</td><td>● New semiconductor investment in US put on hold
● Domestic investment slows on weaker trade and uncertainty</td></tr>
<tr><td>Fiscal policy</td><td>● Domestic political infighting limits scope for fiscal response</td><td>● Existential risk from dispute with the US could force KMT to cooperate with DPP</td></tr>
<tr><td>Monetary policy</td><td>● Tacit currency "agreement", if part of the deal, would put CBC in difficult position
● Governor Yang to attempt gradual appreciation to appease US and limit damage to life insurance industry</td><td>● CBC encourages TWD depreciation
● Two 12.5 bps rate cut in H2/25</td></tr>
<tr><td rowspan="2">Strategic sector tariffs</td><td colspan="2">Steel/aluminum: Tariffs remain – but since pre-Trump 2.0 tariffs on Taiwan steel imports were already set at 25%, the island paradoxically has a new window of opportunity vs other steelmaking countries – until the US grants more zero-tariff steel quotas to allied countries</td></tr>
<tr><td>Auto: Softened stance on auto parts</td><td>Higher tariffs on Taiwan auto parts exporters vs regional peers to hurt an industry with razor-thin margins</td></tr>
</table>

	Other (chips, pharma, critical minerals, lumber/timber): Incentives and threats to encourage chips cooperation and crack down on AI chipmaking diffusion to China	Politically expedient carveouts for certain sectors (consumer electronics, semiconductors etc.)
Geopolitics	● US-Taiwan negotiations are inseparable from US-China competition ● Taipei is attempting a rapid move closer to Washington and may be willing to make trade concessions to achieve this objective	● Loss of US economic relationship is an existential threat for Taiwan ● Lai already under pressure domestically may face blame for a deal failure, further undermining DPP leadership
Other	● Chips are a semi-commoditized product. They are priced in dollars and as such TWD appreciation may not damage export competitiveness for TSMC so long as DXY continues to weaken	● Taiwan is highly vulnerable to the tech cycle. A broader trade war, would cause significant economic damage and raise geopolitical risk

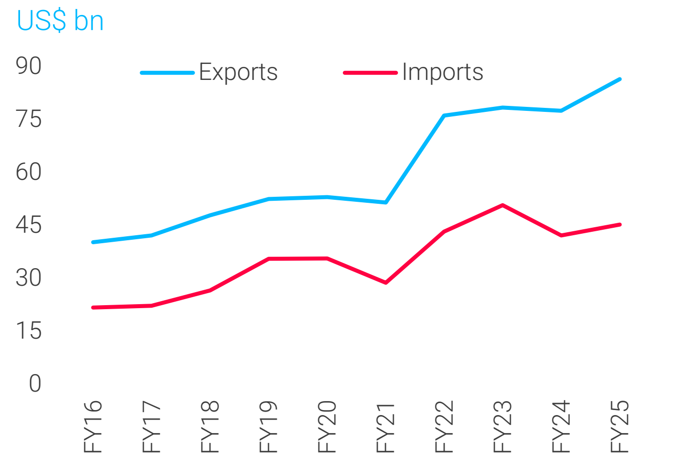
India: US drives harder bargain as talks progress

- India's conciliatory stance turns tougher as Trump ups pressure to extract better deal
- Trump in "no rush" as he wants tariffs scrapped; India offers 0 duty on 60% tariff lines
- Markets remain upbeat as 6%+ GDP growth relatively strong despite trade disruptions

India was expected to be amongst the first to strike a trade deal with the US, but talks seem to be dragging on as President Trump tries to drive a hard bargain and India seeks to protect its domestic industry and farmers. Trump's claim last week that India has promised to scrap all tariffs as well as his assertion that he used trade as a negotiation tool to broker a ceasefire between India and Pakistan (following the military conflict between the two neighbours earlier in May) have been refuted by India. His statements that Apple should shift out of India and a US proposal to tax remittances have also riled Indian policymakers. Meanwhile, the US-China 90-day truce erodes what domestic policymakers thought provided India with a greater competitive advantage (although the current effective tariff rate on China is still 3x that on India).

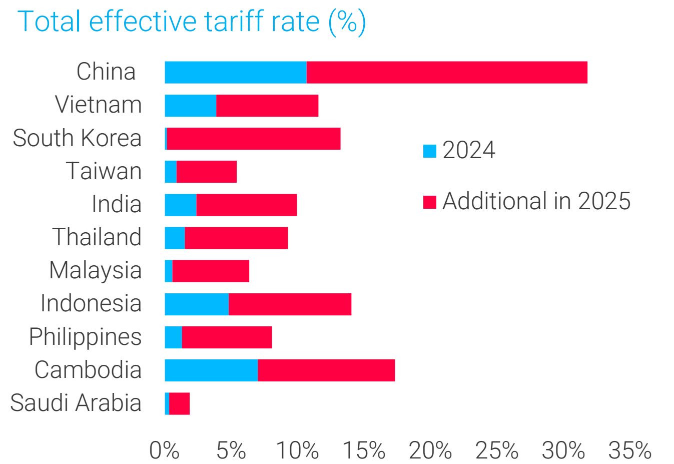
India is seeking a complete tax exemption, including from the 10% baseline tariff, while offering to eliminate 60% of tariff lines and provide preferential access to almost 90% of US merchandise imports, according to the latest reports following Indian Commerce Minister Piyush Goyal's visit to Washington DC this week. Goyal termed his discussions with his US counterpart as "good", and even though Trump said last week that he is in "no rush", **a partial interim deal will still likely go through by early July** so that both sides can claim some sort of victory.

India's trade surplus with US has expanded



Sources: Commerce Ministry, Centre for Monitoring Indian Economy.

Tariffs on India vs largest Asian exporters*



Source: Fitch Ratings. *Countries listed in terms of US import values.

But the conciliatory stance that India has so far adopted is changing to a slightly tougher one: for one, the country notified the World Trade Organization (WTO) of possible retaliatory tariffs against safeguard duties on steel and aluminium imports that the US had imposed prior to the 'Liberation Day' announcement. Its WTO filing states that the 25% safeguard duty by the US could impact US$7.6 bn of India's exports, and losses worth US US$1.9 bn in additional duties. India warned that counter-duties could go into effect 30 days from the 9 May notification, but it hasn't specified on which products they would apply. India took a similar step in 2019 on some US products (including fruit and meat) after the latter slapped additional duties of 25% and 10% respectively on Indian steel and aluminium in 2018; that dispute was finally resolved in 2023. Although India has been eager to protect its exports to the US – its largest market for both goods and services – External Affairs Minister S. Jaishankar said that any trade deal must be "mutually beneficial".

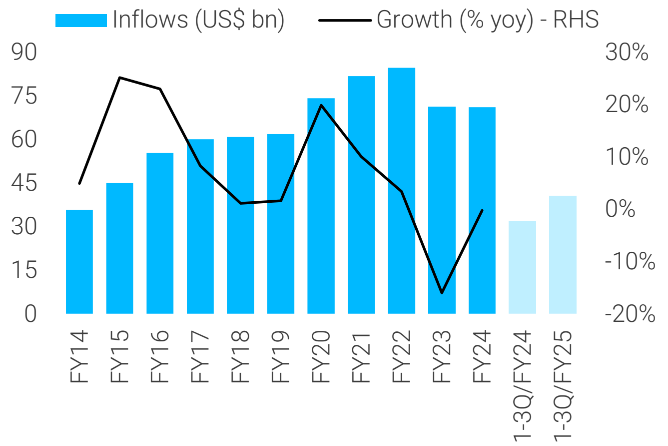
If the India-UK free trade deal that New Delhi signed earlier in May is any indicator, India will push hard to get some short-term benefits even as it cuts tariffs. India got duty-free access for 99% of its exports to the UK (mainly from labour-intensive industries) and in return it cut duties for 90% of tariff lines for imports from the UK; 85% of those UK products will become duty-free over the next 10 years. The deal also exempts Indian professionals working in the UK from social security contributions for 3 years. For its part, the UK gets a more competitive playing field for goods such as whisky and gin, as well as autos (subject to a quota) and aerospace components.

Just as India lowered tariffs on UK products, but did not scrap them, it is unlikely to agree to Trump's demand to eliminate tariffs completely. According to a Bloomberg report, the first tranche of the trade deal focuses on tariff cuts on certain industrial and agricultural goods, as well as reducing some non-tariff barriers (such as quality control requirements). Prior to his US trip this week, Commerce Minister Goyal said that the two countries are "a perfect fit" as there are hardly any products where they compete.

While our base case is that a first tranche of decreased tariffs and lower-hanging fruit will go through by the 8 July deadline, several sticking points will take longer to resolve. To start with, India insists on **data localization** to protect personal data and boost domestic infrastructure, whereas the US wants free cross-border flows to reduce costs and compliance, as well as to increase global integration. Although the interests of both countries converge in terms of tech investment in India as an alternative to China – most notably for chip manufacturing, much depends on how much the US wants to extract and how much ground India is willing to cede.

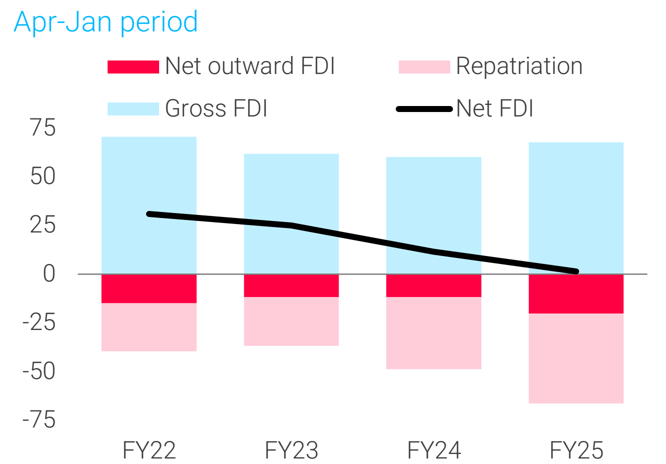
Trump's recent statement that Apple shouldn't produce in India and instead shift its factories to the US has added additional complexity to talks. The Modi government has tried to downplay those remarks by emphasizing India's competitiveness as a smartphone manufacturing hub – a major focus area for the Modi government that has been trying to attract high-value added manufacturing. Apple's iPhone production has been headlined as a prime example of the success of this strategy, which also advertises India as an alternative investment destination to China. India has been struggling to increase the pace of FDI inflows, as the charts below illustrate; although gross FDI flows seem to have recovered in FY25, net FDI inflows continued to decline due to higher repatriation and outbound FDI.

FDI inflows stagnated in recent years



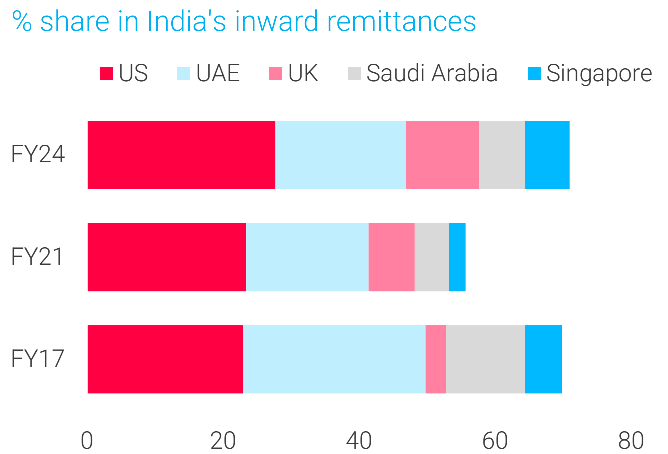
Source: Department for Promotion of Industry and Internal Trade.

Net FDI flows flat due to outward flows



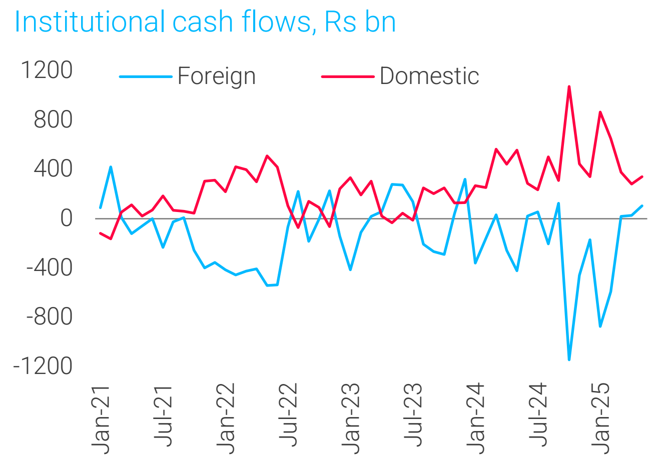
Source: Reserve Bank of India.

US is India's largest source of remittances



Source: RBI.

Foreigners return after extended selloff



Source: Moneycontrol.com.

Meanwhile, a bill from House Republicans for a 5% tax on international money transfers made by non-US citizens (since pared back to 3.5%) will potentially hurt financial flows to India, the world's largest recipient of remittances – more than a quarter of which come from the US (see chart above left). The share of remittances from the US has been rising steadily over the past few years, taking over the UAE as the largest contributor. The bill – part of the Republicans' broader reconciliation bill to extend Trump's 2017 tax cuts – just passed the House and is now in the Senate for review.

Indian markets rallied after Trump's claim last week of India offering to eliminate trade barriers raised hopes of an early deal but have since been flat as Indian industry as well as investors await clarity. The trade deal is arguably more important for India than the US given its heavy dependence on the latter for exports of goods and services as well as inward remittances. Latest data for April show a widening of the trade deficit to a 5-month high as exports dipped, indicating that exporters haven't tried to front-load exports during the 90-day pause on reciprocal tariffs.

Grid	Deal	No deal
Tariff outlook	● US to remove tariffs on labour-intensive sectors (textiles, apparel, gems and jewellery, leather), some industrial goods (chemicals and plastics) as well as agricultural products (oilseeds and fruit) ● India to give duty-free access for certain industrial goods, and lower tariffs or quotas on petrochemicals, agricultural products as well as autos (especially EVs)	● Full "reciprocal" tariff of 26% to take effect from July ● Exporters to lose market share in India's top market (vs Bangladesh, Vietnam, etc) at a time when overall export growth is already weak if rivals ink 'Phase 1' deal first ● Escalation under WTO likely, as was the case in 2018-19
Investment	● Long anticipated recovery in private investment to get a sentiment boost ● Sectors most likely to benefit are manufacturing (especially semiconductor chips and defence) ● Apple still likely to aid FDI into India's tech/AI ecosystem	● Already weak private investment cycle and FDI inflows will stagnate ● Production of Apple iPhones for export to be impacted – a negative signal to PM Modi's Make in India efforts to boost investment ● Hit to labour-intensive industries (textiles, garments, jewellery, spices)
Fiscal policy	● Government under pressure to ramp up spending as private capex remains slow to pick up and public capex has been undershooting budget estimates (it was up just 1% yoy in Apr-Feb FY25) ● Geopolitical tensions with Pakistan have highlighted the need for more defence spending as well ● Budgeted income tax cuts to weigh on revenue, squeezing the room to raise public capex while focusing on fiscal consolidation	● Even a relatively limited growth slowdown due to no deal will compound investor anxieties over weaker vs expected demand, putting further pressure on the government to raise spending ● However, the Reserve Bank of India is set to declare a record dividend transfer to the government while lower oil prices due to a global growth slowdown will also provide room for fiscal manoeuvre
Monetary policy	● Switch in RBI's policy stance to accommodative from neutral signals further rate cuts ahead as it seeks to boost domestic growth amid greater global uncertainty	● The RBI continues to actively intervene in the FX market to smooth rupee volatility as well as manage liquidity to ensure surplus

	● We expect the repo rate at 5.25% by Dec-end vs 6% currently)	● The RBI's rate cut cycle will prolong to 2026
Strategic sector tariffs	**Steel/aluminium/auto/pharma:** ● Zero-for-zero offer by India on specific products is the goal but lower-tariff quota volumes would be accepted ● Steel, pharma and auto parts are prime targets of this policy ● The Commerce Ministry on 2 May cautioned Indian exporters against transshipment and said they must adhere to US CBP Rules of Origin. ● Increased market access to boost Indian exports and provide US manufacturers with more Indian opportunities	● India to escalate retaliatory tariffs after already having filed a notification with the WTO ● Indian steel companies to more proactively seek alternative markets and rejig export strategies ● In some cases, higher tariffs globally have brought investment to India; US' Proctor & Gamble moved steel sourcing to lower-cost India's Jindal (from Sweden and Japan previously).
Geopolitics	● India's perception as an increasingly close ally of the US to increase, making it an important counterbalance to China ● Free trade deals with other countries to progress faster, with India already having signed a deal with the UK and in talks with the EU and Gulf countries.	● Cracks to deepen in US-India alliance after India refuted President Trump's claim that he negotiated peace with Pakistan, making India feel more vulnerable to rising defence partnership between China and Pakistan ● India has so far distanced itself from de-dollarisation and focused on balancing its relationship between the BRICS and the US. This may change at the margin if India feels the US is being unreasonable.
Other trade issues	● Success on the merchandise trade front opens room for talks on the services side as well, with sticky issues such as data protection, remittances and visas important areas that need to be negotiated.	● No deal impact to be felt on India's growing services exports too, the surplus from which help offset India's widening trade deficit ● The US is India's largest market for services exports as well

Mexico

- Mexico remains well-positioned to be an eventual winner of the trade war
- More tariff relief is likely by Q3/25; the big question is when
- Failure to reach a deal would aggravate US/Mexico recession risks

Mexico, the US' top supplier since 2023, remains poised to be an eventual winner from Trump's shakeup of the global trading system; the big question is when. In our base case, **Mexico is likely to number among the initial batch of countries that will secure further tariff relief** from the White House by or before the end of the first 90-day tariff pause on 8 July. Economic and electoral interests will align on this front. While USMCA partners were excluded from Trump's Liberation Day tariff scheme – putting Mexico and Canada on a separate track vs RoW for 'Phase 1' dealmaking – **USMCA competitiveness will erode should Trump fail to scale back regional tariffs in line with RoW dealmaking. Such an omission would further disrupt**

North American integrated supply chains, **threatening jobs (and votes)** ahead of the Nov 2026 midterm elections, at the same time that upcoming USMCA renegotiation talks will likely heighten investor uncertainty – unless pragmatism wins out, as we expect.

Playing a weak hand well. **Broadly speaking, the Sheinbaum government has bent over backwards to accommodate the Trump administration's demands to date**. This has included proactively stepping up raids on Mexican cartels before Trump's return to power as well as offering an unusual degree of cooperation and coordination with the US military (e.g., intelligence-sharing, joint operations, US drones/warships in Mexican territory) unseen in more than a decade. At the same time, instead of imposing tit-for-tat tariffs on the US (as Canada did), Sheinbaum has refrained from a hot-headed response. When Trump threatened last month to slap additional tariffs on Mexico for its (years-long) failure to deliver water from the Rio Grande to Texas farmers, Sheinbaum swiftly promised "immediate" water deliveries, then inked a new water agreement with the US State Dept.

As a result, Mexico today remains a relative winner vs RoW in Trade War 2.0 – aided by its preferential access to the US market via USMCA. According to recent estimates by the Economy Ministry, **some 85% of Mexico's exports that are USMCA-compliant are tariff-free**, giving Mexico a unique advantage among EMs to attract more FDI once Trump's tariff zigzags slow down.

Yet despite Sheinbaum's even-keeled approach that has helped catapult her into the ranks of most popular world leaders (80%+ approval rating as of April), tail risks from Trumpian overreach as concurrent economic and political headwinds buffet the Sheinbaum government in H2/25 cannot be discounted, as we detail below. While not our base case, this keeps a no deal scenario for Mexico a distinct risk. The longer such a scenario were to drag on (e.g., as a Trump negotiating tactic), the worse it will be for Mexico's already sluggish economy in which **exports to the US today account for about one-third of GDP** (12 months to Mar 2025).

Tariff exit off-ramps: Ball in Trump's court

Core Trump 2.0 tariffs fall into the following two general categories; below we unpack the different potential timelines and obstacles ahead of new tariff phasedowns.

1. **25% fentanyl/migration tariffs on non-USMCA compliant goods**. From an economic viewpoint, these tariffs remain a headwind on Mexico but are not the Category-5 storm that surged briefly into view when Trump first levied these tariffs on all goods imported to the US from Mexico and Canada (4-6 March) before he scaled the tariffs back to exempt USMCA-compliant products. At the time these tariffs went into effect, about half of Mexican exports and 38% of Canadian exports to the US were USMCA-compliant.

   Since then, exporters to the US that had previously brushed off filing USMCA paperwork as a result of low MFN tariffs have raced to become compliant. For auto exports – Mexico's top export category to the US in 2024 (US$194bn) totalling over 30% of its export basket – the good news is that **as of April, less than one-tenth of light vehicles and roughly one-fifth of auto parts exports sent to the US were non-USMCA compliant**, according to the Mexican Automakers Association. As of this month, the percentage of auto parts exports that are non-USMCA compliant has fallen to just 8%.

   Amid progress on that front, there are nonetheless indications that the Trump administration is just starting to get warmed up on its cartel crackdown in Mexico. Recent press reports have highlighted that **the US State Dept. is moving to block US visas for between three to four dozen high-profile narco-linked Mexican politicians**

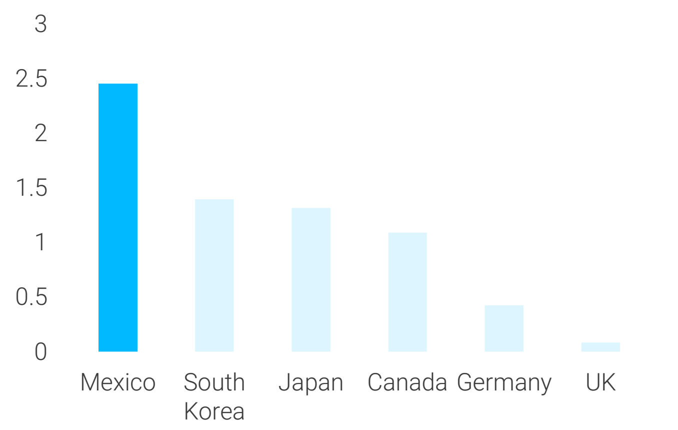
(many affiliated with Sheinbaum's ruling party, Morena). Meanwhile, following the Trump administration's designation of Mexican cartels as "foreign terrorist organizations", the US Treasury has already taken actions to freeze some financial assets of select politicians.

Top Morena leaders on the list reportedly include Lower House leader Ricardo Monreal and Senate leader Adán Augusto López as well as several Morena governors. A separate indicator to monitor is Mexico's upcoming **judicial elections** on 1 June, the country's first, with several judges reported to be affiliated with Mexican cartels who are running for election. However this plays out, growing political fireworks likely lies ahead even as the post-election landscape remains shrouded in judicial uncertainty. This all leaves Sheinbaum walking a political tightrope, with little visibility as to when the Trump administration might scale back the 25% fentanyl/migration tariffs, even if such moves may well come as a result of US domestic economic/electoral reasons rather than Mexican ones.

2. **Strategic sector tariffs (steel/aluminum, auto/auto parts).** In contrast to the murky outlook for fentanyl/migration tariff removal, there is clear economic logic for the White House to scale down strategic sector tariffs: to boost US manufacturing productivity by reducing intermediate input costs. Economy Minister Marcelo Ebrard has made it a top priority in bilateral negotiations to reduce these tariffs. He has said **he hopes to trim steel/aluminium tariffs to 16% and halve auto tariffs to 12%**, ahead of fast-tracked renegotiations of USMCA currently expected in H2/25 (vs the original mid-2026 review deadline).

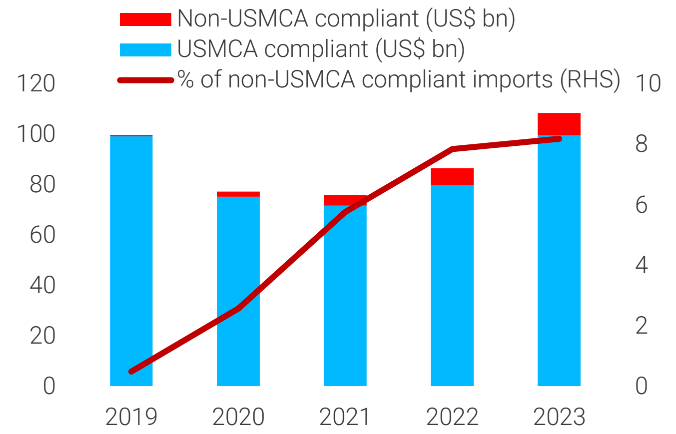
Until recently, USMCA exporters in these strategic sectors have also been granted an advantage vs RoW because Trump exempted US content for USMCA vehicle imports from the +25% auto tariff, while USMCA-compliant auto parts are also exempt (for now) from the +25% tariff on auto parts. As a result **the average auto tariff on USMCA vehicles today is 15%, not 25%, according to Economy Ministry estimates.**

Mexico was the top auto exporter to the US in 2024
No. of new automobile exports (mn units)



Source: El Economista.

Non-USMCA compliant auto imports to the US from Mexico/Canada ticked up between 2019 and 2023



Source: Brookings, USITC DataWeb, GlobalData TS Lombard.

Unfortunately for Mexico (and Canada), this advantage is by no means guaranteed under Trump's shifting tariff rules. This was evident following the announcement this month of the US-UK trade deal, with the UK's lower-tariff auto import quota (10% for first 100,000/year vehicle imports) setting off alarm bells. **A US trade group** (American

Automotive Policy Council) with members **including Detroit's 'Big Three' carmakers immediately slammed the deal, blasting it as one that "hurts American automakers, suppliers and auto workers"** by rewarding British over North American industry. While the UK's auto exports (at some 101,000 vehicles in 2024) are a drop in the bucket compared to Mexico's exports (see chart above left), it is the principle of this concession that worries US automakers. GM, for example, is already forecasting a tariff hit on profits of up to US$5bn this year.

As more RoW trading partners seal Phase 1 deals, US manufacturing will be the loser if similar concessions are granted to Asian and EU trading partners but not USMCA. Given Trump's decades-long hostility to NAFTA, we do not discount the possibility that the President might be tempted to cut off the industry's nose to spite its face, consequences be damned – a scenario that cannot be ruled out especially after Trump's recent comment that a "transitional" USMCA may no longer be "necessary". Still, ripping up the deal and replacing it with nothing will run smack into another of Trump's reported obsessions: a strong desire to keep the House in Republican hands in the Nov 2026 midterm elections.

The upshot is that growing US electoral pressures to keep the economy afloat are likely to dictate the tempo of upcoming tariff off-ramps for Mexico, even as we expect the White House will push to keep an average base level of tariffs of 5-12% in the upcoming USMCA negotiations especially in strategic sectors In the end, Mexico will make do with what it's given. **While it stands to be a relative loser under Trump 2.0 tariffs (at least vs the previous era of NAFTA/USMCA 1.0), the country is positioned to be a relative winner vs RoW.** In the new deglobalizing, reglobalizing trade landscape of half-full glasses, for Latin America's second largest economy, that may be the best it gets, for now.

Grid	Deal	No deal
Tariff outlook	● Strategic sector tariffs + higher US local content rules to be included in fast-tracked USMCA talks in H2/25 or its successor ● 5-12% average tariff to be hard to negotiate away ● Back door to Chinese triangulation of goods firmly closed off ● Team Trump may prefer bilateral to trilateral talks ● Non-trade tariff risks (e.g., migration, fentanyl, water) to stay elevated; target metrics could be included in an eventual deal	● Mexico to start to lose preferential access to the US market if other countries win deals with zero-tariff quotas in strategic sectors first ● The longer Trump fails to strike a deal, the worse it will be for North American integrated supply chains, hurting not just Mexico but the entire region's GDP ● Reduction or removal of 25% migration/fentanyl tariffs for non-USMCA compliant goods could soften the blow of no deal
Investment	● FDI to stay sluggish even after a Phase 1 deal until there is more certainty on the future of USMCA ● Investor worries over the judicial landscape to add to FDI delays even	● FDI delays and sector layoffs will grow, starting with the auto sector ● Renewable energy and other energy infrastructure buildout will stay a top priority of the Sheinbaum

	after first judicial elections (1 Jun) ● Mexico is vital to the eventual success of US onshoring – making rising FDI likely once clarity ensues ● Mexico's privileged access to US market could lead to more FDI from countries slapped with more trade barriers + higher "reciprocal" tariffs	government, but the return to state-led energy policy clouds the outlook for greater private sector growth ● The government's ability to tackle other bottlenecks (e.g., near-term energy/grid problems, water scarcity) – will suffer barring new reforms
Fiscal policy	● Finance Ministry goals to lower the consolidated nominal fiscal deficit to 3.9% of GDP (vs 5.7% in 2024) already under pressure ● Optimistic growth assumptions for 2025 and 2026 could easily compound existing fiscal fragilities, even in the event of a deal	● Fiscal plans of the Sheinbaum government at high risk ● Falling oil export revenues in event of US/global downturn to lead to even greater fiscal erosion ● Sharper risks of sovereign credit downgrade over 12-24 months
Monetary policy	● Banxico to continue its easing cycle, bringing its key policy rate to 7.5% by August ● While Banxico is currently on track to end its rate-cutting cycle there, Fed cuts in H2/25 would raise the odds for further Banxico rate cuts before yearned	● FX volatility to remain elevated, potentially spurring Banxico to pause its rate-cutting cycle early ● Recession risks high if there is no deal for two quarters . . . ● . . . leading Banxico to resume rate cuts; a prolonged recession could see rates fall below 7% this year
Strategic sector tariffs	**Steel/aluminium:** Mexico City is working to halve the 25% tariff but is willing to settle for a higher reduced rate if that is not possible. ● Team Trump may also push for a return to a Trump 1.0 agreement (to cap steel/aluminium exports to the US at a median 2015-17 level) or similar arrangement ● Shutting the USMCA 'back door' to Chinese, Russian and other country transshipments is a top US priority	● While Mexico imports more US steel/aluminium than it exports to US, the 25% tariff rate affects an estimated 4.7% of Mexico's exports totalling US$22.5bn in 2024. ● Sectors hard hit include the auto, construction and household appliance sectors. ● In 2024, Mexico was the US' No. 3 steel + No. 2 steel derivatives supplier; it was also the US' No. 1 aluminum derivatives and No. 9 aluminium supplier
	Auto: Mexico City is keen to slash the +25% auto/auto parts tariffs to a rate lower than 10% following the US-UK deal in which the UK secured a 10% tariff on the first 100,000 British cars imported to the US. ● USMCA-compliant auto exports to the US from Mexico currently have a 15% average tariff rate, as US-content is exempted from the tariff; for now, auto parts exported via USMCA are tariff-free ● Fast-tracked USMCA negotiations	● The longer it takes to reduce auto tariffs for Mexico, the bigger of a hit the North American integrated auto supply chains will see as FDI stalls. ● This is especially true if other US trading partners secure 'Phase 1' auto quotas with lower tariffs first.

	appear likely to include higher US local content rules.	
Geopolitics	● Mexico has little choice but to remain geopolitically aligned with the US, given that over 80% of its exports go to the US ● The US is likely to demand that Mexico remove Huawei and other Chinese tech giants from port/logistical infrastructure ● Tail risks of direct US military action on Mexican territory without the consent of the Sheinbaum government will persist, especially after the designation of Mexican cartels as "foreign terrorist organizations"	
Other trade issues	● Persistent trade frictions in other areas (e.g., IP theft, energy counter-reform, barriers to US GM corn, etc) must also be addressed ● This will add to delays for USMCA renegotiations to be finalized even after a Phase 1 deal is negotiated	● Mexico's huge reliance on US natural gas (at 70-75% of domestic consumption) could be weaponized by Trump

Vietnam

- **Vietnam is keen to secure a Phase 1 deal to avoid a hefty 46% Liberation Day tariff from its top export market**
- **But Hanoi's No. 4 rank in the "Dirty 15' (after China, EU and Mexico) sets a high bar for the US to bring tariffs down to the lowest level of 10%**
- **While Hanoi has offered zero tariffs and more US goods purchases (e.g., LNG, Boeing planes), the crux of the problem remains Chinese transshipment**

Grid	Deal	No deal
Tariff outlook	● Vietnam currently faces a 10% baseline tariff and a delayed 46% Liberation Day tariff ● Given the country's No. 4 rank among the "Dirty 15", a Phase 1 deal could slash the 46% rate but keep it above the 10% level ● Vietnam has offered zero tariffs on US imports and to increase purchases of US products (e.g., LNG, energy infrastructure, Boeing planes, potentially F-16 fighter jets) ● As Vietnam's export growth is driven by transshipment (including where there is value-add to Chinese inputs), a real deal depends crucially on the outcome of US-China talks. ● Vietnam is tightening supply chain rules of origin but "non-tariff cheating" will remain a big concern after a Phase 1 deal is finalized	● The US has so far opted against using tariffs to curb Chinese transshipments while the US limits self-inflicted damage. ● Failure to reach a Phase 1 deal by the end of the first 90-day tariff pause would hit Vietnam hard, as its 46% "reciprocal" tariff is among the highest for peer Asian exporters (e.g., Malaysia [24%], China [30%], Indonesia [32%], Thailand [36%]). ● Vietnam's exports to the US also accounted for ~30% of GDP in 2024 – among the largest of major US trading partners alongside Mexico ● An acrimonious collapse of US-China talks after the second 90-day pause could, in the worst case, lead to sweeping US tariffs on Vietnam/ ASEAN aimed at blocking supply chain inputs from China.

Investment	● A US trade deal will likely allow some transshipment to continue fuelling economic growth and investment but could phase in increasingly stringent rules ● A deal is also likely to include greater access and investment by US firms (e.g., oil, LNG, critical minerals, planned Trump Organization real estate deals); less certain is new chip deals unless Vietnam offers more concessions	● Singapore and South Korea are Vietnam's largest sources of FDI, accounting for nearly 50% of investment in 2024, and growing at more than 30% yoy. ● But since China has more FDI projects and local manufacturers rely heavily on Chinese inputs; China will likely grow its share of FDI if no deal is struck
Fiscal policy	● The Finance Ministry is targeting 8% growth in 2025, driven by ambitious reforms and robust consumer demand. For the moment, however, GDP growth depends on export growth, which will only be facilitated by a deal.	● Efforts to raise GDP per capita and avoid the middle-income trap rely on fiscal expansion and will be put at risk if tariffs lead to slower growth.
Monetary policy	● VND could be as much as 5-10% undervalued based on comparison with historical REER. A trade deal could mean that the central bank is pressured to allow the currency to appreciate.	● The central bank has managed the VND weaker by around 2% this year. Depreciation pressures will increase if trade talks collapse.
Strategic sector tariffs	**Critical minerals:** Vietnam has the sixth-largest reserves of **rare earths** in the world, according to a 2025 update by the US Geological Service (USGS). While Vietnam fell four places from No. 2 the year before after the USGS significantly revised down its estimates for Vietnamese reserves, Trump's focus on critical minerals means this remains a potential area for new investment and bilateral trade deals should Vietnam offer more market access	Although Vietnam has ambitious dreams of building out its domestic rare earths processing industry and becoming a global export hub by 2030, it may fail to achieve these goals as a result of a stringent regulatory framework that allow only a few companies to produce domestically. Steep US tariffs would further disincentive greater FDI in this sector, delaying hopes of faster growth.
Geopolitics	● Despite growing trade links with China, Vietnam has robustly resisted what it sees as China's encroachments on its sovereignty in the South China Sea, including fishing rights, potential oil and mineral exploitation as well as claims to disputed reefs. ● A trade deal will help Vietnam to continue to play both sides in US-China and regional disputes	● Vietnam announced plans to accelerate construction of two nuclear power plants in cooperation with Russia. Vietnam is also strengthening oil & gas and defence cooperation with Russia. ● Efforts to cooperate with the US, France, Japan and others will likely fade if there is no US trade deal, while strategic cooperation with both China and Russia will deepen.

EM: Well-placed to deal but then what?

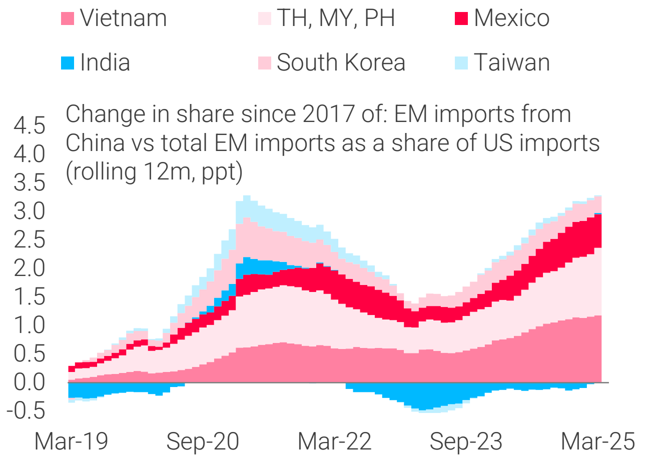
- Growing trade deal optimism will drive EM, but uncertainty has a price
- A US-China deal is key to EM sentiment and could still collapse
- After initial deals are done, EM exporters will face a tougher global environment

Growing trade deal optimism will drive EM. Trump's decision to scale back tariffs ("reciprocal" + China) while negotiations continue during the 90-day trade war hiatuses highlights the desire of the US administration to limit the scale of self-inflicted economic damage and avoid a repetition of earlier equity and bond market turbulence. The fact that the US has refrained from using tariffs to curb China's transshipment via Vietnam and others is another sign that it does not intend to further increase pressure on China (see Chart 1) or indeed further increase the cost to US importers – at least during the all-important window (May/June) for US retailers to put in their Christmas holiday season orders. Among EM, **India and South Korea remain well placed** to agree to Phase 1 deals, while **indications are also positive for Taiwan, Mexico and Brazil** (see our 19 May EM Strategy Monthly).

Uncertainty has a price. Trade deals will ultimately reduce tariffs from the levels currently threatened but will likely settle at rates that are historically high (see Chart 2). In the meantime, companies in the US and elsewhere face uncertainty that will delay hiring decisions and capex, even as higher tariffs further squeeze profit margins. Our baseline scenario is a muddle through for the US economy, but in the worst case, a deeper US slowdown could slip into recession with severe consequences for EM exporters in Asia and elsewhere (e.g., Mexico) that rely on US final demand.

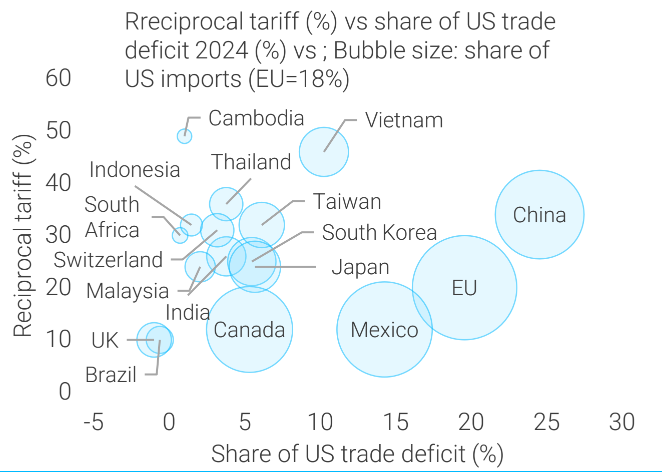
US-China trade frictions could still spill over into EM elsewhere. China is in no rush to make a deal and will continue to use fiscal policy to mitigate risks. A tariff level around 30% is likely sustainable for China given the increasing share of exports to the growing markets of LatAm, the Middle East, Africa and elsewhere, as well as the still wide-open back doors into US demand primarily via ASEAN and, to a lesser extent, Mexico (see Chart 3). China would likely prefer a deal with the US but is prepared for a protracted geopolitical struggle centred on tech rather than trade (see our 1 May China Watch). We expect an agreement to be reached, eventually, but an acrimonious collapse of US-China negotiations at the end of the 90-day truce could lead, in the

Chart 1: Back doors to US demand stay open



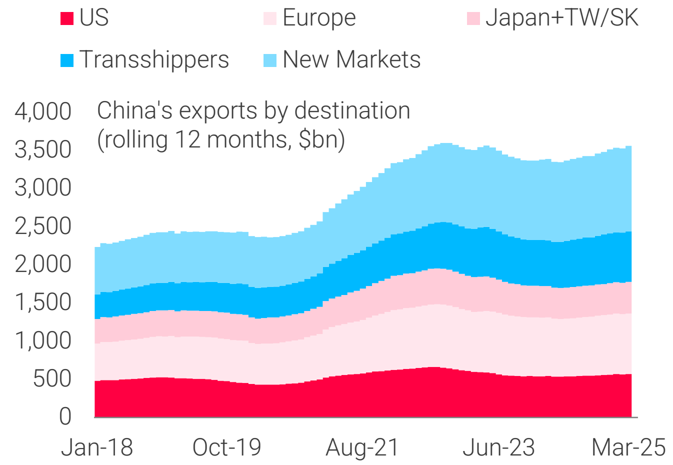
Source: CEIC, GlobalData TS Lombard.

Chart 2: Reciprocal tariffs target EM surpluses



Source: US Census Bureau, USTR, GlobalData TS Lombard.

Chart 3: China still needs US final demand



Source: CEIC, GlobalData TS Lombard.

Chart 4: Many EM depend on US demand

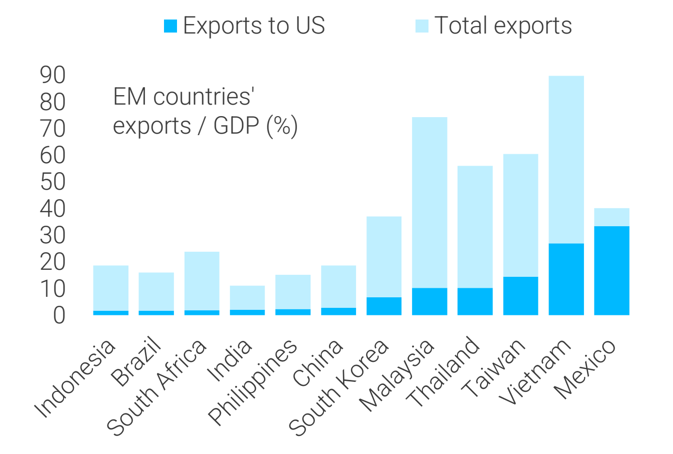
Source: US Census Bureau, GlobalData TS Lombard.

worst case, to sweeping US tariffs aimed at China's EM trading partners that have so far benefited from US-China decoupling (see Chart 4).

Falling corporate profits threaten global growth. Companies in the US and elsewhere face uncertainty that will delay hiring decisions and capex, while higher tariffs further squeeze profit margins. Our baseline scenario is a muddle through for the US economy, with upside and downside risks to growth. Growing clarity on trade war exit routes as new deals are made will gradually allow for more capex in select sectors. In the worst case, however, a deeper US slowdown could slide into recession that would hit EM exporters in Asia and elsewhere that rely on US final demand. In addition, EM exporters will be hit by the overhang from aggressive front loading by US importers ahead of Liberation Day and during the present reprieve period.

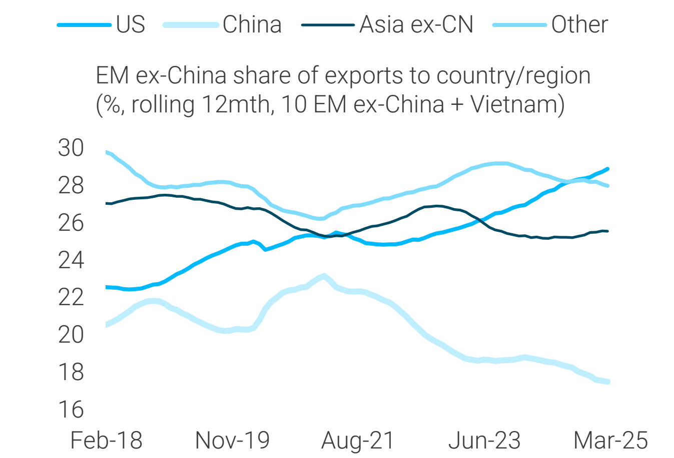
After the deals are done EM exporters will face a tougher global environment. Although we expect several EM framework trade deals to be concluded in the coming weeks, the done deal with the UK points to tariffs ending up higher than before Liberation Day, putting pressure on most EM economies, especially the ASEAN manufacturers. Exports are a material share of GDP for many EM economies, although direct exports to the US as share of GDP are relatively small for most (see Chart 5). Relatively closed economies, including India, are less exposed as are

Chart 5: Some EM less exposed to US demand



Source: CEIC, Bloomberg, GlobalData TS Lombard.

Chart 6: China's demand should increase



Source: CEIC, GlobalData TS Lombard.

commodity exporters, including Brazil. China's fiscal stimulus and structural reform will increasingly rebalance its economy away from export dependency towards domestic consumption (see our 15 May China Watch). In the medium-term, EM exporters will potentially benefit from increasing demand from China (see Chart 6).

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