

Thematic – The US election & the global trade in tariffs

Key points

- Barriers to trade - including through higher tariffs, export controls or subsidies to domestic producers - have been growing for a while and not just in the US. The recent pressure has come from concerns around (bilateral) trade deficits, manufacturing sector job loss, intellectual property theft and increasingly from national security concerns. So far, policies have generally been targeted.
- However, the upcoming US elections carry the prospect of a material increase in trade restrictions, particularly if Donald Trump returns to the Presidency. Trump has flagged tariffs on China of 60% or more as well as on imports from all other countries of 10-20%. (The implied average tariff rate is currently around 2½%).
- If the 2018-19 experience is a guide, when Trump did not increase tariffs to the extent flagged in his election campaign, the rhetoric may be somewhat ahead of the substance. But Trump defended his calls for higher tariffs in this month's debate, saying "*the tariff will be substantial.*" The prospect of a material increase in trade tensions and restrictions is a risk to global growth.
- Ultimately, tariffs work against the more fundamental drivers of macro imbalances. A stronger USD would counteract at least part of the import-dampening effect of broad-based tariffs. That leaves the direct currency implications of a new trade tariff 'war' unambiguously USD positive, both in theory and likely in practice. That said, much of the USD's appreciation in 2018 could be attributed to the Fed tightening cycle and Fed policy will therefore likely remain a major independent influence on the USD in 2025, even if a new trade tariff war ensues.
- For the AUD, downside risks stem from hits to global growth, associated 'risk-off' USD strength, weaker commodity demand and prices, as well as any material weakening in the RMB were this to form part of China's response to increased tariffs on its exports.
- The range of plausible estimates for the impact on GDP and inflation is wide, but the direction is generally clearer – if the US materially raises tariffs, GDP would be lower both in the US and abroad. US inflation would be higher, but only temporarily unless expectations de-anchor. Ultimately, while cost-push inflation may temporarily slow easing, the broader cyclical backdrop will determine the path for central bank rate settings.

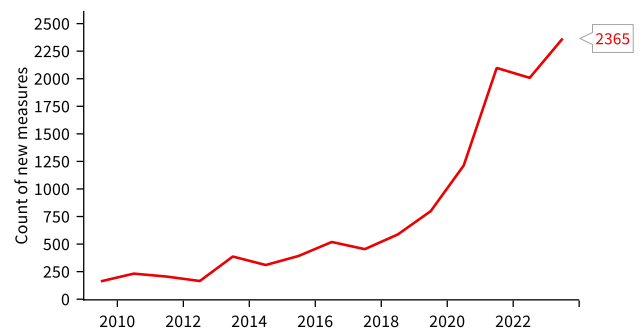
Detail

The context

The risk of a further ramp in trade tensions comes against a backdrop where friend-shoring and de-risking are already part of the policy agenda in the United States and elsewhere. The US, EU and Canada have imposed targeted tariffs on electric vehicles (EVs), and the US has led efforts to impose export controls on strategic technologies. The IMF's Gita Gopinath observed that "national security concerns are shaping economic policy worldwide."

Trade distorting measures are on the rise. There were more than 2000 new interventions in each of the past 3 years, compared to an average of just 400 in the decade prior to the pandemic. The potential cost of more heavily fragmented global trade, measured in terms of GDP, are large. The IMF estimated that trade fragmenting into two blocs would lead to long-term losses of 2 to 7% percent of GDP. Lower income and emerging market economies would be more heavily impacted. For now, though, interventions are generally targeted and aimed to lean against rising imbalances in strategic sectors.

Distorting measures negative for trade and investment



Source: National Australia Bank, Global Trade Alert

This is unlikely to change no matter who wins in the November elections in the US. Trade tensions between China and various other countries have increased in the post-pandemic period, while there have been growing concerns around overcapacity in a range of industries and accusations of intellectual property theft.

At a more macro level, weak demand in China (and strong demand in the US) have been another support for wider Chinese trade surpluses in the post-pandemic period. **Stylised estimates from the IMF** estimate weak Chinese demand boosted China’s current account surplus by about 1.5ppt, close to the increase seen in the data relative to its pre-pandemic level. Chinese authorities have been reluctant to implement policies to boost domestic consumption even as negative wealth effects, including from declining house prices, are depressing consumer sentiment. At the same time, producers have been unwilling to curtail output, leading to a surge in export volumes and a fall in prices for some goods.

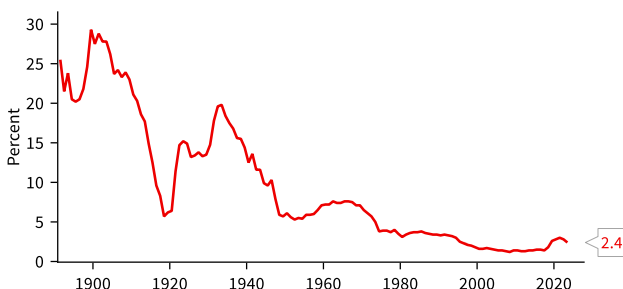
This has created challenges which are not unique to the US. The EU announced tariffs on Chinese EVs in June and Indonesia has flagged higher tariffs of up to 200% on imports from China and in Thailand and India there are calls from domestic industry groups to implement similar trade measures. Canada became the latest country to propose tariffs in late August, announcing a 100% tariff on Chinese EVs and 25% on steel and aluminium products. US election – tariffs a (renewed) focus.

The broader backdrop, where targeted policy interventions seek to shape global trade, will not change come November regardless of who wins the US election. But Trump is clearly more open to broad-based tariffs, which Harris has criticised as a “Trump tax” on basic goods. Instead, continuity with the Biden approach of export restrictions and targeted interventions would be more likely, with Harris criticising Trump for “selling American chips” during his time in office.

Former President Trump has made trade a focus of the election campaign. Most notably, he indicated he could impose a tariff of 10-20% on all imports into the US as well as a tariff of 60% or more on imports from China. He has also stated that the US has a ‘big currency problem’ (i.e., it is overvalued) with specific mention of the Yen and Yuan.

Trump, in his first term as President (Trump 1.0), put in place a range of new tariffs. While early efforts were directed at solar panels, washing machines and steel & aluminium, they were followed by tariffs of up to 25% across a broad range of imports from China. This marked the first major reversal of the easing in tariffs that had occurred since the 1970s. President Biden left the Trump tariffs largely in place, with additional targeted measures in certain industries, and a step up in subsidies or investment incentives to sectors such as EVs, clean energy and semiconductors.

US - average tariff rate (duty revenue/import value, %)



Source: National Australia Bank, United States International Trade Commission, Macrobond

Direction the same but Trump 2.0 threatens a bigger change.

While there has been notable continuity from the Trump Presidency, the tariffs flagged by Trump, if implemented, would represent a marked escalation in trade policy. In contrast, Harris has criticised the tariffs flagged by Trump as a ‘national sales tax’ which would increase prices.

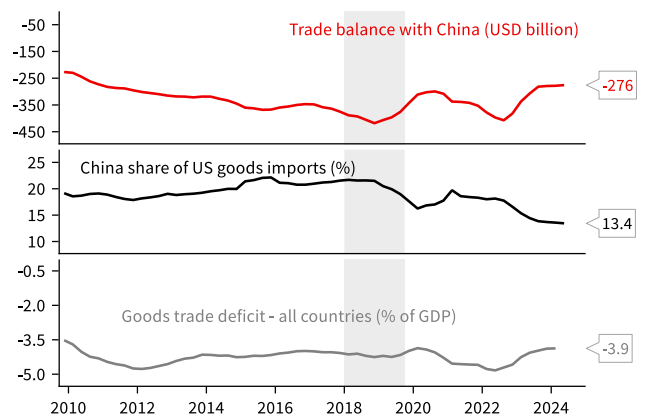
That said, we continue to parse Trump’s comments through the lens of ‘seriously but not literally.’ It also remains likely that concessions, or the prospect of retaliation, lead to outcomes that are less disruptive than initially threatened. The US and Japan reached a trade agreement in October 2019, which ended (or at least delayed) the threat of tariffs on auto imports. Similarly, the threat of tariffs was used by Trump to reach a Joint Declaration with Mexico to reduce migration. Overall, tariffs imposed over 2018-2019 did not match the 35-45% mark threatened pre-election. Trump’s recent comments threatening 100% tariffs if countries move away from the USD are more explicitly a stick to encourage other policy choices.

Tariff increases – will they achieve the desired aim?

Reducing bilateral trade imbalances and increasing manufacturing employment appear to be two key aims of the Trump camp.

Unsurprisingly, tariffs targeted at a particular country can reduce the bilateral trade deficit. China’s share of US imports has fallen materially – from around 20% when Trump started raising tariffs to now around 13%. The impact wasn’t immediate – the threat of tariffs can see imports being brought forward, and it takes time for importers to find alternative sources (or for domestic producers to take up the slack).

US-China trade indicators (rolling annual sum)



Source: National Australia Bank, U.S. Census Bureau, U.S. Bureau of Economic Analysis (BEA), Macrobond. Shaded area is the period in which tariffs on China imports were increased by Trump.

Some of this improvement may be illusory as China exports can be re-routed (and relabelled) through other countries. This may be something that just delays the impact – the Biden administration has identified concerns about transshipments of Chinese exports through Mexico and wants to address this as part of the next USMCA (the US-Mexico-Canada trade agreement) review.

Clearly a 60% (or more) tariff on imports from China would lead to a further – likely highly material – shift away from China imports. While China may retaliate, as it did last time, US exports to China are around one-third of its imports, so this would not stop the bilateral deficit narrowing.

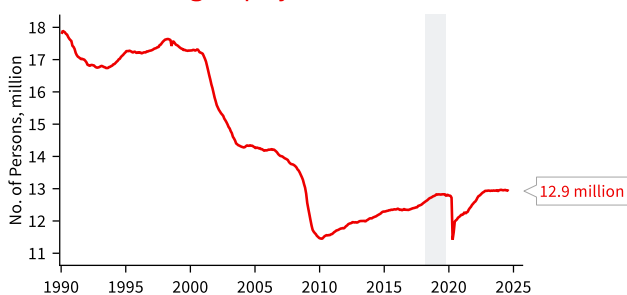
Reducing a bilateral trade deficit may be possible but reducing the overall US trade deficit is harder. While goods imports from China have declined in importance, this has been offset by increases from other countries and the overall US trade deficit (as a % of GDP) has changed little. A 60% tariff on China imports may see a shift of production to other countries (and greater imports from them) rather than a large shift to domestic production.

Imports are also inputs for a range of US manufacturers and other businesses. The rise in domestic prices is part of the rise in the real expected exchange rate that theory would suggest follows a tariff being put in place. This can also occur through a nominal appreciation of the USD, offsetting any improvement in domestic manufacturing sector competitiveness. The combination of higher input costs and USD means that a tariff effectively acts as a ‘tax’ on exporters.

More fundamentally, it is hard to achieve major improvements in the trade balance without changing savings and investment behaviour. Formally, a nation’s current account balance – of which the trade balance (on goods and services) is a major part – equals the difference between national saving and investment.

Empirical studies of the impact of tariffs find that they do not necessarily change the overall trade balance although there can be some impact¹. Studies do not find that Trump’s tariffs lifted manufacturing sector employment. While manufacturing employment rose during the 2018/19 US-China trade war, it was already trending up before this, and the rise in costs of imported inputs, the move in the US dollar, as well as retaliatory measures by China potentially reduced manufacturing (and total) employment.

US manufacturing employment



Source: National Australia Bank, U.S. Bureau of Labor Statistics (BLS), Macrobond

Possible macro consequences of a large tariff increase

While the timing and magnitude of any tariff increases under a Trump presidency are unclear, they could well be material, particularly on imports from China. As a benchmark, we can consider the impact of a 60% tariff on China imports and 10% on the rest of the world (RoW).

Based on current import values, a 60% China/10% RoW tariff on imports would raise revenue equivalent to around 1.6% of GDP. For this to be a burden solely on US importers assumes that overseas exporters do not absorb any of the tariff by lowering their export price. While historically exporters do bear some the (price) burden, studies of the 2018-19 tariff increases suggest it was largely passed through.²

Ultimately the amount of revenue raised would likely be smaller as trade is diverted, but the mooted 10% across the board tariff would still leave a tax increase of around 0.8% of GDP. The effective tax increase of 0.8-1.6% gives a starting point estimate for the impact on GDP but, if the extra revenue was used to fund reductions in other taxes or government spending, then the impact on the economy would be smaller.

The direct fiscal impacts would be magnified by other factors. As already noted, retaliation by other countries is highly likely, which would amplify costs on the US and the rest of the world. Secondly, there would likely be enormous uncertainty around the future direction of trade policy. This makes planning business decisions difficult and can lead to investments being delayed, if not cancelled. Research, and surveys of businesses, found a large impact on business investment from the 2018-19 trade war. Even so, the simple revenue approach falls within the range of estimates in recent studies, which have found an impact of 0.5% to 2.2% of GDP from a 60% China/10% RoW tariff.

While tariffs would be a drag on activity, they would also add to price pressures which will depend on:

- The extent the tariff is absorbed by overseas exporters or is avoided by switching imports from China to cheaper (on an after-tariff basis) countries.
- Whether US producers lift their prices given the effective reduction in import competition. There is evidence that this occurred, to some extent, with the 2018-19 tariffs (Amiti (2019)).
- The extent to which the negative impact on the economy weighs on broader price pressures, including through lower commodity and other export prices.
- The degree of retaliation, which may force some US

¹ For example, see Furceri, Hannan, Ostry, Rose (2019), Macroeconomic consequences of tariffs, IMF working paper, W/19/9; Flaaen, Pierce (2024), Disentangling the Effects of the 2018-2019 Tariffs on a Globally Connected U.S. Manufacturing Sector, Federal Reserve; and Boer, Rieth (2024), The Macroeconomic Consequences of Import Tariffs and Trade Policy Uncertainty, IMF working paper WP/24/13

² See Fajgelbaum, Goldberg, Kennedy, Khandelwal (2019), The return to protectionism; Amiti, Redding, Weinstein (2019), The impact of the 2018 tariffs on prices and welfare, Journal of Economic Perspectives; and Boer and Rieth (2024)

exporters to try and sell into the domestic market, putting some downwards pressure on inflation.

- The extent to which the USD appreciates in response to the tariff increase.

While there is significant uncertainty about the ultimate effects, we estimate a 0.5%-1.2% increase in (economy wide) prices as a benchmark. That assumes 95% pass through by exporters to US importers, making an allowance for US producers lifting prices (in line with estimates from Amiti), and nominal USD appreciation of 5 to 10%.

The ultimate impact on consumer inflation will depend on the degree to which US importers pass on higher costs to consumers. Evidence from 2018-19 is mixed. Washing machine pass through appears to have been 100% (or more). Another study looking at a much wider range of products found it as small as 5% although whether such a small pass through could be sustained over time is less clear.

New tariffs are more akin to a one-off shift in the price level rather than a persistent source of inflation pressure. The demand environment at the time will be the ultimate arbiter for how readily firms can pass cost pressures downstream, and if expectations are well anchored the Fed could be expected to look through much of the temporary inflationary impact. That would be more difficult coming after several years of well-above target inflation.

While the focus is naturally on the immediate consequences of a material rise in tariffs, there will be longer-run consequences as well. In particular, productivity will likely be below what it would otherwise have been. This reflects the reallocation of resources to sectors protected by the tariffs, loss of dynamism as the tariffs effectively reduce competition, or sub-optimal global supply chains as trading blocs emerge. The likelihood of retaliation by other countries, or the perceived need to protect domestic industries as exporters facing higher tariffs search for new markets, suggests that the productivity loss will likely be a global issue, not just a US one.

Tariffs and the USD

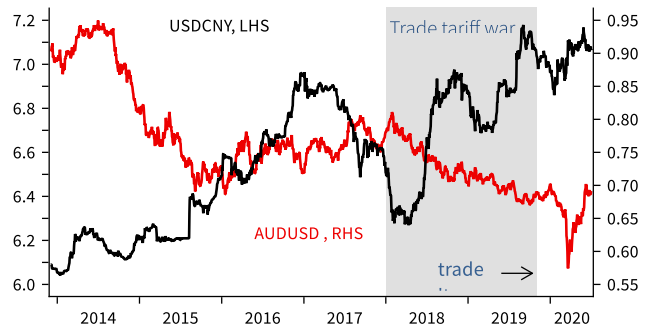
Theories about the exchange rate implications of tariffs vary in their specification but tend to coalesce in their conclusions, namely that the impact of tariffs should be broadly offset by real exchange rate appreciation (realised via higher US inflation, nominal exchange rate appreciation or some combination thereof). We should therefore be in little doubt that the *direct* or first order impact of US tariffs should be to produce USD appreciation against the currencies of countries on whom tariffs are being imposed.

And in practise, the appreciation in the USD during the 2018-2019 Trump-induced trade tariff war, and depreciation in the

CNY, validated the exchange rate theory of tariffs.

That said, a 2023³ study which examined the high frequency impact on the USD and CNY exchange rates from trade tariff news during in 2018-19 concluded that while tariff news could account for more than two thirds of the depreciation in the CNY, it could account for only about one fifth of the USD's appreciation during the same period.

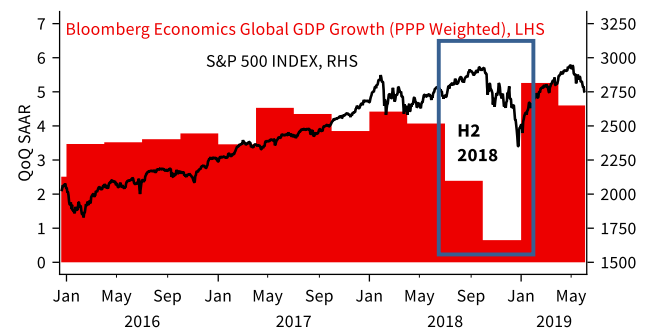
AUD and CNY



Source: National Australia Bank, Bloomberg

This chimes with our own observations from this period, which is that much of the (roughly 10%) nominal appreciation in the USD broad effective exchange rate was the result of firstly, the fact the Fed was tightening monetary policy throughout 2018, boosting the USD, subsequently compounded - in the latter part of 2018 - by a sharp slowing in global growth and associate deterioration in risk sentiment, boosting the safe haven appeal of USD assets. In short, generalised USD strength in 2018 was out of all proportion to the theoretically implied impact on the USD, bearing in mind that the Trump-era tariffs were mostly directed at China and to a very limited extent on other US trading partners.

Global Growth and Equities



Source: National Australia Bank, Bloomberg

This is of vital importance in assessing the potential USD impact of any Trump 2.0 era tariffs. If Trump were to proceed with tariffs of 10% (or more) on all US imports with only few exceptions, the direct exchange rate impact should in theory be very much larger than in 2018, bearing in mind that a 60%

³ Jeanne, Son, John Hopkins University Oct. 2023. To what extent are tariffs offset by exchange rates?

tariff increase on all China imports and 10% on tariffs from the rest of the world would represent about a 5x bigger tariff impost than in 2018-2019. Yet in practice if, at the same time, Fed policy is in easing mode through 2025, as currently projected and assuming tariffs came in soon after a re-elected President Trump took office, there could be a powerful force working on the other side of the USD equation. Much would depend on whether the inflationary consequences of tariffs feed through to a tighter-than-otherwise Fed policy disposition or are overlooked on the premise that they represent a one-off price level shift. Much would likely depend on whether inflation expectations remain anchored and whether broader economic conditions are tight enough to spur second round effects in wages and broader price increases.

Our overall sense is that while there could be competing forces on the US dollar (upward from tariffs, downward if the Fed remains in easing mode), it is the extent to which a new round of trade tariffs impacts on global growth that will ultimately determine the direction the USD takes. Thus, even if Trump-initiated tariffs prompt retaliatory tariff measures by impacted US trade partners, which from a trade theoretical standpoint should counter the pro-USD impact of US tariffs, to the extent a tit-for-tat trade 'war' results in a material hit to global growth as occurred in H2 2028 - we would expect the USD to be a net beneficiary, via a burnishing of its safe-haven status.

Further complicating the exchange rate question is whether countries threatened with tariffs either attempt to head them off via exchange rate adjustments beforehand – or in response to tariffs in an effort to get them removed. Yet except in the case of countries with managed exchange rate regimes (notably China), exchange rates are to a large extent a function of relative monetary policy and (real) yield considerations and which should for the most part be driven by domestic inflation and growth considerations. (In this regard we view the 'success' of the 1985 Plaza accord in bringing about a weaker USD as in large part the result of the Fed having embarked on an easing cycle some months before the accord was struck). Unless a Trump presidency succeeds in its stated ambitions to undercut Fed independence, publicly stated desires for a weak USD aren't likely to get far beyond what is supported by the stance of Fed policy.

Ultimately, tariffs work against the more fundamental drivers of macro imbalances, and currency markets can be expected to counteract some of the direct tariff impact while those fundamental drivers persist.

Specifically for the AUD, the currency would need to contend with both the direct implication of a large-scale tariff increases on Chinese imports and the extent to which CNY depreciation forms part of China's response, as well as the indirect effect from the (negative) global growth implications of tariffs imposed on other US trading partners as well as China. Both are unambiguously negative for the AUD. Indeed, in so far as the imposition of 60% tariffs on China would represent an increase nearly four times larger than during

Trump 1.0, it would require a much bigger CNY depreciation than occurred in 2018 (circa 10%) to offset. The read through to AUD were this to occur would be dramatic, yet we are hesitant to forecast such action by China. It risks further retaliatory actions from the United States, in similar vein to Trump's recent threat to impose 100% tariffs on trading partners who attempt to shift away from using the US dollar.

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