An update on recent developments

April 2025

NAB Economics

What happened?

Last week, the US government announced a significant increase in tariffs on US imports. President Trump announced a 10% baseline tariff on imports (with limited exemptions), with higher tariffs for a number of trading partners running large bilateral trade deficits with the US.

The changes to tariff rates were much higher than expected and pose a material downside risk to both US and global growth. These announcements are the biggest shift in US trade policy in a century and at face value, represent a tax hike of 2.4% of GDP for the US economy (the largest since the late 1960s).

In response, we revised our 2025 US growth forecast down (again); see *"US Economic Update post tariff announcement*" for the detail. The forecast revision simply marks-to-market the tariff announcement. A summary of our forecast changes for 2025 is: lower GDP growth (0.6% from 1.3%), higher inflation and a higher unemployment rate peak. While we are not yet forecasting the US economy to contract, risks of a US recession are clearly elevated.

Key transmission channels for the US economy are household consumption (real disposable income growth will slow sharply as inflation rises to around 4% y/y) **and business sentiment** (elevated uncertainty deters hiring and capex spend). Negative wealth effects from falling equity markets will also impact household consumption.

Given considerable uncertainty about what happens next (retaliation, negotiation and fiscal policy etc.) there is a wide band of uncertainty around these forecasts, and it is fair to say that risks to our forecasts remain biased to the downside. **We have added one 25bp rate cut for 2H25 into our Fed profile** as a result of the forecast changes. While the Fed may possess some hesitancy to act pre-emptively given the near-term inflationary impact of tariffs, we don't believe this should be mistaken for a reluctance to act decisively if growth slows and unemployment rises.

There are some longer-term and potentially major risks around last week's announcement. One is a complete re-organization of global supply chains (a meaningful negative supply side shock to the US and a negative productivity shock for the globe); the other is a loss of confidence in the US dollar. Given the extent of capital flows into the US in the past decade, both of these risks take on additional significance.

What it means for Australia

Australia was one of the "lucky" countries, hit with only the 10% baseline tariff on our exports to the US (outside of aluminium and steel). We have written in the past week on the composition of Australia's export basket to the US and what the most recent tariff announcement implies; see our recent notes *"Australian export exposures by industry"* and *"AUS: US tariff announcement and Australia".*

From the top-down, the 10% tariff on Australian exports to the US is not significant. Australia's exports to the US comprise just ~4% of our overall export basket, and so the direct macro-economic impact will be small. This is not to discount, however, the impact at an industry and / or firm level.

Indirect impacts may turn out to be more significant for Australia. In particular, the new tariff regime imposed elevated tariffs on many Asian countries, including China, which comprise a much larger export destination for Australia. China has since announced retaliatory measures, increasing the tariff rate on all US imports by 34%. Other measures included export controls on some rare earth mineral items. **The extent to which China announces new measures to support its economy via fiscal and monetary policy will be an important development in assessing the broader impact of tariffs on Australia.**

We have not made any changes to our Australian economic forecasts as yet, but the direction of likely forecast changes is not difficult to predict. **After last week's developments, risks to both the growth and inflation outlook are biased to the**

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downside. Nonetheless, the starting point is favourable – our unemployment rate is low and core inflation was already expected to return to the RBA's 2-3% target band by 2Q.

We continue to expect the RBA to deliver a 25bp rate cut in May, and a further 75bp of easing through to February 2026. The May easing is likely to be conditioned on a better-than-expected print for the RBA on Q1 inflation and a shift in the distribution of risks to domestic and global economic growth. Beyond May, further rate cuts are premised on a view that a return to a more neutral policy setting is an appropriate first step, given recent developments. We see risks to our RBA profile as tilted to the downside, acknowledging the risk that RBA may need to take policy settings to an expansionary footing.

For businesses, elevated uncertainty will be the key issue (particularly for those in export intensive industries) and for households, the key risk is that businesses slow hiring and investment in response to greater uncertainty. One possible positive for Australian households could be stable-to-lower prices as a result of trade diversion. Note also that there is ample scope for policy stimulus to provide support for households and businesses if the global economy enters recession.

Our forecast of stronger GDP growth in 2025 for Australia is predominantly a domestic story driven by a pickup in consumption and investment, and thus is not overly reliant on a pickup in export growth. But it is reliant on business and consumer confidence not weakening materially from here, and so the local policy response will be an important support for local economic agents facing into an uncertain global outlook.

Financial Markets

Financial markets have reacted with some large moves in recent trading sessions. Increased risk aversion and a repricing of the economic outlook have driven a large decline in global equities, spurred a rally in sovereign bond markets and a sell-off in the US dollar. The Australian dollar did not fare well on Friday night, falling ~5% towards the USD60c level.

Looking ahead, it is likely that volatility across equity, rates and FX markets will remain elevated. In the US, it appears that absent an immediate policy shift, equity markets will need to find valuation support before stabilising. The combination of earnings downgrades and potential for a further de-rating of the market (a lower P/E multiple) highlights the risk of additional downside for equity indices.

In FX, our forecasts remain unchanged for now, given that at this stage we simply don't know where we are going to land in terms of tariffs, the economic ramifications of US policy and the reactions from other trading partners. **The AUD doesn't perform well during extreme bouts of risk aversion, suggesting near term downside risks remain dominant**.

Looking further out in time, we see the currency ending 2025 in the mid 60s. Given the low starting point, our key assumption that China will look stimulate its economy while keeping the CNY relatively stable and the appeal of relatively attractive real yields in Australia, we expect support for AUD/USD in coming quarters.

The potential for the USD to lose some of its reserve currency dominance is a big swing factor that potentially offers more AUD upside over the medium- to long-term, in our view. This may offset any headwinds that arise for a growth sensitive currency like AUD from a structurally lower global growth outlook.

In fixed income, we remain cautious on credit spreads and view AUD 10Y government bonds as cheap on a spread of +25bp to the US. Unlike the Federal Reserve, the RBA won't be constrained by fears around de-anchored inflation expectations. In the short-term, this may open up scope for the RBA to ease sooner and by more than its US counterpart.

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