The Forward View - Global May 2025

US/China agreement lifts global growth forecasts for 2025 and 2026

NAB Economics

Overview

While the US-China trade détente represents a significant de-escalation from the extremes of early April, tariffs imposed by both countries are well above the last year's levels, as are US tariffs on other countries. With the US considering sector specific tariffs and Liberation Day 'reciprocal' tariffs above 10% only on pause until 9 July (mid-August for China), there is still significant uncertainty on where US tariffs ultimately settle.

The US and UK trade agreement maintained the minimum 'reciprocal' tariff rate of 10% but provided some preferential access in some areas. The UK runs a trade deficit with the US, meaning it has not been a target of US trade policy. This suggests that a 10% tariff rate, with some exceptions, may be the best outcome, with the risk that higher rates ultimately are imposed on a range of other countries. The latter scenario would be a negative for a broad range of emerging economies, particularly in Asia.

For now, **the reduction in US-China bilateral tariffs goes some way to reducing the damage of the April tariffs**. Apart from lowering the direct trade impacts (and a reduced fiscal drag on the US), financial markets were boosted by the news, leading to an improvement in financial conditions (including a recovery in equity prices). However, US tariffs remain high, the continued uncertainty about US tariff policy will remain a drag on business decision making and it is unclear whether business and consumer sentiment will be fully restored.

As a result, **while we have revised up our forecasts for global growth in 2025 and 2026 from post Liberation Day estimates**, we still expect growth to take a step down from its 2024 pace, to a low rate by historical standards.

While the focus is on trade policy, other policy settings will be important. The US Congress is in the midst of a budget reconciliation process, and its looks likely that US fiscal policy will turn stimulatory in 2026. While the reduction in US tariffs is a positive for China growth prospects, this could potentially reduce the scale or delay the implementation of fiscal support to the economy (which we expected would be reactive to the trade slowdown). Energy prices have also softened – while this is partly owing to expectations of weaker demand growth, it also reflects an unwinding of voluntary production cuts by OPEC – all else equal, this represents a (small) positive supply shock in what has otherwise been a year of growing policy headwinds.

We forecast the global economy to grow by 2.9% in both 2025 and 2026 (previously 2¾% in both years). As we have noted in recent months, the confidence bands around our forecasts are unusually wide at present – reflecting the high level of policy uncertainty in the current economic climate.

Contents

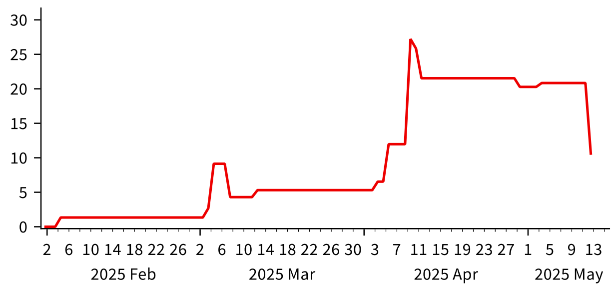
Key Economic Forecasts

	2024	2025		2026	
US	2.8	1.6	(0.3)	1.7	(0.2)
Euro-zone	0.8	1.0	(0.1)	1.3	
Japan	0.1	0.9	(-0.1)	0.6	(0.1)
UK	1.1	1.1	(0.2)	0.9	
Canada	1.5	1.2	(0.1)	1.0	(0.2)
China	5.0	4.3	(0.2)	4.0	(0.1)
India	6.3	6.0		6.2	
Latin America	2.4	1.8	(0.2)	1.7	
Other East Asia	4.0	3.4		3.3	
NZ	-0.5	0.8		2.7	
Global	**3.3**	**2.9**	**(0.1)**	**2.9**	**(0.1)**

(Change since April Forward View in brackets)

US tariffs – two steps back, one step forward

Cumulative change in US average tariff rate in 2025 (ppts)



Source: National Australia Bank. NAB calculations based on 2024 trade flows before substitution effects. 75% of Canada/Mexico exports to US assumed to be USMCA compliant and 40% of content of Can/Mex. auto imports assumed to be US in origin. Auto parts tariff assumed to be implemented 3 May

21 May 2025 | Authors: Gerard Burg, Antony Kelly

Global trade & tariffs

The key development in global trade in May was the relative success in US-China trade talks that led to a significant de-escalation in the trade war. Both sides agreed to reduce the general bilateral tariff rate imposed this year by 115ppts – to 30% for the United States and to 10% for China – although 24ppts of the tariff reduction is only paused for 90 days. While this represents an improvement when compared with the escalatory period of early April, tariffs imposed by both countries are well above the levels prior to this year. In addition, where these bilateral tariffs, along with the US's reciprocal tariffs on other countries, ultimately land at the end of the respective pauses is uncertain.

The first signals around the Trump Administration's longer term trade strategy were revealed with an 'Economic Prosperity Deal' (EPD) between the US and United Kingdom in early May. The EPD maintains a baseline 10% tariff on most imports from the UK (which was the rate under the reciprocal tariff regime), but provides a preferential 10% tariff on motor vehicles (compared with the 25% rate for most countries) up to a quota and exempts some steel and aluminium as well as jet engine imports. It has been suggested that the UK will also have a preferential rate with respect to impending pharmaceutical tariffs.

This is likely to be the best position any country will face in trade with the US, given that the UK runs a trade deficit with the US. What remains to be seen is whether 10% or, where different, the full reciprocal rate announced on 2 April may be the starting point for negotiations. The latter would be a negative for a broad range of emerging economies, particularly in Asia.

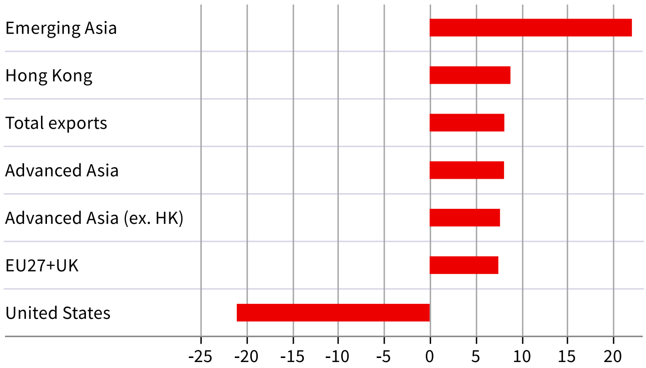
Reports suggest that other countries are attempting to reach agreements with the United States ahead of the end of the reciprocal tariff pause on 9 July. President Trump has indicated that at a certain point the US will notify countries of the rates that will apply, while the US Treasury Secretary stated that countries that do not negotiate in good faith will have the full Liberation Day 'reciprocal' tariff rates applied.

The European Union is currently holding trade negotiations with the US, but has signalled that it intends to increase countermeasures should talks fail – proposing a list of US$100 billion worth of US goods that could face trade measures.

Another key factor in US trade relations is the issue of trans-shipping – particularly efforts to disguise China as the origin of goods delivered to the United States. While China's exports to the US plunged in April (down over 20% yoy), exports to emerging Asian economies surged. Vietnam is widely seen as a key market for trans-shipments – with 38% of its total imports coming from China in 2024. Vietnam's Trade Ministry issued a directive to crack down on trans-shipments. The directive stated there would be a strengthening in supervision and inspection of imported goods, as well as the countries factories to provide greater assurance over "Made in Vietnam" labelling. The threat of punitive tariffs from the United States for accepting China's trans-shipments may be sufficient to limit (and possibly even reduce) this channel for Chinese exporters.

There also remains uncertainty around the timing and scale of proposed US sectoral tariffs on products such as copper, semi-conductors, pharmaceuticals and lumber.

China exports to major trading partners (% yoy April 2025)

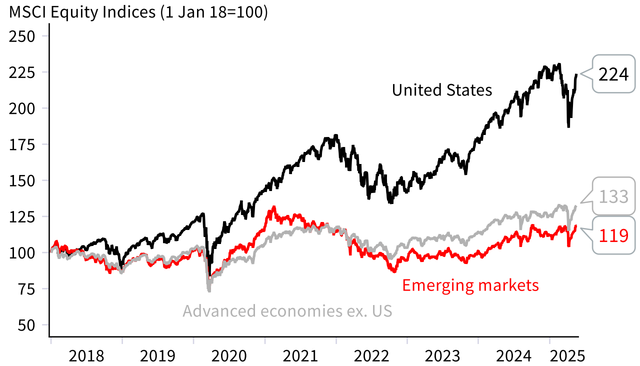


Source: Macrobond, NAB Group Economics

Financial markets

Financial markets responded positively to the US-China trade détente. Global equity markets recovered their losses associated with the early April reciprocal tariff announcement by early May. That said, at the time of writing, US equities remain below the peaks recorded in February – prior to the acceleration in US policy uncertainty.

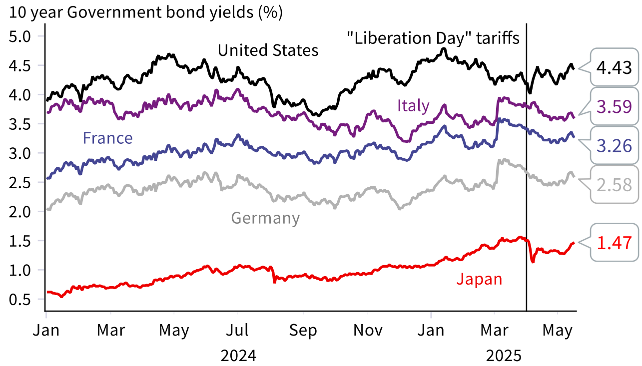
MSCI Equity Indices (1 Jan 18=100)



Source: Macrobond, NAB Group Economics

Advanced economy government bond yields have generally trended upwards since early May – having tracked lower following the Liberation Day tariffs in non-US markets, and exhibited volatility in the US over this period – likely an indication of improved market sentiment around economic prospects following the US-China trade talks.

10 year Government bond yields (%)

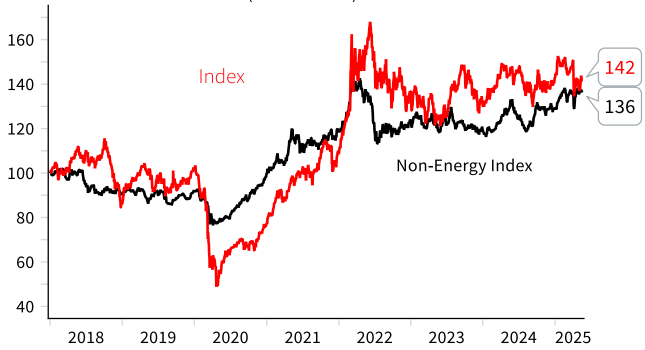


Source: Macrobond, NAB Group Economics

The weaker prospects for global economic growth following the Liberation Day tariffs had an impact on commodity prices. The S&P GSCI measure dropped sharply from its level on 2 April, with subsequent volatility in prices around a lower level. Most of the movement, particularly after the initial shock, has come in energy markets.

This reflects both the softer market expectations for global demand and the expansion in supply, as OPEC+ has started to unwind the voluntary production cuts in introduced in October 2022. That said, there may be limited further downside to oil prices, given that they are already in the range of breakeven estimates for US shale producers – which have been the key source of supply growth in recent years.

S&P GSCI Commodities Indices (1 Jan 18=100)



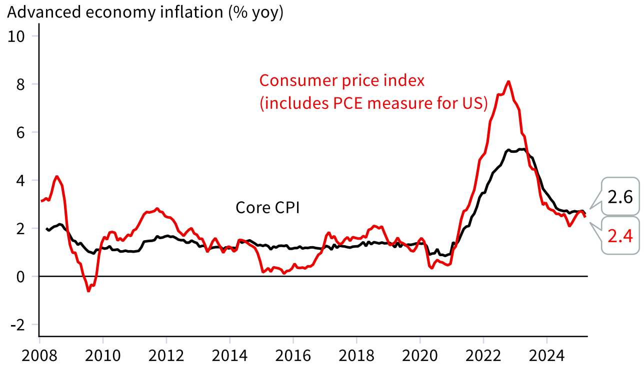
Source: Macrobond, NAB Group Economics

Inflation and monetary policy

Headline inflation in the major advanced economies (AEs) eased in March – down to 2.4% yoy (from 2.6% yoy in February). The main driver of this trend was a slowing in US PCE inflation – down to 2.3% yoy (from 2.7% yoy previously) on steep falls in crude oil prices, while inflation across the EU-27 also eased.

As we have previously noted, most of the movement in inflation has been in volatile items, such as food and energy. Core inflation in advanced economies dipped just below 2.6% yoy in March (from 2.7% yoy in February) – still well above central bank targets.

Advanced economy inflation (% yoy)



Source: Macrobond, NAB Group Economics

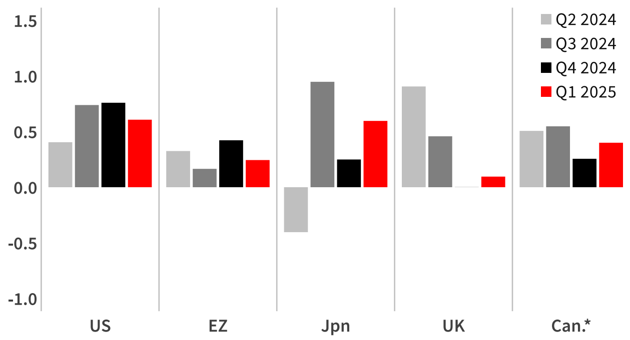
There has also been a notable difference in inflation trends between goods – where price growth has been comparatively modest in most advanced economies – and services, where inflation has persisted at higher rates. This trend has been evident since mid-2022, although this could shift in the US as tariffs impact the cost of imported goods in coming months.

Following the US-China agreement, we shifted our expectations for the resumption of US Federal Reserve cuts to its October meeting (from July previously). The improved growth outlook points to less pressure for the Fed to move from its full employment mandate, while it will still want to lean against the risk of inflation expectations de-anchoring. The latter risk remains even post the agreement, as inflation is still set to rise significantly and a more modest slowdown (and so less spare capacity opening up) means a weaker constraint on second round price effects. We expect 50bps of cuts in Q4 followed by a further 75bps over 2026 (taking the fed funds rate target range to 3.00 to 3.25%). Rates could be cut sooner if unemployment rises more rapidly than anticipated but could stay on hold for longer if the US economy remains resilient or there is evidence of broader price pressures.

Advanced economies

There was a material slowdown in economic growth across the major advanced economies (AE) in Q1 2025 (with only Canada still to report). Major AE growth was 0.1% q/q, the weakest outcome in three years. This comes after several quarters of strong growth and data measurement issues are likely exaggerating the extent of the slowdown.

GDP (q/q%)



Source: Macrobond. Canada Q1 2025 is a NAB forecast

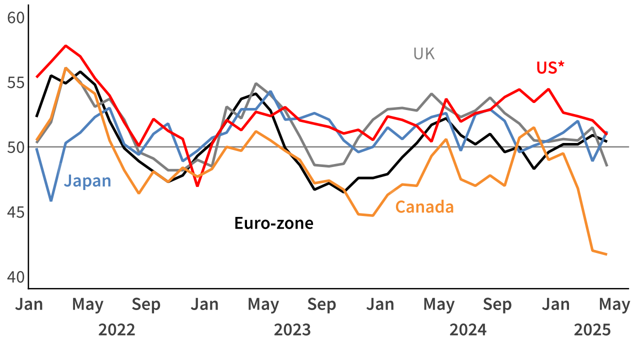
The Q1 outcomes were also varied across the major AEs. US and Japanese GDP declined, Euro-zone growth was solid (and on par with prior quarters), while the UK grew strongly.

In contrast to their GDP declines, domestic final demand grew in both the US and Japan. The GDP falls were due to a large net export detraction from growth because of strong import growth. For the US, it was an historical high and the surge in imports was not fully reflected in final demand or inventories while other indicators do not signal a contraction in domestic production. This points to measurement issues in the face of large trade swings ahead of tariff increases (that may be addressed in subsequent revisions).

There was some evidence of tariff front running in other data – US industrial production has lifted while there was a large increase in Euro-zone pharmaceutical production (consistent with a surge in US pharmaceutical imports). To the extent activity is being brought forward, there will be a subsequent (also temporary) dip, but with some tariffs still expected (e.g. on pharmaceuticals and semi-conductors) or possible (full reciprocal tariff rates), whether there will be a net bring forward of activity in Q2 is uncertain.

Business surveys for the US point to softer growth this year, rather than declines. There has been a significant fall in the Canada PMI, reflecting its large trade exposure to the US and points to the risk of its economy contracting. The UK PMI has also softened, perhaps in part due to trade concerns but also due to tax increases; the decline in April to below break-even coincided with the introduction of increased national insurance contributions for businesses.

Composite PMIs



* Based on S&P Global and NAB weighted composite of US ISM PMIs

The significant reduction in the US-China bilateral tariff rate this month, as well as the improvement in financial conditions, led us to revise up our US growth forecasts. US growth over 2025 is still expected to be weak, as the tariffs put in-place this year remain substantial, and the continued uncertainty over future policy settings is likely to lead some businesses to defer major capital expenditures. At the same time consumer sentiment remains very weak, although this hasn't yet clearly impacted consumer spending.

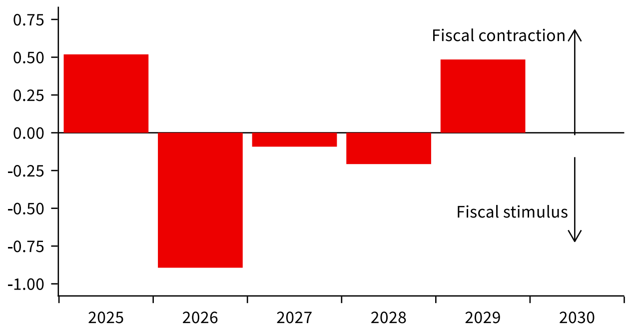
Stronger US (and China) growth, and an improvement in financial conditions, should support activity in other countries. However, modelling suggests the direct trade impact of relatively high tariffs on China can benefit some regions, including the Euro-zone and Canada as China is a competitor in the US market (but not so much Japan which is heavily integrated into east-Asia supply chains). As a result, we have made only small upwards revisions (overall) to our non-US major AE forecasts.

We expect growth to start recovering towards the end of 2025 and into 2026. This reflects our technical assumption of no changes in tariffs from their current level, monetary policy easing, as well as an expectation that US and Euro-zone fiscal policy will turn stimulatory.

Tariffs are a tax and at current levels are imposing a fiscal drag of over 1% of GDP in the US. However, the House bill being developed as part of the reconciliation process provides a guide to what may happen. While the net cost of the bill over a ten year period is less than simply extending expiring TCJA tax provisions, the 'savings' are back-ended. Based on estimates by the Committee for a Responsible Federal Budget (CRFB), the House bill (as of 15 May) has a fiscal impulse of a bit under 1% of GDP in FY 2026.

This House bill has not been passed yet, does not account for tariff revenue, and the Senate is yet to have its say in the process, but broadly our assumption that there will be fiscal stimulus in 2026 appears reasonable at this stage. Similarly, our 2026 forecasts for the Euro-zone also assume fiscal stimulus (particularly in Germany) although the timing and magnitude remains uncertain.

Change in US primary deficit - House recon. bill (% GDP)



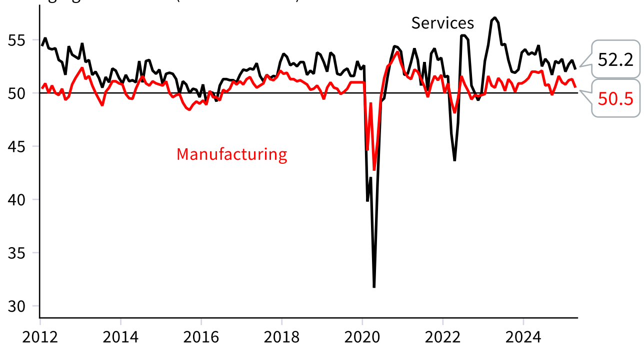
Source: National Australia Bank, CBO, CRFB, NAB

Emerging markets

Business surveys in April provided the first signs of negative impacts related to US trade policy and the heightened levels of uncertainty. That said, the EM composite PMI only edged lower, down to 52.0 points (from 52.6 points in March) – albeit both manufacturing and services were softer.

The EM manufacturing PMI fell to 50.5 points in April (from 51.3 points previously) – driven by weaker readings for China and Indonesia – with the reading plunging in the latter. While the fall in China's PMI was relatively modest, the measure of business confidence fell to its third lowest on record.

Emerging market PMI (Breakeven = 50)



Source: Macrobond, NAB Group Economics

There was a larger decline in manufacturing PMIs across East Asia than China– with Vietnam falling sharply, along with Indonesia noted above, while Malaysia's reading has been in negative territory for several months. The close trade ties with China, along with uncertainty around the reciprocal tariffs (which would hit the region particularly hard), may have impacted this outcome.

The EM services PMI was also weaker in April – at 52.2 points (from 53.1 points previously). Again, China was the key driver of this trend, along with a much weaker reading for Brazil. While services have not been directly impacted by tariffs, they appeared to impact sentiment in China's services sector, which fell to its weakest levels since February 2020, when COVID-19 was emerging.

In May, the People's Bank of China (PBoC) announced another round of monetary policy easing that was broad in scope (with a range of targeted measures including support for motor vehicle financing, agriculture and small business, as well as support for consumer goods trade-in and business equipment upgrade programs) but modest in scale – with the 7 day reverse repo rate and Loan Prime Rate trimmed by just 10 basis points along with a 50 bps cut to the Reserve Requirement Ratio (RRR). These measures are unlikely to provide much of a boost in an environment where loan demand is weak. Cuts to the RRR in 2024 helped to fuel a rally in government bonds as banks searched for viable returns in the absence of borrowers.

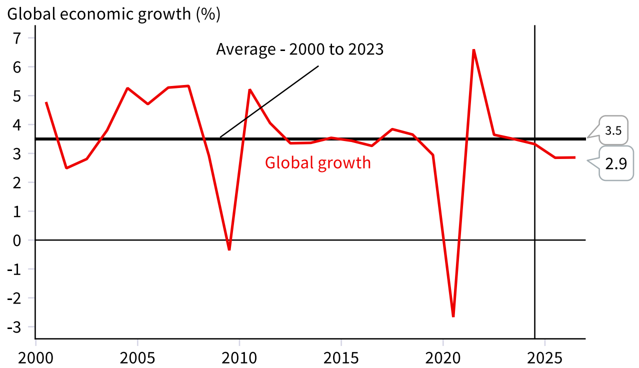
There has been speculation that Chinese authorities are holding back fiscal support until there is greater clarity around the US trade relationship and its impact on the domestic economy. This may come following the Politburo's economic affairs meeting in July.

Forecasts and risks

Last month we made some significant cuts to forecast economic growth for both the United States and China, along with smaller revisions to a broad range of related economies, reflecting the impacts of the escalation in tariffs in early April.

The 90 day pause announced following the US-China talks in Geneva go some way to reducing the damage of the April tariffs. However, trade barriers remain much higher than they were in March and the continuing uncertain direction of US trade policy from here (and the negative flow through to business decision making) – means that even with a somewhat improved economic environment than a month ago, we still see weaker prospects than we did in March.

We forecast the global economy to grow by 2.9% in both 2025 and 2026 (compared with our previous forecast of 2¾% in both years). Growth at these levels would still represent low levels of global growth by historical standards. As we have noted in recent months, the confidence bands around our forecasts are unusually wide at present – reflecting the high level of policy uncertainty in the current economic climate.



Source: Macrobond, NAB Group Economics

This upward revision includes a stronger forecast for China's economic growth. Less restrictive tariff rates – should they remain in place – would see a lower contraction from growth from exports in 2025 than we anticipated in April. That said, this could send the wrong signal to Chinese authorities – potentially reducing the scale or delaying the implementation of fiscal support to the economy (which we expected would be reactive to the trade slowdown). We see China's economy expanding by 4.3% in 2025 and 4.0% in 2026 (compared with our April forecasts of 4.1% and 3.9% respectively) – which remains a weaker outlook than prior to the Liberation Day tariffs.

Trade policy remains the key uncertainty to our global outlook. While the pull back in US and Chinese tariffs from the extremes of April is a positive, US trade barriers remain at levels that, prior to this year, have not been seen for over 80 years.

There remains the risk that the tariff escalation could resume in coming months. Firstly, the Trump Administration has flagged further sector specific tariffs on a range of products – including pharmaceuticals, semi-conductors, copper and lumber – that are likely to be applied to all countries. Secondly, it remains unclear what will happen at the end of the 90 day pause for reciprocal tariffs in July or the US-China bilateral pause in August – with a risk that failed negotiations could see tariffs return to their 2 April levels, while successful talks may lower tariffs from current rates. If US tariffs do rise from here, so may retaliatory measures by other countries, raising a repeat of the US-China tit-for-tat measures in April.

How other policies react to the tariffs that have been put in place, as well as any future US actions, will also be important to how the global economy evolves. This includes fiscal policy – as noted above we expect fiscal policy in the US and Eurozone to turn stimulatory (although the magnitude remains uncertain). It is possible that other countries will use fiscal and other policy supports to shield their economies from the impact of the global growth slowdown. For countries with high debt levels and unstainable fiscal trajectories (which includes the US), how bond markets react to any fiscal measures will be important.

Geopolitical factors could also have an influence on global trade, confidence and investment. While reports suggest that peace talks between Russia and Ukraine could soon commence, it is far from clear whether this conflict can be rapidly resolved. Similarly, tensions between multiple countries in the Middle East persist, which could counter recent easing in oil supply pressures. More generally, the trade and foreign policy approach of the Trump Administration may have negatively impacted the relationship between the United States and its closest allies, which could have longer term geopolitical consequences.

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