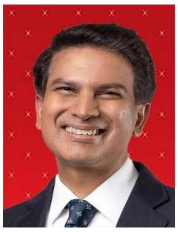
Macro Insights Weekly
The coming trade shock and Asia

Group Research

January 20, 2025



Taimur Baig
Chief Economist
taimurbaig@dbs.com

Chang Wei Liang
FX & Credit Strategist
matieying@dbs.com

Please direct distribution queries to
Violet Lee +65 68785281 violetleeyh@dbs.com

- *The US is about to ramp up tariffs and other trade restrictions on allies and foes alike. How is Asia placed to deal with the impending shock?*
- *Average tariff rate on all imports could more than triple from the average of past half-century.*
- *This has strong near-term inflationary implications for the US.*
- *Exchange rates would also likely adjust to the terms of trade shock.*
- *Asian FX has already sold off against the USD.*
- *More could be in store, especially for those with high export share to the US.*

Chart of the Week: Trade war has barely begun

Between four years of Trump 1.0 and four more under Biden, two US presidents reversed more than half a century of trade policy liberalisation. Under Trump 2.0, more severe protectionist measures are in the cards. The Trump team certainly has plenty of room, as compared to the protectionist waves of the past, tariffs are still modest. An average tariff of 10% or so on all imports, which has been floated by some in the incoming administration, would amount to more than trebling import taxes. We think this could add 20-40bps to 2025 inflation.

US tariff history

	Average rate on dutiable imports	Average rate on all imports
1890s (McKinley)	50%	20%
1930 (Hawley-Smoot)	60%	20%
2018-19 (Trump)	10%	3%
2025 (Trump)		10-20%?

Source: Tax Foundation, DBS

Commentary: The coming trade shock and Asia

With Trump 2.0, higher tariffs are guaranteed. Beyond going after China, US trade and commerce officials will go after Mexico and Vietnam to restrict China's attempts to divert trade. There may well be a 10% (some have even floated 20%) across-the-board tariff on all US imports. Beyond tariffs, restrictions on investments and market access are all likely to be ramped up further.

Countries trading intensively with the US are about to step into unchartered waters. Over the last half a century, the average US tariff rate on all dutiable imports has been below 4%. Despite 8 years of trade wars, average tariff is below 3% presently. A trebling of that rate would be a substantial shock.

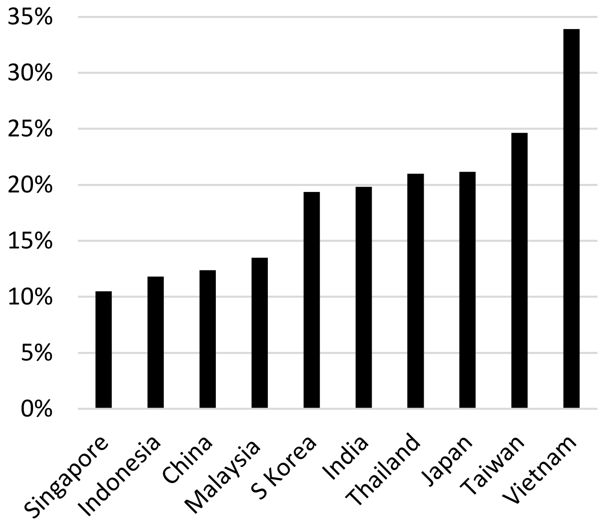
How does the tariff transmission channel work? In theory, it should only impact the exporters through the demand channel, with the tariff being paid for by the US importer, and by extension, the US consumer. Certain products, such as washing machines, saw their demand decline after tariffs were imposed in 2018 by the Trump administration. Indeed, price of those products jumped immediately. In response, South Korean manufacturers diverted some of their production to the US, creating some jobs, but all at the expense of US consumers paying more. As soon as those tariffs were allowed to expire by the Biden administration in 2023, washing machine prices began to decline in the US, demonstrating that shielding domestic industries from competition is a tax on consumers.

The last eight years have shown that once tariffs are imposed, a complex web of responses take place between producers, importers, and consumers, beyond the dynamics of the washing machine case. When pricing power is limited, as was likely the case pre-pandemic, a three-way split of burden sharing takes place. Additionally, over time, trade is diverted, some to the US, a lot to partner countries like Mexico and Vietnam.

We doubt if similar dynamic prevails in the current juncture, given the experience of the pandemic and the sustained strength of the US labour market. We think that much more of the tariff would be passed along to customers this time, especially as trade diversion would make less sense with across-the-board tariffs.

An additional spillover from tariffs is the exchange rate. If markets believe that an economy is particularly vulnerable to US tariffs, that economy will see selling pressure on the currency to adjust for the impending terms of trade shock. The 2-4% depreciation of Asia currencies against the USD since the elections is a harbinger for things to come, in our view. A ranking of exports intensity vis-à-vis the US is a marker of the vulnerabilities out there.

Share of total exports to the US



Source: US Census Bureau, CEIC, DBS.

Taimur Baig

FX: Starting Trump 2.0 with a firm USD

US President-elect Trump's inauguration on January 20 should underpin the USD Index (DXY) this week. Trump had pledged to impose tariffs on his first day of office, particularly on goods entering the US from Canada, Mexico, and China. We expect the Fed to keep rates unchanged at 4.25-4.50% at the FOMC meeting on January 28-29. The Fed will likely become more cautious on rate cuts from Trump's tariffs lifting US inflation expectations. Treasury Secretary Yellen warned that the reinstated statutory debt limit would be reached on January 21, with her agency taking extraordinary measures through March 14.

USD/CAD will likely push above 1.45 on Trump's pledge to impose 25% tariffs on Canadian goods and a 25bps rate cut to 3% expected at the Bank of Canada's meeting on January 29. USD/CAD rose by 0.6% rise to 1.4477 last Friday, nearer the peaks in 2020 (1.4510) and 2016 (1.4580).

EUR/USD is eyeing parity after failing to push above its 1.03 resistance level last week. The European Central Bank will likely maintain a dovish tone after delivering a 25 bps cut to 2.75% on January 30. The ECB views Trump's tariffs as a greater threat to growth than inflation. Although the CDU/CSU is leading the polls ahead of the German elections on February 23, it lacks compatible partners to form a stable coalition government.

USD/JPY should rise after failing to break below 156-158, its month-long range, last week. Despite expectations for the Bank of Japan to hike by 25 bps to 0.50% on January 24, the JPY could not overcome the negative yield differential against the USD. The futures market expects the Fed to delay its next rate cut to 2Q25.

China kept the USD/CNY fixing in a stable 7.1875-7.1891 range since the start of 2025. Trump had pledged to lift tariffs on China imports to 60%, starting with an additional 10% tariff at the start of his second term to bring China to the negotiating table. US Treasury Secretary nominee Scott Bessent said during his confirmation hearing that if confirmed, he intends to pursue the purchase guarantees in the Phase One trade deal that Trump's trade team put together in January 2020. In a phone call last Friday, Trump and President Xi Jinping discussed several issues, including trade. Vice President Han Zheng will represent China at Trump's inauguration on January 20, marking an unprecedented high-level presence from Beijing.

The Monetary Authority of Singapore's policy review on January 24 will likely be a non-event. We expect the authority to keep the three parameters (mid-point, slope, and width) of the SGD NEER policy band unchanged. The SGD NEER's decline from the top to the mid-point of its policy band in recent months does not signal an imminent policy shift. Instead, we view this repositioning as consistent with the recent moderation in the MAS core inflation into the 1.5-2.5% forecast range for 2025 and the official view for the Singapore economy to slow to 1-3% this year from 4% in 2024. Maintaining the SGD NEER's appreciation will help address the cost of living issue, a priority in the upcoming Budget statement on February 18. With the NEER back at the mid-point, we do not expect USD/SGD to repeat its sharp rise seen in the past 3.5 months unless the USD appreciates strongly globally.

Philip Wee

Group Research

Economics & Strategy

Taimur BAIG, Ph.D.
Chief Economist
Global
taimurbaig@dbs.com

Wei Liang CHANG
FX & Credit Strategist
Global
weiliangchang@dbs.com

Tracy Li Jun LIM
Credit Analyst
USD Credit
tracylimt@dbs.com

Amanda SEAH
Credit Analyst
SGD Credit
amandaseah@dbs.com

Nathan CHOW
Senior Economist
China/HK SAR
nathanchow@dbs.com

Eugene LEOW
Senior Rates Strategist
G3 & Asia
eugeneleow@dbs.com

Daisy SHARMA
Analyst
Data Analytics
daisy@dbs.com

Han Teng CHUA, CFA
Economist
Asean
hantengchua@dbs.com

Teng Chong LIM
Credit Analyst
SGD Credit
tengchonglim@dbs.com

Joel SIEW, CFA
Credit Analyst
SGD Credit
joelsiew@dbs.com

Mo JI, Ph.D.
Chief Economist
China/HK SAR
mojim@dbs.com

Tieying MA, CFA
Senior Economist
Japan, South Korea, Taiwan
matieying@dbs.com

Mervyn TEO
Credit Strategist
USD Credit
mervynteo@dbs.com

Byron LAM
Economist
China/HK SAR
byronlamfc@dbs.com

Radhika RAO
Senior Economist
Eurozone, India, Indonesia
radhikarao@dbs.com

Samuel TSE
Economist/Strategist
China/HK SAR
samueltse@dbs.com

Violet LEE
Associate
Publications
violetleeyh@dbs.com

Philip WEE
Senior FX Strategist
Global
philipwee@dbs.com

Sources: Data for all charts and tables are from CEIC, Bloomberg and DBS Group Research (forecasts and transformations)