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What to watch: The Art of the Deal, how the world should respond to the US tariff threats

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In summary

US tariffs: The Art of the Deal. **President Trump's best-**selling book from 1987 could be the handbook for his transactional trade policy in his second term, as seen in the temporary reprieve from tariffs granted to Mexico and Canada. However, China was not so lucky, despite indicating a willingness to negotiate. The 10% increase in tariffs went into effect on 4 February and has already sparked retaliation. If fully implemented, tariffs could cost China -0.3pp of GDP growth in 2026, albeit fiscal stimulus will compensate for the impact. Mexico and Canada could face recession, with a -1.5-2.0pp GDP hit in 2025-26. Though the impact could be mitigated by fiscal easing (especially in Canada), US inflation would be pushed above 3%, shutting the door to further Fed rate cuts this year. The automotive, energy and agrifood sectors are in the crosshairs. Finding new clients and suppliers is hardly straightforward, and rerouting will also prove difficult as US trade agreements will require **the origin country to "improve" or "transform" the product** to avoid tariffs. Ultimately, the final impact will depend on how much companies can stockpile, and how much of a hit they can take on their margins.

Europe: Next in line? Similar tariffs on Europe could cut almost -1.0pp off GDP growth in both the Eurozone and the US over 2025-26, with pharmaceuticals, machinery & equipment and auto suffering the most in Europe. **Trump's focus on reducing the trade deficit with Europe** will make negotiations tougher, though we do expect some agreements, setting the stage for a contained trade war with capital markets already tentatively pricing in a trade deal. Lower European tariffs on US cars and agricultural goods are likely, alongside commitments to increased European purchases of US defense and energy exports. But these concessions would still be a net-negative for the Eurozone, and the prolonged uncertainty will affect economic confidence lowering GDP growth by -0.2pp to around 1% in 2025. Germany would be on the frontlines in a full trade war scenario, facing the risk of a third consecutive year of recession.

Emerging markets: Able to withstand a contained trade war. If a 10% universal US import tariff is implemented, it could threaten USD80bn of emerging market exports, and partners with large trade deficits (Vietnam, Taiwan, India, Thailand, Malaysia) could have a target on their backs. Some are being proactive by cutting import duties early (e.g. India) and some could benefit from rerouting. But the ripple effects of tariffs present a perfect storm for countries with high exposure to USD-denominated debt (Angola, Cameroon, Egypt, Colombia, Peru, Chile, Mexico). Policy makers are likely to address the tariff shocks with a coordinated mix of fiscal measures, monetary adjustments and FX interventions, but there will be no easy way to neutralize the compounded impact.

US tariffs: The Art of the Deal

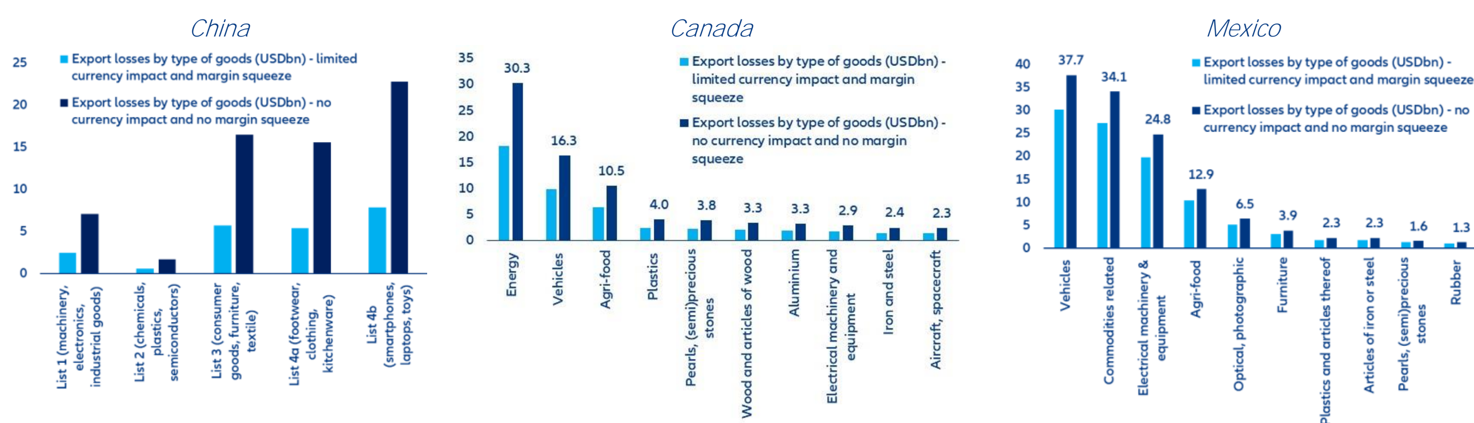
President Trump**'s** best-selling book from 1987 could be the handbook for transactional trade policy in his second term, as seen in the quick turnaround on tariff threats against Mexico and Canada. As expected, over the weekend, President Trump announced that Canadian and Mexican imports into the US will face a 25% tariff (10% for Canadian energy imports, accounting for 5% of total US imports and 35% of US imports from Canada) and Chinese imports an additional 10pps duty, bringing the US import tariffs from China to an average of 23.4%[1]. The President triggered the International Emergency Economic Powers Act (IEEA) on the grounds that Canada, Mexico and China are not taking action to stem flows of illegal immigration, as well as fentanyl and other drugs, into the US. What was perhaps not expected was the quick turnaround, with Trump delaying the enactment of tariffs on Mexico and Canada for 30 days after negotiations with their presidents resulted in promises for border reinforcements. In this way, Trump secured an early victory on border security to reassure his supporters.

China was not so lucky, despite indicating a willingness to negotiate. The 10% increase in tariffs went into effect on 4 February and has already sparked retaliation. China reacted with a 10% tariff hike on US exports of coal and LNG, and a 15% hike on crude oil, agricultural machinery and some automobiles. These targeted goods represent up to USD20bn in annual imports, about 12% of China's total imports from the US – much smaller than the over USD450bn in Chinese goods targeted by the US. Notably, critical imports like high-end chips, semiconductor machinery, pharmaceuticals and aerospace equipment have not been targeted. Additionally, China is adding minerals to its export control list, launching an antitrust probe against Google and labelling US companies Illumina and PVH as unreliable entities. These actions serve as warnings to the US but allow China the flexibility to postpone or even retract them before the 10 February deadline.

If the proposed tariffs on Mexico, Canada and China are fully implemented, the US global effective tariff rate will rise from 2.5% to 11% – the highest level since the 1940s. The average duty on Mexican imports would rise from almost 0% to 25% and for Canadian imports from almost 0% to 20%. If only tariffs on China are maintained, the US global effective tariff rate will rise to 4.1%. In turn, following Chinese retaliation measures, the Chinese effective tariff rate on US imports will rise by a modest +1.15pp, from 12.3% to around 13.5%. The goods sourced from Mexico, Canada and China are large for the US in most sectors. For instance, half of US energy imports and 40% of US forest product imports come from Canada. The imports from Mexico are large for agricultural products, machinery, electronics (20% of total each) and transportation equipment (30%). We estimate the total exports at risk for China stand between USD23bn and USD57bn, or 0.7 to 1.7% of total exports, depending on the currency depreciation (no more than 3%) and the companies' capacity to cut prices / absorb the rise in input costs. For Canada the exports at risk stand between USD60bn and USD100bn – or 10 to 18% of total Canadian exports, while for Mexico they stand between USD110bn and USD140bn – or 19 and 24% of total Mexican exports –see Figure 1 for top 10 most exposed sectors.

[1] 10% on imports of computer & telecom products as well as toys; 17.5% on imports of footwear, clothing, kitchenware and 35% on imports of machinery, electronics, industrial goods, chemicals, plastics, semiconductors, consumer goods, furniture, textile.

Figure 1: Total exports at risk of losses for China, Canada & Mexico, USDbn



Sources: USITC, Allianz Research

Chinese GDP growth would be cut by a meagre -0.1pp in 2025 and -0.3pp in 2026, but Mexico and Canada could face a recession if the tariffs are fully implemented[2]. Exports to the US account for around 20% of Mexico and Canada's GDP, while US exports to these two countries account for only 2.5% of its GDP. In this context, both Mexico and Canada would slip into a recession by Q3 2025. Mexican GDP growth would be -0.4pp lower in 2025 and -1pp lower in 2026 – a cumulative -1.4pp hit – but the likely depreciation of the Mexican peso would attract additional tourism flows, remittances and portfolio investment, partially mitigating the impact, leading to +0.9% growth at end-2025. Canadian GDP growth would be lower by -2.1pp cumulatively, compared to -0.9pp for the US. In 2025, US GDP growth would average +1.8%, down from our previous forecast of +2.3% – a significant yet manageable hit.

Inflation would accelerate in all three economies in 2025, ranging from +0.4pp for US and Mexico to +0.9pp for Canada. The pick-up in inflation would be contained despite the massive increase in duties because part of the cost increases would be spread through supply chains (for intermediate products) and because of lower demand. The impact on prices will depend on sectors: sourced goods that have few alternatives will see higher price increases and sectors with very low margins will be more likely to pass on most of the higher costs on to customers. Faced with this large negative supply shock, the Fed will face a trade-off between controlling inflation and supporting the economy. We think the Fed will look through the tariff-driven rise in inflation but will most likely refrain from cutting interest rates further for the remainder of 2025 despite a weaker economy. The Fed funds rate would likely stay at this current level of 4.25-4.5%. However, in 2026, retreating inflation and economic weakness will prompt the Fed to accelerate rate cuts. On the fiscal front, we assumed no offsetting fiscal easing, which would reduce the GDP hit and increase the inflation impact. For instance, the new duties on Mexico and Canada would generate around 0.7% of GDP of additional revenues for the US Treasury, which could be partly recycled into the economy by cutting taxes and/or boosting government spending, a move already initiated by the Canadian government in the wake of the tariff announcement.

[2] *See our report for more estimates on China.*

Table 1: Allianz Research's current GDP growth and inflation forecasts & impact of US-Mexico-Canada and China trade war (p.p. deviation from baseline)

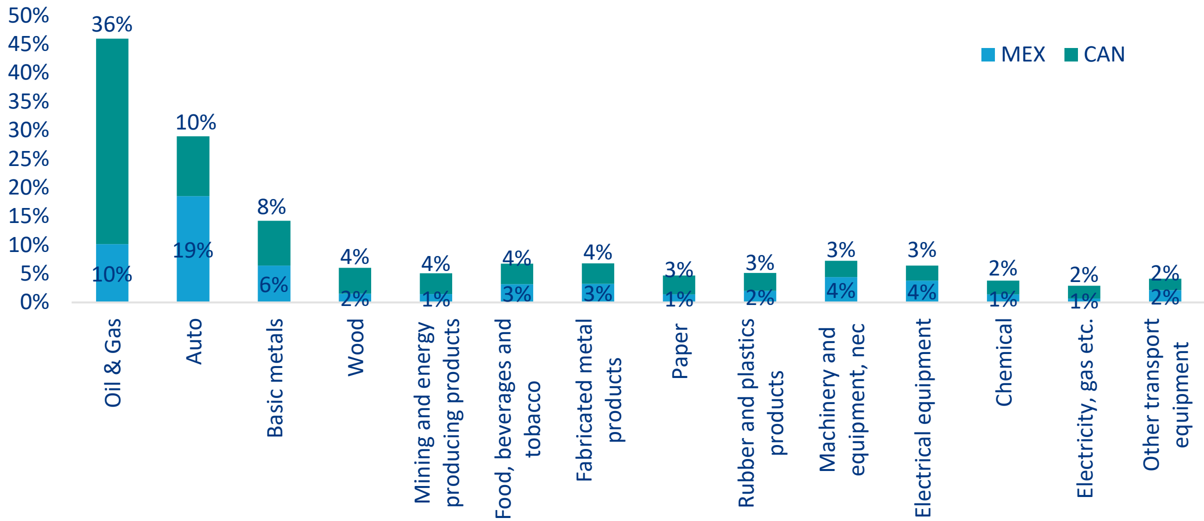
		2025		2026	
		Baseline forecast (%)	Trade war shock (p.p.)	Baseline forecast (%)	Trade war shock (p.p.)
GDP	US	2.3	-0.5	1.8	-0.4
	China	4.6	-0.1	4.2	-0.3
	Mexico	1.5	-0.4	3.5	-1.0
	Canada	1.3	-0.7	1.7	-1.4
Inflation	US	2.8	0.4	2.7	-0.1
	China	1.0	0.0	1.5	-0.1
	Mexico	4.5	0.4	4.0	-0.1
	Canada	2.2	0.9	2.3	0.2

Note: We assume Mexico retaliates in the same way as Canada was prepared to respond, slapping a 25% tariff on 30% of US imports (i.e. bringing the effective Canadian and Mexican effective tariff rate on US imports from around 0% to 7%). Sources: Oxford Economics, Allianz Research.

US-Mexico trade is deeply intertwined, making some sectors much more exposed to protectionist measures and many products difficult to replace without significant additional costs. Auto, oil & gas and agrifood are in the crosshairs. The US imported approximately USD150bn worth of vehicles and auto parts from Mexico in 2023, with Mexico and Canada accounting for over 50% of all auto parts exported to the US and approximatively 45% of new vehicles exported. The potential 25% tariff could raise production costs for US automakers, potentially adding up to USD3,000 to the final consumer price of some vehicles. This could drive down sales due to the high price elasticity for car demand and/or a further compression of margins in an industry that already suffered last year from increasing costs and tepid demand from Europe and China. In the energy sector, the US relies heavily on Canadian energy imports, with Canada supplying about 60% of the oil imported by the country. The fact that the Trump administration is considering imposing "only" a 10% tariff on Canadian energy products is a testament to the importance of these imports, with US oil producers unlikely to ramp up domestic production in the short run[3]. However, a 10% tariff will still increase oil and fuel prices across the US, particularly impacting regions like the Midwest that are heavily dependent on Canadian oil. Mexican imports for the sector are also significant, albeit less so than Canadian ones. Both countries' inputs account for about 46% of the US sector's value added (Figure 2). Such an escalation in energy costs could have a ripple effect, leading to higher transportation and production expenses across various industries. Finally, the agrifood sector is also poised to face challenges in case of higher tariffs. The US sources roughly half of its fresh fruits and vegetables from Mexico, and Mexico is the top market for US agricultural exports. A 25% tariff on Mexican agricultural products would increase the cost of groceries for American consumers. Canadian imports of wood and timber are also critical for the US pulp & paper industry, as well as the construction sector.

[3] *See our previous research : [What to watch | 21 November 2024]*

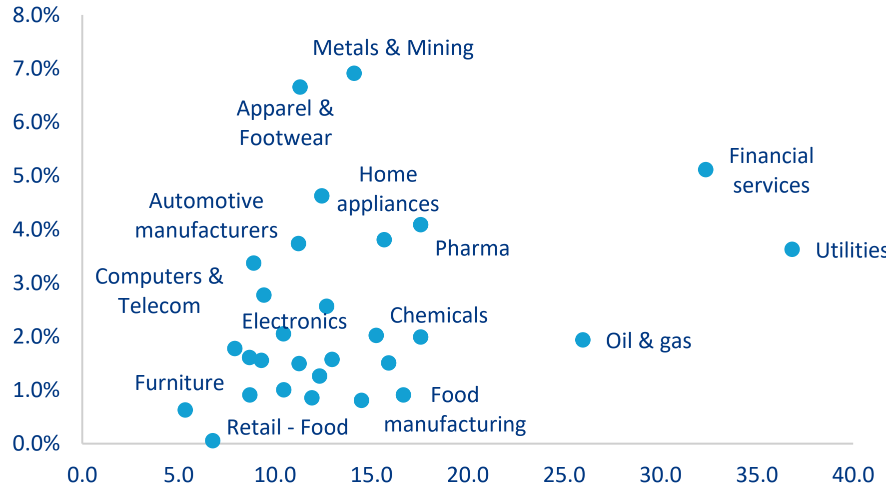
Figure 2: **Share of Canadian and Mexican inputs in US sectors' value added (%)**



Sources: OECD, Allianz Research

Companies cannot switch supply chains overnight so margins will be squeezed to keep up with volumes. Finding new clients and suppliers is not straightforward, especially in some manufacturing segments, due to technological and safety requirements. Rerouting will also prove to be difficult for Canadian and Mexican exporters as US trade **agreements will require the origin country to "improve" or "transform" the product** to avoid being treated as **Canadian or Mexican. This implies that "re-routing" hubs will requ**ire some manufacturing capacities as well as increased transportation capacities – both of which would imply sizeable investments. From a financial perspective, the oil & gas sector has comfortable margins (Figure 3) and could soak up the increase in input prices. However, as fuel demand is rather inelastic, the sector might pass on higher prices to the consumer. Other sectors such as retail or auto have less leeway to absorb higher costs and could be compelled to pass on higher prices and put revenues at risk.

Figure 3: Profitability vs leverage for US sectors (x-axis : EBITDA margin, y-axis : short term debt to assets ratio)

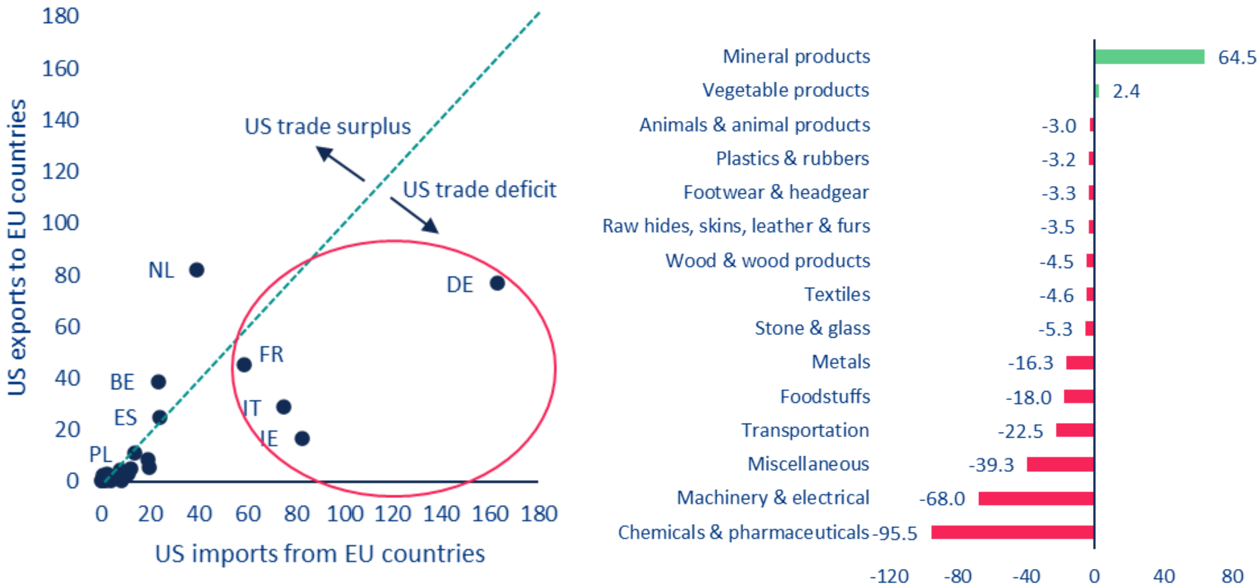


Sources: LSEG Refinitiv, Allianz Research as of Q3 2024

Europe: Next in line?

Trade imbalances between the EU and the US are a thorn in the side for President Trump and might put Europe next in line for tariff threats. However, they reflect a fundamental economic issue: too much consumption relative to production in the US. In 2023, the US trade deficit with the EU reached USD220bn, with US exports to the EU totaling USD370bn and imports reaching USD590bn. But the disparity is particularly pronounced with several major EU economies such as Germany, Ireland, Italy and France (Figure 5, left). Germany alone accounted for 39% of the deficit, with Ireland contributing nearly a third, Italy 21% and France 6%. In contrast, the US has trade surpluses with countries like the Netherlands (USD43bn), Belgium (USD15bn) and Spain (just below USD1bn). By sector, the US has a trade surplus of USD65bn in mineral products, primarily driven by mineral fuels and oils (USD63bn, Figure 4, right). Aerospace contributes a surplus of USD23bn, but the overall transportation sector shows a trade deficit, largely due to a deficit of USD44bn in vehicles with the EU. The only other sector where the US sees a modest surplus with Europe is in vegetable products (USD2bn). This is due to a US trade surplus in oil seeds (nearly USD4bn), fruits and nuts (USD2bn) and cereals (just below USD1bn). On the flip side, the US faces large deficits in chemicals and pharmaceuticals, with the gap totaling USD96bn, driven largely by pharmaceuticals contributing USD68bn to the imbalance. Machinery and electrical equipment follow closely, contributing USD68bn to the deficit.

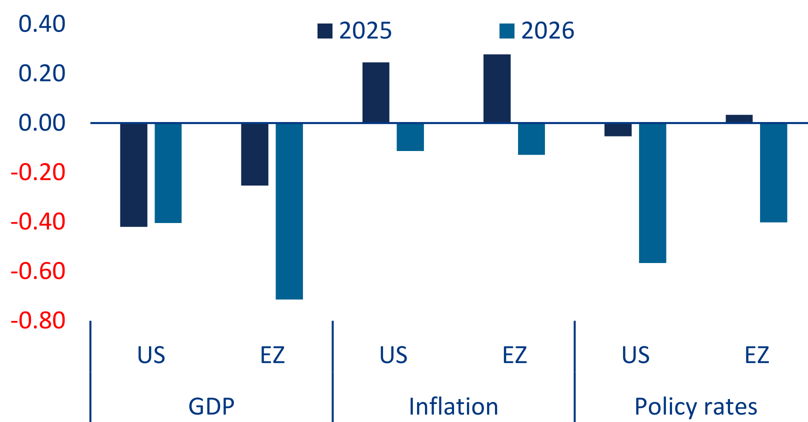
Figure 4: US trade balance according to imports from and exports to European economies (left) and US trade balance with EU by industry (right), in USD bn in 2023



Notes: the green line indicates a balanced bilateral trade, countries below have a trade surplus with the US, countries above a trade deficit with the US. The red circle indicates EU economies with whom the US had a trade deficit in 2023. Sources: ITC TradeMap, Allianz Research.

A full-blown trade-war is unlikely as too much is at stake. Following US trade threats against Colombia, Mexico, Canada and China over the past weeks, and judging from previous comments, Europe is most likely next in line to face at least the threat of tariffs. However, a full-scale trade war, similar to the one threatened against Canada or Mexico, would be devastating for both economies. If both regions were to apply 25% tariffs reciprocally, this would chop off around -1.0pp of GDP growth in the Eurozone and -0.8pp in the US over the next two years (Figure 5). At the same time, inflation would increase in both regions in 2025 before retreating in 2026 as Philipps-curve effects (lower growth, higher unemployment) would outpace any price pressures from imported inflation. In turn, this would prompt central banks on both sides of the Atlantic to speed up their easing cycles. The euro would probably depreciate a bit further against the dollar but not more than 5%. To some extent, we have already seen close to 8% depreciation of the euro since markets were pricing in a Trump presidency and correspondingly a tougher stance on bilateral trade. Secondly, as a reciprocal trade war would also hit the US and prompt easing by the Fed in a similar scale as the ECB, the interest rate differential would not justify much further depreciation of the euro.

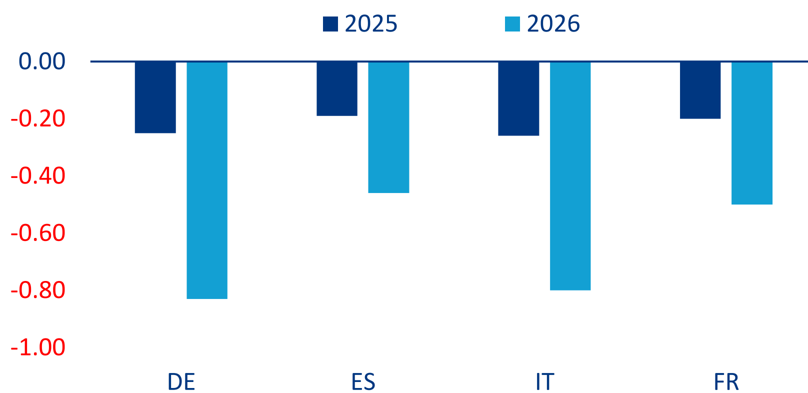
Figure 5: 25% reciprocal tariffs between the US and EU would hit both economies hard, pp deviation



Sources: Oxford Economics, Allianz Research

Germany would be hit the hardest in a full-blown trade war, pushing the fragile economy into recession. Given Germany's economic dependence on exports, it is not surprising that it would suffer the most from a trade war with the US. But as Germany is the major economic power in Europe, contagion effects would also drag down other European nations even though they are less affected by the direct trade repercussions with the US (Figure 6).

Figure 6: A trade war with 25% tariffs would hit Germany the hardest in the Eurozone, pp deviation of GDP growth



Sources: Oxford Economics, Allianz Research

By sector, European pharmaceuticals, machinery and equipment and auto would suffer most from US tariffs. Pharmaceuticals rank as the top goods imported by the US and many European pharmaceutical giants rely heavily on the US market for their sales. Ireland and Germany, for instance, exported over USD30bn worth of products to the US in 2023. In the case of Ireland, those exports represented a hefty 15% of the country's total exports. Although the share is relatively smaller for Germany, it is still quite significant. Pharma companies in other countries such as Belgium or Denmark also export significant volumes of products to the US. Machinery & equipment would also suffer, especially in Germany and Italy, with a combined export value of almost USD50bn and totaling about 2% of each country's total exports. Finally, the US is a key market for the European auto sector, though it has reduced its dependency after learning the lessons of Trump's first term (Figure 8). Germany, Austria and Sweden still have strong economic links to the US. In fact, the US became the largest export destination for German vehicles in 2023, ahead of China, with German auto exports to the US accounting for more than USD32bn. Many auto manufacturers not only have factories in the US but also expanded parts of their supply chains to Mexico and Canada to be closer to US markets and avoid potential tariffs against the EU, which complicates further their production and investment decisions. Beyond these sectors, other industries are also at risk. The European food and beverage industry, for example, has previously suffered from US tariffs, particularly on products such as wine and cheese.

Table 2: **Western Europe's t**op exporting sectors to the US (2023)

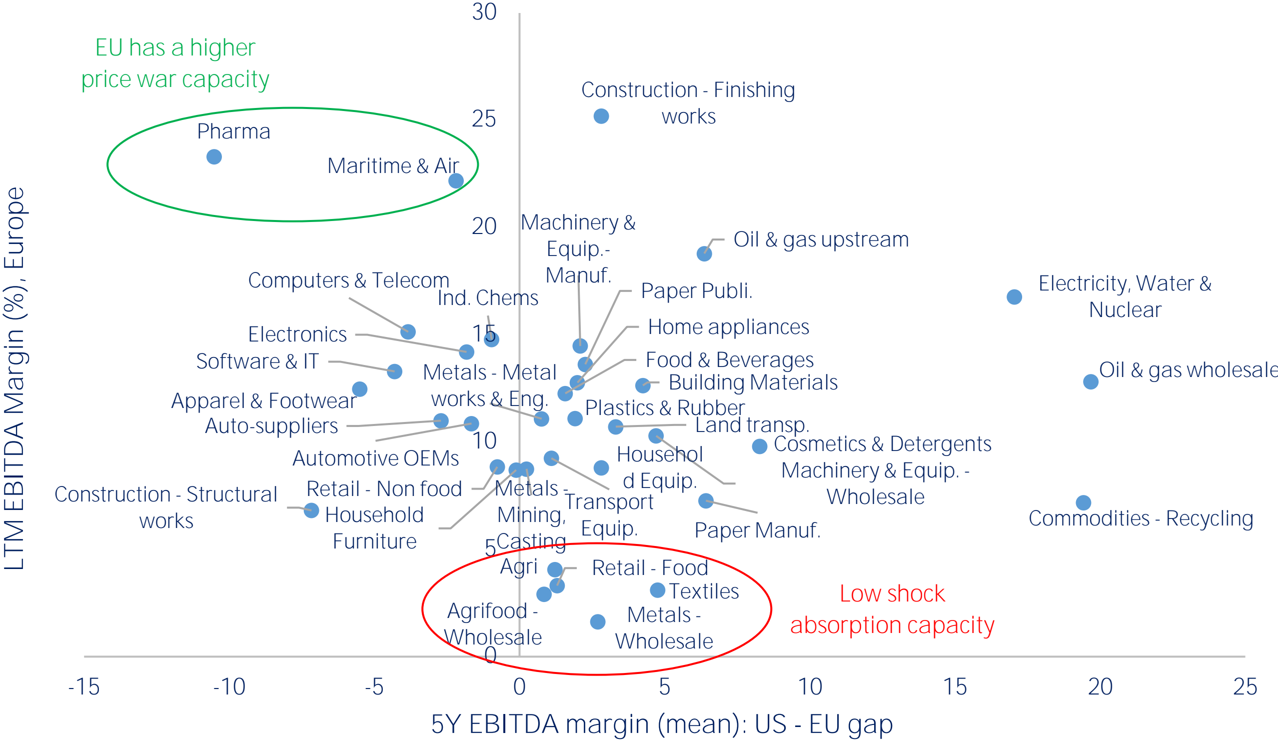
Country	Sector	Value (USD bn)	Share of country's total exports
Ireland	Pharmaceuticals	32.1	15.1%
Switzerland	Pharmaceuticals	33.0	7.9%
Ireland	Chemicals - Industrial	10.2	4.8%
Belgium	Pharmaceuticals	14.9	3.8%
Denmark	Pharmaceuticals	4.6	3.5%
Ireland	Chemicals - Plastics & Rubber	7.0	3.3%
UK	Machinery & Equipment - Manufacturing	12.6	2.6%
UK	Pharmaceuticals	12.2	2.5%
Sweden	Automotive manufacturers	4.2	2.2%
Germany	Machinery & Equipment - Manufacturing	35.9	2.2%
Germany	Pharmaceuticals	34.5	2.1%
Italy	Machinery & Equipment - Manufacturing	13.5	2.1%
Germany	Automotive manufacturers	32.0	2.0%

Sources: UNCTAD, Allianz Research

The pricing dilemma: European firms will be unable to absorb US tariff increases. Over the past decade, companies on both sides of the Atlantic have become significantly more profitable but US companies are outpacing their European peers. In the US, average operating margins have moved from 12.5% to 14.3%, while in Europe they have increased from 9.7% to 11.2%, the difference resulting from stronger innovation in the US, a more favorable regulatory environment and stronger global market expansion. In the past five years, nearly 70% of sectors have become more profitable in the US than in Europe (Figure 7). Most recently, in the past twelve months, only 25% of sectors in the US have reported single-digit EBITDA margins, while in Europe, this figure rose to 40%. In the context of the US trade war, this widening spread is a cause for concern, particularly because the US weight in domestic added value produced in Europe stands at 13% for the entire region (with Ireland (25%) and Denmark (18%) being the most dependent on US inputs), and because the US is a key revenue source for many European multinationals (20% on average). More worryingly, this revenue share can be bigger for sectors such as pharma (35%), luxury (30%), industrial goods including automobiles and machinery (25%) and chemicals (25%).

Some sectors are better positioned than others. To offset any shock, strategies could include expanding presence in other high-growth regions, increasing local production in the US, investing in cost-cutting measures such as automation or even creating alliances (joint ventures with US firms). However, all of these require investment and offer little results in the short-term. Counterproductively, cutting prices in the American market may be a quick fix to avoid losing market share. But the price-reduction capacity varies largely across the whole industry, with relatively better EBITDA margins in **pharma (EU's** LTM mean: 23%), marine & air (22%) and oil & gas upstream (19%) positioning them well to be price-aggressive. In contrast, metals wholesale (1.6%), agrifood wholesale (2.9%), textiles (3.1%) and food retail (3.3%) have very low margins to compete on prices, and their US peers are already wining the profit race. If we simulate a price cut of 25% in 20% of European companies' revenues, the LTM US-EU profit gap would widen by +0.6pp, increasing an average of 2.9% to 3.5%. For the mentioned sectors facing margin pressure, such price reductions would be unfeasible due to the ongoing burden of interest expenses and the relatively less competitive corporate taxes in Europe, factors that further erode the bottom lines of the P&L, and push companies toward break-even far sooner than anticipated.

Figure 7: EBITDA margin across sectors, US vs Europe



Sources: LSEG Refinitiv, Allianz Research. LTM: Last 12 months mean.

Europe could retaliate but negotiating is the better option. During the EU Council meeting on Monday, EU leaders grappled with the challenge of addressing potential tariffs from the Trump administration, creating a dilemma between taking a firm stance or opting for negotiation; an agreement has yet to be reached. Europe could retaliate to potential tariffs and target sectors where the US has significant economic interests, such as energy, metals, pharma, machinery & equipment, aerospace and automobiles. US pharmaceuticals generate a significant portion of their revenues from Europe (30-35%), which makes it an obvious potential target for retaliation by imposing tariffs on US-made drugs, tightening pricing regulations, delaying drug approvals or even accelerating **the introduction** of generic versions of popular US-made drugs. On the aerospace front, the EU could emphasize the strong interdependence of US and EU aerospace industries, with Boeing having around 20% of its suppliers based in Europe and the region representing 30% of Boeing's global revenue. It is unlikely that Europe targets energy imports as the continent is still grappling with a lingering energy crisis.

Negotiations and bargaining should focus on NATO funding and reducing the US trade deficit vis-à-vis the EU. Unlike Canada and Mexico, countries that have used migration and drug trafficking issues as bargaining chips with the US, Europe's room for negotiation is smaller. We see one straightforward option: buy more US energy products (oil and liquified natural gas) and defense equipment. This could re-balance trade between US and Europe while contributing to solve two key policy issues for the block: the need to increase energy supply and ramping up defense amid the current complex geopolitical backdrop. Higher defense spending from the EU could also pave the way towards less US contributions to NATO – which is a long-standing issue for the Trump administration.

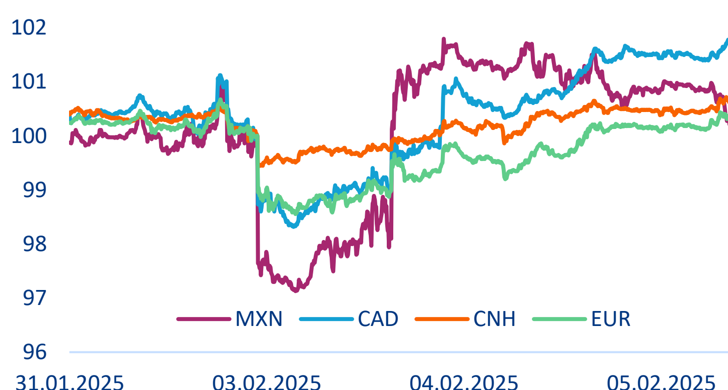
Table 3: US top exporting sectors to the world (ex-Canada & Mexico, 2023)

Country	Sector	Value (USD bn)	Share of US total exports
EU	Energy - Oil & gas	72.2	3.9%
EU	Pharmaceuticals	61.4	3.3%
EU	Machinery & Equipment	27.1	1.5%
China	Agrifood - Agriculture & farming	22.3	1.2%
China	Energy - Oil & gas	19.3	1.0%
South Korea	Energy - Oil & gas	17.2	0.9%
EU	Chemicals - Plastics & Rubber	16.0	0.9%
China	Pharmaceuticals	15.6	0.8%
EU	Automotive manufacturers	15.5	0.8%
EU	Chemicals - Industrial	14.3	0.8%
China	Machinery & Equipment - Manufacturing	14.1	0.8%
UK	Energy - Oil & gas	13.4	0.7%
Japan	Energy - Oil & gas	11.7	0.6%
Switzerland	Metals - Mining, Casting & Processing	11.3	0.6%
Japan	Pharmaceuticals	11.2	0.6%
EU	Metals - Mining, Casting & Processing	10.9	0.6%
EU	Electronics	10.9	0.6%
UK	Metals - Mining, Casting & Processing	10.2	0.6%
India	Energy - Oil & gas	10.1	0.5%

Sources: UNCTAD, Allianz Research

Markets are already tentatively pricing in a trade deal with the EU. The surprisingly strong tariff announcement on 1st February by US president Trump against China, Mexico and Canada caused an initial heavy reaction in markets. Apart from losses in stock markets, the Mexican Peso (MXN) lost up to 2.9% and the Canada Dollar (CAD) 1.7% and the less liquid and still partially restricted Chinese Yuan (CNH) 0.6%. Notably, markets were quick to also price in a forthcoming tariff dispute with the EU as the Euro tanked (-1.4%) on a similar scale as the Canadian Dollar. However, with trade agreements reached quickly in just one day, those moves were priced out again and notably so also for the Euro (Figure 8). Markets obviously cheer the fact that US President Trump is not predetermined to raise tariffs by all means but to use them as a bargaining tool after all.

Figure 8: Intraday currency moves against the USD, normalized index 100=end of 31.01.2025



Sources: Bloomberg, Allianz Research

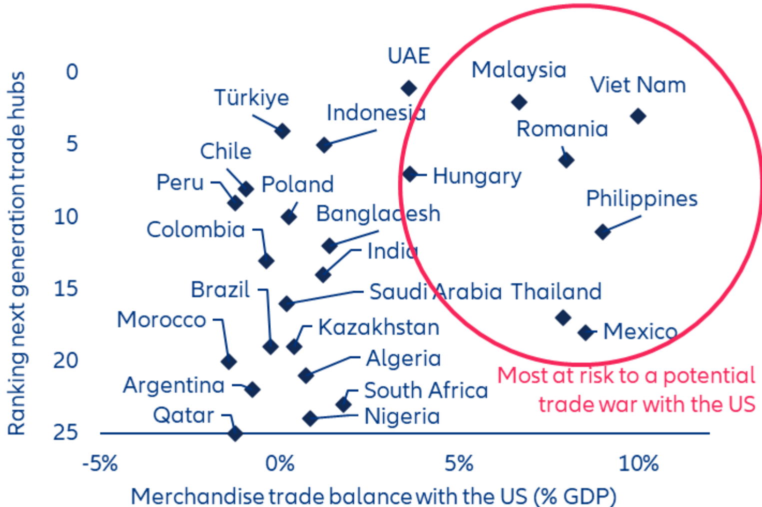
Our base case remains a contained trade war between the EU and the US, with US tariffs rising to around 5% from the current 2.2%. We still see a threat of tariffs from the US looming but believe a deal to avoid a full-blown

trade war can be reached. However, the path will be bumpier. Unlike Mexico and Canada, where border controls satisfied US demands, Trump's focus on reducing the trade deficit with Europe complicates negotiations. A probable outcome includes lower European tariffs on US cars and agricultural goods, alongside a commitment to increase European purchases of US defense and energy products. However, the overall impact on Europe remains negative as these concessions combined with moderate US tariffs would still weigh on growth. On top of this, heightened economic uncertainty could dampen economic confidence, negatively impacting investment and consumption in Europe. Overall, we estimate these effects could lower Eurozone growth by 0.2pp over the next two years to around +1%. While a full-scale 25% tariff scenario remains unlikely due to the significant economic costs for both regions, a 10% universal US tariff remains a plausible downside risk, potentially shaving off an additional 0.4pp of growth over the same period.

Emerging markets: Able to withstand a contained trade war

Under the current baseline, emerging markets could withstand a limited trade war between the US and its main trading partners. However, under the implementation of 10% universal import tariff could target almost USD1trn of US imports from emerging markets[4], or 30% of US imports, while some countries have already taken steps to prepare for a transactional White House. Excluding China, the US import tariff currently stands below 3% for imports from emerging markets. Implementing a +10pps tariff hike would mean that a little more than USD80bn of exports from these markets (or 9% of total) are at risk if EM currencies depreciate by 5% on average, and there are little cuts to selling prices from these markets into the US. In this context, large emerging markets are likely to act proactively to avoid triggering a trade war. India is already taking action by reducing import duties on certain US goods, including high-end motorcycles, by -5pps to -20pps. Should there be a more targeted approach to reducing trade imbalances, we think countries with large trade goods deficits and a good positioning in global value supply chains (such as Vietnam, Taiwan, India, Thailand, Malaysia, Indonesia, South Africa and the Philippines) are likely to be targeted first – see Figure 9. A few of them were hit during Trump's first term, albeit in a very targeted manner – a tariff hike of +25pp on Türkiye, India, Brazil for imports of aluminum & steel; Vietnam for electronics, footwear and textiles and Argentina for steel and agricultural products. South Africa has been in the spotlight in recent weeks, with Trump threaten to cut off funds to the country over its land policy. Pretoria has responded by threatening precious metals exports, a flow valued at around USD5bn.

Figure 9: EMs best positioned to take advantage of a contained trade war



Note: Ranking Next generation trade hubs was developed by Allianz Research, (ranking, best = 1); when the net trade balance with the US of a country is positive, it means the US has a net deficit with the respective, and that the Trump administration might target those countries with additional tariffs. Sources: UN Comtrade, World Bank, Allianz Research.

[4] Excluding China and Mexico, which on their own account for USD928bn

Trade shifts and rerouting will accelerate even further, with Southeast Asian economies likely to gain market share, given their higher competitiveness compared to China, even in a full-fledged trade war scenario. Anticipating further US tariffs on Chinese goods, Southeast Asian nations are preparing for an influx of factories relocating from China. Countries like Malaysia, Thailand and Vietnam are positioning themselves to attract these investments, particularly in sectors such as electronics and automotive manufacturing. Even in a universal tariff scenario of 10% is enacted, these countries will remain more attractive than China. If we look at Vietnam, the current trade effective tariff from the US stands at 4%, a universal tariff would shift it to 14%. Rebalancing trade balances could significantly impact not only China and Mexico but also other EMs. This is particularly true for Vietnam, where the difference between the US as a supply and demand market is more pronounced, as well as other countries whose foreign sales are heavily exposed to the US and are not first-tier suppliers to Washington, such as Colombia, India, Malaysia and Thailand. A different argument can be made for commodity exporters to the US such as Argentina, Brazil and Nigeria, or countries in Africa where only 2.2% of total exports are directed to the US. Yet, secondary round effects from US tariffs to China and Europe could negatively impact African exports to these markets.

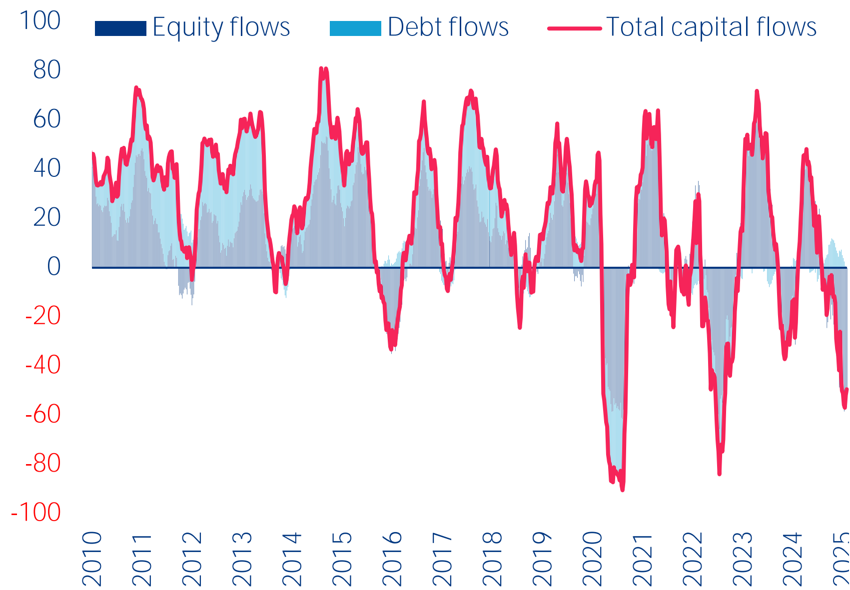
Table 4: Vulnerability scorecard, selected EMs

	FX rate	Policy rate	% of exports to the US	% of US exports	% of US imports
Argentina	↓	↓	7.80%	< 0.5%	< 0.5%
Brazil	↓	↑	12.00%	2.40%	1.30%
China	↓	↓	14.60%	7.00%	13.50%
Colombia	↓	→	29.00%	< 0.5%	< 0.5%
Egypt	↑	→	2.80%	< 0.5%	< 0.5%
India	↓	→	17.90%	2.00%	2.70%
Malaysia	→	→	13.20%	1.30%	1.60%
Mexico	↓	→	82.30%	16.10%	15.60%
Morocco	↑	↓	5.20%	< 0.5%	< 0.5%
Nigeria	↑	↑	8.30%	< 0.5%	< 0.5%
South Africa	↑	↓	6.90%	< 0.5%	< 0.5%
Thailand	↑	↓	17.10%	< 0.5%	< 0.5%
Türkiye	→	↓	6.20%	< 0.5%	< 0.5%
Vietnam	↑	→	31.40%	0.60%	4.20%

Note: FX rates are measured against the USD. Sources: National statistics (trade data as of December 2024 or latest available), Allianz Research

Several emerging markets are facing a perfect storm of tariff pressure, a more hawkish Fed and a stronger USD. Tariff pressure is likely to exert inflationary pressure in the US, prompting the Fed to keep rates higher for longer. EM currencies are expected to face continued depreciation pressures through both trade and capital flow channels, driven by weaker exports and less favorable rate differentials. Even without the actual implementation of tariffs, the uncertainty surrounding trade policies is spurring heightened market volatility, further undermining the appeal of EM assets. Indeed, since April last year, capital inflows to EMs have plummeted and turned later to net outflows (Figure 10**), reflecting investors' increasingly cautious stance towards EM assets.**

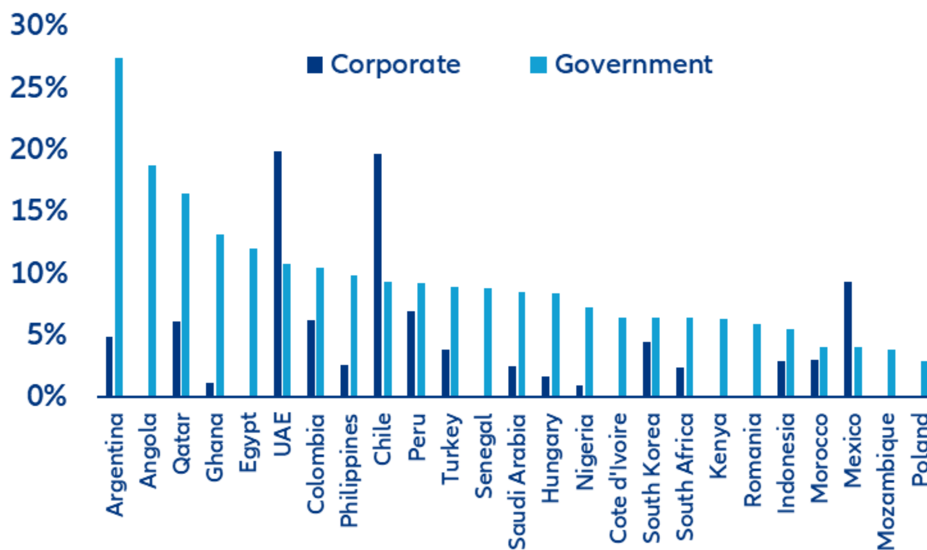
Figure 10: Six-month moving average of EM capital flows (USD bn)



Note: Data as of Jan 31, 2025. Sources: IIF, Allianz Research

Countries with significant exposure to USD-denominated debt could be substantially impacted by President Trump's use of tariffs and other economic coercion policies. The main vulnerabilities include increased servicing costs and higher yields on Eurobonds. During 2025, it is estimated that more than USD152bn of dollar-denominated debt will mature, 75% originating from emerging markets. Latin American countries, along with commodity exporters in Africa and the Middle East, are among the most exposed.

Figure 11: USD-denominated debt across selected emerging markets, % of GDP



Sources: Bloomberg, Allianz Research

In 2025, African commodity exporters will remain the most vulnerable to a higher dollar and the Fed's slower policy rate path. Energy exporters such as Angola, Cameroon or Egypt will all be servicing above 3% of their GDP in repayments. While the pressure to spreads has come down across the board in recent months and stabilized – except for Mozambique – these markets have remained on a weak footing from the combined Covid-19 and Ukraine shocks. Both Angola and Cameroon have already taken steps to lower servicing levels by repurchasing USD-denominated Eurobonds. Yet, the most vulnerable remain non-energy commodity exporters, such as Ghana,

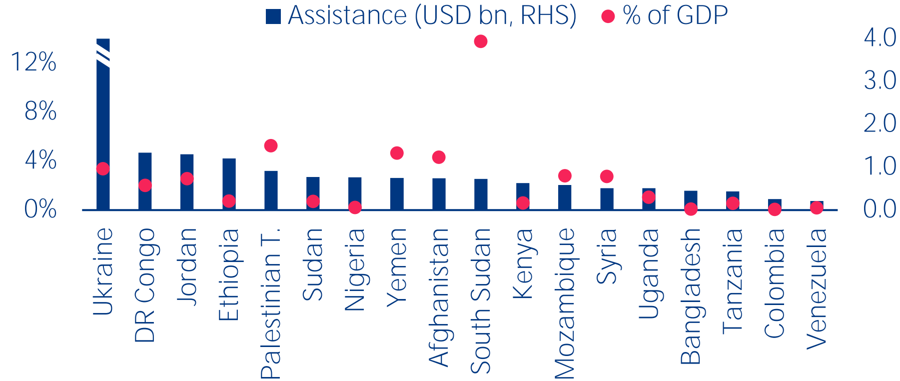
Zambia and Kenya. Markets where USD-denominated debt accounts for between 6-13% of GDP and continue to have a weak fiscal position. Both Ghana and Zambia are still recovering from a sovereign default, and together with Kenya are all under IMF arrangements.

In Latin American, corporates and sovereigns share the exposure to the USD-denominated debt. Colombia (10.5% of GDP) and Peru (9.2%) sovereigns are highly exposed to the USD, with the former and Chile subject to large contingent liabilities, particularly in extractive industries. In parallel, in Chile and Mexico, corporates are the most exposed, by the equivalent of 19.7% and 9.4% of GDP respectively, even though they remain the most liquid markets of the region. Exposures are mostly towards parent companies located in the US or Canada. Markets award Chile and Peru with five-year credit default swap spreads over the US below 50bps, Mexico remains close to 100bps and other large LatAm economies score well above 100bps. Besides Argentina, Colombia and Brazil top the ranking as of early February 2025 at around 170bps. Brazil and Chile have shown the largest spread increases since the US presidential election on 05 November 2024, and political risk will continue to play a role given the next electoral deadlines of 2026 and November 2025, respectively.

EM policy makers are likely to address the tariff shocks with a coordinated mix of fiscal measures, monetary adjustments and FX interventions, but there is no easy way to neutralize the compounded impact. Governments might pursue targeted fiscal consolidation to improve their primary balances and adopt additional measures to stabilize public finances amid heightened market volatility, which will unavoidably compromise growth. Mexico, for instance, has undertaken extensive debt refinancing to extend maturities and reinforced its budget revenue stabilization fund with over MXN100bn, while Brazil plans to cap the expenditures in certain sectors under a general spending limit, attempting to reassure investor confidence. Central banks, on the other hand, face the dilemma of weighing the need of stimulating growth against the imperative to defend their currencies. With narrowing rate differentials, there is less room for cuts to prevent further depressing capital flows and subsequent depreciation of local currencies against the USD. Inflationary pressures add another layer of concern, especially in Latin America and Central and Eastern Europe, where several economies have seen a resurgence in inflation. Additionally, EM central banks may have to resort to direct FX interventions – using their FX reserves to stabilize the exchange rate. Yet, the effectiveness of these interventions depends critically on the depth and liquidity of the FX reserves available, with more robust reserves offering greater intervention capacity. Even so, the broader, multifaceted pressures from weakened growth and persistent currency weakness can hardly be fully offset.

Beyond the tariff threats, the 90-day suspension of USAID activities and the possible tightening of spending on financial assistance for higher risk countries could also escalate security and institutional resilience risks. USAID was founded as a cornerstone of soft power to counter the influence of the Soviet Union during the Cold War. Much of the foreign aid budget, representing less than 1% of the American federal budget and 0.33% of total GDP, went to health expenditures abroad (USD12.3bn) and other essential services, serving as an important international tool for poverty elimination and famine detection. For many countries, especially in Eastern Africa, this assistance was a social and political lifeline, as well as a significant contribution relative to the size of their economies. Its interruption could see American influence wane in Africa, South America and Asia, and leaves room for other major geopolitical actors to swoop in to address those gaps.

Figure 12: US foreign assistance in 2024, selected countries



Sources: ForeignAssistance.gov, Allianz Research

These assessments are, as always, subject to the disclaimer provided below.

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