TALKING ABOUT TRADE

Key themes in Australian and global trade

Westpac Economics

May 2025

Global macro developments

Global trade has experienced policy whiplash over the past two months. On April 2, President Trump dramatically announced country-based ‘reciprocal’ tariffs ranging from 10% to almost 50% to be levied on top of industry-specific tariffs. Multiple rounds of retaliation eventually saw the tariff levied on China’s imports to the US settle at 145% and China’s retaliatory tariff on US goods rise to 125%.

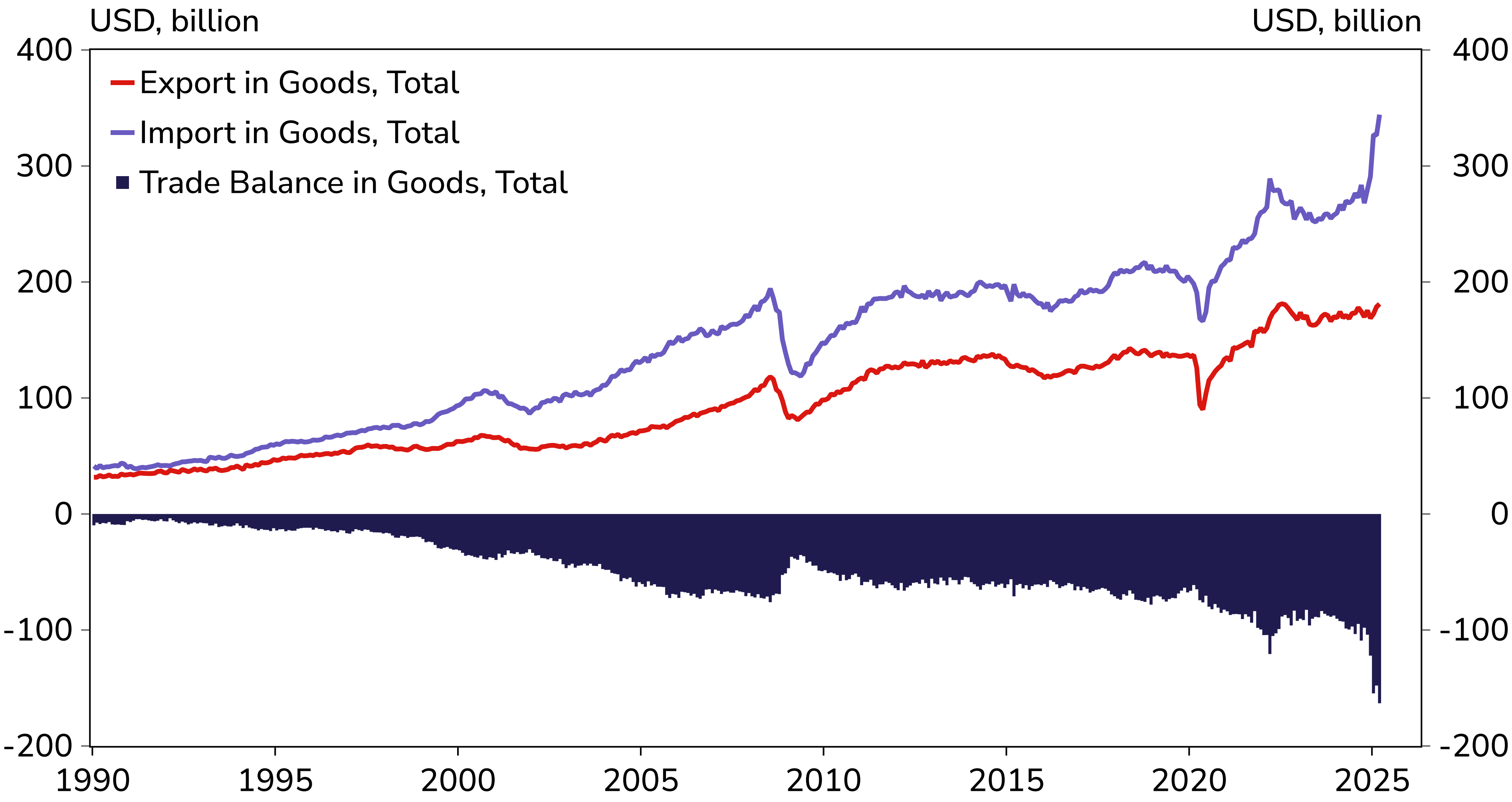
On April 9 however, just after the reciprocal tariffs went into effect, a tariff reduction to 10% was announced by the White House for 90 days to allow time for bilateral negotiations with trading partners.

China was excluded initially, but a month on a deal was reached, the US’ and China’s tariffs lowered to 30% and 10% – again, at least for 90 days. President Trump has threatened to re-escalate tensions since but continues to give time for deals to be reached.

Resilience and long-term economic development are China’s focus amid uncertainty and authorities there remain confident of achieving 5% growth in 2025. In contrast, the risks of economic contraction, persistent above-target inflation and a deteriorating fiscal position dominate debate for the US.

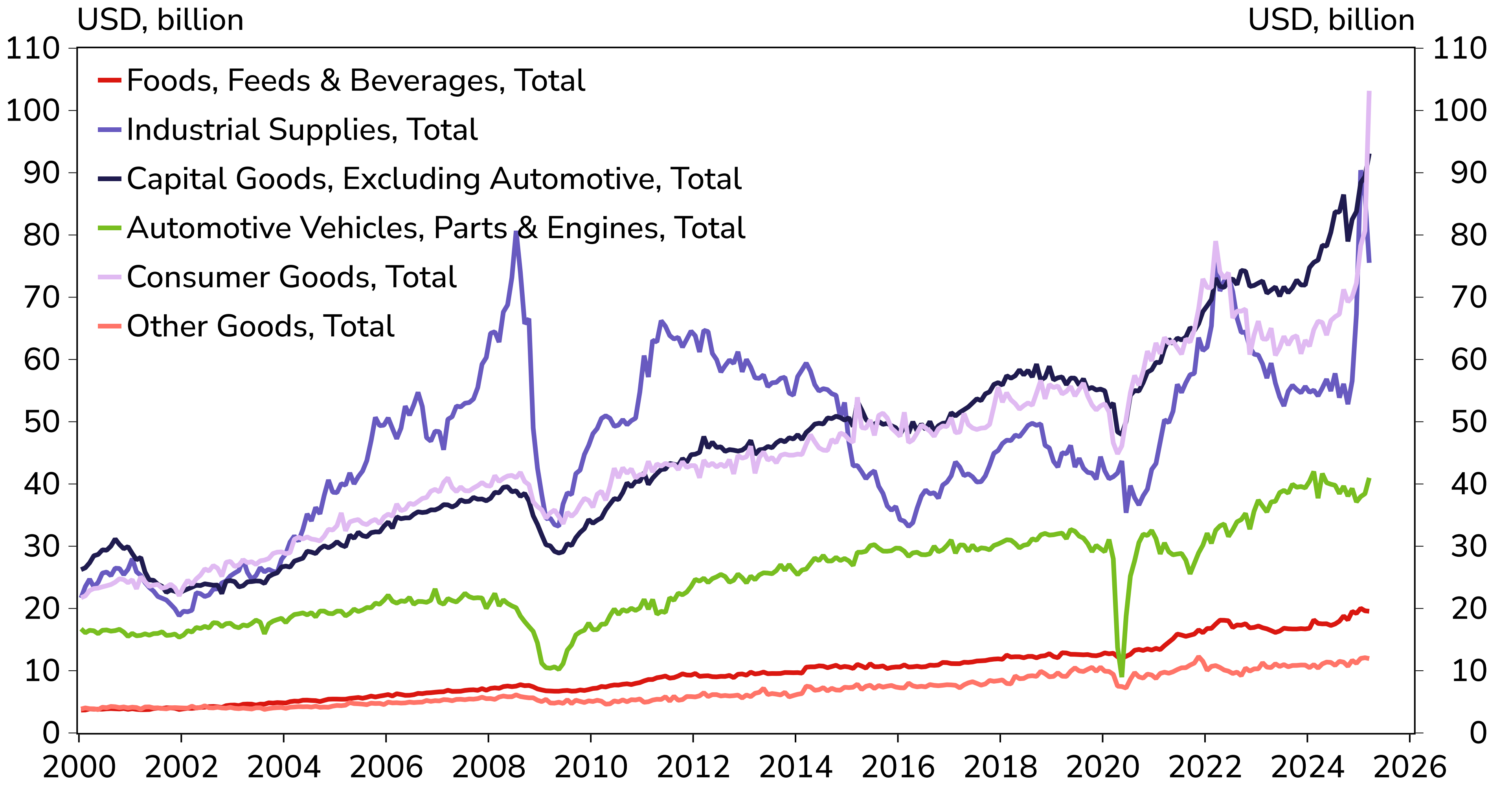
Arguably the ongoing uptrend in US Treasury yields warranted by the US’ growth and political uncertainty is as great a risk to the global economy and trade as tariffs. Although, at this stage, it seems most probable that the consequences will be disproportionately felt by the developed world, not emerging markets.

US goods imports have surged to get ahead of tariffs



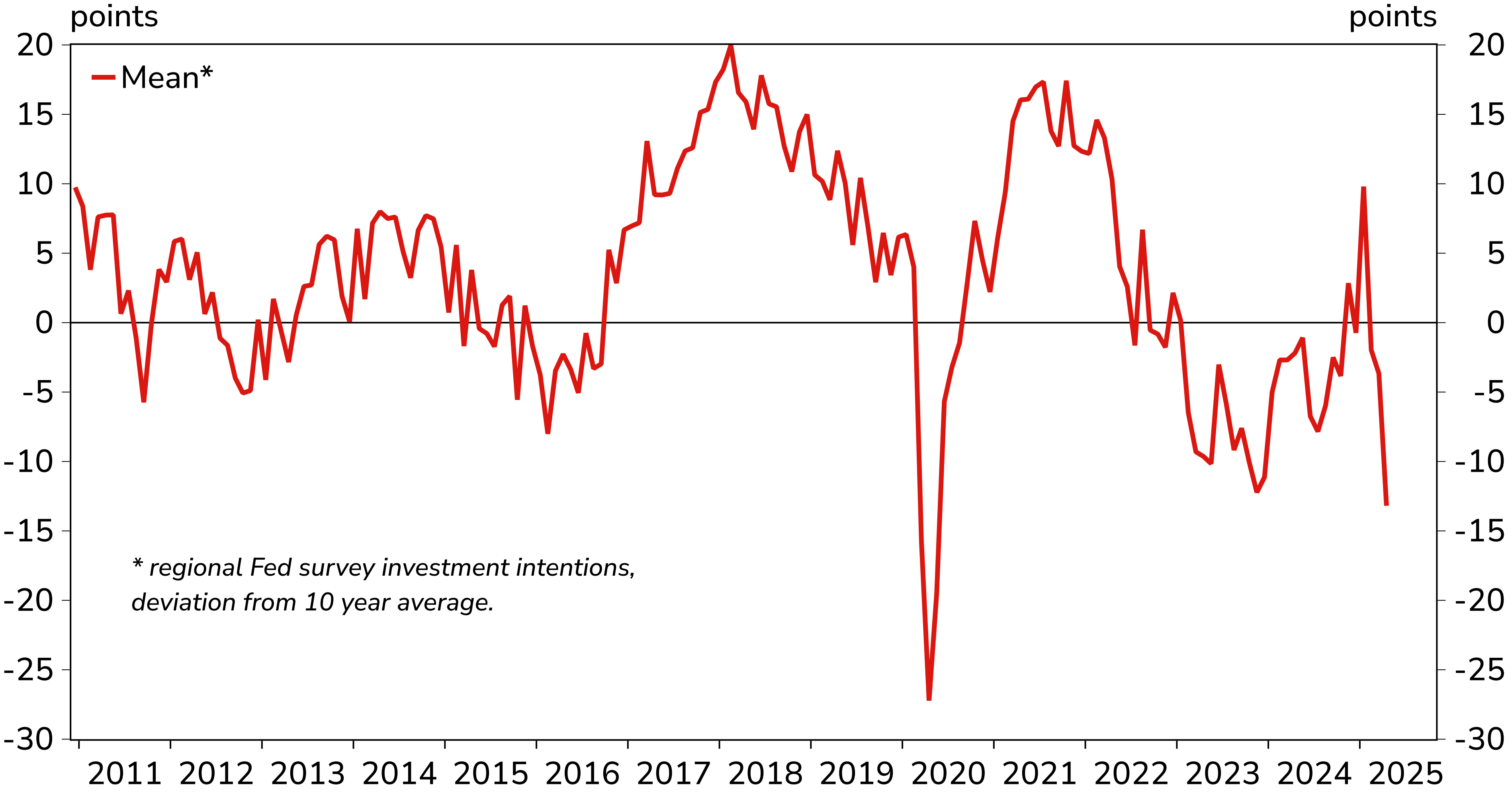
Source: USCB, Macrobond, Westpac Economics

US import pull-forward broad across households and firms



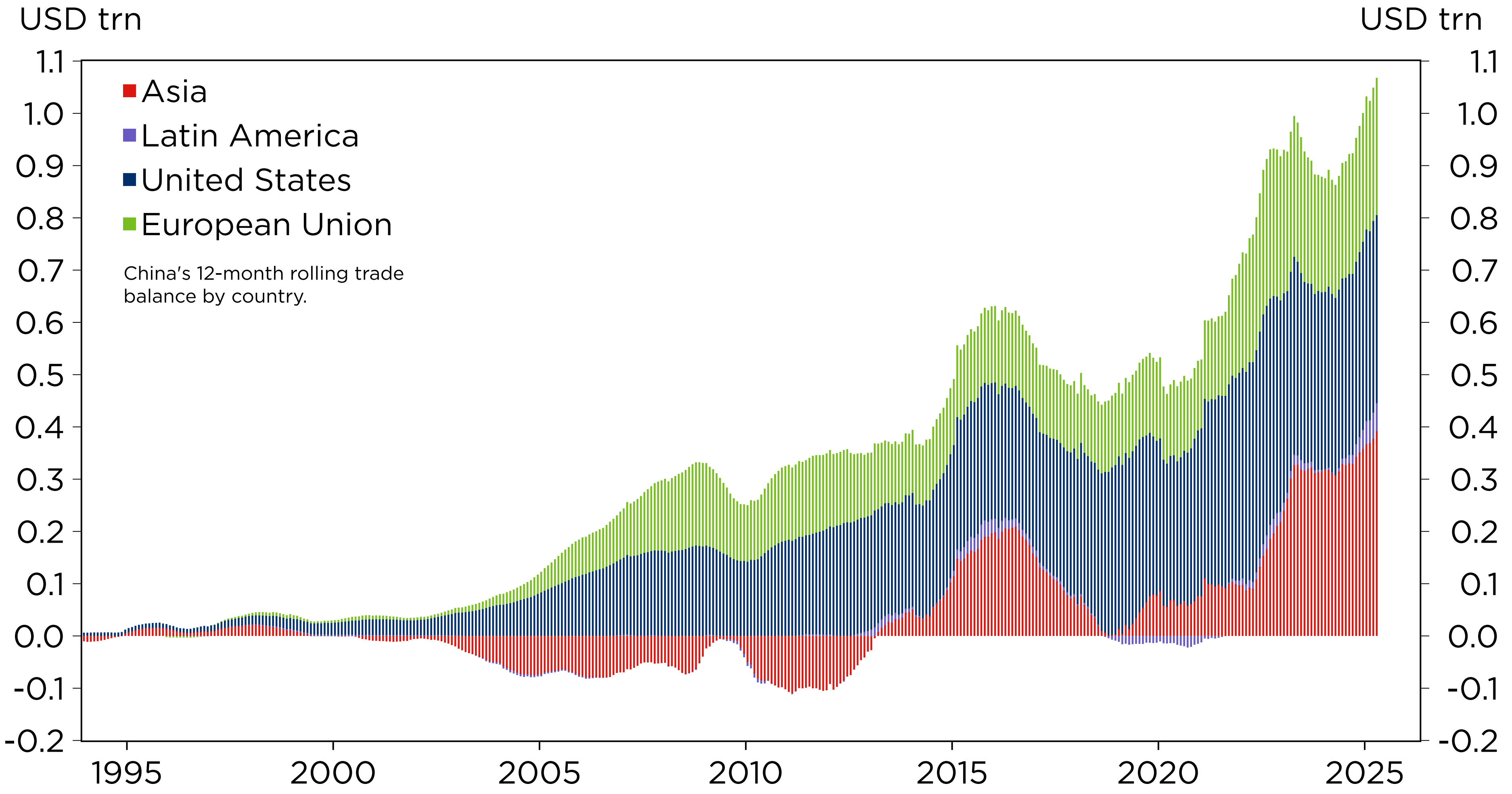
Source: USCB, Macrobond, Westpac Economics

US businesses unwilling to invest: import demand to hold up



Source: Dallas Fed, Kansas City Fed, New York Fed, Richmond Fed, Philadelphia Fed, Macrobond, Westpac Economics

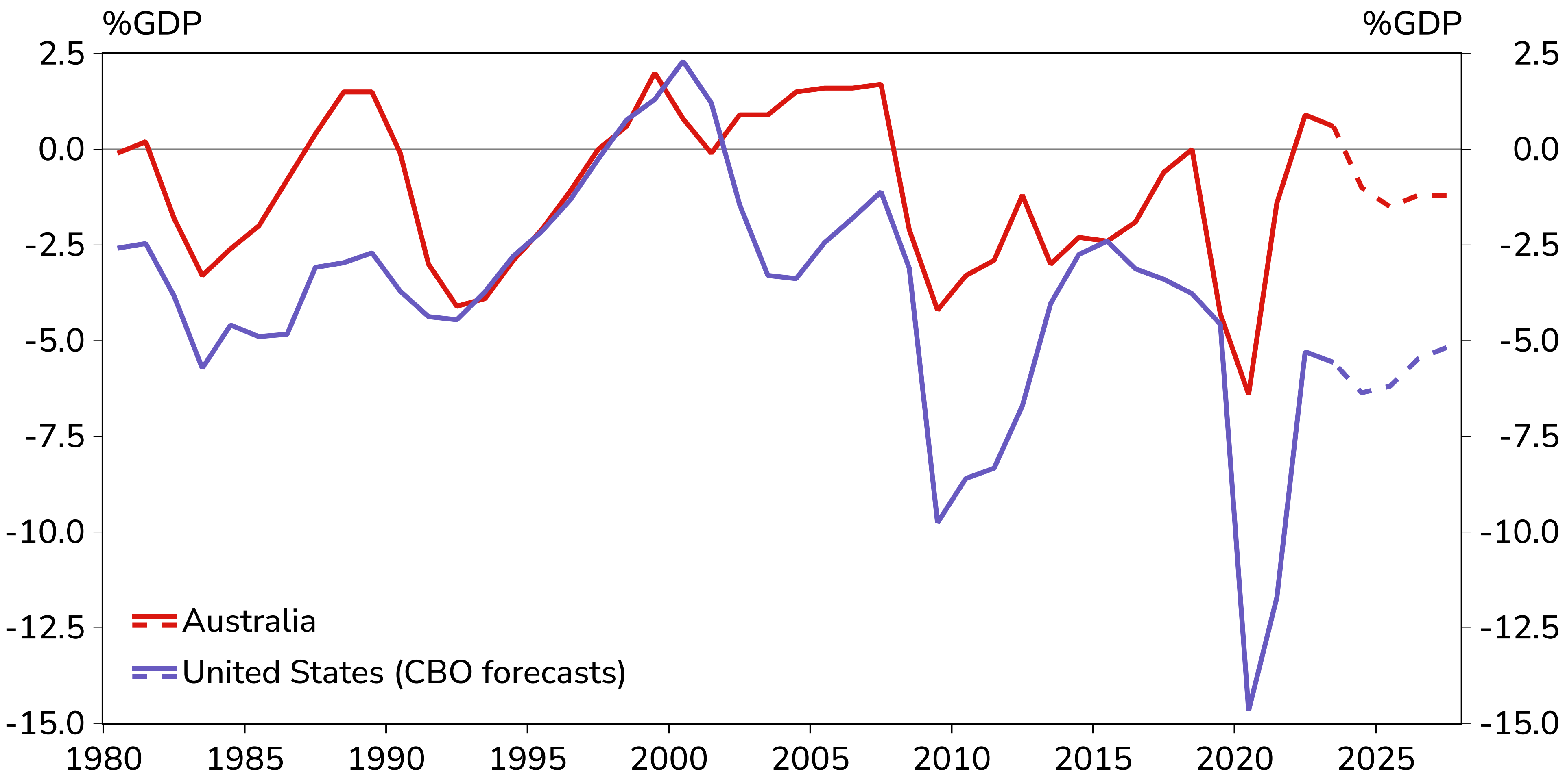
China's export opportunities plentiful outside the US



Source: GAC, Macrobond, Westpac Economics

Deterioration in US fiscal position a major risk for the US

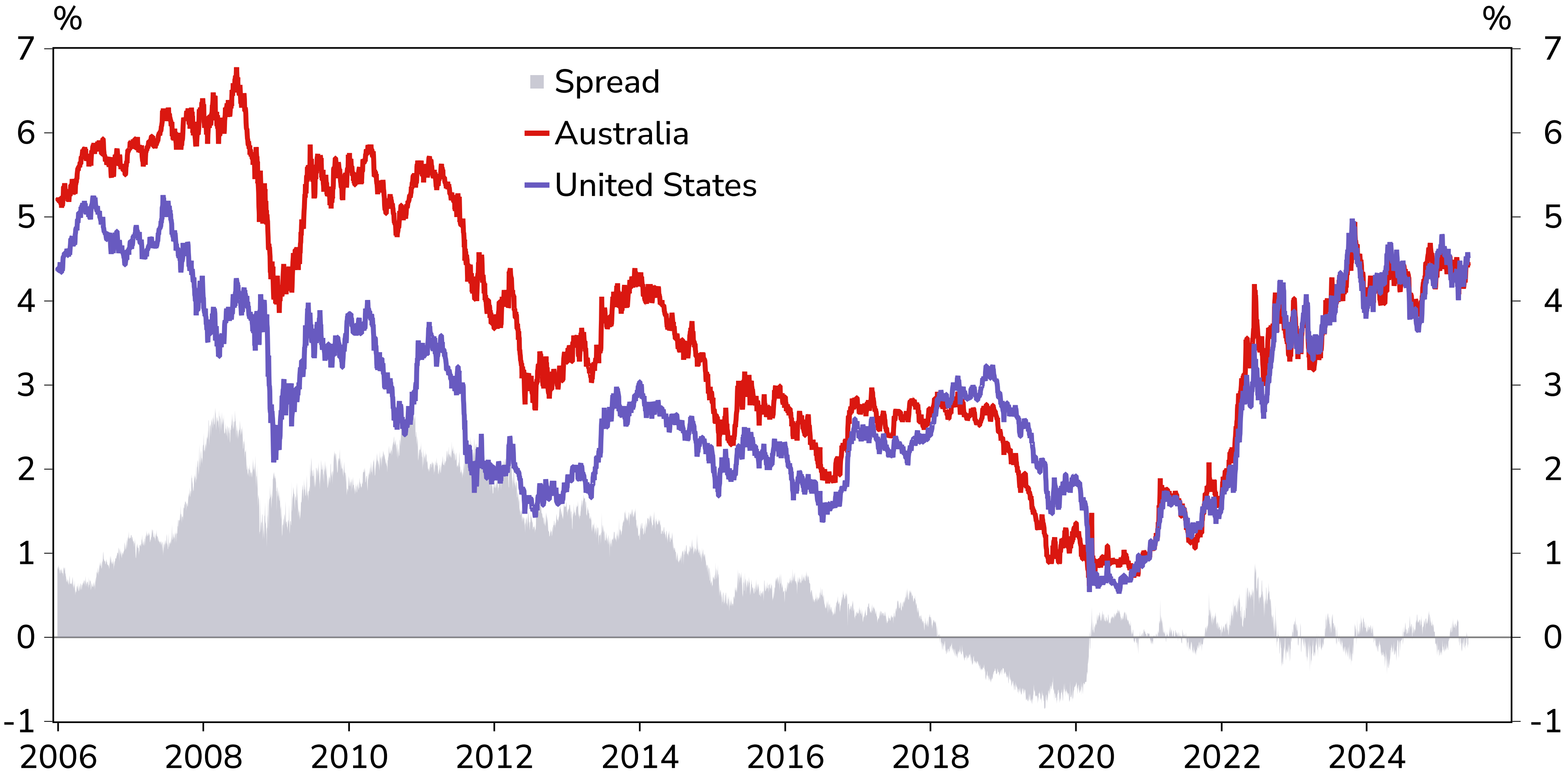
Federal Government Balance



Source: U.S. Treasury, Australian Department of the Treasury, CBO, Macrobond, Westpac Economics

Rise in US yields threatening investment and confidence

Australia & US 10-year Bond Yields



Source: Macrobond, U.S. Treasury, Westpac Economics

Australian trade: pre ‘Liberation Day’ surge continues

After declining to $2.9bn in February, the lowest level since August 2020, Australia’s goods trade surplus widened to a thirteen-month high of $6.9bn in March.

The detail showed Australia’s goods exports surged 7.6%mth in March ahead of the imposition of ‘Liberation Day’ tariffs in early April. The increase was the steepest since the start of 2022, when the re-opening of the global economy boosted trade.

Australia’s goods flow to the US seemed the most likely culprit given it jumped to about $6.0bn in January, three times larger than 2024’s average, and only eased slightly in February.

Australian goods exports to the US strengthened somewhat in March, but this flow contributed only a small fraction of the total increase.

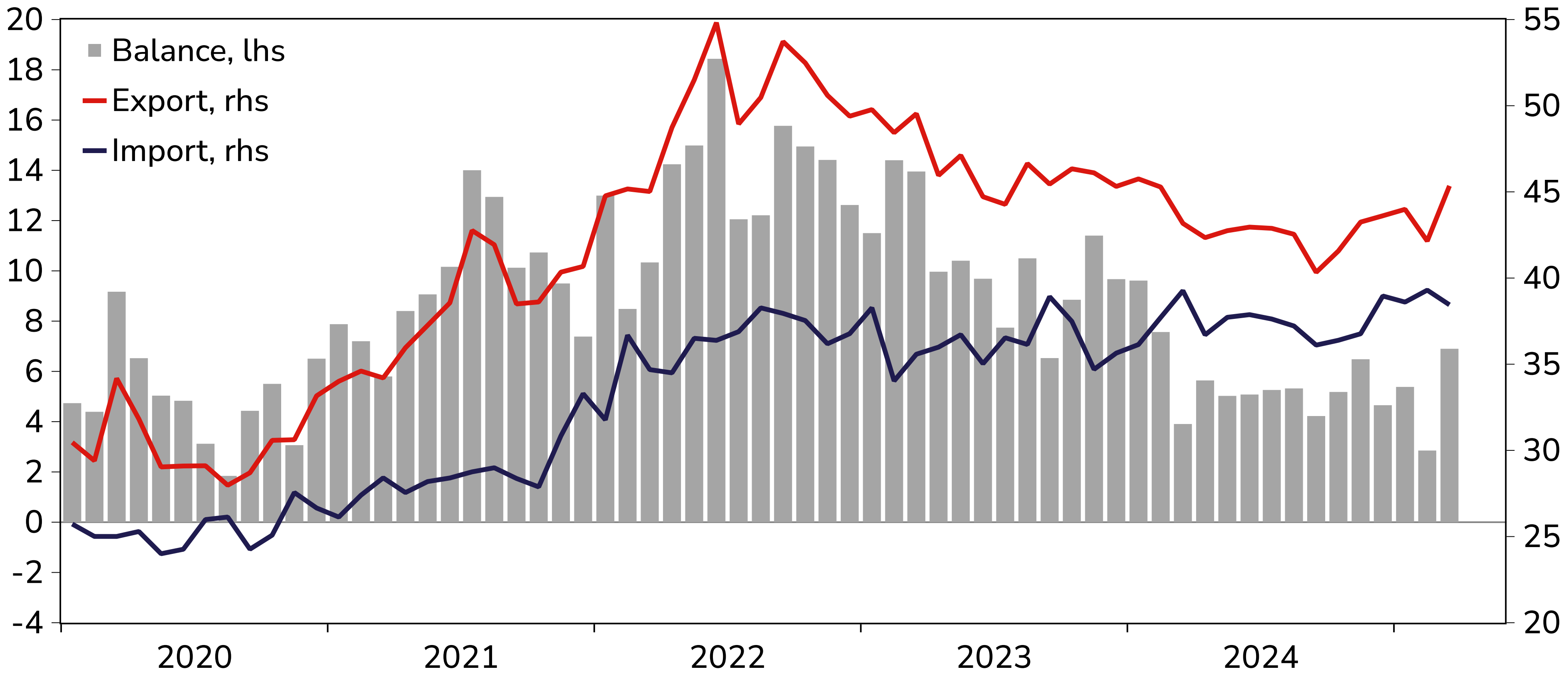
Rather, it was higher exports to China, and to a lesser extent Singapore, that played a more important role in March.

Goods flow to China recovered to near 2024’s average level thanks to stronger commodity shipments, most notably for iron ore.

Australian trade: the latest developments

Goods Trade Balance

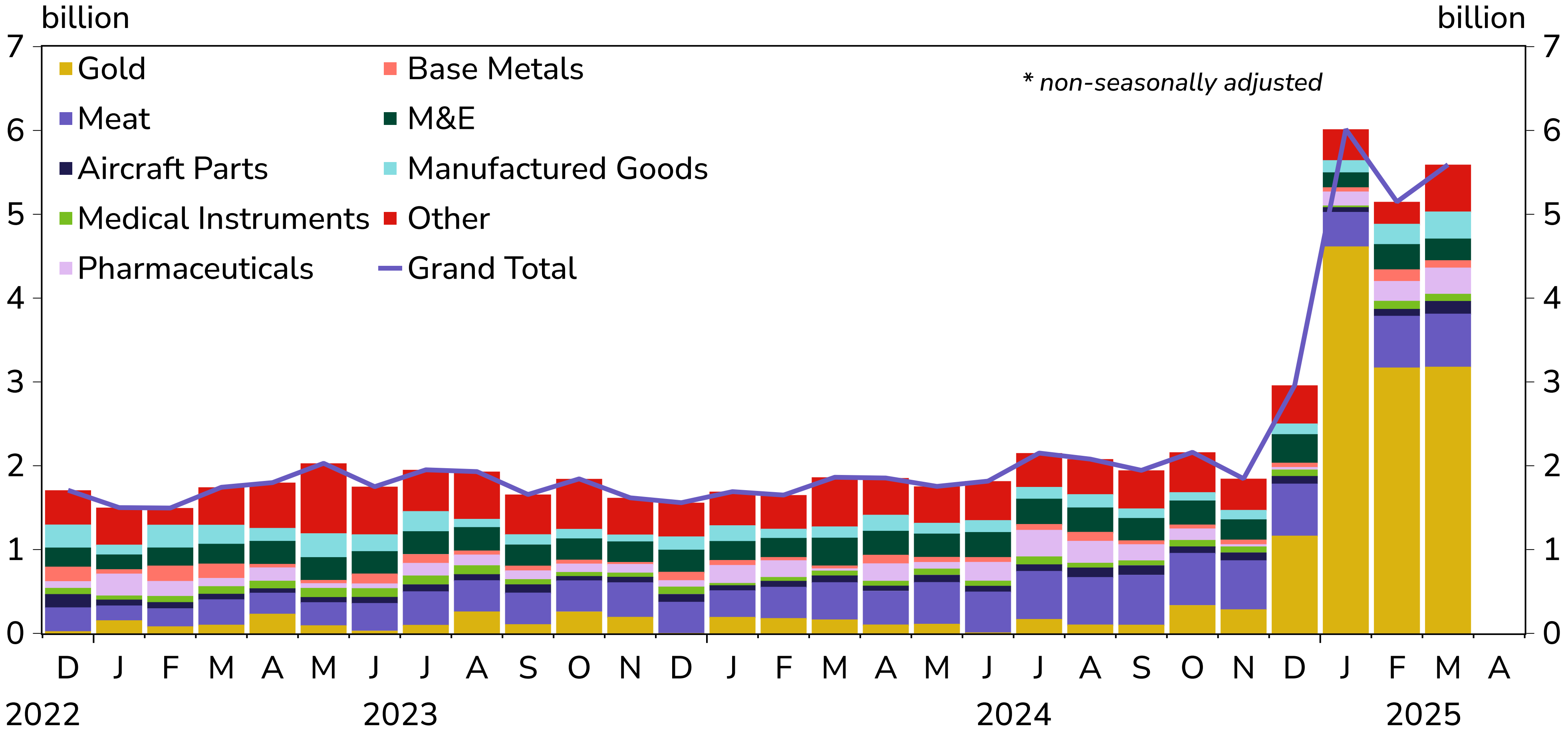
Value, $bn



Source: ABS, Macrobond, Westpac Economics

Australian trade: the latest developments

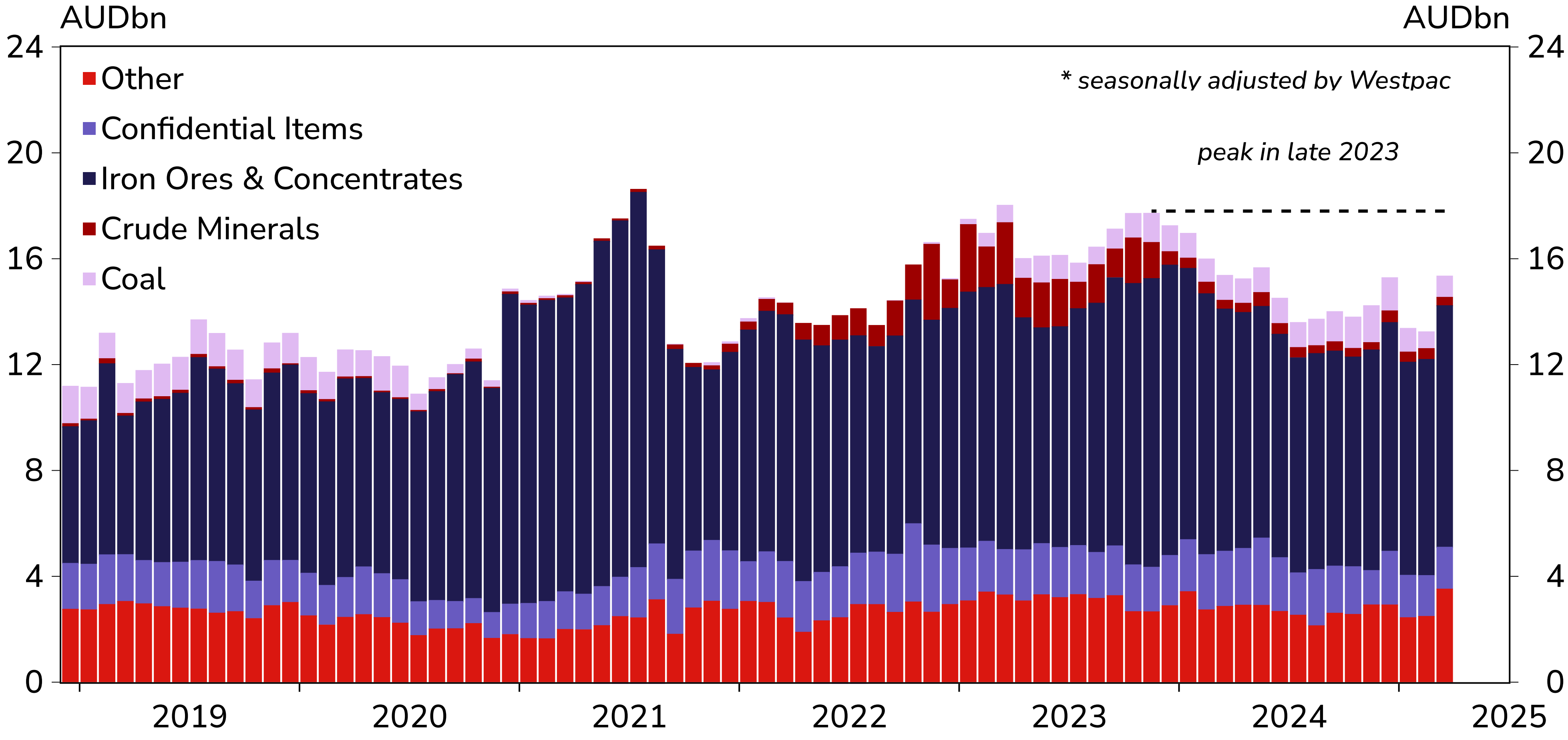
Australian goods exports to the US*



Source: DFAT, Macrobond, Westpac Economics

Australian trade: the latest developments

Australian goods exports to China*



Source: ABS, DFAT, Macrobond, Westpac Economics

Tariff test: how exposed are Australian industries?

The US's extreme trade protectionist policies will have ripple effects on global trade flows and prices. As per our 1 May report, Australian industries will show resilience. But the net impact will not be uniform.

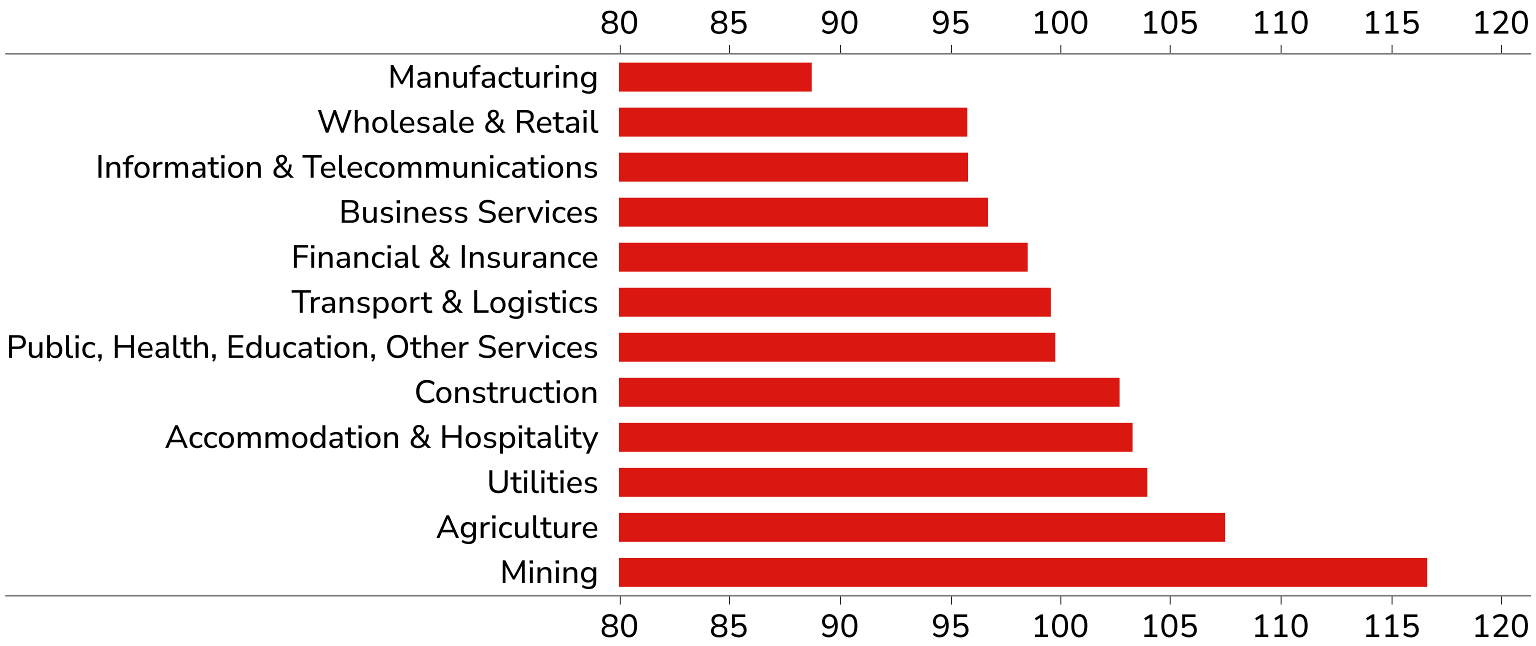
Based on our Industry Trade Exposure Index, the Agriculture and Mining sectors are well-positioned to handle the trade shock. The US is a relatively small market for these Australian exporters who also have the capacity to redirect some commodity goods to other markets, albeit potentially at lower prices.

A 'tariff advantage', particularly vis-à-vis US exports into China, should create opportunities. Critical minerals and the defence industry may also benefit from trade with the developed world given China's restrictions on rare earth exports, an increased focus on diversifying strategically important supply chains and the changing geopolitical landscape. These trends could create positive spillovers for food manufacturing, wholesale, construction, professional services and transport & logistics

In contrast, the manufacturing sector is more vulnerable given its potential exposure to US final demand, US' tariffs and global competition. However, the net impact will vary across sub-sectors. Specialised and high value-added manufacturing are likely be more insulated.

Notwithstanding our constructive view of the impact on Australia industries, the risks are still sizeable. A sharper slowdown across Australia's major trading partners and/or weaker domestic demand due to global uncertainties would ultimately lead to lower GDP growth and industrial activity.

Industry Trade Exposure Index



*Index is a composite measure based on 10 indicators covering direct and indirect trade exposures and broader global trade risk. Index = 100 is the mean across industries. See Appendix A and B.

Source: ABS, OECD, Macrobond, Westpac Economics

To gauge industries' net exposure, we have developed an Industry Trade Exposure Index based on ten indicators looking at the direct and indirect opportunities and risks from trade.

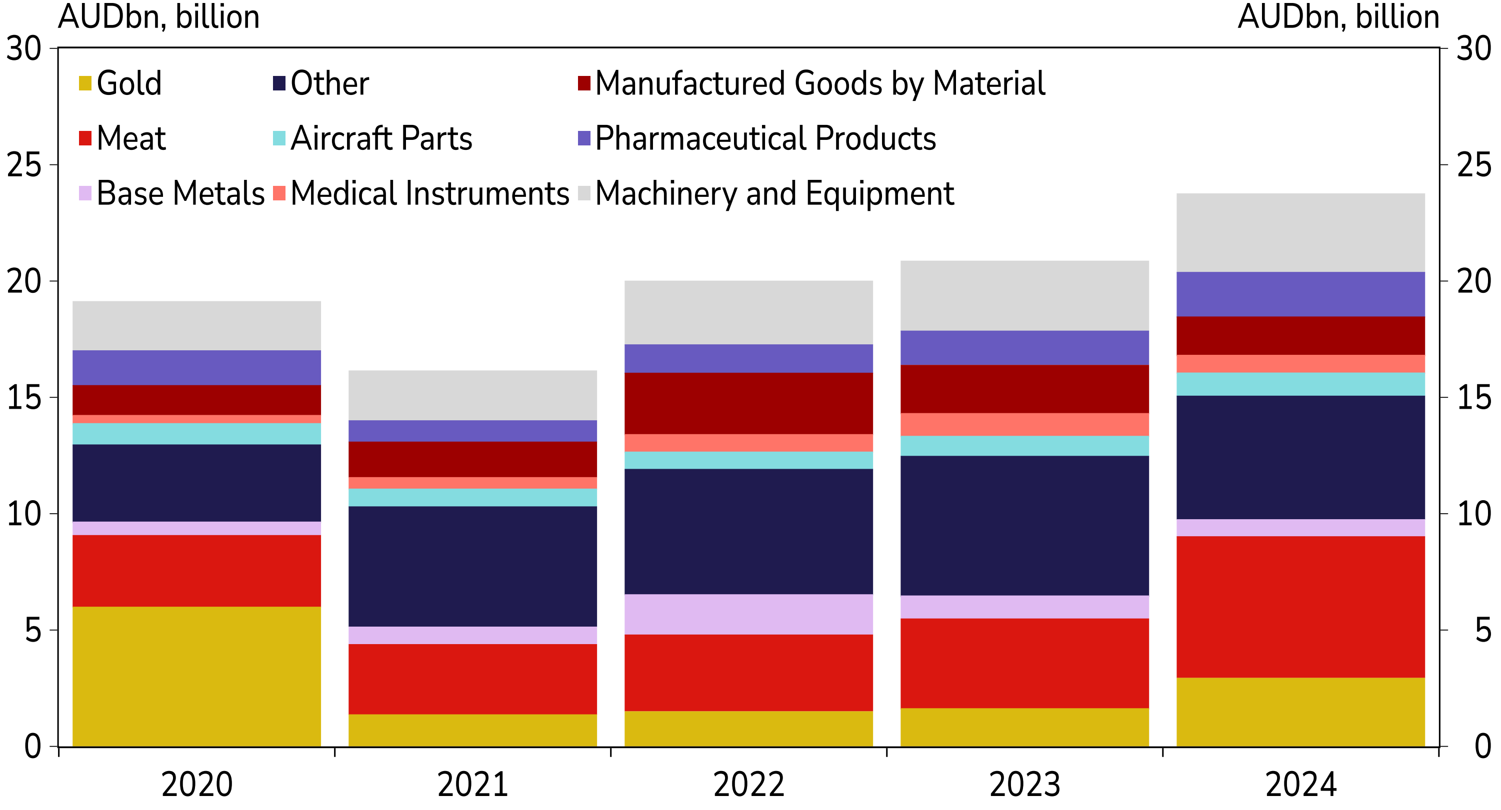
Based on our Industry Trade Exposure Index, the agriculture and mining sectors are well-positioned to handle the trade shock. The US is a relatively small market for these Australian exporters who can also redirect some commodity goods to other markets, albeit at lower prices.

Manufacturing and wholesale & retail are at greater risk. Broadly, these sectors are more exposed to US demand and greater global competition.

Australia's direct trade exposure to the US is modest. With services, gold and pharmaceuticals currently exempted, around 40% of total exports to the US face a 10% tariff, rising to 25% for aluminium and steel (6% of total goods).

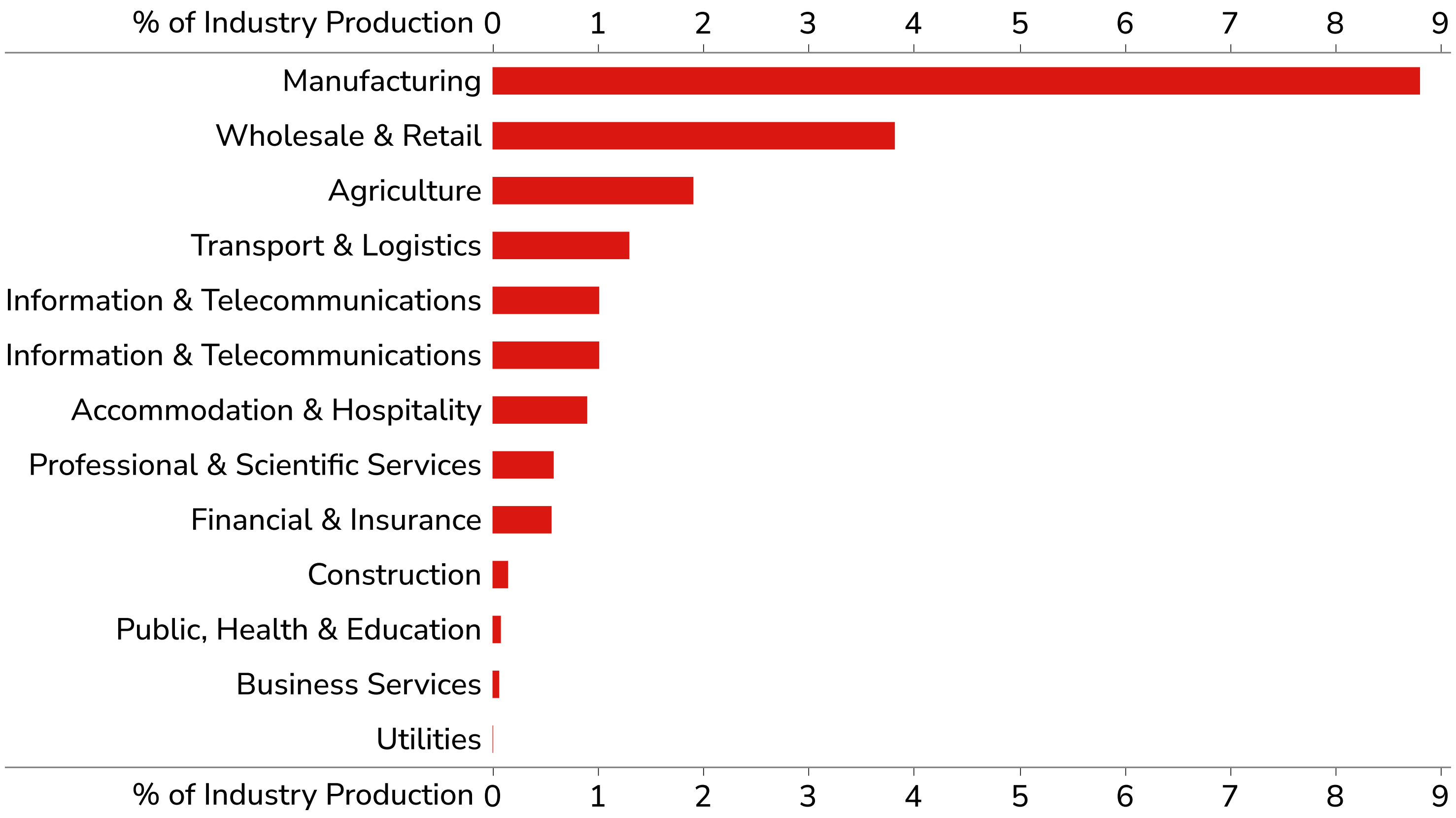
At an industry level, some sectors may face greater pressure from a loss of US market share. For example, beef, Australia's largest export to the US, was worth $4.4bn in 2024, equivalent to 31% of total beef exports. Pharmaceuticals are even more exposed, with 52% of Australia's pharmaceutical exports destined to the US.

Australia Goods Exports to the US



Source: DFAT, Macrobond, Westpac Economics

Domestic Value Added of Exports to US



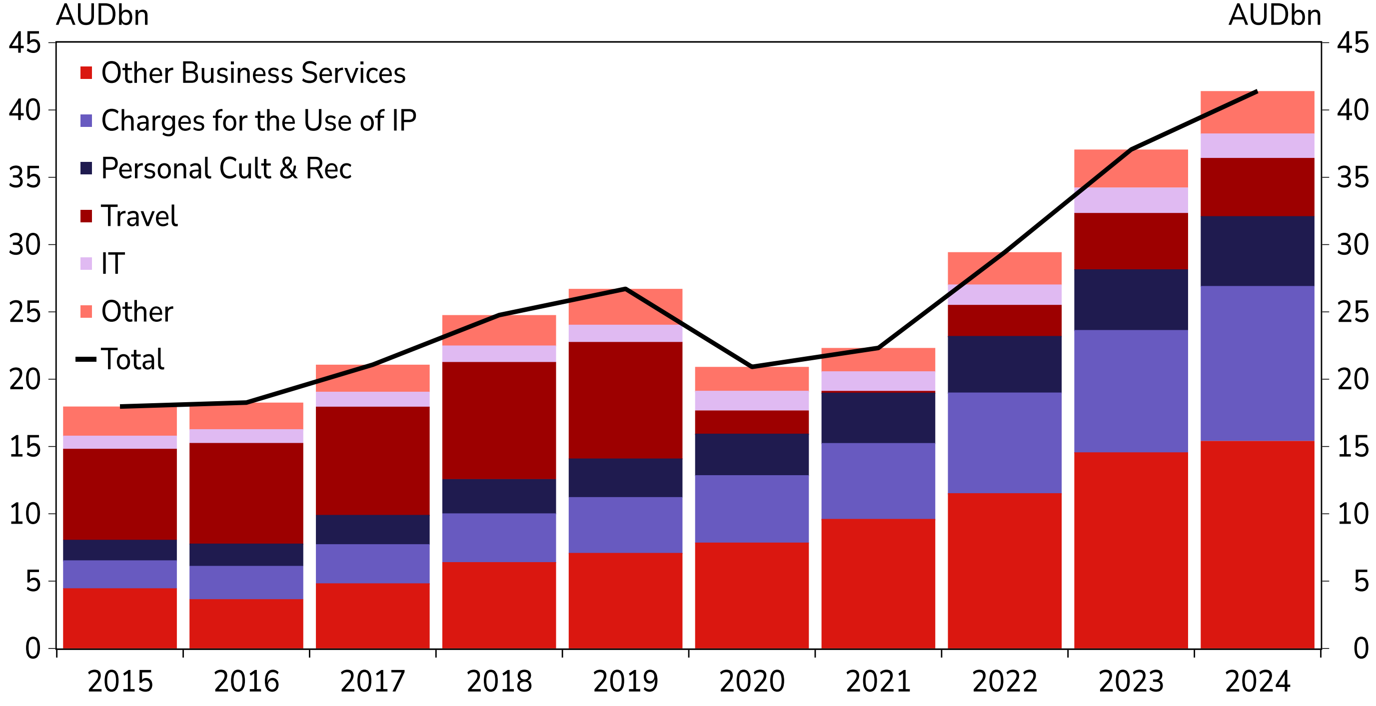
Source: OECD, Macrobond, Westpac Economics

Looking at the share of domestic value-added for exports to the US, manufacturing is a standout at almost 9% of total industry gross value added (the industry's contribution to GDP). This is well over double the share of the next industry.

Still, we estimate that the static direct cost of a 10% tariff across industries would be manageable particularly as there are several mitigating factors that could soften the blow.

Australian exporters could gain from a relative 'tariff advantage' over countries facing higher tariffs. Patented drugs and specialised products, such as medical instruments, may also have few substitutes, reducing demand risk. Importantly, 'lost' exports are likely to be redirected elsewhere.

Australian Services Imports from US by Category



Source: ABS, Macrobond, Westpac Economics

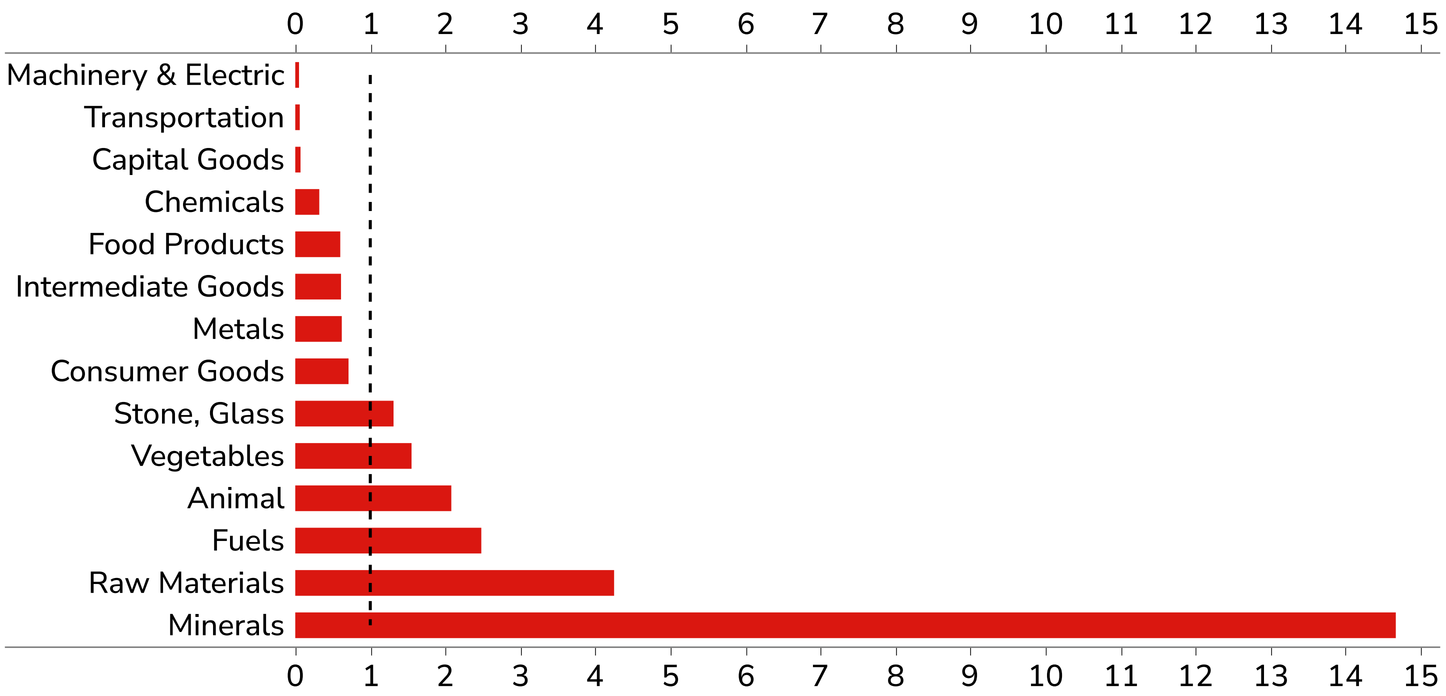
Higher tariffs will lift the cost of US domestic goods. Supply chains spanning multiple countries may even widen and amplify the inflationary effects as tariffs cascade across stages of production and jurisdictions. While the tariff impact on services prices is expected to be smaller than for goods, services will not be immune.

Where substitutes exist, Australian firms will adjust. However, in areas dominated by US suppliers such as intellectual property (~28% of service imports from the US) and IT-related services, cost increases will likely have to be absorbed.

Beyond the immediate trade flows, broader opportunities exist. Critical minerals and defence stand out as industries positioned to benefit from shifting global dynamics.

Critical minerals and rare earths, which are vital for electronics, EVs, aerospace and green technologies, have become central to strategic policy agendas. While Australia is a significant supplier of these minerals, it lacks downstream processing capacity, which is heavily concentrated in China. Under its critical minerals initiatives such as Future Made in Australia, the government is focused on building strategic reserves and bolstering downstream processing capabilities.

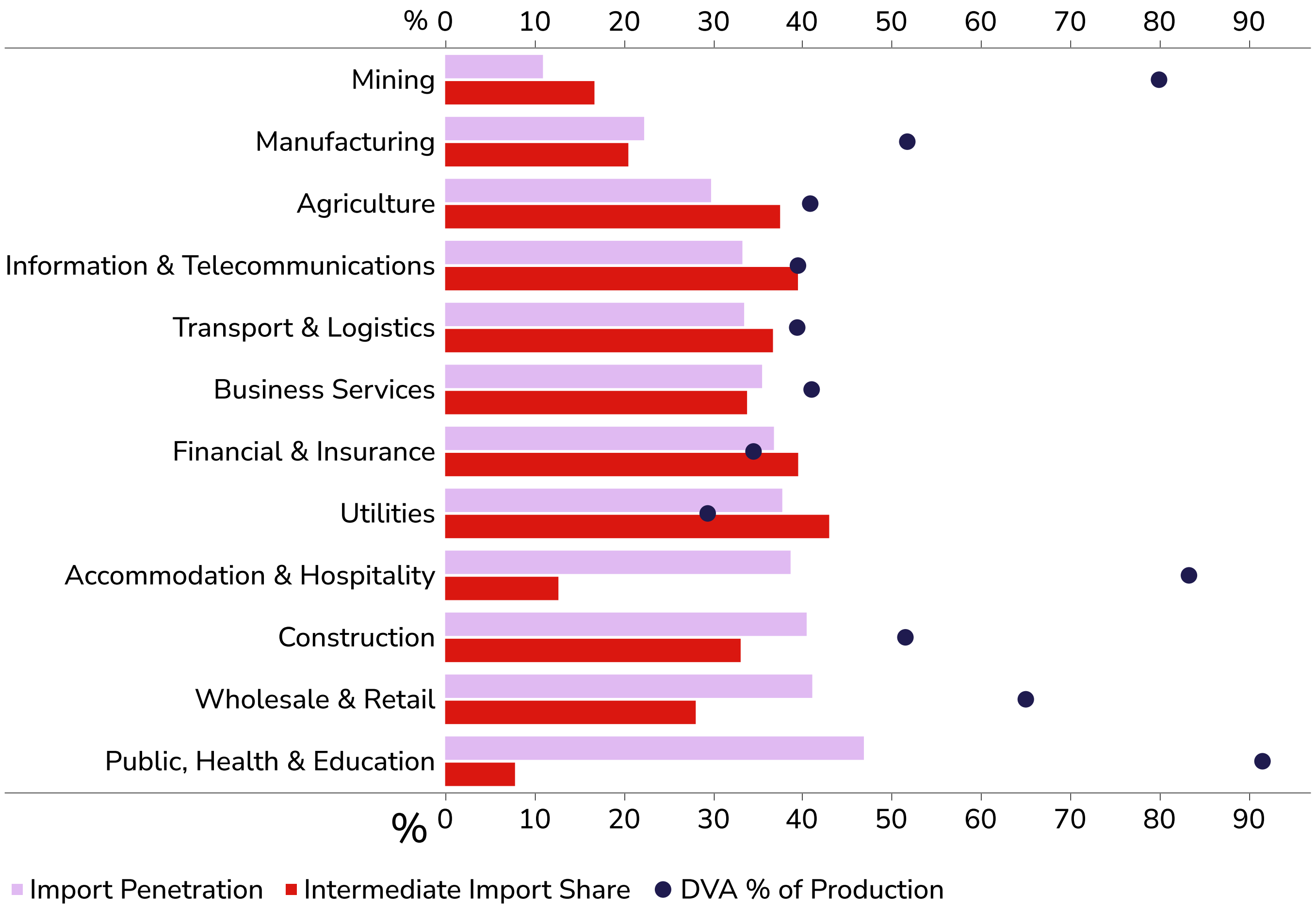
Revealed Comparative Advantage



* >1 indicates a Revealed Comparative Advantage (RCA) in the exportation of the good, and <1 reveals little or no advantage

Source: WITS, Macrobond, Westpac Economics

Import Penetration, DVA & Intermediate Import Share



Source: ABS, Macrobond, Westpac Economics

Trade diversion will not be one-way. Other exporters will also seek new markets, creating both substitution opportunities and vulnerabilities. Three indicators – import penetration, intermediate imports as a share of production and domestic value added as a share of production – help define these risks. These measures reveal more than price movements: they illustrate the relative exposure across Australia's industrial base.

A high import penetration, coupled with a high share of intermediate imports could benefit from the inflow of cheaper goods, lowering input costs for goods like fertiliser, fabricated metal, tiles, and heavy machinery. For construction and other industries facing cost pressures from wages, this imported disinflation could offer significant relief.

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