



WESTPAC ECONOMICS

# TALKING ABOUT TRADE

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# Global Economy



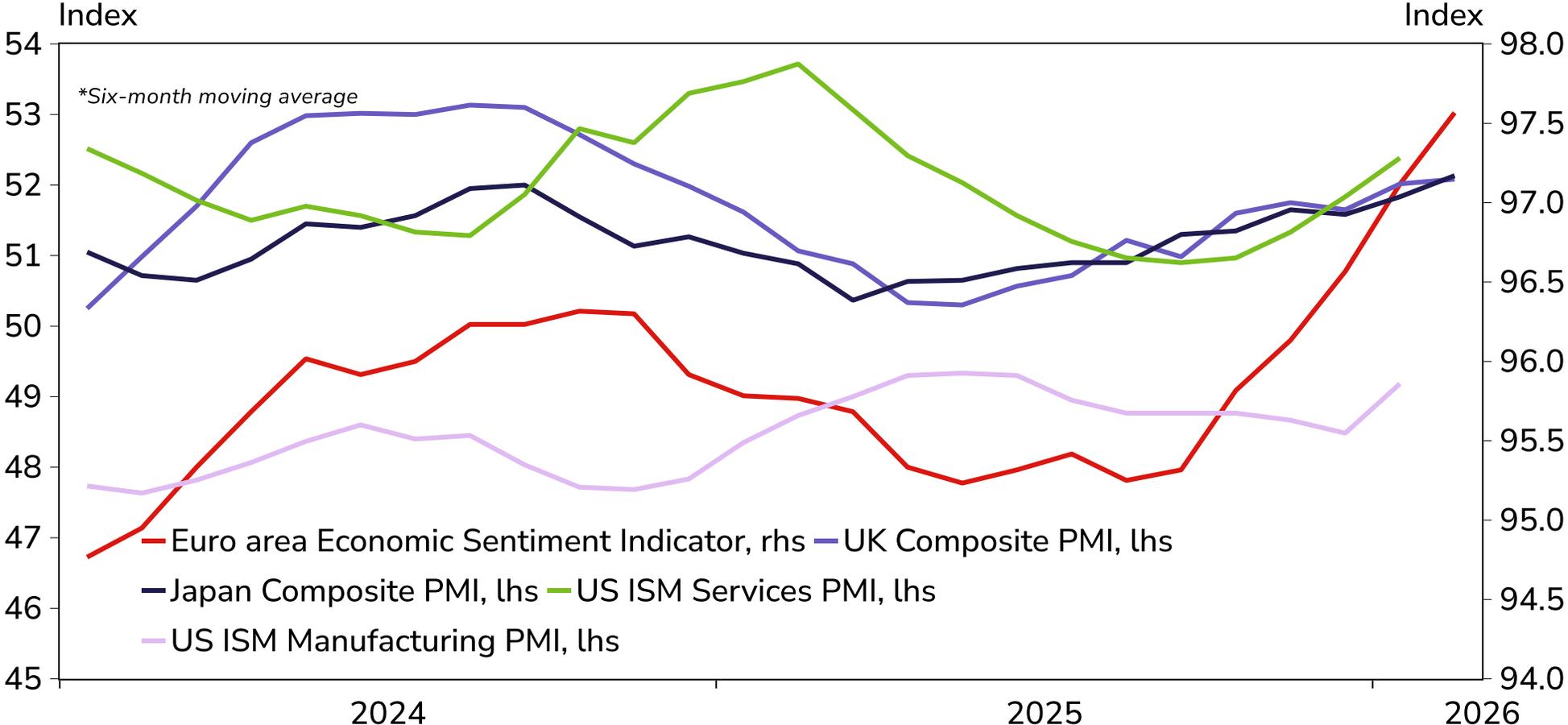
**Growth opportunities for the world are broad, persistent and trade rich.**

- The global economy enters 2026 with strength and vitality. Not only is US growth expected to remain above par amid headwinds, but Asia is showing broad-based momentum while Europe and the UK hold around trend.
- In reality, and the minds of investors, risks have also receded. President Trump is seeking to replace one tariff with another. But the net effect on global trade has been, and is expected to remain, limited.
- Ahead, global trade flows are set to be supported by the economic development of emerging markets, a trend with a long runway. Added to this is the global drive to develop tech infrastructure and green energy, which Asia will also profit handsomely from.

# A cyclical upswing, US manufacturers on shakier ground



## Economic sentiment in major advanced economies\*



Source: DG ECFIN, S&P Global, ISM, Macrobond, Westpac Economics



The US Supreme Court struck down reciprocal tariffs. President Trump replaced them with a temporary flat 10% levy.

- The Supreme Court have ruled the tariffs imposed under the International Emergency Economic Powers Act (IEEPA) are illegal. The sectorial tariffs applied under Section 232 of Trade Expansion Act 1962 and Section 301 of Trade Act 1974 remain valid, however.
- The Supreme Court made no ruling on refunds, deferring the decision to a lower court. Total US custom duties were worth around 0.85% of GDP last year, with 0.5ppts of GDP (\$160bn) linked to the illegal tariffs. Years of litigation is now likely as corporates seek compensation.
- President Trump has responded with a new flat 10% tariff, expected to go up to 15%. Although this measure can only remain in place for 150 days without congressional approval.



The US Supreme Court struck down reciprocal tariffs. President Trump replaced them with a temporary flat 10% levy.

- The Supreme Court ruling may affect trade deals the US signed last year.
- For example, the European Union, which accounts for around a fifth of US imports, highlighted that the new additional 15% tariff means that the total tariff for around \$5bn worth of goods breaches the 15% ceiling the EU and US agreed to last year.
- Overall, the response of trading partners has been guarded so far.



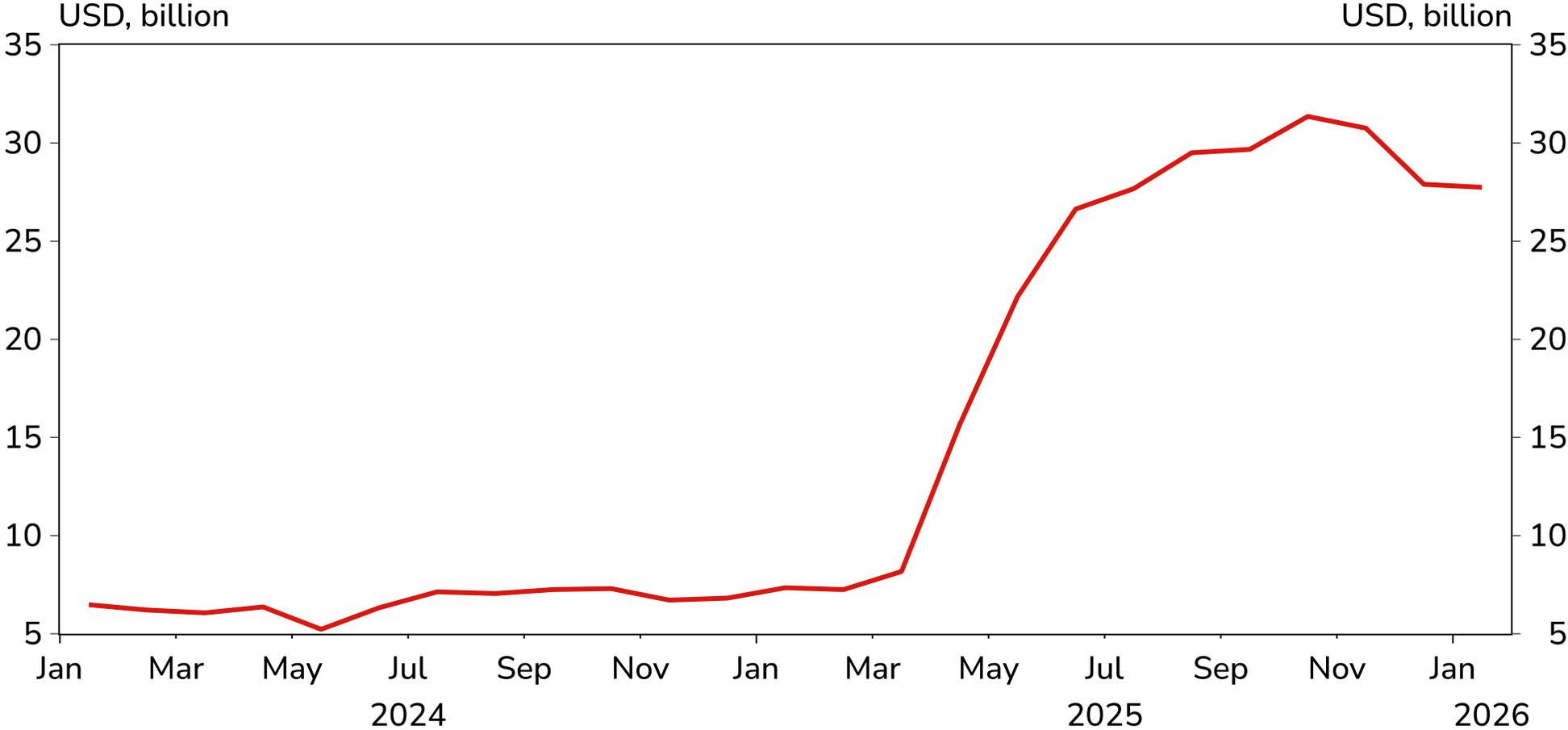
## Implications for the US

- The decision restricts one of Trump's most widely used weapons – his ability to take sweeping unilateral action (i.e. act without Congressional approval).
- This limitation for US tariff revenue comes at a particularly inopportune time with the annual Federal deficit running close to 6% of GDP.
- The US Administration will look to exploit other legal avenues to expand tariffs when the Section 122 duties expire, but the path will be complicated not only legally but also politically, given relatively poor support for tariffs in the US.
- US trade flows were very volatile in 2025, even though the trade balance ended the year little changed from 2024. Uncertainty over future US trade policy will see trade volatility persist this year, and potentially beyond.

# US tariff revenue will decline



## Monthly US Government revenue from custom duties

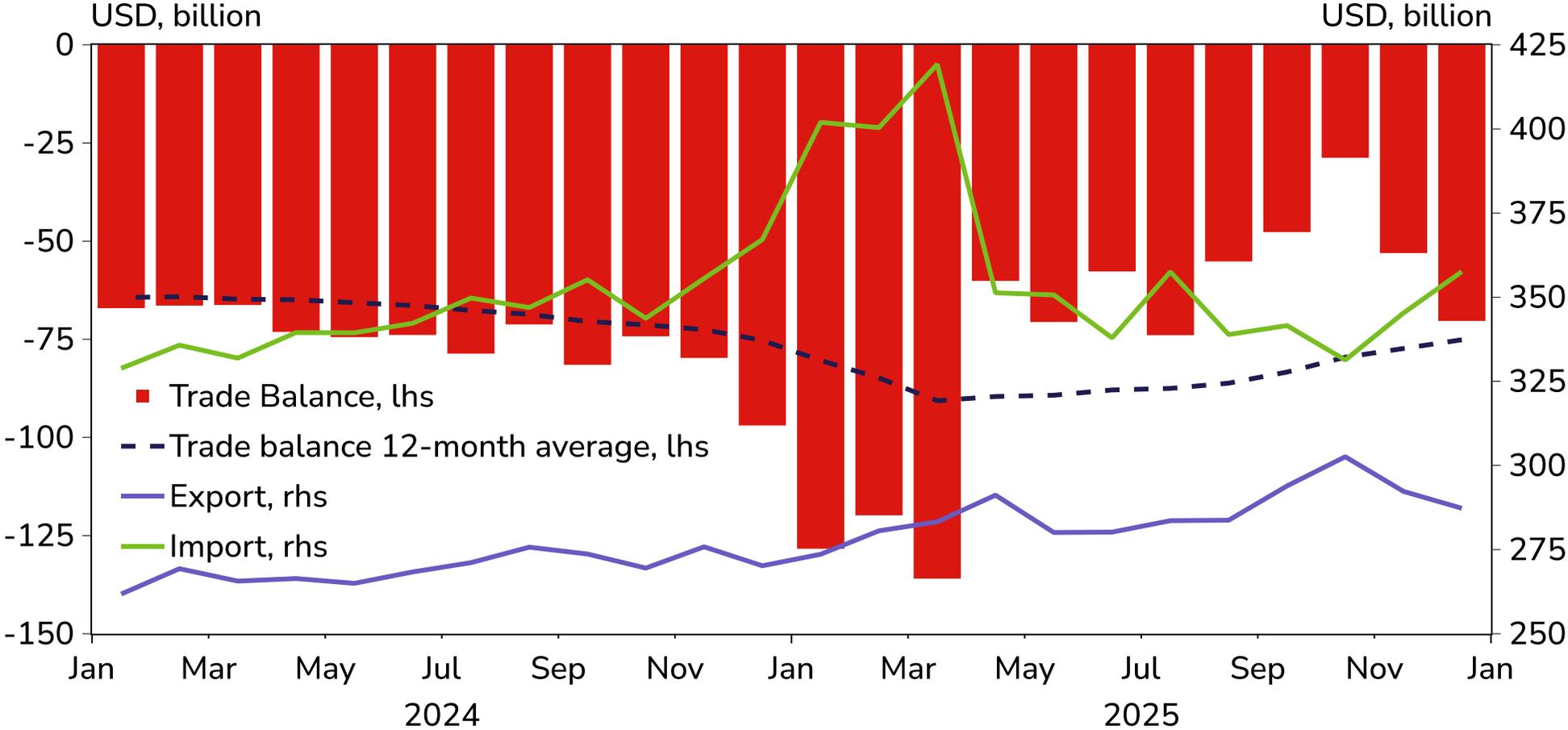


Source: U.S. Treasury, BEA, Macrobond, Westpac Economics

# Tariff uncertainty likely to create more trade volatility



## US Monthly trade balance



Source: BEA, Macrobond, Westpac Economics



# Australia's Economy



## Key domestic themes

- Just six months after its last cut, the RBA increased the cash rate by 25bp to 3.85% at its February meeting. While a further hike at the March meeting is possible, our base case for the next hike is May after which we expect a prolonged pause. We then anticipate a partial reversal of the tightening cycle in Q4 2027 and Q1 2028, with two cuts to take the cash rate back to 3.60%.
- Inflation pressures intensified in the second half of last year, trimmed-mean inflation printing at 1.0%qtr in Q3 and 0.9%qtr in Q4. This acceleration was primarily driven by a combination of higher administered prices and a faster recovery in private sector demand. In its policy statement, the RBA also pointed to the stronger-than-expected growth of Australia's main trading partners and global trade. We expect GDP growth to remain resilient at 2.5% in 2026.



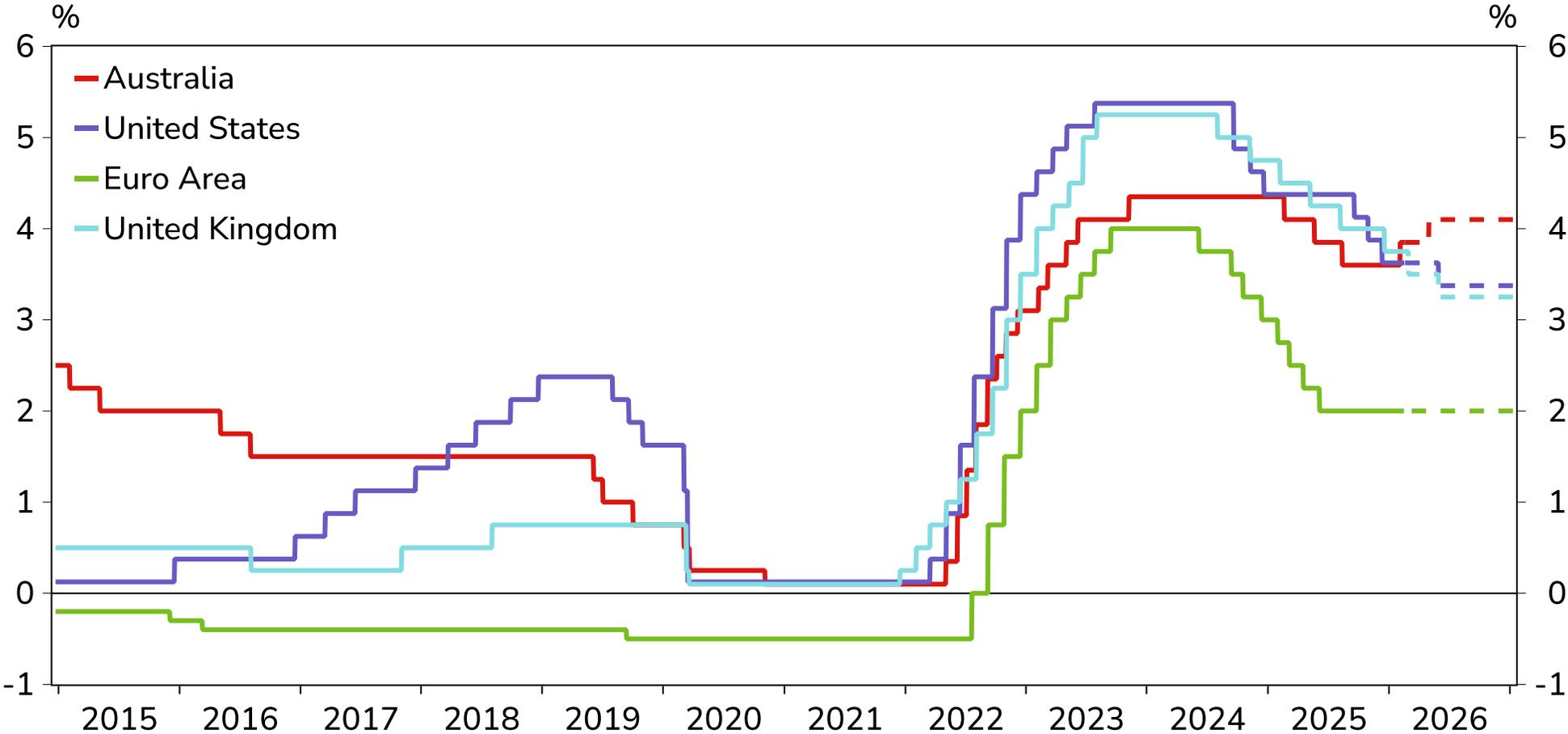
## Key domestic themes

- Job data for December and January suggests labour demand is stabilising and broadly tracking population growth, slowing public-funded employment offset by renewed growth in private sector jobs. Labour supply dynamics have been crucial, easing cost-of-living pressures reducing the incentive for workforce participation, and keeping the unemployment rate around 4.1%.
- Recent indicators suggest that the outlook for Australian consumers is stronger than previously anticipated. Both ABS data and Westpac internal indicators reveal an acceleration in spending growth during the December quarter. Our near-term consumer spending forecasts have been revised higher, with annual growth expected to reach 3.0% for calendar 2025 and some momentum carrying into 2026, despite higher interest rates.

# The RBA raised rates...



## Central bank policy rates (Westpac forecasts)

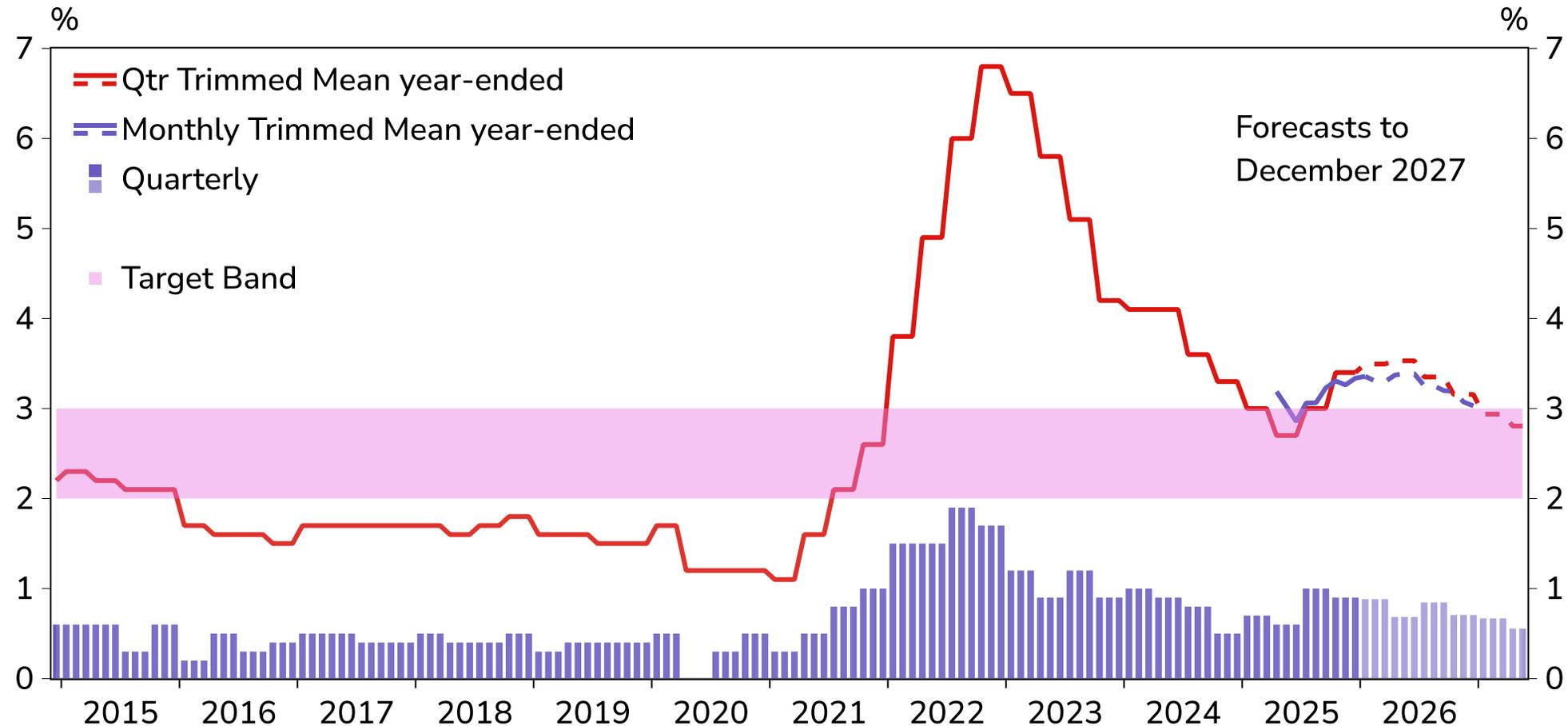


Source: RBA, Fed, BoE, ECB, BOJ, BOK, Macrobond, Westpac Economics

# ...reacting to higher underlying inflation in H2 2025...



## Trimmed Mean Inflation

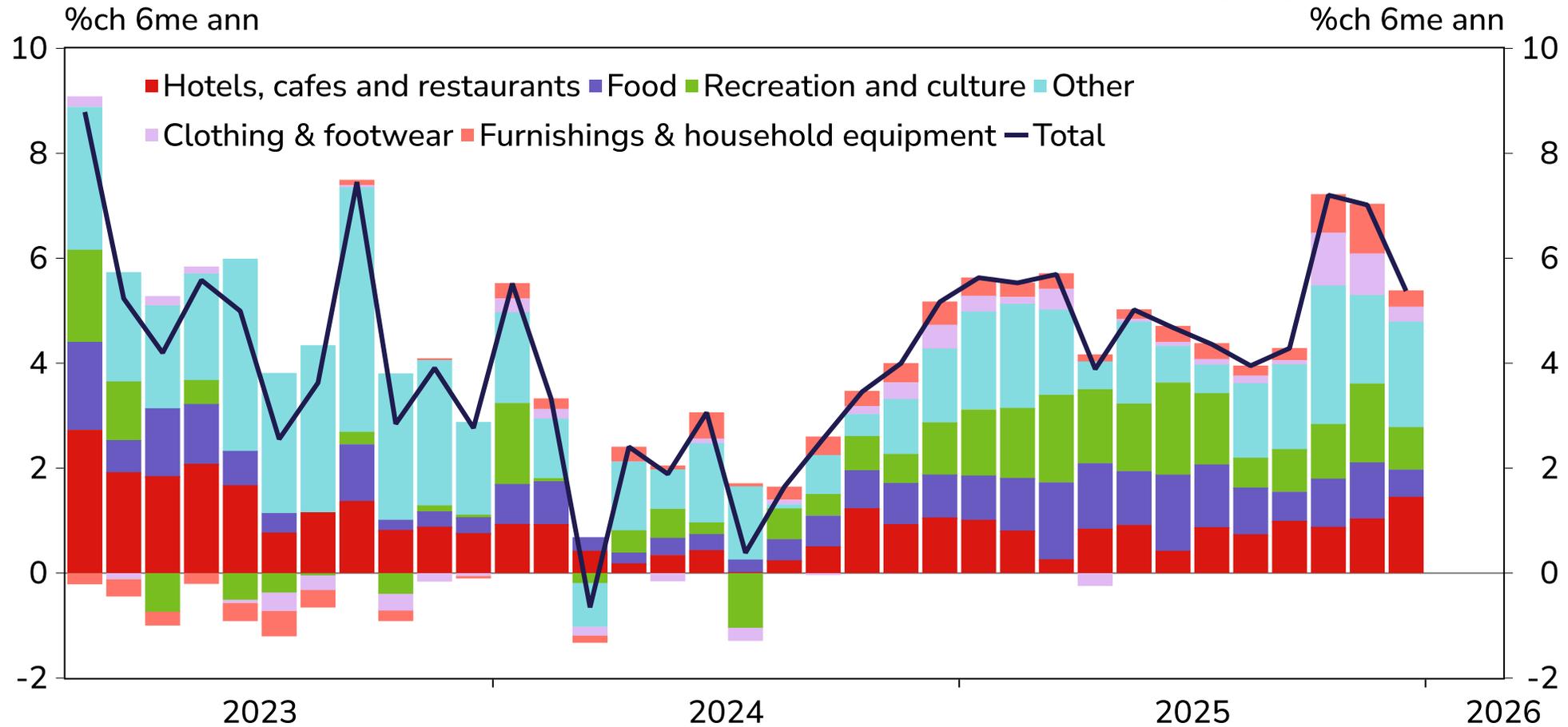


Source: ABS, Macrobond, Westpac Economics

# ...which coincided with the consumer spending recovery...



## Household Spending Indicator: Growth Contributions by Category

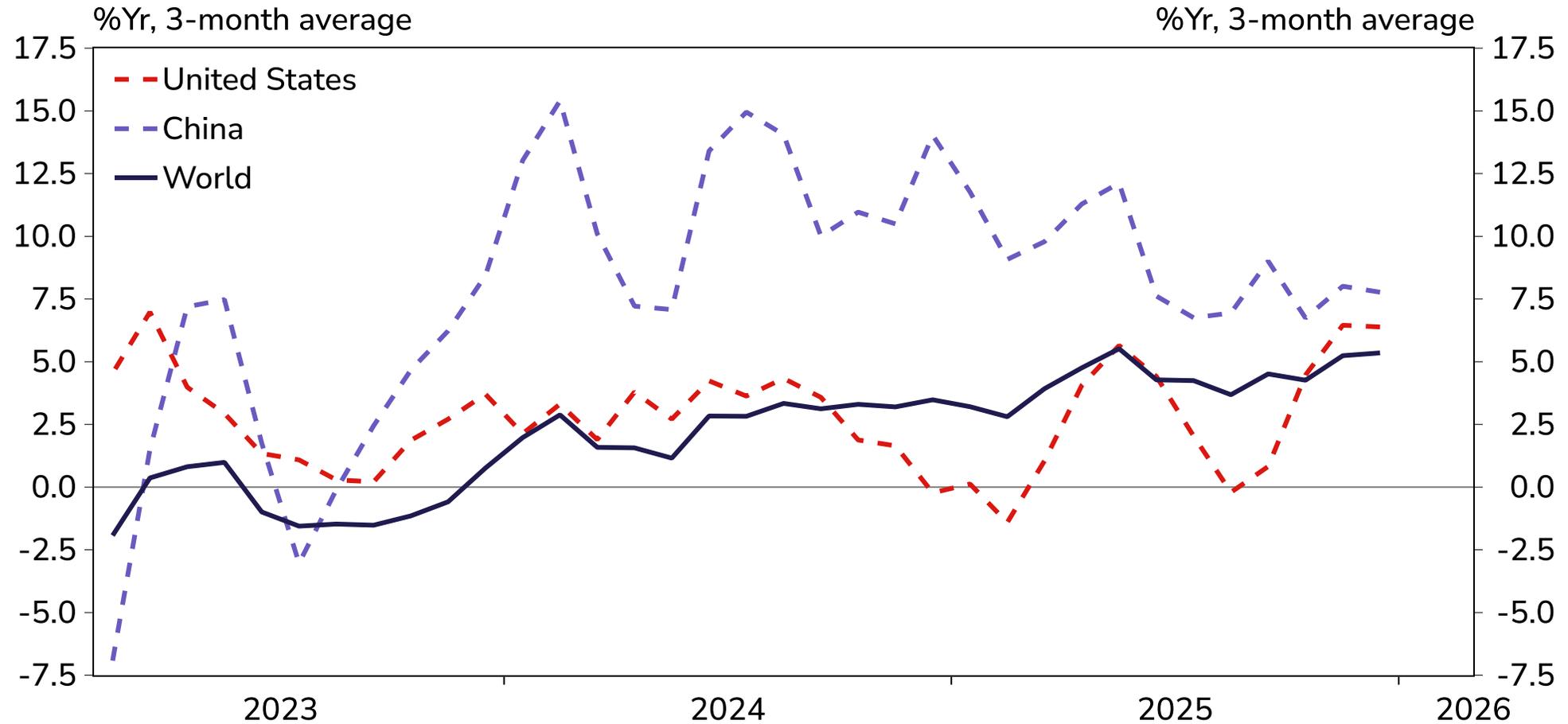


Source: ABS, Macrobond, Westpac Economics

# ... and a more resilient external environment



## Global export volumes



Source: CPB, Macrobond, Westpac Economics



# Australian Trade



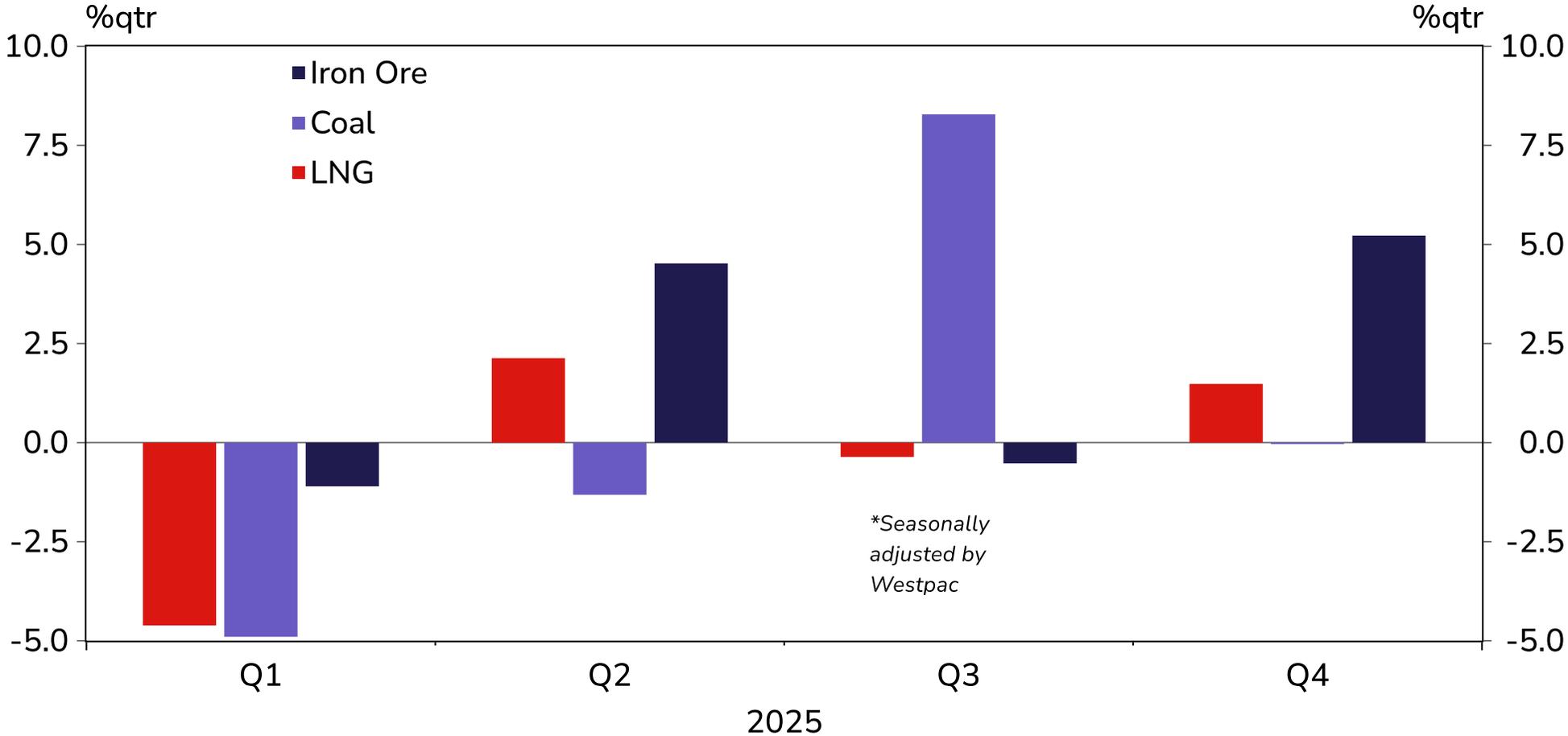
## Strong exports and imports were recorded in the December quarter

- Ahead of the official Balance of Payments release on 3 March, the latest available figures point to strong gains for exports and imports in Q4:
  - Major resource commodity exports look to have increased robustly albeit unevenly, with coal exports soft after a surge in Q3.
  - On the services side though, education exports, a key growth driver pre pandemic, look to be weakening, restricted by tighter student visa rules.
  - Goods imports are strengthening too. Firm consumer spending is driving demand for consumer goods imports, but capital goods imports will most likely be lower owing to a decline in data processing equipment and aircraft.

# Big 3 commodity export volumes volatile and mixed



Australia's Big 3 commodity export volumes\*

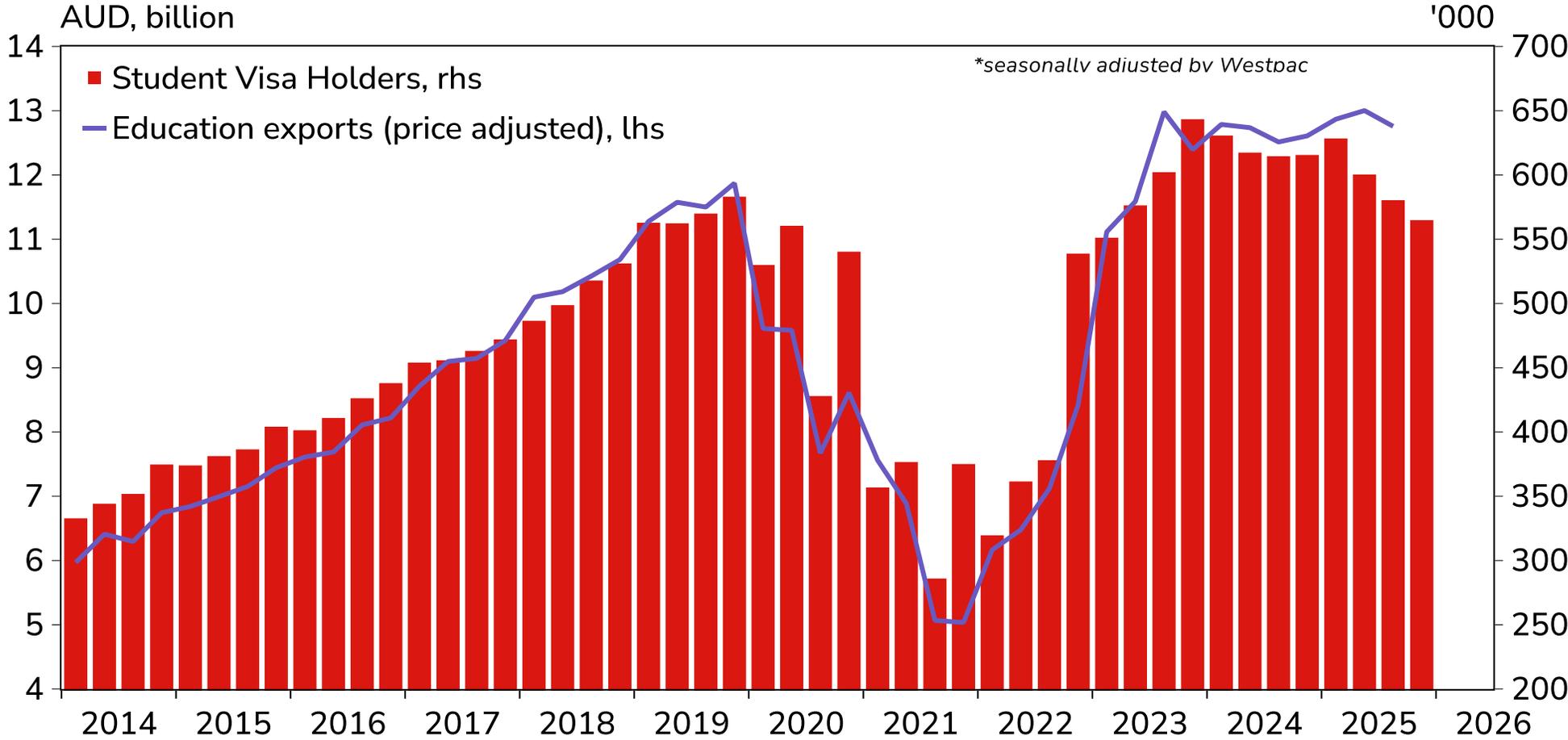


Source: , Macrobond, Westpac Economics

# Visa numbers point to downside risks to education exports



## Education Exports and Student Visa Holders\*

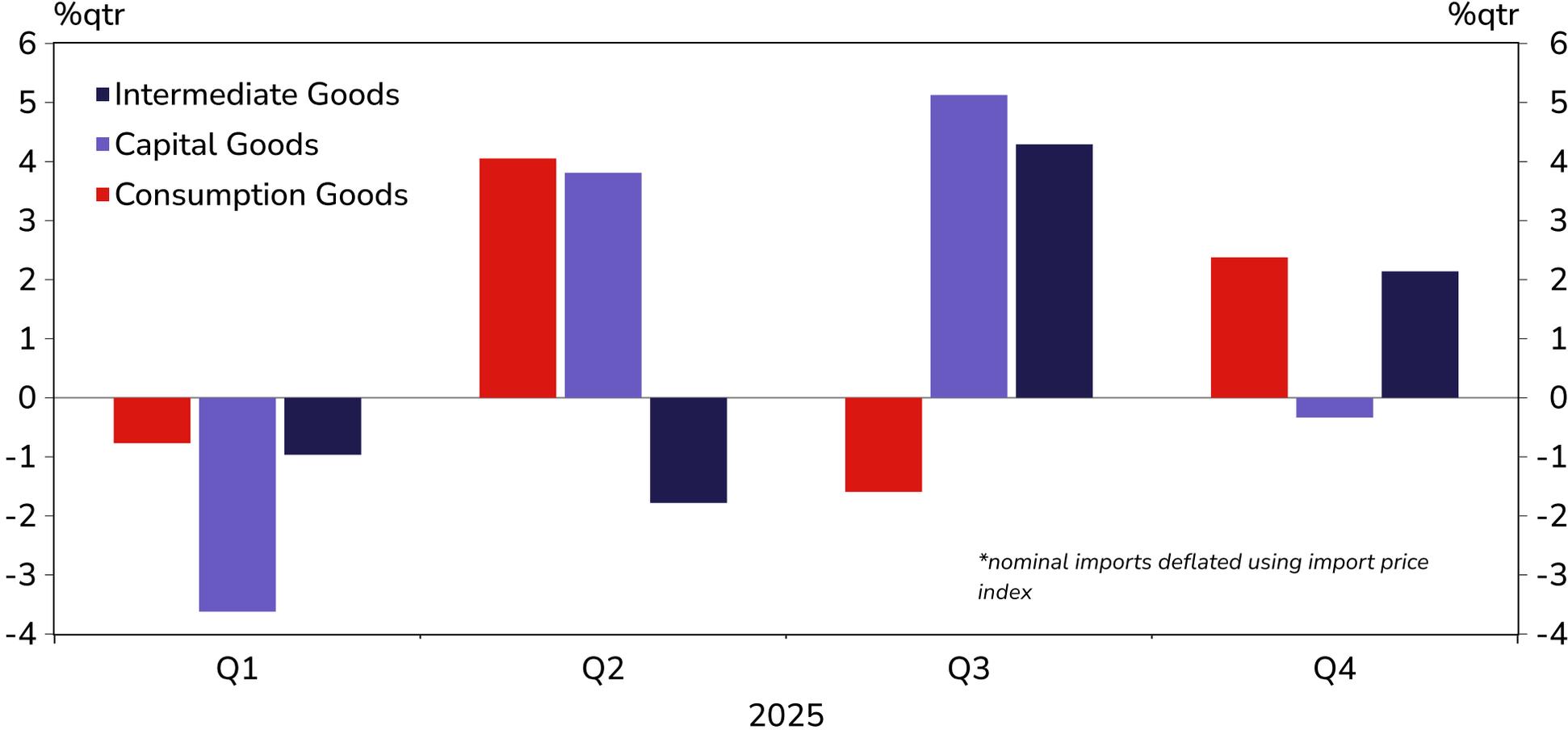


Source: Australian Department of Home Affairs, ABS, Macrobond, Westpac Economics

# Capital goods imports signal softer capex growth in Q4...



## Imports - major categories\*

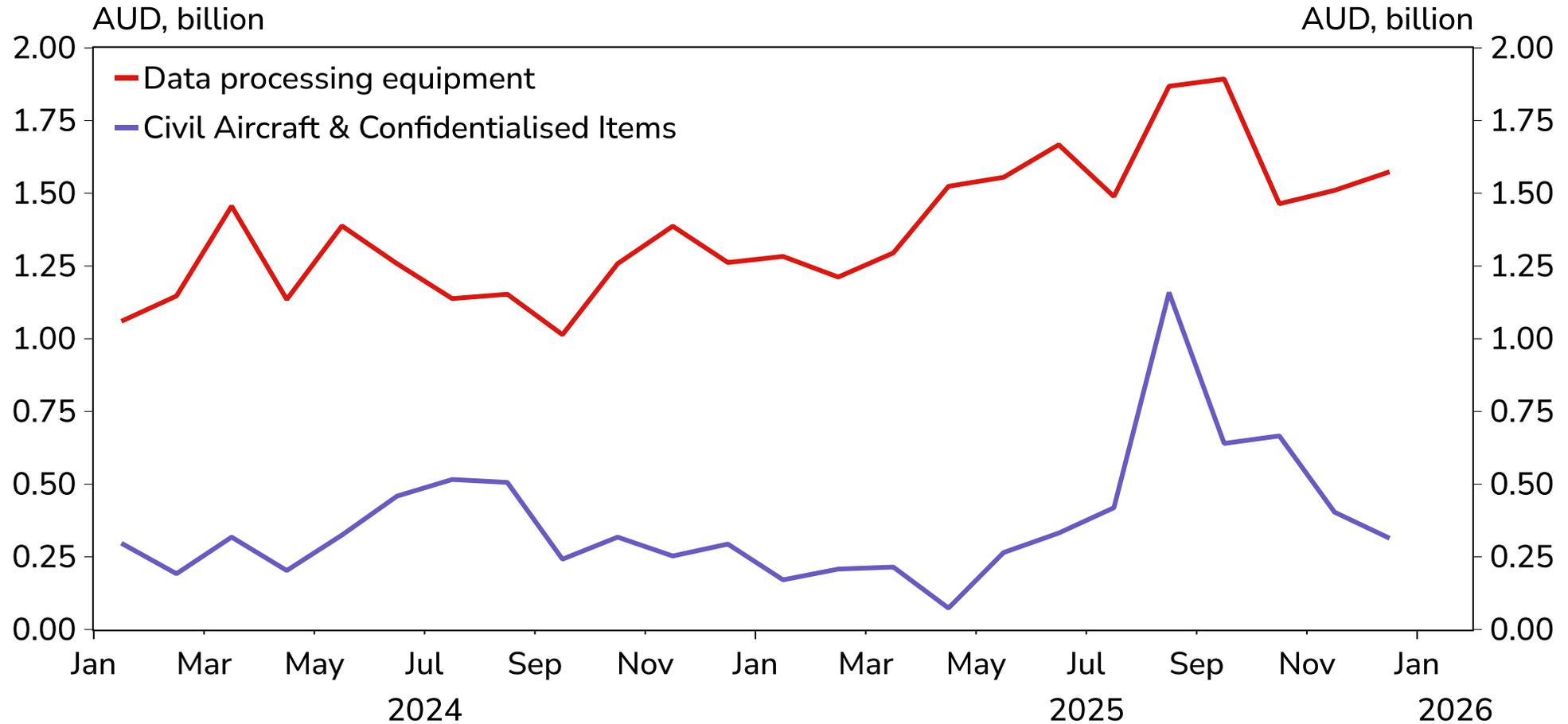


Source: ABS, Macrobond, Westpac Economics

# ...mainly due to weakness in a few key categories



## Selected goods imports categories



Source: ABS, Macrobond, Westpac Economics



## Key domestic themes

- The Australian dollar appreciated significantly this year, extending the upward trend in place since early 2025. The AUD's gains have been driven by 1) USD depreciation and the re-allocation of capital away from US assets; 2) high commodity prices and the AUD's positive correlation; and 3) widening interest rate differentials as the RBA tightens.
- In the last twelve months the AUD has appreciated by around 7% in real effective terms. Historical relationships imply that this gain will have a negative effect on net exports. The RBA's estimates suggest manufacturing good exports and services trade will be impacted the most.

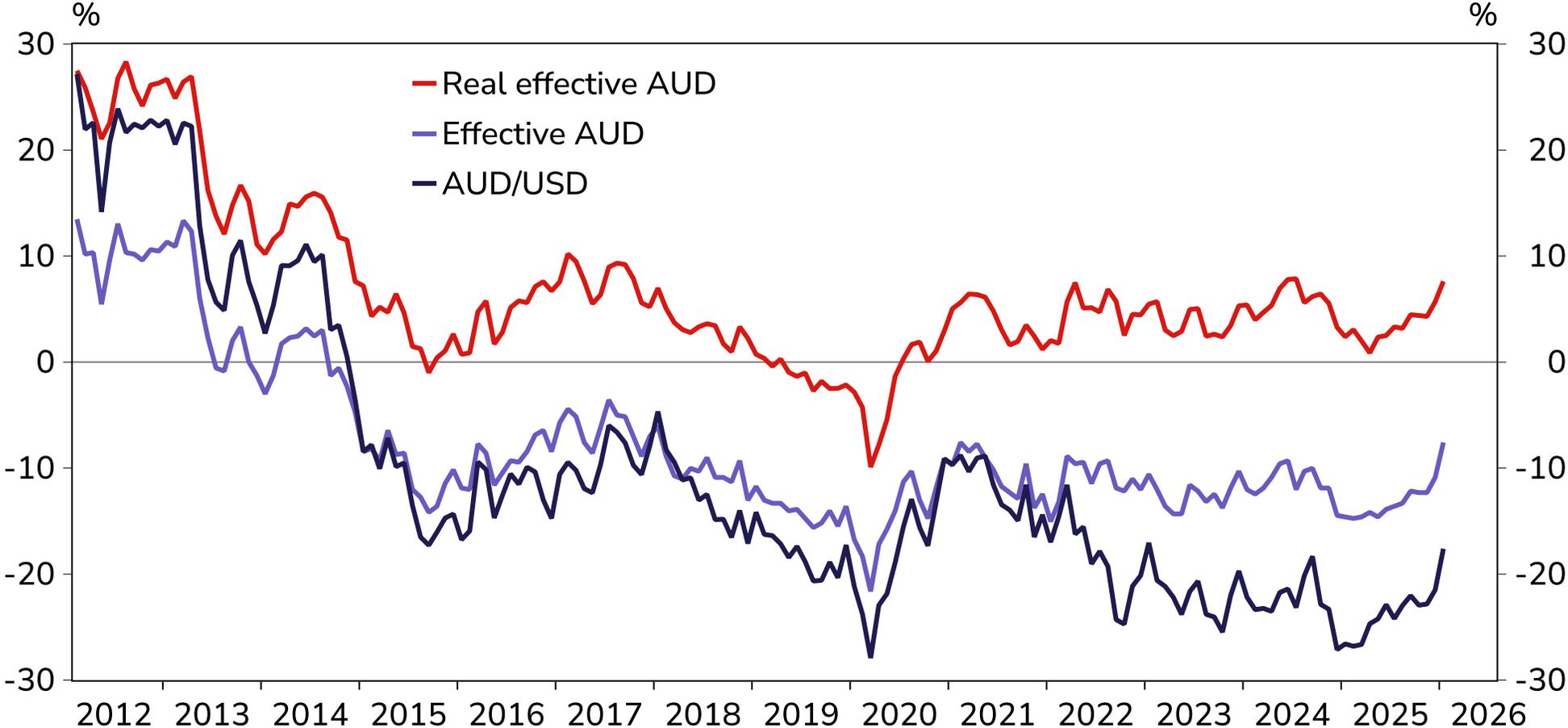
	Long-term effect after 10% AUD Appreciation (%)
<b>Total Exports</b>	<b>-4.1</b>
Resource	-2.2
Rural goods	-0.8*
Manufactured goods	-20.0
Services exports	-11.5
<b>Total Imports</b>	<b>3.5</b>
Consumption goods	1.3*
Capital goods	6.9
Intermediate goods	-1.0*
Services imports	11.3

\*The relationship is not statistically significant. Assumes symmetric relationships. Source: RBA (2016) <https://www.rba.gov.au/publications/bulletin/2016/sep/2.html>

# Real effective AUD up around 7% in the last 10 months



## Australian Dollar Exchange Rates - Deviation from LR average

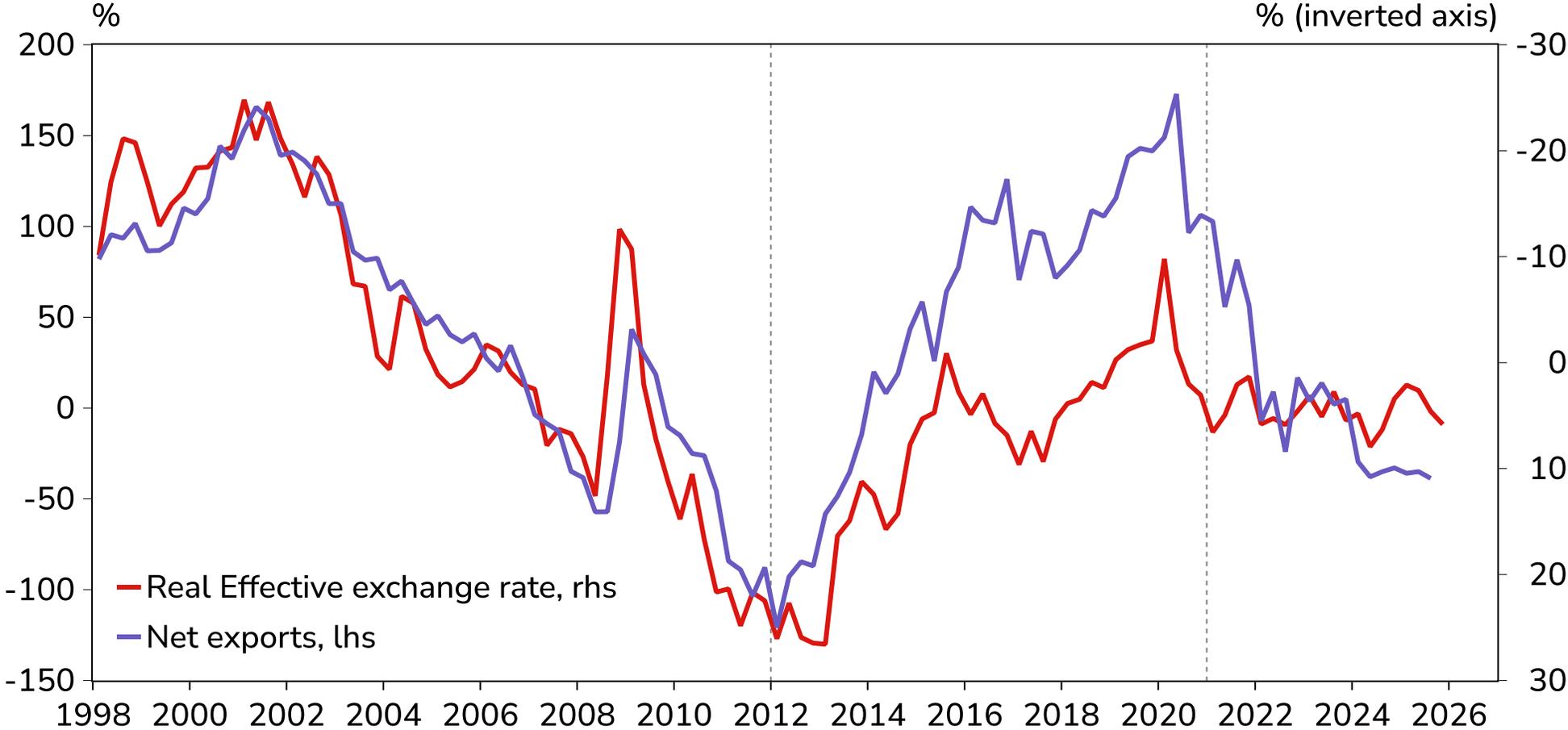


Source: IMF, RBA, Macrobond, Macrobond, Westpac Economics

# Historically, a stronger currency weighs on net exports



## Net exports and AUD - deviation from LR trend



Source: IMF, ABS, Macrobond, Westpac Economics



Australia and the EU are finalizing a Free Trade Agreement (FTA) after years of negotiation.

- The full detail of the FTA will not be available until the deal is finalised. However, media reports indicate that among the more contentious issues:
  - Australia is agreeing to scrap tariffs on EU cars and phase out the Luxury Car Tax, remove tariffs on EU industrial goods and protect the EU's Geographical Indications.
  - The EU will agree to improved access to its market for Australian goods exports, including the removal of tariffs on almost all industrial goods, reduce barriers for services exports, and improve access to European procurement. Agriculture exports, such as beef, appear to be the main point outstanding. The EU seems to be prepared to increase its major quotas; however, it might be politically costly for the EU given the recent backlash to the Mercosur trade deal and its implications for European farmers.



Australia and the EU are finalizing a Free Trade Agreement (FTA) after years of negotiation.

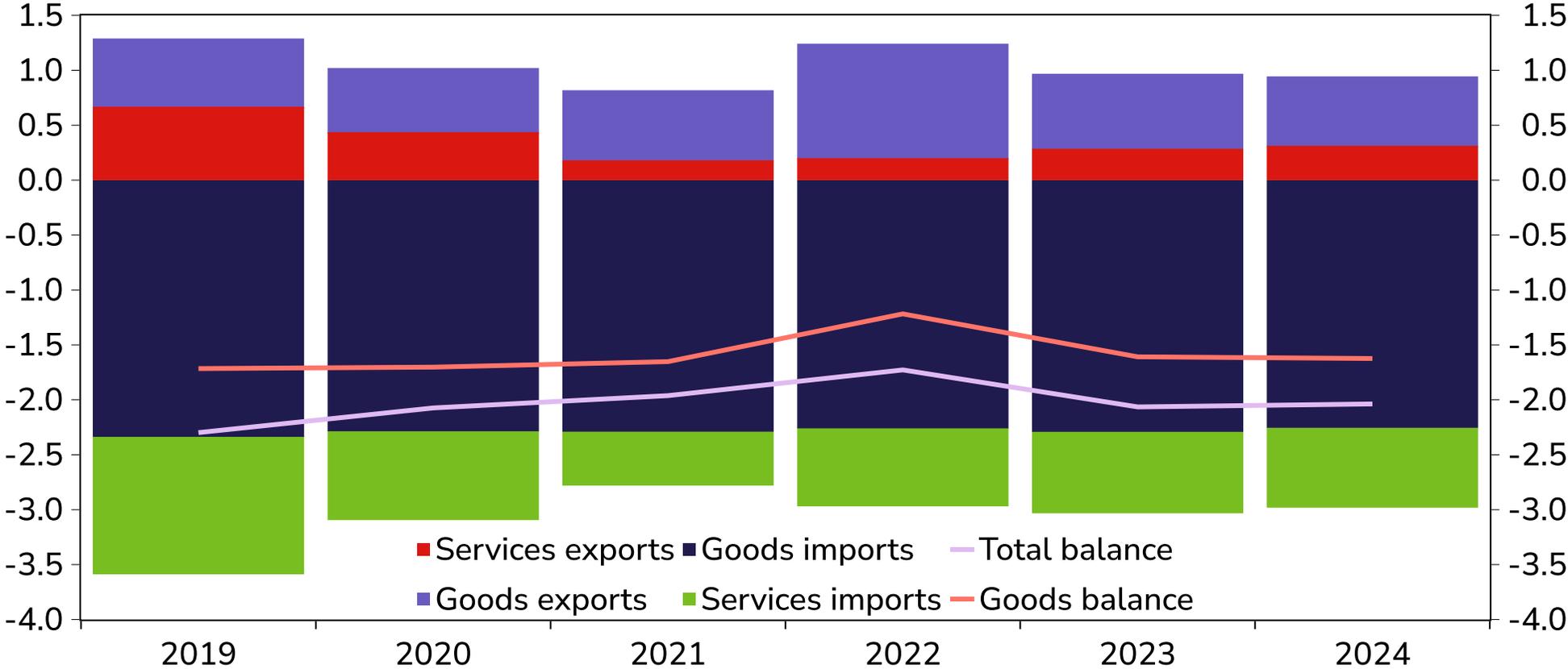
- Australian exports to the EU are worth around 1% of GDP. Even if the FTA successfully lifts goods outflows, the economic impact for Australia's growth is likely to be limited. Imports from the EU are meanwhile worth circa 3% of GDP, resulting in a trade deficit of 2% of GDP.
- Our analysis of historical Free Trade Agreements in the last twenty years provides mixed evidence of the longer-term impacts to trade flows. Australia's exports under new FTAs do not always outperform total exports, but exports usually perform somewhat better than imports, suggesting a positive net trade impact for Australia.

# Australia is running a 2% of GDP trade deficit with EU



## Australia's trade with EU

Share of GDP (%)



Source: DFAT, ABS, Macrobond, Westpac Economics

# Goods trade with the EU – major items



Export Items	Total Exports in 2025 (mn AUD)	Share (%)
Coal	4,327	28.4
Oil-seeds & oleaginous fruits, soft	2,679	15.2
Gold coin & legal tender coin	1,057	7.1
Medical instruments (incl veterinary)	417	2.8
Pharm products (excl medicaments)	290	1.9
Misc manufactured articles, nes	229	1.5
Measuring & analysing instruments	225	1.5
Uncoated flat-rolled iron & steel	224	1.5
Medicaments (incl veterinary)	209	1.4
Beef, f.c.f.	197	1.3

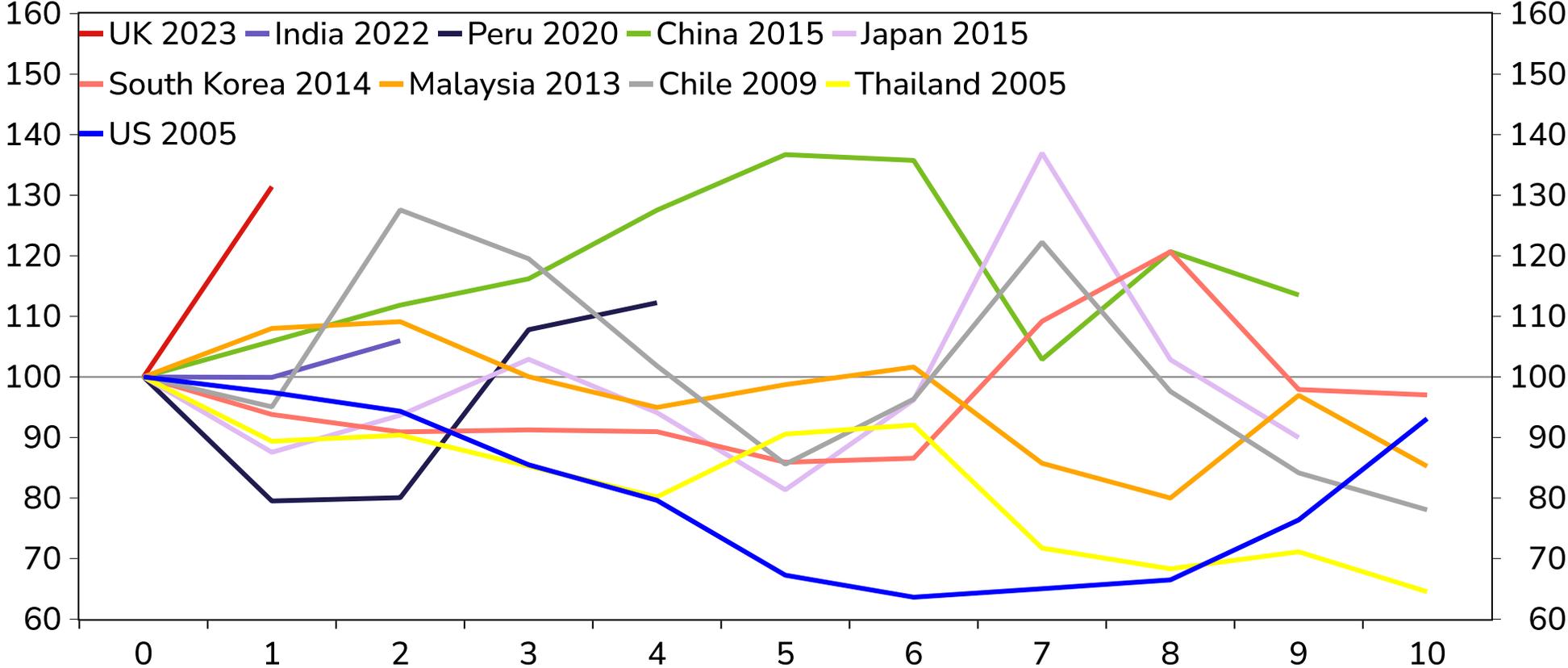
Import Items	Total Imports in 2025 (mn AUD)	Share (%)
Medicaments (incl veterinary)	6,444	10.0
Passenger motor vehicles	4,257	6.6
Pharm products (excl medicaments)	3,332	5.2
Civil engineering equipment & parts	1,824	2.8
Perfumery & cosmetics (excl soap)	1,525	2.4
Measuring & analysing instruments	1,495	2.3
Mechanical handling equip & parts	1,422	2.2
Goods vehicles	1,358	2.1
Computers	1,218	1.9
Specialised machinery & parts	1,085	1.7
Electric power machinery & parts	1,078	1.7
Pumps (excl liquid pumps) & parts	1,055	1.6

# FTAs do not always boost AU's exports...



## Australia exports under new FTAs

Relative to total exports, indexed to 100 when FTA came into force (# of years)



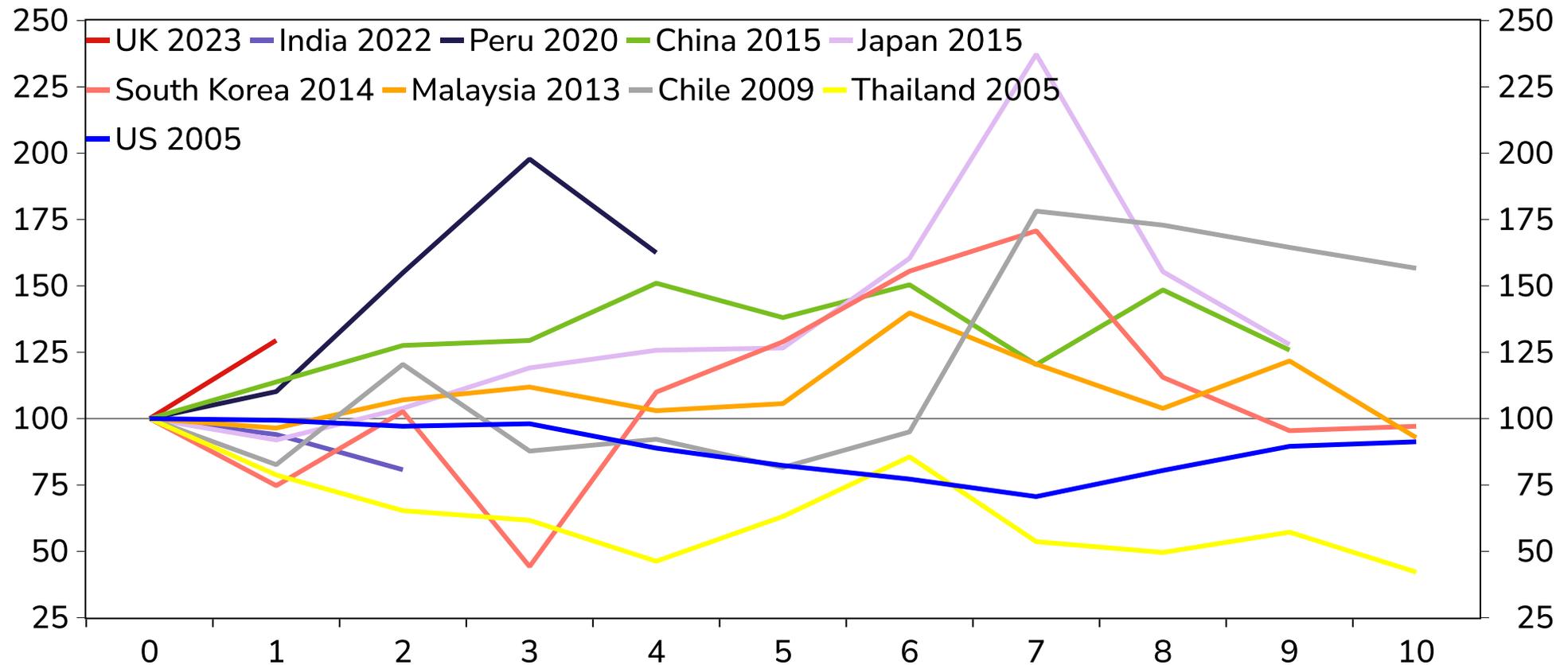
Source: DFAT, Macrobond, Westpac Economics

# ...but exports often outperformed imports under new FTAs



## Australia exports/imports ratio under new FTAs

Indexed to 100 when FTA came into force (# of years)



Source: DFAT, Macrobond, Westpac Economics



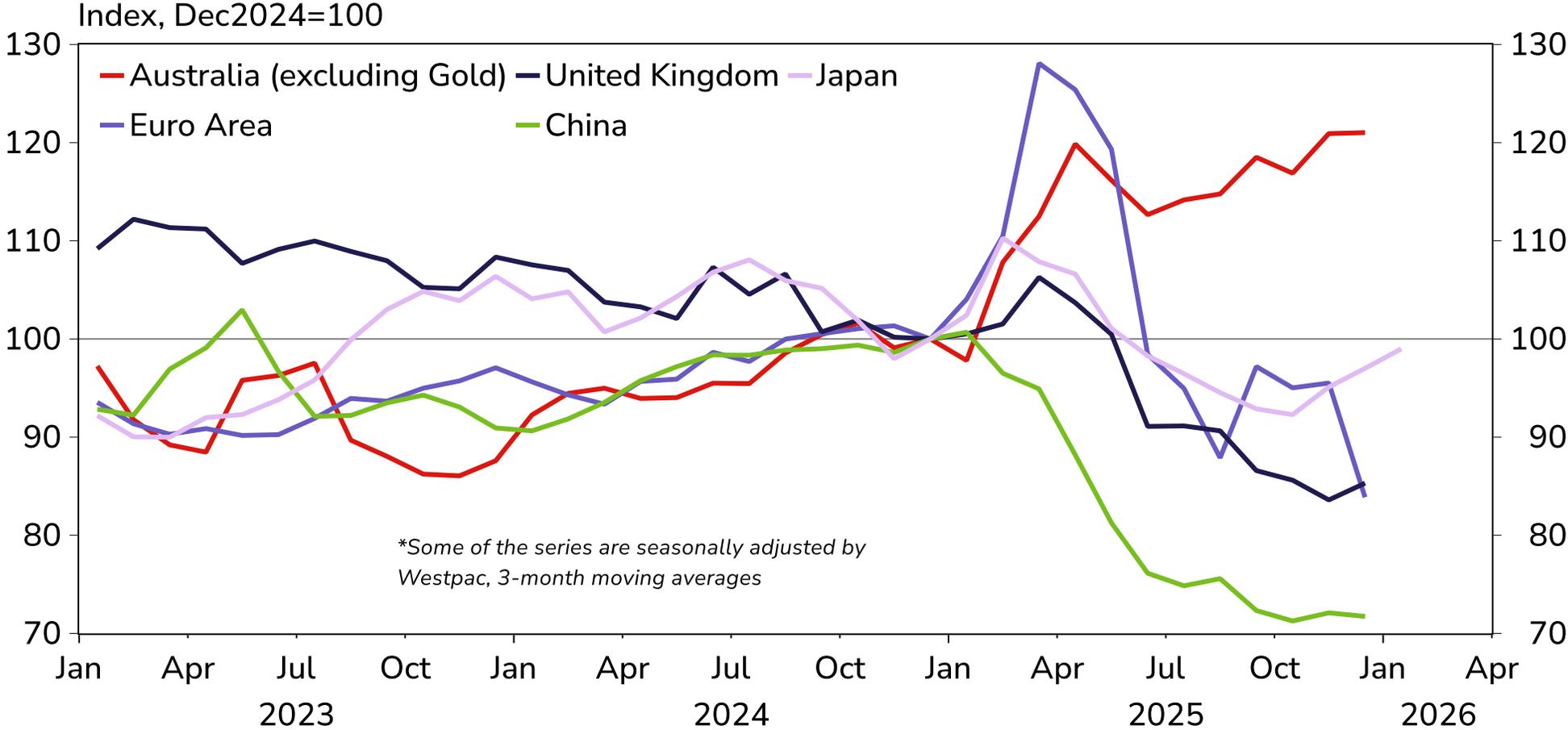
The US import tariff on Australian goods to rise from 10% to 15%.

- The US Supreme Court decision and the response by the US Administration imply that the tariff imposed on Australian imports to the US could rise from 10%, the lowest rate possible for all countries, to 15%.
- Most major economies saw their exports to the US shrink in 2025, but Australia's exports increased. Since all countries are now under the same tariff rate, Australia will lose its relative advantage in the US export market for at least the next 150 days.
- That said, more than half of Australia's goods exports in 2025 would have been exempt from tariffs under the current rules given major export categories, such as gold, beef and pharmaceuticals were excluded. The detail of tariff changes will matter to the effective tariff burden Australia and others face.

# Australia's exporters performed well in US trade in 2025



## Goods exports to the United States\*

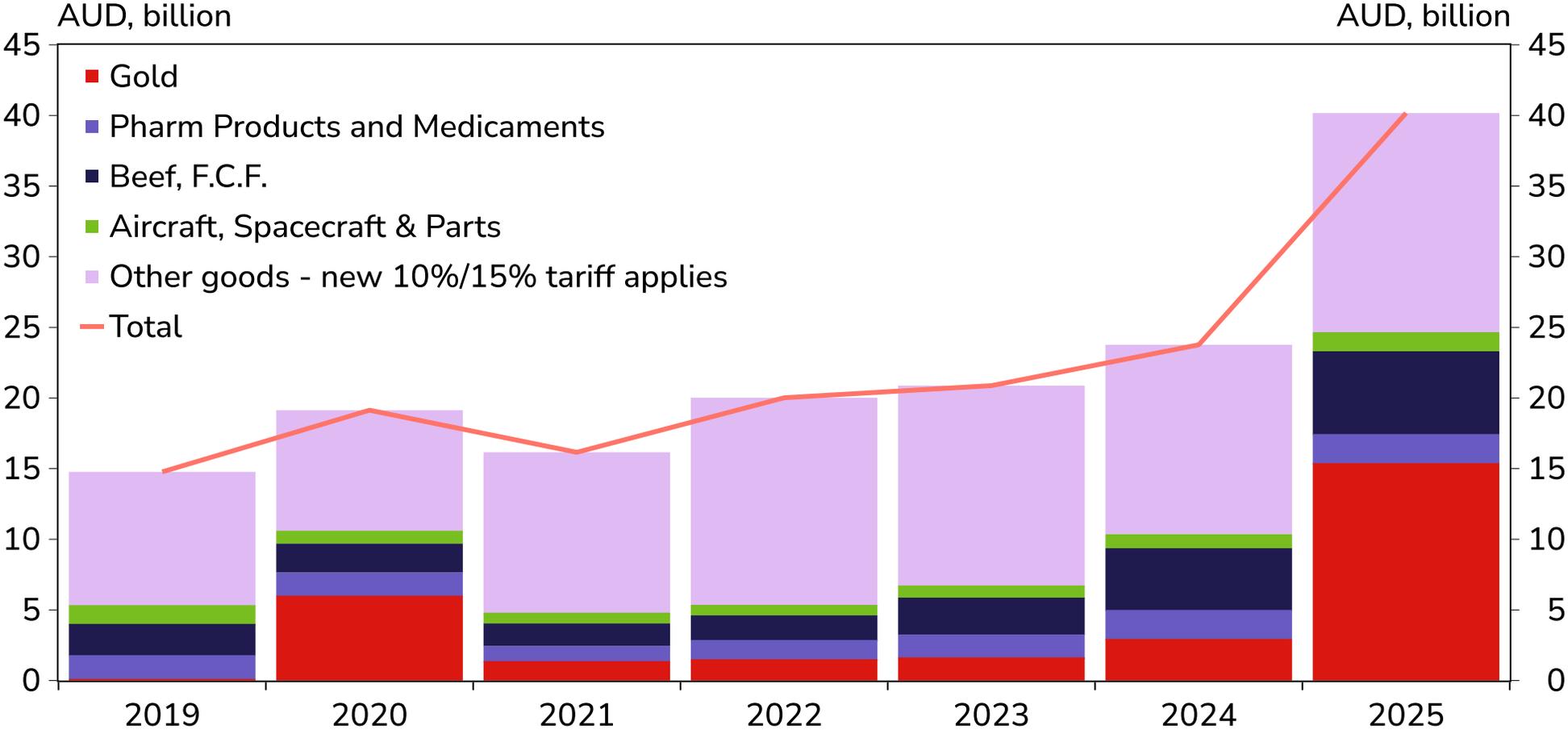


Source: DFAT, Eurostat, ONS, GAC, MOF, USCB, Macrobond, Westpac Economics

# More than half of AU exports to the US are exempt



## Australia Goods exports to US - tariff exempted goods



Source: DFAT, Macrobond, Westpac Economics



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