ECONOMIC BULLETIN

Impact of U.S. tariffs on New Zealand.

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Liberation day tariffs

- **New Zealand is to be subject to additional tariffs of 10% on all merchandise exports.**
- **The direct impact on NZ exporters is likely to be manageable as the direct maximum revenue loss is around NZD900m per annum and 0.2% of GDP.**
- **The indirect impacts will be more significant but are harder to assess, as global demand will weaken but the exchange rate and changes in global fiscal and foreign exchange rates will attenuate the impact.**
- **This is unlikely to be the last word as countries may retaliate and negotiate such that the final resting place for tariffs could be quite different.**
- **The RBNZ will see this as a key downside risk to the global and hence NZ outlook.**

What did the US announce today?

This morning President Trump announced the details of his 'Liberation Day' reciprocal tariffs on imports into the US (more formally known as the "America First Trade Policy Presidential Memorandum"). The measures announced today aim to address what the President views as a global trading environment that unfairly disadvantages US manufacturers, and which also raises concerns about critical US defence infrastructure and food security.

The President announced a minimum additional 10% tariff on goods imports from all US trading partners, and higher tariffs for many countries that are viewed as having large barriers to US exports (for example, tariffs on imports from China were lifted by an additional 34%). New Zealand exports are subject to a 10% tariff.

Today's tariffs did not apply to Canada or Mexico, which are already subject to tariffs of 25% imposed earlier this year. However, in the case of China, today's increase comes atop of the 20% tariff that President Trump had earlier imposed, bringing the total tariff to 54% (China is New Zealand's largest export market and the largest source of US imports).

In setting the level of tariffs, the US considered the extent of existing tariffs in the US and its trading partner nations. It also considered the level of the US' trade balance with those nations. In the case of New Zealand, we had a goods trade surplus with the US of $NZ1.2b in 2024.

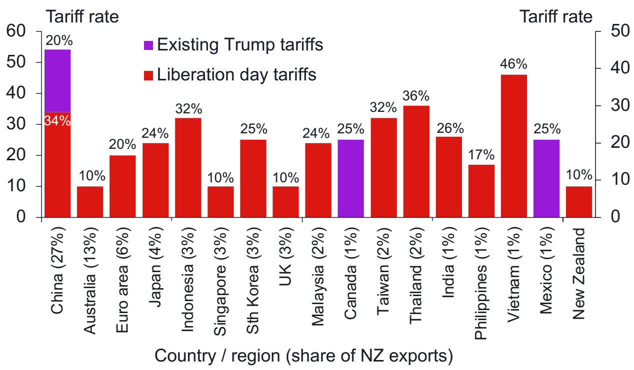
The announced tariffs are intended to take effect from EST 12:01am on 5 April 2025. They are intended to remain in place until the trade and security concerns that the President has raised are resolved or mitigated.

The President has stated that today's tariffs may be reduced if US trading partners take steps to align their trade policies with the aims of the US. Conversely, he also noted that tariffs may be expanded if retaliatory action was taken.

The direct impact of tariffs seems manageable.

The potential maximum direct impact of today's announcements will be significant but likely manageable by NZ exporters. In total, goods exports totalled around NZD9bn in 2024. So, a simple multiplication of the 10% additional tariff rate equates to a loss of export revenue of around NZD900m per annum or 0.2% of annual GDP. The impact will not be evenly spread across industries, however. As the chart below shows, New's Zealand's largest exposure is in the meat industry (especially beef), with exports to the US totalling $NZ2.6bn in 2024, accounting for 30% of all meat exports. Another key exposure is the wine industry, with exports to the US accounting for 35% of total exports.

Trump tariffs on New Zealand and our trading partners



It's important to keep in mind that this direct impact is very much an upper limit. There will be offsets in terms of the end impact, as there will likely be some scope for exporters to increase their prices to US customers, or to utilise transfer pricing arrangements (this is possible when a NZ exporter is dealing with a subsidiary based in the US, as the price paid at the border can be adjusted to reduce the tariff impost to some extent).

Also, importantly, the NZD/USD exchange rate is likely to depreciate and buffer the impact on NZ (indeed it has already done so in recent months). Historical experiences of exchange rate impacts from tariff impacts vary. But it might be reasonable to plan on perhaps half of the ultimate additional impost being offset by exchange rate depreciation. What is unclear is the extent to which the current level of the NZ dollar already reflects an expectation of today's decision.

There may be potential for NZ exporters to divert some goods that might otherwise have gone to the US market to other markets which may now offer better relative returns (albeit lower returns than previously offered in the US). This might especially be the case if some of our trading partners reduce imports of US goods as part of a retaliatory response and then need to find alternative sources of supply.

It may also be that the tariff impost is reduced by other trade agreements in place. For example, the US applies a threshold quota on NZ beef imports under which those imports are tariff free. It's not clear these quotas have been removed (they may require congressional approval).

Indirect impacts are likely to be greater.

As both the RBNZ and ourselves have previously posited, the indirect economic impacts stemming from the changes to US tariff policy are likely to be much greater than the direct economic impact of tariffs on New Zealand's exports to the US. Indeed, citing external research, the RBNZ has suggested that significant US tariffs, accompanied by retaliation, could lower trading partner growth by as much as 1%.

This is because tariffs are likely to lead to:

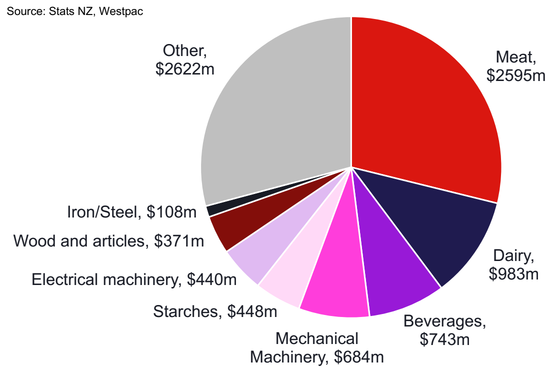
- weaker consumer demand in tariff-impacted countries;
- reduced growth potential due to lost production efficiencies;
- weaker asset prices;
- weaker global commodity prices; and
- greater business uncertainty that will likely weigh on investment spending.

This is especially so given that today's announcement is unlikely to be the final word on US tariff policy, with the possibility that tariffs get either scaled up or down depending on whether impacted countries choose to retaliate or offer concessions.

Weaker global demand is likely to depress commodity prices, including for the products that New Zealand exports (although food commodity prices might reasonably be expected to be less impacted than industrial commodity prices). There has been a range of experiences in periods of historical global economic weakness. In the Global Financial Crisis, New Zealand's terms of trade fell in lockstep with weaker global growth. However, in other episodes, NZ's terms of trade have been less impacted. On average it appears that NZ's terms of trade falls by about 40-60% of the decline in global industrial production or demand. That elasticity would imply a meaningful but not debilitating retracement of the gains in the terms of trade seen in the last year or so.

Many of New Zealand's key trading partners have now been subjected to tariffs that are in many cases much larger than that imposed on us. Of note is the very large 54% tariff on imports into the US from China (20% imposed prior to today and an additional 34% tariff today). Many of New Zealand's key South-East Asian trading partners have also been hit with substantial tariffs. Across the trading partners in this chart, the average trade-weighted tariff stands at 32%, reflecting the fact that China takes 27% of New Zealand's merchandise exports.

NZ's direct export exposure to US tariffs – 2024 (NZ$)



It is likely that many impacted economies will respond to the tariffs with some combination of easier fiscal and/or monetary policy than would otherwise be the case. The scope for monetary easing will be limited in those countries that impose retaliatory tariffs, as they – like the US – will also face at least a short-term positive inflation shock due to the impact of their own tariffs on their domestic price levels.

As noted earlier, in many countries it is likely there will be depreciation pressure on exchange rates versus the US dollar. For New Zealand, we can't rule out the possibility that the NZD/USD falls well below the 0.56 low point in our current forecasts. However, with many of New Zealand's key trading partners facing higher tariffs than New Zealand, the NZ dollar could fare better on some crosses (for example versus some Asian currencies who may move to devalue their exchange rates significantly).

Fiscal policy is likely to be deployed in some impacted jurisdictions to soften the blow. This could be especially relevant in Europe and China (and of course fiscal policy is also easing in Australia). This response could prove to be a significant factor that limits the downside to global growth.

What to watch in coming weeks.

Following today's announcement, attention will now turn to how impacted countries respond. Those that choose to retaliate – for example the European Union – could find themselves in a tit-for-tat fight with the US that leads to even greater tariffs than those announced today. Those that seek to offer concessions may see today's tariffs reduced over time. This seems likely in those jurisdictions with very high announced tariff rates. We will be watching developments closely in coming days, as will the RBNZ in the lead-up to next week's OCR review.

It will also be important to watch key financial and high frequency economic indicators. The behaviour of commodity prices and the exchange rate will be critical in determining the ultimate macro impact on the NZ economy. These will also be a factor in determining the ultimate impact on global inflation and growth.

Stock markets, bond rates and credit spreads will give a flavour if confidence is undermined to the extent that financial conditions tighten. We doubt that the US administration will be very keen on adjusting policy course to save equity markets, however.

We will also be paying close attention to consumer and business sentiment surveys, both in New Zealand and abroad. International trade data, including shipping rates, will likely also offer some insight. The issue is: will NZ businesses and consumers behave differently and in ways that might derail the ongoing economic recovery? This has been a concern although there are few signs (outside of recent consumer confidence trends) that this is happening yet.

For the RBNZ's part, they will see this as a reason to continue to cut the OCR and retain an easing bias. We don't think this means they will step up to a 50bp cut – the 25bp cut will likely remain the preferred option. Global developments will continue to be a key risk factor, and uncertainty, that will drive their actions over the balance of the year. But global weakness will need to translate into domestic weakness to have a significant impact on the outlook for interest rates given the inflation outlook.

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