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Research US

July 9 unlikely to turn into a 'Liberation Day 2.0'

- **We expect possible tariff increases on July 9 to remain smaller in scale compared to the salvo announced on April 1st 'Liberation Day'.**
- **US could strike preliminary deals with trading partners to buy time for more thorough negotiations. Treasury Secretary Bessent has appeared ready to postpone the deadline towards fall for countries negotiating in 'good faith'.**
- **Legality of country-specific 'reciprocal tariffs' and the unclear outlook for new sectoral tariffs complicate the negotiations. Stricter stance on limiting re-routing of trade could mean higher tariffs for especially SEA countries, and cause tariffs to bite harder on the American consumer.**

US administration appears to be settling for mostly 'agreements in principle' instead of comprehensive trade deals as the 9 July deadline looms closer. Despite the earlier claims for striking 90 deals in 90 days, negotiations will likely extend into early fall.

We expect the US to maintain the 10% universal tariff rate in effect for now. Treasury Secretary Bessent reiterated that even if countries agreed to postpone the negotiation deadline, the 10% rate would not be eased. Majority of trading partners will hear their tariff rate over coming days, and for 'about 100 countries', it will be 10% (*Reuters*).

Reuters' sources suggested EU diplomats had also accepted the baseline level as 'unavoidable'. While Trump has not promised any extensions to talks, he has not closed the door for them either. Bessent signalled that he expects trade talks to get 'wrapped up' by Labor Day (1st of September), which appeared to lay ground for delays.

We do not expect the US to reimpose majority of the country-specific rates announced on April 1st next week. Some countries, where negotiations have stalled or are progressing slowly, could face temporary increases as Trump's negotiation tactic. But as before, tariffs could again be lowered quickly when the final agreement is struck.

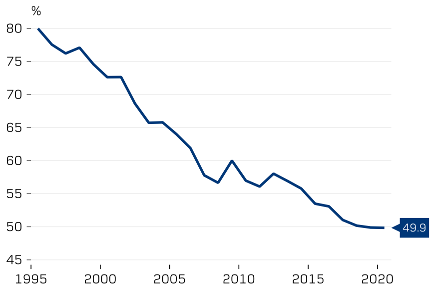
Case-in-point: Vietnam deal

The deal struck with Vietnam this week included higher tariff rates than we had originally assumed. US will charge 20% tariff on imports from Vietnam, and 40% for transhipments from other countries. According to OECD's TiVA database, the foreign value embedded in Vietnam's exports has climbed up to 48%. Domestic value added in exports to US specifically was only 50%, down from 73% in year 2000 (chart 1). Looking at purely Chinese value added, Vietnam also stands out from other SEA countries (Chart 2).

This suggests the effective tariff rate could be as high as 30% if transshipment is defined broadly to include foreign value added embedded in exports. We suspect that challenges in monitoring transshipments and non-compliance could lead to a lower effective rate. In any case, the rate is lower than the originally threatened 'reciprocal tariff' (46%) but significantly above the 10% universal rate that has prevailed since early April. *Politico* reported that the countries would continue to work on a final deal which could still include a lower tariff rate.

Chart 1: Around half of Vietnam's export value to US is of foreign origin

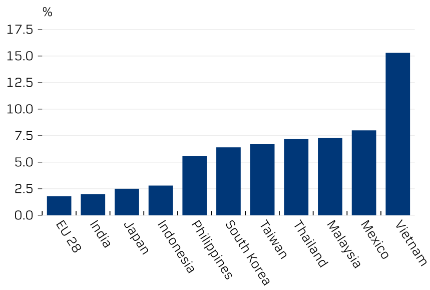
Vietnam: Domestic Value Added Content in Gross Exports to US, %



Sources: Macrobond Financial, OECD

Chart 2: Vietnam stands out with high Chinese value embedded in its exports, but other SEA countries are under US scrutiny as well

Backward Participation: Chinese Value Added Embedded in Exports, Share of Total Value %



Sources: Macrobond Financial, OECD

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Vietnam has been in focus of the US administration not just because it has one of the largest trade surpluses with the US (behind China, EU and Mexico) but because it has seen one of the largest increases in its trade surplus since Trump's 1st term tariffs on China (only behind Mexico). Trump's trade advisor and a long-standing China-hawk Peter Navarro has called Vietnam a 'colony of China', as its exports to the US have been closely correlated with its imports from China (chart 3).

The deal with Vietnam marks a baseline for negotiations with other Southeast Asian countries. The value of bilateral trade relationships with countries like Thailand or Philippines is significantly lower than those with economies like the EU or China. But collectively high tariffs across SEA would limit the room for re-routing trade away from China (charts 4) – and hence cause tariffs to bite harder than we previously anticipated.

Why are the talks likely to drag out?

What complicates majority of the key talks is not the level of reciprocal tariffs per se, but rather the unclear outlook for the final mix of country- and product-specific tariffs. The U.S. Trade Court ruled the country-specific, so called IEEPA-tariffs, illegal back in June. For now, U.S. Court of Appeals allowed the country-specific tariffs to remain in place, but U. S. Supreme Court is expected to make a final ruling towards the end of summer, most likely in August.

Since June, the administration has prepared to shift its focus increasingly towards product-specific tariffs, like the ones imposed on steel, aluminium and car imports under the authority of Section 232 of the Trade Expansion Act. But in addition to waiting for clarity on the legal backdrop, Bessent also flagged section 232 tariffs 'take longer to implement' (see *FT* citing Bloomberg interview). In any case, semiconductors and pharmaceuticals have widely been expected to be among the next targets for product-specific tariffs.

EU and other trading partners have sought to carve out exemptions from the various product tariffs, similar to the preferential treatment British cars got as part of the US-UK trade deal announced in May. But the hazy outlook and, in the EU's case, internal disagreements over priorities (see *Politico*), complicate the negotiations. Hence, extending the negotiation window with a preliminary agreement that blocks the reciprocal rates from coming back into effect on July 9 appears likely.

Which countries are at the highest risk?

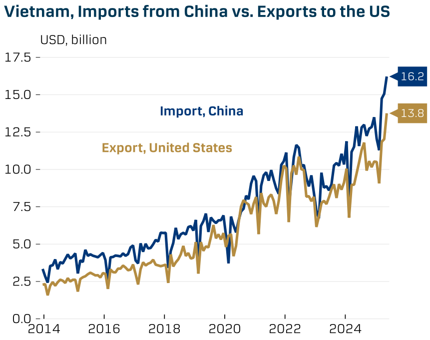
As mentioned, the deal struck with Vietnam suggests other Southeast Asian countries face higher risk of being hit with additional tariffs. Among SEA countries, Thailand holds the largest trade surplus with the US behind Vietnam, followed by Malaysia and Indonesia. Talks between the US and Japan have reportedly stalled, as Japan has not signalled willingness to open its market for rice imports from the US. and US has not promised to reduce the level of tariffs on Japanese cars (according to *FT* sources).

Talks appear to progress more smoothly with India, as Bessent said earlier that the two countries are 'very close' to a deal. *Reuters* sources reported that disagreements remain over agricultural products, but that the Indian delegation remains in Washington to continue the talks.

How has the economy reacted so far?

At the time of writing, the current set of tariffs consists of the 10% universal tariff, 50% tariff on steel and aluminium imports, 25% tariff on car imports, around 40% tariff on China (of which 30% reflect new 2025 tariffs) and 25% tariff on imports from Canada and Mexico (with some exemptions). Including the effective 30% rate on Vietnam, the average trade-

Chart 3: Limiting the re-routing of trade from China via SEA would make tariffs bite significantly harder

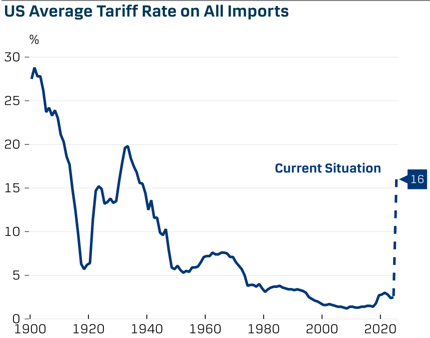


Sources: Macrobond Financial, Vietnam's customs

Chart 4: Trade flows adjusted after Trump's 1st term tariffs, and the move accelerated after Liberation Day

Sources: Macrobond Financial, U. S. Census Bureau

Chart 5: Even if sharpest 'reciprocal tariffs' are averted, tariffs remain at multi-decade high levels

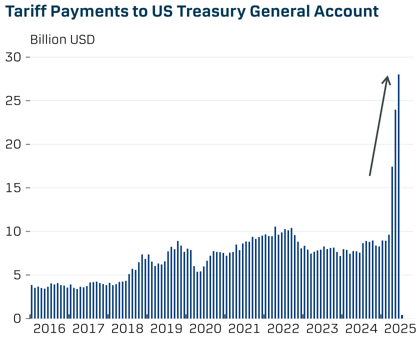


Sources: Macrobond Financial, U. S. Census Bureau weighted tariff rate on all U.S. imports hovers around 16% (chart 5). For context, reinstating the 145% tariff on China and all 'reciprocal' tariffs threatened on 'Liberation day' would lift the rate to around 34%, while removing the universal tariff and all country-specific tariffs would take the rate down to around 7%. We discussed the range of different economic outcomes in our recent scenario report: *Navigating the Uncertainty - Trade and foreign policy scenarios for a turbulent autumn*, 26 June.

US import volumes recovered after April, and the overall trade deficit widened again in May after the preliminary US-China trade deal, as opportunistic firms took advantage of the at least temporarily lowered tariffs. This was also evident in tariff revenues collected for imports in May, which increased despite the average tariff rate declining (chart 6). Freight rates ticked temporarily higher (chart 7) as firms began front-loading imports again, and manufacturing PMI subindices reflecting stockbuilding shifted higher.

As such, preparation for the upcoming tariff announcements and the risk of higher rates might have distorted economic data higher over past couple of months, both for the US and its trading partners. For the time being, US importers have appeared to absorb most of the tariff costs, as increases in consumer prices have fallen short of expectations. For the time being, this has not lead to broad-based needs to reduce other costs, as the overall number of layoffs has remained low. Looking ahead though, we expect inflation of food and goods to increase towards the second half of this year, labour market to cool and private consumption growth to slow. Furthermore, the prolonging trade negotiations also extend the period of uncertainty, which constraints firms' appetite for investments.

Chart 6: Tariff revenue continues to increase



Sources: Macrobond Financial, U. S. Treasury

Chart 7: Demand for freight shifting rapidly

Sources: Macrobond Financial, Drewry Shipping Consultants

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