RESEARCH

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EMERGING MARKETS SNAPSHOT

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Emerging Markets Brace for Trade War Impact: Losers and Winners of Trumponomics

President Trump tariffs are here, and it's a question of how much, where and which sector rather than whether. So far, only 20% higher on all Chinese imports are implemented. But looming are a few measures threatened, from steel and aluminum, auto, chips, pharma, shipbuilding, to reciprocal that are targeted at both foes and friends.

Whether China can cope with higher tariffs like in the past, which is to offset the shrinking of US markets with higher exports to the rest of the world, remains to be seen. Vietnam, Malaysia, Thailand, Singapore and India can benefit from reshuffling of supply chains. On reciprocal tariffs, India and Thailand are most affected due to widest differentials. Korea feels the heat the most for steel and aluminum as it got exemptions and in auto. Singapore and India are vulnerable for pharma and Malaysia is acutely exposed to chip tariffs. Should Trump impose tariffs on everyone, the rest of EM Asia will be hurt, especially Vietnam, and China will benefit from a strategic point of view.

CEEMEA economies are the "winners" being less exposed to US tariff threats compared to Asian ones and not having significant tariff differentials. Within the region, Hungary is the most vulnerable to the auto sector (but also to pharma and electrical equipment, including chips) and Germany while South Africa seems to be the biggest loser with highest exports to the US and significant exposure to commodities including metals. Poland is more resilient and diversified, and Turkey and Saudi Arabia stand out to be unscathed.

In LATAM, Mexico and Colombia are the most exposed to potential tariffs. The trade and investment supply chains between the US and Mexico are closely integrated, particularly in the auto industry, meaning that Mexico would be most affected if tariffs are implemented. In contrast, Argentina, with its more closed economy, is somewhat shielded from US tariffs. Commodity-dependent countries like Brazil, Chile, and Peru could face significant challenges if global commodity prices decline on worries about sagging global demand.

EM Asia

Question 1: Trump Tariffs – Who Should Fear the Most in EM Asia?

The US is the largest importer of goods in the world – and Trump is erecting barriers to trade. President Trump started his presidency with 10% higher tariffs on goods from China on 4 February. By 4 March 2025, we also have another 10% tariffs on Chinese goods and 25% on Canada (10% on Canadian energy) and Mexico. China has retaliated by hitting at US soybean exports at 10% and some other agriculture products such as chicken as well as export controls and unreliable lists (See **Table 1**). And rather quickly, Trump capitulated by pushing the deadline for Mexico and Canada to 2 April 2025.

For now, **only China is targeted by Trump implemented tariffs** with twenty percent higher in tariffs on top of already high trade and investment barriers. But other Asia countries are being vigilant as there is plenty promised in the months ahead. On 12 March, there is a 25% on steel and aluminum. The unilateral tariff is not new but rather impacting those that have received exemptions from 2018 tariffs for 25% tariff on steel and 10% on aluminum. For those without exemptions, it levels the playing field. The 25% aluminum will impact everyone as it rises from 10% that was increased in 2018.

Meanwhile, all nations are facing threats of 25% on autos, chips and pharma to take effect 2 April. At the same time, all nations also have looming reciprocal tariffs on 1 April. In additional to the above, the president proposed additional fees on China commercial maritime ships docking at US ports. Please see **Table 1** for the timeline of Trump tariffs as well as what's implemented, delayed, and potentially incoming.

Table 1: Timeline of Trump's Tariff

	Effective Date	Target Countries	Tariff	Target Goods	Retaliation	Latest Update
Implemented	4-Feb-25	China	10%	All	**Retaliated:** 15% tariffs on coal, coke, lignite and others | 10% tariffs on crude oil, agricultural machinery and vehicles Non-tariff measures: export controls	
	4-Mar-25	China	Another 10%	All	**Retaliated:** Imposed tariffs on agricultural products - 15% on chicken, wheat, corn and cotton | 10% on soybeans and others	
Delayed	4-Mar-25	Canada, Mexico	25%; 10% for Canadian energy	Most	**Retaliated:** **Canada:** Imposed 25% tariffs on $155 billion of goods, with $30 billion of which came in effect immediately	**Auto:** 1-month exemption until 2nd April **Goods Under USMCA:** 1-month exemption until 2nd April
Incoming	12-Mar-25	Major Exporters	25%	Steel, aluminum		The 25% steel and 10% aluminium tariff was implemented in 2018 during Trump's first term. Biden granted exemptions to major trading partners like Brazil, South Korea, Australia, etc. But for most countries, the only difference is 25% tariffs on aluminum.
	24-Mar-25*	China	Non-tariff measures	Vessels		Chinese-built Vessels: **$1.5 mn** port call fee and service fee Chinese Vessels Operators: **$1 mn** port call fee
	2-Apr-25	European Union	25%	All		
	2-Apr-25	Major Exporters	25%	Cars, chips, pharma		
	2-Apr-25	All	Reciprocal, VAT, and other barriers	Unspecified		
	22-Nov-25	Major Exporters	Unspecified	Copper		
	31-Dec-25	EU, UK, Canada	Digital taxes	Unspecified		

Source: Natixis
N.B. The exact date for above tariff schedule subjects to change. The non-tariff measures US proposed to impose on China shipbuilders are still in the public hearing period and will proceed into next stage on 24 March.

As countries are scrambling to limit the fall-out of tariffs, we seek to answer who is most vulnerable on reciprocal tariffs as well as the potential 25% tariff on steel, aluminum, autos, chips and pharma. **For reciprocal tariff, India and Thailand stand out as the highest difference for tariffs with the US**, as in they have higher tariffs on US imports than the US on their exports. That means they will either lower their tariffs on US goods or face higher tariffs from the US. India is already pre-emptively lowering some US tariffs and promised to do more US purchases as well as beefing up bilateral trade.

Table 2: Summary of Tariffs between US on Asia and Asia on US

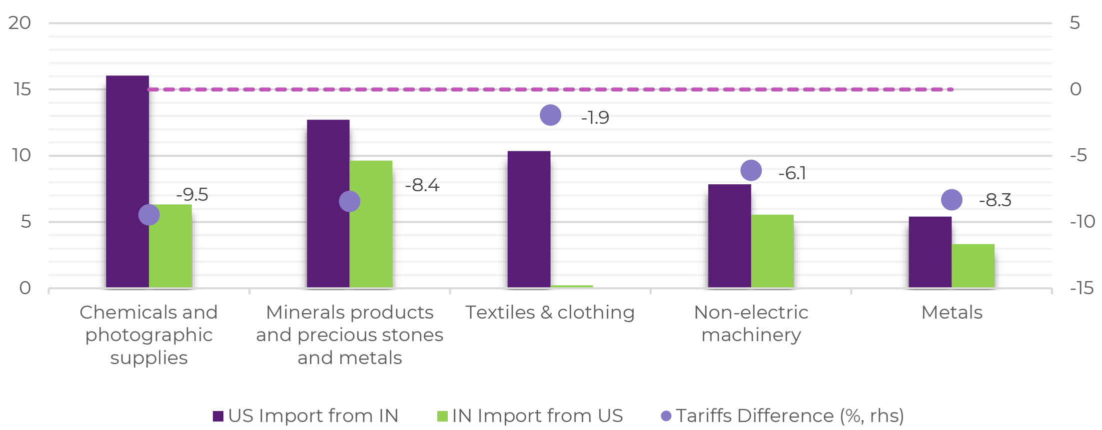
US Imposed Tariffs			Tariffs on US			FTA	Difference in weighted-average tariffs between US on Asia & Asia on US
	Simple Average	Weighted Average		Simple Average	Weighted Average		
IN	3.8	3.0	IN	13.9	9.5	No	-6.4
TH	2.5	0.7	TH	9.8	6.2	No	-5.5
JP	0.0	0.0	JP	3.9	3.9	No	-3.9
PH	2.7	1.0	PH	5.7	4.3	No	-3.3
CN	3.6	2.8	CN	7.1	6.0	No	-3.2
AU	0.1	0.6	AU	2.8	2.3	Yes	-1.7
MY	3.2	0.7	MY	5.8	2.1	No	-1.4
TW	3.5	1.0	TW	4.9	1.7	No	-0.7
ID	2.8	4.0	ID	8.6	4.5	No	-0.6
SG	0.0	0.0	SG	0.1	0.0	Yes	0.0
VN	3.8	3.9	VN	9.1	3.0	No	0.9
KR	3.6	1.6	KR	0.0	0.0	Yes	1.6
HK	4.0	3.4	HK	0.0	0.0	No	3.4

Source: Natixis, UNCTAD TRAINS

N.B. Data is based on 2023 tariff data. Product classification is based on WTO's Multilateral Trade Negotiations (MTN). UNCTAD compute the applied tariff as the lowest tariff among Most-Favored Nation (MFN) and preferential tariff. Any tariff hikes by governments outsides of MFN and preferential tariff will not be reflected. Countries that have FTA with the US are marked in purple.

Digging into sectoral level, we see chemicals and photographic supplies having the largest difference in tariffs (**Chart 1**). Overall, should India not lower US tariffs and Trump go ahead with reciprocal tariffs, we expect this to have an -0.6% of GDP impact on India. For Thailand, non-electrical machinery is the highest value item being exported to the US and there is a -2.3% gap. In Thailand's top five items, they all have large tariff gaps with the US. Should tariffs not decline or if Trump decides to target, then it would have an -2.0% of GDP impact.

Chart 1: India: Trade Value (USD bn) and Effective Weighted Average Tariffs (%) with the US

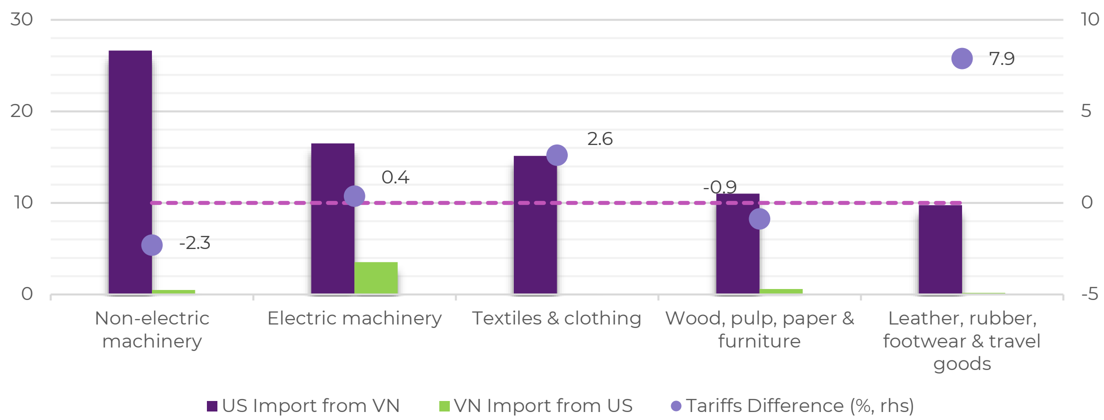


Source: Natixis, UNCTAD TRAINS

N.B. Data is based on 2023 tariff data. Product classification is based on WTO's Multilateral Trade Negotiations (MTN). Tariffs difference is calculated by US imposed tariffs on India vs India on US. UNCTAD computed the applied tariff as the lowest tariff among Most-Favored Nation (MFN) and preferential tariff. Any tariff hikes by governments outsides of MFN and preferential tariff will not be reflected.

Vietnam and Indonesia are least affected by reciprocal tariffs if the headline tariff differentials are being considered. For Vietnam, within the top five items, only non-electrical machinery has higher tariffs than the US while other categories are much lower (**Chart 2**). As Trump considers also non-tariff barriers, it remains to be seen how that will be deployed. If that were to be the case, then Vietnam could be negatively impacted purely for the fact that it has the highest GDP exposure to US exports. (See The Winners and Losers of Trump Tariffs)

Chart 2: Vietnam: Trade Value (USD bn) and Effective Weighted Average Tariffs (%) with the US



Source: Natixis, UNCTAD TRAINS

N.B. Data is based on 2023 tariff data. Product classification is based on WTO's Multilateral Trade Negotiations (MTN). Tariffs difference is calculated by US imposed tariffs on India vs India on US. UNCTAD computed the applied tariff as the lowest tariff among Most-Favored Nation (MFN) and preferential tariff. Any tariff hikes by governments outsides of MFN and preferential tariff will not be reflected.

For steel and aluminum, most EM Asian countries did not get exemptions so steel sector is not impacted. In Asia, only Japan and South Korea got exemptions, as well as Australia. Meaning, EM countries are not facing significantly higher tariffs than status quo, except for the rise of higher tariffs of aluminum from 10% to 25%. Meaning, while Vietnam got high share of GDP exposure, the impact is likely more acute for South Korea as it implies higher tariff rates while Vietnamese steel remains the same.

Table 3: US Product Import by Asia Countries

	Iron & Steel				Chips		
	USD Bn	As % of US Total Iron & Steel Import	As % of Individual Country's GDP		USD Bn	As % of US Total Chips Import	As % of Individual Country's GDP
CN	12.3	14.3	0.1	MY	13.5	21.5	3.4
SK	5.4	6.2	0.3	TW	8.5	13.5	1.1
TW	4.4	5.1	0.6	VN	7.0	11.1	1.6
IN	3.4	3.9	0.1	TH	6.3	10.0	1.2
JP	3.3	3.8	0.1	SK	3.9	6.2	0.2
VN	1.7	2.0	0.4	CN	2.6	4.1	0.0
TH	1.6	1.8	0.3	JP	2.1	3.4	0.1
MY	0.6	0.7	0.2	IN	2.0	3.2	0.1
AU	0.5	0.6	0.0	PH	1.6	2.6	0.4
ID	0.2	0.3	0.0	SG	1.1	1.7	0.2
PH	0.1	0.1	0.0	ID	0.3	0.4	0.0
SG	0.0	0.0	0.0	AU	0.0	0.0	0.0
Worst Impact	**South Korea, Japan and Australia** steel sectors are most affected as they got exemptions while the rest of Asia have had 25% tariffs on steel since 2018 so this levels the playing feel.			**Worst Impact**	**Malaysia** is most affected among EM Asia countries not only it has the higest share of GDP of chips exports but relies heavily on FDI into the sector.		

	Auto				Pharmaceutical		
	USD Bn	As % of US Total Auto Import	As % of Individual Country's GDP		USD Bn	As % of US Total Pharma Import	As % of Individual Country's GDP
JP	50.8	13.3	1.2	IN	11.0	6.2	0.3
SK	38.4	10.1	2.1	SG	9.5	5.3	1.9
CN	16.4	4.3	0.1	JP	6.6	3.7	0.2
TW	3.6	0.9	0.5	CN	6.0	3.4	0.0
IN	2.7	0.7	0.1	SK	2.6	1.5	0.1
TH	2.1	0.6	0.4	AU	1.2	0.7	0.1
VN	1.0	0.3	0.2	TW	0.6	0.4	0.1
ID	0.3	0.1	0.0	MY	0.1	0.1	0.0
MY	0.2	0.0	0.0	TH	0.0	0.0	0.0
AU	0.1	0.0	0.0	VN	0.0	0.0	0.0
PH	0.0	0.0	0.0	ID	0.0	0.0	0.0
SG	0.0	0.0	0.0	PH	0.0	0.0	0.0
Worst Impact	**Japan, South Korea** are most affected due to their high GDP exposures to auto exports. Some Japanese and Korean companies can mitigate the effects by offshoring and investing into the US.			**Worst Impact**	**Singapore and India** pharmaceutical sectors are most affected, while the rest of Asia is largely immune.		

Source: Natixis, UNCTAD TRAINS
N.B. Product classification is based on HS system.

In response to Trump tariffs on global steel and aluminum, Vietnam imposed anti-dumping duties on China for 120 days with tariffs ranging from 19.4% to 27.8% to protect domestic steel firms. **Meaning, the impact of the coming steel and aluminum tariff is worst for Japan and South Korea if the exemptions are removed. Meanwhile, the rest of Asia faces status quo.**

The biggest concern for EM Asia is the 25% on chips that is looming. **In Asia, Malaysia exports the most chips to the US as a share of GDP**, followed by Vietnam and Thailand. Tariffs would impact Malaysia, Taiwan, Vietnam, Thailand and South Korea the most. For China, due to existing curbs, the impact is limited. But the impact for EM Asia and especially Malaysia is not just the chip export exposure to the US but also the FDI inflows. Malaysia has positioned itself as a neutral investment ground to US investment and would lose that status should it receives tariff curbs.

For auto, Japan and South Korea will be most affected. In Southeast Asia, Thailand and Vietnam would be more impacted. Overall, autos primarily impact North Asia. Some companies already deployed FDI into the US and thus some South Korean and Japanese companies are in the position to avoid tariffs but overall, it would lead to lower jobs in those countries should the tariffs go ahead. China already faces high curbs so there is limited impact. For the rest of EM Asia, it is largely muted.

Should pharmaceutical curbs take place, Singapore and India stand out as most affected, followed by Japan and South Korea. Most of Southeast Asia is largely immune.

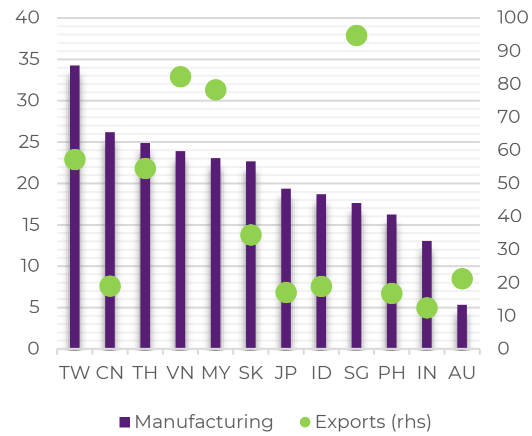
The impact of the targeted tariffs sectoral tariffs is relatively manageable except for Malaysia for chips and Singapore for pharmaceutical. The impact on Malaysia isn't just lower imports but also further investment. Chips is also a sector that Vietnam wants to grow, and the introduction of tariffs would lead to a similar impact as Malaysia. It is less of an issue for Vietnam than Malaysia, although would overall be negative. TSMC already deployed capital to the US to take advantage of the chips act and so there is some avoidance of tariffs possible as it already onshore production but still would be negative for Taiwan. India stands to be most affected for pharmaceutical and reciprocal tariffs.

While Trump is targeting sectors such as steel and potentially autos, chips and pharmaceutical, **he is targeting China in not just 20% tariffs higher** since coming to office in his second term **but also maritime dominance with special levies on Chinese commercial ships**. Trump is proposing to charge any vessel operator of China would be charged for a port call in the US, no matter where it was built. The rate charged is USD1,000 per net tonne up to USD1 million per port call. The US is also proposing to charge the fees proportional to the share of Chinese vessels within operator fleets. While this is not yet implemented, it will affect global shipping, favoring South Korean and Japanese ships relative to Chinese, which dominates global shipping.

Vietnam is most vulnerable to Trump tariffs in Asia due to its high exposure of exports to GDP (Chart 3), but it is not impacted by what Trump has proposed thus far, which is reciprocal tariffs, steel and aluminum, pharmaceutical and autos. Chips are one area that will impact Vietnam, although it is not its most valuable export item.

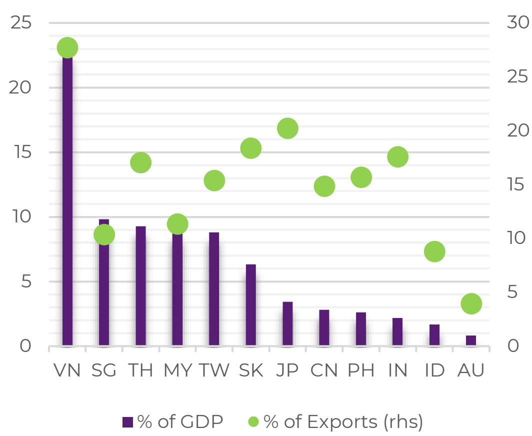
India, despite having low export as a share of GDP, stands out vulnerable to reciprocal tariffs and pharmaceutical tariffs. The good news for India is that it is trying hard to avoid it and can lower tariffs to match with US or get other concessions. This hits India at a vulnerable moment when it has slowing domestic demand. We think the RBI will continue to cut rates to support slowing growth. Meanwhile, the government will be more aggressive in diversifying investment and trade, such as negotiating for the EU-FTA, to mitigate the fallout of US tariffs.

Chart 3: Asia: Exports and Manufacturing Sector as share of GDP (%)



Source: Natixis, UNCTAD

Chart 4: Asia: Exports to US



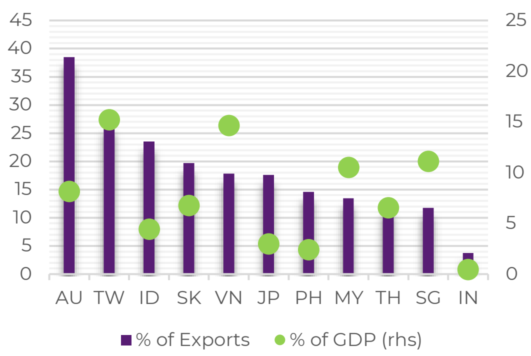
Source: Natixis, UNCTAD

Question 2: What if President Trump only imposes tariffs on China?

So far, President Trump has only imposed tariffs on China (20%) while the rest of Asia is spared thus far. There is more in the works but what is clear here is that President Trump is targeting China more proportionately. It remains to be seen whether the rest of Asia will get tariffed but assuming that China will be more proportionately targeted, we expect China to retaliate further. China has retaliated with tariffs on US agriculture products, some machinery, as well as export controls and restrictions.

Global supply chains are being redrawn and have been reshuffled to Southeast Asia, North Asia and to a lesser extent India. Exports to the US have risen sharply for Vietnam, South Korea, Thailand, and Malaysia. Using data from 2023, China exports to the US totaled 2.8% of GDP. **Depending on the levels of tariffs, that will shave off growth to China about 1.2% of GDP** (See Jianwei Xu's note on China's response to Trump presidency), assuming no corresponding counter stimulus to offset. A softer China will lead to lower aggregate demand, assuming no major offsetting monetary easing and fiscal support. This will affect economies most exposed to China. **In EM Asia, Indonesia will be worst affected when China demand falls as it exports commodities to China** (See **Chart 5**).

Chart 5: Asia: Exports to China



Source: Natixis, UNCTAD

Table 4: US imports by trade partners, product imports from 2017 to 2023, in share of total product imports

	2023										2017				
	China		ASEAN		North Asia		India		EU		China	ASEAN	North Asia	India	EU
	%	Change	%	Change	%	Change	%	Change	%	Change	%	%	%	%	%
Telecommunication and sound recording apparatus	41	▼▼▼	25	▲▲▲	9	▼	1	▲	38	▲▲▲	59	12	9	0	21
Miscellaneous manufactured articles	38	▼▼	8	▲	5	▼	1	▼	17	▲	47	5	6	1	14
Electrical machinery, apparatus and appliances	19	▼▼	20	▲	17	▲	1	▲	40	▲▲	28	17	17	0	35
Office machines and automatic data processing machines	32	▼▼▼	19	▲▲	24	▲▲▲	0	▲	43	▲▲▲	57	12	9	0	21
Other industrial machinery and parts	16	▼▼	4	▲	14	▼	0	▲	22	▲	24	2	15	0	20
Manufactures of metal	29	▼▼▼	6	▲	14	▼	0	▼	25	▲	40	4	15	0	22
Articles of apparel & clothing accessories	23	▼▼▼	25	▲	1	▼	5	▼	32	▲	35	23	1	5	28
Road vehicles	5	▼	1	▲	24	▼	0	▲	26	▼	5	1	25	0	26
Furniture and parts thereof	28	▼▼▼	27	▲▲▲	3	▲	3	▲	32	▲▲▲	50	14	3	1	18
Textile yarn and related products	34	▼▼	5	▲	7	▼	1	▲	28	▲	41	3	7	1	24
Footwear	37	▼▼▼	39	▲▲▲	0	▼	8	▲	41	▲▲▲	56	28	0	6	30
Professional and scientific instruments	10	▼	10	▲	11	▲	0	▼	22	▲	14	8	11	0	20
Specialised machinery	10	▼▼	8	▲	25	▼	0	▲	35	▲	15	6	25	0	33
Medicinal and pharmaceutical products	4	▲	6	▲	5	▲	0	▲	18	▲	3	3	4	0	14
Organic chemicals	11	▼	8	▲	7	▼	0	▲	21	▲	15	6	8	0	19

Source: Natixis, UNCTAD

We expect countries that have the best capability to attract new FDI and have better substitution alternatives to benefit more. **Table 4** shows the existing US imports from China as a share of total by product by value from highest to lowest. The highest value items are telecom, electrical machinery as well as miscellaneous items. For all these items, there have been significant decline of dependence in import from China from 2017 to 2023 to now all are under 50%. Note that the change by more than 10% compared to 2017 will be three arrows, between 5% ~ 10% will be two arrows, and change smaller than 5% will be one arrow. **For China, there has been a drop for all product categories since 2017 except medicine.**

For each corresponding decline in Chinese dependency, **ASEAN has gained the most**. The EU also has gained substantially. **India has gained across the board but not as much as the ASEAN region**. For apparel, India lost share to the US. Impressively, ASEAN has gained across all categories of export to the US, driven by mostly Vietnam, Thailand and Malaysia.

We show in **Table 5** the biggest three winners in ASEAN – Vietnam, Thailand and Malaysia – and India. **Vietnam was a decidedly big winner from the US-China trade-war in every product category**, dwarfing not just its neighbors but also a giant country like India. For example, for the largest product category importing from China, Vietnam now has 15% of US market share of imports. Thailand has gained also substantially except for labor intensive product like footwear and miscellaneous manufactured items. Meanwhile, Malaysia generally gained for most except for ICT products. That said, it is key for the US for semiconductor. The fact that Vietnam has gained substantially relative to India and other more populous countries such as Indonesia and the Philippines point to its more aggressive policy to attract trade and investment.

Table 5: US imports by trade partners, product imports from 2017 to 2023, in share of total product import

	2023								2017			
	Vietnam		Thailand		Malaysia		India		Vietnam	Thailand	Malaysia	India
	%	Change	%	Change	%	Change	%	Change	%	%	%	%
Telecommunication and sound recording apparatus	15	▲▲▲	5	▲	3	▼	1	▲	4	3	4	0
Miscellaneous manufactured articles	4	▲	1	▼	1	▲	1	▼	1	1	1	1
Electrical machinery, apparatus and appliances	5	▲	4	▲	7	▼	1	▲	2	2	10	0
Office machines and automatic data processing	9	▲▲	5	▲	3	▲	0	▲	2	4	3	0
Other industrial machinery and parts	1	▲	2	▲	0	▲	0	▲	0	1	0	0
Manufactures of metal	3	▲	2	▲	1	▲	0	▼	1	2	0	0
Articles of apparel & clothing accessories	17	▲	2	▲	1	▼	5	▼	13	2	2	5
Road vehicles	0	▲	1	▲	0	▲	0	▲	0	0	0	0
Furniture and parts thereof	20	▲▲	1	▲	2	▲	3	▲	10	0	2	1
Textile yarn and related products	3	▲	1	▲	0	▼	1	▲	1	1	0	1
Footwear	30	▲▲	0	▼	0	▲	8	▲	22	0	0	6
Professional and scientific instruments	1	▲	1	▲	4	▲	0	▼	0	1	3	0
Specialised machinery	2	▲	1	▲	2	▲	0	▲	2	1	1	0
Medicinal and pharmaceutical products	0	▲	0	▲	0	▲	0	▲	0	0	0	0
Organic chemicals	0	▲	0	▲	0	▲	0	▲	0	0	0	0

Source: Natixis, UNCTAD

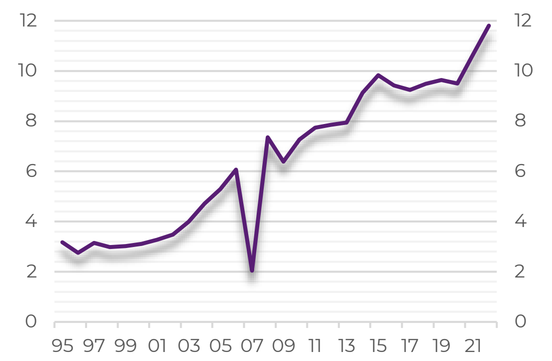
Currently, despite diversifying, the items with the largest dependency on China are baby carriages, toys, games and sporting goods with 74.2% dependency on China. That said, in 2017, it was much higher at 81.5% exposure. We think that this is a product category that also will be diversified in the future as US-China tensions rise.

We expect Southeast Asia, especially Vietnam and Malaysia to be winners but for different segments. India will also attract more FDI but likely in ICT sector as it prioritizes it and less so in labor intensive. North Asia too will gain for high-tech production. For Singapore, it will be for capital market, services and more high-tech products like semiconductor. For many Asians economies, China retaliation on US agriculture products can also be beneficiary such as big producers such as Thailand, Vietnam, India and Australia. That being said, it also faces a larger flood of Chinese goods that will make it more competitive for local firms. Some like Vietnam already imposed higher duties on Chinese steel but we don't expect significant tariffs from the rest of Asia.

Question 3. Is Vietnam's gains merely re-routing masked as exports?

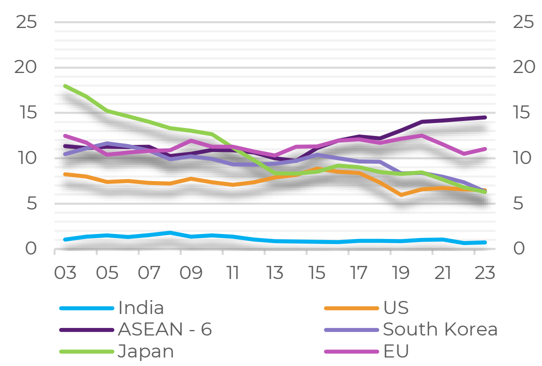
ASEAN biggest traders – Vietnam, Malaysia, Thailand - are winners of the US-China tensions. Southeast Asia is the center of key free trade agreements and such as its own of ASEAN Free Trade Area (AFTA), which signs FTAs with countries in Asian countries such as Australia, New Zealand, China, India, South Korea, and a comprehensive partnership with Japan. Beyond that, countries such as Singapore and Vietnam have EU FTAs and are rather aggressive at courting trade liberalization and investment. Vietnam with its cheap wages, proximity to China, and trade-oriented mind-set has courted key sectors such as electronics, textile, footwear as well as agriculture as key targets for investment and exports. As such, ASEAN exports to China and the US have increased (**See Question 1 on the countries and sectors**).

Chart 6: China: Export of Intermediate Goods as share of World's Export of Intermediate Goods (%)



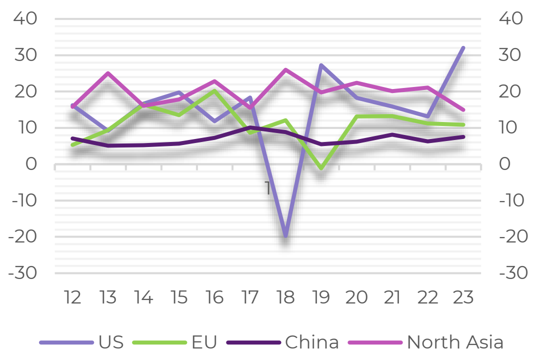
Source: Natixis, WITS

Chart 7: China: Imports from Major Partners as share of Total Imports (%)



Source: Natixis, UNCTAD

Chart 8: ASEAN: FDI Inflow by Source of Country (% of Total)



Source: Natixis, ASEAN Statistics.

N.B.: North Asia includes Japan, South Korea and Taiwan.

Because of ASEAN centricity in regional supply chains, it is not just exports to the US that risen, China imports from ASEAN-6 also rose rapidly as more firms deploy capital to the region. **Chart 7** shows China import from ASEAN-6 rising rapidly to 14.5% of total from 12.4% in 2017. Meanwhile, its imports from the US, Japan, South Korea, India, and the EU have declined.

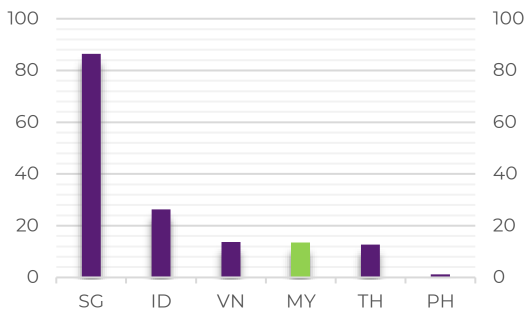
The key reason for this increase is rising investment by global firms into Southeast Asia to diversify supply chains (**Chart 8**). From North Asia to the US and to recently China, firms have deployed more capital to Southeast Asia to rejig their supply chain.

The impact is greater integration of ASEAN in global supply chains, especially regarding China and the US. China has deployed more of its FDI outward to Southeast Asia than other region, primarily due to investment curbs to other locations and also geopolitical neutrality of the region as well as proximity (**Chart 9**).

Thus, because of diversified investment in the region, particularly from North Asia, China, and the US, exports to those three destinations are the largest. Imports from North Asia and China are also the largest, showing the increasing centricity of ASEAN in Asia regional supply chains. The largest investors in ASEAN are North Asians (South Korea, Japanese and Taiwanese), Singapore, the US, and increasingly China.

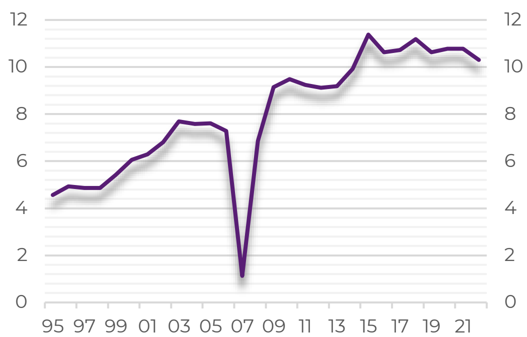
One criticism of the rise of ASEAN exports to the US, especially Vietnam's, is that it is just Chinese exports in disguise or primarily rerouting. A paper published by Harvard Business School used firm-level and macro flows to find that only 1.8% of exports are flagged as firm-level rerouting. And at the product-level, about 16.1% were identified as re-routing. In other words, there is big difference in estimate but it shows that the bulk of the increase of Vietnam export to the US is not due to rerouting.

Chart 9: China: Total Outward FDI from 2003 to 2023 (USD Bn)



Source: Natixis, CEIC

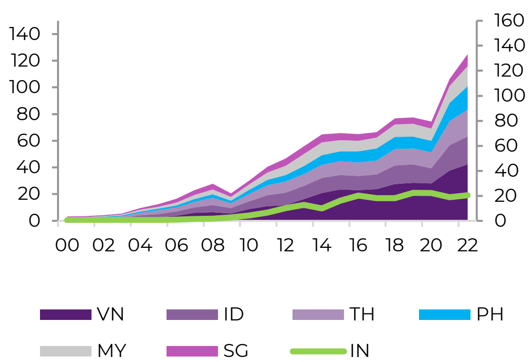
Chart 10: China: Import of Intermediate Goods as share of World's Import of Intermediate Goods (%)



Source: Natixis, WITS

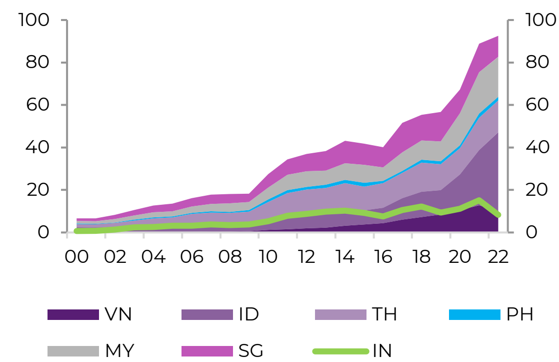
China has increased its share of exports of intermediate goods to 12% of total global export of intermediates from 3% in 1997 and most of that increase of export of intermediate goods has taken place to ASEAN and then to lesser extent India (**Chart 10**). The increase of export of intermediates to Vietnam is the largest amongst Southeast Asian economies. What that means is that Vietnam is linked to China via supply chains rather than mere re-routing and the import of intermediates from China is key to Vietnamese production and assembling (**Chart 11** and **Chart 12**).

Chart 11: China: Export of Intermediate Goods (USD Bn)



Source: Natixis, WITS

Chart 12: China: Import of Intermediate Goods (USD Bn)



Source: Natixis, WITS

China imports of intermediate goods as a share of total imports remain high at roughly 20%. While its imports of intermediates have declined for most of the world, one place where it has risen sharply is ASEAN. Meaning, not only is China trade with ASEAN becomes more integrated, but it is also integrated at the intermediate level and that suggests the rise of ASEAN as key in Asia supply chains. Indonesia is a place where it imports the most intermediate – mostly refined metals such as nickel; meanwhile, intermediate imports are also rising across Southeast Asia, suggesting greater integration of supply chains between China and Southeast Asia.

Table 6: Vietnam Imports by trade partners, change in product imports from 2017 to 2022, in USD billion

	2022												2017					
	Asia ex China		China		North Asia		ASEAN		US		EU		Asia ex	China	North Asia	ASEAN	US	EU
Stage of Products	Nominal	Change	Nominal	Change	Nominal	Change	Nominal	Change	Nominal	Change	Nominal	Change	Nominal					
Intermediate Goods	35		39		18		12		4		4		26	22	15	7	2	3
Consumer Goods	26		20		11		14		2		4		18	8	8	10	1	3
Capital Goods	67		57		54		11		4		7		48	28	40	7	4	5

Source: Natixis, UNCTAD, WITS

Another way to see this is to look at Vietnam's import of goods by stage of production. Vietnam's imports have increased for all partners and its largest partner is China by country for intermediate goods but for the rest of Asia is also almost as equally large (**Table 5**). Overall, Vietnam imports of intermediates rose for China, ASEAN, North Asia, and the US. Most notably, Vietnam's imports for capital goods needed for industrialization amount to almost the same as North Asia and China. If we compare Vietnam's linkage with China vs rest of Asia, its relationship with the rest of Asia is also growing rapidly. Meaning, Vietnam's trade with the world has increased rapidly in all stage of production for all partners.

Table 7: Vietnam imports by trade partners, change in product imports from 2017 to 2023, in USD billion

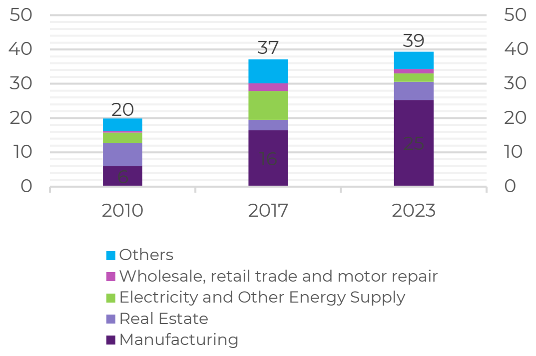
	2023											
	Asia ex China		North Asia		China		ASEAN		EU		US	
Top 15 Importing Products	Nominal	Change	Nominal	Change	Nominal	Change	Nominal	Change	Nominal	Change	Nominal	Change
Electrical machinery, apparatus and appliances	40		34		24		6		5		4	
Office machines and automatic data processing machines	12		11		13		1		0		0	
Textile yarn and related products	6		5		12		1		0		0	
Petroleum, petroleum products and related materials	7		2		1		4		0		0	
Iron and steel	7		4		4		1		0		0	
Plastics in primary forms	6		4		2		2		0		1	
Telecommunication and sound recording apparatus	2		1		6		1		0		0	
Manufactures of metal	3		2		5		0		0		0	
Other industrial machinery and parts	4		2		4		1		1		0	
Non-ferrous metals	5		2		2		2		0		0	
Road vehicles	5		2		2		3		0		0	
Miscellaneous manufactured articles	2		2		4		0		0		0	
Specialised machinery	3		2		3		0		1		0	
Vegetables and fruits	1		0		1		0		0		0	
Coal, coke and briquettes	5		0		0		2		0		0	
Total	**149**	**39**	**94**	**18**	**108**	**50**	**38**	**12**	**17**	**5**	**15**	**6**

Source: Natixis, UNCTAD

Digging into Vietnam's imports by product category, we see that Vietnam has increased its linkages across globe in all categories except telecommunication, specialized machinery, petroleum, and vegetables and fruits. By product, from the highest value item – electrical machinery and appliances - Vietnam's largest import partner is Asia ex China, specifically North Asia (Taiwan, Japan and South Korea), followed by China. In office machines and data processing, the growth of North Asia surpasses the growth of China, although all equally have been strong.

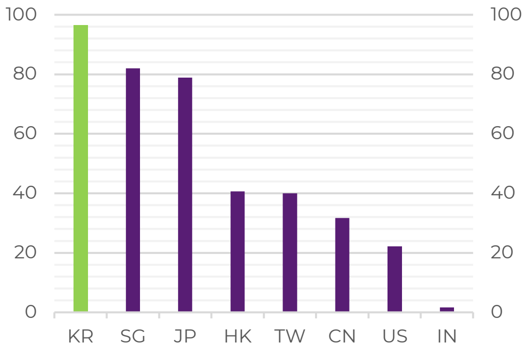
What is clear here is that Vietnam's import growth is diversified across Asia, with the strength strongest with North Asia economies for manufactured goods. **In fact, as more supply chains are established in Vietnam, its import dependency is declining for key items such as telecommunication devices.**

Chart 13: Vietnam: Registered Capital by Industry (USD Bn)



Source: Natixis, CEIC

Chart 14: Vietnam: Total Registered Capital from 2000 to 2023 (USD Bn)

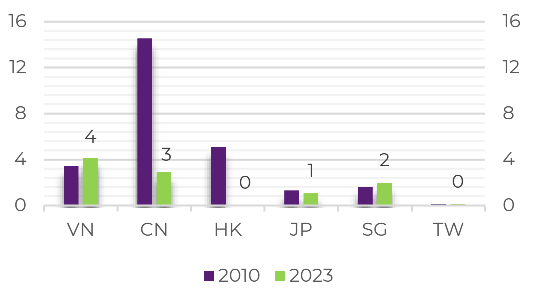


Source: Natixis, CEIC

One of the key reasons for Vietnam's success in growing exports is the rise of FDI int the country. In 2023, a staggering USD39bn was disbursed into Vietnam with 60% being in the manufacturing sector. **Chart 13** shows the rapidly rise of Vietnam FDI over the years. As a share of GDP, it is amongst the highest in the region. The source of investor is North Asian (South Korea, Japan and Taiwan) and Singapore (second largest), Hong Kong and China. Investment source explains why Vietnam is also linked with North Asia and China in its imports, implying that its exports are now much more integrated in the region.

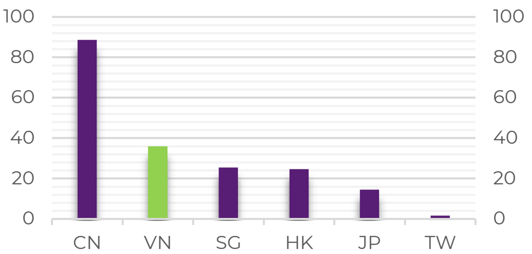
Take South Korea for example, which is Vietnam's largest source of FDI. In 2010, China was the largest source of FDI for South Korea. But due to geopolitical tensions with China, South Korea has increased its investment in Vietnam and thus its flow of FDI to Vietnam is now the largest in Asia, surpassing that of China's in 2023. And rather rapidly, South Korea's stock of FDI in Vietnam is rising (**Chart 16**).

Chart 15: South Korea: Outward FDI as share of Total



Source: Natixis, CEIC

Chart 16: South Korea: Total Outward FDI from 2000 to 2023 (USD Bn)



Source: Natixis, CEIC

In conclusion, based on our analysis of Vietnam's source of FDI and imports, the rapidly rise of Vietnam's exports not just to the US but also across the world is due to increasingly reshuffling of supply chains to Vietnam by North Asia, China, the EU and others. As a result, Vietnam has increased its trade merely through rerouting as some have asserted but due to its rapid integration into regional supply chain thanks to more investment.

We expect Vietnam, along with Malaysia and Thailand to continue to be key beneficiaries to US-China tensions. India, too, will raise its trade with the world but at a much lower level than Vietnam due to less policy emphasis to remove hurdles to doing business and only emphasis on ICT and neglecting labor-intensive manufacturing.

CEEMEA

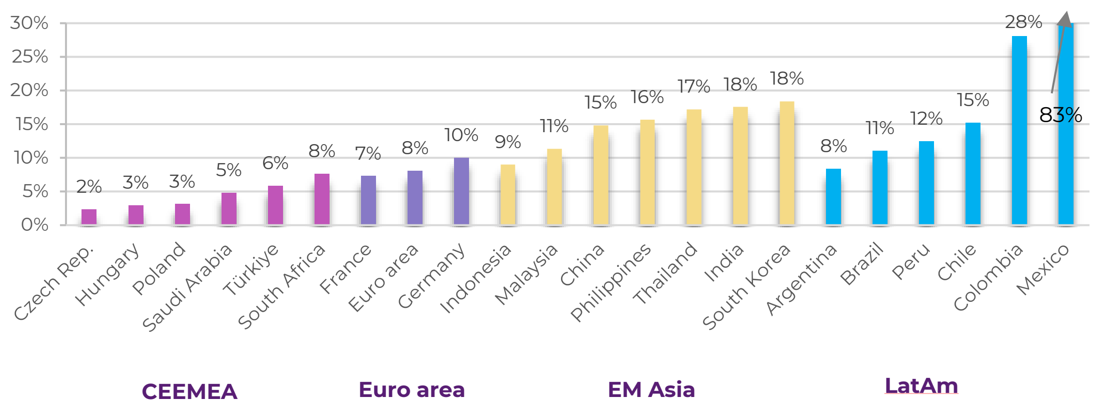
What is the trade tariffs framework of the new Trump administration?

- The current policy shift in the US towards a much more protectionist stance should shape the global economic outlook in 2025-26. So far, Trump administration introduced a 20% trade tariff on all imports from China (yet, not 60% as promised during the Presidential campaign) as well as 25% tariffs on imports from Canada and Mexico (except for 10% duties on the Canadian energy imports). However, President Trump has backed off recently postponing the implementation of the Canadian and Mexican import duties to 2 April. It remains unclear if these tariffs that are mainly used as economic **coercion tools** will take effect at all and for how long.
- In addition, the US will put in place tariffs of 25% on steel and aluminum imports (will take effect on 12 March) in the context of President Trump's **industrial policy** used to promote a domestic economic strategy. Besides, autos, semi-conductors (chips) and pharmaceutical sectors are also facing the threat of 25% tariffs for all nations to take effect on 2 April.
- Also on 2 April, President Trump is poised to enact **"reciprocal" tariffs** on all foreign nations that have import taxes on US goods. These are supposed to bring additional government revenue. Besides, the EU is still facing the threat of the 25% duties on all products.
- Most nations concerned by these policies promised to retaliate or have already put in place additional trade barriers.

What CEEMEA economies might be affected?

- While EM Asia (via China) and Latin America (via Mexico and a short episode with Colombia) have been threatened first, the EMEA region, and the European Union have begun to receive the tariff threats more recently.
- However, beyond the Central European economies that are included in the EU and would thus be subject to the same additional tariffs, other emerging market economies in the CEEMEA zone have not been directly targeted on trade, even though South Africa got its portion of criticism from President Trump on land expropriation law with the US cutting the funding of several health projects (including the HIV program).

Chart 1 Exports to the US in % of individual country's total exports, as of 2023



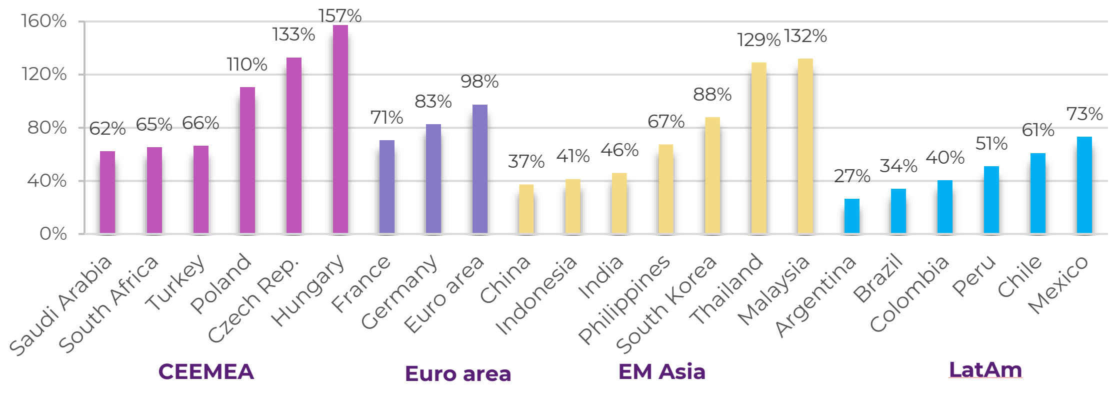
Sources: WB, LSEG DataStream, Natixis CIB

- Yet, amid the threats of more tariffs (25% on the EU and 25% on some industries) to be announced on 2 April, small open Central European economies and **Hungary** in particular would be most vulnerable due to their high trade openness, strong exposure to Germany and automobile sector as well as to relatively more meaningful share of electrical machinery, pharmaceuticals and vehicles (sectors that are subject to potential tariffs) in Hungary's exports to the US. Meanwhile, Poland that generally has more diversified exports and that has benefit from its role of a "connector" country between the trade blocks, should be affected the least.
- "Reciprocal" tariffs might affect **South Africa** most due to higher exposure of the country's exports to the US market (8% of exports) and slightly higher duties levied on the US products imported to the country than on the South African products imported by the US (1.3 percentage point difference on trade-weighted basis). Yet, South Africa has only a slight surplus in the bilateral trade. Meanwhile, as an important exporter of metals and minerals (as well as some other commodities) South Africa is subject to the sectoral tariffs and might also be vulnerable to a fall in their prices.

Foreign trade exposures in the CEEMEA area

- In terms of the trade openness ratio (exports plus imports in % of GDP) as well as for the share of exports in GDP CE3 economies (Poland, Hungary and Czech Republic) stand way above the average for EM and developed economies exposed to foreign trade: at around 130% on average for CE3 in 2023 versus 83% for Germany (98% for euro area) and 37% for China (**chart 2**). So, the escalation of the trade war with the retaliatory measures taken by most concerned nations might weigh on the regional foreign trade flows. The ratio of Türkiye, South Africa and Saudi Arabia is more in line with the global averages at 66%, 65% and 62% respectively.

Chart 2 Trade openness (exports + imports in % of a country's GDP) in current prices, as of 2023



Sources: IMF, LSEG DataStream, Natixis CIB

- However, the effect from the US tariffs would not be direct, via the trade flows between the US and the individual country. Indeed, Central Europe (Poland, Hungary and Czech Republic) only sent 2% - 3% of their exports to the US in 2023 versus 8% for euro area, 10% - 20% for EM Asia and 10% - 30% for Latin America (excluding Mexico that is even more tightly linked to the US, cf. **chart 1** above), Türkiye and Saudi Arabia – around 5% - 6% with South Africa having the highest exposure of 8%.
- In addition, the trade balance with the US which also seems to be an important criterion for the US President to target a particular trade partner, is only slightly positive for the Central European economies and South Africa (around $1.5bn - $2bn) and even negative for Saudi Arabia and Türkiye.

- Meanwhile, the CE3 economies show significant exposure of their trade flows to the euro area and, in particular, Germany. That might become the major channel for the negative impact from new US trade duties. Indeed, Germany represents 27% - 33% of the CE3 countries' exports with 60-65% for the euro area.

Table 1 CE3 (Poland, Hungary Czechia): main trade partners (in % of total), as of 2023

	Poland			**Hungary**			**Czech Rep.**	
1	Euro area, incl.	59%	1	Euro area, incl.	61%	1	Euro area, incl.	66%
	Germany	*28%*		*Germany*	*27%*		*Germany*	*33%*
	France	*6%*		*Italy*	*6%*		*Slovak Rep.*	*8%*
2	Czech Rep.	6%	2	Romania	6%	2	Poland	7%
3	UK	5%	3	Poland	5%	3	UK	4%
4	Ukraine	3%	4	Czech Rep.	5%	4	Hungary	4%
5	US	3%	5	UK	3%	5	US	2%
			6	US	3%			

Sources: IMF, LSEG DataStream, Natixis CIB

- Although we consider the impact of the reciprocal tariffs on the EU to be minor as the US-EU duties differential is rather small, the use of tariffs to promote industrial policy goals seem to be more harmful, especially for the automobile sector that dominates in the Central European economies.
- Saudi Arabia has not been subject of any criticism from the US President as an important ally of the US in the Middle East with a strong personal relationship between the two leaders (D. Trump and Saudi Crown Prince Mohammed bin Salman). The country has also been instrumental for the peace talks between the US and Russia on the war in Ukraine. However, as a major oil exporter it remains vulnerable to changes in oil prices as a result of the increased oil production in the US. Indeed, the sector might get more support from Trump administration.
- Meanwhile, in the CEEMEA region GCC countries have higher tariffs applied on the products imported from the US. In case of Saudi Arabia, food imports of $1.5bn (putting the country in the top-20 markets for US food exports) are levied 5% tariffs with only some exceptions being duty-free (rice, meat, coffee and tea, etc.). While in terms of the trade-weighted average tariffs the differential between the US and Saudi Arabia is 4 percentage points. Yet, it seems unlikely that President Trump would risk the relationship with Saudi Arabia to impose the reciprocal tariffs directly.

Table 2 Bilateral trade duties with the US

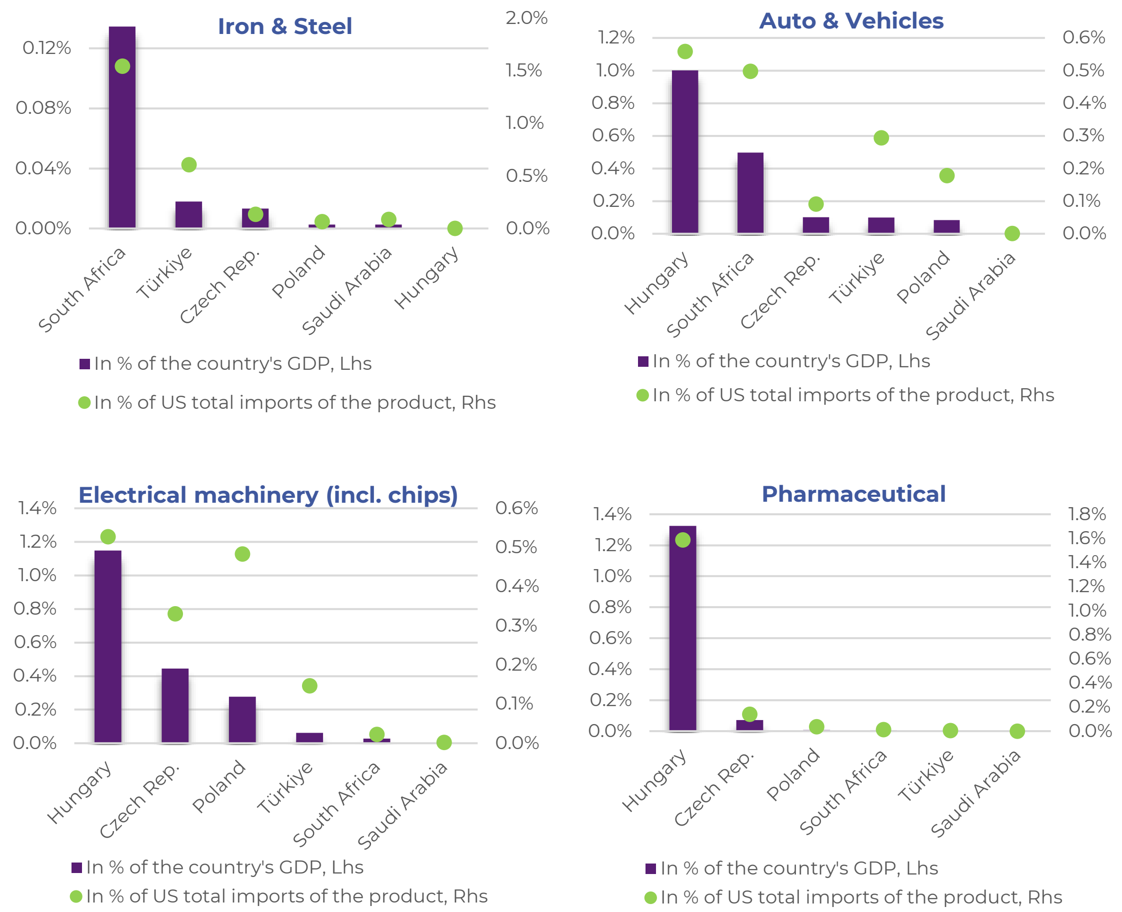
	US imposed tariffs		**Tariffs on US**		**Diff between trade-weighted tariffs imposed by the US and on the US, in percentage points**
	Simple average	**Trade weighted average**	**Simple average**	**Trade weighted average**	
South Africa	3.0%	1.7%	8.1%	3.0%	-1.3
Saudi Arabia	4.0%	0.6%	5.9%	4.6%	-4.0
Türkiye	4.0%	3.1%	13.0%	4.1%	-1.0
Czech Rep.	3.5%	1.4%	4.8%	1.7%	-0.3
Hungary	3.5%	1.4%	4.8%	1.7%	-0.3
Poland	3.5%	1.4%	4.8%	1.7%	-0.3

Sources: WTO IDB, Trade Data Monitor, Natixis CIB

Is there any threat from the sectoral tariffs?

- As mentioned above several industries are under a threat of additional tariffs from the US: automobile, semi-conductors (chips), pharmaceutical and shipbuilding. Meanwhile additional tariffs on steel and aluminum will already take effect this week.
- In terms of the exposure to industrial policy tariffs from the US, Hungary and South Africa will once again be the 'losers' of such policy compared to other countries of the region due to their relatively higher exposure to the sectors under risk.
- US imports from Hungary are indeed concentrated in the auto sector, pharmaceuticals and electric machinery including semi-conductors (chips), all of which could be at least partly subject to additional tariffs.
- South Africa exports to the US precious (gold) and other metals as well as vehicles. Exports of iron and steel to the US are the third biggest category representing 4% of the South African exports to the country (as of 2023 data). However, South Africa is not concerned by this year's tariff as it was already subject to a 25% tariff on steel in 2018. On aluminum the US tariff will increase from 10% introduced in 2018 to 25% now thus putting some pressure on 3% of South African exports to the US.
- With a large part of commodity exports, both South Africa and Saudi Arabia (as well as other GCCs) might be impacted by lower prices on metals and oil & gas when the excess production that can't be sold in the US is rerouted to other markets or if the Chinese demand is dampened further.

Chart 3 Sectoral exports to the US by country in of a country's GDP and in % of the US imports



Sources: Global Trade Tracker (HS), UNCTAD, WTO, LSEG DataStream, Natixis CIB

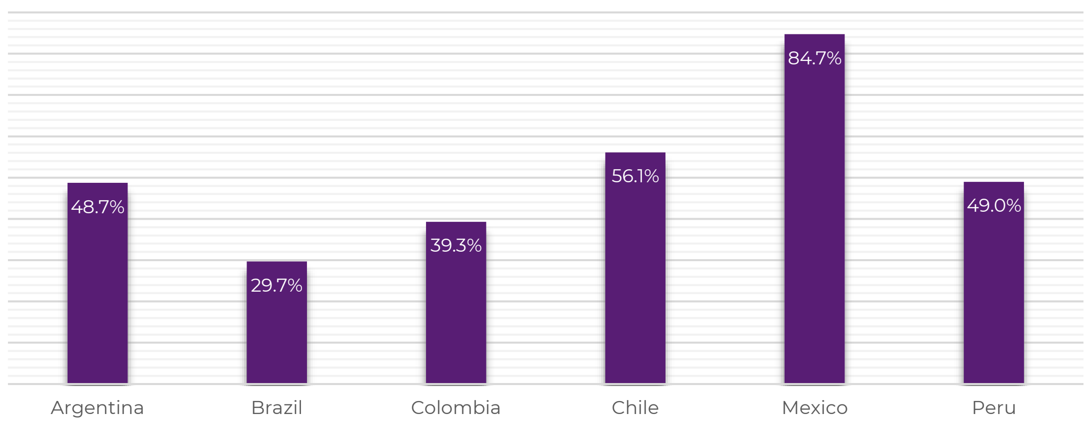
CEEMEA region - the global “winner” with some local “losers”

- All in all, Poland, Turkey and Saudi Arabia seem to be least exposed to the vulnerable sectors in terms of the bilateral trade with the US. Besides, the latter benefits from the political advantage of a country in close relationship with Trump administration. Exposure to commodities for Saudi Arabia and high trade openness of Poland might still be important factors of risk.
- Hungary and South Africa are more exposed to the trade with the US (for the latter) and to some vulnerable sectors. That increases the chances of additional US tariffs being put in place on most their exports to the US. However, the impact on these countries might seem limited compared to other countries in the regions of Asia and Latin America.

LATAM – The Impact of US Tariffs on Latin America

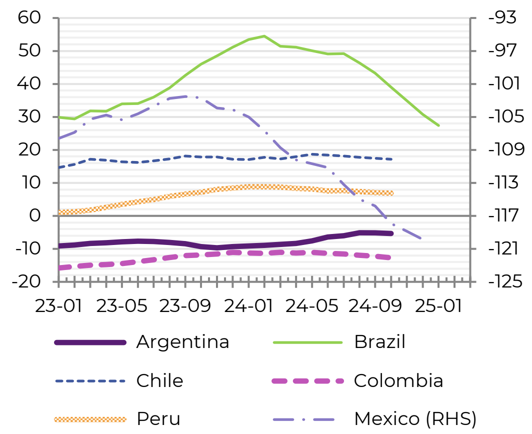
- President Trump has made several tariff announcements since taking office. However, it is not entirely clear what his trade policy objective is, making it difficult to forecast the new tariff equilibrium. While we believe the Trump administration is using the threat of tariffs to extract concessions from some countries, it is not entirely clear that this is the only goal. Alternative goals could include raising revenue by using tariffs to mitigate the impact of potential tax cuts, reducing the US trade deficit (which tariffs alone will not achieve if large budget and investment deficits persist), or bringing manufacturing back to the US. It is important to note that these goals are either at odds with each other or unrelated. For example, the tariff level to bring manufacturing back to the US could be much higher than what is needed to maximize revenue.
- If the goal of tariffs is cooperation on immigration and drug flows, they only need to be threatened to get Mexico to help; but if they are only threatened and not applied, there is no incentive to onshore production. In late February, he first announced that U.S. tariffs on Mexico and Canada would be delayed until April. The next day, he said the tariffs would be implemented in early March. Then, in early March, Trump carved out a one-month exception for the auto sector. Then he delays it until 2 April 2025.
- A US policy of tariffs or the threat of tariffs could disproportionately affect countries that rely heavily on exports to the U.S., with Mexico standing out as the primary loser. Mexico runs a trade surplus with the US, and more than four-fifths of its exports go to its northern neighbor. Thus, Mexico is particularly vulnerable to these policies and could face economic turmoil as tariffs, if implemented, could severely disrupt trade flows.
- Comparing the degree of openness (aka imports plus exports as a percentage of GDP) of the Latin American economies, Mexico is significantly more exposed to a trade war than the rest of the region.

Latin America: Degree of Openness



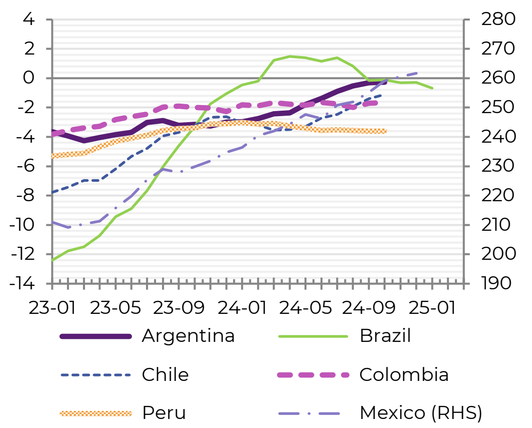
- Argentina appears less vulnerable to the potential impacts of Trump's return to power compared to other Latin American countries. With a more closed economy, Argentina is somewhat shielded from US tariffs. Commodity-dependent nations like Brazil, Chile, and Peru may face significant challenges if global commodity prices fall, particularly due to a slowdown in China and a strengthening US dollar. Brazil, Chile and Peru have trade balance surplus with China. This could result in slower economic growth for these countries, which rely heavily on commodity exports. Similarly, Colombia, primarily an oil exporter, may also be adversely affected if Trump's policies lead to declining oil prices.

Trade Balance with China ($Bn/year)



Sources : LSEG Datastream, IMF, MDIC, Banco de Mexico, Natixis

Trade Balance with US ($Bn/year)



Sources : LSEG Datastream, IMF, MDIC, Banco de Mexico, Natixis

- We analyze the impact of a 10% tariff imposed by the US on imports from the largest Latin American economies. The simulation results show that the impact on Mexico's GDP growth is significant, ranging from 1.0 in 2027 to 0.6 in 2028 in annual growth percentage points. For the other countries, the impact is smaller, but not insignificant. In 2027, the impact ranges from 0.06 in Brazil to almost 0.2 in Peru. Importantly, we emphasize that commodity-producing countries may experience more significant indirect effects, for example due to tariffs imposed on China, a major consumer of commodity prices, or tariffs on specific commodities that may affect global commodity prices. In the following section, we analyze the impact of a 25% U.S. tariff on imports from Mexico.

Impact of 10% US tariff from Baseline (annual growth p.p.)

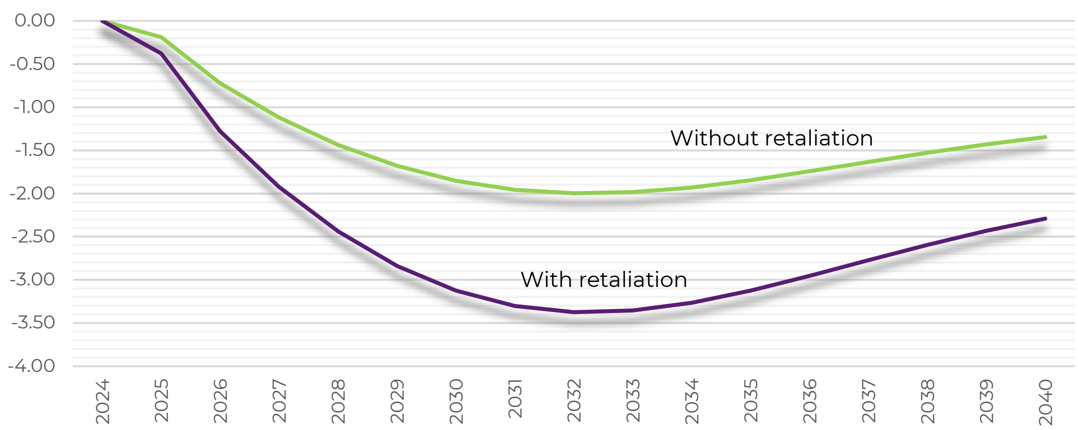
	2026	2027	2028	2029
Mexico	-0.130	-0.970	-0.560	-0.110
Brazil	-0.010	-0.060	-0.090	-0.010
Chile	-0.020	-0.140	-0.180	-0.010
Colombia	-0.010	-0.140	0.000	0.000
Peru	-0.010	-0.190	-0.130	0.000

Source: Oxford Global Model, Natixis.

- **Modeling the impact of a 25% US tariff on imports from Mexico.** Since 1994, when the three North American countries signed a free trade agreement, Mexico has become an integral part of the US manufacturing sector. NAFTA and its successor, USMCA, not only lowered tariffs to zero, but more importantly, created an environment conducive to investment because the agreement guaranteed that tariffs would remain close to zero in the future. This allowed for the integration of the manufacturing sector in the three countries to produce goods in the cheapest and most efficient way possible.
- For example, the automotive industry benefits from established supply networks, where parts and materials can be sourced and assembled across Canada, the US and Mexico to maximize efficiency. The medical device industry is also identified as having a strong case for regionalization. The complexity and regulatory requirements of producing medical devices necessitate a tightly integrated supply chain that can respond swiftly to market needs. By consolidating manufacturing in North America, companies can improve their responsiveness to both regulatory changes and demand fluctuations, while also benefiting from local sourcing and reduced transportation costs.
- This integration means that an imposition of tariffs on Mexico by Trump would cause disruptions in the US manufacturing sector. Eventually, supply chains would move to other regions, but the transition would be costly for US companies that rely on clusters of parts suppliers to make their products cheaply and efficiently.
- Mexico is willing to cooperate with the US on immigration and drug trafficking issues. During Trump's first administration, then-President Lopez Obrador agreed to keep migrants while they wait for their legal cases to be resolved in the US, the so-called "Remain in Mexico" policy. President Sheinbaum has already reaffirmed the above-mentioned policy and agreed to take back Mexican nationals who are deported. Mexico has stepped up seizures of fentanyl flows (finally!) and the destruction of fentanyl production labs.
- **As we will show below, a 25% tariff will send the Mexican economy into recess**ion according to estimations by the Peterson Institute for International Economics (PIIE). This would automatically increase the incentives for Mexicans to try to cross the northern border in search of jobs. In this scenario, the Mexican government would be in a weakened position to stop migration.
- **Mexico will face a tough review of the USMCA, which was supposed to start in mid-2025**. The key for the US, in our view, would be to discourage Chinese investment in Mexico and Chinese imports into goods that Mexico exports to the US. In this regard, Mexico has already taken proactive steps by increasing tariffs on China and discouraging Chinese investment in Mexico as part of the recently announced "Plan Mexico," which includes a series of measures by the Mexican government to stimulate private sector investment.
- We believe that President Trump will not ultimately impose tariffs on Mexico permanently, due to the combination of the immediate negative impact on the US manufacturing sector and Mexico's willingness to cooperate on immigration and drug trafficking issues. However, it is possible that the US will decide to impose tariffs on Mexico, at least temporarily, to ensure cooperation. In addition, the US is likely to continue to exert pressure on Mexico, for example through the revision of the USMCA.

- Finally, there is a small probability that the US will decide to impose tariffs on Mexico on a permanent basis as part of a universal tariff policy if the goal is to increase revenues, reduce the US trade deficit, and/or shift manufacturing production back to the US, even at a cost. In the following section, we examine the impact of US tariffs on Mexico on the currency, inflation, and GDP growth in Mexico.
- Most of the impact of a 25% tariff on inflation would be through exchange rate depreciation of about the same amount. Banxico estimates the pass-through to be about 0.05% in one year and 0.22% in four years, depending on the business cycle. The pass-through would be lower when the economy is growing below its potential GDP and higher when there is a positive output gap. **In the extreme case of a 25% tariff, the MXN would depreciate to 23.00-23.50 and annual inflation could increase by 125 bps in one year and 550 bps of cumulative inflation in 48 months**. The Peterson Institute estimates that a 25% tariff by the US would increase inflation in Mexico by 229 bps in the first year and 46 bps of annual inflation or 484 bps of cumulative inflation by the fourth year. In fact, it is likely that under such punitive tariffs, the economy would likely enter a recession, which would reduce the impact on inflation as domestic demand would contract.
- The Peterson Institute estimates that a 25% tariff could put Mexico's GDP on a permanently lower growth path, with the impact of up to 0.19% in the first year, which would be marginal. But starting in year three, the tariffs would subtract between 1% and 2% every year for the next decade! This impact would be massive given that potential GDP growth is around 2.0%. Mexico's economy has been transformed since the signing of NAFTA to integrate with the US, especially in the manufacturing sector. **Detaching manufacturing supply chains would be painful for the US economy, but disastrous for the Mexican economy.**

Mexico: Impact of 25% tariff on GDP from baseline forecast



Source: Estimation by the PIIE

EM Asia

Indonesia Free Lunch is Costly:

- Indonesia started the year of 2025 with much more populist measures than anticipated. In January, Indonesia's President Prabowo announced a budget efficiency measure, which targeted a one-off expenditure cut of USD 19bn, equivalent to 8.5% of 2025 state's budget. About USD 6bn will be used to fund the free-lunch program, which is will cost USD 28bn annually when fully implemented. The remaining USD 13bn, will be used to finance Danantara, a newly created sovereign-wealth fund. The fund will directly report to the president and bypass the ministry of finance, which is causing uneasiness for investors as it puts the seven state-owned companies under his control. This includes the three largest banks.
- Despite the president describing the measures as to improve government efficiency and promote social welfare, the reduction in spending to fund social welfare will impact Indonesia's long-term growth. For example, twenty-one infrastructure development projects, including connectivity, water sources and human settlements, will be delayed as the budget for Public Works Ministry was cut by 70%. More than 18,000 contractors have been fired. Fourteen dams, 9,550 hectares of irrigation, and the rehabilitation of 29,000 hectares of irrigation networks were all postponed due to the latest efficiency measures.
- The Indonesia rupiah weakened versus the USD by -1.5% from January to 10 March, making it the worst Asian FX. Worries about fiscal slippage due to President Prabowo populist policies enlarging spending while efforts to raise revenue have been derailed. At the same time, the decline of the USD has primarily benefited low yielders while high yielders like INR and IDR have suffered. Bank Indonesia surprise rate cut also adds to IDR pressure relative to other Asian FX. That said, since then, BI has held rates at the latest February 2025 meeting. The IDR has since retraced losses and gained 0.6% versus USD from February to 10 March as the dollar sags on specter of tariffs.
- Inflation further decelerated and fell into negative territory at -0.1%YoY in February from 0.8%YoY in January. Exports also slowed in January to 4.7%YoY from 4.8% in December 2024. The manufacturing PMI, on the other hand, showed that the expansion is still going, with the February's prints climbed to the highest among ASEAN at 53.6 from 51.9 in January. Bank Indonesia will resume cutting rates once the coast is clearer regarding Fed rate cut and Trump tariffs.
- Overall, we are constructive on Indonesia growth given expansionary fiscal spending and likely looser monetary policy. That said, there are concerns regarding fiscal prudence as well as long-term productivity growth given changes to consolidation of power. Regarding impact of tariffs so far, Indonesia is negatively impacted by Trump tariffs on China as it is linked to China via

commodity exports. Indonesia is largely immune on Trump sectoral tariff threats such as steel, auto, chips and pharma as well as reciprocal tariffs. Indonesia also has low exposure to US exports as a share of GDP as it is more exposed to China.

The Thai Baht gained from February to 10 March by 0.6% versus the USD as specter of tariffs took the dollar lower.

- On 26 February, the BOT surprised markets with a 25bps rate cut to 2.00% to support growth. But the forward guidance suggests a pause in the short-term before further rate cuts.
- Somchai Sujjapongse, who was the top bureaucrat of Thailand's Ministry of Finance from 2015 to 2018, will be appointed the next chairman of Bank of Thailand. The Ministry of Finance first nominated ex-Finance Minister Kittiratt Na-Ranong, a critic of BOT's hawkish monetary policy, to be the next chairman. However, due to widely opposition, Kittiratt was deemed to be unfit eventually.
- Fiscal policy is stepping up to provide support. Expenditure is rising in double digits. The issue is how it will finance this cash handout program that is rather sizeable at about USD14bn. In 2025, consumption will be boosted by fiscal policy. And in Q2, we will likely get rate cuts when the USD recede.
- Exports are accelerating at +12.9%YoY in January from 8.4% in December 2024. Imports are rising as demand is firming. The trade balance is still positive but narrowing. Meanwhile, thanks to tourism inflows, the balance of payment is positive. Tourism inflows climbed to the highest point since December 2019, reaching 3.7 million in January 2025.
- We expect the BOT to cut rates by another 25bps in 2025 to ease monetary conditions. Given that the THB is already low yielding, we believe the BOT will tread cautiously in Q1 and pause after the surprise rate cut. We expect Thailand to be a winner should tariffs are only imposed on China by the US. We expect GDP to improve to 3.0%YoY in 2025. Should the US focus on reciprocal tariffs, Thailand is at high risk as it has high differentials in tariffs with the US.

Malaysia ringgit proved resilient as it escapes Trump wrath so far and can be a winner if Trump spares chips.

- The MYR gained 1.3% versus the USD from February to 50 March thanks to the softening of the dollar. The Malaysia's CPI stayed flat at 1.7%YoY in January. While the inflation softened, growth figures continued to be resilient. The Q4 GDP upward revised to 5.0%YoY, which took the annual growth number to an impressive 5.1% in 2024. We think that the BNM will keep rates on hold most of 2025 given Malaysia's strong economic fundamentals and resilient MYR.
- The Malaysian and Singaporean government signed a historic Johor-Singapore Special Economic Zone (JS-SEZ). Johor has a landmass four times the size of Singapore and can be complementary to Singapore's limit in natural resources that have led to high costs of land, real estate and human capital but productive economy thanks to efficiency and productivity. Meanwhile, Malaysia is rich in natural resources and has the large labor market. Thus, the JS-SEZ has great ambition to leverage on relative comparative advantage to develop key areas, namely manufacturing with an emphasis on logistics, food security, tourism, energy, the digital economy, green economy, financial services, business services, education and health. Malaysia has set a flat 5% corporate tax rate that can be extended to 15 years to attract sectors such as AI, quantum computing and aerospace manufacturing, per cent corporate tax rate that could extend to up to 15 years. For knowledge workers, income tax rate is 15% for the first 10 years. Overall, they want to create 20,000 skilled jobs and support 50 projects in the SEZ. To make it a success, the two governments are working on a one-stop shop

to expedite a set-up process known as Invest Malaysia Facilitation Center-Johor, improve local transport links as there are bottle necks, and promote talent training. We think that given on-going US-China tensions that will get worse under President Trump, Malaysia is poised to benefit, especially with initiatives such as this to facilitate investment.

- As one of the beneficiaries of supply chain reshuffling from US-China tensions, we expect Malaysia will continue to shine from both trade and investment perspective. We expect Malaysia GDP to grow by 5.0%YoY in 2025 and 4.9%YoY in 2026. Trump threat of 25% tariffs on chips could derail Malaysia's exports as well as FDI ambition as it targets the sector to attract FDI and move up the value chain.

China promises to mitigate Trump additional 20% tariffs with fiscal expansion and consumption help.

- The CNY weakened versus the USD by -0.3% as tariffs escalated, making it the second worst in Asia. The US-China tariff war has continued to escalate, with the US recently announcing an additional 10% increase in tariffs on Chinese imports, totaling 20% higher. It seems the US is opting for a gradual way to raise tariffs against China. However, there remains uncertainty about where the ultimate rate will end. That said, the marginal impact of these additional tariffs on China's GDP is likely to be increasingly moderate compared to the first round of the trade war. Recognizing the challenges of easing tensions with the US, the Chinese government has begun to focus more on internal measures to bolster economic growth. Recent data shows that the manufacturing PMI has been rising, indicating a recovery in investment confidence. During the two sessions, the Chinese government has also announced more relaxed fiscal deficit and increased support for consumption to help sustain economic growth moving forward.
- One of the major risks going forward is that it's possible that the US accelerate the imposition of tariffs on Chinese imports, potentially implementing larger increases at a faster pace. Another risk is that the Chinese government's policy expansion efforts fall short of our expectations.
- We held our view on China unchanged. We expect the GDP to slightly decelerate to 4.7%YoY in 2025 and further slow to 4.2%YoY in 2026. The deflation problem will also ease, with CPI growing at 0.6%YoY and 1.5%YoY for 2025 and 2026, respectively. As Trump tariffs target China, it remains to be seen if China can still export to the rest of the world as others are starting to retaliate with higher tariffs.

South Korea can be a winner of trade-war if Trump only targets China but domestic politics is knotty

The Korean won rallied 0.5% versus the USD from February to 10 March as the dollar softens. The only bright spot for the Korean economy is dimming with trade-war and softening global outlook. In February, exports rebounded from January's low, which was largely due to fewer working days, growing at 1.0%YoY. Daily exports still rose but at a slowing pace. The Lunar New Year seasonality distorts %YoY but headwinds are showing. On the domestic front, industrial production contracted by -4.1% in January from 4.4% in December, which was due to a deceleration in both mining and manufacturing activities. Retail sales, on the other hand, increased by 11.7%YoY in January from 8.9%YoY.

- Inflation has risen again to 2.2%YoY from 1.9%YoY after falling due to a weaker won and higher energy and food costs. Meaning, the strengthening of the won recently is helpful to give some space but the room to ease via monetary policy is limited given the strong USD and weak won. We think that fiscal policy will be looser in 2025 as the government does not just supplementary budgets but also the potential change of stance should the opposition gain power. They are much looser in fiscal policy than Yoon. As such, we think growth will slow but manageable thanks to fiscal support due to front-loading of the budget.
- As a result, the BOK cut the interest rate in February's meeting by 25bps to 2.75%. The on-gong US-China trade-war is a headwind for South Korea but there is also a silver lining as South Korea can gain market share in the US. A flood of Chinese goods into South Korea and other third markets are issues that Korean chaebols must contend with as they face eroding profit margins from greater competition.
- On tariffs, South Korea is most affected by US auto tariffs. It is vulnerable to steel and aluminum as it got exemptions. Chips is another concern as it is a strategic sector for the peninsula. With an FTA with the US, South Korea is immune from reciprocal tariffs if only tariff barriers are considered. Korean ship building is likely to benefit from Trump's curb to ship building as Korean ships get a premium.

India faces a cyclical slowdown and risks from reciprocal tariffs and pharmaceutical tariffs. But Trump only imposes tariffs on China, India can be a winner of US-China trade-war.

- While it is the second worst FX year-to-date in Asia, the INR improved from February to 10 March by being flat versus the USD. It remains the third worst FX. So far, growth momentum is slowing. The February composite PMI slowed to 58.7 from 60.6 in January. On top of consumption, there are signs that investment will be more sluggish ahead. The government unveiled its FY26 budget and while there was some support for consumption via raising the tax-free income threshold to INR1.2 million, infra capex was scaled back. We expect government infrastructure capex to contribute less to growth. The income tax cut will help with consumption, but much depends on whether the private sector will pick up the baton to deploy investment. Exports are declining towards year-end and suggests that it will be a tough year ahead. As result, we downward revised our forecast on India's GDP to 6.3%YoY in 2025.
- Inflationary pressures further eased to 4.3%YoY in January. This will pave way for the RBI to cut further. But with the rupee weak, this will not be a comfortable position as import price pressure is rising, adding to inflationary pressures. Furthermore, Governor Sanjay Malhotra chaired his first monetary meeting and cut rates by 25bps to shift focus to growth from inflation, a departure from the previous governor. One respite will be the softening dollar and the Fed cutting rates, likely end of Q3 2025. We expect the RBI to cut by a total 100bps in 2025.

CEEMEA

Risks tilt lower

- The growth acceleration in 2025 that we currently expect in the CE3 economies (Poland, Hungary, Czechia) was revised slightly down to take into account a more aggressive scenario on Trump tariffs. As such the impact from more dynamic domestic demand might be hampered by slower exports due to the sluggishness of the euro area, and especially of German growth.
- Türkiye has probably entered a slightly less painful stage of its transition from the hyperinflation regime thanks to declining inflation and a rate-cutting cycle although its impact on growth should be mainly felt in 2026.
- Finally, the rerouted (from the US) Chinese exports might present a cost advantage for consumer goods importers in the GCCs that should also benefit from their peg to the US dollar. Meanwhile, South Africa might suffer from being in the radar of the US president but also from a weakening of its currency and lower Chinese demand for commodities.
- We do not consider US tariffs inflationary for the CEEMEA region, unless further strengthening of the USD weighs significantly and durably on local currencies. As such, the rate cutting cycles should continue in Türkiye, South Africa and Czech Republic while Poland and Hungary should remain on hold due to domestic inflationary pressures, recent spike in food prices and the FX sensitivity
- Risks from the global trade war could mainly be channeling via the following: 1/ weakening of local currencies due to the stronger USD, 2/ weakening of the Chinese and US demand for commodities weighing on their prices (important for South Africa and Saudi Arabia) 3/ weaker euro area growth in Germany (important for CE3) and 4/ lower confidence levels of businesses and consumers.
- All in all, as the direct exposure to the US remains relatively low in the CEEMEA countries so the changes to our scenario are rather modest.
- **Central Europe**: most currencies in the region appreciated in the past weeks (+0.6 for Polish zloty against EUR in February, +1.3% for Hungarian Forint) as the markets started to price: 1/ the end of the war in Ukraine after the first talks between the US and Russia presidents and 2/ additional fiscal space in Europe and a boost of the defense spending in Germany.
- Besides, some domestic developments supported Polish and Hungarian currency, notably still hawkish stance of the respective central banks. Indeed, inflation jumped in January (to 5.3% from 4.7% in Poland and to 5.5% after 4.6% in Hungary) NBP and HNB kept their key rate once again unchanged at 5.75% and 6.25% respectively. Both central banks have kept their rates stable since several months thus increasing further the gap with the ECB (that announced another rate cut in March). We expect inflationary pressures to subside somewhat along with the slightly slowing wage growth, especially in the H2 2025 when the NBP and HNB would consider cutting again. However, as both Poland and Hungary are small open economies, the pass-through effects between the currency and prices are particularly strong increasing the upward risk on inflation in case of heightened volatility on the FX market.

- The threat of the US tariffs on EU products put additional risk on growth and exports through the impact on the German economy (10% of the exports 10% go to the US) while the direct exposure of Poland and Hungary to the US market is only 2% - 3% of the country's exports. Given Poland's and Hungary's strong manufacturing ties to German auto sector, any negative effects on German exports could also impact Polish and Hungarian manufacturers and exporters. In fact, exports to Germany represent 28% of total Polish exports. Yet, on the positive side for growth, Polish government announced that it will shift €7.6bn of the EU funds from the RRP (out of €60bn of total RRP funds for Poland) to boost the defense industry. Hungarian government should also put in place the anticipated fiscal stimulus via the wage hikes and income tax breaks to accelerate the economic recovery.
- **Türkiye**: the Turkish lira lost 2% against USD in February in nominal terms and 0.5% in real effective exchange rate, despite the weakening of the US dollar (-0.7% over the month in DXY terms) and due to additional pressures from the increasing foreign-exchange rate deposits. Indeed, after three consecutive 250 bps rate cuts the interest rate differential became smaller thus lowering the appetite for savings in lira. Since the beginning of the year TRY lost 3% against USD after -16.5% in 2024.
- Positive surprise from inflation in February that declined more than expected and passed under 40% (39.1% after 42.1% in January) allowed for another cut in the CBRT key rate that reached 42.5%. Despite the recent upward revision of the central bank's end-year inflation forecast to 24% from 21%, we expect the rate cutting cycle to continue at the same pace in April but slow down its pace in the second half of the year. However, the private sector (households and businesses) inflation expectations remain above those of the authorities representing an upward risk for the current trend of moderation in inflation.
- Meanwhile, rather low direct exposure to the US (only 5.8% of the country's export), a bilateral trade deficit and rather moderate difference in the trade-weighted tariffs makes Turkey relatively insulated from becoming another target of the US President tariffs policy announcement. Yet, we expect Turkish lira to keep depreciating in the nominal terms against the USD while strengthening in the real effective terms
- **South Africa**: South African rand remained quasi-stable against USD in February, despite the weakening of the US dollar (at -0.7% in DXY terms) and mainly due to the renewed criticism from the US President Trump over the land seizure law.
- The trade war uncertainty might yet weigh on the economy and push inflation higher, according to the central bank that sees an additional risk now. Indeed, South Africa sends 7.6% of it exports to the US and 11.2% to China with mainly commodity exports, while having slightly higher trade-weighted tariffs on the US than the US has on South Africa making it a target for at least the "reciprocal" tariffs or even more targeted ones if the political dispute with US does not appease.
- Yet, the SARB decided to cut its interest rate by 25bps to bring it to 7.5% (after two previous cuts in 2024) despite a slight uptick in the total inflation that reached 3.2% in January after ending the year 2024 at 3% and mainly thanks to further slowdown in the core prices to 3.5% (vs. 3.6% in December). We expect the South African central bank to take a pause in March in its rate-cutting cycle amid growing political and geopolitical uncertainties. More prudent approach of the SARB should therefore support ZAR in the medium-term once tensions with US are over.

- **Saudi Arabia**: is the political winner of Trump presidency enjoying a personal relationship of its leader with the US president and an international status of the peace dealmaker during the negotiations on the war in Ukraine.
- On the economic front, the GDP growth positively surprised with an acceleration to 4.4% YoY bringing the yearly growth to 1.3% in 2024 despite the OPEC+ oil output cuts still being in place.
- The risks are yet coming from the US as D.Trump protectionist agenda includes additional support to the oil extraction industry potentially putting a risk on the oil prices scenario in the context where OPEC+ countries have finally decided to proceed with the winding down of the oil production cuts as scheduled in April 2025.
- As oil production grows at faster pace in Saudi Arabia GDP growth is expected to accelerate in the course of the year compared to a sluggish 2024.
- While the change in oil prices and therefore its final output is still somewhat uncertain, the non-oil sector has been showing a robust performance as some Vision 2030 initiatives bolstered sectors like construction and tourism as evidenced by the PMI index that generally remains above 55.

LATAM

Brazil: The BCB hiked the Selic rate by 100bps in February

- In February, the BCB raised the Selic by 100bps to 13.25% in line with the market and our expectations. The decision, with Galipolo at the helm for the first time, was unanimous. This is important as it sends a clear message to the market and to the government about the Bank's intentions to contain inflation and inflation expectations, which have been rising recently.
- The forward guidance paragraph suggests that the Bank will raise rates by 100 bps at the March meeting, but it is unclear about hikes beyond March: “Beyond the next meeting [March], the Committee reinforces that the total magnitude of the monetary adjustment cycle will be dictated by the firm commitment to converge inflation to the target and will depend on the evolution of inflation dynamics, especially regarding the components most sensitive to economic activity and monetary policy, inflation projections, inflation expectations, the output gap, and the risk balance.”
- The BCB continues to emphasize the impact of unanchored fiscal expectations on the BRL and inflation expectations: ”The Committee continues to closely monitor how the evolution of fiscal policy impacts monetary policy and financial assets. The perception of economic agents regarding the fiscal regime and the sustainability of debt continues to have a significant impact on asset prices and agent expectations”.
- Regarding the inflation forecast, the Bank projected inflation at 5.2% in 2025, and 4.0% in Q3 2026. The underlying assumptions are a Selic level of 15% in 2025 and 12.50% in 2026 with USDBRL at 6.00. In other words, in order for the Bank to hit its 3.0% target in the horizon of monetary policy (24months), the BCB needs to continue hiking the Selic.
- The combination of a stronger BRL and some signs of weakening domestic demand should lead the BCB to moderate hikes in the COPOMs after March. For now, we think the BCB will raise the Selic by 100 bps to 14.25% in March, and signal a moderation in the tightening cycle. If we are right, the BCB will then raise the policy rate by 50bps in May and a final hike of 25bps in June (or pause). We now have the terminal rate at 15.00%, down from 15.75% at the beginning of the year.

Brazil: Monetary Policy Path and Forecasts

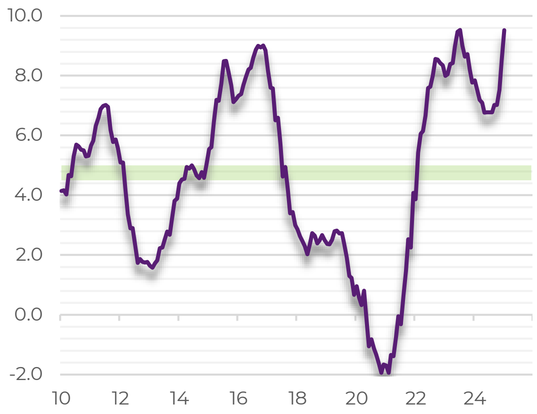
2025							
Jan	Mar	May	Jun	Jul	Sep	Nov	Dec
13.25%	*14.25%*	*14.75%*	*15.00%*	*15.00%*	*15.00%*	*15.00%*	*15.00%*
+100	+100	+50	+25	0	0	0	0
2026							
Jan	Mar	May	Jun	Jul	Sep	Nov	Dec
15.00%	*15.00%*	*15.00%*	*14.25%*	*13.50%*	*12.75%*	*12.00%*	*11.75%*
0	0	0	-75	-75	-75	-75	-75

Source: BCB, Naixis

Mexico Real Interest Ex-Ante vs Neutral Range, %

Source: Bloomberg, Natixis

Brazil Real Interest Ex-Ante vs Neutral Range, %



Source: Bloomberg, Natixis

Mexico: Banxico signals that the pace of –50bps in cuts per meeting will continue

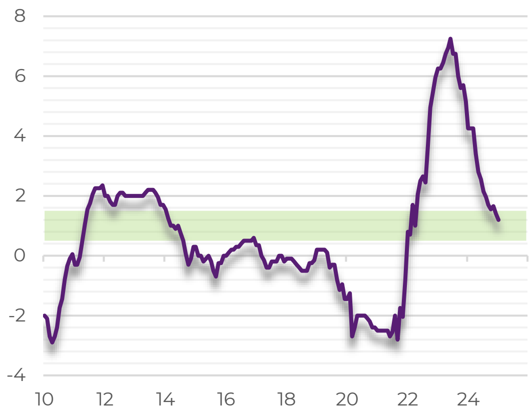
- In February, Banxico released its December Quarterly Inflation Report (QIR) and given the recent acceleration in the pace of cuts, the release was important in confirming the pace of cuts (of -50bps) in the next few meetings. These are the takeaways from the report and the press conference with the board.
- Governor Rodriguez signaled they plan to continue cutting the policy rate at 50bps in the next meeting, but that they will keep the stance of monetary policy restrictive. In our opinion, this means that the terminal rate level would be at or above 8.00%.
- Banxico lowered its GDP forecast for 2025 from 1.2% to 0.6% y/y (within the range of -0.2-1.4%). This is a massive downward revision of the growth outlook. Banxico kept its 2026 GDP growth forecast unchanged at 1.8% y/y (within a range of 0.4%-2.0%).
- The staff didn't make any significant changes to its inflation forecast. Banxico expects inflation to reach the target of 3.0% between Q2 and Q3 2026. In short, Banxico is concerned about growth and confident about the disinflationary process.
- Governor Rodriguez indicated that the real interest rate is at 5.59% and that the neutral range is between 1.8% and 3.6%, also in real terms. The report also indicated that the output gap (see graph) will turn negative in the coming quarters. Both factors support the view of rate cuts in the coming months.
- The board is likely to cut the policy rate by 50 bps in March (to 9.00%) and May (to 8.50%). Given that our forecast for the key rate is 8.00%, we think the relevant question is what they will do in June, -25 or -50 bp. In August, they will cut 25 bps or pause the easing cycle for a long time. The conditions for a cut below 8.00% would only be met if the economy went into recession, in our view.

Andean Countries: Chile's BCCh left rate unchanged and signaled even less willingness to cut than before. Peru paused its easing cycle in February but left door open to further cuts. In Colombia, BanRep is likely to resume the easing cycle in March

In Chile, BCCh left rate unchanged and signaled even less willingness to cut than before

- In January the BCCh left its key interest rate unchanged at 5.00%, in line with the market and our expectations. Going into the meeting, our view was that the BCCh would not only leave the rate unchanged at 5.00% and signal that the possibility of rate cuts remained, albeit without conviction. We expected some rate cuts, but only in the second half of 2025.
- However, the tone of the communique was relatively more hawkish than we had expected. The committee is increasingly concerned about inflation compared to the last rate decision, due to the depreciation of the exchange rate, rising wages, and the increase in electricity tariffs.
- The Board is also less concerned than before about the slowdown in economic activity. In fact, the Board believes that the pace of economic activity is coming in above its macroeconomic projections of the Quarterly Monetary Policy Report (IPOM in Spanish) of December.
- Inflation is likely to remain under pressure in the first half of the year, mainly due to the electricity tariff adjustment. However, inflation should converge to upper bound of the target interval in the second half of the year as the electricity-shock dissipates.
- After the disappointing CPI release for January, we forecasted one rate hike in late 2025 and one in early 2026. However, the CLP has appreciated significantly, in part due to solid copper prices. The CLP rally, if sustained, would make it incredibly difficult for the BCCh to tighten monetary policy. As a result, we now expect the policy rate to remain unchanged at 5.00% through 2025.

Chile Real Interest Ex-Ante vs Neutral Range, %



Sources: Haver, Natixis CIB

Peru Real Interest Ex-Ante vs Neutral Range, %

Sources: Haver, Natixis CIB

In Colombia, BanRep is likely to resume the easing cycle in March

- InColombia, inflation continues to surprise on the upside, which could prolong the pause in the cutting cycle. BanRep started a cutting cycle in late 2023 after having hiked its policy rate to the highest level in real terms in the past two decades. Most of the rate cuts in 2024 were at a 50bps pace, but in December 2024, BanRep reduced the pace to 25bps, and in January, it paused the cycle.
- The lack of progress on the inflation front is the main reason behind the recent hawkish bias of BanRep. February's CPI only exacerbated this dynamic. Both headline and core inflation came in above expectations at 1.14% m/m and 1.26%, respectively. Both accelerated from January in monthly terms. In annual terms, headline inflation accelerated to 5.28% (from 5.22% in January), and core inflation went up 5bps to 5.44%. In other words, inflation is not only significantly higher than the inflation target band (3% +/- 1%), but it is rising.
- Despite a dovish board (4 out of 7 are considered to have a dovish bias), we believe the chances of a pause in March increased to above 50% after the disappointing February CPI. BanRep will likely keep the policy rate at 9.50%, and when it resumes the cutting cycle in the following meeting, it might not have room for 50bps-size cuts. This means that carry will remain high for the coming months, lending support to the COP.

Colombia Real Interest Ex-Ante vs Neutral Range, %

Sources: Haver, Natixis CIB

In Peru, the BCRP pauses in February signaling that it is close to neutrality

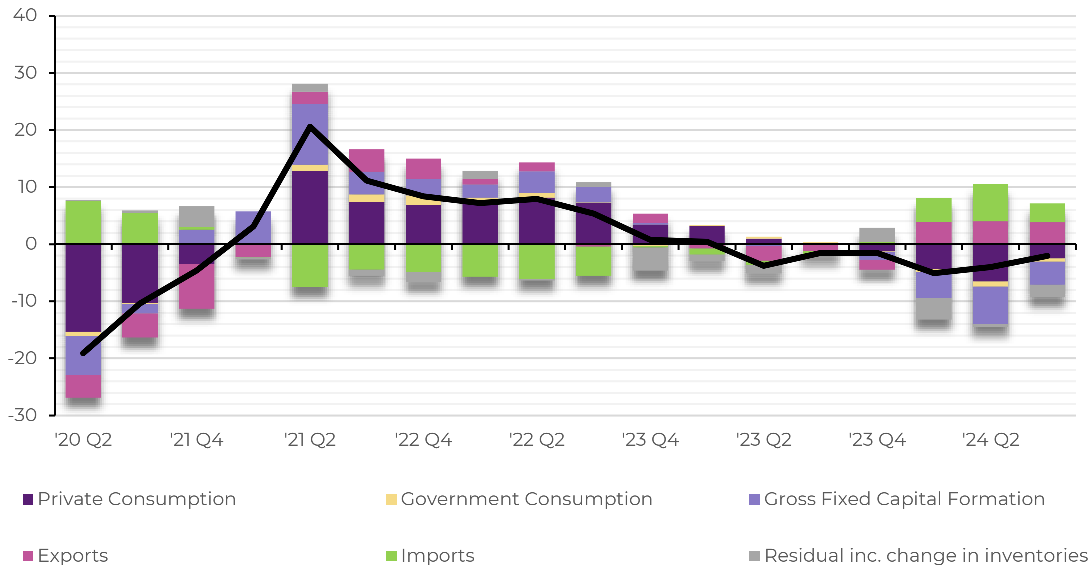
- The BCRP kept its key rate at 4.75%, in line with the market and our expectations. We still expect another rate cut in Q2. However, if the PEN continues to appreciate, we wouldn't rule out an end level closer to 4.00% rather than our current 2025 forecast of 4.50%.
- Despite low inflation, the BCRP seems to recognize that growth remains strong. The communique highlights that *"in January, most of the economic activity expectation indicators recovered and remain in the optimistic range, just like in previous months, under conditions where economic activity is around its potential level."* We expect GDP growth to be around potential in the coming quarters (3.0-3.5%). In 2025, we forecast growth at 3.0% y/y, slightly lower than the 3.3% in 2024.

- Although it wasn't mentioned in the press release, the BCRP may want to avoid putting too much pressure on the PEN by further narrowing the interest rate differential with the US. Given that the US Fed is likely to extend its pause for several months, rate cuts by the BCRP could indeed put pressure on the exchange rate.
- The BCRP confirmed our view that annual inflation is likely to approach the lower bound of the inflation target range (1.0-3.0%) in the coming months and return to the 2.0% target later in the year. Regarding recent inflation dynamics, the BCRP highlights that in January the CPI came in at -0.09% m/m and core inflation at -0.15%. According to the bank, the deflation can be attributed to "the gradual normalization of supply conditions for some food items and the reversal of seasonal factors in transportation services". This pushed annual inflation down to 1.9% in January, below target, from 2.0% in December. Core annual inflation eased to 2.4% from 2.6% in the previous month.
- The communiqué also notes that there has been progress on inflation expectations, but that they remain above target. Inflation expectations (12m forward) have remained consistently above the target, although they moderated by 0.08 pp to 2.37% last month and from 2.64% a year ago.
- In our view, continued moderation in inflation could trigger further monetary easing. However, this will depend on the PEN. If the PEN were to appreciate further due to factors unrelated to the interest rate differential, such as the easing of the tariff threat and/or higher copper prices, the chances of additional rate cuts (say, two or three) would increase significantly. For now, we forecast one 25bp cut this year, most likely in Q2, when annual inflation would be below 1.5% y/y. Our forecast for the policy rate in 2025 is 4.50%.

Argentina: The $Libra Fiasco

- In late February, President Javier Milei recommended a mostly unknown crypto coin $LIBRA in a post on X, promoting it as a private project to encourage the growth of Argentine small businesses and startups. Within hours of the post, the market cap of the coin reached close to $4.6 billion before promptly collapsing after eight individual wallets withdrew almost $100 million, leaving investors with a mostly worthless coin and Milei deleting his post. The monumental failure was very quickly called a “rug pull,” a scam intended to lure investors where the initial backers quickly withdraw funds, leaving investors with tokens that are now worthless. This follows a pattern by the US President and First Lady who launched similar memecoins in the run-up to the inauguration, but the harm caused by the failure in Argentina echoed into other Argentine assets.
- One of the potential political consequences is a loss of momentum for the October 26 midterm elections, when half of the seats in the lower house of Congress and a third of the seats in the Senate are up for grabs. Milei's party, La Libertad Avanza (LLA), has been able to pass some of the reform agenda without a significant presence in Congress with the help of centrist and right-wing parties. In the Senate, the LLA has only 7 out of 72 seats, and in the Chamber of Deputies, the party has 38 out of 257 seats. But Milei had to make concessions. Without a stronger presence in Congress, the pro-market reform agenda could be in jeopardy.

Argentina: Contributions to Real GDP growth (%YoY)



Sources: Haver, Natixis CIB

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