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January 21, 2025 08:25 PM GMT

Asia Economics | Asia Pacific

The Viewpoint: Tariffs, Trade Tensions and Trade

The US is taking up the groundwork for potential implementation of tariffs, with reports on these issues due by April 1. While our base case is a phased rise in tariffs on China, the risk is broad-based tariffs on multiple trade partners, posing further downside to the region's growth outlook.

Key Takeaways

- US President Trump has directed his government to review various aspects related to trade, which may lay the groundwork for tariff implementation.
- Our US public policy team views the developments as being consistent with their base-case expectation of fast announcements and slow implementation.
- We still expect a phased increase in tariffs on imports from China in our base case. But we are concerned that trade tensions may escalate beyond that.
- We see two ways this could happen. First, 7 of the 10 economies which have the largest trade surpluses with the US are in Asia, risking selective tariffs.
- Second, if universal tariffs are taken on all imports, resulting in a broad-based rise in tariffs on all Asian trade partners.

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Multipolar World

A Morgan Stanley Research Key Theme of 2025

Tariffs, trade tensions and trade

The work on tariffs begins: US President Trump has directed officials to look into the country's "large and persistent" trade deficits, and is seeking a review of economic and trade agreements with China as well as an assessment of the 14 May 2024 report on China in relation to the Section 301 investigation (see link). He also directed officials to assess the loss of tariff revenues on imports of US$800 or less, as these are not currently subject to duties, and to recommend measures to increase revenues. The Biden administration has previously flagged that this rule has been exploited by Chinese e-commerce companies to avoid tariffs. **The respective agencies are to submit their reports by April 1, 2025.**

In comments made to the media, President Trump has suggested that he would impose 25% tariffs on Mexico and Canada from February 1 and that he may seek to impose tariffs on China if a sale of TikTok to American companies is not approved by Chinese authorities.

Key excerpts from the America First Trade Policy Document published by the new US administration (highlights are ours)

•"The Secretary of Commerce, in consultation with the Secretary of the Treasury and the United States Trade Representative, **shall investigate the causes of our country's large and persistent annual trade deficits in goods,** as well as the economic and national security implications and risks resulting from such deficits, and **recommend appropriate measures, such as a global supplemental tariff or other policies, to remedy such deficits."**

•"The Secretary of the Treasury shall review and **assess the policies and practices of major United States trading partners with respect to the rate of exchange between their currencies and the United States dollar** pursuant to section 4421 of title 19, United States Code, and section 5305 of title 22, United States Code. The Secretary of the Treasury shall **recommend appropriate measures to counter currency manipulation** or misalignment that prevents effective balance of payments adjustments or that provides trading partners with an unfair competitive advantage in international trade, and shall identify any countries that he believes should be designated as currency manipulators."

•"The Secretary of the Treasury, the Secretary of Commerce, the Secretary of Homeland Security, and the Senior Counselor for Trade and Manufacturing, in consultation with the United States Trade Representative, shall **assess the loss of tariff revenues** and the risks from importing counterfeit products and contraband drugs, e.g., fentanyl, that each result **from the current implementation of the $800 or less, duty-free de minimis exemption** under section 1321 of title 19, United States Code, and shall recommend modifications as warranted to protect both the revenue of the United States and the public health by preventing unlawful importations."

•"The United States Trade Representative shall **review the Economic and Trade Agreement** Between the Government of the United States of America and the Government of the People's Republic of China to determine **whether the PRC is**

acting in accordance with this agreement, and shall **recommend appropriate actions** to be taken based upon the findings of this review, up to and **including the imposition of tariffs or other measures as needed**."

•"The United States Trade Representative shall **assess the May 14, 2024, report entitled "Four-Year Review of Actions Taken in the Section 301 Investigation**: China's Acts, Policies, and Practices Related to Technology Transfer, Intellectual Property, and Innovation" and **consider potential additional tariff modifications** as needed under section 2411 of title 19, United States Code — **particularly with respect to industrial supply chains and circumvention through third countries**, including an updated estimate of the costs imposed by any unfair trade practices identified in such review — and he shall recommend such actions as are necessary to remediate any issues identified in connection with this process."

•"The United States Trade Representative shall **investigate other acts, policies, and practices by the PRC that may be unreasonable or discriminatory and that may burden or restrict United States commerce**, and shall make recommendations regarding appropriate responsive actions, including, but not limited to, actions authorized by section 2411 of title 19, United States Code."

•"The results of the reviews and investigations, findings, identifications, and recommendations"… "shall be delivered to me" [President Trump] by April 1, 2025.

For the full document, please see America First Trade Policy.

Our US public policy base case view remains that of fast announcements, slow implementation: Based on what has been announced so far, our US public policy team led by Michael Zezas, views the developments, outside of the 25% tariffs on Mexico and Canada, as mostly aligned with their base case for "up-front announcements followed by slower implementation". He also notes that the bar for tariffs to go up on China is lower than that for Mexico and Canada. For more details on their takeaways, please see United States of America: Inauguration Takeaways (21 Jan 2025).

This means that our base case remains that tariffs on China will rise in a phased manner: Our base case has been and remains that the weighted average tariff rate will rise in a phased manner from 10% at end-2024 to 15% by end-2Q25, 26% by end-2025 and further to 36% in 2026. Against this backdrop, we expect trade growth to slow, weighing on Asia's GDP growth. The drag on growth will be more from the indirect channels of weaker global corporate confidence and the attendant slowdown in global capex and trade cycle, rather than the direct channel of tariffs on trade. But, given that trade tensions are not new, we believe that the hit to corporate confidence may not be as large this time around as compared to 2018-19. The corporate sector has had time to diversify supply chains since the last cycle, and China has reduced its trade and corporate revenue exposure to the US.

But what if trade tensions escalate? However, having lived through the 2018-19 experience, we are mindful of the fact that trade tensions can move into an escalatory cycle beyond what has been announced. In particular, we consider two other scenarios in which trade tensions may escalate beyond our base case.

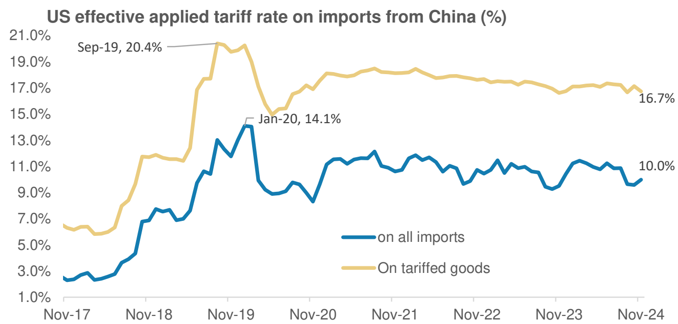
First, selective tariffs on Asian trade partners: Of the economies that run the 10 largest trade surpluses with the US, seven are in Asia (China, Vietnam, Japan, Taiwan, Korea, India, and Thailand). This means that Asian economies will be exposed to potential tariffs if the administration does take up actions to address the persistent trade deficits. This would affect trade and corporate confidence, slowing investment flows to Asia, resulting in a growth shock that would be more than our base case. To be sure, we see the scope for economies like Japan, Taiwan and Korea to be able to take steps to reduce the size of the trade balance or to take up other actions that could potentially mitigate the risk of tariffs.

Second, universal tariffs on all US imports: Another risk scenario that has been highlighted is the potential implementation of universal tariffs on all US imports. Across-the-board tariffs would bring a repeat of the 2018-19 growth shock at a similar magnitude or more.

Tariff scenario	Implications for Asia's growth
Base case: Tariffs directed only at China	• More moderate growth drag vs. in 2018-19. Shock to corporate confidence and capex cycle would be lesser given diversified supply chains and China's reduced trade exposure to the US. • Rest of Asia would also see modest downside. We see varied downward growth pressures depending on exposure to China, with Korea, Taiwan, Malaysia and Thailand most exposed. • Economies with stronger domestic demand offset such as Japan and India are less exposed.
Selective tariffs on Asian trade partners	• Asia is exposed given that 7 of the top 10 economies running the largest trade surpluses against the US are in Asia (China, Vietnam, Japan, Taiwan, Korea, India and Thailand). • A further drag on growth relative to our base case, with the magnitude dependent on the number of economies targeted and the extent of the rise in tariffs. • Some economies like Japan, Taiwan and Korea may be able to take measures to reduce the trade balance or to mitigate the tariff risks.
Universal tariffs on all imports	• Similar or larger growth drag vs. in 2018-19, with substantial shock to corporate confidence and capex leading to a sharp deceleration in exports.

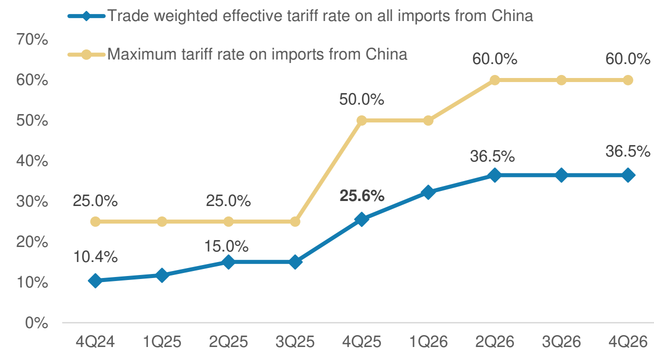
External demand conditions to slow, time to look inward: This rise in trade tensions is taking place against a backdrop where trade growth has already been more moderate than the 2018-19 cycle at the starting point. Moreover, there has been some front-loading which appears to have taken place in the month of December, which supports exports now but risks a bigger drawdown later. It is in this context that we have been highlighting to investors that Asian economies will need to look inward and rely on domestic demand to drive growth. We are constructive on India and Japan, as we see tailwinds supporting consumption growth, but remain cautious on China. The key risk, as highlighted earlier, would be if trade tensions escalate further.

Exhibit 1: Our base case is for tariff rates on US imports from China to rise from 10%...



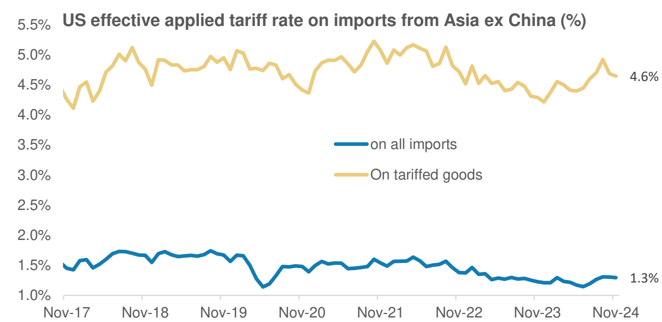
Source: Haver, Morgan Stanley Research

Exhibit 2: ...to 26% in 2025 and further to 36% in 2026



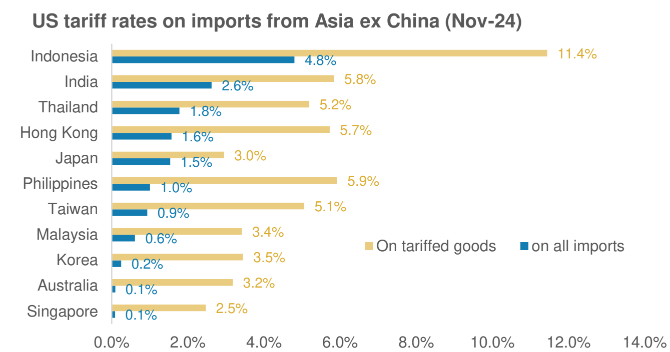
Source: Morgan Stanley US public policy forecasts

Exhibit 3: Watching for risks of escalation in trade tensions for rest of Asia



Source: Haver, Morgan Stanley Research

Exhibit 4: US tariff rates on rest of Asia are relatively low compared to China at the starting point



Source: Haver, Morgan Stanley Research

What if the outlook for tariffs is worse than we expect?

On the watch for further escalation in trade tensions: As we learned in 2018-19, the risk is that trade tensions could broaden and escalate beyond what tends to be expected at any point in time. For instance, the 25% tariffs on Mexico and Canada which may be effective on February 1 would fall outside of our US public policy research team's base case. There have also been a number of other ideas which have been reportedly proposed, though they have not been confirmed by members of the new administration.

1. Risks of selective tariffs on Asian trade partners
2. Risks of universal tariffs – i.e. 10% tariffs on imports from rest of the world

Exhibit 5: Available avenues for tariff actions under US trade laws

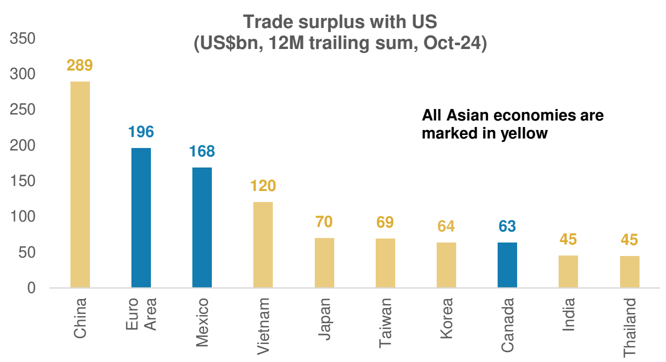
Proposal	Legal Authority	Mechanics	Implementation Lag
Near-Term Expectations			
Incremental tariffs on China (ramping up to maximum 60%)	Section 301: Unfair trade practices (already in place)	To scope in new products, USTR proposes additional items, followed by notice & comment period	Based on 2018-2019: - USTR proposal to announcement: 2-3 months - Announcement to implementation: 1 wk - 3 mos
Other Proposals			
Immediate high tariffs on China (up to 60%)	Restoring Trade Fairness Act or similar legislation to end Permanent Normal Trade Relations with China	Bills proposed in House & Senate would codify tariffs & create new tariff column for China; 35% on non-strategic goods, 100% on strategic goods with 5-year phase-in; assistance for farmers & manufacturers injured by retaliation	Depends on legislative timeline
Universal tariffs, 10-20% all products	Section 232: National security concerns (untested usage)	Labeling "all imports" as a national security threat is untested and subject to legal challenges, but courts have generally deferred to presidents on foreign affairs & trade policy; past legal challenges to Sec. 232 have failed	Unclear given untested authority & legal challenges
	Section 301: Unfair trade practices (untested usage)	President could find that "the acts of all U.S. trading partners are unfair"	Unclear given untested authority & legal challenges
	International Emergency Economic Powers Act (IEEPA) (untested)	President declares state of emergency, presumably over balance-of-payments crisis, allowing for broad & fast economic actions	Implementation can be almost immediate (~1 week) but subject to legal challenges
25% tariffs on Mexico and/or Canada	International Emergency Economic Powers Act (IEEPA)(untested)	President declares state of emergency, presumably over immigration / drug trafficking, allowing for broad & fast economic actions	Implementation can be almost immediate (~1 week) but subject to legal challenges
	Section 301: Unfair trade practices (new trading partners)	USTR initiates investigation (on its own, at president's direction or third party); 12-18 month deadline for recommendation (during first Trump term, USTR often completed investigations several months early)	Based on 2017-2020: - Investigation to announcement: 5-12 months (high variability in investigation length) - Announcement to implementation: 1 week - 3 months
Tariffs on critical imports only (defense metals, medical & pharmaceutical, energy, rare earths), 10-20%	Section 232: National security concerns (new products; authority already in place for steel & aluminum)	President directs Commerce Secretary to investigate; max 270 days to produce report / recommendation for president (in 2017, Trump instructed Commerce to expedite, but still took 270 days)	Based on 2017-2018: - Investigation to announcement: 10 months - Announcement to implementation: 2 weeks
Gradual tariff increases (2-5% per month)	International Emergency Economic Powers Act (IEEPA)(untested)	President declares state of emergency, allowing for broad & fast economic actions	Implementation can be almost immediate (~1 week) but subject to legal challenges
Targeted tariffs on specific products	Section 201: Temporary assistance to domestic industries	USITC initiates investigation (or third-party petition) to determine if a specific domestic industry is being injured (via profits, production or employment levels); 180 day deadline for report	Based on 2017-2018: - USITC investigation to announcement: 7.5 months - Announcement to implementation: 16 days
Temporary universal tariffs (up to 15%)	Section 122: Balance of payments deficit or preventing dollar depreciation (untested)	President can impose up to 15% tariffs for up to 150 days (must be extended by Congress after) to address a trade deficit or prevent significant dollar depreciation	Unclear due to lack of established investigation process
Reciprocity / response to foreign tariffs	Section 338: Foreign discrimination against U.S. Exports (untested)	Never been used for tariffs; no established process for USITC investigation and could face legal challenges	Unclear due to lack of established investigation process
	Reciprocal Trade Act (2019) or similar legislation	2019 proposed bill would allow president to impose tariffs if trading partner applies higher tariffs on U.S. goods or similar non-tariff restrictions, must end tariffs if other nation concedes	Depends on legislative timeline
Carbon tariff	Foreign Pollution Fee Act (2023) or similar legislation	2023 proposed bill would allow U.S. to impose tariffs on imports based on the carbon intensity of the foreign industry	Depends on legislative timeline
100% on BRICS countries	Unclear; possibly IEEPA as other authorities do not apply	President declares state of emergency, allowing for broad & fast economic actions	Unclear given untested authority & legal challenges

Source: Morgan Stanley US Public Policy Research. For full report, please see US Public Policy & Global Macro Strategy: Day One: What to Watch for.

Aside from China, other Asian economies are also exposed to the risk of escalation: As President Trump has framed trade issues in the context of the size of US trade deficits with individual economies, we think this would serve as a good starting point in identifying which economies could be relatively more exposed to potential tariff hikes.

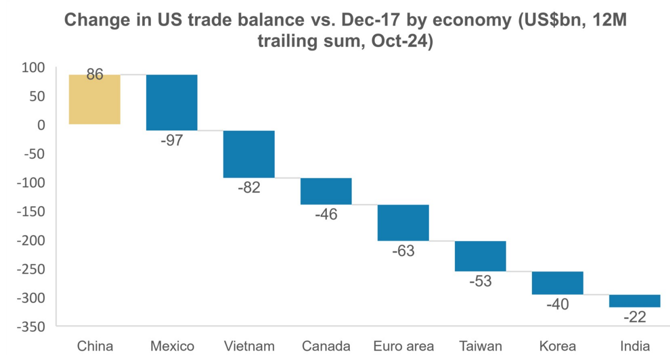
Asia has seven of the 10 economies which run the highest trade surpluses with the US. Apart from China, Vietnam now runs the fourth-largest surplus, increasing 3x since 2017 from US$38bn to US$120bn currently. It is followed by Japan (#5), Taiwan (#6), Korea (#7), India (#9), and Thailand (#10), with the next largest delta within Asia since 2017 being from Taiwan (+US$53bn) and Korea (+US$40bn). From this perspective, this would represent further drag on growth relative to our base case, though the magnitude dependent on the number of economies targeted and the extent of the rise in tariffs. For some of the economies in the region like Japan, Korea and Taiwan, we believe they may be able to take measures to reduce the trade balance or to mitigate the tariff risks.

Exhibit 6: Asia has seven of the 10 economies with the highest trade surpluses with the US



Source: CEIC, Morgan Stanley Research

Exhibit 7: Vietnam, Taiwan, Korea and India have seen trade surpluses with the US rise significantly since 2017

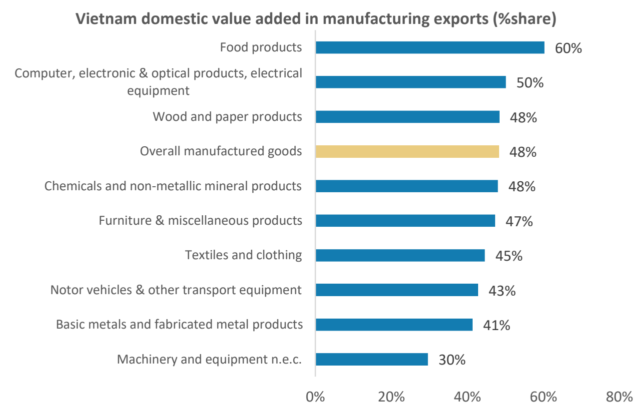


Source: CEIC, Morgan Stanley Research

What if the US administration and trade partners take up more measures against trade rerouting? Both the US and its trade partners have begun taking more measures to address the issue of trade rerouting. The Biden administration took steps in July 2024 to reinstate tariffs on steel and aluminum imports from Mexico unless there is documentary proof that these products were made in Mexico or Canada and that they were not sourced from China, Russia, Belarus, or Iran. If products meet the criteria of being locally produced, they would be excluded from tariffs. President Trump has also now directed the US Trade Representative to consider potential tariff actions "with respect to industrial supply chains and circumvention through third countries" as part of a reassessment of the Section 301 investigation on China. Meanwhile, authorities in Mexico have also taken steps to increase tariffs on imports on goods imported through courier companies as well as incentivize and attract investments for domestic production and reduce imports from China.

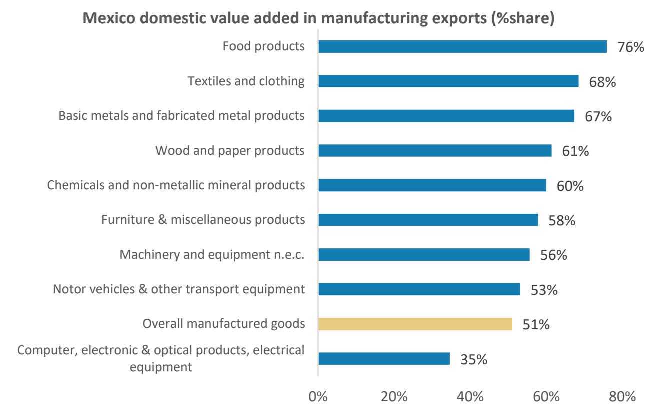
In our view, it may be practically challenging for the US to take a broad-based tariff measure on all exports which have any China-made content. As we will highlight below section in more detail, the scope of re-routing has reduced over time and key economies associated with rerouting in Mexico and Vietnam have been increasing domestic production (see The Viewpoint: Addressing your questions on tariffs, 22 July 2024). Instead, both the US and its trade partners could continue to take measures to restrict imports from Mexico and Vietnam for select sectors in which China is known to have excess capacity such as autos. For example, Mexico has also announced plans to increase the percentage of Mexico-made components in each vehicle to 15% by 2030. From a sectoral perspective, OECD data on domestic value added in manufacturing exports show that domestic value-added shares in Vietnam's machinery and equipment, metals and metal products, and motor vehicles and other transport equipment exports are comparatively lower than other sectors, while Mexico's computer, electronic and optical products and electrical equipment exports have lower domestic value-added shares compared to other sectors.

Exhibit 8: Domestic value added shares in Vietnam's machinery and equipment, metals and metal products, and motor vehicles and other transport equipment exports are comparatively lower than other sectors



Source: OECD, Morgan Stanley Research

Exhibit 9: Mexico's computer, electronic and optical products and electrical equipment exports have lower domestic value added shares compared to other sectors

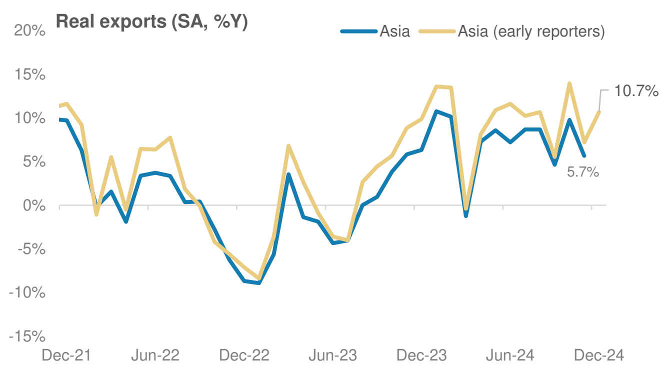


Source: OECD, Morgan Stanley Research

The trade cycle is holding up, for now

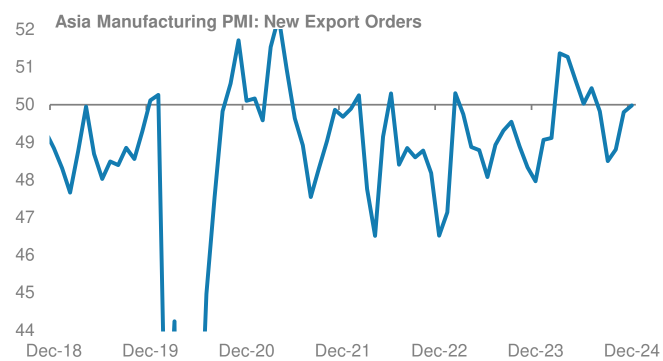
Asia's exports – incoming data shows some reacceleration…: This rise in trade tensions is taking place against a backdrop where the trade cycle is fundamentally slowing. Asia's real exports growth did slow to 5.7% in November from 9.8%Y in October), but the December data from early reporting economies (which include China, India, Indonesia, Korea, and Taiwan and account for 2/3 of Asia's overall exports) showed some reacceleration in export growth momentum on a somewhat broad base. Similarly, December new export orders within PMIs also rebounded to a 5-month high and returned to 50 – the expansion-contraction threshold.

Exhibit 10: December exports growth for early reporting economies appear to show some stabilization at the margin



Source: Haver, Morgan Stanley Research

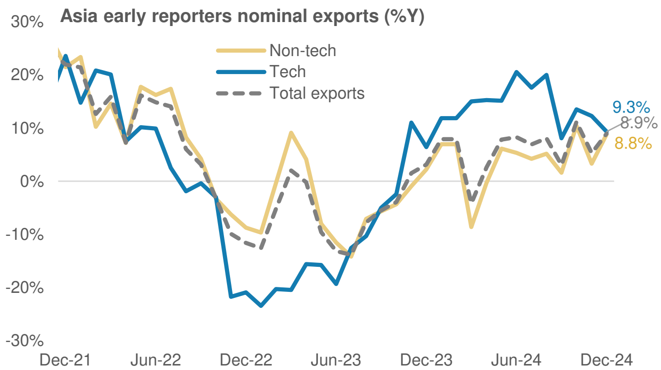
Exhibit 11: New export orders for the region picked up to a five-month high in December



Source: Haver, Morgan Stanley Research

…possibly on account of front-loading: Peering under the hood reveals that tech exports – which accounts for about 25% of overall exports – are indeed beginning to moderate. Tech export growth for early reporters in Asia moderated to 9.3%Y in December, down from a recent peak of 20%Y recorded in August. Korea's daily exports growth for the first 20 days of January for items such as wireless communication devices and computer parts have broadly softened. In contrast, non-tech export growth has picked up at the margin. From an end-use perspective, the improvement in December has been driven more by better commodity and intermediate goods exports. In our view, this pick-up could be attributed to some potential frontloading in trade ahead of potential tariff announcements and also ahead of the Lunar New Year, which falls in late January this year.

Exhibit 12: Asia's non-tech exports have picked up at the margin...

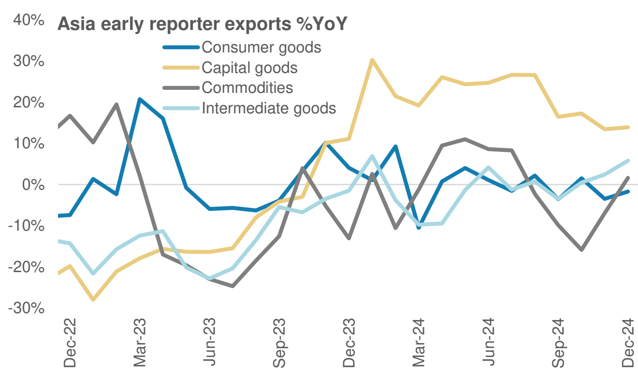


Source: Haver, CEIC, Morgan Stanley Research

Exhibit 13: ...while tech exports have softened

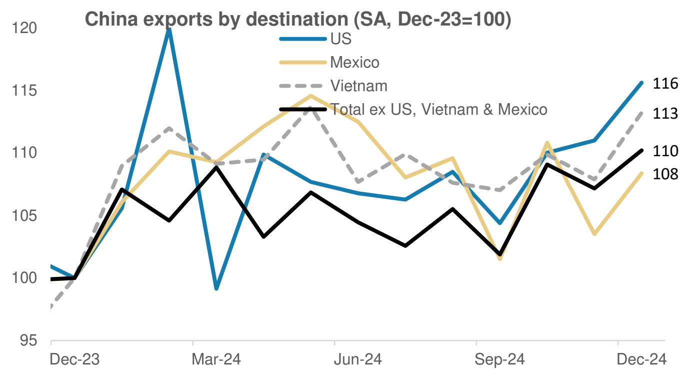
Source: Haver, Morgan Stanley Research. Note: * Due to limited product breakdown in early exports data, we selected semiconductor, computer peripherals, and wireless communication device as tech exports.

Exhibit 14: Marginal pickup driven more by commodities and intermediate goods exports



Source: CEIC, Morgan Stanley Research

Exhibit 15: Sequential momentum in China's exports to the US has accelerated

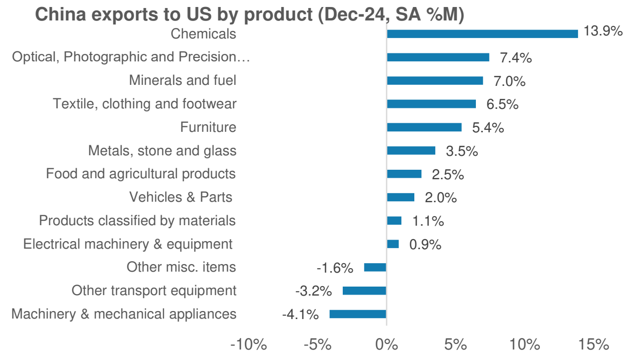


Source: Haver, Morgan Stanley Research

Exports to the US providing support to China's exports...: For China, nominal exports to the US accelerated to 4.2%M SA in December (vs. 0.9%M in November), outpacing sequential export growth to the rest of the world (2.8%M in December). In particular, this is higher than the pre-Covid 5-year average of 1.7%M for the month before Lunar New Year, suggesting this could be more than the seasonal uptick.

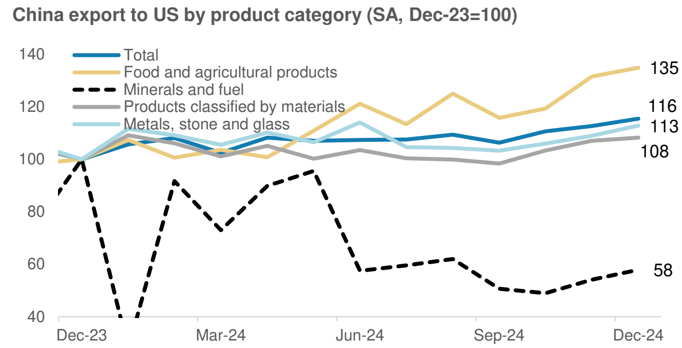
By product, the uptick in exports to the US has been supported by intermediate goods such as chemicals, commodities such as minerals & fuel and agricultural products, select capital goods in optical, photographic and precision instruments, and select consumer goods such as textiles & clothing and furniture.

Exhibit 16: The marginal uptick in China's exports to the US...



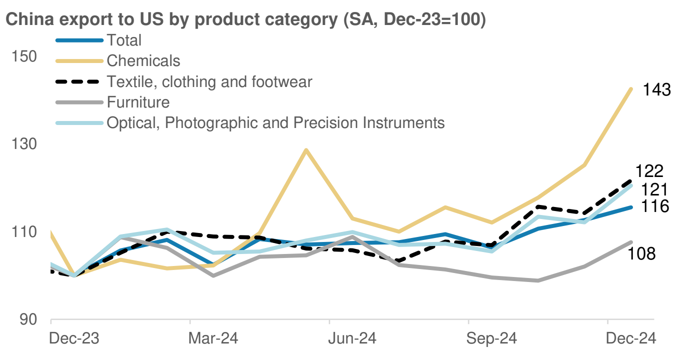
Source: CEIC, Morgan Stanley Research

Exhibit 17: ...has been supported by commodities such as minerals & fuel and agricultural products...



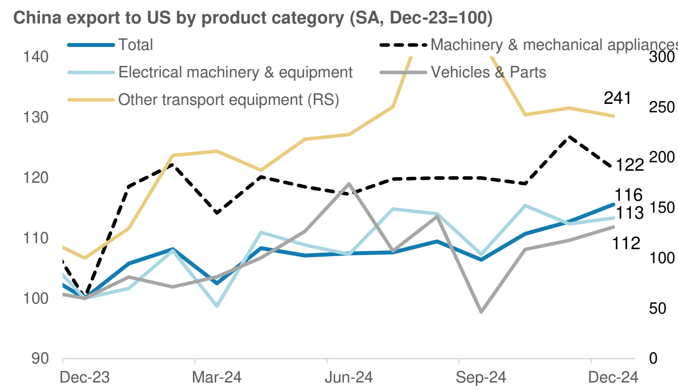
Source: CEIC, Morgan Stanley Research

Exhibit 18: ...intermediate goods such as chemicals, select capital goods in optical, photographic and precision instruments...



Source: CEIC, Morgan Stanley Research

Exhibit 19: ...and select consumer goods such as textiles & clothing and furniture

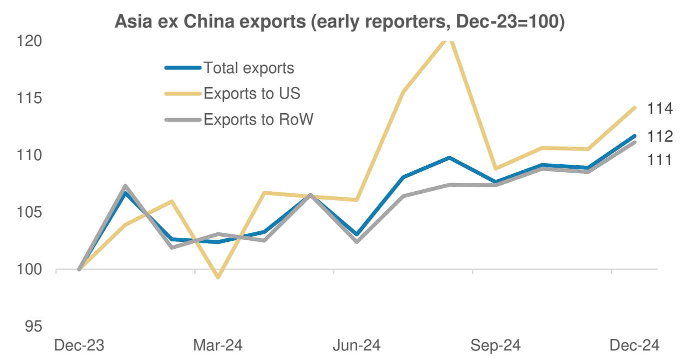


Source: CEIC, Morgan Stanley Research

...as well as the rest of Asia's exports: For early reporting economies in the rest of Asia (Korea, Malaysia, Singapore, Taiwan and Vietnam), growth in exports to the US has also outpaced that of exports to the rest of the world at the margin, rising 3.3%M SA in December vs. 2.4%M SA for exports to the rest of the world. With the %M increase more than seasonality suggests ahead of Lunar New Year, this also implies part of the uptick could be attributed to some frontloading in exports.

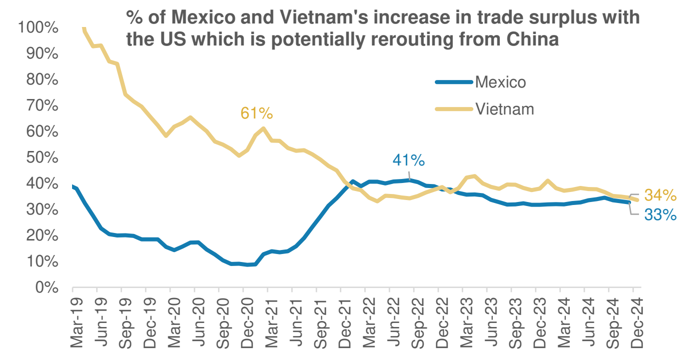
No significant reacceleration in rerouting yet: Relatedly, another point of focus has been the rerouting of China's trade via other countries such as Vietnam and Mexico to the US. Indeed, China's exports to Vietnam and Mexico had accelerated 4.9%M and 4.7%M in December, respectively. We have been of the view that rerouting has been declining and that these economies are now more sourcing components from China for domestic production rather than pure rerouting (see The Viewpoint: Addressing your questions on tariffs, 22 Jul 2024). For example, our calculations of Vietnam and Mexico's trade rerouting ratios – the increase in Vietnam/Mexico's trade deficit with China since Dec-17 in product categories which have also seen a simultaneous increase in trade surpluses with the US (i.e. product categories we identify as potential trade rerouting), expressed as %share of Vietnam/ Mexico's total increase in trade surplus with US in the period – had declined over time. We have seen these ratios hold steady/slightly decline in recent months, with little signs of significant reacceleration just yet. That said, we believe trade rerouting will nonetheless constitute an area of concern for the incoming US administration (see below section).

Exhibit 20: Early reporting economies in rest of Asia have seen an uptick in exports to US too



Source: Haver, Morgan Stanley Research

Exhibit 21: No significant reacceleration in rerouting observed yet



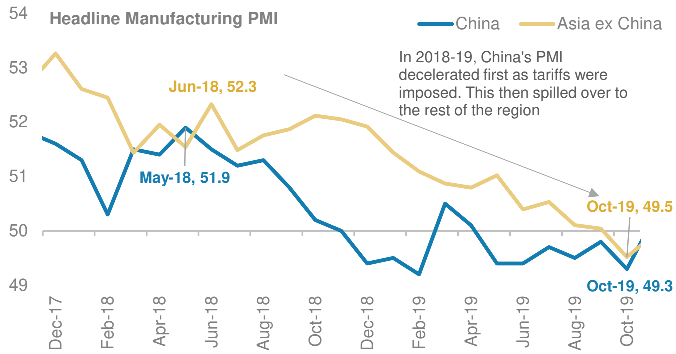
Source: CEIC, Morgan Stanley Research

Learning from the past – How did Asia’s trade cycle evolve in 2018-19?

Asia’s trade and capex trends deteriorated sharply alongside tariff implementation: When trade tensions first emerged in Jan-18 – when the US announced universal tariffs on solar panels and washing machine imports – Asia’s exports had been benefiting from a synchronous upturn in global trade, with real export growth averaging 6.1%Y. The strong external demand backdrop lifted Asia’s capex cycle, and Asia’s real investment growth accelerated to 9.9%Y in 1Q18 (vs. 5.8% in 4Q16). However, as US-China trade tensions began to escalate and the US began implementing multiple tranches of tariffs on imports from China in 2018, export outcomes deteriorated. After benefiting from trade front-loading through 1Q-3Q18, Asia's real export growth began slowing with a lag from 6.5%Y 3MMA in Oct-18 before falling into negative %Y territory in Jan-19. Real export growth averaged an anemic -0.3% in 2019 with similar downtrends across China and Asia ex China in the period. Reflecting the fact that the growth drag on Asia came more from the indirect channel of weaker global corporate confidence and capex, Asia's real investment growth peaked earlier than exports in 1Q18 at 9.4%Y before slowing sharpy to 2.7%Y in 1Q19. Overall, Asia's real GDP growth slowed from 6%Y in 1Q18 to 5% in 4Q18. In China, growth decelerated from 6.9%Y in 2Q18 to 5.9% as of 3Q19. In Asia ex China, the deceleration was sharper, with growth slowing from 5.3%Y in 1Q18 to 2.2% in 4Q19 – though in part this reflected domestic developments in India and Japan.

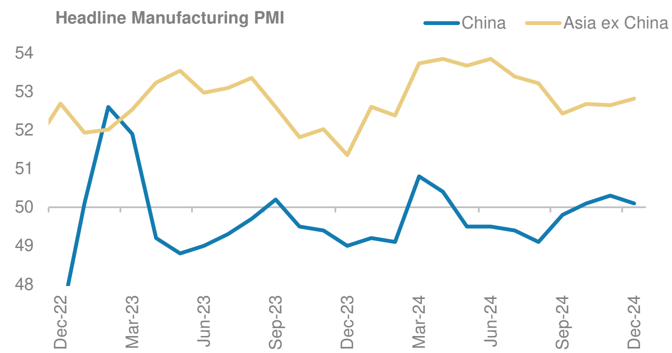
In this cycle, the starting point of growth is somewhat worse: This time around, the starting point of the growth cycle in Asia is less synchronous as compared to the last cycle. In 2024, Asia’s export growth was driven more by the tech cycle, leading to more uneven trade growth in the region with overall stronger exports in China vs. Asia ex China over the past six months. Meanwhile, overall growth trends have also been divergent. In China, the debt-deflation loop has continued to persist despite some near-term stabilization in real growth in 4Q24 amid incremental policy support. As a result, the starting point of growth in China is weaker than in 2017-18. For Asia ex China, the pace of growth has been similar to 2017-18, but importantly we do not expect the domestic demand story in the largest economies of India and Japan now to face the same idiosyncratic factors that drove even weaker growth in 2019 (i.e. consumption tax hike in Japan and the NBFC crisis in India).

Exhibit 22: In 2018-19, China's PMI slowed first amid tariffs, but the rest of the region was affected later on as well



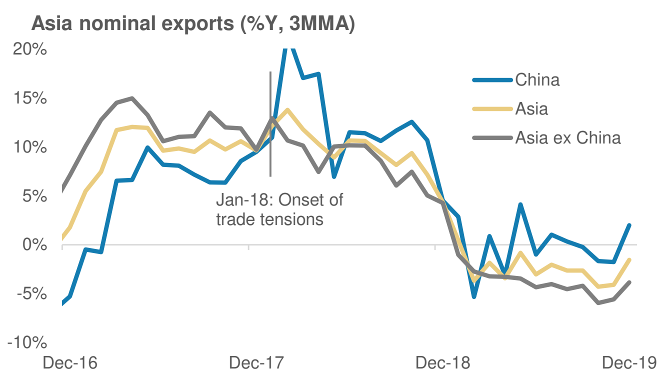
Source: Haver, Morgan Stanley Research

Exhibit 23: This time around, China's PMI is at a weaker starting point compared to 2018-19, while Asia ex China has tracked at a robust level, driven by India



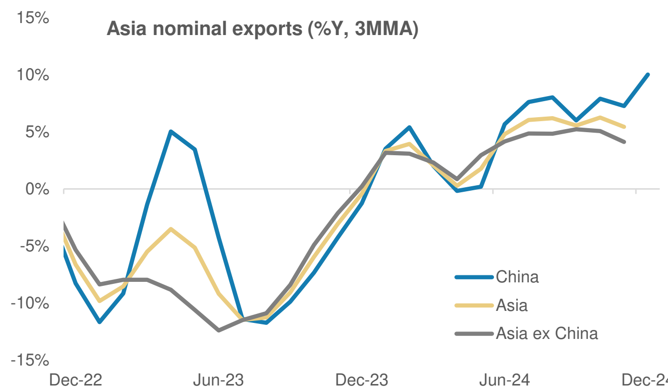
Source: Haver, Morgan Stanley Research

Exhibit 24: In 2018-19, nominal export growth slowed more evidently from 2H18, though China did not underperform the rest of Asia



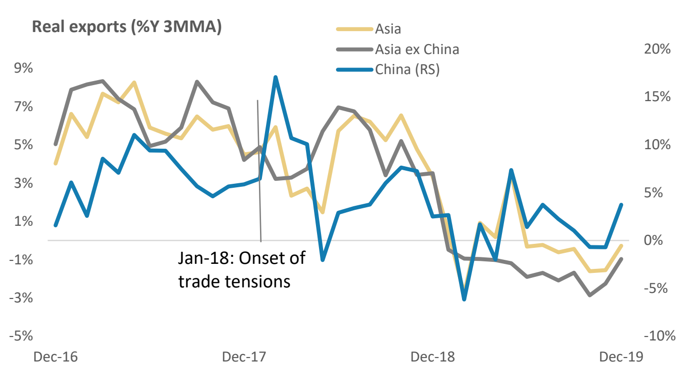
Source: Haver, CEIC, Morgan Stanley Research

Exhibit 25: In this cycle, nominal export growth has held up relatively well



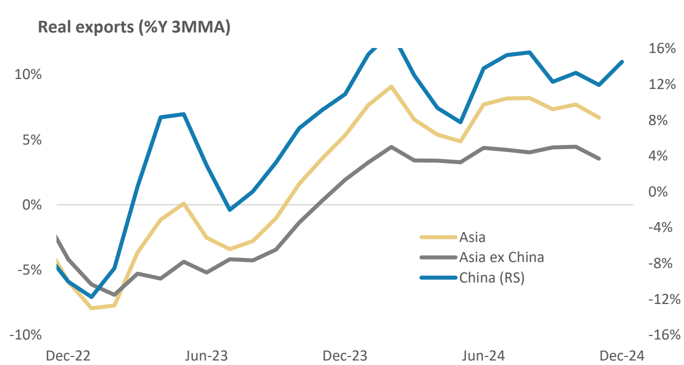
Source: Haver, CEIC, Morgan Stanley Research

Exhibit 26: In 2018-19, real export growth similarly slowed from 2H18



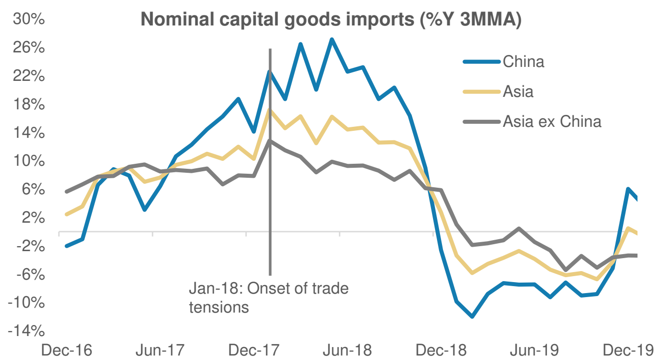
Source: Haver, CEIC, Morgan Stanley Research

Exhibit 27: In this cycle, China's real export growth has been robust



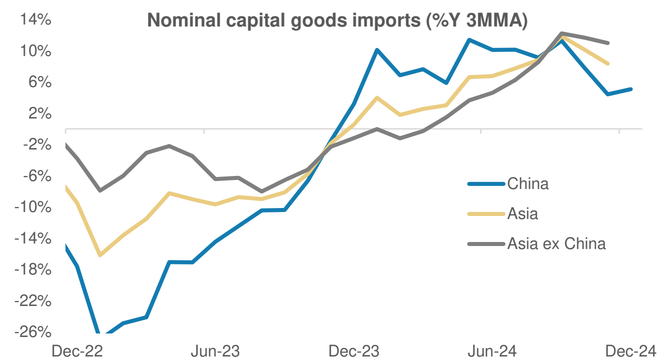
Source: Haver, CEIC, Morgan Stanley Research

Exhibit 28: In 2018-19, the starting point of the capex cycle was tracking at a much stronger pace for China...



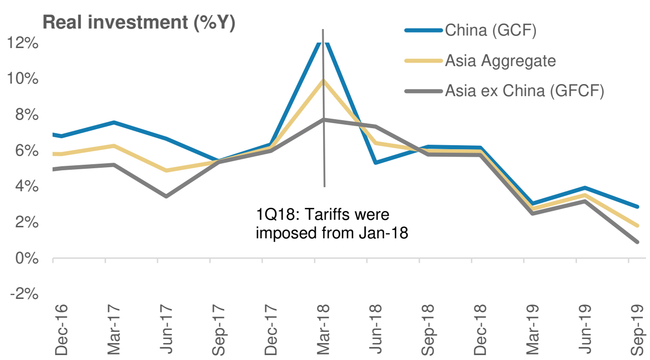
Source: CEIC, Morgan Stanley Research

Exhibit 29: ...vs. in this cycle



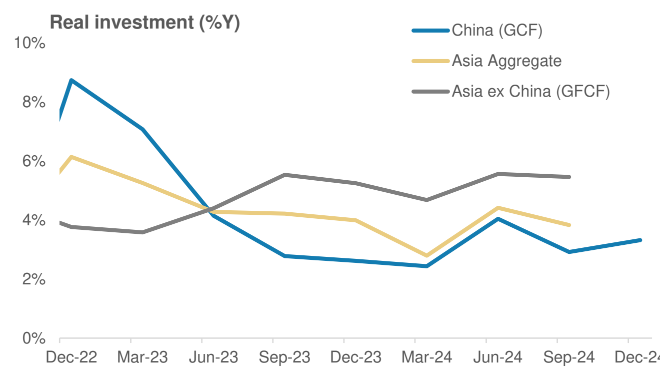
Source: CEIC, Morgan Stanley Research

Exhibit 30: In 2018-19 real investment growth decelerated sharply across the region as trade tensions escalated



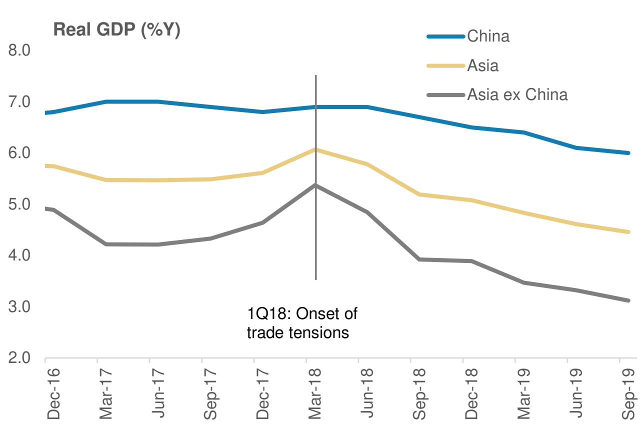
Source: Haver, CEIC, Morgan Stanley Research

Exhibit 31: In this cycle, China's real investment growth is much softer amid adjustment in property sector



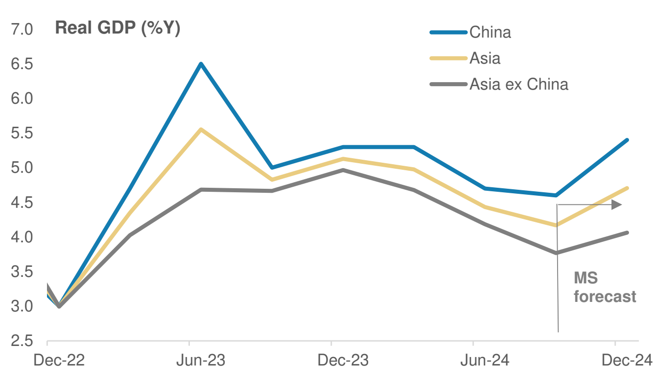
Source: Haver, CEIC, Morgan Stanley Research

Exhibit 32: In 2018-19, the slowdown in global capex and trade cycle meant all Asian economies slowed alongside China



Source: Haver, CEIC, Morgan Stanley Research

Exhibit 33: In this cycle, the starting point of growth is weaker in China, but in-line in Asia ex China



Source: Haver, CEIC, Morgan Stanley Research forecasts

What is the outlook for trade in 2025?

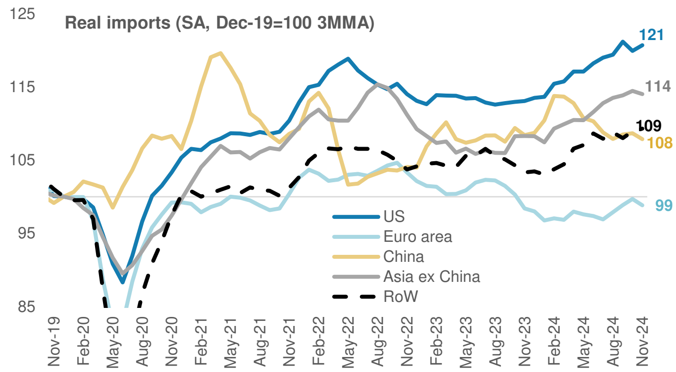
External demand to be a drag on region's growth outlook: While trade has held up better in recent months, we believe the external demand outlook is likely to turn more challenging for Asia (see 2025 Asia Economics Outlook: Time to Look Inward, 17 Nov, 2024). The drags emanating from our global base case of gradual tariff implementation on China alongside a slowdown in the tech exports cycle – the latter of which was supportive of exports in 2024 – would be key headwinds.

We believe the drag from tariffs will be less than in 2018-19 in our base case: We have consistently highlighted that more of the growth downside in the 2018-19 cycle on Asia came from the indirect channels of weaker global corporate confidence and the attendant slowdown in global capex and trade cycle, rather than the direct channel of tariffs on trade. We believe that the hit to corporate confidence may not be as large this time around. Supply chain diversification efforts by the corporate sector and the fact that China has reduced its trade and corporate revenue exposure to the US mean we believe the tariff growth drag could be about half of the 1ppt hit to China's growth experienced in 2018-19.

Asia is nonetheless exposed: While the drag could be lesser, Asia is nonetheless exposed to either an escalation in trade tensions or a slowdown in global trade stemming from weaker US growth. For China, the share of the US in its total exports may have declined, but the US still accounts for 40% of its trade surplus. Additionally, the excess capacity and weaker domestic demand trend in China has meant the economy is now more reliant on external demand than before. For example, net exports' share of headline real GDP growth rose to 30% in 2024, the highest since 1997 and above the average of 1% in 2015-19. The rest of Asia has also become more dependent on the US as a source of end-demand. Its share of exports to the US has increased from 11.7% in Oct-18 to 14.7% currently. In a similar vein, Asia ex China's trade surplus with the US has doubled from US$200bn in Sep-19 to US$400bn currently (see The Viewpoint: All About the US, 2 Sep 2024).

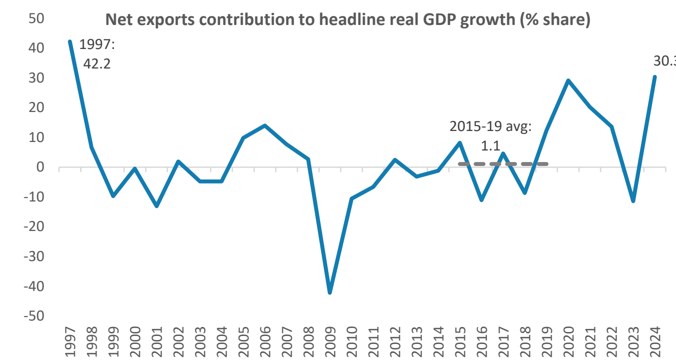
Mind a bigger drawdown after the front-loading: From an end-demand perspective, even ahead of any impact from trade front-loading, US real import trend has been the strongest while China and Europe have been weak. This has also been reflected in regional exports by destination data. As such, any slowdown in import demand from the US, whether be it due to the direct effect of tariffs or from the moderation in growth – will be most keenly felt in Asia. If tariffs are implemented more aggressively than in our base case, this will impart even greater downward pressure on Asia's exports. Moreover, frontloading in trade now also implies that there has been some pull-forward of future demand and that there will be payback in the form of weaker trade down the line.

Exhibit 34: The US has also been the strongest source of end-demand



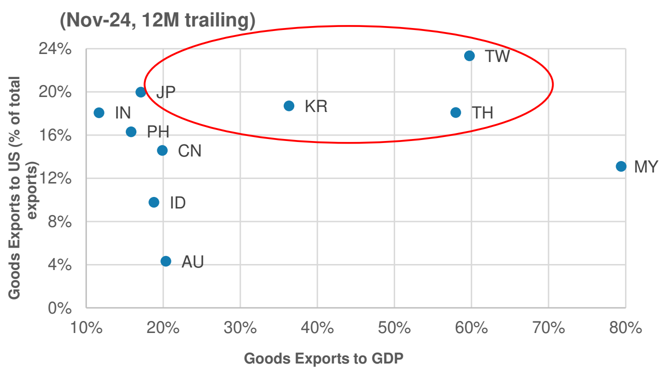
Source: Haver, CEIC, Morgan Stanley Research

Exhibit 35: For China, dependence on trade has increased materially amid weakness in domestic demand



Source: CEIC, Morgan Stanley Research

Exhibit 36: For the rest of Asia, exposure to US demand...



Source: Haver, Morgan Stanley. Note: India exports to US to total exports as of Oct-24.

Exhibit 37: ...has grown

Source: Haver, Morgan Stanley Research

Relying on domestic demand offset

Time to look inward: Given the more challenging external demand backdrop, we believe that Asian economies which have stronger support from domestic demand will do relatively better. In terms of domestic demand, we expect India and Japan will be the two key economies that can generate strong offsets. In particular, we expect private consumption to recover in both economies. In the case of India, a pickup in public capex will be an additional factor supporting domestic demand. We remain cautious on China's outlook as we are skeptical that the easing measures will be enough to boost consumption, keeping the overall policy response still supply-centric in nature and leading to deflationary pressures persisting.

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