

Deal or No Deal: Navigating the US-China Trade Maze

Bottom line: Following the US's announcement of an agreement with UK and China to discuss trade and tariffs, animal spirits revived in financial markets. From a market perspective, US-China trade developments are key. While trade talks are certainly a positive development, we are still far from a deal. Therefore, markets will still have to navigate the US-China trade maze over the coming months. Against this backdrop, we remain cautiously optimistic about the outlook for risk assets. What factors are driving our caution, and what factors are contributing to our optimism?

- ▶ While the recent trade truce allows for talks to progress, the outcome remains uncertain.
- ▶ 2018-19 US-China trade war highlights the need for a realistic view of the current situation.
- ▶ We continue to expect three rate cuts from the Fed in 2025, but with reduced probability now.
- ▶ Recommend staying invested in a diversified portfolio using an asset allocation framework.

When the Eagle talks to the Dragon

- ▷ The US and China have agreed to mutually reduce tariffs by 115ppt for 90 days. The new tariff rate imposed by the US on China will be approximately 40% (including universal rate of 10% applied to all trading partners, 20% of tariffs related to fentanyl which were implemented in February and March, and the pre-election tariff rate of 11%).
- ▷ This means that US tariffs on China will increase by 30ppt in 2025, and China's tariffs on the US will rise by 15ppt. These lower rates are valid for 90 days, after which both sides' rates will increase by 24ppt unless a further pause is agreed upon.
- ▷ This reduction represents a significantly larger compromise than most anticipated and would limit the effective tariff rate increase in the US to 13ppt.

An agreement reached is not a 'deal' done

- ▷ Following the announcement of the US-China agreement that came after the US-UK trade agreement last week, animal spirits revived in financial markets – reflected in strong risk performance on May 12, 2025. Nasdaq has entered a new bull market after falling into a bear market earlier this year, and Dow Jones industrial average exited its correction territory. USD, which has been the casualty of US-asset risk-aversion, bounced off its recent multi-year lows following the announcements on agreements.
- ▷ Here it is important to note that these agreements are not a done deal, and it might take longer than 90 days and require more efforts from more parties than those that participated in initial talks to formalize them. Further, while this window of truce does indeed allow for talks to progress, the outcome will remain uncertain. Also, the process of arriving at a deal could be volatile – going by recent dizzying back-and-forth between the US and China.
- ▷ Also, the US-China trade war episode of 2018-2019 also calls for a more sobering assessment of the current situation (exhibit 1).

Gaming out the steady state

- ▷ While the situation with the overall US tariff picture remains uncertain, our best guess is that the overall effective tariff of US will be around 15%-20% once various agreements are reached. We continue to monitor tariff developments using our five-category framework discussed in our note [From a jump to a stump: Trump's tariff announcements, April 10 2025](#).
- ▷ Our base case assumes the 10% universal tariffs remain in place while the fair and reciprocal tariffs continue to decline as the US strikes agreements and eventually deals with its major trading partners. We also expect tariffs on Mexico and Canada to not materialize following the pause as agreements/deals are reached. Sector-specific tariffs are the wild card, and we see headlines here continuing to feed into volatility. China tariffs should be headline driven and remain volatile too.

Kishore Muktinutalapati

Head - Investment Strategy

Tel: +971 (0)2 812 6457

kishore.muktinutalapati@adcb.com

Prerana Seth, CFA

Fixed Income Strategist

Tel: +971 (0)2 812 6449

prerana.seth@adcb.com

Mohammed Al Hemeiri

Senior Analyst

Tel: +971 (0)2 812 6450

mohammed.alhemeiri@adcb.com

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Implications for investors

- ▷ We continue to believe that the US economy will slow down but will not enter a recession. Upside risks to inflation have certainly faded somewhat following the agreement with China. Stagflation was never our base-case and if anything, the probability of that scenario has now fallen. Indeed, the US CPI data for April surprised on the downside with the headline inflation coming at 2.3% YoY the lowest rate since 2021.
- ▷ In our note [Monetary policy amid uncertainty: Steady stance or unplanned dance?, May 08 2025](#), we discussed our expectations for the US Federal Reserve to cut rates three times this year. While we keep this as our base-case for now, we admit that the probability of this scenario has fallen. There is no hurry for the Fed to cut rates with inflation above target and reduced downside risks to the labor market. However, Fed should still be able to deliver interest rate cuts as a part of its “maintenance” exercise as both growth and inflation cool.
- ▷ Following April 2 Liberation Day announcements, markets sold off aggressively and provided a good point of entry for long-term investors. However, the more recent days (especially May 12, 2025) saw markets bounce back strongly.
- ▷ At this stage, we would stay cautiously optimistic about the outlook for risk as we see the recent positive price action largely reflecting only the good outcomes.
 - Our caution comes when thinking of a scenario in which the rally in risk assets materially reduces the incentive for the US administration to de-escalate.
 - Our optimism comes from the fact the corporate earnings have been strong, and the estimates have scope to improve.
 - We also acknowledge that the impact of tariff uncertainty and supply chain disruptions on the US growth outlook is still unknown.
- ▷ We think investors should stay invested in a diversified portfolio using an asset allocation framework.
- ▷ From a tactical viewpoint, we are neutral equities with US and Japan being our preferred markets. We were never into the “sell America” trade and now with intrigue, we continue to monitor that narrative unwind.

Exhibit 1: What happened during the US-China trade war of 2018-2019

Date	Event
6-Jul-18	US-China trade war begins as US imposes 25% tariffs on USD34bn worth of Chinese imports
7-Jul-18	China retaliates by imposing 25% tariffs on 545 goods originating from the US worth USD34bn
23-Aug-18	Washington imposes 25% tariffs on a further USD16bn worth of Chinese goods
24-Aug-18	China responds by applying 25% tariffs on USD16bn worth of US goods
24-Sep-18	US places 10% tariffs on USD200bn worth of Chinese imports
25-Sep-18	China responds by placing customs duties on USD60bn worth of US goods
1-Dec-18	Xi Jinping and US counterpart Donald Trump call a truce in the trade war at the G20 summit in Argentina
5-Oct-19	After trade talks break down, US increases tariffs on USD200bn worth of Chinese goods, from 10 to 25%
15-May-19	US Department of Commerce announces the addition of Huawei to its "entity list"
31-May-19	China announces plans to establish its own "unreliable entity list"
1-Jun-19	China increases tariffs on USD60bn worth of US products
29-Jun-19	Xi Jinping and Donald Trump again agree to a trade war truce, this time at the G20 summit in Japan
5-Aug-19	US designates China as a "currency manipulator"
13-Aug-19	US announces delay or removal of planned levies on USD455bn worth of Chinese products
23-Aug-19	China announces planned tariffs of 5 and 10% on USD75bn worth of US goods
1-Sep-19	US tariffs on more than USD125bn worth of Chinese imports begin as expected
11-Sep-19	US agrees to briefly delay new tariffs on USD250bn worth of Chinese goods
11-Oct-19	US announces that it will delay a planned tariff increase of 25 to 30% on USD250bn worth of Chinese goods
15-Jan-20	China and the US sign the phase-one trade deal
14-Feb-20	China halves additional tariffs on USD75bn worth of American products imposed in 2019
12-May-20	China announces a second batch of trade-war-tariff exemptions covering 79 American products
14-May-20	China allows imports of barley and blueberries from the US
1-Sep-20	Dozens of US imports from China are granted short extensions to previous tariff exemptions
15-Sep-20	China decides to exempt additional tariffs on a batch of 16 US products for another year
2-Dec-20	The US government says it will begin to block the import of all cotton products made by XPCC.
3-Dec-20	US president-elect Joe Biden tells The New York Times he will not make any "immediate moves" to lift tariffs
18-Feb-21	US Treasury Secretary Janet Yellen says that tariffs on China will be "kept in place"
27-May-21	Chinese Vice-Premier Liu He and US Trade Representative Tai speak in the first trade talks since Aug 2020
2-Jun-21	Chinese Vice-Premier Liu He holds a "candid" exchange on issues of concern with US Treasury Sec. Yellen
10-Jun-21	Chinese Commerce Minister Wang Wentao speaks with his American counterpart Gina Raimondo
15-Jul-21	US says it has no intention to resume highest-level bilateral forum
19-Jul-21	Trade deal did not address 'fundamental problems,' Yellen says



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