INDOSUEZ WEALTH MANAGEMENT

CIO PERSPECTIVES

7 February 2025

"Tariff Man" (Episode 1): Hit first, discuss later

The "Tariff Man" show has commenced, and the art of negotiation tactics goes beyond economist's comfort zone. Indeed, we can not predict the next step, but we can learn from the past and interpret the market's reaction function. As we delve into the facts and financial implications, it's crucial to keep an eye on the endgame. Episode 2 hints at Europe being the next target—but this will not be the same ball game. We remain positive and invested in the stock markets, especially in the United States.

1 - The facts

On 4 February 2025, the American administration launched an initial salvo towards countries from which it seeks concessions. Over the weekend, President Trump signed a series of decrees imposing tariffs of 25% on Mexican and Canadian imports (excluding oil, which will be taxed at 10%) and an additional 10% on current tariffs on Chinese imports. This executive power is being utilised in the context of the opioid crisis, but the negotiations he is initiating with these countries cover much broader issues.

The implementation of the Mexican and Canadian tariffs has been postponed by one month after their authorities committed to strengthening the security of their borders with the United States. Chinese tariffs, however, have come into effect, and China's response has just been announced: Beijing plans to impose a 15% tax on American Liquified natural gas (LNG) and coal and a 10% tax on crude oil and agricultural equipment.

2 - Financial market reaction limited

The market saw through the Canada/Mexico tariff announcement, with only a limited market correction post announcement. With the tariff risk to US inflation, the market now only anticipates one cut in rates by the Federal Reserve (Fed) in 2025 (versus two prior to the announcements). The latter hit stock markets – even if the decline remained contained – and strengthened the value of the dollar that clearly benefits from a tariff premium. Long-term yields remained stable.

3 – Fed prolonged wait-and-see approach justified

The impact on inflation from a potential tariff war, if it comes to that, is main short-term implication to apprehend. In the scenario where these tariffs hold, each additional 10% tariff on Chinese imports would add approximately 0.10 percentage points to the annual US inflation rate, as a one-off effect. The 25% tariffs on Canada and Mexico would each individually add 0.30 percentage points.

On the monetary policy front, Fed Chair Jerome Powell announced in December that he would delay his rate cuts. **We expect he will continue the easing process started in September 2024, but at a later date**. Early January, we also pushed back our estimated terminal rate of 3.5% from end 2025 to 2026. We will also be looking attentively at financial market and consumer inflation expectations that for now remain anchored, although the former reacted sharply to initial tariff announcements. If Trump tariffs are not realised, but uncertainty continues to cloud corporates for too long, impacting unemployment we could also see the Fed decreasing rates. In this context the Fed maintains its wait-and- see approach.

4 – Keeping our eye on the endgame

This initial salvo and the current state of negotiations give us a preliminary idea of what to expect from the Trump administration's use of tariffs — with all the necessary caution when predicting Donald Trump's actions. A full-blown tariff war, resulting in uncontrolled escalation and long-lasting tariffs, is likely in no one's interest, especially not American consumers. It is more probable that Donald Trump aims to apply pressure to negotiate instead. Negotiate what? As seen in the initial Canadian and Mexican reactions: likely more cooperation in the geopolitics of immigration and possibly some form of allegiance to his new administration.

Nevertheless, **Trump's aim to relocate manufacturing to the US through tariffs and tax cuts remain key when interpreting his actions**. President Trump announced the 30-day "pause" in Canada tariffs "to see whether or not a final economic deal with Canada can be structured" this time going beyond the fight against drugs and immigration. He remains determined to weaken or reevaluate the US dollar, although it remains unclear for now how he intends to achieve this goal and will not be able to achieve this through tariffs alone. Bottomline while we believe this initial episode is based on negotiation tactics, we do not underestimate Trump's endgame and possible implementation of tariffs.

Episode 2: Europe?

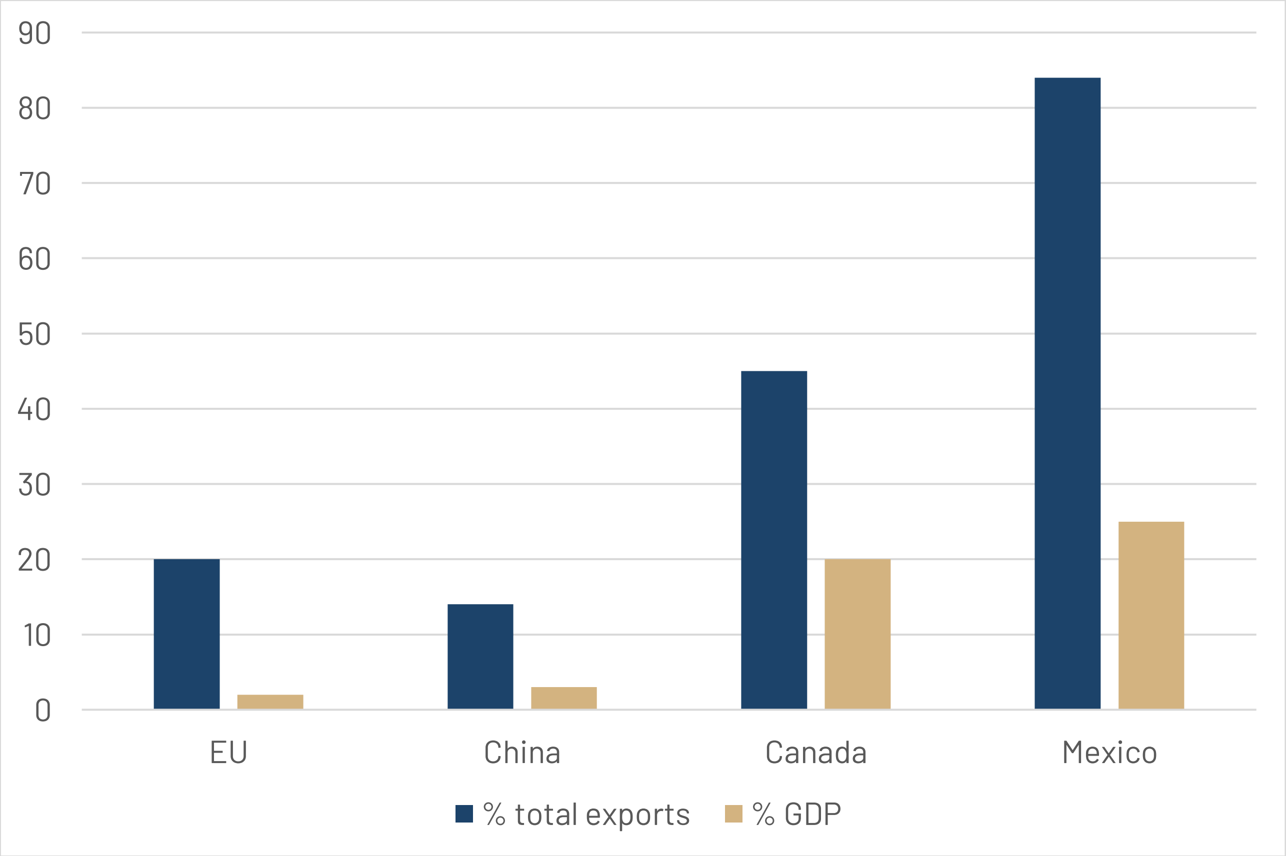
Donald Trump has repeatedly stated that tariffs on Europe will be proposed "pretty soon". This however is **a different ball game than with US neighbouring countries**. First, Trump has a point. Europe has a trade surplus of approximately 1% of GDP with the US, an ongoing irritation for Trump. Second, although the average applied tariff on products from the US (3.95%) is higher than EU products (3.5%), on the automative sector and food sector as a whole, tariffs are higher for the US: for cars the EU tariff rate is 10% compared versus 2.5% in the US, and there is an over 3 percentage point difference for the tariff rate on food and beverages. Tariffs are also higher on chemicals. The European Union (EU) may lose some ground on these areas. However, it has considerable bargaining power as US exports to GDP (a little over 1%) are considerably lower than Mexico (25% of GDP) and Canada (20% of GDP), see Chart 1. According to a study from think tank CEPII, US has more strategic dependencies on EU exports (32 strategic products versus 8 products), notably in the chemicals sector. Finally, the EU and the US are also both their largest investment partner. The implementation of tariffs against Europe would also be more complicated, with increased legal challenges than for tariffs on China which are more easily justifiable through the IEEPA (International Economic Emergency Power Act) that Trump has thus far engaged. **Nevertheless, the EU also has weaknesses, the first being the timing**. The EU economy is considerably weaker than it was in 2017 at the time of first round of Trump tariffs, so this could be the straw the brakes the stalling economic recovery. Ireland and Belgian chemicals, as well as German and Slovakian auto sectors are most directly at risk, while the pharmaceutical and chemicals global value chain is also exposed to the US market. Imposing EU tariffs would thus weaken the already weak EU economy, even if we expected this would prompt the European Central Bank (ECB) into a front loading of its rate cuts and, if tariffs were significant, could also spur more action from the German stimulus.

Our positioning

We remain positive and invested in the stock markets, especially in the United States**. The current robustness of the job market and the strength of consumption indicate that the US economy remains strong**. Earnings growth should also accelerate in 2025. Certainly, the impact of the announcements creates a less favourable environment for activity, and it is likely that expectations of a 14% earnings growth for 2025 are too high.

We entered the year with a more neutral stance on equities, in anticipation of these announcements, we prefer not to react impulsively. If volatility were to remerge with a less pragmatic Donald Trump, our broad diversification, particularly through the dollar and bonds, should provide stability to portfolios if stock markets continue to react negatively.

Chart 1: Market exposure to US trade: it will be harder to "bully" China and Europe (Market exposure to US exports as a % of total trade and % GDP)



Source: Bloomberg, Indosuez Wealth Management.

Bénédicte KUKLA
Senior Investment Strategist

DISCLAIMER

This document entitled "CIO Perspectives" (the "Publication") is issued for marketing communication only.

The languages in which it is drafted form part of the working languages of Indosuez Wealth Management.

The information published in the Publication has not been reviewed and is not subject to the approval or authorisation of any regulatory or market authority whatsoever, in whatever jurisdiction.

The Publication is not intended for or aimed at the persons of any country in particular. The Publication is not intended for persons who are citizens, domiciled or resident in a country or jurisdiction in which its distribution, publication, availability or use would contravene applicable laws or regulations. This document does not constitute or contain an offer or an invitation to buy or sell any financial instrument and/or service whatsoever. Similarly, it does not, in any way, constitute a strategy, personalised or general investment or disinvestment recommendation or advice, legal or tax advice, audit advice, or any other advice of a professional nature. No representation is made that any investment or strategy is suitable and appropriate to individual circumstance or that any investment or strategy constitutes a personalised investment advice to any investor.

The relevant date in this document is, unless otherwise specified, the editing date mentioned on the last page of this disclaimer. The information contained herein are based on sources considered reliable. We use our best effort to ensure the timeliness, accuracy, and comprehensives of the information contained in this document. All information as well as the price, market valuations and calculations indicated herein may change without notice. Past prices and performances are not necessarily a guide to future prices and performances.

The risks include, amongst others, political risks, credit risks, foreign exchange risks, economic risks and market risks. Before entering into any transaction, you should consult your investment advisor and, where necessary, obtain independent professional advice in respect of risks, as well as any legal, regulatory, credit, tax, and accounting consequences. You are advised to contact your usual advisers in order to make your decisions independently, in light of your particular financial situation and your financial knowledge and experience Foreign currency rates may adversely affect the value, price or income of the investment when it is realised and converted back into the investor's base currency.

CA Indosuez a French company, the holding company for the Crédit Agricole group's wealth management business, and its related subsidiaries or entities, namely CA Indosuez (Switzerland) SA, CA Indosuez Wealth (Europe), CFM Indosuez Wealth, their respective subsidiaries, branches, and representative offices, whatever their location, operate under the single brand Indosuez Wealth Management. Each of the subsidiaries, their respective subsidiaries, branches, and representative offices, as well as each of the other Indosuez Wealth Management entities are referred to individually as the "Entity" and collectively as the "Entities".

The Entities or their shareholders as well as its shareholders, subsidiaries, and more generally companies in the Crédit Agricole SA group (the "Group") and respectively their corporate officers, senior management or employees may, on a personal basis or in the name and on behalf of third parties, undertake transactions in the financial instruments described in the Publication, hold other financial instruments in respect of the issuer or the guarantor of those financial instruments, or may provide or seek to provide securities services, financial services or any other type of service for or from these Entities. Where an Entity and/or a Crédit Agricole Group Entity acts as an investment adviser and/or manager, administrator, distributor or placement agent for certain products or services mentioned in the Publication, or carries out other services in which an Entity or the Crédit Agricole Group has or is likely to have a direct or indirect interest, your Entity shall give priority to the investor's interest.

Some investments, products, and services, including custody, may be subject to legal and regulatory restrictions or may not be available worldwide on an unrestricted basis taking into consideration the law of your country of origin, your country of residence or any other country with which you may have ties. In particular, any the products or services featured in the Publication are not suitable for residents of US and Canada. Products and services may be provided by Entities under their contractual conditions and prices, in accordance with applicable laws and regulations and subject to their licence. They may be modified or withdrawn at any time without any notification.

Please contact your relationship manager for further information.

In accordance with applicable regulations, each Entity makes the Publication available:

- **In France:** this publication is distributed by CA Indosuez, a public limited company with a capital of 584'325'015 euros, a credit institution and an insurance brokerage company registered with the French Register of Insurance Intermediaries under number 07 004759 and with the Paris Trade and Companies Register under number 572 171 635, whose registered office is located at 17, rue du Docteur Lancereaux - 75008 Paris, and whose supervisory authorities are the Prudential Control and Resolution Authority and the Autorité des Marchés Financiers.
- **In Luxembourg:** the Publication is distributed by:
  - CA Indosuez Wealth (Europe), a limited company (société anonyme) under Luxembourg law with share capital of euros 415'000'000, having its registered office at 39 allée Scheffer L-2520 Luxembourg, registered with the Luxembourg Companies Register under number B91.986, an authorised credit institution established in Luxembourg and supervised by the Luxembourg financial regulator, the Commission de Surveillance du Secteur Financier (CSSF).
  - Banque Degroof Petercam Luxembourg S.A., whose registered office is located at 12 rue Eugène Ruppert, L-2453 Luxembourg, authorised by and subject to the prudential supervision of the Commission de Surveillance du Secteur Financier ("CSSF"), 283 route d'Arlon, L-2991 Luxembourg, website http://www.cssf.lu/"www.cssf.lu, tel. (+352) 26251-1, and the European Central Bank within the scope of their respective competences.
- **In Spain:** the Publication is distributed by CA Indosuez Wealth (Europe) Sucursal en España, supervised by the Banco de España (www.bde.es) and the Spanish National Securities Market Commission (Comision Nacional del Mercado de Valores, CNMV, www.cnmv.es), a branch of CA Indosuez Wealth (Europe), a credit institution duly registered in Luxembourg and supervised by the Luxembourg financial regulator, the Commission de Surveillance du Secteur Financier (CSSF). Address: Paseo de la Castellana número 1, 28046 Madrid (Spain), registered with the Banco de España under number 1545. Registered in the Madrid Trade and Companies Register, number T 30.176, F 1, S 8, H M-543170, CIF (Company tax ID): W-0182904-C.
- **In Belgium:** the Publication is distributed by CA Indosuez Wealth (Europe) Belgium Branch, located at 120 Chaussée de la Hulpe B-1000 Brussels, Belgium, registered with the Brussels Companies Register under number 0534 752 288, entered in the Banque-Carrefour des Entreprises (Belgian companies database) under VAT number 0534.752.288 (RPM Brussels), a branch of CA Indosuez Wealth (Europe).
  - CA Indosuez Wealth (Europe) Belgium Branch, located at 120 Chaussée de la Hulpe B-1000 Brussels, Belgium, registered with the Brussels Companies Register under number 0534 752 288, entered in the Banque-Carrefour des Entreprises (Belgian companies database) under VAT number 0534.752.288 (RPM Brussels), a branch of CA Indosuez Wealth (Europe).
  - Banque Degroof Petercam SA, located at rue de l'Industrie 44, 1040 Brussels, Belgium, registered in the Business Register under number 0403 212 172, registered with the Crossroads Bank for Enterprises (Belgian business database) under VAT number BE 0403 212 172 (RPM Brussels).
- **In Italy:** the Publication is distributed by CA Indosuez Wealth (Europe), Italy Branch based in Piazza Cavour 2, Milan, Italy, registered in the Register of Banks no. 8097, tax code and registration number in the Business Register of Milan, Monza Brianza and Lodi n. 97902220157.
- **Within the European Union:** the Publication may be distributed by Indosuez Wealth Management Entities authorised to do so under the Free Provision of Services.
- **In Monaco:** the Publication is distributed by CFM Indosuez Wealth, 11, Boulevard Albert 1er - 98000 Monaco registered in the Monaco Trade and Industry Register under number 56S00341, accreditation: EC/2012-08.
- **In Switzerland:** the Publication is distributed by CA Indosuez (Switzerland) SA, Quai Général-Guisan 4, 1204 Geneva and by CA Indosuez Finanziaria SA, Via F. Pelli 3, 6900 Lugano and by their Swiss branches and/or agencies. The Publication constitutes marketing material and does not constitute the product of a financial analysis within the meaning of the directives of the Swiss Bankers Association (SBA) relating to the independence of financial analysis within the meaning of Swiss law. Consequently, these directives are not applicable to the Publication.
- **In Hong Kong SAR:** the Publication is distributed by CA Indosuez (Switzerland) SA, Hong Kong Branch, Suite 2918, Two Pacific Place, 88 Queensway. No information contained in the Publication constitutes an investment recommendation. The Publication has not been referred to the Securities and Futures Commission (SFC) or any other regulatory authority in Hong Kong. The Publication and products it may mention have not been authorised by the SFC within the meaning of sections 103, 104, 104A or 105 of the Securities and Futures Ordinance (Cap. 571) (SFO).
- **In Singapore:** the Publication is distributed by CA Indosuez (Switzerland) SA, Singapore Branch 168 Robinson Road #23-03 Capital Tower, 068912 Singapore. In Singapore, the Publication is only intended for persons considered to be high net worth individuals in accordance with the Monetary Authority of Singapore's Guideline No. FAA-G07, or accredited investors, institutional investors or expert investors as defined by the Securities and Futures Act, Chapter 289 of Singapore. For any questions concerning the Publication, recipients in Singapore can contact CA Indosuez (Switzerland) SA, Singapore Branch.
- **In the DIFC:** the Publication the brochure is distributed by CA Indosuez (Switzerland) SA, DIFC Branch, Al Fattan Currency House, Tower 2 – Level 23 Unit 4 DIFC PO Box 507232 Dubai – UAE a company regulated by the Dubai Financial Service Authority ("DFSA"). This brochure is intended for professional client and/or market counterparty only and no other person should act upon it. The financial products or services to which this publication relates will only be made available to a client who meets the DFSA professional client and /or market counterparty requirements. This brochure is provided for information purposes only. It is not to be construed as an offer to buy or sell or solicitation of an offer to buy or sell any financial instruments or to participate in any particular trading strategy in any jurisdiction.
- **In the UAE:** the Publication is distributed by CA Indosuez (Switzerland) SA, Abu Dhabi Representative Office, Zayed - The 1st Street- Al Muhairy Center, Office Tower, 5th Floor, P.O. Box 44836 Abu Dhabi, United Arab Emirates. CA Indosuez (Switzerland) SA operates in the United Arab Emirates (UAE) via its representative office which comes under the supervisory authority of the UAE Central Bank. In accordance with the rules and regulations applicable in the UAE, CA Indosuez (Switzerland) SA representation office may not carry out any banking activity. The representative office may only market and promote CA Indosuez (Switzerland) SA's activities and products. The Publication does not constitute an offer to a particular person or the general public, or an invitation to submit an offer. It is distributed on a private basis and has not been reviewed or approved by the UAE Central Bank or by another UAE regulatory authority.
- **Other countries:** laws and regulations of other countries may also limit the distribution of this publication. Anyone in possession of this publication must seek information about any legal restrictions and comply with them.

The Publication may not be photocopied or reproduced or distributed, in full or in part, in any form without the prior agreement of your Bank.

Photo credits: iStock.