Weekly round up (Week 28)

This week, we looks back on another week dominated by news about tariffs.

Last week, prices were moderate across most asset classes. Government bond yields remained relatively stable, while corporate credit markets traded in a narrow range as investors focused on coupons. The US dollar traded steady, as did energy markets, despite OPEC+ announcing a further production increase of 548,000 barrels per day for August.

Equity markets were broadly positive, with Europe outperforming and Latin America lagging behind. The Bloomberg World Large & Mid Cap Index ended the week up 0.75%. The relative lack of price movement can be explained by market fatigue, the usual summer lull, and a light economic calendar that provided little new information.

Deflation in China

Among the week's economic highlights, Chinese data showed that deflation is continuing despite the government's efforts. In June, the consumer price index fell 0.1% month-on-month, following a 0.2% decline in May, and fell 0.1% year-on-year for the first half of the year. At the same time, the producer price index fell 0.4% in June and 2.8% in the first half of the year.

The main factors behind the persistent deflation include high tariffs imposed by the US on Chinese products, lower external demand and income expectations, and the prolonged weakness in the residential real estate sector. Together, these factors continue to outweigh the government's efforts to revive the economy, which have focused on stimulating consumption.

In the US, the release of the minutes of the Federal Open Market Committee (FOMC) meeting on June 17-18 revealed that the Fed considers its monetary policy to be moderately restrictive, but believes that caution is warranted pending further clarity on the economic outlook. Committee members emphasized the importance of keeping inflation expectations stable, especially as the effects of US tariff measures and immigration policies continue to feed into the economy.

Although the timing, extent, and duration of these effects on growth and inflation remain uncertain, the Committee generally expects them to fade in the second half of the year, paving the way for a reduction in the federal funds rate before the end of the year. Given this outlook, the overnight index swap (OIS) market currently sees a 70% probability of a rate cut at the September FOMC meeting.

The Greatest Showman

With no other news to grab investors' attention, Donald Trump (once again) took center stage last week. True to form, he did not disappoint. He first announced that there would be no extension beyond the August 1 deadline for reciprocal tariffs. He then unveiled the first in a series of highly anticipated letters threatening to increase tariffs on major trading partners if no agreement was reached.

Starting August 1, products from Japan and South Korea will be subject to 25% tariffs. The same 25% rate will apply to imports from Malaysia and Kazakhstan, while South Africa will be subject to 30% tariffs and Laos and Myanmar to 40% tariffs. President Trump told NBC News that he plans to impose tariffs of 15-20% on most other trading partners.

However, there are two notable exceptions: Canada and Brazil. Trump has threatened to impose 35% tariffs on certain Canadian products starting August 1. This represents an increase from the 25% tariffs currently applied to US imports from Canada that are not covered by the United States-Mexico-Canada Agreement (USMCA). In a letter to Canadian Prime Minister Mark Carney, Trump criticized Canada's trade practices, saying the country maintains numerous “tariff, non-tariff, and trade barrier policies” that contribute to unsustainable trade deficits for the US.

The threat against Brazil cannot be motivated by trade practices deemed unfair. Brazil has always imported more goods from the United States than it exports and has had a persistent trade deficit with the United States for many years. In 2024 alone, Brazil spent $7.4 billion more on US goods than it earned from exports to the United States.

Despite this, Trump announced that the US would impose a 50% tariff on all products imported from Brazil starting August 1. After taking into account sector-specific tariffs and exemptions, Brazil's new average effective tariff rate on US exports will rise from 10.5% to 36.1%.

This suggests that Trump's decision to target Brazil is more political than commercial. In his letter to Brazil, published on his social media account, Trump said he was taking this decision “in part because of Brazil's insidious attacks on free elections and the fundamental rights of Americans to free speech.”

If the new tariff comes into effect, it could have a significant impact on Brazilian growth. This comes at a difficult time for President Lula, who is already facing an economic slowdown, a fragile fiscal outlook, and growing voter dissatisfaction ahead of next year's elections. We believe that negotiations between the US and Brazil will continue, especially as the use of the International Emergency Economic Powers Act seems difficult to justify given the US trade surplus with Brazil.

Prepare for a backlash

However, if this is another example of Trump's efforts to encroach on the sovereignty of other nations, such as his actions toward Canada, Panama, renaming the Gulf of Mexico, or his attempt to take control of Greenland from Denmark, it could backfire. Such measures risk galvanizing nationalist support for Lula on the issue of sovereignty, strengthening his position at a time when he would otherwise have been at high risk of losing the upcoming elections.

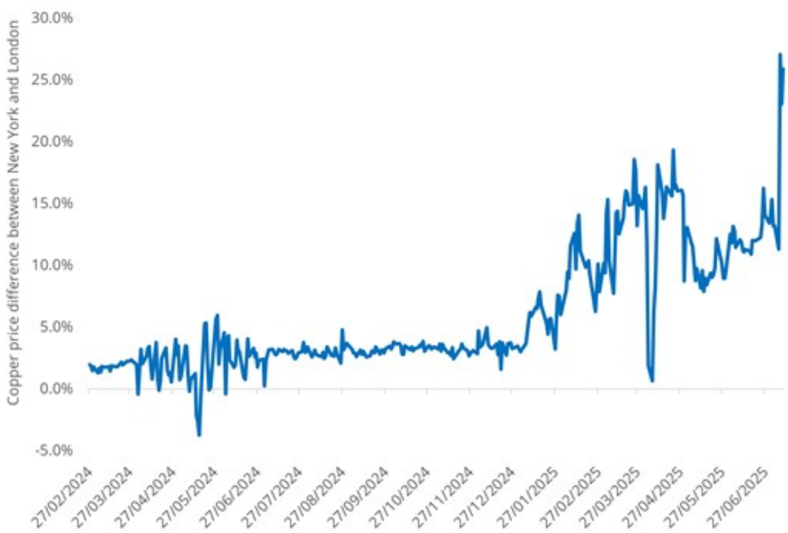
Beyond the headlines on reciprocal tariffs, an often overlooked risk is President Trump's announcement of 50% tariffs on copper imports starting August 1. This could have serious repercussions for US manufacturers in sectors such as automotive, construction, and household appliances, where copper is essential. It is not yet clear which copper-based products will be affected, but the US imported around 908 kilotons of copper in 2024, mainly refined, with a net import dependency of 45%.

The domestic deficit is the result of both insufficient supply of ore and scrap and limited smelting/refining capacity. Restoring balance would require increasing primary and secondary supply, partly by reducing scrap exports and developing domestic refining. However, the high cost of investment and long lead times for mining or smelting projects, combined with political uncertainty, make any investment in the short term unlikely. Even under ideal conditions, it would take at least three to five years to restore the copper trade balance.

In the meantime, copper prices in the US are expected to rise by nearly 40% from their pre-tariff levels, assuming only partial destruction of demand. The actual impact will depend heavily on the elasticity of domestic copper demand. As shown in our “Chart of the Week,” copper prices on the New York Mercantile Exchange have already jumped 25% compared to those on the London Metal Exchange.

These tariffs are a typical example of a supply shock that could slow growth and push up inflation.

Chart of the week: Copper price shock



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