

MIMS – Research Area

Macro Research Team

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Tariffs, Tensions, and Power Shifts: Trade in the New Global Equilibrium

Introduction

On April 2, 2025, the United States (US) announced the “Liberation Day Tariffs,” imposing a 10% baseline tariff on most imported goods and higher rates on different strategic sectors and countries. This tariff has been a major influence on the US and other global economies. Six months later, this policy has reshaped global trade dynamics, provoked legal challenges, and triggered mixed economic outcomes in the US and abroad. This report examines the impact of the Liberation Day Tariffs on the US and its major trading partners, offering a retrospect of the policy’s advantages and drawbacks as well as a 2026 outlook.

Current State of the Tariffs

Liberation Day marked the beginning of a new era in US trade policy, one that many now compare to the Smoot-Hawley tariff period.

In 2024, the United States recorded a goods trade deficit of \$1.21 trillion, in particular the largest share came from China, with a \$295.5 billion deficit, according to U.S. Census Bureau data. In an effort to shrink the trade deficit and bolster domestic production, the Trump administration imposed a series of tariffs on countries with which the U.S. consistently ran large trade deficits. Under the so-called ‘magic Trump formula,’ China faced the steepest increases, an average tariff rate of 34% on most goods, on top of other pre-existing tariffs on specific goods, like the 20% fentanyl-related tariff introduced in March.

China swiftly responded to the tariffs, and tensions heightened to the point of a 125% tariff threat until they reached a 90-day agreement. During the course

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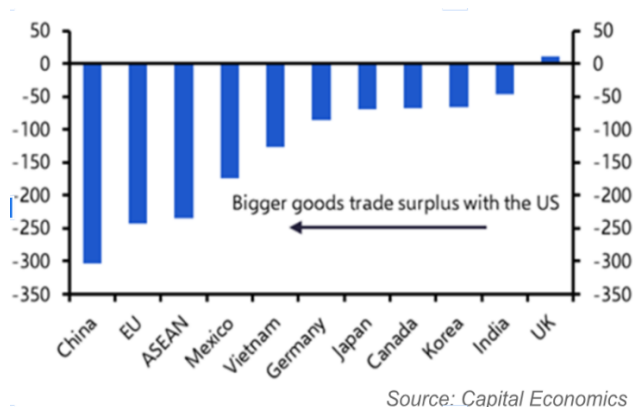
of the 90 days, both countries also expanded the goods covered by tariffs, including critical goods such as electronics and semiconductors. The tariff truce was extended in August for an additional 90 days. The apparent peace did not last long, as China’s restrictions on rare earth minerals triggered the response of an announcement from the US in October of a 100% tariff originally scheduled for November 1st (China Briefing). However, in recent negotiations, export controls on rare earth minerals are to be eased, and the US thus no longer plans to exert the 100% tariff. Additionally, the US is set to remove 10% from the fentanyl tariff, and China has committed to buying more US-produced soybeans, which are a crucial export for the US .

Liberation Day was more than a trade measure, it was a political signal. It marked a strategic shift in how the United States engages with its trading partners, opening the door to new agreements that reach well beyond traditional trade relations.

This new political paradigm also shaped the

transatlantic relationship with the United States' long-standing partner, the European Union (EU). Although the Trump administration still referred to the EU as a 'friend,' it did not spare it from tariff measures. Washington argued that the EU's high external tariffs, regulatory barriers, and subsidies created an uneven playing field, allowing European firms broad access to the U.S. market while putting American exporters at a disadvantage; citing the EU-US goods trade deficit of \$219 billion in 2024 as evidence for the imbalance between the two countries (Office of the United States Trade Representative). In this light, the initial 12% Liberation Day tariff was meant to be corrective, not punitive.

Figure 1: US trade balance by country



Source: Capital Economics

Across Asia, the outlook was more divided. Two of the US's biggest allies in the region, Japan and South Korea, had formally protested the tariffs but also proceeded to negotiate reductions. Similar trends can be seen in the global South, where many opposed the tariffs and claimed that they were a 'Western double standard' but continued to negotiate new bilateral agreements with the US. The countries in the ASEAN block, on the other hand, adopted an opportunistic stance, seeing it as an opportunity to attract foreign investment (World Economic Forum). In the case of Canada and Mexico, they were initially largely exempt since the already existing USMCA agreement was seen as reciprocal. However, tariffs were later imposed, on specific goods, due to the rerouting of Chinese-origin goods into the US through both neighbors, as well as tension regarding illegal immigrants at the US-Mexico border.

Effect on the US economy

Following the introduction of the "Liberation Day" tariffs, trade emerged as a significant factor

influencing US economic activities. Extensive import tariffs and countermeasures disrupted global supply chains, diminished the competitiveness of exports, and increased manufacturing costs, especially for intermediate and capital goods. There was a decline in export volumes, along with a sharp decrease in imports, indicating a shift towards domestic inputs and a downturn in overall demand (WTO, 2025).

The net result has been a worsening of external balance and escalating domestic production expenses. While the significant drop in imports in Q2 2025 temporarily enhanced GDP by reducing the trade deficit, this situation stemmed from constrained trade rather than enhanced competition (Reuters, 2025).

The redirection of supply chains towards local producers led to short-term inefficiencies, capacity limitations, and a slowdown in productivity growth. Export-driven sectors like machinery, transportation equipment, and wholesale trade have experienced a decline, whereas the services sector has shown relative stability.

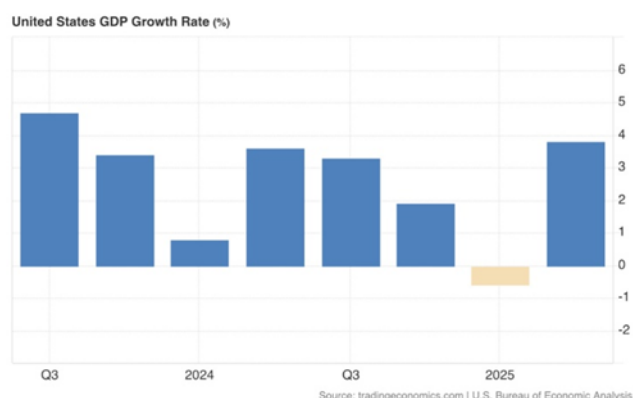
From a broader economic perspective, these trends have created a lasting impediment to potential growth. Protectionist policies have raised unit labor expenses, lowered export responsiveness, and restricted the US economy's ability to take advantage of global demand. Economists project total output losses between 0.4 and 0.6 percentage points compared to pre-tariff forecasts (IMF, 2025). Although reduced imports have momentarily bolstered GDP, the overall decrease in trade volumes indicates weaker external connections and reduced productivity spillovers, implying a transition towards a more consumption-driven yet less efficient growth model.

Economic Growth

US economic growth in 2025 has shown a significant recovery following a contraction earlier in the year, with the driving factors influenced by changing trade patterns, strong consumer spending, and the uneven impact of the "Liberation Day" tariffs. The Bureau of Economic Analysis reported that real GDP decreased by 0.6% in Q1 2025, adjusted from a prior estimate of -0.5%, as the economy adjusted to the initial effects of tariff implementation and tighter financial conditions. This decline was largely attributed to reduced business investment, decreased government spending, and a fall in exports, although it was partially balanced by modest increases in household consumption. Revised higher imports also

negatively impacted growth. Real gross domestic income (GDI) grew by 1.0%; however, it was bolstered by stronger corporate profits and wage growth, indicating that income gains persisted despite the weakness in output. By sector, private goods-producing industries shrank by 5.9%, reflecting a notable downturn in manufacturing and construction, while private services increased by 0.4% and government activity rose by 1.2%, revealing a developing divide between trade-sensitive and domestic sectors.

Figure 2: U.S. GDP growth rate



Source: US Bureau Of Economic Analysis

In contrast, the second quarter saw a notable rebound, with real GDP increasing at an annualized rate of 3.8%, marking the fastest growth since Q3 2023. This growth surge was mainly fueled by an increase in consumer spending, revised upward to 2.5%, with significant contributions from services (+2.6%) and steady goods demand (+2.2%). Fixed investment also gained momentum, rising by 4.4%, driven by equipment (+8.5%) and intellectual property products (+15%), while residential investments and structures remained in the negative. In terms of industry performance, value added in private goods-producing sectors expanded by 10.2%, compared to 3.5% in services, indicating some recovery from the previous contraction. However, the nature of the growth pointed to inherent vulnerabilities: net exports continued to act as a detriment as exports dropped by 1.8%, while imports saw a sharp decline of 29.3% due to weaker global demand and distortions caused by tariffs. The negative impact from private inventories also intensified, deducting 3.44 percentage points from GDP growth. Strictly speaking, the tariff did not “help” accelerate the US economy, but neither was the economy hurt as much as commonly predicted.

Inflation

Following the implementation of President Trump’s “Liberation Day” tariffs in April, inflation in the US

has demonstrated a consistent structural change. According to the Bureau of Labor Statistics, the headline CPI increased by 3.0% year-on-year in September, slightly higher than August’s 2.9% and still exceeding the Fed’s target of 2%. This uptick was primarily fueled by core goods prices, which rose by 1.5% over the year after a long period of stability, as import costs were passed on to consumers. At the same time, a temporary slowdown in Owners’ Equivalent Rent (OER, 2025), which increased only 0.1% in September compared to 0.4% in August, helped to keep headline inflation in check, although economists consider this to be a statistical anomaly.

Analysts from Bank of America, under the direction of Aditya Bhawe, estimate that tariffs currently add between 30 and 50 basis points to core PCE inflation, with consumers bearing 50% to 70% of the total tariff costs. Given that the PCE price index rose by 2.7% year-on-year in August and the effective tariff rate is still on the rise, they anticipate ongoing upward pressure on prices. Additionally, consumer surveys conducted by The Conference Board indicate that inflation expectations have jumped to 5.9% for the coming year, contrasting with the Fed’s outlook for a gradual decrease. While policymakers maintain that the impacts of tariffs will diminish; the combination of rising goods prices and ongoing service inflation implies that achieving a return to 2% inflation, whether measured by CPI or core PCE, may be slower and more unstable than previously thought.

The Labor Market

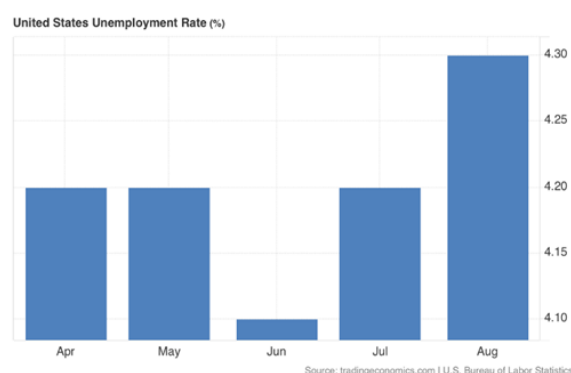
Since the implementation of the “Liberation Day” tariffs earlier this year, US labor market data has indicated a continued decline in sectors affected by tariffs. The Employment Situation report by the US Bureau of Labor Statistics for August revealed that nonfarm payrolls rose by just 22,000, while the unemployment rate held steady at 4.3%, the highest it has been in four years. Industries that have been most impacted by tariffs, including manufacturing, mining and logging, construction, wholesale and retail trade, transportation, and warehousing, have collectively lost approximately 90,000 jobs since February, the last month before the trade conflict escalated. Manufacturing has seen a decrease of 41,000 jobs, wholesale trade of 34,000, and mining and logging of 16,000, which reflects both disruptions related to tariffs and a slowdown in global demand. In contrast, non-trade-exposed sectors like healthcare and social assistance gained 47,000 jobs in August, offering only a slight counterbalance to the losses in goods-producing sectors.

Recent revisions to data have intensified the examination of labor statistics and their political ramifications. The Bureau of Labor Statistics adjusted earlier employment data downward by a total of 258,000 for May and June, marking the largest two-month revision on record outside the pandemic period. This adjustment, influenced by delayed responses from smaller businesses and seasonal recalibrations, coincides with a broader softening in labor demand and underscores the fragility of preliminary estimates during times of economic change. When considered together, the stagnation in employment trends, the disparities across sectors, and the significant historical revisions suggest that exposure to tariffs, tightening profit margins for businesses, and uncertainties in measurement are all contributing to the diminished reliability and momentum of US job growth.

The Sentiment Towards Tariff

The effects of tariffs on consumers have been somehow muted in the first months after their introduction, as companies had built inventories ahead of the duties and absorbed some of the impact through squeezed profit margins (The NY Times). At the same time, different measures of consumer sentiment constantly deteriorated since the beginning of the Trump administration. Consumers began worrying about stagflation, i.e. fewer jobs and higher inflation, when the president started delivering on its tariff promises.

Figure 3: U.S. unemployment Rate



Source: US Bureau of Labor statistics

The share of consumers that spontaneously mentioned tariffs during surveys of the University of Michigan grew steadily between November 2024 and May 2025, just after the “liberation day” announcement and pause of the initial reciprocal tariff schedule. However, the figure moderated in the following months. In August 2025, 76% of consumers expected that they would have to reduce their spending.

Consumers also became increasingly concerned about weaker labor markets. The share of consumers expecting unemployment to worsen in the following year was about 32% in November 2024 but is now about 60%, a figure last seen during the Great Recession (US Bureau of Labor Statistics, 2025).

Business sentiment towards tariffs is divided. According to a survey by West Monroe, in June 2025, one out of three US companies reported that they were experiencing positive effects from duties. Domestic manufacturers are somehow benefitting from protectionist measures, especially in tariff-sensitive industries. For example, trade unions in the automotive industry and steel producers praised tariffs. However, this represents only a portion of the business community, while many others are facing increasing strain from higher input costs and disrupted supply chains.

A survey by the National Association of Manufacturers (NAM) found that optimism among small business owners dropped sharply in Q2, 2025. Only about half of the respondents reported a positive outlook for their companies. The figure later increased in Q3 even as difficulties persisted, likely due to higher expected production and sales. Trade challenges are still considered the top concern, followed by higher input costs (89% of respondents reported that the cost of doing business had increased because of tariffs).

The same survey showed that bond investors’ sentiment saw a complete reversal since the beginning of tariff imposition. In the first months of 2025, bond markets were heavily affected by the announcement of tariffs, amid fears of an economic shock. In the following months, this perspective entirely changed: investors now see tariffs as beneficial for the US public finances and are counting on hundreds of billions of dollars raised by the remaining tariffs to offset Trump’s tax cuts and keep borrowing sustainable. Tariff revenue (exp. \$4tn in the next decade) is seen as the only solution to reduce outstanding public debt in the near term. Rating agencies have indicated that tariff revenues were a factor in their decisions not to downgrade the rating on US sovereign debt, further suggesting this trend.

US equities generally declined in Q1 2025 (S&P500: -4.6%), indicating a dramatic drop in equity investors’ confidence. At the same time, European markets outperformed the US. Investors lost faith in a “Trump put,” i.e. the belief that the Trump administration would back off from severe tariff threats if the market responded negatively. Over the following months, pessimism continued growing.

However, since July, markets turned more bullish as peak uncertainty about tariffs was overcome, and the focus shifted to tax cuts and deregulation. Equity investor sentiment has now evolved to cautious optimism, with resilient markets, despite occasional volatility. This market recovery pattern suggests that investors believe tariff threats are mostly negotiating tactics rather than permanent policy.

Finally, political sentiment towards the tariffs' agenda has been increasingly troubled. Significant dissatisfaction has emerged even within the Republican Party, with prominent figures publicly criticizing the tariffs. Local political leaders from tariff-exposed states/industries are also pushing back.

The Most Affected Industries

The most affected industry was the automotive industry. Trump imposed a 25% tariff on imports of foreign-made vehicles and core car components, such as engines and transmissions. Car manufacturers around the world were adversely impacted after the announcement (especially large-volume German and Japanese manufacturers). Even US automakers were negatively influenced due to outsourced production outside the US (subject to tariffs) and to duties on imported components. According to executives in the industry, these tariffs would increase production costs and generate deep disruptions in the automotive supply chain. This would imply higher end prices and lower US auto production and sales (CNBC, 2025).

The 50% steel and aluminum tariff (and key copper products) raised costs for downstream producers such as appliances, electrical equipment, and wiring (metal-intensive manufacturers). Consumer electronic producers were also heavily affected, even though a levy on semiconductors was later imposed.

Retail and e-commerce firms were strongly harmed, since the 10% universal tariff increased the cost of finished goods to US consumers (as shown by a sharp drop in small-parcel flows).

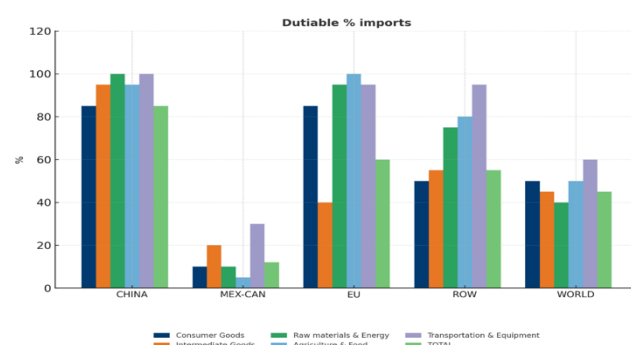
The food industry was hurt as tariffs increased input costs: the US imports more than \$40bn in agricultural products from Mexico and \$45bn from Canada (USDA, 2025). At the same time, retaliatory tariffs hurt the US agricultural sector, pressuring growers on input costs (e.g., fertilizers) and market access (e.g., Canada, China). [Effect on other global economies](#)

The common perception is that tariffs will severely damage domestic economies. Yet what Trump, and many commentators, claim does not always align with the data. For this reason, we examined the US' main global trading partners to assess whether these tariffs have truly been as catastrophic as often portrayed.

After the implementation of the new tariffs, many forecasts portrayed a highly pessimistic trend in trade volume: for example, in April, the World Trade Organization (WTO) expected an 81% trade plunge between the US and China (The Guardian, 2025). During this period, global trade remained above expectations. Even Latin American countries, which were expected to be highly affected due to their huge trade volume with the US and their already fragile economic landscape, are now expected to achieve solid and positive growth rates, according to the most recent estimation carried out by the World Bank (Maloney et al. 2025).

One reason is that the tariffs were there, but the goods on which tariffs were applied, the dutiable share of the imports, were much smaller than declared, and moreover, many countries have successfully reduced their tariff rates through negotiations. Not surprisingly, tariff exemption was on goods critical to the US economy, making up to nearly half of the trade balance of the US with these countries.

Figure 4: Dutiable%Imports by geography



Source: IEP@BU, US treasury data

Another reason for lower effective tariff rates is rule-dodging. A 10-15% non-compliance rate is estimated, and the complex tariff regime likely contributed to such a high rate. One piece of evidence that supports such a theory is the widening gap in trade volume reports between China and the USA. Thus, voicing and relabeling of the products to benefit from tariff exemptions might be reducing the effects of the announced tariff rates (The Economist, 2025).

Finally, one notable point is that many states chose to diversify the countries they trade with rather than implementing retaliatory taxes. Notably, such a trade war would have hit the global economy harder 20 years ago, when the US had a higher percentage of trade volume in the world. However, with the rise in importance of economies like China, the United States has fallen further down the list of most important trading partners for many countries in recent years. As such, many countries, instead of implementing a tit-for-tat retaliatory taxation regime, have resorted to increasing trade with other partners to mitigate the impact of tariffs. (Reuters, 2025)

Going into more detail, let's firstly analyze Canada, a country that enjoys particularly beneficial terms for the USMCA Free Trade Agreement. Mark Carney won the elections at the start of the year, taking into his advantage his perceived authority and ability to deal with President Trump. His first months leading the country have been characterized by very intense and volatile negotiations, as proven by the recent Ontario spot showing Reagan's free trade speech, which enraged the POTUS. The president believes it was done to influence the crucial Supreme Court hearing to assess the legality of the tariffs. It is not a coincidence that it was Ontario and its premier that were particularly opposed to tariffs, as the province is the industrial hearth of the country and relies heavily on US exports. The recent months have been characterized by plant shutdowns and job slashes. Canada enjoys duty-free terms on over 88% of the goods exported to the US due to the CUSMA free-trade agreement between Canada, the US, and Mexico (US Census Bureau Data). But the few sectors impacted, such as steel, aluminum, and automobiles, have been harshly hit. Steel has been imposed 50% tariffs, while automobiles tariffs are up to 25%, and might increase by a further 10% in case the recent threat, following the Ontario's Reagan's spot was to go into effect.

A common trend between the main US trading partners is a surge in exports in the first months of 2025, as a result of a stockpiling process by US companies who wanted to hedge against the rise in prices implied in the tariff imposition, but during Q2 and Q3, data shows a 10-15% total export volume decline compared to last year. Imports have decreased too, but relatively less compared to exports, contributing to the trade surplus reduction, which is one of the main objectives of the American administration.

However, not every country enjoyed the same exemptions that Canada and Mexico benefited from. Infact, during the past 6 months, China was perhaps the country where such a trade war was most readily experienced. However, even China's trade volume remained higher than the aforementioned estimation carried out by the WTO.

China, so far, is not suffering as much as one could expect from this measure imposed by the US, thanks to an export diversification strategy had already started years before the tariffs imposed by the Trump Administration; in fact, it already had significant trade volume with countries like Japan and Vietnam in Asia. In recent years, the EU has become a trading partner at least as important as the US in terms of export revenue, where EU imports from China amounted to €519 billion (Eurostat, 2025), and trade ties with fast-growing markets such as Latin America have also increased significantly. This provides China with a significant hedge against a trade war (Trading Economics, 2025).

However, China had to recalibrate its fiscal and monetary policies in May to maintain its 5% growth trajectory as a reaction to expected tariff threats. Initially, consumer subsidies were increased by \$40 billion, aiming to boost domestic consumption in key sectors like electric vehicles and household goods; however, considering that domestic consumption accounts for only 40% of GDP, a figure approximately 20 percentage points lower than the global average, additional measures became a necessity (Policy Circle, 2025).

Recently, some positive developments were made regarding tariffs when Trump and Chinese communist party president, Xi Jinping, met in South Korea to discuss the new trade truce. In exchange for China taking stricter measures against the fentanyl trade in the United States, continuing to purchase soybeans, a major export item for the United States, and lifting controls on rare earth exports, moreover, China agreed to ease restrictions on US optical fiber imports and US entities and suspend retaliatory tariffs starting November 10 (Reuters, 2025).

In Latin America, even though the region suffered from the effective tariff rates exceeding 10%, "the effects has been less than expected" as Sergio Díaz-Granado, current executive president of the Development Bank of Latin America, said in an interview (Tico Times, 2025). While Latin American countries were expected to suffer a significant growth rate decline due to their high trade volume with the US and their already volatile economic landscapes, many countries have managed to

weather these effects. An important reason is the decline in the US's importance as a trading partner, as China has become the most important trading partner for many Latin American countries over the past 20 years. Secondly, well-established trade networks and deep ties, such as the presence of Hispanics and Latinos within the US, which give the region a comparative advantage over American markets, helped countries to adapt to new tariffs quickly. Finally, many countries were able to renegotiate their tariff rates soon after they were introduced, mitigating the overall effects (Barrons, 2025).

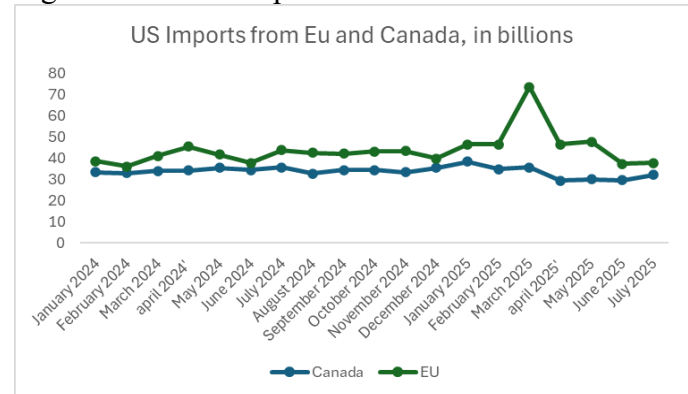
Among Latin American countries, Mexico was highly targeted by the new tariff regime on specific goods. Due to the illegal cross-border trade, a "fentanyl tax" of 25% and a 50% tariff on metals like steel, copper, and aluminum were introduced, whereas most other countries were subject to only a 10% tariff. Another reason why Mexico is exposed to higher rates can be the intention to counter a possible near shoring ducts to the US market. Considering that Mexico has a drastically high export rate of 83% to the US, the initial forecasts were not optimistic (Deloitte, 2025). However, the effective tariff rates remained way under the 25% announced tariff rate, mainly because goods included in the US–Mexico–Canada trade Agreement (USMCA) are subject to exemptions, positioning Canada and Mexico as the countries with the lowest dutiable share. These exemptions include some steel and aluminum products as well, and they account for 49.70% of all exports to the US (IISD, 2025). Thus, effective tariffs, which were around 13% throughout July, decreased to 2.5% as of November and remained below other Latin American countries.

Following the Liberation Day, the Mexican president Claudia Sheinbaum chose to negotiate a discount to the initially introduced tariff rates, addressing the demands, such as more crackdown on drug trafficking and controlling migration, and discouraging the flow of cheap Chinese goods (Americas Quarterly, 2025). Both parties are also expected to finalize an agreement to resolve 54 non-tariff trade barriers, which include matters such as intellectual property rights (Mexico Business, 2025). Hence, Mexico, being a country that pulls a large part of the trade networks of Central America and South America, is expected to recover its investment and export pace (Barrons, 2025)

Turning to Europe, several countries, most notably Germany and Italy, are highly exposed to the U.S.

market, and therefore perceive these tariffs as a significant threat to their already sluggish growth. Yet, according to many experts, what has weighed more heavily on the EU economy over the past year is not the tariffs themselves but the euro's sharp appreciation against the dollar. The exchange rate climbed from 1.02 USD to peaks of 1.18, effectively acting as an indirect tax on American consumers and dampening the competitiveness of European exports

Figure 5: US imports from EU and Canada



Source: US Trade Census Bureau

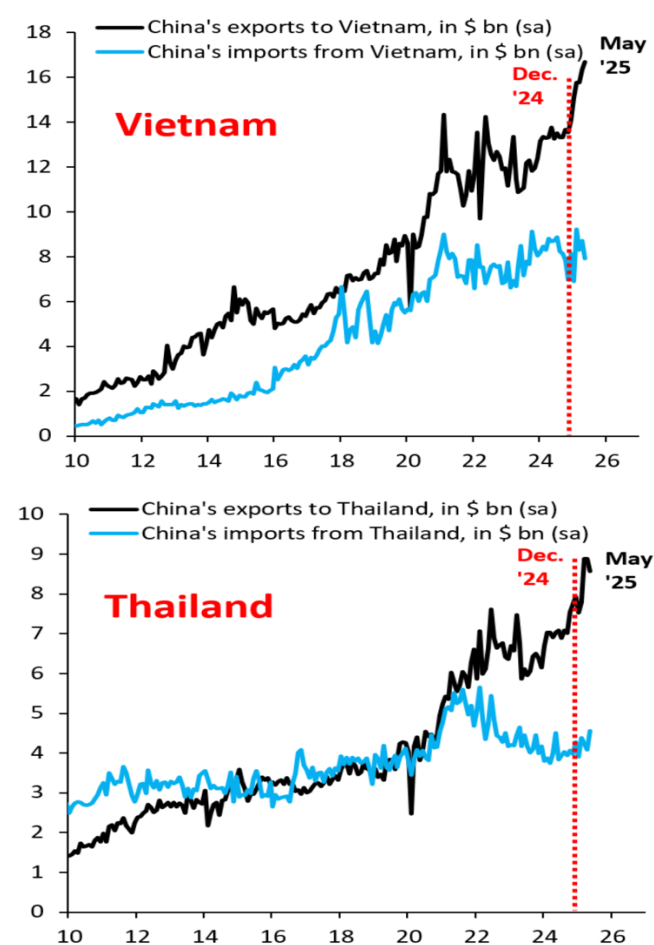
Looking at the broad picture, the EU does not enjoy of the same duty-free advantages as Canada and Mexico do, since most of its goods exported are under a 15% blanket with some carve-outs. This broad tariff estimated on the EU at 15% puts the bloc in a relatively advantageous position compared to its competitors in Asia, but worse off than the UK, Mexico and Canada (IEP@BU, 2025). As seen in US imports from EU, the first months of the year, particularly March, have shown record values in exports due to the anticipation of the Liberation Day tariffs. The rest of the year has seen slight decreases, and exactly the front-loading of the previous months. As expected, the Trade Surplus has fallen down to €6.5 billion in August 2025, from the usual values in 2024 oscillating between €16 and €19 billion (EUROSTAT, 2025). In the case of Italian high-end exporters in particular have relatively "benefited" from these tariffs, as Made-in-Italy is not a price-sensitive product and consumers are willing to spend more for higher quality. This has been helped by the higher tariffs imposed on competing exporters in Asia. Italian exports to the US have fallen in August by over 20%, also due to the front-loading of the start of the year, but have rebounded in September, mostly driven up by the naval sector (ISTAT, 2025). The sectors which have been hit hardest are the automotive and metallurgic. Of particular interest to the Italian economy is the Trump announced tariff rate of 100% on pasta imports, that is supposed to

enter in act starting from January 2026 and would strongly hit the Italian agricultural sector, but there is still ground for revisions of the measure. The imports from the US have slightly declined if we look at Q2 and Q3, but relatively less than exports and have therefore brought down the Trade Surplus. In conclusion, those exporters that can count on the higher perceived quality of their products might benefit from the tariffs, but there is still uncertainty over the next months to assess whether the increased costs will be passed to consumers and how they will react to it. Sectors like automotive, steel, and pasta are the ones that might incur the highest losses.

Trade reallocation and Chinese exports reallocation

Vietnam and Thailand have emerged as a key transit hub for Chinese exports amid the trade tensions. Right before the US announced new tariffs in 2025, looking at figure 6, is clear how Chinese exports to both countries spiked anomalously, far beyond their own demand needs. (R. Brooks, 2025)

Figure 6: Chinese trade by partner



Source: Brookings

The timing suggests that Chinese exporters were anticipating the tariffs and routing goods through Vietnam and Thailand in advance for transshipment (i.e. rerouting Chinese goods through those countries

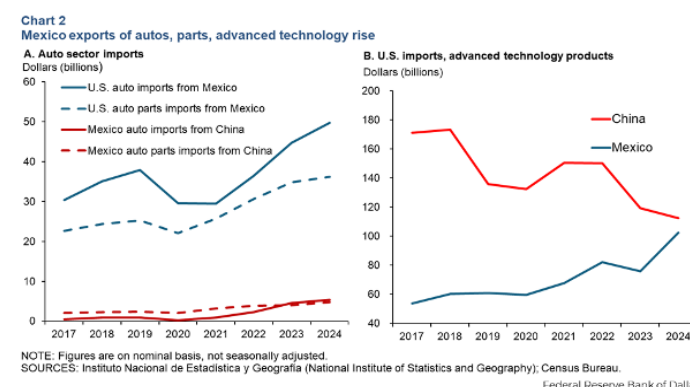
to disguise their origin). As a result of that, the drop in China's direct trade surplus with the US by 2025 was "fully offset" by a rise in its surplus with other countries, especially Vietnam and Thailand (Brooks, 2025). Evidence of transshipment builds up when US imports from Vietnam and Thailand sharply increased starting from March 2025, particularly in consumer goods (Stanford Center on China's Economy and Institutions, 2023).

For example, Vietnam is now the second-biggest foreign furniture supplier to the US, on track to overtake China. In the first 7 months of 2025, Vietnam shipped \$8.2 billion in furniture to the US, just behind China's \$8.4 billion (Lewis).

This trend has been reinforced by rising Chinese foreign direct investment in manufacturing plants in Vietnam and Mexico. In other words, Chinese firms are setting up production in these "friendshore" or "nearshore" locations to assemble or finish goods that ultimately ship to America. Through these channels, China "remains important in US supply chains" despite the fall in direct exports (Stanford Center on China's Economy and Institutions, 2023).

In response, the US threatened Vietnam with steep tariffs and in July 2025, they reached a deal to cap the new tariffs at 20 % with commitment to tighter enforcement. Goods found to be falsely relabeled "Made in Vietnam" would now face a punitive 40% US tariff. In addition, Vietnam passed its own regulations penalizing mislabelling and increased inspections of high-risk exports, including steel, bicycles, batteries, and furniture (Linktrans Logistics, 2025). Through this crackdown, Vietnam aims to demonstrate that it will not serve as a pass-through for Chinese goods, in order to preserve its US market access under lower tariff rates.

Figure 7: Mexico's Nearshoring Boost



Source: NISG, Census Bureau

Mexico also benefits from the shift due to its location and free-trade privileges under USMCA. As tariffs hit China, shipping volumes from China to Mexico

increased 28% and in January 2024 alone, they were up 60 % compared to the previous year (Xeneta). This makes Mexico one of the fastest-growing trade lanes in the world. Much of these goods are not intended for Mexico's market as they "will likely be trucked into the US," effectively using Mexico as a "back door into the US" for Chinese products.

The strategy is particularly evident in the automotive and electronics sectors. In recent years, numerous Chinese auto-parts and electronics firms have established operations in Mexico to serve the US market.

As figure 9 illustrates, Mexico's auto imports from China and its exports of autos and advanced technology products to the US have risen sharply, with Mexico now poised to surpass China in high-tech exports. Lower US tariffs on Mexican goods (0–2.5% versus 25% on Chinese products) make this production shift highly advantageous, spurring Chinese investment and helping Mexico overtake China as a key US supplier (Financial Times, 2024).

After the US–China trade tensions in 2018-2019 and the launch of the USMCA in 2020, Chinese foreign direct investment in Mexico increased drastically (Kelly, 2025). By 2023, \$1.1 billion worth of components were exported to US buyers by 33 Chinese auto-parts companies in Mexico, which is \$711 million more than in 2021 (Financial Times, 2024).

To limit the backdoor, Mexico started raising its own tariffs on Chinese goods over the past 2 years. In 2024, Mexico raised tariffs on over 500 Chinese products, with some rates reaching 50%. The auto sector was initially left out, likely to avoid disrupting local and US key supply chains. But by late 2025, it proposed broader tariffs that included cars and auto parts to cut dependence on Chinese inputs. Since then, Mexico's imports from China have started to slow, dropping about 3% in the first nine months of 2025 (Kelly, 2025).

Conclusion: Advantages and drawbacks of the Tariff - 2026 Policy expectations.

After six months of implementation, the Liberation Day tariffs are some of the most impactful trade policies in modern US history. The Trump administration invoked the International Emergency Economic Powers Act (IEEPA) as an incentive towards economic security and increasing industrial self-sufficiency.

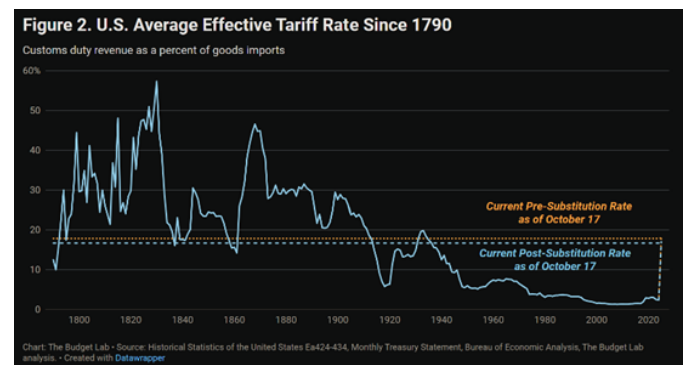
So far, the macroeconomic fallout has been less severe than many early projections suggested. The International Monetary Fund (IMF) revised its 2025

US growth forecast upward to about 2 percent, emphasizing that tariffs have been "less disruptive for now" thanks to resilient consumer spending and front-loaded imports

Inflation remains above the Federal Reserve's 2 percent target, but far below fears of a sustained 1970s-style shock. Industrial production and factory utilization improved modestly in tariff-protected sectors such as steel, batteries, and semiconductors, supporting the administration's argument that selective protection can stimulate domestic capacity.

Politically, the tariffs have become a negotiating instrument rather than a fixed barrier. On 4 November, the White House issued an order capping Chinese duties at 10% add-on and continue to hold trade talks. This signaled a shift from confrontation to conditional collaboration. Similarly, other mini-deals with Asia partners have been re-negotiated, easing uncertainty and offered much better tariff deals for said countries. These arrangements suggest that tariffs now serve more as a lever for negotiation than a wall of protectionism.

Figure 8: U.S. Average effective tariff rate



Source: HSUS, Bureau of Economic Analysis

Yet the costs are tangible. Analysis by the Tax Foundation estimates that the average US household paid roughly \$1,200 in 2025, rising to \$1,600 in 2026, in higher consumer prices tied to tariff pass-through. The Yale Budget Lab reports an effective average tariff rate of 17 percent—the highest since the 1930s—and a 1.3 percent increase in the consumer price level, equivalent to about \$1,800 in lost real income. For firms, the greater burden lies not in duties paid but in planning uncertainty. Oxford Economics notes that persistent tariff threats (whether actually implemented or not) have discouraged corporate investment and make long-term supply-chain planning much more complicated.

Globally, the World Trade Organization (WTO) estimates that trade volume growth will slow to about 2 percent in 2026, (down from 3.3 percent in 2025) as front-loaded shipments unwind and firms adjust sourcing patterns. The Economist Intelligence

Unit (EIU) expects global GDP growth of 2.4 percent in 2026, which reflects continued weakness in industrial output and persistent policy unpredictability. In short, while US macro resilience has bought time, the tariffs are beginning to establish new global trade flows and investment patterns, with early beneficiaries including Mexico, Vietnam, and India through re-routed production.

The legal dimension remains the largest structural risk. According to Reuters, the Supreme Court is scrutinizing the administration's use of IEEPA for broad tariff powers; several justices have questioned whether Congress intended such latitude. If the ruling turns out to limit executive authority, a shift to narrower statutes can occur, which will lead to problems related to reauthorization or refunds which can potentially disrupt trade for a long period of time. Even if the government prevails, the case still emphasizes the fragility of an approach that depends so much on executive power.

2026 Policy Outlook

2026 is likely to mark a phase of consolidation rather than escalation in US trade policy. In the base case, the administration will stick with the Liberation Day framework and keep on expanding selective exemptions to contain inflation, as well as maintaining political flexibility. This is the continuation of 2025's pattern. Policymakers would likely not opt for large reversals, but rather smaller deals that help tame inflation, which is otherwise impossible if the overly broad tariffs remain.

Macroeconomic conditions will put this balance to test. Forecasts from the IMF, EIU, and Oxford Economics show that US real GDP will grow around 2 percent in 2026, with inflation fluctuating between 2.5 and 3 percent. Tariff revenue is expected to stay rather consistent as import volumes moderate. This would limiting fiscal relief as household costs remain elevated. Global wise, the WTO foresees continued trade deceleration. However, no collapse is seen, suggesting that supply-chain reconfiguration will be the main trend in the next phase.

The Supreme Court ruling will be highly influential: a decision opposing IEEPA powers would likely force the White House to restructure tariffs under new legal mechanisms. Such a scenario could do damage to business confidence in the first half of 2026. Conversely, an affirmation of executive latitude would encourage continuity but raise uncertainty about future use of emergency authority power. Either outcome keeps the US trade environment unsettled through mid-2026.

Regionally, the USMCA 2026 review will be of

utmost importance. The re-negotiation of rules of origin, dispute-settlement provisions, and labor-environmental standards will shape whether North America strengthens integration or diverges into managed protectionism. The Chicago Council on Global Affairs warns that a fractious review could reintroduce cross-border frictions while a cooperative outcome could lock in supply-chain resilience across autos, energy, and advanced manufacturing, partially offsetting global trade headwinds.

Beyond 2026, the Economist Intelligence Unit anticipates a gradual normalization of tariff levels, contingent on inflation trends and geopolitical stability. However, should price pressures re-accelerate or global tensions intensify, the tariffs could become a semi-permanent feature of US industrial policy, a fiscal lever and signaling tool for strategic rivalry.

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