

## Australia Viewpoint

# Caught in the (tariff) crossfire: Australia's growth risks

### Australia's growth risks in focus

Despite Australia faring quite well with the "liberation day" 10% tariff lower bound, the escalating trade war between the US and China (Australia's largest trading partner) puts the impact on economic growth and inflation in focus (Exhibit 1).

### Growth at risk: ~0.5ppt downside looms...

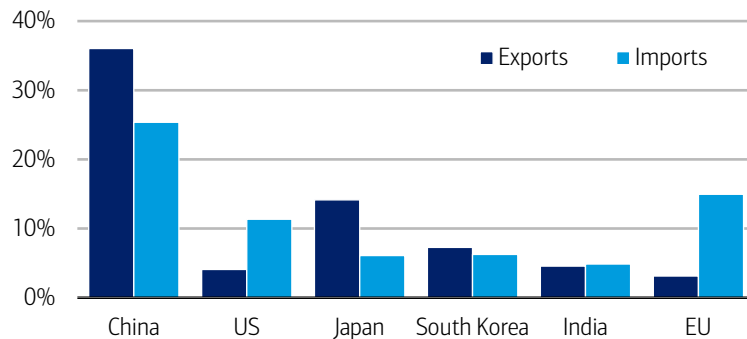
Australia entered 2025 with growth accelerating and a tight labour market, but we estimate the global trade shock leads to downside growth risks of around 0.5ppt. This reflects a modest direct effect, but larger indirect effect through lower global growth (primarily China) with negative spillovers, heightened uncertainty, and lower confidence. Supportive fiscal and monetary policies, and a likely reduction in some tariff rates, should somewhat offset the negative growth hit.

### ... with inflation also likely to decline

The overall impact on inflation is uncertain, but we see risks as skewed to the downside. Trade diversion effects will likely lower import prices as some global exports are redirected to Australia. But inflationary pressure could increase through supply chain disruptions and a lower AUD pushing up import prices.

#### Exhibit 1: Australia goods trade by destination (% of total, 2024)

Direct exposure to US tariffs is small, but indirect through China is large



Source: ABS

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### Australia well-placed for an exemption

Australia is well-placed for exemption on at least some exports due to the US trade deficit, FTA, and security relationship. Stimulus measures, combined with the possibility of lower trade barriers with non-US countries over time, should also support growth.

### RBA to cushion the blow

We retain our call for the RBA to cut by 25bps in May, and don't believe the current outlook and elevated policy uncertainty warrant an unscheduled RBA meeting or 50bps cut in May. The risk distribution has shifted to the RBA easing more than our forecast of 75bps in 2025, but given the uncertainties we think the RBA will likely assess the growth and disinflationary impact of tariffs in the hard data rather than rush to preemptively cut.

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## Negative growth shock, spillovers matter

We estimate the global trade shock leads to downside growth risks of ~0.5ppt. This reflects a modest direct effect, but a larger indirect effect through lower global (primarily China) growth. Supportive fiscal and monetary policies are expected to provide some offset, as will a likely reduction in some tariff rates.

The direction of growth risk (downside) is clear in our view, but the magnitude is highly uncertain and depends on tariff negotiations, retaliation, and the fiscal and monetary response. We assume tariffs are mostly a negotiation tool so some of the current tariffs may eventually be negotiated away, but the China conflict is geopolitical so tariff rates are likely to remain high at least through 2025 (see report: [Global Economic Weekly: The bond market triggers the Trump put](#)).

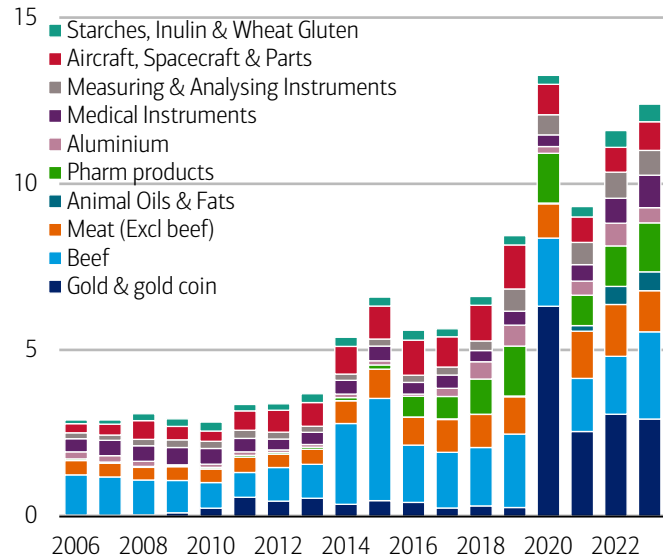
### Direct effects likely to be 5-10bps of GDP

The US only accounts for around 4% of Australian goods exports, with beef, gold, and pharmaceuticals the largest exports (Exhibit 2). Although some products are exempt for now (e.g. pharmaceuticals), we estimate a blanket 10% tariff on Australian exports will lead to an 8-20% drop in export volumes to the US, which would lower GDP by 5-10bps over 2-3 quarters (up to 30bps over three years).

However, this may overstate the negative direct effect as 1) Australian exporters may have a relative price advantage against other countries facing higher US tariffs, and 2) recent history suggests many exporters can successfully redirect exports. This also assumes the 10% tariff remains, but we believe Australia is well-placed to receive some form of tariff exemption, which may lead to a small positive effect given the relative price advantage.

**Exhibit 2: Major goods exports to the US (A\$ bn)**

Beef, gold and pharma are key Australian exports to the US



Source: ABS, Macrobond

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**Exhibit 3: Nominal trade-weighted index**

Lower exchange rate expected to buffer the economy



Source: RBA

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### Global growth shock indirectly lowers GDP

Indirect effects are likely to lower GDP growth by around 0.4ppt in 2025, on our estimates. But there are multiple possible channels, and the magnitude is highly uncertain.

Most notably, the hit to Australia's key export markets, particularly China, should lower domestic growth through reduced export volumes, lower commodity prices and the



negative impact of increased uncertainty and lower confidence (see report: [Global Economic Viewpoint: Kitchen sink tariffs](#)).<sup>1</sup>

On the positive side, a lower exchange rate will help buffer the export sector. The AUD TWI has fallen around 5% since the US election in November 2024 (Exhibit 3). Estimates suggest a 5% TWI depreciation typically leads to a c.50bps increase in GDP and a 20bps decline in unemployment after 1-2 years.

### **Substitution effects could indirectly lower exports**

Substitution effects may weigh on Australian exports as some countries may increase imports from the US as a negotiation tactic, which could crowd out imports from Australia. For example, Australia accounted for the largest share of LNG imports in China, Japan and Korea in 2024, but our economists expect Asia will likely import more LNG from the US as part of trade negotiations (see report: [Asia in the shadow of US tariffs](#)).

### **Chinese fiscal stimulus to help offset the growth hit**

Fiscal stimulus to offset the effects of tariffs may also lead to increased demand for Australian exports. Historically, Australia's GDP and terms of trade have benefitted from China's strong fiscal response to global growth shocks.

Our China economists see monetary easing from the PBoC in the near-term, and a sizable fiscal stimulus (as much as RMB2tn, or 1.5% of GDP of stimulus) to boost both consumption and investment that could be rolled out as soon as the Politburo meeting in late April (see report: [Unpacking the potential fiscal stimulus package amid tariff shock](#)).

The overall impact of Chinese fiscal stimulus on Australia will be determined by both its size and its composition. If stimulus swings more towards investment, then the impact on steel demand, and Australia's main exports, would be larger. While commodity prices are traditionally the dominant channel, consumption-focused stimulus is becoming increasingly important for Australian growth. Services exports, especially education, and manufactured food exports (e.g. dairy products and food supplements) have expanded rapidly due to China's growing middle-class.

### **Uncertainty is the only certainty**

Elevated uncertainty will likely lower GDP and lead to a weaker labour market. Uncertainty typically delays hiring and investment decisions that are costly to reverse (i.e. the 'real options' channel in theory) and may lead to precautionary savings that lowers discretionary consumption. In response to the uncertain environment, RBA Governor Bullock recently stressed their focus is on how uncertainty is affecting decisions made by households and businesses in Australia.

### **Beef without borders: redirecting exports**

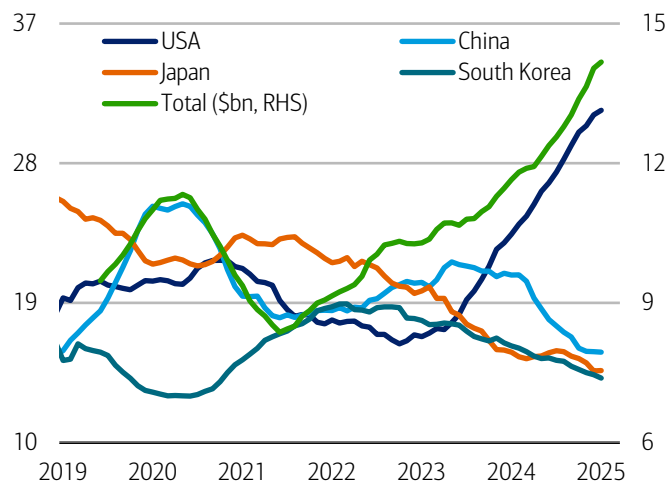
Beef is Australia's largest export to the US, accounting for c.8% of total exports. President Trump specifically called out Australian beef import restrictions on US beef as a key reason behind the 10% tariff on Australian exports. We can use the 2020 China–Australia beef import ban as a case study to see how beef exporters may respond to increased tariffs.

In 2020, China suspended imports from 10 large beef abattoirs as China–Australia relations deteriorated during the early stages of the pandemic. At the time, beef exports to China were growing strongly and accounted for around 24% (A\$2.7 bn in 2019) of beef exports, double the value of China beef exports in 2018 (Exhibit 4).

<sup>1</sup> Research suggests the direct effects of a 5% decline in Chinese GDP lowers Australian GDP by 1.3% over 3 years (growth by 0.8ppt y/y) but increases to 2.5% when considering indirect effects (e.g. weaker confidence, financial market volatility). See 'Spillovers to Australia from the Chinese Economy' by Rochelle Guttmann, Kate Hickie, Peter Rickards, and Ivan Roberts.

**Exhibit 4: Beef exports by destination (% of total, LHS)**

Beef exports to the US rose strongly over 2023/24, crowding out exports to Asia

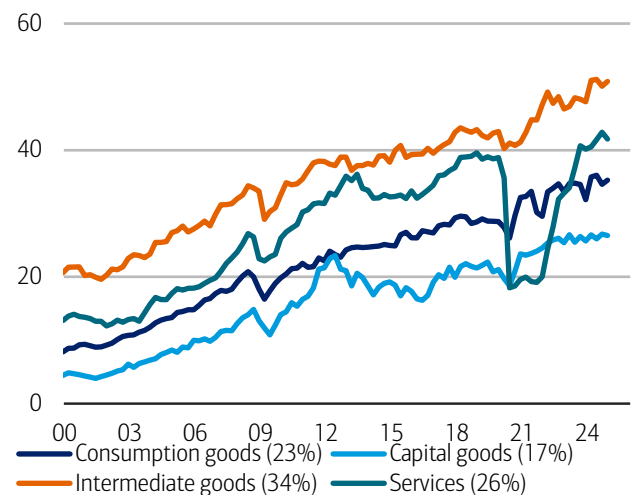


Source: ABS

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**Exhibit 5: Import volumes (A\$ bn)**

Australia may import deflation directly through consumer goods, and indirectly through intermediate and capital goods



Source: ABS, RBA

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Despite the bans, beef exports reached record highs in 2023 and 2024 as some beef exporters redirected to other markets. The value of beef exports to China remained strong as and some processors were not subject to restrictions, rising from \$2.1 billion in 2022 to \$2.5 billion in 2023. Beef exports to the US grew particularly strongly in recent years alongside broader strength in US consumption.

While US tariffs on Australian beef will hurt some individual beef exporters, we view the macroeconomic effects as mild for two reasons:

- **Exports to China set to rise.** In December 2024, all restrictions on beef exports to China were removed, and given the tariff-imposed price differential and China consumer-focused stimulus, some beef exports may shift from the US to China. US beef exports to China (around US\$125 million monthly) may also decline sharply given high China-US tariffs, which may support Australian beef exports.
- **Relative prices.** By country, US imports the most beef from Canada (30%), Australia (23%), Mexico (20%), and NZ (12%). If other beef exporters end up with a higher tariff rate, then Australia would be a beneficiary on a relative price basis, all else equal.

## Inflation effects skewed to the downside

The overall impact on inflation is uncertain, but we view risks as skewed to the downside. Trade diversion effects will likely lower import prices, as some global exports targeted by tariffs are redirected to Australia. Lower import prices would put downwards pressure on inflation, both directly through services and consumer goods (around half of imports) and indirectly through cheaper input costs (Exhibit 5).

Oil prices have fallen c.20% since April 2, which will put downwards pressure on inflation. The negative growth shock will also ease capacity constraints and help reduce domestic price pressures.

Upward pressure on prices could come from higher global trade costs as supply chains adapt to increased trade restrictions and geoeconomic fragmentation (Exhibit 6). US exports may also increase in price due to increasing costs in integrated US supply chains because of tariffs (US accounts for 11% of Australian imports).

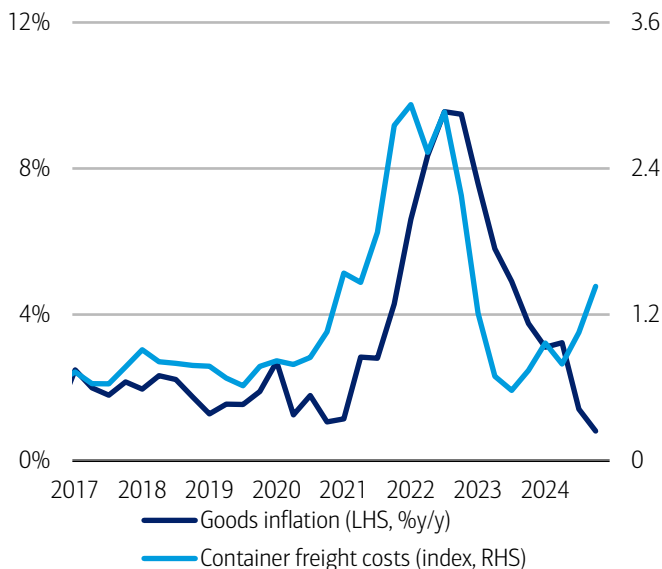


A lower AUD would push up inflation through higher import prices. Estimates suggest a 10% AUD depreciation would increase consumer prices ~20bps after one year and about 1% over three years. We estimate larger exchange rate pass-through for tradable goods, but AUD movements still have a less than one-to-one effect on these prices (Exhibit 7).

The overall effect on inflation is uncertain as it depends on the relative magnitude of these channels and the RBA response, but we view risks as skewed to the downside.

#### Exhibit 6: Shipping costs and goods inflation

Freight costs may rise as supply chains adjust to changing trade dynamics

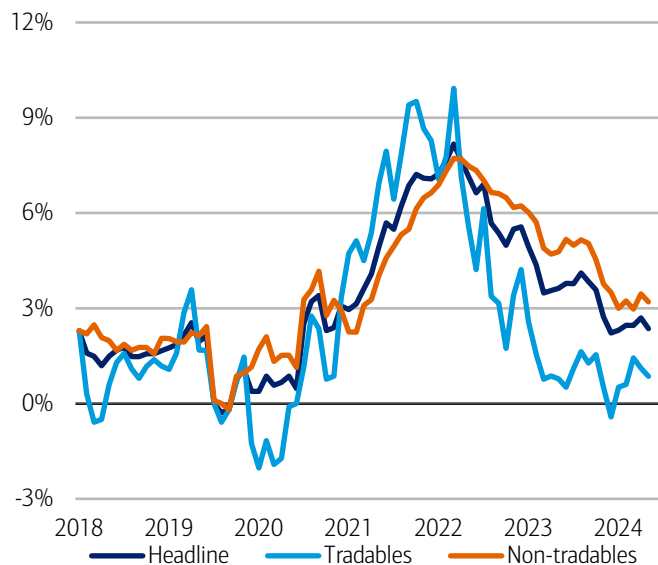


Source: China Ministry of Transport, ABS, Macrobond

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#### Exhibit 7: Tradable and non-tradable inflation (% y/y)

Tradables account for around one-third of the CPI basket



Source: ABS

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## Australia well-placed for an exemption

The Australian government is lobbying for a tariff exemption and have ruled out imposing retaliatory tariffs on the US. We believe Australia is well-placed to receive an exemption on at least some exports due to the trade deficit with the US, FTA, and security ties.

### Targeted fiscal response to support demand

Prime Minister Albanese announced a range of measures to support Australian firms in response. So far, Albanese's response includes establishing a A\$1 billion interest-free loans scheme for firms to expand into new export markets, strengthening the anti-dumping regime, A\$50 million in funding for industry groups to find new customers, and creating a critical minerals strategic reserve. He has also left open the option of filing challenges in the WTO under the provisions of the bilateral FTA.

Australia is in the middle of a tight election campaign ahead of a May 3 vote. Albanese and opposition leader Peter Dutton have both ruled out easing Australia's agriculture biosecurity regime or the Pharmaceutical Benefits Scheme in an attempt to placate US trade officials.

### Shifting trade dynamics: EU and India possible FTAs

Over the medium term, the increased focus on trade policy may help lower trade barriers with non-US countries and support Australian exports.

The EU is Australia's third largest trading partner, but still only accounts for 3% of goods exports, implying large possible upside for Australian exports. Australia-EU FTA talks broke down in 2023 with agriculture being a main sticking point. However, the EU have

recently agreed to revisit negotiations following the increased focus on trade policy due to US tariffs.

India is Australia's fourth largest export market and has strong long-run growth prospects. Negotiations are underway for a comprehensive trade agreement that builds on the Australia-India Economic Cooperation and Trade Agreement.

Prime Minister Albanese has signaled Australia is focusing on strengthening and broadening exporting relationships outside of the US. Australian Trade Minister Don Farrell has recently held meetings with representatives in Japan, Singapore, and South Korea.

## Dovish RBA implications

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We expect the RBA to cut by 25bps in May, and don't believe the current outlook and elevated policy uncertainty warrant an unscheduled RBA meeting or 50bps cut in May as some have suggested. Nevertheless, the risk distribution has shifted to the RBA easing more than our forecast of 75bps in 2025 in response to global and domestic downside growth risks.

Market pricing has shifted notably since April 2, with 35bps currently priced for the May 19-20 meeting, and the implied cash rate declining to around 2.85% in late 2025.

We believe the RBA will likely assess the growth and disinflationary impact of tariffs in the hard data rather than rush to preemptively cut. The RBA will have an updated set of forecasts at the May 19-20 meeting, by which time the inflation implications of the trade shock will be (slightly) clearer, and more data will be available on the growth impact and speed of labour market easing. Globally, trade policy developments and fiscal stimulus in China will be particularly relevant for the RBA's growth and policy outlook.

Given the very uncertain environment, while the cash rate direction is clear, the terminal rate is much less so. Large cash rate movements (e.g. 50bps cut in May) are optimal when the policy rate is far from the desired level, but when global policies are highly uncertain with two-sided inflation risks, we believe a more cautious approach is warranted. The starting point – underlying inflation above target, unemployment rate below the NAIRU – also suggests the RBA has time to assess.

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