AXA Investment Managers

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Investment Institute Macroeconomics

Grey Blueprint

- We look at the implications of the UK-US deal for other countries further down the "negotiation waiting line"
- Industrial globalisation has been slowing down. It is not – yet – true for trade in services.

Now that the Fed has made it plain that it would not offer any pre-emptive support, the pressure on the White House to de-escalate on the trade front is getting more intense. The "piece de resistance" will of course be the talks with China – with the first discussions in Geneva qualified as yielding "substantial progress" by Scott Bessent but without clear content as of Sunday night– but the deal with the UK is a first sign that negotiations can yield tangible results. The UK-US deal will not be easily replicable though. We doubt other countries – even among the strategic allies of the US – will get as favourable conditions as the UK.

Even if the UK-US deal turns out to be the general blueprint, it is not a very engaging one. The 10% "basic tariff" (still four times the pre-Trump average rate) looks non-negotiable beyond very small carveouts, and US concessions come with clear limits. The UK may have found some protection for its car industry's current volume of exports to the US, but in practice, it is now faced with a cap on any expansion. Even the carveout on steel and aluminium comes with "security conditions" which we suspect entail a decoupling from Chinese inputs and investment. Besides, we find it surprising that a debate has not yet started in the UK on whether preferential treatments for US products may make talks with Brussels on better access to the EU market – more central for the British economy – more difficult.

Yet, crucially, no quid-pro-quo on services was included in the UK deal, despite London's readiness to revisit its Digital Services Tax. Any expansion of the trade war to services would be another blow to globalisation. The rise in the trade intensity of global industrial production has been slowing down over the last 15 years: the "enthusiastic phase" of industrial globalisation ended well before the surge in mercantilism in the US political life. Conversely, global trade in services continues to make progress. The US has a vested interest in promoting free trade in services given its dominant position there. The blow could come from those trying to retaliate against US protectionism on goods. Given the share of services trade in their GDP though, higher than in the US, such path would not necessarily work in the best interests of the Europeans

Powell is waiting comfortably

There was nothing particularly striking in the Federal Reserve (Fed)'s press conference last week. Upon keeping policy rates unchanged, the Federal Open Market Committee (FOMC) refused to engage in firm forward guidance – both were widely expected by analysts. The statement made it plain that the Fed is increasingly concerned about stagflationary scenarios, noting that risks are to the upside for both unemployment and inflation, but Powell in the Q&A was very forceful on the fact that at this stage it was not clear which of these risks was the most acute – uncertainty has increased *"further"* in the statement – and candidly stated that "rate cuts may be appropriate, or not". He also highlighted how it is unclear whether tariffs will have a transitory or persistent effect on inflation. Powell's final point on the "*economy is doing fine*" – he downplayed the negative print for Q1 GDP as the result of pre-tariff trade gyrations (we agree) – and his explicit mention of a "wait and see" attitude show that the FOMC is certainly not in a hurry to make decisions, even if he conceded that they could act fast if need be.

Unsurprisingly, this attitude was met with tough criticism by Donald Trump – who called Jerome Powell "a fool" for not cutting rates – but for **now the Fed Chair does not seem to hit difficulties from *within* the central bank to steer his cautious course**. The decisions last week were agreed unanimously at the FOMC, and even those who have expressed sympathies for a more accommodative approach, for instance Christopher Waller who recently opined on the transitory nature of the inflation shock triggered by a tariff hike, for now at least are not breaking ranks, even if we will need to read carefully the minutes of the meeting though to get a sense of possible nuances within the committee. It may well be **that the attack on the Fed's independence is in fact strengthening Powell's internal position, since FOMC members who might disagree intellectually with him on the appropriate monetary policy trajectory may not want to be seen as yielding to external pressure.**

Such unanimity may be more difficult to maintain in the last months of Powell's mandate, since some FOMC members may want then to position themselves for his replacement, but the macro situation will have changed by then. Externally, we noted an interesting piece by Bloomberg News highlighting a high level of support for Powell in the Republican caucus in Congress, with some members going on the record to praise him as a "stabilising force." We covered in detail two weeks ago in Macrocast the legal risks around the Fed's independence resulting from cases which are going to be examined by the Supreme Court before the summer recess, but support for the current Fed Chair in Congress would restrain Trump's capacity to appoint someone with radically different views.

Overall, this strengthens our view that the Fed will not engage in pre-emptive accommodation. We continue to think they will end up cutting, when the impact of the tariffs becomes tangible on the labour market, but that is for the second half of the year.

What to take away from the US-UK deal

While there is still a lot that needs to be clarified, the US-UK deal announced last week is being scrutinized everywhere as it may be seen as a "blueprint" for more agreements to come. We think however that **there are specificities to the UK/US trade relation which limit the lessons we can draw from this framework agreement**. First, the UK has been pursuing a trade agreement with the US for years, with renewed intensity after Brexit, something on which the EU had de facto given up after the failure of the Transatlantic Trade and Investment Partnership (TTIP) negotiations launched in 2013 under Obama and formally closed in 2019. A lot of groundwork had already been laid by previous British governments, and contrary to the EU, London had immediately taken a conciliatory approach to Trump 2.0. Second, the UK is one of the few countries with which the US does not have a bilateral trade deficit. This explains why the UK escaped any country-specific "reciprocal tariff" on top of the basic 10% on "Liberation Day" – the EU was hit by a 10% "add-on". We should therefore take the US-UK deal as probably one of the best ones which can be negotiated in the current circumstances. This has been confirmed by D. Trump himself during his press conference, as he hinted at higher tariffs for other countries further down the waiting line.

The UK deal appears as collection of sectorial agreements – with a lot of details still to be hammered out – but crucially, **the 10% "basic" tariff stays**. For instance, the UK will be able to export to the US up to 100k cars per year at a tariff of 10% (it was 2.5% before Trump's re-election), anything above this would pay the "new normal" 25%. Interestingly, 100K is precisely the number of cars the UK exported to the US last year. In other words, **what the US has created is a de facto cap on car imports from the UK**. Should Jaguar Land Rover want to sell more cars to the US than today, they would be better off producing them in the US. **The UK, under this deal, will not be able to present itself to the rest of the world as a potential base for exporting cars to the US.**

The transactional approach is dominant. Rolls Royce will be able to export tariff-free its parts and engines to the US aircraft industry, while "a UK airline" will buy GBP10bn worth of Boeing planes. The same logic applies to food: British farmers will be able to export 13k tons of beef to the US tariff-free, and US farmers will be able to export to the UK the same quantum of beef tariff-free. The British government stated that this agreement would not result in a lowering of British sanitary and phytosanitary regulations. In practice, this is likely to restrict imports to US Non-Hormone Treated Cattle (NHTC), a program launched in the US in 1999 to fit European rules. While this may be symbolically important, it is irrelevant economically (c. USD100mn).

Some key sectors are not addressed in detail or are left with wide space for interpretation. For instance, the UK government's communique states that British steel and aluminium would pay zero tariff, while the "general terms" of the US text (see link here), while confirming the removal of the 25% tariff on these products for UK exporters, points to "*negotiating an alternative arrangement*" towards a *"quota at most favoured rates for UK steel and aluminium"*. This is certainly not a promise for zero tariff (the default rate on steel and aluminium in the US, pre-Trump, stood at 5.3%). Pharmaceuticals will be subject to specific discussions, but Trump stated that on these, the UK would receive preferential treatment.

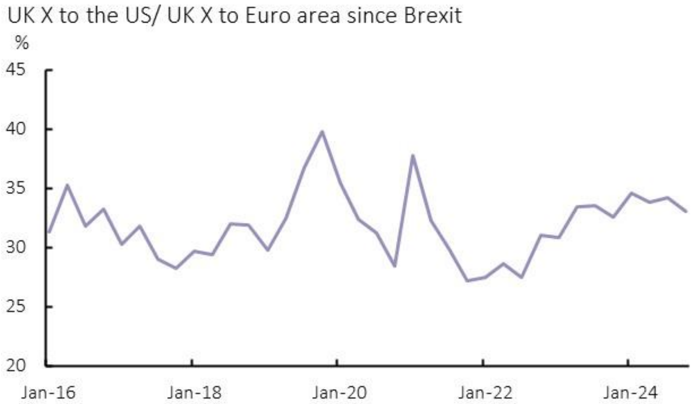
Another crucial feature of the deal – in terms of what it could indicate for agreements with other parties – is the US focus on "security concerns". Indeed, for instance in the part on steel and aluminium, the quota for UK exporters will depend on work on British supply-lines and "ownership." We suspect that this simply means that **British producers will need to completely decouple from Chinese inputs, and Chinese investment, to benefit from preferential access to the American market.**

Another area to monitor is the extent to which the UK will offer **preferential treatment to the US products**. For instance, on top of the deal on beef London has accepted to let US-made ethanol enter tariff free on the UK market. **This would not normally comply with the World Trade Organization rules, in particular the "most favoured nation" (MFN) clause,** according to which, if a country grants a specific trade benefit to one World Trade Organisation (WTO) member, it should extend it to all other members (it is a non-discrimination guarantee). There are exceptions to the MFN principle, but normally only within comprehensive free trade deals (e.g. the EU's single market). The US-UK deal does not fit this definition. This would be another dent into the already eroding WTO order. That the UK – a standard bearer for multilateralism and free trade – accepts this is another important symbol of the "deglobalisation trend".

We find it interesting that the same week the US-UK deal was struck, the European Commission published a list of American products which could be hit by retorsion tariffs if the negotiations fail. The EU side made a completely different choice from London. Size matters there. Beyond the fact that there is no bilateral trade deficit to "correct" from the US point of view when it comes to the UK, **the White House can accept to be "magnanimous" since imports from the UK in 2024 were only one tenth of what the US received from the EU**. Rebalancing trade with the EU is a key battle for D. Trump, in his "zero sum" view of international trade, and Europeans probably made the calculation that "starting tough" was a better negotiating tactic than beginning the talk with a conciliatory tone.

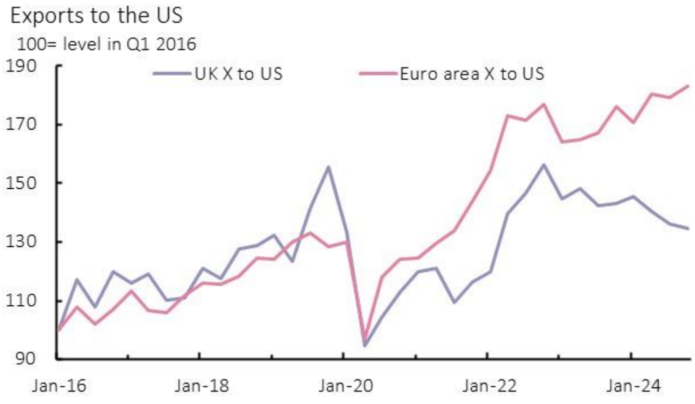
Trade dynamics were also strongly incentivising London to try to secure an agreement almost at all costs. The initial post-Brexit strategy was to offset an unavoidable loss of market share on the EU market by focusing on the US and emerging countries. Nine years after Brexit, there is no strong evidence that UK exporters have been able to get much traction from the US: in 2016, British shipments to the US stood at one third of their shipments to the EU. There have been fluctuations since then, but in early 2025, the proportion was the same as in 2016 (Exhibit 1). Over these nine years, on the US market, Euro area exports have markedly outperformed their British competitors (Exhibit 2). **Starting from an already fragile position, London absolutely needed to clinch a deal to try to at least preserve its competitive position in the US.**

Exhibit 1 – What next on UK/EU trade?



Source: Office for National Statistics and AXA IM Research, May 2025

Exhibit 2 – Weak UK performance on the US market



Source: Office for National Statistics and AXA IM Research, May 2025

Incidentally – and we are surprised that this issue is not more prominent in the British commentariat – **a question arising from the deal with the US is whether it could make trade talks between London and the European Union more difficult**. Indeed, should the "preferential treatment" offered to US products materially deteriorate the competitive position of European products on the British market, Brussels may push for tougher conditions in exchange for improving access to the European single market. Given the respective size of the two markets for British producers, this could matter more, from a macroeconomic point of view, than the deal with the US.

Beware the services issue

Surprisingly, the framework agreement between the US and the UK did not immediately affect trade in services. Indeed, the British government had immediately offered, at the very beginning of the talks with the new US administration, to review its digital tax, set at 2% of revenues earned in the UK from social media platforms, search engines and online marketplaces. The individual payers of the Digital Service Tax (DST) are not known, but according to a report from the UK National Audit Office 90% of the tax proceeds came from just five groups, which are very likely to be American operators, a point forcefully made in a report by the US Trade Representative in 2021 – i.e. under Joe Biden – which called the UK DTS *"discriminatory against US companies"*.

There is a strong, fundamental disagreement on taxing digital activities across the Atlantic. The Internet Tax Freedom Act (ITFA) – which makes it very difficult in practice to tax any digital activity in the US – was passed in 1998 under bi-partisan sponsorship, and regularly renewed to be finally made permanent in 2016 with wide Congressional support. This contrasts with the EU: even though the Commission's plan for an EU-wide DST launched in 2018 has not yet come to fruition, several member states (e.g. France, Italy, and Spain) have proceeded with their own DSTs. We were expecting quantified concessions from London on this front. Instead, the deal stipulates that *"both countries confirm that they will negotiate an ambitious set of digital trade provisions that will include within its scope services, including financial services."* There is thus more to come on this front.

Tangible goods have been the focus of the trade war so far, but from the start a concern for us is whether we should brace ourselves for an extension to services. Donald Trump's mention of "tariffing" foreign films distributed in the US was a first warning. Dynamically, international trade in services should deserve more attention. Indeed**, while "de-globalisation" may already be substantial on trade in goods, the same cannot be said of services exchanges.**

The Dutch Central Planning Bureau (CPB) has been maintaining a very useful series of the *volume* of trade in goods since the beginning of the century. The slowdown after the Great Financial Crisis (GFC) of 2008-2009 is plain to see (Exhibit 3). This cannot be ascribed to a mere adaptation to a slower underlying growth rate in economic activity. The CPB also maintains a world industrial production index weighted according to each country's share in world imports. Industrial production is a good proxy for "tradable activity," i.e. the share of the economy which is the most prone to international exchanges. The ratio of the volume of world trade in goods to global industrial production has been stagnating over the last 15 years, contrasting with the sharp increase seen in the first decade of the century (Exhibit 4). In other words, **the "enthusiastic phase" of industrial globalisation ended with the GFC, pre-dating the mercantilist wave in US politics.**

Exhibit 3 – Post 2009 slowdown in global goods trade

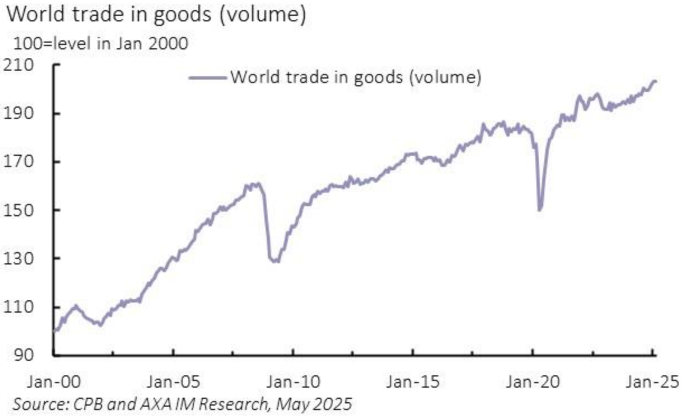
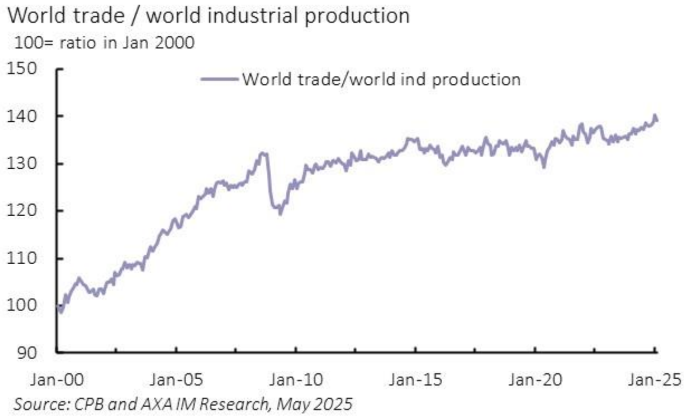
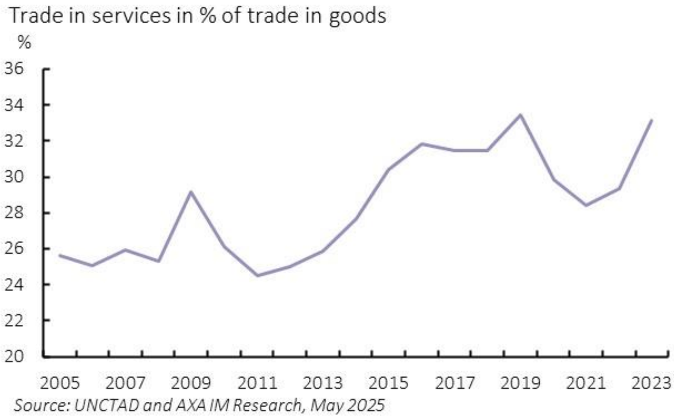


Exhibit 4 – Stagnation in the trade intensity of production Ad



There was no such change of intensity for services. Using the UN Trade and Development (UNCTAD) value data, trade in services stood at a quarter of trade in goods in 2005. The ratio moved up to one third by 2024 (Exhibit 5). This is still relatively small, but the contrasting dynamics are obvious. This is where the next big trade battle is likely to be waged, if de-globalisation becomes ever more pervasive.

Exhibit 5 – From one quarter to one third



It would however be irrational for the US to start such battle given their still prominent role in global services trade. Indeed, as of 2024 the US share in world exports of services stood at nearly 13%, far ahead of the second-biggest player, the UK (Exhibit 6). While net trade in goods usually contributes negatively to US GDP growth meaningfully, net trade in services often brings a small positive contribution (Exhibit 7), and of course this does not take into account the indirect benefits services exports provide to the US economy (we have already made the point in Macrocast that Google employs more people in the US than Ford motors). **Washington is thus likely to focus on dismantling on non-tariff barriers weighing on the further expansion of global trade in services.**

Exhibit 6 – Clear US dominance

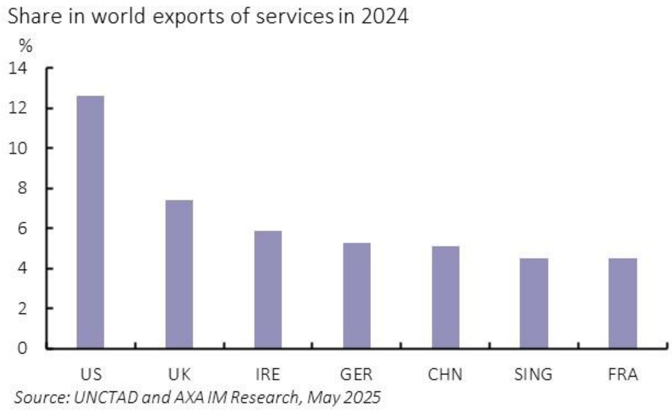
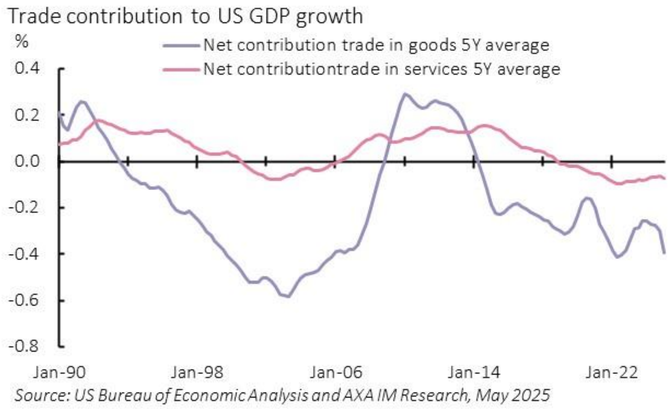
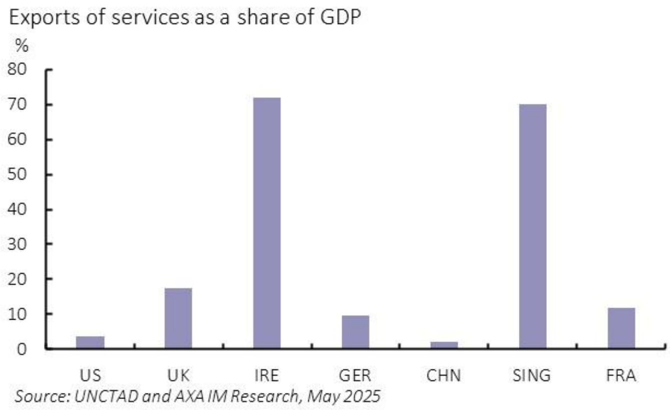


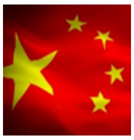
Exhibit 7 – Contribution from net trade to US growth



If there is a threat to global services trade, it may well come from those seeking to retaliate against US tariffs on goods. For now, the list of US products susceptible to be hit published by the Commission on 8 May (for consultations terminating by 10 June) covers only goods, but Ursula Von der Leyen has publicly mentioned a few weeks ago the "bazooka option" of going after US services, which the European Anti Coercion Instrument allows. From an overall macroeconomic point of view, an extension of the trade war to services could ultimately be detrimental to the EU. Indeed, **while the US is the dominant exporter of services in the world, the share of these exports in its GDP is comparatively small** (Exhibit 8). Without even mentioning the specific case of Ireland, the services exports to GDP ratio is three to four times higher in the UK, Germany, and France, than in the US. Europeans should tread carefully on this path.

Exhibit 8 – A comparatively small share of GDP in the US



Country/Region	What we focused on last week	What we will focus on in next weeks
	• FOMC meeting left policy unch at 4.50% as expected. Powell warned Fed could not be pre-emptive. We now see first cut only in Sept. • ISM services index (Apr) rose to 51.6 from 50.8, better than other indicators but still soft • Jobless claims continue at low 228k • Fed 1yr inflation expectations stay high at 3.6% • Trade balance (Mar) rises sharply to $141bn, from $123bn	• CPI inflation (Apr) expected at 0.3%mom headline and core, will strip out tariff and non-tariff effects • PPI inflation (Apr) also expected firmer on tariffs • Retail sales (Apr) gauge any post-surge unwind as well as any tariff impact. Control group f'cast stable • Empire and Philadelphia Fed indices (May) watch for directional impact in first month after tariffs • Michigan Uni consumer sentiment (May, p) watch for further falls in sentiment and increase in prices
	• Ge Chancellor Merz sworn in • EZ services PMI (Apr, f) revised marginally higher on net to 50.1 from 49.7 (p) • Ez retail sales (Mar) -0.1%mom from +0.2% Feb	• European Commission to publish Spring economic forecasts • Ez industrial output (Mar) expt'd solid gains, reflecting individual states increases last week • Ez employment (Q1) rose just 0.1%qoq in Q4 • Ge ZEW survey (May) some rebound expected
	• Final composite PMI (Apr) fell to 48.5, from 51.5 in Mar. • Construction PMI (Apr) broadly unch at 46.6, from 46.4 • BoE rates & MPR: 25bp cut vote split 0-2-5-2. Inflation and growth lower but hawkish meeting • RICS (Apr) price balance dropped to -3, from +2	• BRC retail sales (Apr) look for slight pick up on seasonals • Labour market (Mar/Apr) look for signs of weakness on NIC change and wage growth easing slightly • GDP (Q1) we look for a 0.6% increase but underlying growth likely weaker
	• Final composite PMI (Apr) up at 51.2, from 48.9 • HH spending (Mar) up 0.4%mom and 2.1%yoy • Av. cash earnings (Mar) edged down to 2.1%, from 2.7% • Leading Eco Index (Mar) down at 107.7, from 108.2	• Eco Watchers Survey (Apr) look for drop in sentiment towards next 12 months • PPI (Apr) look for small mom rise • GDP (Q1) look for sluggish growth in Q1, following strong Q4, as consumption eased
	• Caixin sevcs PMI (Apr) down to 50.7 from 51.9 • PBoC cut RRR by 50bps to 9%; and 10bp reduction on 7-day OMO to 1.4% • Exports (Apr) rose by 8.1%, weaker than 12.4% in March, but rather mild damage from tariff • Imports (Apr) up to -0.2% from -4.3%	• Total social financing (Apr), watch if credit demand holds up, especially household loan • PPI inflation (Apr) is expected to deepen the contraction • CPI inflation (Apr) likely to stay stable at very week positive or minor negative level
	• CB: Brazil (50bps hike to 14.75%), Czech Republic (25bps cut to 3.5%), Poland (50bps cut to 5.25%), Malaysia (unch 3.0%) • GDP (Q1 yoy): Indonesia (4.9%), Philippines (5.4%) • CPI (Apr yoy): Thailand (-0.2%), Czech Republic (1.8%), Taiwan (2.0%), Mexico (3.9%), Hungary (4.2%), Chile (4.5%), Turkey (37.9%) • Industrial production (Mar yoy): Hungary (-5.4%), Czech Republic (1.4%), Brazil (3.1%), Malaysia (3.2%)	• CB: Mexico (50bps cut to 8.5%), Romania (unch 6.5%) • GDP (Q1): Colombia, Malaysia, Poland, Romania • CPI (Apr): Colombia, India • Industrial production (Mar): Colombia, Mexico

Upcoming events	US:	Tue: NFIB small business optimism (Apr), CPI (Apr); Thu: Retail sales (Apr), PPI (Apr), Initial jobless claims (w/e 10 May), Philadelphia Fed Index (May), Empire state mfg survey (May), IP (Apr), Business inventories (Mar), NAHB housing index (May); Fri: Housing starts (Apr), Michigan consumer sentiment and inflation expectations (May)
	Euro Area:	Tue: Ge ZEW survey (May); Wed: Ge HICP (Apr), Ge CPI (Apr), Sp HICP (Apr); Thu: Fr HICP (Apr), Ez GDP (Q1), Ez IP (Mar); Fri: Fr ILO (Q1), It HICP (Apr)
	UK:	Tue: BRC Retail sales monitor (Apr), Unemp (Mar), Avg earnings (Mar), Private sector regular pay (May); Thu: GDP (Q1, p), Business inventories (Q1, p), GDP (Mar), Index of services (Mar), IP (Mar), Total trade
	Japan:	Fri: GDP (Q1, p)
	China:	Sat: CPI and PPI inflation (Apr); Next week: total social financing, new loan growth, M2 money supply (Apr)

Our Research is available online: www.axa-im.com/investment-institute

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*As at the end of June 2024, including non-consolidated entities.
** As at the end of December 2023.

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