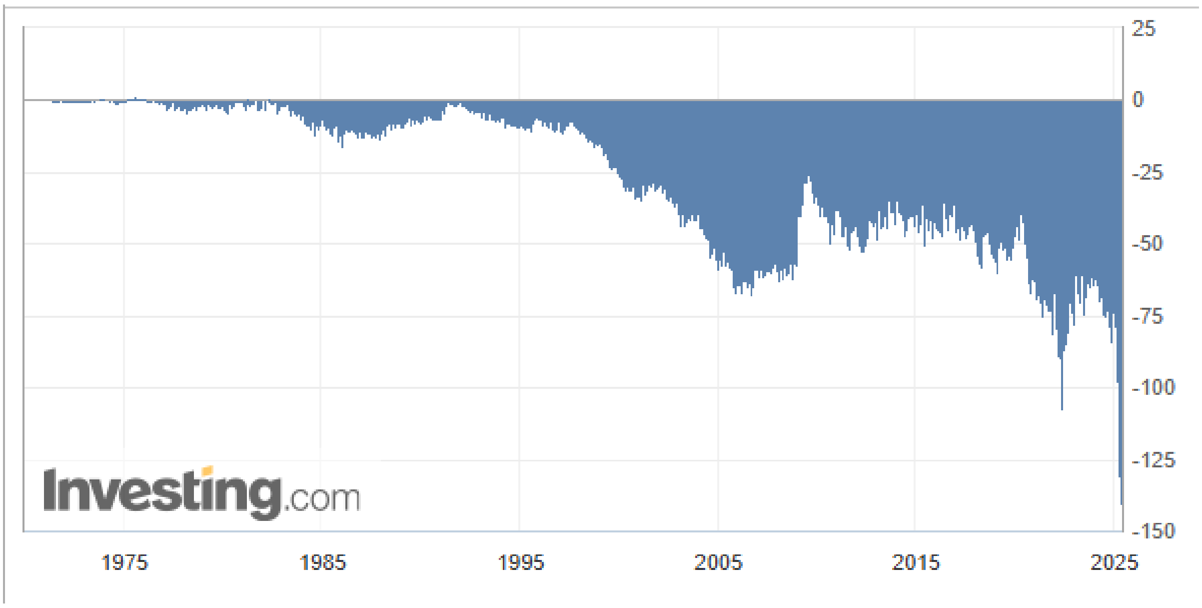
Deals, Deficits and Disputes – Just another week in the Global Economy

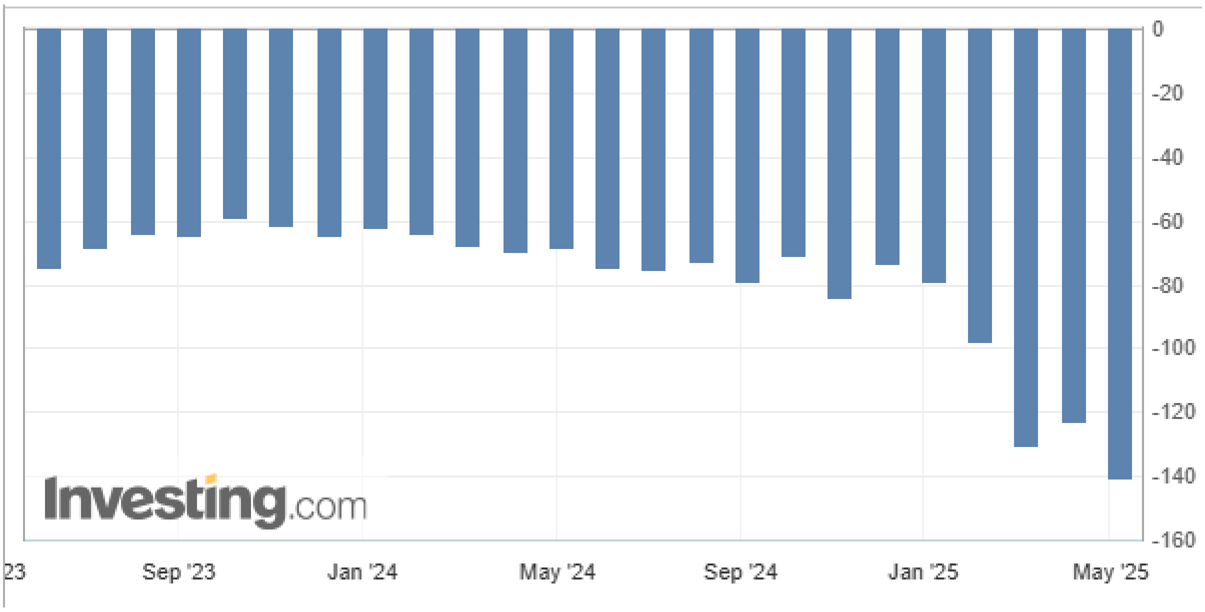
One small blessing of the current geopolitical and macroeconomic environment is that there is not a week goes by where we have nothing to write about, and this week is no exception.

If we start with some of the data that we're interested in, and following on from last week's update, the US Balance of Trade figures were published on Tuesday. As we noted last week US GDP "fell off a cliff" primarily because of the front loading that US importers did, ahead of the tariff announcements, whereby they accelerated their imports in a stockpiling exercise to defer the impact of tariffs.

This "front loading" showed up very visibly in the Balance of Trade figures (the difference between US exports and US imports) with the US running its biggest ever deficit (i.e. more imports than exports). The following chart shows the scale of the US trade deficit since 1970 with the first 3 months of 2025 marking the deepest ever deficit:



Bringing the scale in a little to the last 2 years gives an even clearer picture of just how sharp those deficits are:



The average monthly deficit in 2024 was -$74.01bn so the -$140.5bn deficit in March is getting to almost double the 2024 average. Of course, the expectation is that imports will dry up significantly over coming months and the inventory stockpile in the US will be used to meet demand for the next few months. Over time therefore a mean reversion is expected.

The danger however for both importer and exporters is that the inevitable short-term decline in demand from the US becomes prolonged and therefore causes a disruption to supply chains. We would then have a “double whammy” of the inflationary impact of tariffs, compounded with inflation from supply chain damage.

Taking an opposite view, however, if trade deals get done then we could actually end up with an inventory problem in the US, which could be deflationary. Balance of Trade figures are therefore something that we are paying close attention to.

On that note there were some surprising figures out of China this morning which showed that compared to 12 months’ earlier exports increased by 8.1%, well ahead of the expected figure of 1.9%. This was achieved largely by China successfully diverting its US exports to South Asia and Europe.

At the same time China’s imports shrank significantly, with almost all of the shrinkage attributed to a fall in imports from the US.

This gives China a stronger hand going into crucial talks this weekend with the US over the current trade war impasse. Senior officials including Scott Bessent are to attend, so these will be in depth, progressive talks. In the meantime, Trump plans to rescind some of Biden’s AI chip export restrictions which may give China a brief window of access to more cutting-edge technology until a multilateral export-control regime, coordinated by the US and its allies, can be implemented.

We are beginning to see progress on trade negotiations elsewhere and equity markets are trending from sanguine to optimistic as a result. The UK has crossed the line first with a "breakthrough" trade deal with the United States which will eliminate the 25% tariff on UK Steel & Aluminium, reciprocate vehicle tariffs of 10% with a quota of 100,000 UK vehicles, remove a 19% tariff on US ethanol, give UK pharmaceuticals and aerospace products preferential treatment, and increase agricultural access but maintain UK food standards.

Beyond the headline, this is not that significant, and the broad 10% tariffs on all US imports from the UK will remain, with further negotiations ongoing. The UK represents one of the most lightly affected countries in the wake of Liberation Day so there may be more optimism to be gained from other deals.

There has been little progress in talks with the EU which is for now taking an alternate approach, instead launching a dispute with the World Trade Organisation. This is yet another legal challenge to go along with 231-and-climbing domestic law suits against the Republican Administration.

The UK has also finalised three years of negotiations with India concluding a comprehensive free trade agreement which will remove tariffs on 99% of UK exports which represent 1.5% of GDP.

The UK government expects the deal to increase UK GDP by £4.8 billion and UK wages by £2.2 billion each and every year "in the long run" but the key concession is that Indian workers relocating to the UK will be exempt from NI contributions for the first three years making them temporarily cheaper to employ than their local counterparts. While this will be reciprocated for UK workers relocating to India, it is unlikely to be a welcome move just a week after the electorate shared their discontent by backing the Reform party in local elections.

The other big set piece data points were the US and Central Bank interest rate decisions, where the US Federal Reserve opted to stay on hold at 4.5% whilst the UK Bank of England opted for a rate cut of 0.25% to 4.25%. Both of these came in as expected, although the US Federal Reserve is undoubtedly under huge political pressure to cut rates.

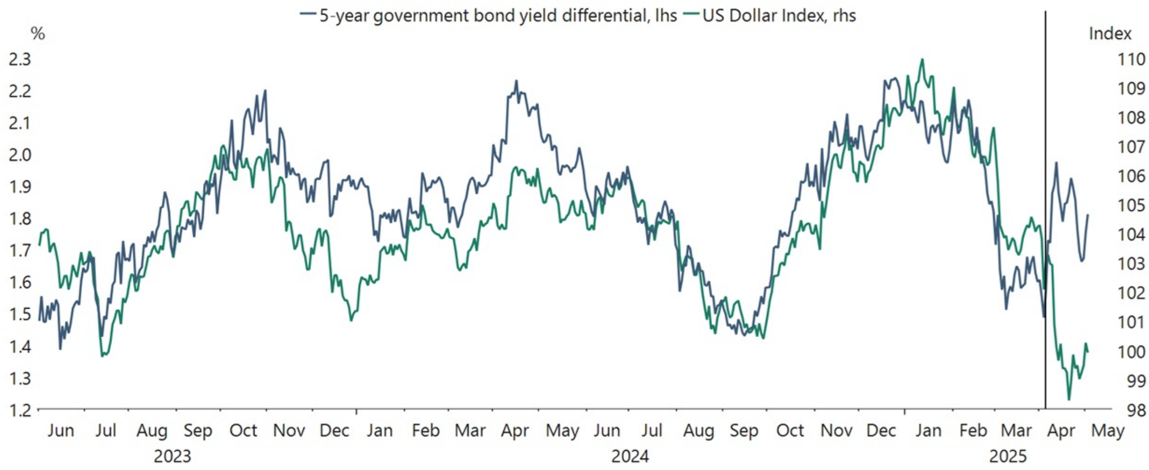
The Chair of Fed, Jerome Powell, cited the level of uncertainty created by the tariff and trade wars commenting that if the tariffs as currently proposed remain in place they are likely "to generate a rise in inflation, a slowdown in economic growth, and an increase in unemployment". This earned him a rebuke from the President who branded him "a fool".

The UK reduction was inevitable given the very weak growth that the economy is seeing and the fact that inflation, for now at least, is receding. There was however some surprise that the rate cut decision was not a unanimous vote from the 9 committee members, where 2 voted for rates to remain on hold.

These interest rate policy differentials were sufficient to see the GBP:USD rate weaken from its recent highs, although we think it is inevitable that both central banks will enter into a rate cutting cycle again this year. The market is currently pricing in 2- 3 rate cuts in both countries, although with a bit less certainty for the UK, given the aforementioned unexpected voting pattern.

There has been a notable dislocation in the value of the US dollar when compared to interest rate differentials. Normally, higher US interest rates are matched by the dollar strengthening sufficiently to balance out the extra yield so investors wouldn't gain an advantage. Lately, though, this relationship has broken down:

After Liberation Day, the dollar has disconnected from interest rate differentials

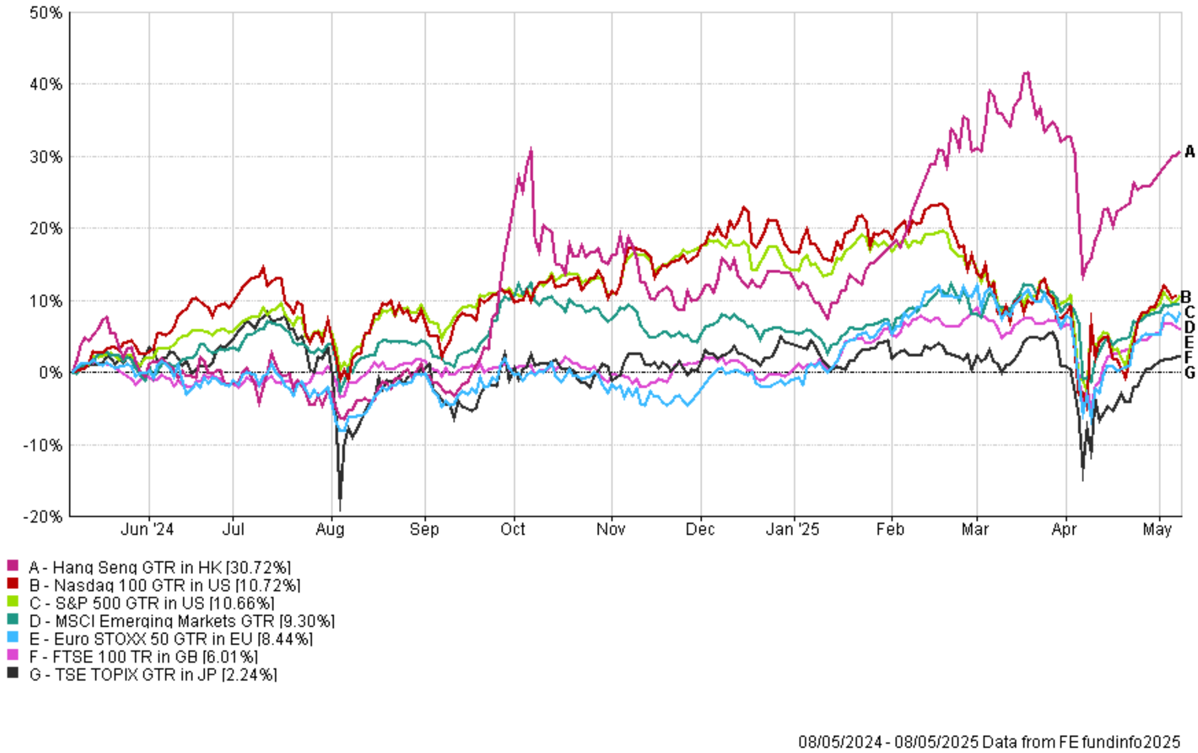


We see this as a potential opportunity but the narrative around the US dollar has turned sour in 2025, with concerns that global holdings of US dollar denominated assets may be reduced. The Taiwanese dollar spiked by near 10% this week and the Korean Won sits at a six-month high as domestic institutions sought to hedge the currency risk of some of their huge Net Foreign Asset holdings. This is being compared to the inverse of the circumstances that led to the 1997 Asian Financial Crisis.

These two countries represent the two larger economies that should structurally reconsider their US dollar exposure, but the other significant holder of US assets is China, and that represents another significant card in its hand going into trade negotiations.

Where are markets up to?

The rolling 12 month % cumulative returns in local currency from various indices is shown in the following chart:



Where are the portfolios up to?

The portfolio performance, net of fees, to close of business on Thursday is as follows:

	1 week	1 month	3 months	12 months
Cautious	+0.39%	-2.72%	-4.55%	+0.58%
Balanced	+0.72%	-5.09%	-6.92%	-1.25%
Adventurous	+0.76%	-6.46%	--8.27%	-2.72%

As ever, if you would like to discuss any aspect of your portfolio, please do not hesitate to contact us on service@blythefinancial.com.