

# Flash Macro Update

TARIFFS | April 2025



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## What You Need to Know

### 1 How are we thinking about the Trump administration's approach to tariffs?

**The 'Liberation Day' tariff plan President Trump rolled out on April 2nd was far more aggressive than we and markets expected. Inflation will rise and growth will be dented more than we originally anticipated, with a mild U.S. recession risk now on the table in coming quarters. See below for details, but for 2025, we lower U.S. GDP to 0.5% growth from 2.1% while Europe falls to 0.6% from 1.0%. Meanwhile, in China, we forecast 4.3% from 4.4% previously.**

**A key area on which to focus now includes shifting stimulus drivers around the world.** For example, the U.S. is in a unique position in that it has both a fiscal headwind from DOGE (around 60 basis points in 2025) and the negative impact from tariffs (approximately 250 basis points in 2025). By comparison, both Europe, Germany in particular, and China are accelerating fiscal tailwinds, helping offset drags from tariffs (*Exhibit 5*). So, the asynchronous global recovery is shifting from the Americas to Europe and Asia, an important change, we believe.

**Looking at the bigger picture, Liberation Day accelerates our *Regime Change* thesis, which has been driven by heightened geopolitics, bigger fiscal deficits (now growing more in Germany and China), a messy energy transition, and stickier inflation.** This is a new era where, as General David Petraeus has been saying, we have shifted from benign globalization to one of great power competition.

**For markets, diversification, non-correlation, operational levers, and upfront yield will matter more.** Credit is likely to bend not fully break, we believe, while Public Equities will likely be de-rated until there is more visibility on policy and growth. We see a weaker dollar, but do not see wildly higher bond yields. Our key themes,

including Intra-Asia Trade, the Security of Everything, Productivity, and Collateral-Based Cash flows, will all gain momentum in this new world order.

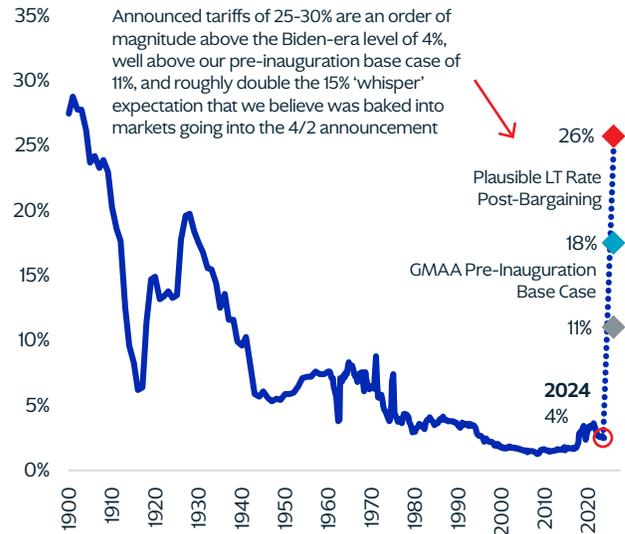
## What Happened

**The tariff plan President Trump introduced on ‘Liberation Day’ was significantly more hard-hitting than we or the markets anticipated.** Details include 10% across the board tariffs effective on April 5th, plus additional country-by-country add-on reciprocal tariffs on April 9th. China, for example, sees an incremental increase since January 1st of 54% (68% in total). Overall, U.S. average tariff rates could be as high as 25-30% if left unchecked (*Exhibits 1 and 5*). This is an order of magnitude above the Biden-era level of 4%, well above our pre-inauguration base case expectation of 11%, and roughly double the 15% ‘whisper’ expectation that we believe markets had baked in going into the announcement. Incredibly, the tariffs will be above 1930s Smoot-Hawley levels, which were around 20% in the U.S.

**No doubt, the Trump administration’s approach to tariffs has proven much blunter than market sentiment coming into this year.** The extent and breadth of tariffs differs markedly from the strategic and targeted approach Trump took in relation to China tariffs in 2018-19 (e.g., segmenting imports into four lists, with higher rates placed on goods for which there were greater alternative sources). The President is also operating with less regard than we expected for the economic dislocations that policy uncertainty creates. In our view, the tariff announcements represent an important structural change in the way the global economy is currently integrated. It also puts an exclamation point on General Petraeus’ view of transitioning from “benign globalization towards one of great power competition”, especially towards China (where our 34% estimate for tariffs was just too low).

**Exhibit 1: Announced Measures Will Take the U.S. Effective Tariff Rate to the Highest Levels in the Past 100 Years (Above Smoot-Hawley Era Peak of 20%)**

### U.S. Effective Tariff Rate (%)



Data as at March 5, 2025. Source: U.S. Bureau of Economic Analysis, Haver Analytics, KKR Global Macro & Asset Allocation analysis.

**Exhibit 2: Headline Tariffs Introduced on 4/2 Represent an Outsized Fiscal Tightening of Roughly 2.5% of GDP, Which Would Take All-In Federal Tax Collections to the Highest Level in Recent History**

### U.S. Federal Net Tax Revenue, % of GDP

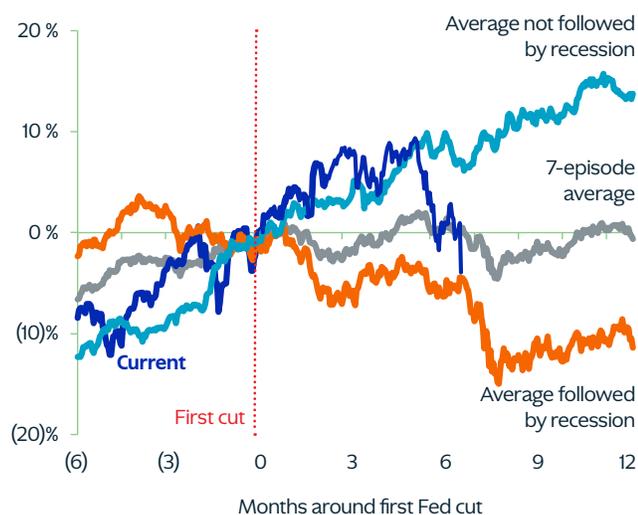


Data as at March 5, 2025. Source: U.S. Bureau of Economic Analysis, Haver Analytics, KKR Global Macro & Asset Allocation analysis.

**Given both the aforementioned breadth and depth of tariffs, growth will be dented more than we originally anticipated, with a mild U.S. recession risk now on the table in coming quarters.** As context: the tariffs represent a U.S. fiscal tightening on the order of 2.5% of GDP, which—all else equal—could take the aggregate U.S. federal tax rate to the highest level this century (*Exhibit 2*). Beyond this direct fiscal drag on growth, one must also subtract a headwind from retaliation by trading partners on U.S. exports, which as a baseline, we are modelling as about half the rates that are imposed by the U.S. Regardless of what happens, the potential for messy negotiations around tariffs, currency manipulation criteria, etc., is quite broad and subjective. If there is good news, it is that the March U.S. jobs data suggested we entered trade negotiations with solid momentum.

### Exhibit 3: The Market Has Now Begun to Price in Some Form of Recession

#### S&P 500 Returns Around the Start of Fed Cutting Cycles



Data as at April 5, 2025. Source: Goldman Sachs Research, KKR Global Macro & Asset Allocation analysis.

On the international front, tariffs will have a dampening effect too on growth, as well as the aforementioned on affect flows. In our view, China's shift towards less dependence on the U.S. will only accelerate further. Big picture, we do not believe that tariffs in isolation will permanently dent China's share of global exports, which have continued to increase for some time (with and without tariffs). One can see this in *Exhibits 12* and *13*, respectively. That said, as we discuss below, the impact from a reduction in China's exports to the U.S. is much more meaningful than we or the market previously estimated.

In the Eurozone, there is no doubt that competitiveness and growth will be impacted, but the 20% tariff on EU goods was broadly expected, with the main incremental impact coming indirectly via the hit to global growth. It is also important to remember that while the trade war impact is significant, it will likely be focused in 2025 and 2026, whereas the fiscal stimulus we are seeing in Germany and potentially elsewhere will play out over multiple years. On inflation, we stick to our prior forecasts of 2.2%/2.4% in 2025/2026 for the Eurozone for now, noting the offsetting impacts of cost-push inflation from (retaliatory) tariffs, and weaker demand due to the income/confidence hit.

Given both the aforementioned breadth and depth of tariffs, growth will be dented more than we originally anticipated, with a mild U.S. recession risk now on the table in coming quarters.

#### Exhibit 4: Bigger Picture, We Think Announced Tariffs Are Likely A Meaningful Shift Away From a Global Integrated Economy

Category	2024 Imports (\$bn)	Prior Tariff Rate (pre-Election)	As-Announced Incremental Tariffs	Post-Bargaining Plausible Case*	As-Announced Final ETR	Post-Bargaining Plausible ETR*
<b>IEEPA Tariffs (Excluding Critical Imports)</b>						
EU	459	2%	20%	10%	22%	12%
Mexico	405	2%	19%	10%	21%	12%
China	397	14%	54%	37%	68%	51%
Canada	234	2%	20%	10%	23%	13%
Japan	112	2%	23%	12%	25%	14%
Rest of World	907	3%	19%	10%	22%	12%
<b>Total IEEPA ETR</b>	<b>2,514</b>	<b>3.3%</b>	<b>25%</b>	<b>14%</b>	<b>29%</b>	<b>19%</b>
<b>Section 232 Tariffs (Critical Imports)</b>						
Autos	227	0%	25%	25%	25%	25%
Energy	176	0%	0%	0%	0%	0%
Steel	34	6%	19%	19%	25%	25%
Aluminum	21	5%	20%	20%	25%	25%
Critical Imports	295	2%	10%	10%	12%	12%
<b>Total 232 ETR</b>	<b>754</b>	<b>0.3%</b>	<b>13%</b>	<b>13%</b>	<b>14%</b>	<b>14%</b>
<b>Total Imports</b>	<b>3,267</b>	<b>3.6%</b>	<b>22%</b>	<b>14%</b>	<b>26%</b>	<b>18%</b>

Post-bargaining plausible case assumes ~50% of announced reciprocal tariff rate; For Canada/Mexico we assume that 50%/38% of imports are USMCA compliant which will be tariffed at a lower 12.5% rate; China rate includes 20% IEEPA tariffs (which sticks) + reciprocal tariffs announced on 04/02; Critical Imports includes Autos/Energy, Copper, Pharmaceuticals, semiconductors, lumber, batteries, oil & gas, semiconductors and electronics, food. Data as at April 2, 2025. Source: KKR Global Macro & Asset Allocation analysis.

#### Changes for GDP, Inflation and Rates:

- As a basic rule of thumb in the U.S., we think every 10-percentage point increase in tariff rates equates to roughly a 1% drag on GDP and a 1% uplift to CPI** (with the GDP hit spread out over about a year, and the CPI uplift spread out over about two years).
  - Absent Trump-related fiscal considerations, our quantitative leading indicator models for U.S. GDP growth would have anticipated 2.9% GDP growth this year**, with key uplifts coming from what have been benign credit conditions, lower energy prices, and easing Fed policy rates.
  - From this 2.9% GDP baseline, we now subtract roughly 200-250 basis points from 2025e due to tariffs. This assumes rates are negotiated somewhat lower in coming months – perhaps closer to 20% from 30% (Exhibit 5). Furthermore, spread across 2025-26, we subtract another 60 basis points due to DOGE-related spending cuts.**
- All-in, you get to close to stall speed (0.5%) growth in 2025, an elongated, modest recovery in 2026 (1.3%), before bouncing back to more normal average growth rates thereafter (2-2.5%). Previously, we had been discounting about 1.4% from DOGE and tariff headwinds. See *Exhibit 5* for full details of our forecast revisions.
- In terms of U.S. inflation, we now expect CPI running in the 4.0% range in 2025 and 3.5% range in 2026.** We have long been well above consensus on CPI due to tariff risks (3.2%/2.8% in 2025-26, vs. consensus of 2.8%/2.5%), but pass-through to goods inflation will now be even higher than expected. As we have mentioned in earlier pieces, we will be watching productivity, as it holds the key to the U.S. being able to navigate the current macroeconomic environment without a modern-day bout of stagflation.
  - Regarding the Fed, the range of potential outcomes has no doubt widened amid what we view as**

**a treacherous mix of slowing growth and re-accelerating inflation. For now, we keep our fed funds base case at two cuts in 2025 but move to three cuts from two in 2026.** As we have previously written, the Fed could be inclined to look through higher near-term inflation and focus more on downside risks to growth in responding to tariffs. At this point, however, we think inflation will be the most apparent risk in near-term economic data, while the growth impact of tariffs will likely become more apparent in the 2Q25-3Q25 economic data. As a result, we think the Fed will take a more gradual approach to rate cuts this cycle than markets expect (forward pricing is currently near four cuts this year).

- **Importantly, the skew of risks for rates and growth now tilts towards the downside.** We no longer see a case where the Fed is forced to hike rates (our previous high case), and we increase the odds of our low case to 30% from 15% previously (representing a world in which growth is sufficiently negative that the Fed ignores inflation risks and cuts well below neutral).
- **For bond yields, we stick to our 4.0% longer-run UST forecast, while lowering our 2025 10-year forecast to 4.0% from 4.25%.** Our reduced target for 2025 reflects the downside skew we now see to growth risks in coming quarters. To be sure, higher tariffs represent some degree of fiscal tightening, but we are cognizant that foreign demand may be coming under pressure (particularly given the fact that the dollar has actually weakened in response to higher tariff rates).
- **For European growth,** we cut our Eurozone and German GDP growth forecasts to reflect the increased intensity of the trade war, including indirect effects via greater-than-anticipated economic weakness in the U.S. and Asia. Our 2025 forecast for Eurozone growth falls to 0.6% from 1.0% previously while Germany falls to 0.2%, from 0.8% previously. See *Exhibit 5* for full details. These forecast updates assume the announced tariffs are sustained, with meaningful retaliation and no widespread near-term détente. It is also important to remember that while the trade war

impact is significant, it will be focused in 2025 and 2026, whereas the fiscal stimulus we are seeing in Germany and potentially elsewhere will play out over multiple years.

- **Regarding Eurozone inflation,** we stick to our prior forecasts of 2.2%/2.4% in '25/'26 for the Eurozone for now, noting the offsetting impacts of cost-push inflation from (retaliatory) tariffs, and weaker demand due to the income/confidence hit.
- **For China, we are revising our 2025 GDP forecasts to 4.3% from 4.4% previously.** We now anticipate a 130 basis points hit to GDP from trade war impacts offset by 160 basis points of fiscal stimulus in 2025. See below for further details. On the inflation front, no change to our forecast of 0.9% for 2025 and 1.0% in 2026.

Specifically, the fiscal impulse that Germany and China are now implementing should help to ease the blow from higher tariffs relative to the U.S., which will be experiencing both fiscal contraction and tariff headwinds.

**Exhibit 5:** The U.S. Is in a Unique Position in That It Has Both Fiscal and Tariff Headwinds. By comparison, Europe, Germany in Particular, and China Have Accelerating Fiscal Tailwinds

Impact of Tariffs and Fiscal Stimulus On KKR GMAA GDP Forecasts, Y/y %								
	U.S.		China		Eurozone		Germany	
	2025	2026	2025	2026	2025	2026	2025	2026
<b>GDP Growth ex Tariffs/Fiscal</b>	<b>+2.9</b>	<b>+2.0</b>	<b>+4.0</b>	<b>+4.0</b>	<b>+1.2</b>	<b>+1.2</b>	<b>+1.0</b>	<b>+1.0</b>
Tariffs Impact	-2.0	-0.5	-1.3	-0.8	-0.8	-0.4	-1.2	-0.6
Fiscal Impulse	-0.4	-0.2	+1.6	+1.0	+0.2	+0.5	+0.4	+1.0
<b>Revised GDP Growth Forecasts</b>	<b>+0.5</b>	<b>+1.3</b>	<b>+4.3</b>	<b>+4.2</b>	<b>+0.6</b>	<b>+1.3</b>	<b>+0.2</b>	<b>+1.3</b>
<b>Previous Forecast</b>	<b>+2.1</b>	<b>+2.0</b>	<b>+4.4</b>	<b>+4.2</b>	<b>+1.0</b>	<b>+1.6</b>	<b>+0.8</b>	<b>+1.6</b>

The fiscal impulse for China is measured as the additional stimulus. Government regular spending for consumption and infrastructure (contributing 1.2 percentage points to growth) is included in GDP growth, excluding tariffs and fiscal measures. Data as at April 3, 2025. Source: KKR Global Macro & Asset Allocation analysis.

## Silver Linings Amidst the Macro Headwinds

# 1

**We heard mostly good news on Canada and Mexico. USMCA compliant trade is unaffected and will remain protected.** Meanwhile, goods trade with Canada and Mexico not under USMCA will be at 25% until President Trump believes that the Fentanyl crisis is resolved. Tariffs would then drop to 12% (this segment totals 40% of trade and will likely 'stick' the way China tariffs did from 2018). We would view this outcome as a 'win' from most vantage points, and it would further cement our view regarding further regionalization of the global economy.

# 2

**The space for offsetting fiscal response has broadened more than we originally thought:** We think President Trump will likely suggest that Congress redistribute some of the \$600-\$750 billion annual haul from tariffs towards fiscal easing elsewhere, including e.g., 'no tax on tips' or even potentially stimulus checks. Until today, our DC channel checks had suggested

that Congress was not taking tariff revenue seriously. However, if he does keep tariffs high as part of his America-First strategy, there are some important offsets that can help bolster GDP growth and consumer and business sentiment.

# 3

**Legal challenges will likely emerge that could potentially put a significant stay on reciprocal tariffs.** While not our base case for now, some advisors have suggested there are very sound grounds to challenge the implementation of these tariffs under IEEPA.

# 4

**Bigger picture, we maintain our view that 'you can only get so hurt falling out of a basement window.'** The most cyclical areas of the economy - including construction spending and inventory investment - remain well below-trend (*Exhibit 8*). Meanwhile, leverage ratios across businesses and households - in aggregate - remain below 2019 levels (*Exhibit 9*), and capital markets issuance is still below-average, as it recovers slowly from historic lows in 2022 (*Exhibit 8*).

## 5

**Technical conditions are still quite favorable.** Consider that there is more than \$6 trillion sitting on the sidelines, and net issuance of IPOs, Leveraged Loans, and High Yield are tracking above 2009 levels, nowhere near what we saw in 2006 or 2021. That should help to keep credit markets better behaved, especially at a time when banks are largely de-levered.

## 6

**We would expect some negotiating before April 9th.** While we do not want to suggest that the current tariff regime will be rolled back in a meaningful way, we do think that countries will look to create some concessions in key areas to appease President Trump. We think this is important because if President Trump can get one country to negotiate, he could start to ease the anxiety and create a path forward. There could also be some meeting of the minds in important areas with key countries such as Japan, India, etc.

## 7

**Finally, rising geopolitical competition (even among friendly nations), trade barriers and industrial policy have been part of our thesis for a decade.**

These barriers and policies grew under both the first Trump and the Biden administration, and we expected significant expansion post the 2024 election. At KKR, we proactively incorporate geopolitics and policy considerations, including tariffs, into our diligence and portfolio management process as we strive to understand potential geopolitical and policy effects on our investments. While the tariff announcement was more aggressive than almost anyone anticipated, we were already working with our companies to mitigate trade vulnerabilities well in advance of the election.

**Exhibit 6: Our Liquidity Indicator Is Still Recovering From Near-Trough Levels**

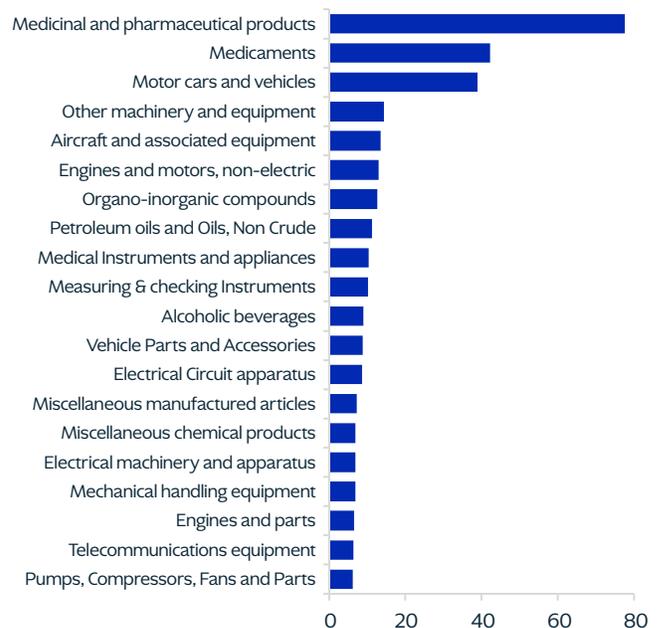
**Capital Markets Liquidity (TTM) as a % of GDP, IPO, HY Bond, Leveraged Loan Issuance**



Data as March 31, 2025. Source: Preqin, Bank of America, Bloomberg, KKR Global Macro & Asset Allocation Analysis.

**Exhibit 7: Pharmaceuticals Are the Largest EU Export Category to the U.S.**

**EU27: Most Exported Goods to the United States, 2024, € Billions**



Data as at December 31, 2024. Source: Eurostat.

**Other Considerations:** Steel and aluminum and autos will stay under the old trade tariffs of 25%, but copper, pharma, semiconductors, and lumber will be investigated further for 232 tariffs down the road. Energy and critical minerals will not be affected.

**Exhibit 8:** True Economic Hard Landings Are Usually Caused by Housing and Inventory Issues. This Cycle Has Not Been Marked by Excesses in Those Areas

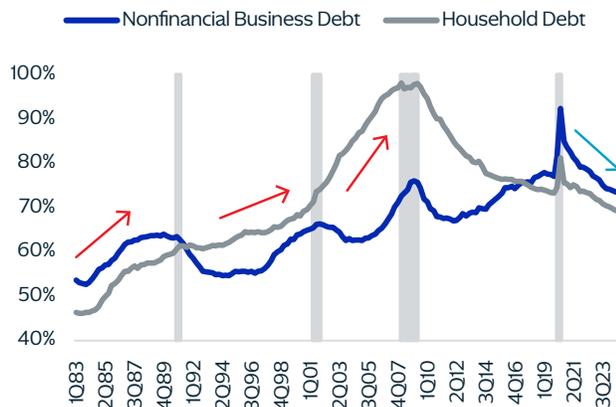
### Real Construction + Inventory Investment, 4Q19=100



Data as at December 31, 2024. Source: U.S. Bureau of Economic Analysis, Haver Analytics, KKR Global Macro & Asset Allocation analysis.

**Exhibit 9:** Also Important Is That Business and Consumer Leverage Levels Have Not Increased This Cycle, Which Helps Buffer Against an Outsized Default Cycle

### U.S. Private Sector Leverage as a % of GDP



Gray shading denotes recessionary quarters. Data as at March 5, 2025. Source: U.S. Bureau of Economic Analysis, Haver Analytics, KKR Global Macro & Asset Allocation analysis.

## What Does this Mean for Markets?

- **Rates:** We expect 10-year rates to rally, but probably not trade sustainably below 4% once investors recognize that inflation could move up closer to 4% plus from 3%. Chair Powell had said that tariff-driven inflation is 'transitory,' but the level of these tariffs will put pressure on that statement. Said differently: even as growth weakens, the Fed will need to follow a measured approach to easing.
- **From a currency standpoint, we expect the USD will likely stay weaker, Euro and JPY stay stronger, and we are watching countries like China and Vietnam.** All else being equal, we see a closer proximity between the U.S. and the rest of the world, which could also affect flow of funds.
- **Equities:** As of this writing, the S&P 500 is down 12% from its 2/19 peak, and down 4.8% vs. the 4/2 close. For now, we would not rush to buy the dip. While the market was discounting 15% or so tariffs, it was not discounting 25-30%. Keep in mind that during the last bout of tariff-driven macro anxiety in 2018 (which ultimately proved benign), markets fell 20% peak-to-trough. Also, as we show in *Exhibit 3*, the market has not fully yet discounted recession risk.

## What Does this Mean for Investing?

Similar to our message in 2020, we think allocators of capital should be prepared with shopping lists in anticipation of opportunities, particularly if hard-landing type conditions occur. Given the amount of money on the sidelines, we think credit will likely bend, not break. On the equity side, we would expect more volatility, potentially presenting an opportunity to lean in, especially if a recession scenario gets fully priced in (*Exhibit 3*). At KKR, we have taken proactive steps to prepare our companies for these challenges and have developed strategies to mitigate negative impacts from tariff uncertainty.

**Bigger picture, we are likely moving more towards a regionalized economy, relative to the globally integrated one that defined much of the last 20 years.** From a thematic perspective, we now think that our *Regime Change* thesis, driven by heightened geopolitics,

big deficits, a messy energy transition, and sticky inflation, has gained additional momentum. Against this backdrop, Intra-Asia trade increases in importance as do our themes around the Security of Everything, Capital Heavy to Capital Light, Collateral-based Cash Flows, and Productivity. By comparison, the potential for cross-border flows and activity will now be more muted. Finally, the asynchronous recovery we have been describing remains, but there is an important baton hand-off. Specifically, the fiscal impulse that Germany and China are now implementing should help to ease the blow from higher tariffs relative to the U.S., which will be experiencing both fiscal contraction and tariff headwinds.

**Exhibit 10:** Even after the 2018 Tariffs, China Continued to Gain Global Export Share

#### Share of World Exports, 12mma, %



Data as at November 30, 2024. Source: IMF Direction of Trade, Haver Analytics, KKR Global Macro & Asset Allocation analysis.

Finally, the asynchronous recovery we have been describing remains, but there is an important baton hand-off.

**Exhibit 11:** China Has Diversified Its Exports, With Increasing Exposure to Emerging Markets

#### Share of China Total Exports, %



Data as at December 31, 2024. Source: General Administration of Customs, China, Haver Analytics, KKR Global Macro & Asset Allocation analysis.

#### Further Details by Region

**The EU: We See Some Incremental Fall-Out from Greater Overall Trade War Intensity.** In the EU, the 20% universal tariff imposed was actually within the range of estimates that market participants and corporates had been preparing for ahead of 'Liberation Day'. We are expecting the EU to impose a carefully calibrated response to the U.S. tariffs. Under the auspices of the Anti-Coercion Instrument (ACI) this might extend to include a tariff on U.S. services exports where the U.S. runs a significant trade deficit, and the EU has significant bargaining power. The countries with the largest goods trade exports to the U.S. that will be the most directly impacted by these announced tariffs are Germany (€161 billion), Ireland (€72 billion - albeit significantly in pharma, where we still await tariffs), and Italy (€64 billion), while Spain and France with less reliance on goods manufacturing will be more insulated.

There are also several rounds of second order impacts on growth and inflation to consider. The key incremental news shock to Europe from the tariff announcement was the level of tariffs imposed on Asia, impacting

both the Asian and U.S. economies. Moreover, we expect some redirection of Asian goods exports away from the U.S. towards Europe which will provide a disinflationary impulse. A deteriorating macro backdrop in Asia will also challenge European exporters to Asia. Given expectations for EU retaliation we do not know where effective tariff rates will eventually settle, and this prolonged uncertainty will provide its own drag on growth.

However, our key point is that now is not the time to turn bearish as the volatility we are seeing is creating meaningful opportunities to deploy capital at interesting valuations. That said, there are many pitfalls to avoid. As per *Exhibit 5*, we reduce our Eurozone and German GDP growth forecasts to reflect the increased intensity of the trade war, including indirect effects via greater-than-anticipated economic weakness in the U.S. and Asia. These forecast updates assume the announced tariffs are sustained, with meaningful retaliation and no widespread near-term détente.

**The U.K.: Better Positioned Than the EU, But Not Immune.** We had assumed the U.K. would escape the worst of the tariffs given its trade surplus with the U.S. is largely services oriented, and recent announcements

suggest that this is indeed the case. The U.K. will be subjected to a lower tariff rate than the EU at 10%, the minimum baseline tariff applicable to all countries, with the exception of autos, steel and aluminum, for which the previously announced 25% tariffs remain in place. In contrast to the EU, the U.K. government appears unlikely to significantly retaliate at this point.

While we expect direct trade impacts to be more limited given the U.K.'s more balanced goods trade position with the U.S., we think second order effects, including weaker corporate sentiment and the spillover effects of softer growth in the Eurozone, could be a meaningful drag. This amplification of uncertainty comes at a particularly challenging time, given U.K. businesses are already contending with domestic policies that mandate an increase in the minimum wage and employers' National Insurance Contributions beginning April 6.

Putting all this together and accepting that the impact on growth will depend on the duration of tariffs (which remains a major unknown), *should tariffs persist at announced levels*, we estimate that the cumulative impact to U.K. GDP growth sits somewhere around 50 basis points over the next two years.

**Exhibit 12: Asian Economies Have Diverse Export Structures to the US: Equipment and Auto from East Asia, Agriculture and Commodities from Australia, and Textiles and Electronics from Southeast Asia**

Sector % of Each Country's Total Goods Exports to the U.S.									
	China	Japan	Korea	Australia	India	Vietnam	Indonesia	Philippines	Singapore
Agri Product, Food and Beverage	2%	1%	1%	33%	7%	4%	21%	10%	7%
Mineral Products	8%	5%	12%	9%	17%	4%	3%	2%	7%
Chemicals	3%	7%	7%	12%	16%	1%	4%	1%	14%
Plastics and Rubbers	5%	3%	4%	1%	3%	4%	8%	3%	1%
Textiles and Clothing	14%	1%	1%	1%	14%	27%	32%	8%	0%
Wood, Wood Product and Paper	2%	0%	1%	1%	1%	1%	4%	1%	0%
Stone, Glass and Precious stones	1%	1%	1%	11%	13%	1%	1%	0%	1%
Machinery and Equipment	20%	28%	20%	19%	9%	10%	5%	14%	34%
Electrical Equipment	25%	10%	15%	5%	13%	36%	15%	58%	29%
Transportation Equipment	4%	37%	36%	7%	4%	1%	1%	2%	5%
Other	17%	7%	1%	1%	2%	11%	7%	3%	2%

Data as at December 31, 2024. Source: UN Comtrade, KKR Global Macro & Asset Allocation analysis.

**China: The Epicenter of the Trade War with Overall U.S. Tariff Rates Rising to About 68%. Exports to the U.S. Now at Risk.** The lion's share of China to U.S. trade includes electrical machinery and equipment (\$124 billion), machinery including computers (\$89 billion), furniture and bedding (\$31 billion), toys, games, and sports equipment (\$29 billion), and plastics (\$23 billions). In conjunction with the fentanyl and reciprocal tariffs, the U.S. effective tariff rates on China are expected to surge from the pre-election level of approximately 14% to a prohibitive level of around 68%. Additionally, the U.S. has announced the end of de minimis exemptions. With an estimated weighted average elasticity of 1.3, we estimate that the rise in tariffs by 54% to 68% in total could affect 70% of China's exports to the U.S., assuming indirect exports to the U.S. via third countries can be curtailed. This reduction would reduce China's total exports by 10%, putting 1.9% of its GDP at risk—a much larger impact than we or the market previously estimated.

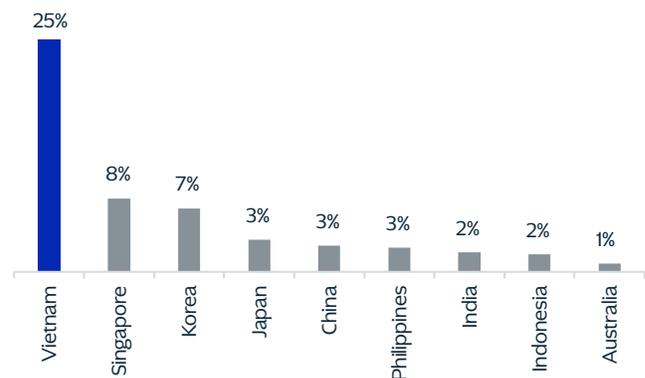
To be sure, there are ways for China to mitigate the negative impact of tariffs including providing more fiscal/monetary support for domestic demand. All told, we expect at least 160 basis points of additional Chinese fiscal stimulus to offset the external shock, totaling 280 basis points for overall fiscal stimulus. One can see this in *Exhibit 5*. China has also announced retaliation measures with an additional 34% tariff on U.S. goods. As a result, we do believe that the Chinese government will need to cut interest rates further (likely by 25-50 basis points) as well as to allow the CNH to depreciate to around 7.5 versus its current level of 7.2.

**Southeast Asia: Vietnam's Exports Are Very Exposed, With Second Order Competition for Manufacturers as Chinese Goods Are Rerouted.** Goods export-to-GDP ratios for Southeast Asia vary distinctly by country, with Indonesia and the Philippines at only about 20%, while Vietnam and Singapore are closer to 100%. The U.S. accounts for a relatively small share of total goods exports (approximately 10-15%), with Vietnam an outlier at close to 30%. The U.S. has imposed initial reciprocal tariffs of 10% on Singapore (minimum level), 17% on the Philippines, 32% on Indonesia and 46% on Vietnam. Given Vietnam's high export exposure and concentration to the goods categories of textiles and

electronics, we forecast Vietnam's at-risk exports equate to around 15% of GDP ahead of any post-tariff negotiations. This makes Vietnam a regional outlier compared to Singapore, the Philippines and Indonesia with GDP impacts from tariffs closer to 1%. In terms of mitigation and investment implications, we see a high chance that the State Bank of Vietnam resorts to currency depreciation in the coming weeks. The second order impacts of U.S. tariffs for Southeast Asia are more difficult to forecast but could be far more consequential. With China needing to re-route a large share of its U.S. exports to other markets in the months ahead, Southeast Asian countries face the risk of competitively priced China imports adding to downward pricing pressure and giving central banks further headroom to cut interest rates.

**Exhibit 13: Vietnam Has High Reliance on U.S. Exports, While India, Indonesia, and Australia Have Less Exposure**

**Exports to the U.S. as a % of GDP**

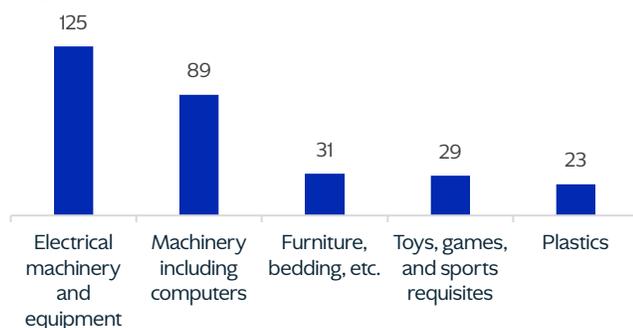


Data as at December 31, 2024. Source: Statistics bureaus and customs authorities of corresponding countries, Haver, KKR GMAA.

To be sure, there are ways for China to mitigate the negative impact of tariffs including providing more fiscal/monetary support for domestic demand.

#### Exhibit 14: China's Main Export Products to the U.S. Are Electrical Machinery and Equipment

##### Key China Exports to the U.S., US\$ Billions



Data as at December 31, 2024. Source: China Customs, KKR Global Macro & Asset Allocation analysis.

**India: Limited Reliance on Goods Exports Means Growth Momentum Is Intact.** India has the lowest goods exports to GDP ratio of the major Asian countries at 12% due to the economy's large services export component, notably its IT sector. This trade diversification reduces trade risk as service exports are more resilient to tariffs. Despite the strong recent negotiating efforts of the Modi government the U.S. has imposed 26% tariffs on India, a level comparable with other major Asian economies. Given that the United States accounts for less than 20% of India's goods exports (along with low trade/GDP ratio), we forecast the impact on India's GDP as a manageable -0.7%, before post-tariff negotiations reduce this impact further to -0.35%. Confidence in this is high, with recent commentary from the U.S. Commerce Department and India's Trade Ministry indicating strong commitment to finalize a comprehensive bilateral trade deal by Q4 2025. With India's economic growth recently accelerating post several softer quarters, and further stimulus provided by the Reserve Bank of India's recent rate cut together with a supportive 25/26 fiscal budget for the Indian consumer, and with scope for additional interest rate cuts with inflation falling back to target, we expect India's growth momentum to remain on track.

**Japan and Korea: Each Takes a Big Hit to the Auto Sector but Potentially Takes the Place of Chinese Exporters in the U.S. Market.** Japan's total exports were valued at \$766 billion in 2024, with \$142 billion

exported to the U.S., accounting for 18.5% of its total exports. The net trade balance with the U.S. is \$68.5 billion. The primary products exported to the U.S. from Japan are vehicles (\$50 billion), machinery (including nuclear reactors and boilers) at \$32 billion, electrical and electronic equipment (\$15 billion), commodities (\$9 billion), and optical and medical apparatus (\$8 billion). These top five categories represent over 80% of Japan's exports to the U.S.

The imposition of a reciprocal tariff of 25% represents a 23pp rise from the pre-election 2%. **This would mean a 28% cut to Japan's exports to the U.S., or a 6% cut to total exports, putting 1.0% of GDP at risk.** However, there could be some mitigating factors, such as reduced imports, replacing China in some sectors in the U.S. market, and negotiations with the U.S. administration to reach a deal. Given the large tariff, BoJ may delay its rate hike to evaluate the impact first. We believe Japan-US may reach a certain deal so that the final tariff won't be this large.

South Korea's total exports amounted to \$684 billion in 2024, with around \$128 billion exported to the U.S., making up 19% of its total exports. The trade balance with the U.S. is \$66 billion, with five products making up the lion's share of exports to the U.S. including: auto and auto parts (estimated at \$36.4 billion), semiconductors (\$31.5 billion), machinery and electronics (\$17.3 billion), petrochemicals (\$7.9 billion), and steel and metals (\$7.2 billion).

The imposition of a reciprocal tariff of 25% represents a 24.6 percentage point rise from the pre-election 0.4%. This would mean a 30% cut to Korea's exports to the U.S., or a 9% cut to total exports, putting 2.1% of GDP at risk. However, there could be some mitigating factors, such as reduced imports, replacing China in some sectors in the US market, and negotiations with the US administration to reach a deal. We had expected the Bank of Korea to cut rates by 3-4 times this year and now more rate cuts will be possible.

**Australia: Will See a Very Limited Direct Impact Given Low Trade Exposure to U.S. and Tariff Rate.** Australia has been hit with a 10% tariff rate, among the lowest of all Asian countries, as it is one of the few to have a trade deficit with the United States. Australia's \$15 billion in

exports to the U.S. comprise only 1% of GDP. Australian trade has already been stress-tested in recent years with China applying restrictions on \$30 billion of goods exports in the aftermath of COVID. The economy was able to navigate that shock with limited overall impact. A terms of trade deterioration in the form of lower agricultural and metals prices and exports represents a small indirect risk. Australia's economy is currently growing at a subpar rate due to high housing leverage and tight monetary policy. A slowdown in international growth should allow the Reserve Bank of Australia to cut rates more than expected. We are anticipating four cuts over the next 24 months (the market expectations are two cuts) which will likely be pulled forward due to slower global growth.

On the international front, tariffs will have a dampening effect too on growth, as well as the aforementioned on affect flows. In our view, China's shift towards less dependence on the U.S. will only accelerate further.

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