MACRO STRATEGY | Economic Monthly

# The Return of Mercantilism? Shifting Goalposts on Trade

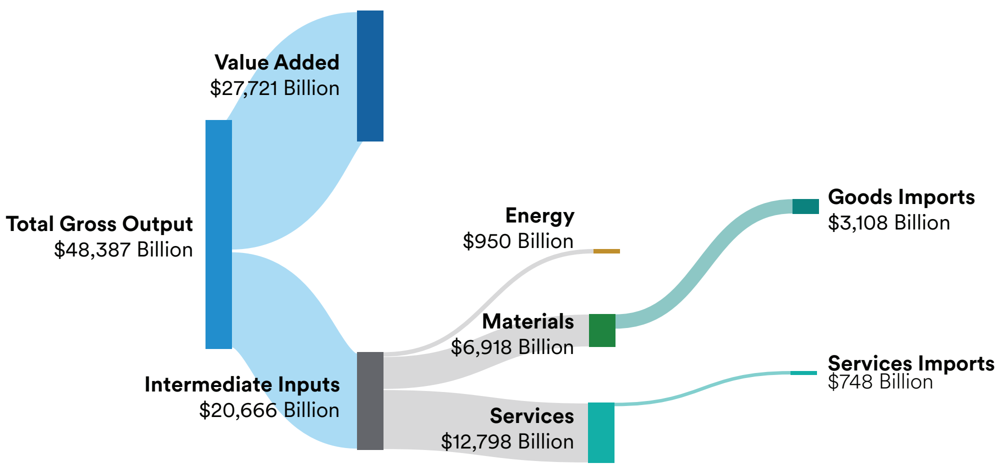
February 20, 2025

President Trump made several changes to trade policy in his first term, and U.S. firms have adjusted accordingly. Trade exposure has shifted away from China, and investment abroad has shifted toward Europe and the Western Hemisphere.

U.S. firms may continue to adapt to additional tariffs in Trump's second term. Marginal adjustments may be smaller, and imports are a relatively small portion of the economy.

However, more sweeping changes intending to promote U.S. self-reliance could be more costly as firms will have to rethink the investments they have made over the last eight years.

### The U.S. Economy is Big

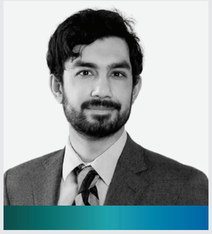



*Source: BEA, MIM. As of February 2025.*

MetLife Investment Management

## Authors


**TANI FUKUI**
*Director, Global Economic & Market Strategy*



**SHAN AHMED**
*Associate, Global Economic & Market Strategy*

**DREW T. MATUS**
*Chief Market Strategist*

The most recent U.S. Bureau of Economic Analysis (BEA) data on gross output by industry show approximately 43% of gross output at 20,666 billion, comes from the purchase of intermediate inputs. Materials and energy inputs are less than $8,000 billion, as the bulk of intermediate inputs comes from purchased services. The share of these intermediate inputs that is imported is even smaller—about one-sixth of total intermediate inputs, or a mere 6% of the cost of the final output. Certain industries that rely more on material inputs are more likely to be affected: manufacturing, construction, and health and education.

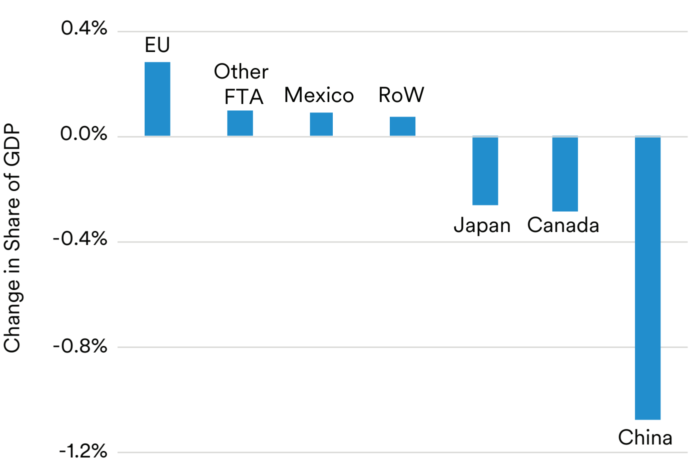
While tariffs would likely have an impact on prices to the consumer and on various supply chains, imports are a drop in the bucket compared to the value of what the U.S. economy produces domestically. Marginally, firms will likely be able to adjust their supply chains as they did after President Trump's first term and the pandemic.

## U.S. Trade Exposure has Shifted Away from China

President Trump has famously spoken about trade deficits. Despite this, his trade policies have not moved the needle on the trade deficit in goods, which has been around 4% of GDP since 2013.

The policies have, however, appeared to influence the composition of trade. U.S. trade exposure (exports plus imports as a share of GDP) to China has declined substantially, and imports from China have seen an outright decline since 2016.

**Chart 1 | Increase (Decrease) in Trade Exposure 2016-2024**




*Source: U.S. Bureau of Economic Analysis, U.S. Census Bureau, MIM. As of 2/11/2025.*
Note: Trade exposure is calculated as (exports+imports)/GDP

The EU has been the largest beneficiary of the shift in trade: exports to the EU rose by 7.1% annually while imports from the EU rose by 6.6%, both outpacing the baseline nominal U.S. GDP growth rate of 5.7% (Source: U.S. Bureau of Economic Analysis). Tariffs against the EU would hit U.S. firms and consumers harder than they did during Trump's first term.

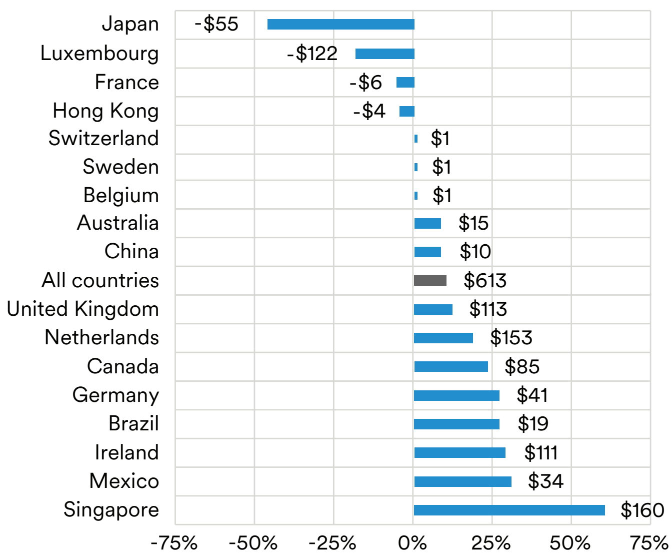
U.S. businesses have also turned to Mexico, other free trade agreement (FTA) partners, and the rest of the world (RoW) to substitute for China.[1]

If President Trump is serious about increasing domestic American manufacturing, then we can expect another dramatic shift in trade patterns. We believe this would require more strict, explicit policies beyond a simple tariff incentive, as firms have already invested significantly in other countries.

## U.S. Foreign Investment has Shifted

U.S. firms took the signing of the USMCA in 2020 as a long-term commitment to the region. Mexico and Canada saw a cumulative $120 billion increase in the stock of direct investment from the U.S., growing respectively by 30% and 23% annually, in a backdrop of overall investment abroad growth of 10%.

**Chart 2 | Change in U.S. Investment Abroad 2020-2023 Bars Represent Percent Change, Labels Represent $BN Change**




*Source: U.S. BEA, MIM. Data for 2023.*
Note: Data shown for countries with at least $20 billion in U.S. direct investment abroad in 2020. These data represent the historical cost stock of investment, without adjustment for inflation, depreciation, market value, or currency fluctuations. They are not netted against foreign investment in the U.S., which is collected as a separate series.

More broadly, Western Hemisphere and Western European countries have seen outsized increases in U.S. investments. Investments in “China+1” countries such as Vietnam, Poland, and Morocco, while much discussed, are not yet among the top tier of investment destinations.

Perhaps surprisingly, investment in China has continued to grow, albeit at a much slower pace than it had before the signing of the USMCA; investment growth has averaged 3% since 2020, compared with 8% from 2009-2020.

Both Singapore and Japan saw dramatic shifts, with Japan seeing a large decline in non-depository financial institutions and Singapore seeing a large increase in holding companies, whose investment dollars could be ultimately destined for other areas of Asia or Southeast Asia.

Investment abroad is likely to increase as tariffs rise, particularly for those firms with foreign customers. If the new administration pushes policies restricting that type of tariff-jumping, firms will have to rethink the last eight years of investment decisions.

## Outlook

We expect growth in 2025 to be very roughly on par with that of 2024, avoiding a recession and growing above trend.

Consumer balance sheets remain comfortable, and the labor market looks to be stabilizing after a period of softness. Wages growth has remained solid. Corporate profits remain robust and could support an increase in investment.

With the incoming Trump administration, we expect the noise-to-signal ratio to be very high, meaning continued volatility across markets. We expect more tariffs, although inflation effects are likely to be muted, and margin compression is a greater concern.

We expect government spending—a major supporting player in the recent growth story—to be pared back over the next two quarters. Stimulative effects and fiscal deficit increases could subsequently arise from an extension of the Tax Cuts and Jobs Act.

We expect the Fed to continue to move slowly toward the neutral rate by cutting two more times by year-end 2025. A moderate pace fits with the Fed’s considerable uncertainty about where the long-run neutral fed funds rate is, even as we expect inflation will take longer to converge toward 2%.

**MIM Forecast**

| U.S. | 2024 | 2025 |
|---|---|---|
| **GDP** | 2.8* | 2.3 |
| **CPI** | 3.2* | 2.8 |
| **10 Year** | 4.57* | 4.25 |
| **Policy rates (upper bound)** | 4.50* | 4.00 |
| **Unemployment** | 4.1* | 4.3 |

*Actual; other data are forecast.
*Source: BEA, BLS, U.S. Treasury, Federal Reserve, Bloomberg, MetLife Investment Management. As of February 2025.*

## Risks to The Outlook

We see a risk that the Federal Reserve doesn’t cut the fed funds rate at all in 2025. If inflation and the labor market continue on their recent path, additional cuts become harder to justify—particularly if the data indicate that the neutral rate is higher than the Federal Open Market Committee (FOMC) currently believes it is.

President Trump’s policies on tariffs, immigration, and other matters could create a range of escalatory economic situations and uncertainty, which may depress investment. Pro-growth strategies by the incoming administration, particularly in the context of an already strong economy, could create overheated conditions. Many of the possible policy combinations have the potential to throw a wrench in the Fed’s rate cut outlook.

**Endnote**

1 Trade exposure to Japan has been on a secular decline since at least the late 1980s, and Canada has seen a secular decline in trade exposure despite a faster nominal growth rate—primarily driven by a deceleration in exports to Canada.

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