

CAPITAL ECONOMICS

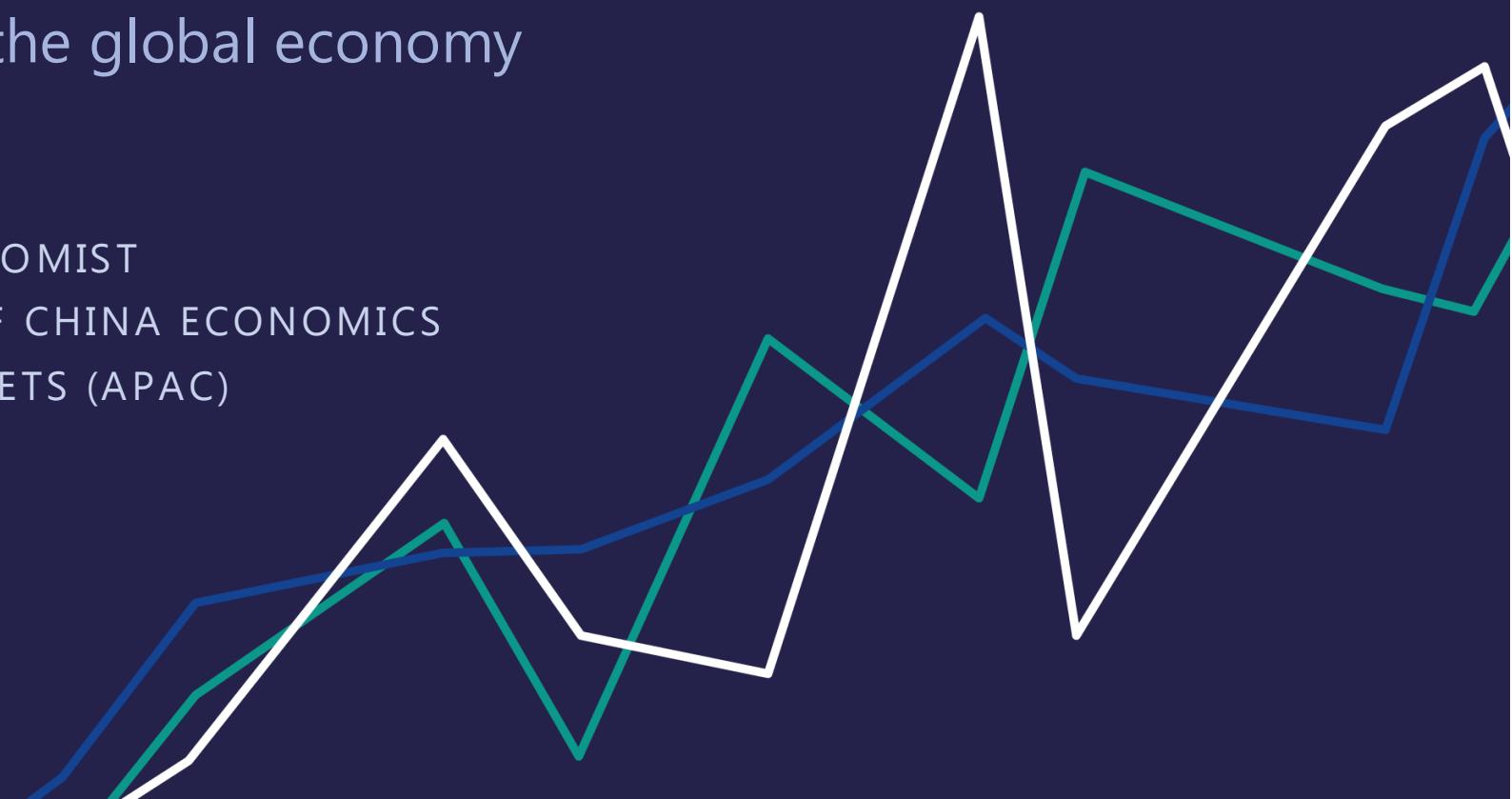
# Fracturing in the age of Trump

How geopolitics is remaking the global economy

NEIL SHEARING, GROUP CHIEF ECONOMIST

JULIAN EVANS-PRITCHARD, HEAD OF CHINA ECONOMICS

THOMAS MATHEWS, HEAD OF MARKETS (APAC)



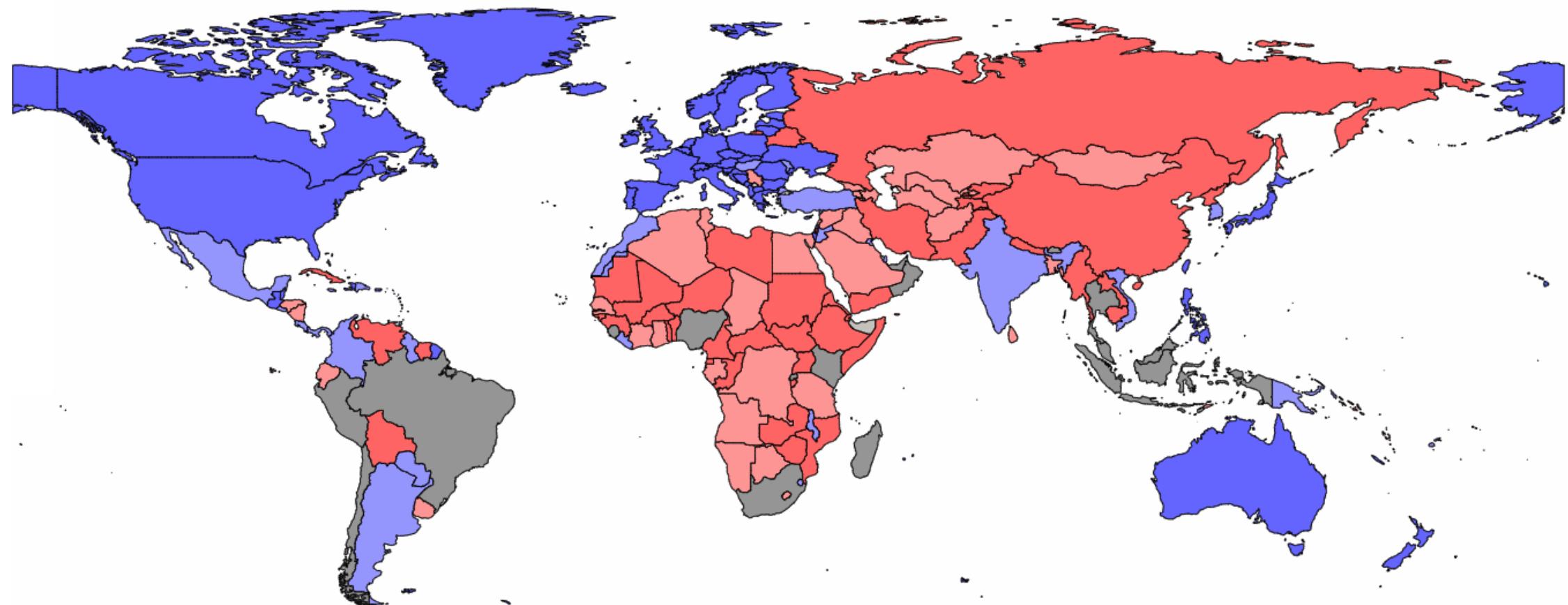
# What is fracturing?

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- Globalisation isn't in retreat – world trade is close to record highs.
- But the political architecture underpinning globalisation is shifting.
- The defining feature of the global economy over the past decade has been a deepening rivalry between the US and China.
- This is causing the global economy to split into competing blocs, with other countries coalescing around superpower nations.
- Economic relations between these blocs are breaking apart, or "fracturing".
- The economic consequences of fracturing will depend on the size of the split and how other countries align.

# CE Classification of Global Alignment at the start of 2025

- US & allies
- Leans US
- Unaligned
- Leans China
- China & allies



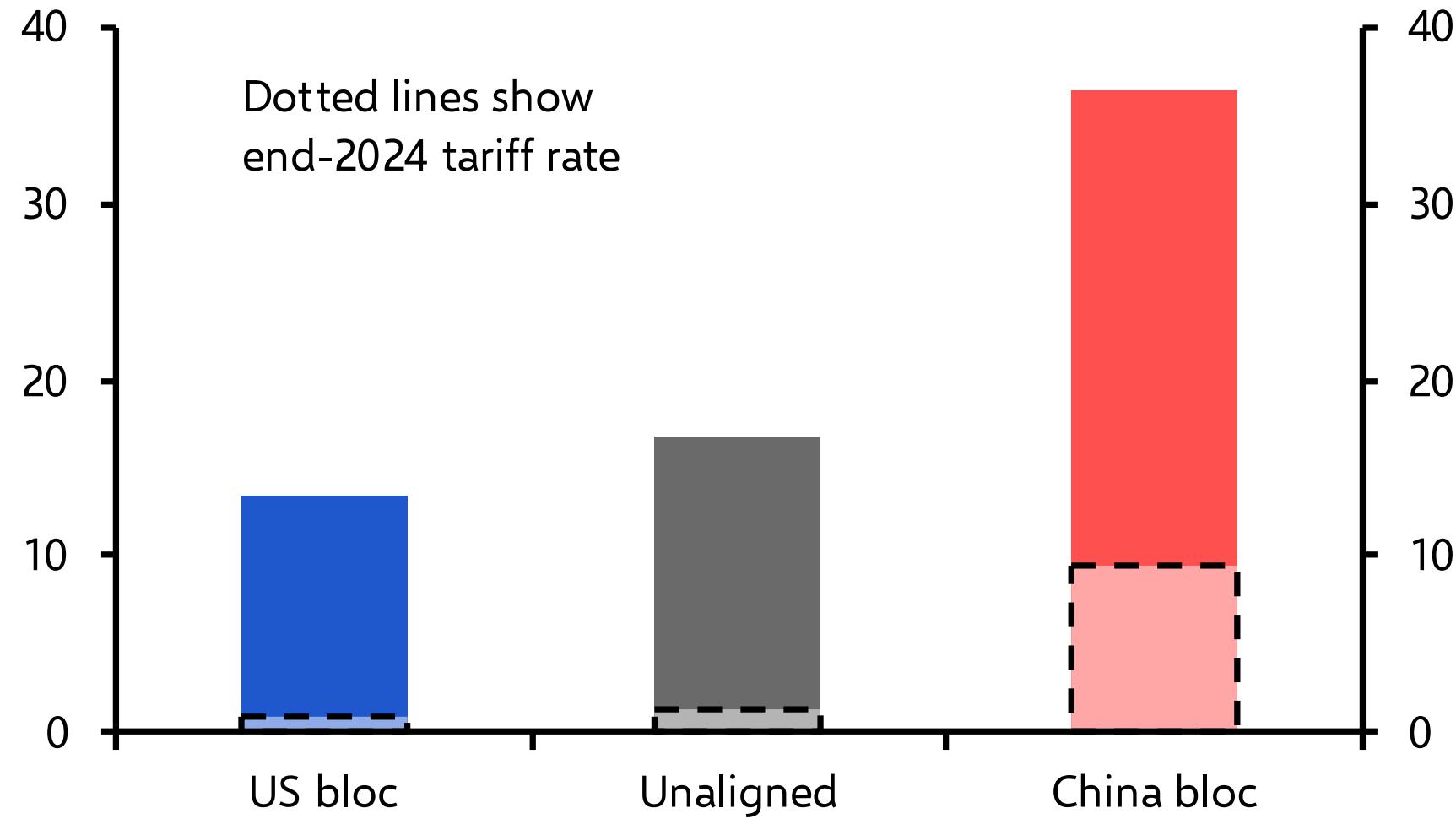
Source: Capital Economics

# What Trump's return means for fracturing

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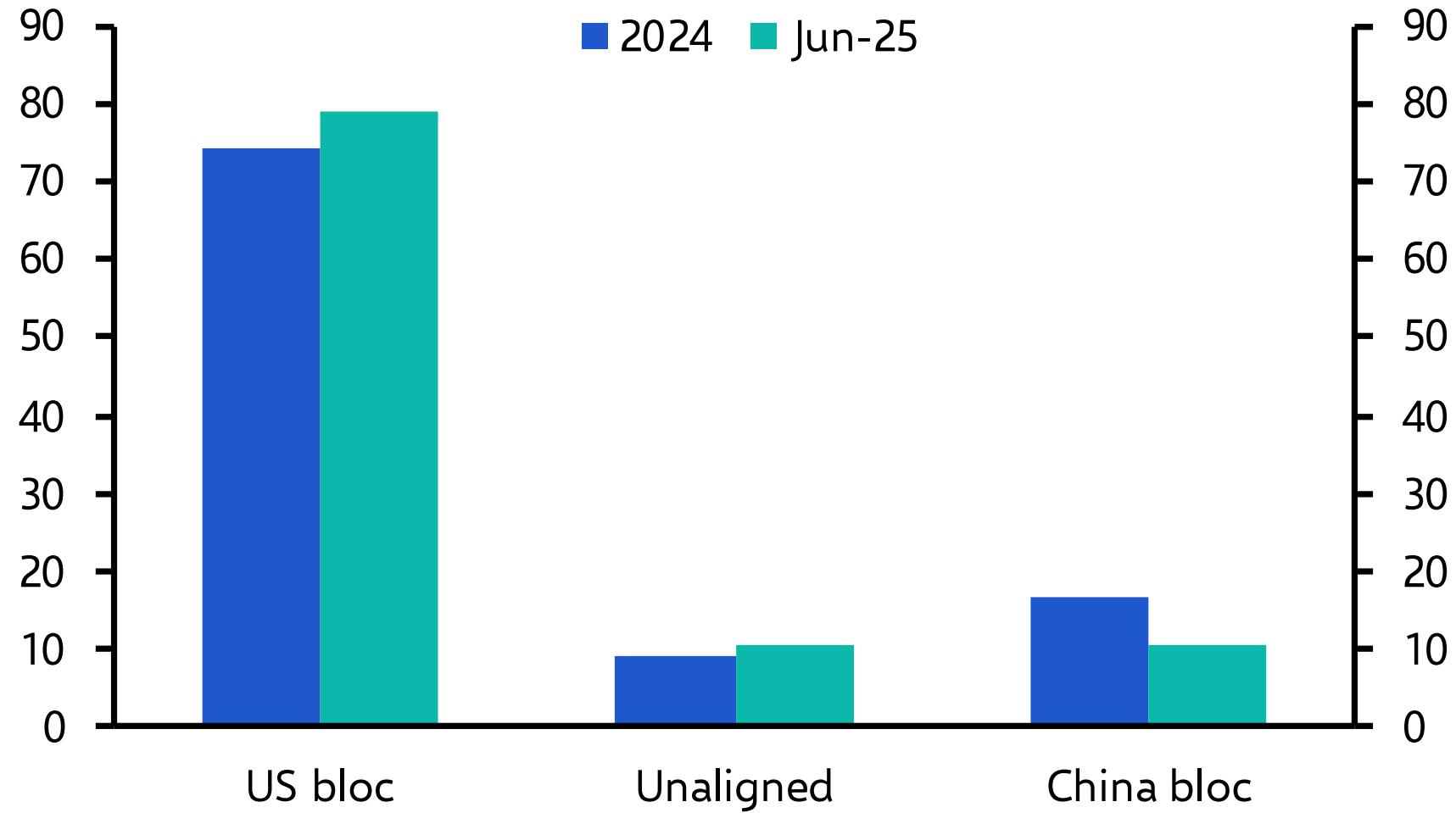
- Lessons from the first eight months of Trump's second term.
- Scenarios for how fracturing might play out over the coming years.
- Implications for the global economy.

# Effective US Tariff Rate by Bloc (%, as of 28 August, 2024 weights)



Sources: US Census Bureau, Capital Economics

# US Import Share (%)



Sources: US Census Bureau, Capital Economics

## Investment flows continue to fracture

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- New US rules prohibit investments in parts of China's tech sector.
- Trump admin has threatened to expand these restrictions.
- By contrast, traditional allies are being encouraged to invest more in US.
- China has frozen approval of FDI into the US.
- China is gradually divesting from US financial assets.

## No geopolitical earthquake so far

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- There have been diplomatic ruptures with a handful of EMs
- And US ties with its traditional allies have come under strain but...
- The Trump admin has not pulled out of Nato or abandoned Ukraine.
- It has maintained pressure on Russia.
- Few signs of a withdrawal from APAC.

# How might the global geopolitical map change under Trump?

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- A US-China détente (distance between blocs diminishes).
- Greater fragmentation (one or more blocs break apart).
- Movement between the blocs (e.g. from US to China).

# What would a US-China deal look like?

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## China would want:

- Concessions on Taiwan
- Relaxation of tech controls
- No tariff increase, or a rollback of tariffs

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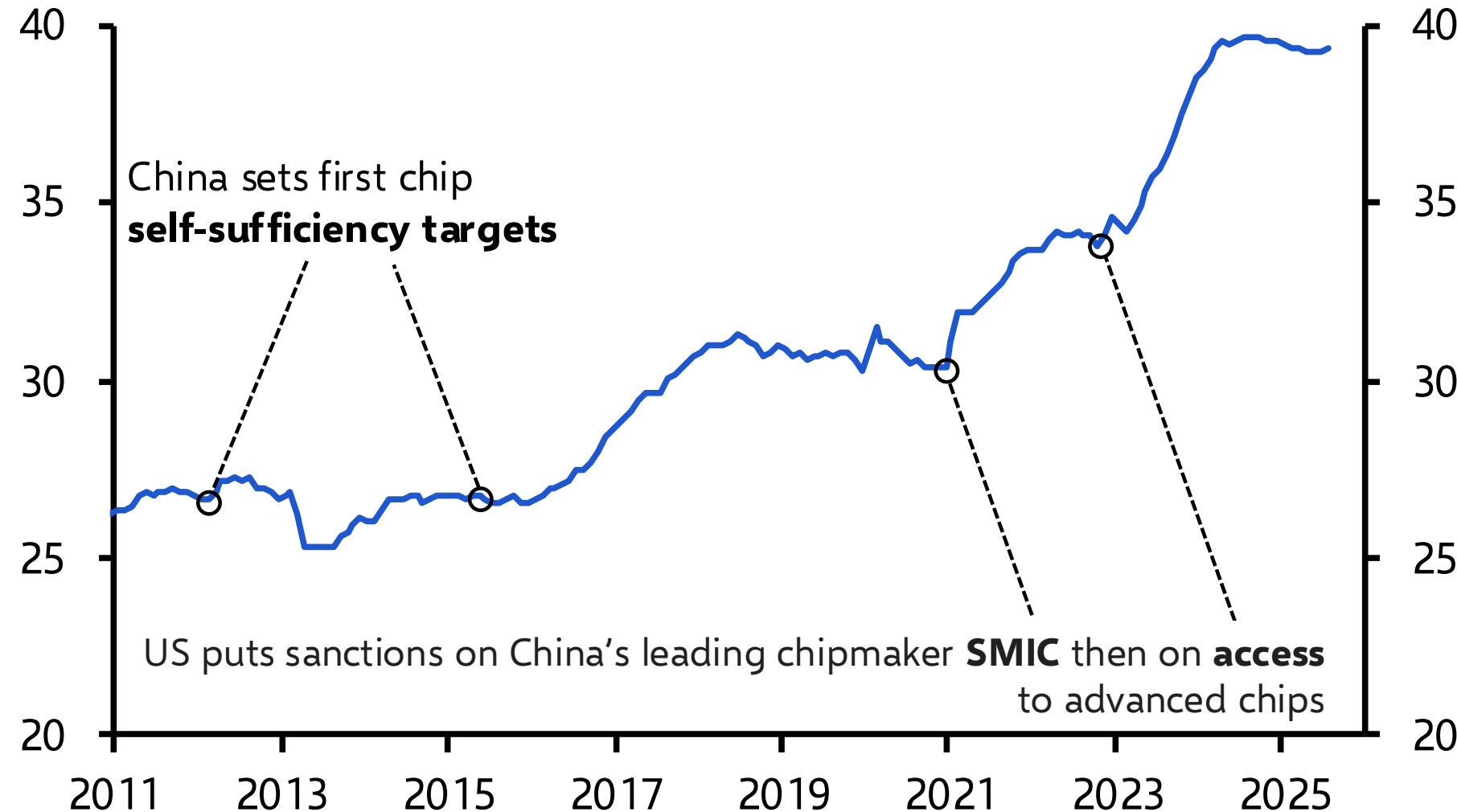
## China would offer:

- Large purchases of US goods
- Investment in the US?
- A stronger renminbi?
- Help in Ukraine?

## ... but resist:

- Structural reform
- Political change

# Domestically-Produced Chips (% of China's consumption, 12m average)



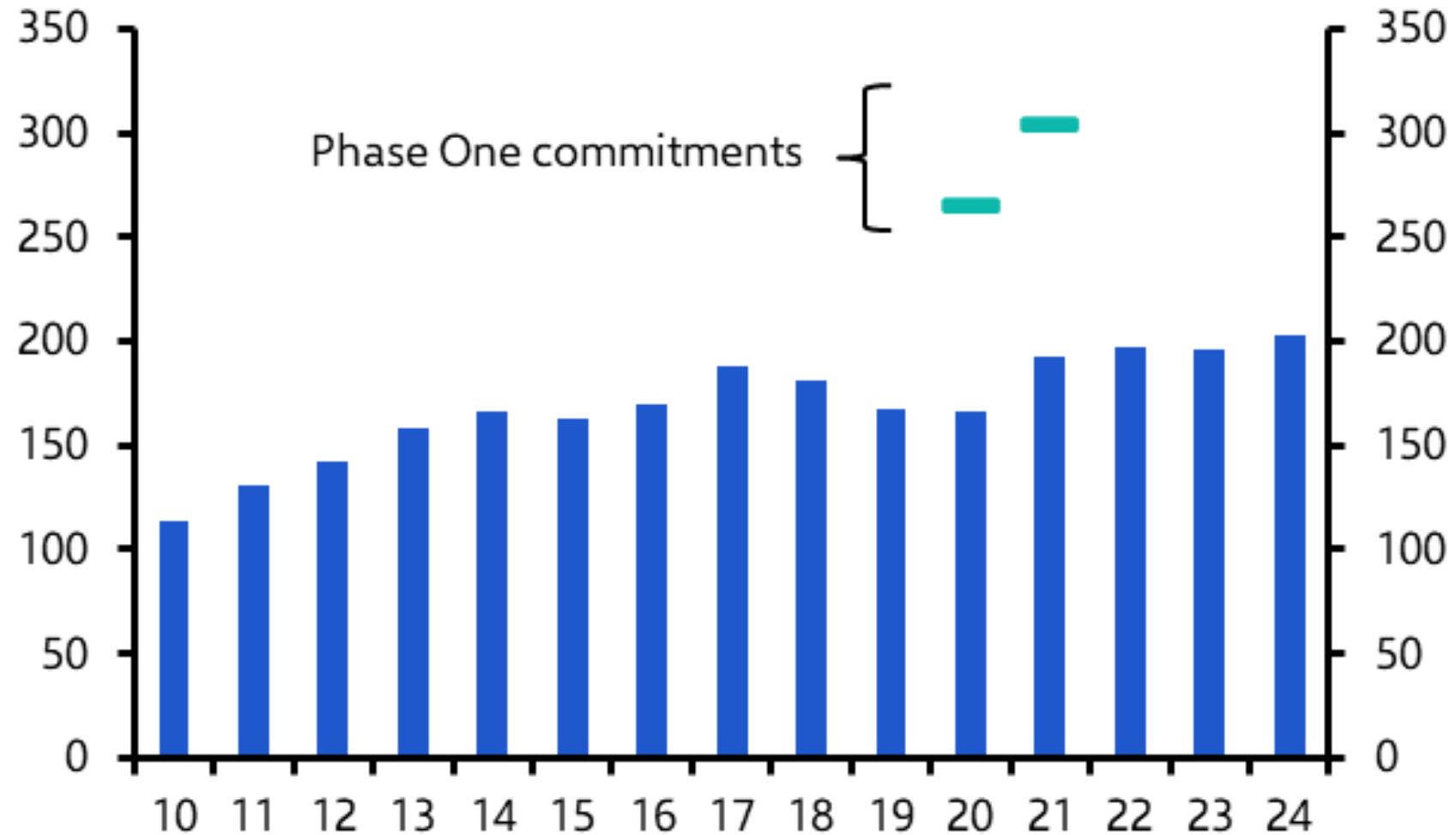
Sources: CEIC, Capital Economics

# Lack of trust makes a meaningful US-China reset unlikely

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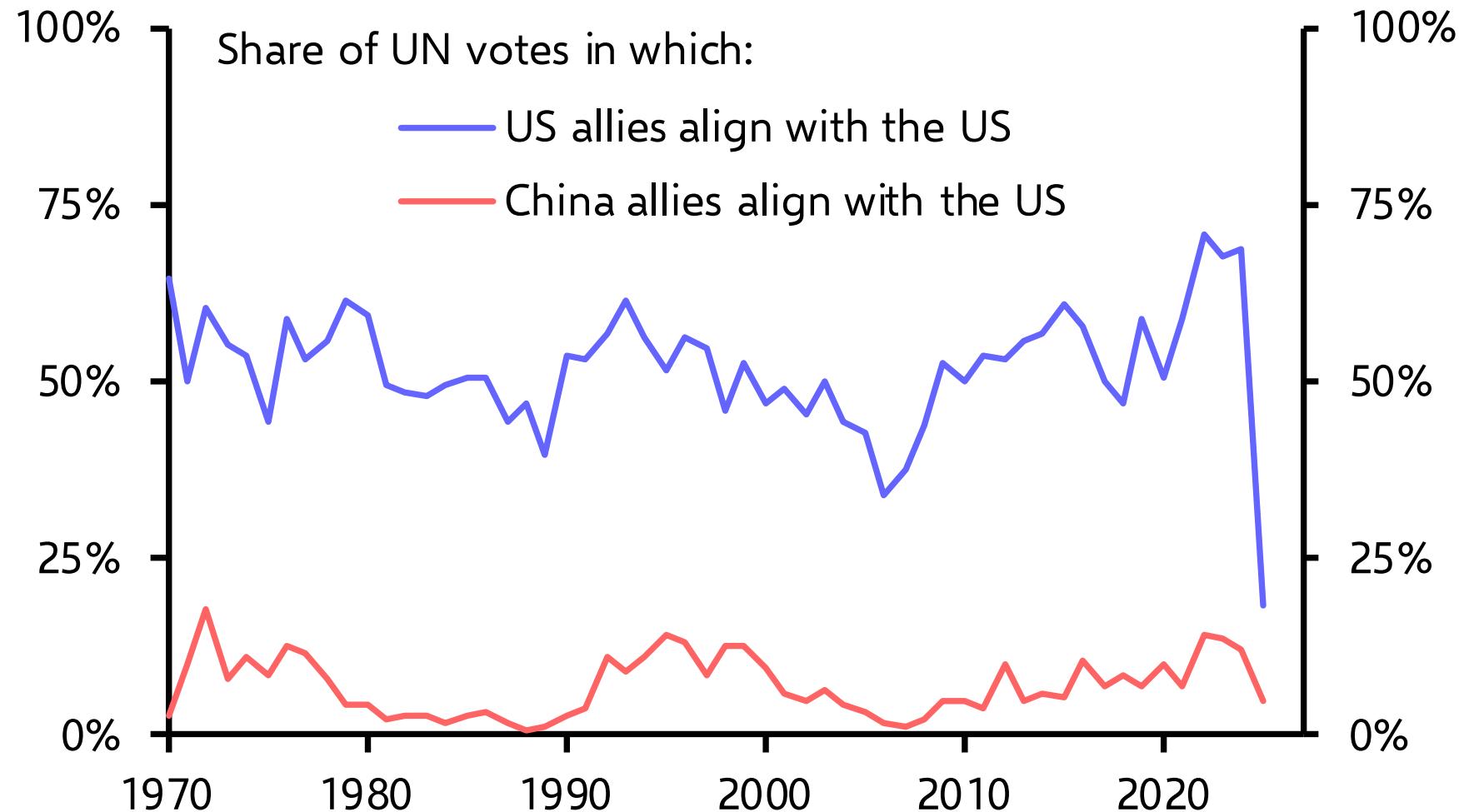
- Both countries feel threatened by the other.
- Neither side can credibly commit not to escalate tensions in future.
- This creates an incentive to keep ties to a minimum.

# China's goods imports from US & China's Phase One commitments (\$bn)



Sources: BEA, Capital Economics

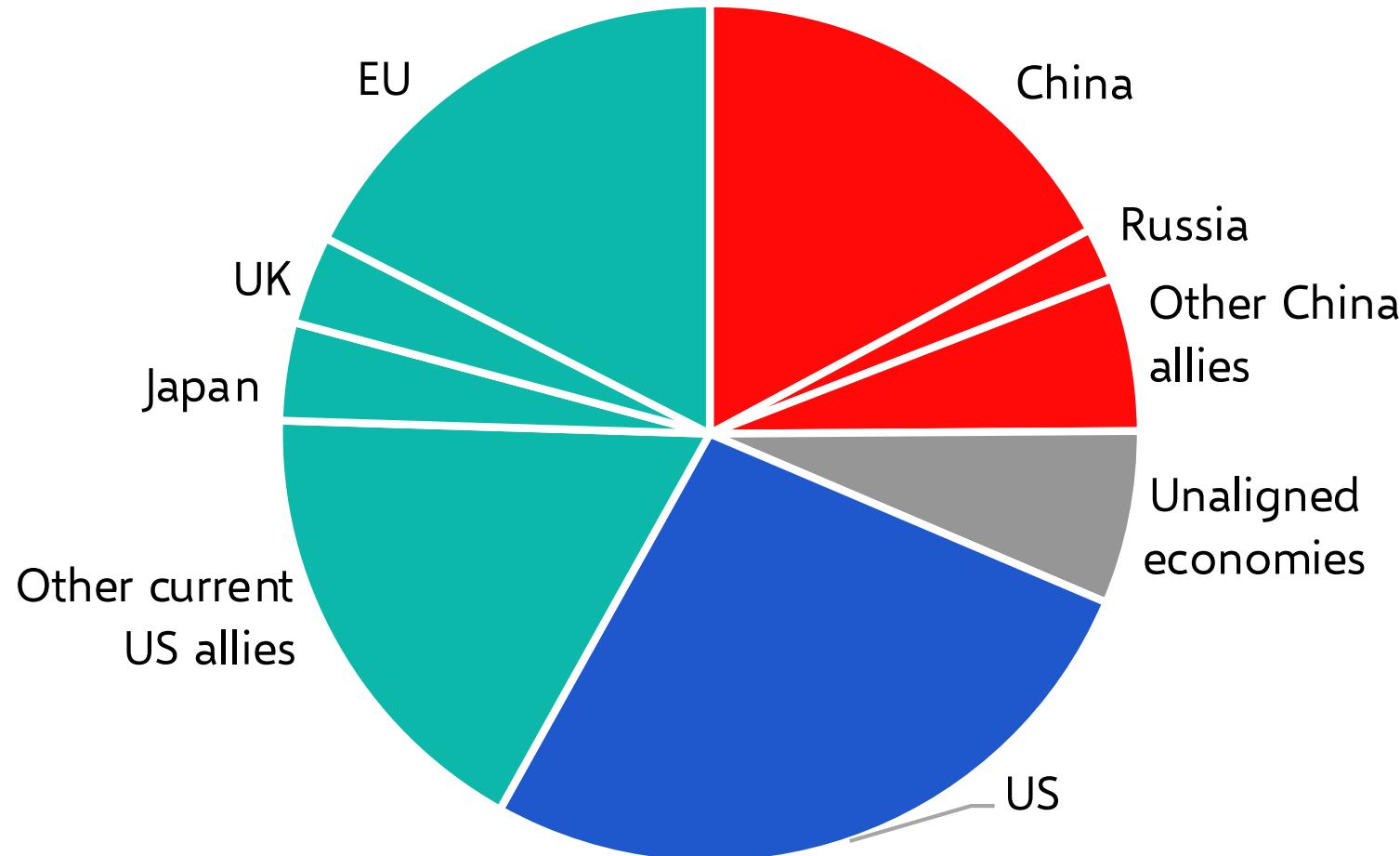
# Alignment with the US at the UN General Assembly



Note: The share of votes in each year that aligns with the US on issues where China & the US cast opposing votes. Median country. 2025 shows votes up to the end of August.

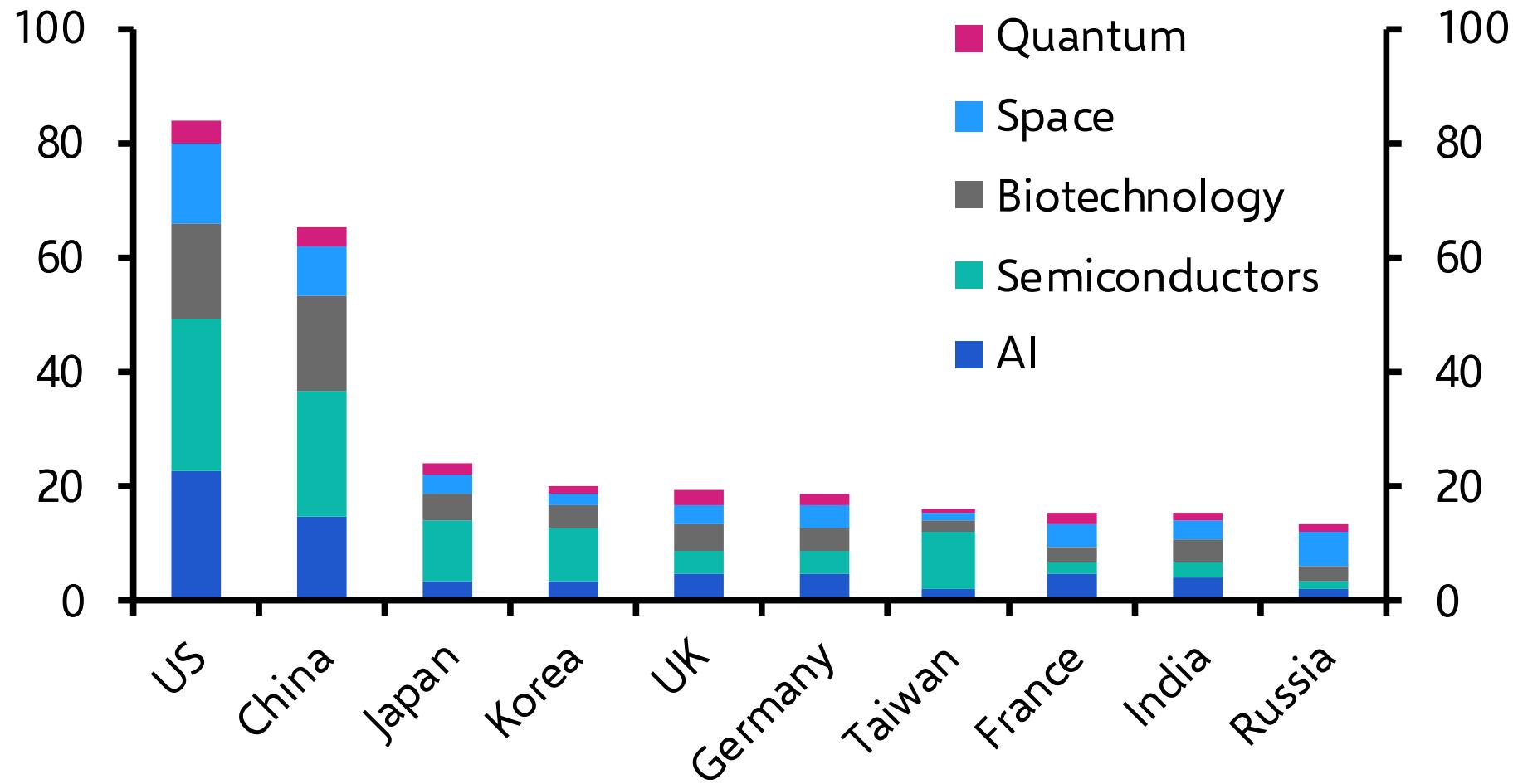
Sources: UN, Capital Economics

# Breakdown of Global GDP (2024, market exchange rates)



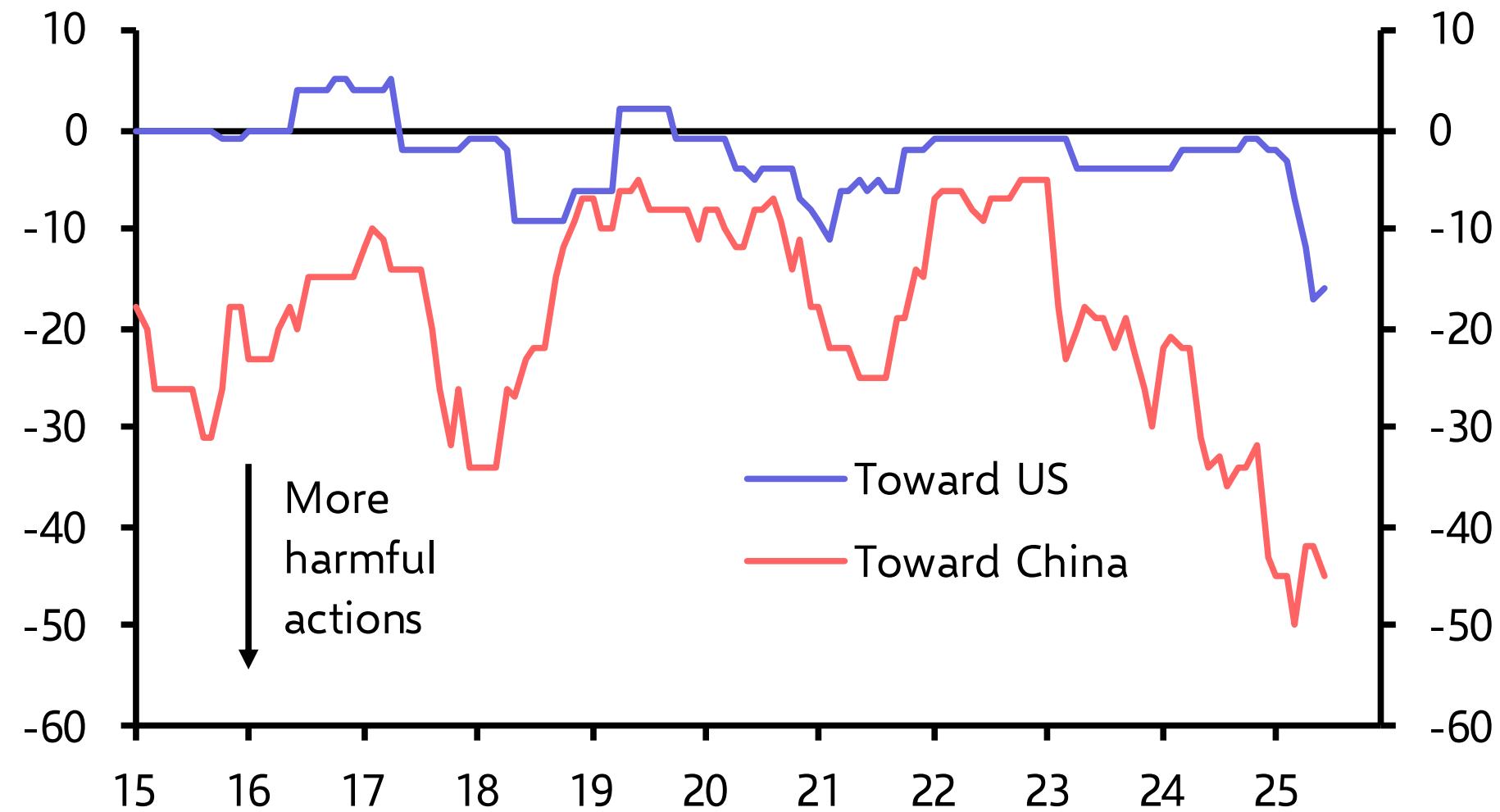
Sources: LSEG, Capital Economics

# Critical & Emerging Technologies Index



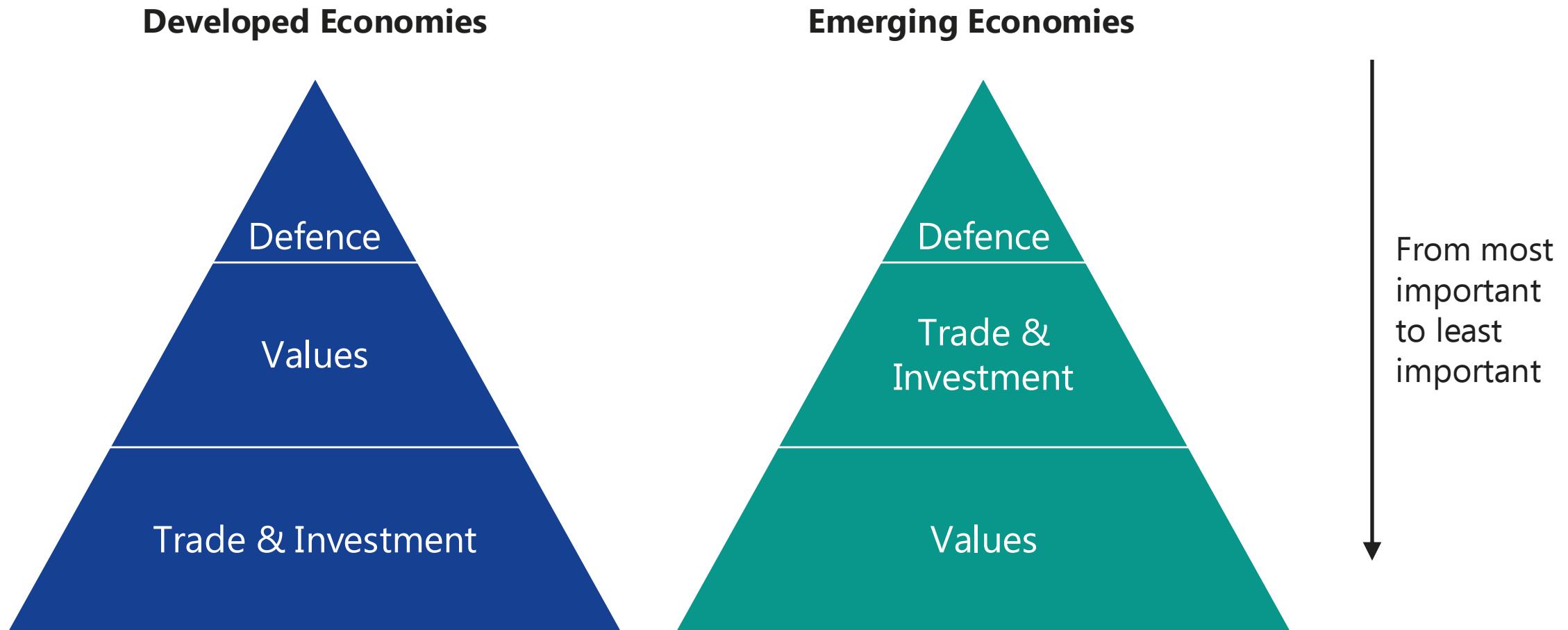
Source: "Critical and Emerging Technologies Index." by E. Rosenbach et al. (2025)

# New Trade Actions by US Allies (#, liberalising minus harmful, 12m ave.)

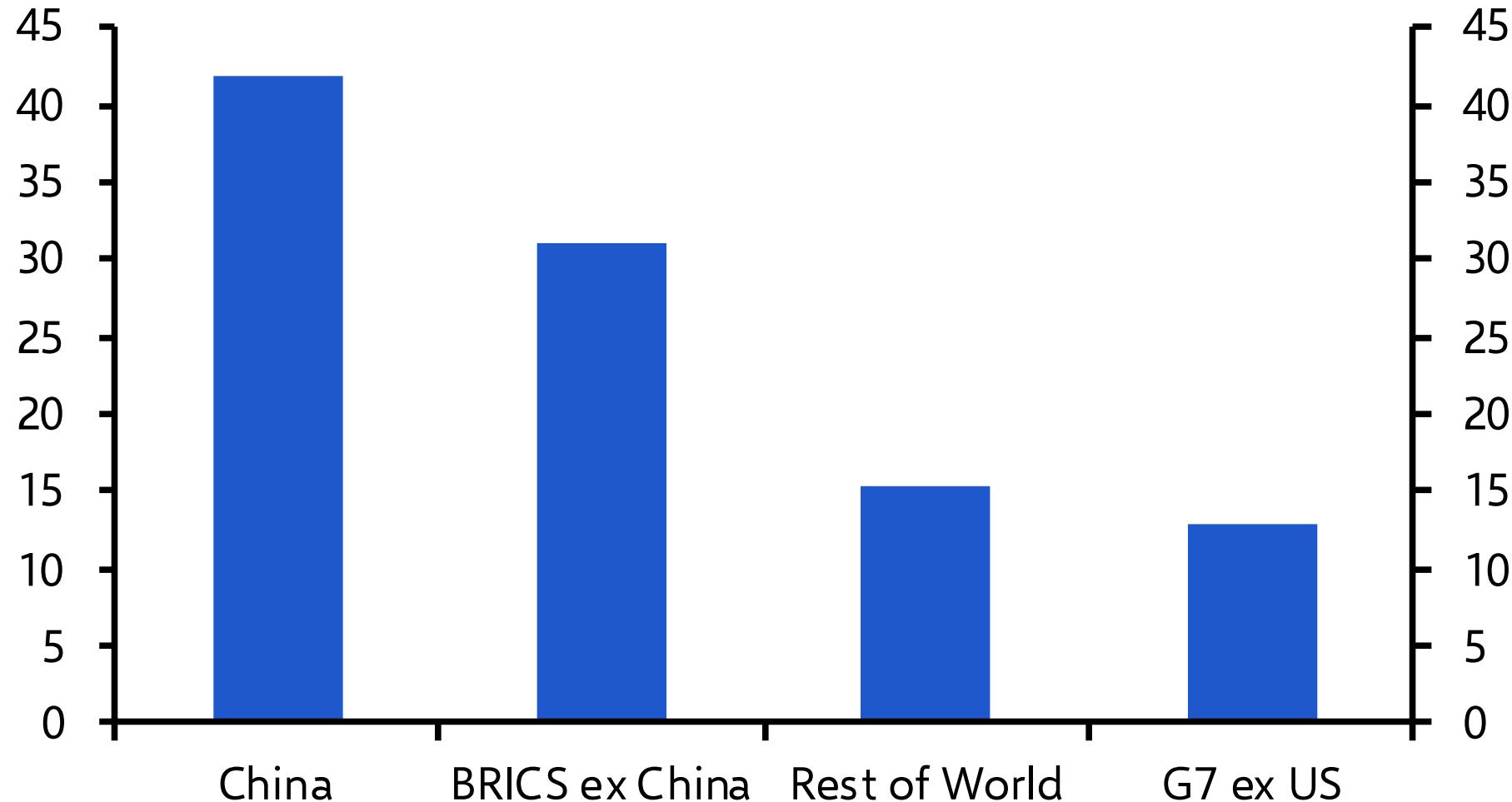


Sources: Global Trade Alert, Capital Economics

# What factors push countries into either bloc?

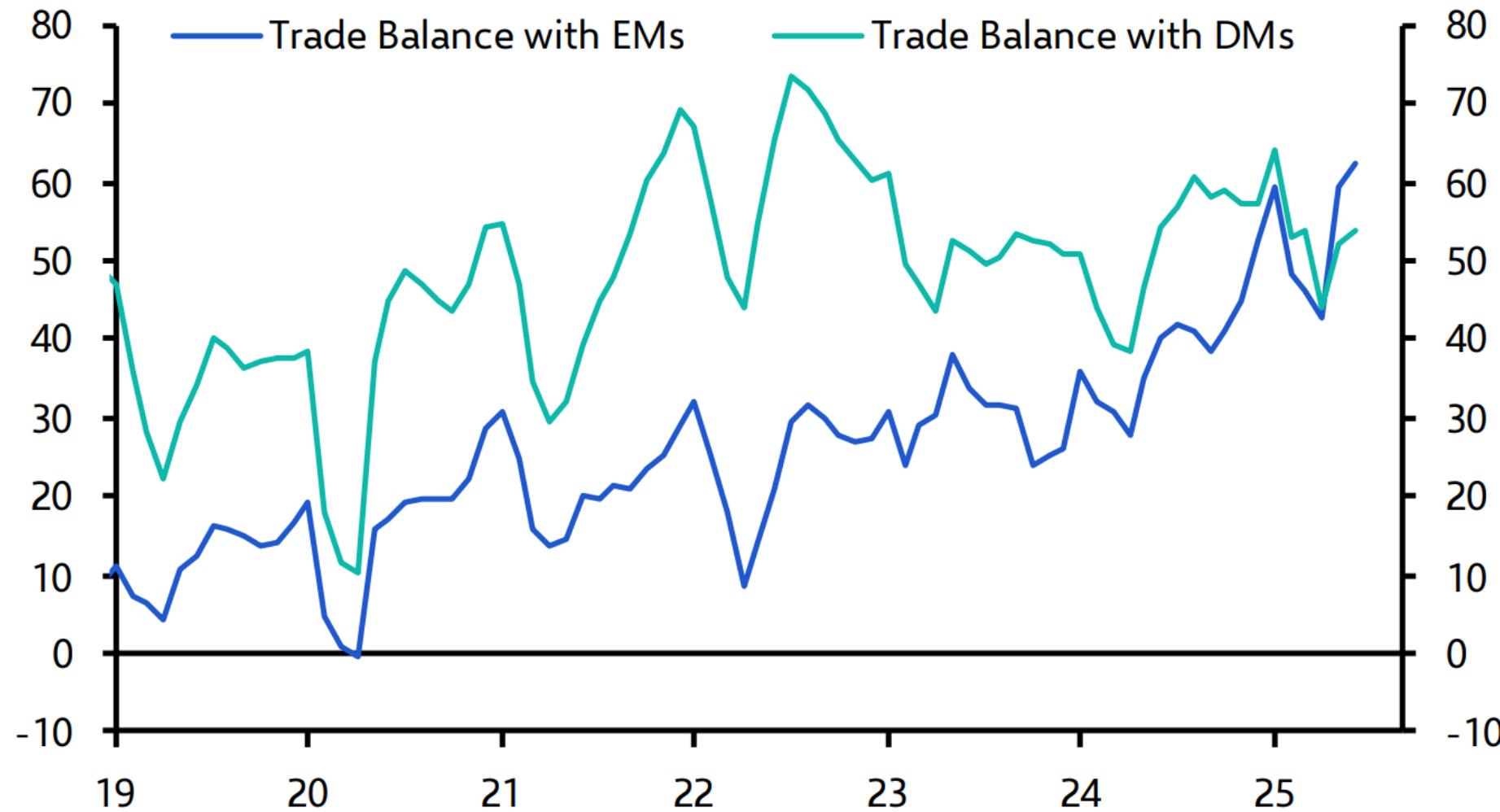


# Effective US Tariff Rate (%, as of 28 August, 2024 weights)



Sources: US Census Bureau, Capital Economics

# China Goods Trade Balance (\$bn, 3m average)



Sources: CEIC, Capital Economics

# The shape of fracturing under Trump 2.0

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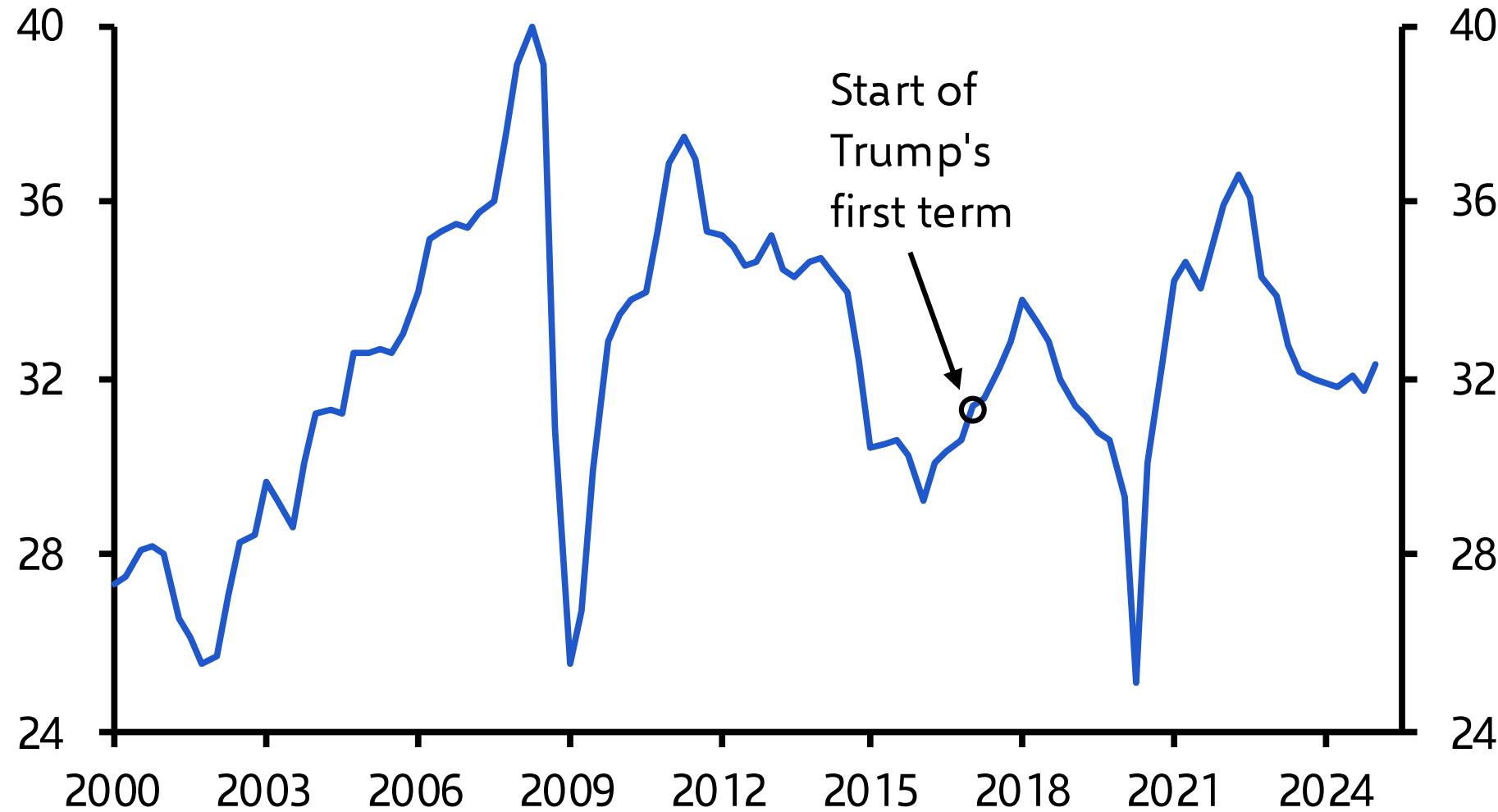
- Mercurial Trump means a wide range of possible outcomes.
- But the US-China divide likely to remain the main fissure globally.
- Trump's policies risk pushing some countries closer to China.

# Implications for the global economy

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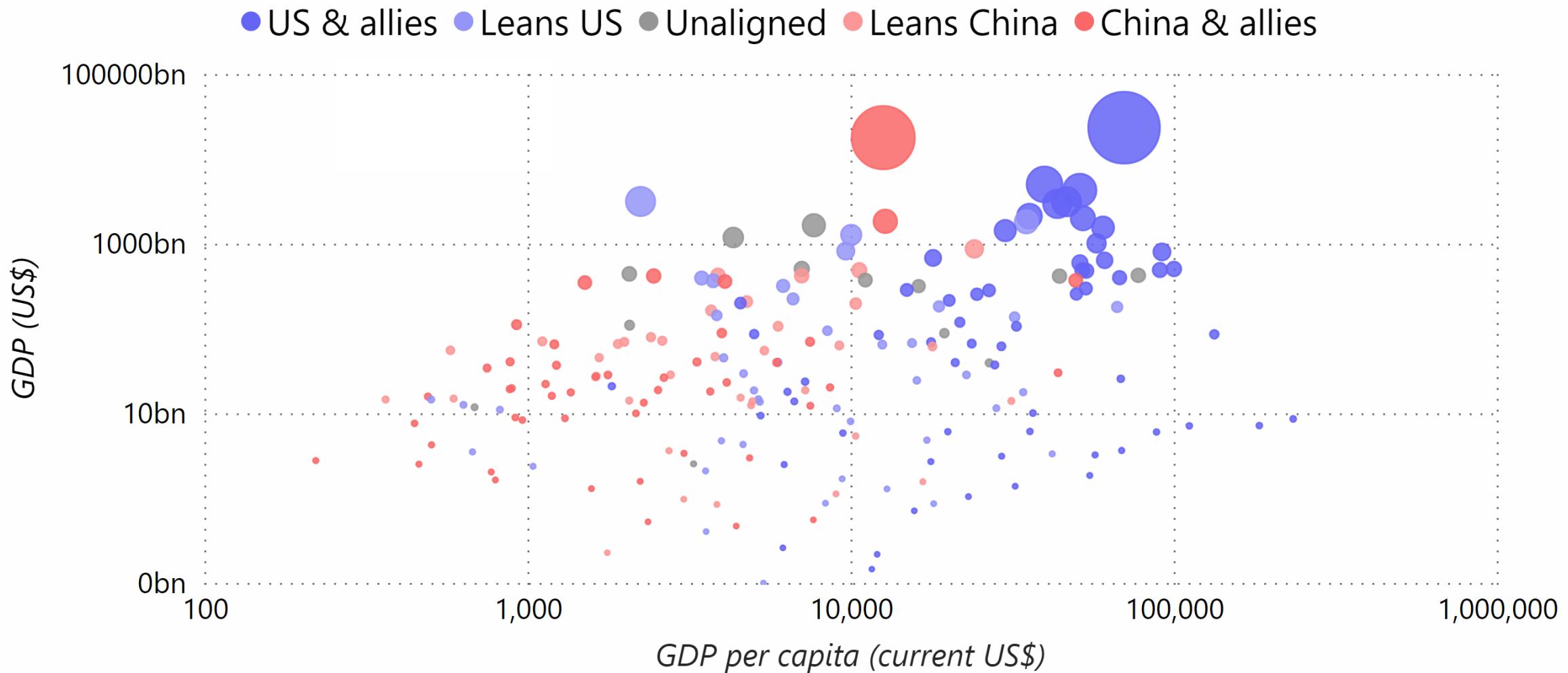
- Will globalisation go into reverse?
- Who are the winners and losers?
- Will fracturing lead to higher inflation?

# Global Goods Trade (% of World GDP, seasonally-adjusted)



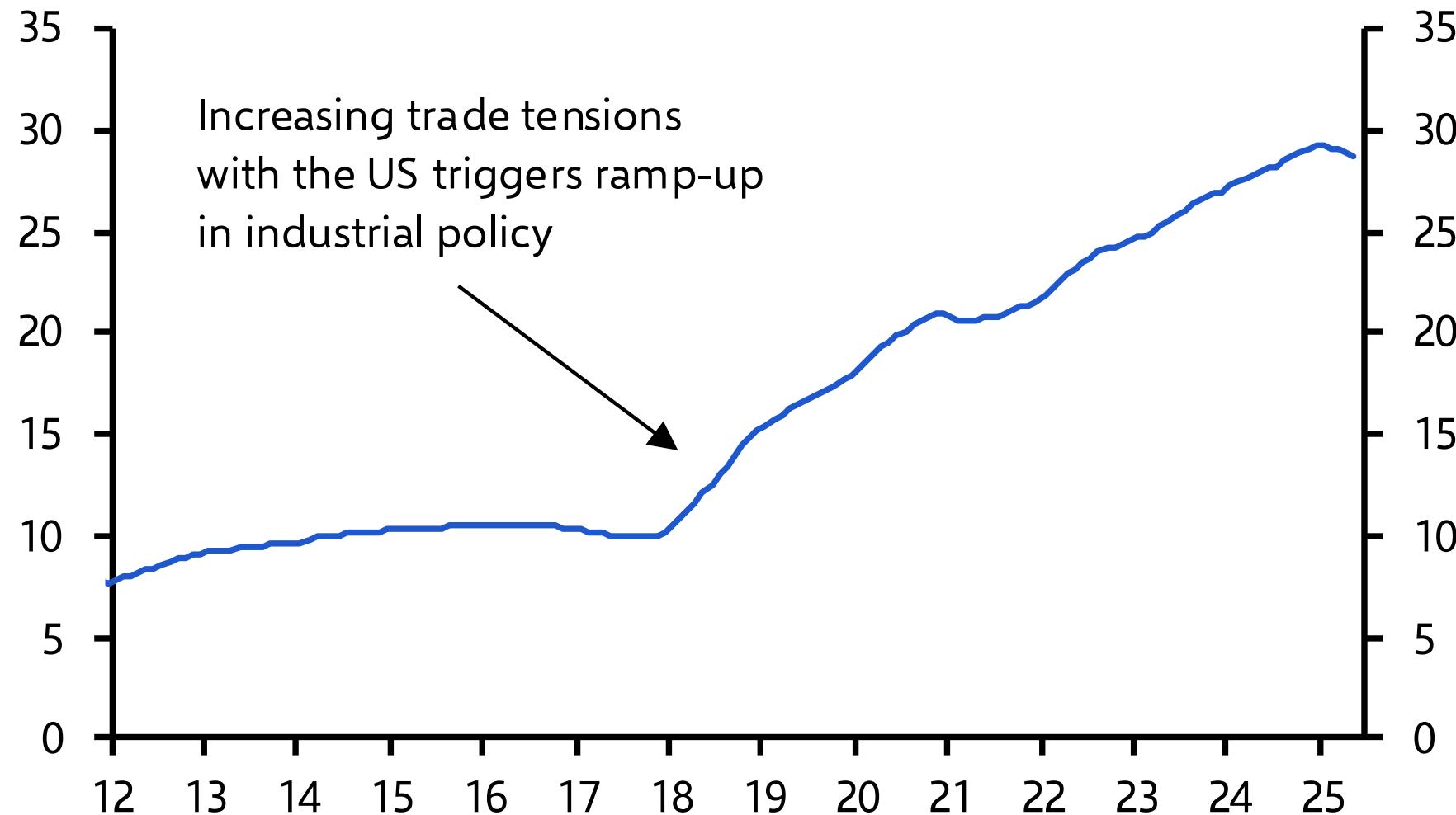
Sources: CEIC, Capital Economics

# Economic Size of Countries & Their Income Level (2024)



Sources: World Bank, Capital Economics

# Lossmaking Share of China's Industrial Firms (%, 12m average)



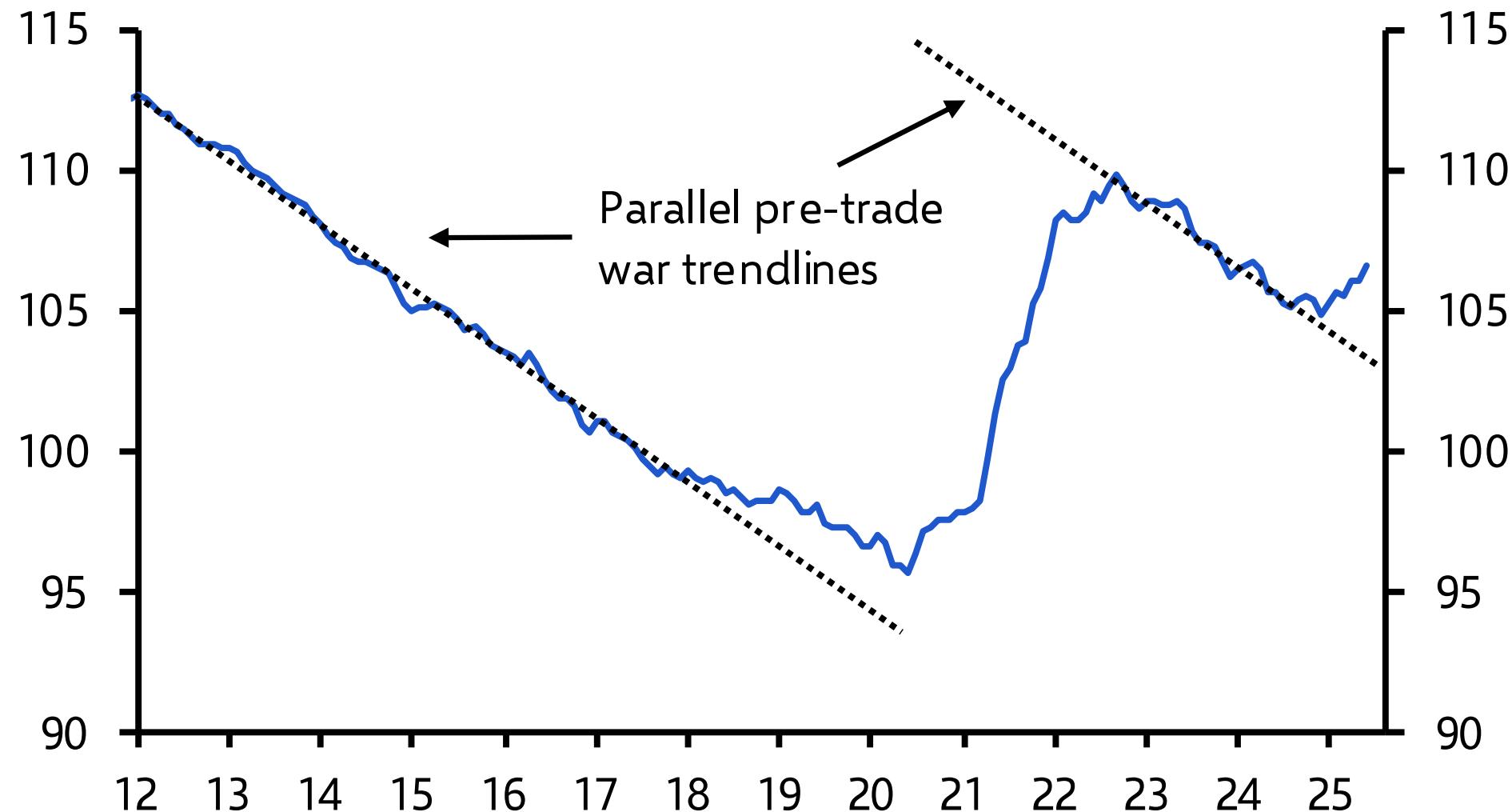
Sources: CEIC, Capital Economics

# Winners and losers from fracturing

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- Both China and the West stand to be worse off.
- The costs are likely to be greater for China.
- The distribution of costs will change if more EMs enter China's orbit.
- Some countries will benefit thanks to friendshoring.

## US PCE Deflator – Durable Goods (2017 = 100)



Sources: LSEG, Capital Economics

## Takeaways on fracturing under Trump 2.0

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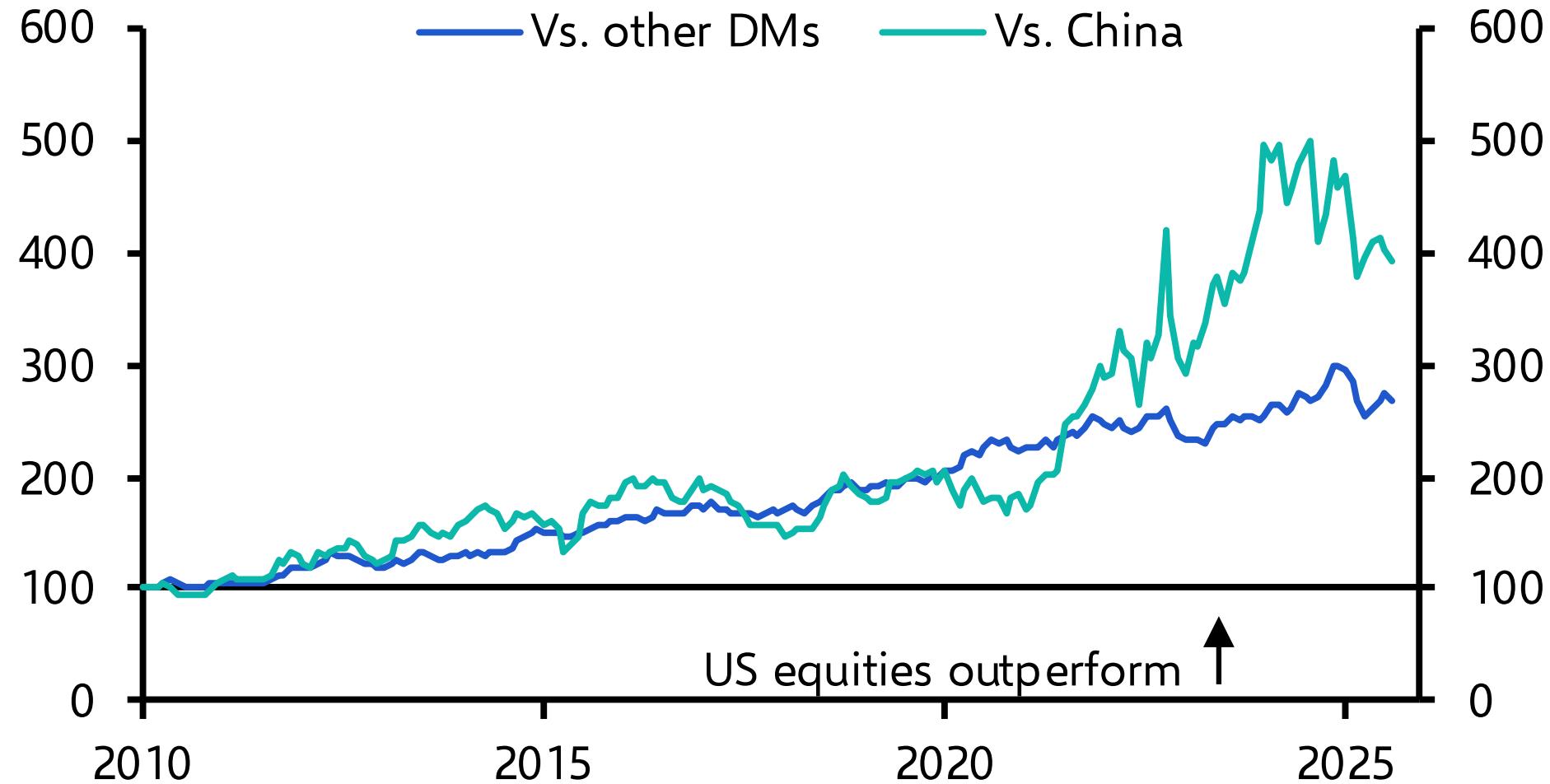
- Fracturing likely to remain centred on US-China competition.
- No deglobalisation but some efficiency losses (~1% of global GDP).
- Costs unevenly distributed, with China more at risk than the West.
- Inflation likely to more volatile but we see little sustained increase.

# Fracturing and global markets: three key questions

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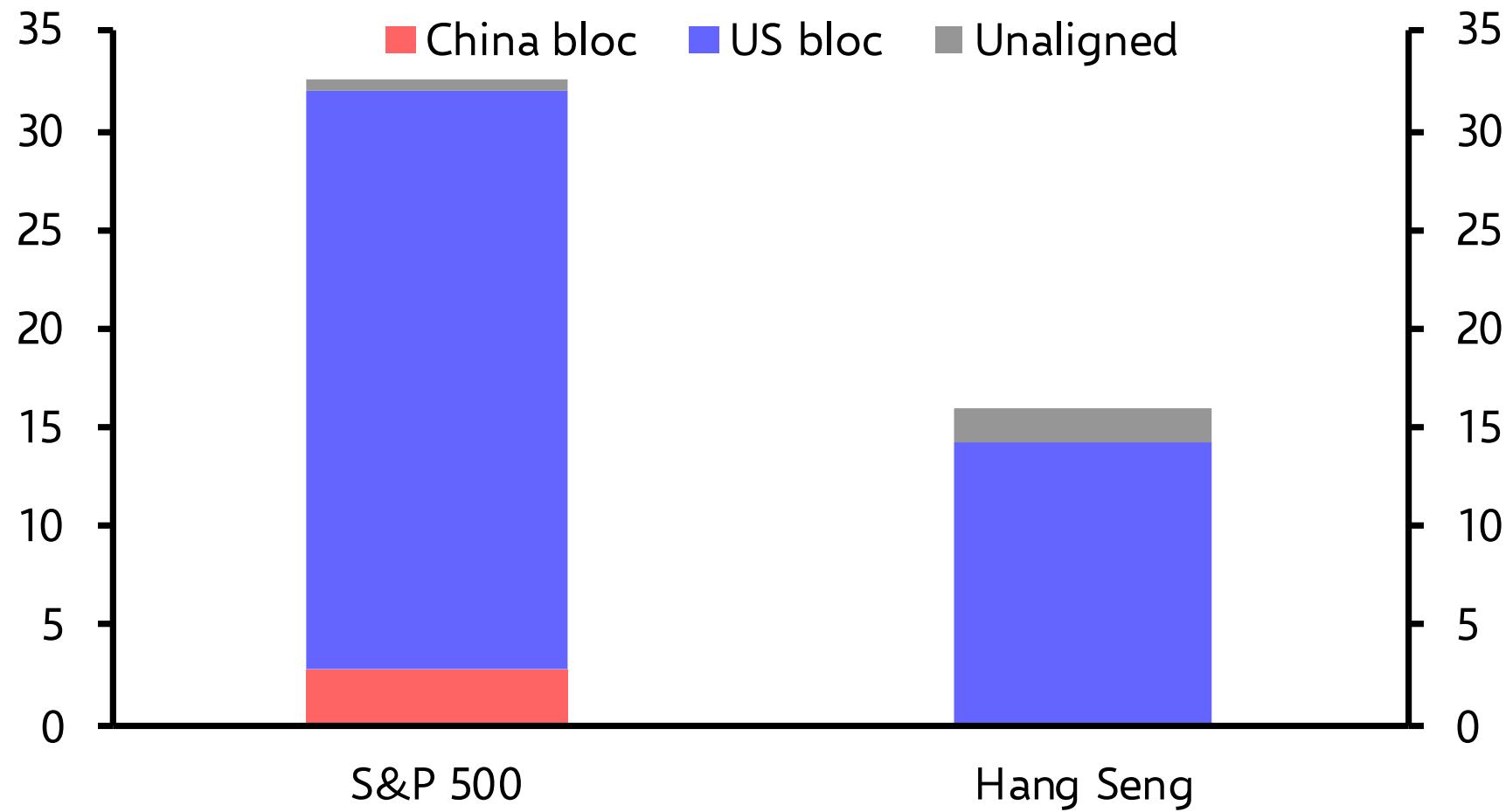
- Are Trump & fracturing derailing US equity market exceptionalism?
- Is fracturing a threat to the DM bond markets?
- Has fracturing knocked the US dollar off its perch?

# MSCI USA Relative Total Return Indices (January 2010 = 100)



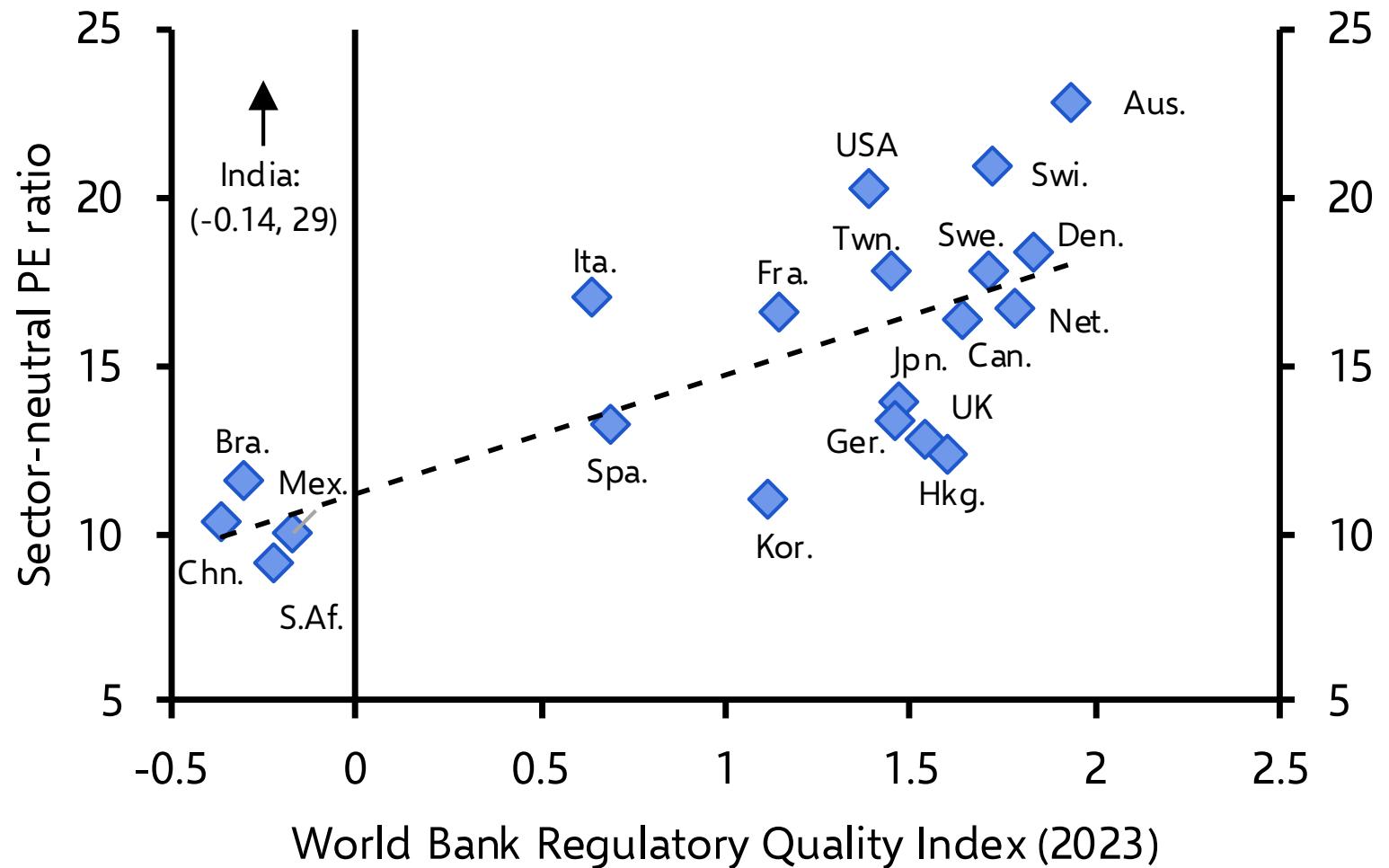
Sources: LSEG Data and Analytics, Capital Economics

# Estimated Breakdown Of Foreign Revenue Sources (% Of Total Revenue)



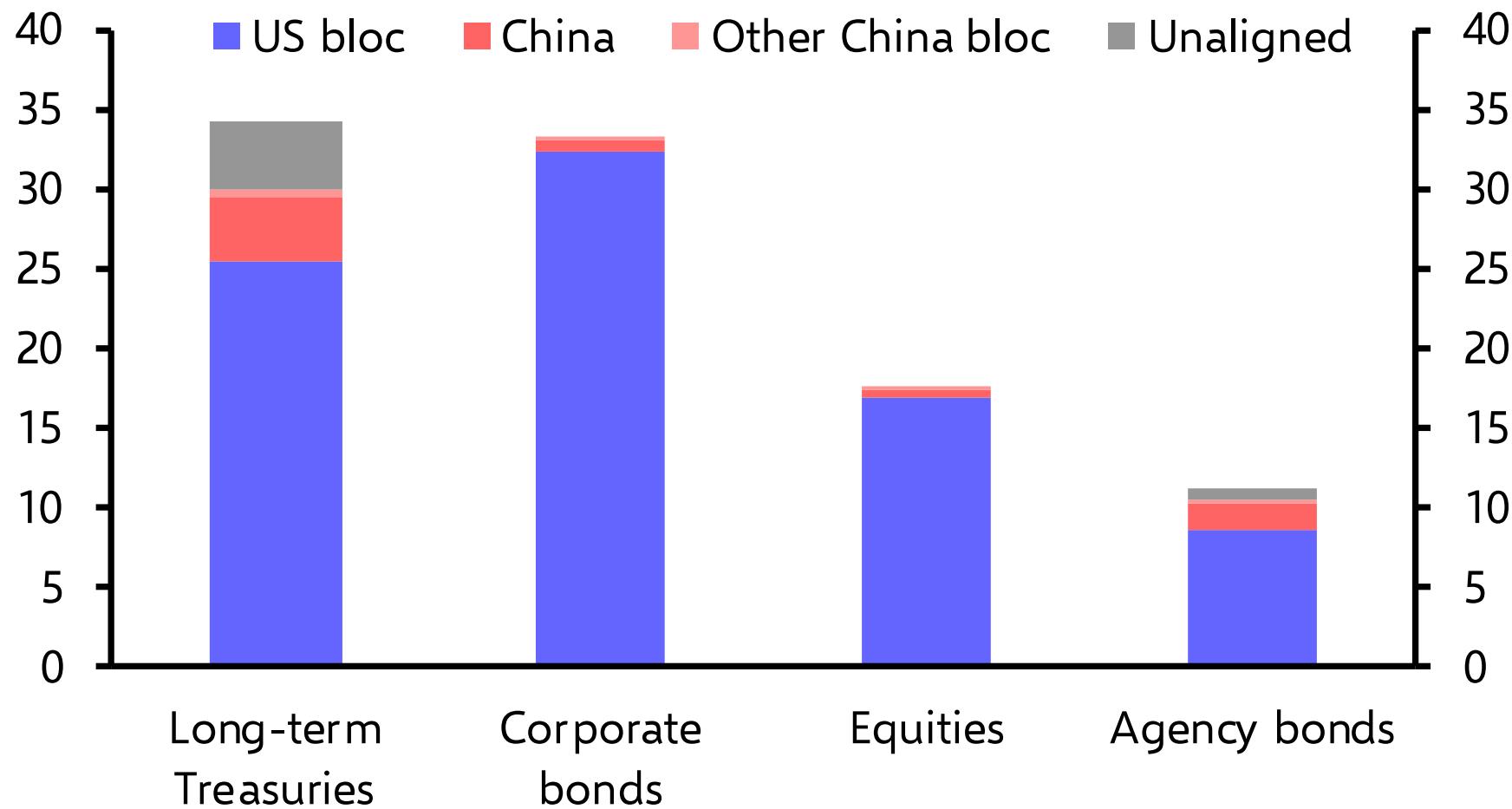
Sources: LSEG Data and Analytics, Capital Economics

# Regulatory Quality & Equity Valuations



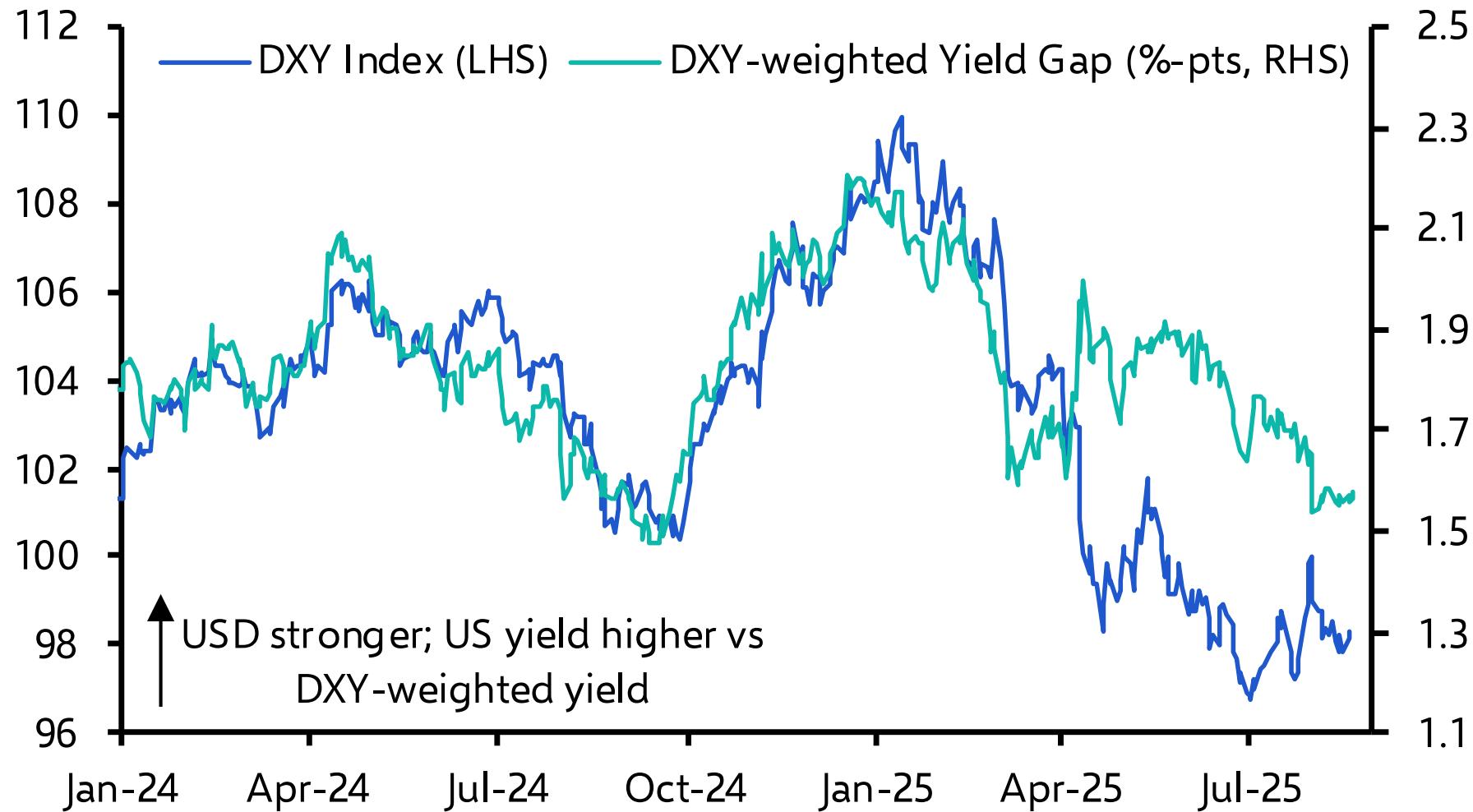
Sources: LSEG Data and Analytics, World Bank, Capital Economics

# Foreign Holders Of US Financial Assets (% Of Total)



Sources: LSEG Data and Analytics, US Treasury, Capital Economics

# DXY US Dollar Index & 5-Year Yield Gap



Sources: DKW/KWW, LSEG Data and Analytics, Capital Economics

# Fracturing and global markets: three key conclusions

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- We expect US equity exceptionalism to resume
- China won't send US yields soaring, but there are other risks to bonds
- The US dollar's dominance is not over yet