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WEALTH MANAGEMENT

INVESTMENT STRATEGY

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US Policy Pulse

Deal or No Deal: Markets and the US Trade Agenda

In this report, we discuss the factors influencing US trade dynamics and what they may mean for the economy and markets.

Key Insights:

- Tariffs have become an enduring feature of the policy regime, and revenues are being used to offset the roughly $4 trillion that the One Big Beautiful Bill Act (OBBBA) is estimated to add to the federal deficit over the next 10 years.
- The effective tariff rate is currently around 11% and is likely to remain at that level despite the US Supreme Court's decision to invalidate the International Emergency Economic Powers Act (IEEPA) tariffs.
- Pass-through inflation from tariffs is estimated to have added 62 basis points to US inflation for the year to date; core goods inflation is expected to normalize as the tariff impulse fades.
- Since the late 2010s, decoupling between the US and China has increased, with US imports from China declining by 29% in 2025. In turn, Mexico and Canada have ascended to the top two among US trading partners, overtaking China, which had previously held the top spot.
- While we expect United States-Mexico-Canada Agreement (USMCA) negotiations to be strained, upon resolution, beneficiaries could include autos, metals and agricultural products.
- In the European Union, US-EU trade flows, down 38% year over year, have already weakened meaningfully, which can be tied directly to adjustments in response to tariffs.

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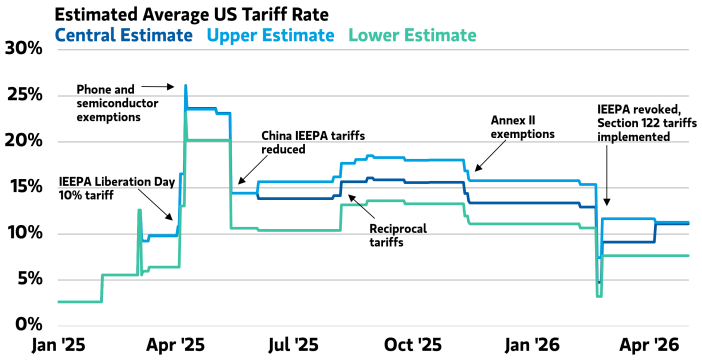
President Trump has made the recalibration of global trade relationships a key component of his second administration. For decades, Washington relied on a pro-globalization trade architecture, anchored by multilateralism and global supply chain integration to advance economic growth and geopolitical influence. That approach began to shift during Trump's first term, when the administration became focused on US import dependence and China's industrial rise. The US used tariffs to move from an "open door" framework toward one defined by reshoring and strategic competition. While the diplomatic tone was altered during the Biden presidency, the Democratic Party did not unwind the Republican tariff regime; instead, it preserved tariffs and in some cases increased them, supporting several China-facing measures to protect semiconductors, electric vehicles, solar cells and other strategic industries.

That policy approach has accelerated under Trump 2.0, with reciprocal tariffs, country-specific trade deals and tariff revenue moving from negotiating tools to central pillars of fiscal, industrial and national security policy. At the same time, the administration's renewed embrace of the Monroe Doctrine and a "Western Hemisphere First" strategy suggests that trade policy is no longer just about goods balances or market access. Rather, it is likely to be leveraged as part of the "America First" policy agenda, rewarding regional alignment with the US and limiting the influence of competitor nations. In this report, we examine how tariffs have moved from policy shock to policy framework and what ongoing negotiations with China; Mexico and Canada; Europe; and other trading partners could mean for trade flows, sector performance and market risk.

Tariff Table Stakes

Since the announcement of the "Liberation Day" tariffs in 2025, Morgan Stanley Wealth Management's US Policy team has maintained that tariffs are not a temporary negotiating tool but an enduring feature of the current policy regime. This view has been informed, in part, by the US fiscal backdrop. Passage of the OBBBA is estimated to add roughly $4 trillion to the federal deficit over 10 years, contributing to the US debt-to-GDP ratio's rise above 100% this year and reinforcing the need for new revenue sources as debt-service costs continue to increase. To date, that thesis has largely played out. Even after the Supreme Court's February 2026 decision invalidated the IEEPA tariff regime, the administration moved quickly to preserve tariff revenues through alternative means, including via Section 122 and Section 232 provisions and proposed Section 301 actions. While the permanency of Section 122 tariffs remains in question, the Committee for a Responsible Federal Budget estimates that their quick utilization has helped the US government to recoup more than half of the lost IEEPA revenue. Furthermore, according to the Brookings Institution, the average effective tariff rate is equal to 11.1% (see Exhibit 1).

Exhibit 1: US Tariffs, on Average, Are Three Times Higher Than in January 2025

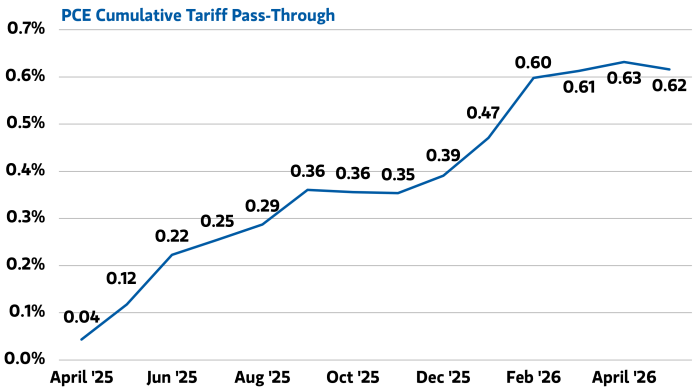


Note: The central estimate includes all implemented IEEPA, Section 232 and Section 122 tariffs. It assumes that 38% of Canadian imports and 50% of Mexican imports are USMCA-compliant and that no derivative product content is tariffed. The upper estimate assumes the same USMCA compliance as the central estimate and that 100% of derivative content is covered. The lower estimate assumes 100% USMCA compliance and that no derivative content is covered.
Source: Brookings Institution, Morgan Stanley Wealth Management Global Investment Office (GIO) as of June 9, 2026

In practice, the proposed Section 301 tariffs replace Section 122 tariffs, applying a duty of 10% on goods from Canada, Mexico, the EU, Indonesia, Ecuador and Pakistan, and 12.5% on goods from China, the United Kingdom and India. If implemented and made permanent, it is estimated that these proposed Section 301 tariffs, along with recent adjustments to Section 232 steel, aluminum and copper tariffs, will raise approximately $970 billion over 10 years, directly offsetting Section 122 tariffs and maintaining the average effective tariff rate around 11%. The result of these potential changes is a trade policy framework that looks less like a temporary disruption and more like a durable revenue, industrial policy and geopolitical instrument.

While the road to tariff stability is slowly being paved, we emphasize that the final outcomes remain uncertain. That said, other areas of tariff-related policy opacity are becoming clear. Namely, the impact of tariff changes has largely been absorbed by the consumer, with Morgan Stanley and Co. economists expecting tariff pass-through to personal consumption expenditures (PCE) inflation to fade over the coming months. While the inflation pass-through from the IEEPA tariff regime continued through the first half of 2026, it decelerated after the February Supreme Court decision, with goods more exposed to tariffs rising less in April than goods less exposed. Morgan Stanley & Co. estimates that tariffs have added 62 basis points to inflation for the year to date, but that core goods inflation will normalize as the tariff impulse fades (see Exhibit 2).

Exhibit 2: Tariff Pass-Through Is Likely to Fade



Source: Morgan Stanley & Co. Research, Morgan Stanley Wealth Management GIO as of May 31, 2026

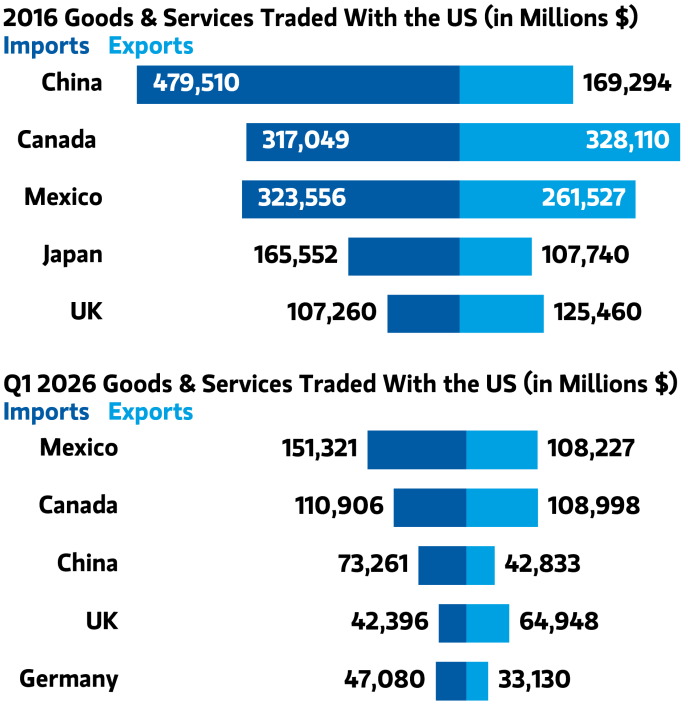
The China Trade Hand

Tariff levels are increasingly serving as the opening bid rather than the final policy outcome; the next phase of the trade agenda is likely to be defined by bilateral trade negotiations. China remains the center point of US trade policy, but the administration is also focused on the 2026 USMCA review, European energy and defense purchases, and a growing list of deals aimed at redirecting supply chains toward countries aligned with US industrial and national security priorities.

World Trade Organization data from 2025 clearly indicates signs of a decoupling of the US and China, with US imports from China declining by 29%. At its peak, China accounted for more than 20% of total US imports, and the US absorbed a similar share of Chinese exports. Since the late 2010s, however, both measures have declined dramatically, with the pace of decline accelerating following the escalation of trade tensions in 2018. By the first quarter of 2026, China's share of US imports had fallen to roughly 6.1%, the lowest in more than two decades. As imports from China decreased, China fell from the position of top US trade partner to the third less than 10 years after reaching the top of the list. In turn, the US sought to expand trade relationships with its closest neighbors. Today, Mexico and Canada have overtaken China and compete for the position of top US trade partner (see Exhibit 3).

The continued decoupling between China and the US reflects the latter's efforts to diversify supply chains amid economic competition and national security concerns. Severing the nations' interdependence, however, is challenging. Notably, last month's Beijing Summit, between Presidents Trump and Xi, resulted in near term deescalation, with negotiations repricing downside risks to China-exposed equities. The agreement reduced pressures on import costs and supply chains, supporting rare-earth minerals, semiconductors, tech-hardware and agriculture. In addition, both countries agreed to continued communication with the creation of the US-China Board of Trade and the US-China Board of Investment, aimed at fostering a more nuanced approach to tariffs and addressing investment-related irritants.

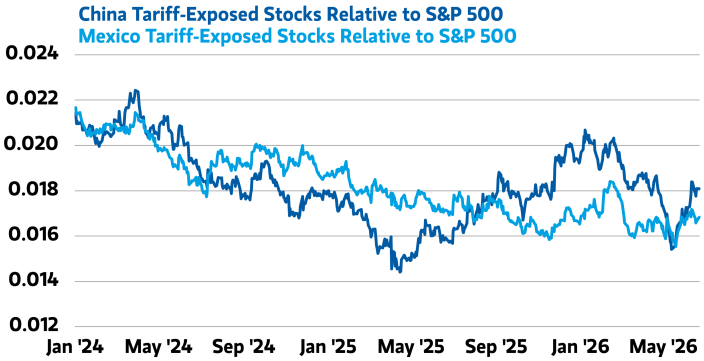
Exhibit 3: The US-China Trade Partnership is Weakening



Source: Haver, Morgan Stanley Wealth Management GIO as of June 22, 2026

The market reaction to these developments was restrained, reflecting investor skepticism. We underscore that more negotiations with China are on the horizon this year and that additional concessions could emerge when Trump and Xi meet this fall. In our view, the developments lower the probability of a near-term trade shock but do not eliminate durable policy risk. While China remains the central target of US trade policy, the sell-off in both China- and Mexico-exposed equities suggests investors are increasingly considering broader supply chain risk rather than just risks pertaining to China. Mexico-exposed stocks have underperformed more sharply than China-exposed stocks, rising 21.6% since 2024, compared with the S&P 500 Index's 55.4%. But China-exposed stocks have also lagged, gaining 31.5% over the same period, underscoring that countries positioned to benefit from decoupling are not immune to markets pricing trade policy risk (Exhibit 4).

Exhibit 4: Impacts of Decoupling on China and Mexico Tariff-Exposed Equities



Source: Morgan Stanley Wealth Management GIO as of June 22, 2026

That distinction matters as the administration turns from China to North America. Mexico's rise as a top US trade partner has been a direct consequence of supply chain diversification, but its deeper integration with the US also increases its exposure to the next round of negotiations. The 2026 USMCA review is likely to serve as a referendum on the strength of US leadership in Western Hemisphere trade dynamics.

Reraising the USMCA

The USMCA replaced the North American Free Trade Agreement (NAFTA) in 2020, preserving duty-free treatment for most qualifying goods while tightening North American rules of origin and strengthening labor provisions, particularly in the auto industry. The agreement includes a 16-year sunset clause, with the first major review date on July 1, 2026. At that point, the three countries can extend the agreement another 16 years; absent consensus, USMCA enters an annual review cycle and would expire in 2036 if no extension is reached. While the Trump administration is pursuing separate bilateral talks with Canada and Mexico, it has also signaled that the current framework may no longer fully serve US economic and strategic interests.

This tension informs our view that a simple renewal of the deal is unlikely. Rather, we expect a protracted debate into the fall, with the US increasing pressure for Mexico and Canada to make concessions in exchange for the core duty-free components of the deal and reduced industry-specific tariffs for non-USMCA-covered goods and services, as illustrated by the Center for Strategic and International Studies (CSIS) in Exhibit 5.

Exhibit 5: USMCA Review Is Likely to Extend Past Current Deadlines

Scenario	Description	Key Risks	Likelihood
Clean Renewal	Agreement extended to 2036 without significant updates	Complacency, missed opportunity to modernize	Low
Expiration in 2036	No consensus, leading to legal end of USMCA	Regulatory drift, investment decline	Low
Early Withdrawal	One country exits via withdrawal clause (Article 34.6)	Trade and supply chain shocks	Low-Moderate
Fallback to Bilateral Deals	No consensus to extend; members pivot to bilateral agreements	Weaker regional coherence, inconsistent rules, exclusion of third party	Moderate-Low
Serial Annual Reviews	No deal to extend reached in 2026; yearly reviews begin	Uncertainty, subpar growth	Moderate
Protracted Extension	Mexico and Canada make concessions to reduce US tariffs and extend USMCA	Regional coproduction platform disrupted, increased distrust	Moderate-High

Source: Center for Strategic and International Studies (CSIS), Morgan Stanley Wealth Management GIO as of March 27, 2026

We expect one of the central themes to emerge will be preventing the transshipment of goods from China, or the import of Chinese goods into the US through indirect channels. The US and Mexico have already begun discussions on this topic, with Mexico agreeing to increase tariffs on China-linked imports in exchange for increased import commitments from the US in support of Mexican manufacturing. This dynamic is critical for Mexico as the US accounts for 80% of Mexican exports.

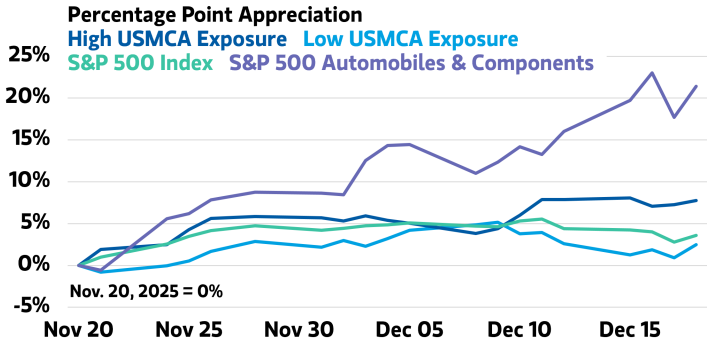
The US-Canada side of the agreement is different, with the transshipment story less foundational, despite US criticism of Canada's trade activity with China. Rather, the focus is expected to be on energy, autos, lumber, steel, aluminum, and agricultural trade. The Canadian trade surplus with the US reached its highest level since before President Trump first imposed tariffs in February 2025. Higher exports of crude oil as well as passenger cars and light trucks drove up exports to the US, supporting Canada's position as the top US trade partner.

Canada has faced lower effective tariff rates than most major US trading partners, with an average effective tariff rate of 3.35% versus the overall average of 7.03%. This is due to a major share of its exports through March 2026 remaining largely duty-free, given USMCA compliance. Despite this advantage, trade policy uncertainty has weighed heavily on Canadian trade and investment decisions. We expect the next phase of trade risk for Canada to be less about broad tariff escalation and more about whether industry-specific industrial policy gradually erodes the value of preferential access under USMCA.

It is possible that higher costs and policy frictions weigh on demand rather than drive capacity extension. When reviewing equities with elevated exposure to USMCA tariffs, such as those on autos, metals, logistics and agricultural products, we see significant outperformance around notable USMCA developments, when compared to the broader market and equities with low USMCA exposure. For example, in the

20-day period around the Dec. 5, 2025, USMCA automotive review announcement, our basket of sectors highly exposed to USMCA, namely automobiles, metals, logistics and agricultural products, outpaced the S&P 500 by more than 4%. Outperformance was primarily driven by auto stocks, which outperformed by nearly 18% over the period and remain highly sensitive to North American trade dynamics. We view the auto industry as one that could outperform following resolution of USMCA renegotiations.

Exhibit 6: USMCA Developments Benefit Equities With USMCA Exposure



Source: Bloomberg, Morgan Stanley Wealth Management GIO as of June 23, 2026

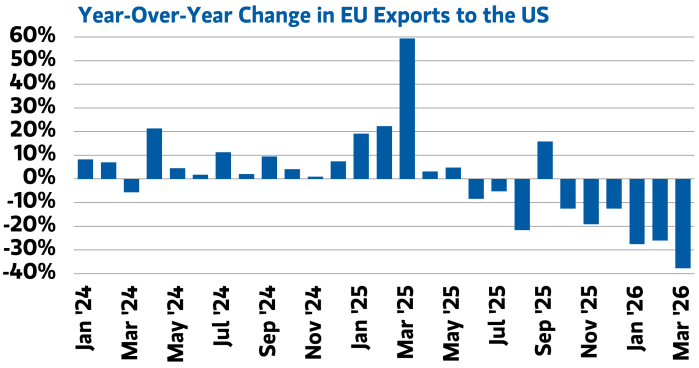
Europe Keeps Its Chips in Despite US Edge

Europe may not sit at the center of the tariff debate like China or have the same supply chain immediacy for the US as Mexico and Canada, but it is becoming one of the administration's most important negotiating fronts. The US-EU trade discussion is less about decoupling and more about using tariffs to extract concessions on energy purchases, defense spending, digital regulation and industrial competitiveness. Europe's growing reliance on US natural gas and renewed focus on defense spending make it a natural venue for dealmaking.

The European Parliament recently approved legislation implementing the EU's tariff commitments under the EU-US Framework Agreement on Reciprocal, Fair, and Balanced Trade, also known as the Turnberry Agreement, struck in July 2025. Under the framework, the EU agreed to lower barriers on certain US exports, while the US maintained a 15% all-inclusive tariff ceiling on most EU exports. The recent vote reduces escalation risk and supports US exporters in energy, defense, agricultural, seafood and industrial goods. Steel, aluminum and copper remain clear outliers at roughly 50%, keeping input-cost pressure alive. However, because of exemptions, most favored nation (MFN)-only treatment, product mix and the temporary Section 122 regime, the effective trade-weighted tariff rate is closer to 11%-12%.

That stabilization matters because recent US-EU trade flows have already weakened meaningfully, falling approximately 38% year over year from March 2025 to March 2026. While the decline in EU exports to the US is not unprecedented in magnitude, with exports declining approximately 25% during the Global Financial Crisis, the current episode is distinct. Unlike prior downturns, which were largely tied to synchronized demand shocks, the recent weakness appears directly linked to tariff policy, front-loaded shipments ahead of implementation and subsequent trade-flow adjustment (see Exhibit 7).

Exhibit 7: EU Year-Over-Year Exports to the US Have Declined



Source: Eurostat, Bloomberg, Morgan Stanley Wealth Management GIO as of March 31, 2026

The Turnberry Agreement is therefore best understood as an asymmetric stabilization deal rather than a traditional free-trade agreement. For markets, the agreement may put a floor under weakening US-EU trade flows, but it does not eliminate the cost of tariffs. Cyclical trade shocks typically recover as demand normalizes, while tariff-driven declines may prove stickier if companies permanently reroute supply chains, reset pricing or localize production. As a result, tariff pass-through, margin pressure and inflation risk remain in place for import-sensitive industries.

The Next Cards to Watch

Beyond China, USMCA and Turnberry, the next phase of the US trade agenda is likely to be shaped by bilateral market-access deals and sector-specific tariff actions. India stands out as the largest unfinished negotiation, given its scale, strategic role as a China-alternative supply chain partner and long-standing US concerns around tariff and nontariff barriers. A US-India agreement could have market implications across agriculture, energy, defense, technology, pharmaceuticals and industrial goods, particularly if it lowers barriers for US exports while reinforcing economic-security alignment.

By comparison, the UK, Japan, Taiwan and Korea provide evidence that the administration is using tariff relief, investment commitments and supply chain alignment to extract concessions from strategic partners. At the same time, pending Section 301 forced-labor tariffs and Section 232 actions on pharmaceuticals, semiconductors and critical minerals may prove more market-moving than any single bilateral deal, given their direct impact on health care, technology, consumer goods and industrial supply chains. For investors, these wild cards reinforce the broader theme of this report: Trade policy is no longer a discrete tariff story, but a recurring source of sector dispersion, margin risk and strategic opportunity.

Investment Conclusion

The US trade agenda is evolving from tariff shock into a more durable policy framework, with implications that cut across inflation, margins, fiscal revenues and supply chain strategy. Tariffs have helped raise revenue and strengthen negotiating leverage, but they also leave consumers and import-sensitive companies exposed to higher costs, even as the near-term inflation impulse begins to fade. For investors, the key distinction is no longer simply which countries face tariffs, but which sectors and industries can absorb, pass through or benefit from the elevated tariff costs. Companies tied to reshoring, domestic capex, defense, energy, agriculture and strategic supply chains may be better positioned, while auto manufacturers, retailers, consumer goods companies, industrial importers and globally integrated manufacturers remain more vulnerable to policy uncertainty and margin pressure.

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