CARLYLE

April 29, 2025

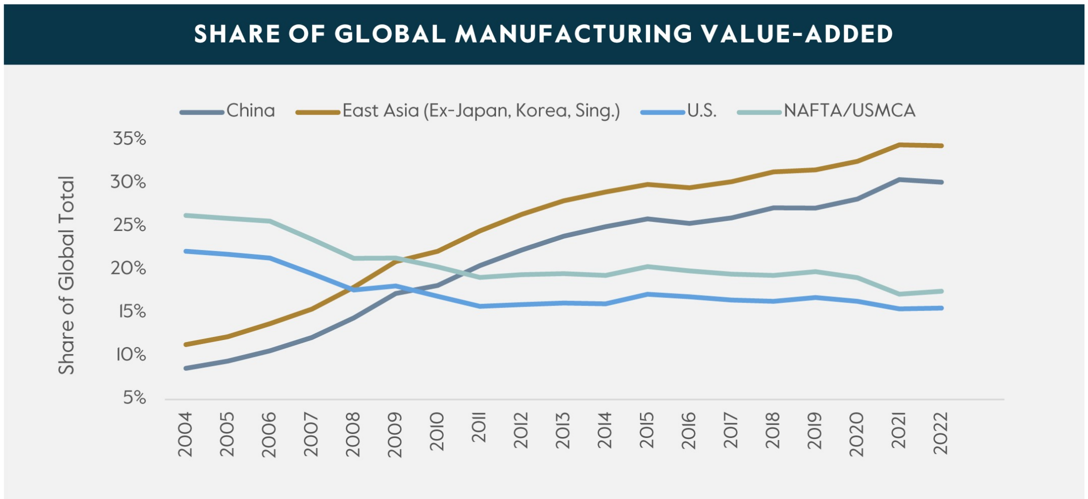
Welcome back to ***The Carlyle Compass****, your weekly newsletter that brings together the latest research and market insights from our global team. Received this email as a forward? Subscribe here.*

Breaking Up is Hard to Do

The *de facto* embargo on trade with China not only risks empty shelves in the U.S. but also shuttered factories. It is hard enough to “decouple” with an economy that accounts for roughly 30% of global manufacturing output, but that’s especially true when that 30% produces the components, parts, and refined materials on which much of the remaining 70% depends.

Twenty years ago, the U.S. manufactured 2.5x as much as China and manufacturing output in NAFTA was 2.3x that of East Asia (excluding Japan, Korea, Singapore and Hong Kong). Today, those relative positions have reversed, with China and developing East Asia manufacturing twice as much as the U.S. and North American economies, respectively (Figure 1). Final demand did not exhibit a similar shift, leading the U.S. deficit in manufactured goods to double over this period.

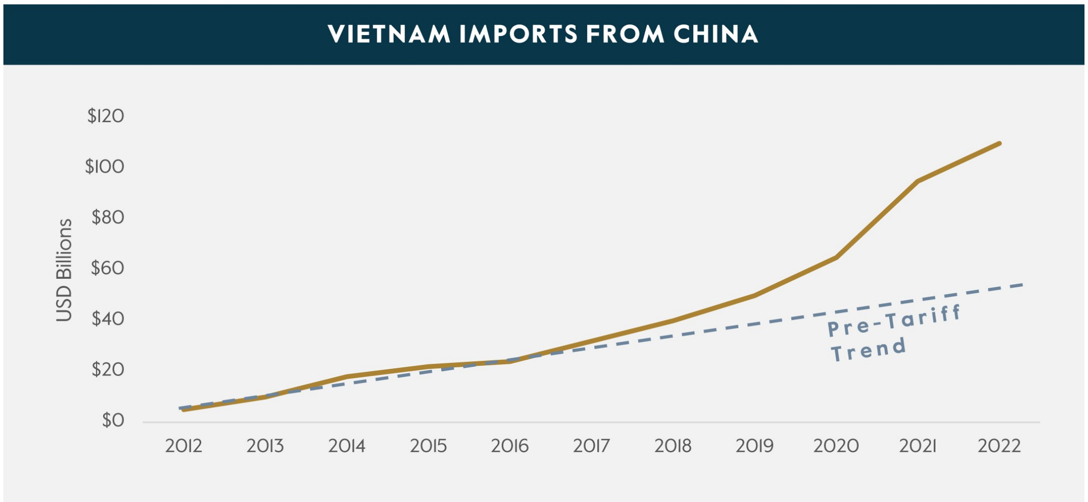
Figure 1: Shift in Global Manufacturing Shares



Source: Carlyle Analysis; WDI Indicators Database, April 2025. There is no guarantee any trends will continue.

Tariffs have been advertised as a tool potentially to reverse these trends. Prior tariff hikes did cause China's share of U.S. goods imports to drop significantly, but research suggests the shift was largely cosmetic. Instead of buying from China, the U.S. increasingly purchased goods from countries supplied by China. This shift is perhaps best seen in the surge in China's exports to Vietnam, which increased 3.4x between 2017 and 2022 (Figure 2), even as goods for domestic consumption account for less than 10% of Vietnam's imports from China. Trade diversion's main effect has been to increase prices; goods sourced from Vietnam and Mexico cost more than earlier Chinese imports.

Figure 2: “Decoupling” Between 2017–2022 Largely Cosmetic

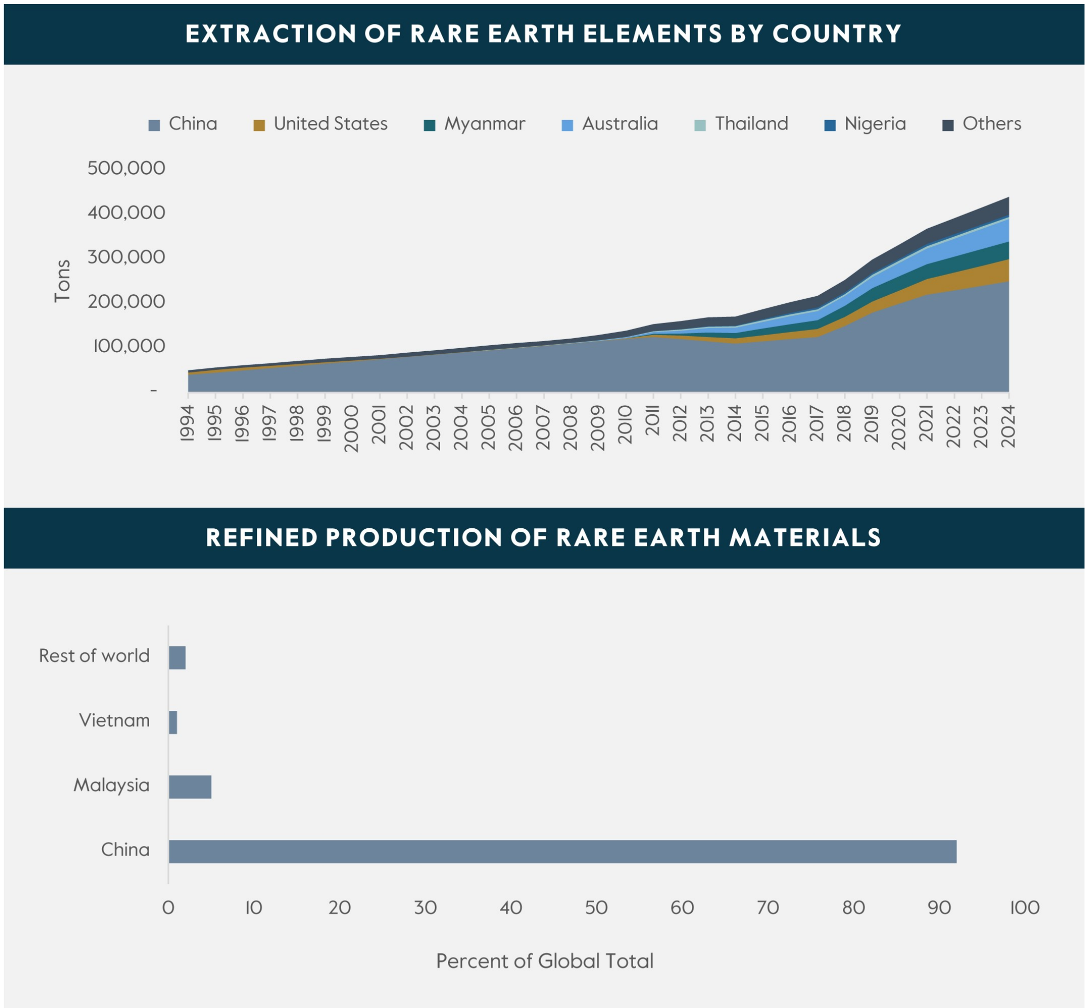


Source: Carlyle Analysis; WITS Database, April 2025. There is no guarantee any trends will continue.

Even when final assembly genuinely moves abroad, China retains dominance in upstream industries, such as critical raw materials and inputs like semiconductors, batteries, and electronics. From 2005 to 2015, every major manufacturing economy became more reliant on Chinese inputs, while China generally became more self-sufficient in its supply chains. Chinese inputs have become so deeply embedded in production networks that even when a U.S. manufacturer has no direct relationship with a Chinese counterpart, chances are that one of its suppliers, or one of its suppliers’ suppliers, do.

Dependence on China’s inputs is perhaps most obvious when it comes to “rare earth” materials, which account for a trivial share of the dollar value of Chinese exports but are critical to the manufacture of computer hard drives, jet engines, electric motors, screens for consumer electronics, and medical diagnostic technologies. China extracts about 60% of rare earth elements, down from 80% last decade, but continues to account for 92% of their refining (Figure 3), mostly because of the radioactive waste that typically results. Earlier this month, China restricted export of “heavy” and “medium” rare earths, citing their use in the defense industry and China’s right to regulate trade in “dual use” technologies. The potential damage to downstream manufacturing could be enormous.

Figure 3: China's Dominance in Rare Earth Materials



Source: Carlyle Analysis; IEA; U.S. Geological Survey, April 2025. There is no guarantee any trends will continue.

One lesson of the pandemic and resulting "supply chain crisis" was that money is fungible in a way the physical, supply-side of the economy is not. A household could take money earmarked for a cruise and instead spend it on camping equipment or a hot tub; it was not quite as easy to transform that unused cruise ship capacity into tents, sleeping bags, air jets, or spa pumps.

Let's hope we're not destined to learn the same lesson again in a somewhat different context.

JASON THOMAS

Head of Global Research & Investment Strategy

This material is provided for educational purposes only. Nothing herein constitutes investment advice or recommendations and should not be relied upon as a basis for making an investment decision. It does not constitute a personal recommendation or take into account the particular investment objectives, financial situations, or needs of individual investors.

Economic and market views and forecasts reflect our judgment as of the date of this presentation and are subject to change without notice. In particular, forecasts are estimated, based on assumptions, and may change materially as economic and market conditions change. Carlyle has no obligation to provide updates or changes to these forecasts. Certain information contained herein has been obtained from sources prepared by other parties, which in certain cases have not been updated through the date hereof. While such information is believed to be reliable for the purpose used herein, Carlyle and its affiliates assume no responsibility for the accuracy, completeness or fairness of such information.

Past events and trends do not imply, predict or guarantee, and are not necessarily indicative of, future events or results. This material should not be construed as an offer to sell or the solicitation of an offer to buy any security, and we are not soliciting any action based on this material. If any such offer is made, it will only be by means of an offering memorandum or prospectus, which would contain material information including certain risks of investing including, but not limited to, loss of all or a significant portion of the investment due to leveraging, short-selling, or other speculative practices, lack of liquidity and volatility of returns.

Recipients should bear in mind that past performance does not predict future returns and there can be no assurance that an investment in a Carlyle fund will achieve comparable results. The views expressed in this commentary are the personal views of certain Carlyle personnel and do not necessarily reflect the views of Carlyle. Investment concepts mentioned in this commentary may be unsuitable for investors depending on their specific investment objectives and financial position; each recipient is encouraged to discuss such concepts with its own legal, accounting and tax advisors to determine suitability. Tax considerations, margin requirements, commissions and other transaction costs may significantly affect the economic consequences of any transaction.

In connection with our business, Carlyle may collect and process your personal data. For further information regarding how we use this data, please see our online privacy notice at https://www.carlyle.com/privacy-notice.