

Putting America First? Trade tariffs likely to be a double-edged sword

Monday, March 05, 2018

Highlights

- US President Trump announced his intention to impose 25% tariffs on steel imports and 10% tariffs on aluminum, as a measure to rebuild the US steel and aluminum industries. The announcement has since been frowned upon by its trading partners and inevitably raised concerns over a potential trade war.
- The decision to impede free trade in both steel and aluminum would have distinct implications for the US: the United States is the world's largest importer of steel and aluminum, accounting for 8% and 13% of global import demand, respectively. The tariffs in our view, are inflationary in nature given the rapid rise in the prices of these commodities to-date, and will have adverse effects especially to both automakers and consumers, while benefiting steel and aluminum makers. Given the sizable contribution steel and aluminum to overall exports, we found that Brazil, Canada and Mexico to be most impacted by the tariffs.
- There are many questions, but answers remain few, though many would agree that impeding free trade is likely a double-edged sword. Any retaliatory efforts by US trading partners could potentially counteract Trump's effort to protect US trade interests and eventually drag both US and global growth. Canada especially, being the largest supplier of steel and aluminum to the US, has cited measures to be "unacceptable" and would take "responsive measures".

What's going on?

It is the fear of a trade war that centered market news. US President Trump's announcement of duties of 25% and 10% of steel and aluminum imports, respectively, is slated to see more concrete details this week. Even with White House officials injecting that tariff details would require more ironing out before implementation, market's reaction was clearly negative while US trading partners' reaction were almost hostile. For that matter, Trump's intentions are to safeguard American jobs and rebuild the US steel and aluminum industries, but international responses of potential retaliation could counteract Trump's goal of "Putting America First". Afterall, the trade barriers would eventually raise prices of steel and aluminum, and could introduce further job casualties on both sides if it spills over to a trade war.

And a trade war seems to be brewing no doubt. Canada, being the largest exporter of steel and aluminum to the US, has cited measures to be "unacceptable" and would take "responsive measures". Brazil, also a large steel exporter to the US, has threatened "multilateral or bilateral" action to protect its interests. Germany and Australia chimed in as well, citing that the move is a clear violation of the WTO rules, and the imposition of such tariffs would ultimately "lead to a loss of jobs". China, being the largest producer and exporter of both steel and aluminum globally, commented that the impact would

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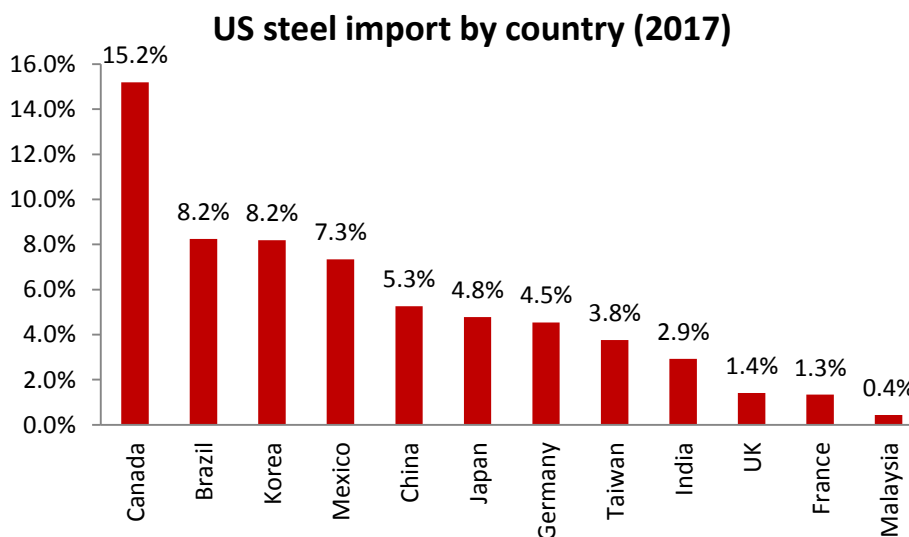
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not be big, while adding that “nothing can be done about Trump. We are already numb to him”.

In fact, this isn’t the first trade tariff Trump has introduced; Trump has also previously imposed a 20% - 50% tariff on large residential washing machines, and a 30% tariff on imported solar cells and modules. Even this move has been criticized by the international community, with the US Solar Energy Industries Association estimating that the decision will eventually result in a loss of 23,000 jobs in the first year as “billions of dollars in solar investments are cancelled”.

More losers than gainers?

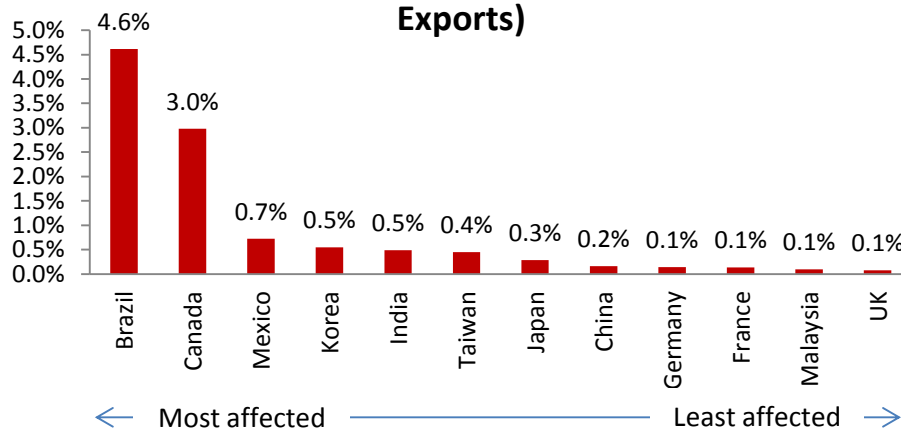
The impact over steel and aluminum tariffs will be far-reaching. The US imports these commodities from over 110 countries, and is the largest steel and aluminum importer globally (see appendix for the breakdown). The tariffs in our view, are inflationary in nature given the rapid rise in the prices of these commodities to-date, and will have adverse effects especially to both US industries and consumers, while benefiting steel and aluminum makers. Across trading partners, we found that Brazil, Canada and Mexico to be the most impacted by Trump’s tariffs, given the sizable contribution both Steel and Aluminum exports have on total exports by these countries.



Source: CEIC, OCBC Bank

Unsurprisingly, China’s sizable production and exports of steel and aluminum garnered much interest as well, although impact to Chinese economic growth and trade balance is likely to be muted. Single-handedly, China accounts for 49.2% of total crude steel production and 50.8% of aluminum production last year, making it the world’s largest producer of these commodities. However, much of these metals are domestically consumed, with China exporting only 23% and 11.2% of steel and aluminum exported globally. Should we look in US-centric numbers, total steel and aluminum exports to the US only accounts 0.2% of China’s total exports, suggesting that the impact to Chinese trade and economic outlook to be insignificant.

**Most impacted by Trump's tariffs
(Steel & Aluminum Exports to the US % of Total Exports)**

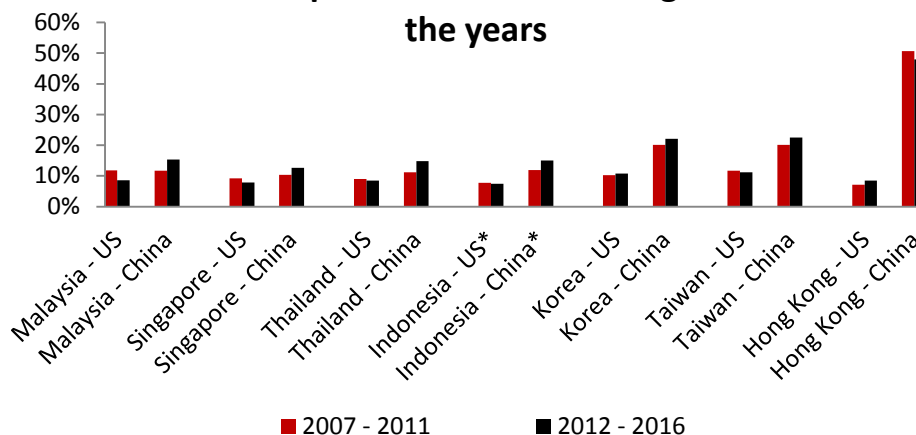


Source: CEIC, OCBC Bank

However, the economies to be most adversely impacted by the tariffs include Brazil, Canada and Mexico. Across its trading partners, Canada accounts for the largest share of steel and aluminum imports into the US, or 15.2% and 40.6% of US steel and aluminum imports, respectively. However, in terms of contribution to total exports, the accumulation of steel and aluminum exports to the United States accounts for almost 5.0% of Brazil's exports, followed by Canada (3.0%) and Mexico (0.7%). Note that on the onset of the tariff announcement last week, the Brazilian Real (BRL) and the Canadian Dollar (CAD) weakened 0.18% and 0.39% respectively from 1st March levels. On the flipside, Asian countries such as Korea (0.5% of total exports), India (0.5%), Taiwan (0.4%), Japan (0.3%) and Malaysia (0.1%) will likely see little impact on their overall trade balance and growth, given the insignificant share of steel and aluminum exports to the United States.

Still, we think that trade protectionism may affect Asia disproportionately, and the impact may not be as significant as before. ASEAN countries' trade with the US as a percentage of total trade have halved over the last 20 years, with China replacing it as a key global trade partner. Statistically across the four Asian Tigers (Hong Kong, Singapore, Korea and Taiwan) and other Asia (Malaysia, Indonesia and Thailand), trade with China has expanded to 21.5% of total trade in 2012 – 2016 (up from 19.4% from 2007 – 2011), while trade with the US fell to merely 9.0% of total trade over the same period (down from 9.5% from 2007 – 2011). Still, Taiwan (trade with the US at 11.2% of total trade), Korea (10.8%) and Malaysia (8.6%) share relatively higher trade exposure with the US vis-à-vis other Asian countries.

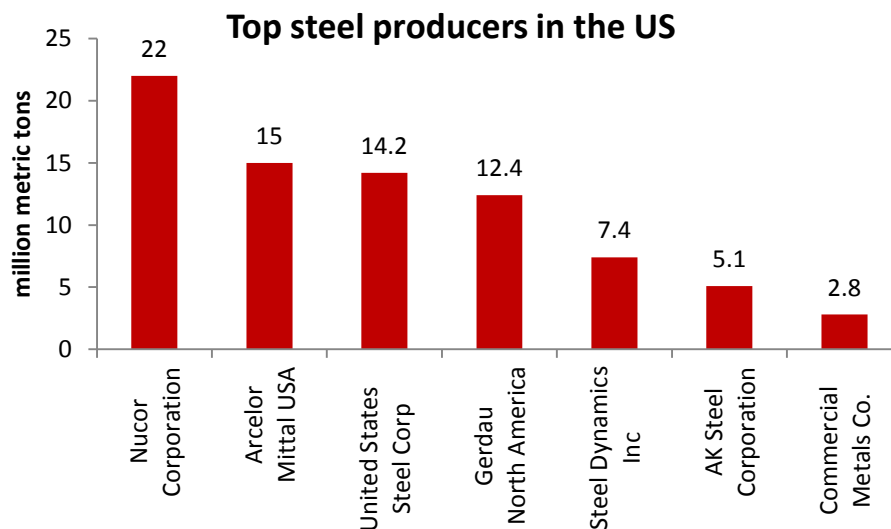
Asia trade exposure with China has gained over the years



* Indonesia trade with US is from 2008 -2011

Source: CEIC, OCBC Bank

In the absence of trade retaliation, Trump's efforts to shield the steel and aluminium industries would likely aid upstream industries, especially in both steel and aluminum makers, though higher prices would eventually unfavorably affect the downstream sectors. In fact, the steel industry has seen a gradual slowdown since 2000s; In 2000, 135,000 people were employed in the industry - a figure that fell to 83,600 in 2016. In production terms as well, it is an industry that is significantly weaker, with 112 million tons being produced back in 2000, which fell to 86.5 million tons in 2016. Elsewhere, steel producers such as Nucor Corporation, ArcelorMittal USA, United States Steel Corp and Gerdau North America (top four largest steel producers which accounts for 81% of total crude steel production in 2016) could also benefit as the protectionist measures would give domestically produced steel a price advantage over the foreign sources.



Source: International Trade Administration, OCBC Bank

However, the tariff is a double-edged sword, with or without trade retaliation. Key losers to the tariffs include consumers of steel and aluminum, especially automakers and the aerospace industries, as well as injecting higher costs for manufacturing and construction industries. The increased cost of input products, according to the US Aerospace Industries Association, cited a *“a cascading effect that has fairly significant impacts on our industry’s global competitiveness”*, while the American Automotive Policy Council iterated that the tariffs will *“place the US automotive industry, which supports more than seven million American jobs, at a competitive disadvantage”*.

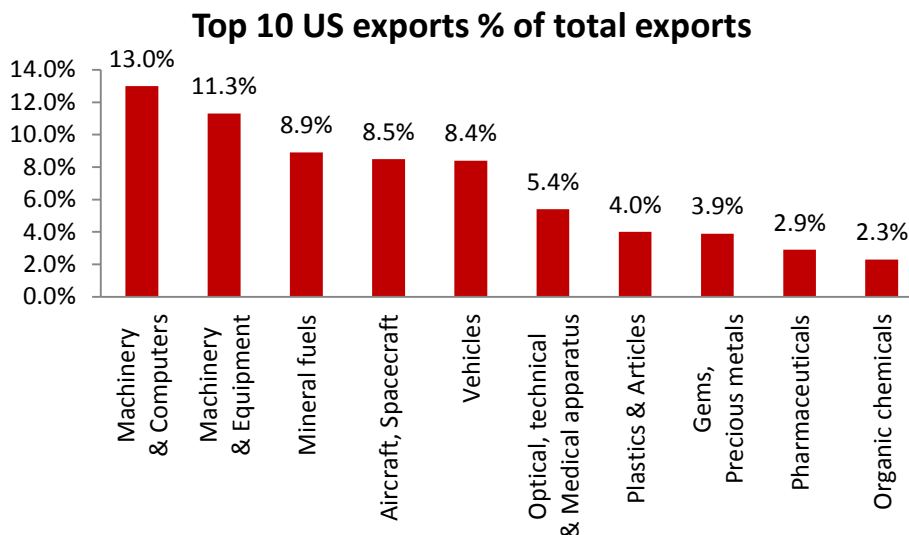
The higher prices for steel and aluminum in the United States, compared to the relatively lower global benchmark seen in other regions, will also affect about 6.9 million American workers in manufacturing and 10.1 million workers in construction, according to the Bureau of Economic Analysis. The tariffs will likely be inflationary in nature as higher raw materials would eventually cascade into more expensive domestically finished goods. This would then adversely affect the competitiveness of downstream firms, reduce US demand for these manufactured products and eventually threaten the many jobs that both construction and manufacturing sectors currently employ.

It is still in the planning stage

With US President Trump likely to sign the tariffs into law in the week ahead, market-watchers will clearly monitor over the detailing of it. At least for now, little information other than a 25% and 10% tariff on steel and aluminum imports are known, and market-watchers will be watching out for two key aspects: (1) on whether the tariffs will be a sweeping measure across all US trading partners, and (2) the possibility of a trade exemptions for certain businesses in the US. Note that Peter Navarro, director of the White House National Trade Council, said that *“there will be an exemption procedure... so that business can move forward”* and exceptions to the trade tariffs can be granted if doing so would serve US interests. Till now however, the official rhetoric regarding country exemptions is clear, in that no countries will be excluded from the tariffs, suggesting that the tariffs will likely be implemented on all US imports of steel and aluminum.

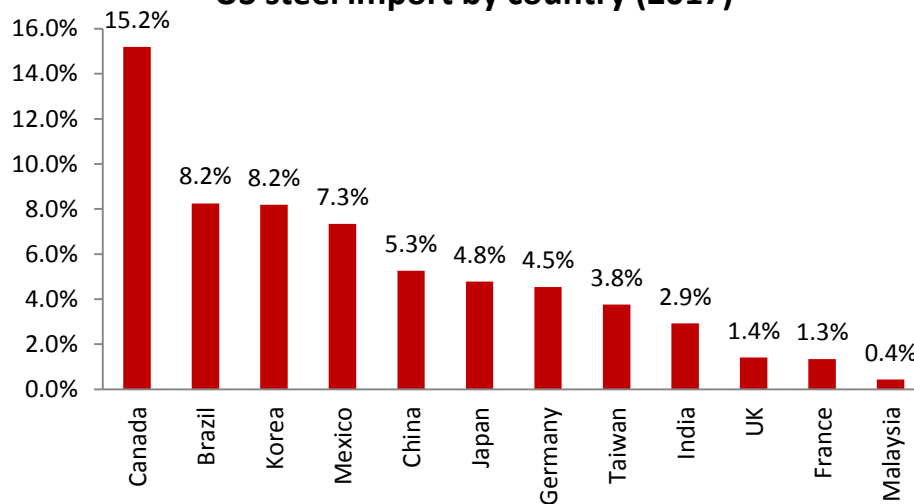
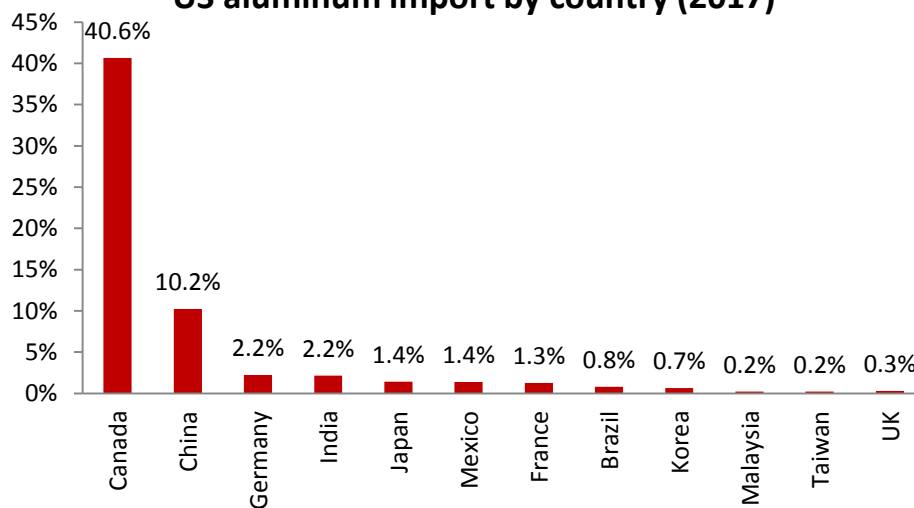
Eventually, we note that the trade tariffs will likely do more harm than good, both to the US economy as well as impeding global growth and trade activities. Even in the absence of trade retaliation, the tariffs would threaten many jobs in the US pertaining to aerospace, automobile, manufacturing and construction industries, while benefiting steel and aluminum makers. Consumers would then face higher inflationary pressures, and thus adversely affect consumer spending and overall disposable income levels. Moreover, the relatively bleaker outlook for the said industries could also worsen investor confidence, and thus dissuade investment spending into the US.

And should retaliation from US key trading partners are seen into the weeks ahead, it could spell further cascading woes into other US industries and its exports, which could spell further US trade tariffs to further Trump’s agenda of *“Putting America First”*. On this aspect, retaliatory tariffs that could seriously worsen America’s trade balance could take form in impeding US top exports, including machinery, electrical and mineral fuel exports especially.



Source: CEIC, OCBC Bank

There is not much of a consolation perhaps, other than noting that impact to overall Asia's trade and economic outlook appears muted. Trump's tariff proposal appears to have more palpable impact on Brazil, Canada and Mexico, given their sizable contribution of steel and aluminum to the US and the percentage of total trade it could suffer as a result of the tariffs. On US especially, the negative impact the tariff could bring may outweigh the benefits; while steel and aluminum makers benefit, the multitude of consumers of these raw materials could threaten the many jobs American hold. But for now, we look on with much anxiety, while market-watchers glean closely on further details the tariff could take form into the week ahead.

Appendix**US steel import by country (2017)****US aluminum import by country (2017)**

Source: CEIC, OCBC Bank

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