# Should investors be worried about tariffs?

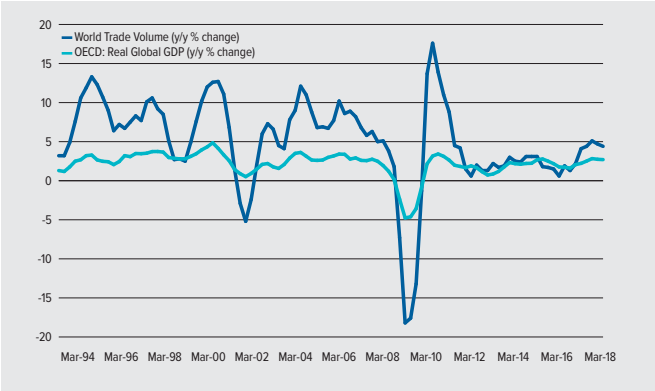
Fears of U.S. protectionism have risen over the last year, as President Donald Trump has enacted tariffs on various countries. **What are tariffs, and what is behind this fear?**

Think of tariffs this way: a tariff is a tax on foreign imports and can be enacted on a specific good or country. Tariffs are primarily used to protect domestic industry, but also can be used to influence another country's economic behavior. There are a variety of tariffs a government can employ, ranging from a fixed fee levied against a specific product to local content rules, which require foreign-owned companies to use a certain percentage of locally sourced components to manufacture its products.

Tariffs often are extremely complex. Let's look at the auto industry. Recent stories have compared the European Union (EU) and U.S. tariffs on cars at 10% and 2.5%, respectively. However, this is a bit of an oversimplification due to the numerous tariffs related to automobiles. There are different tariff rates based on vehicle type (cars, trucks, motorcycles) and even vehicles vs. auto parts. In addition, other countries employ barriers to trade that impact the U.S. auto industry. Japan has no tariff on auto imports, but makes it very difficult for foreign automakers to receive certification and establish dealership networks.

Historically, real global gross domestic product (GDP) growth has been highly correlated to world trade volume (chart). Because of the integrated nature of the global economy, tariffs can be extremely disruptive. If a tariff increases the cost of a good, the demand for that good could wane. Suddenly, corporations' decisions on capital spending (capex) become less clear. Corporate initiatives like building a new factory, investing in new technologies, or adding significant headcount are put on hold until market clarity returns. The longer-term concern on tariffs is export growth may eventually slow, which can hamper global economic growth.

### THE CORRELATION BETWEEN REAL GLOBAL GDP GROWTH AND WORLD TRADE VOLUME




Source: "OECD Total: Real Gross Domestic Product/World Trade Volume," Organization for Economic Cooperation and Development, Netherlands Bureau for Economic Policy Analysis/Haver Analytics, June 2018. Past performance is not a guarantee of future results.

## WHAT WILL THIS ROUND OF TARIFFS DO TO GROWTH?

Trump has imposed several tariffs this year to address what he deems as unfair trade practices against the U.S.

### THE TRUMP TARIFFS

| SECTOR | DATE ENACTED |
|---|---|
| Solar Panels | January, 2018 |
| Washing Machines | January, 2018 |
| Steel | March, 2018 |
| Aluminum | March, 2018 |
| China (round 1) | July, 2018 |
| China (round 2) | August, 2018 |

Most of these U.S. tariffs have elicited a similar retaliatory response from affected countries. While constant talk of tariffs has probably made some U.S. industries nervous, such as agriculture, the economic impact has been relatively minimal up to this point. By our calculations, recently enacted tariffs could cut U.S. GDP growth by 0.2%, which we believe the U.S. economy can easily absorb. Also, enacted tariffs have had a negligible benefit to job growth in the affected industries. President Trump has threatened to put a 10-25% tariff on an additional $200 billion in Chinese goods and said he could follow that with another $200-250 billion. Our estimates point to a 0.3% reduction in Chinese GDP growth stemming from the recently enacted tariffs. There is some evidence business confidence has dipped slightly however, we believe significantly more tariffs would have to be enacted before there is a meaningful economic impact.

## IS THE U.S. HEADED FOR A FULL-BLOWN TRADE WAR?

Currently, the U.S. and China are engaged in a trade stare down, which we believe will linger in the near term and will likely get worse before it gets better. Both sides are likely to increase the number of tariffs and other harmful actions, which could result in a further increase in market volatility. Ultimately, we believe the U.S. and China will come to trade agreement, but it probably will be a little more painful before both sides come to a resolution at the negotiating table.

In late July, Trump and European Commission President Jean-Claude Juncker agreed to forestall threatened U.S. tariffs on imports of EU automobiles. The agreement includes negotiations on eliminating non-auto industrial tariffs and a promise to keep tariffs at bay unless one side withdraws from negotiations. In addition, the EU agreed to increase imports of U.S. soybeans and liquefied natural gas. While the agreement appears to have averted a trade crisis with the EU for now, Trump could enact these tariffs later if he believes the negotiations are unproductive.

At the same time, North American Free Trade Agreement (NAFTA) negotiations are ongoing. Trade representatives from the U.S. and Mexico have been speaking positively about the possibility of a deal to rework the agreement. Meanwhile, relations between the U.S. and Canada are uncharacteristically strained following a contentious G7 summit in June. While we believe that a NAFTA deal will be reached at some point, a failure on this front would impact U.S. manufacturing supply chains and be extremely disruptive.

## A BRIEF HISTORY OF U.S. TARIFFS AND THEIR IMPACT*

U.S. tariffs date back to colonial times. The Tariff Act of 1789 was one of the first major statutes passed by the U.S. Congress. Numerous presidents have used tariffs as part of their foreign and economic policies, leading up to Trump. Here are a few of the more notable U.S. tariffs and their economic impact:

**The Tariff Act of 1789**

First U.S. tariff designed to raise revenue for the federal government.

**Revenue Act of 1913**

Slashed basic tariff rates from 40% to 25%. To offset the lost revenue from tariffs, the U.S. re-imposed the federal income tax under the authority of the 16th Amendment.

**Smoot-Hawley Tariff of 1930**

Act raised tariffs by an average of 59% on more than 25,000 imports. By 1934, global trade had decreased more than 60%.

**Post 9/11**

President George W. Bush levied tariffs on steel and lumber imports in early 2002. The S&P 500 lost more more than $2 trillion in market capitalization during the first year of those tariffs.

*Source: Barrons; "Mr. Trump, Meet Smoot and Hawley"



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