Economics

Macro news

TRUMP'S PROPOSED TARIFFS: THE ECONOMIC IMPLICATIONS OF WRONG-HEADED POLICIES

The White House has announced that it will impose a 10% tariff on imported aluminum and 25% on imported steel. Few details are available. Apparently, these tariffs are being imposed under Section 232 of the Trade Expansion Act of 1962, which gives the president authority to restrict imports and impose limited tariffs if the Department of Commerce concludes that the current reliance on select imports is a national security threat. *Whatever the reason, imposition of these tariffs is bad economic policy and its timing is inopportune, in our view.*

The economic effects of these tariffs on the macroeconomic environment will depend critically on whether they damage business and household confidence. If confidence is unaffected, the economic impact would be relatively small in the aggregate, although it would harm some industries more than others. In 2017, the U.S. imported 34 million metric tons of steel with an import value of $29 billion and 6 million metric tons of aluminum with an estimated import value of $16 billion. Multiply these amounts times the proposed tariffs, and the new import fees are very small relative to the $2.4 trillion of total U.S. imported goods.

However, the danger is if these tariffs adversely jar confidence — perhaps fueled by foreign retaliation — heightened uncertainties would lead businesses to tone back their expansion plans and the trajectory of consumer spending would be softer. The negative impact could be material. A deceleration in U.S. and global trade flows would be a negative. These negative effects would mitigate, but unlikely sufficiently large enough to negate, the positive impacts of the Tax Cuts and Jobs Act.

According to data in the U.S. Department of Commerce's report, The Effect of Imports on the National Security, January 11, 2018, the U.S. currently produces 82 million metric tons of steel and its productive capacity of 113 million metric tons is sufficient to meet domestic demand, and the U.S. produces 785,000 metric tons of aluminum, but its productive capacity is insufficient to meet demand. However, the report shows that U.S.-sourced steel products are significantly more expensive than prices of imported steel (see Chart 1). Moreover, even if the prices of domestically and foreign-sourced steel were the same, and the Department of Commerce's measures of U.S. productive capacity were fully reliable, U.S. producers that rely heavily on imports of steel and aluminum would face sizeable short-run costs and disruptions.

Impacts on the economy and inflation. The tariffs would raise the costs of imported aluminum and steel. Assuming the supplies of U.S.-sourced steel and aluminum are fairly inelastic in the short run, and incorporating disruptions and costs of transitions, business operating costs would rise and business production processes would be less efficient. Uncertainty will be added to business expansion plans. Certain industries, such as motor vehicles that are in the process of transforming the content of their products, will be disrupted.

In an environment of soft aggregate product demand, businesses would have little flexibility to raise product prices, and their margins would be squeezed. The impact on consumer prices and inflation would be minor. *However, current macroeconomic conditions are favorable, and strengthening product demand would provide businesses flexibility to raise product prices.* Nominal GDP, the broadest measure of current dollar spending and aggregate product demand, accelerated to 5% in the second half of 2017, up from an average of 3.7% in the prior five years, and that momentum is expected to be sustained. Accordingly, the impact of the higher tariffs would be shared

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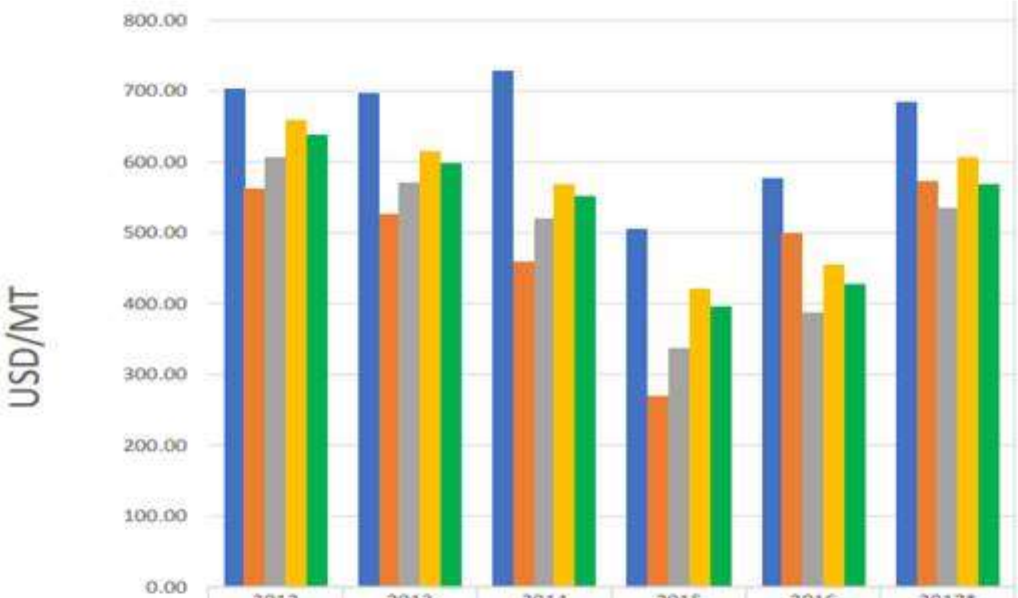
by the real economy and inflation. While the impact on inflation would not be major, it would cut into real consumer purchasing power and add to price pressures at a time when markets are sensitive to inflationary expectations.

Chart 1: Regional Comparison of Steel Prices



	2012	2013	2014	2015	2016	2017*
USA Domestic Hot Rolled Coil	701.84	696.20	727.78	505.65	575.68	684.11
Steel Hot Rolled Coil (FOB Stowed China Port)	562.50	525.00	457.50	269.50	497.50	572.00
Asean Import Hot Rolled Coil	605.66	570.43	519.89	336.55	386.81	534.75
North Europe Domestic Hot Rolled Coil	659.54	614.41	568.41	420.19	455.29	604.90
South Europe Domestic Steel Rebar	636.59	598.34	551.66	394.11	427.68	568.53

Source: Bloomberg, Platts, Antaike. 2017 prices are through December 20, 2017.

Source: "The Effect of Imports of Steel on the National Security," An Investigation Conducted Under Section 232 of the Trade Expansion Act of 1962, as Amended, U.S. Department of Commerce, January 11, 2018.

In response to the perceived negative impact of the tariffs — with the threats of retaliation in the headlines — the natural consequence is to put downward pressure on the U.S. dollar. With a lag, this would raise prices of non-energy imports. Effectively, this would partially mitigate the impact of the tariffs on U.S. multi-national firms but reduce the purchasing power of U.S. consumers. History of international trade policy shows that the nations that impose barriers to trade are hurt the most.

The initial negative response of the stock market reflects concerns about the momentum in the economy and profits.

We try to provide even-handed analysis, but these proposed tariffs may dent the current economic momentum. We have emphasized the very positive economic effects of the elevated business and consumer confidence and anticipate healthy responses to the Tax Cuts and Jobs Act. In this context, the proposed tariffs represent wrong-headed approaches to trade policy, in our view, and their timing is decidedly poor.

We believe the Trump Administration would be wise to reconsider and withdraw its proposal.

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