

FINANCIAL MARKETS

A GLOBAL TRADE WAR? STEEL & ALUMINIUM TARIFFS



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WILL WE SEE A TRADE WAR?

FOREWORD

In recent weeks, the financial markets have been gripped by aggressive changes in US trade policy.

Specifically, investors are concerned that newly imposed steel and aluminium tariffs could spark a global trade war between the world's largest economic powers.

The purpose of this eBook is to make sense of President Trump's steel and aluminium tariffs, while exploring what it means for the global economy.

Patrick Latchford
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TRUMP'S TARIFF PLAN

WHAT DOES TRUMP'S TARIFF PLAN INVOLVE?

Last year, President Donald Trump launched an investigation into the efficiency of the importation of steel and aluminium into the United States.

He wanted to see if the surge in imports compromised the ability of the US to source steel and aluminium for military equipment and further the economic security of the nation.

President Trump decided that the current situation was not coherent and needed to be modified. Initially, Trump faced three options to solve this problem. These included a global tariff, a tariff targeted at mixed quota countries such as China, or a universal quota.

The president opted for a global tariff - but this is seen by the rest of the world as the most drastic option available. He insisted on 25% tariffs on steel imports and 10% tariffs on aluminium imports.

This significant levy has caused global concern amongst leaders and economists, with many fearing that a trade war may be on the horizon.

As soon as this news was announced, it triggered a sharp sell-off in the financial markets. Broader business communities expressed concern for US companies dependant on steel and aluminium that could be hit by much higher import prices.

WHY THE TARIFFS WERE PUT IN PLACE

US workers within the steel and aluminium industry claim that China's cheap steel production has hurt domestic demand.

In recent years, China has become the largest producer of metals in the world. They have inundated the global markets with cheap products, driving demand for Chinese steel and aluminium.

President Trump's reasoning for the new tariffs is simple. He believes a global tariff will restrict the level of imports and boost US-based steel and aluminium production. By increasing national production, the president also believes he can create more US jobs.

WHAT COUNTRIES DO THE TARIFFS AFFECT?

Due to the concerns regarding Chinese production methods and the longevity of the US metal industry, it could be suggested that global tariffs are an attempt to undermine the Chinese.

However, it is highly unlikely that China will suffer any

consequences from this decision. Due to the implementation of country-specific tariffs over the last few years, China does not account for a significant amount of steel and aluminium being imported to the US.

In fact, the leading source of steel and aluminium currently for the US is Canada (which is exempt from these tariffs, along with Mexico). After that, it is other NATO members that happen to be the source of steel for the US, with Germany being one of the largest exporters.

Given the sudden and aggressive shift of US trade policy, there is a very strong chance of retaliation. This will come mainly from the likes of China and the EU. In fact, EU officials have already expressed their willingness to challenge the US in the World Trade Organisation.

The EU is looking for ways to penalise other US products that export to continental Europe. By introducing its own tariffs for certain US products, the EU can also apply political pressure to US leadership. For instance, applying to high tariffs to Kentucky Bourbon and cheese from Wisconsin will influence US government members. These include Republican Senator, Mitch McConnell and House Speaker, Paul Ryan.

It has also been mentioned by former US trade official, Wendy Cutler, that China will have quick and proportional trade measures to put in place in response to US tariffs.

IMPACT AT HOME

US BUSINESS

These tariffs could hurt US businesses dependant on metal imports.

For any business or industry that relies on the use of steel and aluminium, there is a risk of lower profits.

For example, in 2017, automakers accounted for 26% of the steel demand in the US. At this time, Ford Motor Company admitted they were struggling with higher commodity costs (before Trump made the tariff announcement). This is likely to be the case for several other US automakers too.

Low profits will eventually lead to companies deciding to raise their prices in order to become more profitable. This will lead to higher prices for consumers, which is an issue that doesn't always balance itself out. If consumers are unwilling to pay higher prices, there could be a decline for certain industries. This could lead to an

industry-based fallout, damaging the US economy in the process.

If anyone is to benefit from this decision, it will be Canada and Mexico. They are currently the only countries that are exempt from Trump's global tariffs. Compared to their other non-US competitors, this gives them huge opportunity to increase their shares in US steel and aluminium imports.

The reason that Canada and Mexico are exempt is due to the North American Free Trade Agreement. It would have been irrational and irresponsible for President Trump not to take this agreement into consideration. Keeping ties with Canada and Mexico not only protects future negotiations, but also current and future levels of US national security.

ANALYSING HISTORY

Demanding tariffs to preserve the future of one industry could cause serious damage to others. At present, there are around 6.5 million people working in US businesses that rely on steel and aluminium. Failure to produce enough material could have major repercussions.

In 2002, President George W. Bush implemented tariffs on steel imports and in doing so, cost the US around 200,000 jobs. Because of this, many Republicans do not agree with the use of tariffs. New tariffs could reverse efforts made on tax reform to achieve economic growth.

After World War II, a general agreement was formed between nations for a loophole in the global trading system. This loophole

meant that countries could introduce tariffs and other trade barriers to withhold national security. Globally, this loophole has been avoided so not to create a domino effect with threatening trade decisions.

President Trump's decision to impose these tariffs has now left other countries on edge for the possibility of a trade war. There is a strong possibility of China using this as a threat to their own national security. It could easily be an excuse for them to make changes to their own trade measures, which would have even more significant global effects.

If the EU does take President Trump to the World Trade Organisation, he has the power to ignore its views. He can also completely pull the US from the World Trade Organisation. This could threaten future trade deals for other industries.

For the likes of Canada and Mexico, the consequences may be more positive. This is not the first time they will get the opportunity to get ahead of non-US competitors.

Both countries were also exempt from tariffs introduced by President George W. Bush. Even after President Bush's tariffs were revoked, Canada and Mexico held a much larger share for a much longer time period. This means that even if Trump is to revoke his tariff decisions, the two countries will still have an advantage.

For the US themselves, the introduction of the tariffs should not create a need for change in US monetary policy (for now).

Keep in mind that further tariffs could cause further retaliation

and, ultimately, lead to a trade war. Pressure on inflation would grow significantly for the US. This could result in heavy damage to the growth of the US and global economy.

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