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CFA Trending Topics | May 22, 2018

Tariffs, Tariffs, Tariffs!

Tariffs have increasingly become the "talk of the town," being discussed by S&P 500 firms about 4.5x more in first quarter 2018 earnings calls relative to more normalized levels. Given the actions taken and messages delivered by members of the Trump administration, this increased focus on tariffs is likely warranted. While the overall impact of these policy moves will take some time to play out, the following data helps put the potential implications of tariffs in perspective:

- The role of Canada, Mexico and China are stark with the three countries representing 43% of U.S. exports and 48% of imports.
- The U.S. currently ranks amongst the lowest in terms of applied tariffs with an average rate of 1.6% across all products (compare to China's 3.5%, India's 6.3% and Brazil's 8.0%).
- While tariffs have been prevalent in the news, trade deals have historically taken a significant amount of time to negotiate and finalize (average of 43 months from the launch of a trade deal to completion with no deal taking less than 18 months to come into effect per Institute for International Economics).
- Corporate operating margins are currently around 11% which puts them at record high levels compare to the last ten years.
    - This margin improvement is largely without accounting for tax reform and suggests that corporates have some room in case of higher input costs.
- The industries that will be most impacted by the proposed China tariffs will fall on agriculture (biggest detrimental impact), aerospace, motor vehicles, chemicals and plastic and rubber sectors.

Key Takeaways

- Any trade deal will take significant time and likely span multiple U.S. election cycles.
- Given the recent record margin expansion, corporates should be able to weather slight increases in input and material costs.

- Companies may consider potential shifts to cheaper production locations where possible, such as Latin America or other countries in Asia.

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