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# Tariff Impacts on Commodities

## Summary

In 2017, the US began steel and aluminum antidumping investigations against Chinese firms in an attempt to even out a multi-billion dollar trade imbalance. In March 2018, the US applied tariffs on solar panels and then US antidumping duties on steel and aluminum products. This not only impacted China, but also the EU, Canada and Mexico after they failed to receive levy exemptions from the US government. Currently, the US has applied close to $160 billion of levies on agricultural, industrial and consumer goods against its trading partners and is proposing an additional $200 billion of duties on Chinese goods. Retaliatory actions by nations affected will likely ensue. The following summarizes the trade war's medium-term impact on the commodities asset class.

## Commodities Most Affected by the Current Tariffs

- **Steel and Aluminum**: About 1/6 of US steel imports came from Canada in 2017. Canada contributed to more than half of the US' aluminum consumption in 2017. As tariffs make foreign-sourced steel and aluminum more expensive for US domestic importers, consumers will need to either buy from exempt country producers, unless domestic production is boosted from the restarting of idled mines, or produce more through the development of new mills. However, US aluminum assets are in decline generally, and there is a long time lag before new mills can be developed. It is unlikely that US demand in a growing economy will be satisfied through increasing domestic production. For these reasons, domestic US prices initially increased as did the premium for aluminum stored in the US Midwest versus those stored in London Metal Exchange (LME) warehouses. Inventories from non-exempt countries that would have entered the US to be used for industrial purposes may end up in LME warehouses outside of the US, which may contribute to a widening gap between US and global aluminum prices.
- **Soybeans:** Soybean supply is dominated by Brazil and the US, each of which constitute about 35% of world production. Even more dramatic is that Brazil accounts for almost half of world exports this year while the US accounts for about 35%. On the import side, China accounts for over 60% of global imports. China in recent years has moved towards more direct sourcing of soybeans, particularly from Brazil, creating longer-term arrangements to lock in supply. In July 2018, China applied a 25% import tax on US soybeans and other goods. China imports soybeans almost exclusively from Brazil at this time of year, as we are currently in the middle of Brazil's peak soybean export season. Reports also indicate cancellations of US soybean contracts for future delivery, after the implementation of the 25% tariff. Globally, we have seen non-China importers shifting toward imports from the US as Brazilian beans become more expensive, reducing the brunt of the impact from tariffs on US soybean prices.

- **Lean Hogs**: Mexico, one of the largest importers of US pork, applied a 10% tariff on US pork products beginning in June 2018 and then raised it to 20% in July in retaliation for US steel and aluminum tariffs, which came into effect at the end of June. In 2017, Mexico accounted for the largest share of US pork exports, at around 35%. Around 60% of Mexico's lean hog imports in 2017 were from the US. However, the EU, Brazil, and Canada were the largest world pork exporters in 2017 by volume, leaving Mexico with many non-US alternatives for imports. The next largest importer of US pork is China, importing around 9% of total US export volume in 2017. China also announced an additional 25% tariff on US pork during 2Q 2018. However, China produced 97% of its own pork in 2017 and the ~1% of pork consumption that it receives from the US can be easily replaced by pork products from other countries. Since June, Lean Hogs prices have fallen, largely due to the potential building of US inventories as it becomes more prohibitive to export to China and Mexico.

## Outlook

As nations become immersed in trade disputes, the increased barriers are forcing buyers and producers to trade commodities with new partners at greater costs due to more expensive transportation or the introduction of intermediaries within the supply chain. These factors have already been inflationary, particularly for aluminum and steel within the US, as these goods generally became more expensive to the end users. The effects of the tariffs have so far been mixed. The US economy continued to show strength growing at an annual rate of 4.1% during the second quarter, the largest quarterly increase within the past four years. This expansion has strengthened the US' resolve to push forward with additional tariffs. On the other hand, countries subject to increased US tariffs have shown some signs of weakness. Mexico's second quarter GDP actually shrank slightly on a seasonally adjusted basis from the first quarter, while China's July manufacturing activity came in lower than expected.

This increases the challenges posed to governments and their central banks as policymakers look to remove loose monetary policy but are keen to not stall economic growth as trade issues escalate. This may mean an even slower course of action than initially expected by central banks or increasing supportive fiscal measures. The European Central Bank (ECB) announced it would end its bond-buying program by the end of 2018 and is planning to eventually raise rates sometime after the summer of 2019. While the US Fed looks to be much more aggressive than the ECB, and other major central banks, gradual monetary tightening has been complemented with fiscal stimulus, which has helped to move the US economy along. Meanwhile, in July, China announced a series of domestic policies including tax cuts, new business loans and increased infrastructure spending measures with the objective of countering the slowdown in its economy. Even the impacts from the tariffs have been mitigated as the

US seeks to support farmers with a $12 billion aid package, while the Chinese government has announced tariff rebates for buyers of soybeans who are making purchases on behalf of State reserves. In the meantime, Eurozone officials have begun discussions with the US administration in an attempt to resolve trade issues and improve relations. In the long run, if tariffs remain in place, this may be inflationary for the end users of many commodities involved. If a common ground among nations can be found and the risks from tariffs are reduced, then the global economy may continue on its trajectory of synchronized growth first witnessed in 2017.

**About the Author:**

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