Economy

Focus US

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US trade tariffs - who is really paying for them?

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After months of easing in trade tensions, the tariff war has suddenly restarted. According to the US administration, China has reneged on a number of promises. In retaliation, Donald Trump has announced that tariffs on $ 200bn of products imported from China will increase from +10% to +25% (it was done this morning) and has threatened to tax all remaining imports from China. He sees these measures as a "tax" that the Chinese government would pay to its US counterpart. There is no such thing in reality. To date, few end-consumer goods have been affected by these measures. President Trump may think that the US is immune, but he is mistaken.

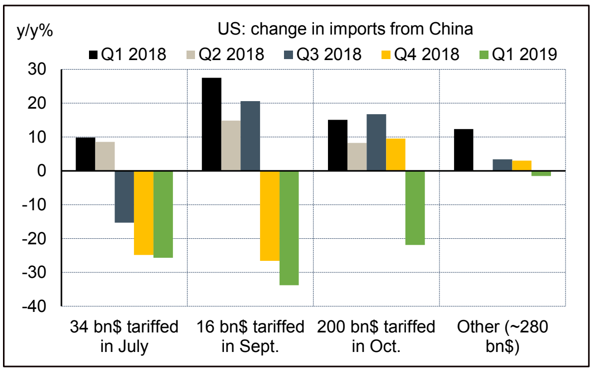
The week's focus

When country X hikes the trade tariffs on the products imported from country Y, two questions arise: 1) what is the impact on trade volumes? and 2) who bears the cost? The trade data sheds ample light on the first question. In the case of US-China trade, we note a sharp reduction in imports of goods, sometimes preceded by an increase in inventories (chart lhs).

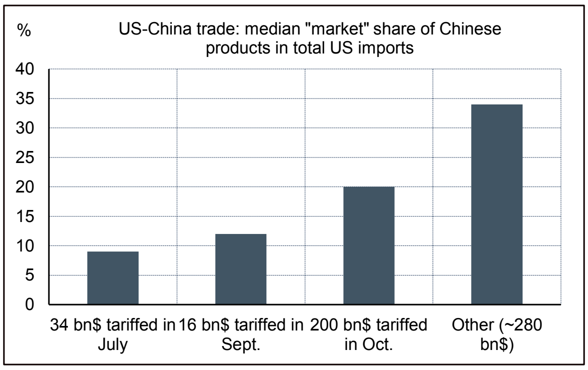
The second question is more complex. Exporter Y can reduce its margins or importer X can pass on the increase, partially or totally, to the price paid by the consumer. The answer depends on the price elasticity and, therefore, competition and substitutability on the relevant product markets. Donald Trump claims that the cost is paid by China. There would therefore be no risk in conducting a tariff war - provided, however, that you ignore the retaliatory measures already adopted by China (US farmers can testify to their severity), which will undoubtedly be extended. In fact, theory and past experience suggest that the final cost falls largely on the consumer because there are never instant and perfect substitutes for taxed products. Studies have identified a significant impact of tariffs on consumer prices[1], but taking into account the gains made by local producers and the increase in tax revenues, the total effect on the economy would be small (0.04% of GDP so far). Other authors argue that if the tariff war is limited to a country or sector, and not general, it should be possible to relocate production and, in doing so, cancel out the impact on prices[2]. However, moving production lines is not without cost and this implies having visibility on trade policy (we are far from that). Finally, we note that if the impact of trade tariffs on US prices is currently low, it is because the trump administration has targeted as a priority goods where the Chinese market share in total imports is low, making it possible to find other suppliers. This would no longer be the case if the tariff war were to intensify and extend to all trade with China (chart rhs).

1 Fajgelbaum & al. (2019), *The return to protectionism*, VoxEU. 2 Flaan & al. (2019), *The production relocation and price effects of U.S. trade policy: the case of washing machines*, NBER.

US: imports from China



US: median market share of Chinese products



Sources: Thomson Reuters, Oddo BHF Securities

Economy

- The cold snap on the labour market seen in February (+33k job creations, revised to +56k) is forgotten. In **April**, non-farm payroll bounced back to +263,000. The smoothed trend has been surprisingly stable for over six years, a shade over 200k per month. Temporary employment rebounded after its recent weakness (+18k vs -8k per month in Q1). Note also an improvement in the construction sector (+33k vs +18k), in most of the services to the private sector and in the government sector. The only genuinely weak point remains manufacturing where employment has been virtually stagnant since the start of the year (vs +22k per month in 2018). The household survey conducted by the BLS indicates a reduction in participation (-0.2 points), which, naturally, is reflected in the unemployment rate's dip from 3.8% to 3.6%. This is a new low point in this cycle, and in fact the lowest level since 1969.
- Total participation has been more or less stable for the past five years, but for the 25-54 year category, less impacted by social or demographic factors and therefore more representative of the business cycle, participation has been on a marked uptrend since end-2015. The other indicators of labour market conditions (quits, new job openings) have plateaued at cyclical peaks.
- After a sharp contraction in March (-3.6 points), the ISM non-manufacturing index continued to dip in **April**, shedding -0.6 points to 55.5, its lowest point since August 2017. In absolute terms, the index is not pointing to anything alarming, but its trend heralds a more moderate pace of growth. The aggregate of all the confidence indices in **April** (services, manufacturing, construction and consumers) paints the portrait of a business climate that has been more or less stable since the start of 2019 after a sharp drop in Q4 2018.

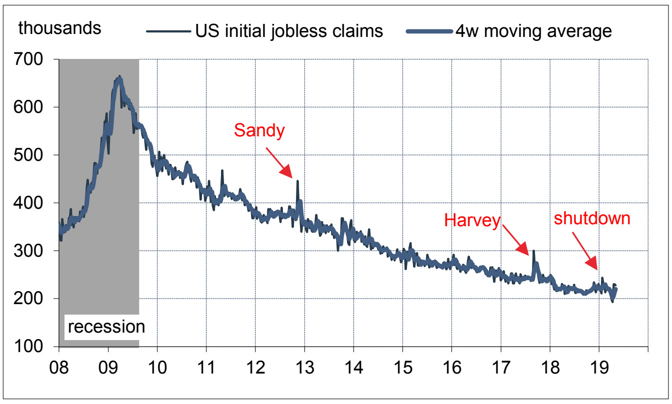
Monetary, fiscal and trade policy

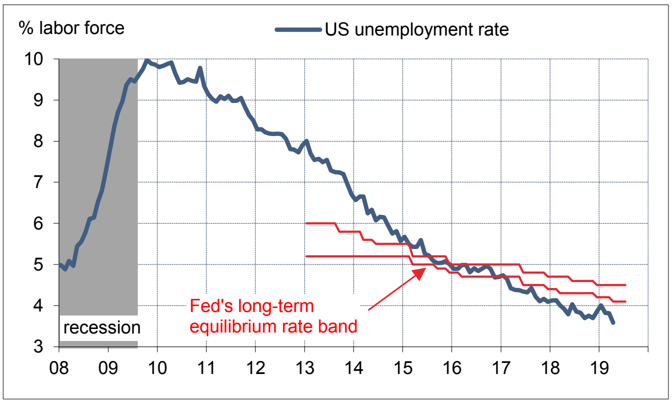
- The Fed's SLOOS survey early **Q2** points to little change in loans to businesses. The overall conditions are neutral or favourable. In commercial property, lending conditions are tightening, but to a lesser extent than in 2016. In residential property, lending conditions are stable and the drop in demand is less rapid than in Q1. The trends for consumer lending are similar: a slight tightening of lending terms and a slight reduction in demand. In addition, the half-yearly report on financial stability notes high asset valuations, low household debt and little risk in the financial sector, but it was concerned about corporate debt, notably for certain product or corporate segments. Nothing really new, except for the reminder that the economy could not withstand a sharp hike in interest rates.
- In two tweets on Sunday **5 May**, the US president reminded us that nothing can be taken for granted in the world of trade until an agreement is signed. (And even if an agreement is signed, such as the USMCA, it still needs to be ratified). Without providing any details, the US administration stated that China has broken certain promises and has given it an ultimatum until **10 May**. The deadline has passed - customs tariffs on $ 200bn in Chinese imports have been raised from +10% to +25%. This could potentially cause major disruption in trade over the next few months, especially if the measure is extended to the non-taxed portion of trade ($ 283bn on our calculations, $ 325bn according to Trump). In subsequent tweets, Donald Trump did not miss the opportunity, as is his wont, to describe the trade deficit as a loss for the US economy. A loss of exactly what is not clear to us! The very principle of trade is to exchange goods for currency freely. In **March**, this so-called "loss" came to $ 872bn (12-month sum on goods only) vis-à-vis the rest of the world and $ 408bn vis-à-vis China alone.

The week ahead

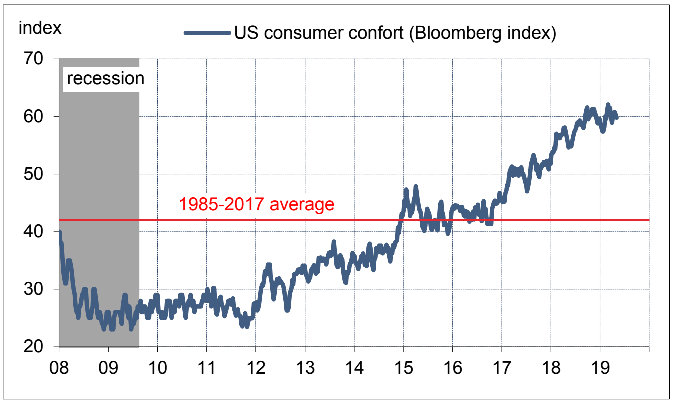
- Household consumption firmed since the start of the year, but the overall result in Q1 was poor (+1.2% q-o-q annualised). At the start of Q2, the fundamental factors were encouraging at first glance: strong job creation, wage gains, low inflation. Nevertheless, car sales showed a clear decline in April (-5.8% m-o-m) and are shy of their average levels for the past four years. Gasoline prices have risen sharply since February, significantly exceeding the normal seasonal pattern, which is eating into purchasing power The report on retail sales in April (**15 May**) bodes to be lacklustre, with an expected increase of +0.2% m-o-m, vs +1.6% in March. The residential construction figures (**16 May**) should be buoyed in April by the correction for an adverse weather effect the previous month. The increase in activity would go in tandem with the rebound in homebuilders' confidence and the recovery in sales following the drop in interest rates.

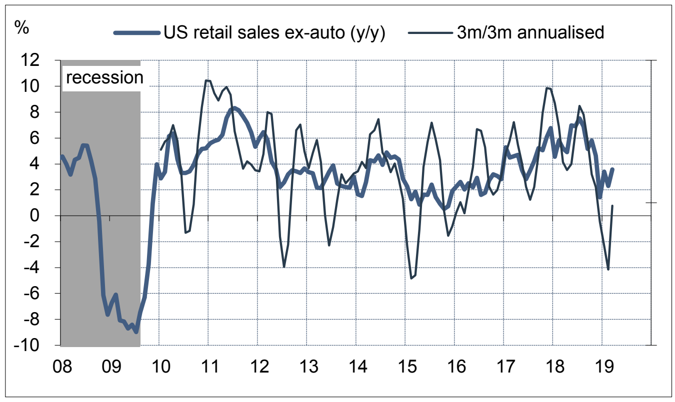
Appendix 1 - Labour market

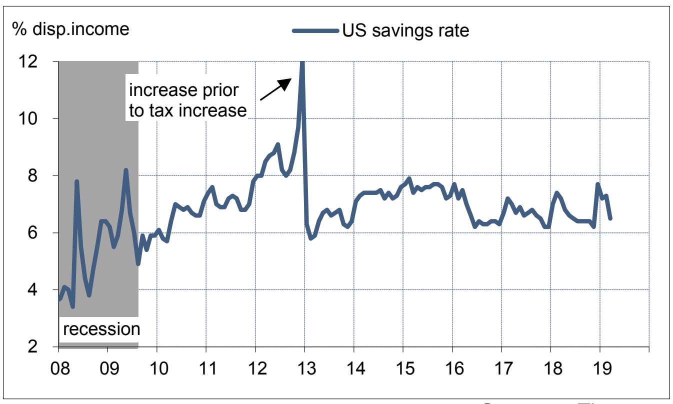


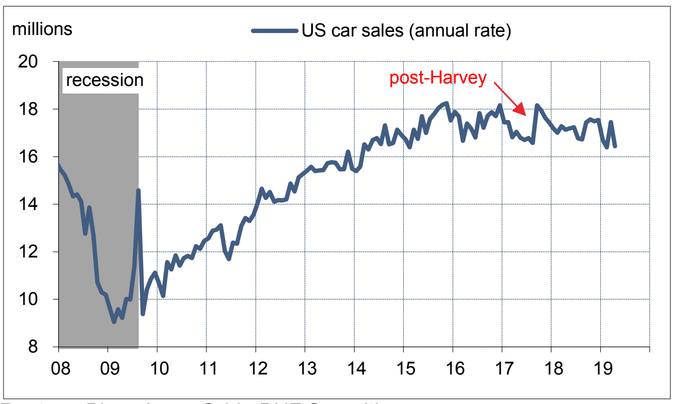


Appendix 2 - Consumer



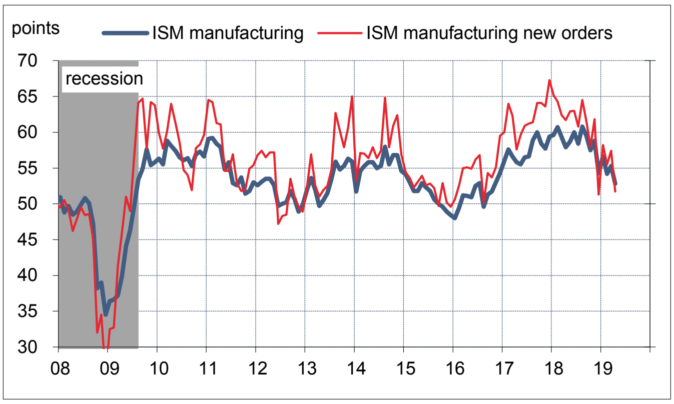


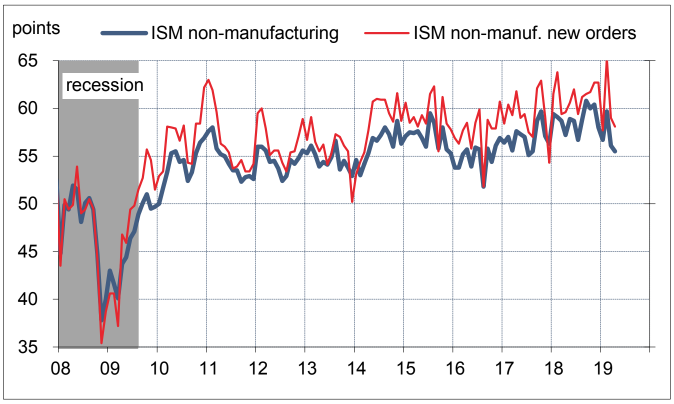


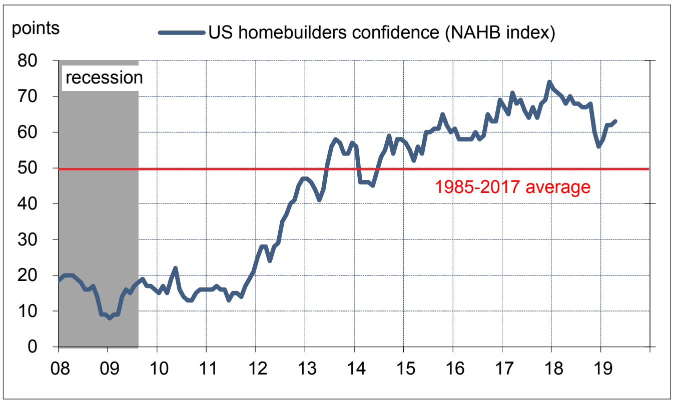


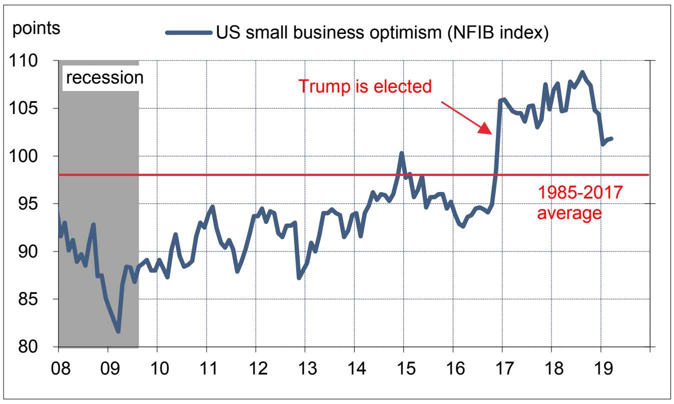
Sources : Thomson Reuters, Bloomberg, Oddo BHF Securities

Appendix 3 - Business climate

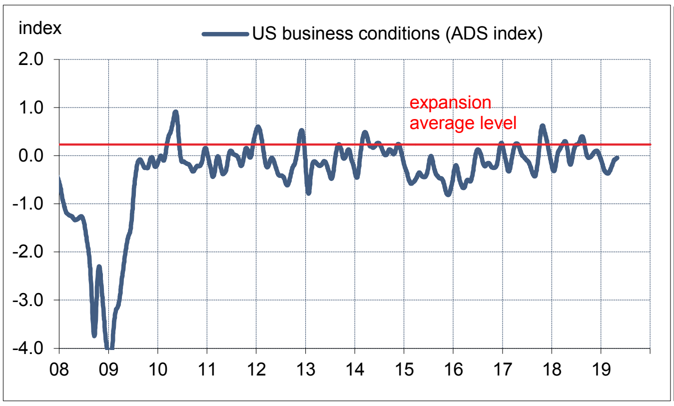


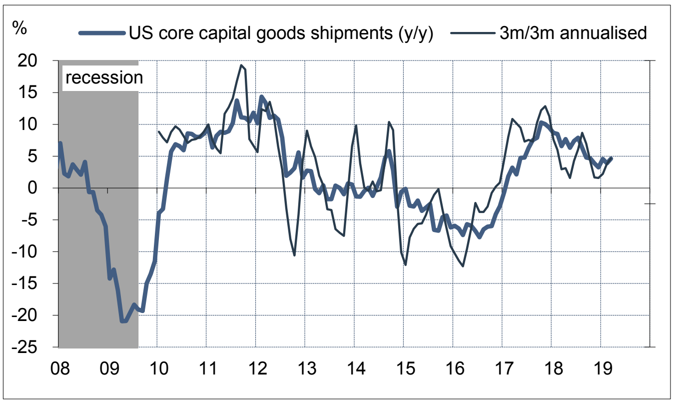


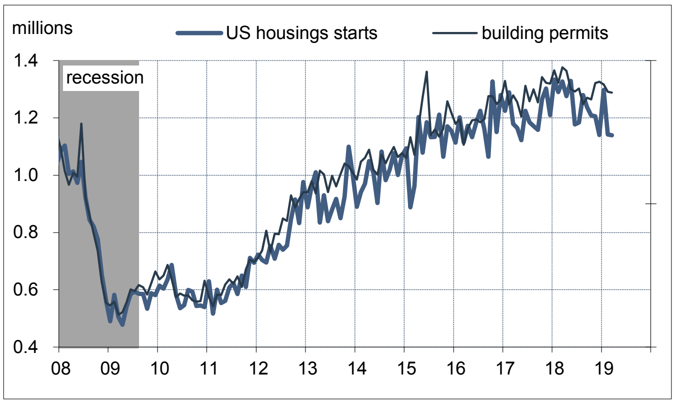




Appendix 4 - Conditions of economic activity

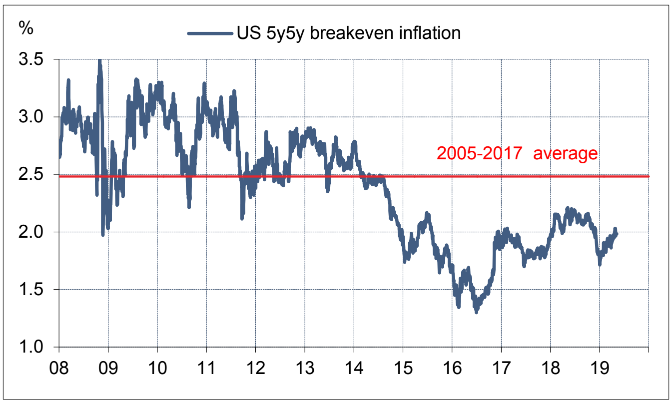


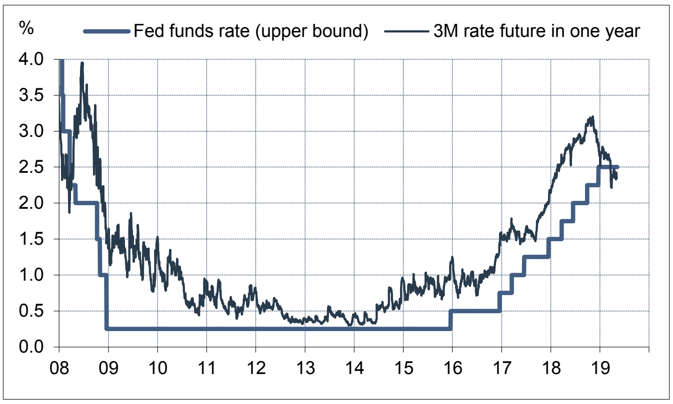


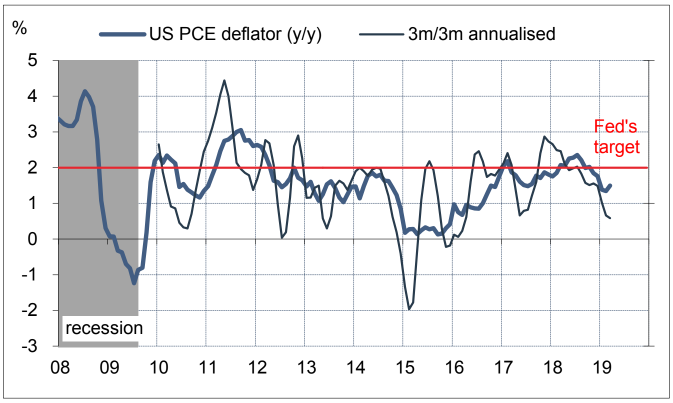


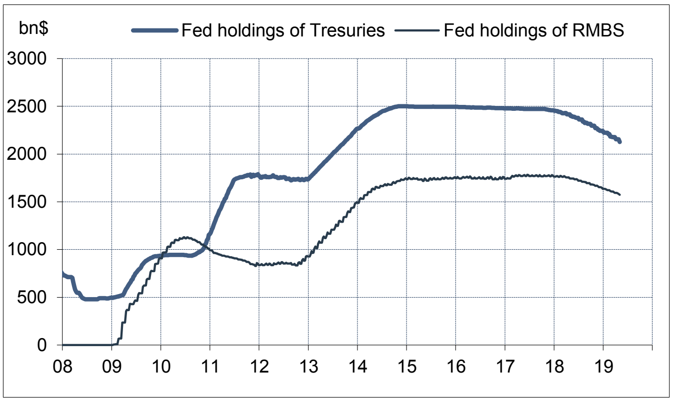
Sources : Thomson Reuters, Bloomberg, Oddo BHF Securities

Appendix 5 - Inflation and monetary policy

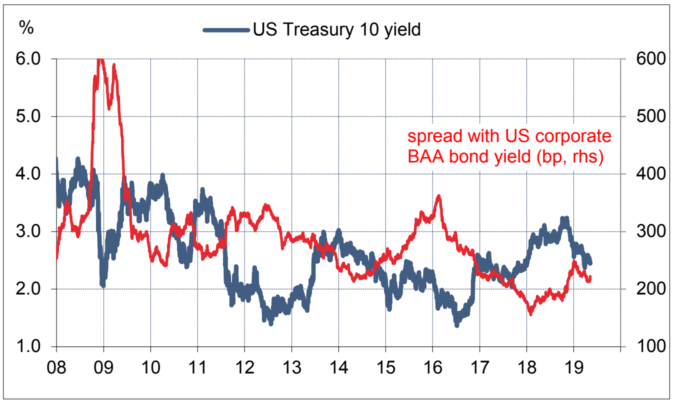


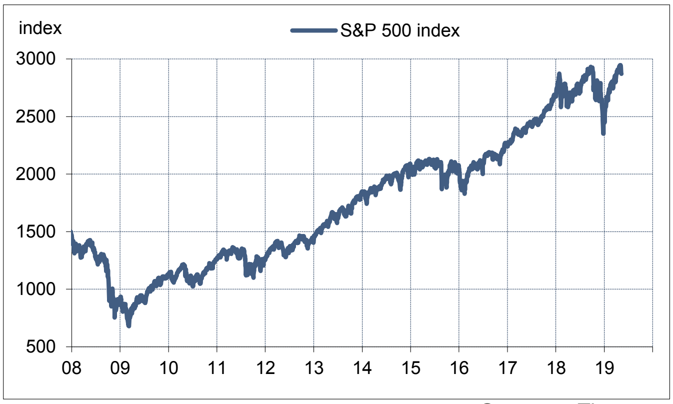






Appendix 6 - Financial markets





Sources : Thomson Reuters, Bloomberg, Oddo BHF Securities

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