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How painful will Trump's tariffs be for American businesses?

Their options range from hoarding goods and raising prices to rewiring supply chains

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IN THE WEEKS after Donald Trump's sweeping election victory, American companies sought to reassure investors that they were amply prepared for a new round of tariffs. Some, like Stanley Black & Decker, a toolmaker, highlighted efforts to shift their supply chains away from China. Others, like Lowe's, a home-improvement retailer, pointed to processes they have put in place to deal with tariffs after Mr Trump's first term, during which levies were imposed on various goods, mostly from China, ranging from furniture to washing machines.

Yet the coming disruption may be more widespread and less predictable than many American businesses expect. On November 25th the president-elect announced on Truth Social, his social-media megaphone, that he would impose a 25% tariff on all products flowing from Mexico and Canada and raise the rate on goods from China by 10%. Mr Trump's intention to follow through with his threat against Mexico and Canada was then thrown into question by subsequent posts in which he described "wonderful" and "productive" meetings, respectively, with the leaders of the two countries.

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That has not been comforting. If Mr Trump were to slap tariffs on America's northern and southern neighbours, the impact on American companies would be devastating. Businesses from Mattel, the maker of Barbie dolls, to Whirlpool, a home-appliance manufacturer, have factories in Mexico. Around three-fifths of America's imported aluminium and a quarter of its imported steel come from Canada, with large volumes of steel also coming from Mexico. According to Citigroup, a bank, Mr Trump's tariffs would raise the price of steel for American manufacturers by 15-20%.

Among the hardest hit by the suggested tariffs would be American carmakers. General Motors, for example, imports over half of the pickup trucks it sells in America from Mexico and Canada. About a tenth of the value of parts for cars produced in America also comes from the two countries. According to Nomura, a

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General Motors next year. Foreign carmakers, such as Toyota, would also be hit.

Companies can respond to tariffs in three ways. The first is to stockpile goods. Microsoft, Dell and HP are among the American tech companies that are rushing to import as many electronic components as possible before the new administration takes office in January. Yet there are limits to that strategy. Stockpiles may be depleted well before tariffs are lifted. And holding inventory requires warehouses and ties up cash. Many big companies already expanded their inventories in the wake of the supply-chain mayhem of the pandemic, and may have limited appetite to increase them further, particularly as higher interest rates raise the cost of doing so. According to JPMorgan Chase, another bank, the average ratio of working capital to sales among America’s 1,500 most valuable listed companies last year was higher than at any point in the past decade except 2020.

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The second option for companies is to pass tariffs on to customers by raising prices. Several firms, including Stanley Black & Decker and Walmart, America’s biggest retailer by sales, have already indicated that they may do so. Again, however, there are limits. The excess savings Americans built up during the pandemic have been whittled away by inflation and there are signs the country’s jobs market is cooling. The delinquency rate on credit cards is at its highest in a decade.

The third, and most difficult, response is to rewire supply chains. New suppliers, once found, have to be tested and negotiated with, a process that can take years. Many American companies have already begun diversifying their supply chains away from China. According to Kearney, a consultancy, China’s share of America’s manufactured-goods imports fell from 24% in 2018 to 15% last year. Meanwhile, the share from other low-cost Asian countries and Mexico, respectively, rose from 13% to 18% and from 14% to 16% (see chart 1). An analysis by Fernando Leibovici and Jason Dunn of the Federal Reserve Bank of St Louis shows that the fall in China’s share of imports has been biggest in industries where America has been most dependent on its rival, including communications and information technology.

Yet shifting production away from China may not be enough. The Biden administration, which kept many of Mr Trump’s original tariffs and added some of its own, has clamped down on Chinese goods entering America via circuitous routes. In July it imposed a “melt and pour” rule on Mexican steel, which requires that the metal be produced in the country to avoid tariffs. It may become

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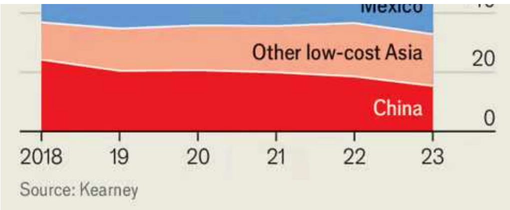

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televisions to seatbelts. On November 29th the federal government imposed anti-dumping duties on solar panels produced in South-East Asia by Jinko Solar and Trina Solar, two Chinese companies, among others.

Mr Trump's protectionist ire is directed not just at China, but at all countries with which America has a trade deficit. As a result, companies that have shifted their supply chains to Mexico, Vietnam or other low-cost countries may be in for a bruising. Some may decide that the only safe option is to bring production back home. That is already happening in a few industries, including semiconductors. Spending on factory construction in America was $172bn in the first nine months of this year, twice as much as in the same period in 2019, adjusting for inflation. A self-sufficiency index compiled by Kearney, calculated as America's manufacturing output (minus exports) as a ratio of imports (minus re-exports), has been ticking upwards since 2021, having fallen over the previous eight years (see chart 2). For many companies, though, making stuff in America will remain prohibitively expensive.

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Terrifying tariffs

The coming wave of tariffs may thus prove even more painful for American businesses than the previous one. According to research by Carlyle Burd of North Carolina State University, American companies that were exposed to tariffs levied on Chinese imports by Mr Trump during his first term saw their operating profit as a share of assets shrink by 5.4 percentage points, compared with those that were not. Some were hit harder. Last month the chief financial officer of Stanley Black & Decker said that the first-term tariffs initially cost the company around $300m annually, equivalent to a quarter of its net profit in 2017, and continue to cost it around $100m a year. Bosses will be watching Mr Trump's Truth Social account closely. ■

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