

Tariff-ic

Sal Guatieri, Senior Economist • sal.guatieri@bmo.com • 416-359-5295

Just when the clouds were parting for the U.S. economy in light of perkier productivity and equity markets, the threat of rising **trade protectionism** struck like a lightning bolt this week. After months of what seemed like constructive talks, the President said China “*broke the deal*”. Although talks continue, hopes of a quick settlement were dashed, and new 25% tariffs kicked in. So, after an eight-month ceasefire, it’s time to sharpen our pencils again and tally the economic casualties from the trade war.

Let’s start with the U.S. To be sure, estimates of tariff effects on GDP are fraught with uncertainty due to the many moving parts. To simplify the analysis, **we exclude currency effects**—the dollar is up 6% against the renminbi in the past year, allaying the loss of spending power though aggravating the effect of retaliatory actions on exports. We also **ignore policy responses** designed to cushion the blow—for instance, China has eased monetary and fiscal policies since the tariff tiff began last summer. **We focus on three channels:** the **loss of purchasing power** from higher-priced imports (with companies running at full tilt, imports will need to come from other countries or still from China, in both cases at higher cost); **China’s retaliatory actions** to punish U.S. exporters; and, an **assumed adverse effect on business confidence and supply chains** that dampens investment. With that understood, the previous tariffs—25% on \$50 billion of China’s goods effective July 6, 2018 and 10% on almost 6,000 items valued at \$200 billion effective September 24—are estimated to reduce U.S. GDP by about 0.2% over roughly a year. Friday’s ratcheting of the latter duty to 25% and expected counter measures by China could hive off another 0.1%. And, if the President carries through with a repeated threat to impose a 25% duty on all other goods imports from China (about \$270 billion based on the 12-month tally to March), then another 0.3% will be added to the roster.

So, the total cost to the U.S. economy of the current trade tiff and threatened escalation with China could amount to 0.6%. Adding earlier tariffs on global imports of metals, solar panels and washing machines slices another 0.1%, while the looming threat of a duty on automobiles (excluding Canada and Mexico) could reduce activity by an additional 0.3% (we’ll know next week as the President is expected to make an announcement by May 18). This implies around **1.0% of lost U.S. output (or 1½ million jobs) due to past and threatened protectionist actions.** No small potatoes.

China will suffer more than the U.S. While U.S. sales to China account for less than 1% of U.S. GDP, China’s shipments to the U.S. make up over 3% of its economy. The earlier tariffs likely lower China’s GDP by 0.5%, and the recent higher duty could strip off another 0.4%. The combined 0.9% impact could then nearly double to **1.7% if all of China’s shipments to the U.S. are hit with a 25% tax.**

Bystander Canada gets off lighter than China and the U.S. but not unscathed. Watching your major trading partner and world’s two largest commodity consumers slug it out on the battlefield doesn’t exactly inspire confidence among businesses (though you wouldn’t know if from the latest jobs report). The estimated 1.0% slowing in U.S. GDP due to current duties and possible further protectionist moves could translate into 0.5%

less Canadian output, based on the estimated impact of a change in U.S. growth on Canada. Lower commodity prices won't help. Including earlier tariffs on steel, aluminum and retaliatory actions could cost the economy another 0.3%, putting the potential **hit from a global trade war at around 0.8%** (or 150,000 jobs) for Canada.

Apart from some firms in protected industries, there are few winners when countries start unfurling the protectionist banner. While the U.S. may extract concessions from China that eventually support its trade balance and economy, the casualties on the ground are starting to mount. It's a high-stakes game for both nations, which is at least one reason to believe that either side will fold and call a truce.

General Disclosure

"BMO Capital Markets" is a trade name used by the BMO Financial Group for the wholesale banking businesses of Bank of Montreal and its subsidiaries BMO Nesbitt Burns Inc., BMO Capital Markets Limited in the U.K. and BMO Capital Markets Corp. in the U.S. BMO Nesbitt Burns Inc., BMO Capital Markets Limited and BMO Capital Markets Corp are affiliates. This document is issued and distributed in Hong Kong by Bank of Montreal ("BMO"). BMO is an authorized institution under the Banking Ordinance (Chapter 155 of the Laws of Hong Kong) and a registered institution with the Securities and Futures Commission (CE No. AAK809) under the Securities and Futures Ordinance (Chapter 571 of the Laws of Hong Kong). BMO does not represent that this document may be lawfully distributed, or that any financial products may be lawfully offered or dealt with, in compliance with any regulatory requirements in other jurisdictions, or pursuant to an exemption available thereunder. This document is directed only at entities or persons in jurisdictions or countries where access to and use of the information is not contrary to local laws or regulations. Their contents have not been reviewed by any regulatory authority. Bank of Montreal or its subsidiaries ("BMO Financial Group") has lending arrangements with, or provide other remunerated services to, many issuers covered by BMO Capital Markets. The opinions, estimates and projections contained in this report are those of BMO Capital Markets as of the date of this report and are subject to change without notice. BMO Capital Markets endeavours to ensure that the contents have been compiled or derived from sources that we believe are reliable and contain information and opinions that are accurate and complete. However, BMO Capital Markets makes no representation or warranty, express or implied, in respect thereof, takes no responsibility for any errors and omissions contained herein and accepts no liability whatsoever for any loss arising from any use of, or reliance on, this report or its contents. Information may be available to BMO Capital Markets or its affiliates that is not reflected in this report. The information in this report is not intended to be used as the primary basis of investment decisions, and because of individual client objectives, should not be construed as advice designed to meet the particular investment needs of any investor. This document is not to be construed as an offer to sell, a solicitation for or an offer to buy, any products or services referenced herein (including, without limitation, any commodities, securities or other financial instruments), nor shall such information be considered as investment advice or as a recommendation to enter into any transaction. Each investor should consider obtaining independent advice before making any financial decisions. This document is provided for general information only and does not take into account any investor's particular needs, financial status or investment objectives. BMO Capital Markets or its affiliates will buy from or sell to customers the securities of issuers mentioned in this report on a principal basis. BMO Capital Markets or its affiliates, officers, directors or employees have a long or short position in many of the securities discussed herein, related securities or in options, futures or other derivative instruments based thereon. The reader should assume that BMO Capital Markets or its affiliates may have a conflict of interest and should not rely solely on this report in evaluating whether or not to buy or sell securities of issuers discussed herein.

Dissemination of Research

Our publications are disseminated via email and may also be available via our web site <http://economics.bmocapitalmarkets.com>. Please contact your BMO Financial Group Representative for more information.

Conflict Statement

A general description of how BMO Financial Group identifies and manages conflicts of interest is contained in our public facing policy for managing conflicts of interest in connection with investment research which is available at http://researchglobal.bmocapitalmarkets.com/Public/Conflict_Statement_Public.aspx.

ADDITIONAL INFORMATION IS AVAILABLE UPON REQUEST

BMO Financial Group (NYSE, TSX: BMO) is an integrated financial services provider offering a range of retail banking, wealth management, and investment and corporate banking products. BMO serves Canadian retail clients through BMO Bank of Montreal and BMO Nesbitt Burns. In the United States, personal and commercial banking clients are served by BMO Harris Bank N.A., Member FDIC. Investment and corporate banking services are provided in Canada and the US through BMO Capital Markets. BMO Capital Markets is a trade name used by BMO Financial Group for the wholesale banking businesses of Bank of Montreal, BMO Harris Bank N.A, BMO Ireland Plc, and Bank of Montreal (China) Co. Ltd. and the institutional broker dealer businesses of BMO Capital Markets Corp. (Member SIPC), BMO Nesbitt Burns Securities Limited (Member SIPC) in the U.S., BMO Nesbitt Burns Inc. (Member Canadian Investor Protection Fund) in Canada, Europe and Asia, BMO Capital Markets Limited in Europe, Asia and Australia and BMO Advisors Private Limited in India.

"Nesbitt Burns" is a registered trademark of BMO Nesbitt Burns Corporation Limited, used under license. "BMO Capital Markets" is a trademark of Bank of Montreal, used under license. "BMO (M-Bar roundel symbol)" is a registered trademark of Bank of Montreal, used under license.

© Registered trademark of Bank of Montreal in the United States, Canada and elsewhere.

™ Trademark Bank of Montreal in the United States and Canada.

© COPYRIGHT 2019 BMO CAPITAL MARKETS CORP.

A member of BMO Financial Group