

Mexico retaliates US tariffs in aluminum and steel

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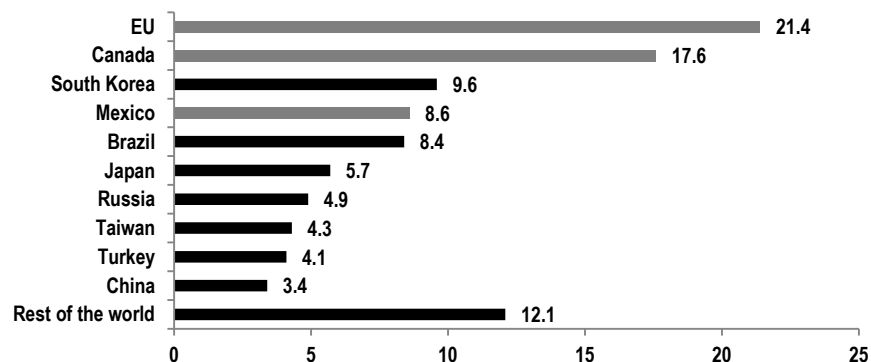
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- US government stepped up protectionist measures allowing tariffs on imports of steel and aluminum from the EU, Canada and Mexico to start applying
- Countries affected have announced retaliatory measures
- In our view, Trump's administration is trying to take a harder line on China but damaging the relationship with traditional allies such as the EU and NAFTA partners
- We recognize that with the available information at moment, it is very difficult to make an evaluation of the impact that these measures will have
- However, we expect a limited impact for the Mexican economy as these products represents less than 2% of CPI and about 1% of total imports from the US
- Nevertheless, if these measures impact NAFTA negotiations or if further protectionist actions are taken, we expect the shock to be reflected on the FX with a larger effect on inflation and economic activity in general

Protectionist measures to start applying as of today. The US government announced that it would allow tariffs on imports of steel (25%) and aluminum (10%) -announced back on March-, from the EU, Canada and Mexico to start applying this month. The US argued national security arguments for this measure. These three countries account for 47.6% of total US steel imports in 2017, as shown in the chart below.

Steel imports in 2017
% of total



Source: enforcement.trade.gov

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Retaliatory measures, but still not a trade war. Countries affected have already announced retaliatory measures. Back in March, the EU announced its intention to impose its own duties on US products such as bourbon, motorcycles and peanut butter. Canada said it would target US\$12.8bn in imports from the US, including aluminum and steel but also everyday consumer goods such as dishwasher detergent. Finally, Mexico announced yesterday retaliatory tariffs on US imports of steel, apples, grapes, cranberries, some types of cheese, pork, sausages and lamps for the same amount as the aluminum and steel tariffs.

We believe that measures announced do not constitute a trade war yet, but if they continue to step up, they could end up in a full-fledged trade war with negative consequences to the economies at a global scale.

In our view, Trump’s administration is trying to take a harder line on China. Nevertheless, he is damaging the relationship with traditional allies such as the EU and NAFTA partners. Moreover, he is trying to step up pressures as NAFTA renegotiation process is taking longer than expected with little to show before the mid-term election. In addition, the U.S. is holding trade talks with China, who Mr. Trump has accused of flooding cheap metals into global markets.

Limited impact for the Mexican economy. We expect the measures announced by the government today to have a limited impact on economic activity and inflation in Mexico. Aluminum and steel trade balance showed a deficit of about US\$15.7bn in 2017 with exports representing only 2.4%, while imports are equivalent to 6.1% of total purchases abroad in the period in question, as shown in the table below. The products included in the retaliation measures account for only about 0.5% of total imports (0.82% of total imports from the US), as shown in the table below. Nevertheless, they have a market share of 70.6% on average in each of the products included in the list. Moreover, Mexico is a very important client for US exporters of these products. For example, according to the U.S. International Trade Commission, Mexico was at the top of the list of apple exports from the US in 2017, as well as, in the case of cheese.

US products subject to retaliation in Mexico

Product	Total		From U.S.		Market share*
	US\$m	% total	US\$m	% total	%
Imports	420,369.1	100.0	194,922.2	100.0	
Products subject to retaliation	1,941.1	0.46	1,605.0	0.82	70.6**
Fresh grapes	144.3	0.03	97.2	0.05	67.3
Fresh apples	281.7	0.07	276.5	0.14	98.2
Cranberries	1.3	0.00	1.3	0.00	100.0
Sausages	104.7	0.02	97.3	0.05	93.0
Swine meat	1,068.7	0.25	946.5	0.49	88.6
Cheese	292.8	0.07	176.5	0.09	60.3
Lamps	47.7	0.01	9.8	0.01	20.6

Source: trademap.org

*Market share of US imports on total Mexico's imports of each product

**Weighted average of market share

In terms of inflation, the possible effect is very low. Products included represent less than 2% of total CPI. Assuming an increase of 25% in the price of each of these products, the contribution to total inflation in 2018 would be of about 2.6bps. Taking our 4.3% forecast for year-end, this would imply just a marginal uptick to 4.33%. Nevertheless, this is a very strong assumption as it implies that: (1) All products are levied with a tariff of that magnitude; (2) all the cost of the tariff is passed on to the consumer; and (3) exchange rate remains unchanged. Moreover, it is worth noting that the Ministry of Economy has not detailed how the retaliation measures are to be applied in each of the products.

Impact on inflation of a 25% increase in the price

	CPI Weight	Contribution
	%	pb
Total	1.97	2.55
Grapes	0.07	0.09
Apples	0.23	0.28
Sausages and ham*	0.32	0.40
Swine meat	0.69	0.87
Cheese*	0.68	0.85
Lamps**	0.05	0.06

Source: Banorte with data from INEGI

*Sum of all the components related

**Other furniture as lamps does not appear in CPI weights

In our opinion, the FX could be impacted if these measures affect prospects on NAFTA negotiations. If the actions taken by Trump’s administration deteriorate prospects on NAFTA negotiations, which seem to have reached an *impasse* or if further protectionist actions are taken, we expect FX levels to reflect this. In this case, the effect on inflation and eventually on economic activity in general could be higher than expected. To this we must add the uncertainty regarding other geopolitical issues as well as the electoral process in Mexico.

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