

Trump's Mexico Tariffs: This Bull Carries His Own China Shop

- President Trump's invocation of emergency economic powers to impose a new round of step-up tariffs on US imports from Mexico, beginning at 5% from June 10, 2019 with a possible move up to 25% by October 1, marks a new level of irrationality and unpredictability in the White House's pursuit of its protectionist agenda. The President's move fell on the same day as the Administration presented a Statement of Administrative Action before Congress, which effectively starts a clock for Congressional action on the Canada-US-Mexico Agreement (CUSMA) and 10 days after so-called "national security" tariffs were lifted on Mexican and Canadian steel and aluminum.
- Pres. Trump's new tariff threat is unlikely to be implemented fully, for very long, or at all: knowing that they would be deeply injurious to the US economy, the White House left itself substantial wiggle room in its statement to roll back its threat. Negotiators from both the US and Mexican sides unsurprisingly now indicate that they may find ways to prevent the tariffs from going ahead.
- Regardless of the extent to which these new tariffs are implemented, their possibility is likely to put a chill on growth in the US and its major trading partners, slow—but not prevent—the ratification of the USMCA, and delay the resolution of trade tensions with China, Europe, and Japan.

A NOT-SO-ARTFUL DEAL

As Churchill once observed of Eisenhower's Secretary of State John Foster Dulles, President Trump is the only bull we know that carries his own china shop around with him. On May 30, 2019, the White House's trade actions took on a new level of unpredictability.

Just days after the Trump Administration's May 19 move to lift so-called "national security" tariffs on Mexican and Canadian steel and aluminum products, the White House both:

- took a first step to initiate US ratification of the United States-Mexico-Canada Agreement (USMCA)—the successor to the North American Free-Trade Agreement (NAFTA)—against the wishes of US House Democrats, who wanted further discussion on labour, environmental, and drug safeguards; and
- issued an official threat, first by Twitter, and then by White House statement, to impose across-the-board tariffs that could progressively impose up to 25 percentage points (ppts) of additional taxes on top of existing charges on all US imports from Mexico if that country does not take what is deemed by the White House to be "effective action" to stem the movement of Central American migrants through Mexico on their way to the US.

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Table 1

Timeline for US Tariffs on Mexican Imports

Date	Tariff rate	USD bn	% of GDP
Jun 10	5%	17.3	0.08
Jul 1	10%	34.7	0.17
Aug 1	15%	52.0	0.25
Sep 1	20%	69.3	0.34
Oct 1 onward	25%	86.6	0.42

Sources: Scotiabank Economics. US Census Bureau. BEA

In a single day, with two ill-considered moves, Pres. Trump dashed hopes that the end of the Section 232 tariffs on Mexican and Canadian steel and aluminum imports marked the beginning of a more rational approach to trade by his Administration. In addition to this latest bout with Mexico, the Administration is currently waging trade disputes on several other fronts, with tariffs on Chinese goods and steel and aluminum products from most countries, as well as the looming threat of 25% tariffs on auto and parts imports from Japan and the EU.

The tariffs threatened against Mexico are consistent with two things. First, they follow a repeated pattern in which this President calls out a problem that doesn't exist, threatens and sometimes launches misguided measures to address the supposed problem, eventually walks these moves back, and claims victory for improving things, meanwhile leaving the US and the world worse off than before. Second, this threat is the most recent instance in which this President, when under new stress and with few legislative accomplishments, resorts to a tariff policy hammer that reduces every challenge to being a nail.

This report argues that any follow-through on Pres. Trump's threat to impose new tariffs on Mexican imports is likely to be partial and temporary given the market's immediate reaction to his statement—but the disruption it causes will probably go far beyond the tariffs themselves. Unlike the Section 301 tariffs that have been imposed selectively (to avoid final consumer goods) on USD 250 bn in imports from China, the threatened tariffs on Mexican goods would have a much bigger direct negative impact on US industry and households. They would also undermine every other action on trade the Trump Administration is taking by demonstrating definitively that its commitments are meaningless and that trade uncertainty is going to remain a chronic feature of the White House's approach to its foreign engagements.

SCALE OF THE THREAT

Imports from Mexico to the US amounted to about USD 347 bn in 2018. An initial 5% tariff on these imports would cost Americans about USD 17 bn (table 1, front page), but the economic impact on the US economy would be much higher. Highly integrated North American supply chains see up to half of these goods move tariff-free back and forth across the US-Mexico border multiple times. Auto parts, for instance, are estimated to move six to eight times across the NAFTA region's borders, thereby compounding the effect of the tariffs. An eventual move to the full 25% threatened by Pres. Trump would cost US business and consumers at least USD 87 bn (table 1, again), all else equal. Any retaliatory tariffs imposed by Mexico would deepen the impact further. Delays at border crossings would impose further costs as most trade between the US and Mexico is currently free of tariffs and accompanied by limited inspections.

Tariffs on the totality of imports from Mexico throw out the window the opportunity to target specific goods, as in the case of duties on Chinese imports. While consumer goods represent slightly less than 20% of goods currently impacted by tariffs on China (chart 1), they account for nearly a third of US imports from Mexico (chart 2). On the other hand, intermediate goods correspond to 37% of US imports from Mexico compared to a 50% share in Chinese goods hit with tariffs (charts 1 and 2 again). However, the deep integration of the US and Mexican manufacturing sectors poses additional costs.

Chart 1

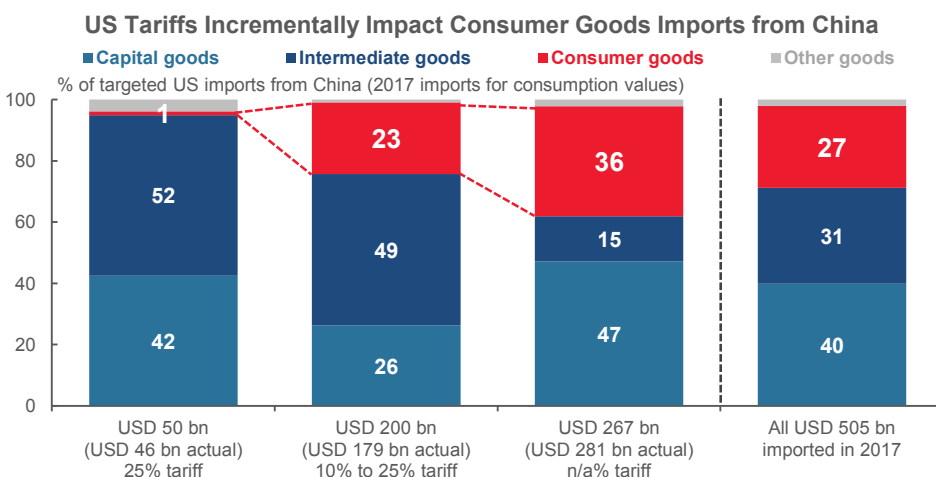
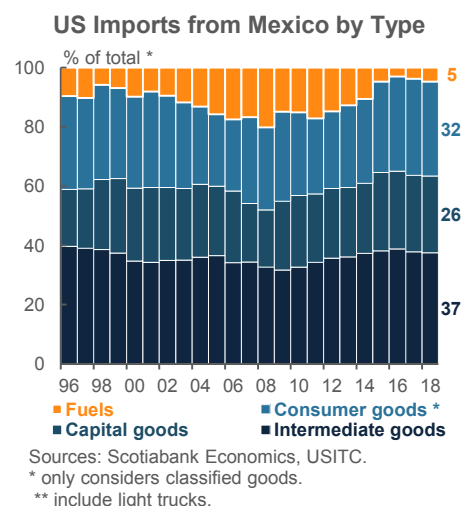


Chart 2



The automobile manufacturing industry would stand to lose the most from one- or two-way tariffs in US-Mexico trade given the high degree of integration in supply chains. On average, US parts account for around a third of the total value in parts of Mexican-made autos sold in the US, while at least around 15% of parts in US assemblies are sourced from Mexico (chart 3). Overall, North American parts represent about 78% and 68% of the total value of components in Mexican and US vehicles, respectively. Tariffs on Mexico would not only increase the price of imported vehicles for US consumers, doubly so if Mexico retaliates with tariffs on US parts, but would also raise the price of domestically-assembled vehicles given the importance of Mexican parts in US production.

It's important to note that the USMCA side-letters on autos would not shield the Mexican (or Canadian) industry from tariffs imposed under the President's emergency powers. While these USMCA side-letters became active upon signature on November 30, 2018 and exempt Mexico and Canada from the so-called "national security" Section 232 tariffs measures imposed on steel and aluminum—and threatened on autos and parts—the letters do not appear to provide protection against tariffs imposed in response to the declaration of a national emergency in the US.

One potential beneficiary of the China-US impasse has been and was always likely to be Mexico as companies consider shifting supply chains away from China toward lower-cost markets closer to American consumers. The latest escalation of Trump tariffs threatens this process. Firms may instead look elsewhere in South East Asia, or even Canada. Even if firms do not relocate to the US owing to tariffs on Chinese imports, an increase in production in Mexico would result in increased demand for inputs from US manufacturers. If producers instead move their operations to other low-cost hubs in South East Asia, other countries in the region, namely China, will act as suppliers, not US firms. Duties on both China and Mexico would nevertheless inflict immediate pain on US firms that will find it difficult to supplant purchases with goods from other countries, as combined purchases from China and Mexico account for 35% of all US merchandise imports (chart 4). More than half of US capital goods imports from the world could be subject to tariffs under the latest imposition of duties on Mexican goods and if the Administration imposes punitive duties on the totality of imports from China (chart 5).

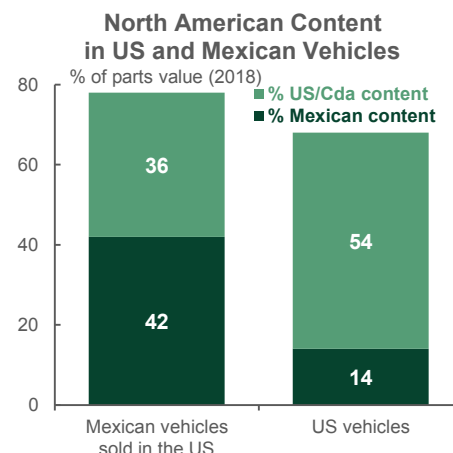
US imports from China and Mexico are so essential to US industry that tariffs on these goods would hurt US competitiveness and possibly drive entire production processes overseas rather than re-shoring them to the US.

WHITE HOUSE PROCLAMATION: TIMING DOESN'T APPEAR COINCIDENTAL

The President's [statement](#) on the threatened Mexican tariffs, released after 7pm EDT last Thursday evening had clearly been prepared some time ago, given its detail. The statement calls for specific action and includes several specific opportunities for the White House to declare victory on little substantive change, notably:

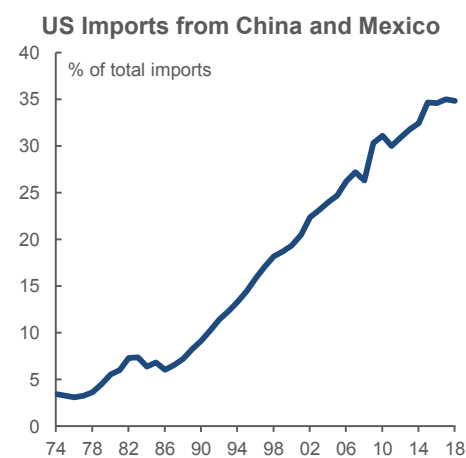
- An across-the-board 5 pts increase in duties on all US imports from Mexico from June 10 unless "effective actions" are taken by Mexico to "alleviate" the so-called "illegal immigration crisis" on the US's southern border.
- If, in the White House's judgment, the "crisis" persists, however, tariffs will be raised another 5 pts on July 1, 2019;

Chart 3



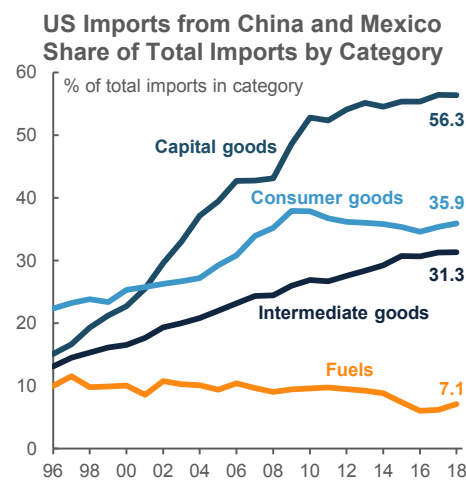
Sources: Scotiabank Economics, NHTSA, WardsAuto.

Chart 4



Sources: Scotiabank Economics, US Census Bureau.

Chart 5



Sources: Scotiabank Economics, USITC.

- Further 5-ppt increases on August 1, September 1, and October 1, respectively, would be contingent on Mexican action “to dramatically reduce or eliminate the number of illegal aliens crossing its territory into the United States” with no mention of action on Mexicans who may enter the US illegally; and
- Thereafter, “tariffs will permanently remain at the 25% level unless and until Mexico substantially stops the illegal inflow of aliens coming through its territory.”

Some version of the White House’s statement has likely been sitting prepared since at least mid-February and has been held at the ready to distract attention from other pressures. Pres. Trump’s February 15, 2019 declaration of a *National Emergency Concerning the Southern Border of the United States* ([Proclamation 9844](#)) provides the enabling pretext for Pres. Trump’s newly-threatened tariffs. Following the announcement of the *Emergency*, Pres. Trump said he would move to close the border with Mexico to stop the movement of illegal immigrants, criminal activity, and illicit drugs, ignoring data that the US-Mexico border had become a declining locus for all three.

In early-April, Congressional, market, and public reaction to the White House’s threat to close the US southern border to all movements of goods and people stopped Pres. Trump from exercising this nuclear option—but he foreshadowed on April 4 that tariffs on Mexico would still remain in the cards. Pres. Trump was quoted as giving Mexico a “one-year warning” to stop the alleged flow of illegal drugs and immigrants from entering the US or he would “put tariffs on Mexico and products, in particular cars.” Pres. Trump argued that “The only thing, frankly, better but less drastic than closing the border is to tariff the cars coming in.” Later that day, he told reporters that “he didn’t say that” the border would stay open for at least a year, but then argued that “I don’t think we’ll ever have to close the border”; instead, he predicted that they would “start with the tariffs and see what happens,” arguing that tariffs would be enough to get Mexico to comply his wishes.

The decision in mid-May to lift US tariffs on Mexican and Canadian steel and aluminum could have reasonably been taken as a sign that additional tariffs on Mexico wouldn’t happen—but instead they were just stayed until they were needed to provide a distraction from other matters.

TESTING THE LIMITS OF PRESIDENTIAL POWERS

Pres. Trump’s threatened tariffs would be enabled by the President’s capacity to take action under the International Emergency Economic Powers Act ([IEEPA](#)) to

...deal with any unusual and extraordinary threat, which has its source in whole or substantial part outside the United States, to the national security, foreign policy, or economy of the United States, if the President declares a national emergency with respect to such threat.

Some legal experts have raised doubts about the legality of the imposition of tariffs under the IEEPA, noting that it provides the President power to “investigate, regulate, or prohibit”, but not to impose taxes or tariffs. The IEEPA powers were envisaged more for the seizure of foreign powers’ assets during times of conflict.

Notwithstanding these concerns, possible challenges to the President’s tariff threat aren’t likely to proceed ahead of the President’s first June 10 deadline. There aren’t good precedents that would incline the courts to challenge the wide-ranging powers granted by the IEEPA to the President. Alternately, Congress could terminate the President’s February 15 declaration of a *National Emergency*, but this would require concurrent resolutions by both the House and Senate, which is unlikely even with some Republican defections from the Trump Administration’s side.

The IEEPA requires the President to consult with Congress and provide a report to both houses that explains and justifies action under the Act. The report is intended to explain why “circumstances constitute an unusual and extraordinary threat, which has its source in whole or substantial part outside the United States, to the national security, foreign policy, or economy of the United States.” Such a report is meant to be provided concurrent with the imposition of any tariffs, with reports and consultations with Congress required every six months.

ROOM TO BACKTRACK

The wording of last Thursday's White House statement leaves wiggle room for the White House to avoid implementing it in its entirety:

- Any action taken merely to “alleviate” the immigration situation, as judged by Pres. Trump and his advisers, could forestall the first tariff increase, whether the action materially changes the *status quo* or not;
- Companies located in Mexico that “start moving back to the United States to make their products and goods” and “relocate to the United States will not pay the tariffs or be affected in any way”. This could provide an opening for the White House to exempt companies, such as a few automakers, that have already announced the reshoring of some production from Mexico to the US;
- The tariff could also be “more readily reduced or removed” if Congress has “promptly corrected” what the White House calls “broken asylum laws, court system, catch-and-release, visa lottery, chain migration, and many other loopholes.”

To sum up, the White House statement leaves at least three ways to limit the damage of the threatened tariffs: stay them on the basis of almost any action by Mexico; exempt select importers; and declare victory on any movement by Congress on Pres. Trump's immigration agenda.

Additionally, the Trump Administration could also act to curtail the scope of the tariffs to focus on goods that are unlikely to cross borders multiple times in integrated supply chains. Capital goods would be the most likely target. The White House could also focus on final consumer goods, but that would also make the costs of the tariffs plain to the American electorate.

On Wednesday June 6th, White House trade adviser Peter Navarro proposed that Mexico accept Central American migrants seeking asylum instead of the US, as well as beefing up security at its Guatemalan border and establishing more checkpoints along routes where buses and trains carry migrants.

BROADER IMPLICATIONS: CAN ANY DEALS BE MADE WITH THIS PRESIDENT?

Pres. Trump's abrupt about-face on tariffs on Mexican imports intensifies doubts that any durable commitments on trade can be made with this Administration. Although the White House has been keen to separate the Mexican tariff threat from their other trade pursuits—especially USMCA—these issues are obviously inseparable.

At a minimum, the new tariff threat against Mexico will put fresh friction in what had been new momentum behind the ratification of the USMCA in Canada and Mexico—and complicates ratification in new ways in the US. The May 19, 2019 lifting of the US tariffs on steel and aluminum imports from Mexico and Canada by the White House had removed a major impediment to ratification of the USMCA in both countries. Both Ottawa and CDMX had indicated that they would not proceed to submit ratification legislation to their legislatures until these tariffs were lifted; similarly, the USTR had promised in mid-2018 that the US metals tariffs would be eliminated once “USMCA was dealt with.”

Both the Mexican and Canadian governments have indicated that they will proceed with the ratification processes that they recently put into motion, but both governments are likely to delay final votes and administrative measures to promulgate ratification until the new US tariff threat is cleared. The ratification processes in both countries are simpler and less time-consuming than in the US, and both governments control legislative majorities to drive their ratification processes. Canada faces a federal election in October 2019, but ratification should not be affected by any change in government as the opposition parties have been engaged in the USMCA lobbying and negotiation processes and they claim some credit for their success.

President Trump's tariff threat deals a blow to his hopes of a quick USMCA approval this summer. The US Trade Representative's (USTR) office submitted to Congress a summary of legal changes necessary for the enforcement of USMCA, which gives Congress thirty days to write up a bill that would enact these provisions. The USTR's submission puts unwanted pressure on House Democrats who wish to include legal provisions for stronger labour and environmental protections, as well as curbs on higher prescription drug prices in the USMCA text—much as they did in side-letters to NAFTA during its 1993 ratification

process. Nevertheless, we anticipate that the new NAFTA will eventually proceed through the US House given Democratic support for trade security with Canada and Mexico—but not on the President’s desired timetable. Pres. Trump may revisit his threats to invoke NAFTA’s Art. 2205 six-month warning period to withdraw from the accord, but he is unlikely to make good on these threats ahead of the 2020 elections given that two-thirds of US states count Canada and Mexico as their most important trading partners.

The threatened Mexican tariffs put into question the credibility of indications by the Administration that tariffs will not be imposed, or will be removed, on countries that make compromises to negotiate a trade agreement with the US. Chinese, Japanese, and European trade negotiators will likely remain cautious in offering trade concessions to the US and may possibly attempt to prolong trade talks in the hope that President Trump is replaced by a more trade-friendly successor in the 2020 elections. President Xi sees his hand strengthened against any domestic critics who may have questioned his decision to delay agreement on a deal with the White House now that it’s clear that Mexico’s concessions under the USMCA didn’t buy it trade peace with the US.

Trade uncertainty is here to stay. The White House continues to cement its reputation as an erratic and unreliable trade negotiator with the long delay in removing tariffs on Canadian and Mexican metals imports, and now, with tariffs on all Mexican imports. The precarious environment created by Pres. Trump is set to put a chill on investment intentions in the US—and globally. Even if the White House rolls back its intent to impose duties on Mexican imports, the Administration’s latest offense has shown that perceived progress on the trade front may only prove ephemeral.

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