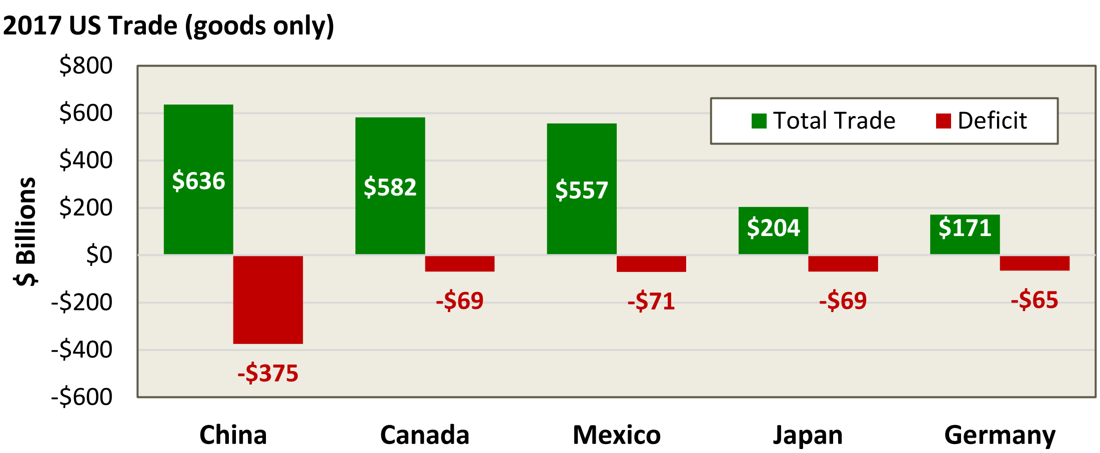
*As history has repeatedly proven, one trade tariff begets another, then another - until you've got a full-blown trade war. No one ever wins, and consumers always get screwed.*

Mark McKinnon

Over the past several months the terms *tariff* and *trade war* have garnered increased attention in the media. President Trump is emphatic that the United States is engaged in several unbalanced trade relationships that require government intervention. To address these inequities, he intends to use tariffs to reduce trade deficits and expedite the renegotiation process. Tariffs are an inviting option as they can be applied in very targeted areas/products and do not require Congressional approval. Against this backdrop, we felt that this was an opportune time to discuss tariffs and the implications for the US economy.

The US has run the world's largest trade deficit since 1975. In 2017, we imported $2.4 trillion of goods and exported $1.6 trillion, leaving a trade deficit of $810 billion. The table below, derived from the US Census Bureau, shows the five largest trade deficits and the trading partner.




The president believes that the US is being unfairly treated in global trade relationships and the following examples have been recently cited:

- For Europe, the focus has centered on auto imports. The European Union charges a 10% duty on vehicles imported from the US. This compares to a 2.5% duty charged by the US on European passenger car imports, and a 25% duty on pickups and light trucks.
- In the case of China, the focus has largely centered on Intellectual Property theft and conditional market access. To sell into certain Chinese industries, US companies are forced to form joint ventures with domestic firms. As part of these agreements, US companies are often asked to transfer technology, but no such requirement exists for their Chinese counterparts selling into the US.

Simply put, a tariff is a tax on imports or exports. Money generated from this tax is referred to as a duty. Tariffs were originally used as means for governments to raise revenue. For example: Company A produces a good or a product in a foreign country which has a duty levied on it when it arrives in the US, either as a percentage of the value or on a per-unit basis. This increases the cost of the foreign product to domestic businesses and/or consumers, forcing them to either pay more for the good or find a suitable substitute (depending on availability). Domestic producers of the product benefit as their prices become relatively more competitive.

Economists generally agree that in most circumstances, tariffs have a negative economic impact, with the elevation in overall cost to consumers and businesses outweighing the benefit to domestic producers.

Three key reasons a government might opt to levy tariffs include:

1) To raise revenues
2) To protect domestic companies from foreign competition, for the following reasons:
    - they are critical for national security (i.e. to ensure we have a domestic steel industry to produce military equipment in war time);
    - a foreign country is subsidizing their local businesses to help them gain an unfair global advantage; or,
    - this industry is an important portion of the local economy or a source of national pride.
3) To punish a foreign country for engaging in unfair trade practices.

The president's trade agenda began with rationale #2 above when he implemented steel and aluminum tariffs in March 2018. More recently, headlines have centered around rationale #3. Historically, rationale #3 risks a trade war when countries engage in a retaliatory exchange of tariffs.

There are material benefits the US receives from global trade. The US Chamber of Commerce estimates that access to imports boosts the purchasing power of the average American household by about $18,000 annually, a considerable amount. They also report that the export of manufactured goods directly supports approximately 6 million American jobs.

Of concern is the rapid speed at which Trump is acting on his trade agenda. The administration has moved from "safeguard" tariffs on solar panels and washing machines totaling approximately $10 billion in trade in January, to a more recent threat on Chinese products totaling $500 billion in trade just this month. Additionally, with US unemployment near record lows and a recent report from the NFIB ("National Federation of Independent Business") Research Center reporting that over 1/3 of small businesses cannot fill job openings, it is not evident that enough American labor is available to compensate for a significant decline in imports. Another potential risk to the economy could come from businesses delaying investments until trade war risks have subsided.

The negotiation of global trade agreements is generally a slow and carefully considered process. While tariffs, or their threat, may be a useful tool for spurring more serious negotiations, a protracted trade war would be negative for the US economy. We believe the administration knows this and we've learned that Trump's rhetoric is often stronger than the actual outcome. Economic and political reality may reign in more extreme escalation, but the risk certainly exists of trade wars impacting global financial markets.

As always, we will continue to keep a close eye on economic metrics, Fed commentary, and the negotiation and implementation of trade agreements to gauge impact to the economy and financial markets.