Mizuho Brief: US Tariffs

Economics & Strategy | Asia ex-Japan

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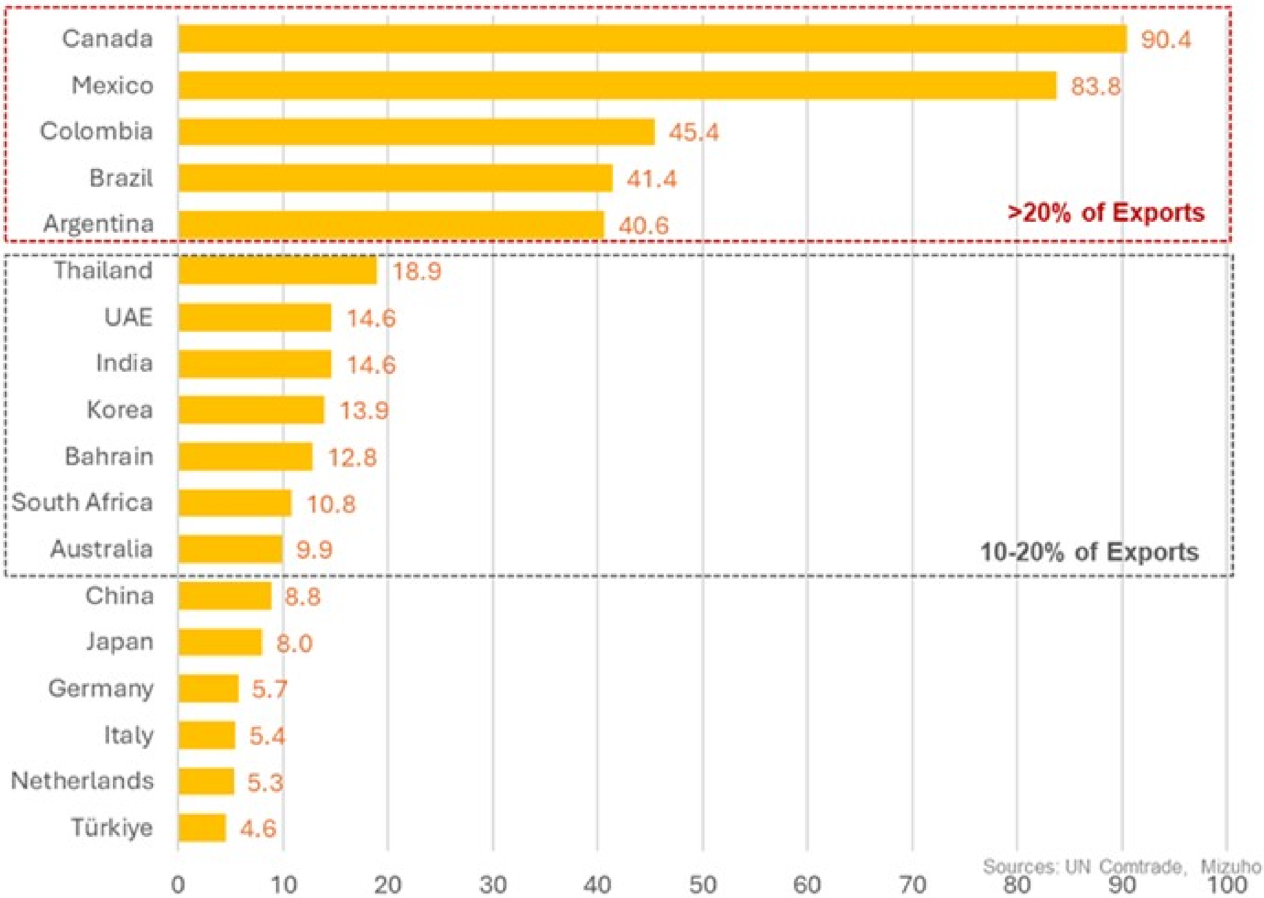
Risks of Doubling Steel (& Aluminium) Tariffs

Figure 1. % of (Weighted) Steel & Aluminium Exports Headed for US



"Maybe self-improvement is not the answer. Maybe self-destruction is the answer" – **Fight Club Wars**

In a Nutshell:

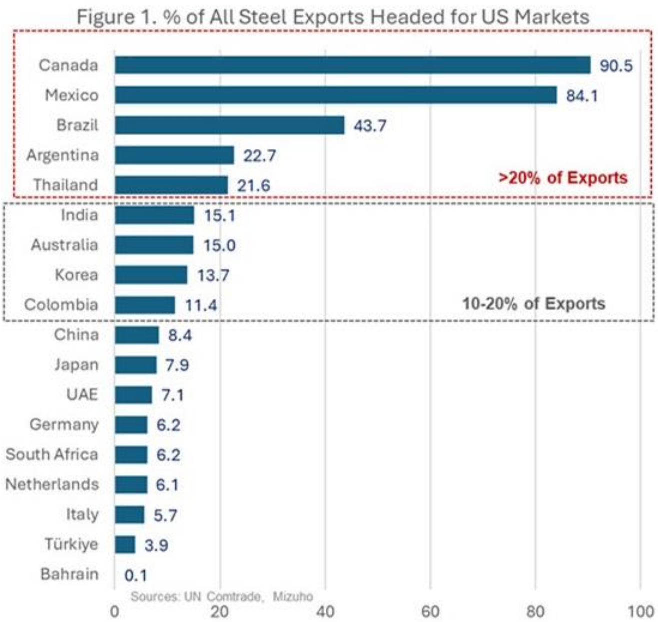
- **Doubling** the **steel** and **aluminium tariffs** are ostensibly aimed at **protecting the US steel industry** and **jobs**.
- And to that end, **sweetening the US Steel-Nippon Steel deal**.
- Although this will necessarily be **at the expense of global** steel (outside of Japan) and aluminium **producers**.
- Notably, *Canada*, *Mexico, Colombia, Brazil* and *Argentina* (given more than 40% US market exposure for steel and aluminium) *will hurt most.*
- In Asia, Thailand, Korea, India are most exposed followed by Australia. In contrast, Japan is hedged (via Nippon) although assuming investment/control risks.

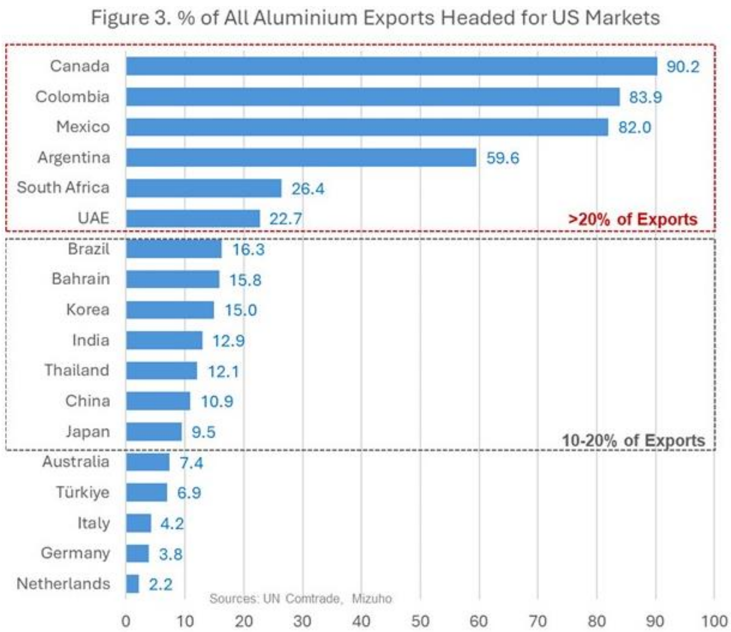
- But the **US will not be unscathed** given more expensive onshore (US) steel and aluminium will inevitably **raise costs**.
- **Ultimately** this will prove to be an act of **self-harm, hurting** the **competitiveness of downstream US industries** (e.g. construction, autos).
- FX/AXJ: Admittedly, ***USD may be hobbled by self-harm.*** But in Asia, ***THB, KRW, INR and AUD may underperform vis-à-vis JPY.***
- Rates: A **higher cost structure in US industries**, with *"US+1" fragmentation a risk,* suggests a ***steeper curve,*** which in turn may *accentuate high-yield under-performance.*

- Doubling Down: President Trump **doubled steel and aluminium tariffs to 50%** from 25% (effective 4th June). While ostensibly aimed at a **leg-up for the US steel industry**, this may *ultimately be self-defeating.*
- To Assure US Production and Jobs: To be sure, by **raising the "fence" for foreign steel imports**, the objectives are, ostensibly, to **lift domestic production** (from import substitution) and consequently **retain/protect jobs** (as capacity cuts are averted).
- Sweetening the US-Japan Deal: Arguably, this **sweetens the US Steel-Nippon Steel merger**, as it hands US-produced steel/aluminium *greater assurance of captive* (US onshore) *demand.*
- Alleviates Uncertainty on Investment Returns: Crucially, the intended demand backstop, **alleviates risks of falling short on required returns on investments**.
- Protects US Steel Margin & Jobs: In turn, this margin buffer (from prohibitively high tariffs) burnishes production, thereby protecting jobs.
- At the Expense of Global Producers/Exporters: This **advantage for the US steel industry comes at the expense of global producers exporting to the US**.
- Steel: **Canada**, **Mexico** and **Brazil** are **worst-hit** (44-90% dependence) followed by **Argentina**, **Thailand**, **India, Australia**, **Korea** and **Colombia** (Figure 2).
- Aluminum: **Canada**, **Colombia**, **Mexico** and **Argentina** (>50% dependence) are **worst-hit** followed by **South Africa**, **UAE**, **Brazil**, **Bahrain**, **Korea**, **India**, **Thailand**, **China** and **Japan** (Figure 3).
- Margin Pressures Elsewhere: Arguably, **global producers most dependent on the US markets**, now *forced to compete in other markets,* will have their **margins hurt most**.
- Differentiated: *But unevenly so,* as **exposures/dependence/access vary considerably**.
- & (USMCA) Dependent: *Without USMCA carveouts*,* **pain may be most acute* for Canada** and **Mexico.**
- LatAm & Asia Vulnerabilities: LatAm (Colombia, Brazil and Argentina) is relatively more exposed, although Asia exposures feature prominently.
- Asia Divergence: In Asia, Thailand, Korea, India, Australia are most exposed followed by Australia.
- Japan's Nippon Hedge that Swaps Risks: Whereas Japan has a hedge via Nippon Steel. But that said, Japan/Nippon Steel may be swapping market access/US margin for investment/control risks.
- US Not Unscathed: The thing though is that the **US will not be unscathed** *as steel/aluminum tariffs are merely passed downstream.*
- Self-Harm: **Ultimately** raised costs of US steel and aluminum will prove to be an act of **self-harm, hurting** the **competitiveness of downstream US industries** (e.g. construction, autos).

- Without Exports Breakthrough: Fact is, *unless US-Nippon scale to become a globally dominant exporter*, **higher import tariffs will only incentivize higher onshore prices**.
- The "US+1" Risk: **Forced manufacturing in the US *at the pain of tariffs*** risks "US +1". That is, US manufacturing **only for the US market** as the **cost structure is not globally viable**.
- FX/AXJ: To be sure, ***USD may be hobbled by self-harm.*** But in Asia, ***THB, KRW, INR and AUD may underperform vis-à-vis JPY***.
- Rates: A **higher cost structure in US industries**, with *"US+1" fragmentation a risk,* suggests a ***steeper curve,*** which in turn may *accentuate high-yield under-performance.*

* Further clarification may be needed on this





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