What Tariffs May Mean for the Economy

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A trade war could pose challenges for exporters and multinationals.

Key Takeaways

- Policymakers in Washington announced plans for potential new tariffs on steel and aluminum imports, triggering concerns about reprisals that could slow growth and boost inflation.
- Protectionist trade policies could hurt export-oriented economies, some multinationals, and consumers and businesses reliant on imports.
- On the plus side, the move comes amid a synchronized global economic expansion.

On March 1, officials in Washington announced preliminary plans for potential tariffs on steel and aluminum imported into the US. The short-term market reaction came quickly—a boost in the stock prices of US steel companies, and losses for importers of steel, including aircraft manufacturers.

The market as a whole moved sharply lower in the wake of the announced tariff proposals, though the exact details of this proposal are still not final. No one knows what will happen next; the short-term reaction could quickly fade in the wake of other news, or it could be the start of a new trend. But these policies, along with renegotiations of existing trade agreements, create concern among some investors. The broader issue is the potential of escalating anti-trade policies globally, which could slow, or even reverse global economic growth and spur inflation.

There is a wide range of potential changes to trade policies, and it is too early to know how the Trump administration will proceed and what the results may be. However, given the interconnected nature of the global economy, the potential impact of greater restrictions will be a growing risk across a variety of economic and market sectors.

China and the United States at the epicenter of trade risk

The US and China stand at the center of global trade

Global trade interdependence

The size of the circles represents total trade. The thickness of the lines represents the volume of trade flows. Grey circles represent other countries. Source: International Monetary Fund, Haver Analytics, as of December 31, 2015.

Statements from the Trump administration and the recently announced intention to raise tariffs suggest a more confrontational approach to trade relationships for the US. While China is not at the center of the steel import issues, that nation has been cited as a target for new US measures due to its large trade surplus with the US and perceived questionable commercial practices.

Over the long term, trade generally raises productivity potential because it facilitates the international transfer of knowledge and technology, allowing local companies to access global markets and benefit from economies of scale, and forcing greater specialization by exposing firms to more intense competition. In the short term, an abrupt disruption of trade flows can create a negative cyclical shock to global growth.

From a systemic standpoint, a protectionist shock would likely reverberate throughout the global economy more easily if it was transmitted through a country or region of great importance to global trade. China and the United States are squarely at the center of a global system of bilateral trade connections (see chart). A trade war between China and the US would be a worst-case scenario, a potentially devastating blow for global trade that might be powerful enough to provoke a global recession.

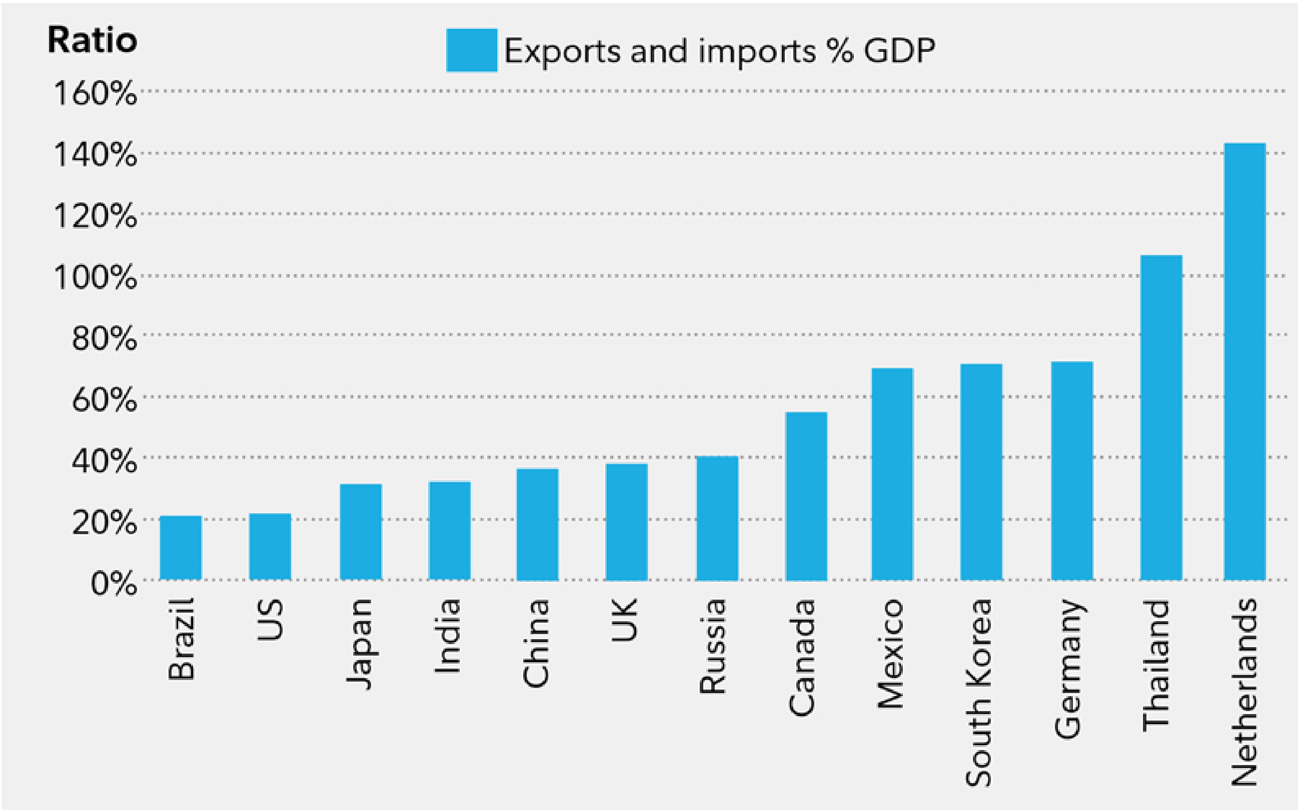
Winners and losers if protectionist risks continue to rise

Even if there is no explicit trade war, the creeping rise of protectionist rhetoric has begun to impact the global economy and the financial markets. During the past several decades, rising globalization has facilitated free trade and cross-border flows of capital and labor. Most countries, including the vast majority of the world's major economies, experienced an increase in trade openness. While this generated benefits for the global economy, it also had negative by-products and created relative winners and losers across countries, industries, and companies. If protectionism rises, entities most at risk include:

Export-oriented economies: Countries most dependent upon exports as a primary source of growth would be directly and negatively impacted by import tariffs or other protectionist policies. In particular, smaller economies more open to trade may have more at stake (e.g., Asian Tigers such as South Korea, European exporters such as the Netherlands), while larger, more closed economies (e.g., US, Brazil, India) may be relatively insulated from protectionist trade pressures (see graph). Emerging markets that have benefited from developed-country demand for manufactured goods over the past few decades, such as Mexico and China, may be more squarely in the crosshairs of US policymakers, while commodity exporters may be somewhat more insulated due to the relatively less elastic nature of these goods.

Protectionist trade policies could hurt smaller open economies and some emerging markets

Trade openness by country

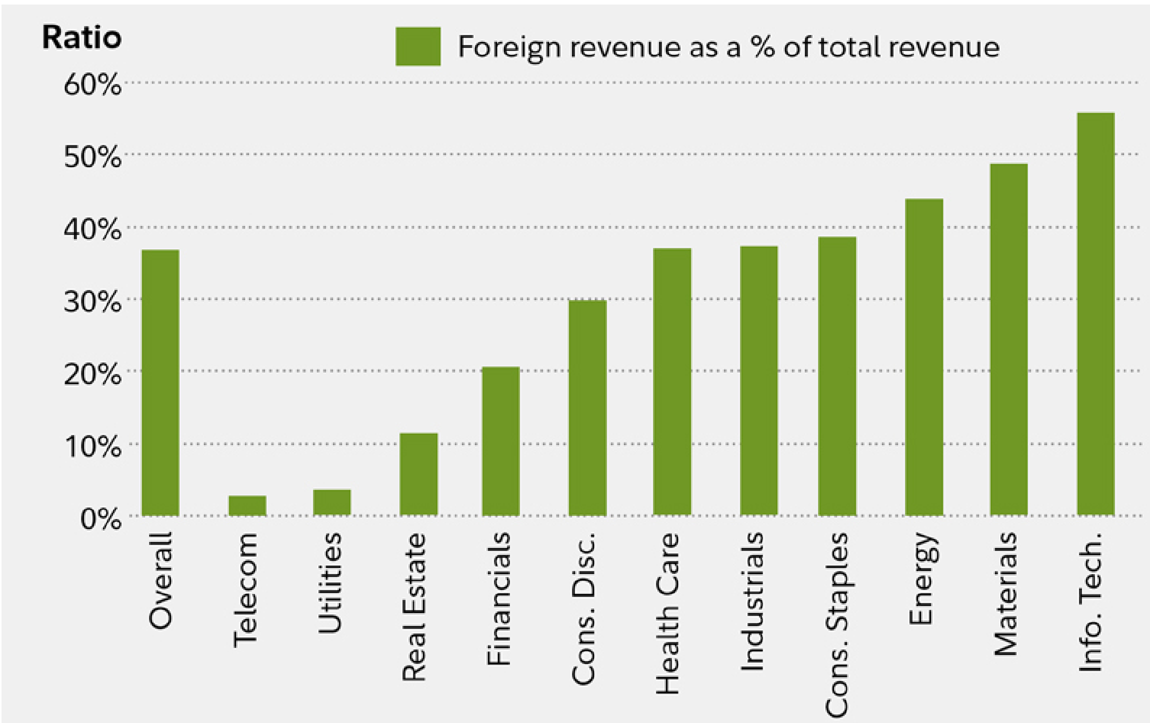


Source: World Bank, Haver Analytics, Fidelity Investments (AART), as of December 31, 2015.

Industries with foreign revenue exposure: Within economies, industries that are more exposed to global trade have more to lose from protectionist policies. For example, half of the revenues for the US information technology sector come from abroad. The utilities and financials sectors, however, earn 80%–100% of their revenues domestically, and are less likely to be impacted by anti-trade policies (see chart).

Industries more exposed to global trade have more to lose from protectionist policies

US company foreign revenue exposure



Source: S&P 500 company data. Sectors as defined by the Global Industry Classification Standard (GICS®); see additional information in the appendix. Source: FactSet, Fidelity Investments (AART), as of December 31, 2015.

Multinational companies with global supply chains: Even within an industry, some companies are more externally oriented in their businesses than others. Larger, multinational companies are more likely to sell goods abroad and be dependent on access to foreign markets. Many have global supply chains that could be disrupted by measures to discourage offshore production, which may also pressure profit margins by raising labor costs. Smaller companies tend to be more domestically oriented, and would be more insulated from protectionist measures.
Consumers and businesses reliant on imports: As companies took advantage of cheaper labor abroad in recent decades, US consumers and businesses benefited from less expensive imported goods. If more restrictive trade policies were to make imported goods costlier, it would at least initially put upward pressure on the prices of consumer goods.

Part of a bigger picture

It is important to note that overall, the global economy continues to experience a synchronized global expansion and that US recession risk remains low. At the same time, tighter labor markets and stronger global growth are supporting inflationary pressures that are giving global policymakers confidence to shift away from monetary accommodation.

Asset Allocation Research Team (AART) Senior Analyst Jacob Weinstein, CFA; Analyst Cait Dourney; and Research Analyst Jordan Alexiev also contributed to this article. Fidelity Thought Leadership Vice President Kevin Lavelle provided editorial direction.

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Investment decisions should be based on an individual's own goals, time horizon, and tolerance for risk.

Fixed-income securities carry inflation, credit, and default risks for both issuers and counterparties.

Although bonds generally present less short-term risk and volatility than stocks, bonds do contain interest rate risk (as interest rates rise, bond prices usually fall, and vice versa) and the risk of default, or the risk that an issuer will be unable to make income or principal payments.

Additionally, bonds and short-term investments entail greater inflation risk—or the risk that the return of an investment will not keep up with increases in the prices of goods and services—than stocks. Increases in real interest rates can cause the price of inflation-protected debt securities to decrease.

Stock markets, especially non-U.S. markets, are volatile and can decline significantly in response to adverse issuer, political, regulatory, market, or economic developments. Foreign securities are subject to interest rate, currency exchange rate, economic, and political risks, all of which are magnified in emerging markets.

Investing involves risk, including risk of loss. Past performance is no guarantee of future results. Diversification and asset allocation do not ensure a profit or guarantee against loss.
All indices are unmanaged. You cannot invest directly in an index. Increases in real interest rates can cause the price of inflation-protected debt securities to decrease.

The commodities industries can be significantly affected by commodity prices, world events, import controls, worldwide competition, government regulations, and economic conditions.

The Business Cycle Framework depicts the general pattern of economic cycles throughout history, though each cycle is different; specific commentary on the current stage is provided in the main body of the text. In general, the typical business cycle demonstrates the following:
During the typical early-cycle phase, the economy bottoms out and picks up steam until it exits recession then begins the recovery as activity accelerates. Inflationary pressures are typically low, monetary policy is accommodative, and the yield curve is steep. Economically sensitive asset classes such as stocks tend to experience their best performance of the cycle.
During the typical mid-cycle phase, the economy exits recovery and enters into expansion, characterized by broader and more self-sustaining economic momentum but a more moderate pace of growth. Inflationary pressures typically begin to rise, monetary policy becomes tighter, and the yield curve experiences some flattening. Economically sensitive asset classes tend to continue benefiting from a growing economy, but their relative advantage narrows.
During the typical late-cycle phase, the economic expansion matures, inflationary pressures continue to rise, and the yield curve may eventually become flat or inverted. Eventually, the economy contracts and enters recession, with monetary policy shifting from tightening to easing. Less economically sensitive asset categories tend to hold up better, particularly right before and upon entering recession.

Please note that there is no uniformity of time among phases, nor is there always a chronological progression in this order. For example, business cycles have varied between one and 10 years in the U.S., and there have been examples when the economy has skipped a phase or retraced an earlier one.

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