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19 February 2019

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Cross-Sector - Global

US auto tariffs would pose risks to global growth and ripple across auto sectors

On February 17, the US Department of Commerce delivered its report on an investigation into whether imported vehicles and parts represent a threat to national security, which could result in President Donald Trump's administration imposing up to 25% tariffs on auto imports. The details of the report will not be made public immediately, however, the Trump administration has 90 days to decide on a course of action in response to the Commerce Department's findings, including remedial trade restrictions.

If implemented, US tariffs of up to 25% and corresponding retaliatory actions from the US's major auto-trading partners would disrupt about $500 billion of trade flows,[1] accounting for 2.8% of 2017 world imports and 0.6% of 2017 world GDP. The economic fallout would be significant, with auto tariffs hurting the global economy by distorting prices and creating inefficiencies, and the impact would reverberate across global supply chains. The already weakening pace of global expansion would magnify global growth pressures, causing a broader hit to business and consumer confidence amid tightening financial conditions.

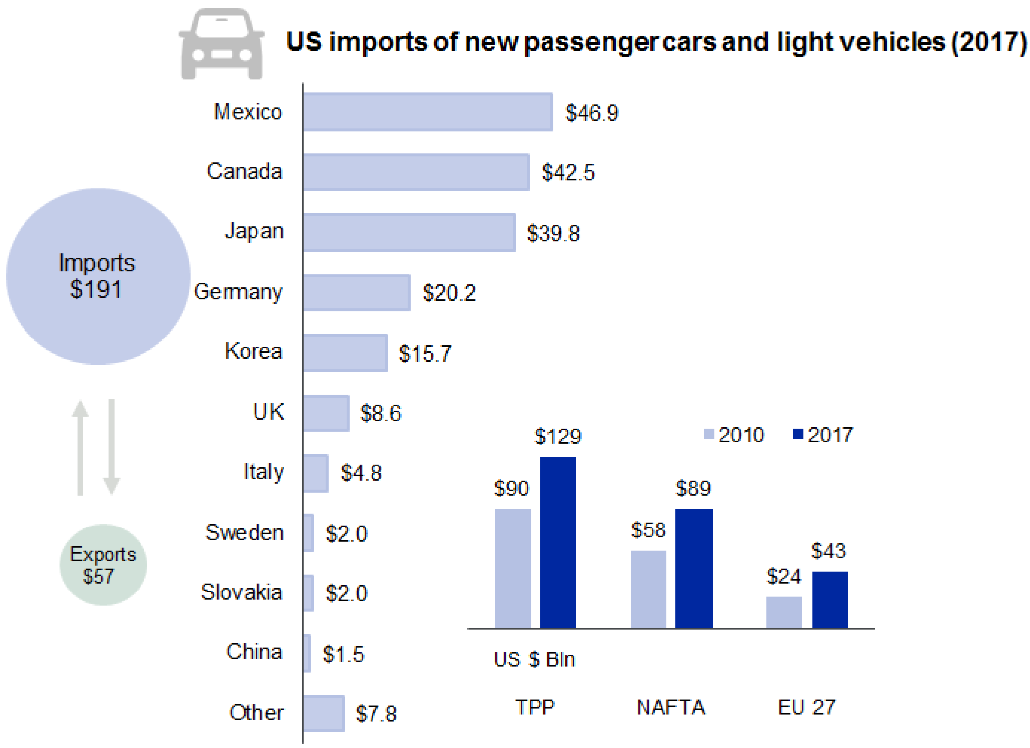
The US administration is currently engaged in ratification of the USMCA with Canada and Mexico and in trade negotiations with Japan, the EU and China, which could lead to trade agreements and potential exemptions from auto tariffs. Tariff imposition on national security grounds could also be challenged in Congress and in US courts, similar to challenges brought against the steel and aluminum trade restrictions that the US imposed in 2018.

Implementing the tariffs on imported vehicles and parts would be negative for nearly every segment of the auto industry — carmakers, parts suppliers, car dealers, transportation companies and auto lenders and securitizations — because they would ripple across highly globalized and tightly integrated supply chains. As previously analyzed in detail in Potential US tariffs on imported vehicles, parts credit negative for most of industry, the most severe negative impact would fall on carmakers, directly affecting their profits. Following the implementation of the tariffs, automakers would need to absorb the increased costs to protect sales volumes, pass the tariff costs to customers or suppliers, or implement a combination of approaches to mitigate the impact on their profitability.

The credit negative impact would be especially pronounced for non-US automakers, particularly those without US-bound production facilities. In our view, Japanese, Korean, Mexican and German manufacturers would be the most vulnerable. In contrast, Chinese automakers would remain largely unaffected because they have minimal exposure to the US market.

Exhibit 1

Vehicles manufactured outside of North America come primarily from Japan, Germany and Korea



Note: The vertical bars show auto imports from countries covered by the Trans-Pacific Partnership (TPP), the North American Free Trade Agreement (NAFTA) and the EU-27. Source: International Trade Administration, Moody's Investors Service.

Tariffs would also be credit negative for auto parts suppliers, with the largest effect on US manufacturers because of their supply chain dynamics. US parts suppliers attempt to optimize production costs and time for completed parts, which often results in multiple cross-border trips for finished goods. As a result, these goods could incur multiple tariff charges under a new tariff regime. Avoiding those costs would also disrupt suppliers down the supply chain. Non-US parts suppliers with limited exposure to the US market would be better equipped to withstand the negative effect of these tariffs.

A 25% tariff would have a modestly negative effect on US aftermarket auto parts suppliers, varying by company. Aftermarket sales are predominantly concentrated on used vehicles, which would not be affected by the tariffs. Additionally, US aftermarket parts suppliers rely mostly on domestically manufactured auto parts. Furthermore, higher prices of imported new cars would encourage some customers to hold on to their existing vehicles, increasing the demand for replacement parts and mitigating some of the negative impact from the tariffs.

The impact of trade restrictions on foreign-built vehicles shipped to the US would also be credit negative for US car dealers with heavy import concentration. However, the sales of used cars, which are more profitable for dealers, would increase as a result of reduced demand for imported cars and offset any potential loss of dealers' revenue.

Potential tariffs would also reduce demand for cross-border transportation of vehicles and parts. However, increased carloads within the US would lessen the impact of this reduction on railroads.

If new US auto tariffs were to translate into higher US vehicle prices, the effects would likely also be credit negative for new asset-backed securities (ABS) tied to auto loans and leases because lending standards would likely weaken to support customer demand. However, higher new vehicle prices would have positive effects on outstanding auto loan and lease ABS if demand and prices for used vehicles rise. In that case, recovery rates following borrower defaults would increase, as would residual values for leased cars. Meanwhile, tariffs could reduce the credit quality of auto dealer floorplan ABS transactions if they result in slower new vehicle sales and trigger a decline in lower monthly payment rates in the deals.

Also as a result of tariffs, auto lenders, including the captive finance companies of automakers, would come under pressure to loosen underwriting standards to make the price of imported vehicles more affordable. This dynamic would introduce riskier loans into the US economy. At the same time, auto lenders would benefit from higher demand for used vehicles, which would have a positive impact on used car values.

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Endnotes

1 The US administration has estimated that the potential auto tariffs would affect $200 billion of vehicle imports, not including auto parts, while the European Commission has estimated the retaliatory trade restrictions would affect $300 billion of imports.

REPORT NUMBER 1162207