Tariff Threats and Trade Wars - Implications for Australian Investors

With the US set to impose 25% tariffs on goods from Canada and Mexico (its two biggest trading partners) plus 10% tariffs on China, as well as tariffs on aluminium and steel without exceptions, financial markets may be in for a rocky ride in the short term. Investors may be wondering what this means for financial markets over the coming year, and whether they should consider changes to their portfolio.

It turns out that Donald Trump, the new US President, is full of surprises. Nothing could have prepared investors for the risk of unpredictable policy-making in such a short period. Where were the signs? If only there had been some sort of dry run, a previous four-year stretch in which — hang on…

Humor aside, Trump's tariffs and the possibility of a trade war are real and will certainly have some impact on the global economy and financial markets. But before we consider the implications for investors, keep in mind that the tariffs are not about economics, they're about politics. Trump is doing this as a negotiating tactic, although there is no doubt that his Administration sees tariffs as a viable way to raise money rather than via domestic taxes.

What is happening with tariffs?

Trump announced a 25% tariff on Canada (with a lower 10% on Canadian energy), 25% on Mexico and 10% China. He has threatened more and on other countries too (like the European Union) but has since negotiated a 1-month delay to tariffs with Canada and Mexico, with both countries agreeing to additional border patrols to stem illegal immigration and drug flows into the US. Around 42% of US imports come from Canada, Mexico and China. The US mainly imports energy, agriculture and motor vehicles from Canada and Mexico and machinery and transport and manufactured items from China.

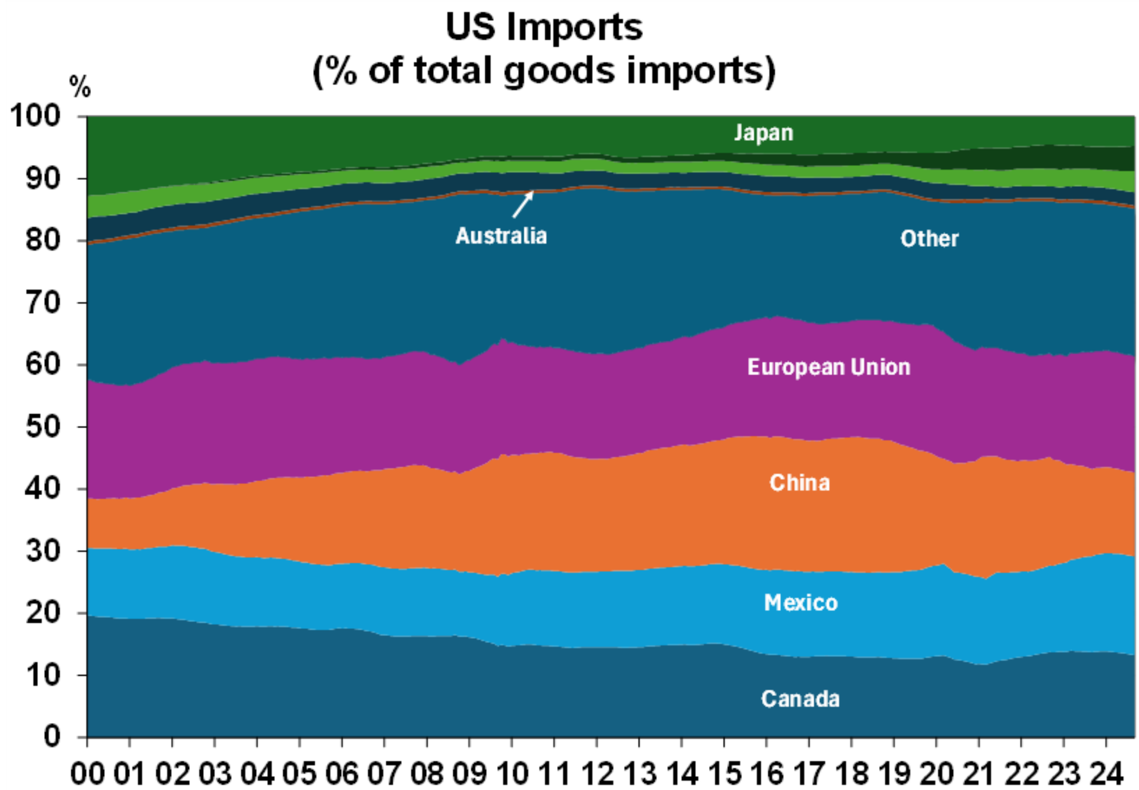
What are tariffs?

A tariff is a tax. The tax is levied on the importer who pays the tax to the government. The importer may ask the exporter for a cheaper price or decide to fully or partially pass the cost down the supply chain until it reaches the consumer. Higher imported goods prices are meant to push consumers to substitute to cheaper products, for example local products that may now become more competitive.

The issue for markets is that tariffs lead to consumer and business uncertainty, weaken trade channels weighing on GDP growth and lift consumer prices which would be inflationary. But at this time, it is not possible to fully factor in potential tariff risks because Trump's statement's change daily. In the near-term expect more volatile moves in equity markets off the back of tariff news, and possibly a higher US dollar and higher US bond yields from the risk of tariff-driven inflation.

What do tariffs mean for Australia?

Australia is not on the tariff list and politicians are hoping America's long-running trade surplus with this country will spare us. It's important to realise that Australia is only a very small importer into the US.



The main indirect impact to Australia from tariffs is from lower commodity prices, as our main trading partner China may see disruption to its growth. China is also likely to push through fiscal spending to offset any economic disruption to which Australian commodities would benefit. There may also be some positive opportunities for Australian businesses to export to the US if the US pivots away from Canada, Mexico and China.

President Trump has also announced a 25% tariff on steel and aluminium “without exception”, although he later confirmed that he was considering an exemption for Australia. Keep in mind that Australia is not the biggest supplier to the United States, ranked only 17th for exports of steel to America and eighth in exports of aluminium.

The financial market implication for Australia will most likely be in a lower Aussie dollar and global equity market volatility, including the Australian share market.

Tariffs rarely achieve their goals.

US tariffs on China have begun and China has retaliated with announcing tariffs on $15bn of US goods imports (this is small relative to the $430bn the US is targeting), but these tariffs may be negotiated down, away or postponed. So, if the tariffs — or at least, the conversation over the tariffs — keeps going, then it’s reasonable to expect some turbulence ahead.

History and economics suggest Trump’s strategy will fail. Tariffs increase prices, disrupt supply chains, and invite retaliation. Past experiments with protectionism reveal a pattern: short-term political wins at the cost of long-term economic prosperity.

Keep in mind that it’s most likely that this strategy is to meet political goals. He doesn’t necessarily want to impose significantly higher costs for US consumers with tariffs given that he doesn’t want the share market to fall too much and still wants to win in the US midterms.

The threat of shifting tariffs creates uncertainty—businesses delay expansions, withhold capital, and hedge bets. Economic security requires competitiveness, not walls. Lowering trade barriers, investing in skills, and streamlining regulations would better position US industries. History indicates that this strategy won’t work.

Implications for investors

It has become evident that President Trump will use the threat of tariffs aggressively. While he may yet alter or even withdraw these latest tariffs, there is less certainty about the future. Hence, we may expect some short term volatility in the local and global share markets as negotiations around tariffs will continue for some time. As always, it is important to realise that the economy and the share market are not the same.

Under any tariff scenario, there may be some sectors that are losers, but other sectors may be winners. Therefore, the best strategy is to tune out the media noise around tariffs and stay disciplined in the portfolio that has been designed to meet your goals. Unless your personal circumstances have changed, there no reason to change your portfolio based on announcements that are politically motivated.

Trump always means what he says, but what he says isn’t always what he means. This is good to keep in mind when trying to analyse his announcements! There will be some volatility ahead, but the best investment strategy will be to grab the popcorn, sit back and watch the show.

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