

TRENDMACRO LIVE!

On the Mexico Tariffs

Friday, May 31, 2019

Donald Luskin

This one's for the base. Trade war, meet immigration war.



Donald J. Trump @realDonaldTrump · 55m
On June 10th, the United States will impose a 5% Tariff on all goods coming into our Country from Mexico, until such time as illegal migrants coming through Mexico, and into our Country, STOP. The Tariff will gradually increase until the Illegal Immigration problem is remedied...



Donald J. Trump @realDonaldTrump · 55m
...at which time the Tariffs will be removed. Details from the White House to follow.

Here we go again. President Donald J. Trump has imposed more tariffs, by reaching into the deep inventory of laws on the books that give presidents vast powers over foreign trade. This time it's the [International Emergency Economic Powers Act of 1977](#). And this time the tariffs are on all imports from Mexico – 5% starting on June 10, then rising in 5% increments on the first day of each month up to 25% on October 1 – until Mexico takes steps to stop illegal immigration across the southern border of the US. This note is

only our hot take. We'll have a more robust view when we've been able to observe more political reaction in the US and in Mexico.

- We're talking big money here – from the US perspective, and even more so from Mexico's. US imports from Mexico in 2018 were \$371 billion – about three-quarters of Mexico's exports. The fully-deployed tax impact on US importers would be \$93 billion per annum, assuming no offsets from weakening of the Mexican peso. We fully expect such weakening when and if the tariffs take effect, as we saw with the Chinese yuan (remember, peso weakness was one of the global markets' first reactions immediately following Trump's election).
- But as with the tariffs on US imports from China, this isn't about tariffs for their own sake, but rather to coerce another nation into taking actions for the US's benefit that it obviously doesn't want to take (see ["Sympathy for the Tariff Devil"](#) May 17, 2019).
- The bet here is that, while the tariffs may be damaging to the US to some extent, they will be worse for Mexico. That may drive Mexico to take the actions Trump wants – or, one can imagine, it could worsen the illegal immigration crisis by making Mexico even less attractive relative to the US.
- So far Mexico isn't exactly rolling over to Trump's demands. President Andrés Manuel López Obrador posted [an open letter to Trump](#) yesterday, which the [New York Times](#) portrayed as conciliatory because it sought to avoid "confrontation" and called for "dialogue." The *Times* left out the letter's zingers such as: "America First' is a fallacy."

Update to strategic view

US MACRO, EMERGING MARKETS MACRO, FX:

Trump has announced tariffs on US imports from Mexico, starting at 5% and increasing to 25% until Mexico cooperates in stopping illegal immigration across the US southern border. At full strength, the tariffs will nominally cost American buyers \$93 billion per annum, but surely some or all of that would be offset by peso weakness. Trump's authority comes from the International Emergency Economic Powers Act of 1977. But the tariffs may be judicially delayed or blocked, which Trump actually may prefer, as this draws more attention to this bold move around a hot-button issue for his base. This appears to complicate Congressional approval of USMCA, but may instead give Trump more ways to win and something to bargain away. It helps in the trade negotiations with China as a sign that Trump doesn't fear living with tariffs, and burnishes his "table image" as an unpredictable and bold opponent.

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- More so than with the China tariffs, these are surely also designed to score political points around a signature hot-button issue for Trump's base. Indeed, the [White House statement](#) on the tariffs – full of hyperbole, slang, slogans and grammatical errors, feels more like a hastily written stump speech than a carefully considered policy memorandum.
- *Like many Trump initiatives, this one will likely be slowed down or entirely blocked by legal challenges.* Even Trump's ally Senator Chuck Grassley (R-IA) [said yesterday](#) that it "is a misuse of presidential tariff authority and counter to congressional intent."
- But at least on our reading as a legal non-expert, the Act seems quite clear that the president has the authority to do this, provided he declares a national emergency:

"...authority granted to the President...may be exercised to deal with any unusual and extraordinary threat, which has its source in whole or substantial part outside the United States, to the national security, foreign policy, or economy of the United States, if the President declares a national emergency..." The president may "...regulate...transactions involving, any property in which any foreign country or a national thereof has any interest by any person...subject to the jurisdiction of the United States..."

- *Our sense, especially after reading the White House's highly politicized statement, is that Trump would be delighted to have the initiative blocked, as this would draw a great deal more attention to it than if it smoothly went into effect without contest.*
- It comes just when Trump has moved to get Congressional approval of the US Mexico Canada Agreement. The Mexico tariffs would seem at first to threaten USMCA by alienating Congress, but they may turn out to be a classic Trump move – to add complexity to negotiations in order to multiply the number of available options for him, that is, to create more ways to win. More simply, they could be something to trade away to Democrats and skeptics within his own party, having already traded away the steel and aluminum tariffs imposed last year.
- The Mexico tariffs may also be intended, at least in part, to play into the ongoing trade negotiations with China. The use of tariffs to deal with a non-trade objective with Mexico, as opposed to sanctions as is typically the case in such initiatives, could be a threat-signal to China designed to show that Trump is not afraid to live with tariffs against key trading partners (again, see "[Sympathy for the Tariff Devil](#)"). If nothing else, the move burnishes Trump's "[table image](#)" as impulsive, unpredictable and bold.
- *Indeed he is, and hopefully not to a fault.*
- Of course, our concern – and it filled our minds the instant the headline about the tariffs flashed across our iPhone – is the risk that, at some point, markets will lose patience with the mercurial Mr. Trump. The immediate reaction has been risk-off, but not violently so – as of this writing, still less than one might have expected considering the potential shock to such a large and deeply integrated US trading relationship.

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- Perhaps markets assign some high probability that these new tariffs will be judicially blocked. Perhaps they believe that Mexico will be able to sufficiently comply, quickly enough, to avoid the onset of tariffs. López Obrador's letter said that the Mexican foreign minister will come to Washington today "to seek a solution that benefits both nations." [White House acting chief of staff Mick Mulvaney said](#), "We are interested in seeing the Mexican government act tonight, tomorrow."
- Or perhaps markets collectively are better than individual market participants seem to be at grasping the full context of Trump's tariffs. Yes, they impose *highly visible* costs and frictions, they heighten uncertainty, and they court global destabilization. But they may very well ameliorate *less visible* – but nevertheless very costly and long-standing – problems. It is not free to the US to have China engage in unfair trading practices, nor to endure out-of-control immigration. Perhaps markets are weighing not only the obvious risk scenarios, but also the less obvious upside payoffs.

Bottom line

Trump has announced tariffs on US imports from Mexico, starting at 5% and increasing to 25% until Mexico cooperates in stopping illegal immigration across the US southern border. At full strength, the tariffs will nominally cost American buyers \$93 billion per annum, but surely some or all of that would be offset by peso weakness. Trump's authority comes from the International Emergency Economic Powers Act of 1977. But the tariffs may be judicially delayed or blocked, which Trump actually may prefer, as this draws more attention to this bold move around a hot-button issue for his base. This appears to complicate Congressional approval of USMCA, but may instead give Trump more ways to win and something to bargain away. It helps in the trade negotiations with China as a sign that Trump doesn't fear living with tariffs, and burnishes his "table image" as an unpredictable and bold opponent. ▶