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Supply Chain Disruptions and Tariff-Fueled Qualms Cloud Sourcing Landscape
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One tweet here and another tweet there by President Trump were all it took to prompt manufacturers and retailers to closely scrutinize their supply chains, but if anyone thought Mexico was a safe option for sourcing, that possibility went by the wayside with the prospect of a new tariff plan.

Trump said in a tweet Friday morning that the plan to scale tariffs on Mexican imports starting June 10 at 5 percent and rising up to 25 percent by Oct. 1 was due to immigration and the influx of refugees into the U.S. at the southern border. Regardless of the reason, the fact remains that the tax is still one that ultimately will be borne by consumers.

With the ongoing trade war with China, companies have tried to leverage their sourcing and supply chains so they can minimize the out-of-pocket impact on consumers. In several discussions connected to quarterly retail earnings reports this month, some executives said that costs likely would be passed along to consumers in the form of higher prices should the final tranche on Chinese imports go into effect. And now there are Mexican imports to worry about.

According to Moody's Analytics chief economist Mark Zandi, "U.S. companies are also grappling with mounting disruptions to their supply chains and prospects that they will need to reorient them altogether. Given that a quick resolution of the war with China looks increasingly unlikely, some U.S. companies have been contemplating moving operations to Mexico. But now even this seems likely to be a bad decision."

Zandi concluded that businesses are "sure to be even more perplexed and uncertain, and they will further delay investment decisions." He noted that U.S. stock prices have gone nowhere since early 2018 despite massive tax cuts due to uncertainty over a trade war resolution with China. And the use of tariffs against Mexico could further unnerve investors.

"It is one thing to impose tariffs in attempts to stop unfair trade practices and other bad economic behavior. But tariffs meant to force other policy changes from U.S. trading partners–particularly an ally such as Mexico–is something very different," the economist said.

Kim Glas, president and chief executive officer of the National Council of Textile Organizations (NCTO), said of the administration's decision to impose penalty duties on Mexico under the International Emergency Economic Powers Act, "We are very concerned about the impact these proposed tariffs would have on a critical and integrated supply chain for the U.S. and Mexico textile and apparel industries…. Adding tariffs to Mexican apparel imports, which largely contain U.S. textile inputs, would significantly disrupt this industry and jeopardize jobs on both sides of the border."

Glas also pointed out that the tariffs would give a "significant competitive advantage to China" by driving business back to the Asian nation at a time when the administration is trying to crack down on intellectual property abuses.

According to the NCTO, the U.S. trading relationship with Mexico represents $12.2 billion in a two-way textile and apparel trade in 2018.

In subsequent tweets on Friday, Trump went on to rationalize proposed taxes on Mexican imports by noting that in order to "not pay Tariffs, if they start rising, companies will leave Mexico, which has taken 30 percent of our Auto industry, and come back home to the USA… The Tariff is about stopping drugs as well as illegals!" That was followed by another comment, also on Twitter, that "90 percent of the Drugs coming into the United States come through Mexico & our Southern Border." But the latter tweet also ended with, "We have a 100 Billion Dollar Trade Deficit with Mexico. It's time!"

That suggests that perhaps some hoped the tariffs on Mexican imports could both exert pressure on the Mexican government to curb the influx of refugees and at the same time help lower America's trade deficit. Published news reports indicate that at least two key members of Trump's administration–Treasury Secretary Steve Mnuchin and U.S. Trade Representative Robert Lighthizer–were not in favor of imposing tariffs on Mexican imports.

Zandi noted that even if the president hoped that tariffs would shrink the U.S. trade deficit, that isn't likely as "other nations have retaliated with their own tariffs and non-tariff trade barriers."

So then what's an American manufacturer or retailer to do?

Katrina Ell, an economist based in Moody's Analytics' Sydney office tracking the Asia-Pacific region, had a caveat for firms trying to figure out where to go next, particularly for companies that have shifted sourcing to Vietnam.

She first noted that the trade war between the U.S. and China led to the "reordering of global supply chains as manufacturers work to circumvent tariffs." While Thailand and Malaysia saw an increase in auto production, Vietnam has seen an increase in textiles production.

While Vietnam has been attractive because of its "relatively low-cost, young and large working-age population," there are limits to opportunities there now that labor costs are rising in the country, even though they are still lower compared with other competitive countries. On top of this, pressure on Vietnam's "infrastructure is rising with increased bottlenecks."

But here’s where her caveat comes into play: “Vietnam has been an attractive alternate destination for manufacturers in China, given it is not subject to U.S. tariffs. This could all change in a tweet from President Donald Trump, who has announced other key foreign trade moves on that platform. There is a risk that the U.S. could take action against Vietnam as well.”

The economist explained that the trade deficit with Vietnam has steadily increased, “making Vietnam vulnerable to accusations of a one-side relationship.”