SPECIAL REPORT

Marcus & Millichap

TRADE WAR & TARIFFS

MAY 2019

Trade War Escalates As White House Implements More Tariffs; China Retaliates

Trade talks with China break down; protectionist policies accelerating. Following over a year of discussion with China, trade talks broke down, prompting the White House to raise tariffs to 25 percent on $200 billion of Chinese imports. The recent escalation represents the latest developments in trade talks that have been ongoing for over a year. Notable tariffs are currently in place covering steel and aluminum, as well as washing machines and solar panels. However, the latest round of tariffs includes furniture, clothing, construction materials and electronics such as TV's and smartphones. China immediately retaliated with new tariffs on agricultural products such as soybeans and cotton and industrial equipment, machinery and airplane parts. As our largest trading partner, total economic activity between the United States and China exceeds $650 billion, potentially creating a significant disruption to the U.S. economy if the trade war drags on.

Higher Tariffs Likely To Shift Consumer Spending Patterns

Prices of consumer goods to rise, shift retail sales. While businesses largely absorbed earlier rounds of tariffs, it's unlikely the latest escalation will be offset to such a high degree. Given the breadth and scope of the list of tariffed goods, the direct costs borne by consumers will undoubtedly rise. As a result, escalating prices will realign consumer spending toward necessity purchases. This could have a potentially large effect on discretionary purchases, particularly large items such as televisions, electronics and furniture, where the size of the new tariffs would be most notable. Should the rate or scope of tariffs rise in the coming months, the impact on retail sales could be even more considerable, especially for bars and restaurants, which are highly correlated with discretionary spending. If a resolution isn't reached in the short-term, longer term impacts could include flattening demand for retail space as consumer spending slows, coupled with slower job growth in retail and other consumer-facing enterprises.

Escalating Tariff Pressure Creating Corporate Uncertainty

Retailers, business community grapple with fallout of latest tariff increases. Due to the rapidly evolving state of the trade war with China, business leaders have struggled with how to react to increasing tariffs. Several years of globalization has integrated many of the largest companies' supply chains with Chinese manufacturing facilities, making a quick unwind extremely unlikely. As a result, the wide scope of the latest round of tariffs will undoubtedly be passed on to consumers, with many retailers and business community members warning of the potential impact. Lower corporate profitability will filter through into business investment and hiring, slowing economic growth. Tariff-related cost pressure could eventually influence firms to unwind supply chains linked to China in an effort to lower input costs if the tariff war continues to show no signs of slowing down. Moving forward, the uncertainty will have the most significant impact, weighing on sentiment and confidence.

Trade War Milestones

Date	Event
4/7/2017	US and China agree to 100 days of trade talks
7/19/2017	No agreement reached in trade talks
8/14/2017	Probe begins into Chinese intellectual property theft
1/22/2018	Tariffs on imported washing machines (20%) and solar panels (30%) begin
3/8/2018	Tariffs on imported steel (25%) and aluminum (10%) begin
4/2/2018	China imposes 25% tariffs on 128 US products (food, wine, steel and aluminum products)
9/24/2018	Tariffs placed on $200B of Chinese imports at 10% (furniture, car parts, electronics, clothes, industrial metals)
12/1/2018	US and China agree to 90-day halt on new tariffs
2/24/2019	US extends 90-day deadline in response to constructive trade talks
5/10/2019	Trade talks break down, US increases $200B in tariffs from 10% to 25% (furniture, car parts, electronics, clothes, industrial metals)
5/13/2019	China retaliates, imposes tariffs on $60B of US products (soybeans, agriculture, cotton, machinery, grains, aircraft parts)

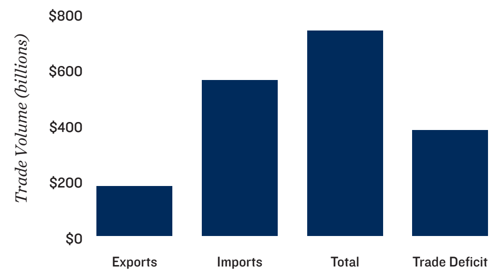
Short-Term Disruption Likely Muted

Timing, scope of impact to build over time. Financial markets reacted quickly to the increase in tariffs, with equity volatility rising amid a rapid fall in interest rates. Economists have forecast that a prolonged trade war could trim 30 basis points off of GDP estimates this year, which is currently forecast for 2.3 percent. Additionally, as many as 900,000 jobs could be affected, although labor markets remain exceptionally tight, potentially limiting the contraction. However, the timing and impact of the tariffs will gradually build, with the vast majority of the cost increases unlikely to be felt for the next two or three months. The estimated cost to the consumer could reach as high as $800 per family per year. Due to the lagged effect of the increased tariffs, the economic impact will be most acute in the second half of 2019, particularly if the trade war escalates further.

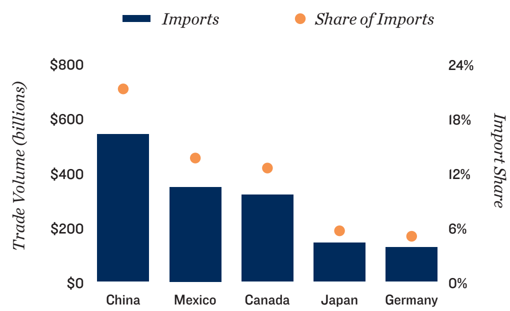
Trade Disputes Offer Opportunities, Potential Challenges For Real Estate Investors

Stability of commercial real estate shields investors from volatility. The rapidly evolving trade landscape has had a tremendous effect on investor sentiment, which has been most pronounced in publicly traded financial markets. Meanwhile, the effect on commercial real estate has been much more muted. Given the long timeline for the majority of the potential outcomes, developers will be less likely to inject new supply, particularly as the new tariffs target raw materials used in construction. Due to the reduced impact of supply growth, commercial real estate vacancy rates should remain tight, particularly as net absorption has already lagged deliveries in most segments of the industry. However, the longer the trade war drag on, the potential for firms to rethink their space needs in key China-facing submarkets such as west coast industrial buildings and big-box retailers reliant on Chinese manufacturing that are already struggling with declining sales could become more prominent. As consumer preferences begin to change in the wake of higher retail costs, a considerable slowdown in high-end consumer goods and more discretionary purchases could trigger a broader economic slowdown.

U.S.-China Trade Relationship*



U.S. Imports by Country*



For calendar year 2018

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Sources: Marcus & Millichap Research Services; Bureau of Labor Statistics; U.S. Census Bureau; U.S. Trade Representative