Are Tariffs Coming to the Auto Sector?

Description

Over the past few weeks, global attention has turned from the steel and aluminum tariffs imposed by the U.S. on Canada and other traditional allies to the prospects that the Trump administration will impose tariffs on the automotive sector, targeting vehicles that are manufactured outside the U.S.

If true, those efforts will have the potential to hit some automotive suppliers, such as **Magna International Inc.** (TSX:MG)(NYSE:MGA), particularly hard.

What's the endgame by imposing tariffs?

From a strictly protectionist standpoint, the U.S. administration is trying to lure jobs back into the U.S., particularly to the "Rust Belt" region, where jobs have been lost over the past decade to outsourcing and automation. In many respects, the promise of getting more jobs back into the region is precisely why many people in those areas voted for Trump.

Here's the problem with that view.

A typical automobile consists of thousands of individual components, and the manufacturer will always act in the best interest of the company and, by extension, the customer, meaning sourcing and manufacturing for the lowest possible price. This leads to a lower sticker price, which attracts more consumers to buy that vehicle.

Saving a few cents on screws, plastic moldings or even seat mats may not seem like much, but when you factor in how many vehicles are constructed and how many screws, moldings, mats and countless other small parts that are part of each vehicle, the savings could add up to be hundreds or more.

Assuming that a tariff was to be imposed on those non-U.S. sourced components, any current cost savings would be lost, and the price of the vehicle would likely rise to cover the tariff, paid for by the customer in the form of higher prices. Even if the automotive supplier decided to move production to the U.S. to eliminate the tariffs, the costs of doing business in the U.S. are higher, which would still result in a higher vehicle cost for consumers.

The higher sale prices would then lead to sales job losses and less money to invest in other advancements, such as autonomous driving and electric vehicles.

Furthermore, all of this assumes that there are workers for those U.S.-based factories, which coincidentally have moved increasingly towards automation in recent years.

In other words, we may end up with higher automotive prices, fewer real jobs (in both the domestic and international markets), a disrupted global supply chain, decreased demand from consumers, who are either unwilling or unable to pay more for a vehicle, and still have tariffs imposed due to other parts of the vehicle that are still sourced and manufactured outside the U.S. market.

Essentially, it's a zero-sum game where nobody wins.

What's the impact to Magna?

As an automotive parts supplier, this could be concerning for Magna. On the one hand, a significant portion of Magna's business is reliant on the U.S., where 40% of all vehicles on the market are imported.

On the other hand, Magna has the benefit of being uniquely diversified with manufacturing facilities located within close proximity of nearly every automotive manufacturer on the planet. This is a key point, which could, in theory, allow Magna to alter its supply chain accordingly, shifting production of components around to bypass any potential tariffs.

In terms of growth, Magna has made strides to expand into new and developing markets recently, revealing a massive long-term opportunity for investors.

Last month, Magna announced two key acquisitions that are set to push Magna's further into the growing and lucrative Chinese market for electric vehicles. Over 750,000 electric vehicles were sold in China last year, and an imposed target of 20% penetration by electric and hybrid vehicles within the next seven years provides a unique opportunity for Magna to grow further.

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Author
dafxentiou