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GOVERNMENT

How would proposed US tariffs affect the luxury business?

March 6, 2018

European automakers are facing a threat of import tariffs. Image credit: Mercedes

By SARAH JONES

President Donald Trump is looking to impose tariffs on steel and aluminum entering the United States, in a move that many expect to ignite a trade war with other nations.

On March 1, President Trump mentioned his plan to impose a 25 percent tariff on steel and a 10 percent tariff on aluminum. Beyond impacting industries such as the automotive sector that rely on those raw materials, this could potentially have a domino effect as mutual trade retaliation boosts taxes on imports.

"Increased taxes and higher prices cause mainstream press and consumers to pause," said Chris Ramey, president of Affluent Insights, Miami, FL. "It's much less an issue for a luxury or affluent consumer.

"The affluent are insulated from pesky tax increases because price is a smaller part of the bigger buying decision," he said.

"Luxury, as a business model, is superlative and beyond price. Luxury is based on brand values, not functionality or comparative deals."

Tax talks

During his presidential campaign, Mr. Trump criticized free trade deals such as NAFTA, promising to implement taxes on goods coming into the U.S.

Soon after taking office last year, he floated the idea of a 20 percent import tax on goods coming into the United States.

While affluent consumers are thought to not worry about a price tag, growing research shows that practicality is a major part of the decision making process. Consumers do not think about the price tag before tax, therefore a significant rise in tax at once could mean many turn down products from overseas (see story).

So far the administration has put tariffs on products such as solar panels and washing machines, but now a new import tax is being considered that could have broader implications.

A proposed plan would place a 25 percent tariff on steel and a 10 percent tariff on imported aluminum, with the goal of supporting the U.S.'s local production of the metals.

This drew criticism from National Retail Federation president and CEO Matthew Shay, who said in a statement, "Make no mistake, this is a tax on American families. When costs of raw materials like steel and aluminum are artificially driven up, all Americans ultimately foot the bill in the form of higher prices for everything from canned goods to electronics and automobiles.

"The reality is that there is nothing this country will gain from such a one-sided policy," he said. "These tariffs threaten to destroy more U.S. jobs than they will create while sending an alarming signal to our trading partners and diminishing markets for American-made products overseas."

Along with retail, higher steel costs will have an impact on the budgets for new construction. It may also hurt U.S. watchmakers such as Fossil, which holds the licenses for brands including Michael Kors and Marc Jacobs.

Michael Kors timepieces are produced by Fossil. Image credit: Michael Kors

Overseas, the European Union fought back, threatening to place a 25 percent tax on the $3.5 billion of goods that it receives from the U.S. per year, according to Reuters.

Mr. Trump has since threatened to raise tariffs on European cars if members of the European Union retaliate to the metal import taxes. This would potentially raise the price of marques such as Mercedes and BMW.

"Steel and aluminum are major inputs in automotive manufacturing and the proposed tariffs would negatively impact sales by raising the prices of domestically-produced luxury cars," said Eric Totaro, senior automotive analyst at Euromonitor International, Chicago.

"The automotive industry is complicated and more globalized than ever before," he said. "The most popular luxury car brands in the United States are foreign, although many of their vehicles are made in the United States already.

"Mercedes-Benz and BMW operate major plants in the United States as do most Asian manufacturers. If the steel and aluminum tariffs become long-standing, expect to see fewer vehicles made in the United States and higher prices on vehicles sold here."

In a tweet, Mr. Trump also criticized the trade imbalance, saying that Europe makes it impossible for U.S. automakers to successfully sell in their markets.

BMW 5 series. Image credit: BMW

“More tariffs won’t help American businesses or families,” said Cody Lusk, president and CEO of The American International Automotive Dealers Association, in a statement. “Tariffs are taxes, and the result will be more expensive vehicles – effectively erasing any positive change Americans saw from the 2018 tax reform bill.

“Auto sales, which are already slowing, will be hamstrung by these tariffs. America’s 2,500 European branded dealerships and their 175,000 employees will be less competitive,” he said. “The resulting trade war will undoubtedly spread to include other industries, including American agriculture. No one wins a trade war.”

As of March 5, Mr. Trump is aiming to use the proposed tariffs as a bargaining chip with Mexico and Canada to renegotiate the North American Free Trade Agreement, which has been in effect since 1994. On Twitter, the president said that he would only eliminate the new duties on the metals if the trade partners sign a "new and fair" NAFTA agreement.

Canada is one of the largest importers of steel to the United States, along with Brazil and South Korea.

Luxury lift

While this latest import duty threat could hamper luxury operations, other moves by the Trump administration have boosted the business.

The controversial United States tax bill passed by Congress in December has given the country’s luxury business a serious boost, according to Savigny Partners.

The Savigny Luxury Index saw a 3 percent bump in December following the passage of the new tax bill, which critics feel has been designed to give more money to the wealthiest U.S. citizens. With more money and lower taxes, luxury investors are celebrating and the U.S. luxury industry felt the effects (see story).

If tariffs do go into effect, luxury brands may not feel as much of a sting as mass brands.

“I do not expect to see a major shift in buying habits in the short-term, as automakers will likely absorb the extra input costs," Euromonitors' Mr. Totaro said.

"Cars are becoming increasingly tech-laden with connected, electric and autonomous technologies," he said. "Luxury cars are often the first to include these features and the rapid pace of development in the tech space is giving consumers plenty of reasons to buy a new vehicle.

"However, if the tariffs remain in place for the long-term, higher prices will lead to less frequent purchases. Research and development funding will shift away from developing vehicles for the American market, reducing consumer enthusiasm and slowing purchase frequency here."

For luxury brands looking ahead at potentially higher duties on goods, their positioning and audience may help lessen the impact.

"Manage your margins, don’t cut prices," Affluent Insights' Mr. Ramey said. "Price is reality and luxury is fantasy. Your price is supposed to be higher.

"An affluent consumer’s ‘competitive set’ is usually not affected," he said. "A Swiss watch collector isn’t going to Timex and a German auto buyer isn’t considering a Kia. Your competitor’s prices went up, too.

"Don’t let your staff’s cognitive bias about price affect sales of your luxury goods and services. Price is never the most important consideration when a high-net-worth individual buys a luxury object."