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RETAIL

Trump's threat to withdraw US from NAFTA could cost luxury retailers

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U.S. luxury retailers like Nordstrom will be affected by a potential withdrawal. Image credit: Nordstrom.

By DANNY PARISI

President Donald Trump has repeatedly spoken of withdrawing the United States from the North American Free Trade Agreement, but this could severely harm the retail business, particularly in luxury.

NAFTA was signed in 1994 and has been in place ever since, guaranteeing free trade between the United States, Mexico and Canada. But as President Trump threatens to withdraw from the agreement, a report from A.T. Kearney found that leaving NAFTA would cost $15.8 billion to the U.S. retail industry in the short-term.

"The bulk of the impact will be felt in other categories, such as food and electronics," said said Marie Driscoll, principal of Driscoll Advisors, New York. "That said, for the middle income customer who is an aspirational luxury shopper once or twice a year, higher costs in one area reduce discretionary spending in an other, say those Chanel sunglasses.

"However, most of the US middle class is enjoying a reduced income tax rate, so it could be a wash. Higher income households are not going to alter their luxury shopping for a non-discretionary, absolute must-have item."

North American trade

When NAFTA was signed more than 20 years ago, the agreement immediately established free trade between the three countries of North America.

Since then, it has survived mostly unscathed. But one of President Trump's campaign promises was to withdraw the U.S. from NAFTA, saying that it was harmful to American businesses.

Currently, U.S. retailers import $182 billion worth of goods from NAFTA partners.

American brands such as Ralph Lauren should keep an eye on NAFTA talks. Image credit: Polo Ralph Lauren

Based purely on tariffs and reduced margins alone, a withdrawal from NAFTA could heap $15.8 billion in costs on American retailers.

While Europe tends to be the base for many popular luxury brands, the United States is a huge market for luxury brands and is one of the top luxury-consuming nations in the world.

Tariffs on imports, such as the ones contemplated by President Trump recently on steel imports, could have a major affect on other countries' economies as well as on the United States'.

A.T. Kearney advises retailers that if the NAFTA withdrawal does indeed go through to keep detailed records of its impacts for use in future discussions with policymakers.

Tax laws

President 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 (see story).

Simultaneously, luxury brands and consumers across the country have begun preparing for what the recently-passed Republican tax reform laws would do their respective businesses.

The tax reform bill passed by Congress late last year is poised to have an effect on the country's luxury real estate industry as buyers consider moving across state lines to deal with tax rate changes.

The SLI had a 3 percent boost in December after the tax law was passed. Image credit: Savigny Partners

A report from Redfin found that 38 percent of prospective home buyers cited high taxes as the primary economic concern that would shape their purchasing decisions. Now that the law has been passed, these concerns may diminish for more affluent customers while increasing for those less well off (see story).

As the current NAFTA talks continue, it remains to be seen if President Trump's threats to leave the agreement are anything more than just that. It would not be the first time that surefire campaign promises have not come through.

In the meantime, luxury retailers need to understand exactly what the curtailing of free trade between North American countries will mean for them.

"The three macro areas we researched were tariff increases, reduced consumer spending, and lost jobs, each and collectively amounting to losses of billions of dollars and displaced lives," said Johan Gott, principal at A.T. Kearney, New York and co-author of the study. "Retailers in different sectors would be affected in different ways—even from product to product.

"But bottom line, the impact will extend to millions of products imported into the U.S."