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No Tariff Impact, Yet

Kevin Grier, April 2019

On May 31, 2018, the United States announced the imposition of tariffs on imports of certain steel and aluminum products from Canada (at the rates of 25% and 10%, respectively).

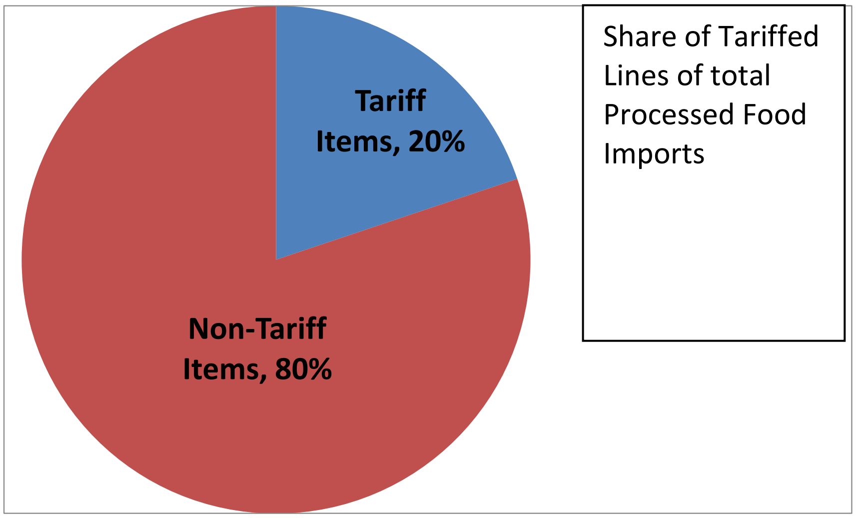
In response to U.S. tariffs on steel and aluminum, Canada imposed surtaxes or similar trade-restrictive countermeasures against up to C$16.6 billion in imports of steel, aluminum, and other products from the U.S., representing the value of 2017 Canadian exports affected by the U.S. measures. The Canadian counter tariffs took effect on July 1. The steel items are hit with 20% tariffs while aluminum and other products face a 10% tariff.

Included in the "other products" are about 45 packaged food product categories that now have a 10% tariff applied. Importers will pay an added 10% duty on top of the purchase price. The impacted imports of food products are valued at C$3.1 billion in 2017.

Products hit with a 10% tariff when imported from the United States included major items such as roasted coffee (C$511 million in 2018); orange juice ($162 million in 2018); ketchup (68 million); mixed condiments ($150 million) and soups and broths ($211 million). Sugar and confectionery items were also heavily targeted. Those items including chocolate and licorice were valued at C$258 million in 2018.

Huge Share of Canadian Processed Food

For perspective, U.S. processed food exports to Canada amounted to about C$15.6 billion in 2017. For additional perspective, the value of processed packaged food products consumed in Canada at the manufacturer level is about C$25-26 billion. As such, the products now under tariffs that were imported into Canada amount to about 20% of the value of U.S. processed food exports to Canada. The tariffed items also amount to about 5-10% of the processed food sold in Canada.



The importers of these products would include the full array of food industry participants including retailers, manufacturers (Canadian and U.S. based), brokers and distributors. The importers would pay the tariff. As noted, the tariffs were put in place as of July 1 2018. Negotiations and discussions between importers and retailers would have gone on through the summer and fall of 2018. Some grocers that were considering those increases were simply treating this as a normal request for a price increase. That is, they were not treating these tariffs as a significant, unforeseen development. As such, some were saying that the increase could only take effect in 90 days. That might be considered a normal increase lag. Any price increases that went through or were accepted by retailers would not likely have been agreed to and implemented until November at least.

The grocers and distributors that are the importer of record for private label or other products were paying the duty right away. That is, if a grocer was the importer of say a private label product or some other item under their name, they were paying the duty. Grocers were paying on those items, even if they would not allow domestic suppliers the increase.

Negotiating the Price/Cost Increases

A sensitive issue between importers and retailers was, and is, the magnitude of the increase itself. The ten percent tariff is on the imported cost. It comes before margins, fees, allowances and promotion. For multinational manufacturers this tariff would be applied to the internal transfer price between the Canadian and U.S. unit. For other importers it is their invoice cost and the U.S. suppliers price. That cost is a closely guarded transaction for any Canadian grocery supplier. Grocers will want to know how the increase is applied. That is and was awkward.

Furthermore, packaged goods cost increases tend to be small in scale. Based on historic StatsCan data, a 3% increase in packaged goods costing is a relatively big increase. In fact, since 2011 the biggest increase in costs grocers faced was 6% in 2011. A ten percent increase is off the charts huge.

In any event, as of March 2019, whatever price changes were necessary would have worked their way through the system. That is, the retailers, the ultimate buyer, would have accepted them by now, or not. In cases where they were not accepted, the importer would either absorb the cost or in some cases, cease to do business with the retailer on the item.

The reality, however, is that there is only so much that those prices could go up between the importer and the retailer. I consider it a safe assertion that most companies that are importing the products are taking a lesser margin than they had before. It would often depend on whether the imported tariff item was the only source or a key product that must be on the shelf. Heinz Ketchup comes to mind as a product that must be on the shelf, for example. If the product was not the only source or if it was not a "must have" item, then chances are the importer would be absorbing more of the tariff.

In other words, there would be varying degrees of margin stress between the retail buyer and the importer.

Regarding consumers, as of the spring of 2019, the degree to which they see higher prices will vary. It will depend on how much of the increase the retailer absorbed as opposed to the importer. If it is the former, then the retailer would be deciding by later in 2018 whether to pass the costs along in the form of higher consumer prices. If it is the latter, where the importer takes a margin hit, consumers would not feel anything.

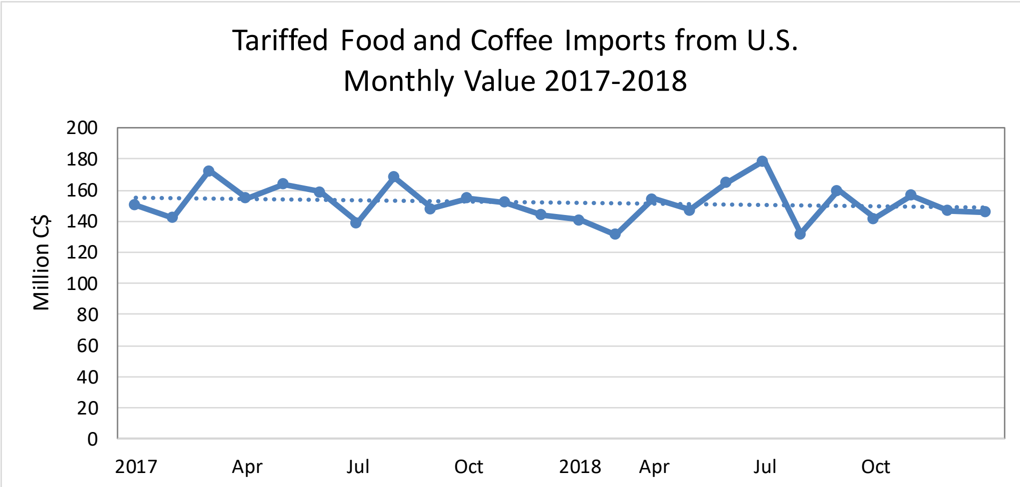
That at least is the short-term interaction between players. Short term decision factors are based on short term leverage between buyers and sellers and alternatives.

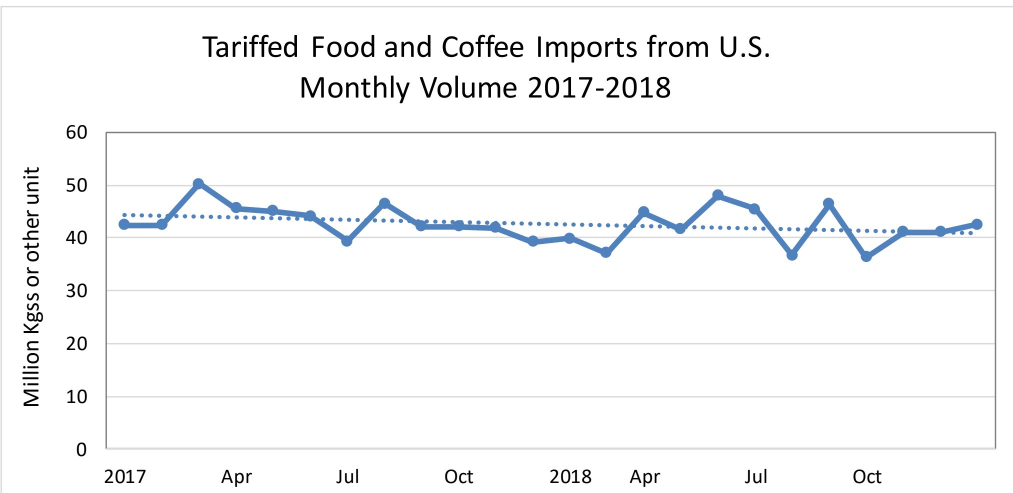
Longer Term Impact?

Looking at the longer term, part of the decision process would be focused on whether these tariffs are going to stay in place and for how long? Many would plausibly consider the tariffs to be temporary. Over the longer term, meaning a year or more, if still in place, the 10% tariff is going to force some other decisions. Those other decisions will be based on profits and returns on investment of the imported items. Importers and retailers will decide whether to carry those items, whether to utilize the ingredients, where to manufacture the item, or whether to stay in that line of business. Those longer-term decisions will be based on the changed profit picture. The decision would also be based on the demand impact of the higher prices.

No Impact Yet

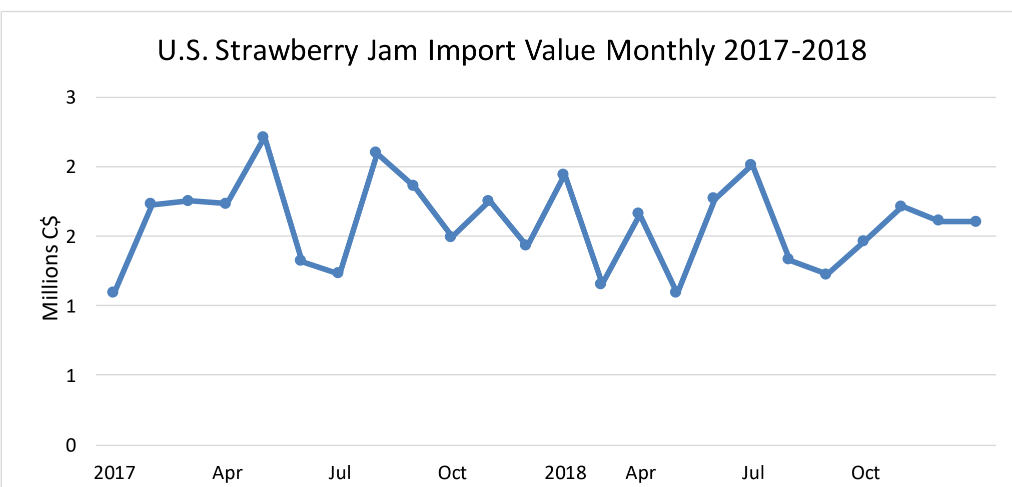
As of the end of 2018, it does not appear that the tariffs have had much impact on the value of trade in these food items. That is probably due in large measure to the fact that any pass through to retailers or consumers might not have happened until the October to December period. Based on monthly Statistics Canada data for 2017 and 2018 for those tariffed items, there does not appear to be a discernable change in the trade between the U.S. and Canada for those items. The trendline for the total value and volume of the items is down slightly, but it is not possible to say it is due to the tariffs.





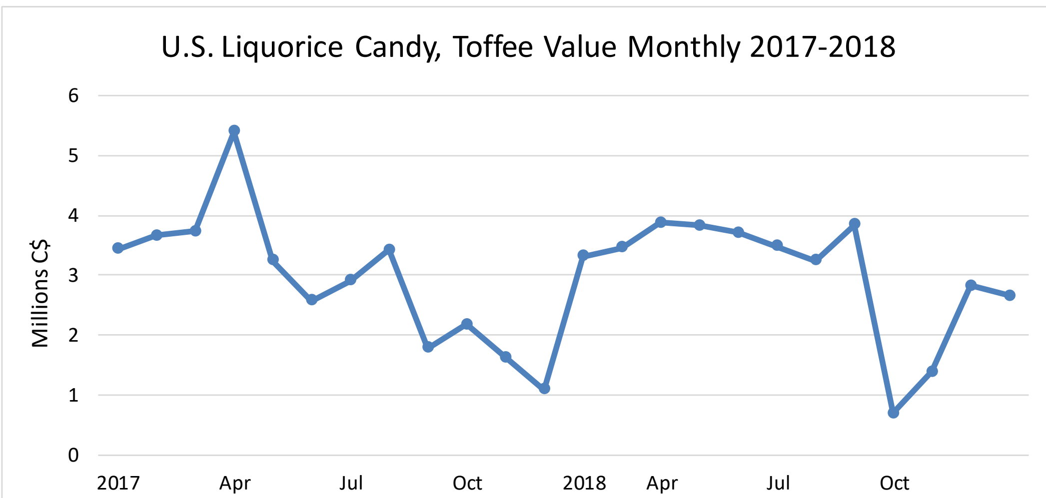
Item by Item Differences

As noted, there are many independent tariffed items and each of them has reacted differently while the total has been somewhat steady. The case of strawberry jam offers an example.



It is likely that the bulk of the strawberry jam imports from the United States is Smuckers. Based on the graph above, there does not appear to be any impact of the tariff. This could mean any number of things as it relates to the trade. It could mean that the importer, Smuckers Canada, absorbed all of the increase. That, in turn, would mean that the retailer did not change its purchases due to the tariff or increase consumer prices. It could also mean that the product is so desired by retailers and consumers that the total increase was passed along with no impact. It could also mean some combination of those two.

Liqourice and toffee are also interesting. Total values have shown a declining trend with a very big decline in October. This, of course, may or may not be associated with the tariff. It could mean that the tariff was passed along to Canadians and it resulted in reduced purchases. It could also possibly mean that there was no pass through between the importer, likely Hershey Canada, and retail. The declining imports could simply reflect that there is a declining consumption trend overall.



The bottom line is that as of the end of the year, there was little evidence of the impact of the tariffs. That may be due to the fact that the grocers did not accept or take the increases until late in the year. The degree of the impact in the first half of 2019 will be reflective of how much of the tariff was taken by retailers and passed along to consumers. If the tariff stays on longer than a year, retailers, manufacturers and brokers will be looking at their offerings and weighing the merits of taking those items. Alternatively, the Canadian-based suppliers could use the tariffs as negotiating leverage in order to help them increase prices.

Why it Matters

As of now, the main beneficiary of the tariff is the federal government. Retailers and importers are either getting squeezed on margins or consumers are paying more for the product.

This article originally appeared in the March 2019 edition of Grocery Trade Report. If you would like a free trial, send me an email at kevin@kevingrier.com.