Commentary

Continued Tariff War Would Negatively Affect Retailers and Discretionary Consumer Product Companies Across Borders

Morningstar DBRS
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Key Highlights

- On March 4, 2025, the Trump administration implemented the previously threatened tariffs on imports from Canada, Mexico, and China and is considering reciprocal tariffs on other trade partners.
- While a temporary reprieve has been announced on goods imported from Canada and Mexico, considerable uncertainty persists.
- For large retailers and discretionary consumer product companies operating in multiple geographies, these changing trade dynamics and tariffs, if implemented, could pose several challenges including changing consumer behavior, supply chain management, and margin pressures, as well as operational challenges.
- Any credit rating actions will largely be driven by company-specific impact, risks related to supply chain diversification, and the companies' relative financial strength.

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On March 4, 2025, the Trump administration implemented the previously threatened tariffs on imports from Canada, Mexico, and China. These include a 25% tariff on goods from Mexico and Canada (excluding autos), with a lower 10% tariff on energy products from Canada, as well as an increase to 20% on goods imported from China. While, just two days later, the administration announced a 30-day reprieve on goods imported from Canada and Mexico that are compliant with the existing United States-Mexico-Canada Agreement, considerable uncertainty around tariff implementation and counter measures persists.

Given the retaliatory tariffs and other measures proposed by each of these nations and the additional reciprocal tariffs on other countries being considered by the U.S., likely beginning April 2, 2025, consumers across borders are likely to face purchasing power pressures. The ultimate impact of the trade war will depend upon the duration and intensity of these trade actions and will likely vary by subsector. Companies and retailers offering more discretionary products in these regions are likely to face declining consumer demand and would also find it difficult to pass through additional tariff-related costs. Conversely, retailers offering value-based products, and the consumer products companies manufacturing them, are likely to be less affected as consumers continue to seek relative value.

In that context, we believe any material adverse effects on the long-term credit risk profiles of most retailers and discretionary consumer product companies would be largely driven by company-specific impact, risks related to supply chain diversification, and the companies' relative financial strength.

Trade Policy Shifts Negatively Affect 2025 Outlook

In our 2025 outlook for global retailers, *2025 Global Retailers Outlook: Light at the End of the Tunnel for Discretionary Retail?*, we noted that, even though retailers and discretionary consumer product companies could face some earnings pressure in the near term, a gradual improvement in the trading environment is likely in the second half of the year, as the macroeconomic environment stabilizes. Furthermore, we noted that there remains considerable uncertainty given the potential shifts in U.S. policy following the 2024 presidential election (particularly regarding tariffs), as well as global geopolitical risks, both of which could affect our views on inflation and earnings growth.

We believe trade tariffs could further erode consumers' purchasing power across regions and dampen consumer confidence, resulting in a slower recovery in consumer spending than was previously anticipated in our 2025 outlook. That said, we expect retailers and consumer product companies will likely feel these effects to varying degrees, depending upon their product offerings and supply chain characteristics.

Tariffs Could Reinstate Supply Chain Challenges

A continuation of the tariff war could reinstate supply chain challenges as retailers look to minimize the tariff impact on their supply chain by sourcing from different markets. Regardless of how the tariff situation evolves, the developments in recent weeks have emphasized how reshoring and supply chain diversification can be critical for business continuity and to drive operating efficiency. There are several companies considering and/or actively pursuing alternatives to avoid the tariffs. Shopify Inc., Canada's leading e-commerce platform, has added a New York headquarters according to its U.S. regulatory filing, and Swiss chocolate company Lindt & Sprungli is considering serving the Canadian market from its European plants, instead of those in the U.S., to avoid retaliatory tariffs from Canada, one of its largest markets.

In addition, given the uncertain climate, discretionary consumer product companies and retailers may choose to defer large capital investment plans to conserve liquidity and/or wait to gain more clarity on market conditions going forward.

Buy Local Theme Driving Consumers Choices

Even if ultimately not implemented, the threat of tariffs alone has already resulted in some shift in consumers preference toward domestically made products. Retailers in Canada, for example, started heavily advertising domestically produced products and brands since the tariff threats were issued. In a trade war, domestic brands could also benefit from a lower relative price point compared with imported products, which may be subject to tariffs. Depending on the duration of the tariffs, a shift in consumer buying habits could result in more permanent market share gains for certain products and/or brands.

Divergences in Regional Trends

The competitive environment across the U.S., Canada, and Mexico markets remains intense, and a further heightening in costs in any one market resulting from the implementation of tariffs could meaningfully amplify the pressures on retailers' operating performance. For example, higher inflationary pressures as a result of tariffs could have a more material impact on consumers in Canada as many households continue to allocate a higher portion of their disposable income toward mortgage and other debt-related payments. Similarly for retailers in the UK that are already facing challenges related to higher taxes and employment costs, a tariff war could result in more severe margin pressure and weaker credit profiles for the retailers in our portfolio of rated credits.

Credit Rating Implications

We believe that, if the proposed tariffs are implemented, retailers and consumer product companies with more discretionary product offerings will experience financial pressures at least over the near term, ultimately resulting in a negative impact on their credit risk profiles. At the same time, for retailers with value-based offerings or mass merchants with more diverse product offerings, long-term credit risk profiles may be less affected given their competitive advantage with price-conscious consumers. Also, large retailers with a strong balance sheet and prudent financial policies and that have the headroom to absorb additional costs, or offset expenses through operational efficiencies, are better-positioned to withstand market uncertainty in the near team.

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