

Principal Authors



Ryan Durfee
Senior Analyst



Ethan Sherman
Analyst

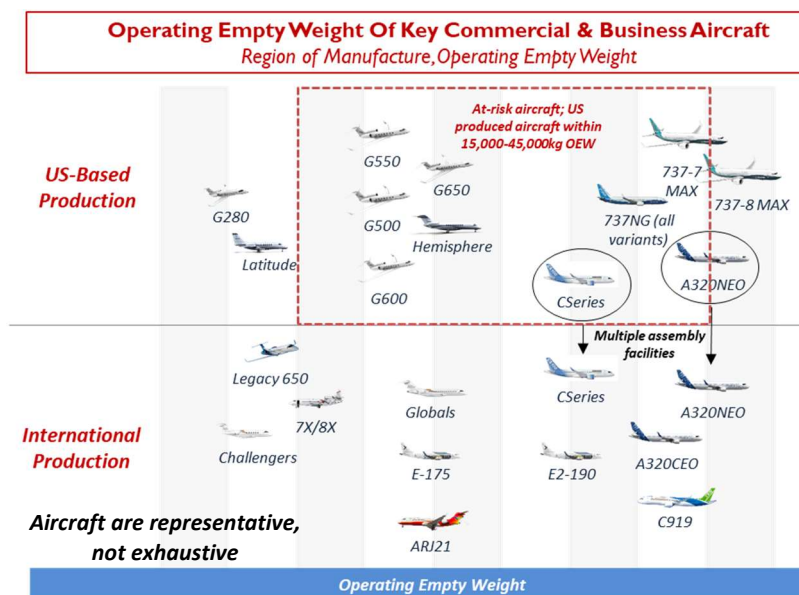
IT'S THE YEAR OF THE DOG: Are Chinese retaliatory tariffs more bark than bite?

Last night's announcement of retaliatory Chinese tariffs was not altogether unexpected, but the scope surprised some. Included in the list of 106 products were aircraft with an operating empty weight (OEW) between 15,000kg and 45,000kg. This action is particularly troubling given Aerospace's historical insulation from tariffs targeting finished goods. Markets reacted swiftly as investors feared that the broader US Aerospace manufacturing base would be pulled into the ongoing trade spat, dragging shares of leading aircraft manufacturers like Boeing, Bombardier, and Embraer down as much as 6% premarket.

The announcement spurred questions across the Aerospace industry:

- What aircraft will be impacted?
- What risk mitigation strategies are available to at-risk OEMs?
- What are the potential long-term implications?

Tariff exposure for US manufactured aircraft are determined by their size. More specifically, the aircraft's OEW. Fairmont isolated and categorized every aircraft manufactured in the United States by OEW to understand which manufacturers and platforms are actually exposed to these measures. **A closer look at precisely which US manufactured or assembled aircraft will be impacted yields a less-troubling view than many are expecting. In fact, Fairmont expects the overall impact on US commercial and business aircraft exports to be relatively muted.**



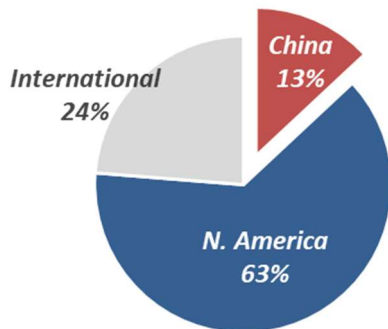
Source: OEMs, Fairmont Analysis

Referencing the graphic to the left, the impact on forward-looking US commercial aircraft exports should be manageable in the near term and minimal in the longer term. The declining tail of Boeing's 737NG production is within the scope of the tariffs, but the vast majority of Boeing's next generation 737 MAX family are largely unexposed. OEW estimates for the smallest member of the MAX family, the MAX 7, suggest it will be within the scope of the tariff, but the point is moot given that no Chinese carriers or lessors have purchased any of that variant. The competing CSeries is in this category as well, but Boeing has recently gone to great lengths to point out that this aircraft is not U.S. in origin in protracted (and overturned) anti-dumping arguments to the U.S. Commerce Department.

category as well, but Boeing has recently gone to great lengths to point out that this aircraft is not U.S. in origin in protracted (and overturned) anti-dumping arguments to the U.S. Commerce Department.

Airbus' A320 and forthcoming CSeries production lines in Alabama are similarly insulated – it is noteworthy that the latter line was announced in part to overcome Boeing's challenges to the CSeries. While a broader portion of the A320 backlog is in theory exposed to the measures, Airbus will likely produce most China-bound A320s at their established assembly plant in Tianjin, with the balance produced in Toulouse. As for the CSeries, there are currently no Chinese customers and no additional orders are expected at this time. However, if needed, Airbus & Bombardier could simply keep CSeries production in Canada.

Geographical Distribution of Recently Sold Gulfstream Aircraft
 0-3 Year Old Aircraft As of 2017YE
 G450, G550, G650, G650ER, G500, G600



Source: JetNet, Fairmont Analysis

Instead, the tariffs appear to disproportionately target General Dynamics' Gulfstream Large Cabin business jets & Textron/Cessna's forthcoming Hemisphere. In particular, Gulfstream's in-production G550 & G650 family as well as forthcoming G500 & G600 platforms fall within the bounds of the tariff. Historically, China has accounted for roughly 10-12% of large Gulfstream jet deliveries and in 2017 accounted for 13% of all of those three years old or younger. This part of the market is typically less sensitive to pricing and has flexibility in terms of avoiding tariffs based on domestic ownership, providing further insulation from these tariffs. The movement of business jet home base locations from mainland China to Hong

Kong at the beginning of the 2014 anticorruption initiatives demonstrates likely abilities to circumvent the tariff (and it is unclear if this current Tariff does indeed apply to jets purchased in HK).

So, if the 737 MAX and other stalwarts of the US Aerospace manufacturing base can escape relatively unscathed, what is China's end game?

Tariffs are by nature protectionist measures, but protecting what? China's state aircraft manufacturing industry could eventually benefit from such state support as they struggle to find buyers for the indigenous C919, but the tariffs do nothing to impact its most entrenched competitors. Furthermore, China has only the most limited domestic business jet manufacturing presence, and even then only exposure in the Very Light Jet end of the market. This begs the question, are these measures actually designed to boost the Chinese aero industry at America's expense, or merely as escalation in trade posturing? The above analysis suggests that it is the latter, and China's tariff appears to have been very effective in that regard.

The Chinese imposed what many will see as a reasonable retaliatory response to US tariffs, showing that no products or markets are off the table while stopping short of measures that would meaningfully impact both US Manufacturing and Chinese civil infrastructure. The possibility remains for China to expand the scope of the tariffs to include the 737 MAX and others in defense of the C919, but it's unlikely. The more troubling aspect remains that last night's events signal an encroachment on a key, previously insulated, piece of the global industrial supply base.