Large Ports Can Weather the Tariff Storm

By The Municipal Bond Team

Trade tariffs have been at the forefront of news in the last few months as the Trump administration increased tariffs on geopolitical allies and rivals alike. US trading partners responded in kind, and the administration has returned with additional tariffs. Since tariffs raise costs, which in principal lower demand for both imports and exports, cargo volumes in US ports will likely decline. While this is not a positive credit development for the sector, many ports, particularly large ones with broad and diverse operations, are well positioned to handle the potentially rough seas.

In August 2018, the US imposed a 25% tariff on $50 billion worth of Chinese products, including steel and aluminum. The administration also announced plans for an additional 10% tariff on up to $200 billion of Chinese goods. In response, China implemented tariffs ranging from 15% to 25% on various US exports, most notably soybeans—the top export. China also announced it could escalate tariffs to include up to $60 billion worth of US products.

The Trump administration also imposed a 25% tariff on steel imports and a 10% tariff on aluminum imports from the European Union, Canada and Mexico. Canada imposed retaliatory tariffs on $16.6 billion worth of goods, while the EU and Mexico each announced tariffs on $3 billion worth of goods. While we are hopeful that cooler heads will eventually prevail and normal trade ties will resume, these tariffs could have a real impact on the broader economy.

2018 Trade Volumes Have Actually Risen

Trade volume is one of the most important metrics for the credit quality of ports. The US imports significantly more than it exports, taking in 70% more shipping containers than it sends out annually. Container volumes have grown between 1% and 4% annually since 2012. That growth is linked considerably to GDP growth and, more notably, to retail and food sales.

Container Volume Growth versus Real Retail and Food Services Sales Growth

Despite uncertainty over new trade restrictions, trade volume growth was robust in the first half of 2018. According to the American Association of Port Authorities, volume across almost all ports in every region, including the East Coast, West Coast, Gulf and Great Lakes, is up from the previous year. Some ports, such as the Port Authority of New York & New Jersey, Port of Long Beach, Port of Oakland and Port of Savannah, had record-breaking months this year. The increase in trade volume is likely attributable to three factors:

1. The economy has grown steadily over the last few quarters, which increased demand for foreign and domestic goods alike.
2. Many ports can now accommodate larger vessels than in previous years due to expansion efforts in their capital improvement plans.
3. Importers likely moved up trade orders from international suppliers amid looming uncertainty over trade restrictions.

While the first two reasons have potential to continue to spur growth, the third reason is entirely temporary.

**Current Tariffs Create Headwinds, but Not Strong Ones**

The majority of steel and aluminum imports enter the US as breakbulk cargo, meaning in non-standard shipping containers that are more difficult to quantify. However, ports across the US handled 282,995 twenty-foot equivalent units (TEUs, the standard measure of bulk units) of containerized steel and aluminum in 2017, according to the Port Import/Export Reporting Service. To put that in perspective, the Port of Los Angeles alone handled over 9 million TEUs in 2017. Even if the country stopped importing steel and aluminum altogether, which is unlikely, it would not be enough to strain the finances and operations of large US ports.

On the export side, so far China has only announced tariffs that affect 3.1% of goods travelling through US ports. Even if China put tariffs on all US products, impact on export volumes would probably be limited; it would not move the needle. The Port of Oakland had the highest amount of TEUs shipped to China in 2017 at 20,000 compared to the 2017 total TEU volume of over 2 million.

**Ports are Financially Stable and Operationally Diverse**

US ports on average have had solid financial performance in the last few years. Both AA-rated and A-rated ports had a median debt service coverage ratio of over 2x in 2017. Liquidity is also very robust. As an example, the Port of Los Angeles had 993 days cash on hand and the Port of Oakland had 637 days cash on hand at the end of fiscal year 2017. Many of the nation’s large ports, such as the Port of Miami and Port of Los Angeles, have contractual minimum guarantees from their tenants, which effectively provide secure revenue streams regardless of trade volume. Many large ports, including the Port Authority of New York & New Jersey, Port of Oakland, Port of Seattle and Massachusetts Port Authority, have diversified operations that include airports. Similarly, Port Everglades, the Port of Charleston and Massachusetts Port Authority, among others, have cruise ship terminals that provide an additional revenue stream. Diverse operations should provide stability even as trade volumes fluctuate.

**Median Debt Service Coverage Ratio**

![Median Debt Service Coverage Ratio](source: Fitch, accessed August 2018.)

**Median Days Cash on Hand**

![Median Days Cash on Hand](source: Fitch, accessed August 2018.)

**Large Ports Are a Safe Harbor**

We believe the impact of tariffs on most ports, especially large ports, will be minimal. Tariffs are likely to lower trade volume from recent highs but should not be enough to deter US demand for foreign goods. The US economy is growing and so is the discretionary income that is available to spend on imports. Larger ports are operationally diverse and financially robust. While the possibility of a trade war is an ongoing concern that requires monitoring and scrutiny, large ports can still be a safe harbor in this political storm.
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