



# SMALLER CAP MARKETS' PERSPECTIVES

## APPAREL SOURCING AND THE TRADE WAR WITH CHINA

DECEMBER 2018

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In what should have been a banner year for retailers and retail stocks given a strong consumer spending environment, favourable weather and clean inventories, turmoil and uncertainty arising from a trade war between the US and China have clouded the final months of 2018. With a looming threat from President Trump to impose a 25% tariff on all goods imported from China, retailers and their suppliers are being prompted to consider restructuring well-developed supply chains that have been in place for years.

Apparel companies appear to be ahead of the pack in terms of diversifying their supply chains. With apparel manufacturing having left the US decades ago, this industry is already accustomed to sourcing goods from numerous countries. Interestingly, after rapidly growing into the US' largest source of apparel imports, China has seen its share decline every year since peaking in 2010 at 39.2%. The primary beneficiary of China's fading importance for apparel manufacturers has been Vietnam, which has grown from near zero at the start of the century to 14.4% in 2017.

Exhibit 1: US Apparel Imports by Country - % of Total

Year	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017
China	7.9%	8.2%	9.8%	11.9%	13.8%	22.0%	25.9%	30.8%	32.0%	37.2%	39.2%	37.8%	37.8%	37.3%	36.4%	35.9%	34.6%	33.7%
Vietnam	0.1%	0.1%	1.6%	3.9%	4.0%	4.0%	4.5%	5.9%	7.3%	8.0%	8.2%	8.6%	9.2%	10.2%	11.3%	12.4%	13.4%	14.4%
Bangladesh	3.7%	3.7%	3.3%	3.0%	3.1%	3.5%	4.1%	4.2%	4.8%	5.4%	5.5%	5.8%	5.8%	6.2%	5.9%	6.3%	6.6%	6.3%
Indonesia	3.6%	3.9%	3.6%	3.5%	3.7%	4.2%	5.1%	5.4%	5.6%	6.1%	6.2%	6.5%	6.4%	6.2%	5.9%	5.8%	5.8%	5.7%
India	3.1%	3.0%	3.3%	3.3%	3.4%	4.3%	4.4%	4.3%	4.3%	4.5%	4.4%	4.3%	4.0%	4.0%	4.2%	4.3%	4.5%	4.6%
Mexico	14.7%	13.8%	13.0%	11.3%	10.3%	8.8%	7.4%	6.1%	5.6%	5.4%	5.0%	4.9%	4.8%	4.6%	4.6%	4.2%	4.2%	4.5%
Honduras	4.1%	4.2%	4.3%	4.1%	4.1%	3.8%	3.4%	3.4%	3.6%	3.2%	3.4%	3.4%	3.3%	3.1%	3.2%	3.1%	3.2%	3.1%
Cambodia	1.4%	1.7%	1.8%	2.0%	2.2%	2.5%	3.0%	3.3%	3.3%	3.0%	3.1%	3.3%	3.3%	3.2%	3.0%	2.9%	2.7%	2.7%
El Salvador	2.8%	2.9%	2.9%	2.8%	2.7%	2.4%	2.0%	2.0%	2.1%	2.1%	2.3%	2.2%	2.4%	2.3%	2.3%	2.3%	2.4%	2.4%
Sri Lanka	2.6%	2.7%	2.5%	2.3%	2.4%	2.4%	2.3%	2.1%	2.0%	1.9%	1.7%	1.8%	1.9%	2.1%	2.2%	2.4%	2.4%	2.4%
Nicaragua	0.6%	0.7%	0.8%	0.8%	0.9%	1.0%	1.2%	1.3%	1.3%	1.4%	1.4%	1.7%	1.8%	1.8%	1.8%	1.7%	1.8%	1.8%
Jordan	0.1%	0.3%	0.7%	1.0%	1.5%	1.6%	1.7%	1.5%	1.4%	1.2%	1.1%	1.2%	1.3%	1.3%	1.4%	1.5%	1.6%	1.7%
Guatemala	2.6%	2.8%	2.9%	2.9%	3.0%	2.6%	2.3%	2.0%	1.9%	1.7%	1.6%	1.7%	1.6%	1.6%	1.6%	1.7%	1.7%	1.7%
Pakistan	1.6%	1.6%	1.5%	1.7%	1.8%	1.8%	2.0%	2.0%	2.1%	2.1%	2.1%	2.1%	1.9%	1.8%	1.8%	1.7%	1.6%	1.6%
Italy	2.4%	2.5%	2.4%	2.3%	2.2%	2.0%	1.8%	1.9%	1.9%	1.4%	1.3%	1.4%	1.5%	1.5%	1.6%	1.5%	1.4%	1.5%
Haiti	0.4%	0.4%	0.4%	0.5%	0.5%	0.6%	0.6%	0.6%	0.6%	0.8%	0.7%	0.9%	1.0%	1.0%	1.0%	1.1%	1.1%	1.1%
Thailand	3.2%	3.2%	3.0%	2.8%	2.8%	2.6%	2.6%	2.4%	2.3%	1.9%	1.8%	1.5%	1.4%	1.3%	1.2%	1.2%	1.1%	1.0%
Philippines	3.3%	3.3%	3.2%	3.0%	2.8%	2.7%	2.8%	2.3%	1.9%	1.6%	1.4%	1.5%	1.5%	1.4%	1.3%	1.3%	1.2%	1.0%
Egypt	0.7%	0.7%	0.6%	0.6%	0.7%	0.6%	0.9%	0.9%	1.0%	1.2%	1.2%	1.2%	1.1%	1.0%	1.0%	1.0%	0.9%	0.9%
Other	41.2%	40.3%	38.3%	36.3%	34.3%	26.5%	21.9%	17.5%	14.8%	9.8%	8.4%	8.1%	7.9%	7.8%	8.1%	7.8%	7.9%	8.0%

Source: BofA Merrill Lynch Global Research

Rising wage rates in China have been the main driver of changing apparel supply chains, with BofA Merrill Lynch Global Research estimating labour costs 30-50% lower in Southeast Asia. While China remains the largest source of apparel imports for the US, the trade war may well just serve to accelerate a trend that has already been in place for many years. Even should the trade war get resolved, China is likely to continue ceding its apparel manufacturing share to Vietnam due to an aging population and increasingly strict environmental regulations.



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