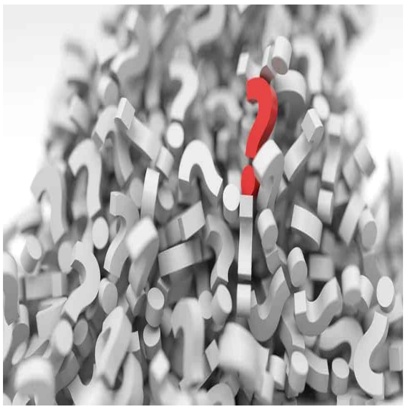

NAFTA Negotiations: Should Investors Retreat to the Sidelines?

Description

The fifth round of NAFTA renegotiations commenced on November 17. Cabinet members from the U.S., Canadian, and Mexican governments are not attending, electing instead to let trade negotiators take the lead. Progress has been slow, with the U.S. delegation unveiling its demands in the previous round. Representatives from Canada and Mexico dismissed the demands as unconstructive.

In early November, the U.S. Department of Commerce finalized duties on Canadian softwood lumber. I discussed this development and the stock that could suffer because of it. **Canfor Corporation** (TSX:CFP), a Vancouver-based forestry company, was hit with a 22% duty on its products.

On November 14, Canada filed a request under NAFTA chapter 19 to set up a bi-national panel in the hopes to strike down the recently implemented duties. Chapter 19 remains one of the more controversial points in NAFTA. The United States requested that the provision be removed in one of the opening rounds of negotiations in August.

Will there be economic fallout in the event of cancellation?

In the event that NAFTA is scuttled, there is still hope among Canadian officials that the Canada-U.S. Free Trade Agreement will come back into effect. The agreement was replaced by NAFTA in 1994. Experts and analysts have expressed concern that this agreement could also be scrapped, which could complicate matters for Canada in the short term.

Royal Bank of Canada has projected that Canada could see its GDP shrink by 1% over a five- to 10-year period if both trade agreements are scrapped. Chief economist at **Bank of Nova Scotia** Brett House has said that there would be a 30% chance of a “short recession” if NAFTA comes to an end.

The long-term implications of a return to economic protectionism and tariffs on the North American continent are more alarming. The International Monetary Fund (IMF) has already projected Canadian GDP growth will dip to 1.5% in 2019. In its recent meeting, the Bank of Canada raised the possibility of a steep drop off in investment of Canadian companies.

The recent battle between U.S. multinational **Boeing Co.** and **Bombardier, Inc.** could give us an insight into the future of a more contentious trade environment. Bombardier was facing 300% in duties implemented by the U.S. Department of Commerce on its CSeries jets before European multinational **Airbus SE** purchased a majority stake in the new planes. Now, both companies hope to avoid duties by manufacturing the new jets in Alabama.

The Comprehensive Economic and Trade Agreement (CETA) between Europe and Canada is set to eliminate 98% of tariffs between the two trading entities. As the agreement developed, it appeared that Europe would gain access to many of the benefits that NAFTA afforded by entering into the Canadian market.

Investors should be prepared to see NAFTA scuttled, as negotiations have shown little sign of improvement. Canadian lumber, manufacturing, and consumer defensives like **Saputo Inc.** (TSX:SAP) could all experience volatility in the immediate aftermath.

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