Could a Collapse in Trade Talks Hurt Bank Stocks in October?

Description

The United Nations General Assembly has reportedly given the United States and Canada the opportunity to extend trade talks, at least informally. The news out of formal negotiations has not been encouraging in recent weeks, at least for those hoping for a trade deal that will include Canada.

U.S. Trade representative Robert Lighthizer was candid when speaking on negotiations at the Concordia Summit in New York. “The fact is, Canada is not making concessions in areas where we think they’re essential,” he said. “We’re going to go ahead with Mexico. If Canada comes along now, that would be best.”

“We’re sort of running out of time,” he added.

The Canadian negotiating team has stood firm while also relying on pressure from business groups in the United States. Business leaders by and large are in favour of maintaining a trilateral deal. There is concern that a breakdown could seriously disrupt trade between the three heavily integrated economies. Optimists should not jump on this perspective right away. Investors have seen trade tensions escalate between the U.S. and its top rivals, even with highly integrated economic relationships in key sectors.

Investors should respond with some deal of caution as trade talks creep closer to the October 1st deadline that was originally introduced by the Trump administration in late August. A breakdown in trade talks and a formal pact between Mexico and the U.S. would likely deal significant damage to the Canadian dollar.

JPMorgan Chase & Co. released a report that forecast the Canadian dollar to fall by roughly 10% in the event of exclusion from a North American trade pact. The analysis also projected that a U.S. withdrawal would entail a 25% tariff on autos and dairy, which would severely disrupt supply chains. JPMorgan also predicted that the Bank of Canada may move to slash interest rates in response.

Canadian bank stocks could also take a hit from this potential disruption. **Toronto-Dominion Bank** (TSX:TD)(NYSE:TD) boasts the largest U.S. footprint of any Canadian bank. Shares of TD Bank have slipped 0.9% over the past week. Earnings were very positive in the third quarter, but a dramatic slowdown in Canada could offset its U.S. business gains.

Bank of Montreal (TSX:BMO)(NYSE:BMO) also boasts a sizable footprint south of the border. Its stock is up 6.4% in 2018 so far, but shares dropped 1.1% on September 25. Its growth in the third quarter was also driven by very good results in its U.S. business.

Bank of Nova Scotia (TSX:BNS)(NYSE:BNS) stock has plunged 4.9% in 2018 as of close on September 25. It is an interesting target because of its large developing market footprint, which could potentially offer shelter if trade tensions worsen between the two close North American allies.

A more in-depth review will certainly be warranted as a more concrete picture emerges in October. At least that is what investors will be hoping for as the last days for a pre-deadline deal wind down.

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Author
aocallaghan