Could the USMCA Deal Mean Trouble for Canadian Retail Stocks?

Description

As Canada and the U.S. announced a new deal replacing NAFTA, called the USMCA, many Canadian investors breathed a sigh of relief. After all, the lack of a deal could have generated a lot of uncertainty and the threat of more tariffs could have led to a sell-off of Canadian stocks.

However, it's not all good news for Canadian stocks, particularly ones that operate in the retail sector. One of the changes in the new trade deal is the amount that Canadians can buy from U.S. merchants without having to pay duties or sales tax. Previously, the threshold was $20 in both instances, which is a very low amount given the amount of online shopping that Canadians do.

Under the USMCA, Canadians won't have pay sales taxes for online purchases up to $40, and duties won't be applied to purchases of up to $150. This is sure to incentivize more online shopping, as it will mean less of a bill for Canadians, but by the same token, this means fewer dollars will likely be spent in Canadian stores.

Will Canadian stores be less competitive?

The big disadvantage for Canadian retailers comes in the way of sales tax, where a higher exemption will make merchants less competitive, at least that's what some would want you to believe. **Canadian Tire Corporation** (TSX:CTC.A) believes that the same rules should be given to Canadian retailers as well in order to make it an even playing field.

However, it's not a valid argument. For one, a $40 exemption for sales taxes would mean $6 avoided for a customer in an HST province where the rate is 15%. And while that may not be a nominal amount for some customers, cross-border shopping also involves foreign exchange costs as well as longer shipping times.

So to assume the playing field is the same is incorrect, as there are other factors that will still make shopping closer to home more appealing. Given the recent focus on home delivery by some merchants, the speed at which someone can get a product has to be taken into consideration, as it does carry value as well.

While Canadian Tire may claim this will make it easier for U.S. merchants to compete, I believe this will have more of an impact on administrative costs for the Canadian government, as collecting duties and sales taxes on such small amounts and trying to track and audit such purchases likely cost more than it was worth.

Bottom line

At a high level, it's easy to say that the new deal with the U.S. and Mexico could make it harder for retailers like Canadian Tire to stay competitive, but in reality, the effect will likely be immaterial. The exchange rate likely plays a much bigger role when it comes to online shopping than taxes or duties will.

That said, Canadian retail stocks aren't good buys, but it's not because of duties or sales taxes not being collected on low-dollar purchases. It's because their operations are just not as efficient, and brick-and-mortar stores incur a lot more overhead than a company like **Amazon** does that primarily operates online. Canadian retail stocks are a strong sell, but not because of any changes under the USMCA.

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