

FINANCIAL MARKETS

THE FUTURE OF NAFTA:
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NORTH AMERICAN TRADE

FOREWORD

Since his election, President Trump has been intent on renegotiating the North American Free Trade (NAFTA) agreement.

Through that process, we've seen diplomatic tensions increase as the Trump administration prioritises balancing its trade deficit. However, as of September 2018, recent reports suggest a breakthrough could be close with Mexico.

In this eBook, we'll explore NAFTA's history and what its future holds

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THE ORIGINS OF NAFTA

NAFTA HISTORY

The North American Free Trade (NAFTA) agreement is a trilateral bloc based in North America. It involves the United States, Canada and Mexico.

Talks first began in 1992 with US President George H. W. Bush, Canadian Prime Minister Brian Mulroney and Mexican President Carlos Salinas de Gortari. The official agreement, however, first came into effect on January 1st, 1994.

The idea of a regional trade agreement first came to light in 1979. The concept was part of Ronald Reagan's presidential campaign. It was a way to compete with the Treaty of Rome - now the European Union.

EVOLVING TRADE DEALS

A free trade agreement first came into play between just the US

and Canada in 1988. It was, unsurprisingly, known as the Canada-United States Free Trade Agreement.

Not long after this agreement, Mexican President Carlos Salinas de Gortan approached US President George H. W. Bush in regards to creating a similar agreement. This plan was a way to gain foreign investment after the trouble caused by the Latin American debt crisis.

These talks worried the Canadian Prime Minister. He believed a new agreement would undermine Canada and its agreements with the US. Because of this, he asked to join forces. This was the origin of NAFTA.

Originally, the goal of NAFTA was to eliminate the barriers to trade and investment between the three nations. Most trade between the US and Canada was already duty-free, so there was a bigger focus on trade with Mexico.

Tariffs on over half of all Mexican exports to the US were removed. In addition, tariffs were removed on over a third of US exports to Mexico.

The original plan was to remove all tariffs from products exported from the US to Mexico within the first 10 years. The only exception to this was agricultural exports, which had a 15-year removal target.

This agreement also enhanced the protection of intellectual property rights and copyright laws across the three nations.

CURRENT US TRADE POLICY

President Trump's trade policy has put the existence of NAFTA into doubt. During the 2016 election campaign, then-candidate Trump promised to renegotiate trade deals that he believes are detrimental to the United States.

Specifically, President Trump wants to build domestic manufacturing and create more US jobs. He also wants to balance the US negative trade deficit (which merely means the US imports more than its exports).

Part of President Trump's negotiation strategy has been the introduction of US import tariffs.

In May 2018, President Trump announced that the US would be imposing tariffs on steel and aluminium for Canada and Mexico, as well as China and the EU. The steel tariffs were set at 25% for steel and 10% for aluminium.

After this, Canada hit back with its own tariffs. This affected more than 100 US products worth 1\$6.6 billion Canadian dollars. These products included washing machines, toilet paper, insecticides and ketchup.

Mexico also announced its own import tariffs on more than a dozen US agricultural products. This mainly affects pork and cheese. As well as this, they also added tariffs on US whiskey, bourbon and steel.

WHAT DOES THE FUTURE HOLD?

NAFTA BREAKTHROUGH?

Despite recent difficulties, there's been a breakthrough of sorts between the US and Mexico. In fact, the two nations have agreed to a preliminary trade deal that could replace elements of NAFTA.

Yet, this agreement still needs to be ratified. A Mexican government official has stated that US import tariffs on steel and aluminium need to be resolved before the deal can be ratified.

There's also no mention of Canada in this deal. President Trump stated in a press conference that this new deal would be called the 'US/Mexico Trade Agreement'.

However, it's understood that the Mexican government still wants Canada to play a major role. President Trump has publicly dismissed the necessity for Canada to be part of any new trade agreement between the US and Mexico.

UNCERTAINTY STILL AHEAD

Despite the recent breakthrough between the US and Mexico, there's still a possibility that NAFTA talks could stall.

So far, President Trump has shown that he will do whatever is necessary to achieve what he thinks is right. Ultimately, it's feasible that the US will leave NAFTA if it isn't satisfied with new terms.

The existing terms of NAFTA state that any of the countries involved can leave after a six month notice period.

In the absence of any new trade deal, import tariffs between US, Canada and Mexico will become the new normal.

Clearly, this will put financial pressure on North American supply chains. But this pressure won't just be felt by businesses. Increases in supply chain costs could be passed on to consumers.

However, exiting NAFTA could give all three countries the opportunity to negotiate bespoke bilateral trade deals with each other. This route might be preferable, as agreeing complex trade deals between two parties is easier than with three.

While the US dollar remains fundamentally strong, we can expect volatility should trade talks hit new difficulty. The Canadian dollar is especially vulnerable to NAFTA difficulties, as the relationship between the US and Canadian governments is strained at this time.

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