THE NEW NAFTA: CAN WE YAWN NOW?

Jeff Weniger – Head of Equity Strategy
10/05/2018

NAFTA is gone, replaced by largely the same agreement with a different name. Talk about tinkering around the edges. The USMCA—a forgettable acronym—stands for the United States-Mexico-Canada Agreement. But an agreement on what? An agreement to keep NAFTA going with a few tweaks. First, the table stakes. Figure 1 shows each nation's respective annual trade with the others, a sum of $1.24 trillion.

Figure 1: Annual North American Exports (in US$ Millions)

U.S. Exports to Canada	U.S. Exports to Mexico	Canada Exports to U.S.	Canada Exports to Mexico	Mexico Exports to United States	Mexico Exports to Canada	Total
$296,030	$258,440	$329,300	$6,260	$339,715	$12,842	$1,242,587

Sources: WisdomTree. U.S. export data by the U.S. Census Bureau through 7/31/18. Other nations' exports by the IMF, through 6/30/18.

Tweaks

One of the big sticking points for Trump was the requirement to increase the percentage of each automobile coming from one of the three nations. The rate will rise from five-eighths of the car to three-quarters under the USMCA. The net effect is that the three countries can "stick it" to China. That is a political winner for all three, so long as auto inflation is tame. Some minimum wages for auto workers were also added, a burden shouldered by Mexico.

Canada was the wild card because Mexico and the U.S. agreed in principle to terms several weeks ago. As we get into the numbers, use U.S. and Canadian GDP of $20.4 trillion and $1.74 trillion, respectively, for context.[1] That gives reason to collectively yawn at the new allowance for 3.5% U.S. market share in the $16 billion to $20 billion Canadian dairy industry. This is a commercial opportunity worth less than $1 billion, frankly.

The much-maligned steel and aluminum export tariffs remain. This too is an afterthought. With steel equal to 1.5% of Canada's export total, and with 91% of it going to the United States, about $4.5 billion worth of Canadian steel will be affected. But as we pointed out in basically every trade-related piece we wrote this past summer, levying a tariff does not make all cross-border trade disappear.[2] Even if the 25% levy causes *half* of Canadian steel exports to the U.S. to completely evaporate, we are talking about $2.25 billion. Also, from a global perspective, presumably most or all of the disappeared Canadian steel would shift someplace else, seemingly the U.S. Again, we are talking about two economies collectively worth about $22 trillion, yet the news cycle is harping on a few billion dollars.

Sensationalism at its finest.

As for aluminum, Trading Economics puts Canadian exports at $9.82 billion in 2017, with 87% headed to the U.S. How much of that $8.54 billion of U.S. sales is going to totally disappear because of a 10% tariff? One billion? Two billion? Add up the dairy, steel and aluminum hit to Canada, and we are talking about numbers that are Big Picture insignificant—for all parties.

Global Trade Peace

With NAFTA seemingly resolved, it is time for the market to move off the tired "global trade war" theme. We suggest "global trade peace," because there looks to be more evidence of that than the former. Yes, Brexit remains front and center until its March 2019 deadline, and we grant this is an obstacle. We will also grant the remaining Sino-U.S. frictions, although anyone who hasn't read "Forget the Trade War, Already: China Is Cutting Taxes" may want to investigate Beijing's massive fiscal stimulus.

In the meantime, the market is glossing over a series of very significant positives on the trade front. First, Japan just inked a new free trade deal with the European Union in August. It is scarcely discussed. Also, keep close watch on improving relations between China and Japan, a breath of fresh air from President Xi Jinping and Prime Minister Shinzo Abe. A partial offset to years of increasingly fraught tensions in the East China Sea is welcome.

Next, of course, there is the massive Belt and Road Initiative (BRI), China's neocolonialist venture to build a multitrillion-dollar land and maritime "Silk Road." Yes, BRI has problems, including its plunking of massive debt on countries like Pakistan and rampant corruption in Malaysia, to name just two. Nevertheless, it is an initiative designed to increasing commercial cooperation between China and upward of not one, not two, but perhaps a hundred nations.

Some "global trade war" this turned out to be.

[1]Sources: Bureau of Economic Analysis for the U.S., Bloomberg for Canada, both as of 6/30/18.

[2]Global Steel Trade Monitor, Steel Exports Report: Canada, September 2018, U.S. Department of Commerce.

IMPORTANT INFORMATION

U.S. investors only: Click here to obtain a WisdomTree ETF prospectus which contains investment objectives, risks, charges, expenses, and other information; read and consider carefully before investing.

There are risks involved with investing, including possible loss of principal. Foreign investing involves currency, political and economic risk. Funds focusing on a single country, sector and/or funds that emphasize investments in smaller companies may experience greater price volatility. Investments in emerging markets, currency, fixed income and alternative investments include additional risks. Please see prospectus for discussion of risks.

Past performance is not indicative of future results. This material contains the opinions of the author, which are subject to change, and should not to be considered or interpreted as a recommendation to participate in any particular trading strategy, or deemed to be an offer or sale of any investment product and it should not be relied on as such. There is no guarantee that any strategies discussed will work under all market conditions. This material represents an assessment of the market environment at a specific time and is not intended to be a forecast of future events or a guarantee of future results. This material should not be relied upon as research or investment advice regarding any security in particular. The user of this information assumes the entire risk of any use made of the information provided herein. Neither WisdomTree nor its affiliates, nor Foreside Fund Services, LLC, or its affiliates provide tax or legal advice. Investors seeking tax or legal advice should consult their tax or legal advisor. Unless expressly stated otherwise the opinions, interpretations or findings expressed herein do not necessarily represent the views of WisdomTree or any of its affiliates.

The MSCI information may only be used for your internal use, may not be reproduced or re-disseminated in any form and may not be used as a basis for or component of any financial instruments or products or indexes. None of the MSCI information is intended to constitute investment advice or a recommendation to make (or refrain from making) any kind of investment decision and may not be relied on as such. Historical data and analysis should not be taken as an indication or guarantee of any future performance analysis, forecast or prediction. The MSCI information is provided on an "as is" basis and the user of this information assumes the entire risk of any use made of this information. MSCI, each of its affiliates and each entity involved in compiling, computing or creating any MSCI information (collectively, the "MSCI Parties") expressly disclaims all warranties. With respect to this information, in no event shall any MSCI Party have any liability for any direct, indirect, special, incidental, punitive, consequential (including loss profits) or any other damages (www.msci.com)

Jonathan Steinberg, Jeremy Schwartz, Rick Harper, Christopher Gannatti, Bradley Krom, Tripp Zimmerman, Michael Barrer, Anita Rausch, Kevin Flanagan, Brendan Loftus, Joseph Tenaglia, Jeff Weniger, Matt Wagner, Alejandro Saltiel, Ryan Krystopowicz, Jianing Wu, and Brian Manby are registered representatives of Foreside Fund Services, LLC.

WisdomTree Funds are distributed by Foreside Fund Services, LLC, in the U.S. only.

You cannot invest directly in an index.

DEFINITIONS

Inflation : Characterized by rising price levels.

Gross domestic product (GDP) : The sum total of all goods and services produced across an economy.

Brexit : an abbreviation of “British exit” that mirrors the term Grexit. It refers to the possibility that Britain will withdraw from the European Unio.