



NAFTA: Perspectives and impact

Renegotiating the North American Free-Trade Agreement (NAFTA) between the US, Canada and Mexico is becoming increasingly problematic as we head into round five in November.

The prospect of ‘no agreement’ and a potential termination of the agreement are moving the radar of investors as the atmospherics around the talks deteriorate.

In our view, terminating NAFTA – driven by US withdrawal – is an increasingly likely scenario over the coming months. However, the innate unpredictability of President Trump leads us to have wide confidence bands around forecasts here.

We see many echoes of the problems between the UK and the EU over Brexit.

Below we outline the key takeaways from each side of the negotiations:

The Canadian perspective

- A number of the demands the Trump administration are making are no goes for both Mexico and Canada: higher US content rules of origin in auto imports, a 5-year sunset clause on the agreement and, in particular, eliminating parts of the dispute resolution mechanism (this echoes the UK’s objections to any involvement of the European Court of Justice in Brexit negotiations).
- The breakdown of the most recent talks (fourth round) and delay in further progress was partly designed by the Canadians and Mexicans to allow more

Market Insight



Mark Bathgate

Portfolio Manager

October/November 2017

time for those negatively affected by NAFTA withdrawal in the US to increase lobbying pressure (this proved effective earlier in the year, but with the Trump administration position so aggressive, hopes for this working similarly are now lower).

- The general view from Ottawa is that the NAFTA renegotiation is primarily focused on preventing the further relocation of manufacturing production to Mexico, and they (Canada) are collateral damage in this process. Recent days have seen US negotiators become more explicit on this point, hence the more strongly worded responses from Canada/Mexico.
- It is unlikely that Canada or Mexico would themselves terminate NAFTA, leaving it to President Trump to take responsibility for ending the agreement.
- It would be an open question whether the pre-existing US/Canada Free Trade Agreement would apply post-NAFTA, or there would be a reversion to WTO terms.

The US perspective

- President Trump has a multi-decade history of consistently criticising US trade deals. Opposition to the current NAFTA agreement was a key focus of his election campaign.



Source: Twitter

- NAFTA is not a priority for Congress – we struggle to see a Republican Congress foregoing tax cuts in an election year (midterms) to save Mexican jobs. The debate over the Budget, tax reform and tax cuts is taking up almost all of Congress’ bandwidth at present (a two-thirds majority in both chambers of Congress would be required to override the President’s authority to cancel the agreement).
- There is scepticism in Washington DC that US domestic lobbying or concerns about populist ‘Chavez 2.0’ being elected in Mexico will be successful in swaying an administration which is very trade/economic focused, broadly excluding other issues. There are varying theories of how Congress could block or delay a termination, but it is unlikely that Congress will prioritise this issue.

The Mexican perspective

- Mexican officials expect NAFTA talks to reach a difficult stage, but are still hopeful that the technical basis for discussion will prevail and there could be a path to a win-win outcome. Having said that, they are making

contingencies for the impasse and a US withdrawal in which there would be a reversion to WTO-based trading.

- The Mexicans believe that their manufacturing competitiveness and locations are enduring advantages under any trade regime, and that the US beneficiaries from NAFTA will increasingly be heard as talks progress. Failing that, the current government proposes enshrining NAFTA investment protection measures in Mexican legislation to safeguard US investment.

Endgame and market impact

- For the time being, we don't think this upsets the positive outlook for US equities/negative view on US rates, but a sense of a more generalised move to implementing – rather than just talking about – protectionist policies in the US could stress global markets.
- The risks to the Mexican peso are for a move back towards the lows of the year – the sharp downward moves of the British pound last year on Brexit concerns are a good roadmap.
- Shorter-term risks for Mexican assets could be amplified by the left-wing populism movement, with the Morena party benefiting from a sense of 'anti-Mexican' actions in the US.
- The medium-term growth impact for Mexico could be negative – but tariffs alone can be offset by relative price adjustments with the FX rate playing the major role. The more problematic near-term aspect is the risk that inward investment dries up in the face of added uncertainty over future trading relationships.
- The impact on Canada is also likely to be negative, but not greater than the Canadian dollar fluctuations around oil price moves have impacted the manufacturing sector. It may well add to the reasons for the Bank of Canada to be cautious on further interest rate hikes and, at the margin, weaken the Canadian dollar.
- EU/Asian governments are watching this situation very closely due to concerns over a broader US approach to the WTO and other multilateral deals.

This document is issued in the United Kingdom (UK) by BlueBay Asset Management LLP (BlueBay), which is authorised and regulated by the UK Financial Conduct Authority (FCA). BlueBay is also registered with the US Securities and Exchange Commission (SEC) and is a member of the National Futures Association (NFA) as authorised by the US Commodity Futures Trading Commission (CFTC). This document may also be issued in the United States by BlueBay Asset Management USA LLC which is registered with the SEC and the NFA. In Japan, by BlueBay Asset Management International Limited which is registered with the Kanto Local Finance Bureau of Ministry of Finance, Japan. In Switzerland, by BlueBay Asset Management AG where the Representative and Paying Agent is BNP Paribas Securities Services, Paris, succursale de Zurich, Selnaustrasse 16, 8002 Zurich, Switzerland. The place of performance is at the registered office of the Representative. The courts of the registered office of the Swiss representative shall have jurisdiction pertaining to claims in connection with the distribution of the Shares in Switzerland. In Germany, BlueBay is operating under a branch passport pursuant to the Alternative Investment Fund Managers Directive (Directive 2011/61/EU). In Australia, BlueBay is exempt from the requirement to hold an Australian financial services licence under the Corporations Act in respect of financial services as it is regulated by the FCA under the laws of the UK which differ from Australian laws. In Canada, BlueBay is not registered under securities laws and is relying on the international dealer exemption under applicable provincial securities legislation, which permit BlueBay to carry out certain specified dealer activities for those Canadian residents that qualify as "a Canadian permitted client", as such term is defined under applicable securities legislation. The registrations and memberships noted should not be interpreted as an endorsement or approval of any of the BlueBay entities identified by the respective licensing or registering authorities.

Unless otherwise stated, all data has been sourced by BlueBay. To the best of BlueBay's knowledge and belief this document is true and accurate at the date hereof. BlueBay makes no express or implied warranties or representations with respect to the information contained in this document and hereby expressly disclaim all warranties of accuracy, completeness or fitness for a particular purpose. The document is intended only for "professional clients" and "eligible counterparties" (as defined by the FCA) or in the US by "accredited investors" (as defined in the Securities Act of 1933) or "qualified purchasers" (as defined in the Investment Company Act of 1940) as applicable and should not be relied upon by any other category of customer. In Hong Kong, the Fund is not authorised by the Securities and Futures Commission for sale to the retail public and this document is only available for professional investors (as defined in the Securities and Futures Ordinance (Cap 571)) only.

This document does not constitute an offer to sell or the solicitation of an offer to purchase any security or investment product in any jurisdiction and is for information purposes only. This document is not available for distribution in any jurisdiction where such distribution would be prohibited and is not aimed at such persons in those jurisdictions. Except where agreed explicitly in writing, BlueBay does not provide investment or other advice and nothing in this document constitutes any advice, nor should be interpreted as such. No BlueBay Fund will be offered, except pursuant and subject to the offering memorandum and subscription materials. This document is for general information only and is not a complete description of an investment in any BlueBay Fund. If there is an inconsistency between this document and the offering materials for the BlueBay Fund, the provisions in the Offering Materials shall prevail.

Past performance is not indicative of future results. The investments discussed may fluctuate in value and investors may not get back the amount invested. You should read the offering materials carefully before investing in any BlueBay fund. Gross performance figures reflect the reinvestment of all dividends and earnings, but do not reflect the deduction of fees and expenses. Net performance figures reflect the reinvestment of all dividends and earnings, and the deduction of fees and expenses. A description of the specific fee structure is contained in the fund's prospectus. The fund return will be reduced by the deduction of the applicable fees.

No part of this document may be reproduced in any manner without the prior written permission of BlueBay. In the United States, this document may be provided by RBC Global Asset Management (U.S.) Inc. ("RBC GAM-US"), an SEC registered investment adviser. In Hong Kong, this document may be provided by RBC Investment Management (Asia) Limited, which is registered with the Securities and Futures Commission. RBC Global Asset Management (RBC GAM) is the asset management division of Royal Bank of Canada (RBC) which includes BlueBay, RBC GAM-US, RBC Investment Management (Asia) Limited and RBC Global Asset Management Inc., which are separate, but affiliated corporate entities. Copyright 2017 © BlueBay, is a wholly-owned subsidiary of RBC and BlueBay may be considered to be related and/or connected to RBC and its other affiliates. ® Registered trademark of RBC. RBC GAM is a trademark of RBC. BlueBay Asset Management LLP, registered office 77 Grosvenor Street, London W1K 3JR, partnership registered in England and Wales number OC370085. All rights reserved.