Canada: Bye bye tariffs, hello USMCA

The United-States-Mexico-Canada agreement was brought back to life last week and progressed relatively quickly as tariffs - namely the US's metal and both Canada and Mexico's retaliation were scrapped, suggesting the scope for ratification by the end of the summer is quite possible

For some time, leaders within the Democrat-led House had signalled that they were not open to discussing the ratification of USMCA unless the Section 232 tariffs on steel and aluminium (25% and 10% respectively) were removed. But talks between the Democrats and Republican administration restarted last week, culminating with the removing of those metal tariffs on Friday 17 May. This, in turn, saw the removal of retaliatory tariffs from Canada and Mexico on US imports.

So is this now the green light for ratification? Possibly, although the main Democrat objections to certain areas of the agreement haven't gone away. For instance, some lawmakers are concerned about the upward impact of USMCA on US drug prices.

> *Passing the deal by the end of summer is ultimately possible*

That said, the removal of the metal tariffs, coupled with recent reports that US Vice President Mike Pence is putting pressure on Congress to pass the deal by the end of the summer, suggests that ratification is ultimately possible.

Until an agreement is formally signed, things could still fall apart

In the meantime though, the risk that things could still derail will continue to cast a shadow over the Canadian economic outlook. Investment spending fell by 2.7% QoQ in the final quarter of 2018, indicating that firms were still holding back. First quarter figures due next week will indicate whether this sentiment persisted into the New Year.

In our view, there are still enough bright spots in the economic outlook to dissuade the Bank of Canada from cutting rates later in the year, despite other dollar-bloc central banks going that way:

1. The robustness of the labour market, amid global trade uncertainties
2. Our trade team expect a US-China trade deal in the third quarter
3. Ratification by the end of the summer appears possible, potentially reducing uncertainty
4. The economy should begin to recover from the late-2018 oil price decline, and while – at the same time, the housing market is likely to emerge out of its current slump (see here), we suspect growth momentum will gradually start to build as we enter the second half of the year

Loonie supported as global trade uncertainty wanes

All of this, combined with our commodity team's view that oil prices should edge slightly higher throughout this year and next, we should see USD/CAD break below 1.30 as we enter 2020 – our FX team believe it could touch 1.26 in around one-years' time.

Read more details about our current FX outlook here

Author

James Smith
Developed Markets Economist, UK
james.smith@ing.com