Mr. PG Has a Sore Lag

When the US gets all cranky about Mexico and China, the little-appreciated, poutine-eating neighbor to its north takes the punishment.

We were latch-key kids before the term was a thing, and we were fairly independent, but not necessary obedient. And truth be told, I don't recall ever locking the door. There was nothing of value to steal from us.

My mother was exhausted that night, returning by bus to our North Vancouver suburban home from her work at a downtown financial business. Earlier, she had assigned chores to my sister and me, but there was a problem -- I didn't do mine. My sister had made dinner, and I had eaten it, meagre as it was, but I refused to do my dishes because – I don't know, TV.

Something logically snapped in my mother's tired mind when she surveyed the mess in the kitchen. She eyeballed my sister, sternly dragged her off to her bedroom and gave her a solid spanking -- my spanking. Sister was indignant. She was 8 years old, just barely sentient enough to sense the injustice of it, but Mom said she got my spanking because she was in charge and failed to deliver appropriate supervision of her obviously innocent younger brother. It still kind of makes me happy to think about that. And of course, my sister will never let me forget it. If I predecease her, it will probably find its way on to my tombstone

And now in the spankingly cranky world of trade, Mexico and China are Donald Trump's supposed naughty children, but Canada – the perennial all-time leading trading partner of America, is the whipping boy. This is nothing new. Once again I borrow heavily here from an excellent and timely piece put out last week by RBC Economics.

Softwood lumber: A shot across the bow?

On April 24, the US slapped 20% average duties on softwood lumber imports from Canada, with fees to be collected retroactively for the past 90 days. The U.S. asserts that the 'stumpage fees' charged to Canadian producers for use of provincial Crown lands are artificially low, and allow Canadian producers to sell their product at below 'fair value' into the U.S. market. The Canadian government contends that this view has been disproved repeatedly by international tribunals since the 1980s.

While softwood lumber accounts for only a small share of Canadian economic activity and exports to the U.S., the shift in tone from our largest trading partner could be a sign of how aggressive the new administration will be in any NAFTA renegotiation. A deterioration in the long-standing bilateral trade relationship could hurt.

Sizing softwood

Softwood lumber accounted for about 5% of total Canadian exports to the U.S. in the early 1990s when NAFTA came into force, but dropped to 1% when the bottom fell out of the U.S. housing market during the 2008/09 recession. Exports gradually recovered to 2% of total exports to the U.S. in 2016. Thus, the impact of these recent tariffs to the broader Canadian economy is likely to be minor nationally. Overall, forestry, logging and wood manufacturing production represents 1% of Canadian GDP.

Of course, the share is larger in British Columbia—where more than half of Canadian softwood exports to the U.S. originate— and the effect is even more pronounced here in the central interior. Softwood exports to the U.S. account for just 2% of B.C.'s overall economy, but there is a reason the City of Prince George's mascot is a bucket-headed log-man, (made of steel). If British Columbia stubs her toe on a softwood trade dispute, Mr. PG breaks his shin just thinking about it. A City of Prince George report from 2015 showed that combined jobs in the city from Forestry, Fishing, Mining, Quarrying, and Oil & Gas was about 7.5% of overall employment.

More worrisome: broader trade implications
The April 24 tariffs on softwood lumber has raised some concern that the new administration will take a more aggressive stance in NAFTA renegotiations. Those concerns were exacerbated by reports that the Trump administration was preparing an executive order to withdraw the U.S. entirely from NAFTA, although the White House moved to play down that possibility.

Which sectors could be at risk?
The motor vehicle sector is a target, but deeply integrated supply chains that run across the border limit the chances that a significant trade disruption will emerge, given the attendant harm on U.S. industrial counterparts.

Dairy trade is another longstanding point of contention in Canadian international trade negotiations, but dairy products account for ~0.1% of Canadian merchandise exports to the U.S. market.

Trump's steam is possibly fueled by the large energy trade surplus that Canada has with the U.S. (C$50 billion in 2016). Targeted import tariffs on Canadian oil output would generate sharply higher gasoline prices for U.S. consumers in the Midwest, where oil supply is more dependent on Canadian production.

Other sectors that are both relatively trade-sensitive and ran a significant trade surplus with the U.S. in 2016 include primary metals, plastic products, chemicals, pharmaceuticals and seafood products.

Canada: on guard
Canadian goods and services exports to the U.S. have more than doubled in size since NAFTA's inception in 1994. Businesses have benefitted from lower tariffs, greater clarity on trade rules and lower technical barriers to trade, making the outright dissolution of NAFTA a trilaterally bad proposition. The softwood lumber development may have been a shot across the bow – a breath of threatening air from the south.

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