Capital Insights

Lorne Gavsie, SVP, Head of Macroeconomic & FX Strategy
Neil Shankar, Economist

NAVIGATING THE U.S. TRADE WAR
Liberation Day Takeaways

April 3, 2025

What Happened and What's Next?

The U.S. administration announced broad reciprocal tariffs targeting imports from nearly all U.S. trading partners. The tariffs will be implemented under the International Emergency Economic Powers Act (IEEPA) of 1997, declaring the U.S.'s persistent trade deficit as a national emergency.

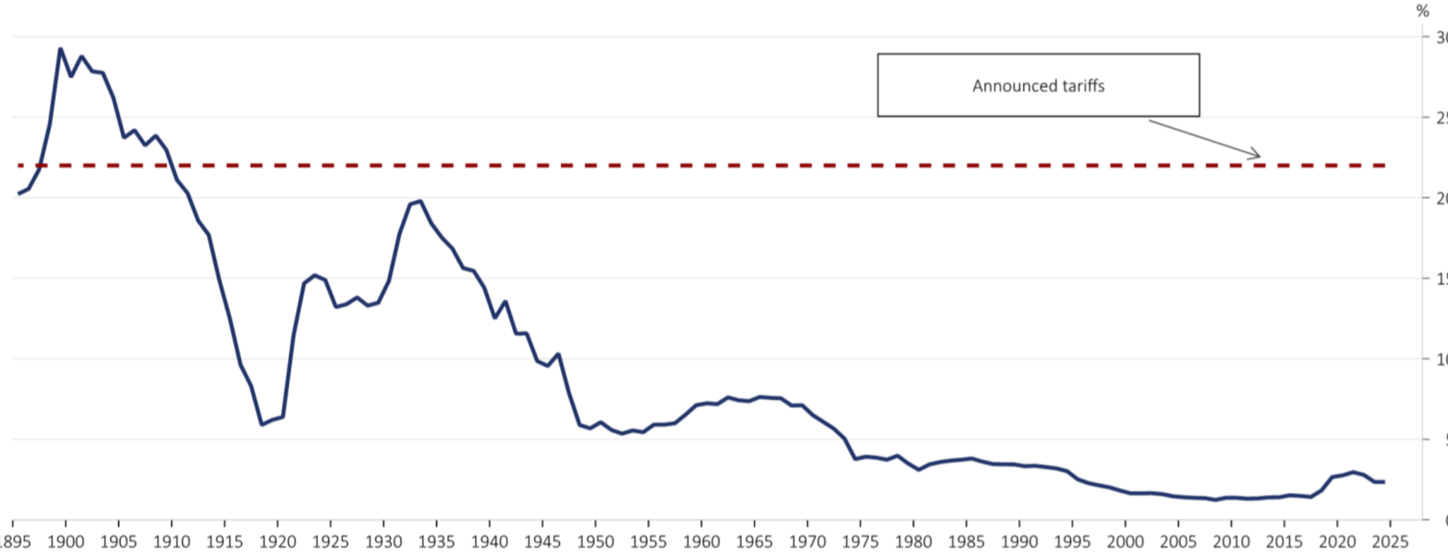
Starting April 5, a 10% baseline tariff will be applied to all U.S. imports. Higher country specific reciprocal tariffs will take effect on April 9, targeting countries with which the U.S. has a large trade deficit. These include China (54% tariff, combining a 34% increase with the 20% tariff imposed earlier in the year), the European Union (20%), Vietnam (46%), among others.

Notably, Canada and Mexico are exempt from both reciprocal tariffs and the 10% baseline tariff as both nations will continue to pay tariffs under the IEEPA order related to border security. As per the executive order, this equates to 25% tariffs on all non-USMCA compliant exports.

In 2024, only 38% of Canadian exports claimed the "USMCA rate provision" although it's estimated that ~90% of Canadian exports are eligible. Canada would also continue to be subject to steel and aluminum tariffs that have been in place since March 12 as well as auto tariffs, effective today.

Our estimates suggest this announcement increases the US's average tariff rate to above 20%, a level not seen since the early 1900's (See Exhibit 1).

Exhibit 1: U.S. Average Tariff Rate



Source: United States International Trade Commission, CIGAM, Macrobond
As of January 8, 2025

The situation remains fluid, with trade policy developments expected to continue to evolve in the coming weeks and months. President Trump indicated that tariff rates could be reduced if other countries lower trade barriers on U.S. exports. That said, there is also still room for further escalation. The executive order states that retaliation by U.S. trading partners could result in even higher U.S. tariffs.

Assessing the Economic Impact

United States

While there is now greater clarity on the depth and breadth of the U.S. administration's tariff policy, the big unknown – and arguably the most important factor – remains the duration for which these tariffs will remain in place.

The broad tariffs introduce meaningful risks for the global economy, creating uncertainty around growth, business investment, and market stability. Tariffs increase costs, disrupt supply chains, and force businesses to adapt in ways that could reshape trade and production patterns.

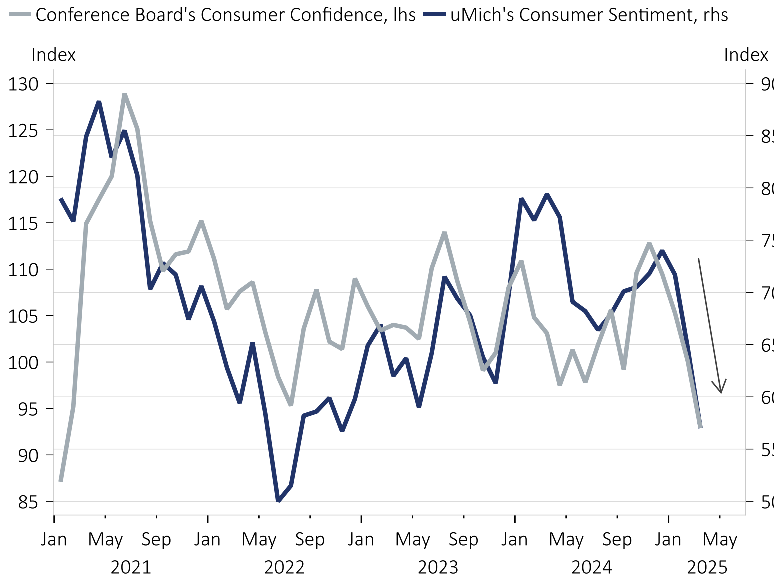
U.S. consumer sentiment has already deteriorated on the back of elevated trade policy uncertainty (see Exhibit 2), and spending is tracking below 1.0% QoQ annualized for Q1 following the roughly 4.0% pace of growth in the second half of 2024.

Tariffs announced this week will only exacerbate headwinds for the U.S. consumer. Indeed, the immediate economic impact of these tariffs are expected to be significant as higher prices for consumers become a reality. A pickup in inflation could lead to negative real income growth in the coming quarters and further weigh on consumption.

Imports have also surged in recent months as firms attempt to front run the implementation of tariffs (see Exhibit 3). This is also expected to weigh on Q1 GDP growth and could have long-lasting effects as businesses may not need to restock inventories for several months.

Other countries may also begin to retaliate against the U.S., which would hurt exporters and place additional strain on economic growth in the months ahead.

Exhibit 2: U.S. Consumer Confidence and Sentiment Indices



Source: University of Michigan, Conference Board, Macrobond
As of March 28, 2025

Exhibit 3: U.S. Goods Imports

Source: U.S. Bureau of Economic Analysis (BEA), Macrobond
As of March 6, 2025

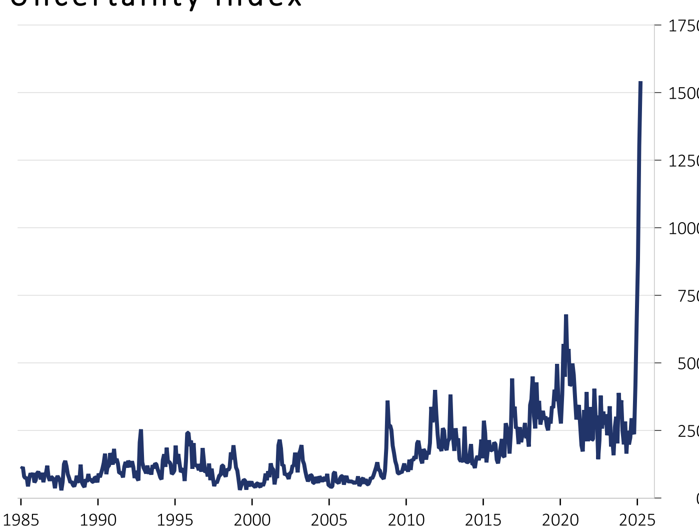
Canada

An economic slowdown in the U.S. poses challenges for Canada, which remains highly dependent on U.S. economic performance despite the announced tariffs. While Liberation Day was better than feared for Canada, the extreme uncertainty (see Exhibit 4) over the past four months has weighed on both business and consumer sentiment in Canada. We expect Canadian business investment will remain depressed over the medium term with the Bank of Canada's recent survey of businesses revealing nearly 50% of respondents are decreasing capital expenditures in response to uncertainty from tariffs (see Exhibit 5). This uncertainty is likely to prevail until the USMCA trade agreement is renegotiated. The first review of the agreement is scheduled for July 2026 but may be moved earlier.

In contrast to the U.S., that has seen a surge in imports, Canadian exports have spiked in Q1 leading to a significant increase in the trade surplus with the U.S. (see Exhibit 6). While this will support real GDP growth in Q1, it will act as a headwind to growth in Q2 and beyond given the expected pull-back in exports.

As such, the Canadian economy is in for a considerable slowdown entering Q2 with certain sectors bearing the brunt of the pain. Although fiscal support will lessen the impact, it is unlikely to prevent near-term economic stagnation as the labour market absorbs the policy shock.

Exhibit 4: Canada Economic Policy Uncertainty Index



Source: , Bloomberg
As of March 31, 2025

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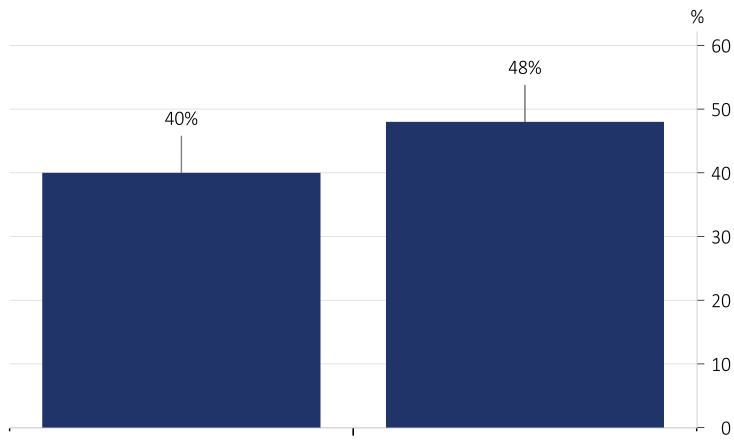
While further interest rate cuts may be forthcoming, the Bank of Canada has indicated that monetary policy cannot offset the impacts of a trade war suggesting the response will not mirror the pandemic experience. This is particularly true given the upward pressure on inflation from higher costs stemming from retaliatory tariffs.

Exhibit 5: % of Canadian Businesses Decreasing Employment/Capex

In response to uncertainty from rising tariffs



Source: Bank of Canada, Macrobond
As of March 12, 2025

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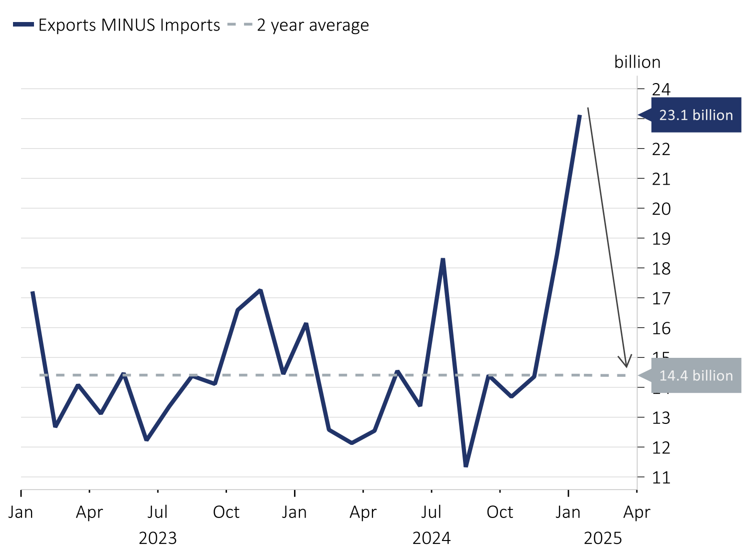
Exhibit 6: Canada/U.S. Trade Balance



Source: Statistics Canada, Macrobond
As of March 6, 2025

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Investment Implications: Managing Risk While Identifying Opportunities

For investors, trade policy uncertainty and market volatility will remain high, requiring disciplined risk management. Sectors most exposed to U.S. tariffs - particularly manufacturing and export-driven industries - face heightened risks.

That said, not all businesses will be negatively impacted. Some firms may find ways to adapt supply chains, develop alternative markets, or take advantage of government incentives aimed at maintaining domestic production.

Navigating this environment requires a measured, long-term approach. While risks are front and center, economic and market adjustments will create pockets of opportunity as businesses reposition.

The coming months will be critical in determining whether tariffs remain in place, escalate, or de-escalate. Our approach remains focused on protecting capital while identifying areas of strength amid volatility, ensuring portfolios are well-positioned for an uncertain but evolving trade landscape.

For more information, please visit ci.com.

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