# Trump Tariffs and Retaliation


The Tariffs and Retaliation will upend trading relationships and will likely result in a new trade agreement with the US. President Trump has long advocated using excess influence to negotiate better deals. The Canadian economy is heavily dependent on the US economy and government policy. Trump used tariffs in 2018 as part of his strategy to negotiate the USMCA agreement. A new agreement is the likely outcome, but Canadians will need to examine their spending decisions and government policies to adapt to a changing relationship with the US, to encourage greater trading alternatives and to encourage greater productivity.

**US actions**

On Saturday, US President Trump declared a "National Emergency", imposing 25% tariffs on February 4 on all products and services, except only a 10% tariff on energy, coming from Canada into the United States. The US is also imposing a 25% tariff on all products and services coming from Mexico and an additional 10% on Chinese goods and services. In addition, President Trump's order included a provision to increase the tariffs if Canada, Mexico or China impose retaliatory tariffs. The tariffs violate the 2017 USMCA trade agreement which was negotiated by President Trump.

**Canadian response**

Prime Minister Trudeau has announced reciprocal 25% tariffs starting on February 4 on $155 billion worth of US products coming into Canada, and most Provincial Premiers have announced the removal of US alcohol and spirits from liquor stores and restaurants. The Canadian tariffs will start on February 4 on $30 billion worth of goods, and after 21 days - an additional $125 billion to allow business and individuals time to prepare and find alternative sources. Canadian governments have indicated that they will be announcing supports for Canadian workers and businesses.

**Questionable US reasons stated for tariffs, facts don't matter**

US President Trump provided the following reasons for the imposition of tariffs:

1. The importation of drugs, primarily fentanyl, and smuggling of illegal immigrants into the United States. **Less than 1% of fentanyl and illegal immigration into the US can be traced to Canada.** The US is demanding that Canada and Mexico fund the US border security. Canada has already announced additional spending of $1.3 billion over 10 years.
2. The United States has a trade deficit with Canada, Mexico and China. President Trump incorrectly calls deficits a subsidy. **Excluding US imports of Canadian oil and gas, the US has a trade surplus with Canada.**

**Trump trolling on Canada becoming the 51st state, "Don't take the bait"**

Trump has used incendiary statements to attempt to gain leverage or undermine people in his negotiations. Trolling about statehood is a distraction from how Canadians should react and conduct negotiations. The Canadian response needs to be forceful but focused.

**More likely reasons for Trump tariffs:**

1. **Renegotiate trade relationships:** President Trump has repeatedly indicated that products being sold in the US should be made in the US to increase the number of **American jobs**. The decline is American factory jobs has been a long-standing complaint against free trade. Free trade has been a philosophy that American governments had advocated since World War II, but Trump is changing this policy to extract greater trade advantages for American government finances and jobs.
2. **Tax cut plans:** President Trump intends to pass an extension of his 2017 income tax cuts and additional corporate and income tax cuts. To pass the tax cuts, Trump will need to show off-setting revenues from other sources. President Trump has argued the tariffs will provide additional government revenues and falsely said that the tariffs are paid by other countries. Trump will need to be able to present tariff revenue projections within the next six months for that budget proposal.

**Implications of tariffs**

US and Canadian Free Trade started with the 1988 Free Trade Agreement and eventually culminated in the 1994 NAFTA Agreement and its update, the 2018 USMCA Agreement which was negotiated by President Trump. The sudden imposition of tariffs and restrictions will undermine the integrated trade relationship that governments and businesses relied upon in forming their long-term strategies. The tariffs will likely result in:

1. **Higher costs for most goods and services**. Companies will look to source goods and services that are not affected by tariffs, but the cost may be higher, or they may not be able to find alternatives. Any additional costs will likely be passed onto their customers wherever possible. Most products and services have inputs that will be affected by the tariffs. Even President Trump has now conceded that individuals will pay higher costs.

2. **Likely job losses**. Many Canadian jobs, specifically in the automotive sector, are directly or indirectly reliant on cross-border trade. Companies will have to decide whether they will need to reduce their growth and spending plans, reduce their workforce, find alternative suppliers for their inputs and new markets to sell their goods and services, and possibly move their production to the US.
3. **Probable recession**. The tariffs will likely result in a decline in the Gross Domestic Product. Preliminary estimates would be for an immediate 2% slowdown in 2025.
4. **Higher government deficits.** The federal and provincial government revenues will decline as corporate profits and individual incomes will come under downward pressure and governments will increase spending as it provides additional support to businesses and individuals.
5. **Interest rates.** The Bank of Canada just lowered interest rates again and indicated its intent was to continue to lower rates as inflation has fallen to 1.8%. The Governor indicated that tariffs would result in re-evaluating their policy. The Bank may reduce the rate further but may be limited by higher inflation rates.
6. **Decline in the Canadian dollar.** The Loonie has already seen a decline to below 69 cents to the US dollar and will likely come under additional pressure as currency traders will be influenced by the slowing growth and higher deficits in Canada and seeking a safe refuge from volatility in the US dollar. The lower dollar will increase the cost of imports, specifically from the US, including fruits and vegetables.

**Possible government actions**

1. **Government support:** The federal and provincial governments have indicated that they will provide financial support to businesses and individuals. While the details have not been announced, the supports during the COVID-19 Pandemic and the 2008-9 Financial Crises have been cited as a guideline for what can be expected. Some have questioned how much support is possible given the current government levels.

2. **Regulation and taxes:** Current policies will need to be re-examined to encourage greater productivity while providing financial supports to businesses and individuals and maintaining manageable deficits.
3. **Less reliance on the US for trade:** Since 1988, the free trade agreements have resulted in greater integration and exposure to the US economy and government policies. Canadian governments and businesses will need to increase international trading opportunities. Specifically, the Canada's excessive export of oil supplies to the US should be diversified with greater trade in Canada and to overseas customers.
4. **Free trade inside Canada:** Long-standing trade barriers between Canadian provinces must be reviewed and reduced to allow greater free trade inside the country. A 2024 study estimated that liberalization of interprovincial trade could increase our GDP per capita by 4 percent as trade barriers between 7.8% and 14.5% to the price of goods and services. (https://smith.queensu.ca/insight/content/Chipping-Away-at-Canadas-Internal.php)

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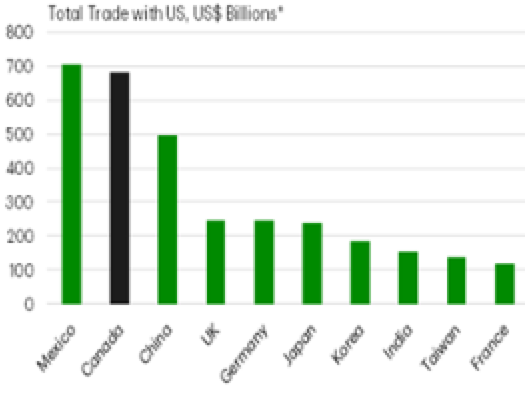
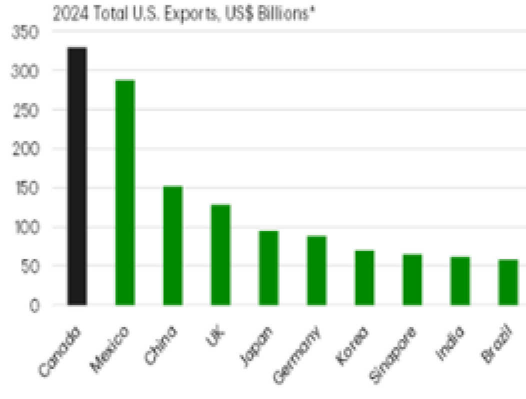
**Chart 1: Canada is the Second Largest Trading Partner to the U.S.**



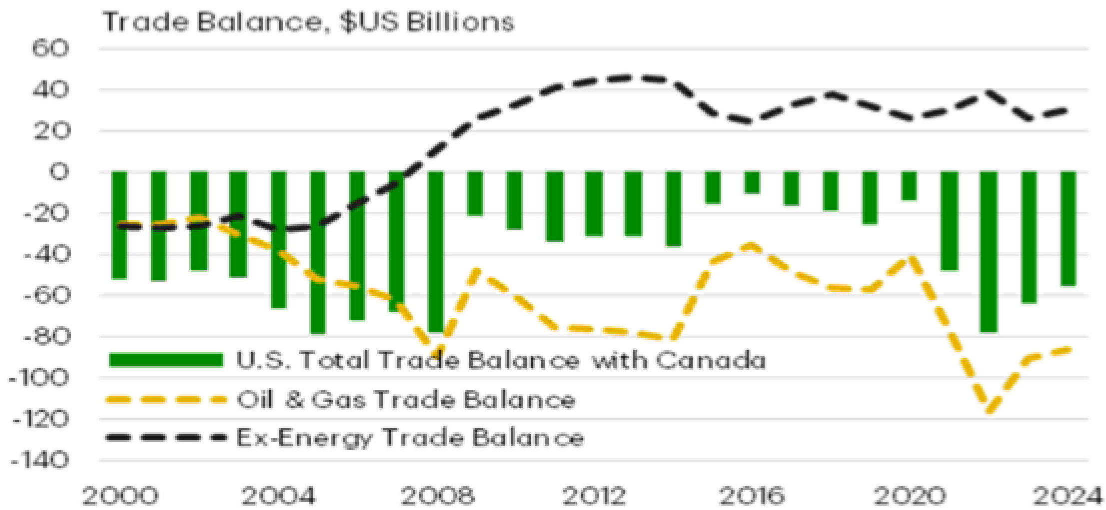

*Through January-September 2024. Source: Census Bureau, TD Economics.

**Chart 2: Canada Remains the Most Important Hub for U.S. Exports**




*Through January-September 2024. Source: Census Bureau, TD Economics.

**Chart 7: The U.S. Runs a Consistent Surplus With Canada If Not For Energy Trade**




Source: Census Bureau, TD Economics.