Navigating the impacts of the new U.S. tariffs on Canada

What has happened?

On February 3, Canada announced a postponement of newly proposed U.S. tariffs against Canada. The initial plan included a 25**%** tariff on all imports from Canada, except for energy products, which were subject to a 10% tariff, originally set to take effect on Tuesday, February 4. Ottawa, in response to the pause, has withheld its previously planned countering tariffs, which would have targeted CAD 30bn worth of U.S. goods starting on the same day, with an additional CAD 125bn worth of U.S. goods subject to tariffs for three weeks later.

This significant shift in trade policy could have far-reaching effects across industries, consumers, and workers throughout North America. However, the situation remains highly fluid, and its duration is uncertain. The pause could signal an effort to open further negotiations on key aspects of the United States-Mexico-Canada Agreement (USMCA) or could evolve into prolonged trade measures. For now, the general market sentiment reflects skepticism that these tariffs will remain in effect over the long term.

Immediate market reactions

The markets reacted swiftly to the U.S. administration's initial announcement:

- The S&P 500 Index fell by 76 bps
- The S&P/TSX Composite Index declined by 14 basis points
- Canadian 10-year bond yields dropped by 11 basis points
- The Canadian dollar weakened to 1.46 against the U.S. dollar

These movements underscore the uncertainty surrounding the potential impact of tariffs, and the initial market reaction reflects a belief that this is more likely part of a temporary negotiating strategy.

Economic and market implications

The potential economic effects of tariffs will largely depend on their duration and whether they escalate beyond the initially proposed measures. Below we detail key considerations.

Short-term impacts

A weaker Canadian dollar could buffer the immediate price impact of higher tariffs on Canadian exports to the U.S., potentially reducing the expected drop in demand for Canadian goods. However, it would amplify the cost increase for Americans importing from Canada.

Long-term risks

If the tariffs remain in place for an extended period, recessionary risks in Canada rise significantly due to slowed economic growth, inflation re-acceleration, and a deeper depreciation of the Loonie.

Corporate earnings could come under pressure, as some analysts have not yet fully incorporated the potential impacts of tariffs into their forecasts. This could lead to significant downward revisions, particularly in sensitive sectors like automotive and consumer goods.

The Bank of Canada (BoC) will likely monitor these developments closely. Depending on the evolution of tariffs, it may pursue rate cuts or maintain dovish policies to address employment and inflation trends. Under prolonged tariffs, the BoC may have more latitude to lower rates given weakening demand and heightened risks to Canada's economic growth.

We have considered three potential scenarios based on how the situation could evolve over the coming months:

	Bear case – 25% tariff to remain	Base case – 25% tariff to remain, but only temporarily, not for the full year of 2025, then USMCA renegotiated by yearend	Bull case – 25% tariff lifted, USMCA to be negotiated in 2026 as scheduled
GDP growth	Significantly negative – recessionary with more than 2.5% hit to GDP	Slightly negative – moderately recessionary but less than 2.5% hit to GDP	Unaffected – back to Canada's trajectory of moderate growth of just under 2%
Corporate earnings	Analysts to cut earnings growth expectations significantly for 2025 and 2026	Analysts to cut earnings forecast in 2025 and 2026, but not as severe as the bear case	Earnings to continue with current growth projections in both 2025 and 2026
TSX P/E multiple by YE2025	Valuations compress to recessionary levels to 13x forward	Multiples remain flat at current level	Valuation multiple expands slightly
2025 YE TSX returns	-20%	Flat	+16%
Canadian dollar	Significant CAD depreciation (15-25%)	Moderate CAD depreciation – likely breakthrough C$1.50	Steady CAD with some appreciation from current extreme levels
Rates	BoC have room to turn very dovish, but will depend on inflation trend	BoC have room to continue with 2 rate cuts	BoC have room to continue with 2 rate cuts
Inflation	One-time bump upward on inflation in the near term, more moderate upward impact on inflation in the medium term	Minimal impact if tariff lifted in the near term, but one-time bump upward on inflation in the medium term	No impact - Stay at current level
Bond yields	Bullish for bonds - Canadian yields to fall due to lower rates and higher risk-off demand	Bullish for bonds - Canadian yields to fall due to lower rates and higher risk-off demand	No impact - Stay at current level

Investor takeaways

Periods of economic uncertainty often prompt concerns, but this climate also reinforces the importance of maintaining a long-term perspective and diversified portfolios.

- **Diversify globally**: foreign equities can provide support as Canadian dollar weakness translates into higher values for foreign investments.
- **Use fixed income strategically**: bonds can offer downside protection and stability when equities face broad declines, as seen with demand for Canadian bonds amid recent tariff fears.
- **Leverage sector diversification**: a balanced portfolio spanning multiple industries can buffer the negative impacts of tariffs on isolated sectors. For example: **energy and materials** are inherently less affected by trade tensions; companies with **strong competitive moats** may better pass on rising costs and protect profit margins under inflationary conditions.
- **Adapt portfolio for volatility:** focus on companies with resilient supply chains that can maintain operational stability and profitability despite higher trade costs.