Tariffs Unpacked:
Canadian Credit Market Analysis

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On March 3, 2025, the U.S. implemented significant tariffs on Canada, Mexico, and China. Here we synthesize the tariff package, expected economic impacts, and how we expect Canadian credit will perform. While we bake the worst case scenario into this paper, our base case is more optimistic. The length of time each measure is implemented remains in question. Markets are expecting that tariffs will have a relatively short to medium term life. If that is true and when some of the current market uncertainty is eliminated, healthy corporate fundamentals underlying the investment grade credit universe should shine through.

Overview of the Tariff Measures and Impacted Sectors

The tariffs target essentially all Canadian exports to the U.S. with a 25% tax, exempting only certain energy products which will be initially taxed at 10%. This package encompasses hundreds of billions of dollars of goods, from industrial components to consumer products. Canada's economy is deeply intertwined with the U.S.: exports to the U.S. equal roughly 21% of Canadian GDP. The impacted sectors are therefore broad:

- **Automotive and Manufacturing** – Vehicles, auto parts, industrial machinery, electronics, and other manufactured goods form a huge share of Canada's exports. Together, Canada and Mexico supply over half of U.S. auto parts imports, so a 25% tariff risks snarling North American automotive supply chains.
- **Energy and Natural Resources** – Canada is a major supplier of oil, gas, and minerals to the U.S., providing ~60% of U.S. crude oil imports. While oil exports face a lower 10% tariff, there is a full 25% duty on lumber, uranium, nickel, potash, steel and aluminum.
- **Agriculture and Food** – Key farm and food products (beef, pork, grain, processed foods, etc.) moving across the border would become 25% more expensive. Canada and the U.S. are each other's top agricultural markets, so farmers on both sides could lose access to markets or face lower prices.
- **Consumer Goods and Other Sectors** – Virtually all other goods – from chemicals and plastics to textiles and consumer appliances – are tagged by a tariff. Even services and travel may feel indirect effects if higher prices and strained relations dampen tourism or cross-border business activity.

Canadian officials warn that these tariffs will disrupt integrated supply chains and raise costs for consumers. In Canada, exporters will struggle to absorb a 25% price disadvantage; many will be forced to cut production, lay off workers, or seek alternative markets. Overall, the tariff shock is poised to hit every major sector of Canada's economy in the coming year, with especially acute pain in manufacturing and resource-dependent industries.

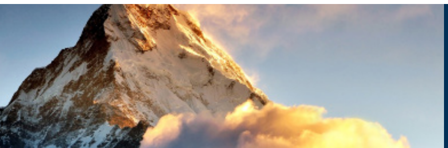
Macroeconomic Impact Outlook

Economic models and forecasts predict a significant macroeconomic tariff-driven slowdown in Canada.

GDP and Growth: Multiple analyses show Canadian output contracting as trade flows shrink. The Peterson Institute estimates a 25% tariff regime would reduce Canada's GDP by about 1.2% over five years, while a Brookings Institution model finds a short-term export decline of ~9% for Canada (rising to 19% if Canada retaliates). BMO Economics projects that tariffs could shave approximately 1 percentage point off Canada's GDP growth in 2025, putting annual growth near 1% (down from a 2% baseline) and raising the risk of a recession by mid-2025. CIBC's economists similarly estimate that sustained 25% tariffs (with a 10% energy levy) could ultimately slash the level of Canadian GDP by about 5% versus its pre-tariff trend– a downturn comparable to the 2008–09 financial crisis in severity.

Importantly, more modest scenarios of lower tariffs or shorter in-force time-frames duration would have smaller, though still material, impacts.

Employment: With reduced output and trade, Canada would see sizable job losses over the next year. Brookings simulations indicate a 1.3% drop in Canadian employment under the 25% U.S. tariff alone (~278,000 jobs), expanding to a 2.5% employment decline (over 500,000 jobs lost) if Canada retaliates in kind. CIBC forecasts a similar outcome – their range of scenarios shows 150,000 to 350,000 fewer jobs countrywide than otherwise, depending on the tariff's severity. This would push Canada's unemployment rate roughly 0.5 to 1 percentage point higher than it would be absent the trade war. Layoffs should initially hit export-focused industries, then ripple through domestic sectors as those workers cut spending and as business confidence erodes. In the United States, by comparison, job losses in percentage terms are projected to be much smaller (on the order of 0.1–0.2% of employment), underscoring how Canada's economy – being smaller and more trade-dependent – is far more vulnerable to this shock.



Inflation and Consumer Prices: The tariff impact on prices will be complex, with distinct phases. Initially, prices in Canada are likely to spike for certain goods – the sudden 25% import tax acts like a sales tax on U.S. products. A weaker loonie makes imports pricier, adding to inflation in the short run. Canadian consumers could see higher costs for U.S.-made food items, household goods, and gasoline, while Canadian exporters might also raise domestic prices if they divert products from the U.S. market. However, any inflation burst is expected to be temporary. As the economy slows and demand weakens, the disinflationary effects of a potential recession would dominate.

Analysts predict that after an initial bump possibly pushing inflation toward the upper end of the Bank of Canada's 1–3% target band, price growth will cool off and could even dip below 2% by 2026 if slack persists. The Bank of Canada and central bankers are likely to "look past" the one-time price jump and focus on the growing output gap. In essence, recession fears trump inflation fears – any upward price pressure from tariffs is outweighed by the broader deflationary impulse of lost trade and income.

Policy Responses: Canadian policymakers are not standing idle. The Bank of Canada has already shifted to an easing stance in anticipation of weaker growth – it delivered a rate cut in January, continuing a string of reductions that brought the policy rate down from 5% to 3%. Further cuts are expected, potentially lowering the rate to ~2.25% by mid-2025. Lower interest rates and potential liquidity injections (the BoC has signaled readiness to resume asset purchases if needed) should support domestic credit and soften the blow.

On the fiscal side, the Canadian federal government and provinces are preparing stimulus measures and assistance for affected industries. Nevertheless, these responses can only partially cushion the impact. No amount of monetary or fiscal stimulus can fully offset the loss of export revenue and efficiency when trade flows are upended. The Canadian economy's "speed limit" for growth could be permanently lower if a protracted tariff regime forces a reallocation away from high-productivity export sectors. In summary, the macroeconomic outlook under Trump's tariffs is one of slower growth (even recession risk), higher unemployment, and a brief inflation uptick followed by easing price pressures – with policy levers engaged to mitigate, but not erase, these adverse effects.

Sector-by-Sector Impacts

The pain of a 25% tariff will not be evenly distributed – some industries face severe disruptions while others are less directly exposed. Below is an analysis of how key sectors of the Canadian economy are likely to fare in the next year under the tariff regime:

Automotive and Manufacturing: The integrated auto industry is arguably the most vulnerable. Canada's automotive sector – including assembly of vehicles and production of auto parts – is deeply entwined with U.S. manufacturers through just-in-time supply chains.

A 25% tariff on Canadian autos/parts effectively prices Canadian-made cars out of the U.S. market and disrupt production networks. Analysts predict automotive exports could plunge by over 50% initially. In fact, one model finds Canadian motor vehicle exports to the U.S. drop 53% under the tariff (and nearly 70% if reciprocal tariffs are in play).

Such a sudden collapse would reverberate through Ontario's economy, where many of these plants are located. Automakers would be forced to idle factories due to lost U.S. sales and costly imported components – Trudeau warned the tariffs could "shut down auto assembly plants" in both countries.

Beyond autos, a wide range of manufactured goods will face hardship, from industrial machinery and equipment to consumer appliances and electronics. Brookings highlights that exports of electrical and electronic equipment could shrink by ~70–80% in volume, a staggering contraction, and "other transport" equipment (including aerospace) could see a similar ~70% drop.

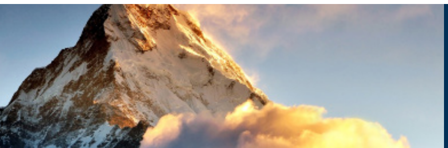
Manufacturing industries are highly interconnected, so the shock to one segment (like auto) also hits parts suppliers, metal fabricators, plastics and rubber manufacturers, etc. The entire manufacturing sector is expected to contract, with some factories relocating production to the U.S. to avoid tariffs. Notably, the Trump tariffs undermine the spirit of USMCA (the NAFTA replacement) – sectors that thrived under free trade, like autos, are suddenly thrown into chaos. Over the next year, we can expect layoffs, deferred investment, and potentially some permanent plant closures in Canadian manufacturing if the tariff war persists.

Ontario and Québec, the industrial heartland of Canada, would shoulder the bulk of these losses (an estimated 80% of the total economic hit would concentrate in those two provinces).

There are a few mitigating factors. The U.S. may carve out exemptions for certain critical inputs – for example, if specific auto parts are irreplaceable or if tariffs threaten too much disruption for U.S. companies, waivers might be granted. Additionally, the lower Canadian dollar provides a slight offset for exporters (making Canadian-made goods cheaper in foreign markets by some margin). But these are marginal reliefs. In the first year, Canadian manufacturing output is set to decline sharply, undoing years of growth. Some sectors with less U.S. exposure (e.g. beverage manufacturing or printing/publishing, which rely more on domestic demand) will fare better, but key export-oriented manufacturers (vehicles, metals, machinery, wood products) face double-digit or worse percentage declines in output.

Energy and Natural Resources: Natural resources are another cornerstone of Canada's economy, and here the tariff impact is mixed.

Recognizing the mutual dependence in energy trade, the U.S. initially set a lower 10% tariff on Canadian oil (vs 25% on most other goods). The U.S. relies on Canadian heavy crude for its refineries – Canada's energy exports to the U.S. were CAD $173 billion in the last year (nearly one-third of total goods exports, and ~6% of Canada's GDP). A full 25% tariff on oil would raise U.S. refiners' costs and likely translate into higher gasoline prices for American consumers, which is politically sensitive. Thus, energy was given somewhat gentler treatment. Even so, a 10% oil tariff squeezes Canadian producers' profit margins and could widen the price discount ("differential") on Canadian heavy crude.



Over the next year, Canadian oil exporters might have to reroute some supply to other markets at lower prices or cut production if storage builds up. The outlook for natural gas and electricity (which flow freely across the border) is uncertain – if new tariffs or restrictions hit those, regions like Alberta and Quebec would suffer further.

Services and Other Sectors: Services (finance, tech, tourism, etc.) are not directly subject to tariffs, but they won't emerge unscathed.

Transportation and logistics firms will see reduced activity as goods trade contracts – fewer trucks crossing the border, less rail and shipping demand. The ***retail sector*** in Canada might see shifts as well – Canadian consumers could substitute away from now-pricier imported U.S. goods, potentially buying more domestic products (if available) or paying higher prices. Retailers will need to manage inventory and supply chains carefully to navigate the tariffs, possibly finding new suppliers outside the U.S. for certain products.

Financial services and real estate may feel second-order effects from the broader economic slowdown. Banks could see a slight uptick in loan delinquencies if businesses in affected sectors struggle or if unemployment rises. The housing market might cool if consumer confidence falters, although lower interest rates from the Bank of Canada could prop it up.

One bright spot could be sectors oriented to domestic demand (local utilities) which might be insulated from trade issues and even see increased government spending. Additionally, if Canada redirects trade toward other partners (Europe, Asia) over time, some service providers in logistics, trade finance, and consultancy could find new opportunities assisting that diversification. But such adjustments won't happen overnight. For the next 12 months, the dominant narrative across sectors is one of disruption and adjustment, as Canada's economy absorbs the largest trade policy shock in decades.

Historical Context: Lessons from Past Tariff Shocks

Canada has weathered trade conflicts with the U.S. before, albeit not on this sweeping scale. Historical episodes provide important context and cautionary lessons:

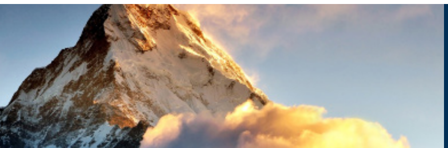
- **2018–2019 Trade Dispute**: During Trump's first term, the U.S. imposed tariffs of 25% on Canadian steel and 10% on aluminum (under national security pretexts), alongside threats of auto tariffs during NAFTA renegotiations. Canada retaliated with duties on U.S. goods. The immediate impact of those tariffs was modest at the macro level – the Bank of Canada estimated that by end-2021 the tariffs (largely U.S.–China, with more limited Canada–U.S. measures) would reduce global GDP by only about 0.6%. However, certain industries were hit hard. Canadian steel exporters saw orders drop and prices fall until the tariffs were lifted in mid-2019, and some faced layoffs or reduced shifts. The episode underscored the importance of supply chain agility: many firms learned to diversify suppliers and stockpile inventory to manage tariff risk . all goods), meaning the damage could be far greater if not resolved quickly.

  It also demonstrated the value of negotiated resolution – the signing of USMCA in late 2018 helped defuse tension, and the U.S. eventually lifted the metal tariffs, restoring tariff-free access by 2019. The current 25% tariff proposal, by contrast, is much broader (affecting all goods), meaning the damage could be far greater if not resolved quickly.

- **Ongoing U.S.–Canada Trade Spats:** Even before Trump, there have been perennial disputes (softer skirmishes) – for example, the softwood lumber wars that date back to the 1980s. The U.S. periodically slaps duties on Canadian lumber, accusing Canada of unfair subsidies. Canada retaliates or litigates under trade agreements. The impact is painful for lumber producers and forestry communities, but the scope is limited to one sector. Similarly, Canada has faced U.S. tariffs on products like potash (fertilizer) and newsprint in years past. These cases usually affected a narrow slice of the economy and were often resolved via World Trade Organization or bilateral settlements. They taught Canadian exporters to be resilient and legally proactive, but they did not cause economy-wide reverberations. A 25% across-the-board tariff is a different magnitude – truly a trade war scenario rather than a sectoral dispute.

- **Great Depression – Smoot-Hawley Tariffs (1930):** The last time broad U.S. tariffs hit most imports (though not targeting Canada specifically) was the infamous Smoot-Hawley Act, which raised U.S. tariffs on thousands of goods in 1930. Canada was actually the first country to retaliate back then, slapping surtaxes on U.S. goods within months. The result was a drastic drop in U.S.-Canada trade – by some estimates, bilateral trade value fell by over 50% in just a few years as the Depression deepened. Canadian exports plummeted and the economy contracted severely. This historical parallel illustrates that tit-for-tat protectionism can be devastating: global trade volumes collapsed in the early 1930s, exacerbating the Depression on both sides of the border. While today's economies and safeguards (like international trade rules and central bank interventions) are more advanced, the fundamental lesson remains that large-scale tariffs tend to be lose-lose. They undermine growth and employment in all countries involved. The Brookings analysis of Trump's tariffs echoes this, noting all three economies (U.S., Canada, Mexico) will incur job losses and higher consumer prices, with no clear winners.

- **1971 Nixon Shock (Import Surcharge):** A more analogous precedent to today was in 1971 when President Nixon unexpectedly imposed a temporary 10% surcharge on all imports to protect the U.S. dollar. Canada, which at that time depended on the U.S. for the majority of its trade (similar to today), was jolted.



In response, Canada let its currency float (ending a fixed exchange rate) and accelerated efforts to diversify trade partners (eventually negotiating freer trade with Europe and Japan). The surcharge was lifted after a few months once currencies realigned, limiting long-term damage. But it spurred Canada to reduce its vulnerability to U.S. trade measures.

The 2025 tariff threat might similarly push Canada to fast-track trade diversification strategies – for instance, leveraging agreements like CETA (with the EU) or CPTPP (Asia-Pacific) to find new export markets. Still, in the near term, there is no escaping the heavy reliance on the U.S. market. Canada's proximity and deep integration with the U.S. means it is uniquely exposed – the "small open economy" problem. If access to the U.S. market is curtailed, Canada stands to lose far more, proportionally, than the U.S. does. In a hypothetical world of across-the-board 25% tariffs by the U.S. on all countries, a Bank of Canada model found Canada's real GDP could eventually fall over 3%, whereas the U.S. long-run GDP might drop just ~1%, since the U.S. economy is more self-contained.

In summary, past episodes show that targeted tariffs inflict localized pain, while broad tariffs risk widespread economic harm. Canada's experience suggests the best outcomes arise from swift negotiation and resolution (as in 2018-19), whereas protracted trade wars (1930s) leave lasting scars. These lessons frame the current situation: if Trump's tariffs persist, history warns of significant economic fallout, but also underscores the importance of policy responses – Canada will likely invoke every tool (from WTO challenges to alliance-building with other trading partners) to shorten the lifespan of these tariffs.

Impact on Canadian Spreads and Credit Markets

To start the year, Canadian corporate credit spreads began creeping wider, driven in part by tariff headlines. Canadian investment-grade spreads widened more than their U.S. counterparts, reflecting the heavier economic risks Canada faces. Spreads on Canadian auto-sector bonds have jumped sharply in recent weeks as investors anticipated weaker earnings and higher default risk for those firms. This sensitivity aligns with 2018's experience, when mere threats of auto tariffs caused a "dramatic" increase in credit spreads for North American auto companies.

At present, Canadian corporate bond spreads remain relatively low by historical standards - they had tightened to multi-year lows in late 2024 amid a strong credit market rally. But the tariff escalation is a clear catalyst for spread widening going forward.

Several factors will drive corporate spreads in this environment:

- **Macroeconomic Deterioration:** As outlined earlier, tariffs are poised to slow growth and increase unemployment.

  Weaker corporate earnings and the prospect of a recession tend to widen corporate spreads, since investors demand more yield to compensate for higher default risk. For example, if GDP growth in 2025 falls by ~1-2 percentage points due to tariffs, the stress on corporate finances (especially in cyclical sectors) will likely push credit spreads wider.

- **Sector Differentiation:** Spread widening is expected to be most pronounced for companies in directly impacted sectors.

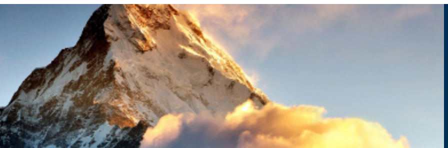
  Export-oriented firms (autos, metals, energy services, etc.) could see rating outlooks downgraded, and their bond spreads could gap out significantly. By contrast, firms in domestic-oriented or tariff-sheltered sectors (telecom, utilities, etc.) may see only mild spread moves.

- **Provincial and Sovereign Spreads:** It's not just corporate bonds – Canadian provincial bonds are also at risk of widening spreads.

  Provinces like Ontario, Québec, Alberta, and Saskatchewan have outsized exposure to impacted industries (manufacturing in Central Canada, energy and commodities in the West). Analysts warn that provincial borrowing costs could rise as investors assess the hit to provincial revenues and higher borrowing needs. In fact, provincial yield spreads could widen by an estimated ~10–15 basis points under a significant tariff scenario.

  CIBC calculates that even a 20% tariff (excluding commodities) might add up to 12 bps to 10-year provincial spreads, which for the ~$135 billion in borrowing planned by provinces in FY2025 translates to about C$162 million in extra interest costs annually. If 25% tariffs hit and provinces need to borrow more due to weaker revenues, the spread impact could be larger.

  Provincial spreads often serve as a benchmark for high-grade corporate spreads in Canada, so a move wider in provincial yields would likely feed through to higher corporate bond spreads as well.



On the positive side, Canada's strong fiscal and financial fundamentals (AAA sovereign rating, well-capitalized banking system) provide some backstop. Major rating agencies have signaled that Canada's sovereign credit rating is not immediately at risk from the tariffs. They view Canada as having the capacity to absorb a short-term shock, though they acknowledge certain provinces are more vulnerable. This implies that investment-grade corporate issuers with solid balance sheets might still find support, especially with the Bank of Canada easing policy (rate cuts tend to reduce interest expenses and can tighten spreads in the short run). Additionally, if the situation deteriorates sharply, the BoC or federal government could enact credit support facilities as they did in 2020 (buying corporate bonds or providing guarantees), which would help contain spreads.

Overall, however, the outlook is for moderately wider Canadian corporate spreads over the next year if the current proposed tariffs are implemented for a significant amount of time, reflecting increased economic uncertainty. The most exposed credits will be those tied to trade activity – their spread could gap out signficantly. The Canadian corporate bond market remains in a fundamentally strong position – default rates are low and many firms extended their debt at low rates in recent years – but a trade-war-driven downturn of a meaningful length could cause deterioration.

Investors should thus be prepared for some credit market volatility and risk repricing in 2025, in tandem with the unfolding trade situation. It is important to note that the outcomes described above assume the tariffs remain in place throughout the year.

There remains the possibility of a negotiated solution or policy reversal, which would substantially improve the outlook. Indeed, financial markets so far appear to assign some probability to a deal, given the relatively muted reaction in Canadian equities and the Canadian dollar retracing some losses after the initial shock.

Fund Positioning

In response to this threat, we repositioned our Funds during February so that they are operating at the lowest risk levels since COVID. This positioning has muted much of the risk associated with spread widening while our Funds continue to earn carry and provide investors access to running yield. When spreads become more stable, either because the tariffs do not last beyond the short term or the impact of tariffs is absorbed by risk markets, we will take advantage of the opportunity and add risk to the Funds.

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