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GLOBAL ECONOMICS

SCOTIA FLASH

April 2, 2025

Contributors

Derek Holt
VP & Head of Capital Markets Economics
Scotiabank Economics
416.863.7707
derek.holt@scotiabank.com

John McNally, Senior Advisor, Climate and Socio-Economic Policy Research
Scotiabank Economics
416.869.2801
john.mcnally@scotiabank.com

With research assistance from:
Jaykumar Parmar
Economic Analyst
Scotiabank Economics
416.866.4212
jay.parmar@scotiabank.com

Neha Sarraf
Climate and Socio-Economic Research Analyst
Scotiabank Economics
416.869.2695
neha.sarraf@scotiabank.com

Trump's Tariffs Are (Almost) Our Worst Fears Realized

- **The good news: Canada and Mexico got off relatively light**
- **The bad news: Massive tariffs on Asia & Europe will slam global growth...**
- **...and by sharply raising the average effective US tariff rate...**
- **...US growth will suffer, and inflation is likely to move higher**
- **Canada has pledged to retaliate tomorrow.**
- **Watch for reactions by others as the situation remains highly fluid.**
- **Markets reacted in sharp risk-off fashion**
- **Watch FOMC reactions to see if markets are correct in adding to cuts**

Canada and Mexico didn't go down with the ship, but they are left bobbing away in frigid waters. That's the bottom-line takeaway from the US announcements that massively raised tariffs on many countries but with Canada and Mexico being relatively spared from what could have been a much worse outcome. Canada and Mexico will nevertheless suffer from sector-specific tariffs and indirectly via the impact on the global economy, commodities and financial markets.

The situation is extremely fluid as markets respond and governments react. This note is intended to summarize what we know so far as an initial reaction with comments on potential implications. Further analysis from Scotiabank Economics will be required as developments unfold. Watch international reactions through the overnight session. Canadian PM Carney has already pledged to retaliate as soon as tomorrow.

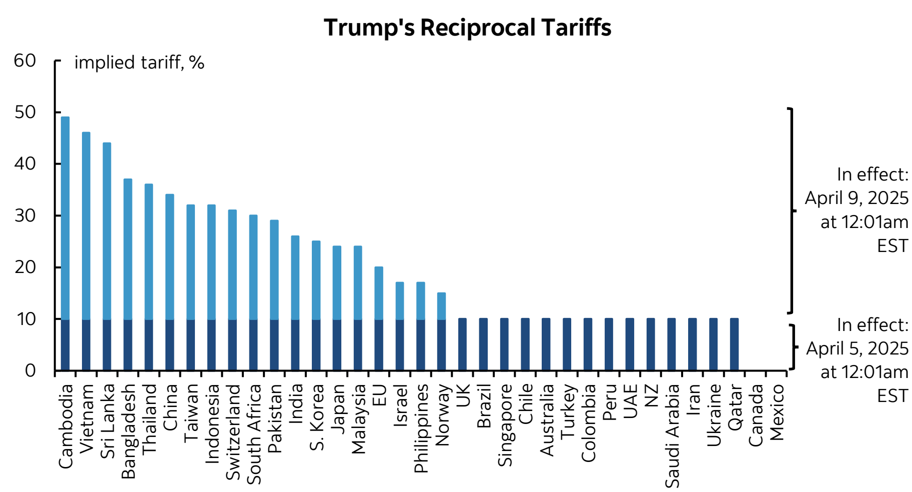
The announcements are **here**, **here** and **here** and their release followed a nearly 45 minute set of remarks by Trump in the White House's Rose Garden.

MARKETS REACTED NEGATIVELY

The market reaction was swiftly negative in what is a highly fluid situation into overnight markets and the risk of retaliatory guidance. South Korea has convened an emergency meeting. Canada is holding meetings tomorrow.

US equity futures are fluctuating within declines of 3–5% across the S&P and Nasdaq composites. Japanese equities are opening down 3%. That's hardly making anyone wealthier despite Trump's slogan.

Chart 1



Source: Scotiabank Economics.

The Canadian dollar rallied at first when it appeared Canada would be spared but is clawing back some of that gain and is highly volatile. The Mexican peso has performed similarly by rallying at first and having second thoughts afterward.

The US 10-year Treasury yield fell by about 5bps in the immediate aftermath. Canadian government bond futures are pointing toward a sharp rally in rates.

WTI oil fell by just over a buck.

Markets initially reacted by adding to priced easing by the Federal Reserve this year with between 3–4 cuts expected by year-end.

WHAT WAS ANNOUNCED

With important exceptions for Canada and Mexico that we will come back to, U.S. President Trump announced that countries would be subject to a minimum baseline tariff of 10% on all imports into the US. For some countries, that will be it. For others, they will be impacted by additional reciprocal tariffs that vary by country. Many of those reciprocal tariffs are extremely high. They are additive to pre-existing country tariffs which is particularly bad for China. In the process, the US economy itself was shot in the foot.

Our understanding is that the reciprocal tariff rates were calculated by taking the US goods deficit with a trade partner, dividing it by US goods imports from that country, divided by 2, and rounding up to the nearest 10%. You can't make this stuff up!! This is the logic guiding US macroeconomic policy.

Chart 1 summarizes the tariff actions taken by US President Trump on a country-by-country basis.

Asian economies are being slammed. China now faces the pre-existing 20% tariff rate plus another 10% baseline tariff rate plus another 24% reciprocal tariff rate for a combined tariff rate of a whopping 54%. In addition, China will lose the de minimis exemption as of May 2nd that enabled packages under US$800 to enter duty free. This is part of why oil prices are reacting negatively.

Japan's combined tariff rate of 24% takes the 10% baseline plus the 14% reciprocal rate. Australia's combined tariff rate is 10%.

Other Asian economies face similarly astounding tariff rates, but they are dwarfed in terms of relative sizes.

Europe was also hit hard. The entire European Union faces a combined 20% tariff rate split 50–50 between baseline and reciprocal tariffs. The UK faces a 10% tariff. Switzerland will be tariffed at a whopping rate of 31%, 21% of which is due to reciprocal tariffs.

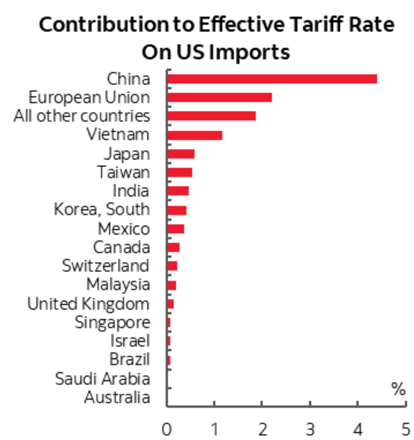
Latin American economies other than Mexico face cumulative tariff rates of 10% for each of Brazil, Chile, Colombia, and Peru.

THE US ECONOMY WILL PAY

As for the US? Well done. We estimate a new effective tariff rate of 13.2% for US imports broken down by country in chart 2. Other tariff rate estimates may be higher, but they likely include goods that should be omitted, given that the order excludes imports of:

- Steel/aluminum articles, and Autos/Auto parts already subject to previous rounds of national security tariffs
- Copper
- Pharmaceuticals
- Semiconductors
- Lumber and lumber articles
- Gold bullion
- Energy
- "Certain minerals that are not available in the United States" (We interpret this to mean critical minerals)

Chart 2

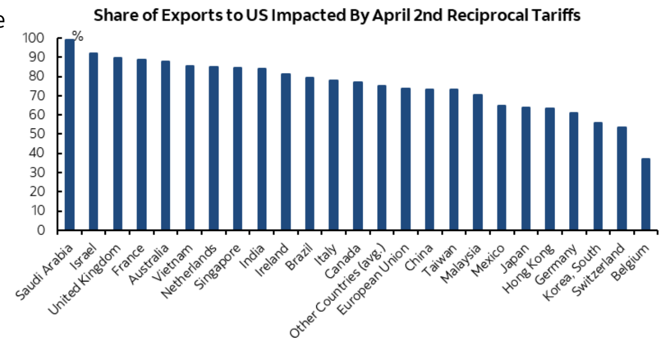


Source: Scotiabank Economics.

It also excludes "other goods that may be subject to future national security tariffs" and other goods deemed exempt by Presidential authority under 50 USC 1702(b), so expect additional changes. These carve outs are good news for countries like Taiwan, whose new 32% tariff rates should not impact semiconductor exports to the US. We also assume the vast majority of Canadian and Mexican exports file paperwork to achieve USMCA compliance. If they only file at historic rates (between 38-49% compliance, according to US customs data), then the US effective tariff rate would jump to 15.9%. If we make assumptions that all goods are included, and USMCA compliance rates apply, then effective tariffs would be over 20%.

This shifts the share of overall exports that will be subject to tariffs by each country (chart 3).

Chart 3



Sources: Scotiabank Economics, WITS.

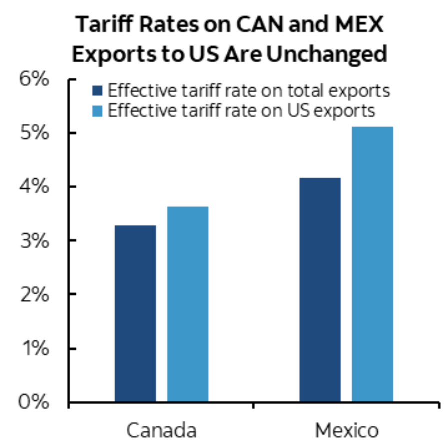
Despite several eye-catching figures of tariff rates around 50%, those likely to have the most significant effects include China, the EU, and Vietnam. Tariffs on China will apparently stack on top of existing measures, imposing a 54% effective tariff rate on Chinese exports. That alone will add 4.4% to the US effective weighted tariff rate, relative to January. Tariffs on the EU will similarly add 2.2% to the US effective tariff rate, while high tariff rates on Vietnam will have disproportionate impacts on costs on textiles and clothing imports. US retailers have an established manufacturing footprint in the country, representing a significant share of the $150B in goods exports to the US in 2024.

That is a significant negative terms of trade shock to the US and global economies that will harm growth, harm employment, and raise prices—thus complicating the outlook for monetary policy in major economies.

CANADA AND MEXICO GOT OFF LIGHT

Canada and Mexico will not be subject to either the baseline 10% tariff rate or any reciprocal tariff rates. That's the good news. This could have been much worse by way of direct effects on both countries. Instead, their effective tariff rates are largely unchanged (chart 4).

Chart 4



Sources: Scotiabank Economics, Author's estimates

The bad news is two-fold. For one, both countries still face sector tariffs. A 25% tariff on vehicles exported to the US net of American content will be applied. The 25% tariffs on steel and aluminum remain. More is threatened.

The announcement offered no meaningful changes for Canada and Mexico. The executive order states that existing fentanyl/migration-related tariffs will remain in effect, unaffected by this order. The list of product exemptions that applied to other tariffs (steel and aluminum, autos, copper, pharma, energy, lumber, critical minerals, gold bullion and semiconductors) mean nothing for Canada and Mexico, since they weren't hit by reciprocal tariffs. For now, tariffs remain stacked, and the outlook unchanged. We estimate Canada and Mexico's effective tariff rates for exports to the world are 3.3% and 4.2% respectively. Effective tariffs on exports to the US are 3.7% and 5.1% for the two countries. Given what other countries faced (particularly the 54% tariff rate now faced by Chinese goods exporters), this outcome is slightly more positive than worst case scenarios might have anticipated.

The executive order also Introduced something new. If the fentanyl/migration tariffs are ever cancelled, it states all non-USMCA compliant goods would face a 12% tariff. This potential offramp offers (in theory) some certainty around future direction, since there is now a clear floor that illustrates what could replace the USMCA if negotiations falter. It also confirms a worry, which is that a return to tariff-free trade is highly unlikely at any point in the next four years.

Secondly, both countries are trade- and commodity-dependent economies. The weaker US growth and negative impact on commodities through global growth will be a dampener

CANADA TO RETALIATE

Prime Minister Carney has already pledged to retaliate. He said that these measures will fundamentally change the international trading relationship and that in doing so, Trump has fundamentally preserve the US-Canada relationship. Yet the tariffs on autos will remain in place, and the US has signalled there will be additional tariffs on strategic sectors. Carney said it will be negative on the US economy and impact Canada while affecting millions of Canadians. Carney bluntly stated “We are going to fight these measures with counter measures” and “we will react with purpose and force.” Carney noted he will speak with provincial premiers tomorrow and meet with the Canada-US cabinet committee in the morning. The indication is that Canada will announce measures afterward.

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