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President Trump announces tariffs on Canada, Mexico and China and the world holds its breath

Late on 1 February, President Trump signed three executive orders, announcing new tariffs on Canada, Mexico, and China. The tariffs include 25% on imports from Canada and Mexico, and 10% on imports from China. Energy products from Canada, crucial for US crude oil imports, are also affected, but 'only' by a 10% tariff

Trump imposes new tariffs on Canada, Mexico, and China

Even though media reports in the last few days indicated that Trump would implement the tariffs this time, there was still uncertainty until the official announcement. On 1 February, President Trump followed through and declared a national emergency, using the powers granted by the International Emergency Economic Powers Act (IEEPA) to impose these additional tariffs for the first time since the law came into effect in 1977. After threatening to invoke IEEPA several times, such as against Mexico in 2019, Trump had to deliver on his threats, otherwise risking them being perceived as empty and ineffective.

What about the timing?

The new tariffs are set to come into effect at 12:01 a.m. Eastern Standard Time on 4 February 2025. This leaves a minimal negotiation period before the tariffs are enforced and gives the US authorities the opportunity to comply with the new regulations and also adhere to the legal requirements, such as the publication of the executive orders in the Federal Register. However, the timeline for fitting everything into the legal framework seems quite tight, which could lead to chaos unfolding at the border in the coming days.

However, since President Trump has not specified his exact demands from Canada, Mexico, and China regarding the fentanyl crisis, reaching an agreement before the deadline seems more challenging than during his first administration.

Retaliation is on: Canada, Mexico, and China respond to US tariffs

Following the announcement, Canada and Mexico declared their intentions to retaliate against the tariffs, while China pledged to challenge them legally at the WTO. Although all three countries would prefer negotiations over retaliatory measures, their respective governments stated that the US stance necessitates a firm response, with Canada already having its masterplan ready.

Canada: On Tuesday, 4 February, US imports entering Canada will face tariffs of 25% on goods worth $20 billion (C$30 billion). Then, in 21 days, additional tariffs for goods worth $86 billion (C$125 billion) will come into effect, including beverages such as beer, wine and bourbon, agricultural products such as fruits and orange juices, as well as clothing, or household appliances. In a public statement, Canadian prime minister Justin Trudeau also called upon Canadian citizens to 'buy Canadian'.

Mexico: Mexico's government stated that they would prepare similar tariffs on US goods, although a detailed list has not been published yet. Mexican President Claudia Sheinbaum instructed her economy minister to apply tariff and non-tariff measures in defence, potentially ranging from 5% to 20%, on agricultural products as well as manufactured steel and aluminium, according to media sources.

China: Next to China filing a complaint with the World Trade Organization, which often takes over a year though, China's commerce ministry announced that it would take unspecified countermeasures. But unlike Mexico and Canada, no immediate tariffs were announced, although this might be due to the fact that some policymakers could still be on holiday during the Chinese New Year break.

Seeing that the tariff hike is with an additional 10%, which is relatively small – don't forget that tariffs against Chinese goods entering the US have been in place for the last 7 years – we expect that the initial retaliation from China's side is likely to be mild. Despite the tough talk, we are still of the opinion that the fentanyl issue is one where China and the US could find it relatively easier to find room for cooperation, so this will be an important early barometer on how relations will develop. We do feel that if pushed into a corner, China's retaliation could be stronger than what most expect, but at this stage we haven't reached that point yet. Overall, the path to avoid a more destructive US-China trade war is a narrow one.

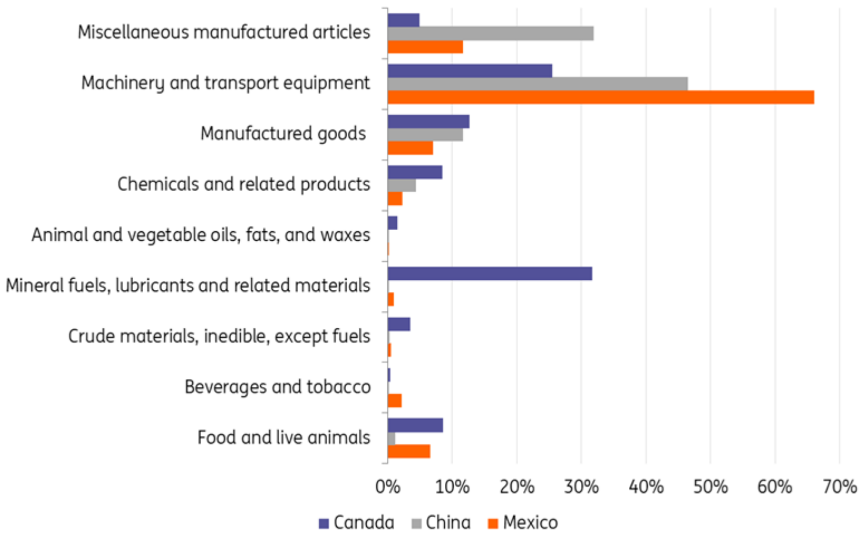
Potential economic impact

With more than 15% of all US imports coming from Mexico, 13.7% from Canada, and 13.9% from China in 2023, almost half of everything the US imports will be affected by higher tariffs, potentially disrupting supply chains and impacting the US, Canadian, and Mexican economies significantly. Industries like automotive and manufacturing, which are deeply integrated with US supply chains, will face increased costs and disruptions, since many parts cross the border multiple times before becoming final product. The total output of US manufacturing was $2.85 trillion in 2023 according to the GDP figures – less than the $3.1 trillion of goods imports that year. As such the US manufacturing sector would need to more than double in size to allow full substitution and that is unfeasible in the near term.

Additionally, agricultural products, food and beverages, and wood could see significant price hikes this year.

Export share by product categories in total exports to the US (Mexico, China, and Canada)

(% of total exports to the US by SITC4 Category as of 2023)



Source: UN Comtrade, ING calculations

In the short term, the additional tariffs may slightly boost spending as awareness spreads and consumers accelerate purchases to avoid the tariffs. However, the squeeze on household incomes, particularly for lower-income families, will become noticeable in the following months as we've discussed in length here. While price increases for non-perishable foods such as cucumbers, lettuce, or meat might be felt almost immediately, the impact on durable goods may be delayed.

For example, in 2018, it took about three months for washing machine prices to rise as retailers depleted their pre-tariff inventory. Subsequently, consumer prices for laundry equipment increased by 12%, leaving consumers to bear the brunt of the tariff hikes. Additionally, domestic manufacturers raised their prices, further impacting consumers, until supply chain adjustments and increased competition eventually lowered prices again.

With the announced retaliations, American exporters will get hurt

Furthermore, with the announced retaliations, American exporters will get hurt, particularly in industries like agriculture and manufacturing. 17% of US goods exports go to Canada, 16% go to Mexico and 7% go to China. When the US imposed tariffs on Chinese goods during Trump's first term, China responded with tariffs on American agricultural products, such as soybeans and pork, hurting American farmers and leading to reduced sales and financial strain. To offset lost US sales to China from the trade war, the US administration had to step in with generous subsidies.

As regards China, we are expecting a very modest impact on China's growth from this initial move. In 2024, China saw exports to the US grow by 4.9% YoY to $524bn and China's trade surplus with the US totalled $360bn, with this data benefiting from some front loading of exports toward the end of the year. Another 10% tariff will further squeeze low margin exports to the US and likely will price out a portion of exports. The more vulnerable sectors will likely be those with easy replacements, such as textiles and certain electronics and machinery goods. However, given tariffs have been in place for the last 7 years, many of the more price sensitive and easily replaceable exports have already been redirected – many of the direct exports remaining often do not have an easy substitute. Given Mexico's tariffs were hiked by 25%, this will also impact one of China's main export rerouting channels. We could see exports redirected toward other countries with ASEAN and Latin American countries as likely targets if the tariffs to Mexico hold, or worse, see further escalation. China is likely to focus on boosting trade ties with other countries to help offset a more protectionist US.

What does this mean for Europe?

The European Union has not (yet) been subject of the US administration's tariff announcements. However, President Donald Trump has regularly publicly criticised the EU for running trade surpluses with the US. In fact, looking at the US bilateral trade balances, the country runs the third largest bilateral trade deficit with Germany, after China and Mexico. Given the swiftness with which the Trump administration implements election promises, it is hard to see how the EU could escape the tariff dance. In fact, Donald Trump already initiated a comprehensive investigation into US trade relationships. A report of this investigation is due on 1 April 2025. A crucial moment for the EU.

However, it won't take until April before the EU would feel the economic pain of US tariffs. Given that many European (car) manufacturers have production facilities for the US market in Mexico, as part of the near-shoring and derisking strategy of the last four years, US tariffs on Mexico will also harm Europe.

US tariffs on Mexico will also harm Europe

There is little known how the EU would react to US tariffs on European goods. During the last Trump administration, the EU first reacted with direct retaliation on US tariffs on European aluminium and steel and was later able to prevent a tariff escalation by threatening to impose tariffs on Levi's jeans and Jack Daniels. Also, the EU promised the US administration to purchase more US LNG and soybeans. A similar strategy looks possible this time around. The EU could, for example, offer to buy more US LNG or military equipment. However, the overarching question remains how transactional president Trump's approach to tariffs in his second term in office will really be.

Trade war is a lose-lose situation

The US administration's first move on tariffs does not only stress the determination to use tariffs as a main instrument in foreign policy but it also marks a complete overhaul of trade as we know it, clearly breaching existing trade agreements like the United States-Mexico-Canada Agreement (USMCA) and World Trade Organization (WTO) rules. If really implemented, the announced tariffs are of a very different nature than the tariffs during Trump's first term in office. Targeting three of the US most important trading partners, with the fourth to follow soon, at the same time is a very different beast. If Mexico, Canada and China push through with the announced retaliation, the global economy would see an unprecedented escalation of trade tensions. During Trump's first term in office, tariffs and trade tensions brought attention to the more general topic of the advantages but also disadvantages of globalisation. Globalisation has not only seen winners but also losers. This time around, it is hard to see how an escalation of trade tensions can do any good, to anyone. At least over the longer run. Economically speaking, escalating trade tensions are a lose-lose situation for all countries involved.

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