

ECONOMIC VIEWPOINT

Where Could Tariffs Go from Here? Rethinking Impacts in a Shifting Trade Landscape

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HIGHLIGHTS

- ▶ The average effective tariff rate (AETR) is a key measure of how tariffs are applied on US imports of Canadian goods. It reflects the actual duties paid at the border, based on a mix of products the US imports from Canada.
- ▶ Recently, the gap between the actual AETR and the predicted average effective tariff rate (PETR) has been widening based on announced tariff rates. Several factors drive this gap between the PETR and the actual AETR, including shifting trade patterns, administrative issues, delayed payments and legacy exemptions.
- ▶ We doubt that the actual AETR will converge to the higher PETR, due primarily to growing CUSMA compliance and shifting trade patterns. Our Canadian economic forecast reflects that skepticism. If the actual AETR were to converge to the PETR, our outlook for Canada's economy and labour market would be much weaker.
- ▶ Still, tariffs are unlikely to return to pre-trade war levels given elevated tariffs on key Canadian exports such as autos, steel, aluminum and wood products. As such, trade barriers are likely to be a persistent obstacle to growth for the foreseeable future.

Introduction

Iron Man once famously said, "sometimes you gotta run before you can walk." At Desjardins Economic Studies, we've done plenty of running to understand how tariffs affect the Canadian economy. For example, we recently examined [sector vulnerability to tariffs based on the latest developments](#).

However, our earlier work focused on assessing the situation, so we only touched briefly on our approach to analyzing these tariffs. This is especially important given the discrepancy between the US tariff rates that we and other forecasters predicted and the actual tariff rates Canadian goods have faced. In this report, we explore what drives the differences between predicted and actual US tariff rates on Canadian exports, how we expect these tariffs to behave moving forward and what it means for our outlook.

Bridging the Tariff Gap

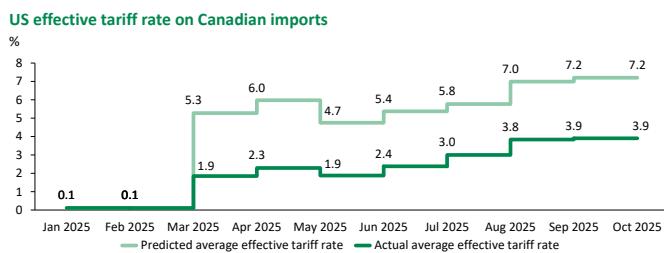
Since the onset of the trade war, the AETR on Canadian exports south of the border has served as a key gauge of US tariff policy. It reflects the actual tariffs paid on Canadian goods entering the United States, based on a mix of products the US imports from Canada. However, tracking the actual AETR in real time wasn't possible early in the trade war, as Washington's tariff measures evolved rapidly and customs data—released with a lag—didn't yet reflect the newly implemented duties. To bridge this gap, we constructed a PETR by applying newly announced tariffs to the value of past trade flows. (See the methodology box on page 2.) Once customs data reflected actual tariff payments, we were able to compare the PETR to the actual AETR. This revealed a persistent gap between the two measures (graph 1 on page 2). At the time of writing, the PETR stands at about 7.2% versus an actual AETR of 3.9% in October.

BOX
Average and Predicted Effective Tariff Rates

As trade dynamics with the US shifted rapidly in 2025, analyzing tariffs on Canadian exports became essential for evaluating the impacts on Canadian producers. (See our [January 2025 analysis](#) and its [March 2025 update](#).) Initially, we estimated industry-level PETRs by applying the new tariffs to annual 2024 export values, incorporating each industry's CUSMA compliance. While this approach provided detailed sectoral insights, the estimates ultimately diverged from the actual AETRs because they assumed full tariff application and ignored trade flow adjustments and increased CUSMA compliance.

To overcome these limitations, we shifted to analyzing the latest customs data from the United States International Trade Commission (USITC) DataWeb to capture trade dynamics as soon as they reflected the tariff shock. This approach enabled us to precisely calculate the actual AETR, CUSMA compliance rates and export shares across all North American Industry Classification System (NAICS) sector codes or Harmonized Tariff Schedule (HTS) product codes. It also brought much-needed clarity to the complex landscape of provisions and programs that exempt Canadian exports from tariffs.

These calculations underpin our [latest industry vulnerability index](#) and the provincial tariff estimates presented in our [Provincial Economic Outlook](#) using Statistics Canada's provincial export data. Our latest prediction framework attempts to more closely approximate the PETR to the actual AETR by using 2025 monthly USITC trade data at the HTS-10 level. We apply announced tariffs to trade values while accounting for each product's CUSMA compliance rate, and limit International Emergency Economic Powers Act (IEEPA) blanket tariff application to each product's dutiable share. This captures exemptions beyond CUSMA and enables us to predict alternative tariff scenarios as policy evolves.

Graph 1
There Is a Persistent Gap Between Actual and Predicted Tariff Rates


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Research from the Federal Reserve Bank of Richmond also identified this gap, attributing it to shifting trade patterns and implementation frictions ([Azzimonti, 2025](#)). Specifically, cross-country sourcing and shifts in product mix tend to inflate the PETR, as firms respond to tariffs by redirecting imports from high-tariff countries like China to lower-tariff alternatives such as Vietnam, and by reducing purchases of heavily taxed goods. At the same time, implementation frictions—such as administrative issues, delayed payments, implementation challenges, and legacy exemptions—can lower the actual AETR.

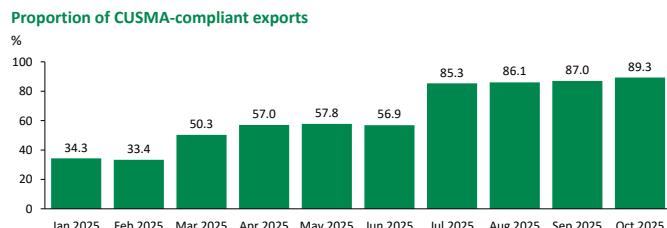
Moreover, PETR estimates struggled to capture highly granular, product-specific tariffs and complex application rules. In addition, the use of highly aggregated trade data and rates of compliance under the CUSMA inevitably reduces the accuracy of PETR estimates. This is especially true given that crude oil—which

makes up about one quarter of Canadian exports—is virtually fully CUSMA compliant.

How Are Tariffs Likely to Evolve Moving Forward?

The future trajectory of the AETR is expected to be driven by two opposing forces: rising CUSMA compliance among Canadian exports and mounting sector-specific tariffs.

The first force relates to the sharp increase in CUSMA-compliant exports and the resulting exemptions from blanket IEEPA tariffs.¹ The latest trade data from October 2025 showed that CUSMA compliance surged to around 89.3% as Canadian exporters quickly adapted to new US tariffs (graph 2). We expect this trend

Graph 2
Canadian Exporters Have Quickly Adapted to US Tariffs


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¹ The US administration invoked the IEEPA, claiming that fentanyl smuggling and illegal immigration across the Canada-US border had reached crisis levels.

to persist, though at a more moderate pace, reaching about 95% by late 2026. As the share of duty-free exports expands, the AETR should gradually decline.

The second force comes from escalating sector-specific tariffs, targeting industries the White House deems strategic and, in some instances, leading to prohibitive tariff levels (table 1). In contrast to increased CUSMA compliance, this is likely to keep the AETR elevated.

Table 1
Sector-Specific Tariffs Have Become the Norm

Sector-specific tariff *	Targeted goods	Applied tariff	Tariff %
Automobiles and heavy vehicles	Finished automobiles and heavy vehicles	If CUSMA-compliant: On non-US content (otherwise on total value)	25
	Finished buses	On the total value	10
Steel and aluminum	Automobile and heavy vehicle parts	Only if not CUSMA-compliant**	25
	Primary metals (input)	On the total value	50
Copper	Derivative products (finished or semi-finished)	Only on metal content	50
	Derivative products (finished or semi-finished)	Only on metal content***	50
Wood	Softwood lumber	On the total value	10****
	Upholstered wood products and wood cabinets	On the total value	25*****

*Powered in order of application and priority. Aside from certain exceptions, sector-specific and IEDPA (border/territory) tariffs cannot be stacked.

**The IEDPA tariff may apply to non-metal content.

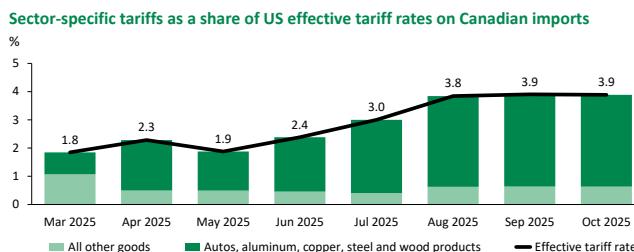
***Exemption: The IEDPA tariff may apply to non-metal content.

****Effective January 1, 2027, the tariff will be 5% for upholstered products and 50% for cabinets.

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A reduction in sector-specific tariffs seems unlikely at present, as the US is showing no interest in negotiating. In addition, sector-specific tariffs have recently reduced the impact of CUSMA compliance in lowering the actual AETR. Because tariff exemptions for these products are still limited, the effective tariff rate remains elevated (graph 3). These factors are expected to persist and add further upward pressure to the AETR. This is particularly the case as US imports of Canadian aluminum should rebound toward 2024 levels as US inventories shrink, given the lack of substitutes stateside.

Graph 3
Sector-Specific Tariffs Significantly Influence the Effective Tariff Rate



NOTE: Sector-specific tariffs refer to tariffs on autos, aluminum, copper, steel and wood products.

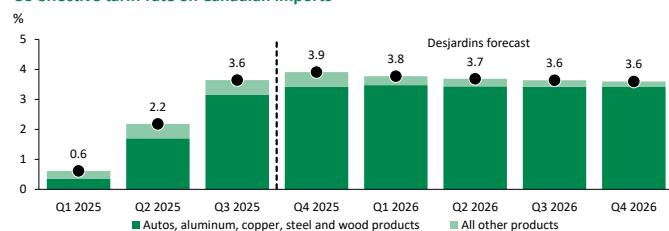
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Combining both forces, we expect the effective tariff rate to have peaked in Q4 2025 at around 3.9%, and then to ease toward around 3.6% by mid- to late-2026 (graph 4). This peak reflects the upward pressure from the combined effect of new sector-specific tariffs and previously-announced tariffs now being fully implemented, temporarily outweighing the downward pressure from growing CUSMA compliance. Assuming no additional measures, as well as increased compliance and lower trade volumes in most targeted sectors (except aluminum), tariff pressures should slowly ease through 2026. That said, the constant threat of new sector-specific tariffs—from pharmaceuticals to semiconductors—adds a layer of volatility to an already uncertain outlook.

Graph 4

Tariffs on US Imports of Canadian Goods Have Likely Peaked and Are Expected to Move Lower

US effective tariff rate on Canadian imports



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Differences Between Tariff Rate Estimates and Forecasts

As outlined in our methodology, we estimate the actual AETR on all US imports from Canada using product-level AETRs from the latest US customs data. These rates provide a snapshot of current conditions and serve as a baseline for forward-looking projections. We then adjust selected tariffs to reflect newly implemented or announced sector-specific measures that are still absent from the data. These adjustments are based on stress test results from our latest PETR framework, which incorporates granular tariff application and recent shifts in export composition to anchor projections in current trade conditions. (See methodology box on page 2.) Finally, we project future effective rates by applying our estimated export elasticities to a set of dynamic export flow scenarios.

Looking at other methodologies, the Bank of Canada (BoC) estimated in its [October Monetary Policy Report](#) that the July tariff rate was 4.4% and that it could rise to 5.9% by October. In a similar fashion, the federal Department of Finance estimated in its [2025 budget](#) that the tariff rate stood at 5.4% as of November 1. In both cases, the estimates apply the 2025 US tariff schedule to 2024 import shares by product. This is why the PETRs estimated by these institutions are well above the actual AETR shown in graph 3.

Will the Actual AETR Eventually Converge Toward the PETR?

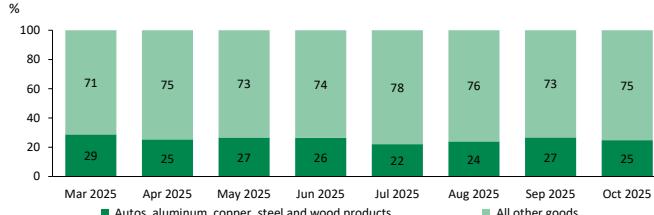
One can assume that the actual AETR will eventually converge toward the PETR, as this gap could largely be the result of temporary implementation frictions that may fade over time. However, analysis of customs data with our tariff frameworks indicates that while the actual AETR is likely to rise in the coming months, full convergence with the PETR appears unlikely.

First, the composition effect must be considered when estimating 2025 tariffs. Since March 2025, the import shares of products targeted by sector-specific tariffs have declined—except in months when the scope of targeted items was expanded—making it unrealistic to assume that the 2024 Canadian export mix will hold (graph 5). This downward trend reflects a gradual reduction in import demand for goods facing higher tariff rates, a typical trade adjustment response that shifts the product mix over time. Hence, because these products bear most of the tariff burden (graph 3 on page 3), even small shifts in their weight can materially affect the actual AETR.

Graph 5

Import Shares of Products Subject to Sector-Specific Tariffs Have Been Volatile

US import product shares



NOTE: Sector-specific tariffs refer to tariffs on autos, aluminum, steel, copper and wood products

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Second, sector-specific tariffs can involve highly complex application mechanisms, which inherently limit the accuracy of simple estimation approaches. For example, the tariff on steel and aluminum derivatives applies only to the metallic content value—typically assumed to represent about half of the finished product's value. This assumption, however, is a broad generalization which can quickly break down in practice. The more value-added a product contains, the more diffuse and uncertain the tariff impact becomes, making straightforward tariff application difficult. This helps explain cases like machinery, often cited—including in the Richmond Fed's research—as an example of persistent tariff undercollection. Yet, it is unlikely that such a product would face an excessively high AETR given its relatively low metallic content compared with total product value.

Third, although implementation frictions are likely to diminish, the idea that their elimination alone could close the remaining gap between the actual AETR and PETR, thereby lifting the actual AETR by 2 to 3 percentage points (ppts), appears overstated in light of recent customs evidence. Although often described as temporary loopholes, several legacy exemptions—including US content thresholds, federal procurement exclusions, the [Agreement on Trade in Civil Aircraft](#) and the [WTO's Pharma Agreement](#)—are longstanding statutory exemptions that are unlikely to disappear entirely. Moreover, even though CUSMA compliance now replaces most legacy exemptions, some products remain only partially protected under CUSMA and will therefore continue to rely on these exemptions for tariff protection. Additionally, recent data show improvements in several cases where duties have been undercollected. While further customs enforcement gains are expected, assuming that this alone will generate a major jump in duties paid would imply a systemic failure in customs procedures—an assumption unsupported by available evidence. Overall, although implementation frictions do contribute to the AETR–PETR gap, their role is often overstated, and this mechanism cannot realistically produce the scale of convergence some envision.

In short, there are many reasons to doubt that full convergence from the AETR to the PETR will happen. Reality introduces far more complexity and noise than theory would suggest.

What Do These Developments Mean for Our Economic Outlook?

We incorporated the latest tariff information into our December 2025 Economic and Financial Outlook (EFO). That said, we can explore the impacts of alternative tariff scenarios on the outlook. Table 2 provides a detailed outline for each scenario.

Table 2
Scenario Assumptions

Scenario	Description*
December 2025 EFO	The effective tariff rate falls slightly from a peak of 3.9% to 3.6% by mid-2026 largely driven by higher CUSMA compliance. However, sector-specific tariffs prevent it from lowering further.
No tariffs	US tariffs on Canadian goods are immediately dropped during early Q1 2026.
Partial convergence to PETR	Tariffs on goods increase and the effective tariff rate rises to roughly 6% starting in Q1 2026, below the PETR of 7.2%.
Full convergence to PETR	The effective tariff rate rises and equals the PETR of 7.2% starting in Q1 2026.

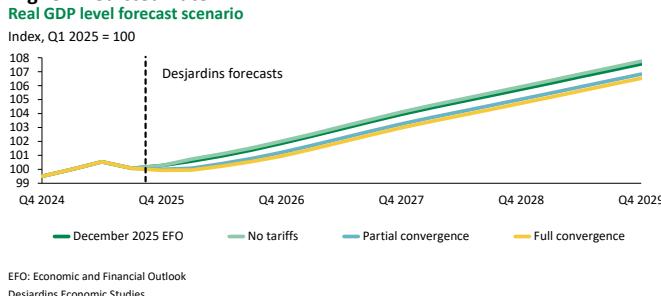
PETR: Predicted effective tariff rate; EFO: Economic and Financial Outlook
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Under a partial convergence scenario, average growth between 2026 and 2029 would be roughly 0.16% lower than in the December 2025 EFO, while growth would be 0.22% lower under a full convergence scenario (graph 6). As part of the upcoming CUSMA review, although a no-tariff scenario currently appears unlikely, this provides an upper bound for our scenario analysis. In contrast to the other scenarios, removing tariffs altogether would lead to increased Canadian exports to the US and output overall.

Graph 6

Canada Could Face Lower Growth If Actual Tariffs Converge Towards a Higher Predicted Rate

Real GDP level forecast scenario

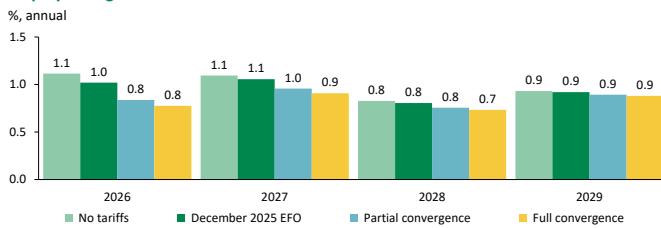


Turning to other key indicators, employment gains are projected to be less if the actual tariff rate converges towards the predicted rate. Under a full convergence scenario, job growth would likely be weaker, with average employment growth around 0.13 ppts lower than our December 2025 EFO forecast (graph 7). In every scenario, the impacts on employment growth are likely to be felt primarily in 2026 and 2027.

Graph 7

Job Creation Is Expected to Be Weaker Under a Tariff Convergence Scenario

Employment growth forecast scenario

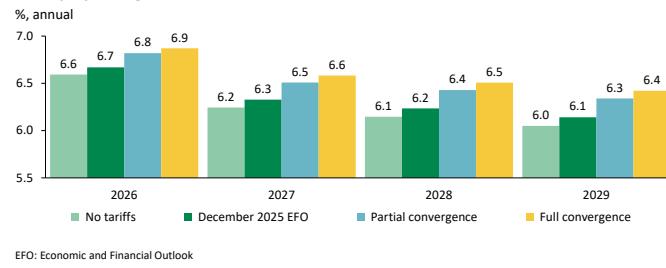


Job losses could also spike under a tariff convergence scenario (graph 8). Under a full tariff convergence scenario, the unemployment rate may increase by as much as 0.2 ppts on average.

Graph 8

Job Losses Are Likely To Be Higher Under a Tariff Convergence Scenario

Unemployment growth forecast scenario

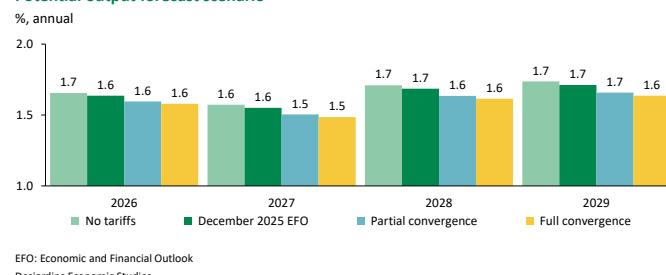


Lastly, we examined the impact of tariffs on Canada's potential output, which is what the economy would look like in a steady and balanced state. In this ideal situation, supply meets demand, the economy is at full employment, and inflation is low and stable. Broadly speaking, any increase in tariffs towards a higher PETR would likely, all else equal, translate to lower potential output growth (graph 9). Potential output growth could fall from an annual average of 1.65% in our December 2025 EFO to 1.58% under a full convergence scenario. Lower potential output growth would imply that the Canadian economy is on a lower real GDP growth trajectory due to the structural shock triggered by US tariffs.

Graph 9

Potential Output Growth Could Be Somewhat Lower as a Result of Tariffs

Potential output forecast scenario



Conclusion

Tariff pressures remain a key drag on our economic outlook. The breadth of recent trade policy changes—combined with uncertainty around the upcoming CUSMA review and lack of meaningful progress in de-escalating trade tensions—suggests that tariffs will remain a structural headwind to growth. However, we are unconvinced that actual effective tariff rates will reach the levels published by the BoC and federal Department of Finance as these don't account for ongoing changes in trade data.