ECONOMIC VIEWPOINT

CUSMA at a Crossroads: Mapping the Pathways That Could Redefine North American Trade

With the upcoming review of the Canada-United States-Mexico Agreement (CUSMA), uncertainty around US trade policy is once again emerging as a major macroeconomic risk for Canada. The range of possible outcomes remains especially wide. At one end of the spectrum is a scenario where the agreement is abandoned, exposing Canadian exports to broad punitive tariffs. At the other end lies the possibility that the agreement is renewed and the existing sector-specific tariffs are lifted. This would bring North America back to a free-trade arrangement like the one in place before Donald Trump returned to the White House. Our baseline economic scenario assumes that the current tariff policy remains in place following the recent US Supreme Court ruling, but the agreement is nevertheless renewed.

This report also presents two alternative scenarios to show what could happen if the outcome of the CUSMA review is less favourable than our baseline scenario assumes. For each scenario, we estimate the implied trajectory of the effective tariff rate on Canadian exports to the United States and then add these assumptions to our macroeconomic frameworks. This allows us to measure the possible effects on variables such as exports, business investment, inflation, interest rates and the exchange rate.

These scenarios aren't forecasts. They're meant to provide reference points in a political environment that remains highly fluid. The broad range of possible outcomes encompasses a number of short-term developments that could significantly change the implied trajectory. We've already mentioned the US Supreme Court decision. The new US tariffs imposed after the verdict will expire after 150 days, and it's unclear what will happen after that. There's also the persistent risk of new tariff announcements or diplomatic escalation (or de-escalation) even before the formal CUSMA deadlines pass. The objective is therefore to map out the plausible range of macroeconomic effects, while keeping in mind that the ultimate outcome of the negotiations remains highly uncertain.

CUSMA: A Scheduled Review

July 1, 2026, will be the sixth anniversary of CUSMA's entry into force. It will also trigger the first joint review to assess how well the agreement is working, as required by its final provisions. All three parties will be required to "review any recommendations for action submitted by a Party, and decide on any appropriate actions." This mandatory review is seen, especially in the United States, as a way to keep the agreement relevant and ensure it evolves with the North American economy. The rigidity of the old North American Free Trade Agreement (NAFTA) and the absence of a mechanism to adapt it to economic transformations were among the reasons the first Trump administration asked Canada and Mexico to negotiate a new trade deal.

Will This Mark the End of CUSMA or Its Renewal?

CUSMA's final provisions also stipulate that it must expire in 2036, 16 years after it came into force. However, as part of this year's joint review, each party shall confirm in writing whether it wishes to extend the term of the agreement for another 16 years (to 2042). **A failure to agree on amendments to the agreement or to confirm its renewal by July 1 therefore will not result in its immediate termination.** Normally such a failure would mean the agreement remains in effect for another 10 years, subject to annual joint reviews. During that period, the parties still have the option to extend it for another 16 years (again, subject to review after six years).

But CUSMA does have another final provision that allows for early withdrawal. Any party may withdraw by providing written notice to the others, with the withdrawal taking effect six

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months later. In such a case, the agreement would remain in force for the remaining parties. That said, this provision isn't directly tied to the joint review requirement. And although President Trump has criticized CUSMA, explicit references to a possible US withdrawal have been relatively limited so far. The administration appears willing—at least for now—to see how this year's review process turns out. But a clear failure to address US concerns (and Donald Trump's specific criticisms) could increase the likelihood that the withdrawal clause will eventually be invoked.

Where Does the US Stand?

The administrative and political process for the joint review is well underway in the United States. The Trump administration officials handling the file were required to hold public hearings on CUSMA and inform Congress of the administration's recommendations and efforts. These requirements have been met. In his report to congressional committees, US Trade Representative (USTR) Jamieson Greer shed some light on US priorities:

- "CUSMA has provided some certainty for North American trade ... But at the same time, it is clear that we have not achieved all of our goals with respect to strengthening US manufacturing capacity and creating good jobs ..."
- Comments submitted in writing or during public hearings showed fairly broad support for CUSMA. Many of them expressly called for the agreement to be renewed, although almost all called for improvements in a number of areas.
- The success of the joint review depends on whether these issues can be resolved. In general, the US is demanding stronger rules of origin, better alignment on economic security, mechanisms to penalize offshoring to Mexico or Canada and a common platform for critical minerals. The US also wants Mexico to curb the use of third-country content and to improve labour law enforcement. As for Canada, US demands are mostly centred on sector-specific issues such as dairy, digital services and online streaming, provincial bans on the sale of US alcohol beverages, Alberta's electricity market, and the simplification of customs processes.

That said, US officials are keeping their cards close to their chests, and we still don't have a clear idea of what a successful joint review would look like. One key statement on the renewal process stands out: "whatever [CUSMA]'s value to the United States and even North America, the shortcomings are such that **a rubberstamp of the Agreement is not in the national interest. USTR will keep the President's options open, negotiating firmly to resolve the issues identified, but only recommending renewal if resolution can be achieved**."

Some Possible Scenarios

This means there's a wide range of possible outcomes for the joint review scheduled to begin on July 1. The macroeconomic impacts would look very different depending on whether the renewal process goes smoothly or the negotiations become so strained the US decides to leave CUSMA instead of just refusing to renew it.

Since Donald Trump returned to the White House a little over a year ago, his administration's tariff policy has shown little regard for existing trade treaties, including the international rules set by the World Trade Organization (WTO). However, for economic, political or legal reasons, the president took CUSMA into account when implementing certain protectionist policies, like the tariffs related to fentanyl and border security (or the new tariffs that replaced them) and some sector-specific tariffs (such as those on automobiles).

Most importantly, the joint review will decide whether CUSMA-compliant goods will remain exempt from tariffs. As of December 2025, 80.2% of US imports of Canadian products and 76.6% of US imports of Mexican products were tariff-free because of CUSMA. If these exemptions were to change, all three economies would have to pay a price. That's what our various scenarios are trying to evaluate.

Our first scenario is the baseline scenario. It is based on our latest Economic and Financial Outlook (EFO), adjusted to include updated data and the tariff changes resulting from the Supreme Court ruling. It assumes that current tariff conditions remain in place throughout the forecast horizon and that CUSMA is fully renewed for 16 years. At first glance, the USTR's statements make it seem unlikely that the Americans agree to extend the agreement without significant changes. But any scenario where the CUSMA exemptions remain in place would resemble this baseline. We could even adopt more positive assumptions in which sector-specific tariffs are reduced. Even then, the macroeconomic impact wouldn't change much. In this baseline scenario, effective US tariff rates on Canada and Mexico would remain at 2.7% and 3.8%, respectively.

The second scenario is an adverse scenario in which CUSMA is not renewed for another 16-year term, but remains in place, subject to annual joint reviews. To differentiate it from the baseline, we assume that CUSMA-related tariff exemptions are eliminated, but the current US tariffs on Canada and Mexico, which replaced the fentanyl and border security tariffs, remain in effect. The CUSMA exemptions would be withdrawn on January 1, 2027, increasing effective US tariffs to 9.7% for Canada and 16.8% for Mexico.

The third scenario is a severe adverse scenario where the agreement breaks down. This scenario's main assumption is that the United States refuses to renew the agreement for another

16-year term and triggers the withdrawal clause. The six-month notice period—and US participation in CUSMA—would end on January 1, 2027. In this scenario, we assume that tariffs similar to the fentanyl tariffs would be imposed, but with no exemptions. For Canada, that would be a 35% tariff (10% for energy, potash and critical minerals). For Mexico, the tariff would be 25%. However, given other US trade measures and exemptions, the effective US tariff rate would rise to 25.0% for Canada and 24.3% for Mexico.

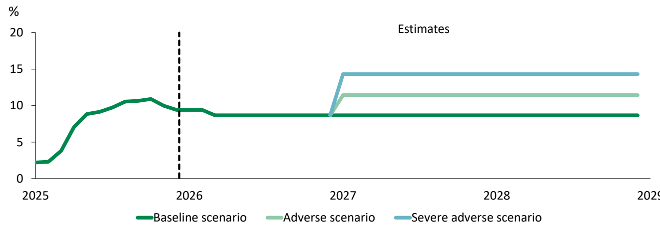
In all three scenarios, we assume the various sector-specific tariffs remain unchanged except for the provisions related to CUSMA. We also assume that Mexico and Canada won't impose countertariffs on imports of US goods. We do not anticipate any changes to CUSMA provisions (on regulations, work visas, etc.) other than tariffs. Finally, we assume there will be no changes to US tariffs on countries that are not parties to CUSMA, and the tariffs implemented since the Supreme Court ruling will remain in force.

All three scenarios are summarized in the table below.

Impact on the US Economy

For the US, the difference between the scenarios is essentially based on the overall effective tariff on their imports. The current effective tariff rate is 10%. The baseline scenario assumes the tariff remains at 10% through the forecast horizon. Canada and Mexico together account for about 28% of total US imports, and an increase in the cost of those imports would naturally affect US economic activity and inflation. That said, the economic impact should remain relatively modest, even in the severe adverse scenario where the US withdraws from CUSMA. The US economy proved in 2025 that it can withstand rising import costs. In fact, for both of the scenarios involving higher tariffs on Mexico and Canada, the increases in the effective rate are smaller than those already implemented since Donald Trump returned to the Oval Office (graph 1).

Graph 1
The Scenarios Show Effective Tariffs Increasing Less than They Did Last Year
Effective tariff rates on total US imports



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As in late 2024 and early 2025, US importers may try to beat the tariffs by fast-tracking imports of certain goods before the tariff hikes take effect. This could slightly reduce real GDP growth in the fall of 2026. After that, they may once again prove reluctant to fully pass cost increases on to consumers, limiting the impact on household disposable income and consumer spending. Even in the severe adverse scenario, we don't expect the US to see a net decline in real GDP, let alone a recession (graph 2 on page 2). The unemployment rate would rise only marginally—by one or two tenths of a percentage point.

Because energy is exempt from the new tariffs, the impact on energy prices would be the same in both the adverse and baseline scenarios. This would help limit their effect on headline inflation. However, the severe adverse scenario shows

Table
Scenarios Presented

	Tariff regime	Sector-specific tariffs	Agreement status	Joint reviews	Expiry date	US effective tariffs in 2027
Baseline scenario	Section 122 equivalent with CUSMA exemptions	Maintained	Renewed for a 16-year term	2032	2042	Canada: 2.7% Mexico: 3.8%
Adverse scenario	Section 122 equivalent without exemptions	Maintained	Remains in place but not renewed	Annual	2036	Canada: 9.7% Mexico: 16.8%
Severe adverse scenario	Fentanyl equivalent without exemptions	Maintained	US withdrawal	---	2027	Canada: 25.0% Mexico: 24.3%

CUSMA: Canada-United States-Mexico Agreement
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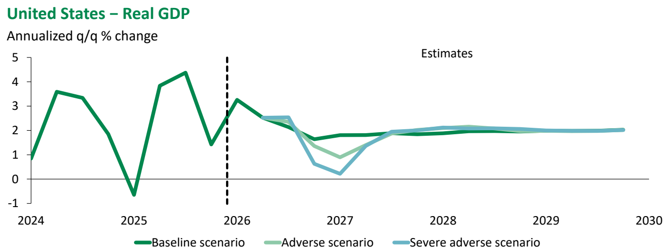
Graph 2
The Scenarios Would Not Lead to a Net Decline in US Real GDP



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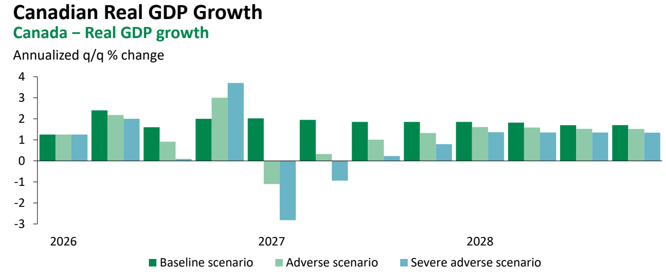
Graph 4
Uncertainty and a Potential End to CUSMA Could Weigh Heavily on Canadian Real GDP Growth



CUSMA: Canada-United States-Mexico Agreement
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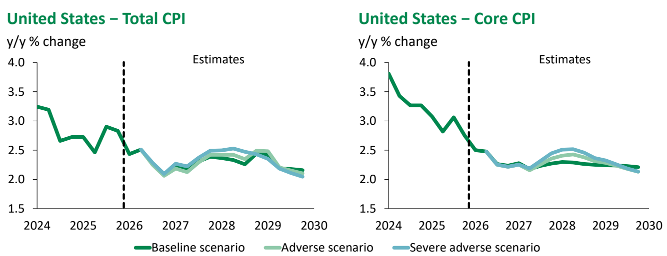
somewhat stronger inflationary pressure, as Canadian energy would be subject to a 10% tariff (25% for Mexican energy). The divergence between the scenarios is more pronounced for core inflation, which excludes food and energy, especially after 2028, when the full impact of the tariffs is felt. But again, the change remains quite modest and core inflation wouldn't rise much higher than it is today (graph 3).

Graph 3
The Impact on US Inflation Is Relatively Modest



CPI: Consumer Price Index
Bureau of Labor Statistics and Desjardins Economic Studies

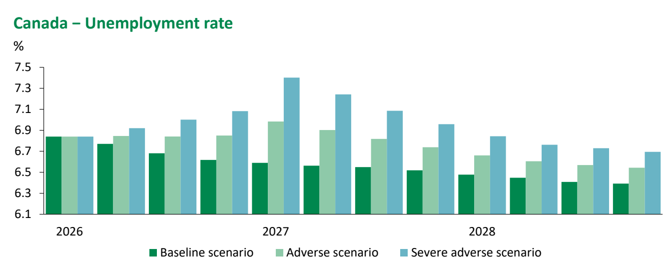
Canada to Be Hit Hard If the CUSMA Review Goes off the Rails

The adverse and severe adverse CUSMA scenarios will have an undisputed negative impact on the Canadian economy relative to our baseline outlook published in the February 2026 EFO.

Canadian **real GDP growth** could slow through mid-2026 if the CUSMA renewal looks unlikely, as uncertainty around the review would discourage business investment and hiring. That drag would intensify if a US withdrawal from CUSMA seems imminent. In the event the US exits CUSMA, US and Canadian companies will have six months to prepare, with the new trade regime taking effect on January 1, 2027. That could support stronger growth in the second half of 2026 than in the baseline or adverse scenario, as exports to the US would likely surge ahead of CUSMA's end date, similar to what occurred in the first quarter of 2025. Overall, this would leave annual real GDP growth in 2026 broadly similar across all scenarios, despite significant quarterly variation (graph 4). However, 2027 growth is likely to be materially weaker in the adverse scenario and significantly weaker in the severe adverse scenario than in the baseline. Indeed, a recession is likely in the first half of 2027 in the severe adverse scenario, followed by a shallow recovery. Over the longer term, reduced export levels and softer business investment should weigh on annual real GDP growth. With potential GDP growth also lower as a result of lost productive capacity, real GDP growth in the adverse and severe adverse scenarios should be permanently weaker than the baseline.

Along with slowing real GDP growth should come labour market weakness, with downward pressure on employment growth and upward pressure on the **unemployment rate** (graph 5). Indeed, in the adverse scenario, we expect the unemployment rate to rise to a peak of 7.0% in Q1 2027 before gradually falling, albeit to a level that is higher than in our February 2026 EFO baseline. A similar pattern is observed in our severe adverse scenario, although with a higher unemployment rate at its peak (7.4% in Q1 2027) and over the long term than in either of the other two scenarios. Note that our baseline scenario assumes a downward trajectory for the unemployment rate, driven by the impact of population growth grinding to a halt. The increase in the adverse and severe adverse scenarios therefore reflects the effect of the layoffs expected to occur.

Graph 5
A Trade Drag Should Lead to a Higher Unemployment Rate in Canada



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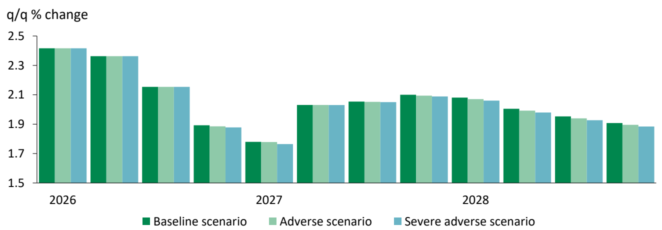
A weaker economy and labour market should put downward pressure on **CPI inflation** in Canada. But there are other confounding factors that could impact price growth. We don't expect the federal government to reapply reciprocal tariffs on imports from the United States. But a likely depreciation in the Canadian dollar relative to the baseline in both the adverse and severe adverse scenarios means the resulting higher import prices could put some offsetting upward pressure on inflation (graph 6). Even if modest, that will keep inflation from falling further and put additional constraints on the Bank of Canada's (BoC's) ability to reduce the policy rate by as much as it might otherwise.

Graph 6
The Canadian Inflation Forecast Is Broadly Unchanged Due to Conflicting Forces
Canada – CPI Inflation



CPI: Consumer Price Index
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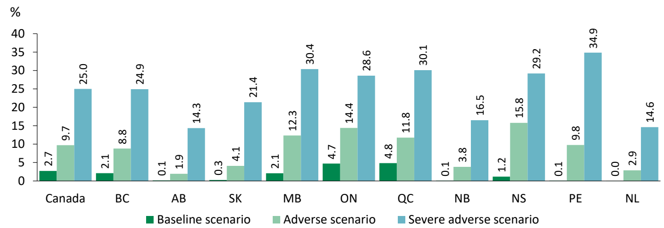
Quebec Would Still Be One of the Most Affected Provinces

Since some industries with a large presence in Quebec are affected by sectoral tariffs (including aluminum, lumber, and truck and bus manufacturing) that are not covered by CUSMA exemptions, the province faces an effective US tariff that's higher than the national average. Consequently, the trade turmoil with the United States has hit Quebec harder than many other provinces. However, in the adverse and severe adverse scenarios, virtually all industries would lose their CUSMA exemptions. As a result, trade tensions could have a bigger impact on sectors and regions that had previously been largely untouched.

That said, maintaining certain sectoral tariffs and preferential treatment for oil will continue to disadvantage Quebec (and other provinces) in both alternative scenarios. Quebec and Ontario would therefore still face higher effective tariff rates than Canada as a whole (graph 7). In both alternative scenarios, the decline in Quebec's real GDP in 2027 would also be more pronounced than the national average (graph 8). Meanwhile, unless reciprocal tariffs are introduced on imports from the United States, inflationary trends should be similar across Canada. As for unemployment, both alternative scenarios see the unemployment rate rising in Quebec (graph 9), but less than you might expect given the demographic factors that are shrinking the workforce and keeping a lid on the province's unemployment rate.

Graph 7
Effective Tariffs on the Provinces Under Both Alternative Scenarios

Average effective US tariff on imports from Canada



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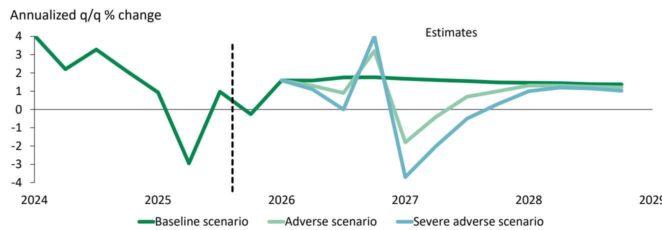
Graph 8
The Scenarios Show a Temporary Decline in Quebec's Real GDP

Quebec – Real GDP



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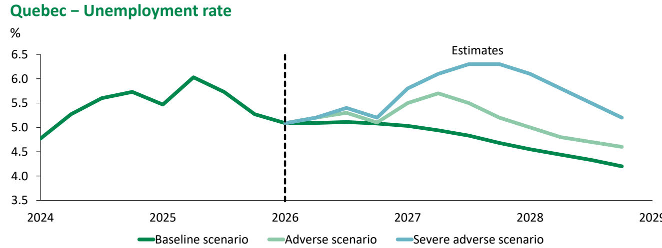
Graph 9
The Scenarios Show a Temporary Increase in Quebec's Unemployment Rate
Quebec – Unemployment rate



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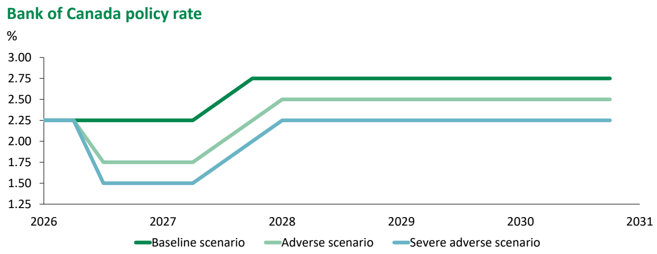
Financial Markets

Our baseline forecast is for the BoC policy rate to remain on hold until 2027. In the adverse scenario, we would expect the BoC to cut interest rates by 50 basis points (bps) to 1.75% in Q3 2026 and keep it there until 2027 (graph 10). We would also expect the low end of the range of the neutral rate to move lower, from 2.25% in the baseline to 2.00%. This is because potential GDP growth would be permanently lower, putting the real policy rate on a lower long-term trajectory. Overall, this would leave a more stimulative level of monetary policy, relative to our baseline

Graph 10
Rates Should Fall Due to a Weaker Economy and Lower Inflation



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view for the overnight rate to stay within the neutral range. In the severe adverse scenario, the BoC could be expected to cut even deeper—by 75bps in Q3 2026. However, we would similarly expect this to be accompanied by a reassessment of the neutral range, with a lower bound at 1.75%. As a result, the level of stimulus would be similar to the adverse scenario.

We think the BoC would shy away from providing much more accommodation, let alone bringing policy rates down to the effective lower bound. Policymakers have been clear that monetary policy is a blunt instrument, not suited for trade disruptions, given their negative impact on productive capacity. The BoC's calculus on the appropriate degree of monetary easing will likely attribute significant weight to the risk of stimulating demand and inflation, in light of a supply-constrained environment.

In such a scenario, Canadian yields would fall across the curve, causing the yield curve to bull steepen. But with long-end yields building in more term premium as investors view the debt as more risky, the passthrough from rate cuts to lower long-term government borrowing rates will be blunted. Fiscal support programs would also likely result in more issuance, further adding to the term premium.

In the US, a deeper breakdown in bilateral trade with Canada should push the policy rate slightly below neutral. That said, the growth hit to the economy should be more limited than in Canada, leaving the medium-term path for the overnight rate relatively unchanged. In the severe adverse scenario, there could be more of a fallout in the Treasury market. In addition to raising inflation expectations, it would likely dent US credibility and curb global demand for Treasuries, including from large Canadian holders, lifting the term premium at the long end of the curve.

Risk assets would probably come under pressure, but less than intuition suggests. Financials would feel some strain, especially where integration with US markets is deepest, and energy prices might fall on the prospect of weaker global demand. But a spike in demand for precious metals should help offset some of those losses. Stateside, assuming the AI theme continues to deliver in line with expectations, US equities should remain relatively resilient, and any wobbles would be more about inflation or global appetite for US assets than a purely domestic demand scare.

The Canadian Dollar

Markets are notorious for underpricing even well-flagged tail risks, and the Canadian dollar today is no exception. Traders have become fixated on chasing broad USD weakness, and the risk of a negative outcome in the CUSMA review has quietly faded into the background.

If either of our risk scenarios materializes, we think volatility will rise sharply. We have seen this pattern before during the Brexit referendum, when markets assumed the status quo would hold even though polls showed a dead-even race. When the "Leave" side prevailed (narrowly), the reaction was immediate and severe.

We expect USDCAD will make a large and immediate adjustment to 1.48 and 1.55 in the adverse and severe adverse scenarios respectively, followed by a gradual retracement over subsequent months.

Conclusion

The CUSMA review marks a critical juncture for the Canadian economy. The alternative scenarios presented here demonstrate the range of risks: from a trouble-free renewal to a sudden breakdown. The macroeconomic repercussions on Canada would vary considerably, while the US would remain relatively unscathed regardless of what happens. This asymmetrical exposure to trade-related shocks reflects a structural dependence that the joint review process—regardless of its outcome—cannot fix.

A severe adverse outcome would probably intensify ongoing debates about economic sovereignty, the development of domestic industrial supply chains and the need to reorient supply chains from a north-south axis to an east-west one. These policy responses are pragmatic but would take several years to implement. There's also the risk that they can't be successfully implemented. In the meantime, the adaptability of industrial sectors, workers and governments will be put to the test, especially in Quebec and Ontario, where vulnerable sectors are most heavily concentrated.

And even if Canada manages to avoid the worst-case scenario, the country still needs to diversify, build on its strengths and improve its productivity and ability to innovate. One thing is clear: achieving real economic sovereignty will require sustained, long-term commitment.