WEEKLY COMMENTARY

Tariff Parallax

By Jimmy Jean, Vice-President, Chief Economist and Strategist

Trade policy whiplash returned last week as Donald Trump announced tariffs on Canadian and Mexican goods on February 1, only to reverse course by February 3 following intense pushback from both countries' officials. Though the immediate threat has faded, the episode has the world on edge given Trump's much more aggressive focus on trade policy than indicated during the campaign.

This also means there's no undoing the uncertainty damage. Whether viewed through the lens of the fluid and wide-ranging motivations behind the announced tariffs, the decision to target two allies—including Canada, arguably America's closest—or Trump's willingness to reverse course based on already-made concessions, his reaction function is far less predictable than many assumed on January 20. One of the immediate effects will be a significant weakening of business investment in Canada. This impact will materialize through both direct channels (e.g., delayed capital expenditures) and indirect channels (e.g., higher corporate borrowing costs as lenders factor in risk, or increased capital goods costs due to a weaker currency given that half of capital goods are imported).

It is mildly encouraging that Canada and Mexico can still influence Donald Trump. The fact that Trump reversed course—rather than escalating as he had threatened in response to retaliation—suggests they retain some negotiating leverage. However, what's unusual is that this leverage stemmed from promises related to border security rather than trade. Our deep dive on sectoral vulnerability highlights the US's lack of self-sufficiency and limited short-term substitutes in areas like oil and gas, steel and aluminum. At face value, the fact that tariffs in these sectors were reduced to 10% seems an acknowledgement of this dependency. But with Trump ready to justify tariffs on a broad list of objectives—e.g., boosting domestic production and raising the contribution of allies to military spending and border security—Canada and Mexico's influence will be tested. As a result, our next forecast will assume tariffs taking effect at the beginning of Q2, rather than the Q4 scenario we had assumed pre-inauguration.

Risks to the outlook are now firmly skewed to the downside. As we noted following Trump's initial announcement, early tariff implementation would eliminate the temporary inventory buildup effects included in our baseline. This tailwind was evident in Canada's December trade report, which contributed to a small upward revision in our Q4 2024 growth estimate. Without this tailwind—and with earlier labour market repercussions—our 2025 forecasts will be revised downwards, regardless of whether tariffs are eventually set at 25% or at some lower rate. The hardest-hit sectors will include auto manufacturing, aerospace, machinery, primary metals and lumber (already subject to 14% duties). In Quebec, we estimate these vulnerable sectors represent 25% of GDP, with an even higher share in Ontario due to the dominant auto industry.

A still-open question is how financial markets factor into Trump's decision-making. Announcing the tariffs on a Saturday may have been a deliberate attempt to limit immediate market turmoil. Markets responded negatively on Monday morning, with Canadian auto and parts stocks hit particularly hard. However, US stocks, despite early losses, rebounded and trended higher throughout the week, largely brushing off other geopolitical headlines. The bond market reaction was more pronounced: Canadian bonds rallied sharply, pushing the Canada–US 10-year yield differential to a record low (-149.9bps) on Tuesday, which dragged the loonie down close to our

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previously out-of-consensus 1.48 USDCAD call for Q4. While Trump is unlikely to care about Canadian market developments, the thumbs-up from US equities—after his decision to hold off—may provide some feedback for his future policy decisions, for instance on the magnitude of eventual tariffs.

But regardless, Canadian policymakers must use the 21 days until March 1 to prepare for the worst. In upcoming Economic Viewpoints, we will analyze emergency fiscal responses from the past two recessions (COVID-19 and the Global Financial Crisis) and assess which measures could be adapted for a tariff shock and which past mistakes should be avoided. The tendency to "fight the last war" has not always served policymakers well; we'll argue that long-term thinking must take precedence this time. The same applies to the Bank of Canada. While we do not see the need for an inter-meeting rate cut—since this is a macro shock rather than a financial crisis—the Bank will need to shift into mildly accommodative territory before long. Our forecast update next week will reflect this shift, though we maintain that rates need not be slashed to the floor given the Canadian economy's strong sensitivity to interest rates in both restrictive and accommodative settings.

What to Watch For

UNITED STATES

WEDNESDAY February 12 - 8:30	
January	**m/m**
Consensus	0.3%
Desjardins	0.3%
December	**0.4%**

Consumer price index (January) – The all items consumer price index (CPI) once again climbed sharply (+0.4%) in December. That month's increase was fuelled by rising gasoline prices. We believe gasoline prices had a more neutral impact in January. That said, the price of certain food items probably spiked, mainly due to issues with bird flu in some states. As for core CPI, which strips out food and energy, the January data still seems to reflect seasonal trends to a certain extent, even though the data is usually adjusted to take them into account. After several months of relatively strong gains, used car prices likely cooled. All things considered, we expect month-on-month upticks of 0.3% for both headline and core CPI. Year-on-year, headline inflation probably held steady at 2.9%, while core inflation likely fell slightly from 3.2% to 3.1%.

FRIDAY February 14 - 8:30	
January	**m/m**
Consensus	0.0%
Desjardins	-0.1%
December	**0.4%**

Retail sales (January) – Retail sales growth was adequate but broad-based in the final month of 2024. The numbers may not be so good in January due to a poor performance by the auto sector. New vehicle sales plummeted 7.5% in the first month of 2025, the biggest plunge since May 2022. Other sectors are expected to post gains, although growth in gasoline station sales was probably subdued. Preliminary data from credit card providers and some major retailers has been promising. That said, the January cold snap and California wildfires could cloud the picture. All in all, we expect a 0.1% slump in total sales and a 0.5% bump in sales excluding motor vehicles and gasoline.

FRIDAY February 14 - 9:15	
January	**m/m**
Consensus	0.3%
Desjardins	0.4%
December	**0.9%**

Industrial production (January) – In December, industrial production recorded its strongest monthly growth since February 2024. This jump was largely due to a surge in energy production, but we also saw robust gains in the mining and manufacturing sectors (excluding motor vehicles). In addition, the positive impact of the end of the Boeing strike was more obvious in December. In January, the energy sector probably boosted production again as cold weather drove up demand for electricity. The ISM Manufacturing index finally rose above 50, which bodes well for manufacturing. But the reduction in hours worked in the manufacturing sector, especially in the automotive industry, points to a dip in manufacturing production. That likely slipped by 0.1% in January. We nevertheless expect total industrial production to have gone up 0.4%.

CANADA

FRIDAY February 14 - 8:30	
December	**m/m**
Consensus	0.7%
Desjardins	0.6%
November	**0.8%**

Manufacturing sales (December) – On manufacturing sales, we anticipate 0.6% m/m growth in December, in line with Statistics Canada's flash estimate. The depreciation of the Canadian dollar likely boosted prices and nominal sales of motor vehicles, lumber and precious metals. In real terms, manufacturing sales appear to have decreased by 0.2%, driven by a 0.8% rise in seasonally adjusted industrial product prices in December.

OVERSEAS

THURSDAY February 13 - 2:00	
Q4 2024	**q/q**
Consensus	-0.1%
Q3 2024	**0.0%**

United Kingdom: Real GDP (fourth quarter) – After a promising start to 2024, the UK economy lost some steam. Despite posting non-annualized growth of 0.7% in the first quarter and 0.4% in the second quarter, real GDP stalled over the summer. And we don't believe things improved much in the fourth quarter. The monthly GDP numbers for October and November so far point to a slight decline in quarterly growth. The December figures would have to be exceptionally buoyant to reverse this trend. Unfortunately, the data released thus far—including retail sales, PMIs and some employment numbers—suggest otherwise. The Bank of England's Monetary Policy Report published on Thursday forecast a 0.1% downturn in fourth-quarter real GDP.

Economic Indicators

Week of February 10 to 14, 2025

Day	Time	Indicator	Period	Consensus		Previous reading

UNITED STATES

Day	Time	Indicator	Period	Consensus		Previous reading
MONDAY 10	---	---				
TUESDAY 11	8:50	Speech by Federal Reserve Bank of Cleveland President B. Hammack				
	10:00	Testimony of Federal Reserve Chair J. Powell before a Senate committee				
	15:30	Speech by Federal Reserve Bank of New York President J. Williams				
	15:30	Speech by Federal Reserve Governor M. Bowman				
WEDNESDAY 12	8:30	Consumer price index				
		Total (m/m)	Jan.	0.3%	0.3%	0.4%
		Excluding food and energy (m/m)	Jan.	0.3%	0.3%	0.2%
		Total (y/y)	Jan.	2.9%	2.9%	2.9%
		Excluding food and energy (y/y)	Jan.	3.2%	3.1%	3.2%
	10:00	Testimony of Federal Reserve Chair J. Powell before a House committee				
	12:00	Speech by Federal Reserve Bank of Atlanta President R. Bostic				
	14:00	Federal budget (US$B)	Jan.	n/a	n/a	-86.7
THURSDAY 13	8:30	Initial unemployment claims	Feb. 3–7	n/a	215,000	219,000
	8:30	Producer price index				
		Total (m/m)	Jan.	0.2%	0.2%	0.2%
		Excluding food and energy (m/m)	Jan.	0.3%	0.2%	0.0%
FRIDAY 14	8:30	Export prices (m/m)	Jan.	0.3%	0.5%	0.3%
	8:30	Import prices (m/m)	Jan.	0.4%	0.5%	0.1%
	8:30	Retail sales				
		Total (m/m)	Jan.	0.0%	-0.1%	0.4%
		Excluding automobiles (m/m)	Jan.	0.3%	0.5%	0.4%
	9:15	Industrial production (m/m)	Jan.	0.3%	0.4%	0.9%
	9:15	Production capacity utilization rate	Jan.	77.7%	77.8%	77.6%
	10:00	Business inventories (m/m)	Dec.	0.1%	-0.1%	0.1%

CANADA

Day	Time	Indicator	Period	Consensus		Previous reading
MONDAY 10	---	---				
TUESDAY 11	8:30	Building permits (m/m)	Dec.	2.0%	1.4%	-5.9%
WEDNESDAY 12	13:30	Release of the Bank of Canada Summary of Deliberations				
THURSDAY 13	---	---				
FRIDAY 14	8:30	Wholesale sales (m/m)	Dec.	n/a	0.1%	-0.2%
	8:30	Manufacturing sales (m/m)	Dec.	0.7%	0.6%	0.8%
	8:30	Release of the Bank of Canada's Senior Loan Officer Survey				

Note: Each week, Desjardins Economic Studies takes part in the Bloomberg survey for Canada and the United States. Approximately 15 economists are consulted for the Canadian survey and a hundred or so for the United States. The abbreviations m/m, q/q and y/y correspond to month-over-month, quarter-over-quarter and year-over-year change respectively. Following the quarter, the abbreviations f, s and t correspond to first estimate, second estimate and third estimate respectively. Times shown are Eastern Standard Time (GMT -5 hours). Desjardins Economic Studies forecast.

Economic Indicators

Week of February 10 to 14, 2025

Country	Time	Indicator	Period	Consensus m/m (q/q)	Consensus y/y	Previous reading m/m (q/q)	Previous reading y/y
OVERSEAS							
SUNDAY 9							
Japan	18:50	Current account (¥B)	Dec.	2,721,0		3,033.4	
MONDAY 10							
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TUESDAY 11							
France	1:30	ILO unemployment rate	Q4	7.5%		7.4%	
WEDNESDAY 12							
Germany	---	Current account (€B)	Dec.	n/a		24.1	
Italy	4:00	Industrial production	Dec.	-0.2%	-2.5%	0.3%	-1.5%
Japan	18:50	Producer price index	Jan.	0.3%	4.0%	0.3%	3.8%
THURSDAY 13							
United Kingdom	2:00	Trade balance (£M)	Dec.	-4,000		-4,757	
United Kingdom	2:00	Construction	Dec.	0.2%	1.2%	0.4%	0.2%
United Kingdom	2:00	Index of services	Dec.	0.1%		0.1%	
United Kingdom	2:00	Monthly GDP	Dec.	0.1%		0.1%	
United Kingdom	2:00	Real GDP – preliminary	Dec.	-0.1%	1.1%	0.0%	0.9%
United Kingdom	2:00	Industrial production	Dec.	0.3%	-2.1%	-0.4%	-1.8%
Germany	2:00	Consumer price index – final	Jan.	-0.2%	2.3%	-0.2%	2.3%
Eurozone	5:00	Industrial production	Dec.	-0.6%	-3.1%	0.2%	-1.9%
FRIDAY 14							
Eurozone	5:00	Net change in employment – preliminary	Q4	n/a	n/a	0.2%	1.0%
Eurozone	5:00	Real GDP – preliminary	Q4	0.0%	0.9%	0.0%	0.9%
Russia	5:30	Bank of Russia meeting	Feb.	21.00%		21.00%	

Note: Unlike release times for US and Canadian economic data, release times for overseas economic data are approximate. Publication dates are provided for information only. The abbreviations m/m, q/q and y/y correspond to month-over-month, quarter-over-quarter and year-over-year change respectively. Times shown are Eastern Standard Time (GMT -5 hours).