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Back down the rabbit hole (on steel & aluminum tariffs)

By Warren Lovely, Taylor Schleich & Ethan Currie

Coming March 12, 2025: Tariffs on U.S. imports of steel and aluminum, initiated by Donald J. Trump, President of the United States, pursuant to Section 232. See the fact sheet **here**. Stop us if you've heard this before, because yes, we've been down this rabbit hole before.

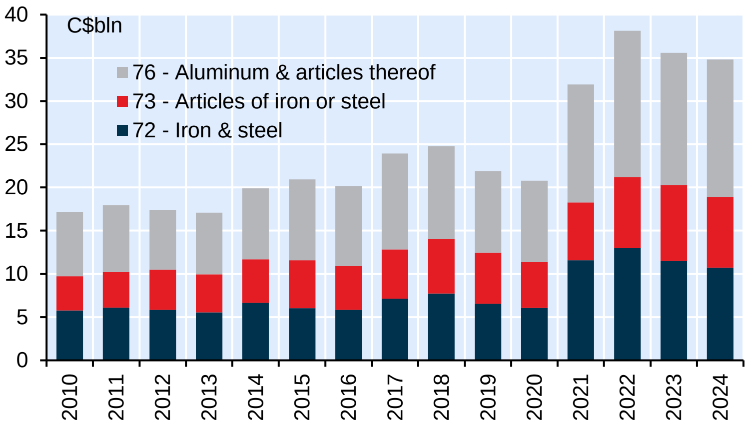
Back in 2018, trade-related jawboning from the Trump Administration (version 1.0) ratcheted up, ultimately culminating in the implementation of steel and aluminum tariffs under Section 232. Canada was subjected to these tariffs for about one year and retaliated in kind. Fast forward to 2025… Back in the White House for a second go-round, President Trump is replaying this particular trade stratagem. Steel/aluminum tariffs should be viewed in the context of a broader 'America first' policy theme, for which the President claims a strong electoral mandate.

Looking back on the 2018-19 episode, targeted industries and some regions were impacted. But the overall fallout from that earlier tariff episode was generally contained. False comfort? Perhaps. Surely few countries have more at stake from rising U.S. protectionism than Canada. That's as true today as it was in seven years ago and extends far beyond steel and aluminum. Moreover, steel and aluminum tariffs are separate/distinct and theoretically incremental to the real existential threat facing Canada: that of broad 25% tariffs (or 10% in the case of energy products) linked to illegal drugs coming into the U.S. via its northern border. This much-more-serious threat remains unresolved.

Markets may have taken the latest steel/aluminum tariff noise in stride, but Canada's outlook is massively contingent on evolving trade policies.

Chart 1: C$35bln of steel & aluminum to the U.S. last year…

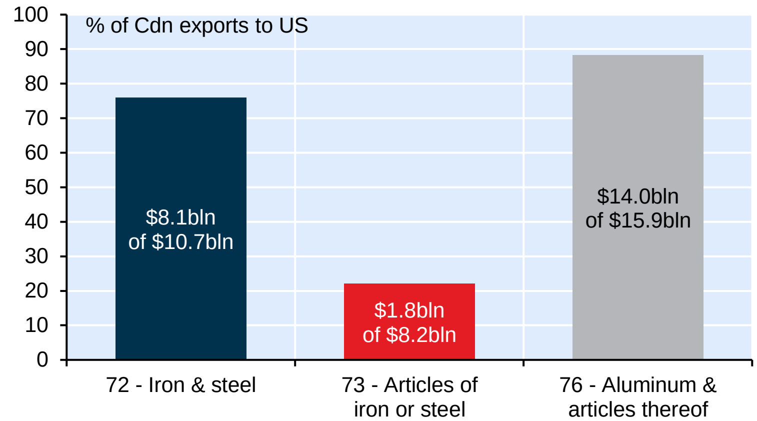
Canada steel & aluminum exports to the U.S.



Source: NBC, StatCan, ISED | Note: Using HS2 codes for products most impacted

Chart 2: …of which about 70% may be under tariff watch

Estimate of U.S. tariff application rate to Canada steel & aluminum exports (2024)

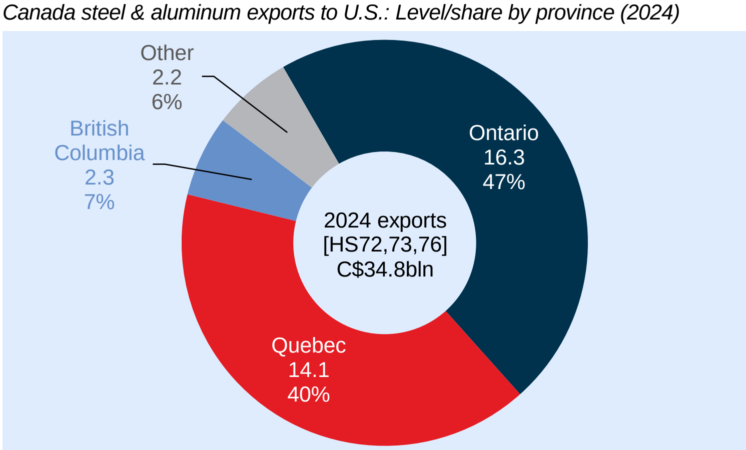


Source: NBC, StatCan, ISED, White House | Note: Based on HS6 codes in U.S. order

U.S.-bound exports of Canadian steel and aluminum amounted to ~C$35bln in 2024 (as classified by HS 2-digit levels). That's split roughly down the middle between steel (HS72/73) and aluminum (HS76). While we don't expect the exhaustive HS2 lists to be included in current tariffs, 2018 specifications from the White House suggest ~C$24bln of direct exposure (tariff application of 69%).

Chart 3: Ontario & Quebec account for bulk of focus exports

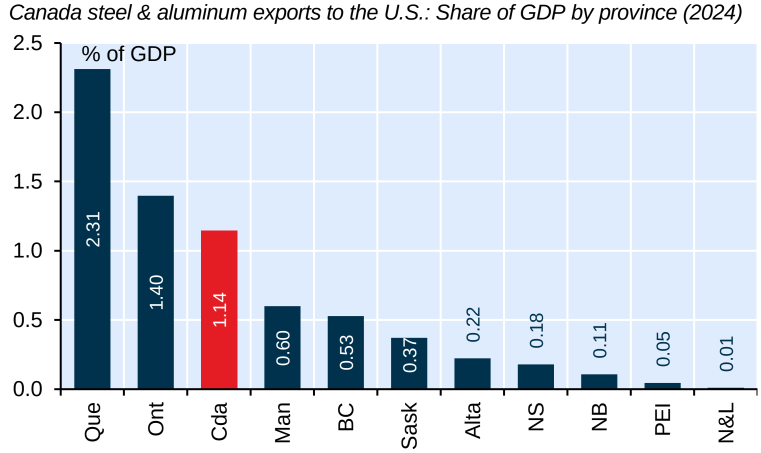
Canada steel & aluminum exports to U.S.: Level/share by province (2024)



Source: NBC, StatCan, ISED | Note: Based on exports to the U.S. of related products (HS72, HS73 & HS76); as per Chart 2, U.S. tariffs will not apply fully

Chart 4: U.S. tariff sting likely to vary by province/region

Canada steel & aluminum exports to the U.S.: Share of GDP by province (2024)

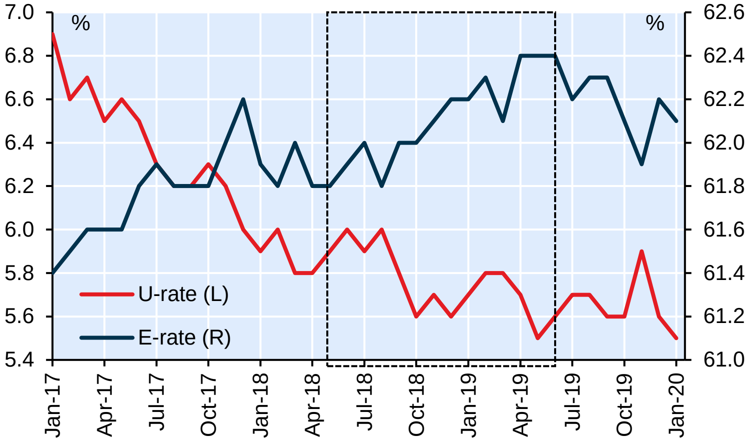


Source: NBC, StatCan, ISED | Note: Based on exports to the U.S. of related products (HS72, HS73 & HS76) relative to nominal GDP est; as per Chart 2, tariffs will not apply fully

The bulk of Canada's steel and aluminum exports to the U.S. originate from Ontario and Quebec. Using broad(er) HS 2-digit classifications, Ontario is responsible for nearly 70% of U.S.-bound steel, while Quebec has a similar share for aluminum. Scaling exposed exports to GDP, Central Canada clearly has more at stake, though no province should be cheering rising U.S. protectionism.

Chart 5: Canada's labour market resilient during 2018-19

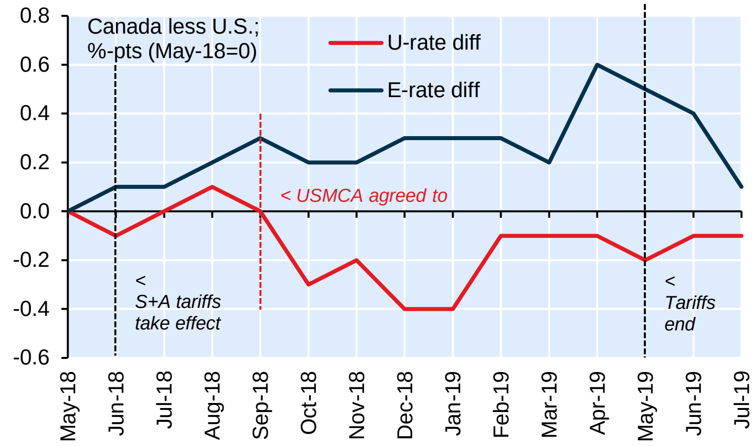
Canada unemployment & employment rate: 2018-19 episode



Source: NBC, StatCan

Chart 6: Relative resilience vis-à-vis the U.S.? Some evidence

Chg in Cda-U.S. unemployment & employment rate differentials: 2018-19 episode

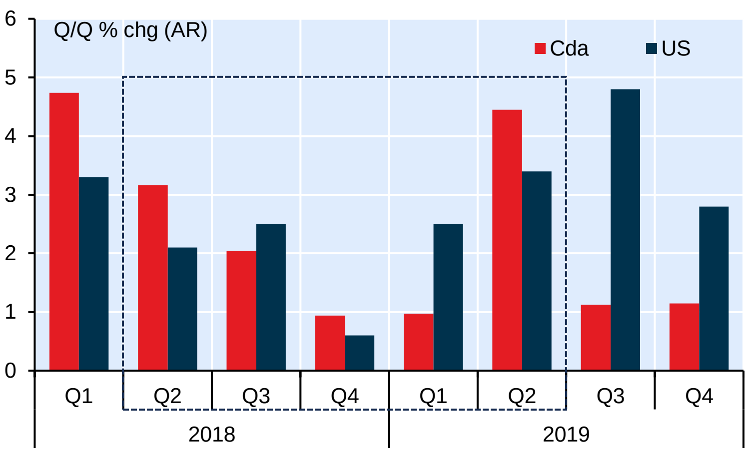


Source: NBC, StatCan, BLS, BBG | Note: Based on difference in Cda-U.S. rates

All in all, Canada's labour market held up during the 2018-19 steel/aluminum tariff period. Strictly speaking, key measures net *strengthened* during the 12-month tariff window from May-18 to May-19, Canada's unemployment rate even falling relatively faster than the U.S. It perhaps suggests that a narrow/short-lived tariff fight is survivable. A broader, more serious fight is another story though.

Chart 7: GDP growth did decelerate in late 2018, early 2019…

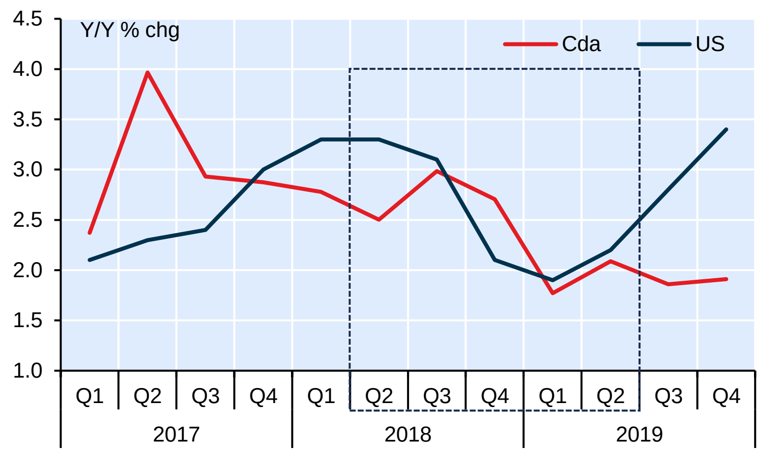
Canada & U.S. real GDP growth (quarter-over-quarter): 2018-19 episode



Source: NBC, StatCan, BEA, BBG

Chart 8: … though again, this was evident in the U.S. too

Canada & U.S. real GDP growth (year-over-year): 2018-19 episode

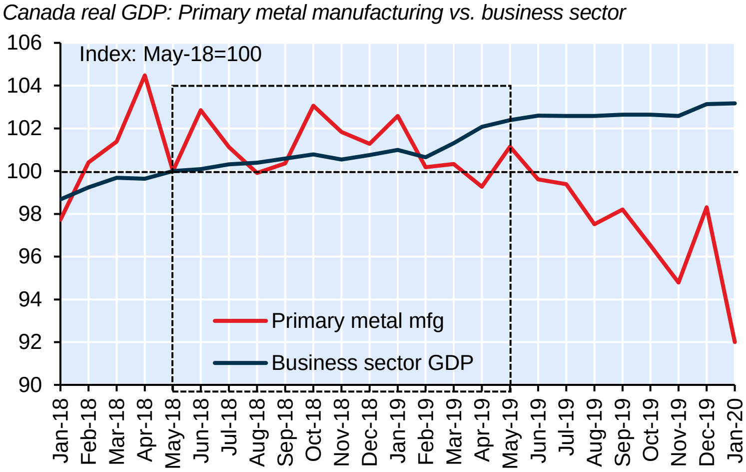


Source: NBC, StatCan, BEA, BBG

Notwithstanding Canada's above-noted labour market resilience, real GDP growth did slow in late-2018, early-2019. In part, that captured, reduced export activity. It's not so clear that Canadian real GDP suffered disproportionately during this earlier period, but serious/sustained trade fights are not helpful for a small, open economy like Canada, geopolitical uncertainty apt to delay investment.

Chart 9: Post-tariff scarring in primary metal manufacturing?

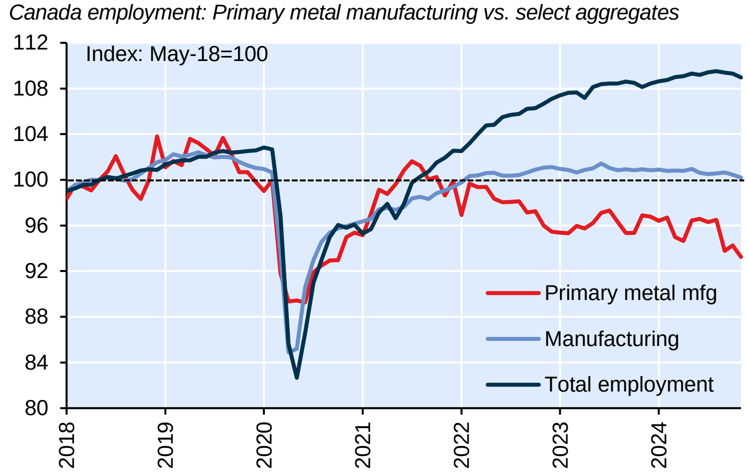
Canada real GDP: Primary metal manufacturing vs. business sector



Source: NBC, StatCan

Chart 10: Primary metals sector has lagged broader economy

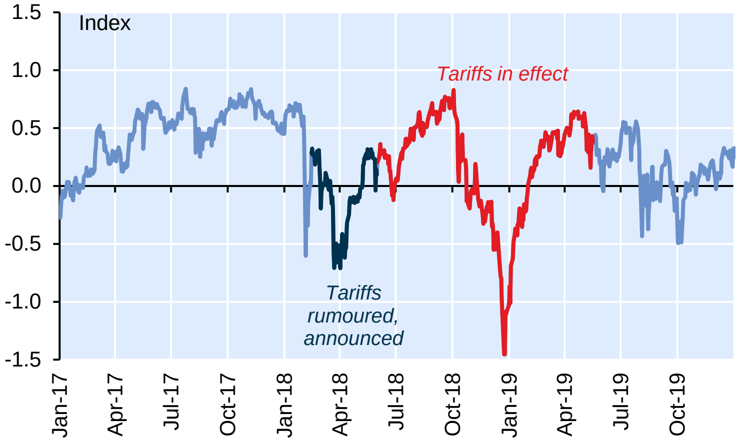
Canada employment: Primary metal manufacturing vs. select aggregates



Source: NBC, StatCan

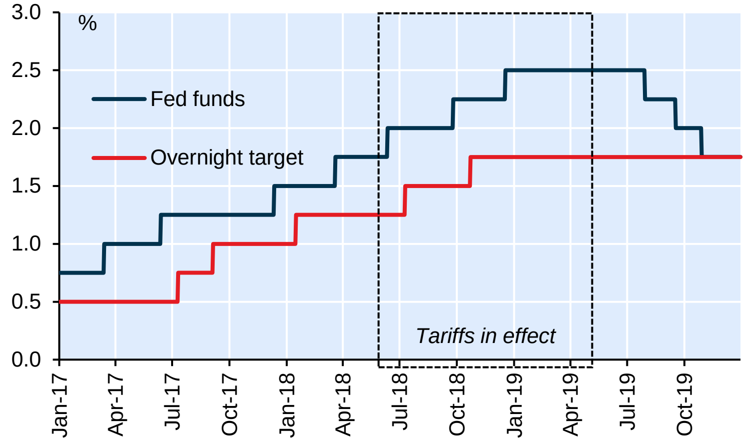
Industry-level data suggest sectors most impacted by the earlier steel/aluminum tariffs held up alright… at least initially. There's perhaps some evidence of 'scarring' in primary metal manufacturing (GDP and jobs) in the post-tariff period (e.g., in the second half of 2019). Overall, steel/aluminum tariffs complicate the outlook for a factory sub-sector that has lagged the broader recovery.

Chart 11: Financial conditions volatile in earlier S&A tariff era
Bloomberg U.S. financial conditions index: 2018-19 episode



Source: NBC, BBG

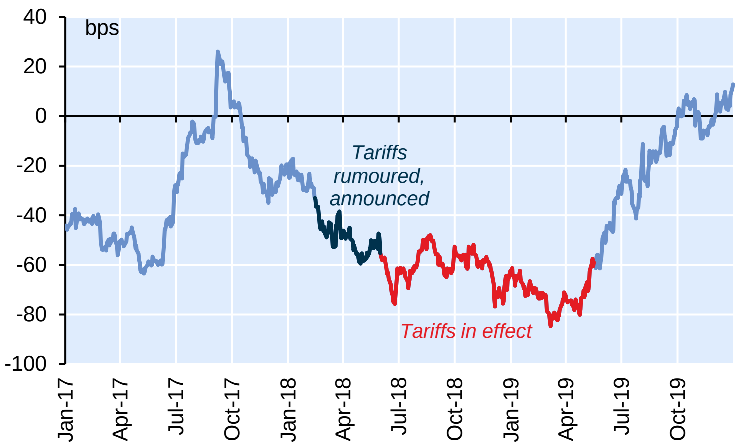
Chart 12: Fed rate hikes contributed to tighter conditions
Fed and Bank of Canada policy rates: 2018-19 episode



Source: NBC, BBG | Note: Fed funds refers to upper bound target

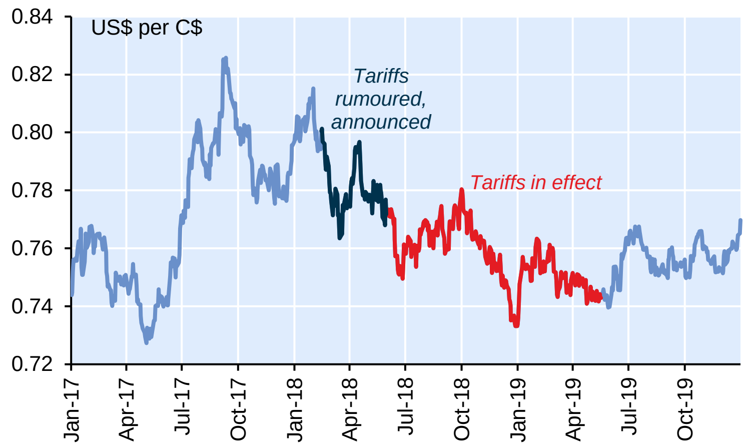
Financial conditions were far more volatile when trade policy was uncertain. An initial deterioration coincided with tariff rumours and the initial announcement. Conditions firmed later in 2018 until an equity meltdown ensued, although tariffs weren't the only reason. At the same time, the Fed was tightening policy. In hindsight, they *over*tightened, having to reverse course in late-2019.

Chart 13: GoCs outperformed during the S&A tariff era…
Canada-U.S. 2-year yield differential: 2018-19 episode



Source: NBC, BBG

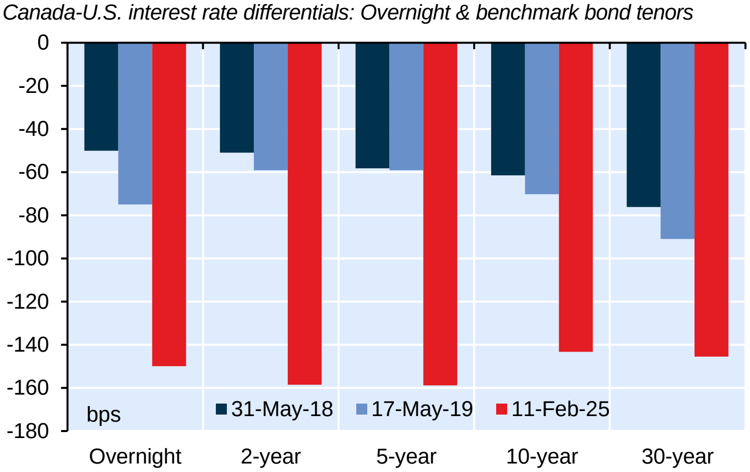
Chart 14: …which helped drive the Canadian dollar weaker
Canadian dollar exchange rate (CADUSD): 2018-19 episode



Source: NBC, BBG

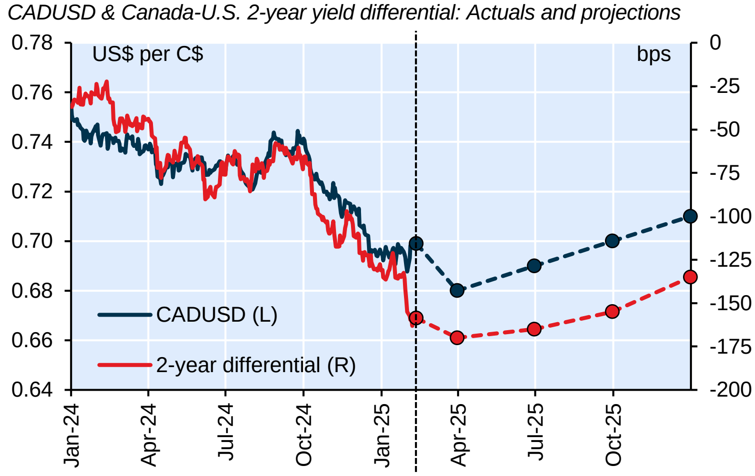
The Fed and BoC were hiking before and *after* tariffs were implemented, but the Fed was more aggressive which led to outperformance of GoC bonds in 2018. The loonie was depreciating during the S&A tariff era and though it's difficult to disentangle generalized trade uncertainty from the C$'s fundamental drivers (rate differentials, oil), the C$ would likely have weakened anyways.

Chart 15: Today, relative rates are historically extreme…
Canada-U.S. interest rate differentials: Overnight & benchmark bond tenors



Source: NBC, BBG | Note: 31-May-18 = tariffs imposed; 17-May-19 = tariffs lifted

Chart 16: …creating scope for 'normalization' later this year
CADUSD & Canada-U.S. 2-year yield differential: Actuals and projections

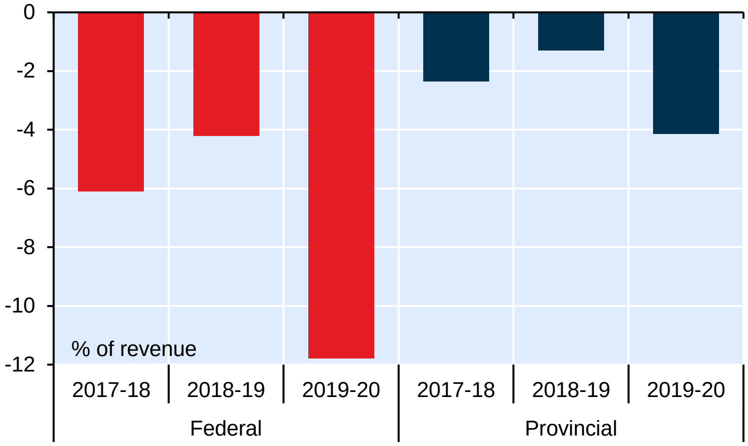


*Source: NBC, BBG | Note: Dotted lines refer to baseline NBF forecasts (see: **here** and **here**)*

Today, relative rates are extreme, far from the levels prevailing when earlier tariffs were implemented and/or lifted (or anywhere in between). We technically see modest further GoC performance in the near-term but expect rate gaps to narrow in the spring. Naturally, we see the loonie firming later this year too. Unlike *blanket* 25% tariffs, levies on S&A shouldn't materially alter this trajectory.

Chart 17: Budget balances held up last time (until COVID came)

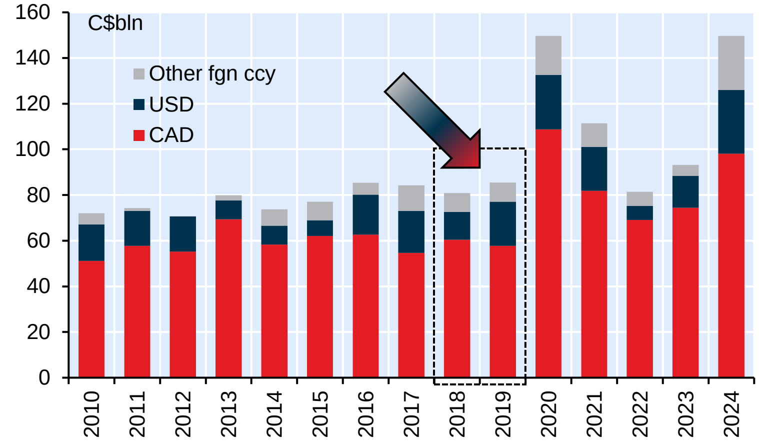
Federal-provincial budget balance: 2018-19 episode



Source: NBC, fed-prov gov'ts | Note: By fiscal year; public accounts basis

Chart 18: No real pick up in provi supply pace in 2018-19

Gross provincial bond supply by currency of issue: Calendar year basis

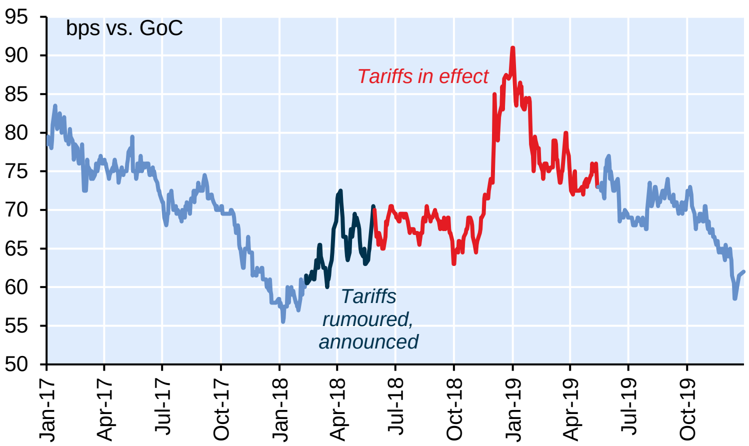


Source: NBC, BBG | Note: Gross marketable issues, converted to CAD at prevailing FX rate

Back in 2018, U.S. tariffs sparked Canadian retaliation. Ottawa's fiscal relief measures far exceeded tariff-related revenue back then. Still, the federal budget wasn't exactly trashed (not until COVID arrived at least). Like now, the aggregate provincial deficit was relatively leaner than the feds (and also saw a net improvement in 2018-19). Nor did provi bond supply really pick up in 2018-19.

Chart 19: Geopolitical noise often equals spread volatility

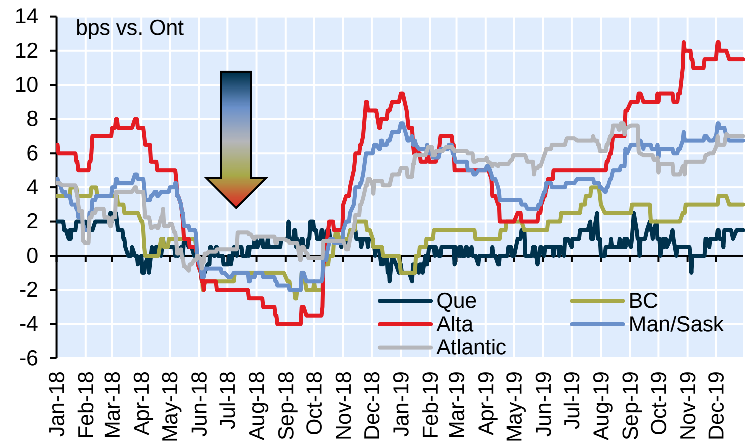
Ontario 10-year constant maturity spread vs. GoC curve: 2018-19 episode



Source: NBC

Chart 20: Provincial relationships were re-priced in 2018-19

Select 30-year constant maturity basis spread vs. Ontario

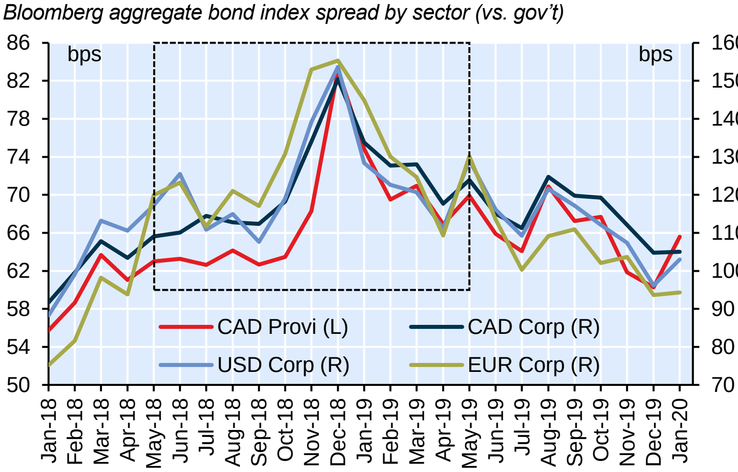


Source: NBC

Even if direct fiscal impacts were relatively contained, provincial spreads had to contend with ample volatility in 2018-19 (as covered on pg. 3). Deteriorating trade relations coincided with wider spreads and even the eventual inking of the USMCA (in Sep-18) failed to soothe nerves. Relative exposures to tariffs saw some provincial relationships (temporarily) re-priced as the tariffs landed.

Chart 21: More broadly, credit markets rode roller-coaster

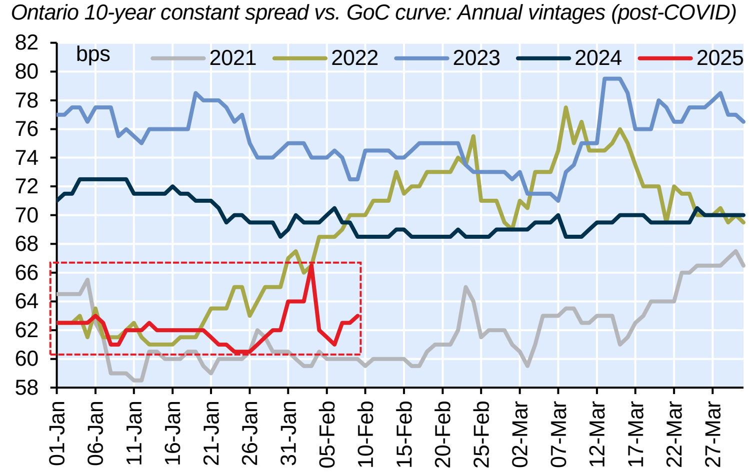
Bloomberg aggregate bond index spread by sector (vs. gov't)



Source: NBC, BBG | Note: Sector aggregates; based on monthly closes

Chart 22: Where do things stand today?

Ontario 10-year constant spread vs. GoC curve: Annual vintages (post-COVID)



Source: NBC | Note: Vintages of constant maturity spreads; 2025 to 11-Feb

Spread noise was hardly limited to provis in 2018-19, as corporates rode a roller-coaster too. Weakness/anxiety most acute in late 2018, before a fed policy reversal ultimately calmed things down. Overall, you're forgiven for a certain sense of déjà vu. Just like 2018, U.S. trade policy is the great wild card, with economic-fiscal-financial risk assessment driving absolute and relative spreads.

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