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Macro Picture:

Trump's Tariffs Hit Canada:

Growth, Jobs, and Inflation in the Crossfire

By

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21 August 2025

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Trump's Tariffs Hit Canada: Growth, Jobs, and Inflation in the Crossfire

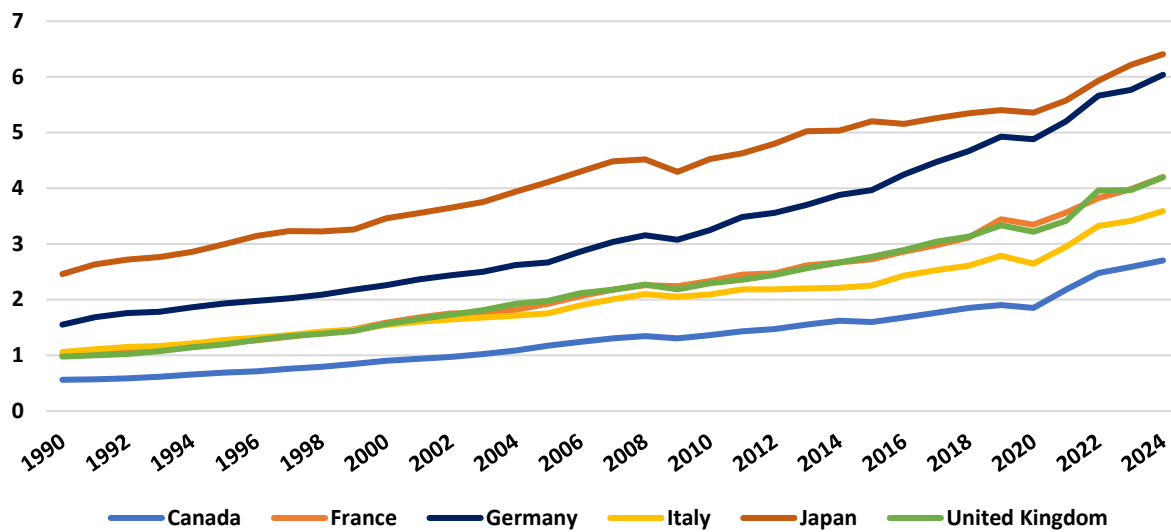
21 August 2025

Executive Summary

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- ✦ Despite vast resource wealth and energy independence, Canada faces a prolonged productivity slump, with stalled growth since 2019, leaving living standards stagnant.
- ✦ U.S. tariffs on Canadian steel, aluminum, and vehicles—raised from 25% to 35%—alongside trade uncertainty have dented growth, confidence, and hiring, with front-loaded exports in early 2025 followed by a sharp April slump.
- ✦ While Q1 2025 GDP rose 0.5% on tariff-avoidance shipments, export declines and costlier goods risk a mild recession later in the year.
- ✦ U.S. tariffs have stalled Canada's job market recovery, pushing unemployment to 7%, triggering major manufacturing layoffs and causing the steepest employment drop since 2022, with further weakness likely into late 2025.
- ✦ U.S. trade policy shifts are driving Canada to diversify exports toward Europe, ASEAN, and high-value services like tech and engineering, with a new ASEAN FTA aimed at reducing G7 reliance and expanding ties in trade, energy, food security, and digital sectors.
- ✦ Tariffs have created mixed inflation pressures in Canada, slowing exports and jobs (downward pressure) while raising import costs through U.S. and Canadian counter-tariffs (upward pressure), with weak demand limiting but not preventing price hikes.
- ✦ As of June 2025, headline inflation rose to 1.9% y-o-y core inflation hit a four-month high of 2.7%, and input costs remain elevated, suggesting tariffs could continue feeding into consumer prices despite slowing growth.
- ✦ The Bank of Canada held its benchmark rate at 2.75% in July for the third consecutive meeting, balancing elevated inflation pressures with a weakening labour market, moderating wage growth, and signs of a potential Q3 contraction, while awaiting more data before deciding on further easing.
- ✦ Policymakers assessed three possible U.S. tariff scenarios—status quo, de-escalation, or escalation—finding modest but rising inflation impacts from tariffs, and keeping the September 17 decision contingent on updated July–August inflation data.
- ✦ Prime Minister Mark Carney's minority Liberal government plans major spending on infrastructure, defense, social programs, and tax relief, but will need cross-party support; its "One Canadian Economy" bill aims to remove interprovincial trade barriers and speed up major project approvals.
- ✦ Rising deficits—projected to climb from \$51B to \$88B in 2025, with provinces accounting for over 60% of the increase—signal a strong fiscal impulse, potentially boosting GDP by up to 0.3 points in 2026, though delays in infrastructure and defense spending could limit the impact.
- ✦ Infrastructure-heavy federal and targeted provincial measures are expected to have high short-term multipliers, especially given the larger-than-expected output gap from U.S. trade tensions.

Key Picture: GDP, PPP (Current International \$, Trillions), G7 Countries, excluding the US

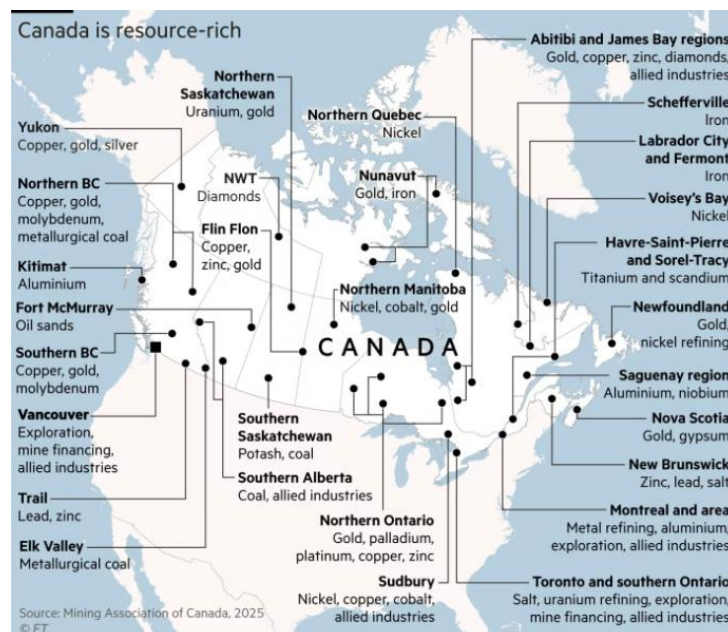


Source: World Bank

Canada's Productivity Crisis: Stagnation Amid Resource Wealth

Among the G7 economies, Canada is the smallest by GDP and population, yet the second-largest country by landmass, with the world's longest coastline and access to both the Pacific and Atlantic oceans—an ideal position for global trade (**Key Figure**). It is energy independent, holding the world's largest high-grade uranium deposits, the third-largest proven oil reserves, and ranking fifth in natural gas production. Canada also possesses vast potash reserves, extensive forests, abundant freshwater, and significant deposits of cobalt, graphite, lithium, and other rare earths vital for renewable technologies (**Figure 1**). Thus, the economy increasingly relies on oil, gas, and mineral extraction, limiting incentives to transition away from fossil fuels.

Figure 1: Map of Canada's Resources



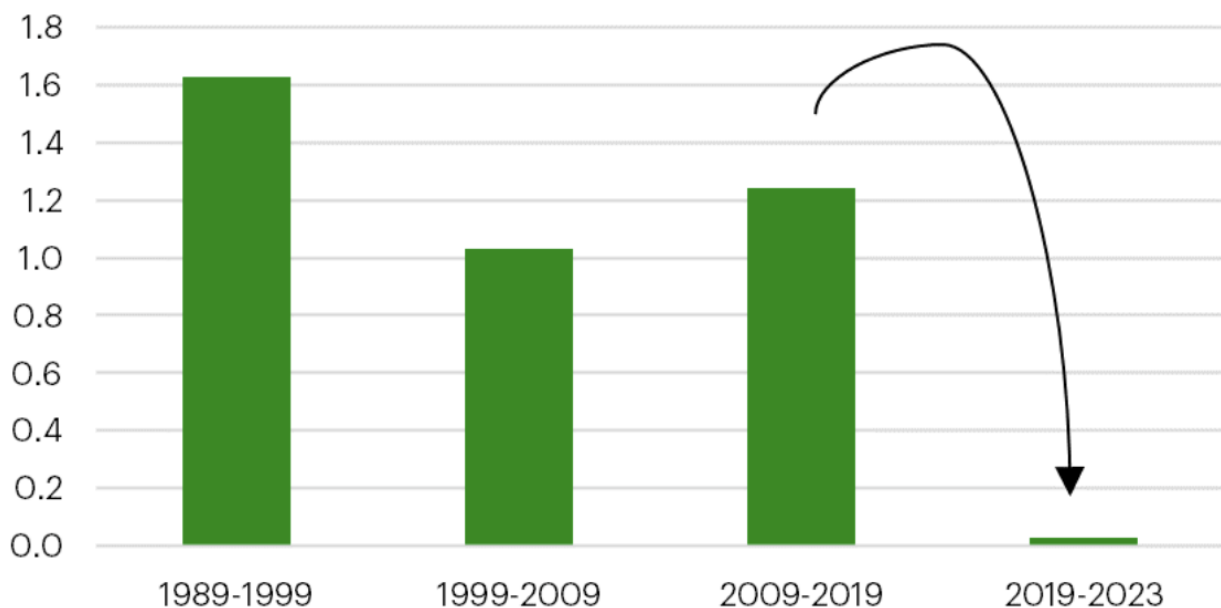
Source: Financial Times

Since 2009, growth has been sluggish, marked by low investment in machinery and equipment, weak industrial capacity use, subdued employment and wage growth, and persistent GDP stagnation, reflecting what some analysts term a “Long Depression” that began before the COVID-19 slump. For much of the past 50 years, Canada’s productivity growth has trailed the US, and other advanced economies. However, [Canada’s productivity has stalled since 2019](#) whatsoever after growing 1.2% annually in the decade before the pandemic, making it one of the weakest performers among advanced economies (**Figure 2**).

[A recent RBC report points](#) to several factors behind Canada’s stagnation. Businesses invest far less than in the US, about half as much per worker, and have devoted a smaller share of GDP to manufacturing over the past decade. This is not due to a lack of capital despite higher interest rates, firms hold cash reserves equal to nearly one-third of GDP. Instead, businesses cite costly and slow project approvals as a key deterrent. Weak investment also keeps firms small—98% have fewer than 100 employees—and smaller firms tend to be less productive on average. Regulatory fragmentation also hinders domestic trade, with a patchwork of provincial and municipal rules creating internal trade barriers equivalent to a 20% tariff, compared to less than 1% on foreign imports. Taxation is another drag: while corporate tax rates are comparable to peers, the total tax on distributed profits is the highest in the G7 once personal dividend taxes are included.

The decline spans most industries. Goods-producing sectors, especially construction, have seen outright reversals. In goods-producing industries, [productivity has not only slowed but reversed](#), cutting an average of 0.4 pp from overall growth each year since the pandemic.

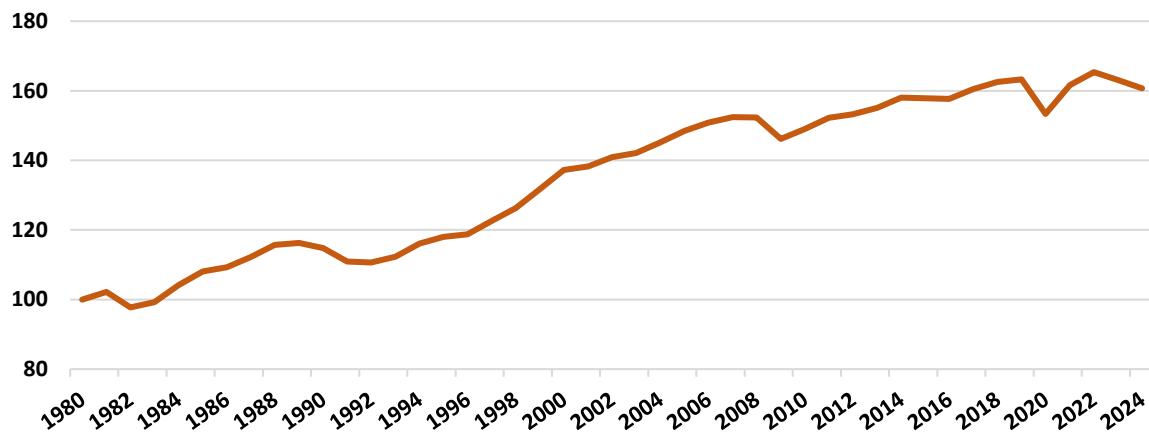
Figure 2: Real Output per Hour Worked, Annual Average % Change



Source: [Economics TD](#)

Canada’s economic growth in recent decades has been driven largely by population increases. Since 2000, the country has recorded the fastest population growth rate in the G7, averaging 1.1% annually more than double the G7 average of 0.5%. Yet despite this rapid growth, Canadians’ standard of living, measured by real GDP per person, is only marginally higher in 2024 than in 2014, reflecting a decade of stagnation (**Figure 3**).

Figure 3: Constant GDP Per Capita For Canada (1980=100)



Source: Fred

Macroeconomic Developments in Canada

Trade Shock

Adding to these internal problems, President Trump is now looming large over Canada's economy. The U.S.–Canada trade dispute has intensified, with President Trump raising tariffs on Canadian imports from 25% to 35%. While most goods continue to move duty-free under CUSMA, the deal faces a scheduled review in 2026 and potential expiry in 2036, with some calling for an earlier review. Conflicting U.S. trade data on compliance and exemptions leaves the exact impact somewhat unclear. [U.S. Census Bureau data labeled](#) as CUSMA shows that 56% of Canadian and 47% of Mexican goods entering the U.S. meet the agreement's requirements. Another dataset, based on tariff rates, indicates that 91% of Canadian and 84% of Mexican imports enter duty-free.

However, tariffs on steel, aluminum, and vehicles, combined with high trade policy uncertainty, are already weighing heavily on growth, business confidence, and hiring. Even though, Canada's GDP grew by 0.5% in the first quarter of 2025, matching the revised pace of the previous quarter and surpassing expectations, much of this gain came from net foreign demand and inventory buildup as firms rushed to get ahead of impending U.S. tariffs, rather than from underlying economic strength. To get ahead of tariffs, Canadian exporters to the U.S. accelerated shipments, [driving a 10% rise in goods exports in Q1 2025 compared to Q4 2024](#).

The surge was led by machinery, equipment, and motor vehicles, with notable gains in lumber, food, and pharmaceuticals. Front-loading shipments to avoid tariffs pulled activity forward, leading to a sharp reversal in April, with Canadian goods exports to the U.S. down over 15%. Tariffs have made Canadian products costlier, with steel and aluminum exports falling 11% and 25%, respectively, and motor vehicle exports nearly 25%. Activity will slow over the summer before a modest recovery late in 2025. Nevertheless, the risk of a mild recession remains, given the ongoing uncertainty with the country's largest trading partner.

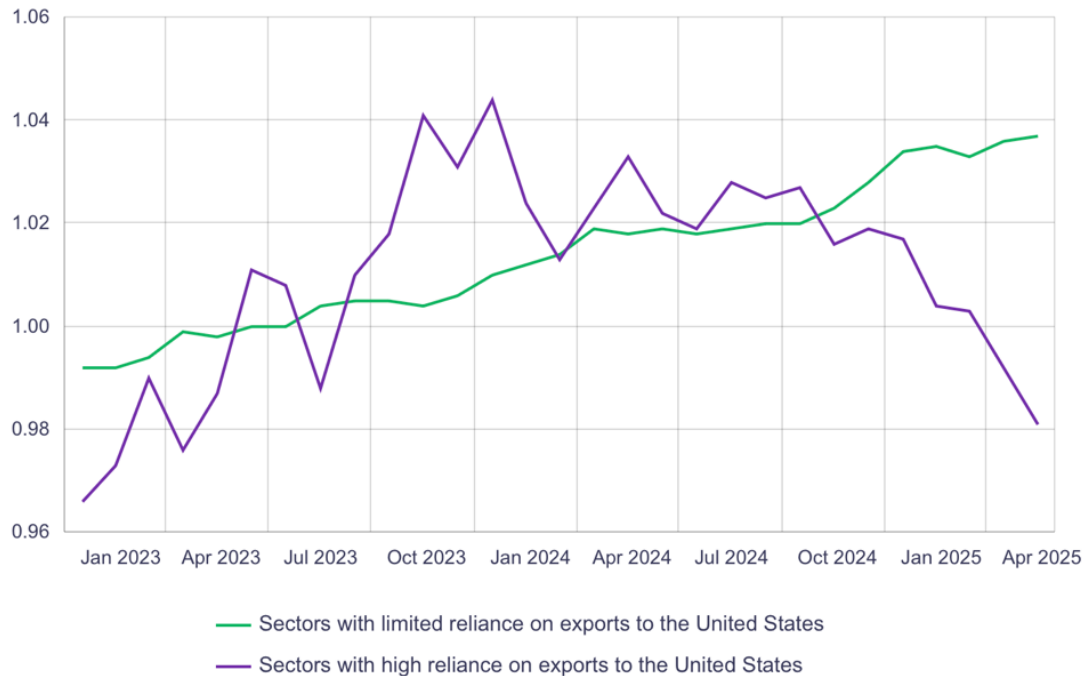
Labour Market Strains

When the trade war began, Canada's labour market was still recovering and never reached full strength before tariffs and uncertainty stalled progress. Then a more volatile economic outlook has made planning harder for Canadian businesses, curbing investment and hiring plans. As a result, employment growth has stalled, driving the unemployment rate up to 7% in May. In June-July, unemployment rate held at 6.9%. The jobless count stayed around 1.6 million, with nearly a quarter unemployed long term. Employment fell by 40,800, the steepest drop since 2022, while participation slipped to 65.2%. Youth unemployment climbed to 14.6%, the highest since 2010 outside the pandemic, amid weak seasonal hiring. Unemployment is expected to peak at 7.3% in Q3 before easing below 7% in early 2026.

According to the Bank of Canada, around two million Canadian jobs depend on U.S. goods exports, and tariffs quickly hit employment in affected industries (Figure 4). Ontario auto plants announced layoffs and production cuts, contributing to a loss of 55,000 manufacturing jobs since January, with broader declines across trade-sensitive sectors.

Figure 4: Employment, Seasonally Adjusted, Index: 2023=1

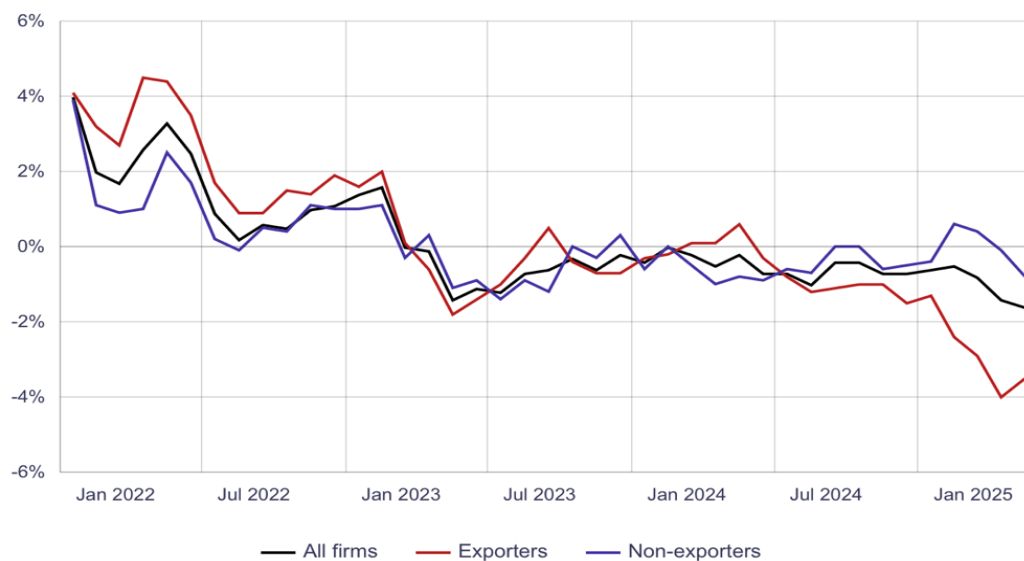
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Source: [Bank of Canada](#)

Business surveys show export-oriented firms slashed hiring plans in response to U.S. tariffs, with other sectors following suit. If these cutbacks continue, overall employment is likely to weaken further, and signs of broader job market softness are being monitored closely (Figure 5).

Figure 5: Expected Employment Growth Over the Next 12 months, Relative to Historical Average



Source: [Bank of Canada](#)

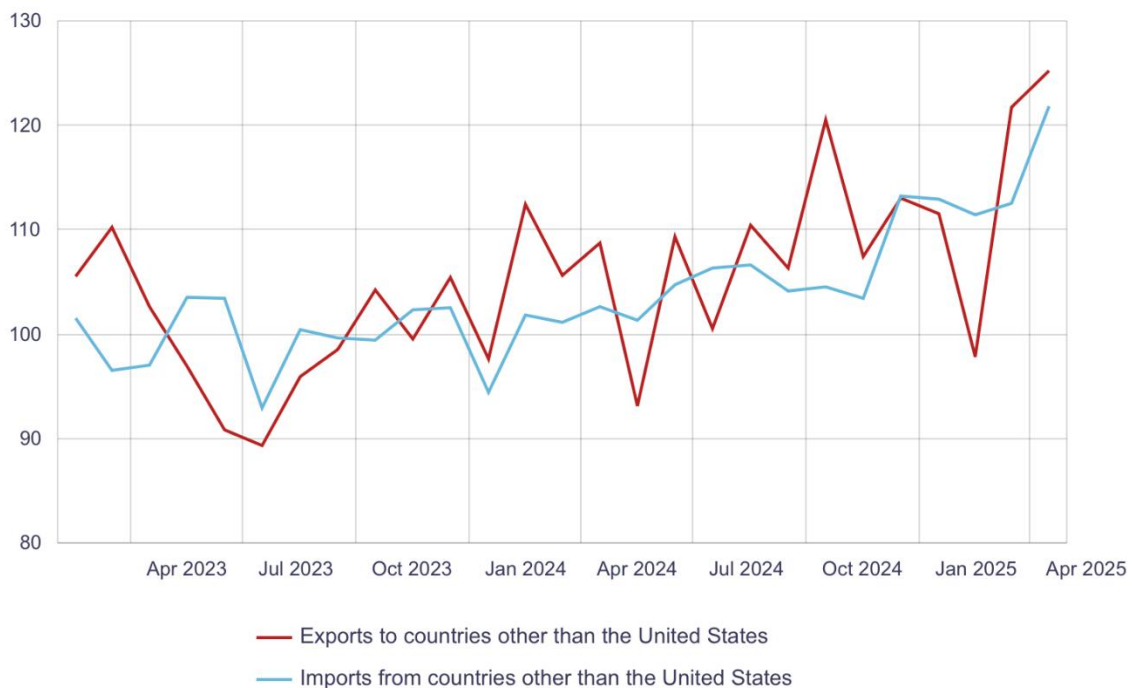
Resilience and Diversification

As already discussed, US trade policy shifts have altered the timing, but it also affected destination of Canadian trade, pushing businesses to seek new suppliers and export markets (**Figure 6**). Diversification builds competitiveness and resilience, reducing exposure to supply disruptions and trade barriers. Newfoundland and Labrador is a strong example, only a third of its exports go to the U.S., with over half of its oil now shipped to Europe and beyond, alongside growth in services exports like tech. Nationally, services exports—particularly in IT, R&D, and engineering—are expanding faster than goods. For landlocked regions, goods diversification is harder, but removing interprovincial trade barriers, improving east–west transport, and investing in efficient ports could strengthen domestic and global trade links.

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[Canada is fast-tracking a free trade agreement with the 10-member ASEAN bloc](#) to diversify markets. Foreign Minister Anita Anand said the Indo-Pacific will drive global growth and highlighted cooperation beyond trade in areas like energy, food security, digital economy, and AI. The FTA aims to reduce reliance on the G7 and expand ties with smaller markets.

Figure 6: Exports and Imports, Seasonally Adjusted, Nominal Data; Index 2023=100



Source: [Bank of Canada](#)

Inflation's Mixed Signals

Before tariffs, headline inflation had returned to the 2% target, core inflation was slightly higher, and expectations were stable. However, tariffs changed the picture here as well. US tariffs have slowed Canadian exports and jobs, pushing inflation down, but also raised US prices, which spill into Canada through imports. Canadian counter-tariffs add further upward pressure. The net impact is hard to measure. Pass-through depends on demand and expectations: weak demand limits price hikes, but tariffs give firms cover to raise prices.

So far, inflation pressures in Canada have risen, with the Bank of Canada's key measures climbing above 3% in April, putting core inflation at the top of its target range. While growth is slowing, tariffs are expected to keep input costs elevated and could feed through to consumer prices. Headline inflation rose to 1.9% y-o-y in June 2025 from 1.7% in May, matching expectations but staying below the Bank of Canada's 2% target for a third month. Fuel deflation eased (-13.4% vs -15.5%), lifting transportation costs, while durable goods prices rose for

vehicles and furniture. Food and shelter inflation slowed to 2.9%. Core inflation remains elevated and rose to a four-month high of 2.7% y-o-y in June.

Bank of Canada's Balancing Act

As inflationary pressures remain elevated, the Bank of Canada (BoC) hold rates steady in July. However, monetary easing is still expected by year-end. A softening labour market and moderating wage growth should help ease inflation, while several indicators point to a possible third-quarter contraction. The lag between economic weakness and its impact on inflation appears to be at play.

The BoC hold its benchmark rate at 2.7% as of July decision, marking a third consecutive hold after reducing rates by a total of 2.25 percentage points over seven straight decisions. As the meeting minutes reveal, senior BOC officials were split on whether to cut rates. Some felt previous reductions had already provided sufficient support amid heightened trade uncertainty, while others argued that persistent economic slack and labour market weakness warranted further easing. In the end, all seven governing council members agreed to hold the policy rate at 2.75% on July 30, opting to wait for additional data before making further moves.

With its rate decision, the BoC outlined three possible U.S. tariff paths: status quo, de-escalation, or escalation, none projecting a sharp inflation surge. Policymakers noted tariff impacts on consumer prices remain modest but are only beginning to appear, and judged inflation risks elevated due to underlying price pressures and trade uncertainty. Updated July and August inflation data will inform the September 17 rate decision.

Economic Agenda Amid Fiscal Pressures

Political Shift

On March 24, newly appointed Prime Minister Mark Carney called a snap election for April 28. Mark Carney's Liberal Party secured enough seats to form a government but fell short of a majority. Carney, who became prime minister in March after Justin Trudeau's resignation, remains in office. Conservative leader Pierre Poilievre and NDP leader Jagmeet Singh both lost their seats. The Liberal Party's election win paves the way for spending plans focused on infrastructure, defense, social programs, and tax relief. However, as a minority government, they will need support from other parties to pass legislation.

"One Canadian Economy" Bill Targets Growth Barriers

Now with the federal election behind, there is some advancement on important files. For example, Recently tabled by the federal government, the "[One Canadian Economy](#)" bill targets two key growth constraints: interprovincial trade barriers and slow regulatory approvals for major investment projects. It allows Ottawa to fast-track nationally significant projects. The One Canadian Economy Act aims to unify Canada's internal market and speed up strategic projects. Through the Free Trade and Labour Mobility in Canada Act, goods, services, and professional licenses meeting one province's standards will be recognized nationwide, easing interprovincial commerce and worker mobility. The Building Canada Act streamlines approvals for major projects of national interest, cutting timelines from five years to two, with a single minister overseeing early approvals and consolidating all authorizations. While the plan promises fewer barriers and faster development, its success will hinge on provincial cooperation and smooth implementation.

Fiscal Outlook

Additionally, the federal government may delay its 2025 budget until fall, but rising deficits seem inevitable, with defence commitments and extensive election pledges setting the course despite uncertainty over timing. Under base assumptions, combined deficits could rise from \$51 billion to \$88 billion, with provinces responsible for more than 60% of the increase. Even by 2027–28, when provincial deficits are expected to be minimal, the federal shortfall could still hover around \$50–60 billion, [according to the RBC Economics](#).

The larger deficits point to a much stronger fiscal impulse than anticipated last fall, potentially approaching 3% of GDP in 2025–26 before easing to around 1.5% in the following two years. Infrastructure-heavy federal measures, along with targeted provincial spending, could deliver a meaningful boost to growth, especially given a wider-than-expected output gap from U.S. trade tensions. Short-term economic multipliers are likely to be higher for infrastructure and low-income support than for corporate tax measures.

RBC has nudged GDP forecasts up by 0.1 percentage point for 2025 and 0.3 points for 2026. Still, fiscal policy remains a wildcard: not all pledged measures may be implemented, and execution delays—particularly in infrastructure and defense—could limit impact. The trend of rising government spending, however, makes fiscal policy a key factor in the economic outlook.