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The Great Trade War of 2025

Invoking emergency powers due to the stated "threat posed by illegal aliens and drugs,"[1] President Trump implemented a 10% tariff on imports from China, a 25% tariff on imports from Mexico,[2] and – perhaps most surprisingly – a 25% tariff on imports from Canada (except for Canadian energy imports that receive a 10% tariff). These tariffs, effective February 4th, are sending shockwaves through financial markets both in North America and around the globe. In his press conference on January 31st announcing the tariffs, President Trump first referenced the drug crisis and then stated, "and number two, we have big deficits."[3] He went on to affirm that tariffs on steel, aluminum, semiconductors, and pharmaceuticals are coming globally and that tariffs are "absolutely" coming for the European Union (EU) and that action directed at the EU will be "very substantial".

In retaliation to U.S. tariffs, Canada announced 25% tariffs on C$30 billion worth of imports from the U.S. also starting on February 4th, and then on another C$125 billion of imports starting 21 days later, with tariffs on the latter group of goods subject to public comments prior to implementation.[4] Mexico's president has also vowed retaliation, but without immediate details. China's government indicated that it would take unspecified "countermeasures,"[5] but we believe that China is likely to let Canada and Mexico take the lead in retaliation while it strategizes for an eventual larger trade negotiation with the U.S.

What is at hand, what is achievable, and at what cost?

In President Trump's economic agenda, tariffs are a primary tool to bring manufacturing jobs to the U.S., reduce trade deficits, fill government coffers, and, yes, enhance border security. The relevance of this broader context for tariffs, beyond the President's stated border security emergency, is exemplified by the fact that Canada was dealt essentially the same treatment as Mexico despite Canada recently enacting a large package to address border security and our shared border representing only a tiny fraction of the illegal border crossing and drug problem. The multifaceted functions of tariffs for the Trump administration imply that there is likely no immediate deal to make these tariffs completely go away.

All of President Trump's stated aims are, to some degree, achievable. The costs of the Trade War, however, are potentially substantial – rising inflation, supply chain disruption, growth slowdown, and rising unemployment. For context, while inflation may not run away to the upside it could easily rise above a 3% annual run rate by mid-year, though would likely cool back down in 2026. Our BMO Economics team has lowered its baseline U.S. GDP growth forecast for 2025 from 2.4% to 2.1%. Ultimately, we believe that the slowdown is unlikely to stumble into a recession.

[1] White House Fact Sheet, https://www.whitehouse.gov/fact-sheets/2025/02/fact-sheet-president-donald-j-trump-imposes-tariffs-on-imports-from-canada-mexico-and-china/

[2] Following a February 3rd morning phone call between President Trump and Mexico President Sheinbaum that included promised actions taken by Mexico to secure the border, the tariffs on Mexico are now set to be delayed by one month.

[3] https://www.rev.com/transcripts/trump-adresses-upcoming-tariffs

[4] https://www.canada.ca/en/department-finance/news/2025/02/canada-announces-155b-tariff-package-in-response-to-unjustified-us-tariffs.html

[5] https://www.reuters.com/world/china/china-denounces-trump-tariff-fentanyl-is-americas-problem-2025-02-02/

Dealmaking – President Trump's number one objective – should eventually limit the risk, but uncertainty about the duration of the Trade War and whether more "fronts" (EU, semiconductors, etc.) open while current ones are raging add to the risk. We believe that the path forward entails negotiation and that the collective incentives to come to the table will become more acute in the coming weeks. While there is some speculation that President Trump's use of the International Emergency Economic Powers Act (IEEPA) to impose tariffs will face legal challenges, we doubt those challenges will stand.[6] According to the Brookings Institute, "executive branch tariffs are statutorily excluded from most checks and balances"[7] and Congressional reforms to restore oversight in trade policy "have gained little traction."[8]

Risks vs opportunities and investor positioning

In the short-term, risks are clearly heightened. Major global stock markets are falling to begin the week by anywhere from 1% to 3% after digesting these weekend developments. Positive momentum will be difficult to sustain until either a favorable turn on tariffs has occurred or more time has passed. The initial impact on long-term interest rates is relatively muted, and the 10-year Treasury yield remains near the middle of our fair value range of 4.25% to 4.75%. This long-term interest rate stability reflects the tension between somewhat higher inflationary pressures from tariffs being offset by lower growth expectations that the market is now pricing in.

Opportunities may very well arise, but for clients with money on the sidelines we recommend taking a patient and measured approach to putting cash to work. The potential severity of the economic disruption will quickly become apparent, and this is only Round 1 of a Trade War, with perhaps the most severe action being reserved for the EU. So, being patient and opportunistic over the course of a few months is more advisable.

Our recommended positioning is overweight U.S. equities based in part on healthy fundamentals of consumers and corporations. In our 2025 Annual Outlook,[9] we discuss that our base case is higher volatility in the first half of 2025 precisely due to disruptions such as tariffs. For the full year, however, the bigger driver of the economy and markets should be productivity growth, which both moderates inflation and raises corporate profits. Those trends look squarely on track, and recent AI news points to less expensive and more rapid adoption of these technologies. President Trump has an affinity for striking deals after walking all parties to the edge – it's risky, to be sure, but he also cares deeply about the economy and markets, and we don't believe he is inclined to go over that edge either.

[6] IEEPA has been previously used to sanction, although not tariff, other countries. IEEPA's predecessor statute, however, the Trading with the Enemy Act of 1917 was used by President Nixon to impose tariffs, and the courts generally give the President broad latitude regarding what constitutes a national security emergency.

[7] https://brookings.edu/articles/why-does-the-executive-branch-have-so-much-power-over-tariffs/

[8] https://brookings.edu/articles/trump-could-impose-tariffs-on-day-one-with-few-checks-on-that-power/

[9] https://uswealth.bmo.com/insights/2025-outlook-the-name-of-the-game/

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