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Canada, Mexico Hit Back Against Trump Tariffs. Markets Brace for Impact As Trade War Kicks Off.

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President Donald Trump spoke to reporters on Friday ahead of announcing tariffs on Canada, Mexico and China on Saturday. (Photo by Chip Somodevilla/Getty Images)

Canada and Mexico plan to retaliate against tariffs announced by President Donald Trump on Saturday, touching off a trade war that is likely to upend global commerce and rattle financial markets.

Trump imposed 25% tariffs on Canada and Mexico and 10% on China on Saturday. Canadian energy products will be tariffed at 10%.

"Today's tariff announcement is necessary to hold China, Mexico, and Canada accountable for their promises to halt the flood of poisonous drugs into the United States," the White House said Saturday evening in a post on X.

Trump said he implemented the tariffs under the International Emergency Economic Powers Act (IEEP) due to the "major threat of illegal aliens and deadly drugs killing our Citizens, including fentanyl." The White House cited trade statutes as well in an executive order on the Canadian tariffs.

Canadian Prime Minister Justin Trudeau said Canada would respond with $155 billion of tariffs on U.S. goods, starting with $30 billion as of Tuesday. Categories include beer, wine, and spirits, household appliances, lumber and plastics.

"We're not looking to escalate but will stand up for Canada," Trudeau said at a press conference. "We didn't ask for this but we will not back down," he added and said he wants to work with the Trump administration.

Mexican President Claudia Sheinbaum said Saturday that she had ordered "Plan B" tariff and non-tariff measures in "defense of Mexico's interests," according to a post on X. "Mexico does not want confrontation," she said, adding she wants to work with the U.S. to address drug trafficking and other issues.

Much remains unknown, including the legality and scope of the U.S. tariffs. Dissent is already showing up among Republicans.

"Certain tariffs will impose a significant burden on many families, manufacturers, the forest products industry, small businesses, lobstermen, and agricultural producers," said Sen. Susan Collins (R-Maine) in a post on X. The tariffs "will have a significant impact on Maine's economy and risk increasing costs for our residents," she added.

In a social media post on Sunday, Trump acknowledged the possible economic effects on American consumers. “WILL THERE BE SOME PAIN? YES, MAYBE (AND MAYBE NOT!),” the post read. “BUT WE WILL MAKE AMERICA GREAT AGAIN, AND IT WILL ALL BE WORTH THE PRICE THAT MUST BE PAID.”

Economists expect widespread disruption.

“These tariffs herald a new era of U.S. trade protectionism that is likely to affect a wide swath of America’s trading partners, whether rivals or allies, and will significantly disrupt international commerce,” said Eswar Prasad, a professor of trade policy at Cornell University, in an email to *Barron’s* on Saturday.

Harvard economist Lawrence Summers castigated the Canada/Mexico tariffs as “inexplicable and dangerous,” saying they will raise prices on gasoline, cars and other products, in a post on X.

“Cars move back-and-forth across the border between five and ten times during assembly,” he wrote. “This makes the whole of North America much less competitive, relative to Europe and Japan.”

The rapidly shifting trade dynamics are likely to cause turmoil in supply chains and have an impact on financial markets, assuming they go into effect as announced.

Here’s what else to know:

What sectors are most at risk?

Energy, autos, and agriculture face some of the biggest hits.

Gasoline prices could increase quickly. Canada supplied 60% of crude oil imports to the U.S. in 2023, about 4 million barrels a day. That crude largely flows from Alberta by pipeline to American refineries that turn it into gasoline and other products.

Refiners in the Midwest rely on heavy Canadian crude, blending it with lighter sweeter domestic crude to make gasoline. Canadian crude is now discounted to WTI, but prices are almost certain to rise with tariffs because refiners have few good substitutes.

Car prices could go up since parts and vehicles have to cross borders multiple times, which could subject them to tariffs. Last year, Mexico supplied the U.S. with nearly 43% of imported motor vehicle body parts through November, and Canada sent over 25%, according to research firm Trade Partnership Worldwide.

Nearly every major car maker would be impacted. More than 40% of Volkswagens sold in the U.S. originate from Mexico or Canada, according to *The Wall Street Journal*. Honda Motor, Stellantis, Nissan, and General Motors also have above-average industry exposure, the Journal reported.

"The imposition of tariffs at each stage of fabrication would be disastrous," researchers for the Peterson Institute for International Economics said in a post on January 17.

Kirsten Hillman, Canada's Ambassador to the U.S., told ABC's *This Week* on Sunday that the tariffs would disrupt a successful trading relationship that was only recently renewed by Trump during his first administration with the renegotiated North American Free Trade Agreement.

"We're really disappointed and we're hopeful that they don't come into effect on Tuesday," Hillman said of the U.S. tariffs.

What's the economic impact?

Much will depend on how long the tariffs last, whether exemptions crop up, and how they ripple through to higher prices and lost profits.

Wall Street has been trying to assess the damage. The effective tariff rate on all goods is now 2.3%, according to JP Morgan. Boosting it to 10% would amount to a roughly $250 billion tax, "assuming no change in nominal import values" on $3.2 trillion of goods, the bank said in a Jan. 10 report. Consumer prices may rise 0.3% to 0.6% and gross domestic product could take a hit of 0.4% to 1.0%.

Consumers might feel the sting through price increases for everyday items like food, beer, and gasoline.

Mexico accounts for 23% of U.S. agriculture imports, including 63% of vegetable imports and 47% of fruit and nut imports. The U.S. bought more than $3.1 billion worth of avocados and more than $2.7 billion in raspberries, blackberries, and strawberries from Mexico last year, according to Trade Partnership Worldwide data.

Along with ubiquitous avocados and berries, Mexico is a major supplier of imported beer and spirits like tequila, products that could see near-term price hikes.

Meat and whiskey could get more expensive. Americans purchased north of $3 billion in beef and pork products from Canada, for instance. Products like Canadian whisky would be pricier.

Agricultural prices are likely to react swiftly because they have short production lead times. But manufactured goods with longer lead times may also soon be impacted, Prasad said, "even in cases where manufacturers and importers have a greater ability to absorb some of the costs of tariffs."

"For products such as automobiles with complex supply chains for components that often cross borders multiple times, the effective tariff hikes could be even greater and, therefore, add to the price pressures," he added.

The White House says tariffs work because they bring more manufacturing to the U.S., pointing a Fox News report that Samsung is considering relocating its dryer production from Mexico to South Carolina and LG Electronics is looking at moving refrigerator operations from Mexico to Tennessee.

What happens next?

Canada and Mexico reiterated they want to work with the U.S. to find solutions to the drug trafficking and immigration problems Trump cited as a rationale for tariffs.

Canada has said it is willing to go forth with surgical tariff strikes, hitting products in Republican-oriented states for maximum political impact, such as Florida orange juice and Kentucky bourbon. Trudeau also urged Canadians to buy more domestic products. Trump has threatened to increase U.S. tariffs in response to retaliation.

The legality of Trump's tariffs is uncertain, partly because the U.S. has a free-trade agreement with Canada and Mexico. China lodged a complaint with the World Trade Organization, but that would take considerable time to be resolved.

Using the IEEP—declaring a national emergency—to impose sweeping tariffs opens the door to legal challenges, according to Peter Harrell, an adjunct senior fellow at the Center for a New American Security. U.S. courts will have to rule on whether a president can use the IEEP for that purpose, though President Trump and his advisors have indicated it can cover them, he wrote in a post on Friday.

The key is "whether the president can do this under international law without invoking some sort of legal complaint under international law," Stanford law professor Alan Sykes told *Barron's*. "The answer, with respect to the WTO, is no."

Hillman told ABC that a trade war isn't the path they want to take. "We buy more from you than any other country on the planet, and we love our American products. So, we support 8 million jobs in the United States through the exports that you send to us. Let's keep that going, and let's build on that. Let's not – let's not diminish it," she said.

How will markets react?

Up until now, the market's working thesis was that tariffs would be short-lived or a negotiating tactic by Trump that will result in a detente with major trading partners, containing the damage.

"Markets appear to be relatively sanguine," Ned Davis Research said in a note on Friday. "Although markets aren't infallible, we always respect their message, especially when it is widespread. As long as this is the case, we wouldn't be too quick to turn bearish on the markets."

Positives in the market include new highs in U.S. and European equities, Treasury yields falling, and spreads on emerging-market bonds falling to their lowest levels since 2007, according to Ned Davis. None of that indicates a market worried about a trade war.

Marko Papic, macro-geopolitical chief strategist at BCA Research, expects the stock market to sell off but he also sees bond yields falling, which would limit the damage, he told *Barron's* in an email.

Currency volatility is likely as the U.S. dollar strengths and other currencies weaken. And if tariffs prove more widespread and lasting, the effects would be recessionary in countries like Canada and Mexico, while also hitting Europe, China, and emerging markets. None of that would be positive for U.S. financial markets or companies, impacting U.S. sales abroad and denting corporate profit growth.

Don't look for safety in AI or the Mag-7; companies like Apple, Nvidia, and Tesla would also be swept up in a trade war.