ECONOMIC VIEWPOINT

United States: Tariffs Less Severe than Estimated, but Their Impact Will Eventually Sting

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The global economy—and particularly the US economy—has shown greater resilience than initially expected in the face of renewed protectionism since President Trump's arrival. One key factor behind this resilience is that the negative impact of tariffs has been more modest than anticipated, in part because the tariffs themselves have been less severe than originally estimated. That said, while our real GDP growth forecasts have been revised upward somewhat since the spring, risks remain. The uncertainty stemming from the Trump administration's protectionist policies continues to cast a shadow over the economic outlook and could still lead to unexpected developments.

We recently upgraded our US, global and Canadian growth outlooks based on the economic data released over the summer. One of the biggest factors behind these revisions was the smaller-than-expected hit from the tariffs introduced since the beginning of President Trump's second term.

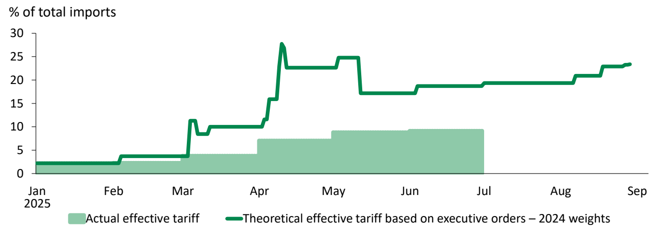
Why Have Tariffs Had a More Modest Effect than Anticipated?

1. Effective Tariffs Have Been Lower than the Announcements Suggested

While President Trump loves making eye-watering tariff announcements, the duties actually collected to date have been significantly lower than we expected based on his many executive orders. If we include all the tariffs related to fentanyl, border security, trade reciprocity, the auto sector, steel, aluminum, copper, Brazil, India and China, as well as the elimination of the "de minimis" exemption for small-value imports, the effective tariff rate should be around 20%. But in June, it was actually 9.1% (graph 1). So if tariff rates are half the theoretical rate we expected based on the administration's many announcements, it makes sense that tariffs have had a much more modest effect than anticipated so far.

There are a number of factors behind this disconnect between our estimates and reality. While we did take the various executive order exemptions into account when calculating the theoretical effective tariff rate, some were more difficult to estimate than others. Take for example the fentanyl tariff exemption for Canadian and Mexican goods that are compliant with the Canada–United States–Mexico Agreement (CUSMA). The compliance rate for Canadian goods exported to the United States jumped from 33.3% in February to 56.9% in June (graph 2 on page 2). And the myriad exemptions and carveouts to the many tariffs have had a bigger impact than expected. For example, it appears that in June, over 80% of non-CUSMA-compliant Canadian exports to the United States were still entering the country tariff-free under various programs and provisions established in US law, including Trump executive orders.

Graph 1
Actual Tariffs Have Been Much Lower than Expected Based on the Various Executive Orders
United States – Effective tariffs



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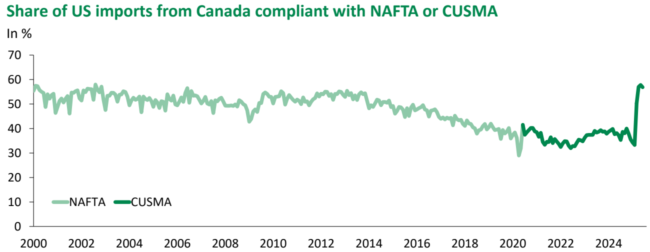
Graph 2
The Share of Canadian Exports to the US Under CUSMA Has Increased



NAFTA: North American Free Trade Agreement (January 1994 – June 2020); CUSMA: Canada–United States–Mexico Agreement (since July 2020)
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Compositional and seasonal effects are also likely dragging down the effective tariff rate. To estimate the theoretical effective rate, we used the level of US imports for all of 2024. But goods flows into the United States aren't necessarily steady throughout the year, which can lead to discrepancies. And tariffs vary by good type and country, so compositional effects may also be at work, with importers ordering more goods with lower tariff rates or ordering more goods from countries with lower tariff rates.

Then there's government bureaucracy, which is probably struggling with the complex, ever-changing tariffs announced by the White House. Border officials are likely well behind schedule implementing tariffs and not exactly sure how to apply them given how often they're changed. So it's possible that as time goes on, the tariffs collected at the border inch closer to our executive order-based estimates.

2. US Importers Moved Quickly to Get Ahead of Tariffs

Importers mitigated the effects of tariffs by frontloading some of their orders. This can be seen in the surge of imports and business inventories in the first quarter of the year. And while inventories fell in the second quarter, they remained well above 2024 levels.

3. It'll Take Time to See the Full Economic Impacts of Tariffs

While effective tariff rates haven't been as high as expected, they're still up sharply. The 9.1% rate recorded in June was the highest since 1946. It's also four times what it was before Donald Trump returned to the Oval Office. As we've seen, US businesses have largely been able to insulate their operations and customers from the effects of tariffs. But this won't last. According to the [latest Texas Business Outlook Surveys] conducted by the Federal Reserve Bank of Dallas, 48.5% of respondents said their costs were up, but only 26.8% reported raising their prices. 40.0% of businesses reported lower profit margins.

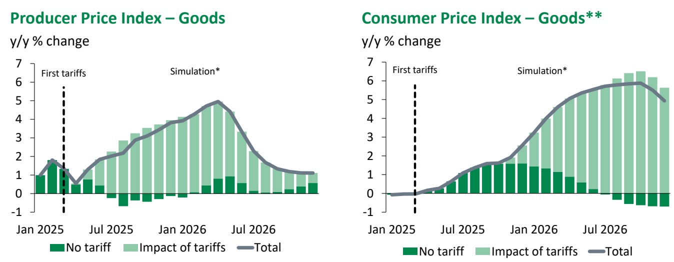
And it can take months or even quarters for economic agents to adjust their behaviour in response to changes such as economic shocks.

On-again, off-again tariffs have fuelled uncertainty, but also expectations that President Trump will chicken out. We saw this with the initial "reciprocal tariffs" in April, the huge tariffs on China and the subsequent reversals and carveouts. Not knowing whether tariffs were coming or going, businesses have taken a wait-and-see approach.

Is a Bigger Tariff Hit Coming?

So far, tariffs have had a limited impact on consumer prices. But sooner or later, we expect tariffs on goods imports to show up in inflation, though it could take a while. Our analysis suggests that sizeable tariffs affect producer prices relatively quickly, but can take over six months to affect consumer prices (graph 3). That's partly why the Consumer Price Index (CPI) hasn't yet risen much in response to tariffs—something Donald Trump has seized on to pressure Fed officials to cut interest rates. But it may be only a matter of time.

Graph 3
US Consumer Prices Are Responding Slower to Tariffs



* Simulated impact of announced tariffs, not a Desjardins forecast; ** Excluding food and energy.
Bureau of Labor Statistics, Datastream and Desjardins Economic Studies

We too expected tariffs to have a more immediate impact on inflation, especially over the summer. This was based on the assumption that businesses would largely be able to pass higher costs on to consumers as they have since the pandemic. However, their ability to do so may have been overstated, which could explain their reluctance to raise prices and possibly alienate their customers. According to the aforementioned Federal Reserve Bank of Dallas surveys, 33% of firms are having a harder time passing on higher costs to their customers, while only 14% are having an easier time. But anecdotally, we're starting to hear about more and more businesses raising their prices, especially retailers.

This means we shouldn't rule out a fall increase in the price of CPI goods (and food). Nor should we assume we've seen the worst of the macroeconomic impacts of tariffs, which have been modest so far. US consumer confidence indexes continue to show that inflation expectations are elevated, albeit slightly lower than they were at the height of US–China tensions. And according to the University of Michigan consumer sentiment index, 58% of consumers plan to cut their spending on items that have seen particularly large price increases and 13% plan to stop buying them altogether. If inflation becomes more widespread, real consumer spending could therefore be affected. So while we've raised our real GDP growth forecasts somewhat since spring (and lowered our inflation forecasts), risks remain. The uncertainty created by the Trump administration's protectionist policies continues to weigh on the economic outlook. And that leaves the door open for more surprises.