

March 23, 2026

## Trading places: Reimagining Canada’s export sector

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It’s a new world for Canada’s exporters, one with less clarity over what lies ahead. Our base case forecast assumes that the US remains in an amended USMCA deal with Canada and Mexico after 2026. But whatever the outcome of the upcoming round of negotiations, the degree of certainty over Canada’s access to the US market will have been permanently dented, as the existing trilateral trade deal didn’t protect the country from several sectoral tariffs and the threat of tariffs on other industries ahead.

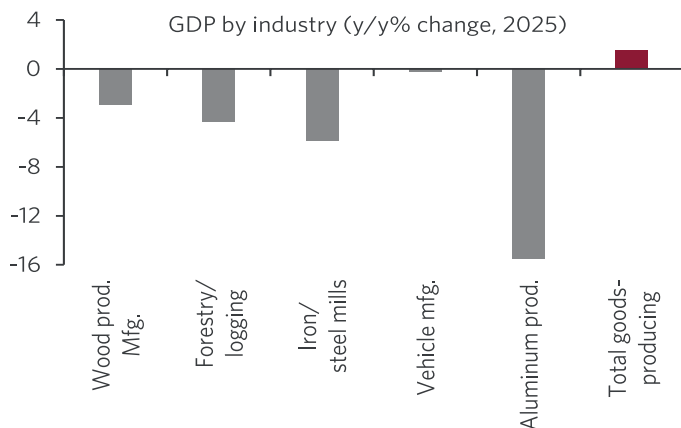
Plan A is still to negotiate the best possible extension of that trade pact, and in any plausible scenario, the US will remain the destination for a solid majority of Canada’s exports. But Ottawa, and corporate leaders, are also looking at Plan B: reimagining what trade can look like with other partners, and potentially in a different mix of products. Our analysis suggests that progress to date, not surprisingly, has been quite limited, reflecting the reality that structural changes take considerable time. Some highly publicized developments and announcements related to non-US export opportunities, while helpful, also don’t measure up that well in terms of their potential scale. But in terms of hopes for the future, there are clues in where trade flows were already headed prior to 2025’s tariff shock.

### Looking at 2025: Not too surprising

Canada escaped the worst of the potential tariff shock in 2025, as the initial threat of a broad 25% tariff on all exports (10% on energy products) got pared back into an average effective tariff rate in the vicinity of 5%. That reflected the exemptions granted to USMCA-compliant goods, but still included elevated tariffs on autos, steel, aluminum, lumber, and selected wood and copper products. In contrast to modest growth in Canada’s overall goods sector, in all of these targeted sectors, there’s been a visible impact on Canadian production over the past year (Chart 1). Vehicle assembly was an exception, but only due to the fact that it was already coming off a large volume drop in 2024.

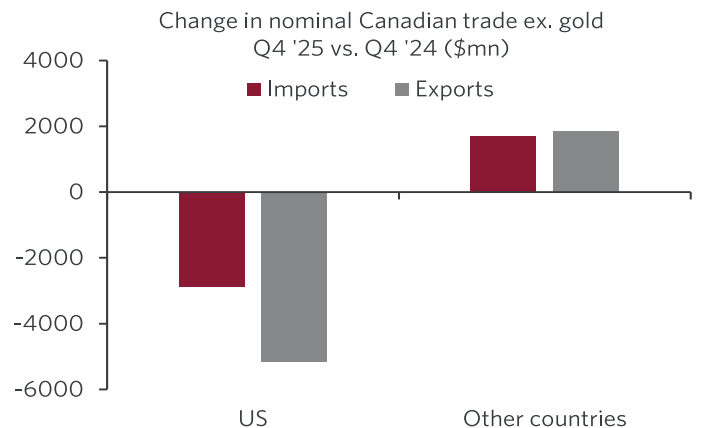
None of this is particularly surprising, given these industries’ dependence on American demand, and the challenges of weaning off that market. Overall exports to the US weakened, but the damage was concentrated in products hit by sectoral tariffs (Chart 2). There has been some improvement in exports to the rest of the world, although stripping out gold, growth in these other exports hasn’t been particularly robust.

Chart 1: Production dented in sectors hit by tariffs



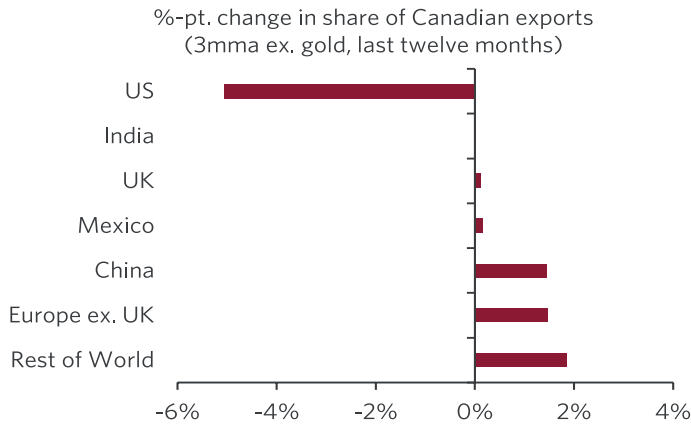
Source: StatCan, CIBC

Chart 2: Trade diversification only somewhat in evidence



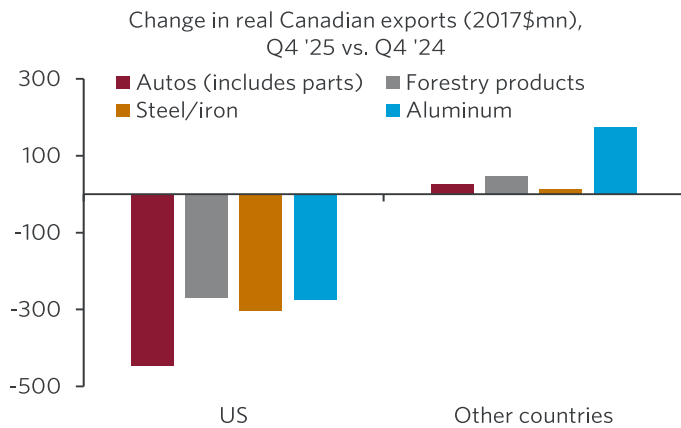
Source: StatCan, CIBC

**Chart 3: Re-directing trade flows**



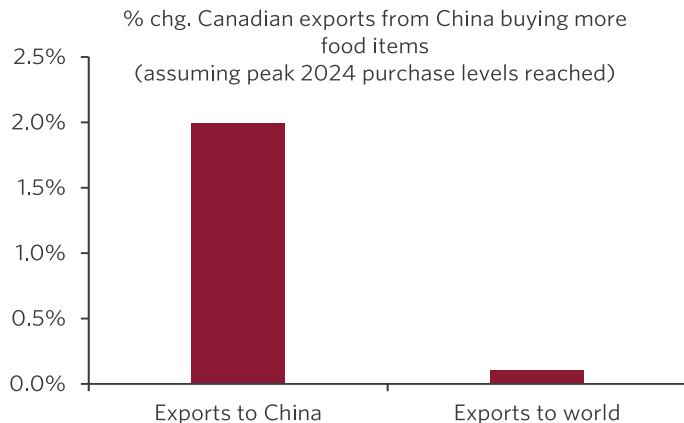
Source: StatCan, CIBC

**Chart 4: Tariffed exports to US hit, little offset to other countries**



Source: StatCan, CIBC

**Chart 5: Big win in China, but small as a share of Canada's total exports**



Source: StatCan, CIBC

Not that anyone would have expected a quick cure for what ails us in the US. The structural changes needed to reengineer Canada's output mix, and the ports, pipelines, and other infrastructure needed to see any sizeable redirection of trade, could take a up to a decade to achieve in full.

Excluding gold shipments that don't necessary respond to new economic output, the share of Canada's exports to the US dropped by 5%-points over the course of the last twelve months. Interestingly, given existing trade frictions with China, that country picked up some of that previous US share, along with continental Europe, Mexico, and the UK (Chart 3).

Aluminum is the one sector targeting by US tariffs where a significant loss of exports to the US has been made up by shipments elsewhere (Chart 4). In other sectors targeted by US tariffs, many of the products under stress don't immediately have viable markets overseas, or much opportunity to divert goods to the Canadian domestic market.

Japanese vehicle makers are unlikely to use their Ontario assembly plants to ship vehicles back to their home market (where they drive on the left) or to Europe. The big-3 auto companies have their own facilities in Europe in some cases, or the pickup trucks and SUVs they make in Canada don't have strong prospects in Europe. For lumber, it's the US where wood frame houses are most common, Europe's lumber market is based on metric dimensions, and only Northern Europe (with its own lumber supply) and the UK build a lot of wood frame houses.

Steel is of course a global industry, and its products do transit the world's oceans. But it's also a sector in which Canada would face strong competitors in Europe and Asia. That includes companies that might be ramping up their efforts in local markets due to US tariffs. Historically, only a very small fraction of Canada's steel exports were destined for overseas markets as a result.

## Plan B: Small wins so far, but some prospects for success

Despite coming off a rocky road in 2025, both governments and private sector are not going to give up on the US export market, and Ottawa will attempt to reach the best possible result in upcoming trade talks with the US. But Plan B is also to take steps to reduce the country's dependence on the US market to the extent possible, and we're seeing the first elements of that plan coming together in what are some important gains for affected sectors.

Part of that process entailed seeking a rapprochement with China and India to put some geopolitical tensions behind us, and repair what have been troubled trade relations. These are large, growing economies that look promising for Canada's exporters over the very long run. But in the near term, while the results have been encouraging for certain sectors, we need to put the scale of these wins into perspective in terms of their macroeconomic benefits.

China's agreement to reduce the tariffs it imposed in in early 2025 on certain food items, if it fully reversed the decline seen in Canadian exports of such products, would represent a 2% bump to Canada's exports to that country. It was also heartily welcomed by the canola sector and the impacted provinces. But it would represent only a decimal place or two in terms of Canada's total exports (Chart 5).

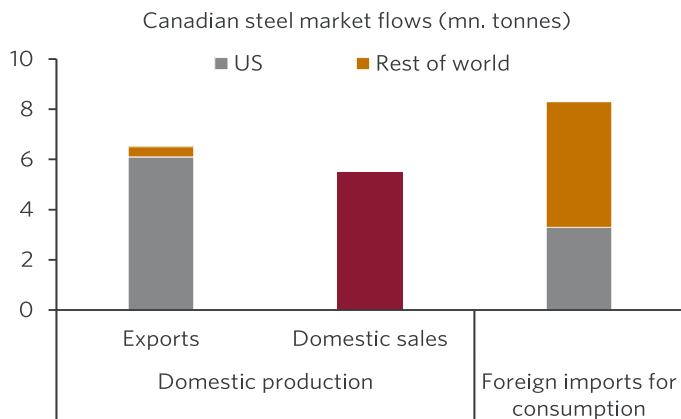
Similarly, the warming in relations with India has opened the door to a growing trade relationship with that country. But the initial fruits of that step, a nine-year \$2.6 bn export deal for Canadian uranium concentrate, while of importance to that sector, would raise Canada's total exports by an average of only 0.04% annually.

In the industries impacted by US as opposed to overseas trade frictions, progress will likely depend on progress at the negotiating table to reduce those sectoral tariffs. That door will likely be open for aluminum producers, given the lack of US capacity to supplant imports.

Thus far, the White House has shown little interest in providing relief to finished vehicles from Canada. Canadian public policy has therefore been aimed at incenting Big 3 producers to keep plants on this side of the border up and running, by threatening to demand repayments of previous support payments to the sector, or by charging tariffs on vehicles they import if they don't retain production here.

Steel differs from autos and aluminum in the fact that domestic shipments of Canadian steel have been not too far below the scale of Canadian steel product exports, and imports currently hold a substantial share of the Canadian market (Chart 6). So with no relief yet from punitive 50% American tariffs, policies have been aimed at generating an offsetting gain for steel producers' share of their own domestic market. That's included protectionist tariffs on imports from countries that have tariffs on Canadian steel, subsidies for transportation costs within Canada, and requirements for Canadian steel usage in government-supported projects.

**Chart 6: Import substitution could cushion steel export hit**



Source: Gov. of Canada, CIBC

Importers were given some temporary relief from tariffs to allow time for supply chains to adjust, so we haven't seen their full impact on market shares in Canada. With the domestic market still crowded with imports and diverted Canadian capacity, the past year has seen a squeeze on margins on sales in the home country. So it's too soon to see how much of the sharp drop in industry activity and profitability can be recovered, but there's more promise for steel makers than other sectors hit by US tariffs, where the domestic market isn't as sizeable relative to exports.

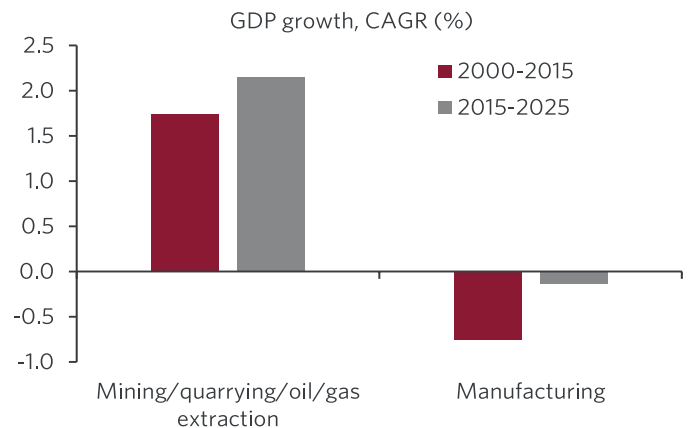
## A longer dated perspective yields some clues

These Plan B strategies to support industries caught in the crossfire of US tariffs, as well as those imposed by China and India, are certainly worthwhile efforts. But putting a longer lens on Canada's trade performance offers clues on where there might be other room to make up for lost ground in exports as a whole.

That's because the challenges we've seen recently in elements of our manufacturing sector are not new, and therefore capture more than just the headwinds of US trade policy. Real GDP in Canadian manufacturing, while seeing the usual cyclical gains and losses, was generally on a weakening trend prior to 2025 (Chart 7). That reflected the rise of China after its entry into the WTO, gains in Mexico's share in sectors like autos, and new competition from non-unionized plants in the US south, among other forces. Today's effort to fend off tariff impacts have to be seen to some extent as efforts assist a sector that was already on the defensive.

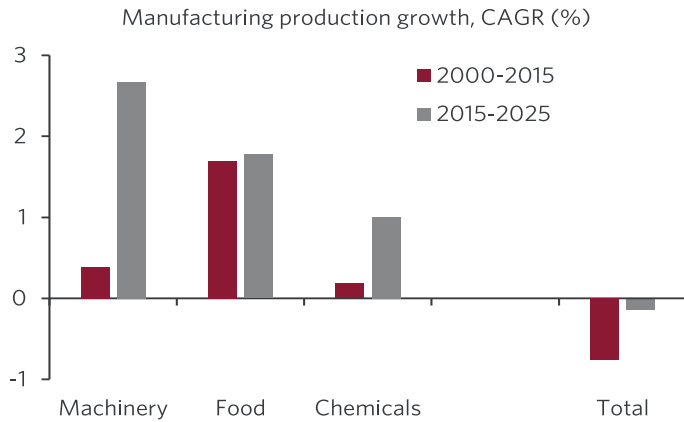
Success in the goods sector has been more evident in capitalizing on Canada's resource base, suggesting that it offers fruitful ground for a further expansion ahead. Even with the slowing in oil industry capital spending after prices retreated in late 2014 and environmental policies tightened, Canada's oil production has continued to climb, as has natural gas output. Resource GDP, unlike manufacturing, has therefore been on a trend climb.

**Chart 7: Resource sector growth, manufacturing shrinking pre-tariffs**



Source: StatCan, CIBC

**Chart 8: Select few manufacturing sectors have outperformed in last decade**



Source: StatCan, CIBC

Energy and mineral production is not only geographically tied to the raw material, but is less likely to be impeded by tariffs. With the right infrastructure, there's a global market for such products in reach, should the US market turn less attractive. Even in the worst days of threatened US tariffs, the White House wasn't prepared to hit oil and gas output with as much of a barrier.

Manufacturing is also, however, a very broadly defined sector, and there are a few areas where recent decades suggest that Canada has a winning hand (Chart 8). Despite challenges faced by Chinese tariffs in the past year, food production has a long history of outperforming other manufacturing sub-sectors, while machinery production made sizable gains post-Covid, although activity has levelled off in the past two years. Chemical sector output was gaining ground pre-Covid, although results in recent years have been less encouraging.

Finally, Canada has plans for significant increases in defense spending ahead, including steps to increase the domestic content in major contracts. Other developed economies with large defense budgets have seen the doors opened by their home government contracts, as a first step towards building gains in exports of defense equipment. That would mirror what Canada has done with nuclear power facilities that were first built at home.

Still, developing new export capacity in resources, realigning steel output to the mix needed by domestic buyers, and building a larger domestic defense equipment sector, will all require fresh capital investment, and time. Realigning Canada's goods sector to be less vulnerable to capricious American trade policies is an important longer term plan, but a successful negotiation with the US will likely be more critical to the economic outlook for the coming year.

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