CLIENT ALERT

Breakdown in U.S.–Canada Trade Talks and What It Means for Mexico

August 25, 2026

It has been a chaotic week in North American trade relations. The last-minute collapse of the U.S.–Canada trade talks led to the U.S. imposition of an additional 50% tariff under Section 338 on roughly $20 billion of Canadian goods—about 5% of Canadian exports to the United States—and a Canadian promise to retaliate dollar for dollar. This was followed Monday by a Trump social media post saying that tariffs on Canadian cars, trucks, auto parts, and steel would be set at 50% beginning January 1, 2027. Although a social media post does not equal implemented trade policy, it further raised the temperature in bilateral relations.

Simultaneously, the collapse of the U.S.–Canada trade talks demonstrated internal inconsistencies on the U.S. side between U.S. Trade Representative Jamieson Greer on the one hand and Commerce Secretary Howard Lutnick and White House trade counselor Peter Navarro on the other, with President Trump as the ultimate wild card. That being said, the Canadian experience should not be seen as a precedent for Mexico, but it is still illustrative of what could happen.

WHAT HAPPENED AND WHY

Despite optimism on the U.S. side that an agreement was close, which had convinced President Trump to extend the deadline for imposition of 50% tariffs on a wide range of Canadian exports, talks broke down at the last minute. Canadian Prime Minister Mark Carney withdrew his negotiators late Friday, August 21. The U.S. tariffs went into effect minutes later, with Canada announcing that it would retaliate dollar for dollar, albeit not until September 8, giving the two sides time to find a negotiated off-ramp from this brewing trade war.

Each side blamed the other for the breakdown in the talks. Carney's Saturday morning address blamed the United States for making last-minute demands, raising issues touching Canadian culture and sovereignty, and changing terms in ways that "called into question the reliability of any deal." Reporting also pointed to Commerce Secretary Lutnick's objections to USTR Greer's willingness to reduce Section 232 tariffs on steel, aluminum, and autos, areas that fall under the Commerce Department's remit. The United States countered that Canada had made the last-minute demands and denied any disunity among U.S. officials.

One of the major unresolved issues appears to have been the treatment of medium- and heavy-duty trucks, which the United States excluded from the contemplated reduction in Section 232 auto tariffs. More broadly, reporting indicates that Washington had been prepared to reduce the tariff on Canadian cars and light-duty trucks from 25% to 15% and steel and aluminum tariffs from 50% to 25%, but with important limitations, including quotas, content requirements, and unresolved implementation details. The Canadians viewed the truck exclusion as threatening the viability of significant GM and Ford production in Canada.

WHAT THIS MEANS FOR MEXICO

There is good news and bad news for Mexico in these developments.

The Good News:

- Mexico is already receiving differentiated treatment from Washington. U.S. officials have publicly described Mexico's approach as pragmatic and constructive, while criticizing Canada for failing to make comparable concessions. Negotiations with Mexico remain active, and most USMCA-compliant Mexican trade continues to enter the United States tariff-free. The difference in treatment is therefore not merely theoretical.
- The Canadian negotiations demonstrate that meaningful Section 232 relief is negotiable. Washington was reportedly prepared to reduce tariffs on Canadian cars and light-duty trucks from 25% to 15% and on steel and aluminum from 50% to 25%. This does not mean Mexico can obtain complete elimination of Section 232 tariffs, but it shows that meaningful relief can be part of a negotiated exchange.
- Mexico has bargaining chips closely aligned with Washington's priorities. The United States has emphasized third-country content, transshipment, non-party "free-riding," stronger rules of origin, and reducing dependence on Asian inputs. Mexico has shown greater willingness than Canada to engage on these issues, potentially allowing it to exchange concessions it can live with for tariff relief and greater commercial certainty.
- The rupture with Canada may increase Mexico's relative value as a North American production platform. To the extent Mexican goods retain preferential access while

comparable Canadian products face higher barriers, some investment and sourcing decisions could tilt toward Mexico. Washington may also have an incentive to avoid simultaneous trade wars with both neighbors and to demonstrate that cooperation can produce better outcomes than retaliation. The advantage should not be overstated, however, because integrated regional supply chains mean a prolonged U.S.–Canada dispute would also impose costs on Mexico.

The Bad News:

At the same time, the Canadian episode illustrates the limits and uncertainty surrounding the tariff relief Washington may be prepared to offer, creating several risks for Mexico:

- Section 232 relief remains a central Mexican ask in its USMCA review talks with the United States. Canada was reportedly offered a reduction in tariffs on cars and light-duty trucks from 25% to 15% and on steel and aluminum from 50% to 25%, but the relief was not comprehensive and was subject to important conditions and limitations. This suggests Mexico may be able to obtain meaningful relief, but perhaps not the complete or permanent elimination of Section 232 tariffs it would prefer.
- The Canadian breakdown also raises questions about the ability of Greer, Mexico's main interlocutor in the review process, to deliver on agreements reached with Mexican counterparts. If Commerce or the White House can intervene late in the process with additional conditions, Mexico will need confidence that any package reflects an administration-wide agreement, not simply a negotiating position reached with USTR.
- The Canadian experience also underscores that the value of tariff relief depends on far more than the headline rate. Coverage, quotas, rules for calculating U.S. or North American content, implementation mechanics, duration, and the ability of Washington to modify the terms will determine whether any agreement provides real commercial certainty. Mexico therefore has an interest not simply in lower tariffs, but in commitments that are clear, durable, and operationally predictable.
- The apparent addition or revision of U.S. demands late in the Canadian process does not bode well for Mexico, despite Economy Minister Marcelo Ebrard's suggestion that an agreement is near. It reinforces the risk that a package that appears close can still be reopened or expanded before final approval.

- One of the reported U.S. demands of Canada concerned economic security and consultation over trade agreements with third countries, which Canada rejected as a threat to its sovereignty. Mexico's greater willingness to engage Washington on third-country content, transshipment, and regional sourcing does not mean it will accept U.S. constraints on sovereign trade policy. An explicit U.S. veto or approval right over Mexican trade agreements could become a serious red line for President Sheinbaum.

More broadly, if the United States and Canada are unable to avoid a sustained trade war, the USMCA risks becoming increasingly hollowed out as a source of commercial certainty even while remaining legally in force. Mexico, given its greater dependence on the U.S. market, is especially vulnerable to that outcome.

LOOKING AHEAD: WHAT TO WATCH

- **A prolonged period of uncertainty may be the new normal.** The breakdown in the U.S.–Canada negotiations may not simply represent a temporary setback. It could point toward a broader scenario in which the USMCA remains formally in place, while key trade issues continue to be negotiated bilaterally and sector by sector. Under this scenario, companies could face an extended period of uncertainty even if the agreement itself remains operative.
- **Recent negotiations suggest what could be described as an emerging U.S. government negotiating playbook:** threat → engagement → optimism → additional demands or pressure → agreement or breakdown → potential retaliation. Variations of this approach have been visible in other negotiations by this administration, where the initial threat, often involving tariffs or other economic measures, is used to bring the counterpart to the table and extract additional concessions. The recent Canada experience is particularly relevant because negotiations appeared to be approaching an agreement before new disagreements emerged, ultimately resulting in a breakdown and retaliation.
- **The United States may have limited incentives to reach a comprehensive agreement quickly.** Maintaining negotiations provides Washington with continued leverage to seek additional concessions from both Mexico and Canada. With the U.S. midterm elections approaching, the administration may also see limited political upside in locking in a comprehensive Mexico deal early; keeping negotiations open preserves both leverage and political flexibility. This raises the possibility that uncertainty is not simply a consequence of difficult negotiations, but also a source of negotiating leverage for the United States.

- **Washington is already pursuing increasingly differentiated strategies toward Mexico and Canada.** The contrast between Canada's more confrontational approach and Mexico's more cooperative strategy gives the United States an opportunity to negotiate separately with each country and selectively reward cooperation. A more favorable outcome for Mexico could also be used to demonstrate to Canada that cooperation produces better results than retaliation.
- **Not all sectors should be expected to receive the same treatment.** Even if the United States remains broadly committed to preferential treatment for USMCA-compliant trade, autos, steel, and aluminum are likely to remain particularly difficult sectors given the administration's objective of increasing U.S. manufacturing and its continued reliance on Section 232 tariffs. As a result, progress in the broader negotiation would not necessarily translate into meaningful Section 232 relief.
- **Mexico has greater negotiating flexibility than Canada, but also greater economic vulnerability.** Mexico's less confrontational approach may provide it with greater room to reach compromises with Washington. At the same time, its high dependence on the U.S. market reduces its ability to withstand a prolonged trade confrontation, something U.S. negotiators are likely to recognize.
- **U.S. public opinion could become an increasingly relevant constraint on the administration's tariff strategy.** More voters currently oppose than support broad tariffs on Mexican imports, and opposition has risen significantly among independents. If the confrontation with Canada produces visible costs for U.S. companies, supply chains, consumers, or financial markets, the political cost of escalation toward Mexico could rise as the midterms approach. Conversely, limited domestic costs—or eventual Canadian concessions—could reinforce Washington's confidence in tariff pressure as a negotiating tool.
- **Legal challenges to the administration's use of Section 338 are likely.** The unusual invocation of Section 338 against Canada is apt to generate statutory and constitutional litigation in the United States. This is worth monitoring, but it should not be treated as a source of near-term relief for Mexico, and even a successful challenge would not resolve the separate Section 232 tariffs affecting autos, steel, and aluminum.
- **Canada's retaliation and the possibility of a negotiated off-ramp will be important to watch.** Canada's decision to delay its dollar-for-dollar retaliation until September 8 leaves time for the two sides to reopen negotiations. A negotiated de-escalation would show that

even a serious breakdown can be reversed; an entrenched cycle of retaliation would instead accelerate the fragmentation of North American trade into bilateral and sector-by-sector arrangements.

RECOMMENDATIONS FOR U.S. MANUFACTURING COMPANIES OPERATING IN MEXICO

- **U.S. manufacturers operating in Mexico should reinforce the message that their Mexican operations are part of a North American, not simply Mexican, manufacturing platform.** Companies should quantify how their operations in Mexico support U.S. employment, exports, suppliers, investment, and competitiveness. This is particularly important as the administration evaluates trade policy through the lens of benefits to U.S. manufacturers and workers.
- **Companies exposed to Section 232 tariffs should prepare separate scenarios rather than assume that a broader USMCA agreement will eliminate these measures.** Autos, auto parts, steel, and aluminum remain particularly sensitive. Companies should model not only different tariff rates, but also quotas, regional- and U.S.-content requirements, and implementation rules, and identify operational, sourcing, and pricing responses in advance. Recent developments with Canada reinforce the possibility that these sectors will continue to be treated differently from general USMCA trade.
- **Companies should audit and document third-country content in their North American supply chains, particularly Chinese and other Asian inputs.** They should be prepared to demonstrate origin, substantial transformation, regional value creation, and the absence of transshipment, while identifying opportunities to replace sensitive non-North American inputs with U.S., Mexican, or Canadian suppliers. More broadly, **companies should prepare for prolonged uncertainty rather than wait for a definitive USMCA outcome**: the objective should be to make existing North American operations more regional, transparent, and resilient.

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The Monarch Global Strategies Team

Michael C. Camuñez
President & CEO
mcamunez@monarch-global.com
Los Angeles

Luis Ricardo Rodríguez
Managing Partner
lrodriguez@monarch-global.com
Monterrey

Geoffrey G. Jones
CFO & SVP Development
gjones@monarch-global.com
Washington, D.C.

Pamela K. Starr
Senior Advisor
pstarr@monarch-global.com
Los Angeles

Juan Pablo López Rojas
Senior Analyst
jplopez@monarch-global.com
Washington, D.C.

Pedro Niembro
Senior Advisor
pniembro@monarch-global.com
Mexico City

Juan Casillas
Senior Advisor
jcasillas@monarch-global.com
Mexico City

Gerardo de la Peña
Senior Advisor
gdelapena@monarch-global.com
Mexico City

Begoña Sánchez
Senior Director
bsanchez@monarch-global.com
Monterrey

Patricio M. Martínez
Senior Associate
pmartinez@monarch-global.com
Monterrey

Gabriel Cavazos
Senior Advisor
gcavazos@monarch-global.com
Monterrey / Mexico City