RBC Global Asset Management

Economic outlook

SPRING 2025

Tariff threats in focus

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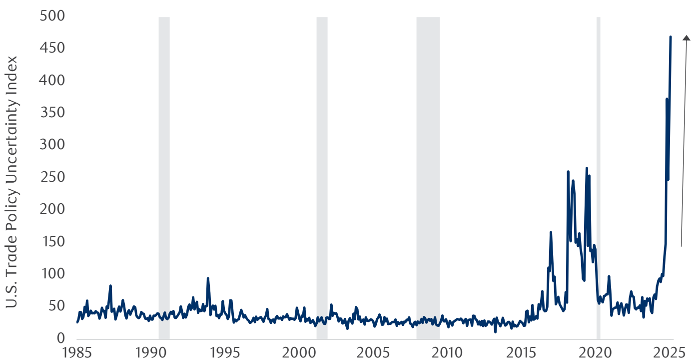
It is a time of nearly unparalleled uncertainty for U.S. public policy (Exhibit 1). The White House has implemented or plans major changes on many economically relevant fronts, including trade, immigration, taxation, government spending, regulations, the civil service and foreign policy.

This heightened activity and the lack of clarity around it threatens to temporarily slow economic growth as businesses and households opt to delay key decisions until they can secure more information.

Exhibit 1: U.S. trade policy uncertainty surges to record high after 2024 election



Note: As of Feb 2025. Index normalized to a value of 100 when share of articles discussing trade policy uncertainty equals 1%. Shaded area represents recession. Source: Caldara, Dario, Matteo Iacoviello, Patrick Molligo, Andrea Prestipino, and Andrea Raffo (2020), "The Economic Effects of Trade Policy Uncertainty," Journal of Monetary Economics, 109, pp.38-59, Macrobond, RBC GAM

As for the expected policies themselves, these run the gauntlet from theoretically growth-positive decisions relating to tax cuts and deregulation to more negative ones relating to immigration and tariffs.

Until recently, one could argue that the net effect of the coming public policy barrage would be to incrementally accelerate U.S. economic growth, if also to raise inflation and slightly diminish rest-of-world economic growth. However, recent developments point in a less favourable direction. In particular, tariffs are being applied with an unanticipated vigour, and animal spirits – the enthusiasm initially shown by households and businesses to the Trump administration – are now notably fading. In turn, the U.S. growth outlook has been somewhat downgraded.

The countries most at risk of U.S. tariffs are those with the greatest trade exposure to the country, including Mexico and Canada (Exhibit 2). Should threatened large tariffs persist, this would be quite problematic for those countries' economies. In contrast, many other countries have only a small exposure to the U.S. economy, making them much less susceptible to tariffs.

Against this backdrop, U.S. economic growth is becoming somewhat less exceptional, with several other developed-world economies – including the Eurozone, U.K. and Japan – accelerating somewhat. These countries appear on track to partially bridge the U.S. growth advantage in 2025 and 2026 (Exhibit 3). Canada was on this list prior to the recent tariff escalation, but no longer.

From an investment standpoint, the high degree of uncertainty continues to argue for a well-balanced portfolio that doesn't deviate too far from neutral positioning. From a regional standpoint, expensive U.S. equity valuations and the threat of North American-focused tariffs support a modest pivot away from the continent's equities.

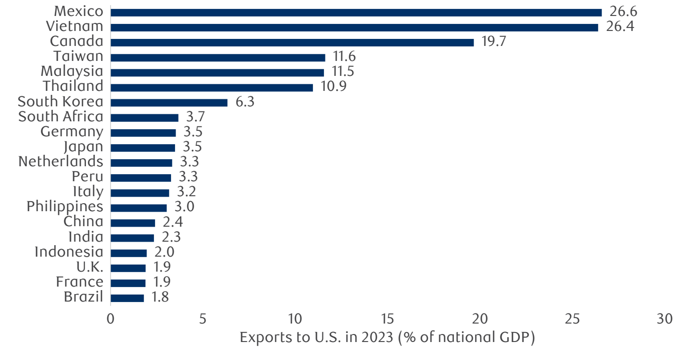
Unconventional U.S. public policy

The second Trump term is currently tracking rather differently than the first one. Whereas the first term quickly unleashed the tailwind of large tax cuts that were only partially offset at a later point by small tariffs, the sequencing and magnitudes are completely reversed this time. Today, the growth-impeding tariffs are coming first, and in a super-sized format, whereas the tax cuts may come at a later date, and are somewhat less exciting than the first iteration since much of the proposed outlay involves merely maintaining earlier tax cuts past their currently-scheduled expiry date.

As this tentative reality comes into view, the animal spirits that had so revived last autumn have begun to retreat (Exhibit 4). This is also reflected in recent stock market weakness.

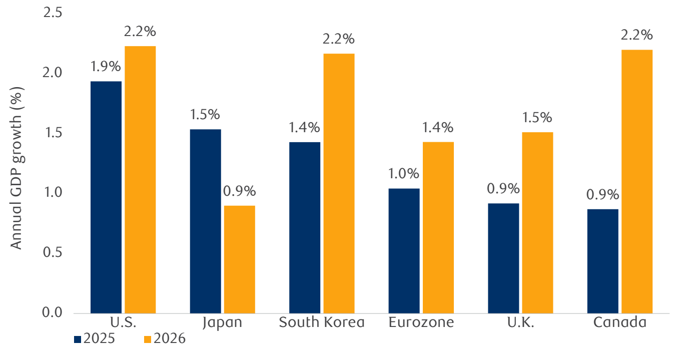
Planned spending cuts are raising concerns, both with regard to the haphazard manner in which the Department of Government Efficiency (DOGE) is eliminating spending, and the unpopular prospect of entitlements being pared if the White House is to deliver the full US$2 trillion it desires in spending cuts.

Exhibit 2: Exports to U.S. are significant for some countries



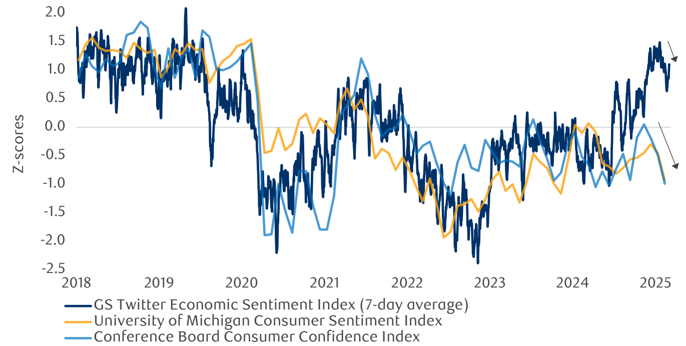
Source: IMF, Macrobond, RBC GAM

Exhibit 3: RBC GAM GDP forecast for developed markets



Note: As of 03/07/2025. Source: RBC GAM

Exhibit 4: U.S. consumer sentiment dropped on Trump policy concerns



Note: Twitter Economic Sentiment Index as of 03/03/2025, University of Michigan and Conference Board indices as of Feb 2025. Source: Goldman Sachs Global Investment Research, University of Michigan, The Conference Board, Macrobond, RBC GAM

This is not the final word on the subject. U.S. public policy may still reveal substantial surprises. The current campaign of shock and awe could slow before too long. The White House could lose its nerve with tariffs, supersize tax cuts or deliver spending cuts with sandpaper rather than a hatchet. But based on the signals so far, it is prudent to expect incrementally less economic growth rather than more (Exhibit 5).

Bigger tariffs

It is difficult to write anything coherent about the outlook for U.S. tariffs as the storyline is in constant flux. It is not even simply whether large tariffs will be applied or not, but additionally whether any large tariffs that are applied will last the week, month, year or presidential term.

Logic would argue that, when the dust settles, the White House is likely to leave in place no more than moderately-sized tariffs that balance the desire to protect American businesses and generate tax revenue with the preference not to overly damage the U.S. economy or financial markets, and perhaps even with legal restrictions.

To be sure, it might make sense to threaten maximal tariffs as an initial negotiating tactic, and then to use that threat as a means to strike a deal with trading partners later, securing concessions without incurring too much economic damage. However, actually delivering large tariffs would make considerably less sense, as tariffs inflict serious economic damage via a wide range of channels, and not just on the targeted nation, but also on the implementing nation (Exhibit 6). They also increase prices. Initially, it had appeared that bluffing was indeed the strategy being pursued, as tariffs were repeatedly delayed.

But, since then, the U.S. appetite for tariffs has proven somewhat larger than expected. China has been hit by two rounds of 10% tariffs. Canada and Mexico had 25% blanket tariffs applied. While a considerable fraction of those tariffs were subsequently delayed until early April, a sizeable fraction remains in place and there is a good chance other parts will be revived later. Large worldwide steel and aluminum tariffs are now in place. And that still leaves reciprocal tariffs in early April, which President Trump has threatened on a large fraction of the world and which he has described as “the big one.”

There is some room for countries to negotiate their tariff blow lower: some countries have tariffs of their own that can be reduced, and it is not unreasonable that many countries should aim to raise their military budgets. But some U.S. demands may prove difficult for targeted countries to comply with. In particular, unorthodox expectations that countries lighten their sales taxes, revalue their exchange rates and/or break down non-tariff barriers (despite the U.S. maintaining many similar barriers) are less likely to be agreed to.

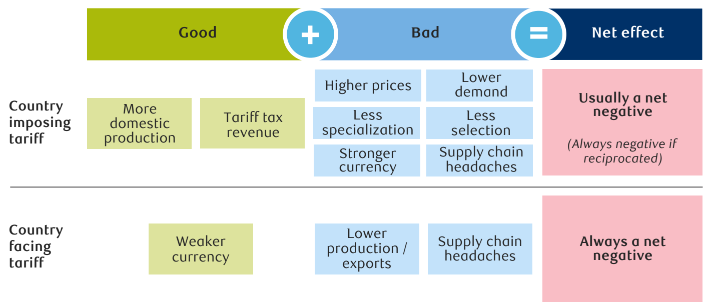
The manner in which big tariffs are being threatened, applied, withdrawn and/or recalibrated on the fly is not reassuring from a magnitude, stability or predictability perspective.

Exhibit 5: Trump policy expectations – tariffs tilt economy toward more negative interpretation

Policy	Short-term economy	Inflation (+ is higher)	Equities	Bond yields	U.S. dollar
Overall effect	–	+ +	neutral	+	+
Tariffs	– – –	+ + +	– – –	+ +	+ +
Immigration	– –	neutral	–	neutral	neutral
Regulations	+ +	neutral	+ + +	neutral	+
Taxes	+ +	+	+ + +	+	+
Animal spirits	+	+	+	+	+
Gov't spending	–	–	neutral	neutral	–
Debt servicing	n/a	n/a	–	+	–

Note: As at 03/03/2025. +/- indicate positive/negative impact on variable at top of column. Source: RBC GAM

Exhibit 6: Economic damage from tariffs comes via a range of subtle channels



Note: As at 02/17/2025. Source: RBC GAM

The process by which countries are selected for targeting is also frequently inscrutable, with the animosity toward Canada particularly puzzling when considered in the context of border control and trade imbalance priorities. Simultaneously, at least so far, several countries with large trade surpluses versus the U.S. including Germany, Vietnam and Thailand have been left untouched – though that could soon change. Predicting the way forward for tariffs is thus extremely challenging.

With that caveat in mind, we conclude that the threat of tariffs is greater than was initially expected, and the potential has risen for those tariffs to be both large and enduring. The most likely scenario is that large tariffs are applied, but later leavened somewhat. But large tariffs that remain problematically in place are also possible, and a scenario of more moderate tariffs is also conceivable, if less likely.

For all of its opacity, the U.S. tariff strategy does send a message to businesses that they should orient themselves toward the U.S. if they want to avoid the potential for major trade headaches. That could do lasting damage to key trading partners like Canada and Mexico, and provide an enduring boost to goods production in the U.S. – albeit alongside lasting reputational damage and foreign consumer boycotts, not to mention a questionable capacity to actually increase production given an already-low unemployment rate.

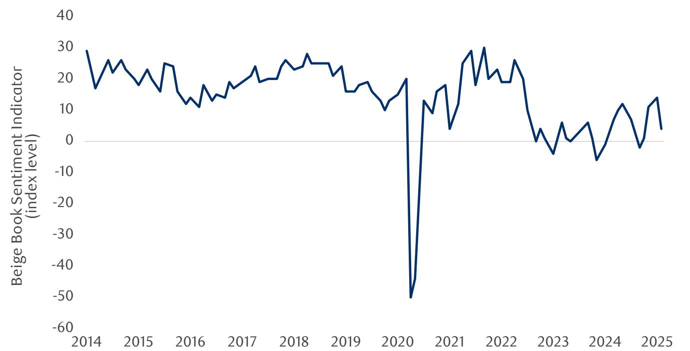
Downgraded growth forecasts

U.S. economic growth has been adequate in recent quarters (Exhibit 7), though some indicators point to a slight recent deceleration. In contrast, after a long period of sluggishness, economic growth across much of the rest of the developed world has picked up somewhat (Exhibit 8). Helping to explain this, most of the other countries have cut their policy rates by more than the U.S., they have softer – and thus more competitive – exchange rates, more space for growth after earlier underperformances, and high household savings rates that promise to unlock additional consumer spending. Several such countries have been startled out of complacency by recent U.S. actions, and are also now planning on reinvesting in their militaries and infrastructure.

Given its status as the central agitator, tariffs are set to damage the U.S. by more than most of its peers since the U.S. fights a multi-fronted trade war whereas the others are engaged in mere bilateral spats with the U.S.

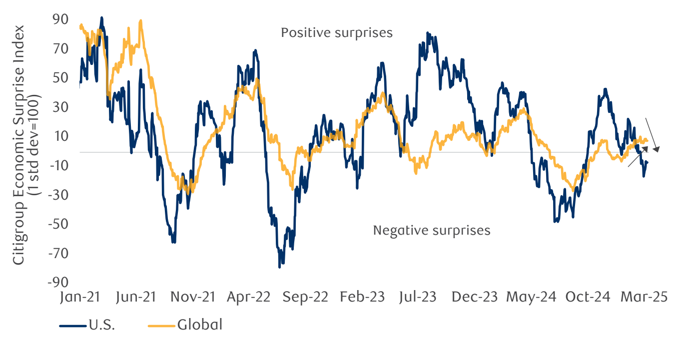
Even before the tariffs have been fully implemented, policy uncertainty is likely weighing on activity. Additionally, U.S. imports have recently been artificially higher than normal as companies seek to front-run tariffs, while exports in certain other countries have also been higher, temporarily flattering those countries (though this does not explain the entirety of the recent strength in most of those countries).

Exhibit 7: Beige Book Sentiment Indicator points to slight deceleration



Note: As of Feb 2025. The indicator quantifies the sentiment of local contacts by assigning different weights to a spectrum of positive and negative words used to describe overall economic conditions in the Fed Beige Book. Source: U.S. Federal Reserve, RBC GAM

Exhibit 8: Global and U.S. economic surprises diverge



Note: As of 03/10/2025. Source: Citigroup, Bloomberg, RBC GAM

Overall, U.S. economic exceptionalism appears to be diminishing after a multi-year run. Our forecasts continue to anticipate somewhat faster growth in the U.S. than most of its peers – the country is still a hotbed of innovation and has superior demographics versus many of its peers even after sharply curtailing immigration – but with a smaller growth advantage than has been the norm. To illustrate, the U.S GDP growth advantage over the European Union was 2.4 percentage points in 2023 and 2.1 percentage points in 2024, versus our forecast for just 0.9 percentage points in 2025 and 0.8 percentage points in 2026.

Largely due to the tariffs, developed-world growth forecasts have been nearly universally downgraded for 2025 and now rest somewhat below the consensus. Illustrating this, U.S. growth is now expected to be just 1.9% for the year – the slowest pace since 2020 when the economy shrank due to pandemic restrictions. The subsequent year, 2026, is set to be somewhat improved, with forecasts that are broadly on or slightly above the consensus.

While the talk of recession has lately picked up, it is really only a big problem for Canada and Mexico. Yes, U.S. growth is set to be slower than otherwise under a tariff regime and given other policy decisions and, yes, the U.S. recession risk has probably jumped from a mere 15% over the next year to something at or above 25%. But it is still more a story of diminished growth than of vanished growth.

For Canada and Mexico, we don't quite forecast outright recessions given the base-case assumption that large tariffs will be applied and then lightened later in the year. But we do assume several months of declining output in the near term as the initial effect of those tariffs is felt, and then temporarily rapid growth several months later as part of that damage is unwound. This adds up to just 0.9% GDP growth for Canada in 2025, and a mere 0.3% for Mexico. These are sharp downgrades from prior forecasts.

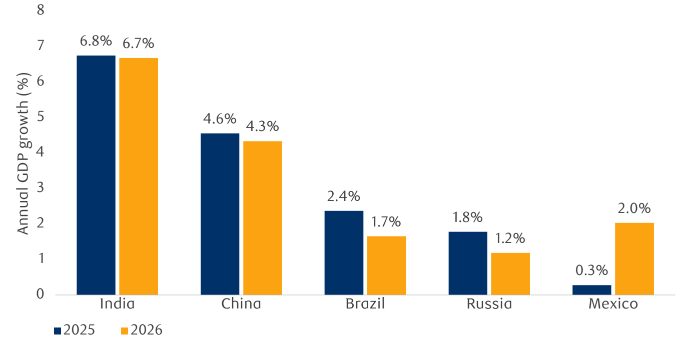
Beyond Mexico, our emerging-market growth forecasts are more subtle in their adjustments. Notably, China's 2025 growth outlook has been upgraded by a few tenths to +4.6%. The India forecast remains roughly unchanged at +6.8% (Exhibit 9).

Risks to these growth forecasts extend in both directions. On the optimistic side, perhaps large tariffs can be avoided after all. On the negative side, perhaps the trade war will be even greater than feared. Another downside risk is the potential for greater geopolitical tension as the U.S. seemingly pulls away from its traditional allies, forcing a rethink of international alliances and creating a window of opportunity for bad actors. Another risk relates to the recent outbreak of Avian flu, which highlights the small chance of another pandemic.

Upgraded inflation forecasts

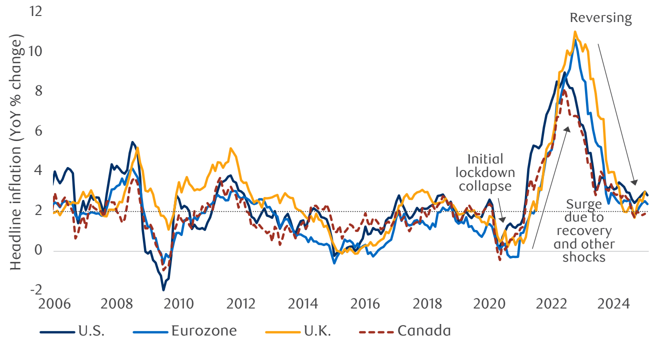
Inflation is no longer the primary market concern that it was several years ago (Exhibit 10). But neither is inflation completely settled, especially in the U.S.

Exhibit 9: RBC GAM GDP forecast for emerging markets



Note: As of 03/07/2025. Source: RBC GAM

Exhibit 10: Inflation has massively improved, but not fully normalized yet



Note: Eurozone and U.S. as of Feb 2025, Canada and U.K. as of Jan 2025. Source: Bureau of Labor Statistics, Office for National Statistics, Statistics Canada, Statistical Office of the European Communities, Macrobond, RBC GAM

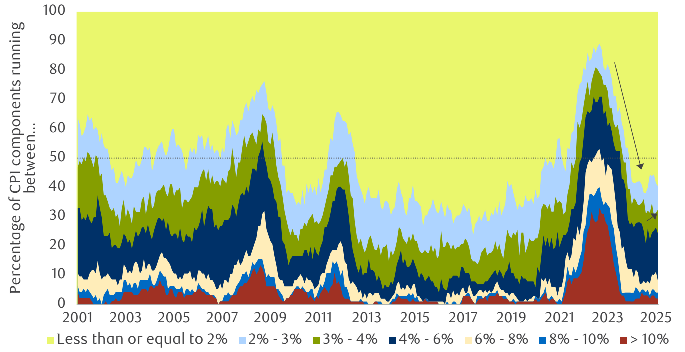
In fact, we have been compelled to increase the 2025 inflation outlook for two reasons. The first is that tariffs are inflationary in the short run, and so the increased potential for significant tariffs is relevant.

The second development is that – at least in the U.S. – inflation has proven quite sticky in recent quarters. There hasn't been much progress in pulling down elevated inflation since the middle of last year. U.S. inflation remains stuck in the realm of 3.0% even as other countries have managed to wrangle their own inflation rates down to the 2.0% to 2.5% range.

The breadth of U.S. inflationary pressures has even broadened slightly again (Exhibit 11). Similarly, while corporate pricing plans have diminished since the massive inflation shock, there has been recent resistance to further normalization (Exhibit 12). An open question is whether companies will take advantage of tariffs by increasing their prices beyond what the tariffs strictly require. In the U.S., insurance costs should rise further after a spate of recent natural disasters including the Los Angeles fires.

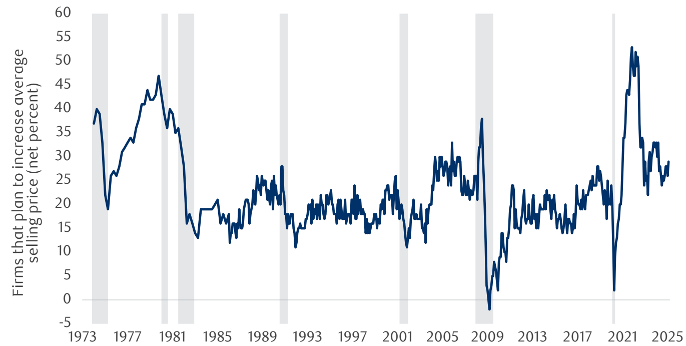
All told, we now look for U.S. inflation to increase outright in 2025, from 2.9% in 2024 to 3.3%. Other countries are also expected to experience inflation upticks (Exhibit 13). As with our growth forecasts, these now land on the undesirable side of the consensus.

Exhibit 11: U.S. inflation breadth has not made much progress lately



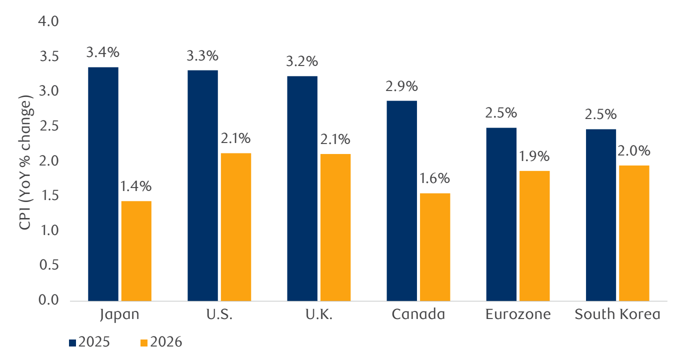
Note: As of Feb 2025. Share of CPI components with year-over-year % change falling within the ranges specified. Source: Haver Analytics, RBC GAM

Exhibit 12: Fraction of U.S. businesses planning to raise prices not yet normal



Note: As of Feb 2025. Shaded area represents recession. Source: NFIB Small Business Economic Survey, Macrobond, RBC GAM

Exhibit 13: RBC GAM CPI forecast for developed markets



Note: As of 03/07/2025. Source: RBC GAM

Torn central banks

Central banks have been in rate cutting mode for the past year, with some further easing likely in 2025 (Exhibit 14).

Let the record show that tariffs – despite the contradiction they present in the form of higher prices pitted against weaker output – are classically a motivation for central banks to cut rates rather than raise them. This is because the inflation effect is a one-time price level shock, meaning that the rate of inflation rapidly returns to normal afterward, even if the price level itself remains permanently higher. Conversely, the economic damage is enduring and so very much relevant to central banks.

In turn, there is room for material further monetary easing for quite a number of countries, with the U.S. a potential exception due to its higher inflation readings. As an aside, the recent arrival at the U.S. debt ceiling is temporarily injecting additional liquidity into the American economy as exceptional measures are pursued, but this boost then reverses once the debt ceiling has been lifted.

Even as interest rates fall, there is still lagged pain from the earlier period of high interest rates. U.S. consumer loan delinquency rates continue to edge higher, with the exception of credit card delinquencies, which have now peaked (Exhibit 15).

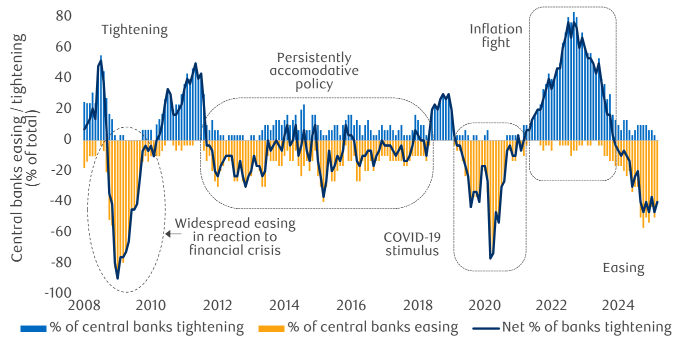
China sails on

The Chinese economy is on a slower growth trajectory than that of several years ago, but nevertheless has several important things going for it.

First, China's export-led economy is not overly vulnerable to U.S. tariffs. Just 16% of what China exports is destined for North America (Exhibit 16), and a mere 2.4% of what China produces overall is consumed directly by Americans. That leaves the vast majority of the country's economy in a position to sail smoothly on.

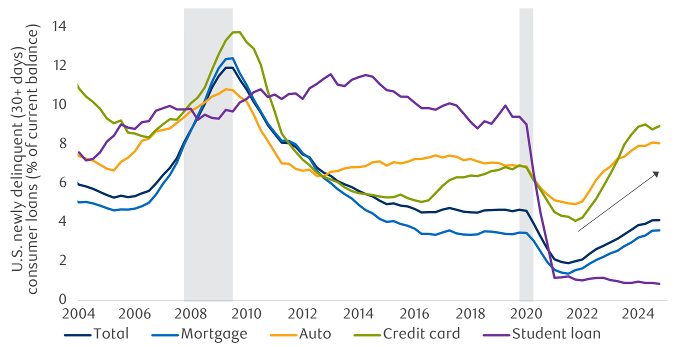
Second, there is tentative evidence that China's property market – which has been the weakest component of the economy in recent years (Exhibit 17) – is at a minimum stabilizing and possibly even beginning to show green shoots. Prominently, new home prices in first-tier cities started to rise at the end of 2024, the first increase since mid-2023.

Exhibit 14: Central bank rate cutting cycle



Note: As of 03/10/2025. Based on policy rates for 30 countries. Source: Haver Analytics, RBC GAM

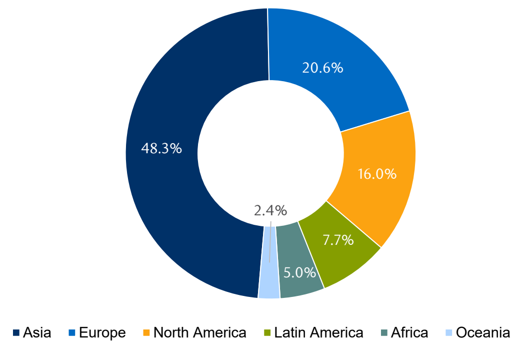
Exhibit 15: U.S. consumer loan delinquency has been rising



Note: As of Q4 2024. Shaded area represents recession. Source: FRBNY, Macrobond, RBC GAM

Exhibit 16: Chinese exports orientation

(12-month rolling sum, % of total exports)



Note: As of Dec 2024. Source: China General Administration of Customs, Macrobond, RBC GAM

Third, concerns that China might prove incapable of pushing the technological envelope forward once it had reached the limits of imitating others appear to be overblown given the country's recent success with large language model DeepSeek, not to mention its world-leading position in such technologies as electric cars, batteries, solar panels and drones. Growing economies feed on innovation.

Fourth, the long chill between the Chinese government and the country's private sector has warmed in recent months. After a sharp pivot away from the private sector in 2020, President Xi recently convened a symposium with leading Chinese entrepreneurs, emphasizing the key role of the private sector in Chinese growth, and committing to provide policies that support the business sector. In line with this, major banks have promised to lend more to the private sector. The Chinese stock market has taken enthusiastic note (Exhibit 18).

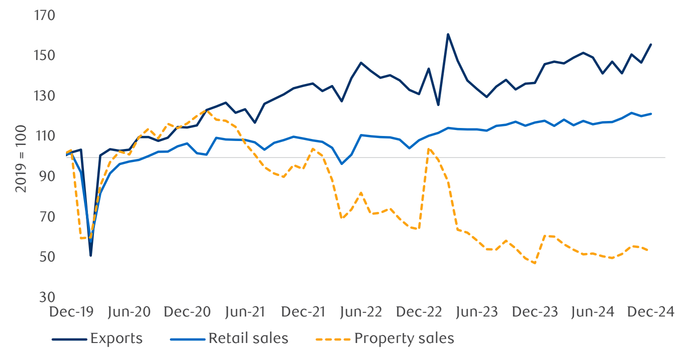
> "The U.S. retreat from international affairs and new concerns about the country's reliability create an opportunity for China…"

Fifth, with a refreshed 5% growth target and some fiscal space, there is likely to be further government support for the Chinese economy. Already, additional capital is being pumped into the banking sector.

Sixth, the U.S. retreat from international affairs and new concerns about the country's reliability create an opportunity for China to expand its global role and even to deepen trade ties with traditional U.S. allies.

Accordingly, the Chinese outlook has improved somewhat. Our growth forecasts for China are above the consensus, and the country remains on track to be – by far – the largest driver of global growth in the coming years (Exhibit 19).

Exhibit 17: Chinese recovery remains uneven

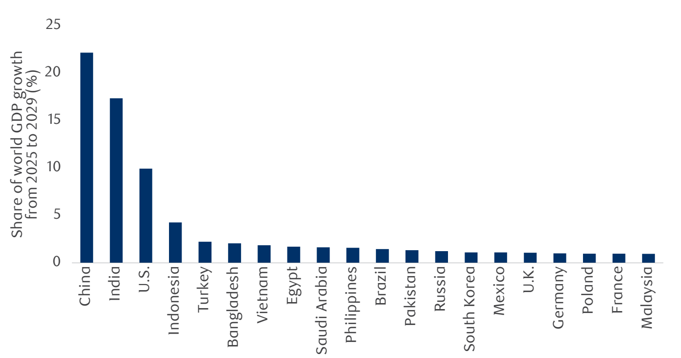


Note: As of Dec 2024. Average of 2019 levels indexed to 100. Source: Haver Analytics, RBC GAM

Exhibit 18: Chinese stock rally led by tech stocks

Note: As of 03/07/2025. Source: MSCI, Macrobond, RBC GAM

Exhibit 19: China to remain the top driver of world growth



Note: Based on IMF forecast from 2025 to 2029. Source: IMF World Economic Outlook, Oct 2024, Macrobond, RBC GAM

Tariffs engulf Canada

The Canadian economy was strengthening at the start of 2025: fourth-quarter 2024 GDP growth arrived ahead of expectations, business expectations were strengthening (Exhibit 20), and the unemployment rate reversed a portion of its earlier increase (Exhibit 21). Productivity growth also turned positive and earlier Bank of Canada (BoC) rate cuts were starting to take effect (Exhibit 22).

To be sure, there was still a great deal of uncertainty about the impact of the country's sharply decelerating immigration figures, but the overall Canadian picture was looking up after a few challenging years.

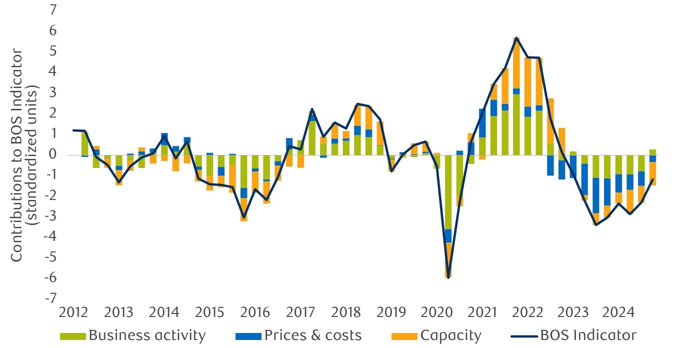
All of that has now been put into considerable doubt given the aforementioned tariff threat. No country is more exposed to U.S. tariffs than Canada. Given maximal uncertainty, it is impossible to forecast the Canadian outlook with any confidence.

A worst-case scenario, in recognition of what appears to be a particular degree of antagonism directed toward Canada, would have the repeatedly-threatened 25% tariff fully delivered, perhaps even with an overlay of steel and aluminum tariffs persisting on top. This would induce a full and fairly deep recession in Canada, with our models arguing the economy would undershoot its normal rate of growth by around 4.5 percentage points over the coming two years. The price of products in Canada would rise by nearly an additional 2%.

A more moderate (and the most likely) scenario would bring largish tariffs that are then significantly reversed within the span of a few quarters once negotiations have concluded. This would also involve some amount of economic contraction, albeit a decline that would later be partially unwound by the reversal of the tariffs. There would be real pain, and the initial experience would be no different than the worst-case scenario, but the end point would be considerably less dire.

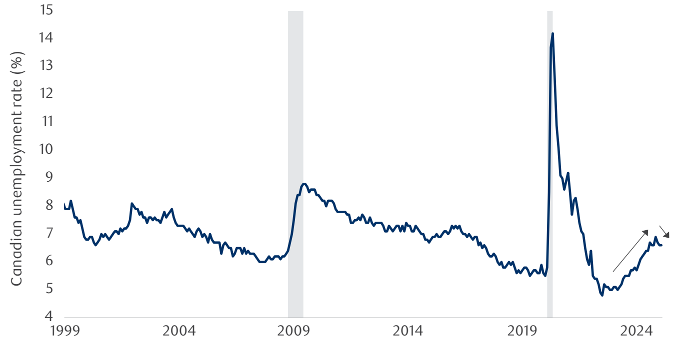
Finally, a best-case scenario would see U.S. tariffs largely avoided, perhaps as the U.S. economy comes to recognize its reliance on Canadian resources. This scenario, while desirable, is hardly perfect. Canada is already likely suffering damage from paralyzing uncertainty, as per the meagre 1,100 jobs created in the country in February. Businesses making

Exhibit 20: Canadian Business Outlook Survey Indicator has become less negative



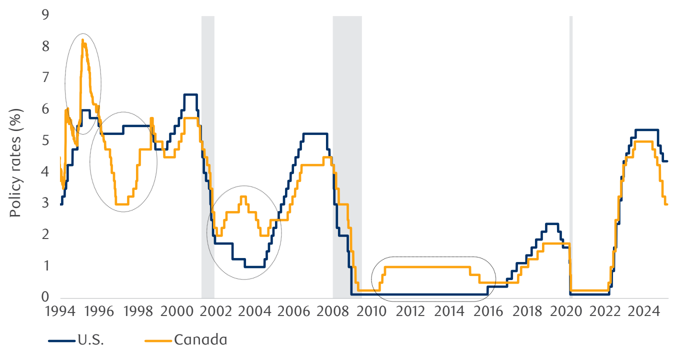
Note: As of Q4 2024. Source: Bank of Canada Business Outlook Survey, Macrobond, RBC GAM

Exhibit 21: Canadian unemployment rate started to reverse



Note: As of Feb 2025. Shaded area represents recession. Source: Haver Analytics, Macrobond, RBC GAM

Exhibit 22: North American monetary policy in easing mode



Note: As of 03/10/2025. Shaded area represents U.S. recession. Source: Macrobond, RBC GAM long-term plans may still decide that it is more logical to expand production within the U.S. given the recurring threat of tariffs.

Regardless of the scenario pursued, Canada must significantly reimagine its relationship with the U.S., both in the context of trade and foreign policy.

Canada's tariff response strategy is already fairly clear: to retaliate against U.S. tariffs in a less than one-for-one capacity, but with an effect magnified via careful targeting. In response to U.S. demands, Canada is likely in a position to oblige via additional border controls and military spending, but with less certainty on other fronts.

Should large tariffs stick, the Bank of Canada would cut its policy rate by more than otherwise, and the government would implement its fiscal support plan which is purported to include expanded eligibility for employment insurance and targeted business supports.

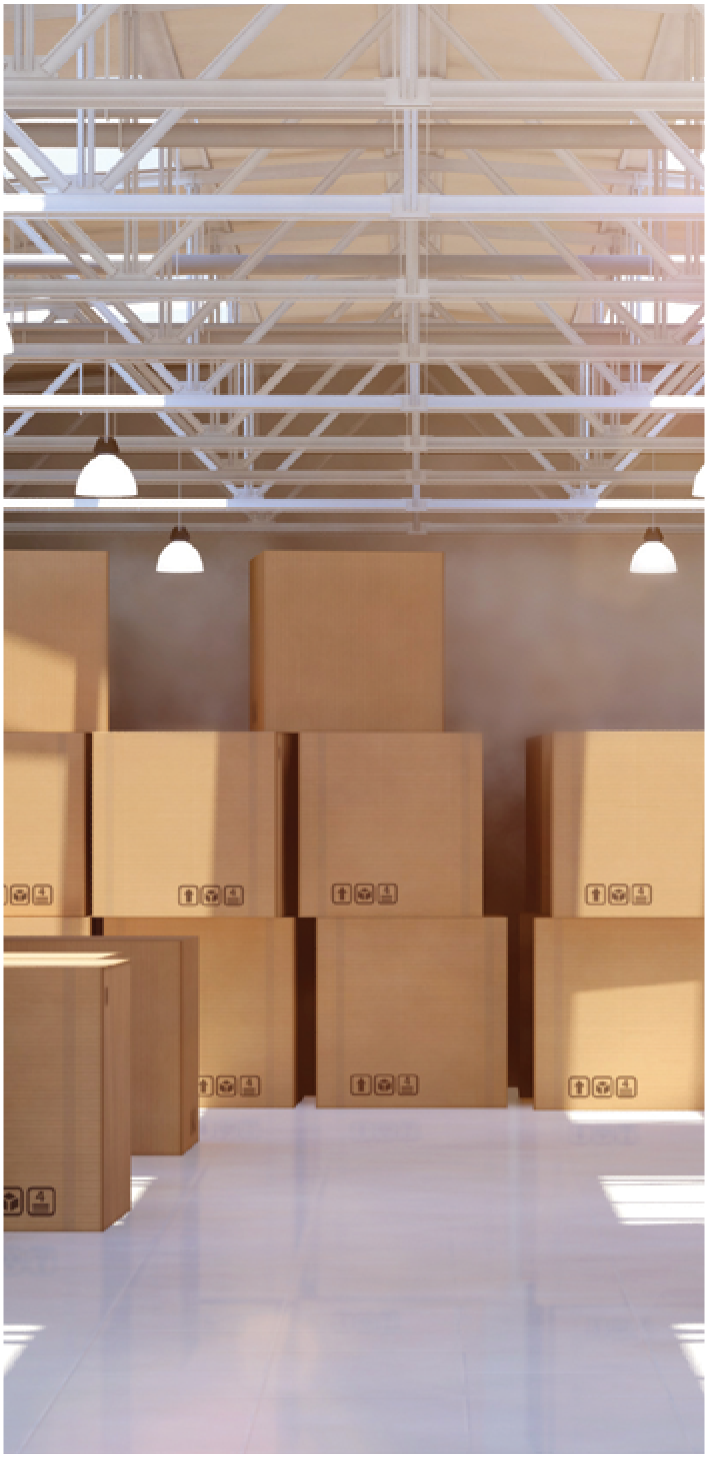
A Canadian election will be held later this year. The Conservative Party currently leads the incumbent Liberals in the polls, though the race has narrowed considerably in recent months and the Liberal Party has just been refreshed via the selection of a new leader. Either way, a new era of public policy beckons for Canada: one focused in the short-run on managing U.S. antagonism, and in the long-run on sustainably reviving productivity growth and prosperity after a long period of neglect.

Bottom line

This is a time of elevated uncertainty, stemming primarily from U.S. government policy. Tariffs are front and centre, with an increased risk that they seriously compromise economic growth for the most adversely affected nations – prominently among them, Canada, Mexico and of course the U.S. itself.

Perhaps the White House will take heed of recent financial market concerns, steering in a more growth-supportive direction. But this is far from certain.

Setting public policy aside, U.S. economic growth is decelerating slightly, whereas the Eurozone, U.K. and Japan are seemingly on an accelerating track. When paired with high U.S. uncertainty and expensive equity valuations, other stock markets are presently more attractive. High uncertainty also argues for holding moderate amounts of bonds and cash, the former as ballast against any market downturn, the latter as dry powder to deploy opportunistically should any market dislocations arise.



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