RBC Global Asset Management

Economic outlook

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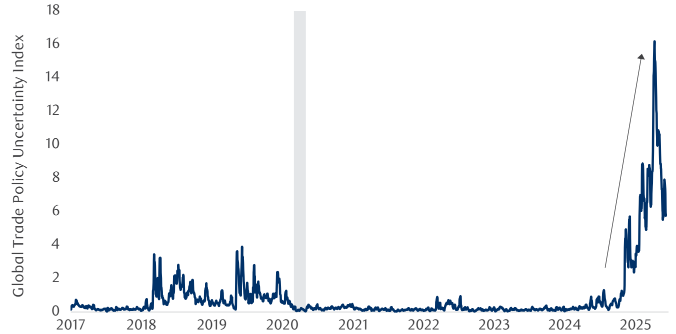
The impact of repeated waves of unorthodox U.S. public policy is washing over the global economy and financial markets. Some policy guardrails are starting to appear: critically, tariffs seem unlikely to be enormous, nor to go away altogether. But there remains substantial uncertainty, particularly with regard to the precise contours of trade policy (Exhibit 1).

The effective U.S. tariff rate on its trading partners has declined substantially from early-May highs after a temporary détente was reached with China and a trade deal was struck with the UK (Exhibit 2). But tariffs are now creeping back up again.

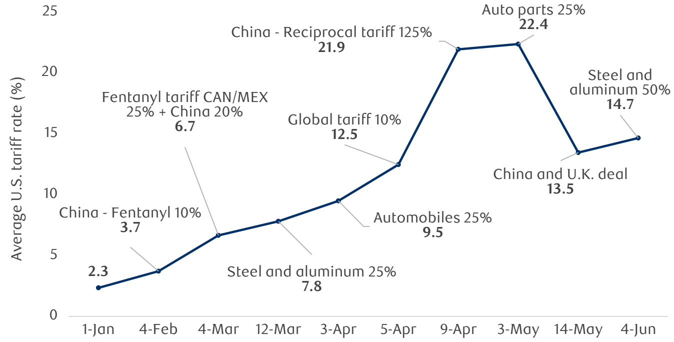
For their part, financial markets are becoming less fussed by the repeated policy shocks, recognizing that the most extreme proposals and actions are likely to later be tempered. The risk of recession has declined, and a contraction is not our base-case forecast. Still, tariffs and

Exhibit 1: Global trade-policy uncertainty has fallen but remains high



Note: As of 06/07/2025. Shaded area represents U.S. recession. Index based on searches in economic, research and government related topics in Bloomberg News and First Word feeds. Source: Bloomberg, Macrobond, RBC GAM

Exhibit 2: Average U.S. tariff rate still material after pauses and deals



Note: Effective tariff rates estimated based on tariffs implemented by the Trump administration up to June 4, 2025. Excludes de minimis effect. All U.K steel exports to U.S. are assumed to be covered under the quota system. Source: Evercore ISI Tariff Tracker, IMF, Macrobond, RBC GAM the other economic-policy decisions emanating from the White House remain central to the U.S. and global economic outlooks and are set to do material damage to growth over the second half of 2025.

Given the stagflationary impulse that emanates from tariffs, U.S. and global growth is set to be weaker than normal in 2025. There is then some scope for recovery in 2026, especially as planned U.S. tax cuts take effect. U.S. inflation should be moderately higher than otherwise, but not on the scale of the inflation shock of a few years ago.

While a handful of countries are substantially exposed to U.S. tariffs, the bulk of the global economy should not be too badly affected given only limited exposure to U.S. demand. Furthermore, with the exception of a small number of countries that are retaliating forcefully against the U.S. with tariffs of their own, any increase in inflation outside of the U.S. should be quite limited.

From a longer-term standpoint, U.S. exceptionalism – economic and otherwise – is diminishing, and along with it the country's previously considerable store of soft power. Concerns about the U.S. fiscal burden have also become palpable. In turn, the U.S. dollar should continue to decline, U.S. longer-dated borrowing costs may be somewhat higher than otherwise, and the American stock market is somewhat less well-positioned to continue outperforming the rest of the world. This presents opportunities that are both economic and financial in scope, especially for the European Union (EU) and China.

When these views are combined with valuation considerations, our recommended geographic equity asset allocation has tilted somewhat away from the U.S. At the same time, the firm's tactical weighting toward equities increased over the past quarter to take advantage of temporarily depressed markets.

Tariffs take effect

There have been a truly remarkable number of tariff twists and turns over the past quarter. Of greatest prominence, large reciprocal tariffs were briefly levied against the majority of the world's nations, and even larger ones were placed on China. New sector tariffs also took effect on steel, aluminum and autos.

After financial markets expressed sharp disapproval, tariff policy mostly lightened from mid-April through May, with reciprocal tariffs downsized to 10% baseline rates, gigantic Chinese tariffs pared, and a trade deal struck between the U.S. and the UK. This sequence showed there are limits to how much tariff pain the White House is willing to endure, and thus that large permanent tariffs are unlikely.

However, and possibly reinvigorated by the recent financial market rebound, the White House is again nudging the tariff frontier outward. It has levelled new threats against Europe and against imported cell phones, doubled the tariffs on steel and aluminum, and still plans a suite of other sector-oriented tariffs set to be implemented on copper, forestry products, pharmaceuticals, computer chips and possibly even critical minerals. The USMCA trade deal also needs to be renegotiated, and for that matter there is still a theoretical queue of well over 100 countries scrambling to negotiate with the U.S. before their 90-day reprieve expires in early July. China's tariff reduction will theoretically expire in August. Given that many countries have reported that they do not know what the U.S. wants of them and don't even have a proper opposite number with whom to negotiate, it stretches the imagination to think that these will all be settled before the deadline.

The British trade deal proves that accords are possible and provides some sense for what other countries might realistically aspire to. While the UK did manage to negotiate down several sector tariffs and avoided too many concessions elsewhere, the main conclusion is that middling tariffs are here to stay, with the bulk of UK exports to the U.S. still subject to the baseline 10% tariff. If this was the deal that a country running a trade deficit versus the U.S. secured, it strongly suggests that others – almost all of whom run trade surpluses versus the U.S. – are unlikely to do better.

The matter of whether the White House's current slate of tariffs is entirely legal remains unresolved, with appeals and counter-appeals ongoing. Our main takeaway is that even if some of the current tariffs are unwound for legal reasons, there are a suite of other tariff-supportive laws on the books that will allow the White House to mostly achieve its objectives.

With the acknowledgement that trade-policy uncertainty remains substantial, we assume that the average effective U.S. tariff rate eventually settles at around 15%. That's approximately in line with the current level and reflects the following assumptions:

- Broad baseline 10% tariffs continue to apply to most countries
- A handful of sector-oriented tariffs are overlaid on top of this, lifting the average rate
- Conversely, a variety of narrow exemptions eventually lower the average rate – achieved through a mix of trade deals and simple American self-interest to avoid its own pain points
- Tariffs on China remain higher than elsewhere, averaging 25% – 50%
- Tariffs on a number of other countries – mostly Asian economies with large trade surpluses against the U.S. – land somewhat higher than elsewhere, at an approximately 20% rate

To the extent there are risks to this view, they arguably tilt toward even higher tariffs. President Trump's desire for tariff revenue and goal of onshoring industrial production should not be underestimated. The UK trade deal technically left in place its full reciprocal tariff allotment, as the UK only ever had a 10% rate levied against it. For comparison, the full reciprocal tariff rates assigned to the EU, Japan and Vietnam are 20%, 24% and 46%, respectively. If those higher rates were to stick, the tariff profile would naturally be worse.

Who, beyond the U.S. is set to be hurt by the tariffs? That is largely a function of which countries trade the most with the U.S., and which countries have been hit by the largest tariffs (Exhibit 3). Mexico and Vietnam are on track to suffer triple the economic damage of any other country due to a combination of high trade connectivity to the U.S. and substantial tariffs. There is then a cluster of six countries – Canada plus Thailand, South Korea, Taiwan, China and Malaysia – that are tracking moderate tariff damage. Beyond those nations, the central takeaway is that most countries rely on the U.S. for only 2%—3% of their economic demand, and so they should be relatively resilient even in the face of tariffs.

Exhibit 3: Which country is most exposed to U.S. tariffs?

Country	Tariff impact on economic output (A) x (B)	Exports to U.S. in 2024 (% of national GDP) (A)	Effective tariff rate (%) (B)
Mexico	3.80	27.30	13.92
Vietnam	3.52	29.72	11.86
Thailand	1.25	12.03	10.37
South Korea	1.08	7.04	15.30
Canada	1.06	18.41	5.78
Taiwan	1.01	14.86	6.79
China	0.95	2.34	40.72
Malaysia	0.89	12.52	7.10
Japan	0.60	3.68	16.22
Germany	0.47	3.44	13.55
Italy	0.40	3.22	12.40
South Africa	0.37	3.66	10.12
Indonesia	0.30	2.01	14.77
Philippines	0.28	3.07	9.00
India	0.25	2.24	11.21
Peru	0.24	3.24	7.42
Brazil	0.23	1.95	11.99
Netherlands	0.22	2.78	7.90
France	0.20	1.90	10.66
Turkey	0.20	1.27	15.87
U.K.	0.17	1.87	9.23
Spain	0.15	1.24	11.99
Australia	0.09	0.93	9.85
Saudi Arabia	0.03	1.17	2.49
Nigeria	0.02	3.04	0.80
Russia	0.01	0.14	3.67

Note: Effective tariff rates estimated based on tariffs implemented by the Trump administration up to June 4, 2025. Excludes de minimis effect. Assumes a quota fully covers all U.K steel imports to the States. Source: Evercore ISI Tariff Tracker, IMF, Macrobond, RBC GAM

Projecting the effect of tariffs onto the economy, inflation and unemployment is not an exact science. Our base-case scenario anticipates a reduction in U.S. economic growth of approximately 1.3%, with an unemployment rate that rises – all else equal – by 0.9%, and an increase in the U.S. consumer price level of 0.9 percentage point. Of course, if tariff rates eventually settle materially above or below our expectations, the story naturally changes (Exhibit 4).

Among other countries, we anticipate a 1.1%-1.8% hit to Canadian GDP growth, a 1.0%-2.0% reduction in Chinese growth, and smaller impacts in the EU, UK and Japan.

The expected global (ex-U.S.) hit to growth should be approximately -0.8%.

Other U.S. policy

While tariffs have sucked the oxygen out of the room, they are not the only remarkable policy initiative emanating from the White House.

On the growth-negative side of the ledger, immigration policies have been tightened, potentially subtracting up to half a percentage point per year from GDP growth relative to the prior trajectory as the workforce expands less quickly.

Exhibit 4: Tariff scenarios and economic implications

		Tariff rate increase (ppt)								
		0%	5%	10%	15%	20%	25%	35%	50%	100%
Global	GDP	-0.2	-0.4	-0.5	-0.8	-1.1	-1.4	-2.1	-3.2	-5.1
	CPI	0.0	0.1	0.1	0.2	0.4	0.5	0.7	1.1	1.8
	Unemployment rate	0.0	0.3	0.3	0.5	0.7	1.0	1.4	2.1	3.4
U.S.	GDP	-0.3	-0.6	-0.9	-1.3	-1.8	-2.4	-3.6	-6.0	-10.8
	CPI	0.3	0.5	0.8	1.1	1.5	2.0	3.1	5.1	9.1
	Unemployment rate	0.2	0.4	0.6	0.9	1.2	1.6	2.4	4.0	7.2
Canada	GDP	-0.5	-1.1	-1.8	-2.5	-3.4	-4.5	-6.9	-11.4	-20.5
	CPI	0.2	0.3	0.5	0.8	1.7	2.3	3.5	5.7	10.2
	Unemployment rate	0.3	0.8	1.2	1.7	2.3	3.0	4.6	7.6	13.7
China	GDP	-0.1	-0.3	-0.4	-0.6	-0.8	-1.0	-1.4	-2.0	-3.2
	CPI	0.0	0.1	0.2	0.2	0.3	0.4	0.6	0.8	1.3
	Unemployment rate	0.1	0.2	0.3	0.4	0.5	0.7	0.9	1.3	2.1
EU	GDP	-0.2	-0.4	-0.6	-0.9	-1.2	-1.6	-2.4	-3.6	-6.4
	CPI	0.0	0.1	0.1	0.2	0.5	0.6	0.9	1.4	2.6
	Unemployment	0.1	0.3	0.4	0.6	0.8	1.1	1.6	2.4	4.3
UK	GDP	-0.2	-0.4	-0.5	-0.8	-1.0	-1.3	-2.0	-3.0	-5.3
	CPI	0.0	0.0	0.1	0.1	0.2	0.3	0.4	0.6	1.1
	Unemployment rate	0.1	0.2	0.3	0.5	0.7	0.9	1.3	2.0	3.6
Japan	GDP	-0.2	-0.4	-0.5	-0.8	-1.0	-1.3	-2.0	-3.0	-5.3
	CPI	0.0	0.0	0.1	0.1	0.2	0.3	0.4	0.6	1.1
	Unemployment rate	0.1	0.2	0.3	0.5	0.7	0.9	1.3	2.0	3.6

Note: As at 05/29/2025. +/- indicate positive/negative expected impact of different levels of tariff increases in ppt change to the trajectory of GDP, CPI or unemployment rate. The tariff rate for the U.S.is the trade-weighted average tariff it applies on others. For other countries and global, the rate is the average tariff applied by the U.S. on that country. A 0% tariff still induces economic damage due to high uncertainty and boycotts. The estimates presume a less than 1-for-1 response by the targeted countries. Source: RBC GAM

On the growth-supportive side, a major budget bill is now wending its way through Congress with substantial tax cuts proposed. Although much of this amounts to the extension of tax breaks that would otherwise have expired at year-end, there are new elements as well. Some of this is set to be funded by spending reductions elsewhere, including, controversially, Medicaid cuts. But the package nevertheless represents a substantial net outlay, potentially helping economic growth recover in 2026 and increasing U.S. borrowing over the next decade by between $2 trillion and $5 trillion. The anticipated tariff revenue is probably not large enough to fully plug this hole.

Section 899 of the bill has drawn considerable international attention because it threatens to increase the tax rate that foreign businesses and investors pay on their U.S. dividend and interest income. This would happen if other countries don't reduce certain "discriminatory" taxes that they levy on U.S. interests. We think it is likely that these new U.S. taxes are ultimately avoided, either because the final version of the bill removes them, because foreign countries scale back their digital-services taxes and global minimum taxes, or a remedy is found as part of trade negotiations. However, if this U.S. tax hike is activated, it stands to hurt not just foreign investors, but also the American economy as foreign capital flees for other shores.

U.S. exceptionalism diminished

Another key emergent theme is the diminishment of U.S. exceptionalism. The U.S. has long been the world's dominant economy and geopolitical power, and it accordingly has possessed the world's reserve currency, which brings the privilege of attracting capital from the rest of the world and benefiting from cheaper borrowing costs.

That exceptionalism now appears to be in retreat for several reasons.

The first reason relates to the deteriorating American political environment. The weaponization of the U.S. dollar in recent years against Russia and other foes, the U.S. retreat from the global institutions that constitute the connective tissue of the global economy, and recent erratic and unfriendly policy decisions all render the U.S. a less attractive market. U.S. soft power is in serious retreat.

Second, the famous U.S. growth advantage is slated to diminish in the coming years as American policymakers curtail immigration, undermine growth with tariffs, and discourage foreign academics and students from bringing their talents to the U.S. Conversely, a large chunk of the developed world, including the EU, has been jolted awake from their long slumber by recent U.S. actions and are now undertaking major fiscal, military and infrastructure outlays that promise to augment their own economic growth.

Third, the U.S. tops the list of countries that are in a precarious fiscal position, according to our fiscal health index (Exhibit 5). This renders U.S. sovereign debt less attractive and implies that the U.S. will eventually have to engage in growth-limiting austerity.

Exhibit 5: Fiscal health scorecard

Country	Fiscal Health Index (1 - 5)	Debt (% of GDP)	Deficit (% of GDP)	Fiscal adjustment (ppt)	Interest payments (% of GDP)	GDP growth (%)	Current Account (% of GDP)	Foreign-held debt (% share)	Committed spending share (%)	Currency control
U.S.	3.8	121	7.7	2.5	3.9	2.1	-3.9	26	70	Yes
U.K.	3.6	101	5.5	1.5	3.1	1.4	-3.4	25	66	Yes
Belgium	3.4	104	4.7	1.0	2.0	1.3	-0.9	52	58	No
Brazil	3.4	87	7.1	1.1	8.2	2.5	-2.8	11	66	Yes
France	3.4	113	5.4	1.3	1.9	1.2	0.4	46	63	No
Italy	3.3	135	3.5	-0.2	3.7	0.7	1.1	28	62	No
Spain	3.2	102	3.8	0.2	2.4	1.6	3.0	41	63	No
Greece	3.1	151	1.0	-3.4	2.8	1.4	-6.9	n.a.	57	No
Japan	3.0	237	2.5	-3.3	1.2	0.5	4.8	13	67	Yes
South Africa	3.0	76	6.0	0.3	5.0	1.8	-0.6	23	43	Yes
Mexico	2.9	58	5.9	2.5	6.2	2.1	-0.3	23	n.a.	Yes
Canada	2.8	111	1.9	-2.6	3.2	1.5	-0.5	21	63	Yes
India	2.8	81	7.4	-0.8	5.4	6.5	-0.8	5	n.a.	Yes
Norway	2.7	43	8.3	7.0	0.6	1.3	17.1	63	60	Yes
Finland	2.6	83	2.8	-0.5	1.1	1.2	0.3	46	62	No
China	2.5	123	6.9	-1.2	0.9	3.4	2.3	3	44	Yes
Portugal	2.4	95	-0.3	-3.1	2.2	1.7	2.2	46	62	No
Germany	2.2	64	2.2	0.0	0.9	0.7	5.7	42	61	No
Turkey	2.1	26	5.5	0.6	2.6	4.1	-0.8	n.a.	62	Yes
Australia	2.1	50	2.9	0.6	1.6	2.3	-1.9	33	57	Yes
Indonesia	1.8	40	2.2	-0.9	2.1	5.1	-0.6	34	32	Yes
Russia	1.8	20	3.0	1.5	0.8	1.2	2.9	8	46	Yes
South Korea	1.6	52	0.6	-1.7	0.9	1.8	5.3	17	n.a.	Yes
Netherlands	1.6	43	1.4	-0.2	0.7	1.2	9.9	37	57	No
Ireland	1.5	41	-3.9	-5.1	0.7	2.3	17.2	56	60	No
Denmark	1.4	28	-3.8	-4.7	0.7	1.5	13.0	26	64	Yes
Sweden	1.4	33	0.8	-0.3	0.7	1.7	7.4	16	56	Yes

Legend	Extremely poor	Very poor	Poor	Fair	Good

Note: 2024 data for all indicators except interest payments (2023) and GDP growth (IMF forecast for 2030 used as proxy for "normal"). Fiscal adjustment refers to the necessary reduction in fiscal deficit to stabilize debt-to-GDP ratio. Source: IMF, Macrobond, RBC GAM

In combination, these adverse developments argue, over time, for capital outflows from the U.S., a weaker U.S. dollar (Exhibit 6), a larger term premium (Exhibit 7), and perhaps even a lower price-to-earnings ratio in the stock market.

Delayed hit to economic growth

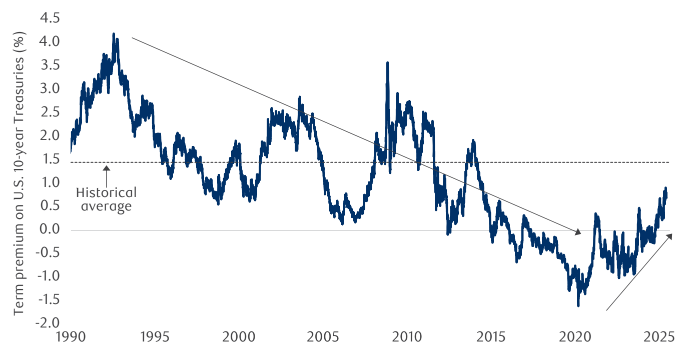
The theory is clear: tariffs should materially hurt economic growth. However, the precise timing of this damage is harder to pin down, and it has been a surprise that activity is only running a few ticks below normal through May despite the arrival of tariffs in March and April. The lagged impact appears to be in large part because many businesses stockpiled inventories before the full brunt of the tariffs arrived, delaying the price increases that normally set demand destruction into motion.

There is no question that sentiment-based and forward-looking indicators have weakened (Exhibit 8), suggesting a later decline in actual economic activity. Various real-time economic indicators are only now beginning to hint at a mild deceleration, including rising weekly jobless claims (Exhibit 9) and a slight dip in the Dallas Fed's Weekly Economic Indicator (Exhibit 10). The bulk of the damage now expected in the third and fourth quarters of the year.

Exhibit 6: U.S. dollar tumbles on Trump tariff turmoil

Note: As of 06/09/2025. Shaded area represents U.S. recession. Source: ICE, Bloomberg, Macrobond, RBC GAM

Exhibit 7: Term premium has been rising

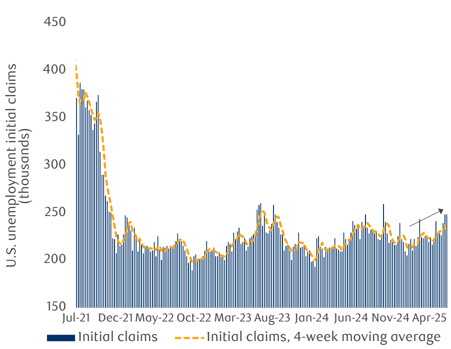


Note: As of 06/05/2025. Source: Federal Reserve Bank of New York, Macrobond, RBC GAM

Exhibit 8: U.S. CEO confidence dropped sharply on Trump policies

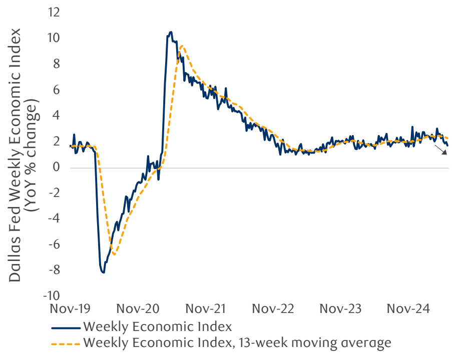
Note: As of May 2025. Shaded area represents recession. Source: Chief Executive Group, Bloomberg, RBC GAM

Exhibit 9: U.S. jobless claims rising slowly, though still low



Note: As of the week ending 06/07/2025. Source: DOL, Macrobond, RBC GAMM

Exhibit 10: Dallas Fed Weekly Economic Index slipping lower



Note: For the week ended 05/31/2025. The WEI is an index of ten indicators of real economic activity, scaled to align with the four-quarter GDP growth rate. Source: Federal Reserve Bank of Dallas, Macrobond, RBC GAM

Providing a partial offset to the tariff blow in 2025, oil prices have fallen considerably – a deflationary and growth-enhancing force. For the U.S., the weaker greenback also provides a modest competitive boost, though it has the reverse effect on other countries. Even as longer-term interest rates prove resistant to decline as the market reprices risk premiums on fiscal concerns and policy uncertainty, policy rates have declined substantially over the past year to create a lagged positive growth impulse.

Tariffs nevertheless dominate the outlook, with the result that 2025 GDP growth is forecast to be quite modest, with sub-2% growth rates across the board for the developed world (Exhibit 11).

The U.S. does not completely shed its international growth advantage, with a 1.4% gain in real GDP expected for the year, versus 1.3% in the UK and 1.1% increases in the eurozone and Canada. But the relative U.S. gain represents a sharp compression of the historical growth advantage, as the U.S. outpaced its peers by a remarkable 1.3 to 2.5 percentage points annually in each of the prior two years. The U.S. forecast also means that growth should be only half as fast in 2025 as it was in 2023 or 2024.

Next year promises to be somewhat better. The worst of the tariff adjustment should be complete by then, and U.S. tax cuts constitute a potential tailwind.

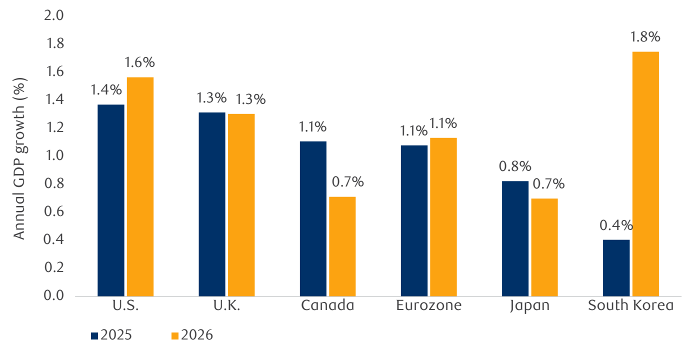
Implicit in all of this is that we do not forecast a recession. The tariff damage should not be large enough. That said, given uncertainties over what exact tariffs will be delivered and how they will interact with the economy, we presently assign a 30% chance of a U.S. recession over the coming year. That is down from earlier estimates, but still elevated.

On the emerging-market side, a 2025 tariff slump is also anticipated, but to a fairly mild extent for major economies (Exhibit 12). China is discussed in more detail in its own section later. Mexico is an obvious exception to this comment, as it is quite deeply connected to the U.S. and faces larger tariffs than most. In turn, we project a mere 0.1% GDP gain for the country in 2025.

Inflation downgrade outside U.S.

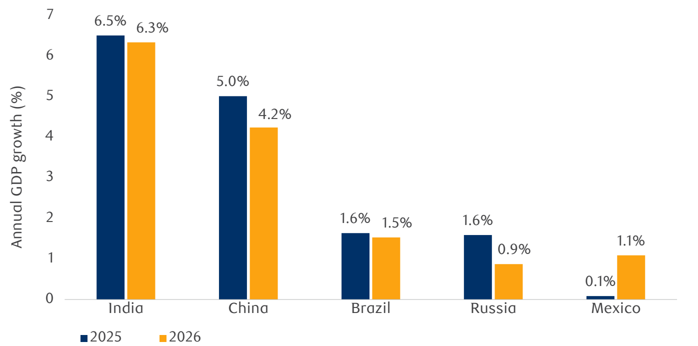
The trauma of the massive post-pandemic inflation shock of 2021-2023 is still fresh, and inflation still hasn't quite returned to normal (Exhibit 13). It is thus doubly unfortunate that a new

Exhibit 11: RBC GAM GDP forecast for developed markets



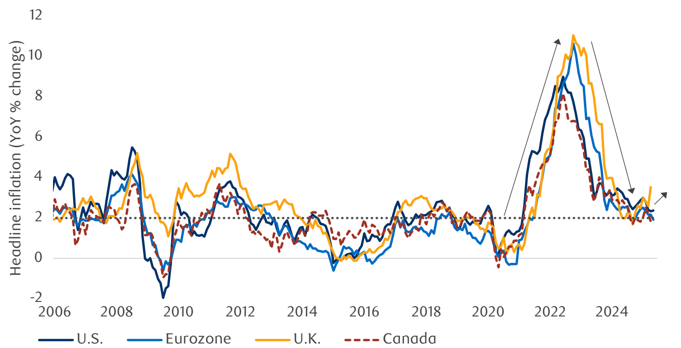
Note: As of 05/29/2025. Source: RBC GAM

Exhibit 12: RBC GAM GDP forecast for emerging markets



Note: As of 05/29/2025. Source: RBC GAM

Exhibit 13: Inflation has massively improved, but tariff impact awaits



Note: Canada and U.K. as of Apr 2025, Eurozone and U.S. as of May 2025. Source: Bureau of Labor Statistics, Office for National Statistics, Statistics Canada, Statistical Office of the European Communities, Macrobond, RBC GAM inflation irritant already looms in the form of tariffs. Tariffs are taxes that are levied on importers, who in turn pass a portion of their higher costs on to consumers in the form of higher prices.

The good news is that the tariff impact remains difficult to see in the price data so far. Much of this is for the same reason: inventory stockpiling that is delaying the impact. But it is possible that some fraction of the higher costs are also being absorbed by other segments of the supply chain.

We still budget for a substantial rise in U.S. prices, with annual inflation rates of 3.0% in both 2025 and 2026 (Exhibit 14). At a more granular level, U.S. monthly inflation is projected to peak at 3.5% in late autumn.

Businesses are now indicating that they plan to raise their prices, though the extent remains relatively contained (Exhibit 15). Real-time price measures argue that price pressures are indeed now running hotter than over the prior year, but these have also not skyrocketed (Exhibit 16).

On the other hand, lower oil prices should exert negative pressure on global inflation.

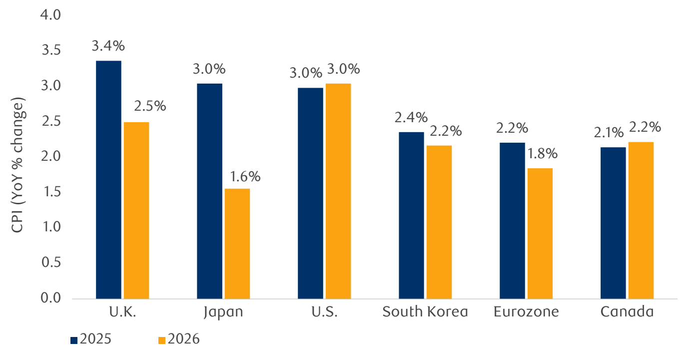
Beyond the U.S., the inflationary effect from tariffs should be much smaller, and less than we had assumed a quarter ago. This is for three reasons.

First, whereas tariffs hurt the economies of both the implementing and targeted countries, it is mainly the tariff-setting country whose prices rise. With only a few exceptions, other countries have reacted with surprising restraint to U.S. tariffs, meaning that they should expect only minimal additional inflation of their own from their direct effect of tariffs.

Second, with access to the U.S. market now more difficult, China and others may choose to dump their surplus production into third-party markets, creating a deflationary force. Already, steel dumping accusations are being levelled.

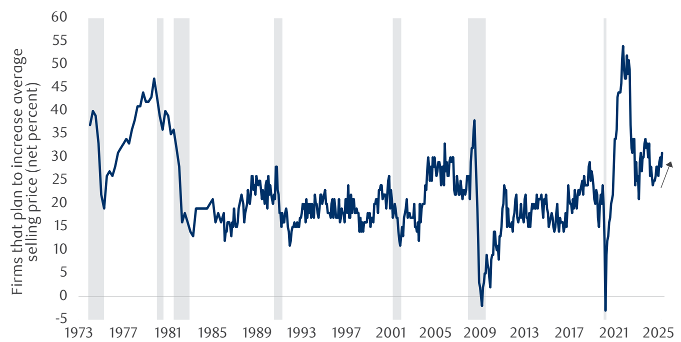
Third, under normal circumstances, countries being hit by tariffs see their exchange rates decline. This makes their imports more expensive and can be inflationary. But these days the opposite is happening: the U.S. dollar has instead fallen.

Exhibit 14: RBC GAM CPI forecast for developed markets



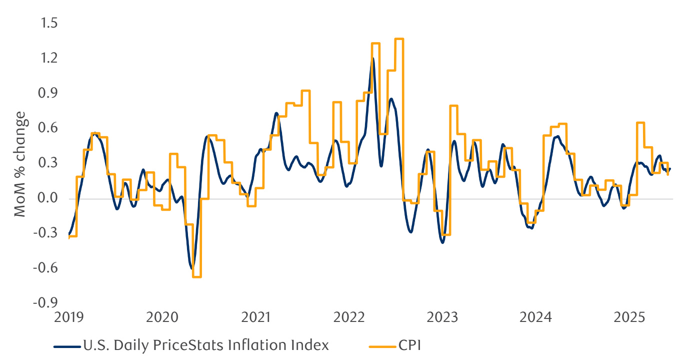
Note: As of 05/29/2025. Source: RBC GAM

Exhibit 15: Fraction of U.S. businesses planning to raise prices perked up lately



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

Exhibit 16: U.S. daily inflation metric sees tentative price pressures



Note: PriceStats Inflation Index as of 06/08/2025, CPI as of May 2025. Source: State Street Global Markets Research, RBC GAM

Central banks proceed with caution

Central banks are proceeding with considerable caution for two sets of reasons. The first is that it is still difficult to say with precision where tariffs will go from here, and accordingly what central banks should be doing. Instead of being proactive, they are forced to wait to see what White House policies are implemented (and even more so, which ones stick), before adjusting policy. That isn't ideal, as it takes several quarters for monetary-policy decisions to substantially impact the economy.

The second complication for central banks is that tariffs give contradictory signals. They simultaneously increase prices and decrease economic output, with the former arguing for rate hikes and the latter for rate cuts. In practice, it is the economic damage that usually takes precedence because the damage to the level of output is enduring, whereas inflation's deviation is short-lived (the price level is enduringly higher, but recall that central banks target inflation).As such, rate cuts can be expected, but of a more cautious nature than one would otherwise expect if this were a run-of-the-mill growth shock, both in terms of magnitude and timing (Exhibit 17). In turn, we anticipate three 25-basis-point rate cuts from the U.S. Federal Reserve over the latter part of the year.

Other central banks have less of a conflict to grapple with, as the primary damage to their economies is through slower growth rather than high inflation. In turn, they are well positioned to continue easing monetary policy to levels that are low enough to stimulate the economy.

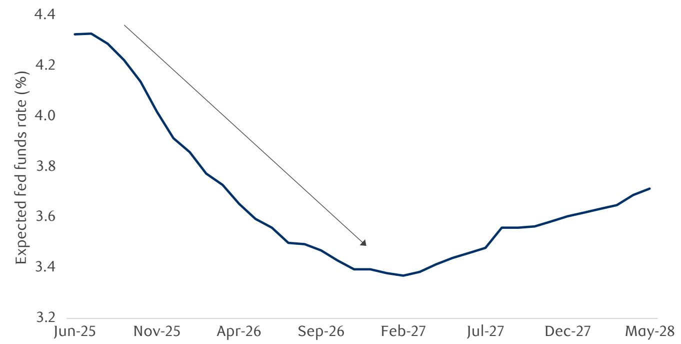
China's opportunity

China has undeniable challenges, from poor demographics to high debt to the U.S. trade war. It is also no longer a poor nation, meaning it can no longer expect to play catch-up via fast economic growth with the developed world to the extent it once did.

Still, we remain optimistic that China's economy can meet or exceed consensus growth estimates for several reasons.

First, while tariffs are a clear negative, China is less exposed than commonly imagined. Not only has there been a détente between the two adversaries, but only 2%-3% of what China produces is sold to the U.S. China has a huge domestic market, sends more than half of its exports to other Asian nations and trades more with Europe than it does with North

Exhibit 17: Market expects rate cuts to start in second half of 2025



Note: As of 06/09/2025. Source: Bloomberg, RBC GAM

America. China is still hurt by tariffs. But it is a manageable blow, and the country has the upper hand versus the U.S. in negotiations given its dominance in critical minerals and the country's dominance in the U.S. consumer goods and electronics markets.

Second, the longstanding question of whether China can pivot from manufacturing mimicry to technological innovation has been resoundingly answered with a "yes." The country is now evidently at the technological frontier, leading the way in such spaces as electric vehicles, batteries, solar panels and drones, and is also advancing quickly in artificial intelligence. This will be key for China's economic growth in the future, as it can no longer count on demographic tailwinds.

Third, after chilly relations for several years, the Chinese government has made peace with its private sector, putting businesses in a better position to grow and thrive.

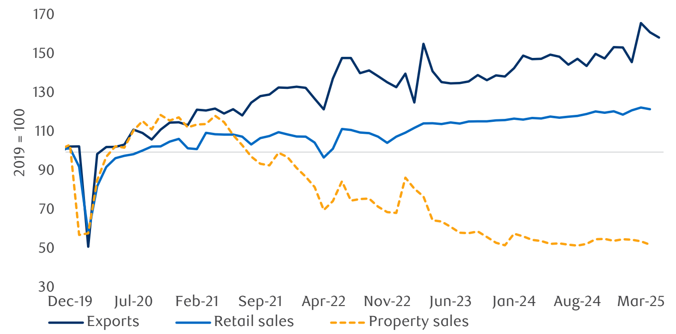
Fourth, China is delivering economic stimulus, and of greatest importance, consumption-oriented stimulus. As the country has reached middle-income status, its consumers should start to contribute more to the economy, but have so far been cautious. As social safety nets are now constructed and other forms of incentive to spend created, the country's famously high household-savings rate can theoretically decline, unleashing a sustained period of faster consumer spending. Retail sales have been ticking higher (Exhibit 18).

Fifth and finally, the country's beleaguered property market is showing some green shoots. Builders no longer appear on the cusp of failure, excess units are being absorbed by the government, and the country's largest cities are again managing tentative home-price increases. These developments don't mean that housing will contribute significantly to growth in the near term, but they are no longer shaping up to be a drag.

From a geopolitical standpoint, China has the opportunity to fill the void now being created by the U.S. retreat from global affairs. China is already an economic superpower and projected to be the biggest driver of global growth in the coming years (Exhibit 19). If it can prove a reliable partner to other nations in a way that the U.S. is not, there is scope for it to gain considerable soft power.

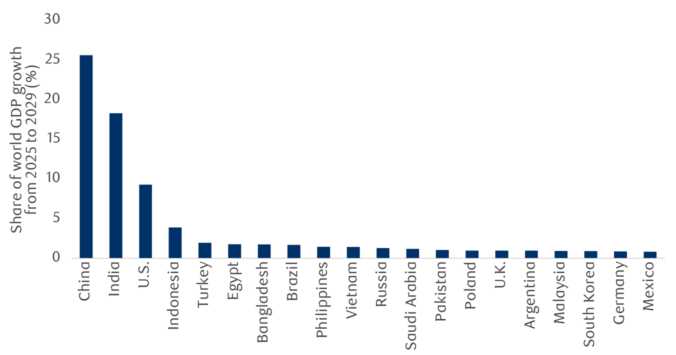
> "We remain optimistic that China's economy can meet or exceed consensus growth estimates for several reasons."

Exhibit 18: Exports have been Chinese driver – now other sectors may help more



Note: Exports as of May 2025, as of Apr 2025 for all other measures. Average of 2019 levels indexed to 100. Source: Haver Analytics, 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, Apr 2025, Macrobond, RBC GAM

Canadian transition

The Canadian economy is naturally quite vulnerable to U.S. tariffs. Canada has so far sidestepped the worst of the tariff impact, with threatened 25% universal tariffs seemingly avoided, and "only" a series of sector-oriented tariffs on steel, aluminum and autos currently in place. Canada (and Mexico) have even managed to avoid the baseline 10% tariff rate charged to most other countries. The deep recession that many investors had feared for Canada is instead tracking toward weak growth.

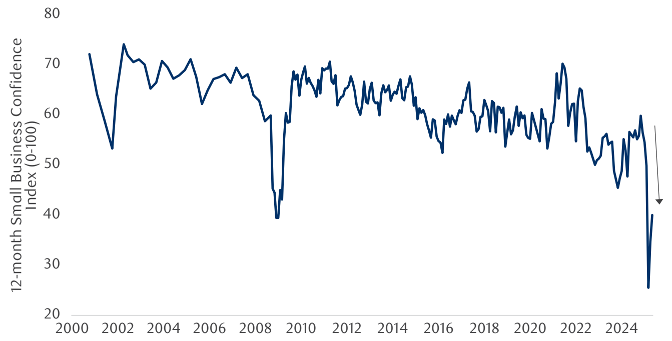
Of course, there are still considerable tariff risks that remain for Canada, including the possibility of U.S. pressure tactics as the USMCA trade deal is renegotiated, and the White House has no shortage of complaints against Canada, including insufficient border security, insufficient military spending, Canada's trade surplus in goods, the country's digital-services tax and policies that protect dairy producers and agricultural suppliers.

Curiously, the Canadian economy has so far shown more damage from tariffs than most countries, despite the lighter tariff touch. This would appear to reflect the nearly existential importance of the U.S. market to the Canadian economy: high uncertainty over the trading relationship and even the mere threat of large tariffs has been sufficient to interrupt economic activity. Sentiment indicators such as Canadian small-business confidence suggest continued nervousness, even after unwinding some of their initial panic (Exhibit 20). Hiring has slowed to a crawl (Exhibit 21). Canadians are also reacting to U.S. antagonism in other ways, with travel to the U.S. down sharply (Exhibit 22).

Our base-case forecast anticipates the introduction of additional sector-oriented tariffs that may include levies on copper, pharmaceuticals and forestry products. At the conclusion of the tariff barrage, we believe the average Canadian tariff rate of 6% may rise somewhat further, to as much as 10%. This would significantly diminish Canadian economic growth and potentially even include a few quarters of small economic decline. It is an open question whether any such drop would be sufficiently deep or sustained to qualify as a true recession. We presently lean toward "no."

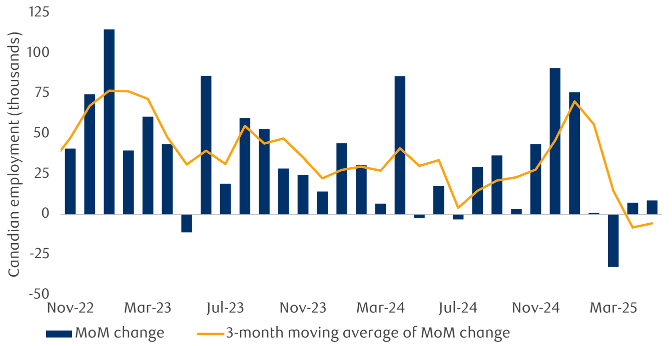
Once the tariff impact has been absorbed, Canada's focus can shift to other matters. The Bank of Canada's overnight rate has fallen substantially over the past year, and there

Exhibit 20: Canadian small-business confidence on future conditions plunged



Note: As of May 2025. Source: CFIB Business Barometer, Macrobond, RBC GAM

Exhibit 21: Canadian employment shows recent damage



Note: As of May 2025. Source: Statistics Canada, Macrobond, RBC GAM

Exhibit 22: Visitors to the U.S. from Canada dropped after Trump returned to White House

Note: As of Apr 2025. Passengers entering the U.S. from Canada at land border crossing stations include bus, train and personal vehicle passengers. Source: Bureau of Transportation Statistics, RBC GAM is space for further easing. This is an economic tailwind. Conversely, immigration has slowed sharply – a negative for workforce growth, though one that is tempered by the unwinding of earlier immigration distortions.

But the biggest medium-term growth consideration for Canada is the new direction for fiscal policy under Prime Minister Mark Carney. It is economy-focused and broadly growth-positive, with commitments to increase infrastructure spending, streamline resource-project approvals, modestly cut taxes and increase residential construction. The deficit will rise as a result of these efforts, though Canada's fiscal position is robust enough to withstand modest increases in debt.

Bottom line

Tariffs are set to exert a substantial drag on economic growth over the second half of 2025, but probably not to the extent of causing a global recession. Inflation has so far been tame, but should become more visible in the U.S., if less so elsewhere.

Other policy decisions matter, too, with U.S. tax cuts set to be growth-positive, but other choices such as reducing immigration and withholding resources from researchers may have a negative effect.

Uncertainty remains considerable but is not quite as high as it was several months ago.

U.S. exceptionalism is in retreat, with adverse implications for the dollar, term premiums and beyond. China and the EU have an opportunity to fill some of the void left by the U.S.

Finally, given a less favourable view on the U.S., our recommended equity asset allocation has shifted somewhat away from the U.S. and toward other markets.

Disclosure

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