NATIONAL BANK OF CANADA FINANCIAL MARKETS

April 2025

Forecast Summary

By Taylor Schleich, Warren Lovely & Ethan Currie

- Remarkable days these, with the economic outlook, financial market conditions, broad investor confidence and forecaster conviction having been whipsawed by the U.S. Administration's truly extraordinary trade policy announcements and walk-backs. How are we left, as at April 10th?
- Vitally, the just-announced 90-day tariff reprieve for many (but not all) of America's trading partners has reduced the odds of an abrupt and widespread global recession that had appeared worryingly close at hand mere days ago. Similarly, the associated seeds of panic that had sprouted in various corners of global financial markets have been partly tamped down, bond markets returning to a higher (if not quite optimal) level of functioning in the immediate wake of the U.S. tariff reversal.
- Still, the global economy has not been left in a better place. The resting or effective U.S. tariff rate is still likely to constitute a headwind. Some of America's mutually beneficial economic relationships have surely been strained if not severed, predictability supplanted by uncertainty. That same uncertainty has led to partial paralysis in sensitive sectors and regions. In sum, global growth prospects must be marked lower, our fresh forecast for U.S. jobs and growth having dimmed appreciably. Canada's economic backdrop likewise remains challenged, even if (as we had all-along anticipated) the effective tariff rate on Canadian exports to the U.S. is likely to settle in a less punitive zone relative to some of America's other trading partners. As an aside: Greater USMCA compliance is a prime avenue for lessening the overall tariff hit in Canada (and Mexico), which seemingly places even greater importance on the upcoming review of that continental trade agreement.
- In the advanced world, some major central banks believe themselves ill-equipped to fully respond to the damage wrought by a serious/sustained trade fight. This is, to some extent, understandable. Critically, there's considerable uncertainty surrounding tariff-related inflation impacts, including how temporary or transitory they may prove. Both the FOMC and the Bank of Canada claim an inability to be forward looking while simultaneously emphasizing the need to keep longer-term inflation expectations well anchored. But that does not mean monetary easing cycles have concluded, the policy rate path still lower for both the Fed and the BoC even if the pacing is likely to be somewhat deliberate (under our baseline forecast).
- For the FOMC, competing risks to both sides of the mandate suggest no immediate rush to change policy. But with fed funds still hovering in restrictive territory, the emergence of weaker growth and more pronounced joblessness should translate into 75 basis points of easing in the second half of 2025 (i.e., fed funds upper ending the year at 3.75%). U.S. Treasury yields may be mechanically pulled lower as the Fed delivers these cuts, but increasingly loose U.S. fiscal policy and an alarmingly steep debt curve should limit relief out the curve. Investors are apt to demand a greater term premium to fund this unsustainable fiscal path and to protect against inflation uncertainty. As recent events have emphasized, overseas bond investor attitudes bear close scrutiny.
- In our view, the Bank of Canada's near-term policy rate decision (on April 16th) is somewhat murky. While far-from-constructive on Canada's growth prospects, we believe a wait-and-see approach could win the day at the coming decision, particularly after U.S. tariff aggression was dialed back and financial markets stabilized. Whether or not the Bank cuts next week, we ultimately see scope for 75 bps of further easing in 2025. Assuming 'soft data' anxiety is converted into 'hard data' weakness, the next step lower on the BoC overnight target could come as soon as June 4th. Unchanged from our March forecast, we see the Bank of Canada's policy rate reaching a terminal rate of 2% this year. GoC bond yields are pointed lower in the shorter end of the curve, but downside potential for longer-term yields appears more limited. Beyond broader/global repercussions for longer-term rates, Canadian bond supply is set to mount, partly a function of incremental stimulus and supports for a fragile economy. And Canada has its own exposure to non-resident investors to think about too, foreign investors controlling an unprecedented share of the nation's debt.

United States						
Quarter	Target	3M	2Y	5Y	10Y	30Y
10-Apr-25	**4.50**	**4.21**	**3.85**	**4.02**	**4.36**	**4.79**
Q2:2025	4.25	3.90	3.60	3.80	4.25	4.70
Q3:2025	4.00	3.65	3.45	3.70	4.15	4.60
Q4:2025	3.75	3.55	3.35	3.55	4.10	4.55
Q1:2026	3.50	3.30	3.25	3.50	4.05	4.50
Q2:2026	3.25	3.05	3.20	3.40	3.95	4.45
Q3:2026	3.00	2.85	3.25	3.35	3.85	4.30
Q4:2026	3.00	2.85	3.40	3.40	3.85	4.30
Q1:2027	3.00	2.90	3.45	3.45	3.90	4.35

Canada						
Quarter	Target	3M	2Y	5Y	10Y	30Y
10-Apr-25	**2.75**	**2.62**	**2.61**	**2.80**	**3.19**	**3.50**
Q2:2025	2.50	2.45	2.40	2.60	3.05	3.35
Q3:2025	2.25	2.15	2.30	2.50	2.95	3.25
Q4:2025	2.00	1.95	2.25	2.45	2.90	3.20
Q1:2026	2.00	1.95	2.20	2.40	2.80	3.15
Q2:2026	2.00	2.00	2.25	2.50	2.85	3.20
Q3:2026	2.00	2.05	2.30	2.55	2.95	3.30
Q4:2026	2.00	2.05	2.30	2.65	3.05	3.30
Q1:2027	2.00	2.35	2.40	2.70	3.10	3.40

FOMC: Do you feel Liberated yet?

Where to begin? It's been a chaotic start to the Trump presidency, but the apex of tumult was reached in the aftermath of Liberation Day. The April 2nd unveiling of 'fair and reciprocal' tariffs had been known for weeks, and the administration had repeatedly assured that it would be, to borrow the president's words, a "big one". Still, markets did not anticipate the size and scope of announced trade levies, which were determined on the basis of some suspect methodology.

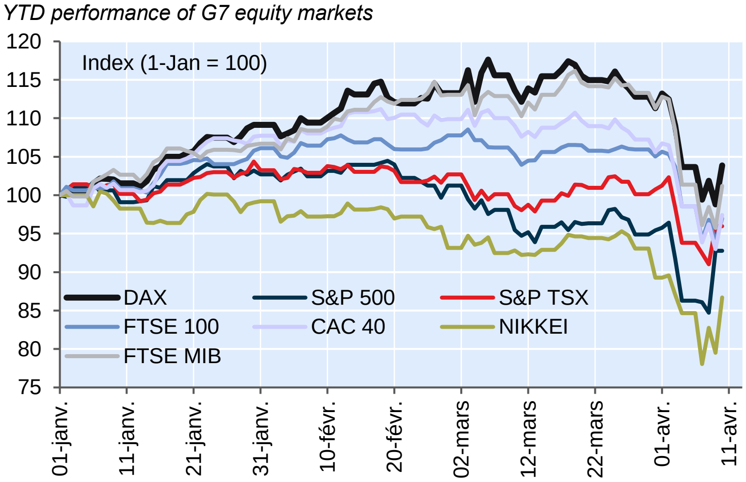
Suspect methodology used to determine 'reciprocal' tariffs
Sample of countries hit by reciprocal tariffs & calculation breakdown

Country	U.S. trade deficit		U.S. imports		Tariff rate 'charged' to the U.S.		Reciprocal tariff rate
Cambodia	12.3	÷	12.7	=	97%	÷2=	**49%**
Vietnam	123.5	÷	136.6	=	90%	÷2=	**45%**
Thailand	45.6	÷	63.3	=	72%	÷2=	**36%**
China	295.4	÷	438.9	=	67%	÷2=	**34%**
Taiwan	73.9	÷	116.3	=	64%	÷2=	**32%**
Indonesia	17.8	÷	28.1	=	64%	÷2=	**32%**
Switzerland	38.4	÷	63.4	=	61%	÷2=	**31%**
India	45.7	÷	87.4	=	52%	÷2=	**26%**
South Korea	66.0	÷	131.5	=	50%	÷2=	**25%**
Japan	68.5	÷	148.2	=	46%	÷2=	**23%**
EU	231.8	÷	597.7	=	39%	÷2=	**20%**
Israel	7.4	÷	22.2	=	33%	÷2=	**17%**

Source: NBC, U.S. government

Before this new era for U.S. trade policy had time to materially impact the economy, wealth destruction was in full effect. The bellwether S&P 500 shed over 12% between Liberation Day and the day in which levies went into effect. This sell-off apparently triggered the so-called "Trump put". Not even 24 hours after the reciprocal tariffs started applying, the President posted that a 90-day pause on reciprocal tariffs would be granted to non-retaliating countries. Those who did "in some shape or form" retaliate were not so fortunate, levies remaining in full force Moreover, he announced that China's already substantial tariff rate of 104% would rise to 125%. The subsequent bounceback was significant, unwinding more than half of the earlier losses. Nonetheless, the extreme volatility is not without consequence and still bruised equity portfolios are likely to have implications for consumption and investment. That's to say nothing of tariff implications themselves.

Global equity market carnage led by S&P 500
YTD performance of G7 equity markets

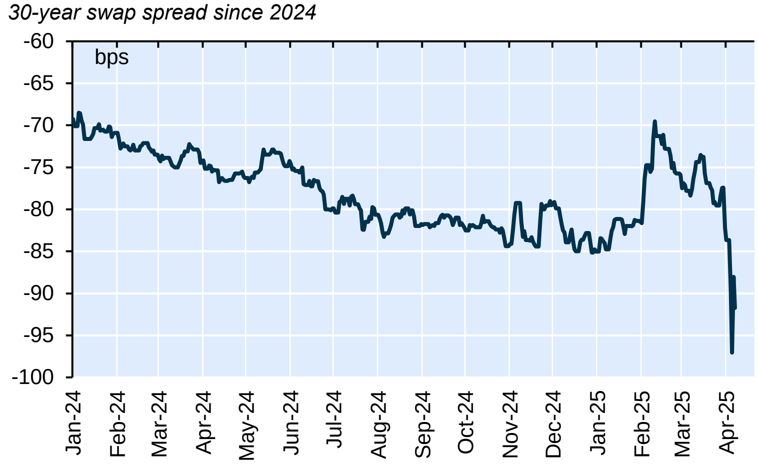


Source: NBC, BBG

Meanwhile, Treasury yields plummeted in the immediate aftermath of the announcement as Fed rate cut expectations mounted. That knee-jerk reaction did not last long though as longer-term yields surged above their pre-Liberation day watermark by the following week.

And while the announcement of a 90-day pause boosted equities, the near-jerk impact was comparatively small on interest rates. The market remains volatile but, as of this writing, the 10-year yield sits at 4.31% (vs. 4.20% on 1-Apr, and a 3.85% intraday low on 4-Apr). Meanwhile, the 30-year yield had made a push back to 5%, although that's moderated to 4.77% as of this writing. The resulting impact on swap spreads has been striking. The earlier widening on the back of regulatory reform optimism was unwound and then some. Intraday, the 30-year spread gapped to -100 bps before the tariff pause.

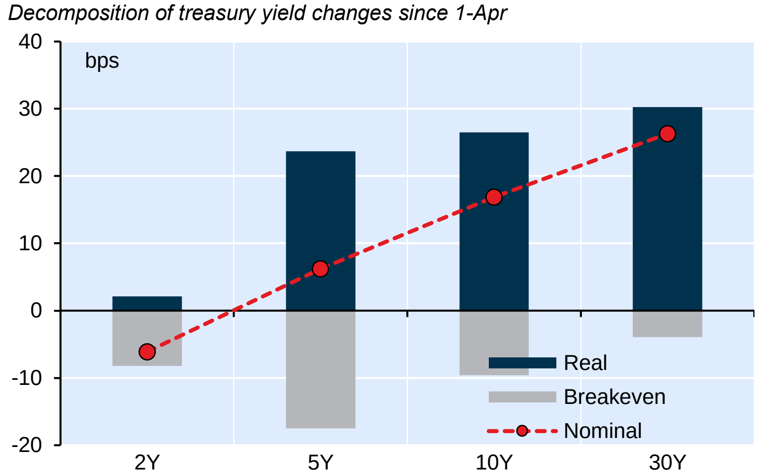
Swap spreads reflecting growing anxiety
30-year swap spread since 2024



Source: NBC, BBG

While volatile, the dynamics of treasury market price action have been informative. When yields initially fell sharply post-Liberation day, it was almost entirely on the back of breakevens (i.e., implied inflation). And when rates sprang higher it was more a function of real yields. On net, implied inflation is lower today than before the reciprocal tariffs were announced. That's a sign that markets expect tariff-related price pressures, beyond the short-run, to be transitory.

Bond market says tariff inflation will pass quickly
Decomposition of treasury yield changes since 1-Apr



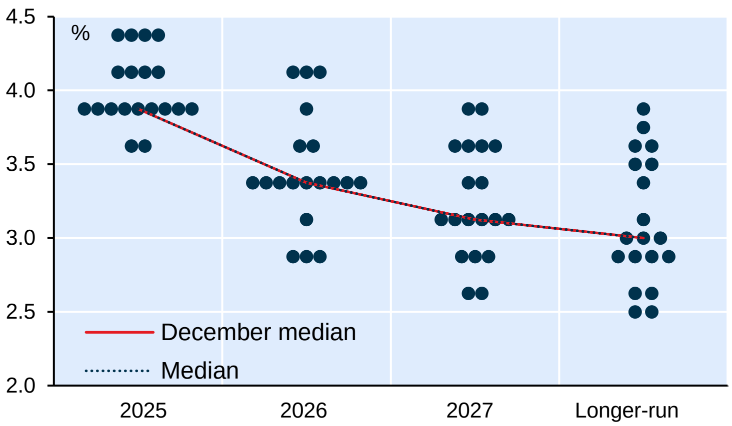
Source: NBC, BBG

That would seem to align with the base case of Fed Chair Jerome Powell. Last month, he advanced the idea that tariff inflation could be "transitory", a surprising choice of word given the central bank's history with it. A post-Liberation Day speech reiterated this sentiment (this time replacing “transitory” with “temporary”). However, that doesn’t mean that price pressures will be “looked through” and that rate cuts are imminent. Powell also stressed it’s “possible” that the effects could be more persistent. Other Fed officials have put more emphasis on this risk. The punchline is that the Fed doesn’t know how the coming months are going to play out, on trade policy itself or the exact economic implications of a sustained trade war. All they can say is that there are competing risks to both sides of the mandate so, for now, there’s no rush to change policy.

This is effectively the message that was communicated way back at the March Fed meeting. There, the FOMC marked *down* growth projections at the same time as the inflation outlook was marked *up*. The net impact on the median fed funds projection? None. In his latest address, Powell acknowledged that larger-than-expected tariff increases will likely have larger-than-expected growth and inflation impact. Here again, the appropriate policy response to this kind of development is ambiguous. Inertia then calls for maintaining a status quo stance.

‘Inertia’ keeps the dots unchanged, despite growing risks

FOMC March 2025 dot plot with December median projection

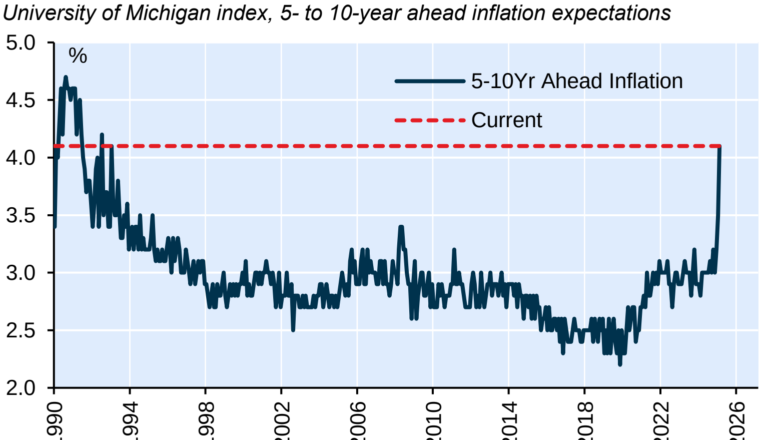


Source: NBC, Fed

For now, the economic data the Fed does have on hand doesn’t imply an immediate need for lower rates. Notwithstanding a cooler-than-expected CPI print for March, inflation remains above target with some preliminary signs suggesting that tariffs / uncertainty may leak into goods prices. Meanwhile, survey-based measures of inflation expectations are on the rise, most acute in the short run. Longer run expectations are a bit more mixed as some surveys show little-to-no uptick (NY Fed), while others have shown a material step-up (UMich).

UMich flagging signs of unanchored expectations?

University of Michigan index, 5- to 10-year ahead inflation expectations



Source: NBC, BBG

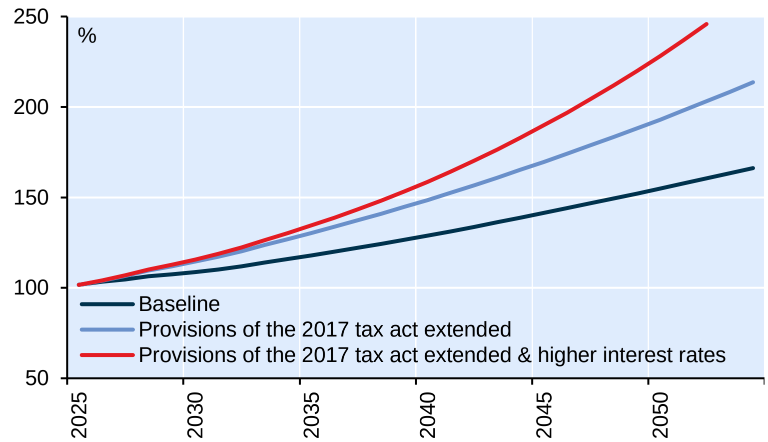
We’d note that growth could slow sharply in the first quarter if the Atlanta Fed’s GDP Now model is any guide (in fact, it could be negative). However, this model estimate is largely a function of a Q1 import surge that mechanically pulls down GDP growth. Underlying domestic demand, while slowing, is going to show continued growth. Similarly, the labour market remains in good shape (or at least it was in March 2025). Hiring surprised to the upside and, while the jobless rate did tick up, this was attributable to a larger increase in the labor force.

Of course, if the White House’s 90-day pause doesn’t become permanent, an already shaky growth outlook will turn into an almost assured recession. At this point, we’re still somewhat hopeful that de-escalation will continue. To be sure, tariffs in some capacity are almost assured to remain in effect. This will still inflict material damage to the growth outlook and would also have inflation implications. However, it might be moderate enough to keep the U.S. economy from *completely* rolling over. In this environment, slower growth and higher inflation environment, we remain comfortable with our earlier Fed rate outlook, involving 75 basis points of easing this year.

When it comes to the treasury market, yields may edge lower as the Fed eases. However, we expect only muted declines out the curve as increasingly loose fiscal policy keeps the U.S. debt curve pointed higher. While the U.S. administration has claimed tariff revenues (and government efficiencies) can fund the renewal of Trump’s 2017 tax cut, we’re not convinced. Investors will increasingly demand more compensation (i.e., term premium) to fund an unstainable fiscal path.

A tax cut extension would likely increase UST supply

CBO extended baseline + alternative projection for debt as a share of GDP



Source: NBC, CBO | Note: Baseline is from March 2024 projections

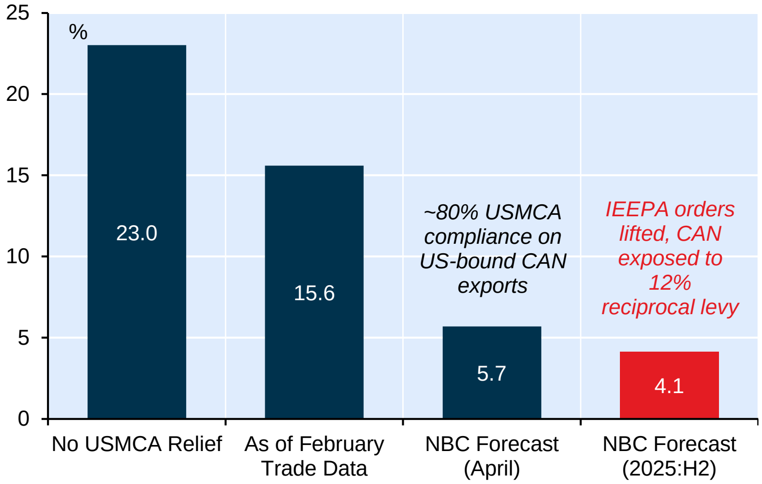
BoC: Modest relief for fragile economy

Canada may have avoided new tariffs on the much anticipated ‘Liberation Day’, but that doesn’t mean the outlook became any brighter on April 2nd. Tariffs had *already* been peppered on the U.S.’s northern neighbour. That began in early March (after a 1-month delay) when 25% blanket tariffs were implemented, with some exemptions for sectors like energy (subject to 10%). Steel and aluminum levies came next, before autos were hit not long after. Indeed, it’s been a dizzying blitz of executive orders which, before carveouts, would be consistent with a 23% effective tariff on U.S.-bound Canadian exports.

In practice, the charge on Canadian goods is lower and subject to further change. Fentanyl/border security tariffs came with exemptions for “USCMA-compliant” goods, which as of February covered about a third of merchandise trade. That quickly drops the effective rate to 15%. For most products, USMCA compliance is a matter of filing simple paperwork which likely produced a rush to registration in March. We assume that roughly 90% of trade can be certified compliant, bringing effective duties down to a more manageable 6%. If the IEEPA-related levies (i.e., those relating to fentanyl/border security) are ultimately lifted, we estimate the effective tariff rate could settle below 5%. While that sounds a lot better than 25%, it's still well above the effective sub-1% levy in effect before Trump's tariff tirade.

USMCA to be primary tariff relief driver as it stands

Effective tariff rate on Canada under varying compliance / tariff scenarios

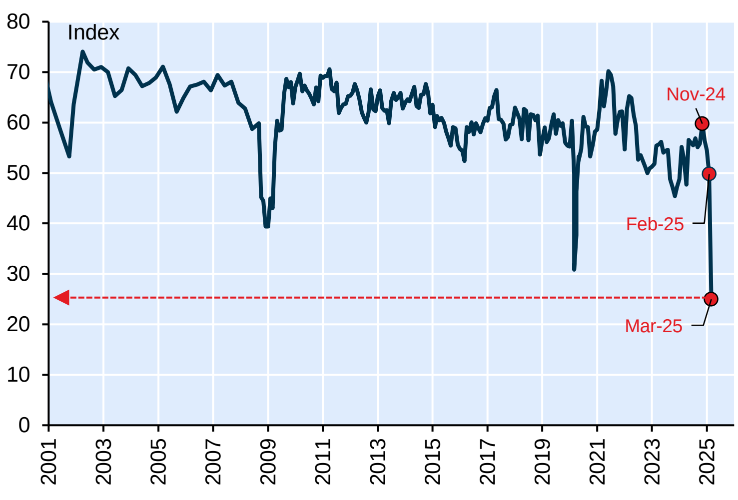


Source: NBC, US Census Bureau | Note: Using Feb trade weights, current tariff policies

The exact steady state trade environment will reveal itself in time (we hope sooner rather than later) but it's more so the uncertainty that's in the driver's seat right now. There's been a steady deterioration in small business confidence so far in 2025, the March drop in the CFIB's business barometer representing a record fall and bringing the series to an all-time (~25-year) low.

CFIB Business Barometer hits an all-time low

CFIB Business Barometer Index

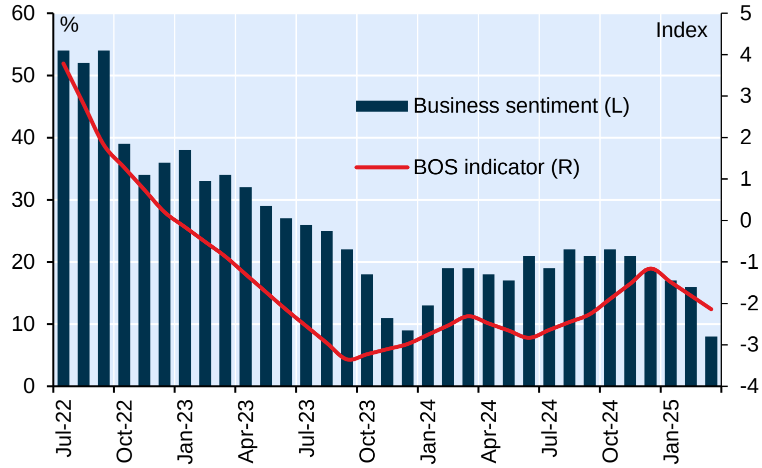


Source: NBC, CFIB | Notes: Reflects outlook over next 12 months

The Bank of Canada's latest Business Outlook Survey likewise paints a downbeat picture. The BOS indicator contracted in Q1 after steadily improving from the most pessimistic levels registered in mid-2023. That's driven by slower expected sales growth, weaker investment intentions and significantly scaled back hiring plans. While these developments are not surprising, this report may even be *understating* anxieties as the survey was conducted from February 6th to 26th, prior to the bulk of trade levies going into effect.

Business sentiment takes another hit on uncertainty

Business Outlook Survey indicator and assessed current business conditions

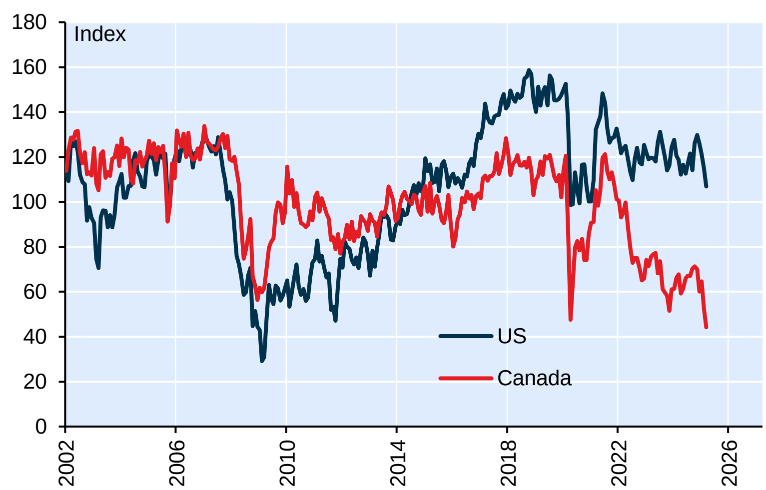


Source: NBC, BoC | Note: BOS indicator is quarterly, interpolated to generate monthly readings

Consumers aren't any more optimistic. The Conference Board's consumer confidence index also fell to a record low in March. U.S. consumers were also under pressure but not nearly to the same extent. This was echoed in the Bank of Canada's Canadian Survey of Consumer Expectations. Canadians are quickly growing more concerned about their job security and as a result, are planning to reduce discretionary spending and defer major purchases. Look to the housing market for a more tangible impact of Canadians' collective anxiety, as activity here has come to a grinding halt.

Canadian consumers have never felt worse

Conference board index of consumer confidence, Canada vs US

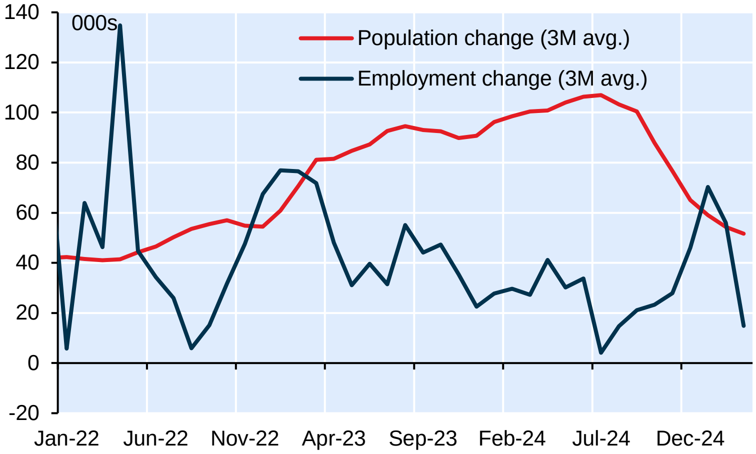


Source: NBC, Conference Board

Up to this point, weakness has been most concentrated in "soft data". However, that's beginning to change. Backward-looking GDP data (for Q1 and January) don't look problematic but the timelier Labour Force Survey is starting to show signs of cracking. The impressive pick-up in hiring on display in late 2024 and early 2025 stalled out in February and started to reverse in March, employment dropping the most since January 2022. After beginning to consolidate, the unemployment rate resumed its ascent. That's a trend we expect to continue in the months ahead.

Labour market foreshadowing weakness in 'hard data'?

Population and employment change according to LFS, 3MMA



Source: NBC, StatCan

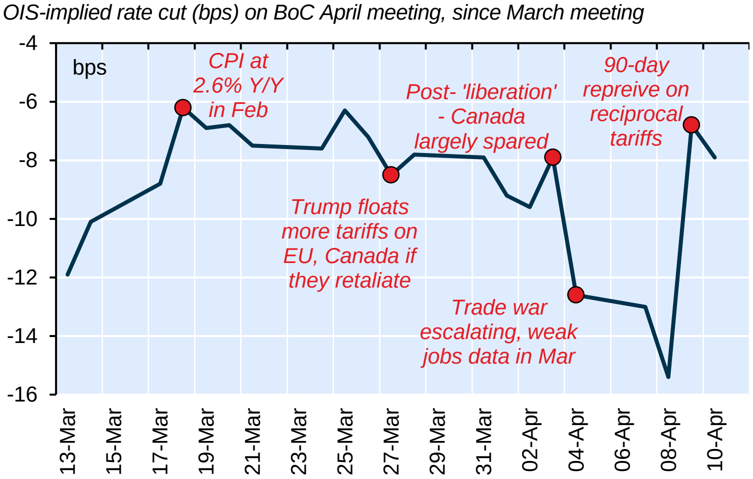
In almost all circumstances, this crisis in confidence (and now, red flags in the labour market) would be consistent with the Bank of Canada easing monetary policy. The central bank would readily admit they are forward-looking after all. These times are far from normal though and thus, as the Governor outlined in a speech last month, policymaking is also far from normal:

> *"When we have this high degree of uncertainty around the base case, we give more consideration to the risks. Our focus is less about the best monetary policy for a specific economic outlook and more about policy that works for different outcomes… [We] need to set policy that minimizes the risk. That means being less forward-looking than normal until the situation is clearer. And it may mean acting quickly when things crystallize."*

It's no surprise to see elevated uncertainty and sweeping tariffs destroy confidence and slow hiring. Slower GDP growth is all but assured too. What we don't know with much certainty is what the inflation impact will be. That is what may limit the extent of monetary policy relief, especially in the immediate term (i.e., the April 16th decision).

Markets aren't convinced BoC will cut in April

OIS-implied rate cut (bps) on BoC April meeting, since March meeting

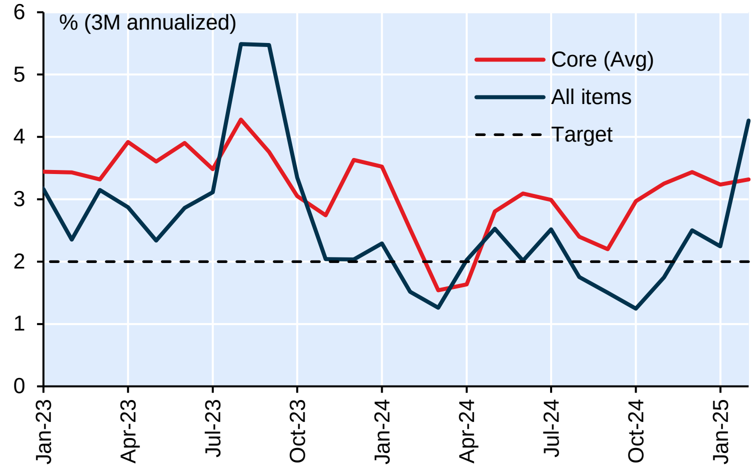


Source: NBC, BBG

While still firmly in the 1-3% control band, all-items CPI inflation has picked up in recent months, consistent with what had been a firming economy. Core measures are throwing off even hotter readings.

Headline, core CPI in control but too high for comfort

All-items and core CPI (3M SAAR), last three years

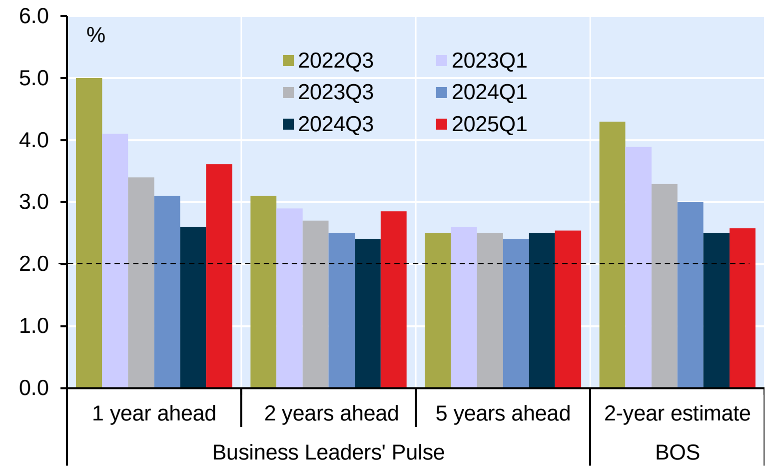


Source: NBC, BBG | Note: Core measure is average of CPI-trim and CPI-median

With that as the underlying inflation backdrop, we can layer on potential pass-through from Canada's retaliatory tariffs and perhaps indirect impacts from rising inflation expectations. Doing so, it's not difficult to see why the BoC isn't in a rush to cut rates.

Inflation expectations picking up

Inflation expectations over varying horizons, from BLP and BOS



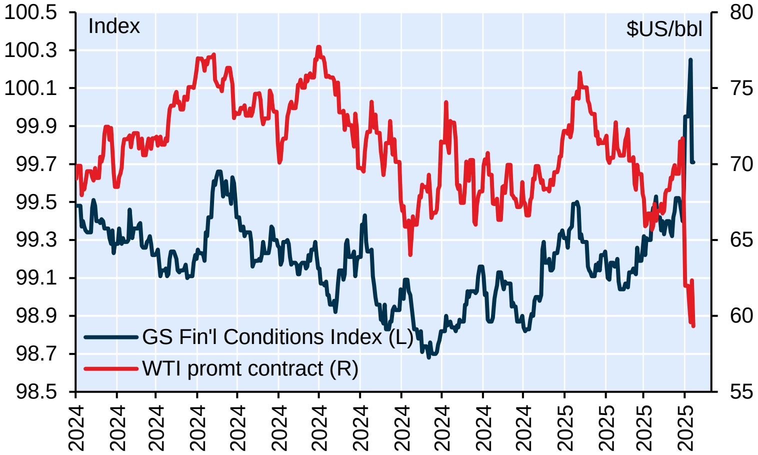
Source: NBC, BoC

We tend to agree that a wait-and-see approach will win the day at the coming decision, particularly after U.S. tariff aggression was dialed back and markets stabilized. But whether or not the Bank cuts in April, we think there's plenty of room for further easing in 2025. Assuming incoming economic data softens as we expect, the next step lower on the overnight target could come as soon as June 4th. And as it's shown/accepted that the negative growth impacts of this trade war are greater than the resulting upward inflation pressure, further cuts will be delivered. Unchanged from our March forecast, we see the Bank of Canada's policy rate reaching a terminal rate of 2% this year.

There are, however, obvious risks to both sides of this call. On one hand, greater-than-expected inflation pressures may limit the rate relief even if growth slows. On the other hand, the hit to global demand and commodity prices may prove more significant, especially if this 90-day reciprocal tariff pause is only temporary. That could lead to even deeper rate cuts. The situation remains fluid. Pronounced financial market stress can also led to central bank intervention to central bank, so financial conditions will warrant close monitoring.

Financial conditions reflect tariff mania

Conference board index of consumer confidence, Canada vs US

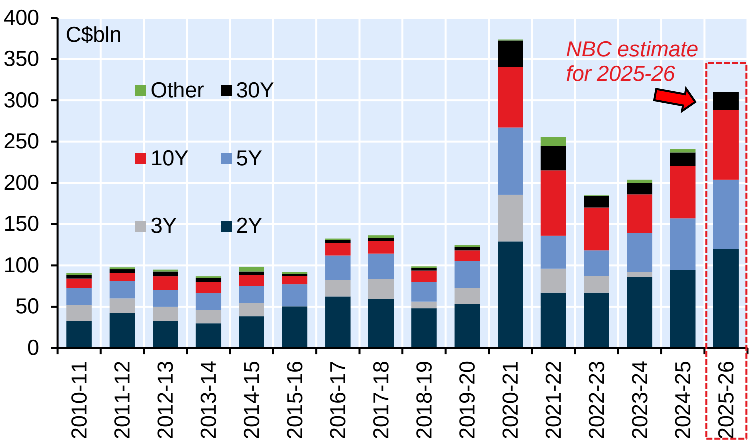


Source: NBC, BBG | Note: A higher reading on the GS index indicates tighter conditions

Given our view that the growth shock will dictate the policy path, the path for Government of Canada bond yields are pointed lower. However, longer-end rate declines will be more muted than in the shorter-end of the curve. That's in part to do with mounting bond supply as governments (at the federal and provincial level) accumulate red ink. With no shortage of campaign promises and potential balance sheet reactions to tariffs, supply risks are tilted higher.

Gross supply in 2025-26 most since peak-COVID

Conference board index of consumer confidence, Canada vs US

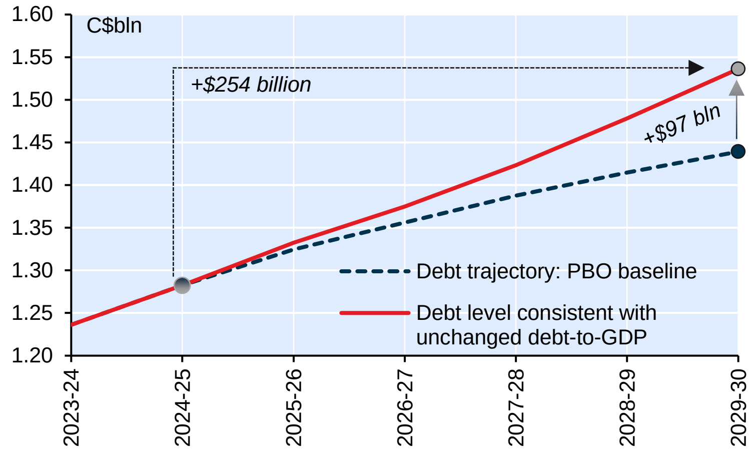


Source: NBC, BoC, GoC | Note: 'Other' refers to sum of green, RRB, ultra-long issuance

Last month, Germany's fiscal policy reset (see our detailed In Focus) was one of the biggest (non-trade) developments of the year. Over €1 trillion in new spending over the next decade is a serious jolt in the arm for the historically frugal nation, and one in need of a positive growth shock. While we don't expect Ottawa and the provinces to institute collective spending package of this magnitude, there will be no shortage of spending/investment demands on this side of the Atlantic. So the size and scope of Canadian fiscal policy over the next decade may be smaller but the direction of travel will be the same. Call it, Germany-lite.

Carney's 'fiscal rule' allows for some marginal debt

Baseline path for federal debt vs. path involving stable debt-to-GDP ratio



Source: NBC, PBO

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