



Forecast Summary

By Taylor Schleich, Warren Lovely & Ethan Currie

- It was a frenetic start to the year on tariff action, but the past month has been comparatively tranquil after the 90-day de-escalation with China was announced in early May. Still, this “steady state” is far from optimal as the U.S. effective tariff rate remains at multi-decade highs and uncertainty lingers. Volatility could rear its head again soon. The end of the 90-day tariff reprieve on reciprocal tariffs draws near (July 9th) and Trump has promised trading partners will be assigned unilateral tariff rates in coming weeks. Déjà vu, anyone?
- Thus far, tariff impacts on U.S. economic data haven’t been as large as anticipated. Of course, trade flows have swung wildly but hiring has barely budged from the pre-tariff run rate and inflation has been surprisingly tame. That’s led to some modest yield declines and Fed rate cuts being pulled forward. However, we don’t interpret a muted initial impact as a sign that the U.S. economy is resistant to tariffs. Indeed, beneath the surface there are signs of rising costs which will either result in higher inflation or reduced profitability (which would have implications for investment, hiring, growth, etc.). The problem is it’s still too early to tell just how things will play out, something Fed speakers have readily admitted. While we concede that recent inflation data has made the path to a September cut clearer, we still expect policymakers to take a more patient approach and wait until Q4.
- Canada took the brunt of Trump’s tariff ire early in the year but subsequent carve outs for USMCA compliance has limited the damage to some extent. There may be scope for some further tariff relief as Canadian and American negotiators, ahead of the G7 summit, are reportedly making progress towards an agreement. Any de-escalation is welcomed de-escalation, but earlier trade ‘deals’ (i.e., between the U.S. and the U.K.) were limited in scope and still left many levies in effect. That leaves us pessimistic that a near-term agreement will return us to a ‘normal’ trade relationship.
- The Bank of Canada remained on hold in June, despite languishing labour and housing markets and a tepid growth outlook. That’s due to an unexpected pick up in core inflation and a lack of clarity on some of the items the BoC is monitoring (export demand, inflation expectations). Important updates to these variables will become available ahead of July 30th, which opens the door to a resumption of the easing cycle. Governor Macklem readily admitted as much while conditioning further rate relief on inflation progress. It means that data dependence will remain the name of the game, but our base case outlook remains consistent with further easing (75 basis points of cuts in H2:2025). Admittedly, markets have moved in the opposite direction which leaves Canadian bonds increasingly attractive.
- For Canada, the U.S. and most advanced economies, fiscal policy will be a key driver of economic performance and is increasingly relevant for the bond market. The ‘One, Big, Beautiful Bill Act’, which passed through the House in May, is poised to add more than \$2 trillion to the U.S. national deficit over the coming decade. While tariff revenues may help fund some of that, borrowing will be pointed higher (and of course, the more trade ‘deals’ that are struck, the lower the potential revenue becomes). That’s likely to keep a high floor on long-term treasury bonds. Even as the Fed is able to get back to neutral in 2026, we expect just token declines in 10- and 30-year yields. While Canadian fiscal policy is in a much more sustainable place, the federal deficit is set to grow this year and bond supply is ramping up as a result. We don’t expect long Canadas to breach 3% despite a policy rate that will settle 100 basis points lower. Gone are the days when bond investors paid little attention to government spending.

United States						
Quarter	Target	3M	2Y	5Y	10Y	30Y
13-Jun-25	4.50	4.26	3.96	4.02	4.41	4.90
Q2:2025	4.50	4.35	3.90	3.95	4.40	4.85
Q3:2025	4.50	4.10	3.80	3.85	4.35	4.85
Q4:2025	4.00	3.60	3.60	3.75	4.25	4.75
Q1:2026	3.50	3.25	3.45	3.65	4.20	4.70
Q2:2026	3.25	3.15	3.40	3.60	4.10	4.60
Q3:2026	3.25	3.10	3.30	3.55	4.05	4.60
Q4:2026	3.25	3.10	3.40	3.60	4.10	4.65
Q1:2027	3.25	3.10	3.45	3.65	4.15	4.70

Canada						
Quarter	Target	3M	2Y	5Y	10Y	30Y
13-Jun-25	2.75	2.68	2.71	2.97	3.37	3.66
Q2:2025	2.75	2.55	2.60	2.85	3.30	3.55
Q3:2025	2.50	2.35	2.45	2.75	3.15	3.45
Q4:2025	2.00	2.00	2.15	2.50	3.10	3.40
Q1:2026	2.00	1.95	2.15	2.55	3.10	3.30
Q2:2026	2.00	1.95	2.30	2.70	3.10	3.40
Q3:2026	2.00	2.10	2.45	2.75	3.15	3.40
Q4:2026	2.25	2.35	2.55	2.85	3.25	3.45
Q1:2027	2.50	2.60	2.60	2.85	3.25	3.50

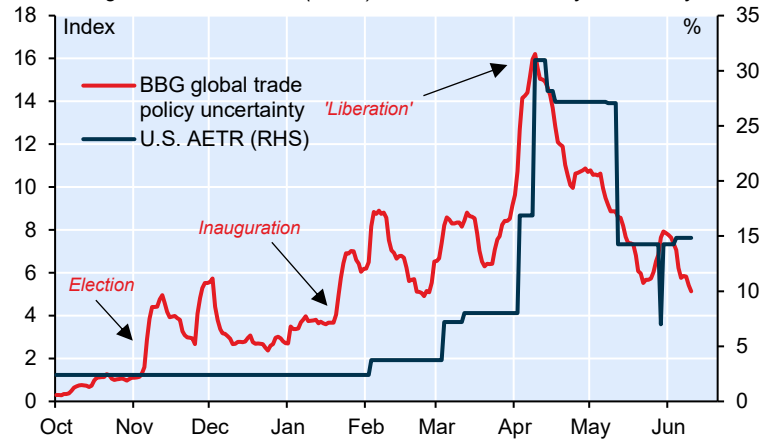


FOMC: Mr. Too Late Right on Time

It was a frenetic start to the year on tariff action, but the past month has been comparatively tranquil after the 90-day de-escalation with China was announced in early May. Briefly, tariffs issued under the IEEPA banner (fentanyl and border security related and “reciprocal” tariffs) were deemed unlawful, but the White House had that ruling overturned on appeal. There also increased steel tariffs (from 25% to 50%) implemented in early June, but it’s been “calm” other than that. To be sure, this “steady state” is far from optimal as the U.S. effective tariff rate remains at multi-decade highs. Similarly, uncertainty has not been resolved as the end of the 90-day reprieve on global reciprocal levies draws near (July 9th). Recently, Trump promised that unilateral tariff rates will be sent to trading partners in coming weeks. Déjà vu, anyone?

Tariffs – threatened and imposed – have driven anxiety

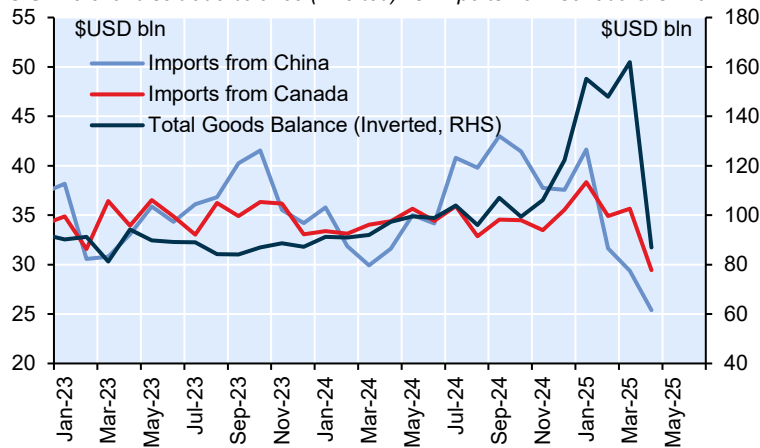
U.S. average effective tariff rate (AETR) and BBG Trade Policy Uncertainty Index



If you’re looking for evidence of earlier trade carnage impacting the real economy, you may be left disappointed. Certainly, trade flows have been disrupted as U.S. companies front-loaded purchases ahead of Liberation Day. Subsequently, April data revealed a sharp reversal in the Q1 import surge, which has had and will have implications for GDP growth. The flat print in Q1 will give way to a very strong Q2.

April trade data - front-loading rebound, or regime shift?

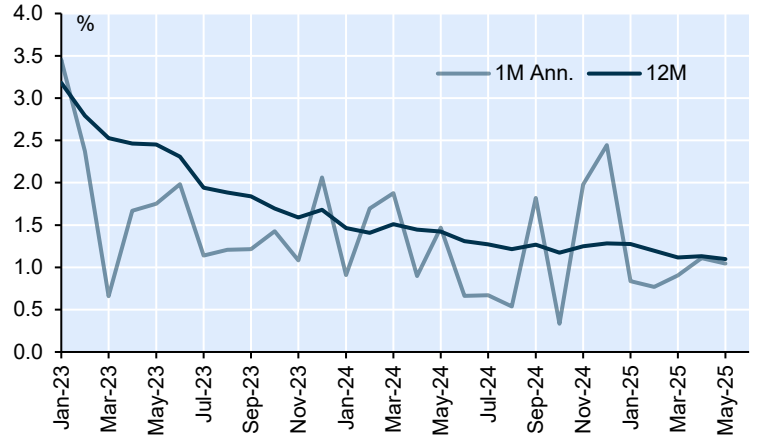
U.S. merchandise trade balance (inverted) vs. imports from Canada & China



However, the labour market hasn’t been materially affected. Job growth has continued at a *decent* pace and the unemployment rate remains low. Sure, hiring has slowed from past years, but this trend was already in the works.

Low-churn labour market, with NFP growth steady

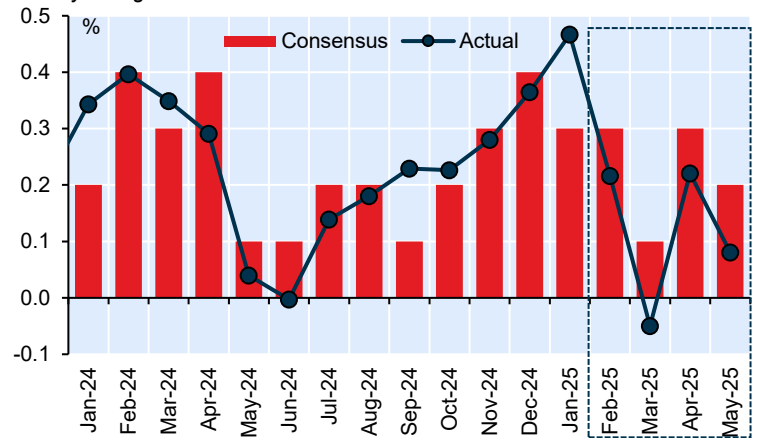
Change in U.S. nonfarm payrolls, Y/Y vs. 1M annualized rate



Similarly, a cursory glance at recent inflation data doesn’t reflect the massive shift in the U.S. effective tariff rate. Headline inflation has actually surprised to the downside in each month of the Trump administration.

White House looks upon inflation data with glee, so far

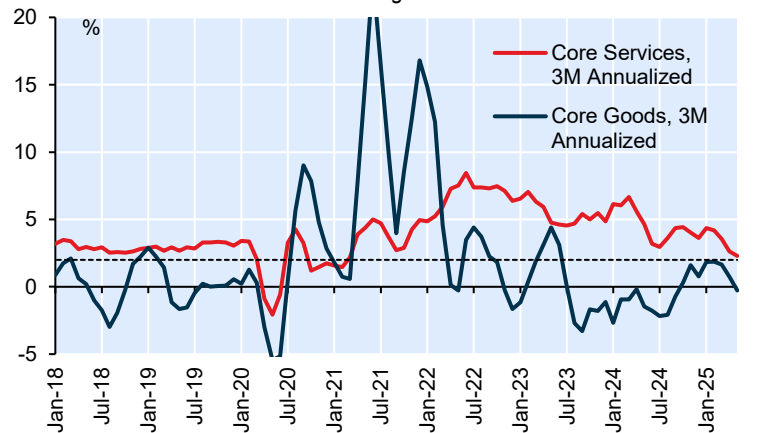
Monthly change in the U.S. CPI vs. consensus forecast



Counterintuitively, goods prices have been little changed while cooling prices for services has allowed overall inflation to steadily fall this year, now only barely above the Fed’s 2% price stability target.

Cooling in services, and no tariff pass-through in goods

3-month annualized core services & core goods inflation

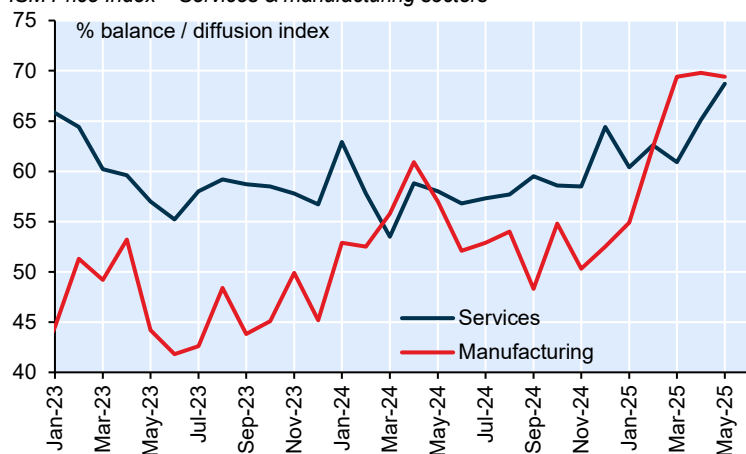




While the data most important to the Fed aren't being disrupted, that's not to say tariffs aren't having an effect. Cost pressures are clearly evident in PMI data, with the prices paid sub-index in the ISM services and manufacturing spiking sharply. That's consistent with anecdotal data from U.S. business who have flagged material price increases, including an "[un]cooperative" vehicle market, where manufacturers are rolling tariff-led price increases over to salvage their bottom line.

Cost pressures are in the pipeline, per businesses

ISM Price Index – Services & manufacturing sectors

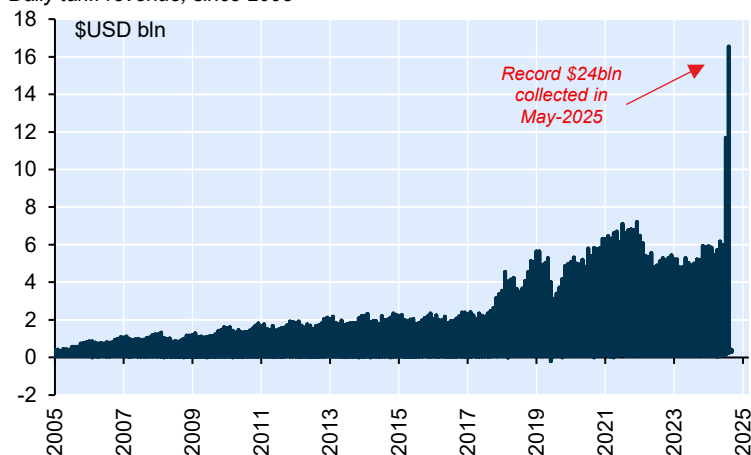


Source: NBC, BBG

There are a few potential explanations for why rising costs pressures are not being reflected in consumer price data. It could be that businesses are eating the costs in their profit margins due to concerns about demand. It could be that competitive pressures have businesses holding off from price increases to defend market share. It could also be that earlier front-loading has businesses well stocked and not yet having to restock at tariffed prices. In any event, tariffs are being collected as U.S. customs data shows. These reflect a real cost that will show up somewhere whether it's higher inflation or reduced profitability (which would have negative implications for hiring, investment, etc.).

Import tax revenue is real... how will it reveal itself?

Daily tariff revenue, since 2005



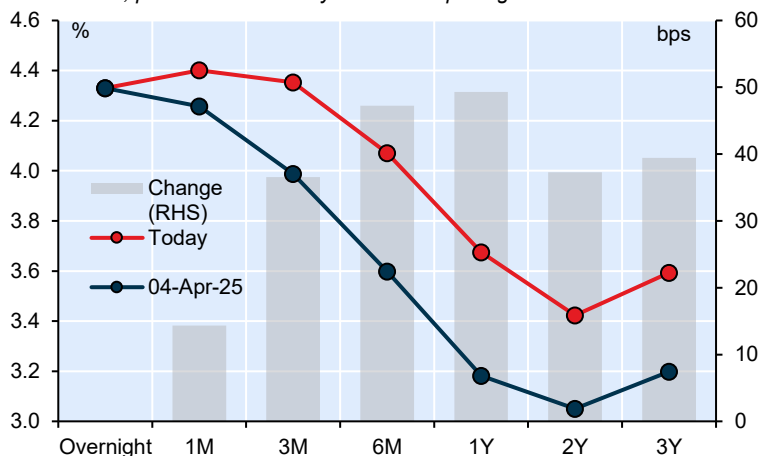
Source: NBC, BBG

The problem is it's unfortunately too early to tell what the effects will ultimately be. As such, the Fed will remain comfortably on the sidelines, for at least the next few months, until there's a better grasp of how things play out. The FOMC's voting members have consistently said as

much, effectively taking the June and July meetings off the table. Market pricing reflects this patient stance, investors now deeming the September meeting as the one where easing will resume. That's in contrast to pricing earlier this year when tariffs were set higher, expected economic impacts were larger, and a dovish Fed reaction function was assumed.

OIS pricing has backed up from the 'worst case scenario'

SOFR curve, post- 'Liberation Day' vs. current pricing



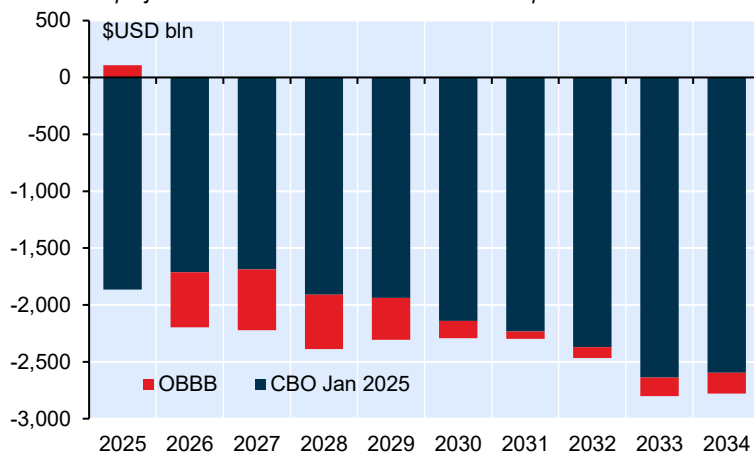
Source: NBC, BBG

We'll concede there's a path to a September rate cut but risks are skewed to later, particularly if inflation starts to pick up (which we think it will). Recall, the March dot plot had begun to show a shift towards less easing relative to December. Overall uncertainty has only risen since then, which may lead to further dot drift. Stay tuned.

While there's been tremendous volatility in the Trump 2.0 era, investors on balance have bet on lower policy rates over the medium term. That's evidenced by a roughly 21 bp decline in the 2-year treasury yield since Trump secured election victory back in November. Rate relief has not extended further out the curve however, as the 30-year yield is up 47 bps over that period. While rates may edge slightly lower in the quarters ahead, we're not counting on a significant move away from 5%. That's in part due to loose fiscal policy, made looser by the "big beautiful" tax bill making its way through Congress. If implemented, it could add ~\$2.4 trillion to the deficit over the next ten years, something investors are unlikely to look favourably on. The lion's share of this marginal red ink (~\$1.8 trillion) would accumulate within five years.

The One, Big, Beautiful... deficit!

U.S. deficit projection – CBO baseline and estimated impact of the 'OBBB'



Source: NBC, CBO | Note: 'OBBB' refers to the 'One, Big, Beautiful Bill' / H.R.1 Act

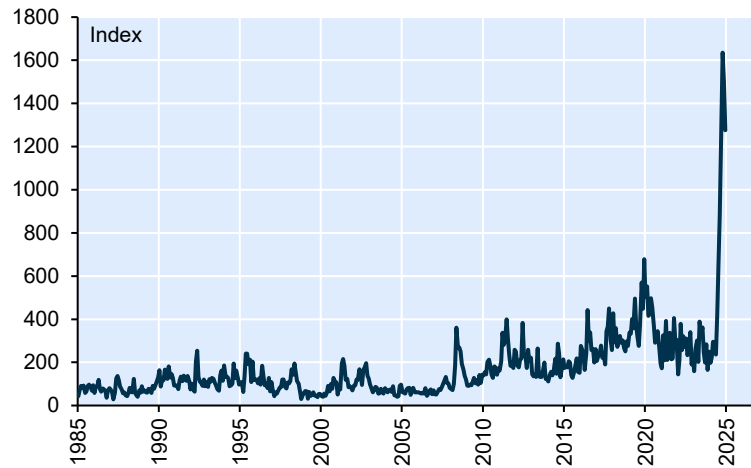


BoC: Stepping off the sidelines this summer?

U.S. data has remained relatively resilient to tariff impacts but the same can't be said for Canadian data. Of course, business and consumer sentiment collapsed earlier in the year on a sharp rise in uncertainty. That's partially improved but remains extremely elevated, posing problems for the outlook still.

Uncertainty has improved (but only relative to the record)

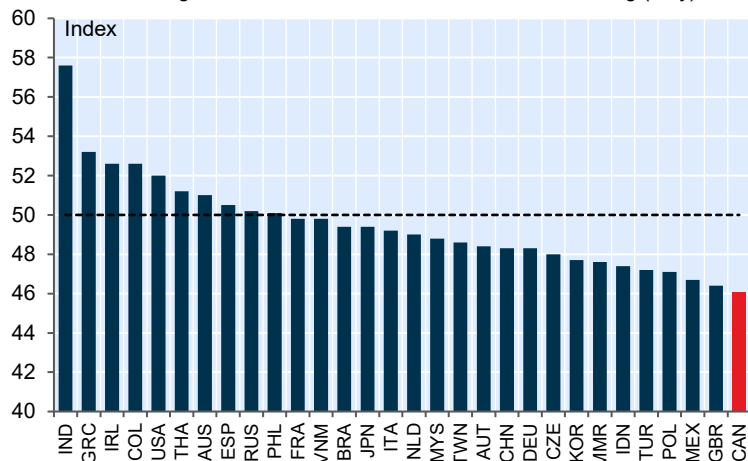
Baker, Bloom and Davis index of Canadian economic policy uncertainty



Subdued sentiment is particularly acute in the areas one would expect, like manufacturing, which has an outsized exposure to the White House trade policy agenda. Consider S&P Global's [manufacturing PMI](#), which remained firmly in contraction (below 50) in May, even with an improvement from an ultra-downbeat April. Canada's manufacturing sector is weak in isolation, but the picture is even uglier when compared to international peers. Of the 30 countries covered by S&P Global, no country fared worse in May than Canada.

Canada's manufacturing sector the worst amongst OECD

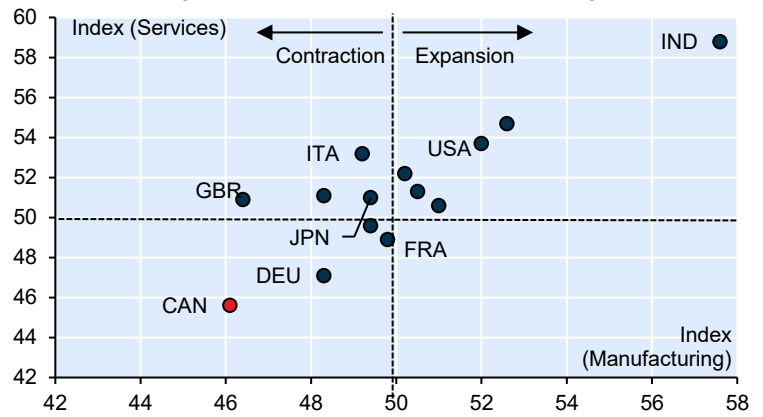
S&P Manufacturing PMI Index – all OECD countries, latest reading (May)



Yes, the manufacturing sector only makes up ~10% of the Canadian economy so this doesn't make or break the outlook. The problem is that the services sector (roughly three quarters of the economy) is similarly troubled. Indeed, S&P Global's services PMI *also* remained in contraction in May (as it has since December) and here too [Canada ranks last](#) among countries whose services sector is covered by S&P Global.

Canada's economy is buckling, broadly

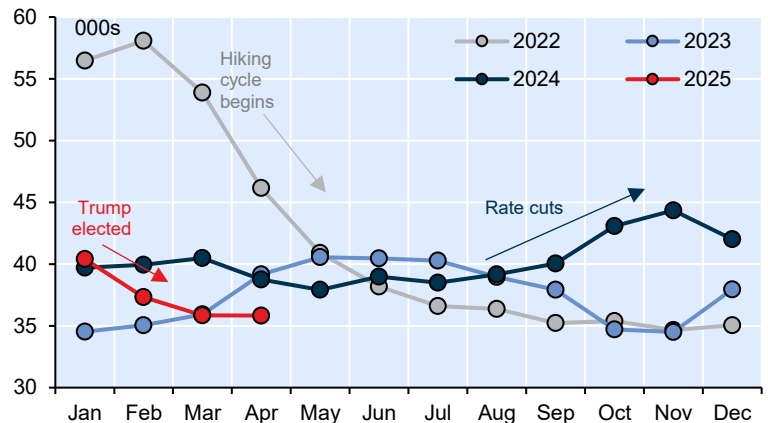
S&P Manufacturing PMI Index vs. Services PMI, latest readings



In addition, housing markets remain paralyzed, an issue that we see as underappreciated. The drop in resale activity ceased in April, but at a very low level. Attributing this to tariffs is overly simplistic. A weaker labour market and mortgage refinancing (from the low rate era of 2020-21) are also key drivers. With supply continuing to mount, confidence will remain problematic, and prices may still be pointed lower.

Housing resale activity steadies at very low level

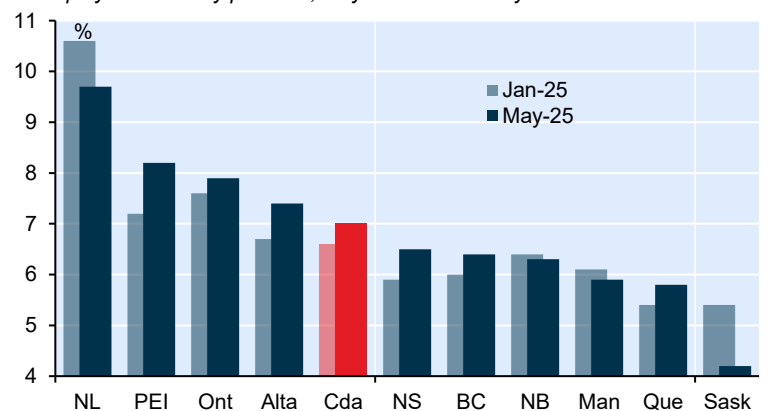
Canadian existing home sales: Monthly pattern by year, Jan-25 to Apr-25



Data more closely watched by the BoC is also flashing red. Hiring has stagnated, and the [jobless rate](#) has moved up four ticks since January. All four of Canada's largest provinces have seen rising unemployment rates this year, including tariff-exposed Ontario closing in on 8%.

Hiring is flat, as UE rates tick up (in all the wrong places)

Unemployment rate by province, May 2025 vs January 2025

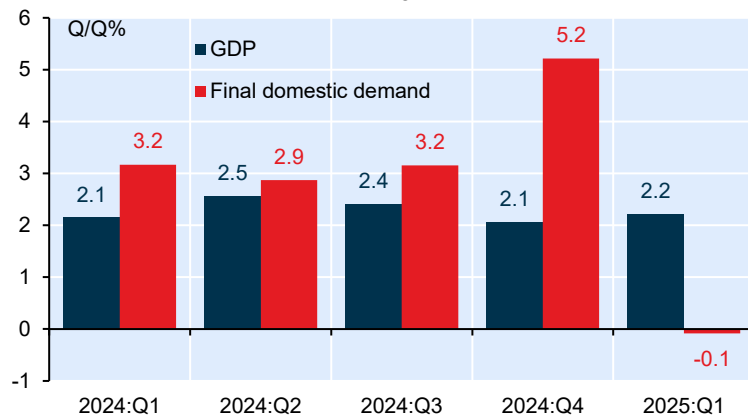




On the surface, Q1 GDP looked solid but that was due to exports and inventories. Domestic demand stagnated. And while that comes after a very strong Q4, it doesn't create much momentum going forward.

Q1 GDP looked good but domestic demand was weak

Canada GDP and final domestic demand growth

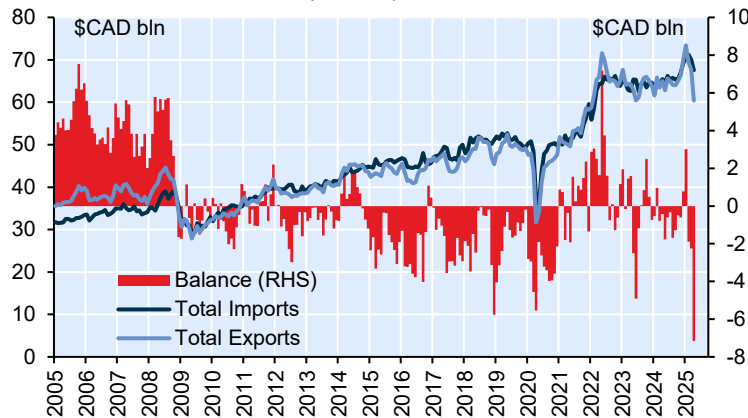


Source: NBC, StatCan

Domestic demand should remain weak in Q2 and headline growth will be soft as earlier U.S. front-loading cuts the other way.

Canada's trade deficit was the largest on record in April

Canada merchandise trade – imports, exports & balance, since 2005

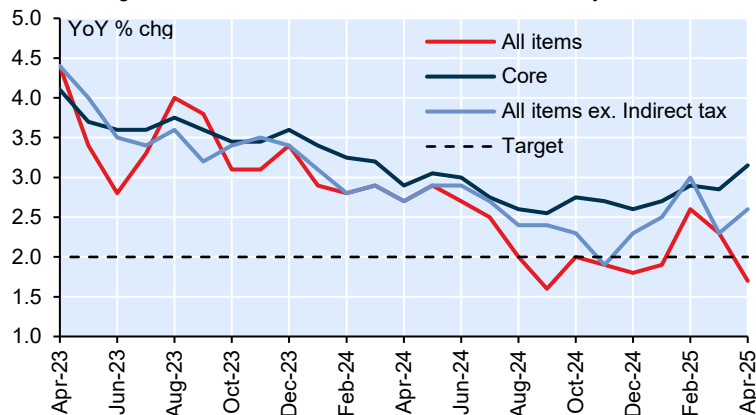


Source: NBC, BBG

With weak labour and housing markets and a challenged GDP outlook, the BoC left rates unchanged for a second straight decision in June. Why? Inflation and inflation risks. Core CPI in April was unexpectedly hot despite well-contained headline inflation (pulled down by tax relief).

Core inflation is proving stickier than anticipated

Y/Y % change in select Canadian inflation measures, last two years



Source: NBC, BBG

Moreover, if you consider what the BoC was focused on, the decision becomes less surprising. See their 'guidance' from April:

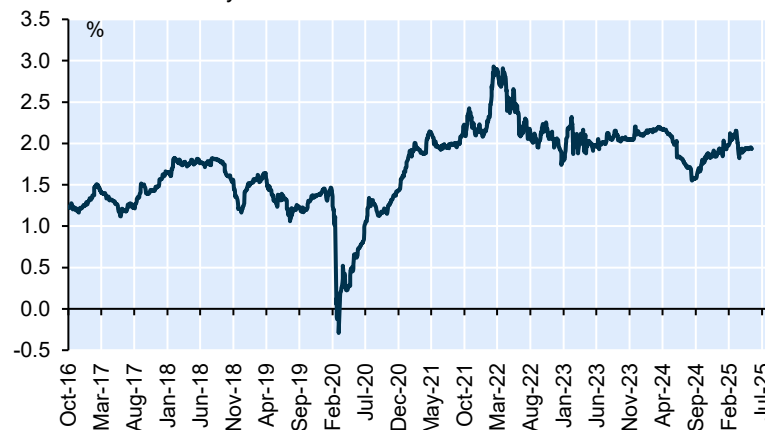
"Governing Council is proceeding carefully, with particular attention to the risks and uncertainties facing the Canadian economy. These include:

- The extent to which higher US tariffs reduce demand for Canadian exports;
- how this [affects] business investment, employment, household spending;
- how much & how quickly cost increases are passed onto consumer prices;
- and how inflation expectations evolve."

Ahead of June, it was too early to tell on many of these items (trade inflation expectations) while inflation and economic impacts were giving opposing signals. Cue the hold. But the eight weeks that follow have brought and will bring greater clarity. As noted, Canadian exports collapsed in April while hiring has remained muted. Meantime, a Business Outlook Survey due in July will deliver an important update on inflation expectations (we're not too concerned about this). But the most important variable in guiding the July decision will likely be the two inflation reports incoming. If these are to co-operate, the easing cycle is likely to continue as the Governor explained: "[There] could be a need for a reduction in the policy rate if the economy weakens [...] and cost pressures on inflation are contained".

Market-based inflation expectations remain well-anchored

Canada 5Y breakeven yield

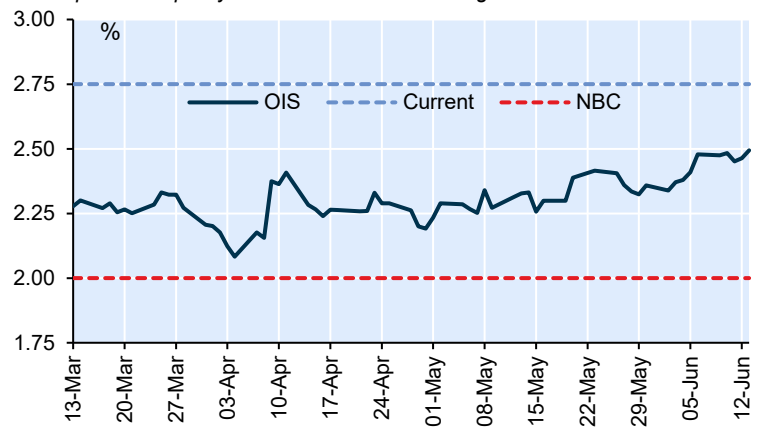


Source: NBC, BBG

On balance, the items on the BoC's watch list are tilting towards cutting in our view, but market pricing has moved the other way. There is now barely over 1 cut discounted this year, which is a stark contrast to what was priced following the Bank's March rate cut.

OIS markets have stripped out plenty of '25 BoC rate relief

OIS-implied BoC policy rate for December meeting vs. current & NBC forecast



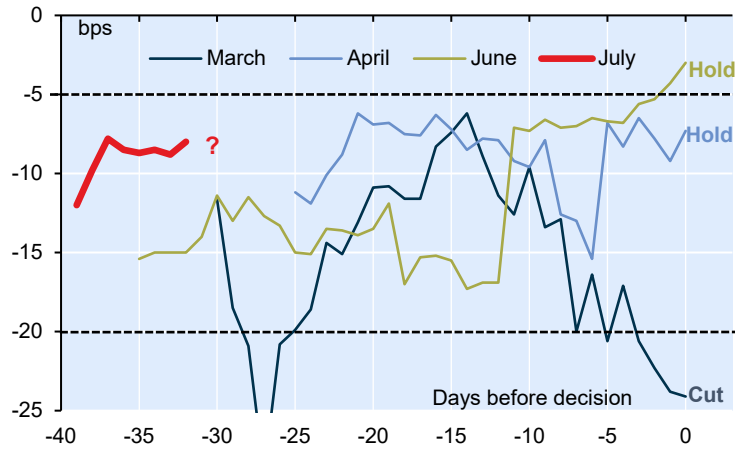
Source: NBC, BBG



The July decision will be data dependent, but we see a cut as more likely than not. The fact that markets are leaning hold right now doesn't deter us. Recent months have reminded us that [BoC expectations can change quickly](#), and Governing Council has no problem with markets lingering in uncertainty.

Investors can be certain of BoC inter-meeting uncertainty

OIS-implied rate change in lead-up to next BoC policy decision

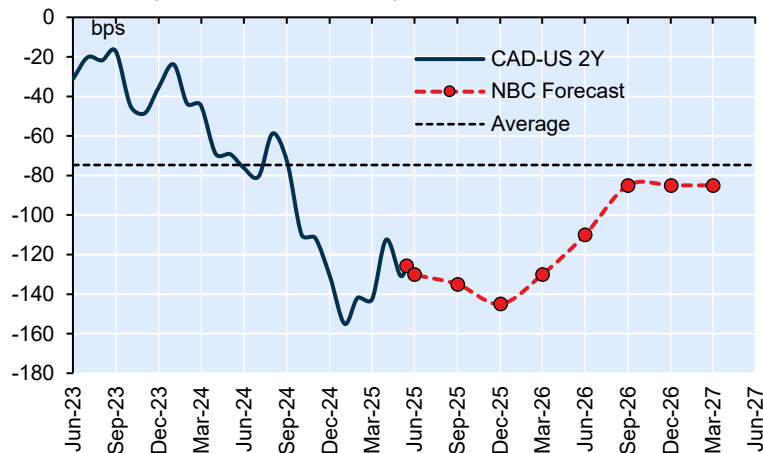


Source: NBC, BBG

Further out, we have retained our call for a total of 75 basis points of easing this year as we continue to see limited inflation and accumulating economic slack. With the rally in U.S. treasuries of late, that would leave Canada bonds well-positioned to outperform in the months ahead.

UST rally + underpriced BoC = GoC outperformance

GoC – UST 2Y yield differential, last two years & NBC forecast

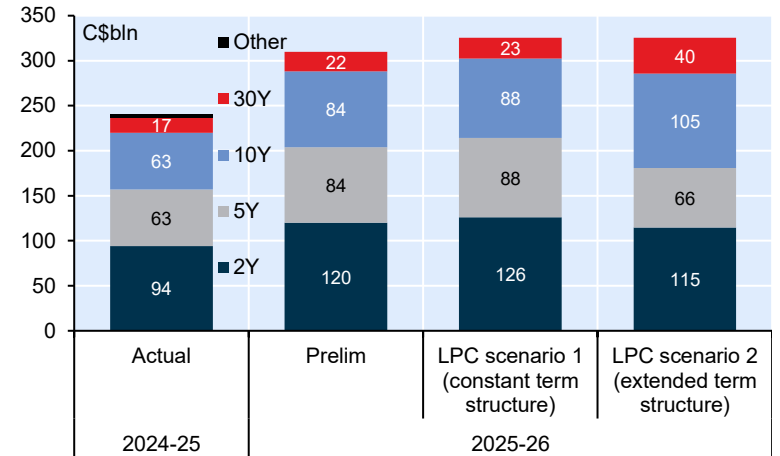


Source: NBC, BBG | Note: Dotted line represents 2Y yield differential, two-year average

Like in the U.S., fiscal policy will be key to watch in Canada (for the economic outlook *and* for bond markets). We earlier downplayed the size of new defense spending as part of the government's plan to meet NATO's 2% spending target ([link](#)), but bond supply is still due to rise. Tack on provincial supply, and investors will not be starved of duration, which should limit the rally out the curve (especially if the government's longer-term investment plans result in a marginal GoC term-out). Importantly, Canada won't be alone. Expansionary fiscal policy is a global story which should mean similar trend playing out in other advanced economy bond markets.

Borrowing set to pick up per LPC costing platform

Gross GoC bond issuance, including preliminary guidance & illustrative scenarios



Source: NBC, BoC, LPC | Note: Extended term structure scenario adopts 2021-22 weighted average term. Projected borrowing on LPC election costing platform



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