



# Financial Markets Monthly

## *Hard Times: Escalating tariffs threaten U.S. economic exceptionalism*

### Highlights:

- U.S. trade policy continues to escalate with grievances extending to virtually all U.S. trade partners today from just a handful a month ago. We have downgraded our U.S. growth outlook, and expect the Federal Reserve to cut interest rates three times (25 bps increments) in 2025 with another three cuts in 2026.
- Risks for the Canadian economy have shifted from being directly targeted with severe U.S. tariffs to more traditional concerns that slower U.S. and global growth will spill over. We made moderate downgrades to our Canadian outlook and continue to expect the Bank of Canada will cut to 2.25% in the summer.

**Issue in focus:** Rising import costs and the end of the consumer carbon tax in Canada are setting inflation up for a volatile year. We take a deep dive into our Canadian inflation outlook, and explain why the tariff impact might be more muted than first thought.

*Claire Fan and Nathan Janzen*  
*April 10, 2025*

*Share*

## Forecast changes:

U.S. trade policy continues to fluctuate dramatically, imposing sizeable volatility and reducing the confidence and durability of economic forecasts. The underlying assumptions also remain highly dependent on the duration, size and scope of tariff policy from Washington.

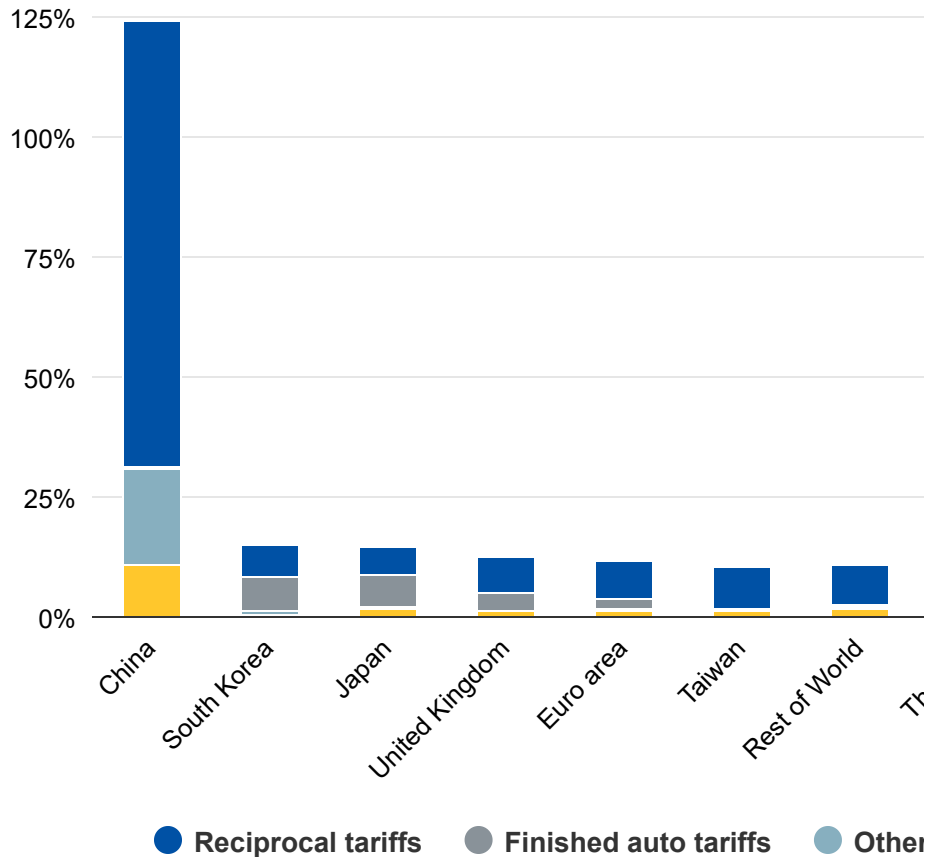
A 90-day exemption for most country-specific reciprocal tariffs was announced less than a day after they were implemented on April 9—yet another dramatic about turn in U.S. trade policy. Still, 10% blanket tariffs imposed on April 5 remain, along with a whopping 125% tariff on U.S. imports from China.

Applying those tariff rates to U.S. imports last year would still have left the effective trade-weighted tariff rate at the highest level in more than a century (24%). But, the impact on the U.S. economy will look very different than from broad-based, exceptionally large tariff hikes that were briefly imposed on April 9.

---

## U.S. import tariff rate by country/region

Custom duties as percent of imports, ranked by increase in rate 2025 to-date



\*Includes tariffs on USMCA non-compliant trade, steel & aluminium and non-reciprocal tariffs on China  
Source: U.S. Census Bureau, RBC Economics

The scope of more punitive measures has now narrowed to just one U.S. trade partner. That should leave American importers more options to find alternative cheaper markets and for trade flows to re-orient. Accounting for those potential shifts, we estimate that the average tariff would be in the 10% to 20% range—still the highest since the 1930s.

Within that context, we see two particular narrative changes to our global outlook:

### *1. Growth (and inflation) risks are now concentrated in the U.S.*

Up until “Liberation Day”, U.S. trade grievances had been primarily focused on a handful of its largest trade partners. That narrative

flipped dramatically with the U.S. imposing blanket tariffs on nearly all countries, except Canada and Mexico, which were less impacted with exemption for USMCA compliant trade.

The U.S. is less sensitive to trade disruptions than most other economies, but tariff increases currently imposed after the 90-day pause are still significant and will weigh on growth while boosting U.S. prices.

Current measures will also have an impact on global growth, but the economic pain will be more concentrated for the U.S. and China than other foreign trade partners. Over three-quarters of U.S. imports are now subject to dramatically higher tariff rates, while the U.S. typically accounts for less than 20% of total goods exports for those countries facing 10% reciprocal tariffs (30% for Vietnam but under 10% in euro area, for example).

Given this, there is now a risk that lower U.S. demand from higher prices could be disinflationary abroad as global producers look for capacity for consumer goods in alternative markets as U.S. demand softens.

## *2. Drivers of Canadian risks have shifted*

As the dust settles on a volatile week, Canada has gone from the second largest target of tariffs imposed to-date to the *lowest target*. That will help the prospects for Canadian exporters, but it's little consolation if the growth in the U.S. economy (still by far the largest destination for Canadian exports) slows significantly.

Risks for Canada have also shifted from a sharp decline in U.S. demand for Canadian exports as U.S. importers seek alternative sources with lower tariff rates to more traditional concerns that a weaker U.S. economy will have negative spillovers for Canadian growth. Downside economic risk to Canada at this point largely depends on how much pain the U.S. will inflict on other importers.

The adage often repeated is "When the U.S. sneezes, Canada catches a cold." We expect bleed through from the U.S. to Canada from a softening U.S. economy. However, Canada has sufficient medicine in the form of fiscal stimulus at the federal and

provincial levels, as well as ongoing easing from the Bank of Canada to help it mitigate symptoms and recover more quickly.

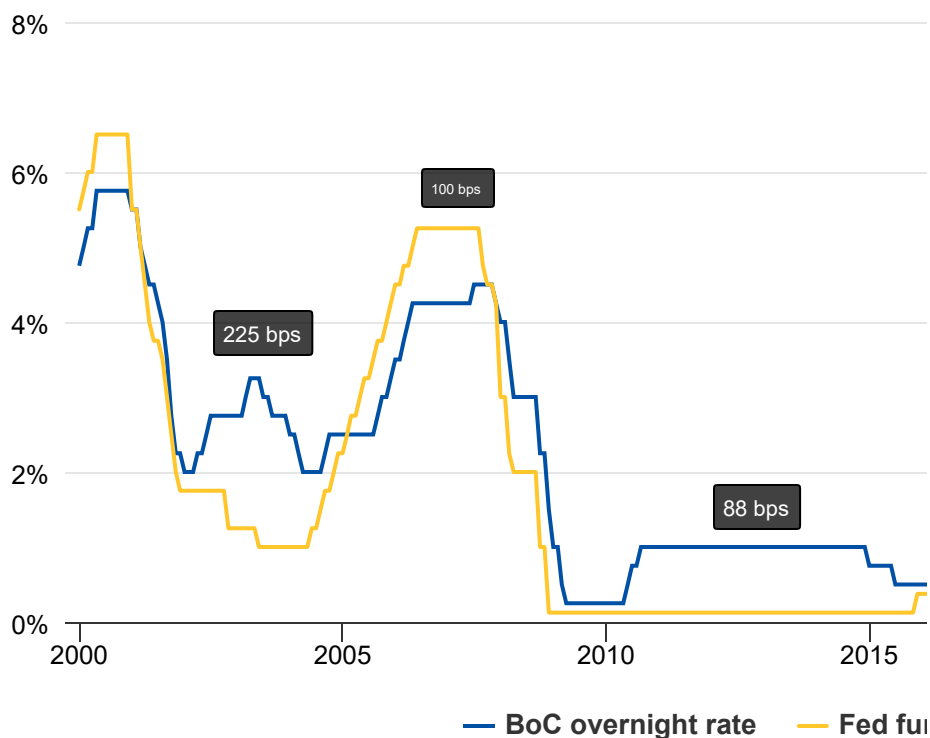
While no approach is faultless within a wide range of possible outcomes, our forecasts assume severe U.S. tariffs (above the 10% effective average tariff rate) for at least six months and elevated tariffs remain through 2026.

- **We do not as a baseline expect a technical U.S. recession in 2025, but we do see materially slower gross domestic product growth,** which has been revised significantly lower to small positives from Q2 through Q4 this year. We now see 1% GDP growth this year versus 1.6% previously. That said, U.S. growth still risks contracting should uncertainty or financial instability put additional downward pressure on the economy.
- **The U.S. unemployment rate will rise in 2025.** Structural supply shortages will contain the near-term bleed through to the labor market, but the U.S. unemployment rate will rise to 4.8% by end of year. This is significantly higher from 4.2% today, and the 4.3% we previously assumed in March for the end of 2025.
- **U.S. inflation remains problematic.** We expect U.S. core inflation to spike to 4.3% by Q3. Roughly 10% of U.S. consumer spending that's sourced from abroad will face price pressure from higher tariffs than a month ago.
- **The U.S. Federal Reserve will begin cutting interest rates as growth slows and the unemployment rate rises.** We currently expect three interest rate cuts in 2025, beginning in Q3 followed by a descent in the Fed funds rate towards 2.75%-3% range in 2026.
- **Canadian GDP growth forecasts have been lowered by less than in the U.S.** Expected quarterly growth rates going forward are lower, but coupled with an upward revision to Q1 growth (driven by strength in January), we see annual 2025 growth only slightly lower at 1.4% from 1.5% last month.
- **Tariffs are expected to have a smaller direct impact on Canadian inflation** with offset from the removal of the carbon tax on consumer energy products leaving headline inflation

projections lower for the rest of 2025 (see issue in focus below for more).

- **The Bank of Canada is still expected to cut the overnight rate down to 2.25%,** but will hit that level slightly earlier by end of Q2. Interest rates are already relatively low in Canada and fiscal policy will likely remain the first line of defense against economic weakness from tariffs than interest rate policy (better able to provide timely/targeted/temporary support).

## Trade war set to narrow BoC and Fed policy rate gap



Source: Haver, RBC Economics

## Central bank bias:

Central Bank	Current Policy Rate (Latest Move)	Next move
--------------	---	-----------

**BoC****2.75%****-25 bps in Mar/25****-25 bps****Apr/25**

The BoC clearly signalled willingness to support the economy in anticipation of future softening as it cut rates in March. We don't expect that to change. Backward looking data continues to show real activities in Q1 may not have been as weak as feared. But the forward looking outlook has also deteriorated. We expect the BoC will make two more 25-bps rate cuts in April and June to lower the overnight rate to 2.25%.

**Fed****4.25-4.50%****0 bps in Mar/25****0 bps****May/25**

In the latest speech after severe reciprocal tariffs were implemented, Fed chair Jerome Powell emphasized that the current state of the U.S. labour market is "in balance," while putting off guidance on how monetary policy would evolve from trade disruptions. We expect the Fed will be slow to react, cutting rates only in September once it gets a clearer picture of the economy slowing and substantial labour market slack building.

**BoE****4.50%****0 bps in Mar/25****-25 bps****May/25**

The Bank of England held rates unchanged while maintaining their "gradual" guidance to future decisions in March. We don't think the UK economy will see much of a direct impact from U.S. tariffs, but do expect some softening this year due to its exposure to global trade that's seeing heightened disruptions. The weaker growth and inflation profile adds conviction to our base of three more rate cuts this year.

**ECB****2.50%**  
**-25 bps in Mar/25****-25 bps**  
**Apr/25**

Even before the reciprocal tariff announcement, the European Central Bank was already tilting more dovish. We assume they will predominantly see the tariff measures as a negative shock to growth this year. For now, we left our ECB profile unchanged and expect another 25-bps cut to the deposit rate in April. Risk to our terminal rate outlook, however, is firmly skewed towards lower than we have expected (at 2.25%).

**RBA****4.10%**  
**0 bps in Apr/25****-25 bps**  
**May/25**

As expected, the Reserve Bank of Australia held rates steady in April after making a first cut in February. We expect upcoming Q1 CPI data will confirm the more encouraging progress on underlying inflation with trimmed CPI back within target. That should give the RBA more room to respond to increasing downside risk to growth from tariffs. The currency backdrop, however, could temper how much easing it may ultimately deliver.

## Issue in focus: Zooming in on our Canadian inflation forecast

Global tariffs are generally recognized as inflationary for the countries imposing them—they raise direct import costs for producers while disrupting global industrial production lines. Our U.S. forecasts, in particular, suggest problematic levels of inflation due to elevated prices to start with, and the tariff burden ahead. The Canadian inflation picture, however, is more nuanced.

A deeper look at retaliatory tariff measures imposed by the Canadian government so far and changes in consumer behavior tells us that the impact on final prices might not be as large as one might think. In Q2, headline inflation could actually drop in



Canada as the removal of the consumer carbon tax significantly lowers energy inflation. It could then rise as tariff impact gradually passes through.

Overall, we estimate the carbon tax repeal and retaliatory tariffs will each have a about 0.6 percentage point impact on prices, leaving headline inflation at the end of 2025 not that far from our prior forecast of at-target inflation despite significant news flow.

## *Repeal of carbon tax will push inflation lower in Q2*

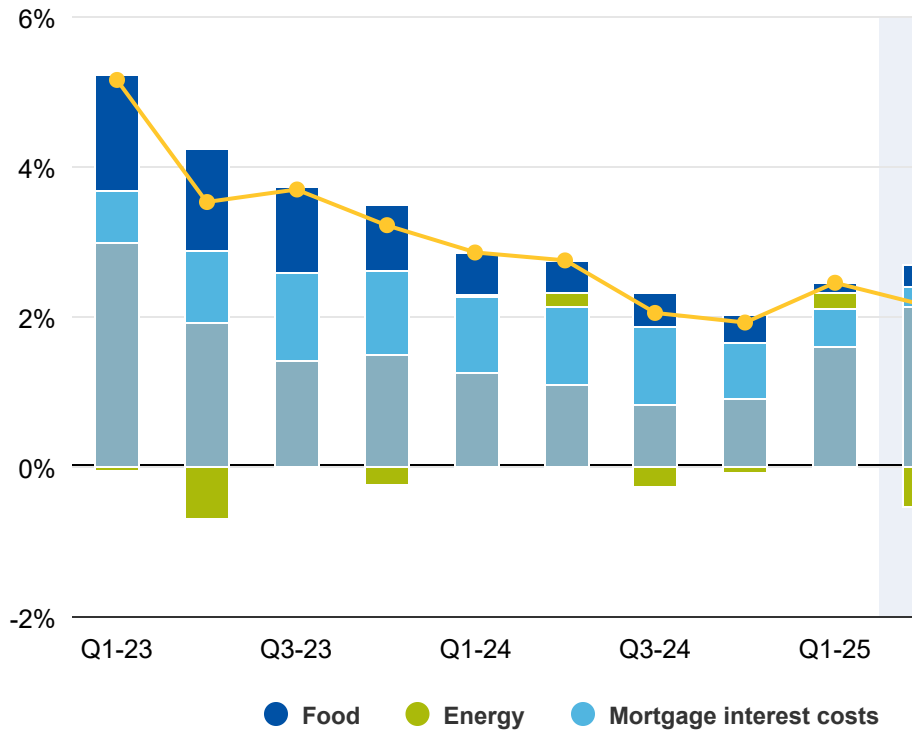
The end of the consumer carbon tax on April 1 will have an immediate downward impact on energy prices and consumer inflation, mostly from declines in gasoline and natural gas and, to a smaller extent, fuel oil prices.

For provinces, Saskatchewan and Alberta will see the largest price drops of 0.8 to 0.9 percentage points, while Nova Scotia and British Columbia see smaller declines of 0.6 percentage points. The Quebec government has yet to follow suit, leaving it the only province not expecting to see any price changes in April.

---

## Headline Canadian CPI by component

Percentage point contribution to year-over-year CPI



Source: Statistics Canada, RBC Economics

Overall, we estimate that a one-time drop in the level of after-tax prices will lower headline CPI growth to about 2% in April (from about 2.5% in Q1). It will continue to impact year-over-year price growth until April next year when it drops out of the year-over-year inflation calculation.

This won't add stimulus to consumer demand. The federal carbon tax is designed to be revenue neutral with taxes collected eventually returned to households through income transfers. The repeal of the tax means those transfers will end, leaving aggregate household disposable income largely unchanged (although, some will have more, and some will have less on net).

## *Strategic retaliatory measures will limit inflation impact of tariffs in Canada*

Unlike the removal of the carbon tax, the impact on prices from tariff increases will show up gradually. Higher costs in industrial

supply chains tend to filter gradually through to final consumer prices. Built-in buffers among businesses that stockpiled inventories in Q1 will also help moderate the initial impact.

The most immediate and direct impact on Canadian inflation from the trade war will be coming from Canadian retaliatory tariff measures. To-date, Canada has imposed 25% tariffs on roughly \$60 billion in imports from the U.S., plus added tariffs on the U.S. content of finished motor vehicles.

If paid fully by consumers, those measures could raise prices in Canada by more than 1 percentage point. Our forecast is for a more benign 0.5% increase to consumer prices, given the assumptions below.

**1. Goods subject to retaliatory measures generally have a lower U.S. import concentration.**

Overall, goods included on Canada's \$60 billion retaliatory tariff lists had a 32.5% average U.S. import concentration by our count. That's still substantial, but is lower than the about 50% of all Canadian imports from the U.S. in 2024. It leaves more options for importers to find alternative sources not subject to tariffs.

**2. Consumers could forego purchases of tariffed products.**

It won't be possible to avoid import tariffs on all products, but consumers can substitute products impacted by tariffs with ones that are not. U.S. ISM manufacturing Survey in March flagged reduced sales in Canada among food, beverage and tobacco product producers as boycott concerns grew.

**3. Importers can request a remission from Canadian import tariffs.**

In cases where it is not possible to find an alternative substitute import market, or where the import tariff is representing a significant threat to the Canadian economy, businesses can apply for tariff exemptions or rebates. A similar process was available in 2018 when the last round of U.S. steel and aluminum tariffs were imposed on Canada, and resulted in broad remissions of tariffs in October that year.

4. **Not all products targeted by retaliatory tariffs are final consumer products.**

Only about 40% of products listed on the \$60 billion list, by our count, are directly on consumer goods. The remainder are on either capital or intermediate goods that will add to upward cost pressure in Canada's industrial sector, and suppress business profit margins before being added to consumer prices.

5. **Most of what Canadians consume is produced domestically.**

About 80% of total consumer spending is produced within Canada, and about half of that (roughly 10% of total consumer spending) is imported from the U.S., according to OECD estimates. Tariffs will increase the price of imports, but weakening economic growth and higher unemployment is net disinflationary for consumer spending produced within Canada.


Risks to our base case inflation forecast could come from large and severe U.S. and Canadian tariffs on finished autos, and additional pending tariffs on parts (threatened to take effect in early May). There are already reports of a temporary shutdown at some Canadian auto manufacturing plants.

Production disruptions could still impact the labour market outlook despite the auto sector not being as large a direct share of the economy as it used to be (manufacturing of finished vehicles and parts combined accounts for about 0.7% of GDP and jobs). This could lead to higher prices for vehicles, which could then threaten activities in other related industries including retail, wholesale, and leasing of vehicles.


In the very near-term, the current manufacturing inventory to sales ratio (at about 1.8) is still above where it was on average before the pandemic (1.5 in 2019). That will help buffer some of the initial shock. For the rest of this year, we see upside risk to our headline CPI forecast from rising auto prices should tariffs on auto parts be added to already significant tariffs imposed on finished motor vehicles.

Detailed forecast tables:


Economic Forecast Detail – Canada

 [See table](#)

Economic Forecast Detail – US

 [See table](#)

Interest rates and Key FX rates

 [See table](#)

About the Authors

**Nathan Janzen** *is an Assistant Chief Economist, leading the macroeconomic analysis group. His focus is on analysis and forecasting macroeconomic developments in Canada and the United States.*

**Claire Fan** *is an economist at RBC. She focuses on macroeconomic analysis and is responsible for projecting key indicators including GDP, employment and inflation for Canada and the US.*

[+ Disclaimer](#)

Read This Next

**Earth Day Edition:  
Canada’s Power Move**  
*April 22, 2025*

**Detect Early, Treat Early:  
Innovations Shaping the  
Fight Against Cancer**  
*April 22, 2025*

**Building Together: How  
Indigenous economic  
reconciliation can fuel  
Canada’s resurgence**  
*April 22, 2025*