

*It's a new dawn (day),
and no one's feeling good:*
Tariffs slash growth
momentum in Canada
and U.S.

Highlights:

- Trade risks are set to wipe out early signs of economic recovery in Canada—we expect gross domestic product growth to slow and the unemployment rate to edge higher in coming quarters.
- The U.S. economy's run of exceptional performance is also facing headwinds from trade disruptions, government spending cuts, and lower immigration rates.
- Central bank paths going forward are little changed from last month. The Bank of Canada will continue to cut interest rates, but we don't expect a race to the bottom, pending fiscal supports.

*Claire Fan**March 12, 2025*

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Issue in focus: We look at how the value added tax (VAT), like Canada's GST, is being tied to possible U.S. tariff plans as the planned April 2 announcement of reciprocal U.S. tariffs threatened on all trade partners approaches, and what it could mean for Canada and others.

Forecast change:

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First, it is general practice to only incorporate formalized policies into our outlook once they become a most likely (or modal) expectation, but even what is current policy is shifting almost daily. As it did [last month](#), our base case incorporates targeted (not broad) U.S. tariffs on Canadian imports. Reality has broadly tracked that forecast with severe blanket U.S. tariffs on imports from Canada and Mexico rolled back for CUSMA compliant trade (covering more than 90% of total Canadian exports to the U.S. by our count) within days. Although, the daily back-and-forth in trade policy have tilted risks towards more tariffs, not less.

Second, we know from the past that significant uncertainty alone, although hard to quantify, weighs on businesses and households who become more constrained in decision making. In the U.S., there have already been signs of slowing in consumption and some (albeit gradual) softening in labour markets early in 2025. In Canada, (where the economy's more sensitive to trade disruptions) business and consumer confidence have declined, raising questions about how long a better-looking run of recent economic data can be sustained.

Within this context, we have made these adjustments to our forecasts:

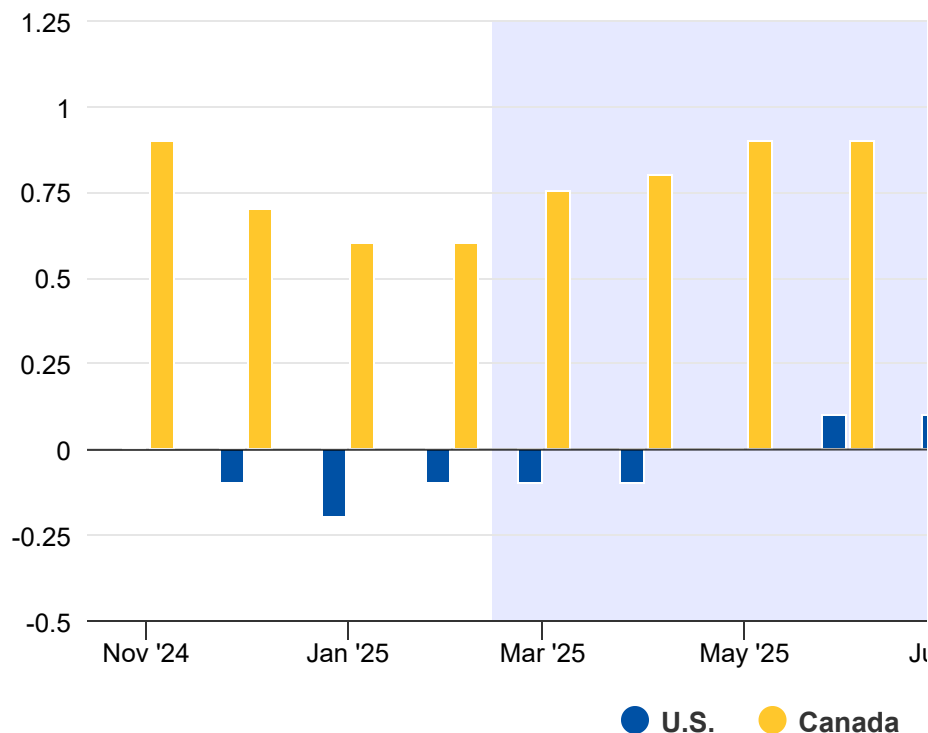
- We have revised 2025 U.S. GDP growth lower to 1.6% from 2%. This is more of a mark-to-market adjustment following distorted trade activity and slower consumption in Q1 and not a material change to our base case "soft landing" view. That said, the balance of risks around this forecast has shifted to the downside. We see a series of early warning signs in U.S. data that could necessitate further downward revisions ahead.
- Meanwhile, we have lifted 2025 core inflation expectations in the U.S. from 2.6% to 2.9% off the back of increased tariff pressures and a still-resilient growth backdrop. At this juncture, we expect this sticky above 2% inflation to remain the larger challenge for the U.S. Federal Reserve relative to growth. On the labour front we continue to see a relatively low unemployment

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- Our forecast for Canadian growth has counter-intuitively been raised slightly from 1.3% to 1.5% for 2025, entirely due to prior upward revisions to 2024 GDP data. Despite this mechanical adjustment, we see a lower path for Canadian growth going forward compared to last month off of slower investment activity and weaker foreign demand for Canadian exports. We look for the Canadian unemployment rate to edge up to 7% in Q3—above the 6.8% peak we expected in our last update in February.
- As we highlighted in February, persistent tariff scenarios could yield much weaker outcomes depending on how long they are left in place. Unlike the U.S., a weaker starting point means we're more concerned about growth in Canada than inflation, which we have upgraded slightly to 2.3% for 2025.

Unemployment rate still cyclically elevated in Canada

Unemployment rate relative to the non-accelerating inflation rate of unempl



Source: Statistics Canada, BLS, RBC Economics

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Despite growing risks to Canadian growth and U.S. inflation outlooks, our base case forecasts for North American central banks remains largely unchanged. The BoC cut interest rates in March, but our projection for total cuts for 2025 is unchanged. We expect the BoC to reduce the overnight rate to 2.25% by mid-2025. And, we continue to expect the Fed to remain on hold over the course of this year.

This forecast is consistent with policymakers' views that monetary policy is ill equipped to fully mitigate economic impacts from trade conflicts, which tend to raise prices and lower growth. Still, for both central banks, the balance of risks is moving towards more easing (versus hiking) should more severe trade related scenarios emerge. And despite the focus on near-term central bank decisions, we continue to see the fiscal side of the picture in both countries as being increasingly relevant.

Earlier this month, the federal government already announced some fiscal support programs designed to support businesses and workers impacted by the trade conflict. The size of the fiscal stimulus could reasonably be expected to grow should conditions worsen. And the central bank will need to take that into when making future interest rate decisions.

On the south side of the border, inflation is still a concern. Labour markets still appear to be in a better shape in the U.S. and government deficits are still [exceptionally large](#). The "good news" for the Fed (and the U.S. economy) is that the long end of the yield curve has eased over March. That should support segments of the economy more leveraged to longer-duration debt, as well as the U.S. housing market, where high 30-year yields have dampened affordability to 40-year lows.

Added to this, we now expect a lower path for the 10-year and 30-year yield compared to last month, because of gathering downside risks to the economy that pushed bias for the Fed going forward towards more easing. But just as fiscal expansion in Canada reduces the BoC's need to ease more aggressively,

Central bank bias:

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

2.75%
-25 bps in Mar/25

-25 bps
Apr/25

The BoC cut the overnight rate in March (we expected a hold previously) with concerns about the impact of international trade uncertainty offsetting upside inflation surprises in recent months and signs of an earlier-than-expected rebound in growth. Additional rate cuts remain likely, although, we do not expect the central bank to race to the bottom. We look for the BoC to cut another 50bps to leave the terminal rate at 2.25%.


Fed

4.25-4.50%
0 bps in Jan/25

0 bps
Mar/25

The Fed judged the U.S. economy to be in "a good place" in January. In the latest speech in March and after recent disruptions to trade policy and government spending, Fed chair Jerome Powell maintained that assessment and again emphasized the need (and room) for patience. Without additional progress on inflation, and/or a worse turnout in the labour market, we think the Fed will hold rates through 2025.


BoE

4.50%
0 bps in Jan/25

0 bps
Mar/25

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far, the panned increase in National Insurance contributions and the minimal wage (to come in effect in April) appear to weigh more on hiring demand than existing employment. We expect the BoE will continue on a gradual easing cycle, and will cut in May, August, and November to leave the bank rate at 3.75%.



ECB

2.50%

-25 bps in Mar/25

-25 bps

Apr/25

The European Central Bank lowered the deposit rate by 25 bps in March as expected. Discussion among the Governing Council was heated, marking a change from prior meetings when cuts were viewed as automatic. President Christine Lagarde again emphasized heightened uncertainty around tariffs, but commented little about fiscal policy. We think there will be one more 25-bps cut in April to the deposit rate this year.



RBA

4.10%

-25 bps in Feb/25

0 bps

Apr/25

As expected, the Reserve Bank of Australia made its first cut of the cycle in February after holding out through 2024. Language adopted in the accompanying statement was cautious, highlighting residual inflationary pressures and a tight labour market. This lends well to the moderate easing cycle that we're expecting with two additional 25 bps reductions in May and August that takes the target rate to 3.6%.

Issue in focus: What's up next in the tariff schedule?

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for those Canadian industries. But as U.S. buyers are expected to be paying most of the up-front costs, the [broader macroeconomic impact](#) on Canada could be limited.

Trying to speculate what's next on the tariff schedule is always a dangerous game. The end goal of U.S. trade policy remains murky and applying a logical framework to international trade policy would not have predicted what has actually been threatened and implemented to-date.

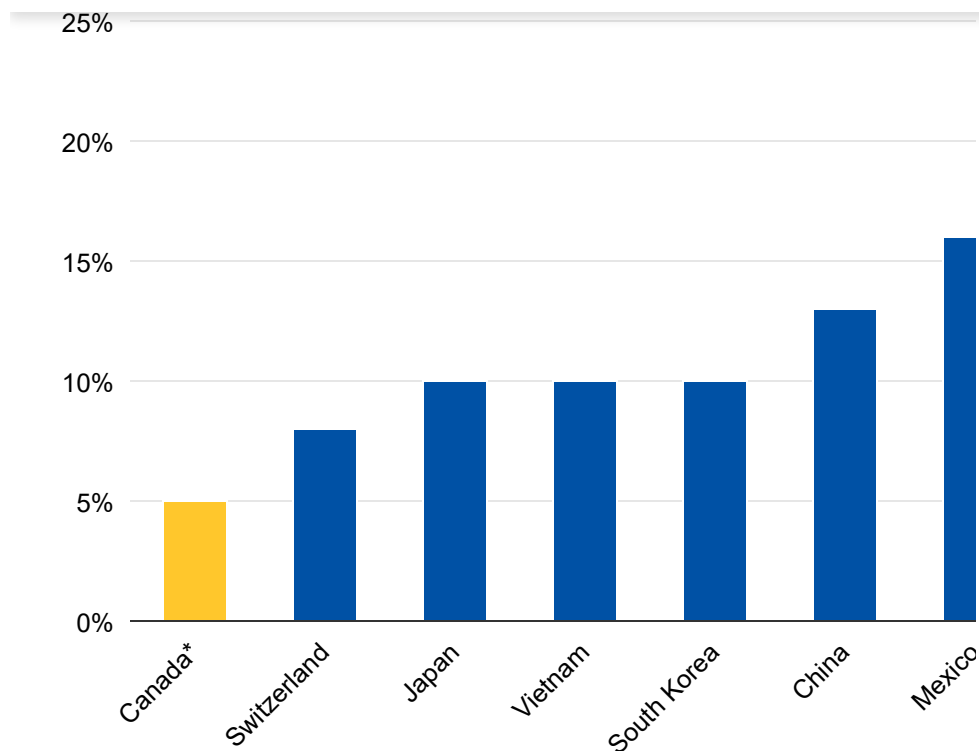
Lately, focus has been shifting to the planned announcement of the "Fair and Reciprocal Plan" from the U.S. administration on April 2, a catch-all U.S. trade response to match tariffs charged by trading partners as well as a broad range of other policies that the U.S. administration view as discriminatory.

Thanks to decades of free trade, Canadian tariffs on imports from the U.S. are generally very low (1.1% on average for nonagricultural imports, according to the World Trade Organization). But traditional complaints about Canadian dairy tariffs (set at very high levels to enforce the Canadian dairy supply management program) and lumber (a recurring complaint that the structure of the Canadian softwood lumber industry unfairly disadvantages U.S. lumber producers) are obvious targets.

Other items that have been flagged as grievances are the Digital Service Tax (3% tax on digital service revenue above a certain threshold globally and in Canada), as well as Canada's [Online Streaming Act](#).

However, perhaps the largest and most impactful for Canada and other U.S. trading partners is the threat of U.S. administration treating value added taxes (VATs), like Canada's GST, as an unfair international trade practice. VAT systems are not unique to Canada. They're adopted in 175 globally, according to the [U.S. tax foundation](#)—and often, at substantially higher rates than Canada's.

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Source: Tax Foundation, RBC Economics | *GST, not counting provincial sales tax in Canada

VAT in Canada is a consumption tax, not a tariff

In reality, value added taxes like the GST do not discriminate against imports in the way that a tariff would. Like the GST in Canada, VATs are taxes that apply to consumer spending within a country or region, whether the product is produced domestically or imported.

In the case of Canada's GST, the tax in the end only applies to final consumer purchases, paid for by consumers. Businesses, generally, are also charged the GST on purchases of raw material and intermediate production inputs, but with those tax payments rebated through the Input Tax Credit.

In 2021, the latest data available, the Canada Revenue Agency reported a total of \$324 billion in GST revenue, and \$262 billion in Input Tax Credit (rebates) to businesses. That nets out to a total of \$62 billion in GST collected, which then amounts to 4.6% of

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That same process also applies at the border. Imports are generally charged the GST when they cross the border into Canada (the same charge as for purchases of goods and services within Canada), but with the tax rebated through the Input Tax Credit unless the importer is also a final consumer.

The problem is the U.S. administration looks poised to treat those domestic consumption taxes incorrectly as tariffs, and could impose an average reciprocal tariff rate of the same rates. For Canada, that means 5% tariffs across the board, and potentially more if provincial HST in Ontario, B.C. and Atlantic provinces are counted.

That would also put other regions globally with substantially higher VAT rates potentially at risk for higher tariffs. In the U.K. and other European countries, VAT rates range around 20%, but with [exemptions or reduced rates](#) available for specific supplies listed.

Detailed forecast tables:

Economic Forecast Detail –
Canada



[See table](#)

Economic Forecast Detail –
US



[See table](#)

Interest rates and Key FX rates



[See table](#)

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