RJL PCS: INSIGHTS & STRATEGIES

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July 2025 Insights & Strategies: Waiting for clarity on reciprocal tariffs and a Canada-U.S. trade/ security deal

Macro Highlights for June

- The Canadian economy is softening, but not weakening dramatically, after strong 2.2% growth in 1Q25, which was partly attributed to a rush of exports to the U.S. in advance of tariffs being implemented. Canadian retail sales started off 2Q25 well in April, up 0.3% from March, but preliminary numbers for May suggest a 1.1% decline m/m, and more weakening into 2H25, which reinforces our forecast of two Bank of Canada (BoC) rate cuts before the end of the year.

- While sentiment and soft data in the U.S. suggests an economic slowdown is coming, hard data has shown that the economy and consumer spending remain resilient, unemployment remains low (and actually declined in June), and inflation pressures remain subdued, although CPI remains stubbornly above the 2% target. Tariffs are only now starting to trickle into consumer prices, and corporations have been slowing down or pausing hiring given the uncertainty, while job seekers have been spending more time trying to find employment. We see unemployment growth to be the most likely catalyst to prompt the Fed to resume rate cuts, which the market is expecting to happen in September.

- Around the world, investors, economists, and central bankers are looking for clarity on how U.S. tariffs, which are still evolving, will ultimately impact economic growth, employment, corporate profitability, and other metrics. Decision-making seems to mostly be on pause in the meantime, although July promises to provide some indications of the path forward as the U.S. continues to push through its budget bill, and we expect to see more progress on U.S. trade deals, specifically with Canada around July 21, and as the delay in the implementation of reciprocal tariffs with dozens of other countries ends on July 9.

Financial Markets in June

- The TSX Composite hit a new all-time high in June, and was up 2.6% by price and 2.9% total return in the month, for year-to-date (YTD) returns of 8.6% and 10.2%, respectively. Similarly, the S&P 500 gained 5.0% by price and 5.1% total return in June, and YTD was up 5.5% and 6.2% respectively, in local currency.

- After a chaotic first half to the year, our U.S. team has slightly increased its year-end target on the S&P 500, from 5,800 to 5,875, based on 2025 earnings of US$255, which is below consensus of US$263. That target is still lower than our pre-tariff target of 6,375 set in January, which our U.S. team now expects to be achieved mid-2026.

- In Canada, we have maintained our 26,300 year-end target on the TSX Composite index from the start of the year, although Canada's out-performance in 1H25, has put the index above 26,800 currently. President Trump's outburst about the Digital Services Tax and his apparent refocusing on Supply Management in Canada is a reminder that a favourable outcome from current trade/security negotiations is by no means a slam dunk, and that we could still face pressure and surprises through 2H25. While we still believe that Canada is relatively well positioned with the U.S. despite the potential for some economic weakness in 2Q25 and 3Q25, and pain in certain tariff-impacted industries, we will more thoroughly review our year-end target once we gain more insights from July tariff announcements and as we watch quarterly corporate earnings updates.

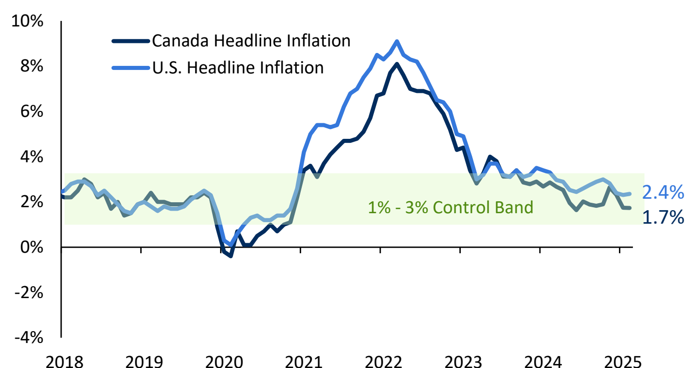
Upcoming

- We are quickly approaching the July 9 date, when Liberation Day tariffs, above the 10% universal rate, are expected to be re-imposed, after being paused for 90 days to enable countries to negotiate lower rates. Expect a flurry of new announcements and deals in principle, with lots of details to be sorted out later. Although Canada was not subject to the Liberation Day tariffs, Prime Minister Carney announced at the G7 Summit, that a new deal on trade and security between Canada and the U.S. could be expected within 30 days, which sets expectations of an announcement by July 21.

Please read domestic and foreign disclosure/risk information beginning on page 22

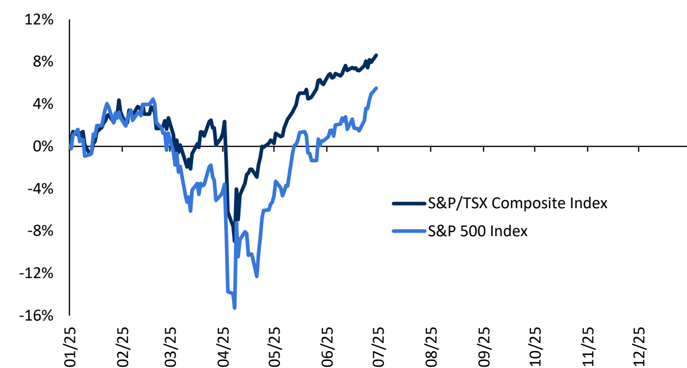
- We will soon be kicking off 2Q25 earnings season and companies should be giving more details on how tariffs have already affected their costs, or will impact prices or cost increases through the remainder of the year and into 2026. If a slowing economy and more reluctant consumers limit the opportunity for businesses to increase prices to pass on tariff-induced costs, we could expect pressure on profits and/or more significant labour impacts, which could then increase unemployment rates.
- We are expecting weakening of economic data, in both Canada and the U.S., to prompt both central banks to reduce their policy interest rates by 50 bps before the end of the year, with the U.S. moving down to 4.00% and Canada moving to 2.25%. This also assumes that the impact of tariffs is more fully understood, and that inflation, other than perhaps a one-time price level adjustment, is deemed to be under control and steady around the 2% target.

Chart 1 - Canada and U.S. Headline Inflation



Source: FactSet, Raymond James Ltd.; Data as of May 31, 2025. Not seasonally adjusted.

Chart 2 - S&P/TSX Composite and S&P 500 2025 Performance



Source: FactSet, Raymond James Ltd.; Data as of June 30, 2025. Price return in local currency.

Executive Summary

As we pass the half-way mark of 2025, we see that financial markets have become more accustomed to President Trump's chaotic announcements and has mostly discounted the most severe scenarios for a world in which the U.S. becomes more transactional and isolationist, with a relatively permanent tariff regime in the 15% range. Canada has also significantly shifted on multiple fronts, at least with stated intentions to invest in and fast-track energy, mining, and defense spending initiatives. If we continue to see follow-through on these promises in Canada and a favourable outcome from negotiations with the U.S. on trade and security, we could see Canada coming through this uncertainty in a relatively good position, in both North America and globally.

We are certainly far from being immune to further announcements, threats, and initiatives by the U.S. administration, and we will still likely see at least mild contraction in the Canadian economy before the year is out, with certain industries, such as automotive, steel and aluminum, facing considerable pressures. With inflation being relatively well contained, we still see two rate cuts from the Bank of Canada (BoC) that will help to stimulate the economy, and more government programs developing infrastructure to offset resources that would have otherwise flowed to the U.S.

Just before a scheduled payment on June 30, of the first installment of Canada's Digital Services Tax (DST), President Trump suddenly lashed out and threaten the end of trade negotiations and a pending tariff against all Canadian goods. Although the DST was established a year ago, and discussed well before that, the fact that it was retroactive to 2022, with a massive payment coming due, inspired a sudden outburst from the President. The retroactive nature of the tax, was also seen as risky back in 2024, potentially in violation of the USMCA, and provoking U.S. retaliation under President Biden, so it was probably not unexpected to antagonize President Trump during intense trade negotiations. It was also likely to be a significant stumbling block in the upcoming USMCA renegotiation. So, it was probably not a surprise to see a quick about-face by Prime Minister Carney, rescinding the tax, to ensure that current trade/security negotiations could continue, although potentially costing Canada a bargaining chip.

We enter 2H25 anticipating some clarity in July on the reciprocal tariffs that were put on a 90-day pause after Liberation Day wreaked havoc with the markets. Although we seem far from the 90 deals in 90 days that the U.S. Administration promised, we apparently now have frameworks of deals between the U.S. and the U.K., China, and Vietnam, with a further flurry of announcements expected before the re-imposition of reciprocal tariffs on July 9. Some kind of trade/security deal announcement between Canada and the U.S. is also expected by July 21. Any kind of favorable

agreements could help to continue the stock market rally. The TSX Composite hit a new all-time high in June, and was up 2.6% by price and 2.9% total return in the month, for year-to-date (YTD) returns of 8.6% and 10.2%, respectively. Similarly, the S&P 500 gained 5.0% by price and 5.1% total return in June, and YTD was up 5.5% and 6.2% respectively, in local currency.

June Recap

While tariffs never left the stage in June, they were temporarily displaced as the hottest topic as Israel and Iran traded missile attacks for approximately 11 days before the U.S. bombed three nuclear sites in Iran, taking much of the steam out of the fight. While a ceasefire seems to be holding, the hostilities led to concerns that Iran would disrupt oil shipments through the Strait of Hormuz, through which approximately 20% of the world's oil supply traverses. This led to a temporary spike in the price of oil, which was mostly reversed by the end of June.

That said, tariffs remain top of mind as we come up to deadlines for the reinstatement of renegotiated or reconsidered tariffs from the April 2 Liberation Day announcements. Most of these tariffs are expected to come back into force as the 90-day postponement expires on July 9. Although the U.S. Administration previously indicated that it would announce 90 deals in 90 days, we have seen only frameworks of deals with the U.K., China, and Vietnam. We await details on further postponements, or revised rates that are unilaterally decided by the U.S. Although it seemed like we would have potential progress or announcements at the G7 Summit in Alberta, President Trump departed early before many of the additionally invited leaders had the chance to get face-time. As the host of the event, Prime Minister Carney had the opportunity for some discussions with the President, which seemed to give him enough confidence to announce that a Canada-U.S. deal would be struck by July 21.

That timeline was briefly put into question as President Trump erupted on social media and threatened to cut off all negotiations with Canada as he seemingly became aware of a 'new' Digital Services Tax (DST). The DST was actually put into place in 2024 after being discussed well before that, but with the first payment being due June 30, 2025. The tax was established as retroactive to 2022, which was likely ill-advised to begin with, and was set as a 3% tax on revenue collected by digital service companies (such as Amazon, Google, Meta, Airbnb, Uber, etc…) from Canadians, over a $20 million/yr exemption, and only from larger providers with global revenues over €750 million (~$1.1 billion). The first payment, retroactive to 2022 was expected to be ~US$2 billion, then generate less than $1 billion in ongoing annual revenues for the Canadian government. Just before the first payment was due, Prime Minister Carney announced that the tax would be rescinded, allowing the much more significant trade/security negotiations to continue.

Although hopes are for a tariff-free future, it is likely that Canada will still be faced with some kind of baseline tariff and potentially quotas, alleviating pressure on certain sectors hit by industry-specific tariffs, and where the U.S. has a strong reliance on Canadian products, like aluminum. A 'win' would also likely include a continued exemption for products covered by the USMCA ahead of its review in mid-2026 and any kind of pre-emptive relief against pending tariffs in other industries.

We also saw further resilience in the U.S. economy, and in supporting data such as employment, as the unemployment rate actually declined to 4.1% in June. As we continue to watch how tariffs impact consumer prices, corporate profitability, inflation, and layoffs, the Fed is taking a wait-and-see approach as there is no obvious pressure to resume cutting rates given the continued uncertainty. Overall sentiment and soft data are suggesting that a slowdown in consumer spending is coming, despite a slight rebound in consumer sentiment in June, while hard data remains generally resilient.

The Canadian economy is on track for a slight contraction in 2Q25 as April GDP showed a 0.1% contraction from March, and preliminary estimates are for a similar decline in May. This was not unexpected given the one-time boost in 1Q25 as U.S. importers rushed to front-run tariffs, leading to an offsetting negative effect in 2Q25. Consumers and businesses have also otherwise been holding their breath as they wait to gauge the ultimate impact of the ever evolving U.S. tariffs. Prime Minister Carney has busily pushed through legislation to help reduce interprovincial trade barriers and accelerate infrastructure projects to stimulate the economy and reduce reliance on the U.S. This should help the economy in the mid to longer-term, but Canada as a whole is feeling the pressure from tariff uncertainty, with certain industries, specifically in the manufacturing sectors such as automotive, steel, and aluminum bearing the heaviest burden in the short-term.

Equity markets have continued their upward trajectory from the April 8 lows caused by a sell-off after the Liberation Day tariffs were announced. Despite approaching some tariff re-implementation deadlines in July, the markets are pricing in expectations that U.S. tariffs will settle down to more manageable rates, averaging in the neighborhood of 15%.

The big U.S. political item in June was the race to get the "One Big Beautiful Bill" passed before Trump's July 4 deadline. The Senate narrowly passed its version by 51-50 on July 1, thanks to a tie-breaking vote from Vice-President Vance after three Republican senators voted against the bill. The deadline seems optimistic given some House representatives having issues with the Senate's version. Even if the July 4 target date is missed, we expect resolution before the end of July.

The TSX Composite hit a new all-time high in June, and was up 2.6% by price and 2.9% total return, for year-to-date (YTD) returns of 8.6% and 10.2%, respectively. Similarly, the S&P 500 gained 5.0% by price and 5.1% total return in the month, and YTD was up 5.5% and 6.2% respectively, in local currency.

Tariffs

Tariffs remain an overriding concern for investors, but the erratic roll-out has lost much of its shock value. As tariffs are threatened, imposed, delayed, re-imposed, and scaled back, markets have been on a roller-coaster ride over the last few months. However, as the July 9 deadline for the re-imposition of the Liberation Day tariffs approaches, investors seem to have become complacent to the idea that more modest tariff levels, averaging around 15%, will be settled on, and that the negative impact to corporate earnings will be modest. We see the potential for this to negatively surprise the markets over the next couple of quarters, although so far, price increases for consumers and cost reductions, such as layoffs, by corporations, have been modest. While we expect to see impacts to pricing on store shelves to increase in 2H25, we will also be watching to see consumer (spending) reactions.

While the U.S. faces these building pressures as their cost of goods increase due to the extra taxes, Canadian businesses, that benefited from the front-running of tariffs and pull-forward of orders into 1Q25, will start to see offsetting negative impacts in 2Q25. Canadian consumers and businesses face potentially more expensive goods coming back across the border and overall slower economic growth in Canada, with risks of higher unemployment as affected Canadian exporters scale back on staff and other Canadian businesses defer hiring or other investment decisions while they wait for a more stable environment.

At the G7 Summit, Prime Minister Carney indicated that a renewed deal with the U.S. could be coming within the following 30 days. This would be a significant relief to investors and businesses, especially if it establishes a more stable environment and insulates Canada from future tariff-induced uncertainty.

Otherwise, we include brief updates on key tariff-related items.

Are IEEPA-based tariffs legal?

On the evening of May 28, the U.S. Court of International Trade (CIT) ruled unanimously (3-0) against President Trump's use of the International Emergency Economic Powers Act (IEEPA) to impose unlimited global tariffs. This has been the Trump Administration's favoured tool to quickly implement massive tariff rates against various countries — including the 'fentanyl' tariffs against Canada, Mexico, and China, that were first announced in early February, and are still being used against non-USMCA-compliant products, as well as all the 'reciprocal' tariffs that were announced on April 2.

IEEPA was by no means the only tariff mechanism in President Trump's toolbox, and the other sector-specific tariffs, such as against the automotive industry, steel, and aluminum, that were implemented using Section 232, are unaffected by this ruling. We do not think this CIT ruling was a surprise to the Administration, and within hours, an appeals court ruled that the tariffs could continue to be collected while the ruling was being appealed, and ahead of it potentially being escalated to the Supreme Court. Even if the CIT ruling is upheld, we will likely just see a shift in how the tariff agenda is imposed, which will do little more than extend the period of uncertainty for countries, companies, and markets. This ruling could also complicate the negotiation of trade deals.

While a ruling against the President could require the reimbursement of tens of billions of dollars already collected, we expect that the Trump Administration was already prepared for the possibility, and aside from challenging it, will also potentially use Section 122 authority, which allows the President to impose tariffs of up to 15% for up to 150 days to address "large and serious" trade deficits (Table 1). An existing Section 301 authorization against China could also be used to continue the pressure on China, and new investigations using Section 301 and 232 are likely to be used against various countries as the Section 122 tariffs expire. Section 232 investigations on pharmaceuticals, semiconductors, copper, and lumber are already underway. Overall, although the mechanisms might change, we see this Administration continuing along the same tariff path regardless of this ruling.

April 2 — Liberation Day tariffs — clock is ticking down to July 9 re-implementation

On April 2, President Trump announced sweeping tariffs on most countries. While termed "reciprocal" tariffs based on each country's tariff and non-tariff trade barriers to U.S. products, the rates displayed were instead based on U.S. trade deficits with each country in 2024, divided by the value of U.S. imports from that country. This rate was then halved to derive the tariff rate that the U.S. would apply against each country, subject to a minimum rate of 10%, but escalating to as high as 50%. These rates stacked on existing rates however, such that the 34% "reciprocal" rate

on China was stacked onto the 20% rate that was previously announced under the 'fentanyl' tariffs, for a combined rate of 54%. On April 9, the reciprocal tariffs over the universal base-rate of 10% were put on hold for 90-days, except for China, until July 9. The 90-day delay was intended to allow countries to reduce or eliminate their own trade barriers, which may also include commitments to purchase large amounts of U.S. goods, in order to gain relief from "reciprocal" tariffs being reimposed July 9. Based on the few details released from the U.K. deal, it seems like the most favourable outcome will still include a universal 10% tariff, except for certain sector or product exemptions.

While 90 trade deals in 90 days seemed ambitious, the Administration is suggesting that it may just unilaterally re-evaluate 'reciprocal' tariffs on a regional basis and provide updated rates for countries, beyond the 18 most 'important trading partners', that have not negotiated better deals by July 9.

China tariffs

After China retaliated to the April 2 tariff plan, which imposed a 34% tax on all goods entering the U.S., a back-and-forth escalation ensued before ending up with a 145% tariff on U.S.-bound products and 125% tariff on China-bound products. This equated to a near trade embargo. With concerns growing of product shortages on store shelves, and supplies of critical minerals from China, on May 12 the two countries announced a de-escalation and delay in the prohibitive tariff rates for 90 days.

On June 9, after a marathon negotiation in London, President Trump claimed that a deal was done. According to his social media post, the effective tariff rate on Chinese goods will be 55%, although it is unclear if that includes other previously imposed tariffs and/or excludes certain products, while China will maintain a tariff of 10% on U.S. goods. On what was one of the most important bargaining points, it appears that China will be providing a more expedited process to export rare earth minerals. The U.S. also seems to be backing off from some more stringent non-tariff measures, such as restrictions on high-tech products that China wants to import, and student visas. Details are still pending, but at least the tone has improved since April, although the relationship and restrictions still seem to be worse than at the start of the year.

European tariffs

President Trump took sharper aim against the European Union in May, as he grew frustrated at the speed and direction of negotiations. It seems that the E.U. proposed a mutual tariff reduction and market access plan, while Trump was more interested in unilateral concessions on the E.U. side. The threat of a 50% tariff on E.U. goods starting June 1 was delayed to July 9 only two days later, after a phone conversation with E.U. Commission Chief Ursula von der Leyen. The E.U. has prepared a list of €21 billion (US$24 billion) worth of U.S. goods on which it intends to impose counter-tariffs if a deal is not struck.

Vietnam tariffs

On July 2, President Trump announced that he had struck a deal with Vietnam. Vietnam will now face a 20% tariffs, up from the 10% universal tariff, but below the 46% reciprocal tariff that would have been reimposed on July 9. Trans-shipments, however, will face a 40% tariff. This is presumably to discourage what was seen as the practice of China passing products through Vietnam, with minimal or no modification, to avoid more stringent tariffs on China that came into effect during Trump's first term. In exchange, Vietnam will have zero tariffs on U.S. goods.

De minimis exemption

Wrapped up in the tariff discussion was the 'de minimis' exemption. A major tax-loophole for American consumers had a dramatic overhaul last month. Previously, shipments by mail that were valued under US$800 were exempt from duties. Now, Americans using e-commerce sites, many of which were primarily sourcing from China, such as Temu and Shein, are going to have to cover taxes, which as in the case of shipments from China, is currently 30%. In 2022, 80% of all U.S. bound e-commerce shipments were covered by the 'de minimis' exemption, with the vast majoring coming from China, and last year, U.S. Customs and Border Protection (CBP) processed 1.36 billion 'de minimis' exempt packages.

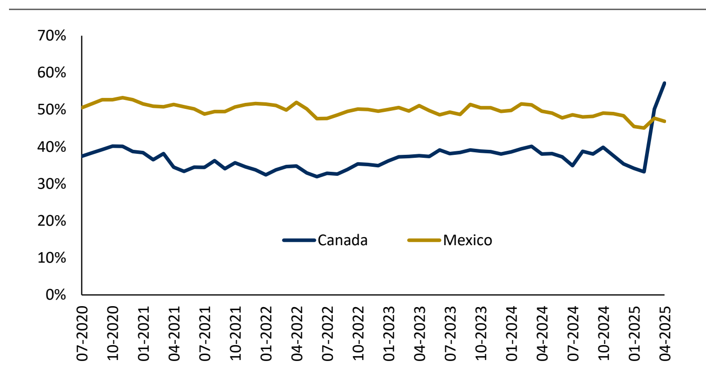
Fentanyl-driven tariffs & USMCA-compliance

After numerous threats, both before and after the election, the first real salvo was fired by President Trump on February 1 with an executive order for 25% tariffs on all goods entering the U.S. from Canada and Mexico (with a reduced 10% tariff on Canadian energy — oil, natural gas, electricity, coal, and uranium), and a 10% tariff on Chinese goods. This round of tariffs was primarily justified as addressing the issue of the influx of fentanyl into the United States.

After various delays and temporary exemptions, these IEEPA justified tariffs settled down to 25% imposed on USMCA non-compliant goods, except for energy and potash, which have a 10% tariff. Qualifying goods as being USMCA-compliant typically requires documenting that at least 50% of the content by value is sourced from North America. Overall, we estimate that 60% of Canadian goods imported into the U.S. are currently exempt

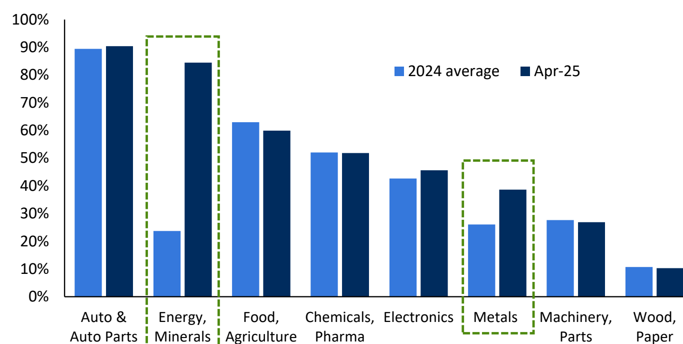
from these tariffs due to USMCA compliance, up from 38% at the beginning of the year (Chart 3). This apparent rise in Canadian compliant products could also be caused by a decline in shipments of non-compliant products, so we need to take this improvement with a grain of salt. Compliance is expected to rise to 80% as exporters complete the necessary paperwork. By contrast, 49% of Mexican exports to the U.S. were compliant in 2024 and were estimated to rise to up to 90%, although we have not yet seen any progress on the Mexican numbers so far. We do see USMCA-compliance as more important to Canadian exporters, who likely do not have the labour cost advantages of Mexico and likely offer goods that are similar in nature to U.S. manufacturers.

Chart 3 - USMCA Compliance Rates of U.S. Imports



Source: U.S. Census Bureau, Raymond James Ltd.; Data as of April 30, 2025.

Chart 4 - USMCA Compliance Rates of Canadian Exports to the U.S.



Source: U.S. Census Bureau, Capital Economics, Raymond James Ltd.; Data as of April 30, 2025.

Steel & aluminum tariffs

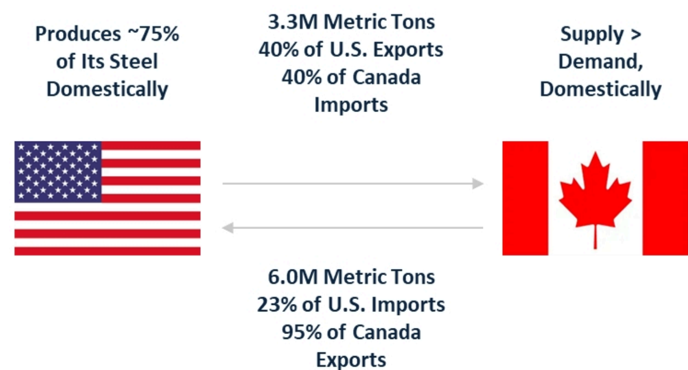
On March 12, a 25% tariff was placed on steel & aluminum products imported into the U.S., including from Canada. This tariff applies to raw metals and finished goods made of steel and aluminum, which is quite an exhaustive list of products. There's an exemption for the finished product if the steel or aluminum is "melted and poured" in the U.S. This tariff threat seems similar to a June 2018 action where President Trump enacted a 25% tariff on steel and 10% tariff on aluminum in his first term. That round resulted in Canadian exports to the U.S. falling approximately 20% over the following year before rebounding after the USMCA ratification in May 2019. Canada is the most exposed economy to this specific tariff as it represents approximately 20% of such U.S. imports and 90% of Canada's exports of these goods, equivalent to approximately US$24.4 billion, or roughly 1% of Canada's GDP. China, by comparison, was already subject to a 47.5% tariff on steel and 32.5% tariff on aluminum and so any incremental tariff there would be of negligible impact, although that country still sold US$15.4 billion of steel and aluminum into the U.S. last year.

On June 4, President Trump doubled the tariff on all steel and aluminum tariffs to 50%. The only country that may be exempted at this point is the U.K., which announced a trade deal with the U.S. that removed the previous 25% tariff on steel & aluminum, and could potentially be finalized in the coming weeks to allow a full exemption.

The Canadian steel industry faces a significant amount of pressure from these tariffs, as it produces approximately 12 million metric tonnes of steel each year, but exports half of that to the U.S., while also importing approximately 3 million metric tonnes back from the U.S (Chart 5). As the 50% U.S. tariff rate becomes an effective trade embargo against all countries, Canada suffers significantly as its exports to the U.S. will likely drop dramatically, and then is further pressured as excess supply from countries such as China are redirected into markets like Canada. In order to support affected Canadian steel producers, as of July 21, Canada will adjust counter-tariffs on steel & aluminum to levels "consistent" with progress made during trade negotiations with the U.S. As of June 30, Canada will also limit federal procurement policies to favour Canadian suppliers and "reliable trading partners". This is presumably being framed to automatically include or exclude the U.S. as negotiations proceed, while excluding other countries such as China.

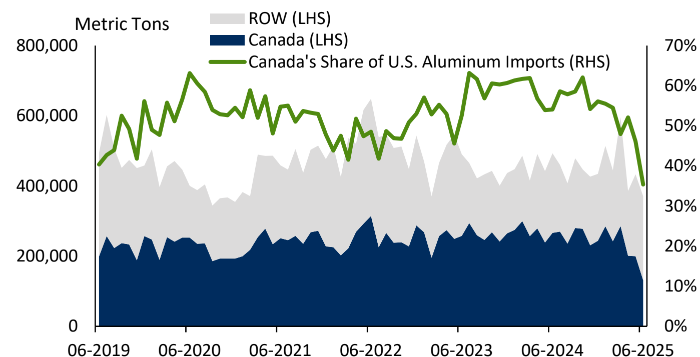
While the U.S. has capacity to increase its domestic supply of steel, the trade relationship between the U.S. and Canada on aluminum is more leveraged to the cost of the massive amount of electricity used in the production of primary aluminum. This is where Quebec, with abundant low-cost hydro-generated power, has a significant advantage over U.S. producers, and why Quebec supplies 90% of Canada's exports to the U.S.

Chart 5 - U.S. and Canada Bilateral Trade of Steel



Source: U.S. International Trade Administration.

Chart 6 - U.S. Monthly Aluminum Imports



Source: U.S. International Trade Administration; Data as of June 30, 2025.

Smartphone tariffs

President Trump seemed to threaten his first company-specific tariff in May, against Apple. It seems that Apple's plan to move some iPhone manufacturing from China to India was seen by the U.S. Administration as a way for Apple to avoid excessive tariffs on products coming out of China, although we don't know where tariffs on China and India will ultimately end up. It was interesting in that it came just weeks after an exemption for certain electronics and computers that were thought to have alleviated some of the pressure on Apple specifically. President Trump now wants Apple (and others) to produce all U.S. sold smartphones in the U.S., a measure that is estimated to drive the price of an iPhone to US$3,500 (over 3x the current price), and would still require tens of billions of dollars and years to achieve. Alternatively President Trump is threatening 25% tariffs, which sound like the vastly better option, although it is unclear if this is another threat that could ultimately be defused by Apple making some commitments to invest in more U.S. operations. This tariff implementation was expected by the end of June.

Lumber

Canada and the U.S. have had a long-standing dispute over softwood lumber. The U.S. objects to the fees that the Canadian government charges the forestry industry, deeming them too low and effectively sees them as the government providing unfair subsidies. The U.S. raised the duty on softwood lumber from 8% to around 14.5% last year. An investigation into global lumber imports and derivative products was launched on March 1, and is to be completed within 270 days. After that, a final determination will be made on tariffs (likely 25%). The expectation is for an increase in anti-dumping duties on Canadian softwood lumber to 20.07%, in combination with countervailing duties of 6.74%.

Tariffs on automobiles

President Trump has reiterated his call for carmakers to close their Canadian facilities and move production to the U.S. As we have suggested before, moving manufacturing of that scale, with integrated global supply chains, is not a quick project.

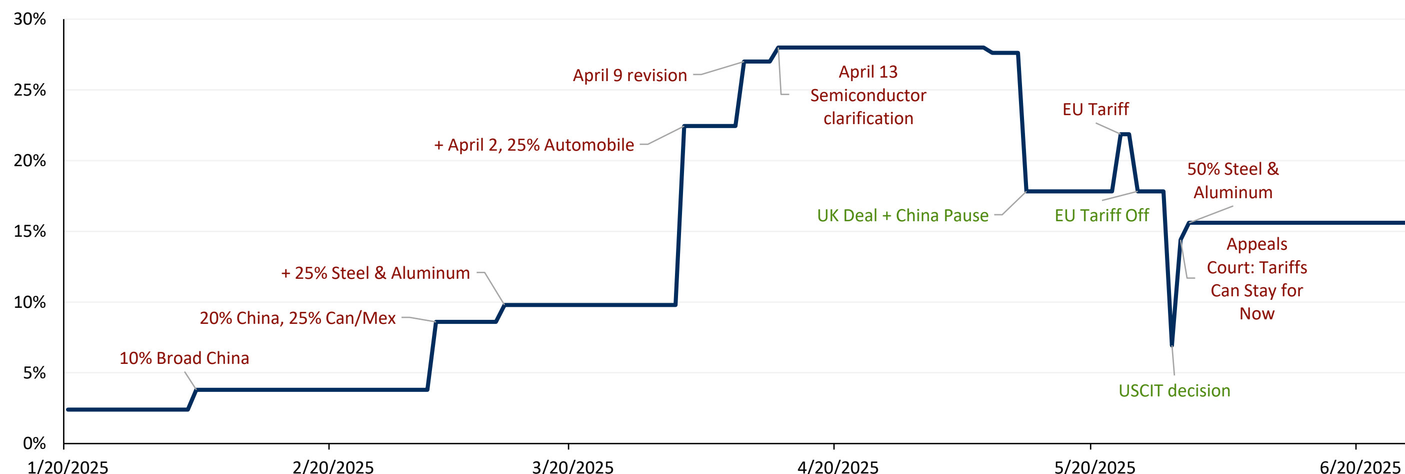
Despite motor vehicles from Canada and Mexico being almost 100% USMCA compliant, with parts being 6-70% compliant, the U.S. still placed 25% tariffs on the non-U.S. portion of finished vehicles. For now, the tariff will not apply to parts imported from Canada and Mexico that are USMCA-compliant. These are likely to be short-term exemptions until the U.S. establishes a process to apply the tariff to all the value of the non-US content.

At the end of April, President Trump announced some modest relief in the auto sector by reducing duties on imported parts used in U.S.-manufactured cars, as well as removing the stacking effect when auto levies are compounded by metal tariffs. Additional relief included a 3.75% reimbursement on tariffs paid on auto parts by U.S. automakers, which will be scaled back to 2.5% after one year, and eliminated in year three.

Upcoming sector threats

President Trump has threatened that more sector-specific tariffs would be coming for semiconductors, pharmaceuticals, and Canadian dairy. An investigation into copper imports is also in process, with the expectation that tariffs similar to the ones of steel and aluminum could be in the works.

Chart 7 - U.S. Effective Tariff Rate



Source: The Budget Lab at Yale; Data as of June 26, 2025.

Table 1 - Summary of U.S. Tariff Announcements Affecting Canada as of June 30, 2025

Date	Targeted Products	Tariff Rate	Trade Remedy	Notes
March 7, 2025	Non-USMCA Compliant goods (excl. potash, Canadian energy)	25%	IEEPA (may be affected by court order)	Close to 80% of imports from Canada entered the U.S. free of duty in 2024, of which about half are USMCA compliant. By April, the share of USMCA-compliant goods had grown to around 60%, but mostly driven by energy exports and a fall in non-compliant exports
March 7, 2025	Non-USMCA Compliant goods (potash, Canadian energy)	10%		
March 12, 2025	Steel & Aluminum	50% (25% from March 12 to June 3)	Section 232 (remain in place)	
April 3, 2025 / May 3, 2025	Autos and Autos Parts	25%	Section 232 (remain in place)	Auto tariffs apply only to non-U.S. made components in USMCA-compliant vehicles USMCA-compliant auto parts are exempt from tariffs Auto parts tariffs are not stacked with Canada and Mexico fentanyl tariffs, nor with the steel and aluminum tariffs

Source: Raymond James Ltd.

Canada's Economic Response to Tariffs

Five months after the initial U.S. tariff threat, we now have a clearer view of how tariffs are impacting Canada's economy. As Governor Tiff Macklem noted in the June 4 BoC press conference, the economy is softer but not sharply weaker, and the likelihood of entering Scenario 2, laid out in the BoC April Monetary Report (four consecutive quarters of GDP contraction starting in 2Q25) has eased somewhat since April. Our own indicator analysis conveys a similar message.

The most significant disruptions are evident in exports, inventories, the trade deficit, and particularly in the manufacturing and wholesale sectors of the auto and auto parts industries. Other segments of the economy have remained relatively stable. While sentiment weakened as early as February, we're only now beginning to see clear signs of damage in the hard data. It may take more time for the full impact of tariffs to filter through the broader economy.

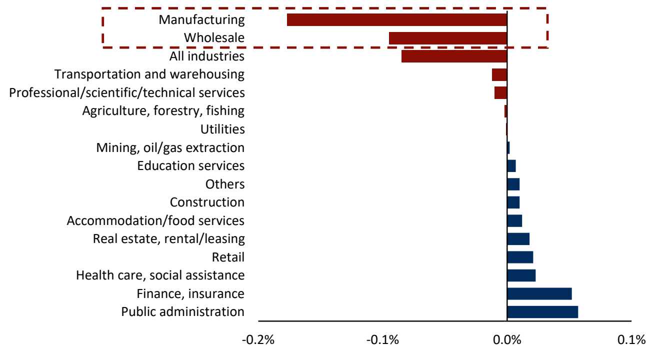
On a more positive note, some sentiment indicators began to recover in May and June. That said, soft data can be volatile and may not always materialize. Still, the deterioration in hard data appears manageable for now. With the Bank of Canada keeping rates unchanged at 2.75% for two consecutive meetings, there's still room to cut if needed. Overall, we're slightly more optimistic than we were two months ago. For detailed commentary on specific indicators, see Table 2 on the next page.

Table 2 - Canada's Economic Response to Tariffs At a Glance

Channel	Indicator	Latest Update	Comment	Primary/ Secondary Impact	Magnitude of Economic Impact	Economic Implications
GDP	Exports	1Q25	up 6.7% ann., strongly boosted 1Q25 GDP growth	Primary	Significant	U.S. importers placed advance orders for Canadian goods, boosting exports. Similarly, Canadian importers front-loaded purchases from the U.S., increasing inventories. This trend may reverse later in 2025, as it borrowed growth from the future and could weigh on GDP. The decline in April's GDP, driven by weaker manufacturing and wholesale activity, combined with the preliminary estimate of another 0.1% month-over-month drop in May, points to flat growth at best for 2Q25.
	Inventories	1Q25	biggest contributor to 1Q25 GDP growth	Primary	Significant	
	Manufacturing, Wholesale	Apr-25	both sectors were down 1.9% m/m (Chart 8); auto manufacturing (-5.2%), other transportation equipment (-21.6%), auto and auto parts wholesaler-distributors (-6.8%)	Primary	Significant	
International Trade	Trade Deficit	Apr-25	surged to a record $7.1B as U.S. exports fell for a third straight month (–15.7%) and the trade surplus narrowed to $3.6B.	Primary	Significant	Reversal of tariff front-running in 2Q25. Canada may increase exports to the ROW to help partially offset the loss.
	USMCA Compliance Rate	Apr-25	up from 38% (Dec-24) to 60% (Apr-25), but mostly driven by energy exports (Chart 4) and a fall in non-compliant exports	Primary	Significant	Further decline in Canada's non-energy exports to the U.S.; effective tariff rates could rise if the USMCA compliance rate falls short of the 80% baseline estimate.
Manufacturing Sales	Manufacturing Sales Values	Apr-25	dropped by a further 2.8% m/m in April after a 1.4% decline in March	Primary	Significant	Due to Canada's proximity to the U.S. within the manufacturing value chain, industries that produce similar goods are especially vulnerable. Once U.S. producers ramp up their capacity, it may be difficult for Canadian exporters to reclaim lost market share following tariff-related disruptions. This dynamic is likely to accelerate the need for Canadian exporters to diversify their customer base. Manufacturing accounts for roughly 10% of Canada's GDP. While certain sectors, such as automotive and steel, may experience more acute impacts, the broader economic effect remains manageable for now.
	Manufacturing Employment	May-25	stood at 1,823k in May, down nearly 3% compared to January (Chart 9)	Primary	Considerable	
	PMI Output & New Orders	Jun-25	have been contracting for five consecutive months (Chart 10), have been contracting for five consecutive months, with no clear signs of recovery even as trade tensions have somewhat eased	Primary	Considerable	
Labour Market	Youth (15-24 Yrs) Unemployment Rate	May-25	stayed elevated in 2025, at 14.2% (May-25) vs. 10.9% (Jan-25)	Primary & Secondary	Considerable	Both indicators suggest that businesses are putting hiring plans on hold due to ongoing uncertainty, mainly driven by tariffs so far in 2025. However, these trade tensions haven't yet led to widespread layoffs among core working-age Canadians, pointing to some resilience in the labour market. In 2024, about 2 million Canadian jobs, roughly 9.5% of total employment, were tied to goods exports to the U.S., where the risk of job losses is highest. Still, we expect the unemployment rate to continue rising, even without the tariff effects, as labour force growth continues to outpace job creation.
	Hiring Intention (S&P Global and CFIB Surveys)	May-25	Anticipated weak employment growth, though they have rebounded recently	Primary & Secondary	Noticeable	
Business Outlook	BoC Analysis in Brief	2Q25	35.4% of exporters expect lower profitability, and 30.4% anticipate reduced exports. Among importers, 53.8% foresee higher operating expenses, and 35.4% expect profits to decline.	Primary & Secondary	Considerable	Tariffs on imports affect more than just cross-border trade. They can disrupt supply chains, raise costs, and create economic uncertainty for all businesses. Even domestic sectors like restaurants and construction can feel the impact through changing costs, wages, and consumer demand. In short, tariffs influence employment, investment, and business strategy across the broader economy.
	CFIB Small Business Confidence Index	Jun-25	more small businesses expect weaker performance than stronger in 12M, despite a partial rebound in confidence recently	Primary & Secondary	Noticeable	
Inflation	BoC Analysis in Brief	2Q25	42.9% of importers expect price increases due to counter-tariffs, while 21.8% of exporters anticipate stronger domestic sales	Primary & Secondary	Noticeable	Although businesses plan to raise prices, we don't expect most CPI components to stay elevated for long. Inflation should continue to ease as (1) weaker consumer sentiment and wage expectations dampen demand, (2) reduced U.S. sales redirect more supply to Canada's domestic market, and (3) a slower pace of rate cuts helps keep inflation in check.
	CFIB Small Business Avg Price Plan	Jun-25	small businesses expect next year average prices to rise by 2.9% in June, down from 3.6% in March, yet still higher than 2.3% in last September	Primary & Secondary	Noticeable	
Policy Rates	BoC Policy Rate Decision	4-Jun-25	Governing Council decided to maintain the policy interest rate at 2.75%, as they continued to gain more information about US trade policy and its impacts on the Canadian economy	Secondary	Noticeable	The BoC confirmed that its bias remains toward loosening policy further. We maintain our projection that the BoC will continue to lower the policy rate throughout the remainder of the year as economic weakness becomes more evident, while inflation remains relatively contained, ending 2025 at 2.25%.
Consumer Spending	Retail Sales	Apr-25	rose by 0.3% in April, while the preliminary estimates suggest a 1.1% decline for May	Secondary	Noticeable	While consumer sentiment took a hit following the initial tariff shock, there is limited hard data so far to suggest a meaningful slowdown in household spending. Signs of softening may begin to emerge in 2Q25 hard data, but the recent rebound in sentiment offers a slightly more optimistic outlook for the 2H25.
	Nanos Canadian Confidence Index	20-Jun-25	after a sharp drop from February to April, it rebounded strongly in May and June, returning to net positive territory	Secondary	Noticeable	
	Equifax Avg Credit Card Spending Per Cardholder	1Q25	declined by $107 during the quarter, reaching its lowest level since March 2022	Secondary	Noticeable	
Housing Market	Sales-to-New Listings Ratio	May-25	remain quite weak. New listings are still high by historical standards in May	Secondary	Considerable	Tariffs and market uncertainty remain key drags on the housing market. Still, home prices could rebound later this year, supported by rate cuts, the First-Time Home Buyer GST Rebate, and broader economic impacts from U.S. tariff de-escalation. May housing starts were solid, and strong permit activity points to near-term resilience. However, momentum may fade, especially in the pre-construction condo segment, developers are facing financing challenges due to sluggish sales, which could lead to project delays or cancellations.
	MLS Home Prices	May-25	The tariff shock halted the home price recovery seen through late 2024, with prices continuing to decline from February to May	Secondary	Noticeable	

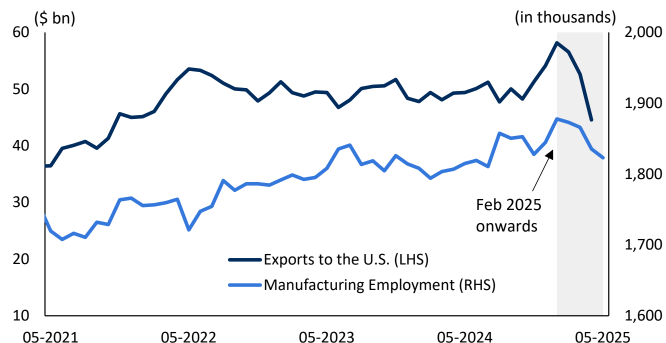
Source: Raymond James Ltd., Bank of Canada, Capital Economics.

Chart 8 - Contribution to the % Change in GDP in April



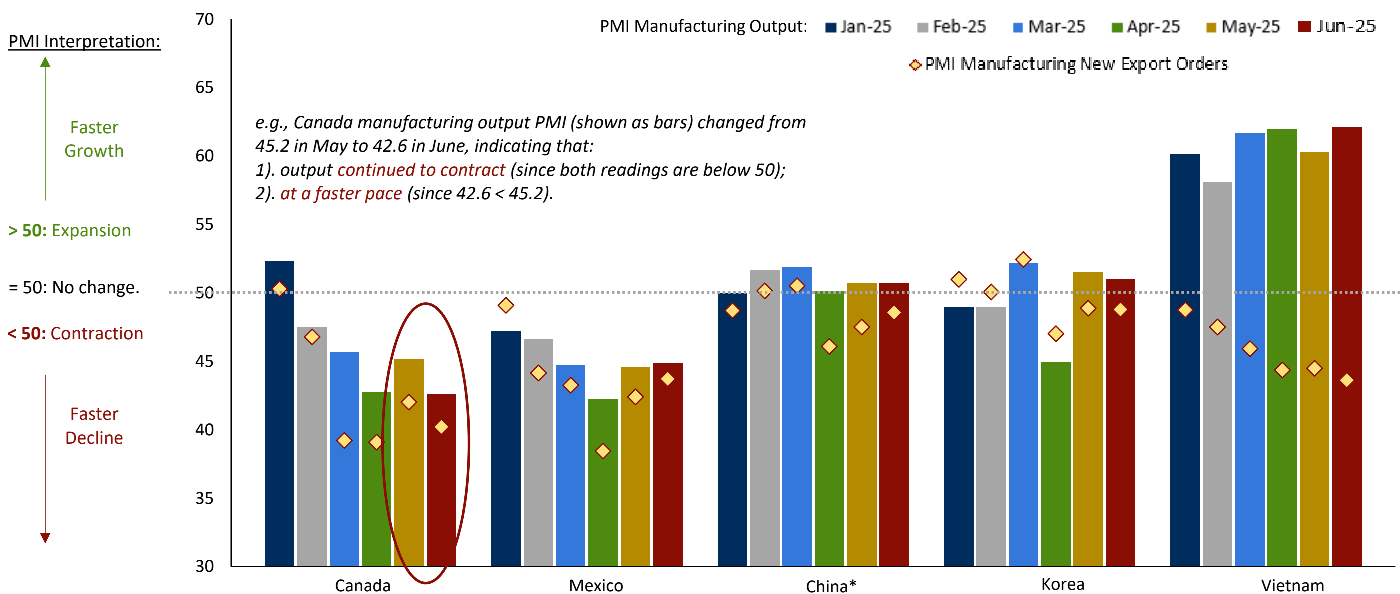
Source: Statistics Canada, Raymond James Ltd.; Data as of April 30, 2025.

Chart 9 - Shrinking Exports to the U.S. Take Toll on Canadian Manufacturing Jobs



Source: Statistics Canada, Raymond James Ltd.; Data as of May 31, 2025.

Chart 10 - PMI Manufacturing New Orders and Output



Source: Capital Economics, Raymond James Ltd.; Data as of June 30, 2025. *China's PMI represents the average of NBS and Caixin PMI surveys.

Economics

Canada — Stepping up to the challenge

Prime Minister Carney has continued to move forward with his platform to boost the Canadian economy, including to reduce reliance on the U.S. One major commitment coming forward in June was the 'One Canadian Economy Act' (Bill C-5), with two key components. The Free Trade and Labour Mobility in Canada Act removes federal barriers to interprovincial trade and labour restrictions. The Building Canada Act provides a framework to fast-track major nation-building infrastructure project.

The benefits cited from removing interprovincial trade barriers have ranged from a 4% increase in per capita GDP (2019 IMF paper) to a 4-8% boost to GDP over the long-term (2022 report from the Macdonald-Laurier Institute). These might be a bit optimistic, but are at least useful justifications for effecting long overdue change. Accelerating infrastructure projects, including power plants, mines, ports, and pipelines, are likely to help absorb surpluses from the steel and aluminum sector, and support growth and jobs, but might still take years to ramp up. When partnered with what looks to be a cautiously optimistic outlook for Canada/U.S. trade relations, we see a relatively favourable path forward.

We still see one or more quarter(s) of economic contraction ahead, and further upside to the unemployment rate, helping to prompt two more rate cuts from the BoC this year, but that the outlook into 2026 and 2027 is brighter.

Monthly GDP Contracts in April, Pointing to a Slight Contraction in 2Q25

Canada's real GDP in April came in lower than expected, contracting by 0.1% m/m (Chart 11). The decline was driven by a sharp 1.9% drop in manufacturing output (the largest drop since April 2021), particularly transportation equipment manufacturing (-3.7%), as auto manufacturers scaled back production due to tariff-related uncertainty. This is the largest monthly contraction in this subsector since September 2021, when global supply chain disruptions and semiconductor shortages affected motor vehicle manufacturing. Wholesale trade also dropped by 1.9%, with motor vehicles and parts leading the decline (-6.8%), as both exports and imports declined within this subsector.

The effects of tariffs were evident in the April data. According to the StatCan survey, 43% of wholesale businesses reported being affected by trade uncertainty in April. In the manufacturing sector, nearly half of respondents indicated they were experiencing the impact of tariffs through various channels. The most commonly cited concerns included rising prices, higher raw material costs, and weakening demand.

While goods-producing sectors weighed heavily on growth, the services sector offered some offset. Arts, entertainment, and recreation rose by 2.8%, and accommodation and food services posted a gain of 0.6%, although the activity in these subsectors was boosted by a rare playoff appearance from five Canadian NHL teams.

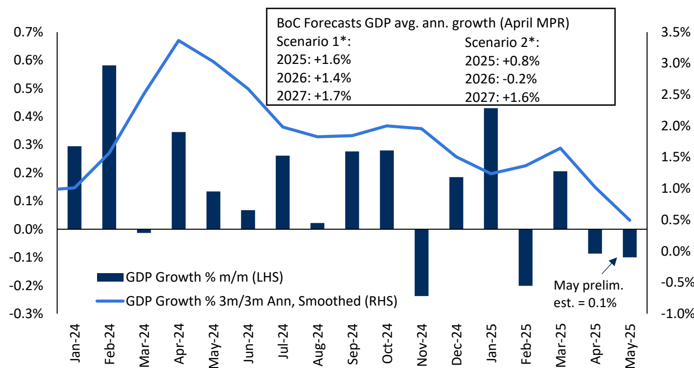
Preliminary estimates suggest GDP contracted by another 0.1% in May, reinforcing the view of a slight contraction in 2Q25. Even with March's GDP growth revised up to 0.2%, the back-to-back monthly declines in April and May, along with tariff uncertainty still looming and leading indicators showing signs of weakness, we remain aligned with Bank of Canada projections that essentially call for a stalling of the economy in 2Q25. On a more positive note, export orders to the U.S. could see a rebound in the coming months as more goods are certified as USMCA-compliant. However, it may be difficult to fully return to pre-tariff levels.

Retail Sales Continue to Rise in April with Signs of Softening Ahead

Continuing the trend from March, retail sales in Canada rose by 0.3% in April. The motor vehicle and parts dealers category led the increase for a second consecutive month, with sales up 1.9%, driven by strong performances at new (+2.9%) and used (+2.1%) car dealers, as consumers continued to advance their vehicle purchases in anticipation of tariff-related price increases. Gasoline sales continued to fall (-2.7%), mainly due to the carbon tax removal, as the volume of gasoline sales actually increased by 0.4%. Core retail sales, which exclude motor vehicle/parts and gasoline sales, ticked up slightly by 0.1% in April, continuing its upward trend for three consecutive months.

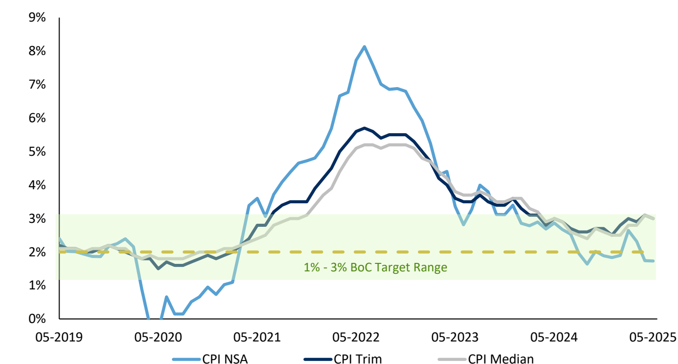
However, this might be the last positive reading before the tariff impact starts to show up in retail sales, as the preliminary estimates suggest a 1.1% decline in retail sales for May. This aligns with our view that consumer spending is likely to soften in 2Q25, as the financial stress indicators continued to rise towards the end of 1Q25. Additionally, the survey conducted by StatCan highlighted that the trade tensions between Canada and the U.S. are beginning to weigh on retail businesses. In April, 36% of retailers reported being affected, citing price increases, demand shifts, and supply chain disruptions as the major concerns. Notably, all nine retail sub-sectors reported experiencing some level of negative impact.

Chart 11 - GDP Contracts in April with Soft Momentum Heading into May



Source: Statistics Canada, Raymond James Ltd.; Data as of April 30, 2025.

Chart 12 - Core Inflation Eased in May but Remains Near Upper Bound of BoC Target Range



Source: Statistics Canada, Raymond James Ltd.; Data as of May 31, 2025.

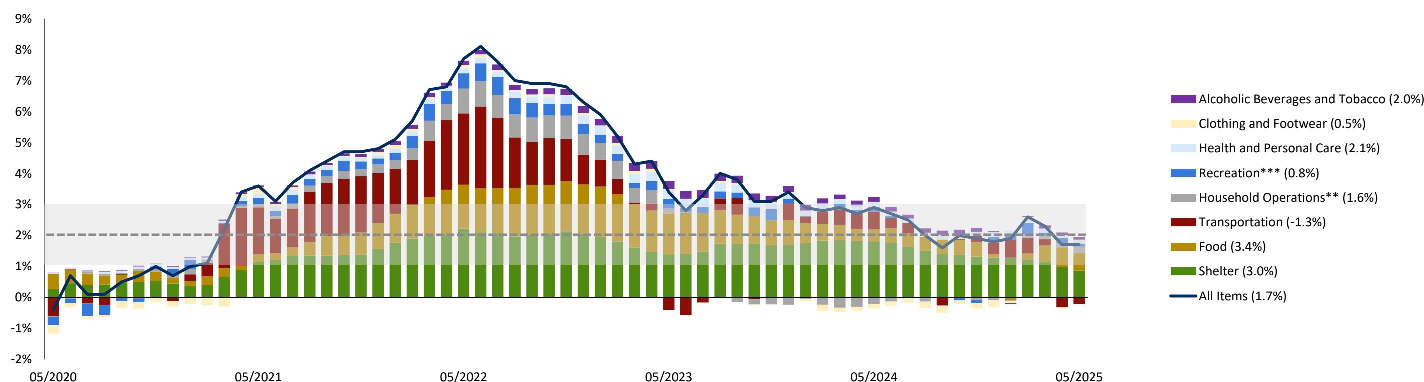
Core Inflation Starts Showing Signs of Cooling

Headline Consumer Price Index (CPI) inflation remained at 1.7% in May, holding below the Bank of Canada (BoC)'s 2% target for a second consecutive month, largely due to the removal of the federal carbon tax in April (Chart 13). Excluding energy, inflation eased from 2.9% in April, to 2.7% in May, pointing to some underlying cooling as well. The BoC's preferred core measures, CPI-trim and CPI-median, both eased down slightly from 3.1% in April, to 3.0% in May (Chart 12).

On a month-over-month basis, new passenger vehicle prices rose 0.5% (+4.9% y/y), potentially reflecting early effects of retaliatory motor vehicle tariffs. However, declines in airfares and travel tour prices helped limit the overall increase in transportation category to just 0.2% m/m. Shelter inflation continued to ease, with mortgage interest costs ticking lower and rent growth slowing to 4.5% y/y, down from 5.2% in April. Notably, the recent annual CPI basket re-weighting increased the influence of both durable goods (which includes motor vehicles) and shelter, meaning these categories will now have a slightly greater impact on headline inflation readings going forward.

Looking ahead, while certain categories may face upward price pressure from retaliatory tariffs, we expect overall inflation to continue easing as weaker consumer sentiment and wage expectations dampen demand, reduced U.S. sales redirect more supply to the Canadian domestic market, and a more cautious pace of rate cuts helps stabilize inflation.

Chart 13 - Major Components' Contributions to Canada CPI (Stacked Bars) and Latest Monthly CPI (Bracket Beside the Legend)



Source: Statistics Canada, Raymond James Ltd.; Data as of May 31, 2025. *Assumptions for both scenarios are in "Possible GDP impacts of tariffs in Canada" section; **Household operations, furnishing and equipment; ***Recreation, education and reading.

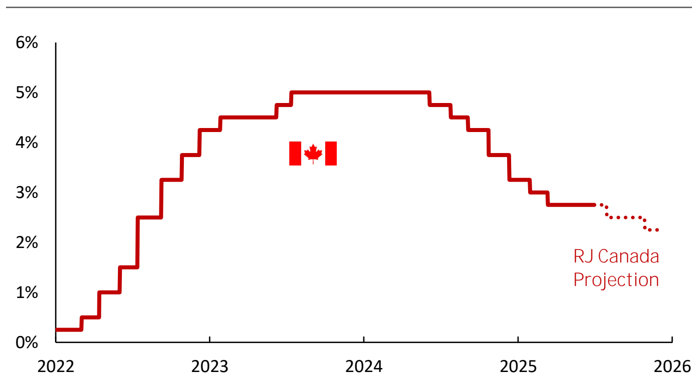
BoC Maintains a Cautious Stance

The Bank of Canada held its policy rate at 2.75% for a second consecutive meeting in June, maintaining a cautious approach amid persistent economic uncertainty and evolving inflation dynamics. According to the Bank's Summary of Deliberations, three key considerations shaped the June decision: elevated uncertainty, a softer economic backdrop, and a recent uptick in underlying inflation. While the economy continues to show signs of strain, particularly in the labour market, the Governing Council expressed concern that cost pressures stemming from trade disruptions could keep inflation elevated for longer than previously expected.

The Bank emphasized that further rate cuts remain on the table, but only if economic weakness deepens and inflationary pressures ease. The members noted that if the recent firmness in core inflation persists, it would be more difficult to justify rate cuts. Conversely, if the effects of U.S. tariffs and uncertainty continue to weigh on growth while cost pressures remain contained, further reductions in the policy rate may be warranted.

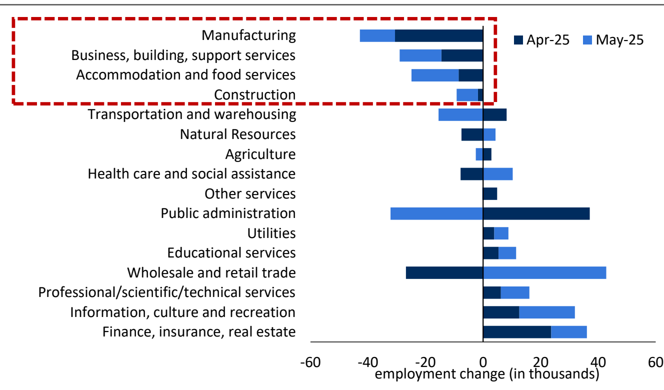
Looking ahead, we maintain our projection that the BoC will continue to lower the policy rate throughout the remainder of the year as economic weakness becomes more evident, while inflation remains relatively contained, ending 2025 at 2.25%. While the pace of cuts may slow, the direction remains clear given growing signs of economic softness (Chart 14).

Chart 14 - BoC Maintains 2.75% Rate for Second Time This Year



Source: FactSet, Raymond James Ltd.; Data as of June 30, 2025.

Chart 15 - Tariff-exposed Sectors Shed Most Jobs in April and May



Source: Statistics Canada; Raymond James Ltd.; Data as of May 31, 2025.

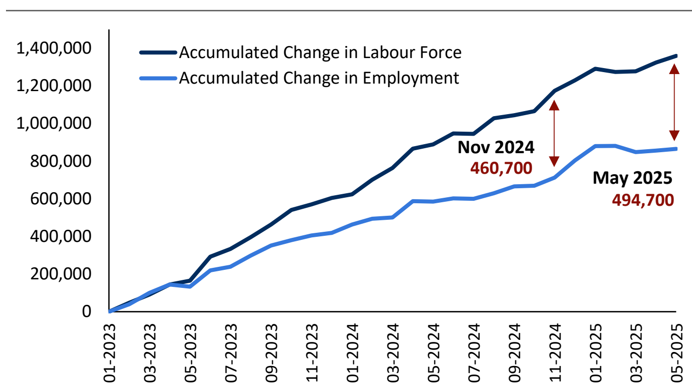
Labour Market Weakness Persists

The Canadian labour market showed further signs of weakening in May, with the unemployment rate rising by another 0.1 percentage points to 7.0% — the highest level since September 2016 (excluding the pandemic period). This marks the third consecutive monthly increase in the unemployment rate. In May, the employment losses remained concentrated in trade-sensitive sectors, including the manufacturing sector (-12.2k) and transportation and warehousing (-15.5k), with manufacturing alone shedding 42.8k jobs over the past two months (Chart 15). In contrast, employment in wholesale and retail trade did well in May (+43k), supported by resilient domestic consumer spending last month. Wage growth remained unchanged at 3.4% y/y in May, matching April's pace and marking the slowest y/y increase since April 2022 (not seasonally adjusted).

The labour market data showed signs of a broader slowdown in hiring activity as well. The average duration of unemployment rose to 21.8 weeks, up from 18.4 weeks a year earlier. Out of those who were unemployed in April, only 22.6% transitioned into employment in May — well below the pre-pandemic average of 31.5% for the same time of year. Youth continued to face challenges in the labour market as the unemployment rate for individuals aged 15 to 24 rose to 14.2%, while the unemployment rate for returning students (students who attended school full time in March and who intend to return to school full time in the fall) reached 20.1%, — the highest since the 2009 recession (excluding the pandemic).

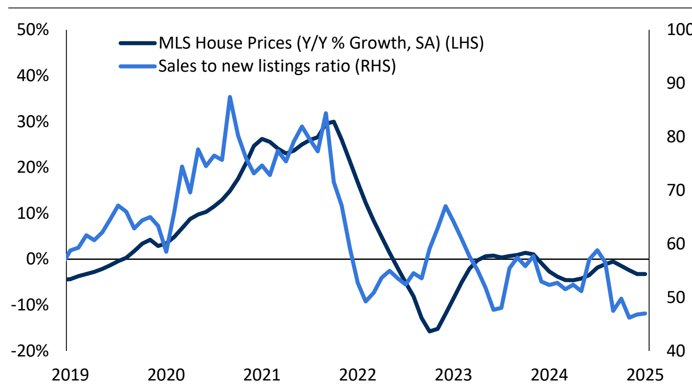
While labour force growth remained modest at 0.2% m/m, the continued weakness in employment gains has widened the gap between cumulative labour force and employment growth for the third consecutive month (Chart 16). As we have been mentioning, even under our base case assumption that each round of threats can be managed with negotiations or that enacted tariffs will be relatively short-lived, it will, unfortunately, cause layoffs and deferrals in adding workers, and we are not expecting any significant improvements in this metric over the short-term.

Chart 16 - Employment Growth Continues to Remain Flat



Source: Statistics Canada, Raymond James Ltd.; Data as of May 31, 2025.

Chart 17 - National Sales-to-New Listings Ratio Held Steady in May



Source: CREA, Raymond James Ltd.; Data as of May 31, 2025

Population Growth Slows

Canada's population growth slowed for the sixth consecutive quarter, increasing by ~20k in 1Q25, to just over 41.5 million people, and the lowest quarterly increase since the pandemic. After several years of record-breaking population growth, Canada started limiting temporary residents in 2024, and there are now just under 3.0 mln, representing 7.1% of the population, down from a peak of 7.4%. Still, Canada admitted 104k immigrants in 1Q25, lost ~6k from natural birth/deaths, and saw temporary residents decline by 61k, mostly from people holding study permits.

Population growth can matter depending on the make-up of people entering and leaving the workforce, as well as against the infrastructure, including housing, available to support that population. If population growth favours professionals, such as engineers and doctors, and skilled tradespeople or entrepreneurs, we can see much more immediate benefit than by increasing the number of students - despite what might be longer-term benefits depending on fields of study and if those students remain in Canada after they graduate. Also, a significant impact on rapidly increasing population growth, such as we saw from 2022 to 2024, without an equivalent increase in housing, has resulted in both housing shortages and severe affordability issues in certain areas.

Housing Market Shows Signs of Improvement, but it's Still Expensive

After months of subdued activity, the housing market showed some signs of improvement in May. National home sales rose by 3.6% m/m in May, marking the first monthly increase in demand since November of last year. This rebound helped ease downward pressure on prices, with the MLS Home Price Index (HPI) declining by just 0.2%, following a series of more substantial monthly drops.

On the supply side, new listings also picked up, rising 3.1% m/m in May. With both sales and new supply increasing at a similar pace, the national sales-to-new listings ratio held steady at 47% (Chart 17), remaining near the levels seen in April. However, despite the improvement this month, overall sales activity remains down 11% on a year-to-date basis.

While recent policy measures such as the First-Time Home Buyer GST Rebate and lower mortgage rates are expected to support affordability and demand, risks remain on the supply side of the market. Rental prices have been declining across all major cities, and with immigration levels expected to reduce further, downward pressure on rents may persist in the near-term. This outlook could also dampen investor interest in pre-construction sales which developers rely on to secure financing.

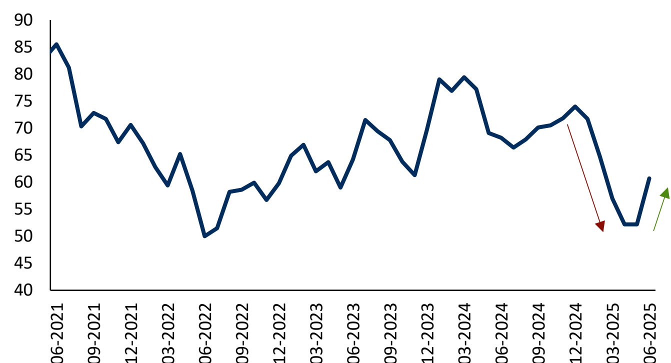
A new report from the Canada Housing and Mortgage Corporation (CMHC) indicates that housing starts need to almost double to 430,000 to 480,000 per year, from 250,000 currently, until 2035 to bring affordability. The organization has also revised its previous goal of bringing affordability back to 2004 levels. Instead, the aim is now to bring levels of affordability at which adjusted house prices (homebuying affordability ratios) are either (1) no higher than 30% of average gross household income, or (2) no higher than their 2019 levels, in the more unaffordable regions (B.C., parts of Ontario, and Montreal). In 2024, the average house payment and homeowner expenses in Vancouver, as a percentage of income, was 99%. With CMHC's 2035 affordability target, that would be brought down to 71%. The second most expensive city was Toronto with a 2024 ratio of 74% and 2025 target of 59%.

The U.S. — 1Q25 GDP Revised Down Amid Weak Consumer Spending and Exports; Sentiment Rebounds in June

U.S. real GDP growth in 1Q25 was revised down to -0.5% in the third estimate from -0.2% in the second estimate, primarily reflecting downward revisions to consumer spending and exports that were partly offset by a downward revision to imports. Post revision, the real personal consumption expenditures (PCE) rose by just 0.5%, significantly below the earlier estimate of 1.2%, with services consumption contributing only 0.6% growth. Export growth was also revised down to 0.4%, from 2.4% previously. As a result, the contribution of real PCE to GDP was halved to 0.3% in the revised estimate.

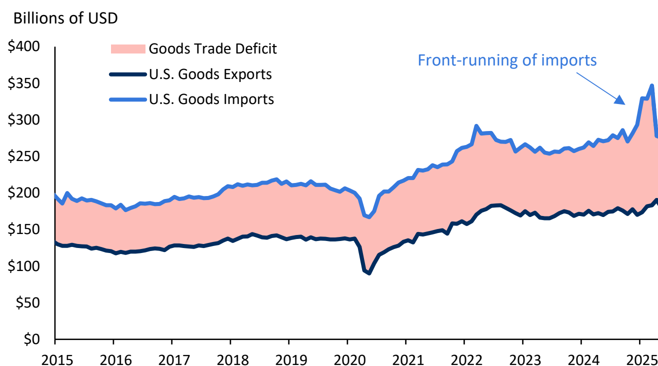
Nonetheless, the U.S. consumer sentiment rebounded in June, rising 16.3% to 60.7, the largest monthly gain in over three decades (Chart 18). This marks the first increase in six months and could reflect some improved expectations for personal finances and business conditions. However, sentiment remains 18% below the post-election high in December 2024 and 11% lower than a year ago. On a positive note, inflation expectations have moderated. Year-ahead expectations fell from 6.6% to 5.0%, while long-run expectations eased to 4.0%, both at their lowest levels in several months.

Chart 18 - Consumer Sentiment Starts to Improve in June



Source: University of Michigan, FactSet, Raymond James Ltd.; Data as of June 30, 2025.

Chart 19 - Advanced Data Points to an Expansion in Trade Deficit as U.S. Exports Fall in May



Source: Bureau of Economic Analysis, United States Census Bureau, Raymond James Ltd.; Data as of May 31, 2025.

Trade Deficit Widens in May as Exports Decline

Following April's sharp narrowing, advanced data from the U.S. Census Bureau shows that the U.S. goods trade deficit widened again in May, rising 11.1% to US$96.6 billion (Chart 19). The increase was driven by a US$9.7 billion drop in exports, which fell to US$179.2 billion, while imports remained relatively flat at US$275.8 billion. This reversal follows April's sharp contraction, which had largely reflected a pullback in imports after businesses front-loaded shipments ahead of the tariffs.

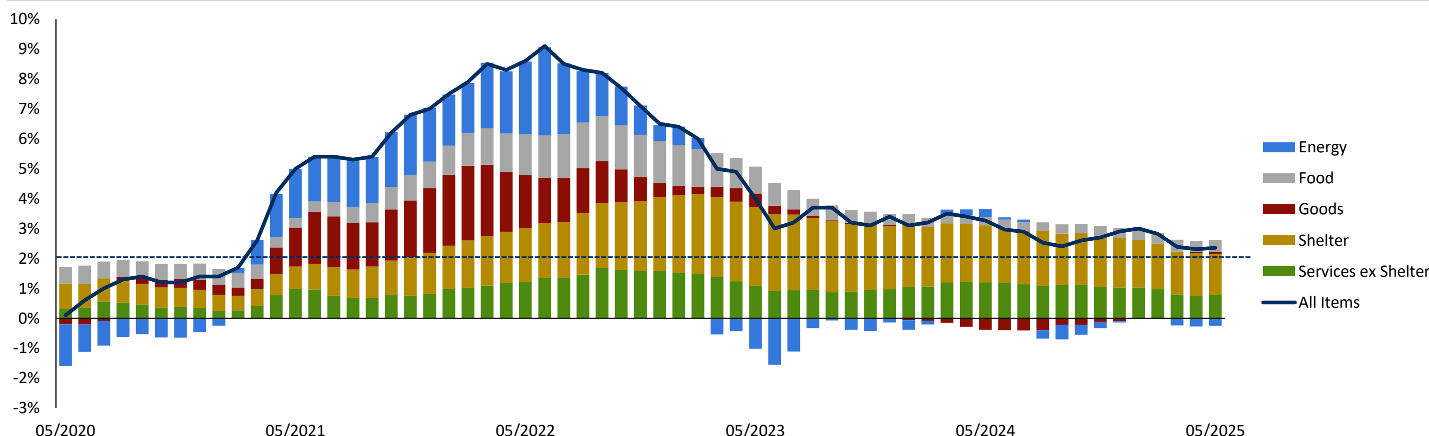
With that front-loading now behind us, we expect import levels to remain modest, easing pressure on the trade deficit. However, as the data from May suggests, a meaningful increase in exports appears unlikely for now — an outcome that may not align with the Trump administration's intended goals.

Tariff Pass-Through to Consumer Prices Remains Contained — for Now

The headline Consumer Price Index (CPI) rose 2.4% y/y in May, slightly up from 2.3% in April (Chart 20). Core CPI remained flat at 2.8% y/y for the third consecutive month. While there were isolated signs of tariff-related price increases, such as a 4.3% m/m jump in major appliance prices and a 2.2% m/m increase in toy prices, core goods inflation was flat overall, as the aforementioned increases were largely offset by declines in used vehicle prices and new car and truck prices, despite the imposition of vehicle tariffs. The Fed's preferred inflation measure, core PCE (which excludes food and energy), rose by a more than expected 0.2% m/m in May, while on a year-over-year basis, the core PCE price index increased by 2.7% in May, up from 2.6% in April.

Looking ahead, while some firms have signaled upcoming price hikes, the limited pass-through of tariffs so far and softening services inflation suggest that core inflation may rise only gradually in the near term. However, risks remain tilted to the upside if tariff impacts broaden.

Chart 20 - Major Components' Contributions to U.S. CPI

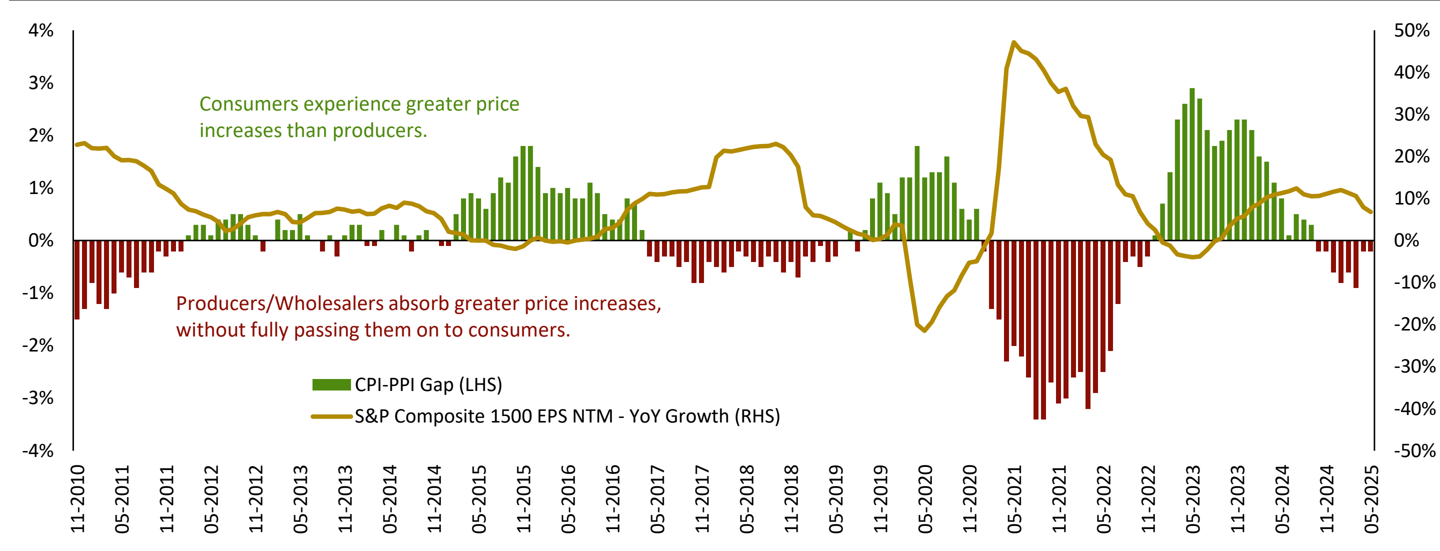


Source: U.S. Bureau of Economic Analysis, Raymond James Ltd.; Data as of May 31, 2025.

To gauge how inflationary pressures are distributed along the supply chain and to consumers, we monitor the gap between the Consumer Price Index (CPI) and the Producer Price Index (PPI). While the PPI reflects price changes at the producer/wholesale level, the CPI captures the prices ultimately paid by consumers. Data from the recent months shows a negative CPI-PPI gap, indicating that producer prices have been rising faster than consumer prices (Chart 21). This suggests that wholesalers and manufacturers are currently absorbing a higher portion of the tariff-related cost increases rather than fully transferring them to end consumers yet. Historically, a negative CPI-PPI gap tends to put downward pressure on corporate profit margins, leading to slower profitability growth in the near term.

As things stand now, the extent to which rising upstream costs are passed on to consumers will largely depend on the demand conditions. In a weaker economic backdrop, subdued demand may force producers/wholesalers to absorb a greater proportion of tariff-related costs. On the other hand, if the demand remains resilient, a larger proportion of these costs is likely to be transferred to the end consumer, potentially resulting in a delayed uptick in consumer prices and CPI inflation.

Chart 21 - CPI-PPI Gap Indicates Tariff Costs Have Yet to Reach Consumers Fully



Source: U.S. Bureau of Labor Statistics, FactSet, Raymond James Ltd.; Data as of May 31, 2025.

Fed Continues to Hold Rates For Now

At its June 18 meeting, the Fed left the federal funds target range unchanged at 4.25-4.50%, maintaining its "wait and see" approach. The Fed acknowledged that the full impact of tariffs remains uncertain, with potential effects on prices, supply chains, and consumer behaviour still unfolding, while reiterating that the current policy stance gives the Fed room to respond to changing conditions.

The Fed's updated Summary of Economic Projections (SEP) revealed a relatively subdued outlook for the U.S. economy as compared to the March projections. Real GDP growth forecasts were revised downward from 1.7% to 1.4% for 2025, and from 1.8% to 1.6% for 2026. At the same time, inflation expectations moved higher, with projected PCE inflation revised upward from 2.7% to 3.0% in 2025, and from 2.2% to 2.4% in 2026. The projected unemployment rate also edged up to 4.5% in both 2025 and 2026 (compared to 4.4% and 4.3% respectively, in the March SEP).

The median dot plot continues to signal two rate cuts in 2025. However, Chair Powell emphasized that the path forward remains highly data-dependent, and also acknowledged that the Fed remains alert to the possibility that its dual mandate — price stability and maximum employment — could come into tension. While refraining from indicating which side of the mandate would take precedence, Chair Powell stated that the priority would depend on how far the economy is from each objective and the expected time frames over which those gaps are likely to close.

Overall, the Fed appears well-positioned to wait for more clarity on the economic impact of tariffs before making further moves. While rate cuts remain on the table, the bar for action has likely risen given the Fed's worries about the potential inflationary pressure from tariffs.

Labor Market Remains Resilient, but Signs of Softening Emerge

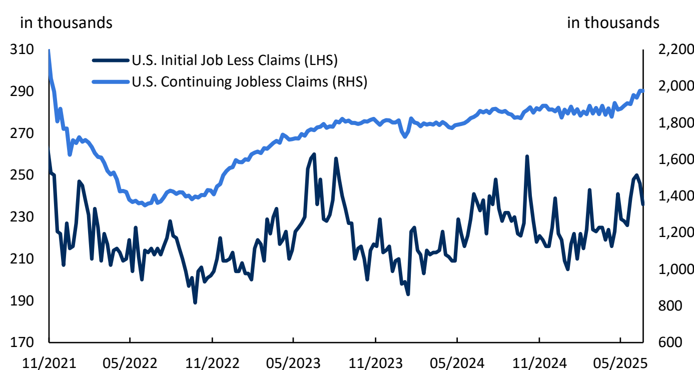
The U.S. employment data continues to look strong, but unemployment is creeping upwards. While initial jobless claims remained low for the week ending June 28, at 233k, and the 4-week moving average came down to 242k (from prior 245k), continuing claims continued to rise to 1.974 million (to June 14) and remained unchanged in the following week (to June 21) (Chart 22). The ADP employment report for June showed a decline

of 33k in U.S. private sector employment — the first monthly contraction since March 2023. While layoffs remain uncommon, the report highlighted a growing reluctance among private sector employers to hire or replace departing workers, resulting in a net reduction in private payrolls.

The June employment report, published July 3 by the U.S. Bureau of Labor Statistics, reiterated the strength in the U.S. labour market but showed signs of narrowing (Chart 23). While the non-farm payrolls rose by 147k, job gains were heavily concentrated in government (+73k) and health care and social assistance (+59k). Job additions in the private sector remained subdued, with manufacturing employment falling (-7k) for the second consecutive month, along with modest gains in retail trade (+2k) and transportation/warehousing (+8k). Despite a significant increase in population, the labour force shrank by 130k in June, and combined with the job gains, this led to a drop in the unemployment rate to 4.1%.

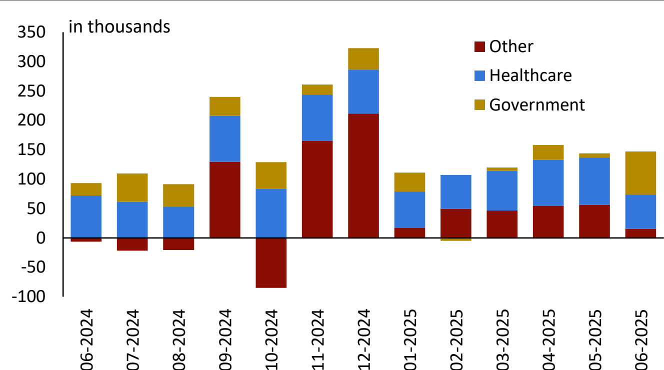
The readthrough is that even though we are not seeing significant layoffs, we are not seeing employers, especially in the private sector, add jobs to keep up with population growth, and therefore it is taking longer for the unemployed to find jobs. With the potential for employers to move from just not hiring, to an acceleration in layoffs, we could start to see more substantial increases in the still currently low U.S. unemployment rate.

Chart 22 - Ongoing Rise in Continuing Jobless Claims Despite Steady Initial Claims



Source: FRED, Raymond James Ltd.; Data as of June 20, 2025.

Chart 23 - Change in U.S. Non-Farm Payrolls



Source: Capital Economics, Raymond James Ltd.; Data as of June 30, 2025.

Financial Markets

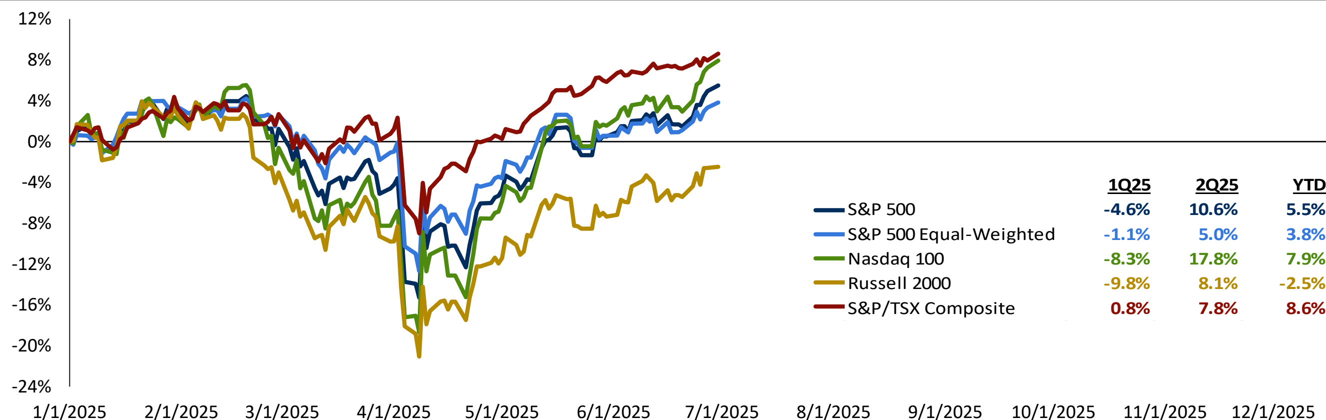
In June, both the TSX Composite, Canada's main stock market index, and the S&P 500, the leading U.S. large-cap benchmark, made new highs, thanks to the overall positive progress made on the trade negotiation front and the upcoming pro-cyclical fiscal support. The TSX delivered a 2.6% price return and a 2.9% total return, boosting the year-to-date price return to 8.6% and 10.2%, respectively. Meanwhile, the S&P 500 posted a 5.0% price return and a 5.1% total return for the month. Its year-to-date price return turned positive at 5.5%, with a total return of 6.2%, all in local currency.

In the TSX Composite, cyclical sectors such as Information Technology, Consumer Discretionary, and Financials outperformed, supported by Canada's economy holding up better than expected. Materials also gained, due to a heavy weighting in gold, following Israel's strike on Iran. Meanwhile, defensive sectors like Consumer Staples and Utilities continued to lag. In the S&P 500, Information Technology and Communication Services benefited from renewed optimism around A.I., while defensive sectors such as Consumer Staples and Utilities underperformed. Real Estate also lagged, weighed down by elevated policy rates.

In June, among the major equity indices, the tech-heavy Nasdaq 100 and the Russell 2000, which tracks U.S. small-cap stocks, led the way as investor interest in risk assets picked up. With the S&P 500 rally being relatively narrow, it outperformed its equal-weighted counterpart. In the first half of 2025, despite an early sell-off in tech, the Nasdaq 100 and S&P 500 have reclaimed their leadership positions, while the equal-weighted S&P 500 has slightly lagged. The Russell 2000, meanwhile, remains in negative territory.

In the second quarter of 2025, the TSX Composite delivered a 7.8% price return and an 8.5% total return, trailing the S&P 500, which gained 10.6% in price and 10.9% in total return, all in local currency terms. However, when measured in a common currency, the TSX Composite outperformed the S&P 500, due to recent U.S. dollar weakness, driven by weakening confidence in the U.S. economy and markets.

Chart 24 - Selected Indices Price Returns



Source: FactSet, Raymond James Ltd.; Data as of June 30, 2025. Price return in local currency.

U.S. Equity Markets

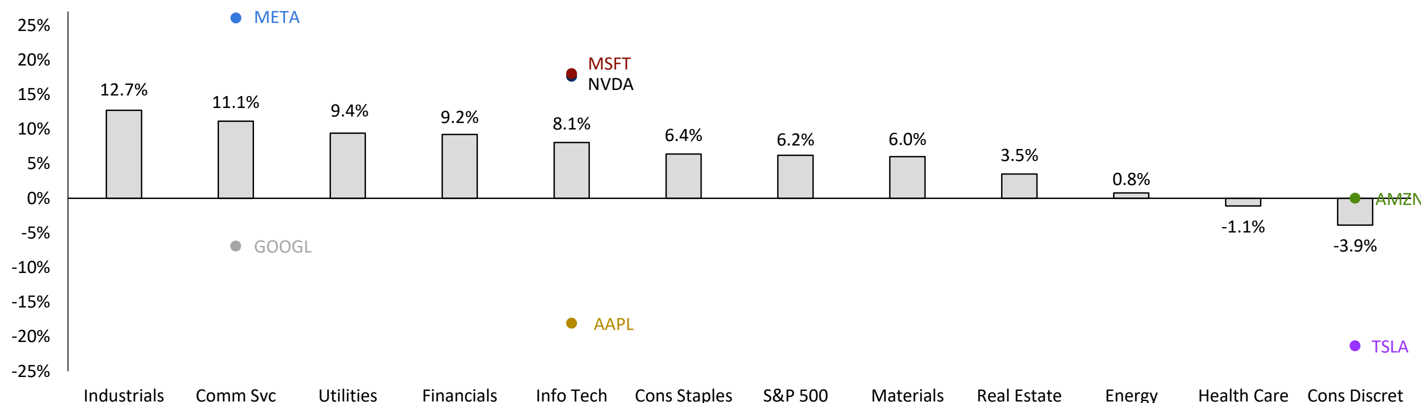
The key U.S. equity market index, the S&P 500, has fully recovered from its 19% intra-year decline after the Liberation Day tariff announcement, reaching a new high on June 27, 128 days after its previous peak on February 19, 2025. As market focus gradually shifts from tariff concerns to positive pro-cyclical fiscal measures like tax reform and eventual monetary easing, investor sentiment toward U.S. equities is showing signs of renewed optimism. This is particularly evident in large-cap cyclical and A.I.-related stocks. In June, the S&P 500 outperformed the major equity indices of the U.K., Germany, and the Eurozone. While the outperformance was more pronounced in local currency terms, the gap narrowed when measured in a common currency due to the weakening of the U.S. dollar.

We remain cautiously optimistic about the S&P 500's performance for the remainder of 2025. However, it's important to highlight that the current rally is relatively narrow. While the index continues to hit new highs, the median number of individual stocks hitting new highs each day has remained subdued since December 2024, at just 13, with a range between 0 and 60. This is notably lower than during the first eleven months of 2024, when the median was 40 and the range spanned from 0 to 130. Given this narrow leadership, the market may be more vulnerable to shifts in sentiment. Any negative developments, whether related to tariff negotiations, geopolitical tensions, economic data, or changes in fiscal and monetary policy, could quickly alter the current narrative. That's why we continue to emphasize the importance of staying diversified across sectors and, within each sector, being selective by focusing on high-quality companies in the near term. Over the longer run, however, we see A.I. as an overarching investment theme. As such, we maintain a favourable view on industries tied to A.I. innovation and adoption.

The 2Q25 earnings report season will kick off around July 14. Consensus estimates for S&P 500 earnings per share (EPS) have been revised down from US$65.3 at the start of the quarter to US$62.5 currently. This still reflects a 4.8% year-over-year increase, but a 1.2% decline quarter-over-quarter. The 4.8% year-over-year growth marks a significant slowdown compared to 12.9% in 1Q25 and the 2024 quarterly average of 11.1%, highlighting concerns about the impact of tariffs on corporate profitability. That said, analysts still view the impact as manageable at this stage. Meanwhile, full-year 2025 EPS estimates have remained stable at around US$263 over the past two months, implying a 9.4% increase compared to CY2024. The notable weakening of the U.S. dollar, with the DXY index down about 11.9% since mid-January, could affect the S&P 500 in two key ways. While the weaker dollar has weighed on the index's year-to-date performance when measured in a common currency, it also provides a potential tailwind for earnings. This is largely due to the S&P 500's significant foreign revenue exposure, which stands at around 40%.

When it comes to U.S. mid-caps, we still see them as a solid long-term opportunity for investors seeking diversification beyond large caps. However, in the near term, there are a few concerns. Mid-caps have significant exposure to the industrial sector, which initially seemed like a strength under the re-industrialization theme. But mid-cap industrials have a much higher share of cost of goods sold (COGS) coming from outside the U.S. around 60%, compared to 40% for large-cap industrials. This makes their profitability more vulnerable to tariffs. Additionally, we don't believe the A.I.-driven rally has run its course yet, and mid-caps tend to have relatively limited exposure to the tech sector, which could cap their upside in that area. As for U.S. small caps, we think their performance will remain highly sensitive to the current macro environment, which could lead to elevated volatility. In our view, new catalysts will be needed to drive sustained outperformance in that space.

Chart 25 - S&P 500 Sector and "Magnificent Seven" Year-to-Date Total Returns



Source: FactSet, Raymond James Ltd.; Data as of June 30, 2025.

Canadian Equity Markets

The TSX Composite extended its upward momentum in June, posting a 2.9% total return for the month. This strong performance contributed to an impressive 8.5% total return for 2Q25. Despite heightened uncertainty around global trade at the start of the quarter, cyclical sectors delivered solid gains as trade negotiations between the U.S. and Canada showed relatively encouraging progress. Information Technology, Consumer Discretionary, and Financials led the way, supported by several tailwinds, including renewed optimism around A.I., easing trade tensions, and stronger-than-expected economic resilience, all of which contributed to their outperformance. On the other hand, Energy underperformed due to weak demand expectations amid slowing global growth. Communication Services and Consumer Staples also lagged, as concerns around growth prospects and profitability weighed on forward-looking earnings estimates.

With trade negotiations between President Trump and Prime Minister Carney still ongoing, uncertainty continues to weigh on Canadian equities. While Canada may have avoided the worst-case scenario of a deeper GDP contraction beginning in 2Q25, it remains too early to fully gauge the impact of tariffs on the broader economy and corporate earnings. The knock-on effects from weaker manufacturing sales and exports will take time to filter through. In the near term, maintaining diversification across sectors remains key. Over a longer investment horizon, however, we continue to favour industries tied to A.I. and those positioned to benefit from increased national defence and infrastructure spending.

Top 3 Sectors (2Q25):

- **Info Tech:** The sector posted strong gains in Q2 2025, supported by signs of easing trade tensions between the U.S. and China—particularly following the May 12 trade truce. With its substantial U.S. revenue exposure and cyclical profile, the sector was well-positioned to benefit from the improved sentiment. Renewed excitement around artificial intelligence also added momentum, offering a potential tailwind for future growth. However, near-term volatility remains possible, depending on the direction of the broader economy.
- **Consumer Discretionary:** The sector posted gains in every month of 2Q25. While April's performance was largely driven by discount retailers, the strength in May and June was more broad-based. While the earnings outlook showed modest improvement during the quarter, Consumer Discretionary remains among the sectors with the largest year-to-date decline in forward EPS. Our outlook remains somewhat cautious. Although the initial shock of tariff uncertainty may have passed, the actual economic impact is likely to emerge in 2H25. The automobile components industry continues to appear most directly affected by U.S. tariffs, while industries such as apparel, leisure products, and specialty retail may face increasing pressure as the broader economic effects of tariffs begin to weigh on consumer demand.
- **Financials:** The strength in this sector was broad-based. Banks, being cyclical in nature, benefited from the Canadian economy's stronger-than-expected resilience. Although uncertainty from tariffs may have temporarily stalled loan growth, previous rate cuts by the BoC, along with market expectations for further easing, helped lower bank funding costs, alleviating some pressure on profitability. Additionally, banks had proactively increased provisions for credit losses (PCLs) in anticipation of a potential recession or significant economic slowdown, but the trade tensions have not yet triggered financial system stress, which has bolstered market confidence in the banks' future earnings potential. Furthermore, the strong rebound in major equity indices in both the U.S. and Canada since April 8, with new highs being reached, has supported a recovery in Capital Markets industry performance since the end of April.

Bottom 3 Sectors (2Q25):

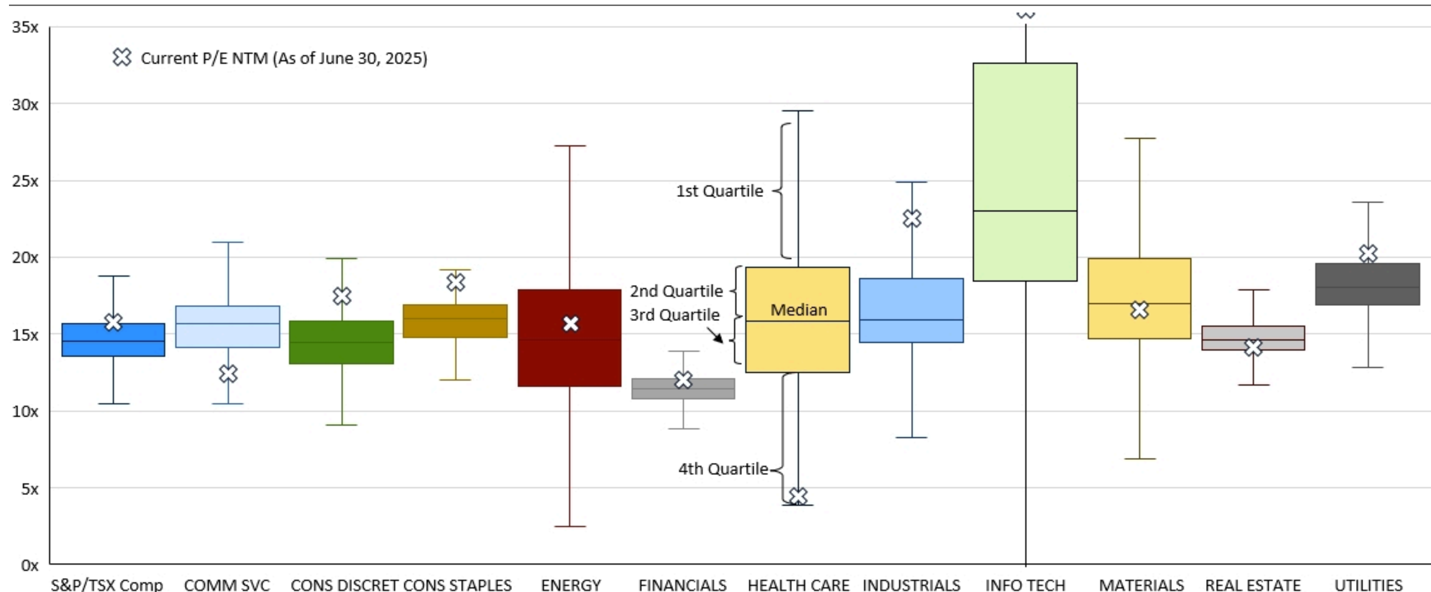
- **Energy:** Although the conflict between Iran and Israel caused a temporary spike in oil prices in June, prices quickly retreated following the announcement of a ceasefire. While any renewed tensions in the Middle East could trigger another surge, the combination of rising OPEC+ supply and subdued global demand growth is likely to keep oil prices relatively contained for the remainder of the year, unless there is a major positive development on the tariff front.
- **Communication Services:** Although this sector is relatively well-insulated from the impact of tariffs, intensified rivalry remains a strong headwind, resulting in reduced pricing power and consequently weaker revenue. With slower population growth this year, a strong recovery in this sector seems unlikely in the near future.
- **Consumer Staples:** After leading the market in April, this traditionally defensive sector lost momentum in May and June as easing tariff concerns prompted a rotation into more cyclical sectors. While earlier concerns about grocers' profit margins, stemming from potential retaliatory tariffs, have started to ease alongside improving U.S.-Canada trade relations, other challenges persist. Shifts in consumer behaviour toward discounts and promotions continue to weaken grocers' pricing power and profitability. These pressures could intensify if the economy slows further. As a result, careful consideration of individual company's profitability within the sector is increasingly important.

Table 3 - S&P/TSX Composite Sector Performance and Valuations (Ranked by 2Q25 Total Return)

Sector Name	Sector Weight	YTD Total Return	2Q25 Total Return	1M Total Return	Current P/E NTM	Historical P/E NTM
Information Technology	9.8%	5.7%	14.2%	4.9%	37.2	23.0
Consumer Discretionary	3.4%	13.9%	14.1%	3.7%	17.8	14.4
Financials	32.8%	10.7%	12.1%	3.6%	12.4	11.4
S&P/TSX Composite	--	10.2%	8.5%	2.9%	16.0	14.5
Industrials	12.8%	6.0%	8.1%	0.3%	22.8	15.9
Materials	13.5%	30.1%	8.1%	3.7%	16.5	16.9
Real Estate	1.8%	3.2%	4.9%	1.4%	14.1	14.6
Utilities	3.8%	10.0%	4.8%	0.2%	20.2	18.0
Consumer Staples	3.7%	4.1%	4.6%	-2.1%	18.2	16.0
Health Care	0.3%	-6.1%	3.1%	9.4%	4.7	15.8
Communication Services	2.2%	4.8%	2.6%	2.9%	12.5	15.7
Energy	15.9%	4.0%	1.3%	3.4%	16.0	14.6

Source: FactSet, Raymond James Ltd.; Data as of June 30, 2025. The S&P/TSX Healthcare sector has been excluded from the performance commentary due to its minimal representation in the S&P/TSX Composite Index.

Chart 26 - S&P/TSX Composite Sector Current vs. Historical P/E NTM



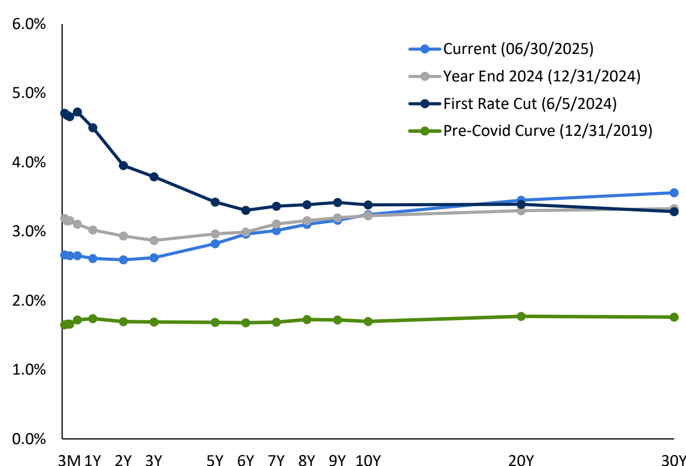
Source: FactSet, Raymond James Ltd.; Data as of June 30, 2025. Historical P/E: 1/1/2000 – 06/30/2025. Excluding outliers.

Fixed Income & Treasury Yields

The U.S. Treasury yield curve for maturities greater than one year saw a noticeable decline in June, partially recovering from a poorly received Treasury auction and the downgrade from Moody's in May. However, the term premium, which measures duration risk (the amount by which the yield on a long-term bond exceeds that of shorter-term bonds), remained quite high during 2Q25 compared to the beginning of the year. The elevated term premium reflects market concerns about the U.S. fiscal position as the "One Big Beautiful Bill" moves through the Senate and House, as well as perceived threats to the Fed's independence. Neither of these concerns appears to pose an imminent crisis as Treasury auctions in June still showed steady demand. However, these issues lead us to expect that the U.S. 10-year yield may remain in the 4% to 4.5% range for an extended period. The front end of the curve moved only modestly during the quarter, as the Fed remains in a wait-and-see mode.

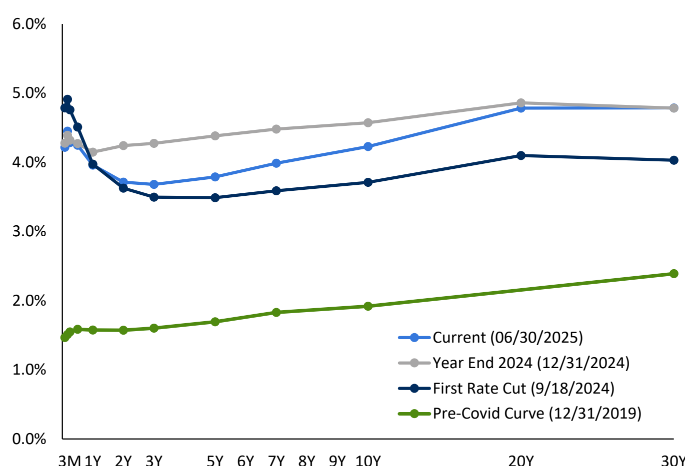
In Canada, yields at the intermediate and long ends of the curve edged higher in June, likely reflecting concerns over elevated inflation and increased fiscal spending. However, the most notable movement during 2Q25 was the rebound in yields for short- to intermediate-term maturities, as tariff-related concerns somewhat eased. Similar to the Federal Reserve, the BoC has adopted a patient stance, resulting in minimal movement at the front end of the curve.

Chart 27 - Canada Government Yield Curves



Source: Factset, Raymond James Ltd.; Data as of June 30, 2025.

Chart 28 - U.S. Treasury Yield Curves



Source: Factset, Raymond James Ltd.; Data as of June 30, 2025.

Table 4 - Global Equities Performance

Select Global Equity Indices	Jun (in LCL)	Jun (in USD)	Jun (in CAD)	2Q25 (in LCL)	2Q25 (in USD)	2Q25 (in CAD)	YTD (in LCL)	YTD (in USD)	YTD (in CAD)	Current PE NTM	Historical PE Median	Premium (RED) / Discount (GREEN)
Major Aggregates												
World (Global)*	4.4	4.4	3.6	11.4	11.4	5.7	9.8	9.8	4.1	19.6	16.0	3.6
EAFE (DM ex U.S. & Canada)*	2.5	2.5	1.7	11.5	11.5	5.7	20.4	20.4	14.2	14.8	13.6	1.2
EM (Emerging Markets)*	6.6	6.6	5.8	11.3	11.3	5.5	15.6	15.6	9.7	12.9	11.8	1.1
Selected Developed Markets												
Nikkei 225 (Japan)	6.8	6.7	5.9	13.9	17.9	11.8	2.6	11.6	5.9	21.0	18.9	2.2
Euro STOXX 50 (Europe)	-1.1	2.2	1.4	3.2	9.8	4.1	11.0	22.8	16.5	15.5	13.2	2.2
FTSE 100 (U.K.)	0.0	1.5	0.7	3.2	8.4	2.7	9.5	17.3	11.3	12.7	12.3	0.4
CAC 40 (France)	-0.9	2.5	1.7	1.0	9.7	4.0	6.8	21.1	14.9	15.4	13.5	1.9
DAX (Germany)	-0.4	3.0	2.2	7.9	17.2	11.1	20.1	35.8	28.8	15.5	12.7	2.8
Hang Seng (Hong Kong)	4.1	4.0	3.2	5.8	4.9	-0.6	22.9	21.6	15.3	10.6	11.8	-1.1
Selected Emerging Markets												
CSI 300 (China)	3.3	3.8	2.8	2.4	3.7	-1.7	1.4	3.3	-2.2	13.7	13.7	0.0
Nifty 50 (India)	3.4	3.2	2.2	9.1	8.9	3.7	8.8	8.6	2.9	22.2	19.0	3.3

Source: FactSet, Raymond James Ltd; Total returns, data as of June 30, 2025. LCL: listed in local currency. Historical P/E Median: 1/1/2000 – 6/30/2025. *Indices are represented by their corresponding iShares ETFs, serving as proxies.

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