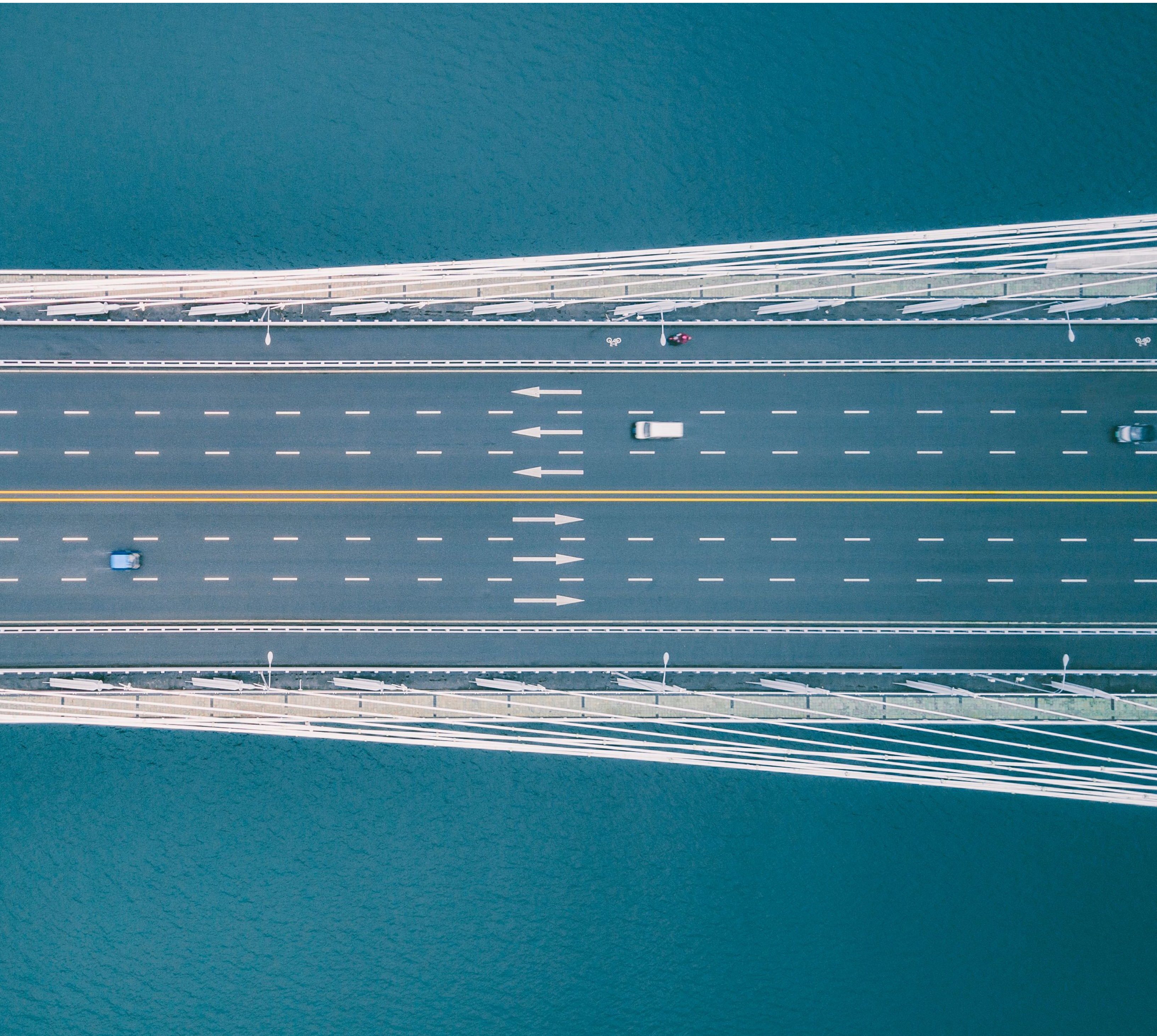
CIBC ASSET MANAGEMENT

Perspectives

Quarterly economic views and asset class outlook

Spring 2025



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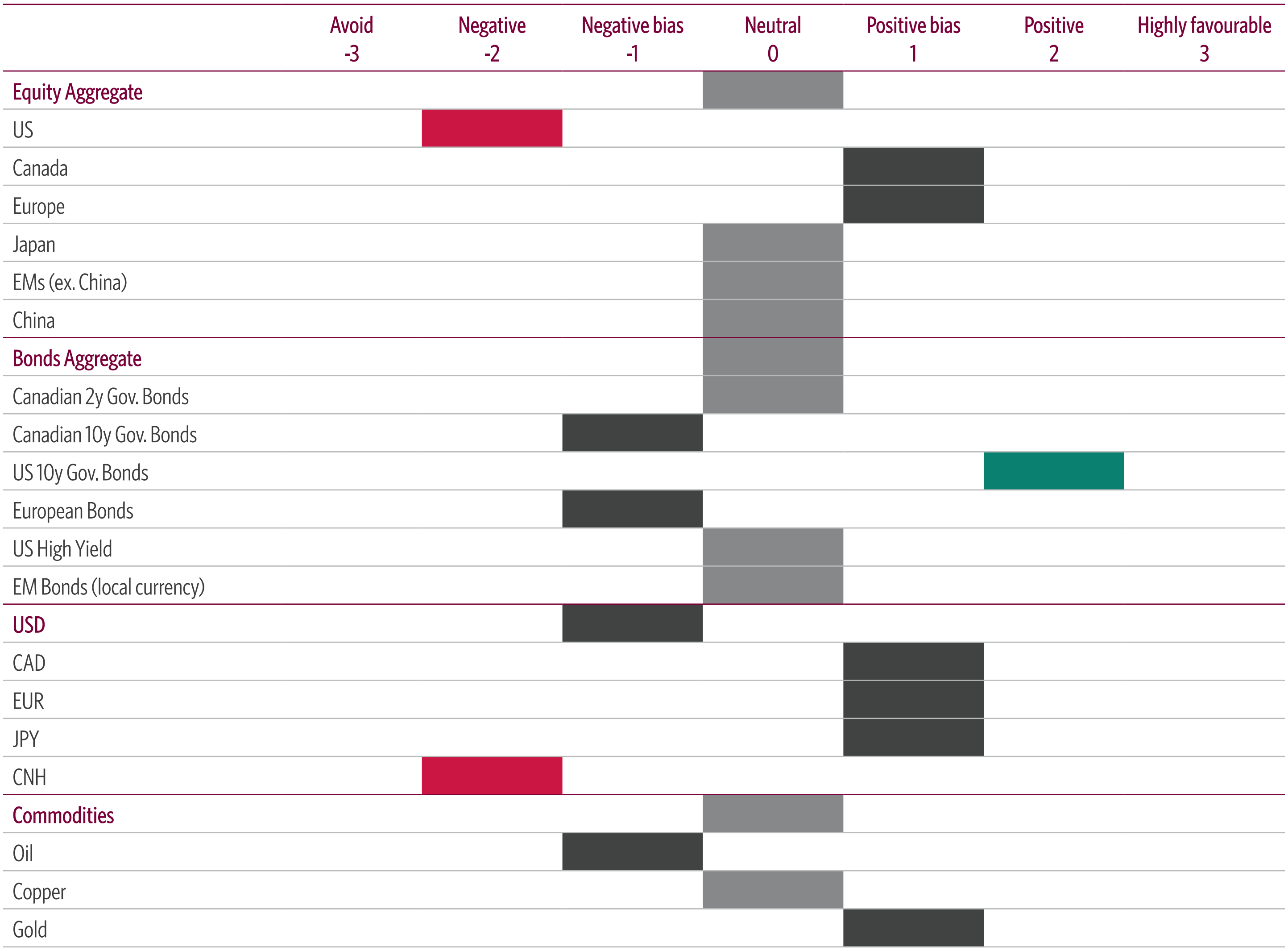
Tariffs: US exceptionalism to be challenged

Key takeaways

- This paper is our thinking as of the time of writing, April 10th, 2025.
- Tectonic plates are moving. The recent "Liberation Day" tariffs, even with the 90-day delay, have significantly increased US import duties, leading to tariff rates unseen for nearly a century.
- The US is using tariffs as a tool of Dollar Diplomacy in an effort to reshape trade dynamics, aiming to strengthen US manufacturing, and undermine the perceived threat from China as a global competitor in tech and long-term military rival.
- Despite significant economic headwinds and elevated uncertainty, we expect the US, Canada, and the global economy to avoid recession in the next 12 months, although downside risks have clearly increased.
- We project a more pronounced growth slowdown in the US than in other economies, reflecting the cumulative impact of global tariffs. For Canada, our outlook encompasses an initial negative uncertainty shock to economic activity until a trade agreement is reached with the US. Subsequently, we expect a muted rebound in growth to a pace around potential. Elsewhere, we anticipate negotiations leading to lower tariffs; stable growth in the Euro zone, supported by monetary policy and fiscal stimulus; limited downside on Chinese growth amid increasing stimulus and tech investment; and lower oil prices to provide an additional cushion against tariffs.
- Given the highly uncertain policy landscape, we recommend a neutral stance on equities relative to bonds for the next 12 months. While the near-term balance of risks favours bonds, we are in a rapidly evolving environment where tariffs threats are magnified by negotiation tactics, meaning that a shift in narrative could lead to a more constructive outlook for risky assets. Timing the market is challenging for investors in the best of times, and is a daunting prospect in the current environment.
- Within equity markets, Dollar Diplomacy is now challenging the perception of US exceptionalism, making overvalued US equities vulnerable to reduced demand from foreign investors, whose holdings are at record highs. We have a positive bias for Canada and Europe. In fixed income, US government bonds are attractive. In foreign exchange, we expect the US dollar (USD) to weaken further, and the Canadian dollar to gradually strengthen against the USD.
- In highly uncertain times, it's crucial for investors to stay disciplined and focused on long-term investment objectives and maintain a well-diversified portfolio. While uncertainty may sustain heightened market volatility for an extended period, history shows that asset markets can overcome significant shocks, such as Covid-19, decades-high inflation, and rising interest rates, as seen over the past five years. Investors who weathered these challenges fared well.

Capital Markets outlook, next 12 months



Source: CIBC Asset Management as of April 10th.

Global macro: Investors must brace for a changed world

Tectonic plates are shifting rapidly

The world is changing. Tariffs have become the main tool of a new Dollar Diplomacy regime under which the Trump administration is seeking to alter trade relationships perceived as unbalanced and disadvantageous to the US. Prior to recent announcements—on so-called 'Liberation Day'—the US typically imposed much smaller tariffs, and non-tariff barriers, than those imposed by other countries. Tariffs are a disruptive tool intended to revitalize US manufacturing, weaken the US dollar, and pave the way for negotiations that lead to more advantageous trading terms for US companies. The overarching theme of the policy is that the US needs a stronger manufacturing base to better compete with China and deter its military ambition. This will be a marathon, not a sprint. Tariffs have an ideological component, suggesting a higher pain threshold for the Trump administration, in terms of economic and market turbulence, than was apparent during the 2018-19 trade war with China.

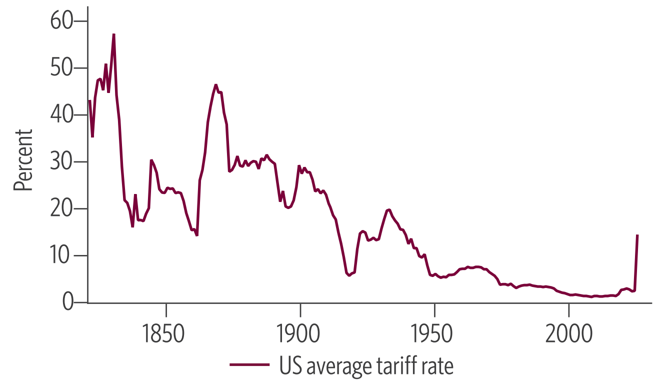
In this new regime we also expect the US to pressure its allies—including via the threat of punitive tariffs—to boost their military spending in order to reduce reliance on US military protection against the risk of Russian and Chinese aggression.

A massive tariff shock to the global economy

Liberation Day tariff announcements delivered tariffs hikes on the aggressive side of expectations. US President Trump imposed a minimum 10% tariff on all goods imports and nation-specific additional duties on dozens of countries that contribute the most to US trade deficits. The tariff shock is most significant in China where tariffs have surged above 100%. While we do see room for negotiations with the US, tariffs could remain elevated. Elsewhere in Asia, negotiations are already underway to avoid or reduce US reciprocal tariffs. In North America, where tripartite negotiations continue, an exemption for USMCA-compliant imports will remain free from tariffs, but non-compliant USMCA goods imported into the US, including autos and auto parts, will be subject to a 25% tariff, except for oil and potash, which will be subject to a 10% tariff.

The effective weighted-average US tariff rate will likely increase from 5% at the start of 2025 to around 20%, the highest increase in nearly a century (**Figure 1**). The tariffs shock is about 6 times larger for the US economy than the one triggered by the China-US trade war of 2018-19—which reduced US GDP by 0.4% and increased US consumer price inflation by 0.2% on average over a two-year period.[1]

Figure 1: A significant shift higher in US tariffs

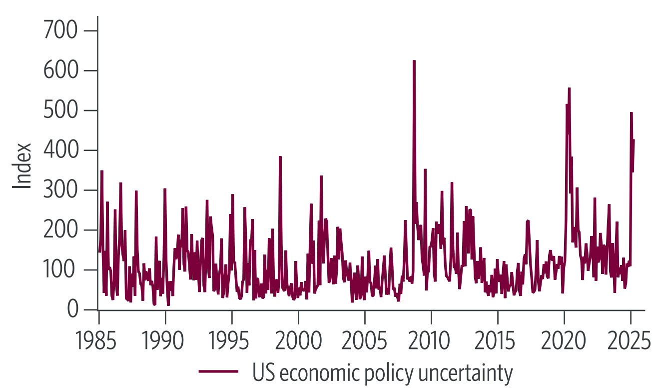


Source: Macrobond, April 2025.

A different kind of uncertainty: Concentrated political risks

Tariffs have triggered a significant surge in economic uncertainty (**Figure 2**). The distribution of risks exhibits fat tails, and probabilities attached to various outcomes for growth and inflation are not currently being influenced by traditional economic factors. Instead, risks to the economy are largely driven by concentrated human factors, such as Trump's willingness to alter tariff policies and the readiness of other countries to reduce their own tariffs in order to negotiate a deal with the US.

Figure 2: Surge in economic uncertainty



Source: Macrobond, April 2025.

The balance of risks surrounding the outlook is skewed to the downside, for several reasons: The Trump administration is likely reluctant to materially reduce tariffs in aggregate; other countries may join China in retaliating against US tariffs; and the interplay of tariffs, high uncertainty, fiscal consolidation, and immigration curbs could negatively impact the US economy more than anticipated.

Our baseline scenario assumes, with a probability of 50%, that the US economy slows materially compared with its performance in the past year, but that it avoids a recession. We also expect the global economy to avoid a recession in the next 12 months. But downside risks are pronounced: we assign a 35% probability of US and global recessions; conversely, we assign only a 15% probability to a more constructive outcome in which fiscal policy supports the global economy more than expected and tariffs are significantly reduced due to expedited trade deals with US allies.

Our global economic outlook—In a nutshell

Our baseline economic outlook foresees the US economy slowing more significantly than the rest of the world. We expect that the US economy will experience a rapid slowdown, with the rate of GDP growth projected to fall below 1% Y/Y before the end of 2025, but the (transitory) inflation shock from tariffs should postpone cuts and reduce their magnitude. We expect the Fed to cut by 100 basis points (bps) in the next 12 months, which would bring monetary policy to a neutral stance. In contrast, European and Chinese economies are expected to remain resilient, bolstered by fiscal and monetary support, as well as lower energy prices. Improving underlying growth in the Euro zone and a stabilization of housing markets in China are additional mitigating factors against tariffs. Appendix 1 provides country details.

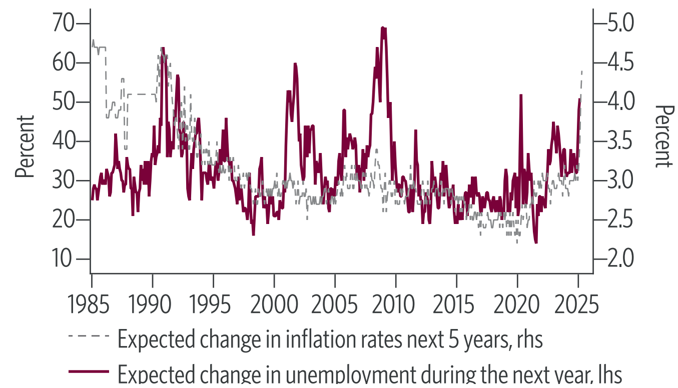
The robust growth recovery we had previously expected for Canada has been replaced by a more muted outcome. The Canadian economy is likely to benefit from a mutually beneficial renegotiated trade agreement with the US. However, GDP growth is expected to be constrained by lingering uncertainty until a new version of the USMCA is fully ratified in 2026. In our baseline outlook, we expect the Bank of Canada to cut by 50 bps in the next 12 months. In the event we are surprised and Canada is unable to agree to a revised trade deal with the US, the Bank of Canada would likely cut by an additional 100 bps and fiscal policy would do the heavyweight lifting to support economic activity.

We are cautiously optimistic the global economy will avoid a recession

With a two-thirds probability we expect that the global economy will avoid a recession in the next 12 months. This view reflects several factors.

First, we are likely at "Maximum Trump" on tariffs due to the rising economic and political costs associated with their implementation. The simultaneous imposition of large-scale tariffs on multiple trading partners poses risks to US employment and could lead to higher prices (**Figure 3**), disproportionately affecting lower-income households. This presents significant political challenges ahead of the 2026 mid-term elections.

Figure 3: Tariffs uncertainty depressing consumer expectations



Source: Macrobond, April 2025.

Second, it is important to recognize that tariffs are also a negotiating tactic aimed at securing better trade deals for the US. We anticipate that several countries will reduce the tariffs currently imposed on US products as a strategy to encourage the US to lower its reciprocal tariffs. Several countries have already indicated their intention to cut tariffs on US goods. Tariff de-escalation will help mitigate downside risks in financial markets. The negotiation facet is important because we do not expect the US to be willing or able to reshore most of its manufacturing needs—it still needs foreign supply chains. Reflecting this, Elon Musk—an influential figure to President Trump—recently expressed the hope for a zero-tariff system between Europe and the US.

Third, we expect global fiscal stimulus, monetary policy accommodation, and lower oil prices—due to rising supply by OPEC+ and slowing global growth—to mitigate the negative impact of tariffs on global GDP growth. Europe is on the verge of initiating a multi-year military stimulus, and China will likely materially step up its own domestic policy stimulus. Fiscal policies will likely magnify the cross-sectional volatility of yields across countries.

We expect a trade deal with Canada

The US president has a limited amount of political capital for persistent "economic pain". A protracted trade war with Canada would likely push the US economy into recession given other tariffs put in place. This incentivizes US policymakers to reach a revised trade agreement with Canada sooner rather than later. This supports our baseline outlook for a trade deal with Canada in the coming months, with a two-thirds probability.

A prolonged trade conflict with Canada would have significant repercussions for both the US and Canada, primarily due to deeply integrated supply chains and US reliance on Canadian intermediate goods, which are more challenging to substitute than consumer goods. Recent research indicates that the economic pain and inflationary pressures resulting from a trade war largely stem from imports of intermediate goods. Imposing long-lasting tariffs on Canada would adversely impact US farmers, automobile manufacturers, and consumers, while jeopardizing the non-energy trade surplus that the US enjoys with Canada. This situation could lead Canadian consumers to continue to boycott US goods—particularly food and automobiles—and reduce travel to the US.

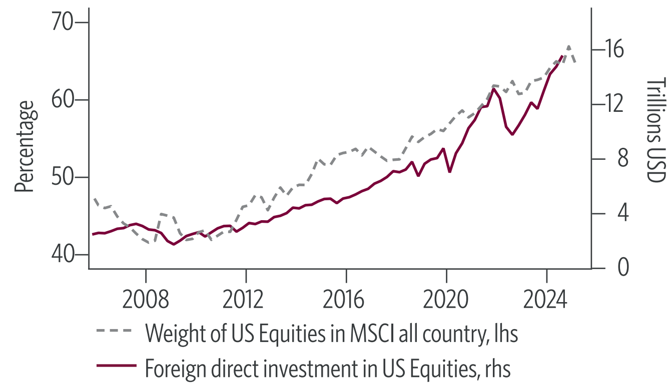
From a geostrategic perspective, the US has a compelling incentive to uphold its free trade agreement with Canada. The Canadian economy effectively complements the US economy, benefiting from integrated supply chains, abundant natural resources, and aligned military interests due to their shared borders—all of which are crucial for the US in its strategic competition against China.

Potentially reduced foreign demand for US assets

In recent years, foreign investors have been attracted to the notion of US exceptionalism (**Figure 4**), leading them to own approximately one-fifth of US stocks. Notably, European investors account for nearly half of the total foreign ownership of US assets. Dollar Diplomacy is now challenging the perception of US exceptionalism. Foreign investors may exhibit a reduced appetite for US assets, which could contribute to underperformance of both US equities and the US dollar. Several headwinds are at play:

- A clouded political and economic outlook in the US;
- US stocks and the dollar are both expensive;
- A deterioration in the political relationship between the US and Europe (including tariffs levied on Europe);
- Europe (Germany for now) is launching a multi-year military and infrastructure stimulus.

Figure 4: US exceptionalism has attracted foreign investors



Source: Macrobond, April 2025.

Global investment strategy

Equity vs bonds: Neutral

Given the highly uncertain policy landscape, we maintain a neutral stance on equities relative to bonds (within an investor's Strategic Asset Allocation). The near-term balance of risks does favour bonds. This includes softer survey data, an expectation for slower growth, and trade uncertainty. Additionally, most major central banks have significant capacity to implement aggressive easing measures, which would support bonds. But we also recognize that we are in an environment where tariffs threats are magnified by negotiation tactics. This means that an abrupt shift in narrative could quickly lead to a more constructive risk environment, and a less favourable outlook for bonds.

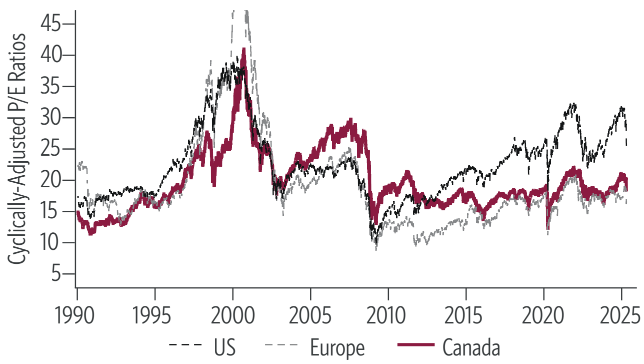
The outlook for equities appears challenging. Markets are expected to trade sideways amid persistent high volatility driven by rising policy and economic uncertainty and slowing economic activity. This environment is likely to result in low single-digit earnings growth, as companies face reduced sales growth and a slowing expansion in profit margins. High US valuations could also present a challenge to returns in the context of slower US GDP growth, tariffs risks, and economic uncertainty.

Equities: US equities to underperform Canada and Europe

A global rotation away from US stocks since the beginning of the year has led to a notable underperformance of US markets compared to global counterparts, driven by mounting policy uncertainty and a reversal of the US exceptionalism trade.

We expect US underperformance to continue. Unfavourable US valuations are likely to become an important headwind in an uncertain environment (**Figure 5**). The US is the most expensive market in our universe. While stocks elsewhere will be hit by tariffs, they are less expensive.

Figure 5: Valuation gap for US equities still significant



Source: Macrobond, April 2025.

We have a more favourable view of both Canada and Europe.

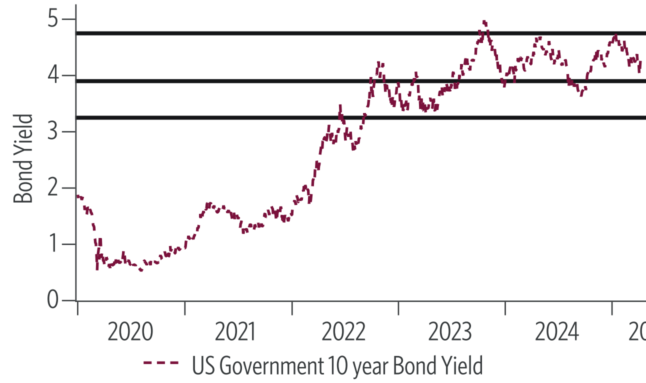
Canadian equities will likely benefit from an expected trade deal between Canada and the US but may be vulnerable to potential slowdowns in sales and earnings growth due to economic uncertainty and weaker US growth. A mitigating factor for Canada is its substantial fiscal capacity and willingness to support the economy should trade headwinds intensify.

The recent transition in US economic and security policies has prompted a response from Europe that seemed unthinkable just a month or two ago. Germany has committed to significant fiscal spending that allows for a considerable increase in defense and infrastructure spending, accounting for several percentage points of GDP. The shift towards increased fiscal stimulus is also evident at the European Union level.

Bonds: US Treasuries have become more attractive

We expect US government bonds to outperform other markets (higher yields with more downside), but that relative performance will likely be front-loaded. The 10-year US Treasury yield has fallen by approximately 80 bps since its recent peak in January 2025. Concerns regarding a potential surge in inflation due to tariffs have been outweighed by gathering concerns regarding their negative consequences for growth. Over the next twelve months, we expect US 10-year bond yields to fluctuate within a range of 3.25 to 4.75%, with a target yield of around 3.9% in our baseline scenario (**Figure 6**). At the time of writing (April 10, 2025), the 10-year yield was trading in the top half of this range, suggesting yields have more downside than upside.

Figure 6: US 10-year yield – a wide range of travel



Source: Macrobond, April 2025.

In Canada and Europe, sovereign bond yields are relatively lower than in the US. For this reason, we have a more neutral outlook, although even in these markets risks are skewed to the downside.

Canadian bonds already price significant cyclical weakness and rank as expensive. The 10-year Canadian government bond yield stands well below our long-term estimated equilibrium of 3.6%. Canadian yields could back up in the event of the trade deal with the US—but they can still provide a hedge against negative tariff developments. Over the next twelve months, we expect Canadian 10-year bond government yields to fluctuate within a range of 2.25% to 3.65%, with a target yield of around 3.25% in our baseline scenario.

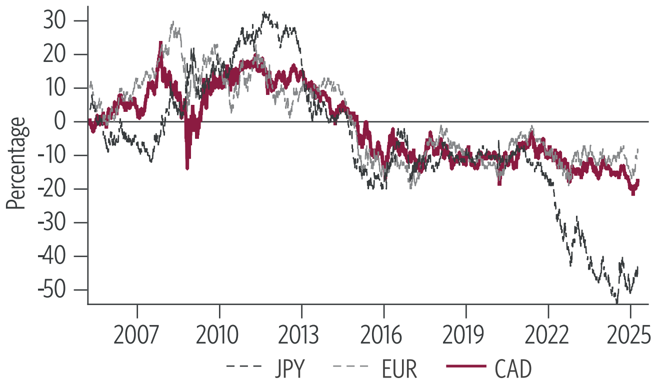
German Bund yields are lower than in North America and could face renewed upside pressures due to aggressive fiscal policy in Germany and constructive tariff negotiations.

Currencies: A bias for a weaker US dollar

USD: The US dollar (USD) has depreciated by about 2% year-to-date against a broad basket of major currencies. We expect further, gradual depreciation owing to self-inflicted US economic headwinds, a desire to engineer a secular depreciation of USD to boost US manufacturing competitiveness, fiscal stimulus in Europe and China and several other countries, prospects of a limited growth slowdown outside the US, a waning appetite among foreigners for US stocks, and USD's chronic overvaluation (**Figure 7**).

The most significant risk to this view is the impact of tariffs on inflation expectations. This could lead to a reduction in the magnitude of expected rate cuts and a more challenging environment for riskier assets.

Figure 7: USD remains expensive and at risk of a gradual decline
(Currency deviation from fair value against USD)



Source: Macrobond, April 2025.

CAD: The Canadian dollar (CAD) has moved sideways against USD since the end of last year, hovering around 70 US cents. This is unsurprising given outsized policy uncertainty. We have become more constructive on CAD against USD for the next 12 months. In large part, this reflects a deterioration in USD fundamentals. While we expect a trade deal with the US in the coming months, trade uncertainty is likely to persist until a new USMCA deal is ratified, most likely in 2026. Along with weak oil prices, this will likely limit CAD's ability to gain significant upside against USD. Under our baseline scenario, CAD is expected to trade between 0.68 and 0.75 against USD.

EUR & JPY: We believe that the Trump administration aims to engineer a secular depreciation of the US dollar to enhance the competitiveness of US manufacturing. Achieving this goal will necessitate a stronger euro. Several policies implemented or influenced by the Trump administration are conducive to a stronger euro, including fiscal consolidation in the US, military stimulus in Europe, and OPEC's decision to increase its supply quotas to lower oil prices. Additionally, the euro may receive support from local investors repatriating investments from the US. We project the euro will trade in a range of 1.06 to 1.20 under our baseline scenario in the next 12 months. The Japanese yen is also anticipated to benefit from repatriation flows and lower oil prices. And as a traditional hedge against downside tail risks, the yen would also likely outperform in a global recession.

CNH: US tariffs on China have surged. While Chinese authorities are expected to ramp up domestic policy stimulus, we believe that policymakers will also engineer a secular depreciation of the renminbi against most of China's key trading partners, while seeking greater currency stability relative to the US dollar in order to protect confidence in the currency. Overall, we have a negative view of the renminbi.

Commodities: Negative bias for oil, more upside for gold but with high volatility

Oil: Until the recent tariff announcements, oil prices had been relatively stable in 2025, trading near $70USD per barrel (WTI) at the end of March. However, these announcements, along with OPEC+ advancing their plan to phase out output cuts, caused prices to drop to the low $60s. Looking ahead, improving US relations with Russia may increase global supply further, whereas tightening sanctions on Iran and Venezuela could have the opposite effect. We expect that oil prices will fluctuate between $60 and $70 per barrel throughout the next 12 months.

Gold has continued its upward trajectory in 2025, surpassing $3,000 per ounce and reaching record highs. USD depreciation has offered support to gold, and geopolitical uncertainties have also enhanced gold's appeal as a hedge against elevated risks. Additionally, several central banks are reducing their reliance on US assets, which should keep gold demand elevated. We believe the outlook remains positive, with gold potentially exceeding $3,500 per ounce this year, although volatility is likely to increase.

Copper: Despite ongoing geopolitical uncertainties, copper prices surged to all-time highs earlier this year. Following recent tariff announcements, prices fell by about 10%. While the outlook is clouded by tariff headwinds, solid fundamentals are supported by strong demand from the tech sector and the energy transition. Additionally, Chinese stimulus could provide renewed upside. We expect copper prices to remain volatile throughout the year.

Alternative global scenarios

Negative risk: Recession (35% probability)

Key assumptions

- Tariffs impair growth more than expected
- Global fiscal stimulus disappoints
- No trade deal is reached with Canada

Market implications

- Overweight bonds as yields continue to fall
- Negative for risky assets; equities suffer a significant further correction, and corporate spreads widen further
- USD, JPY, and gold are safe haven outperformers

Positive risk: Resilient growth and relief from tariffs (15% probability)

Key assumptions

- Important tariff reductions and the global economy is more resilient

Market implications

- Positive for risky assets: equities outperform bonds
- Corporate spreads stabilizes
- USD weakens

Appendix: Detailed economic outlook

Economic outlook (next 12 months)

	Baseline	Consensus/Markets
United States		
GDP	1.2%	1.8%
Inflation	3.2%	2.9%
Policy Rate Change	-100 bps	-113 bps
Canada		
GDP	1.5%	0.9%
Inflation	1.9%	2.4%
Policy rate change	-50 bps	-48 bps
Euro zone		
GDP	0.8%	1.0%
Inflation	1.9%	2.1%
Policy rate change	-50 bps	-81 bps
China		
GDP	4.4%	4.4%
Inflation	0.7%	0.7%
Policy rate change	-40 bps	-43 bps
Japan		
GDP	0.8%	0.9%
Inflation	1.9%	2.3%
Policy rate change	+ 40 bps	+17 bps
World		
GDP	2.9%	--

Sources: Bloomberg, CIBC Asset Management, as of April 10. For illustrative purposes only.

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[1] Cuba-Borda et al., 2025. Trade Costs and Inflation Dynamics. Federal Reserve Bank of Dallas. Working Paper 2508. March.

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