ECONOMIC VIEWPOINT

In the Face of Economic Uncertainty, Flexibility Is Key

Baseline and alternative scenarios

The re-election of Donald Trump, and especially his protectionist stance, could upend the economy. The president-elect himself has floated many different ideas about what he intends to do, each of which would affect the US and Canadian economies differently. We'll go over three possible scenarios, each of which paints a different picture of what will happen with the economy (in terms of real GDP, inflation and unemployment) in a new Trump era. The main difference between the three scenarios is the trade policy implemented by the White House. Of course, many other alternative scenarios could be developed based on different assumptions. Our goal isn't to provide an exhaustive analysis of all possible outcomes, but to outline a range of economic repercussions based on optimistic and pessimistic scenarios.

The baseline scenario, which was also described in our latest *Economic and Financial Outlook*, is based on what Trump promised during the election campaign: 10% tariffs on all countries and 60% tariffs on China. The pessimistic scenario is based on a proposal that would be especially painful for Canada, which (along with Mexico) would quickly be hit with 25% tariffs. The optimistic scenario assumes that the US won't raise its tariffs.

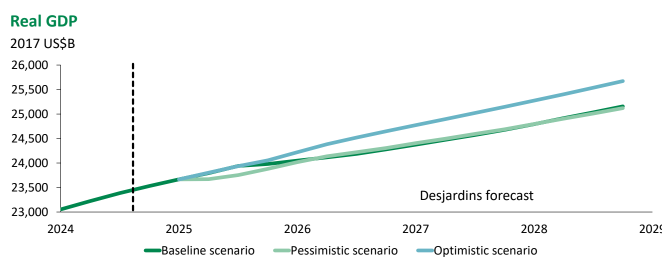
United States

REAL GDP

- The **baseline scenario** shows real GDP growth remaining robust in the first quarters of 2025. Aside from the positive impacts of renewed confidence, economic activity will likely pick up as companies advance their orders in anticipation of higher tariffs. We expect the tariff hikes to kick in as of the fourth quarter of 2025. There will probably be a slew of exceptions to the 10% bump in tariffs on most goods (60% on goods from China), which means that the effective tariffs would not be as high as announced. Real GDP growth is expected to lose steam in late 2025, and will likely remain muted thereafter. Businesses and consumers will start seeing the benefits of tax cuts in early 2026, which is a constant in all three scenarios.

- Paradoxically, the **pessimistic scenario** wouldn't be as bad for the US as the baseline scenario. It is based on Trump's November 25 promise to quickly slap a 25% tariff on imports from Canada and Mexico, while raising tariffs on China by

United States
Alternative Scenarios – Output



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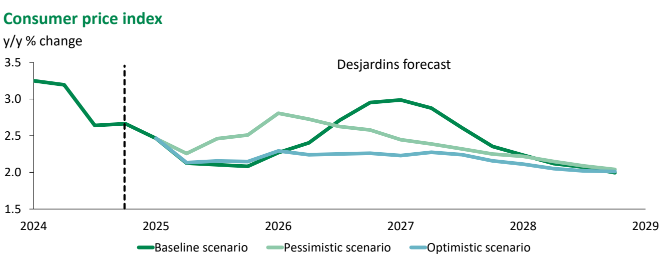
10% (not 60%). We assume that other countries will not be affected. Under this scenario, the effective tariffs imposed by the US would be lower than in the baseline scenario. But it also assumes an even sharper fall in immigration, which would further limit potential economic growth. This scenario expects economic growth to start plummeting even sooner, in the second quarter of 2025, and remain relatively anemic thereafter.

- The **optimistic scenario** is, of course, the one that assumes Trump won't raise tariffs at all. That means US consumers and businesses could benefit from tax cuts and deregulation without dealing with the negative repercussions of a protectionist trade policy. Real GDP growth would remain relatively strong.

INFLATION

- Although tariffs may be seen as a negative factor for the economy of the country that imposes them, they can also fuel inflation. The **baseline scenario** sees inflation continuing to fall toward the 2% target set by the Federal Reserve (Fed), but not for long. Tariff increases implemented in the fall should start exerting upward pressure in late 2025. In addition, tax cuts and slower labour force growth (which apply to all three scenarios) will also boost inflation.
- The **pessimistic scenario** sees inflation heating up faster because tariff hikes will be implemented sooner, even though they'll be more targeted. In this case, importers will have less time to build up inventory and will therefore start passing part of the cost on to their customers earlier than expected.
- Meanwhile, since tariffs don't increase in the **optimistic scenario**, inflation won't be driven to a record high. But robust economic growth will nevertheless keep inflation above the Fed's target for quite some time.

United States
Alternative Scenarios – Inflation



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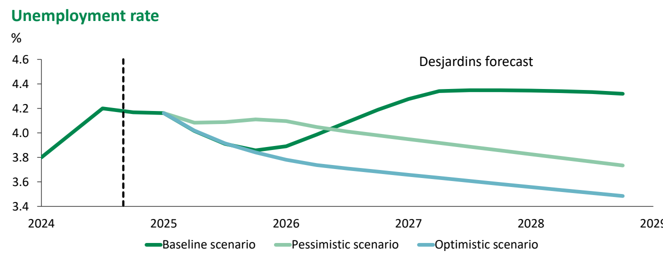
UNEMPLOYMENT RATE

- Tariff policy will also affect the US job market. Before it is implemented, unemployment could shrink in 2025 as a result of strong economic growth in our **baseline scenario**. But in the fall of next year, higher costs for businesses, retaliatory measures by other countries and the impact on real household income will limit demand for workers, driving up unemployment in 2026. The negative impact of all this would nevertheless be reduced by slower labour force growth.
- Meanwhile, the rapid implementation of higher tariffs assumed for the **pessimistic scenario** will cut short the upsurge in growth expected for 2025. In this scenario, unemployment would remain a little higher next year, but would then slow as population growth cools even faster than expected.
- In the **optimistic scenario**, robust economic growth would encourage companies to keep hiring at a fairly solid clip. Consequently, unemployment would gradually fall over the next few years until they return to the record lows seen in 2023.

United States
Alternative Scenarios – Job Market



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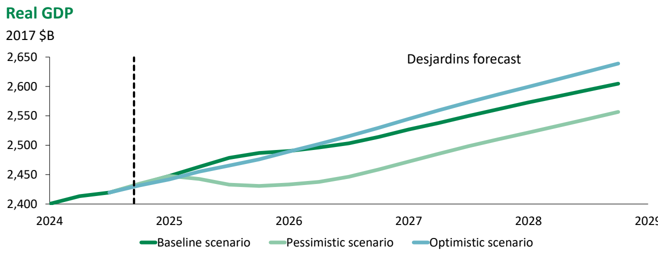
Canada

REAL GDP

- Our **baseline scenario** assumes a 10% tariff will start being applied to all US imports (with exceptions for imports of energy and autos from Canada) in late 2025, although full implementation won't happen until later. Surging demand for Canadian exports before tariffs are implemented, combined with recently announced domestic policy measures, should cause Canadian real GDP growth to accelerate from 1.3% in 2024 to 2.2% in 2025. But as tariffs are implemented, population gains slow and higher monthly mortgage payments mount, we expect Canadian real GDP growth to slow to 1.3% in 2026.

- In our **pessimistic scenario**, we assume a 25% tariff is applied to all US imports from Mexico and Canada. All tariffs are applied in Q2 2025. This will likely push the Canadian economy into a recession in 2025, and the subsequent recovery will be rather tepid. Ultimately, there will be a permanent loss of productive capacity in the Canadian economy.
- Our **optimistic scenario** is one in which tariffs are not implemented. As business investment gradually resumes, driven by demand for Canadian exports from a surging US economy, the Canadian economy advances at a solid pace.

Canada
Alternative Scenarios – Output



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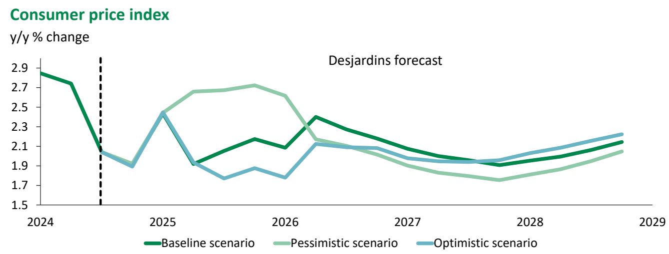
INFLATION

- In our **baseline scenario**, solid economic activity before tariffs are implemented pushes CPI inflation higher due to excess demand. Then as tariffs are applied to US imports, the downward pressure on Canadian inflation from slower growth is offset by a weaker Canadian dollar and reciprocal tariffs on the imports from the US. However, lower oil prices from a North America awash with crude puts further downward pressure on CPI inflation over the medium term.
- Our **pessimistic scenario** points to weaker Canadian CPI inflation than in the baseline scenario over most of the forecast, as greater slack in the economy and sharply lower oil prices more than offset the impact of the lower Canadian dollar and reciprocal tariffs applied to imports from the US.
- The **optimistic scenario** with no tariffs applied has the lowest Canadian headline inflation in the near term, as the Canadian dollar depreciates least in this scenario and reciprocal tariffs are not applied. But over the medium-term, this scenario has the highest inflation as excess demand in the economy pushes core CPI inflation higher and more elevated oil prices further boost headline price growth.

UNEMPLOYMENT RATE

- The unemployment rate falls through 2025 in the **baseline scenario**, as surging US export demand, a reluctance by businesses to invest due to uncertainty, and a slowing pace of labour force growth all provide a tailwind to hiring. However, once tariffs are applied in late 2025 or early 2026, employment growth slows rapidly along with the broader economy, causing the unemployment rate to rise modestly.
- As a result of Canada falling into a recession in our **pessimistic scenario**, the unemployment rate rises rapidly, eventually topping 8% in Canada before gradually falling back to a still-elevated 7% as tariffs are kept in place and productive capacity is permanently lost.
- In our **optimistic scenario**, the unemployment rate rises somewhat in the near term as growth slows modestly, but then gradually falls to below 6% in Canada as real GDP advances at a solid pace driven by a tax-cut-fuelled US economy.

Canada
Alternative Scenarios – Inflation



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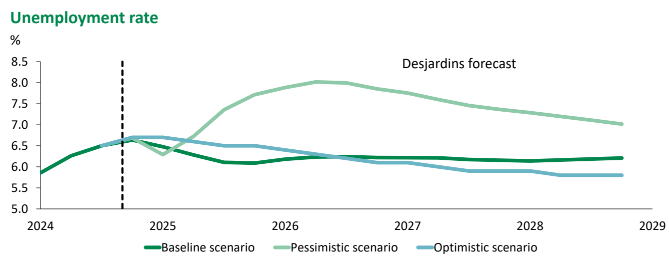
Canada
Alternative Scenarios – Job Market



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