

# Economic Commentary

## Bank of Canada and US Fed Lower Interest Rates

Both the Bank of Canada and the U.S. Federal Reserve lowered interest rates during the quarter. The Fed cut rates twice for a total move of 50 bp while the Bank of Canada held to one move of 25 bp. The Bank of Canada lowered interest rates by a total of 100 bp during the year. They started their moves early in the year, with cuts of 25 bp back in January and March and then followed that up with two more cuts in September and October. The Fed remained on the sidelines until September when they lowered interest rates for the first time this year. They followed that up with the two cuts that occurred during the fourth quarter. The overnight rate ended the year at 2.25% in Canada and 3.75% in the U.S. The term of Fed Chair Jerome Powell ends in May 2026, and it is widely anticipated that President Trump will not extend Powell's term but rather nominate someone who will pursue his objective of being more aggressive in lowering interest rates further. Market expectations are calling for two additional interest rate cuts by the Fed in 2026, while it is expected that the Bank of Canada will remain on the sidelines for the foreseeable future.

## Inflation Levels Surprisingly Decline

After increasing from lower levels earlier in the year, inflation surprisingly declined in the fourth quarter. Canadian headline inflation dropped from 2.4% at the end of the third quarter to 2.2% in November. In the U.S., inflation fell from 3.0% to a better-than-expected level of 2.7% in November. The core rate of inflation in Canada is 2.8% while in the U.S. it is lower, sitting at 2.6%. These lower inflation levels have surprised financial markets as the expectation was that

there would be upward inflationary pressure resulting from the higher tariffs that were implemented by the U.S. A key development during the fourth quarter was the shutdown of the U.S. government from October 1 to November 12, covering a period of 43 days which was the longest in U.S. history. This resulted in the delay of key economic data being released, making it more difficult for the U.S. Federal Reserve to set interest rate policy as well as for financial markets to gauge the strength of the U.S. economy.

## Trade Tensions Continue to Impact Economy

Ongoing trade tensions related to tariff policies continued into the fourth quarter, impacting global economic conditions and causing uncertainty in financial markets. The unpredictable trade policy is making it difficult for companies to plan in terms of investment, production, supply chain logistics as well as staffing levels. There has been little in the way of resolution with many countries despite parameters being agreed to earlier in the year. No trade policies have been resolved between the U.S., Canada and Mexico, with the USMCA coming up for renewal next year. Despite this trilateral agreement being in place, the U.S. has imposed sectoral tariffs on steel, aluminum and autos. This has negatively impacted the integrated supply chain that had existed between these three countries.

Divergent trends began to develop with respect to economic growth and labour market conditions. Canadian GDP was negatively impacted by manufacturing and export weakness, particularly in tariff-sensitive sectors. Monthly GDP was

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## Fourth Quarter 2025

### Key Metrics

Indicator	Value	Chg Q4	Chg 1Y
S&P/TSX Composite	31,712.76	6.3%	31.7%
S&P 500 (USD)	6,845.50	2.7%	17.9%
iShares MSCI EAFE ETF (USD)	96.03	4.7%	31.6%
USD/CAD	\$ 0.73	1.4%	4.8%
WTI Crude (\$/bl)	\$ 57.42	-7.9%	-19.94%
GoC 10Y Bond	3.43%	25 bps	21 bps
GoC Deposit Rate	2.25%	-25 bps	-100 bps
Cdn CPI YoY	2.2%	-0.2%	0.4%
US 10Y Treasury	4.17%	2 bps	-40 bps
Fed Funds Rate	3.75%	-50 bps	-75 bps
USD CPI YoY	2.7%	-0.3%	-0.2%

### Top Themes

BoC and US Fed lower interest rates to varying degrees

Inflation surprises positively to lower than expected levels

Unpredictable US trade policy continues to impact economic growth

### Top Chart: US Approximate Effective Tariff Rate



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negative to start the quarter, which resulted in year-over-year growth of only 0.4%. Despite this slowdown on the economic front, the Canadian labour market had surprising results, exhibiting unexpected strength in September, October and November, following two negative months prior to that. As a result, the unemployment rate decreased from 7.1% in September to 6.5% in November.

## **Equity Markets and Bond Yields Both Move Higher**

Equity markets continued to strengthen into year-end, capping off a solid year, with annual performance in many global markets far exceeding expectations. The robust turnaround in equity markets was astounding, given the stage that financial markets were in back in April when Trump implemented his tariff policies. Interest rate cuts by both the Bank of Canada and the U.S. Federal Reserve helped propel markets. The bond market was not nearly as strong as interest rates increased during the quarter. The yield on the benchmark 10 year U.S. Treasury increased by 2 bp, ending the year at 4.17%. Yields in the Canadian bond market rose more substantially, with the yield on the 10 year Government of Canada bond increasing by 25 bp, ending the year at 3.43%.