

GLOBAL Insight



Wealth
Management

August 2025

Perspectives from the Global Portfolio Advisory Committee



Transmission framework: How tariffs will flow through the U.S. economy

As U.S. tariff policy continues to evolve, investors are facing more questions than answers. RBC Economics provides a roadmap on when and where tariffs will start to impact the U.S. economy.

Frances Donald & Mike Reid | Page 4

Also in this issue



GLOBAL EQUITY
The shift is on



GLOBAL FIXED INCOME
**Changing views precede a
changing of the seasons**



KEY FORECASTS

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Contents

Monthly focus

4 **Transmission framework: How tariffs will flow through the U.S. economy**

As U.S. tariff policy continues to evolve, investors are facing more questions than answers. RBC Economics provides a roadmap on when and where tariffs will start to impact the U.S. economy.

Global equity

10 **The shift is on**

Despite the arrival of tariffs, most major indexes have posted new highs spurred by investor confidence in a resumption of growth next year. Supportive market breadth suggests more new highs lie ahead. Full valuations argue for a watchful commitment to equities.

Global fixed income

14 **Changing views precede a changing of the seasons**

As many global central banks near the end of rate cut cycles, markets start to consider if, not when, the Fed restarts its own.

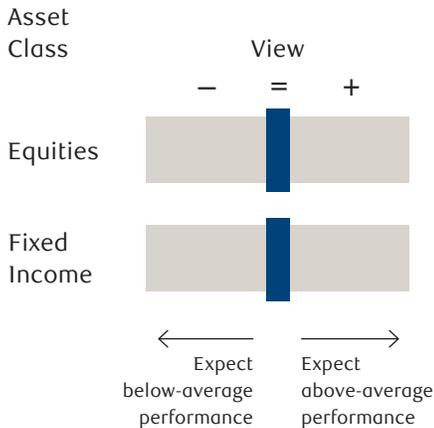
In the markets

3 RBC's investment stance

16 Key forecasts

RBC'S INVESTMENT Stance

Global asset class views



(+/-/-) represents the Global Portfolio Advisory Committee's (GPAC) view over a 12-month investment time horizon.

+ Overweight implies the potential for better-than-average performance for the asset class or for the region relative to other asset classes or regions.

= Market Weight implies the potential for average performance for the asset class or for the region relative to other asset classes or regions.

- Underweight implies the potential for below-average performance for the asset class or for the region relative to other asset classes or regions.

Source - RBC Wealth Management

Equities

- The S&P 500 has traded to a new all-time high recently, buoyed by the Trump administration's tariff de-escalation, trade deals with some key partners, passage of the One Big Beautiful Bill Act, and resilient corporate earnings trends. The Canadian, UK, and Japanese markets have followed suit, but others in Europe and Asia have yet to reach new peaks.
- As tariffs begin to work their way through the U.S. economy, RBC Economics anticipates inflation will rise moderately and GDP will grow at a below-average pace in the coming months and into 2026. Employment has already softened.
- Most developed equity markets outside of the U.S. as well as emerging markets are trading at valuation discounts to the S&P 500—even when adjusted for sector disparities—and are mostly somewhat above their 10-year averages, whereas the U.S. valuation is rather more elevated. We continue to recommend Market Weight exposure for U.S. and non-U.S. equity holdings—the former due to better earnings growth prospects and the latter due to relatively attractive valuations.

Fixed income

- Global bond market volatility has been a fixture of the year as uncertainty and shifting global dynamics upend the status quo. Despite the volatility, the direction of travel has generally been toward lower yields as rising economic growth concerns are outweighing renewed inflationary pressures on the back of tariffs and trade disputes. However, rising global government debt levels leave us more cautious on longer-dated sovereign bonds, and more neutral on interest rate risk exposure.
- We remain Overweight U.S. Treasuries paired with an Underweight for global developed market bonds. Slowing growth in the U.S. despite an anticipated uptick in inflation will likely mean a resumption of rate cuts from the Federal Reserve later this year, in our view. Conversely, many global central banks such as the European Central Bank and the Bank of Canada—which have proceeded steadily with rate cuts—are now likely at the end of such cutting cycles.
- We reiterate our Market Weight stance on U.S. fixed income with yields remaining above multi-decade averages. Credit valuations are still too rich globally, in our view, amid increasing growth risks, which leads us to continue favoring sovereign bonds over corporate bonds.

MONTHLY
Focus

Transmission framework: How tariffs will flow through the U.S. economy

As U.S. tariff policy continues to evolve, investors are facing more questions than answers. RBC Economics provides a roadmap on when and where tariffs will start to impact the U.S. economy.



Frances Donald
Chief Economist
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Mike Reid
Senior U.S. Economist
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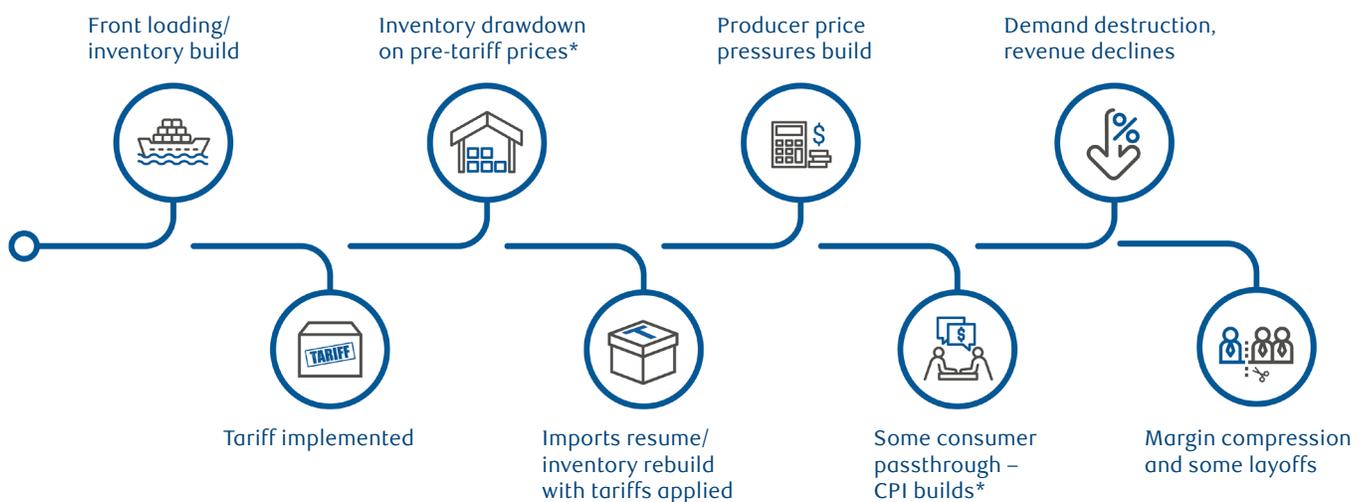
Economists are making a range of assumptions about how tariffs may work their way through the economy without relevant historical precedent. Using our own set of assumptions, we expect tariffs will weigh on the labor market and put upward pressure on inflation, exacerbating our view that the U.S. economy is in a stagflation-lite scenario.¹

But, when and where those pressures show up will ultimately come down to two core questions: How much inventory has accumulated in the system ahead of the implementation of tariffs, and how much of the cost of tariffs businesses will pass to consumers?

As policies continue to evolve in the coming months and data begins to show evidence of the impact of tariffs, RBC Economics will be using a transmission framework as a roadmap to monitor the fallout.

Here’s a deeper look at how we are thinking about this historic economic shock:

Impact of tariffs on U.S. economy and inflation



*Varies by sector.

Source - RBC Economics

¹ We assume current policy holds with the average effective tariff rate at its current level of 13.8%. Specifically, we consider 50% tariffs on steel and aluminum (with the exception of the UK which faces a 25% rate), 25% tariffs on motor vehicles and parts, and a reduced Liberation Day tariff of 10% for most countries while the 90-day pause is in effect with the exception of China that currently faces a 30% import tariff.

HOW TARIFFS WILL FLOW THROUGH THE U.S. ECONOMY

The big inventory question: How much time do we have?

Q1 gross domestic product data shows us that businesses heavily front-loaded goods ahead of tariff implementation with a meaningful surge in imports and resulting jump in inventories.

Until those inventories are drawn down, the impacts of tariffs on the economy are stalled as businesses sit on and sell goods at pre-tariffed prices. As long as inventories remain bloated, we think it will be premature to claim definitively that tariffs will not slow growth or push up prices.

How long will it take for inventories to be fully used up? Problematically, it isn't straightforward to get a clean read.

First, the inventory build varies considerably by sector.

Durable inputs, like metals or motor vehicles and parts, may be stored for much longer than non-durable goods like food products, which do not have a substantial shelf life.

The Monthly Advance Report on Durable Goods showed fabricated metal products as well as electrical equipment and appliances both reported upticks in recent months. Though we suspect the report is understating the full magnitude of the buildup, and we expect to see more upward revisions as new data becomes available.

Second, inventory data is lagging the real-time economy.

The national accounts data showed the U.S. trade balance fell by close to \$1.4 trillion in Q1, and yet real inventories ramped up by (a still sizeable but much smaller) \$160.5 billion.

Interestingly, the Advance Report on Durable Goods has yet to show a meaningful ramp-up in inventories that matches the national accounts data. The data being recorded by businesses and collected by government agencies may not fully align, which could instigate a delay in imports being reported as inventories.

Additionally, as tariffs are implemented, the use of bonded warehouses may further complicate the reporting process, because goods in bonded warehouses are not cleared by customs for domestic distribution.

We expect it will take time to get an accurate picture of the magnitude of the inventory build on a sector basis, and there will likely be significant revisions throughout this process.

Third, the pace of inventory drawdown largely depends on consumer and business demand.

Stronger consumer activity will likely result in a faster depletion whereas a pullback in consumer spending and/or business investment could lead to a more prolonged drawdown.

Recent retail sales reports reflect sustained demand for consumer goods, but also signal pre-tariff front-loading by consumers as well (notably in

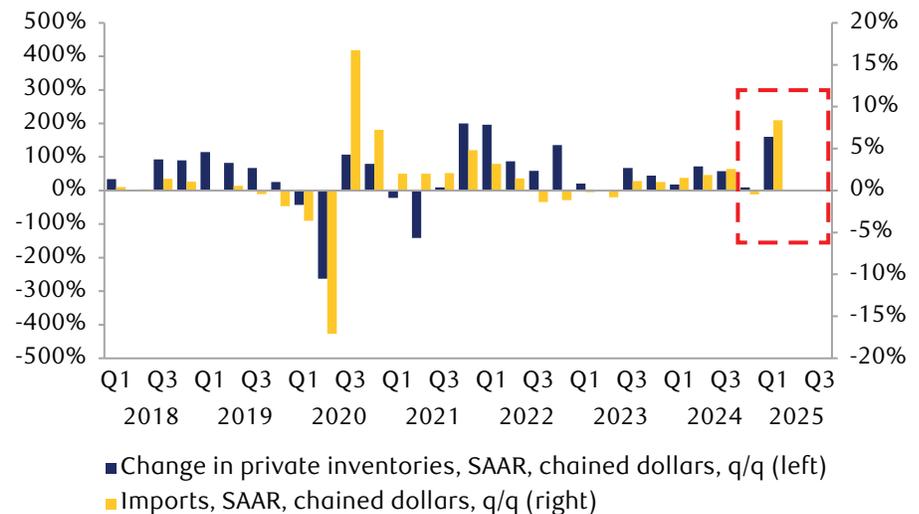
HOW TARIFFS WILL FLOW THROUGH THE U.S. ECONOMY

autos). That could imply that recent consumer demand won't be sustained. Importantly, we continue to expect high-income consumers will dominate consumption activity and have much higher levels of resilience.

Fourth, the volatility of tariff policy, including delays, may have encouraged multiple front-loading cycles that further muddy the clarity of inventories builds.

Based on data we have now, we estimate the aggregate economy has as much as a five months of inventory buildup. In non-durable products like pharmaceuticals which expire, for example, that horizon is shorter.

Q1 import and inventory spike preceded tariffs



Source - U.S. Bureau of Economic Analysis, RBC Economics; as of 6/26/25

Imports will ultimately resume at higher prices—where will we see price pressures first?

Once inventories are largely depleted and imports resume at tariffed prices, we expect to see higher producer prices, for example, in the Produce Price Index (PPI).

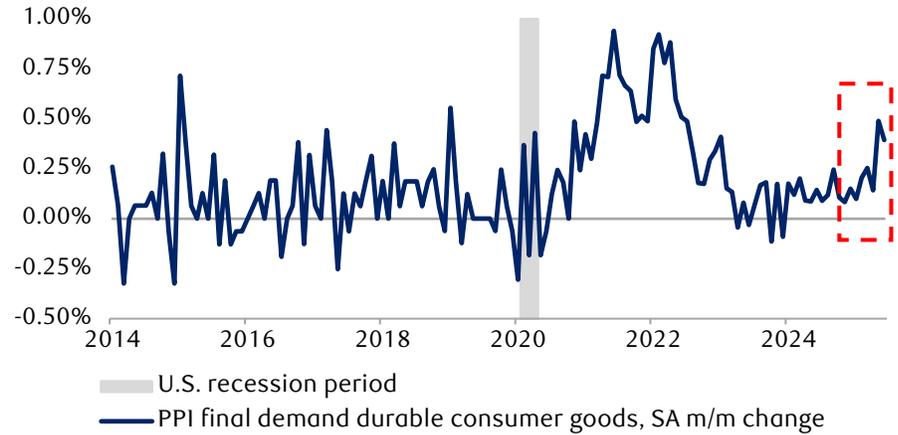
Helpfully, PPI is structured by stage of production, which allows us to see price pressures emerge in raw materials, intermediate inputs, and final goods, giving an indication of potential increases to consumer prices (reflected in Consumer Price Index) in the coming months.

So far, headline PPI seems innocuous, but this is in part because services deflation has been offsetting early upward pressure from goods. Importantly, month-over-month price changes in finished durable consumer goods are heating up, particularly in furniture, household appliances, and electrical equipment.

Going forward, we also expect to see pressure build in trade services PPI, which measures margins, specifically, the difference between selling and acquisition prices of a good sold to non-manufacturing industries. We have not seen this yet, but trade services PPI will give us a gauge of the extent that margin compression is occurring outside of manufacturing.

HOW TARIFFS WILL FLOW THROUGH THE U.S. ECONOMY

Producer Price Index for durable consumer goods heats up



Source - U.S. Bureau of Labor Statistics, RBC Economics; as of 7/16/25

Businesses will pass tariffs to consumers, absorb costs, or do both

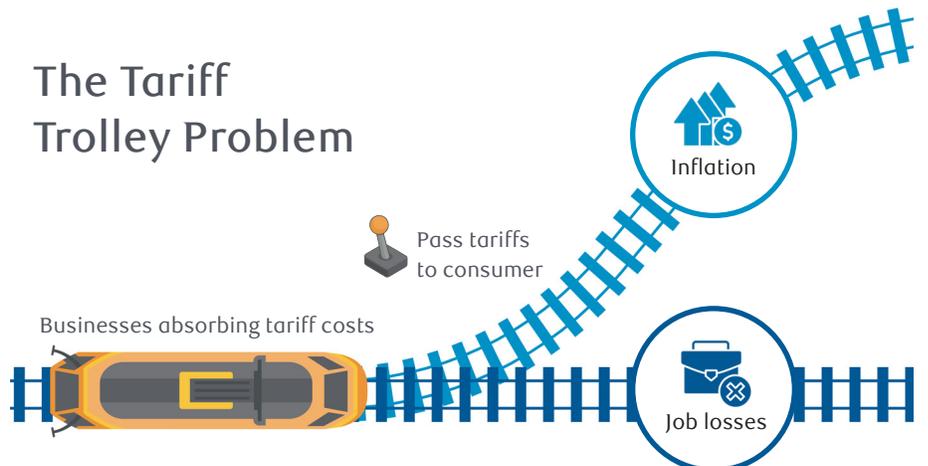
Tariff revenue has already soared by about \$50 billion year to date—doubling from a year ago. Those tariffs will need to be paid by some segment(s) of the economy.

Where the buck stops has different implications for growth, employment, and consumer prices. Again, the outcomes are likely to vary by product. In its most simplified form, there are two paths the tariff burden can follow.

- **If businesses absorb the tariff, jobs are at risk.** The idea that tariffs will not be inflationary is largely based on the concept that businesses will absorb the higher costs, which would certainly be inflationary for them. While that might imply less pressure on consumer prices, we’d caution against the idea that this is a good outcome for the U.S. economy.

If businesses carry the costs themselves, they’ll face margin compression and need to cut costs elsewhere. Labor is a good candidate. Compensation reflects roughly 48% of gross value added by businesses, suggesting that for every dollar of value generated by a business, \$0.48 of that goes to staff.

The Tariff Trolley Problem



HOW TARIFFS WILL FLOW THROUGH THE U.S. ECONOMY

Clearly, there would be implications for households from job cuts but businesses as well. As we've covered in depth [here](#), employers are facing structurally lower labor supply that is complicating their relationship with workers, and there are likely limitations to how weak the labor market can become as a result. Firms may need to spread cost reductions out, including to capital investment, for example.

- **If businesses pass tariffs on to consumers, prices are at risk.** The businesses that can and will pass tariffs on to consumers will likely vary quite a bit by sector and end-consumer. We continue to expect it will be much easier to pass on price increases to higher-income households than lower- and middle-income ones, who are in a more precarious economic position.

How will we know when and where consumers are absorbing higher costs? We'll first see evidence of consumers absorbing tariffs via import-exposed sectors. Think core goods prices first, specifically household furnishings and supplies, where the import share is roughly 50%.

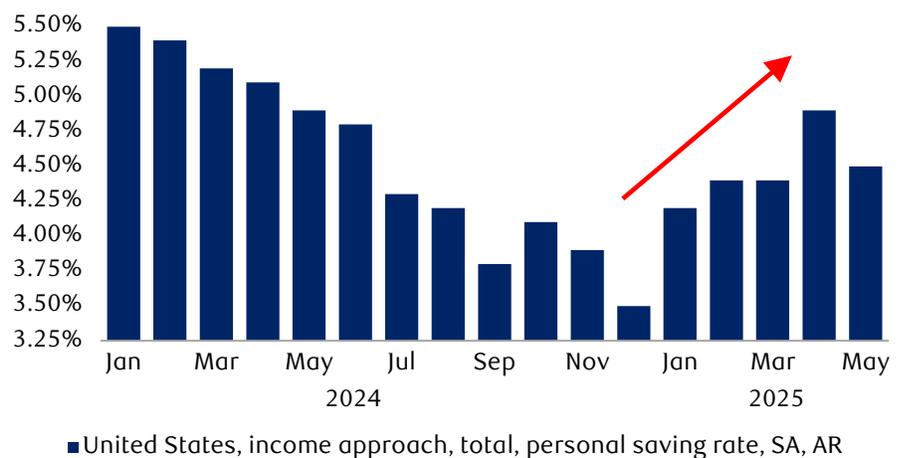
Apparel and recreation commodities are largely imported from Asia and especially exposed to tariffs. Later, should sector-specific tariffs on copper, semiconductors, and pharmaceuticals be announced, we would also see higher prices for electronics, communications equipment, and medical care products.

We would see prices rise in core goods first, but we'd also expect to see it spill over to services with a lag. For example, as motor vehicle parts and equipment become more expensive, auto repairs will cost more and, in time, the cost of auto insurance will be adjusted to account for higher repair costs.

If wages are constant or lower (as we expect), consumers facing higher prices on tariffed products will have to make a choice: Buy less of the tariffed product or buy less of something else.

We believe households are more likely to prioritize services consumption at the expense of discretionary goods. But either way, real demand would

Households ramping up precautionary savings



Source - U.S. Bureau of Economic Analysis, RBC Economics; as of 6/27/25

HOW TARIFFS WILL FLOW THROUGH THE U.S. ECONOMY

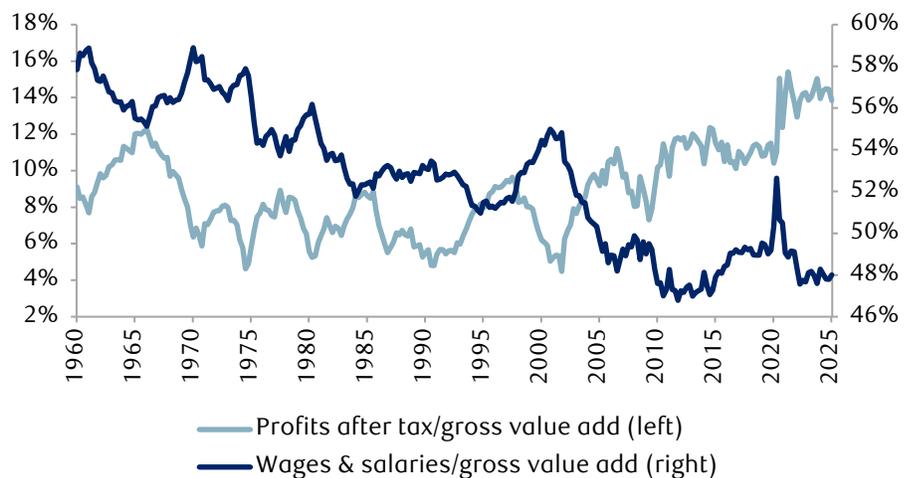
likely fall, and the difficult reality is that if tariffs derail consumption in pockets of the economy (i.e., demand destruction), business profits will weaken, and businesses will also look to cut costs. Consumers may already be preparing for these choices as precautionary savings are already rising.

Ultimately, it's likely that both channels of transmission come into play—with some drift higher in the unemployment rate coupled with higher consumer prices. We expect to see core goods inflation approach 3.4% by year-end as the unemployment rate rises toward 4.5%.

Our concerns are more tilted to the inflation side of the picture because there are other inflationary pressures in the economy, and low- and middle-income households have yet to recover from the pandemic-era inflation shock.

Given the significant variability of outcomes, however, we'll be closely following this transmission framework and updating our forecast as needed.

Wages account for a significant share of firms' gross-value added



Source - U.S. Bureau of Economic Analysis, RBC Economics

About the authors

Frances Donald is the Chief Economist at RBC and oversees a team of leading professionals who deliver economic analyses and insights to inform RBC clients around the globe. Frances is a key expert on economic issues and is highly sought after by clients, government leaders, policymakers, and media in the U.S. and Canada.

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GLOBAL Equity



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The shift is on

Key points

- Tariffs are arriving and are likely to bring economic messiness and stock market volatility with them. Investors are prepared for the likelihood that earnings estimates for this year may have to endure some downward revisions.
- But they are increasingly shifting their focus to the earnings prospects for 2026. If investors can remain convinced that economic and earnings growth can reassert themselves in 2026, then so too should the major uptrend for equity markets.

Most major indexes have posted new highs over the past 60 days. The European equity market is the notable exception although it is close to doing so. This has not happened in isolation as underlying corporate earnings have also been moving higher.

Pulse on P/Es

Valuations (price-to-earnings [P/E] multiples) are somewhat above their average settings for most global indexes and markedly above average for the S&P 500. The latter is where most of the world's mega-cap growth stocks reside; they have accounted for almost all of the S&P 500's valuation premium. Most global index P/Es are somewhat higher than they were at the beginning of the year but not appreciably so.

Equity investors are always trying to get a handle on where earnings and P/Es might be headed. In today's environment, they are posing two questions: Will earnings keep on rising? Are P/Es sustainable at their current, historically elevated levels?

For their part, P/Es have been in the above-average zone for some time. They can stay that way or, more likely, climb even higher as long as investors

remain convinced that earnings are on track to get back onto a robust growth path once the uncertainty/distortions of tariff upheaval fall away.

Consensus estimates suggest that strong earnings growth in 2026 is the prevailing expectation of market strategists.

There are two big reasons why the U.S. earnings outlook is so robust: tariffs and the giant fiscal package just passed into law. We think tariff-protected industries will have room to raise prices, boost revenues, and widen margins. At the same time, we expect the newly introduced ability to rapidly write off capital expenditures for tax purposes could substantially boost corporate after-tax incomes and cash flows.

Capital expenditures are thought to have a bigger multiplier effect on the economy than tax cuts and ultimately would be expected to increase productivity. And it isn't just domestic businesses that are being incentivised to spend. Foreign companies are understandably showing increasing interest in growing their tariff-free capacity in the U.S.

S&P 500 earnings per share versus nominal GDP growth

	2019	2020	2021	2022	2023	2024	2025E	2026E
S&P 500 EPS	\$165	\$137	\$209	\$219	\$211	\$242	\$266	\$301
% change	1.2%	-17.0%	52.6%	4.8%	-3.7%	14.7%	9.9%	13.1%
Nominal GDP growth	4.3%	-0.9%	10.9%	9.8%	6.6%	5.3%	4.4%	4.7%

Source - RBC Wealth Management, Bloomberg

GLOBAL EQUITY

However, there are important questions to be considered. Mike Reid, senior U.S. economist for RBC Economics, put it succinctly in the title of a recent report: “[America needs workers, not jobs.](#)” The so-called working-age population (those between 16 and 64) is about to go into a profound, long-lasting decline. Most other developed economies are already experiencing this and the weaker GDP growth that goes with it.

Even the population behemoths India and China have seen birth rates collapse and population growth slow dramatically (India) or go into outright decline (China). The potential offset to this—immigration—has become politically unpopular everywhere, no more so than in the U.S.

Considerable help wanted

The latest downward revisions to payroll data notwithstanding, a significant proportion of U.S. businesses, especially small and medium-sized, continue to cite the inability to attract, hire, and retain enough qualified employees as a significant headwind to their business prospects.

The exit door from the labor force is wide open. The number of retirees is growing steadily and should go on doing so for at least another decade. Meanwhile, at the other end, there are comparatively few new, younger workers coming through the entrance. So, a large and growing number of retirees who are mostly experienced and productive are being replaced by a diminished number of younger entrants who may be neither.

While labor conditions have eased somewhat from the extreme tightness of the past couple of years, the National Federation of Independent Business (NFIB) reported in its most recent monthly survey that almost 60% of respondents were hiring or planning to hire additional workers; of these, more than 85% reported few or no qualified applicants for the positions offered.

Equity views

Region	Previous	Current
Global	=	=
United States	=	=
Canada	=	=
Continental Europe	=	=
United Kingdom	–	=
Asia (ex Japan)	=	=
Japan	=	=

+ Overweight; = Market Weight; – Underweight
Source - RBC Wealth Management

Money to spend

Meanwhile, capital is building on the sidelines, looking to be invested in fixed assets in the U.S., accelerated by the very generous write-off provisions mandated in the budget bill. Rapidly expanding defense expenditure commitments in Canada, Europe, and Japan add to the flow of capital intended to build capacity that doesn't yet exist.

This spending wave is looking to find its way into a U.S. economy featuring a shrinking pool of available workers, tight electric power supplies, and other constrained inputs like advanced computer chips and critical minerals. “Too much money, chasing too few goods” comes to mind, suggesting to us that inflation, especially wage inflation, could prove to be stickier for longer than expected, perhaps leaving little room for central bank rate cutting.

But that might not matter. With so much aggregate demand in the form of capital spending about to arrive and the employment picture keeping the consumer able to grow household spending moderately rather than cutting back, the economy may not need to be propped up by more rate cutting.

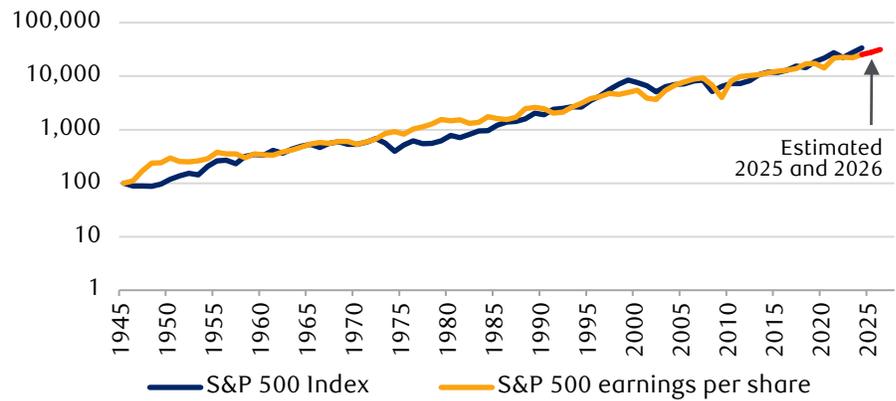
Looking over the valley

Investors have been prepared for the idea that some earnings and market volatility would accompany the actual imposition of tariffs. A bit of the earnings dislocation may have arrived in Q2. Most of that should

GLOBAL EQUITY

Almost a dead heat

S&P 500 and S&P 500 EPS indexed to 100 at 1945 (log scale)



Over the long term, the index has appreciated (7.5% per annum) almost exactly as fast as as earnings have grown (7.3% per annum).

Source - RBC Wealth Management, FactSet, Bloomberg

show up in H2 2025, in our view. As a result, earnings estimates for this year, which have held up remarkably well to this point, might suffer downward revisions in the coming months. We think investors would not be overly distressed by this.

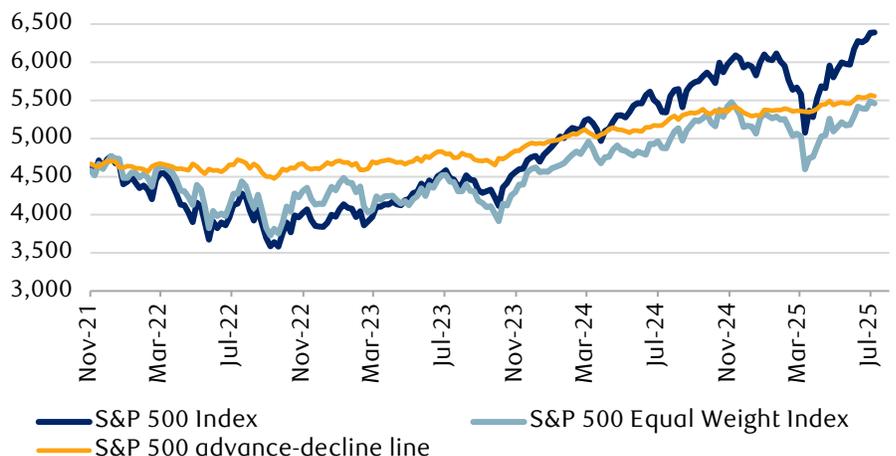
Increasingly, their focus is shifting to the 2026 earnings outlook and the path the economy will take to get there. If investors can feel confident the economic consequences of tariffs will be no more than an interlude of bumpiness and that a recession or more prolonged GDP downturn can be avoided, then any stock market

response is likely to take the form of consolidation/pullback.

So far that is the picture being painted by market “breadth” (see chart below). The advance/decline line for the S&P 500 and the equal-weighted version of the index have both recently posted new highs in sync with the more closely watched capitalization-weighted S&P 500 itself. Were the market close to a major turning point that was destined to turn into a bear market, we would expect those breadth measures to have already rolled over into clear downtrends in advance of the index doing so.

All together now

It’s not just the Magnificent 7; the majority of the stocks in the S&P 500 have been moving higher for most of the past 35 months



Source - RBC Wealth Management, FactSet, stockcharts.com

GLOBAL EQUITY

Invested, but watchful

Market volatility can't be ruled out in the coming months but as things stand today, we expect any such interval would give way to a resumption of the major uptrend.

We expect major equity markets to post further new highs in the months ahead. But with an advance that has now been running close to three years and valuations that have not been compellingly cheap for some time, we advocate for a cautious, watchful approach.

GLOBAL
Fixed income

Changing views precede a changing of the seasons

Key points

- We now believe the Bank of Canada (BoC) and the European Central Bank (ECB) have reached the end of their respective rate cutting cycles.
- The Bank of England (BoE) looks poised to deliver just two more rate cuts before pausing.
- Uncertainty around the Fed remains high, but we expect it to remain on hold until at least December, though a September rate cut remains on the table.



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As summer nears its end in the northern hemisphere, it appears that a growing cohort of global central banks are also nearing the end of their respective rate cut cycles, if they haven't already done so.

Following a more hawkish than expected meeting in July as policymakers were rather constructive about the economic growth outlook while noting inflationary risks, we now see the ECB holding rates steady at the current level of 2.00%.

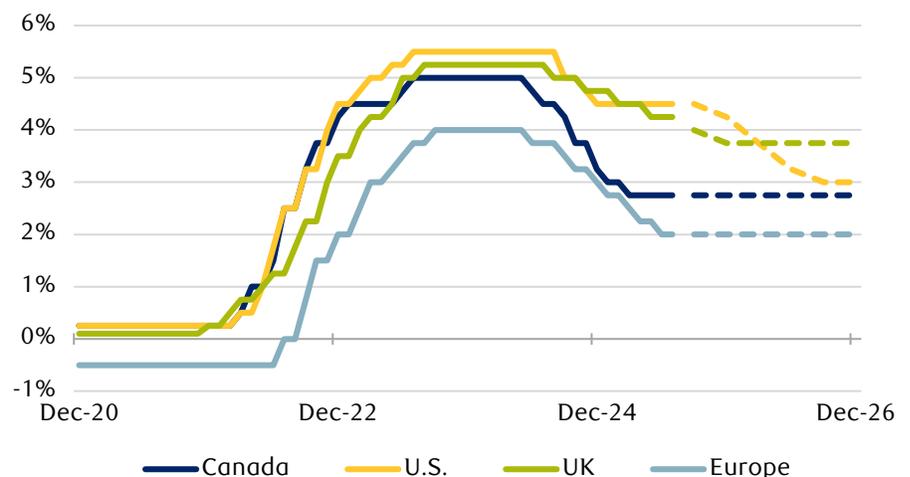
Similarly, although the BoC has kept rate cuts on pause since February, we now see the BoC as likely to be finished with reducing the rate. With direct trade risks fading and looming

fiscal stimulus following tax cuts in the pipeline, we believe further rate cuts from 2.75% will likely prove unnecessary.

However, in our view, the BoE likely still has a pair of rate cuts to deliver. Amid a subdued wage and inflation outlook, we see the BoE cutting in August and November, before stopping at a terminal rate of 3.75%.

Which leaves the Fed as the biggest wildcard of the bunch in our opinion. While the volume has been turned up to 11 in terms of President Trump calling for rate cuts, we now see the Fed cutting rates just once in December, compared to three cuts in our previous forecast back in June. We don't currently envision a later

Most central banks seen at end of rate cut cycles, as the Fed aims to restart its own



Source - RBC Wealth Management, Bloomberg, RBC Capital Markets forecasts as of July 2025

GLOBAL FIXED INCOME

start to mean fewer total cuts—after December we now see cuts at every meeting through next July with the Fed stopping at 3.00%. That said, a September rate cut remains on the table following a weak Nonfarm Payrolls report for July.

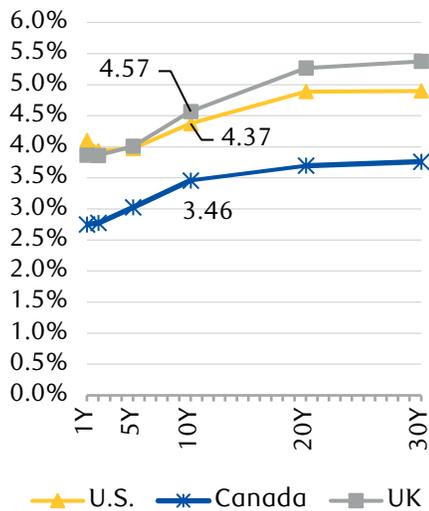
However, after all the policy uncertainty during the first half of the year, a pullback in corporate hiring shouldn't come as much of a surprise. If it persists, the Fed will likely cut out of caution, but we also see core inflation rising north to 3% when data is released for July. Put simply, given so many mixed economic signals the Fed will need to see more data, but policymakers might not have enough by September to begin cutting rates again.

Fixed income views

Region	Gov't bonds	Corp. credit	Duration
United States	+	-	3-7
Canada	+	-	3-7
Continental Europe	+	-	3-7
United Kingdom	+	-	3-7

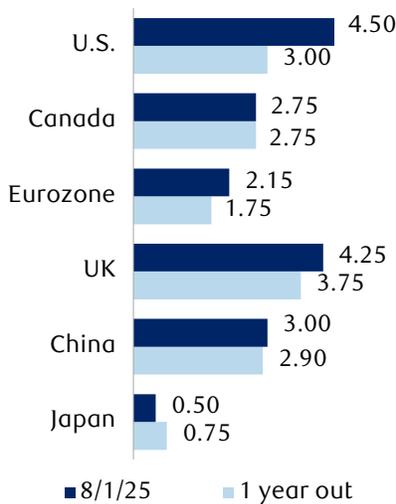
+ Overweight; = Market Weight; - Underweight
Source - RBC Wealth Management

Sovereign yield curves



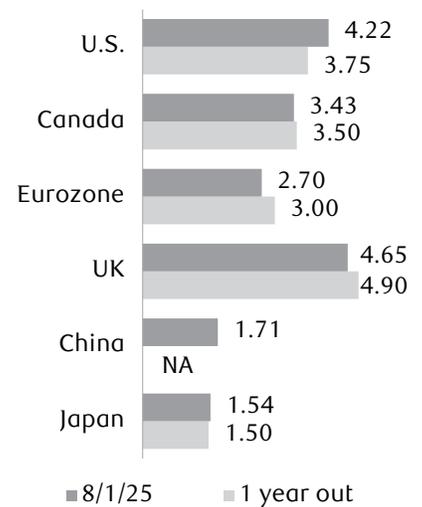
Source - Bloomberg; data through July 31, 2025

Central bank rates (%)



Source - RBC Economics, RBC Global Asset Management, Bloomberg

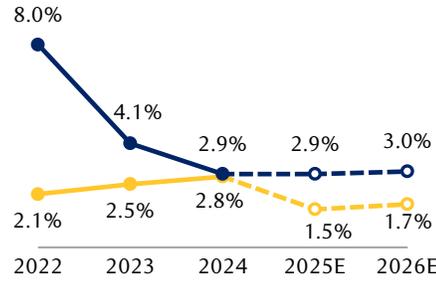
10-year rates (%)



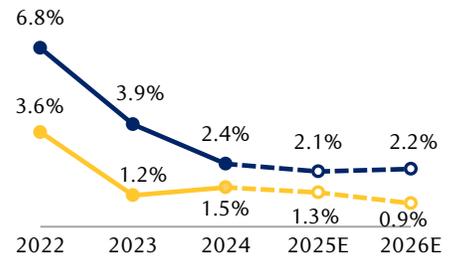
Note: Eurozone utilizes German Bunds.
Source - RBC Economics, RBC Global Asset Management, Bloomberg

KEY Forecasts

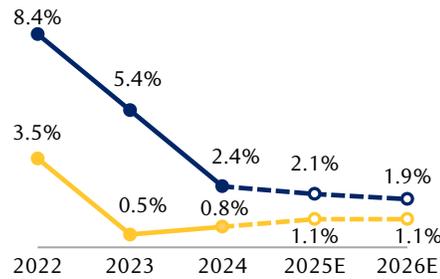
United States



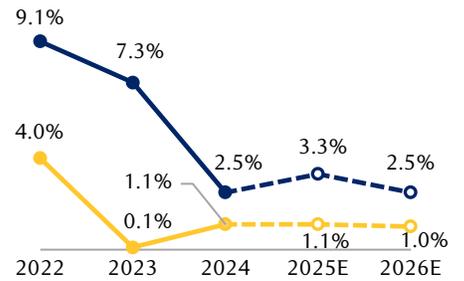
Canada



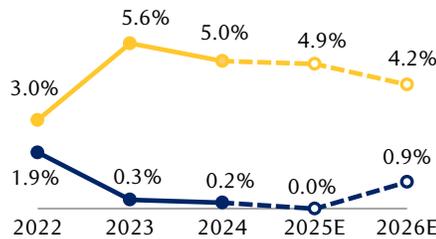
Eurozone



United Kingdom



China



Japan



—●— Real GDP growth

—●— Inflation rate

Source - RBC Investment Strategy Committee, RBC Capital Markets, Global Portfolio Advisory Committee, RBC Global Asset Management, Bloomberg consensus estimates

Research resources

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