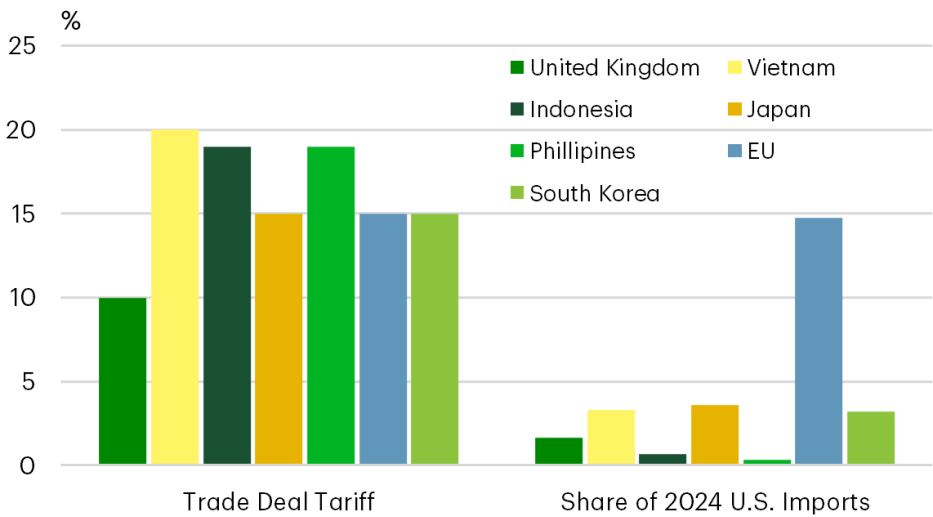




Q1. You get a deal, and You get a deal! Where do U.S. trade deals stand?

Chart 1: Announced U.S. Trade Deals Cover 28% of U.S. Imports



Source: White House, U.S. Census Bureau, TD Economics.

has been six months since the first announced tariffs went into effect, which is now considered the good ‘ol days. Since then, a multitude of country and sector specific tariffs have raised the effective U.S. tariff rate from roughly 2.5% to nearly 20%. Although we expect the effective tariff rate to decline modestly as additional trade deals are reached, elevated U.S. tariff rates will remain a fixture of the economy. So far, seven nations have negotiated trading arrangements: U.K., Vietnam, Indonesia, Japan, Philippines, E.U., and South Korea. Collectively, these nations account for a little over a quarter of U.S. imports, with tariff rates ranging from 15-20%. The U.K. marks the exception at 10% (Chart 1).

In addition, the U.S. agreed to varied reductions in sectoral tariffs captured under section 232 reviews. For steel/aluminum, only



Furthermore, the E.U. agreed to zero-for-zero tariffs on aircraft & parts, semiconductor equipment, natural resources & critical raw materials, in addition to certain chemicals, generics, and agricultural products. Once these become formalized by the U.S. rather than merely statements by the E.U., the effective tariff rate will be nudged down.

To get ahead of the next shoe to drop, the E.U. stated it agreed to 15% tariffs on pharmaceutical and semiconductor products. This is expected to be lower than the eventual sectoral tariff applied to those products. For pharmaceuticals, the E.U. accounted for 62% of U.S. imports in 2024, indicating this adjustment was material. Furthermore, the E.U. stated it had agreed to zero-for-zero tariffs on aircraft & parts, semiconductor equipment, natural resources & critical raw materials, in addition to certain chemicals, generics, and agricultural products. Once these become formalized by the U.S. rather than merely statements by the E.U., the effective tariff rate will be nudged down.

A trade deal with the U.S. is about more than just tariffs. Frameworks have also included over a trillion dollars in cumulative investment intentions in U.S. energy, agricultural, aerospace, and shipbuilding projects. Most of this will come from the E.U., Japan, and South Korea, however it is important to note that the details of these investments are murky. There are conflicting accounts of the arrangements arising between trading partners. Given this is the largest shift in trade policy in generations, the many nuances will need more time to be hashed out. This means that uncertainty over the business environment can prevail for countries long after reaching trade deals in principle.

Q2. How has the U.S. economic outlook changed?

Earlier this summer, we were surprised by the U.S. economy's unwavering resilience amid heightened policy uncertainty, the



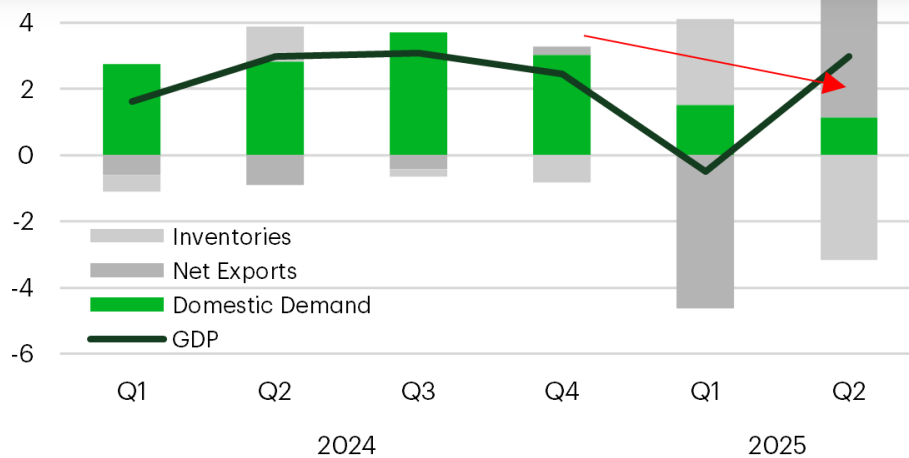
has been marked by significant volatility, with the aggregate GDP measure – which contracted in Q1 before rebounding by 3% in Q2 – due to massive swings in the trade data. Looking under the hood reveals clear signs that the economy is losing steam (Chart 2).

Chief among these is sputtering consumer spending momentum through the first half of the year, which has averaged just 1% (see further detail in [question 3](#)). Fortunately, some offset has come from stronger business investment, particularly within a 10% jump in equipment spending through H1-2025. At first glance, it would be plausible to assume that most of this strength could be chalked up to tariff front running. But the bulk of the gains came from a surge in computer equipment and software, some of which is likely related to AI investments.

We have long argued that the surge in data centers and semiconductor facilities that started to break ground in 2022 would eventually lead to a big push on equipment spending as those projects neared completion. And that is now playing out. By our estimates, spending on tech-related projects added 0.7 percentage points to GDP through H1-2025 and will likely remain a persistent tailwind over the coming years. Absent its contribution, final sales to private domestic purchasers – the best gauge of underlying economic activity – would have flatlined in the first half of this year, reinforcing that there wasn't a growth-catalyst elsewhere in the economy (Chart 3). We see growth averaging around 1% through H2-2025, bringing the annual average to 1.7% – slightly below trend and a notable downshift from 2024's 2.8%.

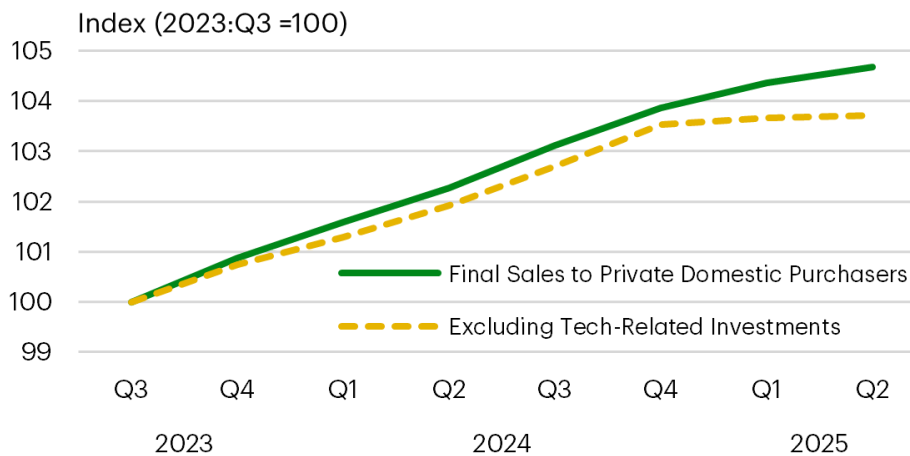
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Source: Bureau of Economic Analysis, TD Economics.

Chart 3: Tech-Related Investments Supporting Growth in H1-2025



Source: Bureau of Economic Analysis, TD Economics. *Tech-related investments include all spending on computers and other peripheral equipment, software, and manufacturing structures (including data centers and semiconductor facilities).

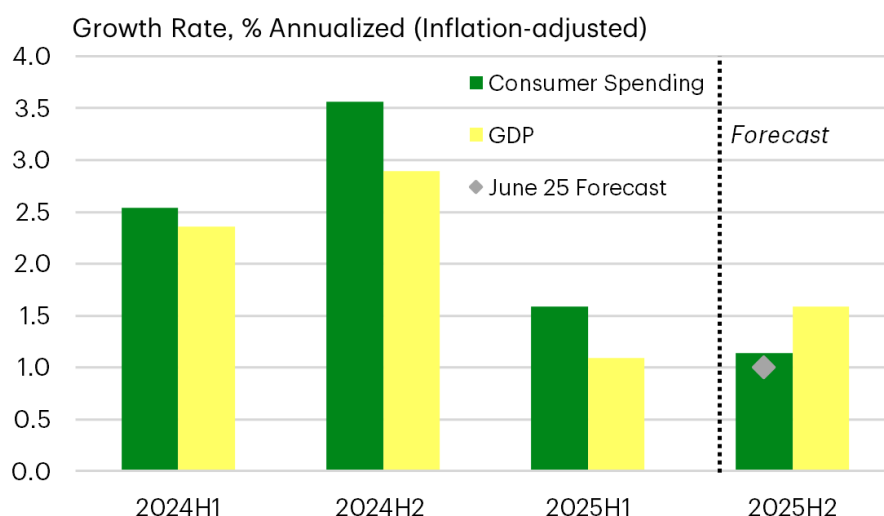
In 2026, the economy should edge up to 1.8%, which is not particularly remarkable and reflects a markdown in our forecast (previously 2.1%). This is because the U.S. effective tariff rate appears to be settling higher than we previously assumed, even as AI and fiscal tailwinds continue to offer a cushion and potential upside risk for 2026. Under the One Big Beautiful Bill Act (OBBBA), the combination of new household tax breaks, the 100% bonus depreciation on equipment and increased federal



opening rate to increase, supplemental nutrition programs and clean energy subsidies ramp-up.

Q3. The U.S. consumer is contending with several forces, what is the outlook?

Chart 4: U.S. Consumers Tap the Breaks



Source: Bureau of Economic Analysis, TD Economics.

Consumer spending crawled at a 1.6% annualized pace in the first half of the year compared to the 3.6% pace through H2-2024. This occurred even as households accelerated big-ticket purchases ahead of expected tariff increases. Much of the loss in momentum was due to a pullback in discretionary spending – a cautionary sign – as many forces conspire against households, including the softening job market, heightened economic uncertainty, and tighter immigration (Chart 4).

Significant downward revisions to payroll figures went a long way to help economists understand why consumer spending had become out-of-step with broader fundamentals. Revisions revealed that job growth stalled in May and June followed by only a modest rebound in July. Hiring averaged only 35k over the



depleted, firms are beginning to pass rising costs on to consumers. Goods prices, which had been declining, are once again trending higher. In response, households have begun cutting back on categories with the steepest price increases, such as furniture and recreational goods. Assuming half the tariff costs are passed onto the consumer, we estimate that it would raise the average household's cost of living by around \$1,900 per year – equivalent to a tax hike of 1% of GDP.

Beyond tariffs and labor market concerns, spending patterns also reflect weak population growth, elevated mortgage rates, and the resumption of student loan payments. Some of these influences will linger, such as those with student loans facing higher monthly payments due to [student debt reforms](#) introduced in the OBBBA.

Offsets will come from the OBBBA on new measures—such as eliminating taxes on tips and overtime, making auto loan interest deductible, and providing a \$6,000 deduction for seniors. However, these changes will only partially offset the impact of higher consumer prices as tariffs snake through the business cost structures with time.

Looking ahead, we expect consumer spending growth to pick up from about 1% this year to 1.7% (Q4/Q4) in 2026. However, this is still considered to be a modest pace.

Q4. Is inflation capturing tariff impacts?

The short answer is yes. Goods prices in the U.S. are showing early signs of tariff passthrough. As of July, price growth on core goods was up 1.2% year/year, compared to 2024 where prices fell by about 1%. Admittedly, this is a relatively small uptick, particularly when benchmarked against the burst of inflation that occurred post-pandemic, when goods prices hit a peak of



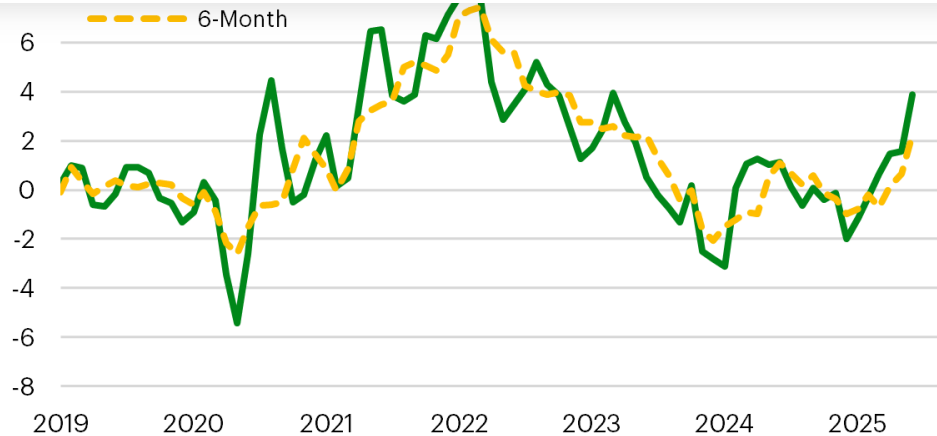
metrics. A single category is masking a resurgence in broader pressures. New and used vehicle prices have fallen by 1% since the auto tariffs were first announced in March, owing to increased inventories alongside a pullback in demand. Outside of this, all other goods prices (as measured by CPI inflation) are up nearly 4% annualized over the last three-months (Chart 5). These pressures risk heating up further in the coming months given that inbound products will be hit by the August 7th reset on tariff rates. It may not be immediately obvious because there's a grace period for goods in transit until early October. This timing will collide with an anticipated rise in vehicle prices, once dealerships start to roll out 2026 models.

Until recently, cooling services inflation had provided an offset to rising goods prices earlier in the summer. But that ended in July, as price pressures on non-housing services turned meaningfully higher. It's too early to know if this trend will persist, but even under the 'best case scenario' where services resume cooling on trend, core measures of inflation are likely to hang around today's 3% for another year.

As for Canada, its retaliatory tariffs have been smaller in scope and focused on U.S. products. In theory, this should result in a smaller uplift from prices, but it is not guaranteed. Global firms can spread the pain of higher prices around the world (in the hopes of limiting the shock to the U.S.). In addition, opportunistic companies could use importers' price hikes as cover for their own increases. However, so far, our analysis shows the CPI categories with items subject to retaliatory tariffs were to blame for much of the price gains in May and June (Chart 6).

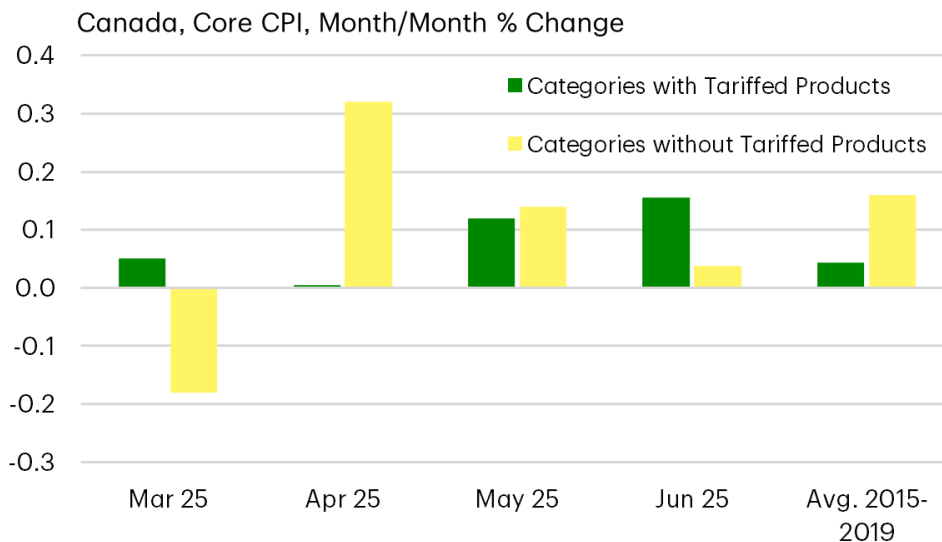
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Source: Bureau of Labor Statistics, TD Economics.

Chart 6: CPI Categories with Tariffed Products
See Outsized Price Gains in June

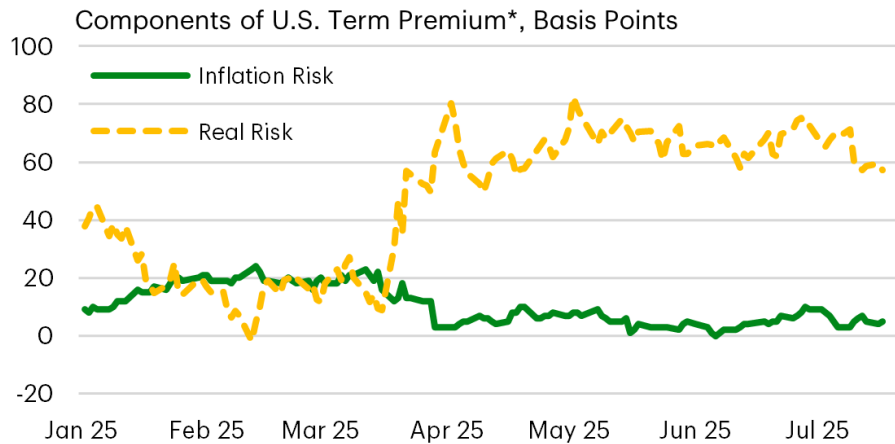


Source: Statistics Canada, Haver Analytics, TD Economics.

How much the recent appreciation in CAD can help offset any future gains is worth monitoring. However, the inflation impulse in Canada should be relatively smaller than in the U.S. The tariffs are targeted on a narrower set of items, and the economy is likely to move through a phase of sustained excess supply due to softer domestic demand conditions (see [question 7](#)).



in Term Premium



* Inflation and Real Risk Premia (IRP and RRP) estimated via the ACM model. IRP is inferred from break-evens, RRP captures residual risk unrelated to inflation.
Source: Federal Reserve Board, Federal Reserve Bank of New York, TD Economics.

Despite inflation still tracking hotter than Fed decision makers might prefer, a softer economic backdrop gives the Fed reasonable grounds to resume cutting interest rates. We expect three quarter-point cuts to the federal funds rate at each of the next three meetings, to an upper target range of 3.75% by year-end. And there's further room to run in order to return to a neutral rate of 3.25% by mid-2026.

That said, a 125-basis-point reduction in short rates may not be felt equally across the curve. The U.S. 10-2-year spread has risen by less than 20 basis points since January, a smaller rise compared to the 40 and 30 basis point steepening seen in Germany and Canada. This suggests that the lift to the U.S. term premium has been relatively small.

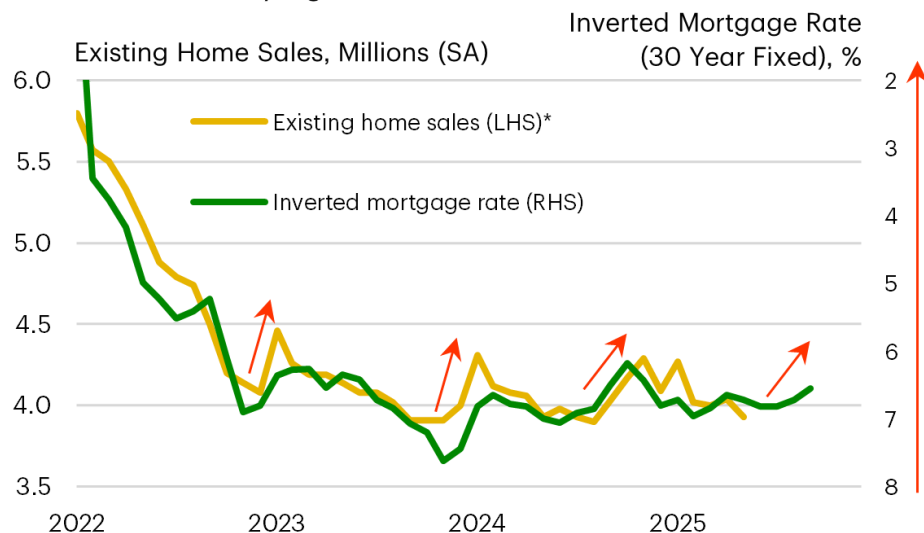
Yet, the risk remains. Our analysis shows that the bulk of the increase in the U.S. term premium thus far captures uncertainty around growth, fiscal sustainability, and geopolitical volatility, as well as evolving supply-demand dynamics for long-term bonds (Chart 7). In contrast, America's large and growing fiscal deficit does not yet appear to be substantially lifting the term premium, which can come back into focus at any time. Several factors may explain this, including markets' expectations of relatively



Treasury's issuance strategy. This includes tilting issuance toward the front end of the curve, holding the pool of longer-dated securities steady, and expanding its buyback program to retire older, less liquid long bonds. The net effect is a shrinking pool of long-dated bonds, which helps cap those yields. However, the risk of another upward leg in the risk premium cannot be dismissed as yet. Inflation risks haven't disappeared, and the trade war may continue to run interference on the Fed's desire to lower rates. For now, our current base-case forecast sees the U.S. 2-year at 3.25% and the 10-year yield at 4.0% by Q2 2026, steepening the 10-2-year yield spread from today's 50 basis points to roughly 75 basis points.

Q6. How does this add up for U.S. housing markets?

Chart 8: Latest Drop in Rates to Help Encourage More Homebuying



Source: TD Economics. *Lagged by 2 months.

Elevated longer-term interest rates have continued to take a toll on housing activity through the first half of 2025. Home sales levels remain near the lows of the Global Financial Crisis, arguing that this segment of the economy has behaved "recession like". However, that's only one side of the equation.



...ness, however, experienced very little growth in 2024, with the recent softness concentrated in the South and West Census regions, with many of those metros recording price declines. Meanwhile, prices in the Midwest and Northeast are holding up better. A similar divide can be seen along the East Coast, with the slowdown in home price growth generally more pronounced in the southern half of the region where seven of nine states have falling prices. A tighter inventory backdrop has favored sturdier price growth in the Northeast, where only two states have recorded price declines recently.

With affordability stretched tight, every little bit of downdraft in mortgage rates should help spur more sales activity, where there are high correlations (Chart 8). Because we anticipate the central bank will offer some rate-relief in the coming months, the market should begin to firm up, albeit this is really a "next year" story.

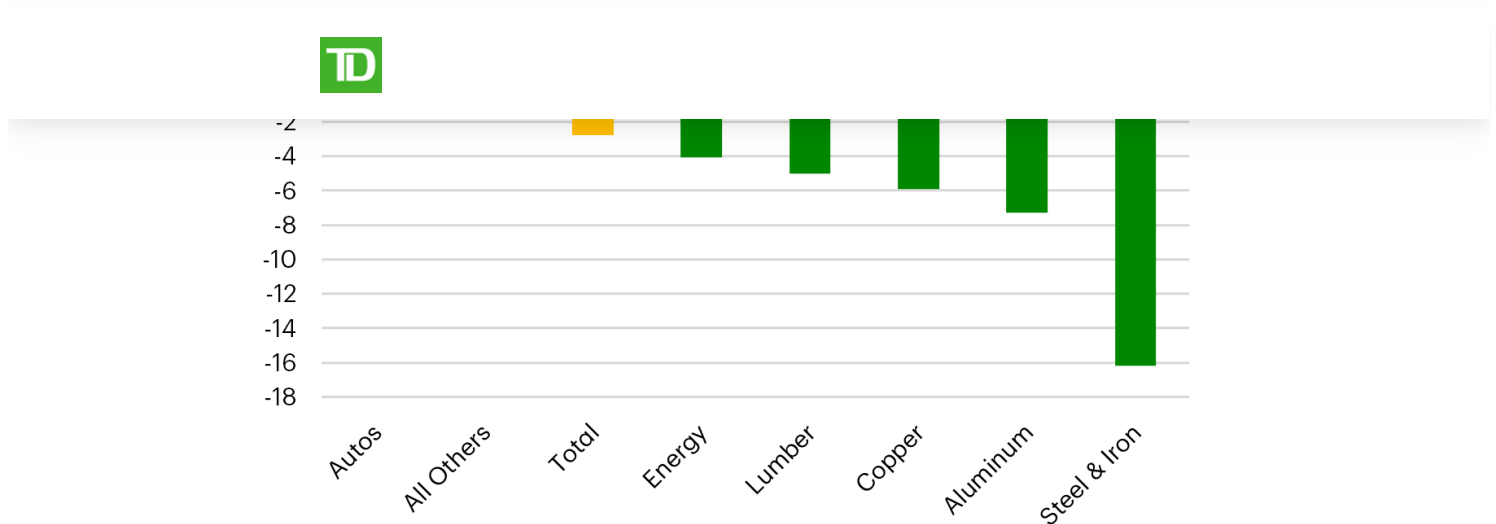
Q7. How has Canada's economic outlook shifted?

The tariff shock is being felt by Canada's economy, but looking through the quarterly volatility, 2025 is shaping up a bit better than expected a few months ago. To be clear, underlying momentum is still performing well below its capacity and accumulating economic slack. Annual growth is anticipated to register 1.3% in 2025, but this figure is flattered by strong growth at the end of last year. On a Q4/Q4 basis, look for the economy to expand by a more modest 0.6% in 2025.

We expect the economy to contract in the second quarter due to a tariff-related plunge in exports, but modest growth is likely to return in the third quarter as the housing market improves (see [question 10](#)) and the initial trade shock fades. The outlook for consumer spending this year is also looking a little better than our priors, amidst ongoing headwinds from confidence and slower population growth.

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Source: Statistics Canada, TD Economics.

The shock from U.S. tariffs is worth a closer look. Canada's trade-sensitive sectors are underperforming the rest of the economy across a variety of metrics ([see report](#)). Over the last six-months, exports across most tariff-exposed categories have underperformed overall goods exports to the U.S. (Chart 9). Notably, steel exports to the U.S. have contracted sharply as domestic producers face a punitive 50% tariff. Real GDP in trade-exposed sectors has tread water, while non-trade exposed sectors have grown by about 1%. Finally, trade exposed sectors have also accounted for only 10% of the roughly 180k Canadian jobs created since Trump won the presidency in November, despite accounting for one-third of total employment.

Due to the lack of high-frequency data on business investment in Canada, that piece of the near-term outlook is murkier. The Bank of Canada's (BoC) recent Business Outlook Survey highlighted that tariff uncertainty is causing firms to hold off on new investment plans, opting instead to focus on routine maintenance. One exception relates to the installation of a major oil platform on the East Coast that will boost investment in a single quarter but have no staying power. Meanwhile, Canadian automakers have slashed production and delayed investments. Overall, non-residential investment is expected to barely tread water this year with a 0.3% expansion in 2025 on a Q4/Q4 basis, but that is still an improvement relative to what we forecasted three months ago.



investments from governments (see [question 8](#)) and businesses.

Q8. How much economic tailwind can come from the government's nation-building agenda?

Canada's commitment to raise its defense spending targets can be viewed as part and parcel of the federal government's broader goal of delivering the largest economic transformation since WW2 that also includes re-orienting trade from the U.S. and building domestic supply-chain resilience.

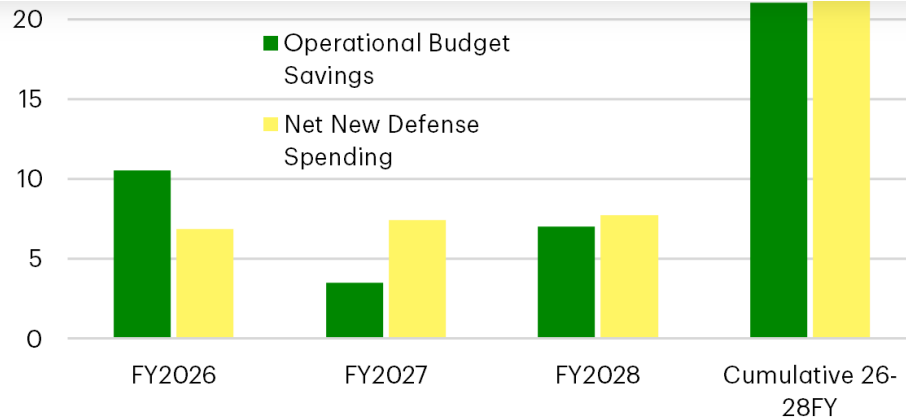
The fall budget should provide a more detailed roadmap around the "nation-building" agenda. But already, some key pieces have fallen into place, notably passage of Bill C-5 that aims to fast-track major projects and knock down interprovincial trade barriers. Other announcements include undertaking comprehensive reviews of both operating spending and federal regulations aimed at making government and processes more efficient.

Taken at face value, these moves have the potential to move the needle on Canadian long-term economic and productivity growth. To what degree will depend on execution, which is where the best-laid plans of governments often go awry. C-5 has been touted as a powerful piece of legislation that will speed up timelines but doesn't address potentially lengthy consultations with Indigenous communities, nor does it over-ride the need to gain provincial support on projects within their jurisdictions.

The Carney government has set an ambitious goal of catalyzing \$500 billion in private investment over 5 years, or about 25% of GDP. While the C-5 legislation will help to increase certainty for private-sector project proponents, attracting capital of this magnitude would require an all-out frontal assault on existing investment impediments.

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Source: PBO, Department of Finance, TD Economics.

Canada's high regulatory burden is often seen as the number one roadblock to investment. The upcoming review of federal regulations could help to course-correct, but the challenge is that most of Canada's complex regulatory quagmire is at the provincial and municipal levels. Interprovincial barriers to goods and labour mobility are a case in point. As we note in our [recent report](#), several provinces have been moving swiftly to remove barriers. But not all provinces are acting with the same urgency, raising the concern that momentum could peter out, blunting potential gains to be had through this channel for the country.

Much is yet to be revealed on all fronts, and we must be mindful that some of the stimulative impact from government investments, spending and other measures could be offset by spending reductions elsewhere. The federal government strives to secure savings in the operating budget of 7.5% over the next year and a total of 15% by year three (Chart 10). However, cost savings were planned in the Liberal platform, while the increase to defense spending beyond 2%, was not. This suggests that even if these targets are met, the net growth impulse from the growing defense bill would still be on the order of 0.2%-0.3% over the next year. Of course, the budget may fail to incorporate other spending measures that could increase fiscal stimulus but also result in faster growth in the debt burden.



turn down the temperature on Canadian inflation, enabling the Bank of Canada to cut interest rates later this year. The labour market is expected to moderate a bit from here and, together with the ongoing effects of the trade shock, the economy should continue to churn out a sub-par performance (see [question 7](#)). A weak domestic demand backdrop should help reduce inflationary pressures.

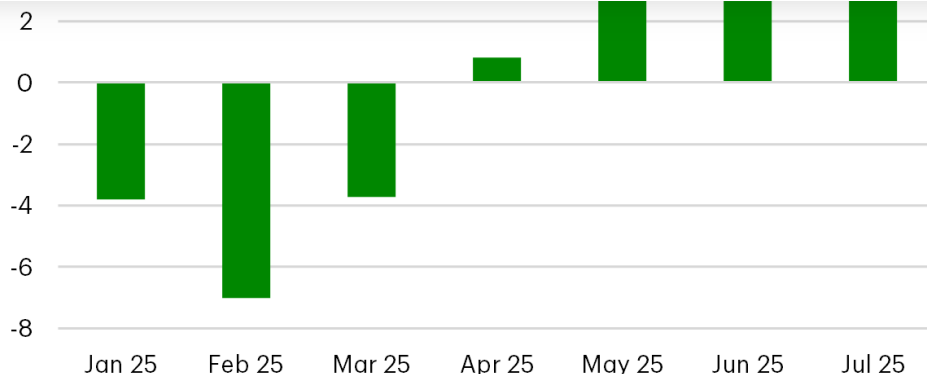
However, we are mindful that Canada's policy rate is already within the Bank of Canada's estimate of the neutral range, and we have yet to account for the full stimulative scope of the upcoming Fall government budget. Both create a less compelling case to cut than stateside if inflation proves more stubborn. In addition, unlike its American counterpart, the Canadian housing market has already staged a modest comeback, in a nod that the interest rate channel is working at stimulating demand. Intuitively, the Bank of Canada has a bit of room to further lower rates, but not a whole lot. The market has one full cut priced for the year, but it would be unusual for the central bank to apply a one-and-done approach. Given this is the "tweaking" stage of monetary policy, we view two options on the table: zero or two cuts.

Q10. Canada's housing market is showing signs of life, is this a flash in the pan?

We don't think so. For context, Canadian home sales have risen for four straight months (Chart 11), as previously sidelined buyers have returned to the market, supported by ample choice in markets like Toronto and Vancouver. Meanwhile, Canadian average home prices have climbed by 5% over that same period. It appears that gains "should have" taken place earlier this year, after significant interest rate relief in 2024, were delayed by a few months under the weight of U.S. tariff upheaval.

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Source: CREA, TD Economics.

We think this improving trend will maintain itself through next year. Some reduction in economic uncertainty should bring back more buyers in B.C. and Ontario, while Bank of Canada rate relief offers modest stimulus in the back half of the year. However, barriers remain, such as stretched affordability in several provinces and a weaker job market. A more robust recovery is unlikely until next year, when a 2% drop in Canadian sales and relatively flat Canadian average home prices (Q4/Q4 basis) in 2025 flips into sales growth of 9% and price growth of around 5%.

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