
Transcript - 06-27-2025**Beyond the Portfolio - Tariffs & the Economic Landscape with Michael Gregory****Mike Miranda:**

Welcome to Beyond the Portfolio. I'm Mike Miranda, Head of Investments for BMO Private Wealth North America. In each episode, we'll bring you expert analysis from BMO's top strategists and economists to help you navigate market conditions and stay informed. Today I am excited to be joined by Michael Gregory, Deputy Chief Economist for BMO Capital Markets. We're recording this episode on Friday, June 27th, and there's no shortage of major economic themes for us to unpack from shifting global growth expectations to central bank policy moves to the rising rhetoric and reality around tariffs and trade. Markets are grappling with a complex backdrop. Inflation has come down from its peak, but remains a concern in pockets. Central banks are signaling different paths at different speeds and geopolitics are once again influencing the macro narrative. Today's conversation will focus on making sense of that landscape, what's happening in the US, Canada, and the global economy, how central banks are responding, and what rising protectionist policies might mean for growth, inflation and investors. So let's get into it.

Michael, thanks for joining me today. Let's start with the tariff landscape first. Today we had Treasury Secretary Bessent say that the Trump administration's agenda for trade agreements could be wrapped up by the Labor Day holiday signaling maybe that there's some pushback past the July deadline that was originally proposed. Seems to be a focus on a subset of global relationships, perhaps the largest 10, and some progress being made on the likes of the UK, China, India and others. They also had EU this morning. Seemed to be confident that they'll hit the July deadline. So where do things stand in terms of the newly announced or implemented tariffs and how does that compare to what we were expecting back in April and May?

Michael Gregory:

Yeah, sure thing. Yeah, there's no doubt we had a little bit of calm here on the tariff front, but we still have four major buckets of tariffs that are in place now being collected at the border. Now, the first of those were the fentanyl and border security tariffs. Remember the 20% on China, the 25% on goods from Canada and Mexico that are not compliant with USMCA. And of course, that slips to 10% for Canadian energy, critical minerals and potash. The 50% tariff on steel and aluminum, the 25% tariff on automobiles and parts, again for automobiles that are assembled in Canada or Mexico, the US content in that is carved out for tariff purposes.

I'll give you an example of that. About half the value of cars assembled in Canada. For example, our US content, which means that those muster a 12.5% tariff rather than 25% parts. However, USMCA compliance parts are exempt from tariffs. And finally, we have the baseline reciprocal tariffs that 10% on most goods coming from most countries. That is the lay of the land right now. And as we saw with the first UK deal, even if there is going to be deals, I suspect that 10% baseline reciprocal tariff will still be there for almost all countries.

Mike Miranda:

All right, thanks for that, Michael. So obviously this has an impact potentially on growth and inflation, so maybe let's pivot to that. I think many have been surprised at the resiliency of the data to date. Undeniably we've seen a good amount of noise in this data given that tariff landscape and a good amount of front running activity from both consumers and corporations earlier this year. But growth has remained reasonably well-supported and on the inflation side, we've yet to see a meaningful push higher from tariffs. I think you could look to even this morning's latest inflation numbers, the PCE release to support the argument that the fear of an inflation spike has yet to materialize. So maybe a question for you, what's our base case view for how these tariff developments and maybe the broader macro conditions will impact both growth and inflation in the US, Canada, and globally?

Michael Gregory:

Well, sure, the main mechanism how tariffs really impact the US economy is through inflation. The erosion of purchasing power causes spending across the board to weaken. In addition to that, we get a hit to US exports coming from retaliatory measures and so far only two countries, China and Canada have imposed counter tariffs on the US. But there's no doubt that we have been a bit surprised, but so far, at least by the inflation impact of tariff has yet to show up. And I think you kind of hit it right on the head at the beginning. We had a lot of front running. We had record surge in imports into the US as businesses and consumers prepared for tariffs, and they are running down those tariff-free inventories as we speak, and it's only a matter of time before we do see the price level creep up because of tariffs.

And the Fed has acknowledged that they're waiting to see that impact before they make a final decision on what to do about rates. And we do think we're going to get an increase in inflation. For example, this year we're looking for core PCE inflation to come in just under three and a 5%. By the way, before the tariffs, we had inflation just under 2.5%, so it's a full percentage point increase in our forecast for US inflation core inflation because the tariffs. And because of that, we've basically lopped average growth this year from again, just under two and half percent to about one and a half percent for this year.

So we are going to get that faster inflation, slower growth impact on the US economy. Canada, the impact there is more on exports, but nearly 20% of the Canadian economy is made up of exports to the US and to the extent these are being dampened by tariffs, that's going to hurt the Canadian economy. We've got growth this year averaging about 1.3%, and that was close to 2% before the tariffs.

Now Canada also has its own retaliatory measures, and of course, those tariffs that Canada's putting on US goods do add to Canadian inflation. Although we don't see as much of an inflation impact in Canada because of the hit to growth, the bigger hit to growth because of weaker export volumes. We see core inflation in Canada, for example, on a fourth over fourth basis, just over two and a half percent for this year. And that was closer to 2% beforehand. And of course, with tariffs not only between Canada, United States, between United States and China and the US sort of imposing these on most countries, it's affecting global growth. And previously we had growth this year about 3%, a good steady state level for the global economy, and we've shaved that a couple of tenths at 2.8, which for the global economy is a meaningful amount of downgrade to growth.

Mike Miranda:

Thanks for that, Michael. So obviously, an impact as you outline both US, Canada and globally to the downside in growth and to the upside on inflation. So maybe we pivot to central banks because that's an important landscape here that we're thinking about as investors, maybe the Fed and the Bank of Canada specifically. How do we expect them to respond over the second half of 2025 and into 2026? As of this morning, the US has its first-rate cut, fully priced in by September, looks like two and a half cuts by the end of the year and a full three by early 2026. So as you outline, the growth trajectory is going to slow and inflation will be somewhat elevated from tariffs. So how might that shape the path for rates going forward?

Michael Gregory:

This kind of, if you'd like, a stag inflationary shock, a mild one mind you, but nevertheless, faster inflation, slower growth makes central bank's jobs very difficult because on one hand you want to temper the inflation, on the other hand, you want to boost the growth. And so both the bank account and the Fed are waiting to see how the scenario unfolds for the Fed. We know they haven't done anything since December and they continue to wait to see what the price impact will be, the inflation impact from tariffs. Now obviously they're not going to wait to see it fully wash out of the year-over-year inflation rate, but if they were to wait until that happens, they would be waiting too long. They'd be too late to help, maybe too much weaker growth in the economy.

So we think that once they get a sense of what kind of impact there is and maybe a month or two of if there's any feedback mechanism, are wages being pressured higher because of higher import prices, things like that. If it looks like that's not happening, I think very quickly the Fed will be pivoting to the fact that growth is slowing. The unemployment rate importantly is beginning to drift up above what they consider to be the longer run level of 4.2%, which we suspect is a very important break even level for them. If we start to rise above that, the Fed, I think is going to get very antsy about cutting rates.

So we do expect to see the Fed cut. It may be one or two times this year and further next year. The bottom line is that Fed policy is actually still quite restrictive. Not really quite restrictive. I mean, it's not as restrictive. It was because I cut 100 basis points, but with rates above 4%, when three percent's a little bit more neutral, that gives you at least 100, 125 basis points of potential easing just to take your foot off the brake, not even put your foot on the gas, take it off the brake.

Bank of Canada's in a different position though. They have been easing more aggressively than the Fed. The Fed's 100 basis points that Bank of Canada's already cut 225 basis points, including 50 basis points this year so far in part because of the increased risk to the Canadian economy coming from the trade war. And I suspect that they've got a little more leeway to wait here because policy is already in the neutral range. The foot is already off the brake and before they want to actually net put it onto the gas pedal, they just want to make sure that the inflation dynamic also in Canada does not suggest that we're getting more than just a one-time impact on inflation coming through tariffs. But I think we'll be ending this year, heading into next year with rates being cut on both sides of the border.

Mike Miranda:

All right, thanks for that, Michael. Very, very helpful. Let's pivot to one last topic maybe as it relates to geopolitical risks. We're sitting here on Friday, June 27th, and fortunately, the landscape has calmed down relative to where we were last week going into the weekend and certainly the early part of this week. But undeniably there's still

tension. So with ongoing tensions in the Middle East and other global hot spots, how are you thinking about that? What kind of impact could these geopolitical risks have on the global economic? Outlaw, energy markets, and currency dynamics broadly?

Michael Gregory:

Well, I think that the key thing is on confidence. And we all know that the trade war alone has been something which has eroded both business and consumer confidence, not only in United States and Canada, but around the world. And I think these further flaring up of geopolitical hot spots, they too cause an erosion of confidence. And while it's true that we haven't seen the continued flare up in oil prices, and other commodity prices, that ultimately is the riskier element of this for the outlook because the worst thing that can possibly happen, or one of the more damning things that can possibly happen for conducting monetary policy now is not only do you get a little bit of inflation risk coming from tariffs, but you also get a little of inflation risk coming from a flare up in oil prices does not reverse course. And that will be a very difficult task to try to contain inflation expectations when you've got this double whammy, if you'd like, of inflation pressures beginning to impact.

We all know that yeah, well, as economists, we look at core inflation and things like that, but the inflation that matters most for consumers is how much does it cost to fill up my gas tank? How much does it cost to fill up the grocery cart? It's food and energy prices that matter most, and now that's where the geopolitical rubber hits the road and the tariff rubber hits the road as far as consumers go.

Mike Miranda:

Really great points. Thanks again, Michael. I really appreciate you joining me today for today's conversation. As we heard, the economic outlook definitely remains complex with trade policy, central bank decisions, and this geopolitical uncertainty all playing a role. While growth is certainly showing signs of slowing in some areas, the underlying fundamentals remain stable enough for us to support a cautiously constructive view.

Talked about it last week on the podcast. We continue to position client portfolios close to strategic asset allocation targets, but with a modest bias towards equities where appropriate. That positioning has managed this environment well as we are sitting here today on Friday with equity markets in many spots, fully recovering the earlier losses and approaching the high set in February. At the same time, we are closely monitoring these macro and policy developments from tariffs to global tensions, and we remain focused on risk management and resilience. Diversification continues to be one of the most important tools we have to navigate an uncertain and evolving environment. Thank you for listening to Beyond the Portfolio. You could follow us on Apple Podcasts, Spotify, or your favorite podcast app. Until next time, I'm Mike Miranda.

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