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CUSMA quandary & dual mandate dilemma

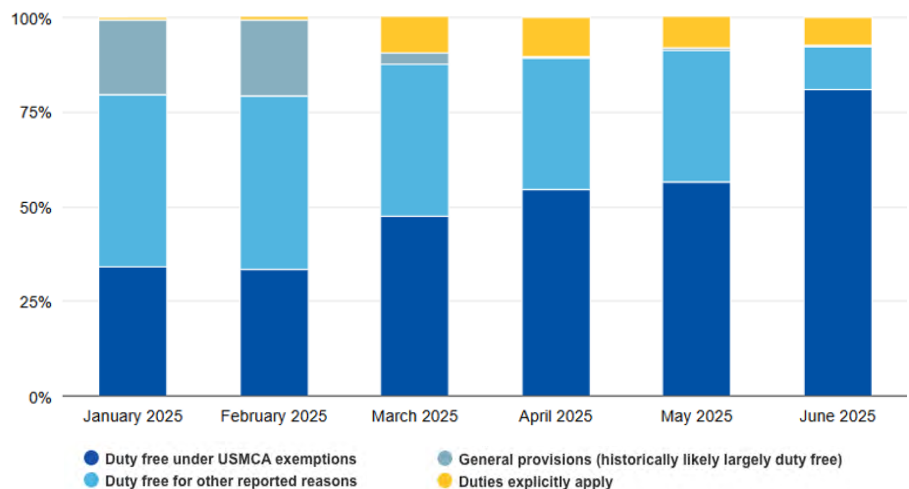
CUSMA 2.0 – Coming to a theatre near you in 2026

The preservation of CUSMA is economically critical to Canada

In mid-September, the U.S. formally began discussions regarding the future of the Canada-U.S.-Mexico Agreement (CUSMA) in anticipation of the formal review date on July 1, 2026. The intense negotiations involving its renewal or replacement are expected to transpire over the course of several months.

While the agreement does not automatically expire until 2036, the ramifications of this review seem far more fraught in light of the Trump administration's exacting tariff agenda. More concerning is that any of the three countries that are parties to the agreement could choose to withdraw from it by providing six months' notice. The other two options on the table are the extension of the agreement for another 16 years or the triggering of annual reviews up until the agreement's expiry in 2036.

U.S. imports from Canada by tariff provision % of total imports from Canada



Source: U.S. Census Bureau, RBC Economics

Source: [Most Canadian exports to the U.S. remained duty free in June](#)

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That the preservation of CUSMA is a critical underpinning of the economic narrative for Canada in the years to come is hardly debatable. When the U.S. slapped a blanket 25 percent tariff on Canadian and Mexican goods earlier this year—which was later increased to 35 percent for Canada in August—CUSMA served as a crucial shield for the country's exporters.

According to RBC Economics, [approximately 90 percent of U.S. imports from Canada](#) in Q2 of this year were free of tariffs as a result of the exemptions covered under CUSMA.

Furthermore, this agreement has resulted in the average effective tariff rate for Canada coming in around the low-to-mid-single-digit range—well below the average U.S. tariff rate on all imports in June. A reconfirmation and continuation of CUSMA in its current form would enhance Canada's competitive position as a trading partner with the U.S., relative to other countries.

In a nod toward trade reconciliation, and to lay the groundwork for smoother negotiations on CUSMA, Canada has already stepped up its military and border security spending in recent months. Perceived underfunding in these two areas was a key point of contention for the Trump administration. In addition, Canada has scrapped the Digital Services Tax (DST) on major U.S. internet-based companies operating in the country. More recently, Prime Minister Mark Carney eliminated retaliatory tariffs on U.S. goods that are in compliance with CUSMA.

As discussions unfold, we suspect other points of contention that the Trump administration may raise with Canada include the country's supply-management system for dairy, eggs and poultry, for which tariffs on U.S. imports are high. Higher North American content in automobiles (currently at 75 percent), alongside demands that a specific portion of each vehicle be made of U.S. auto parts, may also be raised.

The perceived “insular” nature of Canada's banking and financial industry may also be brought into question.

We expect the negotiations, ostensibly on trade, to intersect meaningfully with geopolitics and the Trump administration's desire to secure greater alignment with its allies around its national security priorities. In this regard, China remains in the crosshairs of the U.S., as the latter seeks to isolate the former technologically, and build a stronger domestic manufacturing footprint.

Consider that CUSMA contains a clause that forbids its signatories from trade negotiations with a “non-market economy” (read: China) in the absence of informing the other parties. The U.S. may seek to further curtail Chinese foreign direct investment in North America.

While Canada has already proffered some alignment with the U.S. with respect to its stance on China, a more stringent approach to the world's second largest economy could come at an economic and political cost to Ottawa. Not least because the Liberal government campaigned on a transformational economic agenda for Canada, of which the diversification of trade and global economic partnerships was no small

part. An insistence from Washington that North America must operate as a supposed “bloc” under some new version of CUSMA to fend off the competitive threat China is perceived to pose may in fact further entrench Canada's reliance on the U.S. as a trading partner.

All told, we believe the forging of CUSMA 2.0 will require some concessions from Canada and Mexico for the broader, more meaningful contours of the framework to remain intact.

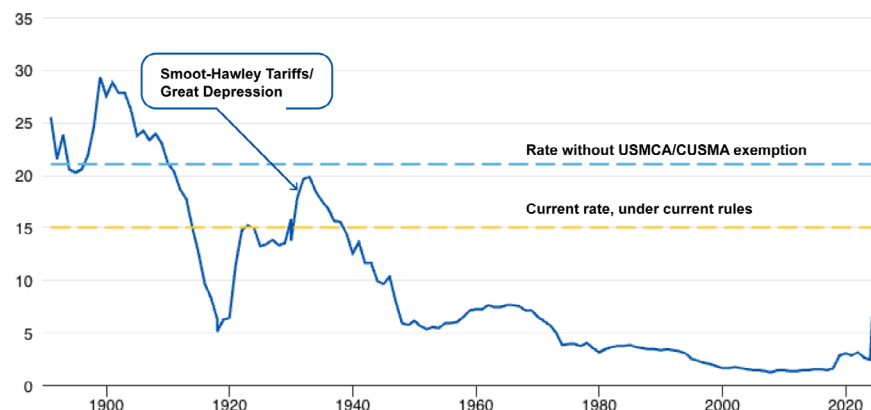
Potential meaningful consequences to U.S. trade and economic growth

While a great deal of energy and ink are justifiably expended on the critical nature of the agreement to Canada's economic outlook, it is important to note that the fate of CUSMA also has the potential to be significantly consequential for several trade sensitive sectors in the U.S.

RBC Economics estimates that the average effective U.S. tariff rate faced by U.S. importers currently sits close to 15 percent — a sizeable jump from under three percent last year—and the highest rate since the 1930s (although this is largely a result of duties on imports from regions other than Canada).

U.S. Average Import Duties rising to highest since 1930s

%, duties collected/total imports



Source: US ITC, RBC Economics

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In Trump's new global trade "playbook," the existence of CUSMA stands out as a safeguard that affords all parties involved—including the U.S.—a relatively lower tariff bill. By RBC Economics' assessment, at least [95 percent of U.S. goods exported to Canada in 2024 had zero tariffs](#) thanks to the agreement. Notably, Canada was the top export market for 32 U.S. states last year. To the extent that CUSMA exemptions are ultimately eliminated, the average effective U.S. tariff rate faced by U.S. importers could move as high as 20 percent, according to RBC Economics' estimates.

CUSMA is good for business and politics

Even though we've been here before, this time feels different. The stakes for Canada feel particularly high in light of persistently soft economic data, high unemployment and anemic GDP growth. History offers an ambiguous barometer of what may come to pass. On the one hand, if the Trump administration's approach thus far to tariff negotiations is anything to go by, one would be right to expect a series of tense and potentially volatile months ahead in parallel with heightened economic uncertainty for Canadians. The Trump administration may very well leverage Canada's reliance on U.S. trade in its favour (as it has done in the past).

And yet, the successful renegotiation of NAFTA (CUSMA's predecessor) during Trump's first term provides some grounds for optimism. Similarly, the president's decision to allow tariff exemptions for those goods that are CUSMA-compliant is also a positive sign in our view. Lastly, given the trade and economic benefits conferred by CUSMA on the U.S. itself, we suspect Trump will be politically motivated to show his voter base that a successful agreement has been secured in time for the mid-term U.S. elections coming in the fall of 2026.

SCOTUS to weigh in on the legality of Trump's tariffs

Importantly, the U.S. Supreme Court has announced it will hear oral arguments on Nov. 5 on the legality of Trump's sweeping global tariffs, with a ruling expected by the end of this year or early next. This announcement follows a ruling by a federal appeals court earlier this year that President Trump overstepped his authority by invoking the International Emergency Economic Powers Act (IEEPA/the Act) to impose sweeping global tariffs (including on China, Canada and Mexico this past spring).

The Federal Circuit majority noted that the U.S. Constitution bestows the power to establish tariffs on Congress, not the president. Indeed, in other instances, the Supreme Court has required Congress to be explicit when yielding its authority over a substantive economic or political issue.

Proponents of Trump's tariff agenda have argued that this policy is authorized under the IEEPA—a law that gives the president a potent myriad of measures to address national security, foreign policy and economic emergencies. Importantly, however, the IEEPA does not explicitly mention tariffs as one of those measures, although a key provision says the president can "regulate" the "importation" of property to address an emergency.

On the opposing side, the court will likely hear arguments that the U.S. trade deficit—cited by Trump as justification for his policy—does not constitute an "unusual and extraordinary threat" required under the law for the president's emergency powers to be triggered under the act.

The eventual ruling—in either direction—carries import (pun intended). Should the court rule against the tariffs, this would cut the current average effective tariff rate, currently in the mid-to-high-teens, by at least half according to [Bloomberg Economics](#). Subsequently, the U.S. government would be directed to [refund tens of](#)

[billions of dollars](#) collected under these tariffs. In addition, the validity of any preliminary trade deal that Trump has already struck with some nations may be brought into question.

And yet, administration officials have suggested that the impact of such litigation may well be overstated, and that most of the tariffs can be imposed via alternative legal avenues. For example, Trump's tariffs on steel, aluminum and automobiles imports were imposed under a different law—Section 232—and as such are not directly impacted by the appeal. In fact, the Department of Commerce, which oversees this type of tariff, seeks to expand the scope of tariffs under this law to potentially include other goods such as timber, critical minerals, aircraft and wind turbines, and that could ultimately result in a further escalation in the levy rate.

Legal experts in the U.S. have opined that Section 232 is relatively secure from legal challenges. By the same token, arguments in favour of tariffs on items such kitchen cabinets and upholstered furniture, predicated on the basis of national security, may well require justification by the Trump administration.

Ultimately, we believe it is reasonable for investors to anticipate some market volatility in the lead-up to and through the CUSMA negotiations. However, as we mentioned, over the medium to long term, the impacts on markets are likely to matter far less than the outlook for corporate earnings and GDP growth, and over the shorter term, we learn towards a positive outcome that will ultimately benefit all three countries. Your Investment Counsellor has the experience and perspective to look beyond the noise and to remain focused on managing your well-constructed, well-diversified portfolios built on a robust investment framework and geared to achieving your goals. Against this backdrop, it is our view that staying the course is the best "trade" you can make through the coming months of negotiations and beyond.

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Federal Reserve update: Dual mandate dilemma and muddled independence

On Sept. 17, the U.S. Federal Reserve moved forward with a widely expected quarter-point rate cut. More importantly, the Fed's "dot plots" (which capture Federal Open Market Committee (FOMC) members' expectations for the Fed's future rate levels) indicated a dovish shift, implying an additional half-point of cuts for the balance of this year (or an ultimate rate range of ~3.5 percent-3.75 percent), and another quarter-point cut next year.

Rather than a nod to a slowing economy (second quarter GDP growth came in at a sizzling 3.8 percent), the impetus behind the rate cut was a signal to the markets that the balance of risks in the Fed's dual mandate is currently skewed less toward inflation and more toward the labour market. This shift in balance comes in the wake of a meaningful downward revision in payrolls seen over the past few months, while unemployment crept higher in August (though it remains relatively low at ~4.3 percent).

Put differently, one could consider the latest move by the Fed to be akin to an "insurance cut," while their commentary relayed low conviction on the path of interest rates moving forward. To wit, on the point of interest rate policy, Federal Reserve Chairman Jerome Powell stated in the post-meeting press conference that, "we're in a meeting-by-meeting situation."

The Fed's mandate of full employment and price stability are in fact moving in opposite directions, as stagflationary pressures seem to be building in the economy, and the narrative of U.S. exceptionalism fades. Indeed, August's Consumer Price Index (CPI) inflation figures add fuel to this argument. Headline inflation crept higher to 2.9 percent year-over-year (which was largely in-line with consensus expectations), but more worryingly is that core CPI inflation (taking out energy and food inflation) accelerated

for the third month in a row, and was up just over three percent year-over-year for the month.

In addition, the Fed must be aware that it is operating in an informational vacuum vis-à-vis the Trump administration's tariff agenda (for which the renegotiation of CUSMA and the Supreme Court of the United States' (SCOTUS) decision give rise to further uncertainty). Thus far it would seem that U.S. corporations have broadly shielded consumers from tariff-related price increases, but there is no telling how long a desire to support demand will give way to the necessity of protecting profit margins.

It's also important to keep in mind that the substantial fiscal stimulus injected into the U.S. economy via the passage of the One Big Beautiful Bill—estimated to cost ~\$3 trillion over the next 10 years according to the [Bipartisan Policy Center](#)—is in effect comparable to at least one or two de facto rate cuts, with likely more immediate impact (given that rate changes tend to impact the economy with a lag). As a result, the balance of risks could very well tilt back toward inflation over the months to come, and the aforementioned dovish stance could tilt back into hawkish territory, and result in a pause from the Fed at the next meeting at the end of October. Therefore, over the medium to long term, while a few more rate cuts may be on the horizon, a full-blown easing cycle is not our base case scenario.

The Fed is likely to remain data dependent. But what about independent?

As if it wasn't enough to contend with a fluid and uncertain backdrop in which both sides of their dual mandates are being uncooperative; more recently, the Fed's very independence has come under scrutiny.

President Trump has not been shy about his view that the Fed should not only be cutting rates but cutting them aggressively. The president has

repeatedly and publicly criticized Powell for what he believes to be his too-cautious approach to cutting interest rates, nicknaming him "Too Late Powell." During his first term, the president considered firing the Fed chief (whom he appointed) but was disabused of that notion as swiftly as the markets revolted against it. He considered this again in his second term and even shared his inclination with fellow GOP lawmakers, who largely seemed to approve.

That Powell remains in his position nevertheless is likely owing to the weak grounds for firing that are specious at best. SCOTUS weighed in earlier this year; in that ruling they signaled that Chairman Powell is legally protected from being removed by the president on the grounds that the relationship between the commander-in-chief and the Fed is different from that of other independent agencies. Trump may have resigned himself to biding his time until Powell's tenure as chairman expires next May, at which point it is not clear if he will retire or remain as governor of the Federal Reserve (with term expiry in Jan. 2028).

In August, Trump escalated his fight against the Fed by attempting to fire Federal Reserve governor Lisa Cook on the basis of allegations of mortgage fraud in connection with applications she filed for two residential properties she owns. Cook has since sued Trump in U.S. district court in Washington D.C. The presiding judge barred Trump from firing Cook in early September as her suit unfolds. Trump's case against Cook now sits with the SCOTUS, which recently ruled that Cook is allowed to stay on as a Federal Reserve governor for now, in effect declining Trump's request to immediately remove her. The court will hear arguments over her firing in January.

In a small win for Trump, he was able to select Stephen Miran—chair of the Council of Economic Advisors—to replace former governor Adriana Kugler, who resigned in early August. Miran will serve out Kugler's term,

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which expires next January, at which point he may be reappointed. Note that Fed governors Christopher Waller and Andrea Bowman were nominated by Trump in his first and second terms, respectively.

For all the handwringing in the media and the admission of two new Fed nominees by Trump in his current term, we believe it may be too early to claim that its independence has been undermined. While much was made of the possibility of dissent from more than one member of the FOMC heading into the latest committee meeting, ultimately the sole dissenter was Miran, who voted for a half-point cut rather than a quarter-point cut. He was not joined by Waller or Bowman, though they have argued in favour of rate cuts and have dissented on interest rate decisions in previous meetings.

Indulge us in a hypothetical game of musical chairs for the Fed: in the event that Miran is reappointed, Cook is pushed out and Powell decides to retire, that would mark three potentially new FOMC members that could conceivably align more closely with Trump's interest-rate agenda—out of the total of 12 committee members. If Waller and Bowman are also included in Trump's rate cut camp, that takes it to five out of 12—still shy of a majority. Lastly, by the time many of these changes transpire (if they do), we are likely to be into the spring or summer of 2026, by which time rates could

be lower and therefore the political pressure may recede from boiling point to simmer.

We suspect that the potential for an adverse reaction toward a further undermining of the Fed's independence may keep the bellicose rhetoric from the Trump administration at bay. A continuation of such would only add to the opacity for the Fed's path going forward and may devalue its subsequent actions in the minds of investors. As Chairman Powell aptly stated at his most recent press conference, there are no "risk-free paths now, it's not incredibly obvious what to do." We are hard pressed to disagree.

Bank of Canada cuts its benchmark rate and leaves room for flexibility going forward

The Bank of Canada (BoC) also cut its benchmark rate by a quarter-point to 2.5 percent during its September meeting in response to a weak jobs market (the unemployment rate hit a nine-year high recently, excluding the pandemic period), a contraction in second quarter GDP of 1.6 percent and somewhat tempered upside risks to inflation.

This was the first cut since March, and the BoC said it remained ready to cut further should economic data soften more meaningfully in the months

ahead. Not surprisingly, BoC Governor Tiff Macklem underscored a still high level of uncertainty related to the U.S. tariffs. Slow population growth because of a meaningful pullback in immigration, and persistent weakness in the labour market, are expected to constrain household consumption for the next few months.

The BoC's next meeting is scheduled for Oct. 29, ahead of the planned release of the federal budget on Nov. 4. Macklem provided scarce forward guidance at the September meeting and allowed the central bank a considerable level of flexibility against a turbulent economic backdrop.

During that time, September readings for inflation and employment, alongside the Q3 BoC business outlook survey, are likely to be closely watched and incorporated into the BoC's next decision. We believe the central bank may seek to implement one more insurance-rate cut prior to the release of the budget, after which it may find that it is prudent to pause in light of the potentially inflationary impact the fiscal spending from the federal government may have, leaving rates at ~2.25 percent by the end of the year (in line with consensus).

[RBC Economics](#) views additional easing from the BoC to be likely in light of the economic concerns, unless the labour market demonstrates a meaningful improvement or inflationary pressures re-escalate.



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