

Economic Commentary

First Quarter 2026

War Against Iran Spikes Geopolitical Risk

Geopolitical risks became the dominant driver of global financial markets during the first quarter following the U.S. war on Iran. The major theme impacting the economy in 2025 was the potential impact that higher tariffs would have on global economic conditions. The landscape changed dramatically following the start of the war as oil prices surged while global trade was disrupted. There has been a shift away from economic fundamentals driving global markets to geopolitical events now shaping the economic cycle. Despite President Trump initially stating that the war would be over in a short period of time, the conflict continues and has led to increased uncertainty and volatility in financial markets. The closing of the Strait of Hormuz has led to supply chain delays, contributing to increased shipping costs and slower global trade. Given that Trump has alienated many of his allies over the past year, there has not been coordinated support from many countries in the Iranian conflict.

Stagflation Concerns Emerge

Even though inflation has declined to start the year, expectations are for it to re-accelerate following the U.S. war on Iran. The surge in oil prices and the immediate impact on the price of gas will most likely lead to higher inflation levels going forward, putting an end to the disinflationary trend that we have seen. U.S. inflation declined from 2.7% in December to 2.4% in February, while Canadian inflation declined from 2.4% to 1.8% over the same period. These levels were surprisingly low given the negative impact that was expected following the implementation of the higher tariffs last year. Global economic growth prospects have been revised downward due to the impact that the war on Iran will have on the economy. The U.S. econo-

my was exhibiting some momentum going into 2026, on the back of a resilient labour market, strong consumer spending and continued investment in AI infrastructure. These trends have cooled recently, putting downward pressure on economic growth. The Canadian economy has exhibited slower growth than the U.S. and is much more sensitive to higher interest rates than the U.S. economy, particularly in the housing market. The Canadian labour market has also slowed dramatically over the past few months.

Central Banks Leave Interest Rates Unchanged

Both the Bank of Canada and the U.S. Federal Reserve left interest rates unchanged during the quarter, after lowering them several times during 2025. The Bank of Canada lowered rates by 100 bp last year, while the Fed cut rates by 75 bp. This change in sentiment is due to the central banks having to balance the threat of higher inflation against the prospects for a weaker economy as stagflation fears have resurfaced in the market. There were already inflationary concerns in the market due to the higher tariffs that President Trump implemented last year and combined with the recent surge in oil prices, there is now increased pressure on inflation. Economic growth, on the other hand, is expected to slow as labour markets soften and prospects diminish for a strong economic recovery. Fourth quarter GDP growth in the U.S. was 0.7% on an annualized basis, while in Canada it was (0.6%). It is now expected that the Fed will remain on the sidelines during 2026, while market expectations are calling for potential rate hikes by the Bank of Canada later in the year. These expectations may be a little aggressive given the weakness in the Canadian econo-

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Key Metrics

Indicator	Value	Chg Q1	Chg 1Y
S&P/TSX Composite	32,768.04	4.0%	34.9%
S&P 500 (USD)	6,528.52	-4.4%	17.8%
iShares MSCI EAFE ETF (USD)	97.13	1.1%	23.1%
USD/CAD	\$ 0.72	-1.4%	3.4%
WTI Crude (\$/bbl)	\$ 101.38	76.6%	41.83%
GoC 10Y Bond	3.47%	4 bp	51 bp
GoC Deposit Rate	2.25%	0 bp	-50 bp
Cdn CPI YoY	1.8%	-0.6%	-0.5%
US 10Y Treasury	4.32%	15 bp	11 bp
Fed Funds Rate	3.75%	0 bp	-75 bp
USD CPI YoY	2.4%	-0.3%	0.0%

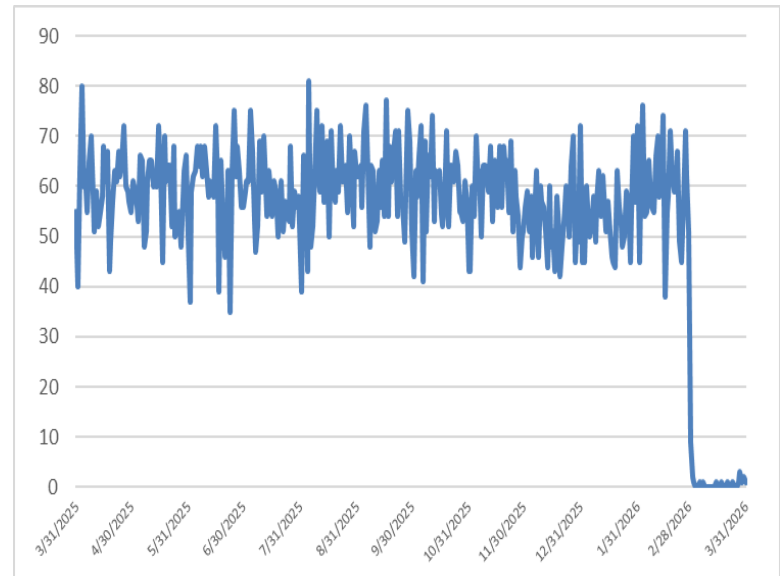
Top Themes

Geopolitical risk increases with U.S. war against Iran

Surge in energy prices sparks concern over stagflation

Bank of Canada and U.S. Fed pause further interest rate cuts

Top Chart: Strait of Hormuz Tanker Vessel Crossings



Source: Bloomberg, Morguard Lincluden

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my, along with the negative impact that it would have on an already depressed housing sector in Canada.

Equity Markets Decline While Bond Yields Both Higher

Most equity markets declined during the quarter as the U.S. war on Iran led to volatile market conditions as oil prices surging dramatically. Concerns in the AI sector also contributed to declines in global markets, particularly in the U.S. The Canadian equity market was one of the few indices that experienced a positive return during the first quarter, due primarily to the heavier weight in commodities in the Canadian market. Bond yields rose modestly during the quarter as expectations for monetary policy by both the Bank of Canada and the U.S. Federal Reserve shifted. After lowering interest rates last year, it is expected that no further cuts will be made in 2026. The yield on the benchmark 10 year U.S. Treasury increased by 15 bp, ending the year at 4.32%. Yields in the Canadian bond market rose to a lesser extent, with the yield on the 10 year Government of Canada bond increasing by only 4 bp, ending the year at 3.47%.