



## In search of a nail

Atul Bhatia, CFA – Minneapolis

The Federal Reserve wields a powerful hammer with its ability to move interest rates. Despite its strength, though, we think the central bank is poorly suited to address key concerns arising from high oil prices and the rollout of AI.

By moving interest rates, the U.S. central bank can help drive the cost of credit, thereby spurring or discouraging investments, and it can push asset prices higher by engaging in longer-term bond purchases. These are undoubtedly powerful economic tools.

But the Fed is not omnipotent. And as we survey the economic landscape, most of the key issues we see are, if not immune, certainly highly resistant to Fed intervention. The result is that while guessing the direction of Fed policy will be critical for certain types of cash management decisions, in the larger investment context, a few 25 basis points moves here or there may well be overshadowed by other policy and macroeconomic factors.

As we see it, the biggest tasks for U.S. and global policymakers are responding to a potential oil supply shock and dealing with the implications of AI on workers—both as economic units and as members of society. Neither of these factors, however, is amenable to correction by the Fed.

### Stagflation nation

Oil price shocks represent a risk of stagflation, a period of above-target inflation coupled with slow, or even negative, economic growth. This is both theoretically and practically tough for a central bank. Inflation calls for

higher rates, contractionary environments call for lower rates, and policymakers risk exacerbating a negative trend with any move.

The real problem, in our view, isn't that the Fed is forced to pick a side between contraction and inflation. The real problem is that the Fed's policy levers are largely useless to deal with either condition.

Let's start with the contractionary effects of an oil supply shock. A contraction generally calls for looser policy and easier credit to spur investment and hiring.

But if energy can't be had at an economically viable price to produce or transport goods, what does it matter if funding costs are a few basis points—or even percentage points—lower? A logistics firm isn't going to go on a truck-buying spree if high diesel prices make it impossible to run the machinery profitably. Even firms that have access to energy supply at a reasonable price aren't immune to an energy shock; there's no point in them building a new factory if their customer base is struggling to pay for gas. Rate policy works well to encourage growth when cost of capital is the binding constraint on investment, and that's just not the case today, in our view.

Dealing with supply-side inflation is equally problematic for the central bank. Rate hikes are the usual policy tool used to deal with rising prices, and the idea is to restrict

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credit and growth to bring supply and demand into better balance. But when there is a restriction in something as fundamental as energy, the amount of contraction required to bring balance would be crushing for the economy and the country, in our opinion. It would amount to killing the patient to cure a symptom.

Rather than offsetting the direct impact of higher oil prices, the main argument in favor of hiking rates in a stagflationary environment is secondary effects. The idea is that restrictive policy helps ward off the dreaded wage-price inflation spiral, where rising prices on consumer goods lead to higher wages which in turn set off another round of consumer inflation. It was this type of self-reinforcing mechanism that played a key role in U.S. inflation in the 1970s. While this is a nice argument in theory and has a reasonable historical hook, it doesn't seem to us to have much relevance to modern reality.

In the 1970s, roughly one-third of U.S. workers were unionized, and cost-of-living adjustments were built into collective bargaining agreements. Today, just over 10 percent of workers are unionized, and wages linked to inflation are largely a thing of the past.

More broadly, the rise of independent contractors and gig workers, combined with the threat of AI and the signs of a softening labor market, mean workers have little effective negotiating power to turn higher consumer prices into higher wages. Even during the post-pandemic labor shortages, real median wages in the U.S. only rose \$3.00 per week between Q1 2022 and Q1 2024. With labor slack building and the threat of AI overhanging the labor force, is it credible to think that the broad core of workers is going to be negotiating better deals now?

The bottom line, we believe, is that the Fed can make a symbolic move by shifting rates half a point lower or higher, but that should be taken for what it is: a symbol. The real-world economic impact of that type of policy is likely, we believe, to be dwarfed by developments in the Middle East.

## The pAIIn trade

AI has begun displacing knowledge workers and, in our view, will almost certainly continue to do so. In economic terms, this is a win. The discipline is, after all, about maximizing output given scarce resources. If AI can achieve the same production while using fewer workers, we think an economic boon will have been achieved.

Key to achieving that win is the belief that these freed-up workers will be deployed elsewhere and create new products. On a macro scale, that's probably true.

But for the newly freed-up worker, the picture is less rosy. Many of them have spent years or even decades acquiring the education and experience that made them "knowledge workers." Stripped of that value, their employment alternatives will likely be fewer and worse. For those who remain employed in their original profession, we expect AI to leverage their skills and provide an economic benefit. But for the rest, uncertainty reigns.

When we look at the AI-labor dynamic, it seems fairly obvious to us that the forces involved are unlikely to respond to a quarter-point change or two in overnight interbank borrowing rates. It's not like anyone will keep a human developer on the payroll at six figures instead of a free AI tool just because their payroll costs can be funded at three percent instead of 3.5 percent. Instead, we think fiscal and legislative policy together are the appropriate tools for addressing the economic and social implications of a technology revolution.

## Wrong tool at the right time

"Don't fight the Fed" is an aphorism for a reason. Within its sandbox, the institution is incredibly powerful. But when it comes to issues such as supply shocks and labor markets upended by innovation, we think the limits of the institution's power become apparent. The Fed will no doubt do what it can, but what it can do may fall far short of what is needed.

## UNITED STATES

Michael Roedl – Minneapolis

- U.S. Treasuries remain pressured in March as broadening hostilities in the Middle East fuel angst around rising energy prices and the risk of hotter inflation in the pipeline. **This month’s slump in Treasury prices raised yields on key benchmark maturities to multi-month highs—particularly the policy-sensitive 2-year yield after recently striking the highs from September 2025.** The sudden resurgence in inflation expectations has revamped the market’s outlook for rate cuts by the Federal Reserve. According to Fed fund futures data on Bloomberg, markets are now pricing in just one quarter-point rate cut by December 2026, down from two to three quarter-point cuts priced in a month ago. **Meanwhile, long-term Treasury yields also jumped on concerns that the war in Iran may further swell the U.S. budget deficit.** In our view, with the 30-year Treasury yield closing in on 4.90%, we think levels could re-test 5% if the war prolongs and leads to increased borrowing to pay for defense spending.
- This week U.S. equity prices also pushed lower amid further turmoil in oil markets. **As of yesterday’s close, the S&P 500 is down 2.5% month to date while oil prices surged over 40% from reduced shipping traffic through the Strait of Hormuz,** a key global trading route that delivers oil from the Persian Gulf. While rising oil prices have benefited performance in energy stocks, most broader indices are down in March from concerns about inflation, demand for labor, and signs of distress in the US\$1.8 trillion private credit market.

### 2-year Treasury yield jumps to September 2025 highs



Source - RBC Wealth Management, Bloomberg; daily data as of 3/11/26

## CANADA

Nguyen Dang, CFA & Claudia Humbert, CFA – Toronto

- Canadian equities have slipped modestly since the U.S. and Israel launched airstrikes across Iran, though the S&P/TSX Composite remains up roughly 4% year to date and close to its all-time high. The Energy sector’s 22% gain has contributed to that strength as investors priced in rising risks of Middle East oil supply disruptions. **As a major oil exporter, Canada is better positioned than global peers to weather higher crude prices, in our opinion, though the broader economic impact is mixed.** Higher oil prices support energy producers and government revenues, but they also raise gasoline and transportation costs for households, which may prompt reduced spending elsewhere in the economy and potentially dampen sentiment. In addition, Canada’s major oil pipelines are already operating near capacity, limiting the country’s ability to increase shipments quickly. **Historically, energy price spikes tied to geopolitical events have faded as supply adjusts and markets stabilize; however, a prolonged conflict could sustain higher prices longer and weigh on risk assets as investors assess risks to growth and inflation.**
- Prime Minister Mark Carney used a recent Indo-Pacific visit to deepen Canada’s strategic ties with both Japan and Australia, signalling a broader effort to diversify economic and security partnerships. In Tokyo, Canada and Japan announced a new comprehensive strategic partnership covering defence, energy, critical minerals, trade, and advanced technologies. The initiative aims to expand investment flows; strengthen supply chains in sectors such as semiconductors, batteries, and clean energy; and increase cooperation on cybersecurity, AI, and defence industrial capabilities. The two countries also committed to greater coordination on energy security—including liquefied natural gas, hydrogen, and nuclear technologies—and to deepen joint military exercises and maritime security efforts. Similarly in Australia, Canada elevated bilateral ties through agreements focused on critical minerals, clean energy, defence, and technology cooperation, including welcoming Australia into the G7-linked Critical Minerals Production Alliance to help diversify supply chains for key resources used in manufacturing and defence systems. The two governments also launched a new Clean Energy Partnership and expanded defence collaboration, including Arctic radar training. The initiatives highlight a growing push among Indo-Pacific partners to reinforce longer-term themes around energy security, critical minerals, and defence, though economic and investment implications will likely unfold only gradually over time, in our view.

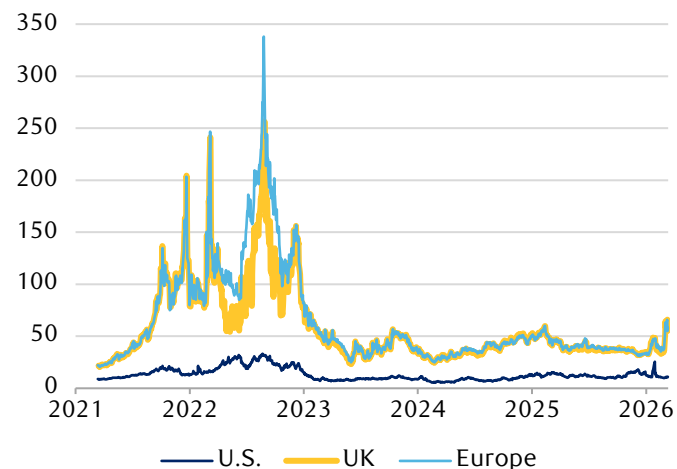
## UK-EUROPE

Frédérique Carrier – London

- **Economic implications of the military intervention in Iran continue to be assessed, although energy prices have risen less sharply than in 2022 following Russia's invasion of Ukraine.**
- **RBC Global Asset Management calculates that a permanent US\$40 increase in oil prices to around US\$105 per barrel—with the additional impact from a similar rise in natural gas prices—would initially subtract some 0.8% from eurozone GDP.** Inflation in the eurozone could rise by around 1.5 percentage points because of higher energy costs. Both effects would likely be somewhat smaller for the UK.
- **Energy price spikes tend to weigh more heavily on the euro area economy than the UK, reflecting Europe's larger manufacturing base and the greater exposure of industrial electricity prices to gas costs.** RBC Global Asset Management notes that the economic impact should be temporary: most of the loss in output levels would likely be recovered over time, and periods of elevated inflation should be followed by periods of lower inflation.
- **Nevertheless, policymakers remain alert to the energy price shock. The European Commission is considering wholesale energy price caps. The UK's response has so far been more limited, relying on its existing household energy price cap—which resets in June and could begin to reflect higher wholesale prices then—and monitoring retail fuel prices.**
- **Interest rate expectations have shifted following the conflict. Markets now price in one rate hike in Europe (from none previously) and no cuts in the UK (versus**

### European economies suffer from higher gas prices

Regional natural gas price, US\$/megawatt-hour



Source - RBC Wealth Management, RBC Brewin Dolphin, Bloomberg; data range 3/12/21–3/11/26

two priced in at the end of February). The latter shift has helped support the pound.

- **Higher energy prices are an unwelcome headwind for Europe.** If sustained, they would weigh on the improving domestic outlook, despite German fiscal stimulus and reform efforts proceeding. The MSCI Europe ex UK Index has surrendered its early-year gains since the conflict began and now sits roughly flat year to date, while the FTSE All-Share remains modestly higher, reflecting its larger Energy sector weighting.

## ASIA-PACIFIC

Jasmine Duan – Hong Kong

- **Investors continue to assess the impact of energy supply disruptions on Asian economies.** The Asian market rebound stalled on investor concerns that the region's reliance on maritime trade via the Strait of Hormuz could leave it vulnerable to the current crisis.
- **Northeast and East Asian economies are relatively better positioned to weather near-term energy shocks, in our view.** Despite their reliance on Middle Eastern oil, these countries maintain large strategic reserves and possess sufficient fiscal capacity to absorb temporary price pressures.
  - Japan and South Korea respectively import over 90% and 70% of their oil from the Middle East, and most of these shipments transit through the Strait of Hormuz. However, **both countries have built substantial strategic buffers**, with Japan holding around 250 days of reserves and South Korea around 200 days.
- **We think China is more resilient than commonly perceived.** While it imports more Middle Eastern energy than any other nation, China's energy sources remain highly diversified, with Russia currently its primary oil supplier. China has been increasing its strategic oil reserves over the past two decades, reinforcing a crucial buffer. Moreover, the Chinese economy largely relies on coal as the primary energy source, with oil only accounting for 18% of energy consumption, much lower than the global average of 32%.
- **South and Southeast Asian economies could face considerably greater risk, in our view, mainly due to their minimal strategic reserves.** India sources roughly half its oil imports from the Middle East yet maintains less than one month of strategic reserves. Indonesia, despite importing less than 25% from the Middle East, could exhaust supplies within 23 days.
- **We think a prolonged closure of the Strait of Hormuz could further pressure Asian economies' fiscal and current-account deficits and weaken currency outlooks.** At this stage, we believe developed economies have greater capacity to postpone the energy supply impact compared to emerging markets.

## MARKET Scorecard

Equities (local currency)	Level	MTD	YTD	1 yr	2 yr
S&P 500	6,775.80	-1.5%	-1.0%	21.6%	32.4%
Dow Industrials (DJIA)	47,417.27	-3.2%	-1.3%	14.4%	22.3%
Nasdaq	22,716.13	0.2%	-2.3%	30.3%	41.8%
Russell 2000	2,542.90	-3.4%	2.5%	25.7%	23.1%
S&P/TSX Comp	33,119.83	-3.6%	4.4%	36.6%	52.1%
FTSE All-Share	5,548.60	-5.2%	3.7%	20.9%	32.2%
STOXX Europe 600	602.54	-4.9%	1.7%	12.2%	20.1%
EURO STOXX 50	5,794.68	-5.6%	0.1%	9.1%	17.5%
Hang Seng	25,898.76	-2.7%	1.0%	8.9%	56.1%
Shanghai Comp	4,133.43	-0.7%	4.1%	22.3%	34.7%
Nikkei 225	55,025.37	-6.5%	9.3%	49.6%	41.7%
India Sensex	76,863.71	-5.4%	-9.8%	3.7%	4.6%
Singapore Straits Times	4,863.81	-2.6%	4.7%	27.1%	55.0%
Brazil Ibovespa	183,969.35	-2.6%	14.2%	49.0%	45.9%
Mexican Bolsa IPC	67,641.13	-5.3%	5.2%	31.3%	22.8%
Gov't bonds (bps change)	Yield	MTD	YTD	1 yr	2 yr
U.S. 10-Yr Treasury	4.224%	28.6	5.7	-5.6	12.6
Canada 10-Yr	3.484%	35.7	5.1	47.6	13.5
UK 10-Yr	4.686%	45.3	20.7	1.2	71.5
Germany 10-Yr	2.932%	28.9	7.7	3.5	62.9
Fixed income (returns)	Yield	MTD	YTD	1 yr	2 yr
U.S. Aggregate	4.37%	-1.0%	0.8%	5.7%	10.1%
U.S. Investment-Grade Corp	4.92%	-1.0%	0.5%	6.4%	11.1%
U.S. High-Yield Corp	6.91%	-0.2%	0.5%	7.7%	16.9%
Commodities (USD)	Price	MTD	YTD	1 yr	2 yr
Gold (spot \$/oz)	5,176.30	-1.9%	19.8%	77.5%	137.1%
Silver (spot \$/oz)	85.73	-8.6%	19.6%	160.2%	250.4%
Copper (\$/metric ton)	13,047.61	-1.9%	4.8%	35.4%	52.4%
Oil (WTI spot \$/bbl)	88.05	31.4%	53.3%	32.9%	13.0%
Oil (Brent spot \$/bbl)	92.62	27.8%	52.2%	33.2%	12.7%
Natural Gas (\$/mmBtu)	3.22	12.5%	-12.8%	-27.8%	82.8%
Currencies	Rate	MTD	YTD	1 yr	2 yr
U.S. Dollar Index	99.2340	1.7%	0.9%	-4.0%	-3.5%
CAD/USD	0.7357	0.4%	1.0%	6.2%	-0.8%
USD/CAD	1.3592	-0.4%	-1.0%	-5.8%	0.8%
EUR/USD	1.1569	-2.1%	-1.5%	6.0%	5.9%
GBP/USD	1.3415	-0.5%	-0.4%	3.6%	4.7%
AUD/USD	0.7152	0.5%	7.2%	13.6%	8.1%
USD/JPY	158.9400	1.9%	1.4%	7.6%	8.2%
EUR/JPY	183.8700	-0.3%	-0.1%	14.0%	14.5%
EUR/GBP	0.8623	-1.6%	-1.1%	2.3%	1.1%
EUR/CHF	0.9026	-0.7%	-3.0%	-6.4%	-5.9%
USD/SGD	1.2743	0.7%	-0.9%	-4.2%	-4.2%
USD/CNY	6.8741	0.2%	-1.6%	-4.9%	-4.3%
USD/MXN	17.6820	2.6%	-1.8%	-12.8%	5.3%
USD/BRL	5.1585	0.6%	-5.8%	-11.2%	3.6%

Equity returns do not include dividends, except for the Brazilian Ibovespa. Bond yields in local currencies. Copper Index data and U.S. fixed income returns as of Tuesday's close. Dollar Index measures USD vs. six major currencies. Currency rates reflect market convention (CAD/USD is the exception). Currency returns quoted in terms of the first currency in each pairing.

Examples of how to interpret currency data: CAD/USD 0.73 means 1 Canadian dollar will buy 0.73 U.S. dollar. CAD/USD 1.0% return means the Canadian dollar has risen 1.0% vs. the U.S. dollar year to date. USD/JPY 158.94 means 1 U.S. dollar will buy 158.94 yen. USD/JPY 1.4% return means the U.S. dollar has risen 1.4% vs. the yen year to date.

Source - Bloomberg; data as of 3/11/26

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			Count	Percent
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