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Navigating global uncertainty: Unlocking strategic advantages through an embedded modelling ecosystem

In the face of geopolitical uncertainty (exemplifies currently by the US tariff disputes), it is crucial for both financial institutions and corporates to adapt and refine their strategies to quantify and mitigate risks while capitalizing on emerging opportunities. Our Financial Engineering and Modelling team is well-equipped to provide the necessary support and expertise in navigating these challenges.

Introduction

The evolving US-Canada trade relationship, characterized by existing tariffs and the significant potential for escalation or modification anticipated through 2025, introduces a heightened level of geopolitical and economic uncertainty demanding immediate strategic attention. For Canadians and Canadian businesses, this uncertainty translates into critical pressure to enhance the accuracy and responsiveness of risk modeling frameworks, mandating the development of robust, forward-looking stress test scenarios that specifically capture plausible tariff-related shocks, including sharp CAD/USD volatility, sector-specific credit deterioration (e.g., automotive, agriculture, manufacturing), and potential impacts on market liquidity. Simultaneously, companies across numerous sectors confront urgent and complex operational and strategic challenges: navigating potentially severe supply chain disruptions, absorbing or passing on increased input costs impacting margins and revenues, making difficult pricing decisions under demand uncertainty, managing intensified foreign exchange risk, and fundamentally reassessing the viability and structure of cross-border investments and operations. Effectively managing this fluid and high-stakes environment necessitates a decisive shift from reactive adjustments to proactive, data-driven strategies grounded in sophisticated scenario analysis and quantitative modeling. Deloitte is well positioned to support, leveraging deep industry knowledge and advanced modelling capabilities to dissect these challenges, quantify potential impacts, and develop robust, tailored responses. In this document, we are going to explore the specific implications and adaptive strategies necessary to build resilience and maintain competitiveness in the face of ongoing US-Canada trade tensions and more broadly the global uncertainty.

> "It's better to be roughly right than precisely wrong"
>
> **— John Maynard Keynes, Economist**

Understanding the shift: key strategic imperatives in a tariff-impacted environment

The US tariff situation mandates a fundamental and urgent shift in business strategy and operational posture, moving beyond standard risk management protocols. Navigating this trade policy uncertainty is no longer a secondary consideration but a primary strategic imperative demanding C-suite and Board-level attention. The key resulting shifts require:

1. **Proactive and integrated planning:** Moving decisively from reactive adjustments to integrated supply chain and financial planning that explicitly models diverse 2025 tariff scenarios.
2. **Enhanced leadership visibility:** Providing Boards and management with clear, quantifiable, near real-time visibility into tariff exposure and mitigation effectiveness, tracked via robust KRIs and KPIs.
3. **Robust risk quantification:** Establishing new methodologies to measure both direct tariff costs and critical indirect risks (supplier stability, FX pass-through, demand elasticity, competitor actions).
4. **Strengthened resilience and contingency:** Intensifying focus and investment in organizational resilience through actionable contingency planning, supplier diversification, and ensuring financial flexibility.

Recommendation: foster a proactive, cross-functional resilience culture

This dynamic landscape demands proactive risk management embedded organization-wide, moving decisively beyond a compliance or reactive stance. It is instrumental to cultivate a 'resilience-aware' culture where anticipating tariff shifts, simulating impacts, and implementing preventative controls (e.g., dynamic multi-instrument hedging, strategic supplier diversification contracts, network optimization) become integral parts of standard business planning cycles, facilitated by breaking down functional silos and enhancing cross-departmental exchanges and collaboration on trade risk.

Impact spotlight: tariffs driving operational disruption and strategic realignment

Tariffs significantly amplify financial and operational risks, creating widespread

Ultimately, embracing proactive adaptation not only mitigates current tariff risks but also strengthens organizational resilience and long-term competitiveness

uncertainty. They directly inflate costs and disrupt finely tuned supply chains, leading to potential inventory imbalances, production delays, and increased logistics expenses. Concurrently, the heightened FX volatility (e.g., CAD/USD) complicates treasury management—affecting cash flow forecasting, intercompany transactions, and repatriation—necessitating more sophisticated hedging strategies and introducing financial reporting volatility. This elevated risk environment demonstrably impacts financing, potentially increasing the cost of capital or reducing availability for trade-dependent businesses. Reacting to this instability, financial institutions like banks and insurers are strategically adjusting their asset allocation, shifting away from volatile equities towards safer investments like bonds and gold to prioritize stability and predictability. This fundamental move towards safety, liquidity, and resilience challenges existing modeling assumptions and highlights the critical need across the board for adaptative, multi-scenario planning, dynamic working capital optimization, and adaptive hedging programs to navigate the unpredictable economic landscape expected through 2025.

Impact spotlight: complex strategic pricing and market access decisions

Passing on tariff-related costs is a complex strategic decision, not merely a cost-plus exercise. It demands a deep, analytical understanding of **price elasticity** within specific customer segments and competitive landscapes to avoid significant market share erosion. Incorrect pricing strategies in a tariff environment can have lasting negative consequences. Furthermore, tariffs fundamentally alter the economics of market access, necessitating a critical re-evaluation of geographic strategies. This may accelerate **diversification** into less exposed or new geographic markets (systematically evaluating opportunities intra-Canada or globally) or drive crucial **innovation** in product design (e.g.,

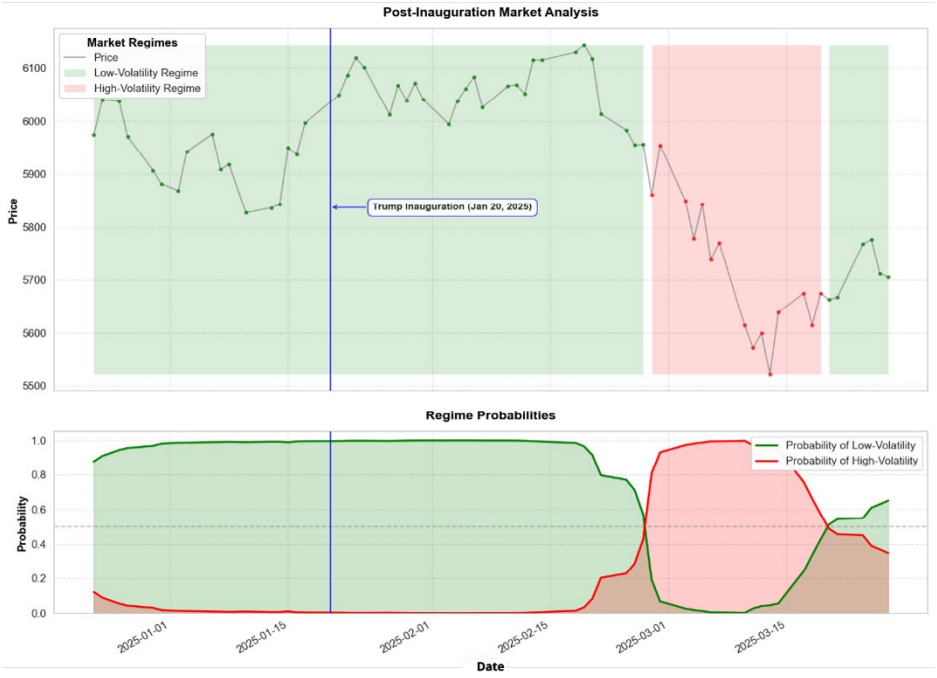


Figure 1. Markov Switching Autoregressive (MS-AR) analysis identifying distinct economic regimes potentially influenced by US tariff dynamics (S&P 500). Since Trump's inauguration, the model has identified a high-volatility regime (coded in Python).

material substitution), sourcing strategies (nearshoring/reshoring), or process re-engineering to circumvent duties and maintain competitiveness.

Financial institutions: enhancing predictive risk frameworks for 2025 and beyond

For Financial Institution, the tariff environment necessitates a significant evolution of risk management practices, moving beyond standard protocols towards more predictive capabilities. Forward-looking **stress testing frameworks** require substantial enhancement to incorporate novel, plausible scenarios reflecting potential 2025 developments – considering not just the level but also the *duration* and *breadth* of tariffs, specific sector vulnerabilities (e.g., cascading effects in auto supply chains, agricultural commodity price impacts, manufacturing competitiveness shifts), potential retaliatory measures, and second-order macroeconomic effects. This demands moving beyond historical data limitations, potentially incorporating expert judgment and macroeconomic overlays. Furthermore, the **performance monitoring and validation of critical models** (credit risk, market risk, liquidity, compliance) becomes paramount. Tariffs can introduce structural breaks and non-linearities that degrade model accuracy and predictive power, demanding rigorous ongoing validation against emerging data, potential recalibration of parameters, challenging underlying model assumptions, and possibly developing entirely new, more resilient modeling techniques (e.g., machine learning applications, regime-switching models) to ensure reliable risk assessment, accurate capital adequacy calculations (meeting OSFI expectations), and informed strategic decision-making.

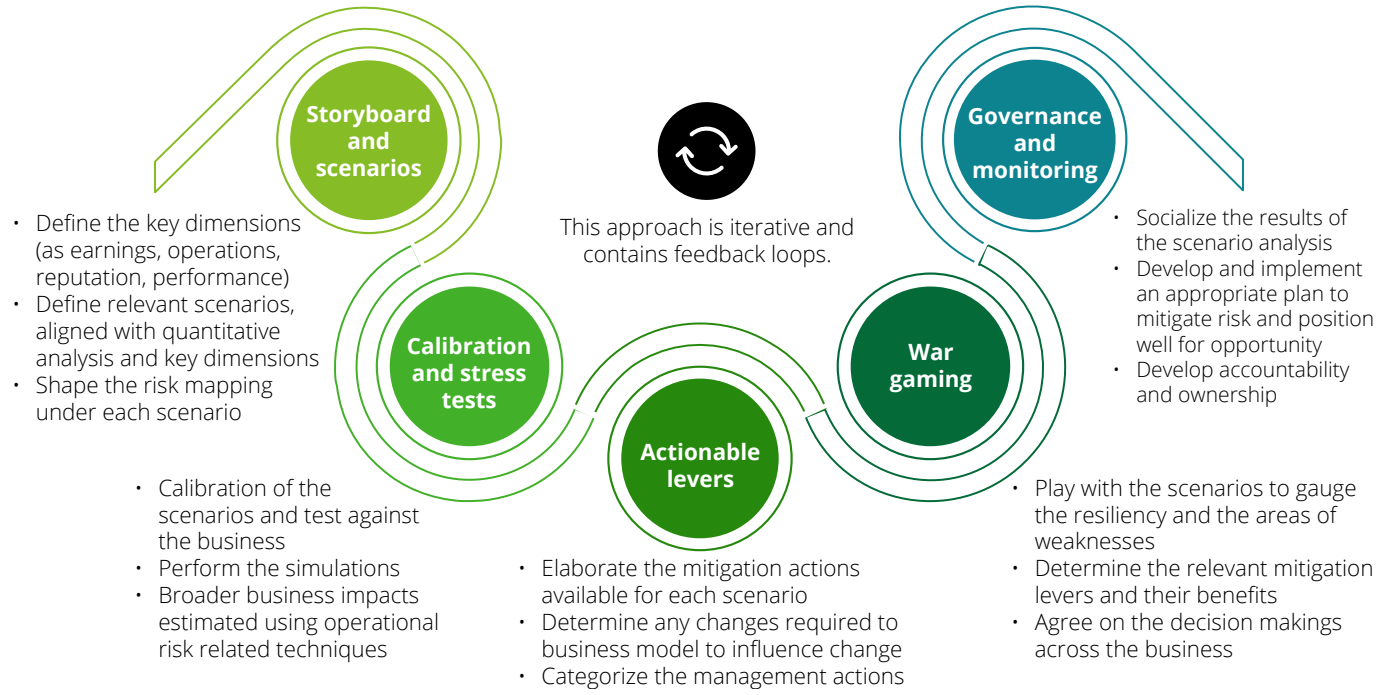
Corporates: addressing integrated operational and financial pressures

Corporate clients face direct, interconnected operational and financial headwinds demanding an integrated response. Effective **treasury management** is vital, requiring enhanced capabilities for precise, scenario-based cash flow forecasting amidst heightened FX and demand volatility, optimizing cross-border working capital structures, and ensuring sufficient liquidity buffers.

Tangible **financing impacts** must be proactively managed; heightened perceived risk for trade-reliant entities can increase capital costs, necessitating strategic initiatives to **diversify funding sources** (exploring capital markets, non-bank lenders, etc.). Targeted, dynamic **hedging strategies** are critical for mitigating volatility, involving potentially sophisticated approaches covering key FX (CAD/USD) and commodity exposures, requiring careful cost-benefit analysis and alignment with treasury policies.

> "In today's volatile world, marked by the impacts of COVID-19, fluctuating inflation, US tariff disputes, and future challenges such as raw material conflicts and climate change, it is crucial for organizations to cultivate adaptability. Developing and utilizing embedded modeling techniques will enable organizations to prepare for the future and respond swiftly to dynamic circumstances. This approach ensures resilience and sustained success amid global challenges."
>
> **— Nicolas Gemin, Risk Leader, Deloitte Canada**

From scenarios to decision making: the pivotal role of an embedded stress test ecosystem



Conclusion: partnering with Deloitte for proactive uncertainty navigation and strategic advantage

Successfully navigating the significant complexities and inherent uncertainties of the anticipated 2025 US tariff landscape requires more than standard business practices; it demands strategic foresight, deep analytical rigor, and decisive proactive adaptation. Deloitte's Financial Engineering and Modelling team provides essential, hands-on partnership, bringing specialized expertise to help clients: design, calibrate, and implement tailored, **forward-looking stress test scenarios** reflecting specific business exposures; rigorously validate and enhance **risk model performance** and predictive capabilities under tariff-induced uncertainty; conduct data-driven **supply chain vulnerability assessments and design optimization strategies**; develop sophisticated and integrated **pricing models, dynamic FX hedging programs, and optimized treasury strategies**; and quantitatively evaluate the strategic ROI and risks associated with crucial **market diversification and innovation initiatives**. We work collaboratively alongside you to translate complex trade dynamics and quantitative analysis into clear, actionable insights, empowering your organization not only to build essential resilience but also to maintain competitiveness and potentially gain strategic advantage by confidently addressing the challenges and opportunities presented by the evolving trade environment.

Leveraging Deloitte's expertise in financial engineering, advanced modeling, and supply chain optimization enables clients to dissect these complex tariff-related challenges, develop data-driven mitigation strategies, and make informed decisions that bolster both immediate performance and long-term strategic positioning.

Implementing proactive 'no-regret' decisions for long-term advantage while addressing immediate tariff pressures and strategic long-term initiatives build crucial resilience. Invest in Innovation to develop alternatives, re-engineer products, or improve processes to circumvent tariff impacts. Enhance Productivity via automation and lean processes to offset costs and protect margins. Critically, Explore and Invest in New Markets (intra-Canada, global) to strategically reduce US dependency and mitigate concentration risk highlighted by the current tariff environment.

However**, it is essential not to let the present challenges blind us to the long-term risks** associated with **climate change, nature risk, and broader ESG** (Environmental, Social, and Governance) factors. Companies must integrate these considerations into their strategic resilience planning to ensure sustainable growth. By proactively addressing these ESG risks, businesses can safeguard their operations against future disruptions, enhance their reputation, and secure long-term value for stakeholders. **Balancing immediate pressures with foresight into these critical areas will position organizations to thrive in an increasingly complex and interconnected world**.

Our services for corporates and financial institutions:

- Development and review of your models and other quantitative decision-support tools,
- Comparative studies with industry best practices for your tools, such as macroeconomic scenarios,
- Advisory on the design and optimization of models, such as those used for hedging,
- Advisory and modelling for treasury, cash management, FX and commodities hedging, cash flow forecasting, and pricing impact.

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Deloitte provides industry-leading consulting, tax and legal, financial advisory, audit and assurance, and risk advisory services to nearly 90% of the Fortune Global 500® and thousands of private companies. We bring together world-class capabilities, insights, and services to address clients' most complex business challenges.

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