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CIBC ASSET MANAGEMENT

Market Spotlight

The interest rate outlook and why this is an important year for ESG investing

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Three themes that will influence ESG investing in 2025

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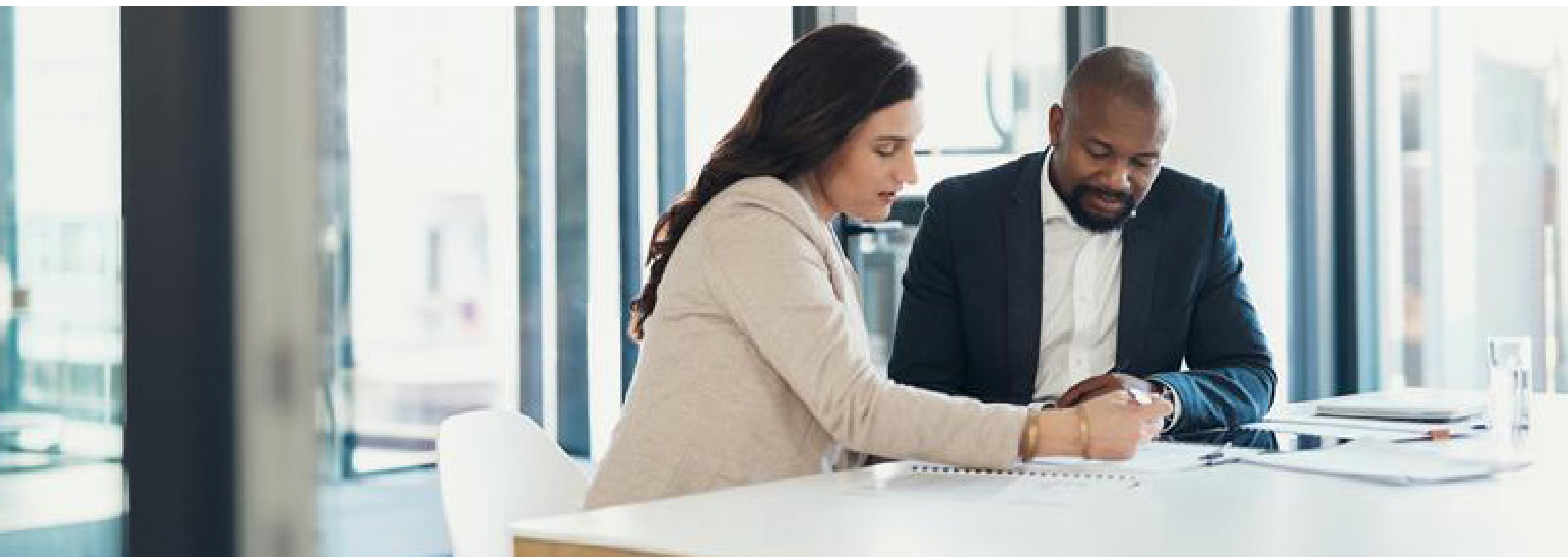

The environmental, social and governance (ESG) landscape has gone through a rapid maturation process over the last few years. Today, the combination of enhanced regulatory oversight and politicization is creating a more cautious environment for both investors and companies in their approach to ESG and sustainability. However, despite these headwinds, many investors are increasingly aware of the importance (and profitability) of operating with a sustainable mindset. Here are three issues and trends you need to be aware of in 2025.

The outcome of COP-30 in November 2025. The Conference of Parties (COP) process is a byproduct of the Paris Agreement created in 2015. COP-30 marks the 10-year anniversary of this agreement and will require involved countries and governments to submit their second nationally determined contributions (NDCs)—the actions they're taking to limit greenhouse gas emissions. This will come at a time when most of them will be behind in their commitments to meet net zero greenhouse gas emissions by 2050. Uncertainty remains around how committed countries are to achieving their targets, and whether they will accelerate or decelerate their actions domestically. This could result in significant investment implications.

How the new administration will impact the ESG landscape in the US. While we're still not clear on which policies will be implemented, we will likely see regulatory rollbacks, reduced focus on climate change, and energy policy shifts once the new US administration takes office. Should this happen, it may result in less stringent reporting requirements and impact the overall transparency and accountability of corporate issuers. This could open to the door to such things as increased greenwashing (when a company isn't as environmentally friendly as it claims), and it may become harder for fund managers to effectively monitor and assess environmental risks and opportunities within their portfolio. However, there may be some positives on the horizon as well. For example, during the presidential campaign, nuclear energy was an important part of the discussion. As a result, we could see moves to reduce the regulatory challenges that come with developing new nuclear energy plants, and a push to increase its importance in the electrification of the US economy.

The development of the carbon dioxide removal market. We're seeing significant advancements in both technology and infrastructure to sequester carbon dioxide. This is extremely exciting because it should help us better achieve net zero greenhouse gas commitments by making it easier to remove residual emissions from such hard-to-abate sectors as industry, agriculture and transport. This is a fast growing market and will represent increasingly significant opportunities for investors.

Where are interest rates headed in 2025?

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The Bank of Canada (BoC) delivered another 50 basis point (bps) interest rate reduction in December, its second like this in less than two months. The BoC has the most aggressive policy easing amongst major global central banks and we expect it to remain one of the most dovish in coming months. This view reflects the near-term economic outlook where the downside risks to growth currently appear to outweigh the risks of a renewed rise in inflation. Although several key inflation indicators have fallen below the BoC's 2% policy target inflation excluding mortgage interest cost averaged just 1.2% over the past three months. The output gap remains negative, applying downward pressure on inflation. And labour markets also softened with the unemployment rate in November two percentage points higher than its 2022 low.

The level of interest rates has also become an increasing impediment for key segments of the housing market. Recent BoC rate cuts are expected to result in only a modest decline in mortgage rates. This further strengthens the case for additional rate cuts to help lower mortgage rates and support Canadian housing activity.

We anticipate an additional 75 bps of cuts in 2025, which would lower the BoC's policy rate to 2.5% and account for 250 bps in total interest rate cuts since June 2024. BoC policy easing through rate cuts is expected to become an increasingly important tailwind for economic activity and we expect gross domestic product (GDP) growth will likely gain momentum in the second half of 2025. Consumer spending is expected to be an important driver of this recovery reflecting strong income growth, excess savings, a modest easing in fiscal policy, and a recovery in labour demand. The threat of US tariffs is a risk to this constructive view. But we currently see this primarily as a negotiating tool. Any increase in spending (for instance on border protection) triggered by tariff negotiations would actually reinforce our positive growth outlook.

An expected recovery in GDP growth will likely be supportive of higher corporate earnings, this is constructive for Canadian equities, particularly in the context of benign longer-term valuations. Our tactical asset allocation positioning remains overweight in Canada and underweight in International equity where the economic outlook is less constructive and where the threat of tariffs may be more significant. Concurrently, with the BoC likely to ease by more than the US Federal Reserve and with the threat of US tariffs likely to linger well into 2025, we see the risk of a further weakening in the value of the Canadian dollar against the US dollar. Against a backdrop of declining interest rates and an outlook of accelerating growth, Canadian bonds present an attractive income generating opportunity with relatively small downside risk—an appealing characteristic in a period of considerable uncertainty.

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