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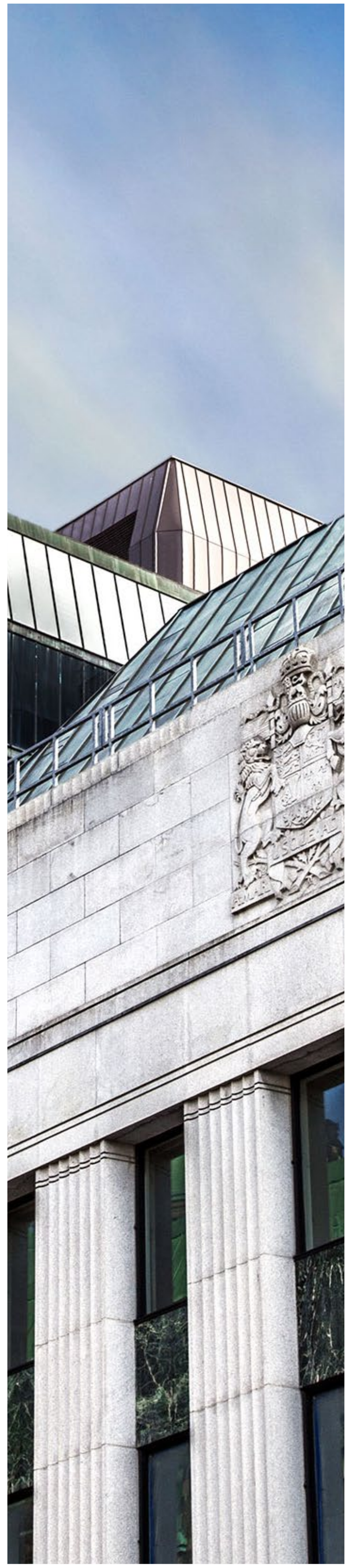
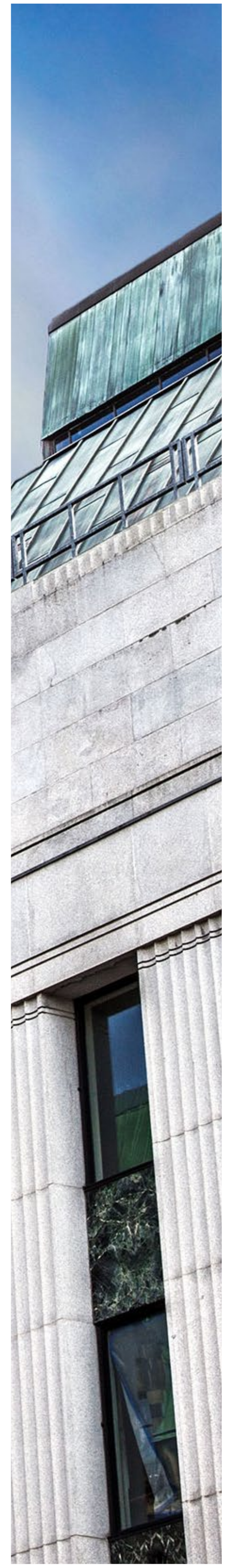




Monetary Policy *Report*

January 2026

Overview

US tariffs and the unpredictability of future trade arrangements are disrupting the Canadian economy. Growth in Canada is expected to remain modest, while inflation stays close to 2%.

The Canadian economic outlook is little changed since the October Report. Canada continues to adjust to a new trade landscape. Affected businesses are reconfiguring their trade and seeking new suppliers and markets. As this adjustment proceeds, capital will start being reallocated and some workers will shift into new roles. This adjustment will take time, and growth will be restrained through the transition.

Uncertainty remains high. The world is becoming more fragmented, and geopolitical risks are elevated. For Canada, the future of trade in North America is an important uncertainty (see **In Focus: The review of the Canada-United States-Mexico Agreement**).

Summary of economic conditions

The Canadian economy continues to evolve much as expected, although quarterly growth patterns have been quite volatile. Much of this volatility has been driven by large swings in trade and inventories. After expanding rapidly in the third quarter of 2025, growth likely stalled in the fourth quarter. Growth over the second half of 2025 is estimated to have averaged about 1¼%.

Gross domestic product is expected to rise by 1.1% in 2026 and 1.5% in 2027. The pace of expansion is modest due to slow population growth and the impact of the ongoing reconfiguration of trade. Nevertheless, it is still sufficient to gradually absorb excess supply.

Consumer price index (CPI) inflation and CPI inflation excluding indirect taxes were both about 2½% in December. In recent months, most core inflation measures have eased, with CPI-trim and CPI-median also now close to 2½%.

Over the projection horizon, inflation remains close to 2%. Downward pressures from excess supply roughly offset upward pressures related to trade reconfiguration and structural adjustments in the economy.

Global economic growth is projected to be solid at around 3%, supported by investment related to artificial intelligence (AI) and stimulative fiscal policies. However, the outlook remains vulnerable. The global economy is still adapting to US tariffs and trade policy uncertainty, geopolitical tensions remain high, and there are questions about the sustainability of the pace of AI-driven investment.

Current conditions

The Canadian economy continues to evolve as expected. Average quarterly growth was subdued in 2025, weighed down by US tariffs and slowing population growth. CPI inflation remains near the 2% target.

US tariffs and heightened uncertainty have weighed heavily on Canadian economic activity, with exports about 4% lower than they were before trade restrictions were imposed. Domestic demand and inventory accumulation underpinned growth in 2025, offsetting the weakness in exports.

Growth in gross domestic product (GDP) likely stalled in the fourth quarter. Quarterly growth has been volatile, largely due to sharp movements in trade and inventories.

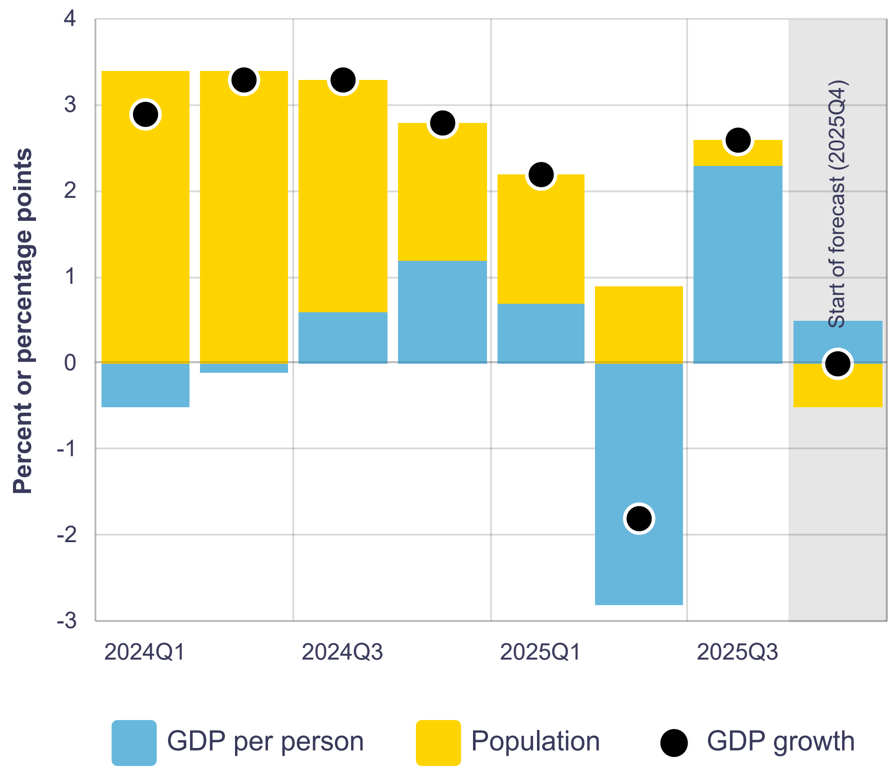
Consumer price index (CPI) inflation excluding indirect taxes has eased in recent months and was 2.5% in December. CPI-trim and CPI-median have also softened.

Economic activity

GDP likely grew by 1.7% in 2025 and was essentially flat on a per-person basis. Slower population growth is pulling down growth in GDP and potential output (**Chart 1**). The volatility in quarterly GDP growth in 2025 mainly reflected swings in net trade and inventory investment. Domestic demand also moved unevenly, slightly outpacing GDP growth.

Chart 1: GDP growth remained volatile, rebounding in the third quarter of 2025

Contributions to GDP growth, annualized, quarterly data



Note: *Population* is based on Statistics Canada's quarterly estimate of residents aged 15 and older. Numbers may not sum to their respective totals due to rounding.
Sources: Statistics Canada and Bank of Canada calculations and estimates
Last data plotted: 2025Q4

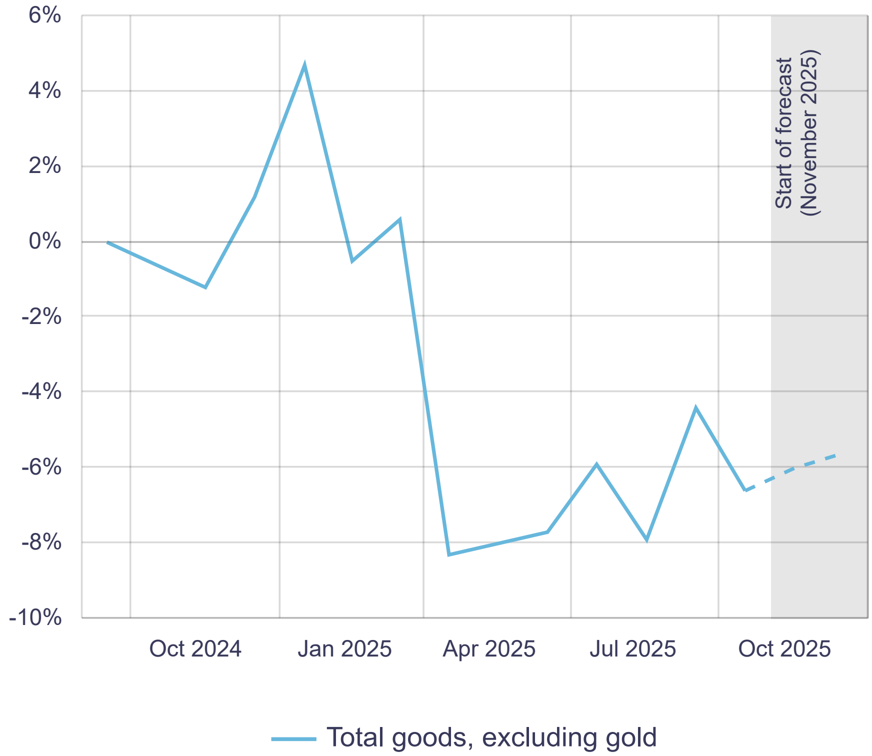
Fourth-quarter GDP growth will likely be weak

Growth in the third quarter of 2025 was strong, supported by a rebound in net exports. However, in the fourth quarter, growth is estimated to have been close to zero. A key reason for this slowdown is an expected pullback in business inventory investment, reflecting continued moderation in the pace of stockpiling.

Exports are anticipated to rise in the fourth quarter, supported by a surge in gold shipments. Yet exports of goods excluding gold remain weak, partly reflecting the impact of tariffs and supply disruptions in the auto sector (**Chart 2**). Exports into new markets provide a modest offset.

Chart 2: Exports of goods excluding gold are weak

Percentage change from September 2024, monthly data



Note: Exports of goods exclude precious metals products because shipments of gold are highly volatile and often reflect inventory management. Shipments of gold do not reflect underlying production levels or demand because gold is frequently re-exported, stored or shipped for financial or custodial reasons.

Sources: Statistics Canada and Bank of Canada calculations and estimates
Last data plotted: December 2025

Growth in domestic demand is estimated to have strengthened. Lower borrowing costs and improvements in the labour market support a rise in consumption growth. Government spending—including ongoing investment in infrastructure—is also expected to contribute to growth. This contribution is led by increased spending by provincial governments.

In contrast, housing activity has been subdued and, in most cities, has either been flat or has declined in recent months. Business investment likely remained weak, mostly reflecting uncertainty about US trade policy.

Capacity pressures

Statistics Canada has significantly revised up GDP data from 2022 onward. The Bank of Canada's estimate of potential output was subsequently revised up by almost as much as GDP (see the **Projections** section). The current estimate of the output gap for the fourth quarter of 2025 is in the range of -1.5% to -0.5%, unchanged from the October Report. Recent data suggest that labour market slack may have eased slightly, although labour market indicators still point to excess supply.

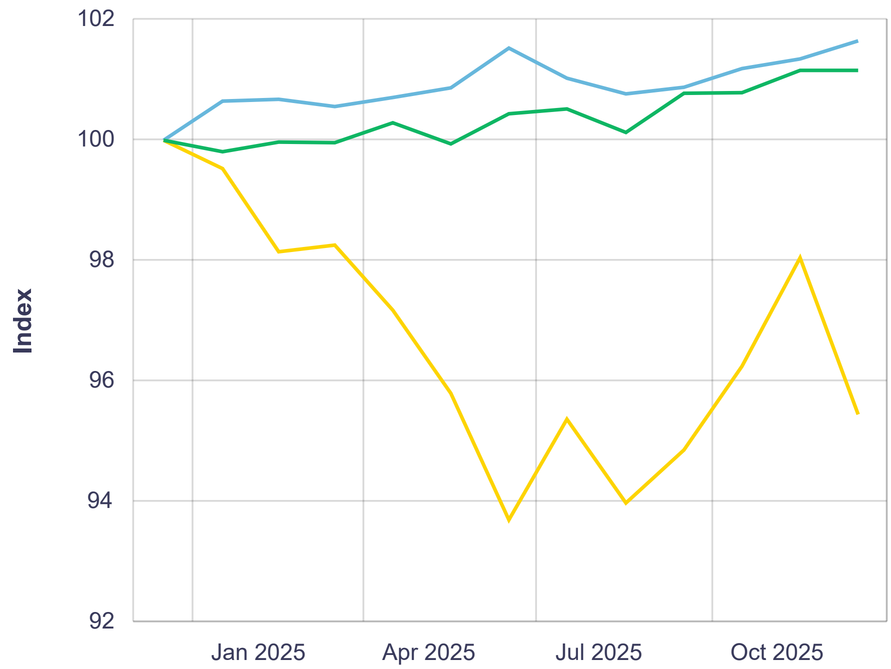
The labour market has remained soft

Employment has risen in recent months, with a net gain of about 190,000 jobs since August. In sectors that rely heavily on the United States for trade, employment has stayed subdued after a sharp decline in early 2025 (**Chart 3**). The unemployment rate remains elevated at 6.8%, and youth unemployment continues to be particularly high despite some recent improvements. Job vacancies have also fallen to their lowest level since October 2017. The share of businesses reporting labour shortages remains low, and hiring intentions are still weak (**Chart 4**).[1]

Most measures of wage growth have converged below 3%, and growth in unit labour costs has been modest.

Chart 3: Employment in sectors reliant on the United States remains subdued

Employment level, index: December 2024 = 100, monthly data



Private sectors with limited reliance on exports to the United States (70% of total employment, 2025)

Private sectors with high reliance on exports to the United States (8% of total employment, 2025)

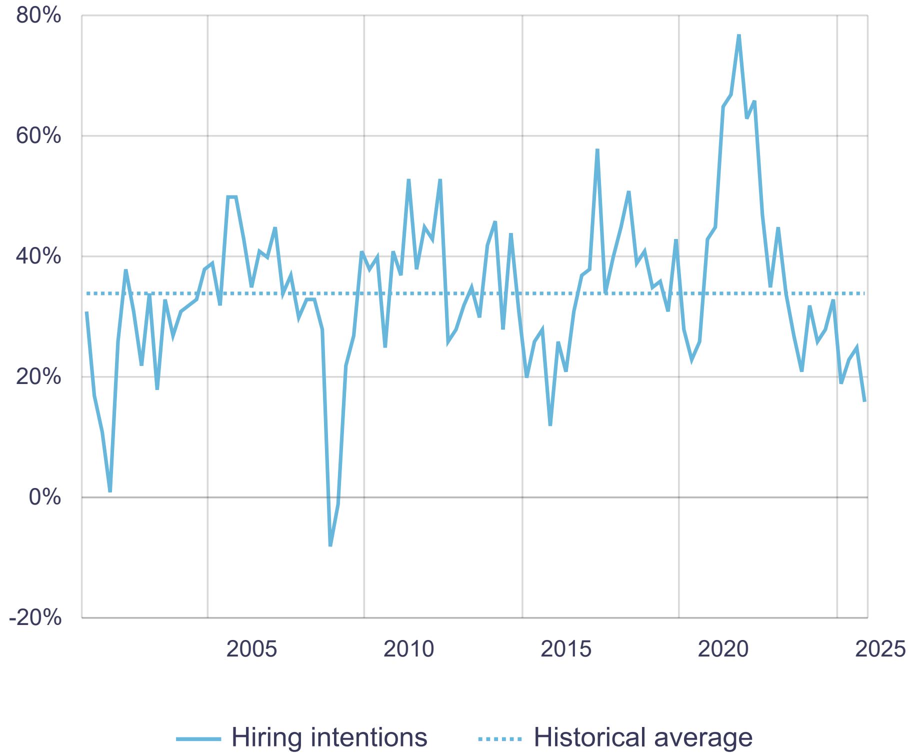
Public sector (22% of total employment, 2025)

Note: A sector is considered to have high reliance on exports to the United States if at least 35% of the sector's jobs depend on US demand. These sectors include several manufacturing and transportation subsectors as well as commodities sectors, including energy and forestry.

Sources: Statistics Canada and Bank of Canada calculations
Last observation: December 2025

Chart 4: Businesses' hiring intentions remain weak

Balance of opinion, Business Outlook Survey, quarterly data



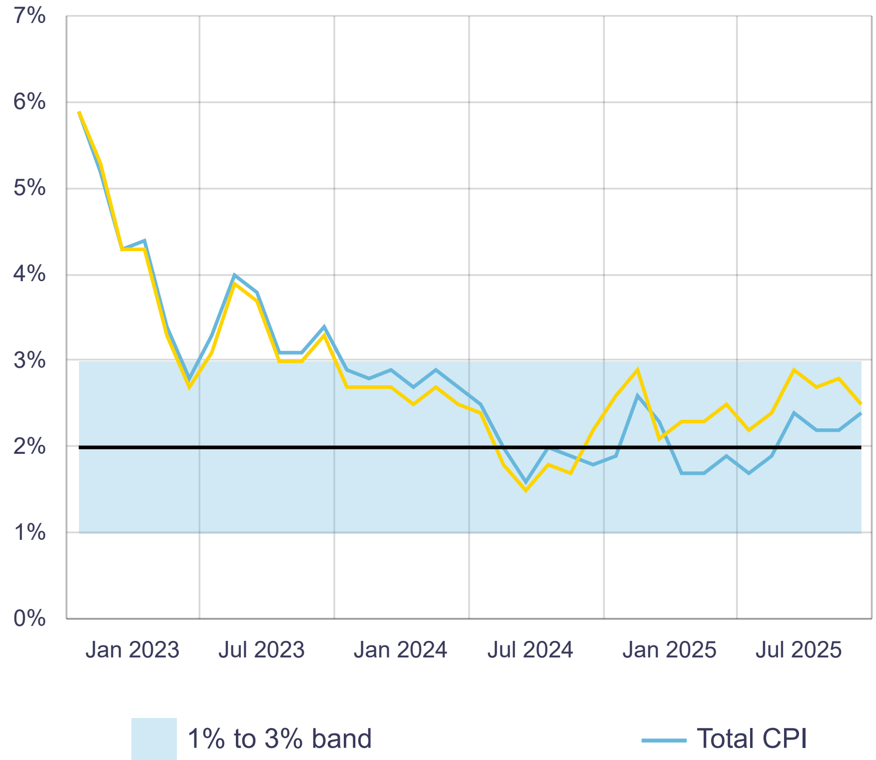
Note: Balance of opinion is the percentage of businesses expecting a higher number of employees minus the percentage expecting a lower number of employees in their organization over the next 12 months.
Source: Bank of Canada
Last observation: 2025Q4

Inflation

CPI inflation and CPI inflation excluding indirect taxes were 2.4% and 2.5%, respectively, in December. Inflation has been within the 1% to 3% band for the past two years (**Chart 5**).

Chart 5: CPI inflation has been within the 1% to 3% band for the past two years

Year-over-year percentage change, monthly data



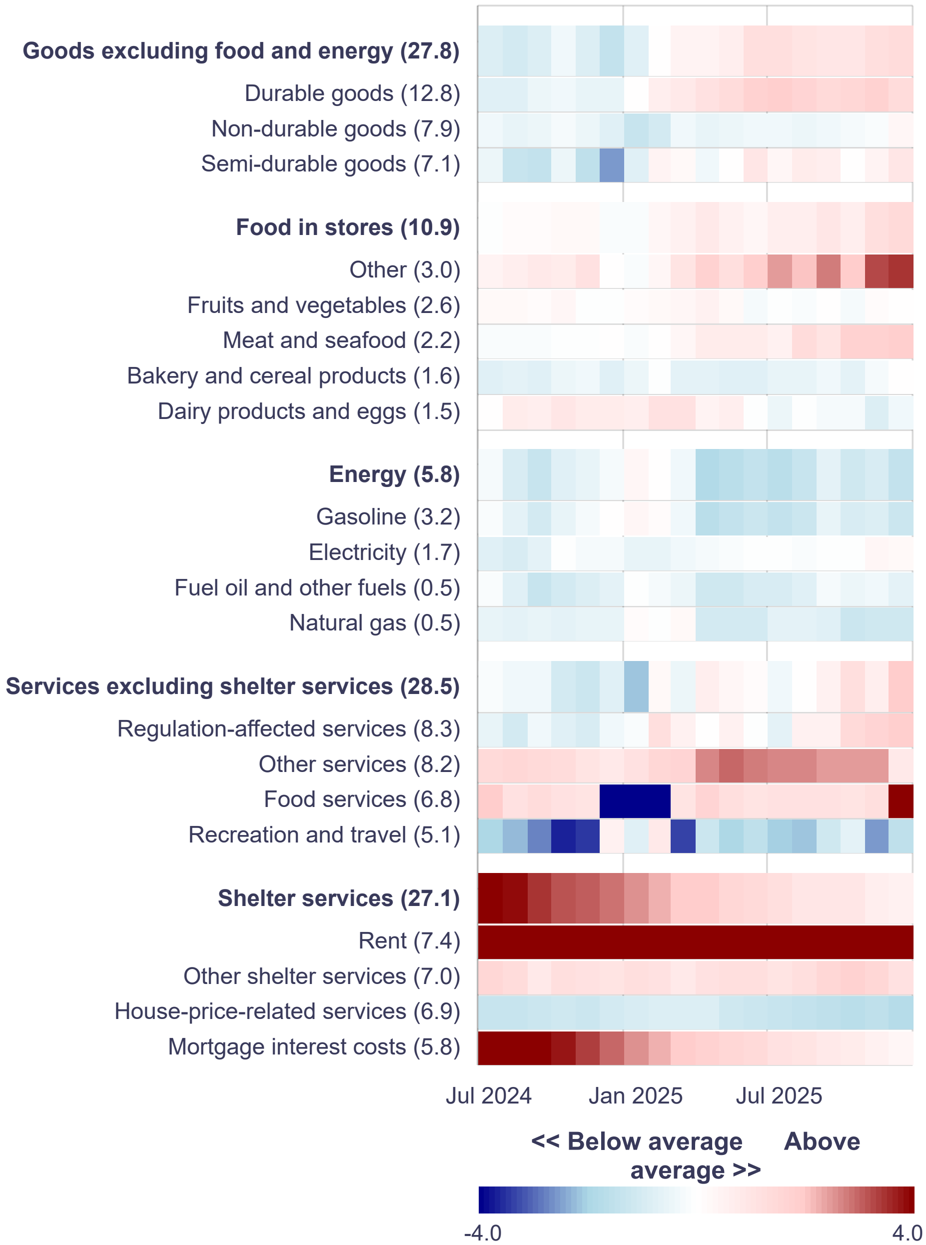
Sources: Statistics Canada and Bank of Canada calculations
Last observation: December 2025

Inflationary pressures have eased

In December, CPI inflation was boosted by a base-year effect linked to last winter's GST/HST holiday.[2] Inflation in restaurant meals and alcoholic beverages was particularly affected.

CPI inflation excluding indirect taxes has eased since September, reflecting lower energy prices and a further easing in mortgage interest costs. This moderation was mitigated by higher food prices, which are still being boosted by previous input cost pressures (**Chart 6**).

Chart 6: Inflation in some food and services components remains elevated

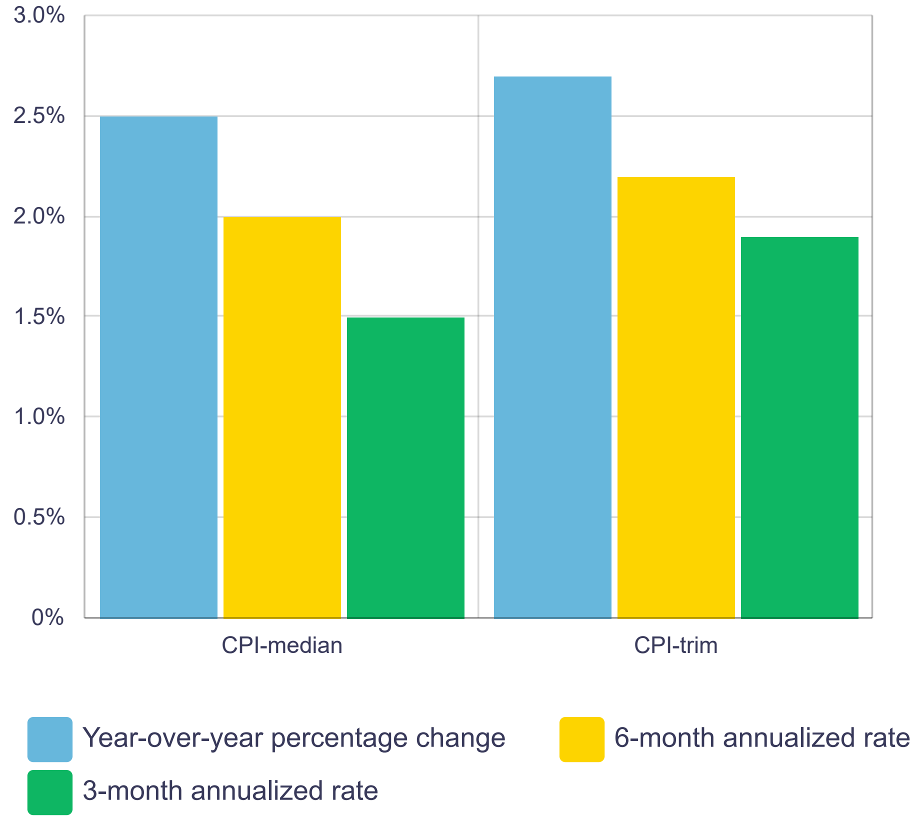


Note: The heatmap shows the distance of each CPI component's year-over-year inflation rate from its historical average. The colour is white when a component's inflation rate is close to its average and is a varying shade of blue (red) when the rate is below (above) the average. Because the historical range of inflation varies widely across CPI components, each inflation rate plotted in the heatmap is standardized by subtracting its mean and dividing by its standard deviation. This standardization is conducted using data from 1996 to 2019, except for *Regulation-affected services* and *Other services*, where available data begin in 2004 and 2008, respectively. *Regulation-affected services* includes prices that are affected by government regulations either directly (e.g., child care services) or indirectly (e.g., telephone services). Values in parentheses are CPI weights (in percent). Due to rounding, weights within categories may not sum to their respective totals.
Sources: Statistics Canada and Bank of Canada calculations
Last observation: December 2025

Measures of core inflation that exclude volatile components, including food, continue to ease. The three-month inflation rates for CPI-median and CPI-trim are now below 2% (**Chart 7**).

Chart 7: Measures of core inflation are showing signs of easing

Monthly data, December 2025



Note: CPI-median is a measure of core inflation corresponding to the price change located at the 50th percentile. CPI-trim excludes CPI components whose rates of change in a given month are located in the tails of the distribution of price changes. All core inflation measures exclude the effect of indirect taxes.
Sources: Statistics Canada and Bank of Canada calculations

The share of CPI components above 3% rose in November and December mainly due to higher inflation in food prices and the base-year effect of the GST/HST holiday. This increase is anticipated to be temporary. Food price inflation is expected to ease because growth in input costs has recently slowed. In addition, the inflationary effect coming from last year's GST/HST holiday peaks in January and then starts to fade in February.

Input cost pressures eased in 2025, and businesses expect modest increases over the coming year. Most cost indicators are now rising at a pace broadly consistent with inflation around 2%. For example, growth in unit labour costs has been modest, and most import prices are now rising at a pace close to their historical averages.

Businesses' short-term inflation expectations remain close to 3%. Consumers' expectations for near-term inflation are still elevated, but their longer-term views have softened.

Commodities

The Bank of Canada commodity price index is up about 5% since October, led by strong growth in the prices of metals. Commodity prices have been volatile amid geopolitical tensions.

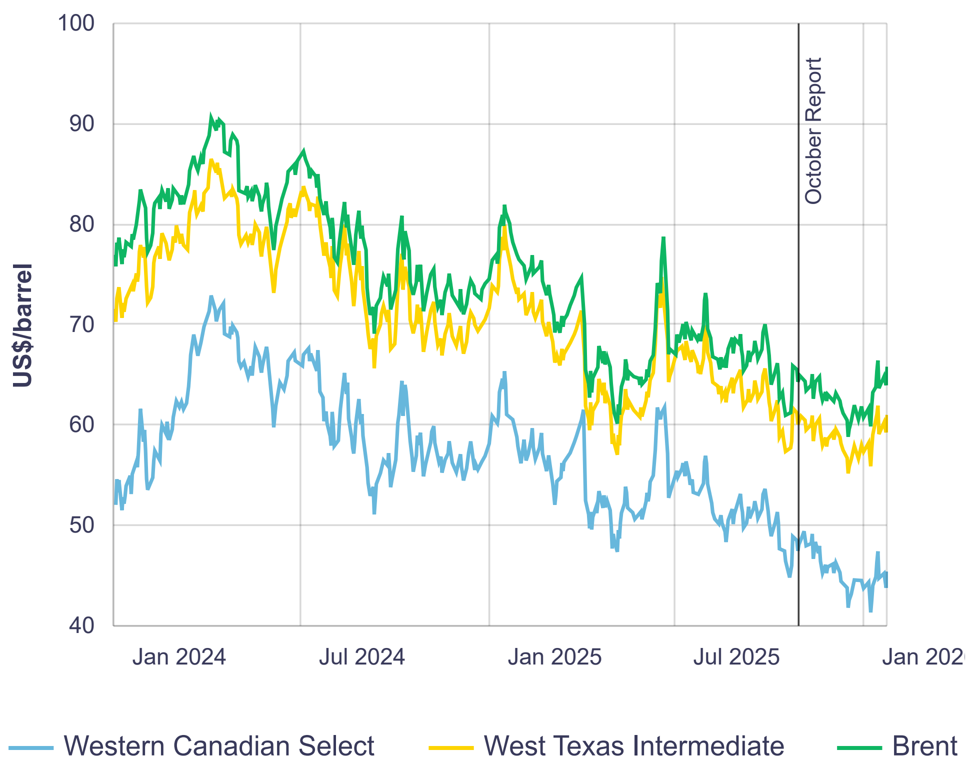
Oil prices are assumed to be lower

Oil prices declined in 2025, reflecting rising global production and an accumulation of inventories. The price of Brent oil has averaged close to US$60 in the past few months, despite the recent uptick linked to geopolitical tensions (**Chart 8**). This is below the US$65 assumption in the October Report. Natural gas prices have surged recently due to unusually high demand for heating.

The Bank's non-energy commodity price index has increased since October, supported by higher prices for base metals amid tight supply. Prices for gold and silver have also climbed, reflecting geopolitical uncertainty. Cattle prices have remained elevated, feeding into higher food prices.

Chart 8: Oil prices have been lower, on average, since October

Daily data



Sources: NYMEX and Intercontinental Exchange via Haver Analytics and Bloomberg Finance L.P.
Last observation: January 23, 2026

Financial conditions

Overall, Canadian and US financial conditions are roughly unchanged since October, following the considerable easing that took place over much of 2025. In recent weeks, geopolitical events have led to some volatility in financial markets.

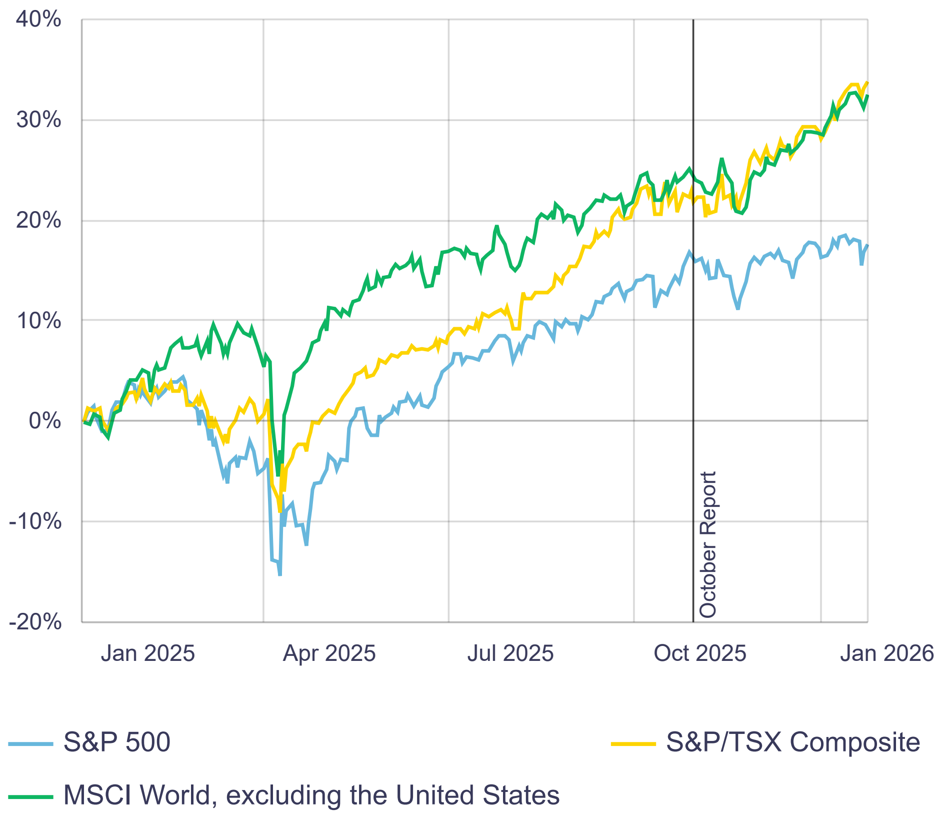
Global equity markets have generally continued to rise, reaching new highs (**Chart 9**). Corporate credit spreads are largely unchanged since October; they remain low and well below historical averages.

Government bond yields have generally risen since October. This partly reflects market expectations for higher policy interest rates across most advanced economies, including Canada, supported by stronger-than-expected economic activity.

In recent months, the Canadian dollar has traded around 72 cents US and has remained largely unchanged against a broader basket of currencies. In recent days, weakness in the US dollar has led to a modest appreciation of the Canadian dollar.

Chart 9: Equity markets have continued to rise since the October Report

Change in equity indexes since January 1, 2025, daily data



Sources: Bloomberg Finance L.P. and Bank of Canada calculations
Last observation: January 23, 2026

Endnotes

1. See Bank of Canada, ***Business Outlook Survey—Fourth Quarter of 2025***.[←]

2. Some prices were temporarily lower from December 2024 to February 2025 because of the GST/HST holiday. A base-year effect, reflecting comparisons with unusually low prices in the same months last year, will briefly push up year-over-year inflation between December 2025 and February 2026.[←]

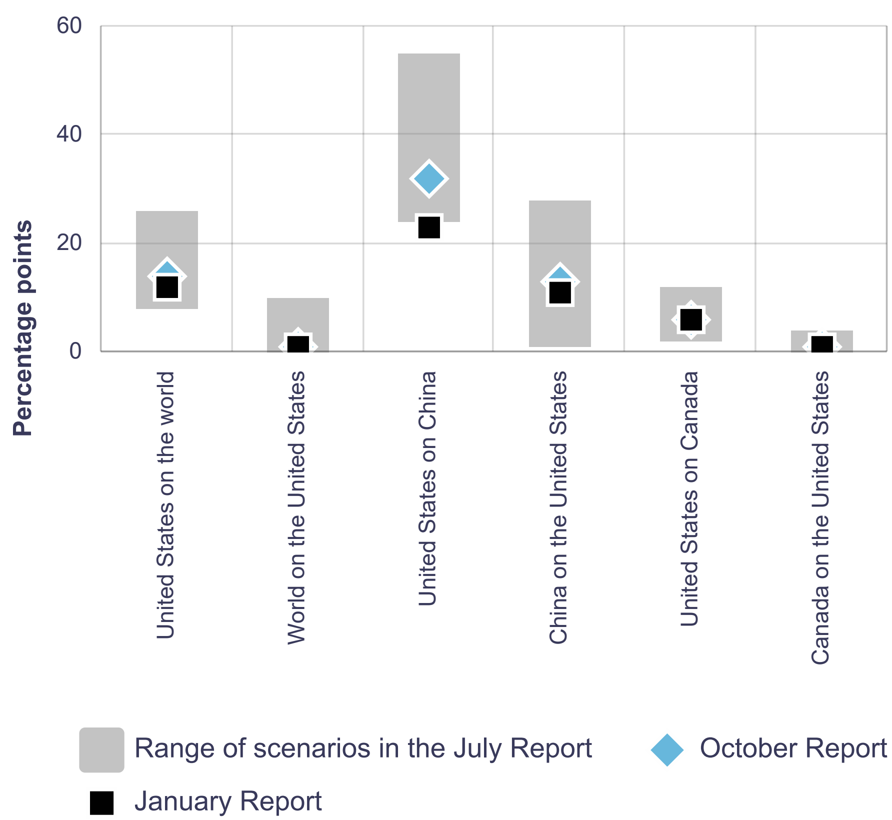
Tariff and other assumptions

US tariffs remain elevated. The future of trade in North America continues to be highly uncertain.

US tariffs on countries around the world are higher than they were in early 2025 (**Chart 10**). Economic uncertainty in Canada remains elevated, particularly because the future of the Canada-United States-Mexico Agreement continues to be unclear. Most assumptions made in the projection are in line with those in the October Report.

Chart 10: US tariffs remain high

Estimated increases to weighted average tariff rates on imported goods since the start of 2025



Note: To highlight changes reflecting the dramatic shift in US trade policy, the chart presents the marginal change in tariff rates since the start of 2025 rather than current tariff levels. Calculating tariff levels from other countries on the United States before 2025 is challenging due to data limitations.
Sources: United States Census Bureau and Bank of Canada calculations

Tariff assumptions

The projection is based on tariffs in place or officially agreed on as of January 23, 2026 (**Table 1**).[1] The outlook includes the impact of Canada's preliminary agreement with China, which lowers Chinese tariffs on Canadian canola and allows a limited number of Chinese electric vehicles to be imported into Canada at a reduced tariff rate.[2]

Table 1: Average tariff rates (goods only) embedded in the outlook (%)

	Before 2025	July 2025	October 2025	January 2026
US tariff rate on Canada	0.1	4.4	5.9	5.8
Canadian tariff rate on the United States*	0.0	2.6	1.0	1.2

* These tariff rates include the impact of Canadian tariff remissions.

Other assumptions

The projection is also conditional on several other assumptions.

- Potential output growth in Canada for 2025 is revised up to 2.3% from 1.6% in the October Report, mainly because of historical revisions to the data for gross domestic product (GDP) (see **Canadian outlook** in the Projections section). Potential output growth is expected to slow to around 1% over the projection horizon.
- An assumed slowdown in population growth and labour productivity is expected to weigh on potential output growth in Canada:
    - The rate of population growth of people aged 15 and over slows from 3.3% in 2024 to 1.4% in 2025. It is then assumed to slow further to around 0.2% in 2026 before rising to 0.4% in 2027.
    - Tariffs and trade tensions are assumed to weigh on total factor productivity and investment, reducing the level of potential output by 0.9% in 2027.
        - For comparison, global potential output in 2027 is 0.2% lower due to tariffs and trade tensions.
- The impact of trade policy uncertainty on GDP is assumed to slowly decrease in 2026.
- In Canada, some tariff revenues are remitted back to affected businesses. All remaining revenues are redistributed to households.
- In all other countries, half of the revenues from tariffs are redistributed to households, while the rest are added to government revenues.
- In all countries, three-quarters of the increased costs from tariffs are passed on to consumer prices within six quarters.

- The projection for Canada incorporates information from the latest federal budget and provincial fiscal updates that have been tabled at the time of writing.
- Over the projection horizon, the per-barrel prices for oil are assumed to be US$60 for Brent, US$55 for West Texas Intermediate and US$45 for Western Canadian Select. These prices are $5 lower than assumed in the October Report.
- The Canadian dollar is assumed to average 72 cents US over the projection horizon, unchanged from the October Report.
- The nominal neutral interest rate in Canada is assumed to be in the estimated range of 2.25% to 3.25%.

Endnotes

1. For more details on calculating average tariff rates, see Bank of Canada, "**How the average tariff rates are calculated**," *Monetary Policy Report—October 2025*.[←]

2. Chinese tariffs on imports of Canadian canola seed are scheduled to be cut from a combined rate of about 84% to about 15%. Canadian tariffs on imports of Chinese electric vehicles are expected to be cut from 100% to 6.1% for the first 49,000 vehicles imported. For more information, see Government of Canada, "**Backgrounder — Preliminary Agreement-In-Principle to Address Economic and Trade Issues between Canada and the People's Republic of China**" (last modified January 17, 2026).[←]

Outlook

US trade restrictions have disrupted the Canadian economy, leading to structural adjustments that will take time to unfold. Economic growth is expected to remain modest. Excess supply roughly offsets upward cost pressures over the projection horizon, keeping inflation close to the 2% target.

Tariffs have led to a lasting reduction in US demand for Canadian goods, weighing on jobs, productivity and living standards in Canada. In response, the Canadian economy is restructuring (see **In focus: How Canadian businesses are adapting to US tariffs**).

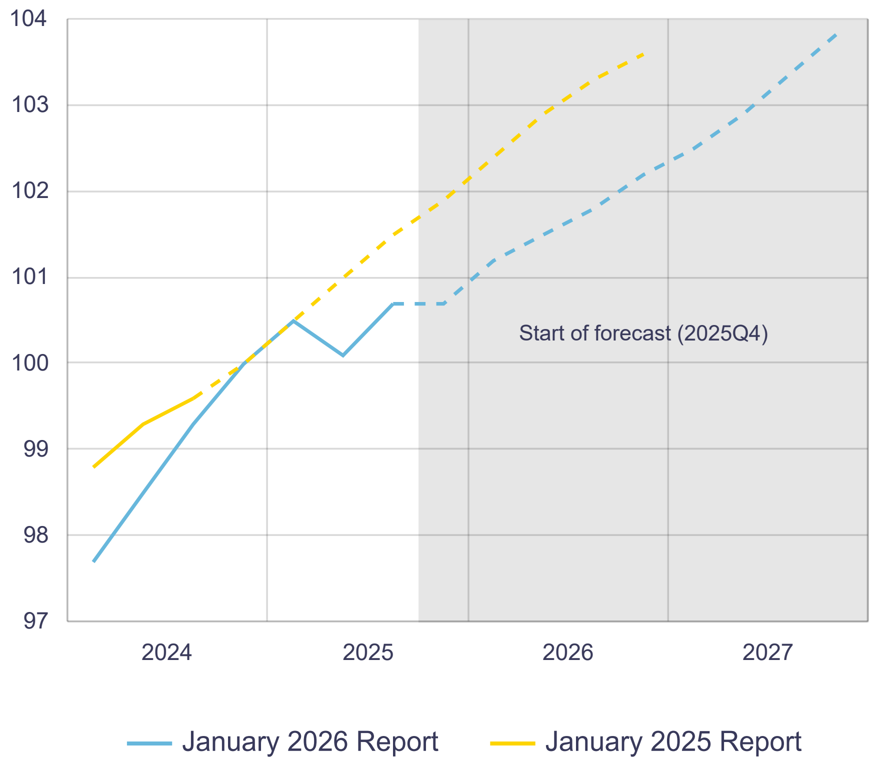
This restructuring involves developing new markets and supply chains to diversify Canada's trade and reduce reliance on the United States. It also means workers and capital gradually shift from industries most affected by tariffs toward other sectors and new opportunities.

This transition will be challenging for affected workers and businesses, and growth will be modest. As restructuring advances, productivity and economic growth are expected to recover gradually.

Overall, US tariffs have a persistent negative impact on the Canadian economy. By the end of 2026, gross domestic product (GDP) is projected to be about 1½% lower than in the January 2025 Report (**Chart 11**). Roughly half of the shortfall caused by US tariffs comes from reduced potential output, while the remainder reflects increased excess supply.

Chart 11: US trade restrictions are expected to have a lasting negative impact on the Canadian economy

Level of GDP, index: 2024Q4 = 100, quarterly data



Sources: Statistics Canada and Bank of Canada calculations, estimates and projections
Last data plotted: 2027Q4

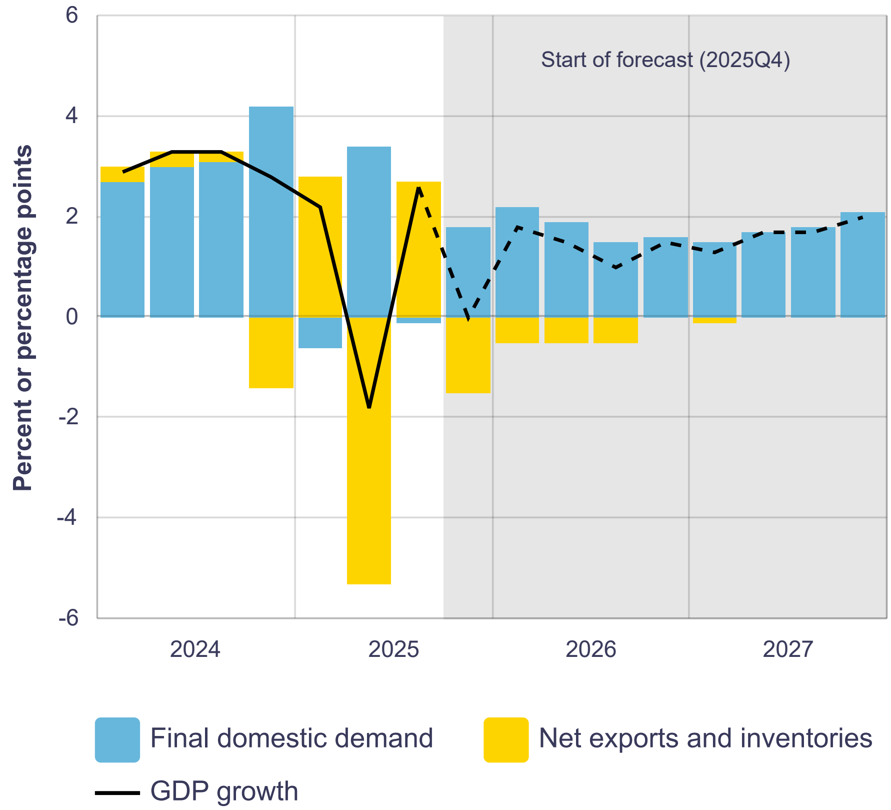
Economic outlook

US trade policy has weakened demand for Canadian exports and led to heightened uncertainty. As a result, some businesses have postponed expansion plans. This is hampering the economy's ability to grow. To capture these dynamics, the projection assumes that potential output growth slows in 2026 and then recovers gradually into 2027.[1]

GDP growth remains modest at 1.1% in 2026 and 1.5% in 2027—enough to gradually absorb the excess supply created by US trade restrictions (**Chart 12**). Overall, the economic outlook remains broadly consistent with that in the October Report.

Chart 12: GDP growth is expected to remain modest

Contributions to GDP growth, annualized, quarterly data



Note: *Net exports and inventories* includes Statistics Canada's statistical discrepancy. Numbers may not sum to their respective totals due to rounding.
Sources: Statistics Canada and Bank of Canada calculations, estimates and projections
Last data plotted: 2027Q4

Trade is expected to adjust gradually

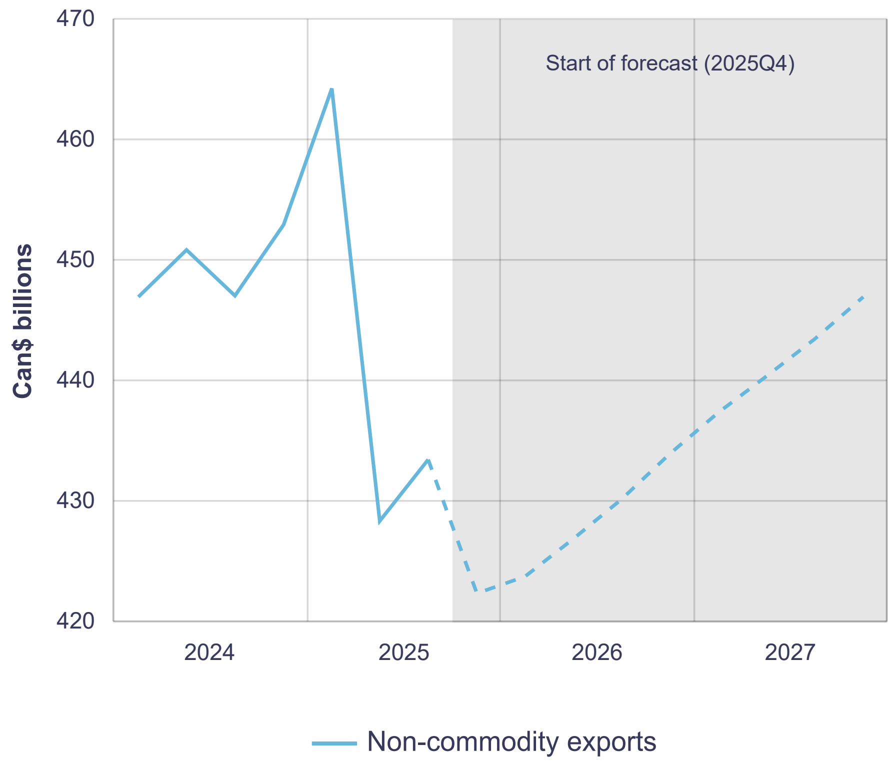
While US tariffs on Canada are limited to specific sectors, such as steel and aluminum, their impact on exports is being felt more broadly. Uncertainty about trade policy is prompting some US customers to delay orders. As well, many Canadian businesses are postponing expansions, and some are approaching new US contracts with caution. Additionally, establishing new trade relationships with customers and suppliers outside the United States will be a lengthy process.

While businesses continue to adapt to the new trade environment, the expansion in exports is projected to be modest (**Chart 13**).

Import growth is anticipated to rise over the projection horizon as domestic demand strengthens.

Chart 13: Non-commodity exports are projected to grow along a lower path than before US tariffs were imposed

Chained 2017 Canadian dollars, annualized, quarterly data



Sources: Statistics Canada and Bank of Canada calculations, estimates and projections
Last data plotted: 2027Q4

Growth in investment increases

Weak demand and trade policy uncertainty continue to weigh on investment plans for both exporting and non-exporting businesses. Growth in business investment is forecast to be soft over most of 2026. It is then projected to increase as uncertainty related to US trade policy decreases and export growth strengthens. Targeted federal government programs are also anticipated to support business investment.[2]

Government spending on infrastructure is projected to rise, mainly reflecting commitments in provincial budgets. Additional federal capital transfers will also bolster infrastructure investment.[3]

After a large buildup in early 2025, inventory accumulation is expected to slow. This will drag on economic growth in 2026.

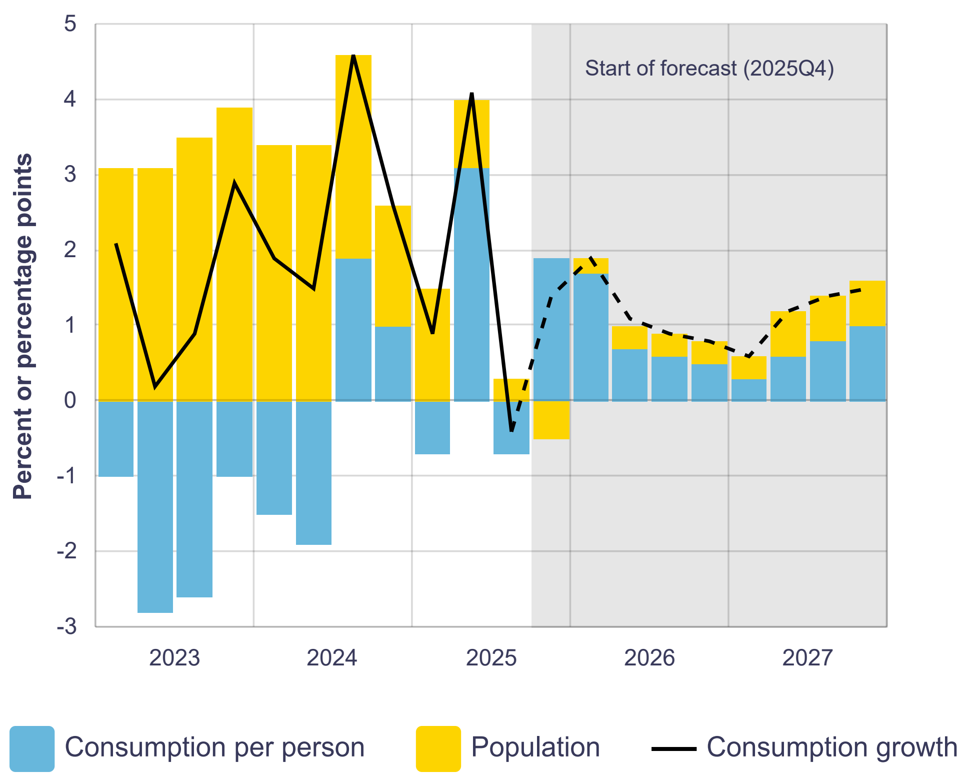
Consumption per person grows modestly

Quarterly growth in consumption is modest throughout most of 2026 and picks up slowly over 2027. This subdued pace reflects muted population growth over the projection horizon.

Growth in consumption per person—a better measure of changes in average living standards than overall consumption—is expected to remain strong in early 2026, supported by past interest rate cuts and higher equity prices. As the impact of these supports wanes, growth in consumption per person slows. It then picks up gradually in 2027, bolstered by gains in real disposable income (**Chart 14**).

Chart 14: Consumption per person is expected to grow modestly

Contribution to consumption growth, annualized, quarterly data



Note: *Population* is based on Statistics Canada's quarterly estimate of residents aged 15 and older. Numbers may not sum to their respective totals due to rounding.
Sources: Statistics Canada and Bank of Canada calculations, estimates and projections
Last data plotted: 2027Q4

Growth in residential investment improves

Residential investment is anticipated to grow moderately over the projection horizon. Pent-up demand for housing, reflecting past strength in population growth, continues to support the housing market. However, affordability challenges persist, especially in major urban centres such as Toronto and Vancouver. As a result, growth in residential investment will be uneven across cities.

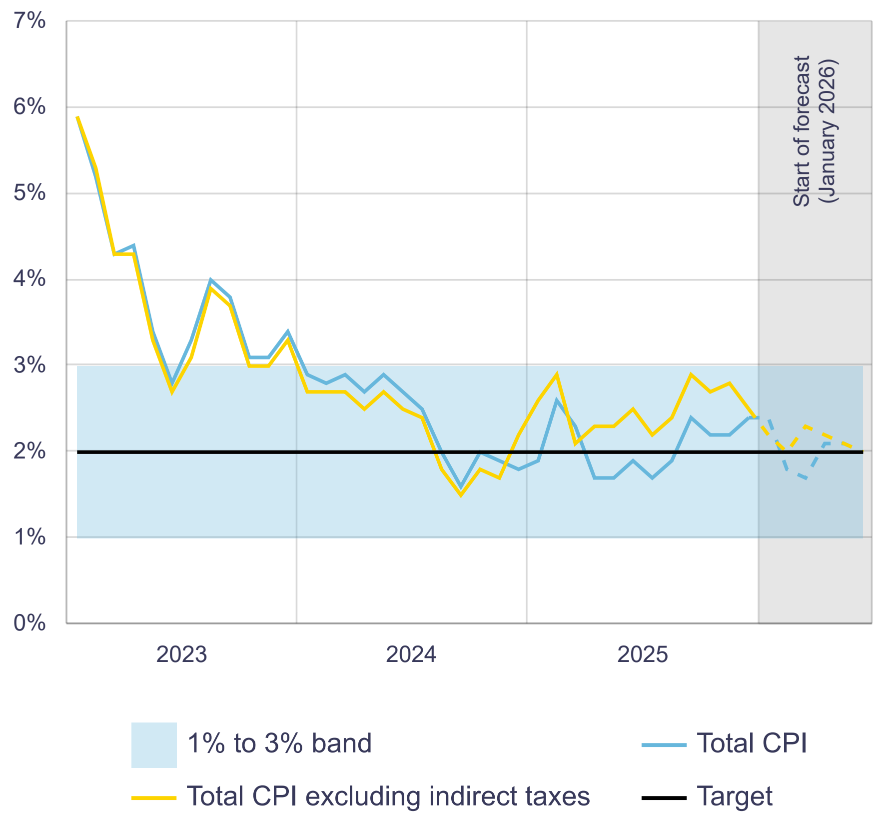
Slower population growth combined with a steady increase in housing supply is helping ease imbalances in the housing market. Housing starts are forecast to remain at elevated levels throughout the projection.

Inflation outlook

Inflation is projected to be close to 2½% in January before slowing to around 1¾% in February and March (**Chart 15**). This reflects lower energy prices, slower growth in shelter costs and the end of the base-year effect from last winter's GST/HST holiday.[4]

Chart 15: CPI inflation is expected to ease temporarily below 2% before settling near target

Year-over-year percentage change, monthly data

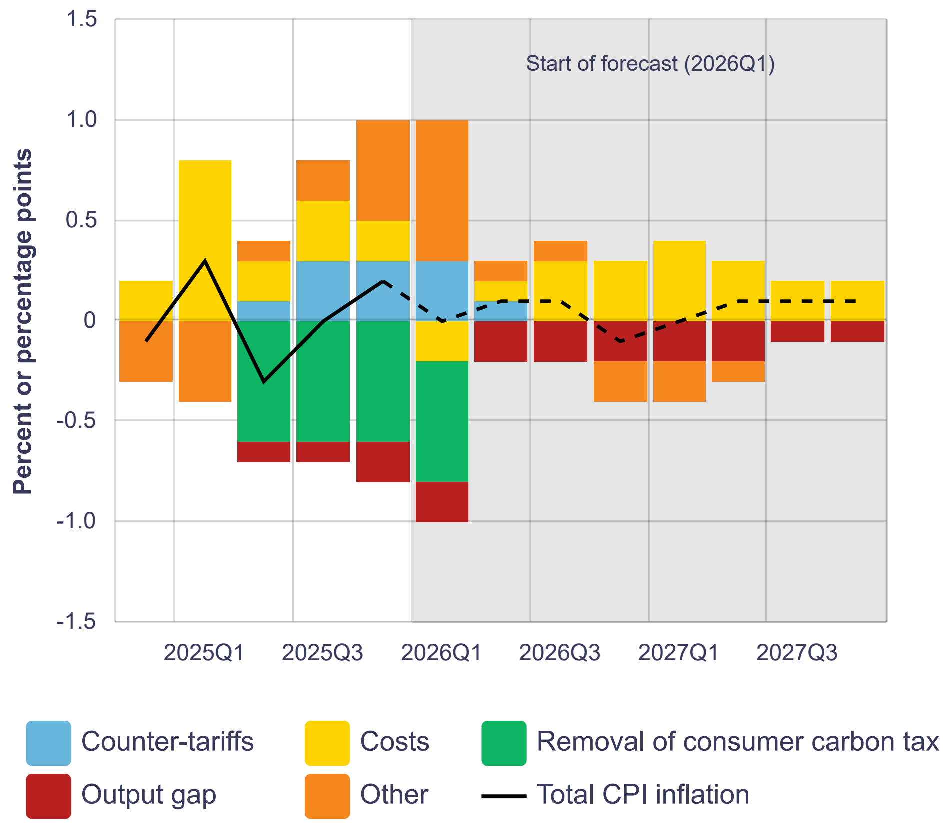


Sources: Statistics Canada and Bank of Canada calculations and estimates
Last data plotted: June 2026

In April, inflation settles just above 2% as the removal of the consumer carbon tax 12 months earlier ceases to have a downward effect on year-over-year inflation. Inflation then remains near 2% over the rest of the projection due to a mix of offsetting forces (**Chart 16**).

Chart 16: CPI inflation stays near 2% over the projection horizon

Contributions to year-over-year CPI inflation, deviation from target, quarterly data



Note: *Costs* includes, for example, commodity prices, import prices and shipping costs. *Other* includes, for example, base-year effects from the previous GST/HST holiday, movements in gasoline refinery margins and inflation not attributed to the identified components. Numbers may not sum to their respective totals due to rounding.
Sources: Statistics Canada and Bank of Canada calculations, estimates and projections
Last data plotted: 2027Q4

Tariff-related costs are expected to place upward pressure on inflation over the projection horizon. These include:

- higher costs for finished and intermediate goods imported into Canada as a result of US tariffs on its trading partners
- higher input costs as Canadian businesses diversify supply chains away from the United States

- higher shipping and logistics costs as imports are rerouted directly to Canada

Other sources of upward pressure on inflation remain, but their significance is diminishing. For example, Canada's counter-tariffs on US goods are estimated to be largely embedded in domestic prices. Inflation in prices for shelter services has eased considerably, although rent inflation continues to be elevated. Rent inflation is projected to moderate as housing supply increases and demand growth slows due to weaker population growth.

Downward forces on inflation are also at play. US trade restrictions have led to excess supply due to softer demand. This excess supply is expected to weigh on unit labour costs and put downward pressure on inflation over the projection horizon.

Endnotes

1. A gradual increase in population growth also contributes to the rise in potential output growth in 2027.[←]
2. Programs include, for example, the Trade Diversification Corridors Fund and the Strategic Response Fund.[←]
3. One such example is the Build Communities Strong Fund.[←]
4. Some prices were temporarily lower from December 2024 to February 2025 because of the GST/HST holiday. A base-year effect, reflecting comparisons with unusually low prices in the same months last year, will briefly push up year-over-year inflation between December 2025 and February 2026.[←]

Global economy

Global growth is expected to remain solid, supported by the boom in investment in artificial intelligence and by fiscal stimulus in several major economies.

Global growth is estimated to be about 3% over the projection horizon, similar to the October Report. However, the growth outlook is vulnerable to several uncertainties. These include the following:

- Trade adjustments stemming from elevated US tariffs and ongoing trade policy uncertainty are reshaping global trade flows, dampening demand and weighing on business investment.
- Artificial intelligence (AI)-related investment and equity market valuations have increased rapidly. The future strength of these investments and valuations and the impacts of AI on productivity and the labour market are uncertain.
- Geopolitical tensions are adding unpredictability. For example, supply chains and financial markets could be disrupted, and global commodity markets could become more volatile.

United States

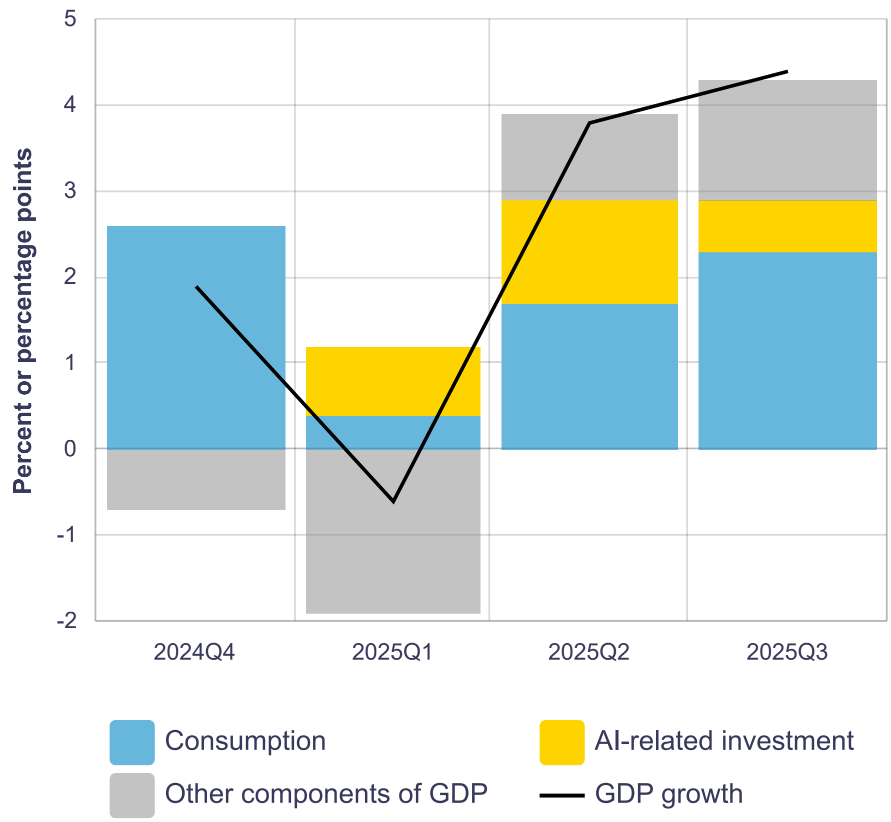
Economic growth in the United States is forecast to remain solid due to ongoing strength in consumption, AI-related investment and fiscal stimulus. Tariffs have pushed up inflation, but this effect is expected to be temporary.

Economic activity remains strong but has slowed

Robust AI-related investment and solid consumption—supported by strong equity markets and lower policy interest rates—are bolstering growth (**Chart 17**). The federal government shutdown weighed on economic activity in the fourth quarter of 2025, but a full rebound is expected in the first quarter of 2026. US economic growth is expected to moderate to about 2.5% over the fourth quarter of 2025 and the first quarter of 2026, from roughly 4% over the second and third quarters of 2025.

Chart 17: Consumption spending and AI-related investment have boosted US GDP growth

Contribution to GDP growth, annualized, quarterly data

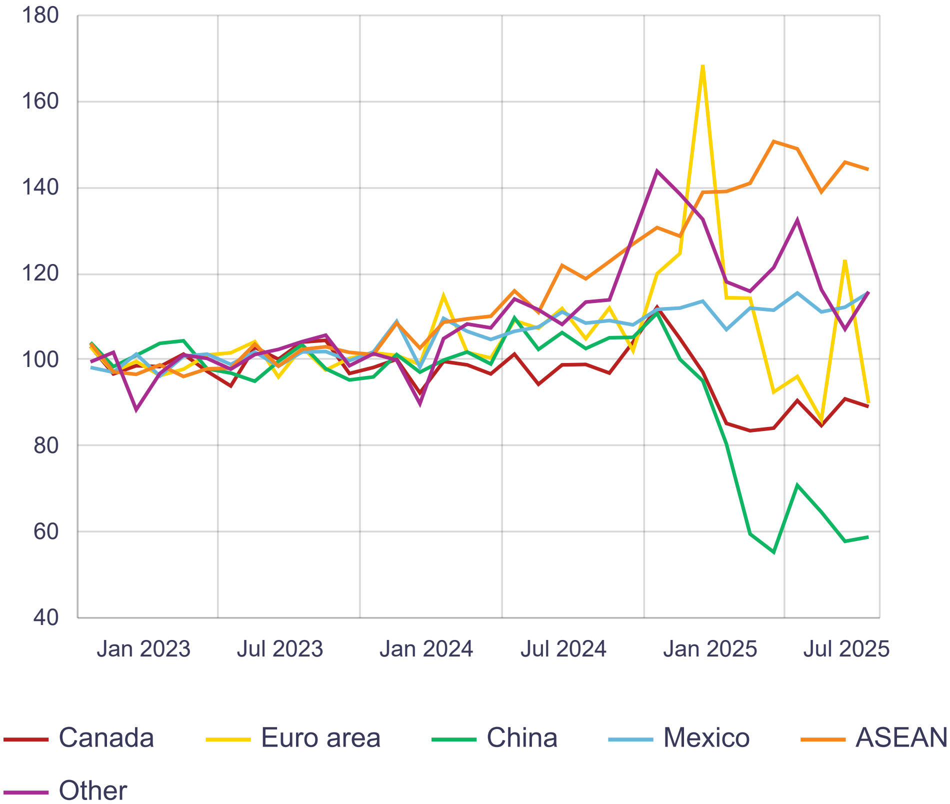


Note: AI is artificial intelligence. *AI-related investment* includes computer and peripheral equipment, intellectual property products for software and research and development, and data centre structures, unadjusted for imports and inventories. Numbers may not sum to their respective totals due to rounding.
Sources: US Bureau of Economic Analysis via Haver Analytics and Bank of Canada calculations
Last observation: 2025Q3

US trade dynamics have been volatile. Imports fell in the second half of 2025, after purchases were pulled forward ahead of tariffs earlier in the year. The shift in US trade policy has reduced how much the United States is importing from Canada and China; meanwhile, most other countries have gained market share (**Chart 18**).

Chart 18: US imports of goods from China and Canada have declined

Nominal US imports of goods by origin, index: 2023 = 100, monthly data



Note: ASEAN refers to the Association of Southeast Asian Nations.
Sources: United States Census Bureau via Haver Analytics and Bank of Canada calculations
Last observation: October 2025

The US labour market has slowed despite the recent strength in economic growth. Employment and wage growth have slowed since mid-2025. Since September, the unemployment rate has remained relatively stable near 4.4% because both labour demand and labour supply have eased.

Growth in gross domestic product (GDP) is projected to be 2.6% in 2026. This growth will be reinforced by fiscal stimulus, an easing in monetary policy and continued strength in AI-related investment. In addition, strong productivity gains are expected to support growth in real incomes over the projection horizon. As these forces wane, growth is expected to ease to 2.1% in 2027.

US inflation is expected to ease

Inflation in the US personal consumption expenditures price index was 2.8% in November, partially reflecting increased tariffs. Inflation is expected to hover near 2¾% through the first half of 2026, amid continued upward pressure from tariffs that is partially offset by the effects of lower global oil prices. As the impacts of tariffs fade, inflation is projected to gradually decline, approaching the 2% target by the end of 2027. This easing is underpinned by a balanced labour market and modest growth in labour costs over the projection.

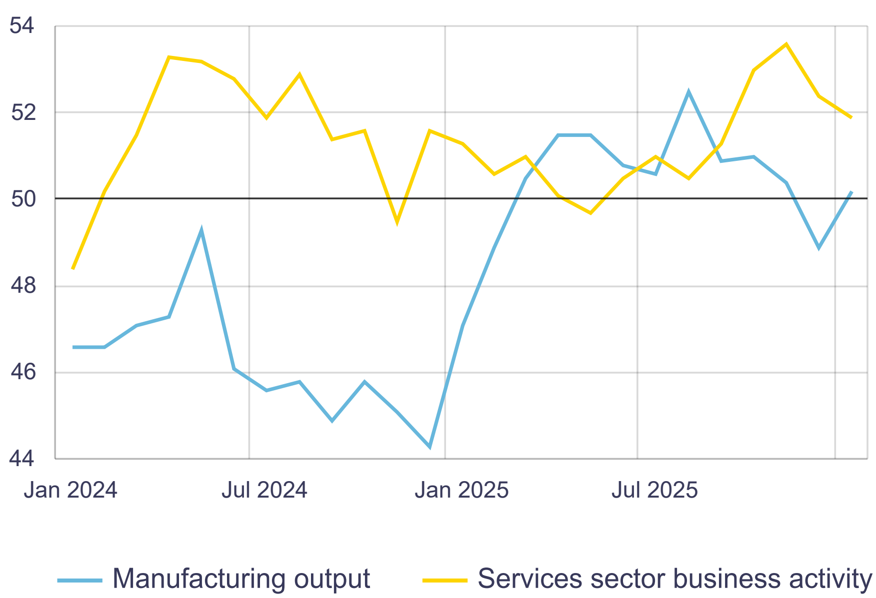
Euro area

The euro area is expected to maintain steady economic growth, averaging 1.3% over the projection horizon. Inflation is anticipated to remain close to the European Central Bank's 2% target.

Growth in the second half of 2025 was supported by strong activity in the services sector, especially tourism and investment in digital services (**Chart 19**). Recent data suggest that this momentum will persist.

Chart 19: A robust services sector is strengthening overall activity in the euro area

Purchasing managers' indexes, monthly data



Note: Purchasing managers' indexes greater than 50 indicate growth in the sector.
Source: S&P Global Purchasing Managers' Survey via Haver Analytics
Last observation: January 2026

In contrast, the goods-producing sector is still adjusting to higher US tariffs and competition from China. Nevertheless, moderate and sustained GDP growth is expected over the projection horizon, supported by government spending on defence and infrastructure. The pace and scale of the fiscal expansion, along with heightened geopolitical tensions, remain sources of uncertainty.

China

China's economic growth remained solid in 2025, supported by a shift in exports away from the United States toward other markets. Domestic demand softened in the second half of 2025 due to:

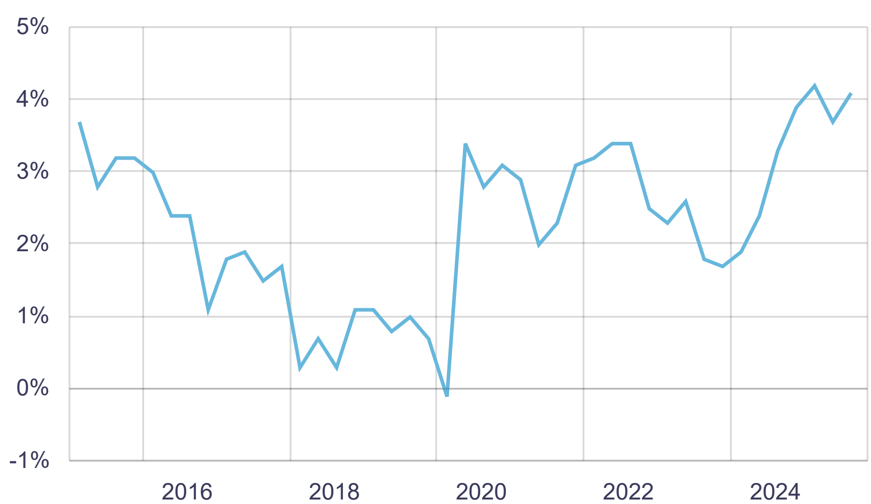
- waning fiscal support for consumers
- a government directive curbing inefficient investment
- a renewed decline in property sector activity

Domestic demand is expected to grow modestly over the projection horizon, held back by a shrinking labour force and ongoing weakness in the property sector. While export growth remains robust, it is expected to ease.

China's trade surplus as a share of GDP is expected to continue its recent rise (**Chart 20**). This increasing reliance on exports leaves growth vulnerable to a slowdown, particularly if strong Chinese exports prompt other countries to put protectionist measures in place.

Chart 20: China's trade surplus is growing

Nominal trade balance of goods and services as a share of GDP, quarterly data



Sources: China's State Administration of Foreign Exchange and National Bureau of Statistics via Haver Analytics and Bank of Canada calculations
Last observation: 2025Q3

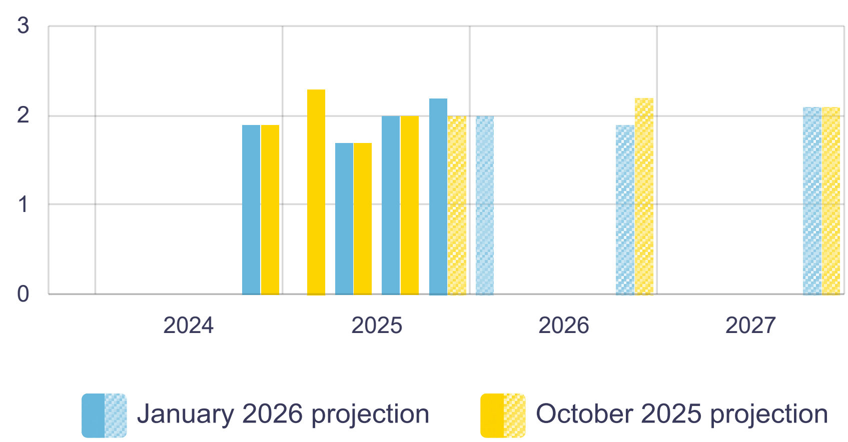
Projections

The outlook for the Canadian economy is evolving largely as anticipated. Economic growth is expected to average around 1¼% over the projection horizon, and inflation remains near 2%.

The outlook for economic growth and inflation in Canada remains broadly similar to that in the October Report (**Chart 21**).

Chart 21: The January 2026 and October 2025 Monetary Policy Report outlooks

CPI inflation (year-over-year percentage change)



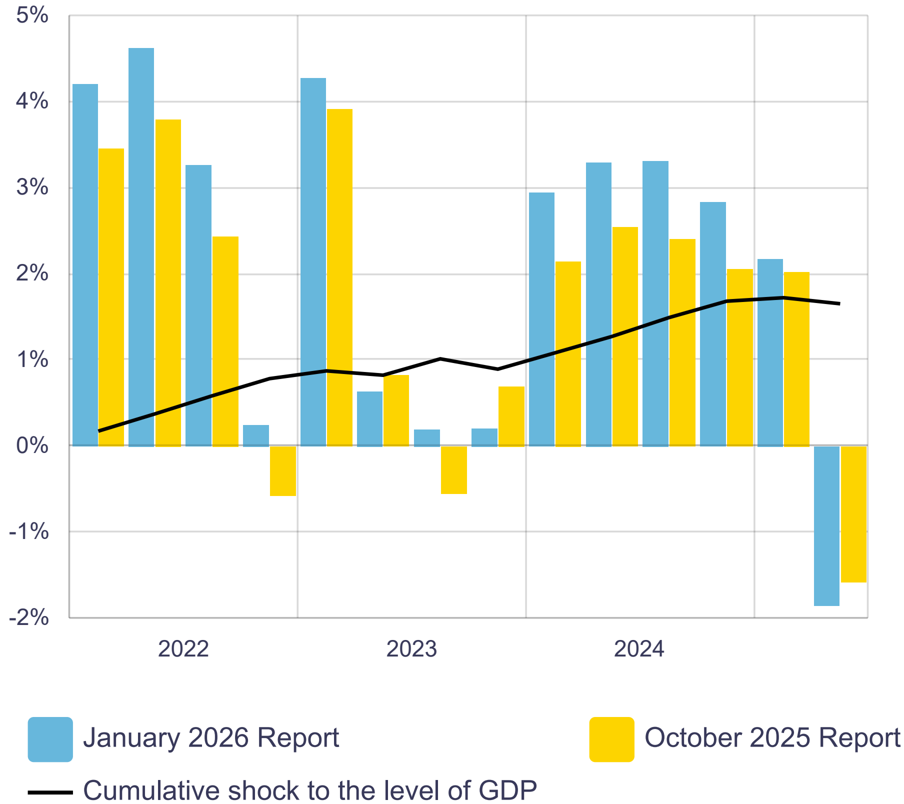
Changes to the projection

Canadian outlook

Statistics Canada revisions to historical gross domestic product (GDP) data show that the Canadian economy was stronger going into 2025 than previously thought (**Chart 22**). By the second quarter of 2025, the level of GDP is revised up by 1.7%, mainly reflecting increased investment, exports and consumption. The revisions also suggest more robust growth in trend labour productivity, partly because stronger growth in investment raised the level of the capital stock. Potential output has thus been revised up by almost as much as GDP, so the amount of slack in the economy remains largely unchanged.

Chart 22: Canada's economy was stronger than previously thought

GDP growth, annualized, quarterly data



Sources: Statistics Canada and Bank of Canada calculations
Last observation: 2025Q2

The projection for GDP growth, compared with that in the October Report, is unchanged in 2026 and slightly weaker in 2027. The outlook for consumer price index inflation is marginally higher in 2025 and marginally lower in 2026, reflecting recent fluctuations in food and energy prices (**Table 2** and **Table 3**).

Table 2: Contributions to average annual real GDP growth Percentage points*†

	2024	2025	2026	2027
Consumption	1.2 (1.3)	1.2 (1.5)	0.7 (0.8)	0.6 (0.9)
Housing	0.0 (-0.1)	0.1 (0.1)	0.2 (0.2)	0.2 (0.1)
Government	1.0 (1.1)	0.6 (0.7)	0.7 (0.7)	0.6 (0.4)
Business fixed investment	-0.1 (-0.2)	0.0 (-0.2)	0.1 (0.0)	0.3 (0.3)
Subtotal: final domestic demand	2.2 (2.1)	1.9 (2.1)	1.7 (1.7)	1.7 (1.7)
Exports	0.3 (0.2)	-0.9 (-1.2)	-0.1 (-0.2)	0.7 (1.0)
Imports	-0.2 (-0.2)	0.2 (0.3)	-0.1 (-0.1)	-0.8 (-1.0)
Inventories	-0.2 (-0.5)	0.5 (0.0)	-0.4 (-0.3)	-0.1 (-0.1)
GDP	2.0 (1.6)	1.7 (1.2)	1.1 (1.1)	1.5 (1.6)
Memo items (percentage change):				
Range for potential output	3.2 (2.8)	1.9–2.7 (1.2–2.0)	0.6–1.6 (0.4–1.4)	0.7–1.7 (1.3–2.3)
CPI inflation	2.4 (2.4)	2.1 (2.0)	2.0 (2.1)	2.1 (2.1)

* Numbers in parentheses are from the October Report.
† Numbers may not sum to their respective totals due to rounding.
Sources: Statistics Canada and Bank of Canada calculations, estimates and projections

Table 3: Summary of the quarterly projection for Canada*

	2025			2026	2024	2025	2026	2027
	Q2	**Q3**	**Q4**	**Q1**	**Q4**	**Q4**	**Q4**	**Q4**
CPI inflation (year-over-year percentage change)	1.7 (1.7)	2.0 (2.0)	2.2 (2.0)	2.0	1.9 (1.9)	2.2 (2.0)	1.9 (2.2)	2.1 (2.1)
Core inflation (year-over-year percentage change)†	3.1 (3.1)	3.1 (3.2)	2.9 (2.9)	2.5	2.6 (2.6)	2.9 (2.9)	2.1 (2.3)	2.1 (2.1)
Real GDP (year-over-year percentage change)	1.6 (1.2)	1.4 (0.7)	0.7 (0.5)	0.6	3.1 (2.3)	0.7 (0.5)	1.4 (1.6)	1.7 (1.6)
Real GDP (quarter-over-quarter percentage change at annual rates)‡	-1.8 (-1.6)	2.6 (0.5)	0.0 (1.0)	1.8				

* See details in the **Tariff and other assumptions** section. Numbers in parentheses are from the October Report.
† Core inflation is the average of CPI-trim and CPI-median.
‡ At the time of the projection, 2025Q4 and 2026Q1 are the only quarters for which some information about real GDP growth was available. For longer horizons, fourth-quarter-over-fourth-quarter percentage changes are presented. They show the Bank of Canada's projected growth rates of CPI and real GDP within a given year. They can therefore differ from the growth rates of annual averages shown in **Table 2**.
Sources: Statistics Canada and Bank of Canada calculations, estimates and projections

Global outlook

The outlook for global growth is similar to what it was at the time of the October Report (**Table 4**).

- US economic growth in 2026 has been revised up, led by stronger consumption and investment in artificial intelligence.
- Growth in the euro area has been revised up slightly. Domestic demand has proved to be more resilient; it is projected to remain robust due to stronger-than-expected growth in the services sector and an increase in labour productivity.
- While the outlook for GDP growth in China is broadly unchanged, the composition of growth is different. Domestic demand is now expected to remain subdued, but exports have been revised up, supported by solid demand from other emerging-market economies.

Table 4: Projection for global economic growth (percentage change)

	Share of real global GDP* (%)	Growth† (%)			
		2024	2025	2026	2027
United States	15	2.8 (2.8)	2.2 (2.1)	2.6 (2.2)	2.1 (2.1)
Euro area	12	0.8 (0.8)	1.5 (1.2)	1.2 (1.0)	1.4 (1.5)
China	19	5.0 (5.0)	5.0 (4.9)	4.5 (4.4)	4.2 (4.1)
World	100	3.3 (3.2)	3.5 (3.2)	3.2 (2.9)	3.0 (3.0)

* Shares of gross domestic product (GDP) are based on International Monetary Fund (IMF) estimates of the purchasing-power-parity valuation of country GDPs for 2024 from the IMF's October 2025 *World Economic Outlook*.
† Numbers in parentheses are projections from the October Report.
Sources: National sources via Haver Analytics and Bank of Canada calculations, estimates and projections

Risks

With geopolitical uncertainty elevated and Canada's trade agreement with the United States and Mexico under review, risks around the outlook are unusually high.

Predicting how geopolitical events will unfold and how they will affect the global and Canadian economies is difficult. If tensions escalate and events disrupt global supply chains and commodity markets, goods inflation could rise more than expected. Geopolitical events could also slow economic activity. For example, financial markets could demand higher risk premiums, which would raise borrowing costs and weaken confidence. This would slow the growth of gross domestic product (GDP) and reduce inflationary pressure.

The other major source of uncertainty is the review of the Canada-United States-Mexico Agreement (CUSMA). The base-case projection assumes that the tariffs and trade policies in place on January 23, 2026, persist over the projection horizon (see the **Tariff and other assumptions** section). It also assumes that the 2026 CUSMA review preserves the existing trade deal, reducing uncertainty for exporters and around integrated North American supply chains.

However, the review could lead to a wide range of other outcomes (see **In Focus: The review of the Canada-United States-Mexico Agreement**). CUSMA could be extended but only after significant renegotiation. Another possibility is that no extension is reached, resulting in ongoing annual reviews. A more adverse scenario would be member countries withdrawing from the agreement entirely. Overall, the CUSMA review is assessed as a downside risk for economic growth, but inflation could be higher or lower.

The inflation outlook also faces other risks. These are considered below.

Main upside risks to inflation

There is less excess supply

Revisions by Statistics Canada indicate that the economy entered 2025 much stronger than previously thought. Nearly all the revision to GDP has been attributed to higher potential output. There is a risk that more of this upward revision could be due to demand rather than potential output. If so, downward inflationary pressures would be weaker than projected.

Restructuring is more costly

The economy is adjusting to the impact of US tariffs. Businesses are seeking new markets and diversifying their supply chains. Capital and labour are expected to move to other sectors of the economy over the projection horizon.

The cost of this adjustment is difficult to assess. If the reorientation of production and supply chains turns out to be more costly or takes longer than assumed, elevated business costs could add more to inflationary pressures.

Main downside risks to inflation

Existing tariffs could weaken the economy further

Tariffs imposed by the United States have led to a sharp decline in exports in affected industries. To date, however, the related declines in production and employment—and the spillovers to other parts of the economy—have been more muted than anticipated. If production and employment were to decline more sharply, spillovers to the broader economy would intensify. This would lead to increased excess supply and additional downward pressure on inflation.

Global financial conditions could tighten

The US outlook depends on the pace of investment in artificial intelligence (AI) and related equity market gains. A sharp reassessment of the prospects for AI could trigger an equity market correction, which would weaken both consumer confidence and household wealth in the United States and abroad.

At the same time, yields for long-term government bonds could rise if investors demand greater compensation given the rapid accumulation of public debt worldwide.

Either development would tighten financial conditions and weaken demand for Canadian goods and services, creating excess supply and adding downward pressure on inflation in Canada.

How Canadian businesses are adapting to US tariffs

Canadian businesses continue their efforts to expand exports to countries other than the United States. Trade tensions are also leading Canadian businesses to rely less on US imports.

Canadian businesses are looking for new markets and suppliers outside of the United States. Although these adjustments will initially be costly, they will help boost future economic growth.

Diversifying Canada’s exports will take time

Increased US protectionism has raised costs and uncertainty. Exports in sectors that are affected by tariffs have fallen sharply. Even in sectors that have not been hit by tariffs, exports have declined. Uncertainty about future trade policy has caused some Canadian businesses and US customers to become reluctant to do business with each other. Overall, exports in the third quarter of 2025 were 4% lower than they were before US tariffs were imposed.

Some businesses in Canada are working to diversify their export markets, but this shift is likely to occur gradually. Finding new markets and building new export supply chains will take time and be costly.

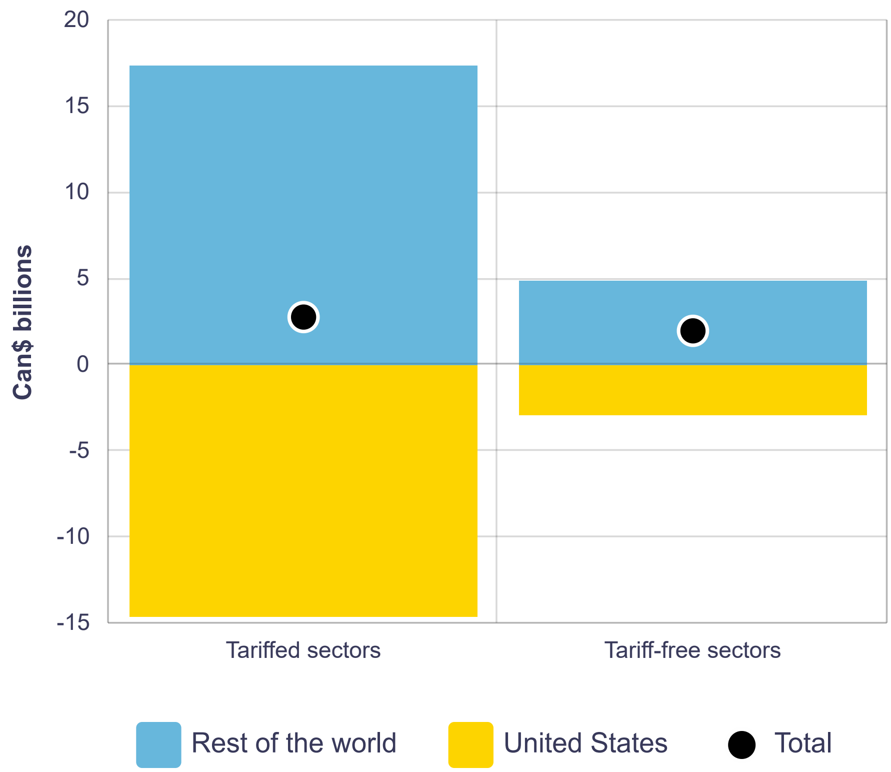
Businesses are adjusting their supply chains

US tariffs have also led Canadian businesses to rely less on US inputs and instead seek alternatives within Canada or from other countries.

Imports from the United States have fallen noticeably since the start of 2025, while imports from other countries have risen. Approximately 80% of the decline in the share of US imports has been in sectors where Canada imposed counter-tariffs (**Chart 23**). However, now that most counter-tariffs have been lifted, the shift away from US imports has partially reversed.

Chart 23: The decline in Canadian imports from the United States is mostly in sectors affected by tariffs

Change in Canada's nominal imports before and after the onset of US trade restrictions, by country of origin



Note: Chart shows the difference in nominal import levels between two periods (one year apart): April–October 2024 and April–October 2025. *Tariffed sectors* refers to sectors where Canada has implemented counter-tariffs, including those that were lifted as of September 1, 2025.
Sources: Statistics Canada and Bank of Canada calculations

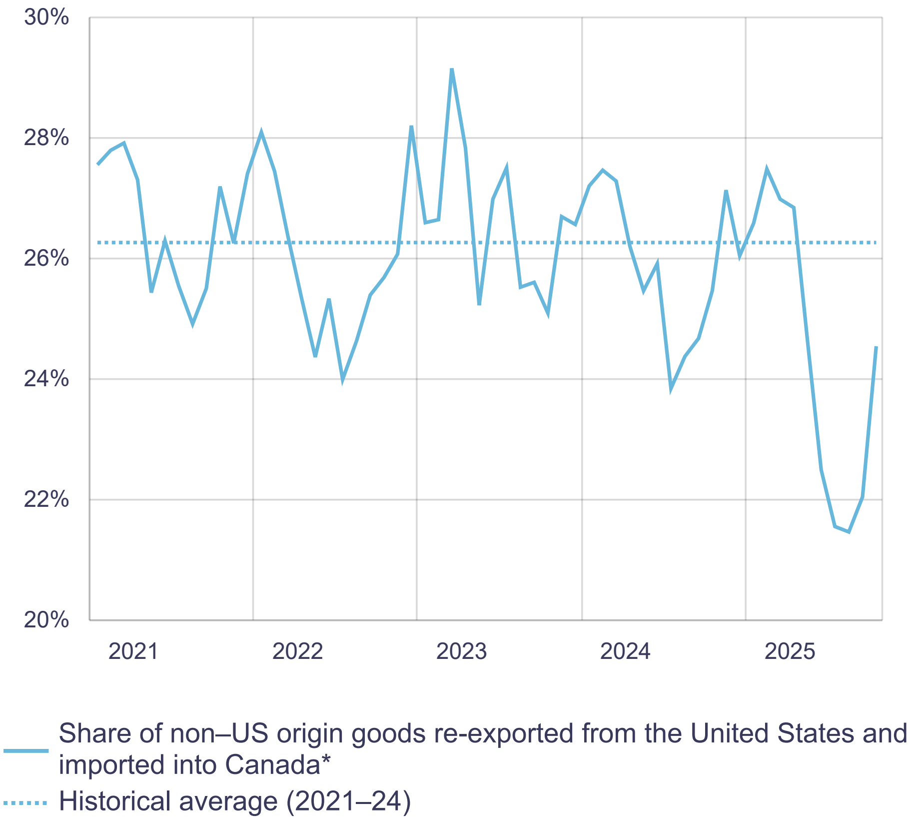
A key feature of trade between Canada and the United States is the cross-border movement of intermediate components. On average, content sourced from the United States makes up about one-fifth of the total value of Canada's exports to the United States. Because demand from US customers has softened, Canadian manufacturers are importing fewer of these intermediate components.

Canadian businesses are also adjusting how they import goods from other countries. In 2024, roughly one-quarter of Canada's non-US imports were routed through the United States before entering Canada. This share has since fallen, and the share of goods imported directly into Canada has grown (**Chart 24**). Importing directly into Canada is likely more expensive than it was to route through the United States before tariffs were imposed, adding to price pressures.[1]

Other factors account for the rest of the decline in imports from the United States. These factors could include the Buy Canadian sentiment as well as an effort by businesses to diversify their supply sources. The latter reflects strategies by businesses to reduce their exposure to trade uncertainty and to strengthen the resilience of their supply chains. New sources of supply tend to be more expensive than those used before US tariffs were imposed, increasing price pressures.

Chart 24: Canada is relying less on the United States to import goods from other countries

Share of nominal imports of non–US origin goods that are re-exported through the United States, non-seasonally adjusted, monthly data



*As a percentage of Canada's total non–US origin goods imports
Sources: Statistics Canada and Bank of Canada calculations
Last observation: October 2025

Endnotes

1. Shipping costs account for only a small portion of a product's final price, limiting the impact on prices.[⟵]

The review of the Canada–United States–Mexico Agreement

The future of Canada's trade agreement with the United States and Mexico is unclear. A review of the agreement could lead to many possible outcomes, and these can have a wide range of impacts on the Canadian economy.

The Canada-United States-Mexico Agreement (CUSMA) is a trilateral trade deal that came into effect in 2020. The agreement is up for review in 2026.[1] The outcome of the review is an important risk to the outlook (see the **Risks** section).

The range of possible outcomes is wide

How CUSMA negotiations will unfold is uncertain. Possible outcomes include the following:

- CUSMA is extended, with limited changes, for a new term of 16 years until 2042. The current regime is maintained, which reduces uncertainty for exporters and around integrated supply chains. The extension of CUSMA is the outcome assumed in the base-case projection.
- CUSMA is significantly renegotiated. This could make trade more expensive. For example, stricter rules around proving where a product was made (rules of origin) or a smaller discount on CUSMA-compliant goods (reduced tariff preferences) would increase effective trade costs. At the same time, as part of the negotiations, some sectoral tariff rates could be lowered, reducing trade costs.
- Members withdraw from CUSMA. This could result in a significant increase in trade barriers. Alternatively, parties could agree to bilateral trade deals.
- No agreement is reached, and CUSMA is reviewed every year until an extension is negotiated or the agreement expires in 2036. This would prolong uncertainty.

Canada's economy could be on a lower path

Nearly all of Canada's exports are compliant with CUSMA, and this has helped preserve the competitiveness of Canadian exports overall. An unfavourable outcome of the review would weaken the competitiveness of Canadian exports, lowering export volumes. Faced with weaker demand, exporters would reduce production, investment and hiring. This would spill over into the broader economy, weighing on sectors such as services and putting Canadian gross domestic product on a lower path.[2]

The implications for inflation are mixed. Higher import costs, potential counter-tariffs, supply chain disruptions and a weaker Canadian dollar would push up consumer prices. At the same time, softer demand and the associated excess supply would dampen consumer prices.

Endnotes

1. See Government of Canada, "Article 34.7: Review and Term Extension," ***Canada-United States-Mexico Agreement (CUSMA) – Chapter 34 – Final provisions*** (December 5, 2019).[←]

2. For more details on how higher tariffs could affect the Canadian economy, see the scenarios in Bank of Canada, ***Monetary Policy Report—April 2025***; Bank of Canada, ***Monetary Policy Report—July 2025***; and Bank of Canada, "**In focus: Evaluating the potential impacts of US tariffs**," *Monetary Policy Report—January 2025*.[←]