



BANK OF CANADA
BANQUE DU CANADA

Monetary Policy *Report*

October 2026



Overview

Inflation in Canada is projected to remain above 3% through much of 2027, materially higher than previously forecast. The Canadian economy entered the second half of 2026 on firmer footing, and the outlook for economic activity has been revised up. Uncertainty remains elevated.

The war in the Middle East has entered its eighth month, and damage to refining capacity continues to disrupt global energy markets and supply chains. Oil prices have increased and refinery margins are elevated, which has pushed gasoline and diesel prices higher. Prices of non-energy imports have also increased.

With measures of core inflation still near 2%, high energy costs have not yet spread broadly to other prices. But cost pressures are building, and businesses anticipate passing on more of their increased costs to customers.

Higher gasoline and diesel prices combined with increased cost pass-through have pushed up the forecast for inflation. Inflation is projected to remain above 3% through much of 2027—longer than anticipated in the July Report. It then gradually declines and settles around the 2% target by the middle of 2028 as cost pressures fade.

There is considerable uncertainty around the outlook. In particular, it remains unclear how long energy prices will stay high, given the rapidly evolving situation in the Middle East, and how quickly and fully higher costs will pass through to consumer prices.

The economy came through the middle of 2026 on firmer footing than expected. In the second quarter, growth picked up and broadened. Household spending grew strongly despite slow population growth. Businesses showed signs of adapting to the shift in Canada's trade relationship with the United States, and investment and exports rose.

Since the July Report, trade tensions have escalated again. Although the direct effects of the latest US tariffs are concentrated in a relatively small share of Canadian exports, renewed uncertainty means businesses may delay expansion and hiring plans, which would weigh on growth. At the same time, elevated oil prices are raising the value of Canada's exports and adding to government revenues.

Growth in gross domestic product is expected to slow in the fourth quarter of 2026, partly as a result of trade tensions. It is then projected to pick up and average 2% in 2027 and 2028, somewhat stronger than anticipated in the July Report. Resilient foreign demand supports non-commodity exports, while energy exports remain strong. Business investment increases in response to recent government incentives. Government spending also rises. But the strength of the pickup in economic growth remains uncertain, particularly given that it is unclear how businesses may respond to recent developments.

There are both upside and downside risks around energy and trade. Further disruptions to energy supply could increase cost pressures, while a quick resolution of the conflict in the Middle East would limit spillovers to broader prices. An escalation in trade tensions could weigh further on activity, while an agreement that reduces tariffs and uncertainty could lift exports and business investment (see the **Risks** section).

The Bank of Canada has a **new macroeconomic model** for projection and policy analysis—Prima. Models are tools that help the Bank interpret data and better understand the forces shaping the economy.

In Prima, costs reflect the balance between supply and demand within each sector of the economy. The model traces how costs move through supply chains and affect the five major components of the consumer price index.

The forecast for inflation has changed significantly since the July Report, mostly because of the upward revision to energy prices. For the October Report, Prima helped analyze how high energy prices affect economic activity and inflation (see the **Outlook** section and **In focus: Using Prima to trace how an energy shock affects inflation**).

Current conditions

Inflation remains around 3%, pushed up by higher gasoline prices. The Canadian economy gained strength in the second quarter. Renewed trade tensions with the United States will weigh on near-term growth.

Economic growth picked up in the second quarter of 2026. This increase was driven mainly by solid consumption and strong gains in investment and exports. The pickup in growth was stronger than expected in the July Report.

Growth is estimated to remain solid in the third quarter. It slows in the fourth quarter mainly due to new US tariffs, heightened trade policy uncertainty and tighter financial conditions.

Consumer price index (CPI) inflation has stayed close to 3% over the past six months, largely reflecting higher gasoline prices. Inflation is estimated to rise to about 3½% by the end of the year, about 1 percentage point higher than anticipated in the July Report.

Disruptions to global energy supply, higher prices of non-energy imports and counter-tariffs have intensified cost pressures since the July Report. Businesses expect to pass through more of these cost increases to consumers. At the same time, US tariffs and the associated uncertainty dampen demand, limiting upward pressure on inflation.

Economic activity

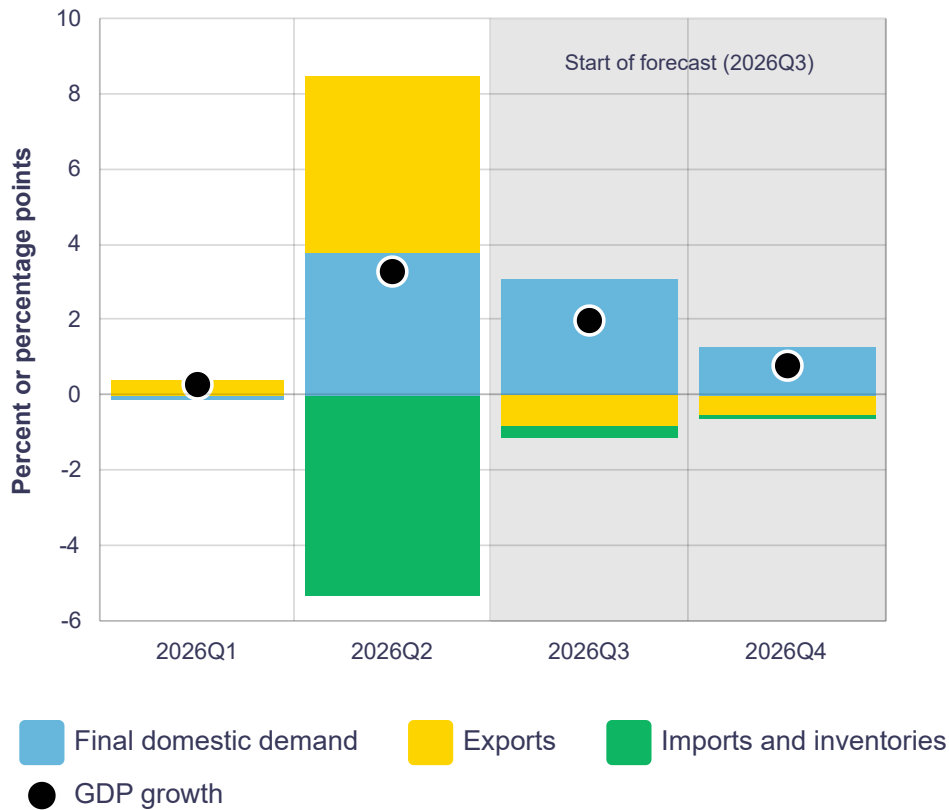
Gross domestic product (GDP) grew strongly in the second quarter, with gains broadening across both expenditure components and industries. This broadening provides a more solid foundation for future growth.

Activity strengthened heading into the summer

GDP rose 3.3% in the second quarter of 2026 (**Chart 1**). This reflected a surge in exports and solid growth in domestic demand, supported in part by temporary factors.

Chart 1: GDP grew strongly in the second quarter

Contribution to GDP growth, annualized, quarterly data



Note: *Imports and inventories* includes Statistics Canada's statistical discrepancy. Numbers may not sum to their respective totals due to rounding.

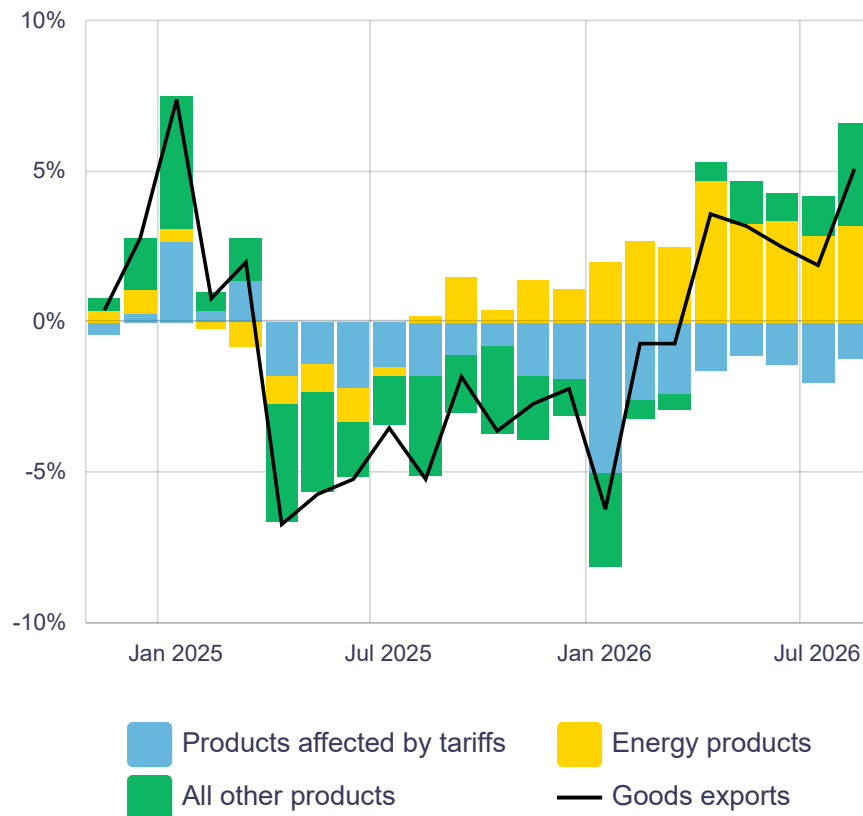
Sources: Statistics Canada and Bank of Canada calculations and estimates

Last data plotted: 2026Q4

Despite ongoing weakness in sectors affected by tariffs, export growth began to broaden (**Chart 2**). Gains in the second quarter reflected a rebound in motor vehicle shipments as some production came back online, as well as strong exports of energy and other commodities, consumer goods, and machinery and equipment. These widespread gains were supported by solid US demand—including for products related to artificial intelligence (AI)—along with businesses adapting to the changing trade environment.

Chart 2: Exports expanded despite weakness in tariff-affected products

Percentage change from 2024, monthly data



Note: *Goods exports* excludes 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. *Products affected by tariffs* does not capture the most recent tariffs announced following the breakdown in trade negotiations between Canada and the United States.

Sources: Statistics Canada and Bank of Canada calculations

Last observation: August 2026

Despite slow population growth, consumer spending grew strongly, supported by growth in labour income and temporary government transfers.¹ Housing activity rebounded but remained subdued overall.

Robust spending on machinery and equipment—including AI-related investment—and activity in the oil and gas sector boosted business investment.

Growth is expected to slow as new tariffs weigh on demand

Growth in GDP is estimated to remain solid at 2% in the third quarter, supported by strong domestic demand. It is then anticipated to slow in the fourth quarter to below 1%. New US tariffs restrain exports, while trade uncertainty dampens business investment and household spending. Government measures introduced in response to the new tariffs provide a partial offset by supporting affected businesses and workers. Housing activity remains weak.

Bank of Canada surveys indicate that businesses' sales expectations improved in the third quarter. But more recent results point to renewed weakness following the breakdown in trade negotiations, particularly among businesses affected by new tariffs. Some consumers also reported that trade-related uncertainty could lead them to postpone major purchases.

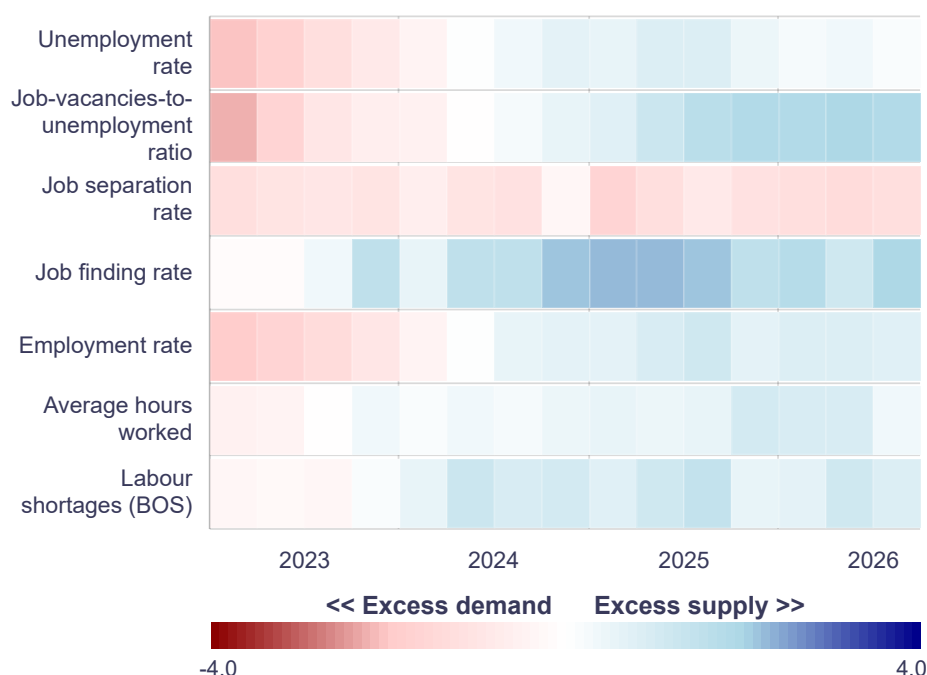
Capacity pressures

Despite sizable monthly fluctuations, employment is unchanged since the start of the year. Finding work continues to be challenging, and some slack remains in the labour market. Other indicators point to some excess capacity across the broader economy.

Employment is unchanged and job seekers face difficulties

Labour market conditions have changed little on net since the start of the year (**Chart 3**). Surveys indicate that labour shortages remain below their historical averages.

Chart 3: Labour market indicators suggest continued slack



Note: BOS is the Business Outlook Survey. The heatmap shows the distance of each labour market indicator from the midpoint of its benchmark range. The colour is white when the indicator is close to the midpoint of its benchmark range, a varying shade of red when it is indicative of excess demand and a varying shade of blue when it is indicative of excess supply. To make the indicators more comparable, each indicator is divided by its standard deviation. The standard deviation is calculated using data from April 2015 to December 2019 for the *Job-vacancies-to-unemployment ratio* and from 2003 to 2019 for all other indicators. Data for the *Job-vacancies-to-unemployment ratio* in 2026Q3 reflect the month of July only. Although most indicators point to some labour market slack, the job separation rate remains low, reflecting modest layoffs, with labour market adjustment occurring mainly through reduced hiring rather than increased separations. The benchmark ranges are established using the methodology outlined in E. Ens, K. See and C. Luu, “Benchmarks for assessing labour market health: 2023 update,” Bank of Canada Staff Analytical Note No. 2023-7 (May 2023).

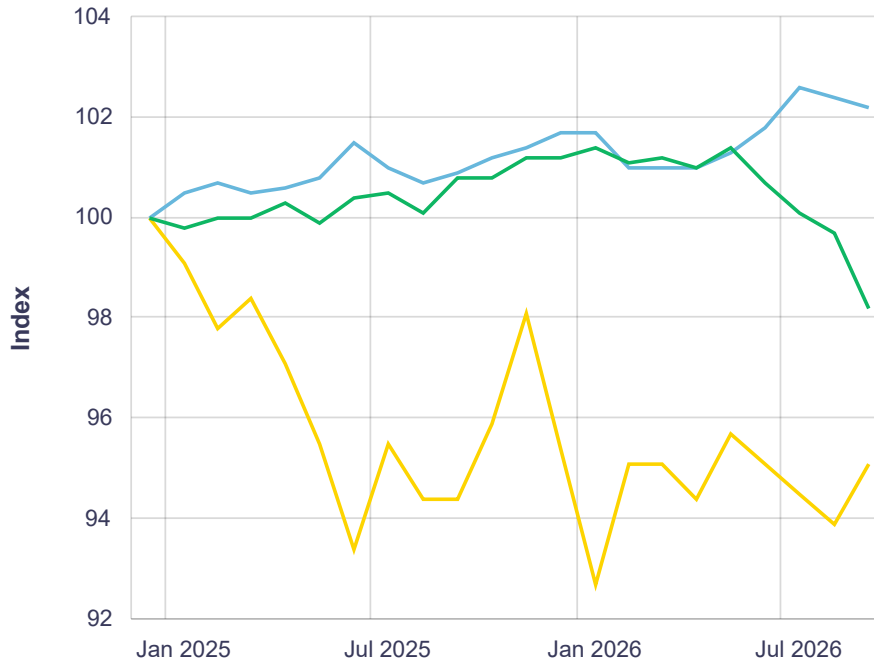
Sources: Statistics Canada, Bank of Canada and Bank of Canada calculations

Last observation: 2026Q3

Employment is roughly unchanged since January. The private sector was a relative source of strength, adding about 87,000 jobs. Net job creation was concentrated in industries less reliant on US demand. Employment remained weak in industries highly reliant on US demand, while public sector employment fell sharply (**Chart 4**).²

Chart 4: Sectors highly exposed to trade with the United States continue to lag in employment growth

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



- Private sectors with limited reliance on exports to the United States (71% of total employment, September 2026)
- Private sectors with high reliance on exports to the United States (8% of total employment, September 2026)
- Public sector (21% of total employment, September 2026)

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: September 2026

The unemployment rate has hovered around 6.5% in recent months. Layoffs remain low, but elevated long-term unemployment and subdued job vacancies suggest that it is more difficult than usual for the unemployed to find work.

Wage growth has been around 3% across many measures, with LFS-Micro data somewhat lower.³ Businesses' wage expectations are little changed and remain near 3%.

Other indicators point to some remaining excess capacity

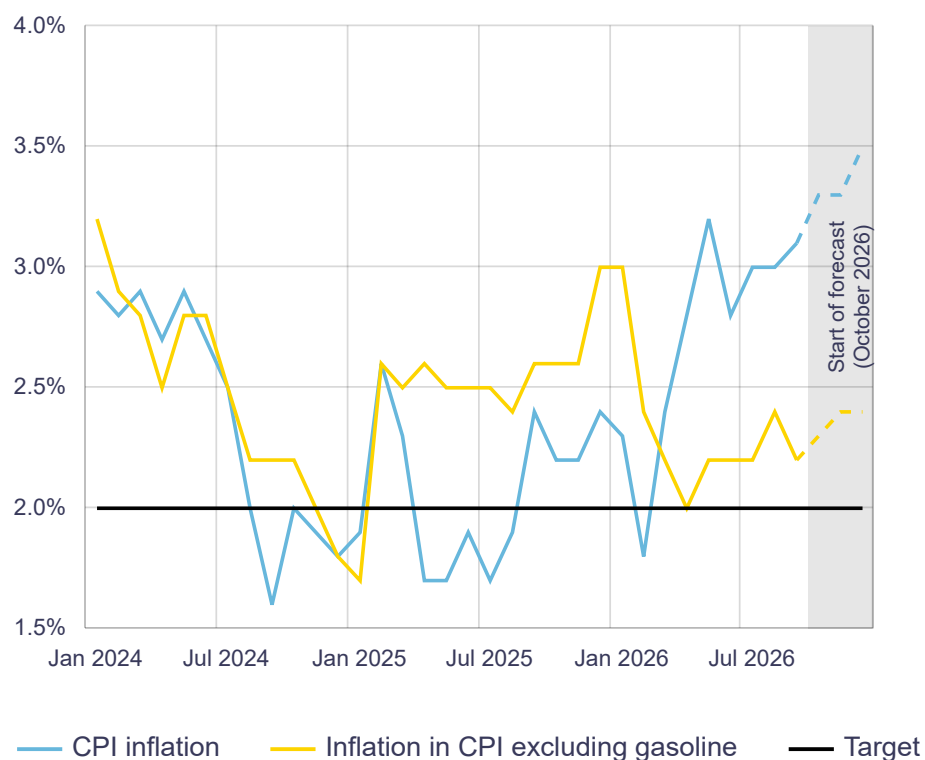
Surveys indicate that many businesses have capacity to meet an unexpected increase in demand, although this spare capacity has declined somewhat since early 2026. The Bank's estimate of the economy-wide output gap provides a broad measure of these pressures and points to a similar degree of slack. The gap is estimated to range from -1.25% to -0.25% in the third quarter, in line with the July Report.

Inflation

CPI inflation was 3.1% in September and, excluding gasoline, inflation was 2.2% (**Chart 5**). Measures of core inflation remained close to 2%.

Chart 5: Inflation in CPI excluding gasoline has remained close to 2%

Year-over-year percentage change, monthly data



Sources: Statistics Canada and Bank of Canada calculations and estimates

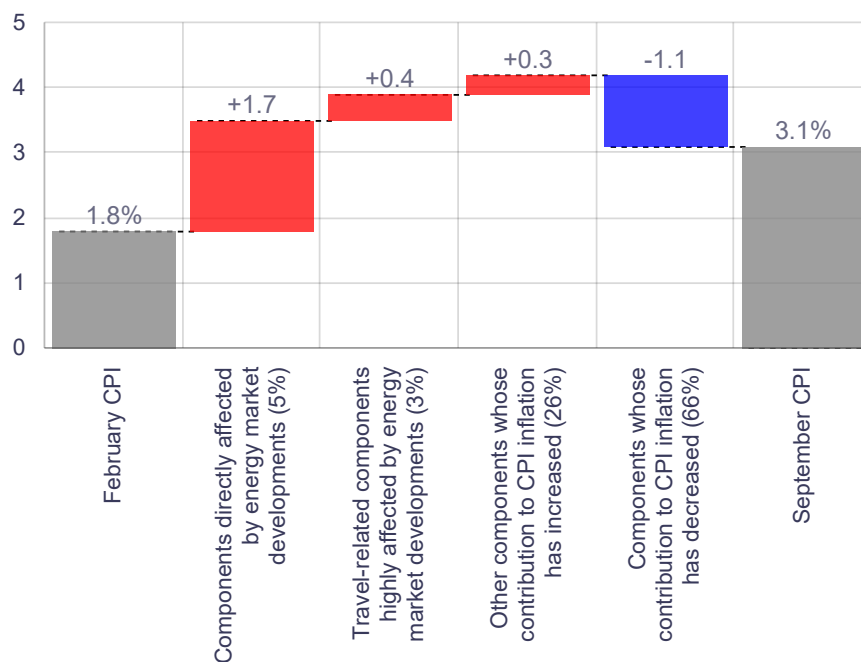
Last data plotted: December 2026

High inflation is limited to a few components so far

The increase in inflation since February 2026 was concentrated in five CPI components that are directly or indirectly affected by energy market developments. These include gasoline, travel services and intercity transportation (**Chart 6**). Moreover, the share of CPI components rising by 3% or more has declined since February and is now near its historical average (**Chart 7**).

Chart 6: Energy prices have driven the rise in inflation

Contribution to the change in year-over-year inflation between February and September 2026, percentage points, monthly data

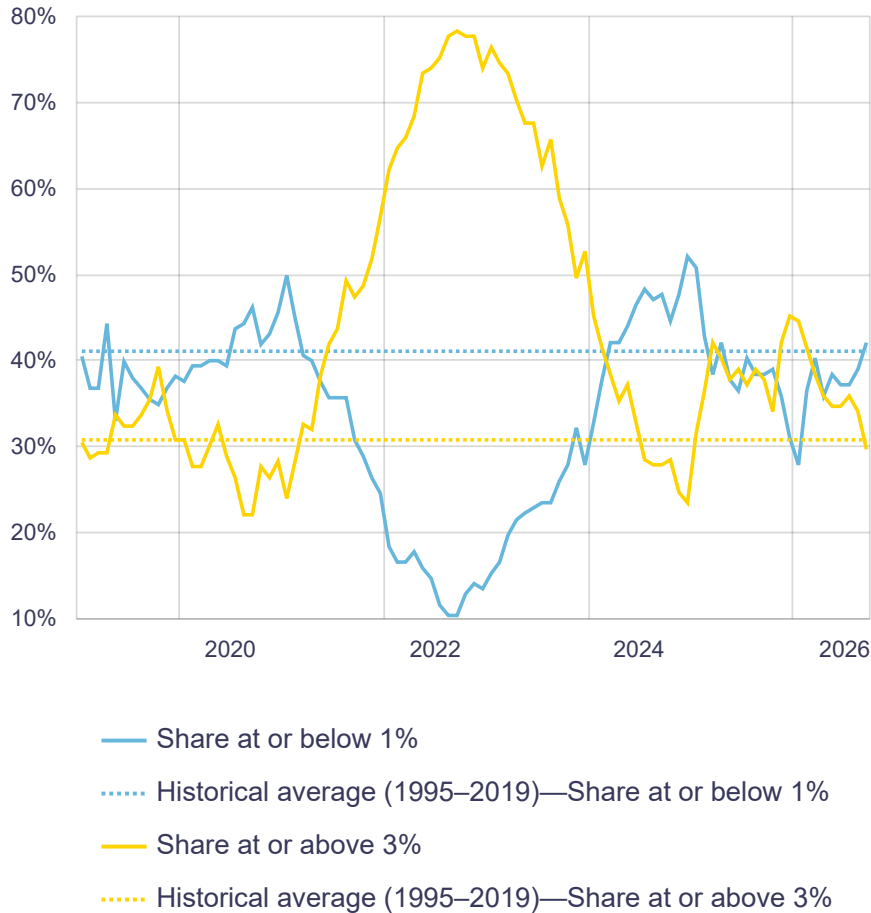


Note: These calculations are based on a 55-component disaggregation of the CPI basket. *Components directly affected by energy market developments* are gasoline, operation of recreational vehicles, and fuel oil and other fuels. *Travel-related components highly affected by energy market developments* are travel services and intercity transportation. Examples of *Other components whose contribution to CPI inflation has increased* include clothing accessories, watches and jewellery, and recreational equipment and services (excluding recreational vehicles). Examples of *Components whose contribution to CPI inflation has decreased* include food purchased from restaurants, other food products and non-alcoholic beverages, rented accommodation and mortgage interest costs. Values in parentheses indicate the combined weight of the individual CPI components within each category. Sources: Statistics Canada and Bank of Canada calculations

Last observation: September 2026

Chart 7: The share of CPI components growing at or above 3% has returned close to its historical average

Share of CPI components with year-over-year price growth outside the 1% to 3% band, monthly data



Sources: Statistics Canada and Bank of Canada calculations
Last observation: September 2026

In September, energy inflation rose to 19%, driven by prices for gasoline and heating oil. This reflected a surge in crude oil prices and elevated refinery margins.

Inflation in goods excluding food and energy was 1.2%. Inflation in durable goods remained above its historical average, partly because strong AI-related demand raised prices for digital computing equipment. Growth in the price of food in stores slowed to 1.7%.

Inflation in services excluding shelter was elevated at 3.7%, partly reflecting the pass-through of higher fuel costs to travel-related services. Shelter inflation was modest at 1.3%, although it has picked up slightly as downward pressure from rents and mortgage interest costs has faded.⁴

Cost pressures are building

Disruptions to the global supply of energy along with strong prices for non-energy imports are raising costs for Canadian businesses. Counter-tariffs are expected to put further upward pressure on import costs in the coming months.

Fuel costs are the main driver of cost pressures

High crude oil prices and wide refinery margins have raised gasoline and diesel prices. In September, refinery margins added the equivalent of roughly US\$40 per barrel, pushing pump prices well above what crude oil prices alone would suggest (see **In focus: Refinery margins and the persistence of energy inflation**).

High fuel prices raise the costs of transportation, distribution and petroleum-based inputs. These pressures are already affecting travel services and intercity transportation prices. They are also raising costs for a broad range of goods and services, including food and plastic products, as well as housing.

Non-energy import cost pressures have also increased

Canada is also importing inflation pressures from other countries. Higher prices for non-energy imported inputs and final goods raise costs for Canadian businesses and put upward pressure on consumer prices.

Outsized increases in import prices are concentrated in industrial inputs that rely on oil-based raw materials, especially chemicals and plastic and rubber products. In addition, strong demand for AI-related equipment is pushing up prices globally for semiconductors and other computer components.

Tariffs and the past depreciation of the Canadian dollar are also adding to import costs.

Cost pass-through is expected to increase

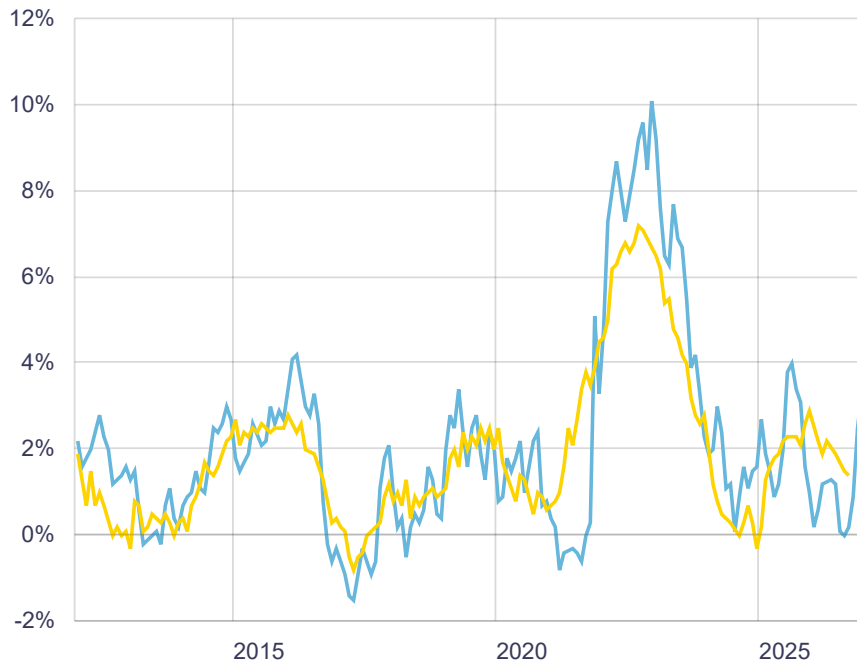
Pass-through from higher energy prices has so far been visible only in the prices of fuel and travel-related services. Energy costs pass through quickly to gasoline and transportation services, while their effects on other consumer goods take longer to materialize. Higher costs for AI-related imports have also begun to push up inflation in computers and personal electronic devices.

Indicators suggest these cost pressures will pass through to consumer prices in the coming months.

- A cost-based indicator used to forecast near-term inflation points to a rise in inflation in goods excluding energy as earlier cost increases work their way through to consumer prices (**Chart 8**).
- Surveys suggest that businesses have absorbed most of the increase in input costs so far. However, businesses expect to pass on a greater share of the increase over the next 12 months (**Chart 9**).

Chart 8: The cost of producing non-energy goods has increased

Year-over-year percentage change, monthly data



- Growth in the cost of producing non-energy goods (lag of 7 months)
- Inflation in CPI goods excluding energy

Note: *Growth in the cost of producing non-energy goods (lag of 7 months)* is estimated as a weighted average of costs incurred along the supply chain, including imports, production, transportation and labour. The methodology extends the framework developed in O. Bilyk, “Understanding the resurgence of food inflation in 2025,” *Sparks at Bank*, Bank of Canada (February 2026) to a broader set of consumer goods. Historically, changes in these costs have tended to be reflected in consumer prices with a lag of approximately seven months; the series is therefore shown with a corresponding lag.

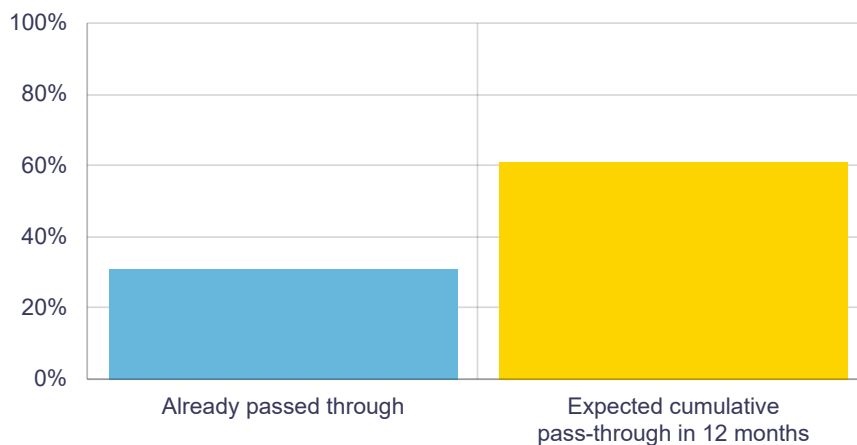
Sources: Statistics Canada and Bank of Canada calculations

Last observations: Growth in the cost of producing non-energy goods (lag of 7 months), June 2026; Inflation in CPI goods excluding energy, September 2026

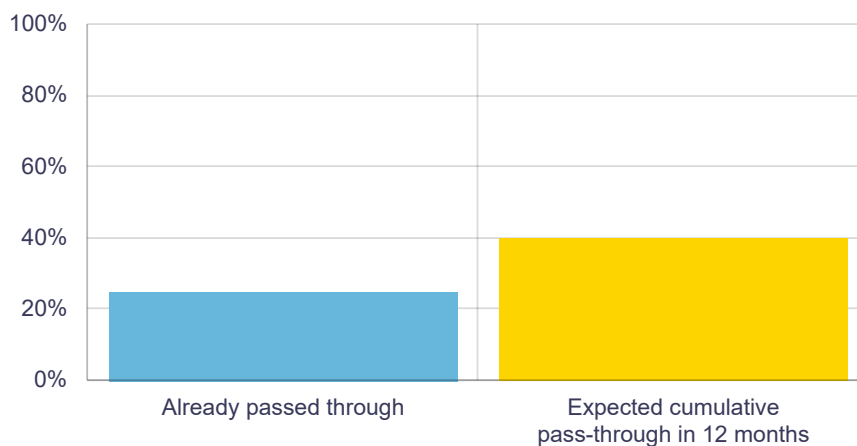
Chart 9: Businesses expect additional cost pass-through in the next 12 months

Cost pass-through among businesses facing larger-than-normal cost increases, monthly data

a. Consumer-facing businesses



b. All other businesses



Note: *Already passed through* shows the average share of larger-than-normal cost increases that businesses report having already passed through to customers. *Expected cumulative pass-through in 12 months* shows the average cumulative share businesses expect to have passed through within 12 months, including amounts already passed through. Results are based on Business Leaders' Pulse survey responses from 35 consumer-facing businesses and from 190 respondents in the "All other businesses" category.

Sources: Bank of Canada and Bank of Canada calculations

Last observation: August 2026

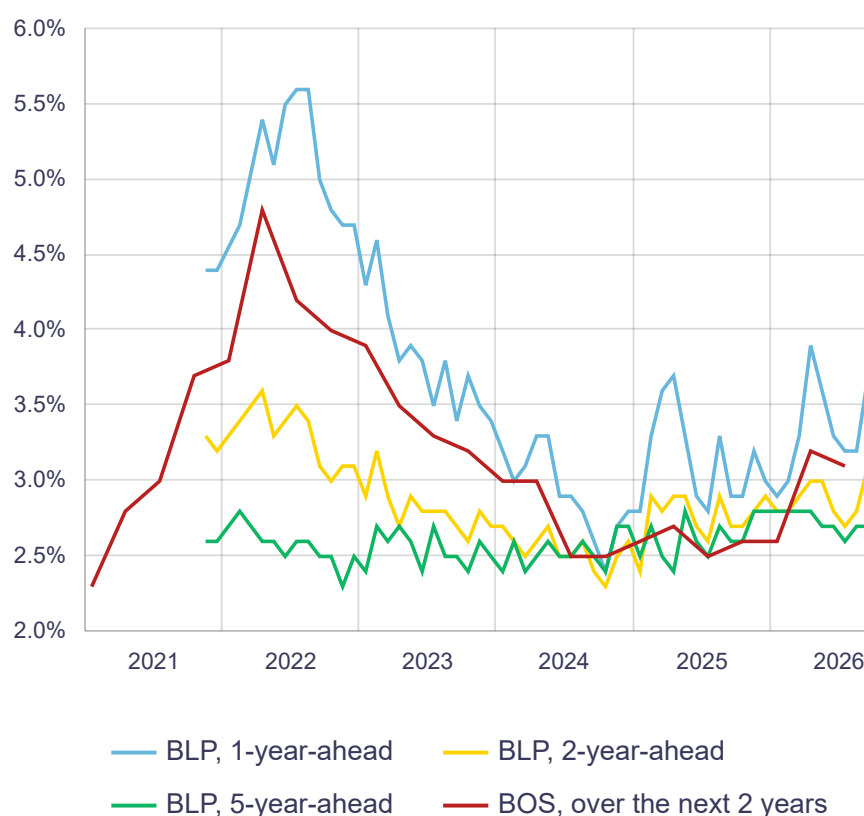
The extent and timing of the pass-through remain uncertain and will depend on the persistence of cost pressures and the strength in consumer demand (see **In focus: Using Prima to trace how an energy shock affects inflation**).

Near-term inflation expectations have risen

Expectations for near-term inflation have risen among businesses, particularly those most exposed to energy and tariff-related costs (**Chart 10**). Businesses' longer-term expectations remain within historical ranges. Consumers' inflation expectations continue to be somewhat elevated.

Chart 10: Businesses anticipate higher inflation in the near term

Quarterly and monthly data



Note: BOS is the Business Outlook Survey; BLP is the Business Leaders' Pulse. *1-year-ahead* refers to inflation expectations for the next 12 months. *2-year-ahead* refers to inflation expectations for the period 12 to 24 months from now. *5-year-ahead* refers to inflation expectations for the period 48 to 60 months from now. This question was not asked in the January or March 2022 BLP.

Sources: Bank of Canada and Bank of Canada calculations

Last observations: Business Leaders' Pulse, September 2026; Business Outlook Survey, 2026Q3

Commodities

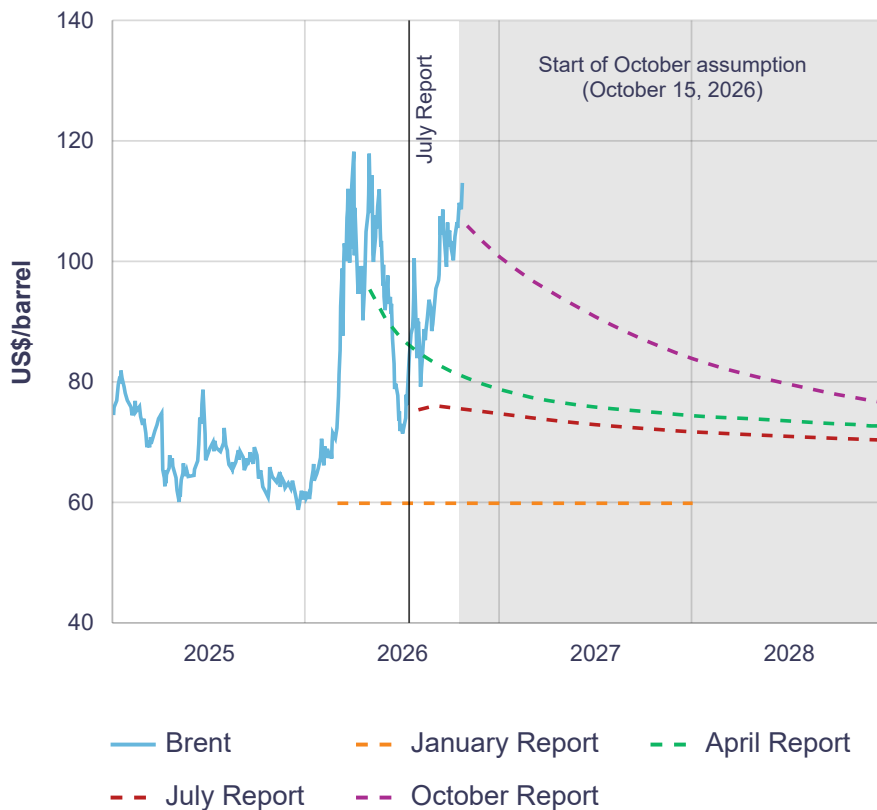
Energy prices have risen sharply since the July Report, while price movements for other commodities have been mixed.

Energy prices are expected to stay higher for longer

Persistent disruptions to oil supply from the Gulf region have led to a sharp increase in crude oil prices. Brent futures are higher across the projection horizon (**Chart 11**).

Chart 11: The oil price futures curve has shifted up substantially

Monthly and daily data



Sources: NYMEX and Intercontinental Exchange via Haver Analytics and Bank of Canada assumptions

Last data plotted: December 31, 2028

The front-month contract is trading at about US\$115 per barrel, about US\$35 above its price at the time of the July Report and up US\$50 since the beginning of the year.⁵ Moreover, the entire Brent futures curve has moved up, with the October 2027 price now about US\$15 higher than it was in the July Report.

Refinery disruptions in the Middle East and Russia are keeping gasoline, diesel and jet fuel prices unusually high relative to crude oil prices (see **In focus: Refinery margins and the persistence of energy inflation**).

Natural gas prices in North America are close to their level at the time of the July Report. Prices in Europe and Asia have risen further amid renewed geopolitical tensions and increased demand for liquefied natural gas.

Non-energy commodities prices are mixed

The Bank of Canada non-energy commodity price index has remained broadly unchanged since the July Report.

Grain prices rose sharply because of dry weather in the United States and disruptions to Russian and Ukrainian exports. Copper prices recently hit record highs, supported by strong AI-related demand and US buying ahead of potential tariffs. In contrast, prices for cattle and forestry products softened.

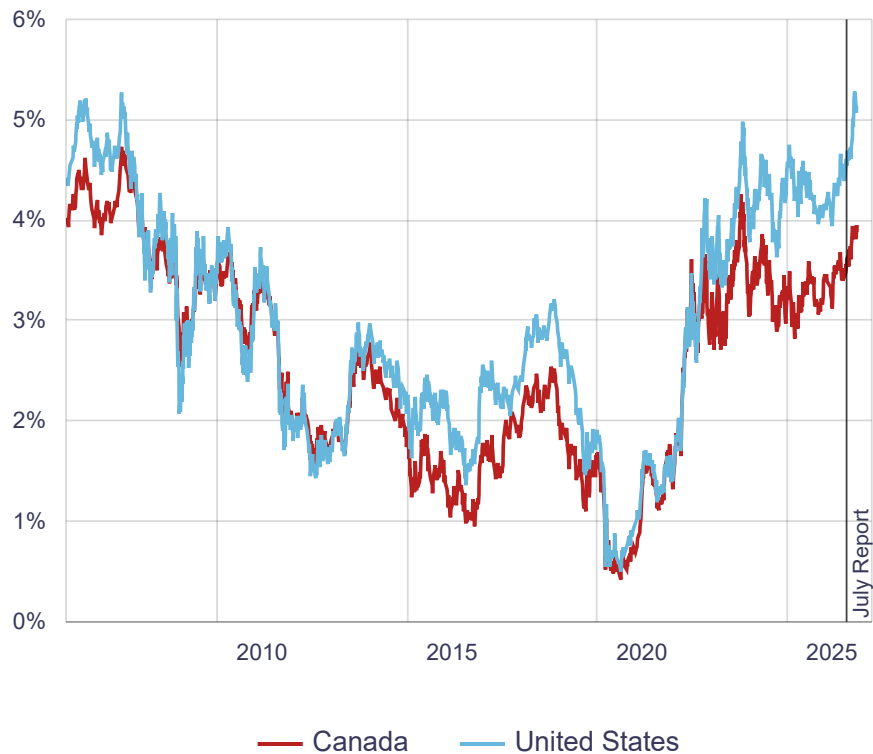
Financial conditions

Global financial conditions have tightened since the July Report.

Amid heightened volatility, sovereign bond yields have risen across advanced economies, reflecting higher expected policy interest rates and higher term premiums. Yields in Canada have also increased but by less than in the United States (**Chart 12**). Term premiums have risen for a variety of reasons, including because private investors require greater compensation to absorb increases in government and corporate issuance (see **In focus: Factors behind the rise in long-term sovereign bond yields**).

Chart 12: Yields on 10-year government bonds in Canada have risen but less than those in the United States

Daily data



Source: London Stock Exchange Group
Last observation: October 21, 2026

Equity markets have been volatile since the July Report. After many reached all-time highs, equity markets have pulled back in part due to investor concerns about the sustainability of earnings growth in the AI sector. These concerns have also been an important factor in the widening of credit spreads.

The Canadian dollar weakened somewhat due to the strength of the US dollar but has since recovered to around 71 cents—the same as assumed in the July Report.

Endnotes

1. *Temporary government transfers* refers mainly to the federal government's one-time top-up of the Canada Groceries and Essentials Benefit and Quebec's special payment to households for groceries and energy costs.[←]
2. Measured public sector employment has softened recently, driven largely by developments in education, health care and social assistance. However, data from the Survey of Employment, Payrolls and Hours suggest that underlying employment trends across public sector industries remain firmer than implied by Labour Force Survey data alone.[←]
3. LFS-Micro is a measure of underlying wage growth derived from the Labour Force Survey (LFS) microdata. It removes the composition effects from the average hourly earnings in the LFS, yielding a wage measure with reduced volatility and a better relationship with labour market fundamentals.[←]
4. For more details on rent inflation, see B. Straus, "**Why asking rents have surged in Canada since 2021**," *Sparks at Bank*, Bank of Canada (September 2026).[←]
5. The front-month contract price is the futures contract with the nearest monthly expiration date.[←]

Tariff and other assumptions

Oil prices and refinery margins remain elevated and are assumed to decline gradually. Trade between Canada and the United States remains mostly tariff-free. But the breakdown in negotiations has led to new tariffs and increased uncertainty.

Tariff assumptions

The projection is based on tariffs and related trade measures in place or officially announced as at October 22, 2026. This includes new measures introduced after trade negotiations between Canada and the United States broke down in late August ([Table 1](#)).¹

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

	Before 2025	October 2025	January 2026	April 2026	July 2026	October 2026
US tariff rate on Canada	0.1	5.9	5.8	5.1	5.0	7.5
Canadian tariff rate on the United States*	0.0	1.0	1.2	1.5	1.5	3.9

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

Most exemptions for goods compliant with the Canada-United States-Mexico Agreement are assumed to remain in place where applicable. Current US tariffs and Canadian counter-tariffs are held constant over the projection horizon.

Following the breakdown in negotiations, the United States invoked Section 338 of the *Tariff Act of 1930* to impose a 50% tariff on a range of Canadian goods regardless of their treatment under the Canada-United States-Mexico Agreement. Some of these goods include machinery and equipment, plastics, furniture and wood and paper products.

For some products, the new 50% tariff was added to existing duties. The United States also announced import bans on selected products, including some alcohol and dairy products. However, crude oil and other energy products, potash and critical minerals remain exempt from the new tariffs.

Canada responded with new counter-tariffs on about \$28 billion of US goods. Most were applied to intermediate inputs such as steel and aluminum, with relatively few final consumer goods affected.

The average US tariff rate on imports from Canada is now estimated at 7.5%, up from 5.0% in the July Report. About 80% of Canadian goods exports to the United States remain tariff-free. The average Canadian tariff rate on imports from the United States has risen from 1.5% in the July Report to 3.9%.

Price assumptions for oil and refined products

- Oil prices are assumed to remain in line with the futures curve as at October 15, 2026. The price of Brent oil is assumed to average about US\$100 in the fourth quarter of 2026 and then decline gradually. Brent oil then settles around US\$75 by the end of 2028, about US\$5 higher than assumed in the July Report. Prices of West Texas Intermediate and Western Canadian Select are assumed to follow a similar path, stabilizing at about US\$70 and US\$55, respectively, by the end of 2028.
- Refinery margins are expected to remain elevated through the end of 2026 (see **In focus: Refinery margins and the persistence of energy inflation**). In line with market expectations, gasoline refinery margins gradually ease over 2027.

Other assumptions

The projection is also conditional on several other assumptions.

- The Canadian dollar is assumed to average 71 cents US over the projection horizon, unchanged from the July Report.
- Potential output growth in Canada is projected to ease to just under 1½% in 2026, reflecting a slowdown in population growth and the effects of US trade policy. Growth remains at about 1½% in 2027 and rises to about 1¾% in 2028. This pickup is due to stronger investment, partly in response to new incentives, and greater adoption of artificial intelligence. The drag on trend productivity from US tariffs also diminishes over the projection horizon.
- The nominal neutral interest rate in Canada is assumed to be at the midpoint of its estimated range of 2.25% to 3.25%.
- The impact of trade policy uncertainty on gross domestic product (GDP) is assumed to ease slowly over 2027 and 2028. It removes 0.4% from the level of GDP in 2027 and 0.2% in 2028.
- The projection incorporates information from the latest provincial budgets, the federal Spring Economic Update 2026 and new federal fiscal measures tabled as at October 19, 2026. It includes the expected effects of the Productivity Mega Deduction and activities related to the Major Projects Office.

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).[←]

Outlook

Inflation remains above 3% through much of 2027. It then eases gradually because energy and import cost pressures take time to pass through. Growth is projected to strengthen to 2% in 2027 and 2028.

The outlook for growth is modestly higher than in the July Report. Growth in gross domestic product (GDP) in 2026 has been revised up to 1%. This reflects strength in the middle of the year, which is partially offset by weakness in the fourth quarter. Growth is expected to strengthen to average 2% in 2027 and 2028, supported by business investment and government and household spending. Exports continue to expand despite US tariffs weighing on affected sectors.

Inflation is projected to remain above 3% through much of 2027, about 1 percentage point higher than anticipated in the July Report. Elevated energy and import costs are expected to feed through into a broad range of prices. Weakened demand due to US tariffs and trade uncertainty provides only a partial offset. Inflation returns close to the 2% target by the middle of 2028.

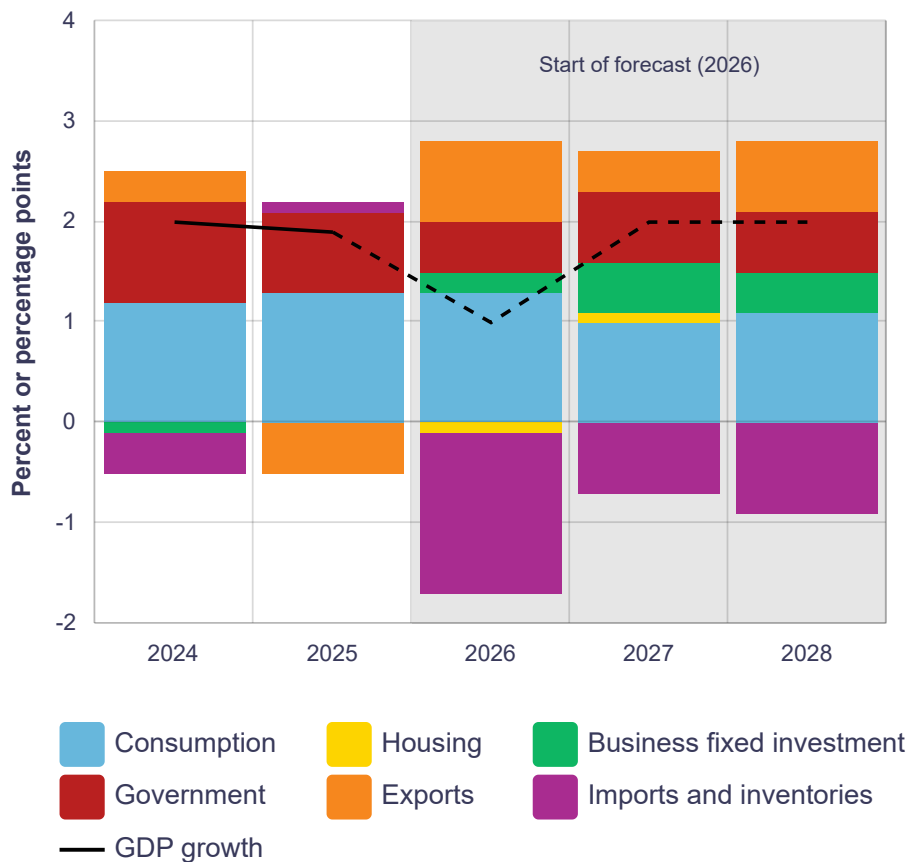
Uncertainty about the future path of energy prices and the evolution of US trade policy remains elevated. How households and businesses will respond to these developments also remains uncertain (see the **Risks** section).

Economic outlook

GDP growth has been revised up to 1% in 2026 and is expected to strengthen to 2% in 2027 and 2028 (**Chart 13**). The rebound is supported by stronger business investment and government spending. It also reflects the fading of the unusually large drag from inventories in 2026. Consumption growth remains steady. Growth is positive across the major expenditure components over 2027 and 2028. As a result, slack in the economy is absorbed.

Chart 13: GDP growth is projected to rise

Contribution to GDP growth, yearly data



Note: *Imports 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: 2028

Rising business investment—bolstered by federal tax incentives such as the Productivity Mega Deduction—and increased adoption of artificial intelligence (AI) support production and labour productivity. Slow growth of the labour force and the impact of US tariffs on productivity growth constrain production.

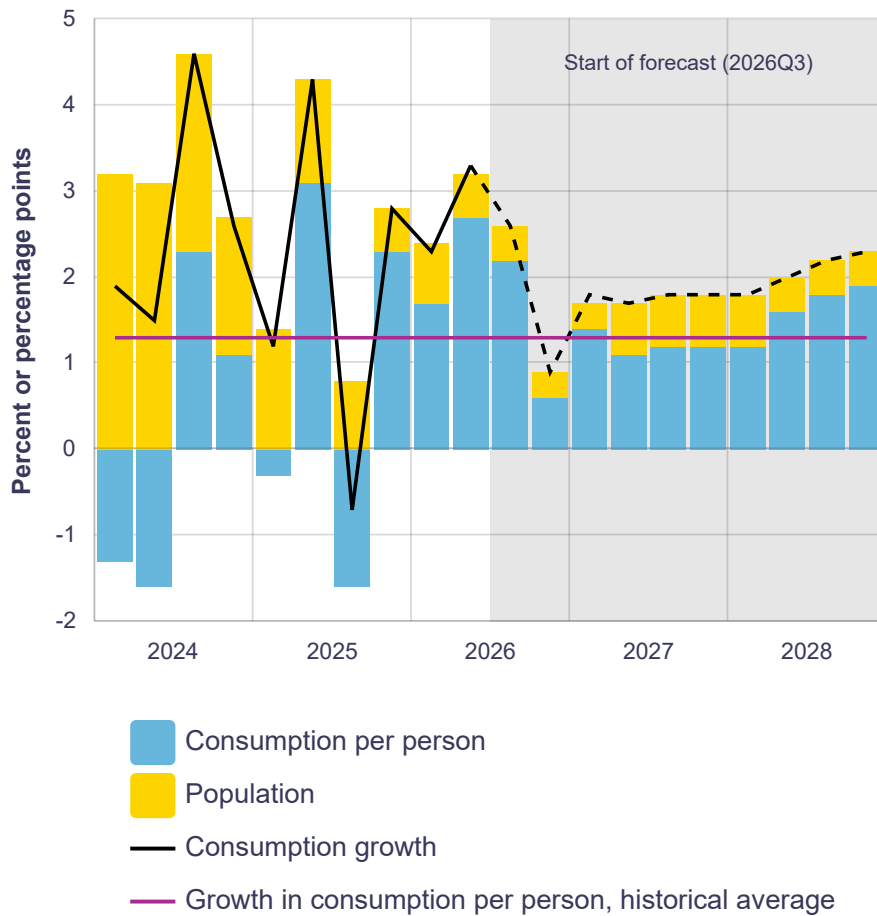
Consumption growth is steady

Growth in consumption is anticipated to be just above 2¼% in 2026 (**Chart 14**). Consumption per person grew strongly, supported by earlier interest rate cuts and rising financial wealth.¹

Consumption growth then settles around 2% on average in 2027 and 2028. Higher long-term interest rates raise borrowing costs and weigh on consumption. This is partially offset by income gains from past improvements in Canada's terms of trade.

Chart 14: Consumption growth is expected to settle near 2%

Contribution to consumption growth, annualized, quarterly data



Note: *Population* is based on Statistics Canada's quarterly estimate of residents aged 15 and older. The historical average is based on the average growth rate of consumption per person from 2010Q1 to 2019Q4. 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: 2028Q4

Residential investment remains weak

Residential investment is projected to increase by slightly less than 1% on average in 2027 and 2028. Affordability constraints, slow population growth and rising borrowing costs weigh on demand. Higher costs for energy and imported inputs are expected to make construction more expensive, restraining building activity.

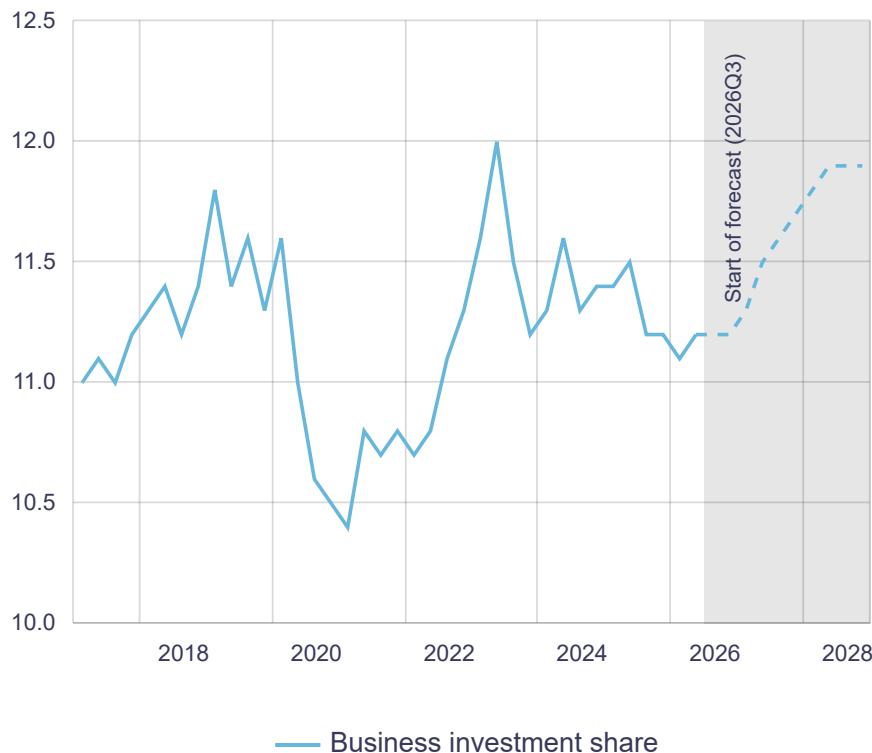
Business investment accelerates

Business investment is projected to grow by about 4% on average in 2027 and 2028 (**Chart 15**). It is boosted by the Productivity Mega Deduction, which substantially lowers the cost of capital for businesses. How strongly and how quickly businesses will respond to the new incentive remains uncertain.

Investment in the energy sector, greater adoption of AI, the gradual ramp-up of projects supported by the Major Projects Office, and the diminishing effects of trade policy uncertainty provide additional support.

Chart 15: Business investment is expected to strengthen

Share of nominal GDP, quarterly data



Sources: Statistics Canada and Bank of Canada calculations, estimates and projections
Last data plotted: 2028Q4

Government spending supports growth

Government spending is projected to grow by about 2½% on average in 2027 and 2028, reflecting increased provincial and federal spending in areas such as health, education, infrastructure and defence.

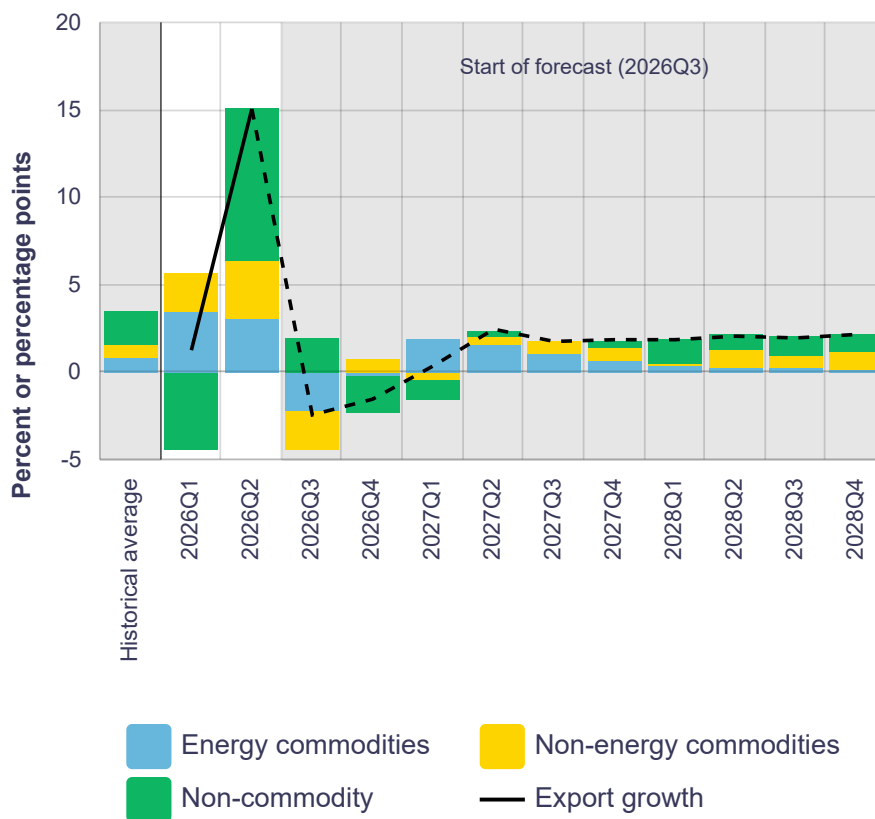
Export growth is modest

Growth in exports slows to around 1¼% in 2027 as US tariffs restrain non-commodity exports. It then picks up in 2028 as the drag from US tariffs diminishes (**Chart 16**).

Non-energy exports are supported by strong US demand. Energy exports rise over the projection as additional pipeline capacity comes online.² However, because of the new US tariffs, the path of exports remains below its trajectory in the July Report.

Chart 16: Export growth picks up after the second half of 2026

Contribution to export growth, quarterly data



Note: The historical average is based on the average contribution of each component of export growth from 2010Q1 to 2019Q4. 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: 2028Q4

Import growth slows

Import growth moderates from about 3% in 2026 to around 2% in 2027 and 2028 as the strength in domestic demand seen in the second quarter of 2026 fades. Rising foreign prices, Canadian counter-tariffs and the past depreciation of the Canadian dollar also make imports more expensive, further restraining demand.

Inflation outlook

Consumer price index (CPI) inflation is projected to remain above 3% through the third quarter of 2027, about 1 percentage point higher than expected at the time of the July Report.

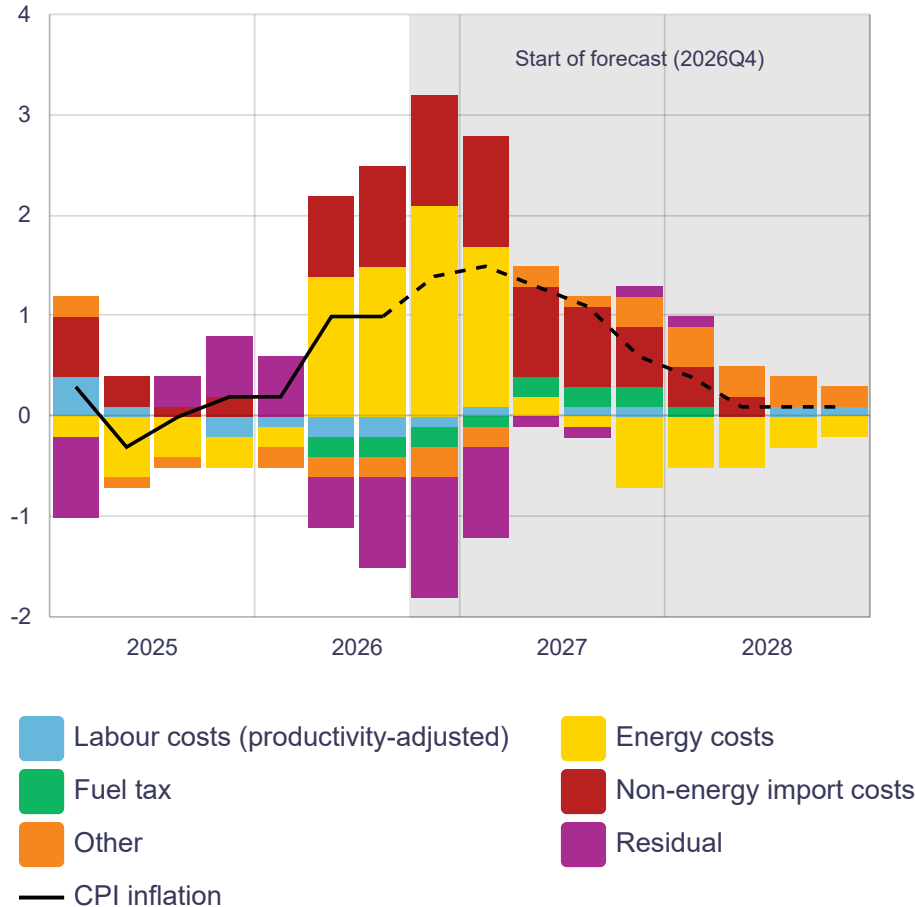
Inflation rises until the first quarter of 2027 as cost pressures from high energy prices and non-energy imports feed through to consumer prices alongside diminishing slack. These pressures continue to spread through the economy, pushing up inflation excluding energy and keeping CPI inflation elevated in 2027. Inflation then eases gradually to close to 2% by the middle of 2028.

Cost pressures contribute to inflation

Chart 17 shows a breakdown of different business costs and their contribution to CPI inflation.³ Shocks, such as a sharp rise in oil prices, generally affect inflation through multiple cost channels. For example, the rise in energy prices shows up mainly in energy costs, but it also has a significant impact on the costs of imported non-energy goods through supply chains.

Chart 17: Energy costs and non-energy import costs keep inflation elevated into 2027

Contribution to the gap between year-over-year CPI inflation and the 2% target, percentage points, quarterly data



Note: Contributions are estimated using Prima, which traces how changes in the costs of labour, energy and imported inputs pass through the production network to consumer prices. The estimates draw on data for producer, import and consumer prices and depend on the model's structure and assumptions. *Other* includes factors such as changes in shelter inflation and capital costs. 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: 2028Q4

In the projection, upward pressure on inflation comes mainly through higher oil prices stemming from a reduction in the global supply of energy and other factors that raise businesses' costs.

- Energy costs put upward pressure on inflation into early 2027. Energy price inflation turns negative at the end of 2027, although earlier increases continue

pushing up other prices as high transportation and production costs work their way through supply chains.

- Non-energy import costs remain a source of pressure through 2027, reflecting elevated prices for industrial inputs sensitive to oil prices as well as Canadian counter-tariffs and the past depreciation of the Canadian dollar.

Businesses initially absorbed most of these cost increases, but they are expected to pass on an increasing share over the next 12 months as excess capacity is gradually absorbed. This is consistent with what businesses report in Bank surveys (see **Chart 9**, panel a, in the **Current conditions** section). This gradual increase in pass-through contributes to keeping inflation elevated through 2027.

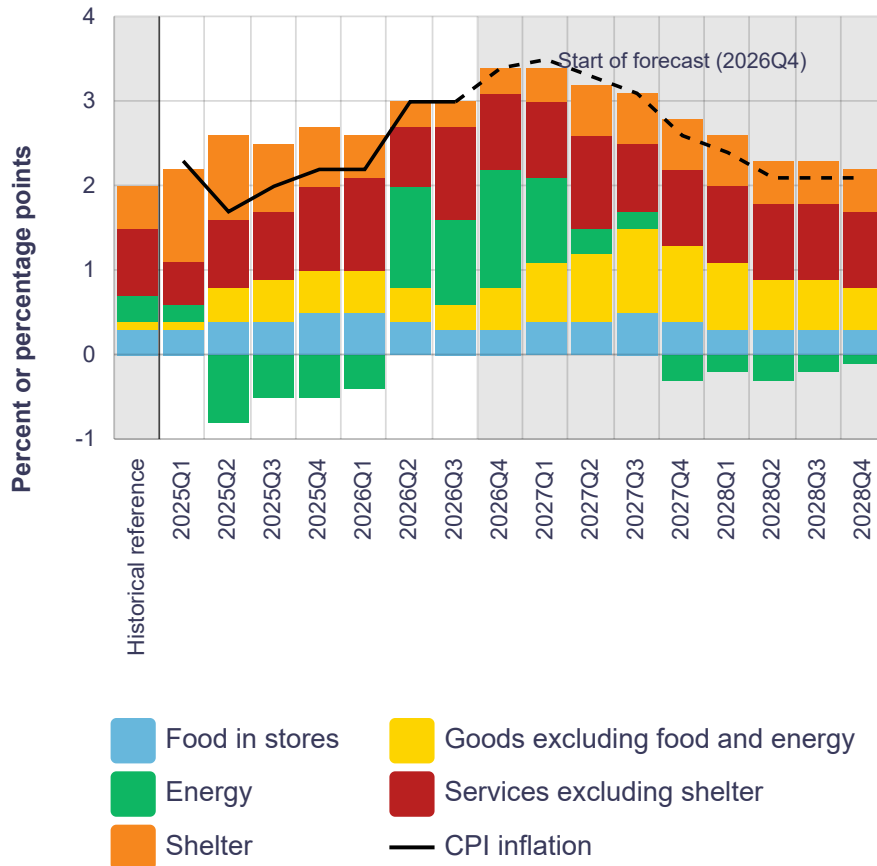
Labour costs remain in line with productivity, reflecting a labour market that is close to balanced over the projection horizon, and are not a material source of upward pressure on inflation.

Elevated costs impact major CPI components differently

Because cost pressures do not affect all components of the CPI to the same extent, it is also useful to look at how each component evolves. **Chart 18** shows the contributions of the five major CPI components—food, energy, goods excluding food and energy, shelter, and services excluding shelter—to year-over-year inflation.

Chart 18: High energy prices and pass-through keep inflation elevated in 2027

Contribution to year-over-year CPI inflation, quarterly data



Note: The historical reference is based on the average contribution of each component to CPI inflation from August 1999 to December 2019 when CPI inflation averaged close to 2%. 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: 2028Q4

Energy inflation is initially elevated and then declines

Energy inflation stays elevated into early 2027 as crude oil prices and refinery margins remain high. The suspension of the federal fuel excise tax partly offsets elevated fuel prices until it expires in April 2027.

As oil prices and refinery margins gradually decline, fuel prices ease. Energy inflation slows and turns negative at the end of 2027.

Food inflation picks up in early 2027

Food inflation picks up over 2027 as high energy and import costs move through food supply chains. Reduced global grain supplies due to deteriorating harvest prospects in several countries also add to cost pressures.

Goods inflation rises and then eases gradually

Inflation in goods excluding food and energy is expected to peak in the second half of 2027 as earlier increases in energy and import costs work their way through supply chains. Higher energy costs raise production and transportation expenses. Moreover, higher costs for non-energy inputs, Canadian counter-tariffs and the past depreciation of the Canadian dollar push up import prices.

As the effects of past cost increases work through consumer prices and some cost pressures ease, goods inflation gradually declines (see **In focus: Using Prima to trace how an energy shock affects inflation**).

Inflation in services excluding shelter remains elevated

Inflation in services excluding shelter is expected to remain elevated through 2027 before gradually easing. Higher energy costs continue to put upward pressure on transportation and travel-related services. Higher energy and import costs also raise the cost of intermediate goods and services used in the production of final services. These cost increases pass through slowly to consumer services prices.

Shelter services inflation picks up

Inflation in shelter services is projected to rise from a little over 1% at the end of 2026 to about 2% in 2027 and remain near that level in 2028. Higher energy and import costs are projected to raise the costs of housing construction and maintenance through higher prices for materials and equipment. Rising borrowing costs add further pressure to housing-related expenses. Easing rent inflation provides some offset in 2027.

Endnotes

1. Consumption was also supported by government policies such as the federal government's one-time top-up of the Canada Groceries and Essentials Benefit.[←]

2. Expansions of the Enbridge Mainline and Trans Mountain pipelines are expected to add a total of roughly 250,000 barrels per day of export capacity in 2027.[←]

3. In Chart 17, the contribution from *Residual* in 2026 is driven mainly by weaker-than-expected quarter-over-quarter inflation in the second quarter. This weakness shows up in subsequent quarters because the chart is expressed in year-over-year terms.[←]

Global economy

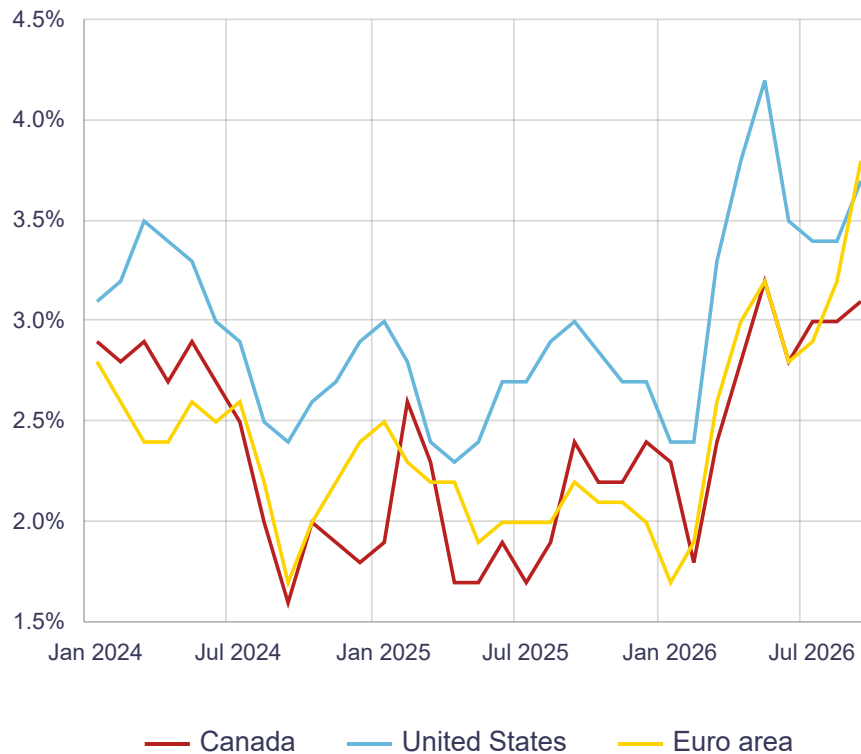
Reduced oil supply from the Middle East and strains on refining capacity are pushing up inflation globally. Higher energy prices are weighing on economic activity. Global growth remains resilient, boosted by strong AI-related investment.

Growth in global gross domestic product (GDP) is projected to pick up in the second half of 2026 and stabilize at around 3% through 2028. Investment related to artificial intelligence (AI) continues to support economic activity in the United States and parts of Asia. High energy costs weigh on growth in the euro area and other energy-importing economies.

Inflation remains above target in many economies, mainly because of high energy costs (**Chart 19**). Strong demand for AI-related products is also adding to inflationary pressures. In response to persistent inflation, some central banks have raised their policy interest rates.

Chart 19: Inflation is rising because of disruptions to global energy supply

Total inflation, year-over-year percentage change, monthly data



Note: Calculations of the inflation rate are based on the Harmonised Index of Consumer Prices for the euro area and the consumer price indexes for Canada and the United States. Sources: Statistics Canada, US Bureau of Economic Analysis and Eurostat via Haver Analytics and Bank of Canada calculations. Last observation: September 2026

United States

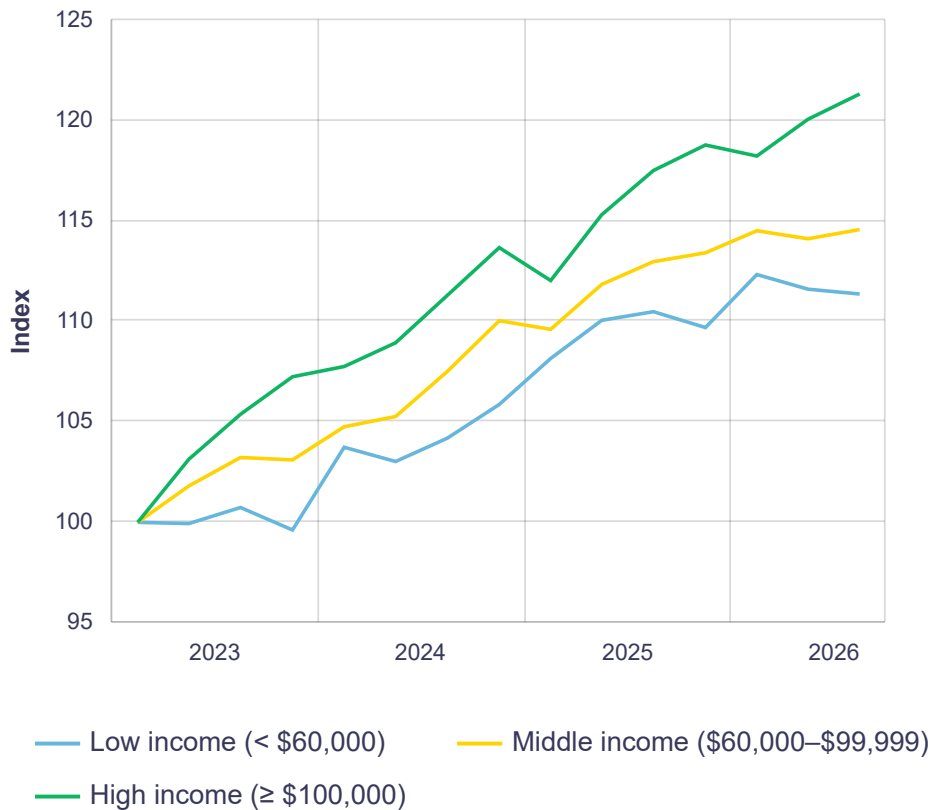
Economic growth in the United States is projected to remain solid, supported by strong private domestic demand. Inflation remains elevated because of high energy prices and robust AI-related demand.

Economic activity remains strong

GDP growth is expected to average about 3% in the second half of 2026, supported by continued strength in consumer spending and AI-related investment. The strength in consumption remains uneven across households (**Chart 20**). Lower-income households are disproportionately affected by high gasoline prices, while higher-income households continue to benefit from earlier gains in equity markets.

Chart 20: Spending disparities have been increasing across US households

Index: 2023Q1 = 100, seasonally adjusted, quarterly data



Sources: Numerator and Bank of Canada calculations

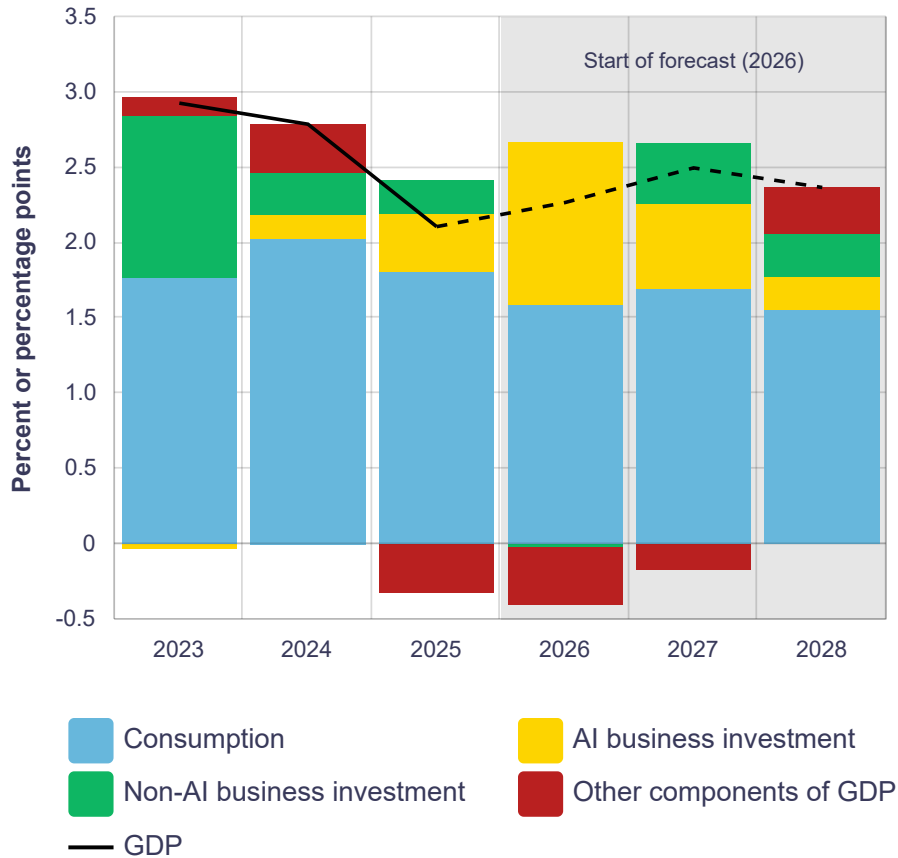
Last observation: 2026Q3

The US labour market is expected to remain in balance, with moderate job gains and the unemployment rate holding just above 4%.

GDP is projected to grow by 2½% in 2027 and 2028, supported by consumer spending and business investment (**Chart 21**). Solid income growth bolsters household spending, with strong productivity growth helping sustain gains in real wages. At the same time, higher interest rates restrain interest-sensitive spending, partly offsetting the strength in demand.

Chart 21: Consumption and AI investment support growth in the United States

Contribution to GDP growth, annual data



Note: AI is artificial intelligence. *AI business investment* is defined as investment in data centre structures as well as computers and peripheral equipment. *Non-AI business investment* is all other business investment, including intellectual property products. Sources: US Bureau of Economic Analysis via Haver Analytics and Bank of Canada calculations, estimates and projections. Last data plotted: 2028

Inflation is expected to stay high in 2026

US personal consumption expenditures (PCE) inflation has remained elevated and is expected to rise from 3.4% in August to about 3.7% in late 2026, largely reflecting the increase in energy prices.¹

Core inflation remains high at about 3%, with recent pressures coming from strong growth in prices for transportation services and the effects of past tariffs. So far, the sharp climb in energy prices has had relatively limited spillover effects on broader consumer prices. But inflationary pressures are expected to increase as high energy costs work their way through supply chains.

In addition, strong AI-related demand is raising costs and inflationary pressures across the economy. This includes prices for some technology goods.

In response to these inflationary pressures, the US Federal Reserve raised interest rates by 25 basis points in September.

Inflation is anticipated to moderate over the projection horizon as the effects of high energy costs and tariffs fade. Higher interest rates also weigh on household spending and inflation. Longer-term yields have risen, and financial markets expect at least two additional rate increases by the end of 2027 (see **In focus: Factors behind the rise in long-term sovereign bond yields**).

Euro area

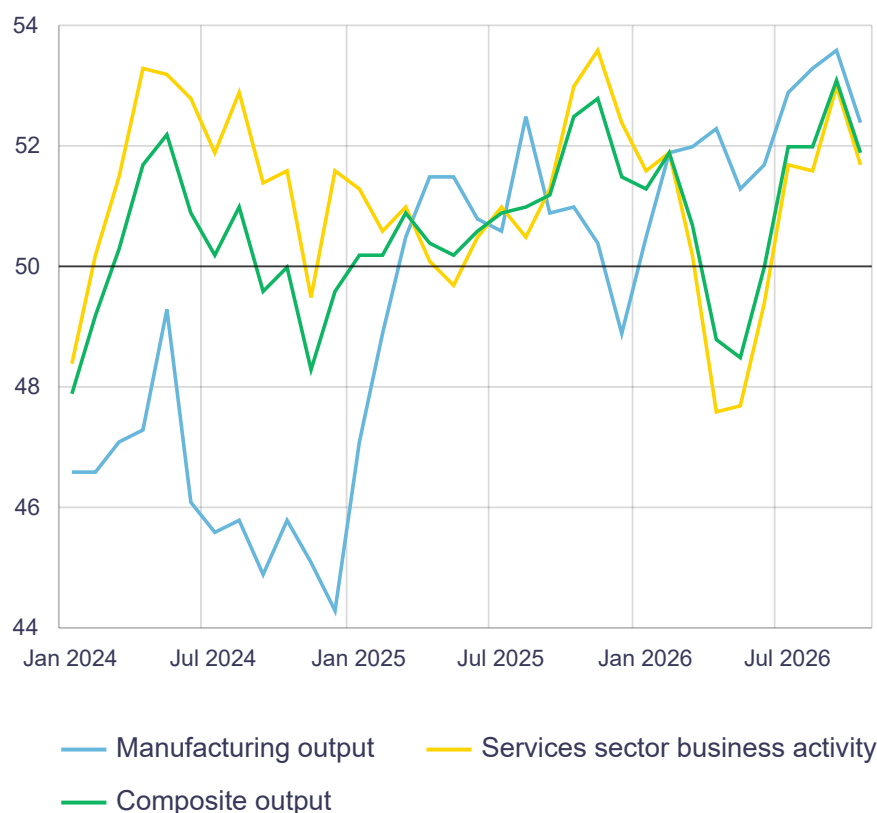
High energy prices pushed up inflation in the euro area to 3.8% in September. Core inflation ticked up to 2.5%, partly reflecting the pass-through of high energy costs to prices in sectors such as transportation, delivery services and tourism.

The European Central Bank has increased its policy rates by 50 basis points since June. This reflects concerns that the energy shock would prove persistent and keep inflation above target for an extended period.

GDP growth was resilient and broad based in the second quarter of 2026 (**Chart 22**). Growth is projected to remain solid in 2027 and 2028 as the drag from high energy prices diminishes and government spending on defence and infrastructure supports domestic demand. As high energy costs gradually pass through to other goods and services, total inflation is expected to remain elevated before easing later in the projection.

Chart 22: Activity in the euro area has remained resilient

Purchasing managers' indexes, monthly data



Note: An index level greater than 50 indicates growth in the sector.

Source: S&P Global Purchasing Managers' Survey via Haver Analytics

Last observation: October 2026

China

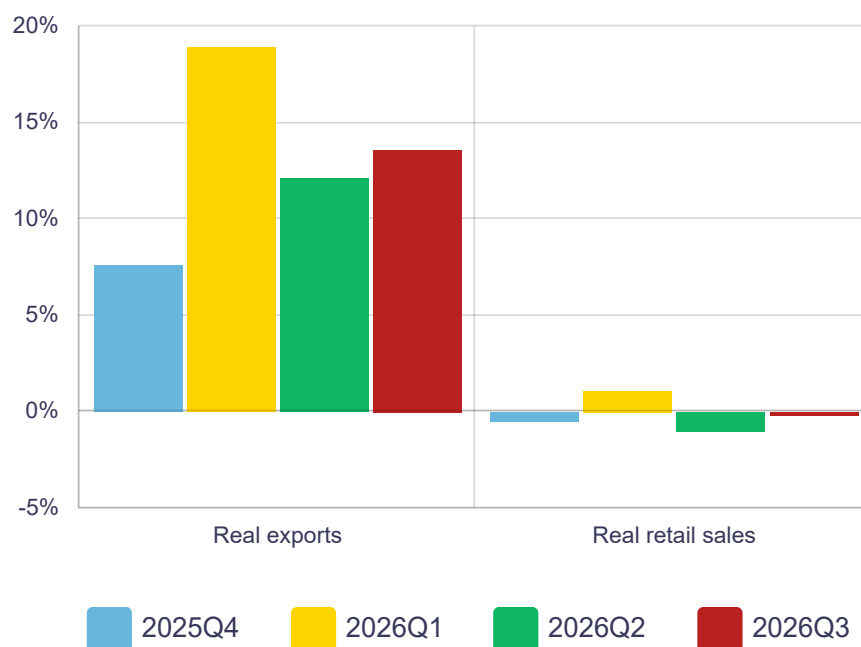
Growth in China rebounded in the third quarter, supported by strong exports and a pickup in government spending. However, growth in consumer demand remains subdued (**Chart 23**).

Over the projection horizon, growth is anticipated to average 4¼%. Fiscal policy and strong exports of AI-related and green technologies are expected to continue to support activity. At the same time, the drag from the property sector is anticipated to gradually subside.

Higher energy prices have pushed up inflation in recent months. However, subdued domestic demand constrains growth in consumer prices over the projection horizon.

Chart 23: Strong export growth and weak consumer demand growth persist in China

Year-over-year percentage change, quarterly data



Note: *Real retail sales* is calculated by deflating nominal retail sales by core consumer price inflation. *Real exports* is calculated by dividing nominal export growth by the export price index. The level of real exports in 2026Q3 uses an estimate for the September value of the deflator in the calculation.

Sources: General Administration of Customs of the People's Republic of China via Haver Analytics and Bank of Canada calculations and estimates

Last data plotted: 2026Q3

Endnotes

1. Historical revisions lowered US PCE inflation in May to 3.8% from 4.1% at the time of the July Report. The revisions mainly reflect changes to methodology and data sources affecting financial services and computer-related prices.[←]

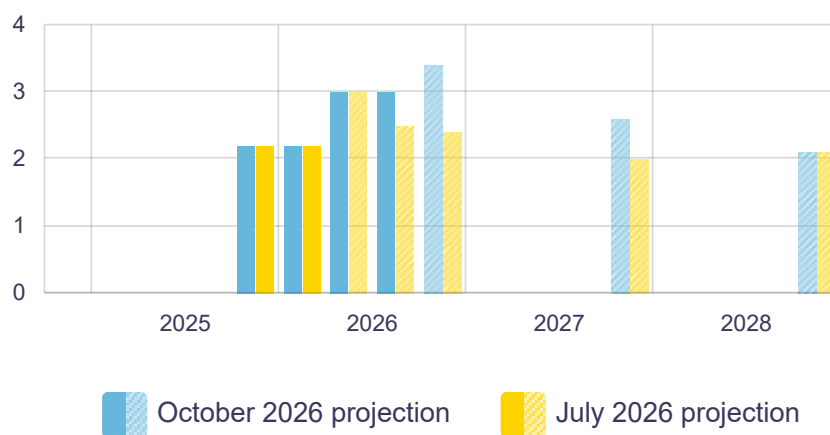
Projections

The outlook for the Canadian economy has improved somewhat, reflecting data showing stronger-than-expected activity, new incentives for business investment and an upward revision to population. Inflation is revised up because of higher and more persistent energy prices as well as higher non-energy import prices.

Inflation in 2027 is projected to be about 1 percentage point higher than forecasted in the July Report (**Chart 24**). Growth in gross domestic product (GDP) is somewhat stronger over the projection horizon.

Chart 24: The October 2026 and July 2026 Monetary Policy Report outlooks

CPI inflation (year-over-year percentage change)



Changes to the projection

Canadian outlook

GDP growth in 2026 is projected to be 0.3 percentage points higher than in the July Report (**Table 2**). Consumption and exports account for most of the upward revision. This is partly offset by a bigger drag from inventories. Potential output is also higher due to an upward revision to Canada's population.

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

	2025	2026	2027	2028
Consumption	1.3 (1.3)	1.3 (0.9)	1.0 (0.8)	1.1 (0.6)
Housing	0.0 (0.0)	-0.1 (-0.2)	0.1 (0.1)	0.0 (0.2)
Government	0.8 (0.8)	0.5 (0.5)	0.7 (0.8)	0.6 (0.5)
Business fixed investment	0.0 (0.0)	0.2 (0.2)	0.5 (0.2)	0.4 (0.2)
Subtotal: final domestic demand	2.1 (2.1)	1.9 (1.4)	2.3 (1.9)	2.1 (1.5)
Exports	-0.5 (-0.5)	0.8 (0.5)	0.4 (0.6)	0.7 (0.8)
Imports	0.1 (0.1)	-0.9 (-1.0)	-0.6 (-0.6)	-0.8 (-0.7)
Inventories	0.0 (0.0)	-0.8 (-0.2)	-0.1 (-0.1)	0.0 (0.2)
GDP	1.9 (1.9)	1.0 (0.7)	2.0 (1.8)	2.0 (1.8)
Memo items (percentage change):				
Range for potential output	2.3 (2.3)	0.8–1.6 (0.8–1.6)	0.8–1.8 (0.8–1.8)	1.0–2.0 (1.0–2.0)
CPI inflation	2.1 (2.1)	2.9 (2.5)	3.1 (2.0)	2.2 (2.1)

* Numbers in parentheses are from the July Report.

† Numbers may not add to total due to rounding and Statistics Canada's statistical discrepancy.

Sources: Statistics Canada and Bank of Canada calculations, estimates and projections

GDP growth is about 0.2 percentage points stronger in 2027 and 2028 (**Table 2** and **Table 3**). Most of the upward revision reflects increased consumption. Business investment is also stronger, driven in part by the federal government's recently announced Productivity Mega Deduction. These effects are partly offset by the impacts of higher US tariffs, greater trade policy uncertainty and higher long-term interest rates.

Table 3: Summary of the quarterly projection for Canada*

	2026				2025 2026 2027 2028			
	Q1	Q2	Q3	Q4	Q4	Q4	Q4	Q4
CPI inflation (year-over-year percentage change)	2.2 (2.2)	3.0 (3.0)	3.0 (2.5)	3.4	2.2 (2.2)	3.4 (2.4)	2.6 (2.0)	2.1 (2.1)
Real GDP (year-over-year percentage change)	0.1 (-0.1)	1.1 (0.8)	1.2 (0.7)	1.6	0.7 (0.7)	1.6 (1.4)	2.2 (1.9)	2.0 (1.8)
Real GDP (quarter-over-quarter percentage change at annual rates)[†]	0.3 (-0.1)	3.3 (2.5)	2.0 (1.5)	0.8				

* See details in the [Tariff and other assumptions](#) section. Numbers in parentheses are from the July Report.

† At the time of the projection, 2026Q3 and 2026Q4 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

Consumer price index inflation is projected to be 0.4 percentage points higher in 2026 and about 1 percentage point higher in 2027 than expected at the time of the July Report ([Table 2](#)). The revision reflects higher oil prices and refinery margins, which are expected to remain elevated for longer because of conflicts abroad. Higher import prices and Canadian counter-tariffs also add modest upward pressure. The suspension of the federal fuel excise tax partly offsets these effects in late 2026 and early 2027 until it expires in April 2027.

Global outlook

The growth outlook across major economies is broadly unchanged from the July Report ([Table 4](#)).

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

Share of global GDP* (%)		Growth [†] (%)			
		2025	2026	2027	2028
United States	15	2.3 (2.1)	2.4 (2.4)	2.5 (2.4)	2.4 (2.4)
Euro area	11	1.3 (1.5)	0.9 (0.4)	1.2 (1.2)	1.3 (1.3)
China	20	5.0 (5.0)	4.6 (4.7)	4.2 (4.2)	4.1 (4.1)
World	100	3.5 (3.5)	3.1 (2.8)	3.2 (3.2)	3.1 (3.2)

* Shares of GDP are based on International Monetary Fund (IMF) estimates of the purchasing-power-parity valuation of country GDPs for 2025 from the IMF's October 2026 *World Economic Outlook*.

† Numbers in parentheses are projections from the July Report.

Sources: National sources via Haver Analytics and Bank of Canada calculations, estimates and projections

Risks

The evolution of energy prices and Canada's trade relationship with the United States remain the two most important risks to the outlook for inflation.

The projection assumes that shipping through the Strait of Hormuz gradually returns to normal and refinery margins ease. Further supply disruptions could push fuel prices higher than projected, and prolonged disruptions could keep them elevated for longer. Higher fuel prices would raise inflation.

However, the conflict in the Middle East could be resolved quickly and oil shipments from the region could return to normal sooner. This would lead oil prices to decline further and faster than assumed. Moreover, if refining capacity recovered more quickly than expected, fuel prices could normalize sooner than anticipated in the outlook.

The base case assumes that US tariffs incorporated in the projection remain in place. The effects of trade-related uncertainty are assumed to fade gradually. Further US trade restrictions or more persistent uncertainty could weaken exports, business investment and household spending. Softer demand would lower costs and restrain the pass-through from higher energy prices.

However, Canada and the United States could reach a trade deal that reduces tariffs and related uncertainty. This would increase exports and business investment, boosting employment and incomes. Higher demand could increase the pass-through from higher energy prices. The removal of counter-tariffs would provide an offset.

The outlook for inflation is subject to other risks as well.

Other upside risks to inflation

- Higher input costs could pass through to consumer prices faster than expected, and inflation expectations could respond more strongly than usual, particularly with the post-pandemic inflation experience still top of mind. This would increase inflation more than anticipated, even if input costs follow their projected path.
- Domestic demand could be stronger than projected. Household spending could remain more resilient. Business investment could also respond more strongly to recent investment incentives. In addition, businesses could face greater capacity constraints before new production comes online. Together, these factors would result in inflation being higher than projected.

Other downside risks to inflation

- Global financial conditions could tighten more than expected, and long-term bond yields could rise further. Investors could become less optimistic about earnings and productivity gains related to artificial intelligence, triggering a fall in equity prices and wider corporate spreads. Higher borrowing costs and lower household wealth would weaken global spending and investment. This would reduce demand for Canadian exports and lower commodity prices, putting downward pressure on inflation in Canada.
- The effects of uncertainty, particularly around the Canada-US trade relationship, could be larger than expected, leading to lower household spending and business investment. In particular, uncertainty could reduce the impact of government incentives on business investment. Weaker domestic demand would reduce cost pressures. In addition, lower consumer spending would lead businesses to absorb more of the cost increases related to high energy prices. Taken together, these effects would keep inflation below its projected path.

Refinery margins and the persistence of energy inflation

Elevated refinery margins have pushed up fuel prices further than the rise in crude oil prices alone would suggest, adding to cost and price pressures. Margins are expected to decline gradually.

Damage to refineries, export disruptions and limited spare refining capacity have reduced the global supply of refined fuel products. As a result, refinery margins and fuel prices have risen.

Margins are assumed to remain around current levels until the end of 2026 and then decline gradually. How quickly they normalize will depend on the extent and duration of the disruptions, the pace of repairs and global demand for refined fuels.

Damage to refineries has pushed refinery margins higher

Fuel prices are influenced by both crude oil prices and refinery margins.

Crude oil prices have risen above US\$100 per barrel. But fuel prices have risen by more than can be explained by this increase. This is because refinery margins have also gone up.

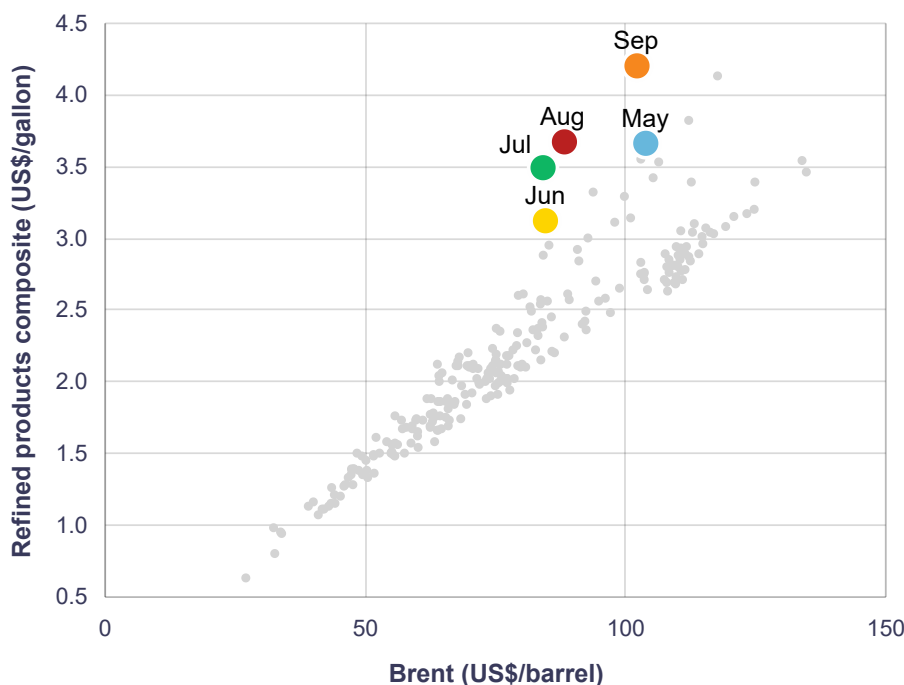
The increase in refinery margins largely reflects export disruptions in the Middle East and damage to refining capacity from attacks in Russia. The resulting decrease in supply has been difficult to offset because there is little spare refining capacity in the rest of the world.

Diesel has been particularly affected because Russia and the Middle East are major suppliers and inventories were already low. In addition, demand for diesel is relatively insensitive to price given diesel's essential role in freight transportation and industries such as agriculture and mining. Reduced supplies of suitable crude oil have also constrained production at some refineries, putting further pressure on margins.

As a result of these disruptions, refinery margins pushed up fuel prices by the equivalent of roughly US\$40 per barrel of crude oil in September (**Chart 25**). In Canada, gasoline refinery margins now account for close to 40% of the pre-tax pump price, compared with around 30% in recent years.

Chart 25: Recent prices for refined products are significantly higher than what elevated crude oil prices alone would suggest

Monthly data



Note: The refined products composite is the weighted average of wholesale prices of gasoline, diesel and jet fuel.

Sources: US Energy Information Administration, Intercontinental Exchange and Bank of Canada calculations

Last observation: September 2026

Higher margins affect inflation through several channels

Like higher crude oil prices, rising refinery margins raise inflation immediately because higher wholesale prices are quickly reflected at the pump.

The indirect effects emerge more gradually. Higher diesel prices raise freight and operating costs in fuel-intensive sectors such as food processing, agriculture, mining and construction. Higher jet fuel prices increase air transportation costs. The longer fuel prices remain elevated, the more likely businesses are to pass these costs on to consumers (see **In focus: Using Prima to trace how an energy shock affects inflation**).

Canada benefits less from high refinery margins than from high crude oil prices because refined products account for a much smaller share of the country's net energy exports than crude oil.

Refinery margins will likely decline gradually

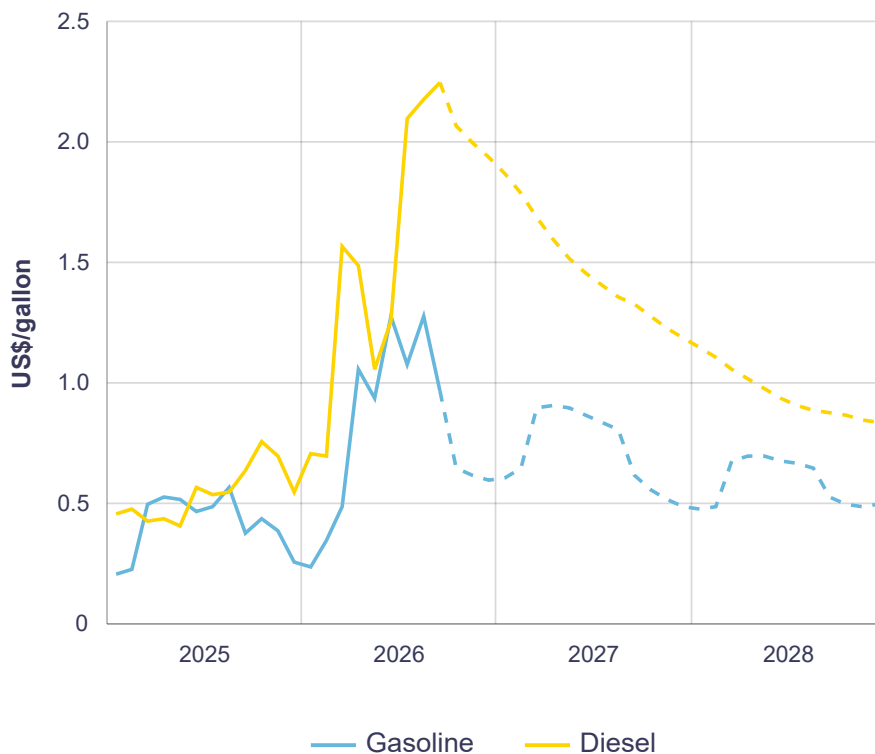
Elevated refinery margins are likely to persist. Damaged facilities can take up to 12 months to return to normal operations, and limited spare capacity will make absorbing further disruptions difficult. How long the shock lasts will also depend on inventories and the ability of trade flows to redirect refined products to affected markets.

The base-case projection assumes that refinery margins remain close to current levels until the end of 2026 and then decline gradually over the projection horizon, in line with market expectations (**Chart 26**).

If disruptions to refining and export capacity broaden or last longer than anticipated, refinery margins could remain elevated for longer. However, faster repairs, a resumption of exports or weaker demand could narrow refinery margins sooner.

Chart 26: Product and crude oil futures prices point to elevated margins through 2027

Difference between fuel and Brent futures prices, monthly data



Sources: London Stock Exchange Group and Bank of Canada calculations
Last data plotted: December 2028

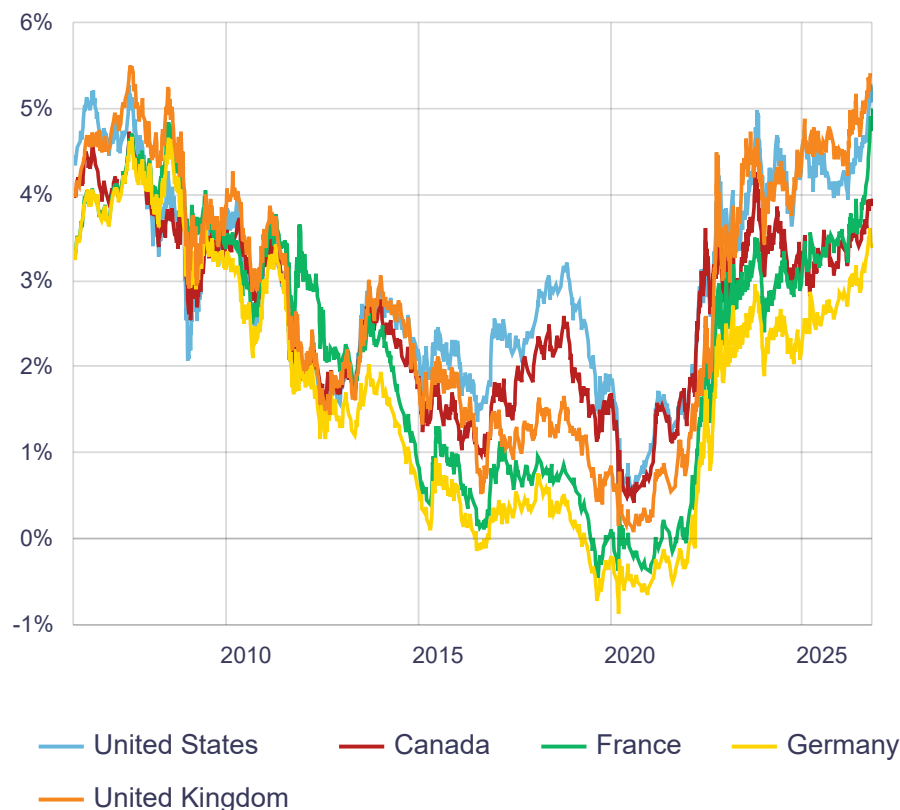
Factors behind the rise in long-term sovereign bond yields

Yields on long-term sovereign bonds have risen sharply since the start of the year, reaching their highest levels in more than a decade across many advanced economies.

Long-term sovereign bond yields—a key measure of government borrowing costs—have been rising since 2021 (**Chart 27**). The pace of increases picked up in 2026 amid heightened volatility. This reflects multiple forces, including expectations of higher policy interest rates, rising issuance of long-term government and corporate debt, and increased uncertainty.

Chart 27: Yields on 10-year sovereign bonds are at or near their highest levels in more than a decade

Daily data



Source: London Stock Exchange Group
Last observation: October 21, 2026

The drivers of higher yields differ across countries

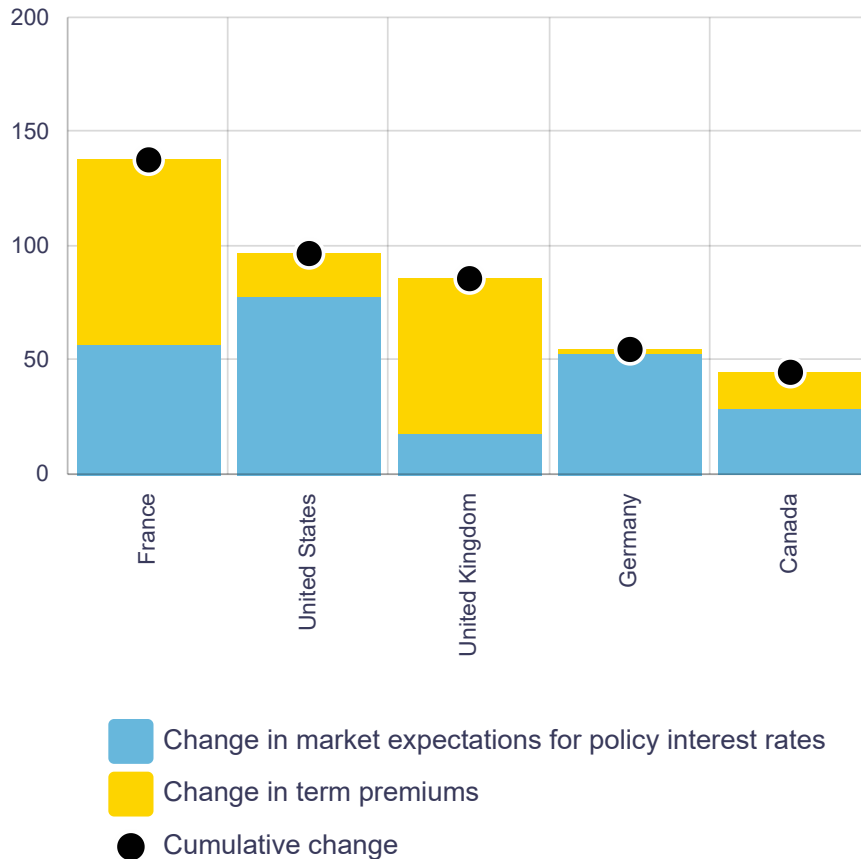
Long-term yields reflect expectations for future policy interest rates and term premiums, which are the extra compensation investors demand for committing their money for long periods. Persistently elevated energy prices have led markets to expect higher policy interest rates. These developments account for the majority of the increase in yields in Canada, the United States and Germany.

However, in several other jurisdictions, rising term premiums have played a larger role. In some cases, this could reflect market concerns about the health of government finances (**Chart 28**).¹

In the United States, there is also some evidence that part of the rise in yields reflects a small increase in longer-term neutral interest rates.

Chart 28: Market policy rate expectations and term premiums have affected long-term sovereign bond yields differently in different countries

Estimated contribution to changes in 10-year sovereign bond yields year to date, basis points, daily data



Note: Term premiums are estimated using the methodology developed in T. Adrian, R. K. Crump and E. Moench, "Pricing the Term Structure with Linear Regressions," Federal Reserve Bank of New York Staff Report No. 340 (August 2008), while using a common sample across countries.

Source: Bank of Canada calculations and estimates
Last observation: October 21, 2026

Markets expect higher policy interest rates

The war in the Middle East and attacks on Russian refineries have led to a persistent increase in energy prices. They have also raised concerns that price pressures could spread beyond energy, leading markets to price in higher policy interest rates. At the same time, rapid investment in infrastructure related to artificial intelligence (AI)—including data centres, semiconductors and power generation—has strengthened demand and reinforced expectations for higher rates.

Term premiums are rising for a variety of reasons

Term premiums have been increasing since 2022, with estimates recently reaching their highest levels in many years in several jurisdictions. Several factors have contributed to this.

In recent years, rising government deficits have led to a notable increase in sovereign debt issuance across many jurisdictions. Meanwhile, corporations are issuing more debt to fund the AI investment boom. Given their funding and balance sheet constraints, private investors have required greater compensation to purchase these additional bonds. This has contributed to the higher term premiums observed both in recent months and over the past several years.

While markets continue to appear confident that central banks will ultimately achieve their inflation objectives, uncertainty has risen about how restrictive monetary policy will need to be to achieve this outcome. This uncertainty may be increasing the compensation investors require to hold longer-term bonds.

Endnotes

1. These estimates are model-dependent and should be interpreted as indicative rather than definitive.[←]

Using Prima to trace how an energy shock affects inflation

Increases in energy prices affect inflation in two stages. First, they quickly push up fuel prices, raising transportation and domestic production costs. Second, those higher costs gradually pass through to the prices of a broad range of goods and services.

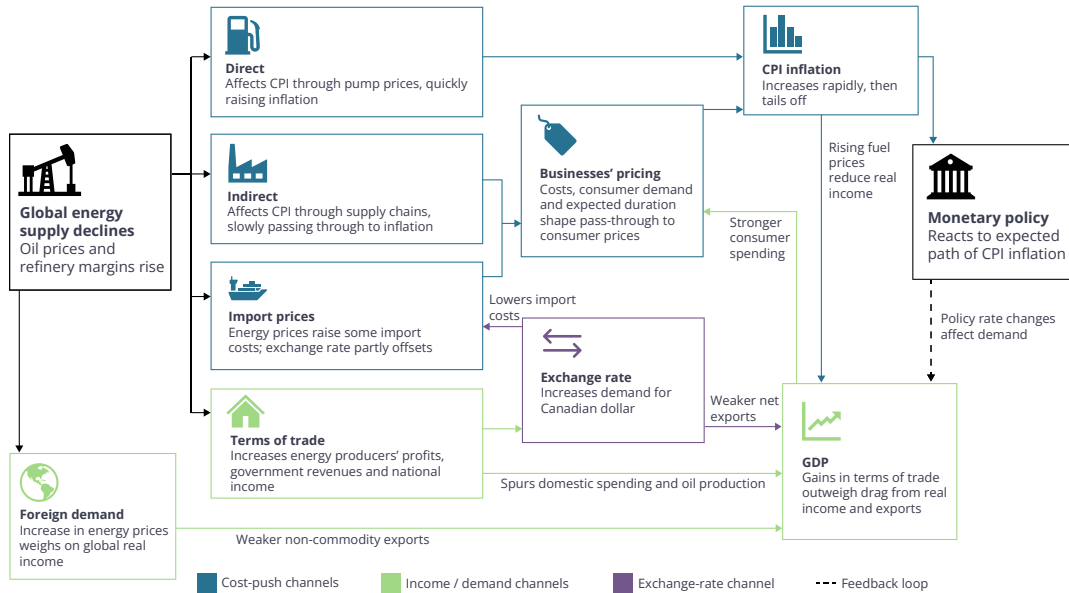
Like the Bank's previous models, Prima takes into account how demand, supply, inflation expectations and monetary policy affect inflation. However, past models assessed inflation pressures largely by comparing economy-wide demand with the economy's capacity to supply goods and services over the medium term.

Prima's assessment starts with the balance between supply and demand in individual sectors and how this balance affects input costs. The model then projects how quickly cost changes in one sector are passed through to other sectors before finally reaching consumer prices.¹

Prima was used to build the outlook in this Report, including to project how the recent rise in energy prices could spread through the economy and affect inflation. This section isolates the impact on inflation from the rise in energy prices since the January Report (**Figure 1**). It then considers a scenario in which Brent oil prices remain close to US\$100 per barrel over the next two years.

Figure 1: How a persistent energy price shock passes through to inflation

Main channels captured in Prima



Prima accounts for the direct effect on prices

Some shocks pass through directly to consumer prices. For instance, the recent rise in energy prices passed quickly into the prices of gasoline, diesel and other fuels (see **In focus: Refinery margins and the persistence of energy inflation**).

Prima traces how costs move through the production network

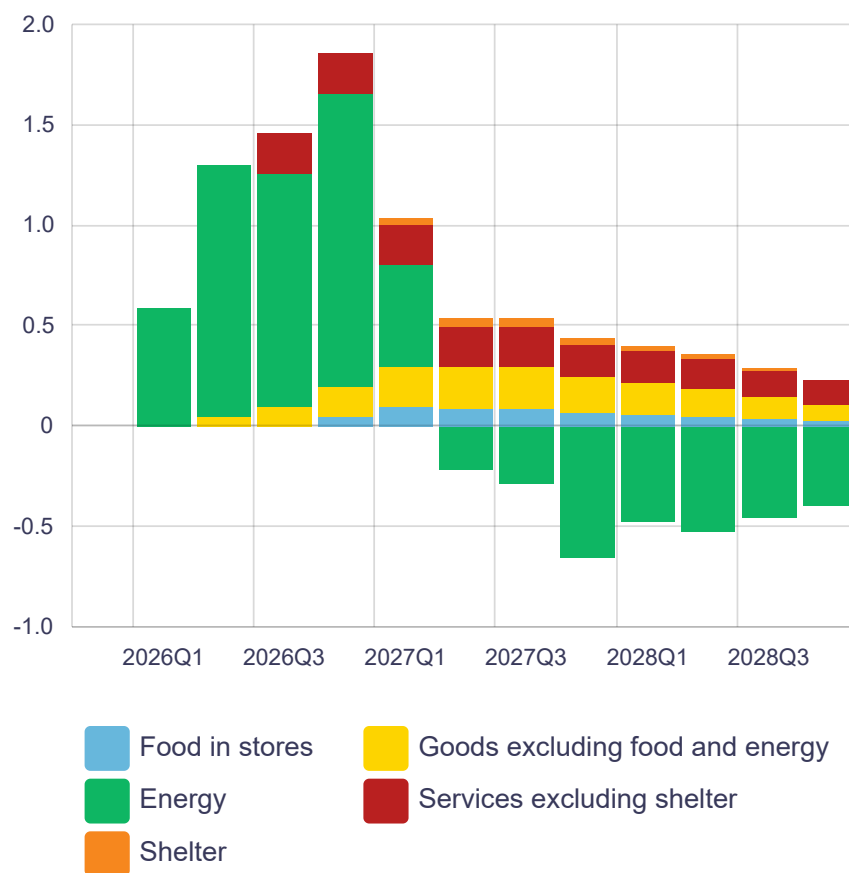
In Prima, sectors buy intermediate inputs from one another, and some adjust their prices more frequently than others. As a result, a cost increase in one sector spreads to other sectors gradually and unevenly. It appears first in the prices charged between businesses and only later in the retail prices paid by households.

Energy is a clear example because it is an input for nearly every economic sector. A rise in diesel and jet fuel prices not only increases the costs of transporting goods but also makes it more expensive to produce food, manufacture goods and deliver many services. Rising energy costs abroad also push up the prices of energy-intensive imports, adding to these pressures.

To illustrate, Prima is used to isolate the effects of the rise in energy prices since the start of 2026. At their peak, the effects add around 2 percentage points to inflation in the fourth quarter of 2026 (**Chart 29**). Most of the initial effect comes from the direct impact on fuel prices. The effect then spreads through supply chains to other major components of the consumer price index, particularly goods excluding food and energy. As oil prices and refinery margins decline, energy prices begin to pull inflation down toward the end of 2027. However, the indirect effects on other components fade more slowly and continue to add to inflation through 2028.²

Chart 29: Energy shocks reach CPI components at different speeds

Contribution of the rise in energy prices to CPI inflation relative to the January Report, percentage points, quarterly data



Sources: Statistics Canada and Bank of Canada calculations, estimates and projections
Last data plotted: 2028Q4

Prima shows how expected costs affect inflation today

Because most businesses adjust prices only periodically, they base their pricing decisions not only on current costs but also on the costs they expect to face before their next price adjustment. Consider a trucking company that sets its rates once a year. If it expects the rise in fuel costs to last only a few weeks, it may absorb much of the increase rather than risk losing customers. If it expects fuel costs to remain elevated, it is more likely to pass the cost increase on to customers through higher prices.

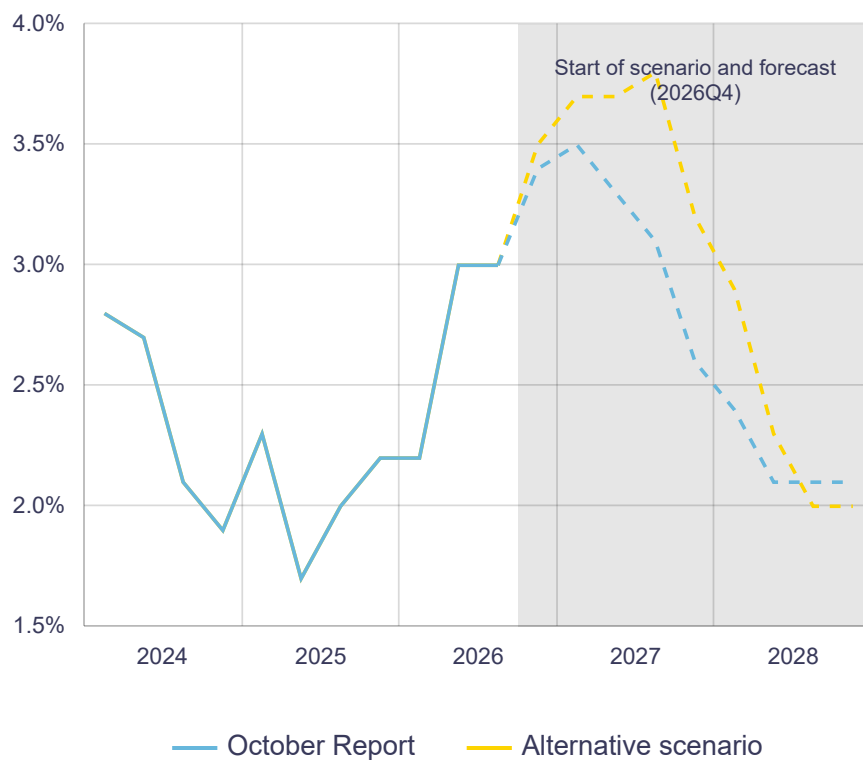
Prima incorporates this pricing behaviour into its projection and analysis. In the model, businesses eventually pass on permanent cost increases in full. But how much they raise prices right away depends on how long cost pressures are expected to persist and the strength of demand for their products.

Consider a scenario in which oil prices stay around US\$100 per barrel and refinery margins remain elevated rather than gradually declining as they do in the base case (**Chart 30**). In this alternative scenario:

- In the fourth quarter of 2026, energy prices are the same as in the base case, but inflation is 0.1 percentage point higher. This reflects the fact that in Prima, when setting current prices, businesses factor in their expectation that future energy costs will be higher.
- By the third quarter of 2027, inflation is 0.7 percentage points higher than in the base case. This illustrates the sensitivity of the outlook for inflation to the assumption for oil prices.

Chart 30: Expected persistence of high energy prices adds to inflation today

CPI inflation, year-over-year percentage change, quarterly data



Sources: Statistics Canada and Bank of Canada calculations, estimates and projections
Last data plotted: 2028Q4

Prima accounts for demand and trade channels

Prima also traces how the energy shock affects household spending and, eventually, inflation (see **Figure 1**). For example, rising fuel prices leave some households with less to spend on other goods and services. However, because Canada is a net exporter of oil, higher energy prices improve its terms of trade. These gains boost wealth, supporting spending by other households. Higher oil prices also boost the oil and gas sector's profits, investment and hiring as well as government revenues.

The energy shock also affects trade. By reducing real incomes abroad, the increase in energy prices weakens foreign demand for Canada's non-commodity exports. At the same time, the improvement in Canada's terms of trade increases demand for the Canadian dollar. The stronger dollar lowers the cost of non-energy imports but weighs on Canada's exports by making them relatively more expensive. On net, Canada's real exports rise by a small amount.

Prima offers a richer analysis of inflation dynamics

Prima strengthens the Bank's analysis of how shocks such as rising energy prices affect inflation. This helps shape how the Bank explains the inflation outlook.

Endnotes

1. See Bank of Canada, "**Prima: The Bank of Canada's model for projection and policy analysis**," (October 1, 2026).[←]
2. Other factors supporting CPI inflation relative to the January outlook include higher import prices from a range of sources, Canadian counter-tariffs and the earlier depreciation of the Canadian dollar. The reversal of the earlier cut in the fuel excise tax also temporarily boosts year-over-year inflation in 2027.[←]