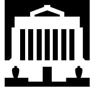
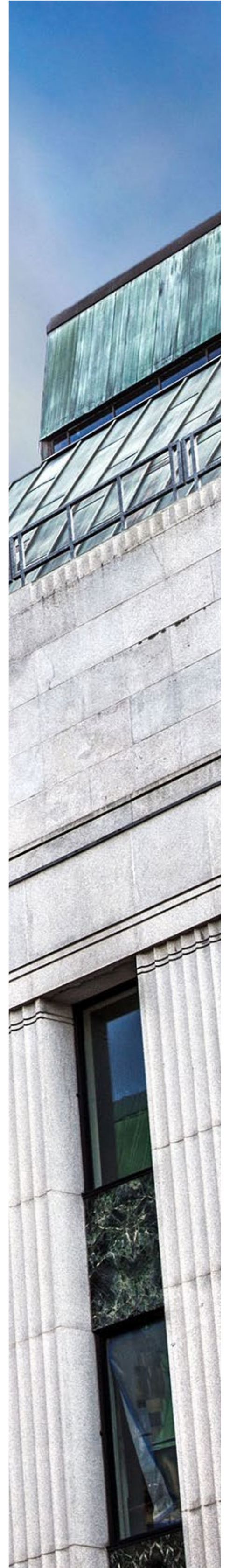


BANK OF CANADA
BANQUE DU CANADA



Monetary Policy *Report*

April 2026

Overview

Before the outbreak of the war in the Middle East, the Canadian economy was evolving as expected. Since the war began, oil prices have risen, pushing inflation up, and the outlook has become more uncertain.

Economic growth in Canada has been broadly consistent with the outlook in the January Report. Consumer and government spending are supporting gross domestic product (GDP), while US tariffs and related trade uncertainty are weighing on exports and investment. Inflation had been slowing as expected before the oil price shock occurred.

The war in the Middle East is already affecting the economy. The immediate impact has been higher gasoline prices, pushing up consumer price index inflation to 2.4% in March.

The outlook is highly conditional on key assumptions, including that tariffs remain unchanged and that oil prices gradually decline from US$90 in the second quarter of 2026 to US$75 per barrel by mid-2027 (see the **Tariff and other assumptions** section).

Summary of economic conditions

The Canadian economy is adjusting to structural changes. US tariffs have upended trade and put economic activity on a lower path. Some businesses are responding by seeking new markets, producing new products and altering their supply chains—but these changes come at a cost. Uncertainty about the review of the Canada-United States-Mexico Agreement is weighing on economic activity. Businesses' adoption of artificial intelligence is starting to boost productivity.

Growth in GDP is estimated to be about 1.5% in the first quarter of 2026. Consumption and government spending are key sources of strength, while exports and business investment remain weak, continuing the pattern seen in 2025. A slowdown in the housing market is also weighing on growth.

The outlook for growth is similar to that in the January Report. Recent data have been broadly in line with the previous forecast. Higher global oil prices are expected to have little impact on overall growth but will affect its composition. As Canada is a net exporter of oil, its national income will be boosted. At the same time, many consumers and businesses will be squeezed by higher costs. Overall, Canada will fare better than many countries.

The economy is expected to grow 1.2% in 2026. Growth is projected to rise to 1.6% in 2027 and to 1.7% in 2028, slightly above potential output growth, as exports and business investment gradually pick up. Excess supply is slowly absorbed over the projection horizon.

Inflation has been close to 2% for over a year. It slowed in February to 1.8%, easing in all major categories other than energy. In March, it climbed to 2.4% as gasoline prices soared due to higher global oil prices. Inflation is expected to peak in April at about 3% and then return to the 2% target in early 2027, assuming that global oil prices decline as expected. In 2027 and 2028, slack in the economy weighs on prices and largely offsets higher costs, keeping inflation close to the 2% target.

The outlook depends crucially on the outcome of trade negotiations with the United States and the duration and severity of the war in the Middle East, as well as how the economy responds to these developments. For example, if the United States imposes new trade restrictions on Canada, GDP growth would be weaker and inflationary pressures lower. But if the war in the Middle East continues and global energy prices rise further or stay high for longer, price pressures could broaden and become more persistent.

Current conditions

The Canadian economy is expected to have grown modestly in early 2026. After being close to 2% for more than a year, inflation increased in March as the war in the Middle East pushed up oil prices. Inflation is expected to rise further in April.

The economy continues to adjust to structural changes. US tariffs and related uncertainty have weighed on affected sectors, curbing investment and hiring. Some businesses have reported diversifying their export markets and reconfiguring their supply chains. At the same time, artificial intelligence (AI) is leading to greater automation and digitalization.

Economic activity is estimated to have grown moderately in the first quarter of 2026. Solid growth in consumption and government spending along with a boost from inventory investment were partially offset by a drop in both housing activity and exports.

Consumer price index (CPI) inflation picked up in March because of higher gasoline prices, while measures of core inflation remained near 2%.

The war in the Middle East is affecting the Canadian economy primarily through higher commodity prices. Since the war began, oil prices have soared. While Canada benefits as a net energy exporter, the boost to growth is likely to be limited. Higher gasoline and food prices weigh on household purchasing power, and foreign demand for Canadian non-energy exports will likely weaken.

The war has also added to overall uncertainty. If the global price of oil remains high for longer than assumed in the base case, broader cost pressures could emerge. This raises the risk that elevated inflation will persist.

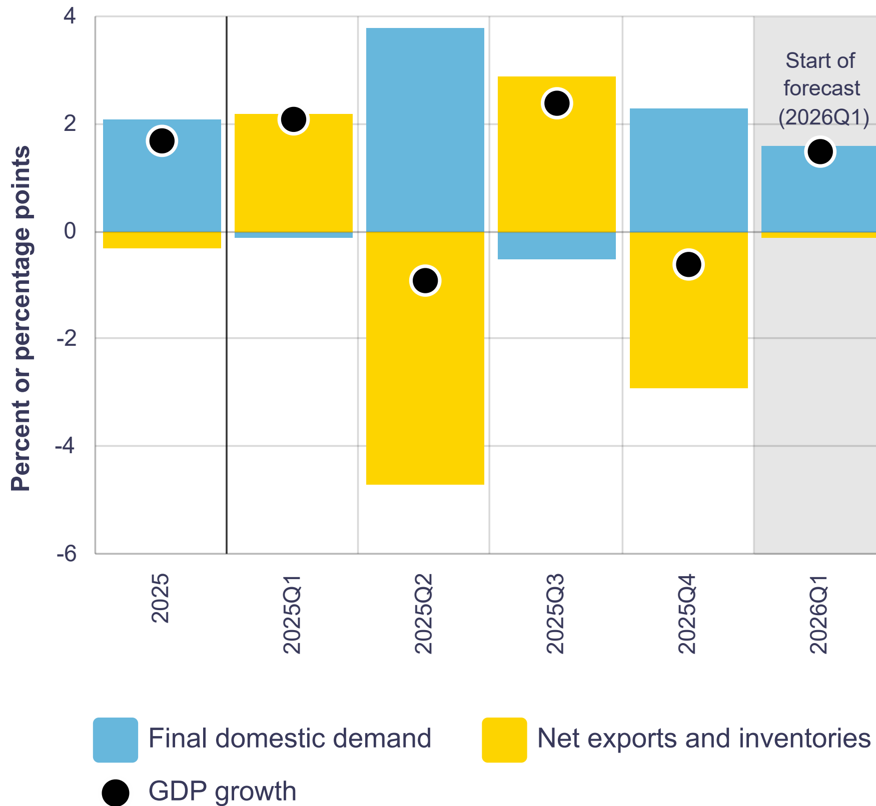
Economic activity

Gross domestic product grew 1.7% in 2025. Growth was uneven across demand components. Consumption and government spending were solid. In contrast, exports and business investment declined amid US tariffs and trade policy uncertainty.

Economic activity contracted in the final quarter of 2025, mainly due to a sharp drawdown of inventories (**Chart 1**). Growth in final domestic demand was solid at 2.4%, and exports were lifted by gold shipments.

Chart 1: A sharp inventory drawdown lowered GDP in the fourth quarter of 2025

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 and estimates
Last data plotted: 2026Q1

Final domestic demand supports growth in the first quarter of 2026

Although the economy started the first quarter of 2026 on a weak footing, recent indicators have been more favourable. The economy is estimated to have grown by about 1.5% in the first quarter, broadly in line with expectations at the time of the January Report. Growth reflects strength in final domestic demand and a boost from inventory investment. Exports and housing will likely subtract from growth.

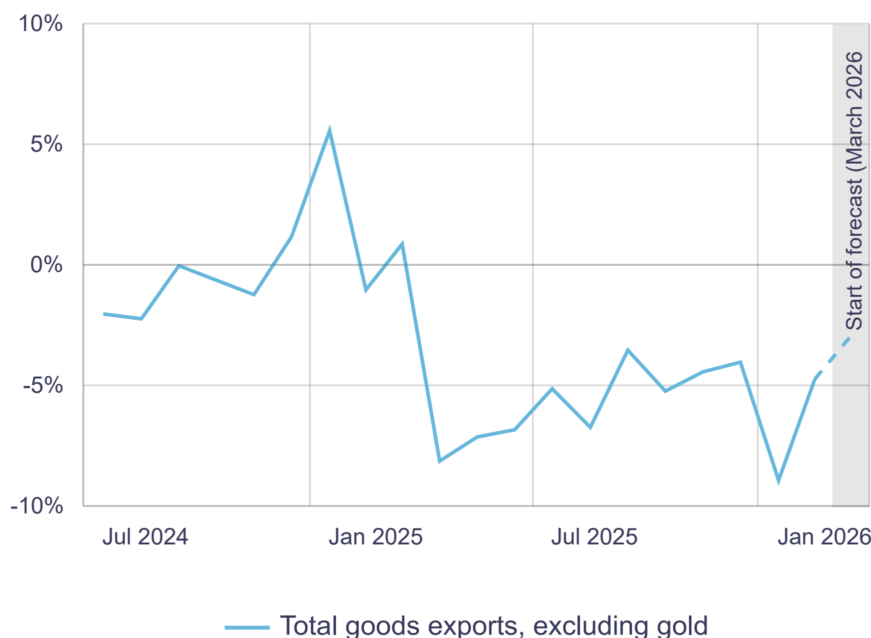
For the first quarter of 2026, consumption growth is estimated to have remained solid, given past interest rate cuts and previous gains in equity prices. However, surging gasoline prices squeezed household budgets late in the quarter, likely weighing on discretionary spending—especially for lower-income households. Growth in government spending continues to be strong, with support from provincial infrastructure investment and federal defence spending. Business investment appears to have risen modestly, although investment intentions remain weak in sectors affected by tariffs.

Residential investment is expected to have contracted in the first quarter. Stretched affordability and the recent slowdown in population growth are constraining demand and weighing on housing activity. Unseasonably cold weather also slowed resale activity.

Exports are estimated to have declined because of both the ongoing effects of US tariffs and a temporary drop in motor vehicle shipments linked to retooling (**Chart 2**). Increased shipments of energy products as well as exports into new markets provide some offset.

Chart 2: US tariffs continue to weigh on exports of goods

Percentage change from September 2024, monthly data



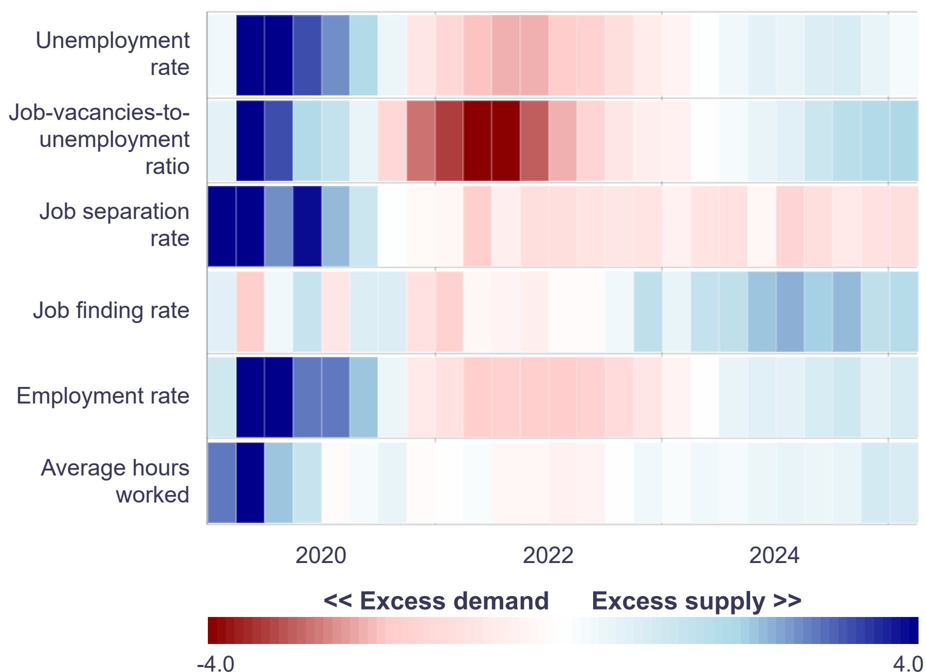
Note: In this chart, *total goods exports* excludes precious metals products because shipments of gold are highly volatile and often reflect inventory management. Shipments of gold do not reflect underlying production levels or demand because gold is frequently re-exported, stored or shipped for financial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

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

Capacity pressures

The output gap for the first quarter of 2026 is estimated to be in the range of -1.5% to -0.5%, unchanged from the January Report. A range of indicators suggest some slack in the labour market (**Chart 3**).

Chart 3: Labour market indicators suggest some slack



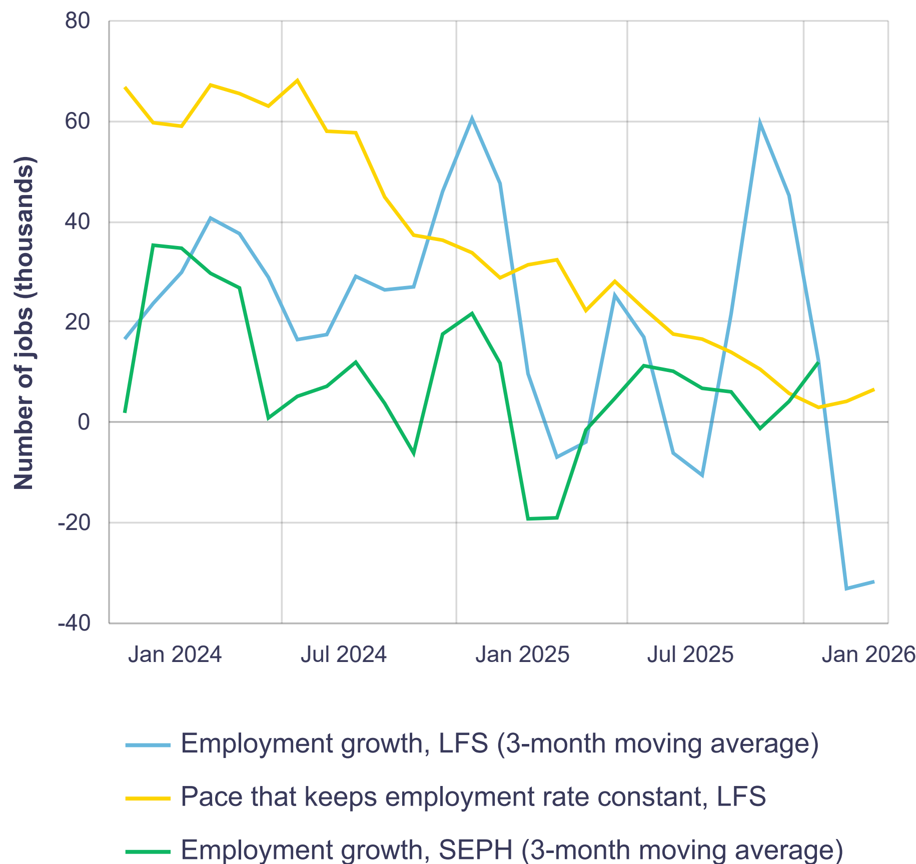
Note: The heatmap shows the distance of each labour market indicator from the midpoint of its benchmark range. The colour is white when the indicator is close to the midpoint of its benchmark range, a varying shade of red when it is indicative of excess demand and a varying shade of blue when it is indicative 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 2003 to 2019 for all other indicators. Missing historical data for job vacancies before 2026Q1 are proxied using information from Indeed. Data for job vacancies in 2026Q1 reflect the month of January 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, Indeed and Bank of Canada calculations
Last observation: 2026Q1

Job growth has slowed

Employment growth has slowed overall since early 2025, with employment contracting in sectors hit hard by higher US tariffs (**Chart 4**). At the same time, population growth has eased and the labour force participation rate has declined. As a result, the unemployment rate has remained in the range of about 6½% to 7% over the past 12 months.

Chart 4: Employment growth has generally been subdued

Seasonally adjusted, monthly data



Note: LFS is the Labour Force Survey. SEPH is the Survey of Employment, Payrolls and Hours. Employment growth needed to keep the employment rate constant is calculated by multiplying the net monthly change in the size of the working-age population in the LFS by the previous month's employment rate.

Sources: Statistics Canada and Bank of Canada calculations

Last observations: Labour Force Survey, March 2026; Survey of Employment, Payrolls and Hours, January 2026

The participation rate has continued to decrease over the past 12 months mainly due to population aging. Labour market weakness has also played a role, although to a lesser extent, with weak hiring and fewer vacancies likely reducing incentives to search for a job.

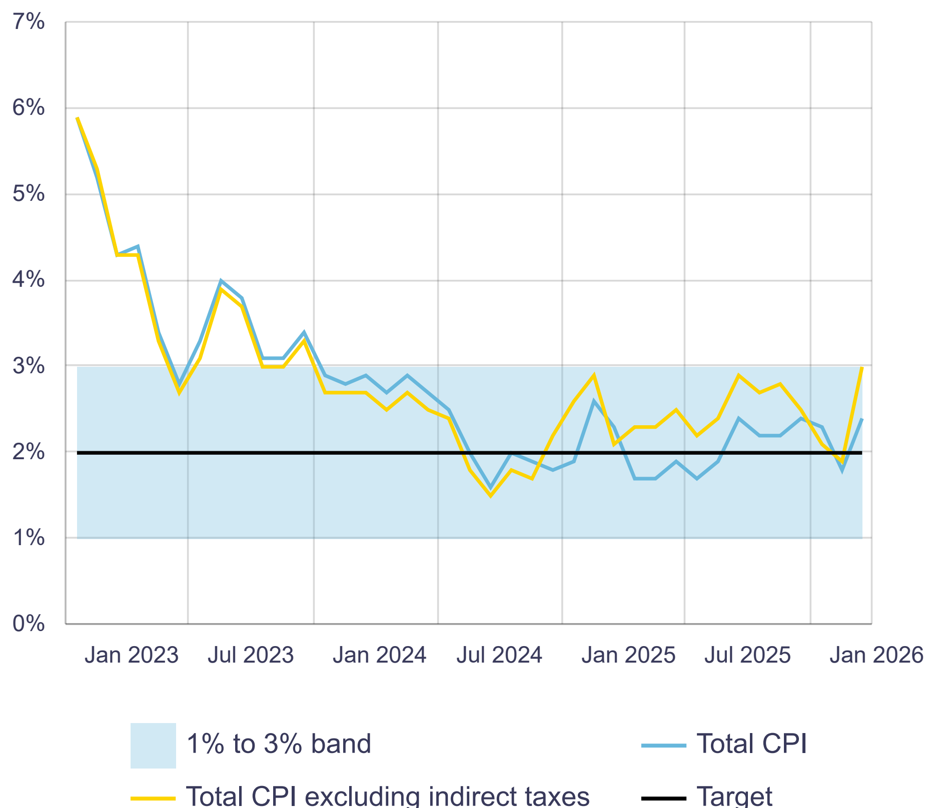
Most measures of wage growth are between 3% and 3½%. Bank of Canada survey results also point to wage growth slightly above 3%.

Inflation

Inflation slowed to 1.8% in February before climbing to 2.4% in March as gasoline prices soared (**Chart 5**). Inflation is expected to rise further in April, reaching about 3%. Measures of core inflation have been easing, with CPI-trim and CPI-median at 2.2% and 2.3%, respectively. Moreover, the three-month annualized rates of CPI-trim and CPI-median are at or below 2%. The share of CPI components with inflation above 3% has declined but remains higher than its historical average, largely due to high inflation across many food categories (**Chart 6**).

Chart 5: CPI inflation has been close to 2% for more than a year, though higher gasoline prices boosted inflation in March

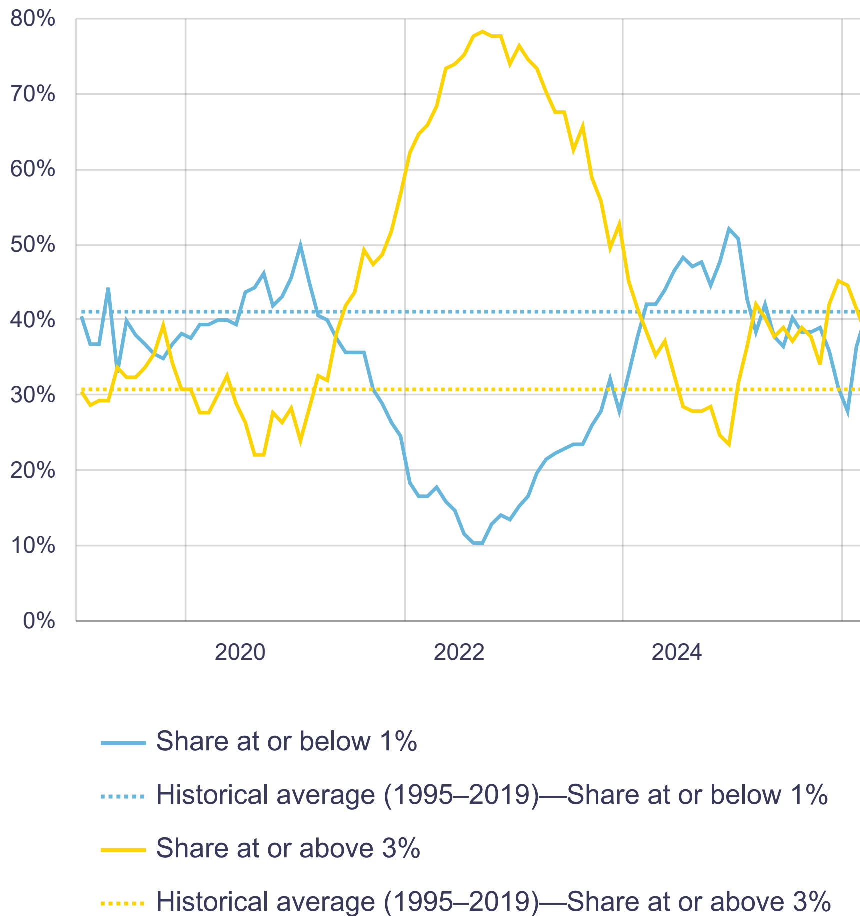
Year-over-year percentage change, monthly data



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

Chart 6: The share of CPI components growing above 3% has declined

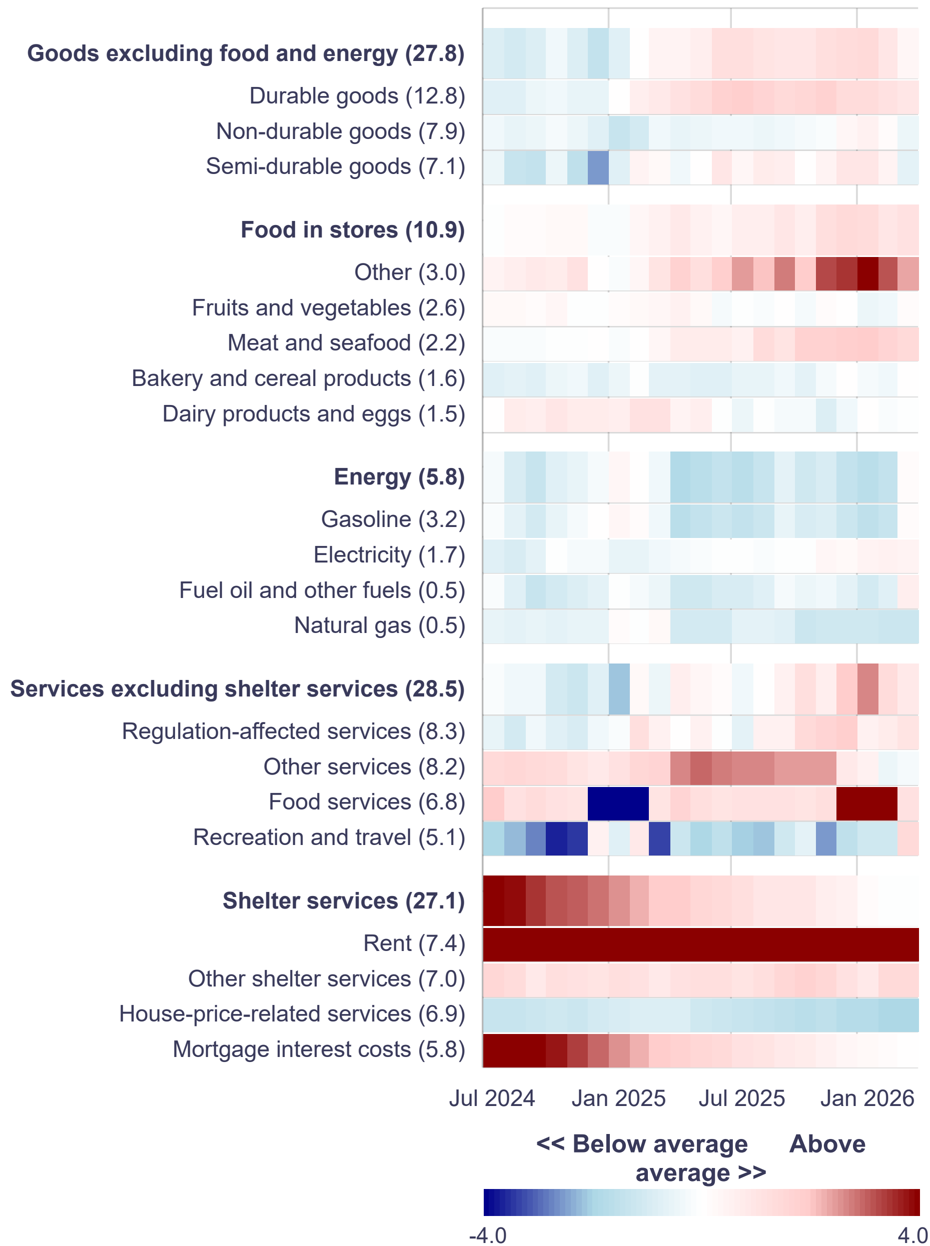
Share of CPI components with year-over-year price growth outside the 1% to 3% band, monthly data



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

Since November, inflation has slowed or remained relatively stable in the major CPI categories except energy (**Chart 7**). With the exception of inflation in rent and some food components, which remains elevated, inflation in the other components is close to historical norms.

Chart 7: Inflation for many CPI components has slowed since November, although elevated price growth persists for some



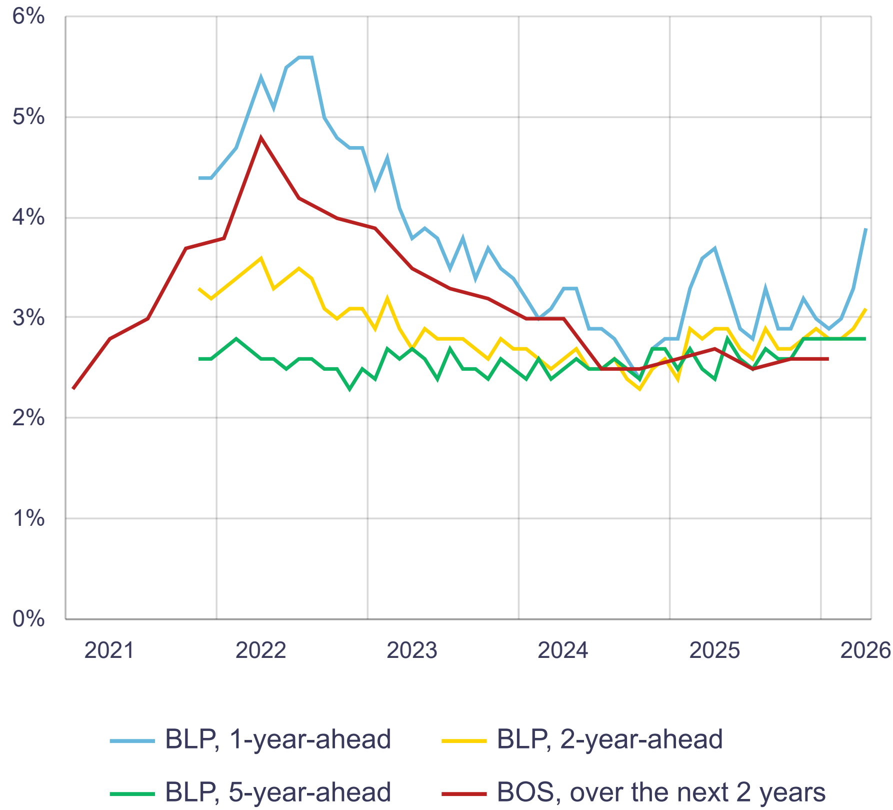
Note: The heatmap shows the distance of each CPI component's year-over-year inflation rate from its historical average. The colour is white when a component's inflation rate is close to its average and is a varying shade of blue (red) when the rate is below (above) the average. Because the historical 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: March 2026

The war is pushing up oil prices and transportation costs. Higher prices for gasoline, diesel and jet fuel have led to the introduction of fuel surcharges for some goods and services. The temporary suspension of the federal fuel excise tax will cushion part of the increase. Fertilizer prices have also risen, and shortages may put upward pressure on food prices over time. Shipping disruptions could further add to cost pressures.

Results of Bank surveys show that businesses' short-term inflation expectations rose in March and April (**Chart 8**). Longer-term inflation expectations remain anchored.

Chart 8: Businesses' short-term inflation expectations have increased because of the war in the Middle East

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. April 2026 BLP data are preliminary, with a last observation date of April 21, 2026.

Sources: Bank of Canada and Bank of Canada calculations

Last observations: Business Leaders' Pulse, April 2026; Business Outlook Survey, 2026Q1

Commodities

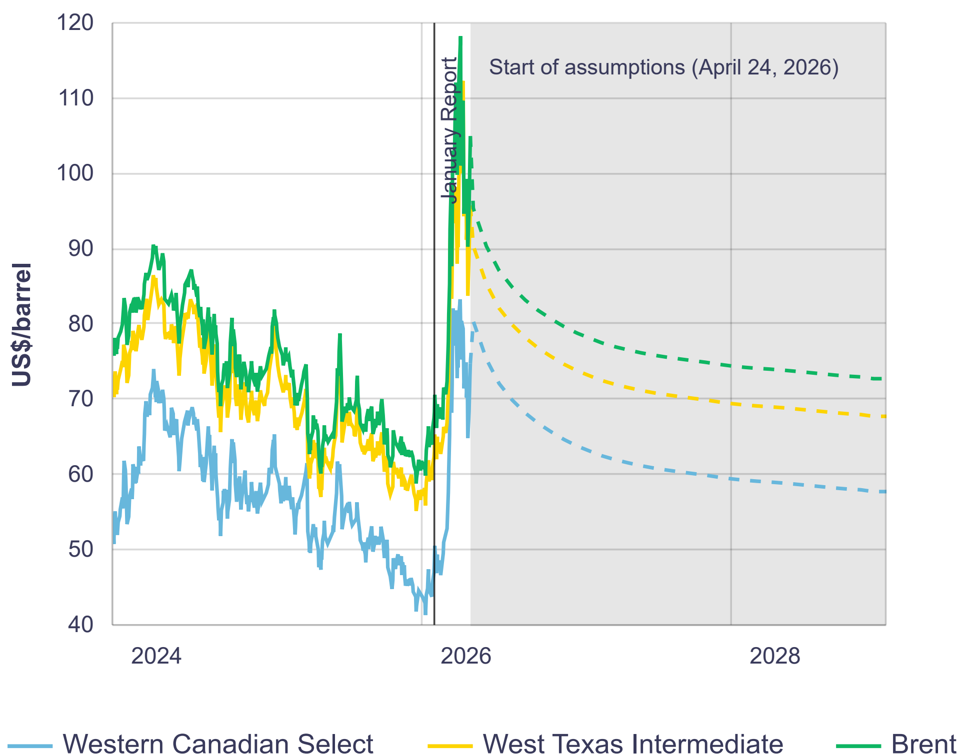
Oil prices have increased markedly since January, reflecting the effects of the war in the Middle East. The war has also affected the prices of other commodities produced in the region, including natural gas and aluminum.

Oil prices are high and volatile

Brent oil prices, as represented by the price of front-month futures contracts, are trading around US$100 per barrel. This is substantially higher than assumed in the January Report at US$60 per barrel (**Chart 9**). The increase in global oil prices reflects severe restrictions on oil shipments passing through the Strait of Hormuz and the resulting production shutdowns. In addition, the disruptions have made it costly to obtain actual physical barrels in the spot market. This has led to an even bigger spike in the price of immediate delivery of a barrel of Brent oil. The spread between the spot price of Brent and the price of the front-month futures contract has widened to over US$40 per barrel (**Chart 10**).

Chart 9: Oil prices have surged as a result of the war in the Middle East

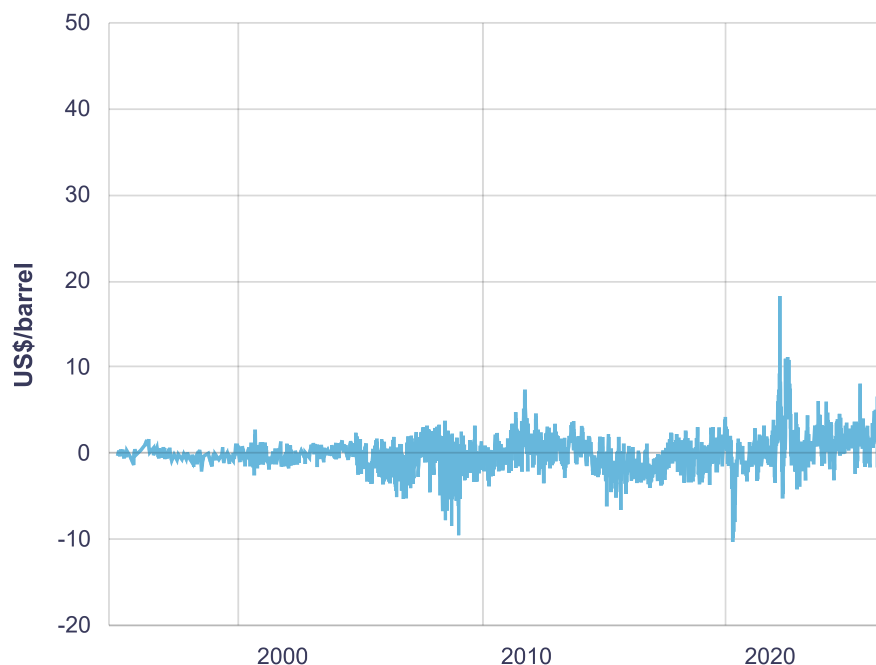
Daily and monthly data



Sources: NYMEX and Intercontinental Exchange via Haver Analytics, Bloomberg Finance L.P. and Bank of Canada assumptions
Last data plotted: December 2028

Chart 10: Oil prices for immediate delivery are far above prices for future delivery

Difference between Brent spot prices and front-month futures, daily data



Note: Brent spot refers to Brent Crude Spot Free on Board Sullom Voe North Sea. Brent front-month futures refers to ICE Europe Brent Crude Electronic Energy Future front-month contract. The chart shows the difference between Brent crude prices for immediate delivery and delivery approximately two months ahead.

Sources: London Stock Exchange Group and Bank of Canada calculations
Last observation: April 23, 2026

In the base-case projection, Brent oil prices are assumed to decline gradually from an average of US$90 in the second quarter of 2026 to US$75 by mid-2027 (see the **Tariff and other assumptions** section). This assumes some normalization of oil supply as crude exports through the Strait of Hormuz gradually resume. This profile is broadly in line with that of the futures curve for Brent oil. However, the outlook for oil prices is subject to a high degree of uncertainty and could change quickly with events (see **In focus: The war in the Middle East—Transmission channels and risks to inflation**).

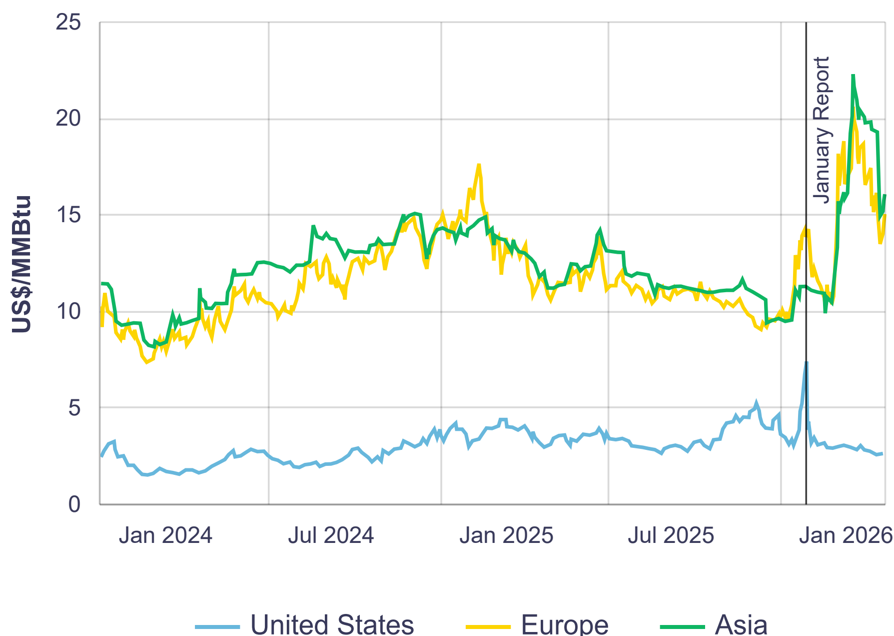
Natural gas prices have diverged globally

The global supply of liquefied natural gas (LNG) has decreased following the shutdown of the LNG terminal in Qatar and the repeated closures of the Strait of Hormuz. As a result, natural gas prices in Europe and Asia have risen sharply (**Chart 11**).

In contrast, prices for natural gas in North America have declined due to abundant domestic production and limited LNG export capacity that reduce exposure to global price pressures.

Chart 11: Natural gas prices have increased in Europe and Asia but not North America

Natural gas benchmark prices, daily data



Note: European natural gas prices are converted from euros per megawatt hour to US dollars per metric million British thermal units (MMBtu). Prices in the United States are based on the Henry Hub benchmark, European prices are based on the Dutch Title Transfer Facility gas benchmark, and Asian prices are based on the Japan Korea Marker for liquefied natural gas.
Sources: London Stock Exchange Group, Haver Analytics and Bank of Canada calculations

Last observation: April 23, 2026

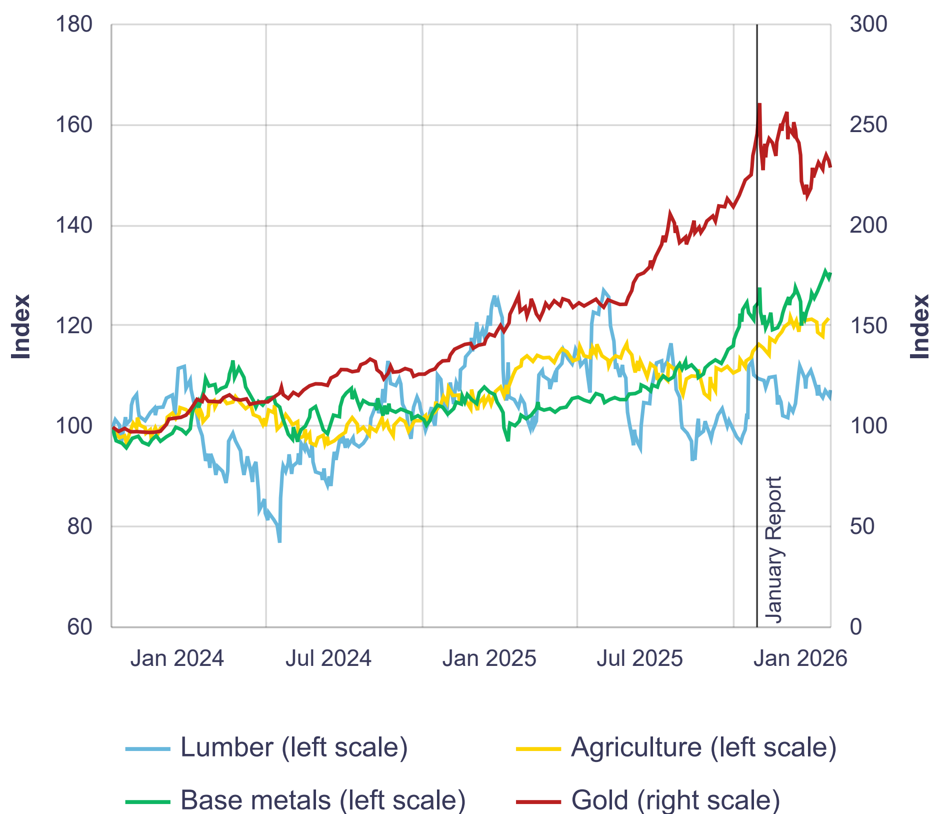
Non-energy commodity prices are roughly unchanged

The Bank's non-energy commodity price index is broadly unchanged relative to the January Report. Prices for base metals increased by about 15% in 2025—due to supply disruptions in several mines and strong global investment in infrastructures, including AI and green technology—and have shown little change since the January Report. A notable exception, however, is the price of aluminum, which rose by about 10% because of supply disruptions in the Middle East. At the same time, prices for precious metals, including gold, have partially reversed their previous sharp gains (**Chart 12**).

The impact of the war in the Middle East on agricultural commodity prices has been limited so far. The Gulf Region accounts for roughly 30% of global exports of urea, a widely used fertilizer. Prices for fertilizer have increased significantly since the start of the war due to shipping disruptions and higher prices for natural gas—a critical input to production. If sustained, these developments could place renewed upward pressure on agricultural prices later in the year.

Chart 12: Some non-energy commodity prices have increased since the beginning of 2025

Commodities prices, index: January 1, 2024 = 100, daily data



Note: Gold is measured in US dollars per ounce and lumber is measured in US dollars per 1,000 board feet.

Sources: Handy and Harman Ltd., Chicago Mercantile Exchange and Bank of Canada
Last observation: April 23, 2026

Financial conditions

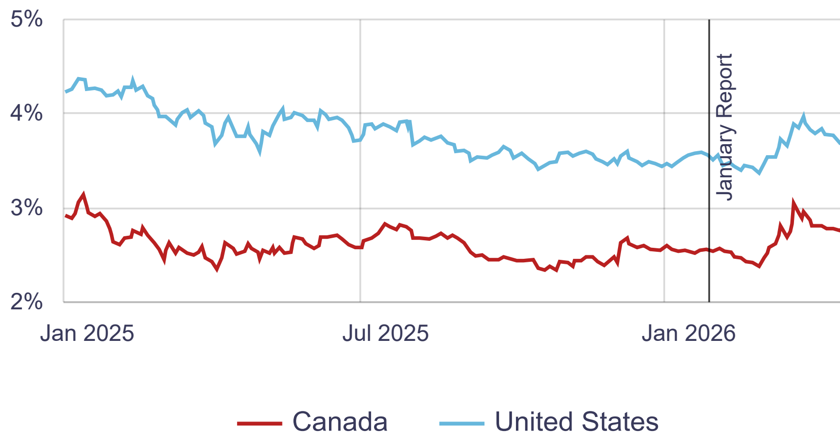
Markets are pricing in higher policy rates at major central banks, reflecting heightened inflation risks from the war in the Middle East. This has supported an increase in global bond yields (**Chart 13**, panel a). Global equity markets declined nearly 10% at the start of the war and most have fully recovered following ceasefire announcements (**Chart 13**, panel b). Credit spreads have widened slightly since the January Report.

The US dollar has appreciated against most major currencies since the January Report, reversing earlier weakening at the beginning of 2026. The Canadian dollar has traded generally near 73 cents US.

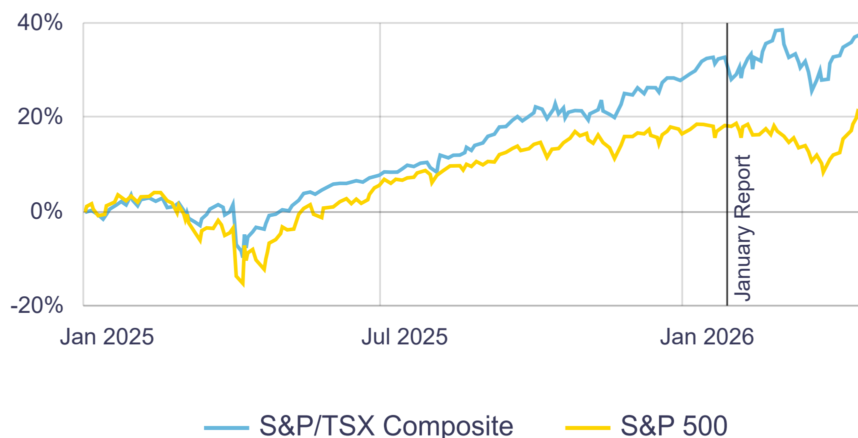
Chart 13: Canadian and US bond yields and equity indexes have risen since the January Report

Daily data

a. 2-year government bond yields



b. Equity index returns



Note: Equity index returns are calculated as the percentage change in the index value since January 2, 2025.
Sources: London Stock Exchange Group and Bank of Canada calculations
Last observation: April 24, 2026

Tariff and other assumptions

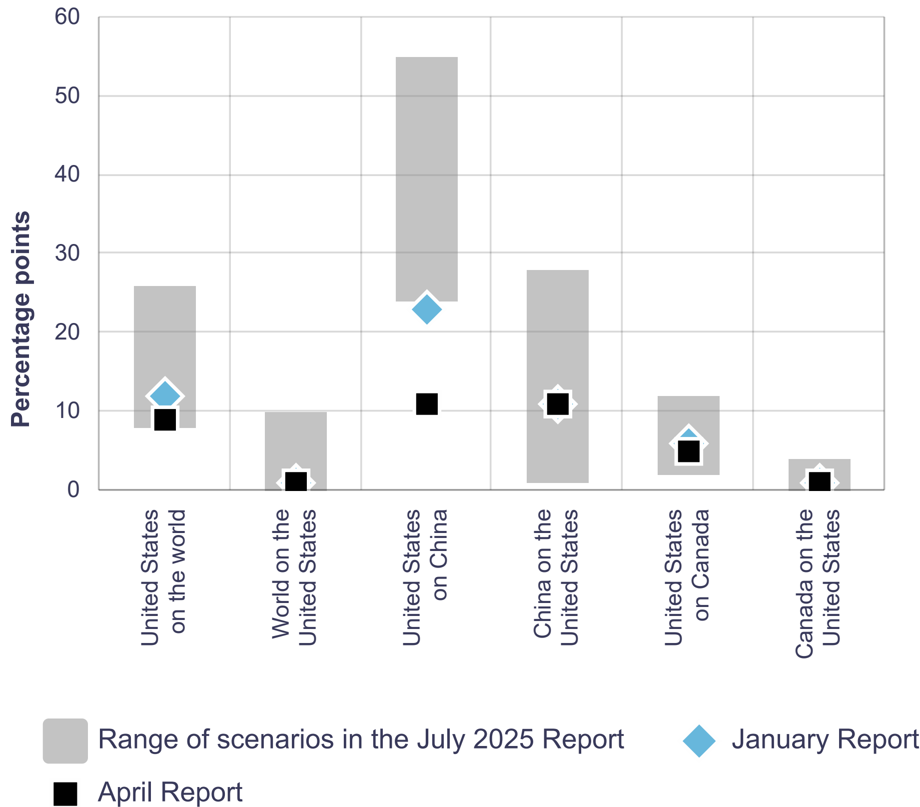
Average US tariff rates decreased recently, both globally and in Canada. But the future of trade in North America remains a key source of uncertainty. The war in the Middle East has pushed global oil prices up sharply.

Tariff assumptions

In February 2026, US tariffs imposed under the *International Emergency Economic Powers Act* were removed by court order. The United States immediately replaced them with a uniform 10% tariff on all imports not covered by a trade agreement. These changes reduce the increase in tariffs that many countries have been facing since the start of 2025. As a result, the increase in the global average US tariff rate is revised down from 12.5 percentage points in the January Report to 9.3 percentage points (**Chart 14**).

Chart 14: US tariffs have decreased from their peak in 2025

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

The projection is based on tariffs in place or officially agreed on as of April 24, 2026 (**Table 1**).[1] Reflecting recent developments, the average US tariff rate on imports from Canada is lowered to 5.1% from 5.8% in the January Report. In contrast, Canada's average tariff rate on US imports has been revised up to 1.5% from 1.2%, reflecting the end of some steel tariff remissions on January 31, 2026. Tariffs in the base-case projection include those set out in Canada's agreement with China.[2]

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

	Before 2025	July 2025	October 2025	January 2026	April 2026
US tariff rate on Canada	0.1	4.4	5.9	5.8	5.1
Canadian tariff rate on the United States*	0.0	2.6	1.0	1.2	1.5

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

Other assumptions

The projection is also conditional on several other assumptions.

- Brent oil prices have recently hovered around US$100 per barrel. Prices are assumed to be US$90 in the second quarter of 2026 and then settle around US$75 by mid-2027 as crude exports through the Strait of Hormuz resume. This profile is broadly in line with the futures curve. Prices of West Texas Intermediate and Western Canadian Select are assumed to follow a similar path, stabilizing at US$70 and US$60, respectively, by mid-2027. These price assumptions are US$15 higher in 2027 than those in the January Report. This reflects a higher risk premium, strong demand to rebuild global inventories and a slow resumption of supply due to the war.
- Investment and employment in the oil sector in Canada are assumed to be less responsive to higher oil prices than in the past, reflecting greater emphasis on dividend payments in the energy sector and improved capital efficiency.[3]
- The Canadian dollar is assumed to average 73 cents US over the projection horizon, up 1 cent US from the January Report. So far, the Canadian dollar has moved less than in previous oil price surges. This likely reflects expectations that the increase in oil prices will be short-lived, and that it will lead to larger dividend payments to foreign shareholders in the energy sector and a smaller rise in foreign direct investment. Increased demand for safe-haven assets due to the war is also a factor.
- Potential output growth in Canada is expected to slow to 1.2% in 2026. This reflects slower population growth and the impact of US trade policy. Potential output growth picks up to 1.3% in 2027 and 1.5% in 2028 as investment recovers. The adoption of artificial intelligence is also expected to raise productivity (see **Appendix: Potential output and the nominal neutral rate of interest**).
- The nominal neutral interest rate in Canada is estimated to be in the range of 2.25% to 3.25%. The projection assumes the nominal neutral interest rate is at the midpoint of this range.
- The impact of trade policy uncertainty on gross domestic product is assumed to ease slowly in 2026.
- 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 provincial and federal budgets that have been tabled as of April 27, 2026.

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. In March 2026, Chinese tariffs on imports of Canadian canola seed were reduced from a combined rate of about 84% to about 15%. Canadian tariffs on imports of Chinese electric vehicles were cut from 100% to 6.1% for the first 49,000 vehicles imported. For more information, see Global Affairs Canada, "**Canada secures renewed market access with China to boost exports and strengthen economic collaboration**" (news release, March 4, 2026).[←]

3. For more details on improved capital efficiency in the Canadian oil and gas sector, see Bank of Canada, "**Box 1: Low oil prices are weighing on sentiment in the oil and gas sector**," *Business Outlook Survey—Fourth Quarter of 2025* (January 2026).[←]

Outlook

The Canadian economy continues to adjust to US tariffs and trade uncertainty, with economic activity on a lower path than before tariffs were imposed. The war in the Middle East is also affecting the outlook. Inflation is projected to rise in the near term before easing toward 2% in early 2027, while economic growth remains modest.

US tariffs and uncertainty about the future of the Canada-United States-Mexico Agreement (CUSMA) are the main factors affecting the outlook for Canada. Current US tariffs are expected to remain in place and have a persistent negative effect on economic activity.

The impact that the war in the Middle East will have on inflation and economic activity depends on the duration and severity of the conflict. The war is expected to add to inflation in 2026, primarily through higher oil prices.

Higher oil prices have broadly offsetting effects on Canadian economic activity. On the one hand, as a net energy exporter, Canada will benefit. Export revenues will rise as more money flows into the country to pay for Canadian oil. Higher profitability can also lead oil producers to increase investment and hire more workers, with positive spillovers to supplier industries. The energy sector distributes some dividends to Canadian investors, and governments receive higher tax and royalty revenues.

On the other hand, higher oil prices reduce household purchasing power because higher gasoline prices mean households have less money to spend on everything else. Some households and businesses will do better than others. Overall, Canada is expected to fare better than many other countries due to its status as a net energy exporter.

The outlook for inflation and economic growth is highly uncertain. It depends on both the outcome of the CUSMA negotiations and the evolution of the war in the Middle East.

Potential output growth is expected to slow in 2026 as US tariffs drive a structural adjustment in the Canadian economy. It then picks up in 2027 as the economy continues to adapt to the new trade regime. Moreover, productivity gains are supported by businesses' adoption of artificial intelligence technology. Population growth is anticipated to remain subdued but picks up slowly over the projection horizon (see **Appendix: Potential output and the nominal neutral rate of interest**).

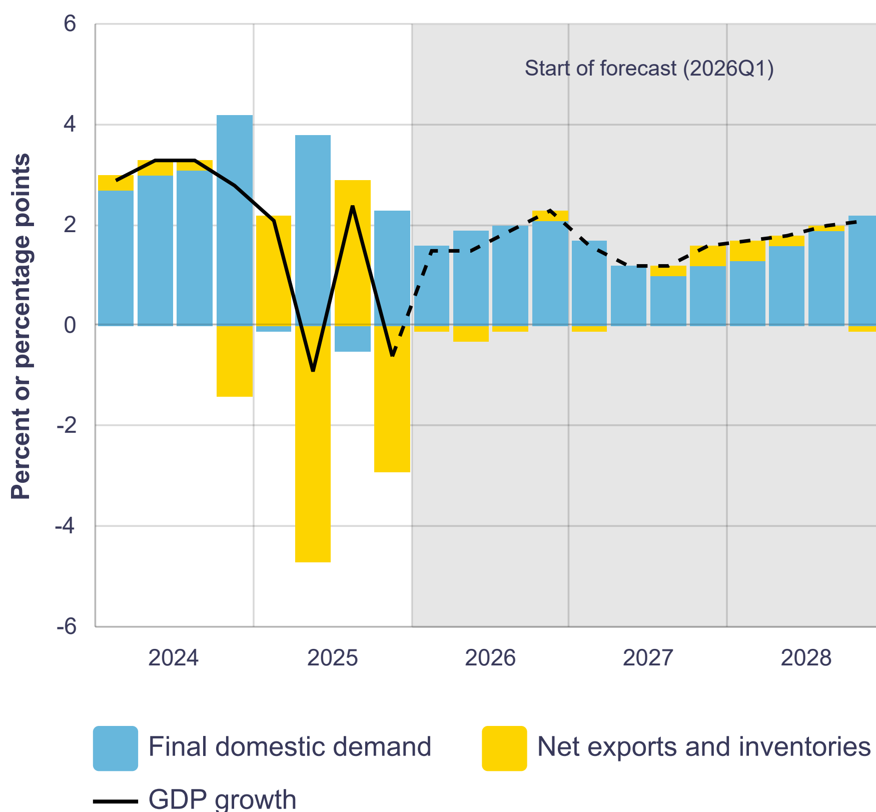
Economic outlook

Growth in gross domestic product (GDP) is expected to rise from 1.2% in 2026 to 1.6% in 2027 and 1.7% in 2028 (**Chart 15**). With GDP growth somewhat stronger than potential output growth, excess supply is gradually absorbed. The outlook assumes that prices for Brent oil gradually fall from around US$90 in the second quarter of 2026 to US$75 by mid-2027 and remain there, in line with the current futures curve (see the **Tariff and other assumptions** section).

This Report also presents an illustrative scenario with persistently higher oil prices to show the potential impact on the Canadian economy (see **In focus: The war in the Middle East—Transmission channels and risks to inflation**).

Chart 15: GDP growth is projected to outpace potential output growth and gradually absorb excess supply

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: 2028Q4

Export growth is expected to resume

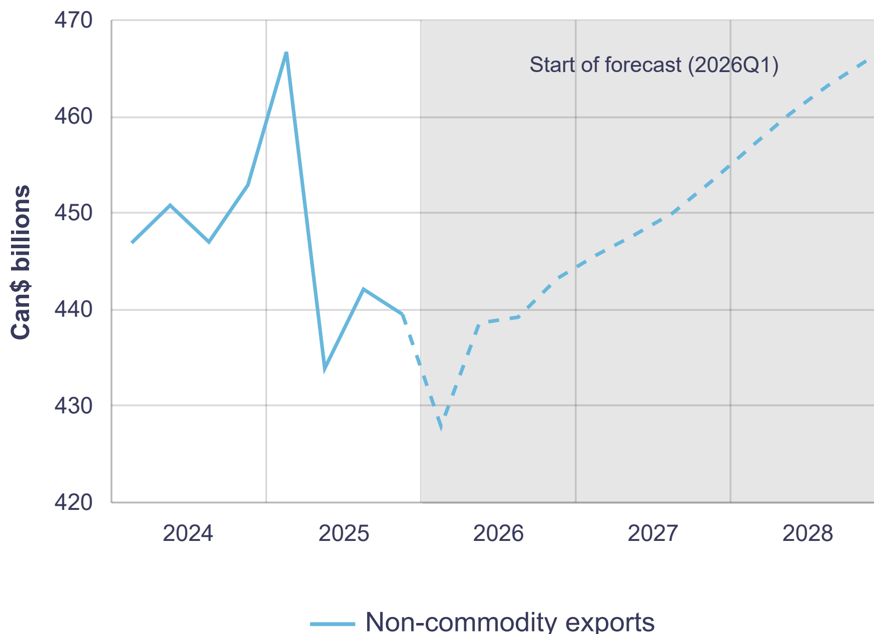
Exports are forecast to expand at a modest pace over the projection horizon, although they remain on a lower trajectory than before US tariffs were imposed. Growth in non-energy commodity exports is projected to rise slowly. Oil exports will pick up, though the effect is limited because the surge in oil prices is assumed to be mostly temporary.

Non-commodity exports are expected to rebound as businesses continue to adjust gradually to the new trade environment (**Chart 16**). Results from the Bank of Canada's latest Business Outlook Survey show that, relative to recent quarters, fewer exporters reported they are hesitant to enter the US market. As well, a smaller number of exporters said that US customers are uncomfortable sourcing from Canadian suppliers. The Canadian dollar has remained broadly flat since the start of the war, whereas in the past it tended to appreciate when oil prices rose. A largely unchanged Canadian dollar has helped preserve the competitiveness of non-commodity exports and has also meant that higher oil prices are felt more directly by consumers.[1]

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

Chart 16: Non-commodity exports are expected to increase over the projection horizon, although on 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: 2028Q4

Investment growth is expected to strengthen

As businesses continue to adapt to the new trade environment, investment is expected to recover. Respondents to a recent Business Outlook Survey pointed to improved investment intentions based on anticipated strength in domestic demand. Targeted federal government programs are also providing support.[2] In addition, government spending on infrastructure is projected to rise.

On balance, the war in the Middle East is anticipated to mildly boost growth in investment in the oil sector. However, this is assumed to be largely temporary because oil prices are projected to fall back toward US$75 by mid-2027.[3]

Consumption expands modestly

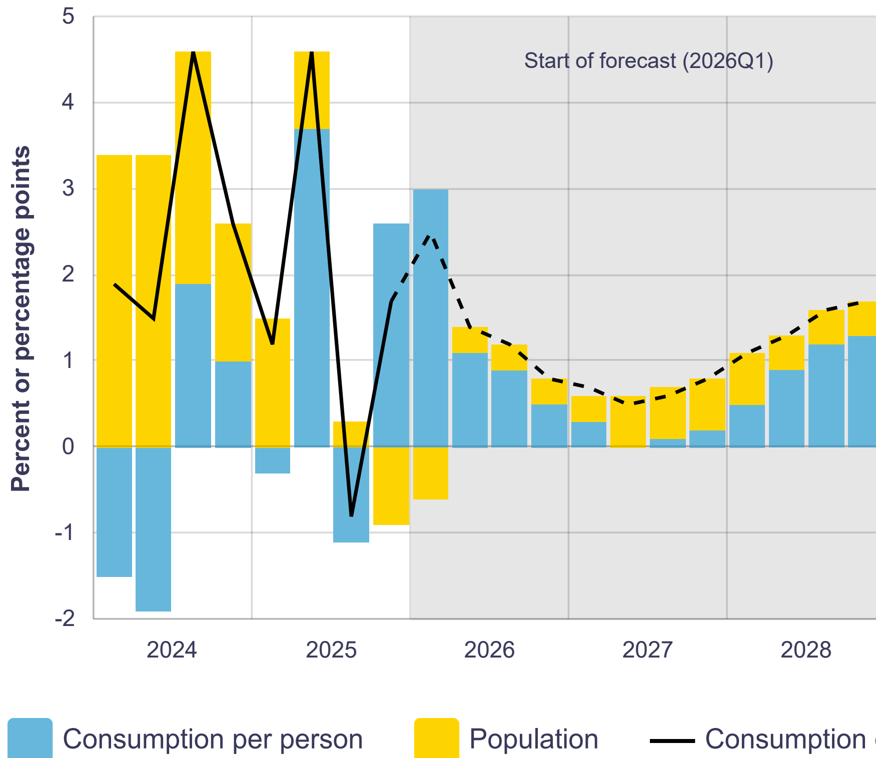
With population growth remaining subdued, consumption growth is forecast to average just above 1% over the projection horizon (**Chart 17**).

Growth in consumption per person will moderate through mid-2027. Higher gasoline prices from the conflict in the Middle East erode consumer purchasing power. However, recent federal measures (e.g., the Canada Groceries and Essentials Benefit and the temporary suspension of the fuel excise tax) provide near-term support. Consumption growth later slows due to the impact of recent declines in house prices on housing wealth.

Throughout the projection, improved terms of trade from higher oil prices are expected to increase wealth, which supports consumption. Per-person consumption is also supported by rising real wages, reflecting productivity gains.

Chart 17: Consumption growth is expected to average just above 1% over the projection horizon

Contribution to consumption growth, annualized, quarterly data



Consumption per person | Population | Consumption growth

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: 2028Q4

Housing activity remains subdued

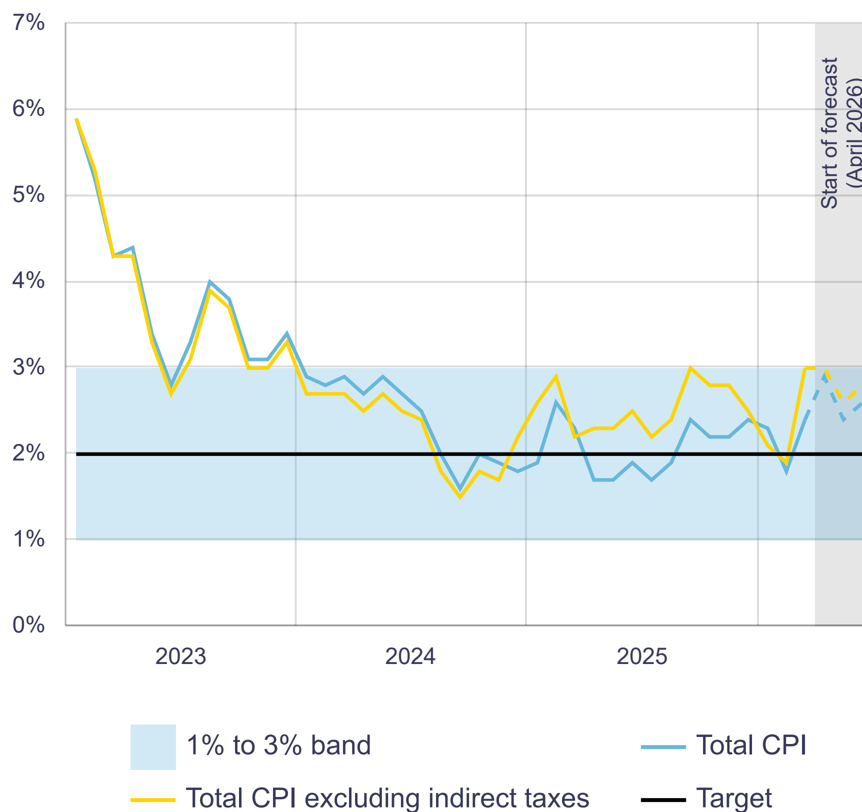
Residential investment is expected to be subdued over the projection horizon. Housing demand is forecast to grow modestly because of slow population growth and weak investor interest. Affordability challenges are also anticipated to continue to weigh on activity. In addition, a substantial inventory overhang of small condominiums in some major centres will restrain new construction.

Inflation outlook

In the base-case projection, total consumer price index (CPI) inflation peaks at roughly 3% in April, driven by higher fuel prices and the end of the base-year effect from the removal of the consumer carbon tax (**Chart 18**). Because the Canadian dollar has remained mostly flat since the start of the war, higher oil prices are putting more upward pressure on CPI inflation than in the past.

Chart 18: CPI inflation rose in March and is expected to be above target, driven by higher gasoline prices

Year-over-year percentage change, monthly data



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

Inflation is projected to ease slightly in May, partly due to the temporary suspension of the federal fuel excise tax.[4] If oil prices decline as assumed in the base-case projection, inflation is expected to slow to 2½% in June and then return to the 2% target in early 2027. Other factors provide additional downward pressure (**Chart 19**). These include:

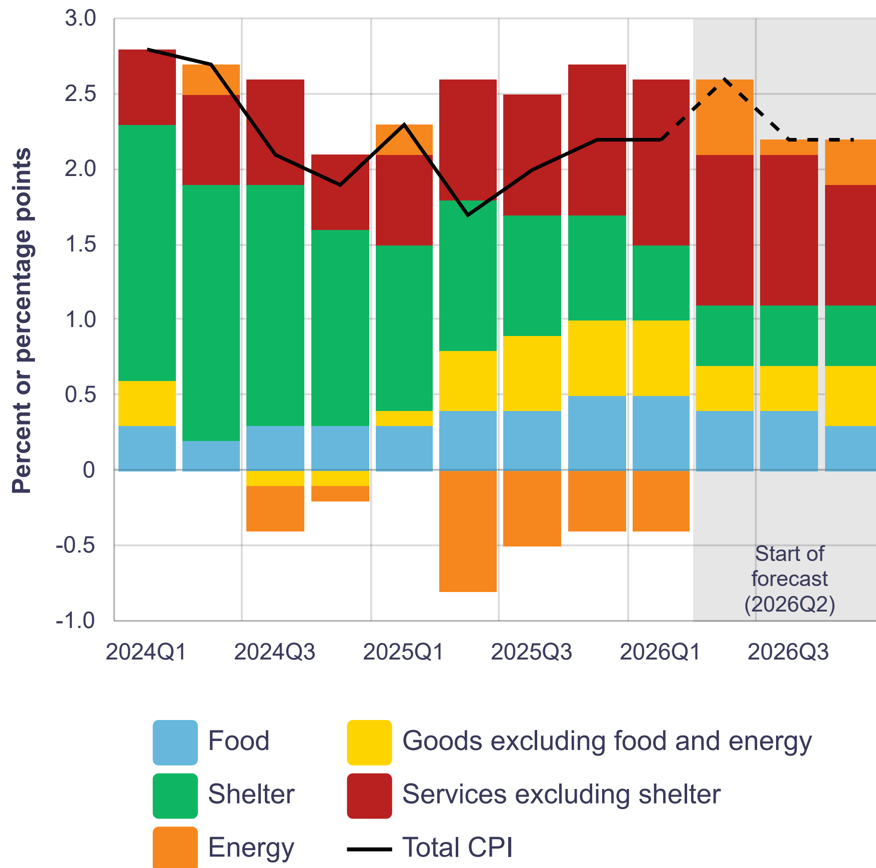
- Inflation slows in prices for services excluding shelter and for goods excluding food and energy as excess supply keeps growth in unit labour costs contained.

However, the restructuring of global trade and the rise in energy costs are expected to keep non-labour cost pressures elevated.

- Rent inflation continues to moderate as housing supply increases while population growth remains modest.
- While food inflation is projected to ease slightly, high prices of fuel and fertilizer are expected to keep cost pressures elevated over 2026.

Chart 19: CPI inflation is expected to peak in the second quarter and then begin to decline

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

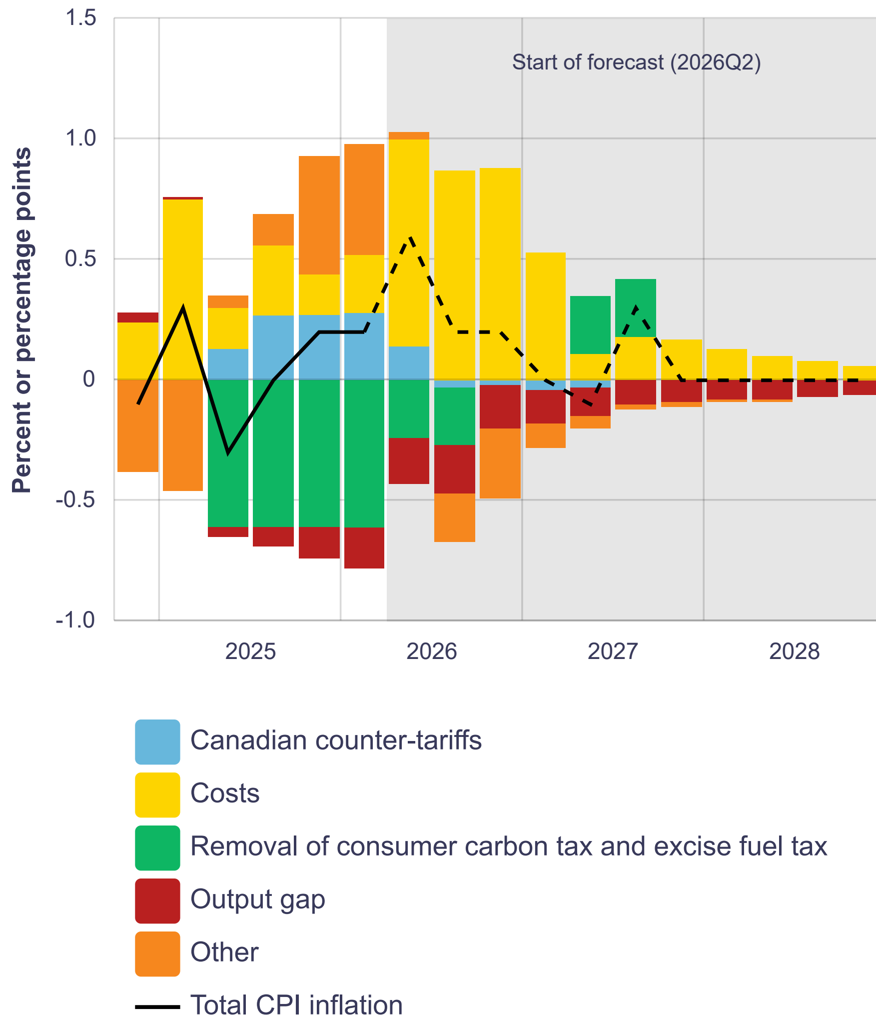


Sources: Statistics Canada and Bank of Canada calculations, estimates and projections
Last data plotted: 2026Q4

The rise in oil prices will boost costs for producers of other goods and services. However, businesses report that weak demand will likely limit their ability to pass through these higher costs. Most of the pass-through will occur over 2026 and is expected to boost CPI inflation by 0.3 percentage points (**Chart 20**).

Chart 20: Oil prices will create upward cost pressures into 2027

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



Note: *Costs* includes, for example, commodity 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: 2028Q4

Inflation is then projected to remain around 2% over 2027 and 2028. Upward pressures on inflation include higher input costs as Canadian businesses shift their supply chains away from the United States and import more goods directly into Canada. Downward pressures come from excess supply caused by US tariffs that softened demand for Canadian exports.

Endnotes

1. Before 2015, the value of the Canadian dollar rose when oil prices strengthened. However, since then, oil-related investment has weakened when oil prices have risen because of improved capital efficiency, regulatory challenges and the perception that oil prices would remain low. Reduced capital spending, in turn, has lessened the need for Canadian dollars, weakening the exchange rate relationship.[←]

2. Programs include the Trade Diversification Corridors Fund and the Strategic Response Fund. [←]

3. In addition, oil extraction has become more efficient over the past decade, requiring less capital for each additional barrel of oil produced.[←]

4. This policy took effect on April 20, 2026. Because its implementation was late in the month, the policy's full impact on the CPI does not become evident until May.[←]

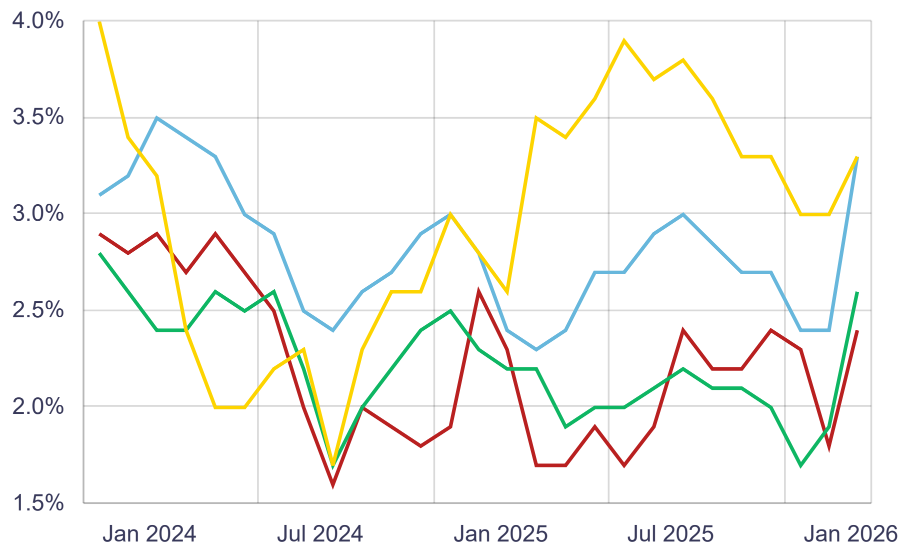
Global economy

The war in the Middle East has driven up inflation worldwide and is weighing on global growth. Uncertainty has risen markedly. US trade policy continues to reshape global trade.

In most economies, inflation is expected to peak in the near term and then gradually ease as energy prices are assumed to decline (**Chart 21**). In the base-case projection, global growth is expected to be steady at around 3%. Robust investment in artificial intelligence (AI) and fiscal measures in several major economies continue to support growth.

Chart 21: With disruptions in global energy markets, inflation is rising

Total consumer price 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 index for Canada, the United Kingdom and the United States.
Sources: Statistics Canada, US Bureau of Economic Analysis, Eurostat and Office for National Statistics (United Kingdom) via Haver Analytics and Bank of Canada calculations
Last observation: March 2026

The war in the Middle East is clouding the outlook. Higher oil prices are weighing on global growth. In particular, regions that import oil, such as Asia and the euro area, will be most adversely affected. If disruptions to the supply of oil and liquefied natural gas persist, shortages may emerge that would severely restrict economic activity in these regions. For example, some countries are already rationing jet fuel and other petroleum products. Meanwhile, US trade policy, which remains unpredictable, continues to reshape trade around the world and weigh on global growth.

United States

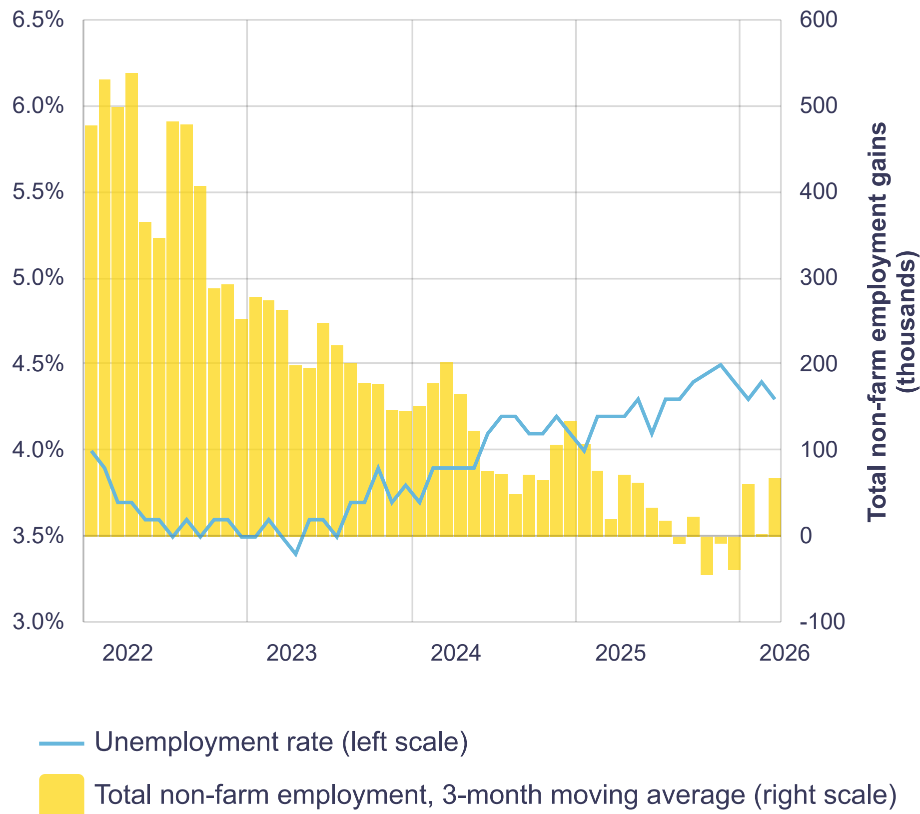
The US economy is projected to grow at a solid pace, supported by strong investment in AI and growth in consumption. The surge in oil prices is pushing up inflation and is expected to have a small negative effect on growth.

Economic activity remains strong despite slow job growth

Growth in gross domestic product (GDP) is estimated to have rebounded to 2.3% in the first quarter of 2026, up from 0.5% in the fourth quarter of 2025 when the shutdown of the federal government suppressed activity. AI-related investment continues to boost GDP growth. Consumption growth is anticipated to have moderated, with higher gasoline prices, a softer labour market and past tariff hikes squeezing real incomes (**Chart 22**).

Chart 22: US employment growth has slowed

Labour market indicators, monthly data



Note: *Total non-farm employment* is the 3-month moving average gains or losses per month in thousands.
Sources: US Bureau of Labor Statistics via Haver Analytics and Bank of Canada calculations
Last observation: March 2026

GDP growth is expected to average about 2¼% over the projection horizon. Consumption growth is forecast to be solid, reflecting income gains due to strong productivity growth. Robust investment in AI will support economic activity. Higher oil prices are expected to have a small negative impact on GDP growth, as real household income falls and investment in the oil sector does not increase in response to a significant but temporary rise in oil prices. Tariffs and elevated uncertainty about economic policy also continue to weigh on activity. The duration of the war in the Middle East and its effects on economic activity remain uncertain, with risks leaning toward weaker GDP growth.

The rise in oil prices is driving up inflation

US personal consumption expenditure inflation was 2.8% in February, partly driven by past increases in tariffs. The rise in oil prices will push inflation higher to reach a peak of roughly 3½% in April. Inflation is then projected to slow due to the assumed decline in oil prices and the fading effect of past tariff increases. With a balanced labour market and moderate growth in labour costs throughout the projection horizon, inflation is expected to ease through 2027 and 2028.

Euro area

GDP growth in the euro area is forecast to average about 1% over the projection horizon. Given the euro area's high reliance on imported energy, the surge in energy prices is anticipated to restrain growth. US tariffs and competition from China will hamper exports. Domestic demand will be supported by government spending on defence and infrastructure, alongside strong growth in digital services.

Inflation is forecast to peak at just over 3% in May, driven by higher energy costs. Inflation slows thereafter, consistent with the assumed decline in global prices for oil and natural gas.

China

China's strong growth at the end of 2025 is expected to continue into the first half of 2026 and reach 4¾% for the year. Robust exports to emerging markets in Asia and to other non-US markets are supporting this growth. In contrast, growth in domestic demand is anticipated to remain modest, weighed down by weakness in the property sector. Higher oil prices also weigh on activity, though government controls on fuel prices, supported by China's large oil reserves, should help mitigate the impact of higher energy costs.

Over the medium term, GDP growth is projected to be around 4¼% in 2027 and 2028. Export growth is expected to slow as gains in competitiveness level off, while the pace of domestic demand improves due to fiscal support and a stabilization in the housing market.

Projections

The outlook for Canadian economic growth in 2026 and 2027 is evolving generally as anticipated. Inflation is expected to increase in 2026 due to higher gasoline prices caused by the war in the Middle East. It will then ease in 2027 as oil prices are assumed to moderate.

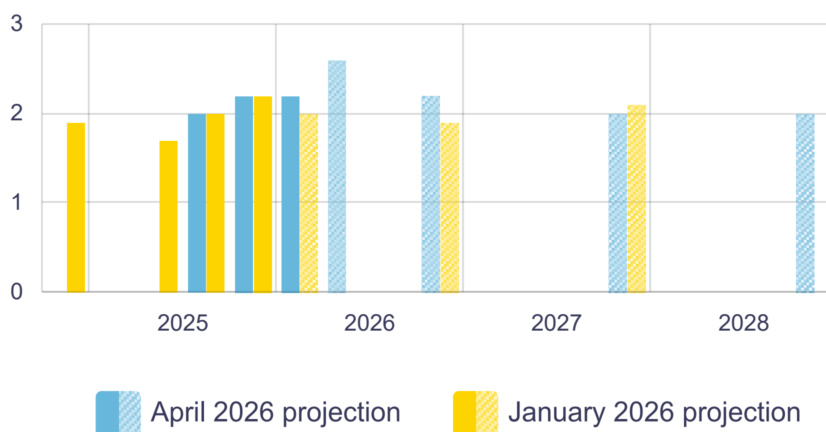
Changes to the projection

Canadian outlook

Projections for growth in gross domestic product (GDP) for 2026 and 2027 are broadly in line with those in the January Report (**Chart 23**). Overall, the impact of higher global oil prices on economic activity is small. Growth in government spending has been revised up, largely due to increased provincial investment outlined in 2026 budgets. Residential investment is revised down, reflecting ongoing affordability challenges for homebuyers.

Chart 23: The April 2026 and January 2026 Monetary Policy Report outlooks

CPI inflation (year-over-year percentage change)



April 2026 projection January 2026 projection

Consumer price index (CPI) inflation is projected to be about 0.3 percentage points higher in 2026 than anticipated in the January Report. The increase is mainly due to higher energy prices resulting from the war in the Middle East, with the temporary suspension of the federal fuel excise tax providing a partial offset. Inflation is then expected to remain roughly in line with the January Report (**Table 2** and **Table 3**).

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

	2025	2026	2027	2028
Consumption	1.2 (1.2)	0.8 (0.7)	0.5 (0.6)	0.6
Housing	0.1 (0.1)	-0.1 (0.2)	0.1 (0.2)	0.2
Government	0.8 (0.6)	0.9 (0.7)	0.7 (0.6)	0.4
Business fixed investment	0.0 (0.0)	0.1 (0.1)	0.3 (0.3)	0.3
Subtotal: final domestic demand	2.1 (1.9)	1.7 (1.7)	1.6 (1.7)	1.5
Exports	-0.5 (-0.9)	-0.2 (-0.1)	0.8 (0.7)	0.9
Imports	0.2 (0.2)	-0.3 (-0.1)	-0.7 (-0.8)	-0.7
Inventories	0.0 (0.5)	0.0 (-0.4)	-0.1 (-0.1)	0.0
GDP	1.7 (1.7)	1.2 (1.1)	1.6 (1.5)	1.7
Memo items (percentage change):				
Range for potential output	2.3 (1.9–2.7)	0.8–1.6 (0.6–1.6)	0.8–1.8 (0.7–1.7)	1.0–2.0
CPI inflation	2.1 (2.1)	2.3 (2.0)	2.1 (2.1)	2.0

* Numbers in parentheses are from the January Report.
† Numbers may not add to total 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	2025	2026	2027	2028
	Q3	**Q4**	**Q1**	**Q2**	**Q4**	**Q4**	**Q4**	**Q4**
CPI inflation (year-over-year percentage change)	2.0 (2.0)	2.2 (2.2)	2.2 (2.0)	2.6	2.2 (2.2)	2.2 (1.9)	2.0 (2.1)	2.0
Core inflation† (year-over-year percentage change)	3.1 (3.1)	2.8 (2.9)	2.4 (2.5)	2.1	2.8 (2.9)	2.0 (2.1)	2.2 (2.1)	2.0
Real GDP (year-over-year percentage change)	1.6 (1.4)	0.7 (0.7)	0.6 (0.6)	1.2	0.7 (0.7)	1.8 (1.4)	1.4 (1.7)	1.9
Real GDP (quarter-over-quarter percentage change at annual rates)‡	2.4 (2.6)	-0.6 (0.0)	1.5 (1.8)	1.5				

* See details in the **Tariff and other assumptions** section. Numbers in parentheses are from the January Report.
† Core inflation is the average of CPI-trim and CPI-median.
‡ At the time of the projection, 2026Q1 and 2026Q2 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 weaker in the near term than it was in the January Report (**Table 4**) because of the war in the Middle East. The medium-term outlook remains broadly unchanged.

- The surge in energy prices is leading to softer growth than projected in January for most regions. The downward revision is more significant for economies that import oil and liquefied natural gas.
- This is partially offset by an upward revision to potential output growth across all regions, driven largely by the growing adoption of artificial intelligence (see **Appendix: Potential output and the nominal neutral rate of interest**).
- The global average US tariff rate has been revised down by 3.2 percentage points since the January Report but remains 9.3 percentage points higher than in the January 2025 Report (see the **Tariff and other assumptions** section). This change has a small positive effect on global growth.

Inflation is revised up in most regions in the short term due to the recent rise in energy prices.

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

	Share of global GDP* (%)	Growth (%)			
		2025	2026	2027	2028
United States	15	2.1 (2.2)	2.4 (2.6)	2.3 (2.1)	2.3
Euro area	12	1.5 (1.5)	0.9 (1.2)	1.1 (1.4)	1.3
China	19	5.0 (5.0)	4.7 (4.5)	4.2 (4.2)	4.2
World	100	3.5 (3.5)	3.0 (3.2)	3.0 (3.0)	3.2

* Shares of 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 January Report.
Sources: National sources via Haver Analytics and Bank of Canada calculations, estimates and projections

Risks

The risks around inflation are unusually high. The main risk is associated with trade relations with the United States. The war in the Middle East presents a new risk.

Uncertainty is unusually elevated around US trade policy and the war in the Middle East. The base-case projection assumes that current trade policies remain in place and that conditions in major shipping routes normalize and global oil prices decline in the second half of the year.

In both cases—US trade policy and the war—there are two layers of uncertainty: how events evolve and how these shocks transmit through the economy as businesses, households and governments adjust. The outlook for inflation hinges on how these uncertainties resolve.

Main upside risks to inflation

The war in the Middle East could stoke inflation further

A more prolonged or more severe war could further disrupt energy markets and global supply chains, leading to broadening and more persistent price pressures. Higher energy prices would raise production and transportation costs globally and could be passed through to consumer prices more than assumed in the base-case projection (see **In focus: The war in the Middle East—Transmission channels and risks to inflation**).

Supply chain disruptions could also be more extensive. Disruptions to shipping routes and to the supply of fertilizers and other chemical products could place more upward pressure on prices of food and other non-energy goods.

For Canada, persistently higher global oil prices would boost activity, particularly related to investment in the oil and gas sector. In the base-case projection, longer-term inflation expectations remain well anchored. However, higher inflation in gasoline and food prices could push up expectations more than assumed. This is because households tend to place greater weight on these frequently purchased items when forming views about overall inflation. With the 2022 inflation surge still fresh in people's minds, households and businesses may also be more attentive to near-term price increases. This raises the risk that higher expectations feed into wage- and price-setting behaviours. This risk increases if war-related price pressures turn out to be more persistent or more severe than anticipated.

Restructuring is more costly

The economy is adjusting to the impact of US tariffs. Businesses are seeking new markets and diversifying their supply chains. Over the projection horizon, capital and labour are expected to move to sectors of the economy not affected by tariffs.

Assessing the cost of this adjustment is challenging. 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

CUSMA outcome is worse than assumed

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

However, a worse outcome could take one of several possible paths, each with different implications for the outlook (see **In focus: The review of the Canada-United States-Mexico Agreement** in the January Report). The parties could extend the agreement but only after significant negotiations and amendments to the agreement, which could potentially further limit access to the US market. Alternatively, the parties may not extend the agreement, leading to ongoing annual reviews that prolong uncertainty. Another possible, more adverse outcome would be a US withdrawal from CUSMA.

Depending on the result of the review, these main effects could come through:

- reduced access to US markets, which would weigh on exports, investment and activity
- heightened uncertainty that could depress business and household confidence and delay spending and hiring

On balance, the outcome of the CUSMA review is assessed as a downside risk for economic growth and inflation.

Trade restrictions weigh on demand more than expected

The economy is adjusting to the impacts of US tariffs. However, the effects on demand are hard to assess. Business confidence could be affected more than expected, leading to greater weakness in business investment and hiring. As well, fears of job loss could make households more cautious, leading to lower spending and exacerbating weakness in the housing market. Weakness in demand would lead to lower inflation.

The war could weigh more heavily on global growth

The war in the Middle East could weaken global economic growth by more than assumed in the base-case projection, reducing demand for Canadian exports. Increased geopolitical risks and higher energy prices could lead to a substantial tightening in financial conditions, and more persistent uncertainty could weigh on household and business confidence. This would dampen spending and business investment and hiring, particularly in energy-importing economies. Softer demand for Canadian goods and services would increase excess supply in the Canadian economy and put downward pressure on inflation.

The war in the Middle East—Transmission channels and risks to inflation

The war in the Middle East is affecting the Canadian economy in several ways. Inflation will be higher in the near term, but the magnitude and persistence of the increase is uncertain. The net impact on growth is expected to be small.

The war in the Middle East is affecting the Canadian economy primarily through higher energy prices. As a net exporter of energy, Canada is expected to fare much better than countries that are heavily dependent on imported energy. The extent of the benefits to Canada will depend on how long energy prices remain elevated. In the base-case projection, prices decline fairly quickly from recent highs, so the impact on gross domestic product (GDP) is small. Persistently high energy prices would tilt the balance toward somewhat stronger economic activity in Canada. Higher prices for energy and agricultural products are expected to raise consumer price index (CPI) inflation in the near term and increase the risk that inflation persists above target.

Canada's economy is affected through several transmission channels

Real GDP

As a net energy exporter, Canada has historically seen stronger economic growth associated with elevated energy prices, particularly when they have risen for an extended period due to robust global demand. In such episodes, improved terms of trade have raised profits in the energy sector, supporting higher consumption, business investment and government revenues. The Canadian dollar has also tended to appreciate.

However, in the base-case projection, the positive impact on growth is expected to be small. The recent increase in oil prices reflects a disruption in the global supply of oil rather than stronger aggregate demand, so non-energy exports do not increase. In addition, greater foreign ownership of shares in oil and gas companies in Canada means that less of the additional profits now accrue domestically. As a result, the positive impacts on employment, consumption and investment are likely to be more muted than in the past.

Higher prices for energy and food will reduce households' purchasing power, and some consumers will have to cut back on spending in other areas.

For the energy sector, the assumed temporary nature of the increase in oil prices and a shift toward higher dividend payments are expected to limit the near-term boost to investment. Improvements to capital efficiency also allow businesses to expand output with less additional investment than in the past. Several factors will likely limit the appreciation of the Canadian dollar, including:

- expectations that the oil price increase will be short-lived
- larger dividend outflows
- a more muted increase to foreign direct investment
- safe-haven effects associated with the war

Overall, the boost to activity in the energy sector and the drag on household spending from higher consumer prices largely offset each other.

Inflation

In the base-case projection, year-over-year CPI inflation temporarily rises to 2.6% in the second quarter and then declines over the remainder of 2026 as oil prices are assumed to moderate. The near-term increase primarily reflects higher oil prices pushing up the costs of gasoline, other transportation and food. Core inflation in 2027 is also modestly higher.

An illustrative scenario with persistently higher energy prices

Considerable uncertainty still exists about the duration of the conflict and its impact on energy prices and global growth. In particular, the base-case outlook for inflation in the second half of 2026 and in 2027 is highly conditional on the assumption that oil prices begin to normalize relatively quickly. The impacts on production and transportation costs and on economic activity in Canada are also highly uncertain and will depend on how business pricing behaviour and household spending respond.

If the conflict intensifies or proves more prolonged than anticipated, CPI inflation could rise higher and remain elevated for longer, despite weaker global growth and lower demand for Canada’s non-energy exports. Such a situation would increase the likelihood of significant cost pressures coming from shipping disruptions, higher freight and insurance costs, and shortages of critical imported intermediate inputs such as semiconductors. Pass-through of cost pressures into a broader set of goods and services prices could also increase. In this situation, safe-haven flows would likely limit the appreciation of the Canadian dollar against the US dollar, reducing the offset to rising cost pressures. This implies that the base-case assumption for the Can$/US$ exchange rate is carried into the illustrative scenario.

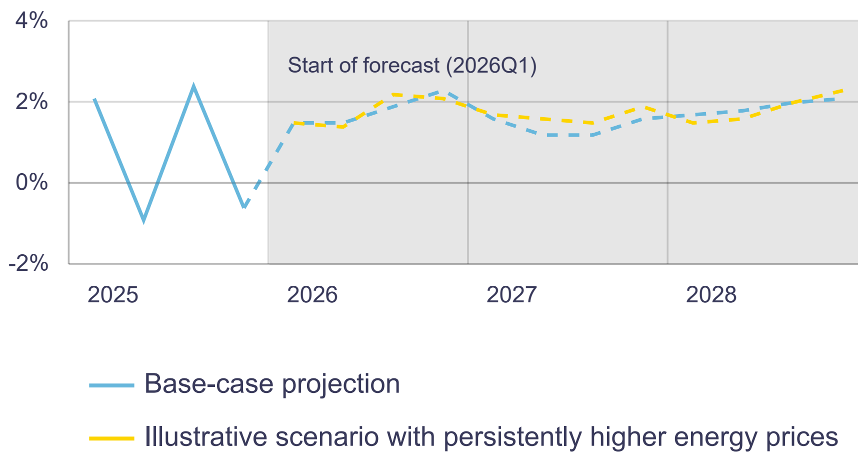
To roughly illustrate the responses of output and inflation to such a situation, this section presents a scenario in which oil prices are at US$100 per barrel for the entire projection horizon and beyond. With a persistent rise in oil prices, government revenues are higher than in the base-case projection. Half of the additional government revenue associated with royalties from the energy sector and taxes is assumed to be transferred back to Canadian households. The pass-through of costs to prices is larger and occurs over a longer period than in the base-case projection.

In this scenario, Canadian GDP growth is little changed in the near term compared with the base-case projection because it takes time for higher energy prices to translate into increased activity (**Chart 24**). In 2027 and 2028, larger government transfers to households, combined with stronger business investment and energy exports, push GDP growth slightly above the level in the base-case projection.

Chart 24: In an illustrative scenario, GDP growth is stronger over the medium term, reflecting increased domestic demand and energy exports

Quarterly data

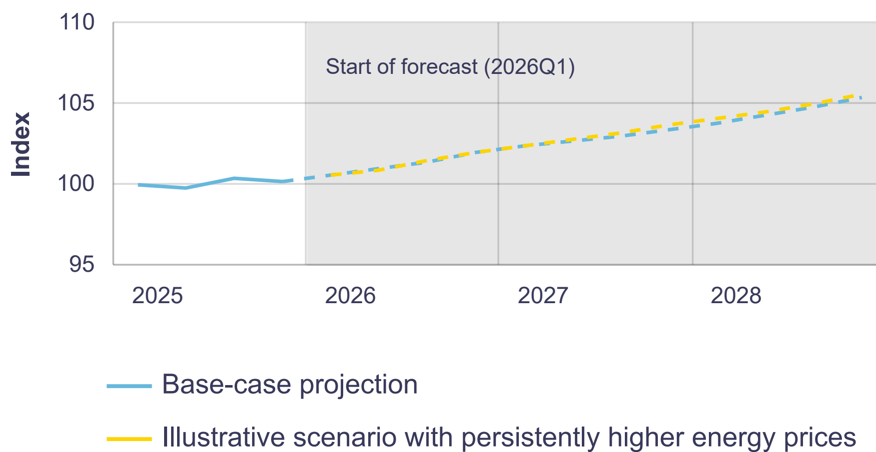
a. Quarter-over-quarter percentage change of GDP at annual rates



Base-case projection

Illustrative scenario with persistently higher energy prices

b. Level of GDP, index: 2025Q1 = 100



Base-case projection

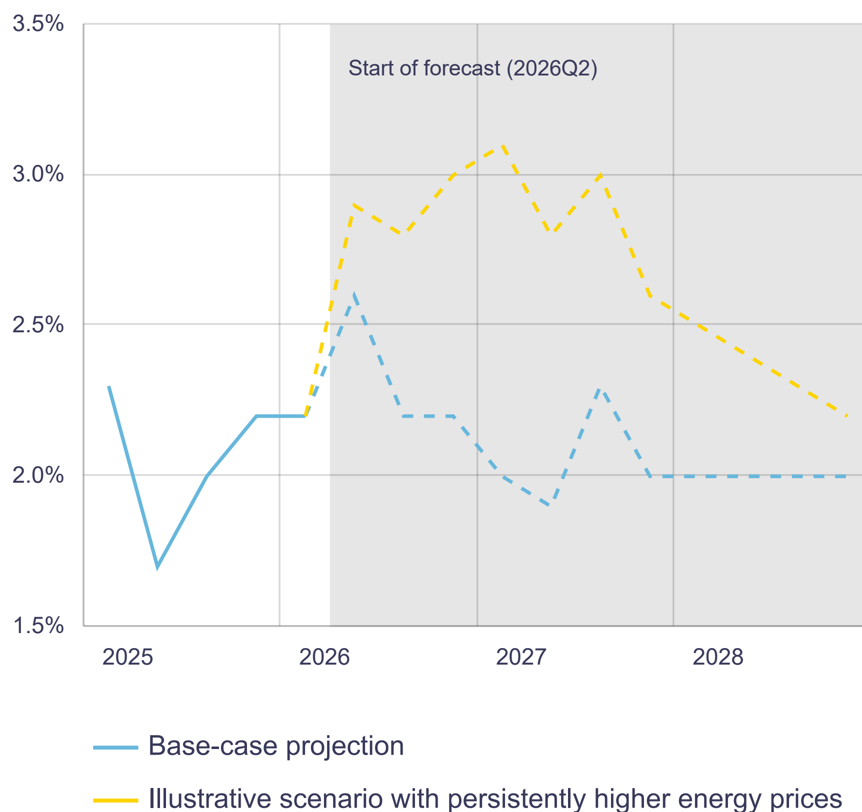
Illustrative scenario with persistently higher energy prices

Note: The Bank of Canada developed an illustrative scenario in which oil prices remain at US$100 per barrel beyond the projection horizon.
Sources: Statistics Canada and Bank of Canada calculations, estimates and projections
Last data plotted: 2028Q4

In the first year of the scenario, inflation pressures are higher than in the base-case projection mostly because of the direct impact of higher oil prices on gasoline and food prices. Inflation peaks at 3.1% in the first quarter of 2027 and is close to 3% for more than a year (**Chart 25**). This is both higher and substantially more persistent than in the base-case projection. Cost pressures gradually broaden, reflecting increased domestic distribution costs and higher prices for imported intermediate goods. As a result, year-over-year inflation remains elevated well beyond the first year of the scenario, reflecting persistently greater inflation pressures outside of food and energy. Importantly, long-term inflation expectations in Canada remain well anchored near 2%. Nevertheless, tighter monetary policy is required, resulting in consecutive increases to the policy interest rate. Higher interest rates significantly limit the increase to GDP and bring inflation back to the 2% target.

Chart 25: In an illustrative scenario, inflation pressures broaden beyond energy and food

Year-over-year percentage change, quarterly data



Base-case projection

Illustrative scenario with persistently higher energy prices

Note: The Bank of Canada developed an illustrative scenario in which oil prices remain at US$100 per barrel beyond the projection horizon.

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

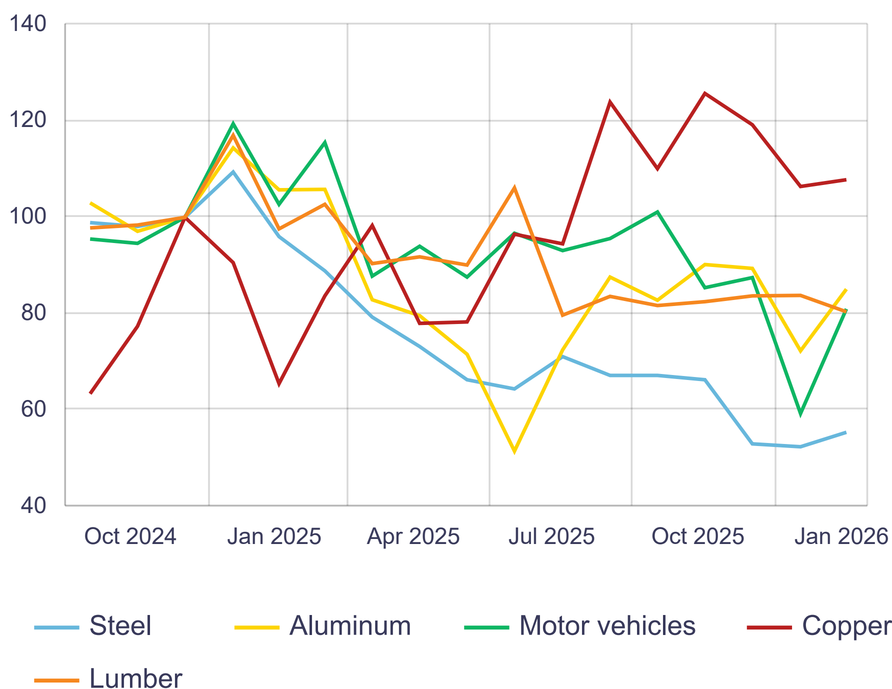
One year later—Assessing the impact of US trade restrictions on Canadian industries

Sector-specific trade restrictions are adversely affecting the Canadian economy. Steel and lumber exports have declined significantly, while others have held up better in comparison. Overall, declines in exports have been less severe than expected, reflecting both business adaptability and government policy actions.

Several Canadian industries have seen steep increases in US tariffs over the past 12 months. Overall, industries facing sectoral tariffs account for about 1% of Canadian output and employment and roughly 15% of Canada's exports.[1] The latest data show that exports in the aluminum, steel, lumber and motor vehicle sectors have declined since tariffs were implemented (**Chart 26**).

Chart 26: Exports in the steel sector have declined more than exports in other sectors since US tariffs were imposed

Level of exports, index: December 2024 = 100, monthly data



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

The steel industry has been hit hard

Most Canadian exports of steel to the United States face a steep tariff of 50%, while derivatives made of steel products are subject to a 25% tariff. As a result, steel exports have fallen by half. Production and employment have also declined, but not by as much. This is partly because government measures—such as the Buy Canadian Policy, counter-tariffs on the United States and tighter import quotas—are helping support domestic production. Consequently, inventory data show little evidence of widespread stockpiling. Industry consultations, however, point to a risk of further declines in exports as some contracts expire in 2026.

Softwood lumber exports continue to decline

Canadian lumber production has been on a multi-year downward trend, partly caused by long-lasting trade disputes that predate recent tariffs. US tariffs on the industry increased in October 2025. By February 2026, lumber exports were roughly 20% below 2024 averages. Employment levels in the industry continue to decrease roughly in line with the fall in production levels. Inventories are steady, suggesting no evidence of widespread stockpiling that could lead to the need for future production cuts.

After a sharp decline, aluminum exports have picked up

Canadian aluminum producers currently face a 50% tariff on sales to the United States—their main export market. In addition, derivatives made substantially of aluminum face a 25% tariff. Exports fell sharply after tariffs were introduced, and by July 2025 they were 50% below 2024 levels. Producers adapted by redirecting sales to Europe but at lower profit margins. After aluminum inventories in the United States were depleted, Canadian exports rebounded, regaining over half of their initial losses.

Results from industry consultations suggest that demand for Canadian aluminum will pick up further due to disruptions to production in the Middle East. Consultations also suggest that employment in aluminum production and processing has remained resilient. However, some layoffs have been observed among manufacturing firms further down the value chain, which are facing higher input costs for aluminum.

Copper exports have surged

In contrast, copper exports to the United States are 40% above their 2024 average. Despite facing a 50% tariff on certain types of products, producers have adapted by instead increasing exports of products that are not tariffed.

Motor vehicle exports are holding steady

The motor vehicle manufacturing sector is currently subject to a complex set of US tariffs. Motor vehicles that are compliant with the Canada-United States-Mexico Agreement (CUSMA) face a 25% tariff on their content produced outside the United States.

Exports are slightly below their 2024 levels. This partly reflects the impact of federal policies that offset some of the tariff burden for businesses meeting domestic production commitments. Production, on average, has been generally in line with exports, while employment has remained more stable over this period.

Risks remain

Overall, industries affected by sectoral tariffs have seen declines in production and employment that track those in exports. There are no signs of rapid inventory accumulation. If inventories were to start building, this could indicate that current production levels are too high and could signal the need for cuts to output and employment.

The trade environment could change once again. Industry consultations suggest that businesses view the upcoming review of CUSMA as a risk. Many have said that diversifying trade away from the United States would be difficult due to barriers such as high transportation costs to more distant markets.

Endnotes

1. Tariff-affected output is calculated on a value-added basis, while tariff-affected exports are calculated on a gross value basis.[←]

Potential output and the nominal neutral rate of interest

US protectionism is expected to dampen labour productivity, while population growth remains subdued. Growth in Canadian potential output is expected to weaken in 2026. It then picks up in 2027 and 2028 as investment recovers and artificial intelligence improves productivity.

Despite a small downward revision to potential output growth over the projection horizon, the estimated level of Canadian potential output has been revised up.[1] This is largely due to an upward revision to trend labour productivity over history.[2] The estimate of the range of Canada's neutral rate is unchanged.[3]

Canadian potential output

Potential output is the highest sustainable level of economic activity while keeping inflation at the 2% target.

Growth in potential output is expected to average 1.2% in 2026 before picking up modestly to 1.3% in 2027 and 1.5% in 2028 (**Table A-1** and **Chart A-1**).

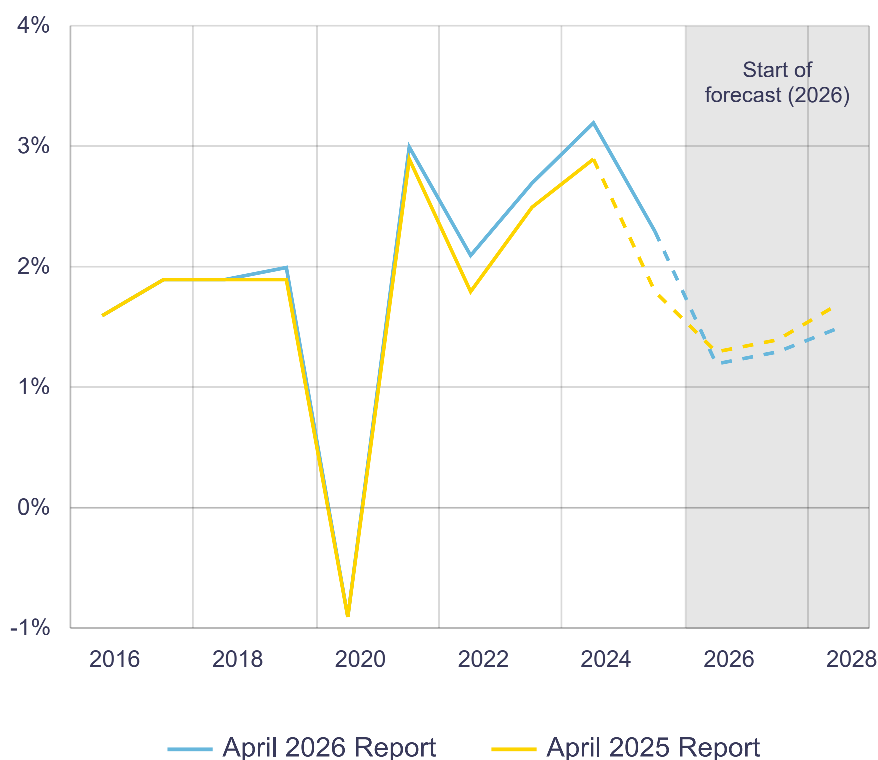
Table A-1: Canadian and global potential output growth over the projection
Estimated growth (%)

	Share of global GDP* (%)	**2025**	**2026**	**2027**	**2028**
Canada	1	2.3 (1.8)	1.2 (1.3)	1.3 (1.4)	1.5 (1.7)
United States	15	2.4 (2.4)	2.3 (2.3)	2.4 (2.2)	2.4 (2.2)
Euro area	12	1.1 (1.1)	1.2 (1.0)	1.2 (1.0)	1.2 (1.0)
China	19	4.5 (4.4)	4.3 (4.2)	4.3 (4.0)	4.2 (3.9)
World	100	3.2 (3.0)	3.1 (3.0)	3.1 (2.9)	3.1 (2.9)

* GDP shares 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*.
Note: Numbers in parentheses are based on **Scenario 1** in the April 2025 Report, which is treated as the control round. Scenario 1 incorporates the effects on investment from elevated trade policy uncertainty, tariff rates on steel and aluminum that are lower than current rates, and counter-tariffs. In contrast, Scenario 2 assumes that broad-based tariffs lead to substantially larger impacts on trend total factor productivity. Scenario 1 is the more suitable control scenario because the broad-based tariffs assumed in Scenario 2 did not materialize. For more details on the 2025 assessment, see S. Boulanger, R. Dastagir, D. de Munnik, E. Ekanayake, K. Mo, W. Muiruri, F. Noor, S. Obaid and L. Poirier, "**Assessing global potential output growth: April 2025**," Staff Analytical Note No. 2025-15 (June 2025).
Source: Bank of Canada calculations, estimates and projections

Chart A-1: Growth in Canadian potential output is expected to slow into 2026 and then pick up

Annual data



Note: Data presented for the *April 2025 Report* are based on Scenario 1 detailed in that Report.
Source: Bank of Canada calculations, estimates and projections
Last data plotted: 2028

Trend labour input is flat over the projection horizon, reflecting modest population growth and population aging. Population growth remains subdued due to low immigration targets and measures to reduce the number of non-permanent residents. Population aging results in a modest decline in the trend labour force participation rate.

Growth in trend labour productivity averages about 1.4% over the projection horizon. This reflects both capital deepening and technological progress, including the adoption of artificial intelligence (AI). AI is expected to boost annual growth in potential output by 0.2 percentage points on average over the projection horizon.

US tariffs are anticipated to weigh on trend productivity growth. Examples include:

- Workers and capital move from industries affected by tariffs to other sectors that are less productive, and workers can take time to adapt to their new job.
- Investment drops significantly in tariff-affected sectors.

Some of these impacts are expected to diminish over time as workers gain new skills and businesses develop new markets and new products. Overall, tariffs are projected to reduce the level of Canadian potential output from where it might have been had tariffs not been imposed. While some sectors are expected to contract, others are anticipated to expand in the long run.

Trend labour productivity could be either higher or lower than projected. On the one hand, businesses could adapt to the new trade environment more effectively or adopt AI faster than expected. On the other hand, labour market scarring could be deeper than anticipated.

The current level of potential output is above the estimated range from the April 2025 Report (**Table A-2**). Upward revisions to historical data for Canadian gross domestic product (GDP) and the capital stock, combined with an assumed positive impact from AI, suggest somewhat stronger trend labour productivity.

Table A-2: Comparison of Canadian potential output estimates relative to April 2025

	2025	**2026**	**2027**	**2028**
Annual growth	2.3 (1.8)	1.2 (1.3)	1.3 (1.4)	1.5 (1.7)
Trend labour input growth	1.3 (0.7)	-0.3 (0.2)	0.0 (0.2)	0.1 (0.6)
Trend labour productivity growth	1.0 (1.2)	1.5 (1.2)	1.3 (1.2)	1.5 (1.1)
Revisions to the level of potential output (percent)	1.4	1.3	1.2	1.0

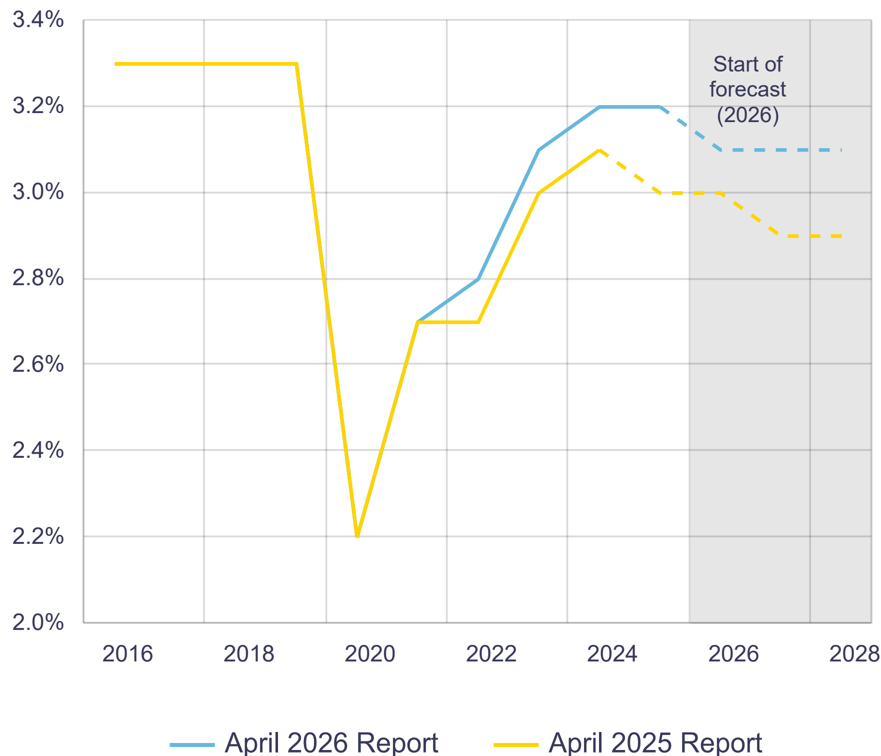
Note: Numbers in parentheses are based on **Scenario 1** in the April 2025 Report, which is treated as the control round. Scenario 1 incorporates the effects on investment from elevated trade policy uncertainty, tariff rates on steel and aluminum that are lower than the current rates, and counter-tariffs. In contrast, Scenario 2 assumes that broad-based tariffs lead to substantially larger impacts on trend total factor productivity. Scenario 1 is the more suitable control scenario because the broad-based tariffs assumed in Scenario 2 did not materialize. For more details on the 2025 assessment, see S. Abraham, D. Brouillette, A. Chernoff, C. Hajzler, S. Houle, M. Kim and T. Taskin, "**Potential output in Canada: 2025 assessment**," Bank of Canada Staff Analytical Note No. 2025-14 (June 2025).
Source: Bank of Canada calculations, estimates and projections

Global potential output

Growth in global potential output is expected to remain broadly stable over the projection horizon at just above 3% (**Chart A-2**). AI boosts productivity in advanced and developing economies, while the boom in AI investment provides additional support for growth in the United States. Population aging in major economies and high US tariffs remain important global headwinds.

Chart A-2: Global potential output growth is revised up

Annual data



April 2026 Report   April 2025 Report

Note: Data presented for the *April 2025 Report* are based on Scenario 1 detailed in that Report.
Source: Bank of Canada calculations, estimates and projections
Last data plotted: 2028

Global potential output growth has been revised up by about 0.2 percentage points per year over 2026–28 relative to Scenario 1 in the April 2025 Report (**Table A-1**). This is because the larger boost from AI more than offsets the drag from tariffs.

- In the United States, growth in potential output is steady at about 2.4%. AI-related capital deepening and broader adoption of the technology provide a lift. This is partially offset by a slowdown in trend labour input from stricter immigration

policies and an aging population. Higher US import tariffs are also anticipated to slightly slow productivity growth.

- In China, potential output growth is expected to ease gradually over the projection horizon. Trend productivity improves gradually, supported by AI adoption. Trend labour input continues to shrink as the population ages.
- In the euro area, growth in potential output is expected to remain close to 1.2% over the projection horizon. Expanding use of AI leads to increases in productivity growth. As in other major economies, the aging population partially offsets these gains.

The outlook for global potential output is subject to upside and downside risks. For example:

- Geopolitical conflicts, including the war in the Middle East, could lead to increased scarcity of energy and other production inputs.
- Potential output growth could rise if countries decide to invest more in the energy or defence sectors.

Neutral rate

The neutral rate is the rate at which the policy interest rate would settle in the long run once output is sustainably at its potential and inflation is at target, after the effects of all cyclical shocks have faded.

Given that Canada is a small open economy, its neutral rate is affected by the global neutral rate. The Bank of Canada uses the US neutral rate as a proxy for the global neutral rate. The US neutral rate is estimated to be within a range from 2.5% to 3.5%, somewhat higher than the 2.25% to 3.25% range presented in the April 2025 Report. The main reason for the upward revision is the boost to US productivity from AI investment and adoption. Gains are partially offset by a downward revision to population growth.

The Canadian nominal neutral rate is estimated to be within the range of 2.25% to 3.25%, unchanged from that in the April 2025 Report. Developments since the April 2025 Report are judged to be broadly offsetting.

- Upward pressures arise from two areas. First are spillovers associated with a higher US neutral rate. The second is a modest increase in growth in trend labour productivity due to upward revisions to the historical data of Canadian GDP and capital stock, as well as the assumed positive impact of AI adoption.
- Downward pressures stem from slower-than-expected population growth in the long term.

Risks to Canada’s neutral rate are judged to be broadly balanced. On the upside, US tariffs could reduce overall demand for Canadian assets in US capital markets, necessitating a higher neutral rate to attract alternative investors. On the downside, heightened trade uncertainty could increase precautionary savings among Canadian households and businesses, exerting downward pressure on the Canadian neutral rate.

Endnotes

1. For more details, see A. Chernoff, C. Hajzler, S. Houle, G. Ruggero, O. Senyuta, K. Sohal, W. Steingress and T. Taskin, “Potential output in Canada: 2026 assessment,” Bank of Canada Staff Analytical Paper (forthcoming).[←]

2. Actual gross domestic product was also revised up.[←]

3. For more details, see F. Alves, W. Beaudoin, H. Desgagnés, W. Dong, J. D. Schneider, A. Toktamyssov, E. Trostin and H. Twieling, “Assessing the US and Canadian neutral rates: 2026 update,” Bank of Canada Staff Analytical Paper (forthcoming).[←]