

Assessing the US and Canadian neutral rates: 2026 update

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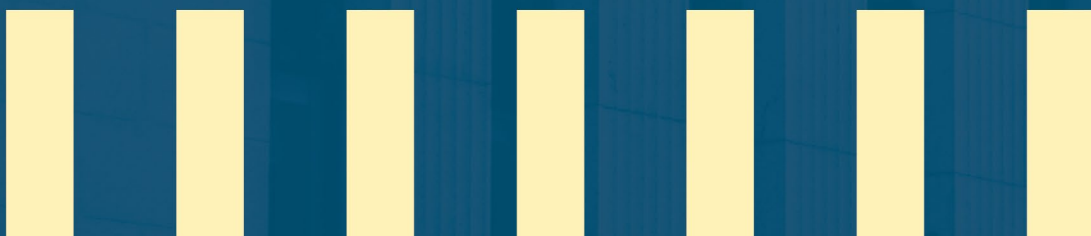
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Overview

This paper presents Bank of Canada staff's current assessment of the US and Canadian neutral rates of interest. The neutral rate is where the Bank expects the policy rate would settle once output is at its long-run potential level and inflation is at target, after the effects of all cyclical shocks have dissipated (Mendes 2014). The Bank does not target the neutral rate, but this is an important input for its economic projections.

We assess the Canadian nominal neutral rate to be in the range of 2.25% to 3.25%, unchanged from our assessment in 2025. We assess the US nominal neutral rate to be in the range of 2.50% to 3.50%, somewhat higher than the range of 2.25% to 3.25% reported in the 2025 assessment.

- In Canada, lower long-term population growth offsets higher long-term productivity growth (Chernoff et al. 2026).
- In the United States, the revision is explained by a stronger outlook for potential output growth (de Munnik et al. 2026).

The neutral rate of interest is unobservable and inferred from the evolution of the factors that influence it, such as potential output growth and the balance between global savings and investment. Measuring the neutral rate involves considerable uncertainty. Staff's assessed ranges reflect the uncertainty inherent in the inputs used in the model, but they do not capture the full extent of uncertainties surrounding the neutral rate in the United States and Canada.

US neutral rate

The estimate of the US neutral rate—the Bank's proxy for the global neutral rate—is based on the Bank's view of US potential output growth and other factors that drive medium- to long-term savings and investment in the United States, particularly inequality, macroeconomic risk and government debt.

We assess the US nominal neutral rate to be in the range of 2.50% to 3.50%, somewhat higher than the range of 2.25% to 3.25% reported in the 2025 assessment. The revision mainly reflects a stronger outlook for US potential output growth.

Details of the assessment

The assessment is informed by a suite of models, including two structural models that account for different drivers of the neutral rate, complemented by an empirical model:

- The overlapping-generation model (OLG), introduced in Adjalala et al. (2024) has the richest structure and captures several key drivers of the US neutral rate, including productivity growth, demographic factors, government debt and inequality.
- The risk-augmented neoclassical growth model (RANCG) considers the tail risk channel, as explained in Bootsma et al. (2020).

- The term structure model extracts information from financial markets (Feunou, Fontaine and Krohn 2024).

Table 1 presents the estimated range for the US neutral rate from each model. The midpoint of the range has moved up for all three models, explaining the revision to our assessment.

Table 1: Summary of estimates of the US nominal neutral policy rate

Annual rates (%)

	2025 estimates	2026 estimates
Overlapping-generation model	2.25–3.25	2.25–3.50
Risk-augmented neoclassical growth model	2.25–3.50	2.50–3.50
Term structure model	2.75–3.25	2.75–3.50
Overall assessment	2.25–3.25	2.50–3.50

Note: Rates are in nominal terms. All estimates have been rounded to the nearest 25 basis points. Reported ranges are constructed methodologically based on different counterfactuals with respect to key inputs.

Stronger outlook for potential output growth drives the revision to the range

Stronger productivity growth in the United States, supported by investment in artificial intelligence (AI) and its broader adoption, drives most of the upward revision to the estimate of the neutral rate in the OLG and RANCG models. Weaker population growth and a slightly lower projected profile for the ratio of government debt to gross domestic product (GDP) relative to 2025¹ provide a partial offset.

Main sources of risks and uncertainty

While the OLG and RANCG models capture most of the key drivers of the US neutral rate typically discussed in the literature, they may not fully reflect the impact of structural shifts in the economic environment that could affect the demand and supply of safe assets. These could include shifts in foreign demand for US safe assets, as well as structural changes to the production function or the capital accumulation process arising from the growing importance of intangible inputs and the diffusion of AI. Moreover, AI could have additional effects on the labour income share of GDP and on inequality, which are difficult to predict. While these factors could put both upward and downward pressures on the US neutral rate, we see the upward pressures as more likely to outweigh the downside, providing additional support for the revision to the range.

¹ Staff rely on the projection of the public debt-to-GDP ratio from the United States Congressional Budget Office.

Canadian neutral rate

We assess that the nominal neutral rate in Canada currently lies in the range of 2.25% to 3.25%, unchanged from the 2025 assessment (Adjalala et al. 2025).

On the domestic side, a downward revision to long-term trend labour input (TLI) growth is offset by an upward revision to long-term trend labour productivity (TLP) growth. On the international side, the upward revision of the US neutral rate provides upward pressure on the Canadian neutral rate. However, this is not sufficient to warrant an upward revision to the assessed range.

Table 2 summarizes the results of the four assessment methods we use to estimate the range of the Canadian neutral rate. This year, we introduce a trend-cycle Bayesian vector autoregressive (BVAR) model into our suite of assessment methods.

Table 2: Summary of estimates of the Canadian nominal neutral rate

Annual rates (%)

	2025 estimates	2026 estimates
Trend-cycle Bayesian vector autoregressive model	(2.50–3.50)	2.50–3.50
Term structure model	2.75–3.25	2.75–3.50
Risk-augmented neoclassical growth model	2.50–3.00	2.50–3.00
Overlapping-generations model	2.25–3.25	2.25–3.25
Overall assessment	2.25–3.25	2.25–3.25

Note: Rates are in nominal terms. All estimates have been rounded to the nearest 25 basis points. The 2025 estimates from the Trend-Cycle BVAR, in parentheses, are retrospective estimates and were not included in the 2025 assessment.

Trend-cycle BVAR

The trend-cycle BVAR, based on Leiva-León, Sekkel and Uzeda (2026), estimates the neutral rate by extracting a common latent trend from macroeconomic and financial variables. The approach relies on a trend-cycle BVAR framework with relatively limited structural assumptions, allowing the data to play a larger role in identifying the underlying trend. As such, it provides an important empirical crosscheck of our more structural assessment methods.

The resulting estimates are well aligned with those from our structural models (Table 2), supporting the overall assessment. Although the model yields a slightly higher estimated range than the others, the trend-cycle BVAR's retrospective estimate for the 2025 neutral rate is the same as for 2026, supporting our view that the overall range for the nominal neutral rate remains unchanged from that in the 2025 assessment.

Term structure model

The term structure model provides estimates of the market-expected neutral rate for the United States and Canada using a two-country framework that integrates the exchange rate and bond markets (Feunou, Fontaine and Krohn 2024). Building on Bauer and Rudebusch (2020), the model decomposes bond yields into trend and transitory components. Differences in trend components across countries generate persistent yield differentials that, under a no-arbitrage condition, translate into currency risk premia and exchange-rate dynamics. Within this framework, yield spreads reflect both time-varying risk compensation and long-run trend interest rate differentials that are conceptually aligned with differences in neutral rates.

The central tendency of the estimate remains unchanged. The overall stability indicates that the long-run interest rate expectations remained anchored. The increase of 25 basis points in the upper bound likely reflects elevated term premia, which push the upper end of the range higher and widen uncertainty around the neutral rate.

Risk-augmented neoclassical growth model

The risk-augmented neoclassical growth model is a closed economy general equilibrium model with aggregate uncertainty. It includes only domestic factors that affect households' consumption and saving decisions.² In the model, higher population and potential output growth exert upward pressure on the neutral rate. Projections of these factors have changed only slightly compared to the last assessment. We keep our assumption for aggregate risk unchanged. The COVID-19 pandemic initially drove this calibration with high perceived future economic uncertainty. More recently, elevated geopolitical risk has become the primary basis for maintaining the heightened uncertainty. The model suggests no change to the neutral rate.

Overlapping-generations model

This open economy general equilibrium model was described in detail in Kuncl and Matveev (2023). In the model, both international and domestic factors determine the neutral rate in Canada. A global neutral rate captures international factors. Domestic drivers that affect changes in the Canadian neutral rate are:

- the growth rates of long-run labour input and productivity
- longevity
- government debt
- inequality

As in previous assessments, the US neutral rate serves as a proxy for the global neutral rate. Domestically, a downward revision to growth in long-run labour input exerts downward pressure on the Canadian neutral rate. In the OLG model, weaker population

² See D. Matveev, J. McDonald-Guimond and R. Sekkel, "[The Neutral Rate in Canada: 2020 Update](#)," Bank of Canada Staff Analytical Note No. 2020-24 (October 2020) for more details on the risk-augmented neoclassical growth model.

growth slows labour-force expansion and increases the relative weight of older savers compared with younger borrowers, which puts downward pressure on the neutral rate. However, this is offset by an upward revision to the growth of long-term TLP.³ Internationally, the upward revision of the US neutral rate exerts upward pressure on the domestic neutral rate; it is however insufficient to trigger an upward revision to the range of the Canadian neutral rate.

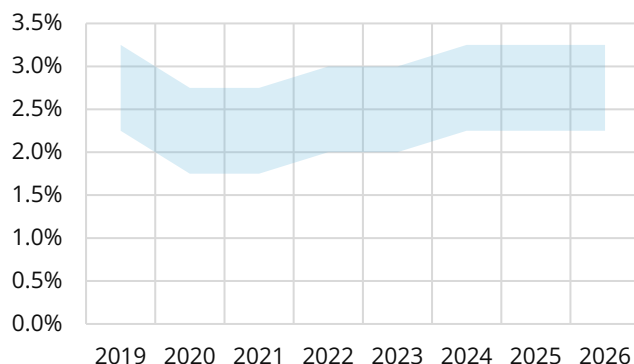
Assessment of the Canadian neutral rate

Overall, our suite of approaches implies an estimate for the Canadian neutral rate in a range of 2.25% to 3.25% (**Chart 1**). This estimate is unchanged from the 2025 assessment despite upward pressure from higher US neutral rates. The main domestic driving forces are:

- higher long-term productivity growth providing upward pressure
- lower long-term population growth providing downward pressure

Chart 1: Evolution of the range of the Canadian neutral rate since 2019

Range of Canadian neutral rate estimates, annual data



Note: The blue band shows the 100-basis-point range for the estimates of the neutral rate in Canada.

Source: Bank of Canada calculations Last observation: 2026

Risks

A heightened trade conflict could affect the neutral interest rate through opposing channels. If financial ties between the United States and the rest of the world weaken, demand for Canadian assets in US capital markets could fall, raising the Canadian country premium and putting upward pressure on the neutral rate. At the same time, higher and more persistent trade uncertainty would boost precautionary savings, exerting downward pressure. Overall, the upside and downside pressures associated with the trade conflict

³ Our long-run view on government debt is unchanged from the 2025 assessment. Any potential future increases of government debt would provide upward pressure on the neutral rate but only in a very limited fashion, reflecting the likely relatively small scale of any such increases.

are expected to largely offset each other, leaving the risks to the neutral rate broadly balanced.

We consider a separate analytical perspective that examines a potential channel where AI could affect the neutral rate by changing the labour share. This perspective is outside our baseline assessment and risk discussion. Instead, it highlights a structural mechanism that we remain mindful of, given the evolving nature of AI and its potential macroeconomic implications, and that we will continue to reflect on as evidence develops.

The perspective considers how automation driven by AI could lower the labour share and, in turn, increase capital demand and put upward pressure on the neutral rate. To inform this perspective, we draw on the SVAR approach of Bergholt, Furlanetto and Maffei-Faccioli (2022) and apply it to Canadian data to assess the historical impact of automation on the labour share. The historical evidence suggests that automation has tended to be associated with declines in the labour share, offering an indication of how AI could exert similar pressures. However, these effects are highly uncertain and may not materialize. To the extent that such dynamics occur, they could place upward pressure on the neutral rate. We will continue to monitor the effects of AI going forward and assess their relevance as evidence on AI and its macroeconomic effects evolves.

Conclusion

We assess the Canadian nominal neutral rates to be in the range of 2.25% to 3.25% in 2026, unchanged from the 2025 range of estimates. We assess the US nominal neutral rate to be in the range of 2.50% to 3.50%, somewhat higher than the range of 2.25% to 3.25% reported in the 2025 assessment.

Inevitably, uncertainty surrounds estimates of an unobservable variable such as the neutral rate of interest. While the ranges presented in this note reflect some of the sensitivity of our estimates to different models and their inputs, these ranges are narrower than what econometric models would suggest (Cacciatore, Feunou and Ozhan 2024).

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