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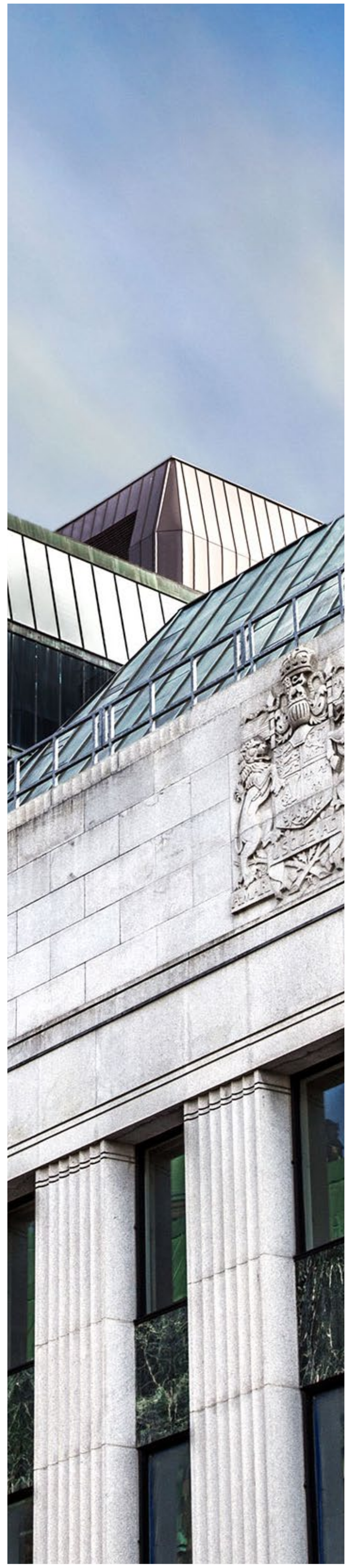
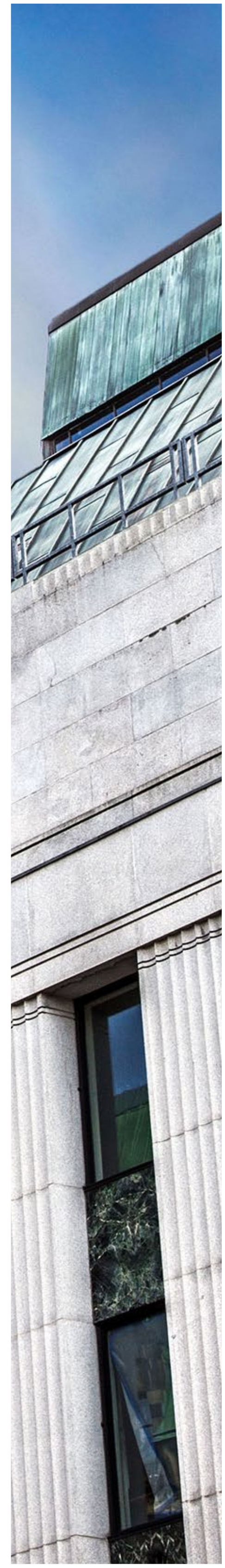




Monetary Policy *Report*

July 2026

Overview

After a year of weakness, Canada's economy is showing signs of improvement. Growth is expected to pick up, and inflation eases gradually from its recent peak. Uncertainty is still high.

The Canadian economy has been adjusting to US tariffs and continued uncertainty about the review of the Canada-United States-Mexico Agreement, as well as slower population growth. Business investment has been roughly flat, exports and housing activity have declined and economic growth has been uneven. As a result, the level of gross domestic product was roughly unchanged from the first quarter of 2025 to the first quarter of 2026. The unemployment rate has generally fluctuated between 6½% and 7%, pointing to excess supply in the economy.

Consumer price index inflation in Canada was close to the 2% target for more than a year and a half until the war in the Middle East began. The hostilities caused global oil prices to spike, pushing up gasoline prices. Inflation rose to 3.2% in May. However, inflation excluding gasoline, as well as measures of core inflation, stayed close to 2%. This suggests that, so far, spillovers to the prices of other goods and services remain contained.

Canadian businesses are adapting to elevated geopolitical uncertainty stemming from US trade policy and developments in the Middle East. Despite some volatility, recent data suggest that the economy is evolving broadly in line with the outlook in the April Report, increasing confidence that households and businesses are navigating this period of global upheaval.

Growth is picking up

Growth in the second quarter is anticipated to be solid at 2.5% after stalling in the first quarter. Much of this strength reflects the unwinding of temporary factors that restrained growth in the first quarter. There are also signs that growth is broadening.

Overall, growth is expected to have averaged just above 1% in the first half of 2026 and to average around 1.5% in the second half of the year.

As the economy continues to adjust, excess capacity is projected to be gradually absorbed, with growth of 1.8% in both 2027 and 2028. Exports increasingly contribute to growth over the projection horizon, while consumer and government spending remain important drivers. Both business and residential investment are expected to recover modestly.

Inflation eases gradually toward the 2% target

Inflation in Canada is expected to ease to about 2½% in the second half of 2026. It then reaches the 2% target by early 2027. The projection for inflation in this Report is based on the oil price futures curve as of July 9, 2026, and on an assumed narrowing in gasoline margins (see **Chart 8** in the Current conditions section). Although oil prices are lower than their peak in April, they remain volatile and highly dependent on events in the Middle East.

Cost pressures will continue to pass through to prices for consumer goods and food (see **In focus: War-related supply disruptions are passing through to consumer prices**). These pressures are being offset by softer inflation in services prices and subdued growth in labour costs.

Inflation stays around 2% over the rest of the projection horizon as remaining cost pressures fade and excess capacity is absorbed. On a year-over-year basis, inflation fluctuates because of some sizable base-year effects. The forecast for inflation is highly dependent on developments in the Middle East.

There are risks to the outlook for inflation beyond those related to the war in the Middle East and US trade policy. Inflation could be higher if global cost pressures or the depreciation of the Canadian dollar pass through more persistently to consumer prices or if excess supply is less than estimated. Inflation could be lower if global financial conditions tighten and sharply curtail economic activity or if the recovery in exports proves weaker than projected (see the **Risks** section).

Current conditions

Economic growth in Canada has been weak but is set to pick up. Headline inflation has risen above 3%. If oil prices and gasoline refinery margins decline as assumed, inflation should ease in the coming months. Inflation excluding gasoline remains near 2%.

Gross domestic product (GDP) in the first quarter of 2026 was at the same level as in the first quarter of 2025. Growth over this period was choppy and uneven across sectors, impacted by US tariffs, trade policy uncertainty and slowing population growth. The labour market has been soft, with the unemployment rate generally between 6½% and 7%. The Canadian economy has remained in excess supply.

Average GDP growth is estimated to be just above 1% in the first half of 2026. GDP growth was close to zero in the first quarter, partly due to temporary factors. It likely rebounded in the second quarter as the effects of these factors faded. A pickup in exports and residential investment provided further support.

After being close to 2% over the past year and a half, consumer price index (CPI) inflation rose to 3.2% in May because of the increase in gasoline prices. Measures of core inflation have moderated and are now close to 2%.

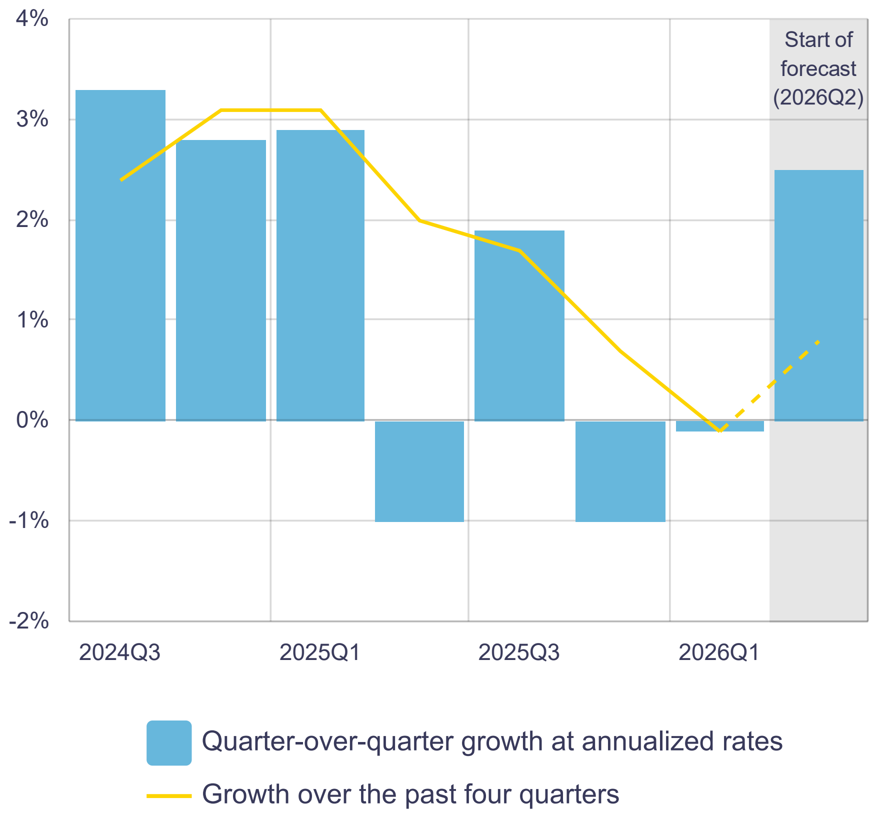
CPI inflation is expected to diminish in the coming months because oil prices have fallen from their peak and gasoline refinery margins are anticipated to gradually decline.

Economic activity

GDP growth has been weak and volatile since the United States introduced tariffs in early 2025 (**Chart 1**). GDP growth is estimated to have averaged about 1% in the first half of 2026.

Chart 1: The level of GDP in the first quarter of 2026 was unchanged from a year earlier

Quarterly data



Sources: Statistics Canada and Bank of Canada calculations and estimates
Last data plotted: 2026Q2

Activity stalled in the first quarter

Economic activity was roughly flat in the first quarter of 2026, weaker than the 1.5% growth projected in the April Report. Several temporary factors weighed on economic growth. These include:

- an unexpected decline in government spending
- a fall in motor vehicle production, with some plants shut down for retooling
- a sudden drop in oil and gas investment

In addition, housing activity declined, hampered by affordability challenges, slow population growth and elevated economic uncertainty.

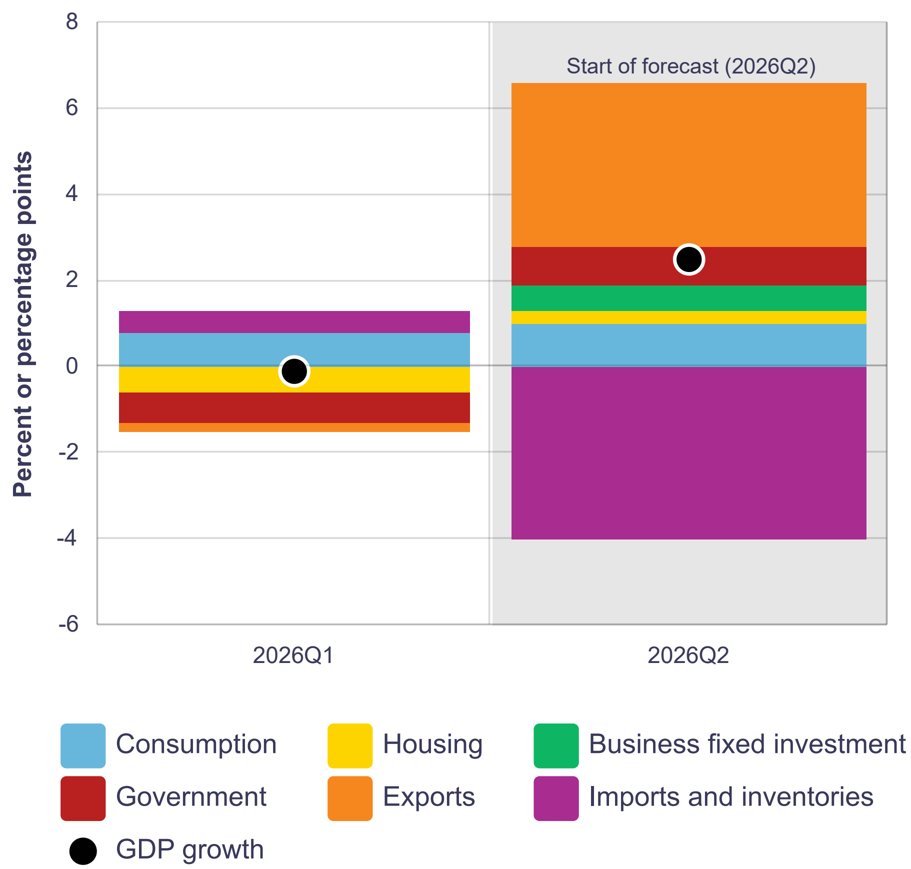
In contrast, growth was supported by consumer spending, which remained resilient even with elevated uncertainty and higher gasoline prices at the end of the quarter.

Growth likely picked up in the second quarter

GDP growth is estimated to have strengthened to 2.5% in the second quarter, partly reflecting the reversal of temporary weakness in the first quarter (**Chart 2**). Strength in exports and residential investment also helped boost growth.

Chart 2: GDP growth likely rebounded in the second quarter of 2026

Contribution to GDP growth, annualized, quarterly data



Note: *Imports and inventories* includes Statistics Canada's statistical discrepancy. Numbers may not sum to their respective totals due to rounding.
Sources: Statistics Canada and Bank of Canada calculations and estimates
Last data plotted: 2026Q2

After a year of sustained weakness, export growth likely resumed in the second quarter, led by exports of energy and non-commodity goods. Investment in oil and gas is estimated to have rebounded in response to higher oil prices. Bank of Canada survey results suggest that business investment outside the energy sector also increased.[1]

Household spending likely strengthened. Consumer spending growth appears to have edged up, supported by high equity prices and one-time government transfers.[2] Recent indicators point to some stabilization in housing activity after a period of weakness, but conditions remain uneven across regions.

Government spending is estimated to have picked up, partly supported by ongoing public investment.

Capacity pressures

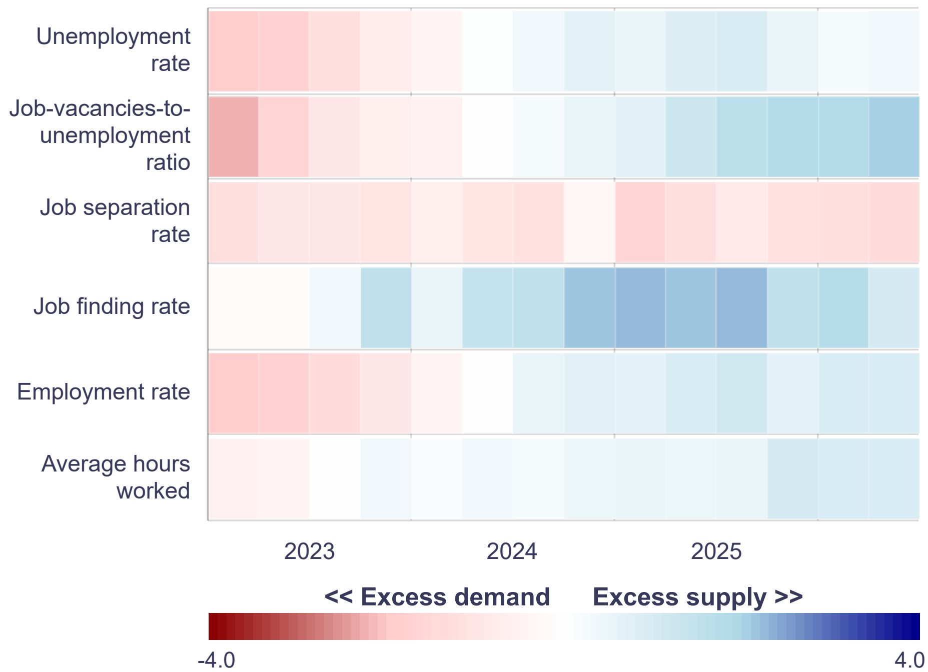
The output gap for the second quarter of 2026 is estimated to be in the range of -1.5% to -0.5%, indicating slightly more excess supply than was anticipated in the April Report.

Many businesses reported they have enough capacity to meet current demand. Fewer businesses than in recent quarters said they would struggle if demand rose unexpectedly.

Hiring remains subdued

Labour market conditions continue to be soft but broadly stable (**Chart 3**). The unemployment rate was 6.5% in June. It has generally stayed between 6.5% and 7.0% since the end of 2024.

Chart 3: Labour market indicators suggest conditions remain soft



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 from 2003 to 2019 for all other indicators. Data for the *Job-vacancies-to-unemployment ratio* in 2026Q2 reflect the month of April 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 and Bank of Canada calculations

Last observation: 2026Q2

Growth in labour demand has been subdued, and job turnover continues to be low.[3] Businesses reported that they are retaining their workers but are reluctant to hire more, given persistent uncertainty and soft demand growth. Businesses also signalled that they expect hiring to remain modest.

Growth in labour supply has been constrained by slow population growth and more people retiring from the workforce.

Wage growth remains close to 3%, with the LFS-Micro measure at 2.7% in June.[4]

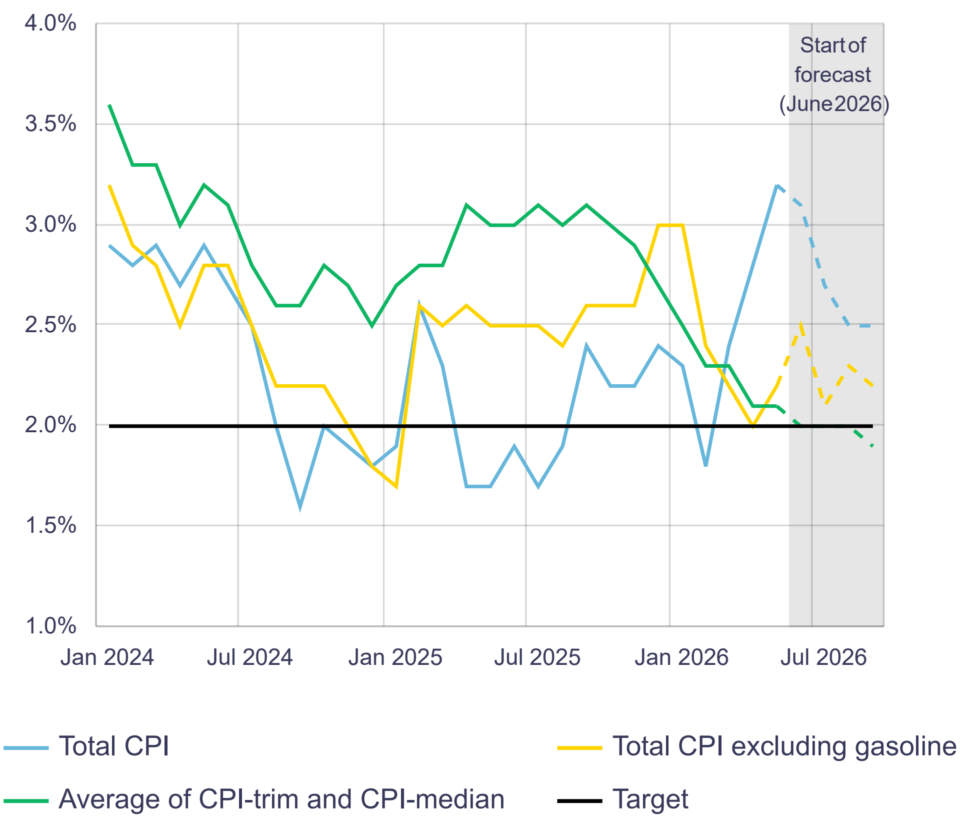
Inflation

After being close to the 2% target for more than a year and a half, CPI inflation rose to just over 3% in May due to higher gasoline prices.

Inflation is expected to have stayed elevated in June but should ease to about 2.5% by August (**Chart 4**). This easing is based on the assumption that oil prices are around US$75 per barrel and gasoline refinery margins edge down. But the situation in the Middle East remains fluid and subject to flare-ups, which could affect oil prices and inflation.[5]

Chart 4: High gasoline prices lifted inflation above 3% in May

Year-over-year percentage change, monthly data



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

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

Gasoline prices are keeping headline inflation elevated

The recent increase in CPI inflation mainly reflects higher gasoline prices. As the conflict in the Middle East disrupted global shipments of both crude oil and refined products, oil prices rose and gasoline refinery margins widened. Higher oil prices have also had knock-on effects, with businesses introducing fuel surcharges for some goods and services.

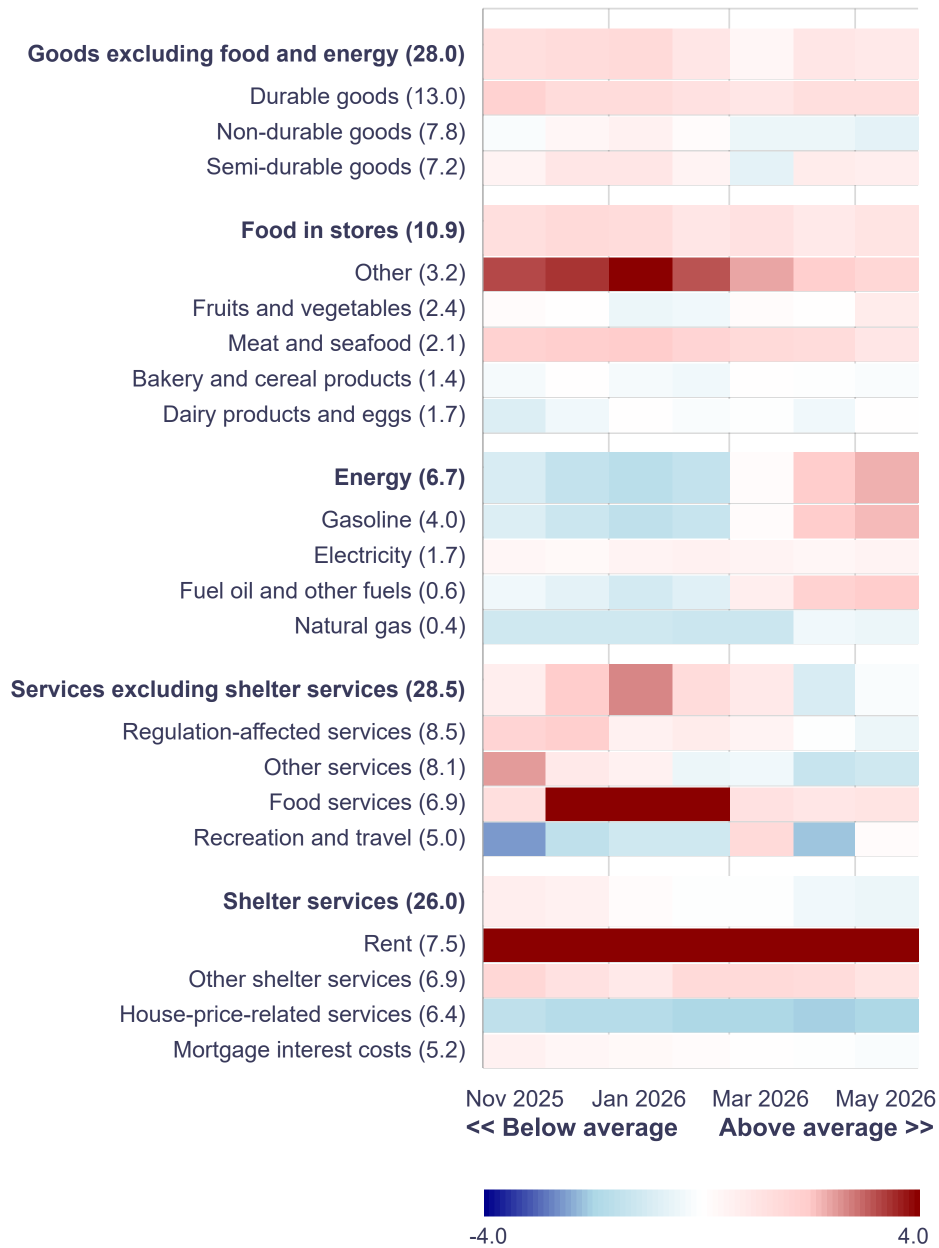
Oil prices have fallen from their peak in April, easing some of the pressure on inflation. However, refinery margins remain elevated and war-related cost pressures are still moving through supply chains (see **In focus: War-related supply disruptions are passing through to consumer prices**).

Excluding gasoline, inflation remains near 2%

The rise in inflation in recent months has been confined mostly to gasoline prices. Inflation excluding gasoline has been stable near 2%. This reflects the offsetting effects of goods and services inflation.

Food price inflation continues to be elevated due to ongoing cost pressures (**Chart 5**). Inflation in goods excluding food and energy is slightly above its historical norm, with strength concentrated mainly in a few durable categories. One such category is computer equipment, where prices are being pushed higher by strong global demand tied to the boom in artificial intelligence.

Chart 5: Below-average services inflation is helping to offset elevated non-energy goods inflation



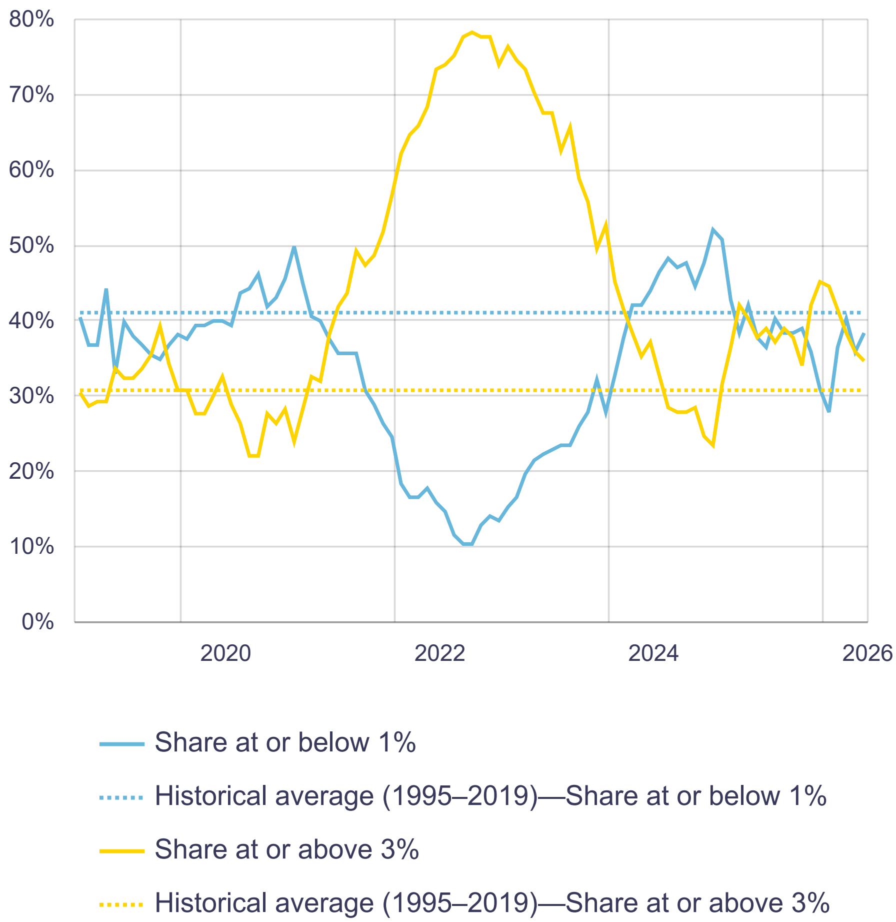
Note: The heatmap shows the distance of each CPI component's year-over-year inflation rate from its historical average. The colour is white when a component's inflation rate is close to its average and is a varying shade of blue (red) when the rate is below (above) the average. Because the historical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

In contrast, services inflation is below its historical average, especially in shelter categories. Inflation in both housing-related services and rent has slowed, partly reflecting lower demand amid slower population growth. Still, rent inflation remains elevated at 3.5%. Inflation in services excluding shelter is also somewhat subdued, partly because of past modest growth in unit labour costs.

Measures of core inflation have been easing since September 2025, with both CPI-trim and CPI-median reaching about 2% in April and May. The distribution of inflation has also normalized in recent months, and the share of CPI components rising above 3% has declined and is close to its historical average (**Chart 6**).

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: May 2026

War-related cost pressures are feeding through supply chains

Cost pressures related to the war in the Middle East are making their way through supply chains. Many businesses expect higher fuel costs to lead to increases in their input and selling prices in the near term. Moreover, cost pressures have emerged in energy-related inputs—such as petrochemicals and plastic resins—and in fertilizer.

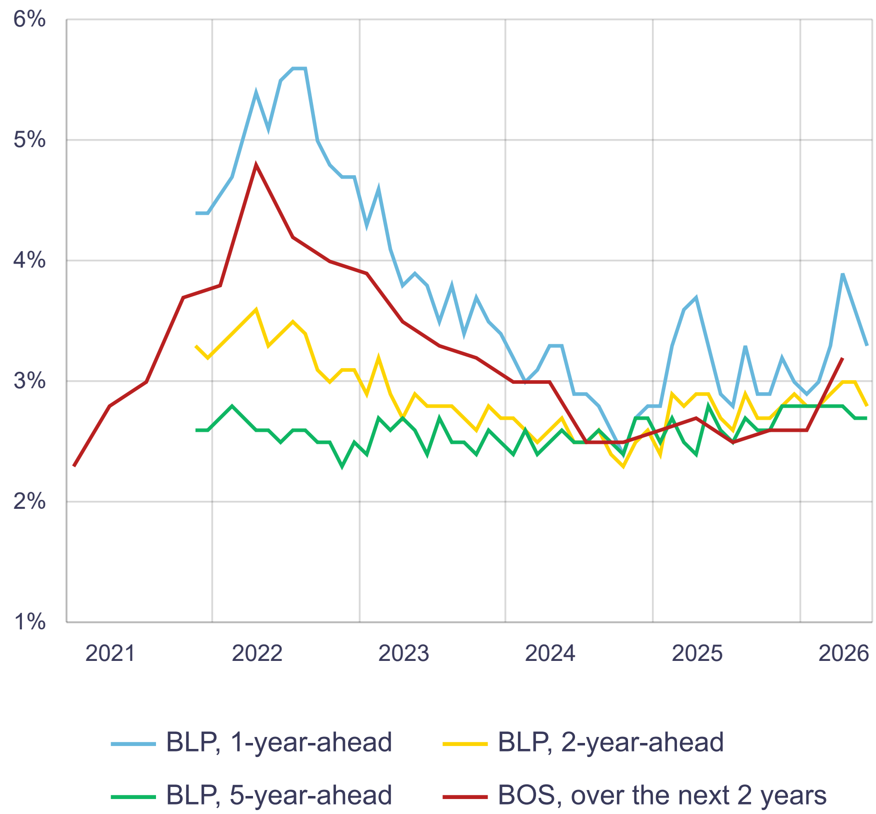
However, competition and weak demand could make it more difficult than usual for businesses to pass on cost increases to consumers. The decline in oil prices since April is also expected to limit the risk of these cost pressures broadening significantly (see **In focus: War-related supply disruptions are passing through to consumer prices**).

Inflation expectations remain anchored

Businesses' long-term inflation expectations remain anchored. Expectations for inflation one year from now rose in April and May before edging lower in June, mirroring movements in gasoline prices (**Chart 7**).

Chart 7: Businesses' short-term inflation expectations have come down from recent highs

Quarterly and monthly data



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

Sources: Bank of Canada and Bank of Canada calculations

Last observations: Business Leaders' Pulse, June 2026; Business Outlook Survey, 2026Q2

Commodities

Oil prices have fallen considerably since their peak in April, though they remain volatile and sensitive to developments in the Middle East. The prices of other commodities have also declined.

Oil prices have fallen

After the US–Iran interim agreement was announced, oil prices fell about 30%. Tensions have since escalated again. Before this flare-up, Brent oil had been trading at around US$75. It is assumed to decline to around US$70 by the end of 2027, in line with the futures curve as of July 9, 2026.

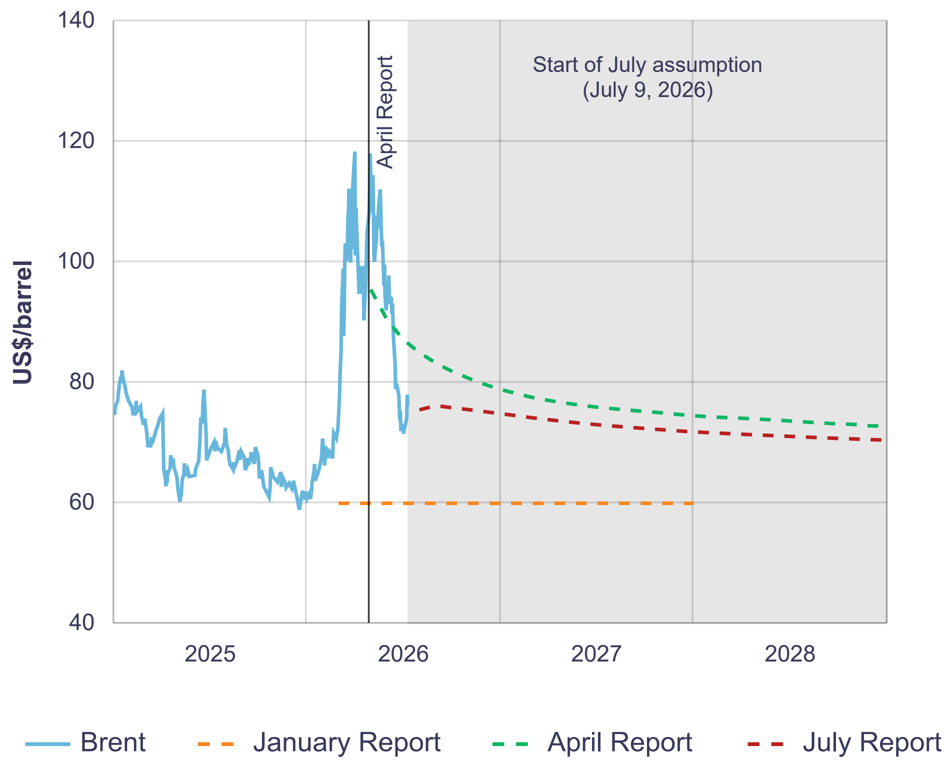
Gasoline prices have also fallen from their peak, although not by as much as the decline in crude oil prices would have suggested. This increase in margins reflects a reduction in global gasoline supply related to damage to refining capacity and restrictions on Chinese gasoline exports.

The assumed path for oil prices is lower than in the April Report but higher than in the January Report (**Chart 8**). The outlook for oil prices remains highly uncertain, as illustrated by the continuing flare-ups in hostilities between Iran and the United States.

Natural gas prices in Europe and Asia remain well above pre-war levels. Prices for natural gas in North America have increased slightly due to higher-than-usual forecasted demand for air conditioning in the United States and strong exports of liquefied natural gas. However, they remain well below prices in Europe and Asia.

Chart 8: Oil prices have fallen but remain above pre-war levels

Daily data



Sources: NYMEX and Intercontinental Exchange via Haver Analytics and Bank of Canada assumptions
Last data plotted: December 31, 2028

Non-energy commodity prices have edged down

Prices of non-energy commodities have fallen about 5% since the April Report, led by declines in the prices of aluminum and precious metals. The drop in aluminum prices is mostly due to expectations for a recovery in Middle East production.

Financial conditions

Canadian financial conditions have eased since the April Report. Sovereign bond yields have remained volatile and have continued to diverge across regions. In Canada, yields are little changed on net.

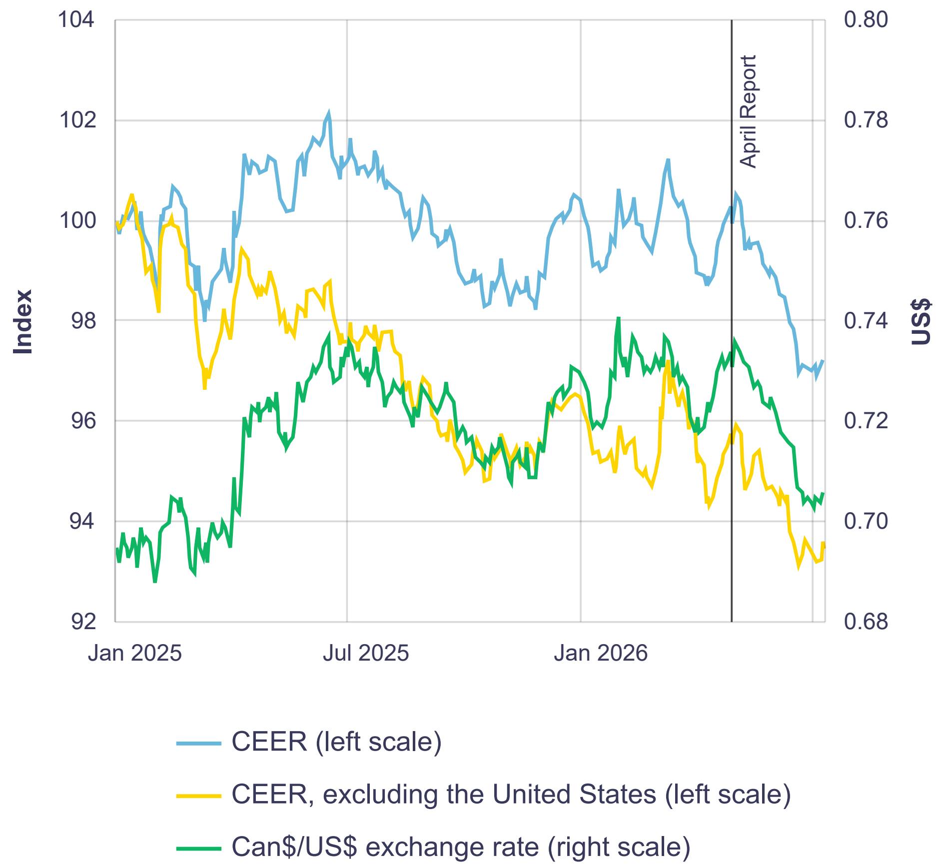
Global equity prices remain buoyant, and credit spreads are compressed.

In the United States, sovereign bond yields and market pricing for the policy rate have increased. This is partly due to stronger-than-expected economic activity.

The US dollar has appreciated broadly since the April Report, while the Canadian dollar has depreciated to around 71 cents US (**Chart 9**). This partly reflects a widening spread between US and Canadian government bond yields.

Chart 9: The Canadian dollar has depreciated

Canadian exchange rates, index: January 2, 2025 = 100, daily data



Note: CEER is the Canadian Effective Exchange Rate Index—a weighted average of bilateral exchange rates for the Canadian dollar against the currencies of Canada's major trading partners.

Sources: London Stock Exchange Group and Bank of Canada calculations

Last observation: July 10, 2026

Endnotes

1. For more, see Bank of Canada, ***Business Outlook Survey—Second Quarter of 2026*** (July 2026). [←]

2. One-time government transfers—including the federal one-time top-up of the Canada Groceries and Essentials Benefit and Quebec's special payment for groceries and energy costs—are expected to boost household disposable income in the second quarter.[←]

3. For more, see N. Vincent, "**Canada's labour market: Between cycles and structural change**" (speech to the Centre interuniversitaire de recherche en analyse des organisations, Montréal, Quebec, May 26, 2026).[←]

4. The LFS-Micro is a measure of underlying wage growth derived from the Labour Force Survey (LFS) microdata. It removes the composition effects from the average hourly earnings in the LFS, yielding a wage measure with reduced volatility and a better relationship with labour market fundamentals.[←]

5. For example, if the price of Brent oil were to settle between US$80 and US$85 in the coming months, inflation would be about 0.1 to 0.3 percentage points higher.[←]

Tariff and other assumptions

Trade within North America remains mostly free of tariffs, but some industries have been heavily affected by sector-specific measures. Oil prices are assumed to decline.

Tariff assumptions

The tariff assumptions embedded in the projection remain the same as in the April Report. Although the Canada-United States-Mexico Agreement has moved to annual reviews, exemptions for compliant goods are assumed to remain in place, along with existing US tariffs.

The projection is based on tariffs in place or officially agreed on as of July 10, 2026 (**Table 1**).[1]

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

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

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

On June 1, the US administration expanded the list of products subject to temporarily reduced tariff rates and introduced new temporary tariffs on specific industrial equipment and machinery products. These changes have little effect overall.

The average US tariff rate on imports from Canada is now estimated to be 5.0%, down slightly from 5.1% in the April Report, while Canada's average tariff rate on US imports is unchanged at 1.5%.

Other assumptions

The projection is also conditional on several other assumptions.

- Oil prices are assumed to remain in line with the futures curve as of July 9, 2026. The price of Brent oil is assumed to average about US$75 in the third quarter of 2026 and settle around US$70 by the end of 2027, about US$5 lower than assumed in the April Report but US$10 higher than in the January Report. Prices of West Texas Intermediate (WTI) and Western Canadian Select (WCS) are assumed to follow a similar path, stabilizing at US$65 and US$50, respectively, by the end of 2027.
    - The spread between the prices of WTI and WCS is US$5 wider than assumed in the April Report. This revision stems partly from increased Venezuelan exports of heavy crude oil to the United States and partly from upward pressures on WTI prices due to declining commercial inventories and strong US crude oil exports.
- The Canadian dollar is assumed to average around 71 cents US over the projection horizon, down 2 cents US from the April Report.
- Potential output growth in Canada is projected to ease to 1.1% in 2026. This reflects slower population growth and the impact of US trade policy. Potential output growth then picks up to 1.3% in 2027 and 1.5% in 2028 as population growth gradually rebounds, the drag on trend productivity from US tariffs eases and investment recovers. The broader adoption of artificial intelligence is also expected to boost productivity.
- The nominal neutral interest rate in Canada is assumed to be at the midpoint of its estimated 2.25% to 3.25% range.
- The outlook embeds additional war-related cost pressures beyond the direct energy shock (see **In focus: War-related supply disruptions are passing through to consumer prices**). Although oil prices have declined from their peak, some cost pressures remain and will continue to pass through to consumer price index inflation over the next few quarters. These include elevated transportation costs and other costs associated with global supply chain pressures. These effects have a peak impact of about 0.4 percentage points on headline inflation in the first quarter of 2027.
- The impact of trade policy uncertainty on gross domestic product is assumed to ease slowly over the projection horizon.
- The projection for Canada incorporates information from the latest federal and provincial budgets and fiscal updates that have been tabled at the time of writing.

Endnotes

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

Outlook

Economic growth is expected to pick up over the projection horizon, rising above potential output growth. Inflation is elevated in the near term before returning to target as cost pressures fade and excess capacity is absorbed.

Growth of gross domestic product (GDP) has been weak and volatile but is forecast to increase to 1.8% in 2027 and 2028. This recovery is supported by a sustained resumption in export growth as foreign demand expands. Although the Canada-United States-Mexico Agreement is now subject to annual review and uncertainty remains, businesses are adjusting to the new trade environment.

Consumption and government spending are the other major sources of growth over the projection horizon. Residential investment expands modestly, and business investment supports growth.

Canada's productive capacity is anticipated to grow slowly in 2026, held back by tariff-related structural adjustments and subdued population growth. Potential output growth then strengthens, in part because business investment—including investment in artificial intelligence (AI)—expands.

With overall demand growing slightly faster than potential output, excess capacity is gradually absorbed.

Inflation is expected to slow in the second half of 2026 due to a decline in gasoline prices. However, additional cost pressures from the war in the Middle East continue to affect inflation (see **In focus: War-related supply disruptions are passing through to consumer prices**).

Inflation returns to around 2% in early 2027 and remains close to the target over the projection horizon. There is some volatility in year-over-year inflation due to base-year effects. The inflation forecast is highly conditional on oil prices, which are sensitive to developments in the Middle East.

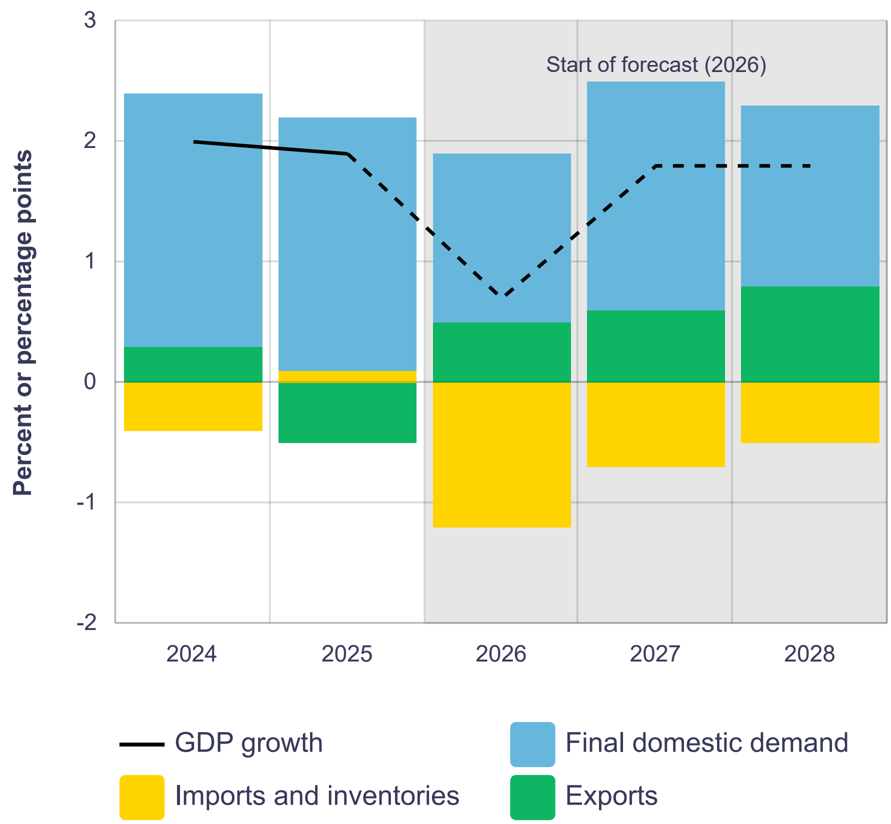
Economic outlook

GDP growth is expected to rise from 0.7% in 2026 to 1.8% in 2027 and 2028 (**Chart 10**). The pickup reflects a resumption in export growth as businesses adjust to the new trade environment, as well as a modest recovery in residential investment following a decline in 2026. Activity in the oil and gas sector also contributes to growth in the near term.

Economic growth outpaces potential output over the projection horizon, and excess supply is gradually absorbed.

Chart 10: A pickup in exports supports GDP growth

Contribution to GDP growth, yearly data



Note: *Imports and inventories* includes Statistics Canada's statistical discrepancy. Numbers may not sum to their respective totals due to rounding.
Sources: Statistics Canada and Bank of Canada calculations, estimates and projections
Last data plotted: 2028

Export growth is expected to strengthen

Growth in exports resumes over the projection horizon in line with foreign demand. However, exports remain on a lower path than before US tariffs were imposed.

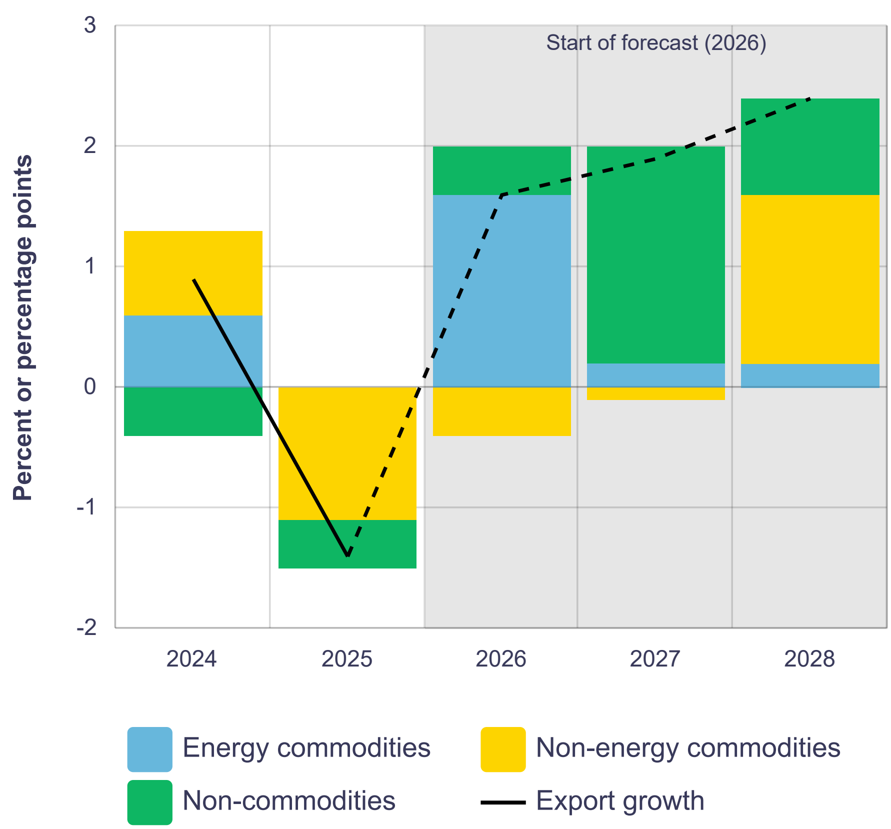
Non-commodity and non-energy commodity exports are projected to recover as businesses continue to adjust to the new trade environment. Results from Bank of Canada surveys show that businesses' outlooks for future export sales have improved despite continued trade-related uncertainty. Rising US investment in AI is anticipated to boost demand for Canadian raw materials, metal products and electrical equipment. The recent depreciation of the Canadian dollar makes Canada's exports more competitive, providing additional support.

Energy commodity exports also pick up in 2026 as elevated oil prices support conventional oil production. They are then projected to slow in 2027 as oil prices decline (**Chart 11**).

Import growth is expected to recover in 2026 as domestic demand expands and export growth continues to rebound.

Chart 11: Export growth is expected to pick up over the projection horizon

Contribution to export growth, yearly data



Note: Numbers may not sum to their respective totals due to rounding.
Sources: Statistics Canada and Bank of Canada calculations, estimates and projections
Last data plotted: 2028

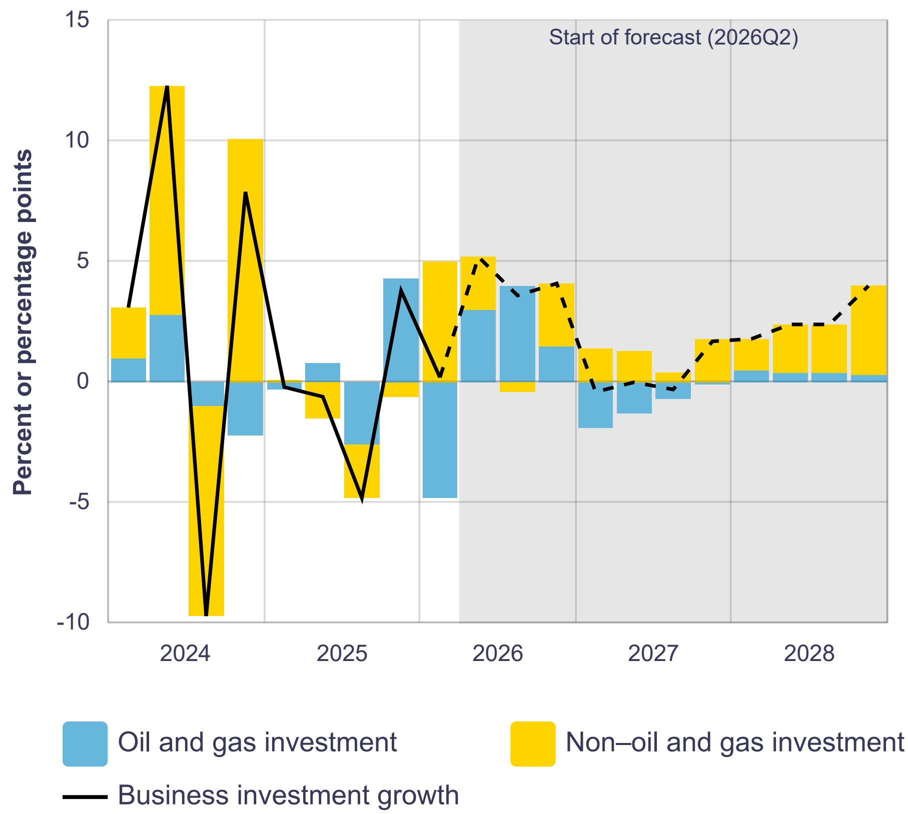
Investment growth is lifted by the oil and gas sector

Growth in business investment is anticipated to strengthen in 2026, led mainly by activity in oil and gas (**Chart 12**). As oil prices decline over the projection horizon, growth in investment in oil and gas moderates.

Investment growth outside the oil and gas sector picks up in 2027 and 2028. Although the drag from trade tensions and uncertainty is assumed to fade gradually, investment remains on a lower path than it was before US tariffs were imposed.

Chart 12: Investment growth in 2026 is boosted by oil and gas

Contribution to business investment growth, annualized, quarterly data



Note: 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

Government spending supports economic activity

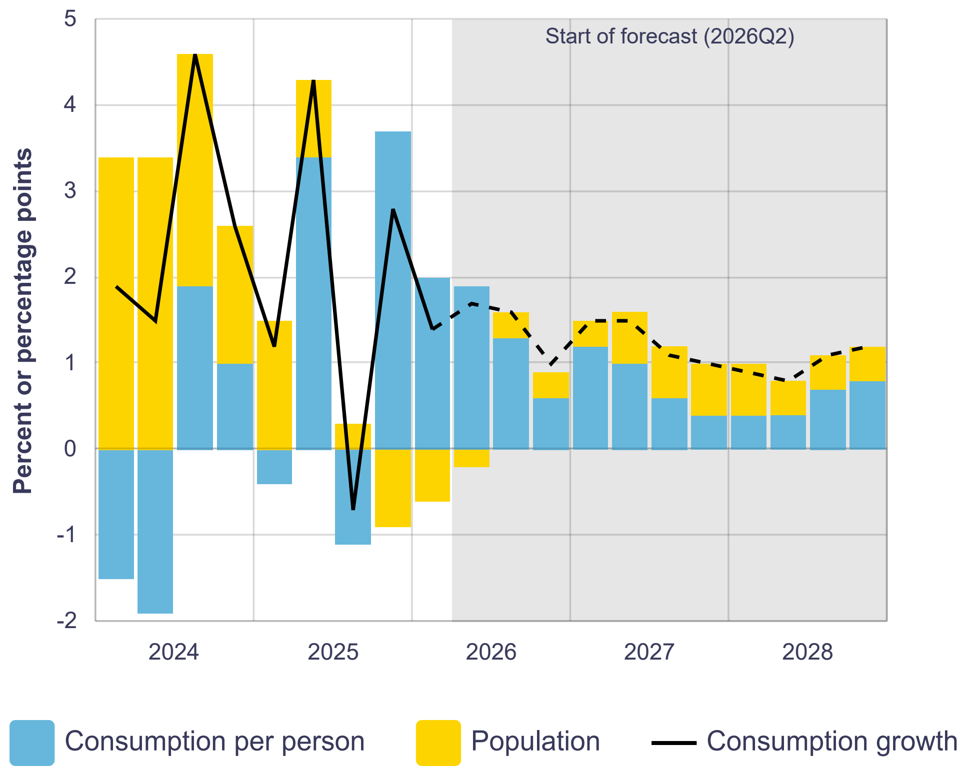
Government spending contributes significantly to growth over the projection horizon. Provincial infrastructure spending and federal programs are also expected to support business investment.

Consumption expands modestly

Consumption growth averages just above 1% over the projection horizon, partly reflecting subdued population growth (**Chart 13**).

Chart 13: Consumption growth averages just above 1% over the projection horizon

Contribution to consumption growth, annualized, quarterly data



Note: *Population* is based on Statistics Canada's quarterly estimate of residents aged 15 and older. Numbers may not sum to their respective totals due to rounding.
Sources: Statistics Canada and Bank of Canada calculations, estimates and projections
Last data plotted: 2028Q4

Consumption growth per person slows from its strong pace in the second half of 2026. Higher gasoline prices leave households with less money to spend.[1] Recent weakness in housing activity also weighs on consumer spending.

After stabilizing in 2027, consumption growth per person picks up in 2028 due to:

- wage growth that outpaces inflation because of productivity gains
- improved terms of trade as assumed oil prices remain above pre-war levels
- elevated financial wealth

Growth in residential investment is subdued

Residential investment growth is expected to increase over the projection horizon. However, it is restrained by slow population growth, affordability challenges in some housing markets and a large stock of unsold small condominiums in Toronto and Vancouver. Households are also expected to remain cautious about home purchases given the uncertain economic environment.

Inflation outlook

Inflation is expected to ease from about 3% in the second quarter of 2026 to about 2½% over the second half of the year. This mainly reflects lower gasoline prices (**Chart 14**). Oil prices are assumed to decline in line with the oil futures curve as of July 9, 2026, and gasoline refinery margins narrow. Excluding the effects of energy, inflation is shaped by offsetting downward and upward pressures.

Downward pressures come from services inflation:

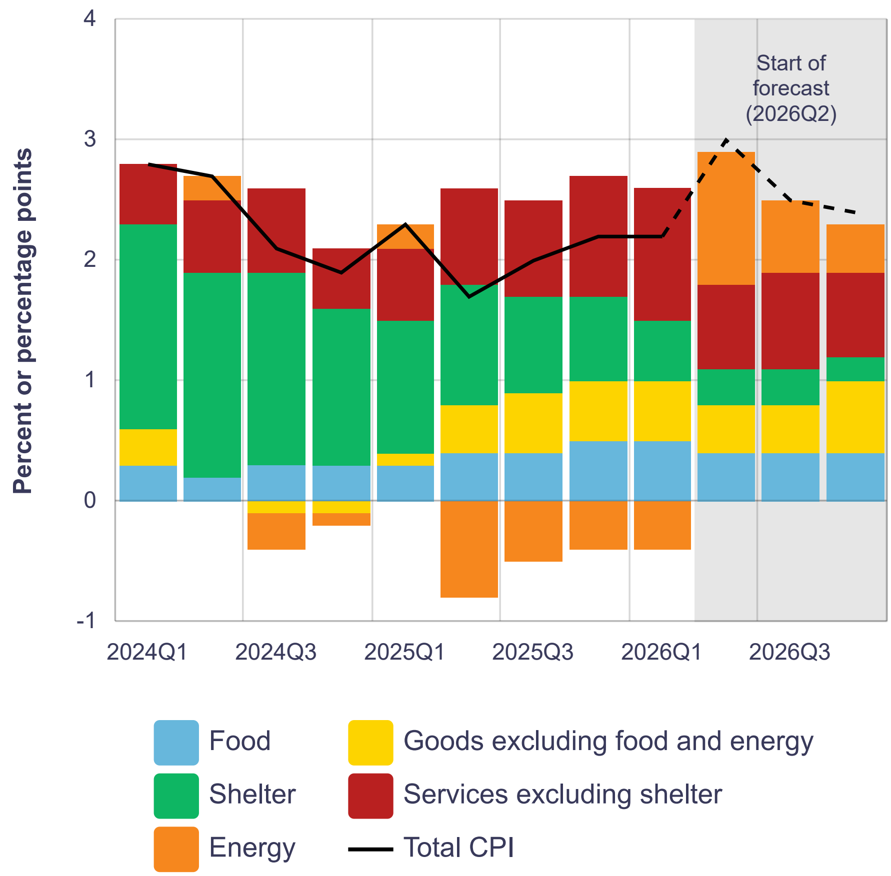
- Shelter price inflation is expected to ease further in the near term, reflecting a sluggish housing market and weak growth in rents.
- Inflation in services excluding shelter, travel and hospitality remains subdued as excess supply restrains growth in unit labour costs.

Upward pressures come primarily from food and other goods:

- Food inflation is expected to remain elevated, reflecting war-related pressures on fuel, fertilizer and other agricultural input costs.
- Inflation in goods excluding food and energy is expected to rise as war-related input costs gradually work their way through supply chains and feed into prices.
- Some services prices are boosted by higher energy and goods prices.
- The depreciation of the Canadian dollar raises import prices.

Chart 14: CPI inflation is expected to be around 2½% in the second half of 2026

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



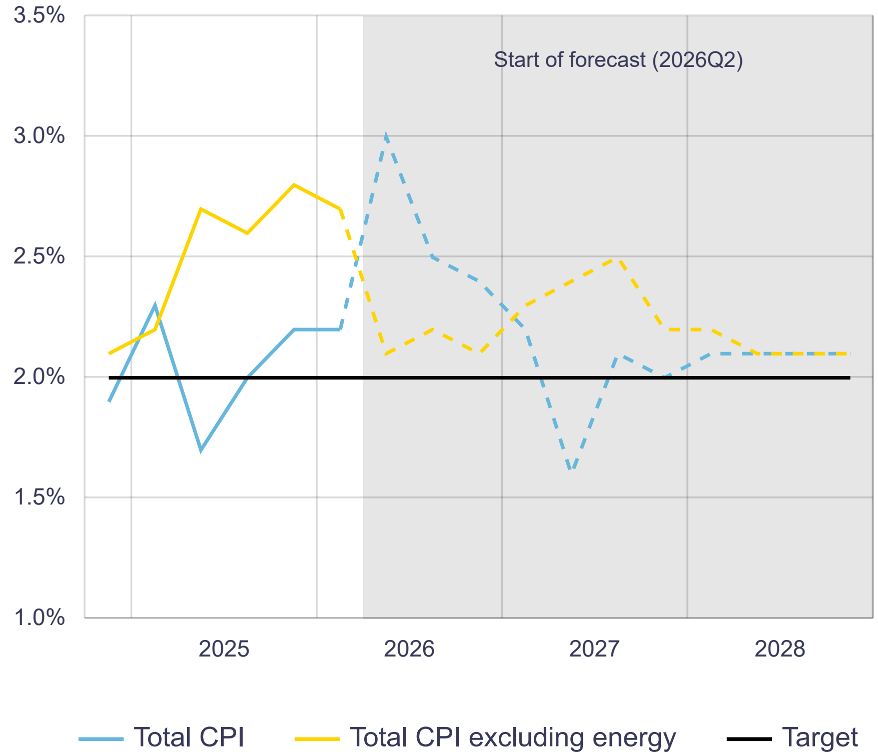
Note: Numbers may not sum to their respective totals due to rounding.

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

In 2027, inflation is projected to fall close to the 2% target because the direct effect of higher gasoline prices will have dissipated (**Chart 15** and **Chart 16**). Other war-related cost pressures continue to pass through to consumer prices. However, supply disruptions are assumed to be relatively short-lived, and weak demand hinders the ability of businesses to pass cost increases on to consumers (see **In focus: War-related supply disruptions are passing through to consumer prices**).

Chart 15: Inflation is expected to converge around 2% in 2027

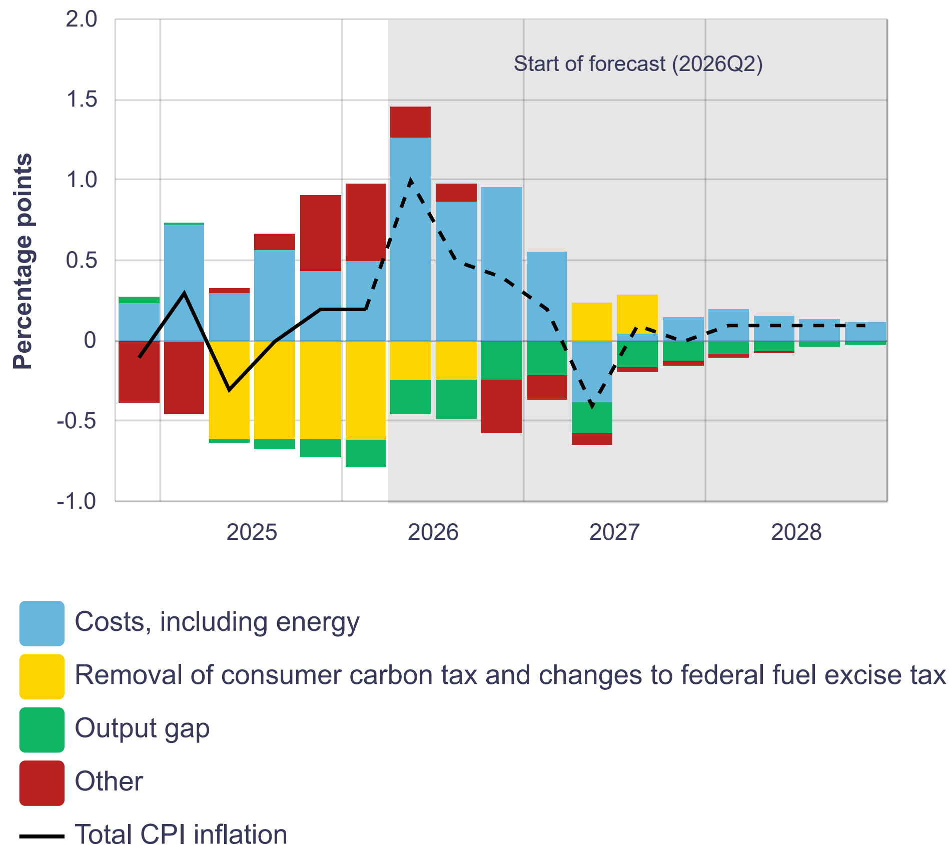
Year-over-year percentage change, quarterly data



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

Chart 16: Inflation is expected to hover near 2% as external cost pressures and domestic slack generally offset each other

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



Note: *Costs* includes, for example, commodity prices (including oil prices), Canadian counter-tariffs 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, including, for example, shelter inflation. 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

There is some volatility in year-over-year inflation in 2027 due to base-year effects coming from the previous spike in gasoline prices and the changes to the federal fuel excise tax (see **Chart 15**).[2]

Inflation remains close to 2% in 2028. Over this period:

- Downward pressures from excess supply fade as the output gap narrows. Shelter inflation also becomes less subdued as population growth slowly recovers.
- Upward cost pressures from war-related supply disruptions and the reorientation of supply chains away from the United States dissipate.

Endnotes

1. However, recent fiscal measures—such as the temporary suspension of the federal fuel excise tax—provide some offset.[←]

2. Base-year effects occur because year-over-year inflation compares current prices with prices from 12 months earlier. If prices moved sharply a year ago because of a temporary event, annual inflation can rise or fall as that movement enters or drops out of the comparison, even if current monthly price changes are stable.[←]

Global economy

The war in the Middle East has pushed up inflation around the world and is weighing on global economic activity. But oil prices have fallen from their peak, and inflation is expected to ease. Investment in AI is boosting global growth.

Overall, inflation is expected to slow due to the decline in oil prices since April. However, supply chain disruptions caused by the war have increased input costs and lengthened delivery times in many regions, adding some upward pressure on inflation.

Strong investment in artificial intelligence (AI)—particularly in the United States and China—and the resulting trade spillovers to other economies are supporting global growth.

Overall, growth in global gross domestic product (GDP) is projected to ease to 2¾% in 2026 due to the war. It then recovers to slightly above 3% in 2027 and 2028.

United States

Economic growth in the United States is expected to remain solid due to strong consumer spending and AI-related investment. While inflation is anticipated to ease because of lower oil prices, it remains elevated through the rest of 2026.

Economic activity remains strong

US GDP growth is estimated to have averaged about 2.5% in the first half of 2026, supported by consumption and strong investment growth.

Consumption has been solid, particularly among higher-income households that have benefited from tax cuts and large gains in financial wealth. In contrast, spending by lower-income households has been held back by subdued income growth and, more recently, high gasoline prices.

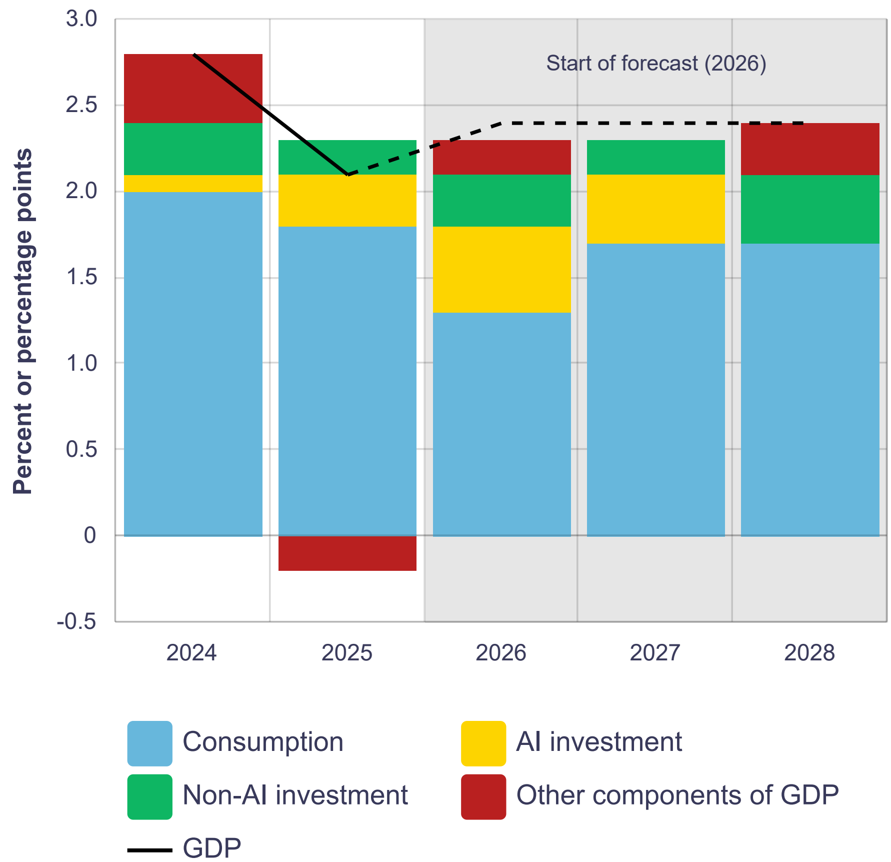
Business investment has been robust due to AI-related spending.

The labour market has firmed up recently. Monthly job gains rose from an average of about 10,000 in 2025 to about 90,000 in the first half of 2026. Job growth has also become more widespread across industries.

Economic growth is expected to remain solid over the projection horizon, supported by rising consumer spending and strong business investment. Overall, GDP is projected to grow by about 2½% in 2027 and 2028 (**Chart 17**).

Chart 17: Growth in the United States is supported by consumption and AI investment

Contribution to GDP growth, annual data



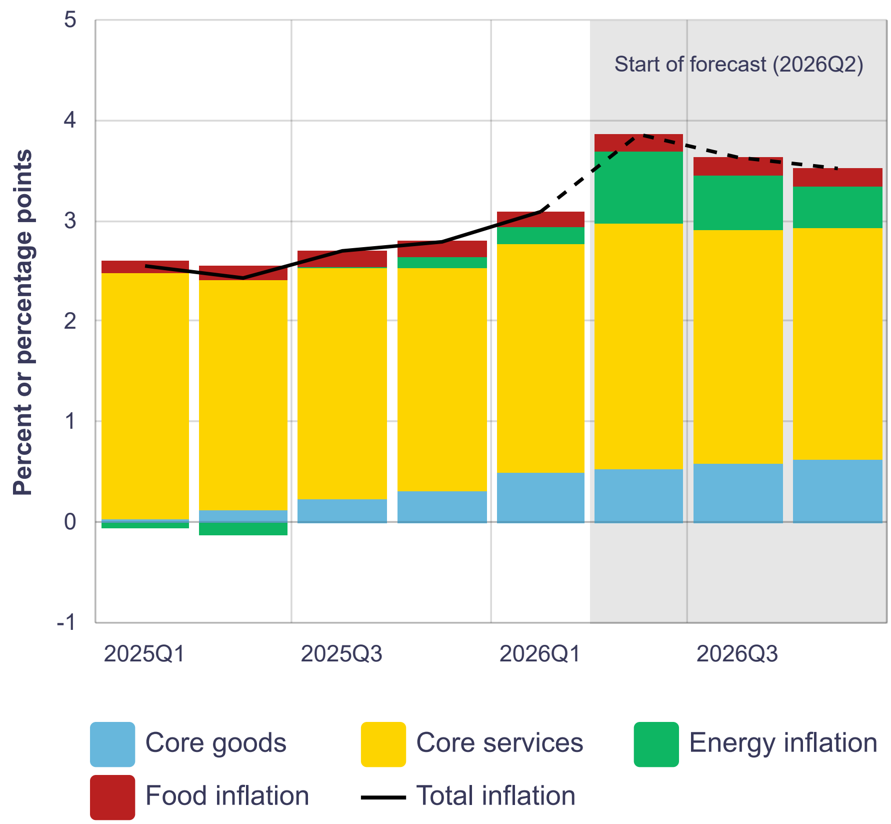
Note: AI is artificial intelligence. *AI investment* is defined as investment in data centre structures as well as computers and peripheral equipment.
Sources: US Bureau of Economic Analysis via Haver Analytics and Bank of Canada calculations, estimates and projections
Last data plotted: 2028

Inflation is expected to remain elevated in 2026

US personal consumption expenditures inflation rose from 2.9% at the start of the year to 4.1% in May (**Chart 18**). This increase was due to the closure of the Strait of Hormuz, which disrupted shipments of oil and other commodities, pushing gasoline prices sharply higher and raising production costs for businesses. These higher costs have started to pass through to prices for some other goods and services.

Chart 18: Increases in the price of energy as well as other cost pressures are pushing up US inflation

Contribution to year-over-year growth in the US personal consumption expenditures price index, quarterly data



Sources: US Bureau of Economic Analysis via Haver Analytics and Bank of Canada calculations, estimates and projections
Last data plotted: 2026Q4

Oil prices have since fallen considerably, putting downward pressure on inflation. Nevertheless, inflation is expected to be around 3½% at the end of 2026.[1] Inflation remains elevated because of the pass-through of cost pressures from the war and persistently high inflation in services prices. Past tariff increases also contribute to inflation.

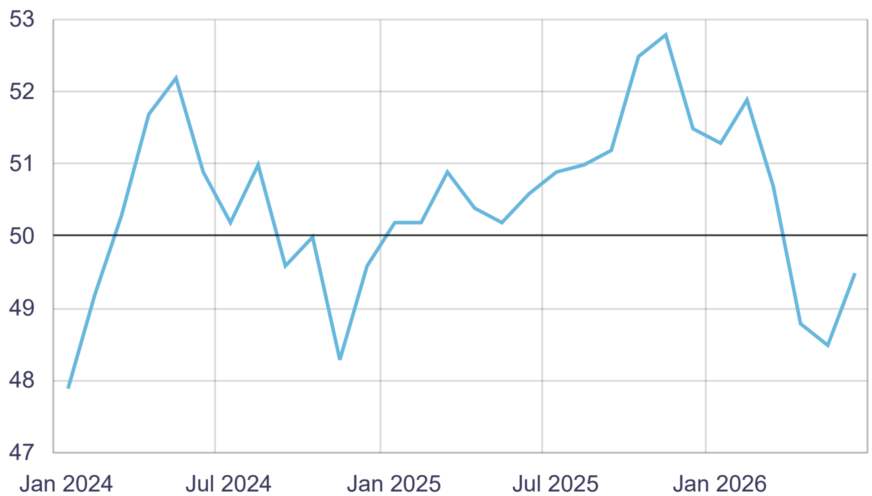
Inflation is expected to slow in 2027 as cost pressures ease and the impact from tariffs fades. A balanced labour market and moderate growth in labour costs help bring inflation back toward the Federal Reserve's 2% target through 2027 and 2028.

Euro area

Economic activity in the euro area softened in the first half of 2026 due to high energy prices (**Chart 19**). Growth is projected to strengthen in the second half of the year as energy prices decline and government spending on defence and infrastructure increases. Overall, GDP growth is expected to be weak in 2026 before rising to around 1¼% in 2027 and 2028.

Chart 19: Activity in the euro area weakened in the first half of 2026

S&P Composite Purchasing Managers' Index (PMI), monthly data



Note: A PMI level greater than 50 indicates growth in the sector.
Source: S&P Global Purchasing Managers' Survey via Haver Analytics
Last data plotted: June 2026

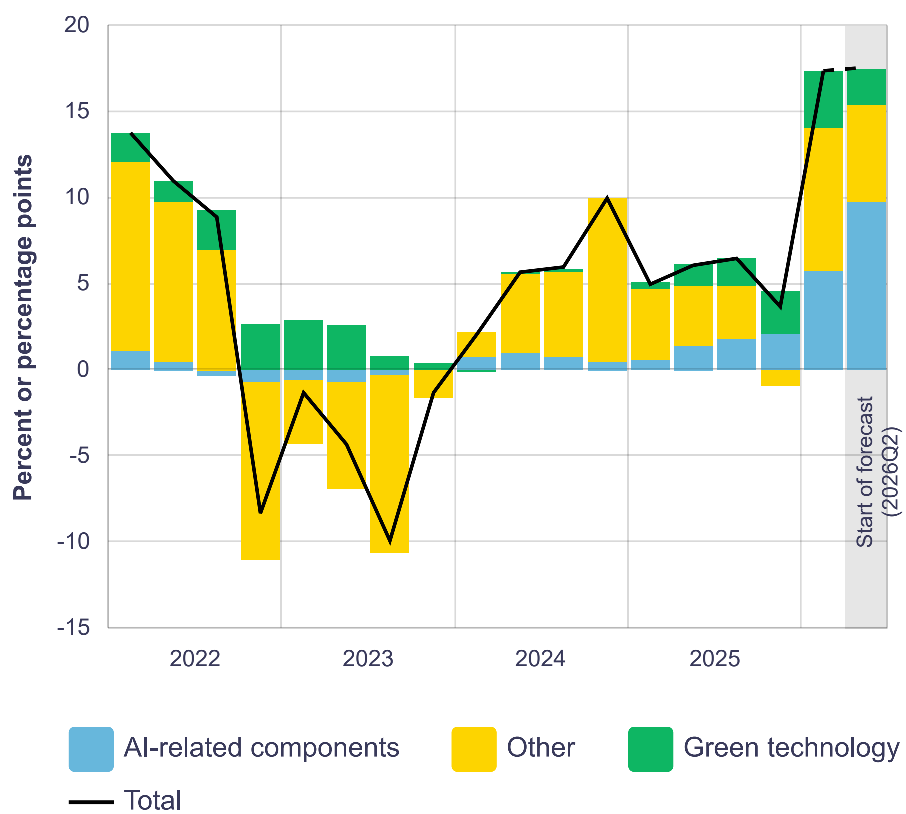
High energy prices pushed inflation up to 3.2% in May. Core inflation was 2.6%. The European Central Bank (ECB) raised its policy rates by 25 basis points in response to ongoing inflationary pressures. Inflation eased slightly in June as energy prices declined and is expected to gradually return to the ECB's 2% target by mid-2027.

China

China's economy is estimated to have grown at a solid pace in the first half of 2026, driven by strong fiscal support and robust exports of AI-related products (**Chart 20**). The property sector continues to weigh on growth.

Chart 20: China's exports have been supported by AI-related components

Contribution to year-over-year growth in nominal exports, quarterly data



Note: AI is artificial intelligence. *AI-related components* is composed of electronic integrated circuits and micro-assemblies. *Green technology* is composed of solar cells, lithium-ion batteries and electric vehicles. The quarterly value is an average of monthly customs data. Data for 2026Q2 are for April and May.

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

Last data plotted: 2026Q2

Over the projection horizon, export growth is expected to slow as additional market share becomes harder for exporters to gain. Domestic demand is anticipated to improve slowly as the housing market stabilizes. Overall, GDP growth is projected to slow to about 4¾% in 2026 and 4¼% in 2027 and 2028.

Despite the recent increase in energy prices, inflation remained subdued at 1% in June because of persistent excess capacity. Inflation is expected to remain moderate through the end of 2026 before rising gradually thereafter as domestic demand slowly improves.

Endnotes

1. Oil prices are assumed to decline in line with the futures curve as of July 9, 2026.[←]

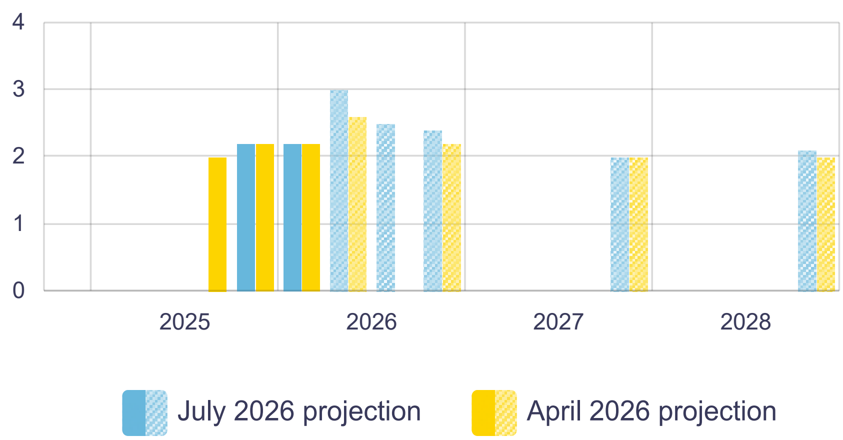
Projections

The outlook for Canadian growth is broadly unchanged. After a weaker-than-expected start to 2026, GDP growth is projected to be slightly stronger in 2027 and 2028. Although near-term inflation has been a bit higher than anticipated, the outlook for inflation is little changed.

The Canadian economy is evolving largely as expected (**Chart 21**).

Chart 21: The July 2026 and April 2026 Monetary Policy Report outlooks

CPI inflation (year-over-year percentage change)



Changes to the projection

Canadian outlook

Growth in gross domestic product (GDP) for 2026 is projected to be 0.5 percentage points lower than estimated in the April Report due to a weaker-than-expected start to the year (**Table 2**). The unexpected weakness mainly reflects a decline in government spending in the first quarter.

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

	2025	2026	2027	2028
Consumption	1.3 (1.2)	0.9 (0.8)	0.8 (0.5)	0.6 (0.6)
Housing	0.0 (0.1)	-0.2 (-0.1)	0.1 (0.1)	0.2 (0.2)
Government	0.8 (0.8)	0.5 (0.9)	0.8 (0.7)	0.5 (0.4)
Business fixed investment	0.0 (0.0)	0.2 (0.1)	0.2 (0.3)	0.2 (0.3)
Subtotal: final domestic demand	2.1 (2.1)	1.4 (1.7)	1.9 (1.6)	1.5 (1.5)
Exports	-0.5 (-0.5)	0.5 (-0.2)	0.6 (0.8)	0.8 (0.9)
Imports	0.1 (0.2)	-1.0 (-0.3)	-0.6 (-0.7)	-0.7 (-0.7)
Inventories	0.0 (0.0)	-0.2 (0.0)	-0.1 (-0.1)	0.2 (0.0)
GDP	1.9 (1.7)	0.7 (1.2)	1.8 (1.6)	1.8 (1.7)
Memo items (percentage change):				
Range for potential output	2.3 (2.3)	0.8–1.6 (0.8–1.6)	0.8–1.8 (0.8–1.8)	1.0–2.0 (1.0–2.0)
CPI inflation	2.1 (2.1)	2.5 (2.3)	2.0 (2.1)	2.1 (2.0)

* Numbers in parentheses are from the April Report.
† Numbers may not add to total due to rounding and Statistics Canada's statistical discrepancy.
Sources: Statistics Canada and Bank of Canada calculations, estimates and projections

GDP growth is then 0.2 percentage points higher in 2027 mainly because of an upward revision to the outlook for consumption spending.

Exports are revised up over the projection horizon, partly supported by additional energy-related activity. For non-commodity exports, the upward revision reflects survey evidence pointing to slightly improved prospects, including stronger demand linked to US investment in artificial intelligence.[1]

Near-term inflation has been a bit stronger than expected in the April Report, but the outlook for inflation is little changed (**Table 3**). The near-term strength is due to higher oil prices, elevated gasoline refinery margins and a weaker Canadian dollar.

Table 3: Summary of the quarterly projection for Canada*

	2025	2026			2025	2026	2027	2028
	Q4	**Q1**	**Q2**	**Q3**	**Q4**	**Q4**	**Q4**	**Q4**
CPI inflation (year-over-year percentage change)	2.2 (2.2)	2.2 (2.2)	3.0 (2.6)	2.5	2.2 (2.2)	2.4 (2.2)	2.0 (2.0)	2.1 (2.0)
Core inflation (year-over-year percentage change)†	2.8 (2.8)	2.4 (2.4)	2.1 (2.1)	2.0	2.8 (2.8)	2.0 (2.0)	2.2 (2.2)	2.1 (2.0)
Real GDP (year-over-year percentage change)	0.7 (0.7)	-0.1 (0.6)	0.8 (1.2)	0.7	0.7 (0.7)	1.4 (1.8)	1.9 (1.4)	1.8 (1.9)
Real GDP (quarter-over-quarter percentage change at annual rates)‡	-1.0 (-0.6)	-0.1 (1.5)	2.5 (1.5)	1.5				

* See details in the **Tariff and other assumptions** section. Numbers in parentheses are from the April Report.
† Core inflation is the average of CPI-trim and CPI-median.
‡ At the time of the projection, 2026Q2 and 2026Q3 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 growth across major economies is broadly unchanged from the April Report (**Table 4**). Global GDP for 2026 has been revised down slightly because the war in the Middle East has weighed more heavily than expected on activity in the Persian Gulf region. Growth in the Persian Gulf region has been revised up for 2027.

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

	Share of global GDP* (%)	**Growth† (%)**			
		2025	**2026**	**2027**	**2028**
United States	15	2.1 (2.1)	2.4 (2.4)	2.4 (2.3)	2.4 (2.3)
Euro area	12	1.5 (1.5)	0.4 (0.9)	1.2 (1.1)	1.3 (1.3)
China	19	5.0 (5.0)	4.7 (4.7)	4.2 (4.2)	4.1 (4.2)
World	100	3.5 (3.5)	2.8 (3.0)	3.2 (3.0)	3.2 (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 April Report.
Sources: National sources via Haver Analytics and Bank of Canada calculations, estimates and projections

Endnotes

1. See Bank of Canada, ***Business Outlook Survey—Second Quarter of 2026*** (July 2026).[←]

Risks

The evolution of Canada's trade relationship with the United States and the war in the Middle East remain the two most important risks to the outlook for inflation.

The base-case projection assumes that the Canada-United States-Mexico Agreement remains in place with annual reviews. The economy is adjusting to US tariffs, and the impact of trade-related uncertainty is assumed to gradually fade. However, the United States could announce further trade measures. Uncertainty could also persist for longer than assumed, weakening business investment and household spending.

The projection also assumes that shipping through the Strait of Hormuz gradually returns to normal. Nevertheless, uncertainty remains high. In recent days the strait has closed once again with an escalation of hostilities. If these hostilities lead to another sustained closure of the strait, energy prices will rise and the supply of other commodities will be disrupted, pushing up inflation globally.

The outlook for inflation is also subject to other risks.

Upside risks to inflation

Cost pressures could be stronger than expected

The war in the Middle East has raised input costs for businesses. This is expected to put upward pressure on prices in Canada, especially for food and other goods. The Canadian dollar has also depreciated recently, adding to the costs of imported goods.

In the base case, businesses are assumed to absorb some of the increase in costs. However, if the increase in costs is greater than expected or if businesses end up passing on more of these costs to their customers, inflation will be higher than anticipated.

Trend productivity growth could be weaker than assumed

The outlook for inflation depends in part on the degree of excess supply in the economy. Estimates of excess supply are influenced by potential output, which depends partly on trend labour productivity. In the base case, trend labour productivity is estimated to have picked up in 2025 and to continue growing strongly over the projection horizon.

However, if it turns out that there was less trend labour productivity growth in 2025 than estimated, the output gap would be smaller at the beginning of the projection. Trend labour productivity growth beyond 2025 could also be lower than assumed. This could occur, for example, if business investment turns out to be weaker than projected. As a result, there would be more upward pressure on inflation.

Downside risks to inflation

Global financial conditions could tighten, spilling into Canada

The outlook for the United States assumes a strong pace of investment in artificial intelligence (AI) and related gains in equity markets. However, technology stocks have been volatile since the start of the year. A sharp reassessment of the prospects for AI could trigger a correction in equity markets, reducing both consumer confidence and household wealth in the United States and abroad.

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

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

The pickup in GDP growth may not be sustained

In the base case, growth in gross domestic product (GDP) picks up and remains solid over the projection horizon. However, several factors could jeopardize the sustainability of the recovery:

- The rebound in exports could be weaker than expected due to ongoing competitiveness issues.
- Continued trade uncertainty could lead to further layoffs in affected sectors. At the same time, skills and geographic mismatches could slow workers' transitions to new jobs. Weaker employment would weigh on household spending.
- The overhang of unsold condominiums in Vancouver and Toronto, along with affordability issues, could mean that the recovery in housing activity is slower than expected.

Weaker growth would reduce domestic pressure on inflation.

War-related supply disruptions are passing through to consumer prices

The conflict in the Middle East has generated both direct and indirect cost pressures that continue to feed through supply chains. These cost pressures are material for the inflation outlook.

The war in the Middle East has disrupted oil production and shipments, pushing energy and other commodity prices sharply higher.

In the base-case projection, the peak impact of higher gasoline prices adds roughly 1.4 percentage points to inflation in the second quarter of 2026. In addition, businesses are assumed to pass on some of the war-related costs from earlier this year rather than absorb them entirely through lower margins. These additional cost pressures are projected to have a peak impact of about 0.4 percentage points on consumer price index inflation in the first quarter of 2027.

Upstream cost pressures pose a challenge for businesses

Upstream costs include the raw materials, components and services that businesses need to produce a good or service. When these costs come under pressure, it takes time for the effects to move through the supply chain. Ultimately, these cost pressures squeeze profit margins and can force businesses to raise their prices.

How much these cost pressures affect inflation depends on two factors:

- how long they remain elevated
- how much of them businesses pass through to consumer prices

In the United States, where upstream and downstream price pressures can be tracked closely, upstream prices have risen in some sectors, while pass-through to final consumer prices has so far been limited (**Chart 22**).

Chart 22: Price pressures for US producers are rising

Price indexes, year-over-year percentage change, monthly data

Note: *Producer price index—stage 1* refers to raw materials. *Producer price index—stage 4* refers to nearly finished goods.

Sources: US Bureau of Economic Analysis and US Bureau of Labor Statistics via Haver Analytics

Last observation: May 2026

How long cost pressures last will affect inflation

The persistence of upstream cost pressures is important for the inflation outlook. The Bank of Canada is monitoring a variety of indicators to assess whether cost pressures are likely to persist. The indicators capture four channels through which the war could affect upstream costs:

- **Supply chain bottlenecks.** It may take time for traffic through the Strait of Hormuz to return to pre-war levels. Volumes in key ports are being monitored for signs that shipping disruptions are easing. Bank of Canada surveys of businesses are providing additional insights.

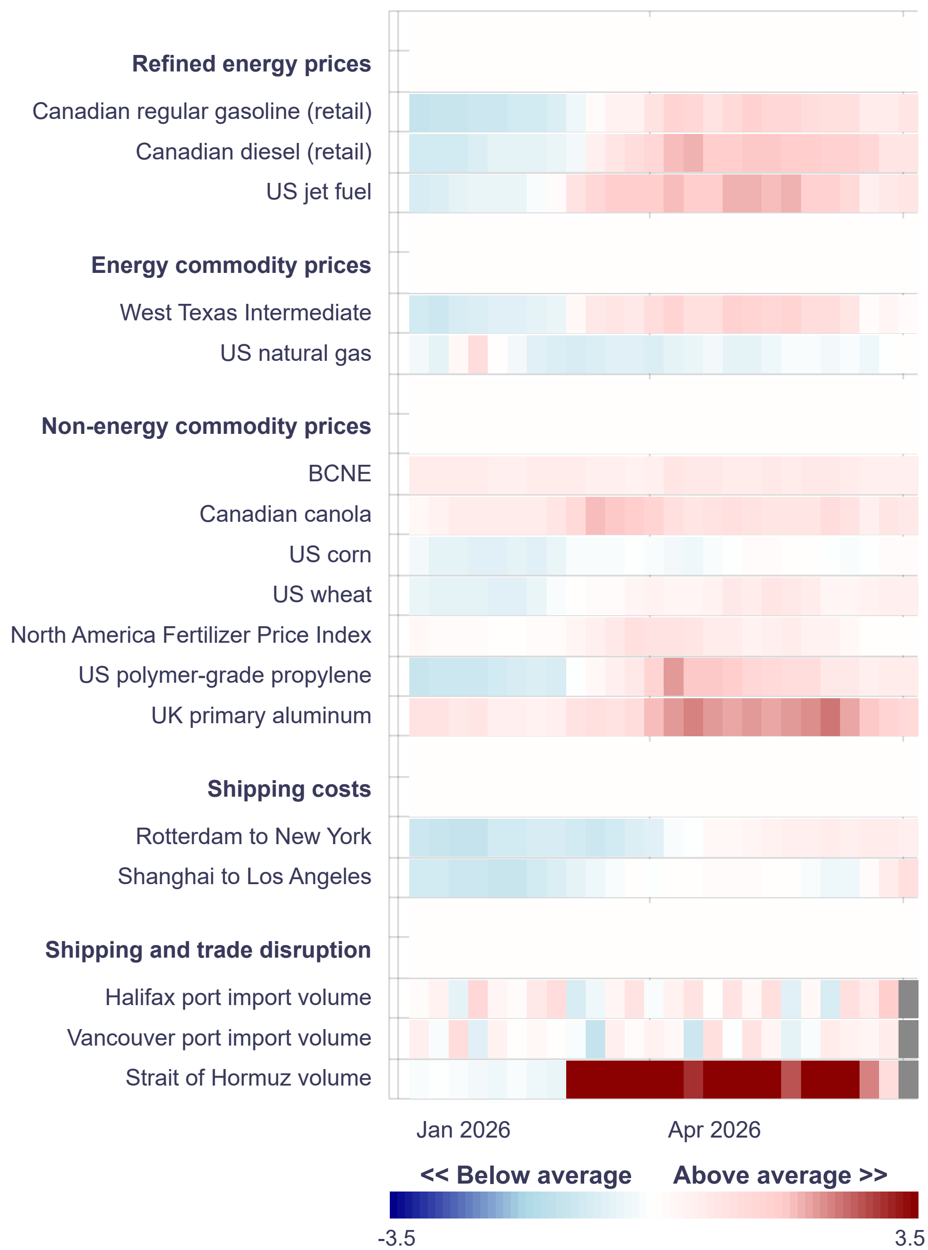
- **Elevated transportation costs.** Shipping costs could remain above pre-war levels until routes through the region are seen as safe and reliable. Data on key shipping routes, including major container traffic between Shanghai and Los Angeles, provide a gauge of whether transportation cost pressures are normalizing.
- **Longer-term supply shortages.** Even after shipping returns to normal, some commodity production may be slow to recover due to war-related damage to infrastructure. Price indicators for these commodities help assess whether supply constraints are keeping input costs elevated.
- **Additional short-term demand pressures.** Inventories of war-affected commodities have been drawn down during the conflict, and restocking could add to demand pressures in the near term. Oil and natural gas inventories and prices are being monitored.

To date, several indicators point to elevated cost pressures related to the war (**Chart 23**). For example:

- Global supplier delivery times have lengthened because some imported goods have become harder to source and because businesses have purchased inputs in advance to avoid further cost increases. Survey results show that the number of businesses in Canada reporting supply chain issues has risen, although most said their ability to meet demand has not been limited.
- Shipping costs have increased.
- Prices of commodities such as diesel, aluminum and jet fuel are elevated.

Chart 23: War-related input costs remain elevated

Weekly data



Note: The heatmap shows the distance of each variable's year-over-year growth rate from its historical average. For *Shipping and trade disruption* components, the colour is white when the variable is close to the historical average, a varying shade of red when it is below, a varying shade of blue when it is above, and grey when no data are available. For all other indicators, the colour is white when the variable is close to the historical average, a varying shade of red when it is above, a varying shade of blue when it is below, and grey when no data are available. To make the indicators more comparable, each indicator is standardized. Those measured in monetary value are converted to Canadian dollars, while the three *Shipping and trade disruption* components are measured in metric tons. Each variable plotted in the heatmap is standardized by subtracting its mean and dividing by its standard deviation. This standardization is conducted using data from 1996, or the oldest data point, to the most recent data point. BCNE is the Bank of Canada non-energy commodity price index.
Sources: Statistics Canada, Kalibrate Canada, US Energy Information Administration, Intercontinental Exchange, Wall Street Journal, New York Mercantile Exchange, Financial Times, Drewry Shipping Consultants Limited, International Monetary Fund, Henry Hub, Bloomberg Finance L.P., Bank of Canada and Bank of Canada calculations
Last observation: June 29, 2026

How much is passed through to consumers can vary

Canadian businesses face a difficult choice on cost pass-through.

On the one hand, if disruptions prove short-lived, businesses that quickly pass on costs risk losing market share to competitors that do not. On the other hand, if businesses hold prices steady and cost pressures remain elevated, their profit margins will narrow.

The ability to raise prices is affected by weak demand in the Canadian economy.