Monthly Forecast Up

BoC on hold while the Fed moves towards the sidelines

Highlights:

Canada’s gross domestic product growth for 2025 is tracking above prior expectations, and the unemployment rate below. Our cautiously optimistic outlook for Canada’s economy remains intact.

We still don’t see the Bank of Canada cutting the overnight rate further. The next move is more likely to be a hike although we don’t expect that until 2027.

U.S. forecasts are in a holding pattern, pending delayed data releases. Stagflation lite remains our key theme with the unemployment rate and core inflation expected to edge higher in 2026.

With a December cut in the books, we expect the U.S. Federal Reserve to try to squeeze in only one more rate cut in 2026 before holding steady for the remainder of the year.

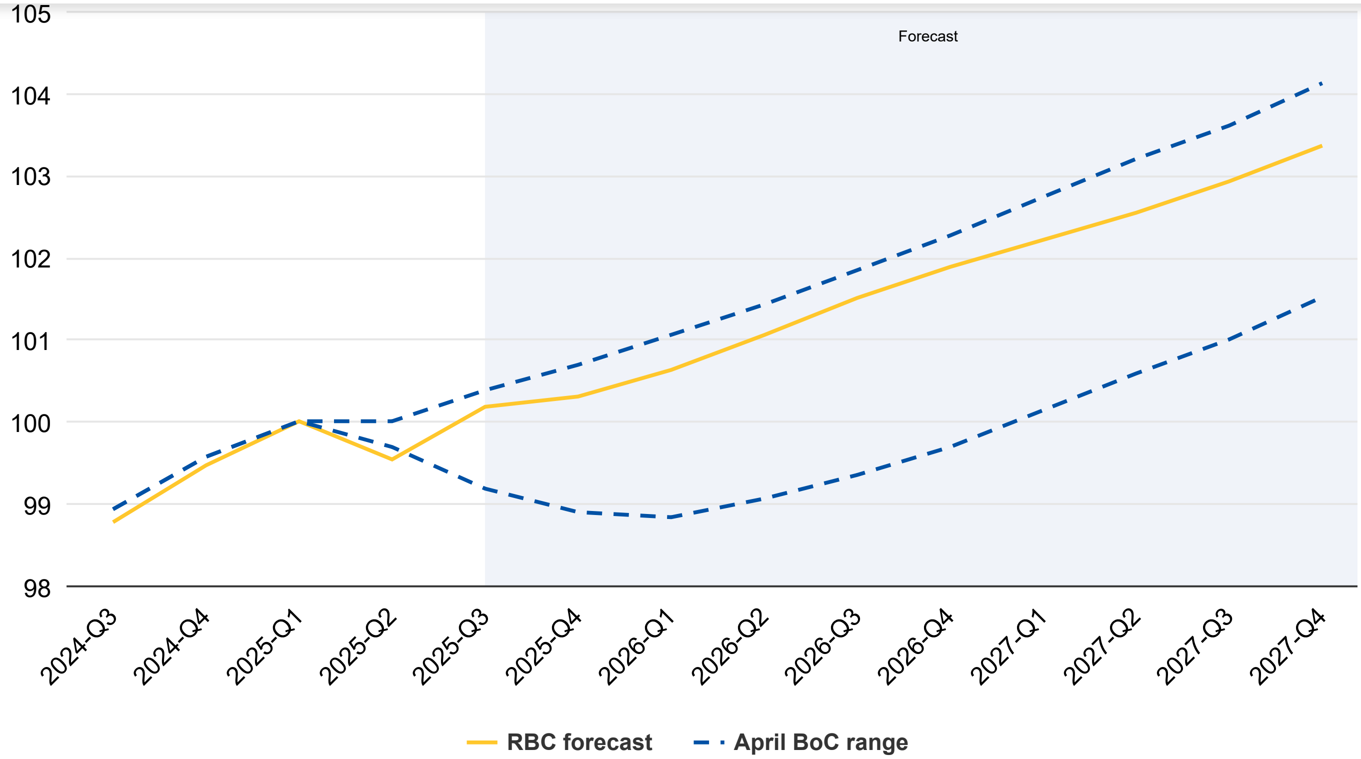
Issue in focus:

It's still early, but we now have enough data to track how heavily tariffed Canadian industries have fared since the U.S. measures were imposed. We break down trends in the auto, metals and lumber industries for production, employment and selling prices this year.

Forecast changes:

Labour market green shoots support Canadian forecast

No single data point should change our view of the economy—particularly not the notoriously volatile monthly labour market data. But consecutive upside employment surprises in Canada, along with a substantial 0.6 percentage point drop in the unemployment rate between September and November, added conviction to our cautiously optimistic outlook on the Canadian economy.



Source: Bank of Canada, RBC Economics

Cautious is the key word. Uncertainty about Canada-U.S. trade remains, sharply slower population growth will weigh on aggregate output, and weak productivity growth persists as a structural challenge. Still, growth in the economy has tracked closer to the optimistic end of possible scenarios from April, and 275 basis points of BoC rate cuts Since June 2024 will continue to help with recovery from a cyclical trough.

Without another external shock, our Canadian outlook remains for soft GDP growth, a gradual drift lower in the unemployment rate, and sticky underlying inflation above the BoC's 2% target in 2026.

Next eventual BoC move is more likely a hike

That outlook, combined with the overnight rate already at the lower bound of the neutral range, makes it challenging to make a case for additional easing from the BoC. Indeed, we think the next move from the central bank is more likely to be a hike, although the timing is uncertain.

For now, we maintain our forecast that the BoC will hold the overnight rate steady at 2.25% throughout 2026 before raising it back up to the top of the 2.25% to 3.25% neutral range in 2027.

Upside risks to our base case—stemming from [stronger-than-expected consumer purchases]() or unwinding of trade headwinds due to a shifting U.S. political landscape—could add to growth and

U.S. macro forecast in a holding pattern

Limited available U.S. economic data since our last forecast update mostly pointed to further, but still gradual softening in the labour market. We continue to expect conditions will get worse before they get better, and the unemployment rate will edge higher to peak at 4.6% in 2026, before gradually dropping lower.

Our prior forecast assumed a significant unemployment spike in October due to federal workers that were furloughed during the U.S. government shutdown. With that data release now cancelled, we have reverted our Q4 unemployment rate forecast to 4.5%, slightly above September's 4.4%.

Zooming out of the current quarter, a worsening stagflation lite (slower growth, higher prices) remains one of the key themes of [our U.S. outlook] in 2026. We expect it will continue to present challenges to the Fed that seeks to balance risks around both the inflation and the employment side of their mandate.

Fed still expected to be on hold through most of 2026

With a third consecutive cut in December that lowered the Fed Funds to neutral range, we see the scope for further downward moves from the Fed as becoming more limited, particularly as we expect core inflation to rise to 3.3% by mid-2026 and the unemployment rate to normalize to still historically low levels.

Between now and the next Fed meeting in January, a deluge of delayed economic data releases should provide more clarity on the state of U.S. labour conditions and inflation after the government shutdown. Consequently, they could materially impact the timing and magnitude of future easing.

For now, we've penciled in only one more rate cut from the U.S. central bank in line with their Summary of Economic Projections. Risks are that the window for further rate cuts closes faster than hoped for.

BoC Fed BoE ECB RBA

Central bank	current policy rate (latest move)	next decision

2.25%

0 bps in Dec/25

0 bps

Jan/26

The BoC delivered a widely expected hold in December, while downplaying recent improvements in economic data. Governor Macklem reiterated the outlook for modest growth, and slow absorption of economic slack, in line with our own forecast. Our base case assumes no additional easing in monetary policy but also no rate hikes until 2027. Risks are tilted toward an earlier hike than that.

Issue in focus:

Tracking the impact of U.S. tariffs on five targeted Canadian industries

Most U.S. tariff revenue collected on imports from Canada this year has come from product-specific (section 232) tariffs imposed on autos, metals, and softwood lumber not protected by CUSMA exemptions.

This has created a fragmented Canadian economy where a subset of sectors face significant trade shock, while most other trade remains duty-free. Even among these targeted sectors, the impact has been uneven.

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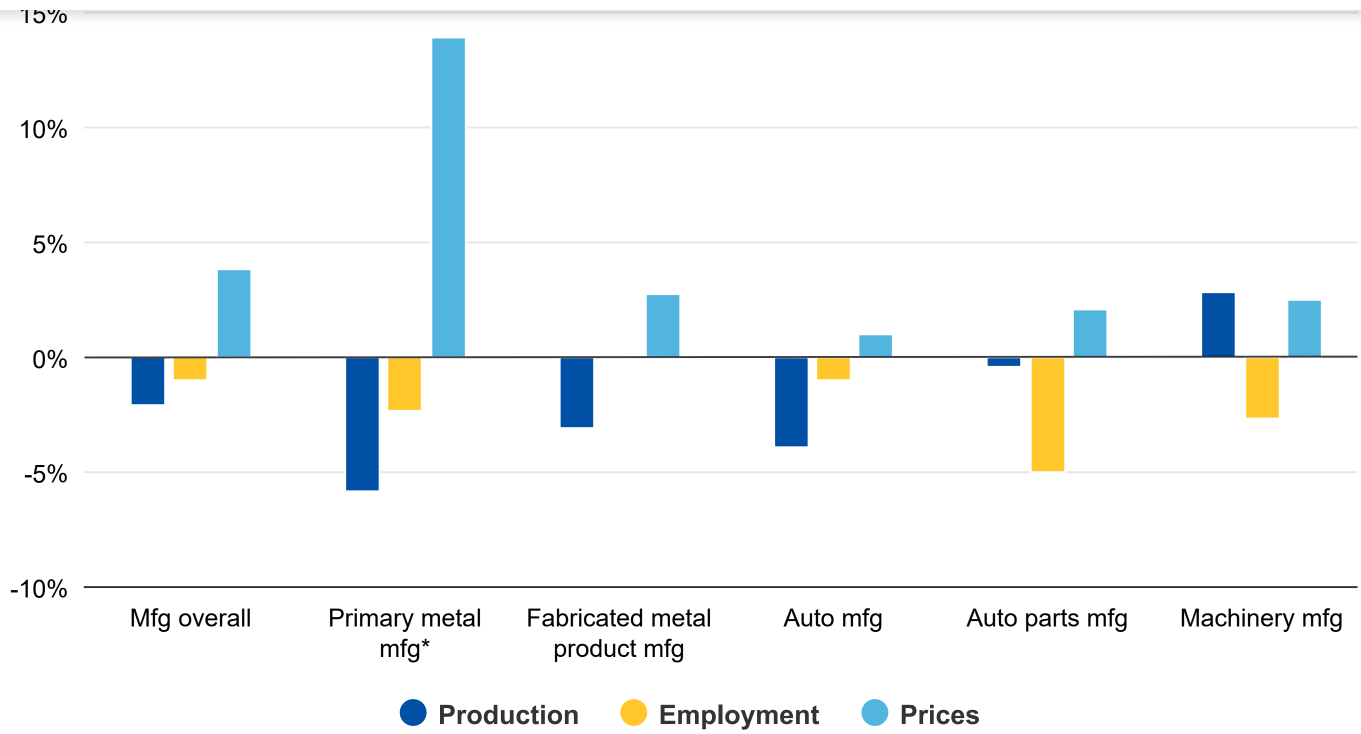

*Prices higher for aluminum and gold mfg, lower for steel mfg
Source: Statistics Canada, RBC Economics

It's still early, but we now have enough data to begin assessing how key Canadian industries behind products (grouped by two-digit harmonized system codes) that accounted for more than 80% of U.S. tariffs collected on imports from Canada this year have fared.

Overall, we track moderately lower manufacturing production and employment after tariffs were imposed. Selling prices among Canadian manufacturers have generally held up, suggesting U.S. buyers are paying the bulk of initial tariff costs. As a result, U.S. corporate profits have broadly declined this year.

Here's a breakdown of how five key Canadian industries have coped with production, employment, and selling prices amid rising U.S. tariffs.

Economic Forecast Detail: Canada

Economic Forecast Detail: U.S.

Interest Rates And Key FX Rates

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