

Monthly forecast update



December 12,
2025

RBC Economics

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:

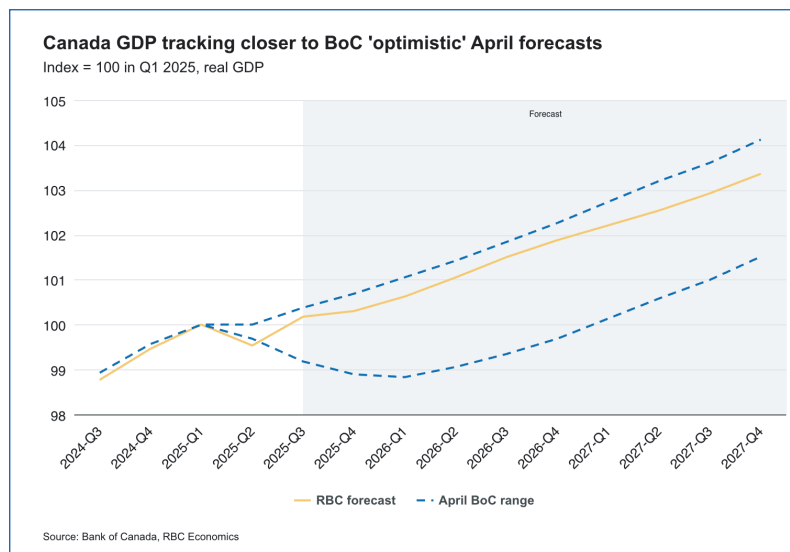


It's still early, but we now have enough data to track how heavily tariffed Canadian industries have fared since the U.S. measures were imposed. We break down trends in the auto, metals and lumber industries for production, employment and selling prices this year.

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.



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 inflation, narrow the output gap faster than expected, and pull rate hikes forward into 2026.

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.

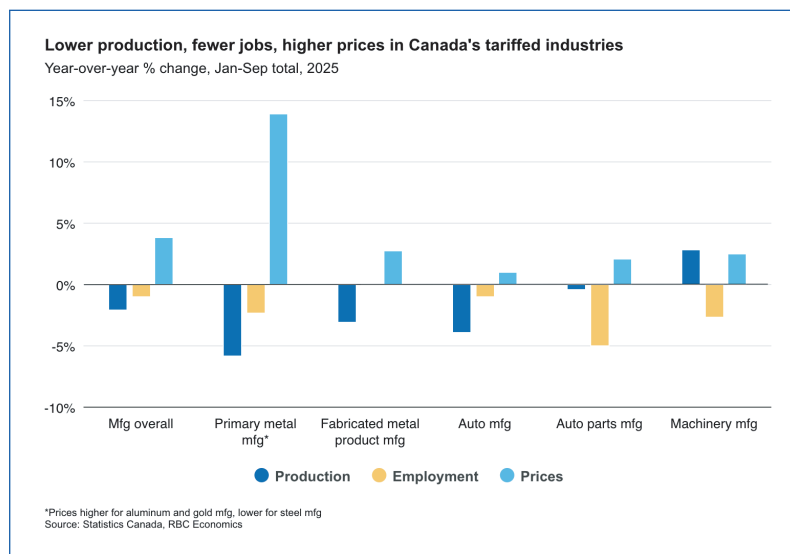
Central bank	current policy rate	next decision	
 BoC	2.25% 0 bps in Dec/25	0 bps Jan/26	<p>The BoC delivered a widely expected hold in December, while downplaying recent improvements in economic data. Governor Macklem reiterated the outlook for modest growth, and slow absorption of economic slack, in 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.</p>
 Fed	3.5-3.75% -25 bps in Dec/25	-25 bps Jan/26	<p>While delivering the December rate cut, Fed chair Jerome Powell focused on the decision being a close call given tough deliberations over two sides of their mandate. The accompanying dot plot was dispersed with median for just one cut in 2026, in line with our base case forecast. Chair Powell set up the guidance for holding steady in upcoming meetings, although incoming data releases could shift that.</p>
 BoE	4.00% 0 bps in Nov/25	-25 bps Dec/25	<p>The U.K. labour market loosened in 2025 as the unemployment rate rose. Beyond an expected 25 bps rate cut in December, we think a change in the Bank of England's assessment of risks surrounding inflation (now "more balanced"), combined with increasing labour slack opens the possibility for two further cuts in Feb and April 2026. We change our forecast for terminal Bank Rate to 3.25%.</p>
 ECB	2.00% 0 bps in Oct/25	0 bps Dec/25	<p>With the European Central Bank adopting a holding bias, we are comfortable with our forecast for the deposit rate to remain at 2% throughout 2026. Despite weak productivity growth, we are optimistic the euro area can undergo a robust cyclical upswing in 2026 fuelled by normalization in savings, fiscal stimulus (some upside risk from a faster rollout of spending in Germany), and easier credit conditions.</p>
 RBA	3.60% 0 bps in Dec/25	0 bps Feb/26	<p>The Reserve Bank of Australia left the cash rate unchanged in December following consecutive upside surprises in economic data. Governor Bullock confirmed deliberations over circumstances for rate hikes, that can be prevented by signs of stabilization in future labour market and inflation data. For now, we expect the cash rate to remain at 3.6%, but see the next February meeting as live.</p>

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.



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.

Interest rate outlook | December 2025

Policy rates and government bond yields, end of period

	Q1-25	Q2-25	Q3-25	Q4-25	Q1-26	Q2-26	Q3-26	Q4-26	Q1-27	Q2-27	Q3-27	Q4-27
Canada												
Overnight rate	2.75	2.75	2.50	2.25	2.25	2.25	2.25	2.25	2.50	2.75	3.00	3.25
3-month	2.62	2.65	2.42	2.15	2.20	2.20	2.20	2.25	2.55	2.80	3.00	3.20
2-year	2.46	2.59	2.47	2.70	2.80	2.90	3.00	3.10	3.25	3.45	3.55	3.65
5-year	2.61	2.83	2.74	3.10	3.15	3.20	3.25	3.30	3.45	3.55	3.65	3.70
10-year	2.97	3.28	3.18	3.45	3.50	3.55	3.60	3.65	3.70	3.75	3.75	3.80
30-year	3.23	3.56	3.64	3.85	3.85	3.85	3.90	3.90	3.90	3.95	3.90	3.90
United States												
Fed funds midpoint	4.38	4.38	4.13	3.63	3.38	3.38	3.38	3.38	3.13	2.88	2.88	2.88
3-month	4.32	4.41	4.02	3.63	3.38	3.41	3.43	3.43	3.13	2.91	2.93	2.93
2-year	3.89	3.72	3.60	3.55	3.75	3.85	3.90	3.75	3.60	3.55	3.60	3.65
5-year	3.96	3.79	3.74	3.70	3.90	4.00	4.05	3.95	3.80	3.75	3.80	3.85
10-year	4.23	4.24	4.16	4.10	4.25	4.35	4.40	4.35	4.25	4.20	4.25	4.30
30-year	4.59	4.78	4.73	4.75	4.90	4.95	4.95	4.90	4.85	4.80	4.80	4.85
United Kingdom												
Bank Rate	4.50	4.25	4.00	3.75	3.50	3.25	3.25	3.25	3.25	3.25	3.25	3.25
2-year	4.20	3.81	3.99	3.80	3.50	3.40	3.40	3.40	3.30	3.30	3.25	3.20
5-year	4.29	3.95	4.14	4.00	3.90	3.85	3.90	3.95	3.90	3.90	3.90	3.90
10-year	4.70	4.48	4.70	4.60	4.55	4.60	4.70	4.80	4.75	4.75	4.70	4.65
30-year	5.29	5.25	5.49	5.40	5.40	5.50	5.55	5.55	5.50	5.50	5.50	5.50
Euro area*												
Deposit rate	2.50	2.00	2.00	2.00	2.00	2.00	2.00	2.00	2.00	2.00	2.00	2.00
2-year	2.05	1.85	2.02	2.10	2.15	2.25	2.40	2.50	2.40	2.50	2.50	2.50
5-year	2.34	2.15	2.31	2.50	2.50	2.60	2.70	2.80	2.75	2.75	2.75	2.75
10-year	2.74	2.59	2.72	3.00	3.00	3.10	3.20	3.25	3.20	3.25	3.30	3.40
30-year	3.09	3.12	3.30	3.40	3.60	3.75	3.80	4.00	4.00	4.10	4.20	4.30
Australia												
Cash rate	4.10	3.85	3.60	3.60	3.60	3.60	3.60	3.60	3.60	3.60	3.60	3.60
2-year	3.68	3.21	3.49	3.90	4.10	4.00	4.00	3.90	3.90	3.90	3.90	3.90
10-year	4.39	4.16	4.30	4.60	4.65	4.60	4.60	4.60	4.50	4.45	4.45	4.50
New Zealand												
Cash rate	3.75	3.25	3.00	2.25	2.25	2.25	2.25	2.25	2.50	2.75	2.75	2.75
2-year swap	3.33	3.18	2.60	3.00	3.10	3.15	3.10	3.00	3.00	3.00	3.00	3.00
10-year swap	4.05	4.03	3.66	4.10	4.15	4.25	4.30	4.25	4.20	4.20	4.25	4.30

Sources: Refinitiv, BoC, Fed, BoE, ECB, RBA, RBNZ, RBC Economics, RBC Capital Markets | *German government bond yields

Economic outlook | December 2025

Real GDP, quarter-over-quarter percent change

	Q1-24	Q2-24	Q3-24	Q4-24	Q1-25	Q2-25	Q3-25	Q4-25	Q1-26	Q2-26	Q3-26	Q4-26	Q1-27	Q2-27	Q3-27	Q4-27	2024	2025	2026	2027
Canada*	2.9	3.3	3.3	2.8	2.2	-1.8	2.6	0.5	1.3	1.7	1.8	1.5	1.3	1.3	1.5	1.7	2.0	1.7	1.3	1.5
United States*	0.8	3.6	3.3	1.9	-0.6	3.8	2.5	0.5	1.7	1.5	1.7	1.8	1.8	1.9	1.9	1.8	2.8	1.9	1.7	1.8
United Kingdom	0.8	0.6	0.2	0.2	0.7	0.3	0.1	0.2	0.2	0.3	0.3	0.3	0.4	0.4	0.4	0.4	1.1	1.5	1.1	1.5
Euro area	0.3	0.2	0.4	0.4	0.6	0.1	0.3	0.3	0.5	0.5	0.4	0.3	0.2	0.3	0.3	0.3	0.8	1.3	1.5	1.3
Australia	0.3	0.2	0.3	0.5	0.4	0.7	0.4	0.8	0.6	0.7	0.5	0.5	0.6	0.6	0.5	0.5	1.0	1.9	2.5	2.3

*annualized

Inflation, year-over-year percent change

	Q1-24	Q2-24	Q3-24	Q4-24	Q1-25	Q2-25	Q3-25	Q4-25	Q1-26	Q2-26	Q3-26	Q4-26	Q1-27	Q2-27	Q3-27	Q4-27	2024	2025	2026	2027
Canada	2.8	2.7	2.0	1.9	2.3	1.8	2.0	2.2	2.2	2.4	2.2	2.0	1.9	2.0	2.0	2.1	2.4	2.1	2.2	2.0
United States	3.2	3.2	2.6	2.7	2.7	2.4	2.9	3.0	2.8	2.9	2.7	2.4	2.3	2.3	2.3	2.2	2.9	2.8	2.7	2.3
United Kingdom	3.5	2.1	2.1	2.5	2.8	3.5	3.8	3.6	3.2	2.8	2.6	2.5	2.3	2.2	2.2	2.3	2.5	3.4	2.8	2.3
Euro area	2.6	2.5	2.2	2.2	2.3	2.0	2.1	2.1	1.6	2.0	1.9	1.9	2.0	2.0	2.1	2.2	2.4	2.1	1.9	2.1
Australia	3.6	3.8	2.8	2.4	2.4	2.1	3.2	3.7	3.5	3.6	3.0	3.1	3.2	3.2	3.1	3.0	3.2	2.9	3.3	3.1

Sources: StatCan, BLS, ONS, EuroStat, ABS, RBC Economics, RBC Capital Markets

Currency outlook | December 2025

US dollar cross rates, end of period

	Q1-24	Q2-24	Q3-24	Q4-24	Q1-25	Q2-25	Q3-25	Q4-25	Q1-26	Q2-26	Q3-26	Q4-26	Q1-27	Q2-27	Q3-27	Q4-27
USD/CAD	1.35	1.37	1.35	1.44	1.44	1.36	1.39	1.39	1.38	1.37	1.36	1.34	1.33	1.32	1.31	1.30
EUR/USD	1.08	1.07	1.11	1.04	1.08	1.18	1.17	1.17	1.16	1.17	1.18	1.20	1.21	1.22	1.23	1.24
GBP/USD	1.26	1.26	1.34	1.25	1.29	1.37	1.34	1.32	1.33	1.34	1.34	1.36	1.38	1.39	1.39	1.39
USD/JPY	151	161	143	157	150	144	148	145	156	153	150	147	144	141	138	135
AUD/USD	0.65	0.67	0.69	0.62	0.62	0.66	0.66	0.64	0.67	0.68	0.69	0.70	0.70	0.69	0.70	0.72

Canadian dollar cross rates

	Q1-24	Q2-24	Q3-24	Q4-24	Q1-25	Q2-25	Q3-25	Q4-25	Q1-26	Q2-26	Q3-26	Q4-26	Q1-27	Q2-27	Q3-27	Q4-27
EUR/CAD	1.46	1.47	1.50	1.49	1.55	1.60	1.63	1.63	1.60	1.60	1.60	1.61	1.61	1.61	1.61	1.61
GBP/CAD	1.71	1.73	1.80	1.80	1.86	1.87	1.88	1.84	1.84	1.84	1.82	1.83	1.84	1.83	1.82	1.81
CAD/JPY	112	117	106	109	104	106	106	104	113	112	110	110	108	107	105	104
AUD/CAD	0.88	0.91	0.93	0.89	0.90	0.89	0.92	0.89	0.92	0.93	0.94	0.94	0.93	0.91	0.92	0.94

Sources: Federal Reserve Board, Bank of Canada, RBC Economics, RBC Capital Markets

For more information please visit:



rbc.com/en/economics



linkedin.com/company/rbc-economics

The material contained in this report is the property of Royal Bank of Canada and may not be reproduced in any way, in whole or in part, without express authorization of the copyright holder in writing. The statements and statistics contained herein have been prepared by RBC Economics Research based on information from sources considered to be reliable. We make no representation or warranty, express or implied, as to its accuracy or completeness. This publication is for the information of investors and business persons and does not constitute an offer to sell or a solicitation to buy securities.

®Registered trademark of Royal Bank of Canada.

©Royal Bank of Canada.