

Monthly forecast update



January 14,
2026

RBC Economics

Steady as she goes – central banks hold the line in 2026

Highlights:



Demographics reshape Canada's growth story: Zero population growth in 2026 means GDP will expand at a slower rate this year, driven entirely by per-capita improvements after past central bank rate cuts—a meaningful departure from prior year trends.



U.S. forecasts see challenges: Upside GDP surprises in 2025 came despite labour market softening, implying productivity gains—not job creation—fuelled economic expansion. The sustainability of those gains, among many other uncertainties are obscuring the outlook.



Central banks to hold steady: We expect both the Bank of Canada and Federal Reserve to keep interest rates unchanged in 2026 with Canada's rates at neutral levels and U.S. rates still slightly restrictive.

Issue in focus:

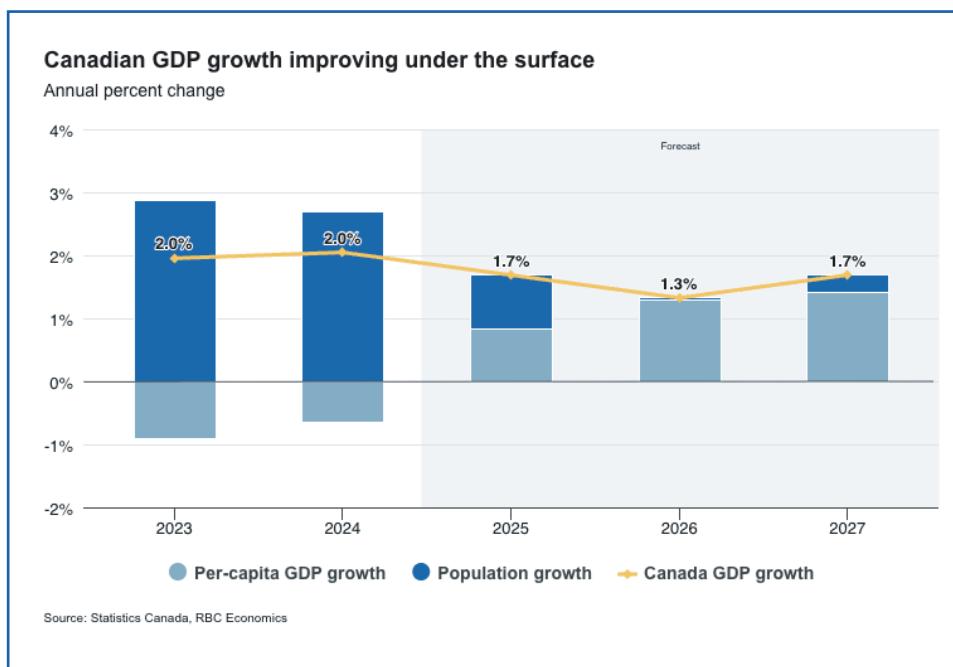


Immigration caps and an aging population are stalling labour force expansion in Canada and the U.S. Consequently, fewer new jobs are needed every month to keep the unemployment rate steady. We zoom in on our break-even employment estimates as benchmarks for accessing the health of the labour market.

Forecast changes:

Demographic shifts may prove a bigger focal point for our Canada economic forecast than trade

Canada will experience zero population growth in 2026 for the first time on record dating back to the 1950s due to the government's pivot on immigration policy. This leaves headline GDP growth driven solely by per-capita improvements. After a turnaround in 2025, we expect per-capita GDP will growth faster this year, supported by central bank easing in the past.



Globally, geopolitical tensions are dominating headlines and dampening sentiment, though their near-term impact on our forecast is likely minimal. U.S. operations in Venezuela, for example, cannot meaningfully improve oil production in 2026 given decades of infrastructure deterioration that will require sustained large-scale investment and operational stability to reverse.

Overall, our outlook for Canada is little changed from a month ago. We continue to expect GDP growth will soften from 2025 to 2026 as population increase slows to a crawl, but that will mask a strengthening backdrop better observed through rising real per-capita GDP growth, a gradually declining unemployment rate and broadly steady (but still above-target) core consumer inflation.

More specifically:

- **We maintained our 2026 GDP forecast at 1.3%, a moderate slowdown from 1.7% in 2025.** With zero population growth, per-capita GDP will expand at the same 1.3% this year as total GDP—up from 0.8% in 2025 to mark the second consecutive annual increase after declines in 2023 and 2024.
- **The 1.3% subdued GDP growth will still outpace potential GDP growth of 0.7% in 2026,** which is constrained by persistent productivity challenges and fewer working hours. This will gradually shrink the negative output gap in the economy before closing it completely in 2027.
- **Labour markets are expected to improve.** We expect the unemployment rate will gradually decline from 6.8% to 6.3% by Q4 2026. Sharply slowing population growth means we won't need to see big job gains this year for per-worker labour conditions (better measured by the unemployment rate) to improve. Read more on our estimates of breakeven employment below.

- **Inflation is expected to hover around the 2% target, but it's a fragile equilibrium.** Core inflation will likely remain above the 2% target. Energy prices could fluctuate more than usual due to geopolitical risks, while food inflation accelerates along with agricultural commodity (particularly meat) prices due to supply shortages that will take time to unwind.
- **The Bank of Canada is not expected to change interest rates in 2026** – and is expected to hike rates in moderately in 2027 following a closing output gap and somewhat sticky core inflation prints. Risks are that stronger (per-capita) activity could accelerate inflation, pulling rate hikes forward into 2026.
- **Finally, our outlook continues to assume that CUSMA exemptions will be preserved** as the scheduled review begins in July, while additional sectoral tariffs remain limited. A sudden tariff escalation, though unlikely, remains a key downside risk to our forecast.

The list of known unknowns challenging U.S. forecasting continues to grow

A new year has not brought the clarity on the U.S. economy that we had hoped for. Challenges continue to mount: data disruptions from the government shutdown still obscure visibility, while the legal status of IEEPA tariffs, subsequent implications for duty collection and refunds, and their pass-through to the economy will remain highly uncertain even with a Supreme Court ruling.

Looking back, U.S. GDP growth kept surprising to the upside in 2025. With a softening labour market and the unemployment rate edging higher, economic growth was driven entirely by higher implied worker productivity. Hours worked grew just 0.6% on an average annualized basis per quarter between Q2 and Q4, and declined outright by 1% per quarter in the trade-exposed manufacturing sector.

Early data points to sustained momentum in consumer demand and a smaller trade deficit in Q4 2025. We have revised our GDP growth forecast quarter higher as a result, but left our broader 2026 outlook of above-target core consumer inflation and below-trend GDP growth tentatively unchanged.

More specifically:

- **We have marked U.S. GDP growth in Q4 2025 higher to 3.1%** following another upside surprise in Q3 (4.3%). In Q4, we assume momentum in household consumption was maintained, alongside an improvement in the trade balance driven by rising non-monetary gold exports. Strength was partially offset by a drag due to the six-week government shutdown that will reverse in Q1 2026.
- **GDP growth upgrades over the second half of 2025 raised our annual tracking for 2025 and 2026** from 1.9% and 1.7%, respectively, to 2.3% and 2.4%. The 2026 increase reflects a stronger starting point. We have not adjusted the quarterly profile that expects uniformly softer GDP growth below 2%.
- **Our forecasts for a softening labour market are unchanged.** Despite upside GDP growth surprises, the unemployment rate has edged higher throughout 2025 and employment growth has stalled. Soft hiring demand has extended job search times for labour market entrants, and we anticipate this will continue to push the unemployment rate higher to a peak of 4.6% in the first half of 2026.
- **U.S. core CPI is expected to hover around 3% throughout 2026**, well above the Federal Reserve's 2% target due to delayed tariff passthrough. Adding to volatility is the BLS's treatment of the owners' equivalent rent of residences (OER) component in the October-November CPI release, which could bias near-term yearly readings lower before reversing in April.
- **The Fed is now expected to remain on hold in 2026**, constrained by competing pressures on both sides of its mandate. Concerns about political pressure on monetary policy have heightened, but we believe the Fed remains insulated from such influence on its policy decisions. We forecast the Fed Funds rate will remain at 3.5%–3.75% this year before easing further in 2027.

Central bank	current policy rate	next decision	
 BoC	2.25% 0 bps in Dec/25	0 bps Jan/26	The BoC delivered a widely expected hold in December. Labour market data after the meeting suggests the recovery progress in the Canadian labour market could be choppy, although still in line with the BoC's and our outlook for slow absorption of economic slack. Our base case forecast assumes no additional easing in monetary policy, but also no rate hikes until 2027. Risks are tilted toward an earlier hike.
 Fed	3.5-3.75% -25 bps in Dec/25	-25 bps Jan/26	In the December meeting, Fed chair Jerome Powell focused on the decision (a 25-bps cut) being a close call, while setting up guidance for holding steady in upcoming meetings. Latest labour market report after the meeting showed improvement, but we expect tension will continue to brew on both sides of the Fed's mandate, limiting mobility. We now expect the Fed funds range will be held at 3.5%-3.75% this year.
 BoE	3.75% -25 bps in Dec/25	-25 bps Feb/26	The Bank of England's Monetary Policy Committee voted 5-4 to cut the Bank Rate by 25 basis points in December, while reiterating guidance for further easing from its restrictive policy stance if data permits, more specifically, if inflation continues to slow while the labour market loosens. We maintain our forecast for two additional cuts in February and April, bringing the Bank Rate to a terminal level of 3.25%.
 ECB	2.00% 0 bps in Dec/25	0 bps Feb/26	We remain comfortable with our forecast for the deposit rate to hold at 2% through 2026. The European Central Bank left rates unchanged in December, and maintained its holding bias. Staff projections showed upward revisions to near-term GDP and core inflation forecasts. The latter reflected elevated wage growth boosting services inflation, though a return to the 2% target is still expected by 2028.
 RBA	3.60% 0 bps in Dec/25	0 bps Feb/26	The Reserve Bank of Australia left the cash rate unchanged in December, although Governor Bullock confirmed that consecutive upside data surprises had prompted deliberations on rate hikes. Data released since the meeting showed some relief in inflation, but stronger household consumption in Q4 relative to RBA's latest forecast. We expect a steady RBA in 2026, but see the next February meeting as live.

Issue in focus

Zooming in on “break-even” employment in Canada and the U.S.

Tightened government immigration policy and aging demographics have slowed labour force growth in both Canada and the U.S. during 2025. Consequently, fewer new jobs are needed monthly to match labour force growth and maintain a stable unemployment rate.

This threshold is called “breakeven employment,” and it’s declining in both economies. In simple terms, any job creation exceeding breakeven—regardless of magnitude—signals an improving labour market and would lower the unemployment rate.

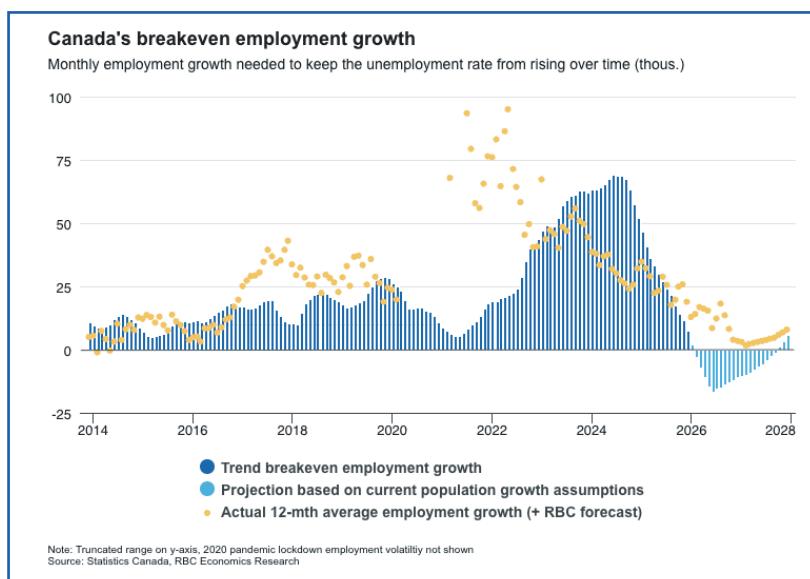
As a result, one can expect an apparent disconnect—low job growth forecasts but without a deteriorating economy or unemployment rate. That will be a significant departure from the traditional way we think about the implications of job growth on the broader economy.

Breakeven employment at sub-zero for Canada

In Canada, we estimate that the break-even rate of employment will average -10,000 each month this year, down from 25,000 in 2025 and well below the elevated 60,000 in 2023 and 2024, during the immigration and population boom.

As a result of the decline, modest job losses that would normally trigger recession concerns would instead be entirely consistent with improvements in the labour market backdrop. We expect to see soft, but mostly positive job gains, for the unemployment rate in Canada to drop to 6.3% by the end of this year.

A recovery in household demand, combined with slower labour force growth and stagnant productivity, could lead to the return of labour shortages. Balancing concerns about rapid population growth with addressing future labour scarcity will be central to Canadian immigration policy over the next decade.



Breakeven employment around 40,000 each month in the U.S.

Stringent immigration policy and aging demographics are also reshaping the U.S. labour force, lowering our break-even employment estimate from 100,000 in 2024 to 40,000 in 2025. We will revisit these estimates following the QCEW benchmark revisions and population adjustments to the household survey in spring.

Big picture wise, unlike Canada's labour market which appears to have bottomed, we expect continued cyclical weakness in the U.S., with the unemployment rate peaking at 4.6% before gradually declining later this year. That means the moderation in job gains at the end of 2025 will persist in the near-term.

Finally, it's important to note that break-even employment is not stagnant, and will continue to fluctuate based on changes in immigration policy and longer-run demographics trends. Read more about our estimate of Canadian breakeven employment rates here, and about our U.S. estimates here.

Interest rate outlook | January 2026

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	2.58	2.80	2.90	3.00	3.10	3.25	3.45	3.55	3.65
5-year	2.61	2.83	2.74	2.96	3.15	3.20	3.25	3.30	3.45	3.55	3.65	3.70
10-year	2.97	3.28	3.18	3.42	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	3.63	3.63	3.63	3.63	3.38	3.13	2.88	2.88
3-month	4.32	4.41	4.02	3.67	3.63	3.66	3.68	3.68	3.38	3.16	2.93	2.93
2-year	3.89	3.72	3.60	3.47	3.65	3.65	3.60	3.55	3.40	3.30	3.25	3.30
5-year	3.96	3.79	3.74	3.73	3.80	3.85	3.90	3.80	3.65	3.60	3.55	3.60
10-year	4.23	4.24	4.16	4.18	4.25	4.35	4.40	4.35	4.25	4.20	4.25	4.30
30-year	4.59	4.78	4.73	4.84	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	3.71	3.50	3.40	3.40	3.40	3.30	3.30	3.25	3.20
5-year	4.29	3.95	4.14	3.93	3.80	3.75	3.75	3.80	3.90	3.90	3.90	3.90
10-year	4.70	4.48	4.70	4.47	4.40	4.40	4.45	4.50	4.75	4.75	4.70	4.65
30-year	5.29	5.25	5.49	5.21	5.15	5.20	5.25	5.30	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	2.12	2.15	2.25	2.40	2.50	2.40	2.50	2.50	2.50
5-year	2.34	2.15	2.31	2.45	2.50	2.60	2.70	2.80	2.75	2.75	2.75	2.75
10-year	2.74	2.59	2.72	2.86	3.00	3.10	3.20	3.25	3.20	3.25	3.30	3.40
30-year	3.09	3.12	3.30	3.48	3.60	3.75	3.80	3.90	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	4.06	4.10	4.10	4.00	3.90	3.90	3.90	3.90	3.90
10-year	4.39	4.16	4.30	4.75	4.75	4.75	4.70	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	2.92	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	4.08	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 | January 2026

Real GDP, quarter-over-quarter percent change

	Q1-25	Q2-25	Q3-25	Q4-25	Q1-26	Q2-26	Q3-26	Q4-26	Q1-27	Q2-27	Q3-27	Q4-27	2025	2026	2027
Canada*	2.2	-1.8	2.6	0.5	1.3	1.7	1.8	1.5	1.3	1.3	1.5	1.7	1.7	1.3	1.5
United States*	-0.6	3.8	4.3	3.1	1.7	1.5	1.7	1.8	1.8	1.9	1.9	1.8	2.3	2.4	1.8
United Kingdom	0.7	0.2	0.1	0.0	0.0	0.2	0.3	0.3	0.3	0.4	0.4	0.4	1.4	0.5	1.4
Euro area	0.6	0.1	0.3	0.4	0.5	0.5	0.4	0.3	0.2	0.3	0.3	0.3	1.5	1.6	1.3
Australia	0.4	0.7	0.4	0.8	0.6	0.7	0.5	0.5	0.6	0.6	0.5	0.5	1.9	2.5	2.3

*annualized

Inflation, year-over-year percent change

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

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

Currency outlook | January 2026

US dollar cross rates, end of period

	Q1-25	Q2-25	Q3-25	Q4-25											
USD/CAD	1.44	1.36	1.39	1.39											
EUR/USD	1.08	1.18	1.17	1.17											
GBP/USD	1.29	1.37	1.34	1.32											
USD/JPY	150	144	148	145											
AUD/USD	0.62	0.66	0.66	0.64											

Canadian dollar cross rates

	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	1.55	1.60	1.63	1.63	1.60	1.60	1.60	1.60	1.61	1.61	1.61	1.61	1.61	1.61
GBP/CAD	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	104	106	106	104	113	112	110	110	108	107	105	104		
AUD/CAD	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

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