Forward Guidance

July 24, 2026

RBC Economics

Six takeaways for Canada from latest U.S. tariff threats; GDP likely rose again in May

For the week of July 27th

Another month of recovery is in the cards for Canada's economy next Friday where we expect to see a 0.2% increase in GDP data for May (more details below), but the outlook is once again clouded by the latest bout of U.S. tariff threats that suggest the path ahead could be bumpier.

Just how bumpy is challenging to clearly assess. For one, we're keenly aware that tariffs threatened in the past have often been significantly modified or halted ahead of the implementation date. New U.S. Section 301 (broader global) tariffs imposed on July 24 maintain a duty free exemption for imports from Canada under CUSMA, and the more severe 50% Section 338 product- and Canada-specific tariffs don't take effect until 30 days after signing.

Secondly, as we emphasized back in February 2025, the economic impact will depend on a wide range of factors from how firms creatively navigate tariffs, the path of the Canadian dollar to government responses and the Bank of Canada's decisions.

1. Big picture: Canada should be able to manage through new wave of potential tariffs

Ultimately, we don't expect the recently announced 50% U.S. tariffs to significantly change broader Canadian growth trends if imposed as threatened. We still expect aggregate growth to improve in the second half of the year, and the unemployment rate to trend downwards.

In large part, that's because the new tariffs, while significant, will still impact a small segment of total trade. They affect about 5% of Canada's exports to the U.S, which would still leave more than 80% of exports crossing the border duty free. The average effective tariff rate on U.S. imports from Canada would rise from around 3% to 5.5%, still below but closer to other major U.S. trade partners like Europe and the U.K. (6%-7%).

Frances Donald | Nathan Janzen | Claire Fan | Salim Zanzana

2. Targeted sectors would struggle

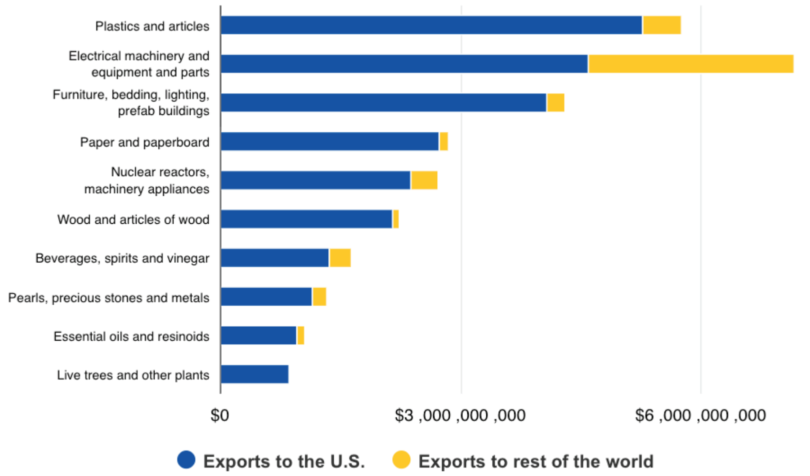
The overall economy should hold, but targeted sectors related to plastics, electrical machinery, furniture and home appliance manufacturing are likely to experience slowdowns, just like after the Section 232 tariffs on products including autos and steel that have created sectoral downturns.

However, this time around, it will be easier for American importers to substitute away from many of these newly tariffed Canadian goods as they make up a small source of U.S. imports. About 3.7% of total U.S. imports of those products from the world in 2025 came from Canada, according to our estimates.

That's different than tariffs on, say, aluminum where Canada made up the majority of U.S. imports, and American importers don't have alternative suppliers or the capacity/infrastructure to domestically produce the good. Importantly, the pain on a sector from a tariff depends on how easy it is for the American importer to substitute from Canada, and that varies significantly by product.

Canadian products at risk of tariffs have high U.S. concentration

$CAD, exports in 2025, products threatened with 50% U.S. tariffs

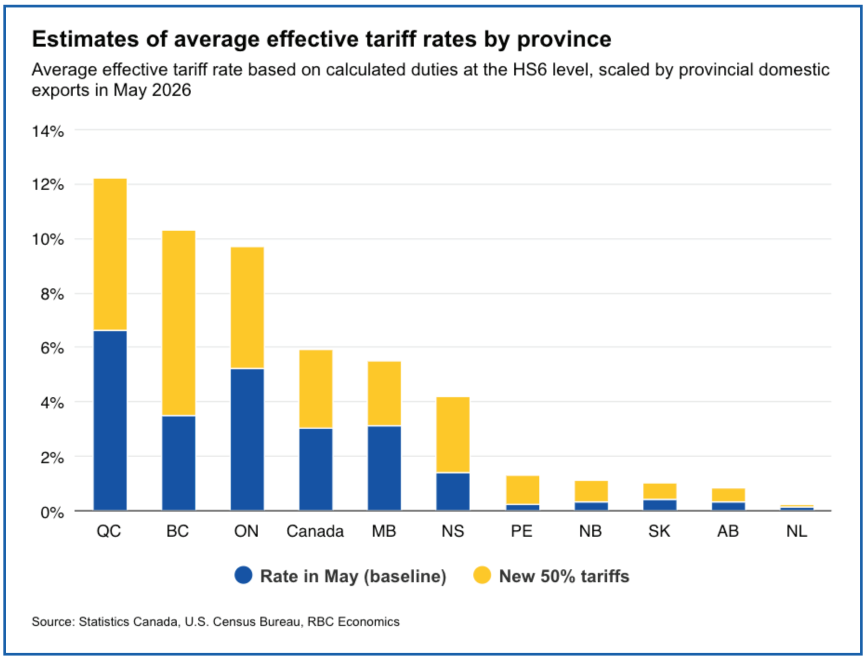


Source: Statistics Canada, RBC Economics

Finally, substitution won't be nearly as easy for Canadian exporters looking for alternative foreign markets. In 2025, we counted 81% of Canada's exports of tariffed products went to the U.S. with certain sectors showing even tighter dependence (e.g. plastics and articles at 92%). Trade diversification remains a more elusive goal for Canada that will take considerable time to achieve.

3. New tariffs would further exacerbate provincial divergences

Previous tariffs on auto, steel, and lumber products disproportionally impacted Ontario, Quebec, and British Columbia. Energy producing provinces have been less impacted by the trade war as they continue to be excluded from tariff shocks, and have seen economy-wide revenues rise in 2026 with global oil prices moving higher.



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The average effective tariff rate estimates are based on calculated duties and total imports reported by the U.S. Census Bureau for Canadian goods based on the May 2026 trade profile. Effective tariff rates are calculated at the HS6 product level and applied to provincial domestic exports to the U.S. at the same level, giving an estimate of the average effective rate provincial exporters could face. Products affected by the new Section 338 tariffs were set at a 50% tariff rate, while the tariff rates for products duplicated under Section 232 were not adjusted.

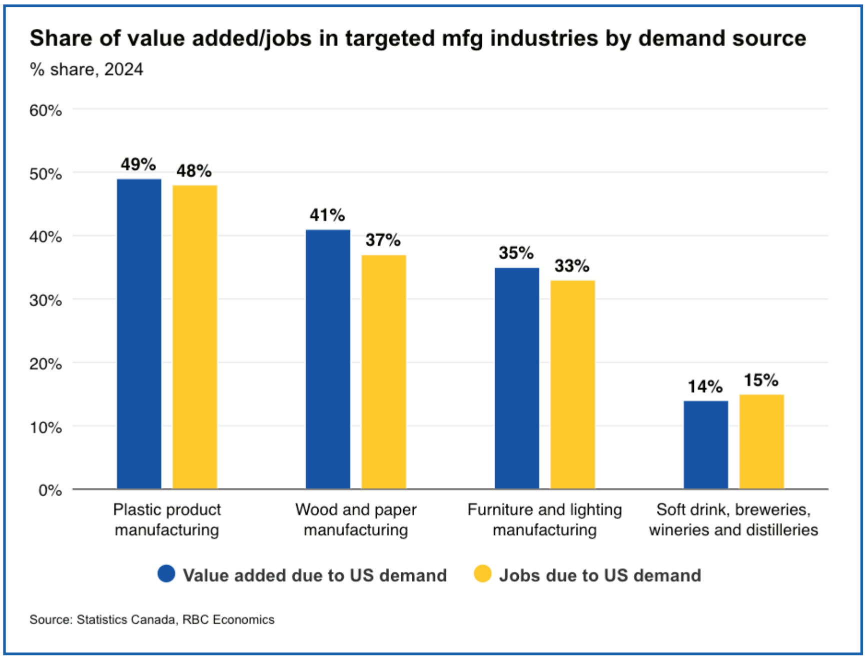
These estimates come with important caveats. First, actual tariffs paid may be lower than announced rates due to processing delays and exclusions. Second, applying uniform HS6-level rates across all products at lower classification levels may overestimate effective tariff rates, since some products within each HS6 category may not be directly targeted by U.S. tariffs. Lastly, some tariffed products may not have been traded in May 2026, potentially understating the actual effective tariff rates. Overall, these estimates sum to an average increase of 2.88% in Canada's tariff rate from Section 338 measures, slightly above but very close to the 2.5% increase estimated for the whole economy using 8-digit HTS.

The new set of tariffs will further exacerbate the energy versus non-energy growth divergence in Canada. Exporting businesses in B.C., Ontario, and Quebec would likely bear the brunt with each possibly facing a significant rise in average effective tariffs on exports to the U.S.

4. Domestic demand for tariffed goods could provide partial offset

Targeted sectors would likely see a drop in U.S. demand as American importers opt for lower-cost countries, but domestic demand in Canada for these products can provide meaningful offset.

Importantly, manufacturing subsectors facing Section 338 tariffs generally derive larger shares of production and employment from domestic demand compared to auto and metal manufacturing targeted in previous rounds of U.S. Section 232 tariffs that rely more on U.S. demand.



Plastics product manufacturing, which accounts for the largest nominal dollar value of at-risk exports in the latest measures, derived roughly half their value added and employment from U.S. demand in 2024. It's still significant, but well below the nearly 80% dependence in auto manufacturing and aluminum production.

For soft drink manufacturers, breweries, wineries and distilleries, the share of value added, and jobs tied to U.S. demand is lower at about 15%. A higher domestic market share should provide better insulation for production and jobs in these industries from volatile U.S. trade policy and demand.

5. BoC even more likely to hold interest rates this year

The BoC has repeatedly emphasized it's facing a dilemma—caught potentially between the need to lower interest rates to support a tariff laden economy, and the need to raise interest rates to keep inflation at bay with conflict in the Middle East again pushing up oil prices. Both risks are meaningfully coming back in play as July winds up.

As a base case forecast, we continue to expect the BoC will hold the overnight rate at current levels through the end of the year, while closely monitoring incoming data on inflation expectations and business sentiment.

6. Business sentiment needs to be monitored

The threat of tariffs even if they are walked back before the Aug. 20 deadline will once again add to uncertainty for businesses, and that can slow business investment across all trade-exposed businesses, not just those directly impacted.

Business sentiment has already been weakening in Q2, according to the BoC's Business Outlook Survey and CFIB Business Barometer. As we've covered before, there won't be a persistent re-acceleration in Canadian productivity growth without business investment coming online.

Canada's economy likely grew for a second month in May

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Canadian Calendar

Day and time	Indicator	RBC	Consensus	Previous
Thu-08:30	Payroll Employment Change - SEPH (May)		-	22.0
Fri-08:30	GDP MoM (May)	0.2	0.2	0.5

U.S. Calendar

Day and time	Indicator	RBC	Consensus	Previous
Mon-08:30	Cap Goods Ship Nondef Ex Air (Jun P)		-	0.1
Wed-14:00	FOMC Rate Decision (Upper Bound)	3.75	3.75	3.75
Thu-08:30	Personal Income (Jun)	0.4	0.3	0.7
Thu-08:30	Personal Spending (Jun)	0.2	0.4	0.7
Thu-08:30	PCE Price Index YoY (Jun)	3.7	3.6	4.1
Thu-08:30	Core PCE Price Index MoM (Jun)	0.2	0.1	0.3
Thu-08:30	Core PCE Price Index YoY (Jun)	3.4	3.3	3.4
Thu-08:30	Initial Jobless Claims (Jul-25)	185	-	187
Thu-08:30	GDP Annualized QoQ (2Q A)	2.4	2.3	2.1
Fri-10:00	U. of Mich. Sentiment (Jul F)		-	54.4

Source: Bloomberg, RBC Economics

- We expect the Federal Reserve will stay on hold in Wednesday's meeting. June' Consumer Price Index report showed broad-based deceleration in inflation pressures—a turn from the run of hotter core CPI prints to take an immediate rate hike off the table. Still, the path forward remains highly uncertain, and entirely contingent on future inflation data while labour market resilience persists.
- On Thursday, we'll receive the advance Q2 U.S. GDP report, where headline growth is expected to come at an annualized 2.4% quarter-over-quarter. Much of this growth has been supported by resilient consumer spending, which is expected to accelerate to 2%. Business fixed investment likely expanded, offset by net trade that is projected to have subtracted from growth.

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