Monthly forecast update

August 13, 2026

RBC Economics

Solid Canadian growth meets narrow tariff headwinds

Highlights:

Canada's economy bounced back strongly in Q2. Hiring picked up to drive the unemployment rate lower. Domestic demand remained resilient, while net trade recovered from a soft Q1.

U.S. Section 338 tariff threats won't derail overall growth in Canada, as they target a narrow base of Canadian products. Impact to targeted producing regions and industries will be more significant.

Broader U.S. tariff rates globally have continued to edge lower, consistent with our outlook for a resilient U.S. economy benefiting from major infrastructure buildouts and government spending.

The Federal Reserve is still expected to remain on hold this year (and next) although sticky inflation leaves risks around that base case forecast tilted towards potentially needing to hike.

The Bank of Canada is more comfortably on hold amid signs of a firming economy and soft core inflation prints. We expect modest adjustment hikes in 2027 should these trends persist.

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Forecast changes:

Latest U.S. tariff threats tangible but manageable

The situation in the Middle East keeps evolving, and its ultimate impact on economic growth, inflation and central bank decisions in Canada and the U.S. will depend on the final scope, duration and details of the development—none which are clear at the time of writing.

On balance, we expect higher oil prices to have a net-neutral effect on Canadian and U.S. GDP growth, though with significant regional variations. Oil-producing regions benefit from higher revenues that boost corporate profits and government royalties, while consumers across the board face elevated energy costs.

In this round of forecast update, we have raised our headline Consumer Price Index projections in 2026, but left our forecast of GDP growth and unemployment rates mostly unchanged. We do not expect central banks to rush to respond to what is fundamentally a supply shock, and see both the Bank of Canada and U.S. Federal Reserve remaining on hold through 2026.

The U.S. administration imposed new Section 122 tariffs after the Supreme Court struck down IEEPA, but nearly half of U.S. imports are exempt, along with CUSMA-compliant goods. This should leave the average effective U.S. tariff rate still slightly lower under the new tariffs, even if the administration were to follow through on threats to raise the Section 122 rate to 15% from the current 10%.

Solid backward-looking data keeps BoC on hold

U.S. tariff policy remains a key source of uncertainty, but economic data in Canada has been strengthening all around.

Q2 real GDP growth is tracking well above our prior expectations, supported by resilient domestic spending from households, businesses and governments, as well as a recovery in net trade from auto-related softness in Q1. Housing activities have picked up, and the labour market has also improved with the unemployment rate easing lower.

The key question is how much of Q2's strength will persist. Early July data—including rising consumer spending and a notable increase in total hours worked—supports our cautiously optimistic outlook that the economy will continue to expand both in aggregate and per-capita over the rest of 2026.

Gradual improvements in the economy and labour market should be sufficient to keep the BoC on hold through 2026, before diminishing economic slack prompts moderate rate hikes in 2027.

U.S. tariffs still easing under Section 301 measures

We risk sounding repetitive, but recent tariff changes—including the transition from now-expired Section 122 tariffs to Section 301 measures—should still leave U.S. tariffs on balance lower, not higher.

Importantly, new Section 301 tariffs, like their Section 122 predecessor, apply to a much narrower range of imports than initial broad-based IEEPA tariffs. They exclude a long list of products in Annex II of the announcement (accounting for more than 50% of U.S. imports in 2025), imports already subject to Section 232 tariffs (20% of U.S. imports in 2025), and CUSMA-compliant imports from Canada and Mexico.

This leaves roughly a quarter of total imports subject to Section 301 tariffs. Threatened Section 338 tariffs would add to overall tariffs, but very marginally, since the 50% tariff rate only affects 0.5% of total U.S. imports from the world.

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Fed is still expected to hold but is increasingly data dependent

Easing tariff headwinds remains broadly consistent with our expectation that strong U.S. growth, supported by structurally large government spending, will persist. The Fed is still left with the tough call on whether current interest rates are restrictive enough to keep pressure on inflation, and bring it back to the 2% target.

Answering that question is difficult and leaves the Fed more data dependent than usual for near-term decisions. Additionally, markets were rattled when new Fed Chair Kevin Warsh's abruptly ended forward guidance and cut off the Fed's communication about its reaction function.

Recent data suggests a tight U.S. labour market despite downside employment surprises that partly reflect demographic shifts. Inflation excluding energy showed some relief in June and July, which should be enough to keep the Fed on hold for now, albeit uncomfortably. Indeed, the hiking bias remains real and could still turn to action this year if inflation turns around and reaccelerates.

Summary of forecast changes in August:

- **We raised Canada's Q2 2026 GDP growth** from 1.7% annualized to 3.4% based on early monthly GDP readings. That pushed the expected annual growth rate to 0.9% from 0.7%—still an acceleration from 2025 once Canada's unprecedented population declines are accounted for.
- **Monthly GDP readings have been highly revision-prone,** but they are consistent with expenditure data showing solid increases in spending and investment across Canadian households, businesses, and governments in Q2, supporting the GDP rebound.
- **U.S. GDP and unemployment rate forecasts are little changed.** Growth in Q3 was marked slightly stronger (from 2.1% to 2.4% annualized), and the unemployment rate slightly lower. Overall, the economy is expected to grow at a similar pace in 2026 as in 2025 just above 2%, with unemployment rate hovering around historical lows.
- **The U.S. yield curve is expected to remain steeper than previously expected.** The gap between 2-year and 10-year Treasury yields is expected to average 60 basis points over the remainder of 2026, before narrowing in 2027.

Central bank	current policy rate	next decision	
BoC	2.25% 0 bps in Jan/26	0 bps Sep/26	The BoC held its overnight rate unchanged at 2.25% in July as widely expected, while broadly signalling comfort with maintaining interest rates at current levels has increased. Revised forecasts largely mirrored ours, expecting excess slack will be slowly absorbed as GDP growth accelerates above potential. Data since the meeting has generally been positive, supportive of our expectation that the BoC will stay on hold in 2026.
Fed	3.5-3.75% 0 bps in Jul/26	0 bps Sep/26	The Fed held rates in July with three dissenters calling for a hike and no material changes to the statement. In the press conference, Chair Warsh repeatedly passed on opportunities to outline a coherent framework for delivering on the inflation target, raising credibility concerns. Recent easing in inflation should be enough to keep the Fed on hold, but the FOMC will likely keep a close watch on near-term inflation data.

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Central bank	current policy rate	next decision	
BoE	3.75% 0 bps in Jul/26	0 bps Sep/26	The Bank of England's Monetary Policy Committee voted 6-3 in favour of holding the Bank Rate at 3.75% in July. Governor Andrew Bailey said the second-round inflationary effect of higher energy prices remain a concern, but in the press conference also pushed back against expectations that the BoE is "edging towards a hike". We still expect the Bank Rate to be held at 3.75% through 2026 and 2027.
ECB	+25 bps 0 bps in Jul/26	2.25% Sep/26	The European Central Bank held rates at 2.25% in July as widely expected. There were both dovish and hawkish elements to the press conference and statement that roughly balanced each other out. With uncertainty in the energy markets, we struggle to put too much weight on the slight dovish elements, and continue to call for one more rate hike in September. Risks are the ECB delivers more.
RBA	4.35% 0 bps in Aug/26	0 bps Sep/26	The Reserve Bank of Australia kept the cash rate unchanged at 4.35% in August, and cautioned on inflation risks. Revised economic projections, however, showed slowing growth, slack building in the jobs market and consumers switching from spending to saving. Overall, we see nothing in the forecasts that would prompt a need for further tightening, and continue to expect 4.35% to be the peak in the current cycle.

Technical details in Section 338 tariffs:

The deadline for the latest U.S. Section 338 tariffs threats (August 19) is fast approaching. Previously, we wrote about six key takeaways for Canada. The bottom line: if the tariffs are imposed, they will have a significant impact on producing sectors and regions, but a more manageable impact on the broader economy as they cover just 5% of Canada's exports to the U.S.

Using a Harmonized Tariff Schedule to North American Industry Classification System (NAICS) concordance, we then mapped products on the tariff lists to the directly impacted industries, and overlaid U.S. trade by industry data with Canadian value-added exports statistics to estimate the potential hit to production and jobs in each of those sectors, and the overall economy.

Overall, our framework suggests new tariffs will impact about 0.4% of Canada's total value-added GDP and jobs, but could hurt some 20% of production and jobs in targeted manufacturing industries like apparel, leather, and allied product manufacturing (NAICS 316), electrical equipment and appliances manufacturing (NAICS 335) and textile and textile mill products manufacturing (NAICS 313).

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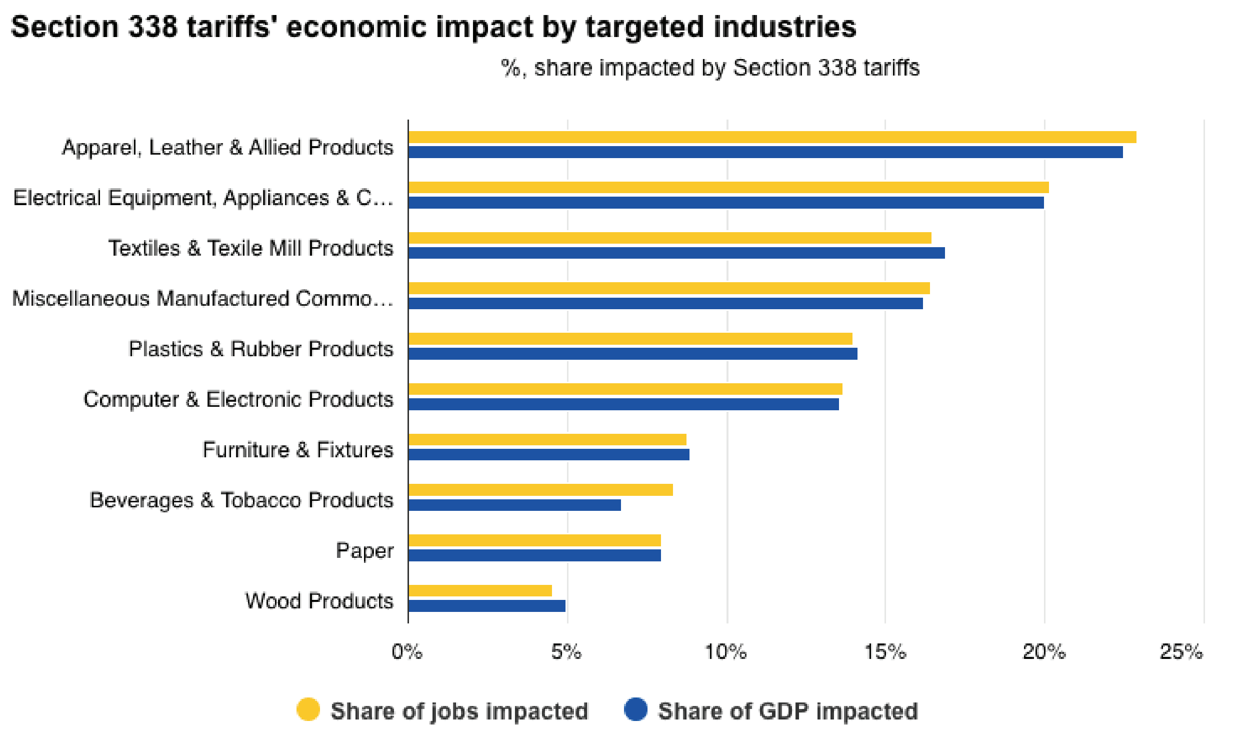

Source: Statistics Canada, RBC Economics

Canadian producers would have a hard time finding alternative foreign export markets for these products (due to relatively high U.S. export concentration in the past), but they could seek offset domestically.

Indeed, not only do these products have a larger domestic market share than some of the earlier targeted goods like autos, metals and lumber, Canada also runs a small trade deficit in the products on the new tariff lists with the U.S.—importing more than it exports. This suggests Canadian buyers could replace some of the foreign demand by purchasing more domestically rather than sourcing from abroad.

Interest rate outlook | August 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	2.31	2.26	2.20	2.25	2.55	2.80	3.00	3.20
2-year	2.46	2.59	2.47	2.58	2.82	2.74	2.85	3.10	3.20	3.30	3.35	3.40
5-year	2.61	2.83	2.74	2.96	3.09	3.01	3.20	3.30	3.40	3.50	3.55	3.55
10-year	2.97	3.28	3.18	3.42	3.46	3.38	3.55	3.60	3.65	3.70	3.75	3.75
30-year	3.23	3.56	3.64	3.85	3.88	3.77	3.95	3.95	3.95	4.00	4.00	4.00
United States												
Fed funds midpoint	4.38	4.38	4.13	3.63	3.63	3.63	3.63	3.63	3.63	3.63	3.63	3.63
3-month	4.32	4.41	4.02	3.67	3.70	3.87	3.77	3.75	3.77	3.80	3.77	3.70
2-year	3.89	3.72	3.60	3.47	3.79	4.14	4.15	4.05	4.25	4.35	4.35	4.30
5-year	3.96	3.79	3.74	3.73	3.92	4.19	4.30	4.15	4.30	4.35	4.30	4.25
10-year	4.23	4.24	4.16	4.18	4.30	4.44	4.75	4.65	4.75	4.75	4.65	4.60
30-year	4.59	4.78	4.73	4.84	4.88	4.91	5.30	5.20	5.30	5.20	5.10	5.05
United Kingdom												
Bank Rate	4.50	4.25	4.00	3.75	3.75	3.75	3.75	3.75	3.75	3.75	3.75	3.75
2-year	4.20	3.81	3.99	3.71	4.37	4.22	4.10	4.05	4.00	4.00	4.10	4.20
5-year	4.29	3.95	4.14	3.93	4.43	4.31	4.30	4.25	4.20	4.20	4.30	4.40
10-year	4.70	4.48	4.70	4.47	4.88	4.76	4.85	4.80	4.75	4.80	4.90	5.00
30-year	5.29	5.25	5.49	5.21	5.49	5.51	5.65	5.70	5.70	5.80	5.90	6.00
Euro area*												
Deposit rate	2.50	2.00	2.00	2.00	2.00	2.25	2.50	2.50	2.50	2.50	2.50	2.50
2-year	2.05	1.85	2.02	2.12	2.58	2.53	2.70	2.80	2.70	2.70	2.60	2.60
5-year	2.34	2.15	2.31	2.45	2.69	2.60	2.80	2.90	2.80	2.80	2.75	2.75
10-year	2.74	2.59	2.72	2.86	2.98	2.92	3.20	3.25	3.20	3.25	3.30	3.40
30-year	3.09	3.12	3.30	3.48	3.46	3.44	3.80	3.90	4.00	4.10	4.20	4.30
Australia												
Cash rate	4.10	3.85	3.60	3.60	4.10	4.35	4.35	4.35	4.35	4.35	4.35	4.10
2-year	3.68	3.21	3.49	4.06	4.66	4.42	4.45	4.35	4.30	4.15	4.00	3.95
5-year	3.86	3.46	3.75	4.29	4.70	4.40	4.55	4.50	4.45	4.35	4.30	4.30
10-year	4.39	4.16	4.30	4.75	4.98	4.72	4.95	5.00	4.95	4.85	4.75	4.55
30-year	4.97	4.84	4.96	5.22	5.36	5.25	5.50	5.55	5.40	5.30	5.20	5.00
New Zealand												
Cash rate	3.75	3.25	3.00	2.25	2.25	2.25	2.75	3.00	3.00	3.00	3.00	3.00
2-year swap	3.33	3.18	2.60	2.92	3.45	3.31	3.50	3.40	3.30	3.30	3.30	3.30
10-year swap	4.05	4.03	3.66	4.08	4.34	3.99	4.30	4.15	4.25	4.30	4.25	4.20

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

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Economic outlook | August 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*	2.89	-0.97	1.90	-0.98	-0.14	3.4	1.8	1.5	1.3	1.3	1.5	1.7	1.85	0.9	1.6
United States*	-0.65	3.84	4.37	0.48	2.09	1.50	2.4	2.2	2.2	2.3	2.3	2.2	2.11	2.1	2.2
United Kingdom	0.57	0.16	0.07	0.05	0.63	0.42	0.2	0.3	0.3	0.3	0.3	0.3	1.31	1.2	1.2
Euro area	0.57	-0.01	0.31	0.20	0.00	0.44	0.2	0.4	0.3	0.3	0.2	0.2	1.31	0.9	1.2
Australia	0.26	0.97	0.38	0.87	0.27	0.3	0.3	0.3	0.4	0.4	0.5	0.5	1.95	1.9	1.6

*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	2.29	1.78	1.98	2.25	2.15	2.95	2.7	2.5	2.4	1.8	2.0	2.0	2.07	2.6	2.1
United States	2.74	2.45	2.88	2.69	2.69	3.86	3.3	3.1	2.6	1.6	1.8	1.7	2.63	3.2	1.9
United Kingdom	2.80	3.49	3.80	3.38	3.11	2.77	3.0	3.2	3.0	2.6	1.9	1.9	3.37	3.0	2.4
Euro area	2.34	2.01	2.10	2.07	2.04	2.98	3.1	3.2	2.9	2.3	2.2	2.1	2.13	2.8	2.4
Australia	2.40	2.10	3.22	3.63	4.09	3.94	3.5	3.8	3.3	3.4	3.2	2.9	2.84	3.8	3.2

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

Currency outlook | August 2026

US dollar cross rates, 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
USD/CAD	1.44	1.36	1.39	1.37	1.40	1.42	1.42	1.45	1.43	1.40	1.37	1.35
EUR/USD	1.08	1.18	1.17	1.17	1.15	1.14	1.13	1.11	1.10	1.10	1.10	1.10
GBP/USD	1.29	1.37	1.34	1.34	1.32	1.33	1.30	1.27	1.27	1.29	1.29	1.31
USD/JPY	149.9	144.2	148.0	156.8	159.1	162.6	158	160	160	158	156	154
AUD/USD	0.62	0.66	0.66	0.67	0.69	0.69	0.70	0.71	0.71	0.72	0.72	0.72

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	1.61	1.61	1.62	1.60	1.61	1.57	1.54	1.51	1.49
GBP/CAD	1.86	1.87	1.88	1.84	1.84	1.88	1.84	1.84	1.82	1.80	1.77	1.77
CAD/JPY	104.3	105.7	106.1	114.4	114.2	114.4	111	110	112	113	114	114
AUD/CAD	0.90	0.89	0.92	0.91	0.96	0.98	0.99	1.02	1.02	1.00	0.99	0.97

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

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