Monthly forecast update

September 11, 2026

RBC Economics

BoC and Fed to hike from different starting points

Highlights:

Resurging oil prices are adding to inflation worries that may prompt global central banks to (in some cases, further) raise interest rates in the near-term. We revised our headline inflation forecasts higher for Canada and the United States, but for now expect gradual and limited passthrough to core **inflation.**

We continue to expect the Bank of Canada will hold interest rates before hiking gradually in 2027 on a stronger economy. Risks are tilting towards earlier hikes if the economy and labour market continue to recover amid the trade shock, but oil prices don't normalize as assumed.

The Federal Reserve is now expected to hike. Another upside inflation surprise in August was likely enough to tip a majority of the FOMC in favour of rate hikes in September. We expect the Fed will follow up with two additional hikes this year, effectively unwinding 75 basis points of "insurance" cuts in 2025.

Escalation of the trade war between Canada and the U.S. doesn't change our cautiously optimistic outlook for Canada. New measures have not significantly expanded the tariff coverage of trade relative to existing measures, though targeted sectors remain vulnerable.

Issue in focus:

We take a closer look at broader energy inflation passthrough dynamics in Canada, and identify key industries and consumption categories that are most oil intensive as prices surge again.

We reiterate the scope of oil intensity is generally narrow, with transportation being by far the most sensitive industry and consumption group outside of direct fuel consumption. There's limited evidence of a passthrough to-date, but risks are heightened as oil prices climb.

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Forecast changes:

In Canada, headlines have centered on the escalation in the Canada-U.S. trade conflict. As we've covered before, we continue to expect measures will have contained impact on the macroeconomy.

For targeted sectors, production and exports will fall from reduced U.S. demand, although federal and provincial government support programs should help to partially lessen the impact.

Meanwhile, both Canada and the U.S. are being hit with two additional shocks in the past month:

1. A material tightening in financial conditions as government bond yields rise across the world, raising costs for households and businesses to borrow even without central bank action.

2. A resurgence in oil prices that's raising the likelihood of a broader inflationary shock.

The two economies are entering these shocks from different staring points.

Canada's starting place is one of some remaining slack in the economy, and core inflation that has, at least until now, remained well anchored around 2%. Consistent with that backdrop, the BoC's policy rate has been sitting at the low end of the estimated neutral range—in other words—borderline stimulative.

The U.S., however, is starting from a completely different backdrop. Inflation has run above 2% for more than five years, growth in the economy has been exceptionally strong and the labour market is tight.

Contrasting starting places simply mean the Fed has a lot less flexibility than the BoC to be waiting for elevated oil prices to turn into bigger inflation problems.

It's time for the Fed to hike rates

Evolving U.S. inflation data, historically low unemployment rates and risks that oil prices could stay high from the ongoing Middle East conflict are sufficient for us to expect a rate hike from the Fed in September. The question then becomes how many more hikes will follow, and how effective they will be.

We expect there will be three rate hikes in total from the Fed this year including September, that could largely be viewed as a reversal of the 75 bps of rate cuts at the end of 2025—billed at the time as insurance cuts against some light weakening in the labour market.

To an extent, sticky core inflation is also being driven by supply-side factors the Fed can't control, including the AI buildout that spurred high levels of business investment (and borrowing) but has shown signs of peaking. A wide government budget deficit will also keep a floor under economy-wide demand.

After the tightening assumed this round, we expect the Fed will go back to "hold and observe", especially with the added layer of high oil prices in play that's exacerbating inflation concerns.

BoC still expected to hike later in 2027

In Canada, higher oil prices mean risks to our call for the BoC to start hiking in 2027 are now tilting towards earlier. The key deciding factor is the degree of the bleed-through from energy into broader inflation, which we expect will be gradual and limited (see Issue in focus below).

And there are other risks to inflation from elevated oil prices. Inflation expectations can rise (we'll learn more in the Business Outlook Survey on Oct. 18), and additional oil revenue in the economy can also add to growth in Canada (albeit very unevenly) to further add to underlying inflation.

But, the economy's recovery is also fragile, especially in an environment where U.S. tariffs may still meaningfully escalate. For now, we continue to view a significant bleed through of oil to inflation, and downside economic impact from additional tariffs as risks to our base case forecast rather than the forecast itself, and expect the BoC will hold through 2026 while watching risks on both sides.

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Summary of forecast changes in September:

- **We leave our economic growth and unemployment rate profile largely unchanged in Canada.** Growth is expected to slow over the second half of 2026 after a stronger Q2, but still consistent with a recovery in the per-capita economy once declining population is taken into consideration.
- **Canadian inflation forecasts are raised to reflect elevated oil prices.** Headline Consumer Price Index is now expected to end the year closer to 3%, up from the 2 ½% assumed in August. Core ex-food and energy CPI is marked slightly higher to reflect very limited oil passthrough. Following oil futures at the time of forecast, we assume West Texas Intermediate will end 2026 and 2027 at about US$90/barrel, and about US $70/bbl, respectively.
- **U.S. GDP and unemployment rate forecasts are little changed.** Overall, the economy is expected to grow at a similar pace in 2026 as in 2025 just above 2% with unemployment rate hovering near historical lows. U.S. headline CPI is marked up from higher oil prices, along with core ex-food and energy CPI to reflect marginal oil passthrough, but also a strong economy.
- **The Fed is now expected to hike rates,** mostly reversing three cuts in 2025 on signs of a strong labour market and sticky core inflation this year. We expect the Fed Funds range will be raised to 4.25%-4.5% by end of 2026, before the central bank pauses again.

Central bank	current policy rate	next decision	
BoC	2.25% 0 bps in Sep/26	0 bps Oct/26	The BoC held the policy rate at 2.25%, but sounded hawkish in its communications. Governor Tiff Macklem noted a broad-based pickup in economic activities in Q2, limited overall impact expected from new U.S. tariffs, and increased upside risks to inflation from elevated oil prices. Without concrete signs of those inflation worries materializing, we leave our base case forecast of rate hikes in 2027 unchanged.
Fed	3.5-3.75% 0 bps in Jul/26	+25 bps Sep/26	The Fed remains unusually data-dependent for near-term interest rate decisions, specifically on inflation prints that have run hotter earlier this year, but cooled off somewhat into the summer. August CPI data showed pressures among core items persisting instead of easing, enough to prompt a rate hike in September followed by two more consecutive hikes in the meetings after.
BoE	3.75% 0 bps in Jul/26	0 bps Sep/26	In July, policymakers voted 6-3 in favour of holding the Bank Rate at 3.75% with Governor Andrew Bailey pushing back against expectations that the Bank of England is “edging towards a hike.” Labour market data since then shows still elevated unemployment rate, but early Q3 GDP data was also strong. For now, we expect the BoE will remain in a “wait and see” stance to observe the oil passthrough.

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Central bank	current policy rate	next decision	
ECB	2.50% +25 bps in Sep/26	0 bps Oct/26	The European Central Bank raised all rates by 25 bps as widely expected in September, and left the policy guidance unchanged at "data-dependent and meeting-by-meeting." We add a December rate hike back into our profile as energy prices track closer to the "adverse" scenario in the latest ECB projections, and see risks for more hikes in 2027 if prices stay elevated or rise further.
RBA	4.35% 0 bps in Aug/26	0 bps Sep/26	Recent Australian data has shown some of those longer-term inflationary forces never really dissipated, and demand has stayed firm. Nominal incomes have held up and some of the second-round inflation effects from the Middle East conflict may still be emerging in final prices. We expect the Reserve Bank of Australia will stay on hold in September, but hike rates in November by 25 bps to reach a fresh cycle high of 4.6%.

Issue in focus

How we track the passthrough of oil in Canada

Resurgence in global oil prices has brought back concerns around potential spillovers to broader, non-energy consumer prices in Canada. Still, as we have argued before, the oil pass-through is not as clear-cut or large as is often thought.

As much as oil is a critical production input across industries, it's not the only one. Wages, rent, capital spending, administrative expenses, and taxes all add significantly to costs across supply chains before products reach store shelves, and can account for more of the sticker price than energy.

To get a sense of one, the scale of overall potential passthrough, and two, the consumer products most sensitive (effectively leading indicators) to second round effects, we calculated the intensity of oil consumption for each Canadian industry, and then mapped those directly to household consumption expenditures using input-output tables. Here's a summary of our findings.

Industry consumption of energy:

As expected, petroleum refineries, synthetic material manufacturing, petroleum and coal product manufacturing (excluding refineries), and a slew of transportation sub-sectors are among the most energy intensive Canadian industries.

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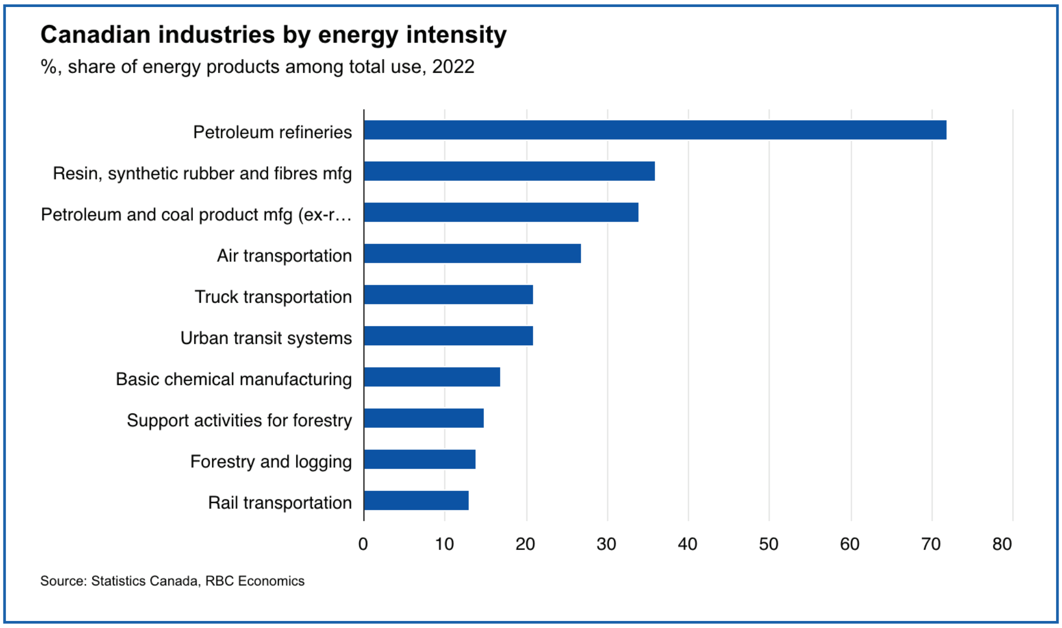


Even for these industries, however, the share of oil and related products as an input may be smaller than many may assume. We included crude bitumen, conventional and synthetic crude oil, motor gasoline, diesel, aviation and heavy fuel oil, petrochemicals and other oil related products in our calculation.

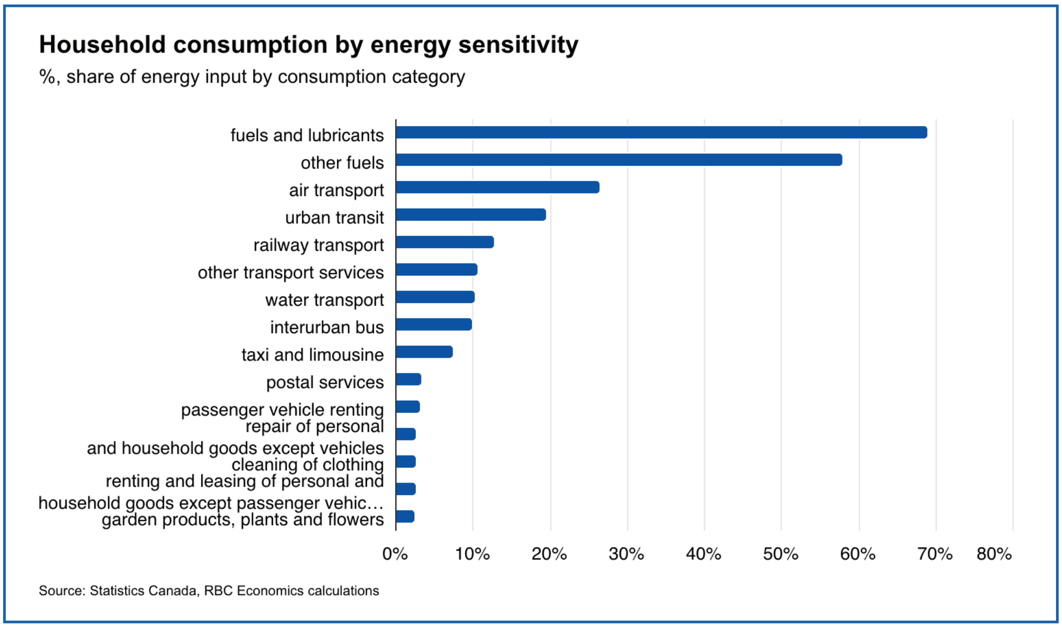
Air transportation is a good example. The industry is highly energy intensive, but aviation fuel still only accounts for 27% of total input costs as of 2022. Wages account for another 21%, air transport support services, aircraft maintenance and repair services account for 19%, gross operating margin for 7%, and the rest is made up by other expenses.

Overall, we estimate 3.4% of total input costs across industries accounted for oil and related products, much lower than 23.7% for wages. That's because about 70% of Canada's economy consists of service industries, where high labour intensity means wages represent a much larger share of input costs while energy inputs are generally low.

Wage growth in Canada has been gradually slowing due to a persistently elevated unemployment rate.

Energy costs embedded in consumer spending:

We then mapped energy consumption by industry data to household consumption expenditure to try to get a sense of which consumer products are the most sensitive to elevated oil prices, and might start to see pressure emerge sooner than others.



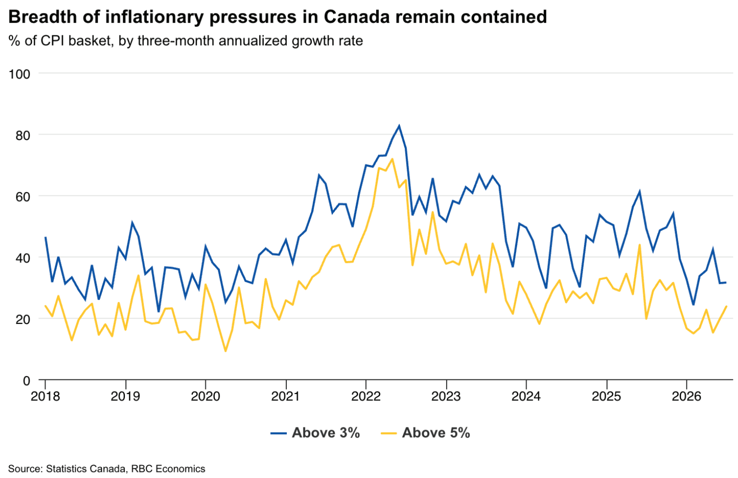
Outside of direct fuel consumption, we found expenditure on air transport, urban transit, and other transport services are most sensitive to oil since they derive a larger share of value-add from the transportation industries highlighted above.

Food products are not as directly affected by oil price changes as transportation, but the sheer volume of food spending in the average household consumption basket means oil price increases can still have a meaningful impact on overall inflation through this channel.

Also meaningful here is the fact that the level of sensitivity starts to drop substantially once we move beyond direct fuel consumption and transport spending. This suggests the scope of second round effects from elevated oil prices can be limited, pertaining to these categories.

No evidence of passthrough yet but risks are rising

Echoing the BoC, we stress that to date we have not seen signs of significant passthrough from high oil prices to broader consumer prices. The best indicator is our diffusion index, which shows the share of the consumption basket experiencing abnormally high price growth. It generally points to a narrowing in the scope of price pressure over the past year.



That doesn't mean there's no passthrough at all. Inter-city transportation consumer prices, including prices for air and rail transport, have risen more meaningfully in Canada into the summer. But, inflation in local and commuter transportation remains low, and food inflation actually eased over the same period.

Overall, we continue to expect gradual and limited oil passthrough given our assumed energy profile that tracks oil futures. Still, risks are present and would only rise the longer oil prices remain elevated.

We will continue to monitor industry and consumer price data, particularly in sectors and categories identified for signs of a more significant passthrough to broader inflation.

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Interest rate outlook | September 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	3.20	3.20	3.20	3.30	3.35	3.40
5-year	2.61	2.83	2.74	2.96	3.09	3.01	3.55	3.45	3.45	3.50	3.55	3.55
10-year	2.97	3.28	3.18	3.42	3.46	3.38	3.85	3.75	3.70	3.70	3.75	3.75
30-year	3.23	3.56	3.64	3.85	3.88	3.77	4.20	4.05	4.00	4.00	4.00	4.00
United States												
Fed funds midpoint	4.38	4.38	4.13	3.63	3.63	3.63	3.88	4.38	4.38	4.38	4.38	4.38
3-month	4.32	4.41	4.02	3.67	3.70	3.87	4.15	4.60	4.50	4.55	4.52	4.45
2-year	3.89	3.72	3.60	3.47	3.79	4.14	4.80	4.85	4.65	4.73	4.73	4.63
5-year	3.96	3.79	3.74	3.73	3.92	4.19	4.90	4.95	4.85	4.90	4.85	4.75
10-year	4.23	4.24	4.16	4.18	4.30	4.44	4.85	4.75	4.70	4.70	4.60	4.55
30-year	4.59	4.78	4.73	4.84	4.88	4.91	5.25	5.15	5.10	5.00	4.90	4.85
United Kingdom												
Bank Rate	4.50	4.25	4.00	3.75	3.75	3.75						
2-year	4.20	3.81	3.99	3.71	4.37	4.22						
5-year	4.29	3.95	4.14	3.93	4.43	4.31			under review			
10-year	4.70	4.48	4.70	4.47	4.88	4.76						
30-year	5.29	5.25	5.49	5.21	5.49	5.51						
Euro area*												
Deposit rate	2.50	2.00	2.00	2.00	2.00	2.25						
2-year	2.05	1.85	2.02	2.12	2.58	2.53						
5-year	2.34	2.15	2.31	2.45	2.69	2.60			under review			
10-year	2.74	2.59	2.72	2.86	2.98	2.92						
30-year	3.09	3.12	3.30	3.48	3.46	3.44						
Australia												
Cash rate	4.10	3.85	3.60	3.60	4.10	4.35	4.35	4.60	4.60	4.60	4.60	4.35
2-year	3.68	3.21	3.49	4.06	4.66	4.42	4.85	4.80	4.75	4.65	4.50	4.40
5-year	3.86	3.46	3.75	4.29	4.70	4.40	4.95	4.95	4.90	4.85	4.80	4.75
10-year	4.39	4.16	4.30	4.75	4.98	4.72	5.30	5.10	5.00	4.95	4.85	4.80
30-year	4.97	4.84	4.96	5.22	5.36	5.25	5.80	5.65	5.55	5.40	5.30	5.25
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	3.85	3.75	3.65	3.60	3.60	3.60
10-year swap	4.05	4.03	3.66	4.08	4.34	3.99	4.60	4.50	4.40	4.40	4.40	4.40

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

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Economic outlook | September 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	0.33	3.32	1.8	1.5	1.3	1.3	1.5	1.7	1.85	1.0	1.6
United States*	-0.65	3.84	4.37	0.48	2.09	1.48	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	0.3	0.2	0.2	0.3	0.4	0.4	1.31	1.3	1.1
Euro area	0.49	0.03	0.31	0.23	-0.01	0.63	0.4	0.4	0.3	0.3	0.2	0.2	1.31	1.1	1.3
Australia	0.39	0.78	0.50	0.91	0.29	0.42	0.4	0.4	0.4	0.3	0.3	0.4	1.98	2.0	1.5

*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	3.0	2.9	3.0	2.4	1.9	1.6	2.07	2.7	2.2
United States	2.74	2.45	2.88	2.69	2.69	3.86	3.4	3.6	3.1	2.0	2.1	1.7	2.63	3.4	2.2
United Kingdom	2.80	3.49	3.80	3.38	3.11	2.77	3.0	3.2	3.0	2.6	2.2	2.2	3.37	3.0	2.5
Euro area	2.34	2.01	2.10	2.07	2.04	2.98	3.2	3.8	3.8	3.2	2.9	2.2	2.13	3.0	3.0
Australia	2.40	2.10	3.22	3.63	4.09	3.94	3.7	4.0	3.5	3.6	3.2	2.9	2.84	3.9	3.3

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

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	under review					
EUR/USD	1.08	1.18	1.17	1.17	1.15	1.14						
GBP/USD	1.29	1.37	1.34	1.34	1.32	1.33						
USD/JPY	149.9	144.2	148.0	156.8	159.1	162.6						
AUD/USD	0.62	0.66	0.66	0.67	0.69	0.69						

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	under review					
GBP/CAD	1.86	1.87	1.88	1.84	1.84	1.88						
CAD/JPY	104.3	105.7	106.1	114.4	114.2	114.4						
AUD/CAD	0.90	0.89	0.92	0.91	0.96	0.98						

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

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