

Monthly forecast update



October 13,
2026

RBC Economics

**Rising bond yields, softer labour data buy
central banks time**

Highlights:



Outlooks for Canada and the United States are little changed from September despite moderately weaker labour data.



The Federal Reserve is still expected to hike by 75 basis points in total (including the hike in September), but at a slower pace than previously forecast.



The Bank of Canada is still expected to hike interest rates, but we maintain our base case forecast for the first move in 2027 as the economy gradually improves.



Bond yields have already risen globally, raising Canadian household and business fixed rate borrowing costs ahead of expected BoC interest rate hikes.



Canadian interest rates remain low relative to global peers.

Issue in focus:



Rising term yields are ending the household debt service reprieve in Canada that started in 2024, but it shouldn't derail the economy's recovery expected to persist into 2027.

Forecast changes:

Our growth and central bank forecasts for Canada and the U.S. are little changed despite moderately weaker labour market data and higher oil prices in the past month.

Employment grew at a slower rate in the U.S. in September, and recorded another sizable decline in Canada to push back against the odds for imminent central bank rate hikes.

Fed officials have already signalled that further increases will be more gradual than the every-meeting pace we had incorporated into our previous outlook after a widely expected hike in September.

Still, resilient U.S. growth and persistently high core inflation (even before meaningful passthrough from energy prices) argues that interest rates are not restrictive enough to return inflation to the Fed's 2% objective.

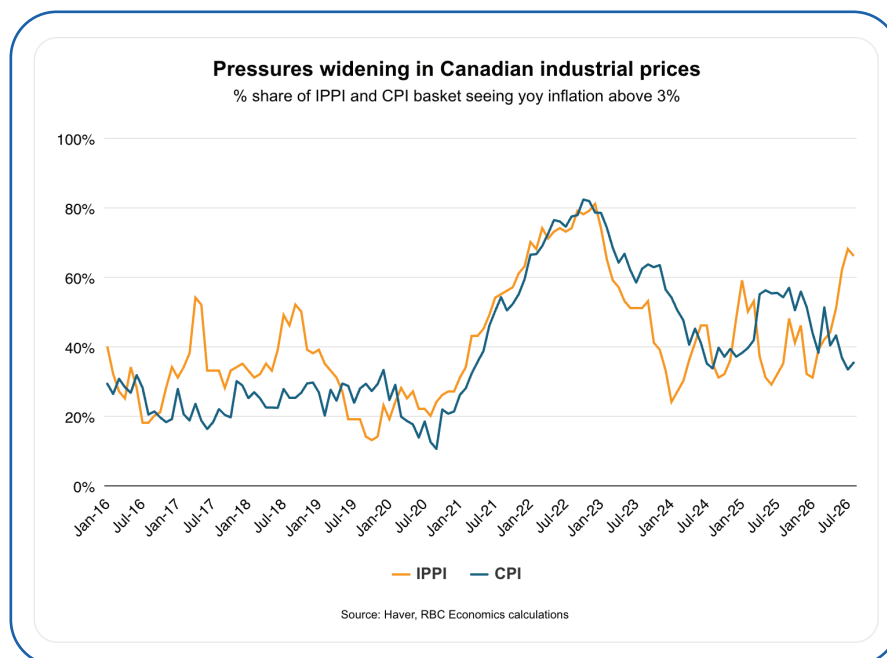
We still expect two additional 25 bps interest rate hikes from the Fed, but now look for the increases to come in December and March 2027—bringing the terminal range to 4.25%–4.50%.

BoC is still weighing costs/benefits of higher rates

Growth-inflation trade-offs are more contentious for the BoC. Our base case forecast remains that the BoC will hold through 2026 before gradually hiking rates in 2027, though significant risk still exists for earlier moves.

The central bank's concern about oil prices bleeding into broader inflation means September inflation data and the Q3 Business Outlook Survey ahead of Oct. 28's rate decision will be closely watched. But, a softer looking September labour market report is also a reminder that the economy is still shaky (even if gradually improving).

Producer price inflation (an early signal for consumer price growth) has broadened, but history suggests those cost increases only pass through supply chains if they prove to be persistent.



We continue to expect the economy to gradually improve, making it easier over time to argue for raising the overnight rate from the low end of the BoC's estimated neutral range (2.25%). Although recent tightening in financial conditions from rising bond yields are also offering the central bank room for patience.

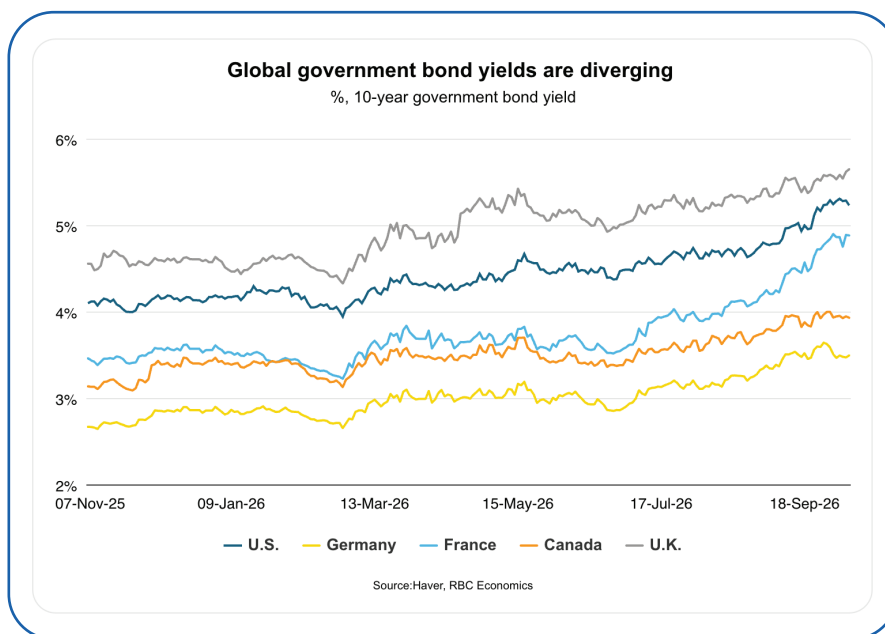
Globally bond yields have risen

Bond yields have already risen sufficiently that the exact timing of the next BoC rate move matters less than it would for a large share of households and businesses now borrowing at higher fixed rates.

We expect the Canadian household debt service ratio (debt payments as a share of disposable income) to start increasing after easing since 2024 (see Issue in Focus below).

Global lenders are broadly requiring an increasing amount of premium to hold longer-duration bonds against a backdrop of high energy prices, higher borrowing to support elevated government budget deficits and the AI infrastructure buildout.

These challenges are beyond the control of any single central bank. But, the domestic economy and monetary policy still matter, and interest rates have begun to diverge more significantly by region.



Ten-year bond yields in France have surged almost 120 basis points over the last three months, reflecting significant fiscal concerns, while U.S. 10-year yields have risen almost 70 bps. In the meantime, the increase in Canada has been smaller at under 50 bps, driving the gap between Canada and U.S. 10-year bond yields wider.

Overall, an improving but still softer (compared to other advanced economies) Canadian economy, subdued inflation pressures and a relatively less worrying fiscal trajectory should be supportive of lower borrowing costs in Canada ahead.

Summary of changes in October:

- **Canadian growth and unemployment rate forecasts are unchanged.** Gross domestic product growth is expected to slow from Q2's 3.3% annualized in the second half of the year. Annual GDP is expected to rise 1% in 2026 and 2.7% in 2027.
- **Canadian inflation forecasts slightly higher reflecting persistently elevated oil prices.** We look for Consumer Price Index growth to average 2.7% in 2026 (unchanged), and 2.5% in 2027 (up from 2.2%). We continue to expect some, but limited, pass-through from higher energy prices, pushing ex-food and energy inflation from 1.9% in 2026 to 2.4% in 2027 (unchanged).

- **U.S. GDP and unemployment rate forecasts are little changed.** GDP growth is expected to average 2.2% in 2026 and 2.3% in 2027—up from 2.1% and 2.2%, respectively, previously. We continue to expect the unemployment rate to average 4.2% in 2026 and 4.3% in 2027.
- **The Fed is still expected to hike rates further, but at a slower pace.** We maintain the same number of rate hikes (a total of 75 bps, including September's increase), but delivered by the end of Q1 2027 rather than the end of 2026 as previously assumed.

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% in September as expected. Their new PRIMA model directly accounts for sectoral supply shocks and their impact on inflation to complement the previous demand driven, output gap-focused framework. Still, a lack of early signs of energy price passthrough to broader inflation in Canada leaves us comfortable with our expectation for gradual rate hikes starting in 2027.
 Fed	3.5-3.75% +25 bps in Sep/26	+25 bps Oct/26	The Fed hiked rates in September for the first time since July 2023 as broadly expected. Chair Kevin Warsh noted the Committee “widely” found it difficult to describe broad financial conditions as restrictive, but recent Fed speakers pushed back against the “urgency” to hike consecutively. Given softer labour market data, and consistent with the latest dot plot, we now see only one more hike this year in December.
 BoE	3.75% 0 bps in Sep/26	+25 bps Nov/26	In September, the Bank of England again voted 6-3 in favour of holding the Bank Rate at 3.75%. Despite no new forecasts released at the meeting, the Bank expected CPI to increase to “around 3¼% in 2026 Q4, and to reach slightly above 4% in 2027 Q1,” levels likely above what they are willing to tolerate. As such, we have added one rate hike to our profile, and expect it in November.
 ECB	2.5% +25 bps in Sep/26	0 bps Oct/26	The European Central Bank raised all rates by 25 bps in September as widely expected, 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 price developments track closer to the “adverse” scenario in the latest projections, and think the risks are for more tightening in 2027 if prices stay elevated or rise further.
 RBA	4.6% +25 bps in Sep/26	+25 bps Nov/26	The Reserve Bank of Australia unanimously voted to lift the official cash rate by 25 bps in September. This marks the fourth rate increase of 2026, pushing the cash rate to its highest level in 15 years. While we keep another hike in November as our base case, we acknowledge it's not a done deal. We expect it could get pushed out or removed if data in the interim shows weakening in the labour market while inflation eases.

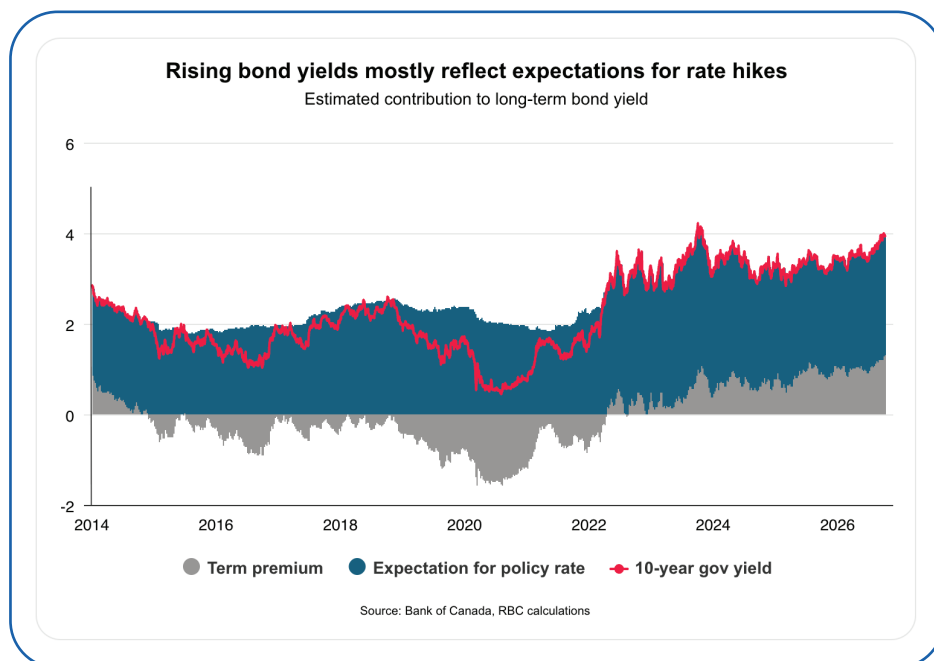
Issue in focus

Rising bond yields end debt service reprieve in Canada

The path of the full yield curve can be as important as the BoC's next policy move for the real Canadian economy.

The overnight rate (set by the BoC) matters for variable-rate mortgages and consumer credit. But, rising term yields are already reshaping fixed-rate borrowing for most households, businesses and governments in Canada, raising debt servicing costs.

While some of the rise in Canadian bond yields has been driven by global factors, the path for interest rates still also depends on domestic economic conditions. According to one common decomposition of bond yields, about 70% of the increase in ten-year government bond yields since last year was driven by higher expected short-term interest rates, and the rest by rising term premium.

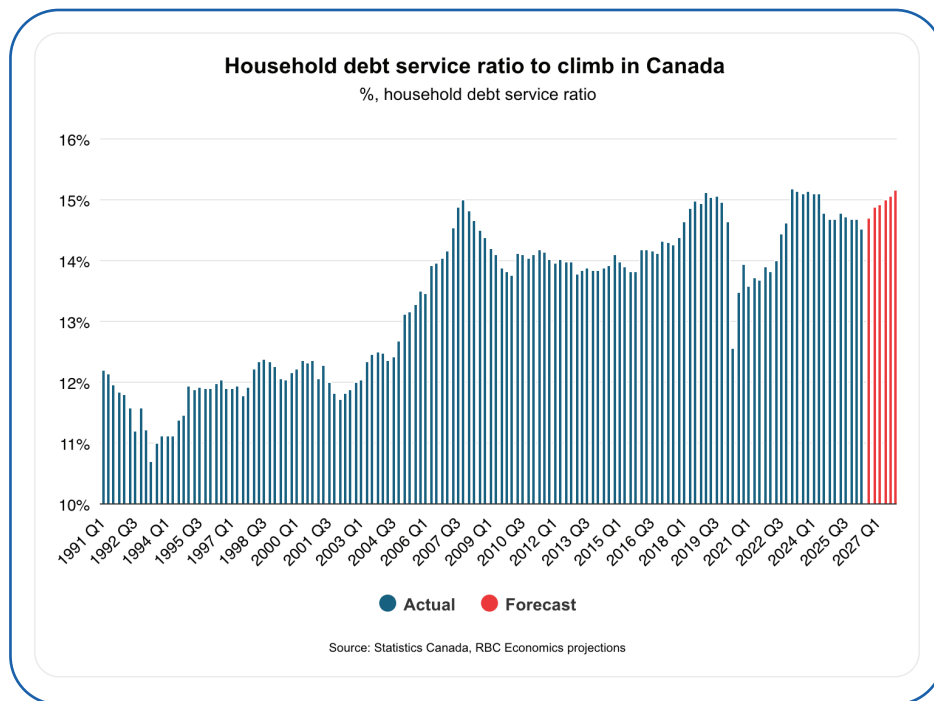


This distinction is important. It means that much of the rise in term borrowing costs is tied to expectations that the BoC will hike interest rates in the year ahead. And, we continue to view those hikes as largely contingent on an improving economy.

In other words, interest rates rising should effectively be contingent on further improvement in borrowers' ability to manage costs.

Debt service ratio set to rise again

Rising interest rates will likely mark an end of the improvement in Canadian household debt serviceability seen over the last two years stemming from moderating interest rates, lower household non-mortgage borrowing relative to pre-pandemic levels, and solid disposable income growth.



In Q2 2026, households' debt payments as a share of disposable income, or the debt service ratio, fell to 14.5%—its lowest in four years. Part of the decline between Q1 and Q2 reflected a temporary income boost to households from Indigenous settlements and a one-time HST rebate set to unwind in Q3.

But bottoming interest rates mean the household debt service reprieve is likely nearing an end – echoing the tapering of housing affordability gains we've flagged in the past.

Heading into 2027, we expected growth in households' debt payments will again begin to outpace growth in disposable income, pushing the debt service ratio gradually higher.

Higher rates impact some borrowers sooner than others

Households taking on new debt or facing imminent renewals will feel the impact of higher interest rates first, but eventually all borrowers will adjust. We saw this play out in real time when rapid rate hikes by the BoC in 2022–2023 triggered a wave of mortgage renewal concerns in subsequent years.

There remains a final cohort of five-year fixed-rate borrowers who locked in ultra-low rates in 2021–2022, but have yet to adjust to higher rates. Other three to four year shorter term fixed rate borrowers could still renew at lower rates compared to 2023.

Still, with existing borrowings continuing to renew and new borrowing added to the books at higher rates, effective borrowing rates on average across households should be trending upward, pushing debt service ratio higher despite relatively low overall households' indebtedness (measured by debt to income).

Rising bond yields could be a larger issue for other regions and governments

Similarly, businesses and governments also face rising debt servicing costs with varying lags. And those that are more leveraged could be particularly sensitive. For governments, rising debt-servicing costs generally means one of three things: Spending cuts, tax hikes, or larger deficits.

Bond yields in recent months have risen more in France and the U.S., where concerns over fiscal sustainability are most acute. Rising interest rates feed into fiscal challenges as they materially worsen the debt-to-GDP trajectory in the U.S. from an already concerning baseline.

Interest rate outlook | October 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	2.39	2.25	2.55	2.80	3.00	3.20
2-year	2.46	2.59	2.47	2.58	2.82	2.74	3.32	3.25	3.25	3.30	3.35	3.40
5-year	2.61	2.83	2.74	2.96	3.09	3.01	3.66	3.60	3.50	3.50	3.55	3.55
10-year	2.97	3.28	3.18	3.42	3.46	3.38	3.97	4.00	3.85	3.75	3.75	3.75
30-year	3.23	3.56	3.64	3.85	3.88	3.77	4.29	4.30	4.15	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	4.13	4.38	4.38	4.38	4.38
3-month	4.32	4.41	4.02	3.67	3.70	3.87	4.20	4.25	4.45	4.46	4.43	4.43
2-year	3.89	3.72	3.60	3.47	3.79	4.14	4.88	4.85	4.75	4.65	4.75	4.80
5-year	3.96	3.79	3.74	3.73	3.92	4.19	5.09	5.05	4.90	4.80	4.85	4.85
10-year	4.23	4.24	4.16	4.18	4.30	4.44	5.29	5.40	5.30	5.25	5.15	5.10
30-year	4.59	4.78	4.73	4.84	4.88	4.91	5.64	5.85	5.80	5.75	5.65	5.60
United Kingdom												
Bank Rate	4.50	4.25	4.00	3.75	3.75	3.75	3.75	4.00	4.00	4.00	4.00	4.00
2-year	4.20	3.81	3.99	3.71	4.37	4.22	4.90	4.75	4.50	4.25	4.10	4.20
5-year	4.29	3.95	4.14	3.93	4.43	4.31	4.99	4.80	4.60	4.40	4.30	4.40
10-year	4.70	4.48	4.70	4.47	4.88	4.76	5.43	5.25	5.00	4.80	4.90	5.00
30-year	5.29	5.25	5.49	5.21	5.49	5.51	5.96	5.75	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	2.75	2.75	2.75	2.75	2.75
2-year	2.05	1.85	2.02	2.12	2.58	2.53	3.20	3.20	3.10	3.00	3.00	3.00
5-year	2.34	2.15	2.31	2.45	2.69	2.60	3.34	3.25	3.15	3.10	3.10	3.10
10-year	2.74	2.59	2.72	2.86	2.98	2.92	3.59	3.30	3.20	3.25	3.30	3.40
30-year	3.09	3.12	3.30	3.48	3.46	3.44	3.95	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	4.60	4.85	4.85	4.85	4.85	4.60
2-year	3.68	3.21	3.49	4.06	4.66	4.42	4.95	4.85	4.80	4.70	4.60	4.60
5-year	3.86	3.46	3.75	4.29	4.70	4.40	4.96	5.00	4.95	4.85	4.80	4.75
10-year	4.39	4.16	4.30	4.75	4.98	4.72	5.34	5.50	5.50	5.40	5.25	5.20
30-year	4.97	4.84	4.96	5.22	5.36	5.25	5.78	5.95	6.00	5.90	5.75	5.70
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	4.02	3.85	3.80	3.75	3.75	3.75
10-year swap	4.05	4.03	3.66	4.08	4.34	3.99	4.72	4.70	4.65	4.50	4.50	4.50

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

Economic outlook | October 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	2024	2025	2026	2027
Canada*	2.9	-1.0	1.9	-1.0	0.3	3.3	1.8	1.5	1.3	1.3	1.5	1.7	2.05	1.85	1.0	1.6
United States*	0.1	4.0	3.9	0.2	2.5	2.2	2.4	2.2	2.2	2.3	2.3	2.2	2.95	2.34	2.2	2.3
United Kingdom	0.6	0.0	0.2	0.0	0.6	0.5	0.2	0.2	0.2	0.3	0.4	0.4	1.11	1.21	1.3	1.1
Euro area	0.5	0.0	0.3	0.2	0.0	0.6	0.4	0.4	0.3	0.3	0.2	0.2	1.12	1.31	1.1	1.3
Australia	0.4	0.8	0.5	0.9	0.3	0.4	0.4	0.4	0.4	0.3	0.3	0.4	1.02	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	2024	2025	2026	2027
Canada	2.3	1.8	2.0	2.2	2.2	2.9	3.0	2.9	3.2	2.6	2.2	1.9	2.38	2.07	2.7	2.5
United States	2.7	2.4	2.9	2.7	2.7	3.9	3.4	3.7	3.2	2.2	2.2	1.8	2.95	2.63	3.4	2.4
United Kingdom	2.8	3.5	3.8	3.4	3.1	2.8	3.1	3.5	3.7	3.3	2.8	2.6	2.54	3.37	3.1	3.1
Euro area	2.3	2.0	2.1	2.1	2.0	3.0	3.3	3.8	3.8	3.2	2.9	2.2	2.36	2.13	3.0	3.0
Australia	2.4	2.1	3.2	3.6	4.1	3.9	3.7	4.0	3.5	3.6	3.2	2.9	3.17	2.84	3.9	3.3

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

Currency outlook | October 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	1.43	1.41	1.39	1.37	1.35
EUR/USD	1.08	1.18	1.17	1.17	1.15	1.14	1.13	1.10	1.05	1.05	1.08	1.10
GBP/USD	1.29	1.37	1.34	1.34	1.32	1.33	1.33	1.29	1.27	1.28	1.29	1.28
USD/JPY	150	144	148	157	159	163	157	155	153	150	148	145
AUD/USD	0.62	0.66	0.66	0.67	0.69	0.69	0.70	0.73	0.73	0.72	0.72	0.71

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	1.61	1.57	1.48	1.46	1.48	1.49
GBP/CAD	1.86	1.87	1.88	1.84	1.84	1.88	1.88	1.85	1.78	1.78	1.76	1.73
CAD/JPY	104	106	106	114	114	114	111	108	108	108	108	107
AUD/CAD	0.90	0.89	0.92	0.91	0.96	0.98	0.99	1.04	1.02	1.00	0.98	0.96

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

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