Monthly forecast update

September 11, 2025

RBC Economics

Tariffs sting but won't derail North American growth outlook

Highlights:

Evidence of economic damage from trade protectionism is piling up. Labour markets have softened in Canada and the U.S., although at a pace broadly in line with our previous assumptions.

We still think there are reasons to be optimistic about Canada's economy. Odds of additional easing from the Bank of Canada have risen but, in a close call, we do not expect further reductions.

In the U.S., a shift in tone from the Federal Reserve prompted by softening labour markets means interest rate cuts are likely to come sooner than we expected.

Issue in focus:

Product specific tariffs are having a significant and negative impact on targeted sectors of the Canadian economy, despite the CUSMA compliant exemptions that protect the bulk of Canadian exports to the U.S. We take a closer look at the sectors under pressure, and how badly they're hurting.

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Forecast changes:

Economic data is increasingly showing the sting from tariffs. In Canada, we still think there are reasons to expect the worst of the drag from trade is likely behind us.

For one, the impacts from tariffs on the economy so far has been pronounced, but also highly concentrated in targeted industries. Manufacturing, transport and warehousing accounted for all job losses since spring, while resilient domestic spending still supports the rest of the economy.

Reduced foreign demand for Canadian exports has been significant, and the main drag on GDP growth in the second quarter. But the decline was also entirely from tariffed goods (read more in Issue in focus below). Other exports to the U.S. that are mostly shielded by CUSMA exemptions actually held up well from last year.

Indeed, the challenges facing the Canadian economy are sectoral and regional, and best served by fiscal support that's continued to ramp up. With all this in mind, we cautiously expect that further deterioration in the Canadian economy will be limited. More specifically:

- **We look for the economy to recover in Q3 as trade balance improves,** and gross domestic product growth to become positive after contracting from weak net trade and business investment. Consumer spending trends held up in July, according to our own tracking of card spending data.
- **Our labour market outlook is unchanged** despite softer data over July and August. We still look for limited additional job losses to stay mostly confined to trade-exposed sectors, and a peak unemployment rate of 7.1%, similar to right now.
- **We continue to expect the Bank of Canada will hold rates, but with low conviction.** Upside risks to inflation have receded but are still present, and worth patience from the central bank. Although weaker jobs and GDP data relative to consensus (though not the BoC's forecast) keeps possibility of rate cuts alive.

In the U.S., near-century high tariffs will continue to slow growth in the economy. We expect "stagflation lite" to persist as inflation and the unemployment rate both rise into year-end.

A more detailed breakdown of our forecast:

- **We expect the Fed to resume interest rate cuts in September**—a change from our prior view of December. Beyond then, we still think policymakers will gradually reduce rates towards a neutral 3% by early 2026.
- **Clearer signs of slowing in U.S. labour markets** have removed a key argument for more hawkish FOMC members to postpone interest rate cuts, even as tariffs push inflation higher. Effectively, we expect the Fed to prioritize the labour side of its mandate, especially given still-restrictive interest rate levels.
- **U.S. inflation will increasingly reflect tariff impact** as businesses deplete inventory buffers, and pass on cost increases to consumers. Core inflation should continue climbing towards an uncomfortable 3 ½ % through year-end, while rising agriculture commodity prices put upward pressure to food inflation and headline readings.

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Central bank	current policy rate	next decision	
BoC	2.75% 0 bps in Jul/25	0 bps Sep/25	The BoC held the overnight rate steady for a third consecutive meeting in July, citing economic resilience, evidence of underlying inflation pressures, and heightened uncertainty over U.S. tariffs as key reasons for the hold. Since that meeting, economic data has softened but we point to concentrated tariff impact and rising fiscal support for why we still expect the BoC to remain on hold.
Fed	4.25-5.50% 0 bps in Jul/25	-25 bps Sep/25	The Fed has been in "wait and see" mode since January. But the latest non-farm payrolls' downward revisions showed much weaker than expected labour trends since spring and eroded one of the key arguments (labour market resilience) for hawkish FOMC members to vote against interest rate cuts. We now expect the Fed to resume cutting in September and reach a terminal of 3% in Q2 2026.
BoE	4.00% -25 bps in Aug/25	0 bps Sep/25	The Bank of England Monetary Policy Committee voted 5-4 in favour of cutting the Bank Rate by 25 basis points in August. An easing bias was maintained, although both the vote split and the meeting minutes were more hawkish, suggesting a less automatic easing path ahead. We continue to expect the BoE will only cut once more in November for a terminal of 3.75%. Risks are tilting toward a later cut.
ECB	2.00% 0 bps in Jul/25	0 bps Oct/25	The European Central Bank held the deposit rate at 2% in September. The Governing Council remained non-committal to a future rate pat but President Christine Lagarde in the press conference emphasized inflation that's at-target and has a stable outlook, resilience in domestic demand, and risks to economic growth coming into balance. We maintain our expectation for a steady 2% deposit rate going forward.
RBA	3.60% -25 bps in Aug/25	-25 bps Sep/25	The Reserve Bank of Australia lowered the cash rate to 3.6% August, a level within the range of model estimates of neutral. The accompanying statement hinted at increasing confidence in underlying inflation softening further. Labour market and consumption fundamentals are also showing strength, supporting our view of only two more cuts from the RBA, in November and February for a terminal of 3.1%.

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Issue in focus

U.S. tariffs spare most Canadian exports but hit key sectors

We have argued since March that the exemption from tariffs for most U.S. imports compliant with the CUSMA would maintain duty-free access for most Canadian exports, and that has largely remained true so far.

In July, 88% of U.S. imports from Canada were duty free, according to U.S. Census Bureau data—down slightly from about 90% on average in Q2—but still covering most Canadian exports.

This doesn't mean the Canadian economy is not being impacted by U.S. tariffs. Section 232 measures imposed on a short list of Canadian products are still having a significant, but concentrated, negative impact on jobs, production and exports in related sectors.

Which Canadian products are tariffed?

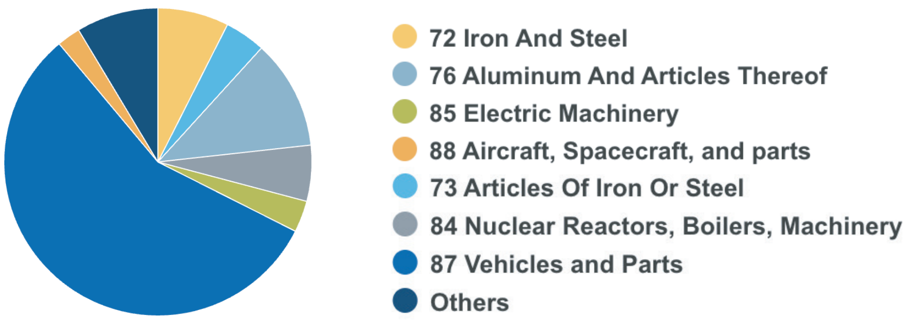
U.S. tariffs on imports from Canada—the 12% of Canadian exports to the U.S. that were not duty free as of July—are heavily concentrated in a subset of industries.

They can be broadly aggregated into three categories. Auto and parts (HS 87), steel and aluminum products (HS 72, 73, 76) and other machinery, parts and equipment including aerospace products (HS 84, 85, 88) each accounted for 57%, 23% and 12%, respectively, (over 90% combined) of total goods exports that were tariffed in July, according to the U.S. Census Bureau.

Together, tariffed goods from Canada were subject to an average U.S. tariff of as high as 27% in July—well above the average 3% tariff across all imports from Canada.

Canadian goods subject to U.S. tariffs

% share of total exports to the U.S. that are subject to duties, July 2025



Source: Census Bureau, RBC Economics

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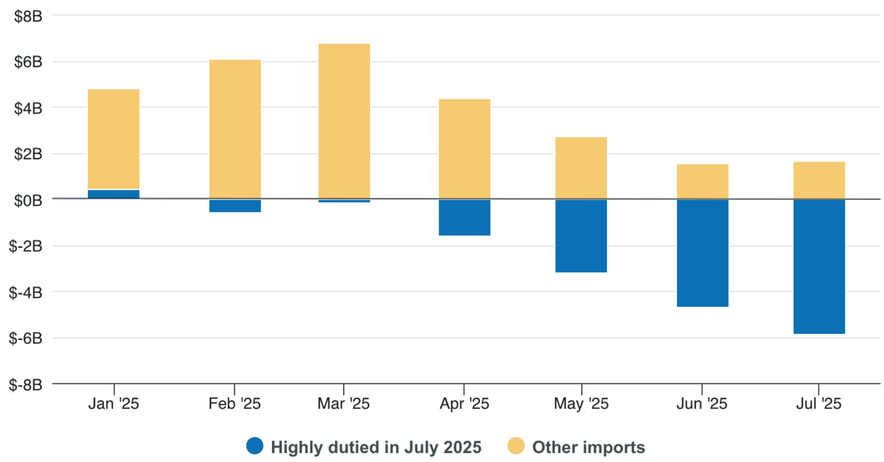
How has that impacted foreign demand for these products and others?

A lack of decline in U.S. import price index (excluding petroleum products) suggests U.S. buyers are paying most of those increased tariff costs with minimal evidence of discounting in foreign country export prices to offset the costs. Those surging tariff costs have led to slower demand for Canadian products.

Canadian goods exports to the U.S. were 5% lower in July from a year ago excluding petroleum product exports (which have declined largely due to lower oil prices from a year ago rather than tariff impacts.) The decline was also entirely accounted for by products subject to substantial tariffs—we define these as products where the share of trade with duties applied is above 5%.

Trade war hit highly dutied Canadian goods

USD billions, year-over-year- change in rolling sums of total U.S. imports from Canada, by duty



Source: Census Bureau, RBC Economics

Among these tariffed products, exports to the U.S. fell by $5.9 billion, or 10% between January and July compared to last year. Meanwhile, other exports predominantly shielded by CUSMA-related exemptions rose by $1.6 billion or 2% cumulatively during the same period.

Outcomes also varied significantly within tariffed goods. Canadian exports of steel and aluminum products to the U.S. and aerospace products plunged by 40% and 39%, respectively, in July from last year. Auto and parts exports only declined by 7% despite substantial tariffs levied on the non-U.S. content of finished vehicles.

What's next for CUSMA?

The substantial impact on Canadian products targeted with tariffs further reinforces the importance of current CUSMA exemptions that give duty free access for most Canadian exports. The backstop is preventing a targeted trade shock in Canada from spreading more significantly across other sectors of the economy.

And as we have argued before, the exemption is also helping U.S. importers avoid even larger import cost increases, particularly among U.S. manufacturers that are already struggling under the weight of tariffs imposed on sector specific products, and broader measures on imports from offshore trade partners.

A "joint review" of CUSMA is set to begin in 2026 or earlier, but the agreement does not expire until 2036. That is unless one country unilaterally withdraws by providing six months' notice (no negotiations required).

The fact that the U.S. and Canada have worked to preserve CUSMA so far is a good sign, along with future negotiations scheduled to start a decade before the sunset of the agreement to allow ample time to address concerns. With CUSMA exemptions largely expected to hold, we cautiously expect trade headwinds will have limited further direct impact on the Canadian economy.

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Interest rate outlook | September 2025

Policy rates and government bond yields, end of period

	Q1-23	Q2-23	Q3-23	Q4-23	Q1-24	Q2-24	Q3-24	Q4-24	Q1-25	Q2-25	Q3-25	Q4-25	Q1-26	Q2-26	Q3-26	Q4-26
Canada																
Overnight rate	4.50	4.75	5.00	5.00	5.00	4.75	4.25	3.25	2.75	2.75	2.75	2.75	2.75	2.75	2.75	2.75
3-month	4.34	4.90	5.07	5.04	4.99	4.64	3.94	3.16	2.62	2.65	2.65	2.70	2.70	2.70	2.70	2.70
2-year	3.74	4.58	4.87	3.88	4.22	3.99	2.92	2.93	2.46	2.59	2.60	2.90	2.95	3.00	3.00	3.05
5-year	3.02	3.68	4.25	3.17	3.58	3.51	2.74	2.96	2.61	2.83	2.90	3.10	3.15	3.20	3.25	3.25
10-year	2.90	3.26	4.03	3.10	3.52	3.50	2.95	3.23	2.97	3.28	3.25	3.40	3.45	3.45	3.50	3.50
30-year	3.02	3.09	3.81	3.02	3.41	3.39	3.13	3.33	3.23	3.56	3.60	3.60	3.65	3.65	3.70	3.70
United States																
Fed funds midpoint	4.88	5.13	5.38	5.38	5.38	5.38	4.88	4.38	4.38	4.38	4.13	3.88	3.38	2.88	2.88	2.88
3-month	4.85	5.43	5.55	5.40	5.45	5.48	4.73	4.37	4.32	4.41	4.07	3.82	3.32	2.85	2.87	2.87
2-year	4.06	4.87	5.03	4.23	4.66	4.71	3.66	4.25	3.89	3.72	3.60	3.50	3.30	3.15	3.25	3.50
5-year	3.60	4.13	4.60	3.84	4.28	4.33	3.58	4.38	3.96	3.79	3.65	3.55	3.40	3.35	3.40	3.60
10-year	3.48	3.81	4.59	3.88	4.27	4.36	3.81	4.58	4.23	4.24	4.15	4.00	3.85	3.75	3.85	4.05
30-year	3.67	3.85	4.73	4.03	4.41	4.51	4.14	4.78	4.59	4.78	4.80	4.70	4.60	4.55	4.55	4.65
United Kingdom																
Bank Rate	4.25	5.00	5.25	5.25	5.25	5.25	5.00	4.75	4.50	4.25	4.00	3.75	3.75	3.75	3.75	3.75
2-year	3.42	5.27	4.91	3.98	4.17	4.23	3.97	4.38	4.20	3.81	4.20	4.25	4.30	4.45	4.50	4.60
5-year	3.33	4.66	4.53	3.46	3.84	4.03	3.85	4.35	4.29	3.95	4.40	4.40	4.50	4.60	4.75	4.80
10-year	3.47	4.39	4.46	3.54	3.95	4.17	4.00	4.57	4.70	4.48	4.70	4.70	4.65	4.70	4.90	5.00
30-year	3.82	4.42	4.92	4.14	4.49	4.67	4.54	5.11	5.29	5.25	5.40	5.40	5.30	5.40	5.50	5.50
Euro area*																
Deposit rate	3.00	3.50	4.00	4.00	4.00	3.75	3.50	3.00	2.50	2.00	2.00	2.00	2.00	2.00	2.00	2.00
2-year	2.66	3.27	3.20	2.40	2.83	2.82	2.09	2.09	2.05	1.85	2.00	2.10	2.15	2.25	2.40	2.50
5-year	2.30	2.58	2.79	1.94	2.32	2.48	1.97	2.15	2.34	2.15	2.60	2.50	2.50	2.60	2.70	2.80
10-year	2.28	2.39	2.85	2.03	2.29	2.50	2.14	2.36	2.74	2.59	2.80	3.00	2.90	2.95	3.00	3.10
30-year	2.35	2.38	3.05	2.27	2.46	2.69	2.46	2.60	3.09	3.12	3.10	3.10	3.05	3.15	3.10	3.25
Australia																
Cash rate	3.60	4.10	4.10	4.35	4.35	4.35	4.35	4.35	4.10	3.85	3.60	3.35	3.10	3.10	3.10	3.10
2-year	2.96	4.21	4.09	3.71	3.76	4.17	3.64	3.87	3.68	3.21	3.35	3.20	3.25	3.30	3.40	3.45
10-year	3.30	4.02	4.49	3.95	3.97	4.31	3.97	4.37	4.39	4.16	4.35	4.25	4.05	3.90	3.95	4.05
New Zealand																
Cash rate	4.75	5.50	5.50	5.50	5.50	5.50	5.25	4.25	3.75	3.25	3.00	2.50	2.50	2.50	2.50	2.50
2-year swap	5.01	5.46	5.69	4.63	4.78	4.95	3.56	3.36	3.33	3.18	2.75	2.90	3.00	3.10	3.30	3.40
10-year swap	4.27	4.46	5.13	4.12	4.35	4.48	3.87	3.91	4.05	4.03	3.90	3.80	3.70	3.65	3.75	3.95

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

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Economic outlook | September 2025

Real GDP, quarter-over-quarter percent change

	Q1-24	Q2-24	Q3-24	Q4-24	Q1-25	Q2-25	Q3-25	Q4-25	Q1-26	Q2-26	Q3-26	Q4-26	2023	2024	2025	2026
Canada*	2.1	2.5	2.4	2.1	2.0	-1.6	0.5	0.8	1.5	1.7	2.0	2.2	1.5	1.6	1.2	1.2
United States*	1.6	3.0	3.1	2.4	-0.5	3.3	0.5	1.0	1.2	1.5	1.7	1.8	2.9	2.8	1.6	1.4
United Kingdom	0.9	0.5	0.0	0.1	0.7	0.3	0.2	0.3	0.3	0.3	0.3	0.3	0.4	1.1	1.0	1.1
Euro area	0.3	0.2	0.4	0.4	0.6	0.1	0.2	0.3	0.4	0.4	0.5	0.4	0.5	0.8	1.4	1.4
Australia	0.2	0.1	0.3	0.6	0.3	0.6	0.6	0.8	0.7	0.7	0.5	0.5	2.1	1.0	1.9	2.7

*annualized

Inflation, year-over-year percent change

	Q1-24	Q2-24	Q3-24	Q4-24	Q1-25	Q2-25	Q3-25	Q4-25	Q1-26	Q2-26	Q3-26	Q4-26	2023	2024	2025	2026
Canada	2.8	2.7	2.0	1.9	2.3	1.8	2.0	2.1	2.0	2.2	2.1	2.1	3.9	2.4	2.0	2.1
United States	3.2	3.2	2.6	2.7	2.7	2.4	2.9	3.0	2.7	2.8	2.6	2.4	4.1	2.9	2.8	2.6
United Kingdom	3.5	2.1	2.1	2.5	2.8	3.5	3.3	3.0	2.7	2.3	2.4	2.4	7.3	2.5	3.3	2.5
Euro area	2.6	2.5	2.2	2.2	2.3	2.0	2.1	2.1	1.8	2.2	2.1	2.0	5.4	2.4	2.1	2.0
Australia	3.6	3.8	2.8	2.4	2.4	2.1	2.4	2.7	2.4	2.4	2.5	2.6	5.6	3.2	2.4	2.5

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

Currency outlook | September 2025

US dollar cross rates, end of period

	Q1-24	Q2-24	Q3-24	Q4-24	Q1-25	Q2-25	Q3-25	Q4-25	Q1-26	Q2-26	Q3-26	Q4-26
USD/CAD	1.35	1.37	1.35	1.44	1.44	1.36						
EUR/USD	1.08	1.07	1.11	1.04	1.08	1.18						
GBP/USD	1.26	1.26	1.34	1.25	1.29	1.37	*Under review*					
USD/JPY	151	161	143	157	150	144						
AUD/USD	0.65	0.67	0.69	0.62	0.62	0.66						

Canadian dollar cross rates

	Q1-24	Q2-24	Q3-24	Q4-24	Q1-25	Q2-25	Q3-25	Q4-25	Q1-26	Q2-26	Q3-26	Q4-26
EUR/CAD	1.46	1.47	1.50	1.49	1.55	1.60						
GBP/CAD	1.71	1.73	1.80	1.80	1.86	1.87	*Under review*					
CAD/JPY	112	117	106	109	104	106						
AUD/CAD	0.88	0.91	0.93	0.89	0.90	0.89						

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

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