Quarterly Canadian outlook

September 15, 2025

RBC Economics

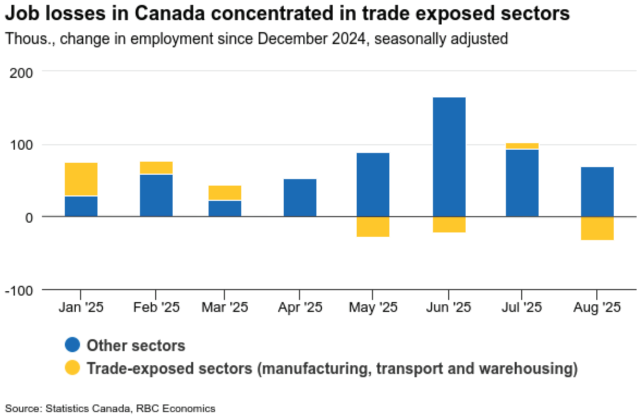
Low but positive growth ahead

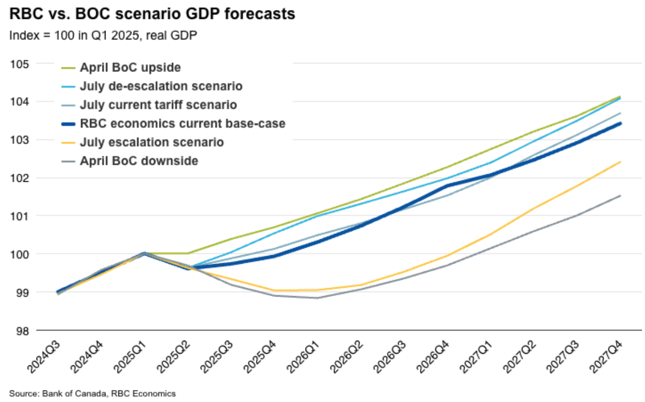
Canadian outlook

The trade war took a larger than expected bite out of Canadian gross domestic product in Q2, but data still shows an economy that has weathered recent trade pressures better than feared when uncertainty was most acute in the spring.

Trade-sensitive sectors have faced significant challenges. Exports declined sharply in Q2 and manufacturing contracted by an annualized 8%. U.S. imports of steel and aluminum products from Canada targeted with 50% tariffs decreased almost 50% year-over-year in July.

But critically, most Canadian exports continue to cross the border duty-free thanks to CUSMA exemptions, and weakness remains largely contained to directly impacted sectors. Employment in manufacturing and transportation sectors are down 32,000 from the end of 2024, but up 70,000 in other industries.





Meanwhile, activity outside of tariff-affected sectors has been resilient. Consumer spending jumped 4.5% in Q2 despite low confidence. Our tracking of RBC card transactions pointed to further Q3 growth.

The unemployment rate reached 7.1% in August—the highest outside the pandemic in nearly a decade—but job openings and improving business confidence suggest hiring demand is stabilizing.

Outlook for rest of the year is brighter

In our last quarterly update three months ago, we noted key developments in Canada's outlook were more positive than anticipated when economic sentiment was lowest in spring. This remains true with growth tracking closer to the least negative scenarios from earlier in the year.

Positive Factors

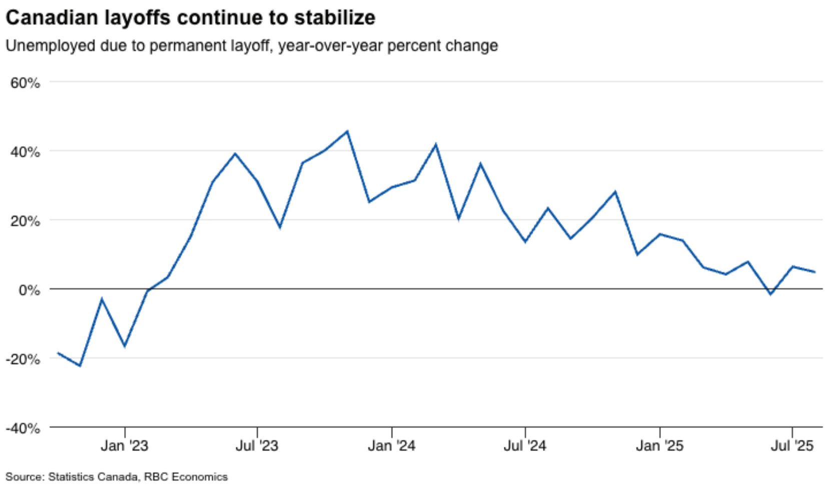
- **Resilient growth:** Early Q3 GDP indicators look better than Q2. Export volumes rose for a third consecutive month in July and manufacturing sales increased, suggesting Q3 will not be similar to Q2's large growth subtraction from trade and manufacturing. Housing markets have shown early signs of improvement, and our tracking of RBC card transactions points to growth ahead in consumer spending.

- **CUSMA exemptions:** Most Canadian exports to the U.S. remain tariff-free (88% in July) under exemptions for trade compliant with CUSMA. Outside of petroleum exports (which are down sharply from a year ago largely due to lower oil prices), exports of products specifically targeted by tariffs are down 16% from a year ago in July. However, products that have remained largely duty-free are up 0.5%.

- **Fiscal support:** Federal and provincial governments have announced significant economic support packages that are increasingly likely to support growth in the year ahead.

  Limited layoffs: The unemployment rate rise mostly stems from longer job search times for new entrants. Youth unemployment, in particular, has increased sharply. But growth in unemployed workers due to permanent layoffs has slowed to 4.7% year-over-year in August, down from 19% and 24% in 2023 and 2024, respectively.

- **Central bank flexibility:** Additional interest rate cuts from the Bank of Canada aren't in our base case forecasts, but policymakers can reduce rates if needed. Net trade likely won't repeat its Q2 decline, household spending has continued to surprise on the upside, and fiscal support (better suited to address sector-specific tariff headwinds) is increasing. However, weak Q2 GDP and recent labour market reports makes a September rate cut essentially a toss-up.



Some downside risks remain

- **U.S. dependency risks:** Canada maintains relatively favorable U.S. tariff rates, but that provides little comfort if broader U.S. tariff hikes cause the tightly integrated North American industrial sector to shrink.

  The U.S. unemployment rate remains historically low, but job growth has stalled since April with weakness concentrated in industrial sectors where Canadian economic ties are strongest.

- **Maintaining CUSMA exemption is critical on both sides of the border:** The CUSMA exemption continues to protect most Canadian exports from U.S. tariffs, and maintaining it is vital for Canadian exporters.

  But, as we argued here, the agreement is also important for U.S. importers, who would see already escalating import costs accelerate significantly without it.

  CUSMA doesn't (automatically) expire until 2036, and negotiations to extend the agreement (negotiated by the first Trump administration) beyond that time start next year at the latest.

  U.S. trade policy remains highly unpredictable, but the continuation of CUSMA protections through multiple rounds of U.S. tariffs is an implicit recognition of its mutual benefits.

Provincial overview

Provincial growth diverges amid trade tensions

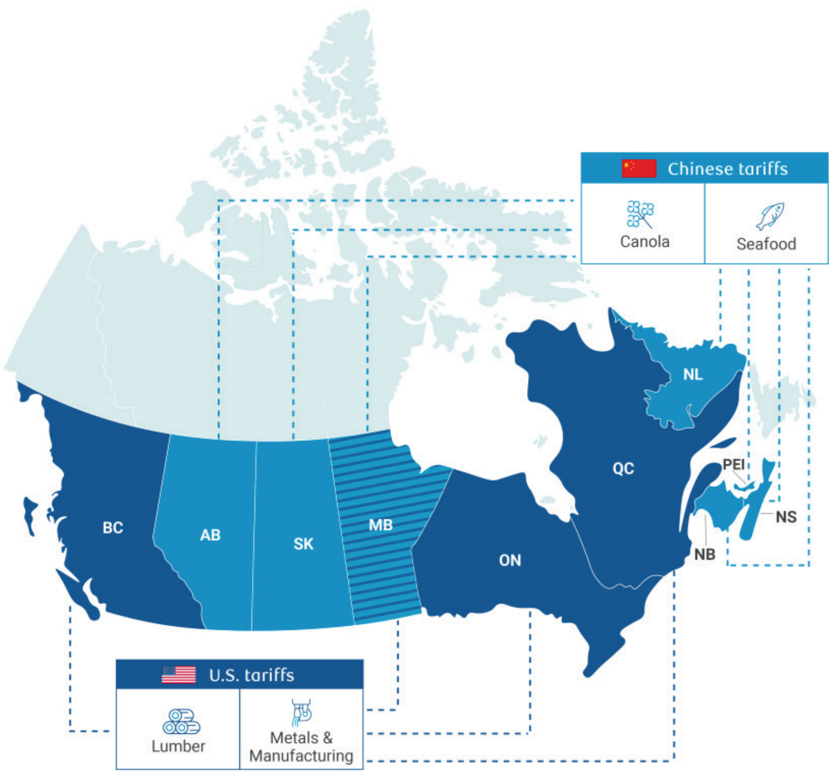
While Canada faces a national shock from its trade relationship with the United States, the provinces are facing differentiated trade shocks that are creating divergences in both growth and growth drivers.

First, the doubling of U.S. tariffs on steel and aluminum to 50%, and newly added tariffs on copper of 50% has prompted further downgrades of our 2025 growth forecasts for: Ontario, Quebec and Manitoba.

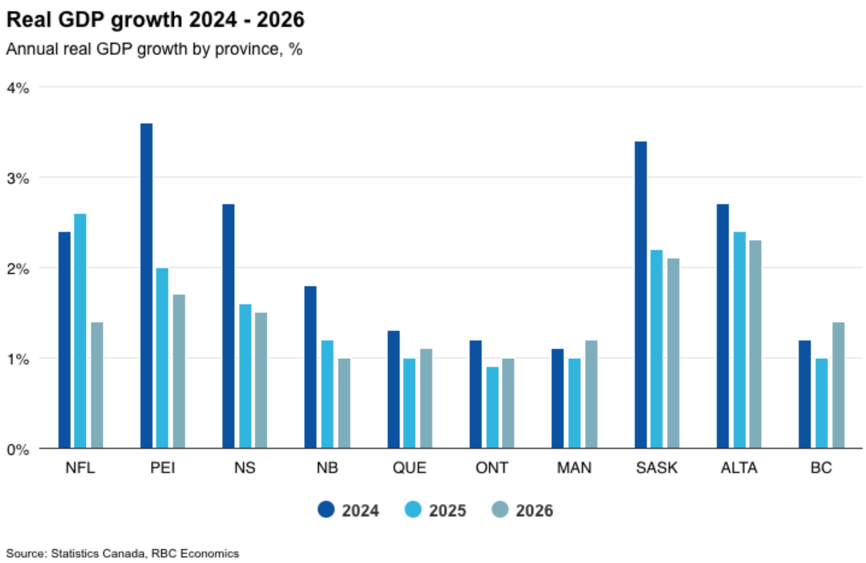
Second, heightened duties on lumber exports—which are compounding existing challenges of investment weakness—implies a lower growth projection for British Columbia as well.

Third, while all eyes are on U.S. tariffs, Chinese tariffs are also in play. Seafood tariffs had already been incorporated into earlier projections, and therefore haven't altered the better-than-national average growth outlook for Atlantic provinces. Chinese canola tariffs in effect from August were implemented too late in the 2025 growing season to impact our gross domestic product outlook for the Prairies this year. We will, however, monitor trade negotiations closely as they unfold over the next six months, and may adjust our 2026 forecasts depending on outcomes.

How Canada's provinces are being hit with tariffs



Meanwhile, Prince Edward Island, for example continues to demonstrate remarkable resilience with robust tourism, and sustained construction investment supporting an upward revision of our 2025 growth forecast to 2% from 1.7%.



Quebec and Ontario hardest hit by trade turbulence

Off the back of trade wars, we are reducing our 2025 growth forecast for Ontario and Quebec from 1.3% to 0.9% for Ontario, and from 1.3% to 1.2% for Quebec.

Importantly, the impacts thus far of U.S. tariffs have fallen more heavily on Ontario than Quebec, reflecting fundamental differences in market conditions for primary metals. Quebec's aluminum production maintains relative competitiveness due to lower production costs and shrinking capacity for U.S. aluminum production.

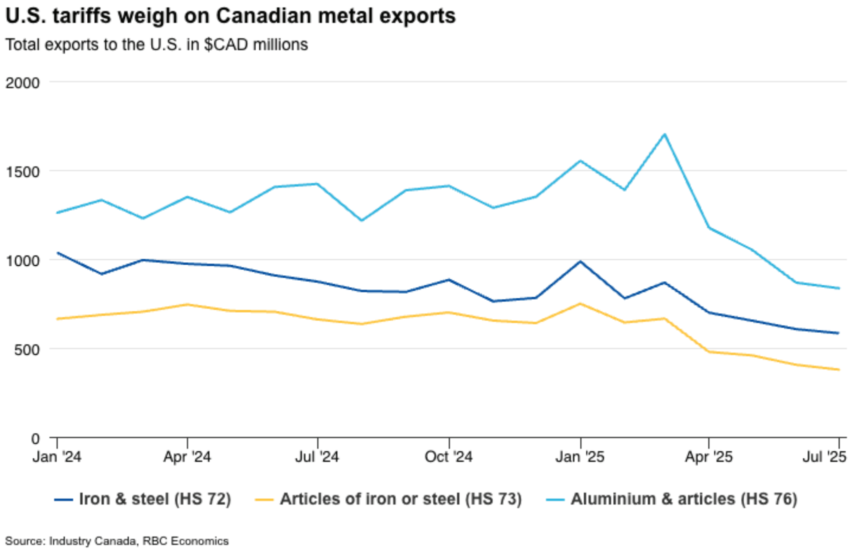
This pattern mirrors previous episodes of tariffs on Canadian primary metals, when Quebec's aluminum sector proved more resilient.

We've also seen early signs of export diversification away from the U.S. with European markets consuming an increasing share of Quebec's metal exports.

Still, the economic spillover from these manufacturing challenges is extending to neighboring provinces, keeping Manitoba and New Brunswick underperforming their regional peers.

U.S. tariffs on steel and aluminum derivatives are creating significant headwinds for Manitoba's manufacturing sector—particularly in transportation equipment such as aerospace and machinery—which rely heavily on embedded metal content. We have downgraded our 2025 real GDP forecast for Manitoba to 1% from 1.2%.

Looking ahead, the mid-August expansion of Chinese tariffs could create challenges for exporters in the Prairies. China is the largest export destination for canola seed from Saskatchewan, Alberta, and Manitoba.

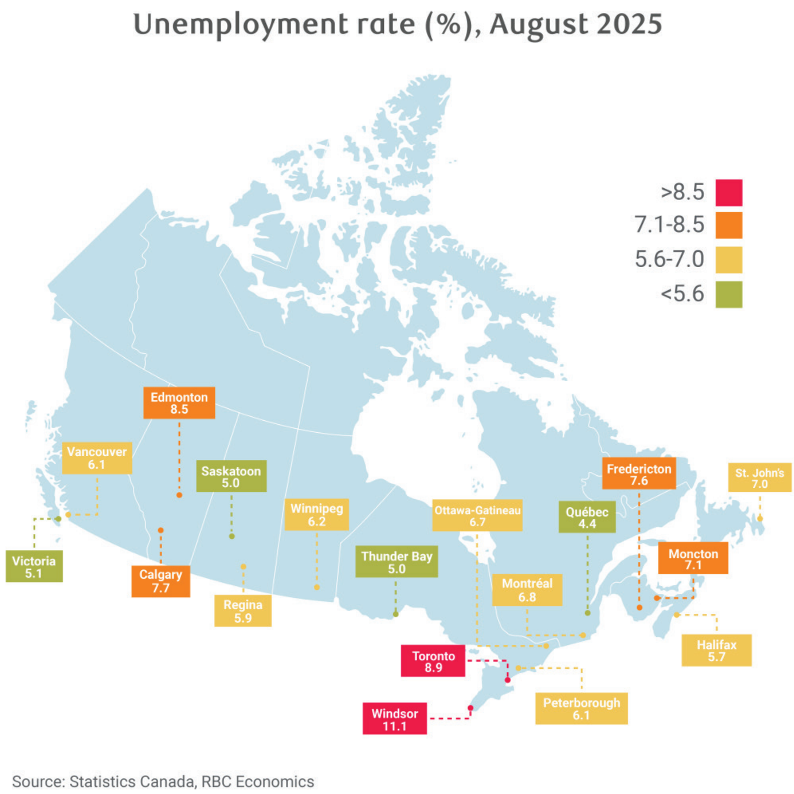


Ontario likely facing localized 'recessions'

Ontario is clearly in the eye of the trade war storm, and we expect the province to face persistent economic headwinds throughout 2025 and into 2026 as it adapts to the new rules of trade. We continue to think the aggregate province will avoid a recession, but local double-digit unemployment rates suggest some municipalities are experiencing meaningful economic hardship and "localized" recessions are possible.

For example, the central-southern and southwestern corner of the province—where a high concentration of Ontario's manufacturing workforce is based—is being hit particularly hard as tariffs targeting automotive and primary metal exports bring economic strain.

That said, while Ontario's economy weakened considerably in Q2 alongside the total Canadian economy, resilient consumers, a stabilizing job market, and rebounding activity in the existing home market suggest the softness will be contained.



Given these resilient factors, the Ontario economy is positioned to maintain low but positive growth.

Increased lumber duties add to B.C. headwinds

We've further reduced B.C.'s 2025 growth forecast to 1% from 1.2%, responding to newly imposed U.S. duties on Canadian lumber.

This comes after our previous outlook already anticipated growth deceleration as major capital projects end in the province.

Steeper duties for the vital softwood lumber industry and increased anti-dumping measures have pushed the total tariff rate to 35.2% in August from 14.4% for some exporters with threats to go even higher.

New trade terms have severely impacted export competitiveness. Strain in the industry is likely to intensify into 2026 as the full impact of new lumber duties take effect later this year, and moderating housing starts at home fail to offset reduced U.S. demand.

B.C. softwood lumber production drops to record low

B.C. softwood lumber production, thousands of cubic metres

Source: Statistics Canada, RBC Economics

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