Outlook

Tariffs and trade uncertainty are expected to weigh on Canadian economic activity for some time. Inflation remains close to the 2% target over the scenario horizon.

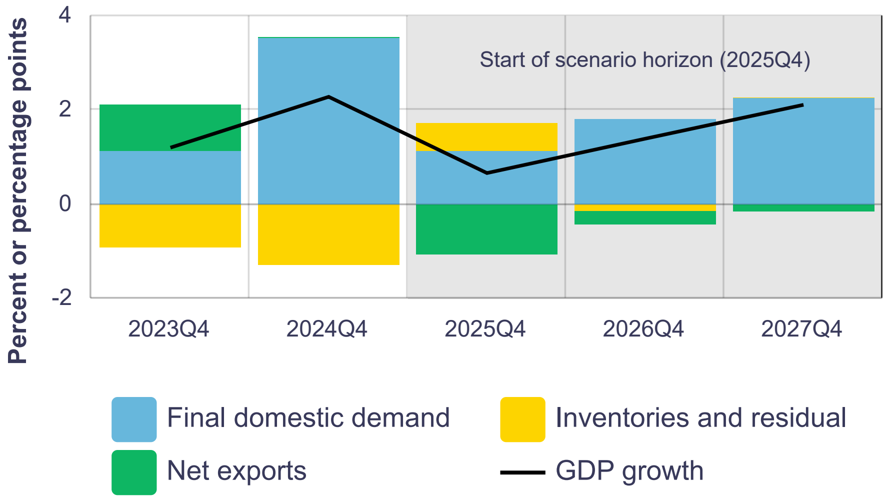
Because the trade environment remains volatile, this section presents a *current tariff scenario* instead of a base-case projection (see the **Scenario assumptions** section). Two alternative scenarios are also presented that, when taken together, encompass a range of potential outcomes (see **In Focus: The path of US tariffs remains uncertain**). Regardless of how US trade policy evolves, risks remain with respect to how businesses, households and governments will react and adapt (see the **Risks** section).

In the *current tariff scenario*, tariffs and trade uncertainty continue to weigh on economic activity. After declining in the second quarter of 2025, gross domestic product (GDP) grows by about 1% in the second half of the year. Exports stabilize—albeit at a lower level of activity—and growth in household spending strengthens.

GDP growth then picks up, reaching 1.8% in 2027, supported by the waning impacts of trade uncertainty and tariffs on export growth (**Chart 14**). Due to the impact of tariffs, the level of activity is on a permanently lower path.

Chart 14: GDP growth slows in 2025 due to the trade conflict but then picks up gradually

Contributions to real GDP growth, fourth-quarter-over-fourth-quarter percentage change, quarterly data



Sources: Statistics Canada and Bank of Canada calculations and estimates
Last data plotted: 2027Q4

Consumer price index (CPI) inflation stays close to the 2% target over the scenario horizon. In 2025 and 2026, this reflects the following offsetting forces:

- upward pressure on inflation from tariffs and the end of the temporary downward impact from the removal of the consumer carbon tax
- downward pressure on inflation from excess supply and a stronger Canadian dollar as well as an easing in shelter price inflation

In 2027, inflation remains close to the 2% target as offsetting pressures from tariffs and excess supply dissipate.

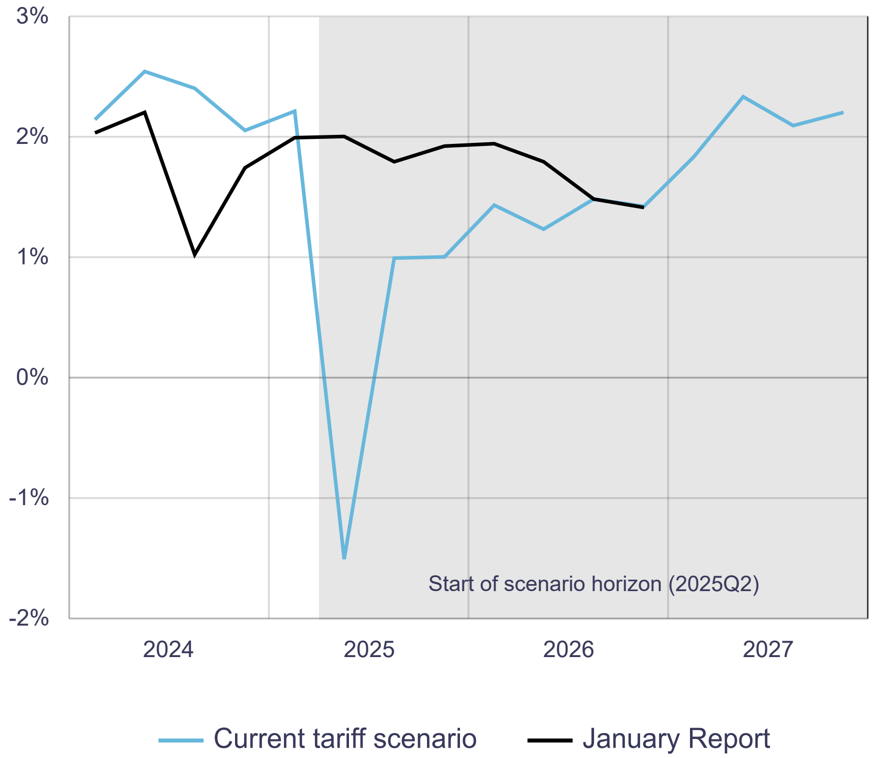
Economic activity

GDP growth picks up in the second half of 2025 as exports stabilize. GDP growth then strengthens to reach 1.8% in 2027 (**Chart 15**), but tariffs permanently lower the path of economic activity.

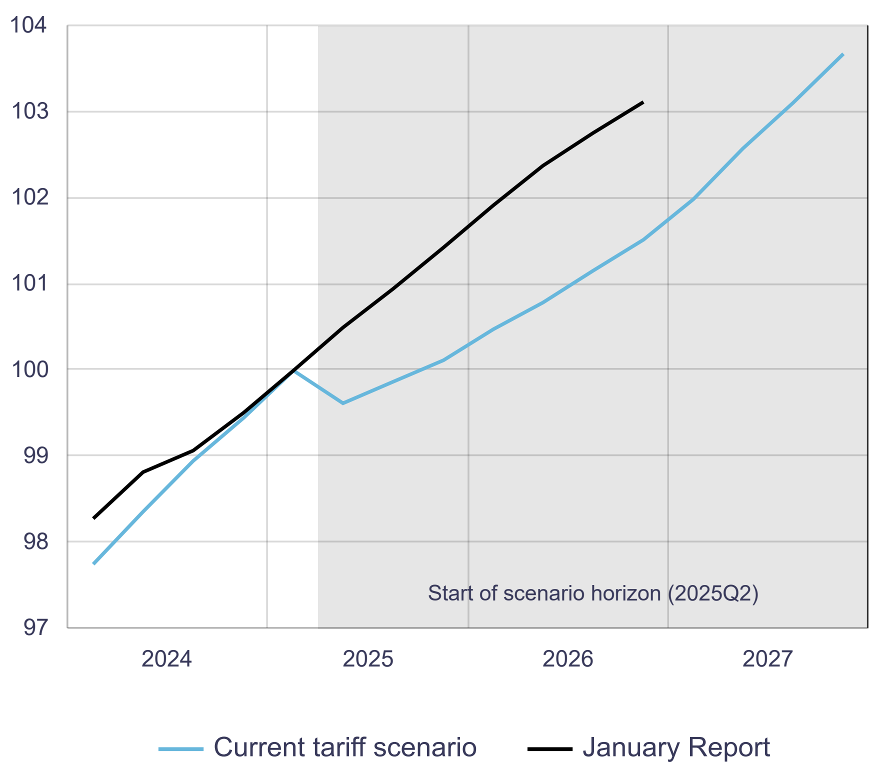
Chart 15: GDP growth strengthens, but the level of activity is permanently lower than projected in the January Report

Quarterly data

a. Quarter-over-quarter percentage change of real GDP at annual rates



b. Level of real GDP, index: 2025Q1 = 100



Sources: Statistics Canada and Bank of Canada calculations and estimates
Last data plotted: 2027Q4

Slow population growth and weak business investment weigh on potential output growth in the second half of 2025. Potential output growth then picks up in 2026 and 2027, mainly due to more robust trend labour productivity growth. Trend labour input growth remains modest.

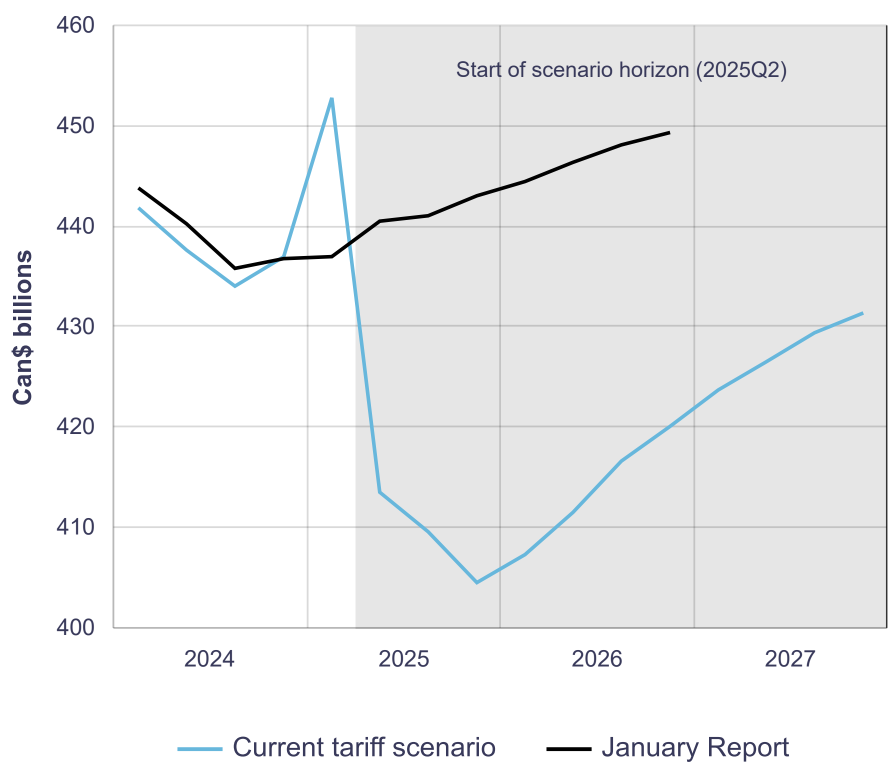
The output gap persists in 2026 and then narrows in 2027 as GDP growth picks up.

Exports rise slowly from current low levels

After falling sharply in the second quarter due to tariffs, exports stabilize in the second half of 2025. They increase modestly over the rest of the scenario horizon as Canadian exporters adjust to the new trade environment. Non-commodity exports remain well below their pre-tariff levels, reflecting the permanent damage done by US tariffs (**Chart 16**).

Chart 16: Non-commodity exports remain below their 2024 levels

Annualized, quarterly data, chained 2017 Canadian dollars



Sources: Statistics Canada and Bank of Canada calculations and estimates
Last data plotted: 2027Q4

Growth of commodity exports is supported by new export capacity for liquefied natural gas and the increased use of the Trans Mountain pipeline.

Imports decline in the second half of 2025 partly because of the impact of Canadian countermeasures. Import growth then picks up in 2026 and 2027 as overall economic activity improves.

Business investment is soft over the near term

Business investment contracts in the second half of 2025, still weighed down by elevated uncertainty.

Growth in business investment picks up in 2026 and 2027. This growth is supported by diminishing uncertainty and a stronger Canadian dollar, which lowers the cost of imported machinery and equipment.

Growth in consumption picks up in 2027

Consumption growth remains modest in the second half of 2025 and in 2026. It is constrained by ongoing trade policy uncertainty, which holds back labour income growth. Higher mortgage payments for some households facing renewals further weigh on consumption. Tax cuts and government transfers provide a partial offset.[1]

Growth in consumption spending picks up in 2027 because of the diminishing impact of trade uncertainty and stronger growth in labour income.

Residential investment rises

Growth in residential investment strengthens in the second half of 2025, partially due to an increase in resale activity after the steep decline in the first half of the year. Growth in residential investment is moderate over 2026 and 2027, supported by dissipating trade uncertainty and rising household incomes.

Government spending supports growth

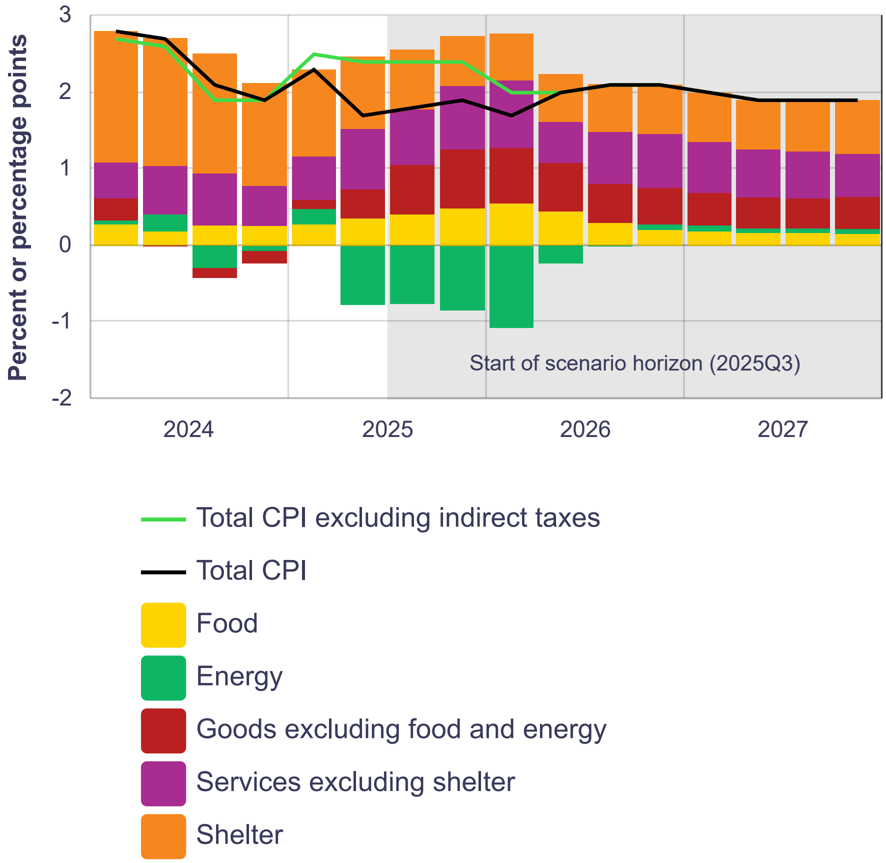
Growth in government spending is assumed to remain above that of potential output over the next year, underpinned by higher defence spending by the federal government and increased investment by provincial governments.

Inflation

Inflation stays close to 2% over the scenario horizon (**Chart 17**). In 2025 and 2026, this reflects a series of offsetting pressures.

Chart 17: CPI inflation averages around 2% over the scenario horizon

Contributions to year-over-year CPI inflation, quarterly data



Note: No changes to indirect tax rates are assumed over the outlook horizon.
Sources: Statistics Canada and Bank of Canada calculations and estimates
Last data plotted: 2027Q4

Factors leading to higher inflation include:

- the end of the downward impact from the elimination of the consumer carbon tax in the second quarter of 2026
- Canada's counter-tariffs, which add up to 0.6 percentage points to inflation, particularly affecting the prices of goods such as food and motor vehicles

In addition, businesses report that they are facing new costs due to the reconfiguration of trade, including the cost of finding new markets and restructuring their supply chains. These cost pressures are particularly difficult to assess, and there is a risk that they will be more significant than anticipated.

Factors leading to lower inflation include:

- excess supply and slower growth in unit labour costs

- easing inflation in shelter prices, reflecting slower growth in rent prices and mortgage interest costs
- the recent appreciation of the Canadian dollar

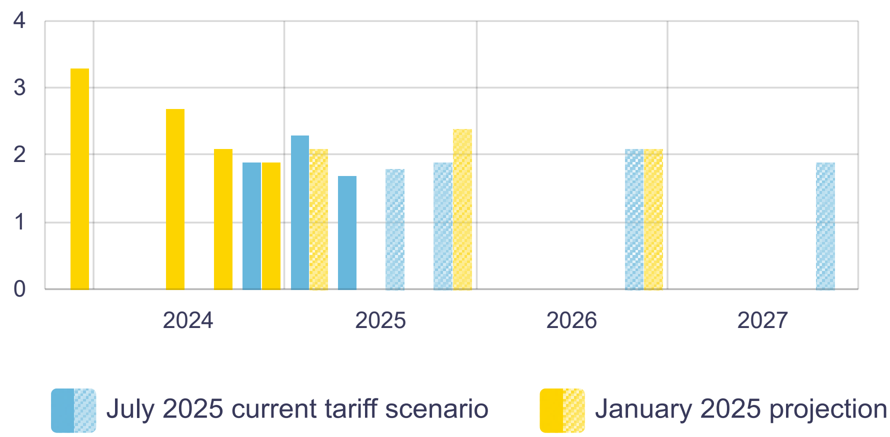
In 2027, inflation remains close to 2% as the effects of tariffs dissipate and excess supply begins to shrink. The composition of inflation shifts, with inflation in goods prices easing and inflation in services prices stabilizing near historical norms.

Comparison of recent Bank outlooks

Chart 18 compares the *current tariff scenario* with the January Report and previous Reports. In January, the near-term outlook for inflation was higher than in the *current tariff scenario* because the consumer carbon tax was still in place. The April Report is excluded because it presented a range of scenarios.

Chart 18: The July 2025 and January 2025 Monetary Policy Report outlooks

CPI inflation (year-over-year percentage change)



The outlook for GDP growth in the *current tariff scenario* is significantly weaker than it was at the time of the January Report, before the trade conflict intensified (**Table 2** and **Table 3**).

- GDP growth is approximately 0.5 percentage points lower in both 2025 and 2026 due to the negative effect of tariffs and associated uncertainty.
- Potential output is weaker by the end of 2026 because tariffs and uncertainty lead to lower trend labour productivity.

The outlook for CPI inflation is around 0.4 percentage points lower in 2025. This is primarily due to lower oil prices and the temporary decline in inflation from removing the consumer carbon tax, which outweigh the one-time price increase from Canada's counter-tariffs.

Table 2: GDP growth and inflation over the current tariff scenario horizon

	2024	2025	2026	2027
GDP (average annual growth)	1.6 (1.3)	1.3 (1.8)	1.1 (1.8)	1.8
Final domestic demand (percentage points)	2.1 (1.6)	2.1 (2.4)	1.8 (1.7)	2.0
Exports (percentage points)	0.2 (0.3)	-1.1 (0.6)	-0.1 (0.8)	0.9
Imports (percentage points)	-0.2 (-0.2)	0.4 (-0.7)	-0.3 (-0.8)	-1.1
CPI inflation (percentage change)	2.4 (2.4)	1.9 (2.3)	2.0 (2.1)	1.9

Note: The assumptions and scenarios were finalized on July 27, 2025. Final domestic demand, exports and imports are calculated as contributions to GDP growth. These components do not add up to total GDP growth because inventories are not included. Numbers in parentheses are projections from the January 2025 Report. In January, the near-term outlook for inflation was higher than in the *current tariff scenario* because the consumer carbon tax was still in place.
Sources: Statistics Canada and Bank of Canada calculations and estimates

Table 3: Summary of GDP growth and inflation for Canada in the current tariff scenario

	2024	2025			2024	2025	2026	2027
	Q4	**Q1**	**Q2**	**Q3**	**Q4**	**Q4**	**Q4**	**Q4**
CPI inflation (year-over-year percentage change)	1.9 (1.9)	2.3 (2.1)	1.7	1.8	1.9 (1.9)	1.9 (2.4)	2.1 (2.1)	1.9
Core inflation (year-over-year percentage change)*	2.6 (2.6)	2.8 (2.5)	3.1	3.1	2.6 (2.6)	3.1 (2.1)	2.4 (2.1)	2.0
Real GDP (year-over-year percentage change)	2.3 (1.8)	2.3 (1.7)	1.3	0.9	2.3 (1.8)	0.7 (1.9)	1.4 (1.7)	2.1
Real GDP (quarter-over-quarter percentage change at annual rates)†	2.1 (1.8)	2.2 (2.0)	-1.5	1.0				

Note: The assumptions and scenarios were finalized on July 27, 2025. Numbers in parentheses are projections from the January 2025 Report. In January, the near-term outlook for inflation was higher than in the *current tariff scenario* because the consumer carbon tax was still in place.
* Core inflation is the average of CPI-trim and CPI-median.
† Over the scenario horizon, 2025Q2 and 2025Q3 are the only quarters for which some information about real GDP growth was available at the time the scenario was conducted. For longer horizons, fourth-quarter-over-fourth-quarter percentage changes are presented. They show the growth rates of CPI and real GDP within a given year in the Bank's scenario horizon. Therefore, they can differ from the average annual growth rates shown in **Table 2**.
Sources: Statistics Canada and Bank of Canada calculations and estimates

Endnotes

1. Half of the revenues from tariffs are remitted to tariff-affected businesses in line with Government of Canada announcements. The remaining half of tariff revenues are redistributed to households.[←]