

ECONOMIC AND FINANCIAL OUTLOOK

Will the Resilience Peter Out?

By Jimmy Jean, Vice-President, Chief Economist and Strategist

The summer saw a gradual clarification of US tariff policy. After a series of announcements, reversals, and temporary truces—particularly with China—the United States stepped up negotiations, exemptions, and deadline postponements. By August 1, the imposition of tariffs on several sectors (steel, aluminum, copper, lumber, etc.) had been formalized and partial agreements had been made with a number of partners such as Europe, Japan, and the United Kingdom. These have helped ease trade jitters, but they don’t change the underlying fact: tariffs are here to stay. CUSMA still protects a large share of Canada’s exports, but unprotected sectors have been hit hard: 60,000 manufacturing jobs have been lost since January, with shutdowns in auto production in Ontario and the forestry industry in Quebec. But, unlike in 2008, this shock hasn’t spread to the broader economy: stock markets have rallied, consumption is holding up and the global economy has avoided a collapse. But the risk is still there, especially since Washington wants to impose even more tariffs. Semiconductors and pharmaceuticals are in the crosshairs, and CUSMA will soon be up for review. The US government has already kicked off the review process by launching public consultations.

These are the circumstances in which the Carney government will release its first budget on November 4. Getting the math to add up will be tough, given the challenges: rearming the country and speeding up infrastructure construction, while simultaneously lowering public spending. The government has set ambitious targets. It wants to ramp up defence spending to 2% of GDP by the end of this fiscal year and 3.5% by 2035, invest \$25 billion of public funds

in “nation-building” infrastructure, and cut back on program spending.

Concerns have been raised over Canada’s credit rating.

We believe the [risk of a downgrade remains low](#). But if, as some rumours suggest, the deficit blows past \$100 billion, the budget will face unusually tough scrutiny from investors. Their verdict will hinge on two key factors: 1) the plausibility of plans to shave 15% off program spending by 2028 and 2) the feasibility of plans to implement nation-building initiatives—including timelines, governance and metrics.

The time for bold declarations is over. What matters now is the nitty-gritty of executing “nation-building” projects, including how to address the knock-on effects of certain measures. For example, in the construction industry, competition for labour and inputs may well intensify, even as scarcity and price pressures already pose significant challenges. Ultimately, the credibility of Carney’s economic vision depends on his ability to follow through. Without that, even the best ideas will be left on the drawing board. Currently, our forecast sees growth picking up in 2026, primarily fuelled by public investment. But that’s still a preliminary estimate pending further information.

As for consumers, a curious contradiction has emerged.

Although confidence has sunk to recession levels, household spending surged in the first half of 2025. The real estate market in Quebec surprised to the upside, while Ontario’s and British Columbia’s showed signs of stabilizing. But consumer fundamentals are deteriorating. Unemployment is rising—not

CONTENTS

Editorial.....	1	Economic Forecasts	
Risks Inherent in Our Scenarios.....	3	<i>Overseas.....</i>	<i>5</i>
Financial Forecasts.....	4	<i>Canada.....</i>	<i>9</i>
		<i>United States.....</i>	<i>7</i>
		<i>Quebec.....</i>	<i>11</i>
		<i>Medium-Term Issues and Forecasts</i>	<i>13</i>

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because the labour force is expanding, but due to the roughly 100,000 job losses recorded over the summer. Although at first unemployment [mostly affected youth](#) and newcomers, it's now increasing among core-aged workers (ages 25 to 54). The unemployment rate for this age group is the highest it's been since 2016 (excluding the pandemic). In July, the number of 25- to 54-year-olds receiving regular Employment Insurance benefits was 15.1% higher than it was 12 months ago. If unemployment really starts to hit this demographic, which accounts for the highest average household expenditure, the main driver of consumer demand would falter. In short, while the link between consumer confidence and spending may have blurred, the relationship between income and consumption remains unshakeable—and several key indicators have recently begun to flash warning signs.

Rapid population shifts represent another challenge. After a post-pandemic spike, demographic growth has plummeted: There are fewer permanent residents, workers and international students. Quebec, British Columbia and the Atlantic provinces are experiencing negative natural growth. Aggressive cuts to immigration have negative implications for potential growth and will lead to mounting fiscal pressure as the dependency ratio increases. Striking the right balance between economic imperatives and the capacity to absorb newcomers remains a pressing challenge.

All things considered, we'll have to wait and see how a number of variables play out. A painful recession or broad-based contraction has yet to materialize, at least for now, and uncertainty seems to have become part of the new normal. But it's not always the initial shock that does the most damage. The real harm often comes later, when paralysis sets in. If businesses and households hold back on spending or investment out of concern that the rules are shifting too quickly, inertia could take hold. Right now, the priority for policymakers is clear: to carve out pockets of predictability in an increasingly unpredictable landscape.

RISKS INHERENT IN OUR SCENARIOS

Global uncertainty should remain high, given the existing tariffs and the threat of other sector-specific measures. Economic growth could also be affected by other policies implemented in the United States, particularly those on immigration and the federal government apparatus. It's also not clear the extent to which central banks will be willing to cut rates if tariffs and supply chain disruptions cause inflation to climb and growth to slow. Geopolitical tensions could further contribute to inflation by pushing the price of some commodities up, including oil. We'll also need to keep an eye on the risks surrounding the independence and neutrality of key US economic institutions. In addition, the US government faces a partial shutdown if Congress fails to pass a spending bill. The state of US public finances may prompt some global investors to further reduce their exposure to the United States. But the rest of the world—including Europe, especially France—is facing its own political and budgetary challenges. In the longer term, geopolitical fragmentation and budget pressures could make it harder for governments to respond effectively to economic slowdowns without straining their public finances or seeing their credit rating lowered. And there are risks of financial instability, especially if regulatory frameworks become more relaxed. Renewed volatility in stock, bond, currency and commodity markets could erode confidence and weigh on global economic prospects.

Table 1
Global GDP Growth (Adjusted for PPP) and Inflation Rates

%	Weight*	Real GDP growth			Inflation rate		
		2024	2025f	2026f	2024	2025f	2026f
Advanced economies	37.7	1.6	1.4	1.3	2.6	2.4	2.4
United States	14.8	2.8	1.8	1.9	3.0	2.8	3.0
Canada	1.3	1.6	1.2	1.5	2.4	2.0	1.7
<i>Quebec</i>	<i>0.3</i>	<i>1.3</i>	<i>0.8</i>	<i>1.3</i>	<i>2.3</i>	<i>2.2</i>	<i>1.9</i>
Japan	3.4	0.1	0.8	0.7	2.7	3.0	1.8
United Kingdom	2.2	1.1	1.3	0.9	2.5	3.3	2.6
Eurozone	11.9	0.9	1.3	1.0	2.4	2.1	1.9
<i>Germany</i>	<i>3.2</i>	<i>-0.5</i>	<i>0.2</i>	<i>0.4</i>	<i>2.3</i>	<i>2.1</i>	<i>2.0</i>
<i>France</i>	<i>2.3</i>	<i>1.1</i>	<i>0.6</i>	<i>0.8</i>	<i>2.0</i>	<i>1.1</i>	<i>1.6</i>
<i>Italy</i>	<i>1.9</i>	<i>0.5</i>	<i>0.5</i>	<i>0.6</i>	<i>1.0</i>	<i>1.7</i>	<i>1.8</i>
Other countries	4.1	1.5	1.0	1.7	2.5	1.9	2.0
<i>Australia</i>	<i>1.0</i>	<i>1.0</i>	<i>1.2</i>	<i>2.0</i>	<i>3.2</i>	<i>2.5</i>	<i>2.8</i>
Emerging and developing economies	62.3	4.2	3.6	3.5	7.3	4.7	3.9
Emerging Asia	32.8	5.2	4.8	4.6	2.0	1.2	2.0
<i>China</i>	<i>18.8</i>	<i>5.0</i>	<i>4.6</i>	<i>4.3</i>	<i>0.2</i>	<i>0.2</i>	<i>0.8</i>
<i>India</i>	<i>7.9</i>	<i>6.5</i>	<i>6.2</i>	<i>6.2</i>	<i>5.0</i>	<i>3.3</i>	<i>4.6</i>
Latin America	5.8	2.2	1.8	1.5	4.2	4.4	3.9
<i>Mexico</i>	<i>1.8</i>	<i>1.4</i>	<i>0.5</i>	<i>1.1</i>	<i>4.7</i>	<i>4.0</i>	<i>3.8</i>
<i>Brazil</i>	<i>2.4</i>	<i>3.0</i>	<i>2.3</i>	<i>1.3</i>	<i>4.0</i>	<i>5.2</i>	<i>4.4</i>
Eastern Europe	8.5	3.5	2.0	2.4	19.5	13.3	9.2
<i>Russia</i>	<i>3.5</i>	<i>4.3</i>	<i>1.2</i>	<i>1.2</i>	<i>8.4</i>	<i>7.1</i>	<i>5.2</i>
Other countries	15.2	3.6	2.1	2.1	16.4	9.4	7.7
<i>South Africa</i>	<i>0.5</i>	<i>0.4</i>	<i>0.8</i>	<i>1.1</i>	<i>4.4</i>	<i>3.4</i>	<i>4.0</i>
World	100.0	3.3	2.7	2.7	5.5	3.8	3.3

f: forecast; PPP: Purchasing Power Parities, exchange rates that equate the cost of a broad basket of goods and services across countries; * 2023.

World Bank, Consensus Forecasts and Desjardins Economic Studies

FINANCIAL FORECASTS

The Bank of Canada came off the sidelines in September, as anticipated, to cut the policy rate by 25bps. While central bankers were tight-lipped about the future path of interest rates, we continue to believe that the Bank of Canada will reduce rates again in October and ultimately take the policy rate down to a terminal rate of 2.00%. Expect yields to move lower into year-end, led by the short end of the curve. Despite global factors weighing on the Canadian long-end, we still expect Canadian duration to outperform relative to other jurisdictions, particularly if the federal government delivers a more restrained-than-feared budget in the fall.

The Federal Reserve cut rates by 25bps at their September meeting, citing growing downside risks to the labour market. The latest iteration of the dot plot is in line with our long-standing view that officials are likely to deliver two additional 25bps cuts by year-end. The September Summary of Economic Projections also didn't see the Fed reaching the 3% neutral rate target until after 2028, which is in line with our view that markets have become overly aggressive in pricing rate cuts in 2026.

Table 2
Summary of Financial Forecasts

End of period in % (unless otherwise indicated)	2024		2025				2026			
	Q3	Q4	Q1	Q2	Q3f	Q4f	Q1f	Q2f	Q3f	Q4f
Key interest rate										
United States	5.00	4.50	4.50	4.50	4.25	3.75	3.75	3.50	3.25	3.25
Canada	4.25	3.25	2.75	2.75	2.50	2.00	2.00	2.00	2.00	2.25
Eurozone	3.50	3.00	2.50	2.00	2.00	2.00	1.75	1.75	1.75	1.75
United Kingdom	5.00	4.75	4.50	4.25	4.00	4.00	3.75	3.50	3.50	3.50
Federal bonds										
United States										
2-year	3.68	4.24	3.94	3.77	3.55	3.50	3.50	3.35	3.30	3.25
5-year	3.56	4.38	3.95	3.78	3.70	3.60	3.60	3.60	3.55	3.50
10-year	3.78	4.57	4.21	4.22	4.15	4.10	4.10	4.10	4.05	4.05
30-year	4.13	4.79	4.59	4.79	4.80	4.75	4.70	4.70	4.65	4.65
Canada										
2-year	2.91	2.93	2.46	2.59	2.50	2.20	2.15	2.10	2.20	2.30
5-year	2.73	2.96	2.61	2.83	2.75	2.65	2.60	2.55	2.65	2.70
10-year	2.95	3.23	2.97	3.28	3.20	3.10	3.05	3.00	3.05	3.10
30-year	3.13	3.33	3.23	3.56	3.65	3.55	3.45	3.40	3.40	3.45
Currency market										
Canadian dollar (USD/CAD)	1.35	1.44	1.43	1.36	1.38	1.35	1.37	1.35	1.34	1.33
Canadian dollar (CAD/USD)	0.74	0.70	0.70	0.74	0.72	0.74	0.73	0.74	0.75	0.75
Euro (EUR/USD)	1.12	1.04	1.09	1.18	1.16	1.18	1.15	1.17	1.18	1.18
British pound (GBP/USD)	1.34	1.25	1.30	1.37	1.33	1.32	1.28	1.30	1.30	1.30
Yen (USD/JPY)	143	157	150	144	148	145	145	142	140	138
Stock markets (level and growth)*										
United States – S&P 500	5,882 (23.3%)		Target: 6,800 (+15.6%)				Target: 7,400 (+8.8%)			
Canada – S&P/TSX	24,728 (18.0%)		Target: 30,250 (+22.3%)				Target: 33,600 (+11.1%)			
Commodities (annual average)										
WTI oil (US\$/barrel)	77 (70*)		67 (65*)				65 (65*)			
Gold (US\$/ounce)	2,390 (2,625*)		3,310 (3,600*)				3,505 (3,500*)			

f: forecast; WTI: West Texas Intermediate; * End of year.

Datastream and Desjardins Economic Studies

Overseas

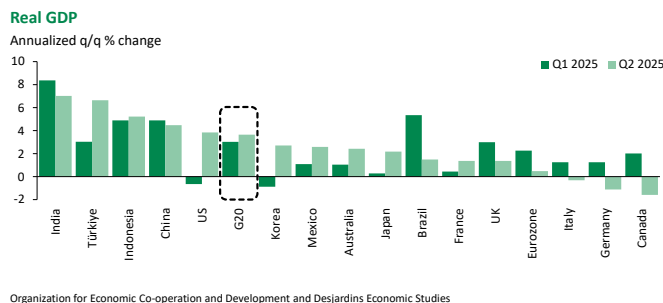
The Global Economy Is Showing Resilience

FORECASTS

Despite the uncertainty surrounding US trade policy, the global economy continues to grow. The most dire predictions about the trade war have yet to come to pass, and most countries have chosen not to retaliate in kind to US tariffs, which has helped keep inflation risks down. That said, the situation remains fragile, and global economic growth should remain muted. Global real GDP is expected to rise by 2.7% in 2025 and 2026.

The wave of protectionist measures announced by the Trump administration had the potential to significantly disrupt global economic dynamics. Real GDP in several countries could have taken a hit in the second quarter, as uncertainty soared and the tariff front-running observed earlier in the year reversed course. Instead, most major economies continued to advance this spring, and G20 real GDP growth experienced a slight acceleration from the previous quarter (graph 1). There are a number of reasons the global economy has been resilient, and those reasons vary from country to country. However, we get the impression that [US trade policy has caused less damage than we feared](#).

Graph 1
Most Major Economies Continued to Advance in Q2



Organization for Economic Co-operation and Development and Desjardins Economic Studies

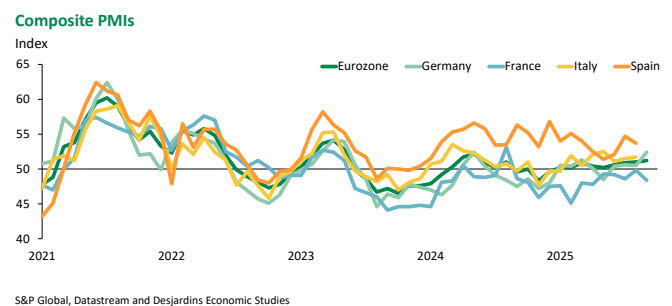
Few countries have imposed retaliatory tariffs, which has helped ease inflationary pressures outside the United States. That said, the trade deals announced so far have been relatively low on substance—and the countries that entered into them are still facing high tariffs from the United States.

The trade war and its knock-on effects could still intensify. The United States applied its latest reciprocal tariffs in early August. New tariffs on copper have come into effect as well, and tariffs on steel and aluminum products have been raised. Specific tariffs have also been applied to Canada, Brazil and India, and the

“de minimis” exemption for low-value US imports was eliminated on August 29. We can also expect new sector-based tariffs in the months ahead (semiconductors, pharmaceutical products, etc.). For the time being, our forecast scenario assumes that tariffs will remain in effect for the entire forecast horizon. That said, the situation is still fluid, and our economic and financial scenarios will be updated as trade policy evolves.

In the eurozone, economic growth slowed in the second quarter but did not collapse. Real GDP expanded just 0.1% (non-annualized) after climbing 0.6% in the first quarter. Exports fell after spiking earlier in the year, and investments declined as well, both of which dragged on growth. Italy and Germany were among the hardest hit, and both saw their real GDP contract. However, the situation doesn’t seem to be getting any worse, and European PMIs have recently improved (graph 2). Industrial production also posted fairly solid gains in July, especially in Germany.

Graph 2
European PMIs Were Fairly Positive



S&P Global, Datastream and Desjardins Economic Studies

Some concerns remain, though. Retail sales figures were soft, an indicator of waning consumer confidence. Political tensions, especially in France, are also adding to the strain, increasing pressure on bond yields and threatening to expose structural weakness in the European economy, including in public finances.

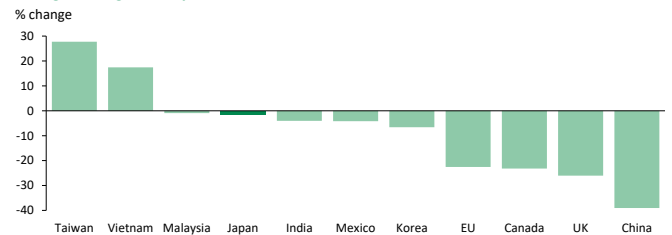
The United Kingdom is also facing fiscal pressures, though its majority government is more than a year into its mandate. It will likely need to scale back its plans for accelerated public investment aimed at “rebuilding Britain.” Here as well, bond yields are climbing and business and consumer confidence are slipping, in part due to concerns over potential tax increases. Monthly real GDP growth also stalled in July. After a non-annualized gain of 0.3% in the spring, we expect growth to be slightly weaker, but not negative, in the quarters ahead.

Japan recorded non-annualized real GDP growth of 0.5% in the second quarter, supported by stronger exports and investments. For the time being, the Japanese economy seems to have been largely unaffected by US protectionist policies. US imports of Japanese goods have remained notably more stable than those from Canada, Mexico and the European Union (graph 3). But US demand may flag as tariffs persist, in spite of the partial trade agreement announced on July 23. We therefore expect Japan’s economy to grow at a slower pace in 2026 than in 2025.

China’s economy is showing signs of fatigue. Until now, it has managed to successfully mitigate the fallout from the White House’s protectionist turn. The country’s approach to export diversification has helped it maintain growth, even though shipments to the United States are down (graph 4). But this growth is fragile. Recent sharp contractions in industrial production, exports and retail sales suggest that the economy has hit a soft patch. Prices continue to slide for both consumers and producers, as well as on the property market. We expect China’s real GDP to grow a bit more slowly in the coming quarters.

Graph 3
US Imports from Japan Were Relatively Stable in Q2

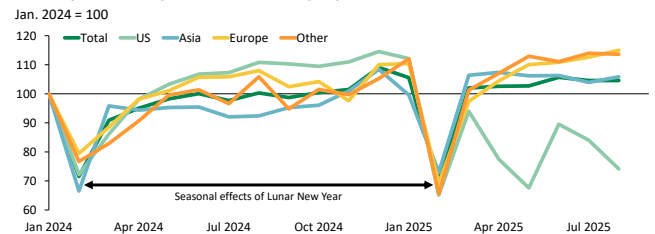
Change in US goods imports between Q1 and Q2 2025



EU: European Union
Bureau of Economic Analysis and Desjardins Economic Studies

Graph 4
China’s Total Exports Held Up Despite Falling Shipments to the US

Monthly Chinese exports (not seasonally adjusted)



National Bureau of Statistics of China and Desjardins Economic Studies

United States

A Surprisingly Strong Economy with Fragility Lingerin Beneath the Surface

FORECASTS

The US economy posted another solid increase in the second quarter. Since then, several indicators have pointed to resilience in the broader economy, even as the labour market shows clearer signs of slowing. Businesses and households are expected to continue to feel the impact of higher tariffs and tariff-related uncertainty. Real GDP growth is expected to remain subdued in 2025 and beyond. The expectation of prolonged tariffs has led us to revise our inflation forecast upward, especially for the first half of 2026.

Since Donald Trump returned to the Oval Office, shifts in net exports have become a key driver of real GDP volatility. In the first quarter, domestic demand was partly met by the pull-forward in imports early in the year, causing annualized real GDP to fall by 0.6%. In contrast, a sharp slide in imports resulted in robust real GDP growth of 3.8% in the second quarter. These shifts create a distorted picture of the US economy, as growth in final domestic demand proved more stable, coming in at 1.4% in the first quarter and 2.4% in the second quarter. That's still below the 3.1% jump posted in 2024, but it shows the economy remained relatively resilient despite the uncertain environment.

Although uncertainty has softened slightly since its spring peak, it remains present. In addition to the new US tariffs announced this summer, ongoing uncertainty is expected to drive volatility in net exports, dampen business confidence, and limit economic growth.

While trade tensions persist, several factors are helping to stabilize the economy. Excitement over artificial intelligence, which has fuelled a stock market craze for companies that develop and use it, has also boosted business investment (graph 5). The AI boom even helped slow the decline in non-residential construction, with data centre construction driving the increase (up 17.8% since the year began, while other sectors lost

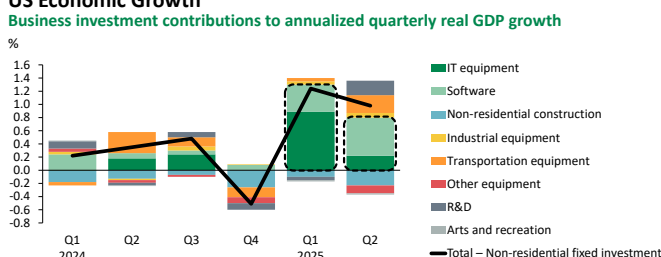
1.9%). As a result, we've revised our non-residential investment forecasts upward for the coming quarters.

Residential construction continues to struggle, posting back-to-back quarterly decreases in the first half of 2025. The August drop in housing starts and building permits, fading home builder confidence and falling resale prices point to further declines in residential investment.

Job losses have also been mounting in the construction sector for several months. Combined with layoffs in manufacturing, net layoffs in goods-producing industries over the past six months totalled 67,000. For now, those losses are being offset by the services sector (+174,000 jobs over the same period), but the labour market looks much weaker than it was in early 2025 or 2024 (graph 6). In August, the unemployment rate reached its highest level since 2017 (excluding the pandemic) and could continue to rise in the coming quarters. Net job losses are expected in the coming months as the federal public service cutbacks early this year start to show up in the data after the deferred resignation program comes to a close.

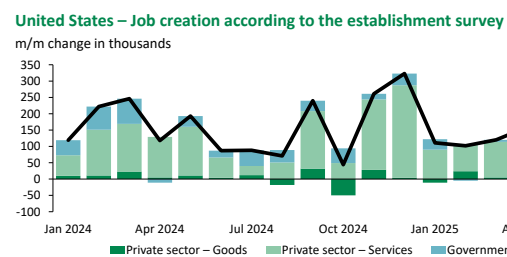
President Trump loves to talk about the record revenues brought in by tariffs. For the past few months, tariffs added about \$30 billion a month to the US Treasury. But even after we

Graph 5
Artificial Intelligence Investment Has Contributed Significantly to US Economic Growth



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Graph 6
Job Creation Has Slowed Sharply

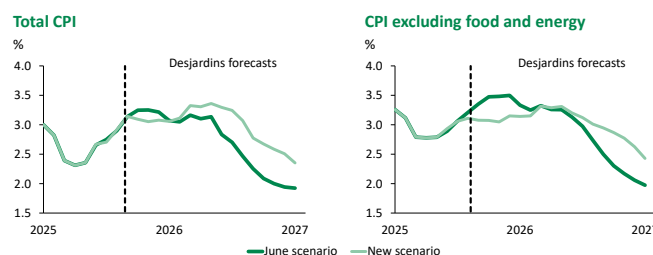


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multiply that figure by 12, it's clear tariffs won't bring in close to enough to address projected budget shortfalls of around US\$2,000 billion annually over the next few years. And the *One Big Beautiful Bill Act* passed in July is exacerbating those shortfalls. That said, the tax break it provides should help prop up household disposable income and consumption, as well as business investment, in 2026.

The reason that tariffs generate revenue for the federal government is because they're a tax on importers and ultimately on American consumers. So far, the increase in import prices before tariffs confirms that it's Americans who are paying the price. For now, businesses appear to be eating the cost of higher tariffs, but we expect consumer prices will increasingly be affected. We should see the full impact in spring 2026 (graph 7).

Graph 7
US Inflation Set to Remain High Longer into 2026



CPI: Consumer price index
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Table 3

United States: Major Economic Indicators

Quarterly annualized % change (unless otherwise indicated)	2025				2026		Annual average			
	Q1	Q2	Q3f	Q4f	Q1f	Q2f	2023	2024	2025f	2026f
Real GDP (2017 US\$)	-0.6	3.8	1.8	1.5	1.4	2.1	2.9	2.8	1.8	1.9
Personal consumption expenditures	0.6	2.5	1.7	1.6	1.3	1.9	2.6	2.9	2.4	1.7
Residential construction	-1.0	-5.1	-1.3	-2.6	-2.8	-0.9	-7.8	3.2	-1.5	-1.8
Business fixed investment	9.5	7.3	3.5	1.6	1.8	2.6	7.3	2.9	4.1	2.4
Inventory change (2017 US\$B)	172.0	-18.3	25.0	-60.0	-40.0	-20.0	47.4	43.5	29.7	-3.8
Public expenditures	-1.0	-0.1	1.3	1.3	1.5	1.7	3.5	3.8	1.5	1.4
Exports	0.2	-1.8	-9.2	-1.7	0.0	0.9	2.8	3.6	-0.7	-1.2
Imports	38.0	-29.3	-2.1	-12.0	1.2	1.6	-0.9	5.8	2.3	-3.9
Final domestic demand	1.4	2.4	1.7	1.4	1.2	1.8	2.9	3.1	2.3	1.6
Other indicators										
Nominal GDP	2.9	6.0	4.4	4.6	5.1	4.2	6.7	5.3	4.5	4.7
Real disposable personal income	2.3	3.1	0.1	4.1	3.0	1.9	5.7	2.9	2.1	2.4
Employment ¹	1.3	0.7	0.3	-0.1	0.4	0.4	2.2	1.3	0.9	0.3
Unemployment rate (%)	4.1	4.2	4.2	4.3	4.3	4.3	3.6	4.0	4.2	4.3
Housing starts ² (thousands of units)	1,401	1,354	1,358	1,312	1,325	1,302	1,421	1,371	1,356	1,304
Corporate profits* ³	6.4	3.6	5.0	0.1	2.0	2.5	7.6	5.1	3.7	2.6
Personal savings rate (%)	5.2	5.3	4.4	4.9	5.3	5.4	3.8	5.5	5.0	5.4
Total inflation rate*	2.7	2.5	2.9	3.1	3.2	3.3	4.1	3.0	2.8	3.0
Core inflation rate* ⁴	3.1	2.8	3.1	3.1	3.2	3.3	4.8	3.4	3.0	3.1
Current account balance (US\$B)	-1,759	-1,005	-1,047	-947	-957	-966	-928	-1,185	-1,190	-970

f: forecast; * Annual change; ¹ According to the establishment survey; ² Annualized basis; ³ Before taxes; ⁴ Excluding food and energy.

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Canada

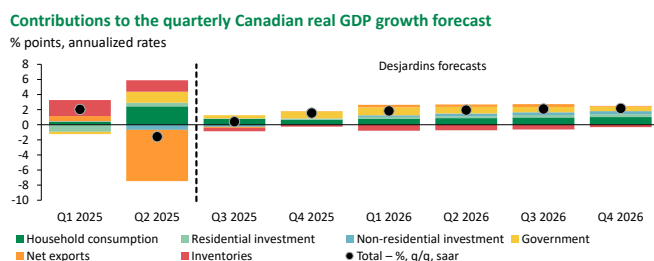
Things Are Looking Up but Further Trade Disruptions Remain an Ever-Present Danger

FORECASTS

While the Canadian economy contracted in Q2 on a near-record drag from trade, cross-border flows of goods are anticipated to stabilize in Q3. Consequently, economic activity in the third quarter should be broadly flat or slightly positive, even if domestic demand doesn't repeat the solid performance posted in the prior quarter. Barring any unforeseen events, the removal of counter tariffs in September, the relatively low effective tariff rate on US imports from Canada, and the likely better performance of the US economy should keep that momentum going into 2026. Additional interest rate cuts by the Bank of Canada will provide a further tailwind to the outlook. Of course, while our baseline forecast has been revised higher, it doesn't preclude the fact that downside risks remain ever present, with the US administration capable of turning trade on its head again with little notice.

What a difference a few months can make. When we published our prior long-form economic outlook back in June, early data through April pointed to a sharp drop in real GDP in Q2. And that turned out to be the case. Real GDP contracted by 1.6% annualized in the second quarter, almost entirely because of slumping trade flows pulling down net exports (graph 8). Indeed, the drag from trade in Q2 was the largest outside of the pandemic going back to 1961. But what really surprised was the strength of domestic demand in the second quarter, despite the anticipated decline in business investment having come to pass. Some of this probably reflected the home bias of Canadian consumers and the desire to make big purchases ahead of tariffs, along with a renewed vigour in government spending. But regardless, it was a silver lining to an otherwise dismal data point.

Graph 8
The Drag from Trade Should Fade Going Forward

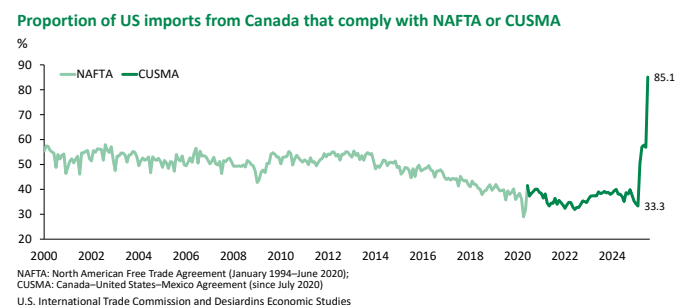


Desjardins Economic Studies

Looking to the third quarter, things are starting to look up. Trade data came in better than expected in July, and exports to the United States have moved consistently higher since April. This no doubt reflects the skyrocketing pace of CUSMA compliance

by Canadian exporters, with roughly 85% of US imports from Canada being CUSMA compliant in July—up from one third in February (graph 9). And still more exports are entering the US duty free for various other reasons. The same is true for US exports coming into Canada, and we expect this to accelerate thanks to the Government of Canada removing retaliatory tariffs on all imports from the United States other than steel, aluminum, and non-CUSMA-compliant motor vehicles and parts. It's no wonder then that business confidence has rebounded from the record-breaking depths plumbed in March. Add to that our better outlook for the US economy in Q3, and a stabilization or mild improvement in economic activity in the third quarter seems well within the realm of possibility.

Graph 9
Proportion of CUSMA-Compliant Exports from Canada Has Skyrocketed



Barring any major external shocks, economic activity should pick up further toward the end of this year and into 2026, for many of the reasons already discussed. Lower inflation resulting from the removal of retaliatory tariffs on many consumer imports is likely to pull inflation down below the Bank of Canada's 2% target, giving the central bank room to ease further through

the end of this year. That should give some breathing room to consumers contending with elevated household debt and mortgage renewals at higher interest rates. And while it may be cold comfort in the face of labour market weakness that could persist through the end of this year, that too should eventually improve. The unemployment rate is expected to fall next year as near-non-existent population growth constrains an advance in the labour force at the same time that economic activity picks up. Government spending is also anticipated to lend a helping hand, as the federal government has telegraphed its plans to boost public investment and defense expenditures, likely more than offsetting planned cuts to the operating expenses. This improved trade and domestic economic environment should help to persuade businesses to come off the sidelines and resume investing, albeit likely at a more gradual pace than policymakers might hope for.

That said, it would be premature to adopt an overly optimistic outlook. While we have revised our baseline higher, there are risks that the current trade tailwind could sharply reverse next year.

Table 4
Canada: Major Economic Indicators

Quarterly annualized % change (unless otherwise indicated)	2025				2026		Annual average			
	Q1	Q2	Q3f	Q4f	Q1f	Q2f	2023	2024	2025f	2026f
Real GDP (2017 \$)	2.0	-1.6	0.4	1.5	1.8	1.9	1.5	1.6	1.2	1.5
Final consumption expenditure [of which:]	0.3	4.6	1.2	1.8	2.1	1.9	2.0	2.7	2.7	2.0
Household consumption expenditure	0.5	4.5	1.1	1.3	1.6	1.7	1.8	2.4	2.7	1.7
Government consumption expenditure	-0.4	5.1	1.6	3.2	3.6	2.8	2.2	3.7	2.7	3.0
Gross fixed capital formation [of which:]	-5.0	-0.4	-0.4	1.7	3.0	3.6	-1.6	0.1	0.3	2.4
Residential structures	-12.2	6.3	1.4	1.8	2.9	3.4	-8.5	-0.6	1.1	3.1
Non-residential structures	-3.9	6.3	-3.7	-0.1	2.1	4.3	3.2	-2.1	0.4	2.1
Machinery and equipment	10.1	-32.6	-4.5	-0.8	1.7	2.1	-2.7	-2.9	-6.2	-2.0
Intellectual property products	-1.4	-0.5	1.7	1.7	1.8	1.9	4.0	0.0	1.4	1.6
Government gross fixed capital formation	-5.6	8.8	2.5	6.4	7.6	6.8	4.8	7.3	3.1	5.9
Investment in inventories (2017 \$B)	7.9	26.9	23.6	21.8	17.7	13.9	25.5	14.3	20.1	12.8
Exports	5.8	-26.8	-0.3	1.2	3.6	4.2	5.0	0.6	-3.4	0.8
Imports	3.6	-5.1	-0.8	0.9	2.6	3.3	0.3	0.7	0.2	1.7
Final domestic demand	-0.9	3.5	0.9	1.8	2.3	2.4	1.1	2.1	2.2	2.1
Other indicators										
Nominal GDP	5.0	-1.6	2.4	3.3	4.0	3.0	2.9	4.7	3.6	3.1
Real disposable personal income	0.8	0.9	0.5	0.3	1.2	1.5	1.6	4.6	2.0	1.1
Employment	2.7	0.4	-0.5	0.7	0.8	1.0	3.0	1.9	1.3	0.7
Unemployment rate (%)	6.6	6.9	7.0	7.1	7.0	6.9	5.4	6.4	6.9	6.8
Housing starts ¹ (thousands of units)	223	283	275	274	271	273	242	245	264	274
Corporate profits* ²	8.8	2.2	3.7	-0.1	0.8	6.6	-14.8	-3.1	3.5	6.0
Personal savings rate (%)	6.0	5.0	5.0	4.7	4.7	4.7	3.7	6.0	5.2	4.7
Total inflation rate*	2.3	1.8	1.9	1.9	1.9	1.8	3.9	2.4	2.0	1.7
Core inflation rate* ³	2.5	2.6	2.5	2.3	2.2	1.6	3.9	2.6	2.5	1.8
Current account balance (\$B)	-1.3	-21.2	-16.0	-12.7	-13.3	-12.1	-18.4	-14.1	-51.2	-49.9

f: forecast; * Annual change; ¹ Annualized basis; ² Before taxes; ³ Excluding food and energy.

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Quebec

The Worst May Be Over, but Headwinds Persist

FORECASTS

After briefly picking up at the start of the year, Quebec's economy suffered its steepest decline since the pandemic in the second quarter (-2.4%). However, recent data points to a modest rebound in the third quarter, which should be enough to avoid a technical recession. Growth should be supported by increased public spending, sustained momentum in the real estate market and a degree of labour market resilience—though job creation has largely been concentrated in part-time positions. In the longer term, outlooks remain limited by the shrinking labour pool and budget consolidation efforts across all levels of government.

After keeping pace with its long-term growth rate for a year (1.3%), Quebec's economy slightly picked up in the first quarter, reaching an annualized 1.5%. This acceleration can largely be explained by rising residential investment and a surge in exports to the United States, as companies rushed to get ahead of upcoming tariffs.

But this burst was short-lived, and the economy contracted severely in the second quarter. Yesterday, the Institut de la statistique du Québec (ISQ) announced that real GDP in the province had dropped an annualized -2.4%. This is hardly a surprise: economic indicators have painted a bleak picture recently, from business and consumer confidence to industrial production. When we look at GDP by industry, we can see that several key sectors have been weak for months, including utilities, manufacturing, wholesale trade and transportation and warehousing. It's therefore unsurprising that yesterday's data revealed a sluggish economy, weighed down by plummeting international exports (-28.0% annualized).

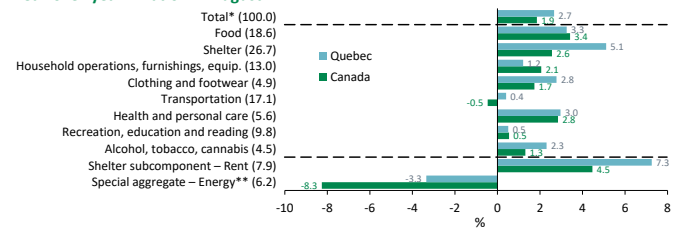
All the same, some indicators have remained stable—or even positive—suggesting that we may see a return to moderate growth in the third quarter. The labour market has shown resilience over the year, though job creation has largely been concentrated in part-time positions. Quebec's real estate market is still one of the strongest in the country. The data thus far on domestic tourism suggest that it was a good summer for the accommodation and food services sector. And finally, US statistics show that while imports of Canadian goods did decline this spring, the situation didn't deteriorate further over the summer.

In recent months, Quebec's inflation has pulled away from the national average. Quebec's annual inflation rate was 2.7% in August, compared to 1.9% Canada as a whole. Part of this gap can be explained by the fact that Quebec is the only province that hasn't abandoned consumer carbon pricing. However, the biggest contribution comes from housing (graph 10). Rents have risen precipitously in Quebec (+7.3% year over year, compared to

Graph 10

Housing and Energy Costs Behind the Inflation Differential

Year-over-year inflation in August



* Number in parentheses: Weight in the Quebec Consumer Price Index;
 ** Includes electricity; natural gas; fuel oil and other fuels; gasoline; and fuel, parts and accessories for recreational vehicles.

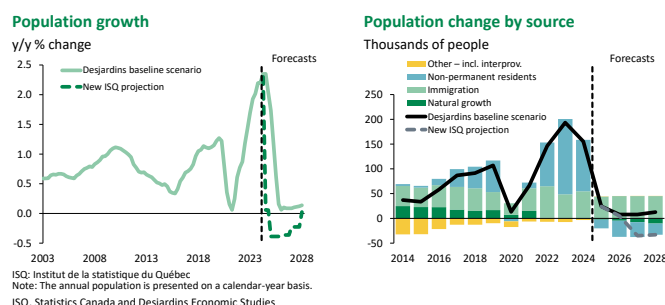
Statistics Canada and Desjardins Economic Studies

+4.5% nationally), in part because increases were more tightly controlled in other provinces. For example, British Columbia capped increases at 3%, and Ontario at 2.5%, while Quebec's authority recommended an average increase of 5.9%. Given the base effects from rent hikes and carbon pricing, it's likely that Quebec's inflation will remain above the national average until the middle of next year.

Our baseline scenario assumes trade tensions will ease in 2026, though this is still uncertain. While the effective tariff rate until now has been lower than what was initially announced this spring, it's still higher than before. Any improvement in tariff conditions would disproportionately benefit Quebec, given its higher share of exports—particularly metals and metal products—that fall outside Canada–United States–Mexico Agreement (CUSMA) exemptions and remain subject to sector-specific tariffs. The provincial government has fast-tracked some of its investments and the federal government has also announced upcoming projects, which should both contribute positively to growth.

However, over the medium and long term, Quebec's economic outlooks will be limited by its demographic profile. The ISQ's most recent forecasts suggest that Quebec's population will stagnate over the next decade (graph 11 on page 12). Our

Graph 11
Population Growth in Quebec Will Slow but Remain Positive



federal budget and Quebec's economic update will provide clarity on the fiscal consolidation measures that will affect portfolio spending over the remainder of the decade and which may limit Quebec's growth in the years ahead.

scenario instead calls for moderate demographic growth, sustained in part by more relaxed rules for temporary foreign workers outside urban areas. The most recent data show that labour shortages are more acute than they were before the pandemic for most administrative regions that are not part of the Montreal and Quebec City metropolitan areas. This fall, the

Table 5
Quebec: Major Economic Indicators

Annual average % change (unless otherwise indicated)	2022	2023	2024	2025f	2026f
Real GDP (2017 \$)	3.4	0.6	1.3	0.8	1.3
Final consumption expenditure [of which:]	4.6	0.7	3.2	2.2	0.8
Household consumption expenditure	5.5	1.8	3.2	2.8	1.2
Government consumption expenditure	2.4	-1.7	3.3	1.0	-0.1
Gross fixed capital formation [of which:]	-2.3	-3.7	-0.1	3.6	1.4
Residential structures	-11.1	-15.1	2.8	12.1	0.8
Non-residential structures	3.7	5.9	-0.7	-2.7	1.3
Machinery and equipment	11.6	-6.3	-1.2	-1.5	-1.1
Intellectual property products	6.3	4.2	0.3	2.5	1.9
Government gross fixed capital formation	-2.4	7.2	-2.4	-0.7	3.9
Investment in inventories (2017 \$B)	11	6	3	0	1
Exports	2.0	4.0	0.8	-1.2	2.6
Imports	6.9	-0.8	2.3	1.9	1.6
Final domestic demand	3.0	-0.2	2.6	2.4	1.0
Other indicators					
Nominal GDP	8.7	5.0	5.4	3.9	3.6
Real disposable personal income	1.1	0.1	5.2	2.9	2.5
Weekly earnings	4.1	3.6	4.5	4.6	2.8
Employment	3.1	2.9	0.9	1.7	0.9
Unemployment rate (%)	4.3	4.4	5.3	5.8	5.3
Personal savings rate (%)	9.3	7.8	9.9	9.7	10.4
Retail sales	8.5	3.7	2.1	3.0	4.3
Housing starts ¹ (thousands of units)	57.1	38.9	48.7	58.9	60.1
Total inflation rate	6.7	4.5	2.3	2.2	1.9

f: forecast; ¹ Annualized basis.

Statistics Canada, Institut de la statistique du Québec, Canada Mortgage and Housing Corporation and Desjardins Economic Studies

Medium-Term Issues and Forecasts

The Context May Have Changed, but There Are Still Many Vectors for Growth

For now, it's hard to imagine a scenario in which the United States removes many of the tariffs it has imposed since the beginning of the year. Even the countries that struck trade deals with the United States over the summer are still being hit with tariffs on their exports. As a result, our forecasts do not call for trade with the United States to normalize in the medium term. This means that for many countries, economic growth will rely on domestic demand. Among other things, demand should get a boost from business investments in artificial intelligence and the continued energy transition. Governments could also accelerate their own investments—and ramp up their military spending in response to a world that is, unfortunately, more geopolitically unstable.

Globalization Under Pressure

In the last five years, globalization has faced a growing number of headwinds. First, the pandemic revealed weak links in global supply chains. Then, the war in Ukraine revived tensions between Russia and the West, echoing those seen in the Cold War. The many sanctions against Russia and its allies have fractured the global financial system and trade flows. Finally, the United States elected Donald Trump, who views tariffs as an economic panacea.

Globalization has been a key driver of economic growth since the 1990s, but its momentum has faded. This means that global economic growth prospects are diminished, though it's too soon to call this deglobalization. Exporting companies will adapt by seeking out new markets. Supply chains will adjust, and new opportunities will arise for many countries. On this front, Canada has an advantage, since it has already signed several free trade agreements.

Domestic Demand Will Have to Do

That said, economic growth in many countries will rely more on domestic demand. Fortunately, there are a several opportunities on the horizon, including the rapid growth of artificial intelligence, which should lead to major investments over the medium term. The labour market may shift in response, but if we look at other periods of innovation throughout history, we can see that they ushered in greater productivity, increased income and higher standards of living.

The energy transition will also require continued investment. While enthusiasm may have moderated, especially in the United States, temperatures continue to rise. We're already approaching global warming of 1.5°C above pre-industrial levels.

This was the threshold set by experts to avoid climate tipping points that could have severe effects on the environment, global populations and the economy.

Another driver of domestic demand over the next few years will be military spending. Member states of the North Atlantic Treaty Organization (NATO) have pledged to increase their defence spendings as geopolitical risks grow. As the Latin proverb goes, "If you want peace, prepare for war."

And there will, of course, be many other investments to maintain or improve our standard of living. For example, we may see major public transit or infrastructure projects, investments in electricity generation or in housing supply. These are all potential vectors for growth in domestic demand—and reasons to be cautiously optimistic about the years ahead.

Economic Growth Should Quickly Return to Its Usual Potential

Our medium-term forecast calls for a fairly rapid return to economic growth that's in line with historical averages. In Canada and the United States, real GDP growth should approach 2%. The unemployment rate is expected to fall in several countries over the next few years. In Canada, the sharp slowdown in immigration will stretch the pool of available workers and will help bring the unemployment rate lower.

As for the financial markets, we have the same optimism about stock markets as we do for the economy. All the same, we can expect interest rates to edge back up. The current respite in interest rates should be short-lived. We could see Canada's overnight rate back at 2.75% in 2027, to keep inflation in check and prevent the economy from overheating. Rising interest rates will smooth investment acceleration. They may also encourage fiscal discipline for governments.

Table 6
Major Medium-Term Economic and Financial Indicators

% (unless otherwise indicated)	Annual average							Averages	
	2023	2024	2025f	2026f	2027f	2028f	2029f	2020–2024	2025–2029f
United States									
Real GDP (% change)	2.9	2.8	1.8	1.9	1.8	1.9	1.9	2.5	1.9
Total inflation rate (% change)	4.1	3.0	2.8	3.0	2.1	2.0	2.0	4.2	2.4
Unemployment rate	3.6	4.0	4.2	4.3	4.2	4.1	4.1	4.9	4.2
S&P 500 index (% change) ¹	24.2	23.3	15.6	8.8	6.0	6.0	6.0	15.4	8.5
Federal funds rate	5.20	5.31	4.25	3.44	3.25	3.25	3.25	2.03	3.49
Prime rate	8.20	8.31	7.25	6.44	6.25	6.25	6.25	5.03	6.49
Treasury bills – 3-month	5.28	5.18	4.07	3.24	3.10	3.10	3.10	1.98	3.32
Federal bonds – 10-year	3.96	4.21	4.17	4.08	4.05	4.05	4.05	2.28	4.08
– 30-year	4.09	4.41	4.73	4.68	4.65	4.65	4.65	2.68	4.67
WTI oil (US\$/barrel)	78	77	67	65	65	68	68	67	67
Gold (US\$/ounce)	1,943	2,387	2,387	3,307	3,506	3,400	3,400	1,742	3,200
Canada									
Real GDP (% change)	1.5	1.6	1.2	1.5	2.1	1.9	1.8	2.6	1.7
Total inflation rate (% change)	3.9	2.4	2.0	1.7	1.9	2.0	2.0	3.4	1.9
Employment (% change)	3.0	1.9	1.3	0.7	1.0	0.9	1.0	1.7	1.0
Employment (thousands)	593	382	270	146	201	188	221	332	205
Unemployment rate	5.4	6.4	6.9	6.8	6.5	6.3	6.2	6.8	6.5
Housing starts (thousands of units)	242	245	264	274	275	271	268	248	270
S&P/TSX index (% change) ¹	8.1	18.0	22.3	11.1	7.0	7.0	7.0	8.3	10.9
Exchange rate (US\$/C\$)	0.74	0.73	0.72	0.76	0.79	0.82	0.83	0.76	0.78
Overnight rate	4.74	4.59	2.50	2.06	2.44	2.75	2.75	2.42	2.50
Prime rate	6.94	6.75	4.70	4.26	4.64	4.95	4.95	4.61	4.70
Mortgage rate – 1-year	7.14	7.64	5.40	4.60	4.70	4.80	4.85	5.05	4.87
– 5-year	6.68	6.73	6.00	5.80	5.50	5.60	5.70	5.76	5.72
Treasury bills – 3-month	4.74	4.37	2.43	2.08	2.55	2.75	2.75	2.37	2.51
Federal bonds – 2-year	4.27	3.67	2.44	2.19	2.60	2.80	2.80	1.95	2.57
– 5-year	3.57	3.30	2.71	2.63	2.86	3.00	3.00	1.89	2.84
– 10-year	3.36	3.34	3.14	3.05	3.16	3.25	3.15	1.97	3.15
– 30-year	3.28	3.33	3.50	3.43	3.46	3.50	3.60	2.19	3.50
Yield spreads (Canada–United States)									
Treasury bills – 3-month	-0.54	-0.81	-1.64	-1.16	-0.55	-0.35	-0.35	-0.15	-0.81
Federal bonds – 10-year	-0.60	-0.87	-1.03	-1.03	-0.89	-0.80	-0.90	-0.31	-0.93
– 30-year	-0.81	-1.08	-1.23	-1.25	-1.19	-1.15	-1.05	-0.49	-1.17
Quebec									
Real GDP (% change)	0.6	1.3	0.8	1.3	1.8	1.7	1.6	1.6	1.4
Total inflation rate (% change)	4.5	2.3	2.2	1.9	2.0	2.0	2.0	3.6	2.0
Employment (% change)	2.9	0.9	1.7	0.9	0.9	0.5	0.5	1.3	0.9
Employment (thousands)	128	39	79	43	41	22	25	53	42
Unemployment rate	4.4	5.3	5.8	5.3	4.7	4.6	4.7	5.8	5.0
Retail sales (% change)	3.7	2.1	3.0	4.3	4.7	4.0	3.1	6.1	3.8
Housing starts (thousands of units)	39	49	59	60	59	61	65	53	61

f: forecast; WTI: West Texas Intermediate; ¹ Changes are based on end-of-period data.

Datastream, Statistics Canada, Canada Mortgage and Housing Corporation, Institut de la statistique du Québec and Desjardins Economic Studies