BANK OF CANADA
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Monetary Policy Report—April 2025

Overview

The Canadian economy ended 2024 strong. However, the escalating trade conflict is diminishing growth prospects. While tariffs are expected to increase price pressures, removing the consumer carbon tax has lowered energy prices. The unpredictability of US trade policy, and the speed and magnitude of the shifts, are making the economic outlook very uncertain.

In February and March 2025, the United States repeatedly threatened, imposed and then suspended tariffs on Canada and Mexico. Significant US tariffs remain in place, particularly on steel, aluminum and motor vehicles. Then, on April 2, the United States announced high and broad-based tariffs on nearly all its other trading partners. One week later, on April 9, it reduced most of those tariffs for 90 days to a 10% universal rate. This universal tariff does not apply to Canada and Mexico. There is a great deal of uncertainty around what will happen next.

Trade policy uncertainty is making it difficult for households, businesses and governments to plan. It is also difficult to know how the tariffs will affect the economy. Consequently, it is unusually challenging to project economic activity and consumer price index (CPI) inflation in Canada and globally.

Instead of a base-case projection, this Report contains two illustrative scenarios that consider different US trade policies. In addition, the **Risks** section focuses on the uncertainty related to how tariffs will impact the economy. The Bank of Canada has chosen this approach to better manage the risks in this highly uncertain environment.

Two layers of trade uncertainty

Two layers of trade uncertainty are affecting the outlook for the Canadian economy. The first layer is around US trade policy. It is difficult to know:

- what tariffs will ultimately be imposed
- the extent of countermeasures from Canada and other countries
- how long the tariffs will last
- the outcome of future trade negotiations

The second layer of trade uncertainty relates to how households, businesses and governments will react and adapt to tariffs. This layer of uncertainty is particularly relevant given the unprecedented scale of the shift in US trade policy.

To address the first layer of uncertainty, this Report presents two illustrative scenarios for how US trade policy could unfold. These scenarios are designed such that when taken together, they encompass a range of possible trade policies.

The details of the scenarios, which were finalized on April 11, are explored in the **Assumptions for the outlook scenarios** section. The standard tables and charts the Bank uses to break down the projection for inflation and contributions to growth in gross domestic product (GDP) have been simplified and are presented in the **Outlook** section.

To address the second layer of uncertainty, the Risks section focuses on how tariffs could impact the economy. For example, the degree to which prices will rise due to tariffs and supply chain disruptions is unclear. It is also unclear how much tariffs will weaken economic activity and subsequently weaken inflation.

Summary of the outlook

The GST/HST holiday has caused inflation to fluctuate in recent months. When the tax holiday period is excluded, inflation rose from 1.9% in November 2024 to 2.3% in March 2025. CPI inflation outside of shelter services has risen to around its historical average.

Growth in the **Canadian economy** was stronger than expected in the second half of 2024 but is estimated to have slowed in the first quarter of 2025. Growth in consumption has eased, reflecting both unsustainable strength in the fourth quarter of 2024 and increased uncertainty about job prospects—particularly in industries relying on international trade. The threat of tariffs pulled trade forward, which boosted both exports and imports.

There is considerable uncertainty around the evolution of US trade policies and their impact on the economy. As a result, this Report considers two illustrative scenarios that can be summarized as follows:

- **Scenario 1**: Most tariffs imposed since the trade conflict began are negotiated away, but the process is unpredictable. Uncertainty about trade policy continues until the end of 2026.
- **Scenario 2**: The uncertainty and limited tariffs in Scenario 1 persist, and other US tariffs are added. A long-lasting global trade war unfolds.

In Scenario 1, global and Canadian growth weaken temporarily before picking up. Inflation in Canada falls to around 1.5% for one year, mostly reflecting the removal of the consumer carbon tax. It then returns to the 2% target.

In Scenario 2, a sharp global slowdown and an increase in inflation occur, especially in the United States. In Canada, a significant recession ensues, and inflation temporarily rises above 3% in mid-2026 before returning to the 2% target.

Taken together, the scenarios frame many plausible paths for Canadian inflation and GDP growth, but uncertainty about how the economy would respond to tariffs is not entirely captured in these scenarios. These uncertainties are treated as risks.

The Bank will continue to monitor developments in the trade conflict, assess the implications for Canadian inflation and provide updates as the situation evolves.

Current conditions

Inflation was near the 2% target in the fourth quarter of 2024, and interest rate cuts had bolstered economic growth. But since then, the trade conflict has intensified. Trade uncertainty and tariffs are expected to slow growth and add to price pressures.

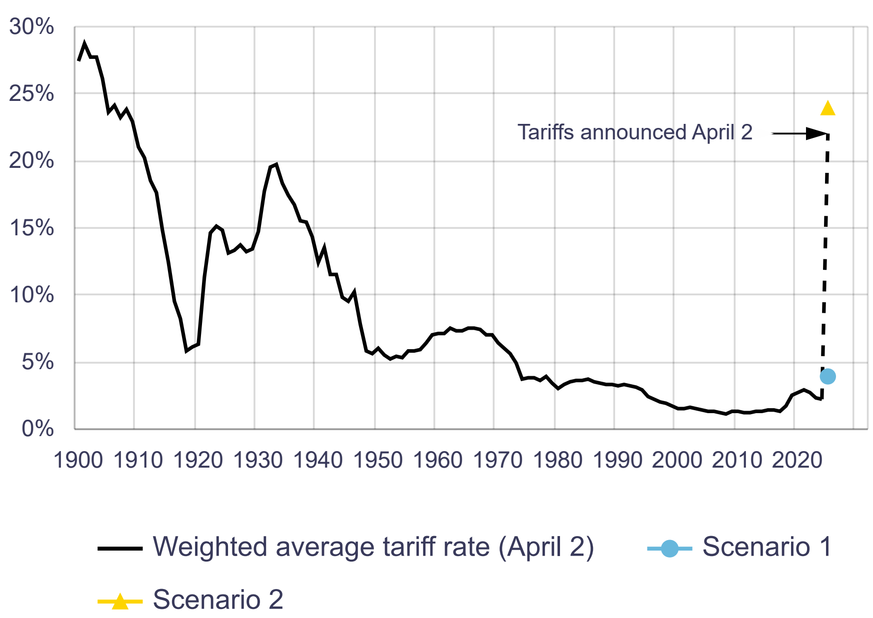
Since the January Report, the United States has imposed large and broad-based tariffs on most of its trading partners (**Figure 1**). If the tariffs announced on April 2 are fully implemented, the weighted average US tariff rate will increase from 2% to about 22% (**Chart 1**). The United States has also imposed tariffs on Canadian goods, and Canada has responded. China has imposed tariffs on some Canadian agricultural and seafood products.

Tariffs and increased uncertainty about US trade policy appear to have slowed growth in gross domestic product (GDP) in Canada.

At the same time, tariffs imposed by Canada on imports of US steel, aluminum and consumer goods, including motor vehicles, and the past decrease in the value of the Canadian dollar are putting upward pressure on prices. However, the removal of the consumer carbon tax and lower oil prices have led to a decline in energy prices.

Chart 1: If fully implemented, US tariffs announced on April 2 would be the highest in more than a century

US tariff rate, weighted average, annual data



Sources: US International Trade Commission and Bank of Canada calculations
Last data plotted: 2025

Figure 1: Global trade tensions are evolving rapidly

Tariff announcements up to and including April 11, 2025

01 Feb

- Announces 25% tariffs on imports of goods from Canada and Mexico (10% tariffs on Canadian energy products) starting February 4
- Announces 10% tariffs on imports of goods from China starting February 4

03 Feb

- Suspends February 1 tariffs against Canada and Mexico until March 4

04 Feb

- Imposes February 1 tariffs on China

10 Feb

- Announces 25% tariffs on all imports of steel and aluminum starting March 12

04 Mar

- Imposes February 1 tariffs on Canada and Mexico
- Doubles tariffs on imports of goods from China to 20%
- Imposes 25% tariffs on $30 billion of US goods and announces potential further tariffs on $125 billion of US goods

06 Mar

- Suspends February 1 tariffs on all goods from Canada and Mexico covered under the Canada-United States-Mexico Agreement and lowers tariffs on Canadian potash to 10%

08 Mar

- Announces 100% tariffs on some Canadian agricultural products and 25% tariffs on some Canadian pork and seafood products starting March 20

12 Mar

- Imposes February 10 steel and aluminum tariffs
- Announces 25% tariffs on $29.8 billion of US goods; tariffs imposed at midnight on March 13

20 Mar

→ Imposes March 8 tariffs on some Canadian agricultural and seafood products

26 Mar

→ Announces 25% tariffs on imports of all finished vehicles, starting April 3, and on certain parts and components, starting no later than May 3; includes exemptions for US-made content

02 Apr

→ Announces 10% universal tariffs on imports of goods from nearly all countries starting April 5, with additional "reciprocal" tariffs for many countries starting April 9

→ Exempts Canada and Mexico from universal and "reciprocal" tariffs

03 Apr

→ Imposes March 26 tariffs on all imports of non-domestic motor vehicles

→ Announces 25% tariffs on vehicles imported from the United States with exceptions for components made in Canada and Mexico

04 Apr

→ Announces 34% counter-tariffs on imports of goods from the United States starting April 10

05 Apr

→ Imposes April 2 universal tariffs

08 Apr

→ Imposes additional 50% counter-tariffs on imports of goods from China

09 Apr

→ Announces additional 50% counter-tariffs on imports of goods from the United States starting April 10

→ Imposes April 3 tariffs on motor vehicles imported from the United States

→ Suspends April 2 "reciprocal" tariffs for 90 days; April 2 universal 10% tariffs remain in place

→ Announces further tariffs on imports of goods from China to bring the total of new tariffs to 145%

10 Apr

China: Imposes April 4 and April 9 tariffs on imports of goods from the United States

United States: Imposes April 9 tariffs on imports of goods from China

11 Apr

China: Announces further tariffs on imports of goods from the United States to bring the total of new tariffs to 125%

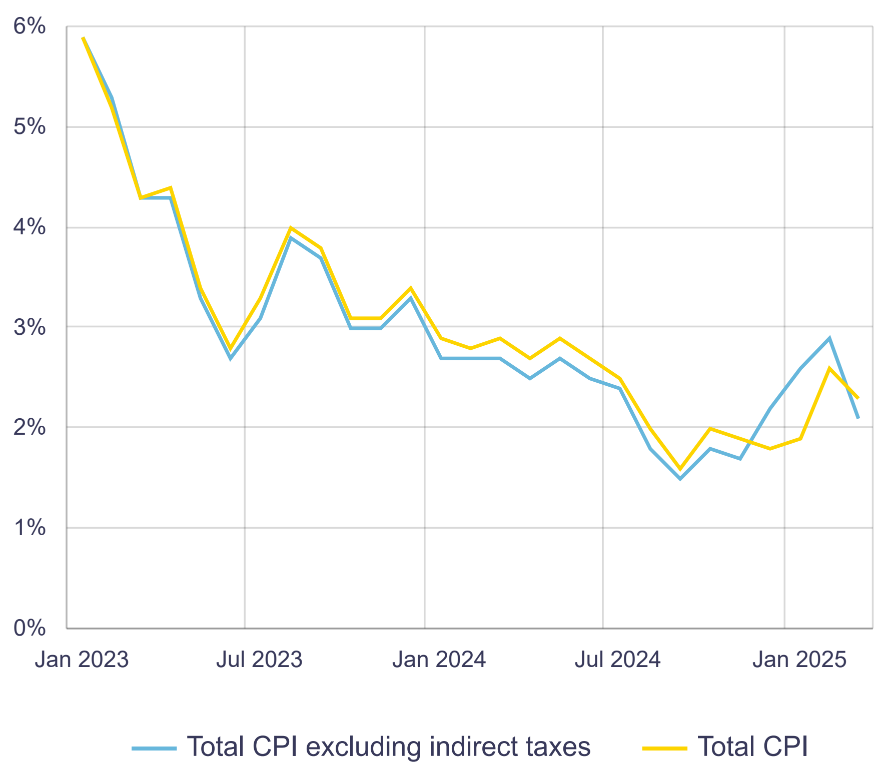
Inflation

Consumer price index (CPI) inflation has been volatile due to the GST/HST holiday. Excluding the tax holiday period, inflation has risen from 1.9% in November 2024 to 2.3% in March 2025 (**Chart 2**).

Total CPI inflation has increased because inflation excluding shelter services has rebounded to near its historical average, outweighing a steady decline in inflation in shelter services (**Chart 3**). While inflation in shelter services remains above its historical average, it is easing. In particular, inflation in both rent and mortgage interest costs—while still high—is declining.

Chart 2: Inflation has risen since late last year

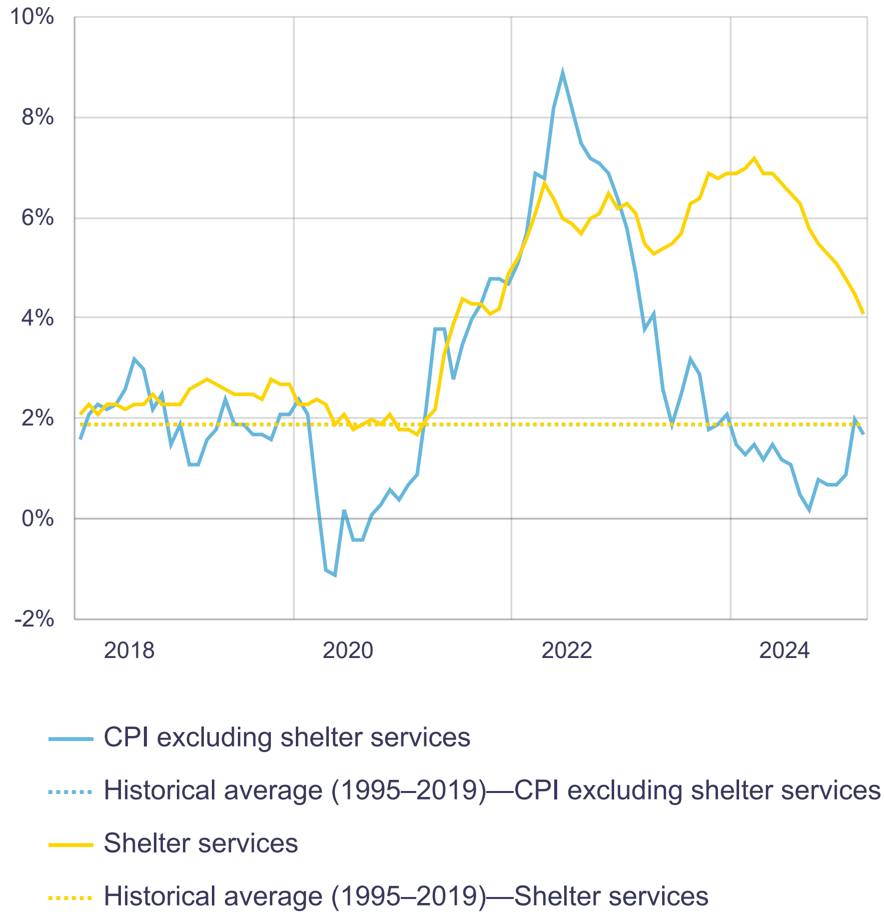
Year-over-year percentage change, monthly data



Sources: Statistics Canada and Bank of Canada calculations
Last observation: March 2025

Chart 3: Inflation excluding shelter services has returned close to its historical norm

Year-over-year percentage change, monthly data



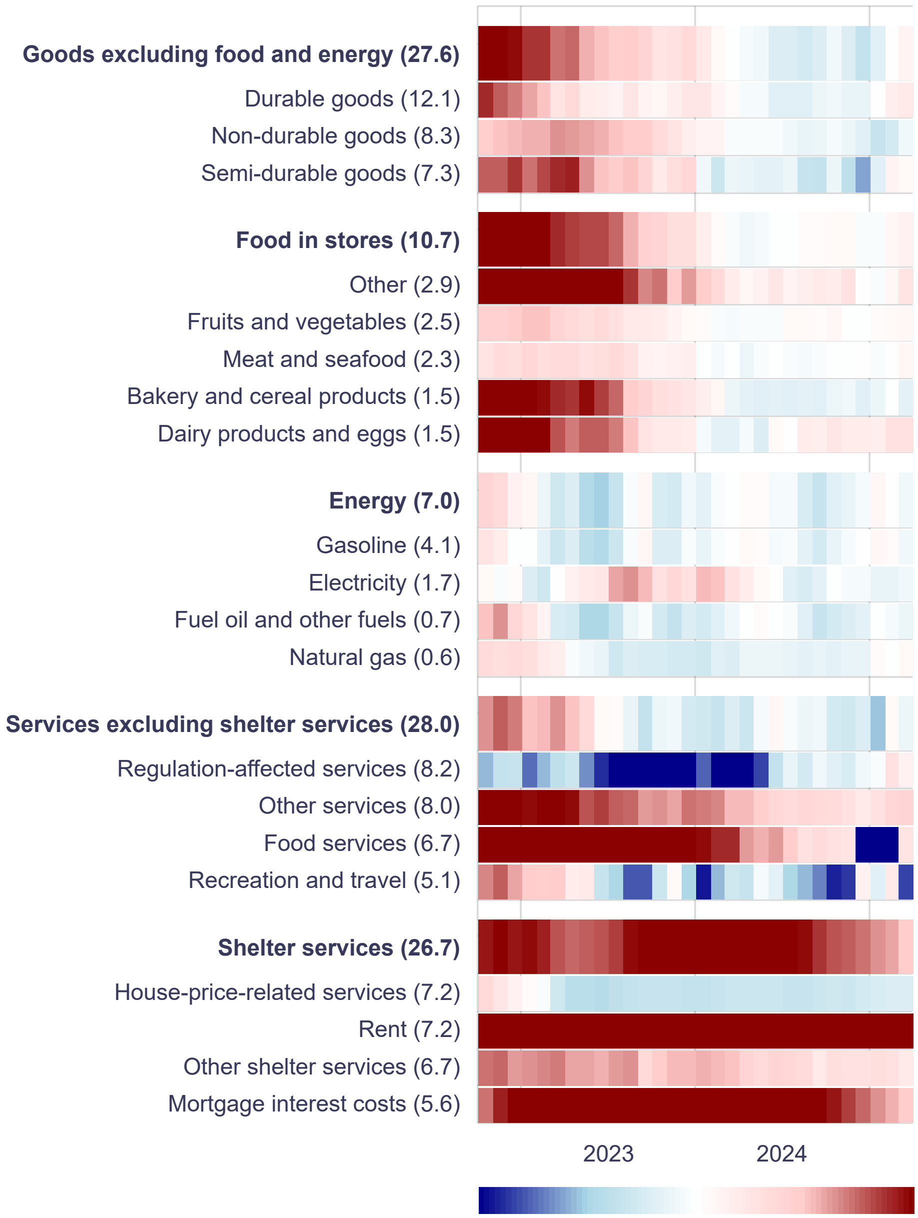
Sources: Statistics Canada and Bank of Canada calculations
Last observation: March 2025

Goods price inflation has increased

Goods prices were roughly flat before the GST/HST holiday, but inflation in goods prices reached 1.3% in March 2025, after the tax holiday ended.

Inflation in goods prices has picked up and is broad-based. For example, inflation has risen in the prices of sporting and exercise equipment, clothing and fresh fruit (**Chart 4**). These increases stem partly from the delayed effect of the Canadian dollar decreasing in value in late 2024, which is making imports more expensive now. Additionally, some businesses have indicated that suppliers are proactively raising prices in anticipation of future tariffs.[1]

Chart 4: Inflation in most goods prices has risen



Note: The heatmap shows the distance of each CPI component's year-over-year inflation rate from its historical average. The colour is white when a component's inflation rate is close to its average and is a varying shade of red (blue) when the rate is above (below) the average. Because the historical range of inflation varies widely across CPI components, each inflation rate plotted in the heatmap is standardized by subtracting its mean and dividing by its standard deviation. This standardization is conducted using data from 1996–2019, except for *Regulation-affected services* and *Other services*, where available data begin in 2004 and 2008, respectively. Note that *Regulation-affected services* includes prices that are affected by government regulations either directly (e.g., child care services) or indirectly (e.g., telephone services). Values in parentheses are CPI weights (in percent). Due to rounding, weights within categories may not sum to their respective totals. The components include the temporary GST/HST holiday (December 14, 2024, to February 15, 2025). This tax change impacts a wide range of goods and services, particularly semi-durable goods and food services.
Sources: Statistics Canada and Bank of Canada calculations
Last observation: March 2025

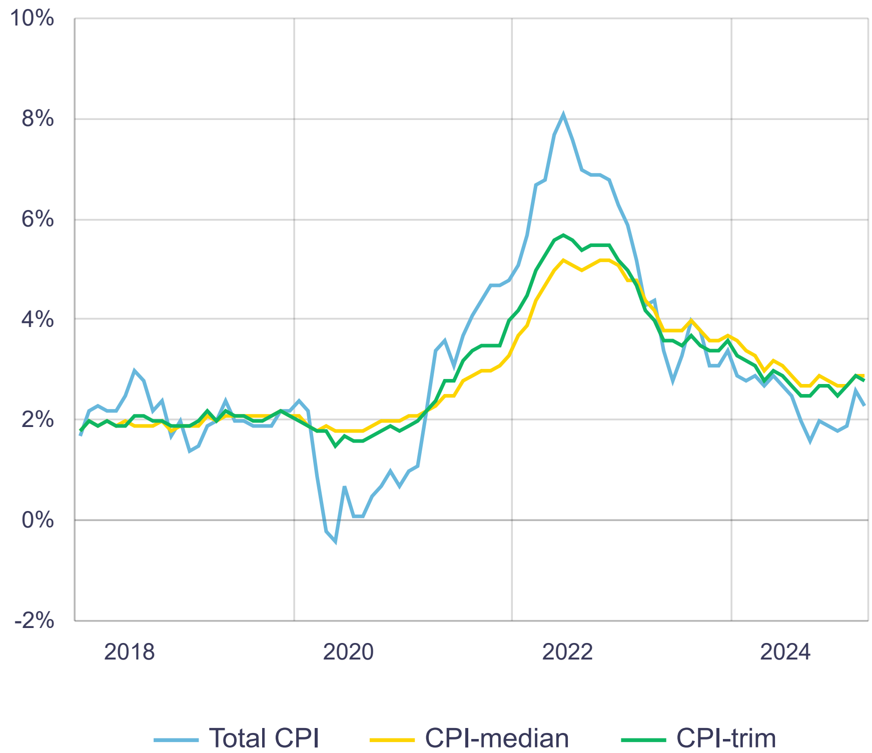
Services price inflation has been stable

Inflation in services prices was around 3.5% before the GST/HST holiday but fell to 3.1% in March 2025. The decline is mainly due to an easing of inflation in shelter prices. In contrast, inflation in services prices excluding shelter has been increasing, rising from 1.7% to 2.2% over the same period.

The Bank of Canada's preferred measures of core inflation—CPI-median and CPI-trim—were 2.9% and 2.8% in March, respectively (**Chart 5**). These measures have remained in the 2.5% to 3% range since summer 2024, partly because elevated inflation in shelter prices continues to affect core inflation.[2] However, higher goods prices are the main reason for the recent increase in core inflation.

Chart 5: Core inflation remains elevated

Year-over-year percentage change, monthly data



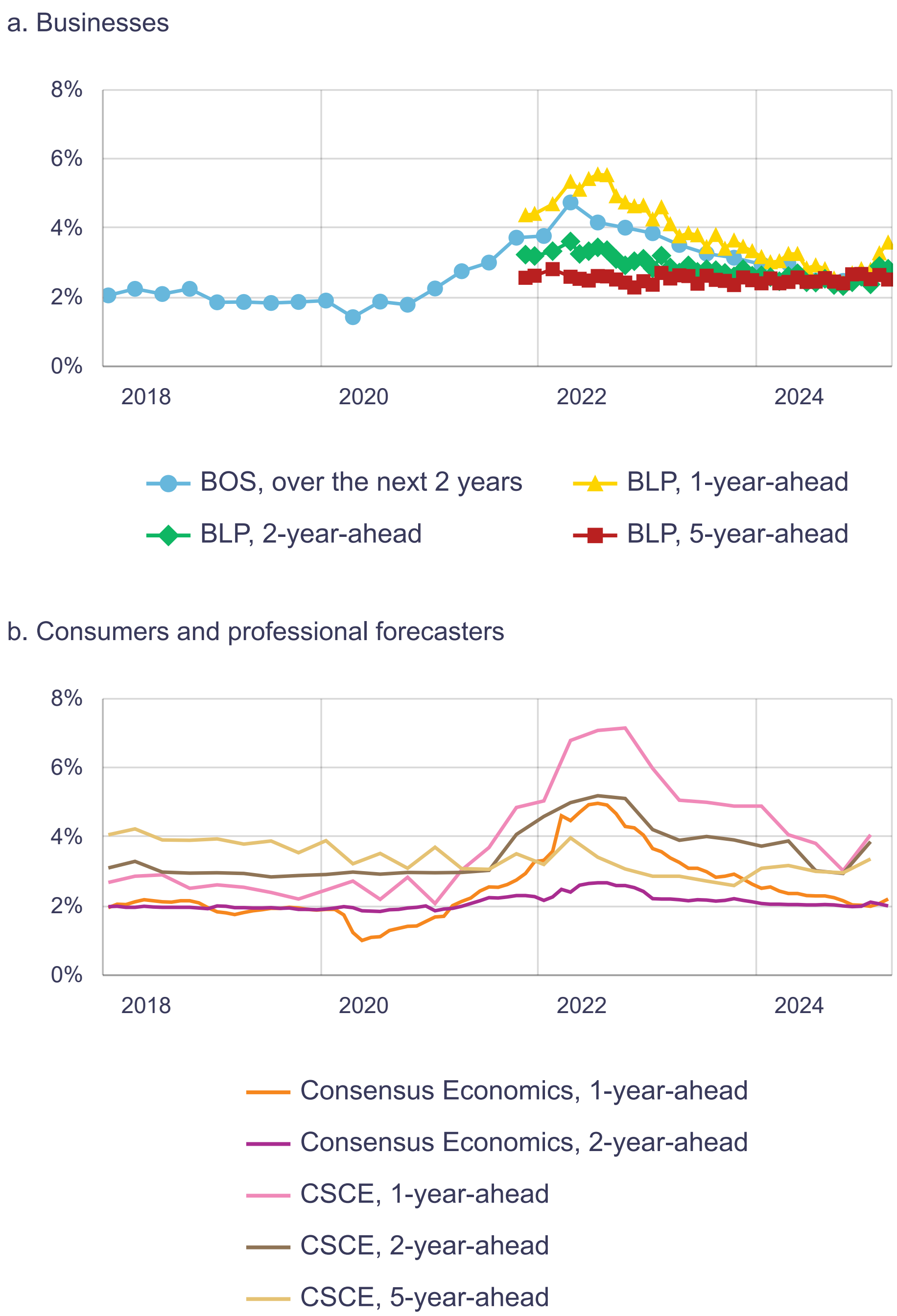
Sources: Statistics Canada and Bank of Canada calculations
Last observation: March 2025

Short-term inflation expectations have risen

Short-term inflation expectations increased in the first quarter (**Chart 6**). Both businesses and households expect the trade conflict to push prices up. Some businesses report that they have already seen an increase in costs and expect these increases to continue.[3] Longer-term inflation expectations remain largely unchanged.

Chart 6: Short-term inflation expectations have increased

Quarterly and monthly data



Note: CSCE is the Canadian Survey of Consumer Expectations; BOS is the Business Outlook Survey; BLP is the Business Leaders' Pulse. Consensus Economics' forecasts for the next year (based on monthly data) and the next two years (based on a combination of monthly and quarterly data releases) are transformed into fixed-horizon forecasts by the weighted average of fixed-date forecasts. *1-year-ahead* refers to inflation expectations for the next 12 months. *2-year-ahead* refers to inflation expectations for the period 12 to 24 months from now. *5-year-ahead* refers to inflation expectations for the period 48 to 60 months from now. This question was not asked in the January or March 2022 BLP.
Sources: Consensus Economics, Bank of Canada and Bank of Canada calculations
Last observations: Consensus Economics and BLP, March 2025; CSCE and BOS, 2025Q1

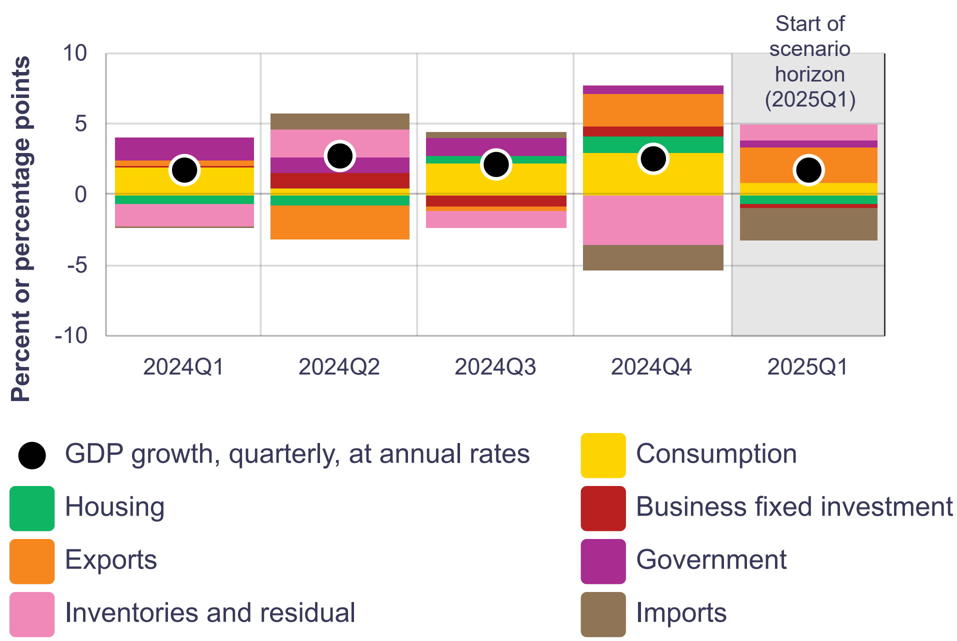
Economic activity

Canada's GDP grew by 2.6% in the fourth quarter of 2024, with third-quarter growth revised up to 2.2%. This fourth-quarter GDP growth was due to strong residential investment and consumption, especially in components sensitive to interest rates. Business investment and exports also contributed to the strength of GDP growth, but this was partially offset by a drawdown in inventories.

For the first quarter of 2025, GDP growth is estimated to have slowed to 1.8%, which is below what was expected in the January Report (**Chart 7**). This slowdown reflects the impact of the intensifying trade conflict and a pullback after a strong second half of 2024.

Chart 7: GDP growth is estimated to have slowed in the first quarter of 2025

Contributions to real GDP growth, quarterly data



Sources: Statistics Canada and Bank of Canada calculations and estimates
Last data plotted: 2025Q1

Growth in final domestic demand is slowing sharply

Final domestic demand expanded by a surprisingly strong 5.6% in the fourth quarter of 2024, partly reflecting households' responses to past cuts to interest rates. Business investment increased by 6.5%.

However, final domestic demand is estimated to have been weak in the first quarter of 2025, reflecting a slowdown in consumer spending, residential investment and business investment.

Growth in consumption is estimated to have slowed from 5.5% in the fourth quarter of 2024 to around 1.5% in the first quarter of 2025. The slowdown in consumer spending reflects both the end of some government incentives that supported motor vehicle purchases and a sharp decline in consumer confidence.

Results from the Canadian Survey of Consumer Expectations for the first quarter of 2025 suggest that households have become more concerned about job security. This worry is especially pronounced for those working in industries that rely on international trade.

Residential investment is on track to contract by roughly 7% in the first quarter, after having expanded by a vigorous 17% in the fourth quarter of 2024. Inclement weather and heightened trade-related uncertainty weighed on housing activity in the first quarter.

Business investment is estimated to have declined by around 2%. Results from the Business Outlook Survey for the first quarter of 2025 suggest many businesses—particularly those in sectors most reliant on US markets—are slowing or even stopping new strategic investments (**Chart 8**).

Chart 8: Businesses affected by trade tensions have weak investment intentions

Investment intentions by exposure to trade tensions, Business Outlook Survey, balance of opinion*

* Percentage of businesses expecting higher investment spending minus the percentage expecting lower investment spending
Note: Bank of Canada staff reviewed interview responses to assess businesses' exposure to trade tensions and to determine whether they were strongly impacted by changing US policies.
Source: Bank of Canada
Last observation: 2025Q1

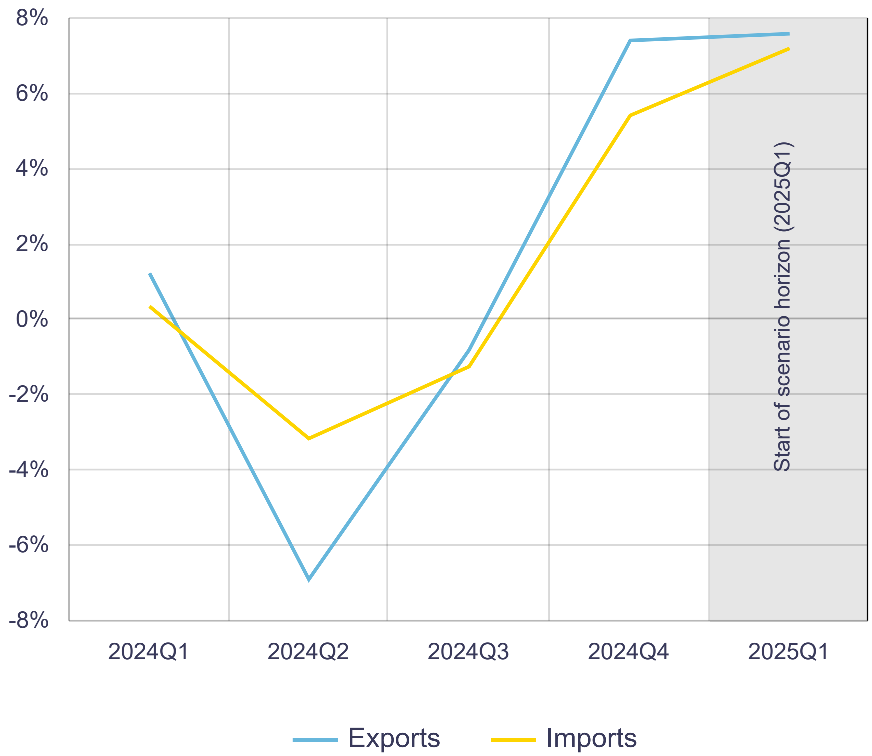
Trade was pulled forward in anticipation of tariffs

Starting in late 2024, businesses on both sides of the Canada-US border began to build up their inventories of imported goods in anticipation of tariffs. This shift in trade activity helps explain an estimated surge of roughly 7.5% in Canadian exports in the first quarter of 2025, along with a close to 7% increase in imports (**Chart 9**).

Inventories are estimated to have expanded in the first quarter, adding around 1 percentage point to GDP growth. This increase in inventories results mainly from the slowdown in growth of Canadian domestic demand.

Chart 9: Businesses pulled their trade forward in anticipation of tariffs

Quarter-over-quarter percentage change at annual rates, quarterly data



Sources: Statistics Canada and Bank of Canada calculations and estimates
Last data plotted: 2025Q1

Capacity pressures

Solid GDP growth in the second half of 2024 reduced excess supply in the Canadian economy. The output gap is estimated to have been between -1% and 0% in the first quarter of 2025, indicating an economy in modest excess supply.

The labour market recovery has been disrupted

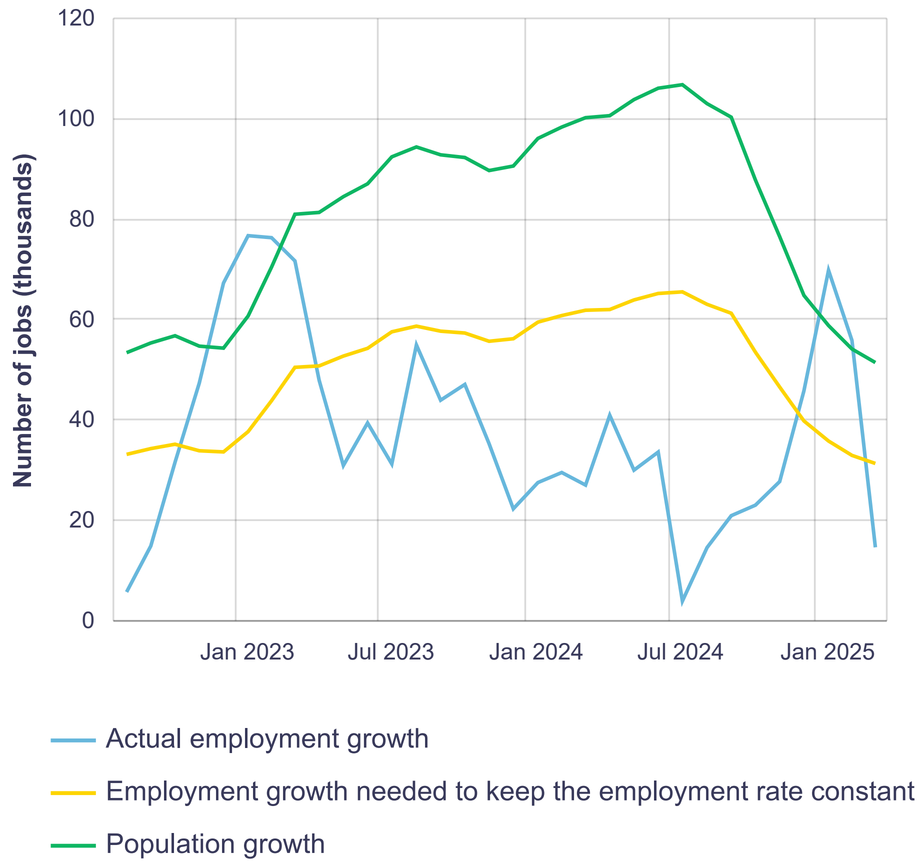
Employment growth strengthened from summer 2024 into early 2025. Strong economic activity boosted demand for workers between August and January, while population growth slowed significantly amid reduced federal immigration targets. As a result, the employment rate stabilized in late 2024 (**Chart 10**).

Employment contracted in March. Tariffs and uncertainty about trade policy are disrupting the recovery in the labour market. The number of job postings on Indeed has decreased since mid-January, especially in industries likely to be affected by US tariffs. As well, many businesses responding to Bank of Canada surveys now say they will slow hiring in the near term.

The overall unemployment rate reached 6.7% in March, up slightly from February but still lower than its recent peak of 6.9% in November 2024. When combined with other indicators, the labour market appears to be in modest excess supply (**Chart 11**). Wage growth in the private sector continues to show signs of moderating (**Chart 12**).

Chart 10: The trade conflict has disrupted the labour market recovery

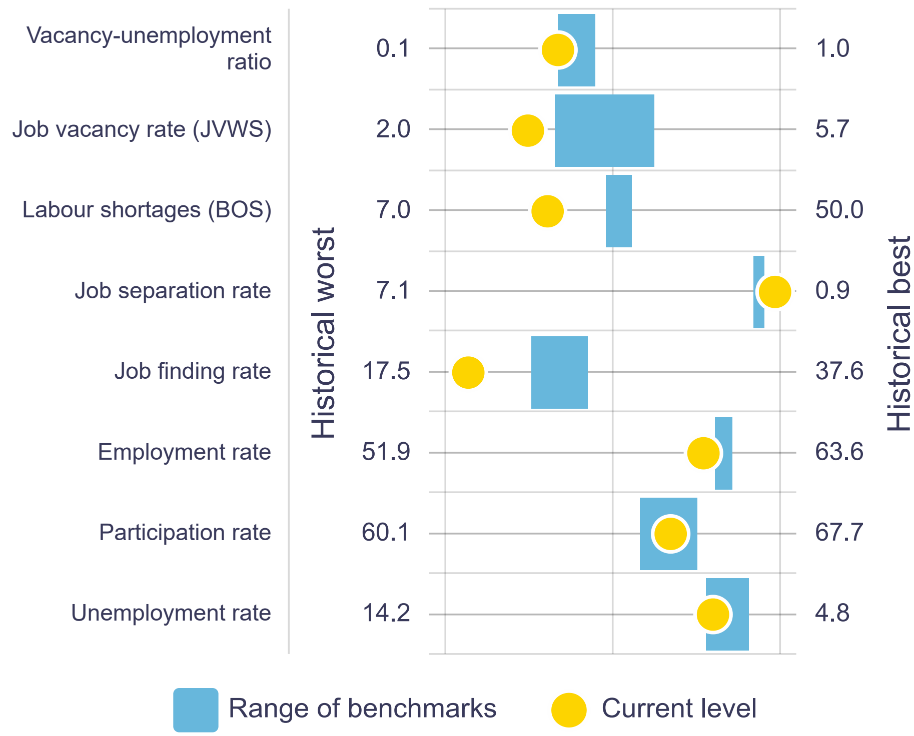
3-month moving average, seasonally adjusted, monthly data



Note: *Employment growth needed to keep the employment rate constant* is calculated by multiplying the net monthly change in the size of the working-age population in the Labour Force Survey by the previous month’s employment rate.
Sources: Statistics Canada and Bank of Canada calculations
Last observation: March 2025

Chart 11: The labour market is in modest excess supply

Selected labour market measures compared with their historical best and historical worst



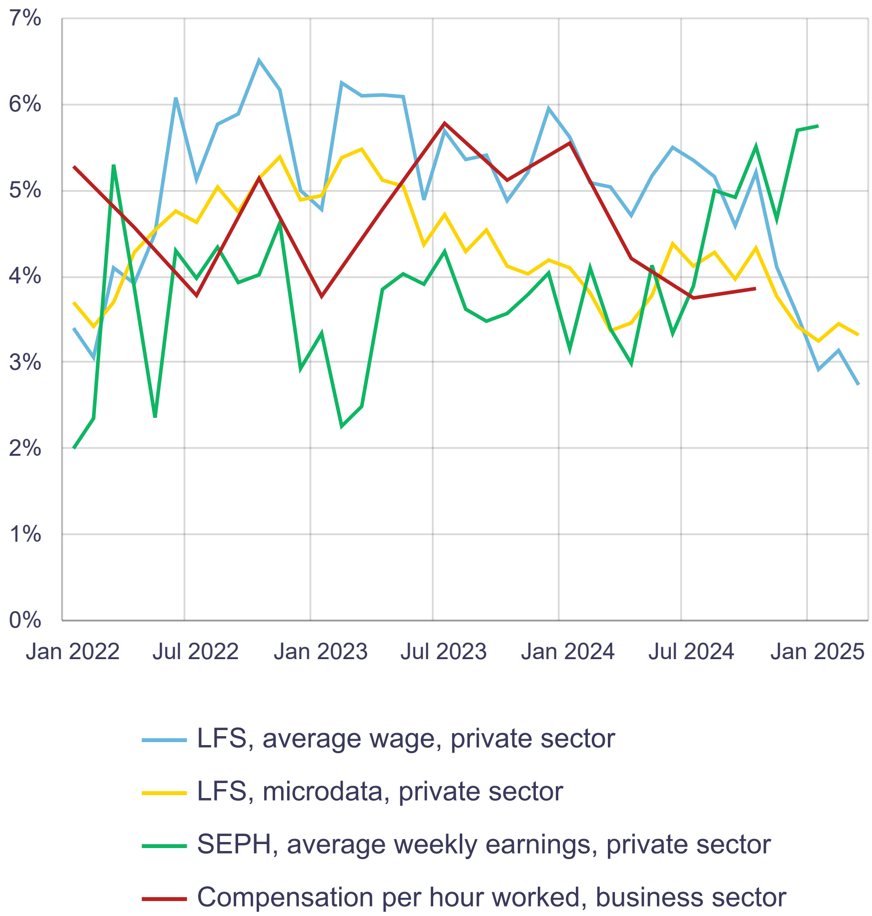
Note: All variables are in percent except the vacancy-unemployment ratio. The benchmark ranges are based on trend estimates using different methodologies: the modified Hamilton filter, the Hodrick-Prescott filter, values of the indicator corresponding to a period when the labour input gap was closed (adjusted for demographic changes) and—for selected indicators—trend estimates produced by the Bank of Canada. Due to limitations from the short sample period, the benchmark range for vacancy measures does not include the Hodrick-Prescott filter. Data for all series are from Statistics Canada's Labour Force Survey (LFS) unless otherwise noted. BOS is the Business Outlook Survey; JVWS is the Job Vacancy and Wage Survey. For more details, see E. Ens, A. Lam, K. See and G. Galassi, "Benchmarks for assessing labour market health: 2024 update," Staff Analytical Note No. 2024-8 (April 2024).

Sources: Statistics Canada, Bank of Canada and Bank of Canada calculations

Last observations: LFS, March 2025; BOS, 2025Q1; JVWS, December 2024

Chart 12: Wage growth shows further signs of moderating

Year-over-year percentage change, monthly and quarterly data



Note: LFS is the Labour Force Survey; SEPH is the Survey of Employment, Payrolls and Hours. LFS, microdata measures wage growth using microdata from the LFS to abstract from changes in worker characteristics, extracting a quality-adjusted price for labour. For more details, see F. Bounajm, T. Devakos and G. Galassi, "Beyond the averages: Measuring underlying wage growth using Labour Force Survey microdata," Bank of Canada Staff Analytical Note No. 2024-23 (October 2024). All wage series are measured as compensation per hour except for SEPH, which is measured in terms of average weekly earnings. Private sector in SEPH excludes wages from public administration, education and health care and social assistance.

Sources: Statistics Canada and Bank of Canada calculations

Last observations: LFS, March 2025; SEPH, January 2025; Compensation per hour worked, business sector, 2024Q4

Endnotes

1. For more information, see Bank of Canada, ***Business Outlook Survey—First Quarter of 2025*** (April 2025).[←]

2. For a more detailed discussion, see Bank of Canada, "**Canadian economy—Current conditions,"** ***Monetary Policy Report*** (January 2025).[←]

3. For more information, see Bank of Canada, ***Business Outlook Survey—First Quarter of 2025*** (April 2025), and Bank of Canada, ***Canadian Survey of Consumer Expectations—First Quarter of 2025*** (April 2025).[←]

Assumptions for the outlook scenarios

The United States has threatened, imposed and suspended tariffs on its trading partners, including Canada. Many tariffs remain in place, and it is unclear what will happen next. This section outlines two illustrative scenarios for how US trade policy could unfold.

The assumptions and scenarios were finalized on April 11, 2025.

The Bank of Canada presents two illustrative scenarios in this Report, each with different assumptions about the future course of US trade policy. They are designed such that, when taken together, they encompass a range of trade policies and associated paths for Canadian inflation and growth of gross domestic product (GDP). These scenarios are presented in place of a base-case economic projection.

Assumptions in Scenario 1

This scenario assumes that most tariffs imposed since the trade conflict began are negotiated away, but the process is unpredictable. Uncertainty about US trade policy continues, and businesses and households remain cautious.

Several assumptions apply in this scenario:

- A limited number of new tariffs remain:[1]
    - US tariffs of 25% on imported steel and aluminum and the associated 25% tariff on $29.8 billion of Canadian imports of US goods as announced by the Government of Canada[2]
    - Chinese tariffs of 100% on some Canadian agricultural products as well as a 25% tariff on Canadian pork and seafood products
    - An additional 10% US tariff on Chinese goods and Chinese retaliation equivalent to an increase of 1% in its weighted average tariff rate on imports of goods from the United States
- In Canada, tariff revenues are fully redistributed to households.
- In the United States, half of the tariff revenues are redistributed to households.
- Trade policy uncertainty remains elevated around the world until the end of 2026, when its effect slowly begins to fade.
    - This uncertainty weighs on demand, particularly business investment and household purchases that require longer-term financial commitments.
    - Potential output growth both globally and in Canada weakens modestly due to the impact of uncertainty on business investment, which leads to a lower capital stock (see **Appendix: Potential output and the nominal neutral rate of interest**).
- World commodity prices increase from current levels. Over the scenario horizon, the per-barrel prices for oil are assumed to be US$70 for Brent, US$65 for West Texas Intermediate and US$50 for Western Canadian Select.
- The Canadian dollar is assumed to average 70 cents US over the scenario horizon.

Assumptions in Scenario 2

This scenario assumes that the uncertainty and limited tariffs in Scenario 1 persist and other US tariffs are added. A long-lasting global trade war unfolds.[3]

United States

- The United States imposes the following additional permanent tariffs:
  - a 25% tariff on the non-US content of imported motor vehicles and parts
  - a 12% tariff on imported goods, other than motor vehicles and parts, from Canada and Mexico[4]
  - a 25% tariff on all goods imported from all other countries
  - a 15% tariff on all goods imported from China to lift the total new tariff on China to 25%
- Half of tariff revenues are redistributed to households.

Canada

- Canada imposes the following additional permanent tariffs:
  - a 12% tariff on $115 billion of US goods imports
  - a 25% tariff on the US content of vehicles imported from the United States with exceptions for components made in Canada and Mexico that comply with the Canada-United States-Mexico Agreement
- Revenues from tariffs on imported motor vehicles are fully redistributed to households while half of the revenues from other tariffs are redistributed to households.

Mexico and other countries

- Mexico imposes:
  - a 12% tariff on imports of goods from the United States
- All other countries impose:
  - a 25% tariff on imports of goods from the United States

Other assumptions

- Tariffs are assumed to be permanent. As a result, potential output, both globally and in Canada, weakens substantially (see **Appendix: Potential output and the nominal neutral rate of interest**).
- Over the scenario horizon, the per-barrel prices for oil are assumed to be US$60 for Brent, US$55 for West Texas Intermediate and US$40 for Western Canadian Select.
  - These prices are US$10 lower than in Scenario 1
- The Canadian dollar is assumed to fall to 67 cents US over the scenario horizon.
  - This is 3 cents lower than in Scenario 1

Scenario 1 and Scenario 2 differ in several key tariff assumptions (**Table 1**).

Table 1: Tariff assumptions in each scenario

US tariffs

Scenario 1	Scenario 2
• 10% on all Chinese goods • 25% on imported steel and aluminum	• 12% on imports of goods, other than motor vehicles and parts, from Canada and Mexico • 25% on the non-US content of imported motor vehicles and parts • 25% on all goods imported from all other countries, including additional tariffs that increase the tariff rate on goods imported from China to 25%

Tariffs imposed by other countries

Scenario 1	Scenario 2
• China—average of 1% on US imports • Canada—25% on $29.8 billion of US goods	• Canada—12% on an additional $115 billion of US goods • Canada—25% on vehicles imported from the United States with exceptions for components made in Canada and Mexico that comply with the Canada-United States-Mexico Agreement • Mexico—12% on all US goods • All other countries—25% on all US goods

Note: For Scenario 2, the uncertainty and limited tariffs in Scenario 1 persist and other US tariffs are added. A long-lasting global trade war unfolds.

Assumptions common to both scenarios

Some economic assumptions are the same in the two scenarios.

- **Tariff pass-through**: In all countries, three-quarters of the increased costs from tariffs are passed through to consumer prices within six quarters.
- **Fiscal policy**: Both scenarios incorporate information from published federal and provincial budgets and fiscal updates. In addition:
  - The federal consumer carbon tax was eliminated on April 1. One additional rebate cheque is issued.
  - The proposed increase in the federal capital gains inclusion rate does not go into effect.
- **Population growth**: The rate of population growth of people aged 15 and over in Canada is assumed to slow from 3.3% in 2024 to 1.2% in 2025 and then to moderate further to 0.5% in 2026. Population growth is assumed to be 0.6% in 2027.
- **Nominal neutral interest rate**: The nominal neutral interest rate in Canada is estimated to be in the range of 2.25% to 3.25%. Both scenarios assume it is at the midpoint of this range (see **Appendix: Potential output and the nominal neutral rate of interest**).

Endnotes

1. For example, Canada's $30 billion in countermeasures announced on March 4, 2025, are excluded from this scenario.[←]

2. For more details, see Department of Finance Canada, "**List of products from the United States subject to 25 per cent tariffs effective March 13, 2025,**" backgrounder (March 12, 2025).[←]

3. Scenario 2 is similar to the illustrative tariff scenario outlined in the January Report (see **In Focus: Evaluating the potential impacts of US tariffs**). However, in Scenario 2, the tariff rates on Canada and Mexico have been adjusted to be more in line with recent US government announcements.[←]

4. The **White House executive order issued on April 2** indicates that goods imported from Canada and Mexico to the United States would be subject to a 12% tariff if they were deemed to not comply with the Canada-United States-Mexico Agreement. Therefore, a permanent 12% tariff for Canada and Mexico is illustrative of what could arise in the case of a long-lasting global trade war.[←]

Outlook

The trade conflict has made the outlook for the Canadian economy highly uncertain. There is a range of scenarios for how US trade policy could unfold, which leads to a wide range of outcomes for Canadian inflation and economic growth.

The assumptions and scenarios were finalized on April 11, 2025.

Rather than focusing on a single, highly uncertain projection, this Report presents two illustrative scenarios for how US trade policy could unfold. These scenarios are designed such that, when taken together, they encompass a range of trade policies (see the **Assumptions for the outlook scenarios** section).

These two scenarios encompass a wide range of economic outcomes. Inflation in Canada could remain around or below target or temporarily rise above 3%. Growth of gross domestic product (GDP) could stall for one quarter, or there could be a significant recession that permanently lowers the standard of living in Canada (**Table 2** and **Table 3**).

Scenario 1

Trade policy uncertainty weighs on activity. GDP stalls briefly in the second quarter of 2025 and then expands at a moderate pace, resulting in persistent excess supply.

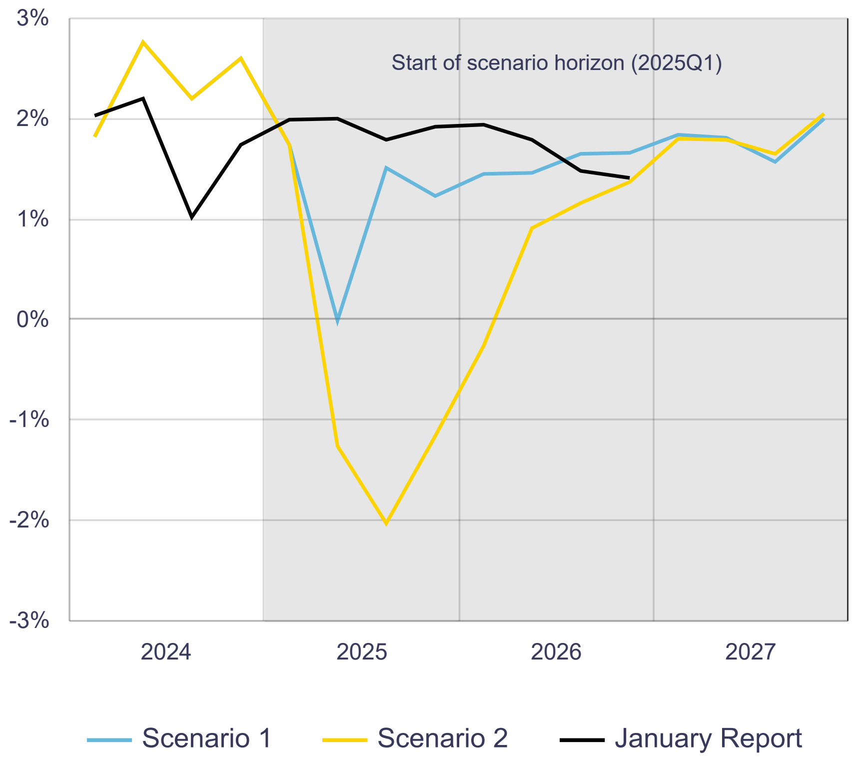
Inflation drops below target for the rest of 2025 and in early 2026 due to both excess supply in the economy and the removal of the consumer carbon tax. This occurs despite the upward pressure on prices from the few remaining tariffs. Inflation then averages around 2% for the rest of the scenario horizon.

Economic activity

GDP growth stalls in the second quarter of 2025 (**Chart 13**). It then averages around 1.6% through the end of 2027. This pace of growth is only slightly stronger than that of potential output, leaving the economy in modest excess supply.

Chart 13: GDP growth stalls in the second quarter of 2025 in Scenario 1

Quarter-over-quarter percentage change at annual rates, quarterly data



Note: The assumptions and scenarios were finalized on April 11, 2025.

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

Export growth drops

Exports fall sharply in the second quarter of 2025 after two strong quarters during which trade was pulled forward in anticipation of US tariffs. Foreign demand for Canadian exports weakens considerably, particularly from the United States, due to the impact of the limited tariffs and trade policy uncertainty.

Export growth then picks up from the second half of 2025 into 2027.[1] The completion of new export capacity for liquefied natural gas in mid-2025 and the increased use of the Trans Mountain pipeline support exports.

Import growth also declines sharply in the second quarter of 2025 after Canadian businesses pulled forward their purchases of US goods ahead of anticipated tariffs. Following this initial drop, import growth recovers, led by a measured improvement in spending on consumption and in business investment.

Final domestic demand expands modestly

Growth in final domestic demand is weak in the near term before expanding at a moderate pace over the rest of the scenario horizon. Consumption is subdued in the near term as households build up precautionary savings due to concerns about their future employment prospects and wealth. While these effects are most prominent for households employed in export-oriented industries, they spill over to the broader economy. Quarterly consumption growth is modest for the rest of 2025 and then slowly strengthens in 2026 and 2027.

Businesses remain uncertain about the strength of demand. As a result, business investment is sluggish, contracting in the second quarter of 2025. Growth in business investment then picks up through 2026 and 2027 as the impact of uncertainty fades.

Inflation

Consumer price index (CPI) inflation initially slows due to the removal of the consumer carbon tax (**Chart 14**). Inflation then rises to about 2% and stays at that level.

The removal of the consumer carbon tax lowers CPI energy prices. This pulls down CPI inflation by 0.7 percentage points for one year, to average about 1.5% (see **In Focus: How removing the consumer carbon tax affects inflation**).

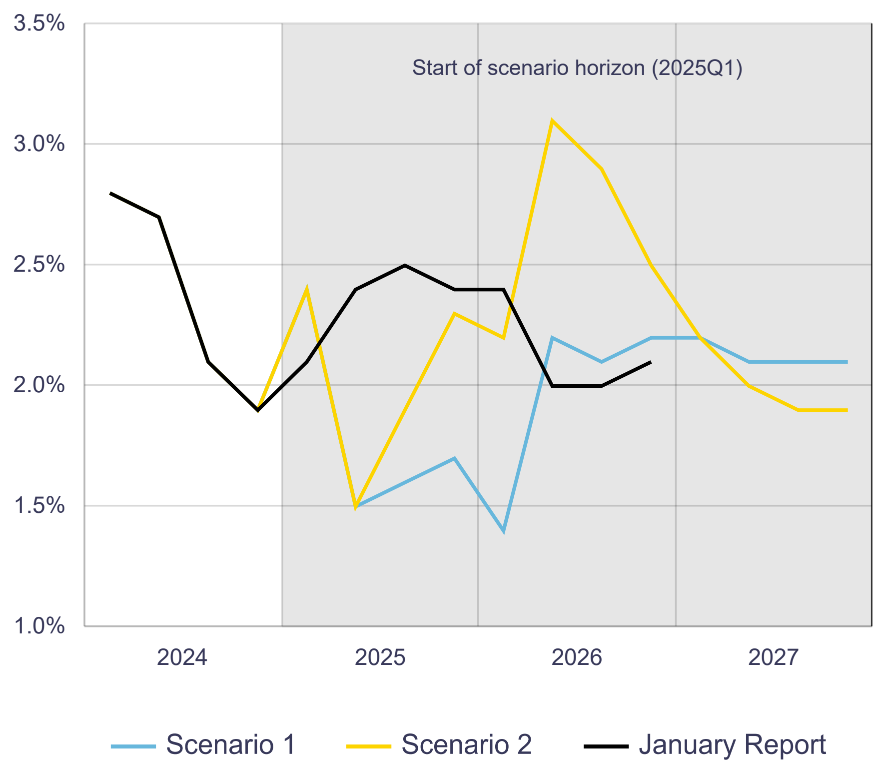
Inflation in goods excluding food and energy is above its historical average in the second half of 2025. This strength is due to:

- Canada's tariffs on some US consumer goods as well as on US steel and aluminum imports
- the delayed effects of the depreciation in the Canadian dollar in late 2024
- businesses' concerns over possible future tariffs, which encourage them to diversify their supply chains to higher-cost suppliers

As these pressures diminish, modest excess supply in the economy leads to a slowdown in goods price inflation as well as softer inflation in the other CPI components.

Chart 14: Inflation temporarily falls below 2% in Scenario 1

Year-over-year percentage change, quarterly data



Note: The assumptions and scenarios were finalized on April 11, 2025.

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

Scenario 2

Canada's GDP contracts over the next year due to tariffs and the adverse effects of uncertainty. Growth gradually recovers to around 1.8% in 2027.

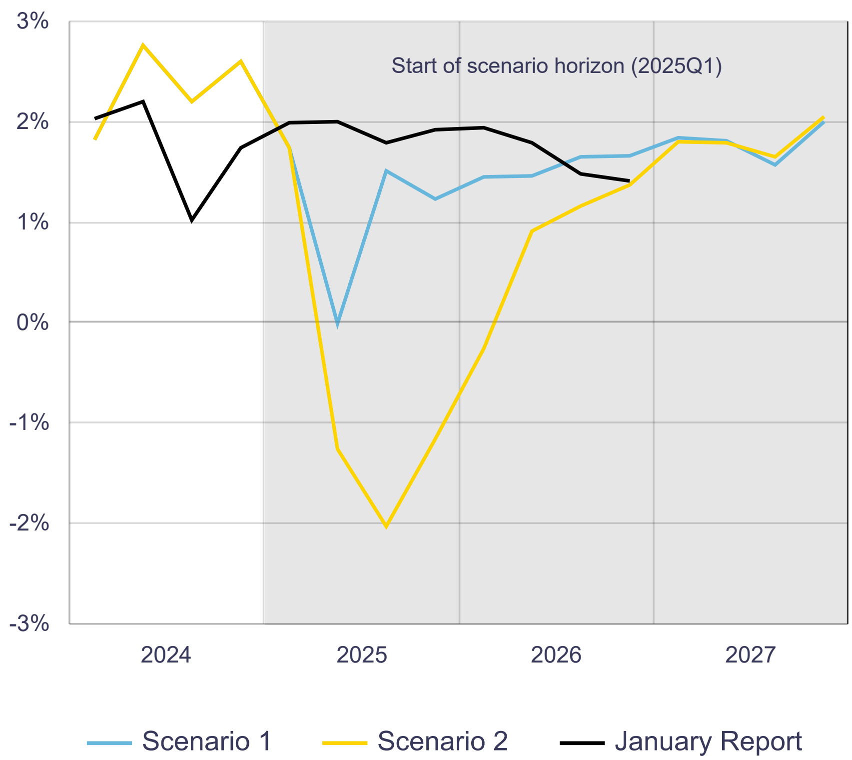
Inflation averages close to 2% through the first quarter of 2026. The removal of the consumer carbon tax and ongoing economic slack roughly offset the impact of tariffs. Inflation then rises above 3% in the second quarter of 2026 due to the impact of tariffs. It then gradually declines to the 2% target in 2027.

Economic activity

The broad trade war severely impacts Canadian households and businesses, precipitating a year-long recession. GDP contracts for four quarters, with growth averaging about -1.2% (**Chart 15**). It then gradually recovers throughout the rest of 2026 and 2027. US tariffs permanently reduce Canada's potential output and its standard of living (see **Appendix: Potential output and the nominal neutral rate of interest**).

Chart 15: GDP contracts over the remainder of 2025 in Scenario 2

Quarter-over-quarter percentage change at annual rates, quarterly data



Note: The assumptions and scenarios were finalized on April 11, 2025.
Sources: Statistics Canada and Bank of Canada calculations and estimates
Last data plotted: 2027Q4

Trade is drastically reduced by tariffs

Exports fall sharply until the middle of 2026. The contraction is mainly due to US tariffs on imports from Canada and a slowdown in global economic activity (see the **Global economy** section).

Export growth resumes in the third quarter of 2026 but remains weak. Tariffs permanently reduce US demand for Canadian products, and it takes time for businesses to find new export markets.

Imports contract until the middle of 2026 for many of the same reasons as exports. Import growth then increases as domestic demand rebounds.

Domestic demand stalls

The impacts of tariffs on trade spread to the rest of the economy. Growth in final domestic demand stalls over the second and third quarters of 2025. It then slowly recovers.

Canadian exporters reduce production and lay off workers. This, in turn, leads to a rise in unemployment, a drop in real incomes and a slowdown in economy-wide household spending.

Lower global commodity prices lead to a decline in Canada's terms of trade, which further reduces households' purchasing power. Tariffs also make imported items more expensive for consumers.

Overall, consumption falls slightly in the second and third quarters of 2025 and then expands modestly through 2026. Growth in consumption gradually strengthens in 2027 as the unemployment rate slowly declines.

Business investment declines significantly due to weak economic activity, particularly in the export sector, and the impact of persistent uncertainty. A lower Canadian dollar raises the cost of imported equipment and machinery, which further weighs on business investment. Growth in investment turns positive in late 2026 and picks up in 2027.

Inflation

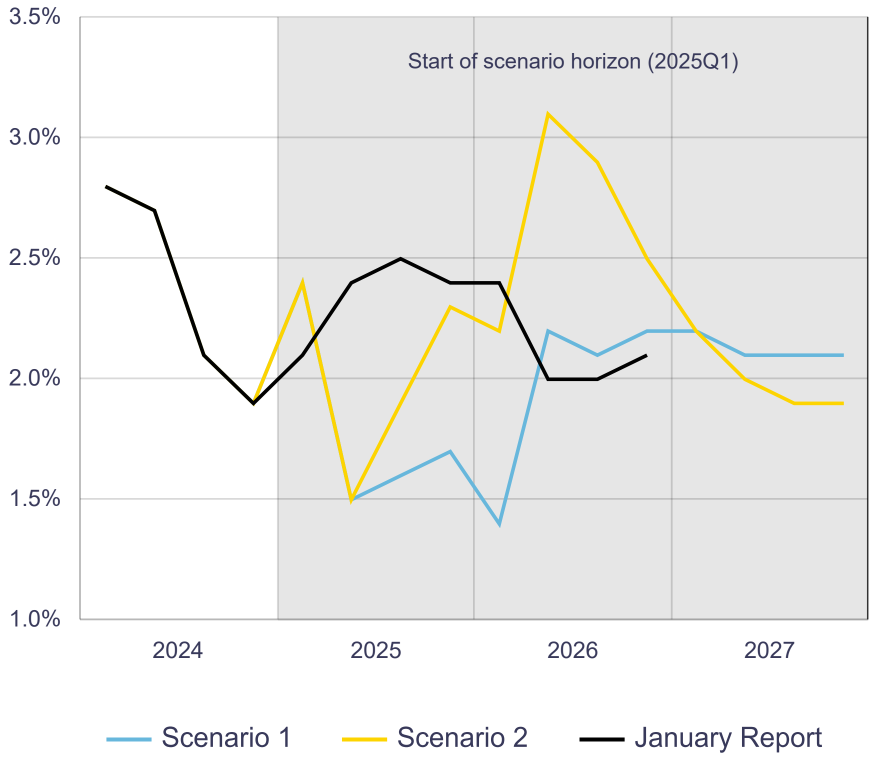
CPI inflation averages around 2% until early 2026 (**Chart 16**). It then rises above 3% because of upward pressure on prices coming from tariffs. Inflation returns to the 2% target in 2027.

Inflation averages about 2% until the first quarter of 2026. This reflects opposing forces. Downward pressures include the effect of removing the consumer carbon tax and the disinflationary impact from excess supply. Upward pressures include the effects that tariffs and supply chain disruptions have on prices of imported goods.

As the effect of removing the carbon tax ends, inflation rises and reaches a peak of 3.1% in the second quarter of 2026. It then gradually returns to the 2% target in 2027. The easing in inflation is due to persistent excess supply in the economy and the fading impact of tariffs on prices of imported goods.

Chart 16: Inflation temporarily declines before rising above 3% in Scenario 2

Year-over-year percentage change, quarterly data



Note: The assumptions and scenarios were finalized on April 11, 2025.

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

Tariffs put temporary upward pressure on inflation

The tariffs that Canada imposes on US goods are estimated to affect roughly 9% of Canada's CPI basket (for details on the included tariffs, see the **Assumptions for the outlook scenarios** section). It is assumed that three-quarters of the increased costs from tariffs will be passed through to consumers over six quarters. Once prices have adjusted to their new level, the rate of inflation normalizes.[2] Moreover, the Canadian dollar depreciates to 67 cents US, and US tariffs drive up the costs of some US goods that are used as inputs to production in Canada. Canadian businesses reorganize their supply chains to help reduce the impact of higher import costs.

The rise in costs mostly affects the prices of goods excluding energy. Inflation in food prices and in prices of goods excluding food and energy rises sharply over the next year. Thereafter, inflation in these categories slows gradually.

Excess capacity weighs on inflation

US tariffs and persistent uncertainty cause a significant slowdown in Canadian economic activity. Although potential output is also lower, considerable excess capacity emerges as workers and capital are displaced.

The output gap reaches about -1.7% in the first quarter of 2026 and then narrows somewhat over the rest of the scenario horizon. Excess supply in the economy exerts downward pressure on inflation over the entire scenario horizon. This pressure is most apparent in prices in the services sector, which are not directly boosted by tariffs.

Table 2: Summary of GDP growth and inflation for Canada in both scenarios

		2024		2025	
		Q3	**Q4**	**Q1**	**Q2**
CPI inflation (year-over-year percentage change)	Scenario 1	2.1	1.9	2.4	1.5
	Scenario 2	2.1	1.9	2.4	1.5
	January 2025 Report	2.1	1.9	2.1	
Core inflation (year-over-year percentage change)*	Scenario 1	2.7	2.7	2.9	2.9
	Scenario 2	2.7	2.7	2.9	3.0
	January 2025 Report	2.5	2.6	2.5	
Real GDP (year-over-year percentage change)	Scenario 1	1.9	2.4	2.3	1.6
	Scenario 2	1.9	2.4	2.3	1.3
	January 2025 Report	1.5	1.8	1.7	
Real GDP (quarter-over-quarter percentage change at annual rates)	Scenario 1	2.2	2.6	1.8	0.0
	Scenario 2	2.2	2.6	1.8	-1.3
	January 2025 Report	1.0	1.8	2.0	

* Core inflation is the average of CPI-trim and CPI-median.
Note: The assumptions and scenarios were finalized on April 11, 2025.
Sources: Statistics Canada and Bank of Canada calculations and estimates

Table 3: GDP growth and inflation over the scenario horizon

		2024	2025	2026	2027
GDP (average annual growth)	Scenario 1	1.5	1.6	1.4	1.7
	Scenario 2	1.5	0.8	-0.2	1.6
	January 2025 Report	1.3	1.8	1.8	
Final domestic demand (percentage points)	Scenario 1	2.0	2.3	1.6	1.5
	Scenario 2	2.0	1.8	1.0	1.7
	January 2025 Report	1.6	2.4	1.7	
Exports (percentage points)	Scenario 1	0.2	0.1	0.5	1.1
	Scenario 2	0.2	-1.0	-2.4	0.6
	January 2025 Report	0.3	0.6	0.8	
Imports (percentage points)	Scenario 1	-0.2	-0.1	-0.8	-0.9
	Scenario 2	-0.2	0.5	1.2	-0.7
	January 2025 Report	-0.2	-0.7	-0.8	
CPI inflation (percentage change)	Scenario 1	2.4	1.8	2.0	2.1
	Scenario 2	2.4	2.0	2.7	2.0
	January 2025 Report	2.4	2.3	2.1	

Note: The assumptions and scenarios were finalized on April 11, 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.
Sources: Statistics Canada and Bank of Canada calculations and estimates

Endnotes

1. China's tariffs also weigh on Canada's exports, which has an important impact on the agricultural and seafood sector but a relatively small effect on exports overall.[←]

2. This scenario assumes that the inflation expectations of Canadian households and businesses remain well anchored to the Bank of Canada's 2% inflation target. It also assumes that businesses do not increase their profit margins and workers do not resist declines in their purchasing power.[←]

Global economy

At the end of 2024, global economic growth was solid, and inflation had eased further toward central banks' targets. Since then, the United States has imposed large and broad-based tariffs on most of its trading partners.

The assumptions and scenarios were finalized on April 11, 2025.

Tariffs and uncertainty have significantly weakened and clouded the outlook for the global economy. If the tariffs announced on April 2 are fully implemented, the weighted average US tariff rate will increase from about 2% to about 22%. This would be its highest level in more than a century.

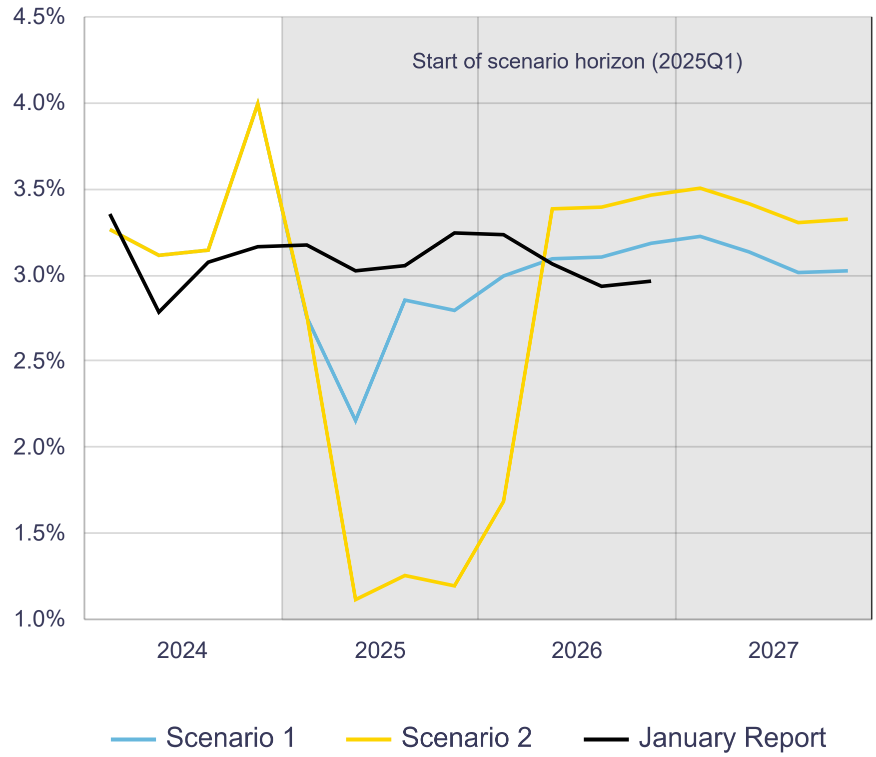
US tariffs are negatively impacting the prospects for global economic growth, although the size and duration of the slowdown is highly uncertain. This Report presents two scenarios with distinct assumptions about US trade policy instead of a single base-case projection (see the **Assumptions for the outlook scenarios** section).

Scenario 1: Most tariffs imposed since the trade conflict began are negotiated away, but the process is unpredictable. Uncertainty about trade policy continues until the end of 2026. Global growth dips below 3% in 2025 (**Chart 17** and **Table 4**), and inflation eases closer to central banks' targets.

Scenario 2: The uncertainty and limited tariffs in Scenario 1 persist and other US tariffs are added. A long-lasting global trade war unfolds. Global output is more than 1% lower in 2026 than it is in Scenario 1, largely reflecting weaker economic growth in North America. Tariffs drive up global inflation, mostly in the United States, starting in the second quarter of 2025.

Chart 17: Global growth falls more sharply in Scenario 2 than in Scenario 1

Global GDP growth, annualized percentage change, quarterly data



Note: The assumptions and scenarios were finalized on April 11, 2025.
Source: Bank of Canada calculations and estimates
Last data plotted: 2027Q4

United States

The US economy grew strongly in 2024 but then slowed in early 2025 amid rising policy uncertainty and weakening sentiment. Inflation remains slightly above target, and inflation expectations have risen.

Consumption growth appears to have eased to below 1% in the first quarter of 2025 due to winter storms, a pullback from robust holiday-related spending and declining consumer confidence. The US administration's trade policies have led to volatility in financial markets and fears of an economic slowdown. Nevertheless, income growth remains solid and continues to support consumer spending.

Despite this elevated uncertainty, business investment likely picked up in the first quarter due to a rebound in aircraft acquisitions and higher spending related to artificial intelligence (AI).

US imports are estimated to have risen sharply in the first quarter because many businesses pulled forward purchases from abroad and built up their inventories to avoid paying anticipated tariffs.

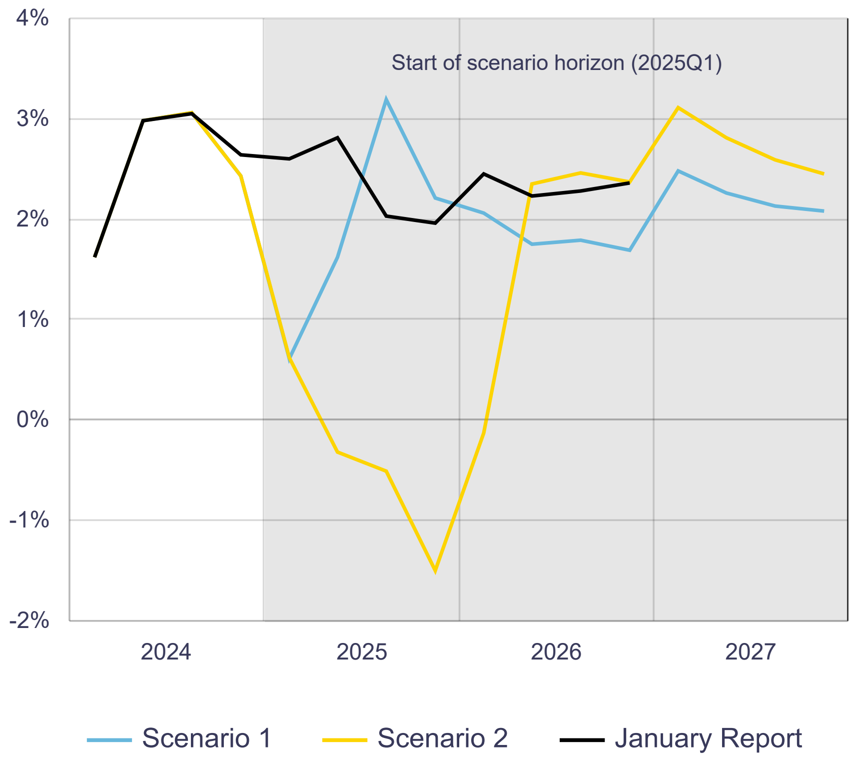
Inflation appears to have remained close to 2½% in the first quarter. Inflation in prices for food, insurance and motor vehicles is estimated to have picked up, while inflation in shelter prices has continued to moderate. Businesses' and households' expectations for future inflation have risen in response to tariffs.

Scenario 1

Growth in US gross domestic product (GDP) weakens from 2.8% in 2024 to about 2% in 2025 and 2026 (**Chart 18** and **Table 4**). Demand is held back by uncertainty about trade policy, weak sentiment and tight financial conditions. Inflation returns to the Federal Reserve's 2% target in 2027.

Chart 18: The US economy has a recession in Scenario 2

US GDP growth, annualized percentage change, quarterly data



Note: The assumptions and scenarios were finalized on April 11, 2025.

Sources: US Bureau of Economic Analysis and Bank of Canada calculations and estimates
Last data plotted: 2027Q4

Table 4: Global economic growth over the scenario horizon

	Share of real global GDP* (%)		Growth (%) 2024	2025	2026	2027
United States	15	Scenario 1	2.8	2.0	2.1	2.1
		Scenario 2	2.8	1.0	0.5	2.7
		January 2025 Report	2.8	2.6	2.3	
Euro area	12	Scenario 1	0.8	0.8	1.3	1.4
		Scenario 2	0.8	0.5	0.8	1.6
		January 2025 Report	0.7	0.8	1.3	
Japan	3	Scenario 1	0.1	1.2	0.9	1.2
		Scenario 2	0.1	1.0	0.3	1.2
		January 2025 Report	-0.2	1.2	1.1	
China	19	Scenario 1	5.0	4.8	4.7	4.3
		Scenario 2	5.0	4.6	4.3	4.2
		January 2025 Report	5.0	4.9	4.1	
Oil-importing EMEs†	34	Scenario 1	3.9	3.7	3.6	4.2
		Scenario 2	3.9	3.4	3.0	4.3
		January 2025 Report	3.7	3.8	4.1	
Rest of the world‡	17	Scenario 1	2.3	2.1	2.1	2.4
		Scenario 2	2.3	1.2	0.9	3.4
		January 2025 Report	2.1	2.1	2.5	
World	100	Scenario 1	3.2	3.0	2.9	3.1
		Scenario 2	3.2	2.5	2.2	3.4
		January 2025 Report	3.1	3.1	3.1	

* Shares of gross domestic product (GDP) are based on International Monetary Fund (IMF) estimates of the purchasing-power-parity valuation of country GDPs for 2023 from the IMF's October 2024 *World Economic Outlook*. The individual shares may not add up to 100 due to rounding.
† The oil-importing emerging-market economies (EMEs) grouping excludes China. It is composed of large EMEs from Asia, Latin America, the Middle East, Europe and Africa (such as India, Brazil and South Africa) as well as newly industrialized economies (such as South Korea).
‡ "Rest of the world" is a grouping of other economies not included in the first five regions. It is composed of oil-exporting EMEs (such as Russia, Nigeria and Saudi Arabia) and other advanced economies (such as Canada, the United Kingdom and Australia).
Note: The assumptions and scenarios were finalized on April 11, 2025.
Sources: National sources via Haver Analytics and Bank of Canada calculations and estimates

The slowdown in US growth is uneven:

- Consumption growth moderates in the second half of 2025 and remains somewhat subdued throughout 2026, reflecting increased household cautiousness.
- Business investment grows strongly because AI-related spending outweighs the adverse impacts of trade policy uncertainty.
- Export growth and import growth are both weaker than global demand growth, partially reflecting the tariffs imposed in this scenario.

US inflation continues to moderate toward the Federal Reserve’s 2% target (**Chart 19**). This gradual decline reflects:

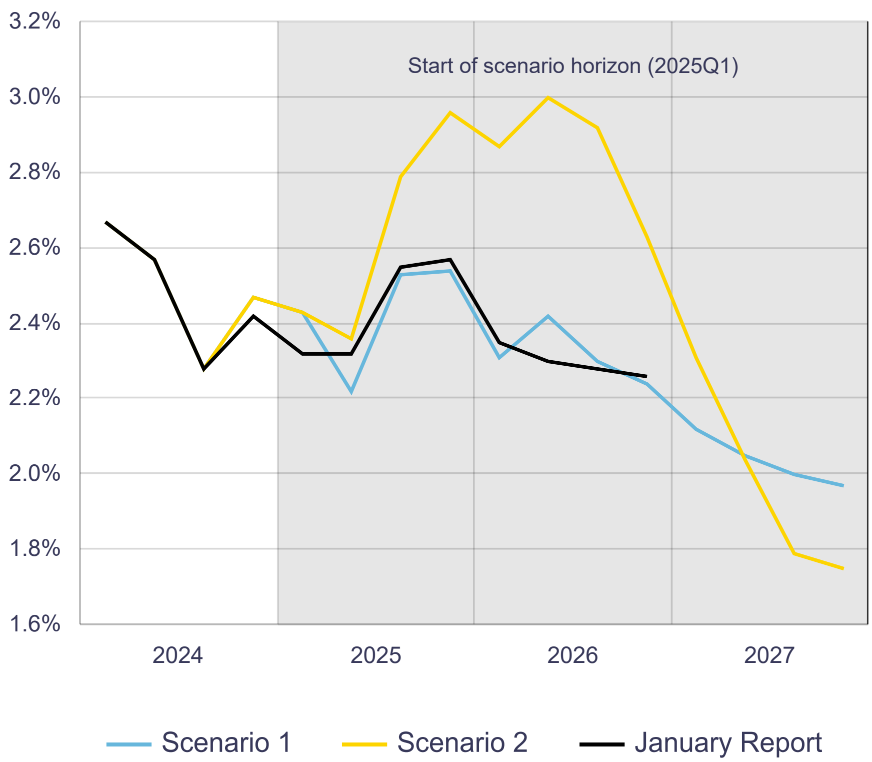
- the lower demand due to trade policy uncertainty and weak sentiment
- the decline in oil prices in early 2025

The factors pushing down inflation are partially offset by upward pressure from an increase in:

- the prices of goods because of tariffs on imports from China as well as on steel and aluminum
- inflation expectations, which affect wage and price-setting behaviour

Chart 19: US inflation rises sharply in Scenario 2

US personal consumption expenditures inflation, year-over-year percentage change, quarterly data



Note: The assumptions and scenarios were finalized on April 11, 2025.

Sources: US Bureau of Economic Analysis and Bank of Canada calculations and estimates
Last data plotted: 2027Q4

Scenario 2

The US economy goes into recession. High tariffs imposed by the United States and countermeasures by US trading partners weaken demand and lower potential output (see **Table 4** and the **Appendix: Potential output and the nominal neutral rate of interest**). Tariffs also push US inflation up.

The US economy experiences a four-quarter recession. GDP contracts starting in mid-2025 before regaining momentum in the second half of 2026 (**Chart 18**). Weaker consumption holds back GDP growth, which is on average 1.3 percentage points lower over 2025 and 2026 than it is in Scenario 1.

- Consumption declines through to mid-2026 due to weak growth in real disposable income. A fall in employment and soft labour productivity growth also contribute to this decline. The transfer of some tariff revenues to households partially offsets the impact of tariffs on consumption.
- US tariffs increase the price of imported machinery and equipment and lower consumer demand. Business investment slows over the second half of 2025.
- Tariffs cause exports and imports to contract sharply starting in mid-2025. They continue to fall until mid-2027.

Tariffs push total inflation to 3% in mid-2026. Lower oil prices and excess supply in the economy partially offset the upward pressure on inflation.

Overall, inflation is higher than in Scenario 1 by about 0.5 percentage points in 2026. Inflation then eases toward the Federal Reserve's 2% target in 2027.

Euro area

Recent data suggest that the euro area economy expanded at a modest pace of 0.5% in the first quarter of 2025, after having grown by around 1% in 2024. Manufacturing appears to have remained weak. Cold weather pushed up natural gas prices in early 2025, and this boosted consumer price index inflation to 2.3% in the first quarter.

Scenario 1

Trade policy uncertainty adds to the ongoing risks associated with the Russian invasion of Ukraine. Proposals to expand fiscal spending—including Germany's boost to infrastructure and defence spending—offset the negative impact from trade policy uncertainty. Overall, euro area growth is 0.8% in 2025 before it rises to close to 1.5% over 2026 and 2027 (**Table 4**).

Inflation in the euro area slows to the European Central Bank's 2% target by early 2026 as the impact of the recent increase in natural gas prices fades.

Scenario 2

Growth in the euro area slows to 0.5% in 2025. US tariffs reduce demand for euro area exports and add to the competitiveness issues faced by the region's manufacturing sector. Additionally, counter-tariffs imposed by the European Union drive up the prices of imports. These price increases reduce real income and increase the cost of investment, leading to slower growth in domestic demand. Growth gradually picks up to 0.8% in 2026 and strengthens further in 2027 as the economy adjusts to the new tariff regime (**Table 4**).

Inflation in the euro area is roughly unchanged from that in Scenario 1. The upward pressure on inflation from tariffs is offset by lower global oil prices and weaker domestic demand.

China

Recent data show that China's growth is slowing modestly. The property sector continues to struggle. Export growth was strong in late 2024, partly because of increased demand from US importers in anticipation of new tariffs. However, it weakened in February when the US imposed a further 10% tariff on imports from China.

China has subsequently become embroiled in an escalating trade conflict with the United States. At the time of this Report, US tariffs on imports from China and China's tariffs on US goods are set at well over 100%.

The Chinese government has indicated that it will provide fiscal support to businesses and households adversely affected by the trade conflict.

Scenario 1

Economic growth in China slows slightly to 4.8% in 2025 (**Table 4**). The property downturn and the associated weakness in consumer confidence continue to put downward pressure on domestic demand. Tariffs weigh on exports.[1] In the long term, population aging continues to slow growth.

Scenario 2

The increase in tariffs weighs on exports.[2] Policy support mitigates the negative impact from the tariffs. Growth slows to 4.6% in 2025—0.2 percentage points lower than in Scenario 1—and averages around 4¼% over 2026 and 2027 (**Table 4**).

Commodities

Oil prices have dropped since the January Report. Other commodity prices have been volatile.

Energy prices have declined

Brent oil prices have fallen to around US$65—US$15 below the assumption in the January Report (**Chart 20**). The decline reflects two main factors:

- concerns that the global trade conflict will reduce future oil demand
- plans by members of the Organization of the Petroleum Exporting Countries (OPEC) and some non-OPEC producers to increase production

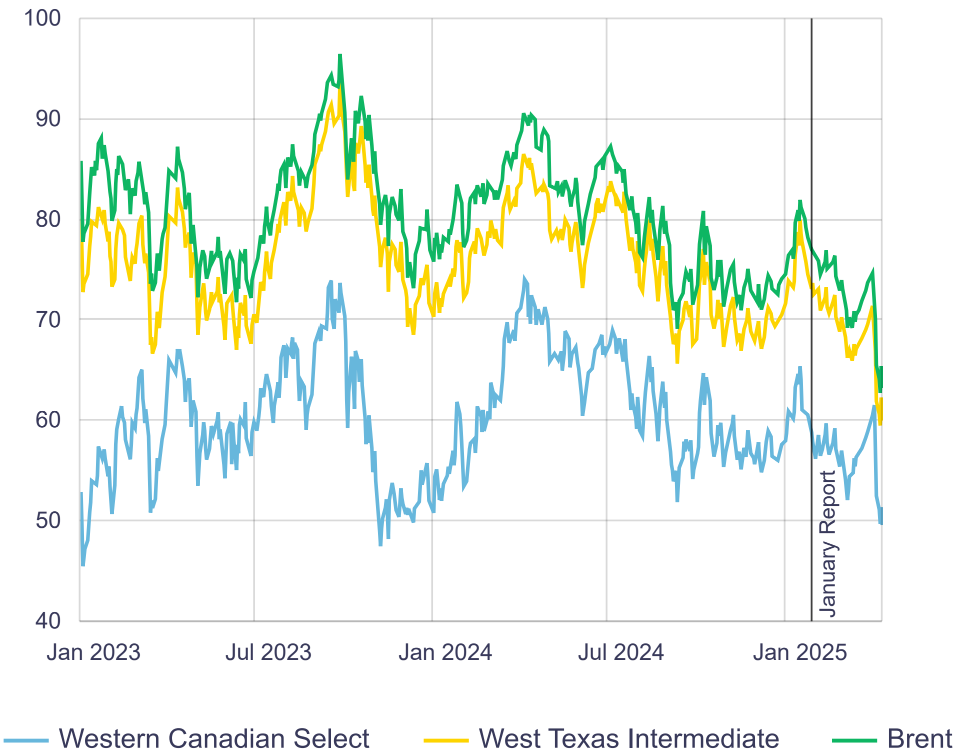
The spread in prices between West Texas Intermediate and Western Canadian Select has narrowed from US$15 assumed in the January Report to about US$10. This is because:

- traders now believe that US tariffs will not be broadly applied to Canadian oil
- Venezuelan oil exports are facing a pending decline
- seasonal oil sands maintenance is restraining Canadian production

Natural gas prices have risen since the January Report due to colder-than-normal weather conditions.

Chart 20: Oil prices have declined

Daily data



Sources: NYMEX and Intercontinental Exchange via Haver Analytics and Argus Media
Last observation: April 10, 2025

Non-energy commodity prices are unchanged

The Bank of Canada's non-energy commodity price index remains roughly unchanged since the January Report. US tariff threats have led US metals traders to pull forward demand. This has caused the prices for some metals that are traded on US exchanges, such as copper, to increase. Gold prices have risen sharply as investors seek to protect themselves against geopolitical uncertainty and the trade conflict. In contrast, agricultural prices have fallen, partly due to tariffs on Canadian exports.

Assumptions about commodity prices

The price of Brent crude oil is US$70 in Scenario 1 and US$60 in Scenario 2. High and broad-based tariffs lead to less global demand and lower oil prices.

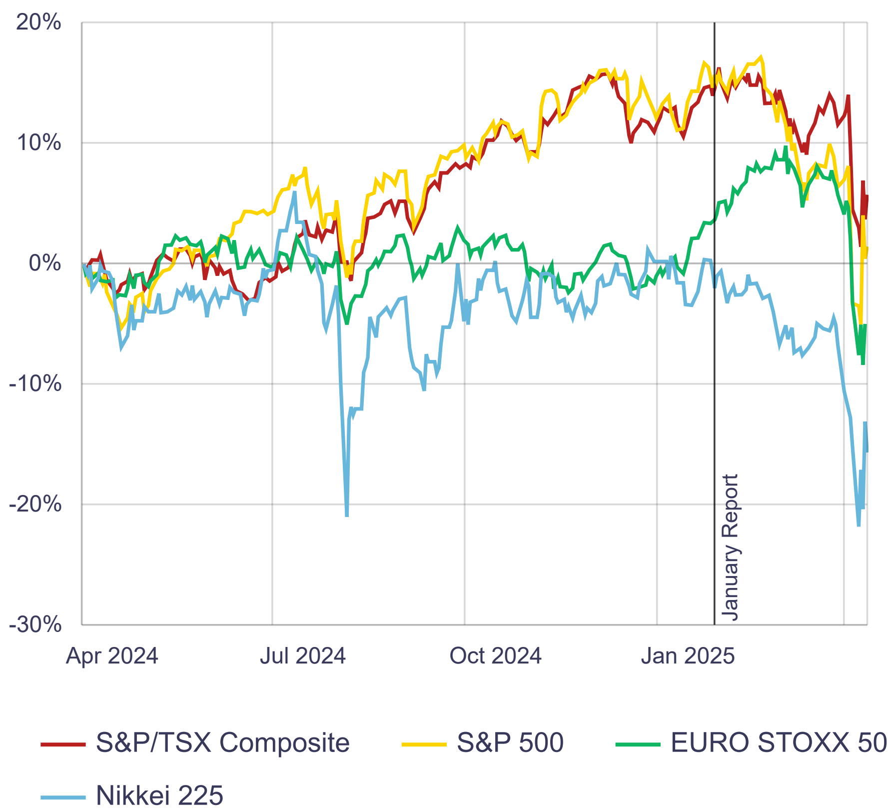
Financial conditions

Since the January Report, financial markets have been extremely volatile. They have priced in a weaker global outlook after announcements of sweeping new US tariffs.

Equity markets have fallen sharply as risk sentiment has deteriorated. The largest declines across major markets ranged from 10% to 20%. Equity markets then partially rebounded after the US administration announced a temporary suspension of some tariffs (**Chart 21**). The deterioration in risk sentiment has also led to higher credit spreads globally.

Chart 21: Equity markets have fallen sharply since the January Report

Returns on equity indexes since April 1, 2024, daily data



Source: Bloomberg Finance L.P.
Last observation: April 11, 2025

In response to weaker expectations for growth, markets are also pricing in additional policy easing. This has led to a decline in short-term government bond yields, both in Canada and globally. Longer-term yields have declined by a lesser extent or risen. Greater uncertainty has led investors to demand a higher term premium to hold longer-term government bonds.

The many shifts in US trade policy have led to a sharp rise in volatility in global equity, foreign exchange and government bond markets. This volatility has also increased the risk of disorderly market dynamics. For example, since April 2, there have been periods of low market liquidity in longer-term government bonds as leveraged participants have liquidated concentrated positions. Despite the decline in liquidity, there has been no sign of disfunction in major financial markets.

The value of the US dollar has fallen against many currencies because of the relatively large downgrade to the US growth outlook. This has supported the Canadian dollar, which has recently risen to about 72 cents US. The Canadian dollar has remained stable against a broad basket of other currencies.

Endnotes

1. In Scenario 1, it is assumed that the United States imposes a 10% tariff on imports of goods from China and China retaliates with the equivalent of an increase of 1% in its weighted average tariff rate on imports of goods from the United States.[←]
2. In Scenario 2, it is assumed that the United States imposes a 25% tariff on imports of goods from China and China retaliates with the equivalent of an increase of 25% in its weighted average tariff rate on imports of goods from the United States.[←]

Risks

Given the unprecedented shift in the direction of US trade policy, there is considerable uncertainty about how tariffs could impact the economy. The degree to which prices will rise and economic activity will weaken is unclear.

Historical tariff episodes can be helpful for gauging the impact of new tariffs when they are of a similar size and scope. The Bank of Canada's economic models use historical data from the start of the inflation-targeting period in 1991 to the present. These data include:

- tariffs that the United States imposed on Canadian steel and aluminum in 2018
- various tariffs on softwood lumber
- tariffs between the United States and China in 2018–19

The size and scope of tariffs considered in Scenario 1 are similar to recent historical experience. However, the unprecedented size and scope of the tariffs in Scenario 2 are not. In scenarios with high and long-lasting tariffs, the economic impacts are particularly uncertain.

There are two main upside and two main downside risks to inflation.

Main upside risks

Tariffs and supply chain disruptions could have a greater impact

In Scenario 2, the tariffs on Canada are assumed to cover a much wider range of goods than experienced in recent history. Because the tariff burden is so broad, businesses may pass on a greater share of the cost of tariffs to consumers than is assumed in Scenario 2. This pass-through may also happen at a faster pace. There is also a risk that businesses not directly impacted by tariffs may try to take advantage of the reduced competition and raise their prices.

The imposition of tariffs and subsequent countermeasures could also damage global supply chains more than is assumed in Scenario 2, resulting in higher production costs and import prices.

Tariffs could raise longer-term inflation expectations

Canadian tariffs will increase the prices of goods imported from the United States. Scenario 2 assumes that tariffs lead to a one-time increase to the prices paid by consumers. Once prices have adjusted to the new level, the rate of inflation will return to its previous trend. This assumption depends partly on longer-term inflation expectations of both households and businesses remaining well anchored to the 2% target.

However, consumers and businesses affected by tariff-related price increases may begin to expect that prices will continue to rise at an elevated pace after the one-time increase. This could lead to an upward drift in longer-term inflation expectations. These expectations of higher future inflation could become self-fulfilling if they feed through to wage demands and if businesses change how they set prices. This risk could be significant, especially considering the recent experience of high inflation.

Main downside risks

Tariffs could weaken the economy more than expected

Demand for Canadian exports may be weaker than anticipated in Scenario 2 because:

- the trade conflict could further weaken global economic activity
- US tariffs on Canadian goods could reduce demand even further

As well, the weakness in the export sector could spill over into the rest of the Canadian economy by more than expected. One way this could happen is if household and business confidence decline by more than is currently assumed. This would result in a more severe labour market downturn, with both the rise in the unemployment rate and the decline in gross domestic product being larger than in Scenario 2.

Greater slack in the Canadian economy would create more downward pressure on inflation. Moreover, there could be more downward pressure on prices as foreign manufacturers that are subject to US tariffs divert their goods to Canada.

Financial stress could worsen

Businesses and households, especially those directly impacted by tariffs, might experience a larger-than-expected deterioration in their financial health. A greater-than-anticipated rise in delinquencies and bankruptcies could spread to lenders and lead to tighter credit conditions. Should this occur, economic growth would be slower and inflation would be weaker.

How removing the consumer carbon tax affects inflation

The removal of the consumer carbon tax will temporarily lower inflation and result in a one-time reduction in the level of consumer prices, mostly reflecting a decline in gasoline prices.

The federal fuel charge rate—also known as the consumer carbon tax—came into effect in 2019. Subsequent annual increases put modest upward pressure on inflation every year until 2024. On April 1, 2025, the federal government set the rate to zero, which will push down inflation for only one year.

The price effect of the consumer carbon tax

Since coming into effect, the carbon tax has added 0.1% to 0.15% to the level of consumer prices each year. This adds up to a total increase in the price level of about 0.7%.

Removing the carbon tax will undo this cumulative impact, decreasing the level of the consumer price index by 0.7% from April 2025 to March 2026 (**Chart 22**).[1] This means, all else being equal, year-over-year inflation will be 0.7 percentage points lower for one year.

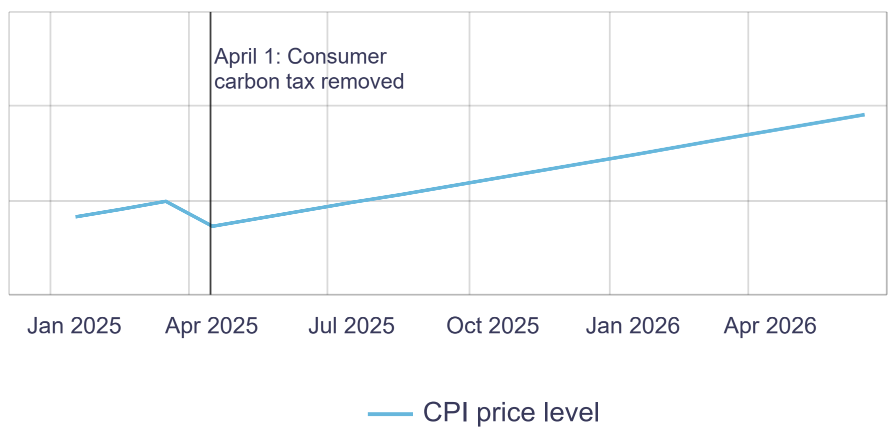
This temporary decline in inflation will be due primarily to lower gasoline prices. The carbon tax is estimated to have added roughly 18 cents per litre to fuel prices.

Starting in April 2026, year-over-year inflation will no longer be affected by the elimination of the consumer carbon tax.[2] Its removal has the same effect under both outlook scenarios because it is unrelated to the trade conflict.

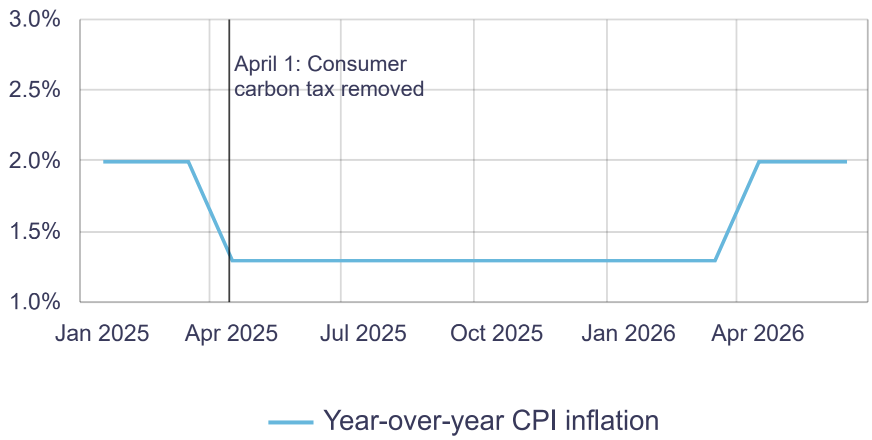
Chart 22: The removal of the consumer carbon tax permanently lowers the path of consumer prices and lowers inflation for one year

Illustrative data (see note for details)

a. CPI price level



b. Year-over-year CPI inflation



Note: This is a stylized example to illustrate how the removal of the consumer carbon tax will affect the level of consumer prices and the year-over-year inflation rate, assuming constant underlying inflation of 2% and holding other factors constant.
Source: Bank of Canada calculations and estimates
Last data plotted: June 2026

Endnotes

1. The estimates include British Columbia's removal of its consumer carbon tax but exclude Quebec, which uses a cap-and-trade system. The estimates reflect the direct impacts on consumer energy prices only. They exclude any indirect effects on other prices or the impact of taxes that are applied in addition to the consumer carbon tax, such as the harmonized sales tax.[←]

2. The inflation outlook in the January Report included increases of 0.1 percentage points in the consumer carbon tax in April 2025 and April 2026. Removing the consumer carbon tax lowers the inflation outlook by 0.8 percentage points between the second quarter of 2025 and the first quarter of 2026 and by 0.1 percentage points between the second quarter of 2026 and the fourth quarter of 2026.[←]

Appendix: Potential output and the nominal neutral rate of interest

Canada's potential output growth is anticipated to slow due to declining population growth and the ongoing trade conflict. The range for Canada's neutral interest rate lies between 2.25% and 3.25%.

The assumptions and scenarios were finalized on April 11, 2025.

Canadian potential output

Uncertainty about US trade policy means that the outlook for potential output growth is less clear than usual. This Report provides two estimates that correspond with the two outlook scenarios (see **Assumptions for the outlook scenarios** and **Table A-1**).

In both scenarios, the sharp decline in population growth—reflecting the federal government's 2025–27 Immigration Levels Plan—plays a significant role in reducing potential output growth. The trade conflict also contributes to this decline. In Scenario 1, weak business investment modestly lowers potential output growth. In Scenario 2, potential output growth decreases further due to long-term efficiency losses from reduced trade and a less efficient allocation of resources.[1]

Table A-1: Canadian and global potential output growth over the scenario horizonEstimated growth (%)

		2024	2025	2026	2027	2028
Canada	Scenario 1	2.9	1.8	1.3	1.4	1.7
	Scenario 2	2.9	1.2	0.4	1.0	1.6
	April 2024 Report	2.5	1.7	1.5	1.7	-
United States	Scenario 1	2.7	2.4	2.3	2.2	2.2
	Scenario 2	2.7	2.3	1.7	1.9	2.2
	April 2024 Report	2.3	2.2	2.1	2.1	-
Euro area	Scenario 1	1.1	1.1	1.0	1.0	1.0
	Scenario 2	1.1	1.0	0.9	0.9	1.0
	April 2024 Report	1.2	1.1	1.1	1.1	-
China	Scenario 1	4.6	4.4	4.2	4.0	3.9
	Scenario 2	4.6	4.4	4.2	4.0	3.9
	April 2024 Report	4.3	4.1	3.9	3.8	-
World	Scenario 1	3.1	3.0	3.0	2.9	2.9
	Scenario 2	3.1	3.0	2.8	2.8	2.9
	April 2024 Report	3.0	3.0	2.9	2.9	

Note: The assumptions and scenarios were finalized on April 11, 2025.
Source: Bank of Canada calculations and estimates

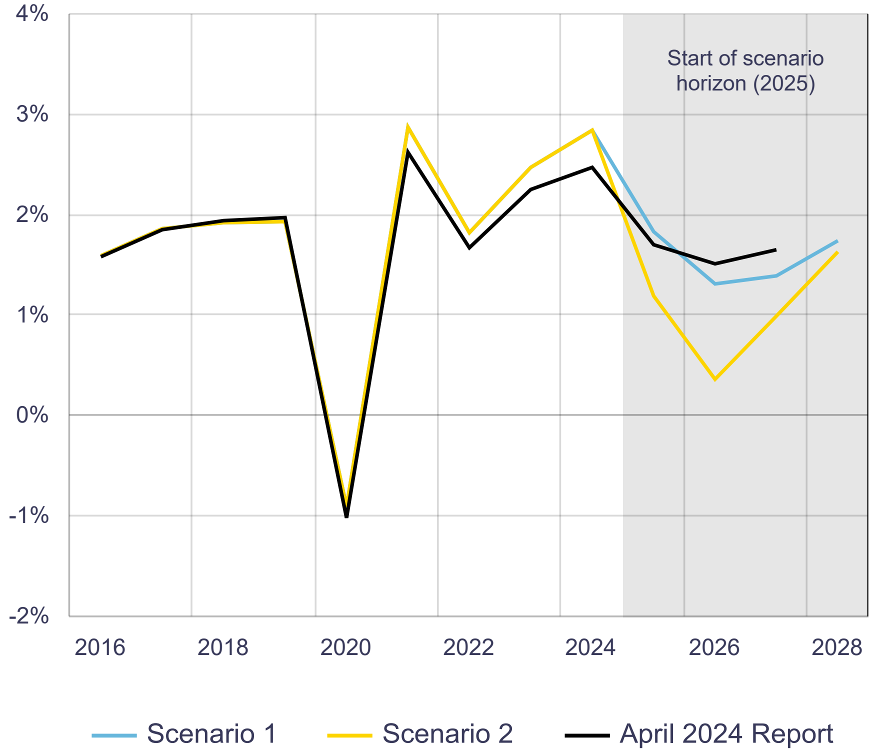
Growth of Canadian potential output slows

Potential output is the maximum level of output that can be supported over the long term while keeping inflation at the 2% target. It is influenced by structural factors, such as demographics, education, technology and innovation. Domestic and foreign trade policies also influence potential output through their impact on how resources are allocated across industries, which matters for total productivity over the long term.

In both scenarios, potential output growth slows significantly due to declining growth of trend labour input (TLI) (**Chart A-1**). This is mainly caused by slower population growth. Population growth moderates from 3.3% in 2024 to 0.5% on average in 2026 and 2027 due to lower immigration targets and measures to reduce the flow of non-permanent residents. It then picks up modestly to 0.9% in 2028.

Chart A-1: Canadian potential output growth slows

Annual data



Note: The assumptions and scenarios were finalized on April 11, 2025.
Source: Bank of Canada calculations and estimates
Last data plotted: 2028

Scenario 1

Canadian potential output growth declines from 2.9% in 2024 to an average of 1.6% in 2025 through 2028 (**Chart A-1** and **Table A-2**). This growth dynamic is broadly similar to that in the April 2024 Report.

Growth in trend labour productivity (TLP) increases from -0.5% in 2024 to an average of 1.2% over 2025 to 2028. This rise is supported by an improvement in trend total factor productivity (TFP) growth and an increase in the ratio of capital to labour due to the slowdown in population growth. These factors more than offset the negative impact on business investment from trade-related uncertainty. Relative to the April 2024 Report, potential output growth is modestly lower.

Scenario 2

Potential output growth in Canada slows more abruptly than in Scenario 1, falling to an average of 0.9% in 2025 through 2027 before recovering to 1.6% in 2028 (**Chart A-1** and **Table A-2**). Despite the gradual rebound in potential output growth, the level of potential output is permanently lower due to the tariffs.

TLP growth rises more gradually than in Scenario 1, increasing from -0.5% in 2024 to an average of:

- 0.4% in 2025 and 2026
- 0.9% in 2027 and 2028

Two factors are behind this:

- investment is even weaker because foreign demand is permanently lower
- broad-based tariffs lead to major structural changes and weaken growth in trend TFP

Over the long term, US tariffs lead to reduced international trade and a shift in production away from sectors where Canada has a comparative advantage, resulting in efficiency losses. In the near term, tariffs have an even more pronounced impact on productivity because businesses affected by reduced trade scale back on their production. This in turn leads them to repurpose their machinery and equipment to less efficient uses and to lay off workers who would need to re-skill.

Risks

Estimates of potential output are highly uncertain because some of its components are unobservable and difficult to project. The outlook for potential output in each scenario is subject to both upside and downside risks. These include:

- a higher or lower future pace of immigration to Canada
- stronger TLP growth resulting from the widespread adoption of artificial intelligence (AI)[2]
- structural reforms, such as reductions in interprovincial trade barriers

Table A-2: Comparison of Canadian potential output estimates with those from April 2024Annual rates (%)

		2024	2025	2026	2027	2028
Annual growth	Scenario 1	2.9	1.8	1.3	1.4	1.7
	Scenario 2	2.9	1.2	0.4	1.0	1.6
	April 2024 Report	2.5	1.7	1.5	1.7	
Trend labour input growth	Scenario 1	3.3	0.7	0.2	0.2	0.6
	Scenario 2	3.3	0.7	0.2	0.2	0.6
	April 2024 Report	3.0	0.9	0.6	0.6	
Trend labour productivity growth	Scenario 1	-0.5	1.2	1.2	1.2	1.1
	Scenario 2	-0.5	0.5	0.2	0.8	1.0
	April 2024 Report	-0.5	0.8	0.9	1.0	
Revisions to the level (percent)	Scenario 1	1.0	1.1	0.9	0.6	
	Scenario 2	1.0	0.5	-0.7	-1.3	

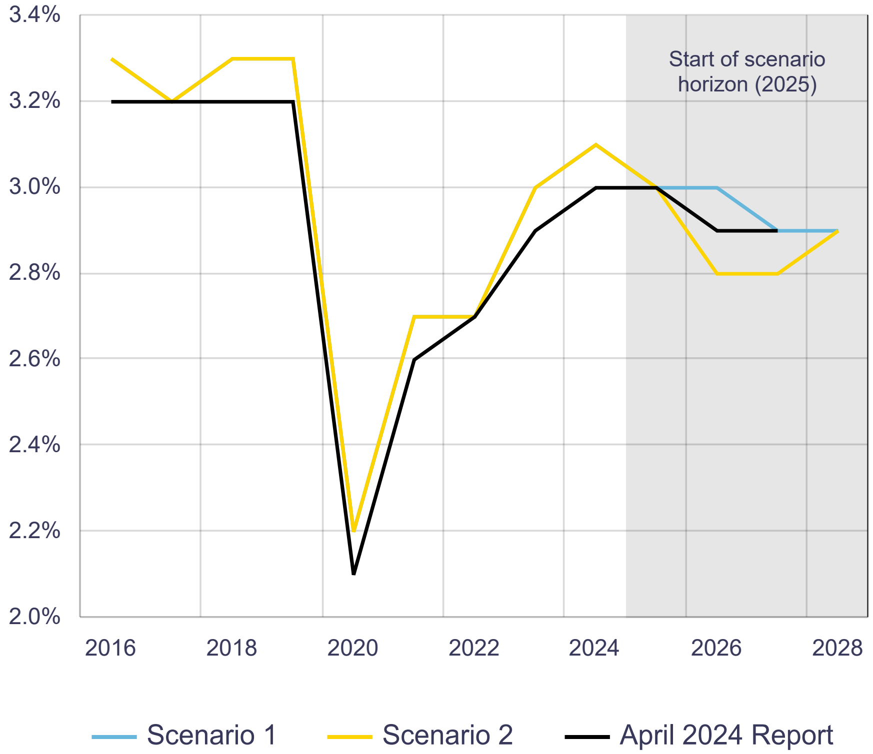
Note: The assumptions and scenarios were finalized on April 11, 2025. The revisions to the level are compared with those in the April 2024 Report.
Source: Bank of Canada calculations and estimates

Global potential output

Growth in global potential output slows in both scenarios due to demographic shifts and the trade conflict (**Chart A-2**).

Chart A-2: Global potential output growth slows

Annual data



Note: The assumptions and scenarios were finalized on April 11, 2025.
Source: Bank of Canada calculations and estimates
Last data plotted: 2028

Scenario 1

Growth in global potential output eases from about 3.1% in 2024 to 2.9% in 2027. The aging global population is the main reason for this decline. Trade policy uncertainty also reduces the level of global potential output by a modest 0.1% by 2027. However, AI-related capital investments and TFP growth support potential output in many economies. The United States experiences the largest gains, followed by China, the euro area and Japan. Overall, Scenario 1 is broadly similar to the outlook for global potential output growth presented in the April 2024 Report:

- Growth in potential output in the United States slows. An aging population and tighter immigration policies weigh on TLI growth. These effects are partially offset by AI-related capital spending and efficiency gains. The outlook is revised up compared with the April 2024 Report as a result.
- In China, potential output growth slows because business investment moderates from its current elevated pace. This impact is partially offset by a higher retirement age and AI

adoption. The outlook for growth has been revised up from the April 2024 Report largely due to these factors.

- Potential output growth in the euro area is modest, at about 1%. The lingering effects of Russia's invasion of Ukraine and competitiveness challenges in the euro area's manufacturing sector lead to a slower pace of business investment, which weighs on growth. This is partially offset by increased fiscal investment in defence and infrastructure.

Scenario 2

A severe US-driven trade conflict slows global potential output growth to around 2.8% by 2026. The level of potential output is about 0.5% lower by 2027 than it is in Scenario 1. Severe tariffs affect all regions, significantly reducing productivity by displacing resource allocation away from more productive uses. The cyclical slowdown in investment results in a lower capital stock in all regions relative to Scenario 1. The impacts are most significant for the United States and its major trading partners:

- US potential output growth slows to 1.7% by 2026 and remains below 2% in 2027. Reduced labour productivity results in potential output being 1% weaker than in Scenario 1 by 2027 (due to less capital deepening and less TFP growth).
- Other regions also see lower potential output in this scenario, although the impact is less severe.

Risks

The outlook for potential output in each scenario is subject to both upside and downside risks. These include:

- The US administration's wide range of policy announcements (from cuts to corporate and personal income taxes to deregulation and tariffs) point to both upside and downside risks.
- Countries may adopt a more expansionary fiscal stance to help offset the impact of the tariffs. If spending is directed toward measures that improve productivity and investment, potential output could rise.

Neutral rate

Under both scenarios, the Canadian neutral rate lies between 2.25% and 3.25%, unchanged from the April 2024 assessment.[3]

Because Canada is a small open economy, its neutral rate is linked to the global neutral rate, which is proxied by that of the United States. The US neutral rate is within a range of between 2.25% and 3.25% in both scenarios, unchanged from the April 2024 Report:

- In Scenario 1, tighter immigration policy and rising macroeconomic uncertainty offset the impact of stronger productivity growth.
- In Scenario 2, potential output growth is weaker than in Scenario 1, and the ratio of government debt to gross domestic product is smaller.[4] Both factors weigh on the US neutral rate but are not large enough to move the range.

With the unchanged US neutral rate and offsetting domestic factors, the Canadian neutral rate remains the same in both scenarios. Slowing growth of long-term TLI is partially offset in both scenarios by a pick-up in growth of long-term TLP. Even in Scenario 2, potential output growth in Canada largely rebounds after about three years as the economy adjusts to reduced trade. Although efficiency losses lead to a permanently lower level of TLP, the effects on its long-term growth rate are limited.

Risks

These estimates are subject to some important risks.

- Structural changes, such as the impact of further isolation of the US economy, could affect the link between the US and Canadian neutral rates. If Canadian borrowers become less willing or find it harder to access funding in US capital markets, they would need to turn to other markets. Since the US capital market is the world's largest and most liquid, this could lead to higher interest rates for Canadian borrowers. This would cause the Canadian neutral rate to rise.
- Low confidence and heightened consumption growth risk could lead to an increase in long-term precautionary savings. This would exert downward pressure on the Canadian neutral rate.

Similar to potential output, the neutral rate is unobservable and can be inferred only by considering the evolution of its observed factors. Because of this, considerable inherent uncertainty exists for the neutral rate estimate. This reflects, in particular, uncertainty around the factors behind it, such as potential output and the balance between global savings and investment.

Endnotes

1. For more details, see S. Abraham, D. Brouillette, A. Chernoff, C. Hajzler, S. Houle, M. Kim and T. Taskin, "Potential output in Canada: 2025 assessment," Bank of Canada Staff Analytical Note (forthcoming).[←]

2. Although Canada ranks high in AI innovation and concentration of talent, it continues to lag behind other advanced economies in terms of business adoption. This lag potentially limits AI's impact on productivity growth. The potential boost to long-term TLP growth from AI adoption is therefore characterized as an upside risk rather than being included in the scenarios.[←]

3. For more details, see F. Adjalala, F. Alves, W. Beaudoin, H. Desgagnés, W. Dong, I. Krohn and J. D. Schneider, "Assessing the US and Canadian neutral rates: 2025 update," Bank of Canada Staff Analytical Note (forthcoming).[←]

4. One-half of the tariff revenues generated in Scenario 2 are used to pay off government debt.[←]