

ECONOMIC AND FINANCIAL OUTLOOK

More of The Same in 2026

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

The global economy is about to enter 2026 still grappling with forces that were in motion well before the latest US political cycle. Geopolitical fragmentation did not begin with the return of Donald Trump to the White House. In fact, it was very much a theme in his first term. But as we approach the one-year mark of his second term, the decisiveness of the break in the post-Cold War global trade order is remarkable.

Over the past year, the world has witnessed notable doctrinal pivots. The United States is now pursuing its most protectionist strategy in roughly a century. Germany has begun rearming and has temporarily relaxed the fiscal discipline that once defined its policymaking. Other countries are adapting in turn, beefing up their military capabilities and reassessing their industrial policies, trade partnerships and energy strategies. Resilience and security considerations increasingly outweigh the traditional virtues of openness. Where openness remains, it is more selective and shaped by a global landscape in which trust is more difficult to secure.

Financial markets have so far managed to defy the gravity of this transition. AI-related enthusiasm has provided a powerful counterweight to the gloom surrounding the shift from free trade to managed trade. But that enthusiasm also raises the risk of correction, especially as valuations stretch and fundamentals become harder to read. The global AI infrastructure boom has capital flowing at levels few anticipated, but it increasingly bumps up against hard constraints, whether in the form of potential overcapacity or binding limitations in power

generation and transmission. These constraints could ultimately compromise expected returns, although trying to time a day of reckoning is a fool's errand.

Meanwhile, the United States heads into a mid-term election year with economic concerns remaining at the top of voters' minds. Early indicators, from fall 2025 electoral results to national polling, suggest that the typical mid-term headwinds for an incumbent administration may be more pronounced than usual. The broader economic backdrop is not one of imminent recession when looking at aggregate data, but the composition of growth will continue to evolve.

Middle- and lower-income households remain under pressure from still-elevated living costs and a weakening labour market. In contrast, the contribution of high-income households is increasingly important to headline activity. A market correction is a meaningful risk in this context given the concentration of financial wealth, though spending patterns among top earners depend more on their stock of wealth than on short-term changes in its valuation.

We see US job creation remaining soft but not collapsing. The softness is in part supply-driven, with the administration's tightening approach to immigration reducing the growth in the labour force. As a result, we expect a relatively limited upward response in the unemployment rate in 2026. Some sectors dependent on low-cost foreign labour may see nominal wage acceleration, though this should not be mistaken for strength; it instead reflects cost-push frictions that will likely generate additional inflationary pressures.

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Adding to those pressures, tariff pass-through should continue to nudge US inflation higher than it would otherwise be. We believe this will complicate the job of the Federal Reserve. Our baseline assumes only an incrementally dovish stance from the incoming Fed Chair. It will be difficult to see the Fed entirely turning a blind eye to tariff-related inflation, particularly in light of the level of dissent witnessed at FOMC meetings this year, but also given the threat of an adverse reaction in bond markets should it take an overly dovish bias.

For Canada, the defining issue of 2026 is the CUSMA joint review. Although the process was originally conceived as nearly a formality, it is increasingly taking on the look and feel of a renegotiation. The range of potential outcomes is broad, shaped by questions about the sectoral concessions each country may be willing to make, whether the United States seeks to fragment the agreement into bilateral deals and the possibility of a looser side arrangement similar to those the US signed with Japan, the EU and the UK. Even if CUSMA is salvaged, uncertainty remains about whether Canada will secure long-term continuity or be faced with a year-to-year renewal cycle. In the end, it is these details that will determine whether exporting businesses obtain the clarity they need to plan, invest and hire.

Canada may have been spared the worst of the tariff escalation, but recent events have nonetheless pushed fiscal policy into a more supportive stance. Beyond modest pocketbook measures and liquidity supports for affected businesses, the largest new commitments relate to defence spending. Initiatives aimed at stimulating private investment are being positioned as making Canada one of the more competitive jurisdictions from a tax perspective. Even so, these measures will take time to gain traction in an environment where uncertainty continues to weigh on risk-taking. We do not expect a spirited rebound in private capital spending in 2026, though some stabilization appears possible.

Canadian population growth is set to keep moderating, guided by the current targets. The execution risks are significant, with many permits expiring for non-permanent residents in 2026 and questions remaining on a range of issues, including transition pathways, exit compliance and headcount tracking. Still, we assume slower population growth will allow the national unemployment rate to edge down modestly, although this decline warrants the same caution as that in the US in that it reflects demographic policy developments more than true economic strength.

The Bank of Canada will be attentive to these distinctions. We expect it to remain on hold through 2026. While the unemployment rate may drift lower, growth is likely to stay weak and uncertainty unusually elevated. But with limited excess capacity, sticky underlying inflation, and fiscal measures gradually filtering through the economy, the bar for a move towards accommodative policy is high.

This being said, the Bank will be navigating 2026 without the benefit of a clear map. Beyond the obvious CUSMA fault line, economic conditions are increasingly fragmented and heterogeneous across the country, whether between trade-exposed and domestically oriented sectors, manufacturing-heavy provinces and energy producers, industries benefiting from government support and those facing soft demand, etc.

In closing, Canadian Energy Minister Tim Hodgson recently remarked that “we cannot look back in nostalgia” when it comes to economic transformation. The same applies to the theme of uncertainty. The year 2026 will reinforce what increasingly appears to be a decisive shift away from a regime of relative stability, trust and predictability toward one marked by greater uncertainty, unpredictability and at times even disorder. This means the outlook we present today will remain subject to revision, and that decisionmakers will be required to act with an uncomfortably low level of confidence about near-term developments. Even so, several structural themes remain firmly in place. Adopting a longer-term vision will thus remain essential for navigating the shifts now underway.

RISKS INHERENT IN OUR SCENARIOS

Global uncertainty should remain high given the existing tariffs and the threat of other measures. Central banks may need to lower their key interest rates further if the economy deteriorates more than expected. In contrast, monetary policy may need to be tightened if inflation spikes due to new tariffs or supply chain disruptions. Geopolitical tensions could further contribute to inflation by pushing up the price of some commodities, including oil. We'll also need to keep a close eye on the threats to the independence and neutrality of key economic institutions in the United States, including the Federal Reserve, where a new chair is expected to take over in May. The issue of US federal government funding is likely to rear its head again in early 2026, although next year's focus will be more on the midterm elections, the Supreme Court's rulings on the Trump administration's trade policy, and CUSMA review, all of which could disrupt the economy. 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, is facing its own political and budgetary challenges. And there are risks of financial instability, especially if regulatory frameworks become more relaxed. The excitement surrounding AI is now bordering on exuberance, and a major equity market correction could damage confidence and spillover to the economy in the form of a negative wealth shock. Meanwhile, further volatility in bond, currency and commodity prices could also weaken the outlook for the global economy.

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

%	Weight*	Real GDP growth			Inflation rate		
		2025f	2026f	2027f	2025f	2026f	2027f
Advanced economies	36.9	1.5	1.5	1.5	2.5	2.5	2.2
United States	14.8	1.9	2.0	1.8	2.8	3.2	2.5
Canada	1.4	1.7	1.3	1.9	2.0	2.1	2.0
<i>Quebec</i>	<i>0.3</i>	<i>0.9</i>	<i>1.1</i>	<i>1.6</i>	<i>2.4</i>	<i>2.0</i>	<i>2.0</i>
Japan	3.2	1.2	0.6	0.9	3.1	1.8	1.8
United Kingdom	2.1	1.4	0.9	1.3	3.4	2.7	2.2
Eurozone	11.5	1.4	1.1	1.4	2.1	1.9	1.9
<i>Germany</i>	<i>3.1</i>	<i>0.3</i>	<i>0.7</i>	<i>0.7</i>	<i>2.1</i>	<i>2.0</i>	<i>2.1</i>
<i>France</i>	<i>2.1</i>	<i>0.9</i>	<i>1.0</i>	<i>1.1</i>	<i>1.0</i>	<i>1.5</i>	<i>1.7</i>
<i>Italy</i>	<i>1.8</i>	<i>0.6</i>	<i>0.6</i>	<i>1.0</i>	<i>1.7</i>	<i>1.7</i>	<i>1.9</i>
Other countries	3.8	1.3	1.9	1.8	1.9	2.0	2.0
<i>Australia</i>	<i>1.0</i>	<i>1.7</i>	<i>2.1</i>	<i>2.1</i>	<i>2.6</i>	<i>2.8</i>	<i>2.5</i>
Emerging and developing economies	63.1	3.8	3.7	3.9	4.4	3.7	3.3
Emerging Asia	33.7	5.2	5.0	4.9	1.0	1.8	2.3
<i>China</i>	<i>19.3</i>	<i>5.0</i>	<i>4.7</i>	<i>4.5</i>	<i>0.0</i>	<i>0.6</i>	<i>1.1</i>
<i>India</i>	<i>8.2</i>	<i>6.5</i>	<i>6.4</i>	<i>6.5</i>	<i>2.9</i>	<i>4.3</i>	<i>4.4</i>
Latin America	5.7	1.9	1.7	2.2	4.2	3.8	3.5
<i>Mexico</i>	<i>1.7</i>	<i>0.4</i>	<i>1.3</i>	<i>1.9</i>	<i>3.9</i>	<i>3.9</i>	<i>3.6</i>
<i>Brazil</i>	<i>2.4</i>	<i>2.3</i>	<i>1.5</i>	<i>1.9</i>	<i>4.8</i>	<i>4.2</i>	<i>3.8</i>
Eastern Europe	8.2	1.8	2.1	2.4	13.1	9.2	7.2
<i>Russia</i>	<i>3.5</i>	<i>0.9</i>	<i>1.0</i>	<i>1.3</i>	<i>7.0</i>	<i>5.1</i>	<i>4.3</i>
Other countries	15.4	2.1	2.1	2.6	9.1	7.5	6.3
<i>South Africa</i>	<i>0.5</i>	<i>0.8</i>	<i>1.4</i>	<i>1.3</i>	<i>3.4</i>	<i>4.0</i>	<i>4.1</i>
World	100.0	2.9	2.9	3.0	3.7	3.3	2.9

f: forecast; PPP: Purchasing Power Parities, exchange rates that equate the cost of a broad basket of goods and services across countries; * 2024.

World Bank, Consensus Forecasts and Desjardins Economic Studies

FINANCIAL FORECAST

The Bank of Canada is likely to stay on hold, though additional economic weakness could reignite the prospect of further easing in early 2026. Yield curves should reach peak steepness in Q1 before flattening as markets begin to price in hikes in 2027. We anticipate flows into Canadian bonds will slow but remain resilient, with demand shifting toward longer maturities as front-end support fades. Following the Fed's 25bp cut at their December meeting, we expect them to hold through mid-2026. Inflation risks—linked to tariffs and sector-specific measures—remain a concern, limiting scope for aggressive easing. US yields should decline overall, with faster falling short rate leading to curve steepening by year end. We remain constructive on equities, expecting global earnings growth to broaden and the US to avoid recession. Fed easing later in the year should support valuations. AI infrastructure spending remains a key driver but introduces risks if monetization lags. Diversification away from tech-heavy US indices is likely, with Canadian equities—supported by resource exposure and strong bank performance—poised to outperform the S&P 500.

Table 2

Summary of Financial Forecasts

End of period in % (unless otherwise indicated)	2025		2026				2027			
	Q3	Q4f	Q1f	Q2f	Q3f	Q4f	Q1f	Q2f	Q3f	Q4f
Key interest rate										
United States	4.25	3.75	3.75	3.75	3.25	3.25	3.25	3.25	3.25	3.25
Canada	2.50	2.25	2.25	2.25	2.25	2.25	2.25	2.25	2.50	2.75
Eurozone	2.00	2.00	1.75	1.75	1.75	1.75	2.00	2.00	2.00	2.00
United Kingdom	4.00	4.00	3.75	3.50	3.50	3.50	3.50	3.50	3.50	3.50
Federal bonds										
United States										
2-year	3.65	3.55	3.70	3.45	3.30	3.25	3.25	3.25	3.25	3.25
5-year	3.72	3.65	3.75	3.60	3.55	3.50	3.50	3.50	3.50	3.50
10-year	4.13	4.05	4.15	4.10	4.05	4.05	4.05	4.05	4.05	4.05
30-year	4.73	4.70	4.80	4.75	4.65	4.65	4.65	4.65	4.65	4.65
Canada										
2-year	2.47	2.50	2.40	2.40	2.45	2.50	2.60	2.65	2.70	2.80
5-year	2.74	2.90	2.70	2.60	2.65	2.70	2.75	2.80	2.90	3.00
10-year	3.17	3.35	3.20	3.10	3.10	3.10	3.10	3.15	3.15	3.25
30-year	3.61	3.75	3.60	3.50	3.45	3.45	3.45	3.45	3.45	3.50
Currency market										
Canadian dollar (USD/CAD)	1.39	1.40	1.42	1.39	1.36	1.35	1.33	1.32	1.31	1.30
Canadian dollar (CAD/USD)	0.72	0.71	0.70	0.72	0.74	0.74	0.75	0.76	0.76	0.77
Euro (EUR/USD)	1.17	1.16	1.15	1.17	1.18	1.18	1.17	1.16	1.16	1.15
British pound (GBP/USD)	1.33	1.32	1.28	1.30	1.31	1.32	1.32	1.31	1.30	1.30
Yen (USD/JPY)	148	155	155	152	150	150	148	146	144	140
Stock markets (level and growth)*										
United States – S&P 500	6,900 (17.5%)		Target: 7,600 (+9.6%)				Target: 8,400 (+11.4%)			
Canada – S&P/TSX	31,800 (28.5%)		Target: 35,400 (+11.4%)				Target: 38,600 (+9.1%)			
Commodities (annual average)										
WTI oil (US\$/barrel)	76 (60*)		60 (60*)				64 (65*)			
Gold (US\$/ounce)	3,420 (4,100*)		4,240 (4,300*)				4,220 (4,135*)			

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

Datastream and Desjardins Economic Studies

Overseas

Global Trade Slowed but Didn't Stall

FORECAST

The global economy continues to grow, albeit more slowly than in 2023 or 2024. Several economies lost steam over the summer, but the outlook for the end of 2025 and 2026 remains positive. However, US tariff policy continues to fuel uncertainty, and the economic climate remains fragile in the major advanced economies, many of which are contending with a degree of political instability. Among the emerging markets, China has weathered US tariff increases relatively well so far but is still suffering from rather weak domestic demand. Global real GDP is expected to rise by 2.9% in 2025 and 2026 and 3.0% in 2027.

Every danger to the global economy, and especially to international trade, has been on the table in 2025. GDP growth slowed somewhat in several countries, particularly during the summer. Germany and the UK were flat, while Japan's and Italy's economies contracted. However, the overall situation is less dire than we predicted when the US first increased tariffs.

Despite the Trump administration's protectionist stance, global trade has remained positive. The real level of trade was even higher in September than it was when countries were frontloading imports in anticipation of increased US tariffs (graph 1). Amid this acute uncertainty, this progress is a testament to global economic resilience.

China, where President Trump has focused his harshest protectionist policies, has held up particularly well. The situation began to look very serious for several weeks in the spring, at the height of the trade war with the United States. The effective US tariff on China soared from 11.04% in January to 39.72% in August (peaking at 48.24% in May). At the same time, China's exports to the US have plummeted 40% since the beginning of the year (graph 2). Despite this, China's total exports have continued to rise, and production has been particularly strong. Domestically, however, China's economy continues to face several structural challenges, including a struggling property

market, a declining population and high government debt. In the short and medium term, several high-value-added sectors are expected to underpin growth, including those related to artificial intelligence, renewable energy and electric vehicles. That said, persistently weak domestic demand continues to cast a shadow of uncertainty that could hobble economic activity in the coming years. China's economic growth is likely to remain modest in 2026, with real GDP expected to advance 4.7%. This pace would represent a slight slowdown from the 5% growth expected for 2025 as a whole.

In Europe, as mentioned above, several economies lost momentum midyear, partly due to protectionist US tariffs. Germany has been hit hardest, with no growth since the first quarter. Germany's export profile means that its effective tariff is higher than France's or Italy's (graph 3 on page 5). As a result, German exports to the US are down 22.5%, compared to 1.2% and 17.4% drops for France and Italy, respectively.

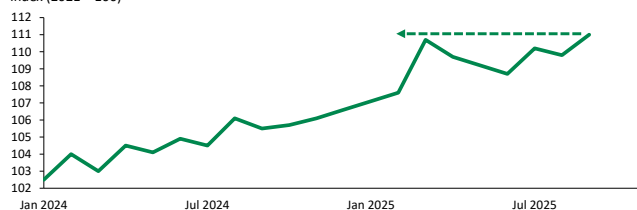
Fortunately, eurozone countries, Germany included, are seeing some light at the end of the tunnel. Some indicators have improved lately: PMIs have risen in recent months, especially on the services side. The eurozone composite PMI even hit its highest level since May 2023 in November (graph 4 on page 5). Business and household confidence indexes have also stopped

Graph 1

Growth in Global Trade Slowed but Didn't Stall

CPB world trade volume index

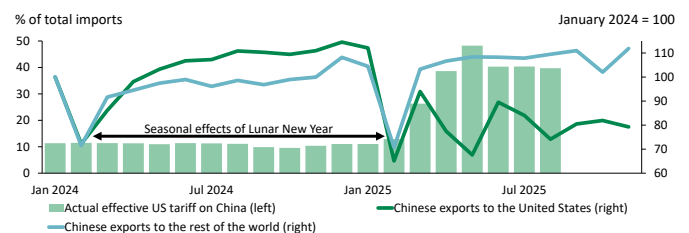
Index (2021 = 100)



CPB Netherlands Bureau for Economic Policy Analysis and Desjardins Economic Studies

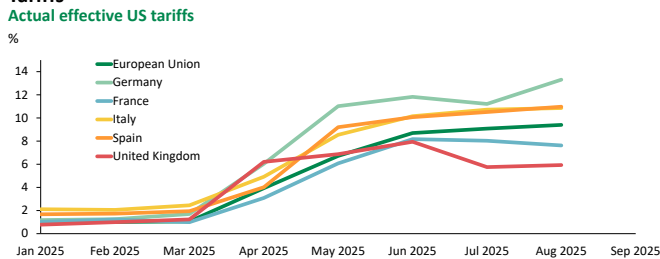
Graph 2

China's Exports to the United States Have Clearly Suffered from Higher US Tariffs



U.S. International Trade Commission, National Bureau of Statistics of China and Desjardins Economic Studies

Graph 3
Germany's Export Profile Means That It Is Subject to Relatively High US Tariffs



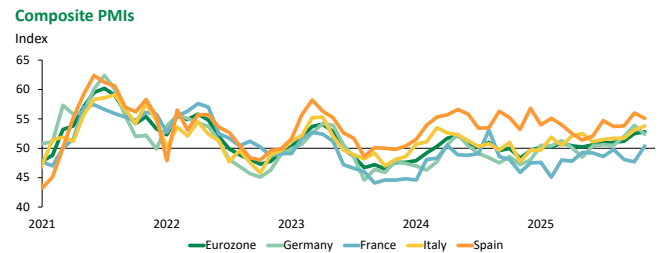
U.S. International Trade Commission and Desjardins Economic Studies

deteriorating. The positive effects of a pickup in investment, particularly in defence, are expected to boost economic growth further in 2026 and 2027. The eurozone economy should also benefit from much less restrictive monetary policy than in previous years. However, we'll have to keep an eye out for unexpected developments given how politically fragile several governments are, especially in Germany and France.

Geopolitical issues are likely to remain front and centre in 2026. Despite negotiations, the war in Ukraine continues, and the United States and European Union remain at odds over the strategy to adopt towards Russia. The situation in the Pacific is also on a knife edge, with tensions over Taiwan ramping up recently between China, Japan and South Korea. Finally, American pressure on the Venezuelan regime and South American drug traffickers appears to be escalating, and military intervention could rapidly intensify.

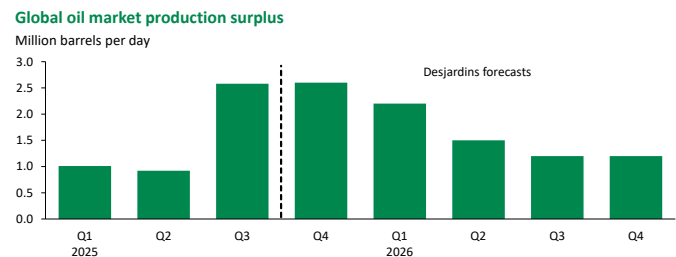
Despite the tense international environment, the global oil market could post a record surplus in 2026. This imbalance is primarily due to increased supply (graph 5). At the same time, demand has been rather sluggish since this summer and may remain low, which explains the recent drop in oil prices. Nevertheless, we expect to see the price of West Texas Intermediate (WTI) recover some of its lost ground, with a 2026 year-end price target of around US\$65 per barrel.

Graph 4
Eurozone Composite PMIs Have Improved



S&P Global, Datastream and Desjardins Economic Studies

Graph 5
A Global Oil Market Glut



International Energy Agency, Datastream and Desjardins Economic Studies

United States

The Fog Is Slowly Lifting

FORECAST

The delay in publishing economic data means we're still waiting for the third-quarter GDP reading. We expect to see fairly strong growth that will likely moderate in the final quarter of 2025. Real GDP is expected to bounce back in early 2026. While the job market appears to be struggling at the moment, hiring should pick up modestly in the new year. The impact of tariffs on goods prices will likely drive inflation higher in the first half of 2026.

The six-week-long US government shutdown disrupted the flow of economic data, clouding the economic picture. That fog is now starting to lift, but certain key indicators—like real GDP for the third quarter—still hadn't been released as of this writing. For many indicators, very little monthly data has been released since September. Inflation and employment figures for November (including some October data) won't be released until later in December.

In the meantime, it's clear that US real GDP growth was robust over the summer. Even though real consumer spending weakened in September, it still rose at an annualized rate of 2.7% for the quarter as a whole. We also expect private investment, excluding non-residential construction, to post another substantial gain, driven once again by the AI boom.

However, the fourth quarter of 2025 is looking more subdued. The end of tax credits for electric vehicle purchases weighed on auto sales in October and November (graph 6). We also need to factor in the direct and indirect effects of the shutdown. Previous shutdowns temporarily affected economic activity. Since this shutdown was particularly long and far-reaching—even disrupting air traffic—it must have had a negative impact on real household disposable income in October and November, while retroactive pay for federal workers should fuel a rebound in December. Consumer confidence indexes also fell during the shutdown, further darkening the mood of households already frustrated by the rising cost of living.

What Should We Expect in 2026?

A temporary bump in income after the shutdown should stimulate growth in early 2026. We also expect the positive impacts of the *One Big Beautiful Bill Act's* tax cuts to become more evident over time, although they'll be partly offset by rising health care costs. Investment in developing and deploying artificial intelligence (AI) is likely to continue, though at a more moderate pace. The sector remains exposed to the risks of a bubble and correction.

The Trump administration's trade policy will likely keep making headlines in 2026. Other industries could be targeted by new sector-specific tariffs. The US Supreme Court is poised to decide the legality of the administration's "reciprocal" andentanyl-related tariffs. Our scenario doesn't expect any changes in this regard, and we see real imports and exports growing slowly in 2026. But we obviously still need to pay attention to the court's decision, as well as the outcome of the US mid-term elections and negotiations between the US, Canada and Mexico on extending CUSMA beyond 2036.

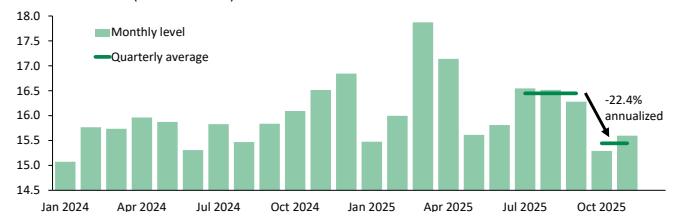
We're therefore forecasting 2.0% growth in US real GDP in 2026, slightly higher than the 1.9% expected for 2025. This reflects the relative resilience of the US economy, even in a very uncertain environment. But these projections are well below the 2.9% and 2.8% gains seen in 2023 and 2024.

This relatively modest growth should lead to a gradual improvement in the labour market. The final months of 2025 have been marked by the lagged effects of DOGE cuts to the federal government and the uncertainty created by the shutdown. We expect hiring to pick up in 2026, but at a slower pace than in previous years. Low immigration, impeded by the Trump administration's policies, and the lingering effects of trade uncertainty will limit the growth of the labour market.

Graph 6
Consumer Spending Made a Sluggish Start to the Fourth Quarter of 2025

United States – New car sales

Millions of vehicles (annualized rate)

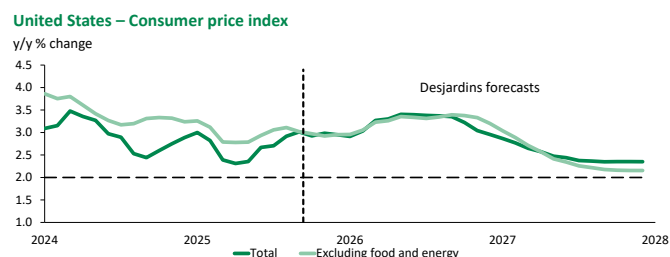


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As for inflation, the effects of existing tariffs should become more pronounced. Year-over-year growth in the consumer price index could climb from around 3% now to 3.5% by mid-2026 (graph 7). This upward trend, driven mainly by goods prices excluding energy, will likely prompt the Federal Reserve to remain cautious throughout the first half of the year. Of course, Jerome Powell's upcoming replacement as Fed chair in May could change everything.

Inflation should ease in 2027 as the impact of higher tariffs on year-over-year price increases fades. Slightly weaker real GDP growth of 1.8% will also help bring inflation closer to the 2% target.

Graph 7
US Inflation Is Not Expected to Spike but Will Remain Sticky in 2026



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Table 3

United States: Major Economic Indicators

Quarterly annualized % change (unless otherwise indicated)	2025		2026				Annual average			
	Q3f	Q4f	Q1f	Q2f	Q3f	Q4f	2024	2025f	2026f	2027f
Real GDP (2017 US\$)	2.7	0.4	2.4	2.1	1.9	1.8	2.8	1.9	2.0	1.8
Personal consumption expenditures	2.7	0.3	2.2	2.0	1.7	1.8	2.9	2.4	1.8	1.7
Residential construction	0.0	-2.6	-2.6	-0.8	0.3	0.5	3.2	-1.3	-1.6	1.0
Business fixed investment	5.1	2.9	2.0	2.2	1.7	1.8	2.9	4.4	2.9	2.3
Inventory change (2017 US\$B)	25.0	-40.0	-20.0	0.0	25.0	40.0	43.5	34.7	11.3	50.0
Public expenditures	1.2	-2.1	4.0	1.6	1.5	1.5	3.8	1.2	1.3	1.6
Exports	-7.0	-0.5	0.0	0.9	1.4	1.5	3.6	-0.3	-0.7	1.6
Imports	0.3	-10.0	1.2	1.6	2.0	2.0	5.8	2.7	-3.2	2.0
Final domestic demand	2.7	0.2	2.2	1.8	1.6	1.7	3.1	2.3	1.7	1.7
Other indicators										
Nominal GDP	5.1	3.2	6.2	4.6	4.9	4.2	5.3	4.5	4.9	4.1
Real disposable personal income	0.4	-0.7	3.2	1.2	1.1	1.9	2.9	1.8	1.4	1.6
Employment ¹	0.3	0.2	0.4	0.4	0.6	0.7	1.3	0.9	0.4	0.7
Unemployment rate (%)	4.3	4.3	4.3	4.3	4.4	4.3	4.0	4.2	4.3	4.2
Housing starts ² (thousands of units)	1,352	1,312	1,325	1,302	1,295	1,295	1,371	1,355	1,304	1,308
Corporate profits ³	5.5	0.5	2.2	2.5	2.5	3.0	5.1	3.9	2.6	0.0
Personal savings rate (%)	4.8	4.5	4.8	4.6	4.5	4.5	5.5	5.0	4.6	4.7
Total inflation rate*	2.9	3.0	3.1	3.4	3.4	3.1	3.0	2.8	3.2	2.5
Core inflation rate* ⁴	3.1	2.9	3.1	3.3	3.4	3.3	3.4	3.0	3.3	2.4
Current account balance (US\$B)	-1,053	-965	-975	-984	-993	-1,000	-1,185	-1,196	-988	-1,019

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

Datastream and Desjardins Economic Studies

Canada

We Wish You a Merry Christmas Before a Still Uncertain New Year

FORECAST

Canada's real GDP growth surprised on the upside in Q3 2025, driven by stronger net exports and higher federal defence spending. In the near term, reduced tariffs to US imports should act as a modest tailwind on consumption and investment. Looking to 2026, uncertainty persists amid a fragile trade environment and the upcoming CUSMA review. The outcome of the negotiations could be a critical turning point. Additional headwinds include slowing population growth, federal payroll cuts and rising mortgage renewals. Still, Budget 2025's tax cuts, spending and faster project approvals should lift growth beyond the Bank of Canada's outlook, helping to keep rates steady.

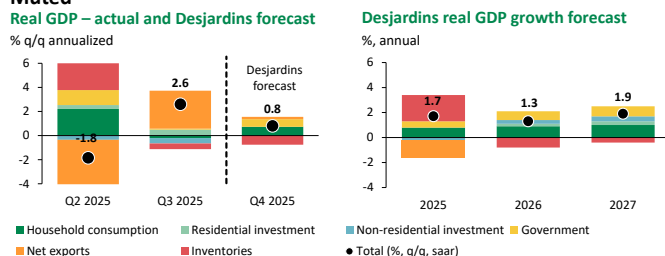
Canada's economy is full of surprises. At 2.6% q/q annualized, real GDP growth in Q3 2025 came in well above the 0.5% consensus of private sector forecasters and expectation of the Bank of Canada. Sharply lower imports caused net exports to lead the advance, while federal government spending on weapons systems skyrocketed. At the same time, final domestic demand lost ground for the second time this year. However, we don't think this surging pace of growth will be repeated Q4 (graph 8). [The removal of tariffs on Canadian imports from the US](#) as of September 1 should boost imports and modestly support consumption and business investment, as lower costs ease pressures on household and business budgets. As such, we anticipate a smaller contribution from net exports and stronger domestic demand to end the year.

Looking ahead to 2026, the uncertainty persists, in many ways similar to what we experienced at the time of our December 2024 Economic and Financial Outlook (EFO). Today's trade environment is one of an uneasy truce, with Canada facing one of the lowest effective tariff rates among major US trading partners. We expect this to continue through the first half of 2026 despite higher tariffs applied to some specific goods (graph 9). However, the Canada-United States-Mexico

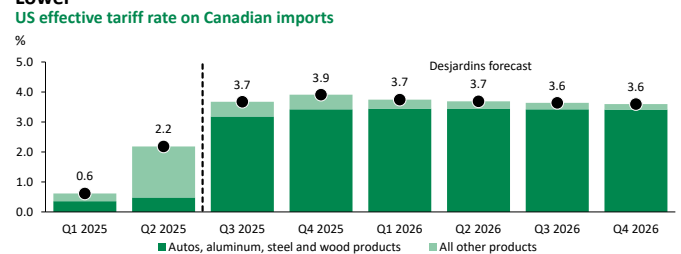
Agreement (CUSMA) joint review on July 1, 2026, is expected to add renewed volatility to trade policy in the first half of the year. This uncertainty is likely to delay investment until there is greater clarity on what comes next. The review must conclude by Canada Day, when signatory countries decide on extending CUSMA. If approved, the trade deal runs for another 16 years, with the next review taking place in 2032. However, if no agreement for an extension is reached, CUSMA will remain in place but will be subject to joint reviews annually until the agreement expires in 2036. The prospect of annual joint reviews risks entrenching the uncertainty Canadians are currently subject to. Notably, this process is separate from CUSMA's withdrawal procedure, which allows any party to exit with six months' written notice. (Note that an extensive analysis on our expectations for future tariff rates will be included in an upcoming Economic Viewpoint.)

While the US trade war is the primary headwind facing the Canadian economy, there are several others that remain a going concern. The first is [slowing population growth](#), which has contributed to the weakness in Canadian hiring this year. This will be weighed down by further restraints introduced in the federal government's [Budget 2025](#). Planned reductions in federal government payrolls are also set to accelerate, adding a further

Graph 8
Q3 Real GDP Growth Surprised to the Upside But Q4 Should Be More Muted



Graph 9
Tariffs on US Imports of Canadian Goods Should Rise but then Move Lower



headwind to the outlook. Finally, ongoing mortgage renewals at higher interest rates are set to accelerate in 2026, as 5-year fixed rate mortgages taken out in 2021 are coming due.

While the federal Budget 2025 introduces some modest headwinds to economic growth in Canada, overall it should support the economy. Large deficits and fast-rising borrowing are funding tax cuts and spending intended to boost investment and productivity. Faster approvals for major projects should help bring forward economic benefits. This is expected to increase growth beyond the Bank of Canada's subdued outlook published just prior to the budget. When combined with our inflation forecast remaining near the Bank's 2% target, stronger fiscal policy-driven growth helps to reinforce our call for the central bank to stay on the sidelines through the end of next year.

Table 4
Canada: Major Economic Indicators

Quarterly annualized % change (unless otherwise indicated)	2025		2026				Annual average			
	Q3	Q4f	Q1f	Q2f	Q3f	Q4f	2024	2025f	2026f	2027f
Real GDP (2017 \$)	2.6	0.8	1.3	1.5	1.7	1.9	2.0	1.7	1.3	1.9
Final consumption expenditure [of which:]	-0.7	1.6	1.7	1.8	1.9	2.0	2.6	2.2	1.6	2.0
Household consumption expenditure	-0.4	1.3	1.4	1.5	1.7	1.8	2.2	2.2	1.4	1.8
Government consumption expenditure	-1.7	2.2	2.6	2.6	2.7	2.8	3.8	2.3	2.1	2.8
Gross fixed capital formation [of which:]	2.3	0.6	2.1	2.6	2.9	3.3	0.7	1.0	2.0	3.3
Residential structures	6.7	0.0	2.3	2.8	3.6	4.4	-0.2	1.8	2.9	3.8
Non-residential structures	-1.0	-0.9	2.0	2.9	3.0	3.5	-1.7	1.0	1.7	3.8
Machinery and equipment	-10.5	0.5	1.1	1.5	1.9	2.1	-1.0	-3.7	-1.7	2.5
Intellectual property products	-2.4	0.9	1.8	1.9	1.9	1.9	2.2	0.8	0.9	2.1
Government gross fixed capital formation	12.2	4.0	3.3	3.8	3.8	4.0	6.1	3.7	4.9	4.1
Investment in inventories (2017 \$B)	23.7	19.8	17.0	14.3	11.8	9.5	6.5	19.1	13.1	4.3
Exports	0.7	1.4	2.6	3.3	3.7	4.3	0.9	-2.9	0.5	3.7
Imports	-8.6	0.8	2.6	3.2	3.7	4.3	0.7	-0.5	0.9	3.6
Final domestic demand	-0.1	1.4	1.8	2.0	2.2	2.4	2.2	1.9	1.7	2.4
Other indicators										
Nominal GDP	5.9	3.3	4.3	3.0	3.5	3.9	4.8	4.3	3.6	4.0
Real disposable personal income	0.0	2.1	-0.5	3.0	-0.3	1.8	4.8	2.2	1.0	1.1
Employment	-0.1	2.6	-0.1	0.6	0.8	1.4	1.9	1.5	0.8	0.8
Unemployment rate (%)	7.0	6.7	6.8	6.8	6.7	6.6	6.4	6.8	6.7	6.6
Housing starts ¹ (thousands of units)	272	255	265	272	273	274	245	258	271	281
Corporate profits* ²	6.6	4.1	3.9	9.9	7.4	6.0	-2.3	6.5	6.7	3.5
Personal savings rate (%)	4.7	5.0	4.6	4.9	4.5	4.5	5.0	4.9	4.6	4.0
Total inflation rate*	2.0	2.2	2.2	2.2	2.0	1.9	2.4	2.0	2.1	2.0
Core inflation rate* ³	2.5	2.4	2.4	1.9	2.0	2.0	2.6	2.5	2.1	2.1
Current account balance (\$B)	-9.7	-13.4	-13.7	-13.0	-13.0	-12.6	-15.0	-47.7	-52.2	-50.0

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

Datastream and Desjardins Economic Studies

Quebec

A Brief Upswing, but Long-Term Potential Has Been Revised Downward

FORECAST

Real GDP growth for 2025 has been revised slightly upward, reflecting past revisions that show Quebec entered the year in a stronger position than expected. Solid domestic demand and strong residential construction have helped offset some of the impact of the trade war and likely spared Quebec's economy from a technical recession. For 2026, little change is in the cards: government operating expenditures will curb growth, household consumption will level off and CUSMA's fate remains uncertain. Demographic pressures will also weigh on potential GDP. Job creation should remain modest overall, as most Quebecers live in regions unaffected by cyclical unemployment.

While we await data for the third quarter of 2025, which was marked by a sharp rebound in Canada's real GDP (+2.6% on an annualized basis), Quebec entered the year in a stronger position than expected, with 2024 growth revised upward from 1.3% to 1.7%. High-frequency indicators show that consumer spending moderated in the fall but remained elevated. Robust [residential construction](#) (graph 10) was also among the key factors that likely helped Quebec avoid a technical recession during a year overshadowed by the trade conflict with the US.

GDP by industry data continue to point to persistent weaknesses, particularly in manufacturing, agriculture and forestry—all of which, based on available data, remained in contraction territory through the third quarter. The November [budget update](#) granted the latter two sectors a payroll tax holiday to help preserve capacity over the longer run. Exports remain vulnerable amid US protectionist measures. Partial data from the Institut de la statistique du Québec suggest that international exports have failed to rebound in the third quarter following a steep decline in the previous quarter. Shipments of aluminum and aluminum products, aircraft, lumber, chemicals and a number of metals continued to decline, albeit at a slower pace.

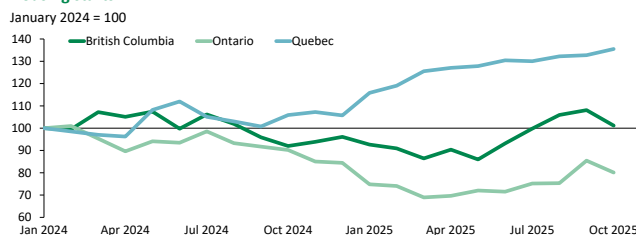
On a brighter note, the labour market has remained resilient over the past six months. The provincial government also brought in more [revenue](#) than expected, reducing the deficit for the current fiscal year by \$1.5 billion before contributions to the Generations Fund.

What does this mean for 2026? Overall, projected real GDP growth remains unchanged at 1.1%. However, CUSMA review pose a downside risk. Consumer spending held up well this year, but future gains will be constrained by limited purchasing power, stagnant population growth and heightened uncertainty. A slowdown in government spending will further weigh on growth. Over the next four fiscal years, provincial expenditures are expected to rise by only 1.5% annually (graph 11)—a historically low pace that would mark the longest period of spending restraint in the past 25 years.

Beyond 2026, assuming no major economic shocks, demographic trends will be the main factor weighing on potential growth. Targets for NPRs have now been revised downward. Combined with recently announced (permanent) immigration targets, this adjustment brings the population back below the trajectory projected before NPR numbers temporarily spiked (graph 12 on page 12). While the population ages 15 and over is expected to

Graph 10
Since 2024, Residential Construction Has Grown Faster in Quebec than in Ontario and BC

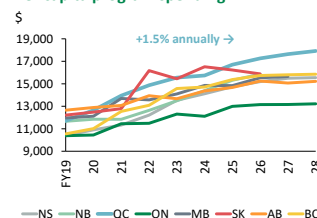
Housing starts



Canada Mortgage and Housing Corporation and Desjardins Economic Studies

Graph 11
Per Capita Spending Remains Higher in Quebec than in Other Provinces

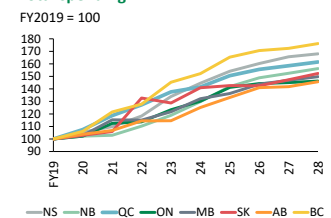
Per capita program spending



FY: Fiscal year

Provincial budget documents and Desjardins Economic Studies

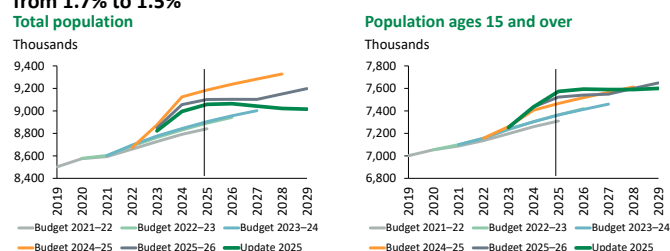
Total spending



hold steady, a significant increase in the number of seniors will tighten the labour pool. Government models reflect this reality: expected real GDP growth in four years has been revised down from 1.7% to 1.5%—and even that may prove optimistic without an acceleration in productivity growth.

Why should this concern us? Quebec's unemployment rate remains low, just above 5%. However, nearly [two-thirds of Quebecers](#) live in administrative regions where unemployment is below the natural rate—around 4.5% to 5%, the rate typically associated with normal job turnover. In a context of persistently weak investment, looming recruitment challenges could reduce the feasibility of ambitious projects.

Graph 12
Population Growth Revised Lower; Potential GDP Reduced from 1.7% to 1.5%



Update on Quebec's Economic and Financial Situation (budget update)
Quebec government budget documents and Desjardins Economic Studies

Table 5

Quebec: Major Economic Indicators

Annual average % change (unless otherwise indicated)	2023	2024	2025f	2026f	2027f
Real GDP (2017 \$)	0.6	1.7	0.9	1.1	1.6
Final consumption expenditure [of which:]	0.7	3.2	2.4	1.0	1.0
Household consumption expenditure	1.8	3.2	3.1	1.6	1.6
Government consumption expenditure	-1.7	3.3	0.8	-0.3	-0.2
Gross fixed capital formation [of which:]	-3.7	-0.1	3.6	1.7	1.6
Residential structures	-15.1	2.8	12.8	1.7	0.4
Non-residential structures	5.9	-0.7	-2.4	1.6	4.1
Machinery and equipment	-6.3	-1.2	-1.2	-0.8	2.4
Intellectual property products	4.2	0.3	1.8	1.0	1.9
Government gross fixed capital formation	7.2	-2.4	-1.8	3.5	1.0
Investment in inventories (2017 \$B)	6	3	1	1	0
Exports	4.0	0.8	-2.0	1.7	3.3
Imports	-0.8	2.3	2.0	1.6	2.3
Final domestic demand	-0.2	2.6	2.6	1.1	1.1
Other indicators					
Nominal GDP	5.0	5.4	3.9	3.4	3.9
Real disposable personal income	0.1	5.2	2.0	2.4	2.0
Weekly earnings	3.6	4.5	4.4	2.8	2.8
Employment	2.9	0.9	1.7	0.7	0.6
Unemployment rate (%)	4.5	5.3	5.6	5.2	5.2
Personal savings rate (%)	7.8	9.9	8.8	9.0	9.1
Retail sales	3.7	2.1	3.8	5.0	4.7
Housing starts ¹ (thousands of units)	38.9	48.7	59.8	62.1	60.3
Total inflation rate	4.5	2.3	2.4	2.0	2.0

f: forecast; ¹ Annualized basis.

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

Medium-Term Forecast

Is This the Start of a New Normal?

Our scenarios assume current tariffs will remain in place, so we expect trade with the United States to continue to be affected. Despite this new reality, we believe economic growth can regain momentum and stabilize at a satisfactory level. But some adjustments are necessary. If the United States reduces its net imports, many countries will have to rely more on domestic demand. We expect business investment to increase given the many opportunities arising from the AI boom and the energy transition, which has continued in many countries, albeit at a slower pace. Governments should also help accelerate investment, aside from increasing military spending in response to heightened geopolitical risks.

A New Investment Cycle

The United States is currently reaping the economic benefits of an investment boom. This boom, which helps counterbalance weaknesses in the US economy, has mainly been fuelled by the rapid push toward AI. The AI boom is expected to spread to other countries in the coming years. However, the scale of investment may be smaller than what we've seen recently in the United States, where an increasing number of analysts are drawing parallels with the 1990s dotcom bubble. We're expecting growth in AI investments to remain strong, without tipping into excess. There's more to this boom than microchip development and the rush to build data centres. It also reflects AI's broader potential, including new applications and the parallel investments they could generate.

But There's More to This Story than AI

The potential for increased investment is also high in several other sectors, especially for anything related to the energy transition and climate change adaptation. Environmentalism may have fallen out of favour in the United States, but that doesn't mean the planet will stop getting warmer. We're already close to 1.5°C above pre-industrial levels. Unless major investments are made, we may be unable to avoid increasingly extreme weather events 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 expanded military budgets and increased investment in defence industries. Member states of the North Atlantic Treaty Organization (NATO) have pledged to increase their defence spending as geopolitical risks grow. 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.

A Demographic Regime Shift

Some trends are becoming increasingly clear all over the world. Birth rates are falling, and so is population growth. In some countries, these trends are more pronounced, with expected impacts on potential economic growth and other variables like unemployment rates.

Canada isn't immune to these trends. In recent years, population growth accelerated, fuelled by higher immigration. But immigration targets have now been revised downward for both non-permanent residents and regular immigrants. As a result, population growth will slow in the years to come.

This shift will be particularly noticeable in Quebec, where we're forecasting minimal population growth based on recent government announcements. When we look at people ages 15 to 64, who make up most of the workforce, our forecast shows a modest decline, signalling a potential reduction in the labour pool. Ultimately, Quebec's potential economic growth should settle below 1.5% in the medium term. Very little of this growth would be driven by an increase in the number of workers. Instead, most of it would result from productivity gains. Meanwhile, unemployment will likely end up somewhere around 4%, which means an increasing number of businesses could face labour shortages.

Table 6
Major Medium-Term Economic and Financial Indicators

% (unless otherwise indicated)	Annual average							Averages	
	2024	2025f	2026f	2027f	2028f	2029f	2030f	2020–2024	2025–2030f
United States									
Real GDP (% change)	2.8	1.9	2.0	1.8	1.8	2.0	1.9	2.5	1.9
Total inflation rate (% change)	3.0	2.8	3.2	2.5	2.0	2.0	2.0	4.2	2.4
Unemployment rate	4.0	4.2	4.3	4.2	4.1	4.0	4.0	4.9	4.1
S&P 500 index (% change) ¹	23.3	17.5	9.6	11.4	10.8	7.7	8.6	15.4	10.9
Federal funds rate	5.31	4.25	3.50	3.25	3.25	3.25	3.25	2.03	3.46
Prime rate	8.31	7.25	6.50	6.25	6.25	6.25	6.25	5.63	6.46
Treasury bills – 3-month	5.18	4.13	3.35	3.10	3.10	3.10	3.10	1.98	3.31
Federal bonds – 10-year	4.21	4.15	4.09	4.05	4.05	4.05	4.05	2.28	4.07
– 30-year	4.41	4.70	4.71	4.65	4.65	4.65	4.65	2.68	4.67
WTI oil (US\$/barrel)	77	66	60	64	65	70	70	67	66
Gold (US\$/ounce)	2,387	3,420	4,242	4,218	4,025	3,838	3,688	1,742	3,905
Canada									
Real GDP (% change)	2.0	1.7	1.3	1.9	1.9	1.7	1.7	2.9	1.7
Total inflation rate (% change)	2.4	2.0	2.1	2.0	2.0	2.0	2.0	3.4	2.0
Employment (% change)	1.9	1.5	0.8	0.8	0.9	1.1	1.1	1.7	1.0
Employment (thousands)	382	306	159	160	194	244	243	332	218
Unemployment rate	6.4	6.8	6.7	6.6	6.4	6.3	6.2	6.8	6.5
Housing starts (thousands of units)	245	258	271	281	285	288	291	248	279
S&P/TSX index (% change) ¹	18.0	28.5	11.4	9.1	8.5	6.4	8.0	8.3	12.0
Exchange rate (US\$/C\$)	0.73	0.72	0.73	0.76	0.79	0.80	0.80	0.76	0.76
Overnight rate	4.59	2.56	2.25	2.44	2.75	2.75	2.75	2.42	2.58
Prime rate	6.75	4.76	4.45	4.64	4.95	4.95	4.95	4.61	4.78
Mortgage rate – 1-year	7.64	5.40	4.60	4.70	4.80	4.85	4.85	5.05	4.87
– 5-year	6.73	6.00	5.80	5.50	5.60	5.70	5.70	5.76	5.72
Treasury bills – 3-month	4.37	2.47	2.23	2.55	2.75	2.75	2.75	2.37	2.58
Federal bonds – 2-year	3.67	2.51	2.44	2.69	2.80	2.80	2.80	2.37	2.67
– 5-year	3.30	2.77	2.66	2.86	3.00	3.00	3.00	2.24	2.88
– 10-year	3.34	3.19	3.13	3.16	3.25	3.25	3.25	2.32	3.21
– 30-year	3.33	3.54	3.50	3.46	3.50	3.50	3.50	2.50	3.50
Yield spreads (Canada–United States)									
Treasury bills – 3-month	-0.81	-1.66	-1.12	-0.55	-0.35	-0.35	-0.35	-0.23	-0.73
Federal bonds – 10-year	-0.87	-0.96	-0.96	-0.89	-0.80	-0.80	-0.80	-0.37	-0.87
– 30-year	-1.08	-1.16	-1.21	-1.19	-1.15	-1.15	-1.15	-0.55	-1.17
Quebec									
Real GDP (% change)	1.7	0.9	1.1	1.6	1.6	1.5	1.5	1.6	1.4
Total inflation rate (% change)	2.3	2.4	2.0	2.0	2.0	2.0	2.0	3.6	2.1
Employment (% change)	0.9	1.7	0.7	0.6	0.6	0.6	0.7	1.3	0.8
Employment (thousands)	39	78	31	29	29	27	31	53	37
Unemployment rate	5.3	5.6	5.2	5.2	5.2	4.9	4.5	5.8	5.1
Retail sales (% change)	2.1	3.8	5.0	4.7	4.7	4.0	3.1	6.1	4.2
Housing starts (thousands of units)	49	60	62	60	60	61	62	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