

ECONOMIC AND FINANCIAL OUTLOOK

Oil Shocks Keep Coming, but No Two Are Alike

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

In December’s Economic and Financial Outlook, titled *More of the Same in 2026*, we maintained that the global economy would spend the year grappling with forces that were already in motion. Three months in, we stand behind this assertion. But Q1 also introduced a new inflection point: two US military interventions in rapid succession, first in Venezuela and then in Iran. We may have feared that such events were possible, but we would never have officially predicted them.

But these new shocks aren’t exactly “shocking.” The tensions in key oil-rich regions are longstanding, and we understand how these conflicts can impact energy prices. It may feel natural to compare recent events with Russia’s invasion of Ukraine in 2022, but that comparison rapidly reaches its limits once we take the two economic climates into account.

Back in 2022, the economy was brimming with pent-up, post-pandemic demand. The labour market was tight, and businesses were easily able to pass along additional costs. When the energy shock hit this economy, filled with surplus demand, it helped kick off an inflationary spiral.

But today’s world is markedly different. Before these military interventions, the oil market was more than abundantly supplied and prices were constrained. Labour markets have been softening in most advanced economies, unemployment rates have begun to climb and economic growth has begun to show signs of slowing. The surplus demand that helped amplify prices in 2022 no longer exists.

This change in context means that the current shocks are having a different macroeconomic impact. Higher energy prices haven’t sent inflation spiralling; instead, they’re acting as a negative shock to income and weighing on global demand when it has already been weakened. This means that the biggest risk here will be the combination of tepid growth and stubborn inflation, not a rush of widespread inflation. It should be noted, however, that rising natural gas prices could put upward pressure on fertilizer costs and ultimately on food prices in the long term. This happened with Ukraine back in 2022 and could happen again now.

These events, against the generally stagflationary backdrop, will make conducting monetary policy a more delicate task. Both the Federal Reserve and the Bank of Canada are facing an uncomfortable choice: they can either support economic activity and risk driving inflation higher, or they can fight inflation and risk a more substantial slowdown. Let’s examine the factors that will help central banks make their final decisions.

For Canada, the situation requires a clear reading of everything in play. As a net exporter of oil, the country is benefiting from higher energy prices in the short term. But while the terms of trade are improving overall, gains are partial and not equally distributed. And this very targeted bright spot exists within a larger landscape that is gloomier as a whole. Year to date, the country has shed around 100,000 jobs. Many real estate markets remain bogged down. Public finances have deteriorated, both at the federal level and in many provinces. Exports to the United States have softened due

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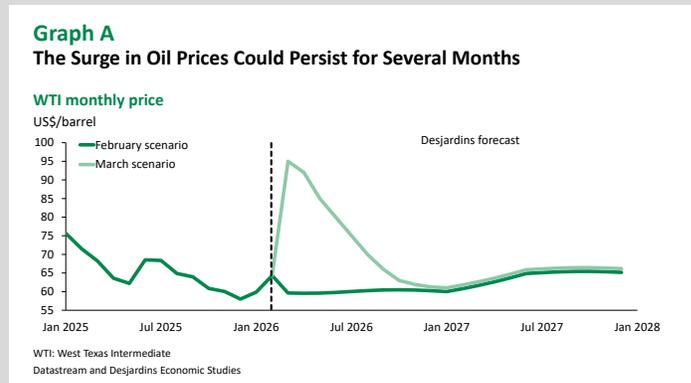
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BOX
Hypotheses Concerning the Conflict in the Middle East

The conflict in Iran and the escalation of regional tensions have triggered the most significant oil supply shock in recent memory. This has resulted in an abrupt contraction in global production of roughly 10%, with the risk that the decline could reach as much as 20%. Although the drop is primarily attributable to the closure of the Strait of Hormuz, energy infrastructure in several Gulf countries has also been targeted by Iran. These disruptions have rapidly pushed international energy prices higher.

In our baseline scenario, we assume that the production disruptions in the Middle East, combined with a partial or full closure of the Strait of Hormuz, will persist for roughly two months before gradually easing. We also assume that Iran's oil and natural gas production will remain negligible throughout the forecast horizon. The conflict could, however, extend over a longer period. In that case, its effects on oil supply and on the global economy would likely diminish, provided that the main export routes remain operational. Conversely, the conflict could subside more quickly, but that seems unlikely for the moment.

Against this backdrop, we expect the price of West Texas Intermediate (WTI) to hold near US\$95 per barrel during the disruption period (graph A). Moreover, the increase in energy prices is expected to be more pronounced in Asia, where dependence on Middle Eastern energy supplies is higher. Natural gas prices should also remain elevated in Europe and Asia. Once maritime passage is restored and supply gradually resumes, energy prices should begin to ease.



to the ongoing trade tensions, and while exports to other countries have grown, they're still far from being a viable replacement for our largest trading partner. What's more, the Canada-United States-Mexico Agreement (CUSMA) is up for review. The outcome of this review is still uncertain—and this uncertainty is already generating additional real costs for Canadian businesses. Altogether, risks seem tilted firmly to the downside in the short term.

In the medium term, though, there are glimmers of hope. The country's efforts to diversify trade relations and strengthen its defence capabilities are part of a necessary strategic repositioning that will eventually bear fruit. At the same time, Canada is more explicitly open to doing business, and its appeal as a destination for foreign investment is growing. But all of these developments do take time. They won't move the needle on current economic constraints.

The biggest lesson we've learned in 2026 so far may be this: Economic shocks can't be analyzed outside of the environment in which they occur. And the environment we're in now is quite different from the one that prevailed up until recently. The adjustments we've made to our projections reflect this shift, while acknowledging that the economy remains in flux, as does the geopolitical framework underpinning it.

RISKS INHERENT IN OUR SCENARIOS

The global geopolitical situation has deteriorated, exacerbated by the war in Iran, which has spread throughout the entire Persian Gulf region. The main risks to our scenarios are a prolonged conflict or spillover to other countries (including the possibility of terrorist acts in the West). If this occurs, energy prices will likely rise to higher levels than expected in our baseline, and supply chains could experience further disruptions. Consumer, business and investor confidence could collapse. This set of circumstances would bring about subdued economic growth, if not a global recession, and very elevated inflation. Beyond the Middle East, tensions remain elevated. Diplomatic and economic relations between the United States and other advanced economies are fragile. The US administration is working on new ways to impose tariffs after the Supreme Court ruling, and the threat of new measures is keeping uncertainty high. Central banks may need to lower their key interest rates if the economy deteriorates more than expected. Conversely, monetary policy may need to be tightened if inflation spikes due to spillover from higher energy prices, new tariffs or supply chain disruptions. Later this year, the focus will also be on the CUSMA review and the midterm elections, both of which could disrupt the economy. A sharp correction in the stock market, which has benefited from an AI boom, could shake confidence and trigger a wealth effect shock, while volatility in bond, currency and commodity prices could weaken the outlook for the global economy.

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

%	Weight*	Real GDP growth			Inflation rate		
		2025	2026f	2027f	2025	2026f	2027f
Advanced economies	36.9	1.7	1.5	1.6	2.4	2.5	1.9
United States	14.8	2.1	2.3	1.9	2.7	3.0	2.1
Canada	1.4	1.7	1.2	2.1	2.1	2.3	1.8
<i>Quebec</i>	0.3	0.7	1.0	1.7	2.4	2.3	2.0
Japan	3.2	1.2	0.2	0.9	3.2	2.1	1.6
United Kingdom	2.1	1.3	0.6	1.3	3.4	2.9	2.0
Eurozone	11.5	1.5	1.0	1.5	2.1	2.2	1.7
<i>Germany</i>	3.1	0.4	0.7	1.4	2.2	2.4	1.8
<i>France</i>	2.1	0.9	1.0	1.2	0.9	1.6	1.4
<i>Italy</i>	1.8	0.7	0.7	1.0	1.5	1.8	1.5
Other countries	3.8	1.5	1.8	2.0	2.0	2.3	1.8
<i>Australia</i>	1.0	2.0	2.0	2.1	2.8	3.5	2.4
Emerging and developing economies	63.1	4.2	3.8	4.0	5.2	5.4	4.1
Emerging Asia	33.7	5.5	4.8	5.0	0.9	1.9	2.0
<i>China</i>	19.3	5.0	4.4	4.5	0.1	0.7	1.0
<i>India</i>	8.2	7.6	6.5	6.5	2.2	4.2	4.2
Latin America	5.7	2.1	1.8	2.3	4.2	4.1	3.4
<i>Mexico</i>	1.7	0.6	1.4	1.9	3.8	4.0	3.4
<i>Brazil</i>	2.4	2.6	1.5	2.0	4.8	4.2	3.5
Eastern Europe	8.2	2.2	2.1	2.5	14.1	10.2	7.5
<i>Russia</i>	3.5	1.0	0.7	1.2	8.7	5.5	4.1
Other countries	15.4	2.7	2.7	3.2	12.5	15.0	11.0
<i>South Africa</i>	0.5	1.4	1.5	1.9	3.2	3.7	3.3
World	100.0	3.2	3.0	3.2	4.2	4.3	3.3

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

North American central banks have more scope to look through the recent energy price shock more than their European and Asian counterparts, with the Bank of Canada harbouring the greatest flexibility. With headline inflation close to target and economic activity weak, the risk of broader inflation spillover is limited, allowing Canadian policymakers to remain patient. The Federal Reserve faces a very different backdrop. Inflation has remained sticky above the central bank's target and current conditions risk further delays. While rate cuts later this year remain our base case, they are contingent on a near-term de-escalation in geopolitical tensions.

The rotation into non-US equities has stalled, with European and Asian equities being hit hard by the impacts of higher energy prices. In Canada, falling precious metal prices have weighed on the TSX, although higher energy prices are providing a slight offset. The US equity outlook has been revised lower amid upside inflation risks and fewer expected rate cuts. In FX markets, USDCAD remains broadly stable, with the Canadian dollar expected to trade sideways against the US dollar while appreciating modestly versus the euro, pound sterling, and yen over the next three months.

Table 2
Summary of Financial Forecasts

End of period in % (unless otherwise indicated)	2025		2026				2027			
	Q3	Q4	Q1f	Q2f	Q3f	Q4f	Q1f	Q2f	Q3f	Q4f
Key interest rate										
United States	4.25	3.75	3.75	3.75	3.50	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	2.00	2.00	2.25	2.25	2.25	2.25	2.25	2.50
United Kingdom	4.00	3.75	3.75	3.75	3.50	3.50	3.50	3.25	3.25	3.25
Federal bonds										
<u>United States</u>										
2-year	3.65	3.49	3.80	3.55	3.40	3.25	3.25	3.25	3.25	3.25
5-year	3.72	3.70	3.90	3.70	3.60	3.50	3.50	3.50	3.50	3.50
10-year	4.13	4.14	4.30	4.15	4.05	4.05	4.05	4.05	4.05	4.05
30-year	4.73	4.84	4.85	4.75	4.70	4.70	4.70	4.70	4.70	4.70
<u>Canada</u>										
2-year	2.47	2.58	2.85	2.50	2.40	2.50	2.55	2.65	2.70	2.75
5-year	2.74	2.96	3.05	2.85	2.70	2.70	2.75	2.80	2.90	3.00
10-year	3.17	3.42	3.45	3.30	3.20	3.15	3.15	3.15	3.20	3.25
30-year	3.61	3.85	3.85	3.75	3.60	3.55	3.55	3.55	3.55	3.60
Currency market										
Canadian dollar (USD/CAD)	1.39	1.37	1.37	1.35	1.35	1.34	1.33	1.31	1.30	1.28
Canadian dollar (CAD/USD)	0.72	0.73	0.73	0.74	0.74	0.75	0.75	0.76	0.77	0.78
Euro (EUR/USD)	1.17	1.18	1.12	1.12	1.15	1.18	1.19	1.20	1.21	1.22
British pound (GBP/USD)	1.33	1.35	1.28	1.28	1.30	1.30	1.31	1.32	1.34	1.35
Yen (USD/JPY)	148	157	160	165	160	155	151	147	143	140
Stock markets (level and growth)*										
United States – S&P 500	6,800 (16.4%)		Target: 7,300 (+7.1%)				Target: 8,100 (+10.8%)			
Canada – S&P/TSX	31,700 (28.2%)		Target: 35,200 (+11.1%)				Target: 39,900 (+13.3%)			
Commodities (annual average)										
WTI oil (US\$/barrel)	76 (60*)		73 (61*)				65 (66*)			
Gold (US\$/ounce)	3,420 (4,100*)		5,020 (5,200*)				5,190 (5,125*)			

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

Datastream and Desjardins Economic Studies

Overseas

The Global Economy Is Shrouded in the Fog of War

FORECAST

Signs for the global economy were quite positive in the first few months of 2026. The oil shock arising from the conflict in the Persian Gulf has, however, clouded the outlook and forced us to downgrade our real GDP growth forecasts for major global economies (albeit only slightly for now). Global real GDP should increase by 3.0% in 2026 and 3.2% in 2027. Obviously, the slowdown could become more severe if the crisis worsens. Inflation, which had been easing in most countries, is expected to rise, at least temporarily.

In Europe, real GDP growth slowed slightly between the summer and fall of 2025. Net exports made a negative contribution to growth for the third quarter in a row. That said, Germany has emerged from a technical recession, with its first quarterly gains since winter 2025. Its economy remains fragile, however, with industrial production posting significant consecutive monthly decreases in December (-1.0%) and January (-0.6%). Germany is still burdened by its industrial sector, which has been hobbled by the rather sluggish international economic climate and US protectionist policy. The country's exports to the United States have plummeted 25% since their peak in early 2025. However, things were going relatively well for the European economy before the conflict in the Middle East began. Recent PMIs were generally trending up in the first few months of 2026, suggesting that economic growth would continue through the first quarter of the year. The United Kingdom was in a similar situation. While real GDP growth had cooled a bit in Q4 2025, several economic indicators did improve in January and February, including the purchasing managers indexes. Inflation had also slowed, though it was still higher than in the eurozone.

Trump's reciprocal tariffs were struck down by the Supreme Court and replaced with a temporary 10% tariff, which should give a small boost to countries with significant exports to the United States. The sector-specific tariffs are still in place, but some countries, including China, who had been hit with higher "emergency" tariffs, should see their effective US tariff rates decrease (graph 1). This could help bolster world trade.

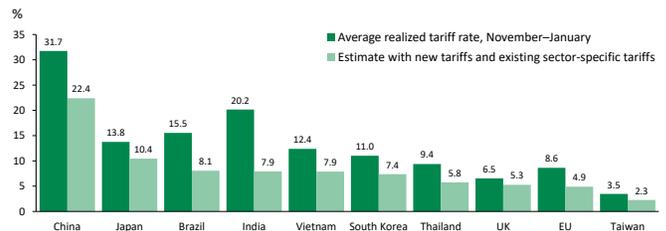
The relatively stable global conditions that prevailed up until February may be eclipsed by the conflict in the Gulf Region. Many countries, especially in Europe, were beginning to enjoy some newfound stability, four years after the war in Ukraine caused a widespread economic shock. Now, this new war in the Middle East is again jeopardizing global energy supplies.

That said, the global economy is less dependent on oil now than it was decades ago. While global real GDP is nearly five times larger than it was in the early 1980s, global oil consumption has only expanded one and a half times (graph 2). Today, one

Graph 1

The New US Tariffs Should Bring Effective Tariff Rates Down for Most Countries

United States – Effective tariff %

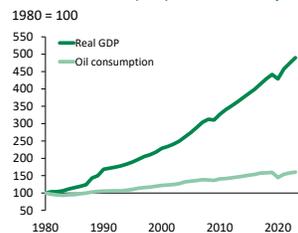


United States International Trade Commission and Desjardins Economic Studies

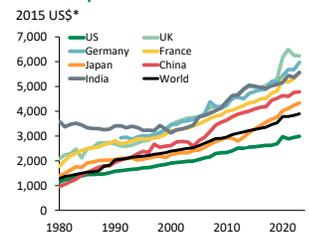
Graph 2

The Global Economy Is Much Less Dependent on Oil

World – Real GDP (PPP) and oil consumption



Real GDP per barrel



* Using purchasing power parity (PPP).
U.S. Energy Information Administration and Desjardins Economic Studies

barrel of oil generates nearly US\$4,000 (2015 dollars) in output, whereas that figure was below US\$1,300 in 1980. This suggests that the global economy is on more solid footing to weather the current storm.

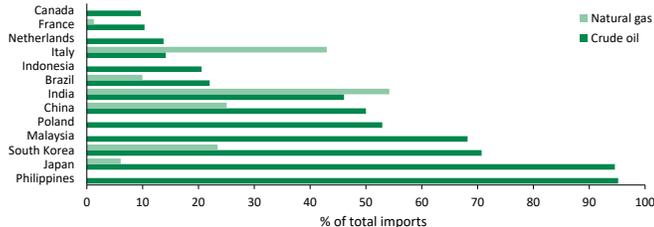
However, that doesn't mean that there won't be any difficulties in the near term. The surge in energy prices and new challenges in securing oil and gasoline will clearly have negative repercussions. But the damage won't be evenly distributed: There's a difference between depending on oil and specifically depending on oil from the Gulf. Many countries, mainly in Asia

but also in Europe, now find themselves in a bind because of where they source their oil (graph 3). They'll need to deal with a temporary spike in inflation, which will weigh on real household income, business profitability and sentiment. Confidence in the eurozone has been creeping up since spring 2025; this modest upward trend could easily reverse. The crisis is expected to shave a few tenths of a percentage point off European real GDP growth in 2026, particularly in the second quarter.

Graph 3

Most of Asia's Major Economies Rely on Oil Arriving via the Strait of Hormuz

% of crude oil and natural gas imports that pass through the Strait of Hormuz*



* According to 2024 data.

World Integrated Trade Solution, Kpler and Desjardins Economic Studies

The situation is even more worrying in Asia, where many economies remain heavily dependent on imports of oil and gas from the Middle East. In India, about 40% of crude oil imports pass through the Strait of Hormuz, and for China, the share is closer to 50%. Not surprisingly, energy prices in the Middle East and Asia rose more sharply than in the rest of the world. Against this backdrop, growth outlooks, which had been robust in Asia at the start of the year, were also cut by a few percentage points.

Japan avoided a technical recession, with growth of 0.3% in Q4 2025 after dropping 0.7% in the previous quarter. Although the country remains heavily dependent on Middle Eastern oil imports, which account for nearly 90% of its supply, it is also uniquely prepared to absorb the shock. Japan has about six months of strategic oil reserves, which is double the average of developed economies, giving it some leeway in the face of the current energy market volatility.

In China, real GDP ended 2025 with a solid quarterly increase of 1.2%, but the data available at the beginning of 2026 suggest that activity is faltering. The manufacturing and non-manufacturing PMIs fell to 49.0 and 49.5 respectively in February, signalling a return to contraction territory. Retail sales have rallied somewhat, but the recovery remains fragile. More broadly, China's economy remains hobbled by weak domestic demand, high public sector debt, the ongoing property crisis and generally depressed business and consumer confidence. As a result, we expect real GDP growth in 2026 to come in slightly below the central government's 4.5% target.

United States

A New Challenge for the US Economy

FORECAST

US economic growth was disappointing at the very end of 2025, but we expect real GDP to post stronger gains in the first quarter of 2026. But the surge in energy prices caused by the conflict in the Persian Gulf is a new stumbling block that will affect growth and real household disposable income. This shock shouldn't drag the US economy into a recession, but it could slow real GDP growth in second quarter and keep inflation above 3% this spring.

After two quarters where annualized real GDP gains came in close to 4%, the 0.7% increase posted in Q4 2025 was underwhelming and out of step with President Trump's claims that the US economy is running hot. While spending, investment and net export figures were all more moderate than expected, the largest detractor was government spending. Because of the shutdown from early October to mid-November, federal spending fell an annualized 16.7% in the fourth quarter, trimming quarterly real GDP growth by 1.16 percentage points (graph 4). We should see a rebound in the first quarter of 2026, as federal spending resumes.

Graph 4
Government Shutdown Caused Government Spending to Plummet, Weighing on Real GDP Growth
 United States – Contributors to annualized quarterly real GDP growth



Bureau of Economic Analysis and Desjardins Economic Studies

The tax provisions of the [One Big Beautiful Bill Act](#), adopted in summer 2025, should also support growth. We're already seeing some of its effects: real household disposable income jumped 0.7% in January, thanks to a 3.2% cut to tax payments. This is the biggest monthly increase in three years. Income tax refunds are also up 10.6% so far in 2026, compared to 2025. But in spite of this boost, consumer spending has remained hesitant, with motor vehicle sales falling and overall household spending creeping up just 0.1% in January.

This lacklustre growth in spending, despite the tax relief measures, is probably caused by weakness in the job market. While gains were fairly solid in January, the month was flanked

by losses in both December and February, even in the private sector. In fact, total employment was lower in February 2026 than it was in spring 2025. Cuts to the federal public service, restrictions on immigration, uncertainty over trade policy and the more widespread adoption of artificial intelligence are all limiting job creation, which is expected to remain moderate over the coming quarters.

The economic portrait is far from rosy, and a new dark spot is threatening to emerge: the conflict in the Middle East and its repercussions. Few of the economic indicators released include data from after the initial bombings. The University of Michigan consumer sentiment index did come in a bit lower in its preliminary March estimate, but half of the survey responses were received by February 28. We expect the consequences of this conflict to manifest more clearly as time passes. The biggest indicator thus far has been the staggering rise in gasoline prices. Prices at the pump went from a national average of US\$2.79 per gallon to US\$3.57 in just three weeks. As long as they stay this high, they'll limit other types of spending or eat into savings. We expect consumption and real GDP to slow in the second quarter, but not contract.

Weaker confidence and heightened uncertainty could drag on businesses and their investments, though we do expect larger investments related to oil and gas extraction. Despite the Trump administration's vocal support, this industry has been rather sluggish for some time. At the end of 2025, investment was 15.7% lower than it was at the end of 2023, though a rebound is expected this spring and summer. In parallel, investments in artificial intelligence have continued to prop up non-residential investment, particularly data centre construction and purchases of IT equipment and software. These investments should continue to grow, though the pace is expected to moderate at some point. Businesses should also benefit from slightly more favourable trade policy, as the Supreme Court has struck down the tariffs Trump imposed under the *International Emergency Economic Powers Act*. These tariffs have been replaced with lower ones that will legally expire after 150 days without congressional approval, though the administration is laying the groundwork for longer-term options.

In the meantime, the lower effective tariff rate since early March should give importers some relief.

Consumer prices were less affected by Trump's tariffs than originally anticipated, so the Supreme Court ruling should have only a limited effect on the cost of living. But while inflation may have been somewhat immune to trade policy, foreign and military policy could have a more pronounced impact. Soaring energy prices will inevitably push it higher. Until recently, inflation had been continuing its slight downward trend; while it had slipped to 2.4% in February, it was still above the Federal Reserve target. We now expect the year-over-year change in the all items index to come in above 3% in March and stay there until the end of spring. Core inflation, which strips out food and energy, won't be affected the same way, but its downward trend could also be interrupted (graph 5).

Graph 5
Rising Energy Prices Should Trigger a Temporary Rebound in Headline Inflation



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Table 3

United States: Major Economic Indicators

Quarterly annualized % change (unless otherwise indicated)	2025		2026				Annual average			
	Q3	Q4	Q1f	Q2f	Q3f	Q4f	2024	2025	2026f	2027f
Real GDP (2017 US\$)	4.4	0.7	2.9	1.1	2.5	2.0	2.8	2.1	2.3	1.9
Personal consumption expenditures	3.5	2.0	1.7	0.8	2.1	1.9	2.9	2.6	1.9	1.7
Residential construction	-7.1	-0.5	-1.4	-0.3	1.4	1.6	3.2	-2.1	-1.5	1.4
Business fixed investment	3.2	2.2	3.5	4.3	3.5	2.5	2.9	4.1	3.5	2.9
Inventory change (2017 US\$B)	-23.9	-7.5	-5.0	-10.0	10.0	15.0	43.5	30.6	2.5	36.3
Public expenditures	2.2	-5.8	7.4	2.6	0.4	1.7	3.8	1.1	1.6	1.6
Exports	9.6	-3.3	7.1	1.6	2.0	1.9	3.6	1.6	2.8	1.8
Imports	-4.4	-1.1	4.8	3.1	0.9	1.8	5.8	2.7	-1.0	2.1
Final domestic demand	2.8	0.6	2.7	1.5	2.0	2.0	3.1	2.4	1.9	1.8
Other indicators										
Nominal GDP	8.3	4.5	6.7	3.4	4.8	4.2	5.3	5.0	5.4	4.2
Real disposable personal income	1.0	0.2	3.4	0.9	2.7	2.3	2.9	1.7	1.7	2.0
Employment ¹	0.1	-0.2	0.3	0.3	0.5	0.7	1.2	0.5	0.2	0.7
Unemployment rate (%)	4.3	4.5	4.4	4.5	4.5	4.5	4.0	4.3	4.5	4.4
Housing starts ² (thousands of units)	1,346	1,328	1,392	1,335	1,345	1,345	1,371	1,357	1,354	1,358
Corporate profits* ³	9.3	4.5	7.5	7.5	3.5	3.2	5.1	5.9	5.4	3.1
Personal savings rate (%)	4.4	4.0	4.4	4.4	4.5	4.6	5.5	4.7	4.5	4.6
Total inflation rate*	2.9	2.8	2.7	3.6	3.1	2.7	3.0	2.7	3.0	2.1
Core inflation rate* ⁴	3.1	2.8	2.5	2.6	2.5	2.5	3.4	2.9	2.5	2.4
Current account balance (US\$B)	-906	-826	-823	-839	-834	-837	-1,185	-1,122	-833	-857

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

The Iran Conflict Pours More Fuel on Canada’s Uncertain Economic Outlook

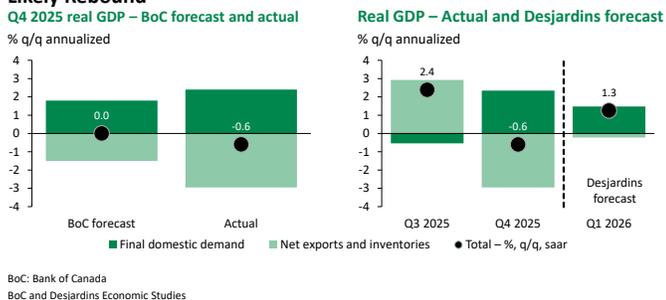
FORECAST

Canada’s real GDP growth surprised on the downside in Q4 2025 due to a large inventory drag, though final domestic demand held up. Through early 2026, focus on the regime shift in Venezuela quickly gave way to the Iran conflict, resulting in skyrocketing oil prices at the end of Q1 2026. As a result, our outlook for growth and inflation has been revised higher starting in the second quarter. That comes at the same time as the federal Canada Groceries and Essentials Benefit. The removal of tariffs under the *International Emergency Economic Powers Act* (IEEPA) is another tailwind. Higher federal and provincial government spending should also lift growth beyond the Bank of Canada’s January 2026 outlook. That said, domestic headwinds in the form of slowing population growth, federal payroll cuts, and rising mortgage renewals remain. The impending Canada-United States-Mexico Agreement (CUSMA) review and the downside risk it poses also haven’t escaped the attention of Canadian policymakers.

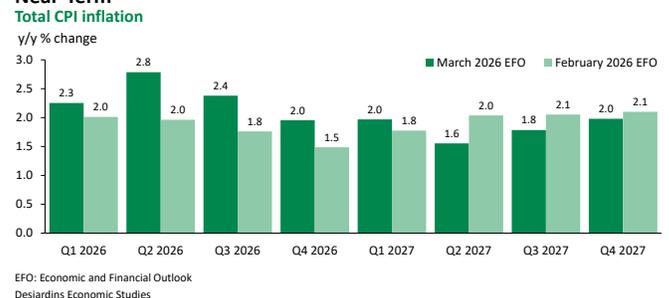
Canada’s economy contracted by 0.6% q/q annualized in Q4 2025, coming in below the Bank of Canada’s expectations of a flat print (graph 6). A significant drag from non-farm inventories weighed down the headline number. That said, final domestic demand proved resilient (2.4%), supported by increased federal defence spending, solid investment in machinery and equipment and higher household spending. Nevertheless, trade headwinds shaped economic activity throughout 2025, leaving growth at 1.7% that year—the slowest pace since the COVID-19 pandemic. In contrast, growth will probably rebound in Q1 2026. Consumption is likely to contribute to the near-term outlook despite the [weak job numbers](#) early in the quarter while private investment probably recovered on the back of solid residential construction. Government capital spending will likely also contribute positively to real GDP growth again in Q1 2026 as investment in weapons systems hits unprecedented, [albeit questionable](#), highs.

the geopolitical and global energy environment has radically changed with the Iran conflict disrupting transportation at the Strait of Hormuz, with no end in sight. At the time of our outlook, the West Texas Intermediate (WTI) oil price benchmark is close to US\$100 per barrel, in line with the severe disruption scenario from [our recent analysis](#). Consequentially, the quarterly outlook has been revised up starting in Q2 2026, largely on the back of greater investment from the energy sector and increased exports. On the latter, the diversification of trade routes via Canada’s west coast should also provide an additional tailwind to energy exports. While higher oil prices should be a tailwind on net, it also comes at the cost of higher inflation, as elevated energy prices contribute more to headline CPI in 2026 (graph 7). Moving to US trade policy, the removal of tariffs under IEEPA is welcome news that should provide a modest tailwind on net exports and investment. We’ve estimated that the average effective tariff rate on US imports from Canada should be roughly 0.1 to 0.3 percentage points lower than in our prior outlook, at around 3.5%, assuming current sector-specific tariffs hold. That said, uncertainty around the upcoming [CUSMA joint review](#) on July 1, 2026, remains a key downside risk.

Graph 6
Q4 2025 Real GDP Growth Surprised to the Downside, but Q1 2026 Will Likely Rebound



Graph 7
Energy Prices Has Pushed Up Our Inflation Outlook Higher in the Near-Term



Looking at the rest of 2026, the [regime change in Venezuela](#) initially introduced some near-term uncertainty for oil prices and a modest headwind to Canadian real GDP growth. However,

Several headwinds remain an ongoing concern for our outlook. The first is [slowing population growth](#) which is weighing down Canada's labour force, as the government pursues its goal to bring the non-permanent resident population to 5% of the total. In addition, ongoing mortgage renewals at higher interest rates are set to ramp up in 2026, as the 5-year fixed rate mortgages undertaken in 2021 are coming due. Lastly, federal government's [Budget 2025](#) introduced restraints to operating spending and planned reductions to federal public sector payrolls, adding another headwind to the outlook.

That said, large deficits and rising borrowing from the 2025 federal budget are also funding tax cuts and spending intended to boost investment and productivity. Growing military spending to meet NATO targets, and infrastructure investment should boost growth.

Table 4
Canada: Major Economic Indicators

Quarterly annualized % change (unless otherwise indicated)	2025		2026				Annual average			
	Q3	Q4	Q1f	Q2f	Q3f	Q4f	2024	2025	2026f	2027f
Real GDP (2017 \$)	2.4	-0.6	1.3	2.5	1.8	2.2	2.0	1.7	1.2	2.1
Final consumption expenditure [of which:]	-1.3	2.1	1.4	2.3	1.5	1.9	2.6	2.3	1.6	2.0
<i>Household consumption expenditure</i>	-0.8	1.7	1.0	2.3	1.2	1.6	2.2	2.3	1.4	1.7
<i>Government consumption expenditure</i>	-2.7	3.1	2.6	2.6	2.7	2.8	3.8	2.4	2.1	2.8
Gross fixed capital formation [of which:]	2.1	3.3	1.6	2.1	2.6	3.1	0.7	1.4	2.3	3.1
<i>Residential structures</i>	5.0	-4.4	1.5	2.0	2.9	3.8	-0.2	1.0	1.2	3.0
<i>Non-residential structures</i>	-0.9	-3.2	-0.5	1.8	2.6	2.9	-1.7	1.6	0.5	3.4
<i>Machinery and equipment</i>	-12.8	12.3	1.0	0.8	1.4	1.8	-1.0	-3.5	-0.3	2.3
<i>Intellectual property products</i>	-2.6	4.9	1.5	1.9	1.9	1.9	2.2	0.3	1.5	2.1
<i>Government gross fixed capital formation</i>	16.5	20.4	5.0	3.8	3.8	4.0	6.1	6.7	8.8	4.1
Investment in inventories (2017 \$B)	13.4	-10.1	-8.5	-6.1	-5.4	-5.0	6.5	7.4	-6.3	-5.0
Exports	3.8	6.1	2.0	5.0	5.3	5.3	0.9	-1.7	2.3	4.2
Imports	-11.0	1.0	3.6	5.8	5.6	5.5	0.7	-0.4	1.7	4.8
Final domestic demand	-0.5	2.4	1.5	2.3	1.8	2.2	2.2	2.1	1.8	2.3
Other indicators										
Nominal GDP	6.2	2.3	4.2	4.5	3.5	3.9	4.8	4.3	3.7	3.9
Real disposable personal income	1.1	-0.9	2.3	2.5	0.7	1.3	4.8	2.3	1.2	1.4
Employment	0.0	2.4	-0.3	-0.6	0.5	0.7	1.9	1.4	0.4	0.8
Unemployment rate (%)	7.0	6.7	6.7	6.8	6.7	6.7	6.4	6.8	6.7	6.5
Housing starts ¹ (thousands of units)	273	255	252	260	262	262	245	259	259	261
Corporate profits* ²	6.2	3.4	3.8	11.4	8.4	8.2	-2.3	5.7	7.9	5.3
Personal savings rate (%)	5.2	4.4	4.7	4.8	4.7	4.6	5.0	4.9	4.7	4.4
Total inflation rate*	2.0	2.2	2.3	2.8	2.4	2.0	2.4	2.1	2.3	1.8
Core inflation rate* ³	2.5	2.5	2.2	2.0	2.2	2.1	2.6	2.5	2.1	2.1
Current account balance (\$B)	-5.3	-0.7	-6.0	-5.8	-7.8	-7.9	-15.0	-30.4	-27.5	-35.8

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

Quebec

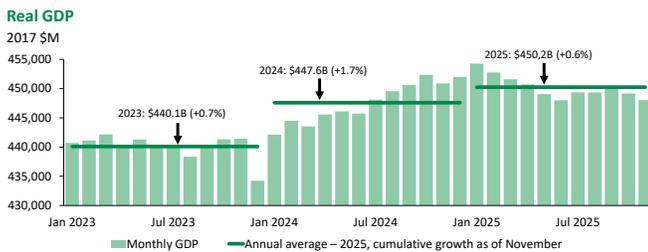
February's Employment Numbers Don't Mean a Recession Is Inevitable, but the Breadth of the Slowdown Is a Cause for Concern

FORECAST

Though we're still waiting on the final GDP figures to come in for 2025, it's already clear that Quebec's economy slowed throughout the year. While the initial shock was limited to international trade, this weakness then spilled over to most other industries. More bad news followed in early 2026, with the labour market posting its largest non-pandemic employment decline in at least 50 years. Beyond the current economic situation, slower demographic growth and the provincial government's fiscal consolidation efforts will accentuate headwinds in the short and medium term. However, there are a few tailwinds, including public investment projects and the housing market's continued strength. Overall, we expect a second year of limited economic growth for Quebec in 2026, at 1.0%.

The Quebec economy likely grew by 0.7% in 2025, although this average conceals an even less favourable reality. The truth is that Quebec's GDP peaked in January 2025, when many businesses ramped up production to get ahead of US tariffs. After that, the [economy contracted](#) in eight of the following ten months, bringing the November 2025 GDP back to its July 2024 level (graph 8).

Graph 8
Quebec's Real GDP Peaked in January 2025



Institut de la statistique du Québec and Desjardins Economic Studies

Throughout 2025, we highlighted the resilience of the job market in spite of the challenging economic conditions. But February's print revived fears about this resilience: the province posted a net loss of 57,300 jobs. A performance like this hasn't been seen outside of the pandemic. It's not yet clear if we're seeing a statistical aberration or if some economic weakness had been flying under the radar. We're waiting for next month's data before delivering a verdict. After all, income tax receipts remain in line with the trends observed in the employment surveys ([from April to December](#)), and collective dismissal notices recorded by the Ministère de l'Emploi et de la Solidarité sociale did not rise meaningfully in January or February.

But an industry-by-industry breakdown of these results does lend further weight to concerns about the state of Quebec's economy. Sometimes, shocks are limited to a single industry and the other sectors will take over until the storm has passed. But this isn't the case here. Since the January 2025 real GDP peak, most industries have posted declines (graph 9). It's hardly surprising that wholesale trade is struggling, in addition to transportation and warehousing; they're closely linked to manufacturing, and the ongoing trade war hasn't relented. But it's more concerning to see this soft patch spreading to industries that are less directly exposed, like professional, scientific and technical services, or accommodation and food services.

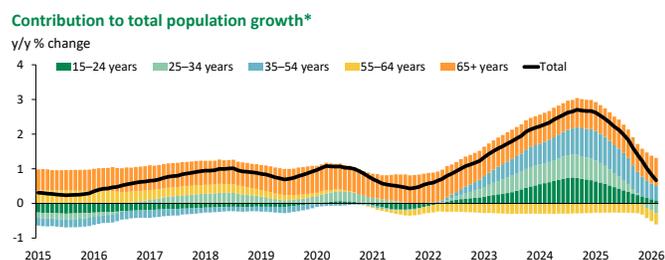
Graph 9
GDP in Goods-Producing Industries Fell Sharply in 2025



Most recent data: November 2025
Institut de la statistique du Québec and Desjardins Economic Studies

We anticipate further headwinds for economic growth in 2026. According to Statistics Canada, Quebec's population fell by about 25,000 in the fourth quarter of 2025 and by about 10,000 for 2025 as a whole. This is consistent with the decreases observed by age group in the Labour Force Survey. The working-age population (15 to 64) seems to be entering a period of decline for now (graph 10 on page 12), as the federal government brings the size of the non-resident permanent

Graph 10
The Working Age Population Is Already Declining



population down to its 5% target. We recently explored the potential [outcomes](#) of various demographic scenarios, including scenarios in which the labour force is under pressure.

Finally, [Quebec's latest budget](#), tabled on March 18, calls for very modest program spending as part of the government's efforts to balance the budget by 2029–2030. Growth in these expenditures is expected to be below inflation for an unprecedented length of time. If this comes to fruition, the implied fiscal consolidation would inevitably limit Quebec's economic potential. There are still some supports for growth, including infrastructure projects from all levels of government, the real estate market, which is still holding strong.

Table 5
Quebec: Major Economic Indicators

Annual average % change (unless otherwise indicated)	2023	2024	2025f	2026f	2027f
Real GDP (2017 \$)	0.7	1.7	0.7	1.0	1.7
Final consumption expenditure [of which:]	1.4	2.7	1.4	0.5	1.1
Household consumption expenditure	1.9	2.5	1.3	0.8	1.6
Government consumption expenditure	0.2	3.2	1.6	-0.2	-0.1
Gross fixed capital formation [of which:]	-2.9	4.4	3.7	1.6	2.4
Residential structures	-14.6	5.9	8.0	0.1	2.2
Non-residential structures	4.8	9.4	5.1	3.3	4.1
Machinery and equipment	-3.2	3.6	-1.4	0.0	2.5
Intellectual property products	5.4	2.6	1.4	1.4	1.9
Government gross fixed capital formation	8.8	-1.0	1.2	3.4	1.1
Investment in inventories (2017 \$B)	4.5	1.2	1.6	1.0	-0.6
Exports	3.9	0.5	-1.9	1.1	3.4
Imports	0.6	1.8	1.5	1.2	2.4
Final domestic demand	0.5	3.1	1.9	0.8	1.4
Other indicators					
Nominal GDP	4.7	5.9	4.3	3.6	3.5
Real disposable personal income	0.1	4.3	1.0	1.8	1.0
Weekly earnings	3.6	4.5	4.0	3.0	2.7
Employment	2.9	0.9	1.7	0.1	0.6
Unemployment rate (%)	4.5	5.3	5.6	5.6	5.3
Personal savings rate (%)	6.3	8.3	8.1	8.3	7.8
Retail sales	3.7	2.1	3.4	4.3	4.7
Housing starts ¹ (thousands of units)	38.9	48.7	59.9	61.4	61.5
Total inflation rate	4.5	2.3	2.4	2.3	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

A Rupture in the World Order, or a Temporary Blip?

The Prime Minister of Canada made headlines with his speech in Davos this January. He described the current circumstances as a “rupture” in the world order, with great powers imposing their will and international multilateral institutions starting to cave. Indeed, the economic conjecture is more difficult than it was, for a good many countries, but it remains to be seen if this rupture is truly permanent or simply temporary. Either way, there are now powerful incentives to forge new alliances and build new trade relationships, though it would be surprising if results materialized as quickly as desired. Fortunately, global trade is not the only driver of economic growth. Much can be accomplished by improving domestic demand. We expect business investment to increase given the many opportunities arising from the AI boom. The energy transition should also continue in many countries—and the recent spike in crude oil prices is an added incentive for change. Finally, infrastructure needs are high in several countries, which could result in accelerated government investment, including increases in military spending.

World Trade Won't Transform Overnight

Trade flows were highly volatile in 2025. The dust has not yet settled after all the tariff shocks, and we don't yet have a clear picture of the latest movements in international trade. Nevertheless, many countries, including Canada, are committed to diversifying their trade partners. This comes on the heels of the challenges encountered during the COVID-19 pandemic, when many supply chains were hit hard.

In addition to seeking out new trading partners, many countries are hoping to reshore production or work more closely with neighbouring countries. We could see regional trading blocs strengthened at the expense of a single large global economy. Countries may also aim to strengthen their ties with allies who share their social, economic and democratic values.

Investment Is Making Substantial Contributions to Growth

Long-term economic growth is linked to growth in the factors of production and productivity gains. The United States is currently reaping the economic benefits of an investment boom that is raising productive capital and improving labour productivity. Investment and productivity gains like these can help offset weaker growth in the number of workers, as populations in many advanced economies are aging.

In the United States, the investment spike is concentrated in artificial intelligence. AI adoption in the United States is quite high, and we believe that many other countries will embrace

this technology in the years ahead (albeit with less excessive investment). The investment boom is driven by microchip development and the rush to build data centres. It also reflects AI's broader potential, including new applications for this technology and the complementary investments they could generate.

Investment potential appears high in a number of other sectors as well. First and foremost, we'll see expanded military budgets and increased investment in defence industries in the coming years. Member states of the North Atlantic Treaty Organization (NATO) have pledged to increase their defence spending as geopolitical risks heighten.

Less Oil-Dependent, but Far from Oil-Free

The war in Iran has sent oil and gas prices soaring, and we are once again reminded just how heavily our economies depend on these resources. While that dependence is waning over time, we still have a long way to go.

This brings Canada's potential role as a stable supply source to the forefront, as well as the importance of securing energy supplies. But we also need to pay close attention to the pace of the energy transition. Environmentalism may have fallen out of favour in the United States, but many other countries have continued to transition to more sustainable energy sources. We're already approaching an average global temperature of 1.5°C above pre-industrial levels. Unless major investments are made in green technology, we may be unable to avoid increasingly extreme weather events that could have severe effects on the environment, global populations and the economy.

Table 6
Major Medium-Term Economic and Financial Indicators

% (unless otherwise indicated)	Annual average							Averages	
	2024	2025	2026f	2027f	2028f	2029f	2030f	2021–2025	2026–2030f
United States									
Real GDP (% change)	2.8	2.1	2.3	1.9	2.0	2.0	1.9	3.3	2.0
Total inflation rate (% change)	3.0	2.7	3.0	2.1	2.3	2.3	2.0	4.5	2.4
Unemployment rate	4.0	4.3	4.5	4.4	4.2	4.1	4.0	4.2	4.2
S&P 500 index (% change) ¹	23.3	16.4	7.1	10.8	8.1	8.6	8.6	14.3	8.6
Federal funds rate	5.31	4.37	3.56	3.25	3.25	3.25	3.25	3.40	3.31
Prime rate	8.31	7.37	6.56	6.25	6.25	6.25	6.25	6.40	6.31
Treasury bills – 3-month	5.18	4.21	3.43	3.10	3.10	3.10	3.10	3.36	3.17
Federal bonds – 10-year	4.21	4.28	4.14	4.05	4.05	4.05	4.05	3.37	4.07
– 30-year	4.41	4.78	4.75	4.70	4.70	4.70	4.70	3.69	4.71
WTI oil (US\$/barrel)	77	77	73	65	65	70	70	79	69
Gold (US\$/ounce)	2,387	3,439	5,022	5,188	5,025	4,900	4,900	2,274	5,007
Canada									
Real GDP (% change)	2.0	1.7	1.2	2.1	1.9	1.7	1.7	2.6	1.7
Total inflation rate (% change)	2.4	2.1	2.3	1.8	2.0	2.0	2.0	3.7	2.0
Employment (% change)	1.9	1.4	0.4	0.8	1.1	1.2	1.1	3.1	0.9
Employment (thousands)	386	296	80	162	236	249	230	255	191
Unemployment rate	6.4	6.8	6.7	6.5	6.3	6.2	6.2	6.3	6.4
Housing starts (thousands of units)	245	259	259	261	261	267	271	257	264
S&P/TSX index (% change) ¹	18.0	28.2	11.1	13.3	9.1	8.0	8.0	13.5	9.9
Exchange rate (US\$/C\$)	0.73	0.72	0.74	0.77	0.79	0.80	0.80	0.75	0.78
Overnight rate	4.59	2.95	2.25	2.44	2.75	2.75	2.75	2.90	2.59
Prime rate	6.75	4.90	4.45	4.64	4.95	4.95	4.95	5.04	4.79
Mortgage rate – 1-year	7.64	6.30	5.55	5.20	5.10	5.10	5.10	5.66	5.21
– 5-year	6.73	6.23	5.75	5.60	5.40	5.40	5.40	6.01	5.51
Treasury bills – 3-month	4.37	2.58	2.23	2.54	2.75	2.75	2.75	2.80	2.60
Federal bonds – 2-year	3.67	2.61	2.56	2.66	2.80	2.80	2.80	2.79	2.73
– 5-year	3.30	2.83	2.83	2.86	3.00	3.00	3.00	2.69	2.94
– 10-year	3.34	3.24	3.28	3.19	3.25	3.25	3.25	2.81	3.24
– 30-year	3.33	3.57	3.69	3.56	3.60	3.55	3.55	2.97	3.59
Yield spreads (Canada–United States)									
Treasury bills – 3-month	-0.81	-1.63	-1.20	-0.56	-0.35	-0.35	-0.35	-0.57	-0.56
Federal bonds – 10-year	-0.87	-1.04	-0.86	-0.86	-0.80	-0.80	-0.80	-0.55	-0.82
– 30-year	-1.08	-1.21	-1.06	-1.14	-1.10	-1.15	-1.15	-0.72	-1.12
Quebec									
Real GDP (% change)	1.7	0.7	1.0	1.7	1.5	1.4	1.3	1.7	1.4
Total inflation rate (% change)	2.3	2.4	2.3	2.0	2.0	2.0	2.0	3.4	2.0
Employment (% change)	0.9	1.7	0.1	0.6	0.7	0.7	0.5	1.3	0.5
Employment (thousands)	39	79	4	28	33	31	25	69	24
Unemployment rate	5.3	5.6	5.6	5.3	4.7	4.3	4.2	5.8	4.8
Retail sales (% change)	2.1	3.4	4.3	4.7	4.0	3.1	3.0	5.6	3.8
Housing starts (thousands of units)	49	60	61	62	62	60	61	55	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