Bennett Jones

2026 MID-YEAR

Economic Outlook

A Changing World: New Risks, New Opportunities

Foreword from Our Executive Chair and Chair of the Board

The economic environment across Canada and the United States is being reshaped by global forces that are testing established assumptions about trade, capital and growth. Geopolitical conflict, shifting trade policy, energy market disruption and rapid advances in artificial intelligence are contributing to a more complex and less predictable environment for decision-making. Yet, within this disruption lies a defining opportunity.

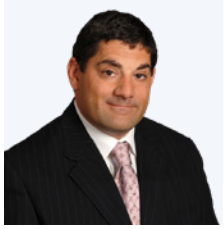
For Canada, the central economic challenge—and opportunity—is not a shortage of capital, but the need to unlock investment at scale. Global capital is actively seeking stable, well-governed markets with long-term growth potential and Canada is well positioned to attract that capital, particularly in sectors critical to future competitiveness and energy security.

Encouraging momentum is already evident. There are tangible signs of renewed international interest in Canadian infrastructure, energy and critical minerals as global demand for secure and reliable supply chains increases. These sectors are not only foundational to Canada's economy; they are central to broader geopolitical and economic realignment. Realizing their full potential, however, will depend on continued progress in creating a clear, predictable and competitive policy and regulatory environment.

In the United States, evolving trade and economic policy will continue to shape cross-border relationships, capital flows and supply chains. For Canadian businesses, success will require a disciplined approach to navigating these dynamics while identifying areas of opportunity in a changing North American and global landscape.

The Bennett Jones *2026 Mid-Year Economic Outlook*, prepared by our Public Policy group, provides a forward-looking perspective on these forces and their implications through 2026 and beyond. It is intended to support informed decision-making as our clients assess risk, allocate capital and position their organizations for long-term success.

While uncertainty remains, the underlying fundamentals—and the opportunity to act—are clear. Those who move with clarity and conviction will help define the next phase of growth. We continue to support our clients and friends, both domestically and abroad, with their Canadian investment objectives, which will serve Canadian growth and prosperity overall.



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Except where otherwise noted, the analysis in this Economic Outlook is based on published data available May 22, 2026.

Executive Summary

A Complex Universe for Decision-Making

Policy and business leaders in 2026 are confronting disruptive global forces that pose daunting economic and financial risks while also transforming markets and creating avenues for growth over the next years.

A rupture in the world order, strategic rivalry among the major powers, wars, an energy crisis, unpredictable U.S. tariff and trade policy, uncertain risks and rewards from massive investments in artificial intelligence (AI), and stress in capital markets are together creating a complex universe for decision-making.

There is wide agreement among political and business leadership in Canada that the adjustment to new global realities and the advancement of our economic and national security rest on unleashing private investment.

There is also a shared understanding that after years of languishing investment and productivity growth, a large step change in investment flows is required to make up for lost opportunity and to secure Canada's future.

The problem to solve is not one of a lack of financial capital. There is ample capital from corporate, institutional and private sources, in Canada and internationally, that is in search of investment opportunities.

As a resource-rich, advanced economy with a well-educated workforce, sound institutions and respect for the rule of law, Canada presents lesser risk as an investment destination than most other places on earth. This said, domestic and foreign investors are driven by target returns.

It is largely the role of business leaders—the boards and executive teams of large, small and start-up enterprises—to identify the market opportunities, to manage the business risks and to execute on the investments.

While the government can set the ambition, and in some cases be an active partner, including as a co-investor, its principal role is to create a predictable and sound policy environment that enables market leaders and innovators to realize a competitive, risk-adjusted return.

In 2025, U.S. import tariffs and threats to our sovereignty and economic security served as a wake-up call.

Governments have sent many positive signals and taken early actions to promote investment. The investor response is still tentative. More remains to be done. Private sector engagement and stronger policy coordination among governments are critical to getting the investment conditions right.

Despite global uncertainty, risks and modest growth prospects in the short term, the direction must be set and the investment unleashed now to build resilience and place the economy on a path of greater prosperity.

The Short-Term Prospects

We outline a reference scenario for the U.S. and Canadian economies for 2026 and 2027.

The scenario is built on the assumption that a resolution to the conflict in Iran restores normal traffic in the Strait of Hormuz and that the effects of the energy and commodity supply disruption begin to dissipate in mid-2026. We assume that existing U.S. import tariffs stay in place, under one or another legal authority, and that the Canada–United States–Mexico Agreement (CUSMA) continues under substantially the same terms as before.

Under this scenario, U.S. real GDP grows by 2.1% on a Q4/Q4 basis in both 2026 and 2027. U.S. core inflation peaks at about 3.5% by mid-2026, and it gradually recedes to slightly under 2.5% by Q4 2027.

We consider that the Federal Reserve under incoming chairman Kevin Warsh will continue to be guided by the careful balancing of its twin mandate of price stability and maximum employment. Accordingly, it would hold its policy rate steady in 2026 and cut it by 25 basis points

around Q2 2027, to 3.5%—near the middle of the range of estimates for the long-term equilibrium rate.

In Canada, real GDP growth would accelerate on a Q4/Q4 basis, from 0.7% in 2025 to 1.7% in 2026; it would moderate slightly, to 1.5%, in 2027. Average annual growth in real GDP would be 1.1% in 2026 and 1.6% in 2027.

Our projected annual rates of growth for Canada are by no means spectacular, but on a per capita basis, they would amount to better performance than in much of the past decade: about 1.1% in both 2026 and 2027.

Headline inflation in Canada would peak at about 3% in Q2 2026, pushed up by higher gasoline and energy prices. Inflation would come down again to the 2% target by the second half of 2027. The Bank of Canada would hold its policy rate steady at 2.25% through to the end of 2027.

There are both upside and downside risks around our reference scenario.

A prolonged conflict in the Middle East and sustained, high energy prices would fuel inflation and depress global demand. For Canada, however, there is an offsetting gain because of higher revenue from our exports. If higher commodity prices encourage stronger investment, there can be a larger net gain.

U.S. trade policy remains a wild card. The downside risk is material, but it must be kept in perspective. For illustrative purposes, if all our exports to the United States now exempt of tariffs under CUSMA were subject to a 10% import tariff, the estimated hit to the level of real GDP in Canada would be about 0.6% in 2027. There would be a permanent loss. But there would also be an adjustment.

Tail risks, particularly on the downside, cannot be ignored. An abrupt repricing of assets, such as AI-related assets that now dominate equity markets, could unsettle markets worldwide and raise the cost of capital. This would spill over to the real economy and depress activity through multiple channels.

The Investment Opportunity

> We are living through a period of mass disruption. And moments like this don't just test leaders. They define them. Because too often, we mistake stability for strategy. We confuse caution with prudence. And we accept gradual decline as inevitable rather than preventable.
>
> —Goldy Hyder, President and CEO, Business Council of Canada

The global forces that may cause businesses to be prudent in the short term also shape the opportunities to capitalize on Canada's strengths, build advantage, and develop and seize new markets.

Canada is committed with its NATO partners to grow its defence spending to 5% of GDP by 2035. The defence build-up is a lever to accelerate public and private investment in military and dual-use infrastructure, including in Canada's Arctic regions, to build new industrial capacity, to stimulate technological innovation, and to expand our global economic and security relationships.

Properly executed, Canada's Defence Industrial Strategy and a new federal agency to transform military procurement can leverage traditional domestic capabilities such as aerospace and communications while developing Canada's proven potential in AI, quantum, cyber and other technologies. A national effort can enlist large and small businesses, domestic and foreign suppliers.

The disruptions in energy and commodity markets underscore for our economic partners the strategic and economic value of a reliable, responsible supply of oil, liquefied natural gas (LNG), fertilizer and critical minerals.

With a wide dispersion of scenarios of global demand, supply and prices, the private sector has to lead in assessing the market opportunity, advancing the commercial arrangements, mobilizing the capital and managing the market risks.

The principal task of governments is to streamline and de-risk the regulatory process and to facilitate consultations and the participation of Indigenous peoples. The diligent implementation of stated policies will help Canada turn the page on years of lost opportunity.

More than one year after "Liberation Day," while much is still uncertain about U.S. trade policy, what is evident is that world trade is driven by a wider set of forces and that it continues to grow as markets adjust.

Canada is, and will remain, a trading nation, with the United States as its principal trading partner. Internationally, our challenge is twofold.

First, to the greatest extent possible, we must strive to secure with the U.S. administration the terms of a renewed, predictable and mutually beneficial trade relationship that includes, in the course of the 2026 review, the renewal of at least the core elements of CUSMA. The experience of other U.S. counterparts shows that expediency is not an answer. Canada is aiming for the right deal.

Second, governments and businesses must work together as Team Canada in expanding our trade and investment relationships with non-U.S. partners, requiring not so much new trade agreements as more aggressive pursuit of

opportunities to sell our goods and services to the rest of the world.

AI and digital technologies are emerging as ever more powerful disruptors, requiring actions by governments and businesses today to realize value while protecting sovereignty and economic and national security.

For Canada, the productive and sound development and diffusion of AI and digital technology necessitate investment in digital infrastructure and in innovation and skills, so as to strengthen our own AI ecosystem and to enable the adjustment of workers to change in the content of jobs.

We can define success in the digital economy by our capacity to scale up innovative enterprises for the commercialization of intellectual property, ensuring that we capture our share of value and not merely grow dependence on U.S. (or Chinese) big tech.

The modernization of framework policy for the digital economy—from data sovereignty and privacy to competition and taxation—requires innovation and new levels of intergovernmental collaboration, in Canada and internationally with other middle powers.

Some Horizontal Policy Conditions

Confronted with harsh global realities, governments over the past year have been inspired by a renewed sense of ambition and urgency.

Discrete and targeted measures to unleash or "catalyze" investment have included the creation of new agencies and funds, the target expansion of public investment, and the introduction of new spending to address immediate pressures and to target early results.

The delivery of these initiatives requires ongoing commitment.

To go further, governments have to transform the *core* of the current policy and service delivery architecture.

This will be harder. It will take longer. The direction must be set early, with interim targets over a timeline.

First, governments have to undertake a principled and structured review of framework legislation and regulation to improve the incentive structure for investment and innovation. The tax system is a priority.

- Targeted tax credits or super-deductions such as legislated in the past years, with defined sunset dates, have merit to accelerate business investment. But they introduce added complexity, and they interfere with the flow of capital to its most productive uses.
- While following through with announced measures, the federal government could set out the direction and principles of a wider review of the tax system to simplify the rules and, over the following years, create a more uniform incentive for all forms of investment.

Second, intergovernmental coordination should be reinforced. Most domains of policy involve shared jurisdiction. In sectors like AI and the digital economy, where competitive forces and technology require agile policy frameworks, collaboration is essential to building capacity. This need not mean a heavy federal hand. Provinces can take the lead.

- The low-hanging fruit remains the dismantling of barriers to internal trade. Despite a holding of arms in early 2025, and some progress, energy behind this priority is not at a level that can generate breakthroughs. Provinces and territories have to step up.
- Governments may also focus together on the task of working with employers and unions to augment and sharpen the skills of the estimated 60% of Canadian workers likely to be affected by the deployment of AI technology over the next five to 10 years. Policy must help accelerate the adoption of productivity-enhancing technology and support adjustment.

Third, while reaching out to the private sector to attract new talent in the public service, governments must also modernize and streamline public institutions to deliver high-quality policy and services.

Our system of government rests on the capacity of the public service to deliver non-partisan, expert advice to ministers and to implement effectively their decisions. There is a concern that this capacity has been eroded. It needs to be reestablished.

Fourth, the actions of governments must be situated within sound fiscal plans.

Canada fares better than most advanced economies, in particular the United States, on important fiscal metrics. Nonetheless, governments are significantly exposed to a disruption in capital markets that, absent margins of prudence, could require painful adjustment.

Fiscal discipline and sound stewardship of the financial system are critical means of inspiring confidence, supporting private investment, and strengthening resilience. Canada demonstrated this strength during the Global Financial Crisis (2007–2009).

In recent years, fiscal anchors have been redefined by governments as convenient to meet their spending pressures. Projected fiscal deficits have been adjusted upward, and the bending of the curve on the debt-to-GDP ratio has been pushed to later years. With a higher debt,

and higher market interest rates, debt service costs have absorbed a rising share of government revenue.

While funding core responsibilities, from national security to education and health care, governments can reclaim and draw strength from a global advantage by establishing credible fiscal plans that place the ratio of public debt to GDP on a firm downward path. This will entail hard choices.

The Time Is Now

In a disrupted world, Canada has assets to build resilience and embark on a path of stronger growth. The right policy conditions must be in place.

Businesses must be prepared to allocate capital and take risks.

Bennett Jones looks forward to working with its clients to help Canada seize this moment.

CHAPTER 1

Global Disruptions: A Canadian Perspective

The normal uncertainty that surrounds economic scenarios is exacerbated today by a rupture in the world order, intense strategic rivalry among the major powers, wars, volatility in energy and commodity markets, unpredictable U.S. tariff and trade policy, uncertain rewards and risks from massive investments in AI and digital technology and infrastructure, and stress in capital markets.

Many of these factors were at play in 2025, and the global economy as well as capital markets proved surprisingly resilient. There is no return to the *status quo ante* and thus adjustment must continue in 2026 and beyond.

The global disruptions represent more than discrete events. They are the manifestation of forces that will affect the structure of our economy over the medium to long term.

In the short term, globally and in Canada, growth prospects are modest and risks are mostly to the downside.

- Wars and geopolitical conflict are factors of instability that depress confidence and investment.
- The energy supply crisis and shortages of other commodities caused by the war in Iran and the closure of the Strait of Hormuz are raising energy and food costs, reigniting inflationary pressures globally and depressing economic activity. Canada gains from a positive terms-of-trade shock, but the benefits are partially offset by higher domestic energy costs and inflationary pressures.
- Uncertain U.S. policy is altering trade and investment flows and causing efficiency losses. For Canada, sectoral U.S. import tariffs and the uncertain outcome of the 2026 review of CUSMA are hurting key industries and regions and holding back investment and spending across the economy.
- Massive investments in AI infrastructure and innovation are pulling the U.S. economy forward. There are positive spillovers for Canada, but there is no comparable surge of tech investment on this side of the border.
- While global capital markets to date have been generally stable and financial conditions accommodative, an abrupt repricing of assets and risk could have severe repercussions. Risks are heightened by historically large sovereign borrowings. A hike in government bond yields would worsen fiscal outlooks and raise interest costs for all borrowers.

At the same time, if governments and businesses respond in a timely and decisive manner, global change presents opportunities for Canada to grow its economy over the medium term by drawing on its assets and strengths.

- A predictable business environment, sound institutions and governance, and respect for the rule of law are factors that can help mobilize domestic and foreign capital in Canada.
- A commitment in NATO to grow defence spending to 5% of GDP by 2035 is a lever to accelerate public and private investment in military and dual-use infrastructure, industrial capacity, and technology and to expand our global economic and security relationships.
- The disruptions in energy and commodity markets underscore for our economic partners the strategic and economic value of a reliable, responsible supply of oil, LNG, fertilizer and critical minerals. The challenge is to develop, approve, permit and build the projects on a timeline and at a cost that are competitive and that meet global demand.
- AI and digitalization are powerful instruments to lift productivity growth across the economy. Worker training and adjustment are key conditions. With the right policy frameworks, public and private investment in AI and digital infrastructure and innovation, including

sovereign compute and data centres, can help develop and commercialize solutions that will allow Canada to capture its share of value in the growing digital economy.

As Canada adapts to a changing, fractured world and as it redefines its relationship with its foremost economic partner and ally, the United States, the pursuit of a stronger economy and the protection of our sovereignty and national security are complementary and self-reinforcing goals.

A surge of investment in defence industries, major resource and infrastructure projects, and AI and digitalization can enable the economy to adjust to structural change and contribute to enhanced economic *and* national security.

This chapter reviews the forces of change that we are facing and elements of a necessary Canadian response.

I. Wars and the End of the Peace Dividend

The world in 2026 is a more dangerous place than in prior decades; the peace dividend earned after the fall of the Berlin Wall is now largely wiped out.

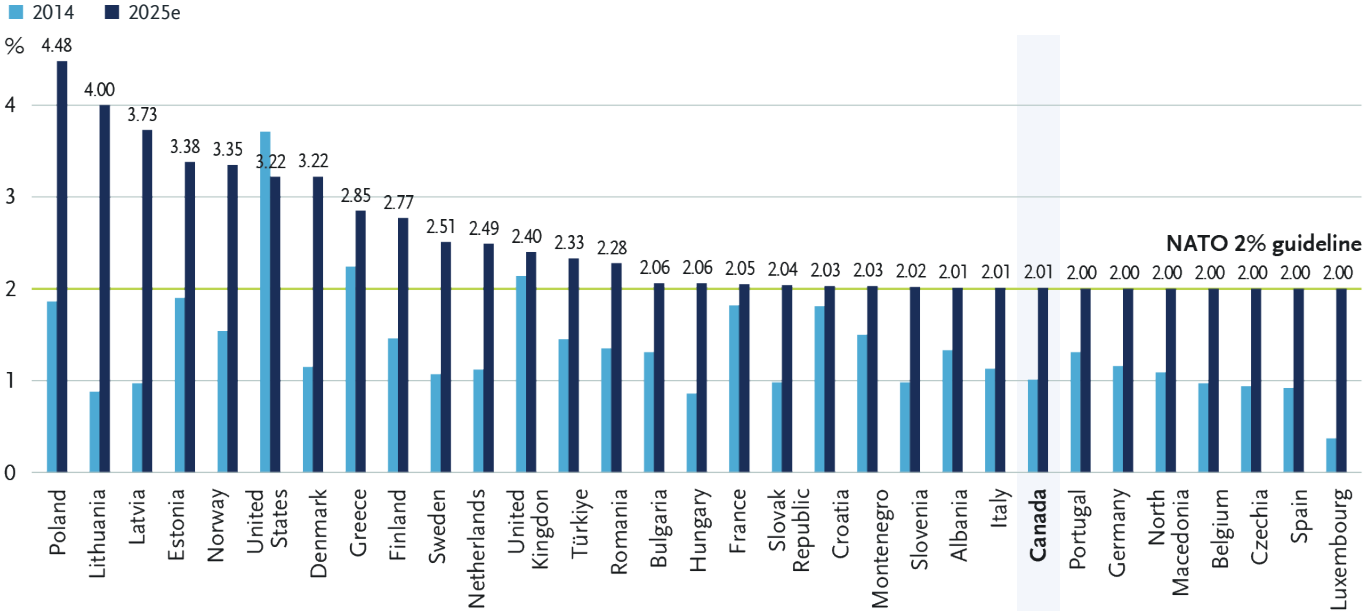
- The war in **Ukraine** rages on after more than four years, and tensions in Europe are high.
- The war in the **Middle East** has caused massive losses. The blocking of navigation in the Strait of Hormuz and the destruction of energy infrastructure have created havoc in oil and commodity markets and disrupted the global economy.
- The U.S. intervention in **Venezuela** and its intent to restore American prominence in the western hemisphere under a renewed Monroe Doctrine have given rise to new questions about respect for sovereignty and international law.
- Meanwhile, **China** is intent on exerting a stronger international role as a superpower. While lamenting that the "international order is crumbling into disarray," President Xi Jinping affirms that the unification of **Taiwan** with the mainland is a "historical inevitability."[1] Despite ongoing domestic economic challenges, Xi was able to host the U.S. President from a position of strength.

In response to both heightened security risks and U.S. pressure for improved burden sharing, NATO members committed at their Summit in 2025 to allocate 3.5% of their GDP to core defence spending and an additional 1.5% of GDP to security-related spending by 2035. For most member states, including Canada, that have only recently reached or exceeded the prior NATO target of 2% of GDP, the new commitments entail a massive shift of economic resources (Chart 1.1).

As they implement this effort, NATO members have to contemplate a diminished U.S. commitment to Article 5 of

CHART 1.1

Defence Spending of NATO Members as a Share of Their GDP



Source: NATO.

the North Atlantic Treaty,[2] **and thus reinforce strategic and operational autonomy as well as relationships with other allies within and outside of the organization.**

In its latest World Economic Outlook (WEO), the International Monetary Fund (IMF) identifies economic risks and opportunities associated with a large expansion of defence spending. The IMF cautions that while defence build-ups "can boost economic activity in the short term—lifting consumption and investment, particularly in defense-related sectors—they also temporarily increase inflation and create significant medium-term challenges." By the same token, "a buildup that makes public investment a priority and fosters more integrated markets for military equipment production could support long-term productivity growth."[3]

Against this backdrop, Canada's defence build-up necessitates a careful balancing of strategic, operational, technological, industrial, trade and fiscal considerations to safeguard sovereignty and strengthen economic and national security.

Properly executed, Canada's Defence Industrial Strategy (DIS) and a plan to defend, build and transform the country's Northern and Arctic region could advance many of Canada's core interests.

- The DIS, launched on February 17, 2026, sets ambitious goals for the next 10 years, including increases of 240% in Canadian defence industry revenues, 50% in Canada's defence exports, and 85% in government investment in defence-related research and development.[4]
- The strategy aims to prioritize Canadian firms in procurement, promote Canadian defence and dual-use innovation and intellectual property, and build partnerships with trusted allies and multinational firms while preserving sovereign control and delivering maximum industrial benefits. The goals will be pursued by building on traditional domestic capabilities such as shipbuilding, aerospace and communications and by capitalizing on Canada's potential in dual-use technologies shaping modern warfare and economies, namely AI, quantum computing, cybersecurity and advanced materials.
- Similarly, previously announced federal investments of more than $35 billion in defence and dual-use infrastructure in the North, together with transportation and power projects referred to the Major Projects Office, could be instrumental in affirming and defending Arctic sovereignty and realizing economic opportunity.[5]

The establishment in Canada of the headquarters of a multilateral Defence, Security and Resilience Bank could supplement the defence industrial strategy and reinforce security, economic and financial relationships with our allies. The information disclosed about this new institution remains embryonic.[6] The mandate, membership, governance, size and *modus operandi* of this bank have not been announced and likely remain to be negotiated among global partners.

An efficient and productive defence build-up requires solid public and private sector capacity *and* collaboration. To overcome long-standing bureaucratic hurdles in procurement, the federal government has launched the Defence Investment Agency (DIA). The DIA is tasked with consolidating and streamlining military procurement and achieving greater industrial benefits, notably by promoting earlier engagement between the Canadian Armed Forces and Canada's defence industry to help anticipate demand and build capacity at pace and scale. New institutions typically take some time to become fully operational and effective. For their part, with the right responsiveness and investments, Canadian firms across supply chains in materials, equipment, infrastructure and technology have a historic opportunity to participate in a national enterprise.

There are *two* important caveats. **First, execution will be key, notably for procurement.** The enunciation of a defence industrial strategy and the creation of a new agency do not by themselves solve the problem of deficient public-private sector collaboration.

Second, stronger military capacity comes with a cost; the government will have to make hard fiscal choices. The Parliamentary Budget Office estimates that, relative to a track where core defence spending remains at 2% of GDP, Canada's new NATO commitment would raise the budget deficit in 2035–2036 by 1.4 percentage points of GDP and increase the debt-to-GDP ratio by 6.3 percentage points.[7] Researchers for the C.D. Howe Institute reviewed how the government could fund the expenditures while keeping the deficit-to-GDP ratio and the debt-to-GDP ratio on a declining trend.[8] The authors found that it would be unrealistic or insufficient to expect to solve the equation only through higher economic growth, higher taxes, or lower growth in other program spending. The authors recommend a one-percentage-point or greater increase in the GST together with curbs on non-defence spending, including transfers to provinces.

Unless the federal government significantly curtails its spending, including transfers to persons and transfers to other levels of government, a new revenue source will be necessary. The phasing in and earmarking of one to two added points of GST would be an efficient and transparent means of signalling that heightened security has a cost that must be borne by this generation.[9]

II. The Energy Crisis

Obviously, the most immediate global economic consequence of the war in the Middle East is what the International Energy Agency (IEA) has described as the largest supply disruption in the history of the global oil market, with severe disruptions for other commodities as well.

The ramifications for global commodity markets have been as serious as they have been sudden.[10]

- The interruption of traffic in the Strait of Hormuz has stemmed the flow of some 20 million barrels per day of oil and oil products, representing about 20% of global demand. Similarly, it has blocked virtually all exports of LNG from Qatar and the United Arab Emirates, representing about 20% of the global LNG trade. Damage to oil and gas infrastructure, including the Ras Laffan LNG facility in Qatar, the largest in the world, means that some of the supply cutback may continue even after a reopening of the Strait.
- Brent crude oil futures and the European benchmark price for natural gas (Dutch TTF) both rose by 60% in March. Since then, prices have been elevated and highly volatile.
- The energy supply shortfall and the impact on prices have been muted by drawdowns of global inventory, including the largest ever agreed release from emergency reserves by members of the IEA.[11] However, the longer the supply disruption persists, the greater the challenges for importing countries to meet their energy needs and sustain their economies.
- The closure of the Strait has interrupted some 30% of the world's trade of urea, a fertilizer, and 20% of the world's trade of ammonia and phosphate, widening the shock from energy to agriculture and food.

The severity of the impact of the war on the global economy depends on the duration of the conflict and the timeline for the recovery of supply. In its April WEO, under a reference scenario that assumes a quick end to the conflict and a normalization of supply and exports from the Gulf region by mid-2026, the IMF projects real world GDP growth in 2026 of 3.1%; that is down from 3.4% in 2025 and down 0.2 percentage points from the IMF's baseline projection in January. Under scenarios where the war results in more persistent impacts on energy supply and prices, the IMF estimates an additional hit to real GDP growth in 2026 of 0.5 to 1.0 percentage point. Higher energy and commodity prices feed into inflation, reducing purchasing power. If sustained, they can raise inflation expectations and force central banks to lift interest rates, further depressing demand, with also potentially destabilizing effects on debt, equity and currency markets.

The longer-term impact of the supply shock on the *structure* of the energy market is also likely to depend on the duration of the conflict. The withdrawal from OPEC and OPEC+ of the United Arab Emirates could signal a further diminishing role of the cartels. If prices are expected to stay higher for longer, more investment will flow to new sources of supply.

For Canada, the supply disruption represents a positive terms-of-trade shock that boosts national income, but with downside effects from higher domestic energy costs. Yet, the net positive impact on real output is initially small: the added revenue flows to producers, boosting their cash position, reducing their debt or raising dividends paid to shareholders (including non-resident shareholders); there is not necessarily early reinvestment in operations or productive capacity. Similarly, the added royalties and taxes earned by governments reduce their fiscal deficits and borrowings but not necessarily their spending. By contrast, consumers and small businesses squeezed by higher energy costs can reduce their demand quickly. The net positive impact on real output is larger if sustained, higher prices incentivize investment in new productive capacity.

In the short term, commodity price fluctuations will require policy agility to contain inflationary expectations. The Bank of Canada may be expected to "look through" one-time or temporary increases in energy or food prices but will need to act if the inflationary pressures are wider and more persistent. The Bank wants to keep inflation expectations well anchored around the 2% target.

The federal government has introduced temporary excise tax relief to mitigate impacts for motorists at the pump; the measure is questionable given its large fiscal cost and the political pressure likely to prevail for an extension, particularly if fuel prices remain high. The removal of the excise tax of 10 cents per litre for gasoline and 4 cents per litre for diesel began on April 20 and will remain in effect until September 7, 2026. It represents an added fiscal cost of C$2.4 billion. The IMF has offered the following advice that the government would be well advised to heed in the future:

> If the cost-of-living squeeze is drastic and some support is unavoidable, (...), it should be timely, explicitly temporary, and channeled through tightly targeted transfers to the most vulnerable, with clear sunset clauses and identified offsets through reductions in nonpriority spending or through new revenue measures, particularly where fiscal space is limited.[12]

For the medium to long term, the question for Canada's governments and the private sector is how they can mobilize to meet the demand of global partners for enhanced energy security and reliability.

- At a time when Canada wants to grow and diversify its exports to reduce its dependence on the U.S. market,

energy importers in Europe and Asia are seeking to diversify their sources of supply of hydrocarbons to reduce their vulnerability to geopolitical or other disruptions.

- Governments and the private sector have an opportunity to collaborate within the frame of the Government of Canada's Bill C-5 and other mechanisms to accelerate project development for new and expanded oil and LNG export infrastructure on sound business terms.
- For example, a May 14, 2026, agreement between the Government of Canada, the Government of British Columbia and LNG Canada aims to progress closure of final items to support a potential 2026 Final Investment Decision for LNG Canada's proposed Phase 2 expansion. This project would position Canada as a top-five global LNG exporter.[13]
- Collaboration between the federal government and the province of Alberta is putting in place key conditions to grow hydrocarbon supply and build the infrastructure for export to new markets. The May 15 Implementation Agreement for the Canada-Alberta Memorandum of Understanding of November 27, 2025, is an important step, reaffirming the commitment of the two governments to an oil pipeline project, with the province undertaking to submit a project to the Major Projects Office (MPO) before July 2026, and laying the foundation for a predictable and workable carbon credit market to 2040.[14]
- In an uncertain environment, with a wide dispersion of scenarios of global demand, supply and prices, the private sector generally has the lead in assessing the market opportunity, advancing the commercial arrangements, mobilizing the capital and assuming the market risks. The principal task of governments is to streamline and de-risk the regulatory process and to facilitate consultations and the participation of Indigenous peoples.
- Canada is not alone. Wood Mackenzie estimates that global exploration by major oil companies has averaged US$19 billion each year from 2021 to 2025.[15] Exxon, Chevron, Shell, BP and TotalEnergies are reported to be considering new drilling prospects in Africa, South America and the eastern Mediterranean to refill their reserves. Large new LNG capacity is also coming on stream across the world as demand expands.[16]
- If decisions are not made on a timely basis, doors will close on market opportunities. **Year-end 2026 should be established as a target for at least some final investment decisions.**

To enhance energy security, partners can aim for a faster transition to a clean economy. Canada can capitalize on growing markets for critical minerals and clean technologies while accelerating investments in the domestic grid to deliver clean and competitive electricity.

- Canada's potential in critical minerals, if realized even in part, can advance economic, energy, climate and national security goals while strengthening our hand with the United States and solidifying other partnerships and alliances, including in the G7 and NATO. Given the near monopoly of China on the supply of many critical minerals, and thus market distortions and highly uncertain prices, governments have to consider means to de-risk private investments, such as price floors and the funding of strategic reserves.
- Investment in a clean electricity grid, within parameters that in each region of the country assure reliability, security and competitiveness of supply, must proceed at pace and scale to power the economy, including the infrastructure for the digital economy.
- Opportunities to draw on domestic strengths include renewed and new arrangements in Atlantic Canada, Quebec and other regions to optimize the development and use of clean electricity through interties. They also include capitalizing on Canada's assets in nuclear energy, spanning the entire supply chain, for reliable, non-emitting baseload power.
- A National Strategy for an Electrified Canadian Economy launched by the Government of Canada may help mobilize partners and provide clarity on climate regulation for the sector.[17]
- **Again, the key for Canada is getting more projects to final investment decisions, faster.**

III. Tariffs and the Review of CUSMA

More than one year after April 1, 2025, "Liberation Day," while much is still very uncertain about U.S. trade policy, what is evident is that world trade is driven by a larger set of forces and that it continues to grow with the adjustment of markets to evolving economic and geopolitical conditions.

At an aggregate level, the impact of U.S. tariffs in the United States and globally has been less than feared for many reasons.

- First, the average effective U.S. import tariff rate through 2025 has been well below the levels implied by the April 1 announcement because of adjustments, exemptions, bilateral agreements and court decisions. As of mid-May 2026, the trade-weighted average U.S. import tariff rate is some 10.2%.[18] The legal foundation, structure and levels of tariffs going forward are highly uncertain. The original "reciprocal" and "fentanyl" tariffs imposed under the authority of the International Emergency Economic Powers Act (IEEPA) were struck down by

the Supreme Court on February 20, 2026, and refunds of tariffs levied under this law have commenced. The replacement 10% import surcharge that was introduced (with exceptions) on February 24 for a period of 150 days under the authority of Section 122 of the Trade Act of 1974 was also found, by a May decision of the U.S. Court of International Trade , to be unlawful. The administration is appealing this decision and the 10% surcharge remains in place. Sectoral tariffs such as on aluminum, steel and automobiles have not been affected by court decisions but the administration has reduced those rates for some trading partners under bilateral trade deals.

- Second, most of the United States' trading partners chose not to retaliate in kind and rather sought accommodation with the U.S. administration. There has been no all-out trade war. The United States and China, in particular, came to a temporary accommodation on tariffs.
  - As of the beginning of 2026, special tariff actions cover 11% of global trade, up from 2% in 2022. However, the vast majority of global trade continues to be conducted under most-favoured nations tariffs or preferential tariffs under World Trade Organization (WTO)-compliant trade agreements (Chart 1.2).
- Third, a surge of imports in the United States in early 2025 to avoid tariffs mitigated the impact on trade volumes for the year as a whole. As tariffs began to be applied, importers absorbed part of the costs, muting the impact on downstream users and on consumer prices.
- Fourth, there was exceptional growth in trade in AI-enabling goods (chips, semiconductors, data transmission equipment), notably to supply the large build-out of data infrastructure in the United States. The WTO estimates that in value terms these goods accounted for 42% of total global trade growth in 2025.[19]

In total, the volume of global merchandise trade grew 4.6% in 2025. Under a baseline scenario, the WTO projects global trade to grow by 1.9% in 2026 and 2.6% in 2027.[20]

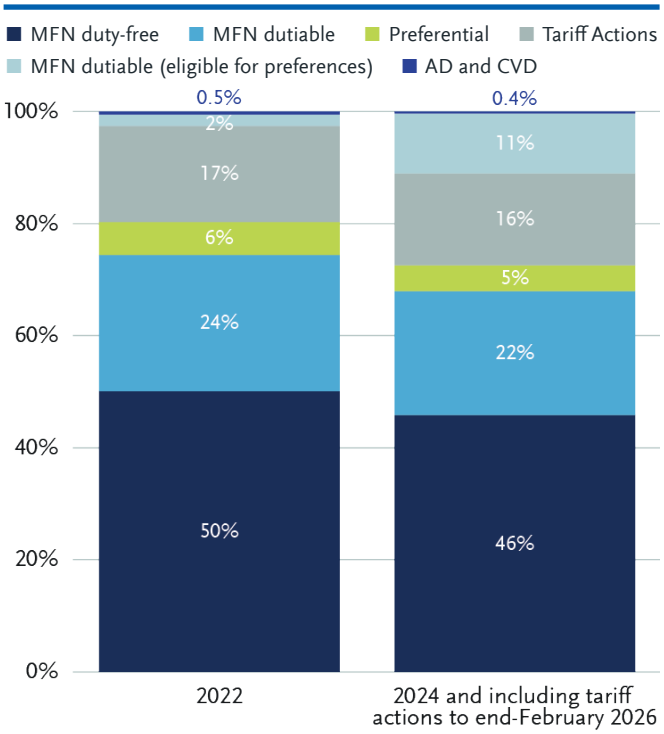
U.S. tariffs and policy actions have affected trade differentially by sector and by trading partner. U.S. imports from China dropped by 29%, while those from many other Asian economies grew robustly. Chinese exports were reoriented to other Asian economies and, temporarily, to Europe. China recorded a record merchandise goods trade surplus of US$1.2 trillion in 2025.[21] The change in the value of U.S. imports in 2025 was also sharply differentiated across categories of goods. While imports of tariff-exempt AI-enabling goods were up through 2025, imports of goods such as automotive vehicles and iron and steel, subject to sector-specific tariffs, were down.

Correspondingly, U.S. tariff policy had differential impacts across sectors and regions in Canada. Compared with other U.S. trading partners, Canada and Mexico benefited from an exemption from IEEPA and Section 122 tariffs for goods eligible for duty-free access under CUSMA. However, the sectoral tariffs on steel and aluminum products (50%) and automotive vehicles and parts (25%, with exceptions), as well as a sectoral tariff of 10% on softwood lumber that applies, for some products, in addition to countervailing and anti-dumping duties, have profoundly disrupted trade and imposed large adjustment costs on key industries in our regional and national economies. Moreover, changes introduced by the U.S. administration on April 2 to the calculation of tariffs on imports of derivative steel, aluminum and copper products have raised effective tariffs on goods exported by many Canadian manufacturers, including small and medium enterprises.[22] In aggregate, the average effective tariff rate on U.S. imports from Canada is estimated to be about 5.1%.[23]

Canada's trade shifted sharply as a result of U.S. tariff actions. After a pre-emptive surge at the end of 2024 and early 2025, our exports to the United States plunged, and in value terms remain about 9% below their levels in the third quarter of 2025 (Chart 1.3). Again, the average change masks larger drops for product categories subject to sectoral tariffs.[24] By contrast, the value of our exports to non-U.S. markets surged by 50% over the past year. The sources of our imports also shifted: imports from the United States dropped, while imports from other trading partners rose by more than 10%.

CHART 1.2

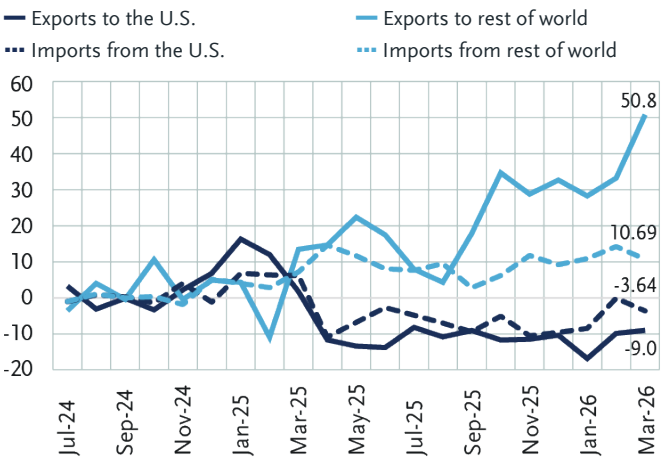
Shares of Global Trade by Tariff Treatment



Source: World Trade Organization.

CHART 1.3

Canadian Merchandise Export and Import Values
(Customs basis, seasonally adjusted, % changes from 2024Q3)



Source: Statistics Canada.

While the direct impacts of U.S. trade policy actions on Canada to date have been contained to some sectors, uncertainty and the deleterious effect on confidence and the investment climate have been more pervasive.

Internationally, the challenge at this time for Canada is twofold.

1. **To the greatest extent possible, to negotiate with the U.S. administration the terms of a renewed, predictable and mutually beneficial trade relationship that includes, in the course of a mandated 2026 review, renewal of at least the core elements of CUSMA. See Box 1.1.**
2. **To expand and diversify our trade and investment relationships with non-U.S. partners, requiring not so much new trade agreements as a more aggressive pursuit of opportunities to sell our goods and services to the rest of the world.**

The Government of Canada has set a goal to double our non-U.S. exports of goods and services by 2035. This is doable on past trends, and indeed the early response has been impressive.[28] It should go hand in hand with expanding and diversifying the wider range of our international business, including imports (to secure supply chains) and investments (to access a larger universe of capital).

Beyond North America, governments and businesses have to work together on at least three tracks.

- **Expanding our strategic and economic linkages with traditional, non-U.S. partners and allies**, including the European Union, the United Kingdom, Japan, South Korea, Australia and New Zealand. There is an opportunity to build on solid economic relationships and institutional frameworks as we also aim to solidify defence and security co-operation. For example, the acquisition by Canada of military submarines from Germany or South Korea is an opportunity to secure industrial and technology benefits. Reciprocally, Canada's participation in the European Union's Security Action for Europe (SAFE) initiative can support the commercialization of Canadian technologies and capabilities.[29]
- **Attracting more capital from sovereign wealth funds and other large investors from Europe, Asia and the Middle East.** Global investors allocate a sizable share of their portfolio to the U.S. market, but they need to diversify their risk. Where concrete opportunities are presented to investors, Canada's political and institutional stability and respect for the rule of law can help mobilize institutional and private equity and debt capital.
- **Expanding our trade and investment relationships with China, India and emerging economies in the Asia Pacific.** Growing our economy requires selling more goods and services to, and promoting two-way investment in, a region that comprises two-thirds of the world's population and that by 2040 may account for some 50% of global GDP.[30] China is developing formidable capabilities that make it a necessary economic partner while also posing economic and security threats that demand acute vigilance. The relationship with India must also be expanded with a clear-eyed assessment of security and interference risks. The federal government must negotiate the frameworks and give guidance to businesses.

IV. AI and the Digital Economy

As geopolitics are transforming the global economy in profound ways, AI and digital technologies represent a disruptive force that governments and businesses also have to integrate into their scenarios, strategies and plans.

In the short term, the impact of AI is manifest in the pace and scale of investment to develop the technology and bring it to market.

Technology investment related to AI is estimated to have added one half point of real GDP growth in the United States in 2025, representing one of the factors mitigating the downside impacts of tariffs on the economy.[31] A race for global advantage has driven the rapid deployment of investment across the different segments of the AI industry, including the hyperscalers supplying the digital infrastructure, the large language model developers, the chip developers and manufacturers, and the software firms building enterprise applications. If investment in the physical data centres and energy infrastructure to power them is attracting much attention, the value of the enterprise resides at its core in the innovation and risk-taking that is

The Review of CUSMA: The State of Play

The terms of CUSMA provide that by July 1, after a formal joint review, parties must signal whether they intend to renew the agreement for a period of 16 years, to 2042, or else to conduct annual reviews and to allow the agreement to expire in 2036. At any time, a party may also withdraw from the agreement with six months' notice.

The Government of Canada has put in place a negotiating team, led by former Clerk of the Privy Council Janice Charette, and it will draw on input from an Advisory Committee on Canada–U.S. Economic Relations.[25]

Canada has indicated that it is not prepared to make concessions simply to begin a negotiation. Steps taken by Canada in 2025, including the renunciation of the Digital Services Tax and the repeal of most retaliatory tariffs, have not secured reciprocal gestures.

The U.S. administration is approaching the negotiation with a strong commitment to its sectoral tariffs that it considers to be outside the scope of the CUSMA review.

United States Trade Representative (USTR) Jamieson Greer has indicated that the administration is seeking concessions from Canada on such matters as market access to dairy products and the application of the *Online Streaming Act* and *Online News Act* to U.S. digital services providers.[26] It also plans to negotiate with both Canada and Mexico such changes as a strengthening of rules of origin for industrial goods and a stronger alignment on tariffs, export controls, and investment screening for third parties (China is clearly in focus).

For its part, Canada seeks a comprehensive arrangement with the United States that comprises relief from sectoral tariffs together with a renewal of CUSMA. Canada has not set out publicly detailed goals or specific outcomes that it wishes to achieve in the negotiations.

- Our negotiating team is starting from the proposition that CUSMA is a sound agreement. It no doubt will bring to the table a list of improvements to CUSMA that will advance Canadian interests while preserving the core of the agreement.
- If zero tariffs are clearly off the table, Canada could possibly pursue sector-specific deals such as tariff rate quotas (TRQs) that would provide tariff relief for specific volumes of trade, based on agreed-upon conditions. TRQs could be a second-best outcome for our steel, aluminum, auto and wood products industries.
- While supply management is often cited as a red line for Canada, a far more basic and strategic imperative is to defend our sovereignty and core interests—including as regards our relationship with third parties—in the face of attempts by the U.S. administration to use trade as an instrument of subordination to its policy agenda.

While there have been many bilateral discussions over trade matters with the United States over the past months, including between the Prime Minister and the President, there is no indication that negotiations comprising the review of CUSMA have begun in earnest.

The date of July 1, 2026, to conclude the review can mobilize the parties, but in practice they can agree mutually to renew and/or to amend the agreement at any time after that date. The USTR has already indicated that negotiations are unlikely to be concluded by July 1.

Bilateral negotiations between the United States and Mexico are taking place on a separate track. Officially, Prime Minister Mark Carney and President Claudia Sheinbaum have agreed to work in close coordination.[27]

At this time, a probable outcome of the negotiations would appear to be a continuation of CUSMA, with amendments, supplemented by bilateral U.S. side letters with Mexico and Canada to address specific sectors or matters. While Canada and Mexico may seek certainty and extension of CUSMA to 2042, as per the original terms of the review clause, it is uncertain whether any deal with this administration may be considered firm.

motivated by the expectation of profits from the widespread commercialization of AI platforms and solutions.

The AI buildout is continuing in the United States and globally: AI-related capital expenditures are projected to amount to US$3.5 trillion over the period from now until 2030. Ten hyperscalers, including seven U.S. firms (Alphabet, Amazon, Apple, IBM, Meta, Microsoft and Oracle) and three Chinese firms (Alibaba, Baidu and Tencent) account for 70% of this projected investment.[32] Four of them (Alphabet, Amazon, Meta and Microsoft) are reported to plan capital spending of US$674 billion in 2026, up from US$410 billion in 2025, a third straight year of 60%+ growth.[33]

The extraordinary development of AI and the promises of future earnings have buoyed capital markets. The performance of technology stocks is a key factor behind an extended rally in U.S. equity markets, with the S&P 500 index posting a third year of solid double-digit gains in 2025 and continuing to beat records in 2026 despite the disruptive effects of the war in Iran. While hyperscalers are able to fund the majority of their investments from operating cash flow, they have broadened the investor base through some US$100 billion of corporate bond issues since January 2025 while also entering into complex intercorporate arrangements. Despite recording large losses in what is still their start-up phase, Anthropic and OpenAI are contemplating large initial public offerings that would value the companies at hundreds of billions of U.S. dollars each.

A short-term risk is a repricing of AI assets that would slow down investment plans and disrupt capital markets. Many factors could trigger a price correction, but fundamentally it would arise from a reassessment by the tech firms and investors of their capacity to execute and to monetize their planned investments. The impact on the real economy of a pullback of investment would be compounded by the effect on consumer confidence and spending of a loss of wealth in the United States but also internationally given the wide global exposure to U.S. capital markets.

Yet, the greater risks and opportunities from AI for the economy will be in the medium to long term. They are highly uncertain, but they require deliberate actions by governments and businesses to realize value while protecting sovereignty and economic and national security.

On the upside, AI offers the prospect of stronger productivity growth. The potential gains within firms and economy wide remain difficult to ascertain at this early stage of the development and application of the technology. A recent review cites estimates of impacts for the U.S. economy over the next 10 years as low as a total factor productivity gain of 0.66% and as high as an expansion of real GDP of 7%.[34] The results are highly sensitive to such assumptions as the rate of diffusion of the technology and the scope and scale of organizational redesign in the economy.

For Canada, realizing value from the development and diffusion of AI and digital technology necessitates investment in digital infrastructure, innovation and skills so as to strengthen our own ecosystem and to enable the adjustment of workers to changes in the content of jobs.

- The massive investments made by U.S. big tech are establishing and consolidating formidable market power that will be used to extract maximum value—or rent—from the commercialization of AI technology around the world. This is, plainly, the business model in the digital economy. Our firms cannot match the ambition or size of these investments. Thus, our governments, AI innovators and researchers, and investors have to collaborate in identifying the best opportunities to build domestic capacity and advantage in AI value chains. Sovereign AI compute and data centres are one piece of a digital infrastructure that can support domestic innovation, the acquisition and commercialization of intellectual property, the development and adoption of Canadian AI solutions in business and government, and the pursuit of global advantage in domains of comparative strength.
- The same considerations apply to other innovation streams in the digital economy that are transforming markets and business models, for example distributed ledgers, tokenized assets, stablecoins and payments. Our governments must work diligently with the private sector to safeguard sovereign choice over critical infrastructure and public goods.
- Collaboration with other middle powers on open-source software and digital infrastructure can also help create platforms for Canadian researchers and start-ups that are not dependent on U.S. hyperscalers.[35]
- In parallel, as discussed in Chapter 3, governments and businesses have to step up investment in the skilling and reskilling of the workforce as it adjusts to AI and other structural changes in the economy. It is estimated that up to 60% of jobs will be affected by AI over the next 10 years: 30% of jobs are at risk of replacement by AI, while another 30% may be modified as workers use AI tools, improving productivity and creating new value. Skills development is essential to realize value that may be broadly shared.

The economic opportunity must be pursued jointly with efforts to protect national security; AI and cybersecurity should attract a sizable proportion of our growing defence spending.

- AI is a domain of intense strategic rivalry between the United States and China, with both governments able to enlist their big tech firms to expand their security and military capacity.

- Meanwhile, a new AI model, Claude Mythos developed by Anthropic, is able to break down the cybersecurity defences of even the most sophisticated organizations, eliciting urgent discussions among model developers, tech firms, security agencies and financial institutions in the United States (and Canada) to contain risks and plan responses.
- Canada will not be able to fend off AI security risks alone. Governments and businesses need to accelerate and grow investment in cybersecurity capacity, building on Canadian strengths in this domain of innovation. Canada must work with allies, including the United States and other NATO members, to stay ahead of the curve and protect its vital interests.

On both economic and security grounds, Canada must affirm and exercise *policy* sovereignty to realize the benefits and manage the risks of AI and digitalization.

- Data sovereignty, security and privacy require that our legislative frameworks, our international agreements, including CUSMA, and our enterprise data management systems be revisited to achieve levels of protection commensurate with evolving risks. Legislation in the prior Parliament to reform the *Personal Information Protection and Electronic Documents Act* and to introduce a framework for the regulation of AI died on the Order Paper. The Carney government has yet to propose new legislation.
- In early discussions with the United States in 2025, the Government of Canada abandoned the Digital Services Tax. There can be ample debate about the correct tax treatment of multinational digital enterprises and the best approaches to international tax collaboration. As a matter of principle, Canada must safeguard its capacity to advance its interests and to make sovereign choices in multilateral (e.g., OECD) or bilateral tax frameworks. Digital and AI enterprises should pay their fair share of tax based on income earned in Canada.

On such complex AI-related matters, Canada can find common cause with the European Union and other middle powers sharing similar economic and national security.

V. Capital Markets and Financial Stability Risks

Despite what is described by some as a period of "polycrisis," capital markets have operated over the past years with remarkable stability. There have been bouts of volatility and some corrections. There have been, and remain, pressure points. But there has been no generalized disruption. For example, equity markets dropped and bond yields rose in the early days of the war in Iran, but as of the end of April 2026, overall financial conditions have generally been accommodating. The U.S. S&P 500 index, at 7200 on April 30, was 5% above its level of January 2026. Government bond yields around the world are considerably higher than before, and especially during the COVID crisis, but governments have not had difficulty funding their debt. Risk spreads on corporate bonds have been reasonably stable. Fluctuations in currency markets have been orderly.

Indeed, accommodating financial conditions are one of the factors that have mitigated in 2025 and 2026 the negative impacts of U.S. tariffs, wars and the energy and commodity supply disruption.

However, the financial system is a delicate construction at the best of times. A single event or the cumulation of pressures can trigger at any time an abrupt price correction in a given asset class, with potentially wider repercussions across public and/or private capital markets.

The repricing of AI assets, as was discussed above, is a prominent risk.

Another risk at a global scale arises from the steady accumulation of sovereign debt and the exposure of bond markets to a potential change of sentiment or strategy among price-sensitive investors.

- In advanced economies, the average gross debt-to-GDP ratio for general government in 2025, at 108.2%, was almost 40 percentage points higher than in 2007 before the Global Financial Crisis.[36] The average debt ratio is projected to continue to rise over the medium term as governments add to their borrowings to finance their deficits and their defence build-up.
- In the United States, the national debt, at US$31.22 trillion, exceeded 100% of GDP in the first quarter of 2026. Under the current fiscal outlook, it would rise to 125% of GDP by 2036.[37]
- Meanwhile, in more recent years, a rising proportion of government borrowing worldwide has been absorbed by hedge funds and other price-sensitive investors. In Canada, the proportion of bonds allocated to hedge funds at Bank of Canada auctions is now about 40%; it was near zero in 2010.[38] Hedge funds finance their bond purchases in the short-term markets, and they realize value by exploiting arbitrage opportunities in the bond markets. While this contributes to liquid and efficient markets, it also creates vulnerability.

In any jurisdiction, a disruption in government debt markets, or even a smooth but material repricing of government debt, would have serious fiscal, financial and economic consequences. Interest costs would absorb a higher proportion of government revenue, crowding out other spending, requiring tax increases, or further adding to debt. The higher government bond yields would

lift borrowing costs for all borrowers, particularly if risk spreads also come under pressure. This would depress business investment and ultimately consumer confidence and spending. In turn, the economic downturn would worsen the fiscal situation of government.

While Canada fares better than most advanced economies, in particular the United States, on important fiscal metrics, our governments are nonetheless significantly exposed to a disruption in bond markets and to a repricing of their debt.

Canada has the lowest general government *net* debt-to-GDP ratio in the G7, as per estimates published by the IMF. However, Canada's *gross* public debt as a share of GDP is about the average of other advanced economies. The funds that our governments need to raise in capital markets annually are thus proportionately equivalent to those of other advanced economies.

- As per IMF methodology, general government (federal, provincial and local) gross debt in Canada in 2025 was 113.5% of GDP, slightly above the average for advanced economies of 108.2%.[39]
- While comparisons of gross debt may be unfair given that Canada holds assets against a higher share of this debt than most other advanced economies, certainly the United States, it is nonetheless gross debt, and the annual additions thereto (the financial requirements), that determines the borrowings of our governments in capital markets.
- Year-to-year, governments must fund not only their fiscal deficit (budgetary expenses, including public debt charges, minus budgetary revenue) but also their investments in Crown corporations and other financial and non-financial assets.
- In the *Spring Economic Update 2026*, the federal government's fiscal deficit for 2026–2027 is C$65.3 billion, but the financial requirements that must be met by new borrowing in the markets are estimated at C$133 billion.[40]
- For example, the C$25 billion Canada Strong Fund does not impact the fiscal deficit, or net debt, because it is properly treated for accounting purposes as an investment. However, the asset on the balance sheet will be matched by an addition to gross debt.

At this time, the federal and provincial fiscal plans are not anchored by short- and medium-term targets that place the debt ratios—net or gross—on a firm downward path. This is despite an apparent understatement of expenditure pressures in the outer years of the plans.

- The federal government's fiscal anchors are to balance "operating spending" with revenue by 2028–2029 and to maintain a declining *deficit*-to-GDP ratio. In the *Spring Economic Update 2026*, the government projects that the federal debt-to-GDP ratio will remain "relatively stable."
- The *Spring Economic Update 2026* projects total program expenses to drop from 15.9% of GDP in 2026–2027 to 15.1% of GDP in 2030–2031, but it is not evident how this may be achieved while also meeting rising defence spending commitments.
- The provincial budgets also tend to project program spending growth in the outer years of their plans that are considerably below recent trends, despite ongoing pressures, notably for health care.

In an uncertain world, with significant risks of disruptions in capital markets, fiscal discipline is a critical means of inspiring confidence, supporting private investment and strengthening resilience. Canada demonstrated this strength in the Global Financial Crisis.

While meeting core responsibilities, and without imposing austerity, federal and provincial governments need to establish sound, medium-term fiscal plans with tight spending discipline, built-in margins of prudence and binding short- and medium-term fiscal anchors.

- It is widely accepted that as a key measure of sustainability, the net debt-to-GDP ratio of governments should be on a firm downward track over the medium term.
- As a general principle, it is appropriate for governments to borrow in order to invest.
- However, in order to manage their exposure to risk in the bond markets and to contain their debt charges, the fiscal plans of governments should also discipline the growth of their gross debt.

Disciplined fiscal management will require difficult choices, including on the funding of incremental defence spending.

Doing it right, there is an opportunity for Canada to reclaim and benefit from a global fiscal advantage.

CHAPTER 2

Prospects for the U.S. and Canadian Economies to the End of 2027

The U.S. economy proved remarkably resilient in 2025 despite trade and domestic policy disruptions, drawing strength from AI-related investment as other parts of the economy slowed down. The economy started 2026 on roughly the same 2% pace of real GDP growth as in 2025.

The U.S. labour market remains tight, and U.S. core inflation, at 3.2% in March 2026, is elevated. Headline inflation jumped to 3.8% in April as a result of higher energy prices.

The Federal Reserve to date in 2026 has kept the policy rate at 3.75% (upper limit). However, there has been upward pressure on long-term interest rates. In mid-May, the 30-year bond yield rose above 5% for the first time since 2007.

By contrast, hit by U.S. tariffs and trade uncertainty, and not benefitting from the same lift from AI as the U.S. economy, Canada's economy slowed considerably in 2025, growing only 0.7% on a Q4/Q4 basis, after a gain of 3.1% in 2024.

There are, correspondingly, less inflationary pressures in Canada than in the United States. There is slack in the labour market, as evidenced by an unemployment rate of 6.9% in April. Year-on-year core inflation has trended downward from about 3% in mid-2025 to 2.1% in April 2026. The Bank of Canada has kept the policy rate steady at 2.25% since last October.

Our reference scenario for the U.S. and Canadian economies for 2026 and 2027 assumes that the effect of disruptions to energy and commodity production and exports from the Middle East starts to dissipate around mid-2026. Existing U.S. import tariffs stay in place. We also assume a continuation of CUSMA under substantially the same terms as before.

Under the reference scenario, U.S. real GDP grows by 2.1% on a Q4/Q4 basis in both 2026 and 2027. Core inflation peaks at about 3.5% by mid-2026, and it gradually recedes to slightly under 2.5% by Q4 2027.

Under a view that U.S. monetary policy will continue to be guided by economic data, the Federal Reserve would hold its policy rate steady in 2026 and cut it by 25 basis points around Q2 2027, to 3.5%—near the middle of the range of estimates for the long-term equilibrium rate.

In Canada, real GDP growth would accelerate in 2026 on a Q4/Q4 basis to 1.7%; it would moderate slightly to 1.5% during 2027. On a year-over-year basis, real GDP would grow 1.1% in 2026 and 1.6% in 2027. Public and private investment, as well as exports, would make improved contributions to growth by 2027, while household and government consumption would contribute less than they did in 2024 and 2025. The beginning of a pivot to investment and exports would be welcome as a stronger foundation for medium-term growth.

Our projected rates of growth for Canada are by no means spectacular, but on a per capita basis, they would amount to better performance than in much of the past decade. Considering an underlying assumption of population growth of 0% in 2026 and 0.5% in 2027, average annual growth in real GDP per capita would be 1.1% in both 2026 and 2027.

Headline inflation in Canada would peak at about 3% in Q2 2026, pushed up by higher gasoline and energy prices, but come back down again to the 2% target by the second half of 2027. The Bank of Canada would hold its policy rate steady at 2.25% through to the end of 2027.

There are both upside and downside risks for Canada around our reference scenario.

Canada is in an advantageous position relative to many other economies regarding the energy and commodity supply disruption. Higher energy prices boost our export

revenue. By the same token, they also raise costs for energy users and thus pose distributional issues. If the event is short-lived, the net effect on real output is small. If the market perceives that higher energy prices will prevail over the medium term, a positive investment response to grow the supply and export of commodities represents an upside risk for the outlook.

For Canada, the prominent risk remains the trade relationship with the United States. On the upside, some form of tariff relief may be secured through negotiation together with a continuation of CUSMA and a normalization of the trade relationship. However, on the downside, the U.S. administration could decide to shortcut negotiations and impose tariffs at a higher rate or on a wider range of goods.

To gauge the sensitivity of our outlook to the trade relationship, we consider the impact of a 10% tariff that would apply to *all* of Canada's exports currently exempted under CUSMA. The existing U.S. tariffs on steel, aluminum, autos and lumber would remain the same.

In this scenario, the level of real GDP in Canada is lower than in our reference scenario by 0.125% in 2026 and 0.6% in 2027. As a result, annual real GDP growth would be 1% in 2026 (compared with 1.1% in the reference scenario) and 1.1% in 2027 (compared with 1.6%).

Tail risks to the outlook, mostly to the downside, include an abrupt repricing of AI-related assets in public and private equity and debt markets that could reverberate globally and disrupt the real economy through a number of channels.

For business planning, what matters more than the numerical projections (from any source) are:

- the direction of change: does the economy appear to be heading in the direction of stronger, balanced and non-inflationary growth?
- the risks: are they reasonably balanced, and can they be reasonably mitigated and managed?

We would argue that on both counts, despite high uncertainty, there is scope for cautious optimism, with continued vigilance and responsiveness to change.

I. Recent Developments

Growth in the United States and Canada

The U.S. economy continued to exhibit resilience in the beginning of 2026, drawing strength from AI-related investment. Real GDP grew at an annualized 2% rate in Q1, the same pace as in 2025 (Table 2.1). Investment in AI-related information-processing equipment and software, exports of goods, government consumption and change in inventories made larger positive contributions to growth than before, and this was accommodated by a sharp rebound in imports of goods. The pace of personal consumption continued to slow. This is consistent with near-record lows for consumer sentiment as measured

TABLE 2.1

Annualized Contributions to U.S. Real GDP Growth

	Q4 2024/ Q4 2023	Q4 2025/ Q4 2024	Q2 2025	Q3 2025	Q4 2025	Q1 2026
Annualized growth:			%			
U.S. real GDP	2.4	2.0	3.8	4.4	0.5	2.0
Final domestic demand	3.0	1.8	2.4	2.8	0.6	2.8
Contributions from:			**Percentage Points**			
Household consumption	2.3	1.4	1.7	2.3	1.3	1.1
Business non-residential investment, of which:	0.1	0.7	1.0	0.4	0.3	1.4
Information Processing Equipment + software	0.2	0.8	0.8	0.3	0.8	1.3
Residential investment	0.1	-0.2	-0.2	-0.3	-0.1	-0.3
Government consumption	0.5	-0.3	-0.1	0.4	-1.0	0.7
Exports of goods	0.1	0.1	-0.3	0.6	-0.1	1.2
Imports of goods	-0.6	0.3	5.0	0.6	0.1	-2.4
Change in inventories	-0.2	-0.2	-3.4	-0.1	0.1	0.4

CHART 2.1

University of Michigan: Consumer Sentiment

Index Q1 1966 = 100, not seasonally adjusted

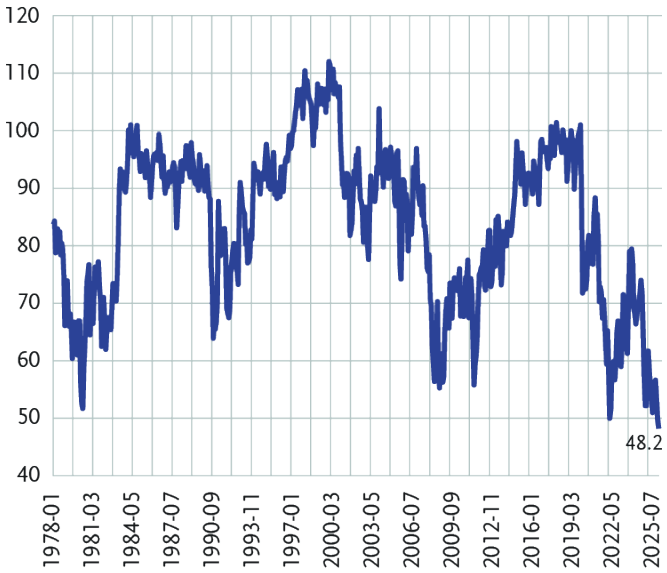


TABLE 2.2

Annualized Contributions to Canadian Real GDP Growth

	Q4 2024/ Q4 2023	Q4 2025/ Q4 2024	Q2 2025	Q3 2025	Q4 2025
Annualized growth:		%			
Real GDP	3.1	0.7	-0.9	2.4	-0.6
Final domestic demand	3.3	1.4	3.8	-0.5	2.4
Contributions to GDP growth:		**Percentage Points**			
Household consumption	1.5	0.9	2.5	-0.5	0.9
Residential investment	0.2	-0.2	0.1	0.4	-0.3
Government consumption	1.0	0.3	0.9	-0.6	0.7
Government investment	0.2	0.4	0.4	0.6	0.8
Non-residential business investment	0.3	-0.1	-0.2	-0.5	0.3
Exports of goods	0.4	-1.0	-8.5	1.0	1.9
Imports of goods	-0.1	0.5	1.0	3.0	-0.3
Net exports of services	0.3	-0.1	-1.2	1.0	-0.1
Changes in inventories	-0.7	-0.1	4.1	-2.1	-4.2

by the University of Michigan Consumer Sentiment Index (Chart 2.1). The full story is somewhat more complicated: a Federal Reserve survey shows that while only one quarter of respondents in October 2025 judged the national economy to be in "excellent" or "good" shape, 73% said that they were "doing OK financially" or "living comfortably."[1] At the risk of oversimplifying, one could advance that the United States is a tale of many economies: one AI-related, the other not; one lived, the other felt.

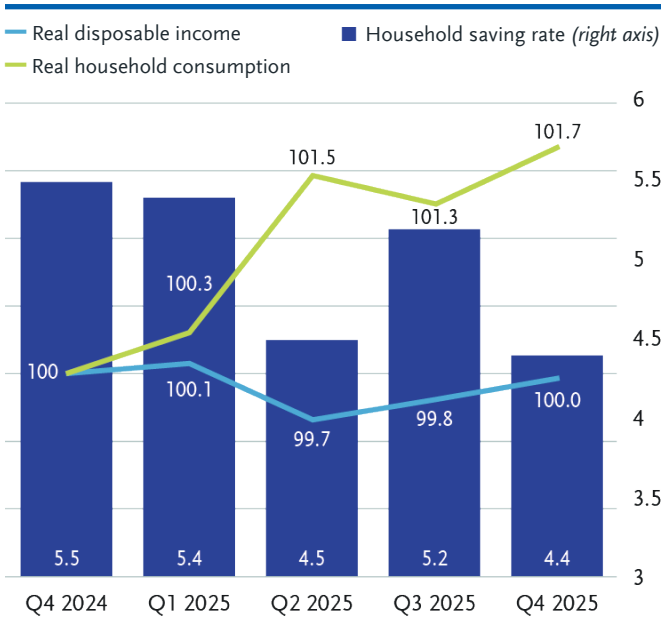
In Canada, real GDP growth slowed to only 0.7% on a Q4/Q4 basis in 2025, from 3.1% during 2024 (Table 2.2). Quarterly fluctuations were wide as economic activity, domestic demand and inventory adjustment responded to U.S. tariff developments, high uncertainty and slower population growth. A plunge in exports of goods to the United States mostly accounted for the aggregate slowdown during 2025. However, boosted by increases in exports to the rest of the world, exports of goods made a positive contribution to growth in the second half of the year. Household and government consumption, as well as residential and non-residential business investment, all saw their contribution to growth during 2025 cut by about 0.5 percentage points relative to 2024. Government investment accelerated starting in Q2 2025, contributing 0.7 percentage points to real GDP growth over the second half of the year.

Canadian households reduced their saving rate during 2025 to grow modestly their real consumption despite a stagnant real disposable income (Chart 2.2).

CHART 2.2

Canadian Household Consumption and Income

Q4 2024 = 100



By contrast, the Canadian business sector, despite some improvement in aggregate profitability, cut real non-residential fixed investment in response to slower economic activity and high uncertainty (Chart 2.3).

Statistics Canada's advance estimate for Q1 2026 suggests that the economy expanded at an annual rate of about 1.5%. This is what we carry in our reference scenario for 2026.

The Labour Market

Headline labour market indicators in the United States—the unemployment rate and job openings per unemployed—have been stable in 2025 and early 2026 (Table 2.3). Given uncertainty over trade and economic developments, employers in 2025 postponed hiring as well as firing, and employees were cautious about switching jobs. So far in 2026, growth in employment (labour demand) has picked up, the labour force (labour supply) has diminished due to lower immigration and labour force participation, and the unemployment rate has stayed roughly constant at about 4.3%. Yearly gains in average hourly earnings exceeded headline CPI inflation through 2025 and in the beginning of 2026. However, the 3.8% surge in prices in April will have caused some, still modest, erosion of real wages.

In Canada, slack in the labour market, as measured by the unemployment rate and job vacancies per unemployed, diminished in early 2026, but it increased markedly in April when the unemployment rate jumped to 6.9%, its highest level since October 2025. In the first three months of the year, labour supply (the labour force) dropped 2.3% at an annual rate relative to December because of a fall in the participation rate, fastest among those 15-to-24 years old, while labour demand (employment) fell by a more modest 1.8%. In April, however, labour supply rebounded 1.8%, largely on a rise in the participation rate, fastest among those 25-to-54 years old, while employment continued to decline by 1%. Thus, after contracting in Q1, slack expanded considerably. Average hourly earnings gained 4.1% year-on-year so far in 2026, faster than in 2025 when the average gain was about 3.5%. However, the stronger gains in 2026 to date can be explained by a shift in the composition of employment, including a lower proportion of employees with shorter job tenure. Statistics Canada reports that after controlling for the composition of employees by occupation and job tenure, hourly earnings rose by 3.5% year-on-year on average over the three months to April, about the same average increase as in 2025 and about the same as in the United States so far in 2026.

CHART 2.3

Investment and Profitability in Canadian Business Sector

Q4 2024 = 100

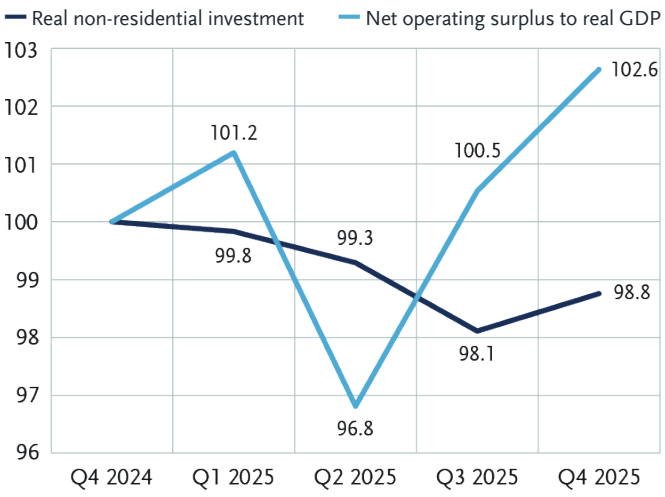


TABLE 2.3

Labour Market Tightness and Wage Inflation

	2025		2026	
United States:	**January to June**	**July to December**	**January to March**	**April**
Employment - m/m% s.a.a.r.	0.2	-0.1	0.5	0.9
Unemployment rate - s.a.	4.2	4.4	4.3	4.3
Job vacancies per unemployed	1.0	0.9	0.9	0.9
Average hourly earnings - y/y% s.a.	4.0	3.9	3.6	3.6
Canada:	**January to June**	**July to December**	**January to March**	**April**
Population 15+ - m/m% s.a.a.r.	1.7	0.8	0.3	0.3
Labour force - m/m % s.a.a.r.	1.5	1.0	-2.3	1.8
Employment - m/m% s.a.a.r.	1.2	1.0	-1.8	-1.0
Unemployment rate - s.a.	6.8	6.9	6.6	6.9
Job vacancies per unemployed*	0.34	0.32	0.33	
LFS average hourly earnings - y/y% not s.a.	3.5	3.4	4.0	4.5

*Data available only up to February 2026.

Inflation

Annual CPI inflation in the United States jumped to 3.3% in March, and 3.8% in April (a three-year high), from a recent low of 2.4% early in 2026 (Table 2.4). In both March and April, the price surge was largely attributable to higher energy prices, notably gasoline and fuel oil. Twelve-month core inflation, as measured by the price index for Personal Consumption Expenditures Excluding Food and Energy (PCEXFE), was 3.2% in March, its highest level since November 2023. Economists at the Federal Reserve Bank of Dallas estimate that, absent tariff effects, core inflation would have been 2.3%. The three-month annualized rate of increase in PCEXFE has greatly accelerated in 2026, notably for durable goods, clothing and footwear, likely reflecting an increasing degree of passthrough of tariffs to consumer prices.

In Canada, headline inflation, which had fluctuated around 2.2% in the second half of 2025 and in the first months of 2026, jumped to 2.8% in April 2026, pushed up by rising energy prices.[2] Excluding gasoline, headline inflation has trended downward from a peak of 3% around the end of 2025 to 2% in April. Twelve-month core inflation based on the average of CPI-median and CPI-trim (CPI-M&T) has also trended downward from about 3% around the end of 2025 to 2.1% in April. The pace of CPI-M&T increases on a three-month basis has slowed from an average of 2.4% in the second half of 2025 to only 1.8% in April 2026, suggesting further core disinflation to come on a 12-month basis. The inflation trend in Canada supports a judgment that the Bank of Canada can look through a temporary hike in energy prices while staying alert to the risk that high energy prices persist and feed through supply chains.

Interest Rates and Exchange Rates

The Federal Reserve has maintained its policy rate at 3.75% (upper limit) so far in 2026 (Table 2.5). It refrained from raising it on the judgment that tariff inflation, inflation running above target, and the effect of the recent oil price shock may be temporary, and it refrained from cutting it on lack of evidence of high, immediate downside risks to employment.

The 10-year Treasury yield, which was stable around 4.1% from September to February, rose after the beginning of the war in Iran. It averaged 4.4% in the first half of May. In mid-May, the 30-year bond rate rose above 5% for the first time since 2007 on fears that the conflict may endure and that high energy costs may continue to contribute to price inflation.

The Bank of Canada has maintained its policy rate at 2.25% since last October. This level is judged to be at the lower bound of the estimated range of the neutral rate at which monetary policy is neither contractionary nor expansionary.

TABLE 2.4

Consumer Price Inflation in the United States and Canada

	2025	2026			
United States:	**July to Dec.**	**Jan.**	**Feb.**	**March**	**April**
CPI - all items 12-month	2.8	2.4	2.4	3.3	3.8
Core inflation: PCEXFE 12-month	2.9	3.1	3.0	3.2	
Core inflation: PCEXFE 3-month s.a.a.r.	2.8	3.8	4.6	4.4	
Canada:	**July to Dec.**	**Jan.**	**Feb.**	**March**	**April**
CPI - all items 12-month	2.1	2.3	1.8	2.4	2.8
CPI - all items ex. gasoline 12-month	2.6	3.0	2.4	2.2	2.0
Core inflation: CPI-M&T 12-month	2.9	2.5	2.3	2.3	2.1
Core inflation: CPI-M&T 3-month s.a.a.r.	2.4	1.2	1.0	1.6	1.8

PCEXFE: Chain-type price index for personal consumption expenditures excluding food and energy.
CPI-M&T: average of the CPI-median and CPI-trim measures designed by the Bank of Canada.

TABLE 2.5

Key Financial Rates for the United States and Canada in 2026

	Jan.	Feb.	March	April	May
Fed funds rate (upper limit) - %	3.75	3.75	3.75	3.75	3.75
Bank of Canada policy rate - %	2.25	2.25	2.25	2.25	2.25
U.S. 10-year Treasury yield - %	4.21	4.13	4.25	4.35	4.41
10-year Canada bond yield - %	3.40	3.29	3.44	3.48	3.56
U.S. dollar per Canadian dollar	0.726	0.733	0.729	0.727	0.735
Nom. advanced econ. US dollar index *(% change, - = depreciation of US$)*	-0.4	-0.9	1.7	-0.3	

PCEXFE: Chain-type price index for personal consumption expenditures excluding food and energy.
CPI-M&T: average of the CPI-median and CPI-trim measures designed by the Bank of Canada.

With a lower policy rate, more slack in the labour market, and smaller fiscal deficits and debt in Canada than in the United States, the 10-year Canada bond rate has maintained a negative differential of some 85 basis points relative to the 10-year Treasury yield so far in 2026. This confers an advantage to all Canadian borrowers, since bond yields are a benchmark for all forms of long-term borrowing.

Meanwhile, the Canadian dollar has remained close to US$0.73. The value of the U.S. dollar against the currencies of other advanced economies has fluctuated considerably since last December, but by April it was at roughly the same level as at the beginning of the year.

II. A Reference Scenario

Our reference scenario for the U.S. and Canadian economies for 2026 and 2027 is based on assumptions for the global economy founded on some stabilization of the geopolitical and trade environment.

- Diplomacy succeeds soon in ending the armed conflict in Iran and restoring normal traffic through the Strait of Hormuz. Thus, the effect of disruptions to energy and commodity production and exports from the Middle East starts to dissipate around mid-2026.
- The West Texas Intermediate (WTI) benchmark oil price averages US$85 per barrel in 2026 and US$75 in 2027, measurably higher than US$65 in 2025, but down from levels of US$100 and above since March 2026.
- Current U.S. tariffs are treated as permanent (for example, the current tariffs imposed under Section 122 of the Trade Act continue, or else they are replaced by equivalent tariffs under other legal authorities).
- The existing sectoral U.S. tariffs on steel, aluminum, autos and lumber remain intact.
- CUSMA continues, albeit without necessarily an agreement to extend the deal beyond the current expiry date of 2036; any changes are minor. Canada secures no special deal on sectoral tariffs.
- Uncertainty about trade and other U.S. economic policies as well as geopolitical developments remain elevated through to 2027.

Our assumptions for the global economy are similar to those adopted by the IMF in its April 2026 *World Economic Outlook*, by the Bank of Canada in its *April Monetary Policy Report*, and by most other forecasters.

Another important parameter in constructing a reference scenario for Canada in 2026 and 2027 is population growth. Given the federal government's goal to reduce the non-permanent resident population to less than 5% of Canada's total population by the end of 2027, while also moderating permanent immigration, we assume that population growth will slow from 1.2% in 2025 to zero in 2026, before edging up to 0.5% in 2027.

Reference Scenario: The U.S. Economy

In our reference scenario, real U.S. GDP grows by 2.1% on a Q4/Q4 basis in 2026 and 2027, about the same pace as in 2025 (Table 2.6). Higher consumer prices, restrictive immigration policies and elevated uncertainty weighing on confidence are partly offset by the positive impacts of tax cuts. Growth in real consumer expenditures, while moderate, stays positive. Investment in AI slows somewhat by 2027, but it continues to support demand. Meanwhile, residential investment picks up steam. The war in Iran has a small impact on growth because of the small net-energy-exporter status of the United States. Given our assumptions, its impact on consumer prices is temporary. On a per capita basis, real GDP growth averages about 1.8% over 2026 and 2027 as population expands at a rate of 0.4% per year.

TABLE 2.6

U.S. Real GDP Growth (%)

	2024	2025	2026	2027
Q4/Q4	2.4	2.0	2.1	2.1
Year-Over-Year	2.8	2.1	2.2	2.1
Year-Over-Year per capita	1.8	1.4	1.8	1.7

U.S. core inflation is expected to peak at about 3.5% by mid-2026; it recedes gradually to slightly under 2.5% by Q4 2027. Meanwhile, headline CPI inflation peaks at about 4% in Q2 2026 before trending downward to 2% by Q4 2027.

Under the inflation and growth profiles contemplated in this scenario, a data-dependent Federal Reserve holds the policy rate steady in 2026; it would cut it once, by 25 basis points to 3.5%, around Q2 2027. This would reflect a balancing by the Federal Reserve of upside risks to inflation because of tariffs and the passthrough of higher energy costs, and downside risks to employment because of moderating demand. At 3.5%, the policy rate would be near the middle of the range of estimates for the long-term equilibrium rate.

On balance, we expect that monetary policy will not be altered materially under incoming Federal Reserve chairman Kevin Warsh. Given the decision of Jerome Powell to stay on the Board of Governors of the Federal Reserve and thus on the Federal Open Market Committee (FOMC)

that makes the policy interest rate decisions, the balance of opinions on the FOMC is not shifting; Kevin Warsh will replace Stephen Miran, who was openly supportive of lower interest rates. Thus, the best assumption is that despite pressures that may be exercised by the U.S. President in favour of lower interest rates, monetary policy will remain guided by data and by a careful balancing of the Federal Reserve's dual mandate of price stability and maximum employment. Moreover, once sworn in, Kevin Warsh will want early on to assert his independence and protect the credibility of the central bank.

Correspondingly, markets will maintain their confidence in the Federal Reserve, and this will help moderate the pressure on long-term rates, despite inflation continuing to exceed the 2% target and federal fiscal deficits continuing to hover in a range of 6% of GDP. The 10-year Treasury yield would remain at about 4.4% in 2026, before declining to about 4.1% by the end of 2027 (Table 2.7), pulled down by lower expected inflation and short-term rates.

TABLE 2.7

U.S. Core Inflation and Interest Rates: Reference Scenario (%)

	Q4			
	2024	2025	2026	2027
Core inflation: PCEXFE 12-month	3.0	2.9	3.0	2.3
Fed funds rate (upper limit)	4.5	3.75	3.75	3.5
U.S. 10-year Treasury yield - %	4.4	4.1	4.4	4.1

Reference Scenario: The Canadian Economy

In our reference scenario, after a sudden loss of momentum in 2025 caused by U.S. tariffs and trade uncertainty, real GDP growth in Canada accelerates in 2026 on a Q4/Q4 basis to 1.7% and it moderates slightly to 1.5% during 2027 (Table 2.8).

On a year-over-year basis, real GDP grows 1.1% in 2026 and 1.6% in 2027.

TABLE 2.8

Canadian Real GDP Growth (%)

	2024	2025	2026	2027
Q4/Q4	3.1	0.7	1.7	1.5
Year-Over-Year	2.0	1.7	1.1	1.6
Year-Over-Year per capita	-0.9	0.6	1.1	1.1

Such real output growth numbers are by no means spectacular, but on a per capita basis they amount to better performance than in much of the past decade. Indeed, considering our underlying assumption of population growth of 0% in 2026 and 0.5% in 2027, average annual growth in real GDP per capita would be 1.1% in both 2026 and 2027.

Going forward, the composition of growth in Canada shifts slowly from household and government consumption, which generated much of the growth in 2024 and 2025, to public and private investment and exports. Held back by low population growth, high consumer prices, elevated unemployment and economic uncertainty, household consumption makes a modest contribution to growth in 2026, notwithstanding the effect of recent federal support measures in the near term. The contribution from household consumption increases somewhat in 2027, but it remains sub-par. Also affected by slow population growth and affordability issues, residential investment remains subdued in the short term. Economic uncertainty continues to restrain business confidence, and non-residential fixed investment remains weak in 2026. However, investment gains strength in 2027 as businesses adjust to a new trade environment and as more infrastructure projects get under way. The adjustment of firms also favours a resumption of export growth.

Fiscal Impulse

Taking at face value the latest budgets and fiscal updates of the federal government and the four largest provinces, the fiscal impulse to growth that was significant in the fiscal year ended on March 31, 2026, will be lower during this fiscal year and turn slightly negative in 2027–2028 (Table 2.9). The "fiscal impulse" is calculated as the year-to-year change in net borrowing of governments as a proportion of GDP. If governments raise their net borrowing (to fund their fiscal deficits and their net capital investments), there is (mechanically, and with a lag) a positive contribution to growth in the short term; conversely, if they reduce their net borrowing, this acts as a drag on growth. Of course, the longer-term effects are more complex. At this time, the federal and the four provincial governments together are planning an increase in net borrowing as a percentage of GDP in 2026–2027 and then a tightening in 2027–2028.

This said, fiscal outcomes may vary considerably from plans set out by governments as early as February, before the commodity supply shock and the spike in energy prices. In all cases, results will be sensitive to economic and fiscal developments, including oil prices. For example, the average of private sector forecasts that underpins the federal *Spring Economic Update 2026* provides for a WTI oil price of US$73 per barrel in 2026 and $US66 in 2027—considerably lower than our assumption of US$85 in 2026 and US$75 in 2027. The risk section below discusses the risks for Canada associated with energy prices.

TABLE 2.9

Net Impulse to Canadian Growth from Federal and Provincial Budgets

	2024-2025	2025-2026	2026-2027	2027-2028
Federal Fiscal Update - April 28				
Deficit (C$B)	36.3	66.9	65.3	63.1
Net capital investment (C$B)	10.5	12.0	17.7	20.2
Net borrowing as % of Can. GDP	1.5	2.4	2.5	2.4
Ontario budget - March 26				
Deficit (C$B)	1.1	12.3	13.8	6.1
Net capital investment (C$B)	9.4	15.3	17.8	17.5
Net borrowing as % of Can. GDP	0.3	0.9	1.0	0.7
Quebec - March 18				
Deficit (C$B)	7.6	9.9	7.1	4.2
Net capital investment (C$B)	9.9	8.8	8.5	9.2
Net borrowing as % of Can. GDP	0.6	0.6	0.5	0.4
Alberta - February 26				
Deficit (C$B)	-8.3	4.1	9.4	7.6
Net capital investment (C$B)	-0.1	0.5	1.4	1.7
Net borrowing as % of Can. GDP	-0.3	0.1	0.3	0.3
British Columbia - February 17				
Deficit (C$B)	7.3	9.6	13.3	12.2
Net capital investment (C$B)	7.2	8.6	9.4	8.4
Net borrowing as % of Can. GDP	0.5	0.6	0.7	0.6
Total: Federal + 4 largest provinces				
Deficit as % of Can. GDP	1.4	3.2	3.3	2.7
Net capital investment as % of Can. GDP	1.2	1.4	1.6	1.6
Net borrowing as % of Can. GDP	2.6	4.6	4.9	4.3
Change in net borrowing as % of Can. GDP		2.0	0.3	-0.6

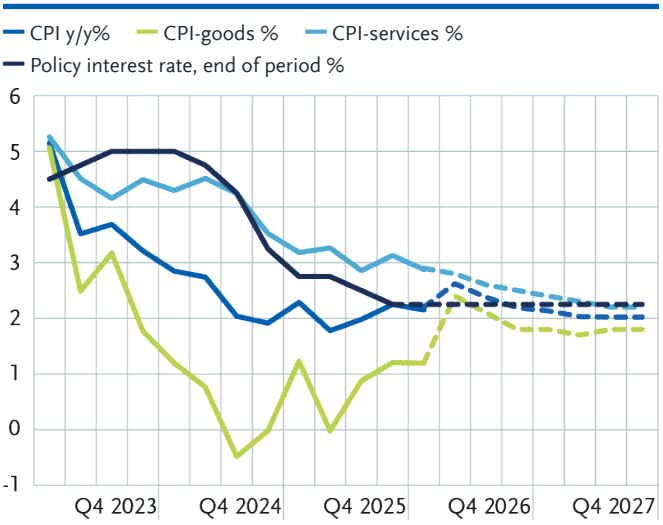
Note: Canadian nominal GDP as projected in the Spring Economic Update 2026.

CPI Inflation

Headline CPI inflation in Canada is projected to rise to 3.1% in Q2 2026, pushed up by higher gasoline and energy prices; it would come back down to the 2% target by the second half of 2027 (Chart 2.4). Excess supply in the economy, and moderating rent inflation due to modest population growth and increases in housing supply, will put downward pressure on CPI inflation. Services price inflation generally will continue a trend downward to just over 2% by the end of 2027.

CHART 2.4

Year-on-Year Inflation and the Policy Rate in Canada



Interest Rates

In the reference scenario, the Bank of Canada keeps its policy rate at 2.25% through to the end of 2027. The central bank looks through a short-lived oil price shock. At the same time, there is no adverse change to the effective U.S. tariff on imports from Canada that would further disrupt our exports, depress the economy, and require monetary easing (Table 2.10).

Despite moderating inflation, the 10-year Canada bond yield stays firm at around 3.5% as capital markets absorb continued, heavy borrowings by governments in Canada and globally.

The Canadian dollar tends to appreciate slowly over the projection period, to US$0.75 by 2027, with the narrowing of U.S.–Canada differentials for both interest rates and economic growth.

TABLE 2.10

Canadian Interest Rates in the Short Term

	Q4			
	2024	2025	2026	2027
Bank of Canada policy rate - %	3.75	2.25	2.25	2.25
10-year Canada bond yield - %	3.2	3.3	3.5	3.5
U.S. dollar per Canadian dollar	0.71	0.72	0.74	0.75

III. Risks and Sensitivity of the Outlook for Canada

Trade Policy Risks

Relative to the reference scenario, there are both downside and upside risks related to U.S. trade policy and the future of CUSMA. Trade negotiations between Canada and the United States have stalled. Progress on this front may be slow, as the U.S. administration is absorbed by many competing international priorities. The timeline and outcome of the CUSMA review are hard to predict (see Chapter 1). On the one hand, given that consumer confidence in the United States is low and business confidence fragile, certain sectoral tariffs on Canadian exports could be lowered in order to reduce costs for producers and improve affordability. This would stimulate sectoral exports in Canada, support employment, and improve investment prospects. If this were combined with an agreement to maintain the current treatment of most CUSMA-compliant goods, it would substantially reduce uncertainly, further improving the Canadian outlook. On the other hand, the U.S. administration, in part because it needs the fiscal revenue, may want to expand tariffs through the review of CUSMA (or separately). The resulting increase in the average U.S. tariff on Canadian goods would have negative effects on Canada's net exports, real GDP and employment. As long as there is no agreement, uncertainty will hold back business investment in many sectors, thereby restraining demand in Canada. The strategy of pursuing new markets for Canadian exports overseas is already helping to mitigate the detrimental effects of U.S. tariffs, but efforts need to be sustained to reduce materially our exposure to U.S. trade policy risks.

To gauge the sensitivity of the economic outlook for Canada to our trade relationship with the United States, we consider the impact of a 10% tariff on goods currently exempt under CUSMA. We rely on elements from Scotiabank's empirical analysis entitled "Low Probability, High Cost: The Macroeconomics of Abandoning CUSMA."[3] This analysis in turn relies on Scotiabank's integrated U.S.–Canada macro model to capture bilateral trade flows and the endogenous monetary and fiscal policy responses that partially offset the drag from higher trade barriers. The illustrative scenario of the imposition by the United States of a 10% tariff on imports from Canada that are currently exempt from tariffs under CUSMA would lift the average effective tariff rate on total Canadian exports (to all markets) by 8 percentage points.

A hike in the effective tariff on U.S. imports from Canada would affect our economy through a number of channels. Scotiabank cites four channels: reduced trade flows, which account for the bulk of the GDP decline relative to a reference scenario; weaker productivity, as dismantling supply chains leads to less efficient production; confidence effects as uncertainty remains elevated during the transition period, with negative impacts on household and business expenditures; and the spillovers for Canada of tariff-driven inflation in the United States, including higher policy rates slowing down U.S. demand. Canada would avoid retaliation, and consequently there would not be any direct impacts on domestic inflation.

On a net basis, the tariff shock would cause a drop in the level of real GDP of some 0.125% in 2026 and 0.6% in 2027. Working back from our reference scenario, this would result in average annual real GDP growth in Canada of about 1% in 2026 and 1.1% in 2027. Layoffs would push the unemployment rate by as much as 0.5 percentage points above the reference scenario rate by the first half of 2027 and by 0.3 percentage points above the reference scenario rate by Q4 2027. Headline CPI inflation would be slightly lower than in the reference scenario due to weaker domestic demand. The policy interest rate could be lower by at most one quarter of a percentage point. Relative to the reference scenario, part of the loss of output by 2027 would be permanent, but about one half would be recovered by 2030 as the economy adjusts to the tariff structure.

Risks Associated with AI

The potential of AI technology to improve productivity and create value has been a major driver of investment-led economic growth in the United States, and it has fueled sustained gains in equity markets. In turn, the investment has supported demand for U.S. imports, including from Canada. Meanwhile, the wealth effect from high asset valuations has supported consumption growth in both the United States and Canada. There is considerable debate on whether the AI boom is based on realistic profit forecasts. While AI is likely to transform the organization of work in many sectors, it is unclear whether the private gains will be sufficient to generate the high returns expected by investors. As evidence of the impacts of the technology in the workplace mounts, there could be a substantial re-evaluation of asset values and risks. This could cause

both a rethinking of future AI investment plans and an important, possibly sudden, (downward) correction in stock prices. Given inflationary pressures, the Federal Reserve may not be in a position to cut interest rates aggressively to counter the market-destabilizing effects of such a repricing of assets. Together with a pullback of AI-related investment, the loss of wealth could substantially depress demand in both the United States and Canada.

Risks Associated with Energy Prices

The oil price remains highly sensitive to geopolitical developments. Because Canada is a large net energy exporter, a high oil price raises national income. However, there is uneven distribution of gains. Higher oil prices increase the profits of Canadian producers and the royalties and taxes earned by governments from the energy sector. Yet, for most households and businesses they represent a financial burden, which tends to depress their spending. If the increase in price is considered temporary, there is no significant investment response and the net impact on economic activity (e.g., real GDP) is small. However, if geopolitical developments are such that the energy industry expects higher oil prices to prevail over the long term, then, relative to the reference scenario, investment can strengthen while the economy also earns a higher price for its exports.

Canadian Private Sector Investment Risks

One of the major drags on the Canadian economy has been the low level of non-residential investment. This reflects a set of factors, with tariff increases and uncertainty playing a significant role over the last year. The federal government and the provinces have set out plans aimed at increasing both private and public investment in Canada. The speed and extent to which these policy initiatives will boost private investment remain to be seen. Persistently high sectoral tariffs, in addition to the uncertainty associated with the renegotiation of CUSMA, could keep investment depressed and incite firms to relocate to the United States. This would depress aggregate demand in the short run and hinder growth in the productive capacity of the Canadian economy in the long run. Such forces would create substantial downside risk to Canadian growth prospects over our projection horizon and beyond. In contrast, the change in the Canadian policy environment, especially that associated with major resource projects, could substantially decrease the perception of risks associated with investing in Canada. This has the potential to favour investments by both domestic and foreign firms, with positive spillovers across the economy. This is the upside risk.

CHAPTER 3

Policy Conditions to Attract and Mobilize Private Capital

There is wide agreement among political and business leadership in Canada that the adjustment to new global realities and the advancement of our economic and national security rest on unleashing private investment.

Large amounts of private capital must be mobilized to:

- build and expand physical and digital infrastructure;
- develop and capitalize on our resource base;
- restructure and reposition our trade-oriented manufacturing industries;
- grow our defence industrial base;
- equip our workers with better skills, tools and technology;
- leverage our AI capabilities for commercial advantage; and
- innovate and create and commercialize IP.

There is also a shared understanding that, after years of languishing investment and productivity growth, a large step change in investment flows is required to make up for lost opportunity and to secure Canada's future.

The Government of Canada has set an ambition to "catalyze" C$1 trillion in investment from public, private and institutional partners over the next five years. In support of this goal, it is pledging regulatory streamlining, tax assistance and participation by publicly owned investment vehicles. The MPO is reviewing 15 projects, representing over C$125 billion in capital investments, and it is developing six "transformative strategies" aiming to develop other large projects.

RBC Thought Leadership sees an opportunity for investment of C$1.8 trillion over the next 10 years in six sectors alone: oil and gas, agriculture and food processing, electricity, metals and minerals, defence and space.[1]

However large the investment gap to close over the next 5 to 10 years, the problem to solve is not a lack of financial capital. There is ample capital from corporate, institutional and private sources, in Canada and internationally, that is in search of investment opportunities.

As a resource-rich, advanced economy with a well-educated workforce, sound institutions and respect for the rule of law, Canada presents lesser risk as an investment destination than most other places on earth. This said, domestic and foreign investors seek a competitive return.

It is largely the role of businesses to identify the market opportunities, to manage the business risks and to execute on the investments.

In some cases, governments can be active partners, including as co-investors, but mostly the role of governments is to create a predictable and sound policy environment that enables market leaders and innovators to realize competitive, risk-adjusted returns.

In Canada, federal leadership is paramount, and it can set the tone, but it is the collective actions of federal, provincial and even local governments that shape the business environment and the incentive structures for investment.

Governments have sent many positive signals and taken early actions to promote investment. The investor response is still tentative. More remains to be done. Private sector engagement and stronger policy coordination among governments are critical to getting the investment conditions right.

Business Investment: Outcomes and Trends in 2025

As analyzed in detail in prior issues of our *Economic Outlook* and in many other analytical reports, by virtually any measure business investment has been dismal in Canada over the past 10 years. In aggregate, and as a proportion of GDP, Canada never recovered from a sharp drop in investment precipitated in 2014 by a collapse of oil prices (Chart 3.1). Despite improved corporate profits since then, our economy has incurred chronic shortfalls in non-residential business investment. In 2025, this shortfall relative to prior levels represented up to 3 percentage points of GDP, or about C$100 billion.

According to researchers from the C.D. Howe Institute, in 2025 Canadian workers received about 70 cents of new capital for every dollar received by their counterparts in the OECD and 55 cents for every dollar received by U.S. workers.[2] The researchers also show that since 2015 real capital stock per worker in Canada has been declining across all forms of capital: non-residential buildings and engineering structures, machinery and equipment, and IP products. Employers are asking our workers to do their job with less physical and intangible capital than 10 years ago, despite ever more intense competitive pressures. Year-on-year, we are further handicapping them relative to workers in the United States and the OECD.

I. Putting Canadian Investment Targets into Context

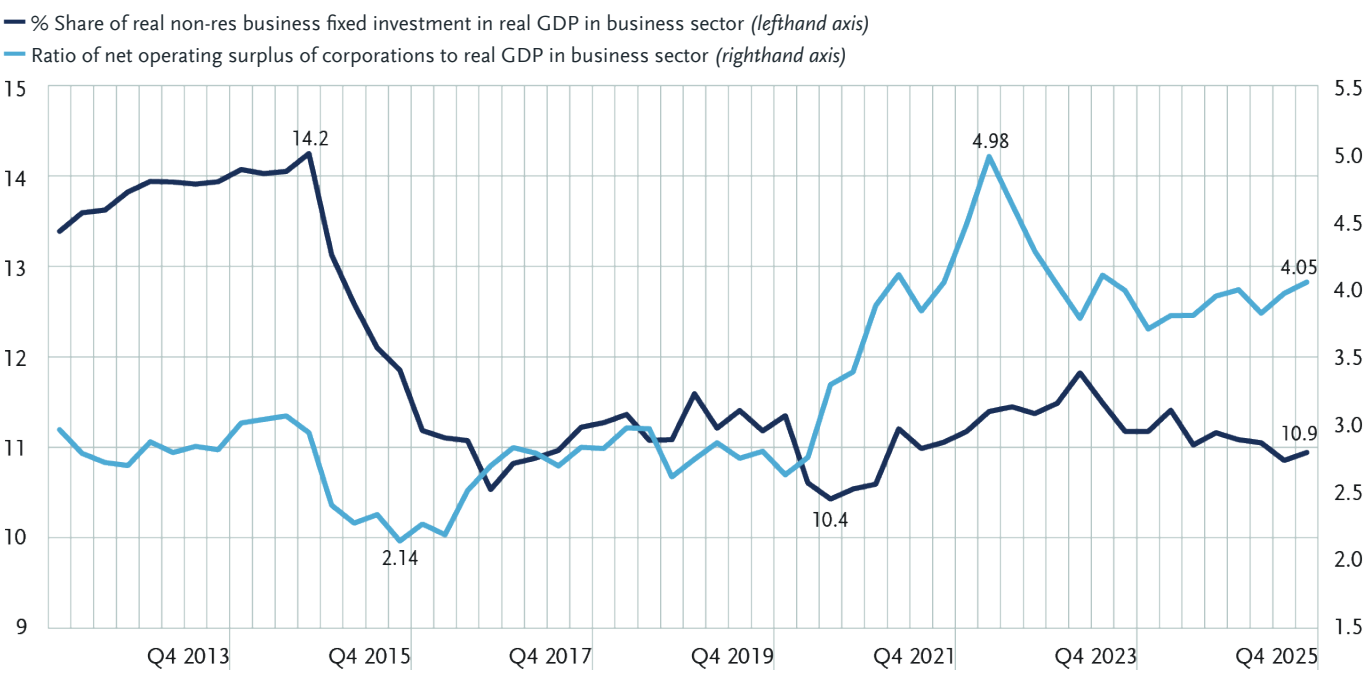
The past trends and the recent performance of business investment put into context the federal target of C$1 trillion of investment from public, private and institutional partners over the next five years. The notional amounts must be understood as *incremental* investment in tangible and intangible *productive* capital to be led and to be funded in large majority by the private sector. To make up for lost ground and to respond to new global realities, business investment must grow substantially, and sustainably, for the next five to 10 years.

Flows of financial capital are a gauge of investor interest in the Canadian economy and in Canadian assets. Some recent developments are encouraging. In 2025, for the first time since 2022, the growth of foreign direct investment (FDI) in Canada (6.9%) exceeded the growth of Canadian direct investment abroad (2.8%).[3] There has been strong mergers and acquisitions activity in 2025 and in the first quarter of 2026.[4] There is also solid domestic and foreign private and institutional investor interest in infrastructure in Canada, including in energy, mining, defence and digital infrastructure.[5]

The Government of Canada is currently seeking to grow the pool of available financial capital for investment, including

CHART 3.1

Investment and Profitability in Canada's Business Sector



Source: Statistics Canada, tables 36-10-0104-01,36-10-0206-01 and 36-10-0103-01.

by attracting sovereign wealth funds and other institutional and private investors, and by creating the new C$25 billion Canada Strong Fund.

- The Prime Minister, working with premiers and business leaders, is engaging actively with investors in Canada and internationally. He has convened a Canada Investment Summit to take place September 14–15, 2026, in Toronto.
- Details on the Canada Strong Fund are thin, and the gap it is intended to close is unclear. Yet, it again conveys an ambition to mobilize capital—in this case, borrowed capital, plus savings of individual Canadians under a new retail investment product—"to invest in strategic Canadian projects and companies alongside other investors—with a clear objective to achieve commercial returns to build the wealth of Canada."[6]

Global and domestic capital are plentiful and highly mobile. The determining question for financial investors is whether there are "investible" projects and enterprises with prospective risk-adjusted returns as high or higher than those of competing propositions globally.

Investors may be initially attracted to assets that already generate a solid stream of income. Corporate M&As, as well as privatizations of public assets such as airports, can contribute to the efficient management of assets and help mobilize capital to grow the asset base.

- For example, Shell's proposed acquisition of ARC Resources, announced on April 27, in a cash-and-share transaction valued at approximately C$22 billion, represents a vote of confidence in Canada's resource sector only years after the divestiture by Shell of its oil sands assets.[7] While delivering a premium to ARC shareholders of about 27%, the transaction may help expand shale gas and liquids production in Canada's Montney Basin.
- The *Spring Economic Update 2026* states that "the government is assessing opportunities to unlock the full value of airports in support of investments in Canada's long-term growth, including through alternative models of ownership." The privatization of airports or related assets and revenue streams could enable the recycling of proceeds by the government (including via the Canada Strong Fund) into other infrastructure assets.

To enable the adjustment of firms and workers, to accelerate productivity growth and to compete in new markets, what is required even more critically is the mobilization of capital for investment in *new* productive assets and ventures.

While the government may set the ambition and the target, this is principally the task of business leaders—the executive teams in large, small and start-up enterprises that drive the investment decisions from original design to development, financing and execution.

II. The Perspective and Responsibility of Business Leaders

Business executives are confronting a complex global environment as they weigh strategies and plans to mobilize and allocate capital and to create the best value for shareholders.

Start-up entrepreneurs similarly are dealing with concurrent forces of change as they develop plans to finance and commercialize their innovation and scale up their businesses.

Decisions are time-sensitive, and they must be responsive to short-term pressures. Nonetheless, the planning horizon is the medium to long term. The investment choices must weigh many factors, namely:

- the availability and competitiveness of the needed physical or digital infrastructure;
- the security of access to markets;
- the security of supply chains and confidence bands around the cost of inputs;
- the availability and cost of talent and labour, from design, to engineering, to execution and commercialization;
- the competitiveness and predictability of the regulatory and taxation environment;
- the opportunity, for major projects, to partner with Indigenous peoples and to secure consent and legal clarity;
- where necessary to overcome market failures or gaps, the availability of public financing or risk-mitigation instruments (e.g., price floors or strategic reserves for critical minerals); and
- the prospective risk-adjusted return (taking all of the above into account) and whether it is competitive with what may be earned in other business ventures and other jurisdictions.

Engagement with governments is needed to convey clearly the factors and the timeline that are decisive for final investment decisions and that are within the latter's control. Ultimately, businesses have to make strategic decisions, manage the risks, execute the investments, realize the returns and adapt as market conditions dictate over time.

III. The Responsibility of Governments

Chapter 1 reviewed necessary actions that governments must take in order to address our national security commitments and interests, to diversify our markets and international partnerships, to capitalize on our resource endowment and to leverage AI for economic advantage.

Cutting across these domains of intervention, the responsiveness of governments to both long-standing economic challenges and new global realities commands a sharp policy focus on the promotion of private investment.

In recent years, the federal government has created new public vehicles to lower the risk-adjusted cost of capital for private investors and to invest alongside private partners in commercial enterprises. These vehicles have a role in some circumstances.

However, as repeated in many reports or submissions over the years, the principal role of government is to establish the policy frameworks that enable investments by market leaders and innovators to realize a competitive, risk-adjusted return.

Key policy drivers are well known. They include:

- regulation;
- competition;
- taxation;
- public infrastructure;
- economic immigration; and
- education and training.

In any of these policy domains, there is tension among the concurrent objectives and goals of governments, including economic prosperity, national security, public safety, climate and the environment, consumer protection, income distribution and Indigenous reconciliation.

The task of governments today is to recalibrate, and in many cases transform, policy such that private investment and innovation may be unleashed to serve multiple private and public goals.

IV. Early Actions in Response to Threats to Our Economic Security

U.S. tariffs and threats to Canada's economic security were a wake-up call for Canada in 2025, and governments responded with early actions to reset policy and stimulate private investment.

By and large, measures have been incremental: they have included the creation of new agencies, the expansion of public investment and the introduction of new spending to address immediate pressures and to target early results.

For example:

- The federal government passed Bill C-5, and it created the MPO to overcome regulatory obstacles to projects in the national interest.
- It launched Build Canada Homes with an initial investment of C$13 billion over five years "to supercharge the housing industry."
- It tweaked the tax system by introducing the "Productivity Super-Deduction" to allow a faster write-off of capital investment while confirming or expanding a series of targeted tax credits for the clean economy.
- It launched the Defence Industrial Agency to overhaul and streamline defence procurement and to build domestic manufacturing and supply chains.
- In Budget 2025, it allocated over C$25 billion for industries affected by tariffs and trade disruptions to help workers acquire new skills and businesses retool their production and diversify their products.

Provinces and territories have also taken measures in their domains of jurisdiction:

- They have worked with the federal government to implement arrangements to achieve the goal of "one project, one review" and to accelerate energy, mining and infrastructure development.
- They have also reduced some barriers to internal trade through an (imperfect) mutual recognition agreement on the sale of goods and through a series of bilateral agreements.

Delivery on these initiatives will require ongoing commitment.

Yet, the next budgets and policy initiatives of governments cannot simply add to a long list of funds, programs, ad hoc measures or institutional workarounds. To go further, governments have to transform the *core* of the policy and delivery architecture. This will be harder to do.

V. Four Conditions for Structural Policy Transformation

***First*, governments have to undertake a principled and structured review of legislation, regulation and policies as needed to remove barriers and to improve the incentive structure for investment and innovation. Taxation and project regulation are priorities.**

- Targeted tax credits or super-deductions such as legislated in the past years, with defined sunset dates, have merit to accelerate business investment. But they introduce added complexity and they interfere with the flow of capital to its most productive uses. The federal government is following through with announced measures to give certainty to businesses that are undertaking the eligible investments. It should also use this time to undertake a comprehensive review of the business tax system to simplify the rules and, over the next years, create a more uniform incentive for all forms of investment. This would involve addressing delicate matters such as the small business tax rate. Broadly, the structure of the tax system should evolve to shift the burden of taxation from savings and investment to consumption. The next federal budget could announce the parameters of a review.
- Bill C-5, the *One Canadian Economy Act*, and the MPO have created new tools to accelerate the review of projects in the national interest. To date, projects have been referred to the MPO, but none have been added to the schedule of the Act to benefit from the new legislative authorities. Thus, the workings of the legislation and the legal risks for proponents are difficult to evaluate at this time. Agreements with provinces on "one project, one review" are positive developments. However, these initiatives do not alter the core federal regulatory system comprising many acts and regulations that still confront investors and proponents contemplating large projects. On May 8, the government launched 30-day consultations on "potential changes that would ensure federal reviews and decision-making timelines take no longer than one year, once all information from the project proponent has been received."[9] The next budget could announce the legislative reform to streamline and improve the efficiency of the system.
- In this regard, the government must also consider the risks for investors arising from a lack of clarity on the Indigenous consultation process and the rights of Indigenous peoples, notably title rights. Federal and provincial government initiatives to facilitate Indigenous participation in projects have been well received by both project proponents and Indigenous groups. They can help secure Indigenous consent and advance reconciliation. Nonetheless, the legal framework requires greater clarity. The British Columbia and federal acts recognizing the United Nations Declaration of the Rights of Indigenous Peoples have introduced new questions and given rise to court judgments that have created uncertainty. Governments must establish a framework that respects constitutionally protected rights while assisting project proponents in consulting, seeking consent and achieving legal certainty.

***Second*, intergovernmental coordination should be reinforced. Most domains of policy, for example the environment or labour markets, involve shared federal and provincial territorial jurisdiction. In sectors like AI and the digital economy, where competitive forces and technology require agile policy frameworks, collaboration is essential to build capacity.**

- The dismantling of internal barriers to trade remains low-hanging fruit. The *Spring Economic Update 2026* notes the recent study by the IMF estimating that the elimination of all internal trade barriers could raise the level of Canada's real GDP by nearly 7%. The pronouncements and initiatives of premiers in early 2025 do not yet appear to have resulted in policy breakthroughs that would represent an unequivocal signal to markets.
- The regulation of AI and the protection of privacy and security in the digital economy are unlikely to be effective unless tightly aligned and coordinated among levels of governments and across provinces. Indeed, Canada as a sovereign country will benefit from collaboration with other middle powers in designing and administering viable frameworks.
- As reviewed in Chapter 4, Canada faces formidable challenges over the next years to match the supply of skills in the labour force with demand from employers as will evolve with new trade flows, the building of large projects and the dissemination of AI across industries. Economic immigration and even more importantly the skilling of the workforce require close coordination of efforts among the federal and provincial governments as well as tight collaboration with employers, unions and educational institutions.
- First Ministers' Meetings can elicit high-level undertakings, but detailed work must take place under the strong direction of federal and provincial ministers, with clear agendas and timelines. These should be communicated to the public to build accountability.

***Third*, while reaching out to the private sector, governments must modernize and rebuild the capacity of public institutions and the core public service to deliver effective policy and services.**

- A competitive and productive economy requires capable, high-performing governments.

- To push forward its priorities in support of investment and to accelerate business transformation, the Carney government has created new agencies and appointed leaders from the private sector. This can help drive culture change.
- Yet, the efficient delivery of services to businesses and individuals and the adaptation to technology and other forces of change require modernization and capable governance and operations across the universe of departments, agencies and Crown corporations.
- Moreover, our system of government rests on the capacity of the public service to deliver non-partisan, expert advice to ministers and to implement effectively their decisions. There is a concern that this capacity has been eroded and so needs to be reestablished.
- Federally, the Prime Minister has created a Cabinet Committee on Government Transformation, chaired by the Minister of Finance, "to realize more effective and efficient government services and processes and to improve service delivery for Canadians."[10]
- Given the rapid expansion of the public service over the past 10 years, and given fiscal pressures, this will include a streamlining of institutions and a reduction in the size of the public service. However, the effort must be broader.
- As stated in a work co-authored by former Clerk of the Privy Council Kevin Lynch:

> A 21st century public service needs to be lean and productive, with employees who have the skills for a digital economy and society. These would include sophisticated policy capacity, data analytics, IT operations, big data information systems, complex project management, procurement, cybersecurity and AI.[11]

- The Minister of Finance could report on the goals for and progress of government transformation in his next budget.

***Fourth*, as discussed in Chapter 1, the actions of governments must be situated within sound fiscal plans, with tight spending discipline, built-in margins of prudence, and binding short and medium-term fiscal anchors.**

- Sound fiscal plans will help Canada consolidate a global advantage and favour the stability and predictability that can help investors and businesses plan and execute their investments with confidence.

Early actions in support of private investment such as those taken by the federal and provincial governments are essential to achieving early results and building momentum. Execution is key.

Time is of the essence. The resetting of policy and the rebuilding of government capacity will require sustained efforts over the medium term. Strong leadership, intergovernmental collaboration and the engagement of businesses will be essential to sustain progress.

CHAPTER 4

The Labour Market: Current Conditions and Structural Change

The review of developments and prospects in Canada's labour market provides valuable insight into current economic conditions, structural trends and adjustments, and challenges lying ahead for Canada in developing human capital to adjust and grow the economy.

As we near the mid-point of 2026, the labour market is exhibiting a measure of slack consistent with an economy going through a period of slow, but still positive, output growth amid adjustment to global change. The unemployment rate, at 6.9% in April, is within a band of 6.5% to 7.1% that has prevailed since the beginning of 2025.

Changes in employment since the beginning of 2025 are sharply differentiated by industry and region, reflecting in part exposure to trade disruption by the United States. There have been material job losses in manufacturing as well as in retail trade. Employment has dropped significantly in Quebec, particularly in the first months of 2026. Since January 2025, job growth has been modest in Ontario and robust in Alberta. Generally, employers appear prudent in both their hiring and firing decisions.

Under a baseline projection, slack in the labour market will be absorbed slowly in 2026 and then more quickly in 2027. However, there are significant downside risks, and conditions could get worse before they get better.

Under any scenario, structural trends and pressures will continue to act upon the labour market, and, in turn, the responsiveness of the labour market will be an important factor in determining Canada's economic prospects over the medium term.

Looking back over the past 10 years, employment trends across industries reveal several undercurrents. For example:

- Canada is increasingly a services economy: 83% of jobs today are in the services sector.
- Jobs in the public sector have grown at close to twice the rate in the private sector, now representing more than one job out of five.
- In the manufacturing sector, employment has been basically flat, while it has grown robustly in the construction sector.

For any given industry, a finer analysis would draw out the forces—such as demography, technology, exposure to trade and competition—that will be shaping outcomes, including the creation, distribution and content of jobs.

Canada's workforce is increasingly skilled. In the last 10 years, job growth in high-skills occupations was close to 40% compared with less than 5% in low-skills occupations. Some 77% of the workforce aged 25–64 has a post-secondary education certificate or diploma, or higher.

Looking forward, net growth in Canada's population and labour force will be driven by immigration.

However, productivity and wage growth will be determined more critically by how the economy succeeds in matching the supply and demand of skills, and adjust to some of the most significant structural pressures in decades: U.S. trade tariffs and protectionism; the added demand for workers to build more infrastructure and homes across the country, faster; and, last but not least, the integration of AI.

Some orders of magnitude from available statistics and third-party studies are helpful to seize the dimensions of the challenge.

- There are currently 21 million Canadian workers.
- Over 10 years, based on analysis conducted in 2024, there will be 8 million job openings, roughly one-third of which will come from the net creation of jobs and two-thirds of which will come from the replacement of workers.

- Given demographic trends, and subject to immigration intake, two-thirds of jobs will be filled by individuals leaving school and one-third will be filled by immigrants.
- Some 2 million jobs in Canada's economy are linked to goods exports to the United States, including 800,000 in manufacturing. These jobs are directly exposed to the future of the trade relationship between the two countries.
- Workers in the trades are in high demand today. To meet the ambitions of governments, it is estimated that Canada's construction workforce will have to grow by about one-third by 2030, from about 1.7 million today.
- The impacts of AI on productivity and growth are uncertain, and to date there has been only limited repercussions on jobs. However, AI will likely be the most powerful force affecting the future of work. Detailed analyses of occupations and tasks that can be automated suggest that about 60% of jobs in Canada are exposed to AI: in about one half of these cases, AI could replace human labour; in the other half, it could complement and enrich it.

Over time, *market* instruments to match skills supply and demand, including investment in the workforce and changes in the wage structure to attract and retain the workers sought by employers, will be the principal levers to drive economic adjustment.

For its part, labour market *policy* must be focused on helping to build a skilled, adaptable, innovative workforce. Given the breadth and pace of structural change in the economy, and the current uncertainty about its ramifications, there are significant limits and risks to micro-targeting labour market interventions, including economic immigration, to meet immediate and projected needs.

The governance of labour markets in Canada is complex, with significant roles played by the federal and provincial governments, universities, colleges and vocational schools, employers, unions, sector councils, Indigenous groups and local communities.

To help match the supply and demand of skills in the economy as it undergoes structural change, the federal government can exert leadership by providing data and analysis and by promoting collaborative efforts among stakeholders.

- The Government of Canada has the greatest capacity to collect, analyze and disseminate labour market data and intelligence at national, regional and local levels. It can leverage the Canadian Occupational Projection System (COPS) to model scenarios of future supply and demand across a wide range of occupations.
- Scenarios can be a starting point for regular, structured conversations nationally and regionally among the stakeholders on strategies and plans to grow, upskill and reskill the workforce to meet demand and to make the best use of our human capital.

Many interventions will be necessary. The process of adjustment will be considerably facilitated by labour mobility across the country, requiring the provinces and regulatory bodies to accelerate the recognition of professional and worker credentials in the spirit of building one, strong economy.

I. Recent Developments and the Short-Term Outlook

As we near the mid-point of 2026, the labour market is exhibiting a measure of slack that is consistent with an economy going through a period of slow, but still positive, output growth amid adjustment to global change.

The **unemployment rate**, at 6.9% in April, is elevated compared with a level below 5% in mid-2022 when labour markets were unusually tight (Chart 4.1). However, since the beginning of 2025, it has been relatively stable, moving within a band of 6.5% to 7.1%.

Conversely, the **employment rate**, at 60.5% in April, is down materially from a high of about 62.5% in the first quarter of 2023, lying at the bottom of a band of 60.5% to 61.1% that has prevailed over the past 16 months.

- If the employment rate were still 62.5%, there would be 660,000 more Canadians employed today.

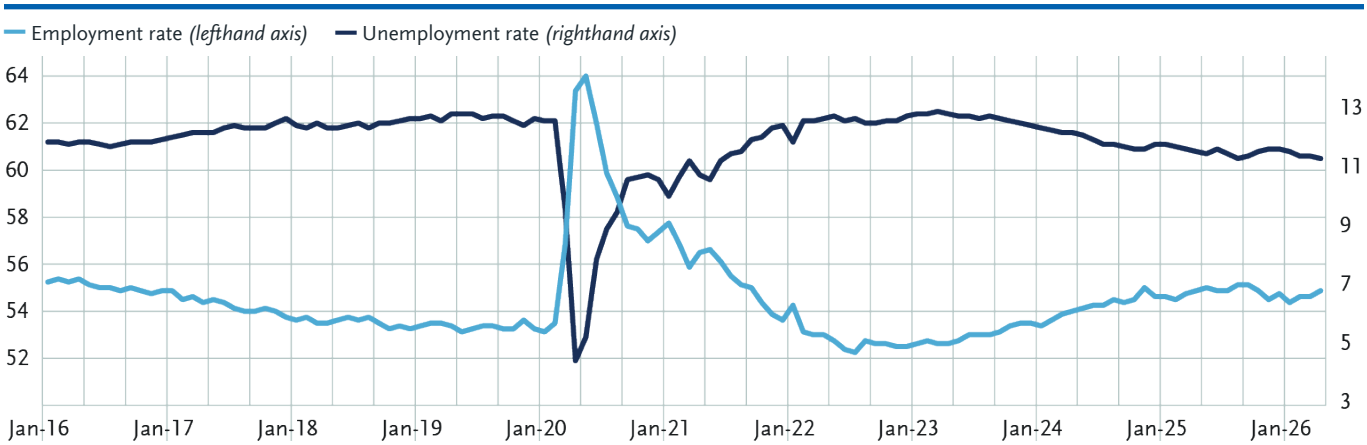
The **ratio of job openings to unemployment**, which shot up during the COVID recovery period to reach close to 1.0 by the summer of 2022, has been about 0.3 since March 2025: it is the lowest in almost 10 years (Chart 4.2). It is getting harder for the unemployed to find new jobs.

In March 2026, the year-over-year increase in **average hourly earnings** was 3.1%, down from close to 5% in early 2023 (Chart 4.3). This reflects in part the success of monetary policy in bringing this element of cost pressure in the economy more in line with the Bank of Canada's inflation target.

CHART 4.1

Employment Rate (%) vs Unemployment Rate (%) to April 2026

15 years and over, seasonally adjusted

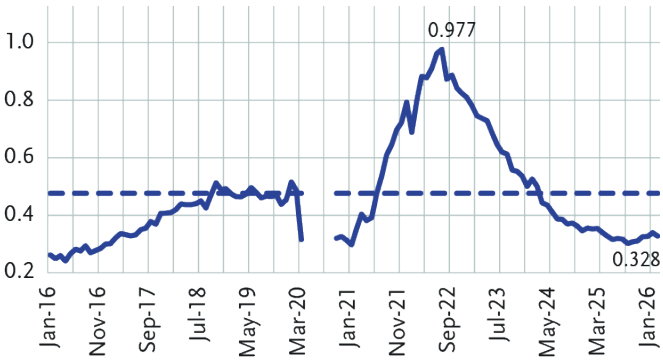


Source: Statistics Canada, Labour Force Survey, table 14-10-0287-01.

CHART 4.2

Job Vacancy to Unemployment Ratio: All Economy

January 2016 to February 2026 (seasonally adjusted)



Source: Statistics Canada, Labour Force Survey, table 14-10-0406-01.

CHART 4.3

Average Hourly Earnings: "LFS-Micro"

(y/y % changes, January 2016 to March 2026)

Source: Bank of Canada.

In a climate of economic uncertainty, employers appear to be prudent with both hiring and firing decisions. In the first eight months of 2025, when labour market conditions deteriorated largely as a result of trade policy actions by the United States, what Statistics Canada observed in aggregate was less a higher-than-normal rate of job firings than a lower-than-normal rate of job hirings.[1]

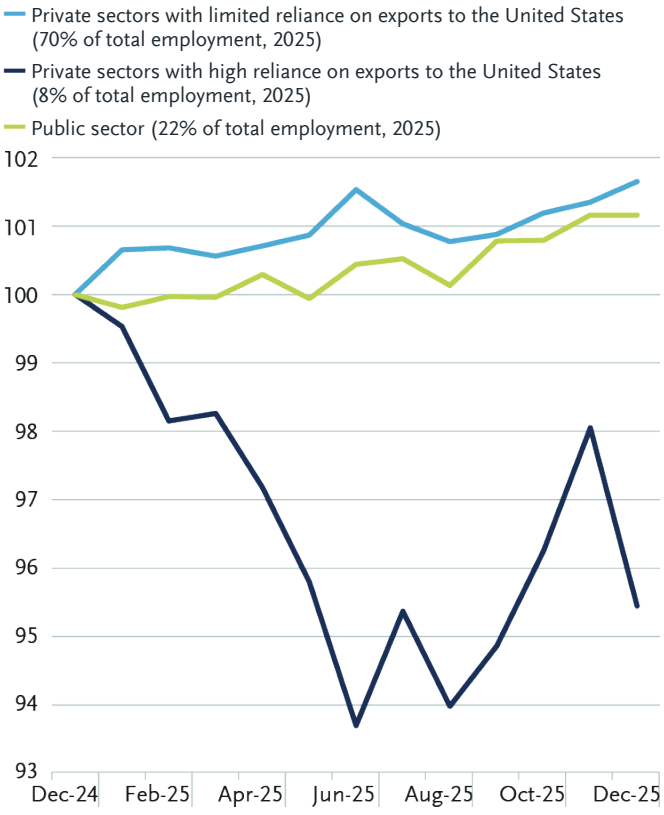
Labour market developments since January 2025 have been sharply differentiated across sectors. The driving force weighing on employment has been trade disruption and uncertainty.

- The Bank of Canada estimates that in 2025, in private sectors with high reliance on exports to the United States, representing 8% of total jobs in the country, employment dropped by close to 4.5% (Chart 4.4). By contrast, it rose in private sectors with limited reliance on exports to the United States (1.7%) and in the public sector (1.1%).

CHART 4.4

Employment in Sectors, Depending on Reliance on Eexports to the United States

Employment level, index: December 2024 = 100, monthly data



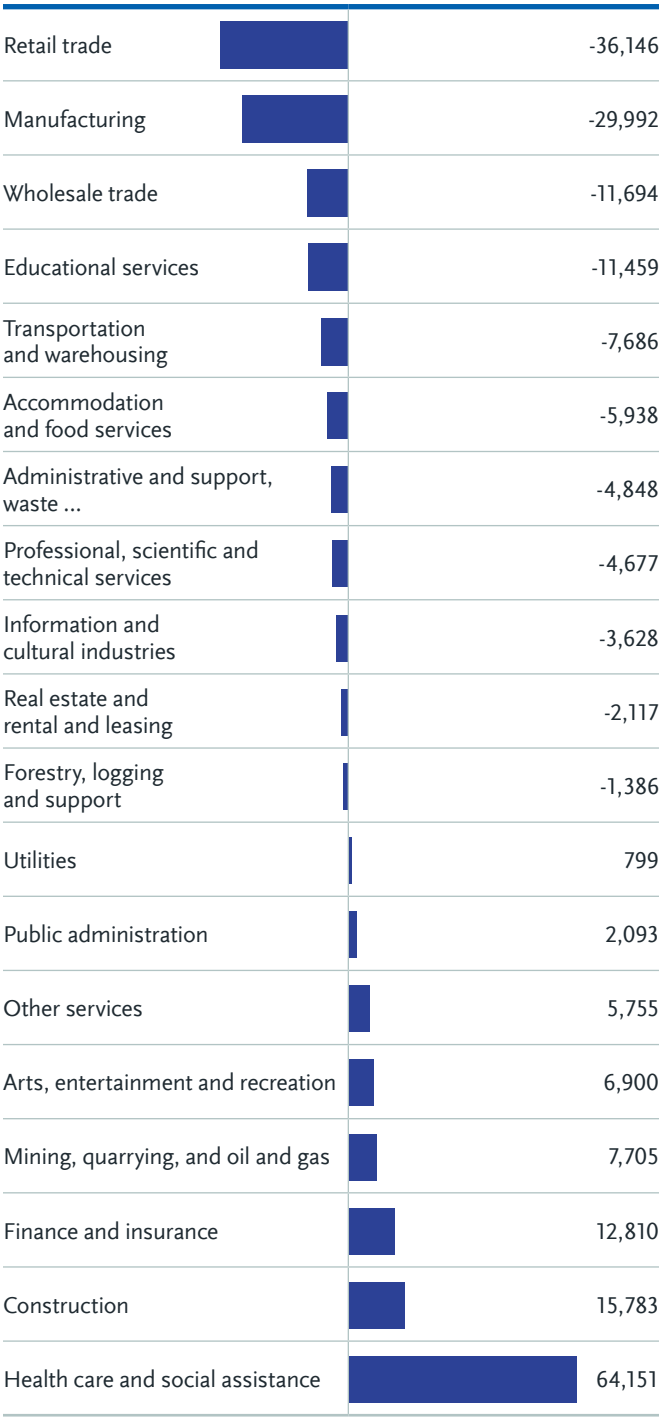
Source: Bank of Canada, Monetary Policy Report, January 2026.

- As per the Survey of Employment, Payrolls and Hours, for the period of January 2025 to February 2026, employment fell sharply in **manufacturing** (30,000 jobs or 1.8%) and **retail trade** (36,000 or 1.7%) (Charts 4.5 and 4.6).

CHART 4.5

Cumulative Change in Employment by Industry

February 2026/January 2025 (seasonally adjusted data)



Source: Statistics Canada, Survey of Employment, Payrolls and Hours, table 14-10-0220-01.

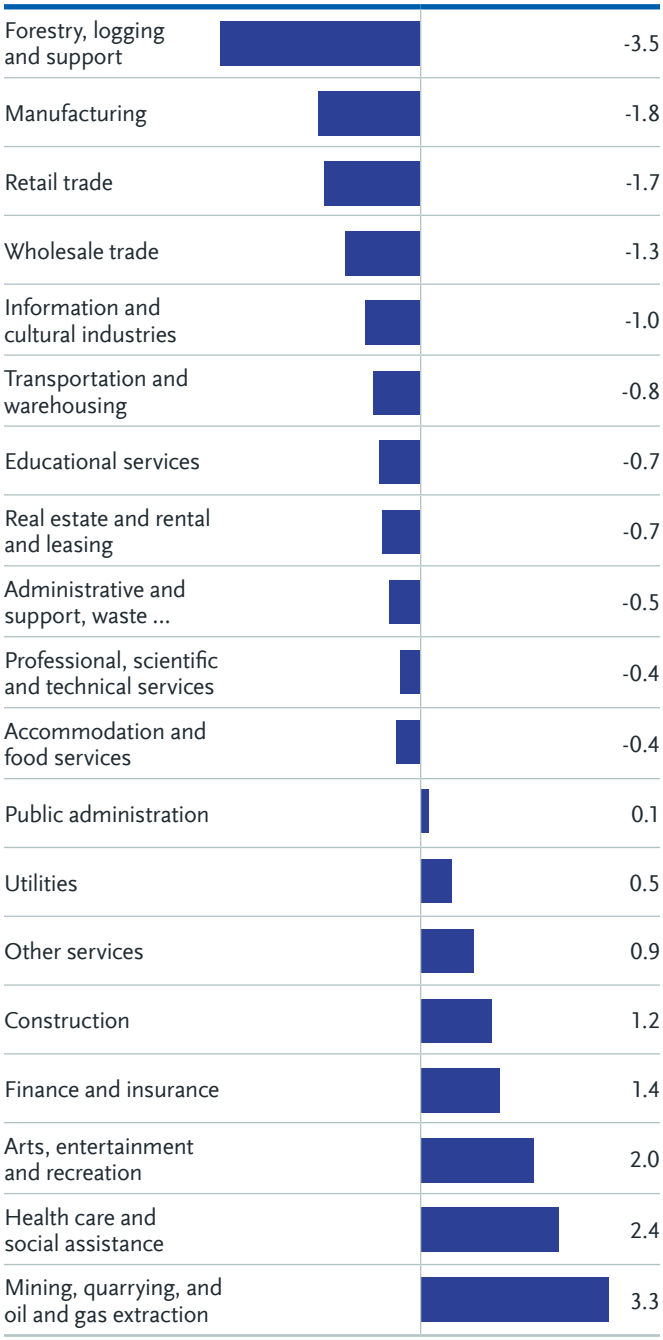
- By contrast, there was a gain of over 64,000 jobs, or 2.4%, in **health care and social assistance**, a sector fully shielded from trade disruption.
- The **construction** industry (15,800 or 1.2%) and **finance and insurance** (12,810 or 1.4%) also realized material job gains. From a smaller base, employment in **mining and oil and gas** was up 7,700 or 3.3%.

In manufacturing, employment losses have been broadly distributed and not limited to industries directly affected by tariffs (e.g., steel and aluminum, wood products, automotive vehicles and parts). For example, losses have been pronounced in plastics and rubber, food, and chemicals, suggesting that trade *uncertainty* is also depressing employment (Chart 4.7).

CHART 4.6

Average Annualized Employment Growth (%) by Industry

February 2026/January 2025 (seasonally adjusted data)

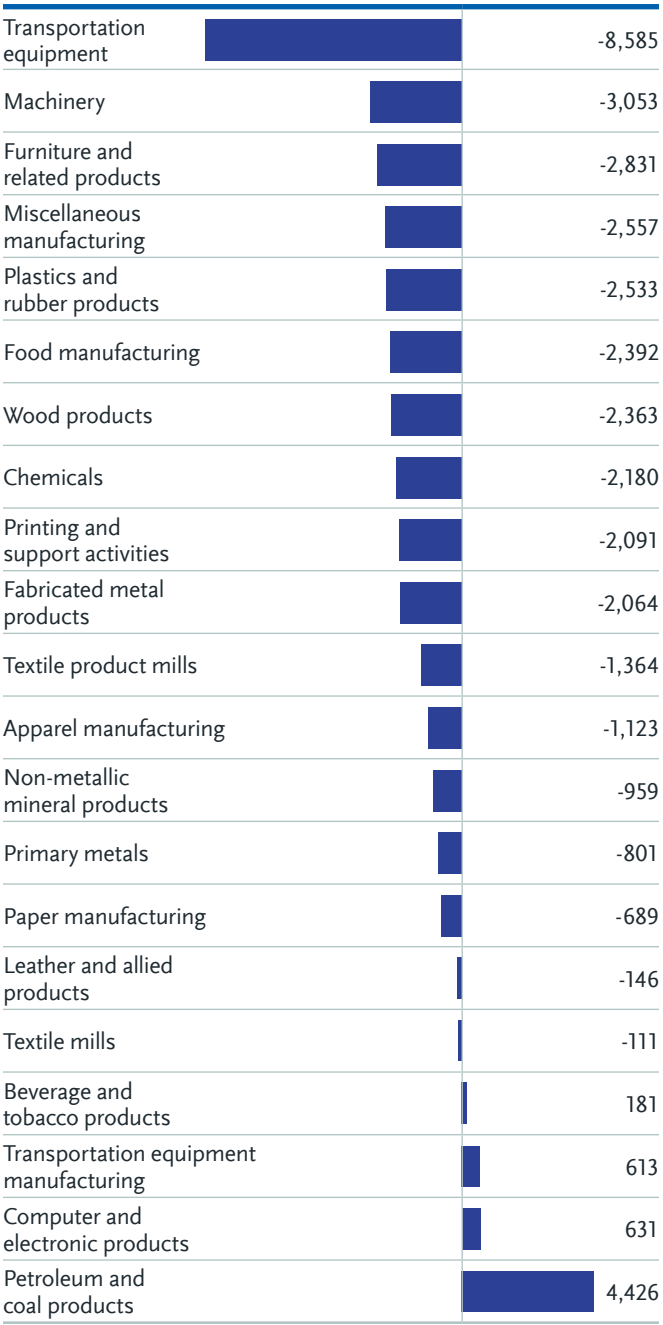


Source: Statistics Canada, Survey of Employment, Payrolls and Hours, table 14-10-0220-01.

CHART 4.7

Cumulative Change in Employment by 3-digit Manufacturing Industries

February 2026, minus January 2025 (seasonally adjusted data)



Source: Statistics Canada, Survey of Employment, Payrolls and Hours, table 14-10-0220-01.

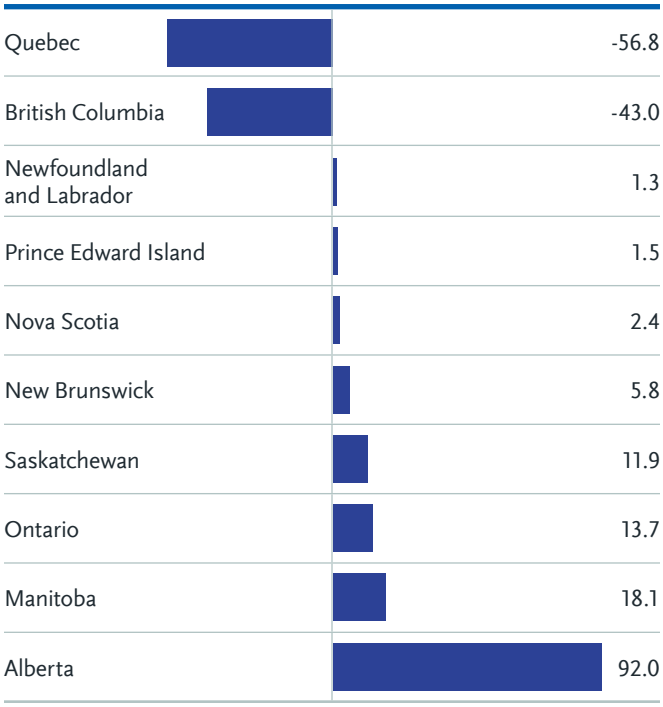
Exposure to U.S. trade actions also explains some of the regional differences in employment gains and losses since January 2025. Quebec (-56,800) and British Columbia (-43,000) have incurred large job losses. Gains in Ontario have been modest (13,700). Meanwhile, job growth in Alberta has been robust (92,000), helped by the fact that U.S. tariff actions have not applied to energy (Chart 4.8).

Under baseline projections presented in Chapter 2, absent major further disruptions in trade with the United States or other externally driven supply or demand shock, aggregate slack in the labour market is likely to be absorbed slowly in 2026 and then more quickly in 2027. Employment growth will be moderate. Labour force growth will also be contained given the tightening of immigration policy. Conditions will continue to be differentiated across industries and regions as the economy adjusts to a new trade environment and to other factors of change.

Risks to this projection are mostly to the downside: there could be further deterioration in the state of labour markets and a longer period for the economy to adjust to new conditions and for the aggregate slack to be absorbed.

CHART 4.8

Cumulative Change in Employment (000s) by Province
April 2026/January 2025 (seasonally adjusted data)



Source: Statistics Canada, Labour Force Survey, table 14-10-0287-01.

II. Structural Change: Retrospective 2016 to 2025

Shifting the lens to a 10-year retrospective on employment draws out structural change in the economy.

First, the evolution of the economy towards one employing a large majority of workers in services industries is continuing. Over the period of December 2015 to December 2025, average annual employment growth was 1.45% in services industries versus 1% in goods industries (Chart 4.9). In absolute terms, close to 2 million net new jobs were created in services industries over the last 10 years, compared with less than 300,000 in goods industries. The share of services in total employment is now about 83%. Even considering that much activity in the services industries is derived from, or is in support of, the extraction or production of goods, Canada, like other advanced economies, is largely, and increasingly, a services economy.

Second, over the past 10 years, employment in the public sector, including in health care and social assistance, education and public administration, has grown at almost twice the rate of employment in the private sector, with the former at 2.7% and the latter at 1.4% (Chart 4.10). One-third of net job creation since 2015 has originated in the public sector, which now employs about 22% of workers. The shift in the distribution of jobs towards the public sector can be explained in part by the impact of population aging on the demand for services and in part by policy choices about the role of government in the delivery of those services in the economy. While the first factor is deeply structural, the second is subject to political direction.

CHART 4.9

Average Annualized Employment Growth (%) by Sector
February 2026/December 2015 (seasonally adjusted data)

Source: Statistics Canada, Survey of Employment, Payrolls and Hours, table 14-10-0220-01.

CHART 4.10

Average Annualized Employment Growth (%)
February 2026/December 2015 (seasonally adjusted data)

Source: Statistics Canada, Labour Force Survey, table 14-10-0288-01.

Third, the differentiation of employment growth across industries over the past 10 years reflects a range of forces.

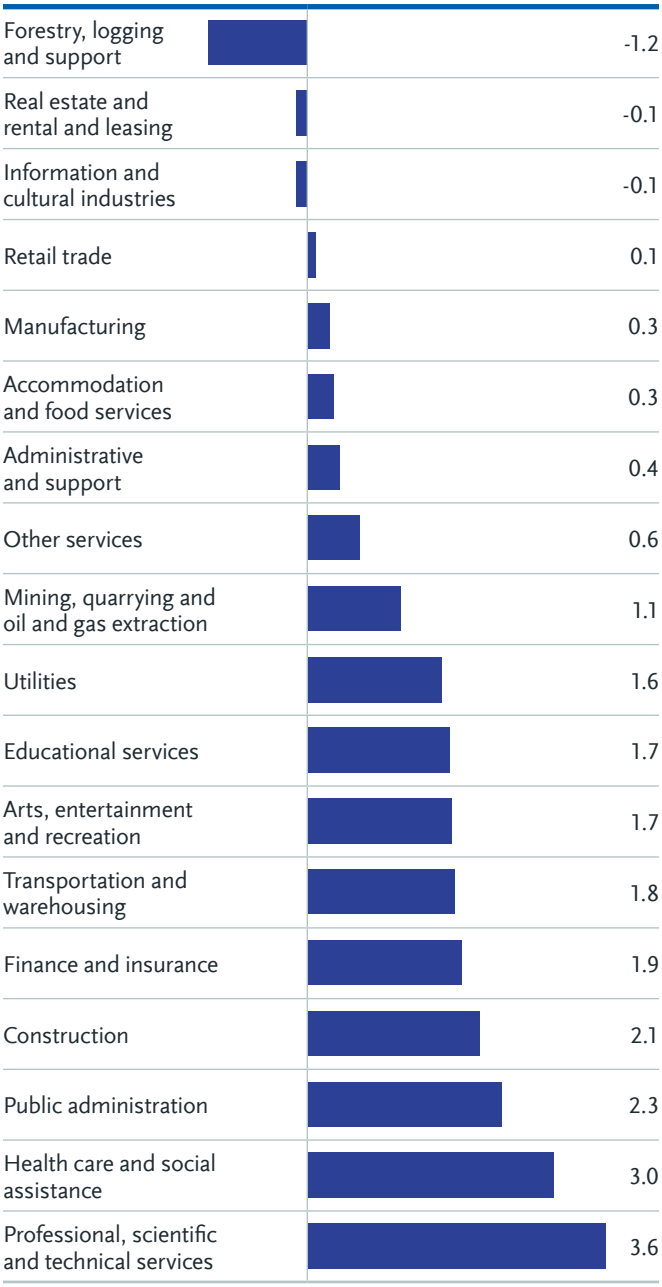
For example:

- In the **goods** sector, the **construction** industry realized the strongest employment growth over the period in both percentage (2.1% annually) and absolute (210,000) terms (Charts 4.11 and 4.12). Activity in both the residential and non-residential segments of the industry has been robust, productivity gains have been mediocre, and thus job growth has been strong. In the **utilities** industries, demand for energy infrastructure, including electricity and natural gas, has also resulted in high annualized job growth (1.7%), but from a smaller base. The recent strengthened policy impetus and market interest to build homes, energy and transportation infrastructure, and data centres may sustain the demand for workers in these industries over the medium term, as discussed below.
- By contrast, employment in **manufacturing** over the past 10 years has been almost flat, even before accounting for trade actions by the United States in 2025. Manufacturing accounts for a share of total employment, now below 9%, that has been diminishing for decades. The industry is heavily exposed to global competition, especially from low-cost jurisdictions. To grow, firms must relentlessly innovate, invest in productivity-enhancing equipment and processes, and develop new markets. The intensity of global competition creates added vulnerability to shocks, and in this regard U.S. tariffs and trade uncertainty are posing an extraordinary challenge. Industrial policy efforts to build a stronger defence industrial base and to improve the security of critical supply chains may be judged on the extent to which they succeed in arresting a trend of declining jobs in manufacturing. However, even under a scenario of rejuvenation of the industry, automation and robotics are likely to limit employment growth.
- In **services**, employment growth is also differentiated across industries by such factors as demography, business structures, exposure to competition, and technological innovation, in particular digitalization and AI.

CHART 4.11

Average Annualized Employment Growth (%) by Industry

February 2026/December 2015 (seasonally adjusted data)

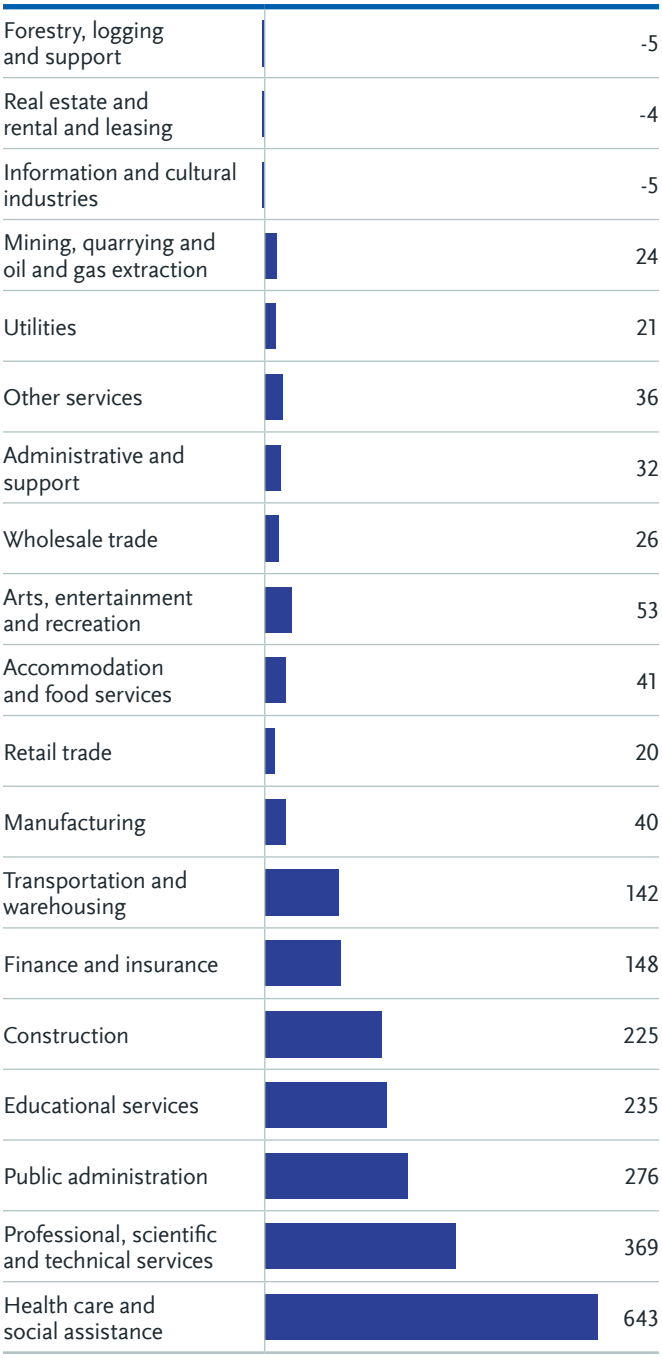


Source: Statistics Canada, Survey of Employment, Payrolls and Hours, table 14-10-0220-01.

CHART 4.12

Cumulative Change in Employment by Industry (000s)

February 2026/December 2015



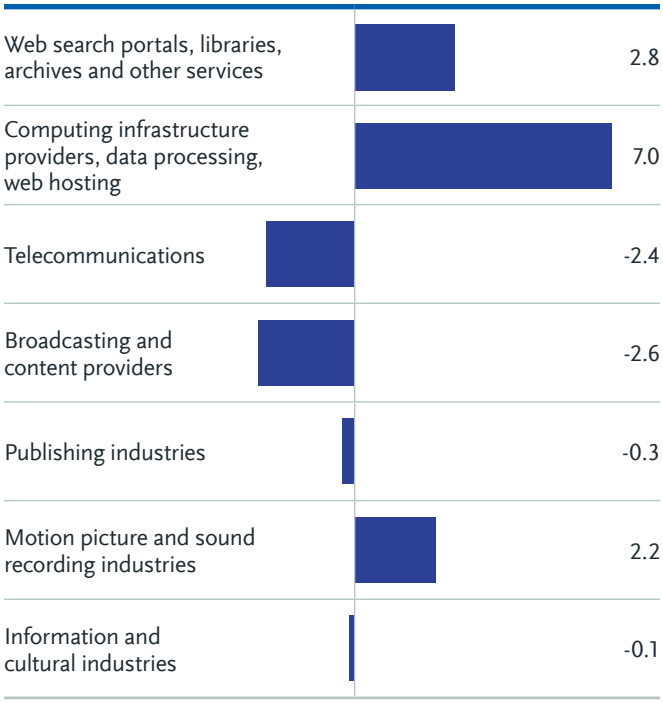
Source: Statistics Canada, Survey of Employment, Payrolls and Hours, table 14-10-0220-01.

- In absolute terms, the strongest net job gains (570,000) occurred in **health care and social assistance**. Looking forward, while there is ample scope to improve productivity in the health-care system, notably by making better use of technology and by experimenting with alternative service-delivery models, demand for professional and personalized care will continue to grow with population aging.
- In percentage terms, the fastest job growth (3.7% annually) has been in **professional, scientific and technical services**. This may be explained by growing business reliance on expert firms for specialized, professional work (e.g., legal, accounting, human resources, advisory).
- The impact of technology, and specifically of e-commerce, may be most visible from the virtual plateauing of employment in **retail trade** (0.1% annual growth), and by contrast the robust growth of jobs in **transportation and warehousing** (1.7%). Jobs in Sears or Hudson's Bay department stores have been lost to Amazon warehouses and private delivery services. This trend is unlikely to be reversed.
- Employment in **finance and insurance** has grown consistently. The industry, somewhat shielded from competition because of foreign investment restrictions and regulation, still has created new value for customers by digitalizing large parts of its services offering. Most Canadians no longer walk into bank branches. Financial services is a compelling example of an industry that has transformed its business through technology while, to date, employing more, not less workers.
- There are contrasts *within* industries. For example, roughly flat employment in **information and cultural industries** over the past 10 years hides significant job losses (2.2% annually, or over 36,000 cumulatively) in the highly regulated **telecommunications** and **broadcasting** industries as well as spectacular job growth, from a smaller base, in **computing infrastructure**, **data processing** and **web hosting** (6.6% annually), reflecting the digitalization of the economy (Charts 4.13 and 4.14). There were also significant gains in some of the content industries, including **motion picture** and **sound recording** (2.3% annually).

CHART 4.13

Average Annualized Growth of Employment in Information and Cultural Industries (%)

February 2026/December 2015 (Seasonally Adjusted Data)

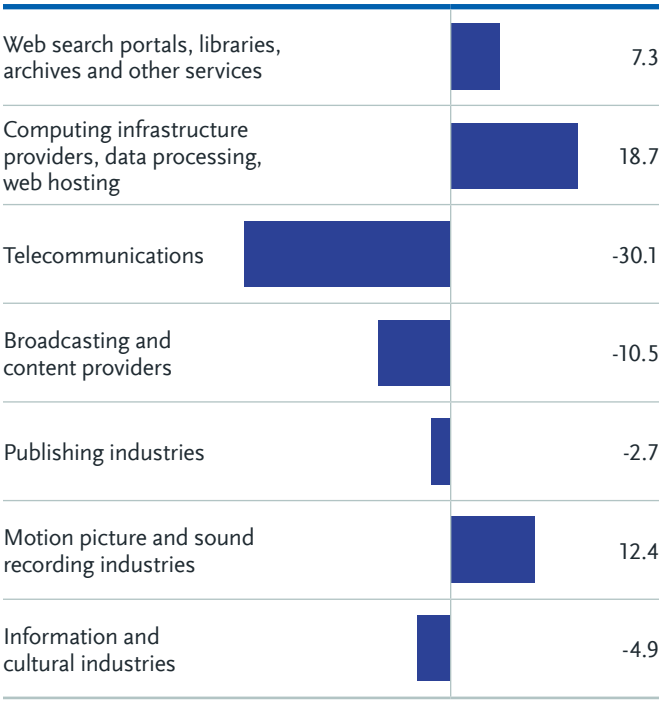


Source: Statistics Canada, Survey of Employment, Payrolls and Hours, table 14-10-0220-01.

CHART 4.14

Cumulative Changes of Employment in Information and Cultural Industries (000s)

February 2026/December 2015 (Seasonally Adjusted Data)



Source: Statistics Canada, Survey of Employment, Payrolls and Hours, table 14-10-0220-01.

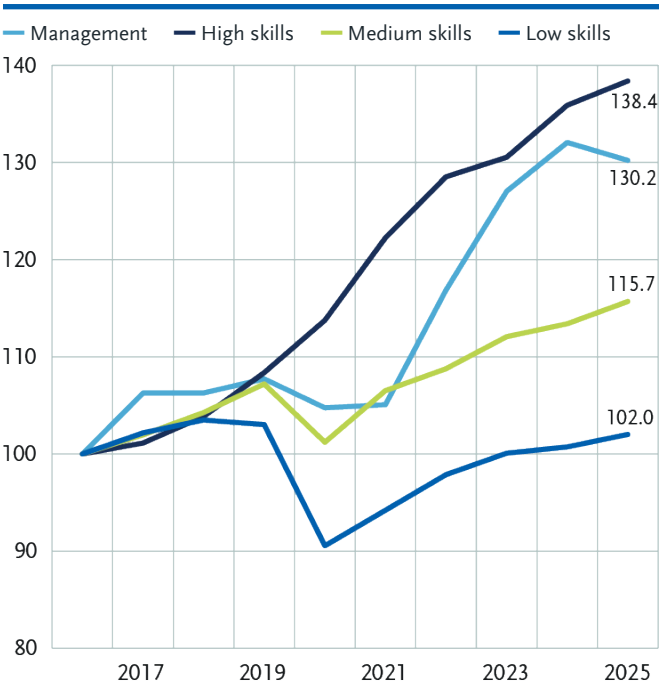
The analysis of net changes in employment levels by industry over time reveals only some dimensions of structural change. Net numbers alone do not show the amount of "churn" in the labour market within and across industries: the rate of hirings by new and existing businesses, and the rate of job separations because of retirement, voluntary departure, firing, lay-off and business closure. A full analysis of the dynamic response of the labour market to economic forces would require attention to relative movements in hours worked, productivity, wages, unit labour costs, the age structure of workers, and the nature and content of jobs in each industry.

One persistent trend across the economy is the employment of an increasingly skilled workforce. As observed in the C.D. Howe Institute's *Labour Market Review*,[2] employment gains in high-skills occupations have far outstripped gains in medium-skills occupations (e.g., the trades), which in turn have exceeded gains in low-skills occupations (Chart 4.15). In the core employment group aged 25 to 64, 77% of workers have a postsecondary certificate or diploma, or higher (Chart 4.16). As we will discuss below, even with the automation of increasingly sophisticated cognitive tasks with AI, the past trend may be expected to continue inasmuch as highly educated and skilled workers will be better able to adapt, retrain and meet the future needs of employers.

CHART 4.15

Evolution of Employment by Skill Level

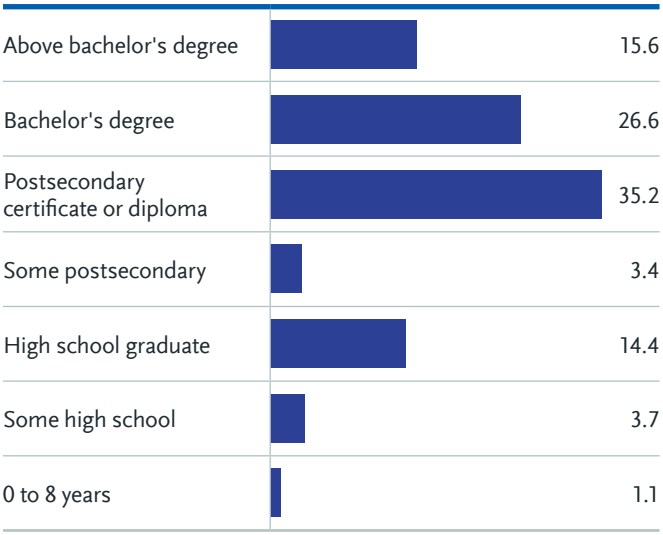
Index 2016 =100



Source: Statistics Canada, Labour Force Characteristics by Occupation, table 14-10-0416-01.

CHART 4.16

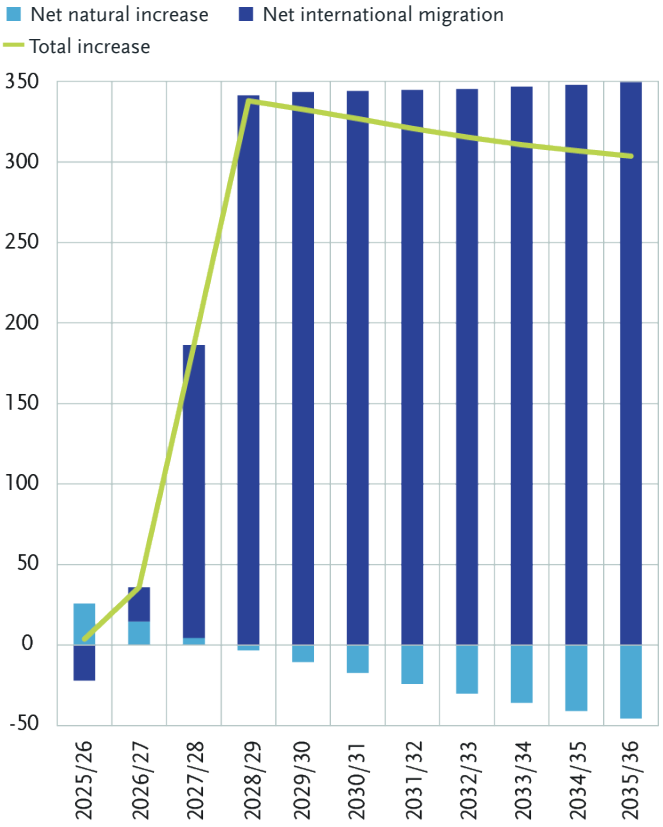
Distribution of Employment by Educational Attainment for Canadians 25 to 64 Years: 2025 (%)



Source: Statistics Canada, Labour Force Characteristics by Occupation, Annual, table 14-10-0019-01.

CHART 4.17

Net Variations in Projected Canadian Population (000s)
Projection scenario M1: medium-growth



Source: Statistics Canada, Projected Population, by Projection Scenario, Age and Gender, as of July 1, 2025, table 17-10-0057-01.

III. The Medium-Term Outlook: Demography and the Labour Force

The latest projections (medium-growth scenario) from Statistics Canada show that over the medium to long term, *all* of Canada's population growth will be the result of net international migration.

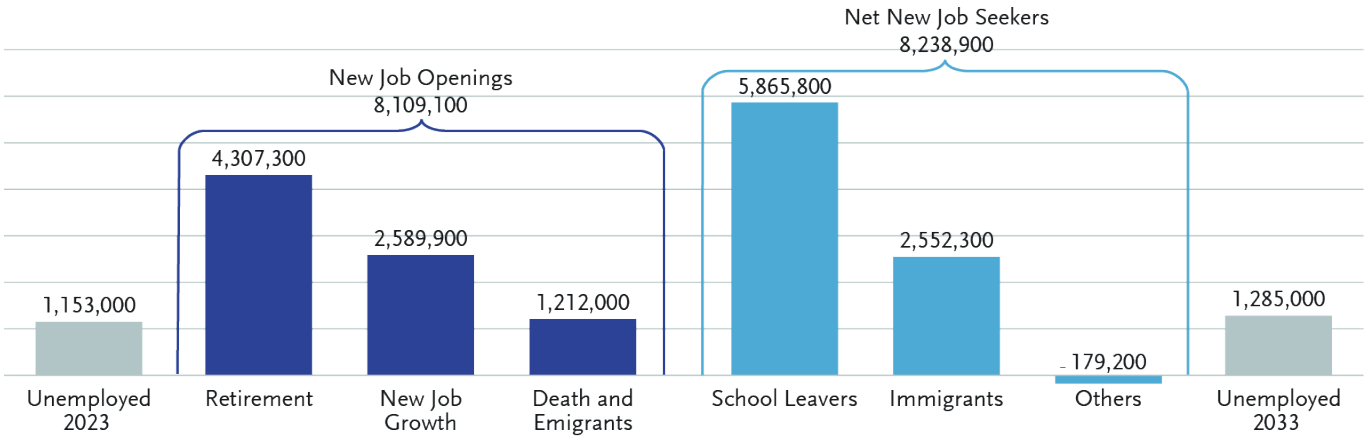
- Population growth, including net immigration, will be restrained in 2026 and 2027 by the government's commitment to bring down the proportion of temporary residents (temporary workers and international students) to 5% of the total population; that proportion was 6.4% in the first quarter of 2026, already down from a peak of 7.6% in October 2024.[3] The stabilization of targets for permanent resident admissions to 385,000 in 2026 and 370,000 in 2027 and 2028 will also contribute to a moderation of population growth.[4]
- From 2028 onward, under the medium-term growth scenario of Statistics Canada, the population is projected to grow at an annual rate of less than 1% per year, with net migration representing *all* of the increase, indeed offsetting a small but growing natural population decline (Chart 4.17).

Similarly, projections from Employment and Social Development Canada (ESDC) under COPS suggest that *all* of the *net* new demand for labour over the medium term will be met by immigrants.[5] The COPS scenarios, developed in the fall of 2024, do not reflect the current immigration levels plan or the global and domestic economic developments in 2025. Nonetheless, they are indicative of underlying trends shaping the labour market and of the rough orders of magnitude of future flows in and out of the labour force. Over the period 2024–2033, annual employment growth of some 1.2% in Canada, or 260,000 jobs, will be met by an equivalent inflow of immigrant job seekers.

This said, taking into account the replacement of workers as they retire or move out of employment rolls, the large majority of job openings (over 70%) will be met by individuals leaving school and entering the job market. Over the period 2024–2033, based on the COPS analysis, 2.6 million net new jobs will be created, 4.3 million employed Canadians will leave the workforce and another 1.2 million will decease or emigrate (Chart 4.18). Correspondingly, there will be job openings for new workers in an amount of some 8.1 million. This demand is projected to be met by 2.6 million new workers from immigration and 5.9 million from schools. The role of the educational system in meeting labour market needs remains paramount.

CHART 4.18

Projected Inflows and Outflows of the Labour Market, 2024-2033



Source: Canadian Occupational Projection System (COPS), Summary of Results (2024–2033).

IV. The Matching of Skills Supply and Demand

As structural change in the economy deepens and accelerates, success in sustaining high levels of employment *and* raising wages and living standards requires the best utilization of human capital and ongoing investment to match skills supply with evolving skills demand.

Immigration intake and population growth will not square this circle. Population growth is an important driver of GDP growth, but higher or lower levels of immigration do not, in aggregate, determine changes in GDP per capita. Nor is immigration a solution to what may be perceived as a generalized shortage of workers confronting an aging population. Immigration contributes to supply but also to demand in the economy. Immigrants also age. Immigration policy must be responsive to labour market conditions, and the judicious selection of economic immigrants will facilitate structural adjustment and contribute to prosperity. However, this contribution must be situated within the context of a wider human capital strategy.

In fact, flows in and out of the labour force will respond to only a portion of the changes in the labour market: structural change will affect virtually *all* existing 21 million jobs and workers. Structural change, in particular technological change, will alter the content of jobs, the skills required by employers, as well as the level and the distribution of labour income. As discussed below, fears of a generalized loss of jobs because of AI may be misplaced given the historical experience with technological innovation that in net terms creates rather than destroys jobs. However, change is likely to be profound, and adjustment across the labour force will be vital not only to sustain employment but to enable a wide distribution of the productivity dividends of AI.

Over time, market instruments to match skills supply and demand, including investment in the workforce and changes in the wage structure to attract and retain the workers sought by employers, will be the principal lever needed to drive economic adjustment. For example, in low-skills occupations, worker shortages are best addressed over time through improvement in wages that, together with access to training, can incentivize greater participation in the labour force; except in seasonal industries, temporary immigration is at best a stop-gap measure. Employers unable to pay competitive wages have to adjust.

Compensation structures that encourage older workers to remain in the labour force can also help meet labour demand across skills levels. The economy is far from utilizing all of its available human capital. Illustratively, if the participation rate for Canadians aged 55 to 64 (68.1% in April 2026) were the same as for those aged 25–54 (88.5%), Canada could have about 1 million more available workers, including experienced and skilled workers, to close gaps. Improved participation by under-represented groups in the labour force would also yield benefits.

While being responsive to immediate pressures, labour market policy must have as its principal focus the building of a skilled, adaptable, mobile workforce for the medium to long term.

- Temporary measures are appropriate when the economy faces shocks that expose workers to loss of working hours or to outright loss of employment. In 2025, the federal government introduced temporary flexibilities under the Employment Insurance (EI) Work-Sharing Program and temporary EI measures, including waiving the one-week waiting period for EI benefits and providing

20 additional weeks of benefits for long-tenured workers. The government also introduced in 2026 worker retention grants for employers implementing work-sharing agreements and training for employees.[6]

- Targeted interventions can also be judicious to address critical shortages of workers where this poses serious risks for the economy or for local communities, for example in health care or social assistance. The Provincial Nominee Program that is the vehicle to recruit close to one half of Canada's economic immigrants gives the provinces the flexibility to nominate immigrants based on skills, education and work experience that meet their priorities. In the *Spring Economic Update 2026*, the federal government introduced a series of measures to promote the certification of trades workers (see below).
- However, given the breadth and pace of structural change in the economy, and uncertainty about its ramifications for jobs over the medium term, there are significant limits and risks to micro-targeting labour market interventions, including economic immigration.
- A labour market policy promoting participation, skills, flexibility and adjustment to structural change over the medium term is the best means to achieve economic resilience, productivity growth and the wide distribution of economic gains.

Even before U.S. tariffs, the Canadian response, and any large-scale manifestations of the impact of AI on jobs, projections of labour supply and demand in Canada highlighted challenges in building the workforce and preparing it to meet the future demand for skills.

Demographic and economic projections made by ESDC in the spring of 2024 suggested that about 20% of 516 occupations analyzed presented risks of shortage over the period 2024–2033, while only 3% presented a risk of surplus.[7] For example, based on trends observed and assumptions made then, ESDC projected shortages of workers in health-care occupations, the construction trades, and the engineering profession.

No projections are definitive. The principal takeaway is that there needs to be flexibility and responsiveness in the labour market, across levels of skills, to ensure that available human capital is (a) utilized and (b) allocated over time in the most efficient and productive manner.

This was already the case in a baseline scenario such as the one projected by ESDC in 2024. Flexibility and responsiveness in the labour market are even more critical as Canada presently confronts some of the most serious structural economic challenges of the last decades.

V. Critical Challenges for the Medium Term

At least three critical challenges for the labour market over the medium term emerged or intensified in 2025:

- **adjustment in the manufacturing sector and in the rest of the economy to U.S. trade tariffs and protectionism;**
- **added demand for workers, including engineers and construction workers, from a renewed policy and business interest in building energy, mining and transportation infrastructure as well as more homes, faster; and**
- **adjustment to AI as it reshapes the future of work.**

The Adjustment to U.S. Tariffs and Protectionism

The Bank of Canada estimates that 2 million Canadian jobs in 2024 were linked to goods exports to the United States, including jobs in the exporting firms themselves and jobs in businesses supplying inputs (goods and services) to those firms.[8]

- Again, the **manufacturing** sector is the most heavily exposed, as 800,000 jobs, or 44% of total employment in the industry, rely on goods exports to the United States (Table 4.1). Moreover, the manufacturing sector, including steel, aluminum, autos and softwood lumber, is the one most directly targeted by U.S. tariffs and the one most directly affected by uncertainty over the review of CUSMA.
- Our **mining and oil and gas industries** are largely dependent on exports to the United States, such that 61% of their workers are exposed to U.S. trade risk, but they are more capital-intensive and thus jobs at risk represent a smaller share of the total for Canada at only 9%. Except for copper, these industries to date have not been subject to, or threatened by, U.S. tariffs.
- Other industries, such as **wholesale trade**, **transportation and warehousing**, and **professional, scientific and technical services** are exposed indirectly by providing services to goods exporters. Together, they have some 460,000 workers at risk.
- Some primary industries employing a smaller number of Canadians have high proportional exposure. One-third of jobs in **agriculture** and 40% in **forestry and logging** in 2024 were linked to exports to the United States.

TABLE 4.1

Jobs Linked to Goods Exports to the United States, Selected Industries

Industry	Total jobs	Jobs that rely on goods exports to the United States		
	2024	2024	as share of jobs in the industry	as share of total affected jobs
	(000s)	(000s)	(%)	(%)
Manufacturing	1,808	796	44	41
Mining, quarrying and oil and gas extraction	290	176	61	9
Wholesale trade	704	166	24	9
Professional, scientific and technical services	1,950	161	8	8
Transportation and warehousing	1,075	134	12	7
Agriculture	232	76	33	4
Retail trade	2,208	72	3	4
Business, building and other support services	701	63	9	3
Finance and insurance	1,033	58	6	3
Forestry, logging and support activities	41	16	40	1
Other	10,495	236	2	11
Total	**20,537**	**1,954**	**9.5**	**100**

Source: Statistics Canada and Bank of Canada calculations as per staff analytical note 2025-17, June 2025.

For most workers who may be displaced as the economy adjusts to U.S. trade policy (which may evolve over the following months and years), the principal risk is not unemployment as much as it is employment at lesser pay, with lesser benefits, and in many cases lesser union protection. Analysis carried out by Statistics Canada shows that jobs in industries dependent on U.S. demand for Canadian exports are more likely to be full-time, high-tenured, well-paying and unionized, with employee-sponsored pension plans, than jobs in private industries not dependent on trade.[9]

If policy and markets operate efficiently, there are opportunities for firms and workers affected by trade disruptions to transition to industries and activities that can utilize their assets and skills productively, including defence industries and the nuclear energy supply chain. The process of adjustment cannot be programmed by policy, nor is it likely to occur efficiently through market forces alone. Governments, employers and unions have to work together and assess market risks, opportunities, skills training needs and mechanisms to facilitate transitions.

The Ambition to Build More and Faster across the Country

The realization of the ambition of the federal and provincial governments to advance large energy and transportation infrastructure projects while simultaneously accelerating the building of homes is contingent on the supply of workers to design, manage and carry out the projects.

Rough estimates by Deloitte suggest that total recruiting requirements over the next ten years for construction workers could amount to as much as 800,000, equivalent to close to 50% of the current headcount of 1.7 million.[10]

- Many factors will influence the actual volume and pace of investment in both non-residential and residential construction projects, such that the analysis is illustrative.
- Deloitte estimates a need for new construction workers by 2030 of 410,000 to 520,000. Taking into account projected retirements of 15% of existing construction workers, or 270,000, by 2034, the total required intake of new construction workers rises to 800,000.

In fact, the *Spring Economic Update 2026* anticipates even larger requirements. It states that "Canada will need more than 1.4 million additional trades workers by 2033, and the scale of investments in housing and infrastructure projects will add to this demand."[11]

Clearly, the matching of the supply and demand of engineering and construction skills across the country is a formidable task, requiring planning and investment by governments and project proponents working together with unions, professional bodies and local actors. Solutions have to be responsive to project timelines such that lack of labour supply does not become an obstacle to final investment decisions, nor a source of uncontrolled cost escalation.

Investment in employment in the trades was the most substantive measure in the Spring update. The federal government is allocating C$6 billion over five years to create an accelerated path to Red Seal certification for 80,000 to 100,000 new trades workers. The initiative includes support for entry-level work experience, wage subsidies for apprenticeship, the expansion of union-led and employer-led training, and the facilitation of the transition from apprenticeships to permanent jobs.

The federal announcement has been generally well received, but solutions will require the sustained, coordinated efforts of governments, employers and unions toward a mix of complementary actions:

- attracting a wider pool of candidates to the trades, including women and under-represented groups, by an offer of working conditions that can appeal to a diverse population;

- ensuring capacity and responsiveness in community colleges and other educational institutions;
- accelerating and easing the recognition of credentials across provinces and territories, thus facilitating labour mobility;
- working with Indigenous groups and local communities to expand business and employment opportunities, including by offering on-site training; and,
- within a planned, national framework, targeting skilled construction workers under the permanent economic immigration streams and—if necessary to address temporary, acute shortages—temporary worker programs.

If major project plans ultimately match current ambitions, even with successful recruitment and deployment of skilled workers, markets are likely to be tight and wages under pressure.

AI and the Future of Work

Perhaps no factor may impact the labour market more profoundly over the next decade than AI. There is not yet evidence of widespread job disruption, and there is considerable uncertainty about future aggregate effects, but the technology is demonstrating an impressive capacity to perform sophisticated, cognitive tasks and to transform the content of work.

To date, the effects of AI on jobs is not apparent in aggregate data because only a small proportion of firms are early adopters and because productivity gains are not realized immediately. Bank of Canada Governor Tiff Macklem recently cited results from the Bank's Business Leaders' Pulse Survey indicating that only 8% of Canadian businesses currently use AI in their operations, with 11% planning to use it over the next year.[12] The Governor added that, while there was increased demand for workers with AI skills, and early evidence of some reduction of entry-level jobs in some occupations, AI had not yet widely impacted the labour market. An international review of empirical evidence on AI, productivity and the labour market conveys similar results.[13] The authors observe that, even where there is early adoption of AI, firms have to invest in organizational redesign, worker training and process changes before efficiency gains are realized. Early adjustment appears to be taking place through task reallocation, quality improvement and within-firm productivity gains changes rather than through broad-based layoffs.

The future aggregate effects of AI on productivity, employment and incomes remain highly uncertain, with a wide range of estimates depending on assumptions about key parameters. The previously cited international review includes estimates of impacts for the U.S. economy over the next 10 years as low as a total factor productivity gain of only 0.66% and as high as an expansion of real GDP of 7%.[14] Most studies aim to estimate the proportion of tasks that may be automated across different occupations and then how AI may improve the productivity of work, eliminate jobs or create new jobs. The results are highly sensitive to such assumptions as the rate of diffusion of the technology and the scope of organizational redesign across the economy.

The judgment of businesses and economists converge nonetheless in projecting widespread and significant impacts for the future of work.

- **Some 86% of 1,000 employers, representing more than 14 million workers across 22 industry clusters, surveyed by the World Economic Forum (WEF) in 2025 expect AI and information-processing technologies to transform their business by 2030.**[15] Other technologies expected to be transformative include robots and automation (58%), energy (41%), and new materials and composites (30%).
- **Empirical analyses for advanced economies by the IMF and, for Canada, by Statistics Canada, suggest that about 60% of jobs will be exposed to AI, of which one half may be negatively affected and one half may become more productive.**[16] Drawing on broadly the same methodology, the authors of these studies assess the exposure of a universe of occupations to AI (on one scale) and the extent to which AI may complement, versus simply replace, human labour in these occupations (on the other scale). Accordingly, occupations are categorized into three groups: high exposure, high complementarity (cognitive jobs with a high degree of responsibility and interpersonal interactions—for example, family physicians, lawyers or secondary school teachers); high exposure, low complementarity (cognitive jobs that AI may perform to the point of potentially replacing human labour—for example, computer programmers or customer service agents); and low exposure (jobs comprising tasks unlikely to be performed by AI—for example, manual labourers). Based on the structure of the workplace in Canada in 2021, researchers from Statistics Canada estimate that 31% of employees in Canada were in the first group, 29% in the second group, and 40% in the third group.
- **Given AI and other sources of structural change, employers surveyed by the WEF expect that about 60% of their workforce will need skilling or reskilling by 2030.**

Indeed, even in occupations where AI may complement or augment the content of work and contribute to higher productivity, the benefits will not be realized unless workers have the skills to utilize the technology and add value. As noted in the WEF survey, AI and other changes in the workplace require not only digital literacy but also analytical thinking, flexibility and agility, along with leadership and social skills. In some occupations, such as the legal or accounting professions, AI will require a

rethinking of training for entry-level positions and of the career path to the senior positions where experience, judgement and critical thinking best complement AI.

Employers that succeed in developing and applying the technology, redesigning work accordingly, training their workers and delivering value to customers will build competitive advantage. In the best of cases, businesses will grow, and workers will earn higher wages.

Economy wide, realization of the benefits of AI will also depend on highly skilled professionals, entrepreneurs and business leaders who can drive innovation and develop applications and IP that are commercialized for global advantage. While the application of available technology will drive efficiency gains for many organizations, the benefits will be diminished inasmuch as value is extracted by foreign owners of IP and digital platforms (e.g., large language model developers, cloud service providers). The realization of value, and gains in employment and incomes in Canada, thus will be a function of success in enabling and nurturing a *domestic* ecosystem of innovative firms. In turn, this will be contingent on world-class talent in digital technology from our universities, supplemented by targeted immigration, deployed productively within the frame of innovative business and policy strategies. The Canadian offer to top talent has to be competitive with U.S. offers that are monetarily very attractive.

Given the still-uncertain impacts of AI on the future of work, the priority for the public and private sectors is to invest in a workforce that has the capacity to adapt and to make the best use of the technology while also meeting the needs of Canadian firms at the frontier of innovation. Immigration has a role to play, but the education, skilling and reskilling of our workforce is paramount.

Notes

CHAPTER 1

1. Xi Jinping Says World in "Disarray" as Spain Pushes China to Help End Iran War, [Internet], Financial Times, April 14, 2026; China's Xi Tells Taiwan Opposition Leader Unification an "Inevitability", [Internet], Financial Times, April 10, 2026.
2. Article 5 of the Treaty states that an armed attack against one NATO member shall be considered an attack against all members, and triggers an obligation for each member to come to the former's assistance. This assistance may or may not involve the use of armed force, and can include any action that the Allies deem necessary to restore and maintain the security of the North Atlantic area.
3. International Monetary Fund, Global Economy in the Shadow of War, [Internet], World Economic Outlook, April 2026, especially chapter 2.
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