Economics
FORECAST

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Different strokes for different folks

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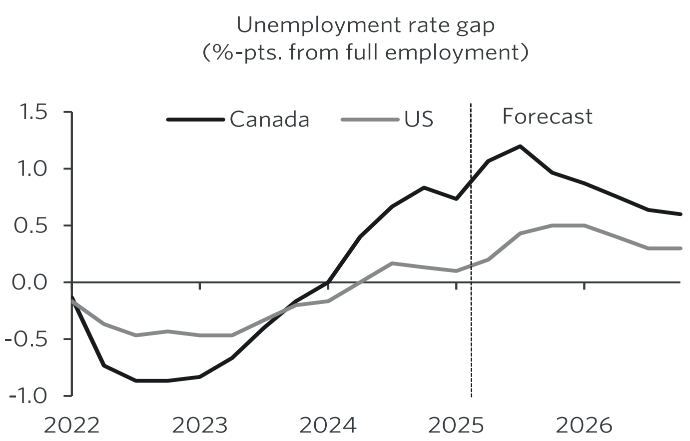
It may only be an imaginary line in a certain President's mind, but these days, the Canada-US border divides two parts of North America that have diverged in some key dimensions of economic performance. That in turn will imply a parallel divergence in monetary policy and interest rates in the near term, or a case of different strokes for different folks.

Where the gap is now most evident is in the labour market. Canada's 7% jobless rate is expected to creep even higher, and is already roughly a percentage point from where full employment lies. America's 4.2% unemployment rate is within a hair of full employment (Chart 1). While we do see more slack emerging in the US labour market in the next few quarters, its tighter starting point, and greater US tariff levels, imply higher near term inflation risks stateside.

Trade policy remains the greatest uncertainty. The odds of a return to the extremely high tariffs announced on April 2nd appear to have fallen as the US seeks bilateral deals that would moderate them. But even if a lower court ruling against blanket reciprocal tariffs holds up, further sectoral tariffs on national security or counter-subsidy grounds could still see average tariffs of 10% or so in 2026. Our global growth forecast has been downgraded as a result, postponing the pick-up that as of last year we were expecting to see in 2025 (Table 1, Page 3). Tariffs will also impede US growth in 2025 (Table 3, Page 3) by reducing household purchasing power and hampering US exports (see pages 5-8), and we can't yet rule out a deeper shock with even higher tariffs.

Chart 1: Canada has much more labour market slack



Source: Statistics Canada, US BLS

Including a likely increase in lumber duties, the tariff on Canada averages out to about 7%, but hits some sectors (primary metals, autos) that our research showed have the highest sensitivity to such levies. While we expect a deal to lower auto tariffs in both directions, there will still be a broader drag from lingering uncertainty over the USMCA renewal that will weigh on capital spending by firms considering Canada as a base for US-bound exports. Fiscal and monetary policymakers will therefore have to pull some levers to deliver the improved growth we're expecting for 2026 (Table 2, Page 3).

In search of a one handed central bank

We've dropped our call for two Fed rate cuts this year, and now see only a single quarter point move in Q4 2025. Simply put, Chairman Powell is in no rush to act with inflation at risk of heading higher again, and the Fed's full employment mandate not yet being in jeopardy. If tariffs moderate enough to contain their impact to a one-time price level shock, and their negative growth impacts open up economic slack, the Fed could have room to lower rates by a further 75 bps in 2026 (Table 5, Page 4).

But even that degree of easing could be put in doubt by fiscal policy decisions that are still a work in progress. Some of what's in the House draft budget bill won't provide a year-on-year boost to growth even though it lifts the deficit from the baseline, since it merely extends current tax rates that would otherwise have headed higher. But the rest of the bill would still add a further 0.8% of GDP to next year's deficit, thereby supplanting some of the room for less restrictive monetary policy. The Fed will be able to wait and see how the final bill adds or pares back that impact.

Our Treasuries forecast has also been shifted to a higher range. While yields at the front end should benefit from the resumption of Fed easing, the continuation of larger deficits than would have been in place if no new tax cuts were added will add to supply and thereby pare back the scale of the rally that we had previous expected. Without the draw of a climbing greenback, foreign buyers are going to need to see rising long term rates by the turn of the year.

Fiscal policy also could steepen the longer end of Canada's yield curve owing to pressure on supply. Indeed, although combined federal/provincial deficits aren't likely to top 5% of GDP, versus at least 6% for projected US deficits, having run lower deficits in prior years, the percentage increase in the outstanding stock of publicly-held long term debt will actually be greater than what we see stateside.

But the front end of the curve should get some near term relief from the central bank as rate cuts come earlier than markets are now expecting. The Bank of Canada, facing a much weaker job market, doesn't have the luxury of a long pause. The Bank's "on the one hand, on the other hand" messaging, which has cited upside risks to prices and downside risks to growth, will have to start focusing on the latter. The wide output gap should contain inflation after a modest one-time lift from tariffs, some of which was already in the April data, and the recent firming in the loonie will reverse some price pressures from its earlier weakening.

The federal government's tilt toward infrastructure spending, and the lags inherent in getting such projects going, suggests that fiscal stimulus will land too late to offset the near term softness in trade. Rome wasn't built in a day, and neither are pipelines, ports and high speed rail projects.

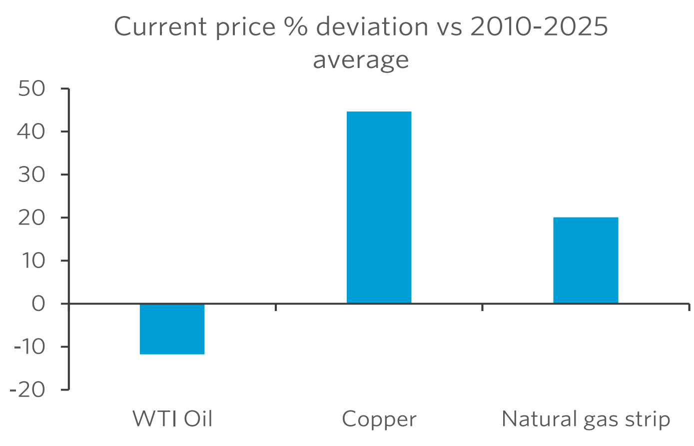
We look for a quarter point Bank of Canada rate cut in both July and September to be the final leg of this easing cycle (Table 4, Page 4), as long as the US doesn't accelerate the trade war and prompt a full-blown global recession. That won't spark an extended weakening of the loonie, given that by year end the market will be looking towards Fed cuts, and a backdrop of a weaker US dollar against the pack of major currencies after a long run stronger.

Resources sing their own tune

The interest rate outlook — lower at the front end, but ending up higher further out the curve — is a mixed bag for equity valuations. Wall Street stocks are clearly banking on our view that tariffs will be moderated enough to avoid a bruising recession. But they've also shrugged off downwards adjustments to earnings estimates, and are giving little elbow room for any negative surprises in trade talks, potentially limiting further near term upside.

As in North American monetary policy, we'll also be facing different strokes for different folks in Canada's resource sector. Henry Hub natural gas prices should be able to average near $4 next year, above its longer term average, as it benefits from its link to an AI-driven increase in electric power demand, expanding LNG export plans, and a US political environment that is now less tilted to renewables. Copper prices have a similar tie to electric power demand. In contrast, weak global growth that reduced transportation activity, including downside risks to China, are along with loosening OPEC+ supply constraints, likely to hold crude oil prices below our prior forecast range. Even with somewhat better economic news in 2026, we see WTI averaging near US$65/bbl, above current futures pricing, but as we're seeing today, still well below longer term averages (Chart 2).

Chart 2: Mixed picture for commodity prices



Source: Haver, CME

Table 1: Real GDP growth rates

Region	2020A	2021A	2022A	2023A	2024A	2025F	2026F
World[1]	-2.7	6.6	3.6	3.3	3.3	2.9	3.1
US	-2.2	6.1	2.5	2.9	2.8	1.8	2.2
Canada	-5.0	6.0	4.2	1.5	1.6	1.5	1.6
Eurozone	-6.0	6.3	3.5	0.4	0.9	1.1	1.3
UK	-10.3	9.5	5.0	0.4	1.1	1.2	1.5
Australia	-2.1	5.5	4.2	2.1	1.1	1.8	2.2
Japan	-4.2	2.7	0.9	1.4	0.2	0.9	1.0
China	2.2	8.4	3.1	5.4	5.0	4.2	4.0

[1] At purchasing power parity.

Table 2: Canadian forecast summary (% change except where noted)

Variable	2023A	2024A	2025F	2026F
GDP at market prices	2.9	4.7	4.0	3.5
GDP in $2012	1.5	1.6	1.5	1.6
Consumer price index	3.9	2.4	2.2	1.7
Unemployment rate	5.4	6.4	6.9	6.6
Pre-tax profits (net operating surplus)	-22.5	-4.5	5.8	12.7
Housing starts (K)	242	245	256	276

Table 3: United States forecast summary (% change except where noted)

Variable	2023A	2024A	2025F	2026F
GDP at market prices	6.6	5.3	4.8	4.5
GDP in $2012	2.9	2.8	1.8	2.2
Consumer price index	4.1	2.9	3.0	2.9
Unemployment rate	3.6	4.0	4.3	4.4
Pre-tax profits (with IVA/CCA)	6.9	7.9	3.8	3.6
Housing starts (K)	1,389	1,389	1,415	1,564

Table 4: Canadian interest rates (end of period)

Variable	2025 6-Jun	2025 Sep	2025 Dec	2026 Mar	2026 Jun	2026 Sep	2026 Dec
Overnight target rate	2.75	2.25	2.25	2.25	2.25	2.25	2.25
98-Day Treasury Bills	2.66	2.20	2.15	2.20	2.00	2.30	2.35
2-Year Government Bond	2.68	2.35	2.50	2.85	3.00	3.10	3.25
5-Year Government Bond	2.93	2.65	2.75	3.00	3.10	3.20	3.25
10-Year Government Bond	3.32	3.15	3.25	3.35	3.45	3.55	3.70
30-Year Government Bond	3.57	3.35	3.40	3.45	3.50	3.60	3.65
Canada - US T-Bill Spread	-1.78	-2.15	-1.95	-1.55	-1.50	-1.05	-1.10
Canada - US 10-Year Bond Spread	-1.25	-1.00	-0.95	-0.90	-0.90	-0.85	-0.75
Canada Yield Curve (10-year — 2-year)	0.64	0.80	0.75	0.50	0.45	0.45	0.45

Table 5: US Interest rates (end of period)

Variable	2025 6-Jun	2025 Sep	2025 Dec	2026 Mar	2026 Jun	2026 Sep	2026 Dec
Federal funds rate (midpoint)	4.375	4.375	4.125	3.875	3.625	3.375	3.375
91-Day Treasury Bills	4.34	4.35	4.10	3.75	3.50	3.35	3.45
2-Year Government Note	4.01	3.90	3.65	3.45	3.60	3.75	3.85
5-Year Government Note	4.09	3.85	3.75	3.60	3.55	3.75	3.90
10-Year Government Note	4.47	4.15	4.20	4.25	4.35	4.40	4.45
30-Year Government Bond	4.94	4.60	4.70	4.80	4.85	4.90	5.00
US Yield curve (10-year — 2-year)	0.48	0.25	0.55	0.80	0.75	0.65	0.60

Table 6: Foreign exchange rates

Exchange rate	2025 6-Jun	2025 Sep	2025 Dec	2026 Mar	2026 Jun	2026 Sep	2026 Dec
CAD-USD	0.73	0.73	0.74	0.74	0.74	0.74	0.75
USD-CAD	1.37	1.37	1.36	1.36	1.35	1.35	1.34
USD-JPY	145	137	135	134	133	133	132
EUR-USD	1.14	1.16	1.16	1.17	1.18	1.19	1.20
GBP-USD	1.35	1.37	1.36	1.38	1.39	1.40	1.41
AUD-USD	0.65	0.63	0.63	0.64	0.64	0.65	0.65
USD-CNY	7.19	7.27	7.26	7.24	7.22	7.21	7.20
USD-BRL	5.60	5.70	5.85	5.98	6.10	6.05	6.00
USD-MXN	19.17	19.55	19.60	19.70	19.80	19.90	20.00

US outlook: It's the end of the world as we know it (and the US economy feels fine)

by **Ali Jaffery** ali.jaffery@cibc.com

Putting out a US forecast these days is risky business. We're crossing our fingers and silencing our notifications with the hopes that our assumptions don't become irrelevant after the next tweet or court ruling. If we're lucky enough for that to happen, our base case forecast assumes that the US effective tariff rate stays close to where it is right now, about 13-15%, and implicitly that the broad-based nature of tariffs remains in place. Given that, we expect inflation will jump during the summer and early fall, with core PCE rising to a peak of over 3%, but the price level shock will start to fade by year end, giving the Fed room to start to ease and support what will be a job market that is losing steam (Table 1). If tariff rates in place right now remain, this won't be a catastrophic shock that tips the economy into recession. That's the good news. The bad news is that this is still a serious shock that will leave a permanent scar on the economy and job market, resulting in a slowdown from the breakneck pace over the past two years to annual growth of 1.8% this year and 2.2% next year.

So far, so good

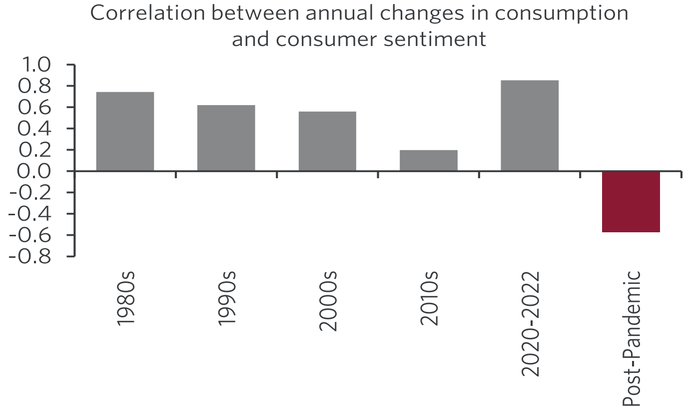
In part, the US economy can avoid the worst because it enters the trade war on such strong footing. The job market looks about balanced with unemployment at 4.2% as of April, although its dynamism has slowed with very low job turnover and reduced hiring, and the economy looks solid with final domestic demand growing at 2% in Q1 of this year, which is in line with what we've seen in the past two years.

The American consumer remains the anchor of the economy and the fundamental supports to households look solid with falling debt-to-income, still strong wealth gains and solid wage growth, especially for higher-skilled workers. While it's true that consumer confidence has deteriorated, the relationship between measures of consumer confidence and consumption has weakened over the decades (Chart 1), in part because party affiliation is increasingly biasing perceptions about the economy (O'Trakoun, 2024; Hsu, 2024).

Table 1: US Forecast detail (real % change, s.a.a.r., unless otherwise noted)

Indicator	25:1	25:2F	25:3F	25:4F	26:1F	26:2F	26:3F	26:4F	2025F	2026F
GDP at market prices ($Bn)	29,978	30,419	30,791	31,150	31,466	31,792	32,103	32,472	30,584	31,958
% change	3.5	6.0	5.0	4.7	4.1	4.2	4.0	4.7	4.8	4.5
Real GDP ($2012 Bn)	23,526	23,694	23,779	23,908	24,031	24,172	24,300	24,458	23,727	24,240
% change	-0.3	2.9	1.4	2.2	2.1	2.4	2.1	2.6	1.8	2.2
Final sales	-2.5	3.9	2.0	2.1	1.7	1.8	1.7	1.9	1.6	2.0
Personal consumption	1.8	1.5	1.1	1.8	1.4	1.8	1.8	1.8	2.4	1.7
Total government expenditures	-1.5	1.0	1.5	1.5	1.5	1.5	1.5	1.5	1.5	1.5
Residential investment	1.3	3.2	2.5	5.9	7.3	4.5	3.5	5.5	1.9	5.2
Business fixed investment	9.8	-6.3	-1.0	1.4	2.5	2.3	2.0	3.1	1.3	2.5
Inventory change ($2012 Bn)	140.1	81.7	51.7	56.7	76.7	111.7	136.7	181.7	82.6	126.7
Exports	1.8	-2.7	-2.7	-3.3	0.1	1.1	1.7	1.4	0.6	1.0
Imports	41.3	-20.5	-7.7	-3.5	0.6	2.2	2.6	3.0	4.6	2.1
GDP Deflator	3.7	3.0	3.5	2.5	2.0	1.8	1.8	2.0	2.9	2.3
CPI (yr/yr % chg)	2.7	2.6	3.3	3.5	3.3	3.1	2.8	2.7	3.0	2.9
Core CPI (yr/yr % chg)	3.1	3.0	3.4	3.3	3.1	3.1	3.1	2.8	3.2	2.9
Core PCE (yr/yr, % chg)	2.8	3.0	3.3	3.3	3.0	2.7	2.2	2.0	3.1	2.5
Unemployment rate (%)	4.1	4.2	4.4	4.5	4.5	4.4	4.3	4.3	4.3	4.4

Chart 1: Consumer confidence measures don't tell us much about what the consumer will do anymore



Note: Consumption is measured in year-over-year percentage change whereas the average year-over-year difference in current confidence readings of the Conference Board and Michigan survey are used as measures of sentiment. Both are at quarterly frequencies.

Source: BEA, Consumer Conference Board, University of Michigan

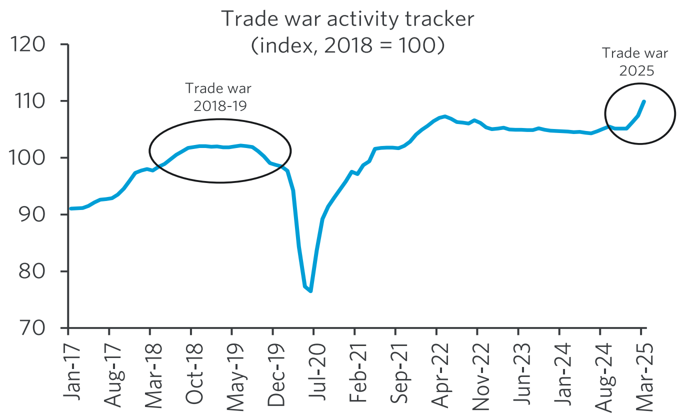
The impacts of the trade war will show up first in trade-intensive sectors like manufacturing, transportation and warehousing. To track the impact of the trade war, we developed a tracker that aggregates the high-frequency hard data where we expect the impact of trade tensions should show up first (Chart 2). This includes measures such as capital and consumer goods imports, capital goods orders and employment in trade-sensitive industries, amongst others. This measure captured weaker growth in 2018 and showed a recession in these select industries in 2019, as well as the slowdown from supply disruptions and tight monetary policy in 2022 and 2023.

What that measure tells us is, so far, so good. The trade-sensitive part of the economy has benefitted from front-loading, which also means the strength in Q1 GDP could be inflated particularly in the investment component. But it strengthens the view that the US economy might continue to demonstrate resilience at least in the early period of the trade war with businesses exposed to trade having bolstered inventories and fast-tracked necessary purchases of electronic equipment and computers.

Of course, that also means the pull-forward of demand in will amplify a future slowdown. That is coming, but there are reasons to believe that slowdown won't necessarily be significant for the economy as a whole. Although we haven't seen tariffs like this in over a century, trade shocks should in theory be less damaging for the US economy than other shocks, like financial crises. For starters, the US isn't a very trade-intensive economy with two-way trade accounting for only a quarter of nominal GDP, far below other advanced economies. It has also become less trade-intensive over time, with imports of goods dropping by 3%-points of GDP over the past decade, with most of that in manufacturing imports (Chart 3). The only manufacturing import category that has secularly risen faster than GDP over the past decade is consumer-related electronics/appliances.

Moreover, the knock-on effects from a shock to trade-intensive sectors to the rest of the economy are not going to be large for the tariffs in place today. More than 70% of employment is tied up in industries that are not import-intensive (Chart 4). These services, including finance, information and technology,

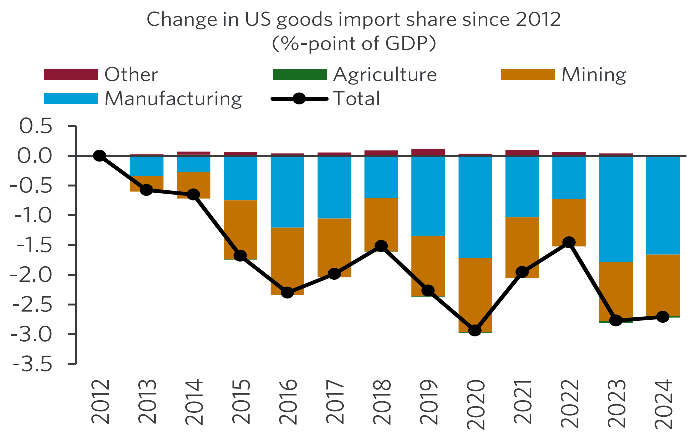
Chart 2: Trade-sensitive part of the economy has been benefitting from front-loading



Note: Aggregate measure of activity using principal component analysis of the following measures: capital & consumer goods imports, capital goods orders, retail sales, hours worked in durable goods manufacturing and transportation/warehousing, IP manufacturing production.

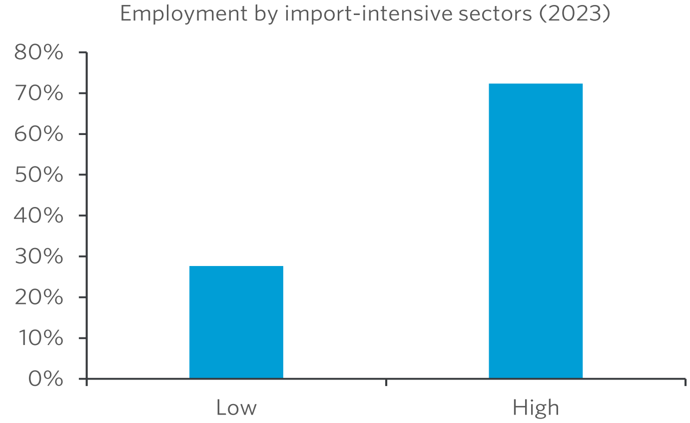
Source: Bureau of Economic Analysis, US Census Bureau, CIBC calculations

Chart 3: The US economy is not heavily dependent on trade and imports have fallen as a share of GDP



Source: World Bank, BEA, Census Bureau

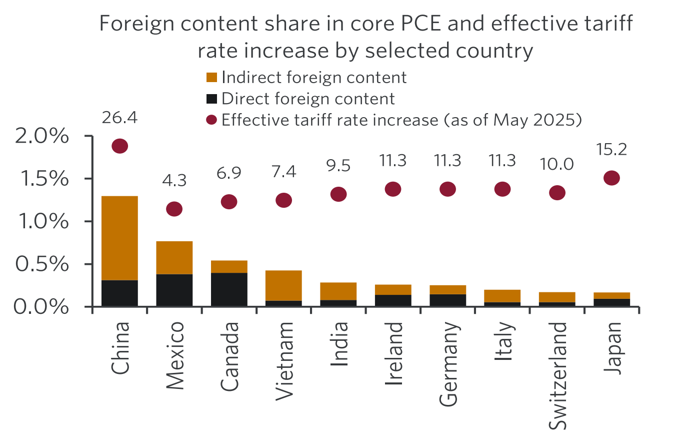
Chart 4: Over 70% of employment is outside of import-intensive sectors



Note: Import-intensity is defined as imports as a share of intermediates from BEA's input-output tables within an industry. Low import-intensity is categorized as an import intensity of below 7% (the median across industries).

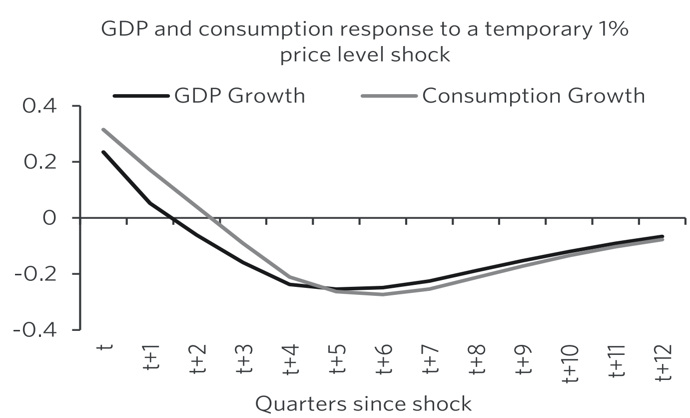
Source: BLS, BEA

Chart 5: Foreign content share in Core PCE is 10% and current tariff rates could boost prices by up to 1%



Source: Barbiero and Stein (2025); Tradewartracker.com

Chart 6: The transmission of the trade war to the economy is mainly through lost purchasing power



Note: Bayesian SVAR with Litterman prior and short-run restrictions. Includes CPI, UST 2Y and GDP or Consumption.

Source: BEA, CIBC calculations

education, healthcare, leisure and hospitality, have limited dependence on foreign imports, with most of the costs in these industries being domestic. And estimates of the linkages between sectors (from the OECD's Leontief Inverse Matricies) show diminished spillovers from manufacturing to the rest of the economy over the past decade, so the rest of the economy won't get seriously sick if the trade-intensive segment of the economy catches the flu.

The price of folly

All that implies that US economy should avoid a recession if trade policy doesn't materially get ratcheted up from here. But the bad news is that there will very likely be a significant slowdown that will leave permanent damage to the economy. Supply chains will become more inefficient, inventories less abundant and delivery times will get longer, and the market for some products will just dry up completely. Investment in trade-related industries will undoubtedly slow down, due to both tariffs and the uncertain environment. But the most important channel will be the impact of higher prices, which will erode household purchasing power.

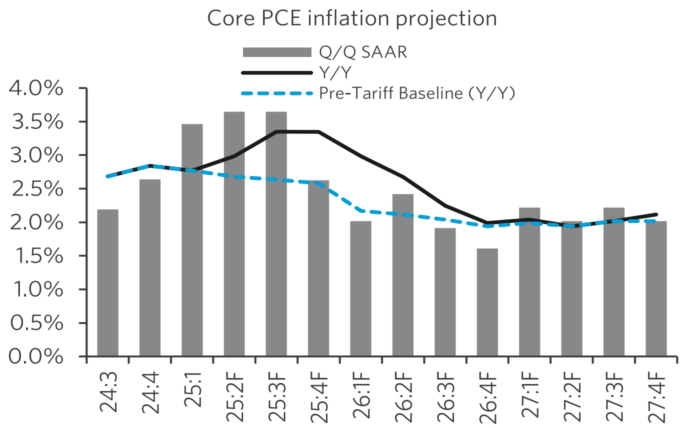
To assess what the tariff impact on prices will be, we combine our own analysis with research from the Boston Fed, which details the foreign content in core PCE by country and by sub-component (Barbiero and Stein (2025)). We map their estimates of foreign content in PCE components and selected countries to the administration's tariff rates and detailed trade data to calculate what the tariffs mean for core inflation, assuming these tariff rates are the end game.

Some of the key assumptions are shown in Chart 5. Overall, the estimated foreign content in core PCE is around 10%, and China, Mexico and Canada are the largest contributors to US prices. Using the effective tariff rates as of May 2025, full pass-through of the tariff would on its own imply about a 1% price level boost.

But the actual impact will be smaller, as the price shock will open up economic slack by slowing GDP and consumption, reducing growth up to a two year horizon according to our modelling (Chart 6). The uncertainty of whipsawing trade policy and other challenges including "revenge taxes" on foreign capital holders, are also going to dampen economic activity. Businesses will forgo investment and try to wait it out, settling to do less than they otherwise might have. Some of that could be offset by higher investment at home, but it will be a real challenge to bring back production at home (See Can, or should, the US bring the factory jobs back? CIBC Economics). We estimate that the combined effect of tariffs and uncertainty will be permanent drag of about 0.5% of GDP based on a mix of modelling of price shocks on consumption and investment, and drawing from the literature on the economic impact of uncertainty (Caldara et al, 2020; Jackson et al, 2020).

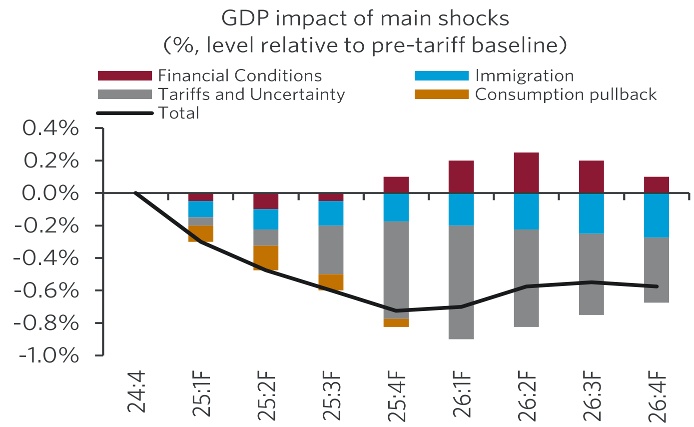
Putting together tariff-induced price shocks and the cushioning from some increased economic slack, we project inflation to rise to just above 3% in year-over-year terms before gradually coming back to target in 2026 (Chart 7). Included in that is the

Chart 7: Core PCE will rise to over 3% under current tariffs



Source: BEA, CIBC calculations

Chart 8: Without fiscal support, the administration's policies will lower GDP by about 0.7%



Source: CIBC calculations

assumption that only 80% of the tariffs pass-through. Solid margins at the major big box and online retailers suggests that margin compression is going to limit full-pass through, and there are already reports that exporting firms are doing some of that. That the tariff shock is happening in a period of widening slack will also limit the degree of opportunistic price increases.

Altogether, a price shock of just under 1% will likely be passed through over the summer and fall. That reflects high-frequency estimates at selected US retailers which are telling us that this process is already underway (Cavallo et al, 2025). But with most of the price level shock passed on quickly, the quarter-over-quarter inflation measures — which is a better future guide for inflation — will moderate materially in Q4 and inflation momentum will return to target in early 2026.

Of course, there is a risk of inflation begetting more inflation — as we saw in the COVID crisis — but we think that risk is materially lower this time around. The US economy is slowing and facing slack, as opposed to the surging demand conditions in the years after 2020, juiced by massive fiscal stimulus. As well, the tariff shock is likely to be far-less broad based than what we saw in post-pandemic period, when commodity prices surged because the Russia-Ukraine war, there were wide-spread labor shortages and work-from-home exploded, affecting prices of goods and services alike.

Putting the pieces of the puzzle together

For the Fed, what matters is the net effect of the policies the administration will pursue. The drag from tariffs and uncertainty will be amplified by restrictive immigration and lower population flows, and the net impact of the policies we know about as of writing is a drag on GDP of about 0.7% (Chart 8).

Offsetting that will be the Fed with easier monetary policy, with a gradual move to neutral policy in 2026, with the start of the easing cycle in late 2025 when sequential inflation looks tame again. The other part of this is the One Big Beautiful Bill, which as of writing has made it through the House but is going to get a makeover in the Senate. If we believe the House version of that bill, it would weaken GDP this year a little but provide a modest boost by the end of 2026. However, growth would still be in the low 2%-range because the Fed could end up delaying or slowing its easing path and financial conditions could be tighter for longer, offsetting some of the fiscal boost. We will wait to see what the Senate does with the bill before building it into our forecast, as there is a reasonable chance that it could look very different, both in terms of size and composition.

Even though it looks like the world is ending (especially the global trade world), the US economy feels fine. A stagflationary slowdown is coming, with the end result being an economy that is growing at a decent clip but with the cost of higher inflation for some time and more slack in the job market. All of that rests on our expectation that tariffs will not snap back to the extremes proposed on April 2, the triple-digit tariffs we saw on China, or an entirely new tariff regime to circumvent the latest court challenges. Fingers crossed.

Canadian outlook: Half steam ahead

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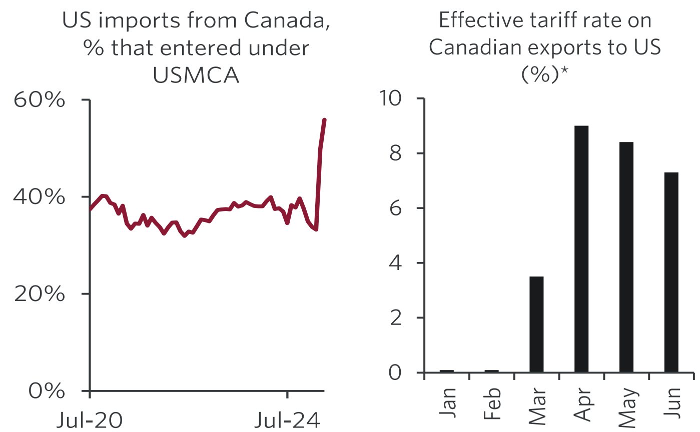
It's been half steam ahead for the Canadian economy recently, with trade uncertainty not just negatively impacting the manufacturing sector but also stalling the upward momentum seen in other areas of the economy during the second half of last year. While we expect growth to remain sluggish in the near term, some further progress in lessening trade uncertainty, combined with a return to interest rate cuts from the Bank of Canada, should stoke the engines of the Canadian economy and see growth accelerate again in 2026 (Table 1).

Not the best of times, not the worst of times

Tariff uncertainty has been a rollercoaster so far this year, and given the recent doubling of tariffs on steel and aluminum, it appears that the ride is far from over. Luckily though, even with developments this week, it appears that we may be avoiding the worst of times on the trade front.

While steel and aluminum are important sectors, on a macro level they represent only 0.5% of GDP and were already scaling back Canadian operations prior to the doubling of tariffs.

Chart 1: Sharp uptake in exporters using USMCA tariff exemptions (l), softening tariff impacts (r)



Note: Assumes USMCA compliance rate rises to 60% in May and 65% in June.

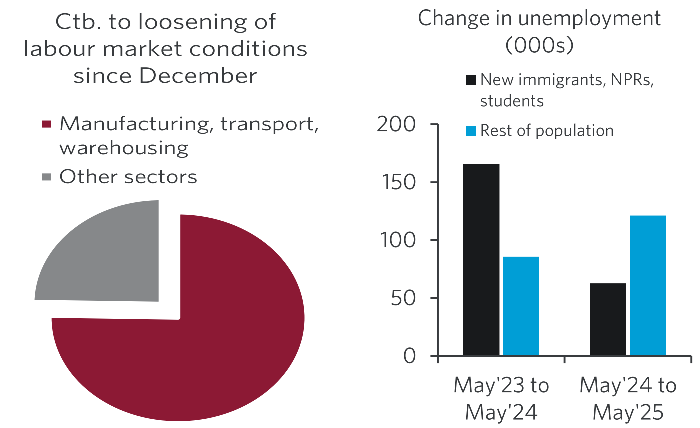
Source: US Census Bureau, CIBC

Table 1: Canadian forecast detail (real % change, s.a.a.r., unless otherwise noted)

Indicator	25:1A	25:2F	25:3F	25:4F	26:1F	26:2F	26:3F	26:4F	2025F	2026F
GDP at market prices ($Bn)	3,174	3,180	3,202	3,222	3,245	3,285	3,327	3,369	3,195	3,306
% change	4.9	0.7	2.8	2.4	3.0	5.0	5.3	5.1	4.0	3.5
Real GDP ($2012 Bn)	2,456	2,456	2,458	2,465	2,478	2,492	2,507	2,519	2,459	2,499
% change	2.2	0.0	0.2	1.2	2.0	2.4	2.3	2.0	1.5	1.6
Final domestic demand	-0.1	1.0	0.9	1.4	2.2	2.0	2.3	1.8	1.9	1.8
Household consumption	1.2	0.9	0.5	1.4	2.0	2.2	2.4	2.0	2.2	1.7
Total government expenditures	-0.8	4.1	1.3	1.3	1.9	1.2	1.9	1.5	2.4	1.7
Residential construction	-10.9	-0.8	2.0	2.5	5.2	2.9	3.1	2.4	0.3	3.0
Business fixed investment[1]	2.9	-4.6	0.9	1.1	2.3	2.4	1.9	1.5	0.4	1.4
Inventory change ($2012 Bn)	2.7	2.1	5.4	6.0	7.4	8.7	10.7	12.4	4.1	9.8
Exports	6.7	-1.8	1.0	2.1	2.1	3.2	1.8	1.9	2.5	1.9
Imports	4.4	1.1	4.6	3.0	3.3	2.6	2.8	2.1	2.4	3.0
GDP Deflator	2.5	0.8	2.6	1.2	0.9	2.5	2.9	3.0	2.4	1.8
CPI (yr/yr % chg)	2.3	1.8	2.3	2.5	2.0	1.9	1.4	1.6	2.2	1.7
Unemployment rate (%)	6.6	7.0	7.1	6.9	6.8	6.7	6.5	6.5	6.9	6.6
Employment change (K)	141	-8	13	40	35	102	110	92	271	224
Goods trade balance (AR, $bn)	-1.9	-10.3	-18.0	-19.3	-25.3	-22.4	-25.9	-27.3	-12.3	-25.2
Housing starts (AR, K)	223	269	265	266	271	275	277	280	256	276

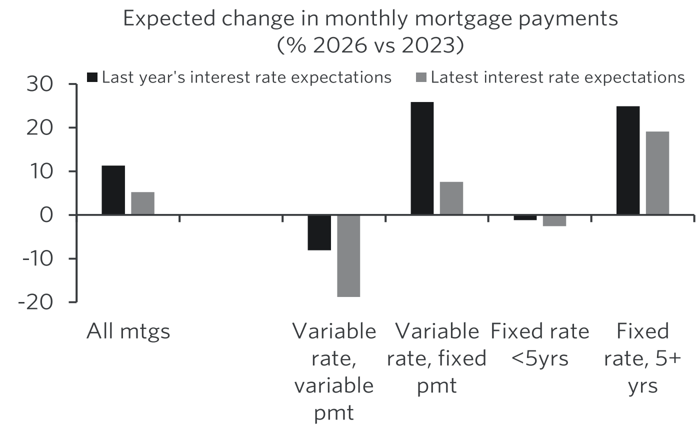
[1] M&E plus Non-Res Structures and Intellectual Property and NPISH.

Chart 2: Labour market deterioration has spread to non-trade exposed sectors (l), and broader demographic groups (r)



Source: Statistics Canada, CIBC

Chart 4: 5-Year fixed rate mortgage holders facing higher payments upon renewal



Source: Bank of Canada, CIBC

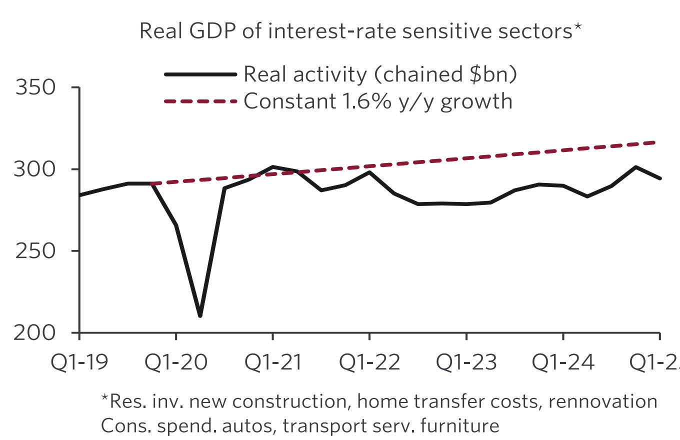
Because of that, the direct impact of recently raised tariffs will be quite small (0.1-0.2% of GDP, albeit higher for Ontario and Quebec). However, there will be an indirect impact on business confidence as it is a reminder that trade developments can take a step back as well as forward.

On a macro level, though, the impact of tariffs on Canadian exports is being softened by the exceptions made for CUSMA/USMCA compliance, and retaining that as renegotiation takes place will work to limit the negative impact of tariffs on the Canadian economy. The proportion of Canadian companies exporting into the US under that trade agreement has risen sharply in recent months and we expect further increases will be seen ahead (Chart 1, left). That has helped reduce the trade-weighted tariff rate that Canada is paying, even after including the recent increase in steel & aluminum tariffs (Chart 1, right).

A broader slowdown than perceived

Unfortunately, however, trade uncertainties are not just weighing on directly impacted sectors, but also other areas of

Chart 3: Interest-sensitive activity falling further below trendline



Source: Statistics Canada, CIBC

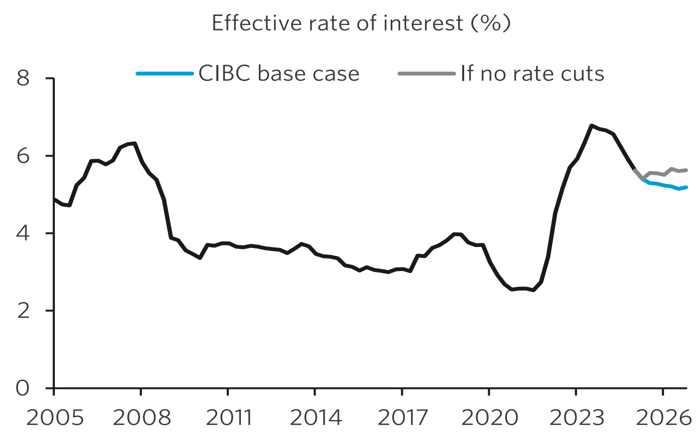
the economy. Even though recent job losses have been concentrated in industries such as manufacturing, that hasn't been the only cause of the loosening in labour market conditions seen during the first half of this year. Slower job growth, on aggregate, in other sectors of the economy relative to labour force growth has also contributed to the increase in unemployment (Chart 2, left). Unlike throughout much of 2023 and 2024, the increase in unemployment has been broader by demographic groups, and not led by new immigrants and young people (Chart 2, right).

This broader-than-perceived slowdown is a sign that further interest rate cuts are needed to help stabilize the economy. Another signpost of that is the renewed weakness being seen in interest-rate sensitive sectors. While spending and investment in these areas was strengthening late last year as interest rates were coming down, the level of activity remained well below its pre-pandemic path. The slowdown in housing in Q1 took the level of interest-sensitive activity even further below its prior trend (Chart 3).

While the weakness seen in Q1 was likely driven by trade uncertainties, it isn't obvious yet that interest rates have come down far enough to support growth, close the output gap, and ensure that inflation doesn't actually decelerate below the 2% target over the medium term.

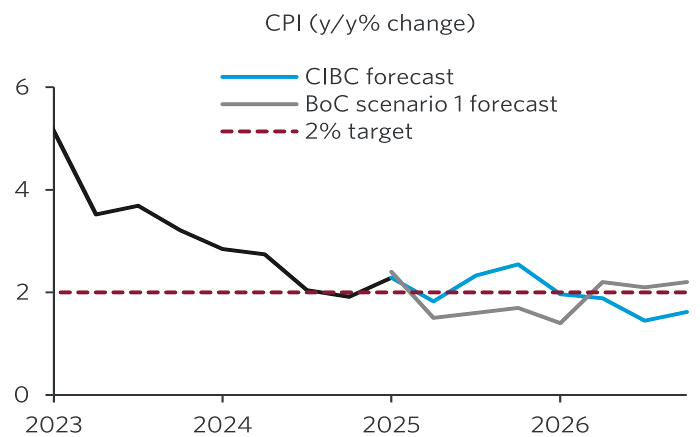
That's particularly true given the mortgage renewals approaching in the second half of this year and into 2026. While interest rate reductions seen so far have reduced the refinancing risk for households that took out variable rate mortgages with fixed payments during the pandemic, the same can't be said for households coming off 5-year fixed rate mortgages (Chart 4). That means that without further rate cuts from the Bank of Canada above and beyond what is already priced into financial markets, the recent reduction in households' effective interest rate will stall at a level that's well above where it stood pre-pandemic (Chart 5).

Chart 5: Effective interest rates staying elevated



Source: Haver Analytics, CIBC

Chart 7: Inflation could undershoot target next year



Source: Bank of Canada, Statistics Canada, CIBC

A timing issue

In order to feel comfortable in returning to the interest rate cutting table, the Bank of Canada doesn't just need to see signs of softening growth, but also that inflationary pressures are contained. Unfortunately, recent data has moved in the opposite direction, with price pressures (excluding the April carbon tax reduction) not just accelerating, but doing so more than policymakers were anticipating.

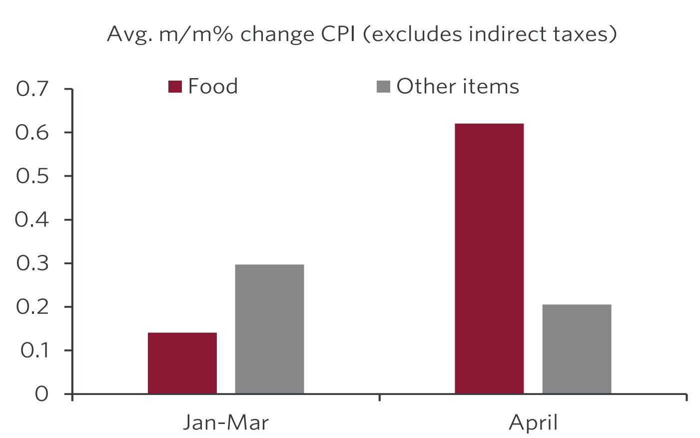
But much of this reflected the start of a one-time passthrough of tariffs, as well as an earlier weakening of the Canadian dollar that has since be reversed, rather than a sign that underlying inflationary pressures are stronger. Retaliatory tariffs imposed on US goods in March already appear to be having an impact on inflation, particularly in food categories, which could also be picking up the impact of previous currency depreciation (Chart 6). Inflation rates for other goods have come down, and the uptick seen recently in rental prices is unlikely to be sustained given industry data that suggest asking rents are falling in major cities.

While that earlier pass through of retaliatory tariffs could mean that inflation stays above the Bank of Canada's previous expectations in the near-term, the opposite could be true in 2026. Indeed, we expect that by then the slack that has opened up in the economy will become the predominant factor, bringing headline inflation back below 2% again (Chart 7).

Half steam ahead…for now

For the remainder of this year, it will be a case of half steam ahead for the Canadian economy, with only slow growth expected on average in the remaining quarters. However, there are reasons to believe that the economy could gather steam again later in the year and into 2026. Fiscal stimulus from both the federal and provincial governments will help, but to really stoke the fire we also need to see continued progress in trade negotiations and further interest rate cuts from the Bank of Canada.

Chart 6: Acceleration in food inflation partly reflects tariffs



Source: Statistics Canada, CIBC

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