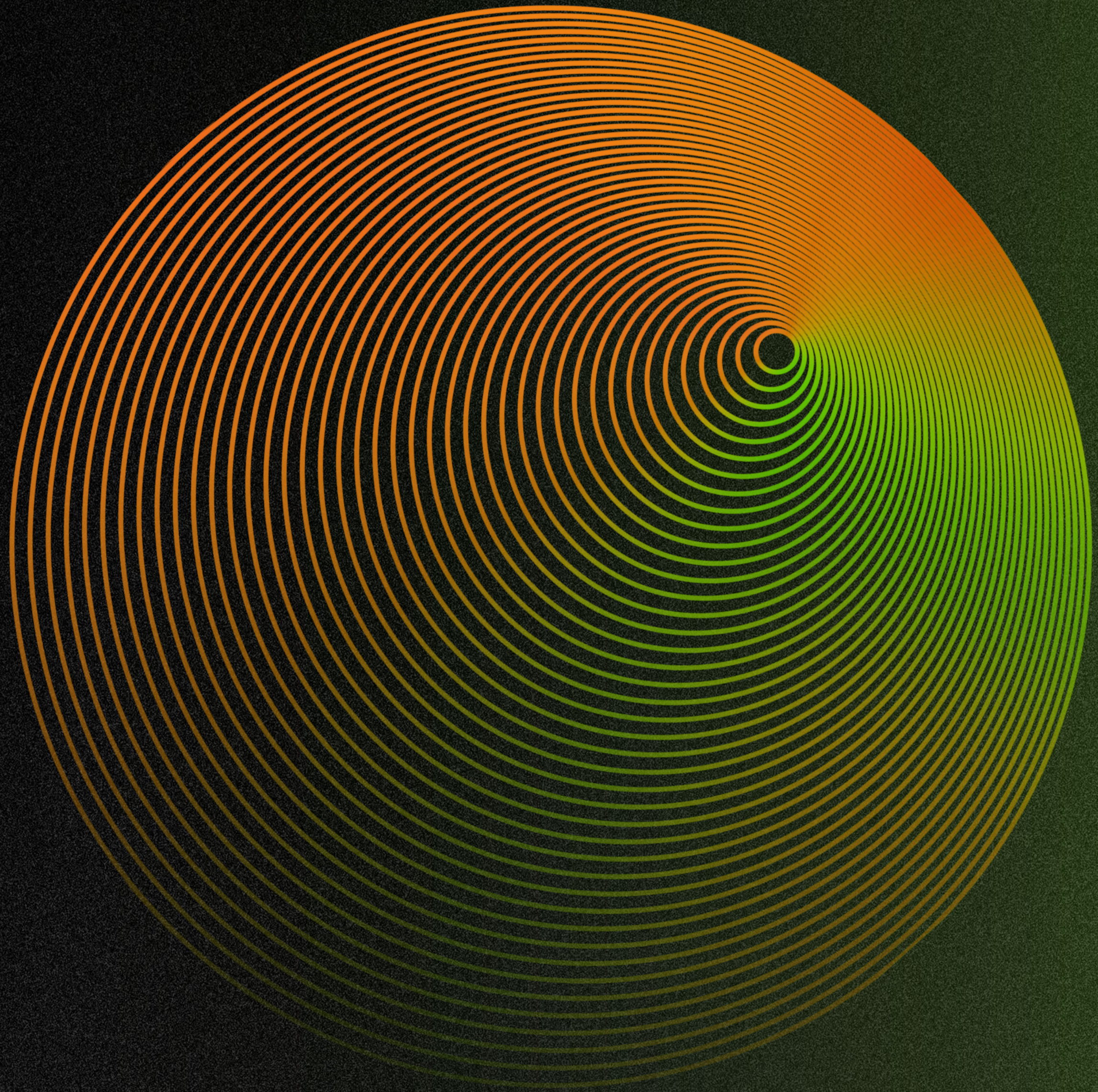
Deloitte.



Tariffs, trade, and a new path forward

Economic outlook | Summer edition

Foreword by Chief Economist, Dawn Desjardins

The tariffs on steel, aluminium, and finished vehicles will certainly weigh on growth, but it is the uncertainty over future trade that is most damaging to the economic outlook this year.

Global policy uncertainty is having a marked impact on growth forecasts which have been downgraded significantly in recent months. Falling consumer and business confidence, disrupted trade flows, expectations of higher costs and financial market volatility are expected to depress spending and investment. In Canada, the extreme rise in policy uncertainty, which now exceeds levels experienced during the pandemic, is taking a toll on confidence with consumer and business confidence measures falling to the lowest levels outside the pandemic. In the near term, we expect uncertainty about the future relationship with our largest trading partner to delay business investment and weigh on hiring which, in turn, will keep consumers sidelined. A modest recession is likely to occur this year. However, with negotiations between the US and its trading partners continuing, a new Canadian federal government in place and interest rates lower than they were a year earlier, our base case assumes the economy will regain its footing later this year. Overall, our forecast calls for real GDP to grow by 1.1% this year before accelerating to a 1.6% pace next year.

Striking the right balance

Canada's economy posted a solid gain in the first quarter of 2025 largely due to companies working to front-run tariffs on exports and imports while building up inventories. Consumer spending slowed appreciably and investment in housing dropped. Business investment increased modestly as companies rushed to buy machinery and equipment in anticipation of tariffs on imports from the US.

Uncertainty about demand for Canadian exports and challenges to pivot to other markets will likely prevent businesses from making major investments in the near term. The prospect that ongoing trade talks between the Canadian and US governments will yield results and governments will follow-through with policies to ease regulations, boost defense spending and unleash funds to build badly-needed infrastructure, should be sufficient for business confidence to return.

Economic Activity to Subside over the Summer

GDP, expenditure based, percent change

Sources: Statistics Canada; Deloitte. f = forecast

Foreword by Chief Economist, Dawn Desjardins

Tariffs are expected to hit Central Canada hardest with weak growth prospects forecast for Quebec and Ontario which export most of the tariff exposed products.

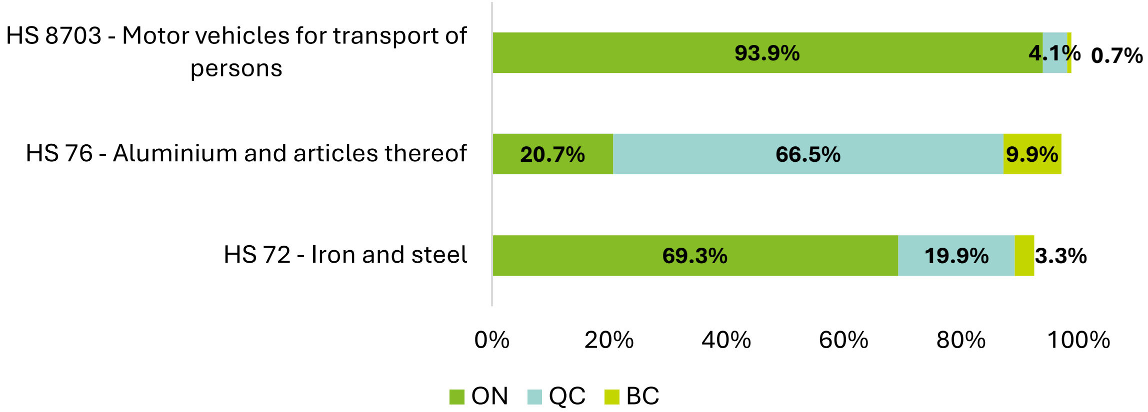
Canada's tariff on exports to the US so far has averaged less than other countries providing some prospect that US companies will continue to purchase Canadian goods. This is because, at this point, Canadian goods exporters who comply with CUSMA, are not subjected to the US 25% tariff or 10% tariff on energy and potash. Recent data however showed a sharp drop in Canadian exports to the US which may continue over the months ahead especially for products, like steel and aluminum and finished autos, that continue to face steep tariffs. These tariffs are expected to be most impactful in Ontario as it is the top exporter of steel and finished automobiles. Indeed, Central and parts of Eastern Canada are facing the most subdued economic growth forecast this year, with Ontario particularly hard hit given its exposure to industries with large tariffs in place. BC will also be hit by the tariffs and, when coupled with their high household debt levels and recent completion of major infrastructure projects, will leave the province facing another year of soft growth. Energy producing provinces will lead gains with decent growth expected in Alberta, Saskatchewan, and Newfoundland and Labrador.

Inflation pressures have picked up with the measures followed most closely by the Bank of Canada edging above 3% in April. With core inflation at the upper end of the target band and growth slowing, the Bank is in a difficult position. Upcoming policy decisions will consider not only the current level of inflation but where businesses and consumers expect inflation to be in the year ahead. As a result, further decreases in the policy rate will be limited by the concerns about the persistence of tariffs increasing input costs and ultimately consumer prices. As a result, we now look for just two more rate cuts by the Bank in the months ahead.

The newly elected federal government has put forth an aggressive policy agenda with the details of spending coming in the autumn budget. In the meantime, the government is negotiating with the Trump Administration on tariff and trade policy and pledged to increase Canada's defence spending to 2% of GDP this fiscal year. Our forecast therefore assumes a gradual ramping up of government investment and spending in the quarters ahead.

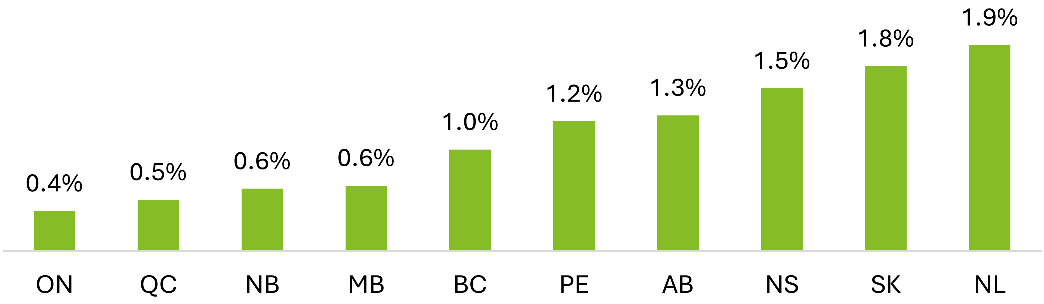
Ontario and Quebec are Most Exposed to Industries Facing Tariffs

Share of exports by province, by product, 2024.



Central and parts of Eastern Canada to Experience the Slowest GDP Growth this Year

GDP, basic prices, percent change, 2025



Sources: Statistics Canada; Trade Data Online; Deloitte. f = forecast

Economic Outlook

Monetary and fiscal policy

- With the economy headed for a rough patch and core inflation already breaking through the upper limit of the target band, we expect to see stimulus come predominantly from the fiscal side.
- The Bank of Canada held interest rates steady in June, the second consecutive meeting where it chose to stay on the sidelines. Even with evidence that the economy is set to soften, the latest communication from the Bank emphasized their focus on price stability. With tariffs set to nudge inflation higher over the coming months, the Bank is likely to cut interest rates only two more times in July and September, when the economy is contracting mildly, before pausing and turn the stimulus baton over to government.
- With the federal election behind us, we have seen quick movement on some important files, most notably the tabling of the “One Canadian Economy” bill. This bill looks to address two major irritants holding back our economic growth: interprovincial trade barriers and an excessively cumbersome regulatory regime for major investment projects. Specifically, the bill allows the government to identify projects that are in the national interest and expedite their approval process. Many provinces are following suit to reduce interprovincial trade barriers and build more infrastructure, boding well for our economic resilience and long-term prosperity. Overall, we expect to see modest growth in fiscal operational spending and a ramp up in government investment starting in the final quarter of this year.

Employment and labour markets

- After a strong start to the year, employment growth has stagnated in recent months with the number of people employed in May about 15,000 lower than January. Losses have been most pronounced in the manufacturing sector where tariffs on steel, aluminium, softwood lumber, and finished passenger vehicles are already having an impact. We are seeing that weakness spill into other industries with transportation and warehousing and business services also recently reducing their workforces.
- Unfortunately, these tough labour market conditions are expected to persist throughout the summer and early fall with modest job losses pushing the unemployment rate up to 7.3% in the third quarter. Employment growth is forecast to resume in the final months of the year, but a subdued economic recovery will limit the demand for new workers leading to soft employment growth. However, slower population growth will limit labour force growth and therefore, even with modest job growth, the unemployment rate will drop below 7% by early next year.

Consumer spending and residential investment

- Interest rates have been trending lower for a year, but those lower rates have failed to spark a rally in housing investment or household spending. Indeed real per capita consumer spending is almost exactly where it was heading into the pandemic meaning no increase in real per person spending for the last five years. Residential investment is faring even worse with real per person investment off 15% from pre-pandemic levels.
- Household spending growth is forecast to be subdued over the remainder of this year and into next due to several factors. Weak labour market conditions will limit employment opportunities and hold back wage growth. We are also seeing high levels of household savings in response to economic uncertainty which is limiting funds flowing into the economy. Finally, reduced population growth due to changes in immigration will result in fewer newcomers to the country, which have been a large driver of spending in the past few years.
- Many of these same factors are also weighing on the housing market, which is more sensitive to cyclical fluctuations than overall consumer spending. After a very brief recovery last fall coinciding with lower interest rates, a freeze returned to the resale market over the winter months. Given already low levels of investment and government plans to ramp up new home construction, our forecast calls for residential investment to be one of the fastest growing sectors of the economy next year.

Economic Outlook

Business investment

- Business investment has been lagging in Canada for several years and, unfortunately, 2025 does not appear to be the long-awaited turning point. There are many factors holding back investment with uncertain trade policy topping the list. While Canada is currently enjoying a tariff reprieve on products that are compliant with our free trade agreement with the US (aside from product specific tariffs), there is uncertainty as to how long that will last and what tariff rate products might face. And, as we've seen with the recent increase in steel and aluminium tariffs to 50%, even when tariffs are set, there is no guarantee that they will stay at that level. This lack of clarity is making it very difficult to make investments. Layer in softening domestic demand and it is no surprise that firms are hesitant to invest.
- The good news is that we expect to get clarity on the trade file before the end of this year given that the US is unlikely to stay in this on-again-off-again pattern indefinitely. Combine that clarity with policy initiatives aimed at improving project approval times and investment should fare much better next year, led by strength in engineering construction and machinery and equipment. Overall, after falling 0.8% this year on the heels of last year's 1.8% decline, non-residential business investment is expected to rise 2.4% next year.

Exports

- Exports started the year with a bang to post back-to-back quarters of very strong growth. However, much of that growth was driven by firms front loading their purchases to avoid tariffs. While Canada is not currently facing broad-based tariffs, the 25% tariff on the non-US content of finished vehicles and a whopping 50% tariff on steel and aluminum exports to the US are weighing on the outlook for exports of those products. In our forecast, we assume that these tariffs remain in place indefinitely but that no new tariffs are introduced.
- The targeted tariffs are already impacting jobs in the manufacturing sector even though the increase to 50% on steel and aluminium had only been in place for a few days when this forecast was prepared.
- In the steel industry, ArcelorMittal has laid off workers in Hamilton, Algoma Steep Group Inc. in Sault Ste. Marie and Ivaco Rolling Mills in L'Orignal. Losses were also observed in motor vehicle manufacturing with Stellantis temporarily laying off thousands of workers at its Windsor assembly plant in April. Overall, employment in manufacturing was down 55,000 jobs in May relative to January and as manufacturing capacity is scaled back, exports will soon follow.
- Indeed, we saw exports fall precipitously in April, down 10.8% month-over-month resulting in the largest trade deficit in history. This is setting up deep losses for the second quarter which are expected to be followed by further declines in the third quarter. Heaviest losses will be concentrated in the autos and metals manufacturing segments, but annual declines are also expected in exports of forestry products and industrial equipment and machinery. The tariffs from China on some canola, pork and seafood products are also expected to impact farm exports midyear. Overall, real exports are forecast to fall by 1.5% in 2025.
- There is some potential upside to our trade outlook. Should high tariffs remain on US imports of Chinese products, US manufacturers could lose some of their competitive advantage, opening up market demand for Canadian producers should we maintain our exemption for CUSMA compliant goods. However, slowing economic growth in the US will limit the potential upside.

Imports

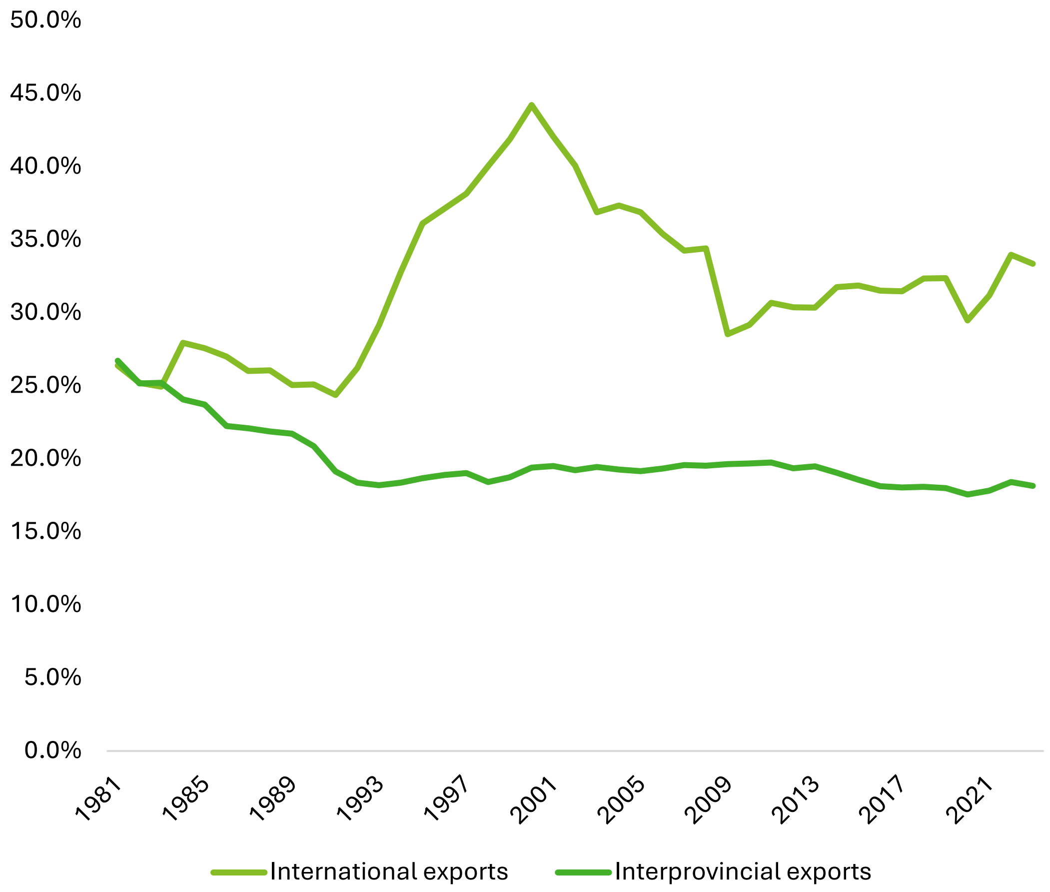
- Imports were also strong in the first quarter as Canadian businesses and consumers were frontloading purchases ahead of retaliatory tariff measures. Like exports, imports are expected to fall in the middle two quarters of the year. However, we expect imports to continue to decline in the final quarter of the year as the current reprieve on purchases used as intermediary inputs comes to an end. Driving the decline in imports this year is weak consumer spending, falling business investment and the decline in exports. These factors will bring total import growth down by 1.1% and with exports falling at a faster pace, trade will act as a drag on growth this year.

Several upside risks are starting to emerge

Movement on interprovincial trade barriers and focus on investment are sending encouraging signals that some long-standing impediments to productivity will be tackled.

- While a worsening of the tariff situation is the number one risk to our forecast and very clearly a downside risk, there are several upside risks emerging. We have seen a surge in buy Canadian sentiment and renewed interest in vacationing at home, two important factors that will help cushion the blow as the economy adjusts to targeted tariffs on important industries.
- Other policy initiatives won't have as immediate of an economic impact but have significant potential to shape our long-term economic prospects. The One Canadian Economy bill, which looks to work at reducing interprovincial trade barriers and fast-tracking investment has the potential to inject some much-needed investment and productivity gains into Canada's economic landscape.
- Progress on improving approval times and internal trade are also evident in several provinces. Bill 5 in Ontario and Bill 15 in BC are both aimed at reducing project approval times with a focus on infrastructure. Improved infrastructure spending, from both the private and public sector is crucial for helping our country boost productivity and after years of lagging performance on both the investment and productivity front, progress on this front is especially encouraging.
- Further, Nova Scotia, Alberta, BC, Manitoba, Ontario and PEI have drafted plans or signed agreements to remove barriers to internal trade between their provinces. Movement on the internal trade front is important as gains have been stagnant for decades. Our modelling estimates suggest that fully eliminating interprovincial trade barriers would create over 100,000 jobs but even getting part of the way will provide a sizeable economic boost.
- Perhaps one of the biggest challenges facing the economy is not losing sight of this momentum should the tariff situation improve. Irrespective of our trading relationship with the US, we must seize the opportunity in front of us to build a more prosperous and resilient economy.

International and interprovincial exports as a share of GDP, Canada



Source: Deloitte and Statistics Canada

Forecast tables

GDP by expenditure

	2024Q1	2024Q2	2024Q3	2024Q4	2025Q1	2025Q2f	2025Q3f	2025Q4f	2026Q1f	2026Q2f	2026Q3f	2026Q4f	2024	2025f	2026f
Canadian GDP	2.1	2.5	2.4	2.1	2.2	-1.7	-1.0	2.9	1.9	2.0	2.4	2.2	1.6	1.1	1.6
Household consumption	3.2	1.7	4.4	4.9	1.2	1.3	1.0	1.2	1.2	1.2	1.3	1.3	2.4	2.3	1.2
Non-profit consumption	1.5	1.5	3.2	2.1	2.3	0.8	0.7	0.8	0.9	0.9	1.0	1.0	2.0	1.8	0.9
Government consumption	5.9	5.6	5.5	2.4	-0.3	-0.2	0.1	1.3	1.8	2.1	1.9	2.1	3.7	1.4	1.5
Total investment	0.6	3.3	-1.8	9.0	-3.0	-3.9	-1.5	4.4	5.2	4.6	4.1	3.2	0.1	0.1	3.2
Government investment	14.2	6.8	4.0	7.3	-3.2	2.1	3.8	4.9	7.6	6.8	5.9	3.0	7.3	2.6	5.6
Business investment	-2.1	2.6	-2.9	9.4	-3.1	-5.3	-2.8	4.3	4.7	4.1	3.6	3.3	-1.4	-0.4	2.7
Residential investment	-4.5	-9.4	5.4	16.8	-10.9	0.1	0.5	1.7	4.1	4.5	4.9	4.9	-0.6	0.2	3.2
• Residential - renovations	-12.4	-9.5	0.5	6.3	1.8	1.4	1.3	2.0	6.0	4.7	6.1	5.5	-4.4	1.6	4.1
• Residential - ownership transfer costs	17.9	-5.0	18.3	52.6	-56.0	-9.6	-4.0	1.7	7.1	8.4	10.6	12.4	5.1	-12.5	4.5
• Residential - new housing	-6.0	-10.9	4.3	11.6	7.1	2.6	1.4	1.6	1.9	3.1	2.3	2.2	0.0	4.4	2.1
Non-residential investment	-0.2	12.0	-8.3	4.5	2.7	-8.4	-4.7	5.9	5.1	3.9	2.9	2.3	-1.8	-0.8	2.4
• Engineering structures	5.1	17.3	-1.1	-0.7	-10.4	-5.0	-2.5	3.5	4.8	4.3	3.3	2.5	-1.6	-3.0	2.6
• Non-residential buildings	-5.8	-6.5	-0.2	6.6	4.7	-6.5	-3.0	5.0	3.0	2.5	2.0	2.0	-3.4	0.6	1.7
• Machinery and equipment	-4.1	24.3	-27.7	10.5	22.9	-16.5	-10.4	12.6	9.2	5.9	4.0	3.0	-2.9	0.3	3.7
• Intellectual property	0.6	0.3	6.4	4.1	-1.5	-3.1	-1.0	1.7	1.5	1.4	1.3	1.3	0.0	0.5	0.9
Total exports	-0.7	-4.8	-0.6	7.1	6.7	-15.1	-8.4	2.5	6.1	7.5	7.7	5.4	0.6	-1.5	2.4
• Exports - goods	-0.6	-3.4	0.8	10.4	9.6	-18.7	-12.0	1.9	6.7	8.9	9.2	6.1	0.4	-1.3	2.1
• Exports - services	-1.3	-9.6	-5.6	-4.1	-3.9	-1.4	4.6	4.6	4.0	3.2	2.7	2.9	1.0	-2.5	3.4
Imports	-1.1	0.0	-1.0	2.5	4.4	-9.8	-4.7	-0.1	8.4	6.9	5.7	4.4	0.7	-1.1	3.0
• Imports - goods	-1.1	3.2	-1.9	6.2	9.0	-12.7	-6.7	-2.1	8.7	7.0	5.9	4.5	0.3	-0.3	2.3
• Imports - services	-1.1	-10.5	2.2	-9.8	-11.1	2.3	3.0	7.4	7.1	6.6	4.7	3.9	2.5	-4.0	5.7
Inventories	(7,230)	7,448	(5,244)	(26,035)	8,700	1,838	(1,587)	1,430	3,456	(836)	(486)	567	(11,213)	(10,644)	3,466
US GDP	1.6	3.0	3.1	2.4	-0.3	1.5	1.3	1.3	1.6	2.5	2.7	2.9	2.8	1.5	1.9

Notes: Unless otherwise noted, all figures are expressed as annualized % changes; data is based on seasonally adjusted real 2017 chained dollars; f = forecast.
Sources: Statistics Canada; Bank of Canada. Forecast by Deloitte Economic Advisory, as of June 10, 2025.

Key indicators

Key macroeconomic indicators

	2024Q1	2024Q2	2024Q3	2024Q4	2025Q1	2025Q2f	2025Q3f	2025Q4f	2026Q1f	2026Q2f	2026Q3f	2026Q4f	2024	2025f	2026f
Labour force participation rate (%)	65.6	65.6	65.3	65.3	65.3	65.3	65.3	65.3	65.3	65.3	65.3	65.3	65.5	65.3	65.3
Change in employment (000s)	84.7	105.1	40.0	97.2	141.1	-19.0	-51.7	13.7	29.1	38.2	49.1	51.3	381.9	223.6	74.8
Unemployment rate (%)	5.9	6.3	6.6	6.7	6.6	7.0	7.3	7.2	7.1	6.9	6.7	6.5	6.4	7.0	6.8
Household savings rate (%)	4.7	6.2	7.2	6.0	5.7	7.1	6.7	6.3	5.8	5.6	5.4	5.3	6.0	6.5	5.5

Key financial market indicators

	2024Q1	2024Q2	2024Q3	2024Q4	2025Q1	2025Q2f	2025Q3f	2025Q4f	2026Q1f	2026Q2f	2026Q3f	2026Q4f	2024	2025f	2026f
Overnight rate	5.00	4.75	4.25	3.25	2.75	2.75	2.25	2.25	2.25	2.25	2.50	2.50	3.25	2.25	2.50
90-day t-bill	4.96	4.79	4.20	3.36	2.79	2.62	2.16	2.04	2.09	2.12	2.16	2.19	3.36	2.04	2.19
1 year t-bill	4.78	4.62	3.71	3.22	2.75	2.55	2.29	2.27	2.35	2.40	2.43	2.45	3.22	2.27	2.45
Government 2-year bond	4.11	4.21	3.23	3.11	2.68	2.56	2.45	2.50	2.59	2.64	2.70	2.75	3.11	2.50	2.75
Government 3-year bond	3.86	4.07	3.13	3.07	2.67	2.58	2.51	2.60	2.62	2.66	2.71	2.76	3.07	2.60	2.76
Government 5-year bond	3.51	3.71	2.95	3.06	2.78	2.77	2.75	2.80	2.82	2.85	2.87	2.90	3.06	2.80	2.90
Government 10-year bond	3.44	3.67	3.09	3.26	3.09	3.17	3.15	3.10	2.95	3.00	3.00	3.00	3.26	3.10	3.00
90-day 10 year spread	1.53	1.12	1.11	0.10	-0.30	-0.55	-0.99	-1.06	-0.86	-0.88	-0.84	-0.81	0.10	-1.06	-0.81
2-year 10 year spread	0.67	0.54	0.14	-0.15	-0.41	-0.61	-0.70	-0.60	-0.36	-0.36	-0.30	-0.25	-0.15	-0.60	-0.25
Exchange rate CAD/USD	0.741	0.731	0.733	0.715	0.697	0.722	0.725	0.729	0.733	0.736	0.738	0.740	0.730	0.718	0.737

Notes: f = forecast. The overnight rate represents the end of the period. All other indicators quarterly values are quarter averages. Annual figures reflect the end of the period as measured by Q4.
Sources: Statistics Canada; Bank of Canada. Forecast by Deloitte Economic Advisory, as of June 10, 2025.

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