Macro landscape

Navigating uncertainty

MASTERCARD ECONOMIC INSTITUTE

CANADA Q3 2025

Navigating uncertainty

Canada's economic outlook remains clouded by uncertainty, particularly around trade policy. The recent U.S. decision to raise tariffs on non-United States-Mexico-Canada Agreement (USMCA) compliant Canadian goods from 25% to 35% has added to tensions, though the impact should be limited given most exports remain USMCA-compliant. Still, the broader imposition of tariffs continues to weigh on trade-sensitive sectors, contributing to weakness in exports, slower job growth in those industries and early signs of price pressures in durable goods like vehicles and furniture. However, the Canadian economy has proven more resilient than expected at the start of the year. This resilience is partly because tariffs have been more narrowly targeted than initially feared in February, limiting their broader economic impact and allowing momentum to persist in other parts of the economy. As such, Mastercard Economics Institute (MEI) expects the economy to continue growing, though at a more moderate pace, supported by ongoing consumer spending and relatively localized labour market softness.

MEI forecasts a

1.4%

GDP growth for 2025

MEI now forecasts GDP growth of 1.4% in 2025, down from 1.6% in 2024, reflecting the drag from elevated uncertainty and fading momentum. Much of the early-year strength was driven by a temporary boost from exports and inventory accumulation in Q1, which pushed real GDP growth to 2.1% quarter over quarter annualized. MEI expects that momentum to fade in the coming quarters as those temporary drivers unwind. MEI forecasts GDP to contract by 0.4% in Q2, and growth of just 0.9% in the second half of the year. MEI expects this weakness to be concentrated in exports, where MEI forecasts an annualized decline of 10.3% in Q2, though improved USMCA compliance should provide modest support. At the same time, MEI expects higher input costs and softer demand to weigh on profits and dampen business investment.

Real GDP growth of

2.1%

in Q1 quarter over quarter was pushed by exports and inventory accumulation

MEI forcasts a

2.2%

consumption growth year over year in 2025

On the upside, MEI expects household consumption to remain relatively resilient, supported by lower interest rates and the Canada Day income tax cut. MEI forecasts consumption to grow by 2.2% year over year in 2025, a slight moderation from the 2.4% growth in 2024. MEI expects most of this growth to be driven by stable spending on services, with our data showing that consumers continue to prioritize experiences. However, MEI expects ongoing uncertainty to weigh on spending on discretionary goods, particularly big-ticket items.

94,200

jobs added in domestic-facing industries since January

The dynamics of consumption growth depend on the path of the labour market. While tariffs have had a negative impact on employment, job losses have been largely concentrated in trade-sensitive sectors. Manufacturing, for example, has shed 38,900 jobs since January. However, this has been offset by gains in domestic-facing industries, such as finance and insurance, health care, and education, which have added 94,200 jobs over the same period. The key risk is that mounting uncertainty and weaker demand begin to spill over more broadly, leading to more widespread job losses. MEI expects the unemployment rate to peak at 7.4% in 2025 before gradually declining in 2026, though it is likely to remain elevated relative to the current level of 6.9%.

MEI forecasts CPI inflation to rise to 2.0% year over year as tariff effects continue to feed through the economy. The recent removal of the carbon tax will temporarily suppress headline inflation and mask underlying price pressures. This shift has prompted the Bank of Canada to place greater emphasis on core measures. The average of its preferred measures of core inflation stands at 3.1%, up from a more than four-year low of 2.5% in September 2024 and slightly above the Bank's target range of 1%–3%. The rise in core inflation is being driven by higher prices for services such as restaurants and recreation, as well as tariff-related pressures that are pushing up the cost of vehicles and personal goods. Still, lower headline inflation could help reinforce the Bank's messaging and support inflation expectations, reducing the risk that households and businesses build higher inflation into their wage- and price-setting behaviour.

Bank of Canada to proceed cautiously

The stagflationary risks facing the Canadian economy leave the Bank of Canada in a difficult position. On one hand, tariffs are pushing up input costs and inflation, arguing for tighter policy. On the other hand, weakening demand and a softening labour market point to the need for looser monetary conditions. MEI expects the Bank to proceed cautiously amid this backdrop of elevated uncertainty and asymmetric risks. Assuming core inflation remains contained, MEI anticipates two additional 25-basis-point rate cuts this year as trade tensions weigh on growth and labour market conditions weaken. Afterwards, MEI expects the policy rate to stabilize at 2.25% through 2026.

Economic outlook is subject to considerable uncertainty

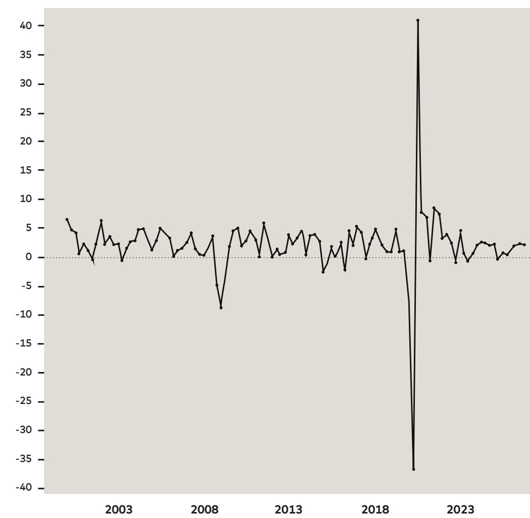
Forecast of key macroeconomic indicators

(QoQ% SAAR, unless indicated otherwise)

	2024 Q1 Actual	2024 Q2 Actual	2024 Q3 Actual	2024 Q4 Actual	2025 Q1 Actual	2025 Q2 Forecast	2025 Q3 Forecast	2025 Q4 Forecast
Real GDP	2.2	2.6	2.4	2.1	2.2	-0.4	0.6	0.4
Real consumption	3.2	1.7	4.4	4.9	1.2	0.5	1.3	1.3
Nominal consumption	5.1	5.8	6.4	7.7	4.2	2.1	2.9	3.0
Unemployment rate (%)	5.9	6.3	6.6	6.7	6.6	6.9	7.1	7.2
CPI yoy	2.8	2.7	2.1	1.9	2.3	1.8	1.9	2.1
Bank rate (EOP)	5.0	4.8	4.3	3.3	2.8	2.8	2.5	2.3

Source: MEI, Statistics Canada

Real GDP



RISKS

Downside risks:

Renewed escalation in the trade conflict:
Additional tariffs and retaliatory measures could further raise production costs, disrupt the labour market and weigh on both investment and consumer spending.

Slower-than-expected population growth:
Population growth has been a key driver of economic momentum in recent years. The federal government's plan to reduce the number of newcomers could dampen consumption and add to downside pressures.

Broadening labour market weakness:
While job losses have so far been concentrated in trade-sensitive sectors, persistent trade uncertainty could further slow spending and investment, leading to broader job losses.

Upside risks:

Larger-than-expected fiscal spending:
The federal government's plan to meet NATO's defence spending target of 2% of GDP by year-end—along with any additional infrastructure investment—would support economic growth. More clarity is expected with the release of the 2025 federal budget this fall.

Lower-than-expected inflation:
If the inflationary impact of tariffs proves more muted than anticipated, core inflation could come in lower than expected. This would give the Bank of Canada greater room to reduce interest rates and support consumption, investment and overall economic growth.