November 2025

Canada: A whiff of stagflation

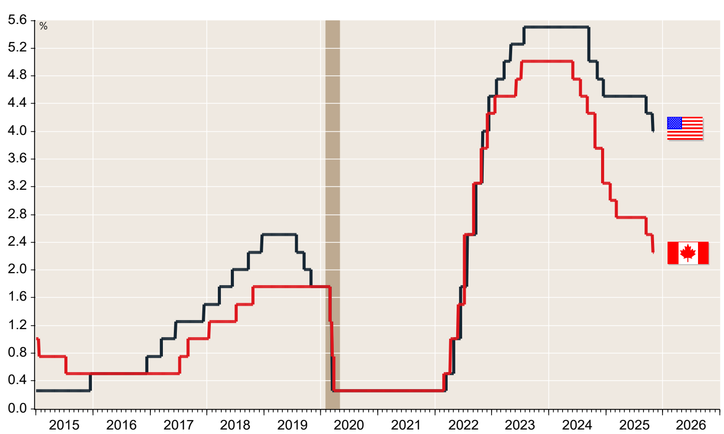
By Matthieu Arseneau and Alexandra Ducharme

Summary

- The Bank of Canada lowered its policy interest rate for the second consecutive time in October, but indicated that it believed it had finished cutting rates for the time being. This conviction has likely strengthened in recent weeks.
- While economic data has been mixed, wage pressures have accelerated recently despite numerous indicators suggesting excess supply of labour. In 2025, employees involved in wage negotiations secured an average annual wage increase of 3.3%, well above the level seen in the decade prior to the pandemic.
- This situation is having an impact on inflation, particularly in the services sector, which is much more sensitive to wage pressures. In October, annual inflation in services excluding shelter rose by 3.5%, the highest rate since May 2023. In this context, we believe that suspending interest rate cuts is appropriate.
- Combined with interest rate cuts, the federal government's announcements have limited the damage in 2025 and should enable the economy to emerge from its slump in 2026, provided that trade tensions with the United States ease. We forecast GDP growth of only 1.1% in 2026 due to demographic weakness, following 1.7% in 2025. This forecast incorporates economic weaknesses that are expected to persist until the end of the current year, as well as a gradual improvement next year.

In a context where the economy has been weakened by trade tensions with the United States and uncertainty persists, the Bank of Canada opted for a second consecutive rate cut in October, bringing the policy interest rate to 2.25%, a neutral or slightly stimulative level, according to the Bank's own estimates. However, the members of the Bank's governing council shared their belief that this rate should be appropriate in the coming months, given the current circumstances and their forecasts.

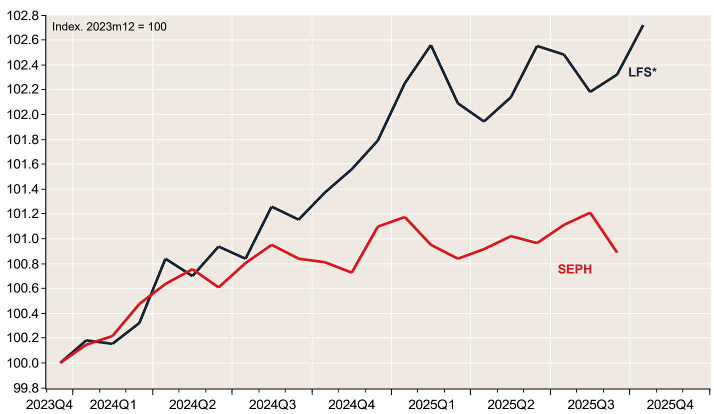
Canada: BoC indicates rate cuts have likely run their course
Central bank policy rate: Canada vs. the U.S.



NBC Economics and Strategy (data via Refinitiv)

This intention to suspend rate cuts has likely been reinforced in recent weeks. Third-quarter gross domestic product came in much stronger than the Bank had anticipated, at 2.6%. However, stagnant domestic demand will certainly be the focus of attention for monetary policy makers. Meanwhile, October labour market data from the Labour Force Survey (LFS) surprised on the upside with an increase of 67K jobs, following an increase of 60K the previous month. This brought the unemployment rate down by two-tenths of a percentage point to 6.9%. While these figures are certainly reassuring, we must remain cautious before concluding that the worst is over for the labour market. Indeed, these figures can be highly volatile, and we are all the more cautious as they contradict other indicators suggesting that the labour market could remain fragile. The results of the Business Outlook Survey published in October show that hiring intentions among large companies are at a level generally associated with rising unemployment, while the proportion of companies reporting labour shortages is the lowest since the 2008-2009 financial crisis. On the other hand, the Survey of Employment, Payrolls, and Hours (SEPH) paints a much less favorable picture of employment in Canada. September data show a contraction of 58K jobs, rather than the 26K suggested by the LFS after adjustment for comparability. For the first nine months of the year, the SEPH indicates a contraction of 38K jobs, while the LFS suggests an increase of 101K.

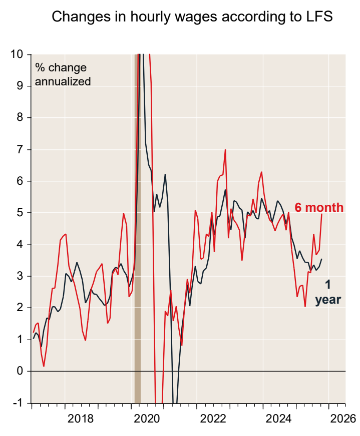
Canada: A mixed picture of the labor market
Employment trends since 2023, EERH vs. EPA (data adjusted for comparability)



* Self-employed workers are not included, nor is the agricultural sector. We take into account individuals with multiple jobs.
NBC Economics and Strategy (data via Statistics Canada)

While employment trends diverge, the message these surveys send about wage pressures is consistent. Over one year, hourly wage growth stands at around 3.5%, but this masks an acceleration over the last six months. In fact, in both cases, wages are rising at an alarming rate of around 5.0%.

Canada: Wage pressures accelerated in 2025



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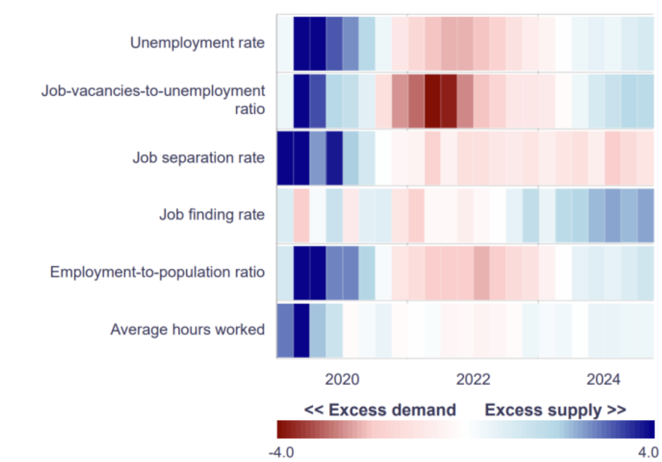
This development is surprising, as several labour market indicators were already in a state of excess supply when trade tensions intensified at the beginning of the year, and these indicators have become even more fragile, as indicated by the Bank of Canada in its October Monetary policy report. It is estimated that the unemployment rate was back to its equilibrium level in the third quarter of 2024 and increasingly in a state of excess supply thereafter. It is normal for labour market conditions to affect wages with a certain lag, but this lag seems particularly long at the moment.

Canada: The labour market is showing some slack

Situation of the labour market (excess supply or excess demand) as assessed by the Bank of Canada

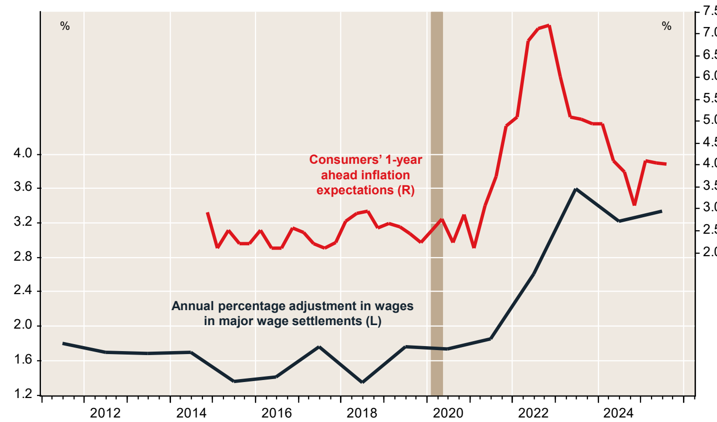


Bank of Canada

The inflationary shock we have just experienced may have contributed to this delay, accentuating the mismatch between persistent wage pressures and excess supply in the labour market. On the one hand, many workers, particularly union members, are trying to compensate for past losses in purchasing power due to inflation. In addition, inflation expectations have also changed, with consumers still expecting prices to rise at a faster pace than in the past. In 2025, employees involved in wage negotiations obtained an average annual wage increase of 3.3%, which is much higher than the level observed in the decade prior to the pandemic. On average, agreements were concluded for a period of 4.1 years, reflecting the fact that the surge in inflation in recent years will continue to have an impact on business costs and, ultimately, on inflation.

Canada: Higher inflation expectations mean higher wage adjustments

Consumers' 1-year ahead inflation expectations and annual % adjustment in wages in major wage settlements



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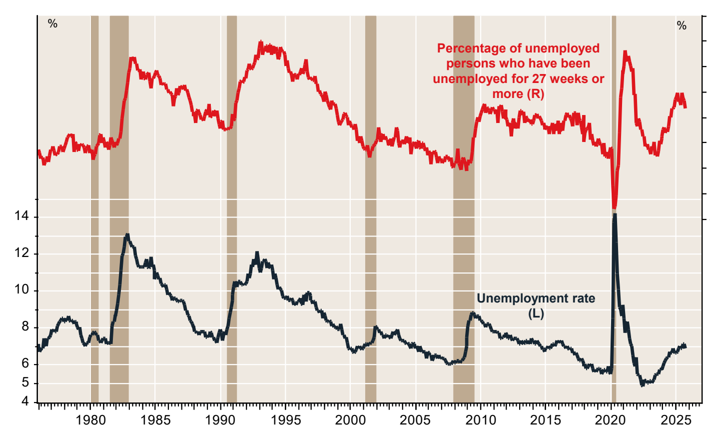
Another factor that may explain the discrepancy between wage growth and high jobless rate figures is the composition of the those workers on the sideline. The rise in unemployment since 2022, and particularly over the last year, has been gradual, with no significant waves of layoffs. This has resulted in a high proportion of long-term unemployed, who, according to several studies, have less impact on wage growth in the economy. This can be explained by a mismatch between their skills and those sought by employers, or by an erosion of their skills and employability.

Canada: Long-term unemployment on the rise

Unemployment rate and share of unemployed persons who have been unemployed for 27 weeks or more



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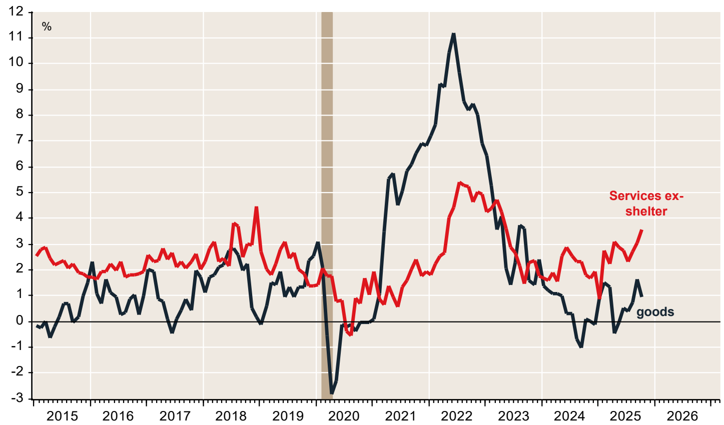
There is no doubt that wage pressures, which remain too high, are contributing to persistent inflation. In October, core inflation measures rose on average at an annualized monthly rate of 3.0%. This rate is also virtually identical to the rate observed over three months and over the past year. Annual inflation in goods prices has fallen significantly, but it's a different story for services, which are much more dependent on wage pressures in the country. In October, annual inflation in services excluding housing rose 3.5%, the highest rate since May 2023.

Canada: Inflation in services remains persistent
Annual CPI



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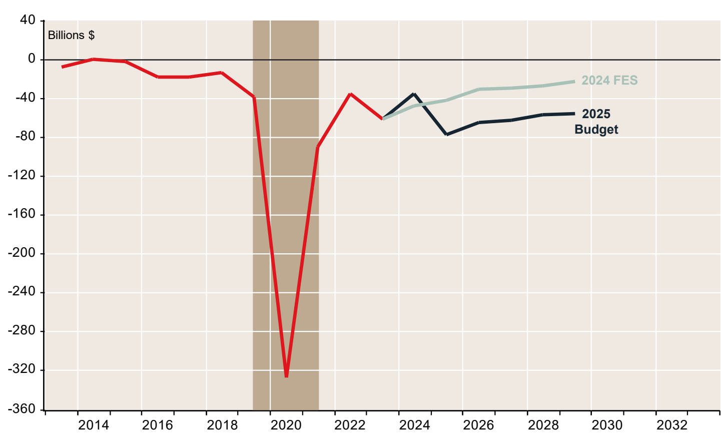
Given the current situation, which has stagflation overtones, we also believe that, for now, the best course of action is to suspend interest rate cuts. We continue to believe that core inflation should moderate in the coming months amid excess supply, but the lack of progress so far on the inflation front calls for caution. The Bank of Canada has therefore left it up to governments to fine-tune the stimulus needed to inject into the economy amid trade tensions. Fiscal policy is more flexible than monetary policy and can target specific sectors of the economy. In this regard, the federal government presented a budget announcing deficits twice as large as in the last update in fall 2024. The budget projected a deficit of $78 billion for 2025-2026 and $65 billion for 2026-2027 (compared to the previous estimates of $42 billion and $31 billion). It detailed several measures aimed at bolstering household consumption, such as tax cuts since July, the elimination of the carbon tax last April, and a reversal on capital gains taxation. The government also announced additional investments in housing and infrastructure, as well as measures to stimulate business investment.

Canada: Largest deficits on the horizon
Federal government deficits



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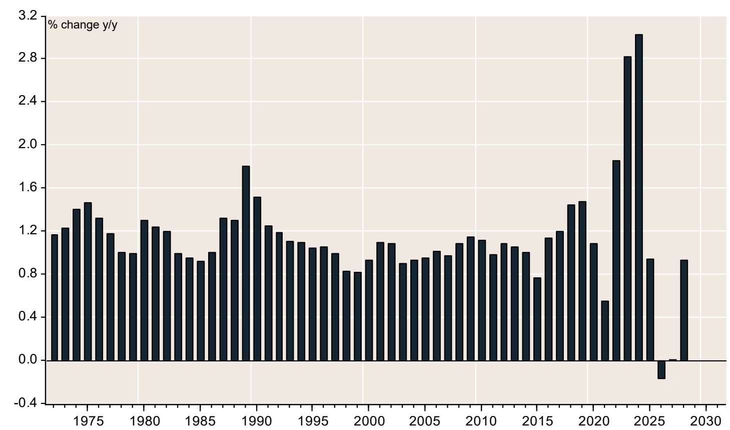
Combined with interest rate cuts, these measures limited the damage in 2025 and should enable the economy to emerge from its sluggishness in 2026, provided that trade tensions with the United States de-escalate. In our view, securing access for Canadian companies to the U.S. market is a necessary condition for an upturn. We forecast GDP growth of just 1.1% in 2026, following 1.7% in 2025 (revised upward due to historical data and strong growth in Q3). This forecast incorporates economic weaknesses that are expected to persist until the end of the current year, as well as a gradual upturn next year. Over the four quarters of 2026, we anticipate growth of 1.6%, which is not spectacular by usual standards, but higher than the potential growth we estimate at between 0.5% and 1% given the current demographic slowdown. This should allow the unemployment rate to decline slightly.

Canada: A temporary slowdown in population growth
Population growth, annual data (forecast for 2026, 2027 and 2028)



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Canada economic forecast

(Annual % change)*	2023	2024	2025	2026	2027	Q4/Q4 2025	Q4/Q4 2026	Q4/Q4 2027
Gross domestic product (2012 $)	2.0	2.0	1.7	1.1	1.7	0.8	1.6	1.7
Consumption	2.2	2.2	2.1	1.0	1.3	1.3	1.1	1.4
Residential construction	(9.5)	(0.2)	1.5	0.8	2.5	(1.4)	1.6	2.2
Business investment	3.1	(1.4)	(0.8)	0.4	2.7	(2.8)	2.6	2.6
Government expenditures	2.9	4.2	2.4	2.1	2.1	1.7	2.2	1.9
Exports	6.2	0.9	(2.9)	(0.3)	1.9	(5.6)	1.6	2.0
Imports	1.2	0.7	(0.4)	0.6	2.0	(0.9)	1.9	2.0
Change in inventories (millions $)	10,912	6,536	19,951	24,442	25,192	....	....	....
Domestic demand	1.5	2.2	1.9	1.2	1.8	0.8	1.6	1.7
Real disposable income	2.3	4.8	2.2	1.1	1.4	0.7	1.3	1.5
Employment	3.0	1.9	1.4	0.4	0.5	0.9	0.5	0.5
Unemployment rate	5.4	6.4	6.9	6.9	6.6	7.0	6.8	6.5
Inflation	3.9	2.4	2.1	2.3	2.2	2.3	2.3	2.1
Before-tax profits	(11.8)	(2.3)	5.9	3.4	4.9	2.1	4.2	5.0
Current account (bil. $)	(20.4)	(15.0)	(50.0)	(55.0)	(48.0)	....	....	....

** or as noted*

Financial Forecast**

	Current 11/27/25	Q4 2025	Q1 2026	Q2 2026	Q3 2026	2025	2026	2027
Overnight rate	2.25	2.25	2.25	2.25	2.25	2.25	2.25	2.75
Prime rate	4.25	4.25	4.25	4.25	4.25	4.25	4.25	4.75
3 month T-Bills	2.19	2.15	2.20	2.20	2.30	2.15	2.40	2.70
Treasury yield curve								
2-Year	2.40	2.40	2.40	2.45	2.50	2.40	2.55	2.90
5-Year	2.70	2.70	2.70	2.75	2.75	2.70	2.80	3.05
10-Year	3.13	3.15	3.15	3.20	3.20	3.15	3.25	3.45
30-Year	3.58	3.55	3.55	3.60	3.60	3.55	3.65	3.80
CAD per USD	1.40	1.42	1.39	1.37	1.35	1.42	1.35	1.33
Oil price (WTI), U.S.$	59	55	58	60	63	55	65	68

*** end of period*

Quarterly pattern Canada

	Q3 2024 actual	Q4 2024 actual	Q1 2025 actual	Q2 2025 actual	Q3 2025 actual	Q4 2025 forecast	Q1 2026 forecast	Q2 2026 forecast
Real GDP growth (q/q % chg. saar)	3.3	2.8	2.2	(1.8)	2.6	0.2	1.0	1.6
CPI (y/y % chg.)	2.0	1.9	2.3	1.8	2.0	2.3	2.1	2.5
CPI ex. food and energy (y/y % chg.)	2.5	2.1	2.5	2.6	2.5	2.7	2.4	2.2
Unemployment rate (%)	6.6	6.7	6.6	6.9	7.0	7.0	7.0	7.0

National Bank of Canada

Provincial economic forecast

	Real GDP (% growth) 2023	2024	2025f	2026f	2027f	Nominal GDP (% growth) 2023	2024	2025f	2026f	2027f
Newfoundland & Labrador	-3.0	2.7	1.8	1.6	2.0	-4.0	4.6	1.4	2.6	3.3
Prince Edward Island	2.9	3.8	1.6	1.2	2.0	6.7	7.5	3.0	3.4	3.7
Nova Scotia	2.4	3.1	1.6	1.2	1.3	7.6	8.0	3.5	3.3	3.6
New Brunswick	2.0	2.7	1.5	1.0	0.9	3.5	4.0	4.2	3.4	3.2
Quebec	0.7	1.7	1.5	1.0	1.2	4.7	5.9	4.4	3.0	3.6
Ontario	2.4	1.6	1.5	0.9	1.8	6.9	5.1	4.2	3.1	3.8
Manitoba	2.8	1.7	1.6	1.1	1.4	5.4	3.3	5.0	3.5	3.1
Saskatchewan	3.1	3.0	2.1	1.3	1.8	-3.7	0.0	3.9	2.2	3.2
Alberta	2.5	3.0	2.3	1.9	2.1	-4.0	5.1	3.8	2.9	3.2
British Columbia	2.8	1.1	1.7	1.2	2.0	3.6	3.5	4.4	3.4	3.9
Canada	2.0	2.0	1.7	1.1	1.7	3.5	4.8	4.2	3.2	3.7

	Employment (% growth) 2023	2024	2025f	2026f	2027f	Unemployment rate (%) 2023	2024	2025f	2026f	2027f
Newfoundland & Labrador	1.7	2.7	-0.1	0.4	0.0	9.8	10.0	10.2	9.8	9.5
Prince Edward Island	6.2	3.6	0.8	-0.2	0.6	7.3	7.8	8.3	8.6	8.1
Nova Scotia	2.7	3.1	0.4	0.6	0.7	6.4	6.5	6.7	6.3	5.7
New Brunswick	3.4	2.8	1.1	0.5	0.5	6.6	7.1	7.3	7.1	6.7
Quebec	2.9	0.9	1.7	0.4	0.2	4.4	5.4	5.7	5.5	5.3
Ontario	3.1	1.7	1.0	0.2	0.6	5.6	7.0	7.7	7.7	7.3
Manitoba	2.7	2.6	1.5	0.3	0.4	4.9	5.5	5.8	5.9	5.6
Saskatchewan	1.6	2.6	2.4	0.5	1.0	4.7	5.5	5.1	5.6	5.4
Alberta	3.7	2.9	2.7	0.7	1.0	5.9	7.1	7.4	7.6	7.4
British Columbia	2.6	2.4	1.1	0.3	0.3	5.2	5.6	6.2	6.2	6.0
Canada	3.0	1.9	1.4	0.4	0.5	5.4	6.4	6.9	6.9	6.6

	Housing starts (000) 2023	2024	2025f	2026f	2027f	Consumer Price Index (% growth) 2023	2024	2025f	2026f	2027f
Newfoundland & Labrador	1.0	1.7	1.5	1.0	1.0	3.3	1.8	1.5	2.3	2.2
Prince Edward Island	0.9	1.2	1.7	1.0	1.0	2.9	1.9	1.5	2.4	2.4
Nova Scotia	7.1	7.4	9.6	8.0	8.5	4.0	2.3	2.1	2.5	2.4
New Brunswick	4.7	6.2	7.0	6.0	6.2	3.5	2.2	1.6	2.4	2.2
Quebec	39.9	48.8	60.6	56.5	57.5	4.5	2.3	2.5	2.5	2.4
Ontario	90.0	74.5	59.9	62.0	63.5	3.8	2.4	1.9	2.3	2.1
Manitoba	7.1	7.2	7.5	7.0	7.2	3.6	1.0	2.6	2.3	2.3
Saskatchewan	4.6	4.3	6.7	5.8	6.0	3.9	1.4	2.1	2.3	2.3
Alberta	35.9	47.8	57.2	55.5	56.5	3.3	2.9	2.1	2.2	2.0
British Columbia	50.6	45.8	42.8	42.0	43.0	4.0	2.6	2.1	2.2	2.3
Canada	241.8	245.1	254.5	244.8	250.4	3.9	2.4	2.1	2.3	2.2

e: estimate f: forecast

Historical data from Statistics Canada and CMHC, National Bank of Canada's forecast.

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