Economic Commentary

January 28 2026

Bank of Canada holds, and is likely to stay on sidelines for 2026

As anticipated, the Bank of Canada maintained its policy interest rate at 2.25 per cent today. This came as no surprise given inflation and inflation expectations holding within the 1-3 per cent target, tempered business sentiment, and the Bank's messaging in recent months that the current rate was at about the right level. The Bank Rate remained at 2.5 per cent with the deposit rate at 2.20 per cent.

The Bank's communique was relatively neutral, with little guidance on direction of rates or duration of the current hold, highlighting mixed patterns of a strong U.S. economy, weaker domestic patterns and unpredictable trade and geo-political uncertainties. Specifically, the U.S. economy continues to grow at a strong pace underpinned by AI investment even as tariffs lift prices. Domestically, Canada economic growth is expected to have stalled in Q4 after the strong Q3 reading, and while employment has risen, the slack persists in the labour market with an unemployment rate of 6.8 per cent and limited signs of hiring based on is business expectations survey.

That said, trade uncertainty is clearly a risk to the Bank outlook, which is already modest at 1.1 per cent this year and 1.5 per cent in 2027. The review of the USMCA/CUSMA agreement is a source of uncertainty. The Bank sees steady consumer spending, and a gradual strengthening of business investments alongside fiscal support.

Inflation is deemed to have slowed, and excess supply in the economy is expected to offset trade-related cost pressures, holding inflation near two per cent. Inflation is expected to remain near two per cent through the forecast horizon.

The Bank reiterated that the current policy rate of 2.25 per cent is still appropriate, conditional on its outlook, albeit with heightened uncertainty. Given a stable labour market and modest near-term inflation pressures, we now see the Bank on hold through 2026 before hiking in 2027.

Monetary Policy Report highlights

Canadian economic growth was revised up to 1.7 per cent for 2025 compared to 1.2 per cent from the last MPR even as Q4 GDP growth stalls to zero in Q4. This owed in large part to historical revisions by Statistics Canada (2024 was revised up to 2.0 per cent) which also pointed to stronger productivity than previously estimated. Broadly the economy continues to be dragged down by the direct and indirect impacts of tariffs on trade and investment. The output gap is still estimated at -1.5 per cent to -0.5 per cent, point to slack in the economy.

The Bank forecast GDP growth of 1.1 per cent this year and 1.5 per cent in 2027 which is in line with previous forecasts. Consumption, government, and mild recovery in business investment are expected drivers. Population growth is also expected to drag on the economy. Potential growth is expected to rise at about 1 per cent annually.

This is of course contingent on trade policy, and assumes that tariffs in place on January 26, 2026 hold. The effective U.S. tariff rate on Canadian goods was 5.8 per cent in January. The Bank's outlook also included the trade thaw with China.

Inflation pressures remain tame as we have seen in monthly readings. The MPR noted that inflation has held in the 1-3 per cent band for the past two years, while the underlying 3-month trend in core measures is below

2 per cent. While breadth of price growth above 3 per cent expanded in December, it was largely due to food and the impacts of the GST/HST tax holiday. Business expectations for inflation are close to 3 per cent. The Bank forecasts inflation of 2.0 per cent in Q1 with core inflation at 2.5 per cent, with a forecast near 2 per cent through 2027. This includes a temporary period in which inflation falls below 2 per cent in Q1 2026 due to lower energy prices, weaker shelter costs growth, and end of base-year effects from the tax holiday. Broad upward pressures on prices from the trade environment are offset by softer demand in the economy.

Global economic growth is forecast to expand by 3.2 per cent this year after 3.5 per cent growth in 2025. The U.S. economy accelerates to 2.6 per cent in 2026 from 2.2 per cent in 2025 with strength from AI.

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