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Structural change — Canada at a crossroads

Tiff Macklem | Governor of the Bank of Canada

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Abstract

Governor Tiff Macklem discusses how structural change — driven by U.S. protectionism, AI, and slowing population growth — is reshaping Canada's economy. He outlines the Bank's role in maintaining low and stable inflation while helping the economy through the transition.

Disclaimer: This policy note is based on the speech by Governor Tiff Macklem, delivered at the Empire Club of Canada, on February 5, 2026, Toronto, Ontario.

Introduction

Canada is at a crossroads. The era of rules-based open trade with the United States is over, the potential of artificial intelligence (AI) looms large, and our demographics are shifting. The impact of these forces on the Canadian economy will not be a temporary cyclical fluctuation. These are deep structural changes that are transforming the economic landscape. And how Canada responds — which road we take — will define our economic future.

The Bank of Canada needs to understand the economic implications of structural change to deliver on our mandate—low and stable inflation. Governments need to understand it to direct public investment, encourage private investment and use industrial policy to capitalize on our economic strengths. Businesses need to understand it to develop new markets and products, invest in productivity-enhancing technology and help their workers gain skills for the future. And Canadians need to understand it so they can see the opportunity, while managing what could be difficult adjustments along the way.

Let me break the topic down into three questions.

First, what do we expect for the economy this year and next — what does structural change mean for growth, jobs and inflation?

Second, where do we see adjustments already happening, and what could be in store in the years ahead?

And finally, what are the monetary policy implications? This last question is important because monetary policy should not try to mitigate structural change. Our role is to preserve price stability while supporting the economy through the upheaval. That's easy to say, but hard to do in the moment.

What is structural change?

Let us start by defining what we mean by structural change.

Things are always changing in the economy. Oil prices, the stock market and exchange rates go up and down. Consumer and business sentiment shifts. And the strength of the global economy ebbs and flows. But these changes are not structural change.

Structural change is bigger and broader — and it's not temporary. It permanently changes the level or composition of economic activity. It alters what and how much the Canadian economy can produce at full capacity without causing inflation. Structural change is a journey. It's the transition between one steady state and the next — between Canada's old economy and the new one taking shape.

In truth, the economy is always adjusting to structural forces like new technology. Most of the time structural change is gradual and relatively smooth. It's operating in the background.

But sometimes structural change is more prominent because the pace of change is unusually rapid. This can happen because of a fundamental policy shift — such as the *Canada-US Free Trade Agreement in 1989* — or the dawn of a new transformative technology like the internet in the 1990s.

Today is one of those times of rapid change—we are facing a convergence of structural breaks. Advances in AI have dramatically broadened its application, the United States has swerved to protectionism, and our population growth has declined.

Structural change can be disruptive, rendering some investments obsolete and displacing some workers. And spillovers from sectors that are restructuring can create cyclical weakness in other parts of the economy. Structural

change can also increase uncertainty because it's hard to know how transformative it will be. When the internet emerged in the 1990s, we didn't know just how valuable the new technology would be or which investments would pay off. Even as the internet proved to be an enormously powerful new technology, the dot-com bust of 2000 was a painful reminder that many new companies could fail.

Like the internet, AI is a transformative technology, and its rise has sparked concerns about over-investment and over-valuation as well as fears of job destruction. But just as the internet enabled new services and business models that boosted productivity, the rise of AI has the potential to put the economy on a higher path and raise our standard of living.

While AI is building on past innovation, the US swerve to protectionism is reversing gains from trade. When Canada embarked on free trade with the United States in 1989, it did bring some pain in the short term—competition can be tough. But, in time, a bigger market and new competition brought innovation and investment, increasing productivity and growth and lowering inflation.[1] Now, new US trade restrictions are reducing efficiency, raising costs and lowering incomes in Canada.

Trend growth in gross domestic product (GDP) is also being pulled down by lower population growth, which reflects both a decline in fertility and lower rates of immigration. That means fewer new consumers and workers in the economy, which lowers our economic potential. The Bank's population forecast suggests the Canadian labour force will hardly grow at all over the next few years after annual growth of almost 1½% on average for the past 20 years.

Looking back at history makes identifying structural breaks look deceptively easy. But identifying what is happening in real time is challenging because structural change happens at the same time as cyclical changes in demand and supply. That makes it hard for businesses, workers, governments and central banks to know which change is temporary and which is permanent — and hence where to invest and how to set policy. I'll come back to the policy implications momentarily.

Canada's economic outlook

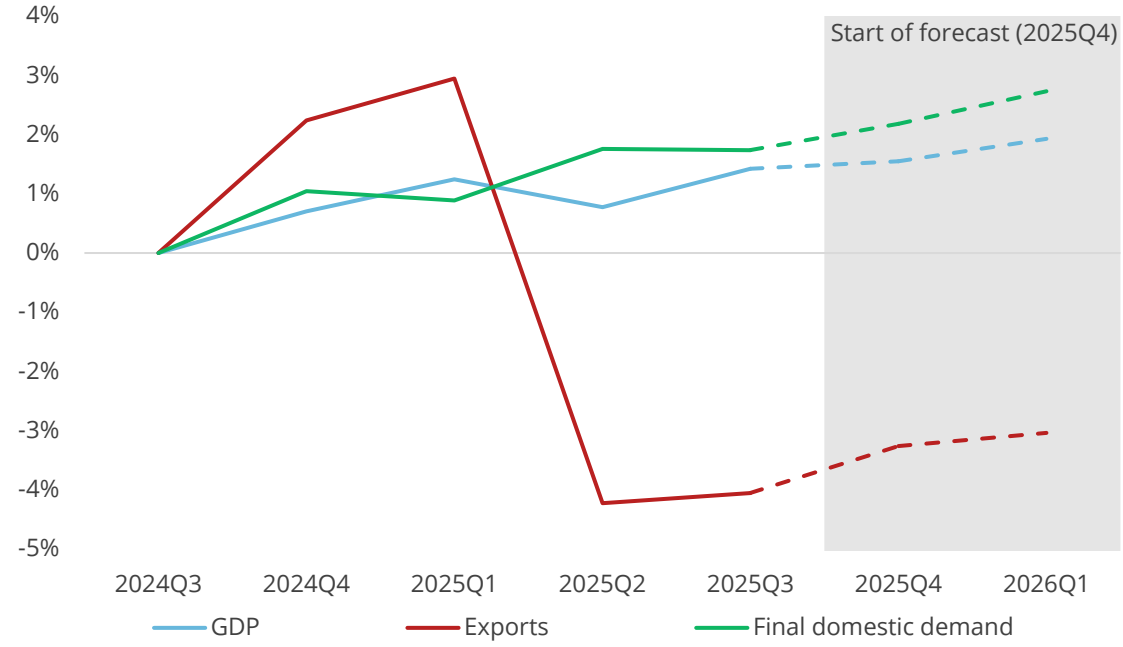
What does structural change mean for the economy over the next couple of years?

Last week, the Bank of Canada released its quarterly Monetary Policy Report, including our economic outlook for 2026 and 2027. US tariffs have weakened the Canadian economy. Exports are down sharply. And while some export growth is expected to resume this year, exports grow along a lower path (Chart 1).

[1] With the benefit of hindsight, economists can measure the impact of free trade and new technology on productivity. Empirical studies of the 1989 *Canada–United States Free Trade Agreement* estimate that productivity gains in Canadian manufacturing ranged from 5% to 14% between 1988 and 1996 (D. Trefler, "The Long and Short of the Canada–US Free Trade Agreement," *American Economic Review* 94, no. 4 (2004): 870–895; A. Lileeva and D. Trefler, "Improved Access to Foreign Markets Raises Plant-level Productivity…For Some Plants," *Quarterly Journal of Economics* 125, no. 3 (2010): 1051–1099; M. J. Melitz and D. Trefler, "Gains from Trade When Firms Matter," *Journal of Economic Perspectives* 26, no. 2 (2012): 91–1180).
A range of estimates suggest that the information and communication technology (ICT) revolution contributed between 0.4 and 0.6 percentage points to Canada's annual productivity growth in the 1990s. (J. Mollins and P. St-Amant, "The Productivity Slowdown in Canada: An ICT Phenomenon?," Bank of Canada Staff Working Paper No. 2019-2 (January 2019); B. Robidoux and B.-S. Wong, "Has Trend Productivity Growth Increased in Canada?" *International Productivity Monitor*, Number Six (Spring 2003); T. M. Harchaoui, F. Tarkhani, C. Jackson and P. Amstrong, "Information Technology and Economic Growth in the Canada and the U.S.," *Monthly Labor Review* (October 2002)).

Chart 1. Exports are sharply lower due to US tariffs

Percentage change since 2024Q3, quarterly data



Sources: Statistics Canada and Bank of Canada calculations and estimates
Last data plotted: 2026Q1

The trade conflict has also spilled over to the broader economy. Business investment has been weak across sectors — largely because of elevated uncertainty. But investment is expected to strengthen as businesses adapt to the new trade environment and governments increase infrastructure spending.

Household spending is also expected to grow moderately, supported by past cuts in interest rates and rising disposable incomes.

Adding it all up, the economy is forecast to grow — but it's soft growth. We expect GDP growth to average only about 1¼% over the next two years.

Part of this softness reflects cyclical weakness and part reflects structural change. The lower US demand for Canadian exports and trade-related uncertainty has spilled over into lower business investment and hiring. But tariffs have also increased costs and reduced the efficiency of the economy. And lower immigration means less labour force growth. In our baseline forecast, the spillover effects from the trade shock and uncertainty gradually dissipate and the economy recovers from the cyclical weakness. But the path for potential output is lower because of increased trade friction and slower population growth.

Turning to jobs, we expect businesses to be cautious in their hiring this year. But with little growth in the labour force, we are not expecting the unemployment rate to trend higher. Indeed, with modest economic growth, we should see some gradual improvement in the labour market over the projection. But structural change means this improvement could be uneven across sectors and occupations. I'll come back to this.

Inflation is expected to remain close to the 2% target. Tariffs and the costs of reconfiguring trade are putting some upward pressure on inflation. But the cyclical weakness in demand is constraining price increases.

With the Canada-United States-Mexico Agreement under review this year, uncertainty will continue to weigh on the economy. And broader geopolitical risks are elevated. We could see a lot of worrying headlines — and uncertainty makes it hard for businesses to invest.

But some things are clear. The United States has rejected open trade, population growth has slowed, and AI will change the marketplace. And when the economic landscape changes, Canadian businesses need to adjust. Recent federal and provincial budgets include measures to help businesses pivot, support workers in the transition and help the economy restructure. These policy measures are included in our economic outlook, along with past interest rate cuts and other announced fiscal measures.

As the Canadian economy works through this transition, growth will be modest. In time, the economy restructures and productivity and potential output pick up, but this will be measured in years, not quarters.

The transition could be faster than we expect, particularly if trade uncertainties ease and businesses move more boldly to invest in new technology, markets and products. But it could also be more painful than we'd like — particularly if the trade situation darkens or other shocks disrupt the economy.

Worse still, the Canadian economy could fail to restructure. If that happens, productivity and GDP growth do not recover. Canada becomes a less attractive place to invest. Businesses become less competitive. Job and wage growth are weak, our incomes don't recover, and affordability worsens. That's what we really can't afford. That's why we need to lean into this structural change.

Structural change, sectoral adjustment and supply

Where do we see adjustment already happening?

Let us start with trade. As we approach the one-year mark of US tariff threats, supply chains have started to shift. Goods imports from the United States have declined, while those from other countries have increased (Chart 2).

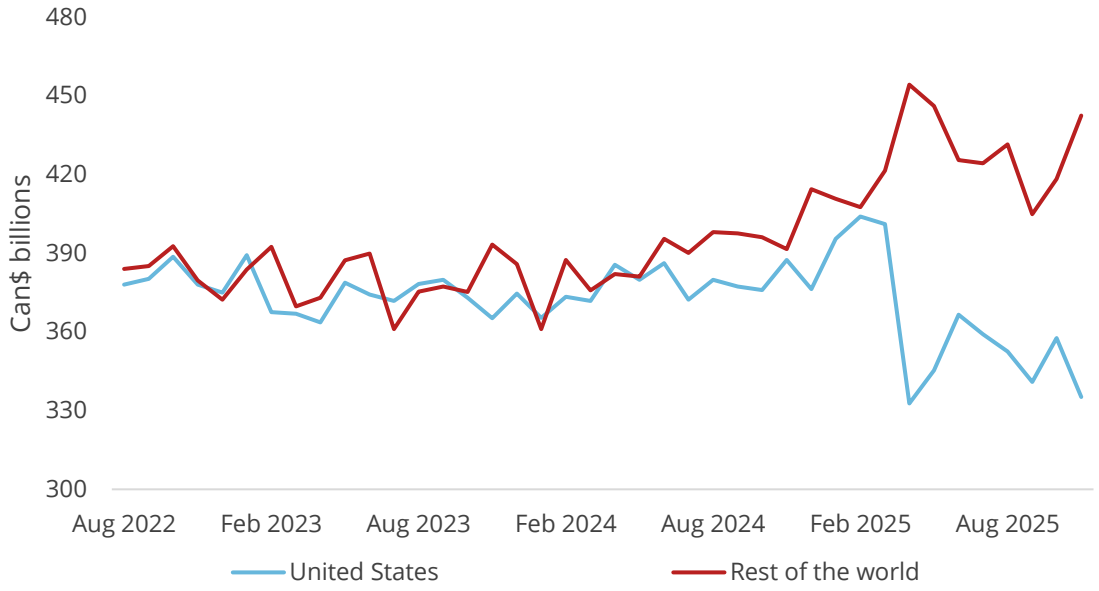
That decline in imports from the United States has mostly happened in sectors affected by Canada's retaliatory tariffs— we're diversifying to avoid higher costs. There are also indications our imports from overseas are being rerouted to avoid going through the United States. Increasingly, we're getting them directly.

Exports too, are shifting, though not as quickly. Exports of goods to non-US markets have risen, while exports to the US have fallen (Chart 3).

A small but growing share of exporters have increased sales to overseas markets. So far, the increase is largely limited to existing clients — businesses have not found many new clients just yet. And with so much of our exports going to the United States, the increase in other markets only provides a partial offset. You can see this in the large overall decline in our exports (Chart 1).

Chart 2. The level of goods imports from the United States has fallen

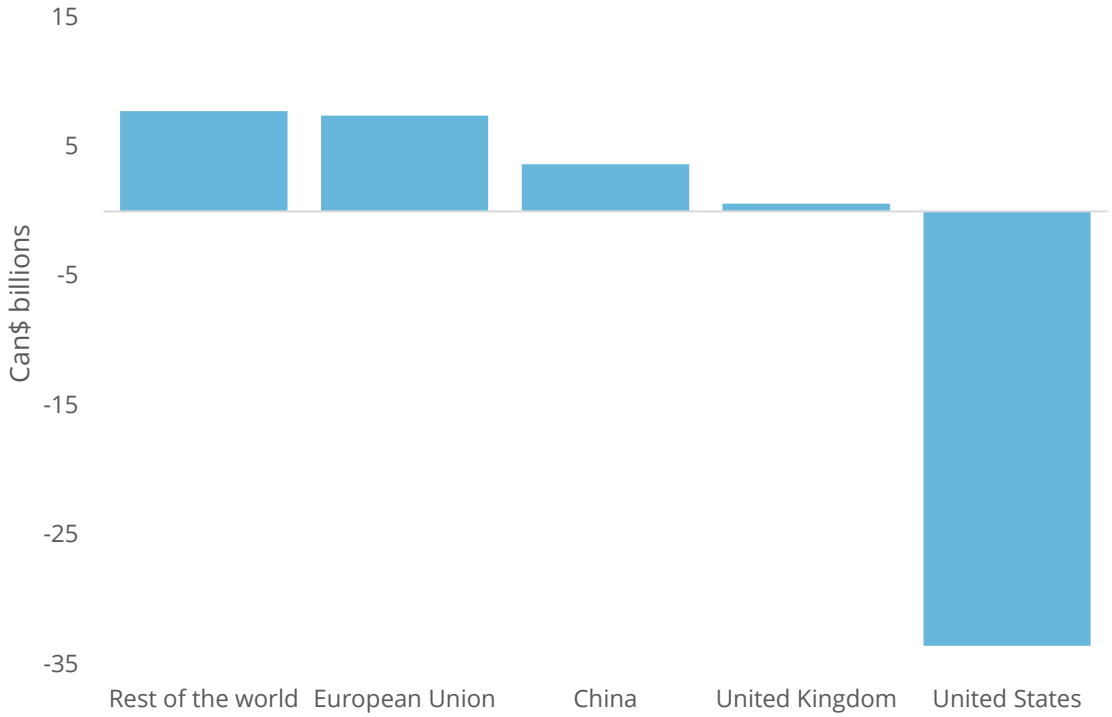
Nominal, customs basis, seasonally adjusted, annualized data



Sources: Statistics Canada and Bank of Canada calculations
Last observation: November 2025

Chart 3. Exports to markets outside the United States have increased

Change in Canada's exports of goods since 2024, by destination, annualized data



Note: Exports of goods exclude those originating from the gold and silver ore mining industry because shipments of gold are highly volatile and often reflect inventory management. Shipments of gold do not reflect underlying production levels or demand because gold is frequently re-exported, stored or shipped for financial or custodial reasons. Annual averages are calculated using 2024 and 2025 data from January to November of each year.
Sources: Statistics Canada and Bank of Canada calculations
Last observation: November 2025

You can also see it in the labour market. Employment in sectors with high exposure to trade fell in the first half of last year and remains subdued (Chart 4).

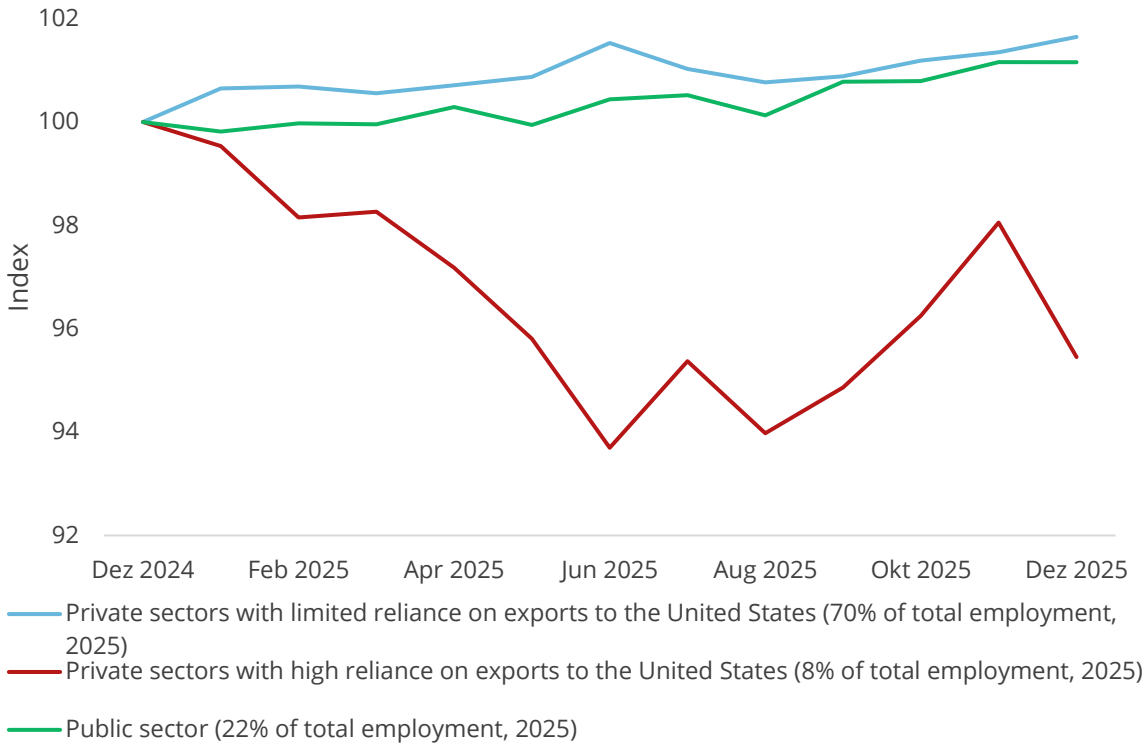
It's still early days. It will take time to develop new markets, and the transition will weigh on our export sector. It is encouraging that businesses have started adapting, but there is a long way to go.

The changes brought by AI are not as easy to capture. We're certainly seeing some AI investment, and we expect efficiencies brought by AI will ultimately boost productivity. AI will also likely affect the labour market, and we're watching that closely. So far, it's too early to see significant AI impacts on productivity or employment in Canada. But we are seeing a few early indicators of change.

AI adoption looks to be increasing in Canada but remains modest. When we talk to companies, they tell us their workers are increasingly using AI at work. But significant adoption of AI to produce or deliver goods and services remains low. Statistics Canada's Survey on Business Conditions puts this at 12% of businesses. Our most recent Business Leaders' Pulse survey yielded broadly similar responses. Only 8% of businesses surveyed reported significant AI use in their operations, with another 11% reporting plans to use AI over the next year. But the majority had either no use or infrequent use of AI. And while AI may be expected to boost productivity at some point, it may be a while before we see a significant impact.

Chart 4. Employment in sectors with high reliance on US exports has declined

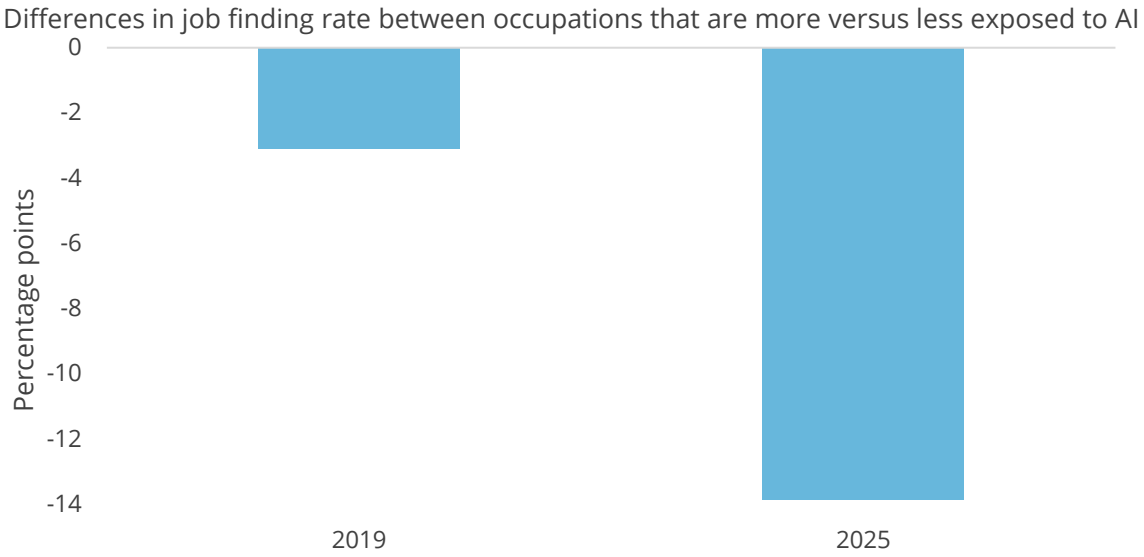
Employment level, index: December 2024 = 100, seasonally adjusted, monthly data



Note: A sector is considered to have significant reliance on exports to the United States if at least 35% of the sector's jobs depend on US demand. These include several manufacturing and transportation subsectors as well as commodities sectors, including energy and forestry.
Sources: Statistics Canada and Bank of Canada calculations
Last observation: December 2025

So far, we are not seeing much impact of AI in the labour market either.[2] Not surprisingly, we are seeing increased demand for workers with AI skills.[3] The flip side is we may be seeing some early evidence that AI is reducing the number of entry-level jobs in some occupations. And this may be boosting youth unemployment, although separating the effects of AI from the impact of trade and demographic changes is difficult. There are more media reports that professional services companies are cutting back on entry-level positions because AI can do some of the work. And there is some hard evidence that it is getting more difficult to find a job in occupations with a larger proportion of tasks that can be performed by AI (Chart 5). At the same time, we are seeing a decline in the share of entry-level job vacancies (Chart 6). Long-term youth unemployment is also elevated.

Chart 5. The job finding rate has fallen much more in occupations that are exposed to artificial intelligence



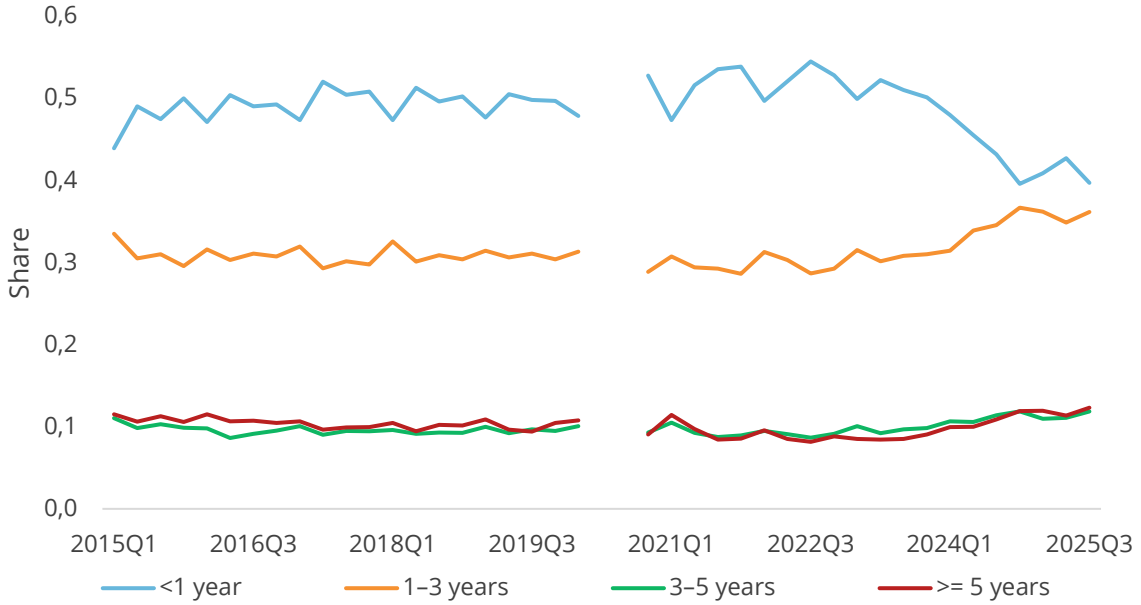
Note: The difference is estimated using a regression of job finding probability on occupation-level AI exposure as defined in M. Benítez-Rueda and E. Parrado, "Mirror, Mirror on the Wall: Which Jobs Will AI Replace After All? A New Index of Occupational Exposure," *Inter-American Development Bank Working Paper Series*, no. 1624 (2024)
Sources: Statistics Canada and Bank of Canada calculations and estimates
Last observation: 2025

As we monitor employment through this structural change, it's important to remember that technological progress doesn't just benefit companies at the expense of workers. Canadians benefit too. Productivity growth pays for higher wages. And recent innovations have given us more choice for less cost. The internet brought instant communication, e-commerce at our fingertips, GPS warnings of traffic ahead, crowdsourced reviews and online bookings for everything. AI holds similar promise for new goods and services and lower cost.

[2] See T. Mehdi and M. Frenette, "Canadian Employment Trends in the Era of Generative Artificial Intelligence: Early Evidence," *Economic and Social Reports*, Statistics Canada, January 2026.
[3] See B. Bernard, "Indeed's 2026 Canadian Jobs & Hiring Trends Report: Familiar Themes Meet Emerging Trends," Hiring Lab: Economic Research by Indeed (December 18, 2025).

Chart 6. The share of entry-level job vacancies has fallen

Share of vacancies by years of experience required, not seasonally adjusted, quarterly data



Note: The Job Vacancy and Wage Survey was temporarily suspended during the pandemic.
Sources: Statistics Canada and Bank of Canada calculations
Last observation: 2025Q3

Monetary policy implications

With structural change underway and lots of runway ahead, we come to the third question: What are the implications for monetary policy?

Recall our definition of structural change: it's the transition from Canada's old economy to the new one that's taking shape. Monetary policy can't change the destination. But it can help smooth the journey. Let me explain.

The Bank of Canada is helping the economy through this restructuring, while keeping inflation low and stable. Monetary policy can support demand that's being restrained by spillovers and cyclical weakness.

What monetary policy can't do is restore the lost efficiency caused by increased trade friction. Monetary policy isn't going to have much effect on the adoption of AI either. And monetary policy certainly can't influence fertility or immigration rates.

But what's clear in principle is more complicated in practice. Several realities complicate monetary policy in the face of structural change. I'll focus on two.

First, it is hard to differentiate structural change from cyclical fluctuations as they are happening. In the short term, structural change is hard to see through the ups and downs in the economy — so it can be hard to know whether a drop in GDP growth is part of a structural trend or a temporary downturn.

We have to be careful not to misdiagnose economic weakness. Monetary policy should not try to compensate for lost supply. Lowering interest rates in the face of weak economic activity risks stoking future inflation if the weakness is due to lower productive capacity rather than a cyclical downturn in demand. And there is also a risk that overstimulating demand when the problem is structural could delay needed structural change.

Second, by its nature, structural change will affect different sectors and workers differently. We can't just look at the average impacts. US tariffs are already hitting the economy very unevenly. AI is poised to disrupt some industries and occupations more than others. Experience has taught us that these sectoral differences are important to understand inflation. For example, strong demand in some sectors may boost inflation by more than weakness elsewhere lowers it.

Navigating the transition will require a lot of careful analysis and thoughtful judgment. We have to look beyond the aggregate and dig into more granular data to see how workers and capital are moving across sectors and regions.

The dynamics of the labour market can offer important clues about what's cyclical and what's structural. While cyclical downturns always affect some jobs more than others, experience tells us that cyclical downturns result in a broad-based weakness in the labour market. So if unemployment, job vacancies, separations and finding rates are unusually different across sectors, occupations and demographic groups, it suggests structural change is at play.

Our surveys of businesses and consumers will also help identify how capital is shifting, jobs are changing and workers are adjusting. And given that Canada's main industrial sectors are concentrated in different parts of the country, our regional analysis and outreach will be important.

Finally, we need multi-sector models to understand the monetary policy implications of structural change. Since the pandemic, we've developed richer models that capture sectoral differences and the links between sectors.

More granular analysis, continued regional outreach and richer models will all help us separate what is cyclical and what is structural. Even so, the confluence of geopolitical, demographic and technical change increases the risks of getting it wrong. That's why we're using more scenario analysis. It allows us to explore alternative interpretations and reduce the risk of policy errors. And we will be ready to respond if new information changes our outlook.

In short, we'll be working hard to identify and assess the relative importance of cyclical and structural changes. Through it all, our 2% inflation target will remain our ultimate policy beacon.

Conclusion

The heightened uncertainty we continue to face is making it difficult for businesses, families and communities to plan and prepare for the future — but we need to play the new hand we've been dealt, not the one we had.

Even with increased uncertainty, the structural forces of US protectionism, new AI-driven technology and shifting demographics are unmistakable. How Canadian households, businesses and governments respond to these structural breaks will determine our future prosperity. We can be victims of US tariffs and AI disruption, or we can lean into structural change, expand our internal market, diversify our trade, embrace new technology and raise our productivity. Monetary policy will not be at the centre of the action. But the Bank of Canada will play a supporting role. Our focus is on maintaining low and stable inflation while helping the economy through this period of structural change. And it's on managing through this period of elevated uncertainty. That means being alive to the risks and prepared to adjust if the outlook changes.

About the author

Tiff Macklem was appointed Governor of the Bank of Canada, effective June 3, 2020, for a seven-year term. As Governor, he is also Chair of the Bank's Board of Directors and a member of the Board of Directors of the Bank for International Settlements (BIS). In addition, he is Chair of the Group of Governors and Heads of Supervision, the oversight body of the Basel Committee on Banking Supervision, and Chair of the Financial Stability Board's (FSB) Standing Committee for the Assessment of Vulnerabilities. He is also co-Chair the FSB's Regional Consultative Group for the Americas and Chair of the BIS Consultative Council for the Americas. Born in Montréal, Quebec, Mr. Macklem graduated from Queen's University in 1983 with a bachelor's degree in economics. He completed a master's degree in 1984 and a PhD in economics in 1989, both from the University of Western Ontario.

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SUERF Secretariat
c/o OeNB, Otto-Wagner-Platz 3A-1090 Vienna, Austria
Phone: +43 1 40 420 7206
E-Mail: suerf@oenb.at
Website: https://www.suerf.org/