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Canadian Election: Liberals win but changes still coming

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The ballots are still being tallied, but as we go to print, major media outlets are projecting a Liberal government. That would have been a major upset a couple of months ago, but pollsters had generally predicted a Liberal victory. What's still up the in the air, but likely to be known by the time that readers open this document on Tuesday morning, is whether the Liberals have a parliamentary majority, or whether they will need the support of either the NDP or the Bloc Quebecois.

So unless Mark Carney ends up being today's Thomas Dewey (you can look that up), in the coming few days, he will be choosing a cabinet and getting down to business as Canada's 24th prime minister. While the election was the fourth consecutive win for the Liberals, the change in leadership from Justin Trudeau to Carney will bring with it some notable policy changes, given both the heavy hand that recent PMs have played in setting the government's course, and the need to respond to a changing economic environment ahead. Budget deficits look likely to head higher in the near term, as would typically be the case when an economic shock, in this case from trade frictions, hits revenues and prompts fiscal stimulus measures. Deficits are likely to somewhat exceed what the Liberals suggested during the campaign, while still tracking miles below US federal deficits as a share of GDP.

If this ends up being a minority government it could also put some additional upward pressure on deficits. Gaining support in parliament from either the NDP or the Bloc could mean allocating additional funds towards those parties' priorities, including health care for the NDP, and items of importance for the Bloc (health care, other transfers, support for the metals sector). Some of that might be funded by delaying some of the Liberal's own initiatives rather than by running an even larger deficit.

What's in the Platform?

The first order of business isn't a line in the platform, but perhaps of greater importance than anything else on the government's agenda. A phone call between Carney and President Trump shortly after the former became PM has reportedly set the stage for direct talks over the current trade frictions between the two countries. Hopefully, that meeting won't be at the back of a long line of national leaders seeking redress with the White House. Unlike others, but on par with Mexico, Canada doesn't face a 90 day countdown to even higher tariffs if no deal is reached. But there is still a lot at stake in getting back to free trade, or something much closer to it, in the auto, steel and aluminum sectors, warding off threated tariffs on copper and electronics, and preventing a proposed increase in lumber tariffs. Looming further out is a 2026 deadline for extending the USMCA trade pact with the US and Mexico.

The Liberals' campaign platform already highlights some of the potential policy moves that would represent a change in direction from Trudeau, some of which have already been undertaken in the month leading up to voting day. As if often the case, the platform includes a long list of items designed to appeal to a particular region or voting block that are generally too small to move the needle on the national economy. But there are some items that will have an impact on the economy, major sectors, or the fiscal balance:

- Large scale infrastructure initiatives aimed at facilitating the movement of people and good and the electricity grid.
- A shift in energy policy, including dropping the carbon tax on consumers while retaining a reformed version of it for large industrial emitters, alongside a tax on imports from countries lacking equivalent programs, while at the same time pledging to speed approval processes for new pipelines and more broadly, other major infrastructure projects.
- Dropping the GST on homes under $1 mn for first time purchasers, and providing over $25 billion, largely in debt financing, as a contractor for the construction of affordable housing
- A 1%-point cut to the lowest income tax bracket
- Shortening the deadline to meet a 2% of GDP target for defence spending to get there in five years.
- Targeting a balanced budget on operating spending (but not capital spending) within three years, with efforts aimed at efficiencies in the public service and a cap on staffing headcounts that had been growing briskly under Trudeau. Overall, the platform leans towards a shift in spending growth from operations to infrastructure.

How Much Red Ink?

Does the party that has its election signs in red also imply a lot more fiscal red ink? While the major parties each provided a costing of their programs that included estimates for budget deficits ahead, we have cautioned our clients about reading too much into any of the parties' estimates. For one, the Liberal plan (and those of other parties) assumed that the economic backdrop would align with the March forecast from the Parliamentary Budget Office. That included 1.7% real GDP growth in 2025 and a falling jobless rate, likely overstating revenues, and understating employment insurance benefit costs unless US tariffs, including those on other countries that threaten a global recession, disappear in the hurry.

The Liberal's 2025 deficit path adds about a 0.5% to 0.8% of GDP to the PBO baseline, with the first year (2025/26) coming in at 2% of GDP or $62 billion. That might be a reasonable estimate if trade negotiations are fruitful and our forecast for a one quarter dip in activity, rather than an outright recession, ends up on the mark, although the multiyear path relies on savings from government efficiencies that aren't really spelled out. But there is more downside risk to the economic outlook than upside risk, and the reverse will therefore be true for the budget deficit. Odds of the deficit topping 2% of GDP are likely more material than an undershoot. Even so, that will still leave Canadian federal deficits running not much more than a third of where the US is headed, even if Congress comes up with sizeable US spending cuts to offset its tax measures.

In addition to some slippage from weaker revenues, a recession in Canada from the fallout of US trade policy would also create a need to either increase spending or tax relief, or reallocate priorities within those envelopes, to provide more meaningful upfront stimulus. While the platform would have added 1% or more to GDP growth through fiscal stimulus and multiplier effects, most of that lift would come well into Carney's term, given the lags between appropriations for infrastructure and homebuilding, and when shovels would actually hit the ground. There would likely be political pressure to respond to a recessionary economy with some faster-acting medicine, either at the expense of higher deficits or by shifting spending from slow moving infrastructure investment towards greater near-term support for affected households and industries.

What to Watch Next

In addition to news on upcoming talks with Washington, several events on the calendar will provide further insights into the public policy direction. The reality is that the Trump administration might also pivot on its own in the face of pressure to avoid an unpopular spike in inflation, although that would be facilitated by Canada agreeing to some undertakings that the US could position as a "win" for American interests.

In Ottawa, first up will be the choice of a new cabinet, likely larger than the interim cabinet that ran things during the election, allowing Carney to place his own stamp on the government's leadership. The Throne Speech that opens the new session of parliament should clarify which of the items in the campaign platform are set to be tackled early in the mandate. But an updated costing of these proposals, along with a new baseline revenue forecast, won't be forthcoming until the actual Budget. Typically, that would have taken place in March, but having been delayed by the election, we're likely looking at June. So its going to be a busy spring for investors with interests in Canada's bonds, foreign exchange and equities with sensitivity to environmental, regulatory and trade policies.