CIBC CAPITAL MARKETS

Economics

FEDERAL BUDGET BRIEFS

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Federal budget 2026: Staying on script

The Federal government is sticking with the same script it used in drafting its first budget under the current team, and in last spring's fiscal update, both of which were aimed at spurring capital spending to offset tariff headwinds in some sectors, and addressing concerns over affordability. Helped by room tied to a higher than expected tracking for revenues and a much lower growth rate for 2025/26 spending, Ottawa found room to deliver further measures aimed at these broad themes. Even with today's measures, and those announced since the spring, the better starting point will mean that deficits are set to track marginally lower in the current and subsequent years than what was estimated last spring, and the debt/GDP ratio will hold steady.

Financing requirements will move up to a greater extent to cover the funding needs for government capital projects and loans to support private sector activity, and with the backdrop of higher interest rates, debt service costs will be edging higher as a share of GDP. But relative to others, notably including our neighbour to the south, Canada's fiscal position remains much less worrisome, even if you throw in the provinces, suggesting that bond markets should see the budget as continuing to support relatively lower yields on sovereign bonds here.

The payoffs for this budget will depend on what lies ahead, in terms of how much the private sector responds to these investment incentives, and how effective public sector projects are in raising longer term growth rates. The details matter: which projects get built, not just the total dollars thrown at them by businesses and governments, and those choices are still a work in progress. In the near term, the economic lift will be more closely tied to how quickly these projects move from the drawing board to the construction site, and while some are already underway, we expect to see a greater boost in 2028 and beyond.

Table 1: Fiscal outlook: (C$ billions)

Fiscal measure	2024/25 Actual	2025/26 25 Budget	2025/26 26 Budget	2025/26 Change	2026/27 26 Budget	2027/28 26 Budget	2028/29 26 Budget	2029/30 26 Budget	2030/31 26 Budget
Budgetary revenue	511.0	507.5	526.4	18.9	540.3	564.2	581.5	607.7	629.1
• % Change		-0.7	3.0	3.7	2.6	4.4	3.1	4.5	3.5
Program Spending ex. Actuarial Losses	489.9	525.2	498.5	-26.7	542.7	559.3	568.3	586.3	600.2
• % change		7.2	1.8	-5.5	8.9	3.1	1.6	3.2	2.4
Public debt charges	53.4	55.6	53.5	-2.1	60.2	67.3	73.8	78.4	85.5
Budgetary balance (Before Actuarial Losses)	-32.3	-73.4	-25.7	47.7	-62.6	-62.4	-60.6	-57.0	-56.6
Net Actuarial Losses	-4.0	-5.0	-13.6	-8.6	0.4	-0.2	3.0	3.6	3.7
Budgetary balance	-36.3	-78.3	-39.3	39.1	-62.3	-62.5	-57.6	-53.4	-52.9

At $39 billion, the deficit for 2025-26, the fiscal year than ended in March, was much smaller than expected in the Spring update, and chopped even more dramatically from the $78 billion in red ink that had been built into the 2025 budget. Helped by higher oil prices that lift the nominal GDP tax base, revenues will continue to track higher than what was envisaged a year ago. While that was expected, more surprising is that program spending in 2025/26 grew at a lean 1.8%, well below estimates in either the prior budget or the spring update. If 2026/27 comes in on plan, that will end up

being largely a timing shift, as an expected increase of nearly 9% will take the level of program spending to $543 billion, versus the $536 billion that was estimated in the spring update. But the better base for revenues in the prior year will essentially cover the increased spending plan and leave the deficit on track, and subsequent years have spending contained to a somewhat slower pace than nominal GDP.

Table 2: Average private sector forecasts - economic assumptions

Economic assumptions (Y/Y % unless stated)	2026	2027	2028	2029	2030
Real GDP	1.0	1.7	2.0	2.0	1.9
Nominal GDP	5.6	3.7	3.6	3.9	3.9
Unemployment rate (%)	6.6	6.2	5.9	5.9	5.8
CPI	2.8	2.2	1.9	2.0	2.0
US real GDP	2.1	2.2	2.2	2.3	2.3

The Economic Backdrop: more real growth, slower nominal growth ahead

As always, the budget takes its economic assumptions from the private sector consensus, one that is very closely in line with CIBC's own forecasts. In our case, we're assuming a deal with the US that reduces current two-way tariffs and helps support better growth in 2027, but its less clear what the consensus has in mind on that front. We share the budget's planning assumption that growth will climb to 2% in 2028, sending the job market towards full employment, and in our case, that relies on getting an increased lift from private and public capital spending by then.

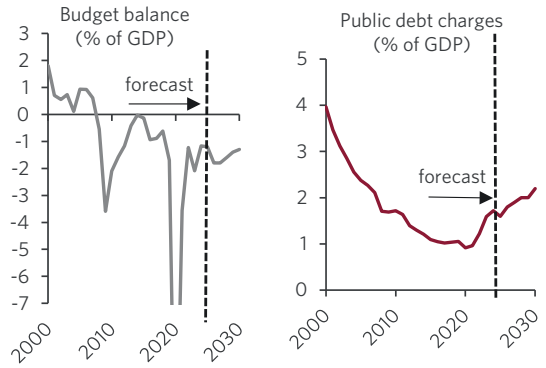
Beyond 2028, the consensus has growth continuing at a 2% clip, despite the likelihood that population and labour force growth will have picked up a bit by then. That implies no material lift to productivity, and clearly, the government's thinking differs. The build-up in capital assets should by the end of the decade be showing up in an increase in output per hour, so if these projects do get off the ground, there should be some room to do better, particularly if AI usage improves service sector productivity in existing businesses.

The outlook to 2028 is brighter in terms of real GDP and unemployment than it is for nominal GDP that drives government revenues. A projected cooling in oil prices will be central to that deceleration in nominal GDP, but should help government finances by restraining the run up in interest rates. The consensus forecast sees short term rates not running higher than where the neutral rate lies, consistent with inflation averaging close to the Bank of Canada's 2% target over the forecast horizon, but in contrast with a Bank of Canada projection that has higher inflation persisting in 2027.

Table 3: Average private sector forecasts - financial assumptions

Financial assumptions	2026	2027	2028	2029	2030
WTI (US$/bbl)	85	79	69	67	69
3-month T-bills (%)	2.3	2.6	2.7	2.7	2.7
10-year GoC bonds (%)	3.6	3.8	3.7	3.6	3.7
Exchange rate (US¢/C$)	72.1	72.4	73.0	73.4	73.8

Chart 1: Deficits contained (l), but debt charges edging higher (r)



Source: Finance Canada

Where's the beef? Where the big new dollars are going

New initiatives in the budget, including the tax incentives announced ahead of the investment summit, come to $15 billion in the current fiscal year ending in March, and then average a bit over $30bn in subsequent years. Roughly a third of that will go towards investment initiatives, notably including the recently announced Mega Productivity Deduction. Note that the timing of the revenue cost of that measure will depend on how quickly businesses respond with increased capital spending, and the budget's figures appear to assume a significant upswing in year one. The other major line item aimed at investment spending, labelled "Powering Canada Strong", devotes $2-3 billion annually in upcoming fiscal years towards clean energy and electric power developments.

On another major theme, affordability, the budget's measures are more heavily tilted to the first two years of the plan, with a fiscal cost of $8.6 bn this year and $8 bn in 2027/28. Much of that will go to an enhanced "grocery rebate", and early childcare and learning, and a new Build Canada Workers Benefit. As is typical in federal budgets, there's a smorgasbord of other measures that those with other interests can dine out on, aimed at culture, affordable housing, indigenous communities, and other priorities. The budget announced a number of steps to simplify the tax system, but those looking for a wholesale tax reform didn't find it, at least not this year.

Higher bond issuance to be focussed on shorter-end

Borrowing requirements are expected to be higher in fiscal 2027/28 than in the current year, rising to $611bn from $587bn. That reflects increased requirements for non-budgetary transactions, covering loans and the actual cash devoted to capital projects (rather than what can be smaller amortization charge on existing assets built into the deficit) as well as slightly greater refinancing. Bond issuance is rising to $316bn in fiscal 2027/28 from $284bn this year, with that focused on 2-year and 5-year bonds. Bill issuance will also be higher, but fall as a percentage of the total.

Table 4: Borrowing requirement (C$ billions)

Borrowing requirements	2026/27F	2027/28F
Budgetary (Surplus)/Deficit	62.3	62.5
Non-budgetary transactions[1]	87.2	106.5
Net Financial Requirement/(Source)	149.5	169.0
Domestic Maturities, Adj. & Buybacks	433	437
Foreign currency maturities	5.0	5.0
Gross Borrowing Requirement	587	611

Table 5: Sources of funding (C$ billions)

Funding requirements	2026/27F	2027/28F
Cash & Other (net)	0.0	0.0
Treasury Bills (net)	284	290
Canadian Dollar Bonds	298	316
Retail (net)	0	0
Foreign Currency Debt (net)	5	5
Total	587	611
Change in stock of domestic bonds	151	163

[1] Non-budgetary transactions comprise loans/advances to Enterprise Crown Corporations, pension costs & other

Table 6: Gross issuance (C$ billions)

$bn	2026/27E	2027/28F
Treasury bills	284	290
2yr	110	120
5yr	80	88
10yr	80	80
30yr	24	24
Green bonds	4	4
Total bonds	298	316
Total Gross Issuance	582	606

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