

Economics

FEDERAL BUDGET BRIEFS

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Federal budget 2025: Your Patience is Appreciated

With exports and related capital spending facing tariff headwinds, today's federal budget was aimed at generating economic tailwinds elsewhere. Higher fiscal deficits will reflect both those efforts and the drag on revenues from a sluggish economic backdrop. While both the economy and federal borrowing needs should improve as fiscal stimulus kicks in, Canadians will have to be patient given the lags inherent in using large scale projects as a source of growth.

Expect to hear concerns from some quarters over the projected \$78bn shortfall in 2025-26 and \$65bn in 2026/27 (Table 1). That's a bit below market expectations, helped by a downward revision to the deficit for the prior year, which is now estimated at \$36bn, versus \$48bn as of the fall statement, helped by an upward boost to revenues worth \$15bn. The current year deficit is still substantially elevated year-on-year, and well above the plan laid out in the 2024 fall statement, which projected a \$42bn deficit for 2025/26.

Table 1: Fiscal outlook: (C\$ billions)

Fiscal measure	2023/24 Actual	2024/25 24 Budget	2024/25 25 Budget	2024/25 Change	2025/26 25 Budget	2026/27 25 Budget	2027/28 25 Budget	2028/29 25 Budget	2029/30 25 Budget
Budgetary revenue	459.5	497.8	511.0	13.2	507.5	523.2	541.3	560.2	583.3
• % Change		7.0	11.2	4.2	-0.7	3.1	3.5	3.5	4.1
Program Spending ex. Actuarial Losses	466.7	480.5	489.9	9.4	525.2	528.4	537.9	549.7	568.3
• % change		6.7	5.0	-1.7	7.2	0.6	1.8	2.2	3.4
Public debt charges	47.3	54.1	53.4	-0.7	55.6	60.0	66.2	71.4	76.1
Budgetary balance (Before Actuarial Losses)	-54.4	-36.8	-32.3	4.5	-73.4	-65.2	-62.8	-60.9	-61.1
Net Actuarial Losses	-7.5	-3.1	-4.0	-0.9	-5.0	-0.2	-0.7	3.0	4.5
Budgetary balance	-61.9	-39.8	-36.3	3.6	-78.3	-65.4	-63.5	-57.9	-56.6

Even so, that shouldn't raise alarm bells over fiscal sustainability. For one, a line item relating to government pensions and benefits has significantly lowered this fiscal year's borrowing requirement as an offset to the larger deficit, so that financing needs are coming in lighter than the market may have feared. This year's 2.5% of GDP federal deficit isn't out of line with past periods of economic weakness. Adding in the provinces will likely entail a 4% to 4.5% of GDP gap, still below the nearly 6% US federal deficit, and keeping Canada middle of the pack amongst peer countries. That US deficit is structural and likely to be sustained, rather than linked to a lull in economic activity as is the case north of the border.

The real challenge won't be to finance a few years of higher deficits, but to get money out the door, and into large capital projects and housing developments, in time to lift growth while the economy struggles to adjust to US tariffs. Even with its best efforts, that's not likely to be the story for 2026. Rome wasn't built in a day, and neither are ports, housing projects or LNG terminals. Indeed, the budget cuts to operating spending and civil service headcounts might show up at the same time as, or even sooner than, its lift to capital spending and homebuilding. So Canadians will need to exercise some patience in judging this budget's ultimate impacts on growth, which might show up over the longer term as the economy benefits from the improvements in capital assets and infrastructure.

Economic backdrop: Ongoing Malaise, and a Modest Lift

Not surprisingly, the budget's projections allow for the economy's weak starting point, as captured in the consensus forecast from outside economists (Tables 2 and 3). Real GDP growth this year is projected at 1.1%, nearly matching CIBC's own forecast, and the 2026 pace of 1.2% is a couple of ticks below our call.

The level of nominal GDP got a lift from where it stood as of the fall 2024 statement due to upward revisions to the historical data. Since then, adverse developments on the trade front, and weaker population growth assumptions, have been lowering economic projections, impacting both revenues and cyclically-linked expenditures on employment insurance. The budget assumes a 1.8% reduction in the level of GDP over the projection horizon compared to the 2024 fall statement, as tariffs roughly halve pace of growth in 2025 and 2026. As a consequence, unemployment is projected to remain more elevated, averaging 7.0% this year, before gradually declining to 6.4% by 2027. Oil prices have been revised down by an average of \$8 over the projection horizon, while the trends in interest rates and the exchange are also not expected to be of further help. Bond yield projections show a slow, steady rise and the budget assumes a stronger CAD starting in 2026.

The budget reflects both the economic outlook and impacts it in the future. While today's budget was stimulative overall, our assessment is that, due to lags in generating the lift to capital projects, versus the more immediate impacts of operating spending cuts, the GDP impact of this budget is likely to be modest in the near term. The government plans to substantially boost capital expenditures through a mix of transfers, tax-incentives and deployment of federal assets. The government's direct and induced capital spending rises from 1% of GDP in 2024-25 to a projected peak of 1.6% in 2027-2028.

While that provides most of the boost to growth, this budget also comes with a substantial "spending review", the code words in Ottawa for cuts. The budget plan entails finding close to \$57 bn in savings over the projection horizon, while also keeping a lid on what it now calls "day-to-day" operating spending in the new capital budgeting framework. That includes a retreat in the size of the public service to bring it back to its historic relationship to the population trend, after outpacing population over 2019-24.

The result is that the overall GDP impact of the budget will be more muted, as the operating slowdown counteracts some of the boost in capital spending. We estimate it will add roughly 0.6% to the level of GDP by 2027.

Table 2: Average private sector forecasts - economic assumptions

Economic assumptions (Y/Y % unless stated)	2025	2026	2027	2028-29 avg.
Real GDP	1.1	1.2	2.0	2.0
Nominal GDP	3.5	3.0	4.1	4.0
Unemployment rate (%)	7.0	6.8	6.4	6.1
CPI	2.1	2.0	2.0	2.0
US real GDP	1.6	1.6	2.0	2.0

Table 3: Average private sector forecasts - financial assumptions

Financial assumptions	2025	2026	2027	2028-29 avg.
WTI (US\$/bbl)	66	65	67	70
3-month T-bills (%)	2.6	2.3	2.5	2.6
10-year GoC bonds (%)	3.3	3.4	3.5	3.6
Exchange rate (US\$/C\$)	72.2	75.1	76.4	77.2

What's hot, what's not in the spending and tax cut plan

As expected, this was not a skimpy meal in terms of what the budget served up in new expenditures and tax-based incentives, aimed mostly towards the military, infrastructure, and supporting productivity. On the infrastructure side, the budget proposes to allocate almost half towards core public infrastructure such as water, wastewater and transit. The productivity-related measures are a mix of spending as well as tax-incentives and write-offs for manufacturing equipment, LNG facilities, green investments, and R&D-related spending, amongst other targeted areas. However, the size of some

of these benefits does not appear to be very large, with the government projecting the “Productivity Super-Deduction” amounting to just under \$1.5bn over four years.

Consistent with the Prime Minister’s earlier pledge to ramp up defense spending, the budget allocates a net \$59 bn over five years in added spending on “defending our sovereignty”, largely on the armed forces, with \$7 bn this fiscal year at \$11 bn in 2026/27. That is the single largest line item in the budget. The allocation to housing was less eye popping, at \$13 bn over five years. That was largely directed at the earlier announced Build Canada Homes plan, and a somewhat broader reduction in GST for first time home buyers that included a reduction for properties in the \$1-1.5 million price bracket, but didn’t include some other ideas that had been bandied about but didn’t make it into this year’s budget.

The government is also upping commitments to support businesses and workers in strategically affected. That adds up to over \$10bn excluding funds already booked in the fiscal framework. About two-thirds of that support is front-loaded, particularly the portions for workers and for financing.

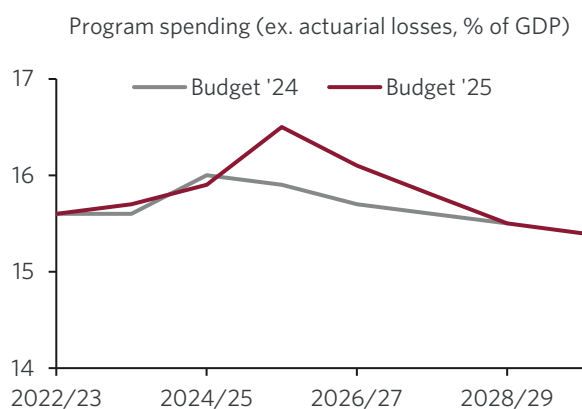
Beyond new spending measures, the government made some important policy updates on the environment and immigration. The emissions cap on the oil and gas sector is “no longer required” and the EV targets for 2026 were dropped to provide some relief to struggling automakers, with the government pledging to come back with a major regulatory review soon.

On immigration, the 2026-2028 “levels plan” showed the government is bringing down non-permanent resident (NPRs) targets from over 670K to 385K by 2026, or 131K lower than the prior levels plan. The permanent resident (PR) targets were only slightly changed, being set at 380K over the next three years. Practically, this implies NPRs will continue to be converted to PRs, keeping population growth fairly anemic for the next year or so.

Putting it all together, overall program spending excluding actuarial losses is set to grow by roughly 7% in 2025-26, but then spending growth is projected to decelerate to just 0.6% in 2026-27, due to operating spending restraint and a recalibration of program spending. That will put overall program spending on a slowly declining path as a share of GDP, down from 16.5% of GDP in 2025/26 to 15.4% in the last year of the projection (Chart 1).

On the revenue side, revenues are expected to take a big step down this fiscal year, dropping by about 0.6%-percentage points of GDP to 16% in 2025-26 and edging down to 15.8% by final year of the projection. Most of that is due to weaker income tax revenues as a result of the middle-class tax cut (\$27bn total fiscal cost) as well as the cancellation of capital gains tax increase.

Chart 1: Spending-to-GDP temporarily higher



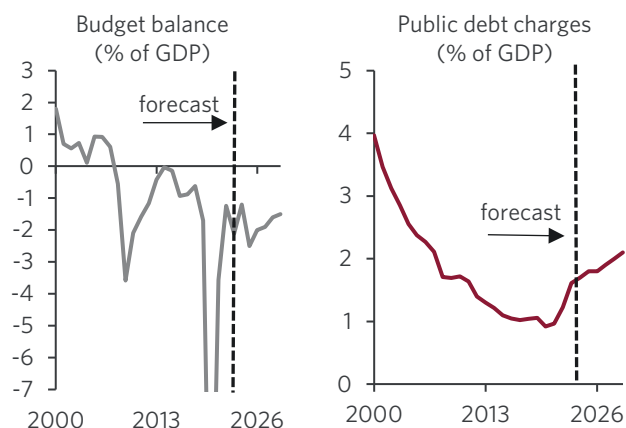
Source: Finance Canada

A detour on the road to fiscal progress

The government introduced two fiscal anchors, bringing operating spending into balance with revenues by three-years, and a declining path of deficits-to-GDP, both of which they expect to meet. Beyond this year, deficits decline to about 2% of GDP over the next two fiscal years, roughly in line with what we expected (Chart 2, left). Gross federal debt is expected

to rise and then stabilize from 41% of GDP in 2024-2025 to 43% by the end of the projection. Those fiscal anchors are not a high bar, and public debt charges will edge higher as a share of GDP (Chart 2, right), but we doubt foreign investors will fret about federal debt in the low 40% range, viewing this as a small but likely necessarily detour on the road to fiscal progress in the future.

Chart 2: Deficits contained (l), but debt charges edging higher (r)



Source: Finance Canada

Borrowing requirements for 2025/26 didn't see the upturn that markets had anticipated, as the wider budget deficit was largely countered by a lighter requirement for "non-budgetary transactions", which dropped from \$94 bn in the prior fiscal year to \$59.5 bn in 2025/26 (Table 4). That was largely owing to pension and benefits developments, which meant that their cash requirements are currently lighter than what is being accrued in the deficit figures. As a result, net financial requirements of \$137.9 bn in this fiscal year are only modestly up from the \$130 bn that had to be covered in 2024/25, although we will see further climb to \$149 bn in 2026/27 (Table 5). Even so, we expect that markets were braced for a sharper increase in financing needs.

After maturities, the stock of domestic bonds will climb \$130 bn in the current fiscal year, and by \$151 bn in 2026/27. Gross domestic issuance climbed from \$529 bn last year to a planned \$609 bn this year, with increases across all terms, but is slated to ease off to \$589 bn in 2026/27, with reductions in all terms other than 30-year bonds (Table 6). Our FICC Strategy team released a more comprehensive review of the borrowing plan implications, noting that an announced increase in CMB issuance might weigh on the bond market slightly, while also supporting swap spreads.

Table 4: Borrowing requirement (C\$ billions)

Borrowing requirements	2025/26F	2026/27F
Budgetary (Surplus)/Deficit	78.3	65.4
Non-budgetary transactions ¹	59.5	83.6
Net Financial Requirement/(Source)	137.9	149.0
Domestic Maturities, Adj. & Buybacks	471	440
Foreign currency maturities	5.0	5.0
Gross Borrowing Requirement	614	594

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

Table 5: Sources of funding (C\$ billions)

Funding requirements	2025/26F	2026/27F
Cash & Other (net)	0.0	0.0
Treasury Bills (net)	293	291
Canadian Dollar Bonds	316	298
Retail (net)	0	0
Foreign Currency Debt (net)	5	5
Total	614	594
Change in stock of domestic bonds	130	151

Table 6: Gross issuance (C\$ billions)

\$bn	2024/25A	2025/26E	2026/27F
Treasury bills	285	293	291
2yr	94	120	110
5yr	63	84	80
10yr	63	84	80
30yr	17	24	24
Green bonds	4	4	4
Total bonds	241	316	298
Total Gross Issuance	526	609	589

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