

BUDGET ANALYSIS

Canada: Budget 2025

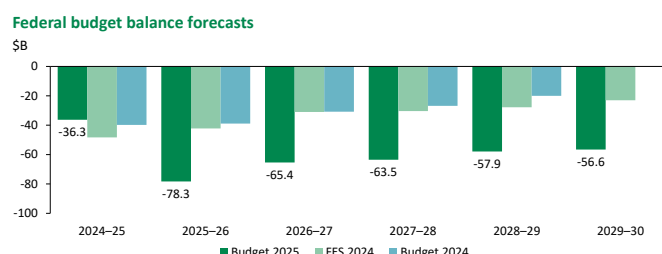
“Transformative” Is in the Eye of the Beholder

By Jimmy Jean, Vice President and Chief Economist, and Randall Bartlett, Deputy Chief Economist

HIGHLIGHTS

- ▶ As [we anticipated](#), the Government of Canada is projecting its deficit to increase substantially in the 2025–26 fiscal year (FY26), widening to \$78.3B from \$36.3B last year (graph 1). That’s \$36.1B larger than planned in the Fall Economic Statement 2024 (FES 2024). Deficits are expected to be smaller thereafter but to remain substantially larger than projected previously.
- ▶ Spending is the primary culprit behind the larger deficits, with program spending topping previous forecasts. Defence is the largest contributor, although increased investment in infrastructure and housing, as well as measures to support tariff-impacted industries, also played a role. This increase came in spite of expected savings from a comprehensive expenditure review which, at \$60B over five years, fell short of expectations.
- ▶ Revenue measures to boost investment also helped to expand the deficit, but these were a welcome change in direction from the past. However, these too fell short of the ambitious expectations the Government of Canada built up prior to Budget Day. Many of these were previously announced, leaving the Productivity Super-Deduction (\$1.5B) as the latest revenue announcement. Combining tax cuts with the weaker outlook for the economy and labour market has put revenues on a downward trajectory as a share of GDP—a very different path from the FES 2024.
- ▶ As a result of larger deficits and a softer outlook for nominal GDP, the federal debt-to-GDP ratio is expected to rise over the next couple of years before stabilizing and then tracking lower. However, lowering debt as a share of economic activity is no longer a fiscal anchor for the Government of Canada. Neither are debt servicing costs, as measured by public debt charges as a share of revenues, which is also expected to rise over the outlook. Instead, reducing deficits as a share of GDP is one of the federal government’s new fiscal anchors, and the budget checks that box. The same is true for the “operating” balance, which is expected to return to surplus within three years, thereby meeting the second of the new fiscal anchors. That said, we anticipate rating agencies will be satisfied that the fiscal forecast was in line with expectations, and that a debt downgrade is unlikely in the near term as Canada continues to have one of the best fiscal positions among advanced economies. Bond yields fell after the budget was published.

Graph 1
Large Deficits Are Forecast to Persist for the Foreseeable Future



FES: Fall Economic Statement
Government of Canada and Desjardins Economic Studies

Main Takeaways

If Canadians were hoping for a “transformative” or “generational” budget, they will be disappointed with the Government of Canada’s Budget 2025. Investment is expected to fall short of the lofty expectations that were telegraphed, while savings to offset the new spending are projected to come in at about half the pace proposed earlier in the year. Overall, while it is broadly headed in the right direction, Budget 2025 seemed to reflect a reluctance to go all in on investing in Canada and finding savings to help pay for it.

This being said, the somewhat more prudent approach means that the deficit does not hit the three-digit level that some were speculating might be reached (table 1). Neither is the government completely abandoning its fiscal anchors, but those anchors are evolving—and not for the better. The government now promises to balance its operating budget, as part of its newly unveiled framework separating operating and capital budget, by FY29. It also pledges to ultimately maintain a declining deficit-to-GDP ratio, a promise that could be difficult to uphold in a recession, as its downside scenario shows.

Against the somewhat relieving headline numbers, this is still a government that has been promising transformational measures to boost economic growth. Beyond the previously announced initiatives—which we discuss in more detail in the section on program spending and savings—there is little that catches the eye when it comes to new compelling measures to kickstart Canada’s lagging business investment.

The government does not come entirely empty-handed, announcing a new Productivity Super-Deduction, which allows businesses to write off a larger share of new capital investment costs sooner. This includes the reinstatement of the Accelerated Investment Incentive; immediate expensing of manufacturing or processing machinery and equipment; immediate expensing of clean energy generation and energy conservation equipment, and zero emission vehicles; immediate expensing of productivity-enhancing assets, including patents, data network infrastructure and computers; and immediate expensing of capital expenditures for scientific research and experimental development.

While encouraging at first glance, the measure comes short of fully matching similar incentives enacted in the United States over the summer, as it is set to begin sunseting in 2030, whereas immediate expensing was made permanent south of the border. Moreover, coming in at \$1.5B, it is only a small portion of the government’s new spending, despite being arguably among the policies that pay off the most growth-wise.

Our research has also identified R&D in the defence sector as a key catalyst to ensure that the ramp-up in military spending, aimed at meeting NATO targets, translates as much as possible into innovation and wealth generation. With a mere \$2.3B over five years in defence R&D, we view the government’s commitment to address this critical issue as rather underwhelming.

TABLE 1
Summary of transactions

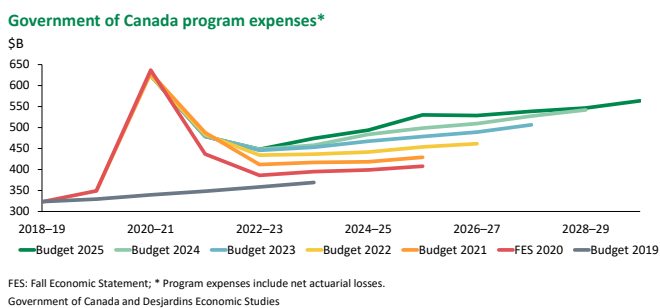
IN \$B (EXCEPT IF INDICATED)	ACTUAL	DESJARDINS PROJECTIONS				
	2024–2025	2025–2026	2026–2027	2027–2028	2028–2029	2029–2030
Budgetary revenues	511.0	507.5	523.2	541.3	560.2	583.3
Growth (%)	11.2	-0.7	3.1	3.5	3.5	4.1
Program spending	-489.9	-525.2	-528.4	-537.9	-549.7	-568.3
Growth (%)	5.0	7.2	0.6	1.8	2.2	3.4
Debt charges	-53.4	-55.6	-60.0	-66.2	-71.4	-76.1
Growth (%)	12.9	4.1	7.9	10.3	7.9	6.6
Net actuarial losses	-4.0	-5.0	-0.2	-0.7	3.0	4.5
Budgetary balance	-36.3	-78.3	-65.4	-63.5	-57.9	-56.6
Federal debt ¹	1,266.5	1,347.0	1,412.4	1,476.0	1,533.9	1,590.5
Growth (%)	2.5	6.4	4.9	4.5	3.9	3.7
Budgetary revenues (% of GDP)	16.6	16.0	16.0	15.9	15.8	15.8
Program spending (% of GDP)	-15.9	-16.5	-16.1	-15.8	-15.5	-15.4
Public debt charges (% of GDP)	-1.7	-1.8	-1.8	-1.9	-2.0	-2.1
Budgetary balance (% of GDP)	-1.2	-2.5	-2.0	-1.9	-1.6	-1.5
Federal debt (% of GDP)	41.2	42.4	43.1	43.3	43.3	43.1

¹ Debt representing the accumulated deficits including other comprehensive income.
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Increased Program Spending but More Muted Savings

Budget 2025 laid out a path for higher program spending over the coming five years (graph 2). Defence spending topped the list of new expenditure measures, totalling \$56.6B from FY26 to FY30. Other major new spending includes Protecting Canada's Strategic Industries (\$12.1B), Generational Infrastructure Investments (\$9.0B), launching Build Canada Homes (\$7.3B) and a New Trade Infrastructure Strategy (\$4.2B), all of which were included in the 2025 election platform.

Graph 2
Spending Is Forecast to Be Higher than in Previous Budgets



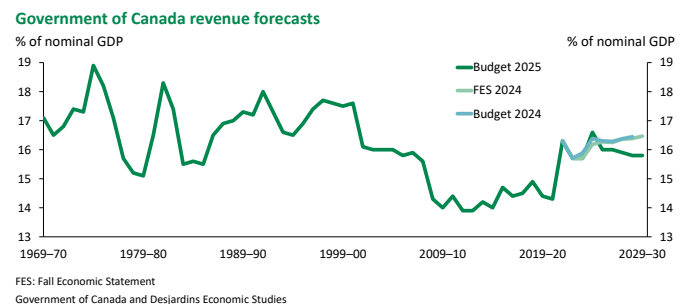
To offset this new spending, the federal government has said that it will embark on a Comprehensive Expenditure Review, which the federal government expects to result in \$60B in savings over five years. However, this falls well short of the savings that were put in the window by the Finance Minister earlier in the year, which were expected to come in at closer to \$60B over the next three years alone. Additionally, the savings are coming from changing the rate of pension benefit indexation (\$5.8B in savings over four years starting in FY27), adjusting medical cannabis benefits to reflect market price (\$4.4B), and returning international development assistance to a pre-pandemic level (\$2.7B), along with other measures that hardly speak to resolve in finding material savings in operating expenses. That said, Direct Program Expense (DPE) growth is expected to slow to a compound annual growth rate of 0.5% after FY26—well below the pace of population growth plus inflation and the 8.1% annual pace of DPE growth over the past decade.

Of additional concern is the planned increase in public debt charges over the forecast. At \$76.1B in FY30, the cost of servicing the federal government's debt is now anticipated to be nearly \$7B higher than projected in FES 2024. This reflects a combination of both higher long-term interest rates and more elevated Government of Canada debt over the outlook.

Lower Revenues Due to Tax Cuts and a Weaker Economy

While the increase in spending was large as expected, revenues were more of a mixed bag. Many of the measures were announced prior to Budget 2025. These included the reduction in the lowest marginal personal income tax (PIT) rate (\$24.2B over five years), cancelling the consumer carbon price (\$4.2B), and eliminating the GST for first-time home buyers (\$3.9B). The reversal of the planned increase in the capital gains inclusion rate also contributed to lower revenues. The notable new tax measures are the Productivity Super-Deduction (\$1.5B) and the elimination of the consumer carbon tax announced last Spring. Not surprisingly, as a result of these tax cuts, revenues as a share of GDP are expected to fall over the outlook, and come in well below the projection in the FES 2024. All told, total revenues are forecast to be about \$100B lower over the next five years than anticipated in late 2024 (graph 3).

Graph 3
Revenues as a Share of GDP Are Expected to Decline Going Forward



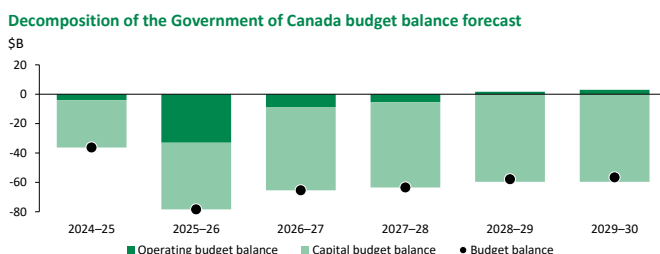
But the lower expected tax take isn't entirely the result of tax cuts. Nominal GDP—the broadest measure of the tax base—is expected to be materially lower than projected in the FES 2024. Weaker real GDP growth in 2025 and 2026 is largely responsible for the change in economic fortunes, as the trade war with the US weighs on the outlook of private sector economists. A higher unemployment rate over the outlook will also continue to lower PIT revenues. A slower pace of population growth, which was not included in the private sector forecasts that underpinned the budget, will also act as a further headwind to economic and revenue growth. In our opinion, the risks to the baseline forecast used in the budget are tilted to the downside.

Deficits Will Be Larger, No Matter How One Defines It

With total expenses now anticipated to well outpace revenues, it comes as no surprise that deficits are expected to increase substantially over the projection. However, to highlight its intention to pivot away from operating spending and toward capital expenditures, the federal government has recategorized

many big ticket spending measures as capital outlays. Keep in mind, this is largely not capital that will be held by the federal government, but instead fiscal support from households and businesses who invest in everything from LNG facilities to secondary suites and research & development to films and videos. All in, this is a very generous definition of what is capital, and doesn't conform with Canadian public sector accounting standards. But what it does is allow the Government of Canada to divide its budget balance into operating and capital deficits. And now its overall budget deficit is almost entirely the result of a capital deficit, allowing it to move its self-defined operating balance into surplus after three years (graph 4). This is now one of the federal government's two new "fiscal anchors", although we would argue that this one does not add much more credibility to the Government of Canada's fiscal plan. The Government of Canada hopes this new fiscal approach will catalyze \$500B in new private sector investments over the next five years—an ambitious target by any measure and one we hope the federal government is able to reach.

Graph 4
Capital Deficits Are Projected to Drive the Fiscal Deterioration



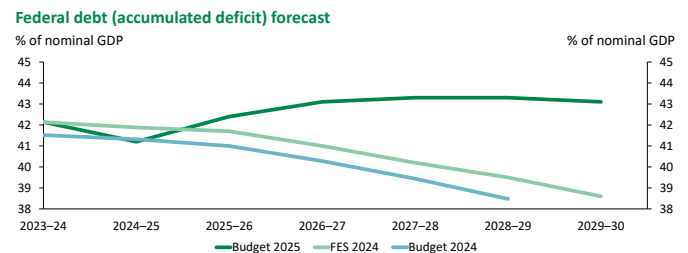
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Importantly, rating agencies and investors will largely look through this recategorization of federal government spending to the overall bottom line. After peaking at -2.5% of GDP in the current fiscal year, the deficit is then projected to decline each subsequent year as a share of the economy. And that constitutes the second of the Government of Canada's new fiscal anchors: maintaining a declining deficit-to-GDP ratio. Notably, if the federal government's downside economic scenario comes to fruition, this fiscal anchor will be breached almost immediately, calling into question its value.

Debt and Debt Service Costs Are on the Rise

As go deficits tends to go the debt. And these sustained large deficits should cause the federal debt-to-GDP ratio to rise until at least FY28, before they are then projected to gradually start to decline (graph 5). One of the prior administration's fiscal anchors, the direction of the debt-to-GDP ratio will be of particular concern to rating agencies, investors and economists. A rising

Graph 5
Federal Debt Is Expected to Steadily Rise as a Share of the Economy



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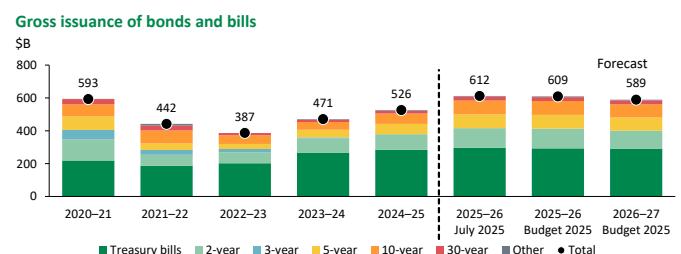
debt-to-GDP ratio over time is a red flag for fiscal sustainability, and moves in a very different direction to past forecasts. And that's if all goes according to plan. In the federal government's downside scenario, it rises consistently over the projection to levels not seen since the pandemic. That said, we anticipate that rating agencies will be satisfied that the fiscal forecast was in line with expectations, and that a debt downgrade is unlikely in the near term as Canada continues to have one of the best fiscal positions among advanced economies.

Rating agencies and investors will also be looking at the ability for the federal government to service its debt. Looking to public debt charges as a share of revenues, they are expected to move higher relative to the prior fiscal path. That said, at about 13% of revenues in FY30, the debt service ratio should be nowhere near the dark days of the 1990s, when the Government of Canada was paying more than 35¢ per dollar of revenue brought in.

Debt Management Strategy

With the deficit this year projected to come broadly in line with the level implicit for this year in the Debt Management Strategy (DMS) published in July 2025, it's not a surprise that total planned debt issuance this year is similar in Budget 2025 (graph 6). Looking ahead to FY27, the issuance is expected to be lower largely as a result of the smaller planned deficit, going from \$78B this year to \$65B. That said, the total financial

Graph 6
Planned Debt Issuance Is Little Changed for the Current Fiscal Year



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requirement is expected to rise to \$149B next year from \$138B in FY26, while total refinancing needs are projected to fall from \$476B this year to \$445B in FY27. The composition of market debt should change such that, of the \$1,761B outstanding, 82% will be domestic bonds, up from 80% this year. At the same time, treasury bill issuance should fall to 16.5% of total market debt (from 18.1% this year) and foreign debt should fall to 1.5% (from 1.8% this year). Treasury bills are expected to make up a slightly larger share of gross issuance next year, rising to 49% from 48% in FY26. The share of long-term bonds is expected to increase to a similar extent, going from 48% to 49% in FY27. Issuance has been decreased in the 2-year, 5-year, and 10-year sectors relative to FY26.

One of the more notable changes in the DMS is the change to the Canada Mortgage Bond (CMB) program. The annual CMB issuance limit will increase from \$60B to \$80B starting in 2026. The increase in CMB issuance will solely apply to multi-unit housing. The federal government will maintain the current pace of its purchases of CMBs, up to \$30B annually, to allow the private market full access to the additional issuance.

Conclusion

Budget 2025 was expected to be one for the record books, but in some ways it was more of the same. While it does move policy in the right direction by lowering the tax burden on investment and finding some savings in the fiscal framework, the Government of Canada could have gone further on both without meaningfully impacting the outlook for the deficit. It seems like a lost opportunity, although it may just be the beginning of the reorientation of federal fiscal policy toward investment, productivity and growth.