ECONOMIC VIEWPOINT

Will Canada Stay Triple A, Eh?

Canada's Credit Rating and Where It May Be Headed

By Randall Bartlett, Deputy Chief Economist

- With new spending promises and tax cuts being announced at a torrid pace, investors are rightly asking: what would this substantial increase in borrowing mean for the Government of Canada's credit rating?
- To answer that question, in this note we dig into the sovereign credit rating methodologies of the big three rating agencies. In this context, Canada's gross general government debt is currently middle of the pack among comparable advanced economies and is forecast to stay there. So is net general government debt when public pension assets are removed, and it's best in class when they aren't. Meaningfully higher defence spending may erode this advantage, but not as much as it would if other countries weren't also massively expanding their defence budgets. Of course, a broad-based expansion in public borrowing risks raising global interest rates more generally. Fortunately, Canada's external risks—current account balance and international investment position—are also currently central among similar countries and are projected to remain so. And Canadian institutional quality remains high, even if it has slipped modestly by some metrics in recent years. Bank of Canada independence further boosts this institutional strength.
- We conclude that the likely substantial increase in borrowing ahead probably doesn't mean much for the Government of Canada's top-notch credit rating, at least in the near term.

With the myriad new spending measures and tax cuts announced since the 2025 federal election, investors are rightly asking: what would this substantial increase in borrowing mean for the Government of Canada's credit rating? To answer that question, in this note we dig into the approaches used by different rating agencies and explore the direction that key fiscal and economic indicators are moving in to understand where Canada's sovereign rating may be headed.

What Is Canada's Current Credit Rating?

Looking to the big three sovereign credit rating agencies—Standard & Poor's (S&P), Moody's and Fitch—the Government of Canada has AAA, Aaa and AA+ ratings on its debt, respectively. Canada's sovereign credit rating is currently among the best of its peers such as the G7, Australia, New Zealand and Spain (table 1). Ratings by S&P and Moody's are the highest possible. In contrast, Fitch downgraded Canada's federal debt in 2021 to AA+ from AAA, citing the sharp increase in pandemic-related borrowing. Government of Canada debt was downgraded before, in the early 1990s, as a result of its unsustainable rise. But the rating subsequently improved after a string of federal budget surpluses and a falling debt-to-GDP ratio.

Table 1
Canada's Sovereign Credit Rating Is Among the Highest of Its Peers

Sovereign credit rating	S&P	Moody's	Fitch
Australia	AAA	Aaa	AAA
Germany	AAA	Aaa	AAA
Canada	**AAA**	**Aaa**	**AA+**
New Zealand	AA+	Aaa	AA+
United States	AA+	Aa	AA+
United Kingdom	AA	Aa	AA-
France	AA-	Aa	AA-
Japan	A	A+	A
Spain	A	Baa	A-
Italy	BBB+	Baa	BBB

S&P Global Ratings, Moody's Ratings, Fitch Ratings and Desjardins Economic Studies

How Are Credit Ratings Determined?

There is no one-size-fits-all approach to calculating sovereign credit ratings. Each credit rating agency does it differently. And while there are many broad parallels that make these approaches comparable, they vary enough to provide different information.

S&P Global Ratings

Among the most widely cited credit rating agencies is S&P Global Ratings. S&P's approach to determining a sovereign's creditworthiness looks at five key areas, including institutional, economic, external, fiscal and monetary assessments. These assessments are combined to give an indicative rating, which is then augmented with supplemental adjustment factors to further refine the rating. This provides the foreign currency issuer credit rating, which is then possibly adjusted slightly upward if the sovereign can issue debt in its own currency. More recently, S&P also incorporated sector and industry variables into its methodology. Key metrics used in S&P's sovereign credit assessment include, but are not limited to, those listed in table 2.

Table 2
Common Indicators Used by Rating Agencies to Rate Sovereign Credit

Key indicator	S&P	Moody's	Fitch	Bank of Canada
Gross general government debt (% of GDP)		X	X	X
Net general government debt* (% of GDP)	X			
Interest payments (% of revenues)	X	X	X	X
GDP per capita (level)	X	X	X	X
Real GDP or real GDP per capita (growth)	X	X	X	X
Current account balance (% of GDP)	X	X	X	X
International investment position (% of GDP)	X		X	X
Reserve currency status	X	X	X	X
Measures of fiscal policy effectiveness	X	X	X	X

*Adjusted for social security fund or public pension plan assets.
S&P Global Ratings, Moody's Ratings, Fitch Ratings and Desjardins Economic Studies

Notably, the Bank of Canada (2021) has replicated S&P's sovereign credit rating methodology using publicly available data. This was done to help manage Canada's foreign exchange reserves. The Bank has augmented S&P's approach further by including climate change factors to adjust the indicative credit rating.

Moody's Ratings

Like S&P's approach, Moody's Ratings' sovereign methodology framework starts with four factors: economic strength; institutions and governance strength; fiscal strength; and susceptibility to event risk. These feed into what are called the scorecard-indicated outcomes, after which other adjustments are made to determine the final rating. Key indicators used in Moody's sovereign credit rating framework include, but are not limited to, those listed in table 2. Among the more notable differences with S&P's approach is the use of gross general government debt (as a share of GDP) to determine Moody's initial sovereign credit rating as opposed to net general government debt. Moody's also considers environmental, social and governance (ESG) factors in its ratings.

Fitch Ratings

Last but not least, Fitch Ratings' sovereign rating criteria start with four groups of indicators that feed into its sovereign rating model to determine the predicted rating. These include structural features; macro performance, policies and prospects; public finances; and external finances. A qualitative overlay is then applied to adjust the rating up or down given a variety of other considerations, including the macroeconomic outlook. Table 2 also outlines some key indicators used by Fitch to determine sovereign credit ratings.

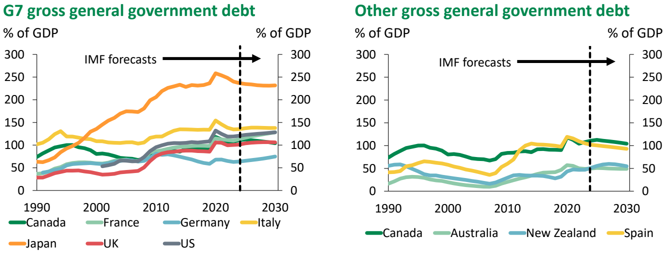
What This Suggests for Canada's Credit Rating

A sovereign credit rating is both an absolute and a relative ranking. It's absolute in that it pertains to the change in a sovereign's outstanding credit and ability to service that debt, and it's relative in that the evolution of other sovereigns' credit positions is also considered. This section looks at some of the key indicators considered by rating agencies and juxtaposes Canada to other comparable advanced economies.

General Government Debt

Starting with gross general government debt as a share of GDP, which is the measure favoured by both Moody's and Fitch, Canada is roughly middle of the pack compared to similar advanced economies (graph 1 on page 3). For instance, in 2023, Canada's gross general government debt-to-GDP ratio was higher than those of Germany and the UK in the G7, but lower than those of France, the US, Italy and Japan. It was also higher than that of other comparable countries, such as Australia, New Zealand and Spain. Going forward, the International Monetary Fund (IMF) expects Canada's gross general government debt position to improve modestly as a share of GDP. By this metric, at least, the Government of Canada doesn't appear to be vulnerable to a credit downgrade anytime soon. However, this forecast was published before the 2025 federal election and the substantial spending announcements that came thereafter, as well as the release of some 2025 provincial budgets.

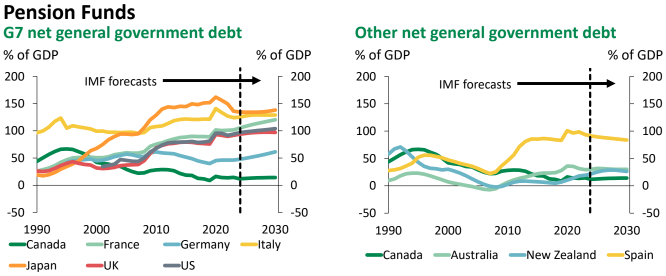
Graph 1
Canada Is Middle of the Pack on Gross General Government Debt



International Monetary Fund (IMF) World Economic Outlook and Desjardins Economic Studies

Turning to the S&P's preferred measure of debt—net general government debt—the IMF's estimates and forecasts put Canada in a very favourable position (graph 2). By this metric as well, the Government of Canada doesn't look to be in any way at risk of a credit downgrade. However, this highly favourable debt measure largely reflects the substantial assets held by Canadian public pension plans. But these are heavily discounted by rating agencies. That's because those assets are often unavailable to service debt in the event of a debt crisis. However, it does speak to the well-funded status of Canadian public pension plans versus the underfunded pension obligations of some other developed countries.

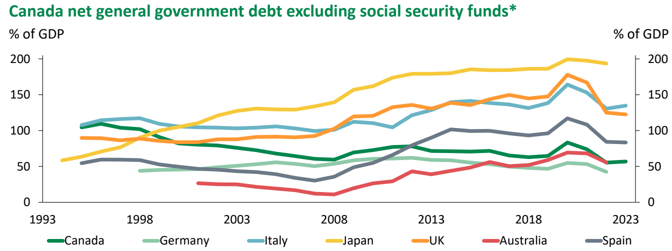
Graph 2
Canada Is Best in Class on Net General Government Debt Thanks to Pension Funds



International Monetary Fund (IMF) World Economic Outlook and Desjardins Economic Studies

To get a more representative view of Canada's net general government debt, we need to look to the IMF's Government Finance Statistics (GFS). And while the GFS data don't include a forecast, they helpfully provide a historical comparison of net general government debt excluding social security funds (where possible). Canada ranks well in this regard too, roughly in the middle between its standing in gross and net general government debt presented previously (graph 3).

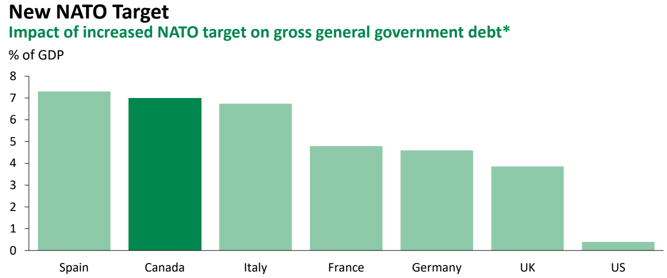
Graph 3
Canada's Net General Government Debt Remains Low Even When Pension Assets Are Excluded



*Social security funds include public pension plans. Comparable countries are excluded because net general government debt data excluding social security funds are not available.
International Monetary Fund Government Finance Statistics and Desjardins Economic Studies

Looking forward, the biggest change in national budgets since the IMF released its April 2025 World Economic Outlook (WEO) is the substantial increase in planned defence spending. At the recent meeting of the North Atlantic Treaty Organization (NATO) on June 24 and 25, countries committed to increasing defence spending to 5% of GDP by 2035. This is divided between 3.5% in core defence expenditure and 1.5% in defence-adjacent spending. For Canada, that implies an increase from 1.4% of GDP in 2024 and a promised target of 2% of GDP by the end of the 2025–26 fiscal year. The implications for general government debt can be determined in relation to the gap that must be closed between recent military outlays as a share of GDP versus newly planned spending. By this measure, Canada lags well behind its NATO allies, implying that it may need to increase spending, deficits and debt more than many other NATO members to close this gap (graph 4). Based on IMF forecasts, Canada's gross general government debt as a share of GDP would need to be about 7% higher if defence spending increased to 3.5% of GDP by 2030 instead of holding steady at the 2024 level of 1.4% of GDP. Of course, that assumes no new revenues and/or spending cuts elsewhere to offset the new miliary expenditures. (For the broader fiscal and economic implications of the planned increase in defence spending, see our recent report.)

Graph 4
Canada's General Government Debt Could Be Higher in 2030 Due to the New NATO Target

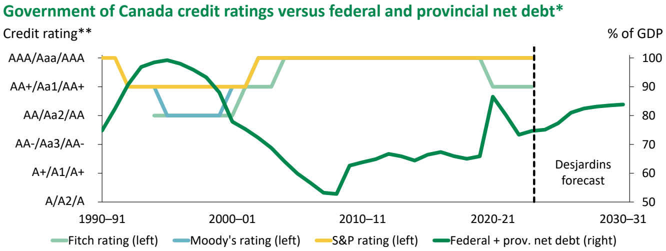


*Assumes defence and defence-adjacent military spending increases to 3.5% of GDP by 2030 before then continuing to rise to 5% of GDP by 2035 versus remaining unchanged at the 1.4% of GDP level in 2024. The estimate also excludes the impact of higher debt on public debt charges.
International Monetary Fund World Economic Outlook, North Atlantic Treaty Organization (NATO) and Desjardins Economic Studies

Drilling down into Canada's government finances specifically, one can look to the net debt forecasts published on a Public Accounts basis to get a more up-to-date sense of where the country's finances are headed. This is informed by provincial budgets and, in the absence of an official federal fiscal outlook, the 2025 Liberal Party of Canada election platform and post-election announcements since (such as the commitment to reach the new NATO target). Based on these sources, net public debt as a share of GDP is unquestionably moving higher (graph 5). Whether this is enough to trigger another downgrade is anyone's guess, but it certainly doesn't appear to be imminent. (Provinces don't publish forecasts for gross government debt, hence graph 5 refers to net government debt. However, the IMF (2016) found that net debt is a better indicator of sovereign bond spreads than gross debt, so this debt measure may be more relevant for investors.)

Graph 5
The Government of Canada's Credit Quality Remains High For Now

Government of Canada credit ratings versus federal and provincial net debt*



* As presented here, net debt is the sum of federal and provincial net debt from Public Accounts historically and forecasts from budgets, recent election platforms and policy announcements.
** End of fiscal year, in order on the y-axis of Fitch, Moody's and Standard & Poor's (S&P).
Bloomberg, provincial governments, Government of Canada, Liberal Party of Canada and Desjardins Economic Studies

All this to say, while Canada is expected to see public debt end the decade at a higher level than previously forecast, the country is likely to remain in a respectable fiscal position relative to comparable advanced economies. As long as interest payments stay moderate as a share of revenues, Canada should maintain a middling level of fiscal flexibility going forward even as debt servicing costs continue to rise. However, higher borrowing costs than currently anticipated pose a notable risk to the financial outlook for all levels of government in Canada. That in part reflects the dramatic increase in advanced economy debt expected over the next decade to fund NATO rearmament and broader fiscal shortfalls, notably in the US.

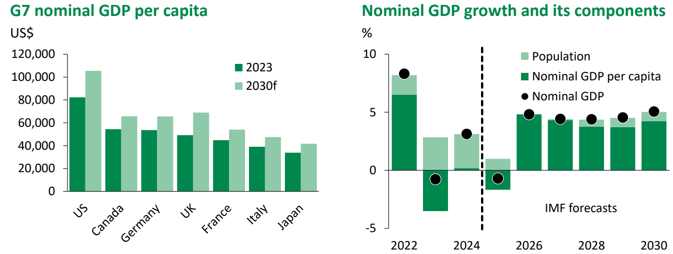
Economic Output and Growth

All rating agencies look at some measure of GDP per capita and real GDP growth to get a sense of the ability of a country to raise revenues to meet its credit commitments. In this regard, Canada has had—and is likely to continue to have—a mixed performance relative to comparable countries.

Looking first to nominal GDP per capita, the IMF ranked Canada 16th on its list of advanced economies in 2023 but second in the G7, well behind the US (graph 6). By 2030, the IMF expects Canada to fall to just behind the UK, roughly on par with a reinvigorated Germany. When combined with planned weakness in population growth as the number of newcomers to Canada is restrained, growth in nominal GDP—the broadest measure of the tax base—is likely to be even lower according to the IMF.

Graph 6
Average Income in Canada Trails That of the US and Is Expected to Fall Further Behind

G7 nominal GDP per capita | **Nominal GDP growth and its components**



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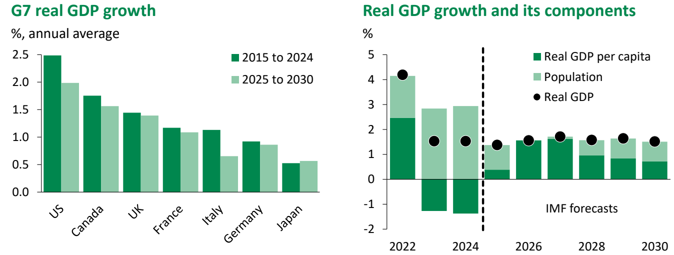
Weak nominal GDP growth wouldn't just be the result of weak population growth but also moribund growth in real GDP per capita (graph 7). This broad measure of living standards had been declining for much of the post-pandemic period in Canada, as population growth outpaced the advance in headline real GDP. But as population growth slows and substantial new federal investment is made in infrastructure and defence, growth in real GDP per capita has the potential to accelerate. This would particularly be the case if the trade war with the US is resolved, potentially leading to a further step up in Canadian real GDP growth.

Graph 7
Real GDP per Capita Will Likely Replace Population as the Driver of Canada's Growth

G7 real GDP growth | **Real GDP growth and its components**

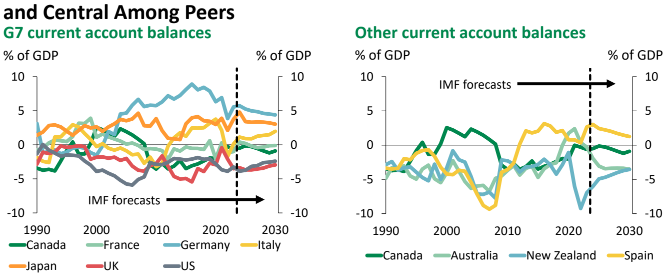


International Monetary Fund (IMF) World Economic Outlook and Desjardins Economic Studies

External Risks

A common metric used by credit rating agencies to evaluate a country's external risks is the current account balance, which represents the trade and investment flows between a county and the rest of the world. Helpfully, the IMF publishes this economic indicator in its semi-annual WEO, along with forecasts. The IMF expects Canada's current account as a share of GDP to remain broadly balanced and in the middle of the pack among comparable countries (graph 8). We were slightly less optimistic in our most recent Economic and Financial Outlook. Canada's consistently negative net international investment position—which indicates the balance between a nation's external assets and liabilities—further reinforces the country's middling standing when it comes to external vulnerabilities.

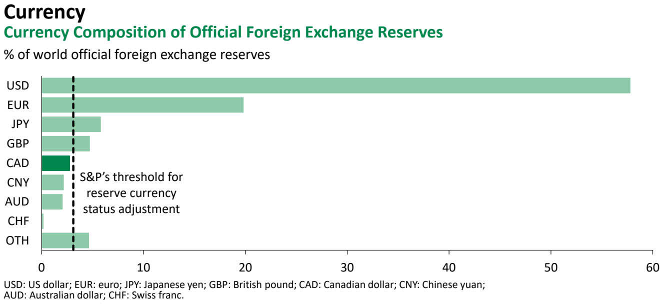
Graph 8
The IMF Expects Canada's Current Account to Remain Broadly Balanced and Central Among Peers



International Monetary Fund (IMF) World Economic Outlook and Desjardins Economic Studies

Another consideration in assigning a sovereign credit rating is the reserve status of a country's currency. S&P adjusts a country's sovereign rating upward if it comprises more than 3% of the world's total allocated foreign exchange reserves based on the IMF's Currency Composition of Official Foreign Exchange Reserves report. In 2024, the currencies getting a boost from this adjustment included the US dollar, euro, Japanese yen and British pound (graph 9). The Canadian dollar fell just short of S&P's threshold for qualifying as a reserve currency. However, this may change in the future as the Canadian dollar share of global reserves has steadily increased over the past decade.

Graph 9
Canada Falls Just Short of the Upward Credit Adjustment for a Reserve Currency

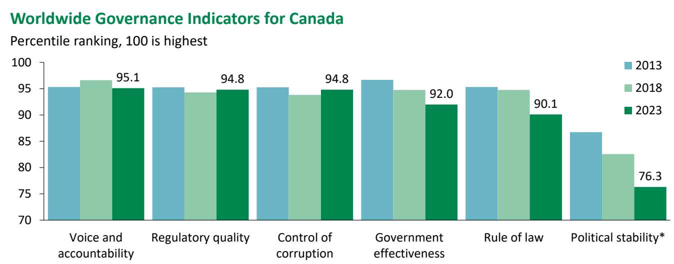


USD: US dollar; EUR: euro; JPY: Japanese yen; GBP: British pound; CAD: Canadian dollar; CNY: Chinese yuan; AUD: Australian dollar; CHF: Swiss franc.
International Monetary Fund and Desjardins Economic Studies

Institutional Strength and Policy Effectiveness

While harder to put a number on, institutional strength and policy effectiveness are key inputs when determining a country's sovereign credit rating. There is a wide range of indicators that can be used for this, but the most commonly chosen are the World Bank's Worldwide Governance Indicators. These include country rankings for voice and accountability; regulatory quality; control of corruption; government effectiveness; rule of law; and political stability and the absence of violence/terrorism. Canada ranks very highly on the first three of these indicators, and that ranking has been relatively unchanged over the decade up to and including 2023 (graph 10). Conversely, Canada's rankings for rule of law, government effectiveness and particularly political stability and the absence of violence/terrorism have all fallen markedly. This likely reflects in part the protests against pandemic restriction measures that paralyzed the nation's capital and temporarily shut down border crossings in early 2022. But the COVID-19 period was a uniquely disruptive global shock, and provided that Canada's social environment remains as stable as it typically is, some of these recent declines in Canada's relative ranking may be reversed going forward. Either way, applying the Bank of Canada's methodology for determining its Institutional Framework and Political Developments score puts Canada on the second rung of countries, which have a strong political framework with a good policy track record. Canada's rankings on comparable indicators by the big three rating agencies are likely to be similar.

Graph 10
Canada Generally Ranks High on Worldwide Governance Indicators



*Refers to political stability and absence of violence/terrorism.
World Bank and Desjardins Economic Studies

The other important institution that requires an honourable mention is the Bank of Canada. Its strong capacity and flexibility to undertake independent monetary policy improves its effectiveness through rapid transmission to short-term bond yields. This said, what weighs somewhat on Canada's credit rating is the relatively low average term to maturity of Government of Canada debt, which is below the OECD average and second only to the US in the G7. That leaves Government of Canada finances more vulnerable to changes in short-term interest rates than the finances of many other advanced economies.

Conclusion

Taking all these considerations into account, the Government of Canada's reputation for high credit quality looks to be well deserved. That said, recent developments not accounted for in the IMF's latest analysis and forecasts, such as the massive increase in planned defence spending coupled with ongoing tax cuts, point to potential downside fiscal risks. But the bar for a credit downgrade is high, suggesting things would need to get much worse than they are today, and any further downgrades would likely be well into the future if they occur.

From a market standpoint, our macro strategists note that Canada's term premium appears to have widened excessively relative to that of the US given the two countries' respective fiscal landscapes. Our assessment of sovereign ratings vulnerabilities tends to reinforce this view.