ECONOMIC VIEWPOINT

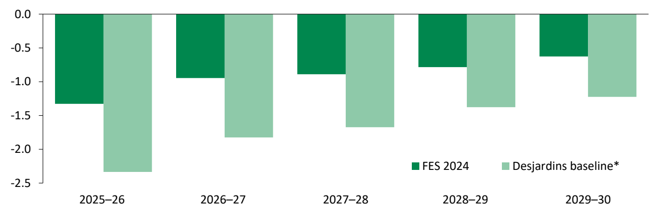
Federal Budget 2025 Preview: A Budget Like No Other

By Randall Bartlett, Deputy Chief Economist

HIGHLIGHTS

- After a long delay, the 2025 federal budget is finally coming on November 4. While it's difficult to know exactly how big the planned deficits will be, announced spending and tax cuts make clear that they will be among the largest in recent memory as a share of GDP outside of a recession or pandemic (graph 1).
- Defence should take centre stage in Budget 2025, but there is likely to be plenty of other planned spending between its covers. Expenditures on infrastructure, housing, and tariff-impacted industries and workers are likely to have big price tags attached as well, not to mention the dozens of other smaller measures included in the 2025 election platform. This expansion in federal government spending is expected to be partially offset by substantial cuts to operating expenses and a reduction in public sector payrolls.

Graph 1
Federal Deficits Could Be the Largest in 30 Years Outside of a Recession or Pandemic
Government of Canada budget balance forecasts



* Based on Desjardins Economic Studies September 2025 Economic and Financial Outlook
FES: Fall Economic Statement
Government of Canada, Office of the Parliamentary Budget Officer, Liberal Party of Canada and Desjardins Economic Studies

- These spending increases wouldn't have as substantial an impact on the deficit if it weren't for the accompanying reduction in tax and tariff revenues. Lower revenues without an offsetting spending reduction increase the government's deficit and debt. Indeed, we've determined that the economic benefits of these measures will not generate sufficient revenues to offset the planned reduction.
- We expect the federal debt-to-GDP ratio to rise steadily over the next decade—a stark contrast to the decline projected in the prior federal fiscal outlook. Risks to this outlook are tilted to the downside, with the possibility of renewed trade shocks and rising global long-term interest rates all threatening the sustainability of federal finances. While a debt downgrade isn't imminent, Canada's AAA status shouldn't be taken for granted.

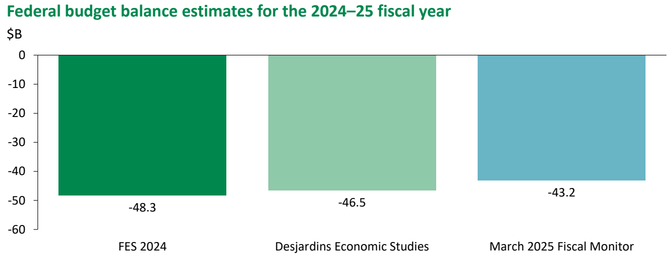
After an unprecedented delay, the 2025 federal budget will soon finally be here. Since the federal election in the spring, the current sitting of Parliament has been characterized by a barrage of new legislation, tax cuts, announcements of substantial increases in defence and other spending, and a push to find savings in federal operating expenses. All of this is expected to add up to bigger deficits and higher debt, and ultimately risks putting federal finances on an unsustainable path.

Filling In the Blanks

While we don't want to spend too much time discussing what's already in the rearview mirror, as of the time of writing we still don't have official data on the size of the federal deficit in the 2024–25 fiscal year (FY25). Applying a tried and tested approach to leveraging more high-frequency federal fiscal and national economic data, we find that last year's deficit could be slightly smaller than projected in the Fall Economic Statement 2024 (FES) (graph 2). Of course, that precludes any surprise accounting adjustments. For instance, in FY24, the budget deficit went beyond expectations largely as a result of Indigenous contingent liabilities, such as the settlement of land claims.

Graph 2
The Federal Deficit May Have Been Smaller than Expected Last Year

Federal budget balance estimates for the 2024–25 fiscal year



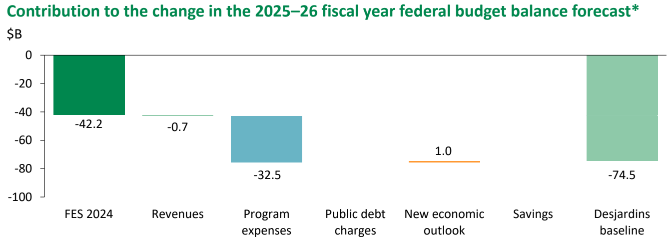
FES: Fall Economic Statement
Government of Canada and Desjardins Economic Studies

Less Money, Mo' Problems

But we don't expect that the honeymoon of smaller deficits lasted long. By our estimate, the budget shortfall in the current fiscal year could exceed $70B—almost double that projected in the FES 2024 (graph 3). There have been rumours out of Ottawa that the deficit could be even larger, possibly reaching $100B this year. The commitment to increase defence spending to 2% of GDP by the end of the current fiscal year is the main reason. However, tax cuts just before the summer and other spending commitments announced in the 2025 election platform are also likely to contribute. And while the improved economic outlook relative to our earlier forecasts should be a tailwind to the federal fiscal forecast, customs duties will come in far lower than anticipated on the hustings in the spring.

Graph 3
Increased Spending Should Drive a Substantially Larger Deficit This Year

Contribution to the change in the 2025–26 fiscal year federal budget balance forecast*



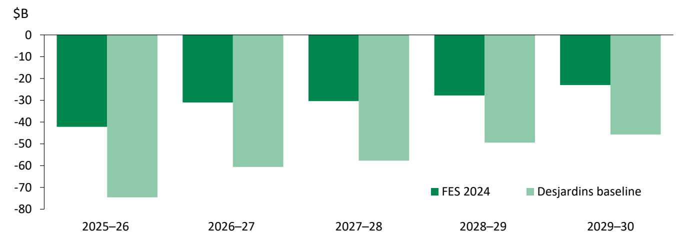
* Based on Desjardins Economic Studies September 2025 Economic and Financial Outlook
FES: Fall Economic Statement
Government of Canada and Desjardins Economic Studies

Big Plans, Big Price Tag

Looking beyond the current fiscal year, elevated levels of spending combined with lower projected revenues than forecast in the FES 2024 point to large budget deficits throughout the horizon (graph 4). But while the topline fiscal numbers often get the most attention, it's worth unpacking them to better illustrate the drivers of Canada's evolving fiscal forecast.

Graph 4
Federal Deficits Will Be Larger Due to Higher Spending and Lower Revenues

Government of Canada budget balance forecasts*



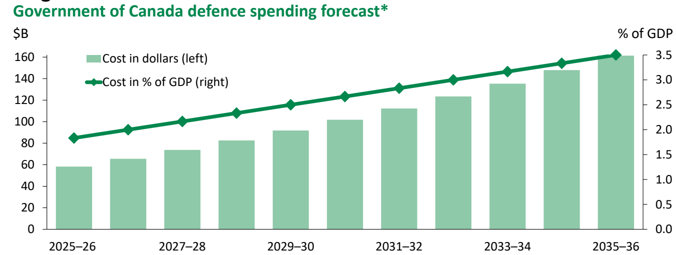
* Based on Desjardins Economic Studies September 2025 Economic and Financial Outlook
FES: Fall Economic Statement
Government of Canada, Office of the Parliamentary Budget Officer, Liberal Party of Canada and Desjardins Economic Studies

Defence Spending

Spending on defence is likely to be front and centre in Budget 2025. In June, the federal government first committed to reaching the former 2% of GDP NATO defence spending target by the end of the current fiscal year. It later signed on to an expanded NATO pledge of 3.5% of GDP on defence spending plus 1.5% on defence-related expenditures by 2035. According to the Prime Minister, 3.5% of GDP in 2035 would be equivalent to about $150B annually at that time—a number that we can corroborate (graph 5). By our projection, that could be as much as double the previously planned allocation for defence spending by the federal government. (Keep in mind that these defence

Graph 5
Much Higher Defence Spending Is Needed to Meet the New NATO Target

Government of Canada defence spending forecast*



* Based on Desjardins Economic Studies September 2025 Economic and Financial Outlook; defence spending is measured and forecast on a cash basis
NATO: North Atlantic Treaty Organization
Government of Canada, Office of the Parliamentary Budget Officer, Liberal Party of Canada and Desjardins Economic Studies

expenditure forecasts are done on a cash accounting basis, meaning the numbers presented in the budget will not line up on an annual basis as they are determined using accrual accounting.)

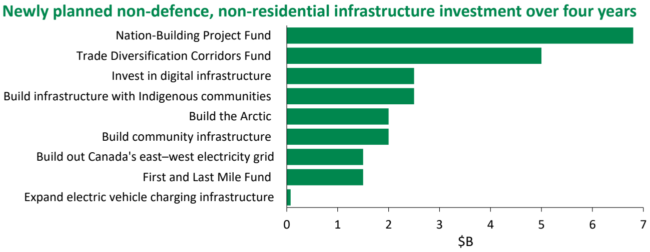
Just as important as the deficit implications is whether this substantial fiscal expansion will pay off in terms of long-term productivity and economic growth. The federal government can acquire the necessary military hardware from allied countries, but as always there is a desire for these expenditures to bear fruit in the form of economic benefits at home. However, the track record of military-industrial benefits is checkered at best. As federal government defence procurement is an export-oriented industry, our research has outlined the many ways in which it can help to support what is still a relatively modest defence industry in Canada.

Infrastructure Spending

Another central focus of the federal government during and after the 2025 election has been infrastructure investment (graph 6). With the passage of the *Building Canada Act* in June and subsequent list of major projects subject to an accelerated federal approval process, momentum has continued on this plank of the Government of Canada's agenda. But as we've highlighted previously, metrics matter to investors. The criteria used to select these projects remain vague and lack the transparency that would help better understand why some projects are selected over others. Budget 2025 could provide an opportunity to clarify the criteria used to select the current short list of projects and all future projects, big and small.

Graph 6
The Federal Government Plans to Spend Much More on Infrastructure

Newly planned non-defence, non-residential infrastructure investment over four years



Liberal Party of Canada and Desjardins Economic Studies

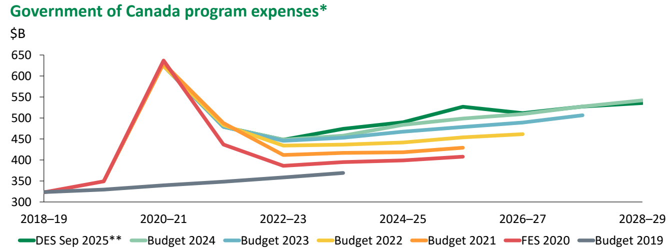
Other Spending

Defence and infrastructure aren't the only spending measures the federal government has put in the window. With over 100 new expenditure measures in the Liberal Party of Canada (LPC) election platform, there could be a lot more spending in the pipeline than has been announced since election day. That said, new non-defence spending announced to date has been substantial and lines up relatively well with the estimates back in the spring. For instance, the initial $13B in funds to capitalize Build Canada Homes is only modestly higher than the projection included in the 2025 election platform. Additionally, the Strategic Response Fund is expected to be several billion dollars larger than was projected on the campaign trail, at $5B versus $2B. However, it appears to include other measures that were also in the election platform while replacing the existing Strategic Innovation Fund, thereby providing some offset. Greater transparency on overall spending in Budget 2025 would improve clarity and accountability.

All told, program spending is now expected to again be revised higher than was projected previously (graph 7). And program spending would be even higher if not for the elimination of the price on pollution, as the end of quarterly payments to households in provinces that were under the federal scheme will bring down the top line of program expenses. However, as the consumer carbon tax was largely revenue neutral, its elimination will have a roughly equal and offsetting impact on revenues.

Graph 7
The Federal Government Has Permanently Raised the Level of Spending

Government of Canada program expenses*



* Program expenses include net actuarial losses; ** Based on Desjardins Economic Studies September 2025 Economic and Financial Outlook, the Fall Economic Statement 2024 and the 2025 Liberal Party of Canada election platform; FES: Fall Economic Statement; DES: Desjardins Economic Studies

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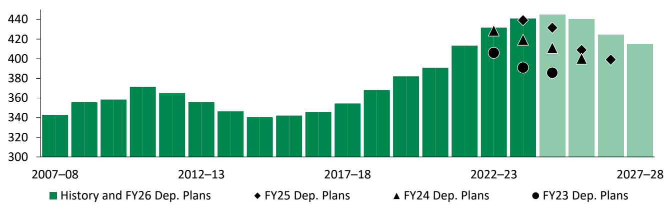
Newfound Savings

The outlook for program spending would be higher still if it weren't for planned savings of 7.5% in FY26, 10% in FY27 and 15% in FY28 relative to projected direct program expenses. By our calculations, this translates into nearly $15B, $20B and $30B in savings in each of those fiscal years, respectively. That's significantly higher than the "savings from increased government productivity" included in the LPC election platform.

The scale of the planned savings harkens back to the Deficit Reduction Action Plan (DRAP) initiated by the Harper government. However, the planned savings—and likely staffing reductions—could be even larger than those in the DRAP. This reflects in part the substantial increase in staff levels that took place before and during the pandemic (graph 8 on page 4). Indeed, according to Government of Canada data, the number of full-time equivalents in the federal public service

Graph 8
Public Sector Hiring Has Consistently Outpaced Departmental Plans

Full-time equivalents in the federal public service
Thousands of people



Note: FY26 refers to the 2025–26 fiscal year; other fiscal years are similarly abbreviated
Government of Canada, Office of the Parliamentary Budget Officer and Desjardins Economic Studies

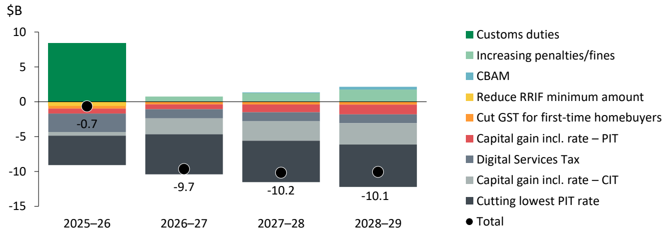
was nearly 30% higher than in 2015 at last reading. That's more than double the pace of increase in Canada's population over the same period. However, according to Statistics Canada, the federal government has already begun cutting staff, with employment in federal government public administration down more than 5% in June 2025 from the historic peak reached in April 2024. This decline may need to accelerate going forward for the government to reach its program spending objectives.

Lower Revenues

Higher spending wouldn't be as much of a problem for the federal finances if it weren't for the lower revenues that are expected relative to the FES 2024 and the LPC election platform. That's not a judgment on the nature of the tax cuts themselves, but instead just a statement of the fiscal impact they will have (graph 9). Indeed, while the removal of countertariffs on goods imports from the US will meaningfully reduce this year's tax take, our research shows that it will have the positive impact of boosting economic growth while reducing inflation. Tax breaks such as rolling back the increase in the capital gains inclusion rate, cutting the lowest marginal personal income tax rate and eliminating the GST for first-time homebuyers will no doubt also be a positive for economic activity. However, we don't believe that economic tailwind will be sufficient to offset the revenues that will be lost. Further, while the elimination of the Digital Services Tax may be necessary to get an eventual trade deal with the US, it's also revenue that will be permanently lost.

Graph 9
Revenues Are Being Reduced Even While Spending Is Rising

Revenue and cost of various proposed and implemented tax measures
$B



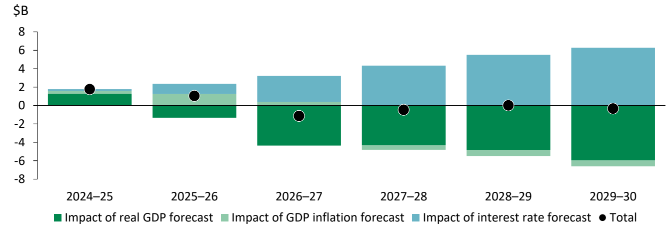
CBAM: Carbon Border Adjustment Mechanism; PIT: Personal Income Tax; CIT: Corporate Income Tax
Government of Canada, Office of the Parliamentary Budget Officer, Liberal Party of Canada and Desjardins Economic Studies

The Economy

One bright spot in our federal fiscal forecast is the improved economic outlook relative to the FES 2024. Stronger projected nominal GDP growth in the near term is likely to give the fiscal outlook a bit of a helping hand, although we expect this to be short-lived (graph 10). Instead, almost all of the benefit over the medium term should come from the lower interest outlook compared to that in the FES 2024. However, if rising interest rates on longer-term government debt make new debt issued more expensive to service, federal finances could underperform our projection. (For more information, see our analysis on the potential federal fiscal implications of a steepening yield curve.) An adverse economic shock stemming from, say, US trade policy could erode this outlook for federal finances further. All this to say, if the economic impact of expected new spending goes according to the Government of Canada's plan, growth could be much higher than currently projected. This, combined with the federal government reducing regulations and supporting renewed private investment, could spur the long hoped for boom in Canadian productivity.

Graph 10
The Fiscal Tailwind from the Economy Should Be Short-Lived

Fiscal impact of the change in the economic outlook since the FES 2024*
$B



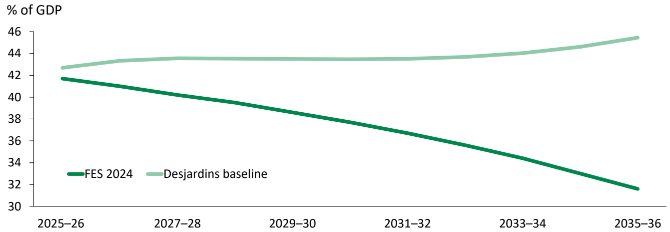
* Based on Desjardins Economic Studies September 2025 Economic and Financial Outlook
FES: Fall Economic Statement
Government of Canada, Statistics Canada and Desjardins Economic Studies

Debt Path Reverses Course

Unsurprisingly, substantially larger deficits than previously planned mean higher levels of debt for the Government of Canada. When compared to the most recent projection in the FES 2024, the debt-to-GDP ratio is expected to go from a declining to a rising path over the outlook (graph 11 on page 5). The Parliamentary Budget Officer's (PBO) recent Economic and Fiscal Outlook corroborated this finding. And this assumes the Canadian economy broadly recovers from the trade shock that dragged down growth in Q2 2025, the federal government is able to manage rising borrowing costs at the long

Graph 11
Larger Deficits Should Push the Debt-to-GDP Ratio Steadily Higher

Government of Canada debt forecasts*



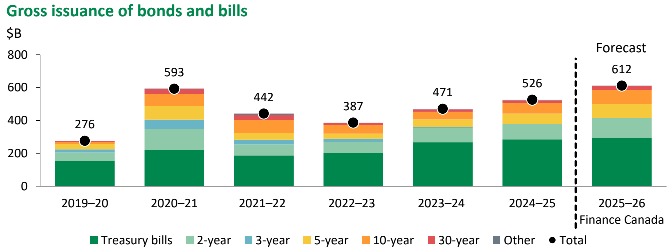
* Based on Desjardins Economic Studies September 2025 Economic and Financial Outlook; federal debt refers to the accumulated deficit or gross liabilities less financial and nonfinancial assets
FES: Fall Economic Statement
Government of Canada, Office of the Parliamentary Budget Officer, Liberal Party of Canada and Desjardins Economic Studies

end of the yield curve and there is no federal debt downgrade anytime soon. (See our analysis on the unlikely event that federal debt is downgraded in the foreseeable future.) As such, the risks to this outlook are tilted to the downside, even if we believe our baseline debt forecast is the most likely outcome.

A key consideration for bond investors isn't only the amount of debt being issued, but the maturity at which it's being issued. In July, the federal government published its 2025–26 Debt Management Strategy (DMS), which outlined the amount of bills and bonds the Government of Canada intends to issue in the current fiscal year (graph 12). However, this publication contained less information than it normally would as it didn't include an explicit projection for the budget deficit this year. Given what we've been able to reverse engineer, it appears that the federal government's deficit assumption for the current fiscal year is in line with ours. If the deficit balloons to $100B in FY26, issuance could be closer to $25B more than assumed in the DMS. As such, unless bond auctions are increased in size and/or number this year, Treasury bill issuance could be above the $296B projection published back in July.

Graph 12
Federal Issuance Is Expected to Increase in the 2025–26 Fiscal Year

Gross issuance of bonds and bills



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New Accounting, More Accountability?

On October 6, the federal government satisfied an election commitment when it announced its intention to introduce a distinction between operating and capital spending in the budget. A similar approach is used in countries like the United Kingdom and New Zealand, as well as by some provinces here at home. In principle, this shift could enhance transparency by allowing a better understanding of how public funds are allocated between day-to-day program spending and long-term investments intended to boost future growth.

However, according to the PBO, "Finance Canada's definition and categories expand the scope of capital investment beyond the current treatment of capital spending in the Public Accounts of Canada. Based on our initial assessment, we find that the scope is overly expansive and exceeds international practice such as that adopted by the United Kingdom." The new definition of capital expenses includes everything from investment in tangible capital assets—which currently constitute about 90% of federal non-financial assets in the Public Accounts (PBO, 2025)—to tax incentives and grants to the private sector for capital investment, R&D and housing. Given the federal government's generous definition of what constitutes a capital expense, it raises questions about credibility and transparency. Indeed, we've estimated that capital spending could total more than $50B in the current fiscal year, but what gets included is completely at the discretion of the federal government. This expansive definition of capital spending could also lead to investor uncertainty about what expenses the government is using to calculate the deficit.

Notably, however, Finance Canada has made clear that "the budget will continue to include tables categorizing planned spending according to Public Accounts concepts, in order to maintain the ability to compare budgeted amounts with results." These estimates and forecasts should therefore conform to Canadian public sector accounting standards, and this should be the spending used to calculate the deficit that is included in the financing requirements for the DMS. As such, deficits, debt and debt servicing costs should continue to be presented in a way that is comparable with prior fiscal years and other jurisdictions, which is what matters to rating agencies. This is even more critical given neither the Auditor General nor the PBO will be tasked with providing oversight on what's categorized as capital spending in the federal budget. This despite the LPC election platform explicitly stating that the PBO would be asked to do so.

If the goal of this accounting change is improved fiscal transparency, it will be important for the government to present a comprehensive view of its balance sheet in future budgets. This includes providing assessments of the expected rates of return on capital investments—whether direct or via induced economic growth—and comparing these to the government's cost of borrowing. This would allow a better assessment of whether the investments deliver value for money.

Capital budgeting also poses communication and market risks. Infrastructure projects typically involve significant upfront spending, with returns that aren't guaranteed or that only materialize over longer time horizons. As such, debt-to-GDP metrics may worsen in the near term, even if long-run benefits are positive. This could affect investor sentiment, especially at a time when market conditions are volatile and fiscal credibility remains a key consideration for credit rating agencies. In this context, adopting a new budgeting framework while the economic outlook is clouded by downside risks may prove to be a delicate exercise.

Finally, at the same time that the federal government announced the accounting changes, it also revealed that budgets will now be published in the fall as opposed to the spring. This is intended to better align the timing of the budget with the Main Estimates—the main funding bill at the start of the fiscal year—which must be passed by March 31. This seems like a reasonable change and is in line with past PBO recommendations.

Conclusion

There is a lot to unpack in the run-up to what will be a truly unprecedented federal budget. It has been unprecedented not only in its delay, but also in its planned spending, tax cuts and savings. Deficits could rise to levels not seen in decades outside of a recession or pandemic, and the debt-to-GDP ratio is likely to be headed in the wrong direction. The budget will also include accounting changes that will be a first for the Government of Canada. With significant fiscal costs and downside risks, the real test will be whether Budget 2025 delivers the clarity and certainty that stakeholders require and whether it sets out a compelling path for lifting Canada's longer-term economic potential.