BUDGET ANALYSIS

Federal Budget 2026

Dubious Deficits and Debt Raise Doubts

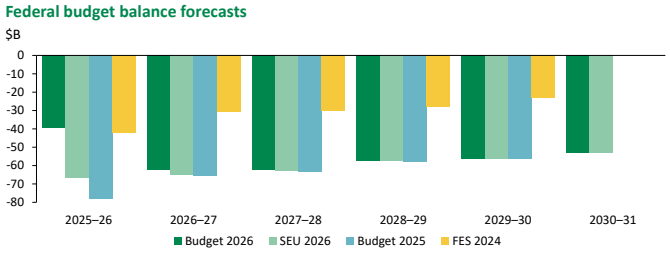
By Jimmy Jean, Vice-President, Chief Economist and Strategist, and Randall Bartlett, Deputy Chief Economist

HIGHLIGHTS

- Much to the surprise of fiscal forecasters, federal deficits are anticipated to be broadly in line with those projected in the Spring Economic Update (SEU) starting in the 2027–28 fiscal year (FY28), after improving modestly this year (graph 1). That said, the federal deficit as a share of nominal GDP is expected to deepen in FY27 before shrinking thereafter, calling into question whether the federal government will meet its fiscal anchor of a falling deficit-to-GDP ratio.

- Higher revenues on the back of elevated oil prices and inflation are largely to thank for the better fiscal outlook, improving the total tax take by nearly $120B over the next five year. However, the sustained higher revenue outlook seems out of step with the projection of nominal GDP—the broadest measure of the tax base—suggesting the revenue outlook may prove aspirational.

Graph 1
A Smaller Deficit This Year Isn't Expected to be Repeated in Future Years



SEU: Spring Economic Update; FES: Fall Economic Statement
Government of Canada and Desjardins Economic Studies

- New revenue measures were mostly already announced, including $36.1B over five years for the Productivity Mega Deduction and $2.9B this year for the temporary reduction in the federal fuel excise tax. The new Canada Growth Incentive ($0.7B) might be one of the most interesting fresh measures rolled out, as it could encourage entrepreneurship in Canada, reward serial entrepreneurs and also facilitate SME business successions, in addition to further closing fiscal competitiveness gaps to the United States. When combined with smaller revenue measures, tax cuts and deductions tally up to about $42B in lost net revenue over the next five years.

- New spending measures since the SEU are expected to total almost $110B over the next five years starting in FY27. The largest measures include support for Indigenous Peoples' housing, infrastructure, health and education ($26.6B over five years); supporting Canadian workers and businesses ($11.5B); and putting Canada on a path to end homelessness in 10 years ($11.2B). Offsetting these are modest new savings from government efficiency and money already baked into the fiscal framework, most notably in defence. But that pales in comparison to the more than $60B in lower direct program expenses thanks to higher interest rates reducing future obligations (despite the long-term interest rate forecast being broadly unchanged from the SEU 2026).

- With smaller deficits now and similar-sized deficits in the future, the level of the federal debt (accumulated deficits) is forecast to be lower than in SEU 2026, albeit still reaching nearly $1.6T by FY31. That said, a sustainable debt position today can't be taken for granted. With little fiscal room left, a continued climb in long-term interest rates, re-escalation in the trade war or some other negative external shock could put the federal debt-to-GDP ratio on an unsustainable path.

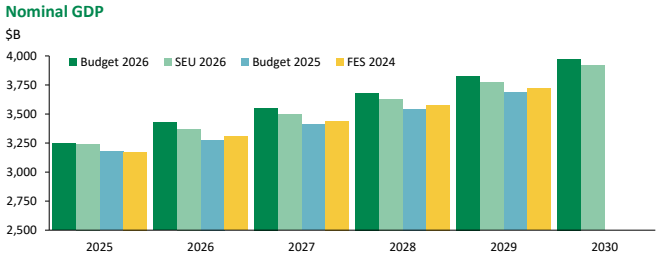
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Much to the surprise of fiscal forecasters, federal deficits are anticipated to be broadly in line with those projected in the SEU starting in the 2027–28 fiscal year (FY28), after improving modestly this year (table 1). Higher revenues on the back of elevated oil prices, inflation and nominal GDP are largely to thank for the better fiscal outlook, totalling nearly $120B over the next five years. New revenues measures were mostly already announced, tallying up to about $42B in lost net revenue over the next five years. New spending measures since the SEU are expected to total almost $110B over the next five years starting in FY27. This should be partly offset by $39B in lower direct program expenses thanks to higher interest rates reducing future obligations (and despite the long-term interest rate forecast being broadly unchanged from the SEU 2026). Other saving measures are much more modest. Similar-sized deficits and higher nominal GDP projected over the next five years are sufficient to lower the federal debt forecast and keep it on a sustainable path.

High Oil Prices to the Federal Fiscal Rescue

The Government of Canada has sustained high oil prices to thank for much of improved revenue outlook. Compared to the SEU, the price of a barrel of West Texas Intermediate (WTI) is expected to be US$13 higher in 2026 and 2027, respectively, and US$5 higher on average annually over the next five years (our forecast for oil prices is less elevated). This has helped to significantly boost outlooks for inflation and nominal GDP—the broadest measure of the tax base—relative to the SEU 2026 (graph 2 and table 2 on page 3). At the same time, real GDP growth is expected to be slightly lower than in the spring, although most private-sectors forecasters have revised their forecasts up slightly since the survey was taken, which may provide some upside to the outlook. However, actual and forecast interest rates have kept rising since the private-sector survey was conducted, meaning there is potentially more downside risk to the fiscal outlook than is baked into Budget 2026.

Graph 2
The Outlook for Nominal GDP Has Improved Since SEU 2026



SEU: Spring Economic Update; FES: Fall Economic Statement
Government of Canada and Desjardins Economic Studies

TABLE 1
Summary of Transactions

	ACTUAL	PROJECTIONS				
$B (UNLESS OTHERWISE INDICATED)	2025–2026	2026–2027	2027–2028	2028–2029	2029–2030	2030–2031
Budgetary revenues	526.4	540.3	564.2	581.5	607.7	629.0
Growth (%)	*3.0*	*2.6*	*4.4*	*3.1*	*4.5*	*3.5*
Program spending	-498.5	-542.7	-559.3	-568.3	-586.3	-600.2
Growth (%)	*1.8*	*8.9*	*3.1*	*1.6*	*3.2*	*2.4*
Debt charges	-53.5	-60.2	-67.3	-73.8	-78.4	-85.5
Growth (%)	*0.2*	*12.5*	*11.8*	*9.7*	*6.2*	*9.1*
Net actuarial losses	-13.6	0.4	-0.2	3.0	3.6	3.7
Budgetary balance	**-39.3**	**-62.3**	**-62.5**	**-57.6**	**-53.4**	**-52.9**
Federal debt[1]	1,306.1	1,366.5	1,429.0	1,486.6	1,540.1	1,593.0
Growth (%)	*3.1*	*4.6*	*4.6*	*4.0*	*3.6*	*3.4*
Budgetary revenues (% of GDP)	16.2	15.8	15.9	15.8	15.9	15.8
Program spending (% of GDP)	-15.4	-15.8	-15.7	-15.4	-15.3	-15.1
Public debt charges (% of GDP)	-1.6	-1.8	-1.9	-2.0	-2.0	-2.2
Budgetary balance (% of GDP)	**-1.2**	**-1.8**	**-1.8**	**-1.6**	**-1.4**	**-1.3**
Federal debt (% of GDP)	**40.2**	**39.9**	**40.2**	**40.4**	**40.3**	**40.1**

[1] Debt representing the accumulated deficits including other comprehensive income.
Department of Finance Canada and Desjardins Economic Studies

TABLE 2
Economic and Financial Forecasts

AVERAGE ANNUAL GROWTH IN % (UNLESS OTHERWISE INDICATED)	2025		2026f			2027f		
	Actual	SEU 2026	Budget 2026	SEU 2026	Desj. Group	Budget 2026	SEU 2026	Desj. Group
Real GDP	1.9	1.7	1.0	1.1	1.0	1.7	1.9	2.0
GDP deflator	2.5	2.6	4.6	2.8	4.5	1.9	1.8	1.3
Nominal GDP	4.4	4.3	5.6	4.0	5.5	3.7	3.7	3.3
Treasury bills – 3-month	2.6	2.6	2.3	2.2	2.3	2.6	2.5	2.7
Federal bonds – 10-year	3.2	3.2	3.6	3.4	3.4	3.8	3.6	3.3
Unemployment rate	6.8	6.9	6.6	6.5	6.6	6.2	6.2	6.5
Exchange rate (US¢/C$)	72.0	71.5	72.1	73.7	73.0	72.4	75.4	76.0
Real GDP – United States	2.3	2.2	2.1	2.4	2.4	2.2	2.0	2.5

f: forecast
NOTE: Data may not add to totals due to rounding.
Department of Finance Canada, Statistics Canada and Desjardins Economic Studies

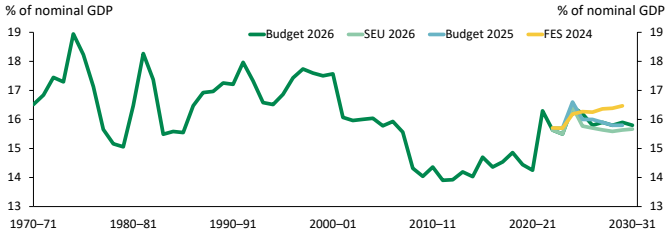
Budget 2026 rounds out the economic outlook with upside and downside scenarios. In the high investment scenario, real GDP growth and inflation would be meaningfully higher than in the baseline, pushing nominal GDP ahead faster, thereby supporting better fiscal metrics. The lower growth scenario characterized by increased global supply disruptions, the economic forecast would be more sluggish than in the baseline while fiscal metrics would deteriorate. That said, in all scenarios, the federal debt-to-GDP ratio would return to a declining profile after FY28.

Overall, this is a much less conservative risk analysis than the rhetoric of fiscal responsibility suggests. The adverse scenario is built around prolonged global supply disruptions, higher energy prices and tighter financial conditions. That would clearly hurt Canadian households and real activity, but higher oil prices would simultaneously support Canada's term of trade, nominal GDP and government revenues. This is the reason the scenario lowers nominal GDP by only $8B per year on average and widens the deficit by a mere $2.2B. By contrast, Budget 2025's trade-driven downside, which also incorporated lower commodity prices, reduced nominal GDP by $51B annually and worsened the deficit by $9.2B per year. Considering the absence of an explicit contingency reserve, this leaves the government's risk analysis looking notably asymmetric.

Do Tax Cuts Pay for Themselves?

Higher revenues on the back of elevated oil prices and inflation are largely to thank for the better fiscal outlook, totalling nearly $120B over the next five years. Much of that appears to be predicated on a lofty outlook for future oil prices buoying the tax take from corporate and personal income tax revenues. However, the sustained higher revenue outlook seems out of step with the projection of nominal GDP. Indeed, despite new tax cuts and deductions announced since SEU 2026, revenues are now expected to be a larger share of nominal GDP than they were back in the spring (graph 3).

Graph 3
Planned Revenues Have Been Revised Up in Budget 2026 Despite Tax Cuts and Deductions
Government of Canada revenue forecasts



SEU: Spring Economic Update; FES: Fall Economic Statement
Government of Canada and Desjardins Economic Studies

New revenue measures were largely already announced, including $36.1B over five years for the Productivity Mega Deduction and $2.9B this year for the temporary reduction in the federal fuel excise tax. Attempts to simplify the tax code ($1.4B over five years), an expansion of Clean Economy investment tax credits ($2.2B) and making the Canada Caregiver Credit refundable ($0.8B) round out the large new tax cuts and deductions. Importantly, the federal government believes it can offset this to the tune of $1.2B in net new revenues from strengthening tax compliance and the effectiveness of fines and penalties. This tallies up to about $42B in lost net revenue over the next five years.

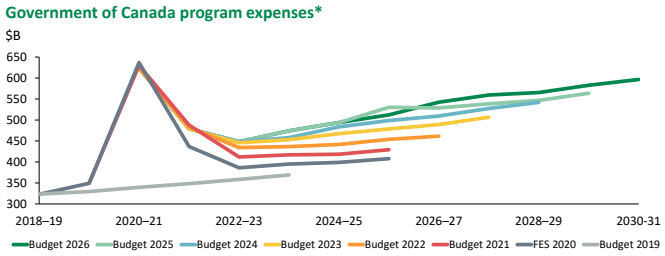
The Canada Growth Incentive may be one the more interesting new measures in the budget. It comes with two components: a new exemption on up to $15M of capital gains from successful eligible Canadian investments and an enhanced small-business rollover allowing greater deferral of capital gains when proceeds are reinvested into another Canadian small business. The budget estimated $715M in tax relief over four years. This could prove consequential for Canada's entrepreneurial system, as the measure attacks a different part of the investment problem than the Mega Deduction. Rather than reducing the cost of acquiring capital, it increases the after-tax reward to building a successful Canadian company and makes it easier to recycle the proceeds into the next one. This is particularly relevant for serial entrepreneurs, for whom the incentive to build, exit and reinvest in Canada can matter as much as the tax treatment of the initial investment. The rollover provisions may also help on the buyer side, encouraging reinvestment in existing Canadian businesses at a time when population ageing is widening the gap between owners looking to exit and buyers willing to step in. While the list of eligible sectors is relatively narrow, there may be scope for broadening it in the future.

Mo' Revenues, Mo' Spending

New spending measures since the SEU are expected to total nearly $110B over the next five years starting in FY27. The largest measures include support for Indigenous Peoples' housing, infrastructure, health and education ($26.6B over five years); supporting Canadian workers and businesses ($11.5B); putting Canada on a path to end homelessness in 10 years ($11.2B); Canada's national electricity strategy ($8.7B); a further expansion of the Canada Groceries and Essential Benefit ($4.7B); supporting the Mackenzie Valley Highway construction ($3.1B); supports for the forestry sector ($2.2B); and the national artificial intelligence strategy ($2.0B). Offsetting this are modest new savings from government efficiency and money already baked into the fiscal framework, most notably in defence, as well as more than $60B in lower direct program expenses thanks to higher interest rates reducing future obligations (despite the interest rate forecast being broadly unchanged from the SEU 2026). In total, program expenses are expected to be higher over the next five years than in SEU 2026 or any other fiscal document published in the past (graph 4).

While much has been said about the Productivity Mega Deduction, Finance expects a sizeable investment response and for it to ultimately lead to about $22B in additional annual GDP. That provides a concrete benchmark against which the policy can be judged but leaves open the question as to whether the response will be that large, in an economy where taxation is only one of several constraints on capital formation.

Graph 4
Despite Near-Term Savings, the Spending Outlook Remains Elevated

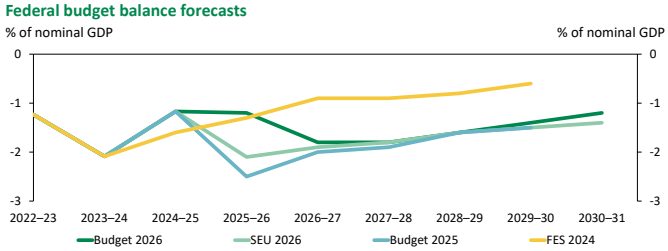


SEU: Spring Economic Update; FES: Fall Economic Statement;
* Program expenses include net actuarial losses.
Government of Canada and Desjardins Economic Studies

The Fiscal Hole's Deep but Not Getting Deeper

A widely expected smaller deficit looks to be in the cards for the Government of Canada in FY26 and FY27. However, much to the surprise of fiscal forecasters, deficits are anticipated to be broadly in line with those projected in the SEU 2026 in later years. That said, the federal deficit as a share of nominal GDP is expected to widen in FY27 before shrinking thereafter, calling into question whether the federal government will meet its fiscal anchor of a falling deficit-to-GDP ratio (graph 5). The other fiscal anchor—balancing day-to-day operating spending with revenues by FY28, a year ahead of schedule—is less relevant as the federal government determines what is and is not an operating expense without external validation. Indeed, the definition of capital spending in Budget 2026 largely doesn't conform to national and international best practices or public sector accounting standards.

Graph 5
The Government of Canada Will Breach Its Own Fiscal Rule in the Near Term

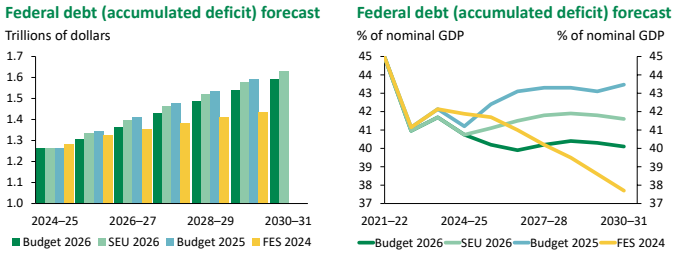


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Better Debt Outlook on Dubious Assumptions

With smaller deficits now and similar-sized deficits in the future, the level of the federal debt (accumulated deficits) is forecast to be lower than in SEU 2026, albeit still reaching nearly $1.6T by FY31 (graph 6). This suggests that after falling recently, the federal debt-to-GDP ratio should stabilize over the remainder of the five-year forecast before declining over the long term. The projected long-term decline in the federal debt-to-GDP ratio implies that the federal debt is on a sustainable path. And as we outlined in our recent federal Budget 2026 preview, the Government of Canada is not at risk of an imminent debt downgrade by rating agencies. That said, a sustainable debt position today can't be taken for granted. With little fiscal room left, a continued climb in long-term interest rates, re-escalation in the trade war or some other negative external shock could put the federal debt-to-GDP ratio on an unsustainable path.

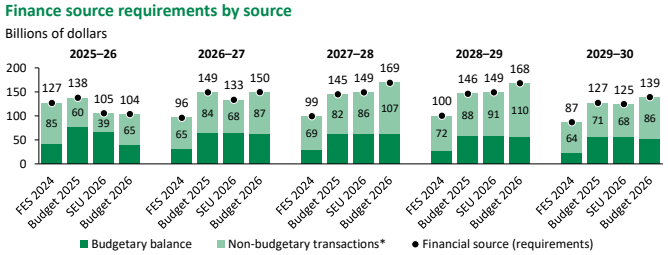
Graph 6
Federal Debt Outlook Largely Improved Due to Higher Nominal GDP



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A notable shift in Budget 2026 is the sharp increase in planned non-budgetary transactions relative to past fiscal forecasts (graph 7). Now expected to top $100B in each of FY28 and FY29, the increase in non-budgetary transactions "reflect the reversal of certain revenues and expenses included in the budgetary balance that have no impact on cash flows in the year, such as the amortisation of non-financial assets. They also include the addition of changes in asset and liability balances that have no accrual impact in a year but do result in the inflow or outflow of cash, such as the payment of accounts payable." While the impact on the size of the budget deficit is unclear, non-budgetary transactions do increase the financial requirements of the federal government regardless. This is a result of Ottawa increasingly using loans, equity investments and Crown-corporation financing to implement policy. The consequence is visible in debt service, with public debt charges set to increase by a whopping 42% between this fiscal year and FY31.

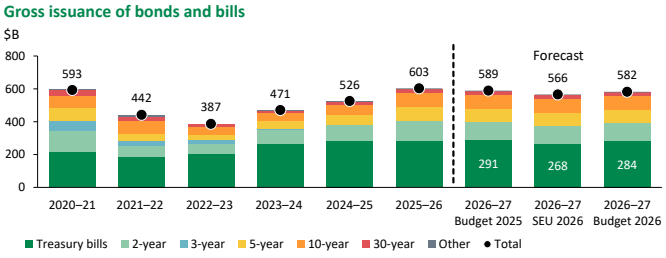
Graph 7
Federal Financing Requirements Increased Considerably in Budget 2026



* Non-budgetary transactions include loans, investment and advances; accounts payable, receivable, accruals and allowances; foreign exchange activities and derivatives; non-financial assets; and pensions and other accounts.
Government of Canada and Desjardins Economic Studies

Digging into the federal government's Debt Management Strategy, debt issuance is expected to be $16B higher in FY27 than anticipated in the SEU 2026. That is entirely planned to come from greater issuance of short-term Treasury bills, as has typically been the case in the past and as we expected. Looking ahead, despite a lower level of planned federal debt, the increased financial requirements mean debt issuance may need to increase going forward.

Graph 8
Planned Debt Issuance Has Increased Slightly Since SEU 2026



SEU: Spring Economic Update
Government of Canada and Desjardins Economic Studies

Conclusion: Whatever it Takes

In conclusion, Budget 2026 is based on ambitious economic and revenue assumptions complemented by generous planned savings to offset substantial new spending. If not for the benefit of these fiscal tailwinds, the deficit outlook wouldn't be almost identical to that in SEU 2026 and Budget 2025 starting next year. As such, we question whether revenues will be as high or spending as low as projected in Budget 2026, implying the risk is to larger deficits and higher debt.

On the flipside, the budget reinforces the package of incentives aimed at stimulating capital formation, fostering and retaining intellectual property in Canada, and boosting the supply of electricity. While much work remains to be done, including on the skilled-labour availability, regulatory and cross-jurisdictional coordination fronts, there is an unequivocally strong ambition to jumpstart capital formation in Canada.