ECONOMIC VIEWPOINT

Federal Spring Economic Statement 2026 Preview

A Revised GDP Lifts the Federal Fiscal Boat

By Randall Bartlett, Deputy Chief Economist, and LJ Valencia, Economist

HIGHLIGHTS

- With the 2026 provincial budget season largely in the rearview mirror, the only major government left to update its fiscal outlook is the Government of Canada.
- Many of the changes since the introduction of Budget 2025 have been in the federal government's favour, particularly in relation to the economy. That has freed up fiscal room to increase defence spending and transfers to households while still posting an improved deficit and debt outlook relative to the budget.
- Canada remains one of the "cleanest fiscal dirty shirts" among advanced economies, and investor demand for government debt reinforces that positive sentiment. We don't expect a credit downgrade is in the Government of Canada's future, at least not in the near term.
- But this shouldn't be taken for granted. Despite the economic tailwind, risks loom on the horizon. These include the Canada-United States-Mexico Agreement (CUSMA) joint review and rising interest rates. The Government of Canada would be wise to keep some fiscal powder dry in case it needs to confront these risks.

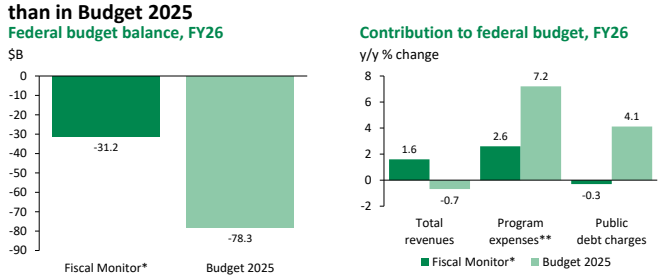
With the 2026 provincial budget season largely in the rearview mirror, the only major government left to update its fiscal outlook is the Government of Canada. A lot has changed since the introduction of Budget 2025. But many of those changes have been in the federal government's favour, especially in relation to the economy. That has freed up fiscal room to increase defence spending and transfers to households while still posting an improved outlook relative to the budget. Still, risks loom on the horizon, and the Government of Canada would be wise to keep some fiscal powder dry if it needs to confront them.

FY26 Is Likely to Be Better than Expected

With the 2025–26 fiscal year (FY26) now complete, it's important to gauge where the final deficit and debt numbers will come in. A natural starting point is the federal government's monthly Fiscal Monitor, which shows a deficit of $31.2B from April 2025 to January 2026 (graph 1). That's much smaller than the $78.3B deficit forecast in Budget 2025, due to greater revenue gains and slower expense growth. (See our analysis on the usefulness of the Fiscal Monitor for estimating the final fiscal year federal budget balance.)

Graph 1

The Fiscal Monitor Points to Stronger Revenues and Lower Expenses than in Budget 2025



FY26: 2025–26 fiscal year; * January 2026; ** Excluding net actuarial losses.
Government of Canada and Desjardins Economic Studies

Normally, the deficit in the Fiscal Monitor for the first 10 months of the fiscal year provides a reasonable estimate for the deficit in the final audited financial statements, even when excluding

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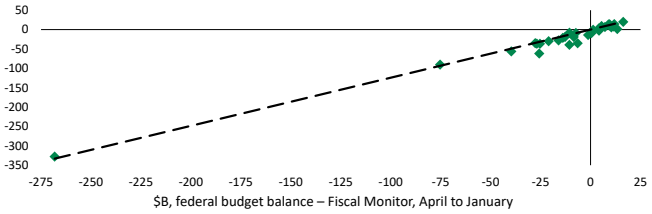
the pandemic years (graph 2). However, FY26 was not a normal fiscal year. A significant amount of spending was expected to be jammed into the final quarter—and likely the last month—of FY26. Much of this was probably related to defence. According to the Office of the Parliamentary Budget Officer (PBO), the one-time payment portion of the Canada Groceries and Essentials Benefit should also boost end-of-year spending to the tune of $3.1B. Meanwhile, revenue growth through January 2026 was likely inflated by the boost to coffers from counter tariffs on US imports prior to their removal in September 2025. As such, it is likely that the in-year deficit number in the federal Fiscal Monitor significantly underestimated the size of the Government of Canada's deficit for FY26.

Graph 2
The Fiscal Monitor Has Historically Provided a Good Estimate of the Final Federal Budget Balance
Public Accounts of Canada vs. Fiscal Monitor estimates of the federal budget balance*



* Includes the 1994–95 fiscal year through the 2024–25 fiscal year.
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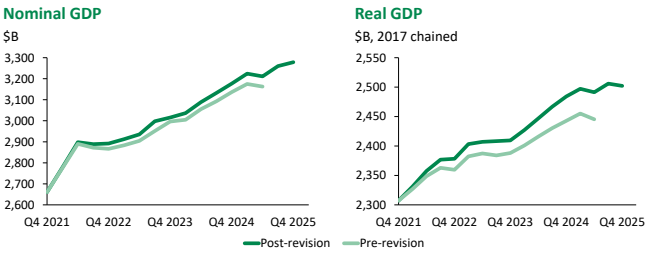
Another consideration in estimating the FY26 deficit is Statistics Canada's upward revision to Canadian real and nominal GDP—the broadest measure of the tax base—for the three years to Q3 2025 (graph 3). Notionally, this should point to higher revenues. However, when Budget 2025 was published on November 4, 2025, the federal government had as much as five months of actual tax and spending data for FY26. Therefore, not all this economic tailwind should feed into the federal government's updated deficit estimate for the last fiscal year.

Graph 3
Canada's GDP Was Revised Up, Improving Federal Fiscal Metrics



Statistics Canada and Desjardins Economic Studies

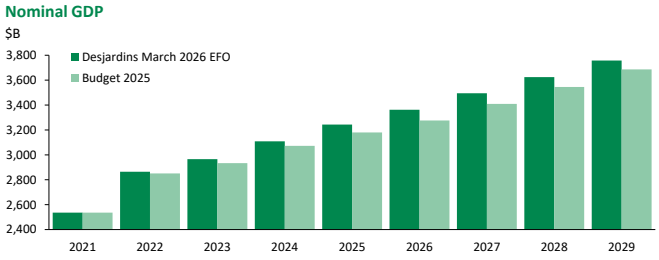
Putting this all together, we think the improved economic and revenue tailwinds are likely to be largely offset by higher spending, bringing the deficit estimate for FY26 broadly in line with that of Budget 2025. However, uncertainty persists around our estimate for the federal deficit last year, reflecting the unprecedented policy changes that occurred. Regardless, a higher-than-expected level of nominal GDP should reduce the federal debt-to-GDP ratio by 0.8 percentage points to 41.6% in FY26.

Higher Growth and Inflation Should Boost Revenues

Looking ahead, not only are revenues likely to be higher than expected last year, but they should remain elevated moving forward. This partly reflects a better starting point across several revenue categories, notably corporate income tax.

Higher revenues should also be supported by stronger economic growth than assumed in Budget 2025, with both real and nominal GDP expected to outpace earlier projections. This reflects higher oil prices because of the conflict with Iran and a smaller-than-anticipated drag from trade with the US, as noted in our March 2026 Economic and Financial Outlook. Even if FY26 unfolds as expected in Budget 2025, the improved economic outlook would reduce the annual deficit forecast by an average of $3.4B (graph 4). Higher GDP inflation is the main economic tailwind in FY27 and FY28, with lower interest rates providing support thereafter. Any boost to last year's revenues because of better economic performance will further improve the fiscal outlook.

Graph 4
The Outlook for Nominal GDP Has Improved Since Budget 2025



EFO: Economic and Financial Outlook
Government of Canada and Desjardins Economic Studies

There's been more good news for the federal government. Upward revisions to nominal GDP, combined with higher forecasts for nominal GDP growth, mean deficits and debt will be a smaller share of GDP. That's true even if those measures didn't improve in dollar terms. With rating agencies looking to this data when assessing creditworthiness, that reinforces the Government of Canada's strong credit rating.

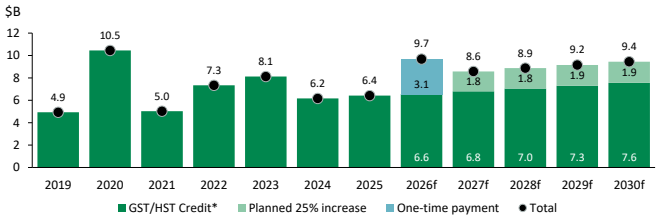
New Spending Is Likely to Use Up the Fiscal Windfall

While the Government of Canada could have been content with smaller projected deficits, that's rarely how politics works. Instead, the federal government revived a previously proposed policy, expanded it and rebranded it as the Canada Groceries and Essentials Benefit. This program will cost roughly $10.5B over five years, absorbing much of the newfound federal fiscal windfall (graph 5).

Graph 5

Changes to the GST/HST Credit Will Cost an Additional $10.5B over Five Years

Cost outlook for the GST/HST credit with new measures



f: forecast; * The Goods and Services Tax/Harmonized Sales Tax Credit numbers through 2026 are from Finance Canada's latest Report on Federal Tax Expenditures and grown thereafter by Desjardins Economic Studies nominal consumption forecast.

Government of Canada, Office of the Parliamentary Budget Officer and Desjardins Economic Studies

It was serendipitous that the increase in the GST/HST credit came just in time for the spike in oil prices due to the conflict with Iran. But judging this support to be insufficient, the federal government also cut the excise tax on gasoline, diesel and aviation fuel. This 10 cent per litre reduction in the price at the pump (4 cents per litre for the other fuels) from mid-April through Labour Day is estimated to come with a $2.4B price tag.

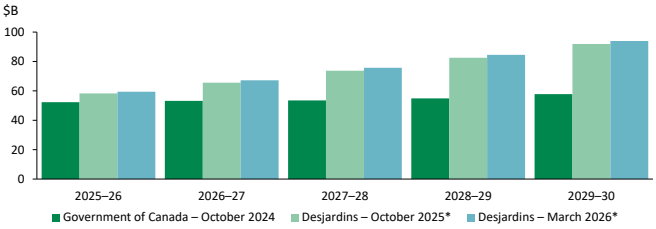
But the new spending doesn't stop there. Given that the defence spending target for the North Atlantic Treaty Organization (NATO) is expressed as a share of GDP, higher nominal GDP also raises the dollar amount needed to meet those commitments. With Canada's nominal GDP expected to be 2.2% higher by the end of FY26 than we forecast last fall, defence spending must rise by a similar amount. This should translate into roughly an additional $1.2B last year and an average of $1.9B every year through FY30 beyond what was previously budgeted for (graph 6). To the best of our knowledge, recently announced defence expenditures are included in the planned spending envelope for FY26.

Other, more modest spending measures have also been introduced since Budget 2025. These include Bill C-26, the *Improving Housing Supply Act*, which authorizes a one-time payment of $1.7B to increase new housing supply in FY26. The federal government has also matched Ontario's planned elimination of the Harmonized Sales Tax (HST) on all new homes for one year. The Government of Ontario has estimated it will

Graph 6

Higher Projected Nominal GDP Means Increased Planned Defence Spending

Planned Government of Canada defence spending



* Reflects the NATO target of 3.5% of GDP in defence spending by 2035.

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provide nearly $1.4B in tax relief in FY27, leaving $0.8B of the total $2.2B bill to be covered by the federal government.

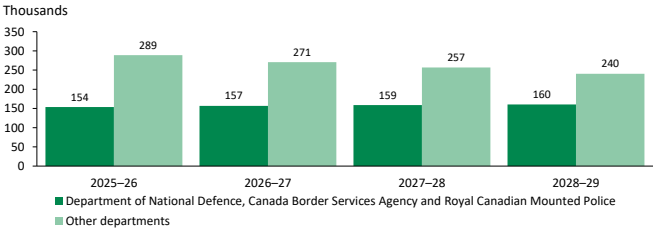
Job Cut–Induced Savings Are Being Realized

Budget 2025 introduced planned reductions to the size of the public service, and the FY27 departmental plans (DP) have formalized that intention. From FY27 onward, planned full-time equivalents (FTEs) are projected to fall from a peak of 440k in FY24 to roughly 400k by FY29, moving closer to the pre-pandemic level of 382k in FY20. This translates to a decline of roughly 40k FTEs, consistent with the planned reductions in Budget 2025. Most departments are expected to see either smaller workforces or no change over the next few years. In contrast, the Department of National Defence is set to expand to around 107k FTEs by FY29, reflecting Canada's push to meet its NATO defence spending commitments (graph 7). Other departments slated to see sizable growth in FTEs include the Canada Border Services Agency and the Royal Canadian Mounted Police.

Graph 7

FTEs in National Defence, Law Enforcement and Border Services Are Expected to Rise

Number of federal FTEs by department



FTEs: Full-time equivalents

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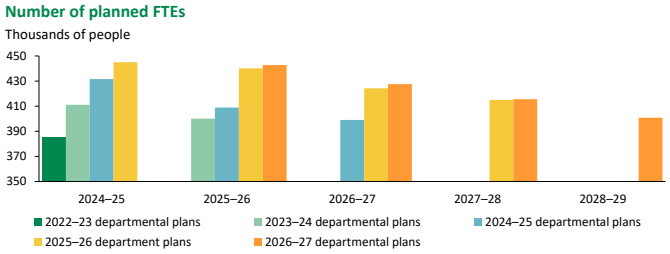
As stated in Budget 2025, the federal government plans to achieve much of its intended workforce reduction via normal attrition—retirements, voluntary departures and prior saving

exercises. The Comprehensive Expenditure Review is estimated to shave off roughly 16k FTEs across three years, including 650 executive positions. That said, consistent with prior DPs over the past three years, the FY27 plan saw early upward revisions to its projected FTEs relative to the previous FY26 DP, though the revisions in the latest DP have been relatively modest (graph 8).

Graph 8
The Level of Planned FTEs Has Seen Slight Upward Revisions

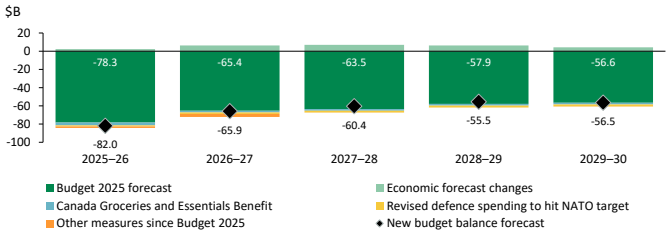


FTEs: Full-time equivalents
Government of Canada, Office of the Parliamentary Budget Officer and Desjardins Economic Studies

Wrapping It All Up in a Nice Little Deficit Bow

Accounting for new spending, any improvement in the deficit from stronger economic activity and achieved savings should essentially be absorbed. Indeed, our current outlook for the federal deficit is close to that in Budget 2025 (graph 9).

Graph 9
Recent Spending Changes Should Offset the Improved Economic Outlook



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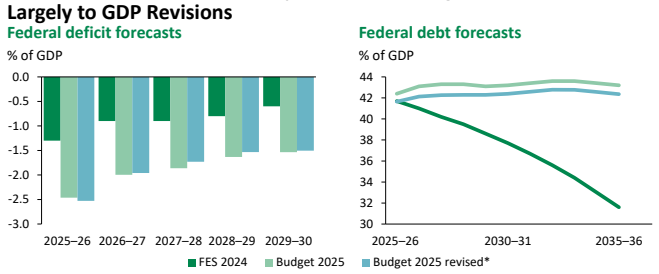
With the deficit expected to come in close to what was published in Budget 2025, the federal debt-to-GDP ratio is estimated to also show a downward revision due to a higher level of nominal GDP (graph 10). Over the decade to FY36, we expect the federal debt to be 1 ppt lower on average annually as a share of nominal GDP than published in Budget 2025. That said, with the level of forecast debt largely unchanged, we don't see much reason for the level of planned issuance in FY27 to change much relative to the most recent plan. The essentially flat debt-to-GDP

Graph 10
Federal Fiscal Metrics Have Improved Since Budget 2025, Thanks Largely to GDP Revisions



FES: Fall Economic Statement; * Updated for National Accounts revisions, Desjardins March 2026 Economic and Financial Outlook and new policy announcements since Budget 2025.
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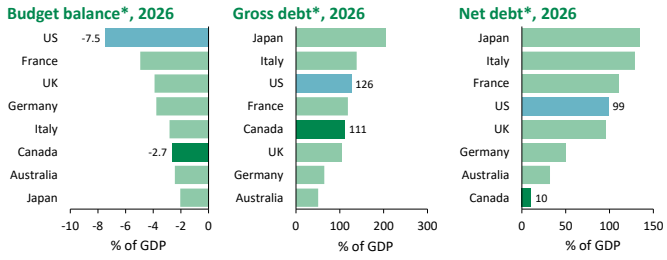
profile suggests that federal finances remain sustainable over the long term, assuming all goes according to plan. That said, federal deficits are substantially larger and debt materially higher than projected at the end of 2024, leaving little fiscal buffer if there is an external economic shock.

Canada's Fiscal Situation Is the Envy of Many

Despite the elevated level of federal debt, the Government of Canada continues to maintain one of the highest credit ratings among its advanced economy peers. Even when including the provinces and other levels of government, the International Monetary Fund (IMF) recently predicted that Canada's general government deficit and gross debt would likely fall in the bottom half of the Group of Seven (G7) plus Australia this year (graph 11). And when subtracting financial assets from gross debt, a measure known as net debt, Canada's general government net debt as a share of GDP falls to the lowest in the group. That's almost entirely the result of financial assets held by the Canada and Quebec Pension Plans (CPP and QPP).

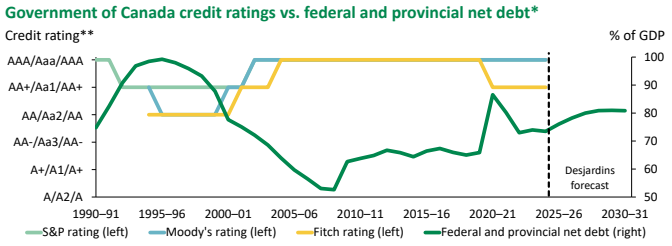
Graph 11
Canada Is One of the "Cleanest Fiscal Dirty Shirts" Among Its Peers



* General government.
International Monetary Fund and Desjardins Economic Studies

Even when we include the provinces, the net debt-to-GDP ratio is expected to climb only modestly over the rest of the decade (graph 12 on page 5). This should help reduce the risk of a downgrade in the federal government's credit rating. (See

Graph 12
The Government of Canada's Credit Quality Remains High for Now

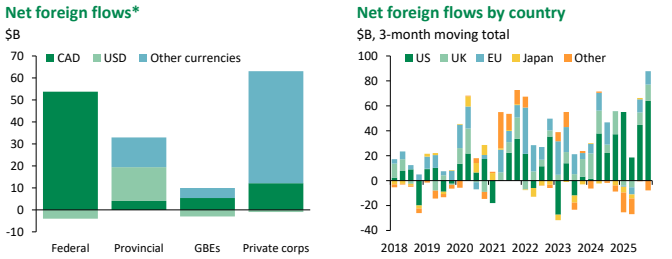


* As presented here, net debt is the sum of federal and provincial net debt from Public Accounts historically and forecasts from budgets, recent election platforms and policy announcements; ** End of fiscal year, in order on the y-axis of Fitch, Moody's and Standard & Poor's (S&P).
Bloomberg, provincial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

our analysis comparing the methodologies for sovereign credit ratings and what it means for Canada.)

The Government of Canada's strong fiscal position also helps to explain the substantial inflows into Canadian fixed income in 2025 (graph 13). This isn't just a government bond story, although bonds play a key role. International investors have also stepped up diversification away from US dollar-denominated assets—a trend that has gained momentum since the current US administration came to power. (See our latest Investment Strategy and Interest Rate Analysis for more information.)

Graph 13
Foreign Interest in Canadian Sovereign and Subsovereign Bonds Persists



GBEs: Government business enterprises; * December 2024–December 2025.
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Fiscal Forecasting Can Be a Risky Business

While the federal fiscal forecast could be worse, the risks to the Government of Canada's deficit and debt projections are largely to the downside. First, elevated oil prices because of the conflict with Iran may fade sooner than expected, reducing the associated boost to national revenues. Alternatively, higher-for-longer oil prices could weigh more heavily than expected on consumption, possibly offsetting the fiscal boost from inflation and corporate profits. Second, the outcome of the CUSMA joint review, set for July 1, 2026, remains highly uncertain. Our analysis suggests that the current US tariff regime that Canada is facing probably won't get much better and could get worse. Third, bond yields have been rising, driven by increased term premium from the US and, more recently, growing inflation expectations and markets repricing central bank policy interest rates higher. If interest rates continue to rise, this could erode federal fiscal fortunes. As such, the Government of Canada would be well advised not to bank on a future fiscal windfall and should maintain the flexibility it has left for potential future needs.

Conclusion

Events since Budget 2025 have been broadly positive for the federal fiscal outlook. This has allowed the Government of Canada to increase spending without entirely erasing the deficit and debt windfall generated by upward revisions to nominal GDP and stronger growth. Hence, Canada remains one of the "cleanest fiscal dirty shirts" among advanced economies, a view reinforced by solid investor demand for government debt. But this shouldn't be taken for granted, as the risks to the federal fiscal outlook are tilted to the downside. Keeping some fiscal powder dry for any future need would be wise.