2025

Federal Budget

Constructive Pivotal Budget

Budget 2025 proposes a pivotal shift toward smarter spending and protecting Canada's AAA credit rating.

Moderate Reallocation Between Operational and Capital Spending

The new capital budgeting framework divides total projected expenses – of $586B in FY 2025–26 – between day-to-day operational expenses and capital spending. Operational expenses will account for the bulk of this amount despite the shift toward pro-growth investment policies, at $546 billion in FY 2025-26. Operational expenses are expected to dip briefly by 1.5% in FY 2026–27 before rising again gradually over the medium-term. The brief drop, which could be characterized as a flash austerity moment, will notably be driven by restructuring operations and reducing the public service workforce by 10% compared to its peak reached in FY 2023–24. The ultimate objective of the proposed expenditure review is to find $13B in annual recurrent savings.

Annual capital spending is projected to nearly double, from $32B in FY 2024–25 to $55B in FY 2029–30. Most of this increase will occur in FY 2025–26 and FY 2026–27. Among flagship policies aimed at catalyzing investment and productivity, the new productivity super-deduction allowing companies to write off faster new capital investments tied to clean energy, AI and manufacturing is a good response to the recent tax and domestic policy bill implemented in the U.S. Also, a new fund will provide federal support for housing, transportation and health infrastructure projects in communities. Provinces will need to match federal contributions to get access to funding and reduce development charges that currently limit housing supply. Additional funding will be dedicated to Transport Canada to build infrastructure that supports exports and unlocks new non-U.S. markets.

In addition, Ottawa will use its various levers of government-led financing. Canada Infrastructure Bank and the Business Development Bank will get more funding for instance to support Indigenous-led projects and AI initiatives. The federal government also puts $2B aside to take out equity stakes in critical mineral projects and aims to attract capital from institutional investors. *Budget 2025* also proposes to amend legislation to facilitate the expansion of credit unions. Among targeted measures, Budget 2025 drops the luxury tax on planes priced over $100K and boats priced over $250K, effective immediately, and the underused housing tax on foreign ownership by non-residents.

Budget 2025 also introduces new immigration targets. The number of new permanent residents is set at 380,000 per year for the next three years. This objective is lower than the 395,000 target of 2025; however, the plan is to increase the share of economic migrants. At the same time, temporary resident admissions will be cut nearly in half over three years, reaching 370,000 by 2028.

Deficit Projection: From Large to Moderate Over Time

The largest annual deficit projected over the next five years is in the current fiscal year. The proposed $78B shortfall in FY 2025–26, or 2.5% of NGDP, marks a significant fiscal expansion compared to the $36B deficit of the prior year. Almost all of this deterioration is driven by higher spending. Total revenues are projected to edge down by 0.7% in FY 2025–26 relative to the year before due to the cancellation of the consumer carbon tax last April. Under the new spending framework, $33B of the $78B shortfall, or 42%, is tied to operational expenses.

The 5-year outlook proposes a gradual, moderate reduction of the deficit size over time. It begins with a $65B shortfall in FY 2026–27 (2.0% of NGDP) before culminating in a $57B deficit in five years (1.5% of NGDP). As discussed in our federal budget preview report, the goal of balancing operational expenses with fiscal revenues within three years is a very soft fiscal anchor. As such, the entire deficit of $57B proposed in FY 2029–30 will be exclusively driven by capital expenditures.

The proposed deficits are large enough to bring the net debt-to-NGDP ratio on a modest upward path for three years, followed by a stabilization. This ratio, projected at 41.2% in FY 2024–25, is expected to peak at 43.3% in FY 2027–28 and settle at 43.1% in FY 2029–30. This trajectory does not appear to threaten Canada's AAA credit rating.

GoC Bond Issuance Down in FY 2026–27

The Debt Management Strategy (DMS) for FY 2025–26 includes an increase in the 30-year benchmark size range, from $22–32 billion to $28–38 billion, to maintain the current benchmark building cycle is maintained. Total Government of Canada (GoC) issuance for FY 2025–26 is virtually unchanged at $316B versus $315B in the DMS plan released last July. T-bill issuance has been revised slightly upward to $293 billion from $285 billion.

Budget 2025 projects a modest drop in GoC issuance in FY 2026–27, to $298B. This decline is mainly due to lower refinancing needs in FY 2026–27. Just over half of the decline comes from a $10 billion reduction in the issuance of 2-year Government of Canada bonds, now projected at $110 billion. Issuance of 5-year and 10-year Government of Canada bonds has remained fairly consistent in recent years. In FY 2026–27, both are projected at $80 billion, slightly below the $84 billion issued in FY 2025–26.

DMS pegs T-bill issuance at $291B in FY 2026–27, just below this year's level. The main takeaway is that federal financing will be split almost 50-50 between bonds and T-bills.

There is no change to green bond annual issuance, which is projected to remain at $4B in FY 2026–27. *Budget 2025* also maintains Canada Mortgage Bonds (CMBs) purchases at up to $30B per year. To support the goal of boosting housing supply, the federal government will increase the CMB annual issuance limit to $80B from $60B, starting in 2026.

Takeaway

Budget 2025 unveils a moderate fiscal expansion compared to the 2024 Budget. It proposes moderate, rather than excessive, deficits over time to propel economic growth, a challenging goal given considering ongoing economic uncertainty. As such, the budget should be considered as a positive pivotal moment rather than a guaranteed transformational structural shift to the Canadian economy. The federal government did not go "all in," as shown by the absence of major, across-the-board business tax income relief. Ultimately, the success of *Budget 2025* will depend on the economic multiplier of the proposed funds and levers available.

The reallocation of spending is also moderate and pragmatic. It may not be more ambitious because a larger shift could have seemed unrealistic. As usual, one can see the glass as half-full or half-empty. The plan to balance the operating budget within three years acts as a very light fiscal anchor, especially since the structural deficit is expected to remain moderate due to higher capital spending. At the same time, keeping the deficit-to-GDP ratio at or below 2.5% going forward—well below the 5–6% range seen in the U.S., the UK, and France—reflects an effort toward the preservation of fiscal sustainability. Despite the rapid shift in global trade dynamics, the new U.S. administration isn't solely responsible for structural deficits. After all, Budget 2025 estimates that U.S. tariffs are contributing to a direct fiscal drag of $7 billion per year.