TD Economics

2026 Federal Budget
Money In, Money Out

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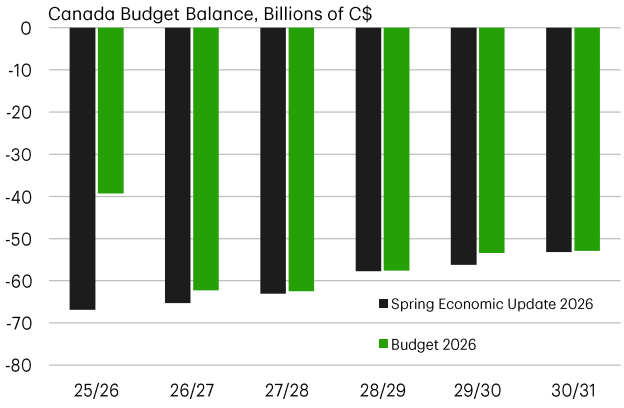
Prime Minister Carney's second budget maintained a focus on fostering a longer-term boost to investment, endearingly adopting TD Economics' reference of an investment supercycle. Measures focused on major projects, productivity, competitiveness and growth, along with a smattering of initiatives aimed at affordability and supporting low-income Canadians. Despite a hefty page count, net new initiatives were light because the government had already front-run many measures publicly ahead of the budget: Productivity Mega Deduction, tariff relief, and enhancements to the early learning and childcare agreements with the provinces.

The significant revenue windfall from stronger-than-expected growth and higher energy prices was recycled into spending to support the focus on productivity and competitiveness. Of course, this means that the fiscal state of the government is getting murkier. Although the deficit picture remains aligned to the Spring Economic Update, there's no escaping that the debt and borrowing picture is deteriorating. This is because the accounting framework masks the near-term cash needs that come with direct investment and large capital outlays. The net result is public debt charges as a share of revenues are expected to rise from 11.1% this fiscal year to 13.6% by 2030-31. This is still far from the 30% in the 1990s, but it is growing when investor attention on public finances is sharpening and the unfavourable trend could bring scrutiny from markets if there's financial slippage from this guidance in the future.

Economic and Fiscal Updates

Absent policy actions, windfall revenues from higher energy prices and a more elevated GDP outlook should have cut the budget deficit by 2030-31 from $53.2 to $20.8 billion. However, spending initiatives have absorbed all that additional space, and the budget deficit is expected to still hold at $52.9 billion by the end of the projection horizon. The deterioration in the fiscal outlook for the outer years is the product of government's spending priorities and the large corporate tax cut delivered through the Productivity Mega Deduction. The tax cut, coupled with additional funding for supports to offset tariffs, a one-time payment for the Groceries and Essentials benefit, and infrastructure for indigenous communities lifts total expenses to $685.7 billion by 2030-31, compared to $672.5 billion in the Spring Economic Update (SEU). The good news is that the starting point is looking better.

Chart 1: Spend It If You Got It



Source: Department of Finance Canada, TD Economics.

Real GDP growth assumptions were downgraded relative to the SEU for 2027 after the August tariffs were announced. Growth is now assumed to register 1.7% in 2027 before accelerating to 2.0% in 2028 and 2029. This is slightly above TD Economics' forecast of 1.8% but isn't a material gap. Importantly for the fiscal outlook, nominal GDP is expected to be $45-$50 bil-

lion bigger each year of the projection horizon and the budget is starting on a better-than-expected footing.

The deficit in fiscal 2025-26 of 1.2% of GDP is a much better outcome than the expected deficit of 2.1% in the SEU. However, the government was unable to fully capitalize on this better starting point due to needed initiatives to pivot the economy into a more competitive position. Although the deficit widens back to 1.8% of GDP in 2026-27, it remained in close alignment to SEU expectations. Thereafter, it gradually declines on assumptions of a much-improved revenue and expense outlook.

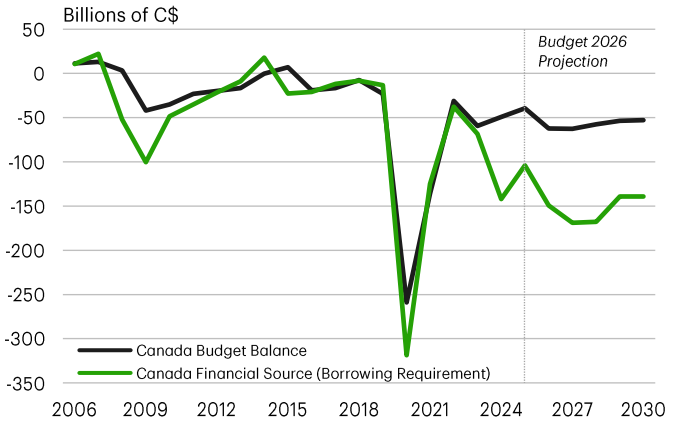
Windfall profits from higher energy prices have provided a level shift to the size of the economy. Coupled with a rosier growth expectation, the revenue projection gets a lift by an average of roughly $24 billion per year. Direct program expenses too are expected to be smaller (~ $12.4 billion per year), helping to lower total expenses by ~$11 billion per year. Importantly, these savings reflect changes to expectations for the timing of program uptakes (e.g. deferred battery manufacturing supports) and capital amortization expenses. Nonetheless, the total improvement to the fiscal picture is $175 billion between 2026-27 and 2030-31.

What this all means for debt is a rise from 39.9% of GDP this year to a peak of 40.4% in 2028-29, before the curve bends through 2030-31. This path adds $226 billion in debt to the economy over that time horizon. Like other countries, Canada will feel the weight of higher debt, even though it remains better positioned among its G7 peers. This will be an ongoing theme for bond markets to watch in the coming years. One datapoint that markets will likely embrace is that the operational deficit is expected to flip to surplus in 2027-28, one year ahead of Budget 2025 and in line with prior expectations.

Public debt charges are now expected to be $12.7 billion higher through 2030-31 relative to what the government reported in the SEU. That reflects issuance rising to $606 billion in the 2027-28 fiscal year, compared to $566 billion previously expected in the SEU and a higher interest rate profile over the budget horizon.

The fiscal shortfall reflects a pull-forward of public borrowing necessary to finance loans to Crown corporations and to pay for large capital and defense purchases. For instance, the cash requirements (those that need to be paid through revenues or borrowing) for core defense spending are projected at $451 billion. Only $303 billion will register according to accounting rules. The important thing here is that interest must be paid on the debt that is borrowed, causing the interest bill to rise more than the deficit would suggest. Looking out, the divergence between the annual borrowing requirements and the reported deficit figure could remain wide if government continues its capital plan.

Chart 2: Deficit Masks Actual Cash Requirements



Source: Department of Finance Canada, TD Economics.

New Spending Initiatives

The big story was the upward revision of $175 billion in the fiscal picture through 2031, mainly a result of higher revenues and reduced program spending. That additional ammunition gave the federal government capacity to announce $141.8 billion in net new spending, across tax and competitiveness, affordability and homelessness, supporting journalism and the arts, Indigenous Reconciliation, and Defense. Some of the additional spending was choreographed ahead of time, but there were a number of net new measures and additional detail on previous announcements.

Competitiveness and business taxation

- The headline spending initiative was the previously announced Productivity Mega Deduction, which amounts to $36 billion over 5 years. As we discussed in our commentary, the policy allows immediate 100% expensing of a wide range of capital investments for firms of all sizes. The government estimates that the measure lowers the marginal effective tax rate on new investment, opening a 10 percentage point gap relative to the U.S. and creates a permanent upward shift in GDP of $22 billion.

- A new $15 million capital gains exemption for small businesses, called the Canada Growth Incentive. The government estimates the cost at $715 million over 4 years beginning in 2027-28.
  - This exemption is modeled after similar tax incentives in the United States and intended to directly address Canada's tax competitiveness.
  - This new exemption sits on top of the existing lifetime capital gains exemption and allows each investor or owner of a small business access to the exemption on disposition of shares with additional $15 million exemptions available per business or investment.
  - This is clearly aimed at start-ups in sectors-of-interest, focusing on those with high capital mobility, including technology & software. The supplementary information was quick to exclude a raft of industries from accessing the exemption, including any professional service, finance, health care, forestry, agriculture, mining, real estate, food & accommodation, arts & entertainment, and franchise owners.
  - The exemption is also exclusive to Canadian tax residents, meaning foreign investors cannot take advantage of the incentive.
  - We view the move as generally positive for growth & competitiveness in retaining domestic capital. The sectoral restrictions are aimed at preventing the measure of contributing to aggressive tax planning, but could present implementation issues by excluding innovation activities occurring in some high-growth firms.
- Budget 2026 also expands the Scientific Research & Experimental Development Credit to apply to commercialization expenses, hoping to address a longstanding concern around firms conducting successful research & development, but struggling to commercialize the innovation. This measure is estimated at $935 million over 5 years and $235 million on an ongoing basis.

Affordability & Homelessness

- Top billing on the affordability side was an additional top-up for the re-branded GST/HST rebate, now called the Groceries and Essentials Benefit. This one-time 50% top-up mirrors an identical policy announced earlier this year and is in addition to the 25% increase in the rebate over 5 years beginning in 2026. This is expected to cost $4.7 billion over 5 years and will have a small, but material impact on our forecast for early 2027, as did the 2026 measure.

Table 1: Federal Budget 2026 Fiscal Summary
[Billions of C$ Unless Otherwise Noted]

Fiscal Year	25-26	26-27	27-28	28-29	29-30	30-31
Budgetary Revenues	**526.4**	**540.3**	**564.2**	**581.5**	**607.7**	**629.1**
Program Expenses	498.5	542.7	559.3	568.3	586.3	600.2
Public Debt Charges	53.5	60.2	67.3	73.8	78.4	85.5
Net Actuarial Losses (Gains)	13.6	-0.4	0.2	-3.0	-3.6	-3.7
Total Expenses	**565.7**	**602.6**	**626.8**	**639.1**	**661.1**	**682.1**
Budget Balance	**-39.3**	**-62.3**	**-62.5**	**-57.6**	**-53.4**	**-52.9**
Federal Debt	**1,306.1**	**1,366.5**	**1,429.0**	**1,486.6**	**1,540.1**	**1,593.0**
Per Cent of GDP						
Budgetary Revenues	16.2	15.8	15.9	15.8	15.9	15.8
Program Expenses	15.4	15.8	15.7	15.4	15.3	15.1
Public Debt Charges	1.6	1.8	1.9	2.0	2.0	2.2
Budget Balance	-1.2	-1.8	-1.8	-1.6	-1.4	-1.3
Federal Debt	40.2	39.9	40.2	40.4	40.3	40.1

Note: Totals may not add due to rounding. Source: Department of Finance Canada, TD Economics.

- Budget 2026 also proposed to replace the Canada Workers Benefit by lowering the minimum earnings threshold and increasing the maximum benefit at a cost of $2 billion over 4 years.
- In perhaps one of the most ambitious goals, the federal government announced an intention to end homelessness, allocating $11.2 billion over 4 years and $17.8 over an unspecified future time horizon in order to build dedicated supportive housing and wrap-around services such as heath, mental health and social support services. In addition, the budget also allocates $13 billion over 10 years to Build Canada Homes to "supercharge" non-market housing construction.

Climate, Clean Energy and Indigenous Reconciliation

- Budget 2026 expands on the government's Clean Technology and Clean Electricity Investment Tax Credits by extending these programs through 2040. In addition, the latter credit now includes high-voltage intraprovincial transmission in the hopes of meeting the government's target of doubling the country's electricity capacity by 2050. In total, the Budget allocates $8.7 billion over 5 years on expanding the grid.
- Just last month, Prime Minister Carney announced a new program aimed at clean energy home retrofits, providing up to $2000 per household switching from fossil-based heating to electric. This measure was estimated at $1.3 billion over 5 years and could move the dial on emissions somewhat. The Canadian Climate Institute assessed that emissions rose in 2025 due primarily to increased emissions from buildings given a particularly bitter winter season.
- The federal government allocated $26.6 billion over 5 years in funding for Indigenous Communities across housing, infrastructure, clean water, health care, education and support for children and represents the largest net new spending bucket not previously announced.

Defense

- The federal government noted that it is well on its way to reach its mandated 5% of GDP NATO spending target and expects to reach 4% by 2030. Budget 2026 allocated an additional $17.1 billion less $10.6 re-allocated from the fiscal framework.
- Notably, the budget transparently showed the difference in cash versus accrual expenditures, showing $148 billion gap between the two over 5 years. Actual cash outlays total $451 billion through 2030-31.

Little Detail on Immigration Plans

The government is maintaining a target of 380,000 permanent resident arrivals between 2027 and 2029, and 370,000 new temporary resident arrivals over the same period. More details are expected to come when the Minister of Immigration, Refugees and Citizenship tables the Annual Report to Parliament on Immigration. Notably absent from the document was an affirmation of the government's target that Non-Permanent Residents (NPRs) should make up 5% of the population. This leaves the question on whether the government is going to maintain their policy in the update. Any changes in stance would have material impacts on the trajectory of the country's population, as the reduction in the number of NPRs in the country has been the primary drag on population growth.

Conclusion

So how do we think about this budget? The broader strategy taken by the Carney government can be summarized as: more direct investment, more tax expenditures, and more picking winners and losers in the hope that de-risking major projects will pull in private capital. But in doing so through loans and equity positions, higher cash outlays do not end up as expenditures, which muddies the waters for assessing the government's books. A fulsome assessment of the fiscal picture is more difficult because it requires looking at the budgetary balance, financial requirements, public debt charges, net debt, and the accumulated deficit all at once to get a more holistic view.

This coin has two sides. On the one side, it opens up difficulty for Canadians to understand what taxpayers are ultimately on the hook for, but it also suggests that the program spending understates just how much government is doing to move the dial on what many agree are important priorities: diversifying trade, building infrastructure and ultimately raising the country's productivity and standard of living. This budget is titled Masters of our Destiny, but that also asks Canadians to take a lot on faith.

Exhibits

Table 2: Federal Budget 2026 Economic Assumptions					
[Annual % Change Unless Otherwise Noted]					
Calendar Year	2026	2027	2028	2029	2030
Real GDP					
Spring Economic Update 2026	1.0	1.9	1.9	1.9	1.8
Budget 2026	**1.0**	**1.7**	**2.0**	**2.0**	**1.9**
TD Economics Forecast	0.9	1.6	1.8	1.8	1.7
Nominal GDP					
Spring Economic Update 2026	4.1	3.7	3.8	3.9	3.8
Budget 2026	**5.6**	**3.7**	**3.6**	**3.9**	**3.9**
TD Economics Forecast	5.5	4.3	3.7	3.8	3.8
Consumer Price Index Inflation					
Spring Economic Update 2026	2.5	1.9	2.0	2.0	2.0
Budget 2026	**2.8**	**2.2**	**1.9**	**2.0**	**2.0**
TD Economics Forecast	2.9	2.5	1.9	2.0	2.0
Unemployment Rate (%)					
Spring Economic Update 2026	6.5	6.2	6.1	6.0	5.9
Budget 2026	**6.6**	**6.2**	**5.9**	**5.9**	**5.8**
TD Economics Forecast	6.6	6.4	6.0	5.9	5.9
3-Month Treasury Bill Rate (%)					
Spring Economic Update 2026	2.2	2.5	2.7	2.6	2.6
Budget 2026	**2.3**	**2.6**	**2.7**	**2.7**	**2.7**
TD Economics Forecast	2.3	2.5	2.3	2.3	2.3
Source: Department of Finance Canada, TD Economics.					

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