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High political drama attends Ottawa's much-anticipated update

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Note: In a rather dramatic sequence of events, Canada's Deputy Prime Minister and Finance Minister Chrystia Freeland announced her resignation on Monday, December 16th—the same day she was scheduled to present the minority Liberal government's much-anticipated Fall Economic Statement. Despite the extraordinary political volatility created by Freeland's surprise resignation, the government's FES was still tabled (without an accompanying speech), while Dominic Leblanc was simultaneously sworn in as Canada's new Finance Minister. A summary of key elements of the FES follows, although the government's ability to maintain the confidence of parliamentarians will ultimately need to be confirmed. All this comes at a pivotal time for an underperforming Canadian economy. US President-elect Trump has threatened punishing tariffs, adding tremendous uncertainty to the economic and fiscal outlook. Clear/decisive action is likely to be needed by Canadian leaders at different levels of government across the country. Readers should note that Canada's political situation is extremely fluid.

Highlights

On a truly extraordinary day for the ruling Liberal government, a long-awaited fiscal update included considerably more red ink for 2023-24. The ~$62 billion shortfall confirmed for last fiscal year broke (by a wide margin) an earlier pledge to limit the deficit to $40 billion. The prior year's budgetary deterioration reflected extra provisions for Indigenous liabilities and lower repayments of COVID supports. Despite the larger deficit, the 2023-24 debt burden was kept at 42.1% as the government benefited from meaningful upward revisions to nominal GDP. For the current fiscal year, Ottawa now projects a deficit of $48.3 billion (or 1.6% of GDP), which marks a deterioration vs. the $39.8 billion shortfall flagged in April. As it stands, the government aims to respect an earlier promise to reduce the deficit to less than 1% of GDP by 2026-27. Meanwhile, a declining debt-to-GDP ratio over time is still the so-called 'fiscal anchor', upward adjustments to GDP seemingly allowing the feds to carry more debt without breaching this notional covenant. (Never mind that the debt burden increased year-over-year in fiscal 2023-24.) Consistent with the fiscal erosion, there's quite a bit more borrowing to be done, a mini funding update steering marginal supply to both bills and bonds. While a previously announced temporary GST holiday stays, Ottawa has opted against a $250 rebate that was to arrive early in 2025. Elsewhere, there was policy action across a number of fronts. Perhaps most significant was new tax relief designed to spur investment. While headed in the right direction, it's not clear to us that the marginal incentives to boost investment and research will be sufficient to drive the type of productivity renaissance our relatively stagnant economy so desperately needs. Nor does the $1.3 billion over six years for border security look particularly transformative, where action (or the lack thereof) is sure to be closely scrutinized by the incoming Trump administration. While some marginal dollars were steered to national defense, Canada still looks to be far removed the level of spending NATO members are to commit to. This is another potential thorn in the side of Canada-US relations. Most significant of all, of course, are threatened US tariffs, which if implemented would massively upend Canada's economic prospects. Simply put, geopolitical risk factors add a high degree of uncertainty to this budget update. So too does the unsettled political backdrop in Ottawa, with the current administration is in ongoing need of opposition party support in a minority parliament.

- **Economic outlook** — A lot has changed in the Canadian economy since the last federal budget was presented in the spring: inflation is back at the 2% target, the Bank of Canada has lowered its policy rate from 5% to 3.25%, historical GDP figures have been revised significantly upwards, Donald Trump has been elected President of the United States and is threatening tariffs on Canadian exports, and the federal government's immigration policy for the coming years has been completely overhauled.

  Since 1994, the private sector consensus has been used as the basis for fiscal planning. No change here, with the latest survey conducted in September. Since the 2024-25 Budget, real GDP growth has been revised upwards for 2024, from 0.7% in the spring to 1.3% today. This improvement is largely due to stronger-than-expected population growth, more robust wage growth which has stimulated consumption, and a positive revision to historical data. Looking ahead to 2025, real GDP growth is expected to accelerate to 1.7%, lower than the 1.9% increase forecast in the Budget, mainly due to a major change in immigration targets. It should also be noted that the survey of private sector economists was carried out before Donald Trump's election, and that the effect of his potential future policies has therefore not been considered in the growth forecasts on which the FES is based. In subsequent years, the Canadian economy should grow by 2.1% in 2026 and 2027, then by 2.0% in 2028 and 2029.

  As for nominal GDP, which has a much greater impact on public finances and fiscal anchors, the FES forecasts growth of 4.3% in 2024, an upward revision from the 3.7% anticipated in the Budget. This improvement is entirely due to the positive revision of real GDP, while GDP inflation remained stable at 3.0%. Nominal GDP growth should then slow to 3.7% in 2025 due to lower inflation. It should also be noted that the forecast for the coming year has also been revised downwards from the 3.9% initially anticipated this spring. In subsequent years, the consensus sees growth accelerating to 4.2% in 2026, before gradually slowing to 4.0% by 2029.

  If there's one place where the FES paints a far less positive picture, it's on the labour market front. Indeed, the unemployment rate in the country reached 6.8% in November. As a result, the average unemployment rate in 2024 has been revised upward from 6.3% at the time of the Budget to 6.4% today. While this revision may seem marginal, the one for 2025 is much more severe, as the jobless rate is expected to reach 6.7% on average next year, as opposed to the 6.3% initially forecast in the spring. In subsequent years, the unemployment rate is expected to remain higher than forecast in the Budget over the entire forecast horizon, moving from 6.2% in 2026 to 5.7% in 2029.

- **Final budgetary tally 2023-24** – At long last, the deficit for last fiscal year (i.e., 2023-24) is confirmed. As had been rumoured (feared?), the shortfall is considerably larger than previously telegraphed. Recall that the government had earlier committed to keep the 2023-24 deficit at or below the $40 billion level originally planned for in Budget 2023. In the end, however, the federal deficit ballooned to $61.9 billion in 2023-24, surpassing 2% of GDP. This hardly classifies as a rounding error, given that the ~$40 billion level had been reiterated (re-estimated) as recently as April. The much-enlarged deficit is largely a function of end-of-fiscal year adjustments, most significantly related to extra provisions for Indigenous contingent liabilities ($16.4 billion) and unrecovered COVID-related loans/supports ($4.7 billion). On the Indigenous contingent liabilities, these are dubbed "potential future payments… for which legal actions remain ongoing and are evolving". As to the late nature of the fiscal adjustment, the government notes that these Indigenous contingent liabilities were confirmed following the end of the fiscal year. So the 2023-24 deficit breaches an earlier pledge by a significant margin. However, the one-off nature of certain elements means current and future fiscal year balances are much-less radically altered, as we detail below.

- **Revised deficit for 2024-25** – As per the FES, Ottawa now pegs the 2024-25 deficit at $48.3 billion (or 1.6% of GDP). That represents a net deterioration of $8.5 billion vs. the April 2024 budget plan, where a deficit of $39.8 billion had been planned for. The in-year erosion captures both economic developments since the budget was first tabled and new policy actions (some of which had been announced prior to the FES and some of which were confirmed today). In all, post-budget policy actions add $5.5 billion to the deficit in 2024-25 (equivalent to a marginal 0.2% of GDP).

- **Medium-term budgetary outlook** – Although to be interpreted with some caution—given the evolving political backdrop in Ottawa—the FES presents a revised budgetary path on a five-year forward basis (i.e., way out to 2029-30). On balance, there is somewhat more red ink in future fiscal years than in Budget 2024, although the net deterioration in the average annual balance is relatively modest when scaled to federal revenue or nominal GDP. Certainly, the change vs. budget for future years is far less striking than what was confirmed for last fiscal year (i.e., 2023-24). And while clearly missing a self-imposed budget target for 2023-24, the FES repeats a separate pledge whereby the deficit-to-GDP ratio is to fall below 1% by 2026-27. Additional details on the government's most consequential and oft-repeated 'fiscal anchor'—the federal debt-to-GDP ratio—can be found below.

- **Debt burden & interest bite** – Given the considerably larger deficit for 2023-24, federal debt ended last fiscal year at $1,236 billion. In the end then, there was an extra $21 billion of unplanned debt as of March 2024. Note, however, that favourable (i.e., positive) revisions to nominal GDP—earlier reported by StatCan—aid the closely watched debt-to-GDP calculus. The debt burden ended 2023-24 at 42.1%, which perhaps not coincidentally exactly matched the ratio last estimated in Budget 2024. Less clearly acknowledged is the fact the year-over-year increase in the debt burden is larger than previously envisioned. Meanwhile, the FES reiterates that the government's primary fiscal objective—its so-called 'fiscal anchor'—remains a declining federal debt-to-GDP ratio over time. So, after increasing last fiscal year, the fresh fiscal plan sees debt-to-GDP edging down slightly starting in 2024-25 (to 41.9%). Given the medium-term fiscal profile, the base case scenario would see debt-to-GDP stepping down each fiscal year through 2029-30 (where a ratio of 38.6% is loosely estimated). Again, to be clear, there is to be more federal debt outstanding than the earlier forecast, offset to a degree by the improved starting point for nominal output. In the meantime, federal debt charges are expected to consume nearly 11% of total federal revenue in 2024-25 and future years. This interest bite had averaged closer to 7% of revenue pre-COVID, with the annual interest bill having more than doubled in the past two fiscal years (i.e., from 2022-23 to 2024-25). Notwithstanding the weaker budgetary picture painted here (vs. budget), there was the standard section highlighting Canada's relatively favourable fiscal characteristics vs. many advanced peers. That includes the lowest general government net debt-to-GDP ratio in the G7 and what the FES labeled "Canada's lower interest rate advantage". The FES also referenced work by the non-partisan Parliamentary Budget Officer that had earlier characterized federal fiscal policy as sustainable over the long-term. These reminders are presumably designed to defray concerns over larger federal deficits and today's heavier debt load.

- **New Initiatives** – The 2024 FES calls for a marginal stimulus of $21.3 billion through 2029-30. The budget is broken down into three chapters, which shine a spotlight on cost reduction, investment initiatives, and safety / governance. Key components are highlighted below:

  Reducing Everyday Costs ($3.15 billion): The most prominent item in this chapter is what the government is calling "a Tax Break for All Canadians", or the two-month GST/HST holiday announced earlier. $1.64 billion has been earmarked for this measure. Note that the $250 rebate cheques initially announced are not included in this FES. Also in this chapter are a handful of housing-related measures which include interest-free loans for homeowner costs associated with energy retrofitting and additional funding for the Federal Community Housing Initiative.

  Investing to Raise Wages ($18.5 billion): This is the chapter in the FES where more dollar signs are attached. The largest fiscal impact comes in the form of **extending the Accelerated Investment Incentive** (AII), with an estimated cost of $17.4B extending through to 2029-30. The FES proposed to fully reinstate the AII with the goal of bolstering investment in domestic businesses. The tax measure will allow for enhanced capital cost allowances for manufacturing or processing machinery and equipment, as well as clean energy generation, conversion or vehicular equipment. The government aims to ensure that Canada's corporate tax setting remains competitive amongst the G7, highlighting that Canada's marginal effective tax rate is currently the lowest in the bunch. The government also looks to strengthen Canada's AI sector by announcing the **Canadian Sovereign AI Compute Strategy**, which will provide $2.4 billion within the next six years aimed at "securing Canada's position as a global AI leader". The FES also outlines the Feds' plans to '**unlock pension investment in Canada**'. Specifically, the Statement outlines intent for a few plans, including removing the 30% rule for Canadian entities, making it easier for domestic pension funds to invest. The fiscal update also announced that the government is exploring easing restrictions on private sector ownership of municipal-owned utility corporations, and consulting on potential regulations that seek to increase transparency of pension fund investments for larger federally regulated plans. Another prominent item in this chapter aims at '**Boosting Scientific Research and Development**' (SR&ED) through tax incentives. The FES proposes a handful of new enhancements to the SR&ED program, including extending the enhanced refundable credits to publicly traded Canadian companies, increasing the annual expenditure limit for the enhanced 35% investment tax credit for private corporations, and raising the taxable capital phase-out thresholds for the enhanced credit. These proposals sum to a projected $1.9 billion in cost over the next 6 years. Of this, $0.75 billion would be sourced from Budget 2024 funding.

  Safety, Security, and Fair Governance (+$0.5 billion): Stronger penalties for financial crime (+$0.63 billion) and cracking down on tax evasion (+$2.88 billion) leaves this 'chapter' as a source of net revenue, although there are some additional spending initiatives. Of note, $1.3 billion has been allocated to **securing the border**, addressing an issue raised by President-elect Trump. The FES also proposes to provide a package to

Public Safety Canada, Canada Border Services Agency, Communications Security Establishment and the RCMP to protect public safety and the integrity of our immigration system. Also in the realm of public safety, the FES proposes a 3-year, $0.6 billion plan to fund Public Safety Canada and the RCMP in their goal to **remove prohibited firearms** from communities.

- **Update to the Debt Management Strategy** – With a larger-than-planned deficit and additional non-budgetary transactions, there are naturally questions of how this will be funded. An update to the Debt Management Strategy can provide some answers, although guidance on the borrowing program is confined to 2024-25 (i.e., the next three months). Nonetheless, we'll walk through some important takeaways for the remainder of the fiscal year:
    - The government will issue an additional $23 billion Treasury bills relative to Budget 2024 guidance, the year-end outstanding target being upgraded to $295 billion from $272 billion.
    - The $224 billion gross bond issuance signaled in the April DMS has also been revised up. There will be an additional $13 billion bonds sold in 2024-25.
    - Together, this amounts to $36 billion in net new supply relative to what had been laid out in the budget (a 7.2% increase).
    - The $13 billion of marginal bond issuance will be distributed as follows: +$6 billion in 2-years, +$3 billion in 5-years, +$3 billion in 10-years and +$1 billion in 30-years. Note that new bond supply is distributed on the curve *broadly* in proportion to the prior plan, so there's no major impact on the weighted average term. However, a disproportionate share of new requirements will be funded in the bill market which means the overall debt stock will be shorter in term than the prior plan.
    - To account for increased bond issuance over the next three months, benchmark sizes have been revised up across the board (from $2 billion in the long end to $6 billion in 2s and 10s). In addition, a fifth 2-year auction will be added to the quarterly bond schedule (which is likely to be published later this week).
    - As for auction sizes, we can infer that tenders for the final quarter of the fiscal year will be as follows: $5.5 billion for 2-years, $6 billion for 5- and 10-years and $2.5 billion for 30-years.
    - When it comes to the green bond program, the government intends to issue $2 billion over the rest of the fiscal year. Together with October's $2 billion reopening of the March 2033 green bond, the government would reach its planned $4 billion of issuance from Budget 2024.
- **Current long-term credit ratings** — S&P: AAA, Stable | Moody's: Aaa, Stable | DBRS: AAA, Stable | Fitch: AA+, Stable
  [Refer to our Provincial Ratings Snapshot for additional colour on specific credit rating drivers/considerations]

Summary Statement of Transactions

Table A1.6

Summary Statement of Transactions

billions of dollars

	Projection						
	2023-2024	2024-2025	2025-2026	2026-2027	2027-2028	2028-2029	2029-2030
Budgetary revenues	**459.5**	**495.2**	**516.2**	**537.1**	**563.1**	**586.3**	**612.8**
Program expenses, excluding net actuarial losses	466.7	485.7	500.3	509.3	529.7	549.7	570.3
Public debt charges	47.3	53.7	54.2	57.6	62.0	66.3	69.4
Total expenses, excluding net actuarial losses	**513.9**	**539.5**	**554.5**	**567.0**	**591.7**	**615.9**	**639.7**
Budgetary balance before net actuarial losses	-54.4	-44.3	-38.3	-29.8	-28.6	-29.6	-27.0
Net actuarial losses	-7.5	-4.0	-3.8	-1.1	-1.8	1.9	4.0
2024 Fall Economic Statement budgetary balance	**-61.9**	**-48.3**	**-42.2**	**-31.0**	**-30.4**	**-27.8**	**-23.0**
Financial Position							
Total liabilities	2,057.8	2,150.9	2,268.5	2,363.7	2,463.6	2,559.8	2,643.7
Financial assets	705.0	748.2	819.3	879.5	945.8	1,010.7	1,067.7
Net debt	1,352.8	1,402.7	1,449.2	1,484.2	1,517.8	1,549.1	1,576.0
Non-financial assets	116.6	121.3	125.6	129.6	132.9	136.4	140.3
Federal debt[1]	**1,236.2**	**1,281.5**	**1,323.6**	**1,354.6**	**1,385.0**	**1,412.7**	**1,435.7**
Per cent of GDP							
Budgetary revenues	15.7	16.2	16.3	16.3	16.4	16.4	16.5
Program expenses, excluding net actuarial losses	15.9	15.9	15.8	15.4	15.4	15.4	15.3
Public debt charges	1.6	1.8	1.7	1.7	1.8	1.9	1.9
Budgetary balance	-2.1	-1.6	-1.3	-0.9	-0.9	-0.8	-0.6
Federal debt	42.1	41.9	41.7	41.0	40.2	39.5	38.6

[1] The projected level of federal debt for 2024-25 includes an estimate of other comprehensive gains of $0.4 billion for enterprise Crown corporations and other government business enterprises, and an estimate of $2.6 billion for net remeasurement gains on swap agreements, foreign exchange forward agreements, and other financial instruments.

[2] Numbers may not add due to rounding.

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