Scotiabank
GLOBAL ECONOMICS
FISCAL PULSE
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Contributors

Rebekah Young
VP & Head of Inclusion and Resilience Economics
Scotiabank Economics
416.862.3876
rebekah.young@scotiabank.com

Canadians Heading to the Polls

A PRELIMINARY GUIDE TO BALLOT BOX BUDGET ISSUES

- **It is near-impossible to lock down economic forecasts with any degree of precision these days, let alone a fiscal outlook. Geo-political turmoil, trade tensions, and broader policy uncertainty cloud the horizon, while imminent federal elections compound this unpredictable outlook.**
- **A more expansionary fiscal stance looks likely under almost any scenario. Recall, the federal government had expected to run a deficit of 1.6% of GDP in FY25 ($48 bn) declining to 0.6% by FY30 when it tabled an (ill-fated) update last December.**
- **The chill of uncertainty alone, along with the cancellation of the capital gains tax increase and the removal of GST on first-time home purchases, could add ~$57 bn to the bottom line over the planning horizon. This would drive a delayed and more gradual reduction of the deficit—from close to 2% of GDP in FY25 to 1% by FY30 (chart 1).**
- **If tariff threats materialise, it wouldn't be unreasonable to see an incremental $100 bn shortfall *on top* of this baseline as any government is very likely to actively support the economy in such a downturn. Stimulus over the course of such a crisis could be in the order of 2% of GDP (~$60 bn) with the remaining shortfall stemming from additional revenue losses owing to much weaker economic activity.**
- **Vying leaders will be setting out platform promises in this highly volatile context in what is shaping up to be a competitive race. Meanwhile Canadians are conditioned for high-priced campaign pledges and fiscal affairs sit low on their list of preoccupations (chart 2).**
- **Potential campaign pressures loom large even just looking at a couple of the big-ticket items both leading parties are likely to (have to) address. Middle income tax relief, along with ramped up military investments, alone could tally close to $50 bn.**
- **Both parties are expected to seek savings from expenditure restraint, but even aggressive attrition of the public service footprint would likely only make a small dent in spending pressures given compensation reflects only 12% of total federal outlays. The party to the right on balance may dig deeper when it comes to broader cuts to bring down the final price tag.**
- **There will be dozens of promises set out in the coming weeks and the country could very well be in a once-in-a-generation trade war by election day. This primer attempts to put some order-of-magnitude numbers into perspective.**

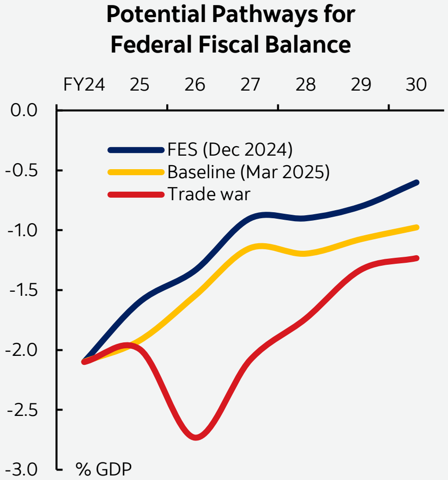
ROLLING RISKS

Canada's economic outlook is highly uncertain. Geo-political turmoil is already taking a toll on consumer and household confidence leading Scotiabank Economics to lower its growth **outlook** taking into account only currently-implemented policies, not outstanding threats. Stated threats—if executed—would result in substantially weaker economic growth against potential inflationary pressures.

The Bank of Canada is passing the baton to elected officials for now. The Governor has indicated its inflation-targeting mandate limits its ability to provide forward guidance in the current environment, while monetary policy can only smooth an adjustment to a permanently lower growth path in a trade war. Only elected officials can introduce fiscal and structural measures to make up for lost ground.

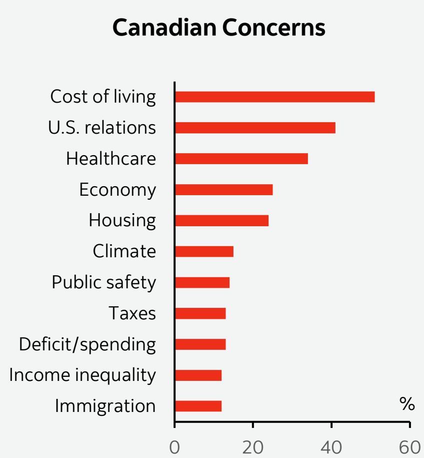
Canadians will choose who picks up that baton on April 28th. The widely-anticipated race is shaping up to be competitive. Over the next five weeks, voters will hear from vying leaders

Chart 1



Sources: Scotiabank Economics, Finance Canada.

Chart 2



Sources: Scotiabank Economics, Angus Reid Institute (Mar. 17, 2025).

where they might run with that baton if elected. There will be a deluge of promises and the Parliamentary Budget Officer will helpfully cost them out in due course. In the meantime, this provides a fiscal primer on some numbers to watch.

MARCH 24TH

The economic jumping-off point is not bad. Strong economic momentum at year-end likely leaves output modestly higher in 2024 relative to the last official update in December's Fall Economic Statement. At that time, finance officials had anticipated running a $48 bn deficit (1.6% of GDP) in FY25 (ending March 31st). Stronger revenue performance (through end-December) so far largely offsets expenditure misses, keeping the bottom line in line with earlier projections.

But expect near-term fiscal deterioration before the books are closed in a couple of weeks. The recent reversal of the capital gains tax increase would leave a $7 bn revenue hole in FY25 (and $25 bn over the horizon through FY30). Additionally, the recent slew of federal liquidity measures announced in response to trade threats may also carry modest budgetary impacts. This includes the $6.5 bn announced on March 7th and $40 bn in business tax deferrals on March 21st (starting in FY26), along with tweaks to employment insurance. The bulk of these liquidity measures would likely be non-budgetary, i.e., would have issuance implications but would likely carry only smaller budgetary provisions for losses. *The net effect suggests an FY25 deficit could once again approach $60 bn or almost 2% of GDP on par with FY24* (chart 3).

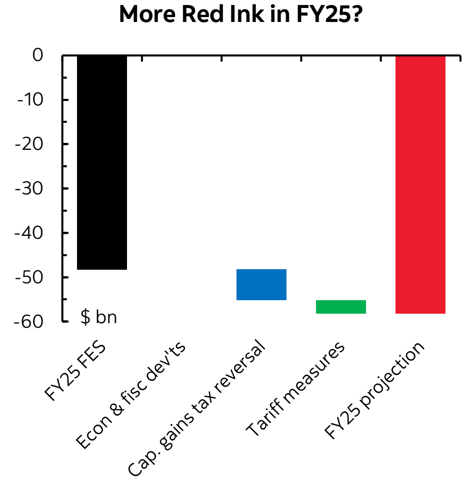
Beyond FY25, it is reasonable to expect a further erosion in the bottom line over the planning horizon. The PBO set out its fiscal outlook earlier in March—consistent with our own—which is essentially a placeholder for what's known to-date. The stronger revenue hand-off largely offsets the weakened growth outlook relative to the Fall update (nominal GDP sits 0.6 ppts lower by the end of 2026). The net effect would leave only a minor ($4 bn) incremental shortfall over the horizon (FY30) but this grows to $32 bn when the impacts of the capital gains tax cancellation on March 21st and the elimination of GST for first-time homebuyers on March 20th are folded in. Call this a mechanical 'placeholder' that applies no judgement on material risks on the horizon.

A more prudent 'baseline' would likely incorporate an additional budgetary buffer. This is less a forecast than a skate-to-where-the-puck-is going prediction. First, federal finance officials anchor their baseline around private sector forecasts. At least one has scrambled to be first-out-the-gate with a recession call and more are likely to follow. Expect officials to also include a risk margin consistent with past practices. Meanwhile, expect to see a continued roll-out of precautionary policy responses to stay a step ahead of trade threats and potential impacts. We would pencil in an *additional* $25 bn through FY30—for an incremental tally of $57 bn through FY30 relative to the Fall update—as the starting point while awaiting further policy clarity.

APRIL 2ND

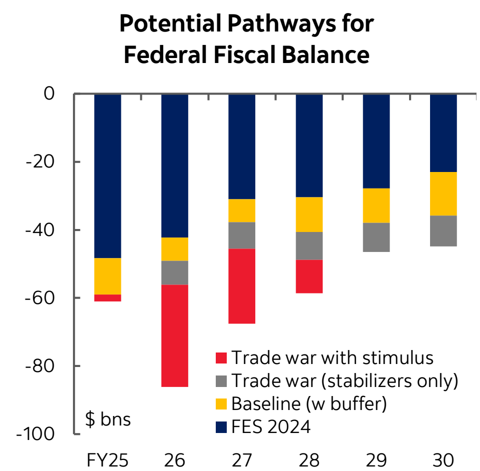
Canadian policymakers are otherwise bracing for April 2nd when Trump tariff threats materialize (or morph). The Bank of Canada estimates that output could be about 2.6 ppts lower than its non-tariff baseline over the next two years if stated threats are implemented and Canada retaliates as currently announced ($155 bn). This would essentially stall growth over this period, but would likely be a shallower recession than the Global Financial Crisis (GFC). It is not hard to imagine any range of deeper and darker scenarios but for now we consider the one for which the world is readying.

Chart 3



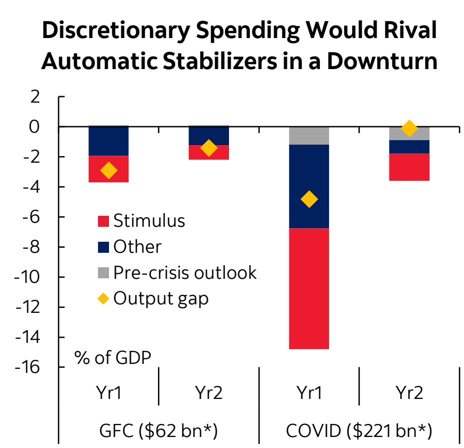
Sources: Scotiabank Economics, Finance Canada.

Chart 4



Sources: Scotiabank Economics, Finance Canada.

Chart 5



Sources: Scotiabank Economics, Statistics Canada.
**Total federal stimulus package.*

Automatic stabilizers would provide a first line of defence against this weakening outlook. Progressive taxation, employment insurance, and other social welfare programs that kick in automatically deliver the ultimate "timely, targeted, and temporary" response. This could add another ~$40 bn on top of our earlier baseline that had already incorporated some revenue losses—for a $92 bn deterioration in the five-year fiscal outlook relative to the Fall forecast—but before inevitable discretionary policy measures are incorporated (chart 4).

Policymakers could reasonably roll out a rescue package in the order of 2% of GDP in the event such a trade war materialises (or ~$60 bn in discretionary spending over ~ 2 years). This was broadly the GFC playbook, while pandemic spending blew through most benchmarks for more traditional economic downturns (chart 5). (*Scotiabank Economics will return to what policymakers 'should do' in such a scenario, but for now we put a number on what they 'might do' only to inform a potential range of direct fiscal impacts*.) Such discretionary measures could bring the total five-year shortfall closer to $160 bn through relative to the Fall update. (This tally does not include non-budgetary measures: liquidity support already tallies $46 bn.) In this illustrative scenario, the final price tag could be offset—potentially by several tens of billions—by retaliatory tariff revenues but this risks adding false-precision to highly speculative estimates.

These ranges are highly tentative not only due to external policy ambiguity but also domestic uncertainty owing to a leadership change at home.

APRIL 28TH

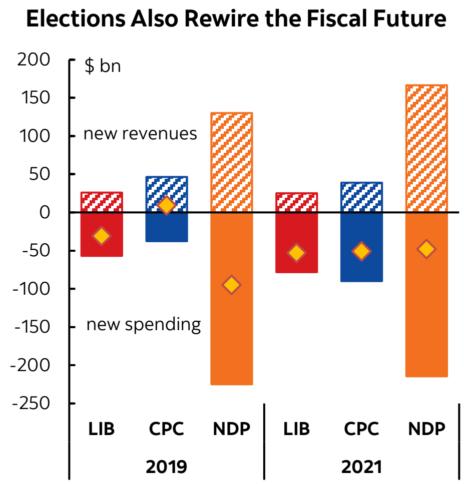
The fiscal outlook gets rewritten regardless of who takes the helm after April 28th. Over the next five weeks, vying candidates will set out policy platforms to guide the country not only through the coming quarters, but years ahead. Canadians are hardly preoccupied with the federal deficit right now as affordability, trade tensions, and healthcare dominate minds and hearts. Canadians are also conditioned to expensive promises: pandemic-era platforms came in at around a net $50 bn mark (over four years), while pre-pandemic campaign promises were mixed—but with the big spenders coming out on top (chart 6).

Neither leading party is campaigning on fiscal austerity. Both parties may be poised to spend when platforms are tabled and tallied (especially against mounting economic headwinds). The Conservatives' "fix the budget" slogan has not yet been quantified but it doesn't sound like they will "balance the budget" any time soon. The Liberals have promised to balance a new 'operating' budget within 3 years—which, absent a sharp economic deterioration, may be close to or already balanced depending on the definition—while suggesting they are setting the stage for greater capital investments over the medium-term.

Outside a full-blown economic crisis, military investments are among the largest fiscal deliberations facing the next government. The Liberals have already explicitly committed to accelerating Canada's 2% NATO target by two years (by 2030). The Conservatives have not explicitly made a commitment yet, but the geo-political landscape makes it increasingly difficult to avoid. Annual military spending currently sits around $41 bn (1.35%) while the 2% target suggests it would need to rise to about $76 bn annually by FY31 (chart 7). Only operating expenditures would be recorded as a budgetary expense, but the full increment could have issuance implications absent offsets. Assuming an historic 65% operating ratio, this suggests incremental budgetary investments of ~$25 bn beyond plan through FY30.

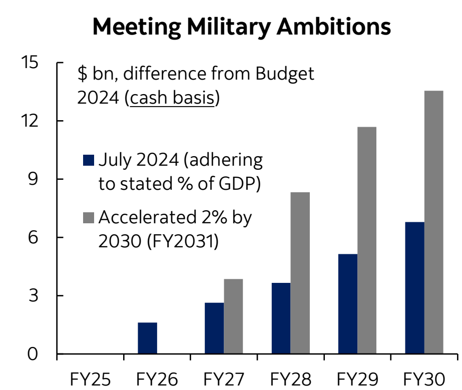
Both leading parties have alluded to tax relief for middle-income households. Both have committed to broader tax reform that could eventually offset the price tag, but the timing and sequencing is unclear. There would inevitably be a lag, along with implementation risk, to any comprehensive (but necessarily) tax review. Furthermore, many Canadian households

Chart 6



Sources: Scotiabank Economics, PBO.

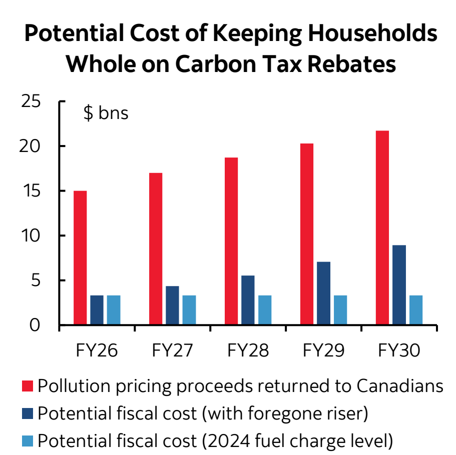
Chart 7



Sources: Scotiabank Economics, Finance Canada, PBO, DND.

Note: July's military spending profile likely understimated GDP materially. Dark blue reflects incremental increase if the ONSAF % of GDP were met (i.e., not the stated $ level).

Chart 8



Sources: Scotiabank Economics. Finance Canada, PBO (direct costs only).

may perceive a net-negative starting position for any tax relief with the final carbon rebate cheques going out on April 15th. The scheme has left most households in a net-positive financial position after netting out fuel charges paid (i.e., the consumer carbon tax) as rebates were income-tested. Sizing of any eventual personal tax cuts just to keep those households whole could run in the order of $15–20 bn through FY30 (chart 8). This would broadly align in magnitude with past campaign-trail tax cut pledges.

Both leading parties have also committed to reining in government spending. Growth in the public service is a particular lightning rod with a 40% increase in the headcount since 2015 (at 368 k in FY24). Budget 2024 had committed to reducing this count by 5 k over four years, whereas the Conservatives suggest a more aggressive attrition rate (~17k/year). An attrition rate of ~10 k /year (broadly consistent with the age profile of the public service) suggests any path to normalisation is likely slow (chart 9). Furthermore, compensation ($58 bn in 2024) reflects only about 12% of total federal expenditures. Cuts of any reasonable magnitude are only likely to deliver a couple billion in savings at best. Transfers to households and governments comprise a much larger 42% of total outlays and do not appear to be on the table. All this suggests there is no easy route to finding quick savings in the order of magnitude of potential spending pressures.

There will no doubt be a host of other promises in the weeks ahead including some potentially big-ticket ones not yet aired. Platforms often contain dozens of line items. We only touch on a few known ones where the fiscal impact could be quite substantial. Otherwise, it is currently difficult to distinguish the end goals of different parties in areas such as housing, immigration, interprovincial barriers, and energy development, although their methods may vary. Time will tell.

WEEK SIGHTLINES

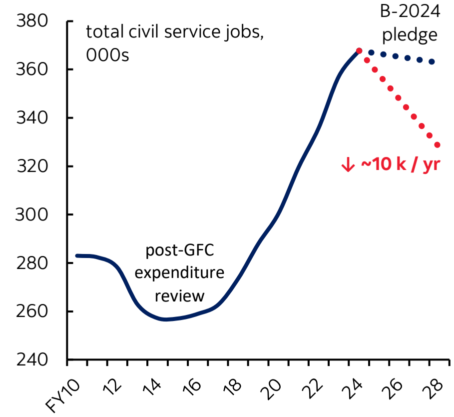
The weeks ahead should provide greater clarity at least on the domestic front, but exogenous uncertainty is likely to persist. The country could very well be in a once-in-a-generational trade war by election day. The net effect is most likely a more fiscally expansive path ahead for federal finances. While the party to the right is likely to seek greater offsets to new promises consistent with past platforms, the country is unlikely to avoid more red ink irrespective of who leads the country.

The country has the fiscal capacity to face potential headwinds. It no doubt could have been better, but its relatively low debt and deficits (general and federal, gross and net) provide a buffer (charts 10–12). Meanwhile, peers especially in Europe are also embarking on fiscally expansive paths in a world of relativity. Canada's lack of reserve status, disproportionate trade exposure, weak productivity performance, and the illiquidity of some of its financial assets all warrant caution. The country cannot afford pandemic-era policy over-reaches, nor can it afford to miss the opportunity to front-run major investments to unlock greater productivity gains over the medium-term. These ultimately are the best insurance against the current uncertainty facing the country.

Let's see if vying leaders pick up that baton and run with it.

Chart 9

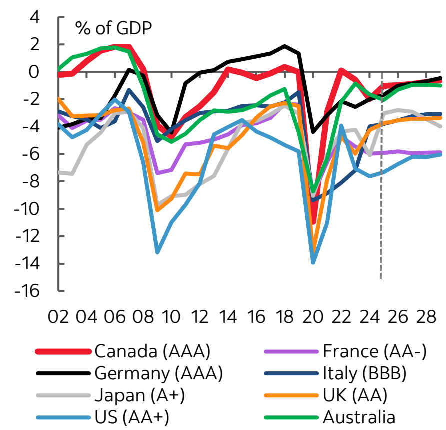
Limits to Savings from Potential Public Service Reduction



Sources: Scotiabank Economics, GoC.

Chart 10

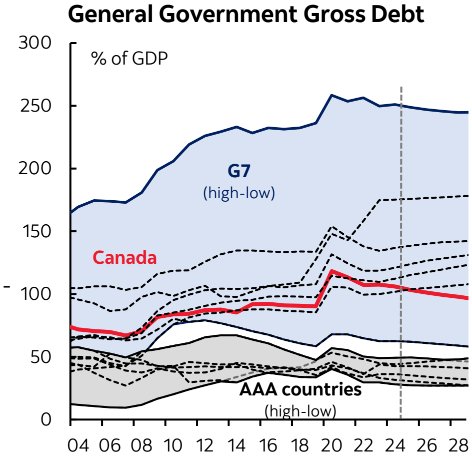
General Government Budget Balance



Sources: Scotiabank Economics, IMF, S&P.

Chart 11

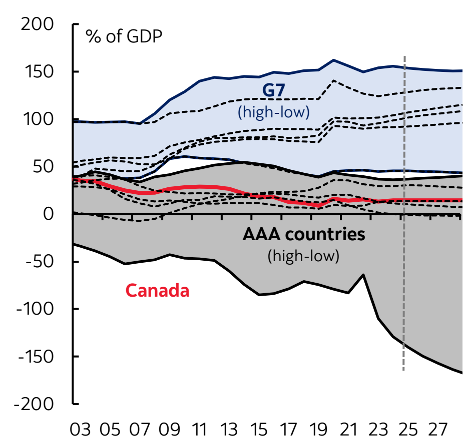
General Government Gross Debt



Sources: Scotiabank Economics, IMF, S&P (exc. SG).

Chart 12

General Government Net Debt



Sources: Scotiabank Economics, IMF, S&P (exc. SG).