Scotiabank

GLOBAL ECONOMICS

FISCAL PULSE

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Tariff War, Lower Oil Prices Weigh on Provincial Budgets

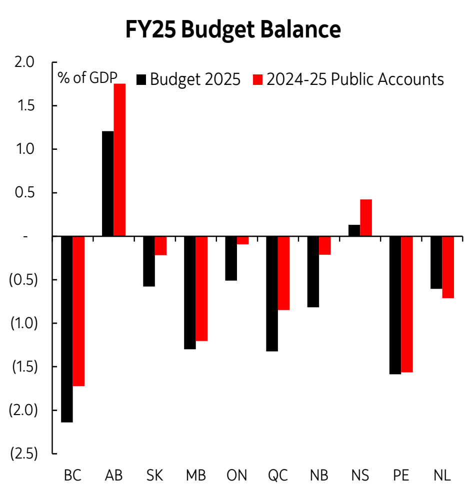
PROVINCIAL FALL FISCAL UPDATES PREVIEW

- **Many provincial fiscal outlooks have deteriorated due to weaker growth, spending increases, and/or oil price declines.**
- **While Ontario and Quebec showed unchanged deficit projections for 2025–26 (FY26) in their Q1 fiscal updates, the other seven provinces that released Q1 updates showed a worse budget balance projection compared to their budget forecast, with the largest deteriorations in Alberta, British Columbia (B.C.) and Nova Scotia.**
- **However, the final numbers for FY25 came in better than previously projected in most provinces, leading to a better handoff, especially for net debt burdens. As a result, net debt projections for FY26 were broadly unchanged in the Q1 updates.**
- **Over the next couple of months, provinces will publish their mid-year fiscal updates, starting with Ontario on November 6th.**
- **Our latest economic projections are broadly in line with most provinces' growth assumptions in their Q1 updates. In addition, new spending announcements have broadly been within contingency envelopes.**
- **As a result, we expect most provinces' mid-year updates to be broadly in line with their Q1 updates (i.e., unchanged or somewhat worse deficits compared to the Spring budget projections).**
- **Pressures for new spending are likely to continue, including to support businesses and workers impacted by the ongoing tariffs from the U.S. and China. However, most provinces have built in prudence and/or contingency reserves into their fiscal frameworks to help fund new measures.**
- **Credit spreads in all provinces have narrowed over the course of the year, though Alberta and Newfoundland & Labrador have enjoyed the largest reductions.**

Q1 UPDATES ROUND-UP

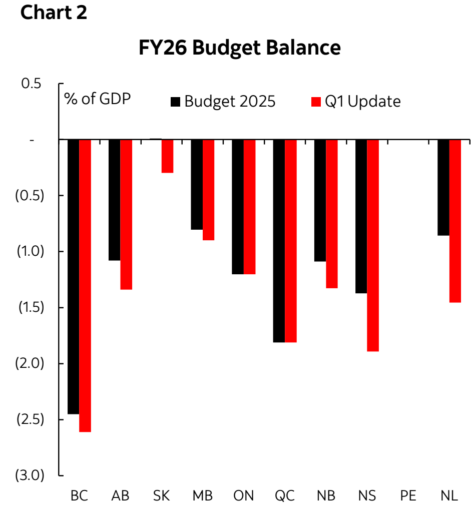
Almost every province overperformed its Budget 2025 estimates for FY25 (chart 1). Each province released its 2024–25 Public Accounts over the past few months, and New Brunswick and Alberta led the pack by beating the budget balance estimate in their Spring budget by more than 0.5% of GDP. Quebec, B.C., and Ontario were not far behind at around 0.4% of GDP. Alberta and Nova Scotia were the only provinces that recorded a

Chart 1



Sources: Scotiabank Economics, provincial reports.

Chart 2



Sources: Scotiabank Economics, provincial reports.

surplus last year, but Ontario, Saskatchewan, and New Brunswick were close to balance, registering deficits of 0.2% of GDP or less. B.C. and Prince Edward Island registered the largest deficits, at more than 1.5% of GDP.

The Q1 fiscal updates showed mostly worsened outlooks for FY26 (chart 2). While Ontario and Quebec did not make changes to the deficit projections for this year (FY26) compared to their Spring budgets, the other seven provinces that released Q1 fiscal updates increased their deficit projections—led by Newfoundland & Labrador and Nova Scotia at over 0.5% of GDP. Six provinces revised down their revenue projection, given the slowdown in the economy and lower oil prices, with Newfoundland & Labrador revising revenues down the most at -2.4%. Alberta's revenue revision was more modest, as a narrower light-heavy differential helped to offset some of the impact of lower WTI prices. On the spending side, six provinces also revised up their spending projections, with Nova Scotia seeing the highest at 2.8% (reportedly driven by higher health care service utilization). Most provinces are now forecasting deficits of between roughly 1% and 2% for this year, with B.C. the outlier on the high side at 2.6%, and Saskatchewan the outlier on the low side at 0.3%.

Net debt projections for FY26 were broadly unchanged in the Q1 updates (chart 3). The FY25 overperformance in most provinces has led to a better net debt number to start this year, helping to offset the increased deficit projections for most provinces. Newfoundland & Labrador and Quebec continue to project the highest net debt burdens for this year, and Alberta and Saskatchewan continue to project the lowest.

ECONOMIC CHALLENGES CONTINUE

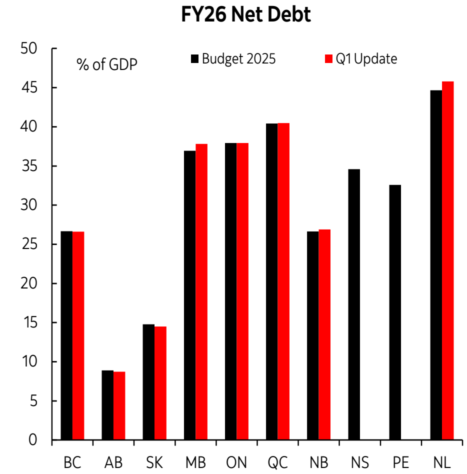
While some of the downside risks to the macroeconomic backdrop have eased, the outlook remains uncertain and challenging. The U.S. tariffs have been less harmful than some initially feared, thanks to most Canada-U.S. business continuing on a free-trade basis under CUSMA. However, the U.S. continues to announce new tariff measures, and the tariffs and related uncertainty continue to weigh on growth and the labour market. The Bank of Canada made two additional rate cuts this Fall to provide additional support to economic activity.

Recent provincial growth assumptions are broadly in line with our views. Most provinces made changes to their assumed economic growth rates for 2025 in their Q1 updates (chart 4), with some revising down and some revising up—in part reflecting the fact that some provinces set the growth assumptions for their Spring budgets before the tariff war started. However, most provinces' latest growth assumptions (which drives revenues forecasts) are broadly in line with our views—with perhaps the most scope for Alberta to come up, and Newfoundland & Labrador to come down. However, growth in these oil-producing provinces is fairly volatile and difficult to forecast with accuracy. Overall, we continue to expect modest but positive growth in each province.

FALL UPDATES COULD INCLUDE NEW MEASURES

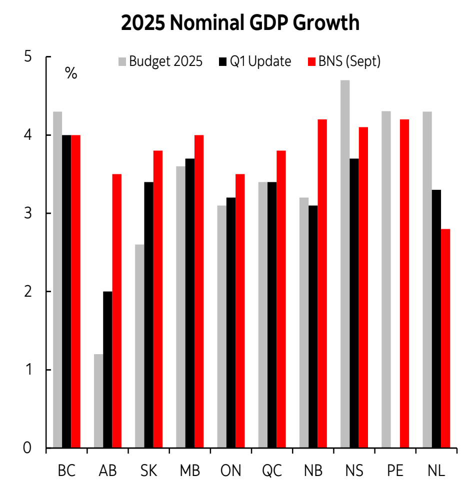
Provinces may start to use some of their contingency budgets to fund new measures. Many provinces set aside considerable contingency funds in their Spring budgets to protect against lower revenues and/or new spending pressures (chart 5). With some of the downside risks abated, some may choose to use some of their contingency reserves to fund new measures. Ontario has already announced that it will include in its mid-year update an expansion of its GST rebate on new homes, to fully refund the 8% provincial portion of the HST for first-time homebuyers. This is a fairly narrowly scoped measure, which should be able to be absorbed with Ontario's considerable forecast buffers.

Chart 3



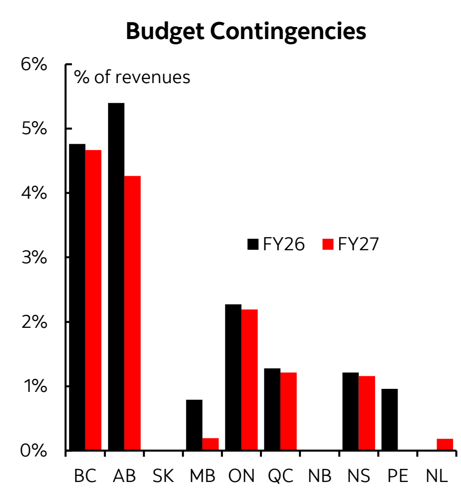
Sources: Scotiabank Economics, provincial reports.

Chart 4



Sources: Scotiabank Economics, provincial reports.

Chart 5



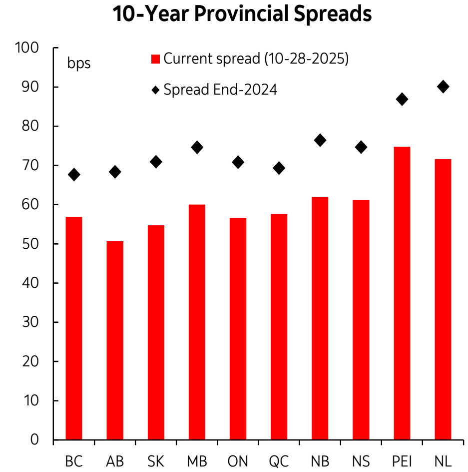
Sources: Scotiabank Economics, Budget Documents.

The new government in Newfoundland & Labrador is starting to implement its agenda. A new PC government formed earlier this month, running on a platform of broad tax relief, targeted benefits for seniors and students, and increased funding for policing. While we expect most major measures will be saved for the next Spring budget(s), there could be some initial new measures announced as part of the Fall update. However, fiscal space is likely limited. Newfoundland & Labrador's Q1 update showed a deterioration in the fiscal outlook, and the new government has started a review of, and has committed to holding a public referendum on, the agreement with Hydro Quebec on the expansion of Churchill Falls. This could potentially put at risk some of the potential associated provincial revenues, which were baked into Newfoundland & Labrador's Spring budget projections.

SPREADS NARROWER DESPITE THE CHALLENGING FISCAL LANDSCAPE

The challenging fiscal environment has led to some credit actions, but spreads have narrowed. S&P downgraded B.C. and Quebec over the summer, with Moody's also downgrading B.C. The outlook for a number of provinces were also downgraded. Despite the deteriorated outlook, spreads in all provinces have narrowed over the course of the year. 10-year spreads down 10–20 basis points, with Alberta and Newfoundland & Labrador enjoying the largest reductions (chart 6).

Chart 6



Sources: Scotiabank Economics, Bloomberg.