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GLOBAL ECONOMICS

FISCAL PULSE

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Contributors

Mitch Villeneuve
Director, Economic Policy
Scotiabank Economics
416.350.1175
mitch.villeneuve@scotiabank.com

John Fanjoy
Economist
Scotiabank Economics
416.866.4735
john.fanjoy@scotiabank.com

Managing Through the Ongoing Storm

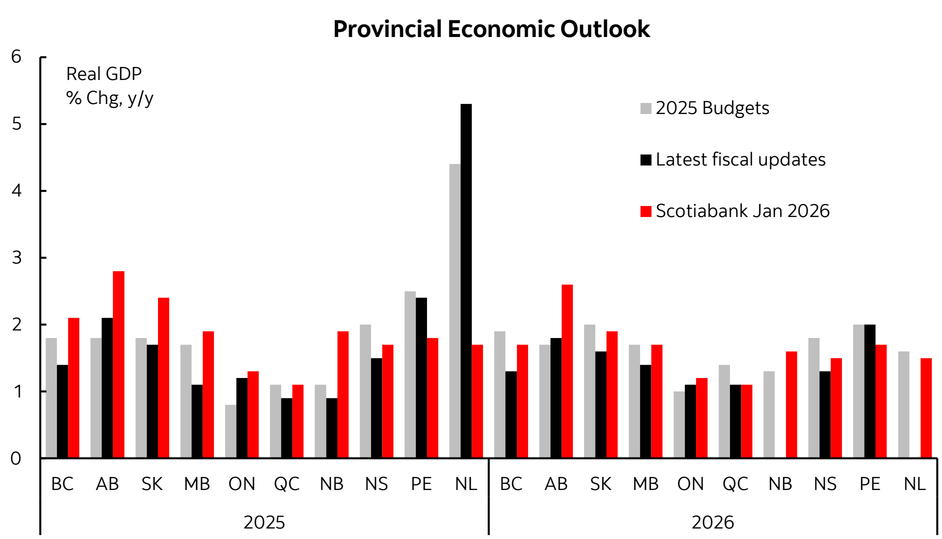
2026 PROVINCIAL BUDGETS PREVIEW

- **The 2026 budget season kicks off today on the west coast. Ongoing economic uncertainty and modest growth suggest continued pressures on provincial budgets, especially for those governments that have not delivered on planned expenditure restraint and/or are impacted by lower oil prices.**
- **In their latest fiscal updates, most provinces revised up their projected deficits for FY26 compared to their plans at the start of the fiscal year, driven by higher spending in all provinces and lower revenues in most.**
- **We expect most provinces to also increase their deficit projections for future years, given the spending overruns this year, ongoing modest economic growth, and the impact of lower oil prices on some provinces.**
- **However, we also expect many provinces to strengthen expenditure restraint efforts in order to limit the increases in their projected deficits—especially those with higher net debt burdens. Some provinces have already signalled that spending cuts will be part of their new budget plans. New measures will likely be modest.**
- **The provinces will need to balance deficit reduction efforts with needs to invest in infrastructure, including to help expand overseas trade. As a result, finding operational spending efficiencies will be critical, in addition to using a "pro-growth" lens for incremental new spending. Provinces should also focus on other economic policy levers, including removing barriers to business investment.**
- **The aggregate net debt-to-GDP ratio is projected to increase to around 31% in FY26 from roughly 29% the previous year. Given elevated deficits and capital investments, provincial borrowing is likely to increase in FY27. Despite mostly higher deficits, provincial spreads narrowed over the course of the last year.**

REVENUE GROWTH IS LIKELY TO BE MUTED

The provinces are bracing for another year of modest economic growth. While the biggest downside risks were avoided last year, growth is slower and we expect it to remain modest again this year. We expect Canadian real GDP growth of about 1.5% in both 2025 and 2026, with Western Canada somewhat overperforming the national average, and Ontario and Quebec somewhat underperforming (chart 1).

Chart 1



Sources: Scotiabank Economics, Provincial government documents.

Most provinces downgraded their FY26 revenue forecasts, though some may end up overperforming. Since their 2025 budgets a year ago, six provinces revised lower their revenue forecasts for the 2025–26 in their fiscal updates throughout the year, with Manitoba and Newfoundland & Labrador marking down the most at around 3% (chart 2). Our latest real GDP forecast for 2025 sees weaker growth in Prince Edward Island and Newfoundland & Labrador than they assumed in their latest fiscal plans, which could result in weaker revenue performance than expected in their Fall fiscal updates. On the flip side, we currently anticipate that six provinces will record somewhat stronger real GDP growth for 2025 than they assumed in their latest fiscal updates. In addition, some provinces have maintained buffers/reserves in buffers in their FY26 revenue projections to protect against weaker-than-expected revenue performance. As a result, some provinces may see their FY26 revenues may end up beating the latest projections—though the final numbers for FY26 will not be known until the Fall.

Many provinces were counting on revenue growth rebounding quickly. While provinces broadly anticipated weak revenue growth in FY26 (and some have downgraded expectations further for last year), their multi-year fiscal plans released last Spring generally expected a robust rebound in revenues in FY27: 4% on average. However, given that the growth outlook remains subdued (compounded by the sharp slowdown in population growth, given the outsized contribution of personal income taxes to overall provincial revenues) and revenues have underperformed this year in many provinces, we could see many provinces revise somewhat lower their expected revenues across their new forecast horizons.

Lower oil prices are also weighing on revenue outlooks in the oil-producing provinces. While oil prices have strengthened somewhat in recent weeks, they trended lower for most of the last year—rather than increasing as some provinces expected. Alberta's 2025 budget anticipated a WTI price of $71 in 2026, compared to our latest forecast of $60. Alberta's latest fiscal rules of thumb suggest that this could reduce annual revenues by more than $8 billion compared to previous expectations, though somewhat higher oil production and a narrower WTI-WCS differential will help offset some of the impact of the lower prices. Saskatchewan and Newfoundland & Labrador will also feel the impacts of the lower oil prices.

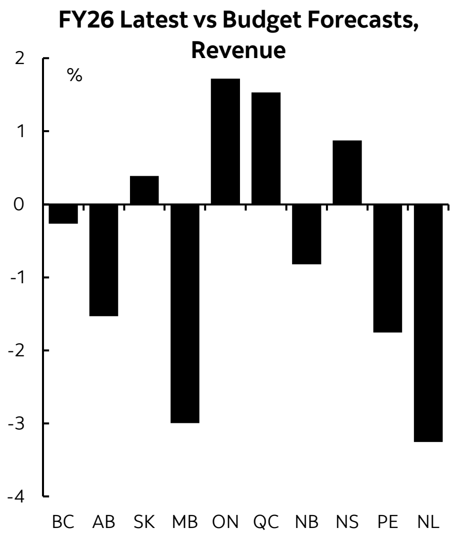
Economic risks remain tilted to the downside. While some downside scenarios were avoided last year and the trade disputes with China seem to have been resolved, uncertainty over the renewal of CUSMA—including the spectre of the U.S. withdrawing from agreement entirely—hangs over the outlook. As a result, provinces should continue to be cautious in their assumptions for near-term economic growth and taxation revenue.

SPENDING OVERRUNS HAVE ALSO WORSENED FISCAL SITUATIONS

All provinces have upgraded their expectations for expenses in FY26. While not unusual, each province revised higher its spending plans for the current fiscal year over the course of the year (chart 3)—though with considerable variability between provinces. British Columbia has been most diligent in keeping to its spending plan, with Quebec not far behind. In contrast, Nova Scotia and Prince Edward Island's spending plans for FY26 were increased by over 4% compared to their 2025 budgets—driven in both provinces mainly by higher-than-planned health care costs.

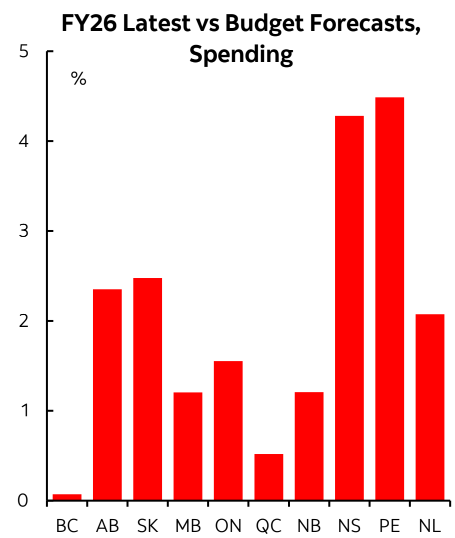
Stronger expenditure restraint will be needed to stay roughly on track. In their budgets last year, most provinces planned for more modest expense growth in FY27 and FY28 compared to FY26. Given spending overruns this year and possible revenue downgrades, many provinces will need to strengthen efforts to limit spending growth in order to maintain deficit reduction targets. British Columbia and Nova Scotia have already signalled publicly to expect spending cuts in this year's budgets, and other provinces could follow.

Chart 2



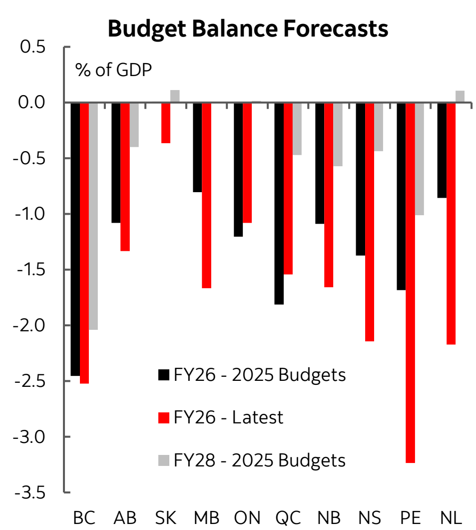
Sources: Scotiabank Economics, Budget Documents.

Chart 3



Sources: Scotiabank Economics, Budget Documents.

Chart 4



Sources: Scotiabank Economics, Budget documents.

Political factors could put upward pressure on spending growth in some provinces. The 2026 budgets will be the first for the new Premiers/governments in Prince Edward Island and Newfoundland & Labrador, and these governments will be keen to implement some commitments from their platforms. New spending promises are also likely in Quebec at some point this year, as it will have a new Premier in April and a provincial election due by October.

MANY FISCAL OUTLOOKS WILL BE WORSE, BUT IMPACTS LIMITED SO FAR

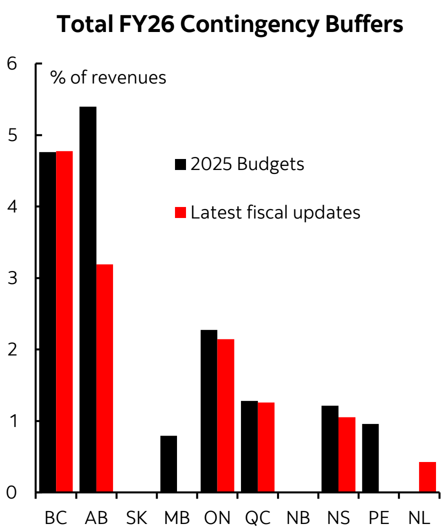
FY26 deficit projections were increased in most provinces, though some may end up smaller than currently projected. In their mid-year (or later) fiscal updates, most provinces increased their projected deficits for the current fiscal year—in some cases fairly substantially (chart 4). Prince Edward Island and Newfoundland & Labrador increased their FY26 deficit projections by at least 1.3 percentage points, and are now projected to join British Columbia with deficits above 2% of GDP. In contrast, Ontario and Quebec revised lower their projected deficits for this year. In addition, considerable contingency buffers in some provinces (chart 5), combined with other sources of prudence in their forecasts, could result in some provinces registering smaller deficits for the current fiscal year than estimated in their latest fiscal updates.

Deficits for future years are likely to also be increased in many provinces. Fiscal slippage in FY26 in most provinces will spill over into future years, and likely lead to higher deficits for future years than previously expected—though also new measures to limit the impacts on deficits, especially in those provinces with the highest debt burdens (chart 6). New measures are likely to be modest in fiscal cost this year.

Debt burdens will be impacted. While [upward revisions to 2022–2024 GDP estimates released in November] helped slightly reduce previous estimates of most provinces' debts as a share of their nominal GDP, higher deficits will lead to faster growth in provincial debt burdens. In addition, provincial capital budgets have remained high and are likely to remain so, given ongoing infrastructure needs—including to facilitate expanded overseas trade. Overall, the aggregate provincial debt burden is expected to increase to around 31% in FY26, up from roughly 29% in the previous year, with Newfoundland & Labrador highest at around 46% and Quebec next at around 40%. Alberta and Saskatchewan continue to have by far the lowest net debt burdens, and thus will be best able to withstand higher short-term deficits.

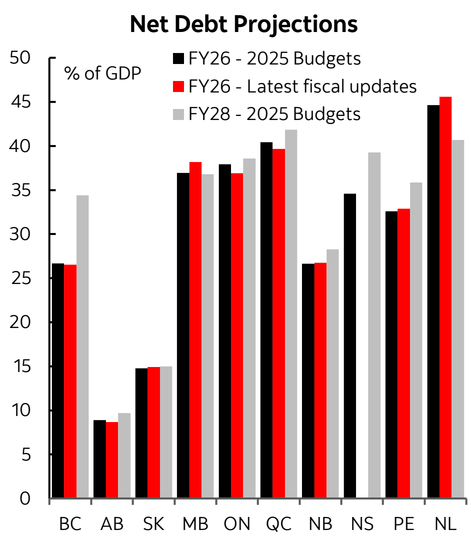
Spreads narrower despite mostly higher deficits. Notwithstanding the deterioration in most provinces' fiscal situations, provincial spreads narrowed over the course of 2025 (chart 7). Most provinces have seen their spreads on 10-year bonds narrow by 15–20 basis points over comparable GoC bonds since the end of 2024, with Prince Edward Island and Newfoundland & Labrador seeing even larger spread compression—despite their projected FY26 deficits increasing the most since the Spring. In addition, Quebec has seen the least spread compression, despite the improvement in its projected FY26 deficit—though this could reflect perceived risk around another sovereignty referendum as we get closer to the next Quebec provincial election.

Chart 5



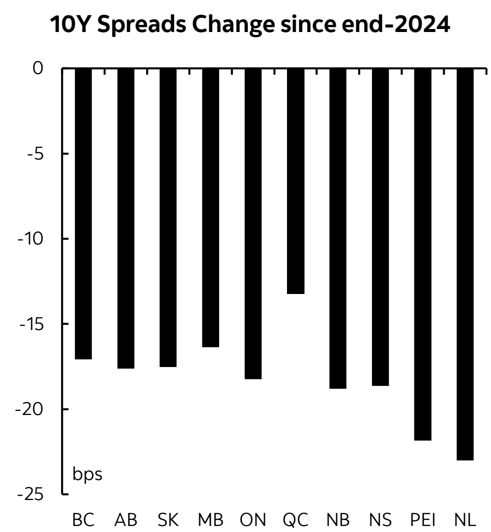
Sources: Scotiabank Economics, Budget documents.

Chart 6



Sources: Scotiabank Economics, Budget Documents.

Chart 7



Sources: Scotiabank Economics, Bloomberg.