PBO Assessment of Budget 2026: Fiscal Anchors and Fiscal Sustainability

Highlights

Budget 2026 projects that the government will meet both of its fiscal anchors. Some margins are close – the deficit anchor has about $2 billion of room in 2027-28 and is not met in the Budget's downside scenario.

Without new tax and spending measures, the operating balance would have reached surplus in 2026-27, two years earlier than the government's original target of 2028-29.

Neither anchor limits borrowing, which totals $765 billion over five years, $476 billion more than cumulative deficits of $289 billion.

To provide context on spending growth, new measures in Budget 2025, the Spring Economic Update (SEU) 2026 and Budget 2026 total $331.6 billion.

Budget 2026 anticipates that debt-to-GDP will rise from 39.9 per cent in 2026-27 to 40.4 in 2028-29 and decline thereafter. This track is lower than expected in SEU 2026.

Fiscal Anchors

Context

In Budget 2025, the Government introduced two fiscal anchors, which it reaffirmed in the Spring Economic Update (SEU) 2026 and in Budget 2026:

- Maintain a declining deficit-to-gross domestic product (GDP) ratio; and,

- Balance operating spending with revenues by 2028-29.

Under the Government's Capital Budgeting Framework, capital investment is broadly defined to include expenses and certain tax measures that support capital formation across the public and private sectors, including infrastructure, major equipment and defence capital, research and development, inventories, capital transfers and selected tax expenditures. All other revenues and expenses are classified as operating by default.

Under this framework, the Government aims to fund day-to-day operating spending from current revenues by 2028-29, so that any remaining deficit reflects capital investments. The framework does not apply to borrowing for non-budgetary transactions, such as loans to Crown corporations and other financial investments.

Assessment

Declining deficit-to-GDP ratio

Budget 2026 projects that the government will meet the deficit-to-GDP anchor. Stronger revenue and expense results brought the 2025-26 deficit down to 1.2 per cent of GDP, well below the 2.1 per cent projected in the SEU 2026. The ratio then jumps to 1.8 per cent in 2026-27, as the deficit rises from $39.3 billion to $62.3 billion. Budget 2026 assesses the anchor from 2026-27. Had it been assessed from 2025-26, the anchor would not have been met. From there, the ratio declines slowly, falling only slightly in 2027-28 and reaching 1.3 per cent by 2030-31 (Table 1). Despite $158.3 billion in new fiscal room over the planning horizon, the ratio ends just 0.1 percentage points below the SEU 2026, as new measures absorb almost all of it.

The anchor has little margin in 2027-28. If the deficit that year were about $2 billion higher than projected, the deficit-to-GDP ratio would stop declining.

Budget 2026's downside scenario adds $3.6 billion to the 2027-28 deficit, which would raise the ratio from 1.8 to 1.9 per cent of GDP. Budget 2026 also assumes counter-tariffs remain in place into 2027-28. If they ended earlier, customs revenues would be about $5 billion lower.

Table 1
Budgetary balance, per cent of GDP

	2025-26	2026-27	2027-28	2028-29	2029-30	2030-31
Budget 2026	**-1.2**	**-1.8**	**-1.8**	**-1.6**	**-1.4**	**-1.3**
SEU 2026	-2.1	-1.9	-1.8	-1.6	-1.5	-1.4

Source:
Government of Canada, Spring Economic Update 2026 and Budget 2026.

Balancing operating spending with revenues by 2028-29

Budget 2026 projects a day-to-day operating surplus of $11.2 billion in 2027-28, one year ahead of the 2028-29 target, and $20.3 billion in 2028-29 (Table 2). The SEU 2026 projected a deficit of $5.2 billion in 2027-28 and a surplus of $0.9 billion in 2028-29.

Table 2
Day-to-day operating balance, billions of dollars

	2025-26	2026-27	2027-28	2028-29	2029-30	2030-31
Budget 2026	**-2.0**	**-3.5**	**11.2**	**20.3**	**24.6**	**25.2**
Budget 2026, before new measures	-2.0	11.2	29.0	30.9	34.2	34.5
SEU 2026	-26.4	-10.5	-5.2	0.9	4.5	6.1

Source:
Government of Canada, Spring Economic Update 2026 and Budget 2026.

Note:
Before new measures excludes day-to-day operating measures since the SEU 2026. Capital measures do not affect the operating balance.

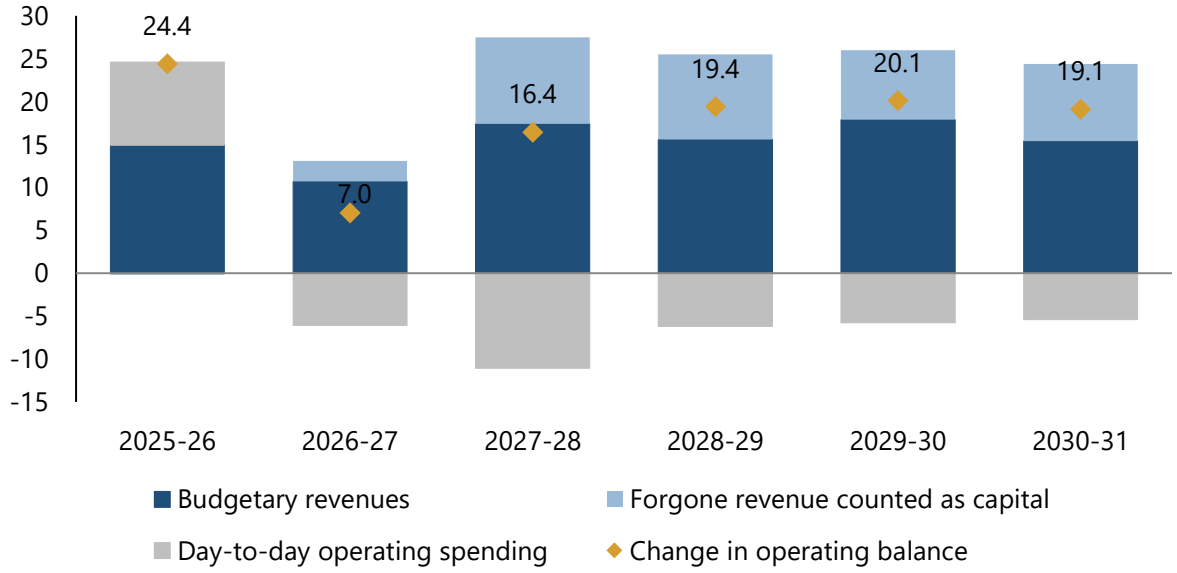
Relative to the SEU 2026, the operating balance improves by $16.4 billion per year on average over 2026-27 to 2030-31 (Figure 1). On average, higher budgetary revenues contribute $15.4 billion per year, and tax measures classified as capital, mainly the Productivity Mega Deduction, add $7.9 billion. These measures reduce budgetary revenues, but under the Capital Budgeting Framework the forgone revenue is counted as capital investment, and so does not reduce the operating balance. Higher day-to-day operating spending offsets $6.9 billion per year.

Without new measures, the operating balance would have reached surplus in 2026-27, at $11.2 billion, two years ahead of the 2028-29 target. New day-to-day operating

measures cost $14.7 billion that year, turning the surplus into a $3.5 billion deficit and pushing the return to surplus to 2027-28.

Figure 1

Change in the day-to-day operating balance, Budget 2026 relative to the SEU 2026, billions of dollars



Source:
Government of Canada, SEU 2026 and Budget 2026; PBO calculations.

Note:
Positive values improve the operating balance. Forgone revenue counted as capital is revenue forgone through tax measures that the Capital Budgeting Framework classifies as capital investment, mainly the Productivity Mega Deduction.

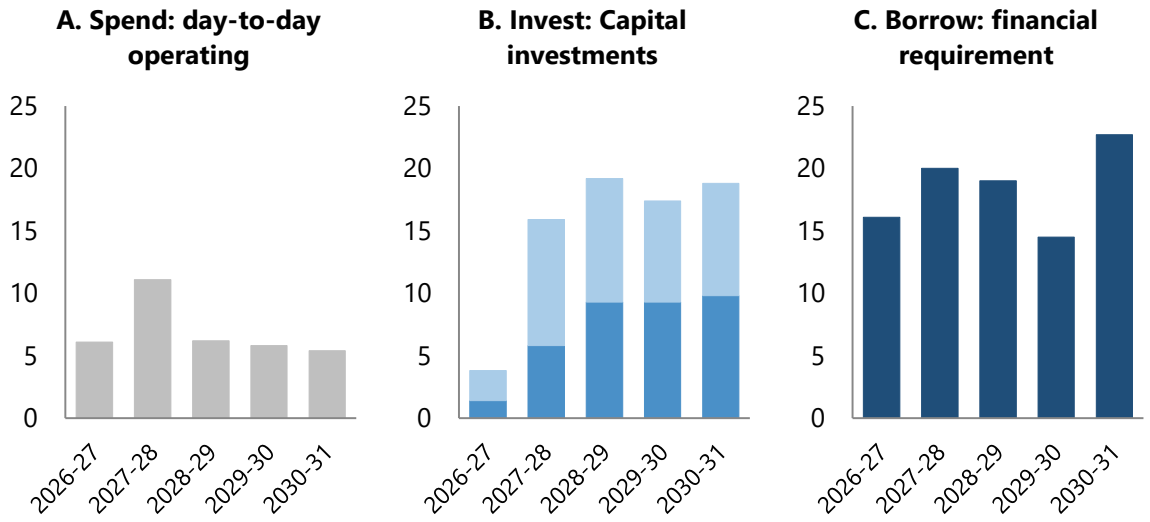
Spending, investments and borrowing: what do the anchors constrain?

Relative to the SEU 2026, Budget 2026 spends more on both day-to-day operations and capital and borrows more (Figure 2). Over 2026-27 to 2030-31, day-to-day operating expenses are $34.6 billion higher, capital investments are $75.3 billion higher, and the financial requirement is $92.3 billion higher. Neither anchor directly limits these increases. The operating anchor shapes the mix between day-to-day and capital spending, and the deficit-to-GDP anchor requires the deficit-to-GDP ratio to decline but

sets no limit on its level. Borrowing for loans, investments and capital purchases falls outside both.

Figure 2

Changes in spending, investment and borrowing, Budget 2026 relative to the Spring Economic Update 2026, billions of dollars



Source:
Government of Canada, Spring Economic Update 2026 and Budget 2026; PBO calculations.

Note:
Each panel shows Budget 2026 less the SEU 2026. Panel A shows the change in day-to-day operating expenses and panel C the change in the financial requirement. In panel B, the darker segment is the change in capital investment expenses, and the lighter segment is revenue forgone through tax measures classified as capital.

Spending less to invest more

In Budget 2025, the Government committed to "spend less on government operations, so we can invest more."

Most of the $34.6 billion increase in day-to-day operating expenses (Figure 2, panel A) reflects major transfers and public debt charges, which fall outside the commitment to spend less on government operations.

The Government has committed to holding growth in direct program expenses, excluding capital investments, to under 1 per cent per year, supported by savings from the Comprehensive Expenditure Review. This includes a commitment to reduce the federal public service to about 330,000 employees by 2028-29. The public service grew

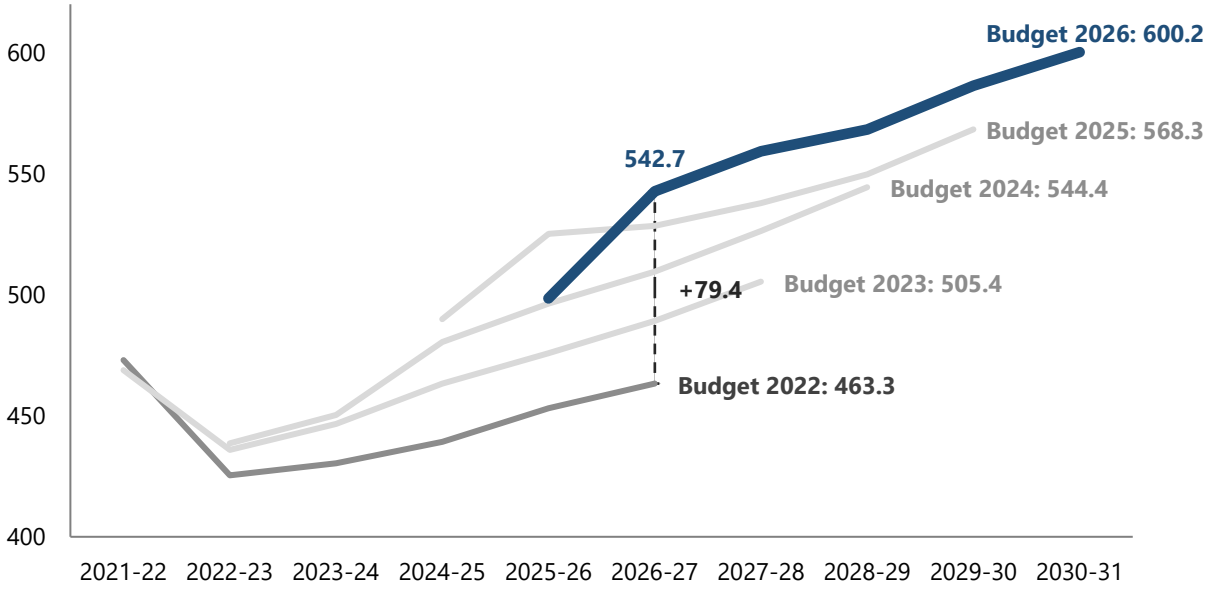
by 42 per cent from March 2016 to March 2024, reaching about 368,000, and had declined to about 332,000 by August 2026, close to the target. From 2015-16 to 2023-24, direct program expenses, which include the operating costs of federal departments, more than doubled, from $114.8 billion to $236.0 billion, and reached $241.7 billion in 2025-26 as the public service shrank.

These federal employment totals do not include employment in Crown corporations, which have been mandated to deliver many aspects of the Government's capital agenda. A broader measure that includes Crown corporations could show a different trend.

Further, the commitment to restraint applies to less than half of program spending, as major transfers to persons and to other levels of government, as well as capital investments, are excluded. Budget 2026 projects program expenses to increase from $542.7 billion in 2026-27 to $600.2 billion in 2030-31, a cumulative $53.9 billion more than in the SEU 2026.

This follows a trend of repeated upward revisions to program spending across budget cycles. Budget 2022 projected program expenses of $463.3 billion in 2026-27, with that projection increasing by an average of $19.9 billion in each subsequent budget (Figure 3). Put differently, projected program expenses for 2026-27 are $79.4 billion higher than in Budget 2022.

Figure 3
Projected program expenses by budget, billions of dollars

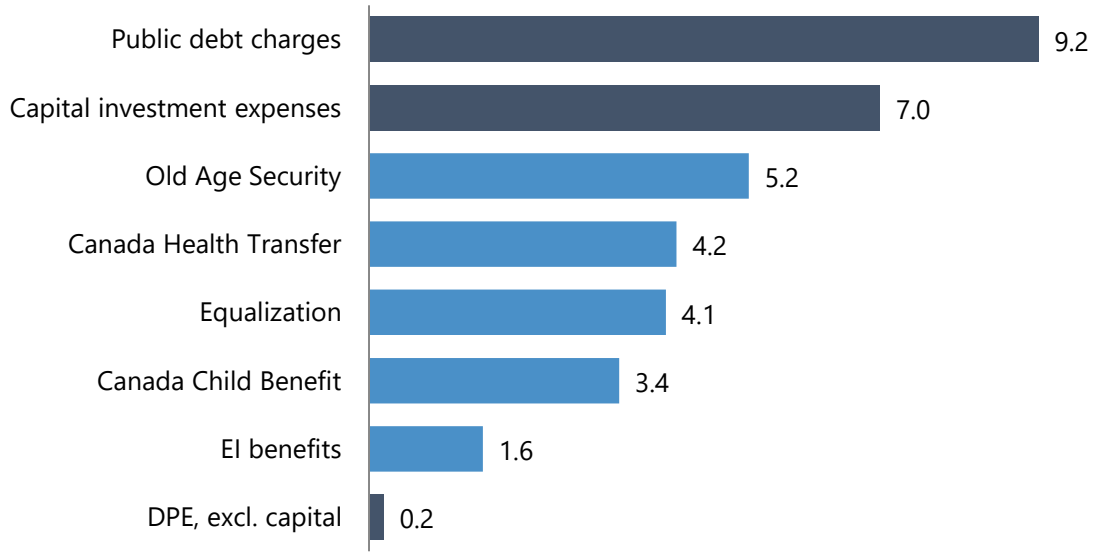


Source:
Government of Canada, Budgets 2022 to 2026.

Major transfers to persons and to other levels of government are not covered by the commitment to constrain costs through CER and account for 71 per cent of the increase in program expenses over the projection horizon. Direct program expenses (DPE) excluding capital investments grow by 0.2 per cent per year, while public debt charges and capital investment expenses grow fastest (Figure 4). This low growth partly reflects a downward revision to projected direct program expenses, before new measures. Economic and fiscal developments since the SEU 2026 lower projected direct program expenses by $1.5 billion in 2026-27 and by $17.3 billion in 2030-31, based on lower-than-expected spending in 2025-26.

Figure 4

Average annual growth in major expense components, 2026-27 to 2030-31, per cent



Source:
Government of Canada, Budget 2026; PBO calculations.

Note:
Compound annual growth from 2026-27 to 2030-31. Growth in capital investment expenses and in direct program expenses excluding capital is as reported in Budget 2026.

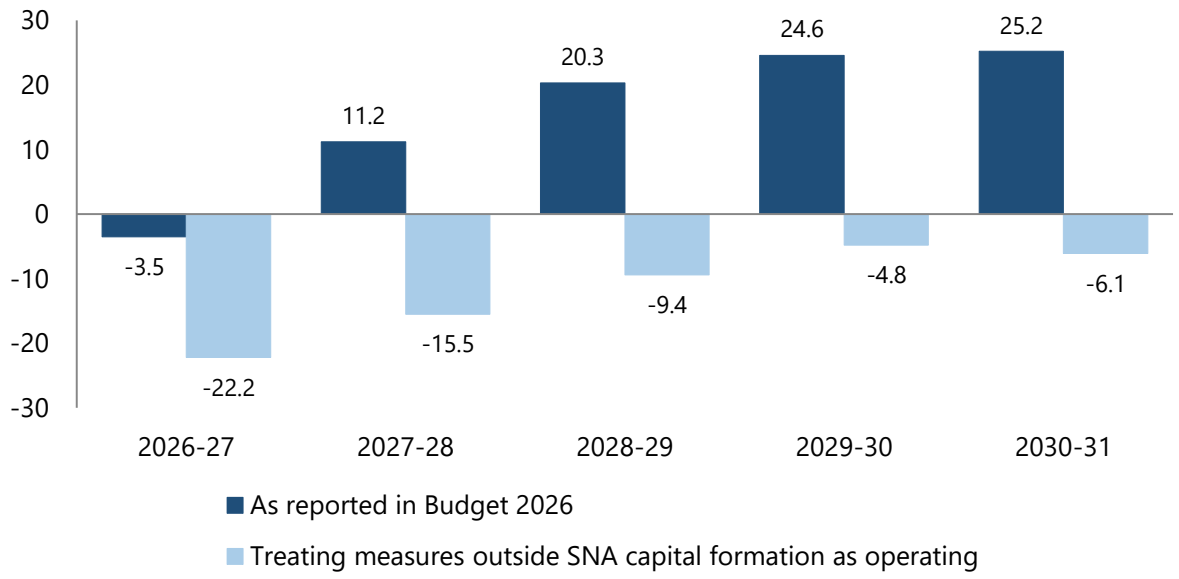
Across Budget 2025, the SEU 2026 and Budget 2026, the Government has announced $331.6 billion in new measures, of which $201.7 billion, or 61 per cent, is day-to-day operating spending rather than capital investment. Budget 2026 shifts toward capital, with $89.5 billion of its $151.5 billion in new measures classified as capital, notably the Productivity Mega Deduction. Even so, most new measures from Budget 2025 onward have gone to day-to-day operations.

The operating anchor guides the composition of the budget between operating and capital but does not limit the overall size of the deficit. It can be met by raising revenues, reducing day-to-day spending or directing spending toward capital. The anchor does not apply to capital investment, whether delivered through spending or through tax measures.

Whether the anchor is met depends on how capital is defined. The Government's definition extends beyond the System of National Accounts (SNA). In our Budget 2025 Issues for Parliamentarians, we constructed an SNA-consistent measure of capital investments. Capital-focused tax incentives, housing tax measures, support for private sector research and development, and support for battery manufacturing would not be considered capital formation under the SNA. In Budget 2026, these measures total $135.8 billion over 2026-27 to 2030-31, 37 per cent of capital investments. Treating them as operating spending would keep the operating balance in deficit in every year to 2030-31 (Figure 5).

Figure 5

Day-to-day operating balance, billions of dollars



Source:
Government of Canada, Budget 2026; PBO calculations.

Note:
Only measures clearly outside SNA capital formation are treated as day-to-day operating spending.

Budget 2026's operating surplus is large enough to absorb its downside scenario, which lowers the budgetary balance by $3.6 billion in 2027-28 and $2.8 billion in 2028-29, the target year. Assuming capital investment is unchanged, the operating surplus would remain about $7.6 billion and $17.5 billion in those years. A deeper downturn could require raising revenues or reducing day-to-day operating spending to continue meeting the anchor. Most of this spending consists of legislated transfers and public

debt charges, so reductions would fall largely on day-to-day direct program expenses, which are already projected to grow by only 0.2 per cent per year from 2026-27. Tax incentives and subsidies classified as capital, which would be considered operating spending under the SNA, would not face the same pressure.

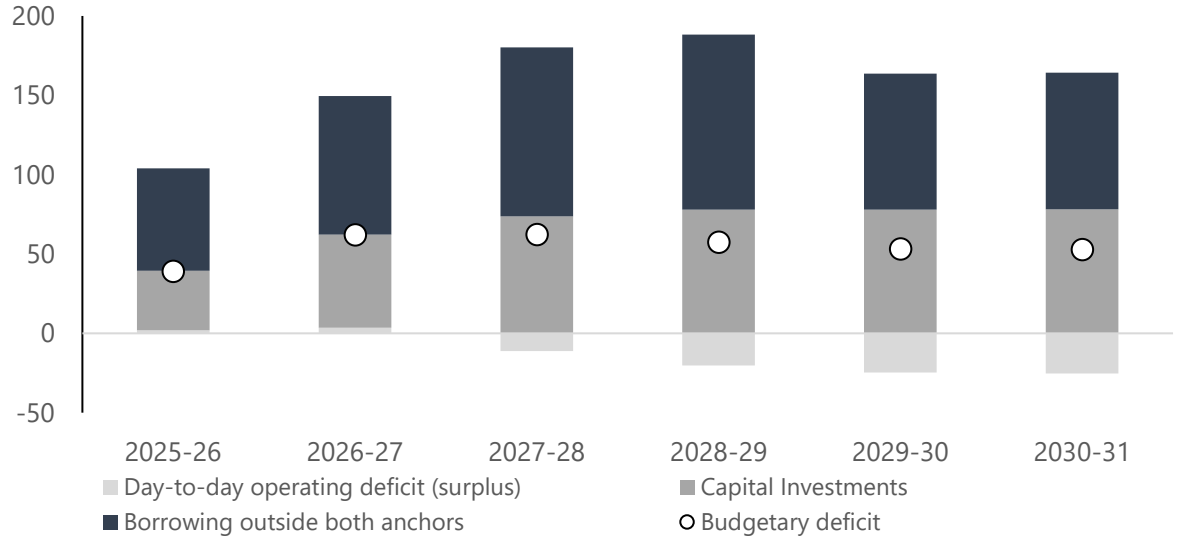
Borrowing more to invest more

The declining deficit-to-GDP anchor applies to the full budgetary balance, including capital investment. It requires the deficit ratio to fall each year but does not set a limit on its size. It also records capital purchases on an accrual basis, so their cost enters the deficit gradually through amortization rather than when they are paid for (cash basis). In the SEU 2026, capital investments over 2026-27 to 2030-31 totalled $291.3 billion on an accrual basis and $445.7 billion on a cash basis. In Budget 2026, they total $366.6 billion and $616.3 billion, respectively.

Borrowing for loans, investments and the up-front cost of capital purchases falls outside both anchors. Loans to Crown corporations and investments such as the Canada Strong Fund are financed through borrowing. The amounts lent or invested do not enter the budgetary balance, although the associated public debt charges, interest revenues and Crown corporation profits or losses do.

In the SEU 2026, loans to enterprise Crown corporations ($241.1 billion) and net acquisitions of non-financial assets ($94.3 billion) added $335.4 billion to borrowing requirements over 2026-27 to 2030-31. In Budget 2026, these transactions total $439.1 billion, $103.7 billion more. Net of slightly smaller deficits and lower requirements for pensions and other transactions, the financial requirement is $92.3 billion higher than in the SEU 2026 (Figure 2, panel C). This extra borrowing pays for loans, investments and the up-front cost of capital purchases, which neither anchor limits. Federal borrowing can therefore keep growing even while both anchors are met (Figure 6).

Figure 6
Financial requirement by component, billions of dollars



Source:
Government of Canada, Budget 2026.

Note:
The day-to-day operating balance is shown as a deficit above zero and a surplus below zero. Borrowing outside both anchors is total non-budgetary transactions. Totals above each bar are the financial requirement.

Fiscal Sustainability

Context

Fiscal sustainability refers to a government's capacity to maintain its current fiscal policies over the long term without requiring large and abrupt adjustments to taxes, program spending or borrowing. A fiscally sustainable government manages revenues and expenditures in a way that can be maintained over the long-term while keeping debt at a manageable level relative to the size of the economy and population. Sustainability is commonly assessed by whether the debt-to-GDP ratio is stable or declining over the long term.

Long-term debt projections incorporate demographic and economic factors that affect government revenues, expenditures, and borrowing costs over time. Key considerations

include population growth and aging, labour force participation, productivity and economic growth, inflation, and interest rates. Together, these factors influence the sustainability of public finances and determine whether debt is projected to increase or decline relative to the size of the economy.

Governments must both maintain existing programs and commitments and deliver on new priorities. A sustainable fiscal plan allows them to do both while leaving room to absorb shocks, including recessions, natural disasters, pandemics or geopolitical events. Over the medium term, it is also important to consider gross financing needs, which capture borrowing that the deficit does not, debt structure, which determines how quickly changes in interest rates affect public debt charges, and the resulting interest burden.

Assessment

Debt-to-GDP

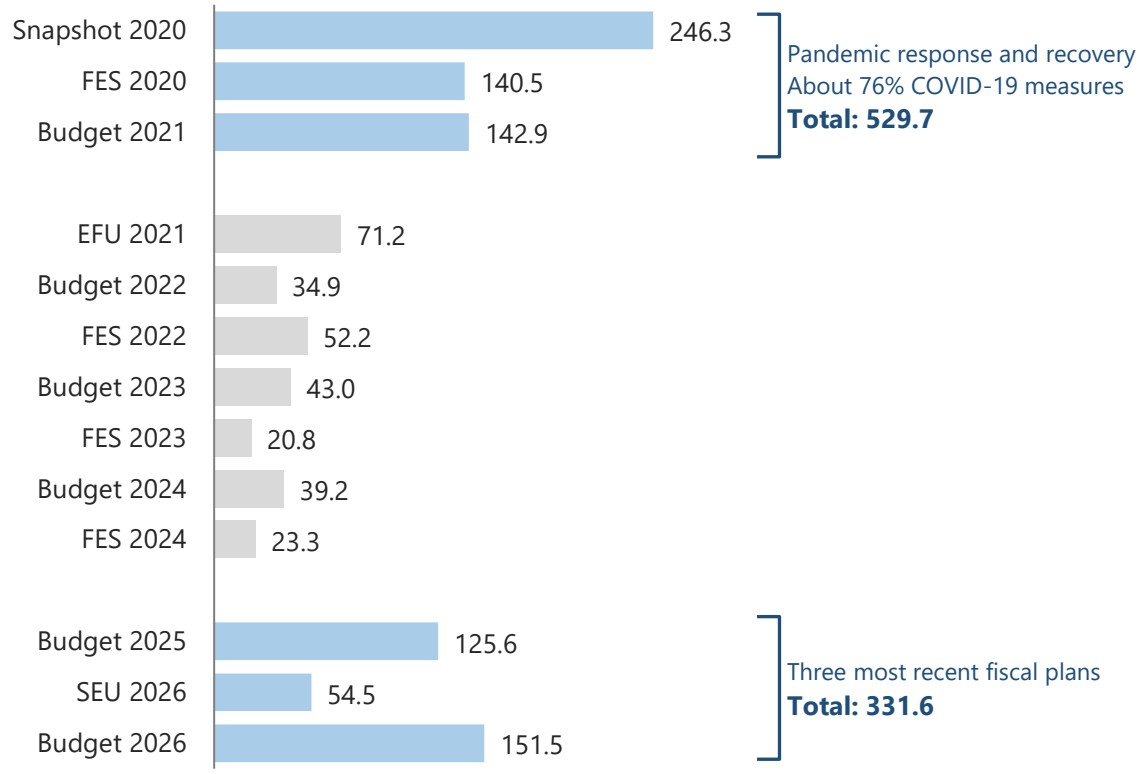
Budget 2026 projects the federal debt-to-GDP ratio to remain broadly stable at about 40 per cent through 2030-31, edging down from a peak of 40.4 per cent in 2028-29 to 40.1 per cent in 2030-31 (Table 3). The ratio is lower than in the SEU 2026, reflecting stronger 2025-26 results and higher nominal GDP rather than new measures, which absorb almost all the fiscal room created since the SEU 2026.

Over the long term, Budget 2026 projects the debt-to-GDP ratio to decline to 18.6 per cent by 2060-61, compared with 25.1 per cent in the SEU 2026. The improvement reflects economic and fiscal developments, as new measures since the SEU 2026, totalling $151.5 billion over 2026-27 to 2030-31, absorb almost all the fiscal room these developments create. The long-term projection starts from a lower debt ratio in 2030-31 and carries forward a slightly larger primary surplus. With the debt-to-GDP ratio declining over the long term, current federal fiscal policy would be deemed sustainable. This track does not incorporate higher defence spending, at 5 per cent of GDP, by 2035, however.

This longer-term assessment reflects current policy. Recent fiscal plans show how quickly policy can change, as the Government has announced a total of $331.6 billion in new measures in the three fiscal plans tabled since November 2025 (Figure 7).

Figure 7

New measures by fiscal plan, billions of dollars



Source:
Government of Canada, 2020 Fall Economic Statement to Budget 2026; PBO calculations.

Note:
Net new measures, including policy actions taken since the previous plan and COVID-19 measures, over each plan's projection horizon (two to seven fiscal years). Later re-estimates of previously announced measures are not reflected.

Defence spending

At the 2025 NATO Summit, Canada committed to spend 5 per cent of GDP on defence by 2035. This includes 3.5 per cent of GDP on core defence spending and 1.5 per cent of GDP on defence- and security-related investments.

On a cash basis, Budget 2026 projects total defence spending of 4.1 per cent of GDP from 2027-28 to 2030-31, including 2.6 per cent on core defence. Budget 2026 projects $99 billion in core defence spending in 2030-31. At 3.5 per cent of GDP, using NATO's GDP estimate, spending would be $37 billion higher that year, at about $136 billion.

The long-term projections do not include the additional spending needed to reach the target. If financed through borrowing, it would substantially reduce the fiscal room shown in Budget 2026.

Interest burden

Public debt charges are the fastest-growing expense. Budget 2026 projects them to rise from $53.5 billion in 2025-26 to $85.5 billion in 2030-31, an average increase of 9.8 per cent per year, reaching 13.6 per cent of revenues (Table 3).

Public debt charges already exceed GST revenues and are projected to surpass the Canada Health Transfer (CHT), the largest federal transfer to provinces and territories, from 2026-27. By 2030-31, they are 26 per cent larger than the CHT ($67.7 billion) and 31 per cent larger than GST revenues ($65.1 billion). They also grow about twice as fast, compared with 4.4 per cent per year for the CHT and 4.7 per cent for GST revenues.

Higher interest rates pose a growing risk to public debt charges, which are now more than twice as sensitive to rate increases as in pre-pandemic outlooks. In its October 2026 Economic and Fiscal Outlook, PBO estimated that a permanent 100 basis point increase in interest rates would raise public debt charges by $5.1 billion in the first year and $15.8 billion by the fourth year, worsening the budgetary balance by $3.2 billion and $5.9 billion, respectively.

Federal borrowing and debt structure

Budget 2026 projects a lower federal debt-to-GDP ratio than the SEU 2026, but higher borrowing needs. Federal debt, which is the accumulated deficit, rises by $286.9 billion over 2026-27 to 2030-31. Borrowing also finances loans, investments and capital purchases, which do not add to federal debt. Cumulative financial requirements therefore total $764.7 billion, 2.7 times the increase in federal debt, compared with 2.3 times in the SEU 2026 (Table 3).

The Government pays interest on this borrowing, partly offset by interest earned on the assets it finances. This contributes to public debt charges growing faster than federal debt, at 9.8 per cent per year compared with 4.1 per cent over 2025-26 to 2030-31.

Total federal borrowing is broader still. Borrowings subject to the *Borrowing Authority Act* also include the market debt of agent Crown corporations, which are obligations of

the Government. Budget 2026 projects these borrowings at $2,256 billion at the end of 2027-28, against a legislated limit of $2,541 billion. In its October 2026 Economic and Fiscal Outlook, PBO projects them to reach $2,728.3 billion by 2030-31, with agent Crown corporation market debt rising from $313.3 billion in 2025-26 to $411.2 billion.

Gross financing needs, which add maturing debt to financial requirements, total $611 billion in 2027-28. Of this, $442 billion refinances maturing debt, about a quarter of market debt.

The structure of federal debt determines how quickly changes in interest rates reach public debt charges. Treasury bills, which mature within a year, make up about 15 per cent of market debt but almost two thirds of refinancing needs in 2027-28, at $284 billion. Changes in short-term rates therefore pass through to public debt charges quickly. In October, the Bank of Canada raised its policy rate by 25 basis points to 2.5 per cent, earlier than expected in the September private sector survey underlying Budget 2026. Budget 2026 estimates that a sustained 1-percentage-point increase in all interest rates would raise public debt charges by $7.2 billion in the first year and $14.7 billion in the fourth year.

Considerations

- Of note, the IMF recently recommended reinstating the debt-to-GDP ratio as the primary fiscal anchor for Canada, noting that it would "strengthen discipline, transparency, and credibility while preserving fiscal space for high-return investment."
- The long-term debt path in Budget 2026 shows a steeper decline in the debt-to-GDP ratio than the SEU 2026, reaching 18.6 per cent in 2060-61, compared with 25.1 per cent. This suggests more long-term fiscal room than in the SEU 2026. However, the projection is sensitive to assumptions. If interest rates were 1 percentage point higher, the ratio would reach 30.0 per cent in 2060-61. Additionally, these projections do not include all anticipated spending related to the NATO defence commitment.
- In Budget 2025, the Government noted that it would use available fiscal room for investments that will grow the economy over the long term, while ensuring that the debt-to-GDP ratio remains stable despite higher deficits. The economic impact of these measures is contingent on the successful implementation of the investments

and their ability to attract incremental third-party investment that leads to subsequent economic activity. The debt must still be serviced and refinanced whether the growth objectives are met or not.

- Budget 2026 does not extend funding for several agreements that expire in the coming years. The Canada Health Transfer returns to its legislated growth formula after 2027-28. Extending the 5 per cent escalator would raise federal expenses by about $1.3 billion per year on average over 2028-29 to 2030-31. Early learning and childcare transfers decline by $2.8 billion in 2028-29, when the temporary $5.4 billion top-up for 2026-27 and 2027-28 ends. Health agreements also fall by $1.8 billion in 2028-29, as Budget 2026 extends home and community care and mental health funding for one year only and long-term care funding expires.
- Parliamentarians may wish to seek more detail on the composition of federal borrowing. Budget documents report lending to enterprise Crown corporations as a single line, without identifying the corporations involved or the purpose of the lending, such as purchases of Canada Mortgage Bonds. They also do not report the net revenue the Government expects to earn on its growing holdings of these bonds.

Table 3
Fiscal sustainability indicators, Budget 2026

	2025-26	2026-27	2027-28	2028-29	2029-30	2030-31	SEU 2026, 2030-31
Federal debt							
$ billions	1,306.1	1,366.5	1,429.0	1,486.6	1,540.1	1,593.0	1,629.4
$ per person	31,390	32,693	34,217	35,455	36,480	37,437	38,293
% of GDP	40.2	39.9	40.2	40.4	40.3	40.1	41.6
Total liabilities							
$ billions	2,318.3	2,484.1	2,671.8	2,855.3	3,003.9	3,151.7	3,046.7
$ per person	55,716	59,430	63,976	68,097	71,152	74,068	71,601
% of GDP	71.4	72.5	75.2	77.6	78.5	79.3	77.8
Primary balance							
$ billions	14.2	-2.1	4.8	16.2	25.0	32.6	27.7
$ per person	341	-50	115	386	592	766	651
% of GDP	0.4	-0.1	0.1	0.4	0.7	0.8	0.7
Public debt charges							
$ billions	53.5	60.2	67.3	73.8	78.4	85.5	80.9
$ per person	1,286	1,440	1,612	1,760	1,857	2,009	1,901
% of revenues	10.2	11.1	11.9	12.7	12.9	13.6	13.2
Financial requirement							
$ billions	103.9	149.5	169.0	168.0	139.1	139.1	116.4
$ per person	2,497	3,577	4,047	4,007	3,295	3,269	2,736
% of GDP	3.2	4.4	4.8	4.6	3.6	3.5	3.0

Source:
Government of Canada, Spring Economic Update 2026 and Budget 2026.

Note:
Population projections are PBO numbers.

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