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From: Colin Busby, Nicholas Dahir and Kate Koplovich
To: Fiscal Update Watchers
Re: NOT ENOUGH DEFICIT DISCIPLINE IN THE UPDATE, THE FALL BUDGET MUST GET SERIOUS

Yesterday's spring economic update should leave Canadians with mixed feelings. There is reason for both optimism and alarm. Most importantly, with a majority in hand, the federal government now has the runway to go big in the upcoming fall budget.

The good news: The fiscal outlook has improved. Stronger GDP figures, both historically and in projections, have eased some pressure on the government's bottom line. The update itself is also more disciplined than its predecessors: It is shorter, more upfront about the numbers, and contains fewer new policy announcements.

Its priorities are largely the right ones: Investment, trade, skills, and defence. A \$2-billion commitment to financially assist young people to start in the skilled trades shortages is a step forward – especially if coordinated effectively with the provinces. So too are new pathways to skilled trades through the Canadian Armed Forces. A smaller, but meaningful, change is the inclusion of enhanced oil recovery as an eligible use for carbon capture and storage tax credits. It's a step in the right direction to spur investment, recover costs, and reduce emissions. And at a time of tariff tensions and shifting global alliances, a stronger focus on Canada's economic and military capacity is well placed.

What is the bad news? The government has once again chosen to spend its fiscal windfalls rather than strengthen its fiscal position and reduce deficits. Improvements to the economic and fiscal outlook, which boosted the bottom line by roughly \$15.7 billion in 2026-27, are being absorbed by new entrenched spending. This leaves projections of future deficits nearly identical to those in Budget 2025. It would have been preferable to see material improvement in the federal government's deficit, a plan to reduce non-defence spending, and movement towards a balanced budget over time, especially at a time of global uncertainty where spare fiscal capacity is valuable.

Some large spending commitments appear only on the balance sheet, for now. Defence spending commitments to get Canada to the 5-percent NATO target are made on a cash basis. So upcoming, large investments in new military machinery and equipment will not be recognized as expenses upfront. Instead their cost will be recorded overtime as they depreciate. As a result, the cumulative effects of consistently high defence spending will take a few years to seriously hit the bottom line.

The government's largest new commitment, the Canada Strong Fund, is a balance sheet transaction that will leave the deficit largely unaffected in the short term. The update notes that the Canada Strong Fund will be seeded with \$25 billion over three years. The money will come from borrowing, but this is not an expense since there will be a financial asset of equal value. As a future Crown corporation, dividends paid from the fund or losses will appear in the income statement through "other revenues." But debt issuance goes up, exposing taxpayers to more risks in debt financing markets and interest costs to finance them, leaving them without a clear view of the true medium-term costs.

So where does that leave us?

With a backdrop of tariff tensions and upcoming trade negotiations with the United States, Canada faces a major turning point whereby it can tackle its serious, long-standing economic challenges. The spring update contains encouraging priorities, signs of boldness, and some worthwhile policy steps.

Meanwhile, equipped with a majority government, the fall budget presents a unique opportunity to be bolder. It means getting more serious about growth. Canada's investment climate remains weak relative to its peers, and transformational measures are needed.

More ambitious options would open up major infrastructure assets – such as airports – to institutional investment, unlocking capital and improving efficiency. Tax reform should also be part of the conversation: Shifting the mix away from income taxes and toward consumption could strengthen incentives to invest, innovate, and work.

Regulatory reform also cannot be ignored. On major projects the government needs to continue focusing on better coordination between federal and provincial assessments, while improving the predictability of assessment outcomes. If these projects continue to face high uncertainty, long timelines, shifting rules and opportunities for political interference, capital will keep flowing elsewhere.

Future economic growth projections should be treated as fragile. As in recent years, the government continues to spend windfalls rather than use them to reduce deficits – a pattern that should stop. Restoring fiscal discipline means treating windfalls as temporary, not permanent, and committing to a credible path to balance anchored by restraint in non-defence spending.

Heading into the fall budget, the government should commit to a fiscal plan that works towards a balanced budget and grows the list of bold policy options, working towards a major overhaul in Canada's climate for private investment and productivity. The government has an opportunity to make big, lasting changes. In the fall, it needs to use it.

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