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**From:** Don Drummond and Nicholas Dahir  
**To:** Fiscal and Monetary Policy Decision-makers  
**Re:** KEEPING OUR EDGE: THE BENEFITS OF SOUND MONETARY AND FISCAL POLICY

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For much of the second half of the twentieth century, the United States enjoyed a borrowing-cost advantage over Canada. Today, the advantage is in Canada's favour. That reversal should serve as a warning to those who argue Canada has room for fiscal expansion given its lower net debt burden than countries like the United States.

From 1960 to 1996, Canada's 10-year bond yield was 104 basis points on average above the American equivalent. Higher inflation in Canada likely explains much of the difference as inflation ran 72 basis points higher on average here than in the United States from 1960 to 1991. Investors typically demand higher interest rates to offset the erosion to purchasing power from higher inflation. Canada carried a lower net-debt-to-GDP ratio than the United States in the 1960s and 1970s, but by the 1980s, the gap had narrowed as both countries experienced rising debt levels.

Then the story changed.

Price stability became the central objective of Canadian monetary policy when inflation targeting was introduced in 1991. Inflation fell, became more stable and predictable, and increasingly stayed in line with that of the United States. Since 1992, inflation has averaged 2.04 percent in Canada and 2.14 percent in the United States.

Meanwhile, fiscal performances shifted in Canada's favour. Both countries accumulated substantial debt during the 1980s and early 1990s, but by the late 1990s and early 2000s, Canada's federal net debt burden had stabilized and gradually moderated while America's continued to rise.

Financial markets responded.

From 1996 to 2004, Canada still paid a modest premium on its 10-year bond yields – about 29 basis points on average – but the large gap that had characterized earlier decades had largely disappeared. After 2005, the relationship reversed and Canadian yields generally moved below those of the United States, with the average difference between 2005 and 2014 reaching 15 basis points in Canada's favour.

By 2014, inflation targeting in Canada had established a decades-long record of credibility and inflation remained broadly aligned with that of the United States. The debt story became increasingly in Canada's favour. Canada's federal net-debt-to-GDP ratio remained comparatively stable, only surpassing 50 percent in 2020, while the American debt burden climbed steadily higher, exceeding 95 percent in some years.

As the fiscal gap widened, so too did the bond yield gap.

Today, bond yields in Canada are well below those in the United States. On June 12, 2026, Canada's 10-year government bond yield stood at 3.40 percent compared with 4.45 percent in the United States – a difference of 105 basis points in Canada's favour. It is the largest borrowing-cost advantage Canada has enjoyed in more than half a century and a complete reversal of the Canadian interest premium that prevailed for decades.

That advantage matters. Lower bond yields reduce borrowing costs for businesses at a time when Canada desperately needs stronger investment and productivity growth. They also lower fixed mortgage rates, providing relief to households. This is especially beneficial in limiting the economy-wide risks from the renewal of mortgages taken out during the exceptionally low-rate environment of 2021 and 2022.

Credible inflation targeting and fiscal policy that has been less profligate than in the United States have transformed Canada from a country that paid a borrowing premium into one that now enjoys lower borrowing costs relative to the United States.

That advantage is worth protecting. Yet some, including the managing director of the International Monetary Fund, continue to argue that Canada has ample fiscal room to emulate the borrowing and spending practices increasingly common in other countries, including the United States. The bond market suggests otherwise. Markets may tolerate rising debt for a time, but eventually investors demand compensation for greater risk.

The lesson is straightforward. Sound monetary and fiscal policy are the foundation of lower borrowing costs, stronger investment, and higher living standards. Canada should solidify its advantage on interest costs by reducing its debt burden further and renewing the inflation targeting agreement between the Bank of Canada and the government of Canada when it expires this December 31.

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