ECONOMIC VIEWPOINT

Is There Enough Federal Fiscal Firepower to Support Canadians Impacted by Tariffs?

By Randall Bartlett, Deputy Chief Economist

Highlights

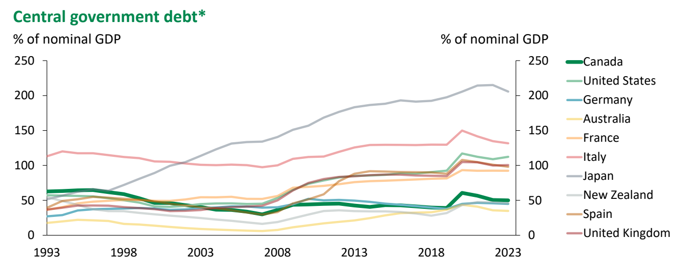
- Since Donald Trump was re-elected President of the United States in November 2024, the threat of renewed tariffs has been top of mind for Canadians. It has raised the question: is there enough federal fiscal firepower to support Canadians impacted by tariffs?
- We think the answer is yes. Central government net debt in Canada (which excludes CPP and QPP) is in the same league as that of other best-in-class advanced economies such as Germany, Australia and New Zealand, and well below debt levels in the US and elsewhere in the G7. Federal deficits are also projected to be lower in the coming years, again as a share of GDP, than in the US and elsewhere. As such, even in our pessimistic economic and downside fiscal scenarios, the Government of Canada could increase spending by a one-time $100B and still keep the federal debt-to-GDP ratio below its pandemic peak. Fortunately, there are also additional savings to be found, particularly in federal operating expenses tied to personnel.
- However, with Parliament prorogued, a Liberal Party of Canada leadership race underway and a federal election on the horizon, there doesn't seem to be much the Government of Canada can do to respond to a tariff shock in the near term. Until new spending is approved by Parliament, automatic stabilizers and existing programs may need to do much of the heavy lifting. The provinces may also have to shoulder more of the fiscal burden than during the pandemic, at least until Parliament returns.

With a re-elected President Trump once again threatening to apply tariffs on US imports from Canada, the question has been raised: is there enough federal fiscal firepower to support impacted Canadians? In this note, we address that question, as well as outline some of the considerations around a new round of federal stimulus.

Federal Finances Could Be Much Worse

First, Canada's federal government has a much lower level of net debt as a share of GDP than the US and many other large advanced economies (graph 1). Indeed, Canada's central government net debt-to-GDP ratio is broadly in line with the best performing comparable economies, including Germany, Australia and New Zealand. In contrast, the US central government's net debt-to-GDP ratio is in more dubious fiscal company with France, Italy, Spain and the United Kingdom. Hence the relatively high standing of Government of Canada debt among credit rating

Graph 1
Canada's Federal Government Net Debt Is Low Relative to Peer Countries



* Total stock of debt liabilities issued by the central government. Doesn't include the assets or liabilities of public pension plans in Canada.
International Monetary Fund and Desjardins Economic Studies

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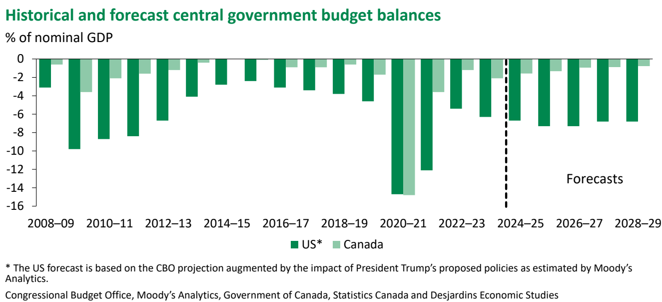
agencies. (It should be noted that Canadian central government debt does not include the Canada and Quebec Pension Plans, which are included in total government debt.)

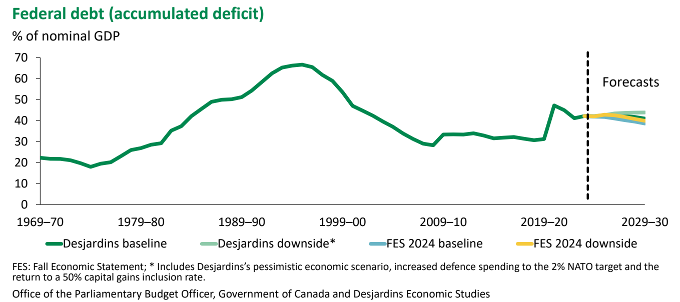
Second, the Government of Canada is expected to run much smaller budget deficits over the medium term than the US federal government (graph 2). Based on the policies Trump ran on during the campaign, new tax cuts will likely spur this fiscal shortfall south of the border. Spending reductions are possible as an offset, but so far details are scant.

Graph 2
Canada Is Forecast to Run Much Smaller Budget Deficits than the US



* The US forecast is based on the CBO projection augmented by the impact of President Trump's proposed policies as estimated by Moody's Analytics.
Congressional Budget Office, Moody's Analytics, Government of Canada, Statistics Canada and Desjardins Economic Studies

Graph 3
In a Historical Context, the Federal Debt-to-GDP Ratio Remains Contained

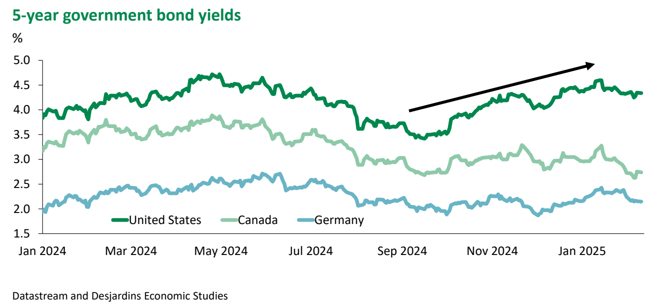


FES: Fall Economic Statement; * Includes Desjardins's pessimistic economic scenario, increased defence spending to the 2% NATO target and the return to a 50% capital gains inclusion rate.
Office of the Parliamentary Budget Officer, Government of Canada and Desjardins Economic Studies

Even if our more pessimistic economic scenario from December 2024 transpires, which assumes a recession in Canada thanks to an immediate 25% tariff on all imports from Canada starting in the first half of 2025, federal debt would likely remain on a broadly sustainable path in the absence of substantial new spending. Indeed, putting this debt outlook in a longer historical perspective suggests that fear of the erosion of debt sustainability at the federal level in Canada may be overblown. Even in our downside federal fiscal scenario—which combines our pessimistic economic scenario with defence spending rising to 2% of GDP by 2032 and a return to the 50% capital gains inclusion rate—the federal debt-to-GDP ratio should remain closer to its recent historical low of 28% of GDP, achieved just prior to the Global Financial Crisis (GFC), than the peak of over 66% reached in the mid-1990s (graph 3).

As a result of these considerations, the Government of Canada has not seen a rise in bond yields to the extent of its neighbour to the south (graph 4). Indeed, since Donald Trump was re-elected President of the United States in November 2024, longer-term US government bond yields have risen considerably across the curve. Canada is also subject to a lower interest rate on its debt.

Graph 4
US Bond Spreads Continue to Widen Against Other Major Economies



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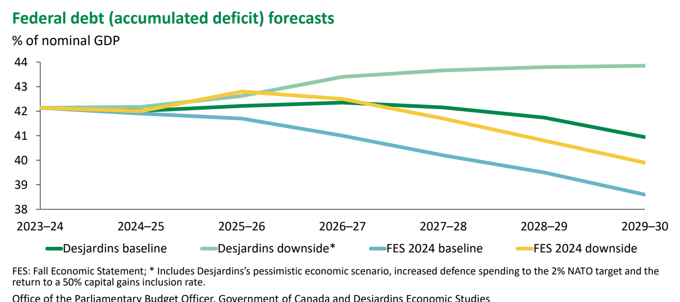
What Could a New Round of Federal Stimulus Look Like?

If our pessimistic economic and downside federal fiscal scenarios come to pass, the Government of Canada would likely see its debt-to-GDP ratio slowly rise even before any new stimulus spending is rolled out (graph 5). That's because tariff revenues would likely be insufficient to cover the lower personal and corporate income tax revenues resulting from slower economic growth. Expenses would also rise, as Employment Insurance (EI) benefit payments would increase while EI premiums tumble. Spending on means-tested programs such as the Canada Child

Graph 5
Federal Debt-to-GDP Would Keep Climbing Higher in Our Downside Scenario



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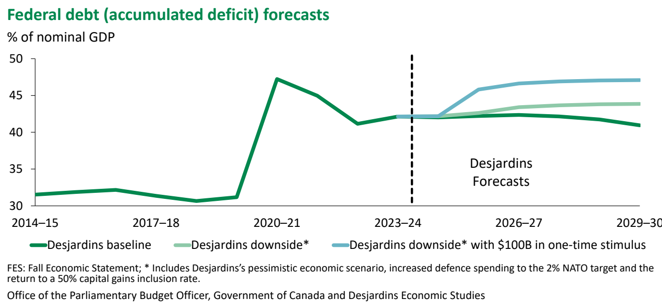
Benefit and elderly benefits would also likely rise in the event of a recession.

To support the economy through the period of adjustment that would follow a trade war with the US, there has been widespread speculation that the Government of Canada is planning a multibillion-dollar, pandemic-style relief package. By our estimate, the federal government could increase spending by a one-time $100B in the 2025–26 fiscal year and keep the federal debt-to-GDP ratio below the recent high of 47.2% reached during the pandemic (graph 6). And that's not accounting for the economic boost that would come from short-term income replacement or longer-term, productivity-enhancing investment in things like infrastructure.

Graph 6
Even One-Time Stimulus of $100B Would Leave the Debt-to-GDP Ratio Below the Pandemic Peak



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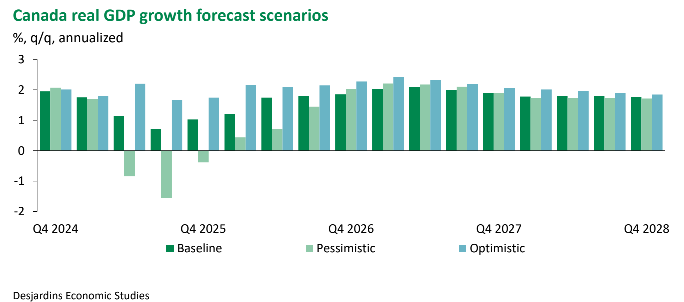
But unlike during the pandemic, support for the economy may need to be more sustained than acute, as it is in a typical recession. If economic support is more drawn out, the overall size of the stimulus could be larger while still keeping the debt-to-GDP ratio below its recent pandemic peak.

There are also reasons to believe that a pandemic-era level of support may not be necessary. (See our recent deep dive on the suitability of various policy interventions for the current circumstance.) For instance, in our pessimistic economic scenario, we are projecting a much shallower recession than experienced during the pandemic, even in the absence of substantial new stimulus spending (graph 7). Indeed, the depth of the recession in the next few quarters could look more like that during the GFC. Overdoing stimulus could therefore spur inflation beyond its tariff-induced level. In this context, targeted and time-limited support for individuals and industries most adversely impacted by tariffs would deliver more bang for the buck than broad, indiscriminate support. And finally, as we saw during the pandemic, programs that are rolled out too quickly and without sufficient oversight are more likely to be subject to fraud, possibly eroding trust in governments to meet the needs of Canadians.

Graph 7
Our Pessimistic Scenario Points to Sustained Economic Weakness



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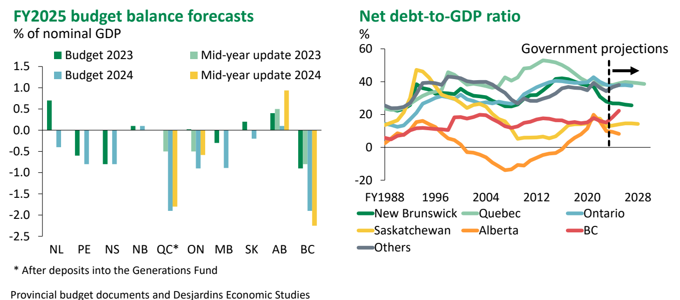
Unfortunately, with Parliament prorogued, a Liberal Party of Canada leadership race underway and a federal election on the horizon, much of this speculation may be for naught, at least for now. That's because there is a lot of uncertainty about how well the Government of Canada can respond to a tariff shock. Outside of existing programs that can be funded when the House of Commons isn't sitting and other modest measures, it seems as though there isn't much new stimulus the federal government can provide in the event of a full-blown trade war. As such, it may not be able to shoulder the fiscal burden of new spending that it did during the pandemic, at least in the near term. Instead, provincial governments may need to step into that void, leading to larger deficits and higher debt among subsovereigns than would otherwise be the case (graph 8).

Graph 8
Some Provinces Are Entering the Trade War in a Difficult Fiscal Position



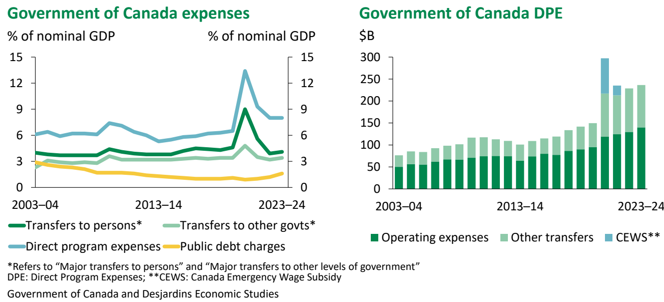
Provincial budget documents and Desjardins Economic Studies

Where Could Potential Federal Savings Come From?

To offset potentially higher government spending to support the economy in the event of a trade war with the US, the federal government could try to identify some savings. But it's an open question as to where spending cuts may come from, particularly if there is a desire to cut taxes going forward as well. Looking to federal spending, it's clear that major transfers to persons and other levels of government are roughly back to their pre-COVID levels as a share of GDP. However, direct program expenses

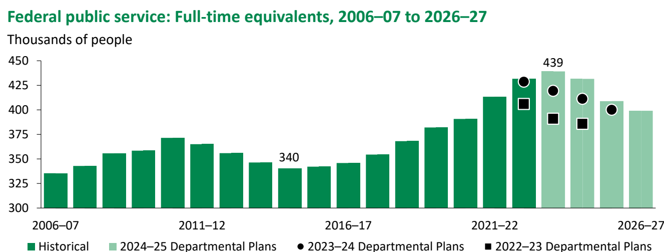
(DPE) remain elevated (graph 9). This increase in DPE over the past five years looks to be roughly evenly divided between operating expenses—the cost of running federal departments and programs—and other transfer payments.

Graph 9
Direct Program Expenses Remain Structurally High



The sharp rise in federal operating expenses can be largely chalked up to the roughly 30% increase in federal full-time employees since the 2014–15 fiscal year (graph 10). And every year, actual hiring consistently surpasses the previous year's forecast as new programs are proposed and developed. As such, this could be an area where a future prime minister and finance minister look for savings.

Graph 10
Federal Public Sector Employment Has Increased Significantly



GC InfoBase, Open data, 2022–23 to 2024–25 Departmental Plans, Office of the Parliamentary Budget Officer and Desjardins Economic Studies

Conclusion

All told, the Government of Canada's current fiscal standing is the envy of many of our peers, even if it may be heading in the wrong direction. This could allow for substantial new stimulus spending in the event of a full-blown trade war. However, given the nature of the economic shock, there may not be a need to deploy spending at the torrid pace seen during the pandemic. And even if the need is there, it's not clear that the federal government would be able to respond until after Parliament resumes at the end of March, and possibly not until after the next federal election.