Canada election preview – A reversal of fortune for the Liberals

Macroeconomic Research

Gabriella Dickens,
G7 Economist
Macro Research

Key points

- Since Liberal Party leader Mark Carney called for a snap election – scheduled for 28 April – the party has continued its remarkable recovery in the polls. It now looks like a very close race, with the Liberal Party on track to clinch the victory, albeit by a thin margin. A Liberal/New Democratic Party/Bloc Québécois coalition is not off the cards
- Regardless of the outcome, policy implications are likely to be broadly the same with both major parties advocating for a moderately more accommodative fiscal stance. Both are looking to cut personal taxes and boost support for businesses most affected by US tariffs. Higher fiscal spending is warranted given the tariffs and growing uncertainty
- Borrowing is therefore likely to rise. But Canada's public finances are relatively well placed to support additional borrowing, given that the debt-to-GDP is low compared to the rest of the G7

Canada's political fortunes have been on a rollercoaster ride since late 2024 and will culminate at the country's Federal Election on Monday 28 April. At the turn of the year, the ever-more unpopular Justin Trudeau was still Prime Minister, and the incumbent Liberal Party was trailing the main opposition Conservative Party by over 20 points in the polls, a trend that had been in place since mid-2022.

It looked as though a new era would soon be underway after a decade of Liberal rule. But the combination of Mark Carney replacing Trudeau and US President Donald Trump turning his attention to US-Canadian relations – marked by steep tariffs and threats to its sovereignty – resulted in a staggering turn of events. Indeed, the Liberal Party's popularity recovered and closed the gap in the polls by mid-March, a move Carney seized upon by calling a snap election for 28 April – ahead of the mandated time in October this year.

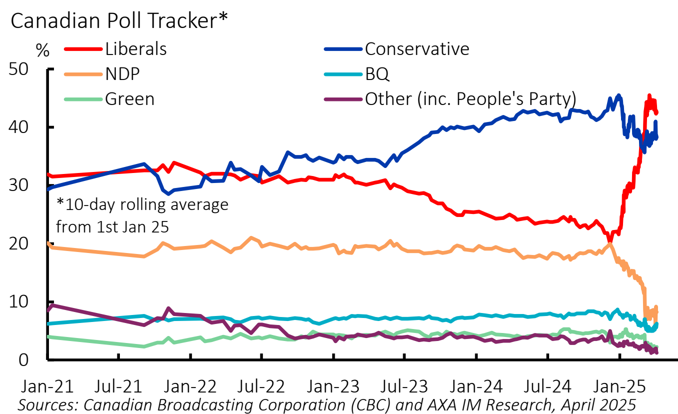
Whoever wins will inherit a challenging outlook. Domestic issues are still very much at the fore, including ongoing housing issues, tackling immigration numbers, sluggish private sector employment and weak productivity growth. But external pressures from the US – Canada's key trading partner and ally – and growing trade tensions broader impact on global growth are currently most pressing. Together, these factors amount to a deteriorating economic environment, with elevated uncertainty already impacting Canada's economy and growth expected to slow to a crawl in the second quarter (Q2). In this paper we examine the

current polling and consider what this will mean for government formation; we run through the key main policy differences; and discuss the reality of the public finances.

Polls are a rollercoaster

The recent turnaround in the Canadian political polls has been unprecedented. At the turn of the year, when Trudeau stepped down and parliament was prorogued while the Liberal Party's leadership race went ahead, the incumbent party was trailing the Conservative Party by around 22 points following a slow decline in Trudeau's popularity over previous years (Exhibit 1). But the success of Carney's leadership bid has boosted the Liberal Party's fortunes, particularly in the face of growing threats from the newly elected US President and his team against Canada's sovereignty and economy. Polling currently suggests Canadians have more faith in the Liberal Party when it comes to facing down the threatened onslaught from its closest ally, with many drawing obvious parallels between opposition leader Paul Poilievre and President Trump himself. From trailing just seven weeks ago, the Liberals have now stormed ahead, gaining over 20 points and had at one point garnered a 12-point lead.

Exhibit 1: Canadian political polls



Sources: Canadian Broadcasting Corporation (CBC) and AXA IM Research, April 2025

But most of the increase in the Liberal's support has not come from the main opposition party: the Conservatives have maintained a fairly stable position over the past couple of months given the rapid reversal in fortunes elsewhere, dropping by around six points to 38%, from 44% with its base continuing to be swayed by the party's focus on the underlying domestic issues, including immigration and the cost of living crisis. Rather it has come from other parties on the left of the political spectrum as Canadian's recognise that political polarisation means a vote for their party is effectively a vote for the Conservatives. The New Democratic Party (NDP) has seen around an 11-point drop in popularity to 8.3%, from 19.3%, since the turn of the year, Bloc Québécois (BQ) has witnessed just under a three-point fall to 5.9%, from 8.5%, while the Green Party has seen around a two-point decrease.

That said, the gap between the two major parties has narrowed once again over the past few days, as support for some of the smaller parties has started to rebound. Following the leaders' debate last week and with a fractious truce reached between Trump and Carney last month, the Liberals have seen their polling lead slip from an average of around six or seven points to around five at the time of writing, with one IPSOS poll over the weekend putting the Liberal lead at just three points – well within the polls' margin for error. At the same time, support for the NDP, BQ and the Greens has started to rise. Pollsters note that a near one-point increase in support for BQ will be a concern to Carney's hopes of a majority government, given the Liberals need to do well in Quebec to win. If the Bloc continue to improve its standing, a majority could be off the cards.

This is shaping up to be a tight race. For now, most statistical models suggest the Liberals will clinch the 172 seats needed for an outright majority in parliament. The CBC poll tracker, for instance, puts the Liberal's final seat count at 194, compared to 122 for the Conservatives, 21 for the BQ and five for the NDP. Canada operates a first past-the-post-system, with voters casting their ballot for their local representative and each winner gaining a seat in parliament. But it is close and while over half of Canadians would prefer the new ruling party to gain an outright majority, according to recent IPSOS polling, the chances of another minority government are now rising.

Indeed, some party leaders, including Yves-Francois Blanchet of the BQ and Jagmeet Singh of the NDP, are actively advocating for a Liberal minority government, with the former stating that he feels "reasonably optimistic" that he'd be comfortable supporting and collaborating with a Carney-led government, something that might convince Canadians who are hesitant about an outright Liberal government. If there is a hung parliament, then, we expect to see the resurrection of the Liberal/NDP coalition which fell apart in the latter days of Trudeau's premiership sparking the new leadership election in the first place. However, the geopolitical backdrop has shifted significantly and the Liberal Party has a new leader.

Fiscal expansion regardless of who wins

The direction of fiscal policy looks set to be relatively similar regardless of which of the main parties enter government. Both parties have outlined plans for a moderately more accommodative policy stance – equivalent to around 0.2% to 0.7% of GDP – with promises of tax cuts and measures to protect the– industries most exposed to Trump's tariff policies in an effort to win over voters.

On the personal taxes side, both have pledged to reduce the lowest income tax bracket, albeit to differing degrees. The Liberals have promised to reduce it by one percentage point (pp) to 14%, while the Tories have said they plan to decrease it

by 2.5pp to 12.5%, equivalent to 0.2% and 0.5% of GDP, respectively. Additionally, the Liberals plan to simplify access to employment insurance, while deferring corporate income tax payments and goods and services tax (GST) remittances throughout the summer. Meanwhile, the Conservatives are pledging to raise the Tax-Free Savings Account (TFSA) threshold by $5,000 (Canadian dollars), if the money is invested in Canadian companies, and are reducing the burden for seniors both by increasing the personal allowance for those earning between $34,000 and $42,000 and by allowing them to contribute to their Registered Retirement Savings Plans (RRSP) until the age of 73. The Conservatives also plan to write off the full cost of food, transportation and accommodation for workers when travelling.

One of Canadians' key policy concerns in this election is the housing market's unaffordability. And on this front again, both parties' policies look to be broadly similar. They've each pledged to offset some of the cost of housing by eliminating GST for certain buyers, again to differing extents. The Conservatives appear most generous, getting rid of GST for all buyers of new homes under $1.3m, whereas the Liberals intend to eliminate the tax just for first-time buyers buying a property under the value of C$1m. But Carney's party also intends to create a new entity called *Build Canada Homes* which would facilitate large orders of units from housing manufacturers while providing $10bn in low-cost financing and grants, in line with his campaign slogan "it's time to build".

A clearer difference between the two main parties can be seen in foreign policy. The Liberals have laid out plans for an increase in spending to offset the impact of tariffs, creating a $2bn strategic response fund to protect the jobs of workers affected by auto tariffs and help diversify supply chains. In addition, the party plans to put together a T*rade Diversification Corridor Fund*, equivalent to around $5bn over two years, to help exporters by investing in ports, railways and other transport infrastructure. Together these schemes are equivalent to 0.2% of GDP. They have also set a clear plan for defence spending, pledging to meet the required 2% of GDP by NATO by the end of the decade – defence spending was equivalent to just 1.4% in 2024 – and have orchestrated a deal with Australia to develop an artic radar system and have said they plan to invest an additional $420m to boost their military presence in the Arctic.

The Conservatives, by contrast, have put together a smaller temporary loan programme to help tariff-affected businesses, called the *Keep Canadians Working Fund* and have pledged to remove GST on Canadian-made autos, both of which are likely to have a negligible impact on GDP. On the defence side, they have merely said they will "meet the 2% target", but with no timeline, while making vague pledges to "secure the North". Elsewhere, the Liberals have promised to invest more in the green economy, increasing subsidies and consumer incentives to make homes more energy efficient, investing in electric vehicle (EV) charging infrastructure, as well as spending on indigenous reconciliation initiatives, including a liquified natural gas (LNG) processing facility. And the Tories are offering provinces a bonus if they get a free trade deal done with regards to removing inter provincial barriers to trade and have promised $1bn over three years to construct a road between First Nation communities and critical mineral deposits.

More borrowing, more debt

All this additional spending will need to be funded. In the previous Budget, the deficit was projected at $42.2bn for this fiscal year (FY), equivalent to around 1.3% of GDP and at $23bn by FY 2029/2030, equal to 0.6% of GDP, with the debt set to fall to 38.6% of GDP by FY 2029/2030, from 41.7% this year[1]. But despite both Carney and Poilievre openly discussing the need for fiscal restraint, the spending and tax promises of the two main parties combined with the negative impact of the trade war on tax revenues suggest these projections will end up wide of the mark. To give some context, Poilievre's 2.5pp tax cut alone will cost the Canadian taxpayer around $14bn annually, while the deferral of capital gains taxes on Canadian investment would leave a $10.5bn-sized hole over two fiscal years. Similarly, Carney's *Build Canada Homes* project requires $46bn in funding.

A looser fiscal stance, however, is warranted given the hit to consumers and businesses from the uncertainty surrounding US trade policy and new tariff barriers. Admittedly, Canada came out of the so-called Liberation Day relatively unscathed, despite the strong rhetoric earlier in the year, with the effective tariff rate at around 17.4%[2]. In the event, President Trump left those products covered by the USMCA trade deal – that he signed in his first term – tariff free, while noting that should the exemption end in the future, USMCA-compliant goods would face a tariff rate of 12%, excluding energy and potash, which would remain tariff free potentially pushing the effective rate higher.

While the direct impact of tariffs poses a significant headwind to economic activity, heightened uncertainty is also having a detrimental effect. While Canada's economy entered 2025 on a slightly stronger footing with solid retail sales driving annualised growth of 2.6%, as households started to feel the benefit of lower interest rates, monthly activity data showed no growth in February and the S&P composite Purchasing Managers Index (PMI) plunged to 42.0 in March, from 46.8 in February - a low

[1] "2024 Fall Economic Statement", Department of Finance Canada, Dec; 2024

[2] "State of U.S. Tariffs: April 15, 2025", The Budget Lab at Yale

not seen since the early stage of the pandemic and before that the financial crisis. The negative supply shock likely necessitates a greater fiscal response rather than a monetary one, allowing policy to target those areas of the economy most affected. Indeed, the Governor of the Bank of Canda (BoC) Tiff Macklem, has noted the trade-offs the BoC faces between keeping interest rates higher to limit the upside risk to inflation and lowering them to boost growth.

Moreover, Canada's overall public finance position allows much more flexibility to absorb additional – particularly contra-cyclical – borrowing. Canada's debt-to-GDP ratio is relatively small compared to its peers at around 42%, where the G7 average is just under 120%. As a result, the Canadian government starts from a place of relative stability enabling it to borrow more without spooking capital markets. Notably the yield on Canadian 10-year government bonds is currently more than 100 basis points below the US 10-year.

Starting with the Liberals, Carney intends to split the government budget into two parts. The first component will be an operating budget, covering day-to-day government spending, which Carney intends to balance by the third year of the forecast horizon. The second part will be a capital spending budget, dedicated to funding projects that enhance the country's productivity and would maintain a deficit of around 1% of GDP. To bring the former into balance, the Liberals plan to slow the government spending growth by capping the size of public services and using artificial intelligence to boost efficiency – a horse many governments are placing big bets on. Poilievre, meanwhile, has said he will fund tax cuts by reducing foreign aid, consultants and public services jobs. The upshot, though, is that revenues are likely to dip, spending will be higher, and consequently, borrowing will rise as well.

Looser fiscal policy will only partially offset tariff hit

Despite a moderately looser fiscal stance, we still expect Canadian growth to slow this year, due to the size and scope of the uncertainties stemming from geopolitical tensions. However, making precise forecasts under the current circumstances is challenging, not least because of the swings in US trade policy. Indeed, in its latest forecast round, the BoC did a scenario-based analysis based on two sets of assumptions. In the first, the BoC assumed the latest tariffs would eventually be "negotiated away" but in an unpredictable manner, with uncertainty remaining elevated throughout. In the second, the BoC assumed the US ramps up its tariff policy further sparking a long-lasting trade war.

In the first, the BoC expects trade-related uncertainty to be the main drag on activity, with GDP growth dropping to 1.6% annualised in Q2 before reaccelerating, albeit at a modest pace, leaving growth at 1.6% this year. In addition, weaker growth increases the negative output gap and persistent excess supply, which keeps inflation below target throughout 2025 and into early 2026, before returning to the 2% target over the rest of the forecast horizon. In the latter, the Bank expects GDP to drop to 0.8% this year and to fall outright by 0.2% in 2026, before eventually recovering to around 1.8% in 2027. But inflation picks up from spring 2026, due to the impact of tariffs, rising above 3%, before dropping back to the target over the forecast period.

Taking a step back, these scenarios are at two ends of a wide spectrum, with the eventual outcome likely somewhere in between. While acknowledging high levels of uncertainty, we expect events to align more closely with the BoC's first scenario given our current expectation that US trade tariffs will ease in the coming months - particularly after the passage of the fiscal bill - albeit over a bumpy path and with significant uncertainty in the near term. However, our expectation for US growth is weaker than that of the BoC in this scenario, which will also act as a drag on Canadian growth. We see a direct hit of around 1% to Canadian GDP and a further 0.5% hit from weaker US growth, meaning the boost from fiscal policy – which looks set to be between 0.2% and 0.7% of GDP depending on the election outcome – will not prevent a slowdown. On the inflation front, we see only modest upward pressure on inflation in the near term of less than 0.3% due to moderate retaliation.

What does this mean for the BoC? In our view, the downward impact on growth due to tariff uncertainty and the corresponding opening of slack looks set to be stronger and more persistent than any upward pressure on costs, leaving the BoC on track to cut twice further this year, leaving the policy rate at 2.25% by year-end. Further ahead, if US tariff pressure relents, there is scope for the Bank of Canada to restore the key policy rate back to its current level as private consumption recovers.

Our Research is available online: www.axa-im.com/investment-institute

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