



A responsible budget with a new debt-management strategy

Highlights

- A return to balanced budgets is still targeted for 2015-16. Budget balance could come a year earlier if targeted savings from the Strategic and Operating Review are realized.
- The deficit for the fiscal year just ending is estimated at \$40.5 billion. This is \$4.9 billion less than projected in last October's fiscal update, essentially because revenues were stronger than projected and spending was less than projected (partly as a result of deferrals to next year).
- The deficit budgeted for 2011-12 is \$29.6 billion, little changed from the October update. Additional revenues were offset by new measures costing about the same amount (\$2.3 billion).
- Since some measures introduced in today's budget are non-recurring (e.g. extension of the ecoEnergy home retrofit program, subsidy to Atomic Energy of Canada), their fiscal impact is offset by savings measures in subsequent years. Thus the deficits projected in today's budget after 2011-2012 are little different from those that would have resulted from the status quo (before new initiatives and savings measures).
- Increase in the Guaranteed Income Supplement for seniors (annual cost \$307 million).
- Innovation, education and training initiatives costing slightly more than \$300 million in each of the next two fiscal years.
- For 2011, a temporary hiring credit for small business (total cost \$165 million).
- Beginning March 31, 2011, one-year extension of the temporary 15% mineral exploration credit.
- Beginning in 2012-13, two-year extension of the temporary accelerated capital cost allowance treatment for investment in the manufacturing and processing equipment and machinery.
- Real GDP growth assumed at 2.9% in 2011, 2.8% in 2012 and an average 2.6% in the following three years.
- At the end of the coming fiscal year, debt from accumulated deficits is expected to be \$586 billion or 34.4% of GDP. The ratio is projected to decline in subsequent years to 29.7% in 2015-16.
- Financing requirements (net of refinancing) are estimated at \$34 billion in 2011-12, including \$12 billion for the new liquidity plan. The requirement falls to \$15 billion in 2012-13. Over the following two years, maturing assets of the Insured Mortgage Purchase Program will bring in net financial resources.
- The government has updated its strategy for management of medium-term debt and liquidity.

Opinion

Without today's budget, the strength of the economy since last October's fiscal update, even after risk adjustment, would have reduced the deficits of the next three years by an average \$2 billion each. This will not happen in 2011-12 because the budget introduces new measures costing \$2.3 billion. Since some of these are non-recurring, the cost will be less in subsequent years and will be offset in those years by savings measures. Consequently the deficits projected today for the years from 2012-13 on differ little from the updated outlook before today's budget. The government also announces a Strategic and Operating Review to be held in 2011-12 with the aim of finding annual savings of \$4 billion by 2014-15. The

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budget for 2011-12 does not incorporate these targeted savings. If they are realized, the federal budget will return to balance a year earlier than projected.

New debt-management strategy

For the first time since 2003-04, this budget updates the federal strategy for management of medium-term debt. The new approach, focused on stability and risk reduction, represents advanced practice in developed countries. In the wake of the financial crisis, the government is moving to smooth its cash flow and increase its cash reserves. Since modelling analysis has shown that portfolios weighted more toward short- and mid-term bonds would improve the cost-risk characteristics of the debt structure, the new strategy has an increased focus on issuance of 2-, 3- and 5-year maturities. In addition, four new maturity dates will be introduced to reduce rollover risk, with an increase in target size for benchmark maturities. The stock of T-bills outstanding is to decline \$15 billion over the next year. Under the new strategy, the government expects that the share of debt to be refinanced each year will range from 31% to 37% over the next decade and that the average term to maturity of market debt will range between seven and eight years.

The new debt-management strategy incorporates a plan to increase the government's liquid financial assets, such as Canadian-dollar deposits and foreign exchange reserves. When this liquidity plan is fully implemented, the government's overall liquidity will cover at least one month of net projected cash flows including coupon payments and debt refinancing. To accomplish this, the government will increase its deposits at financial institutions and the Bank of Canada by about \$25 billion over the next three years. It will increase its liquid foreign exchange reserves by US\$10 billion over the next fiscal year, to almost \$50 billion, and by enough thereafter to keep the reserves equal to at least 3% of nominal gross domestic product.

Implementation of the new debt-management strategy does not require adoption of the budget.

Conclusion

All things considered, we think the new budget initiatives, highly focused and partly non-recurring, will not derail the return to balanced budgets. In view of the IMF's recent statements about the imperative of establishing credible plans to restore the health of public finances, the federal government needed to show leadership. In investor eyes, the Canada brand is not tarnished by this budget.

Stéfane Marion / Marc Pinsonneault

**Summary Statement of Transactions
(Including Budget 2011 Measures)**

	2009– 2010	2010– 2011	2011– 2012	Projection			2015– 2016
				2012– 2013	2013– 2014	2014– 2015	
	(billions of dollars)						
Budgetary revenues	218.6	235.6	249.1	264.4	281.2	296.8	309.2
Program expenses	244.8	245.2	245.7	247.3	252.0	257.7	265.6
Public debt charges	29.4	30.8	33.0	36.5	38.6	39.4	39.4
Total expenses	274.2	276.0	278.7	283.8	290.7	297.2	305.0
Budgetary balance	-55.6	-40.5	-29.6	-19.4	-9.5	-0.3	4.2
Other comprehensive income	0.2	3.1					
Federal debt	519.1	556.4	586.0	605.4	614.9	615.2	611.0
Per cent of GDP							
Budgetary revenues	14.3	14.5	14.6	14.8	15.0	15.1	15.1
Program expenses	16.0	15.1	14.4	13.8	13.4	13.1	12.9
Public debt charges	1.9	1.9	1.9	2.0	2.1	2.0	1.9
Budgetary balance	-3.6	-2.5	-1.7	-1.1	-0.5	0.0	0.2
Federal debt	34.0	34.3	34.4	33.8	32.7	31.3	29.7

Note: Totals may not add due to rounding.