Quick Hit — Canadian general government debt: Don’t be so ‘gross’

We penned a Quick Hit last week, the primary subject of which was the Government of Canada’s better-than-planned fiscal result for 2016-17, as Ottawa’s deficit came in at less than 1% of GDP. Notwithstanding this Federal focus, we couldn’t resist highlighting Canada’s relatively favourable general government debt burden. As noted last week and illustrated once more in Chart 1, Canada may not have a tremendous edge if one keys on gross debt burdens, but this country’s general government net debt-to-GDP burden is a fraction (just 1/3rd) of the G-7 average. No sooner had we sent last week’s note than the questions started rolling in: what sectors are included in general government, what makes up the difference between gross and net debt, etc. Given the level of enquiry, we thought it appropriate to provide some additional colour/context/clarification on Canada’s broad fiscal standing.

First off, the ‘general government’ sector can be thought of as an amalgamation/consolidation of four subsectors: central, provincial/state and local governments, plus social security funds. So it’s a fairly broad concept, even if government business enterprises are technically clumped into the corporate sector. Meanwhile, the difference between ‘gross’ and ‘net’ debt is financial assets. We’ve presented a table on page 2, highlighting core balance sheet elements at each level of government in Canada. Ok, with these definitions/distinctions out of the way, here are a few observations:

- Canada may not have the largest pool of government financial assets in the advanced world—Norway, with its massive sovereign wealth fund, holds that crown—but we’re definitely up there (Chart 2). So when it comes to government balance sheet analysis, the netting of financial assets is a much bigger deal for Canada than for many other advanced countries.
- The sheer size of Canada’s public sector financial assets (and the corresponding gap between our general government gross and net debt ratios) tends to catch some by surprise. But make no mistake, Canada has long possessed an outsized stock of financial assets. General government financial assets have been worth 30% or more of GDP since at least 1980. The value of those financial assets has nonetheless stepped up measurably in the past ten years or so (i.e., since the global financial crisis).
- Dig through the National Balance Sheet Accounts and you’ll find that Canada’s general government sector is home to fully $1.5 trillion of financial assets (book value in Canadian dollars as at 2017:Q2). The market value is actually closer to $1.6 trillion.
- As you can see in Chart 3 and Table 1, balance sheet composition/health varies notably across the four layers of Canada’s general government sector. There are more liabilities in the provincial/territorial government sector than anywhere else. But it’s here where the largest stock of financial assets resides. Net those financial assets from provincial/territorial liabilities and the resulting net debt burden (<25% of GDP) slips below that of the federal government (where it’s closer to 30%). Of course, anyone halfway familiar with our federation knows individual provincial debt ratios vary widely.
- Given the generalized prohibition against operating shortfalls, Canada’s local/municipal government debt burden is eminently manageable. Net financial debt across the entire local/aboriginal government sector is less than 5% of GDP. Add in a predictable/balanced institutional framework, healthy regional economic fundamentals and conservative risk/financial management policies/practices, and you end up with a highly rated municipal bond market in Canada, where net funding needs are currently limited.
- Folding social security funds into general government is a key differentiator for Canada. Net financial assets in our social security system were approaching 20% of GDP (based on Q2 market values) and will march higher in the years ahead. A well-funded/actuarially sound public pension system bolsters Canada’s long-term fiscal sustainability. And to us, the demonstrated financial health and ultra-strong policy importance of the Canada Pension Plan makes related debt securities, issued by CPPfB, compelling investments ... particularly when you factor in important bondholder safeguards and the incremental spread one receives vs benchmark provincial credits.

So when it comes to Canada’s debt burden, don’t be ‘gross’. Focus instead on net debt, which we consider to be a much truer test of our nation’s fiscal health. Hopefully this note clears things up a bit, but if not, you know where to find us.

**Chart 1: Cda has leanest net debt burden in G-7**

*General government gross & net debt-to-GDP ratios (2016)*

![Graph showing Canada's net debt burden in G-7 countries](Source: NBF, IMF)

**Chart 2: Financial assets across advanced world**

*Difference between general government gross & net debt (2016)*

![Graph showing financial assets across advanced world](Source: NBF, Statistics Canada)
Chart 3: A view of balance sheet health in Canada’s general government sector

Financial assets, liabilities & net financial assets/(debt) by level of government in Canada (book value as at 2017:Q2)

Table 1: Dissecting balance sheets across Canada’s general government sector

Select balance sheet elements by level of government in Canada (book value as at 2017:Q2)

<table>
<thead>
<tr>
<th>C$bln (book value)</th>
<th>General government</th>
<th>Federal government</th>
<th>Provincial/territorial governments</th>
<th>Local/aboriginal governments</th>
<th>Social security funds</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total assets</td>
<td>A=B+C</td>
<td>2,406.3</td>
<td>400.7</td>
<td>1,115.0</td>
<td>494.9</td>
</tr>
<tr>
<td>Non-financial assets</td>
<td>B</td>
<td>902.8</td>
<td>63.5</td>
<td>459.7</td>
<td>379.6</td>
</tr>
<tr>
<td>Financial assets</td>
<td>C=sum(D:H)</td>
<td>1,503.6</td>
<td>337.2</td>
<td>655.3</td>
<td>115.3</td>
</tr>
<tr>
<td>Currency/deposits</td>
<td>D</td>
<td>118.9</td>
<td>54.0</td>
<td>28.9</td>
<td>36.0</td>
</tr>
<tr>
<td>Debt securities</td>
<td>E</td>
<td>306.2</td>
<td>6.7</td>
<td>178.1</td>
<td>33.5</td>
</tr>
<tr>
<td>Loans</td>
<td>F</td>
<td>235.5</td>
<td>79.7</td>
<td>132.3</td>
<td>1.2</td>
</tr>
<tr>
<td>Equity/investment fund shares</td>
<td>G</td>
<td>594.6</td>
<td>149.3</td>
<td>190.2</td>
<td>6.4</td>
</tr>
<tr>
<td>Other</td>
<td>H</td>
<td>248.5</td>
<td>47.5</td>
<td>125.8</td>
<td>38.3</td>
</tr>
<tr>
<td>Liabilities</td>
<td>I=sum(J:M)</td>
<td>2,400.7</td>
<td>974.2</td>
<td>1,156.7</td>
<td>210.6</td>
</tr>
<tr>
<td>Debt securities</td>
<td>J</td>
<td>1,614.1</td>
<td>726.7</td>
<td>796.5</td>
<td>69.0</td>
</tr>
<tr>
<td>Loans</td>
<td>K</td>
<td>69.4</td>
<td>6.0</td>
<td>53.0</td>
<td>10.3</td>
</tr>
<tr>
<td>Life insurance/pensions</td>
<td>L</td>
<td>254.4</td>
<td>150.2</td>
<td>104.2</td>
<td>0.0</td>
</tr>
<tr>
<td>Other</td>
<td>M</td>
<td>462.8</td>
<td>91.3</td>
<td>203.0</td>
<td>131.3</td>
</tr>
<tr>
<td>Net financial assets/(debt)</td>
<td>N=C-I</td>
<td>-897.1</td>
<td>-637.0</td>
<td>-501.5</td>
<td>-95.3</td>
</tr>
<tr>
<td>Net worth</td>
<td>O=A-I</td>
<td>5.7</td>
<td>-573.5</td>
<td>-41.7</td>
<td>284.3</td>
</tr>
</tbody>
</table>

Source: NBF, Statistics Canada
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