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Larger budget deficits amid fiscal stimulus and actuarial revaluations

By Krishen Rangasamy

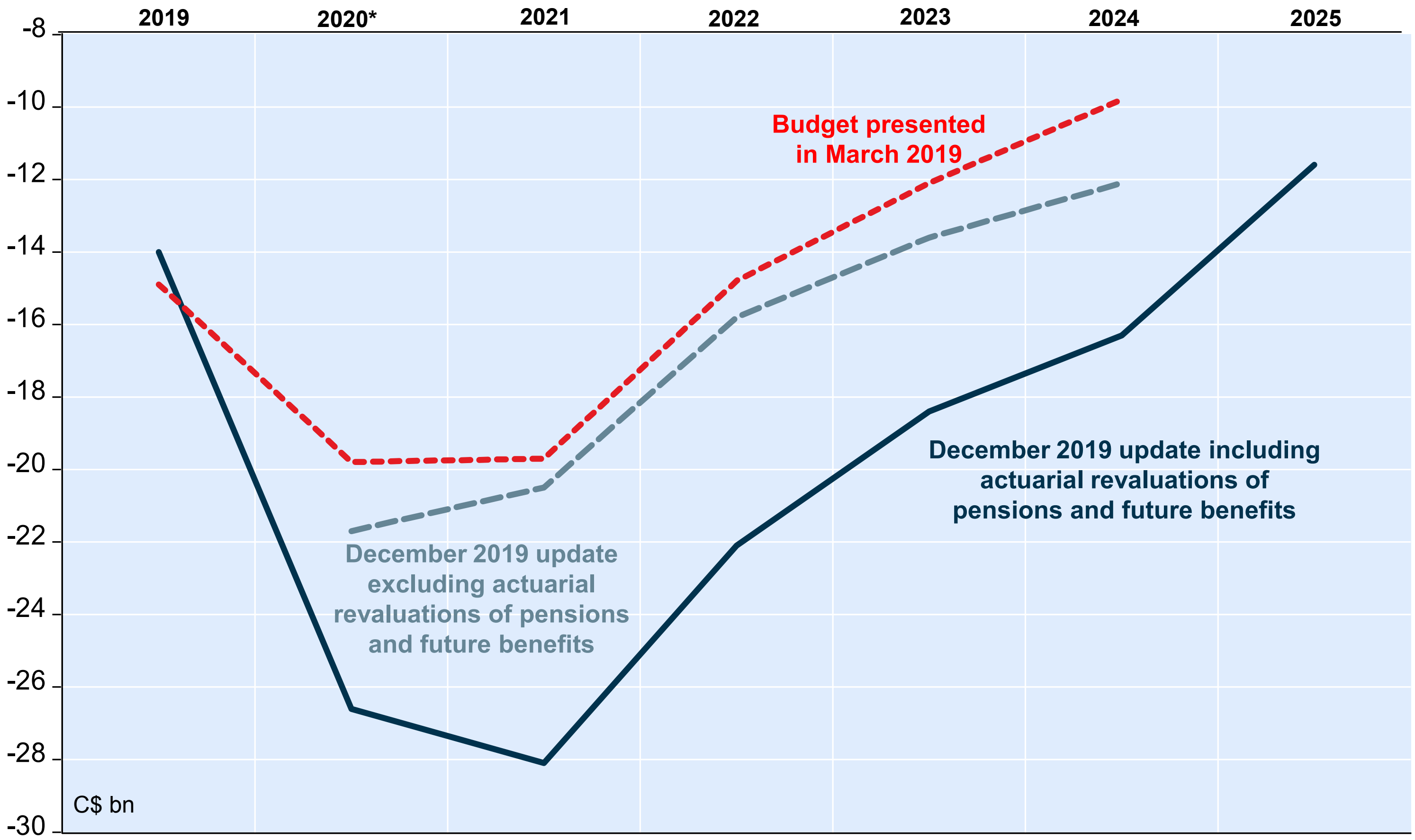
Less than two months after winning the federal elections, Justin Trudeau's Liberal government (now reduced to a minority) presented a fiscal update. Finance Minister Bill Morneau was tasked by Prime Minister Trudeau to maintain four key principles for the implementation of his government's fiscal plan. The latter has to reduce the government's debt as a function of the economy, build confidence by preserving Canada's AAA credit rating, invest in people and in the things that give people a better quality of life, and preserve fiscal firepower to respond to an economic downturn. Does today's fiscal update abide by those key principles? We think so. Here are some of the highlights:

- Economic outlook – The federal government touted Canada's economic performance but acknowledged growth remains uneven across the country. Private sector real GDP growth forecasts for 2019 and 2020 are unchanged from the ones used by Ottawa in last March's budget – growth is expected to come in at 1.7% and 1.6% respectively for those two years. The out years were tweaked marginally. However, the forecast level of nominal GDP, the broadest measure of the tax base, is higher by an average of about $3 billion per year over the forecast horizon compared to Budget 2019 projections. Interest rate forecasts have been revised down significantly by private sector forecasters compared to last March.
- Current fiscal year budget balance – Ottawa expects to run a $26.6 billion budget deficit for the fiscal year ended March 2020, equivalent to roughly 1.2% of GDP. That's almost $7 billion larger than projected in last March's budget, although the adjustment for risk is just $1.5 billion (versus $3 billion in last March's projection).
- Medium-term fiscal outlook –The budget deficit is projected to peak at $28.1 billion in 2020-21 before edging down to $22.1 billion in 2021-22, $18.4 billion in 2022-23, $16.3 billion in 2023-24 and $11.6 billion in 2024-25. Those projections include a $3 billion adjustment for risk in every year. There is no timeline for deficit elimination.
- Revenue outlook – Thanks in large part to higher projections for the level of nominal GDP, the federal government's revenues are forecasted to grow by an extra $13 billion over the next four years, i.e. through 2023-24.
- Spending outlook – Ottawa's obligations for pensions and other benefits are determined on a present value basis. As such, lower forecasts for interest rates translate into larger estimated obligations for Ottawa. Such actuarial revaluations of employee pensions and future benefits are responsible for causing an extra $27.8 billion in expenses over the next four years.
- Personal income tax cuts – By raising the "Basic Personal Amount" — the threshold above which personal income is taxed by the federal government —, Ottawa will reportedly lower the tax bill of nearly 20 million Canadians. The finance department expects a fiscal impact of C$25.1 bn over the next five years.
- Fiscal anchor – With fiscal red ink as far as the eye can see, count on the Liberal government to highlight its fiscal anchor i.e. the declining debt to GDP ratio. The latter is expected to drop from 30.8% to 29.1% by 2024-25 (after including an adjustment for risk), the lowest since 2008-09.
- Other announcements – Ottawa will launch the first phase of a comprehensive review of government spending and tax expenditures "to ensure that resources are efficiently allocated to continue to invest in people and keep the economy strong and growing". The government thinks this will result in $1.5 billion in annual savings starting in 2020-21. Cognizant of significant impacts of actuarial revaluations, Ottawa will start consultations to explore the possibility of changing the way those are reported in financial results. The federal government also pledged to "accelerate its efforts to ensure that Canadian companies have the support they need to break into new markets, expand their presence in existing markets, execute on their export growth plans and take full advantage of new trade agreements".

Bottom line:

The combination of fiscal stimulus and actuarial revaluations of employee pensions and other benefits has left Ottawa with larger projected budget deficits than forecasted last March (see chart next page). Even then, a projected budget deficit of 1.2% of GDP in 2020-21 compares favourably with those of many economies in the OECD (including our southern neighbours) and is no threat to Canada losing its AAA rating. As such, there is still "fiscal firepower" or room for action from Ottawa should the economic outlook deteriorate. We are encouraged by the government's plan for a comprehensive review of expenses and its pledge to provide assistance to exporters to fully exploit trade deals, something we have been advocating for a while now. The proposed cuts to personal income tax will provide relief at an opportune time for a household sector that's reeling from a high debt burden and should help boost GDP growth by roughly 0.2% in each year. Expect the Bank of Canada to include this new fiscal stimulus in its growth forecasts next month. The situation of minority government means there's no guarantee the Liberal's fiscal plan will be approved by the new Parliament. But it's hard to imagine opposition politicians objecting to tax cuts aimed at the middle class. Doing so would effectively be a no-confidence vote, setting the stage for new federal elections for which opposition parties have little appetite at this point in time.

Larger budget deficits amid fiscal stimulus and actuarial revaluations
Federal budget balance projections for each fiscal year end (include C$3 bn adjustment for risk)



** For 2020, the adjustment for risk is only C$1.5 bn*
NBF Economics and Strategy (data via Department of Finance)

Summary Statement of Transactions
billions of dollars

	2018–2019	Projection 2019–2020	2020–2021	2021–2022	2022–2023	2023–2024	2024–2025
Budgetary revenues	**332.2**	**340.1**	**352.3**	**367.2**	**381.8**	**395.9**	**411.9**
Program expenses	322.9	340.8	353.6	361.0	370.0	379.8	389.1
Public debt charges	23.3	24.4	23.7	25.3	27.3	29.5	31.5
Total expenses	**346.2**	**365.2**	**377.4**	**386.3**	**397.2**	**409.2**	**420.5**
Adjustment for risk		-1.5	-3.0	-3.0	-3.0	-3.0	-3.0
Final budgetary balance	**-14.0**	**-26.6**	**-28.1**	**-22.1**	**-18.4**	**-16.3**	**-11.6**
Federal debt[1]	685.5	713.2	741.4	763.4	781.8	798.1	809.7
Per cent of GDP							
Budgetary revenues	14.9	14.8	14.7	14.8	14.8	14.8	14.8
Program expenses	14.5	14.8	14.8	14.6	14.4	14.2	14.0
Public debt charges	1.0	1.1	1.0	1.0	1.1	1.1	1.1
Budgetary balance	-0.6	-1.2	-1.2	-0.9	-0.7	-0.6	-0.4
Federal debt	30.8	31.0	31.0	30.8	30.4	29.8	29.1

Note: Totals may not add due to rounding.
1 The projected level of federal debt for 2019-20 includes an estimate of other comprehensive income.

Economic and Fiscal Developments Since Budget 2019[1]
billions of dollars

	2018–2019	Projection 2019–2020	2020–2021	2021–2022	2022–2023	2023–2024	2024–2025
Budget 2019 budgetary balance	**-14.9**	**-19.8**	**-19.7**	**-14.8**	**-12.1**	**-9.8**	
Adjustment for risk from Budget 2019	0.0	3.0	3.0	3.0	3.0	3.0	
Budget 2019 budgetary balance (without risk adjustment)	**-14.9**	**-16.8**	**-16.7**	**-11.8**	**-9.1**	**-6.8**	
Economic and fiscal developments since Budget 2019							
Revenues	0.0	1.7	1.8	2.2	3.5	3.8	
Expenses	0.9	-5.8	-7.6	-6.3	-5.7	-5.2	
Of which: Employee pensions and future benefits	*0.0*	*-4.9*	*-7.6*	*-6.3*	*-4.8*	*-4.2*	
Total	0.9	-4.2	-5.9	-4.1	-2.2	-1.5	
Revised budgetary balance before policy actions and investments	**-14.0**	**-21.0**	**-22.6**	**-15.9**	**-11.3**	**-8.3**	
Policy actions since Budget 2019[2]							
Hibernia Dividend Backed Annuity Agreement with Newfoundland and Labrador		-1.9	0.0	0.0	0.0	0.0	0.0
Other Policy Actions since Budget 2019		-1.5	0.5	0.9	1.1	1.0	1.2
Increase to the Basic Personal Amount		-0.7	-3.0	-4.1	-5.1	-6.0	-6.2
Final budgetary balance	**-14.0**	**-25.1**	**-25.1**	**-19.1**	**-15.4**	**-13.3**	**-8.6**
Federal debt (per cent of GDP)	*30.8*	*30.9*	*30.9*	*30.5*	*30.0*	*29.3*	*28.5*
Adjustment for risk[3]		-1.5	-3.0	-3.0	-3.0	-3.0	-3.0
Budgetary balance after adjustment for risk	**-14.0**	**-26.6**	**-28.1**	**-22.1**	**-18.4**	**-16.3**	**-11.6**
Federal debt after adjustment for risk (per cent of GDP)	*30.8*	*31.0*	*31.0*	*30.8*	*30.4*	*29.8*	*29.1*

Note: Totals may not add due to rounding.
1 A negative number implies a deterioration in the budgetary balance (lower revenues or higher expenses). A positive number implies an improvement in the budgetary balance (higher revenues or lower expenses).
2 Table A1.7 provides a detailed list of policy actions since Budget 2019.
3 The adjustment for risk for 2019-20 has been revised to $1.5 billion, as actual economic data are now available for two-thirds of the fiscal year, meaning the risk for 2019-20 as a whole has been reduced. For prudent planning purposes, the adjustment for risk is $3.0 billion in future years, to account for risks and uncertainty in the economic and fiscal forecast.

Source: Department of Finance (Economic and Fiscal Update 2019)

Economics and Strategy

Montreal Office
514-879-2529

Stéfane Marion
Chief Economist and Strategist
stefane.marion@nbc.ca

Matthieu Arseneau
Deputy Chief Economist
matthieu.arseneau@nbc.ca

Krishen Rangasamy
Senior Economist
krishen.rangasamy@nbc.ca

Paul-André Pinsonnault
Senior Fixed Income Economist
paulandre.pinsonnault@nbc.ca

Marc Pinsonneault
Senior Economist
marc.pinsonneault@nbc.ca

Kyle Dahms
Economist
kyle.dahms@nbc.ca

Jocelyn Paquet
Economist
jocelyn.paquet@nbc.ca

Angelo Katsoras
Geopolitical Analyst
angelo.katsoras@nbc.ca

Toronto Office
416-869-8598

Warren Lovely
Chief Rate Strategist, Economics and Strategy
warren.lovely@nbc.ca

Taylor Schleich
Associate, Rates Strategist, Economics and Strategy
Taylor.Schleich@nbc.ca

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