

## Market View – Bill Morneau: Canada's \$3 trillion man

By Warren Lovely

With a single press release (announcing a "more dynamic" stress test for insured mortgages), Finance Minister Bill Morneau reminded us he's arguably the most influential Canadian in financial markets. Yes, Morneau has a boss: the bearded wonder that is Prime Minister Justin Trudeau. But Trudeau's detailed instructions to Morneau—in a December 2019 mandate letter—are as long as my arm (page 2). Technically, the mandate letter to the Minister of Innovation, Science and Industry ran a bit longer, but on close inspection the Minister of Finance (or his Associate) has a direct role to play here too, as he does in the majority of ministries.

**Fiscal reach & borrowing authority** The finance minister is the architect of Ottawa's budget, where outlays are \$365 billion or ~15% of GDP. As the holder of the purse strings, the finance minister must be pretty popular with colleagues seeking funding for various initiatives. Morneau has managed more than a few "yesses", as evidenced by a \$25 billion deficit (about 1% of GDP). There's no end in sight for federal red ink and we expect more "investments" in an upcoming budget. Morneau's crew handles all federal borrowing, pursuant to a legislated borrowing cap of \$1.168 trillion. That's one heck of a credit card! Debt market liquidity and the slope of Canada's yield curve (notably in the longer end) derive as much from Finance's decisions on when, where and how much to issue as anything.

**Recession fighter** It will fall to Morneau (or his eventual successor) to craft/orchestrate much of the federal response to any bump in the economic road ahead. Thinking back to the Global Financial Crisis, Finance (headed by the late Jim Flaherty) rushed out tax cuts/incentives and all kinds of spending, simultaneously implementing an Extraordinary Financing Framework (EFF). A pillar of the EFF was an Insured Mortgage Purchase Plan, which was *quasi* quantitative easing (in a sense). Mind you, in that particular case, the purchase of almost \$70 billion of NHA-insured MBS product was administered not by the monetary authority, but by CMHC—a federal crown responsible in part to... you guessed it... the Minister of Finance. It was likewise Finance that granted the authority for the Bank of Canada's extraordinary liquidity facilities, designed to keep financial markets from seizing up. To be fair, the BoC pitched in with substantial rate relief from 2007–2009, and provinces channeled Keynes. But in today's low rate environment, with aggregate provincial debt near record highs, the feds will presumably need to carry the heaviest load the next time Canada's economy really stumbles.

**Tax/transfer man & national champion** Finance's tax and tariff policies help determine our relative competitiveness and influence affordability/wealth metrics for Canadians of all political leanings. Federal tax changes can jolt markets. Take the decision to tax income trusts (2006's 'Halloween Massacre'), changes to 'synthetic equity arrangements' (which sent debt markets into a tizzy five years back) or 'income sprinkling' provisions (sparking an outcry from farmers, doctors and small business). As the guardian of the sovereign's vaunted 'AAA' rating, the finance minister drives investor attitudes towards Canada. Along with the provinces, Morneau oversees the Canada Pension Plan—the bedrock of the retirement income system. His department sets the framework for federal-provincial transfers, with Morneau hand delivering envelopes to his provincial counterparts each year. It may have been former PM Stephen Harper's signature on the original loan guarantee for Muskrat Falls... or Jim Carr's name, as former Natural Resources Minister, on a subsequent guarantee... but Morneau's pretty involved here, including on needed rate mitigation for Newfoundland and Labrador.

**BoC tie-in** The portfolio of agencies/crowns where Finance has complete or partial statutory authority is extensive. Critically, it includes the Bank of Canada. In his role, Morneau is the government's point man on the renewal of the central bank's inflation-control target (next due in 2021). The appointment of the next BoC Governor (a much nearer-term decision) is subject to his approval (and that of the broader federal cabinet). If that wasn't enough, Morneau's easing of the insured mortgage stress test could impact the BoC's monetary policy calculus. It seems likely OSFI (also under the purview of Finance) will parallel the changes for uninsured mortgages. While hardly trying to erode central bank independence, the Finance Minister is making it easier/cheaper for Canadian borrowers to get credit. That's kind of like what happens when the BoC overtly cuts its policy rate, if you'll permit a bit of a generalization.

**The Three Trillion Dollar Man** The entire \$1.6 trillion residential mortgage stock may not be under Morneau's thumb. But for a bit of fun, add the value of those mortgages to the ~\$1 trillion of federal interest-bearing debt, the \$300 billion or so of CMB, EDC and Muskrat bonds outstanding (explicitly guaranteed by Ottawa), and the roughly \$40 billion of bonds so far printed by CPPIB and PSP Capital (where the relationship with Canada is sometimes labeled "stronger than an implicit guarantee"). Do that, and Morneau could be dubbed Canada's \$3 trillion man! That's like Col. Steve Austin times 5E+5. And that's without connecting any of the debt at provincial, local or aboriginal levels of government, where Finance's policies play an important role and implicit support is assumed by some.

**Bottom line** Given virus-related disruptions to global supply chains and widening fallout from blockades of Canada's core transportation infrastructure, who are we to rule out an insurance BoC rate cut. Really, the odds that Stephen Poloz has to cap his Governorship with a cut rise in proportion to the economic damage currently being wrought. But with Canada's Three Trillion Dollar Man flexing some of his macroprudential and fiscal stimulus muscles, there's less of a need for significant and sustained monetary policy accommodation in Canada than elsewhere. So if the BoC does indeed pull the trigger on a rate cut, don't be surprised by how quickly Morneau helps Governing Council take it back. In today's low-rate world, it's increasingly in Bill we trust!

### Excerpt: As Minister of Finance, Morneau's fresh mandate is wide ranging indeed

Selected elements of Prime Minister Trudeau's December 2019 Mandate Letter to Minister of Finance Morneau (with sections highlighted by us). To read all 2,360 words of Morneau's mandate, go to: [pm.gc.ca/en/mandate-letters/2019/12/13/minister-finance-mandate-letter](https://pm.gc.ca/en/mandate-letters/2019/12/13/minister-finance-mandate-letter)

I will expect you to work with your colleagues and through established legislative, regulatory and Cabinet processes to deliver on your **top priorities**. In particular, you will:

- **Maintain four key principles** for the implementation of our **fiscal plan**:
  1. Continue to **reduce the Government's debt as a function of our economy**;
  2. Continue to build confidence in Canada's economy by **preserving our AAA credit rating**;
  3. **Continue to invest** in people and in the things that give people a better **quality of life**; and
  4. **Preserve fiscal firepower** in the event that we need to **respond to an economic downturn**.
- As our **top Parliamentary priority**, introduce legislation to **cut taxes for the middle class and those working hard to join it**. You will develop a new Basic Personal Amount (BPA) of \$15,000. **Higher income individuals should not benefit from this tax cut but will still receive the existing BPA tax credit**.
- **Cut tax rates by 50 per cent for companies that develop and manufacture zero-emissions technology**. Eligible sectors should include but not be limited to: manufacturing related to renewable energy, renewable fuels production, zero-emission vehicles, carbon sequestration and removal technology, batteries for use in zero-emission vehicles, and grid storage and electric vehicle charging systems.
- Continue to work with the Minister for Women and Gender Equality and Rural Economic Development and the Minister of Diversity and Inclusion and Youth to **improve the quality and scope of Gender-based Analysis Plus (GBA+) in future budgets**.
- Work with the Deputy Prime Minister and Minister of Intergovernmental Affairs to support the Minister of Health to **strengthen Medicare, renewing our health agreements with the provinces and territories** in four priority areas:
  - Ensure that every Canadian has access to a family doctor or primary health care team;
  - Set national standards for access to mental health services so Canadians can get fast access to the support they need when they need it;
  - Continue to make home care and palliative care more available across the country; and
  - Continue to implement national universal pharmacare, including the establishment of the Canada Drug Agency, a national formulary and a rare disease drug strategy to help Canadian families save money on high-cost drugs.
- Ensure that all **proceeds** that the federal government receives **from the Trans Mountain Expansion project**, including incremental corporate income tax revenue, dividends and capital gains on sale, are **invested in nature-based climate solutions and clean energy projects**.
- Undertake a new **comprehensive review of government spending** that provides transparent and public reporting to Canadians of the results and analysis.
- Undertake a **review of tax expenditures to ensure that wealthy Canadians do not benefit from unfair tax breaks**. Ensure that this process provides transparent and public reporting to Canadians of the results and analysis.
- Modernize anti-avoidance rules to **stop large multinational companies from being able to shop for lower tax rates** by constructing complex schemes between countries.
- **Close corporate tax loopholes** that allow companies to excessively deduct debt to artificially reduce the tax that they pay.
- Introduce a **new 10 per cent tax on luxury boats, cars and personal aircraft over \$100,000**.
- **Ensure that multinational tech giants pay appropriate corporate tax** on the revenue that they generate within Canada.
- Work with the Organisation for Economic Co-operation and Development to ensure that **international digital corporations** whose products are consumed in Canada **collect and remit the same level of sales tax** as Canadian digital corporations.
- Work with the Minister of Families, Children and Social Development who is the Minister responsible for the Canada Mortgage and Housing Corporation (CMHC) to **limit housing speculation** by developing a framework and **introducing a 1 per cent annual vacancy and speculation tax** on applicable residential properties **owned by non-resident non-Canadians**. This would involve working with provinces, territories, municipalities and law enforcement to track housing ownership and speculation.
- In the upcoming **review of the Canada Pension Plan (CPP)**, work with the Minister of Seniors and the provinces and territories to **increase survivor benefits** under the CPP and the Quebec Pension Plan by 25 per cent.
- Support the Minister of Employment, Workforce Development and Disability Inclusion in **implementing the Canada Training Benefit**.
- Finalize a report, which will **include a list of federal fossil fuel subsidies** including the description of the subsidies, annual costs and analysis of the subsidies. This report will be made public once a peer review is finalized.
- Work in collaboration with provinces to **ensure that the CPP enhancement is completed**.
- Support the Minister of Innovation, Science and Industry in concluding consultations with provinces and territories on the creation of a **pan-Canadian public registry for beneficial ownership** and in preparing legislation reflecting the outcome of those consultations.
- Finalize amendments to the *Income Tax Act* to **limit the benefit of the employee stock option deduction** for high-income individuals employed at large, long-established mature firms.
- Review and consider recommendations from financial agencies related to **making the borrower stress test more dynamic** — Cue Tuesday's announcement
- Support the Minister of Crown-Indigenous Relations and the Minister of Indigenous Services in developing a **new fiscal relationship with Indigenous Peoples**.
- Work with the Minister of Agriculture and Agri-Food on tax measures to **facilitate the intergenerational transfer of farms**.
- Support the Minister of Infrastructure and Communities in **ensuring that the Canada Infrastructure Bank has the support it needs** for its core purpose of **attracting private sector and institutional investment** to **expand the scope of public infrastructure investment** in Canada.
- Complete implementation of the **new financial consumer protection framework**.
- Support the Minister of Innovation, Science and Industry in developing enhanced consumer protections, including the **creation of a new Canadian Consumer Advocate**.

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