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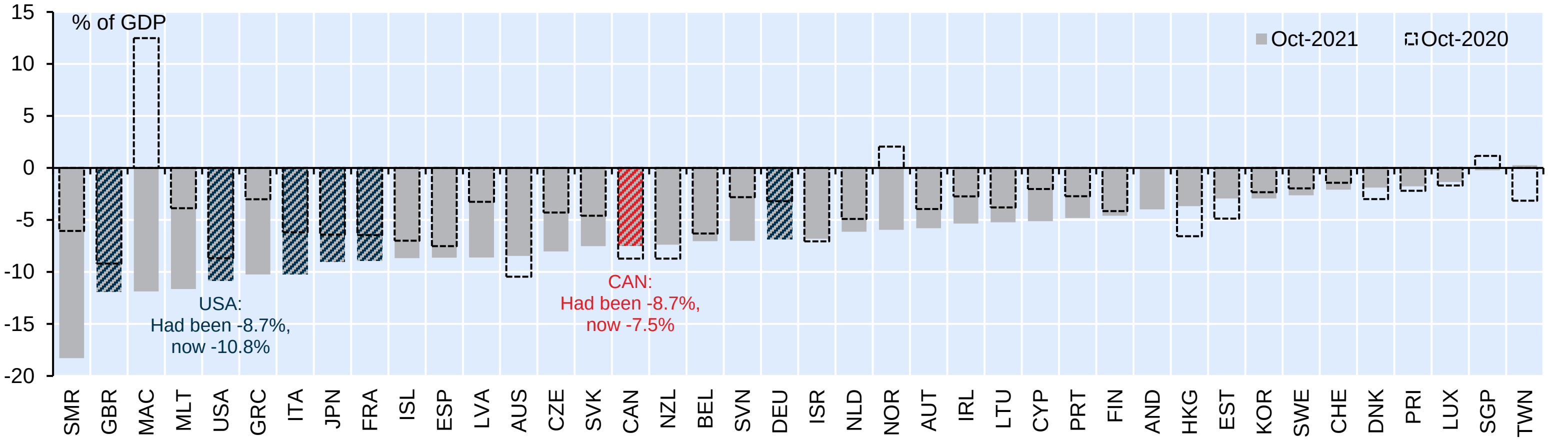
Canada's fiscal advantage preserved

By Warren Lovely & Taylor Schleich

With the release of the IMF's latest global outlook, a lot of attention was rightly placed on the detrimental impact of supply chain disruptions. But nestled alongside the IMF's fresh country-by-country forecasts of growth and inflation is the latest assessment of fiscal prospects. For Canada, there's still a lot to be relatively proud of.

Chart 1: 2021 fiscal balances across advanced world… Canada's fiscal picture improves, while many others see deterioration

2021 general government fiscal balance (i.e., net lending/(borrowing)): Current outlook for 40 advanced nations vs. last October for comparison

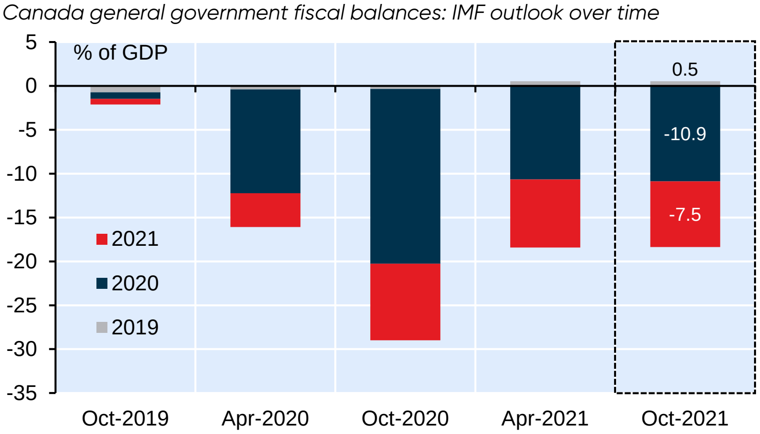


Source: NBF, IMF | Note: Red pattern fill denotes CAN; blue pattern fill denotes other G7 nation; dotted lines refer to projected fiscal balance from one year ago; no prior-year forecast available for AND

(1) Adding all levels of government plus the social security system (aka 'general government'), Canada is still running a deficit. But Canada is no outlier, with governments swimming in red ink all over the world. Canada is one of a small handful of major advanced nations where the estimated shortfall for 2021 is now skinnier than what was being forecast last fall. This relative shift is particularly notable vs. the U.S.; whereas last fall the two nations were expected to have an equivalent deficit, Canada has made fiscal progress while the U.S. outlook has deteriorated.

Chart 2: Canada's fiscal picture much improved vs. last fall

Canada general government fiscal balances: IMF outlook over time

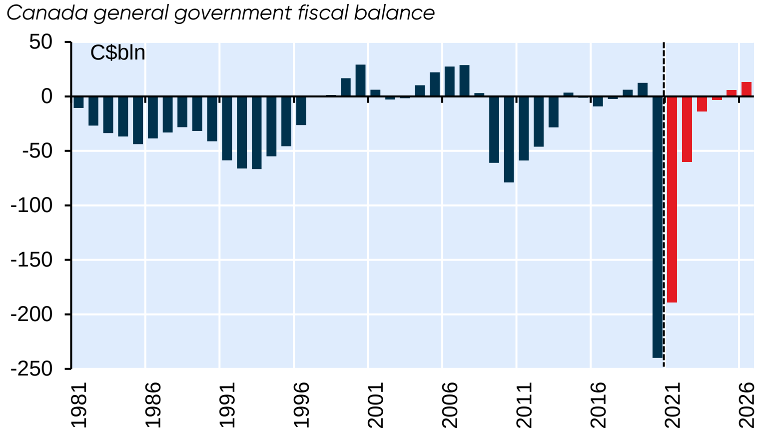


Source: NBF, IMF

(2) There's also a much-improved handoff from 2020, where Canada's shortfall is now pegged at 10.9% of GDP. That's nearly half of what was feared at one point. Putting 2020 and 2021 together, we're talking about a material improvement in Canada's fiscal fortunes relative to prior guidance and vs. a number of other advanced nations. Moreover, if you've been following this country's fiscal updates, you're aware that there's still very much positive fiscal momentum on display, hinting at an even smaller 2021 shortfall when all is said and done.

Chart 3: General government deficit erased mid-decade?

Canada general government fiscal balance

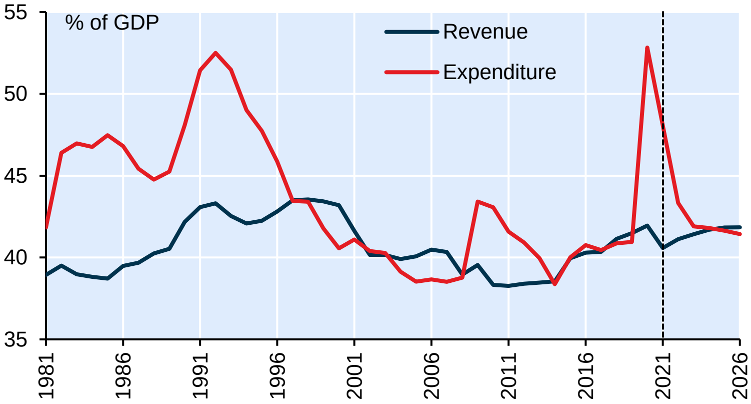


Source: NBF, IMF | Note: Forecast from 2021 onwards

(3) On a forward-looking basis, the IMF's latest outlook sees Canada's general government sector all but erasing its combined deficit by 2024. We'd note that federal-provincial governments have yet to commit to such a timeline, but there will be consistently positive contributions from the nation's social security regime. By mid-decade, when it's thought that Canada's general government sector may once again be balanced, the average advanced economy fiscal deficit will still be around 3% of GDP. Advantage Canada.

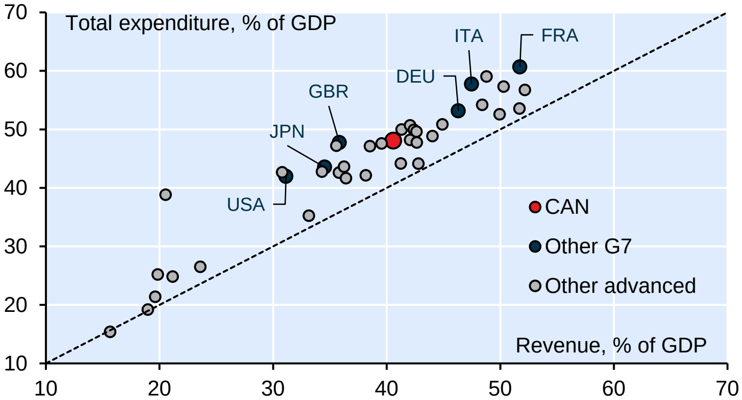
(4) Canada's expected fiscal improvement captures a wind down of extraordinary government spending, combined with a gradual and sustained firming of revenue. As our Economics and Strategy colleagues have argued, we believe Canadian households are well positioned to survive the dismantling of COVID supports. If anything, an increasingly tight labour market could argue for ending certain income-support programs in the near term, if only to encourage more Canadians to rejoin the labour market. [Note: Related chart on government revenue/expenditure located on following page.]

Chart 4: Extraordinary spending to fade while revenue firms
Canada general government revenue & total expenditure



Source: NBF, IMF | Note: Forecast from 2021 onwards

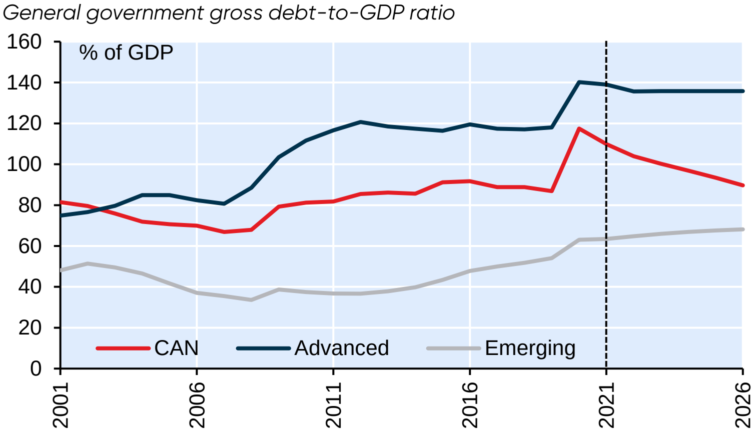
Chart 5: Canada's tax-spend balance hardly extreme
General government revenue & total expenditure relative to GDP: 2021



Source: NBF, IMF | Note: Placement above dotted line implies fiscal deficit

(5) For fiscal hawks dismayed by the seeming permanency of some government spending pledges and/or the potential for a larger and more progressive tax bite, consider how Canada stacks up against other advanced nations. Sure, there are countries with a much lighter touch tax wise, but the tradeoff typically comes via the provision of fewer public services. Canada, as it stands, is somewhat middle-of-the-pack vs. G7 nations (or a broader advanced economy sample) when it comes to the revenue and spending share of GDP. The fresh pledges made on the federal election campaign trail are unlikely to seriously alter the nation's relative standing.

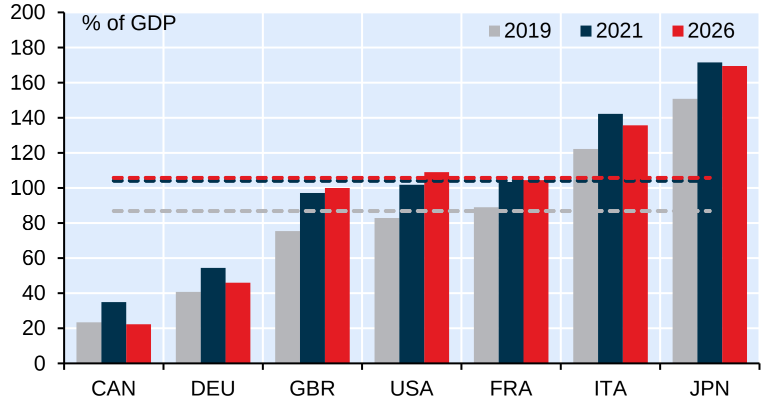
Chart 6: Cdn debt trajectory breaks from advanced camp
General government gross debt-to-GDP ratio



Source: NBF, IMF | Note: Forecast from 2021 onwards

(6) As for government debt, COVID's impact is undeniable. Canada's gross debt burden jumped roughly 20%-pts in 2020. But evident fiscal healing, combined with solid nominal GDP growth, suggests Canada's gross debt burden will lighten up faster than most advanced nations. Over time, Canada looks to edge closer to the emerging economy average, where government debt burdens have generally remained lighter than in most parts of the developed world.

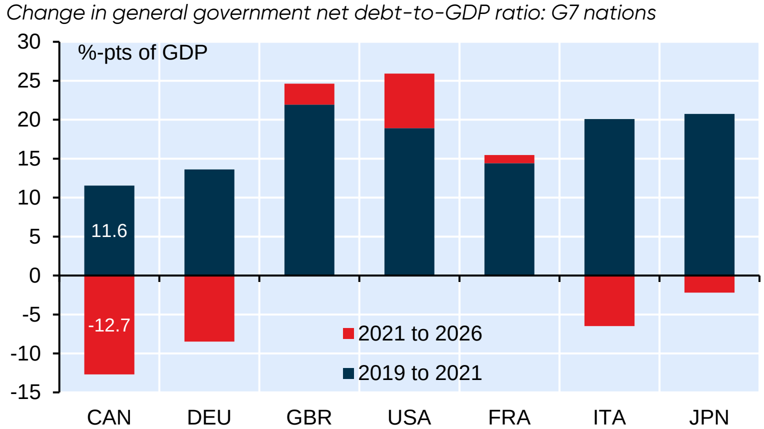
Chart 7: Canada retains, nay extends, net debt edge
General government net debt-to-GDP ratio: G7 nations



Source: NBF, IMF | Note: Dotted lines represent G7 average for given year

(7) For most Canadian governments, the focus tends to be on net debt as opposed to gross debt. Note that the difference between gross and net debt is financial assets, including those held in the social security system. When it comes to these financial assets, Canada remains relatively well endowed. Canada's general government net debt-to-GDP ratio, while rising during the pandemic, remains best-in-class in the G7. If anything, our net debt edge could become even more pronounced, the IMF pegging Canada's 2026 ratio at a lean 22% vs. 105% for the G7 average.

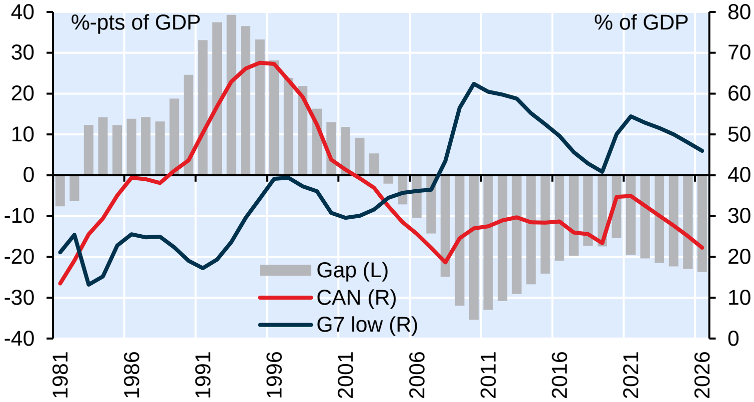
Chart 8: Cda to repair damage, others less so (or not at all)
Change in general government net debt-to-GDP ratio: G7 nations



Source: NBF, IMF

(8) Looked at another way, over the coming five years Canada is expected to fully undo the increase in the general government net debt ratio that was suffered during the pandemic. The U.S., in contrast, is expected to continue to add to its already heavy debt load. Ditto for the U.K. As for Italy and Japan, a modest expected improvement in debt ratios through 2026 won't change the fact that these two countries are massively indebted, with their sovereign credit ratings reflecting as much.

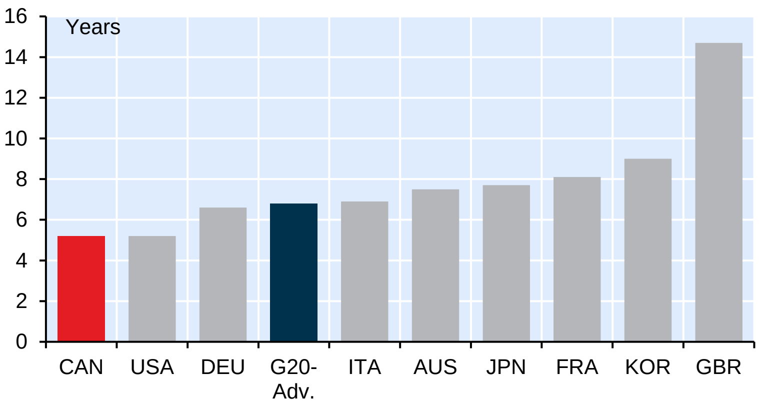
Chart 9: Preserving debt edge vs. G7 not a tall challenge
General government net debt-to-GDP ratio: Canada vs. lowest G7 peer



Source: NBF, IMF | Note: Forecast from 2021 onwards

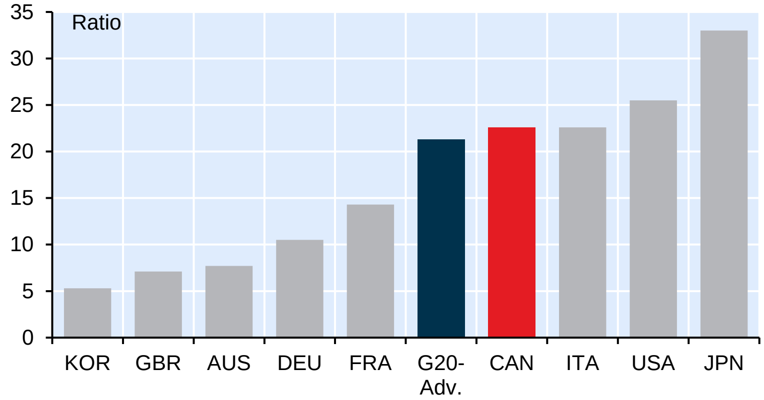
(9) So for Canada's Deputy PM and Finance Minister Freeland, living up to the Liberal government's goal of preserving a net debt edge vs. the G7 doesn't look like it will be the tallest of tasks. Germany, the next closest nation is currently about 20%-pts above Canada, the gap relative to this traditionally fiscally conservative country seen widening not narrowing in the coming years.

Chart 10: Canada's debt remains relatively short…
Average term to maturity: 2021



Source: NBF, IMF

Chart 11: …even if you control for lower debt load
Government debt vs. average maturity: 2021



Source: NBF, IMF

(10-11) Canada remains something of an outlier on another noted debt metric: the average term of outstanding central government securities. At 5.2 years, Canada's average term to maturity remains relatively short, the advanced economy average more like 7 years. Sure, there's a lower debt load in Canada, but the ratio of debt to average maturity is nonetheless higher than a number of large, advanced peers. Moreover, unlike the U.S. or Japan, which remain bona fide safe havens, Canada can't necessarily bank on being sought out by anxious investors during times of turbulence. So Freeland may not need to stress much about meeting the relative debt burden targets her boss has favoured, but the feds still have a bit of work to do when it comes to terming out the GoC bond portfolio. Granted, this process is underway in Ottawa. And while the feds only recently got religion on this, Canada's provinces have been focused on securing long-term debt for ages and have a much longer debt portfolio to show for it. That looks to pay off with BoC rate normalization moving ever closer.

For details on the interest rate outlook, we'd refer you to our fresh *Fixed Income Monitor* here.

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