

Reinforcing fiscal narratives (as slowdown comes into focus)

By Warren Lovely

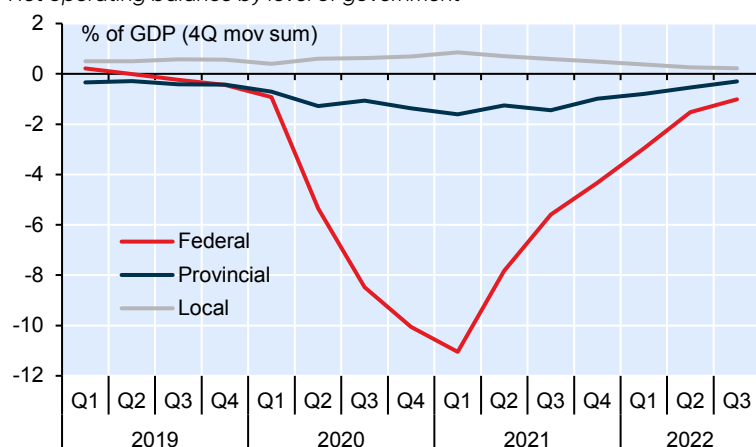
StatCan's government finance statistics slice and dice Canada's fiscal performance every which way. These data conform to IMF standards, allowing for comparisons between countries and across levels of government. Being of a higher frequency (quarterly), we use this release to compare and contrast with the narrative(s) emanating from official government releases that may arrive intermittently and/or less frequently. The latest data drop (for 2022:Q3) reinforces arguments we've earlier advanced, providing useful fiscal context as a slowdown takes root.

Here you'll see a striking/rapid fiscal recovery in Canada's general government sector. Deficit reduction has been most pronounced at the federal level, where disproportionate red ink was earlier spilled. That the provincial sector survived the pandemic without colossal budgetary damage is itself notable. Even if the provinces had a smaller hole to climb out of, a pronounced revenue surge—still in evidence through 2022:Q3 owing to resplendent nominal GDP gains—has meant much-improved operating results. There's a continued string of positive balances at the local government level, as is generally required by law, with municipal revenue proving less sensitive to economic swings. Not for nothing, we'd note (caution?) that expenditure growth has traditionally been more closely correlated with headline inflation at the local government level than has been the case federally or provincially, which is but one unique dimension of a municipal credit outlook we'll explore separately.

Balance sheet metrics generally show a provincial sector relatively well positioned for slower growth. The provincial net debt burden has receded faster than at the federal level—one of the more striking elements of the 'normalization' in Canada's public sector finances. In fact, you won't find a lower quarterly provincial net debt ratio than what we had in 2022:Q3 (based on over 30 years of data back to 1990).

Chart 1: Portrait of a fiscal recovery (less red ink spilled provincially)

Net operating balance by level of government

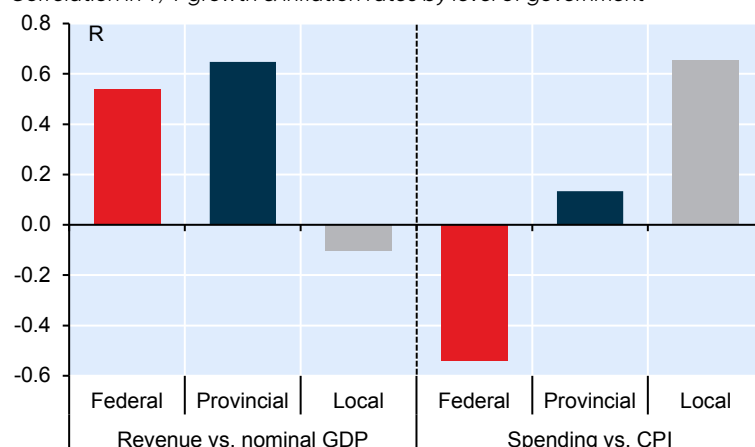


Source: NBF, StatCan

Canada's fiscal recovery has been striking. Ottawa has cleaned up red ink. Provincial damage was relatively contained, all things considered. Local government budgets remain balanced.

Chart 2: How well are finances aligned to growth & inflation?

Correlation in Y/Y growth & inflation rates by level of government*

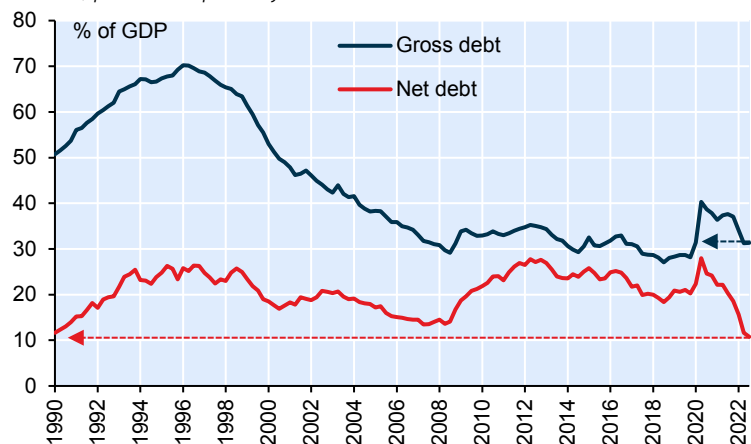


Source: NBF, StatCan | Note: Based on latest 10 years of quarterly data to 2022:Q3

Federal/provincial revenue is well-attuned to economic swings, so a 2023 slowdown bears watching. Local government spending growth has tended to be more closely linked with inflation.

Chart 3: Provi leverage lightens up (vs. feds & relative to history)

Federal/provincial quarterly net debt burden

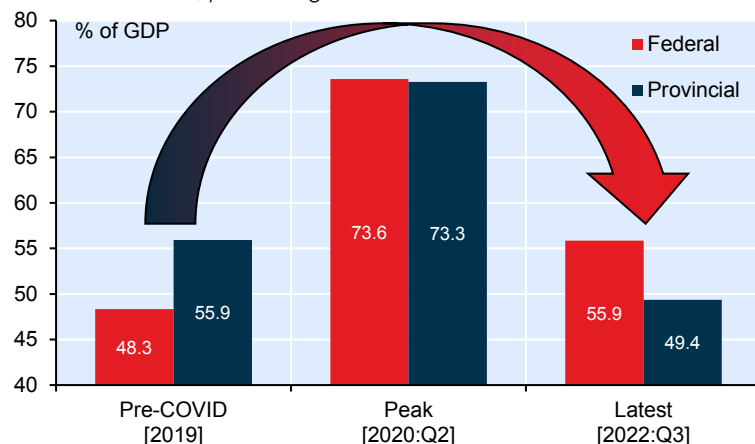


Source: NBF, StatCan

While burgeoning GDP definitely helped, notably lower net debt burdens leave governments (including key provinces) relatively well positioned for slower growth (all else equal).

Chart 4: Trading places in terms of gross leverage

Evolution of federal/provincial gross debt burden: Pre-COVID to latest

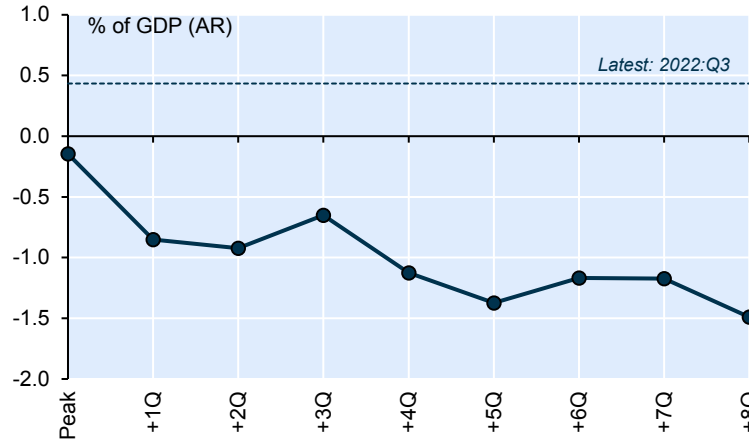


Source: NBF, StatCan

Ottawa and the provinces have effectively traded places when it comes to gross leverage. Pre-COVID, the provinces were the more heavily indebted. Today, it's the other way around.

Chart 5: Slowdown will weigh, but starting point a help

Average path for provincial budget balance during recession/slowdown

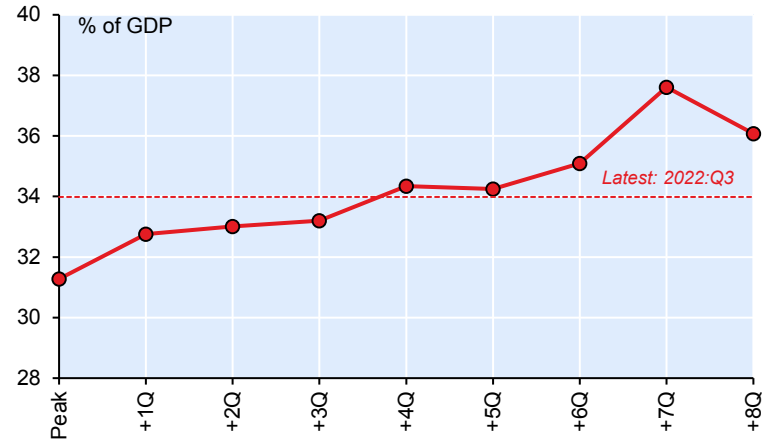


Source: NBF, StatCan | Note: Based on 6 recessions/slowdowns, excluding pandemic

An economic stall (or outright recession) is never good news for provincial government finances. But at least we're entering this central bank-induced slowdown from a relatively solid (if cyclically juiced) starting position, provincial governments collectively in the black.

Chart 6: Gross debt burden non-trivial, so market access key

Average path for o/s provincial debt securities during recession/slowdown



Source: NBF, StatCan | Note: Based on 6 recessions/slowdowns, excluding pandemic

As per Chart 3, provincial net debt has eased markedly. Still, there's no shortage of gross debt (and plenty of bonds to refi in 2023). We've been encouraged by the early tone to debt capital markets, but we can't entirely lose sight of what will be a larger year of central bank QT.

Table: Comparing/contrasting today's fiscal health with where things stood prior to earlier downturns

Canada general government fiscal metrics: Latest quarter vs. level observed prior to Canadian recessions/slowdowns

	Latest: 2022:Q3			Pre-recession level				Pre-downtown level (excl. recessions)				
	Level	vs Rec	vs Down	1990:Q1	2008:Q3	2019:Q4	Avg	1995:Q1	2000:Q3	2014:Q4	2018:Q3	Avg
Revenue												
General	37.6	-1.6	-2.6	42.2	36.7	38.7	39.2	42.6	42.5	37.1	38.6	40.2
Federal	13.5	-1.5	-2.0	17.4	13.5	14.0	14.9	17.1	17.6	13.1	14.1	15.5
Provincial	20.6	-0.6	-0.5	22.0	20.0	21.4	21.1	22.4	20.6	20.7	20.5	21.1
Local	7.4	-0.7	-0.6	9.0	7.0	8.5	8.1	9.7	6.8	7.9	7.9	8.1
CPP/QPP	3.1	0.6	0.5	2.4	2.5	2.6	2.5	2.6	2.4	2.3	3.0	2.6
Expense												
General	37.9	-3.5	-3.4	50.1	34.7	39.2	41.4	52.4	37.9	37.4	37.5	41.3
Federal	14.7	-2.7	-1.9	24.7	13.1	14.4	17.4	24.8	14.8	13.1	13.7	16.6
Provincial	20.1	-1.2	-1.0	23.4	19.1	21.6	21.4	24.8	18.6	20.8	20.4	21.2
Local	7.2	-0.6	-0.7	8.6	6.6	8.2	7.8	9.5	7.1	7.7	7.5	8.0
CPP/QPP	2.8	0.4	0.2	2.0	2.2	2.9	2.4	2.6	2.2	2.6	2.8	2.5
Interest												
General	2.7	-2.4	-2.8	9.2	3.5	2.8	5.2	9.6	6.7	3.0	2.9	5.6
Federal	1.1	-1.8	-1.8	6.1	1.8	1.0	2.9	5.6	4.0	1.2	1.0	3.0
Provincial	1.4	-0.5	-0.9	2.7	1.5	1.7	2.0	3.3	2.5	1.7	1.7	2.3
Local	0.1	-0.1	-0.2	0.5	0.2	0.1	0.3	0.6	0.3	0.2	0.1	0.3
CPP/QPP	0.1	0.1	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Balance												
General	-0.3	1.9	0.8	-8.0	2.0	-0.6	-2.2	-9.8	4.6	-0.3	1.1	-1.1
Federal	-1.3	1.2	-0.1	-7.3	0.4	-0.3	-2.4	-7.7	2.8	0.0	0.4	-1.1
Provincial	0.4	0.7	0.5	-1.4	1.0	-0.2	-0.2	-2.4	2.0	-0.1	0.1	-0.1
Local	0.2	-0.2	0.1	0.4	0.4	0.3	0.4	0.2	-0.3	0.1	0.4	0.1
CPP/QPP	0.3	0.2	0.3	0.3	0.3	-0.2	0.1	0.0	0.2	-0.3	0.3	0.0
Gross debt												
General	119.6	17.1	1.5	101.9	88.0	117.5	102.4	133.2	111.3	114.5	113.2	118.1
Federal	55.9	6.9	-1.4	59.1	40.0	47.8	49.0	75.5	58.0	48.4	47.1	57.2
Provincial	49.4	5.8	-1.3	35.5	39.6	55.6	43.6	49.0	46.2	54.3	53.1	50.6
Local	8.9	0.8	0.3	7.3	7.6	9.4	8.1	8.7	7.1	9.2	9.3	8.6
CPP/QPP	5.5	3.7	3.9	0.0	0.7	4.7	1.8	0.0	0.0	2.6	3.8	1.6
Net debt												
General	21.6	-20.2	-35.4	58.6	37.2	29.7	41.8	90.6	64.6	44.3	28.4	57.0
Federal	31.4	-4.7	-12.3	50.7	29.2	28.2	36.0	67.3	49.8	30.6	27.1	43.7
Provincial	10.8	-4.6	-10.5	11.7	14.1	20.3	15.3	24.8	16.9	25.0	18.4	21.3
Local	2.3	-0.9	-1.3	3.9	3.0	2.7	3.2	5.0	3.6	3.2	2.6	3.6
CPP/QPP	-22.8	-10.1	-11.2	-7.7	-9.0	-21.5	-12.7	-6.5	-5.7	-14.5	-19.6	-11.6

The government revenue share of GDP is currently lower than pre-recession or pre-slowdown averages. We're not advocating for tax hikes, but this hints at a degree of underlying fiscal flexibility.

Government spending has evolved massively. Extraordinary outlays have been walked back, but pressures linger. Like revenue, spending ratios vs. GDP capture inflated levels of nominal output.

In the wake of large-scale/rapid rate hikes, the interest bite has been a focal point. Interest charges are rising, but debt remains relatively affordable. Provis have done a good job locking debt in.

The feds led the pandemic response and had outsized red ink to show for it. Provincial finances were less bruised, with extraordinary transfers helping. The provi sector was balanced as of '22:Q3.

Canada likes to trumpet its debt advantage vs. key peers. But make no mistake, there's plenty of gross debt to go round, much of it taking the form of outstanding federal-provincial bonds.

The closely watched net debt burden has been placed on an improving trajectory. Net leverage has receded quite quickly at the provincial level, providing some breathing room as growth now slows.

Source: NBF, StatCan | Note: Table reflects select income statement/balance sheet metrics; data for the latest available quarter (2022:Q3) have been compared to the level observed immediately prior to earlier Canadian recessions and other economic slowdowns



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