BUDGET ANALYSIS

FOCUS ECONOMICS ANALYST FORECAST AWARDS 2017
#1 BEST OVERALL FORECASTER - CANADA

Canada: Budget 2018

A mid-term budget!

HIGHLIGHTS

- Generally speaking, Budget 2018 is aimed at strong economic growth and greater equality for all Canadians.
- The fiscal, economic and financial projections have changed little since the fall update. Moreover, budgetary deficits will continue throughout the federal government's forecast horizon, though will gradually decline.
- Program spending growth should slow starting in 2018–19.
- The rise in interest rates expected over the next few years will significantly increase debt charges from $24.1 billion in 2016–17 to $33.1 billion in 2022–23.
- The debt-to-GDP ratio is projected to decline gradually in the coming fiscal years.
- Budget 2018 includes many new initiatives. Some, however, are merely a reallocation of funds already earmarked by the federal government. The bottom line is that the net financial cost of the new measures announced in Budget 2018 is fairly low.

TABLE 1
Summary of transactions

	ACTUAL	PROJECTIONS					
IN $B (EXCEPT IF INDICATED)	2016–2017	2017–2018	2018–2019	2019–2020	2020–2021	2021–2022	2022–2023
Budgetary revenues	293.5	309.6	323.4	335.5	348.0	362.1	373.9
Variation (%)	*-0.7*	*5.5*	*4.5*	*3.7*	*3.7*	*4.1*	*3.3*
Program spending	-287.2	-304.6	-312.2	-321.5	-331.5	-340.7	-350.1
Variation (%)	*6.0*	*6.1*	*2.5*	*3.0*	*3.1*	*2.8*	*2.8*
Debt charges	-24.1	-24.4	-26.3	-28.6	-30.3	-32.2	-33.1
Variation (%)	*-5.1*	*1.2*	*7.8*	*8.7*	*5.9*	*6.3*	*2.8*
Adjustment for risk	---	---	*-3.0*	*-3.0*	*-3.0*	*-3.0*	*-3.0*
Budgetary balance	-17.8	-19.4	-18.1	-17.5	-16.9	-13.8	-12.3
Federal debt[1]	631.9	651.5	669.6	687.1	704.0	717.8	730.1
Variation (%)	*2.6*	*3.1*	*2.8*	*2.6*	*2.5*	*2.0*	*1.7*
Budgetary revenues (% of GDP)	14.4	14.5	14.5	14.5	14.5	14.6	14.5
Program spending (% of GDP)	14.1	14.2	14.0	13.9	13.8	13.7	13.6
Public debt charges (% of GDP)	1.2	1.1	1.2	1.2	1.3	1.3	1.3
Budgetary balance (% of GDP)	-0.9	-0.9	-0.8	-0.8	-0.7	-0.6	-0.5
Federal debt (% of GDP)	31.0	30.4	30.1	29.8	29.4	28.9	28.4

[1] Debt representing the accumulated deficits including other comprehensive income.
Sources: Department of Finance Canada and Desjardins, Economic Studies

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Still no balanced budget

Budget 2018, presented today by Minister of Finance Bill Morneau, contains few changes to the federal government's fiscal projections from the October update. For the fiscal year ending next March 31, a $19.4 billion deficit is now forecast, compared to $19.9 billion at the time of the update. For 2018–19, the deficit is expected to drop to $18.1 billion (compared to $18.6 billion in the update). The deficit should continue to decline gradually thereafter to $12.3 billion in 2022–23. This projection is nearly identical to the $12.5 billion deficit forecast in October for this period. As expected, the federal government has still not announced a specific plan for re-balancing the budget.

To gradually reduce the size of deficits, program spending growth will have to slow and drop from about 6% to close to 3% on average, a pace more sustainable over the medium term. With respect to revenues, the improvement in economic conditions has led to a strong rebound in 2017–18 of 5.5%. Although less spectacular, budgetary revenue growth should remain, all in all, satisfactory in the coming fiscal years, at 3.8% on average, and stay above program spending growth (2.8% on average). This will help partially offset the impact of the faster rise in debt charges stemming from the current and future rise in interest rates.

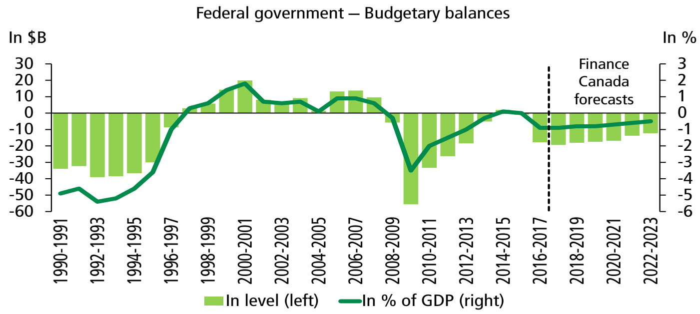
The stability of fiscal projections since the fall update is due largely to the fact that the economic and financial forecasts changed little in recent months. After an estimated increase of about 3% for 2017, real GDP should get back to a more sustainable pace in 2018 and 2019, with increases of about 2%. Despite this slowdown, this is a very favourable projection, which should, in particular, foster job creation and keep the unemployment rate at historic lows. In addition, consumer spending is expected to remain strong, as consumer confidence is very high. This is, of course, good news for tax revenues associated with consumption taxes as well as business and personal income taxes.

Caution is still called for, however, as many major risks hover over the economy. NAFTA's future is still uncertain, which could not only have repercussions for foreign trade, but also for business investment. In addition, the housing market might cool down more than expected in response to the introduction of tighter rules and higher interest rates. Under these conditions, maintaining a $3 billion adjustment to take into account the risk for the 2018–19 to 2022–23 fiscal years is a good practice.

The presence of budgetary deficits in the coming years will inevitably drive debt higher. However, debt growth is expected to remain below economic growth. Thus, the relative size of debt to the size of the Canadian economy should gradually shrink, from 31.0% on March 31, 2017, to 28.4% on March 31, 2023.

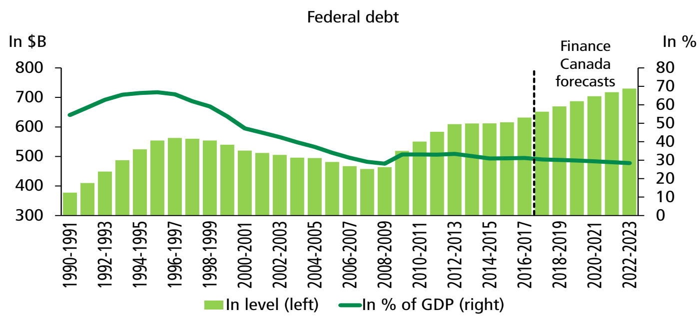
For 2018–19, the Canadian government's debt program should reach $258 billion. Refinancing of existing debt will reach

GRAPH 1
The federal government's budgetary deficits should gradually decrease



Sources: Finance Canada and Desjardins, Economic Studies

GRAPH 2
The relative size of debt will shrink below 30%



Sources: Finance Canada and Desjardins, Economic Studies

$227 billion, while the financial requirements for the year will be $32 billion in order to finance the budgetary deficit and non budgetary transactions (factoring in the adjustment for risk).

Many new measures…but with a limited financial impact

As is customary, Budget 2018 contains many new budget measures. Some, however, are a mere reallocation of funds already earmarked by the federal government. The bottom line is that the net financial cost of the new initiatives announced in Budget 2018 is therefore fairly low. That cost is $6.3 billion for 2017–18, $5.4 billion for 2018–19 and between $2.0 billion and $3.0 billion for subsequent fiscal years. In total, the federal government's new measures will amount to $21.5 billion by 2022–23, an average of $3.6 billion per fiscal year. Below is a summary of the key measures that caught our attention:

- A number of measures have been proposed to invest in Canadian scientists and researchers. The total investment will be $3.2 billion over the next five fiscal years.
- Budget 2018 announced a "re-imagined" National Research Council and proposes to provide $540 million over five years, starting in 2018–19, or $108 million annually, for measures that will reinforce its research strengths and role as a trusted partner of industry.

TABLE 2
Economic and financial forecasts

AVERAGE ANNUAL GROWTH IN % (EXCEPT IF INDICATED)	2017			2018f			2019f		
	2017 Update	2018 Budget	Desj. Group	2017 Update	2018 Budget	Desj. Group	2017 Update	2018 Budget	Desj. Group
Real GDP	3.1	3.0	2.9	2.1	2.2	2.2	1.6	1.6	2.0
GDP deflator	2.4	2.2	2.1	1.8	1.8	1.7	1.8	1.9	2.1
Nominal GDP	5.5	5.2	5.1	4.0	4.0	3.9	3.4	3.5	4.2
Treasury bills—3-month	0.8	0.7	0.7	1.5	1.4	1.5	2.0	2.0	2.2
Federal bonds—10-year	1.8	1.8	1.8	2.5	2.3	2.6	2.9	2.8	2.9
Unemployment rate	6.5	6.4	6.3	6.3	6.0	5.8	6.3	6.0	5.7
Exchange rate (US¢/C$)	77.80	77.20	77.20	81.30	79.00	80.00	81.20	79.60	82.00
Real GDP—United States	2.2	2.3	2.3	2.3	2.4	2.8	1.9	1.9	2.5

f: forecasts
NOTE: Data may not add to totals due to rounding.
Sources: Department of Finance Canada, Statistics Canada and Desjardins, Economic Studies

- To help Canadian entrepreneurs and small business owners develop innovative technologies and successfully commercialize them in a global marketplace, the Industrial Research Assistance Program (IRAP) offers flexible funding along with consulting services. To enable IRAP to support business research and development for projects up to a new threshold of $10 million, the Government proposes investing $700 million over five years, starting in 2018–19, and $150 million per year thereafter.
- Many measures are introduced to support Indigenous Peoples. The net cost of these measures will total $4.8 billion over the next five fiscal years.
- The Government will introduce legislation for the Pension for Life plan for veterans, which will include the possibility of tax-free monthly payments for life to recognize service related disability. This will essentially result in additional spending of close to $4.2 billion for the 2017–18 fiscal year.
- The federal government announced its intention to strengthen and modernize Canada's financial sector. Moreover, Budget 2018 proposes introducing legislative amendments to the Canada Deposit Insurance Corporation Act. In addition, the Government intends to initiate the process to remove the legal tender status of bank note denominations no longer issued by the Bank of Canada (i.e. $1000, $500, $25, $2 and $1). The Bank of Canada will continue to honour these bank notes and exchange them at their face value.
- The Government of Canada is putting in place a number of pay equity and gender equality measures. An additional $2 billion in assistance over five years associated with the Feminist International Assistance Policy is also proposed.
- The federal government will continue its efforts to close tax loopholes. In so doing, it plans to recover a total of $2.6 billion by 2022–23. Measures to limit tax planning by private corporations are also planned, which could bring a total of $3.4 billion into government coffers.

A budget that will not make history from an economic standpoint
As is often the case mid-term, the federal government's Budget 2018 ultimately offers very few major changes, despite the many new initiatives announced. This is because the process of integrating the ambitious recovery plan from Budget 2016 is not yet finished, which continues to reduce the Canadian government's wiggle room.

While it comes as no surprise, it is disappointing that the federal government has yet to develop a specific plan to re balance the budget in its forecast horizon. Nevertheless, the conditions are there to make the task easy for the Department of Finance. Economic growth should remain above its potential in the coming years, and the labour market is very strong. That said, the $12.3 billion deficit projected for 2022–23 is just 0.5% of Canada's GDP. This is a relatively small proportion, so balancing the budget seems to be within reach.

Budget 2018 also does not include any real tax reform in response to the measures recently implemented by the United States. The Department of Finance Canada has nonetheless announced that it will be conducting a thorough analysis of the U.S. federal tax reform in the coming months to assess its potential impact on Canada.

In closing, all eyes are on next year, when Budget 2019 will in theory be the final fiscal year for the Liberal government before the country's next general election. More meaningful measures, within the federal government's financial framework, can already be anticipated.