BUDGET ANALYSIS

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

Canada: Budget 2019

Government Shows Caution in the Face of Rising Economic and Geopolitical Uncertainty

HIGHLIGHTS

- The federal government's fiscal projections have changed very little since the fall update. After an estimated deficit of $19.8B in 2019–2020, the budgetary balance could gradually improve, with a projected deficit of $9.8B in 2023–2024.
- For 2018–2019, the fiscal position is a little better than the prognosis in the update last November, thanks to more favourable economic conditions in 2018.
- The government used part of this room to manoeuvre to finance several new initiatives in its 2019 budget.
- The economic outlook for 2019 has darkened recently, however, which may have negative consequences for the federal government's financial projections.
- The federal government's debt will continue to increase, but its size relative to the size of the economy will gradually decline.

TABLE 1
Summary of transactions

	ACTUAL	PROJECTIONS					
IN $B (EXCEPT IF INDICATED)	2017–2018	2018–2019	2019–2020	2020–2021	2021–2022	2022–2023	2023–2024
Budgetary revenues	311.2	332.2	338.8	351.4	366.7	380.7	395.5
Variation (%)	*6.0*	*6.7*	*2.0*	*3.7*	*4.4*	*3.8*	*3.9*
Program spending	-308.3	-323.5	-329.4	-339.7	-348.3	-358.4	-369.1
Variation (%)	*5.9*	*4.9*	*1.8*	*3.1*	*2.5*	*2.9*	*3.0*
Debt charges	-21.9	-23.6	-26.2	-28.5	-30.2	-31.4	-33.2
Variation (%)	*3.3*	*7.8*	*11.0*	*8.8*	*6.0*	*4.0*	*5.7*
Adjustment for risk	---	---	*-3.0*	*-3.0*	*-3.0*	*-3.0*	*-3.0*
Budgetary balance	-19.0	-14.9	-19.8	-19.7	-14.8	-12.1	-9.8
Federal debt[1]	671.3	685.6	705.4	725.1	739.8	751.9	761.7
Variation (%)	*3.0*	*2.1*	*2.9*	*2.8*	*2.0*	*1.6*	*1.3*
Budgetary revenues (% of GDP)	14.5	14.9	14.7	14.8	14.9	14.8	14.8
Program spending (% of GDP)	14.4	14.6	14.3	14.3	14.1	14.0	13.8
Public debt charges (% of GDP)	1.0	1.1	1.1	1.2	1.2	1.2	1.2
Budgetary balance (% of GDP)	-0.9	-0.7	-0.9	-0.8	-0.6	-0.5	-0.4
Federal debt (% of GDP)	31.3	30.8	30.7	30.5	30.0	29.3	28.6

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

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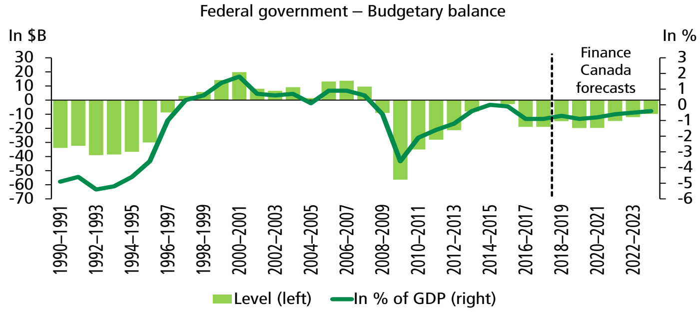
Few Changes in the Fiscal Projections

Economic conditions have been generally favourable in the last few months for Canadian public finances. Strong job growth and the upward trend in salaries led to a faster increase in budgetary revenues. After an exceptional increase of 6.0% in 2017–2018, budgetary revenues continued their momentum in 2018–2019, with an increase of 6.7%. According to the Department of Finance Canada, positive developments in economic conditions since last fall's statement helped reduce the budget deficit by $5.9B for 2018–2019 and by just over $4B, on average, for each subsequent year.

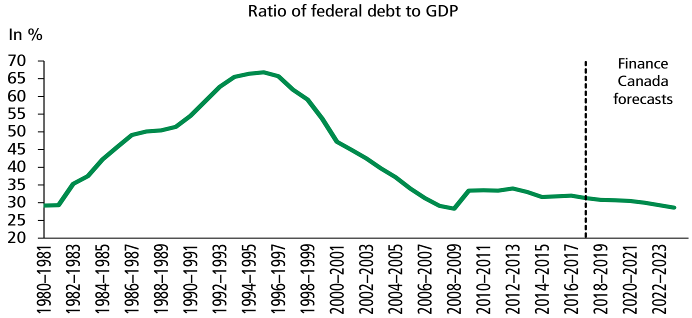
However, the federal government has almost entirely absorbed this flexibility to fund new initiatives in this budget and those announced since the fall update. As a result, program spending will increase by 3% per year, on average, between 2018–2019 and 2023–2024, a reasonable pace of expansion from a historical perspective. The debt charges will grow more sharply, though, at an average annual rate of 7.2% between 2018–2019 and 2023–2024 due to rising interest rates and the increase in the net debt, which will rise from $671.3B on March 31st, 2018, to $761.7B on March 31st, 2024. The ratio of the net debt to GDP should, nevertheless, continue to decline in the coming years, dropping to 28.6% by March 31st, 2024. Ultimately, except for the budget year ending next March 31st, the budget deficits projected by the Department of Finance Canada are very similar to the projections presented in the fall update. For 2018–2019, however, the deficit may be a little lower than expected at $14.9B, or about $3B less than forecast in the fall.

GRAPH 1
The federal government's budget deficits remain high but should gradually decline



Sources: Department of Finance Canada and Desjardins, Economic Studies

GRAPH 2
The relative size of the debt will decrease slightly



Sources: Department of Finance Canada and Desjardins, Economic Studies

TABLE 2
Economic and financial forecasts

	2018*			2019f			2020f		
AVERAGE ANNUAL GROWTH IN % (EXCEPT IF INDICATED)	2018 Update	2019 Budget	Desj. Group	2018 Update	2019 Budget	Desj. Group	2018 Update	2019 Budget	Desj. Group
Real GDP	1.9	1.9	1.8	1.9	1.8	1.4	1.6	1.6	1.7
GDP deflator	2.0	1.9	1.7	2.0	1.6	1.2	1.7	1.9	1.8
Nominal GDP	3.9	3.8	3.6	4.0	3.4	2.7	3.3	3.5	3.5
Treasury bills—3-month	1.4	1.4	1.4	2.1	1.9	1.7	2.4	2.2	2.0
Federal bonds—10-year	2.3	2.3	2.3	2.8	2.4	2.0	3.0	2.7	2.4
Unemployment rate	5.9	5.8	5.8	5.8	5.7	5.7	6.0	5.9	5.7
Exchange rate (US¢/C$)	77.6	77.2	77.2	78.4	76.3	75.0	78.7	77.2	76.0
Real GDP—United States	2.8	2.9	2.9	2.5	2.4	2.5	1.8	1.7	2.2

f: forecasts; Update: as of November 21st, 2018
* The 2018 figures in Budget 2019 for the GDP and the deflator were established before the publication of the 2018 economic accounts.
NOTE: Data may not add to totals due to rounding.
Sources: Department of Finance Canada, Statistics Canada and Desjardins, Economic Studies

It must be acknowledged, however, that downside risks are weighing on the federal government's projections. Since the beginning of the budget planning process, the economic forecasts have been revised downward by most forecasters, and domestic demand is showing signs of fatigue. On the one hand, consumer spending is clearly slowing, mostly in reaction to higher interest rates. On the other, investments are struggling with the downward trend in the housing market and the pullback in capital expenditures by businesses. Despite the signature of a new trade agreement between Canada, the United States and Mexico, there still appear to be many uncertainties for businesses. Some uncertainty will continue as long as the agreement is not officially ratified. Under these circumstances, we recently revised our projection for Canada's real GDP down from 1.8% to 1.4% for 2019. An increase of 1.7% is still expected for 2020. The economic projections used in the budget seem too high in light of recent developments, especially for 2019, and it goes without saying that this gap could eventually lead to higher budget deficits than the Department of Finance Canada's current estimates.

Measures Targeting the Middle Class

Despite the elections next fall, the federal government resisted the temptation to hand out new measures all around. The relatively moderate growth in program spending over the coming years attests to this clearly. The 2019 budget does, of course, offer an array of new initiatives and, as has been the case throughout this administration's term in office, the focus is on the middle class. Here is a summary of the measures that caught our attention.

- The 2019 budget offers a number of measures to improve the affordability of housing, reduce obstacles for first-time home buyers and increase the supply in the housing market and the rental market:
    - To help make homeownership more affordable for first-time home buyers, Budget 2019 proposes to introduce the First-Time Home Buyer Incentive. The Incentive enables home buyers to reduce the amount of money required from an insured mortgage without increasing the amount they must save for a down payment. In practical terms, the Incentive would offer financing of 5% (for existing properties) or 10% (for new construction) of the home purchase price. No monthly payments are required. The buyer would repay the Incentive, for example, at resale. The Incentive would be available to first-time home buyers with household incomes under $120,000 per year. At the same time, the participants' insured mortgage and the Incentive amount cannot be greater than four times the participants' annual household incomes.
    - The maximum withdrawal amount for the Home Buyers' Plan (HBP) would increase from $25,000 to $35,000.
    - To provide more affordable rental options for middle-class Canadians, Budget 2019 proposes to provide an additional $10B over nine years in financing through the Rental Construction Financing Initiative, thereby extending the program until 2027–2028.
    - To help municipalities increase the housing supply and unlock new solutions for Canadians searching for a home, Budget 2019 proposes to provide $300M to launch a new Housing Supply Challenge.
- Introducing the Canada Training Benefit: This new, non-taxable credit would help Canadians pay for training fees. Every year, eligible workers between the ages of 25 and 64 would accumulate a credit balance of $250 per year, up to a lifetime limit of $5,000. With this credit, a Canadian worker would accumulate $1,000 every four years to be used for training fees.
- Introducing the Employment Insurance (EI) Training Support Benefit: This new benefit, which is expected to launch in late 2020, would be available through the EI program and would provide up to four weeks of income support, every four years. This income support, paid at 55% of a person's average weekly earnings, would help workers cover their living expenses while they are on training and without their regular paycheque.
- Through the federal Gas Tax Fund, Budget 2019 proposes a one-time transfer of $2.2B in 2018–2019 to municipalities and First Nations communities to finance infrastructure.
- To help reduce Canadians' electricity bills, the federal government proposes to invest nearly $1B in 2018–2019 to increase energy efficiency in residential, commercial and multi-unit buildings. These investments will be delivered through the Green Municipal Fund.
- To improve access to high-speed Internet in remote regions, the government is proposing a new, coordinated plan that would deliver $5B to $6B in new investments in rural broadband over the next ten years.
- To support the implementation of the Border Enforcement Strategy and process 50,000 asylum claims per year, as well as facilitate the removal of failed asylum claimants in a timely manner, Budget 2019 proposes to invest $1.18B over five years, starting in 2019–2020, and $55M per year ongoing. Additional resources will be provided to strengthen processes at the border and accelerate the processing of claims and removals.

A Modest Budget… despite the Upcoming Elections

The new initiatives introduced today are relatively limited, and Budget 2019 appears to be more of a report on the various measures put into place by the Liberal government since its election. Over the years, the Liberal government has introduced many measures focused primarily on the middle class while still making major investments in infrastructure. These measures have led to a clear deterioration of the budgetary balance, which went from -$2.9B in 2015–2016 to -$19.8B in 2019–2020. Despite comparatively favourable economic conditions (especially in 2017 and the first half of 2018), the federal government has not succeeded in reducing the size of the budget deficits. A return to a balanced budget has clearly never been a priority for the current government, which is more focused on controlling the relative size of the debt in comparison with the economy. However, the recent deterioration of the economic forecast will probably complicates the federal government's budget situation. Under these circumstances, the prudent approach in today's budget was the right path to take.