BUDGET ANALYSIS

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

Canada: Economic and Fiscal Update

Several Measures for Businesses and Exports Along with Larger Deficits

HIGHLIGHTS

- A slight rebound in economic conditions is leading to faster growth in some budgetary revenues.
- However, several initiatives have been introduced since the 2018 budget, and today's update also includes many new expenditures.
- All told, budget deficits could be higher than anticipated for the years ahead.
- The new initiatives announced in the update focus on corporate taxation and greater geographic diversification of Canada's foreign trade.
- The federal government will allow businesses to immediately write off the total cost of machinery and equipment used to manufacture or process goods, as well as the total cost of specified clean energy equipment.

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	313.6	328.9	339.2	352.1	367.9	382.1	396.7
Variation (%)	*6.8*	*4.9*	*3.1*	*3.8*	*4.5*	*3.9*	*3.8*
Program spending	-310.7	-320.2	-328.3	-337.3	-348.2	-359.0	-370.8
Variation (%)	*6.7*	*3.1*	*2.5*	*2.7*	*3.2*	*3.1*	*3.3*
Debt charges	-21.9	-23.8	-27.5	-29.9	-31.8	-32.7	-34.3
Variation (%)	*3.3*	*8.7*	*15.5*	*8.7*	*6.4*	*2.8*	*4.9*
Adjustment for risk	---	-3.0	-3.0	-3.0	-3.0	-3.0	-3.0
Budgetary balance	-19.0	-18.1	-19.6	-18.1	-15.1	-12.6	-11.4
Federal debt[1]	671.3	687.7	707.3	725.5	740.6	753.2	764.7
Variation (%)	*3.0*	*2.4*	*2.9*	*2.6*	*2.1*	*1.7*	*1.5*
Budgetary revenues (% of GDP)	14.7	14.8	14.6	14.7	14.8	14.8	14.8
Program spending (% of GDP)	14.5	14.4	14.2	14.1	14.0	13.9	13.8
Public debt charges (% of GDP)	1.0	1.1	1.2	1.2	1.3	1.3	1.3
Budgetary balance (% of GDP)	-0.9	-0.8	-0.8	-0.8	-0.6	-0.5	-0.4
Federal debt (% of GDP)	31.4	30.9	30.5	30.3	29.8	29.2	28.5

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

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NOTE TO READERS: The letters k, M and B are used in texts and tables to refer to thousands, millions and billions respectively.
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Higher Budget Deficits

The economic outlook has changed little since the last budget. Nonetheless, the update assumes nominal GDP will rise a little quicker due to a somewhat faster increase in prices and real GDP. It should be noted that the overhaul of the North American Free Trade Agreement (NAFTA) in the form of the United States–Mexico–Canada Agreement (USMCA) reduced uncertainties, which could result, in particular, in slightly higher growth in business investment.

Even if it seems marginal, the improvement in economic conditions is positively impacting the federal government's past and future revenue. From fiscal year 2017–2018 to fiscal year 2022–2023, revenue from income taxes as well as excise taxes and duties will total nearly $23B more than projected in the last budget.

On the other hand, the federal government has also accelerated its spending in recent months. Budgetary measures passed between the 2018 budget and today's update amount to more than $15B by 2023–2024. Taking into account the cost of the new initiatives announced in today's update as well, program spending has increased significantly since last February's budget. For this reason, the relative size of program spending compared with the size of the Canadian economy for the 2018–2019 fiscal year rose from 14.0% to 14.4%.

This influences the budget balance. Despite the positive impact of slightly improved economic conditions, the negative effects of new spending will lead to higher budget deficits than those announced for 2019–2020 and beyond in the last budget, even when taking into account changes in the federal government's accounting standards. For this reason, budget deficits for the fiscal years from 2018–2019 to 2022–2023 will total more than $5B than what was projected in the 2018 budget.

Reflecting the previous projections, the federal government is still predicting that the budget deficit will go down gradually over the next few years. It should shrink from $19.0B as at March 31st, 2018, to $11.4B as at March 31st, 2024. The federal debt's relative weight should keep going down in the next few years compared to the size of the economy; from 31.4% as at March 31st, 2018, it should drop to 28.5% as at March 31st, 2024.

Measures Aimed at Businesses

In total, today's update comprises new measures worth $17.6B between now and the 2023–2024 fiscal year. They will focus mainly on improving the tax situation for businesses while encouraging investment. Additional efforts will also be deployed to promote better geographic diversification in Canada's international trade. Here are some highlights.

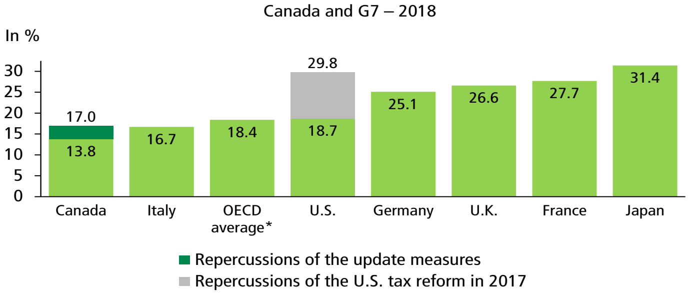
- The update proposes three immediate changes to the tax rules for businesses:
  - Businesses will be able to immediately write off the total cost of machinery and equipment used to manufacture or process goods.
  - Businesses will be able to immediately write off the total cost of specified clean energy equipment.
  - The Accelerated Investment Incentive is being introduced, an accelerated capital cost allowance (i.e. larger deduction for depreciation) for businesses of all sizes, across all sectors of the economy, that are making capital investments.
- The 15% Mineral Exploration Tax Credit, which helps junior exploration companies raise capital to finance early stage mineral exploration away from an existing mine site, will be extended through March 31st, 2024.

TABLE 2
Economic and financial forecasts

	2018f			2019f			2020f		
AVERAGE ANNUAL GROWTH IN % (EXCEPT IF INDICATED)	2018 Budget	2018 Update	Desj. Group	2018 Budget	2018 Update	Desj. Group	2018 Budget	2018 Update	Desj. Group
Real GDP	2.1	2.0	2.1	1.6	2.0	2.1	1.7	1.6	1.7
GDP deflator	2.0	2.2	2.0	1.9	2.1	1.9	2.0	1.7	1.5
Nominal GDP	4.1	4.2	4.2	3.5	4.1	4.0	3.8	3.3	3.2
Treasury bills—3-month	1.4	1.4	1.4	2.0	2.1	2.2	2.3	2.4	2.4
Federal bonds—10-year	2.3	2.3	2.3	2.8	2.8	2.9	3.1	3.0	2.9
Unemployment rate	6.0	5.9	5.9	6.0	5.8	5.8	6.1	6.0	5.6
Exchange rate (US¢/C$)	79.00	77.60	77.00	79.60	78.40	77.00	80.30	78.70	79.00
Real GDP—United States	2.4	2.8	2.9	1.9	2.5	2.7	1.9	1.8	2.0

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

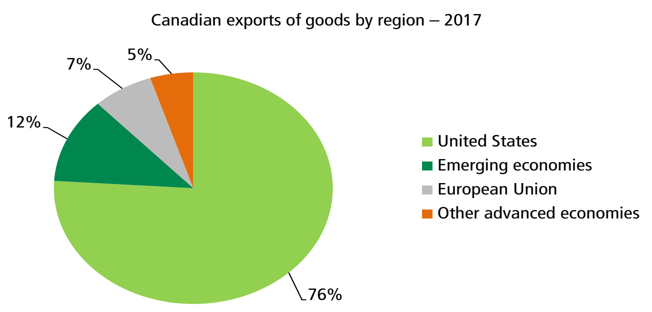
GRAPH 1
Comparison of effective marginal tax rates on new investments



OECD: Organisation for Economic Cooperation and Development;
* The OECD average does not include Canada and Lithuania.
Sources: Department of Finance Canada and Desjardins, Economic Studies

- A further $800M will be provided over five years to the Strategic Innovation Fund, which will continue to support innovative investments across the country and in all economic sectors.
- The update announces the government's intention of considerably strengthening export possibilities for Canadian businesses and diversifying the country's foreign trade. Starting in 2018–2019, the Export Diversification Strategy will invest a total of $1.1B over the next six years to help Canadian businesses access new markets. The strategy will focus on three key components: investing in infrastructure to support trade, providing Canadian businesses with the resources needed to carry out their export plans and enhancing trade services for Canadian exporters.

GRAPH 2
Canada's foreign trade is not very diversified geographically



Note: Trade figures are based on customs duties.
Sources: Department of Finance Canada and Desjardins, Economic Studies

- Three new initiatives have been announced to support Canadian journalism: allowing non-profit news organizations to receive charitable donations and issue official receipts, introducing a new refundable tax credit to support original news content creation, and introducing a new temporary non-refundable tax credit to support subscriptions to Canadian digital news media. In total, these measures will cost the federal government close to $600M over the next five fiscal years.

Help to Adjust the Economy

With the new USMCA, the recently concluded Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPATPP) and the Comprehensive Economic and Trade Agreement between Canada and the European Union (CETA), Canada now has several tools to further diversify its international trade. The many initiatives introduced in today's update should help Canadian businesses take full advantage of them.

That said, we would have liked to see a more aggressive plan for achieving a balanced budget while the economic conditions are so favourable. This would give the federal government more leeway if the economic outlook worsens in the coming years.