# ECONOMIC VIEWPOINT

# Will the Federal Fall Economic Statement 2024 Be More Trick than Treat?

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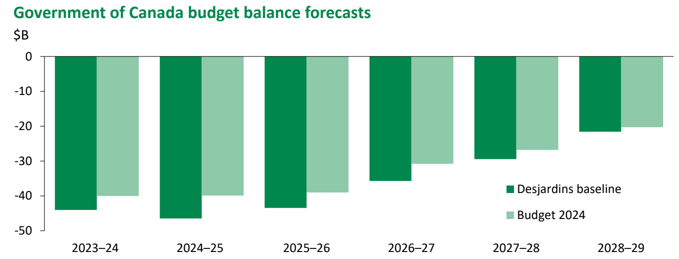
### Highlights

- It's that time of year again, when kids don costumes, adults give out candy and the federal government tables its Fall Economic Statement (FES).
- In the FES 2024, we expect to see larger budget deficits than published in Budget 2024 (graph A). The reasons include a weaker start to the fiscal forecast than expected in the spring and a deeper primary deficit projection offsetting the improved economic and lower interest rate outlook.
- But the fiscal outlook could be even worse than that. From increased military spending commitments to slower planned population growth to a potential second Trump presidency, the risks to the budget balance are tilted to the downside. As such, some fiscal tricks (or higher taxes) may be in the cards if the Government of Canada chooses to hand out some new treats in the FES while keeping federal debt-to-GDP ratio on a sustainable path.


**Graph A**
**Federal Deficits Should be Larger than Forecast in Budget 2024**

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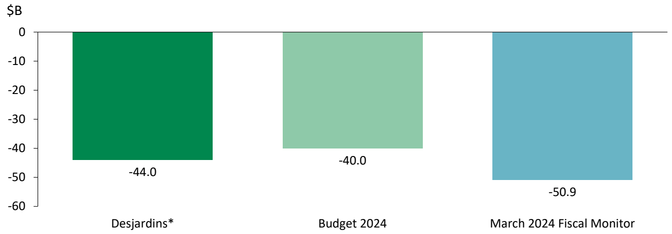
It's been just over six months since the federal government published Budget 2024, and the fiscal headwinds keep piling up. A deeper starting point for the deficit should offset much of the improved economic outlook. Meanwhile, new spending promises, slower planned population growth and a possible second Trump presidency add to the downside risks. This begs the question: Will the Fall Economic Statement (FES) 2024 include some treats or will it all be tricks?

### The Ghosts of Deficit Past …

Deficit watchers are patiently waiting for the final numbers for the 2023–24 fiscal year to be published in the Public Accounts of Canada 2024. Currently, the only numbers that we have for last year are from Budget 2024 and the March 2024 Fiscal Monitor. The latter pointed to a larger deficit than the federal government had projected in the budget. While the Fiscal Monitor calculated a deficit of $50.9B, after adjusting for historical estimation errors and the like, we concluded that the deficit was likely closer to $44B (graph 1 on page 2). And while the Fiscal Monitor hasn't recently provided as good a guide to the deficit as it did prior to the pandemic, it does suggest that the balance of risks is tilted toward a deficit that is larger than the $40B shortfall published in Budget 2024.

### Graph 1
**Last Year's Deficit May Be Larger than Projected in Budget 2024**

Government of Canada 2023–24 fiscal year deficit estimates




*Also accounts for revisions to economic data since Budget 2024 was published
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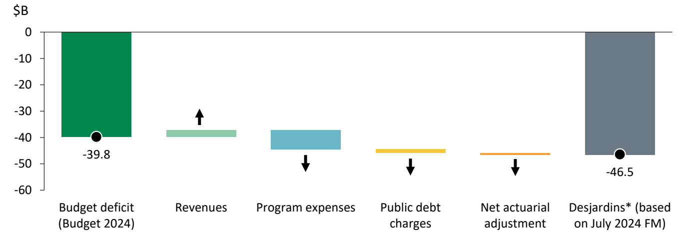
### Graph 3
**The Federal Deficit Should Be Larger This Year than Forecast**

Difference in 2024–25 fiscal year budget balance by source




*Also accounts for revisions to economic data since Budget 2024 was published; FM: Fiscal Monitor
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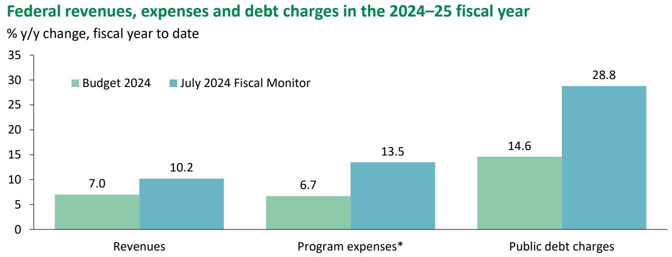
## … Deficit Present …

The federal Fiscal Monitor also points to a larger deficit in the current fiscal year. Lower revenues and higher spending estimated for last year have led to a deeper hole to start 2024–25. Add to that the higher growth in spending relative to revenues so far this year (graph 2), and the deficit should exceed the expectations laid out in Budget 2024.

### Graph 2
**Growth in Revenues and Expenses Came in Hot through July 2024**

Federal revenues, expenses and debt charges in the 2024–25 fiscal year




*Excluding net actuarial losses
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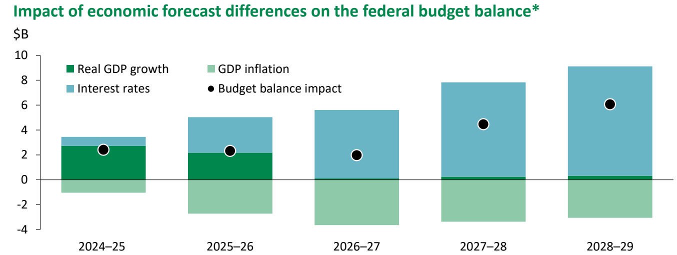
However, it's worth noting that the economic outlook has improved for 2024 relative to the time of the budget. This has provided a tailwind to growth, reducing the expected deficit by about $2.7B in the 2024–25 fiscal year alone. But it's not nearly enough to offset the drag from higher spending. All in, we expect a larger-than-projected deficit in Budget 2024, at $46.5B (graph 3), which is also a deterioration relative to the 2023–24 fiscal year.

## … and Deficit Future

While the starting point for the federal deficit forecast after the 2024–25 fiscal year is likely to be worse than in Budget 2024, the one saving grace is the better economic outlook (graph 4). In the near term, higher-than-expected real GDP growth should provide the bulk of the lift. And when that fades, the lower interest rate forecast should take over, helping to pull down the forecast for public debt charges. In contrast, the lower outlook for GDP inflation is likely to be a drag on the forecast, weighing most heavily on the revenue outlook. That said, on net, the savings from lower interest payments should dominate everything else.

### Graph 4
**The Federal Deficit Should Benefit Most from Low Interest Rates**

Impact of economic forecast differences on the federal budget balance*




*Desjardins' latest Economic and Financial Outlook less the Budget 2024 economic forecast
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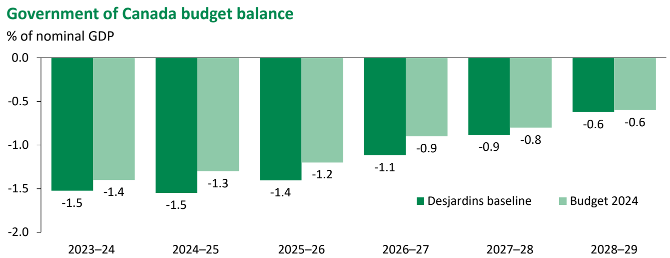
But even when the better economic outlook is accounted for, the prognosis for the federal deficit isn't good. Over the course of the fiscal forecast, deficits are likely to be larger than projected in Budget 2024 (graph 5 on page 3). Thankfully, the difference is expected to be relatively modest, particularly as a share of nominal GDP, as the drag from a deeper primary deficit profile (revenues minus program expenses) is offset by meaningfully lower public debt charges. Notably, our deficit outlook happens to be very close to that published recently by the Parliamentary Budget Officer (PBO).

**Graph 5**
**Federal Deficits Should be Larger than Forecast in Budget 2024**

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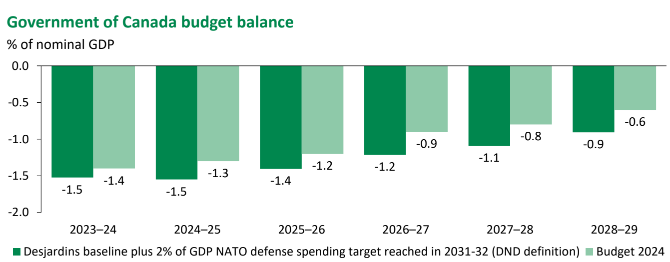
## The Fiscal Sugar High May Be All but Over

Unfortunately for the federal government, this may be the best news it can hope for. In July, we highlighted a couple of considerations that could weigh on the federal fiscal outlook relative to this comparatively rosy base case.

The first is the proposed increase in defense spending to the 2% of nominal GDP NATO target. While there remains a great deal of uncertainty regarding the pace and extent of the additional military expenditures, the one thing we know for sure is that it won't be cheap. Even under the most optimistic assumptions, it could add an additional $10B to the federal deficits by the 2028–29 fiscal year. This alone would risk violating the federal government's fiscal anchor of keeping deficits below 1% of GDP in 2026–27 and future years (graph 6).

**Graph 6**
**Deficits May Violate Fiscal Anchors if NATO Spending Target is Met**




*DND: Department of National Defence
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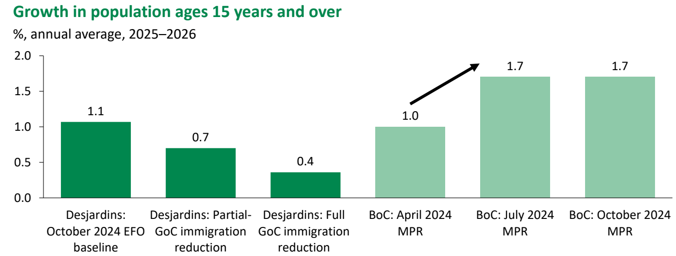
The second consideration is the Government of Canada's plan to reduce the number of immigrants and non-permanent residents admitted to Canada. If fully implemented, population growth could fall below the record-low pace posted during the pandemic, putting further downward pressure on nominal GDP—the broadest measure of the tax base. This would hit revenues especially hard. But as we discussed in a recent note, the reactionary nature of immigration policy in Canada has added substantial uncertainty to the population projection (graph 7).

**Graph 7**
**Forecasts of Future Population Growth Vary Significantly**




EFO: Economic and Financial Outlook; NPR: Non-permanent resident; MPR: Monetary Policy Report; BoC: Bank of Canada; GoC: Government of Canada
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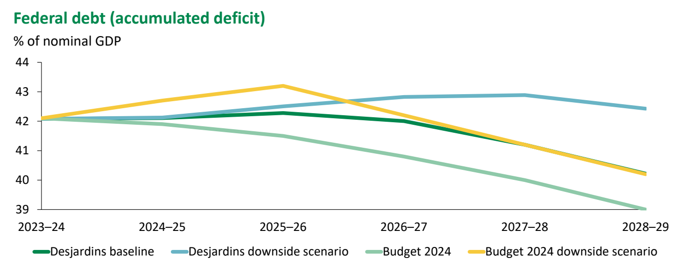
Putting this together, the federal debt-to-GDP ratio risks moving off the declining profile in Budget 2024 to an outlook that is flat at best (graph 8). This would leave little, if any, room for additional new spending in the FES 2024 without either raising additional tax revenues or abandoning any attempt at maintaining fiscal sustainability. As a result, there could be few goodies on offer in this year's FES. Indeed, if the recent housing measures are any indication, new policies could be modest with only a marginal budgetary impact.

**Graph 8**
**Federal Debt Could Keep Rising on Fewer Newcomers and More Spending**

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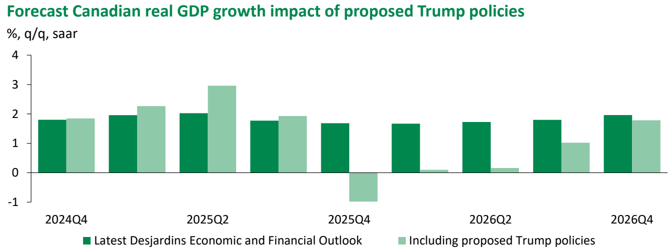
But these aren't the only potential sources of federal deficit and debt deterioration. For instance, the Parliamentary Budget Officer (PBO) estimated that the recent increase in the capital gains inclusion rate could generate as much as $2.0B less revenue over the next five years than forecast in Budget 2024. A further expansion of the recently passed national pharmacare plan also poses downside risks to the federal fiscal outlook. Add to this calls for a dramatic increase in seniors' benefits, and the dour downside scenario presented above may ultimately prove too optimistic.

However, this still doesn't account for the greatest uncertainty facing the Canadian economy right now: the potential for a second Trump presidency. As we wrote recently, if former President Trump follows through with his plan to slap an across-the-board tariff of 10% (up to 20%) on all imports and 60% on imports from China specifically, that has the potential to hit the Canadian economy hard (graph 9). When combined with the previously mentioned fiscal headwinds, a Trump re-election would almost inevitably cause the federal debt to rise continuously as a share of nominal GDP.

**Graph 9**
**Trump's Proposed Policies Could Lead to a Recession in Canada**

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## Conclusion

There are a lot of fiscal headwinds facing the federal government. Increased spending commitments, expected slower population growth and a possible second Trump presidency are chief among them. And while the Government of Canada can increase its tax take further to offset some of these deficit drags, that well is increasingly running dry. Planned tax revenues are inching toward the share of nominal GDP they clocked in at in the 1980s and 1990s, all to support structurally higher spending since the pandemic (see our take on Budget 2024). But taxing and spending can only take you so far. Indeed, if taken too far, it risks taking you backward.