WEEKLY COMMENTARY

Provincial Governments Should Be Cautious with Spending as New Costs and Economic Pressures Mount

By Marc Desormeaux, Principal Economist

As at the federal level, recent forecast updates suggest the fiscal backdrop is weakening for some of Canada's provinces. A series of revenue and deficit forecast downgrades has reversed the trend seen since calendar year 2020, when budget balances consistently outperformed. With a recession looming, what does this mean for soon-to-be-released fiscal year 2023–24 (FY2024) provincial budget updates? And what does it portend for policymakers seeking to address the cost-of-living crisis?

We'll start with the good news: following early-year weakness, we see some upside potential from commodity prices. BC is now expecting a deeper deficit for FY2024 due to an unexpected plunge in natural gas prices. But in response, Canada's westernmost province prudently lowered its natural gas price assumptions to within just the 20th percentile of the range of private-sector forecasts. Alberta also expects related royalties to come in well below previous projections. However, tightness in the discount between Alberta and American oil prices continues to mitigate the fiscal drag from early-year softness in global crude values. And oil prices have rallied recently, which led us to upgrade our WTI forecasts.

Stronger-than-anticipated recent population gains represent another fiscal tailwind but come with two caveats. First, a headcount-induced boost to topline economic activity and tax revenues can mask deeper weakness at the provincial level just as it can nationally. Amid decades-high population growth, Canadian real GDP per capita was down 2% year-over-year as of the second quarter of this calendar year. Similarly, following upgrades to the Q1 FY2024 population growth forecast, tax receipts per person barely increased in Alberta and declined in BC. Second, the ongoing demographic surge reinforces the need for governments to meet affordable housing supply and infrastructure spending targets. FY2024 updates released so far suggest that some critical infrastructure projects are behind schedule, putting some downward pressure on government debt in the short run but posing further challenges to restoring affordability over the longer run.

Tax base trends are less sanguine for government revenues than they were in the spring. Ontario and BC's expectations for personal income tax revenues fell following federal income tax reassessments. That comes less than a year after unexpected boosts to the tax base were responsible for windfalls. If a nationwide trend increasingly emerges—as it did in prior years following upward revisions in some provinces—weaker starting points could translate into a lower trajectory for outer-year receipts across jurisdictions.

First-quarter FY2024 updates also revealed upward pressures on government expenditures. Wildfire costs are expected to total almost $1 billion in Alberta and nearly $800 million in BC and will likely feature more prominently in Quebec's spending plans as the year progresses. While these are one-off factors, they highlight the growing risk presented by extreme weather events. Meanwhile persistent inflation and ongoing wage negotiations still pose upside risk to public sector spending after driving up expenditure projections in at least one provincial update so far.

Against that backdrop, fiscal buffers matter. In their 2023 budgets, the four biggest provinces all included larger-than-usual contingency allocations to absorb unexpected costs and minimize damage to the bottom line. But BC stands out for setting aside nearly $17 billion in contingencies over the next three fiscal years—more than the combined deficits forecast for that period. It also explicitly set aside funds for public sector

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wage agreements and potential future cost of living adjustments beyond the baseline budget increases.

Demographic growth, tax base adjustments and new spending pressures may be changing the fiscal picture for Canada's provinces, but they shouldn't change policy objectives. Inflation remains too high, and broad-based government spending or household supports—though tempting amid still-stretched affordability and slowing economic growth—could re-inflame it. The prospect of higher-for-longer interest rates also poses risks for borrowing costs and debt sustainability. For now, provinces should keep their fiscal powder dry while remaining focused on boosting the housing supply and meeting infrastructure targets. That's the best way to support recovery from the coming downturn and improve affordability over time.

What to Watch For

By Randall Bartlett, Senior Director of Canadian Economics, Tiago Figueiredo, Associate – Macro Strategy, Marc Desormeaux, Principal Economist, Marc-Antoine Dumont, Economist, and Francis Généreux, Principal Economist

UNITED STATES

THURSDAY October 12 - 8:30

September	m/m
Consensus	0.3%
Desjardins	0.3%
August	**0.6%**

Consumer Price Index (September) – Rising gasoline prices caused the consumer price index (CPI) to spike in August, but they likely impacted September's print less. We've actually seen pump prices decline slightly, but this will be easily offset by seasonal adjustments. Stripping out food and energy, we expect to see a 0.3% increase for September, just like the previous month. We think the all items index will edge up by the same amount. The year-over-year change in the all items index should fall from 3.7% to 3.6%, with core inflation edging down from 4.3% to 4.1%.

FRIDAY October 13 - 10:00

October	
Consensus	67.5
Desjardins	63.0
September	**68.1**

University of Michigan consumer sentiment index (October – preliminary) – The University of Michigan consumer sentiment index fell a combined 3.9 points in August and September, wiping out part of its June and July gains. This latest downward trend in confidence is showing up in other indexes too. The Conference Board index plummeted in August and September, while the TIPP index hit its lowest level since October 2011. Poor stock market performance over the last month combined with rising mortgage rates won't help improve consumer sentiment, despite the recent fall in gasoline prices. Problems in Washington—a shutdown was avoided, but only until November, and infighting continues among congressional Republicans—are adding to concerns. As a result, we expect the University of Michigan consumer sentiment index to fall further.

CANADA

FRIDAY October 13 - 9:00

September	m/m
Consensus	n/a
Desjardins	-1.0%
August	**-4.1%**

Existing homes sales (September) – Friday, October 13 should be unlucky indeed for Canada's housing market, as we expect Canadian Real Estate Association (CREA) data to reveal that national-level home purchases fell by 1.0% in September. Regional differences should persist. Early data from the local real estate board suggests further weakness in the Toronto area, with the cumulative effects of higher borrowing costs increasingly weighing on sales activity in the high-priced market. BC Lower Mainland markets also appear to be cooling, though not as much as Toronto. Meanwhile Calgary and Edmonton still look to be benefiting from relative affordability and Alberta's nation-leading population gains. However, the key question once again will be what happens to new listings, which have spiked nearly across the board since the Bank of Canada resumed rate hikes. Following demand–supply tightness earlier in 2023, market sentiment seems to have soured considerably, which doesn't bode well for home values going forward.

OVERSEAS

THURSDAY October 12 - 21:30

September	y/y
Consensus	0.2%
August	**0.1%**

China: Consumer Price Index (September) – While most countries are still grappling with stubborn inflation, prices are stagnating in China. After falling 0.3% in July, China's consumer price index eked out a year-over-year gain of just 0.1% in August. It'll be interesting to see whether this muted price pressure continued in September.

Economic Indicators

Week of October 9 to 13, 2023

Date	Time	Indicator	Period	Consensus		Previous reading
UNITED STATES						
MONDAY 9	8:00	Speech by Federal Reserve Vice Chair M. Barr				
	9:00	Speech by Federal Reserve Bank of Dallas President L. Logan				
	12:50	Speech by Federal Reserve Governor P. Jefferson				
TUESDAY 10	9:30	Speech by Federal Reserve Bank of Atlanta President R. Bostic				
	10:00	Wholesale inventories – final (m/m)	Aug.	n/a	-0.1%	-0.1%
	13:00	Speech by Federal Reserve Governor C. Waller				
	15:00	Speech by Federal Reserve Bank of Minneapolis President N. Kashkari				
WEDNESDAY 11	4:15	Speech by Federal Reserve Governor M. Bowman				
	8:30	Producer price index				
		Total (m/m)	Sept.	0.3%	0.1%	0.7%
		Excluding food and energy (m/m)	Sept.	0.2%	0.2%	0.2%
	14:00	Release of the Federal Reserve's meeting minutes				
THURSDAY 12	8:30	Initial unemployment claims	Oct. 2–6	215,000	212,000	207,000
	8:30	Consumer price index				
		Total (m/m)	Sept.	0.3%	0.3%	0.6%
		Excluding food and energy (m/m)	Sept.	0.3%	0.3%	0.3%
		Total (y/y)	Sept.	3.6%	3.6%	3.7%
		Excluding food and energy (y/y)	Sept.	4.1%	4.1%	4.3%
FRIDAY 13	8:30	Import prices (m/m)	Sept.	0.6%	0.7%	0.5%
	8:30	Export prices (m/m)	Sept.	0.5%	1.0%	1.3%
	9:00	Speech by Federal Reserve Bank of Philadelphia President P. Harker				
	10:00	University of Michigan consumer sentiment index – preliminary	Oct.	67.5	63.0	68.1
CANADA						
MONDAY 9	---	Markets closed (Thanksgiving Day)				
TUESDAY 10	---	----				
WEDNESDAY 11	8:30	Building permits (m/m)	Aug.	n/a	-0.1%	-1.5%
THURSDAY 12	---	---				
FRIDAY 13	9:00	Existing home sales (m/m)	Sept.	n/a	-1.0%	-4.1%

Note: Each week, Desjardins Economic Studies takes part in the Bloomberg survey for Canada and the United States. Approximately 15 economists are consulted for the Canadian survey and a hundred or so for the United States. The abbreviations m/m, q/q and y/y correspond to month-over-month, quarter-over-quarter and year-over-year change respectively. Following the quarter, the abbreviations f, s and t correspond to first estimate, second estimate and third estimate respectively. Times shown are Eastern Daylight Time (GMT - 4 hours). Desjardins Economic Studies forecast.

Economic Indicators

Week of October 9 to 13, 2023

Country	Time	Indicator	Period	Consensus m/m (q/q)	Consensus y/y	Previous reading m/m (q/q)	Previous reading y/y
OVERSEAS							
MONDAY 9							
Germany	2:00	Industrial production	Aug.	-0.1%	-1.6%	-0.8%	-2.1%
Japan	19:50	Current account (¥B)		2,407.6		2,766.9	
TUESDAY 10							
Italy	4:00	Industrial production	Aug.	-0.3%	-5.0%	-0.7%	-2.1%
WEDNESDAY 11							
Germany	2:00	Consumer price index – final	Sept.	0.3%	4.5%	0.3%	4.5%
Japan	19:50	Producer price index	Sept.	0.2%	2.4%	0.3%	3.2%
THURSDAY 12							
Germany	---	Current account (€B)	Aug.	n/a		18.7	
China	---	Trade balance (US$B)	Sept.	73.70		68.20	
United Kingdom	2:00	Monthly GDP	Aug.	0.2%		-0.5%	
United Kingdom	2:00	Industrial production	Aug.	-0.2%	1.7%	-0.7%	0.4%
United Kingdom	2:00	Index of services	Aug.	0.3%		-0.5%	
United Kingdom	2:00	Construction	Aug.	0.3%	2.6%	-0.5%	2.8%
United Kingdom	2:00	Trade balance (£M)	Aug.	-4,100		-3,446	
China	21:30	Consumer price index	Sept.		0.2%		0.1%
China	21:30	Producer price index	Sept.		-2.4%		-3.0%
FRIDAY 13							
France	2:45	Consumer price index – final	Sept.	-0.5%	4.9%	-0.5%	4.9%
Eurozone	5:00	Industrial production	Aug.	0.1%	-3.5%	-1.1%	-2.2%

Note: Unlike release times for US and Canadian economic data, release times for overseas economic data are approximate. Publication dates are provided for information only. The abbreviations m/m, q/q and y/y correspond to month-over-month, quarter-over-quarter and year-over-year change respectively. Times shown are Eastern Daylight Time (GMT - 4 hours).