2018 Canadian Federal Budget

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CIBC

Economics

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Federal Budget—Staying the Course

by Andrew Grantham and Avery Shenfeld

With the economy cooling to more trend-like growth after a hot 2017, and given uncertainty over how US policy may impact Canada, today wasn't the time to make a big adjustment in fiscal course. And even though there was some new spending announced and other spending redistributed to current priorities, the overall deficit projections were very similar to those issued at the time of the Fall Statement.

The Finance Minister had already made it clear that there wouldn't be a knee-jerk reaction to tax changes stateside, and that was reiterated in his speech by saying they would let "evidence, and not emotion" guide future decisions on how or when to respond. As such, today's budget was focused largely on the long-term, in trying to improve growth by making it easier for low income earners, women and minority groups to enter and remain in the workforce.

Deficits Abating, But No Surprises There

Strong economic growth in 2017, resulting in higher revenues than had originally been budgeted for, were key in meaning that the current 2017/18 fiscal year will see a smaller deficit than originally projected (Table 1).

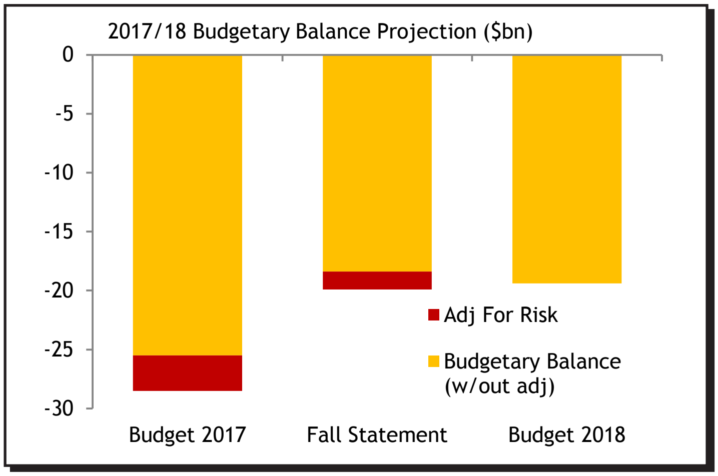
However, most of that good news was already known and factored in at the time of the Fall Statement. And even though economic factors would have lowered the deficit modestly further since then, new spending under the bucket of "Advancement" (specifically related to support for Veterans) means that the current -$19.4bn projection for 2017/18 is slightly larger than it was in the Fall, after accounting for the removal of the contingency (Chart 1).

The deficit is expected to dip modestly to $18.1bn in 2018/19, with that projection

Table 1
Fiscal Outlook

$Billions	2016/17 Actual	2017/18 17 Budget	2017/18 18 Budget	2017/18 Change	2018/19 18 Budget	2019/20 18 Budget	2020/21 18 Budget	2021/22 18 Budget	2022/23 18 Budget
Budgetary Revenues	293.5	304.7	309.6	4.9	323.4	335.5	348.0	362.1	373.9
% change	*-0.7*	*3.8*	*5.5*	*1.7*	*4.5*	*3.7*	*3.7*	*4.1*	*3.3*
Program Spending	287.2	305.4	304.6	-0.8	312.2	321.5	331.5	340.7	350.1
% change	*6.0*	*6.4*	*6.1*	*-0.3*	*2.5*	*3.0*	*3.1*	*2.8*	*2.8*
Public Debt Charges	24.1	24.7	24.4	-0.3	26.3	28.6	30.3	32.2	33.1
Adjustment for Risk	-	*-3.0*	-	-	*-3.0*	*-3.0*	*-3.0*	*-3.0*	*-3.0*
Budgetary Balance	**-17.8**	**-28.5**	**-19.4**	**9.1**	**-18.1**	**-17.5**	**-16.9**	**-13.8**	**-12.3**
Federal Debt	631.9	665.5	651.5	-14.0	669.6	687.1	704.0	717.8	730.1
% of Nominal GDP	*31.0*	*31.6*	*30.4*	*-1.2*	*30.1*	*29.8*	*29.4*	*28.9*	*28.4*

Chart 1
2017/18 Deficit Lower Than Previous Budget, Little Changed From Fall Statement



Source: Budget 2018, CIBC

Table 2
Average Private Sector Forecasts

Y/Y % Chg	2017	2018	2019	2020-22(1)
Economic Assumptions				
Real GDP	3.0	2.2	1.6	1.7
Budget 2017	*2.1*	*2.0*	*1.7*	*1.8*
Nominal GDP	5.2	4.0	3.5	3.7
Budget 2017	*4.3*	*4.0*	*3.5*	*3.8*
Jobless Rate (%)	6.4	6.0	6.0	6.0
CPI	1.6	1.9	2.0	1.9
US Real GDP	2.3	2.4	1.9	1.9
Financial Assumptions				
WTI (US$/bbl)	51	56	57	59
3-month T-Bills (%)	0.7	1.4	2.0	2.4
10-year GoC Bonds (%)	1.8	2.3	2.8	3.2
Exchange Rate (US¢/C$)	77.2	79.0	79.6	80.7

(1) "Budget 2017" figures for real/nominal GDP based on 2020-21 average

including a $3bn adjustment for risk. Spending is set to decelerate in the coming year to not much above the rate of inflation. But there could be program spending pressures building for an election year budget, including a pledge for pharmacare that has not yet been costed, as well as wage adjustment tied to the budget's pay equity plan.

The government still has infrastructure dollars up its sleeve to help stimulate growth in the event of an adverse shock. Details related to the infrastructure plan in Budget 2016 once again showed spending being pushed back into later years, with the allocation for 2017/18 $2.2bn lower, and 2018/19 $1.0bn beneath, previous plans. In the near-term, focus will be on spending on sciences.

Instead of trying to achieve a budget balance by the end of the forecast horizon, the government once again chose to focus on maintaining a downward trajectory for the debt-to-GDP ratio. Meanwhile, deficits are still less than 1.0% of GDP and compare favourably to the growing budget shortfalls in the US. Due to the combination of a smaller deficit and higher level of GDP, the ratio of 30.4% for 2017/18 is more than a percent lower than had been expected at the time of last year's budget, and is set to fall to 28.4% by the end of the forecast horizon.

The projections are based on economic performance returning to more trend-like growth rates of around 1.5-2.0% for real GDP and 3.5-4.0% for nominal GDP over the longer-term. The unemployment rate is expected to remain steady around 6.0% and oil prices actually average below current levels (Table 2).

Supporting Workforce Participation, Long-Term Growth

A key theme in today's budget was promoting participation in the economy among many groups including low income earners, women and minorities, with the aim of not just fairness but also supporting workforce growth as the population ages.

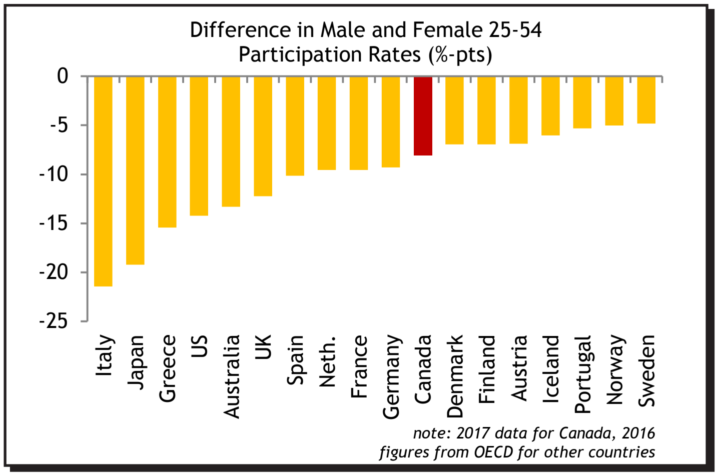
The new Canada Workers Benefit, replacing the existing Working Income Tax Benefit, is designed to see low income earners join and stay in the workforce. The maximum benefit of $1355 per year for individuals ($2335 for families) compares to the status quo of $1192 ($2165) and comes at an estimated cost of more than $3bn to the government over the forecast horizon when including both the enhancement and efforts to improve access.

As was widely rumored before the Budget, promoting the role of women in the workforce was a key theme. Canada already has a greater share of women in the workplace than many other countries, and today's budget aims to further narrow the gap between male and female participation rates (Chart 2).

Those policies include a new use-it-or-lose-it Employment Insurance Parental Sharing Benefit to encourage both parents in two-parent families to share early child care duties, and thus enable women to return to work earlier if they so choose. Those who do share responsibility will receive an additional 5-8 weeks of leave starting in June 2019. The government expects that to cost $1.2bn over the forecast horizon.

Chart 2

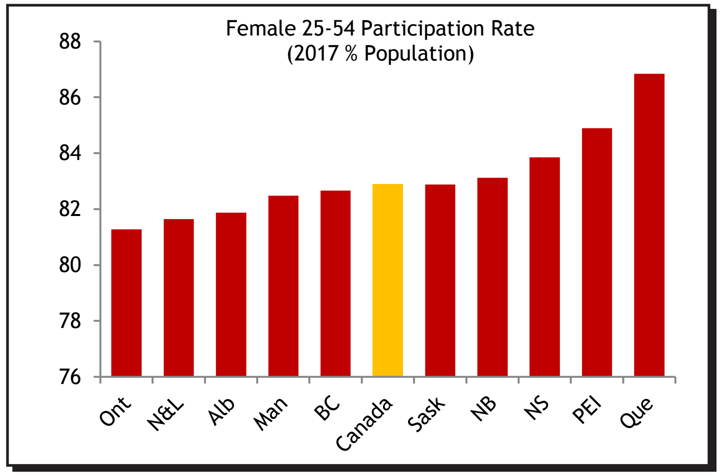
Canada Already Better Than Many In Terms Of Female Labour Force Participation



Source: OECD, Statistics Canada, CIBC

Chart 3

Quebec Experience Shows Further Gains In Female Participation Are Possible



Source: Statistics Canada, CIBC

How successful the policies will be will, of course, take years to judge. However, there is an example close to home of how making it easier for women to work can boost labour force growth. In Quebec, where paternal leave is already available and where day-care is highly subsidized, the continued increase in 25-54 female participation above the national average (Chart 3) has helped partly offset the demographic challenges faced in that Province when it comes to working-age population growth.

Scattered, Modest Tax Increases

Also included were some final details of changes in small business tax treatment. After consultations last year, Budget 2018 introduced two new measures, applicable to taxation years that begin after 2018, to limit tax deferral advantages on passive investment income earned inside private corporations. Combined these changes are expected to bring in roughly $2.3bn over the five-year time horizon.

Other tax policies include a rise in tobacco tax, bringing in an additional $1.47bn total over the five year of forecasts. The government also laid out expectations for taxation of legal cannabis, with $690mn of revenue coming in over the five years from its 25% share of the takings.

Borrowing Set to Rise Despite Lower Deficit

Even with the deficit projected to move marginally lower in 2018/19, borrowing is set to rise due to deterioration in the non-budgetary transactions balance, namely a smaller surplus from pensions. With total non-budgetary transactions set to cost $16.7bn in 2018/19, compared to $4.1bn in 2017/18, the net financial requirement will rise by around $11bn. Maturities/buybacks are slated to be similar in the coming year to that seen during 2017/18, so the higher net financial requirement translates into the gross borrowing requirement as well.

Lower borrowing in 2017/18 than was originally budgeted for, thanks to the strength of the economy and lower deficit that went along with it, was reflected

Table 3

Net Bond Stock to Increase by $20 bn in 2018/19

$Billions	2017/18F	2018/19E
Borrowing Requirements		
Budgetary Deficit/(Surplus)	19.4	18.1
Non-Budgetary Transactions (1)	4.1	16.7
Net Financial Requirement/(Source)	23.5	34.8
Domestic Maturities, Adj. & Buybacks (2)	95.0	94.0
Gross Borrowing Requirement	**118.5**	**128.8**
Sources of Funding		
Cash & Other (Net)	-4.5	1.8
Treasury Bills (Net)	-12.0	13.0
Canadian Dollar Bonds (incl. RRBs)	138.0	115.0
Retail (Net)	-1.0	-2.0
Foreign Currency Debt (Net)	-2.0	1.0
Total	**118.5**	**128.8**
Change in Bond Stock	43	20

(1) Non-budgetary transactions comprise loans/advances to Enterprise Crown Corporations, pension costs & other
(2) Domestic bonds only; excludes refinancing requirements for Treasury bills, retail and foreign currency debt

in smaller Treasury bill auctions. The stock of bills is projected to be $125bn at the end of 2017/18, which would be $6bn less than projected in Budget 2017.

In response to feedback from market participants, adjustments are being made in 2018/19 to raise the stock of treasury bills again to ensure healthy market functioning. That increase in bill issuance, combined with a slight rise in foreign debt and cash/other funding, means that gross bond issuance will actually be lower than in the prior year. The bond stock will rise $20bn, compared to $43bn in 2017/18.

Over the coming decade the proportion of debt with terms of more than 10 years is expected to remain around 40%, and the average maturity is expected to remain relatively stable between 5.5-6.5 years.

The lighter calendar for borrowing in Canada contrasts with the US, where the bond market is financing rising deficits and the unwind of the Fed's balance sheet.