Economics

FEDERAL BUDGET BRIEFS

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Federal budget 2023: a healthy meal, but skipping desert

A windfall tied to full employment and healthy nominal GDP growth allowed Ottawa to continue to climb down from huge deficits in the past year. However, as revenue growth slows, fresh items on the policy menu would not only threaten that progress, but could give a push to inflation in what is for now a fully-employed economy. The 2023 budget still makes a healthy meal out of new initiatives, but attempts to save some fiscal calories by skipping desert, trimming spending in government operations, repurposing money that had been allocated in past budgets for other programs, and raising taxes here and there.

A year ago, Ottawa was projecting a deficit of nearly $53 bn for the fiscal year that's just ending. Above-plan revenues, partially offset by in-year spending announcements, trimmed that to a $43 bn shortfall (Table 1). That's up a bit from the $36 bn projected in last fall's update due to spending measures announced since then or in this budget. Looking ahead, the deficit is expected to see little change, with a base case of $40 bn in 2023/24.

A gradual improvement is projected thereafter, but deficits will be about $10-15 bn wider each year than in the fall statement, with that revision about equally attributable to a softer projected economic outlook and new policy measures. Unlike the fall statement, a modest deficit will remain in the final year of the plan.

Table 1: Fiscal outlook: (C$billions)

Fiscal measure	2021/22 Actual	2022/23 22 Budget	2022/23 23 Budget	2022/23 Change	2023/24 23 Budget	2024/25 23 Budget	2025/26 23 Budget	2026/27 23 Budget	2027/28 23 Budget
Budgetary revenue	413.3	408.4	437.3	28.9	456.8	478.5	498.4	521.8	542.8
• % Change		3.5	5.8	2.3	4.5	4.8	4.2	4.7	4.0
Program Spending ex. Actuarial Losses	468.8	425.4	435.9	10.5	446.6	463.3	475.9	489.2	505.4
• % change		-10.1	-7.0	3.0	2.5	3.7	2.7	2.8	3.3
Public debt charges	24.5	26.9	34.5	7.6	43.9	46.0	46.6	48.3	50.3
Budgetary balance (Before Actuarial Losses)	-80.0	-43.9	-33.2	10.8	-33.7	-30.8	-24.1	-15.7	-12.9
Net Actuarial Losses	-10.2	-8.9	-9.8	-0.9	-6.4	-4.2	-2.8	0.0	-1.1
Budgetary balance	-90.2	-52.8	-43.0	9.9	-40.1	-35.0	-26.8	-15.8	-14.0

Economic Backdrop: Hitting the Brakes to Cool Inflation

With inflation running above target over the past year, Bank of Canada policy has been firmly aimed at stalling growth and opening up labour market slack to get the CPI pace back to 2%. Canada's major trading partners are in the same boat. As a result, the consensus forecast on which the budget is based, as well as CIBC's own outlook, are in general agreement that 2023 will see a decided deceleration in both real GDP growth, and nominal GDP, which is a key driver for government revenues (Table 2). Our own forecast is a bit more optimistic on real GDP this year, but roughly in line with the nominal GDP trend.

This isn't, however, a slowing that calls for a fiscal boost to demand, at least not until we've gone through enough of a soft patch to get inflation under wraps. Several provinces have added somewhat to demand pressures in the economy by doling out cheques or announcing tax cuts for this year. So where does this federal budget sit in terms of the balance between stimulus and restraint?

Typically, the spending side captures programs, but several of this budget's programs are actually delivered through the tax system. In total, new spending and tax measures since the fall statement net out to a $5 bn addition to the budget deficit in 2023/24 and the following year, or less than 0.2% of nominal GDP.

That calculus, however, ignores spending programs announced last fall, or in prior budgets. All in, government program spending (excluding actuarial losses) will be advancing at a 2.5% clip in the coming fiscal year, or very little in real terms, helped by the fact that $3.5 bn of the new spending will come from reallocating money previously aimed elsewhere, but also cushioned by the fact that a new one-off payment to help low income Canadians cope with inflation was charged to the outgoing year. Still, it's fair to say that the federal government's initiatives in this document won't be material for the Bank of Canada's interest rate decisions this year.

Table 2: Average private sector forecasts - economic assumptions

Economic assumptions (Y/Y % unless stated)	2022	2023	2024	2025-27
Real GDP	3.4	0.3	1.5	2.1
Nominal GDP	11.0	0.9	3.6	4.1
Jobless rate (%)	5.3	5.8	6.2	5.8
CPI	6.8	3.5	2.1	2.1
US real GDP	2.1	0.8	1.4	2.0

Table 3: Average private sector forecasts - financial assumptions

Financial assumptions	2022	2023	2024	2025-27
WTI (US$/bbl)	94	81	81	78
3-month T-bills (%)	2.4	4.4	3.3	2.5
10-year GoC bonds (%)	2.8	3.0	2.9	3.1
Exchange rate (US¢/C$)	76.9	74.7	76.8	78.9

Trimming here, but adding there

Last year's fiscal plan pledged to identify billions in then-unspecified savings on programs, and the 2023 budget does do some trimming, not only by repurposing funds, but also by pledging to ease up on consulting fees.

While there were no broad-based tax hikes in the near term, details were unveiled on two previously-planned revenue-raising reforms as well as yet another tax hitting financial institutions. A promised "reform" of the alternative minimum tax included raising the rate from 15% to 20.5% while exempting more of those with moderate incomes from it altogether, to raise $0.6 bn by 2024/25. A tax on share buybacks will raise $0.5 bn by that same year, and taxing dividends received on shares owned by financial institutions is slated to reap $0.9 bn.

Against that, there is the usual laundry list of new initiatives, which as always, are too numerous to fully detail here. Among the larger items by dollar value are a multi-year program of tax credits in support of clean electricity and a greener economy. These initiatives are aimed at dulling the competitive challenges raised by massive credits offered in the US under Biden's Inflation Reduction Act. While having a very small impact on the 2023/24 fiscal year, they will grow to $2.5 bn the following year and over $6 bn by fiscal year 2027/28.

Other spending measures include fulfilling pledges to enhance health and dental care at a fiscal cost of $3.6 bn in the upcoming year, but growing to more than twice that by 2027/28. The inflation relief provided to low income Canadians through an earlier temporary enhancement of the GST credit will now be supplemented by a further $2.5 bn in payments, which were charged to the outgoing fiscal year, as was a major settlement in a residential schools case.

Despite the message of restraint in terms of the scale of net new measures, federal government program spending will still stand at 15.9% of GDP in 2023/24 and the following year, easing to 15.4% in 2027. That's up from 14.4% back in fiscal 2017, as the government has opted to provide Canadians with new social programs and increased health care funding, and now looks to assist the manufacturing and electricity sector in the transition to clean energy.

Whither the fiscal balance

That's not to say that Canada's fiscal balance isn't in reasonable shape, at least compared with other jurisdictions, particularly since increased transfers are part of a much better picture these days for provincial balances. The federal deficit at 1.4% of GDP in the coming year, is projected to reach only 0.4% in 2027/28. That does, however, abandon the plan for a small surplus in that final year that had been present at the time of the fall statement.

Weaker growth this year will see the debt/GDP ratio climb from 42.5% in the prior fiscal year to 43.5% in 2023/24, before easing to just under 40% in 2027/28. Prior to the pandemic, Ottawa aimed to contain debt to 30% of GDP. So after a surge in deficits and a hit to the economy at the height of the pandemic, and the lack of more aggressive slashing now, we've set our sights at a higher benchmark, as have other major industrialized countries. That will also see public debt charges climb materially from their lows as a share of GDP, but still too only in the vicinity of 1.5 % of GDP in the base case scenario presented in the budget, roughly a quarter of their peak in the early 1990s.

Borrowing to favour bills over bonds

A slightly slimmer budget deficit, combined with smaller refinancing needs, means that the gross borrowing requirement for fiscal 2023/24 is roughly $22bn lower than the prior year's (table 4). However, for the fiscal year just ending, the borrowing program was lightened by the running down of cash balances that had been kept elevated during the height of the pandemic. As a result, gross issuance of bonds and bills combined is actually rising to $414bn in fiscal 2023/24, from $387bn in 2022/23 (table 6). Issuance of treasury bills will rise to $242bn, from $202bn, with this increase informed by consultations with market participants that suggested continued high demand for treasury bills due to market uncertainty and the rising interest rate environment. In contrast to the increase for bills, gross bond issuance will fall to $172bn in fiscal 2023/24, from $185bn in the outgoing fiscal year.

After real-return and ultra-long bonds were dropped from the borrowing program last year, this year sees the demise of the 3-year sector. The government will cease issuing 3-year bonds as of the second fiscal quarter, with the decision taken to support liquidity within its core funding sectors as overall borrowing requirements continue to shrink from their pandemic highs. Issuance in the 2 and 5-year sectors will rise relative to fiscal 2022/23. While issuance of bonds with maturities of over 10 years is falling, the government noted that at 29% of the total bond program this is still higher than the average share pre-pandemic (around 20%).

The government didn't provide a specific target for green bonds in the year ahead, stating instead that it is committed to regular issuance which will be subject to market conditions. The government will also be holding consultations regarding a proposal to consolidate Canadian Mortgage Bonds (CMB's) within the government's regular borrowing program.

Table 4: Borrowing requirement (C$billions)

Borrowing requirements	2022/23E	2023/24F
Budgetary (Surplus)/Deficit	43.0	40.1
Non-budgetary transactions[1]	17.3	22.8
Net Financial Requirement/(Source)	60.2	62.9
Domestic Maturities, Adj. & Buybacks[2]	178.0	153.0
Gross Borrowing Requirement	238.2	215.9

Table 5: Sources of funding (C$billions)

Funding requirements	2022/23E	2023/24F
Cash & Other (net)	37.2	-1.1
Treasury Bills (net)	15.0	40.0
Canadian Dollar Bonds	185.0	172.0
Retail (net)	0.0	0.0
Foreign Currency Debt (net)	1.0	5.0
Total	238.2	215.9
Change in bond stock	7	19

[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

Table 6: Gross issuance (C$billions)

$bn	2021/22A	2022/23 E	2023/24 F
Treasury bills	187	202	242
2yr	67	67	76
3yr	29	20	6
5yr	44	31	40
10yr	79	52	40
30yr	28	14	10
Green bonds	5.0	-	-[3]
Total bonds	257[4]	185	172
Total Gross Issuance	444	387	414

[3] Issuance subject to expenditure availability and market conditions.

[4] Total issuance includes real-return bonds and ultra-long bonds.

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