Budget Analysis

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CANADA: 2016 BUDGET

$118.6B in budget deficits on the way!

HIGHLIGHTS

- The budget deficit could rise from $5.4B in 2015–2016 to $29.4B in 2016–2017. It is then projected to decline gradually.
- The federal government debt will go up substantially, resulting in greater financing needs.
- The debt to GDP ratio could edge up, from 31.0% in 2014–2015 to 32.5% in 2016–2017. It is expected to slowly drop back to 30.9% by 2020–2021.
- More than $120B in total infrastructure investment over 10 years, in two phases.
- Several new measures for families, aboriginals and seniors.
- The new budget measures should translate into stronger economic growth, especially as of 2017.

Table 1
Summary statement of transactions

	Actual	*Projections*					
In $B	**2014–2015**	**2015–2016**	**2016–2017**	**2017–2018**	**2018–2019**	**2019–2020**	**2020–2021**
Budgetary revenues	**282.3**	**291.2**	**287.7**	**302.0**	**315.3**	**329.3**	**344.4**
- Change (%)	3.9	3.2	-1.2	5.0	4.4	4.4	4.6
Program spending	**-253.8**	**-270.9**	**-291.4**	**-304.6**	**-308.7**	**-314.2**	**-323.2**
- Change (%)	2.1	6.7	7.6	4.5	1.3	1.8	2.9
Debt charges	**-26.6**	**-25.7**	**-25.7**	**-26.4**	**-29.4**	**-32.8**	**-35.5**
- Change (%)	-5.7	-3.4	0.0	2.7	11.4	11.6	8.2
Budgetary balance	**1.9**	**-5.4**	**-29.4**	**-29.0**	**-22.8**	**-17.7**	**-14.3**
Federal debt[1]	**612.3**	**619.3**	**648.7**	**677.7**	**700.5**	**718.2**	**732.5**
- Change (%)	0.1	1.1	4.7	4.5	3.4	2.5	2.0
In % of GDP							
Budgetary revenues	14.3	14.6	14.4	14.5	14.5	14.5	14.5
Program spending	12.9	13.6	14.6	14.6	14.2	13.8	13.6
Public debt charges	1.3	1.3	1.3	1.3	1.3	1.4	1.5
Budgetary balance	0.1	-0.3	-1.5	-1.4	-1.0	-0.8	-0.6
Federal debt	31.0	31.2	32.5	32.4	32.1	31.6	30.9

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

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THE FEDERAL GOVERNMENT TURNS ON THE TAPS

As expected, the $1.9B budget surplus of 2014–2015 will be followed by a return to deficit budgets. A deficit of $5.4B is projected as of 2015–2016, a figure that should then rise substantially, hitting $29.4B in 2016–2017 and $29.0B in 2017–2018. After that, it is expected to decline gradually, going to $14.3B in 2020–2021. In all, the deficits should total $118.6B by March 31, 2021. To do this, however, the federal government will have to repeal the *Federal Balanced Budget Act* enacted by the previous government. Currently, after a deficit year, the law requires a budget adjustment of 1% of nominal GDP.

There are two reasons for the erosion in the Canadian government's budgetary balance. Firstly, economic conditions worsened as a result of the drop in commodity prices, helping generate a budget deficit. Secondly, the measures introduced by the new federal government—a cut to the tax burden on some taxpayers, implemented in early 2016, and the new announcements in the 2016 budget—helped to increase the budget deficit further. Among other things, growth by program spending will go from 2.1% in 2014–2015 to 6.7% in 2015–2016, and 7.6% in 2016–2017.

The federal government's goal is clearly to boost Canada's economic growth by introducing stimulus measures, such as the increase to infrastructure spending (see the box for more on the economic outlook). Note that these actions are possible due to the efforts made in the last few decades, which efforts had a big hand in reducing the size of federal debt, giving the Canadian government some flexibility. The debt to GDP ratio, which hit a historic high of 67.1% in fiscal 1995–1996, was down to just 31.0% in 2014–2015. Given the deficits projected for the next few years, the debt to GDP ratio will rise to 32.5% in 2016–2017, a slight increase, historically speaking. After that, the debt to GDP ratio should decline again, hitting 30.9% in 2020–2021, close to where it was in 2014–2015.

The increase in the federal debt load over the coming fiscal years will trigger a substantial increase in its financing needs, taking them to $37.2B in 2016–2017, and $43.4B in 2017–2018. Under the circumstances, the government will expand its issuances in all nominal yield bond segments, including the 2- to 5-year segments; it will reintroduce the 3-year segment for 2016–2017.

We should also mention that the federal government remains cautious in developing its budget assumptions. Although the line for adjustment for risk has dropped out of table 1 on page 1, flexibility of approximately $6B per fiscal year has been introduced into the fiscal outlook as of 2016–2017. The adjustment stems from a $40B cut to the nominal GDP used in the budgetary assumptions.

The budget measures should stimulate economic growth

The drop in oil prices triggered many problems for Canada's economy. Real GDP grew by just 1.2% in 2015, and energy-producing regions were in recession. The Canadian economy has not yet fully adjusted to the drop in commodity prices; this ongoing process means that some difficulties will remain over the coming quarters. The growth outlook for 2016 is moderate; our scenario calls for real GDP growth of 1.5%, a projection similar to the one used in Budget 2016.

However, real GDP growth should accelerate in 2017. For one thing, commodity prices are expected to stabilize or even tick up. For another, the spinoffs of lively U.S. demand and a weaker loonie will keep having an impact. Moreover, the budgetary measures announced today, with total value of $11.6B in 2016–2017 and $14.9B in 2017–2018, will clearly have a positive impact on Canada's economy. According to the Department of Finance, their total impact on real GDP will be +0.5% in 2016–2017, and +1.0% in 2017–2018. Some uncertainty naturally looms over these estimates, because the magnitude of the fiscal multipliers is imprecise. That being said, the impact of public investment would be greater in a time of relatively weak economic growth, as we are experiencing now. Under these conditions, we have upgraded our growth forecast for 2017 from 1.9% to 2.3%. Note that our previous scenario had already factored in some of the impact.

In the end, however, the most important factor in the budget parameters is nominal GDP growth. The combined impact of the drop in commodity prices and slower real GDP growth was devastating for nominal GDP in 2015: it only rose 0.7% over the year. This lacklustre performance had a big impact on budgetary revenue and spending and went a long way toward increasing the budget deficit. Thankfully, nominal GDP is forecast to improve gradually in 2016 and 2017. Not only will growth by the deflator be stronger due to an uptick in commodity prices, but real GDP growth will be faster, as mentioned earlier.

Table 2
Economic and financial forecasts

Average annual growth in %	2015			2016f			2017f		
	2015 Budget	2016 Budget	Desjardins Group	2015 Budget	2016 Budget	Desjardins Group	2015 Budget	2016 Budget	Desjardins Group
Real GDP	2.1	1.2	1.2	2.2	1.4	1.5	2.3	2.2	2.3
GDP deflator	-0.3	-0.4	-0.4	2.6	1.0	0.8	2.3	2.4	2.3
Nominal GDP	1.6	0.7	0.7	4.9	2.4	2.3	4.7	4.6	4.6
Treasury bills—3-month	0.6	0.5	0.5	1.0	0.5	0.5	2.0	0.7	0.6
Federal bonds—10-year	1.7	1.5	1.5	2.5	1.6	1.5	3.2	2.3	1.9
Unemployment rate	6.7	6.9	6.9	6.6	7.1	7.3	6.3	6.9	7.1
Exchange rate (US¢/C$)	79.2	78.3	78.3	80.8	72.1	74.8	83.6	75.9	76.0
U.S. real GDP	3.1	2.4	2.4	2.9	2.3	2.2	2.6	2.4	2.5

f: forecasts
Sources: Department of Finance of Canada, Statistics Canada and Desjardins, Economic Studies

BUDGETARY MEASURES TO SUPPORT ECONOMIC GROWTH

As expected, Budget 2016 introduces a number of new measures especially for families, aboriginals, and seniors. Given the substantial number of measures announced today, here is a quick overview of Budget 2016's key initiatives:

- Implementation as of 2016–2017 of Phase 1 of Canada's new infrastructure plan. A total investment of $11.9B over five years.
  - $3.4B over three years to upgrade and improve public transit systems across Canada.
  - $5.0B over five years for investments in water, wastewater and green infrastructure projects across Canada.
  - $3.4B over five years for social infrastructure, including affordable housing, early learning and child care, cultural and recreational infrastructure, and community health care facilities on reserves.
- Phase 2 of Canada's new infrastructure plan will consist in executing the government's long-term infrastructure plan over the next eight years. In the second phase, infrastructure investments will total more than $120B over 10 years. The goals for this phase will be bigger and more ambitious: a more modern, cleaner economy, a more inclusive society, and an economy that is better positioned to capitalize on global trade.
- Help for the middle class:
  - Introduction of the Canada Child Benefit, which will consist of a maximum annual allowance of $6,400 per child under the age of 6, and $5,400 for a child aged 6 to 17. Families with incomes of less than $30,000 will receive the maximum benefit.
  - Budget 2016 proposes to introduce a package of reforms to the Canada Student Loans Program which will make post-secondary education more affordable for students from low- and middle-income families, and ensure that student debt loads are manageable. Among other things, Budget 2016 proposes to increase Canada Student Grant amounts by 50%, from $2,000 to $3,000 a year for students from low-income families, from $800 to $1,200 a year for students from middle-income families, and from $1,200 to $1,800 a year for part-time students.
  - To facilitate access to venture capital by small and medium-size businesses and help the middle class save, Budget 2016 proposes to restore the labour-sponsored venture capital corporations (LSVCC) tax credit at a rate of 15% for the purchase of shares in provincially registered LSVCCs for the 2016 and later tax years. The measure will deliver approximately $815M in federal tax relief during the 2015–2016 to 2020–2021 period.
- Budget 2016 proposes to invest $8.4B over five years to improve socioeconomic conditions for aboriginals and their communities as of 2016–2017, a substantial increase from the investment that would have been made under the Kelowna Accord. The proposed investment in education, infrastructure, training and other programs will make a direct contribution to improving the quality of life for aboriginals and building a stronger, more unified and prosperous Canada.
- Help for seniors:
  - Budget 2016 proposes to increase the Guaranteed Income Supplement by up to $947 a year for seniors who live alone and are the most vulnerable, starting in July 2016.

- Budget 2016 proposes to cancel the provisions in the *Old Age Security Act* that increase the age of eligibility for Old Age Security and Guaranteed Income Supplement benefits from 65 to 67, and Allowance benefits from 60 to 62 over the 2023 to 2029 period.
- Introduction of enhancements to financial benefits for today's veterans, including an increase to disability benefits, expanded access to higher grades of the Permanent Impairment Allowance, and an increase to the Earnings Loss Benefit.

➢ At this time, it is impossible to have a perfect grasp of the role of foreign homebuyers in the Canadian housing market since there is no comprehensive, reliable data set on the number of homes sold to such buyers. Budget 2016 proposes to address this gap by allocating $500,000 to Statistics Canada in 2016–2017 to develop methods for gathering data on purchases of Canadian housing by foreign homebuyers.

➢ To protect Canadian taxpayers in the unlikely event of a major bank failure, the government plans to institute an internal recapitalization regime that would reinforce the fact that bank shareholders and creditors are responsible for the risks incurred by banks, not taxpayers. The measure will allow authorities to convert a failing, systemically important bank's long-term debt into common shares so as to recapitalize the bank and allow it to stay in business and not have to close its doors. This measure is in keeping with what is being done internationally to control potential risks to the financial system and overall economy from institutions that are considered to be "too big to fail."

TRUE TO THE LIBERAL PLATFORM... TO BILLIONS AROUND

In unveiling the first budget in the era of Trudeau the son, the Liberal government wanted to provide relief to the middle class and make the country fairer and more prosperous, as it pledged in its election campaign. This comes with a big price tag: two straight $29B deficits and a total deficit of nearly $120B by the start of fiscal 2021–2022.

The global and national environments do not augur well for blockbuster economic performance right now. Substantial stimulus for Canada's economy had become necessary, and is now possible given the federal government's flexibility thanks to past efforts to clean up public finances and given the financing costs that are historically very low. Here, the government has not succumbed to the temptation of pointless recurrent spending. The budget could therefore be back in balance in the early 2020s, unless the U.S. economic cycle runs into trouble or winds down. This is a real risk that could have major consequences for Canada's economy. If this happens, the string of budget deficits will not stop as forecast, and could mount up.

Above all, today's budget offers a very credible, promising strategy for Canada's future. Getting economic growth back above 2%, combined with flexibility in the area of $6B per fiscal year, means we can expect future budget deficits to drop over the 5-year forecast period, with the budget eventually being balanced.