Fall 2019 Federal Fiscal and Economic Update

Tax Change And Pension Costs Blow A $37 Billion Hole In Canada's Finances

Brian DePratto, Director & Senior Economist | 416-944-5069

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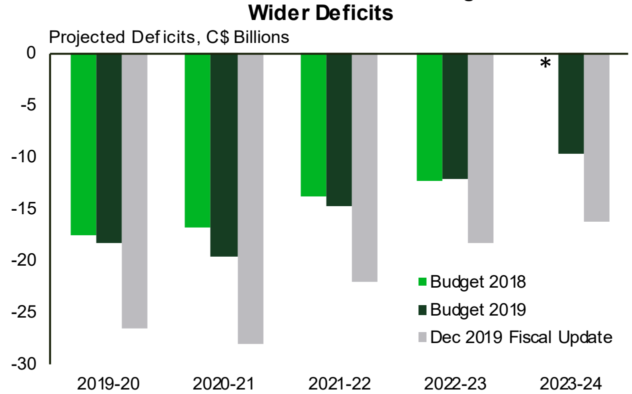
- Federal Finance Minister Bill Morneau delivered his first fiscal update since returning to Ottawa post-election. Billed as a cut and dry affair, there was nevertheless some significant headlines, notably a hefty cumulative upgrade to its deficit profile to the tune of $36.8 billion over a five-year window.
- Part of this was already known: the government has already undertaken actions to get an increase to the 'basic personal amount' on the books ahead of the 2020 tax year. At a cost of about $19 billion over five fiscal years, this change accounts for about half of the projected deterioration in the budget deficit.
- The bigger shock was a significant increase in projected government employee pension and benefit costs, which pushed up the deficit by a total of $27.8 billion through fiscal 2023-24. This change stems largely from the annual actuarial revaluation, and with a much lower interest rate outlook (Table 1), these costs are accordingly quite a bit higher than had been thought last spring.
- Offsetting these negative shocks are higher than anticipated revenues on both the personal and corporate side, adding about $13 billion to the total take over the five-year window. The government has also booked $1.5 billion per year in revenue starting in fiscal 2020-21 to come from a 'comprehensive review of government spending'. It is perhaps notable that this is a bit more conservative than the figures included in the Liberal election platform ($3bn in revenues by fiscal 2023-24).
- The bottom line is deficits that around $7bn wider per year on average (Chart 1). Including the risk adjustment, the deficit is expected to widen to $28.1 billion in the coming fiscal year, or about 1.2% of GDP (Table 2).
- Top of the list of priorities for Minister Morneau in his mandate letter was to "continue to reduce the Government's debt as a function of our economy". This commitment now requires a qualifier: ' over the medium term'. The starting point was again revised higher, and no improvement in this measure is expected in fiscal 2020-21, but thereafter and all else equal, a downward trajectory is anticipated (Chart 2).
- The phrase 'all else equal' does a lot of heavy lifting in that last bullet, and all else may not be equal. The economic outlook used in today's update is reasonable, with GDP and labour market assumptions that are not terribly different from

Chart 1: Pension Costs and Tax Changes Drive Wider Deficits

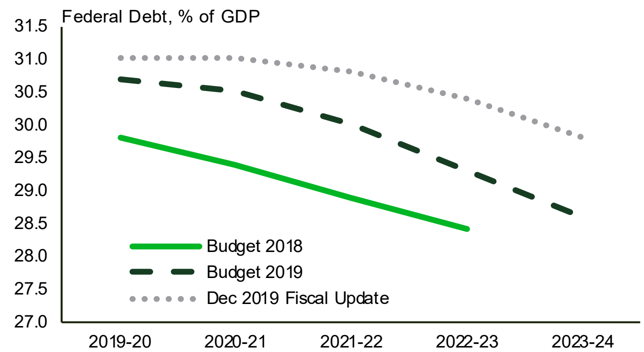


Source: Department of Finance Canada, TD Economics. *: Forecast not provided.
Note: Budget 2019 figure altered to make 'risk adjustment' comparable with today's update.

our own (Table 1). However, in contrast to the government's planning assumption, we expect only modest upward movement in yields in the coming years, meaning that should our forecast be realized, we can expect further increases in pension-related costs in the years to come.

- Beyond the impact of borrowing costs, there are significant questions around which election promises get delivered in a minority parliament setting, and what policies will need to be dropped or added to get enough support to get the budget through Parliament.

Chart 2: Downward Slope for Debt/GDP Still Expected, Albeit from a yet Higher Starting Point



Source: TD Economics

- On the expenditures side, there remains a number of promises that are yet to be brought into the fiscal framework, including proposals around childcare costs, changes to the Old Age Security System, employment insurance, and others. Among the priorities of other parties that may be looked to for support, national pharmacare stands out as a significant potential cost.

- Revenue proposals included a 'luxury goods tax', a tax on large technology companies, and a limit on interest deductibility for larger corporations. On this front, given the commitment to a downward debt-to-GDP ratio and the need to get at least one other party's support to pass the budget and avoid an election, it seems a safe bet that further changes to revenue and/or expenditure policies will be forthcoming.

- Today's update can reasonably be described as more interesting than expected for relatively uninteresting reasons. Given the combination of starting points, promises and minority parliament calculus, we expect that, for better or worse, Budget 2020 will bring more than its share of excitement.

Table 1: Economic Assumptions Annual,Percent Change (Unless Otherwise Indicated)					
Calendar Year	**2019**	**2020**	**2021**	**2022**	**2023**
Real GDP					
Budget 2019	1.8	1.6	1.7	1.9	1.9
December Update	**1.7**	**1.6**	**1.8**	**1.8**	**1.9**
TD Economics Forecast	1.7	1.6	1.8	1.8	1.7
Nominal GDP					
Budget 2019	3.4	3.5	3.7	3.9	4.0
December Update	**3.6**	**3.7**	**3.7**	**3.9**	**4.0**
TD Economics Forecast	3.6	3.6	3.8	3.7	3.6
Unemployment Rate (%)					
Budget 2019	5.7	5.9	6.0	6.0	5.9
December Update	**5.7**	**5.8**	**5.8**	**5.8**	**5.8**
TD Economics Forecast	5.7	5.9	5.8	5.8	5.7
3-Month T-Bill Rate					
Budget 2019	1.9	2.2	2.3	2.4	2.5
December Update	**1.6**	**1.5**	**1.6**	**1.9**	**2.2**
TD Economics Forecast	1.7	1.5	1.4	1.5	1.7
10-Year Gov't Bond Yield					
Budget 2019	2.4	2.7	2.8	3.1	3.3
December Update	**1.5**	**1.6**	**2.0**	**2.4**	**2.7**
TD Economics Forecast	1.6	1.6	1.8	2.0	2.1
Source: Department of Finance Canada, Statistics Canada, Bank of Canada, TD Economics					

Table 2: November 2018 Federal Fiscal Update Forecast Summary (C$ Billion, Unless Otherwise Specificed)					
Fiscal Year	**2019-20**	**2020-21**	**2021-22**	**2022-23**	**2023-24**
Budgetary Revenues	**340.1**	**352.3**	**367.2**	**381.8**	**395.9**
Program Expenses	340.8	353.6	361.0	370.0	379.8
Public Debt Charges	24.4	23.7	25.3	27.3	29.5
Total Expenses	**365.2**	**377.4**	**386.3**	**397.2**	**409.2**
Risk Adjustment	-1.5	-3.0	-3.0	-3.0	-3.0
Budget Balance	**-26.6**	**-28.1**	**-22.1**	**-18.4**	**-16.3**
Federal Debt	713.2	741.4	763.4	781.8	798.1
Per cent of GDP					
Budgetary Revenues	14.8	14.7	14.8	14.8	14.8
Program Expenses	14.8	14.8	14.6	14.4	14.2
Public Debt Charges	1.1	1.0	1.0	1.1	1.1
Budget Balance	-1.2	-1.2	-0.9	-0.7	-0.6
Federal Debt	31.0	31.0	30.8	30.4	29.8
Source: Department of Finance Canada, TD Economics.					