TD Economics

2024 Federal Budget

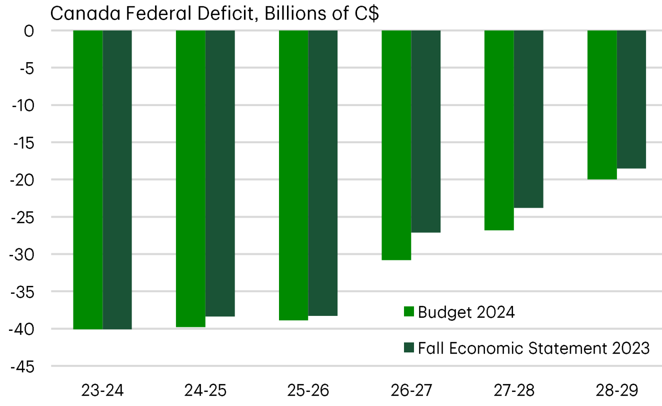
Beata Caranci, SVP & Chief Economist | 416-982-8067
Francis Fong, Managing Director & Senior Economist
James Orlando, CFA, Director | 416-413-3180

April 16, 2024

Highlights

- Budget 2024 re-upped the Liberal government's efforts to improve affordability for low-and-moderate income Canadians, with new spending totaling $53 billion earmarked over the five-year horizon ($57 billion including spending since the FES).
- Programs to fast-track the building of new homes and improve affordability were a key focus, with the cost amounting to $8.5 billion. Most of the spending is occurring in the middle years of the forecast horizon.
- Details on the national pharmacare program lay the groundwork for a more fulsome program down the road, but spending in this budget is on the low end at $1.5 billion over five years.
- While the government talked up productivity enhancing policies ($2.4 billion), largely in A.I. and computer infrastructure, only time will tell if these efforts improve the trajectory of the Canadian economy.
- Some may question this notion given the "surprise" increase in the capital gains inclusion rate to two-thirds on capital gains over $250,000 and for all capital gains earned by corporations. As an offset on the business side, the government increased the lifetime capital gains exemption from $1 million to $1.25 million and introduced a new Entrepreneur's Incentive.
- The deficit is expected to ease from $40 billion in FY 2023-24 (1.4% of GDP) and $20 billion in 2028-29 (0.6% of GDP, slightly higher than in the FES). The debt-to-GDP ratio is expected to peak at 42.1% in the current fiscal year, before moving lower over the remainder of the budget forecast.

Chart 1: Deficits to Widen in New Budget



Source: Department of Finance Canada, TD Economics.

The federal government largely maintained the medium-term deficit profile it set out in the 2023 Fall Economic Statement (FES). Thanks in part to a late-year upswing in economic growth, the deficit for FY 2023-24 came in at the $40 billion target, equivalent to 1.4% of GDP. In what seems to be a familiar pattern, the deficit was upgraded, albeit modestly, to $156.3 billion over the next five years, versus a previous estimate of $146.1 billion in the FES (Chart 1). Ambitious new spending amounts to a hefty $53 billion ($57 billion including new spending since the FES) over the budget horizon, with the focus on improving housing affordability and establishing a foundation for national pharmacare. Interestingly, the largest line item was supporting national defence ($10.7 billion). The government has partially counterbalanced these budget impacts through a combination of tax increases ($18.2 billion/5 years, $19.4 billion from a new capital gains inclusion rate) and a follow through on past promises to improve government spending efficiency ($15.8 billion/5 years since Budget 2023).

The higher deficit next year causes the debt-to-GDP ratio to peak at 41.9%, before easing over the remainder of the budget horizon. Meanwhile, the deficit-to-GDP peaked at 1.4% in the current fiscal year and is expected to move below the government's target of 1% in 2026-27.

The budget is expected to pass in Parliament due to the existing partnership agreement between the Liberal minority government and the NDP.

Strong economy paves way for more spending

An upgrade to economic growth partly explains why the government was able to increase spending commitments without breaching its fiscal anchors (Table 1 and 2). Nominal GDP growth for 2023 came in

Table 1: Federal Budget 2024 Fiscal Summary

[Billions of C$ Unless Otherwise Noted]

Fiscal Year	22-23	23-24	24-25	25-26	26-27	27-28	28-29
Budgetary Revenues	**447.8**	**465.1**	**497.8**	**514.6**	**535.7**	**561.4**	**586.3**
Program Expenses	438.6	450.3	480.5	496.3	509.6	526.3	544.4
Public Debt Charges	35.0	47.2	54.1	54.9	57.0	60.9	64.3
Net Actuarial Losses (Gains)	9.6	7.6	3.1	2.4	-0.1	1.0	-2.4
Total Expenses	**483.1**	**505.1**	**537.6**	**553.5**	**566.5**	**588.2**	**606.3**
Budget Balance	**-35.3**	**-40.0**	**-39.8**	**-38.9**	**-30.8**	**-26.8**	**-20.0**
Federal Debt	**1,173.0**	**1,215.5**	**1,255.3**	**1,294.1**	**1,324.9**	**1,351.7**	**1,371.7**
Per Cent of GDP							
Budgetary Revenues	15.9	16.1	16.6	16.5	16.5	16.6	16.7
Program Expenses	15.6	15.6	16.0	15.9	15.7	15.6	15.5
Public Debt Charges	1.2	1.6	1.8	1.8	1.8	1.8	1.8
Budget Balance	-1.3	-1.4	-1.3	-1.2	-0.9	-0.8	-0.6
Federal Debt	41.7	42.1	41.9	41.5	40.8	40.0	39.0

Note: Totals may not add due to rounding.
Source: Department of Finance Canada, TD Economics.

stronger than expected (2.7% from 2.0%), while 2024 was upgraded based on private sector forecasts (3.8% from 2.5%). From 2025 through 2028, nominal GDP is expected to average 4.1%, slightly less than what was expected in the FES (4.3%), but above our TD Economics view (4.0%).

A better-than-expected GDP performance contributed to government revenues being upgraded by $8.9 billion for FY 2023-24 relative to FES. This better starting point is assumed to carry forward into future years, leading to roughly $25 billion in additional fiscal space over the next five years. In addition, the government is expecting coffers to benefit from $19.4 billion in new tax measures and in particular new capital gains on wealthy Canadians. Importantly, the government isn't 'banking' this fiscal improvement, as new spending more than offsets the improvement in revenues.

New spending measures were consistent with the government's announcements prior to the release of Budget 2024. New program spending has been upgraded by $53 billion, spread out evenly over 2025-29.

Spending as a percent of GDP will remain elevated between 15.5% to 16.0%. That's well above the 13.2% average over the 20 years prior to the pandemic and much closer to the 16% average of the early/mid-1990s – a time when Canada's credit rating was under threat.

Interest cost pressures will continue to challenge the government in the coming years. While the Bank of Canada (BoC) is expected to start cutting its policy rate in 2024, the policy path is expected to remain higher than previously thought over the coming years. Consequently, debt service charges are expected to rise to approximately $64.3 billion by 2028-29. That's $3.6 billion more than expected just six months ago. As a share of GDP, interest costs are expected to average 1.8% from 2024-29, about double the rate prior to the pandemic. The last time interest costs as a percent of GDP averaged this level was 1966-69, when the BoC policy rate averaged close to 6%. Interestingly, this was the start of an unrelenting rise in government debt costs, which took 40 years to get under control.

New programs in Budget 2024

Budget 2024 continues to build on past efforts related to affordability, with specific focus on housing and pharmacare. While most of the new programs were leaked ahead of the budget announcement, details provided greater context on the cost and timing of the spending commitments.

Housing: Affordability has been a major focus for the government, with Budget 2024 adding on to past policies. The budget opened with the government's plan to lease public lands to build new housing, reducing upfront costs for builders, while attempting to cut red tape on permit approval times. The highly contested (Alberta and Ontario) $6 billion program to develop critical housing infrastructure related to water and sewers is spread out evenly from 2025-29. But given the requirements of provinces to eliminate single family zoning and implement a three-year freeze on development charges for larger cities, the uptake, and consequently, the program's success, remains uncertain. An additional $400 million has also been added to the Housing Accelerator Fund program, which is believed to add an additional 12k homes.

The measures above will help address housing supply, but on the demand side, there are also several new initiatives. The government will increase the withdrawal limit on the Home Buyers' Plan, which allows First-Time Homebuyers to withdraw $60k from an RRSP to buy a home (up from $35k). This will help households enhance their down payments (and reduce their mortgage), but an extra $25k ($50k per household) is only marginally going to move the needle in terms of stimulating sales or prices. Also helping first time home buyers is the increase in amortizations for insured mortgages from 25- to 30-years. This only applies to newly built homes and given that most housing sales are for existing homes, this will have a minimal impact on our sales/price forecast.

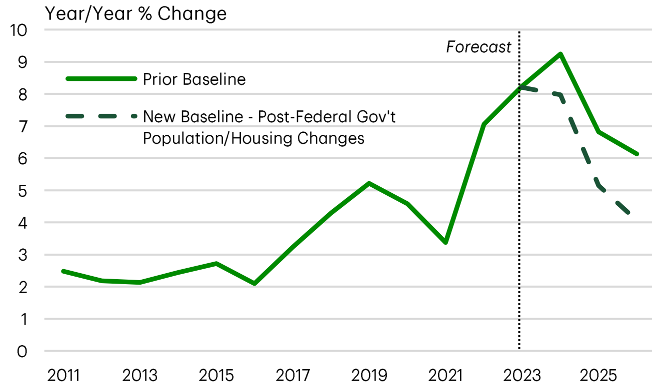
On the rental side, the Apartment Construction Loan program offers loans to builders that reserve 20% of a rental project to affordable housing has been increased by $15 billion. The total loan program will now reach $55 billion, with the intent to build 131k rental units by 2031-32. This is a good start, but our population forecast infers that Canada needs 385k – 415k new rental units over the next five years.

To support renters, the government launched a 'renters' bill of rights', which isn't costly, but will provide useful support, such as a nationwide standard lease agreement, allowing rental history to be used for credit assessments, and a requirement for landlords to disclose past rental pricing. The Canada Greener Homes Grant to incentivize investment in green home renovations has been renewed with a price tag of $800 million, but this time the focus is on helping lower income homeowners and renters. There is also the $1.5 billion fund to buy existing apartment buildings and keep them available for Canadians with low income. This mimics the B.C. Rental Protection Fund (started in January 2023), which has been hailed as a proof-of-concept. So far, B.C.'s $500 million fund has preserved 700 units, with a goal to secure 2,000 additional units.

These policies add on to the ever-increasing list of efforts by the government to increase housing supply in Canada, such as the Tax-Free First Home Savings Account and enhanced GST rebate on purpose-built rental properties. We'd argue that the government is moving in the right direction, by setting a strong foundation to spur greater home building activity.

The issue is that the supply deficit is so great that the government's policies won't be able to bring affordability back down to levels hoped for by Canadians. We'd note that the pace of building is currently trending at about 245k units (on a 6-month annualized basis). High financing costs have slowed this from a pace of 270k in 2021, before the BoC started to hike rates. The PBO estimates that Canada needs to build approximately 181k more units alone per year ($3.87 million new housing units by 2031) to bring the vacancy rate back to historical averages.i We believe the government's new policies objectives will be stunted due capacity constraints in the private sector. The number of construction workers in Canada have consistently comprised 8% of Canada's labour force since 2011, and there has been no ability to punch above that share. This makes some sense given that newcomers tend to get into construction at a lesser rate than all other major industries, according to Bank of Canada analysis. ii Given that the government thinks it can achieve the PBOs housing supply goal, it is banking on the construction sector reaching a level of productivity that it has never been able to achieve.

Chart 2: Rent Inflation to Decelerate Faster



Source: Statistics Canada, TD Economics.

While these new supply-side policies likely won't significantly move the needle on affordability, what will have a bigger impact on housing inflation is the government's announcements ahead of the budget around changes in population policy. Last year saw the population jump by nearly 1.3 million, with the majority driven by non-permanent residents. We had previously called out this policy, which was focused on helping firms fill low wage job vacancies with foreign workers, without considering the need for housing (and other) infrastructure around them. The new policies to reduce the number of NPRs, limit immigration, and cap the number of international students will not unwind the negative impact of past policy on affordability. Rather, it will slow the rapid pace of shelter inflation. The best example can be seen with rent inflation. Rent price growth is running at 8% annually and this was unlikely to ease much without the government intervening. Importantly, the new immigration policies mentioned above will have a big impact, causing our forecast for rent price growth to decelerate relatively quick to around 4%. This is still high, but closer to historical averages prior to the recent population surge.

Pharmacare/Disability Benefit: The new pharmacare program is budgeted to cost $1.5 billion over the budget horizon, much lower than the expected $1 billion per year that was expected prior to the release of the budget. This program aims to provide coverage for contraceptives and diabetes medications. The question is whether this program grows to include more prescriptions over the coming years. Canadians are spending $27 billion annually on private drug plans, so the current government program is just dipping its toes into the costs related to a universal national plan. A new addition to the budget was the $6.1 billion Canada Disability Benefit. This bridges the gap between the existing child and old age security benefits. This will provide a maximum of $2.4k per year for low-income persons with disabilities between ages 18-64 (estimated 600k people).

Productivity: To support AI investment in Canada, the government is allocating $2.4 billion to be spent over five years. The intention is to increase AI adoption across sectors, help research efforts, and enable businesses to scale-up faster. The majority of the money will go to build computing infrastructure. The government will also allow firms to write off costs relative to patents and a host of electronic infrastructure. There is also a $1.8 billion allocation to enhance scientific research and improve research coordination across various research groups.

We won't mince words on this: Canada's productivity has been abysmal. It has grown just 0.3% since 2019, while U.S. productivity has grown at a robust pace of 1.5% annually. Low investment is a huge problem. Intellectual property investment as a share of GDP is three times larger in the U.S. compared to Canada. The government has tried to boost this with prior policies, such as tech-driven superclusters in 2018, without any improvement in productivity.

On that front, the biggest surprise in the budget was in the announcement of a new increase to the capital gains inclusion rate to two-thirds for annual net capital gains above $250,000 for individuals and for all capital gains earned by corporations. In exchange, the government announced an increase to the lifetime capital gains exemption for the sale of small businesses from $1 million to $1.25 million (indexed to inflation thereafter) and a new Entrepreneur's Incentive which would reduce the inclusion rate to one-third for the sale of qualifying investments in the Canadian-controlled private corporation (CCPC) up to an additional $2 million.

According to government estimates, only 0.13% of Canadians will be impacted, who earn an average gross income of $1.4 million per year. In addition, they estimate only 12.6% of corporations earn capital gains with an average taxable income of $702,000. Despite the supposed small percentage of households and businesses impacted, the revenue estimated to be generated is significant, amounting to $19.4 billion over five years. It would have been helpful to know which industries are largely impacted and whether these corporations are large contributors to investment. For individuals, the usual exemptions still apply, including principal residences and financial assets held in tax-preferred accounts, including RRSPs and TFSAs.

This follows up on previous consideration under then Finance Minister Bill Morneau to raise the entire capital gains inclusion rate. Government ultimately never followed through with it then given its potential impact on Canadians at all income levels, but there are broader productivity implications to consider here. Canada is already in the midst of a prolonged slump in capital spending, itself a consequence of slow growth and high interest rates and higher tax rates on capital can further disincentivize business owners from re-investing capital gains back into the economy. Re-focusing the higher inclusion rate to high-income individuals along with the introducing of higher lifetime capital gains exemptions and a progressive, graduated rate for entrepreneurs does go some way in mitigating these negative effects, but this design does not completely remove the disincentive. Consider the decision of an entrepreneur deciding where to locate their start-up. Considering the entire package of possible tax treatment of both the business and the longer-term treatment of divestment, a higher tax on that divestment could very well be the straw that breaks the camel's back and pushes that new firm elsewhere in a globally competitive environment. To be clear, taxing capital gains at a rate closer to income is consistent with Canada's position, "a buck is a buck is a buck". However, in our current economic environment, it is at best unhelpful in promoting capital investment that Canada desperately needs.

Clean Energy: This year's affordability and cost-of-living budget included a focus on the clean energy economy. Much of the budget reiterated actions already taken, including moving existing tax credit legislation through parliament. However, the budget did feature a new $1 billion for a new 10% EV supply chain investment tax credit, which applies to eligible property for firms already claiming the clean technology manufacturing tax credit in 3 segments: EV assembly, battery production, and active cathode production. This new credit is primarily concerned with ensuring the entirety of the supply chain locates here in Canada by incentivizing large incumbents from locating different parts of the supply chain here. While the credit is sized at over $1 billion, much of it is backloaded beyond the forecast horizon. The fiscal impact was estimated at just $80 million through 2028-29.

Outside of that, the budget also reiterated a commitment by government to bring down energy and mineral project approval timelines through a re-jigged assessment act – this is critical if Canada is to ensure its position in global supply chains of goods needed in the energy transition. Natural Resources minister Wilkinson has already made public comments suggesting government aims to bring down mine approval times. The budget commits to an assessment and permitting timelines of 2 years or less for non-federally designated projects and 5-years or less for federally designated ones. Importantly, government committed to amending the impact assessment act while remaining consistent with the UN Declaration on the Rights of Indigenous Peoples Act.

Indigenous reconciliation: The federal government lifted the veil on their highly-anticipated Indigenous Loan Guarantee Program, aimed at helping indigenous communities take equity investments in resource extraction projects. The program includes $5 billion in loan guarantees covering projects across any sector relevant for economic reconciliation and self-determination. The budget also includes $16.5 million for capacity building among indigenous communities in making applications for loans through the program, which will be administered by a new subsidiary crown corporation under the department of finance.

Bottom Line

Going into Budget 2024, Minister Freeland had indicated the government would help create the conditions for interest rates to fall. Was that achieved? The results are mixed. Using tax increases may dampen the inflationary force of new spending, but deficits are on track to widen over the next five years. Moreover, provinces are ramping up spending and deficits in the near-term, so the overall government sector is still getting in the BoC's way. As for the risk to Canada's AAA credit rating, the country is not currently on a negative watch. And given that this budget didn't stray too far from the FES, it shouldn't change the narrative much around the credit rating.

Having said that, the fiscal plan is still reliant on a steadily expanding economy, even if modest. Any major economic potholes would leave Canada vulnerable to missing the fiscal anchors. While the government will tout the potential for its new policies to boost economic growth though higher productivity, new taxes on capital gains may run afoul. All told, higher taxes won't be beneficial to investment, something which is sorely needed given the significant underperformance in capital spending, meaning it will not improve the trajectory of Canadian economic growth nor boost the real incomes of Canadians.

Exhibits

Table 2: Economic Assumptions

[Annual % Change Unless Otherwise Noted]

Calendar Year	2024	2025	2026	2027	2028
Real GDP					
2023 Fall Economic Statement	0.4	2.2	2.4	2.2	2.0
Budget 2024	**0.7**	**1.9**	**2.2**	**2.1**	**2.0**
TD Economics Forecast	1.4	1.5	1.9	2.0	1.8
Nominal GDP					
2023 Fall Economic Statement	2.4	4.3	4.5	4.3	4.2
Budget 2024	**3.8**	**3.9**	**4.2**	**4.2**	**4.0**
TD Economics Forecast	4.5	3.4	3.8	4.0	3.9
Consumer Price Index Inflation					
2023 Fall Economic Statement	2.5	2.1	2.1	2.1	2.1
Budget 2024	**2.5**	**2.1**	**2.1**	**2.0**	**2.0**
TD Economics Forecast	2.5	2.2	2.0	2.0	2.0
Unemployment Rate (%)					
2023 Fall Economic Statement	6.4	6.2	5.9	5.8	5.7
Budget 2024	**6.3**	**6.3**	**6.0**	**5.8**	**5.7**
TD Economics Forecast	6.3	6.6	6.2	5.9	5.9
3-Month Treasury Bill Rate (%)					
2023 Fall Economic Statement	4.3	2.9	2.7	2.6	2.6
Budget 2024	**4.5**	**3.1**	**2.7**	**2.7**	**2.7**
TD Economics Forecast	4.6	2.8	2.3	2.3	2.3

Source: Department of Finance Canada, TD Economics.

Disclaimer