TD Economics

2024 Budget Season Recap

Necessary Roughness

Rishi Sondhi, Economist | 416-983-8806
Marc Ercolao, Economist

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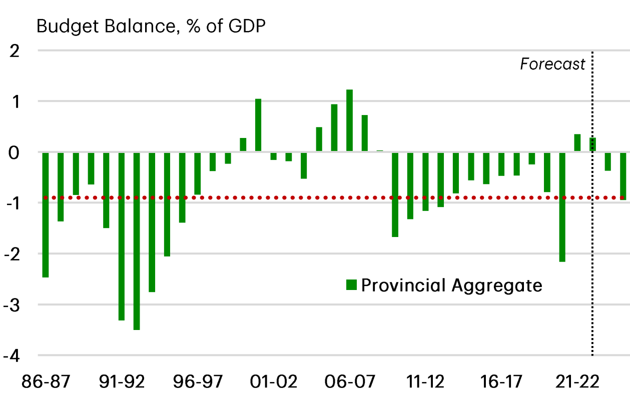
Highlights

- The combined federal and provincial shortfall is projected to run in the range of 1-1.5% of GDP this fiscal year. This – alongside busy capital spending programs – will continue to push up debt-to-GDP ratios from their already-elevated levels.
- We'd argue that some of this spending and investment is necessary given the pressures of a rapidly expanding population, although governments have less fiscal wiggle room to weather unexpected events.
- Near-term risks to the economic outlook have tilted to the upside which may pay off in terms of faster-than-expected revenue growth.
- All told, new measures in the budget season may contribute marginally to overall GDP growth this year, with most of this impulse coming from provincial governments.

As the 2024 budget season has drawn to a close, federal and provincial finances are in a challenging position. Spending has ramped up across many jurisdictions at a time when tepid economic growth is taking a bite out of revenues. This has led to a broad-based deterioration in budget balances and has pushed the expected trajectory of the aggregate debt burden higher for the 2024/25 fiscal year. Across provinces, program spending and large-scale capital investment plans were in focus. On the federal side, new spending targeted at housing and health care as well as a hike in the capital gains tax took center stage.

Chart 1: Provincial Budget Deficit Will Deepen



Source: Government Budgets, TD Economics.

There is room for cautious optimism as nation-wide economic conditions appear to have started the year on a modestly stronger footing than had been expected leading up to budget season. This is a welcome development for budget projections that hinge on conservative GDP growth estimates. In addition, most governments have continued to build in sizeable contingencies into budget planning. Together, these practices put governments in a solid position to meet this year's budget targets.

This report highlights some key themes from the 2024 budget season.

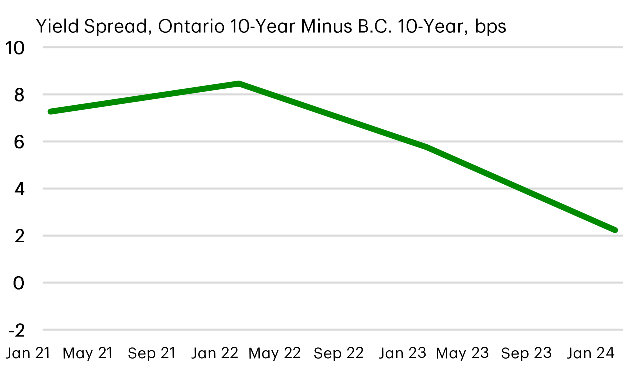
Budget Balances Worsen Across Provinces...

The cumulative provincial FY 2023/24 deficit is forecast to land at about $10.6 billion (-0.4% of GDP). From here, a worsening aggregate deficit amounting to $28 billion (-0.9% of GDP) is expected in FY 2024/25. This is not threatening by historical standards (Chart 1) but does represent the largest shortfall relative to GDP since 2012, outside of the pandemic. The deterioration was not uniform across provinces. The likes of Alberta and New Brunswick are expected to remain in black ink, albeit narrowly. In contrast, Quebec and BC expect the biggest deteriorations this year, with their shortfalls swelling to around 1.5-2% of GDP.

For their part, the federal government forecasts a deficit path largely in line with what was tabled in their Fall Economic Statement last November. The $40 billion projected deficit in FY 2023/24 remained intact, with it expected to shrink to $20 billion (-0.6% of GDP) by FY 2028/29.

The federal government imposes fiscal guardrails in order to keep deficits and debt burdens in check over time. Still, the deficit path carved out doesn't leave much wiggle room relative to these anchors. For example, the federal government aims to keep its shortfall below 1% of GDP from FY 2026/27 onwards. However, assuming GDP comes in as planned, a slight miss of $1-2 billion between now and FY 2026/27 would breach this anchor, given their current deficit trajectory.

Chart 2: B.C.'s Aggressive Spending Plans Have Pushed Up Its Borrowing Costs



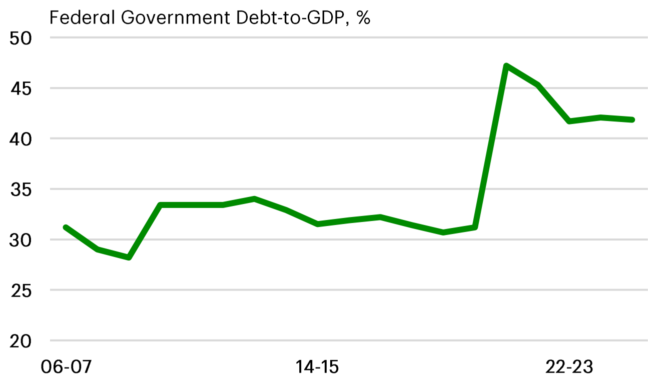
Source: Ontario and B.C. Government, TD Economics.

Although the aggregate budget position is set to worsen, there are some caveats. First, we'd argue that some of the spending driving these deficits is, in fact, necessary to service the growing needs of a ballooning population. Second, the economic growth backdrop is shaping up to be better than what was envisioned at the time when budgets were being prepared, implying a good case for revenue upside this year. Notably, the provincial-weighted aggregate real GDP growth for 2024 based on budget estimates sits at around 1.0%, less than our most recently updated tracking of national growth at 1.4%. Narrowing in on the provinces, Quebec (0.6%) in particular looks conservative as Q1 growth will likely surprise prior expectations. Meanwhile, commodity producing provinces built projections around conservative oil price estimates ($74–78/bbl). We are still in the early days of the fiscal year, but WTI prices are averaging $83. What's more, to account for unforeseen revenue loss or spending needs, provinces are targeting sizeable contingencies and provisions amounting to over $10 billion in total in the current fiscal year.

...Ditto For Debt Backdrops

The arguments made above as to why provincial budget balances could surprise to the upside this year can also be applied to the provincial debt situation. That said, the debt backdrop is, indeed, expected to deteriorate. Aggregate provincial net debt-to-GDP is forecast to hit 30.9% this fiscal year - in line with the pre-pandemic, 5-year average which captured two major negative oil price shocks. B.C. is a standout, in that the province expects an outsized 3.4 ppt climb in its ratio this year and has since suffered a credit rating downgrade, with two of the four main rating agencies holding a negative outlook. Aggressive spending plans have caused borrowing costs to rise faster in B.C. than in other large provinces in recent years (Chart 2), although they are all paying very similar rates overall.

Chart 3 Federal Government in Vulnerable Fiscal Position



Source: Provincial Governments, Federal Government, TD Economics.

Seven of 10 provinces expect to see their debt ratio climb this year, with relatively steep increases (outside of B.C.) expected in Quebec, Ontario, PEI, and Nova Scotia. On the opposite end of the spectrum, Newfoundland and Labrador expects its ratio to decline by 1 ppt (although at 44% will still be the highest in the country), thanks to a solid gain forecasted for nominal GDP. Elsewhere, net debt-to-GDP is projected to dip slightly in Alberta and New Brunswick, aided by anticipated surpluses.

Provincial debt servicing charges as a share of revenues, meanwhile, are set to climb to 6.2% across provinces this year on the back of weak revenue growth, elevated interest rates, and growing net debt. If realized, this would be the second straight increase in this ratio and would mark its largest 2-year gain since the mid-90s. While this is noteworthy, at 6.2%, the ratio would still be more than one standard deviation below its long-term average. Indeed, servicing charges as a share of revenues have generally been on the decline for over 20 years, benefiting from a long-term downtrend in interest rates.

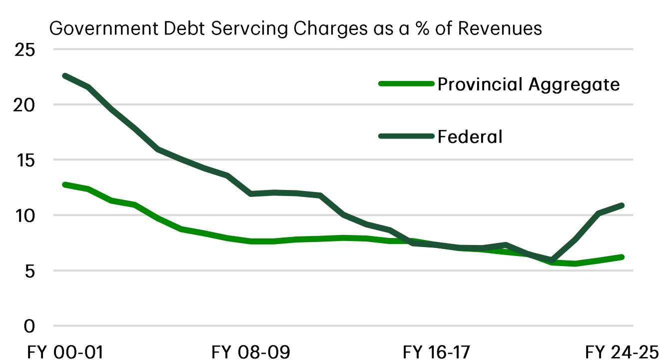
An important driver of the rising provincial debt burden arises from aggressive capital spending plans. This type of investment is needed to service the population, with the potential for a productivity boost over the longer run. It's also required to replenish aging assets, and data from Statistics Canada suggests that the useful life of assets such as highways, roads and public security infrastructure is trending downwards.

The federal government expects to run a debt burden as a share of GDP that's over 10 ppts higher than its level of only 6 years ago (Chart 3). Of course, this is a legacy of massive pandemic-era supports, and the federal debt-to-GDP ratio is forecast to glide gradually lower through the projection horizon and remain at the low end of international comparisons. Still, the rising trajectory over time continues to leave the federal fiscal position relatively more vulnerable in the event of unanticipated economic weakness, and debt servicing charges are set to gobble up 11% of revenues this year. While below its long-run average, this so-called "interest bite" will be the highest in nearly 15 years (Chart 4). Even maintaining the interest bite at its prior year figure of 10% could have given the federal government an additional $4 billion to put towards its shortfall.

Key Measures

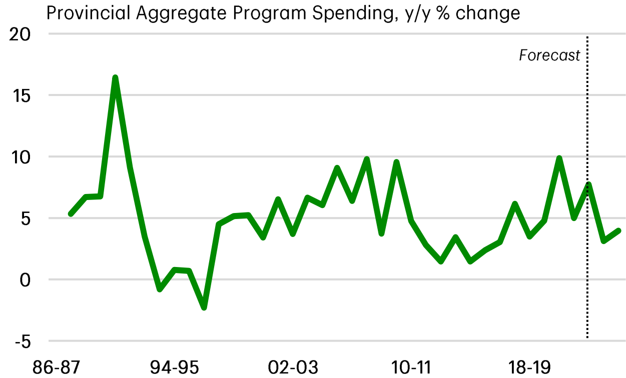
Across provinces, program spending is expected to advance by just over 4% in FY 2024/25. This figure is not insignificant, especially given the softer economic backdrop for revenues, but it is still lower than historical spending averages (Chart 5). British Columbia and New Brunswick sport the highest levels of program spending for this fiscal year at around 6.5%, while Ontario, Manitoba, and Saskatchewan will see the lowest growth in program spending relative to last year. On the tax front, provinces were roughly split down the middle, with Quebec, Saskatchewan, and most of the Atlantic Region refraining from introducing any new major tax measures. For the remaining provinces, major tax-reduction measures are

Chart 4: Federal Debt Servicing Charges The Highest in About 15 Years



Source: Provincial Governments, Federal Government, TD Economics.

Chart 5: Program Spending Expected to Be Elevated



Source: Government Budgets, TD Economics.

expected to cost governments about $1-1.5 billion in forgone revenues this fiscal year. Please see table 2 for an overview of key provincial tax initiatives.

At the federal level, ambitious new spending, amounting to $53 billion over the next five years, is focused on improving housing affordability and establishing a foundation for national pharamacare. To offset the bottom-line impacts from spending, the government upped the capital gains inclusion rate to two-thirds on capital gains over $250k and for all capital gains earned by corporations. This measure will contribute sizably to the $19.4 billion the government expects in realized revenues from tax measures.

Fiscal Measures to Add to Economic Growth

Tallying up all the tax and program spending measures from this budget season, we estimate an incremental boost of 0.2 ppts to GDP this year, with the provinces doing the heavy lifting. For their part, the federal government has pledged heavy new spending commitments, relative to the fall fiscal update, although much of this is pushed out until later into the projection horizon. For this fiscal year, we estimate modest net new stimulus from the federal government.

This is less of a growth fillip than in recent years (Chart 5). For example, we estimated that tax and operating spending measures during the 2023 federal and provincial budget season would add roughly $25 billion, or 0.9 ppts to last year's growth. Any net fiscal injection at this stage of the cycle risks fanning inflationary pressures, further complicating the Bank of Canada's fight to achieve it 2% target.

Bottom Line

Based on 2024 budget plans, the federal and provincial fiscal backdrop is set to remain challenging. Budget positions are projected to be squeezed from an unenviable mix of rising spending and relatively subdued revenue growth. There is a risk that the federal government could breach its self-imposed fiscal anchors (potentially risking some credibility), should downside growth surprises manifest. On the plus side, the federal and most provincial budgets were prepared using cautious economic assumptions around near-term growth, potentially yielding a revenue windfall this year.

Tables

Table 1: Provincial Credit Ratings				
	Moody's	S&P	Morningstar DBRS	Fitch
BC	Aaa	AA-	AA(High)	AA+
AB	Aa2	AA-	AA	AA-
SK	Aa1	AA	AA(Low)	AA
MB	Aa2	A+	A(High)	n/a
ON	Aa3	A+	AA(Low)	AA-
QC	Aa2	AA-	AA(Low)	AA-
NB	Aa2	A+	A(High)	n/a
NS	Aa2	AA-	A(high)	n/a
PE	Aa2	A	A	n/a
NL	A1	A	A	n/a

Table 2: Selected Budget 2024 Tax Measures	
Jurisdiction	Measure
Ontario	Extension of the temporary gas and fuel tax rate cut until the end of 2024. Estimated to total $620 million in foregone revenues in FY 2024/25.
British Columbia	Introduced a home flipping tax and topped up the BC family benefit by 25%. Also introduced an electricity affordability credit. These measures equate to roughly $500 million in foregone revenues.
Alberta	Introduced a $5,000 "Attaction Bonus"– a refundable tax credit– to certain individuals in eligible occupations who move to Alberta beginning in April 2024. They also froze the education property tax rate and introduced a $200/year EV tax.
Manitoba	Rolled out numerous tax measures including enhancing the Renters Tax Credit, introducing a Rental Housing Construction Tax Credit, raising the Basic Personal Amount for high income households, and temporarily extending the fuel tax credit. This is expected to knock $55 million off government revenues.
Nova Scotia	Introduced personal income tax relief effective January 1st, 2025.