

Canadian Federal: 2021–22 Budget

BUDGET 2021—WE LIKE THE AMBITION, BUT IS IT EXECUTABLE?

- Government caps debt-to-GDP ratio at 51.2% this fiscal year despite massive new spending and indicates debt-to-GDP will fall beyond this year.
- A broad range of measures are proposed, with national \$10 a day childcare a key objective. Even though the government is committing \$30 bn over the next five years to achieve this, it is unclear that negotiations with provinces will lead to meaningful progress on childcare this year.
- Overall, measures seem well targeted to raise potential output by focusing on economic inclusion, the green transition and measures to encourage business investment.
- Budget should have at best marginal impact on growth forecasts for this year and next.

The Liberal Government's plans to rebuild the economy are taking shape. They include \$100 bn in new spending over the next three years to shape the post-pandemic economy. Overall, measures seem well targeted to helping raise potential output in Canada by focusing on economic inclusion, the green transition, and measures to encourage business investment. Given the number of measures put forward in the *Budget*, one would be hard-pressed to say that efforts are laser-focused; the considerable firepower being deployed could best be characterized as a shotgun blast. The expenditure plans are partly offset by a range of revenue measures, but strong growth and a rapid unwind of pandemic support measures beyond this fiscal year result in a debt-to-GDP ratio that begins its downward trajectory next year (chart 1). This will be a commendable achievement if it occurs. Equally important, Canada will remain at the bottom of the G7 pack from a general government net debt perspective.

From a macroeconomic viewpoint, the fiscal impulse implied by the *Budget* is roughly what we had assumed following the Fall Economic Statement. As a consequence, we are unlikely to significantly modify our Canadian forecast this year or next on account of *Budget 2021*.

KEY POLICY MEASURES

Though economic outcomes and growth expectations have clearly improved in recent months, the government maintained a commitment to provide ample fiscal stimulus in the near-term. According to the government's fiscal guardrails, labour market outcomes remain below pre-pandemic levels, even though recent data suggest the gap relative to the pre-COVID period is shrinking rapidly. The *Budget* seems to strike a good balance between extending measures to help Canadian firms and households weather the current and trailing impacts of the pandemic by maintaining some supports without providing excessive stimulus in the short run.

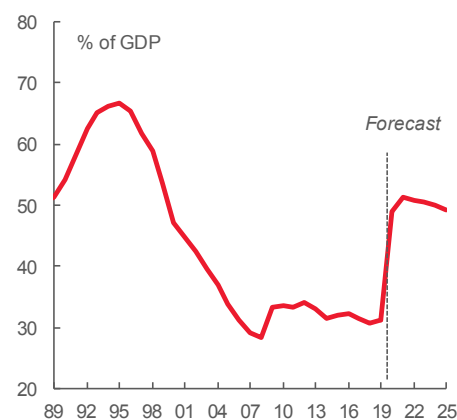
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Chart 1

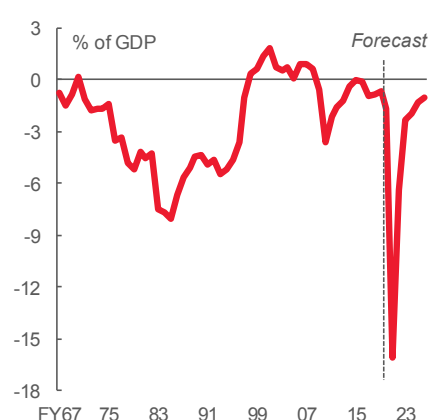
Net Federal Debt Baseline



Sources: Scotiabank Economics, Department of Finance Canada.

Chart 2

Federal Deficit Baseline



Sources: Scotiabank Economics, Finance Canada, Statistics Canada.

The government is clearly serious about moving forward with a comprehensive national childcare plan and is committing \$30 bn in funding over the next five years to achieve \$10 a day childcare. We very much support this ambition. However, as we have flagged multiple times, a national childcare program is likely to require extensive and extended negotiations with the provinces. In the absence of tangible progress in the short run, the childcare landscape is unlikely to change much this year. We continue to believe the government's vision on national childcare should be complemented by measures to ease the financial burden of care until their vision is reality.

Support for businesses: The government proposes to spend a little more than \$16 bn over the next 5 years, including \$3.7 bn this year to support business activity. Among the many proposals, these supports include nearly \$600 mn this year to help hard-hit businesses hire more workers, ongoing strategic investments to help reduce greenhouse gas emissions, accelerate the industrial transformation, and funding to help SMEs move into the digital age. The hope is that these measures will boost chronically low business investment in Canada, but it bears noting that multiple efforts by previous governments to raise investment have been fruitless. Given the fiscal path implied by current proposals, we would have preferred to see larger sums devoted to measures designed to raise investment as part of the post-pandemic transformation.

Beyond these areas, the *Budget* contains dozens of other measures in a range of areas. The list of new initiatives is so long that it cannot possibly be summarized in this note, but a few key measures are: The Employment Insurance system will be modified to ease accessibility and increase the duration of sickness benefits. The Canada Workers Benefit will be made more generous. The Old Age Security payments are to be raised by \$12 bn over the next five years. A number of investments are made to increase affordable housing, including adding \$1.5 bn to the Rapid Housing Initiative. The government is also moving forward with its plans for a 1% tax on vacant or underused residential real estate owned by non-resident non-Canadians.

On revenues, beyond measures to curb foreign homebuyers the *Budget* proposes a number of tax measures such as limiting the amount of interest that certain businesses can deduct; luxury taxes on cars, personal aircraft and boats; improving duty and tax collection on imported goods; strengthening the CRA's ability to collect outstanding taxes; along with a number of other measures. All told, revenue measures will add \$8.3 bn to Federal coffers in the next 5 years. This compares to \$135 bn in new spending.

FISCAL PROJECTIONS

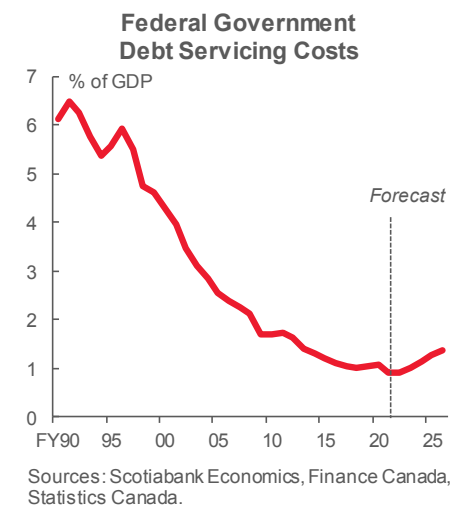
Though larger in absolute terms than the projection released late last year, the \$155 bn deficit expected in FY22 represents a smaller portion of forecast nominal GDP than projected in the Fall Economic Statement. The level increase since November largely reflects nearly \$50 bn in new policy initiatives, with a partial offset via a \$16 bn improvement in the economic and fiscal backdrop since then. Outer-year fiscal shortfall projections likewise account for more modest shares of national output (chart 2, p.1).

As a share of output, government debt levels are expected to progress on a considerably more muted path than outlined as of late last year. Ottawa now anticipates that its net debt-to-GDP ratio will hit just 51.2% in FY22 and decline in each successive fiscal year. That contrasts with the steady escalation towards 58% through FY24 that had been pencilled in as of November 2020 under various stimulus scenarios and maintains Canada's long-touted advantage relative to G7 peers.

The government expects public debt charges to reach minimum shares of revenues (6.2%) and nominal GDP (0.9%) in FY22—after which point, they are forecast to rise steadily, in line with bond rates (chart 3). By FY26, Ottawa expects debt servicing costs to account for 9% and 1.4% of revenues and output, respectively—both rates are well below the peaks attained in the late 1980s and early 1990s. Using the government's estimates of the impact of a sustained increase in all interest rates, debt service costs would rise to 10.8% of revenues and 1.7% of GDP if interest rates rose by 100 basis points.

The government anticipates that it will borrow \$523 bn in FY22. That figure includes \$332 bn in refinancing needs, and \$191 bn in financial requirements—the bulk of which relates to the projected deficit. In the current fiscal year, it will continue efforts to maximize the financing of COVID-19-related debt via long-term bonds, which it expects to account for 42% of issuance.

Chart 3



Updated Fiscal Forecast				Economic Assumptions				
CAD bn				annual % change except where noted				
	FY21	FY22	FY23		20	21f	22f	Average 20-25f
	<u>Bud.</u>	<u>Fcst.</u>	<u>Fcst.</u>					
Personal Income Tax (PIT)	168.2	180.4	187.5	CANADA - Real GDP				
Corporate Income Tax (CIT)	46.2	50.3	52.8	Finance: 2021 Budget*	-5.4	5.8	4.0	1.7
Other Tax Revenue	52.5	67.1	72.2	2020 Fall Statement	-5.5	4.8	3.2	1.5
Total Tax Revenue	266.9	297.8	312.5	Scotiabank Mar. 10, 2021	-5.4	6.2	4.0	n.a
Employ. Insurance (EI) Premiums	22.2	23.7	25.4	GDP Deflator				
Other Revenue	2.6	27.3	32.0	Finance: 2021 Budget*	0.8	3.3	2.0	2.0
Total Revenue	296.2	355.1	377.9	2020 Fall Statement	0.1	2.2	2.0	1.7
Elderly Benefits	58.8	62.5	68.0	Scotiabank Mar. 10, 2021	0.8	3.2	2.7	n.a.
Employ. Insurance (EI) Benefits	59.8	41.2	28.1	Nominal GDP				
Children's Benefits	27.6	27.2	26.3	Finance: 2021 Budget*	-4.6	9.3	6.0	3.8
Major Transfers to Persons	203.5	144.8	122.3	2020 Fall Statement	-5.4	7.0	5.3	3.3
Transfers to Other Levels of Gov't	106.7	86.6	84.3	Scotiabank Mar. 10, 2021	-4.6	9.7	6.9	n.a
Direct Program Spending	304.3	244.3	196.4	Unemployment Rate, %				
Total Program Spending	629.9	487.8	411.9	Finance: 2021 Budget*	9.6	8.0	6.5	7.0
Debt Service	20.4	22.1	25.7	2020 Fall Statement	9.8	8.2	7.1	7.3
Total Expenditure	650.3	509.9	437.6	Scotiabank Mar. 10, 2021	9.6	8.0	5.7	n.a
Budget Balance	-354.2	-154.7	-59.7	T-Bills**, 3-month, %				
Accumulated Deficit	1,079.0	1,233.8	1,293.5	Finance: 2021 Budget*	0.4	0.1	0.2	0.7
Annual Change, %				2020 Fall Statement	0.4	0.2	0.3	0.7
Personal Income Tax (PIT)	0.4	7.3	3.9	Scotiabank Mar. 10, 2021 (% eop)	0.1	0.2	0.6	n.a
Corporate Income Tax (CIT)	-7.7	8.9	5.0	Bonds**, 10-year, %				
Total Tax Revenue	-5.0	11.6	4.9	Finance: 2021 Budget*	0.7	1.5	1.8	1.9
EI Premiums	-0.1	6.8	7.2	2020 Fall Statement	0.7	0.9	1.2	1.5
Total Revenue	-11.4	19.9	6.4	Scotiabank Mar. 10, 2021 (% eop)	0.7	1.7	1.9	n.a
Elderly Benefits	4.6	6.3	8.8	Canadian Dollar**, US¢/C\$				
Employ. Insurance (EI) Benefits	174.9	-31.1	-31.8	Finance: 2021 Budget*	76.6	79.4	79.8	79.4
Children's Benefits	13.4	-1.4	-3.3	2020 Fall Statement	74.2	76.1	76.6	77.2
Major Transfers to Persons	90.1	-28.8	-15.5	Scotiabank Mar. 10, 2021 (eop)	78.6	81.3	80.0	n.a
Transfers to Other Levels of Gov't	34.8	-18.8	-2.7	U.S. - Real GDP				
Direct Program Spending	99.9	-19.7	-19.6	Finance: 2021 Budget*	-3.5	6.0	4.3	2.1
Total Program Spending	80.4	-22.6	-15.6	2020 Fall Statement	-4.3	3.7	3.3	1.6
Total Expenditure	74.1	-21.6	-14.2	Scotiabank Mar. 10, 2021	-3.5	6.3	4.4	n.a
Memo Items, %				WTI Oil, US\$/barrel				
Tax Revenue / GDP	12.1	12.4	12.2	Finance: 2021 Budget*	39	60	61	57
Total Revenue / GDP	13.4	14.7	14.8	2020 Fall Statement	39	46	52	51
Total Program Spending / GDP	28.6	20.3	16.1	Scotiabank Mar. 10, 2021	39	61	65	n.a
Budget Balance / GDP	-16.1	-6.4	-2.3					
Accumulated Deficit / GDP	49.0	51.2	50.7					
Debt Service / Revenue	7.6	7.4	8.2					

Sources: Finance Canada, Statistics Canada; nominal GDP forecasts: Scotiabank Economics.

* Updated for historical revisions, retroactive change in Government's discount rate methodology for unfunded pension benefit obligations

**Annual averages.

Sources: Scotiabank Economics, Finance Budget 2021.

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