Canadian Budget Season Preview

Robert Kavcic
Senior Economist
robert.kavcic@bmo.com
416-359-8329

The 2019 budget season is underway, with the federal document to be tabled on March 19th. This will be closely-watched given it will effectively serve as the final campaign document heading into an election later this year (October 21st). Meantime, while this year is likely to be relatively low on provincial drama, there will still be some key themes to keep an eye on.

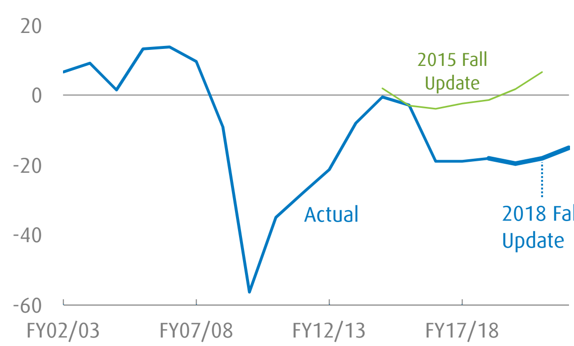
Ottawa's shift back into deficit over the past three years has been noteworthy. Rewind the clock back to Fall 2015, and Ottawa (in the first fiscal update under the current government) was projecting a minimal $1.4 billion deficit down the road in FY18/19. Today, however, Ottawa is now estimating an $18.1 billion shortfall (*Chart 1*). This evolution has come despite an economy that has performed relatively close to expectations (despite some interim swings) and much lower-than-expected interest rates over that period. In other words, had Ottawa just turned out the lights in 2015 and let the budget evolve on its own, it would quite likely be sitting on a sizable surplus this fiscal year. But, a hefty increase in program spending has swung the balance into the red versus that prior track. This brings up two questions: Is the current fiscal situation troubling? And, what can we expect in the 2019 document?

The **fiscal situation is certainly not dire in Canada**, with the $18.1 billion deficit weighing in at a modest 0.8% of GDP. It even looks downright responsible compared to that south of the border. Also, Ottawa's $3 billion risk adjustment is enough, at this point, to absorb some modest downside risk to the near-term economic growth forecast. We currently see 1.8% real GDP growth in 2019 versus 2.0% assumed in the fall update, and a softer deflator as well, but interest rates are tracking meaningfully lower. Finally, while the monthly flows don't always match official annual public accounts, the fiscal year-to-date balance (through December) is running about $9 billion better than the same period a year prior. These factors considered, Ottawa is hardly in bad shape. Meantime, Ottawa has held to its promise of keeping its new fiscal anchor, the debt-to-GDP ratio, steady (it is actually on pace to dip for a second straight year). But, the concern with this measure is that it's an anchor that is destined to break. Given we are late in the economic cycle, the next downturn will immediately weaken the denominator, sending that metric higher. From a longer-term credit perspective, it would be prudent to see this ratio falling more significantly late in the cycle.

On the policy front, if history is any guide, Ottawa will likely prioritize program spending over tax relief. While we're not in the game of predicting budget measures, the recent chatter has centred on areas such as expanded universal pharmacare, skills training and measures to help housing affordability. On the latter, there has been some hints that Ottawa could bring back 30-year amortizations for first-time buyers, but the details at this point are minimal. At any rate, these measures could be big 'selling features' in the budget that come with a small immediate dollar figure attached to them—on the last point, we suspect Ottawa will not want to run even deeper deficits at this point in its mandate.

Chart 1
Red River Runs Deeper

Federal Government—Canada ($ blns : incl. contingency)
Budget Balance



Sources: BMO Economics, Federal budgets

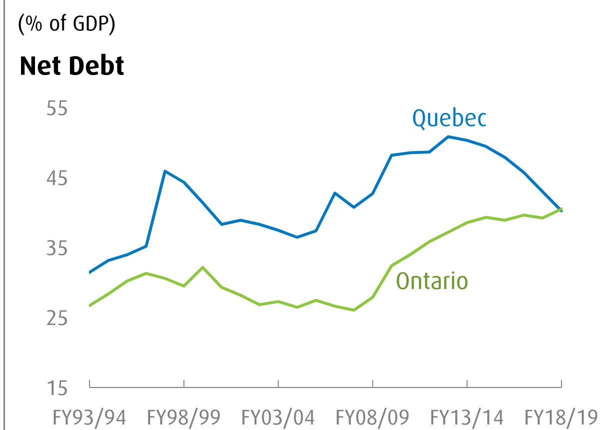
At the provincial level, **Ontario** will likely be the most closely watched, not only because it is the benchmark for the group, but also since the new government, despite two rounds of fiscal updates, has yet to give any guidance beyond the current fiscal year. That said, the initial $14.5 billion deficit assessment was clearly setting the bar low to begin with, and the Province has already trimmed that total by $1 billion, with more improvement likely coming before the year is up. The medium-term fiscal plan will be key, including any guidance on the timing of promised tax relief—we suspect that will be a story for the second half of the current mandate. **Quebec's** recently-elected government already served up a budget-like fall fiscal update, with the recent fiscal strength in that province firmly in place. Notably, the net debt-to-GDP ratio in Quebec has now dipped below that of Ontario for the first time on record (*Chart 2*).

Meantime, **Alberta** has quietly posted better-than-expected numbers this year despite the oil price drama. At last check, the Province was estimating a $7.5 billion deficit, $1.3 billion better than expected in the original budget plan. And, assuming WTI, the WCS differential, and the loonie hold around current levels through March, the Province could be looking at a further $1.5 billion of bottom-line improvement this year, with FY19/20 not far off the mark either. The 2019 budget will be of the pre-election variety (vote expected in May), and the incumbent NDP would surely like to publish an earlier return to balance, currently not planned until FY23/24. **Newfoundland & Labrador** and **Saskatchewan** have been more aggressive with their oil price assumptions, so they probably won't see as much positive momentum heading into 2019.

Finally, the **Maritimes** have quietly been riding stronger population and economic growth, with all three provinces running balanced budgets for the first time in more than a decade. **Nova Scotia's** net debt is down almost 4 percentage points from its recent high as a share of GDP. In fact, relative to Ontario, the net debt burden (5 ppts lower on average for the three provinces) is the most favourable on record going back to the late-1980s (*Chart 3*). That said, these Provinces do still face far less favourable medium-term demographic trends, so we'll see if the group chooses to use the current strength to build fiscal capacity for down the road.

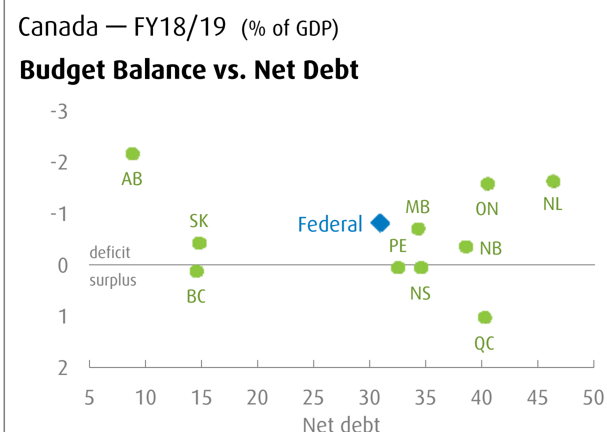
All told, the **combined provincial deficit** is currently on track to widen to $17.7 billion in FY18/19 (or 0.8% of GDP), more than twice year-ago levels (*Chart 4*). But, that is entirely Ontario-driven, as the ex-Ontario deficit has narrowed for a third straight year—the overall combined shortfall should begin to shrink again in FY19/20. Net debt could also edge down as a share of GDP, after rising to a record high in FY18/19, now matching the federal total for the first time on record.

Chart 2
Historic Crossover



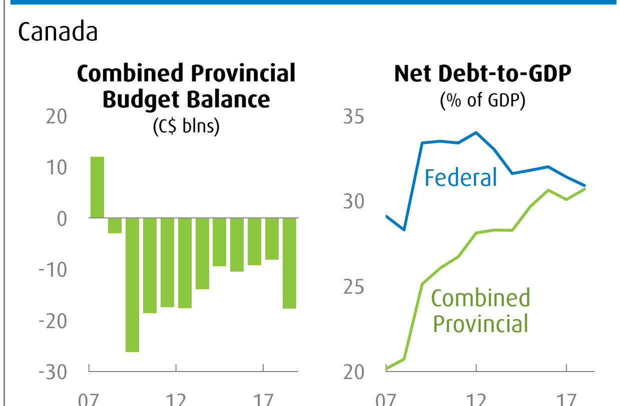
Sources: Fiscal Reference Tables/Provincial budgets

Chart 3
The Lay of the Fiscal Land



Sources: BMO Economics, 2018 Federal fiscal update, Prov. budgets

Chart 4
Provincial Deficit Widens



Year is start of fiscal period (17 = FY17/18); FY18/19 = estimate
Sources: BMO Economics, Haver Analytics