2019 Federal Budget Recap

Pre-Election Prescription: Another Dose of Spending

Douglas Porter, CFA, Chief Economist • douglas.porter@bmo.com • 416-359-4887
Robert Kavcic, Senior Economist • robert.kavcic@bmo.com • 416-359-8329

The fourth budget of the current federal government has been overshadowed by events, but is quite important in its own right as it will serve double-duty as the pre-election economic document. Stronger-than-expected revenues over the past year provided some fiscal leeway to fund yet another spending boost. **Ottawa is again projecting a string of double-digit budget deficits as far as the eye can see, widening to $19.8 billion in the coming fiscal year** (*Chart 1*)**, while the key debt-to-GDP ratio continues to gradually drift lower—it's pegged at 30.7% in FY19/20** (*Chart 2*). This outlook comes as little surprise, as a fading debt ratio has become the de facto anchor for fiscal policy. The major new measures in this year's document also did not come as a shock, and include moves to address housing affordability, skills training, support for seniors and a wide spattering of spending programs on other priorities.

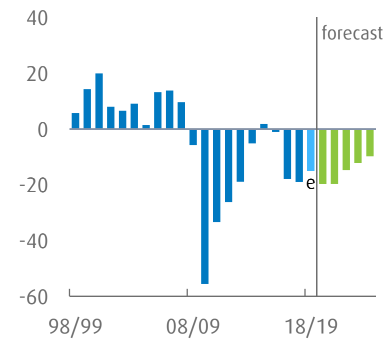
A firmer-than-expected revenue backdrop provided a big tailwind for finances, although that favourable trend has likely just about run its course with economic growth cooling markedly late last year and into early 2019 (*Chart 3*). While the FY18/19 deficit is tracking $3.2 billion better than what was expected in the 2018 Fall Statement (effectively the now-removed risk adjustment), the upcoming two fiscal years will run with slightly deeper shortfalls. There remains no plan to balance the books, with a $9.8 billion deficit persisting by FY23/24. Beneath the surface, **a stronger-than-expected revenue base in FY18/19 has helped lift underlying finances by roughly $5 billion per year through the forecast horizon, but that gain has been almost precisely offset by increased spending across a wide range of initiatives**. In other words, Ottawa has chosen to let it flow rather than improving the bottom line, clearly revealing the fiscal priority. This is notable, given that the economic outlook has quickly deteriorated. For example, we now expect this year's real GDP growth to come in 0.5 ppts below the budget assumption, and nominal growth a full percentage point lower.

A contingency of $3 billion per year remains in place through the forecast horizon (*Table 1*), but **we judge that the current downside risk from the economy carves into the entire FY19/20 reserve**. And, we'd just reiterate that we are observing some tell-tale late-cycle conditions in North America, often a period that governments should build fiscal capacity.

The net fiscal impact of new measures proposed in this year's budget is $4.0 billion (or 0.2% of GDP) for FY19/20, rising to $5.7 billion in the following year—not big by any stretch, but not immaterial either. Here's a recap of some of the many new initiatives:

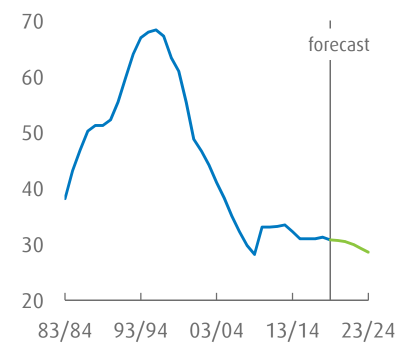
- **Housing affordability:** The headline measure is the **CMHC First-Time Home Buyer Incentive**, expected by September 2019. Effectively, CMHC will contribute 5% of the purchase price of an existing home (10% on a new build), to be repaid later on sale of the property (not yet clear is whether CMHC will share in home value changes—both on the way up and down). The program will only apply to those with household income below $120,000, and with a maximum mortgage and incentive amount of 4-times

Chart 1
Deficits Persist
Canada (C$ blns)
Budget Balance



Source: Federal Budget e = estimate

Chart 2
Debt Ratio Tracking Lower
Canada (% of GDP)
Federal Debt



Source: Federal Budget

Chart 3
Revenues Grow with GDP
Canada (% of GDP)
Revenue

Source: Federal Budget

income. As such, the impact will be contained to the lower end of the market below roughly $500,000 and, arguably, that's the level where affordability challenges only really begin. For example, the most acute affordability problems surround larger units or single-detached homes in the GTA and GVA; yet, most of these are beyond the price range covered by this program. The impact, of course, would be broader in other regions, but affordability in many of those cities is historically quite normal. The biggest impact will be in low-priced new builds. More fundamentally, this measure runs counter to the many other recent policy measures to cool housing demand.

- Ottawa will also modify the **Home Buyers' Plan**, which allows tax-free withdrawal from an RRSP (repaid over time). The withdrawal limit will rise from $25,000 to $35,000.
- **Pharmacare:** Ottawa will continue to progress toward a national pharmacare program. While the advisory process is still underway, this budget takes three steps: 1) Create a Canadian Drug Agency to negotiate prescription drug prices on behalf of all drug plans, targeting $3 billion per year in long-term savings; 2) Develop a national list of prescribed drugs; and, 3) National strategy for high-cost drugs for rare diseases.
- **Program spending** will rise 1.8% in FY19/20 after a 4.9% jump in FY18/19. A big chunk of the new announcements in this budget ($4.2 billion) will be rolled out before FY18/19 ends. One of the key features is just how wide a range of areas the spending increases have been spread across.
- **Infrastructure spending:** One of the chunkier dollar amounts is an immediate $2.2 billion transfer to municipalities to top up their infrastructure funding (through the Gas Tax Fund), and $1 billion for energy efficiency. These costs were loaded into the fiscal year that ends in March 2019, effectively using up a large portion of the extra revenues for the year. Municipalities will have 12 months to use the money.
- **Support for supply-managed farmers** totalling $3.9 billion in the wake of CETA and CPTPP ratification.
- **Skills training:** The **Canada Training Benefit** will provide a means-tested tax credit for skills training that accumulates at $250 per year, up to $5,000 over a lifetime. Income support will also be offered through the EI program.
- **Lower interest rate on student loans**, to prime from prime plus 2.5 percentage points (on the much more popular variable rates) and to prime plus 2.0 ppts from prime plus 5.0 ppts (for fixed). This meaningful reduction will cost Ottawa $345 million by FY20/21.
- **GIS** full earnings exemption increase for seniors, from $3,500 to $5,000 and a 50% partial exemption is introduced up to $10,000.
- **Electric Vehicle subsidies:** Will provide $5,000 on cars with a purchase price of less than $45,000.
- **Stock option taxation:** Will limit the future benefit of the employee stock option deduction for high-income individuals at mature (i.e., not start-up) firms by applying a $200,000 annual cap—further details pending, as was the case for many measures.

Table 1
Fiscal Outlook

(C$ blns, except where noted)

	Est.	— Forecast —		
	18/19	19/20	20/21	21/22
Revenues	332.2	338.8	351.4	366.7
Expenditures	347.1	355.6	368.2	378.4
Program Spending	323.5	329.4	339.7	348.3
Public Debt Charges	23.6	26.2	28.5	30.2
Adjustment for Risk	—	(3.0)	(3.0)	(3.0)
Budget Balance	(14.9)	(19.8)	(19.7)	(14.8)
Federal Debt	685.6	705.4	725.1	739.8
As a percent of GDP:				
Budget Balance	(0.7)	(0.9)	(0.8)	(0.6)
Federal Debt	30.8	30.7	30.5	30.0

Source: Federal Budget ( ) = deficit