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Federal Fall Economic Statement

Competitiveness: Takin' Care of Business

Douglas Porter, Chief Economist • douglas.porter@bmo.com • 416-359-4887;
Michael Gregory, Deputy Chief Economist • michael.gregory@bmo.com • 416-359-4747

Ottawa's Fall Economic Statement reveals a brighter federal fiscal picture than the Budget of nine months ago, opening the door for some new policy measures. And, as widely expected, the centrepiece of the update was a major-league ramping up of depreciation allowances on business capital spending. This big-ticket item (which will alone cost almost $5 billion in FY19/20), along with a sprinkling of other measures, will more than absorb the moderate revenue windfall, with the budget deficit now expected to tick up slightly in the next fiscal year (which begins next April). Notably, buried in the fine print is the fact that the budget estimates include $1.75 billion of *"non-announced measures"* in this fiscal year, that cumulate to $9.5 billion over six years, which may possibly include—among other items—provisions for compensation for farmers.

Real GDP growth for this year is actually tracking a tad below the initial Budget plan, but next year's outlook has been upgraded largely due to less uncertainty on the NAFTA/USMCA front. While the recent pronounced weakness in oil prices is a concern, the 2018 Budget had been based on WTI prices close to today's levels. Finance now expects the deficit to come in at $18.1 billion this year and $19.6 billion next (both a bit less than 1% of GDP), versus the initial estimate of $18.3 billion on average. There is still no intention to aim for a return to balance in the foreseeable future. **The major focus of today's Statement, however, was not on the finer points of the fiscal outlook; instead, it was on the steps taken to help support business competitiveness.**

The policy changes: As largely expected, Ottawa's big response to the aggressive U.S. corporate tax package was accelerated depreciation for business investment. It will be immediate expensing (100%) for manufacturing and processing machinery and equipment, along with clean energy equipment (these had 25% depreciation rates before). The depreciation rate for computer software will be doubled from the current 50%; so it, too, becomes 100%. All other depreciation rates will be tripled. For example, the previous 27.5% for computers will be raised to

Fiscal Outlook

(C$ billions, unless otherwise indicated)

		forecast		
	17/18	18/19	19/20	20/21
Revenues	**313.6**	328.9	339.2	352.1
Expenditures	**332.6**	344.1	355.8	367.2
Program Spending	**310.7**	320.2	328.3	337.3
Public Debt Charges	**21.9**	23.8	27.5	29.9
Adjustment for Risk		(3.0)	(3.0)	(3.0)
Budgetary Balance	**(19.0)**	(18.1)	(19.6)	(18.1)
(% of GDP)	**(0.9)**	(0.8)	(0.8)	(0.8)
Federal Debt	**671.3**	687.7	707.3	725.5
(% of GDP)	**31.4**	30.9	30.5	30.3
Budgetary Balance	(19.0)	(18.1)	(19.6)	(18.1)
Previous Estimate [1]	(19.9)	(18.8)	(17.8)	(16.5)
Change	0.9	0.7	(1.8)	(1.6)

[1] From 2018 Budget; After accounting changes   Source: Federal forecasts   ( ) = deficit

Economic Assumptions

(percent)

	— 2018 —			— 2019 —		
	Budget	**Current**	**BMO**	Budget	**Current**	**BMO**
Real GDP Growth	2.2	**2.0**	**2.1**	1.6	**2.0**	**2.0**
Nominal GDP Growth	4.0	**4.2**	**4.3**	3.5	**4.1**	**4.2**
3-month T-Bill	1.4	**1.4**	**1.4**	2.0	**2.1**	**2.2**
10-year GoC	2.3	**2.3**	**2.3**	2.8	**2.8**	**2.7**

82.5%; on freight-hauling trucks and tractors, the new rate will be 60%, up from 20%. The new depreciation rates apply to investments made after November 20th. They will be gradually phased out starting in 2024, and will no longer be in effect after 2027. The cost to the government is estimated to be $0.5 bln in the remaining four months of the current fiscal year (ending March), which jumps to $5.0 bln next year. The cumulative cost by FY23/24 is projected at $14.4 billion.

This measure, along with the lifting of NAFTA uncertainty (once the USMCA is signed by November 30) could combine to meaningfully spark investment. After a strong 6.4% average gain in real business fixed investment this year, we were forecasting it to ebb to about 3% in 2019 and 2020. There's now some upside risk to our forecast, which could provide at least a partial counterweight to the rising pressure from weak domestic oil prices.

Nothing Personal: With the intense focus on business competitiveness, there was no mention of another important competitive issue—our world-topping personal marginal tax rates. With top marginal rates of more than 53% in the two largest provinces, attracting top talent is a strain, especially in a world of tight job markets.

Economic outlook lifted on trade relief: A slightly firmer economic outlook for next year, even with the recent market volatility and slide in oil prices, provided Ottawa with some fiscal wiggle room. Real GDP growth for 2019 is now expected to come in at 2.0% versus the Budget expectations of just 1.6%. The medium-term forecast, however, has not increased despite some indications that potential growth has stepped up on strong population growth—real GDP is expected settle down to 1.8% between 2019 and 2023. Nominal GDP growth is similarly expected to come in well above initial expectations for next year at above 4%, boosting tax revenues, while a better labour market has pulled down program spending (lower EI benefits and other transfers). Notably, the biggest source of improvement in Ottawa's finances this fiscal year has flowed from much higher-than-expected income taxes, both of the corporate and personal variety.

Debt tracking slightly higher: Total debt is now pegged at $688 billion this fiscal year, up from $670 billion in the Budget plan, with the difference almost entirely due to a restating of the government's finances a few months ago. As a share of GDP, debt will actually dip slightly to 30.9% this year from 31.4% last year, and the revised deficit path will still allow that ratio to keep falling through the forecast horizon (to below 30% by FY 21/22). The prevailing assumption is that a stable net debt-to-GDP ratio is the de facto fiscal anchor.

The Bottom Line: Today's measures will provide important support to business capital spending, which should already find some foundation from reduced uncertainty on the Canada-U.S. trade outlook. Will today's steps be enough to quell the rising tide of competitiveness concerns? In a word: Probably not, at least not by themselves. **Today's announcement is a good first step in strengthening the business climate in Canada—but we would encourage an even more forceful response in coming months to the multitude of competitive challenges now facing the economy.** While Ottawa will get yet another chance in next year's pre-election Budget, we suspect the focus will revert back to some key social policy goals (say, pharmacare?) and away from business challenges at that time.