BUDGET ANALYSIS

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2022
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# Federal Fall Economic Statement 2022

## Something old, something new, something borrowed, something … *PHEW*

### HIGHLIGHTS

- High inflation and incomes started the federal fiscal outlook on a positive note. This boosted revenues by $30B higher than in Budget 2022 on average every year of the forecast. Largely as a result, budget deficits are expected to continue to decline, ultimately leading to a surplus in the 2027-2028 fiscal year.
- But new revenue measures were few and far between. The only new one in the Fall Economic Statement 2022 (FES 2022) is a 2% tax on share buybacks in the hope of spurring investment, similar a policy in the Inflation Reduction Act (IRA) in the United States.
- There was more on the spending side, however, with an IRA-inspired $6.7B investment tax credit for clean technologies taking the headlines. But there were other measures as well for skills development, affordability and government efficiency, which took total new spending to nearly $25B in the six fiscal years starting in the 2022-2023 fiscal year (excluding the provision for anticipated near-term pressures).
- The federal government also noted that the economic outlook has deteriorated since it la st surveyed private sector forecasters in September. To account for downside risks to the forecast, it included a much more bearish downside economic scenario characterized by a deep recession resulting from much higher short-term interest rates. But even under this scenario, the debt-to-GDP ratio will resume declining after a near-term increase.

The Fall Economic Statement 2022 (FES 2022) was a combination of good luck and prudent planning while at the same time trying to keep up with our neighbours to the South. Indeed, the United States' Inflation Reduction Act (IRA) is a key driver of the industrial policies laid out in FES 2022, although there were a few other goodies as well. But even in this context of modest new program spending, the federal government expects the budget deficit to fall gradually as much higher revenues than expected in Budget 2022 outpace moderately higher-than-anticipated spending. This will support a more rapid decline in the debt-to-GDP ratio than expected in Budget 2022.

### Smooth sailing now but storm clouds ahead

There is a lot of good news in the fiscal forecast published in FES 2022, in large part due to higher inflation and incomes. Everyone knew the starting point would be much better than expected in Budget 2022, and this set the stage for higher revenues over the full forecast. Indeed, revenues are projected to be more than $30B higher than in Budget 2022 on average every year of the forecast. And while adding higher program and interest expenses that will chew into about a third of this windfall, the federal government is still projected to post an improved outlook for the deficit of over $10B in every year of the forecast before any new measures. Not too shabby!

New spending in FES 2022 will eat into this improved outlook by upwards of $5B every year of the forecast. But even this will leave the federal government in a better fiscal position than it expected to be back in the spring. In fact, the federal government suggests that a surplus may be in its future before the decade is through (graph 1 and table 1 on page 2).

The improved deficit outlook means the debt-to-GDP ratio is projected to fall more quickly than presented in the budget (graph 2 on page 2). This has reduced the Government of Canada's planned debt issuance by $42B in the current fiscal year. This planned reduction is equally divided between Treasury bills ($21B) and bonds ($21B), and then largely concentrated in bonds with maturities under 10 years (see Box on page 5 for Debt Management Strategy Takeaways). An interesting

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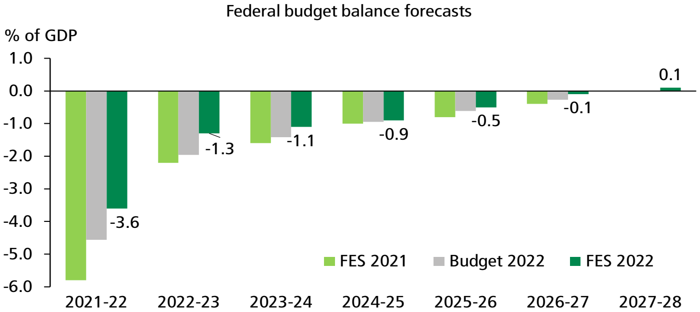
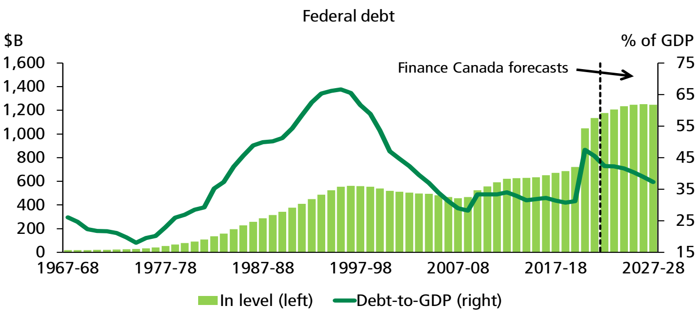
**GRAPH 1**
**The deficit outlook has improved enough to include a future surplus**




Note: 'FES' refers to Fall Economic Statement
Sources: Department of Finance Canada

**GRAPH 2**
**The federal debt is expected to fall faster than planned in Budget 2022**




Sources : Finance Canada and Desjardins, Economic Studies

development on the debt front is the previously announced Ukraine Sovereign Bond. At $500M, the proceeds from the bond issuance will be channelled into a loan administered by the International Monetary Fund to support the government and people of Ukraine.

### The Feds want to say 'bye bye' to share buybacks

The one revenue-raising measure in FES 2022 is a proposed 2% tax on the net value of all types of share buybacks by public corporations in Canada. This is similar to a measure introduced in the United States' Inflation Reduction Act (IRA). While the details of this new tax measure won't be announced until Budget 2023 (for implementation on January 1, 2024), the federal government expects this to raise $2.1B over five years starting in the 2023-2024 fiscal year. However, as this measure is expected to encourage investment by Canadian corporations, the desired change in behaviour may lead to a lower-than-expected tax take.

### From big spender to spending slender

With nearly $25B in new spending announced in FES 2022, this may be one of the most prudent fiscal documents introduced since 2015. But as spending is still moving higher than anticipated in Budget 2022, this may be best considered a moderation in the typical ambition we've come to expect from the federal government.

*Investing in skills and the energy transition*

The biggest spending line in FES 2022 is an investment tax credit for clean technologies, with a price tag of $6.7B over five years starting in the 2023-2024 fiscal year. This will be a refundable

## TABLE 1
## Summary of transactions

| | ACTUAL | DESJARDINS PROJECTIONS | | | | | |
|---|---|---|---|---|---|---|---|
| IN $B (EXCEPT IF INDICATED) | 2021–2022 | 2022–2023 | 2023–2024 | 2024–2025 | 2025–2026 | 2026–2027 | 2027–2028 |
| Budgetary revenues | 413.3 | 445.9 | 462.5 | 479.4 | 500.8 | 520.3 | 542.4 |
| *Growth (%)* | *30.6* | *7.9* | *3.7* | *3.7* | *4.5* | *3.9* | *4.2* |
| Program spending | -468.8 | -437.8 | -443.8 | -457.6 | -469.1 | -479.0 | -491.9 |
| *Growth (%)* | *-23.0* | *-6.6* | *1.4* | *3.1* | *2.5* | *2.1* | *2.7* |
| Debt charges | -24.5 | -34.7 | -43.3 | -42.7 | -42.9 | -44.1 | -44.8 |
| *Growth (%)* | *20.3* | *41.7* | *24.8* | *-1.4* | *0.5* | *2.8* | *1.6* |
| Net actuarial losses | -10.2 | -9.8 | -6.0 | -4.6 | -3.3 | -0.6 | -1.2 |
| **Budgetary balance** | **-90.2** | **-36.4** | **-30.6** | **-25.4** | **-14.5** | **-3.4** | **4.5** |
| Federal debt[1] | 1,134.5 | 1,177.3 | 1,207.9 | 1,233.4 | 1,247.8 | 1,251.2 | 1,246.7 |
| *Growth (%)* | *8.2* | *3.8* | *2.6* | *2.1* | *1.2* | *0.3* | *-0.4* |
| Budgetary revenues (% of GDP) | 16.6 | 16.0 | 16.2 | 16.2 | 16.2 | 16.2 | 16.2 |
| Program spending (% of GDP) | 18.8 | 15.7 | 15.5 | 15.4 | 15.2 | 14.9 | 14.7 |
| Public debt charges (% of GDP) | 1.0 | 1.2 | 1.5 | 1.4 | 1.4 | 1.4 | 1.3 |
| **Budgetary balance (% of GDP)** | **-3.6** | **-1.3** | **-1.1** | **-0.9** | **-0.5** | **-0.1** | **0.1** |
| **Federal debt (% of GDP)** | **45.5** | **42.3** | **42.2** | **41.6** | **40.4** | **38.9** | **37.3** |

[1] Debt representing the accumulated deficits including other comprehensive income.
Sources: Department of Finance Canada and Desjardins, Economic Studies

tax credit equal to 20-30% of the capital cost of investments such as electricity generation systems, stationary electricity storage systems, low-carbon heating equipment and industrial zero-emission vehicles. Eligibility for the full 30% tax credit will depend on adherence to 'certain labour market conditions', such as paying prevailing wages based on local labour market conditions and ensuring apprenticeship training opportunities. Other proposed measures to spur Canadian competitiveness include an investment tax credit for clean hydrogen and launching the Canada Growth Fund, among others. But we'll need to wait for Budget 2023 to get a better sense of what these initiatives will cost.

Another big-ticket item in FES 2022 is an investment in improving the regulatory processes for major projects. With a price tag of $1.3B over six years, "[t]his funding will ensure agencies designed to protect our environment can increase their capacity and improve the efficiency of assessments in order to respond to a growing number of projects being proposed."

The federal government is also allocating $1.6B over the next six years to support the newly-announced immigration plans. This is expected to attract over 400,000 international immigrants to Canada ever year, culminating in a recording-setting 500,000 net Canadians in 2025.

Finally, there is renewed investment in the skills of Canadian workers, including a total of $310M over the budget planning horizon for skills needed for a net-zero economy. Meanwhile, north of $800M is expected to be spent on investing in jobs for young Canadians.

*Addressing, if not improving, affordability*

With inflation having hit decades-high levels, it's not a surprise the affordability crisis played a central role in FES 2022. Some of these measures were reannouncements of policies already in the works. These include doubling the GST credit for six months ($2.5B this year), a top-up to the Canada Housing Benefit (net new spending of nearly $700M this fiscal year) and the Canada Dental Benefit (already planned in Budget 2022).

But there were also a few surprises in the mix. The big one was an automatic advance for the Canada Workers Benefit, expected to cost nearly $4B in the five years starting in the 2023-2024 fiscal year. Essentially, if you qualified last year, you can automatically receive payments this year that you won't need to pay back even if you no longer qualify for the program. This will help to support low-income households today. However, it is a missed opportunity to draw people back into the labour force to help address significant labour shortages across industries. The federal government is also eliminating interest on Canada Student Loan and Canada Apprenticeship Loans, at a cost of about $2.7B over five years. This will impact loans currently being repaid and all future loans, to the tune of nearly $600M annually.

Missing from the FES 2022 are meaningful new measures to address the cost of housing in Canada. This will disappoint housing advocates hungry for the federal government to show greater leadership in this area.

*Making government more effective?*

Last but not least, there is a renewed focus on making government more effective by improving Employment Insurance and Old Age Security delivery ($1.6B over four years). This is also new spending to improve service delivery at the Canada Revenue Agency call center, veterans, and the Canada Border Services Agency. However, conspicuously absent is an update on the Strategic Policy Review and 'Reducing Planned Spending' announced in Budget 2022, which together are expected to generate $9B in savings over five years.

## Forecasting is a risky business

Not all is rosy in Ottawa. According to FES 2022, "[s]ince the private sector survey was conducted in early September, global economic and financial conditions have continued to deteriorate." As such, "the risks to the growth outlook are tilted to the downside." We couldn't agree more (table 2 on page 4). Thankfully, Finance Canada provides a downside scenario to compare the baseline FES 2022 forecast against. And it's not pretty. Real GDP growth would contract by nearly 1% in 2023 as short-term interest rates ratchet up. Deficits would rise sharply according, projected to hit $52.4B next year, up from $30.6B in FES 2022.

## Conclusion

Overall, we were pleased to see that the federal government didn't spend all of the revenue windfall brought on by high inflation. This will serve it well in the coming economic downturn. And while there is new spending in FES 2022, there is a lot more put in the window for Budget 2023. It's a prudent move. And given the way the global economy is trending, one shouldn't get their hopes up for a lot of new spending next year. With nearly $25B in new spending announced in FES 2022, this may be one of the most prudent fiscal documents introduced since 2015. But as spending is still moving higher than anticipated in Budget 2022, this may be best considered a moderation in the typical ambition we've come to expect from the federal government.

## TABLE 2
### Economic and financial forecasts

| AVERAGE ANNUAL GROWTH IN % (EXCEPT IF INDICATED) | 2021 | 2022f | | | 2023f | | |
|---|---|---|---|---|---|---|---|
| | Actual | FES 2022 | Down. Scen. | Desj. Group | FES 2022 | Down. Scen. | Desj. Group |
| Real GDP | 4.5 | 3.2 | 3.1 | 3.2 | 0.9 | -0.9 | 0.0 |
| GDP deflator | 8.1 | 0.3 | 7.6 | 8.0 | 1.9 | 1.8 | 0.2 |
| Nominal GDP | 13.0 | 11.8 | 11.0 | 11.4 | 2.6 | 0.9 | 0.2 |
| Treasury bills—3-month | 0.1 | 2.2 | 2.4 | 2.6 | 3.6 | 4.4 | 3.9 |
| Federal bonds—10-year | 1.4 | 2.8 | 2.8 | 3.1 | 3.1 | 3.2 | 3.1 |
| Unemployment rate | 7.4 | 5.4 | 5.5 | 5.4 | 6.1 | 6.6 | 6.5 |
| Exchange rate (US¢/C$) | 80.0 | 77.9 | 77.0 | 75.5 | 77.1 | 73.0 | 72.5 |
| Real GDP—United States | 5.7 | 1.7 | 1.4 | 1.7 | 0.6 | -1.2 | 0.0 |

f: forecasts
NOTE: Data may not add to totals due to rounding.
Sources: Department of Finance Canada, Statistics Canada and Desjardins, Economic Studies

### DEBT MANAGEMENT STRATEGY TAKEAWAYS – SO LONG TO RRBS

**A downwardly-revised overall issuance estimate for 2022-2023 was the natural extension of the government's fiscal outperformance.** Gross debt issuance is now forecast at $383B for the current fiscal year, $42B lower than forecast in Budget 2022. Where the government elected to make the cuts is interesting, however. The Real Return Bond (RRB) program is being scrapped effective now. RRBs were always a tiny fraction of issuance, and the long-standing liquidity issues characterizing the product have persuaded the government to refocus liquidity on other maturities. This also comes after the government cancelled an ultra-long bond auction last spring. Only $1B will have ended up being raised from these two bonds, as opposed to the $5B that was planned in the budget.

**While the retirement of RRBs is the more striking highlight, half the gross issuance reduction comes from T-bills.** At the end of the fiscal year, the stock of bills is projected to stand at $192B, close to its level of 2021-2022 but still somewhat above the average of the 2010s decade. In nominal bonds, issuance is reduced to $191 in the 2-year sector is revised $6B lower, the 3-year sector is revised $4B lower, the 5-year sector gets a $3B cut, whereas 10s and longs are shaved by $2B each. In the case of 10s, planned auctions were already dropped to three per quarter starting in the current quarter, from four per quarter during the first half of the fiscal year. Proportionally-speaking, the cut is heaviest for the 3-year sector, as it represents 17% of the issuance originally planned. However, this is nothing surprising, as 3-year auction sizes were lowered to $2.5B (from $3B) starting in July.

**There were little other new highlights of consequence for market participants.** The $0.5B planned issuance in Ukraine Sovereignty bonds was announced last week. Another issuance of Green bonds is being planned for the current fiscal year, after the warm reception of the inaugural Green bond issue last March. This reaffirms the intent stated in Budget 2022. One novelty is that the government is looking to broaden this type of issuance to include "social" and "transition" bonds, within a sustainable bond framework aimed at growing Canada's sustainable finance ecosystem.