WEEKLY COMMENTARY

The Federal Deficit Will Be Larger than Expected This Year but Is Far from a Debt Spiral

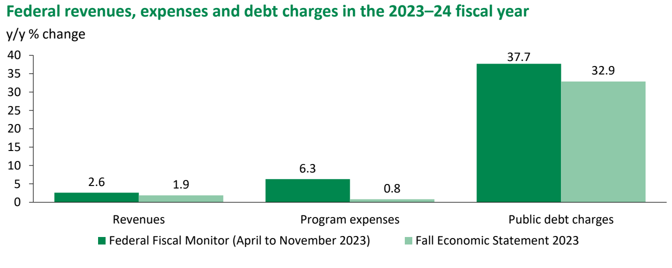
By Randall Bartlett, Senior Director of Canadian Economics

It's that time of the year again when economists sharpen their pencils in preparation for government budget season. Some provinces have already announced release dates. But the federal government tends to wait until the last minute to announce a publication timeline, typically in late March or early April. And we expect this year will be no exception.

Fortunately for federal fiscal watchers, the Government of Canada publishes a monthly Fiscal Monitor, which gives a year-to-date tally of how federal finances are evolving. The latest, published the last Friday of January, is for April through November 2023. It concluded that the fiscal-year-to-date budget deficit of $19.1B was substantially larger than the deficit over the same period the previous year, which clocked in at $3.6B. The biggest driver of the larger deficit is program expenses, which grew 6.3% over a year earlier (graph 1). In contrast, the 2023 Fall Economic Statement (FES) projected program expenses to climb by just 0.8% in the 2023–24 fiscal year. The problem most fundamentally is that the federal government baked significant savings into the outlook for Direct Program Expenses (DPE) that have not yet materialized. While the FES 2023 assumed an 8.1% year-over-year decline in DPE, the Fiscal Monitor has shown a 5.2% advance year-to-date. This is worrying, as DPE is the cost of operations over which the Government of Canada should have the most control and from which it expected to find significant savings.

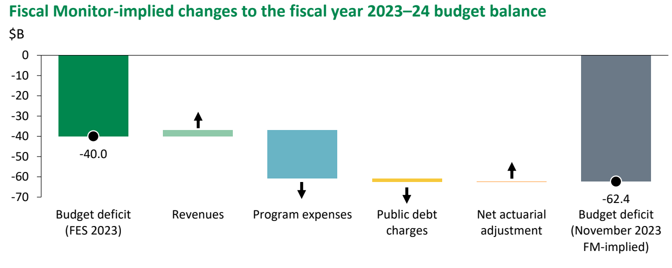
Of course, there's more to a budget deficit than just program expenses. Revenues are coming in moderately better than expected due primarily to higher personal income taxes (PIT), Goods and Services Tax revenues and Employment Insurance premiums. However, public debt charges—the cost of servicing the federal debt—are also growing more quickly than anticipated in the FES 2023. Taken together, this suggests that if the growth in revenues and expenses currently estimated in the Fiscal Monitor persisted for the full fiscal year, the deficit would balloon from $35.3B last year to $62.4B in the current fiscal year (graph 2). That's substantially greater than the $40.0B deficit

Graph 1
Federal Expenses Are Coming in a Lot Hotter than Expected



Government of Canada and Desjardins Economic Studies

Graph 2
Higher Expenses Will Be the Main Driver of a Larger Deficit



FES: Fall Economic Statement; FM: Fiscal Monitor
Government of Canada and Desjardins Economic Studies

CONTENT

Desjardins Economic Studies: 514-281-2336 or 1-866-866-7000, ext. 5552336 • desjardins.economics@desjardins.com • desjardins.com/economics

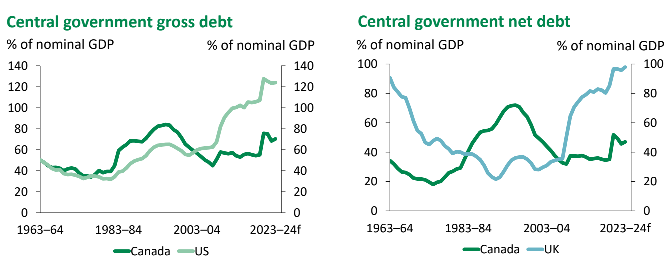
projected for the 2023–24 fiscal year in the FES 2023. Higher program expenses, and DPE specifically, are almost singularly responsible for the erosion of the federal fiscal forecast. As such, the federal government can't blame its deteriorating fiscal position on a weak economy.

That said, we don't think the federal deficit is likely to be as large as the Fiscal Monitor suggests. End-of-year accounting adjustments, particularly for PIT revenues, almost always push the final numbers in the government's favour. Still, we expect the budget deficit will be larger than the federal government projected in the FES 2023, probably closer to $50B in the 2023–24 fiscal year. We pointed to downside risks to the deficit forecast in both our preview and overview of the Fall Economic Statement.

In the unlikely event that the deficit projection based on the Fiscal Monitor comes to fruition, it would deteriorate to 2.2% of nominal GDP this year, from a forecast 1.4% in the FES 2023. By way of comparison, the Congressional Budget Office expects the US federal government to run a deficit of nearly 6% of GDP this year. Meanwhile, the Office for Budget Responsibility in the UK anticipates the central government there to run a deficit of around 5.5% of GDP.

But larger deficits do mean more debt, and so the debt-to-GDP ratio is likely to be less rosy than the forecast published back in the fall of last year. That said, the federal government isn't headed toward some sort of debt spiral as some have suggested. Even if the 2023–24 fiscal year deficit were to come in at the $62.4B suggested by the Fiscal Monitor, the federal debt-to-GDP ratio would rise to somewhere around 43% from the prior forecast of 42.4% last fall. A move in the wrong direction to be sure, but still well below the historic (66.6%) and pandemic-era (47.5%) peaks. And when the Government of Canada's debt level is juxtaposed with those of the US and UK, for example, it pales in comparison as a share of the economy (graph 3).

Graph 3
Federal Debt Is Lower in Canada Than in Other Major Economies



f: forecast
Congressional Budget Office, Office for Budget Responsibility, Government of Canda and Desjardins Economic Studies

More important than discussing the size of the possible federal deficit in Canada this year should be a conversation about where that money is going. And where it's going is to greater-than-expected operating expenses like personnel costs and minor transfer payments that just keep piling up. At the recent press conference that accompanied the January Monetary Policy Report, Bank of Canada Governor Tiff Macklem warned about the need for policymakers to resist the urge to spend more. Otherwise, government spending risks working at cross purposes with monetary policy, making the Bank's job of returning inflation to 2% that much more difficult. Interest rates could be higher for longer as a result, and nobody wants that.

What to Watch For

By Randall Bartlett, Senior Director of Canadian Economics, Tiago Figueiredo, Associate – Macro Strategy, Marc Desormeaux, Principal Economist, Marc-Antoine Dumont, Economist, and Francis Généreux, Principal Economist

UNITED STATES

MONDAY February 5 - 10:00

January	
Consensus	52.0
Desjardins	51.3
December	**50.4**

ISM Services index (January) – In December, the ISM Services index fell to its lowest point since May 2023. The component that fell the most was employment, which dropped 6.9 points to a level unseen since 2009, if we don't count the first few months of the pandemic. But at 50.6 points overall, the ISM Services index nevertheless stayed above the 50-point threshold. We also believe the index probably started to reverse its decline in January, since most regional indexes improved over the past month and consumer confidence indexes posted strong gains. We therefore expect the ISM Services index to have climbed from 50.4 to 51.3 in January.

WEDNESDAY February 7 - 15:00

December	US$B
Consensus	16.500
Desjardins	-7.500
November	**23.751**

Consumer credit (December) – Consumer credit surprised to the upside in November by expanding US$23.8 billion, its biggest increase in a year. We expect it to have shrunk significantly in December, based on weekly data from the banking sector. However, some upside risk remains given the good growth in consumer spending in December and the resulting decline of the savings rate.

CANADA

WEDNESDAY February 7 - 8:30

December	$B
Consensus	1.10
Desjardins	-0.30
November	**1.57**

International merchandise trade (December) – Canada's trade balance is expected to have fallen into negative territory in the final month of 2023. This should mainly be a price story, as the hefty seasonally adjusted depreciation of the Canadian dollar on a month-over-month basis in December likely weighed on export prices. Moreover, inputs to our forecast suggest that motor vehicle and parts exports were also down. On the import side, the change in the loonie is anticipated to have pushed prices higher. That said, the general weakness of the Canadian economy probably weighed on import volumes.

FRIDAY February 9 - 8:30

January	
Consensus	15,000
Desjardins	-5,000
December	**100**

Labour Force Survey (January) – After sputtering in December, Canadian employment may have contracted by 5k in January. This labour weakness comes as population growth probably remained well above pre-pandemic trends, all of which is adding further slack to the labour market. That should see the unemployment rate move higher by one tick to 5.9%. The drop in job vacancies relative to the number of unemployed throughout last year points to a Canadian labour market that has normalized quickly. Meanwhile annual wage growth should moderate as the bar for it to accelerate remains high.

OVERSEAS

WEDNESDAY February 7 - 2:00

December	m/m
Consensus	-0.5%
November	**-0.7%**

Germany: Industrial production (December) – German industrial production hasn't accelerated month-on-month since April 2023. In fact, it has tumbled 6.4% from last year's high. Given that the German manufacturing PMI has stayed below 50 for the past year and a half, we don't expect the country's industrial production to recover decisively anytime soon. But we're keeping an eye on the situation to see if it began to improve slightly in late 2023, which would offer some hope for the new year.

WEDNESDAY February 7 - 20:30	
January	**y/y**
Consensus	-0.5%
December	**-0.3%**

China: Consumer price index (January) – China experienced a third straight month of deflation in December, with the consumer price index down 0.3% year-on-year. Core inflation, which strips out food and energy, nevertheless remained stuck at 0.6%. The pullback was mostly in the cost of food, especially meat (-15.9%), which is often seen as an indicator of domestic demand in China. That said, persistent deflation may prompt the government to pour on more stimulus. The January 2024 print will tell us more about where Chinese prices are headed.

Economic Indicators

Week of February 5 to 9, 2024

Day	Time	Indicator	Period	Consensus	Desjardins forecast	Previous reading
UNITED STATES						
MONDAY 5	10:00	ISM Services index	Jan.	52.0	51.3	50.4
	14:00	Speech by Federal Reserve Bank of Atlanta President R. Bostic				
TUESDAY 6	12:00	Speech by Federal Reserve Bank of Cleveland President L. Mester				
	13:00	Speech by Federal Reserve Bank of Minneapolis President N. Kashkari				
	14:00	Speech by Federal Reserve Bank of Boston President S. Collins				
	19:00	Speech by Federal Reserve Bank of Philadelphia President P. Harker				
WEDNESDAY 7	8:30	Trade balance – goods and services (US$B)	Dec.	-62.2	-60.7	-63.2
	11:00	Speech by Federal Reserve Governor A. Kugler				
	11:30	Speech by Federal Reserve Bank of Boston President S. Collins				
	12:30	Speech by Federal Reserve Bank of Richmond President T. Barkin				
	14:00	Speech by Federal Reserve Governor M. Bowman				
	15:00	Consumer credit (US$B)	Dec.	16.500	-7.500	23.751
THURSDAY 8	8:30	Initial unemployment claims	Jan. 29–Feb. 2	215,000	226,000	224,000
	8:30	Speech by Federal Reserve Bank of Richmond President T. Barkin				
	10:00	Wholesale inventories – final (m/m)	Dec.	n/a	0.4%	0.4%
	12:05	Speech by Federal Reserve Bank of Richmond President T. Barkin				
FRIDAY 9	---	---				
CANADA						
MONDAY 5	---	---				
TUESDAY 6	8:30	Building permits (m/m)	Dec.	n/a	3.2%	-3.9%
	12:45	Speech by Bank of Canada Governor T. Macklem				
WEDNESDAY 7	8:30	International trade ($B)	Dec.	1.10	-0.30	1.57
THURSDAY 8	---	---				
FRIDAY 9	8:30	Net change in employment	Jan.	15,000	-5,000	100
	8:30	Unemployment rate	Jan.	5.9%	5.9%	5.8%
	10:30	Release of the Bank of Canada's Senior Loan Officer Survey				

Note: Each week, Desjardins Economic Studies takes part in the Bloomberg survey for Canada and the United States. Approximately 15 economists are consulted for the Canadian survey and a hundred or so for the United States. The abbreviations m/m, q/q and y/y correspond to month-over-month, quarter-over-quarter and year-over-year change respectively. Following the quarter, the abbreviations f, s and t correspond to first estimate, second estimate and third estimate respectively. Times shown are Eastern Standard Time (GMT - 5 hours). Desjardins Economic Studies forecast.

Economic Indicators

Week of February 5 to 9, 2024

Country	Time	Indicator	Period	Consensus m/m (q/q)	Consensus y/y	Previous reading m/m (q/q)	Previous reading y/y
OVERSEAS							
SUNDAY 4							
Japan	19:30	Composite PMI – final	Jan.	n/a		51.1	
Japan	19:30	Services PMI – final	Jan.	n/a		52.7	
MONDAY 5							
Germany	2:00	Trade balance (€B)	Dec.	18.7		20.8	
Italy	3:45	Composite PMI	Jan.	50.0		48.6	
Italy	3:45	Services PMI	Jan.	50.8		49.8	
France	3:50	Composite PMI – final	Jan.	44.2		44.2	
France	3:50	Services PMI – final	Jan.	45.0		45.0	
Germany	3:55	Composite PMI – final	Jan.	47.1		47.1	
Germany	3:55	Services PMI – final	Jan.	47.6		47.6	
Eurozone	4:00	Composite PMI – final	Jan.	47.9		47.9	
Eurozone	4:00	Services PMI – final	Jan.	48.4		48.4	
United Kingdom	4:30	Composite PMI – final	Jan.	52.5		52.5	
United Kingdom	4:30	Services PMI – final	Jan.	53.8		53.8	
Eurozone	5:00	Producer price index	Dec.	-0.8%	-10.5%	-0.3%	-8.8%
Australia	22:30	Reserve Bank of Australia meeting	Feb.	4.35%		4.35%	
TUESDAY 6							
Germany	2:00	Factory orders	Dec.	-0.2%	-5.3%	0.3%	-4.4%
Italy	4:00	Consumer confidence	Jan.	107.0		106.7	
Italy	4:00	Economic confidence	Jan.	n/a		107.2	
United Kingdom	4:30	Construction PMI	Jan.	47.2		46.8	
Eurozone	5:00	Retail sales	Dec.	-1.0%	-0.8%	-0.3%	-1.1%
WEDNESDAY 7							
Japan	0:00	Leading indicator – preliminary	Dec.	109.4		107.6	
Japan	0:00	Coincident index – preliminary	Dec.	116.1		114.6	
Germany	2:00	Industrial production	Dec.	-0.5%	-2.3%	-0.7%	-4.8%
France	2:45	Trade balance (€M)	Dec.	n/a		-5,943	
France	2:45	Current account (€B)	Dec.	n/a		-2.8	
France	2:45	Wages – preliminary	Q4	n/a		0.5%	
Italy	4:00	Retail sales	Dec.	n/a	n/a	0.4%	1.5%
Japan	18:50	Current account (¥B)	Dec.	1,934.2		1,885.4	
China	20:30	Consumer price index	Jan.		-0.5%		-0.3%
China	20:30	Producer price index	Jan.		-2.6%		-2.7%
India	23:30	Reserve Bank of India meeting	Feb.	6.50%		6.50%	
THURSDAY 8							
Mexico	14:00	Bank of Mexico meeting	Feb.	11.25%		11.25%	
FRIDAY 9							
Germany	2:00	Consumer price index – final	Jan.	0.2%	2.9%	0.2%	2.9%
Italy	4:00	Industrial production	Dec.	0.9%	-2.5%	-1.5%	-3.1%

NOTE: Unlike release times for US and Canadian economic data, release times for overseas economic data are approximate. Publication dates are provided for information only. The abbreviations m/m, q/q and y/y correspond to month-over-month, quarter-over-quarter and year-over-year change respectively. Times shown are Eastern Standard Time (GMT - 5 hours).