BUDGET ANALYSIS

Federal Fall Economic Statement 2023

A Fiscal Forecast Only a Contortionist Could Love

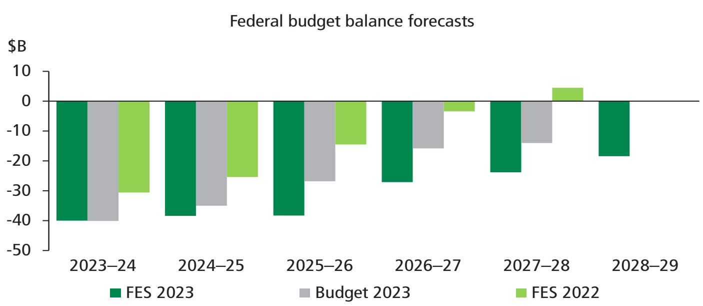
By Randall Bartlett, Senior Director of Canadian Economics

HIGHLIGHTS

- As expected in our federal Fall Economic Statement 2023 (FES 2023) preview note, the Government of Canada plans to run larger deficits than anticipated in Budget 2023. While anticipated to be little changed from Budget 2023 in the 2023–24 fiscal year, at around $40B, the deficit is now projected to be $9B greater on average annually in the four fiscal years starting in 2024–25. Indeed, the federal government has abandoned all hope of running a surplus at any point over the fiscal planning horizon.
- Program spending is expected to be higher than in Budget 2023, coming in $8.2B greater on average annually in the four fiscal year starting in 2024–25. This is the result of new measures announced for industrial subsidies and building more affordable housing, which has been only partly offset by as-of-yet undisclosed savings. Larger deficits are also the result of higher public debt charges. Higher interest rates look to be increasing the deficit by roughly $6.1B on average annually relative to Budget 2023.
- On the revenue side, the weaker economic outlook (and other fiscal developments since Budget 2023) is expected to weigh on the budget balance by about $3.7B on average annually. This was further reduced by removing the GST from new rental housing. However, revenues in aggregate were revised higher thanks to greater planned proceeds from the pollution pricing framework resulting from higher expected emissions and unspecified other revenues.
- Taken together, the debt-to-GDP ratio is expected to increase from an estimated 41.7% in the 2022–23 fiscal year to 42.4% in 2023–24 and then again to 42.7% in 2024–25. After that, debt as a share of the economy is expected to track lower. Having announced somewhat dubious 'fiscal anchors' in FES 2023, the federal government took credit for managing to keep the debt-to-GDP profile at or below that published in Budget 2023. This despite the ratio having come in much better than expected in the 2022–23 fiscal year.

Another Fall Economic Statement (FES), another string of deficits planned for the foreseeable future (graph 1). Fortunately for the federal government, a surprise tailwind from revenues last year helped to improve the starting point for the debt-to-GDP ratio, giving them ever-more room to spend while claiming victory on keeping it in check. However, the path to get to a falling debt ratio over the medium term is a winding one, requiring booking additional savings that have yet to be found and new revenues that are a real head scratcher on their origin. All this to offset piles of new spending for industrial subsidies and housing affordability. Taken together, there needs to be a modest suspension of disbelief to buy into a fiscal forecast that only a contortionist can love.

GRAPH 1
Bigger Deficits As Far As The Eye Can See



Note: 'FES' refers to Fall Economic Statement
Sources: Finance Canada and Desjardins Economic Studies

The trend is not the economy's friend

With high interest rates weighing heavily on the Canadian economy, the federal government rightly lowered its outlook for real GDP growth in 2024 relative to the projection in Budget 2023. The same is true for growth in nominal GDP—the broadest measure of the tax base. While we applaud the downward revisions made in the right direction, our outlook remains more bearish (table 1). Indeed, the significant indebtedness of Canadian households suggests the risks to this baseline economic forecast are tilted to the downside. And since many Canadians will be renewing their mortgages in 2025 and 2026, this points to the economic forecast in 2025 and after likely being too optimistic. See our most recent Economic and Financial Outlook for more information.

But the Government of Canada can't be blamed for this overly optimistic forecast as they take the average of private sector economists. As such, we applaud them for including a downside scenario as well (table 2). Indeed, this looks very dismal to even these dismal scientists. But given the federal government is projecting a fall in the debt-to-GDP ratio starting in the 2025–26 fiscal year even under this gloomy scenario, Canadians and credit rating agencies should breathe a sigh of relief.

It's getting harder to find more tax revenues in the couch cushions

While we may be of the view that the baseline economic forecast is overly optimistic, the downward revision combined with other fiscal developments since Budget 2023 are expected to weigh on revenues and the budget balance. Indeed, it plays out clearly in the federal government's projection for income taxes. But despite this, the revenue forecast in FES 2023 has been revised up relative to the budget. There are a few reasons for this, and they don't inspire a lot of confidence. First, the federal government expects to pull in greater proceeds from the pollution pricing framework due to "revised emission estimates" (presumably upward) and the addition of New Brunswick to the framework. But the biggest boost to revenues comes from "other revenues", an amorphous category that includes interest revenue from Crown corporations, tax debt and net foreign exchange account holdings. Please excuse our skepticism.

These newfound revenues have helped to more than offset the drawdown in revenues coming from the removal of GST from new rental housing. Announced in September 2023 and part of "Canada's Housing Action Plan", this is expected to total $4.6B in the six fiscal years starting in 2023–24, equivalent to $1.5B in the final year of the fiscal outlook. They appear to have booked no revenues from cracking down on non-compliant short-term rentals, despite preventing the deduction of some expenses when in violation of municipal requirements.

The federal government spends a lot more than it saves, again

The federal government again increased program spending in the most recent fiscal forecast. While expected to fall in the 2023–24 fiscal year, largely as a result of lower-than-planned spending related to COVID-19, program spending increased by an average of $8.2B over the four years starting in the 2024–25 fiscal year relative to Budget 2023. Of this, estimates have put the total new spending in the FES 2023 at $20.8B.

New spending is broken into three areas, all of which are relatively sparing in terms of the number of new measures. The first is housing. Most of this is related to building more affordable housing, to the tune of $1.0B over the outlook. After that the amounts get relatively modest by historical comparison including support to municipalities for cracking down on non-compliant short-term rentals, which is essentially a rounding error at a total of $50M over the outlook. In total, there likely wasn't enough spending put in the window for housing to make a material difference in improving housing affordability.

Second, measures to support a strong middle class total $168M over the outlook. Again, not much here to write home about. Helping more households make the switch to electric heat pumps made an appearance, but this was already funded in past fiscal documents.

But then we get to the Clean Economy Industrial Subsidies, which are expected to total $8.5B over the full forecast in addition to measures announced in previous budgets. This is much lower than estimated by the Parliamentary Budget Officer. And it was complemented by additional details regarding previously

TABLE 1
Economic and financial forecasts

AVERAGE ANNUAL GROWTH IN % (EXCEPT IF INDICATED)	2022	2023f			2024f		
	Actual	FES 2023	Budget 2023	Desj. Group	FES 2023	Budget 2023	Desj. Group
Real GDP	3.4	1.1	0.3	1.1	0.4	1.5	0.1
GDP deflator	7.5	0.8	0.6	1.0	2.0	2.0	2.3
Nominal GDP	10.9	2.0	0.9	2.1	2.4	3.6	2.4
Treasury bills—3-month	2.6	4.8	4.4	4.8	4.3	3.3	4.0
Federal bonds—10-year	2.8	3.3	3.0	3.1	3.3	2.9	3.5
Unemployment rate	5.3	5.4	5.8	5.4	6.4	6.2	6.8
Exchange rate (US¢/C$)	76.0	74.3	74.7	74.0	75.2	76.8	73.5
Real GDP—United States	1.9	2.1	0.8	2.4	0.7	1.4	1.5

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

TABLE 2
Economic and financial forecasts

AVERAGE ANNUAL GROWTH IN % (EXCEPT IF INDICATED)	2022	2023f			2024f		
	Actual	FES 2023	Down. Scen.	Desj. Group	FES 2023	Down. Scen.	Desj. Group
Real GDP	3.4	1.1	0.9	1.1	0.4	-1.0	0.1
GDP deflator	7.5	0.8	0.9	1.0	2.0	1.6	2.3
Nominal GDP	10.9	2.0	1.7	2.1	2.4	0.5	2.4
Treasury bills—3-month	2.6	4.8	4.9	4.8	4.3	5.2	4.0
Unemployment rate	5.3	5.4	5.5	5.4	6.4	7.0	6.8

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

announced tax credits for clean energy investment—something business and investors had been waiting for. A new push for further developing a market for carbon contracts for difference also earned an honourable mention. It looks like it will be up to $7.0B of the $15.0B in capital allocated to the Canada Growth Fund and administered by PSP Investments.

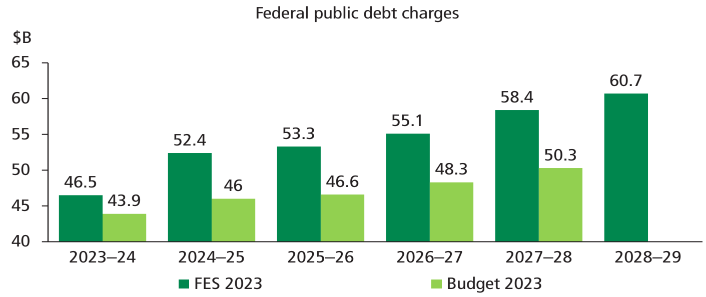
Finally, the federal government has booked an additional $2.5B in savings over the outlook. However, they remain vague on how this will be achieved. Indeed, we have yet to see a fully formed plan on how they expect to achieve the savings already announced. As such, we remain skeptical that the federal government will be able to achieve this, which points to higher deficits than the Government of Canada is currently expecting.

Big deficits are causing the debt to pile up

As expected, larger deficits led to an increase in the debt-to-GDP ratio in the 2023–24 and 2024–25 fiscal years, despite improving considerably on a revenue tailwind in 2022–23. Indeed, the debt-to-GDP ratio is expected to increase from an estimated 41.7% in the 2022–23 fiscal year to 42.4% in 2023–24 and then again to 42.7% in 2024–25. After that, debt as a share of the economy is expected to track lower (graph 2). Having announced somewhat dubious 'fiscal anchors' in FES 2023, the federal government took credit for managing to keep the debt-to-GDP profile at or below that published in Budget 2023.

We remain skeptical that the federal government can achieve this falling debt ratio over the medium term. With every new fiscal forecast published, the federal government takes any windfall of the prior year and fills the gap with new spending. This leaves it vulnerable to an economic downturn. Further, rising public debt charges have pushed up the debt service ratio to an extent that the federal government can't ignore (graph 3). This is expected to contribute significantly to the rising deficit and debt forecast, and put Canada at the mercy of higher-for-longer interest rates and the international bond market.

GRAPH 3
Substantial Increases in Public Debt Charges Over the Outlook



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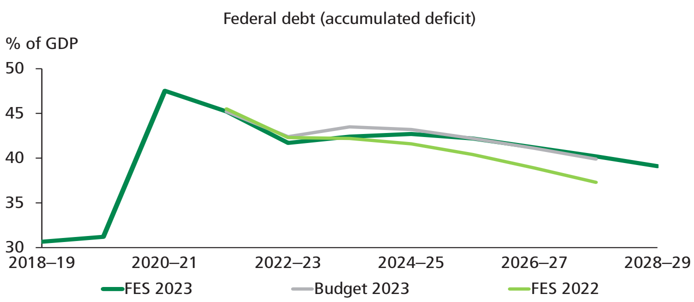
Sources: Finance Canada and Desjardins Economic Studies

Substantial increase in planned borrowing doesn't match the deficit

For 2023–24, the Debt Management Strategy (DMS) includes a debt issuance program of $485B, up from the estimated $387B raised in 2022–23 and a projected $414B for the current fiscal year estimated in Budget 2023 (graph 4). This is bigger than implied by the deficit alone. In addition to the impact of the deficit increase, the financial requirement is influenced by non-budgetary transactions, which include repayments to Canada Emergency Business Account (CEBA) loans. And while details are scant, financing for the now protracted period of CEBA loan repayment looks to be baked into the DMS, given how outsized it is compared to the deficit outlook.

The increase in overall issuance will largely be conducted via treasury bills. The target for the year-end stock of treasury bills for 2023–24 is $281B (which was upwardly revised from the $242B projection in Budget 2023), up from the $202B estimated for March 31, 2023. The federal government is also considering introducing "a temporary 1-month t-bill to support the transition from Bankers' Acceptances in the Canadian money market." It will return to the market in advance of the Canadian Dollar

GRAPH 2
Federal Debt to GDP Outlook Is Largely Unchanged from Budget 2023



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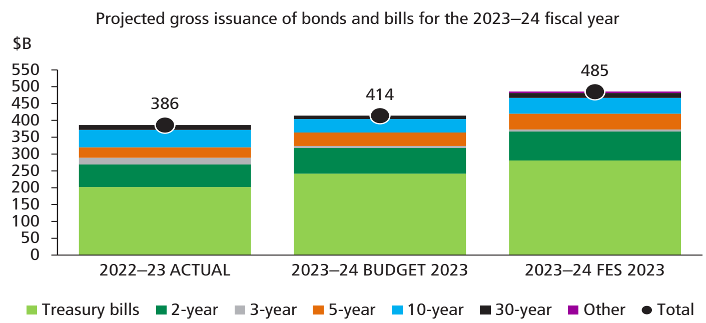
Sources: Finance Canada and Desjardins Economic Studies

GRAPH 4
Planned Debt Issuance Has Increased Substantially



Sources: Finance Canada and Desjardins Economic Studies

Offered Rate (CDOR) transition when it has finished considering the proposal.

Meanwhile, the bond program continues to expand, with an expected $204B in 2023–24, up from the $172B estimate in Budget 2023 and the $185B issued in 2022–23. This planned $19B increase in issuance over last year will come primarily via increases in the 2-year and 5-year sectors, offset by reduced issuance in the 3-year and 10-year sectors. Issuance of 30-year bonds ($4B) is expected to match the level of the prior fiscal year but increase relative to the nil anticipated at the time of Budget 2023. This has increased the share of long-term bonds to 30% relative to 29% in Budget 2023, but it remains well below the 36% in the 2022–23 fiscal year.

In the 2023–24 fiscal year, there are now expected to be four auctions of 2-year bonds with a benchmark range of $18-26B, one auction of 3-year bonds with a benchmark range of $8-12B, two auctions of both 5-year and 10-year bonds with benchmark ranges of $18-26B respectively, and one auction of 30-year bonds with a benchmark range of $20-30B.

One of the more interesting aspects of the DMS is how the federal government plans to transform the Canada Mortgage Bond (CMB) program. After putting the future of the program out to consultation, it later announced in September 2023 that it planned to increase CMB issuance by $20B annually. This would take total annual CMB issuance to as much as $60B. FES 2023 makes clear that the federal government now plans to buy up to half, or $30B, of CMBs issued annually. This will presumably be undertaken on the primary market, with no need to match the maturity structure of the purchased CMBs outlined in the update. The remaining CMBs will continue to be available for market participants, which is potentially less than is available today.

Conclusion

In conclusion, we weren't surprised to see deficits pencilled in for as far as the eye can see. Pressed with priorities, the federal government spent all its windfall from the last fiscal year and then some. The resulting rise in the debt-to-GDP ratio over the next two years is a preoccupation, even if it is expected to fall over the long term. But we've heard this story before. What strikes us as more concerning is the fact that the federal government had to twist its forecast in knots to get this result. But it could have been worse. Hopefully the federal government sticks to this plan going forward, and we don't see another spending-driven rise in the debt-to-GDP ratio in Budget 2024.

TABLE 3
Summary of transactions

	ACTUAL	DESJARDINS PROJECTIONS					
IN $B (EXCEPT IF INDICATED)	2022–2023	2023–2024	2024–2025	2025–2026	2026–2027	2027–2028	2028–2029
Budgetary revenues	447.8	456.2	483.4	502.4	527.4	551.0	573.8
Growth (%)	*8.4*	*1.9*	*6.0*	*3.9*	*5.0*	*4.5*	*4.1*
Program spending	-438.6	-442.2	-466.8	-484.8	-499.4	-515.5	-534.1
Growth (%)	*-6.5*	*0.8*	*5.6*	*3.9*	*3.0*	*3.2*	*3.6*
Debt charges	-35.0	-46.5	-52.4	-53.3	-55.1	-58.4	-60.7
Growth (%)	*42.7*	*33.0*	*12.7*	*1.7*	*3.4*	*6.0*	*3.9*
Net actuarial losses	-9.6	-7.6	-2.6	-2.6	0.0	-0.9	2.5
Budgetary balance	**-35.3**	**-40.0**	**-38.4**	**-38.3**	**-27.1**	**-23.8**	**-18.4**
Federal debt[1]	1,173.0	1,216.2	1,254.6	1,292.9	1,320.0	1,343.8	1,362.2
Growth (%)	*2.9*	*3.7*	*3.2*	*3.1*	*2.1*	*1.8*	*1.4*
Budgetary revenues (% of GDP)	16.1	15.9	16.5	16.4	16.5	16.5	16.5
Program spending (% of GDP)	-15.8	-15.4	-15.9	-15.8	-15.6	-15.4	-15.3
Public debt charges (% of GDP)	-1.3	-1.6	-1.8	-1.7	-1.7	-1.7	-1.7
Budgetary balance (% of GDP)	**-1.3**	**-1.4**	**-1.3**	**-1.2**	**-0.8**	**-0.7**	**-0.5**
Federal debt (% of GDP)	**42.2**	**42.4**	**42.7**	**42.2**	**41.2**	**40.2**	**39.1**

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