

# WEEKLY COMMENTARY



## When It Comes to Federal Finances, the Sky Isn't Falling

By Randall Bartlett, Senior Director of Canadian Economics

There has been a lot of ink spilled recently on the federal government's fiscal situation. And it's not without reason. Federal deficits are large by historical standards, and the level of spending is projected to remain elevated. Revenues are up, but inflation has played an outsized role, in no small part due to the federal government's substantial pandemic-era transfers. But with interest rates elevated and the economy teetering on a recession, even this silver lining in the fiscal framework may not last for long.

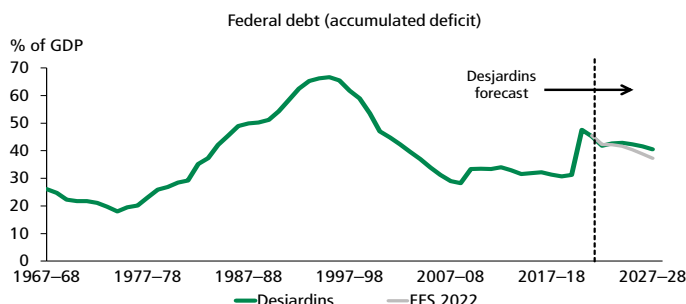
It's against this fiscal backdrop that earlier this week the federal government announced \$46.2 billion in new healthcare spending over the next 10 years. Few would doubt that Canada's healthcare system is suffering under the weight of post-pandemic surgical backlogs and a mental health crisis—not to mention the inevitable and long-anticipated strain on health systems because of aging. And it's just getting started. But a sustainable, long-term cure for what ails healthcare in Canada won't be cheap.

There is more spending on the way too. The federal government telegraphed in the Fall Economic Statement that more measures to accelerate the energy transition are coming in Budget 2023. From growth funds to investment tax credits to industrial strategies, a proverbial alphabet soup of measures has been put in the window. And this doesn't include a national pharmacare plan, increased defense expenditures or other spending promises. But despite their differences, these proposals all have one thing in common—they cost money. In some cases, a lot of money.

In this context, concern regarding the sustainability of federal finances is completely reasonable. Many will remember the era of high inflation and unsustainable deficits of the 1980s and draw parallels to today's circumstances. Few alive at the time will forget the prolonged period of economic malaise, high interest rates and deep federal spending cuts that followed.

So, how comparable is the federal fiscal position today versus 30 years ago? The answer is not much. Deficits and debt are larger now relative to the size of the economy than they were pre-pandemic, but they are nowhere close to being as concerning as in the past (Graph 1). Importantly, the interest-to-revenue ratio is near its historic low and is expected to stay there according to a variety of credible forecasts (see our December 2022 forecast or the Parliamentary Budget Officer's October 2022 forecast). At its peak in 1990, nearly 40 cents for every dollar of revenues went to pay interest (Graph 2 on page 2). Today, that number is about 8 cents, up from a historic low of around 6 cents just before the pandemic. It is projected to peak at just shy of 10 cents before falling again as central banks cut interest rates. The effective interest rate—total interest paid on outstanding debt—is also near its historic low. Even the common refrain of the consistently rising level of actual and projected spending is often presented without the context that revenues are also consistently higher.

**GRAPH 1**  
The federal debt is expected to gradually decline as a share of GDP

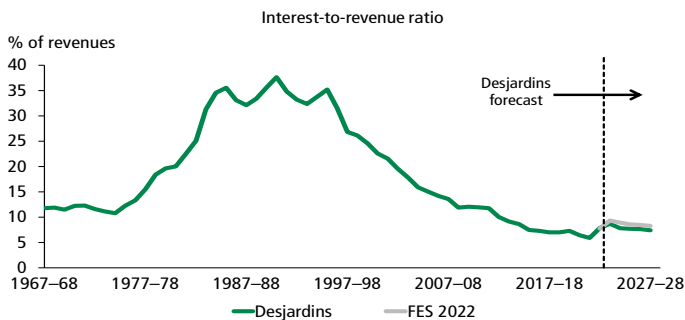


FES: Fall Economic Statement  
Sources: Finance Canada and Desjardins Economic Studies

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**GRAPH 2**  
Federal interest costs are rising quickly but should remain modest

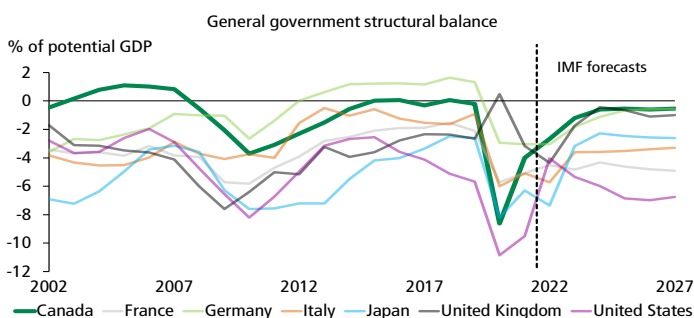


FES: Fall Economic Statement  
Sources: Finance Canada and Desjardins Economic Studies

And love them or hate them, comparable international measures of outstanding debt, such as gross and net debt to GDP, are lower in Canada than in most, if not all, other G7 countries. An international comparison of advanced economy deficits leads to a similar conclusion. To top it all off, the federal government has about \$60 billion in deposits sitting with the Bank of Canada it can draw from if needed, up from an average of closer to \$20 billion prior to the pandemic.

Where we would caution the federal government is on the size of the structural deficit—the deficit that exists after removing the impact of the business cycle. By Finance Canada’s own estimates, it’s large, particularly after the impact of interest rates is removed. This poses a risk of the federal government not only living beyond its means, but also exacerbating inflation if stimulative fiscal policy is rolled out when it’s not needed. Indeed, there is a risk that perennial increases in spending by even modest amounts could gradually erode fiscal sustainability unless they are offset by revenue-raising measures. But again, Canada has and is expected to continue to have one of the smallest structural budget deficits in the G7 according to the International Monetary Fund (Graph 3).

**GRAPH 3**  
Canada has one of the smallest structural deficits in the G7



Source: International Monetary Fund (IMF)

Could government spending be better targeted and more efficient? With certainty, and at all levels. Should Canadians be actively debating the role of government in society and the size of the public sector that is commensurate with satisfying that role? Always. Is it wise for Canadians to track government spending, taxing and debt sustainability closely? Absolutely. But when it comes to the federal fiscal numbers, the results are clear. This is not the 1990s, and the sky isn’t falling.

# What to Watch For

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

## TUESDAY, February 14 - 8:30

January	m/m
Consensus	0.5%
Desjardins	0.5%
December	-0.1%

## WEDNESDAY, February 15 - 8:30

January	m/m
Consensus	1.7%
Desjardins	2.1%
December	-1.1%

## WEDNESDAY, February 15 - 9:15

January	m/m
Consensus	0.5%
Desjardins	0.4%
December	-0.7%

## THURSDAY, February 16 - 8:30

January	
Consensus	1,361,000
Desjardins	1,375,000
December	1,382,000

## FRIDAY, February 17 - 10:00

January	m/m
Consensus	-0.3%
Desjardins	-0.3%
December	-0.8%

## UNITED STATES

**Consumer price index (January)** – Headline inflation has been retreating steadily from last June's peak of 9.1%, primarily on the back of falling energy prices—especially gasoline. However, we expect the latter to have risen in January. Pump prices jumped 5.5%, which is more than we usually see in the first month of the year. Meanwhile, we're anticipating a 0.4% rise in food prices, slightly more than December's 0.3% increase. Stripping out food and gasoline, we think January's print will mirror the previous month's 0.3% gain. The downtrend in goods prices is expected to continue in January, although prices of used cars and trucks appear to have temporarily stopped declining. Once again, services will drive price growth. Overall, the month-over-month change in the all items index should come in at 0.5%, the biggest jump since June 2022. However, we expect the year-over-year print to fall from 6.5% to 6.2%, with core inflation edging down from 5.7% to 5.4%.

**Retail sales (January)** – Holiday cheer was in short supply in the retail sector. Retail sales fell 1.0% in November and 1.1% in December. However, the bad weather around Christmas may have disrupted store traffic at the very end of the year. January's milder weather was certainly more favourable. We already know that new vehicle sales surged in the first month of 2023. Higher gasoline prices so far this year are also likely to have boosted gasoline station receipts. Excluding motor vehicles and gasoline, preliminary card transaction data is positive, particularly for food services and online purchases. All in all, we expect total retail sales to increase 2.1%, while sales excluding motor vehicles and gasoline are projected to rise 1.4%.

**Industrial production (January)** – Industrial production fell in each of the last three months of 2022, and has only risen twice since last April. However, we expect a rebound in January. Part of December's decline was probably caused by the bad weather at the end of the month. Hours worked show that the manufacturing (excluding automotive) and mining sectors are bouncing back. The anticipated 0.8% rise in manufacturing is likely to be temporary given the weakness of the ISM Manufacturing index. Look for a sharp drop in energy production in January given the much milder than normal weather. Overall, we expect industrial production to have risen 0.4% in January.

**Housing starts (January)** – Housing starts fell 3.1% in 2022 compared to 2021, the first time since 2009 that the annual average has contracted. However, December's print revealed that housing starts were down 23.4% from April's peak. We expect the modest decline seen in late 2022 to extend into early 2023, mainly because the number of building permits issued continues to fall. With only 100 net hires in January, weak job creation in the residential building construction sector suggests that new builds stalled again. That said, other housing market indicators are stabilizing, while the milder weather likely helped drive construction. We think January's housing starts print will come in at 1,375,000 units.

**Leading indicator (January)** – The Conference Board's leading indicator remains one of the clearest signs of a US economic downturn. It fell again in December, by 0.8%. If we exclude the sharp drops during the first wave of the pandemic, the leading indicator's three-, six- and 12-month changes are the worst since 2009. However, we expect January's decline to be smaller than previous months. The ISM index, consumer confidence and interest rates will drag the indicator down further, but this will be partly offset by the equity market, hours worked and unemployment claims. Overall, we expect the indicator to fall 0.3%.

**WEDNESDAY, February 15 - 8:15**
**January**

Consensus	n/a
Desjardins	245,000

**December 248,600**
**WEDNESDAY, February 15 - 8:30**
**December**
**m/m**

Consensus	n/a
Desjardins	-1.5%

**November -0.0%**
**WEDNESDAY, February 15 - 8:30**
**Décembre**
**m/m**

Consensus	n/a
Desjardins	-1.7%

**November 0.5%**
**WEDNESDAY, February 15 - 9:00**
**January**
**m/m**

Consensus	n/a
Desjardins	-2.9%

**December 1.3%**
**MONDAY, February 13 - 18:50**
**Q4 2022**
**q/q**

Consensus	0.5%
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**Q3 2022 -0.2%**
**WEDNESDAY, February 15 - 2:00**
**January**
**y/y**

Consensus	10.3%
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**December 10.5%**
**CANADA**

**Housing starts (January)** – Housing starts are expected to have edged lower in January, as both existing home sales and building permits continued their downward trend. That said, we think starts are still likely to remain elevated compared to their pre-pandemic level as the tailwind from past presales continues—for now.

**Manufacturing sales (December)** – Manufacturing sales likely dropped 1.5% in December, slightly better than the 1.8% decline published by Statistics Canada in its flash estimate. Volumes probably led the charge lower, weighed down by lower auto production and falling imports of manufacturing inputs in the month, although higher non-commodity exports were a bright spot in the month. On the price side, the Industrial Products Price Index fell at its fastest pace since July in December on a seasonally-adjusted basis, pointing to a similar decline in manufacturing prices in the month.

**Wholesale trade (December)** – Wholesale trade is expected to have fallen 1.7% in December, likely coming in broadly in line with the 1.8% decline published by Statistics Canada in its early indicator. The drop in the month should be roughly evenly split between lower volumes and prices.

**Existing home sales (January)** – Existing home sales are estimated to have fallen back 2.9% m/m in January, as local real estate boards in major centres across the country indicated they lost ground in the month. In Ontario, while data from the Toronto Regional Real Estate Board point to a modest decline in sales in January, outcomes in other centres in Canada's most populous province look to have been more mixed.


**OVERSEAS**


**Japan: Real GDP (fourth quarter)** – Japan's economy is struggling to leave the pandemic behind. Japanese real GDP hasn't risen in two successive quarters since the second half of 2020. Meanwhile, non-annualized real GDP fell by 0.2% in the summer of 2022. However, growth should return in the fourth quarter.

**United Kingdom: Consumer Price Index (January)** – Inflation in the UK remains extremely high. The year-over-year change in the consumer price index was 10.5% in December, although this is down slightly from October's 11.1% peak, so some progress is being made. However, core inflation—which excludes food and energy—rose from 6.4% to 6.5% in December. As a result, price pressure remains acute in the UK, despite a slowing economy and the Bank of England's aggressive monetary policy.

# Economic Indicators

## Week of February 13 to 17, 2023

Day	Time	Indicator	Period	Consensus		Previous data
UNITED STATES						
MONDAY I3						
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TUESDAY I4						
	8:30	Consumer price index				
		Total (m/m)	Jan.	0.5%	0.5%	-0.1%
		Excluding food and energy (m/m)	Jan.	0.4%	0.3%	0.3%
		Total (y/y)	Jan.	6.2%	6.2%	6.5%
		Excluding food and energy (y/y)	Jan.	5.5%	5.4%	5.7%
	14:05	Speech by Federal Reserve Bank of New York President J. Williams				
WEDNESDAY I5						
	8:30	Empire manufacturing index	Feb.	-20.0	-12.0	-32.9
	8:30	Retail sales				
		Total (m/m)	Jan.	1.7%	2.1%	-1.1%
		Excluding automobiles (m/m)	Jan.	0.8%	1.9%	-1.1%
	9:15	Industrial production (m/m)	Jan.	0.5%	0.4%	-0.7%
	9:15	Production capacity utilization rates	Jan.	79.1%	79.1%	78.8%
	10:00	Business inventories (m/m)	Dec.	0.3%	0.3%	-1.3%
THURSDAY I6						
	8:30	Initial unemployment claims	6-10 feb.	200,000	203,000	196,000
	8:30	Housing starts (ann. rate)	Jan.	1,361,000	1,375,000	1,382,000
	8:30	Building permits (ann. rate)	Jan.	1,350,000	1,330,000	1,337,000
	8:30	Philadelphia Fed index	Feb.	-6.9	-12.0	-8.9
	8:30	Producer price index				
		Total (m/m)	Jan.	0.4%	0.5%	-0.5%
		Excluding food and energy (m/m)	Jan.	0.3%	0.3%	0.1%
	13:30	Speech by Federal Reserve Bank of St. Louis President J. Bullard				
FRIDAY I7						
	8:30	Export prices (m/m)	Jan.	-0.2%	0.6%	-2.6%
	8:30	Import prices (m/m)	Jan.	-0.1%	0.4%	0.4%
	10:00	Leading indicator (m/m)	Jan.	-0.3%	-0.3%	-0.8%
CANADA						
MONDAY I3						
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TUESDAY I4						
---						
WEDNESDAY I5						
	8:15	Housing starts (ann. rate)	Jan.	n/a	245,000	248,600
	8:30	Manufacturing sales (m/m)	Dec.	n/a	-1.5%	0.0%
	8:30	Wholesale sales (m/m)	Dec.	n/a	-1.7%	0.5%
	9:00	Existing home sales (m/m)	Jan.	n/a	-2.9%	1.3%
THURSDAY I6						
	17:55	Speech by Bank of Canada Deputy Governor P. Beaudry				
FRIDAY I7						
	8:30	Industrial product price index (m/m)	Jan.	n/a	-0.1%	-1.1%
	8:30	Raw materials price index (m/m)	Jan.	n/a	0.1%	-3.1%

Note: Desjardins, Economic Studies are involved every week 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 monthly, quarterly and yearly variation respectively. Following the quarter, the abbreviations f, s and t correspond to first estimate, second estimate and third estimate respectively. The times shown are Eastern Standard Time (GMT - 5 hours).  Forecast of Desjardins, Economic Studies of the Desjardins Group.

# Economic Indicators

Week of February 13 to 17, 2023

Country	Time	Indicator	Period	Consensus		Previous data	
				m/m (q/q)	y/y	m/m (q/q)	y/y
<b>OVERSEAS</b>							
<b>MONDAY 13</b>							
Japan	18:50	Real GDP – preliminary	4Q	0.5%		-0.2%	
Japan	23:30	Industrial production – final	Dec.	n/a	n/a	-0.1%	-2.8%
<b>TUESDAY 14</b>							
United Kingdom	2:00	ILO unemployment rate	Dec.	3.7%		3.7%	
Eurozone	5:00	Real GDP – preliminary	4Q	0.1%	1.9%	0.1%	1.9%
Eurozone	5:00	Net change in employment – preliminary	4Q	n/a	n/a	0.3%	1.8%
<b>WEDNESDAY 15</b>							
United Kingdom	2:00	Consumer price index	Jan.	-0.4%	10.3%	0.4%	10.5%
United Kingdom	2:00	Producer price index	Jan.	0.1%	13.3%	-0.8%	14.7%
Eurozone	5:00	Industrial production	Dec.	-0.8%	-0.7%	1.0%	2.0%
Eurozone	5:00	Trade balance (€B)	Dec.	-16.0		-15.2	
Japan	18:50	Trade balance (¥B)	Jan.	-2,469.8		-1,724.2	
<b>THURSDAY 16</b>							
Italy	4:00	Trade balance (€M)	Dec.	n/a		-1,445	
<b>FRIDAY 17</b>							
United Kingdom	2:00	Retail sales	Jan.	-0.3%	-5.8%	-1.0%	-5.8%
France	2:45	Consumer price index – final	Jan.	0.4%	6.0%	0.4%	6.0%
Italy	4:30	Current account (€M)	Dec.	n/a		446	
Eurozone	5:00	Current account (€B)	Dec.	n/a		13,6	

Note: In contrast to the situation in Canada and the United States, disclosure of overseas economic figures is much more approximate. The day of publication is therefore shown for information purposes only. The abbreviations m/m, q/q and y/y correspond to monthly, quarterly and yearly variation respectively. The times shown are Eastern Standard Time (GMT - 5 hours).