Economic Viewpoint

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Last chance budget!
To kick start the economy, governments will have to inject at least $20B over two years

The next federal budget, to be tabled on January 27, is particularly important. Clearly, for the sitting government, there are major political issues but, aside from these considerations, the budget represents the last opportunity to create an effective economic stimulus plan. Canadian demand for goods and services needs a good shot of adrenalin quickly to keep the recession from lasting or even expanding, and to prevent an overly slow recovery.

The big question the government must answer is: how much must be injected to make sure the economy recovers properly? It is not easy to answer this question, which deserves some attention. In fact, if the amounts are too small, there is a real risk that the economy could sink deeper. Moreover, spending too much would mean wasting public money and it could give too big a push to the economy, which would then have to be reined in. However, one thing seems fairly clear under these circumstances: the consequences of injecting too little money would be much more harmful than injecting too much.

A PLAN SIZED TO OUR AMBITIONS
To figure out how much is needed, we must first grasp the purpose of the economic stimulus plan. The first goal must be to increase production in the near term by stimulating domestic demand growth to offset the problems in foreign trade. In evaluating the amount needed, the basic premise is to shorten and lessen the recession and, ideally, secure a slow economic recovery around mid-2009.

Two forecast scenarios have therefore been drafted. The first considers that the various tiers of government (federal and provincial) have not provided any additional aid. Under this scenario, the current recession would be profound and long-lasting, somewhat like Canada’s previous classic recessions. Note that Canada’s last two recessions, the one that occurred in the early 80s and the recession of the early 90s, had persisted for a period of about two years. The second scenario put together considers an economic recovery around mid-2009. Based on this scenario, the federal and provincial governments should inject from $15B to $20B (graph 1) into Canada’s economy as quickly as possible to have the impacts felt by the third quarter and thus bring back positive growth. This would be the minimum needed to achieve the goal of shortening the recession.

To validate our previous estimate, we also considered another goal. The government may want to make sure that no quarter slides into negative territory in 2009 and 2010 and thus manage to barely avoid a recession, according to the technical definition. We thus calculated the amount the government would have to inject to keep economic growth flat using the basic scenario with no economic stimulus plan. This showed that direct cash injections into the economy in the order of $20B would be needed over the next two years.1

In short, the governments will have to inject at least $15B to $20B over the next two years to minimize the impacts of the current recession and foster economic recovery as quickly as possible. These amounts could be invested by any tier of government.

Graph 1 – The governments’ economic recovery plan should shorten the recession

Sources: Statistics Canada and Desjardins, Economic Studies

NOTE TO READERS: The letters k, M and B are used in texts and tables to refer to thousands, millions and billions respectively.

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government. Based on the relative size of its debt load, the federal government could finance almost two thirds of this amount, from $10.0B to $13.3B. The remainder would come from the provincial governments. The federal and provincial governments could also opt for a more daring plan to ensure the return of economic growth in the second half of 2009. In reality, the ceiling on the recovery plan is more dependent on our ambitions. However, as the federal budget is already in deficit, the additional expenditures will inflate the public debt. Investments that will have long-term structuring effects on the economy must therefore be favoured.

**A NECESSARY DEFICIT**

That said, how big will the budget deficit be with these new measures? First, note that, in November 27’s *Economic and Fiscal Statement*, the federal government’s budgetary balance was appraised at -$5.9B for fiscal 2009-2010, and at -$3.4B for fiscal 2010-2011. Economic conditions have deteriorated further since then, causing the growth of budgetary revenues to slow. Therefore, maintaining the status quo on program spending (as cutting public spending is inadvisable during a recession) means an increase in budgetary deficits. If we add the new economic recovery measures to these deficits, the next two budget years could on average wind up with yearly deficits just above $15B (graph 2). The federal government’s gross debt should therefore increase by just over $30B by March 2011 (graph 3). Note, however, that the gross debt had declined by $21.3B from fiscal 1999-2000 to fiscal 2007-2008.

1 It should be specified that we are referring to direct government spending on the economy. Here, a $10B tax cut would only represent an injection of $5B into the economy, assuming that 50% of the taxes saved would be channelled into savings or debt repayment. This reasoning applies to all of the measures that will be announced.

If the federal government is not able to meet all of these expectations with its January 27 budget, it would miss out on an excellent opportunity to kick start Canada’s economy. After that, it could be much too late.

**WE MUST ACT QUICKLY!**

Determining the minimum amount that the different tiers of government must invest in an economic stimulus plan is not all: the most effective methods for achieving this must also be found. Suggestions could take several forms, but there seems to be a consensus regarding four fundamental factors:

1. It must be possible to institute the actions quickly and efficiently.
2. To avoid generating structural deficits, the amounts injected must not be recurring.
3. Measures must be coordinated with other administrative tiers.
4. Spending must be targeted to have the most structuring impact on Canada’s economy (productivity, labour quality, innovation, etc.).

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