

Economics and FICC Strategy

FEDERAL BUDGET BRIEFS

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Making a statement with the mid-year statement

Today's mid-year fiscal statement was about making a statement on housing costs, while delivering the obligatory update of the deficit and economic projections. The current year's deficit path remains on target, perhaps a better-than-expected number given that the Parliamentary Budget Officer that predicted at deterioration, although as we discuss below, gross issuance of debt has been revised higher. Thereafter, soft growth, higher interest rates and measures announced since the budget mean that the refreshed deficit numbers aren't quite as favourable in terms of fiscal balances as what was anticipated at budget time, but are still miles better than what we're seeing in the US, with Canadian federal deficits slated to be less than 1.5% of GDP in each of the next few years. Thereafter, the government is pledging to hold to a new commitment to keeping deficits below 1% of GDP.

Growth has held up better this year than expected,, and helped by lower transfer payments for the unemployed and recoveries of some previously paid out funds, the government is essentially holding to its projection for the overall balance, with the deficit expected to come in at \$40.0 bn. But a weaker outlook for 2024 and higher interest rates, coupled with \$3-\$4 billion in additional measures announced since then (mostly prior to today), contributes to a slower trajectory for deficit reduction thereafter (Table 1).

The debt-to-GDP ratio is expected to hit 42.4% of GDP in the current fiscal year, from 41.7% last year. Better than expected nominal GDP growth in 2023 has shaved that forecast from 43.5% expected at budget time. That better head start gets offset by slower growth next year and new measures, so the projection for the debt/GDP ratio beyond this year is essentially in line with the last budget's outlook. Where Ottawa hopes to make headlines isn't on the fiscal fine tuning, but on new steps aimed at enhancing the supply of rental housing, with rent inflation now one of the most stubborn parts of the country's inflation backdrop.

Table 1: Budgetary Deficit Projections

\$bn	22/23	23/24	24/25	25/26	26/27	27/28	28/29
Budgetary balance - Budget 2023	-43.0	-40.1	-35.0	-26.8	-15.8	-14.0	-
Budgetary balance - latest	-35.3	-40.0	-38.4	-38.3	-27.1	-23.8	-18.4
Budgetary balance (% GDP) – latest	-1.3	-1.4	-1.3	-1.2	-0.8	-0.7	-0.5
Federal debt (% GDP) – latest	41.7	42.4	42.7	42.2	41.2	40.2	39.1

Source: Canada Economic and Fiscal Update 2023

The government's elbow room for spending has been constrained by the desire to avoid boosting inflation, as well as by targets for deficit restraint. While spending levels after the update are higher than at budget time, much of that reflects announcements released prior to today. Collectively, those interim actions added \$2 bn to the deficit this year, and \$2.8 bn next year, with the largest items directed at Indigenous communities and military assistance to Ukraine. By comparison, new measures announced today will have minimal fiscal impacts, adding less than \$0.8 bn to this year's deficit, and a shade less than that next year, with some new spending measures offset by plans for additional restraint measures that will kick in starting in 2025/26.

A laundry list of various measures were announced with respect to addressing Canada's housing challenges. The largest new step was the addition of \$15 bn in loans under a program that finances developers of rental housing, with these fresh funds to flow in 2025/26 and beyond. A further \$1 bn was added to a fund that supports affordable housing, beginning in 2025/26. That's in addition to the earlier announced steps to remove the GST on purpose built rental housing, and to

ramp up CMHC insurance activity related to rental apartments. These steps are material relative to the size of the sector, but it will of course take time for this additional supply to be built and work to slow rent inflation. Other steps aimed at rent inflation included denying the tax deductibility of expenses on units used for short-term rentals where there are local restrictions against them, aimed at encouraging these units to be made available to longer term renters. Other items discussed in the update aren't material to the near term fiscal outlook, and relate to such issues as climate priorities and steps to encourage pension fund investments in Canada.

The fiscal projections are, as is customary, centred around a survey of private sector economists. At the time of the March budget, that survey was already looking for almost no growth in Canada's economy in 2023. The update has a stronger 1.1% pace assumed for real GDP in 2023, largely due to the economic health seen way back in Q1 of this year, and has nominal GDP advancing at 2% this year (more than twice the budget assumption). But the consensus has simply shifted that weakness into 2024, with only 0.4% real growth next year (versus 1.5% assumed back in March) and nominal GDP growth cut by more than a percentage point from the prior forecast to 2.4%. Short term interest rates will be about a full percentage point higher next year (with bills at 4.3%) than what was expected back in March, while 10-year rates will be 0.4%-points higher (at 3.3%).

Table 2: Planned borrowing

\$bn	2022-23	2023-24 Budget'23	2023-24 FES	Change from Budget'23
Treasury Bills	202	242	281	39
2-year	67	76	86	10
3-year	20	6	6	0
5-year	31	40	47	7
10-year	52	40	47	7
30-year	14	10	14	4
Green Bonds	-	0	4	4
Total Bonds	185	172	204	32

Source: Canada Economic and Fiscal Update 2023

While the deficit remains on target for this year, net financing requirements, and therefore bond issuance, will be larger than projected at budget time, with much of the addition coming at the long end and the very short end of the curve (Table 2). Part of that reflects a desire to get ahead of a big maturity right after the close of the fiscal year, while other factors include funding a First Nations settlement, and the first tranche of a plan to purchase Canada Mortgage Bonds. After consulting with the financial community, Ottawa has opted to leave the CMB program in place rather than wind it up entirely, but will buy up to \$30 bn annually of CMBs and effectively earn the spread on these products, while still leaving the rest of the issuance available for market participants.

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