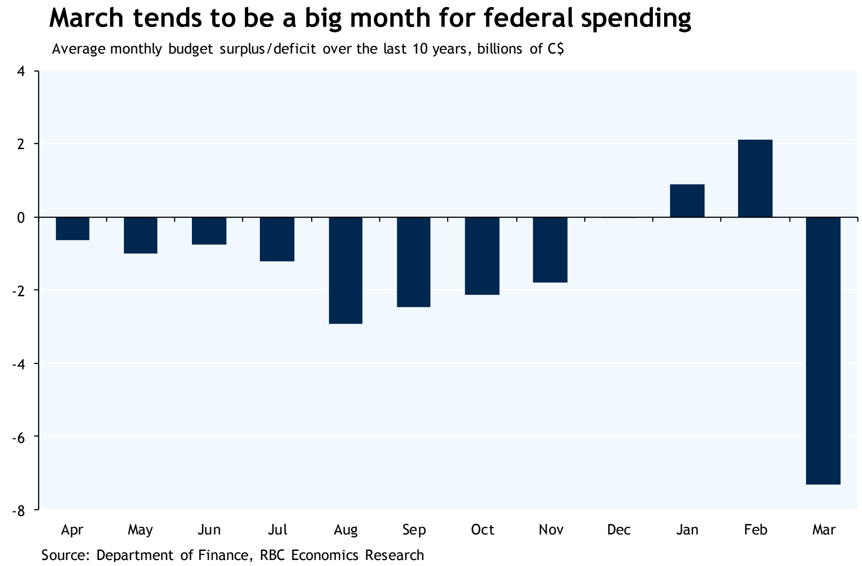
2019 FEDERAL BUDGET PREVIEW

March 2019

Brace for March (Spending) Madness

We expect the March 19 federal budget to reflect this government's penchant for spending. After all, it had no trouble boosting spending by an average of 6 ½% annually while the political and economic winds were blowing favourably. With storm clouds appearing, in the form of weaker-than-expected domestic economic growth, we doubt the finance minister will change course.

That's not to say the minister has no scope to print a smaller deficit. The fiscal accounts for the first nine months of fiscal 2018/19 showed a surplus of $324 million, compared with the government's deficit target of $18.1 billion…for the entire year. In all likelihood, this favourable fiscal performance has only opened the door wider to aggressive spending for a Liberal government that has shown no interest in balancing the budget. Indeed, we fear the loose fiscal anchor of keeping the debt-to-GDP ratio on an improving trend will act as the only restraint on spending.



Our view is bolstered by the fact that the final month of the government's fiscal year is typically a large deficit month. Over the last 10 years, the March deficit has averaged $7.3 billion, and the average over the last three (under the current finance minister) was $10 billion. The most recent run includes 3 of the 4 largest monthly federal deficits on record. With that history in mind, we anticipate the March madness to continue in the form of substantial spending announcements.

Any spending initiatives need to be considered against a weakening revenue backdrop. The economic slowdown we saw in the fourth quarter is likely to continue in the first quarter. As a result, growth forecasts for nominal GDP (a key driver of government revenues) are being reduced. We currently expect nominal GDP to rise by 2.1% this year compared to an assumed growth rate of 4.1% in the government's Fall Economic Statement. The slower growth suggests the finance minister should exercise spending caution if he is to avoid a miss on next fiscal year's $19.6 billion deficit forecast and a reversal in the downward trend in the debt-to-GDP ratio.

To be sure, the government will get a break from lower-than-anticipated interest rates, but this won't be enough to offset the impact of slower economic growth.

So with all that fiscal space, a slowing economy and a keen interest in spending, what can we expect from this government, especially in an election year? Potential budget measures that have been discussed include support for child care, a national pharmacare program, and attempts to address the skills/labour challenges that plague many Canadian businesses and workers. Each could have substantial costs associated with them. We're betting that each of these initiatives will get a downpayment in the current budget, with promises of more to come in future years.

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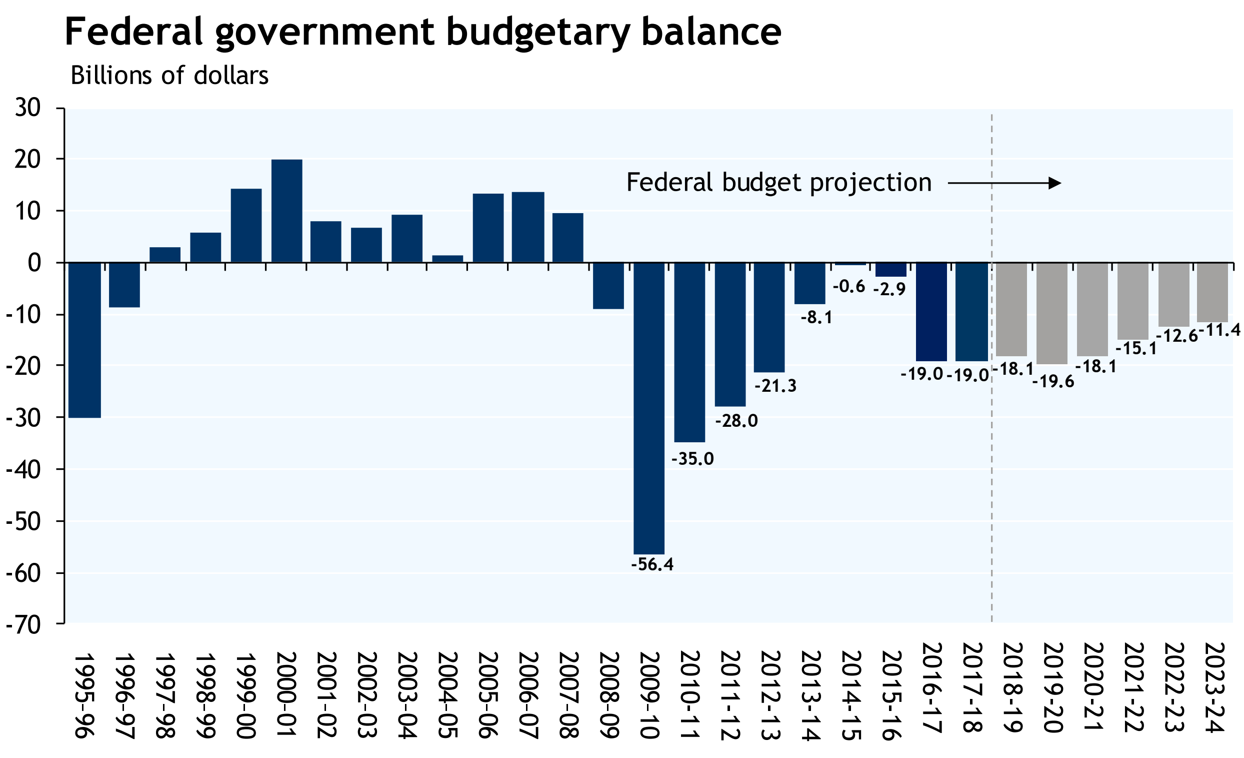
We would welcome a focus on skills, since it could address a current business challenge while at the same time creating better conditions for stronger economic growth in the period ahead. A stronger economy would go a long way in supporting many of the government's income redistribution goals.

Much of the budget speculation has focused on housing-market support, particularly measures to improve home ownership for millennials. As we recently argued, it isn't even obvious that there is a problem with ownership rates themselves, and most of the proposed solutions would actually make home ownership more challenging by inflating prices, unless they were accompanied by measures to improve supply. To the extent that the government follows this path, we also worry it would lead to a rise in the number of highly indebted, higher-risk households in Canada.



Source: Department of Finance, RBC Economics Research Forecasts