



FEDERAL GOVERNMENT'S FISCAL UPDATE

October 30, 2007

The 2007 *Economic and Fiscal Update* continues last year's practice of leaning more in the direction of a full fledged budget. The economic case for such a move is derived from one of Ottawa's largest embarrassment of riches ever recorded by way of dramatically overshooting budgetary revenue forecasts that were made just seven months ago.

All told, this is very much a budget focused upon reducing taxes and debt. A total of \$60 billion in new tax relief has been offered to households and businesses over six fiscal years. However, the fact that three quarters (\$45 billion) of this is focused upon personal relief will disappoint those who point to Canada as being in line with the OECD average on personal taxes, but much less competitive on business taxation once provincial tax rates are included (especially Ontario). Nothing was offered by way of further spending stimulus in sharp contrast to the recent trend.

Personal tax relief

Balanced tax relief included three carrots thrown to consumers and workers. Though ill-advised, three quarters of this personal tax relief (\$34 billion over six years) goes to spenders via a one point reduction in the Goods and Services Tax (GST) effective January 1st 2008. This may well have the effect of postponing some retail spending during the holiday season into early next year. It also strengthens our case for the next move on interest rates being up, by virtue of adding further stimulus to an already strong consumer.

Second, the basic personal exemption has been hiked by \$700 to \$9600 effective retroactively to January 1st 2007. A further \$500 hike in the exemption is planned for 2009.

Third, the lowest personal income tax rate will be cut by a half percentage point to 15%, again retroactively to January 1st 2007. The government estimates that these measures will remove 385,000 individuals from income tax rolls.

Business tax relief

Businesses also had a carrot thrown in their direction. The corporate income tax rate will drop by a further 1% in 2008 compared to earlier plans, and ultimately fall to 15% by 2012 from 22% currently. This back-end loaded tax relief costs \$14.1 billion in foregone revenues over five years. Announced tax relief for small businesses is tiny (a total of \$265 million over five years).

Projected surpluses and debt reduction

In addition to revenue measures, the government announced that it will allocate \$10 billion to debt reduction for the current fiscal year, and an extra \$3 billion for each year thereafter. The target 25% debt-to-GDP ratio is now forecast to be hit by 2011-12, three years ahead of the original target date. After taking account of all measures included in this update, the government is still forecasting rising planning surpluses, from \$1.6 billion this year to \$9.8 billion in 2012-13, possibly providing room for future initiatives.

Of further interest is what's missing by way of any talk of capital gains tax relief as once promised to investors. In the end, a cottage industry of those hoping for a confrontation between the minority government and its opposition critics may not get its way given preliminary readings of the political reaction, but these proposed measures must still be passed by Parliament.

Summary statement of transactions (billions of dollars)

	Actual		Projection				
	2006-07	2007-08	2008-09	2009-10	2010-11	2011-12	2012-13
Budgetary transactions							
Revenues	236.0	243.9	245.8	255.4	266.7	277.8	288.9
Program expenses	188.3	198.4	207.6	217.0	225.1	233.7	242.9
Public debt charges	33.9	34.0	33.7	34.2	34.0	33.9	33.3
Total expenses	222.2	232.3	241.4	251.1	259.2	267.6	276.2
Underlying surplus	13.8	11.6	4.4	4.3	7.5	10.2	12.8
Planned debt reduction		10.0	3.0	3.0	3.0	3.0	3.0
Planning surplus		1.6	1.4	1.3	4.5	7.2	9.8
Federal debt	467.3	457.3	454.3	451.3	448.3	445.3	442.3
Per cent of GDP							
Budgetary revenues	16.3	15.9	15.3	15.2	15.2	15.1	15.1
Program expenses	13.0	13.0	12.9	12.9	12.8	12.7	12.7
Public debt charges	2.3	2.2	2.1	2.0	1.9	1.8	1.7
Total expenses	15.4	15.2	15.0	14.9	14.7	14.6	14.4
Federal debt	32.3	29.9	28.3	26.9	25.5	24.3	23.1

RBC Economics assumptions

(Year-over-year % change)

	2006	2007	2008	2009
Real GDP growth	2.8	2.7	2.5	2.6
Nominal GDP growth	5.2	6.0	4.4	3.9
3-month Treasury bill rate*	4.2	4.3	4.8	4.9
Ten-year government bond rate*	4.1	4.6	5.1	5.3
CPI inflation	2.0	2.3	2.0	1.9
Unemployment rate	6.3	6.1	6.2	6.3
U.S. real GDP growth	2.9	2.0	2.6	2.7

* %, end of period

Source: Statistics Canada, Bureau of Economic Analysis, RBC Economics Research