

Looking to Canada's 2018–19 Federal Budget

Federal deficits narrower than the government forecast last October will accommodate new initiatives in the 2018 Budget. However, elevated uncertainty, in large part due to ongoing NAFTA negotiations, argues for a “wait-and-see” bias before major pre-election commitments in the 2018 Fall Statement and the 2019 Budget. In the upcoming year, rolling out this government’s multiple multi-year programs with definitive progress on actions introduced during the first half of the Liberals’ term is required to better frame subsequent policy.

SOME NEAR-TERM FISCAL FLEXIBILITY

In the 2017 Fall Statement, economic and fiscal developments trimmed projected deficits from fiscal 2017–18 (FY18) to FY22 by a hefty \$46.4 billion (side table), and Scotiabank Economics looks for a further narrowing of the FY18 and FY19 deficits by \$1.5 billion and \$0.8 billion, respectively. The FY18 bottom line will be further assisted by the expected decrease in the \$1.5 billion ‘Adjustment for Risk’ reflecting the imminent March 31st year-end.

For the first eight months of FY18, cumulative revenues are up 4.8% y/y, less than the 5.9% annual rise projected in the October 2017 Fall Statement, but growth in Personal Income Tax receipts and ‘Other Revenue’ is picking up. Reflecting the buoyancy in Canada’s housing sector and consumption in calendar 2017, GST general sales tax receipts are outpacing the 6.8% forecast.

Program spending growth of 3.2% over the first eight months of FY18 is substantively lagging the October estimate of 9.0%. However, a significant upswing during the remaining months of FY18 is anticipated for several items such as transfers other than the Major Transfers to Individuals and Other Levels of Government as federal funding flows for infrastructure and other new programs. The cumulative debt service through November is \$0.5 billion less than a year earlier, significant but less than prior years, signaling a diminishing benefit from historically low interest rates.

Boosting federal revenues as of FY19 are the GST on legalized cannabis sales and the federal government’s share of an excise tax on cannabis (levied at \$1/gram or 10% of the producer price) which will be set at 25% for the next two years, to a \$100 million annual maximum, with remainder to the Provinces and Territories. Federal coffers also will benefit from GST collected on pan-Canadian carbon prices and the tax changes for Canadian Controlled Private Corporations (CCPCs). The Parliamentary Budget Officer estimates that changes on the taxation of passive income held in Canadian Controlled Private Corporations could raise annual revenues by up to \$1 billion over the first two years, an estimate that may prove low, even after the final details, expected in this Budget.

ELEVATED UNCERTAINTY AND SLOWING GROWTH LIE AHEAD

With Canada’s output growth now closed and the Bank of Canada gradually unwinding the post-recession monetary accommodation, our forecast of Canada’s nominal GDP growth slows from an estimated 5.1% in 2017 to less than 4.0% from 2020 to 2022. Entering the next decade, Ottawa must adjust to a significantly weaker revenue profile.

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Finance Canada Deficit Forecasts ex Adjustment for Risk, \$ billions

	Budget <u>2016</u>	Budget <u>2017</u>	Fall Update <u>2017</u>
FY17	-23.4	-23.0	-17.8*
FY18	-23.0	-25.5	-18.4
FY19	-16.8	-24.4	-15.6
FY20	-11.7	-20.4	-14.3
FY21	-8.3	-18.7	-13.8
FY22	n.a.	-15.8	-10.9
FY23	n.a.	n.a.	-9.5

* Final. Source: Finance Canada.

LIKELY MEASURES

The gender focus of this *Budget* is likely to involve multiple issues such as pay equity; enhanced capital access and other support for female entrepreneurs; and paternity leave for fathers and non-birthing parents to better accommodate mothers' career objectives. Improving early learning and available, affordable child care received an additional \$0.5 billion for FY18 in *Budget 2016* and, in *Budget 2017*, a further \$7 billion over ten years beginning in FY19, partnering with the Provinces and Territories.

Services for Indigenous peoples remains a priority, with details possible on longer-term housing funds to be directly distributed to each community, following \$225 million in *Budget 2016* for off-reserve housing needs.

The government remains focused on innovation. This *Budget* could present several new initiatives or a more comprehensive restructuring of the current federal programs that total roughly \$5 billion, including the \$3 billion *Scientific Research and Experimental Development* tax credits. An advisory panel on Canadian research led by David Naylor presents a renewed framework for basic research with enhanced coordination, performance metrics and funding.

On trade, an overview of Canada's multiple current initiatives is expected, but no specific new responses. As a small, trade-dependent nation, it is important to signal that Canada remains competitive and open to expanded economic ties with nations around the world

Skills development is likely to receive further attention, with adult retraining a possible area given the rapid technological changes expected over the next decade. The Working Income Tax Benefit to assist lower-income workers and encourage work force participation was enhanced in the *Fall Statement* and could receive further attention.

Building up Canada's cyber defences may prompt an announced investment of up to \$1 billion that would cover updating the *National Cyber Security Strategy*, training and retaining cyber talent, and drawing domestic cyber innovators from the private sector to develop made-in-Canada solutions.

On the environment, apart from the considerable effort now directed towards implementing a pan-Canadian carbon price, expanded land and water conservation may be introduced. With respect to infrastructure, a re-profiling of the Phase 1 and 2 federal funding is likely to be presented. Green infrastructure projects remain scheduled, but have a limited impact on overall infrastructure spending,

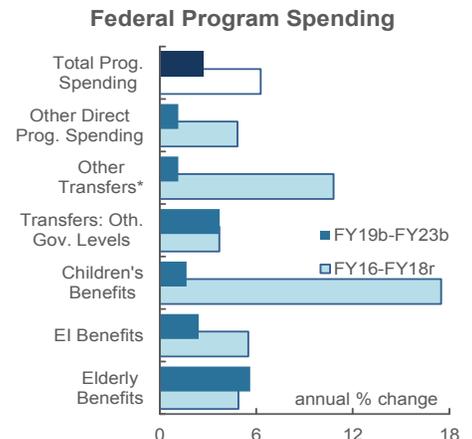
Additional attention to consumer protection is anticipated, and any proposal may relate to several industries, including financial services and telecommunications.

LESS LIKELY MEASURES

A substantive response to the recent US corporate and personal tax reform is not expected in this *Budget* as Ottawa awaits further details of the domestic and international tax reforms and their impact. Through 2019, the Canadian economy is expected to benefit from the near-term boost in US investment and growth. However the US tax reform removes Canada's prior advantage in statutory corporate income tax rates and the Marginal Effective Tax Rate on capital, arguing for a detailed reassessment of Canada's overall competitiveness in attracting and retaining business activity going forward.

Among the measures proposed to Ottawa, but not expected in this *Budget* is broadening the GST/HST to digital product purchases from suppliers operating outside of Canada. This would level the playing field with domestic digital providers who must charge GST/HST ranging from 5% to 15% on their services. A national pharmacare program is likely deferred to a future budget. On issues discussed but not resolved, one example relates to Canada's airports with the expiry of their long-term leases beginning with several major cities over the next two years.

It is very possible that the federal measures most evident to the Canadian public over the next year will reflect progress on the initiatives announced during the first half of the Liberals' term. Examples include the Smart Cities Challenge, proceeding with the selected industry superclusters and work on Phase 1 of the infrastructure plan.



* Included in direct program spending for infrastructure and other cost-sharing programs.
Source: Finance Canada, *Fall Statement 2017*.

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