



Federal Fall Economic Statement: Larger deficits but fiscal path still sustainable

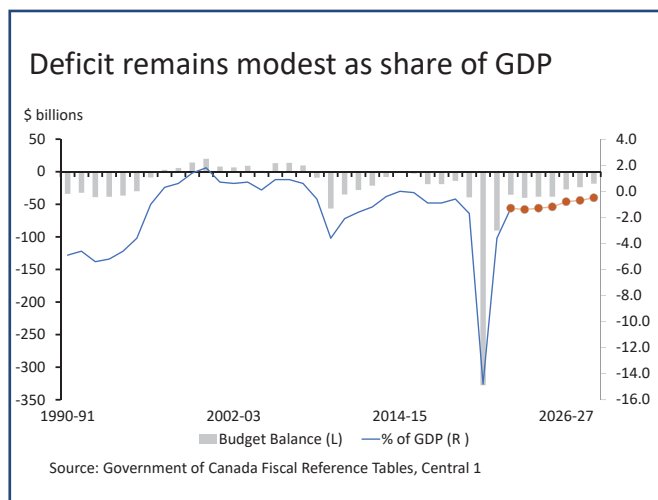
Against the backdrop of slowing economic conditions in 2024, the federal government has showed few signs of restraint with the release of the Fall Economic Statement (its non-budget, mini budget), adding modestly to funding allocated to tackle Canada's housing crisis.

Despite a stronger than expected fiscal position in 2022-23 due to higher tax revenue, there were no savings to be found going forward. The federal budget deficit for 2023-24 is expected to remain in line with Budget 2023 at \$40 billion. However, projected deficits inclusive of announcements made with the FES and in prior months, shifting economic conditions and higher interest costs, have lifted deficits for the foreseeable future relative to Budget 2023. While falling to about \$38 billion in 2023-24 and 2024-25 and down to \$23.1 billion by 2027-28, deficits from FY 2025-26 to 2027-28 are about \$10 billion above Budget 2023. The deficit is projected to be \$18.4 billion in 2028-29. That said, government priorities and spending initiatives will change, and Budget 2024 is likely to introduce new spending measures.

Deficits as a share of nominal GDP, the deficit peaks at 1.4 per cent in the current fiscal year and slips to 1.3 per cent next year. The government projects a declining trend in the deficit-to-GDP ratio, but it is not eliminated through the projection period. While the dollar value of deficits seems large, relative deficits are still moderate and well below the levels observed in the mid-1990s.

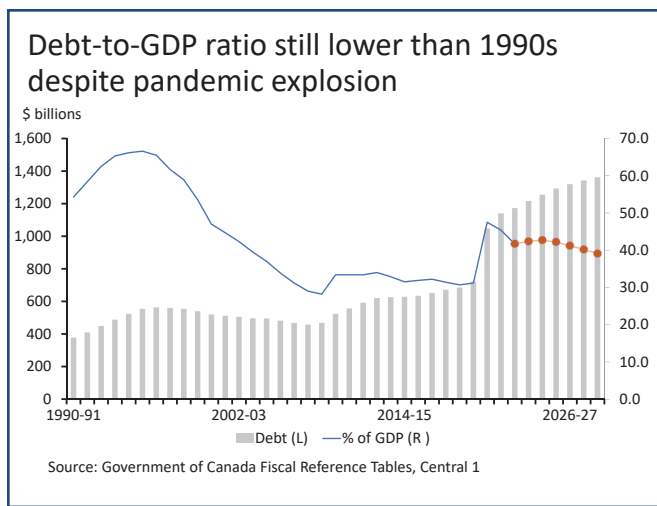
Debt has ballooned during the pandemic and continues to rise. On a nominal basis, the debt reaches \$1.2 trillion this fiscal year and is nearly double the pre-pandemic level. As a share of GDP, debt peaks at 42.7 per cent in 2024-25 but remains above 40 per cent through 2027-28, before moving slightly below. This is 10 per cent above pre-pandemic levels but well below the 1990s when levels had shot to over 60 per cent. High debt introduces more risk from higher interest rates, but even as public debt charges are expected to climb from \$46.5 billion to \$60 billion by 2028-29, this is about 1.7 per cent of GDP which is sustainable, and well below the 6.5 per cent observed during the debt bulge of the 1990s.

It is key that projected deficit growth and debt relative to GDP will decline suggesting sustainability of the fiscal situation and better than peer countries. That said, this will depend on future spending announcements, interest rate trends, and economic path.



Deficits rise on deteriorating economic conditions and increased spending

The federal government's increasing budget deficit reflects a combination of deteriorating economic conditions and spending initiatives. On the revenue front, income tax revenue is more than \$1 billion below Budget 2023 projections annually through 2026-27. This deterioration reflects economic growth and income forecasts which were revised lower. Economic forecasts align to private-sector consensus for the purpose of budget transparency.



The economic baseline is unsurprisingly weaker than projected in Budget 2023 reflecting interest rate hikes and stagnant economic trends. Real GDP growth was revised lower to 1.1 per cent in 2023 and 0.4 per cent in 2024, albeit without a technical recession. Growth is forecast to rebound above 2.2 per cent thereafter, although this may be optimistic. Due to the lower front-end growth, nominal GDP is below Budget 2023 projection through the forecast period. Revenues are projected to increase in areas related to federal loans to crown corporation. Policies related to elimination of GST on rental construction, tax deduction policy on short-term rentals, and loan funding also factor into the patterns.

Budget expenses revised up from 2025-26 onwards

On the expenditure side, the federal government showed no signs of restraint on spending but did bend the curve potentially on rate of growth with few new measures expense measures announced. That said, this piggy-backed on policies announced prior to the FES. Expense growth largely emerges in 2025-26 onwards with pension costs and benefits, wage growth and refundable tax credits. The 2023-24 figures are lower revised lower due to recoveries of overpayment in COVID income supports.

Interest bite is also rising as high debt and rates drive increased public debt charges of more than \$5 billion above Budget 2023 baseline in the coming two fiscal years.

Policy measures

FES 2023 was light, as it should be as an update, but the government remained geared to focusing on Canada's housing crisis. The latest policy announcement was an additional \$15 billion in new loan funding, starting in 2025-26, for the Apartment Construction Loan Program, bringing the program's total to over \$40 billion in loan funding. This is to support an additional 30,000 units, albeit still a drop in the proverbial housing bucket. An additional \$1 billion was committed to the Affordable Housing Fund, to support co-op, non-profit and public housing. This adds to the previous policy announcement to eliminate GST on rental construction.

Adding to the wave of announcements from various governments to try to "unlock" housing for long-term use, the government announced tax measures for short-term rentals. Specifically, it looks to eliminate income tax deduction on short-term rental income, including interest expense, in areas that prohibit short-term rentals. This will be interesting to see how it will be enforced. This would apply to all expenses as of January 1, 2024.

For financial institutions, there were several noteworthy announcements that do not impact federal fiscal performance. This includes open banking, and the intent to *introduce legislation through Budget 2024 to establish a consumer-driven banking framework that would regulate access to financial data. This framework will ensure that Canadians and small businesses have safe and secure access to financial services and products that help them manage and improve their finances.*

There is also an intent to amend the *Canadian Payments Act to expand membership eligibility in Payments Canada to payment service providers supervised by the Bank of Canada, credit union locals that are members of a credit union central, and operators of designated clearing houses.*

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