

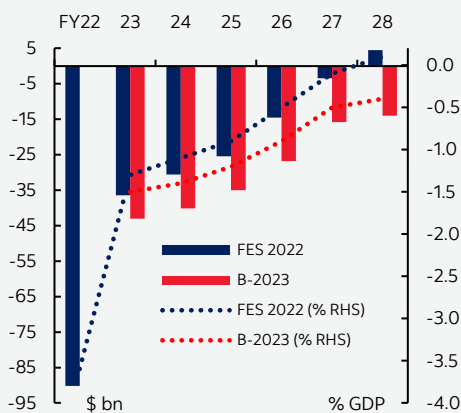
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Chart 1

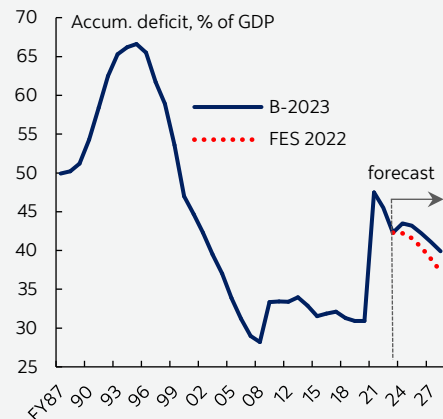
Federal Budget Balance



Sources: Scotiabank Economics, Finance Canada.

Chart 2

Federal Net Debt



Sources: Scotiabank Economics, Finance Canada.

# Canada’s Federal 2023 Budget

## STEPPING UP TO THE PLATE ON THE GREEN TRANSITION (AND COVERING ALL BASES)

- Canada’s Federal Budget 2023 delivers *mostly* against expectations as priorities were well-channeled ahead of its March 28th release and readied markets for another fiscally expansive plan.
- Gross new spending measures tally \$67 bn over the planning horizon through FY28, including \$21 bn in “clean economy” investments, \$31 bn for healthcare (most announced earlier but with some cost inflation), a \$9 bn catch-all category, and \$3.2 bn in near-term affordability measures.
- Revenue-raising measures in the budget are material: \$12 bn in additional targeted tax measures—including a change to dividend taxation for financial institutions—along with a somewhat opaque \$12.7 bn in government savings and reallocations in outer years. These render *net* new spending lower at \$46 bn in Budget 2023.
- Unlike recent updates, a weakening economic outlook adds another \$26 bn in fiscal needs over the horizon. Folding in new budgetary measures, the net impact amounts to a \$69 bn deterioration in the bottom line relative to earlier projections.
- The fiscal balance is still projected to decline over the horizon, albeit at a slower pace, from -1.5% of GDP in FY23 to -0.4% of GDP in FY28 (chart 1). Net debt trends downward over the medium term, but is expected to temporarily breach the government’s soft fiscal anchor this year owing to weak output (chart 2).
- Two signature initiatives are new refundable investment tax credits for clean manufacturing industries and clean electricity (30% and 15%, respectively). These are welcomed developments that should go some way in addressing anemic investment within strategic sectors and put Canada on stronger footing vis-à-vis the US.
- Near-term demand measures in the order of \$3.2 bn are well-targeted, but are additive to a host of other supports already in the system, which, cumulatively don’t make the Bank of Canada’s job any easier as it tries to steer inflation back to target against a range of upside risks.
- Nevertheless, the budget will be digested in a volatile market environment where exogenous factors are mostly carrying the day. Continued federal fiscal activism is largely anticipated and Canada’s relative debt advantage should still be intact when the dust settles.

## A COUPLE OF LEFT-FIELDERS

**Canada’s federal Finance Minister delivers another budget amidst heightened uncertainty.** The baseline economic projections underpinning this budget provide limited value. Despite pre-dating recent financial market turmoil, it reflects persistent bearishness on economic resilience, while underestimating inflationary pressures (table 1). Projections for real and nominal growth this year are 0.3% and 0.9%, respectively. This leaves room for some potential upside (and this budget includes such a scenario), but clearly a downside scenario is not far-fetched.

**The budget delivers a fresh round of spending (and then some) mostly channeled ahead of budget day.** Gross new spending measures amount to \$67.2 bn through FY28, offset by \$21.6 bn in revenue-raising measures, for net new measures of \$45.6 bn. A deteriorating economic outlook further weighs on the outlook in the order of \$26.1 bn yielding a net budgetary impact of \$68.9 bn (table 2). This is expected to drive a modestly

looser fiscal path over the horizon relative to earlier projections, with a -1.5% deficit in FY23 declining to -0.4% of GDP by FY28. This would keep net federal debt on a downward *over time* (from 42.2% of GDP in FY23 to 39.9% of GDP by FY28), but not before breaching its own soft fiscal anchor with a near-term uptick this year (to 43.4% of GDP) owing to weaker expected growth.

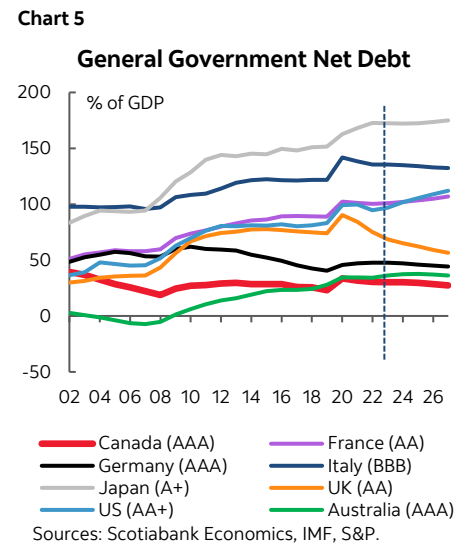
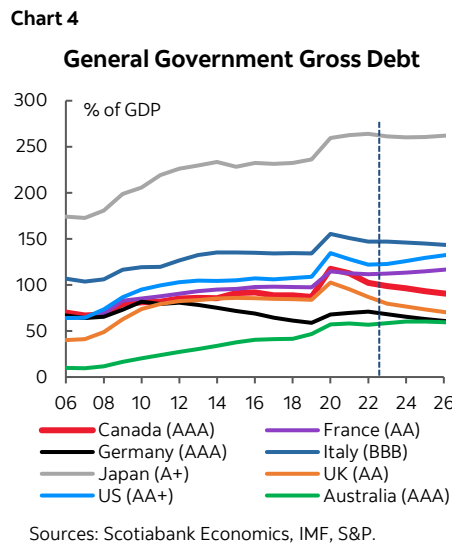
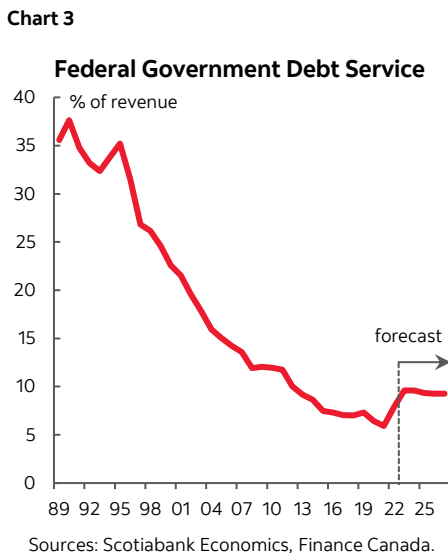
**Key thrusts of the budget were widely reportedly ahead of Tuesday’s release.** A “clean economy” is the centerpiece with \$21 bn in new spending, notably refundable investment tax credits for green manufacturing (30%) and clean electricity (15%). Healthcare measures are mostly expected though surprise on the upside as dental costing doubles bringing total new health-related spending to \$31 bn. Targeted affordability measures are costed at \$3.2 bn, mostly via a one-time Grocery Rebate. A residual \$9 bn ticks off boxes in a wide range of other areas.

**Revenue-side measures may raise some eyebrows.** New tax measures raise \$11.6 bn over the horizon, mostly delivering on earlier commitments (an Alternative Minimum Tax for high-income Canadians; a Global Minimum Tax for multinational corporations; a tax on share buybacks), while expanding an earlier one: changing the tax treatment of dividends received on Canadian shares held by financial institutions that is expected to yield \$3.15 bn over five years starting in FY25 (and \$790 mn ongoing). The government also tables an opaque \$12.7 bn in government savings involving a combination of savings on travel and consultants (\$7.1 bn) and reallocation of existing spending but with no discernable impact on operating costs relative to the Fall outlook (flat), while program expenses increase by \$42 bn expenditures over this horizon relative to earlier projections.

**Major new investments in the “clean economy” should help enhance Canada’s growth potential over the medium term.** It is not likely enough to alter our growth outlook this year or next (though clearly there are sector-specific implications in this budget overall), particularly as pervasive uncertainty is working in the opposite direction and implementation will lag,

Table 1: Evolution of Economic Assumptions			
%	2022e	2023	2024
<b>Real GDP</b>			
Budget 2023	3.4	0.3	1.5
EFU 2022	3.2	0.7	1.9
Scotia Econ. (Mar. '23)	3.4	0.7	1.5
<b>Nominal GDP</b>			
Budget 2023	11.0	0.9	3.6
EFU 2022	11.8	2.6	3.7
Scotia Econ. (Mar. '23)	11.0	3.3	3.6
<b>Nominal GDP (bns)</b>			
Budget 2023	2,785	2,810	2,910
EFU 2022	2,787	2,859	2,965
Scotia Econ. (Mar. '23)	2,785	2,877	2,980
<b>Unemployment rate</b>			
Budget 2023	5.3	5.8	6.2
EFU 2022	5.4	6.1	6.2
Scotia Econ. (Mar. '23)	5.3	5.4	5.9
<b>CPI</b>			
Budget 2023	6.8	3.5	2.1
EFU 2022	6.8	3.5	2.1
Scotia Econ. (Mar. '23)	6.8	4.2	2.1
<b>3-month T-bill</b>			
Budget 2023	2.4	4.4	3.3
EFU 2022	2.2	3.6	2.8
Scotia Econ. (Mar. '23)	2.8	4.4	3.2
<b>10-Yr GoC Yield</b>			
Budget 2023	2.8	3.0	2.9
EFU 2022	2.8	3.1	2.8
Scotia Econ. (Mar. '23)	3.0	3.1	3.5
<b>WTI crude oil price (USD/bbl)</b>			
Budget 2023	94	81	81
EFU 2022	97	88	85
Scotia Econ. (Mar. '23)	94	85	76

Sources: Scotiabank Economics, Finance Canada.



March 28, 2023

but it should overall be viewed positively. Along with earlier-announced measures amounting to \$37 bn in the last two years, Budget 2023's \$21 bn should put Canada on firm footing with US policy measures in key sectors. (Further details on new spending are included in Box 1 and table 3.)

**Near-term demand-side measures won't make the Bank of Canada's job easier, but they likely represent a risk—not a revision—to its baseline.** Fiscal activism across all levels of government has been predictable, if not persistent. Budget announcements layer in about \$3.2 bn (0.1 % of GDP) in near-term support measures that are well-targeted, but are additive to a host of previously-announced federal and provincial measures that are likely closer to 0.5% of GDP. This is likely already embedded in fiscal expectations for the most part. While acknowledging inflation is not exclusively a Canadian phenomenon, continued household supports will likely keep the Bank of Canada guarded against premature policy loosening absent a substantially worse-than-warranted deterioration in the economic outlook as demand sits above capacity.

**The government looks to markets to finance the new plan.** Borrowing requirements for FY24 are estimated at \$421 bn (85% reflecting refinancing needs) slightly higher than FY23 requirements of \$394 bn reflecting in the fall update. This includes \$172 bn in bond issuance versus \$185 bn issued in FY23, while increasing treasury stock. Though bond issuance will lighten up its pandemic-era long-term emphasis, 10-year and over issuance will still sit above historic levels), while canceling the 3-year sector. (Note, the incremental change in supply would be overwhelming offset by maturing government bond assets rolling of the Bank of Canada's balance sheet.) Otherwise, the debt management strategy signals some potentially big changes underway including a review of Canada Mortgage Bonds (with a view to consolidating them into regular borrowing and reinvesting savings in affordable housing programs, an area mostly absent in the budget) absent in the budget) and it continues to hold its cards close with respect to green bond issuance and an eventual sustainable bond framework.

**This budget will be digested in a volatile market environment where exogenous factors are mostly carrying the day.** Market uncertainty is underpinning demand for all risk-free securities even if relative rate paths and reserve currency status are driving differences within the global asset class. Earlier efforts to term out federal debt reduce some exposure to interest rate risk, but interest rate uncertainty over the medium term should caution against complacency despite relatively low debt servicing costs (chart 3). Nevertheless, Canada's relative debt advantage should still be intact when the dust settles. Today's budget, along with broad-based improvements in most provincial fiscal outlooks in recent weeks, should underpin a continued consolidation of general government finances—a claim few peers can make—when the IMF updates its comparative data next month (charts 4 & 5).

Table 2: Fiscal Projections

\$ billions	Projection						
	FY22	FY23	FY24	FY25	FY26	FY27	FY28
<b>Budgetary Balance - Economic &amp; Fiscal Developments and Policy Actions</b>							
Budget 2022 budgetary balance	-90.2	-36.4	-30.6	-25.4	-14.5	-3.4	4.5
% of GDP	-5.8	-2.2	-1.6	-1.0	-0.8	-0.4	
Economic & fiscal developments		6.4	-4.7	-4.9	-5.1	-7.5	-10.3
Policy actions since FES 2022		-5.4	0.7	3.2	2.6	1.7	0.1
New measures in FES 2022		-7.6	-5.3	-7.8	-10.0	-6.6	-8.3
<b>Budget 2023 budgetary balance</b>	<b>-90.2</b>	<b>-43.0</b>	<b>-40.1</b>	<b>-35.0</b>	<b>-26.8</b>	<b>-15.8</b>	<b>-14.0</b>
% of GDP	-3.6	-1.5	-1.4	-1.2	-0.9	-0.5	-0.4
<b>Budgetary Balance - Summary of Transactions</b>							
Budgetary revenues	413.3	437.3	456.8	478.5	498.4	521.8	542.8
Program expenses, excl. actuarial losses	468.8	435.9	446.6	463.3	475.9	489.2	505.4
Public debt charges	24.5	34.5	43.9	46.0	46.6	48.3	50.3
Net actuarial losses	-10.2	-9.8	-6.4	-4.2	-2.8	0	-1.1
<b>Budget 2023 budgetary balance</b>	<b>-90.2</b>	<b>-43.0</b>	<b>-40.1</b>	<b>-35.0</b>	<b>-26.8</b>	<b>-15.8</b>	<b>-14.0</b>
<b>Federal Net Debt (accumulated deficit)</b>							
EFU 2022 net federal debt	1135	1177	1208	1233	1248	1251	1247
% of GDP	45.5	42.3	42.2	41.6	40.4	38.9	37.3
<b>Budget 2023 net federal debt</b>	<b>1135</b>	<b>1181</b>	<b>1221</b>	<b>1256</b>	<b>1283</b>	<b>1298</b>	<b>1313</b>
% of GDP	45.5	42.3	43.5	43.2	42.2	41.1	39.9

Sources: Scotiabank Economics, Finance Canada.

### Canada has stepped up to the plate on the green transition, now it has to hit a homerun.

Implementation is key and the feds have their work cut out for them against a complex policy, regulatory and constitutional landscape. Meanwhile, other longer term policy challenges are mostly punted to another day (and another mandate). Notions of fiscal restraint are mostly farcical with a patchwork approach to revenue-raising measures to support ever-growing expenses, while the government breaches its own soft anchor in a baseline scenario as growth moderates no longer preserving this escape clause for a more serious deterioration in the outlook. The government needs to shift from fiscal restraint to fiscal reform if it wants to keep hitting homeruns even as the economy slows.

**Table 3: Key Budget Measures**

\$ billions	6-yr total
<b>Spending measures</b>	<b>67.2</b>
<b>Affordability</b>	<b>5.2</b>
Grocery rebate	2.5
Student affordability	0.8
Indigenous housing	1.9
<b>Healthcare</b>	<b>31.3</b>
Healthcare transfers	22.4
Dental care	- 13.0
<i>less provisions</i>	6.0
<b>Clean economy</b>	<b>20.9</b>
Investment tax credit for clean electricity	6.3
Investment tax credit for clean tech manufacturing	4.5
Investment tax credit for clean hydrogen	5.6
Enhancing CCUS investment tax credit	0.5
Canada Labour transfer agreements	0.6
Transportation & infrastructure	0.9
Tomorrow's technologies	0.8
<b>Reconciliation &amp; communities</b>	<b>9.1</b>
<b>Global leadership</b>	<b>0.7</b>
Defense spending (before offsetting provisions in fiscal framework)	3.5
<b>Revenue measures</b>	<b>-21.5</b>
Effective government	12.7
Taxation	11.6
Minimum tax on wealthiest	3.0
Global Minimum Tax	5.1
Tax on share buyback (\$2.1 bn provisioned)	2.5
Taxation of dividends received by financial institutions (\$0.6 bn provisioned)	3.7

Sources: Scotiabank Economics, Finance Canada. List of measures not exhaustive.

**BOX 1: BUDGET WINNERS**

**A “clean economy” is the budget’s centrepiece.** Signature initiatives are a new 30% refundable tax credit for green manufacturing investments in machinery and equipment (\$4.3 bn) along with a 15% refundable investment tax credit for clean electricity (\$6.3 bn) that both taxable and non-taxable entities (including Crown- and publicly-owned entities) would be eligible. These are broadly calibrated to similar measures under the US Inflation Reduction Act both in terms of the maximum level of the credit, along with labour and apprenticeship conditions though focus on investment versus production incentivise. These investments reflect an important follow-through to last Fall’s acknowledgement of Canada’s abysmal productivity, suppressed in part by a lagging investment landscape. It should dually address competitiveness concerns—a long with earlier-announced investment tax incentives—while boosting growth potential over the long run.

**Healthcare investments are largely contained to earlier-announced measures, but with inflationary costing.** The \$198 bn for provinces over ten years announced in earlier February works out to \$22.2 bn in incremental funding through FY28. The budget also announces a new dental care plan, as expected, expanding coverage from children to all uninsured Canadians with household incomes below \$90k. The costs has more than doubled—from an earlier-provisioned \$5.9 bn over five years to \$13 bn (and \$4.4 bn on-going—to be administered by a third-party benefits administrator. This adds a fairly substantial structural cost to federal finances with minimal consideration of trade-offs, including NDP’s pharma care pitch that doesn’t make the budget cut again. Overall, healthcare investments in this budget should stem some of the bleed from Canada’s patchwork healthcare systems, but are unlikely to tackle root causes (though cross-country data will be a start). Structural adjustments to long term healthcare funding sustainability are punted down the road (and potentially exacerbated as provinces start rolling out tax cuts).

**The budget also delivers additional affordability measures as expected.** A new “grocery rebate” will provide \$2.5 bn in FY23 delivered through the existing GST rebate program which is income-tested but otherwise unconditional. It would work out to about \$467 per low-income household with children. There is another \$814 k in near-term relief for students with a 40% increase in grants and interest-rate relief. Housing measures are folded into the affordability chapter, with \$4 bn towards Indigenous housing, but otherwise no major new measures announced. While not minimizing the cost of living pressures facing many Canadians, the budget fails to move on more enduring support, for example, supporting greater supply of social housing in light of elevated shelter costs that are likely to remain unaffordable for vulnerable Canadians even after general price appreciation subsides.

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