Canada's Federal Elections 2019

- **In a highly divided vote, Justin Trudeau's Liberal Party was narrowly elected to lead a minority government last night.**
- **The Liberals courted the "middle-class" voter with a $31 billion spending package over its next mandate. A parliamentary alliance—formal or otherwise—will likely put upward pressure on the final tab as compromises are negotiated.**
- **Nevertheless, deficits will not significantly exceed 1% of GDP. Markets will continue to shrug off modest deficits as debt-to-GDP continues to decline.**
- **Beyond a very modest near-term boost to consumption, broader economic impacts are expected to be minimal.**

DÉJÀ VU DEFICITS

The Liberal Party will lead Canada's 43rd Parliament after a tight race. Failing to capture a majority with only 157 seats, the Liberals now face the challenge of building sufficient Parliamentary support to maintain confidence of the House. At a minimum, a parliamentary alliance with the New Democratic Party (NDP) is a most likely outcome. Meanwhile, the Conservative Party of Canada will sit in opposition, trailing the Liberals with 121 seats but winning the popular vote (table 1).

Household affordability was the dominant theme across all parties. The message resonated well with voters as Canadian households grapple with high debt levels despite a more dovish interest rate path and strong job and wage growth. The Liberals shift part of this burden onto the federal government's balance sheet with a platform courting "middle class" voters at net cost of $31 bn over the four-year mandate.

Consequently, deficit spending will continue, albeit at still modest levels. Net new spending investments and tax cuts will ramp up from about $4 bn next year (FY21) to $9 bn by FY24. This is in addition to modest deficits already projected over the horizon heading into the elections (chart 1). The deficit should peak at about 1.2% of GDP next year before declining modestly over the mandate to about 0.8% of GDP—or double what it would have been absent new spending.

A TETHER AGAINST ERRATIC WINDS

A downward debt-to-GDP trajectory will remain the soft fiscal anchor. A tried-and-tested blueprint under the Liberal's first mandate, it was among the only predictable indicators of fiscal performance as revenue windfalls enabled a succession of new spending pledges. It also revealed, by and large, a fiscal ambivalence among voters and markets alike, particularly in light of the relatively small deficits (at less than 1% of GDP), a low net federal debt load, and the low interest rate environment. Absent a major downturn in the Canadian economy, this formula will likely persist (chart 2).

The new fiscal path will face upward pressures. Net new spending figures mask a much bigger pledge to new investments totaling almost $57 bn over four

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Table 1

2019 Federal Election Results

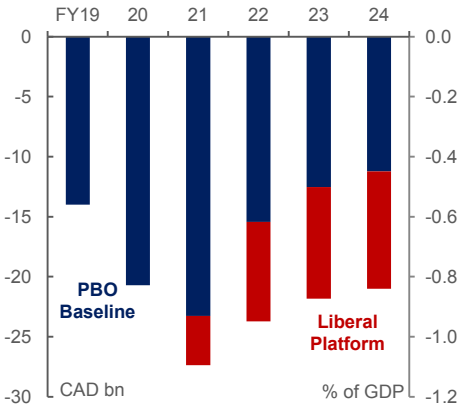
Party	Seats*	% Votes
LIB	157	33.1%
CON	121	34.4%
BQ	32	7.7%
NDP	24	15.9%
GRN	3	6.5%
IND	1	2.1%

*170 seats required for majority.

Source: Scotiabank Economics, Elections Canada.

Chart 1

Deficits to Continue



Sources: Scotiabank Economics, PBO, Liberal Platform.

years, against more tenuous revenue-generating proposals tallying about $26 bn (chart 3). New spending proposals for the most part are prescriptive and precise, whereas revenue measures embed a high degree of uncertainty. For example, the costing of corporate and wealth tax measures, comprising almost 50% of expected savings, likely underestimates behaviourial impacts. A new spending review is also expected to yield 40% of savings, however these exercises are notoriously protracted and contentious, even in a majority government context.

Big ticket items pivotal in garnering broader political support are also noticeably absent. The Liberal platform provides a 'down-payment' towards universal pharmacare in the order of $1.75 bn per year against the NDP's pledge of over $10 bn per year. New investments in a green transition under the Liberal platform are also relatively modest—at less than 7% of new commitments (or $1 bn per year)—and less than a third of those pledged under the NDP platform. With the NDP pledging new annual spending of about $30 bn per year (with equally steep revenue measures), there will be no lack of pressure to spend in an alliance.

On the other hand, there could be some positive offsets to the budget balance. Finance Canada's most recent fiscal projections (Budget 2019) are more modest than the Parliamentary Budget Officer (PBO) baseline projections in June. Since then, the 2018–19 Annual Financial Results confirmed exceptionally strong fiscal revenue performance last year despite a weakening economy. The final budget balance came about a billion under forecast—at minus $14 bn—even after taking into account a $5.9 bn windfall that was redirected towards new spending in Budget 2019.

KEEPING THE CONSUMER ALIVE AND WELL

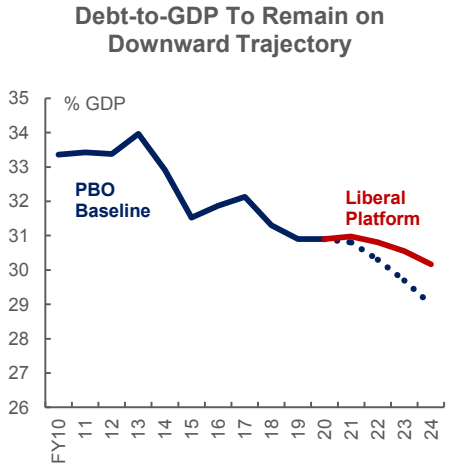
New spending measures will line the pockets of consumers. A personal tax cut for low-to-middle income Canadians (through an increase in the basic personal amount phased out at higher incomes) comprises a third of new spending. Another 40% will take the form of transfers to individuals and households with a similarly high propensity to spend: seniors, families with kids under one and/or in childcare, veterans, the disabled, and the sick. This will provide an admittedly small and transitory, but positive boost to consumption in the near term against the backdrop of a slowing economy and high external risks.

A largely stay-the-course approach to housing markets can be anticipated. In the midst of elections, the Liberal's modified their First-Time Home Buyer Incentive by increasing the maximum eligible home price in Toronto, Vancouver, and Victoria for the interest-free loan. This was more or less a design correction to better reflect home prices in these markets (chart 5). This can reasonably be expected to put further upward pressure on home prices locally against the backdrop of a broad-based market rally as Canadian home sales continue a seven-month streak of gains. The vacancy tax will create a nuisance for mobile homeowners and will generate a modest revenue source for the government, but it is unlikely to have broader economic impacts. Otherwise, the leading party has so far resisted broader measures pitched by other parties that would further fuel price escalation. An NDP alliance would put welcomed pressure on accelerating supply side solutions but its broad-based foreign buyer's tax proposal warrants caution.

A BARK LOUDER THAN THE BITE

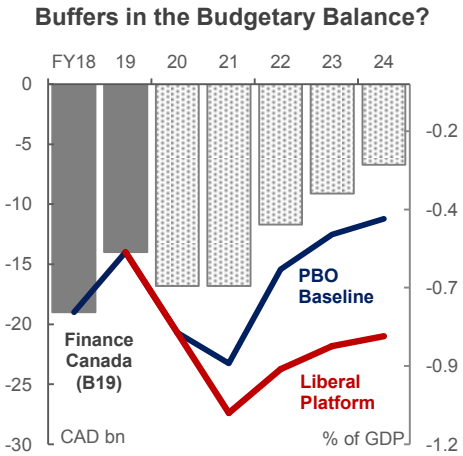
There is little by way of productivity-enhancing investments in the pipeline. Instead, much like other party platforms, Liberal rhetoric took a more punitive tone

Chart 2



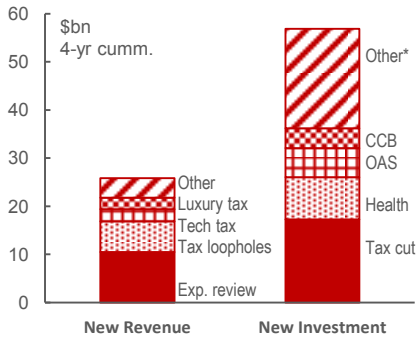
Sources: Scotiabank Economics, PBO, Liberal platform.

Chart 3



Sources: Scotiabank Economics, Finance Canada (*$3b risk factor excluded), PBO, Liberal Platform.

Chart 4



Sources: Scotiabank Economics, PBO, Liberal platform.
** 44 'other' investment commitments.*

towards corporations "paying their fair share". They expect to close corporate tax loopholes, tax multinational tech giants, and impose a luxury tax among other targeted measures. While details are scant, the international tax agenda is already (slowly) approaching consensus in areas related to base erosion, profit- and debt-shifting, and digital taxation. Canada at best will be a policy-taker in these areas, while international spillovers render fiscal revenue projections highly uncertain directionally, let alone in magnitude.

Concerns around tax planning miss the mark. The large and growing wedge between Canada's personal and corporate tax regimes, along with an increasingly complex architecture, create incentives for arbitrage. Furthermore, the interplay between the federal, provincial, and municipal tax regimes, as well as an evolving international tax landscape, underscore the criticality of a comprehensive tax review in Canada. A piecemeal approach has a high risk of creating unintended consequences, including undermining stronger growth that could eventually better support redistributive policies.

Ultimately business can expect a rather benign environment with respect to growth. While it is a missed opportunity to advance Canada's competitiveness and productivity agenda, new policy directions are unlikely to have major macroeconomic impacts on the economy though specific sectors may come under pressure including telecom and luxury markets. One caveat to watch will be the negotiations pertaining to pipeline capacity in Canada. While the Liberal government has maintained that Canada can advance tougher environmental standards alongside the construction of new pipelines—particularly the Trans Mountain Pipeline and its expansion project (TMEP) purchased by the federal government in mid-2018—the latter will face tough pushback from the NDP, which has taken a strong position opposing new pipelines and the TMEP specifically. In the end, the Liberal government will likely make (fiscal) concessions in other policy areas in efforts to advance Canada's pipeline interests. The sooner uncertainty can be resolved, the better.

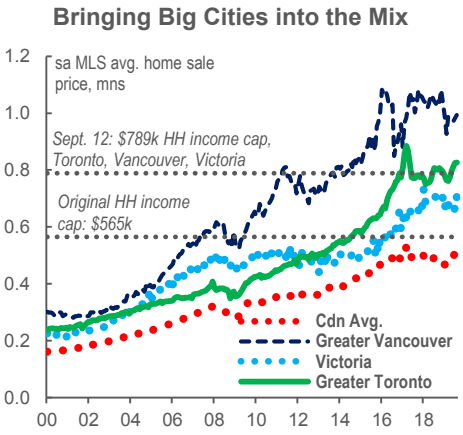
MARKETS WON'T SHOW STRIPES

Any near-term market impacts from election outcomes will quickly fade against broader global developments. Results will be digested into the same global markets that will be dealing with the aftermath and potential next steps in the Brexit saga, not to mention ongoing trade tensions and US impeachment developments. Furthermore, markets have a history of seeing through party stripes in the context of Canadian elections. In the immediate aftermath of elections, there is no discernable party bias in terms of the impact on the two year Canada yield (chart 6). The same holds for impacts on the Canadian dollar.

Markets will not price in further fiscal effects at present. A minority government context introduces a degree of fiscal uncertainty—that will increase the longer it takes to establish a credible governance path forward—which could have markets guardedly positioned toward the election outcome itself. It could take a while for the fuller effects to be priced, and implications will likely only be known once a budget is tabled.

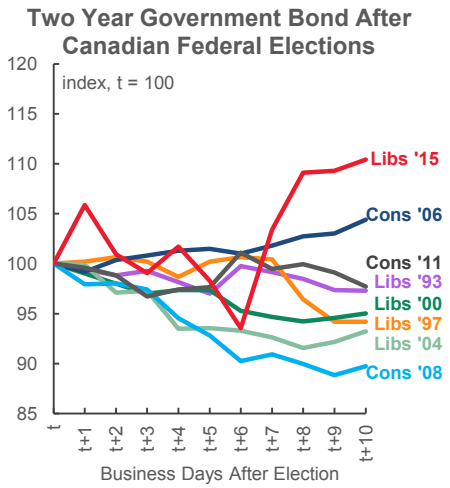
Canada will rest on its laurels for now. Its relative fiscal stance remains among the best in the world. Total debt across all levels of government after netting out financial assets amounted to about 27% by the end of last year. That positions Canada the best (or least worst) among peers and in some cases by a long shot (chart 7). Canada also continues to offer a significant yield pick-up relative to many other global debt markets and that likely dominates considerations in a reach-for-yield market environment.

Chart 5



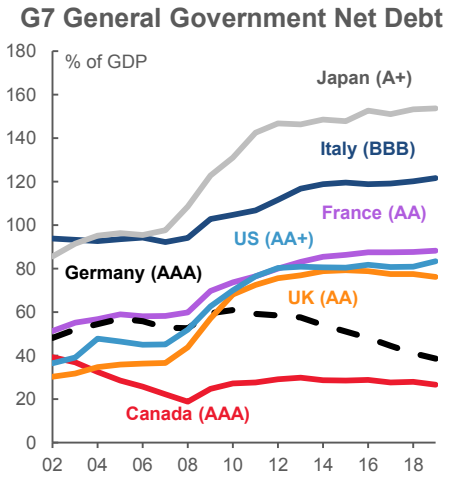
Sources: Scotiabank Economics, CREA, Finance Canada, CMHC.

Chart 6



Sources: Scotiabank Economics, Bloomberg.

Chart 7



Sources: Scotiabank Economics, IMF, S&P.