

Canadian Federal: 2017–18 Final Results

ACCOUNTING CHANGES DON'T ALTER BUDGET PICTURE, FOR NOW

SUMMARY

- **The Government of Canada published its *Annual Financial Report and Public Accounts* for the 2017–18 fiscal year (FY18) Friday.** Final FY18 results indicated a budgetary shortfall of 19.0 bn¹, in line with a revised FY17 deficit and slightly narrower than the restated 19.9 bn shortfall projected in the February 2018 budget (*Budget*) (table).
- **Accounting policy changes, implemented to align the Government's fiscal framework with industry practices, led to revisions of historical fiscal balance and debt figures.** Unfunded pension benefits are now discounted using actual bond yields in effect at year end, which reflect market expectations of future cash flows. The previous discounting methodology employed a 20-year weighted moving average of long-term Government of Canada bond rates, projected over time. Changes were applied retroactively.
- **Changes associated with the new accounting methodology:**
 - ◇ **Wider deficits were reported throughout FY09–17.** What had been the lone surplus during that period—the 1.9 bn reported in FY15—was reclassified as a 0.55 bn deficit. FY17 spending is 1.2 bn higher than previously reported—despite a 2.9 bn decrease in public debt costs—pushing the deficit up to 19 bn.
 - ◇ **The *Budget* deficit projection for FY18 was restated as 19.9 bn, 0.5 bn greater than the previous estimate (chart 1, p.2).** Upward revisions to program spending dominated lower debt charges.
 - ◇ **Net debt was revised higher from FY09 to FY17.** FY17 net debt of 734.1 bn exceeds the prior fiscal 2016–17 estimate by nearly 20 bn.
- **FY18 revenue details:**
 - ◇ **Total revenues were 20.1 bn higher than in FY17 and exceeded the restated *Budget* estimate by 4 bn.**
 - ◇ **Personal income tax receipts were 1.3 bn higher than rebased *Budget* projections and surpassed FY17 revenues by 9.9 bn.** This mirrors stronger-than-expected economic growth and diminished effects from tax planning in response to the higher marginal tax rates that took effect in 2016.
 - ◇ **Higher-than-expected net income from enterprise Crown corporations pushed other revenues 3.1 bn higher than *Budget* estimates.** The Government attributes this to the surge in personal

CONTACTS

Marc Desormeaux, Provincial Economist
 416.866.4733
 Scotiabank Economics
marc.desormeaux@scotiabank.com

Canada's Fiscal Results

CAD billions except where noted

	FY17	FY18	FY18
	Final*	Bud*	Final
Personal Income Tax (PIT)	143.7	152.3	153.6
Corporate Income Tax (CIT)	42.2	48.2	47.8
Other Tax Revenue	58.4	61.9	61.7
Total Tax Revenue	244.3	262.3	263.1
Employ. Insurance (EI) Premiums	22.1	20.6	21.1
Other Revenue	27.1	26.8	29.4
Total Revenue	293.5	309.6	313.6
Elderly Benefits	48.2	50.9	50.6
Employ. Insurance (EI) Benefits	20.7	20.1	19.7
Children's Benefits	22.1	23.4	23.4
Major Transfers to Persons	90.9	94.4	93.8
Transfers to Other Levels of Gov't	68.7	70.5	70.5
Direct Program Spending	131.6	142.5	146.4
Total Program Spending	291.2	307.4	310.7
Debt Service	21.2	22.1	21.9
Total Expenditure	312.5	329.5	332.6
Budget Balance	-19.0	-19.9	-19.0
Accumulated Deficit	651.5	**	671.3
Net Debt	734.1	**	758.8
Memo Items, %			
Tax Revenue / GDP	12.0	12.2	12.3
Total Revenue / GDP	14.4	14.4	14.6
Total Program Spending / GDP	14.3	14.3	14.5
Budget Balance / GDP	-0.9	-0.9	-0.9
Accumulated Deficit / GDP	32.0	**	31.3
Net Debt / GDP	36.1	**	35.4
Debt Service / Revenue	7.2	**	7.0

* Adjusted to reflect retroactive change in Government's discount rate methodology for unfunded pension benefit obligations. ** Data not available. Sources: Finance Canada; Statistics Canada; nominal GDP forecasts: Scotiabank Economics.

¹ All dollar figures in CAD unless otherwise indicated.

income tax receipts and one-time equity adjustments stemming from implementation of new International Financial Reporting Standards.

FY18 expenditure details:

- ◇ **Program expenses were \$3.3 billion higher than the restated Budget projection and 19.5 bn greater than in FY17.**
- ◇ **Direct program spending exceeded the Budget estimate by 3.9 bn.** This was attributed to higher-than-expected increases in provisions for claims and litigation.
- ◇ **Major transfers to persons were 0.6 bn lower than the rebased February forecast.** Elderly benefits fell 0.3 bn relative to projections, while the 0.4 bn fall in employment insurance payments likely reflects last year's labour market strength.
- ◇ **Public debt charges were \$0.2 billion weaker than expected in Budget.** The stock of interest-bearing debt was lower than the rebased February estimate, though a higher effective average interest rate drove a 0.7 bn rise in debt servicing costs versus FY17.

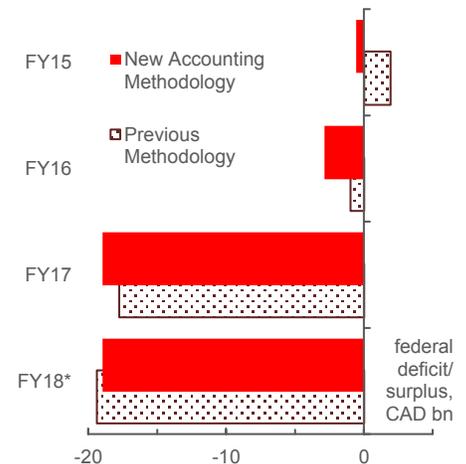
- **Respective accumulated deficit and net debt figures of 671.3 bn and 758.8 bn were reported for FY18.** Both results were higher than in FY17 but lower than the rebased FY18 estimates from the March 22, 2017 budget. The Government continued to tout its favourable fiscal position in relation to international peers, indicated by a 31.3% federal debt-to-GDP ratio in FY18 (chart 2).

IMPLICATIONS

- **Absent more information, our broad view of Canada's financial position is largely unchanged.** We still expect a return to black ink to become more challenging as economic growth slows, but the Federal government's relatively low net debt-to-GDP ratio implies solid fiscal balances at this time.
- **Discount rate methodology changes cloud the outlook somewhat.** The rates used for unfunded pension benefits under the new approach are lower than those employed previously, contributing to higher public pension obligations and interest-bearing debt. It remains to be seen how the new accounting policies will influence cost projections and resource allocation in future fiscal years.
- **We do not anticipate that the accounting changes will alter the Government's course in the Fall Economic Statement.** It appears increasingly likely that the Government will modify depreciation allowances for tax purposes to boost competitiveness following the US federal reforms that took effect in January. We expect this to be a highlight of the *Statement* to be released in the coming weeks.

Chart 1

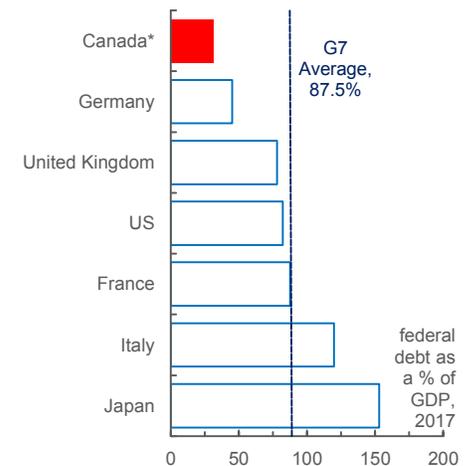
Adjustments to Historical Deficits



* Budget 2018 projection used for FY18 estimate under previous methodology. Sources: Scotiabank Economics, Finance Canada.

Chart 2

Canada's Fiscal Anchor



* FY18. Sources: Scotiabank Economics, Finance Canada, International Monetary Fund, *Fiscal Monitor* (April 2018).

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