

Canadian Federal Tax Cut for All (But a Few)

- Today, the federal government introduced its promised personal income tax cut for middle income Canadians.
- The measure will increase the basic personal amount that is exempt from taxes for 20 million Canadians.
- The cut will result in annual tax savings between \$300 and \$600 depending on household circumstances by the time it is fully implemented in 2023, while the highest earners will be ineligible.
- The measure will provide a modest and transitory bump to consumption, but insufficient (in magnitude or timing) to materially impact the economic outlook as it is phased in over the next four years.

NO SURPRISE

Canadians will get their tax cut as promised. Today, Finance Minister Morneau and the newly-created Minister of Middle Class Prosperity Fortier announced personal income tax cuts for all but the highest earners. As set out in the Liberal election platform commitment, the basic personal amount—which would otherwise sit at \$12,298 in 2020—will be increased to \$15,000 by 2023.

Households will pocket up to an additional \$600 annually. By Finance Canada's estimates, the average individual will save close to \$300 in taxes each year by 2023, while families and single-parents will save \$600 annually. The measure will apply fully to household incomes under \$150,473 (i.e., for those falling within the first three tax brackets). The benefit will be reduced for those in the next tax bracket (i.e., households earning between \$150,473 and \$214,368), while earners in the top tax bracket will be ineligible.

BIG COST, SMALL IMPACT

The tax cut should pump about \$25 bn back into the economy as the measure is phased in over the next 6 years. The impact in fiscal year 2020 will be modest as the measure begins to take effect only in calendar year 2020. In its first full year, the anticipated impact is in the order of \$3 bn (FY21), ramping up to about \$6 bn annually by FY25. As a percentage of GDP, it will be negligible this fiscal year and a rounding error the next few years in the range of 0.1–0.2 percent of GDP (chart 1).

It is hardly a targeted measure. While the measure focuses on Canada's "middle class", it captures 97% of tax filers. And of these 27 million Canadians, about 10% (or about 2.8 million) tax filers already fell below the federal tax threshold in 2017. According to Finance Canada, about 20 million Canadians will benefit from today's measure, including an additional 1.1 million that will no longer pay any taxes.

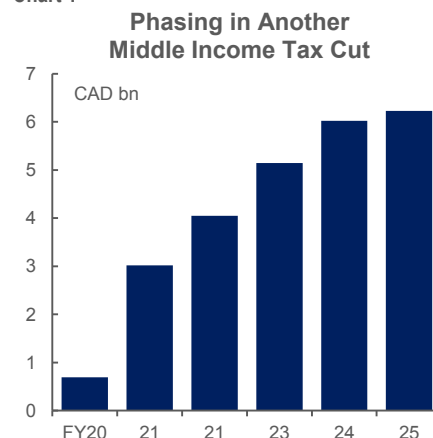
The measure will provide a small and transitory boost to growth at best.

Multipliers—or the ratio by which government spending prompts onward spending—will be small. Categorically, this measure likely falls closer to a broad-based personal income tax measure versus a targeted transfer to vulnerable households (table 1). If growth forecasts hold next year, the impact would almost be negligible. Even if growth cools substantially, the multiplier would still be relatively small. Across the 20 million Canadians affected by the measure, there would be some propensity to spend the windfall, particularly in light of prolonged

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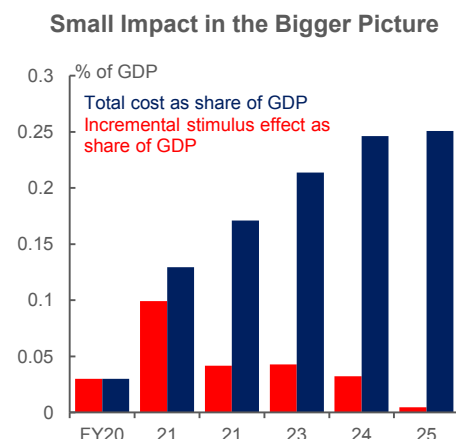
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Chart 1



Sources: Scotiabank Economics, Finance Canada..

Chart 2



Sources: Scotiabank Economics, Finance Canada..

Table 1				
Fiscal Multipliers: In Good Times and Bad				
% impact on real GDP	Recession (Budget 2009)		Growth (Budget 2016)	
	Yr 1	Yr 2	Yr 1	Yr 2
	FY10	FY11	FY17	FY18
Infrastructure investment	1.0	1.5	0.2	0.4
Housing investment	1.0	1.4	0.1	0.1
Measures for low-income households	0.8	1.5	0.2	0.4
Personal income tax measures	0.4	0.9	0	0
Corporate income tax measures	0.1	0.2	0	0

Source: Scotiabank Economics, Finance Canada.

affordability challenges and stretched balance sheets, but its impact will be weakened by the breadth of the cut.

Impacts will trickle in slowly. For payroll Canadians receiving a biweekly deposit, the measure amounts to a little more than \$20 per paycheck at the most that will flow with a modest lag later in 2020, while non-payroll employers will not see a boost until they file their taxes in the Spring of 2021.

This is not 2015. The Canadian economy benefited from a small boost to growth in the post-2015 election period as a package of measures took effect. The most significant was an annual boost in the order of \$5 bn in transfers to households with children that resulted in an average boost to consumption of about 3.5% (saar) in the six ensuing quarters before dropping off sharply (chart 3). Households with children are notorious for a high propensity to spend. Today's broad-based tax cuts will reach a diverse range of households reflected in the 20 million taxpayers affected by the cut. Only about 40% of Canada's 14 million households have children.

The impact will thus be relatively small and slow. Targeting middle income households will provide a welcomed backstop to consumption, but it will not likely shift the growth outlook, inflation expectations, or the policy rate path. Ultimately a resumption of business investment and activity will be required to durably shift expectations.

A MUCH ANTICIPATED FISCAL UPDATE

Today's announcement delivers a substantial component of the government's spending plans. The increase to the basic personal amount comprises about a third of new spending commitments under the Liberal platform. Other transfers to individuals—including seniors, students, veterans, and the disabled—will likely be laid out in a winter budget, with even smaller impacts on the macro economic outlook given the expected size.

The true costs of today's measures are contingent on the health of the economy. Recall, the post-2015 middle income tax cuts were expected to lead to revenue losses of a similar magnitude before an offset from top-bracket increases. In fact, while the individual tax burden fell, the number of taxpayers grew amidst a hot job market (chart 4). Consequently the impact on government finances was far smaller. So in a benign economic environment, there could be some upside to revenue risk for the federal government. On the other hand, if the economy takes a serious downturn, the tax measure will do little for those out of work.

Fiscal plans are unlikely to change substantively for now. The Liberals ran on a spending platform, reaffirmed in the recent Speech from the Throne with a commitment to "pursue a responsible fiscal plan to keep the economy strong and growing". We interpret this to mean that the government will continue to run modest deficits that maintain support across parties and regions, while staying under the radar of markets by keeping the deficits relatively low and the debt-to-GDP ratio on a declining path. This will provide a degree of constraint on spending pressures beyond the Liberal platform fiscal path (chart 5).

Otherwise, we can anticipate a check-in on the health of the government's balance sheets and its view on the outlook. Minister Morneau indicated that he will table a Fall statement before the holidays which will provide an update on the government's finances and the assumptions underpinning them. With mixed signals—ranging from robust fiscal revenues, to the recent boost in business investment, to weakness in the latest job numbers—an official Finance view will no doubt be welcomed. It can be expected to take on a cautious tone with an abundance of prudence built in at this stage given it will provide the fiscal baseline against which the entire mandate will be assessed.

Chart 3

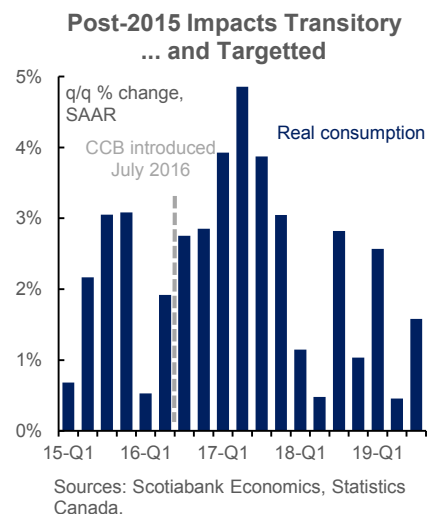


Chart 4

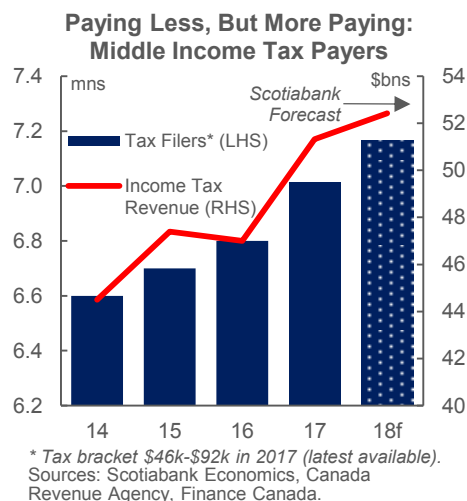
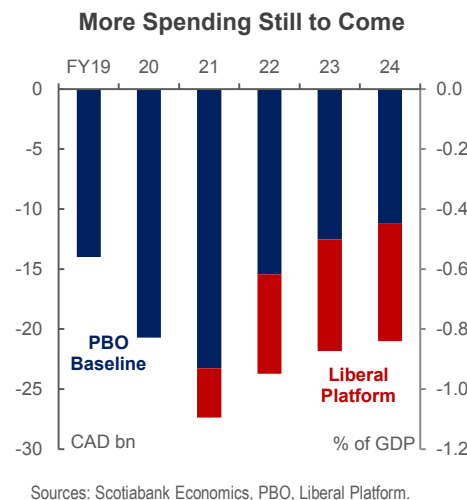


Chart 5



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