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Bigger, costlier government trains focus on housing crisis

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Summary

The 2024 federal budget arrives at a somewhat delicate time for Canada. While distorted by breakneck population gains, Canada's economy has sagged under the weight of restrictive monetary policy, pressuring the underlying revenue outlook. Labour markets have weakened; consumer confidence has faltered. So too has Canada's relative standard of living, which should make the nation's productivity 'problem' hard(er) for government to ignore. Notwithstanding welcome progress towards price stability, fiscal policy (including direct government spending) still has the potential to complicate the life of monetary policymakers, not just here in Canada. What's a government to do?

In seeking to respond to capacity issues caused by a surging population, Canada's federal government aims its 2024 budget squarely at housing. As a particular focus, new measures aim to galvanize new home construction, which it is hoped will ameliorate pronounced housing affordability concerns. Normalizing such an acute imbalance between housing demand and supply will take time, however. (As an aside: When it comes to balancing the housing market, we are more optimistic about the impact of the previously announced cut in non-permanent residents than in a prospective surge in residential construction activity.) Other budget measures—many pre-announced—focus on a school food program, mental health, child-care, student grants, disability benefits, indigenous-related initiatives, AI capacity and security/national defence (as global conflicts leave military budgets in greater focus). The full suite of measures is expansive. Former BoC Governor Poloz will chair a working group tasked with uncovering opportunities for Canada's large pension funds to invest more at home. Pursuant to a pre-existing Liberal-NDP supply and confidence agreement, the first steps towards a national pharmacare program have been taken.

When it comes to the fiscal framework, prior commitments on the deficit and debt mean incremental spending needs to be paid for with new revenue. Thus, high-income earners/the wealthy will (once more) face a heavier tax burden. Most notably, an increase in the capital gains inclusion rate, for individuals and corporations, aims to net almost $7 billion this fiscal year and nearly $20 billion over the full five-year fiscal horizon. As expected, the resulting deficit, pegged at roughly $40 billion or 1.3% of GDP for 2024-25, all but matches the prior year's shortfall.

On balance, the latest fiscal plan spills cumulatively more red ink than Budget 2023, the modified budgetary path capturing a larger, costlier and arguably more intrusive federal government. There remains no firm commitment to return to balance. Instead, the government aims to gradually work down the deficit as a share of GDP. A sub-1% deficit-to-GDP ratio from 2026-27 onwards is the official commitment. While the baseline scenario adds more than $150 billion to the accumulated deficit over the coming five fiscal years, underlying growth in the economy aims to keep the closely watched debt-to-GDP ratio edging lower each year. This is the government's core 'fiscal anchor'. Having ended 2023-24 at an estimated 42.1%, the debt burden is meant to decline to 39% come 2028-29. (For reference, this ratio hovered closer to 30% pre-COVID.) Yes, Canada continues to boast a meaningful edge vs. advanced economy peers on general government net debt, as fresh IMF data make clear. But this government can't rightly take credit for that. Moreover, it's clearly costing taxpayers more to service the federal debt. Public debt charges have more than doubled in three fiscal years, lifting the 'interest bite' to 10.9% of total revenue. For the first time in over a decade, the feds will spend more servicing debt in 2024-25 than they will flow to the provinces via regular Canada Health Transfer cash.

Meanwhile, there's no little amount of borrowing to do. The government intends to issue $228 billion of GoC bonds this year, up 12% from last fiscal year with marginal issuance disproportionately skewed to 5s and 10s. While net bill issuance appears relatively better contained, this program is hardly status quo. Ottawa will start issuing 1-month T-bills in May, following through on a proposal first floated in the fall.

Selected highlights

- **Economic backdrop ➢ *Soft landing as the baseline scenario***

  Since 1994, the private sector consensus has been used as the basis for fiscal planning. No change here, with the latest survey conducted in March. The government is thus adopting the "soft landing" scenario that has gained popularity in recent months. After modest real growth of 1.1% in 2023, it is expected to fall to 0.7% in 2024 (from 0.5% in the Fall Economic Statement), well below the Bank of Canada's estimates for potential growth. Under this scenario, the unemployment rate would not exceed 6.3% in 2024 and 2025, barely above the level recorded in March this year. Real economic growth is expected to be around 2.0% in the years thereafter. While the revisions to real GDP growth are small, those to nominal GDP are more significant. In 2023, nominal GDP growth surprised at 2.7%, compared with expectations of only 2.1% last fall. In 2024, growth is now expected to be 3.8% (up from 2.5%). Thanks to slower growth and a less tight labour market, the fight against inflation is progressing and economists expect the BoC to begin easing this year. The 3-month treasury bill yield is seen falling from 4.8% to 4.3% between 2023 and 2024. The decline would be even greater in 2025, when it would hit 2.9%. This assumes that inflation falls from 2.5% in 2024 to 2.1% in 2025, essentially on the BoC target.

- **Fiscal outlook ➢ *Respecting earlier pledges albeit with narrow margin for error***

  As a steady diet of pre-budget announcements and our related summary of new measures should make clear, there's a fair bit going on in this budget. Taking a step back and focusing on the budgetary bottom line, 2023-24's deficit matches November's FES at an even $40 billion. By the narrowest of margins, that satisfies a commitment to limit the 2023-24 shortfall to no more than the $40.1 billion originally planned for in Budget 2023. Note that the actual tally will be confirmed via public accounts, so some final adjustments are possible.

Deputy PM/FinMin Freeland had likewise promised to maintain a declining deficit-to-GDP ratio for 2024-25 and beyond. Again, in the strictest sense, this pledge is being respected, even if the margin for error is rather limited. For 2024-25, the budget outlines a deficit of $39.8 billion, representing a mild deterioration vs. November's FES (deficit of $38.4 billion). Assuming 3.8% nominal GDP growth in 2024, that would see the deficit-to-GDP ratio edge down ever so slightly from 1.4% to 1.3%. (Thankfully, we don't quite need a second decimal place to observe progress on the deficit ratio.)

Beyond that, you'll find a fairly gradual reduction in absolute and relative budget shortfalls, fulfilling a commitment to get the deficit-to-GDP ratio under 1% by 2026-27. We're hesitant to put much stock in long(er) term fiscal plans, but officially a $20 billion deficit (equivalent to 0.6% of GDP) has been pencilled in for 2028-29. It perhaps follows that there's no firm commitment to return to balance.

Lining Budget 2024 up against its predecessor (i.e., Budget 2023), the cumulative balance for the five-year period inclusive of 2023-24 to 2027-28 has worsened by roughly $45 billion or about $9 billion/year. This translates into a shallower or slower deficit reduction path than outlined last year.

As far as budgetary nuts and bolts are concerned, tax hikes help to spur 7% total revenue growth in 2024-25—nearly double the expected pace of nominal growth this year. While not a record high, Ottawa's tax bite has pushed higher, the federal revenue-to-GDP ratio rising to 16.6% in 2024-25 vs. the 14.3% level averaged in the decade prior to the pandemic. This enlarged revenue take is theoretically needed to finance a bigger, freer spending federal government, as program outlays have been placed on a structurally higher plane (even after stripping out/controlling for pandemic-related outlays).

Consistent with recent practice, the budget outlines 'upside' and 'downside' scenarios. The former, more optimistic scenario obviously involves greater/quicker progress on the deficit. Nonetheless, even under this upside budgetary pathway, the projected deficit would still generally be larger than the baseline projection offered up a year ago. Under an adverse/downside scenario, the deficit could reach $52 billion (or 1.7% of GDP) by 2025-26, which would mean slower progress on the debt burden all else equal.

Supplementing these budgetary scenarios are customary fiscal sensitivities on real/nominal GDP growth and borrowing rates. On its own, and barring corrective action, a 1%-pt miss on real GDP growth would cost the government $4.9 billion in year one. An equivalent 1%-pt hit to the GDP deflator initially subtracts a net $2.3 billion/year. Meanwhile, as has now been clearly demonstrated, an interest rate shock can lead to material adjustments in public debt charges. It's currently assumed that a 100 bp parallel shift in all borrowing rates has a net fiscal impact of $3.7 billion in year 1, with that sensitivity more than doubling to $7.7 billion by year 5 (as more and more debt is gradually refinanced). While official best estimates, these sensitivities are to be interpreted with some caution. Rarely do GDP or interest rate surprises occur in isolation, with more than a few moving fiscal parts generally to be controlled for. Fair to say, however, that the shorter duration to the outstanding debt portfolio means the federal government has a significantly larger degree of interest rate reset risk than Canada's other levels of government. Note that the relative affordability of Ottawa's debt is addressed in a following section.

▪ New measures ➢ *Housing, tax fairness, and so much more*

At 430 pages, the 2024 Budget plan is massive compared to previous years and calls for a marginal stimulus of $52.9 billion over 5 years, financed in part by increases in certain taxes. Distilled to their most basic elements, core focus areas include housing, "tax fairness", social support and cost of living, economic growth, although action items extend to several other corners. Key components/elements include:

- ***Housing*** – The budget's #1 priority is undoubtedly housing, as housing/homes were mentioned 606 times throughout the document. The 2024 budget sets out a plan to build 3.87 million homes by 2031, 2 million more than would have been built anyway over that period, according to CMHC estimates. To this end, the government is announcing the new *Public Lands for Homes Plan* to build 250,000 new homes by 2031 on public land, whether federal, provincial, territorial, or municipal. The budget also includes an additional $400 million to the existing *Housing Accelerator Fund* so more municipalities can cut red tape, fast-track home construction, and invest in affordable housing. Among other improvements to existing programs, an additional $15 billion will be granted in loans starting in 2025-26 under the *Apartment Construction Loan Program* to build a minimum of 30,000 new rental units by 2031. In addition, access to this program will be extended to allow longer loan terms and more flexible criteria in terms of affordability, energy efficiency and accessibility requirements. To complement this program, the Budget announces the creation of *Canada Builds* to develop partnerships with the provinces to build more rental housing across the country. To support the infrastructure needed to build all these new homes, the government is also announcing the creation of a $6 billion *Canada Housing Infrastructure Fund* over 10 years. $1 billion will be available directly to municipalities to support urgent infrastructure needs, with $5 billion for agreements with provinces and territories to support long-term priorities. Provinces and territories will only access this funding if they commit to key actions that increase housing supply such as relaxing zoning requirements.

  The 2024 Budget also aims to make it easier to own or rent a home. To do this, the government wants to allow tenants to report their rent payment history to their credit bureau to strengthen their credit score. For renters, the Budget also includes a new $15 million *Tenant Protection Fund* to provide funding for legal services and tenants' rights advocacy organizations. The idea is to better protect tenants against unfair rent increases, renovictions, or bad landlords. The government also wants to create a new *Canadian Renters' Bill of Rights* that would require landlords to disclose a clear history of apartment pricing so renters can bargain fairly. For first-time home buyers, the Budget announced that, from 1 August 2024, the amortization period for insured mortgage loans for the purchase of a newly built property will be allowed to reach a maximum of 30 years, compared with 25 years at present. The real impact of this measure is likely to be rather marginal, given that insured loans account for only ~15% of new mortgages and new builds represent only a fraction of these. The withdrawal limit under the *Home Buyers' Plan (HBP)* will also be increased from $35,000 to $60,000 and the period for starting repayment will be extended from 2 to 5 years. Combined with the First Home Savings Account (FHSA) introduced last year, first-time buyers will now be able to accumulate $100,000 tax-free (or $200,000 for a couple) as a down payment on their future property. In our view, the increase in the HBP will have a limited impact on improving affordability for the middle class, since few of them will be able to accumulate such sums in their investments. Among other measures affecting housing, the Budget extends the ban on foreign buyers of Canadian homes until January 1, 2027. The government will also invest an additional $1 billion in the *Affordable Housing Fund* to launch a permanent Rapid Housing Stream, and $1.5 billion to create the new *Canada Rental Protection Fund* to protect and expand affordable housing ($1 billion in loans and $470 million in contributions to non-profit organizations and other partners so they can acquire units and preserve rent prices in the long term).

- ***"Tax fairness"*** – In order to adhere to earlier-established fiscal anchors, it was likely the government would need to introduce new revenue measures (i.e., tax increases) to offset marginal spending. That's exactly what they did. The most notable tax proposal relates to capital gains treatment, as the government plans to increase the inclusion rate from one-half to two-thirds. While this applies to individual Canadians and corporations/trusts, Canadians will only face a higher tax burden on realized capital gains above $250,000 per year. In total, this measure is seen boosting revenues by more than $19 billion over the next five years. Favourable treatment is afforded to entrepreneurs under a proposed Canadian Entrepreneurs' Incentive. This would reduce the inclusion rate to one-third (on a lifetime maximum of $2 million in capital gains) with a price tag of $1.7 billion. There are also plans to implement a Digital Services Tax and a Global Minimum Tax which could boost revenues by $5.9 billion and $6.6 billion, respectively. 'Sin tax' increases on nicotine products are also planned and could generate $1.7 billion over the next five years. The budget also outlines more than $4 billion in potential cost savings from a declining public sector workforce (which will be achieved through attrition over the next four years).
- ***Social support and cost of living*** – Resulting from a political pact with the NDP, the 2024 Budget announces the first steps towards launching a *national pharmacare program*. With an initial investment of $1.5 billion over five years, this program will initially cover the contraceptive and diabetes drugs. The government also announced a new *Canada Disability Benefit* that will cost $6.1 billion over 5 years and support more than 600,000 working-age persons with disabilities. Starting in July 2025, this new program will provide support of up to $2,400 per year for low-income persons with disabilities. The Budget also includes $1 billion over five years for the creation of a *National School Food Program*, $1 billion for the launch of the *Child Care Expansion Loan Program* to build or renovate child-care facilities, and $500 million over five years for the creation of a new *Youth Mental Health Fund* which will help younger Canadians access mental health care. Furthermore, the budget aims to limit extra fees charged by airlines and telecommunications companies, enhances bank account options and caps non-sufficient funds fees charged by banks at $10.
- ***Economic growth*** – With major advances in artificial intelligence, the government wants to ensure that Canada maintains its lead in the field. To this end, the Budget provides $2.4 billion in support for the AI sector. This amount includes $2 billion over five years to launch a new *AI Compute Access Fund and Canadian AI Sovereign Compute Strategy*, $200 million over five years to boost AI start-ups to bring new technologies to market, and accelerate AI adoption in critical sectors, $100 million over five years for the *National Research Council's AI Assist Program*, and $50 million over four years, starting in 2025-26, to support workers who may be impacted by AI, such as creative industries. The government will temporarily allow businesses to immediately write off the full cost of investments in patents, data network infrastructure equipment, computers, and other data processing equipment to help them boost productivity. They're also launching a new 10 per cent *Electric Vehicle Supply Chain investment tax credit* for businesses that invest across key segments of the electric vehicle supply chain. Finally, they propose to return fuel charge proceeds from 2019-20 through 2023-24 to an estimated 600,000 businesses, with 499 or fewer employees through a new refundable tax credit.
- ***Other*** – Over the next five years, the government has allocated more than $6 billion to a file titled 'Safer, Healthier, Communities'. Funding here is earmarked for electric vehicle charging stations, combatting hate, promoting Canadian arts, improving community safety and bolstering infrastructure, among other items. When it comes to indigenous communities, the budget provides more than $9 billion across a number of investments including in education, community health and safety. 'Protecting Canadians and Defending Democracy' was the one of eight chapters contained in the budget and carried a net fiscal impact of more than $10 billion through 2028-29. Major line items here include investments in national defence, support for Ukraine's war effort and humanitarian assistance.

Debt burden & interest bite ➢ *Debt ratio (aka fiscal anchor) to ease but interest bill takes bite out of revenue*

Moving from the income statement to the balance sheet, federal debt (more accurately the accumulated deficit) was estimated at more than $1.21 trillion as of March 2024. The projected string of future budget deficits would see $156 billion of new debt added over the coming five fiscal years. The Canadian economy is nonetheless expected to grow, allowing the closely watched debt-to-GDP ratio—the government's stated fiscal anchor—to edge lower each year. This was a pledge made earlier and Budget 2024 technically follows through. Specifically, debt-to-GDP amounted to 42.1% in 2023-24 and is meant to ease slightly to 41.9% this fiscal year. Assuming deficits moderate as planned, progress on the debt burden would gradually accelerate, this key ratio aimed at an even 40% by 2027-28, all but matching the corresponding level presented in Budget 2023.

As to be expected, the budget once again plays up Canada's relative debt advantage vs. our large advanced economy peers. Indeed, fresh figures from the IMF (coincidentally released on budget day) show Canada with the lowest general government net debt-to-GDP ratio in the G7. Really, it's not even close. Mind you, this government can't take too much credit for placing Canada in such an enviable position, the legitimately tough(er) budgetary choices and genuinely greater fiscal discipline on display many years earlier. Moreover, it should be noted that some of Canada's pronounced net debt edge reflects a rapidly growing pool of assets held in the social security system, which government doesn't have access to. Strip out the abundant (and growing) stockpile of assets at the CPP/QPP, along with various other financial assets squirrelled away in the government sector, and Canada's gross debt edge becomes less impressive. (On pensions more generally, we'd note that former Bank of Canada Governor Poloz is to chair a working group tasked with unearthing greater opportunities for our large pension funds to invest in Canada.)

Nor does a relatively lower debt burden fully inoculate taxpayers from the impact of higher interest rates. No question, debt affordability has become a growing focal point for governments the world over. In Canada's case, public debt charges have adjusted quite rapidly, the interest bill having more than doubled in just three years' time (from $24.5 billion in 2021-22 to $54.1 billion in 2024-25). As it stands, public debt charges are set to consume 10.9% of total federal revenue this fiscal year vs. the roughly 7% level averaged in the handful of years prior to the pandemic. True, the federal interest bite is far removed from the rather ugly 35%+ levels witnessed in the early 1990s. But debt charges are a non-trivial and costlier expense item for today's federal government. To put this in perspective, the feds expect to spend more servicing the public debt this fiscal year than will be transferred to the provinces via the crucially important Canada Health Transfer—the first time in over a dozen years interest trumps regular CHT cash.

The good news, in a sense, is that the relatively shorter duration of federal marketable debt outstanding means a good portion has already been re-couponed. (Think of this as somewhat akin to the quick(er) adjustment to higher interest rates being felt in Canada's mortgage market.) Moreover, the consensus viewpoint off which the budget is based sees GoC bonds yields easing from here. It all suggests that the federal interest bite may be at or near its relative peak, the budget seeing this important gauge of debt affordability ranging from 10.6% to 11% in the out years.

Of course, there's a conceivable scenario characterized by timelier and/or more meaningful interest rate cuts than current assumed. Such prospective relief in GoC borrowing rates could limit/trim the interest bill. But that would typically be accompanied by an even weaker economic and revenue outlook, so perhaps one needs to be careful what they wish for. Refer to the budgetary outlook section for detailed interest rate sensitivities.

- **Debt Management Strategy ➢ *No shortage of supply for bond investors***

What does the updated fiscal outlook mean for the Government of Canada's borrowing plans? Bear with us as we walk through several important takeaways from the fresh Debt Management Strategy, included as always as an Annex to the budget.

- The aggregate principal amount to be borrowed in 2024-25 is estimated to be $508 billion. Roughly 83% of this will be used for maturity refinancing, with the balance to go towards funding the financial requirement. Existing cash will also be utilized as the government plans to reduce its cash balance by $16 billion this year.
- When it comes to the Treasury bill stock, today's DMS signals an end-of-fiscal year outstanding target of $272 billion. That's only slightly above the level reached at the end of 2023-24 ($267 billion) and is in line with the current size of the bill stock. However, steady outstandings don't mean it's a status quo bill program as the government confirmed it would be introducing a 1-month Treasury bill in May (this was originally flagged in the Fall Economic Statement). For now, details are sparse and it's not clear how large these issues will be. However, given that the bill target is little changed, 1-month issuance will likely eat into the amounts that would otherwise be reserved for 3-, 6-, and 12-month paper. Note that the stated goal is to "support the transition from Bankers' Acceptances" and as a result, this is being introduced on a temporary basis. That said, continued issuance beyond the CDOR transition "will be assessed".
- 2024-25 gross bond issuance is projected to total $228 billion, representing a year-on-year increase of $24 billion (+12%). With $155 billion GoC bonds maturing this fiscal year, the overall bond stock will rise by $73 billion. After accounting for the bonds held by the Bank of Canada that are maturing this year (i.e., the QT impact), there's a chunky $129 billion that needs to be absorbed by end investors. Note that the equivalent figure for 2023-24 was $112 billion. Even when QT ends, it will be some time before the BoC returns to the bond market so don't expect this significant tally to be mitigated by the central bank.
- While each of the core tenors will see more supply this year, increases are concentrated in 5s and 10s. However, some of this shift had started after the DMS update last fall. Specifically, nominal issuance looks like this: $88 billion in 2s, $60 billion in 5s, $60 billion in 10s and $16 billion in longs. The document notes that they've skewed supply a bit longer this year in response to more demand for duration. While that's true (the share of 10- and 30-year issuance will rise from 30% to 33%), much of this shift had already started in the last quarter of 2023-24. The implied weighted average term of issuance in 2024-25 is 6.9 years, less than half a year longer than 2023-24.
- The DMS outlines the number of auctions in each tenor, giving us a sense of average auction sizes. Here, we can expect auctions of $5.5 billion in 2s, $5 billion in 5s, $5 billion in 10s and $2 billion in 30s. For 5s and 10s, these amounts are in line with recent tenders, but 2-year and 30-year auctions will be marked lower.
- Target benchmark sizes were left unchanged in 2s and 30s but were adjusted up for 5s and 10s. Now, the minimum benchmark threshold for these tenors stands at $26 billion versus $18 billion previously.
- Cash management bond buybacks will continue in 2024-25 to help manage cash flows ahead of large bond maturities.
- In addition to its standard bond program, the government plans to issue another $4 billion green bond in 2024-25 after a successful issue in February 2024.
- The government also announced it is proposing two legislative amendments related to the CMB program. The first is to "increase the insurance-in-force and guarantees-in-force legislative limits under the National Housing Act to $800 billion." The second is to amend the Borrowing Authority Act to eliminate the 'double counting' of debt related to its CMB purchases. As it stands, CMBs and the GoC debt issued to purchase those CMBs both count towards the government's borrowing limit.
- Net requirements for the exchange fund account are estimated to be US$11 billion in 2024-25. As always, the mix of funding sources can and will vary in response to a number of considerations including cost, market conditions and objectives. Potential funding sources include a US-dollar paper program, MTNs, cross-currency swaps and the issuance of global bonds.

Table A1.5

Summary Statement of Transactions

billions of dollars

		Projection					
	2022–2023	2023–2024	2024–2025	2025–2026	2026–2027	2027–2028	2028–2029
Budgetary revenues	447.8	465.1	497.8	514.6	535.7	561.4	586.3
Program expenses, excluding net actuarial losses	438.6	450.3	480.5	496.3	509.6	526.3	544.4
Public debt charges	35.0	47.2	54.1	54.9	57.0	60.9	64.3
Total expenses, excluding net actuarial losses	473.5	497.5	534.6	551.1	566.6	587.2	608.7
Budgetary balance before net actuarial losses	-25.7	-32.5	-36.8	-36.5	-30.8	-25.8	-22.4
Net actuarial losses	-9.6	-7.6	-3.1	-2.4	0.1	-1.0	2.4
Budget 2024 budgetary balance	-35.3	-40.0	-39.8	-38.9	-30.8	-26.8	-20.0
Financial Position							
Total liabilities	1,925.0	2,004.5	2,091.3	2,200.0	2,298.0	2,400.1	2,491.4
Financial assets	642.3	676.6	719.1	783.9	844.8	915.0	978.5
Net debt	1,282.8	1,327.8	1,372.2	1,416.1	1,453.2	1,485.1	1,513.0
Non-financial assets	109.7	112.4	116.9	121.9	128.3	133.4	141.3
Federal debt[1]	1,173.0	1,215.5	1,255.3	1,294.1	1,324.9	1,351.7	1,371.7
Per cent of GDP							
Budgetary revenues	15.9	16.1	16.6	16.5	16.5	16.6	16.7
Program expenses, excluding net actuarial losses	15.6	15.6	16.0	15.9	15.7	15.6	15.5
Public debt charges	1.2	1.6	1.8	1.8	1.8	1.8	1.8
Budgetary balance	-1.3	-1.4	-1.3	-1.2	-0.9	-0.8	-0.6
Federal debt	41.7	42.1	41.9	41.5	40.8	40.0	39.0

[1] The projected level of federal debt for 2023-24 includes an estimate of other comprehensive losses of $1.1 billion for enterprise Crown corporations and other government business enterprises, and an estimate of $1.3 billion for net remeasurement losses on swap agreements, foreign exchange forward agreements, and other financial instruments.

[2] Numbers may not add due to rounding.

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General

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