BUDGET ANALYSIS

Federal Budget 2024

Which Came First? The Spending or the Taxing?

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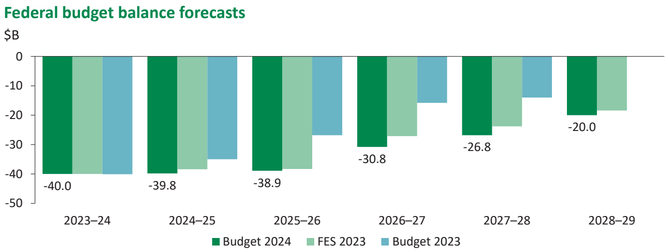
HIGHLIGHTS

- As expected in our federal Budget 2024 preview note, the Government of Canada plans to run larger deficits than anticipated in the Fall Economic Statement 2023 (FES 2023) (graph 1). Despite this, the federal government expects to meet its two deficit-related fiscal anchors: maintaining the 2023–24 deficit at or below the Budget 2023 projection of $40.1B and maintaining a declining deficit-to-GDP ratio in 2024–25 while keeping deficits below 1% of GDP in 2026–27 and future years.

Graph 1
Bigger Deficits as Far as the Eye Can See



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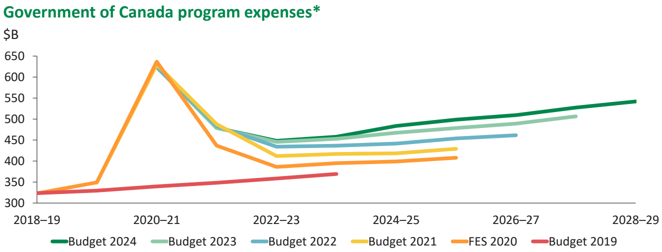
- Program spending increased by an eyebrow-raising $56.5B over five years in Budget 2024 relative to what was in the FES 2023. New measures were heavily tilted toward housing, but additional spending to address affordability, productivity, defense and the needs of Indigenous people also contributed to the tally. At the same time, public debt charges edged slightly higher, contributing further to budget deficits in this big spending budget.
- On the revenue side, the improved economic outlook wasn't enough to keep the deficit in line with the fiscal anchors laid out in the FES 2023. As a result, the federal government intends to raise taxes, largely by increasing the tax rate on capital gains realized by individuals annually above $250K (excluding principal residence and select other income) and corporations. More modest tax breaks for entrepreneurs and other measures provided a minor offset.
- Taken together, the debt-to-GDP ratio is expected to gradually decline from its recent peak of 42.1% reached in the 2023–24 fiscal year to 39% by the end of the forecast. As a result, the federal government expects to meet the threshold for its third and final fiscal anchor: lowering the debt-to-GDP ratio in 2024–25 relative to the FES 2023, and keeping it on a declining track thereafter.
- We're skeptical that the federal government will be able to meet its fiscal anchors in the coming years. As a result of the Government of Canada's plan to reduce the number of non-permanent residents allowed to work and study in Canada, the economic outlook has deteriorated after 2024 from the time when forecasters were last surveyed. As such, the downside economic forecast is increasingly likely starting in 2025. And given spending edges higher with each new fiscal plan, taxes will need to rise to offset additional spending and/or deficits will be larger.

The federal government had a few tricks up its sleeve in Budget 2024. While most of the spending measures with big price tags attached were announced well in advance, the increases in taxes weren't. As such, some business owners and wealthier Canadians could be in for a surprise. But Canadians at large will ultimately be the judges of whether the new measures are worth the cost.

Hey Big Spender

In the run up to Budget 2024, the federal government announced a spate of measures that left little to surprise. In total, program spending (excluding loans) in the budget increased by an eyebrow-raising $56.5B over five years relative to FES 2023. Spending is now almost $90B more annually than projected in the final year of the budget forecast that preceded the pandemic (graph 2).

Graph 2
Another Budget, Another Substantial Increase in Spending



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*program expenses include net actuarial losses
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Starting with housing, the spending measures in Budget 2024—largely announced in the weeks leading up to it—totalled about $7.4B (proposed transfers to the provinces were conspicuously absent). Detailed in a new federal housing plan, some (but not all) of the proposed measures were supported in our extensive analysis of successful housing supply policies around the world. Those with big dollars attached include $1.5B over the next five years for a new Canada Housing Infrastructure Fund to help municipalities investment in housing-related infrastructure, $1.3B for addressing homelessness and encampments, and $1.1B for sheltering asylum claimants. On the tax side, introducing a temporary accelerated capital cost allowance at a rate of 10% for eligible purpose-built rentals, at a cost of $1.1B over five years, is a step in right direction. In addition, the federal government announced a $15B top-up to the Apartment Construction Loan Program, plus reforms to increase access for builders. Other more modest measures announced in the run-up to Budget 2024 are intended to provide support to homebuyers. But maybe most importantly among these, "enhancements to the Canadian Mortgage Charter will also include an expectation that, where appropriate, permanent amortization relief will be made available to protect existing homeowners that meet specific eligibility criteria." (Government of Canada, 2024) The devil is in the details, however. And ultimately, the Canadian Mortgage Charter consists more of a set of recommendations and doesn't override current OSFI and CMHC requirements.

Other measures of potential interest to members and clients over the next five years include $10.7B to shore up the defence budget; $4.9B for a Canada Disability Benefit; $2.4B for AI research, development and adoption, which may help to address some of the causes of Canada's significant productivity gap with the US (see our recent analysis on the topic); $1B in low-cost loans and grants to public and not-for-profit childcare providers, so they can build or renovate their care centres; $1.5B and growing for a national pharmacare plan, with PBO (2023) putting the incremental cost of a single-payer universal drug plan reaching $13.4B by the 2027–28 fiscal year if fully implemented; $1B over five years for a proposed National School Food Program; and a $500M investment for a new Youth Mental Health Fund.

The budget provides little by way of spending offsets. Only $9B of the $15.4B worth of savings through 2027–28 had been identified as of March. And as we've noted, successful spending review initiatives historically occurred early in government terms, propelled by significant political urgency to course-correct drifting public finances. From the outset, the current spending review was plagued by a lack of credibility, a situation only worsened by subsequent government announcements of additional spending, exceeding expected savings by several orders of magnitude.

A silver lining to all this new spending is that it's unlikely to be especially inflationary on its own. This stands in contrast to inflation-boosting checks sent to households by some governments shortly after the pandemic ended. That said, some of the demand-related measures, such as the those targeted at first time homebuyers, would be likely to boost home prices, albeit on the margins.

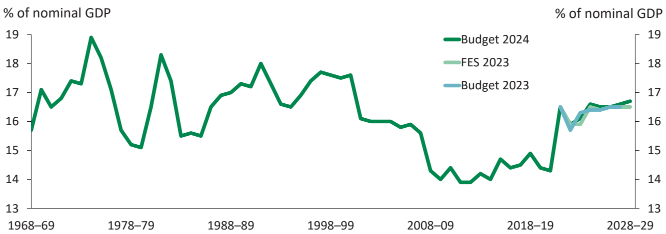
Kicking the Tax Take up a Notch

To offset much of this new spending, Budget 2024 moves further down the road of increasing the tax burden on high-income Canadians and corporations, along with more minor measures. By committing to increasing the inclusion rate on capital gains realized annually above $250K by individuals and on all capital gains realized by corporations and trusts from one-half to two-thirds, the federal government expects to raise $19.4B in revenues over the coming five fiscal years. However, this is an approach that has had mixed results in the past, raising revenues but never by as much as expected.

Fortunately for many Canadians, the new $250K threshold excludes capital gains from selling your primary residence, income from registered retirement and savings accounts, and pension income. And for Canadian companies, the federal government has introduced a tax break for entrepreneurs, which will reduce the inclusion rate to 33.3% on a lifetime maximum of $2M in eligible capital gains. That said, it should be noted that Canada is already a relatively high-tax jurisdiction. According to the Organisation for Economic Cooperation and Development (OECD), Canada had the fifth highest top personal income tax rate among its advanced and emerging economy members in 2022. It also kicks in at a comparatively low threshold.

Notably, in Budget 2024, revenues as a share of the economy are expected to move even higher, climbing to 16.7% of GDP by the end of the forecast. That's the highest level as a share of the economy since the 2000–01 fiscal year and up from closer to about 14.5% of GDP on average in the decade that preceded the pandemic (graph 3). In all, the federal government expects to generate an extra $21.4B in revenues from new tax measures over five years.

Graph 3
As a Share of GDP, Revenues to Hit the Highest Level Since 2000–01



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Economic Tailwind Today but Maybe Not Tomorrow

Besides new tax measures, the remaining spending is expected to be paid for by revenues coming organically from the improved economic outlook (table 1). With revenues estimated to have been $8.9B higher last year, the further tailwind from the economy (and more minor fiscal developments) is projected to boost revenues by an additional $36.4B over the next five years.

Notably, the forecast for growth in nominal GDP—the broadest measure of the tax base—is higher than our most recent Economic and Financial Outlook (EFO) in all years of the projection. As a result, we think there may be some downside risk to the Budget 2024 deficit outlook relative to our March 2024 projection. That's in large part because at the time when Finance Canada collected the forecasts from private sector economists, the Government of Canada had yet to announce its plan to reduce the number of non-permanent residents allowed to work and study in Canada. Our analysis of that decision found that it will weigh on real GDP growth and inflation, causing the deficit to be as much as $5B larger in every year of the projection than our latest EFO suggested. As such, we believe that the federal government's downside economic forecast provides a better starting point for fiscal planning, particularly after 2024 (table 2).

TABLE 1
Economic and financial forecasts

AVERAGE ANNUAL GROWTH IN % (EXCEPT IF INDICATED)	2023 Actual	2024f Budget 2024	2024f FES 2023	2024f Desj. Group	2025f Budget 2024	2025f FES 2023	2025f Desj. Group
Real GDP	1.1	0.7	0.4	0.9	1.9	2.2	2.0
GDP deflator	1.6	3.0	2.0	2.6	1.9	2.0	1.2
Nominal GDP	2.7	3.8	2.4	3.6	3.9	4.3	3.2
Treasury bills—3-month	4.8	4.5	4.3	4.2	3.1	2.9	2.5
Federal bonds—10-year	3.3	3.3	3.3	3.2	3.2	3.1	2.7
Unemployment rate	5.4	6.3	6.4	6.3	6.3	6.2	6.2
Exchange rate (US¢/C$)	74.7	74.4	75.2	74.3	76.4	77.4	74.4
Real GDP—United States	2.5	2.2	0.7	2.1	1.6	1.9	1.8

f: forecasts
NOTE: Data may not add to totals due to rounding.
Department of Finance Canada, Statistics Canada and Desjardins Economic Studies

TABLE 2
Economic and financial forecasts

AVERAGE ANNUAL GROWTH IN % (EXCEPT IF INDICATED)	2023 Actual	2024f Budget 2024	2024f Down. Scen.	2024f Desj. Group	2025f Budget 2024	2025f Down. Scen.	2025f Desj. Group
Real GDP	1.1	0.7	-0.1	0.9	1.9	1.2	2.0
GDP deflator	1.6	3.0	2.6	2.6	1.9	1.8	1.2
Nominal GDP	2.7	3.8	2.4	3.6	3.9	3.0	3.2
Treasury bills—3-month	4.8	4.5	5.0	4.2	3.1	4.2	2.5
Unemployment rate	5.4	6.3	6.5	6.3	6.3	6.9	6.2

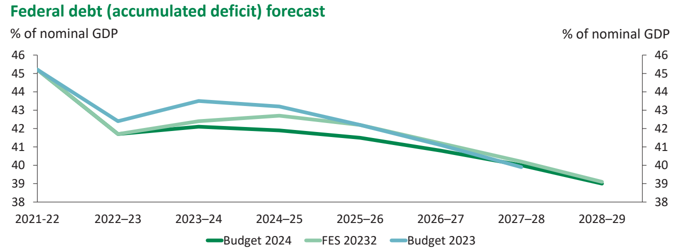
f: forecasts
NOTE: Data may not add to totals due to rounding.
Department of Finance Canada, Statistics Canada and Desjardins Economic Studies

Deficits and Debt Remain Anchored to the Fiscal Anchors

Higher revenues aren't expected to fully offset the bump in program spending and resulting higher public debt charges, ultimately leading to larger deficits over the next five years than projected in the FES 2023. However, the higher forecast for nominal GDP has helped to ensure the federal government met its two deficit-related fiscal anchors: maintaining the 2023–24 deficit at or below the Budget 2023 projection of $40.1B and maintaining a declining deficit-to-GDP ratio in 2024–25 while keeping deficits below 1% of GDP in 2026–27 and future years (table 3 at the end).

Of course, these larger deficits will ensure the level of the federal debt is likely to be higher than it would have been otherwise. However, again because of the outlook for higher nominal GDP, the federal debt-to-GDP ratio is not expected to get as high as previously forecast and is projected to trend lower over the next five years (graph 4). Consequently, the federal government expects to meet the threshold for its third and final fiscal anchor: lowering the debt-to-GDP ratio in 2024–25 relative to the FES 2023, and keeping it on a declining track thereafter. Credit rating agencies will no doubt be happy to see this.

Graph 4
Federal Debt-to-GDP Is Expected to Trend Lower Starting Next Year



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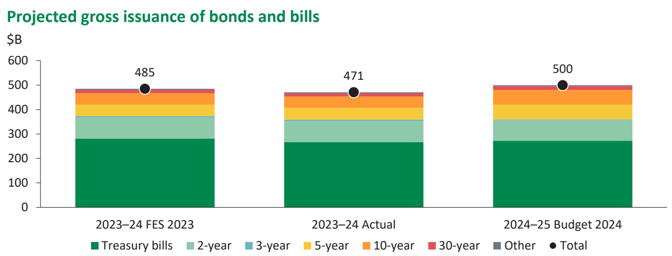
Bond Supply Will Hit a Record

While the Government of Canada managed to stay the course on deficits, significant lending initiatives are, to a large extent, expected to push issuance higher. For the 2024–25 fiscal year, the Debt Management Strategy (DMS) outlines a gross domestic debt issuance program of $500B, up from the $471B raised in 2023–24 (graph 5). In terms of composition, most of the increases in bond issuance are in 10-year and 30-year bonds, responding to strong investor demand. Issuance declines in treasury bills (where a 1-month bill is being introduced) and rises only modestly for 2-year bonds. This total includes $414B for maturing debt and $102B to meet financial requirements, encompassing the deficit of $40B and the effects of non-budgetary transactions amounting to $102B. Non-budgetary transactions are coming in higher than usual, notably as a result of the Canada Mortgage Bond (CMB) buyback program announced in the FES 2023. CMB purchases began in February and a total of $7.5B was purchased in the final quarter of the 2023–24 fiscal year, and the government will be buying $30B worth of CMB primary issuance in the 2024–25 fiscal year.

Other lending initiatives, that get accounted for in the balance sheet and not the deficit, will have a material impact on funding requirements. This is particularly the case with housing measures, as we estimate that as much as two-thirds of the measures laid out in this file consist of loans. The high number of balance sheet initiatives implies that contrary to the deficit, which the government projects to decline, the financial requirement goes in the opposite direction. The government projects the financial requirement to increase further, to $106.7B in 2025–26.

So don't be fooled by the rosy headlines: this is a heavy issuance package. To put the plan to issue $228B in bonds in perspective, recall that pre-pandemic bond programs typically ranged between $95B and $100B. And since it's clear that the Bank of Canada is not looking to start purchasing Government of Canada bonds this year, the upshot is that 2024-25 will see the biggest volume of net bond supply hitting the market on record.

Graph 5
Despite Little Change in the Deficit, Bond Issuance Should Rise



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Conclusion

Budget 2024 tacked in a very different direction to recent federal fiscal plans. While ensuring to meet the fiscal anchors outlined in FES 2023, the revenue windfall from an improved economic outlook wasn't enough to cover the substantial increase in spending. As a result, the federal government leaned more heavily on tax increase than at any time in recent memory. Only time will tell if this has the intended impact of improving affordability and boosting living standards. Or if the old adage, "You can't tax your way to prosperity," proves correct.

TABLE 3
Summary of transactions

	ACTUAL	DESJARDINS PROJECTIONS					
IN $B (EXCEPT IF INDICATED)	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	586.0
Growth (%)	*8.4*	*3.9*	*7.0*	*3.4*	*4.1*	*4.8*	*4.4*
Program spending	-438.6	-450.3	-480.5	-496.3	-509.6	-526.3	-544.4
Growth (%)	*-6.5*	*2.7*	*6.7*	*3.3*	*2.7*	*3.3*	*3.4*
Debt charges	-35.0	-47.2	-54.1	-54.9	-57.0	-60.9	-64.3
Growth (%)	*42.7*	*35.0*	*14.6*	*1.5*	*3.8*	*6.8*	*5.6*
Net actuarial losses	-9.6	-7.6	-3.1	-2.4	0.1	-1.0	2.4
Budgetary balance	**-35.3**	**-40.0**	**-39.8**	**-38.9**	**-30.8**	**-26.8**	**-20.0**
Federal debt[1]	1,173.0	1,215.5	1,255.3	1,294.1	1,324.9	1,351.7	1,371.7
Growth (%)	*2.9*	*3.6*	*3.3*	*3.1*	*2.4*	*2.0*	*1.5*
Budgetary revenues (% of GDP)	15.9	16.1	16.6	16.5	16.5	16.6	16.7
Program spending (% of GDP)	-15.6	-15.6	-16.0	-15.9	-15.7	-15.6	-15.5
Public debt charges (% of GDP)	-1.2	-1.6	-1.8	-1.8	-1.8	-1.8	-1.8
Budgetary balance (% of GDP)	**-1.3**	**-1.4**	**-1.3**	**-1.2**	**-0.9**	**-0.8**	**-0.6**
Federal debt (% of GDP)	**41.7**	**42.1**	**41.9**	**41.5**	**40.8**	**40.0**	**39.0**

[1] Debt representing the accumulated deficits including other comprehensive income.
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