Budgeting for the future

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Few expected Canada's 2018 budget to deliver sweeping economic stimulus or drastically change the course of Canada's deteriorating competitiveness. Light on investment implications, this year's focus was geared toward social changes including a focus on science, increased gender equality, and preparing for the future.

The focus of Budget 2018 was around support for innovation, skill development and gender equity. While some questioned whether a review of Canada's corporate tax plans would be introduced given deteriorating competitiveness, few expected it to be addressed, and indeed there was limited mention. Instead, Budget 2018 focused on supporting programs that address the gender wage gap, introducing programs to increase employment in skilled trades, and expanding outreach to Indigenous communities to enable better access to federal benefits.

Takeaways from an investment perspective were few and far between:

- Budget 2018 acknowledged the significance of U.S. tax reform and the economic challenges potentially being introduced through NAFTA negotiations, though it did not respond with specific measures to address concerns.
- A total of about $20 billion was introduced for the support of new programs and initiatives – less than half of that introduced in 2016, and a marked slowdown from the government's spending mode a couple of years ago.
- The government expects to continue running a fiscal deficit through 2022-23, albeit at a moderating pace. Meanwhile, Canada's debt-to-GDP is forecasted to decline to 28.4%.

The major components

A number of programs were expanded and initiatives introduced in support of gender equity and innovation.

As it relates to gender equity, Budget 2018 introduced a new "use-it-or-lose-it" EI benefit of an additional five weeks in support of two-parent families should they decide to share parental leave responsibilities. Legislation will also be introduced for proactive pay equity amongst federally regulated sectors and increased transparency. Additional incentives to support women in skilled trade programs and newcomers to Canada were also announced, as was a strategy to support investment in women-led businesses.

For low- and middle-income earners, a Canada Workers Benefit was introduced, evolving the current Working Income Tax Benefit that supplements the earnings of low-income workers. This new iteration increases the maximum benefits and increases the income level at which the benefit is phased out, as well as improving access by allowing CRA to automatically determine if filers are eligible. In addition, support for new rental housing construction specifically geared towards low- and middle-income earners was introduced.

Indigenous communities were also in focus, whereby Budget 2018 allocated funding towards extending outreach and improving access to federal benefits as well as improving health, housing, job opportunities, and child welfare initiatives.

Research and innovation were central themes, and funding commitments included investments in tools, facilities and resources to support Canada's research system, in areas like natural sciences and engineering, health research, and social sciences. As part of this, a strategic innovation fund to support larger projects that lead to job creation has been announced as well as a focus on attracting and retaining early-career researchers at post-secondary institutions.

A handful of other funding plans were introduced, including increased environmental protection standards, support for the Youth Employment strategy, support for veterans, and extended programs geared toward clean energy.

New measures to crack down on tax evasion and combat tax avoidance were also addressed.

Finally, the budget set limitations on passive investment income within private corporations and introduced a restricted ability to claim refundable dividends.

Fiscal shift

Although the deficit is set to be slightly smaller over the coming years, the overall trajectory is fairly similar over the next six years. Technically, the cumulative deficit is now expected to be slightly smaller, but the change is trivial.

If projections are taken at face value, Canada does not have a federal debt problem despite deficits set to persist indefinitely into the future. The debt-to-GDP ratio – a measure of debt sustainability – is low and set to decline slightly over the next few years as economic growth outpaces debt growth.

Canada's AAA-rated debt rating seems safe for now, but if economic growth underperforms, program spending continues to bounce higher, or competitiveness continues to deteriorate, the situation could become more precarious.

Economic implications

Given the light nature of this budget, we maintain our assumption that the Canadian economy will decelerate from levels seen in recent months and settle back into a more subdued rate of growth. We look for 1.5% GDP growth in both 2018 and 2019. While Canada's fiscal deficit and public debt load are not in isolation problematic or unsustainable, current economic conditions are unusually good and the deficit picture would deteriorate sharply in a malaise or recession. Canada should be running surpluses during these fat and happy years to provide a buffer against the dark part of the cycle.

Supporting this cautious Canadian outlook, the country's competitive landscape is arguably deteriorating, and housing risks remain ever-present. From the perspective of businesses choosing where to expand their operations, Canada now suffers several disadvantages versus the U.S., including a sharp increase in minimum wages, tightening environmental rules and a general increase in tax rates. These concerns will only be further magnified should the U.S. continue to increase the imposition of tariffs.

Financial market implications

We suspect that markets will be broadly unchanged given few expectations and how little was announced. Indeed, Budget 2018 is likely to be perceived as a 'placeholder' until next year, given that budgets are generally bigger in scope when immediately before or after an election year. Spending and initiatives should continue to be supportive for growth, and initiatives towards innovation and the support of research should be positive for the long-term outlook, but our concerns around Canada's competitiveness remain a focus and went largely unaddressed.

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