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Analyses and Highlights of Fall Economic Statement – 2 Summaries

Introduction - The Price You Pay

The global fiscal situation is precarious as a generation of rock bottom interest rates now seems to be at an end. The Era of 'We Can't Afford Not to" may be about to be replaced by the era of "We Can't Afford Anything".

As the United States Federal Reserve and the Bank of Canada have spent recent weeks laying track for interest rates that may end up higher than the previously thought terminal rate between 4% and 4.5%, governments at the federal and provincial levels have been wearily eyeing their balance sheets.

Recent events in the United Kingdom, that saw a run in the currency markets followed by increased borrowing costs, have everyone wondering "who is next?" as short-term government debt becomes much more expensive.

Against that backdrop, the Liberals are walking a tightrope with the NDP Confidence-and-Supply-Agreement (CASA). The New Democrats have been sending very loud signals that they have no appetite for anything perceived as 'austerity' and have even gone so far as to criticize recent Bank of Canada interest rate increases.

The Liberals are caught between the proverbial rock and a hard place: unforgiving financial markets on the one hand and demanding New Democrats on the other.

All of this against a background of a winter that could see energy and food shortages tied to the Russian invasion of Ukraine. Two very real threats that could push inflation back into the stratosphere.

Finance Minister Chrystia Freeland seems to understand this. She has the unenviable task of trying to face a new fiscal reality, while living in a political reality that badly wants it to be 2017 again.

Today was her first test for this new era.

Let's see how she did.

Fiscal Outlook - "The Name's Bond...Bond Markets."

As expected in an inflationary environment, higher prices – and higher wages – are leading to more government revenue. Revenue is up more than $37.1 Billion from what was projected in the budget. Meaning that the government's deficit is now $36.4 Billion, which is $16.4 Billion less than projected in the April budget, but still more than the $25.8 Billion that the Parliamentary Budget Officer is projecting.

Total government spending has been under the microscope in recent weeks as the Finance Minister wrote to her Cabinet colleagues earlier this fall about an expectation that they find 25% savings for every dollar in new spending that they request. Total government spending revealed today was $472.5 Billion, which is $20 Billion more than the government was projecting it would spend in April.

Recent events in financial markets, including rate hikes by the Bank of Canada and the U.S. Federal Reserve, along with the crash of the UK's mini budget have drawn the focus of the business press and financial markets back to debt servicing costs for the first time in decades. During the pandemic, low interest rates and quantitative easing meant record low debt servicing costs. While no one is expecting an imminent return to the debt servicing issues that plagued the federal government in the early nineties, an increase in that cost pressure was expected as interest rates increased, and short-term government debt came to amortization.

The most recent budget had an intermediate term balanced budget outlook of $8.4 Billion by 2026-27. While the Parliamentary Budget Officer has suggested that number is more likely to be $3.4 Billion in the same timeframe. New cost pressures, along with new revenue can change that, and today's balanced budget timeline was revealed to be Fiscal Year 2027-28 when the government is now projecting a $4.5 Billion surplus.

Back is talk of fiscal anchors, after a notable absence from a couple of federal updates. The Liberals are highlighting the Debt-to-GDP ratio as a key guidepost to navigate tougher fiscal times.

New Government Priorities

Key announcements in this document include federal student and apprenticeship loan interest forgiveness, a doubling of the GST rebate (which the Finance Minister pointed out in her remarks would be hitting doorsteps tomorrow), and new housing measures related to market speculation and retrofits to help aging, or disabled, Canadians in multigenerational households.

The government also took an interest in a key pocketbook issue, pledging to help Canadians and small businesses tackle rising credit card fees – a key ask of many small business advocacy groups in recent weeks.

On top of that, one of the headlining measures that the government is keen to point to for its progressive critics, is a new share buyback tax that will take effect in fiscal year 2023-24. The tax is expected to generate $2.1 Billion in new revenue over five years. That will be key to track to see if the revenue materializes, but its presence may be more important than the revenue it generates. Any new taxes are a signal to the markets that the government is interested in the overall monetary supply and isn't afraid to take fiscal measures to tighten it.

A key policy announcement that will bear long-term watching is the Canada Growth Fund. The focus here is squarely on productivity, technological development, and capital investment. The Fund was initially announced in Budget 2022, but its appearance here has more meat on the bone, including an arms-length governance structure, a clear focus on natural resources and supply chains, and a target date for its launch.

The Liberals are selling this as their response to the Inflation Reduction Act recently launched in the United States, to guard against capital flight to our southern neighbour especially with the American dollar enjoying a gangbusters year on currency markets. Critics will wonder how this exercise will be different from the languishing Canada Infrastructure Bank experiment.

Time will tell. But, for now, it's likely that the business community will welcome a new focus on capital, technology, and productivity.

Liberal Political Outlook

The position this government finds itself in is unenviable, trying to address the rising cost of living, while not adding to inflation– all with the looming fear of even tougher times ahead. Yet, it is still much more enviable to be in government than in opposition, and the Fall Economic Statement that the Finance Minister delivered shows that the Liberals are trying to do everything they can to keep it this way. It was a restrained FES with targeted investments to help swat off criticism from both sides.

With recent polling showing that the Liberals are behind (by a rather significant margin) to the Conservatives on who is the best party to deal with the rising cost of living, it is no surprise that what Freeland touched on at the top of her remarks was just that. She recognized the challenging times that Canadians are facing, but in order to avoid any blame that Poilievre and his team will try to attribute to Liberal spending, Freeland reiterated how Canada's economic growth is the strongest in the G7 and defended the government's decision to invest in Canadians during the height of the pandemic, though at the same time mentioning how many of them can no longer be supported.

The investments that they did make were strategic political maneuvers in large part because they responded to the key concerns of the NDP while also scoring wins for themselves.

Neither surprising nor exciting, the FES delivered on what Freeland had been laying the groundwork for over the last few months. It should be enough to keep the opposition at bay for a while, but it will be interesting to see if this strategy stays consistent through to Budget 2023.

If times become more challenging in the New Year, as Freeland suggests they could be, the Liberals have a Conservative opposition who will want to see more restraint, and an NDP partner who will want to see more spending. A line that is harder to walk in a federal budget.

Opposition Political Outlook

Jagmeet Singh's reaction is the most important because of his Confidence-and-Supply Agreement with the Liberals. Singh has staked out comfortably left-wing territory in recent weeks on interest rates, perceived corporate profiteering, and any notion of government austerity. Fiscal Year 2022-23 spending remains notably above pre-pandemic projections for the year, even with new cost pressures, but that seems to matter little to Singh based on his rhetoric.

The question for Singh, as it always is, is will he back up his threats this time? The statement, even while forecasting a potential recession, had no new employment insurance measures that some New Democrats had been looking for. Also notably absent from the document is the biggest funding football in Canadian politics: healthcare.

NDP numbers have shown a notable softness in recent weeks as the electorate increasingly sees the contest shaping up between Prime Minister Trudeau and new Opposition leader, Pierre Poilievre. Singh's challenge is to remain relevant, and to criticize the government meaningfully without wearing any of its less popular decisions. That's a balance he has yet to succeed in striking. New Democrats can point to some small wins around the recently passed dental care supplement and GST rebate. But those will seem of cold comfort to many NDP activists if fiscal times get tighter.

For Pierre Poilievre, the narrative is much simpler. The Conservative leader has already spent weeks trying to portray Liberal spending as the root cause of the country's inflationary woes. Whether his message is resonating is still to be determined and Minister Freeland is working hard to take back the narrative with every speech she delivers.

On the one hand, you have to think that Poilievre prefers seeing Justin Trudeau's Liberals have to try a course correction, rather than having to handle that job himself. Sometimes Opposition does have its benefits. If, as some economists are predicting – and the Fall Economic Statement itself foreshadows - the country takes a turn into recession sometime in early-to-mid 2023 though, Poilievre may find an electorate less interested in the blame game, and more interested in a vision, or plan, to get them out of this.

Poilievre's critics will be quick to point out that this where he has often run into some difficulties of his own – turning his strong words into actions.

Analysis 2

Fall Economic Statement 2022: Buffering – Stay Tuned for Budget 2023

Today, Thursday November 3, Finance Minister Chrystia Freeland tabled the government's Fall Economic Statement (FES), which outlines the current and projected state of the Canadian economy and proposes new measures intended to make life more affordable for Canadians, and make the Canadian economy greener, more sustainable, and more competitive relative to our global peers as a direct response to the U.S.' own inflation reduction plan.

The statement forecasts a deficit of $36.4 billion, approximately $16 billion lower than projected in Budget 2022 due predominantly to high inflation. And, while the statement does propose new measures, many will not be launched before Budget 2023 and several others will be open for consultation before being advanced further.

This year's statement was delivered through a cloud of unpredictability. The pandemic is still a real concern, and it is unknown whether new vaccine-resistant variants of COVID-19 might take hold as fall turns to winter.

Sitting at the centre of the matrix of "generational events" and cascading crises we are currently grappling with is runaway inflation which hit a forty-year high earlier this year. Just as public health officials unexpectedly took the spotlight in the pandemic, central bankers across the world are suddenly assuming leading roles in political theatres as they collectively try to put the brakes on global inflation – largely through blunt force and the aggressive ratcheting up of interest rates.

Inflation has no doubt made life more unaffordable for many Canadians, with the effects being felt most heavily in places like grocery stores where the price of many items on the shelf has been subject to inflationary increases in the double digits. The 'downside' scenario put forth by Finance Canada, predicts that the Canadian economy will be in recession by early 2023.

Other countries are responding at speed and at scale to the challenges in front of us. For example, in August, the U.S. Inflation Reduction Act (IRA) – a comprehensive bill that puts forward nearly $600 billion (CAD) in new spending towards energy security, health, and climate change, as well as enacting revenue raising measures that will be used for deficit reduction, thereby ostensibly reducing inflation – was signed into law by Joe Biden.

The IRA establishes several new tax credits to incentivize the production of zero-emission energy, including significant new credits for nuclear – as well as the manufacturing of the technology, machinery and equipment non-emitting and renewable energy producers rely on. It cannot be understated how significant these measures are.

In addition to needing to respond to affordability and inflation, the federal government had to establish measures that keep Canada's clean energy economy competitive, or risk losing significant new investment to our counterparts south of the 49 parallel.

Making our electricity grid cleaner is a key goal of Natural Resources Minister Jonathan Wilkinson, and if Canada can't effectively attract investment in non-emitting energy and technologies, the endeavor will become increasingly costly, and timelines protracted.

All told, the key themes of this year's Fall Economic Statement can be summarized as:
That amidst the global economic uncertainty, the Canadian economy is slowing down. The Fall Economic Statement confirms that Canada and much of the global economy should be bracing for a mild recession.

A signal that the federal government will exercise fiscal restraint so as not to further stimulate demand in the economy and interfere with the central bank's plans to cool inflation via rate hikes.
Making life affordable for the most vulnerable Canadians, students and lowering credit card transaction fees for small business.

Advancing Canada's net-zero economy with select investments and tax credits.

Affordability

In addition to the rental, dental, and GST measures, the government has put in place already, the government plans to implement measures that eliminate interest payments from all student loans, lowering credit card transaction fees for small businesses, make advance payments on the Canada Worker's Benefit and capitalize the Disaster Financial Assistance Arrangements to help those Canadians impacted by Hurricane Fiona.

Clean Energy and the Net-Zero Economy

A much-anticipated clean energy tax credit was included in statement, in direct response to the tax credit established by the Inflation Reduction Act in the United States. The tax credit is equal to 30 per cent of capital costs will be made available on investments clean technologies, with a focus on net-zero technologies, battery storage solutions, and clean hydrogen. It will be made available for example to nuclear technologies and industrial zero-emission vehicles used in construction and mining and related charging equipment.

The statement also commits to move forward with an additional tax credit for clean hydrogen that was previously announced in 2022.

To incentivize industry to make additional investments in the net-zero economy, the government has re-committed to standing up the Canada Growth Fund, which will incentivize companies to take risks and invest in cutting edge technology in Canada thereby keeping our economy competitive relative to other jurisdictions. At the same time, it's intended to help reduce emissions and meet climate targets; accelerate the deployment of key technologies, such as carbon capture, utilization, and storage (CCUS); and scale up companies that will create jobs, drive productivity and clean growth, and encourage the retention of intellectual property in Canada.

Additionally, the statement commits to establishing the Sustainable Jobs Training Centre to help 15,000 workers upgrade or gain new skills for jobs in a low-carbon economy.

Research and Innovation

The statement confirms that the government will move ahead with the launch of the new Innovation and Investment Agency and will release a blueprint in the coming weeks. The National Research Council will also receive $962 million to modernize their facilities.

Tax on Stock Buy Backs

The statement announces the government’s intention to introduce a corporate 2 per cent tax that would apply to the net value of all types of share buybacks by public corporations in Canada, similar to what was introduced in IRA. Further details will be announced in Budget 2023 and the tax will come into force January 1, 2024.

What to Expect Next

The government has given notice that, when it returns from the Parliamentary break the week of November 15, it will move to legislate the implementation of measures outstanding from Budget 2022 and to formalize some of the initiatives announced today.