Canada: Budget Day

Envy of the G7? Debt to GDP projected to peak at 35.4%

The long and short of the budget, the numbers spilled out slightly better than the projections made in September of 2009. On this point the market was probably already leaning in this direction. The Canadian economy's performance in September 2009 was largely characterized as disappointing in contrast to the upside surprises that have characterized Q4/09 GDP.

Near term government projections see the budget deficit at -CAD53.8bn for 2009-10 which compares with September's forecast of -CAD55.9bn. Skipping ahead to the end of the forecast period, fiscal 2014-15 deficit is wrestled down to a paltry -CAD1.8bn down from September's projection at -CAD5.2bn. That's a pretty aggessive target but a good slug of the improvements in the fiscal profile are expected to be achieved by a firm end date (March 31, 2011) to the government stimulus "Action Plan" which will help to halve the deficit by 2011-12 (projected at -CAD27.6bn).

Achieveable? Curbing spending growth on direct program spending is the one component of total program spending over which the Government has the greatest control. On this front, recent holy cows such as defense spending (1/5 of total gov;t direct spending) are seeing curbs applied that will see a slowing in the rate of previously planned growth. So too are curbs being applied to the international assistance envelope, government administration costs, and closing tax loopholes. In total, over the projection through to 2014-15, is expected to knock out CAD17.5bn worth of spending.

Yet regardless of whether or not the government hits its targets, and there is likely to be significant hand wringing in the domestic press over the details, for markets and foreign investors in Canada, the only real number that they care about is a debt to GDP level and how that stacks up against the rest of the G7 and developed world economies overall. Against the G7, Canada's debt to GDP is the lowest by a very wide margin (half the G7 average). It is a debt to GDP ratio that is expected to peak at 35.4% in fiscal 2010-11 and work its way lower, down to 31.9% by the end of the projection period in fiscal 2014-15. It is a profile that divorces Canada from the negative credit rate risks associated with other developed world sovereign credits.

In an environment whereby the only forecast investors are likely respecting is the date printed on the mayonnaise jar, even in the presence of a substantial miss by the Canadian government on their budgetary projections (changes in the forecasts out over the 5-year projection period can have very sizeable impacts on the size of the tax base - nominal GDP), the risk associated with an adverse deterioration in the Canadian debt profile to the point at which there arises a negative ratings event risk, seems exceedingly remote.

Let the political posturing begin.
The minority Conservatives will need the support of one of the opposition parties to pass the budget legislation. Budgets constitute votes on confidence and a failure to pass a confidence vote forces the collapse of the government. As the polling numbers for any of the opposition parties are less than compelling, it is generally expected that one will step up. Early headlines suggesting that the Bloc Quebec and NDP will vote against. Liberals are on the newswires declaring that they oppose the budget, but will not bring government down now.

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Disclosure appendix

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2 All market data included in this report are dated as at close 04 March 2010, unless otherwise indicated in the report.

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