Market View
Economics and Strategy
NATIONAL BANK OF CANADA FINANCIAL MARKETS
October 2, 2024 - (Vol. VIII, No. 73)

Essence and form of Canada's fiscal advantage

By Warren Lovely

Forget the old stereotype about Canadians being overly apologetic and utterly self-deprecating. When it comes to our nation's relative fiscal standing, we really are braggarts… and have been for some time.

Federal officials rarely miss an opportunity to boast of Canada's lower general government debt burden vs. key peers. The prime minister himself recently held up this balance sheet advantage in defending prospective spending initiatives. But the current federal government can't really take credit for Canada's favourable budget standing. Nor is this notional fiscal advantage, to the extent it exists, really theirs to fully deploy. Instead, the primary assist for Canada's general government debt edge should rightly go to the social security system (i.e., CPP/QPP). Canada's local and regional governments deserve some credit too, where a firm(er) commitment to relative debt containment in certain provincial capitals has been acknowledged by rating agencies.

So yes, Canada's broad public sector model is more fiscally sound than many other advanced countries. But an analysis of budgetary conditions suggests the feds are currently a bit of a weak(er) link. Having locked in a structural deficit, Ottawa is accumulating debt (and paying interest) at a faster clip. Meanwhile, a heavier tax burden has been needed to partially finance elevated levels of federal spending, the latter also reflected in a burgeoning federal employee headcount.

Want to better understand the essence and form of Canada's fiscal advantage? Read on, as we lean into StatCan's recent release of the *Government Finance Statistics* for 2024:Q2.

Box: Federal fiscal bragging is par-for-course

Federal Budget 2024: Excerpt related to international fiscal comparisons

International Comparisons

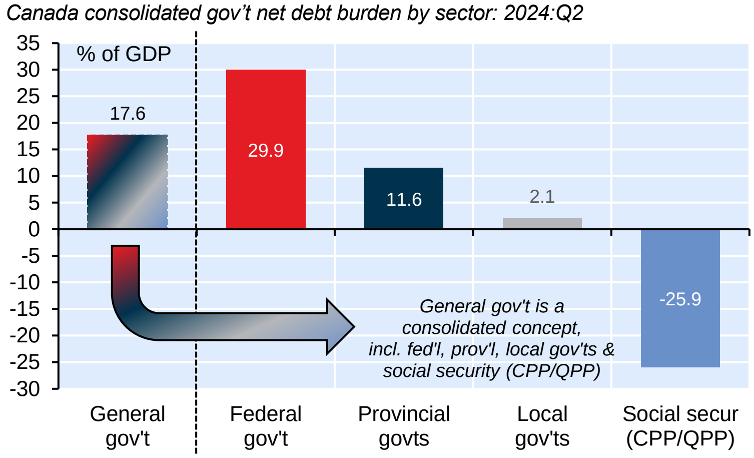
Canada's net debt as a share of the economy remains lower today than in any other G7 country—an advantage that Canada is expected to maintain. Canada's responsible economic plan has also delivered the fastest fiscal consolidation in the G7 since the depths of the pandemic, resulting in Canada having the smallest net debt and deficit in the G7 as a share of the economy over the current and next two years.

By meeting the additional fiscal objectives introduced in the 2023 Fall Economic Statement, Budget 2024 maintains a long Canadian tradition of fiscal responsibility, which is a pillar of Canada's excellent credit ratings from Moody's (Aaa), S&P (AAA), Fitch (AA+), as well as DBRS Morningstar (AAA). Along with Germany, Canada is one of only two G7 economies to have a AAA rating from at least two of the three major global credit rating agencies. — Government of Canada

*Source: GoC (**Budget 2024**, pg 25) | Note: Chart references in original text removed*

Chart 1: A fair bit of nuance to Canada's net debt picture

Canada consolidated gov't net debt burden by sector: 2024:Q2

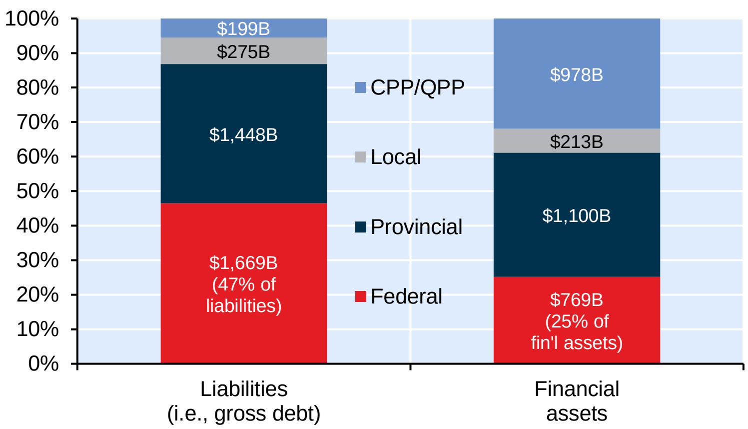


Source: NBC, StatCan (GFS) | Note: Net debt refers to liabilities less financial assets

Federal government officials are seemingly programmed to repeat 'we're number 1', as Canada boasts the lowest general government net debt burden in the G7. While technically true, the general government concept is broad and somewhat nuanced, particularly in Canada where a large (and growing) pool of net assets at the CPP/QPP make a significant contribution to our international edge.

Chart 2: Feds have more debt, fewer financial assets

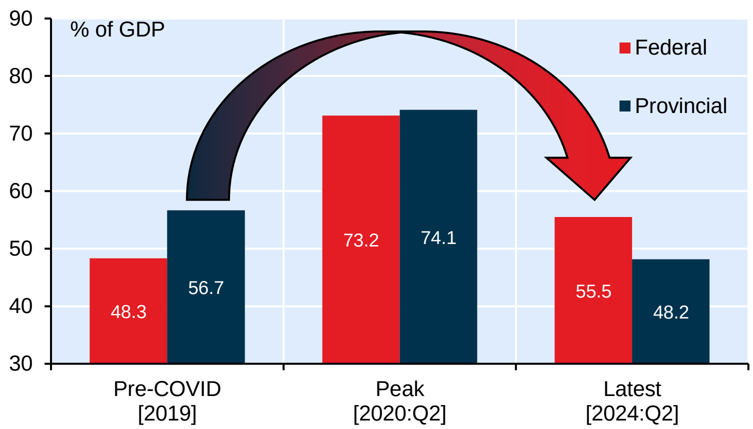
Canada consolidated gov't balance sheet elements by sector: 2024:Q2



Source: NBC, StatCan (GFS) | Note: Financial assets are at market value

Chart 3: Federal & provincial debt loads have been recast

Evolution of Canada federal-provincial government gross debt burden

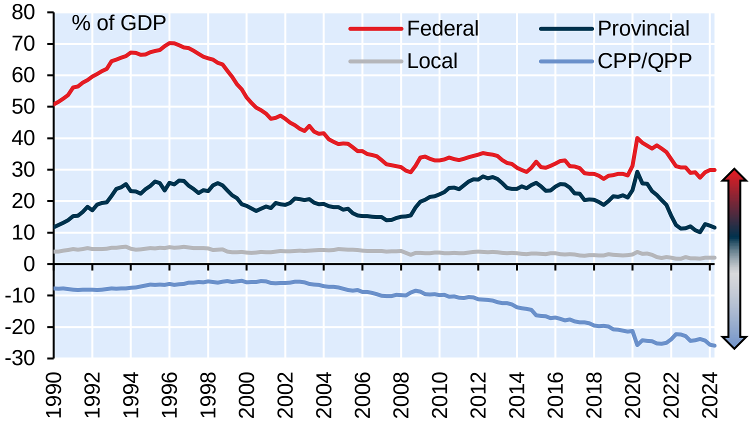


Source: NBC, StatCan (GFS) | Note: 2019 is pre-COVID reference, based on full-year average

Looking at the consolidated government balance sheet, Ottawa accounts for more gross debt and lays direct claim to fewer financial assets than at the provincial level of government… to say nothing of the actuarially sound social security system. On gross debt, the feds and the provinces have essentially swapped positions since COVID hit, Ottawa now carrying the relatively heavier load.

Chart 4: Different (debt) strokes for different (gov't) folks

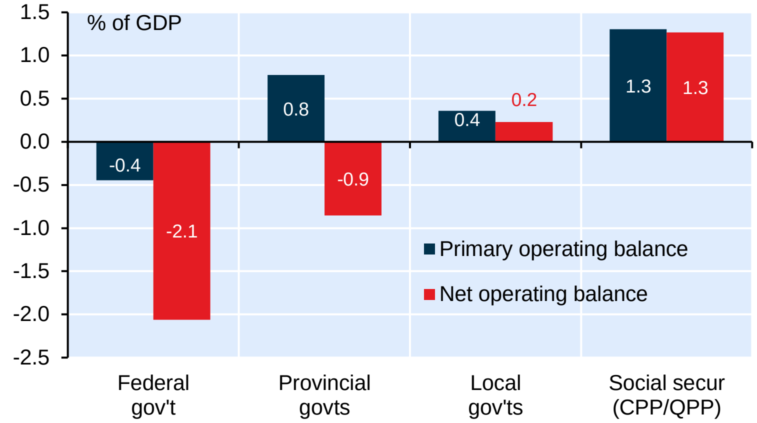
Canada consolidated gov't net debt burden by sector



Source: NBC, StatCan (GFS) | Note: Quarterly data to 2024:Q2

Chart 5: Feds running relatively larger operating deficit

Canada consolidated gov't operating balance: Latest 4Q to 2024:Q2

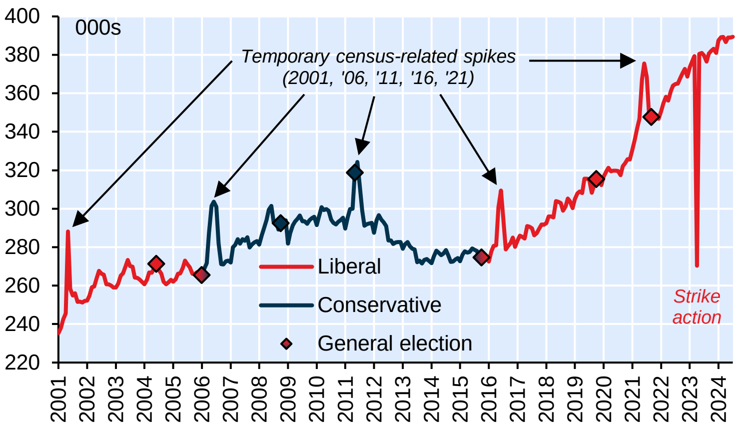


Source: NBC, StatCan (GFS) | Note: Primary operating balance excludes interest expense

Thankfully, the federal debt burden is far removed from the bad-old-days in the 1990s. Moreover, the nonpartisan Parliamentary Budget Office has again stamped Ottawa's status quo policy posture 'fiscally sustainable'. Still, the feds failed to balance the books even when Canada attained full employment and the current operational shortfall compares not-so-favourably to other sectors.

Chart 6: Visualizing today's larger federal gov't model

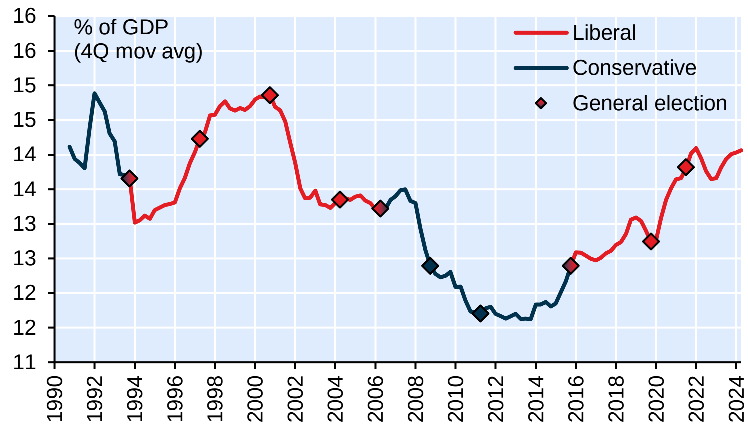
Canada employment: Federal government public administration



Source: NBC, StatCan (SEPH) | Note: Monthly NSA data to Jul-24; special factors highlighted

Chart 7: Federal tax bite has also grown

Canada federal government tax revenue-to-GDP ratio

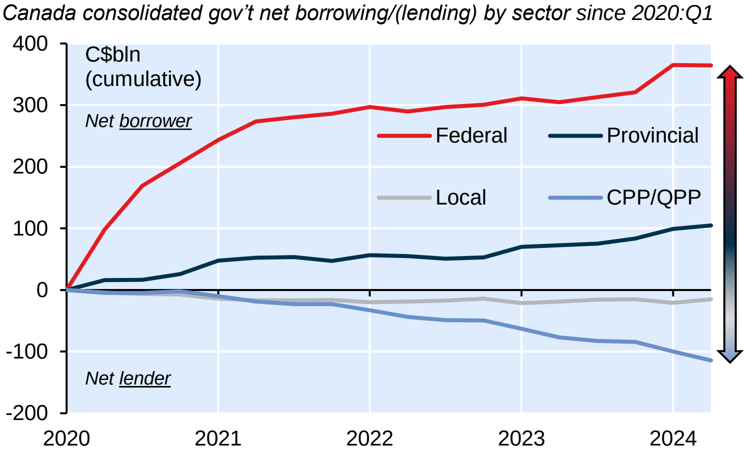


Source: NBC, StatCan (GFS) | Quarterly data to 2024:Q2; mov avg can obscure Q/Q swings

Philosophically, the feds have opted for a bigger government model. A higher ratio of federal program spending-to-GDP tells the story. Ditto for the swelling ranks of federal government employees. This costlier model requires a bigger federal tax bite, which may be sub-optimal given pre-existing concerns over Canada's relative tax competitiveness and our pressing need for new investment.

Chart 8: Ottawa's COVID-related debt made permanent

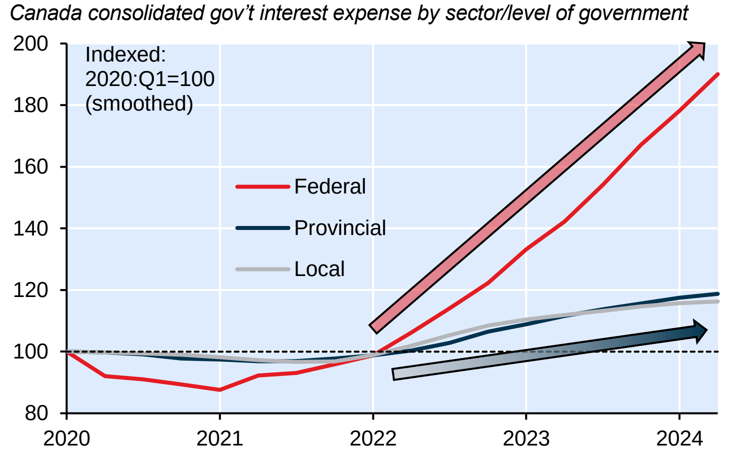
Canada consolidated gov't net borrowing/(lending) by sector since 2020:Q1



Source: NBC, StatCan (GFS) | Note: Cumulative totals covering 2020:Q2 to 2024:Q2 (17Q)

Chart 9: No free lunch, as federal interest bill expands

Canada consolidated gov't interest expense by sector/level of government



Source: NBC, StatCan (Q4) | Note: 4Q mov avg to smooth Q/Q swings in NSA data

While certain COVID support measures were time-limited, the large chunk of debt Ottawa took on during the pandemic has ultimately proven permanent. And again, we're still adding to this debt stock in non-trivial fashion. That pushes Ottawa's funding needs structurally higher. Investors haven't exactly balked mind you, with non-residents swooping in for a record amount of GoC product so far this year. That's nice for as long as it lasts. Meantime, the combination of a larger debt stock, ample interest rate-reset risk and elevated borrowing rates propelled the federal interest bill higher. But wait you say: The BoC is easing policy and GoC bond yields have fallen, right? Really though, debt-laded entities might want to be careful what they wish for, since policy rate easing reflects anemic domestic demand and less underlying inflation, which could complicate the minority government's budgetary path (all else equal). A debt edge yes, but let's have some perspective please.

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