WEEKLY COMMENTARY

It May Be Time to Make Federal Spending Reviews Permanent

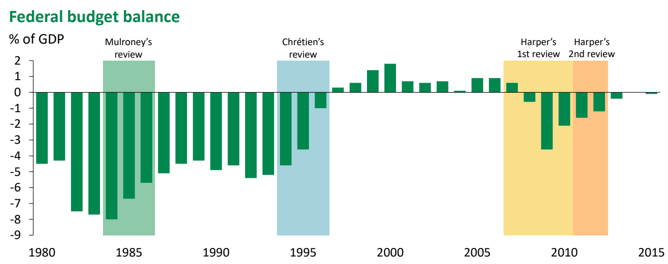
By Jimmy Jean, Vice-President, Chief Economist and Strategist

When the Canadian federal government released its 2023 budget over a year ago, it pledged to conduct a strategic spending review to find $15.4 billion in savings, including $1.3 billion from Crown corporations. The savings were supposed to offset the $43 billion in announced new government spending. It was an attempt to maintain fiscal credibility. The government had previously set a number of fiscal anchors, like keeping the deficit below 1% of GDP starting in 2027. But nearly a year after its announcement, the spending review has found just $9 billion in savings. Meanwhile the government has been announcing new spending measures every day for weeks now.

So what exactly is a spending review? It's when the federal government takes a close look at its operations to either find savings and reduce the deficit, prioritize other spending or optimize the delivery of public services. Five such reviews have been conducted over the past thirty years by both Conservative and Liberal governments. The results have been mixed. The Nielsen review under the Mulroney government was poorly executed and failed to materially turn public finances around. Hence why, after taking office, Jean Chrétien's Liberal government had to do its own review in 1994, with the deficit-to-GDP ratio approaching 5% (graph 1). Unlike his predecessor's review, Chrétien's led to real belt-tightening and laid the groundwork for the budget surpluses his government came to be known for.

Stephen Harper's Conservative government inherited pristine public finances when it took over in 2006. To keep Canada's fiscal house in order after cutting personal and corporate taxes, however, Harper faced some tough choices. But no sooner had he announced a spending review than the financial crisis hit. When the government conducted a second review in 2011, its stated goal was to return to a balanced budget—something it more or less did in the 2014–2015 fiscal year.

Graph 1
Government Spending Reviews from 1980 to 2015



Government of Canada and Desjardins Economic Studies

According to a report by the C.D. Howe Institute, the success or failure of a spending review often hinges on political will. And that tends to be in greater supply at the beginning of a government's mandate. But zealously pursuing unpopular measures can be politically treacherous. After conducting a provincial spending review, Premier Philippe Couillard implemented strict budget controls in Quebec, helping it lose the infamous title of Canada's most indebted province. The Couillard government was subsequently routed at the ballot box in 2018.

The federal Liberals have learned you can't run on fiscal restraint and win. (Some would say they've known it all along.) As a result, the 2023 spending review—announced alongside new spending—failed the sniff test. After all, our policymakers aren't exactly known for budgetary discipline.

This begs the question: is it time to make spending reviews permanent? Countries like the Netherlands and Denmark conduct systematic, transparent, non-partisan reviews of their government spending, and their healthy public finances

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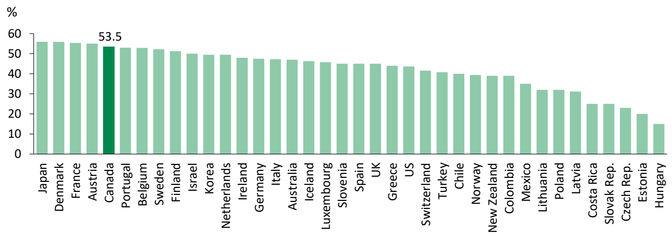
consistently earn them AAA ratings. So there is a blueprint for sound fiscal management that's independent of the election cycle and occasional qualms about fiscal sustainability.

Canada's debt looks pretty good compared to its international peers, but huge challenges lie ahead, including the climate transition, housing affordability and the aging population. The federal government will need to be as lean as possible. But to meet these challenges, trimming $15 billion here and there won't cut it.

Once again, we as a nation need to ask ourselves some tough questions. First, given the challenges we face, what's a realistic and sustainable debt level? Second, what tolerance do we have for approaching this limit, assuming we're not already there? To answer this question, we also need to decide how to fairly distribute the financial burden of those major challenges between generations. Third, assuming we can't get around these imperatives, how much can we leverage taxes given that Canada already has the fifth highest marginal tax rate in the world (graph 2) and needs to stimulate investment, not scare it away?

Graph 2
Canada Has among the Highest Top Marginal Tax Rates in the OECD

Top statutory personal income tax rates, 2022



OECD: Organisation for Economic Co-operation and Development
OECD and Desjardins Economic Studies

We as a country need to have a frank, forward-looking discussion about these issues. Labelling all new spending as bad—even necessary spending and real investment in the future—won't get us anywhere. And any constructive debate must incorporate a counterfactual basis of comparison. At the same time, on the policymakers' side, engaging in the occasional opaque, essentially symbolic spending review isn't a real solution.

It will be difficult to meet all the challenges we face if we don't increase government revenues. Don't be surprised if Tuesday's budget contains tax increases. (See our budget preview for more.) But there is a tendency to underestimate how hard it is to raise taxes. Especially since capital, companies and brainpower know no borders and the 15% global minimum tax on multinationals is really just symbolic.

We've said it before and we'll say it again: generating economic wealth by encouraging private investment and boosting productivity is still the solution that checks the most boxes. The government needs to set a good example and—most importantly—send the right message. Canada's political class has yet to put forward a concrete, cohesive plan to generate the wealth the country needs and keep public finances on a solid footing. And that's a problem.

What to Watch For

By Randall Bartlett, Senior Director of Canadian Economics, Marc Desormeaux, Principal Economist, Marc-Antoine Dumont, Senior Economist, Francis Généreux, Principal Economist, and Tiago Figueiredo, Macro Strategist

UNITED STATES

MONDAY April 15 - 8:30

March	m/m
Consensus	0.4%
Desjardins	0.2%
February	**0.6%**

Retail sales (March) – After adverse weather caused retail sales to decline 1.1% in January, February's 0.6% gain was the biggest monthly increase since September. Sales probably rose further in March. However, based on new vehicle sales data published earlier this month, the automotive sector likely contracted. We expect gasoline stations to have provided some lift, as pump prices climbed further. Preliminary card transaction data is negative for furniture, electronics and food services and drinking places but indicates expansion in other retail categories. Overall, we expect total retail sales and sales excluding motor vehicles and gasoline to have grown by 0.2%.

TUESDAY April 16 - 8:30

March	ann. rate
Consensus	1,480,000
Desjardins	1,520,000
February	**1,521,000**

Housing starts (March) – Housing starts surged 10.7% in February. This was the biggest monthly increase since May 2023, albeit on the heels of a 12.3% drop in January. Based on job creation in the construction industry, improved builder confidence and robust sales of single-family homes, housing starts are expected to have remained virtually flat in March.

TUESDAY April 16 - 9:15

March	m/m
Consensus	0.4%
Desjardins	0.7%
February	**0.1%**

Industrial production (March) – After two straight months of declines in December and January, industrial production edged up 0.1% in February. However, we're expecting March's print to show a more substantial gain, driven by the auto industry and the broader manufacturing sector, where hours worked have increased over the past month. We also think energy production rebounded 2.5% after falling 7.5% in February. Overall, manufacturing output likely edged up 0.4% and industrial production probably rose 0.7%.

THURSDAY April 18 - 10:00

March	m/m
Consensus	-0.1%
Desjardins	-0.1%
February	**0.1%**

Leading indicator (March) – After falling for 23 consecutive months, in February the leading indicator posted its first monthly advance since February 2022. However, its 0.1% gain pales in comparison to the earlier 12.9% decline. It probably won't last either, as we think the indicator edged down by 0.1% in March, with consumer confidence, the ISM index and the interest rate differential likely the biggest detractors.

THURSDAY April 18 - 10:00

March	ann. rate
Consensus	4,110,000
Desjardins	4,250,000
February	**4,380,000**

Existing home sales (March) – After a rather challenging second half of 2023, existing home sales have been quite robust so far this year. At 4,380,000 units, February's home sales were the highest they've been in a year and 13.8% above October 2023's low. Based on pending home sales and preliminary regional data, we expect a decline in sales in March, but they should remain solid at 4,250,000 units on an annualized basis.

CANADA

MONDAY April 15 - 8:30	
February	**m/m**
Consensus	0.7%
Desjardins	0.7%
January	**0.2%**

Manufacturing sales (February) – Manufacturing sales are expected to have increased by 0.7% in February, in line with Statistics Canada's flash estimate, with the largest gains likely in the petroleum and coal subsector. With the seasonally adjusted Industrial Product Price Index suggesting prices probably fell around 0.3% in the month, that would put the increase in manufacturing sales volumes at around 1.0% in February.

TUESDAY April 16 - 8:15	
March	**ann. rate**
Consensus	245,000
Desjardins	230,000
February	**253,500**

Housing starts (March) – Housing starts are expected to have taken a step back in March, dropping to 230K from 253K a month earlier. Input and borrowing costs remain high, skilled labour is in short supply and homebuilder sentiment remains near record lows. And with existing home sales and building permits seemingly going through a bit of a soft patch, it wouldn't come as a surprise if housing starts slowed in the month. Indeed, we expect housing starts to underperform in 2024 relative to last year.

TUESDAY April 16 - 8:30	
March	**m/m**
Consensus	0.7%
Desjardins	0.7%
February	**0.3%**

Consumer price index (March) – Headline consumer price growth likely reaccelerated to 3.0% on an annual basis, a two-tick increase relative to February. Most of that increase will probably be explained by energy prices, in particular gasoline, which rose almost 6% over the month. That said, there is scope for price growth excluding food and energy to have also accelerated, given the precipitous fall in certain categories earlier this year. The Bank of Canada's core measures should remain relatively unchanged on a year-over-year basis, although our recent research does suggest that these indicators are overestimating the stickiness of inflation. Canadian policymakers have indicated they are now looking at a broader suite of inflation indicators, something we have been monitoring for some time.

OVERSEAS

MONDAY April 15 - 22:00	
Q1 2024	**q/q**
Consensus	1.5%
Q4 2023	**1.0%**

China: Real GDP (Q1) – After China posted non-annualized real GDP growth of 1.0% in the fourth quarter of 2023, we expect to see a slight pick-up to start 2024. However, stronger quarterly real GDP growth is likely to trigger a year-over-year slowdown due to a potentially negative base effect. Furthermore, although China continues to grapple with economic challenges, things are improving. PMIs trended up slightly between December 2023 and March 2024. Meanwhile, after four straight months of declines in the consumer price index, inflation turned positive again in February and March. But it's not all good news. Producer prices fell 2.8% year-over-year in March, extending their negative streak to 18 months. Plus, with average home prices dropping again in February, China's property market remains fragile.

WEDNESDAY April 17 - 2:00	
March	**y/y**
Consensus	3.1%
February	**3.4%**

United Kingdom: Consumer price index (March) – UK inflation cooled to 3.4% in February. While still high, that's half the inflation of mid-2023. It's also another step in the right direction for the Bank of England, which is likely to consider cutting its key interest rates soon. However, with core inflation still sticky at 4.5%, the central bank needs to tread carefully. It'll be interesting to see if prices dropped again in March.

THURSDAY April 18 - 19:30	
March	**y/y**
Consensus	2.8%
February	**2.8%**

Japan: Consumer price index (March) – Japanese inflation picked up again in February after falling in the previous three months. Excluding fresh food and energy, prices continued to ease. That said, headline and core inflation are still very high by Japanese standards, which prompted the Bank of Japan to begin cautiously raising its key interest rates at its last meeting. Based on preliminary data from the Tokyo area, inflation likely edged up again in March.

Economic Indicators

Week of April 15 to 19, 2024

Date	Time	Indicator	Period	Consensus	Desjardins forecast	Previous reading
UNITED STATES						
MONDAY 15	8:30	Empire State Manufacturing Index	April	-7.0	-5.0	-20.9
	8:30	Retail sales				
		Total (m/m)	March	0.4%	0.2%	0.6%
		Excluding automobiles (m/m)	March	0.5%	0.4%	0.3%
	10:00	NAHB housing market index	April	52	n/a	51
	10:00	Business inventories (m/m)	Feb.	0.4%	0.4%	0.0%
	20:00	Speech by Federal Reserve Bank of San Francisco President M. Daly				
TUESDAY 16	8:30	Housing starts (ann. rate)	March	1,480,000	1,520,000	1,521,000
	8:30	Building permits (ann. rate)	March	1,520,000	1,500,000	1,524,000
	9:00	Speech by Federal Reserve Vice Chair P. Jefferson				
	9:15	Industrial production (m/m)	March	0.4%	0.7%	0.1%
	9:15	Production capacity utilization rate	March	78.5%	78.7%	78.3%
	13:00	Speech by Federal Reserve Bank of Richmond President T. Barkin				
	13:15	Speech by Federal Reserve Chair J. Powell				
WEDNESDAY 17	14:00	Release of the Beige Book				
	16:00	Net foreign securities purchases (US$B)	Feb.	n/a	n/a	36.1
	17:30	Speech by Federal Reserve Bank of Cleveland President L. Mester				
THURSDAY 18	8:30	Initial unemployment claims	April 8–12	215,000	215,000	211,000
	8:30	Philadelphia Fed index	April	-1.5	-5.0	3.2
	10:00	Leading indicator (m/m)	March	-0.1%	-0.1%	0.1%
	10:00	Existing home sales (ann. rate)	March	4,110,000	4,250,000	4,380,000
FRIDAY 19	9:15	Speech by Federal Reserve Bank of New York President J. Williams				
	17:45	Speech by Federal Reserve Bank of Atlanta President R. Bostic				
CANADA						
MONDAY 15	8:30	Wholesale sales (m/m)	Feb.	n/a	0.8%	0.5%
	8:30	Manufacturing sales (m/m)	Feb.	0.7%	0.7%	0.2%
TUESDAY 16	8:15	Housing starts (ann. rate)	March	245,000	230,000	253,500
	8:30	Consumer price index				
		Total (m/m)	March	0.7%	0.7%	0.3%
		Total (y/y)	March	2.9%	3.0%	2.8%
	13:15	Speech by Bank of Canada Governor T. Macklem				
	---	2024 Federal Budget				
WEDNESDAY 17	8:30	International securities transactions ($B)	Feb.	n/a	n/a	8.88
THURSDAY 18	---	---				
FRIDAY 19	---	---				

Note: Each week, Desjardins Economic Studies takes part in the Bloomberg survey for Canada and the United States. Approximately 15 economists are consulted for the Canadian survey and a hundred or so for the United States. The abbreviations m/m, q/q and y/y correspond to month-over-month, quarter-over-quarter and year-over-year change respectively. Following the quarter, the abbreviations f, s and t correspond to first estimate, second estimate and third estimate respectively. Times shown are Eastern Daylight Time (GMT - 4 hours). Desjardins Economic Studies forecast.

Economic Indicators

Week of April 15 to 19, 2024

Country	Time	Indicator	Period	Consensus m/m (q/q)	Consensus y/y	Previous reading m/m (q/q)	Previous reading y/y
OVERSEAS							
MONDAY 15							
Eurozone	5:00	Industrial production	Feb.	0.8%	-5.5%	-3.2%	-6.7%
China	22:00	Real GDP	Q1	1.5%	4.8%	1.0%	5.2%
China	22:00	Industrial production	March		6.0%		n/a
China	22:00	Retail sales	March		5.0%		n/a
TUESDAY 16							
United Kingdom	2:00	ILO unemployment rate	Feb.	4.0%		3.9%	
Eurozone	5:00	Trade balance (€B)	Feb.	n/a		28.1	
Germany	5:00	ZEW Current Conditions Survey	April	-76.0		-80.5	
Germany	5:00	ZEW Expectations Survey	April	35.0		31.7	
Italy	5:00	Trade balance (€M)	Feb.	n/a		2,655	
Japan	19:50	Trade balance (¥B)	March	-280.0		-451.6	
WEDNESDAY 17							
United Kingdom	2:00	Consumer price index	March	0.4%	3.1%	0.6%	3.4%
United Kingdom	2:00	Producer price index	March	0.2%	0.6%	0.3%	0.4%
Eurozone	5:00	Consumer price index – final	March	0.8%	2.4%	0.8%	2.6%
THURSDAY 18							
Japan	0:30	Tertiary Industry Activity Index	Feb.	0.8%		0.3%	
Eurozone	4:00	Current account (€B)	Feb.	n/a		39.4	
Italy	4:30	Current account (€M)	Feb.	n/a		-1,091	
Eurozone	5:00	Construction	Feb.	n/a	n/a	0.5%	0.8%
Japan	19:30	Consumer price index	March		2.8%		2.8%
FRIDAY 19							
United Kingdom	2:00	Retail sales	March	0.3%	1.0%	0.0%	-0.4%
Germany	2:00	Producer price index	March	0.0%	-3.2%	-0.4%	-4.1%

NOTE: Unlike release times for US and Canadian economic data, release times for overseas economic data are approximate. Publication dates are provided for information only. The abbreviations m/m, q/q and y/y correspond to month-over-month, quarter-over-quarter and year-over-year change respectively. Times shown are Eastern Daylight Time (GMT - 4 hours).