ECONOMIC VIEWPOINT

Chilly Fall Fiscal Update Season Could Make for a Lean Winter

Five Themes from the 2023 Mid-Year Budget Plans in Canada's Provinces

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Highlights

Now that most of Canada's provinces have released mid-year updates to their 2023–24 (FY2024) budget plans, we discuss five takeaways for investors and policymakers.

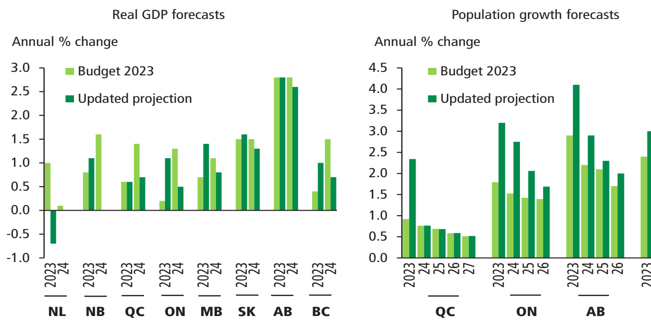
- Economic growth was downgraded, while population growth forecasts were increased
- The budget outlook is generally worse; some of the weakness will persist and some won't
- Most provinces are easing up on affordability relief
- The ongoing population boom complicates the spending picture
- Contingencies are still large, especially in Ontario and BC

1. Economic Growth Was Downgraded, While Population Growth Forecasts Were Increased

The latest government economic forecasts generally assume stronger growth in 2023 and a weaker expansion next year (graph 1). That's in line with the changes to private sector projections since spring budget season. Indeed, we're expecting a mild recession in Canada next year. The exception is Newfoundland and Labrador, where GDP is heavily dependent on oil production, which continues to be held back by shutdowns at offshore oil fields.

However, the four largest provinces significantly increased their population growth forecasts—both for 2023 and the ensuing years. That's consistent with the weakening path of GDP per capita we've seen at the national level.

GRAPH 1
Population Up, Growth Down

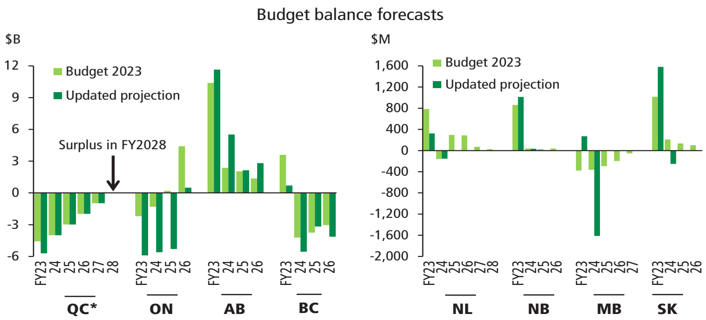


Sources: Provincial budget documents and Desjardins Economic Studies

2. The Budget Outlook Is Generally Worse; Some of the Weakness Will Persist and Some Won't

So far, most provinces have projected worse FY2024 budget balances than they expected in Budget 2023 (graph 2). In dollar terms, Ontario's budget balance downgrade was the biggest, but Manitoba and Saskatchewan also made large downward revisions. Saskatchewan now also expects a modest deficit in FY2024 instead of a solid surplus. Only Alberta bucked the trend, forecasting larger surpluses for each of the next three fiscal years.

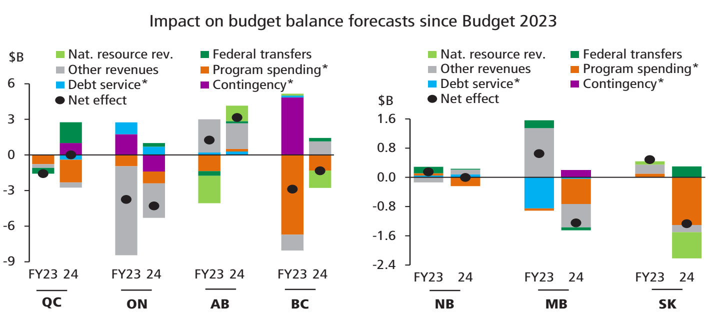
GRAPH 2
Budget Balances Mostly Expected to Be Worse



* After deposits into the Generations Fund
Sources: Provincial budget documents and Desjardins Economic Studies

Though nearly all provinces incorporated a deteriorating economic backdrop into their projections, the drivers of forecast revisions vary. After the federal government reassessed its tax base last year, which we described here, Ontario reduced its personal income tax receipt forecasts significantly for FY2024. Manitoba was hit by the same effect in its mid-year update (graph 3) and impacted by drought-induced income losses at Manitoba Hydro. Saskatchewan was also impacted by drought, which drove up agricultural insurance payments and related spending pressures. BC reported a downward revision in personal income taxes in its first quarter update followed by an offsetting upward revision at mid-year, but a plunge in natural gas prices increased its FY2024 deficit.

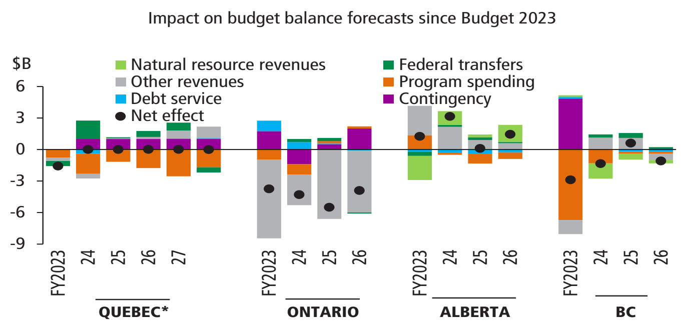
GRAPH 3
Drivers of Budget Balance Changes Vary by Province This Year…



* A positive impact indicates an improvement in budget balance and vice versa
Sources: Provincial budget documents and Desjardins Economic Studies

Some of these effects will persist and some won't. With a considerably smaller tax base than previously anticipated, Ontario reduced its personal income tax receipt forecasts by a total of nearly $22B for FY2024 to FY2026 (graph 4). Manitoba's downward tax base adjustment could reasonably be expected to affect tax receipts in later years as well. The hit to Manitoba Hydro revenues may not. We suspect that Saskatchewan's spending plans will normalize in FY2025, but extreme climate events continue to present downside risk in both jurisdictions. In BC, barring a wholesale plunge in expectations for natural gas prices, the drag on natural resource revenues should diminish beyond this year as well. Meanwhile Alberta expects stronger resource and non-resource revenues in each of the next three fiscal years, driving larger surplus projections alongside plans to keep spending in line with Budget 2023 targets. In Quebec reduced forecast reserves are helping to absorb spending increases in every year of the fiscal forecast horizon.

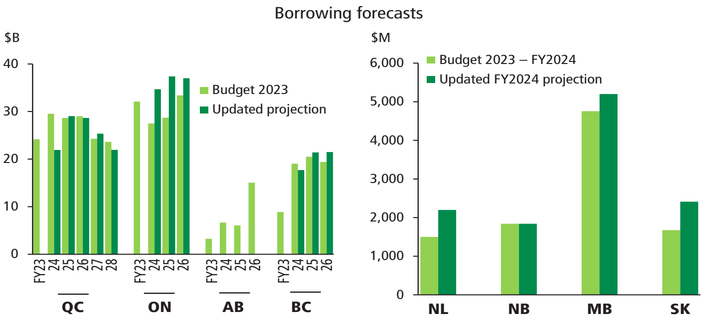
GRAPH 4
…And in the Future



* A positive impact indicates an improvement in budget balance and vice versa
Sources: Provincial budget documents and Desjardins Economic Studies

Changes to borrowing projections mostly mirrored the changes in budget balances. Again leading the pack, Ontario increased its borrowing forecasts by nearly $20B over the next four years (graph 5 on page 3). Newfoundland and Labrador, Manitoba and Saskatchewan boosted their borrowing expectations by $700M, $400M, and $737M respectively.

GRAPH 5
Ontario Is Expanding its Borrowing Plans



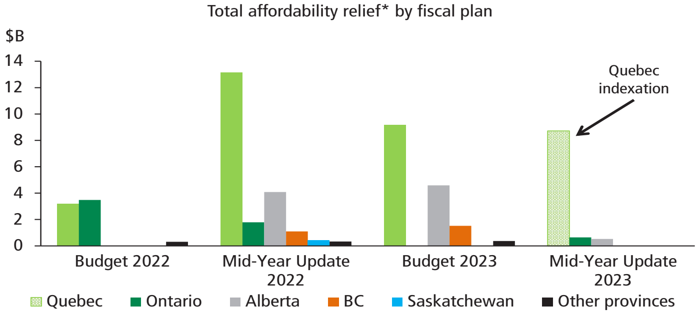
Sources: Provincial budget documents and Desjardins Economic Studies

3. Most Provinces Are Easing Up on Affordability Relief

For the most part, provincial governments continued to wind down affordability supports in their mid-year updates, which we still think is a good thing. While significant progress has been made in the fight against inflation, the battle isn't over yet. Against that backdrop, broad-based tax or fee reductions or household transfers risk restimulating consumer demand and therefore upward price pressures. This in turn could necessitate more restrictive monetary policy than would otherwise be needed, with all the associated economic consequences.

Quebec's mid-year fiscal plan featured further indexation of the income tax system and some social benefits. This is a normal annual process that occurs across provinces and at the federal level, and as such isn't directly comparable to tax/fee relief or direct transfers to households. However, the government did state that "the indexation represents nearly $8.7 billion over five years, that is $2 billion per year to the benefit of all Quebecers." It builds on a series of prior affordability measures (graph 6) and should offer relief to lower- and middle-income individuals who tend to be most adversely affected in periods of high inflation.

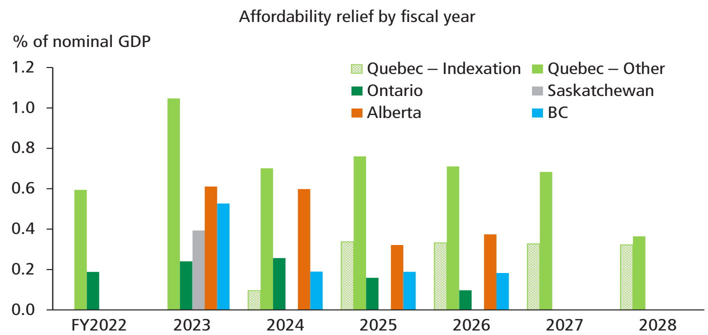
GRAPH 6
Most Provinces Are Easing Up on Affordability Relief



* Includes current and future fiscal year estimates
Sources: Provincial budget documents and Desjardins Economic Studies

It appears that affordability supports peaked in FY2023 and will continue to fall beyond FY2025 (graph 7). In Quebec, however, policies amounting to more than 0.6% of GDP are penciled in for the foreseeable future (not including indexation). Going forward, Alberta may implement the $3.6B personal income tax reduction promised during the 2023 provincial election campaign despite holding off on doing so at mid-year. We discussed the pros and cons of that move here.

GRAPH 7
Most Provinces Are Easing Up on Affordability Relief

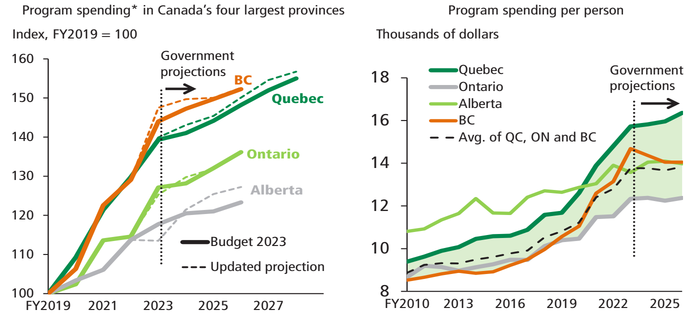


Sources: Finance Canada, provincial budget documents and Desjardins Economic Studies

4. The Ongoing Population Boom Complicates the Spending Picture

Except for the provinces noted above, most governments kept expenditure plans in line with Budget 2023 expectations, and that has several implications. For one thing, combined with still-high inflation and sharp increases in population growth projections, planned trajectories amount to effective spending reductions in some places. Nowhere is that more evident than in BC. The province has lifted spending more than any other Canadian jurisdiction since the pandemic but is currently pencilling in meaningful per-person cuts going forward (graph 8).

GRAPH 8
Incremental Spending Increases + Surging Population Growth = Per Capita Cuts



* Including COVID-19 response measures
Sources: Provincial budget documents, Statistics Canada and Desjardins Economic Studies

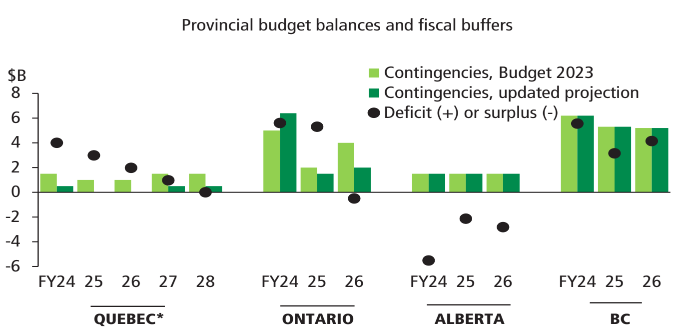
A common refrain on Bay Street these days is that all government spending should be restrained. While we agree that there's reason to be cautious amid uncertain economic conditions, there's also room for nuance. Spending control combined with record or near-record population growth means that provinces will continue to face pressure to increase expenditures or else reduce the overall level of public services. And this comes at a time when longer-run challenges related to affordability and climate change are in full view, which raises the stakes for governments to achieve their infrastructure and homebuilding objectives.

Against that backdrop, we also reiterate that persistent inflation and ongoing wage negotiations still pose upside risk to public sector spending. As more provincial updates were released, we saw several additional increases in health and education expenditure projections in response to this risk.

5. Contingencies Are Still Large, Especially in Ontario and BC

Although forecast reserve reductions helped improve bottom line projections in some jurisdictions this year, there's still a lot of potential fiscal upside in the four largest provinces. Combining the remaining reserve with an increase in the standard contingency fund, Ontario's buffers exceed the planned deficit this year. That's true in every fiscal year of BC's plan (graph 9). The nearly $17B in allocations expected over the next three fiscal years in BC's first and second quarter updates includes $7.5B in funds set aside for public sector wage boosts beyond the base budget increases already assumed for these purposes. That means that in BC, there's less risk of bottom-line deterioration from inflation and public sector wage increases than there is in other jurisdictions. And amid historically high fiscal sensitivity to crude values, Alberta combined unusually large buffers with very conservative oil price forecasts.

GRAPH 9
Contingencies Still Present Some Upside in Large Provinces



* Balance after deposits into the Generations Fund
Sources: Provincial budget documents and Desjardins Economic Studies

The Bottom Line

For Canada's provinces, generally more downcast 2023 mid-year fiscal updates highlighted a range of short-run and long-run challenges. The good news is that still-large contingencies and prudent planning can help these governments avoid the worst.