FEDERAL BUDGET 2019 ANALYSIS

Business Council *of* British Columbia
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BUDGET 2019: LOTS MORE SPENDING, NOTHING TO IMPROVE COMPETITIVENESS OR PRODUCTIVITY

HIGHLIGHTS

- Budget 2019 is a pre-election document that sprinkles new spending across numerous domains. As such, most of the benefits are directed towards households, workers and students.
- While the Budget lacks any clear theme, housing and support for skills development and new training are prominent features of the document.
- The Budget fiscal plan has the government running deficits over the next five years and signals no intention of returning to balance. The annual deficits, however, are manageable as they amount to less than 1% of GDP.
- Unfortunately, the Budget is silent on improving Canada's competitive position. It contained nothing to indicate the federal government is concerned about Canada's waning competitive position.
- The Canadian economy is projected to grow by 1.8% in 2019, down slightly from 2018's 1.9% pace. However, in light of recent data showing the Canadian economy stalled at the end of 2018, risks to the growth outlook are squarely on the downside.

Federal Finance Minister Bill Morneau delivered a pre-election Budget that mainly features a grab bag of new spending measures. There is no real top-line theme to the Budget, with billions of additional spending scattered across a myriad of program areas. The concerns of the business community received short shrift, but there are some measures aimed at households (voters), including assistance for first-time home buyers, relief for indebted students, and new initiatives aimed at training and upskilling the workforce.

There is a smidgeon of extra fiscal stimulus but not enough to prompt forecasters to alter their outlook for the Canadian economy. Budget 2019 includes virtually nothing to help bolster Canada's waning competitive position globally or in the North American context. Among the balls dropped by the Minister was rejecting any notion that the time is right for a broad-ranging review of Canada's increasingly creaky, inefficient and outmoded tax system. Apparently, the current government believes that the steps it took in the Fall Economic Update – introducing the full expensing of business investments in certain categories of capital equipment – are all that's needed to respond to growing worries over Canada's competitiveness. From our perspective, this counts as the biggest shortcoming of Budget 2019.

The document also confirms that the Liberal government is not interested in balancing the books, even with the economy operating near potential. We see no case for running a string of $20 billion operating deficits when the economic cycle is well-advanced and the unemployment rate is hovering near a four-decade low. The planned deficits, however, are small, amounting to less than one percent of GDP. South of the border, the Trump Administration and Congress seem content with deficits in the range of 4% of GDP, at a time when the American economy is operating at full tilt.

TABLE 1: **BUDGET 2019 ECONOMIC ASSUMPTIONS AND FORECASTS**

		FORECAST		
	2018	**2019**	**2020**	**2021**
Canada Real GDP growth (% change)	1.9	1.8	1.6	1.7
Nominal GDP growth (% change)	3.8	3.4	3.5	3.7
Unemployment rate (%)	5.8	5.7	5.9	6.0
CPI Inflation (%)	2.3	1.9	2.0	1.9
Cdn 3-month T-bill (annual average %)	1.4	1.9	2.2	2.3
Cdn 10-year gov't bond (annual average %)	2.3	2.4	2.7	2.8
Exchange rate (US cents/Cdn$)	77.2	76.3	77.2	77.7
Real US GDP growth (chained $2009)	2.9	2.4	1.7	1.7
WTI Crude oil price (US$ per barrel)	66	59	60	61

Source: 2019 Federal Budget.

FISCAL PLAN AND ECONOMIC BACKDROP

Budget 2019 is a pre-election document, with new spending sprinkled across numerous domains. The overall increase in program expenditures for fiscal 2018/19 amounts to ~$15 billion, with another ~$17 billion jump over the following two years. There is a fair degree of back-end loading, as many initiatives do not kick in until 2020 or later. Revenue growth is pegged to downshift from a strong 6.7% increase in fiscal 2018/19 to just 2.0% in 2019/20.

Surging revenues over the last 12 months mean that the deficit for 2018/19 is now projected at $14.9 billion, lower than the $18.1 billion envisioned in the Fall Economic Statement. For 2019/20 and 2020/21, the deficit climbs to roughly $20 billion. The government evidently sees no need ever to return to budget balance, nor does it seem keen to prioritize spending. The good news is that the accumulated federal debt doesn't increase as a share of GDP over the next few years, assuming no recession intervenes. In part, this reflects the impact of continued very low interest rates.

The Finance Minister's expectation that revenue growth will moderate is consistent with the current private sector consensus forecast that Canada's economy is set to lose steam this year. Beyond 2020, Canada will struggle to achieve real GDP growth rates of even 2%, given persistent sluggish productivity growth and a slower expansion in the working age population (notwithstanding Ottawa's ramped up immigration targets). In our assessment, the economic risks for Canada are squarely on the downside. The Canadian economy flatlined in the fourth quarter of last year, and most recent indicators signal a further softening of economic conditions. The job market, however, remains surprisingly solid, even as the data for consumer spending, housing market activity and exports point to a more muted pace of growth going forward.

NEW HOUSING MEASURES

Help for home buyers is a prominent element of Budget 2019, which proposes targeted support for first-time buyers, steps to boost the supply of housing (including in rental markets), and more transparency in the residential real estate sector.

A new First-Time Buyer's Incentive, administered through CMHC, is the Budget's headline housing initiative. It will provide funding of 5-10% of the purchase price to reduce the size of insured mortgages for first time home buyers. CMHC will supply equity funding to qualified home buyers of 5% for existing homes and 10% for newly constructed homes. The Incentive will only be available to first-time home buyers with household incomes under $120,000 per year. A borrowing limit of four times debt-to-income means buyers putting down 5% of the purchase price won't be able

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TABLE 2: **FEDERAL GOVERNMENT FISCAL PLAN**
(BILLIONS OF DOLLARS UNLESS OTHERWISE INDICATED)

	2017/18	2018/19	2019/20	2020/21	2021/22	2022/23	2023/24
Revenues	311.2	332.2	338.8	351.4	366.7	380.7	395.5
% change	*5.5*	*6.7*	*2.0*	*3.7*	*4.4*	*3.8*	*3.9*
Program Expenses	308.3	323.5	329.4	339.7	348.3	358.4	369.1
% change	*6.1*	*4.9*	*1.8*	*3.1*	*2.5*	*2.9*	*3.0*
Public Debt Charges	21.9	23.6	26.2	28.5	30.2	31.4	33.2
% change	*1.2*	*7.8*	*11.0*	*8.8*	*6.0*	*4.0*	*5.7*
Total Expenses	330.2	347.1	355.6	368.2	378.4	389.8	402.2
% change	*5.7*	*5.1*	*2.4*	*3.5*	*2.8*	*3.0*	*3.2*
Adjustment for risk	-	-	-3.0	-3.0	-3.0	-3.0	-3.0
Budgetary Balance	-19.0	-14.9	-19.8	-19.7	-14.8	-12.1	-9.8
Federal Debt	671.3	685.6	705.4	725.1	739.8	751.9	761.7
Per cent of GDP							
Budgetary Balance	-0.9	-0.7	-0.9	-0.8	-0.6	-0.5	-0.4
Federal Debt	31.3	30.8	30.7	30.5	30.0	29.3	28.6

Source: 2019 Federal Budget.

to access the Incentive for homes worth much more than $500,000. In Metro Vancouver, the Incentive will essentially be limited to small condos and apartments.

The new Initiative will create some demand-side stimulus. A proposed increase in the Home Buyers' Plan tax-free RRSP withdrawal limit from $25,000 to $35,000 will also help more first-time buyers amass down payments. In the absence of additional supply of entry-level market housing, more demand will likely put upward pressure on prices. Thus, the government's actions in Budget 2019 may actually work to undermine affordability for first-time buyers – the exact opposite of what policy-makers claim to want.

Meanwhile, a raft of provincial policies and some municipal ones have been put in place to dampen housing demand. In B.C., we see indications that, in response to demand dampening efforts, developers are curtailing building activity as the housing market softens. As we noted in our recent provincial budget review, even the B.C. government is forecasting a steep drop in housing starts in 2019 and 2020. With multiple levels of government implementing new housing policies and taxes with differing objectives, a pull-back in new home construction coupled with the demand side stimulus provided in the federal budget may end up undermining policy efforts to improve affordability.

The Budget does set aside $300 million for a new Initiative that will invite municipalities and other stakeholders to propose new ways to break down barriers that limit the supply of new housing. Here, mark us down as skeptical. Some of the biggest barriers to new housing development are protracted permitting delays and prohibitive municipal development charges and permitting fees. Ottawa is doing little to tackle these issues, which of course are not under its direct jurisdiction.

The government is also targeting the supply of new rental homes for modest and middle-income Canadians through an additional $10 billion in funding over nine years for the Rental Construction Finance Initiative. This Initiative, first launched in 2007, provides low-cost loans for the building of new rental housing, but so far it has resulted in little new construction.

SUPPORT FOR TRAINING AND SKILLS DEVELOPMENT

Budget 2019 includes a handful of measures intended to support Canadians with training and education at varying stages of their careers. For younger people, the government has chosen to reduce the cost of education by cutting the interest rates levied on student loans to prime rather than prime plus 2.5 percentage points. Further, no student will have to repay Canada student loans until they are earning at least $25,000. And, student loans will not accumulate interest during the six-month non-repayment period. Budget 2019 also allocates $40 million over four years to encourage more young people to consider training and work in the skilled trades.

For workers aged 25 to 64, the government is rolling out a new Canada Training Credit to help Canadians pay for training fees. Every year, eligible workers will accumulate a credit balance of $250 per year, up to a lifetime limit of $5,000. To qualify, workers will need to have at least $10,000 in earnings from work and an annual income of less than $150,000. The government is also committing $800 million over five years to support work-integrated learning, mostly through expanding student work placements. The Business Council of B.C. supports this measure.

To further support training, the government is also introducing a new EI Training Support Benefit, expected to launch in late 2020. It will be available through the EI program to provide up to four weeks of income support, every four years, to eligible individuals. This support will amount to 55% of a person's average weekly earnings to help cover their living expenses while on training and without their regular paycheque.

NATIONAL PHARMACARE

Budget 2019 announces the government's intention to advance national pharmacare. While details are scarce, the initial intention is to create a new national drug agency that builds on existing provincial and territorial successes and takes a coordinated approach to assessing drugs' effectiveness and negotiating prescription drug prices on behalf of Canadians. The new agency will also take steps toward the development of a national formulary—a comprehensive, evidence-based list of prescribed drugs. A national strategy for high-cost drugs for rare diseases will also be developed.

NOT MUCH FOR BUSINESS

As noted, Budget 2019 is relatively light on policies, programs and measures to strengthen competitiveness or boost business productivity. But there are a couple of exceptions. One is the support for work-integrated learning, referenced above. A second is a change in the tax rules governing business R&D.

The SR&ED Tax Incentive Program is often cited as a significant source of support by Canada's innovative firms, as it provides a 35% refundable tax credit to eligible small and medium-sized businesses and a 15% tax credit to all businesses performing R&D in Canada. Access to the 35% rate is determined by a business's level of income and capital. To better support growing innovative businesses as they scale up, the government proposes to eliminate the income threshold for accessing the enhanced credit. This will benefit small and medium-sized innovative businesses that are experiencing rapid growth or that may have variable income from year to year.

Businesses will welcome the announcement that the Global Talent Stream pilot becomes a permanent program. Making the Global Talent

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Stream permanent will give Canadian businesses expedited, predictable access to top talent from other international jurisdictions when Canadian workers are unavailable. Budget 2019 directs $35 million over five years, beginning in 2019–20, for this program.

A FEW MEASURES WILL BENEFIT B.C.

For B.C., the proposal to invest $251 million over three years (starting in 2020–21) in Natural Resources Canada to extend existing innovation and diversification programs in the forest sector is a welcome step. This investment includes $92 million over three years for the Forest Innovation Program to support pre-commercial research and development. Another $83 million (also over three years) is targeted to the Investments in the Forest Industry Transformation program, to facilitate the industrial commercialization and adoption of innovative technologies and processes. There is also $64 million directed towards diversifying market opportunities for Canadian forest products and to expand wood use in non-residential and mid-rise construction.

Budget 2019 earmarks funding for a number of research organizations across the country. Of particular interest is $196 million over five years (starting in 2020–21) directed to TRIUMF. TRIUMF is a worldclass sub-atomic physics research laboratory located at UBC. It is home to the world's largest cyclotron particle accelerator and has played a leading role in many medical breakthroughs.

In support of Western Diversification Canada's (WDC) longstanding objective to foster a more resilient and diversified economy in the west, Budget 2019 allocates $100 million over three years to expand WDC's programming in western Canada.

The Budget also includes funding for new tourism related initiatives. While these are pan-Canadian in nature, because B.C. has one of the largest tourism industries in the country our province should gain from the almost $59 million over two years (starting in 2019–20). The funds will be targeted to supporting Canadian businesses and organizations improving tourism-related infrastructure and developing new tourism products or experiences.

A SMATTERING OF GREEN INITIATIVES

For individuals/households, the government is introducing a $5,000 credit for electric and fuel cell vehicles, up to $45,000. To encourage businesses to buy zero-emission vehicles, firms will be eligible for a full tax write off in the year they are put in use.

The federal government is transferring $1 billion to the Federation of Canadian Businesses to support energy-efficiency retro-fitting. Municipalities will also benefit from $2.2 billion directed towards infrastructure needs more generally via a one-time transfer from the Gas Tax Fund.

CONCLUDING THOUGHTS

Budget 2019 contains some promising measures but takes a scatter gun approach rather than focusing on one or two overarching priorities. With an election looming, that isn't surprising. The commitments to strengthen lifelong learning and assist students facing high debt loads are welcome. The First Time Home Buyers' Incentive will benefit some first-time purchasers and stimulate housing demand to a certain degree. And while the measures to support the development of additional low-cost rental stock make sense, we doubt they will have much impact in the near to medium-term given the long time lags involved in building housing in urban areas.

Our biggest concern with Budget 2019 is the absence of meaningful steps to bolster Canada's competitive position or establish an environment that fosters faster productivity growth. While the Fall Statement did provide tax benefits for new investment via enhanced capital cost allowances and investment incentives, we were hoping for further actions to spur capital investment, business scaling, and higher productivity.

Finally, the absence of any commitment to return to a balanced budget is somewhat concerning, especially at this advanced state of the economic cycle. However, the projected deficits are modest in size relative to Canada's $2.2 trillion economy, and the debt/GDP ratio is likely to remain on a gentle downward trajectory as long as the economy continues to grow.

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