Bill Morneau's conundrum: Should the Canadian government spend billions more today?

By Michael Babad
November 1, 2016 – *The Globe and Mail*

Should Ottawa spend more?

Bill Morneau faces a conundrum: With Canada's economy lagging, and Ottawa's fiscal outlook in question, should he spend billions more?

The Finance Minister is expected to unveil fresh measures when he releases his fiscal update later in the day. One big question is whether these will include new stimulus spending.

Recent economic forecasts suggest the Canadian government is under the gun because slower-than-expected economic growth means weaker-than-expected revenue.

But slower-than-expected economic growth also means that perhaps Ottawa should do something about it.

The Nomura economics group, for one, believes Mr. Morneau will devote more money to the cause.

"We expect an increase in the fiscal stimulus to be announced, hoping to boost Canada's underperforming economy," said Nomura's Charles St-Arnaud and David Wagner.

"We believe the Finance Minister could announce an increase in investment spending of about $5-billion for fiscal year 2016 and about $10-billion for fiscal year 2017," they added.

Part of the problem, said Mr. St-Arnaud and Mr. Wagner, is how well the last Liberal tax credit succeeded.

"There is little evidence that the tax credit stimulated consumer spending, as it seems that highly indebted households prefer to save money rather than spend it," they said.

Mr. Morneau could take one of two paths should he choose to boost infrastructure spending, the Nomura economists added.

He could speed up, and thus front-load, the current $120-billion now planned for 10 years, or simply raise the amount.

"In terms of size, we believe the government needs to at least compensate for the lack of impact from the family tax credit," Mr. St-Arnaud and Mr. Wagner said, noting that the measure was projected to juice economic growth by 0.2 of a percentage point this year and 0.4 of a point in 2017.

That's how they arrived at the up to $5-billion in potential added spending this year and $10-billion next.

Others aren't so sure Mr. Morneau will add fresh stimulus, and here's why:

The Bank of Canada and private economists have rejigged their expectations.

The central bank, noted BMO Nesbitt Burns senior economist Robert Kavcic, has cut its forecasts for real economic growth to 1.1 per cent this year and 2 per cent next.

Those are "meaningfully below" the 1.4 per cent and 2.2 per cent, respectively, assumed in the last budget.

"Note that a one-percentage-point miss in real GDP impacts the bottom line by roughly $5-billion, with the impact felt through both government revenues (e.g., lower tax receipts) and program spending (e.g., increased EI benefit payments," Mr. Kavcic said in a report, though he did not say whether he thinks Ottawa will or won't spend more.

Nominal GDP is also below estimates, though bond yields, too, are shy of forecasts, making Mr. Morneau's job a bit easier.

"All told, after spinning these updated forecasts through the budget sensitivity machine, it looks like Ottawa could be facing a deficit of roughly $32-billion for fiscal year 2016-17, versus $29.4-billion projected in the original plan," Mr. Kavcic said.

"Keep in mind, though, that this underlying deterioration could be lessened if Ottawa decides to whittle down the size of its planning contingency (currently equivalent to a hefty $6-billion in the budget), or if the prior-year upside surprise ($4.4-billion smaller deficit) is allowed to flow through this fiscal year," he added.

"But, it could be increased if new measures are unveiled in this update, or other areas like pension liabilities are revised."

Mr. Morneau has some "elbow room' to beat this year's deficit target, said CIBC World Markets chief economist Avery Shenfeld, but he may choose to keep the contingency intact.

"A downgraded outlook for next year might eat into some of the cushion in the 2017-18 budget target, but not jeopardize hitting it," Mr. Shenfeld said.

"These are all just decimal places in terms of the deficit as a share of GDP, so the real focus will be on what Morneau has to say, if anything, about the proposals from his outside advisory group on the infrastructure bank issue, and its other recommendations."