TD Bank Financial Group

TD Economics

Special Report

April 28, 2009

PRIMING THE FISCAL PUMP

Federal and Provincial Stimulus Actions Combine to Inject More than 2% of GDP into Economy in FY 09-10

HIGHLIGHTS

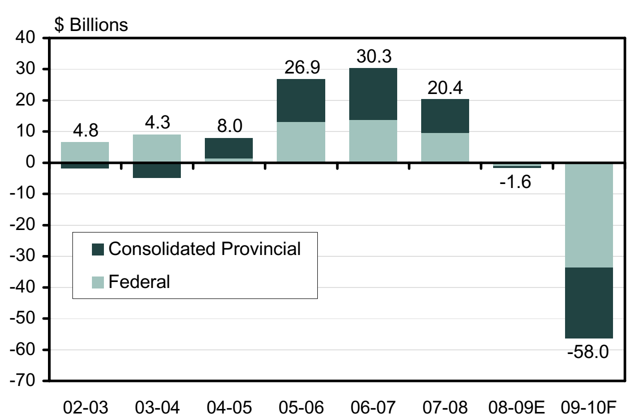
- **A back of the envelope calculation suggests that the amount of federal and provincial stimulus from discretionary actions will exceed 2% of GDP in FY 09-10.**
- **Of this overall tally, the federal and provincial governments are each expected to kick in about one half.**
- **The hefty fiscal injection is consistent with a negative Y/Y swing of $57 billion (3.7% of GDP) in the combined federal-provincial budget balance in FY 09-10.**
- **Still, about one-third of this slippage represents the impact of economic factors (i.e. automatic stabilizers), while two-thirds is discretionary action.**

Among the many objectives in this year's round of federal and provincial budgets, one that stood out was the goal of mitigating the downside risks on economies through fiscal-pump priming. Much of the focus on fiscal stimulus measures has been placed on the federal government in view of its G-20 commitment to take dramatic action. However, developments at the provincial level were every bit as important. In fact, by our estimates, provincial commitments will roughly double the overall amount of stimulus hitting the economy in the near term.

Measuring the amount of fiscal stimulus is no easy task. Generally, the goal is to isolate the dollar value of economic kick from government policy changes. This requires detailed information. Yet government budgets are usually lacking in detail and present information differently, so inferences must be drawn. There are often sizeable discrepancies when policy initiatives are booked in government budgets and when the money is actually spent; infrastructure is a case in point. Then there are the definitional questions. Is the primary objective to identify the new stimulus in a budget or total stimulus from a base period (i.e., taking into account those measures in previous updates and fiscal statements)? Other questions and challenges abound.

In view of these complexities, the purpose of this note is not to nail down the total fiscal boost from federal and provincial fiscal actions to the exact cent, but to provide some key observations and ball-park approximations. Given that a large part of the measures are focused on the cur-

GOVERNMENT BUDGET BALANCES*



*Values are combined totals; Source: 2008 Fiscal Reference Tables (Finance Canada), Government Budgets, TD Economics rent fiscal year (FY 09-10), that is our where our main interests lie.

$55 billion swing in budget balances in FY 09-10

Swift and decisive measures to stimulate an economy through fiscal action usually comes hand in hand with either a declining budget surplus or rising deficit. This year, only one province – Nova Scotia – has yet to bring down its 2009 budget, so we virtually have the full picture. For this fiscal year, the federal and provincial governments are projecting a total budget deficit of $58 billion, representing a $56.5-billion negative swing from the modest $1.5 billion shortfall estimated for FY 08-09.

This dramatic widening works out to be a hefty 3.7% of GDP and is leaps and bounds above the extent of fiscal slippage in both FY 08-09 (1.4%) and FY 07-08 (0.7%).

As we show in the accompanying table, the provincial governments are expected to account for about 40% – or $22 billion – of the overall deterioration in budget balances in the upcoming year. The most substantial negative fiscal swings in FY 09-10 are expected to take place in two jurisdictions that racked up massive surpluses last year: N&L (10.1%) and Saskatchewan (3.2%). Above average deteriorations are also likely for New Brunswick and Ontario.

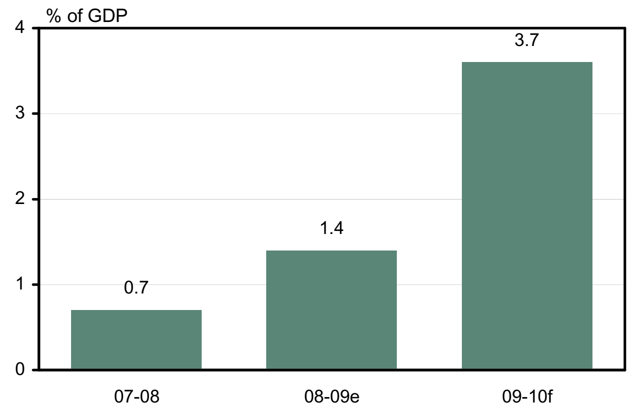
Two-thirds of budget swing discretionary

That's not the end of the story, however. Only a proportion of the deterioration in budgets can be chalked up to discretionary policy changes by governments. The other key driver is the direct impact on coffers from declining tax receipts and rising expenditures that are *automatically* triggered by an economic downturn and that help to moderate economic fluctuations. There is often debate on whether automatic stabilizers qualify as fiscal stimulus. Indeed, at the recent G-20 meeting, European countries argued that their more generous social safety nets should be taken into account in assessing the agreed-upon 2% stimulus target. In any event, it is important to distinguish between these two channels that are used to combat economic downturns.

The impact of automatic stabilizers is most pronounced on the revenue side of the ledger. In FY 09-10, total federal and provincial revenues are projected to decline by about $15 billion. Part of this drop reflects the impact of new or previously-announced tax cuts. However, most of the tax relief hitting the books in FY 09-10 has been targeted and comes with a relatively small price tag. Those governments that unveiled significant multi-year tax reduction plans in their 2009 budgets – such as New Brunswick and Ontario – largely back-end loaded the cuts to FY 10-11 and beyond.

A simple calculation supports the notion that the economic decline – rather than tax cuts – accounts for the majority of the projected revenue loss. Taking the difference in projected nominal GDP on a year-over-year basis (about $70 billion based on TD Economics relatively pessimist forecast) and multiplying it by the average combined federal and provincial tax rate of about 30% yields a total revenue hit in the order of $20 billion.

DETERIORATION IN BUDGET BALANCES*



*Consolidated Federal and Provincial budgets;
Source: Government Budgets, TD Economics

Change in Budget Balances

	$ Millions		% of GDP		
	08-09e	09-10f	08-09e	09-10f	Change
Federal	-1,100	-33,700	-0.1	-2.2	-2.1
Provincial					
N&L	2,434	-750	7.6	-2.5	-10.1
PEI	-41	-85	-0.9	-1.9	-1.0
NS	--	--	--	--	--
NB	-265	-741	-1.0	-2.7	-1.8
Que	0	-3,946	0.0	-1.3	-1.3
Ont	-3,900	-14,100	-0.7	-2.4	-1.7
Man	316	48	0.6	1.0	0.4
Sask	2,318	425	3.9	0.8	-3.2
Alta	-1,426	-4,714	-0.5	-1.8	-1.4
BC	50	-495	0.0	-0.3	-0.3
Total Prov	-514	-24,358	0.0	-1.6	-1.6
Fed & Prov	-1,614	-58,058	-0.1	-3.8	-3.7

Source: Government Budgets, TD Economics

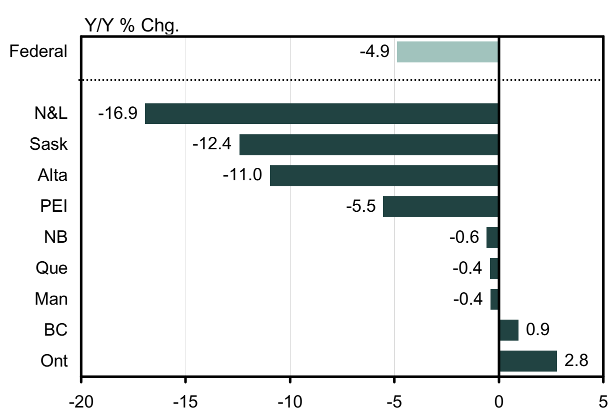
On the spending side, stabilizing mechanisms include the federal employment insurance and provincial welfare programs. Rising net expenditures in these areas are expected to account for another $6-$8 billion of the negative fiscal swing in FY 09-10.

Adjusting the decline in budget balances for these recession-induced impacts leaves a still-lofty injection from discretionary actions of approximately $30 billion or 2% of GDP. Just over half of this total is due to provincial measures. Not surprisingly, there is less provincial variation in the cyclically-adjusted changes in budget balances than the overall changes as those economies suffering a larger decline in total nominal income are also experiencing the largest fiscal reversals. For example, N & L's fiscal deterioration once automatic stabilizers are factored in shrinks to about 4% of GDP, less than half of its projected 10% slippage in its overall budget balance.

Infrastructure the centerpiece of the stimulus

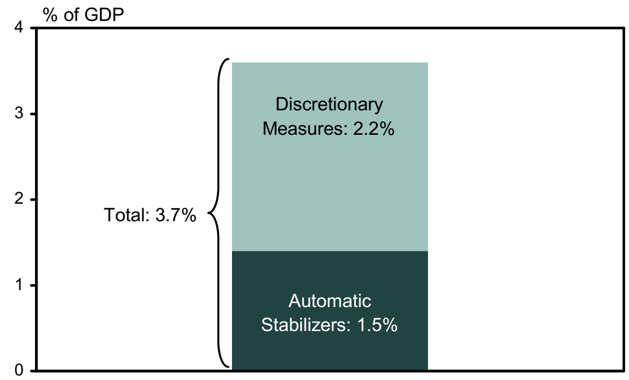
Even adjusting for the economic factors, changes in budget balances alone may actually understate the true amount of stimulus working through the system. This is because infrastructure spending formed the centerpiece of fiscal stimulus packages in this year's budgets. Large public capital projects can provide a significant lift to economies in the short term when the cash leaves the door, but are generally charged to government spending over the life of the project (i.e., accrual accounting basis). As a result, budget spending numbers – which averaged a brisk 7% on average across the 11 jurisdictions – don't capture the whole story.

PROJECTED GOVERNMENT REVENUES, FOR FISCAL YEAR 2009-10



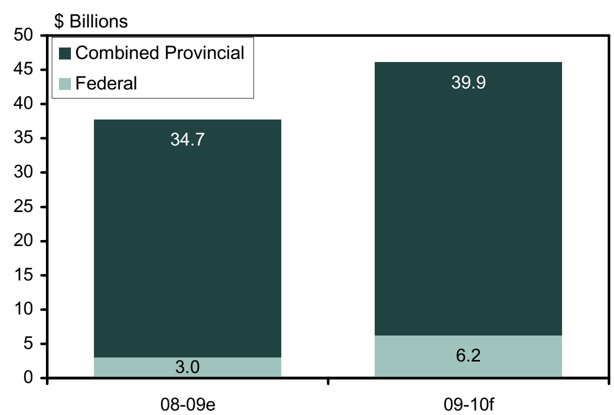
Source: Government Budgets, TD Economics

COMPOSITION OF CONSOLIDATED BUDGET DETERIORATION, FISCAL YEAR 2009-10



Source: Government Budgets, TD Economics

INFRASTRUCTURE SPENDING*



*Cash basis; Source: 2009 Government Budgets, TD Economics

Based on numbers reported in budgets, total federal-provincial capital spending is projected to reach about $47 billion in FY 09-10, or roughly 20% higher than last year's $38 billion estimated tally. The nearly $10 billion increase represents about 0.7% of GDP. In addition, it can be reasonably argued that a significant share of the FY 08-09 capital injection is being directed at projects that are currently providing a significant boost in 2009.

Governments do need to borrow for capital outlays even if the short-term hit on budget balances is mitigated by accrual accounting. This is a key reason why borrowing requirements are poised to surge in the year ahead. Based on a simple add-up of reported debt across jurisdictions, government debt-to-GDP is poised to rise to a combined 51% of GDP in FY 09-10 from 44.6% this year. Keep in mind that this ratio remains half of the peak of close to 100% reached in the early 1990s. During that period, the combined deficit was running at an alarming 9% of GDP.

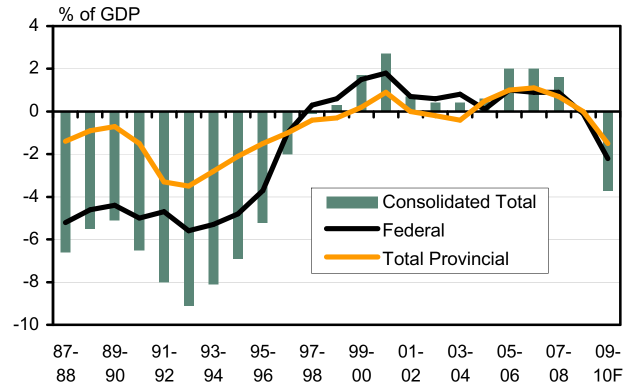
Infrastructure was the measure of choice this year due to its high estimated "multiplier", or the boost to real output from each dollar in budgetary outlay or tax reduction. In its budget, the Federal Department of Finance showed an infrastructure multiplier of 1, which was highest on the list. Most spending measures are deemed to have a multiplier of about 0.8, or at least double the 0.1-0.4 estimated for tax cuts. Nonetheless, the jury is out on how much of this infrastructure money will actually be spent over the next 1-2 years, since the track record of timely capital spending – especially when all three levels of government are involved – has been far from stellar. This may change, however. For example, Ontario has made the case that most of their big-ticket health and other capital projects were already well along in the planning process.

There have been other stimulus measures of note unveiled this year, including ramped up education and training budgets, and help for the most vulnerable sectors/individuals. At the federal level, there were a number of credit measures aimed at unfreezing markets – similar to infrastructure, these measures will help to stimulate economies and will require financing, but won't have an immediate budget hit.

Bottom Line

A back of the envelope calculation suggests that the amount of federal and provincial stimulus from discretionary actions exceeds 2% of GDP. Taking into account the infrastructure cash that has been earmarked in budgets, the ultimate tally could approach 3%.

GOVERNMENT BUDGET BALANCES



Source: Government Budgets, TD Economics

Next year, the economic kick from fiscal policy actions is likely to diminish but only to a modest extent. For one, although this fiscal year has been the focus of fiscal measures, many of the stimulus programs are being phased in over a two-year period. Second, despite building in expectations of a return to economic growth in 2010, most governments that undertake multi-year planning horizons are targeting budget positions that either deteriorate further or remain roughly on par with this year. Lastly, to the extent that capital projects planned for this year encounter delays, the fiscal boost could be further elevated.

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