



April 30, 2010

HIGHLIGHTS

- A surprisingly strong rebound in the economy and revenue take since last autumn point to a deficit closer to \$46-\$47 billion (3% of GDP) in FY 09-10 rather than the \$54 billion (3.5% of GDP) shortfall estimated in the March 2010 budget.
- Based on TD Economics updated economic assumptions, the “status-quo” deficit profile has been shaved by a cumulative \$34 billion over the next five years compared to budget projections. Small surplus now forecast for FY 14-15.
- Debt-to-GDP ratio to peak at 34% in FY 10-11, then fall back to 30% by FY 14-15.
- TD’s “status-quo” projections assume that the government allows the temporary stimulus measures to expire and implements the planned spending restraint.

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FISCAL GREEN SHOOTS

Federal Debt on track to be \$34 billion lower in FY 14-15 than budget projections

As revealed in the February edition of the monthly Fiscal Monitor, the federal government has reaped the benefits of the surprisingly strong bounce in Canadian economic activity since last autumn. While a small budget deficit of \$0.9 billion was still recorded in February, this concealed the fact that revenues are quickly coming back to life after the substantial retreat earlier in the year. In light of this showing, the government is on track to record smaller deficits than it had projected at the time of the March budget.

On the economic front, figures for the fourth calendar quarter of 2009 showed growth in nominal GDP (a good proxy for the tax base) tipping the scales at 10% annualized, well beyond private-sector forecasts. And early readings on the first calendar quarter of 2010 are consistent with another gain of 9-10% in that period. Job markets have also been snapping back, with about two-fifths of the losses during the recession having been recouped by March.

These outsized economic gains have left an indelible imprint on the revenue side of the federal ledger. Year-to-date (April

2009-February 2010) corporate income taxes are running 16.6 per cent below the flow of the previous fiscal year, or less than half the rate of decline experienced during the mid-part of this fiscal year. Personal income taxes revenues are now down 6.9 per cent year-to-date, relative to the 7.8 per cent rate of decline in mid-year. Year-to-date GST revenues are now down 5.3 per cent relative to the previous year compared to declines of 17.9 per cent and 16.5 per cent through September and October respectively.

Accounting adjustments at year-end can have a significant impact on the overall annual fiscal result. Still, with 11 months of the past fiscal year (FY) in the books, it appears likely that the \$53.8 billion deficit (3.5% of GDP) estimate presented in last month’s budget will ultimately get downgraded to about \$46-\$47 billion (3%

**CURRENT TD FORECAST VS. MARCH BUDGET ASSUMPTIONS*
(ANNUAL AVERAGE PERCENT CHANGE UNLESS OTHERWISE INDICATED)**

	2010	2011	2012-14
Real GDP			
Budget	2.6	3.2	2.8
TD	3.5	2.9	2.3
Nominal GDP			
Budget	4.9	5.4	5.0
TD	6.5	5.3	4.4
3-month Tbill (%)			
Budget	0.7	2.4	4.2
TD	0.8	2.6	4.2
US cents/C\$			
Budget	95.5	98.3	98.5
TD	102.6	97.2	92.7

* TD Projections as at April 30, 2010



FEDERAL GOVERNMENT FISCAL POSITION											
(C\$ billions, unless otherwise indicated)											
Fiscal Year	Actual					Est.	Projection				
	04-05	05-06	06-07	07-08	08-09	09-10	10-11	11-12	12-13	13-14	14-15
Budgetary revenues	211.9	222.2	236.0	242.4	233.1	218.5	237.0	257.5	270.4	283.5	297.0
% change	6.7	4.8	6.2	2.7	-3.8	-6.3	8.5	8.6	5.0	4.8	4.8
% of GDP	16.4	16.2	16.3	15.8	14.6	14.3	14.6	15.0	15.1	15.2	15.3
Program expenses	176.4	175.2	188.3	199.5	207.9	235.8	249.0	241.4	245.2	251.4	257.7
% change	14.8	-0.7	7.5	6.0	4.2	13.4	5.6	-3.1	1.6	2.5	2.5
% of GDP	13.7	12.8	13.0	13.0	13.0	15.4	15.4	14.3	13.9	13.6	13.4
Public debt charges	34.1	33.8	33.9	33.3	31.0	29.2	30.6	34.3	37.1	37.9	38.3
% change	-4.6	-1.0	0.5	-1.8	-7.0	-5.8	4.8	12.0	8.3	2.1	1.0
% of Debt (-1)	6.9	6.8	7.0	7.1	6.8	6.3	6.0	6.2	6.5	6.5	6.5
% of Revenues	16.1	15.2	14.4	13.7	13.3	13.4	12.9	13.3	13.7	13.4	12.9
Total expenditures	210.5	209.0	222.2	232.8	238.8	265.0	279.6	275.7	282.3	289.3	296.0
% change	11.1	-0.7	6.3	4.8	2.6	10.9	5.5	-1.4	2.4	2.5	2.3
% of GDP	16.3	15.2	15.3	15.2	14.9	17.3	17.2	16.1	15.8	15.5	15.2
Budgetary balance	1.5	13.2	13.8	9.6	-5.8	-46.5	-42.6	-18.2	-11.9	-5.8	1.0
% of GDP	0.1	1.0	0.9	0.6	-0.4	-3.0	-2.8	-1.1	-0.7	-0.3	0.1
Federal debt*	494.7	481.5	467.3	457.6	463.7	510.2	552.8	571.0	582.9	588.7	587.7
% of GDP	38.3	35.0	32.2	29.9	29.0	33.4	34.0	33.3	32.6	31.6	30.2
2010 Budget											
Budgetary balance	1.5	13.2	13.8	9.6	-5.8	-53.8	-49.2	-27.6	-17.5	-8.5	-1.8
% of GDP	0.1	1.0	0.9	0.6	-0.4	-3.5	-3.1	-1.6	-1.0	-0.5	-0.1
Federal debt*	494.7	481.5	467.3	457.6	463.7	517.5	566.7	594.3	611.9	620.3	622.1
% of GDP	38.3	35.0	32.2	29.9	29.0	33.9	35.4	35.2	34.4	33.3	31.9

* Accumulated deficits. Source: Department of Finance Canada; Estimate for 09-10 and Forecast by TD Economics

of GDP). For one, the revenue momentum likely picked up even more steam as FY 09-10 came to a close, suggesting a \$5 billion revenue overshoot compared to the estimate in the March 4th budget. But as well, there's a good probability that spending will fall short of budget estimates due to departmental expenditure "lapses" and lower-than-anticipated debt service charges.

An upside risk to TD's budget projection for FY 09-10 relates to General Motors' recent announcement that it would repay in full the \$8.6 billion in loans from the U.S., Canadian and Ontario governments. The Canadian federal share of the loans was about \$1.5 billion, although the exact impact will be dependent on the size of the provision that was incorporated into last year's budget. And that provisional amount is uncertain. In any event, the one-time loan recovery could shave another \$500-\$750 million off TD's projected deficit for FY 09-10.

Building in this better starting point, we have provided an updated 5-year fiscal forecast. Some of the assumptions include:

- A stronger nominal GDP performance over the next two years compared to the budget, offset by weaker expected turnouts after 2011 (see table). The difference appears to boil down in part to our interpretation of slower potential growth compared to other private-sector forecasters. On a net basis, the level of nominal GDP (and total revenue) at the end of the 5-year period is slightly higher than that shown in the budget.
- While the Canadian dollar's resilience has led us to upgrade our near-term Canadian dollar call, the projected interest rate profile remains more or less in line with that shown in the budget. Still, debt service charges will fall about \$2 billion below budget by FY 14-15 due to a quicker reduction in the federal debt.
- This forecast is also heavily predicated on the federal government following through with its commitment to allow temporary stimulus programs to expire. We have also assumed that the federal government meets its objective to contain average program spending growth to about 2% per year beginning in FY 12-13. While the



government had provided some broad-brush ideas on how it will accomplish this goal, it has yet to provide specifics.

Putting it all together, our projections slash a cumulative \$34 billion off the 5-year deficit profile contained in the March budget, the bulk of which is front-end loaded to the first three years. Under this scenario, the debt-to-GDP ratio falls back to 30% of GDP by FY 14-15, or 2 percentage points lower than in the Budget. Whereas the govern-

ment continues to project a modest deficit of \$2 billion in FY 14-15, we anticipate a slight \$1 billion surplus. Given this razor-thin improvement five years from now, the good news in the current year cannot breed complacency. What's more, any number of nasty economic surprises could emerge over the next half decade, potentially knocking the federal government off track. And again, the government does have to terminate the temporary stimulus plans and implement the planned spending restraint.

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