



# TD Economics

## Observation

June 2, 2009

### TD ECONOMICS' 5-YEAR FEDERAL FISCAL FORECAST

- TD Economics has released an updated 5-year federal fiscal forecast in the wake of Minister Flaherty's remarks last week on the anticipated deficit for FY 09-10.
- Shortly after the January budget, we released a 2-year-out fiscal projection that super-imposed our economic forecast on the budget figures. We did not include any cost for the auto bailout. At the time, we projected deficits of \$39.2 billion for FY 09-10 and \$42.3 billion for FY 11. Comparable deficits presented in the budget were \$33.7 billion and \$29.8 billion.
- The projection below builds in the cost of the auto bailout. The exact price tag for auto assistance is not yet known, not to mention how the amount will ultimately be reported in the government accounts. We have as-

*The report released earlier today did not include the \$4.3 billion in assistance provided to the Ontario government for sales tax harmonization, a commitment made subsequent to the January budget. The government plans to book \$3 billion of that amount in FY 10-11 and \$1.3 billion in FY 11-12. This version builds in those impacts into the spending forecast, resulting in higher deficits in those two years.*

sumed that an \$8-\$10 billion reserve will be booked in the current year. Furthermore, the March 2008-09 Fiscal Monitor, which was released last week, pointed to a higher deficit last year. Some of this weakness will have carried over into the current year. Putting all of

FEDERAL GOVERNMENT FISCAL POSITION												
(C\$ billions, unless otherwise indicated)												
Fiscal Year	Actual						Est.	Projection				
	02-03	03-04	04-05	05-06	06-07	07-08	08-09	09-10	10-11	11-12	12-13	13-14
<b>Budgetary revenues</b>	190.6	198.6	211.9	222.2	236.0	242.4	229.3	218.6	229.5	245.3	260.8	275.7
% change	3.6	4.2	6.7	4.8	6.2	2.7	-5.4	-4.7	5.0	6.9	6.3	5.7
% of GDP	16.5	16.4	16.4	16.2	16.3	15.8	14.3	14.3	14.7	15.0	15.1	15.1
<b>Program expenses</b>	146.7	153.7	176.4	175.2	188.3	199.5	203.6	240.1	241.6	236.4	244.5	254.1
% change	7.7	4.8	14.8	-0.7	7.5	6.0	2.1	17.9	0.6	-2.2	3.4	3.9
% of GDP	12.7	12.7	13.7	12.8	13.0	13.0	12.7	15.7	15.5	14.5	14.1	14.0
<b>Public debt charges</b>	37.3	35.8	34.1	33.8	33.9	33.3	31.0	29.5	33.3	37.2	39.4	41.0
% change	-6.0	-4.0	-4.6	-1.0	0.5	-1.8	-7.0	-4.8	12.9	11.7	5.9	4.1
<b>Total expenditures</b>	183.9	189.4	210.5	209.0	222.2	232.8	234.6	269.6	274.8	273.6	283.9	295.1
% change	4.6	3.0	11.1	-0.7	6.3	4.8	0.8	14.9	1.9	-0.4	3.8	3.9
% of GDP	16.0	15.6	16.3	15.2	15.3	15.2	14.6	17.6	17.7	16.8	16.4	16.2
<b>Budgetary balance</b>	6.6	9.1	1.5	13.2	13.8	9.6	-5.3	-51.0	-45.3	-28.3	-23.1	-19.4
% of GDP	0.6	0.8	0.1	1.0	0.9	0.6	-0.3	-3.3	-2.9	-1.7	-1.3	-1.1
<b>Federal debt*</b>	505.3	496.2	494.7	481.5	467.3	457.6	462.9	513.9	559.2	587.5	610.5	629.9
% of GDP	43.8	40.9	38.3	35.1	32.2	29.8	28.9	33.6	35.9	36.0	35.2	34.6

\* Accumulated deficits. Source: Department of Finance Canada.

these impacts together, we arrive at the \$50 billion-plus deficit figure referred to by the Minister for FY 09-10.

- With the bulk of the upside surprise since our February forecast representing the auto bailout – which represents a “one-off” expense – we have elected to leave next year’s deficit forecast unchanged at \$42.3 billion.
- Looking out beyond FY 10-11, we have set annual revenue growth to match our economic projections, which are shown in the table. Differing opinions on the evolution of nominal GDP (a good proxy for the overall tax base) is a key point of distinction between our fiscal forecast and that presented in the January budget. Private-sector forecasters, ourselves included, have chopped their 2009 nominal GDP forecasts significantly since January. And, indeed, the government’s acknowledgement of the higher deficit in FY 09-10 is consistent with this downgrade. Still, we continue to build in a substantially weaker rebound in export prices and, to a lesser extent, real GDP in 2010 and 2011 compared to the assumptions in the budget. What’s more, this lost nominal activity is not recouped in future years in our projections. TD’s lower estimate of potential output growth is important to reconciling this difference in viewpoint.
- As noted in the box on page 1, the \$4.3 billion cost to

ECONOMIC & FINANCIAL ASSUMPTIONS*						
Annual average percent change, unless otherwise noted						
	2009	2010	2011	2012	2013	2014-16
Real GDP	-2.4	1.3	3.3	4.1	3.2	2.5
GDP Deflator	-2.2	0.4	1.4	2.0	1.8	2.0
Nominal GDP	-4.5	1.7	4.8	6.2	5.1	4.5
3-Month T-Bill (%)	0.3	0.8	2.8	4.0	4.8	4.8
10-Year Bond (%)	2.8	3.0	4.2	4.8	5.3	5.3

\* Forecast by TD Economics as at March 2009

assist Ontario with sales tax harmonization has been built into FY 10-11 and 11-12. Other than that, we have simply adopted the growth rate track shown in the budget for FYs 11-12 to 13-14. However, debt service costs have been boosted due to the loftier debt-load.

- Under this profile, the federal deficit ends the 5-year period at \$19.4 billion, or 1.1% of GDP. Thus, balancing the budget is elusive unless changes to the policy parameters are undertaken.

#### Constrained spending scenarios

- We also examine two alternative program-spending scenarios (see accompanying tables on page 2 and 3). The goal of this simple exercise is provide an indication of the extent of spending restraint that would be required in order to return to balance over the medium-to-longer term. By comparison, annual program spend-

ALTERNATIVE SCENARIO 1: TWO PER CENT PROGRAM SPENDING GROWTH FROM FY 12-13												
(C\$ billions, unless otherwise indicated)												
Fiscal Year	Actual			Est.	Projection							
	05-06	06-07	07-08	08-09	09-10	10-11	11-12	12-13	13-14	14-15	15-16	16-17
<b>Budgetary revenues</b>	222.2	236.0	242.4	229.3	218.6	229.5	245.3	260.8	275.7	289.4	303.9	317.6
% change	4.8	6.2	2.7	-5.4	-4.7	5.0	6.9	6.3	5.7	5.0	5.0	4.5
% of GDP	16.2	16.3	15.8	14.3	14.3	14.7	15.0	15.1	15.1	15.2	15.3	15.3
<b>Program expenses</b>	175.2	188.3	199.5	203.6	240.1	241.6	236.4	241.1	246.0	250.9	255.9	261.0
% change	-0.7	7.5	6.0	2.1	17.9	0.6	-2.2	2.0	2.0	2.0	2.0	2.0
% of GDP	12.8	13.0	13.0	12.7	15.7	15.5	14.5	13.9	13.5	13.2	12.9	12.6
<b>Public debt charges</b>	33.8	33.9	33.3	31.0	29.5	33.3	37.2	40.0	41.3	42.1	42.3	41.9
% change	-1.0	0.5	-1.8	-7.0	-4.8	12.9	11.7	7.4	3.4	1.9	0.6	-0.9
<b>Total expenditures</b>	209.0	222.2	232.8	234.6	269.6	274.8	273.6	281.1	287.3	293.0	298.2	303.0
% change	-0.7	6.3	4.8	0.8	14.9	1.9	-0.4	2.7	2.2	2.0	1.8	1.6
% of GDP	15.2	15.3	15.2	14.6	17.6	17.7	16.8	16.2	15.8	15.4	15.0	14.6
<b>Budgetary balance</b>	13.2	13.8	9.6	-5.3	-51.0	-45.3	-28.3	-20.3	-11.6	-3.5	5.7	14.6
% of GDP	1.0	0.9	0.6	-0.3	-3.3	-2.9	-1.7	-1.2	-0.6	-0.2	0.3	0.7
<b>Federal debt*</b>	481.5	467.3	457.6	462.9	513.9	559.2	587.5	607.7	619.2	622.6	616.9	602.1
% of GDP	35.1	32.2	29.8	28.9	33.6	35.9	36.0	35.1	34.0	32.7	31.0	29.0

\* Accumulated deficits. Source: Department of Finance Canada.

ing growth has been run at a trend rate of 6-8% per year since the late 1990s.

- These scenarios only assume a starting period of FY 12-13, since economic conditions are expected to be sub-par over the next few years, limiting the scope for significant restraint measures. As well, spending in FY 11-12 is already poised to come under pressure from the expiration of a number of temporary measures put in place in budget 2009.
- Under the first alternative scenario, we hold annual program spending growth at 2% beginning in FY 12-13, or

roughly zero in real terms. Under that plan, balance would not be achieved for six years (FY 15-16).

- If spending were held flat in nominal terms beginning in FY 12-13, the government's books would move back into balance by FY 14-15. Note that many programs have explicit or implicit indexation to inflation and caseloads tend to rise with population. So freezing spending in nominal terms requires cuts to program parameters.

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#### ALTERNATIVE SCENARIO 2: ZERO PROGRAM SPENDING GROWTH FROM FY 12-13

(C\$ billions, unless otherwise indicated)

Fiscal Year	Actual			Est.	Projection							
	05-06	06-07	07-08	08-09	09-10	10-11	11-12	12-13	13-14	14-15	15-16	16-17
<b>Budgetary revenues</b>	<b>222.2</b>	<b>236.0</b>	<b>242.4</b>	<b>229.3</b>	<b>218.6</b>	<b>229.5</b>	<b>245.3</b>	<b>260.8</b>	<b>275.7</b>	<b>289.4</b>	<b>303.9</b>	<b>317.6</b>
% change	4.8	6.2	2.7	-5.4	-4.7	5.0	6.9	6.3	5.7	5.0	5.0	4.5
% of GDP	16.2	16.3	15.8	14.3	14.3	14.7	15.0	15.1	15.1	15.2	15.3	15.3
<b>Program expenses</b>	<b>175.2</b>	<b>188.3</b>	<b>199.5</b>	<b>203.6</b>	<b>240.1</b>	<b>241.6</b>	<b>236.4</b>	<b>236.4</b>	<b>236.4</b>	<b>236.4</b>	<b>236.4</b>	<b>236.4</b>
% change	-0.7	7.5	6.0	2.1	17.9	0.6	-2.2	0.0	0.0	0.0	0.0	0.0
% of GDP	12.8	13.0	13.0	12.7	15.7	15.5	14.5	13.6	13.0	12.4	11.9	11.4
<b>Public debt charges</b>	<b>33.8</b>	<b>33.9</b>	<b>33.3</b>	<b>31.0</b>	<b>29.5</b>	<b>33.3</b>	<b>37.2</b>	<b>40.0</b>	<b>41.0</b>	<b>41.1</b>	<b>40.3</b>	<b>38.4</b>
% change	-1.0	0.5	-1.8	-7.0	-4.8	12.9	11.7	7.4	2.6	0.3	-2.0	-4.6
<b>Total expenditures</b>	<b>209.0</b>	<b>222.2</b>	<b>232.8</b>	<b>234.6</b>	<b>269.6</b>	<b>274.8</b>	<b>273.6</b>	<b>276.4</b>	<b>277.4</b>	<b>277.5</b>	<b>276.7</b>	<b>274.8</b>
% change	-0.7	6.3	4.8	0.8	14.9	1.9	-0.4	1.0	0.4	0.0	-0.3	-0.7
% of GDP	15.2	15.3	15.2	14.6	17.6	17.7	16.8	16.0	15.2	14.6	13.9	13.2
<b>Budgetary balance</b>	<b>13.2</b>	<b>13.8</b>	<b>9.6</b>	<b>-5.3</b>	<b>-51.0</b>	<b>-45.3</b>	<b>-28.3</b>	<b>-15.6</b>	<b>-1.7</b>	<b>11.9</b>	<b>27.2</b>	<b>42.7</b>
% of GDP	1.0	0.9	0.6	-0.3	-3.3	-2.9	-1.7	-0.9	-0.1	0.6	1.4	2.1
<b>Federal debt*</b>	<b>481.5</b>	<b>467.3</b>	<b>457.6</b>	<b>462.9</b>	<b>513.9</b>	<b>559.2</b>	<b>587.5</b>	<b>603.0</b>	<b>604.6</b>	<b>592.6</b>	<b>565.3</b>	<b>522.4</b>
% of GDP	35.1	32.2	29.8	28.9	33.6	35.9	36.0	34.8	33.2	31.1	28.4	25.1

\* Accumulated deficits. Source: Department of Finance Canada.

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