OBSERVATION

TD Economics

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WITH A LIBERAL WIN, INFRASTRUCTURE SET TO TAKE A BIGGER ROLE

Liberal Party forms a majority government; back in power for first time since 2004

- The federal Liberal Party led by Justin Trudeau appears likely to have taken 184 seats (54% of the newly expanded house) in last night's election, a strong gain from the 36 seats (12%) held pre-election; handily passing the 170 seat threshold required for a majority government.
- Strong seat gains were seen in the Atlantic provinces, where the Liberals won all 32 seats available, while also making impressive advances in Quebec, Ontario, and British Columbia.
- The Conservative party was elected in 99 ridings, down from the 159 held when the writ was dropped. As such, the Conservatives will form the official opposition. Former Prime Minister Stephen Harper has stepped down as head of the party, which will now seek an interim leader. Rounding out the major parties, the NDP, led by Thomas Mulcair, won 44 seats, a loss of 51 seats.
- With a strong majority government, the Liberal Party has received a clear mandate from voters for their election platform.

Liberal platform emphasizes infrastructure, tax revamp

- In their election platform, the Liberal party promised a revamping of the tax system and increased infrastructure spending, supported by deficits.
- Many Conservative tax programs, such as income splitting and the Universal Child Care Benefit are to be eliminated, replaced by new programs and benefits. A new Canada Child Benefit targeted at middle income levels is to be introduced, and the personal income tax for those earning between $44,701 and $89,401 is set to be reduced to 20.5% (from 22%).
- A new tax bracket at 33% is to be brought in for those individuals earning more than $200K per year. This would bring the top marginal tax rates to between 43% and 58.75% depending on the province of residency. New Brunswick will have the highest combined tax rate, while a number of other provinces would also have combined top marginal tax rates above 50%, including Nova Scotia, Quebec, and Ontario.
- Income splitting is to be eliminated, and the limit on Tax-Free Savings Account (TFSA) is to be maintained at $5,500 (rather than expanded to $10,000). The TFSA limit will remain indexed to inflation.
- The small business tax rate is set to be reduced to 9% from 11% currently. Employment Insurance premiums are to be reduced to 1.65% (from 1.88% currently), while the qualifying age for Old Age Security will be returned to 65.
- The Liberal platform also includes a plan to revamp and expand the Canada Pension Plan (CPP) to assist those without workplace pension plans. Specifics of how this revamp would work have not yet been released.
- The Liberals have also committed to additional infrastructure spending of $5 billion in the 2016/17 and 2017/18 fiscal years, although exact details of projects and the timing of the spending are not yet available.

Derek Burleton, Vice President and Deputy Chief Economist, 416-982-2514
Brian DePratto, Economist, 416-944-5069

Fiscal plan likely to provide modest stimulus to economy

- To fund their election promises, deficits of roughly $10 billion per year are to be run over the next two years, returning to a balanced budget by fiscal 2019/20. With borrowing costs low and economic growth set to continue, the result of these deficits will be a slightly higher federal debt level than under the current budget path. Table 1 shows the net impact of the Liberal budget plan relative to the Conservative's Spring 2015 budget path.
- While federal debt is likely to be higher than it might otherwise have been, relative to GDP, it will remain on a declining trajectory. Federal net debt is expected to reach 26.5% of GDP by 2021, down from roughly 30% at present, and still the lowest level among the G7 major economies.
- From a growth perspective, our outlook is likely to change as policy is implemented and further details become available.
- It is difficult to assess exact impacts at this early stage, but should the Liberal infrastructure spending materialize, the program could boost annual growth in 2016 and 2017 by up to 0.1 and 0.3 percentage points respectively.

Table 1. Liberal fiscal policy has limited impact on debt level
(Per cent of GDP, relative to spring 2015 budget)

Fiscal year	2016-17	2017-18	2018-19	2019-20
Budgetary Revenues	1.1%	1.2%	1.2%	1.3%
Program Expenses	1.6%	1.6%	1.5%	1.5%
Public Debt Charges	0.01%	0.02%	0.03%	0.04%
Budgetary Balance	0.4%	0.4%	0.3%	0.2%
Federal Debt	0.4%	0.8%	1.1%	1.3%

Source: Liberal Party of Canada, Finance Canada, TD Economics

- For the Bank of Canada, which publishes its quarterly Monetary Policy Report tomorrow, today's election results are unlikely to have a meaningful impact. The boost in growth from infrastructure spending will help take up economic slack, but the bulk of the impact is likely to occur after the output gap has already closed.
- Our current forecast is for the Bank of Canada to begin raising interest rates in July of 2017, increasing the policy rate to 1.25% (from its current level of 0.5%) by the end of 2017. It is possible that with additional infrastructure-led growth the Bank may choose to begin hiking rates earlier.

Markets processing implications, but lasting impacts likely small

- The Canadian dollar was down versus its American counterpart on Election Day, alongside the TSX. Overnight trading saw the Loonie further weaken as election results came in, but the currency has since recovered and was trading above yesterday's close as of 7:45 this morning.
- Pre-election polling had suggested that a Liberal minority was likely, leading to a risk that market volatility could spike around potential no-confidence votes. With a majority government, this risk has been eliminated.
- Looking at interest rates, the election impact is likely to be small. The commitment to infrastructure spending funded by budget deficits may create some pressure on rates, but given the favourable fiscal dynamics and small size of the spending commitment, any impact is expected to be minor, and likely show up on the very long end of the yield curve.