Placing A Balanced Playing Field Ahead of A Balanced Budget

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Not that long ago, global policymakers ushered in an era of government austerity. But, with growth in most parts of the world still disappointing eight years after the financial crisis, the tide is turning. Indeed, here in Canada the Liberal party won an outright majority in the recent federal election by running on a platform of increased spending and a return to deficits.

However, amidst all of the press that Prime Minister Trudeau's government has received for the bold change in tack, it's easy to forget that provincial government finances can either add or subtract materially to the overall thrust of fiscal policy.

Alberta and Saskatchewan, both of which have low levels of debt outstanding, have seen their growth rates turn sharply negative and surpluses transform into deficits as commodity prices have tumbled. Conversely, Ontario and Québec, which have some of the highest provincial debt loads, will reap much of the benefits from a weaker Canadian dollar, aiding the fiscal consolidation planned in those provinces over the coming years.

Deficits to Shift Away from Provinces

In aggregate, provincial governments will likely see deficits this fiscal year rise to $15.7 bn, their highest level since 2012-13, as restraint in Ontario and Québec is overshadowed by deficits in resource-centric provinces.

That will no doubt add fuel to debt hawks' point that, when provincial finances are combined with those of the federal government, Canada's fiscal position looks decidedly less favourable. However, the total government budget shortfall still looks small in both historical terms (Chart 1, left) and relative to countries like the US (Chart 1, right), where deficits are now rarely discussed outside of far right-wing factions of the political spectrum.

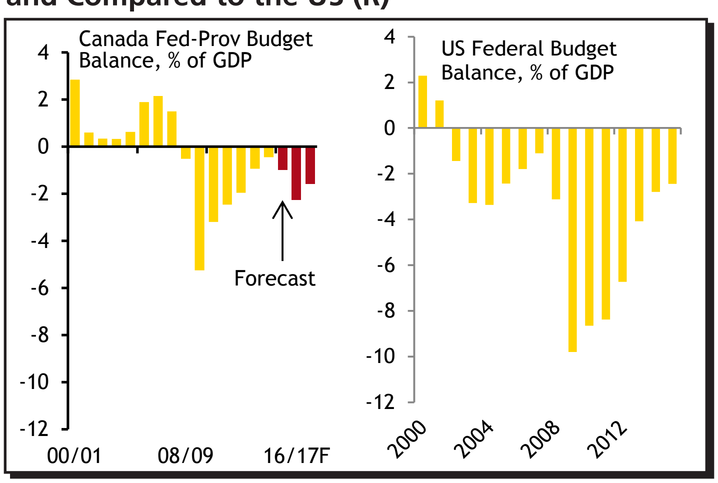
Moreover, the increase in spending at the federal level will actually allow more room for consolidation in some of the provinces with the highest debt-to-GDP ratios by offsetting the associated drag on the economy (Chart 2).

Indeed, further restraint is coming in Ontario and Québec and will see the aggregate provincial budget almost balanced by fiscal year 2017-18. Upcoming budgets in Alberta and Saskatchewan could alter that picture if their governments increase spending meaningfully, but the federal government's deficit plan actually allows provinces to undertake less stimulus than if Ottawa shunned easier fiscal policy.

Only a few years ago, it seemed like the aggregate

Chart 1

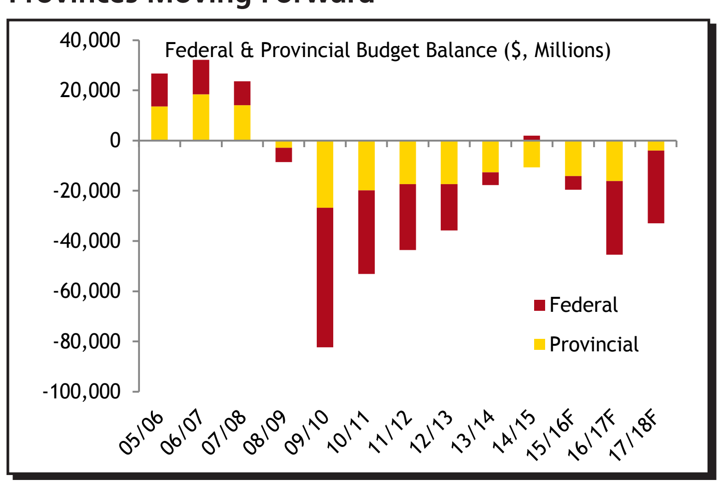
Total Deficits Still Small By Historical Standards (L) and Compared to the US (R)



Source: Haver Analytics, Provincial Budgets, CIBC

Chart 2

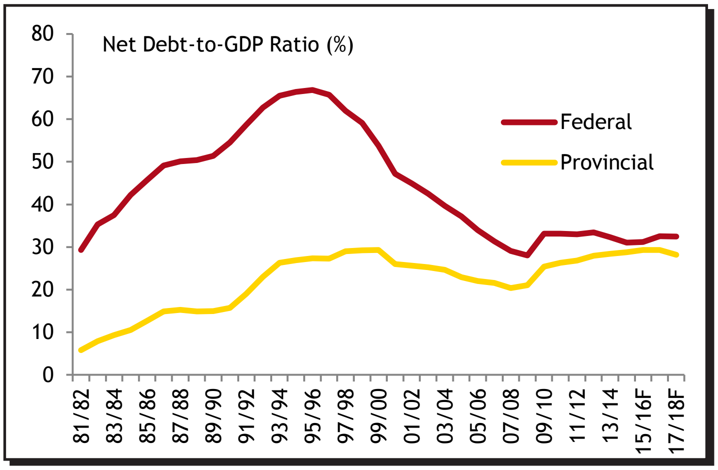
Canadian Government Deficits Less Attributable to Provinces Moving Forward



Source: Haver Analytics, Federal & Provincial Budgets, CIBC

Chart 3

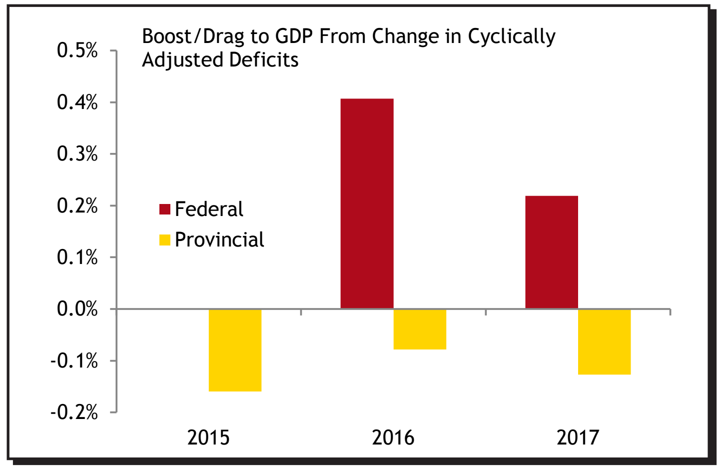
Growth in Outstanding Debt Will Shift Away From Provinces Toward the Federal Government



Source: Haver Analytics, Federal & Provincial Budgets, CIBC

Chart 5

The Federal Government Will Support Growth Over the Next Few Years



Source: Haver Analytics, Federal & Provincial Budgets, CIBC

provincial debt-to-GDP ratio was at risk of rising well above both the federal government's ratio and its own historic high reached in fiscal year 2000–an undesirable shift given the federal government's more favourable borrowing terms. But current policies will see growth in outstanding debt move away from provincial governments and toward the cheaper credit of the federal government (Chart 3). That change will begin to balance a playing field that had become overly reliant on debt-fueled provincial spending.

Stimulus: A Federal Government Exclusive

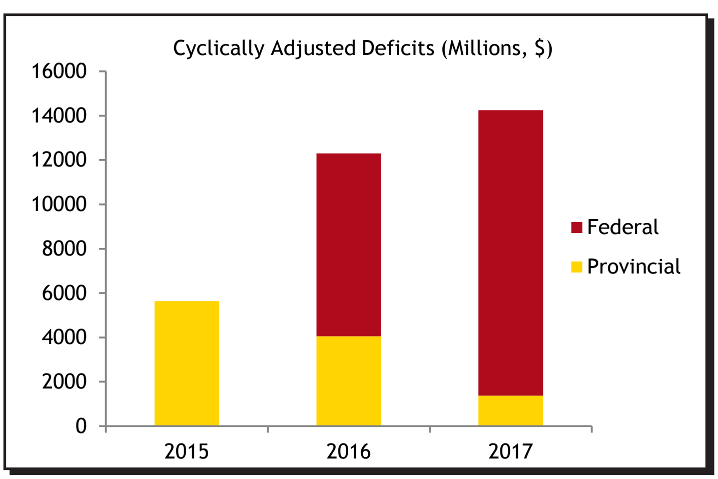
To derive estimates of fiscal policy stimulus, we looked at factors including budget projections, trend growth rates at both the national and provincial level and commodity prices. After accounting for the portion of deficits that were attributable to economic underperformance, we were able to find cyclically adjusted deficits that represented the stimulus being injected by each level of government.

While provinces will continue to run cyclically adjusted deficits over the next couple of years (Chart 4), they will be a net drag on growth as the level of red ink is scaled back (Chart 5). That will offset some of the lift to growth from the ramp up in federal stimulus.

Deficits will marginally increase the debt-to-GDP ratio at the federal level before the effects on growth outstrip the increase in debt and cause the ratio to trend down again. At the provincial level, debt ratios will converge over the coming years as energy-producing provinces see deficits, while central Canada tightens policy (Chart 6).

Chart 4

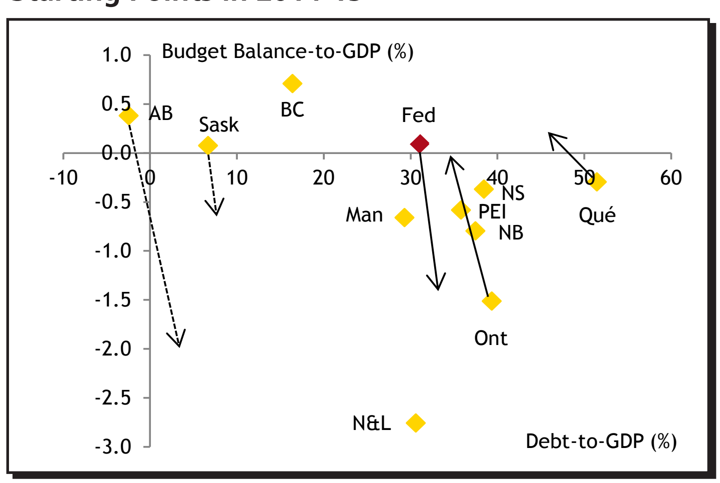
Total Government Stimulus Will Rise This Year



Source: Haver Analytics, Federal & Provincial Budgets, CIBC

Chart 6

Debt-to-GDP Ratios Converging From Divergent Starting Points in 2014-15



Source: Haver Analytics, Federal & Provincial Budgets, CIBC