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A word on the fiscal impact of Canada's wireless spectrum auction

By Warren Lovely

TMT analysts (equity and debt) are understandably abuzz in the wake of Canada's jumbo wireless spectrum auction. If you missed the provisional results (available here), bidders collectively committed a whopping C$8.92 billion for 3500 MHz license rights (vital for 5G networks). This is hardly the first spectrum auction for Canada, but total proceeds were notably larger than anticipated and the most expensive per unit (MHzPOP) globally. Empirically speaking, the latest spectrum auction also absolutely smashed the prior record. Note: The prior high-water mark was C$5.27 billion (back in early 2014); last go-round (in spring 2019), bidders plunked down a combined C$3½ billion at auction (Chart 1).

Again, we'll leave it to equity/corporate credit analysts to opine on the implications for the various bidders (e.g., Rogers, Bell, Telus, Vidéotron, etc). Note: Our colleague, Jonathan Cohen-Domanus, has provided particularly useful context for corporate bond investors. Rather, our focus is on what the spectrum auction means for the Government of Canada's fiscal position. After all, the nearly C$9 billion spent by various wireless players "will be remitted to the Consolidated Revenue Fund, administered by the Receiver General of Canada". More specifically, winning bidders have until August 13th to remit 20% of their payment, the balance being due on October 4th. So the feds will see a couple nice chunks of cash come their way in a couple weeks and again in early fall. How will this be accounted for?

As per government policy: "Spectrum licence fees are recognized as revenue on a straight-line basis over the term of the licence." In this case, the C$8.92 billion relates to a series of 20-year licenses. Quick division means Ottawa will book/record roughly C$445 million per year from the latest spectrum auction. The unrecorded portion (i.e., the remaining 19 of 20 years' worth of revenue) will be treated as "deferred revenue" on the federal balance sheet. As per the public accounts: "Deferred revenue consists of spectrum licence fees and other amounts received in advance for the delivery of goods and rendering of services that will be recognized as revenue in a subsequent fiscal year as it is earned."

By recording only 1/20th of the proceeds per year, the spectrum auction results—while no doubt supportive of federal revenue—won't on their own radically transform Ottawa's report budget balance. Not to trivialize C$450 million/year, but that's barely 0.1% of planned federal revenue for 2021-22 and likewise a tiny fraction of the ~C$155 billion deficit penciled in for this fiscal year via Budget 2021.

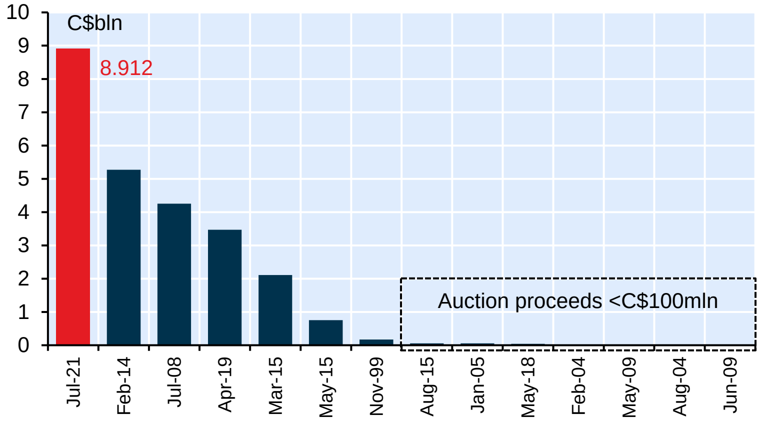
Mind you, if you've even glanced at the latest nominal GDP growth expectations for Canada, you'll sense some (serious) fiscal upside vs. official planning results. We believe stronger-than-planned growth will translate into all sorts of extra federal revenue, above and beyond the spectrum auction proceeds. Aside: The upside "surprise" on nominal GDP growth is even more pronounced at the provincial level, where growth estimates were set down earlier and are, in our opinion, massively conservative at this stage. See a related note here. Moreover, there's mounting evidence of a positive base effect from 2020-21, implying a stronger fiscal handoff than many governments had earlier assumed.

While early days, today's federal *Fiscal Monitor*—covering the first two months of the 2021-22 fiscal year (i.e., April-May 2021)—showed: (a) a surge in revenue; (b) a steep drop in program outlays; (c) a dramatic improvement in the budget balance; and (d) massively lighter (although still notable) net financing requirements compared to the prior fiscal YTD period (Chart 2). Of course, the current base of comparison (i.e., April-May 2020) was a pretty bleak period in terms of COVID impacts, so this is one massively distorted year-over-year fiscal comparison.

All this to say, the feds have a lot of cash coming their way from the spectrum auction, only a portion of which they'll be able to immediately recognize. More broadly, government revenue (federal and provincial) should top planning expectations by a wide margin, spending perhaps going out the door at a slower-than-expected rate. That hints at quicker-than-expected progress on deficit reduction, all else being equal.

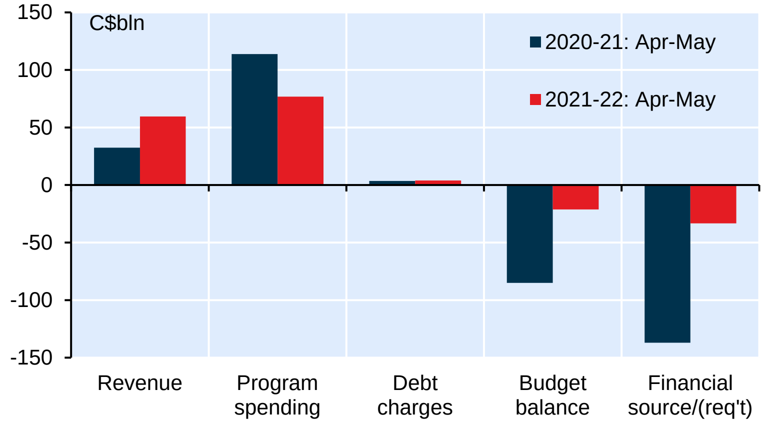
Finally, as for Ottawa's cash influx, might it allow the feds to step down on their bond issuance? Not so fast. At least at first, the extra cash could be used to pay down T-bills not necessarily to cut back on bond issuance, where terming out remains a strategic focus. Fiscal repair would, over time, be consistent with a moderation in net bond issuance (after controlling for maturities), but that's a story for another day.

Chart 1: Latest spectrum auction smashes prior record
Total price paid by winning bidders at Canada spectrum auctions



Source: NBF, Gov't of Canada | Note: Full spectrum auction results available at: https://www.ic.gc.ca/eic/site/smt-gst.nsf/eng/h_sf01714.html

Chart 2: Truly massive swing in fiscal year-to-date results
Government of Canada summary fiscal/financing results: Fiscal YTD basis



Source: NBF, Govt of Canada | Note: Based on first two months of fiscal year; budget balance excludes net actuarial losses

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