Market View
Economics and Strategy

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Better 21, better 22? No contest, however…

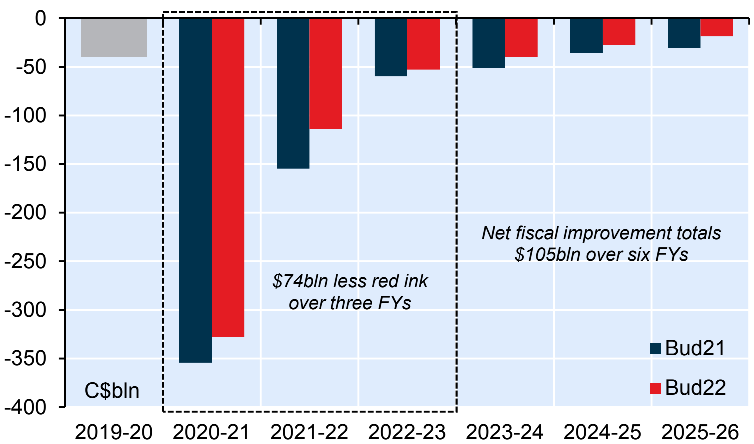
By Warren Lovely

As we await Ontario's pre-election budget (due Thursday), one thing is clear enough: Comparing 2022 budgets to the fiscal blueprints presented a year ago, Canadian government finances have undergone a radical transformation. Subject to final adjustments/updates, the cumulative budgetary improvement to the federal-provincial aggregate deficit as of 2022-23 is north of $200 billion. That is, more than $200 billion has been erased from budget deficits at the federal and provincial levels of government relative to Budget 2021 estimates/forecasts. The provinces account for the majority of this upgrade, with nearly every jurisdiction seeing their finances on a healthier glide path vs. Budget 2021. There's no secret to what's gone on. A resilient economy intersected with ultra-cautious planning assumptions, which meant revenue vastly outstripped expectations while some planned outlays failed to materialize. At this moment, total provincial government revenues for 2022-23 stand 13% higher than what was originally assumed. Not surprisingly, those with greater leverage to commodities are seeing the largest revenue windfalls. Credit the provinces for steering much of their revenue improvement to the bottom line, even if this fiscal rectitude has in some cases frayed a touch of late. Factor in buoyant nominal growth and debt-to-GDP ratios are notably improved vs. earlier forecasts and the prior fiscal year. Interest bites remain quite manageable, provinces having done a nice limiting interest rate reset risk. Annual gross borrowing needs, meanwhile, appear to be tracking ~$50 billion below the level estimated in 2021 budgets. All told, it's an overwhelmingly favourable set of fiscal revisions. What's not to like you ask? Without raining on this budgetary parade, we'd caution that rapid monetary policy normalization will weigh on interest sensitive demand, with some provinces more exposed than others. Aggressive rate hiking combined with quantitative tightening will likewise tighten financial conditions, which could place credit markets increasingly on the back foot.

Note: Additional analysis, including details on projected bond issuance, will be presented following Ontario's 2022 budget. Stay tuned.

Chart 1: Ottawa's fiscal improvement nothing to sneeze at…

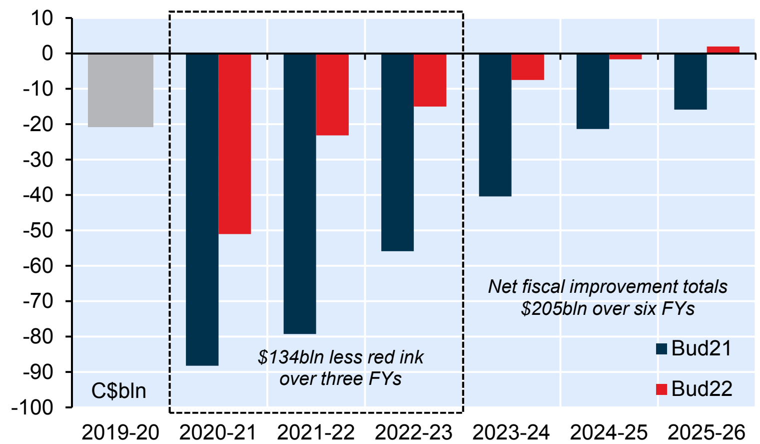
Federal budget balance: Budget 2022 vs. Budget 2021



Source: NBF, GoC

Chart 2: … but more striking revisions at provincial level

Combined provincial budget balance: Latest vs. Budget 2021

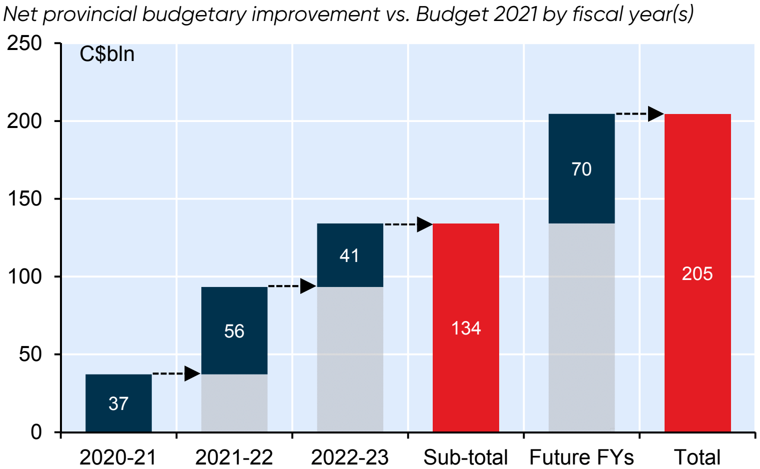


Source: NBF, prov gov'ts, FAO

Canadian budget balances are everywhere improved. Federally, the recent Liberal budget (supported by the opposition NDP) marked down deficits. But the net fiscal improvement is relatively more striking at the provincial level, some $134 billion (and counting) of red ink erased from accumulated deficits through 2022-23. Note: The 10th and final provincial budget, from Ontario, arrives April 28th.

Chart 3: Dissecting provincial fiscal improvement by year…

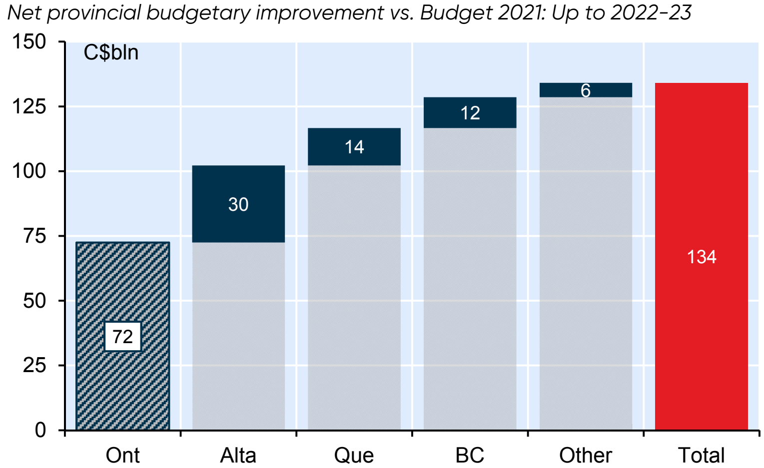
Net provincial budgetary improvement vs. Budget 2021 by fiscal year(s)



Source: NBF, prov gov'ts, FAO

Chart 4: … and jurisdiction (with Ontario budget coming Thursday)

Net provincial budgetary improvement vs. Budget 2021: Up to 2022-23

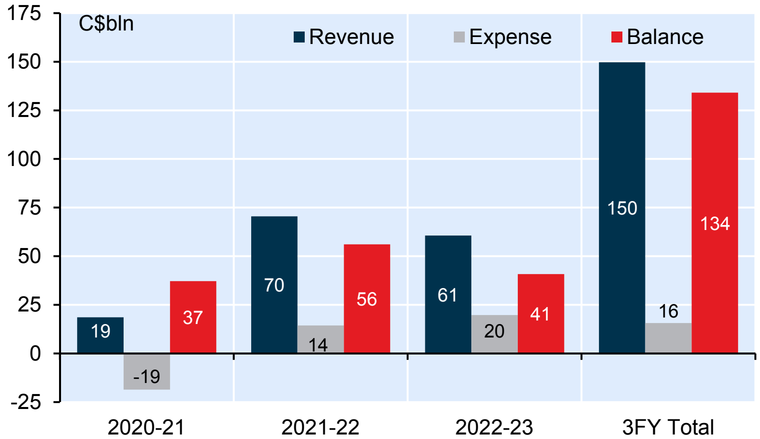


Source: NBF, prov gov'ts, FAO | Note: Ontario subject to change in Bud22

Last fiscal year (2021-22), the combined provincial deficit was $56 billion lighter than planned (with residual improvement still to come). The momentum carries over to the fiscal year that started April 1st, where the combined shortfall is presently $41 billion lighter than what was thought possible this time last year. Most provinces have confirmed net fiscal improvements… some of them huge.

Chart 5: Provincial revenue topped expectations handily

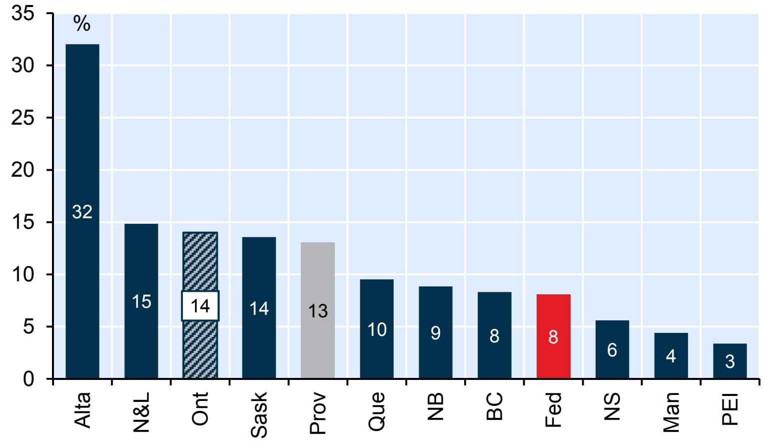
Total provincial revenue & spending: Latest vs. Budget 2021



Source: NBF, prov gov'ts, FAO

Chart 6: Energy leverage = larger relative revenue windfall

Change in 2022-23 federal-provincial revenue vs. Budget 2021

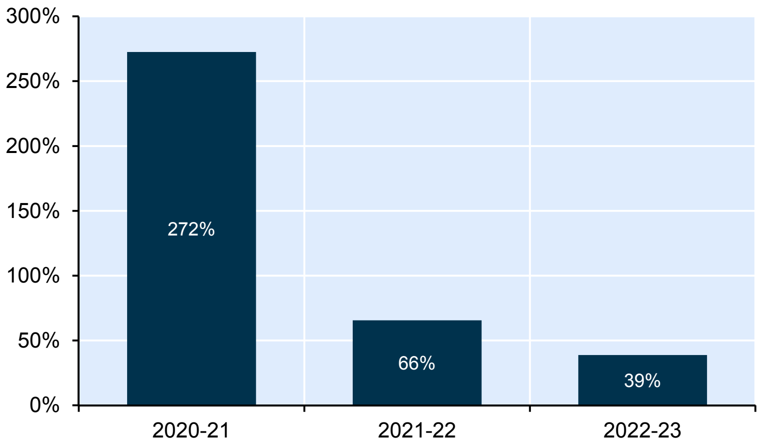


Source: NBF, GoC, prov gov'ts, FAO | Note: Ontario subject to change in Bud22

Resilient/robust economies have keyed the fiscal improvement, with revenues having vaulted above plan. To little surprise, those jurisdictions with greater direct and indirect exposure to commodities (particularly energy) have tended to see revenues better the budget by a larger margin. But the revenue pictured has brightened in all cases.

Chart 7: Bonus revenue applied to bottom line (less so in 22/23)

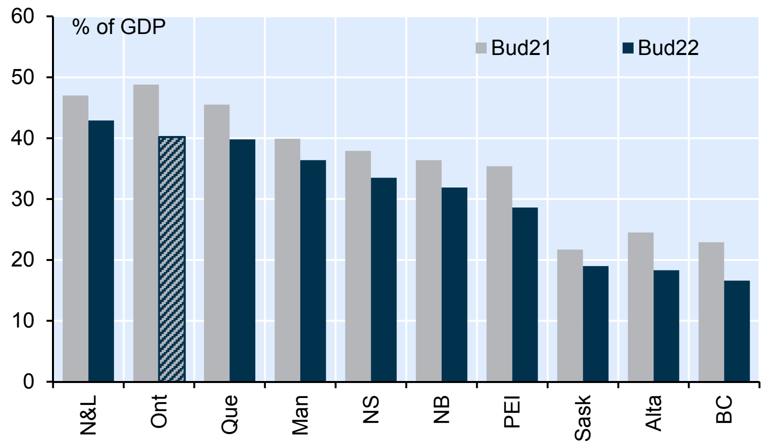
*Share of above-plan revenue directed to budget balance: 9 province total**



Source: NBF, prov gov'ts | Note: Excludes Ontario; revenue windfall vs. Bud21 estimates

Chart 8: Debt burdens are everywhere improved

2021-22 provincial net debt-to-GDP ratio: Latest vs. Budget 2021

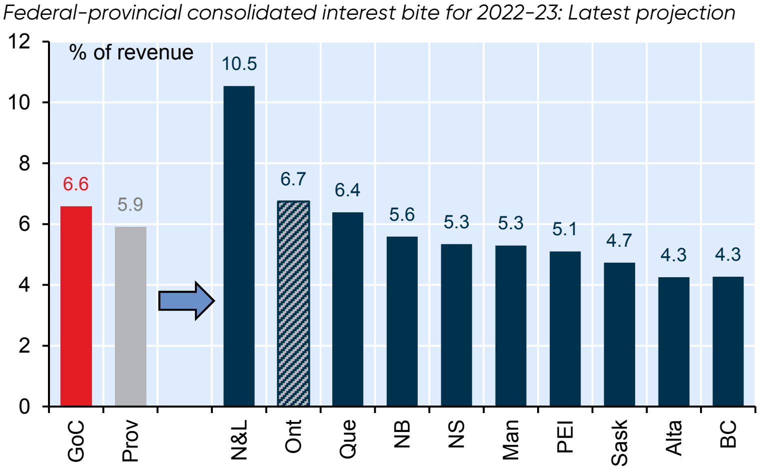


Source: NBF, prov gov'ts, FAO | Note: Ontario subject to change in Bud22

Much/all of the bonus revenues related to prior fiscal years got applied to budget balances. Some governments have allocated above-plan revenue to new spending in 2022-23, and we'll see what Ontario has in mind Thursday. Still, the cumulative budgetary improvement + buoyant nominal GDP growth means debt burdens have moved down vs. earlier forecasts and relative to the prior FY.

Chart 9: Provincial interest bite lower (refi risk long managed down)

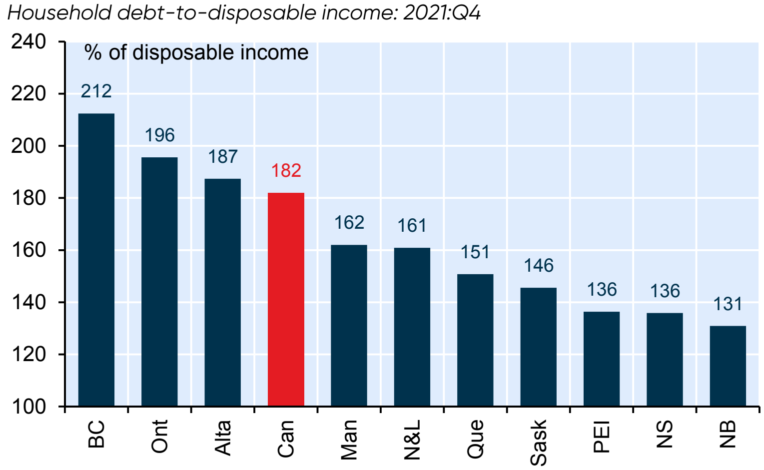
Federal-provincial consolidated interest bite for 2022-23: Latest projection



Source: NBF, prov gov'ts, FAO | Note: Ontario subject to change in Bud22

Chart 10: Rate hikes put highly levered households at risk

Household debt-to-disposable income: 2021:Q4



Source: NBF, StatCan

Interest rates are moving up. While provincial borrowing rates are less attractive and additional interest charges will accrue, provinces generally face less immediate/significant interest rate reset risk vs. the feds. That said, higher interest rates can be expected to bind, particularly in the more highly levered jurisdictions. Meanwhile, a tightening of financial conditions could weigh on all credit spreads.

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