Top News
By Country +
Central Banks +
Commodities
Energy
Equity Market
Market Preview
Market Commentary
Technical Analysis
All Catagories +

Forex Brokers

Email Print Bookmark

CA Preview: Planned Federal Deficit Divides Economy Watchers

01/26/09 02:29 pm (EST)

(CEP News) Ottawa - The government of Canada will wander into territory it hasn't visited in more than a decade Tuesday when it introduces a budget that it concedes will put the federal books into deficit for the first time since the 1996-97 fiscal year.Prime Minister Stephen Harper and Finance Minister Jim Flaherty have spent the last few weeks softening up taxpayers for the foray back into deficit spending.

A senior government official last week dispelled the last bit of mystery about the budget shortfall, telling reporters to look for a deficit of $34 billion in fiscal 2009-10 and another $30 billion the year after that.

In the same briefing, the government official said it will be five years before Canadians should look for the budget to be back in the black.

On Monday, federal Transport and Infrastructure Minister John Baird broke with the tradition of budget secrecy and held a press conference to announce the budget will include a number of items to stimulate the economy through infrastructure spending. Among the measures he announced were a $4 billion infrastructure stimulus fund for provinces, territories and municipalities, a $2 billion plan for repairs and maintenance at colleges and universities and a $1 billion green infrastructure fund.

"Tomorrow the finance minister will produce an economic action plan that responds to the global recession," said Baird. "It will stimulate the economy, help create jobs, take immediate action to build roads bridges and other critical infrastructure across the economy and help protect the hardest hit by the recession," said Baird.

Other budget details have leaked out in recent days including a $1 billion community adjustment fund for one-industry towns that have been hit by the global downturn, $1 billion for renovating social housing, $500 million for older workers, $600 million for aboriginal housing on reserves, $400 million for housing for senior citizens, $1.5 billion for job retraining programs for those who have been laid off, $150 million in forestry sector aid, $550 million for Canada's farmers and $160 million in new spending for arts and culture.

Taxpayers appear to be in the mood to forgive a period of deficit spending as the government attempts to deal with the effects of a global recession that has wrapped its tentacles around Canada.

Two separate polls released in recent days show that a small majority of Canadians sides with the idea of running a deficit to stimulate the economy and help the country through the current downturn.

An Ipsos Reid poll made public last Friday indicated that 53% are okay with a deficit of $30-$40 billion and a Nanos poll released Monday showed 56.6% approved of a budget overrun.

The Canadian Taxpayers Federation (CTF), however, is dead set against the idea. Acting federal director Kevin Gaudet says the return to deficits comes despite a campaign promise by the Conservatives to balance the budget.

Canadian federal government program spending will break the $200-billion mark for the first time and by a wide margin, he said. "When the Liberals left office total program spending stood at $175-billion (2005/06 fiscal year). In fiscal 2009/2010, the federal government's annual outlays will likely approach $225-billion."

Gaudet said the government should be looking for ways to reduce instead of increase spending and that the CTF is calling Ottawa to balance the 2009 budget.

Canadian Federation of Independent Business (CFIB) president Catherine Swift said her organization is concerned that the Harper government "has caved in to pressures to abandon fiscal restraint, given recent reports it will be running deficits of $64 billion over the next two years."

Slipping back into major deficit spending and growing the national debt "is not something the small business sector supports nor would it be in the best interests of the country," said Swift.

Niels Veldhuis, the director of fiscal studies at the Fraser Institute, said the budget measures that have leaked out so far appear to be built on an incorrect premise - that deficit spending, particularly on infrastructure can stimulate the economy in the short term.

"I think the federal government has bought into the group think belief that they need to spend to stimulate the economy," said Veldhuis. Improving infrastructure, especially infrastructure that facilitates the mobility of goods and services, can benefit the economy in the medium and long term, Veldhuis said. However, in the short term the money the government borrows to fund the stimulus package will mean less money will be available for loan to the private sector, he said.

Veldhuis said he would like to see the federal government eliminate the capital gains tax, reduce middle and upper income tax rates and accelerate the pace of corporate tax cuts.

Veldhuis noted that permanent corporate and personal income tax relief would be most beneficial for the economy as it would provide greater incentives for investment and work effort, but he said he is unsure if the tax measures rumoured to be in the budget will be of the permanent or short term variety.

"Let's hope the government doesn't go down the road it went down in 2006 introducing all sorts of different tax credits," he said. "Each credit you introduce just adds complexity to the tax system."

BMO deputy chief economist Doug Porter estimated the stimulus package will be about $20 billion and said the biggest mystery remaining about the budget is what will happen to taxes.

"I would like to see roughly half of the stimulus measures aimed at producing tax relief," he said.

Related Stories »

Morning Market Recap: Europe Leading No...
BOC's Carney Says Remember G7's Commitm...

Latest Forex TV Video »

PM Exchange - Stocks Fall, Dow Near Below 8,000
01/30/09 05:09 PM - Forex TV - Equities fall on job cuts, shrinking GDP. USD, JPY, gain on majors. Oil gains on OPEC cuts. GBP gains on EUR. Deutsche Bank's Boyton with his FX forecast.

NY Forex Market Buzz - USD, JPY Gain on EUR
01/30/09 02:08 PM - Forex TV - US Q4 GDP contracts by 3.8%. Gold rallies on safe haven status. GBP makes month long strides on EUR. Aspen Trading's Floyd with his FX forecast.

I Want My TARP Money Back - January 30, 2009
01/30/09 11:11 AM - US Capital Markets, New Home Sales Plunge, I Want My TARP Money Back

AM Forex NY
01/30/09 09:39 AM - Crude oil gains in early trading on OPEC cuts. US Q4 GDP contracts by 3.8%. UK consumer confidence hits low.

PM Exchange - Stocks Drop
01/29/09 05:53 PM - Forex TV - Equities lower on employment, and housing numbers. USD, JPY, gain on EUR. Oil falls on larger than expected increase in stockpiles. FXDD's Michalowski with his FX forecast.

NY Forex Market Buzz - JPY Gains on Majors
01/29/09 02:10 PM - Forex TV - Continuing claims for unemployment in US hit all time high. Durable goods orders fall. USD lower on negative releases. RBC's Watt with his FX forecast.

Porter said Veldhuis's concern about the government crowding out public sector lending with deficit financing would be valid if the economy were operating "at close to flat out capacity."

"I think there is very little danger of the crowding out," he said. "I think what we are going to see is the government stepping in and doing some of the spending that the private sector is pulling away from. I'm not often in favor of fiscal stimulus, but clearly this is an exceptional time and stimulus is needed to avoid a worse outcome for the economy."

Porter estimated about $5 billion of the new stimulus spending could be directed toward tax measures, but added the final sum may well be more than that.

CIBC economist Avery Shenfeld said the actual amount of fiscal stimulus in the budget will likely be about $15-$20 billion, or roughly 1% of GDP. "That's in line with what we had assumed in our forecast for a -0.5% growth rate for real GDP this year, and entirely appropriate for an economy fighting off a recession and boasting the lowest debt/GDP ratio in the G7," Shenfeld said. "Canada needn't worry about becoming the world's fiscal basket case when the U.S. will be borrowing more than 10% of GDP."

Where the funds are allocated will determine the extent of the economic boost, he said. Infrastructure spending will be welcome, even if it lags a bit in getting going. "It's not as if the economy won't welcome a boost in 2010, given some of the structural challenges in reigniting private sector demand worldwide," said Shenfeld. "Properly selected projects also leave future generations of Canadians with an asset that should be worth at least as much as the deficit to be financed."

Putting money in consumer or corporate pockets can also work, he said, "but only if the money is spent. For the household sector, the recipe has to be trickle-up economics - increasing transfers and refundable tax credits for those who are simply too poor to save, such as the unemployed and low income working families. For the corporate sector, temporary tax credits have to be targeted at those doing hiring and capital spending."

Broad cuts in the corporate tax rate, while an excellent long-term growth strategy, can't help much in a year in which many companies will have no profits to tax, Shenfeld said.

HSBC Canada economist Stewart Hall said a budget deficit of about $30 billion could give a meaningful boost to the economy.

However, Hall added that unless the stimulus package involves changes to the tax structure or unemployment benefits that "can be enacted at the push of a button, the impact of the effort risks being sprinkled out over the next couple of years and invariably late to arrive."

Hall said it is also worth noting that in an open economy such as Canada's, "fiscal stimulus tends to leak outside of the domestic economy."

By Geoff Matthews, gmatthews@economicnews.ca and Sean McKibbon, smckibbon@economicnews.ca, edited by Sarah Sussman, ssussman@economicnews.ca