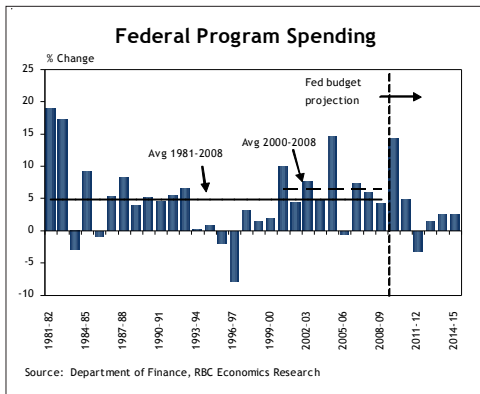


FEDERAL BUDGET 2010

March 4, 2010



Fiscal Actions Along Two Fronts

As was widely expected, the federal government fiscal agenda was to achieve both stimulus near-term before turning to restraint over the medium-term. Today's budget provided the details as to how that was to be reached. In the near-term, the stimulus was achieved by the "second-year" of the two-year Action Plan introduced in Budget 2009. This stimulus was supplemented at the margin by some shifting of infra-structure spending from FY2009/10 to FY2010/11 along with some modest additional initiatives. The medium-term restraint was largely achieved on the expenditure side with the government making good on its commitment to largely avoid tax hikes. (However, it was the case that \$1.6 billion is being raised over the next five years by changes to the tax treatment of some employee stock option programs.)

Some of the fall-off in expenditure over the forecast period reflects the ending of the near-term stimulus in FY2011/12 with program spending declining 3.1%. However, in the out-years (FY2012/13 to FY 2014/15), restraint is achieved via lowering program spending to annual increase of between 1.6% and 2.5%. The combination of winding down the fiscal stimulus and restraining spending sends the deficit down from a projected \$53.8 billion in FY2009/10 to \$1.8 billion in FY2014/15. Thus by the end of the budget projection period the federal government will be on the cusp of balance. The federal debt remains high as a percentage of GDP peaking in FY2010/11 at 35.4% but does trend lower to 31.9% by FY2014/15.

As promised, Budget 2010 does provide stimulus near term and fiscal restraint in the out year largely via spending cuts. With a sizeable share of the spending restraint coming from "containing the administrative cost of government," there is the clear risk that the relatively restrictive cutbacks will not be achieved. However, some offset is provided by some upside risk to revenue growth in the near-term. The budget projections assume real GDP growth of 2.6% and 3.2% in 2010 and 2011 respectively. RBC's current economic forecast allows for higher growth of ½ a percentage point over this two year period (and closer to ¾ of a percentage point on a nominal GDP basis).

Near-term Stimulative Measures

The near-term stimulus largely reflected the second year of the two-year Economic Action Plan introduced in Budget 2009. Budget 2010 mainly updated the initiatives, raising the total dollar amount of stimulus to \$19.2 billion from the \$17.2 billion projected a year ago. The upward revision largely reflected infrastructure spending initially-estimated to occur in FY2009/10 being delayed until FY2010/11. Budget 2010 outlines some modest additional spending of \$1.1 billion and \$0.9 billion in FY 2010/11 and FY 2011/12, respectively. This reflects small increases in a myriad of programs led by increased spending of almost \$0.4 billion in both years on "modernizing Canada's infrastructure."

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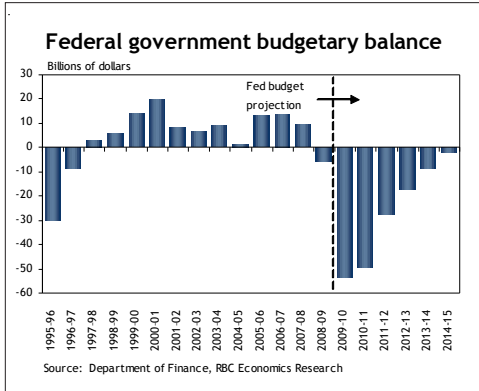
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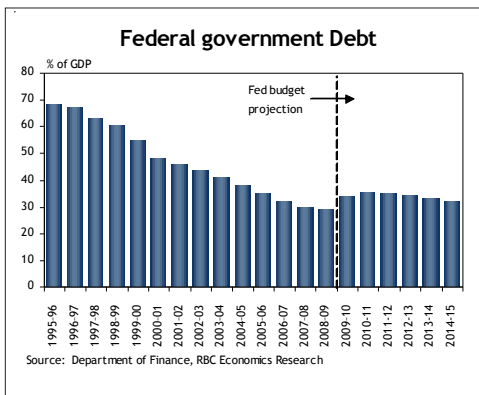
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Medium-term Restraint

New measures introduced over the medium term were more focused on sending the deficit back on the projected downward trajectory. Fiscal savings on program expenditure of approximately of \$13.1 billion were projected for FY2012/13 through FY2014/15. (An additional \$1.7 billion in savings came on the revenue side reflecting initiatives to “close tax loopholes.” This included changes to taxation on some employee stock option programs referred to above.) About one-third of this savings is coming from “containing the administrative cost of government.” The savings will largely reflect the cumulative effect of freezing operating budgets of government departments at FY2010/11 levels. The Department of Defence was excluded from this operating budget constraint though it did see its growth in spending lowered which was projected to yield an additional \$1 billion in fiscal savings in each of FY2013/14 and FY2014/15. The other major restraint initiative over the medium term yielding an average annual savings of \$1.3 billion over the three fiscal years ending FY2014/15 was from reducing planned spending for international assistance.



These restraint measures result in a much lower growth profile for program spending over the forecast period. In FY2011/12 spending drops a sizeable 3.1%. In part this reflects a cessation of the fiscal stimulus though the decline is larger than the 1.7% drop projected in the September 2009 Budget update. It also reflects a higher base in 2010/11 reflecting the shifting of some infrastructure spending from 2009/10. The Government also attributed this greater decline on lower public debt charges that in turn resulted from lower-than-expected interest rates and a smaller take-up of the Insured Mortgage Purchase Program (IMPP). The decline would have even been greater if the government had not introduced “higher average benefits and the extension of certain EI benefits to the self-employed.”



In the out-years the restraint introduced limits growth in program spending to 1.6% in FY2012/13 and 2.5% in both FY2013/14 and FY2014/15. This is down significantly from comparable growth rates projected in September 2009 of 2.6% and 2.9% for the comparable periods. These growth rates are less than one-half the average rate of increase in program spending that prevailed over the previous ten-year period ending FY2008/09. Though the argument could be made that the earlier pace of growth was too high, it still implies a considerable amount of restraint that is highly dependant on squeezing savings from the operation of government. In mid- to late-1990’s we saw even more aggressive program spending restraint, suggesting that the task has been done in the past and is achievable in the current environment.

Financial requirement drops

In Budget 2009 the government’s financial requirement for FY2009/10 ballooned to \$101 billion with about \$65 billion allocated for the Extraordinary Financing Framework. Within this total \$45 billion was allocated to the Insured Mortgage Purchase Program for the purchase of mortgages from various financial institutions in the face of private sector purchases drying up at the height of the financial crisis. As financial markets have started to function more normally, the need for this special provision has waned significantly. As a result, the financial requirement for FY2010/11 has dropped to \$45 billion which is more in line with, and slightly less than, the \$49 billion budgetary balance.

Fiscal plan and economic assumptions

Summary statement of transactions (billions of dollars)

	<u>2008-09</u>	<u>2009-10</u>	<u>2010-11</u>	<u>2011-12</u>	<u>2012-13</u>	<u>2013-14</u>	<u>2014-15</u>
Budgetary transactions							
Budgetary Revenues	233.1	213.9	231.3	249.0	266.5	282.7	296.5
Program Expenses	207.9	237.8	249.2	241.4	245.2	251.4	257.7
Public debt charges	31.0	29.9	31.3	35.3	38.9	39.8	40.6
Total Expenses	238.8	267.7	280.5	276.7	284.0	291.2	298.3
Budgetary Balance	-5.8	-53.8	-49.2	-27.6	-17.5	-8.5	-1.8
Federal Debt	463.7	517.5	566.7	594.3	611.9	620.3	622.1
Per cent of GDP							
Budgetary revenues	14.6	14.0	14.4	14.8	15.0	15.2	15.2
Program Expenses	13.0	15.6	15.6	14.3	13.8	13.5	13.2
Public Debt Charges	1.9	2.0	2.0	2.1	2.2	2.1	2.1
Total Expenses	14.9	17.6	17.6	16.4	16.0	15.6	15.3
Budgetary Balance	-0.4	-3.5	-3.1	-1.6	-1.0	-0.5	-0.1
Federal Debt	29.0	33.9	35.4	35.2	34.4	33.3	31.9

Economics assumptions

(Year-over-year % change)

	<u>2009</u>	<u>2010</u>	<u>2011</u>	<u>2012</u>	<u>2013</u>	<u>2014</u>
Real GDP growth	-2.5	2.6	3.2	3.0	2.8	2.6
GDP Inflation	-2.1	2.2	2.1	2.2	2.1	2.0
Nominal GDP growth	-4.6	4.9	5.4	5.3	4.9	4.7
3-month Treasury bill rate*	0.3	0.7	2.4	3.8	4.3	4.4
Ten-year government bond rate*	3.3	3.7	4.3	4.9	5.2	5.3
Unemployment rate	8.3	8.5	7.9	7.4	6.9	6.6
U.S. real GDP growth	-2.5	2.7	3.0	3.4	3.1	2.9

*%, end of period

Source: Statistics Canada, Bureau of Economic Analysis, RBC Economics Research

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