Post-Election Economic Landscape

A Publication of BMO Capital Markets Economic Research • Douglas Porter, CFA, Chief Economist, BMO Financial Group

ECONOMIC RESEARCH
1-800-613-0205
economics.bmo.com

Douglas Porter, CFA, Chief Economist
+1 (416) 359-4887
douglas.porter@bmo.com

Robert Kavcic, Senior Economist
+1 (416) 359-8329
robert.kavcic@bmo.com

Minority Report Card

The **Liberal Party has secured a minority government in Canada's 43rd federal election**, with the opposition NDP winning enough support to potentially push above 170 seats for a Commons majority (*Table 1*). Markets had largely been braced for a minority government since the day the election was called in mid-September, so the broad-brush outcome was no surprise. The big change since the start of the campaign was the resurgence in the Bloc Québécois, but even that substantial shift didn't alter the big-picture result—a Liberal-led minority government.

Canada has a long history of dealing with minority governments, of various stripes, most recently with three different versions spanning from 2004 to 2011. Typically, markets and the economy are driven by much bigger global forces than domestic political considerations. The main point is that **we are likely dealing with somewhat less clarity on policy**, and issues are expected to be dealt with on a case-by-case basis. There will be plenty of horse-trading ahead of next year's key budget. The first real sense we will get on that front will be the government's Throne Speech, when it sets out its priorities, and will be treated as a confidence issue.

Table 1
Summary of Votes and Seats
2019 Canadian Federal Election

	2019		2015	
Political Party	**Votes (%)**	**Seats**	**Votes (%)**	**Seats**
Liberals	33.1	**157**	39.5	**184**
Conservatives	34.4	**121**	31.9	**99**
Bloc Québécois	7.7	**32**	4.7	**10**
NDP	15.9	**24**	19.7	**44**
Green	6.5	**3**	3.4	**1**
Independent	0.4	**1**	0.2	**0**
PPC	1.6	**0**	—	**—**
Other	0.4	**0**	0.6	**0**

Sources: BMO Economics, Elections Canada

With a murkier policy backdrop, we can glean some insights from the campaign proposals of the two parties. While any party can theoretically support the Liberals, **the NDP are the consensus first choice to step up and deal**, partly because many issues in the two party platforms overlap nicely. For example, both parties are in line on the carbon tax; both are looking to crack down further on non-resident ownership in real estate; they're each seeking to expand pharmacare; both want to cut cell phone bills; and, neither sees any need to balance the budget.

But, **it will likely take more to earn NDP support**, with the party outlining priorities during the campaign that included a wealth tax, national dental care program, elimination of subsidies to the oil sector, and waiving interest on student loans. Of course, the ruling party need not accept every demand, but that's a rough initial take on what might be on the table. All told, if that's how the support lines are drawn, the first budget could look a lot like past Liberal budgets, but with spending commitments and deficits scaled up a few more notches even beyond those laid out in the Liberal platform.

For full details of the pledges, see the Table on page 5. Here are a few of the key implications we can draw for the economy, some sectors, and financial markets:

Fiscal Policy

It's highly likely that we will be looking at **a further net loosening in fiscal policy**—i.e., a wider budget deficit—with a minority government. It's not yet crystal clear where the major spending changes will come from; even the Liberals were projecting larger deficits in the coming years compared with this year's budget, and that was before any specific demands from other parties. For example, the Liberal campaign pledges were projected to widen the deficit to $27.4 billion for FY20/21 (or about 1.2% of GDP), and then narrow only modestly to $21.0 billion by FY23/24. That compares with an expected deficit this fiscal year of $19.8 billion (or 0.9% of GDP) and just $14.0 billion (0.6% of GDP) reported in the FY18/19 public accounts.

Meantime, the Liberal platform doesn't appear to include the cost of a national pharmacare program, which will likely be a key NDP demand, and one in which the Liberals would likely be willing to cooperate on. The cost of such a program could run in excess of $10 billion per year. Other likely NDP demands, such as dental care, housing investments and student loans could run around $4 billion, offset partly by closing loopholes or possibly even some form of a wealth tax. The bottom line here is that **the already-wider deficits laid out in the Liberal platform only mark the starting point, and will likely be shaded even wider**.

The de facto fiscal target of this government had been a stable debt/GDP ratio (of just over 30%)—that's not going to hold with deficits of the magnitude we're now likely to face in coming years. While there is nothing magical about the 30% level, a rise in the debt/GDP ratio would weaken Ottawa's fiscal position heading into the next downturn, leaving them less room to manoeuvre—and possibly leading to a loss of Canada's coveted triple-A status down the line.

Taxes

The Liberal platform included roughly $2 billion of net tax increases by FY21/22, including a 10% luxury tax on vehicles, planes or boats above $100,000, and closing various loopholes.

The NDP will surely look to increase taxes on higher-income earners or wealthy Canadians. Their proposed 1% wealth tax (a possible sticking point for support) would apply annually to those with net worth greater than $20 million. Higher corporate tax rates, top marginal rates and capital gains taxes were also featured in their platform, and could be alternatives.

Housing

A Liberal/NDP mandate could see a much more active involvement in housing markets in a bid to improve affordability. Whether the policies tilt more toward boosting demand over supply will determine how successful they are in actually achieving this goal. The NDP proposal to "create" a half million affordable units over a decade (50,000 per year) would boost annual housing starts by about one quarter, so it's a material pledge. But, the question is: how can that be accomplished, and would it involve subsidizing builders or buyers? If the latter, the boost to demand could neutralize the restraining effect on prices of new supply. Here is a look at some of the specific housing proposals from the two parties:

Liberal

- Increase the income threshold on the First-Time Home Buyer Incentive in Vancouver, Victoria and Toronto so that families can bid on properties up to nearly $800,000 (versus over $500,000 currently) in these high-priced regions. By reducing monthly mortgage payments, the program effectively increases home-buying power by about 7% (roughly halving the loss of buying power from the stress tests).
- Impose a 1% nationwide tax on foreign-owned vacant properties to reduce speculation and increase available supply.
- Provide interest-free loans to finance energy-efficient renovations.

NDP

- Create 500,000 affordable housing units over ten years.
- Waive the federal portion of the GST/HST on new low-income rental units.
- Nationwide 15% tax on home purchases by non-citizens and non-permanent residents.
- Double the first-time home buyer tax credit to $1,500.
- Provide a subsidy for renters spending more than 30% of income on housing.
- Allow 30-year amortization for first-time buyers of entry-level homes.

All told, there is enough overlap here to roll out further meaningful measures on the housing front.

Energy Sector

The biggest question mark with this election outcome is for the energy sector, and specifically the fate of the Trans Mountain Pipeline, but the result is likely a net negative. The NDP have opposed the pipeline, but to a lesser extent than the BQ or the Green Party. Still, it's worth noting that between the Liberals and Conservatives, a strong majority of MPs will be in support of the project, and recall that it has already been approved—so doesn't necessarily face a confidence vote in the House. Whether or not the Liberals can finesse the project forward; or, if it is a hard no from the NDP, remains to be seen. More broadly, the NDP are in-line with the Liberals on their broader climate change and carbon tax plan. But, the NDP may seek to reduce tax breaks in the sector.

Overall Economic Growth

As a standalone development, a loosening in fiscal policy would temporarily lift GDP for a spell, on roughly a one-for-one basis. So, a rise in the budget deficit to around $30 billion (or 1.2% of GDP) by 2021 could lift GDP by roughly 0.4 ppts by that time. However, that could be offset by a dimmed outlook for the energy sector, heightened business caution, or somewhat higher interest rates than would otherwise be the case. For now, we will not be fine-tuning our growth outlook for Canada, until we at least get more clarity on broad spending and budget plans from the new government. We are currently expecting growth to come in around 1.5% this year, and pick up slightly to 1.7% in 2020. The small improvement next year runs against the global grain—growth is expected to slow in much of the world in 2020—and is driven by three factors: 1) less drag from oil production cuts in Alberta, 2) a firmer housing market; and, 3) modest fiscal stimulus that was in place even before the election.

Interest Rates

A looser fiscal policy and the potential for firmer growth would—all else being equal—set the stage for a tighter monetary policy than would otherwise be the case. However, with most major central banks cutting interest rates recently, or preparing to cut further, the BoC is highly unlikely to step in the opposite direction. We look for the Bank to remain on hold for the foreseeable future, with an easier fiscal policy (i.e., larger budget deficit) providing the stimulus instead.

For bond yields, larger budget deficits than previously planned and the related ramp-up in borrowing requirements may put some slight upward pressure on Canadian yields versus others. Still, bond markets are barely responsive to budget deficits in most cases these days—witness the plunge in U.S. Treasury yields in the past year, even as the U.S. budget deficit forged higher to nearly $1 trillion (or over 4.5% of GDP). It's quite telling that the initial post-election market response was for bond yields to fall in Canada—in line with lower U.S. yields, and reflecting a soft retail sales report.

Canadian Dollar

The Canadian dollar managed to strengthen during the course of the election campaign, partly due to the fact that markets had long since assumed a minority government outcome, and partly due to fundamental factors. First, the U.S. dollar has weakened moderately in recent weeks as the tone around the Brexit negotiations and trade with China has improved. Second, mostly firm Canadian domestic data—especially on housing and jobs—have markedly reduced odds of the Bank of Canada trimming interest rates anytime soon, even as the Fed seems poised to cut for the third time on October 30th.

Looking ahead, we expect global factors to dominate domestic political considerations, which may otherwise be a modest dampener on the currency. On balance, we are slightly constructive on the loonie despite the political backdrop, with oil prices expected to hold in the mid-$50 range, Canadian interest rates holding at the high end of the range among major economies, and a less negative tone in the U.S./China trade battle.

Equities

There's not much to move the needle on equities broadly, as growth concerns, interest rates and oil prices are much bigger factors. And, unlike the Cannabis sector in 2015, there's no apparent big winner from this result. On the flip side, both the Liberals and NDP have actively endorsed cutting cell phone bills. What form that takes (i.e., through regulation, subsidies or more competition) is unclear, but is something to watch in the telecom sector. The energy sector would clearly be a net loser if Trans Mountain faces any further delay, as that project is an anticipated relief valve for Alberta crude supplies and WCS prices.

Table 2

Major Economic Issues

	Liberals	NDP
Taxes	- Increase basic personal amount by $2,000 (for those earning less than $147k)	- Raise top income bracket 33% to 35% - Raise corporate rate from 15% to 18% - Raise capital gains inclusion rate to 75% - 1% wealth tax if net worth > $20 mln
Families	- CCB increase by 15% for kids < age 1 - Make EI parental benefits tax free	- Universal childcare - National dental care plan
Environment	- $20/tonne carbon tax rises to $50/tonne by 2022 - Interest-free loans for renovations	- Largely maintain Liberal carbon tax plan - Low-interest loans for renovations - End subsidies for oil companies - Abandon Trans Mountain pipeline
Housing	- 1% annual tax on nonresident owners	- 15% federal foreign buyer tax - Double first-time homebuyer tax credit - Eliminate GST on rental construction - Subsidy for low-income renters
Other	- Expand national pharmacare - Lower cell phone bills - Increase OAS by 10% for ages > 75	- National pharmacare plan - Lower cell phone bills - Waive interest on student loans
Fiscal	- FY20/21 deficit $27.4 bln; FY23/24 deficit $21.0 bln - Debt/GDP 30.2% by FY23/24 - No plan to balance budget	- FY20/21 deficit $32.7 bln; FY23/24 deficit $16.6 bln - Debt/GDP 29.0% by FY23/24 - No plan to balance budget

= platform overlap; = additional (reported) NDP demands

General Disclosures