

# Post-Election Economic Landscape

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

## As You Were, Canada

The incumbent **Liberal government has secured another minority mandate** in Canada's 44th federal election. While the final seat count might still drift around in the coming days as mail-in ballots are counted, the ultimate result is set. At last check, the Liberals were on track (leading or elected) to take 158 seats, almost right in line with the 155 seats held by the party at dissolution (and the 157 won in the 2019 election), leaving them shy of the 170 needed for a majority. So, as for the past two years, they will need to lean on support from another party (*Table 1*).

The Conservatives are looking at 119 seats (down from 121 in 2019); the Bloc Québécois took 34 (32 in 2019); the NDP holds 25 (24 in 2019); while the Green Party comes away with 2 seats (3 in 2019). Note that the Conservatives should again win the popular vote, with 34.0% support at this point, versus 32.2% for the Liberals. The key takeaway here is that **Canada's political landscape looks remarkably similar after this election to the way it did before**—almost as if Canadians spelled out “we don't want an election now” with their votes.

As usual in a minority situation, there will be plenty of horse-trading ahead of next year's budget, although the Liberals' 2021 document largely set the course for the coming years. 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.

With another minority mandate in store, we can glean some insights from the campaign proposals of two of the major parties. While any party can theoretically support the Liberals, **the NDP is the likely first choice to step up and deal**, as we have seen pre-election, and because many issues in the two parties' platforms overlap. For example, both parties will look to extend some pandemic-era programs (e.g., wage and rent subsidies); both have clearly prioritized taxing the upper end of the income spectrum and corporations; both are in favour of subsidized child care; agreement should easily be found on housing-related policy; and, neither has any inclination to balance the budget.

For **a more detailed list of major pledges, see the Table on page 5.**

Here are a few of the key implications for the economy, some sectors, and financial markets:

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Table 1  
**Summary of Votes and Seats**  
2021 Canadian Federal Election

Political Party	2021*		2019	
	Votes (%)	Seats	Votes (%)	Seats
Liberals	32.2	<b>158</b>	33.1	<b>157</b>
Conservatives	34.0	<b>119</b>	34.4	<b>121</b>
Bloc Québécois	7.7	<b>34</b>	7.7	<b>32</b>
NDP	17.7	<b>25</b>	15.9	<b>24</b>
Green	2.3	<b>2</b>	6.5	<b>3</b>
PPC	5.1	<b>0</b>	1.6	<b>0</b>
Other	0.9	<b>0</b>	0.8	<b>0</b>

Sources: BMO Economics, Elections Canada \* as of Sep. 21<sup>st</sup>, 8:00 am

## Fiscal Policy

Fiscal policy will likely remain loose under a minority Liberal government. In fact, **the new deficit path will likely look decidedly similar to that laid out in Budget 2021** but, because of better underlying economic and revenue performance, it will also come with increased spending. The Liberal platform laid out a net \$12.6 billion in new measures for FY21/22 (roughly 0.5% of GDP), rising to \$13.8 billion in FY22/23, before fading gradually to \$6.4 billion by FY25/26.

All told, the Budget 2021 deficit projected by the Liberals for FY21/22 sat at \$154.7 billion. After the PBO adjusted that baseline to a \$138.2 billion shortfall ahead of the election, newly-announced priorities in the Liberal platform pull the deficit back up to \$156.9 billion (including a \$6 billion contingency). In both the 2021 budget and Liberal platform, the deficit by FY25/26 sat just above \$30 billion.

Longer term, **balanced budgets are not a priority**, and a stable debt-to-GDP ratio (after taking a big step up during the pandemic) seems to be the fiscal anchor. Note that, in the Liberal platform, after hitting 51.2% this fiscal year, the ratio falls gradually to 49.2% by FY25/26. As we noted many times pre-pandemic when a 30% debt-to-GDP ratio was the de facto fiscal anchor, it is an anchor that is destined to break during challenging times.

## Taxes

The Liberal platform included roughly \$4 billion of net tax increases/revenue collection measures by FY22/23, rising to \$8 billion by FY25/26. The biggest-ticket items are proposed taxes on large financial institutions, at around \$2.5 billion per year. At the same time, expanding the CRA's revenue-collecting ability adds a net \$4.6 billion by the latter year of the plan.

Smaller-ticket items in the Liberal plan, such as a minimum tax on higher-income earners and a flipping tax (on homes) carry lower dollar amounts, but are important to signal the party's priorities. In that light, the NDP are openly pushing for taxes on higher-income earners, corporations and an increase in the capital gains inclusion rate. It appears that these are areas that the Liberals potentially may be willing to go in order to garner support. In fact, it's notable that tax changes are an area where the Liberals and NDP see plenty of overlap, and **one could argue that the risk of tax increases is higher in this minority mandate that it was in the last.**

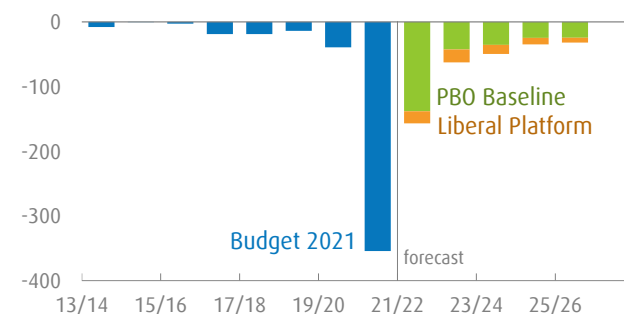
## Housing

A Liberal/NDP mandate could see **continued involvement in the housing market**, with an eye on affordability. Non-resident buyers are the first likely target, with the

Chart 1  
**Deficit Path Well Defined**

Canada (\$ blns)

### Federal Budget Balance



Sources: BMO Economics, PBO, party platforms FY20/21 = estimate

Budget 2021 vacancy tax taking effect in 2022. That could be supplemented by an outright ban (Liberal platform) and/or transactions tax (NDP platform).

Various other measures to 'improve affordability' are also likely in play. We tend to be skeptical on this front given that such measures usually just increase demand and get capitalized into prices. For example, the Liberals have promised tax-free savings accounts for first-time home buyers, while the NDP seeks to bring back 30-year amortizations for insured mortgages. Additionally, the Liberals have pledged to open the market to more price transparency, as well as implementing a short-term flipping tax.

Longer term, supply is a focus of all parties, but we've been down this road many times. The reality is that Canadian housing starts have averaged nearly 270k annualized units over the past twelve months, or a third more than in the decade leading up to the pandemic. While the federal government can certainly push for affordable housing units, ultimately the pace of new development falls to provincial and municipal jurisdictions, and the economics of owning such properties (especially on the rental side).

### Overall Economic Growth

This **election result will not prompt any changes to our growth outlook** for Canada. While the backfilling of fiscal upside with more spending, as per the Liberal platform, means marginally more stimulus for longer, it won't prompt a forecast change given much larger issues at play for the economy, like the Delta variant and supply-side constraints. Interestingly, all major parties ran with promises to boost employment, but most of them push on the demand curve. With more than 700,000 job vacancies as of 2021Q2, it's the supply side that needs the push. We are currently expecting growth to come in at 5.0% this year, before fading next year to a still-strong 4.5%.

### Interest Rates and the Canadian Dollar

With no change in the growth outlook expected, and budget deficits likely sticking to the already-telegraphed course, there's little in this election result to alter the interest rate outlook. For the **Bank of Canada**, the broader economic backdrop, completeness of the labour market recovery and percolating inflation pressure remain the biggest factors. At this point, we judge the Bank will continue to taper asset purchases this year, and the stage should be set for rate hikes in the second half of 2022.

For **longer-term yields**, there's little to change the fundamental fiscal picture in Canada, which was already deteriorating before the pandemic. If anything, a Liberal/NDP policy program for a few more years could delay the pace of post-COVID fiscal consolidation, although the market has likely already adapted to that reality. In the meantime, borrowing requirements will continue to fall from last year's pandemic high, and Ottawa's debt-servicing burden remains historically low relative to revenues.

The **Canadian dollar** faded slightly during the course of the election campaign, but the external backdrop was a much bigger factor than the status-quo election result. That is, a generally softening growth forecast and cooler global risk appetite have moved the currency, while oil prices have held relatively steady. We continue to see modest upside for the currency over the next year, as the economic recovery progresses and

the Bank of Canada lifts interest rates somewhat ahead of the Federal Reserve. Suffice it to say that, with so many major global cross currents right now, this stable election result is well down the list of factors impacting the loonie.

### Equities

Economic growth, interest rates, oil prices and broader market sentiment are still much bigger factors for stocks, but there are a few areas to note. The Liberals promised to raise corporate income taxes on **banks and insurance companies** who earn more than \$1 billion per year, and introduce a second temporary levy on these companies. The combined cost is estimated at roughly \$2.5 billion per year through FY25/26. It's more than likely that the NDP would support such measures, if not petition for a broader increase in corporate tax rates.

Some **REITs** could also be in focus, with the Liberals pledging to further tax corporate owners of residential property that *"are amassing increasingly large portfolios of Canadian rental housing"*. Details on this front remain vague for now.

A Liberal/NDP government is also a net negative for the **energy sector** versus a Conservative win. But on this front, it is largely status quo, with the Liberals targeting a 40%-to-45% reduction in greenhouse gas emissions (versus 2005 levels) by 2030. The NDP will push harder on this front (50% reduction), while both will look to eliminate subsidies to the oil & gas sector.

### Bottom Line

The most significant development from an economic perspective during the election campaign was the broad tilt to increased fiscal spending proposed by almost all major parties. While the specific details need to be ironed out in a minority government, there are clear areas of overlap between the Liberal proposals and the NDP, their most likely dance partner. The extra spending does not move the needle on our growth forecasts, but it does suggest that the pressure will remain firm on the inflation front—that's because the constraint on the economy is on the supply side, and not the demand front.

Table 2

# Federal Election 2021: Major Economic Issues

Liberals	NDP	Conservatives
<b>Businesses</b>		
Extend the recovery hiring program to March 31, 2022	Continue existing small business wage and rent subsidies	Paying up to 50% of salary for net new hires for six months after CEWS ends
Extend the wage and rent subsidies to Sept 25, 2021; phase-out began in July	Long-term hiring bonus to pay the employer portion of EI and CPP for new or rehired staff	Loans of up to \$200k for SMEs in hospitality, retail, and tourism; up to 25% forgiven
Temporary wage and rent support of up to 75% for tourism industry		
<b>Taxes</b>		
3% digital services tax to start in 2022	Increase the capital gains inclusion rate to 75%	5% investment tax credit for capital investments made in 2022 and 2023
Luxury goods tax	Raise the top marginal tax rate 2 ppts to 35%	
Raise taxes on banks and insurance companies that earn more than \$1 bln/year	1% wealth tax for >\$10 mln in wealth	25% tax credit on investments up to \$100k in small businesses over the next two years
Minimum 15% tax on people who qualify for top marginal tax bracket	Raise corporate income tax rate 3 ppts	15% tax credit for vacation expenses of up to \$1k/Canadian for trips in Canada in 2022
	Taxes on multinational internet companies	Sales tax and 3% digital services tax on companies that don't pay tax in Canada
	Temporary 15% tax on excess profits by large corporations who received the wage subsidy during the pandemic	1-month GST exemption and dine-in rebate
<b>Fiscal</b>		
FY22/23 deficit \$62.7 bln (PBO)	\$48 bln of net new spending over the next 5 yrs; no plan to balance budget	FY22/23 deficit \$57.3 bln (PBO)
No plan to balance the budget		Balanced budget still a long-term priority
<b>Health Care</b>		
Funding for virtual care; strengthen federal powers under the Canada Health Act	National pharmacare starting in 2022	Boost annual growth rate of the Canada Health Transfer to at least 6%
Domestic vaccine production in Quebec; free vaccine boosters	Universal dental care	Prioritize COVID booster shots and accelerate homegrown production of vaccines and PPE
	Establish a crown corporation responsible for domestic production of vaccines	
<b>Environment</b>		
Reduce corporate income tax by 50% for manufacture of zero-emission technologies	Reduce emissions by at least 50% from 2005 levels by 2030; maintain carbon tax	Personal Low Carbon Savings Account and a Small Business Low Carbon Savings Account
Reduce emissions to 40%-45% below 2005 levels by 2030	Goal of 100% non-emitting electricity by 2040	Remove the carbon tax backstop system; cap carbon tax at \$50/tonne
Interest-free loans for home retrofits	Retrofit all buildings by 2050	Reduce emissions to 30% of 2005 levels by 2030
Transition away from fossil fuel industry with increased emissions caps; end subsidies	End subsidies to oil & gas sector	
<b>Child Care</b>		
Cut child care fees by 50% by the end of 2022	Universal \$10/day child care	Create refundable child care tax credit; cover up to 75% of child care costs (income tested)
Universal \$10/day child care within five years	Expanded access to EI for parents	Expand Canada Child Benefit and EI benefit
Expanded Canada Caregiver Credit		
<b>Housing</b>		
1% annual vacancy tax on non-resident owners	Build 500k+ units of affordable housing in the next ten years; half within five years	Encourage 1 million homes in the next 3 years
Eliminate blind bidding; open price transparency		Ban on homebuying by non-residents with a review in two years
Flipping tax on sales within 12-months	20% tax on non-resident foreign buyers	Encourage 7-to-10-year mortgages
Tax on large residential REITs; assess downpayment requirements for investment property	Double Home Buyers Tax Credit to \$1,500	Amend the mortgage stress test to improve access for non-permanent employees
Tax-free First Home Savings Account	Re-introduce 30-year terms to CMHC-insured mortgages for first-time homebuyers	
<b>Other</b>		
Expanded EI and worker benefit	Targeted student debt forgiveness up to \$20k; double Canada Student Grants	Double the Canada Workers Benefit up to a maximum of \$2.8k/person or \$5k/family
Double Canada Student Grant for two years	Cap cell phone and internet prices	Connect all Canadians to high-speed internet by 2025
Federal minimum wage of \$15/hr	Expand sickness benefits from 15 to 50 weeks	
Permanently eliminate interest on Canada Student Loans	Guaranteed basic income	
	Federal minimum wage starting at \$15/hr	

Sources: BMO Economics, Federal Budget, party statements

■ = potential policy overlap

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