

Opinion | Freeland's financial update encouraging but successes are tenuous

By Charles Smedmor, Contributor

A December budget update is like basting a turkey. The outcome can be tweaked but not substantially changed.

Finance Minister Chrystia Freeland's Tuesday economic update tells Canadians that our fiscal 2022 turkey will be more palatable financially than previously expected. Delaying until December has also allowed the update to be adjusted for supply challenges, inflation and the Omicron variant.

The update reports better-than-expected results for revenues, focused spending and the deficit. The update also provides a financial menu through to fiscal 2027.

In overview, the minister deserves a solid "B" for this update. It reports eight months of fiscal 2022 in a reasonably objective tone. However, it ignores the pressures of higher inflation and interest rates and needs to better address Canada's electric vehicle rebates policy.

The key numbers

The update focuses extensively on measuring our economic result in terms of GDP percentages. GDP percentages mean little without first knowing the underlying dollar amounts. Here are the key numbers for the year ending March 31, 2022 ("fiscal 2022" in finance-speak):

- **Gross Domestic Product (GDP):** the fiscal 2022 value of all goods and services produced is now projected to be [\\$2.644](#) trillion (\$69,500 for each of 38 million Canadians), up a significant 9.4 percent from 2021.
- **Total revenues:** \$371 billion (\$9,750 per person), up 17 percent from 2021.

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- **Total spending:** \$505 billion (\$12,900 per person), down 20 percent from 2021's \$644 billion. That \$505 billion includes \$24.5 billion in debt charges.
- **Deficit for 2022:** the 2022 deficit is projected as \$145 billion (\$3,800 per person), down 56 percent from 2021.
- **The net federal debt:** Canada now owes \$1.192 trillion (\$50,250 per person), up 13 percent over fiscal 2021.

Higher inflation and interest rates: game changers for our finances

Included in total 2022 spending is \$24.5 billion (\$6.6 percent of federal revenues) for interest charges; an average interest rate of 2.1 percent. Despite inflation hitting more than 4 percent annually, Ottawa expects the economy will revert to low inflation and continuing low interest rates.

However, that is unlikely. Current interest rates provide no after-inflation return and are effectively negative. Inflation is unlikely to drop from 4 percent to 2 percent; thus interest rates and Canada's borrowing costs will increase, potentially to 6 percent as long-term rates require both a real rate of return and compensation for inflation.

Interest of 6 percent applied to the update's projected fiscal 2027 debt of \$1.3 trillion could require \$78 billion for interest charges, 16 percent of fiscal 2027's currently projected federal revenues. That 300 percent increase in interest would require either program cuts or tax increases.

Freeland's Spring 2022 Budget needs to provide Canadians with objective numbers for both inflation and federal borrowing costs.

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Other update disclosures

The update provides other tax news. While the federal portion of the HST and income taxes are unchanged, two new taxes and one rebate are worth addressing.

- **Underused Housing Tax on 40,000 mothballed homes:** This new tax is a 1 percent levy on the value of vacant Canadian residential properties; it is projected to generate \$200 million annually. Notably, if the average value of these mothballed homes is \$500,000, that \$200 million could represent 40,000 underused homes. This new tax is intended to get mothballed homes back into circulation.
- **Digital Services Tax:** This tax will begin in 2022. The tax, 3 percent on digital media revenues of large entities (at least \$20 million in Canadian sales) will begin in January. It is projected to generate \$650 million annually after start-up outlays.
- **Electric vehicles rebates require revamping:** Electric vehicles (EVs) are the future. EV rebates, a negative tax, encourage the transition from internal combustion vehicles. The U.S. Congress is considering large rebates for purchases of only U.S.-made EVs. Excluded and unhappy, Canada is now threatening trade sanctions. Surprisingly, the update reports that the existing federal EV and hybrid rebate of up to \$5,000 expires at the end of Fiscal 2022. Premier Doug Ford cancelled Ontario's EV rebate in 2018. Other provinces have a patchwork of rebates.

To persuade the U.S. to allow Canada's access to the proposed U.S. rebates, Canadian governments need a co-ordinated plan to encourage Canadians to buy EVs, with the carrot that our rebates will be available to the U.S. (and other nations), that provide reciprocal rebates to Canadian EVs.

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In summary, federal finances are in a much better state than in April. However, the recovery is tenuous. All eyes will be on Freeland for any update revisions and the Spring 2022 Budget.

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