Focus

Feature Article

Green Energy Goals, Red Ink Realities

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The Longest Month

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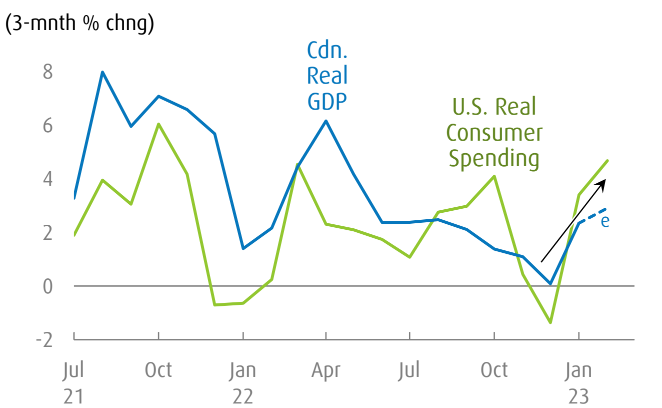
After a tumultuous month and a comeback week, equity markets find themselves higher today than at the start of March. Beyond modest monthly gains, the MSCI World Index managed to grind out a 5% advance for all of Q1. As one sly commentator suggested, markets believe things will be so bad that the Fed will need to cut rates in the second half of the year, yet not so bad as to prompt investors to sell stocks. Amid this week's much-improved market mood, the pressing question is whether this is the calm after the storm, or perhaps the eye of the storm? **It certainly appears that the acute phase of the banking stress is behind us, but now we await the potential after-shocks, notably through the credit channel.**

Chart 1
Comeback Kids



Sources: BMO Economics, Haver Analytics *e = estimate*

Even as many are looking forward for signs of a potential hit to growth, **the rear-view mirror is showing evidence of surprising economic resiliency through the first quarter of the year**. For example, U.S. consumer confidence perked up in March, according to the Conference Board, with sentiment for all of Q1 at its best level in a year. Initial jobless claims remained doggedly below 200,000 for most of the quarter, or about 10% below last year's average level. The consumer is the big story, as even with a small correction in February, an early-year blastoff suggests that real consumption rose at a better-than-4% clip in Q1. As a result, **we are boosting our U.S. GDP estimate for the quarter to a 2.0% annual pace, which lifts the full-year estimate three ticks to 1.0%**.

The faces and the names are a bit different in **Canada**, but the end result is the same for GDP. A freakishly mild January helped drive a 0.5% jump for the overall economy in that month, but the big surprise was the lack of a reversal in February. The flash reading was +0.3%, **prompting us to crank up our estimate for all of Q1 by a whopping 1.5 percentage points to 2.5% annualized growth**. In turn, that boosts our annual call to 1.0%. While the first quarter was much stronger than the Bank of Canada anticipated (it had estimated just 0.5% growth), our revised annual figure happens to fit their latest number to a T.

Putting that upward growth revision for 2023 into context, note that **this week's federal budget was based on a conservative assumption of just +0.3%** for real GDP this year. One of our main quibbles with the budget plan was that it allowed the fiscal anchor to slip in the coming year—that is, for the debt/GDP ratio to rise by more than a point to 43.5%. At a time of full employment, and when inflation is the economy's public enemy #1, the net new spending of about 0.2 ppts of GDP in FY23/24 did not look entirely appropriate. If we add in the so-called grocery rebate, as well as net new measures from the provinces, the total net fiscal stimulus from this year's round of budgets comes closer to 0.5 ppts of GDP for 2023. If the upside surprises to growth continue to roll in, it is still entirely possible that the debt ratio does not rise in the coming fiscal year.

What do these upside revisions do for the outlook for central bank policy? Probably not much, at least not yet. First, our new estimates are not much different from official forecasts. For instance, last week's FOMC revealed that the SEP had shaved the 2023 Q4/Q4 GDP call by just a tenth to 0.4% (our call translates into a milder 0.1% rise on that basis). In other words, the Fed is still a bit more optimistic than we are, at least officially. And, as noted, our revised call leaves us right in line with the BoC's view. Second, both central banks will be closely monitoring for any signs that credit is tightening in the wake of the banking stress.

The wait won't be long in Canada, as **the Bank's quarterly Business Outlook Survey lands on Monday**. It includes a question on credit conditions, which were already flagging a significant tightening in the past year (amid the steep back-up in rates). However, the timing of the survey was likely a bit early to have caught the full flavour of the recent strains. We'll also get a (very) early read on how the economy held up in the midst of the turmoil, with March jobs due on Thursday, auto sales earlier in the week, and home sales from the major cities sprinkled in between. Our assumption is that there won't be a major break signalled for growth yet, with employment expected to grind out a moderate gain and auto sales supported by improving availability of supplies.

Markets will have to wait one day longer for U.S. payrolls, which will be released on Good Friday this year (thus producing the rare case of Canadian jobs arriving earlier). We expect it will be worth the wait, with a solid gain of around 240,000 likely on tap, lifting the tally for all of Q1 to above 1 million net new jobs—making a mockery of recession talk, at least at the start of the year. While a slight sag in auto sales and the factory ISM is expected, the overall tone for the early read on March is expected to be generally firm in the face of the banking sector strains.

The reasonably positive news for Q1 doesn't end in North America. **The mild winter and the big pullback in energy prices clearly helped Europe avoid the worst-case scenario**, and have greased a steep slide in inflation. The Euro Area CPI fell to a much more manageable 6.9% y/y pace in March from 8.5% the prior month, a record one-month step down. While core trends are still headed in the wrong direction, nudging up to 5.7% (versus 5.5% in the U.S.), the break in headline inflation is nevertheless a massive relief for consumers.

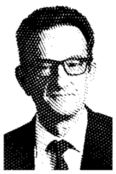
Finally, **China is dealing with an entirely different set of concerns**, including a cooling in its manufacturing PMI amid slowing global growth. But we would highlight the 12-year high in the non-manufacturing PMI as a sign that the domestic economy is snapping back with purpose amid the re-opening. This will help with the transition to a greater focus on internally-generated demand, as the global trade outlook turns much frostier amid the push for friend-shoring elsewhere.

If you think this felt like a very long month, it's more than just your imagination. There is only one month that can ever possibly have as many as 23 workdays (at least in Canada) and that is March. The reason? It's one of the seven months with 31 days of course, and it's the only one of the seven that doesn't (typically) have a statutory holiday in it. But to hit the cherished mark of 23 workdays, the month also has to start on a Monday, Tuesday or Wednesday, and Easter can't be early…and this year satisfied all conditions. So, **this is one of the four times in a typical decade to have the**

wonderful confluence of events to produce a 23-working day month. Add in a banking crisis to make it seem doubly long and suffice it to say that was one special month.

Technically, the U.S. can also have a 23-workday August, with no set holidays in that month, and this year fits the bill (starts on a Tuesday). But that month is always welcome to go on for as long as it wants.

Supercore's Case of Hesitant Disinflation



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Hot on the heels of the CPI's theme of **stubborn underlying inflation**, the PCE price index sang the same song, albeit less enthusiastically. The total index increased 0.3% in February, lowering the annual change by three-tenths to 5.0%. Despite this being a 17-month low, it is still 2½ times the Fed's 2% target.

Excluding food and energy, the **core PCE price index** also increased 0.3%. This reduced the yearly change by one-tenth to 4.6% and matches December's low. But, unrounded, it dipped below that mark, scoring a new 16-month nadir. It's noteworthy that these last 16 prints have all hovered in a relatively narrow range around 5.0%, running from the latest result to the pair of 5.4% prints hit a year ago (which were four-decade highs), painting a picture of hesitant disinflation.

Further, excluding goods and housing costs, the *de rigueur* supercore index increased 0.2%, which kept the annual move unchanged at 4.6%. Although the monthly move, which annualized to 3.0%, was a more soothing tune, changes in the supercore PCE price index are more volatile than those in their core cousin, some 40% more since the start of 2020. So, **the adage about 'one month not making a trend' is important here**.

However, the three- and six-month changes in supercore prices do denote short-term trends, and they were both 4.8% annualized. The same measures for the CPI's supercore were comparably stubborn, running in an (expected) higher range of 5.2%-to-5.3%. The annual change here was much higher at 6.1%

Stubbornness doesn't sound the Fed's inflation siren more loudly or quickly than a stronger-than-expected payroll print or a faster-than-expected CPI result would. In the March 22 presser, Chair Powell said: *"the intermeeting data on inflation and the labor market came in stronger than expected"* and *"before the recent events [banking stress]… it looked like we'd need to raise rates over the course of the year more than we had expected at the time of the SEP in December"*. And recall that the Fed viewed the recent events *"as being the equivalent of a rate hike or perhaps more than that"*, acknowledging that such equivalency lacked "*any precision whatsoever".*

However, **stubbornness keeps the Fed's inflation alarm ringing the same as before**. And, the FOMC is poised to hike policy rates again unless banking sector developments argue otherwise. For now, we're sticking with our call for another 25 bp rate hike on May 3 despite the low surprise on supercore's monthly change. The sticking is also supported by the slight upgrade to our call for economic growth for Q1 and the full year, in the wake of today's PCE data revision.

U.S. Economy: Resilient, for Now

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The U.S. **economy continues to put up a good fight**. Apart from some rationalization in the tech space, companies remain wary of shedding staff with workers so hard to find, keeping initial jobless claims stuck below 200,000. With job prospects the best in decades, consumer confidence seemingly brushed off recent bank stress to turn up in March and remain above long-run norms, at least according to the Conference Board. The University of Michigan's final read for March had a different take on sentiment, turning down and remaining stuck at recession-like levels, likely because it puts more emphasis on financial matters. Pending home sales managed to rise for a third straight month in February, albeit after sledding downhill for more than a year. Home prices are holding up better than expected, with the Case-Shiller 20-city index within 5% of last summer's peak. Firmer sales are underpinning prices, as are a lean number of listings (surely, no one with a 30-year fixed mortgage rate below 4% is itching to sell).

But the marquee release this week was **personal spending**. After a blowout gain in January, all eyes were on how much payback we would get with the return of more typical winter weather in February. The result: very little. In fact, considering the big upward revision to real spending in January (to 1.5% from 1.1%), the 0.1% decline in February left spending on a much stronger growth track than expected. Real consumer spending growth looks to top 4% annualized in Q1, and this assumes another mild decline in March (amid a further pullback in preliminary auto sales). So much for the pivot toward services spending. While it still looks to cruise at a solid 3% rate in Q1, this will be eclipsed by even faster spending on goods, led by an earlier acceleration in autos. Sturdy consumer spending should more than offset some inventory downdraft to **lift Q1 real GDP 2.0%** annualized, up from our earlier call of 0.5%. For all of 2023, growth looks to land around 1.0%, revised up from 0.7% previously, though still marking a deceleration from 2.1% in 2022.

The resilient consumer again calls into **question our forecast of a 1% annualized contraction in real GDP in the next two quarters**. For now, pending more clarity on the fallout from the bank stress, we suspect that some tightening of credit conditions alongside the full weight of past rate increases will more than offset the lift from excess savings and pent-up services demand to pull the economy downward. The **economy was losing momentum** prior to January's weather-aided spike in activity. While real GDP grew a decent 2.6% in Q4 (marked down slightly from the BEA's second estimate), the details were uninspiring. Growth was led by hefty increases in business inventories, non-residential structures (the first gain in nearly two years), and government spending (mostly for higher public sector compensation)—none of which are sustainable. Meanwhile, final sales to private domestic purchasers (or spending by consumers and businesses plus residential construction) completely stalled after minimal gains in the prior two quarters.

While the U.S. economy continues to hold up better than expected, it might still be too early to yank our call for a mild downturn.

Debt Management Strategy: T-bills Pick Up the Slack

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With Ottawa's budget deficit shrinking slightly, **federal government borrowing requirements will take another small step down** in the coming fiscal year. Gross bond issuance is expected to fall to $172 bln, down $13 bln from the prior year. After accounting for maturities, that pegs net issuance at $19 bln. While the issuance figure continues to step down from prior years, keep in mind that the Bank of Canada is still running its quantitative tightening (QT) program through balance sheet runoff. In other words, **the Bank will have roughly $70 billion of bonds maturing this year**, adding to the amount that will need to be taken down by the market. To date, this hasn't proven to be an issue. A speech from Deputy Governor Gravelle this week noted that QT is expected to continue until late 2024 or early 2025, so **it appears as if the BoC won't be returning to the market any time soon**.

The massive increase in issuance to support pandemic spending saw a focus on longer duration; that was toned down last year, and issuance in the 10- and 30-year sectors continues to decline on a relative basis. Planned issuance is $40 bln in the 10-year sector (23% of total) and $10 bln in the 30-year sector (6% of total), versus $52 bln (28%) and $14 bln (8%) respectively in the prior fiscal year. Meantime, 2- and 5-year issuance will increase to $76 bln (from $67 bln) and $40 bln (from $31 bln), respectively. That comes alongside a phase-out of the 3-year sector due to lower overall issuance needs. Benchmark sizes will increase from last year at the shorter end to absorb the loss of 3-year issuance, while the gradual move away from the long end will reduce benchmark sizes further out the curve. **Treasury bill issuance is planned to rise to $242 bln, up $20 bln and a key reason why bond issuance is declining.** Ottawa will aim to continue the Green Bond program, with issuance dependent on market conditions.

In a surprise move, Budget 2023 announced that **the Canada Mortgage Bond (CMB) program is under review to be potentially consolidated into the regular Government of Canada borrowing program**. The stated rationale is that it could provide an opportunity to reduce debt charges which could be reinvested into affordable housing programs. The reality is that the program is structured so that there is no actual cost to taxpayers/CMHC/the government, but it appears the government is keen to consolidate the program in GoCs. There were no additional details, and there will be market consultations over the next six months, with the government reporting back on potential changes at the fall economic and fiscal update. There was significant volatility in CMB spreads post-announcement, but the market settled down by the end the week. Still, uncertainty on the future of the program could create challenges for the product over the coming months. See Robert Kavcic's full budget recap in this week's Feature article on page 8.

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Indications of stronger growth and a move toward price stability are ***good news*** *for the economy.*

	Good News	Bad News
Canada ▪ Federal budget projects deficits for the foreseeable future; no plan to balance ▪ BoC signals end to QT by early 2025	**Monthly Real GDP** +0.5% (Jan.)—and StatCan estimates February grew 0.3% **SEPH Employment** +71,062 (Jan.) **Conference Board's Consumer Confidence Index** +4.2 pts to 75.7 (Mar.)	**Federal Budget Deficit** projected to narrow slightly to $40.1 bln (FY23/24)—worse than previous estimate **Ottawa's Fiscal Monitor** -$0.9 bln (Jan.)—but smaller than -$5.2 bln last year
United States ▪ Stocks rally as fears over banking sector ease ▪ Treasury yields unwind last week's rally	**Personal Income** +0.3% (Feb.)—yearly rate still above 6% **Core PCE Deflator** slowed to +0.3% (Feb.)—and **supercore** measure +0.2% **Wholesale Inventories** +0.2%; **Retail Inventories** +0.8% (Feb. A) **S&P Case-Shiller Home Prices** +2.5% y/y; **FHFA Home Prices** +5.3% y/y (Jan.)—but slowing **Pending Home Sales** +0.8% (Feb.) **Conference Board's Consumer Confidence Index** +0.8 pts to 104.2 (Mar.)	**Real Personal Spending** -0.1% (Feb.)—but January revised up sharply **Real GDP** revised down a tick to +2.6% a.r. (Q4) **Corporate Profits** slowed to +2.6% y/y (Q4) **Goods Trade Deficit** widened to $91.6 bln (Feb. A) **Initial Claims** +7k to 198k (Mar. 25 week) **U of M Consumer Sentiment** revised down to 62.0 (Mar.)
China ▪ Services activity gaining momentum; manufacturing growth slowing	**Non-manufacturing PMI** +1.9 pts to a 12-year high of 58.2 (Mar.)	**Manufacturing PMI** -0.7 pts to 51.9 (Mar.)—but above expected
Japan ▪ Yen weakens as risk appetite returns	**Retail Sales** +1.4% (Feb.) **Industrial Production** +4.5% (Feb. P)	**Jobless Rate** +0.2 ppts to a 4-mth high of 2.6% (Feb.) **Tokyo Core-Core CPI** +3.4% y/y (Mar.)—fastest since 1990
Europe ▪ Underlying price pressures in the Euro Area show no signs of relenting ▪ ECB Economic Bulletin: Inflation is expected to remain too high for too long ▪ BoE Gov. Bailey suggests rates won't return to pre-GFC highs ▪ France's highest court will rule on pension reform on April 14	**Euro Area—Jobless Rate** steady at 6.6% (Feb.) **Germany—Consumer Prices** slowed to +7.8% y/y (Mar. P)—but mostly due to natgas decline **Germany—ifo Business Climate** +2.2 pts to 93.3 (Mar.); **GfK Consumer Confidence** +1.1 pts to -29.5 (Apr.) **France—Jobless Rate** -0.1 ppts to 7.0% (Feb.) **Italy—Jobless Rate** steady at 8.0% (Feb.) **Italy—Consumer Confidence** +1.1 pts to 105.1 (Mar.) **U.K.—Real GDP** revised up to +0.1% q/q (Q4)	**Euro Area—Core Consumer Prices** jumped to +5.7% y/y (Mar. P)—record high **Euro Area—Adjusted Private Sector Credit** +4.3% y/y (Feb.)—slowing **Euro Area—Economic Confidence** -0.3 pts to 99.3 (Mar.) **Germany—Unemployment** +16,000 (Mar.)—and **Jobless Rate** +0.1 ppts to 5.6% **France—Consumer Spending** -0.8% (Feb.) **France—Business Confidence** -1 pt to 103; **Consumer Confidence** -1 pt to 81 (Mar.)
Other ▪ WTI rebounds above $75 ▪ Bank of Mexico hikes 25 bps	**Australia—Consumer Prices** slowed to +6.8% y/y (Feb.) **Australia—Retail Sales** +0.2% (Feb.)	

Green Energy Goals, Red Ink Realities

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Overview: Food for Fiscal Thought

The 2023 federal budget is set against a backdrop of still-elevated inflation, disruption in the global financial sector and a likely looming recession. Despite uncertainty on a number of fronts, and a weaker-than-expected underlying budget balance, **Ottawa continues to roll out net new stimulus to the tune of $4.8 billion in FY23/24, and $43 billion over six years**. That mostly comes through targeted spending and a swath of tax credits aimed at the clean energy sector. While tax revenues are raised in a few areas and there is some trimming of government operations, the budget deficit sits at $43.0 billion in FY22/23, and about $10 billion per-year deeper through the forecast horizon, with **no plan to balance the books**. Indeed, the first hint of a balanced budget that we've seen in years, which showed up in the Fall Economic Statement for the out-years, lasted all of four months.

It's notable that the FY23/24 deficit of $40.1 billion is now roughly back to pre-COVID levels ($39 billion deficit in FY19/20). Over that period, revenues have surged by $120 billion. But, program spending has jumped by $110 billion, even after pandemic-era support spending has fallen away. In that sense, **there has been some permanence to the jump in government spending that has prevented more fiscal consolidation**. While the average price level in Canada is up about 13% from before the pandemic, and the population has expanded by another 4%, we're still seeing program spending hold above pre-COVID norms in real per-capita terms and as a share of GDP, and we continue to see each budget add progressively more spending (*Chart 1*).

This budget does a number of things. There are immediate direct household transfers of $2.5 billion, billed as a "grocery rebate" even though groceries have nothing to do with it. Ottawa is also acknowledging the possibility of recession through a stress test of how finances would look in a below-expected economic outlook. This downside scenario features a recession-like 0.2% decline in real GDP in 2023 that comes with a $47 billion deficit. On the policy front, there are measures aimed at the clean energy sector in a response to the U.S. Inflation Reduction Act. More money flows into health and dental care, and there are some more tax increases aimed at higher-income Canadians and businesses worth roughly $4 billion annually a few years down the road.

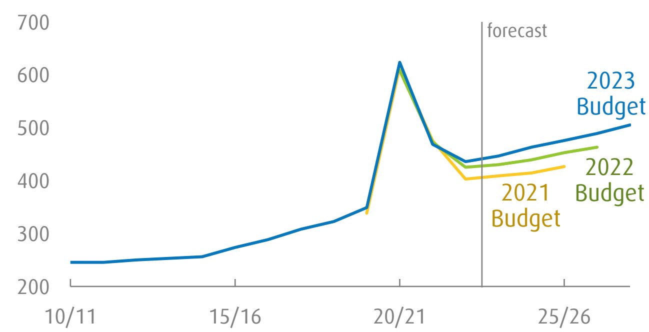
Table 1
Fiscal Outlook
(C$ blns, except where noted)

	22/23e	23/24f	24/25f	25/26f
Revenues	437.3	456.8	478.5	498.4
Expenditures	470.4	490.5	509.3	522.5
Program Spending	435.9	446.6	463.3	475.9
Public Debt Charges	34.5	43.9	46.0	46.6
Net Actuarial Losses	9.8	6.4	4.2	2.8
Budget Balance	(43.0)	(40.1)	(35.0)	(26.8)
Federal Debt	1,180.7	1,220.8	1,255.8	1,282.7
As a percent of GDP:				
Budget Balance	(1.5)	(1.4)	(1.2)	(0.9)
Federal Debt	42.4	43.5	43.2	42.2

Source: Federal Budget *( ) = deficit; e = estimate; f = forecast*

Chart 1
Evolution of Ottawa's Spending Plan

Canada (C$ blns)
Federal Program Spending



Sources: BMO Economics, Federal Budgets *FY22/23 = estimate*

This budget also avoids doing a number of things. Most importantly, large-scale immediate fiscal stimulus is held in check with net new measures weighing at around 0.2% of GDP this year. While inflation has shown signs of cooling, the Bank of Canada remains in a dog fight with price and wage pressures, rendering stimulative measures counterproductive (like direct support payments), although Ottawa just couldn't fully resist on that front. Oft-rumoured and more contentious policy measures (e.g., broad capital gains inclusion rate, top income tax rate and principal residence exemption) are again unchanged in this budget.

All told, this budget continues to push fiscal priorities against a weaker and riskier economic backdrop, leaving behind a deeper deficit path.

Steady Fiscal Outlook

The **budget deficit is pegged at $40.1 billion in FY23/24** (1.4% of GDP), improved slightly from $43 billion in FY22/23. The latter is revised wider from $36.4 billion in the Fall Economic Statement (FES), as increased spending dwarfs a further in-year improvement resulting from the economy. While the deficit is now well down from the record $328 billion at the depth of the pandemic in FY20/21 (thanks to resurgent revenues and expired emergency programs), still-elevated spending, higher interest costs and a downward turn in economic momentum keep the balance in the red through the forecast. Cumulatively, the **total deficit between FY22/23 and FY27/28 is now running $69 billion larger than in the FES**, split roughly one-third due to economic developments, and two-thirds the result of new measures net of tax increases.

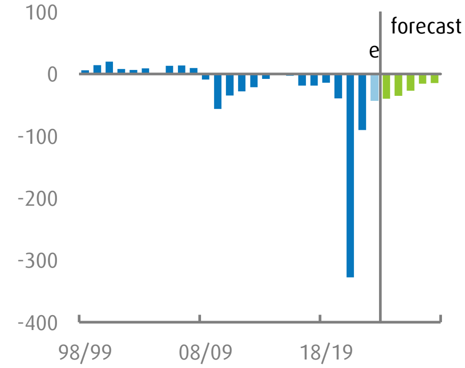
Revenues are projected to rise 4.5% to $457 billion in FY23/24, led by gains in personal income and sales tax receipts. Meantime, program spending is projected to rise 2.5% this fiscal year, with medium-term growth pegged at a similar rate. In the five years pre-COVID, total spending averaged a steady 14.5% of GDP. This year, total spending will run at 15.9% of GDP, before fading to 15.4% late in the forecast. That's still a noteworthy increase in government spending as a share of the economy, especially at a time of full employment and when nominal output itself has surged on the back of rising prices.

The **debt-to-GDP ratio** will rise to 43.5% in the coming fiscal year, from 42.4% in FY22/23, before declining gradually to just under 40% by FY27/28. Given that economic momentum is stalling, the major positive surprises of the past two years seem to have run their course. The **downward drift in the debt-to-GDP ratio is now the key major fiscal objective**, and this budget continues to project a gradual decline over the forecast horizon, but only after a near-1 percentage point increase this coming fiscal year. The issue with this as a fiscal anchor is that the debt-to-GDP ratio is not a hard anchor, and it is usually destined to jump when the economy (the denominator) slows or falls, as is the case this year.

Chart 2
Deficits to Narrow, but No Path to Balance

Canada (C$ blns)

Budget Balance

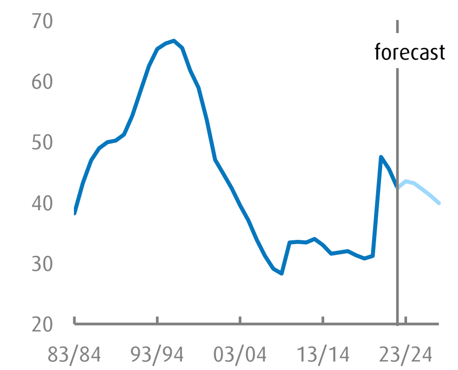


Source: Federal Budget *e = estimate*

Chart 3
Debt Turns Up Again

Canada (% of GDP)

Federal Debt



Source: Federal Budget

Cloudy Economic Assumptions

As is the convention, the budget projections are based on the private sector consensus. This round was put in place before turmoil broke out in the global banking sector, which would ordinarily point to immediate downside risk. But, the pre-turmoil consensus was on the conservative side, especially for early-2023 growth. That combination leaves the 2023 growth forecast looking light, but we're fully aware that this could turn back in a hurry depending on how the situation evolves in coming months.

Table 2
Economic Assumptions

(percent)		Ottawa			BMO Capital Markets	
		*2022	2023	2024	2023	2024
GDP Growth	Real	3.4	0.3	1.5	**1.0**	**1.3**
	Nominal	11.0	0.9	3.6	**2.6**	**3.6**
Yields	3-month T-Bill	2.4	4.4	3.3	**4.5**	**3.9**
	10-year GoC	2.8	3.0	2.9	**3.2**	**3.0**

Sources: BMO Economics, Federal Budget * = actual

The budget is based on real GDP growth of 0.3% this year (we are now at 1.0% with Q1 tracking strongly), and 1.5% next year (1.3%). While real growth gets the focus, nominal growth has been the big story and the driver of revenues. Ottawa expects nominal growth to slow substantially to 0.9% this year after an 11% pop in 2022 (we're at 2.6%) and pick up to 3.6% in 2024 (3.6%). After a multi-year run of large and persistent upside surprises to nominal GDP and revenues, it looks like the bar has been reset to a more neutral level, even if there is some immediate upside room. In the downside scenario of a more significant recession (-0.2% real GDP growth this year and muted 1.0% rebound in 2024), the full path of the budget deficit runs about $7 billion deeper per year.

Meantime, interest rates now sit much higher than Ottawa expected along the curve last year. The 10-year yield is pegged at 3.0% this year, while the Bank of Canada is presumed to be finished raising rates. Both of those assumptions are generally consistent with our current view, although we are a bit higher than consensus in 2024.

Summary and Market Impact

This budget continues to press ahead with policy priorities despite a more challenging and less certain economic backdrop, leading to deeper deficits through the forecast horizon. But, those deficits hold at or less than 1.5% of GDP, still a long way from the depths of a few years ago. From a high-level perspective, temporary spending-driven deficits have subsided and Ottawa is now back to budget deficits roughly consistent with pre-pandemic levels. That said, **an opportunity for even faster or more significant fiscal consolidation has been foregone given high-side persistence in program spending**. Longer-term measures that aim to spur investment and improve the supply side of the economy remain worthwhile goals. From a credit perspective, a gradually falling debt-to-GDP ratio remains the fiscal target, but history (and even the year ahead) remind us that the ratio can turn quickly.

The budget should have a negligible market impact overall. Broadly, the tax-and-spend nature of fiscal policy now and in recent years, along with persistent and larger deficits, could be viewed as somewhat negative for **the loonie**. But, Canada has not been alone on this front and other major drivers such as interest rates and oil prices will dominate. For **bond yields**, a small step down in borrowing runs alongside central bank quantitative tightening, leaving still-chunky issuance for the market to absorb. But, inflation and recession dynamics will far outweigh any impact on yields. Finally, aside from another tax increase on financial institutions, a tax on buybacks and the impact of some credits, there's not much for the **equity market** to digest.

Appendix: Highlights of Major Measures

The net additional stimulus in Budget 2023 amounts to $4.8 billion in FY23/24 and $43 billion over six years. The total net fiscal impulse for Canada this budget season, if we consider also the GST rebate booked at the end of FY22/23 and provincial tax measures, looks to be in the 0.4%-to-0.5% range. Here are some of the most significant measures:

Affordability measures

GST rebate increase: While billed as a “grocery rebate”, it really has nothing to do with groceries. The GST credit for lower-income Canadians is increased in what amounts to a maximum of $153 per adult. This is an immediate direct cash transfer to lower-income Canadians worth $2.5 billion, with the cost booked in FY22/23.

Student affordability: The Canada Student Grant is lifted by 40%, and the interest-free loan limit is raised modestly. Total relief will amount to $814 million in FY23/24.

RESP withdrawal limit: Limit is increased from $5,000 to $8,000 for full-time students, and from $2,500 to $4,000 for part-time students.

Taxation measures

Alternative Minimum Tax (AMT) framework: The AMT is a tax calculation run parallel to ordinary income tax rules, with the taxpayer paying whichever amount is higher. Three broad changes include lifting the AMT rate from 15% to 20.5%; raising the basic exemption level from $40k to $173k; and devaluing many exemptions and deductions (e.g., increase the capital gains inclusion rate from 80% to 100%).

Global Minimum Tax: Ensures that large multinational corporations are subject to a 15% effective tax rate on profits in the jurisdiction they are operating in, and is consistent with moves made in other countries.

Taxes on financial institutions: Changes the tax rate paid on dividends received by financial institutions by treating the flow as ordinary income. Ottawa is expecting roughly $900 million per year from this measure, starting in FY24/25.

Tax on the share buybacks: A 2% tax on share buybacks will apply to public companies as of January 1, 2024, if those buybacks exceed $1 million. The revenue impact will reach north of $600 million in two years.

Clean economy and response to the U.S. Inflation Reduction Act

The majority of Canada’s focus in this area looks to be coming in the form of tax credits to incentivize investment. The following new/expanded credits come with modest fiscal cost in FY23/24, rising above $5 billion per year by FY26/27, and come with some labour market requirements.

Clean Electricity Investment Tax Credit: A 15% refundable tax credit on eligible investments (e.g., wind, solar, electricity, transmission equipment).

Clean Technology Manufacturing Investment Tax Credit: A 30% refundable tax credit on machinery and equipment in clean technology manufacturing, and to offset the cost of mining and production equipment for critical minerals.

Clean Hydrogen Investment Tax Credit: Credit ranges from 15%-to-40% on project costs.

Clean Technology Investment Tax Credit expansion: The recently-announced 30% refundable rate for those adopting clean technology will expand to include geothermal energy, and the credit will be phased out later.

Carbon Capture, Utilization and Storage Tax Credit expansion: The list of allowable expenses under the credit is expanded, and the credit expands to projects in B.C.

Other notable measures

Canadian Dental Care Plan: Coverage for all Canadians with family income below $90k and without insurance, and will cost an additional $2 billion per year by FY24/25 ($1 billion more than previously budgeted).

Provincial health transfers: The provinces are receiving an immediate $2 billion top-up the Canada Health Transfer amount, and annual growth is set at a minimum of 5% for the next five years (the formula is normally driven by nominal GDP growth).

Various measures to monitor and limit foreign interference, money laundering and risk in the crypto space. For example, OSFI’s mandate will expand to oversee measures related to limiting foreign interference; and a federal beneficial ownership registry will be created. Amendments to the criminal code will be made to strengthen the AML/ATF regime.

Cost savings: Ottawa will clamp down on internal travel and outsourcing work to consultants. Savings in this area look to run at $7 billion over five years before settling into $1.7 billion per year thereafter. Other departmental spending reduction targets look to cut 3% by FY26/27 for additional ongoing savings of $2.4 billion per year. A good chunk of this ($3 billion per year by FY26/27) was built into last year’s budget.

Gross bond issuance is expected to fall to $172 billion, down $13 bln from the prior year. After accounting for maturities, that pegs net issuance at $19 billion.

Canada Mortgage Bond program is under review to be potentially consolidated into the regular Government of Canada borrowing program.

Economic Forecast Summary for March 31, 2023

	2022				2023				Annual		
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	2022	2023	2024
CANADA											
Real GDP (q/q % chng : a.r.)	2.4	3.6	2.3	0.0	2.5 ↑	-0.5	-0.7	1.0	3.4	1.0 ↑	1.3
Consumer Price Index (y/y % chng)	5.8	7.5	7.2	6.7	5.3	3.6	3.3	2.9	6.8	3.8	2.5
Unemployment Rate (percent)	5.7	5.1	5.1	5.1	5.0	5.3	5.6	5.8	5.3	5.4	5.6
Housing Starts (000s : a.r.)	241	271	281	259	235	242	225	220	263	230	220
Current Account Balance ($blns : a.r.)	11.0	22.0	-33.7	-42.6	-33.5 ↑	-33.7 ↑	-39.6 ↑	-41.5 ↑	-10.8	-37.0 ↑	-42.0 ↑
Interest Rates	(average for the quarter : %)										
Overnight Rate	0.33	1.17	2.75	3.92	4.50	4.50	4.50	4.50	2.04	4.50	3.88
3-month Treasury Bill	0.39	1.43	2.91	3.96	4.40	4.45	4.45	4.45	2.17	4.45	3.85
10-year Bond	1.92	2.98	3.01	3.16	3.00	3.30	3.20	3.05	2.77	3.15	2.95
Canada-U.S. Interest Rate Spreads	(average for the quarter : bps)										
90-day	9	33	16	-22	-40	-55	-60	-60	9	-54	-52
10-year	-2	5	-10	-67	-61	-62	-57	-52	-18	-58	-44
UNITED STATES											
Real GDP (q/q % chng : a.r.)	-1.6	-0.6	3.2	2.6	2.0 ↑	-1.0	-1.0	0.8	2.1	1.0 ↑	1.3
Consumer Price Index (y/y % chng)	8.0	8.6	8.3	7.1	5.9	4.5	4.0	3.7	8.0	4.5	2.5
Unemployment Rate (percent)	3.8	3.6	3.5	3.6	3.5	4.0	4.6	4.8	3.6	4.2	4.7
Housing Starts (mlns : a.r.)	1.72	1.65	1.45	1.40	1.40	1.38	1.34	1.37	1.55	1.37	1.41
Current Account Balance ($trlns : a.r.)	-1.12	-0.95	-0.88	-0.83	-0.87 ↑	-0.89 ↑	-0.90	-0.90 ↑	-0.94	-0.89 ↑	-0.92
Interest Rates	(average for the quarter : %)										
Fed Funds Target Rate	0.21	0.96	2.63	3.79	4.63	5.04	5.13	5.13	1.90	4.98	4.42
3-month Treasury Bill	0.30	1.10	2.75	4.18	4.80	5.00	5.05	5.05	2.08	5.00	4.35
10-year Note	1.94	2.93	3.10	3.83	3.65	3.90	3.80	3.55	2.95	3.75	3.40
EXCHANGE RATES	(average for the quarter)										
US¢/C$	79.0	78.4	76.6	73.7	73.9	73.8	75.1	76.5	76.9	74.8	77.7
C$/US$	1.27	1.28	1.31	1.36	1.35	1.35	1.33	1.31	1.30	1.34	1.29
¥/US$	116	130	138	141	132	133	132	130	131	132	127
US$/Euro	1.12	1.06	1.01	1.02	1.07	1.08	1.09	1.10	1.05	1.08	1.12
US$/£	1.34	1.26	1.18	1.17	1.21	1.22	1.23	1.25	1.24	1.23	1.27

Blocked areas mark BMO Capital Markets forecasts; up and down arrows (↑↓) indicate forecast changes; spreads may differ due to rounding

United States

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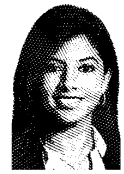

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ISM Manufacturing PMI

Monday, 10:00 am

Mar. (e)	**47.2**
Consensus	*47.5*
Feb.	47.7

The **ISM manufacturing PMI** looks to resume its slide in March (down 0.5 pts to 47.2) after edging up in February for the first time in six months. New orders are expected to fall deeper into contraction territory and production could fall for the fifth month in a row. Meantime, the prices sub-index likely fell back below the 50-mark. With the Fed expected to raise rates one more time before pausing, the ISM's manufacturing gauge should continue to lose steam, signalling a contraction.

ISM Services PMI

Wednesday, 10:00 am

Mar. (e)	**54.5**
Consensus	*54.5*
Feb.	55.1

The **ISM services PMI** barely fell in February after an astonishing 6-pt increase at the start of the year. Although the gauge is expected to drop 0.6 pts to 54.5 in March, it remains comfortably in expansionary terrain. Business activity has waxed and waned without making much progress over the last year. Meantime, new orders likely retraced some of the prior month's surge, but are still expanding along with employment. After hitting a record high of 84.5 back in December 2021, the prices sub-index has been trending lower, while holding above the 60-mark amid stubborn wage pressures. Looking ahead, if momentum in the still-strong services sector is to slow, labour market conditions will likely need to soften.

Nonfarm Payrolls

Friday, 8:30 am

Mar. (e)	**+240,000**
Consensus	*+240,000*
Feb.	+311,000

Unemployment Rate

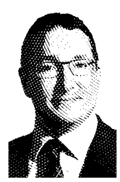
Mar. (e)	**3.6%**
Consensus	*3.6%*
Feb.	3.6%

Average Hourly Earnings

Mar. (e)	**+0.3%**	**+4.3% y/y**
Consensus	*+0.3%*	*+4.3% y/y*
Feb.	+0.2%	+4.6% y/y

If anyone asked at the start of the year if the economy would pump out over one million new jobs in the first quarter, we would have raised both eyebrows, bulged our eyeballs, and glared intently. But that's more than possible now after a total of 815,000 positions were cranked out in just the first two months of the year, and with still-low jobless claims flagging a solid 240,000 rise in **employment** for March. Limiting factors are a pullback in job openings (according to Lightcast weekly data) and recent banking stress, though the latter (via tighter credit for businesses) will likely show up later. The public sector (mostly education) contributed to a fifth of the payroll gains of the past two months, but the private sector has also been a steamy locomotive, led by leisure and hospitality services, with high-tech and manufacturing bringing up the rear. Assuming some further rise in the participation rate, the **unemployment rate** should hold at 3.6%, close to January's 54-year low of 3.4%. The tight job market should lift average hourly **earnings** 0.3% following a surprisingly weak advance the prior month. Although the yearly wage rate should slide a few notches to 4.3%, that's still inconsistent with price stability barring a material pickup in productivity.

Canada



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BoC Business Outlook Survey and Survey of Consumer Expectations (Q1)

Monday, 10:30 am

The **Bank of Canada's Business Outlook Survey (BOS)** for Q1 was likely compiled around mid/late-February to mid-March. It was during this period that the BoC became the first major central bank to pause its tightening cycle *and* the collapse of Silicon Valley Bank incited global market volatility. We'll be keeping an eye on any follow-up questions to the survey addressing sentiment around the banking sector. And, we look for the **BOS indicator** to step down for the fifth straight quarter, likely dipping slightly into negative territory for the first time since 2020.

Inflation expectations remain the focus, with an improvement expected as headline inflation decelerated through the quarter. In Q4, the share of firms expecting inflation to be above 3% over the next year hit a new record high of 84%. More encouragingly, measures of input and output price inflation pointed to further slowing. Additional progress on this front could support the Bank's pause, notwithstanding further upward pressure on labour costs.

Labour shortages eased in the previous quarter but stayed elevated; this looks to remain the case as the labour market tightened even further to start the year, likely keeping upward pressure on wage expectations. The survey's measures of **capacity pressures** are expected to ease further as Q1 GDP growth is forecast to be below potential for a second straight quarter.

The outlook for future **sales growth** should remain weak as recession concerns weigh, though fewer supply chain disruptions will provide some offset. We expect hiring and investment intentions to fall further from elevated levels amid the softer outlook.

Finally, the balance of opinion on **credit conditions** likely deteriorated further from the already tight reading last quarter. Despite the BoC's pause in March, the banking sector stress tightened global credit conditions.

The Bank's **Consumer Expectations Survey** will be released at the same time and is expected to reflect similar concern about the cumulative impact of monetary tightening and market volatility. The previous survey showed inflation expectations remaining elevated one year ahead, but moderating at longer time horizons; we will look for additional easing on that front as headline inflation stepped down in the first quarter.

Merchandise Trade Balance

Wednesday, 8:30 am

Feb. (e)	**+$1.0 bln**
Consensus	*+$1.7 bln*
Jan.	+$1.9 bln

After posting a sizeable surplus in January, Canada's **merchandise trade** balance likely weakened slightly. We look for a $1 bln surplus in February, down from $1.9 bln in the previous month. Energy exports were supported by higher oil prices, though lower natural gas prices provided a small offset. A negative manufacturing flash suggests a reversal of the January strength in imports and non-energy exports. Our estimate would still point to a solid surplus, marking ten of the past twelve months in the black.

Employment

Thursday, 8:30 am

Mar. (e)	**+0.1% (+15,000)**
Consensus	*+0.1% (+12,500)*
Feb.	+0.1% (+21,800)

Unemployment Rate

Mar. (e)	**5.1%**
Consensus	*5.1%*
Feb.	5.0%

Average Hourly Wages

Mar. (e)	**+5.5% y/y**
Feb.	+5.4% y/y

Labour market momentum remained firm through the early stages of 2023, with January's mammoth jobs gain followed up by a respectable February increase. We're looking for another steady 15k rise in **employment**, though that would be a step down from the 3- and 6-month pace. Given rapid population growth, our call for a 15k gain isn't particularly strong, and less than half the pace of labour force growth over the past year. Indeed, we're looking for the **unemployment rate** to rise a tick to 5.1%, with further upside risk. **Wage** growth rebounded in February, accelerating to +5.4% y/y, and there's likely further upside for March after a modest monthly gain a year ago. Lastly, hours worked surged at an 8.4% annualized rate through the first two months of the year, so we'll be watching for any retracement of that strength and the implications for Q1 GDP growth.

Financial Markets Update for March 31, 2023

		Mar 31 [1]	Mar 24	Week Ago	4 Weeks Ago (basis point change)	Dec 31, 2022
Canadian	Call Money	4.50	4.50	0	0	25
Money Market	Prime Rate	6.70	6.70	0	0	25
U.S. Money	Fed Funds (effective)	5.00	5.00	0	25	50
Market	Prime Rate	8.00	8.00	0	25	50
3-Month Rates	Canada	4.33	4.29	4	-11	10
	United States	4.74	4.61	12	-10	39
	Japan	-0.25	-0.27	2	-7	-7
	United Kingdom	4.29	4.35	-6	-1	42
	Australia	3.71	3.70	1	8	45
2-Year Bonds	Canada	3.77	3.41	36	-45	-28
	United States	4.12	3.77	35	-74	-31
10-Year Bonds	Canada	2.92	2.75	17	-42	-38
	United States	3.52	3.38	14	-43	-35
	Japan	0.32	0.28	4	-18	-9
	Germany	2.32	2.12	19	-40	-25
	United Kingdom	3.52	3.28	24	-33	-14
	Australia	3.30	3.22	8	-60	-75
Risk Indicators	VIX	18.7	21.7	-3.0 pts	0.2 pts	-2.9 pts
	Inv. Grade CDS Spread [2]	79	87	-8	7	-3
	High Yield CDS Spread [2]	484	530	-45	48	0
					(percent change)	
Currencies	US¢/C$	73.88	72.76	1.5	0.5	0.1
	C$/US$	1.354	1.374	—	—	—
	¥/US$	133.03	130.73	1.8	-2.1	1.5
	US$/€	1.0864	1.0760	1.0	2.2	1.5
	US$/£	1.237	1.223	1.1	2.7	2.3
	US¢/A$	66.97	66.45	0.8	-1.1	-1.7
Commodities	CRB Futures Index	264.38	258.49	2.3	-3.9	-4.8
	Oil (generic contract)	74.83	69.26	8.0	-6.1	-6.8
	Natural Gas (generic contract)	2.19	2.36	-7.5	-27.4	-51.2
	Gold (spot price)	1,975.51	1,978.21	-0.1	6.4	8.3
Equities	S&P/TSX Composite	20,087	19,501	3.0	-2.4	3.6
	S&P 500	4,074	3,971	2.6	0.7	6.1
	Nasdaq	12,112	11,824	2.4	3.6	15.7
	Dow Jones Industrial	33,040	32,238	2.5	-1.1	-0.3
	Nikkei	28,041	27,385	2.4	0.4	7.5
	Frankfurt DAX	15,652	14,957	4.6	0.5	12.4
	London FT100	7,647	7,405	3.3	-3.8	2.6
	France CAC40	7,338	7,015	4.6	-0.1	13.3
	S&P ASX 200	7,178	6,955	3.2	-1.5	2.0

[1] = as of 11:10 am *[2] = One day delay*

	Monday April 3	Tuesday April 4	Wednesday April 5	Thursday April 6	Friday April 7
China	**Caixin Manufacturing PMI** **Mar. (e) 51.4** Feb. 51.6		Markets closed	**Caixin Services PMI** **Mar. (e) 55.0** Feb. 55.0 **Foreign Reserves** [D] **Mar. (e) $3.1 trln** Feb. $3.1 trln	
Japan	**Tankan Large Mfg. Index** **Q1 (e) 3** Q4 7 **Jibun Manufacturing PMI** **Mar. F (e) 48.6** Feb. 47.7		**Jibun Services PMI** **Mar. F (e) 54.2** Feb. 54.0		**Household Spending** **Feb. (e) +4.8% y/y** Jan. -0.3% y/y
Europe	EURO AREA **Manufacturing PMI** **Mar. F (e) 47.1** Feb. 48.5 UNITED KINGDOM **Manufacturing PMI** **Mar. F (e) 48.0** Feb. 49.3	EURO AREA **Producer Price Index** **Feb. (e) -0.4% +13.3% y/y** Jan. -2.8% +15.0% y/y GERMANY **Trade Surplus** **Feb. (e) €16.8 bln** Jan. €16.0 bln	EURO AREA **Services PMI** **Mar. F (e) 55.6** Feb. 52.7 GERMANY **Factory Orders** **Feb. (e) +0.5% -9.5% y/y** Jan. +1.0% -10.9% y/y FRANCE **Industrial Production** **Feb. (e) +0.5% -0.2% y/y** Jan. -1.9% -2.2% y/y ITALY **Retail Sales** **Feb.** Jan. +1.7% +6.2% y/y UNITED KINGDOM **Services PMI** **Mar. F (e) 52.8** Feb. 53.5	GERMANY **Industrial Production** **Feb. (e) -0.3% -2.0% y/y** Jan. +3.5% -1.6% y/y	EURO AREA Markets closed FRANCE **Trade Deficit** [D] **Feb.** Jan. €12.9 bln UNITED KINGDOM Markets closed
Other	OPEC Joint Ministerial Monitoring Committee meeting	AUSTRALIA Reserve Bank of Australia Monetary Policy Meeting	NEW ZEALAND Reserve Bank of New Zealand Monetary Policy Meeting	AUSTRALIA **Trade Surplus** **Feb. (e) A$11.2 bln** Jan. A$11.7 bln INDIA Reserve Bank of India Monetary Policy Meeting	AUSTRALIA Markets closed

[D] = date approximate

Upcoming Policy Meetings | Bank of England: May 11, June 22, Aug. 3 | European Central Bank: May 4, June 15, July 27

	Monday April 3	Tuesday April 4	Wednesday April 5	Thursday April 6	Friday April 7
Canada	9:30 am **S&P Global Manufacturing PMI** **Mar.** Feb. 52.4 **10:30 am BoC Business Outlook Survey and Survey of Consumer Expectations (Q1)** **Auto Sales**[D] **Mar.** Feb. +5.1% y/y **PEI Election**	8:30 am **Building Permits** **Feb. (e) -1.0%** Jan. -4.0% 11:15 am Cash management bond buybacks $0.5 bln	8:30 am **Merchandise Trade Balance** **Feb. (e) +$1.0 bln** *Consensus +$1.7 bln* Jan. +$1.9 bln Noon 10-year bond auction $3.5 bln	8:30 am **Employment** **Mar. (e) +0.1% (+15,000)** *Consensus +0.1% (+12,500)* Feb. +0.1% (+21,800) 8:30 am **Unemployment Rate** **Mar. (e) 5.1%** *Consensus 5.1%* Feb. 5.0% 8:30 am **Average Hourly Wages** **Mar. (e) +5.5% y/y** Feb. +5.4% y/y 10:00 am **Ivey PMI (s.a.)** **Mar.** Feb. 51.6 2-year bond auction announcement	**Good Friday (markets closed)**
United States	9:45 am **S&P Global Manufacturing PMI (Mar. F)** 10:00 am **ISM Manufacturing PMI** **Mar. (e) 47.2** *Consensus 47.5* Feb. 47.7 10:00 am **Construction Spending** **Feb. (e) -0.2%** *Consensus +0.1%* Jan. -0.1% **Autodata Total Vehicle Sales**[D] **Mar. (e) 14.6 mln a.r.** Feb. 15.2 mln a.r. **OPEC Joint Ministerial Monitoring Committee meeting** Fed Speaker: Governor Cook (4:15 pm) 11:30 am 13- & 26-week bill auctions $105 bln	10:00 am **Factory Orders** **Feb. (e) -0.5%** *Consensus -0.5%* Jan. -1.9% 10:00 am **Job Openings & Labor Turnover Survey (Feb.)** Fed Speakers: Governor Cook (1:30 pm); Cleveland's Mester (6:15 pm) 11:00 am 4-, 8- & 17-week bill auction announcements	7:00 am **MBA Mortgage Apps** **Mar. 31** Mar. 24 +2.9% 8:15 am **ADP National Employment Report** **Mar. (e) +210,000** *Consensus +213,000* Feb. +242,000 8:30 am **Goods & Services Trade Deficit** **Feb. (e) $68.8 bln** *Consensus $68.5 bln* Jan. $68.3 bln 9:45 am **S&P Global Services/ Composite PMI (Mar. F)** 10:00 am **ISM Services PMI** **Mar. (e) 54.5** *Consensus 54.5* Feb. 55.1 11:30 am 17-week bill auction	7:30 am **Challenger Layoff Report** **Mar.** Feb. +410% y/y 8:30 am **Initial Claims** **Apr. 1 (e) 200k (+2k)**[C] Mar. 25 198k (+7k) 8:30 am **Continuing Claims** **Mar. 25** Mar. 18 1,689k (+4k) 10:00 am **Global Supply Chain Pressure Index** **Mar.** Feb. -0.26 Fed Speaker: St. Louis' Bullard (10:00 am) 11:00 am 13- & 26-week bill, 3-, 10[R]-year note, 30[R]-year bond auction announcements 11:30 am 4- & 8-week bill auctions	**Good Friday (stock markets closed; limited bond market activity)** 8:30 am **Nonfarm Payrolls** **Mar. (e) +240,000** *Consensus +240,000* Feb. +311,000 8:30 am **Unemployment Rate** **Mar. (e) 3.6%** *Consensus 3.6%* Feb. 3.6% 8:30 am **Average Hourly Earnings** **Mar. (e) +0.3% +4.3% y/y** *Consensus +0.3% +4.3% y/y* Feb. +0.2% +4.6% y/y 3:00 pm **Consumer Credit** **Feb. (e) +$18.0 bln**[C] Jan. +$14.8 bln

[C] = consensus [D] = date approximate [R] = reopening

Upcoming Policy Meetings | Bank of Canada: Apr. 12, June 7, July 12 | FOMC: May 2-3, June 13-14, July 25-26

General Disclosures

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