Market Perspectives

PRIVATE CLIENT SOLUTIONS

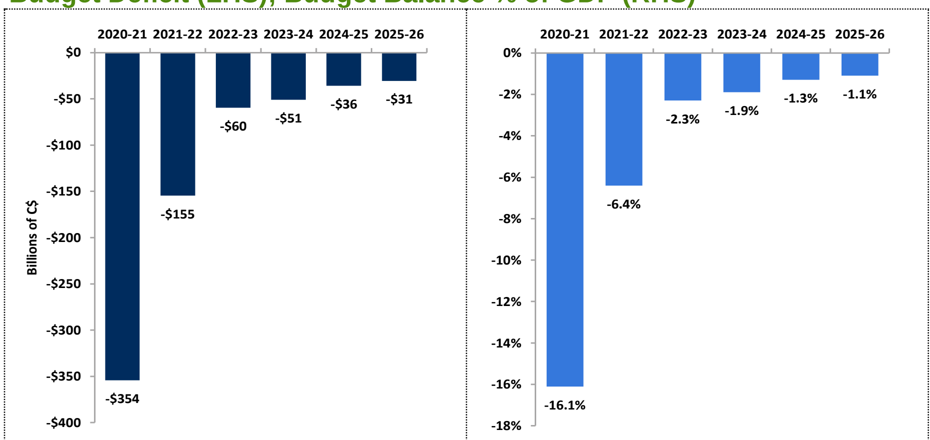
Nadeem Kassam, MBA, CFA and Ajay Virk, CFA, CMT **April 22, 2021**

Adding Fuel to the Fire: Budget 2021

The federal government announced their first budget in more than two years, with plans for additional spending of $101.4 billion over the next three years. After combing through the entire 700+ page budget, it was clear that the focus of this budget is on the government's plan to finish the fight against COVID-19, ensure a robust economic recovery, and to invest in jobs and growth for all Canadians. We believe these additional spending commitments, estimated at ~4-5% of GDP (versus the recently passed US$1.9 trillion coronavirus relief bill in the US at +10% of GDP), will remain supportive of the economic recovery for the next several years. We would note, however, that expectations for real GDP growth heading into the budget announcement were already very strong at +5.2% and +3.9% for 2021 and 2022, respectively, and have since inched even higher to +5.8% and +4.0%, respectively, post the Budget 2021 announcement. While we could easily argue the case for less spending at a time when economic growth is rebounding so sharply, continued suffering among the most vulnerable in the population, uncertainties on the path of the pandemic, elevated unemployment levels, and borrowing costs near record lows lean in favor of higher spending and large deficits.

We note that despite the large price tag of the additional spending measures announced in the budget, the figure was mostly in-line with Street expectations and within the guidance range provided by Finance Minister Chrystia Freeland in the fall economic statement (range of $70 billion – $100 billion). In addition, while the planned spending means the government will run another huge deficit this fiscal year (~$155 billion, compared to $354 billion in 2020/21), the projections beyond this fiscal year are reasonable and remain well below what had been estimated last fall. Moreover, the government is now expecting the deficit to narrow to $60 billion in 2022/23 (just 2.3% of GDP), and falling to ~$36 billion in 2024/25 (just 1.3% of GDP). We believe these forecasts are based on very reasonable assumption for economic growth, inflation, employment, etc.

Budget Deficit (LHS); Budget Balance % of GDP (RHS)



Source: Department of Finance

Investment Strategy Team

Nadeem Kassam, MBA, CFA

Larbi Moumni, CFA

Peter Tewolde

Mutual Funds & ETFs

Spencer Barnes, MSc, CIM®

Structured Notes & Alternatives

Chris Cafley, MBA

Emma Querengesser

Fixed Income & Foreign Exchange

Harvey Libby

Rick Michaels, CFA

Ajay Virk, CFA, CMT

Charlotte Jakubowicz, CMT, CIM®

Preferred Shares

Chris Antony, CFA

Raymond James Ltd. 5300-40 King St W. | Toronto ON Canada M5H 3Y2. 2200-925 West Georgia Street | Vancouver BC Canada V6C 3L2.

RAYMOND JAMES®

Below we provide a high-level overview on some of the larger spending initiatives that the government outlined in Budget 2021 for the next several years.

Big-Ticket Measures Announced in Budget 2021:

- **Emergency Support Programs (~$32 billion over 5yrs):** the federal government has extended essential support programs introduced during the pandemic including: **1)** the Canada Emergency Wage Subsidy (~$10 billion); **2)** the Canada Emergency Rent Subsidy and Lockdown Support (~$2 billion); **3)** additional weeks of recovery benefits and employment insurance regular benefits (~$12.1 billion); **4)** additional weeks of the Canada Recovery benefit and the Canada Recovery Caregiving benefits (~$2.5 billion); and **5)** maintaining flexible access to employment insurance benefits (~$6.9 billion).
- **Establishing a Canada-Wide Early Learning and Child Care System (~$30 billion over 5yrs):** this includes new investments for early learning and child care and indigenous early learning and child care, with the goal of bringing fees for regulated childcare down to $10 per day on average within the next five years.
- **Investing in Climate and Green Initiatives (~$17.6 billion over 5yrs):** Budget 2021 includes investments for a green recovery to create jobs, building a clean economy, and fighting and protecting against climate change.
- **Investments in Core Infrastructure, Affordable Housing, and the Tourism Sector (~$12 billion over 5yrs):** Budget 2021 directs $8.6 billion towards the government's plan to revitalize Canada's core infrastructure (e.g., rail, roads, bridges, community centers, and water and wastewater plants), which is in addition to the $3 billon being directed towards creating more affordable housing/end homelessness, and $1 billion to help revitalize the tourism sector.
- **Targeted Investments to Support Canada's Businesses (~$12 billion over 5yrs):** This includes: **1)** investments of $4.1 billion to helping small-medium enterprises recover from the pandemic; **2)** $2.2 billion to support business investments; **3)** $4.5 billion to support innovation and industrial transformation; and, **4)** $1 billon to support the digital economy by accelerating broadband access for everyone.
- **Increasing Old Age Security (OAS) for Canadians 75+ (~$12 billion over 5yrs):** This includes investments in programs and services that better respond to the unique needs of vulnerable people and improve quality of life for all Canadians. This includes one-time payment of $500 in August 2021 to OAS pensioners who will be 75+ as of June 2022 and a 10% increase to the regular OAS payments for pensioners 75 on an ongoing basis as of July 2022.
- **Strengthening the Health Care System (~$9.6 billion over 5yrs):** The federal government is making investments to shore up the public health system, which includes: **1)** $1 billion committed to speed up the roll-out of vaccines; and, **2)** $2.5 billion to strengthen long-term care and supportive care. This spending is in addition to the $4 billion already committed by the federal government last month.
- **Strengthening Indigenous Communities (~$6 billion over 5yrs):** This consists of investments to help improve the quality of life and create new opportunities for people living in Indigenous communities. This includes $6 billion directed toward building infrastructure and economic growth infrastructure investments.

Other Noteworthy Initiatives in Budget 2021:

- Supporting national capacity in bio-manufacturing and vaccine development and production with a commitment of $2.2 billion.
- Introduction of a $15 per hour minimum wage.
- Job creation programs geared at young Canadians, with a focus on skilled trade and high-tech industries as well as skill-development programs.
- Interest-free loans for green home renovations.

Paying Down the Deficit:

While there were no changes to corporate/personal taxes and/or the capital gains inclusion rate in Budget 2021, there were several other new taxes introduced. In aggregate, we expect these taxes will raise less than $5 billion over the next three years and thus we expect to see additional details on funding the deficit in future budgets, especially as it relates to higher personal and corporate taxes.

- **Digital Services Tax:** a 3% tax on revenue from digital services that rely on data and content contributions from Canadian users starting on January 1, 2022.
- **Luxury Tax:** a tax on the sales of luxury cars and personal aircraft (for personal use) with a retail sales price over $100,000, and boats for personal use priced above $250,000.
- **Tax on Unproductive Use of Canadian Housing by Foreign Non-resident Owners:** a national, annual 1% tax on the value of non-resident, non-Canadian owned residential real estate that is considered vacant or underused, effective January 1, 2022.

Final Thoughts for Investors:

Overall, Budget 2021 came in as expected with additional spending at the top-end of the guidance range, which we believe is largely the result of the current third wave of the pandemic. There were few surprises in the budget and very little mention on how the government was planning to fund the deficit, including no changes to capital gains inclusion rate, the top personal tax rate, and the corporate tax rate. For equity investors, we continue to maintain a bullish view on the outlook for Canadian economy and for Canadian equities, which we believe continue to be supported by very accommodative monetary and fiscal policy measures. In addition, over the last year, Canadian households have built up significant savings which total ~8% of 2019 nominal GDP (vs. the US and UK at 6-7%). We believe once the pandemic recedes, the unwinding of pent-up demand could translate into a tangible, if only temporary, boost to economic activity. Additional benefits are possible from the large-scale fiscal support and investment in the U.S., which could have substantial spillover into the Canadian economy. For fixed income investors, there were some noteworthy changes to the government's planned bond issuances by maturity. 2021-22 will see a decrease in the share of bond issuance for short-dated issues (2-, 3- and 5-year) from 71% last year to 56%, while long-dated issues (10-year+) will increase from 29% to 42%. In addition, "green" bonds will now enjoy a 2% share of total bond issues this time around (0% last year). As a result, increasing longer-term issuances should translate into higher yields and a steepening yield curve, all else equal, which coupled with the expectation of rising inflation and a robust economic outlook, should continue to remain a headwind for long duration bonds. For investors we suggest reducing portfolio duration and allocating more to corporate issues and higher yielding debt which offer higher real yields.

Important Investor Disclosures

Complete disclosures for companies covered by Raymond James can be viewed at:
https://raymondjames.bluematrix.com/sellside/Disclosures.action

This newsletter is prepared by the Private Client Services team (PCS) of Raymond James Ltd. (RJL) for distribution to RJL's retail clients. It is not a product of the Research Department of RJL.

All opinions and recommendations reflect the judgement of the author at this date and are subject to change. The author's recommendations may be based on technical analysis and may or may not take into account information contained in fundamental research reports published by RJL or its affiliates. Information is from sources believed to be reliable but accuracy cannot be guaranteed. It is for informational purposes only. It is not meant to provide legal or tax advice; as each situation is different, individuals should seek advice based on their circumstances. Nor is it an offer to sell or the solicitation of an offer to buy any securities. It is intended for distribution only in those jurisdictions where RJL is registered. RJL, its officers, directors, agents, employees and families may from time to time hold long or short positions in the securities mentioned herein and may engage in transactions contrary to the conclusions in this newsletter. RJL may perform investment banking or other services for, or solicit investment banking business from, any company mentioned in this newsletter. Securities offered through Raymond James Ltd., Member-Canadian Investor Protection Fund. Financial planning and insurance offered through Raymond James Financial Planning Ltd., not a Member-Canadian Investor Protection Fund.

Commissions, trailing commissions, management fees and expenses all may be associated with mutual funds. Please read the prospectus before investing. Mutual funds are not guaranteed, their values change frequently and past performance may not be repeated. The results presented should not and cannot be viewed as an indicator of future performance. Individual results will vary and transaction costs relating to investing in these stocks will affect overall performance.

Information regarding High, Medium, and Low risk securities is available from your Financial Advisor.