Ottawa Forecasts a $343 Billion Deficit: How Should You React to This?

Description

The federal government has released its fiscal snapshot, and it isn't pretty.

In a 168-page document, the feds revealed that they're projecting a $343 deficit for 2020, taking federal debt to $1.2 trillion. Described as the "biggest spending increase since World War II," federal spending on COVID-19 emergency measures greatly exceeded tax revenue in the first half of 2020.

Of course, strong financial measures were necessary to contain the fallout from COVID-19. Without them, millions more Canadians would have been laid off and unable to make rent.

But it's undeniable that they came at a heavy cost. A $343 billion budget deficit works out to $9,026 per Canadian — including seniors, children, and the long-term unemployed. That increase will be financed by debt, taking the federal government's total debt load to $1.2 *trillion.*

Those are scary numbers. But what do they actually mean for the average Canadian?

What these figures mean

When government debt increases without a corresponding increase in tax revenue, that means a greater percentage of future tax revenue goes to paying interest. Therefore, to maintain the same level of services, you'd need either GDP growth or an increase in tax rates.

In normal circumstances, GDP growth tends to increase tax revenue. The reason is that with rising GDP comes higher incomes and corporate profits. But we aren't in normal circumstances. The COVID-19 emergency measures were introduced simply to keep the economy afloat; they weren't intended to stimulate massive growth.

The federal government is projecting a 6.8% decline in GDP this year followed by a 5.5% increase next year. That's not exactly a massive boom. So, the average Canadian would be wise to plan for tax increases in the year ahead.

Investing implications

The basic investing implications of the federal government's fiscal snapshot are pretty obvious. First, slow GDP growth could put a damper on corporate earnings. Second, an increase in corporate taxes could decrease after-tax earnings. Third and finally, companies that may need bailouts — like **Bombardier** and **Air Canada** — could have a hard time getting them.

Beyond these basic conclusions, there isn't that much more that can be said about investments per se. Broadly, current fiscal and economic trends look bad for most Canadian companies.

However, there is one actionable piece of advice that you can implement that should save you money.

That is, to the extent that you *are* investing, you should hold as much of your positions in a Tax-Free Savings Account (TFSA) as possible. TFSAs are tax-free accounts that keep your returns safe from taxation. You can deposit up to $69,500 in one, allowing you to not only grow but also withdraw your money tax-free.

If taxes rise to pay for the COVID-19 deficit, then investing in a TFSA will be a wise move. By doing so, you'll shelter a part of your income — investment income — from the higher taxes rates. This can be illustrated by looking at the tax consequences of holding a stock like **Fortis** (TSX:FTS)(NYSE:FTS) in a TFSA.

Fortis is a dividend stock that provides two sources of income: cash payouts and capital gains. The dividends from a stock like Fortis are grossed up 38% and taxed at your marginal rate minus a 15% credit. Capital gains are taxed at your marginal rate, but with 50% of the gain exempt. An increase in federal income taxes would increase the taxes you'd pay on any gains from FTS stock. Unless, that is, you hold the stock in a TFSA. In that situation, you'd pay no taxes — not even if you chose to withdraw the money. Talk about a win!

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