Observation

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HIGHLIGHTS

- Voters elected a Conservative majority government in yesterday's election. The NDP are now the official Opposition.
- In the coming days, March budget is likely to be passed with only minor tweaks.
- This outcome was partly anticipated in market movements leading up to the election. The surprise majority win led to a small boost to Canadian dollar trading overnight towards $US1.06.
- Conservatives have committed to eliminate the deficit by FY 14-15, one year earlier than last scheduled. This will be accomplished through securing additional cost savings.
- Unless legislation is tabled to the contrary, previously announced corporate income tax cuts will proceed on schedule.
- While the stability embedded in the election results are market supportive, few are likely to pop champagne corks in today's trading.

Derek Burleton
Vice President and Deputy Chief Economist
416-982-2514
derek.burleton@td.com

Sonya Gulati
Economist, Regional and Government Finances - Canada
416-982-8063
sonya.gulati@td.com

David Tulk
Chief Canada Macro Strategist
416-983-0445
david.tulk@tdsecurities.com

CONSERVATIVE MAJORITY TO PROVIDE MODERATE BOOST TO MARKETS

Yesterday's election result – a surprising Conservative majority and the drubbing of the sovereigntist Bloc Québécois – will likely be perceived as market friendly. This is because investors generally dislike uncertainty, and the outcome promises a stay-the-course policy path, including lower corporate income tax rates and political stability for another four years. Notably, the budget tabled in March – which was victim to the election call – is likely to be passed in the coming weeks with only some modest tweaks.

A brief summary of the results

As shown in the chart to the right, the Conservatives (+24 seats) and the NDP (+65 seats) gained seats this election relative to last. The NDP are now the official Opposition. The better showing came at the expense of the Liberals (-43 seats) and the Bloc (-45 seats). The result of the election confirmed the trend revealed in recent tracking polls. This outcome was partly anticipated by the subdued performance of the Canadian dollar since the support for the NDP surpassed the Liberals on April 28th. What the currency did not anticipate, however, was the ability of the Conservatives to win a majority. This surprise is reflected in a modest move higher in overnight markets – towards $US1.06.

CANADA FEDERAL ELECTION RESULTS

	Voter Share	Seats
2008 ELECTION RESULTS		
Conservatives	37.63	143
Liberal	26.24	77
Bloc Québécois	9.97	49
New Democratic Party	18.2	37
Other	7.96	2
2011 ELECTION RESULTS		
Conservatives	39.62	167
New Democratic Party	30.62	102
Liberal	18.91	34
Bloc Québécois	6.05	4
Other	4.34	1

Note: 2011 election results are accurate at the time of publication. Numbers may not add due to rounding.
Source: Elections Canada.

Implications of a strengthened Conservative government

From the perspective of the market and investors, a Conservative-led government represented the most benign scenario. This is because they simply represent the status-quo. But, their new majority status provides enhanced stability to the political climate – Canadians have not had a majority government in power for the past seven years. An incumbent government, with only modest new platform measures, also means that the current fiscal plan will remain largely intact. While platform estimates should be viewed as preliminary, the Conservatives' document includes a commitment to return to surplus of $2.8 billion (or 0.1% of GDP) in FY 14-15. This would be one year earlier than previously scheduled. In addition to the shorter timetable, the five-year cumulative deficit total is poised to be $4.4 billion less than what was presented in the March budget.

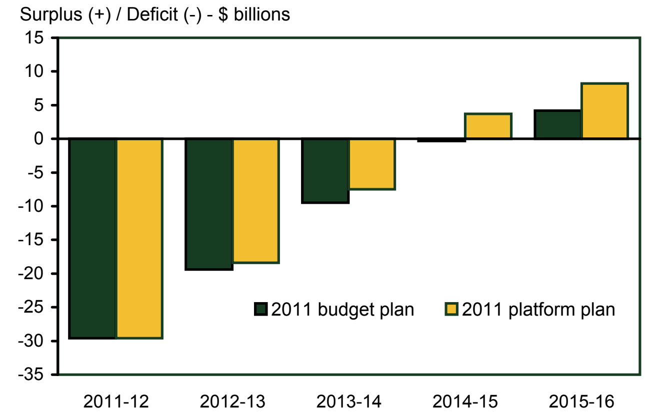
The commitment to prudent fiscal management will be favourably received by markets and investors. Furthermore, bringing forward the timetable by one year would heed the recommendation made recently by the International Monetary Fund (IMF) to prioritize fiscal consolidation efforts. A shorter deficit reduction timetable would also help the government avoid heightened risk premiums at a time when worldwide financing needs are expected to be significant. While medium-to-long term government bond yields are expected to creep up over the next few years due to upcoming interest rate hikes, the relatively strong fiscal footing of Canada should keep the increases in check. Yesterday's election results do not give us reason to change our call for interest rates to begin their gradual increase starting in July of this year.

The government plans to return to surplus by restraining program spending growth and reducing administrative inefficiencies. The platform details that $11 billion in savings over four years have been earmarked, with specifics still outstanding. These savings will be partially offset by $6.6 billion in modest platform spending commitments over the next five years. Big ticket items such as a new Family Tax cut and changes to Tax Free Saving Account rules would come into effect only after a surplus is realized in FY 14-15.

Unless legislation is tabled to the contrary, the previously announced corporate income tax rate cuts will proceed on schedule. To recall, the rate is set to fall to 15% on January 1, 2012. This move will give Canada the lowest corporate tax rate in the G7 and in turn, should help position the country as tax competitive with an attractive investment environment. The economic impacts of this policy move should be felt more over the longer-term horizon. What's more, businesses, markets and investors have already priced in this policy and a reversal no longer appears in the cards.

In addition to the benefits to the private sector of lower taxes, investors are likely to perceive other Conservative policies as being market positive. For instance, the NDP and the Liberal platform included more stringent environmental regulations and climate control policies, which raised some concerns in financial markets about increased medium-term costs facing the oil and gas sector. In particular, the NDP platform included a plan to raise $4-$7 billion through a cap and trade program, which would have helped raise funds to cover other campaign pledges.

CONSERVATIVE PLAFORM FISCAL PLAN SHAVES $4.4 BILLION OFF THE FIVE-YEAR PLAN



Source: 2011 Federal Budget (not approved) and 2011 Conservative election platform.

That being said, the scope for a relief rally appears relatively limited as Canadian equity and currency markets were resilient in the days leading up to the election. This is because from a higher-level perspective, all of the federal parties shared similar policies in a number of key areas. In particular, all major party platforms included similar deficit elimination plans. As well, Canada's challenges pale in comparison to those in other advanced economies. So while the stability embedded in the election results are market supportive, few are likely to pop champagne corks in today's trading.

FEDERAL PARTIES STANCE ON MAJOR ISSUES

	Conservatives	Liberals	NDP	Bloc
Fiscal Plan	• Eliminate deficits by 2014-15 through restrained program spending growth	• Reduce deficit to 1% of GDP within 2 yrs, with return to balanced budget by 2015	• Balance federal budget within next 4 years	• Balance budget by 2015-16 by controlling spending
Corporate Income Taxes	• Proceed with planned reduction to CIT • Extend 50% straight-line CCA rate for M&P equipment acquired before 2014	• Cancel CIT cuts, restore 2010 rate of 18% • No increase to small business rate • Cancel accelerated CCA on oil sands investment	• ↑ Corporate income taxes to 19.5% • ↓ Small business tax rate to 9% from 11% • Extend 50% straight-line CCA rate for M&P equipment acquired before 2016	• Make scientific research & experimental development credits refundable and payable quarterly
Personal & Other Tax Changes		• Voluntary low-cost option within CPP for small business • Cap stock option deduction at $50K per year • Innovation & Productivity tax credit of 15% for investment in stage start-ups	• ↑ Increase CPP/QPP benefits	• Establish a 2% surtax on incomes $150-250K, 3% over $250K • Employee stock option plans or other non-monetary benefits will no longer be tax deductible
Tax Harmonization	• Complete a harmonization agreement with Québec no later than Sept.15, 2011		• $2.2B to Québec for harmonizing its sales tax with federal GST	• Negotiate an agreement to indemnify Québec for harmonization of its sales tax
Environment	• GHG emissions 17% below 2005 levels by 2020, consistent with U.S.	• All 3 parties state a target of GHG emissions 80% below 1990 levels by 2050		
	• Achieve GHG emission targets through a regulatory approach	• Establish carbon cap-and-trade system and keep auction revenues in province they were generated • Invest $1B in Renewable Power Production Initiative	• Establish a cap-and-trade system and direct revenue to investments in green technology	• Establish at carbon exchange in Montreal
Social Programs	• Planned spending of $5.6B over next 2 yrs, “low-tax plan for jobs and growth” through investment in training, new trade relationships and low taxes	• Planned spending of $8.2B over next 2 yrs, to promote equal opportunity with investments in making post-secondary education more affordable and enhancing family home-care	• Planned spending of $21.7B on social programs over next 2 yrs • Implement national minimum wage • Enhance consumer protection through cap interest rates on credit cards, and alleviate “gouging” by wireless providers	
Infrastructure Spending	• Continue the $33B Building Canada Plan beyond 2014 with a longer-term infrastructure spending plan	• End the Public-Private Partnership Fund and invest the remainder in affordable housing	• Invest 1 cent of gas tax for urban infrastructure • Continue the Building Canada Plan unit completion in 2014	