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ECONOMIC IMPACT OF CANADA'S FEDERAL ELECTION

Author:

Alex Bellefleur, M.Ec., CFA
Chief Economist & Strategist
Mackenzie Multi-Asset Strategies Team

With a Canadian federal election producing a minority government, several investors have asked us to comment on the possible implications for the Canadian economy and markets.

Our view on this issue is that Canadian political developments, from a macro perspective, represent largely noise that should be broadly ignored by investors. From a historical perspective, the implications of federal elections on Canadian markets (the Canadian dollar, bonds and the local equity market) have generally been close to nil. We think this time will be no different. Here is why.

- Canada is a relatively small open economy. As such, it is much more driven by swings in the global economy and macro trends among its largest trading partners (think the United States) than it is by its own political developments.
- The Canadian dollar, as the currency of a relatively small open economy, is therefore much more driven by factors such as the terms of trade (think commodity prices) and by global growth, than it is by domestic federal fiscal policy.
- While the Prime Minister's Office holds significant executive power when compared to other systems with more checks and balances (again, think the United States), the very nature of the federal system limits the power of the federal government and relies on significant inter-provincial consensus to implement policies. For this reason, sweeping economic changes generally do not tend to arise out of federal elections, and what happens at the provincial level is often just as important, if not more.
- On the issue of the federal government's ability to implement economic policies unilaterally, one contentious issue which might affect markets is the construction of pipelines going through many provinces. We say "might" affect markets, because a narrowing of the Western Canadian Select / West Texas Intermediate crude oil spread would improve Canada's terms of trade, while a better ability to export crude oil may improve Canada's balance of payments, potentially helping the currency. However, there is absolutely no certainty of that, and even if the federal government had the power to impose the construction of pipelines (which isn't clear at all), the impact on the Canadian dollar likely would prove limited.
- The size of the federal deficit has been an issue during the election campaign, with various parties promising various paths to balance. However, from an economic standpoint, we would argue that at about 1% of GDP, the federal deficit is not a significant issue for markets. To put things in perspective, this compares to a federal deficit of about 4.5% of GDP in the United States. With Canadian bond yields near all-time lows, there is hardly a fiscal crisis and it is very unlikely that markets would worry about Canada's budget deficit regardless of which political party is in power.

So, overall, we believe the results of the federal election are unlikely to influence our investment decisions when it comes to Canada. At the moment, we hold a slight overweight in the Canadian dollar in the active currency management component of our Symmetry portfolios.

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