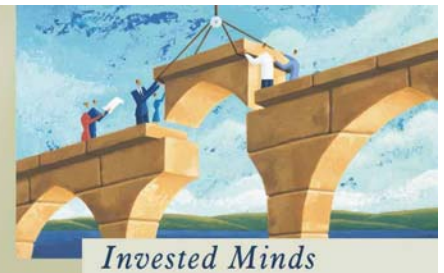




Global Asset Management Inc.

Market Insight



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The Federal Budget: Prudence and Caution

While the Federal budget was delivered by Finance Minister Ralph Goodale yesterday, it really reflected the vision and direction of the new Paul Martin government. It was constructed to reinforce Martin's reputation as a good money manager, and with the emphasis on debt repayment, prudent fiscal management and fighting the deficit, it did. New tax cuts were glaringly absent.

The budget predicts that the economy will grow by 2.7% in 2004 and by 3.3 % in 2005. This is slightly higher than the TAL Global Asset Allocation team's forecast of 2.5% GDP growth in 2004, but in line with private sector forecasts.

The growth prediction is stronger than the 1.7% recorded last year when the economy was rocked by crises including SARS, mad cow disease, forest fires in British Columbia and a massive power blackout in central Canada. Despite the economic troubles last year, Goodale was able to scrape together \$1.9 billion for debt repayment in fiscal 2003-04, which ends March 31, to reduce the debt to \$508.7 billion. He forecast a contingency fund and economic prudence reserve of \$4.0 billion in each of the next two fiscal years, which could be used to repay debt.

The budget promises to reduce the debt-to-GDP ratio, the size of debt relative to the size of the economy. From a peak of 68% in 1995-96, it fell to 42% in 2003-04 and the government is aiming for a goal of 25% within 10 years.

"This drastic debt reduction goal is quite extraordinary," John Braive, Vice-chair of TAL Global Asset Management says. "The fiscal rectitude shows the market that for the foreseeable future, Canada will be in a much better fiscal situation than the United States. The declining debt-to-GDP ratio and the surpluses are positive for Canadian interest rates and we continue to see the narrowing trend that we have been forecasting in interest rate spreads."

This budget anticipates program spending in fiscal 2004-05 of \$147.9 billion, a 3.1% increase from the previous year. Also, revenues in the 2004-05 fiscal year are boosted by \$2.2 billion from the sale of the government's stake in Petro-Canada.

That will be just enough to ensure that Goodale has the cash to restore the \$3 billion contingency fund Martin initiated when he was finance minister. Anything left over at year-end will go to debt repayment. A further \$1 billion economic prudence reserve could also be used for extra spending or debt repayment.

As expected, income trusts received limited attention in the budget. Pension funds, but not RRSPs or RRIFs, will be restricted to holding no more than 1% of the book value of their assets in business income trusts or 5% of any single business income trust. Excess holdings will be subject to a 1% per-month penalty tax based on the fair market value of the excess units held, just like a foreign property violation in a registered investment vehicle. This restriction does not include resource royalty trusts or REITs. A ten-year transitional relief for existing investments by pension funds in income trusts was proposed.

Budget Highlights

- ✓ Seventh consecutive balanced budget
- ✓ Projected surplus of \$1.9-billion for 2003-04, which must go to pay down the \$510-billion debt
- ✓ Government to identify \$3 billion in annual savings within four years
- ✓ Debt-to-GDP ratio to be reduced to 25% within 10 years
- ✓ Reinstatement of \$1-billion prudence reserve, on top a \$3-billion rainy day fund, to ensure the country's books stay balanced.
- ✓ Pension funds restricted to holding no more than 1% of the book value of their assets in business income trusts or 5% of any single business income trust.