Statement by Jean-Denis Fréchette
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to the House of Commons Standing Committee on Finance
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Good afternoon Mr. Chair, Vice-chairs, and members of the Committee.

My colleagues and I are pleased to be here to present the PBO's Economic and Fiscal Outlook, which we released yesterday.

Economic Outlook

Global economic activity picked up in the second half of 2013, and is expected to continue to improve in 2014 and 2015, as more modest fiscal tightening is complemented by still highly accommodative monetary policy in advanced economies. That said, downside risks remain, with risks related to low inflation in advanced economies coming to the fore more recently.

In the United States, growth in the second half of 2013 was much stronger than expected in October 2013. Despite this stronger-than-expected growth, PBO has left its outlook for U.S. growth in 2014 unchanged at 2.7 per cent, in large part due to weathe- related weakness in the first quarter of the year. Growth over the remainder of the projection is broadly unchanged from the October 2013 EFOU.

Based on the Bank of Canada's Commodity Price Index (BCPI), the PBO outlook for commodity prices is modestly stronger than the October 2013 EFOU projection. That said, PBO's outlook for the BCPI remains higher over the projection than futures prices would suggest but below the no-change projection assumed by the Bank of Canada in its April 2014 Monetary Policy Report.

These developments have led PBO to revise up the outlook for the Canadian economy relative to its October 2013 EFOU. Currently, PBO projects Canadian real GDP to grow by 2.1 per cent this year, 2.7 per cent next year and 2.5 per cent in 2016. As the economy reaches its potential level of economic activity, PBO projects real GDP growth to be below 2 per cent annually in 2017 and 2018.

PBO's outlook incorporates both stimulative and restraint measures introduced beginning in Budget 2012. PBO projects that the level of real GDP will be 0.5 per cent lower in 2016 than would have been the case in the absence of these measures. Further, this economic impact translates into about 46,000 fewer jobs being created by 2016.

PBO's outlook for nominal GDP – the broadest measure of the Government's tax base – is, on average, $17 billion lower than the projection based on average private sector forecasts. PBO judges that the balance of risks to the private sector outlook for nominal GDP is tilted to the downside, likely reflecting larger impacts from government spending reductions, as well as differences in views on commodity prices and their impacts on real GDP growth and GDP inflation. However, based on its projection of nominal GDP, PBO judges that the downside risk to the private sector outlook for nominal GDP is broadly in line with the Government's $20 billion annual adjustment for risk.

Fiscal Outlook

Prospects for budgetary surpluses are higher over the outlook than in PBO's October 2013 EFOU, due to a combination of an improved economic outlook and measures in the Update of Economic and Fiscal Projections 2014 and Budget 2014, in particular further planned restraint in Direct Program Expenses (DPE).

PBO estimates that the deficit will be $11.6 billion (0.6 per cent of GDP) in 2013-14 and will return to a surplus in 2015-16 ($7.8 billion or 0.4 per cent of GDP), maintaining a surplus of $8.6 billion (0.4 per cent of GDP), on average, over the remainder of the outlook. PBO estimates that the likelihood of realizing a budgetary balance or better is approximately 50 per cent in 2014-15, 70 per cent in 2015-16, 60 per cent in 2017-18 and 65 per cent in 2018-19.

While PBO projects budget surpluses over the medium term, these are primarily attributable to the economy growing faster than trend, rather than revenues being structurally higher than expenses. Therefore, there is limited room to implement new policies which reduce tax revenues or increase spending without re-introducing structural deficits.

That said, PBO has identified several risks to the fiscal outlook.

First, the PBO projection of the BCPI assumes that, after two years, real commodity prices will remain broadly unchanged. In contrast, the projection using energy and non-energy futures prices suggests that the BCPI will decline over the projection. Were this to be realized, the level of nominal GDP would be $26 billion below PBO's baseline projection in 2018.

Second, the discretion granted to the Governor-in-Council for setting Employment Insurance rates introduces considerable uncertainty in the outlook for revenues. Were the Government to set rates to balance revenues with forecast expenditures, it could decrease the revenue outlook and the budget surplus by $2.2 billion in 2015-16 and $2.8 billion in 2016-17.

Third, PBO currently takes Finance Canada's projection for DPE as given, as the Government has refused to release the data required to assess if the current restraint is sustainable and to allow PBO to do its own projection of DPE. Such a prolonged period of suppressed DPE growth has never occurred in the history of the modern Public Accounts. Historically, a year of reductions is typically followed by a year of increases in DPE of around 6.4 per cent. As a result, DPE may face significant pressures following the 2014-15 cuts, as the most significant year-over-year reduction in DPE is set for 2014-15. Were the typical rebound from a period of DPE reductions to occur in 2014-15 or 2015-16 it would eliminate the projected surplus in 2015-16.

I and my colleagues will be happy to respond to questions you may have regarding our Economic and Fiscal Outlook or any other relevant matter.