



**Opening Statement of Kevin Page, Parliamentary Budget Officer,
to the House of Commons Standing Committee on Finance
October 30, 2012**

Good afternoon Mr. Chair, Vice-chairs, and members of the Committee.

Thank you for inviting me and my colleagues to speak to you today about Canada's economic and fiscal outlook. Yesterday, as you know, PBO released two reports:

- the first, examining the short- and medium-term outlook; and
- the second, analyzing the performance of the Canadian labour market.

In addition, just over a month ago, the PBO released its 2012 Fiscal Sustainability Report, which examines Canada's fiscal structure from a longer-term perspective.

My remarks will focus on three topics that go to the core of the PBO's mandate:

1. the nation's economic and fiscal outlook over the medium term;
2. the government's fiscal sustainability in the long term; and
3. Canada's labour market performance.

Economic and Fiscal Outlook

The global economic outlook has deteriorated since PBO's April 2012 Economic and Fiscal Outlook (Slide 1). The recent International Monetary Fund (IMF) *World Economic Outlook* indicates that uncertainty surrounding policymakers' ability to control the euro crisis and to avoid the "fiscal cliff" (i.e., automatic tax increases and spending reductions) in the U.S. are weighing on growth in advanced as well as in emerging market and developing economies.

The expected weakness in the global economy and commodity prices combined with government spending reductions and restraint are expected to weaken economic growth and job creation going forward. As a result, PBO projects Canadian real GDP to grow by 1.9 per cent this year, 1.5 per cent next year and 2.0 per cent in 2014. The weakness in near-term growth pushes the economy further below its potential (Slide 7) resulting in an increase in the unemployment rate in the short term.

Since the release of PBO's April Economic and Fiscal Outlook (EFO), private sector forecasters have revised down their outlook for real GDP growth in 2012 and 2013, bringing it more into line with PBO's April EFO outlook (Slide 9). Compared to the average of private sector forecasts published in September, PBO is projecting slower real GDP growth and lower GDP inflation in 2013 and 2014. As a result, PBO's outlook for nominal GDP – the broadest measure of the Government's tax base – is lower, by \$22 billion annually, on average, 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 and a more sluggish U.S. recovery, as well as differences in views on commodity prices and their impacts on real GDP growth and GDP inflation.

On the basis of this economic projection, PBO's fiscal projection shows significant improvement in the Government's budgetary balance from a deficit of \$18.1 billion (1.0 per cent of GDP) in 2012-13 to a surplus of \$13.8 billion (0.6 per cent of GDP) in 2017-18 (Slide 14). The improvement is partly due to a cyclical rebound in revenues but can be mainly attributed to policy actions to restrain operating expenses. Based on the outlook presented in Budget 2012, the Government's direct program expenses are assumed to remain essentially frozen for 6 years, growing at 0.2 per cent annually, on average, which is well below the average of 6.3 per cent observed over the last 10 years (Slide 13).

Given PBO's assessment of the balance of risks to the private sector economic outlook, PBO estimates that the likelihood of realizing budgetary balance or better is approximately 60 per cent, 70 per cent and 75 per cent in 2015-16, 2016-17 and 2017-18, respectively (Slide 15).

Fiscal Sustainability

Although PBO projects the Government's structural balance to improve from a deficit to a surplus position over the medium term, assessing whether a government's fiscal structure is sustainable requires looking over a longer horizon to take into account the economic and fiscal implications of Canada's ageing population.

In its 2012 Fiscal Sustainability Report (FSR), the PBO concluded that the Government's fiscal structure was sustainable over the long term given recent policy changes, which include:

- the reduction in growth in the Canada Health Transfer (CHT) beyond 2016-17;
- reductions in direct program expenses; and
- the increase in the age of eligibility for the Old Age Security (OAS) program (Slide 19).

The PBO estimated that the Government would have sufficient fiscal room—amounting to 1.4 per cent of GDP—to reduce taxes, increase spending on programs or some combination of both while still maintaining fiscal sustainability.

The PBO is pleased to note that last week, Finance Canada published a report on Canada's ageing population and long-term fiscal sustainability. Finance Canada's report confirms the PBO's analyses of the federal fiscal structure presented in its:

1. September 2011 FSR;
2. January 2012 assessment of the CHT renewal; and
3. September 2012 FSR.

That is, prior to the Government's December 2011 change to the CHT the federal fiscal structure was not sustainable, as federal debt relative to GDP was projected to rise unchecked over the long term. PBO noted in its January 2012 assessment that as a result of the reduction in the growth rate of the CHT, the federal fiscal structure was rendered sustainable.

Furthermore, PBO's January 2012 assessment did not incorporate the Government's program spending reductions and restraint or the increase in the age of eligibility for the OAS program.

Canada's Labour Market Performance

In its labour market report, the PBO provides a richer perspective on the performance of Canada's labour market by:

- analyzing a broad set of labour market indicators;
- comparing current levels to PBO estimates of their underlying trends;
- exploiting longer time periods, which include previous recessions; and
- comparing Canada's recent performance to a large group of advanced economies.

Most of the key labour market indicators in Canada have improved significantly from their recessionary lows, but they remain below the PBO's estimate of their underlying trend values. PBO analysis also suggests that the labour market in the current cycle has generally fared better relative to past economic cycles in the 1980s and 1990s. Looking abroad, Canada's labour market is currently out-performing the U.S. and some European countries and scores above average among the G7 and OECD countries.

Improving Budget Transparency and Accountability

PBO is pleased to note that Finance Canada is now publishing its estimates of the Government's structural, or cyclically adjusted, budget balance on a Public Accounts basis in its annual *Fiscal Reference Tables*. Consistent with PBO's estimates, Finance Canada's estimates now indicate a relatively small but growing structural deficit over the period 2008-09 to 2011-12 (Slide 20).

Further, to improve budget transparency and accountability, the PBO continues to strongly encourage the Government of Canada to publish:

- historical estimates and medium-term projections (i.e., five years ahead) of the economy's potential GDP (income), accompanied by the methodology and assumptions relied upon to arrive at such estimates;
- medium-term projections of the Government's structural, or cyclically-adjusted, budget balance, accompanied by the methodology and assumptions relied upon to arrive at such projections; and,
- The fiscal sustainability analyses of the provincial-territorial government sector that it has prepared in the past, which the Auditor General noted in his recent report.

Thank you again for inviting us here today. We would be happy to take your questions.