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Economic and Fiscal Assessment *Update*

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The *Federal Accountability Act* mandates the Parliamentary Budget Officer (PBO) to provide independent analysis to the Senate and House of Commons on the state of the nation's finances, government estimates and trends in the national economy. The following report provides an update of the PBO Economic and Fiscal Assessment that was submitted to the Standing Committee on Finance on July 6, 2009.

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* The authors would like to thank Mostafa Askari and Kevin Page for their helpful comments. Any errors or omissions are the responsibility of the authors.

Key Points

Although considerable uncertainty continues to surround the outlook, a general consensus has emerged that a recovery in the global economy is now underway. Indeed, the September 2009 PBO survey of private sector forecasters suggests little change in the Canadian economic outlook from the July Economic and Fiscal Assessment (EFA). The outlook for nominal GDP – the broadest measure of the Government's tax base – is essentially unchanged over the medium term. The updated survey implies that the Canadian economy will not fully recover, that is return to its potential, until the end of 2013. This represents a cumulative loss of over $200 billion in unrealized output, adjusted for inflation.

	2008	**2009**	**2010**	**2011**	**2012**	**2013**	**2014**
			(per cent difference of real GDP from potential)				
Output gap	-0.5	-4.6	-4.3	-3.2	-1.6	-0.3	+0.8

PBO's projection of the Government's budgetary balance is slightly lower compared to the July EFA, with a projected cumulative budgetary deficit of $167.4 billion over the period 2009-10 to 2013-14. The budget deficit is projected to rise from $5.8 billion in 2008-09 to a peak of $54.2 billion in 2009-10, improving to $19.0 billion in 2013-14. Federal debt is projected to rise to $631.2 billion – 33.8 per cent of GDP – in 2013-14, well above the Government's 25 per cent medium-term debt ratio objective. PBO continues to judge that the balance of risks to the medium-term fiscal outlook is tilted to the downside.

	2008-09	**2009-10**	**2010-11**	**2011-12**	**2012-13**	**2013-14**
			($ billions)			
Budgetary balance	-5.8	-54.2	-43.1	-27.9	-23.2	-19.0
Federal debt	463.7	517.9	561.0	588.9	612.2	631.2
Per cent of GDP						
Budgetary balance	-0.4	-3.6	-2.7	-1.7	-1.3	-1.0
Federal debt	29.0	33.9	35.3	35.1	34.5	33.8

PBO has improved its approach to estimating the Government's structural balance. Based on PBO's own estimates of potential output and using the new approach, PBO calculations continue to suggest that the budget is not structurally balanced over the medium term. PBO estimates that the structural balance would deteriorate from essentially a balanced position in 2007-08 to an $18.9 billion structural deficit in 2013-14.

	2008-09	**2009-10**	**2010-11**	**2011-12**	**2012-13**	**2013-14**
			($ billions)			
Structural deficit	3.2	12.5	13.5	13.1	16.8	18.9

That said, the structural deficits projected over the medium term are significantly smaller than those of the 1980s and early 1990s and are also small relative to the size of the economy. However, a more thorough assessment of the sustainability of the current fiscal structure requires a longer-term perspective, in particular taking into account the fiscal challenges posed by population ageing. PBO is undertaking such analysis and will release a comprehensive assessment of the sustainability of the Government's finances in the coming months.

1. Economic Situation and Outlook

Since the release of PBO's July 2009 Economic and Fiscal Assessment (EFA) a general consensus has emerged that a recovery in the global economy is now underway. Although the origins of the current global recession are external, the Canadian economy has been negatively affected by the reduction in foreign demand and sharp fall-off in commodity prices. Thus far the Canadian economy has weathered the global recession better than most economies, posting the second strongest performance among the G7 (Table 1-1). Specifically, although Canadian real GDP has contracted for three consecutive quarters, the cumulative decline in Canadian real GDP since the beginning of the global recession (3.3 per cent) is smaller than the average decline among G7 countries (4.7 per cent).

Table 1-1

Real GDP in G7 Countries, 2008Q1 to 2009Q2

(Per cent change at annual rates)

	08Q1	08Q2	08Q3	08Q4	09Q1	09Q2
Canada	-0.7	0.3	0.4	-3.7	-6.1	-3.4
United States	-0.7	1.5	-2.7	-5.4	-6.4	-0.7
United Kingdom	2.4	-0.3	-2.9	-6.9	-9.6	-2.3
Germany	6.5	-2.2	-1.3	-9.4	-13.4	1.3
France	1.9	-1.7	-1.1	-5.7	-5.4	1.1
Italy	2.1	-2.3	-3.1	-8.1	-10.4	-2.0
Japan	3.5	-2.8	-5.1	-12.8	-12.4	2.3

Sources: Office of the Parliamentary Budget Officer; Haver Analytics.

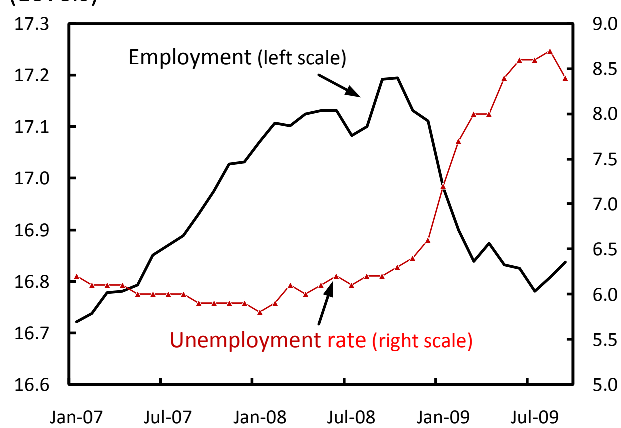
The Canadian economy is expected to return to positive growth in the second half of the year following real GDP declines of 6.1 and 3.4 per cent, at annual rates, in the first and second quarters of 2009 respectively. The return to positive growth can be attributed, in part, to the exceptional policy responses of monetary and fiscal authorities around the globe which have led to a marked turnaround in consumer and business confidence.

As a consequence, the trend decline in overall employment has been halted – the level of employment now stands at its March 2009 level – and the unemployment rate appears to have stabilized following a significant increase at the beginning of the year (Figure 1-1). However, according to the Labour Force Survey (LFS), since March, employment gains in the public sector and in self-employment have offset 129,000 job losses in private sector employment as the trend decline in private sector employment persists.

Figure 1-1

LFS Employment and the Unemployment Rate, 2007 to 2009

(Levels)



Sources: Office of the Parliamentary Budget Officer; Statistics Canada; Haver Analytics

Note: Employment figures are expressed in millions.

Despite the return of positive growth and some improvements in the labour market, considerable uncertainty continues to surround the economic outlook. Both the International Monetary Fund (IMF) and the Organization for Economic Coordination and Development (OECD) expect the recovery to be more muted than previous upturns given the synchronous and financial nature of the shock to the economy.

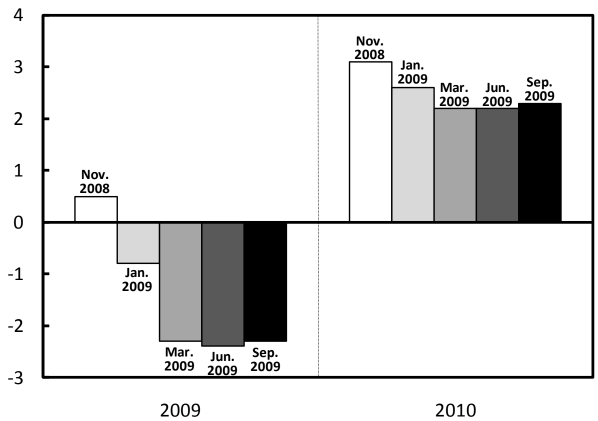
PBO updated its survey of private sector forecasters in September. Table A-1 in Annex A provides the complete results of the September 2009 PBO survey of private sector forecasters.

Following a series of downward revisions, the near-term outlook for real GDP growth appears to have stabilized in recent months (Figure 1-2).

Figure 1-2

Private Sector Outlook for Real GDP Growth

(Per cent)



Source: Office of the Parliamentary Budget Officer

The private sector outlook for annual real GDP growth in 2009 and 2010 has been revised up only marginally from the July EFA to -2.3 per cent and 2.3 per cent respectively (Table 1-2). The near-term outlook is identical to Finance Canada's August survey results but slightly more positive than the recent IMF forecast for Canada at -2.5 per cent in 2009 and 2.1 per cent in 2010.

Table 1-2

Real GDP Growth Outlook

(Per cent)

	2009	2010	2011-2014
June 2009 PBO survey	-2.4	2.2	3.4
September 2009 PBO survey	-2.3	2.3	3.2

Source: Office of the Parliamentary Budget Officer

However, the growth outlook for 2011 to 2014 has been revised down modestly (0.2 percentage points annually on average), reflecting the impacts of weaker U.S. demand and a higher Canadian dollar. Real GDP growth over the medium term (2011-2014) is expected to average 3.2 per cent, which is marginally higher than Finance Canada's August survey results (3.1 per cent).

PBO has recently developed its own estimates of the Canadian economy's potential output (Box 1-1). PBO estimates that the Canadian economy reached a trough in the second quarter of 2009 at 5.1 per cent below its potential (4.6 per cent below potential for 2009 as a whole). The September 2009 PBO survey implies that the Canadian economy should return to its potential by the end of 2013 (Figure 1-3 below). On a cumulative basis, this represents a loss of over $200 billion in unrealized output (adjusted for inflation), similar in percentage terms to the cumulative loss experienced in the 1990 recession.

Box 1-1: PBO Estimates of Potential GDP

Potential output is the amount of output that the economy can produce when capital, labour and technology are at their respective trends. PBO has recently constructed its own estimate of potential output for the Canadian economy by estimating trends in labour input and labour productivity. Trend labour input is a function of the working age population, the employment rate, and average hours worked per week. Trend labour productivity is constructed by 'filtering' or smoothing the level of labour productivity and implicitly captures capital deepening (increases in capital relative to labour) as well as technological improvements (typically referred to as total factor productivity). PBO's estimates suggest that potential output growth of the Canadian economy will average 1.9 per cent over the 2009 to 2014 period.

Potential GDP Growth Outlook

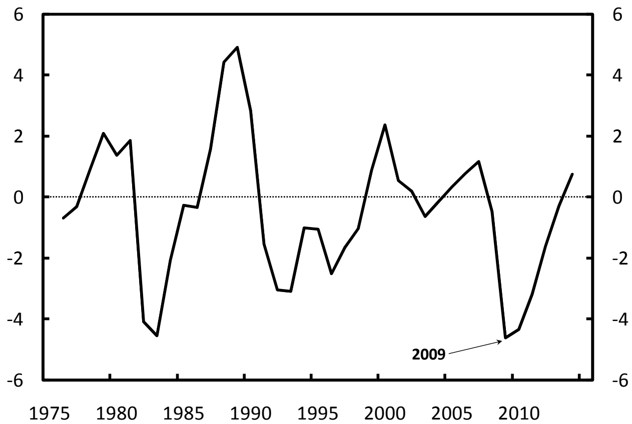
	2008	2009	2010	2011-2014
Potential Growth	2.1	1.9	2.0	1.8
Contribution from:				
Labour Supply	1.4	1.1	1.0	0.6
Labour Productivity	0.7	0.8	1.0	1.2

A forthcoming briefing note will provide further details on PBO's new methodology.

Figure 1-3

Output Gap

(Per cent of potential GDP)



Source: Office of the Parliamentary Budget Officer

Reflecting upward revisions to the outlook for commodity prices, the private sector outlook for GDP inflation in 2009 and 2010 has been revised up which, in combination with the upward revisions to real GDP growth, has lifted nominal GDP growth to -4.6 per cent in 2009 and 4.0 per cent in 2010 (Table 1-3). However, as a result of downward revisions to real GDP growth over 2011-2014, the outlook for nominal growth over the medium term has been revised down to 5.4 per cent on average over the period.

Table 1-3

Nominal GDP Growth Outlook

(Per cent)

	2009	2010	2011-2014
June 2009 PBO survey	-4.8	3.6	5.6
September 2009 PBO survey	-4.6	4.0	5.4

Source: Office of the Parliamentary Budget Officer

These revisions to nominal GDP growth are essentially offsetting and result in a projected medium-term level of nominal GDP – the broadest measure of the Government's tax base – that is virtually unchanged from the June PBO survey.

Moreover, the level of nominal GDP based on the September PBO survey is very much in line with Finance Canada's August survey results; PBO's projected level of nominal GDP is only $3 billion (0.2 per cent) higher annually on average over 2009-2014.

Reflecting the better-than-expected employment performance since May and upward revisions to real GDP growth, private sector forecasters have revised down their outlook for the unemployment rate in the near term (Table 1-4). Based on the September 2009 PBO survey, forecasters expect the unemployment rate to average 8.4 per cent in 2009 and 8.9 per cent in 2010 – lower than the 8.7 per cent and 9.4 per cent, respectively, expected in the June survey.

Based on PBO assumptions, the September private sector outlook for the unemployment rate in 2009 implies that the level of employment by the end of 2009 would be about 76,000 jobs higher than expected at the time of the July EFA, and almost 142,000 jobs higher by the end of 2010. Despite these upward revisions, the level of employment would still remain well below levels expected at the time of Budget 2009. By the end of 2009 and 2010, the level of employment would be about 246,000 and 205,000 jobs lower, respectively, than anticipated at the time of Budget 2009.

Table 1-4

Unemployment Rate Outlook

(Per cent)

	2009	2010	2011-2014
June 2009 PBO survey	8.7	9.4	7.7
September 2009 PBO survey	8.4	8.9	7.5

Source: Office of the Parliamentary Budget Officer

Forecasters have revised down their medium-term outlook for the unemployment rate to 7.5 per cent on average over 2011-2014. This results in a somewhat faster return to their previous long-run or 'structural' estimates of unemployment which have typically ranged around 6.0 to 6.5 per cent. The September PBO survey-based outlook for unemployment is virtually identical to Finance Canada's August results which showed the unemployment rate averaging 7.6 per cent over 2011-2014.

The outlook for interest rates and CPI inflation based on the September PBO survey is presented in Table A-1 in Annex A. PBO assumptions about income and expenditure components of GDP – which play an important role in the fiscal projection because components of GDP are taxed at different rates – are essentially unchanged from the July EFA.

2. Fiscal Outlook

PBO's current budget balance projection is slightly below that shown in the July EFA. The cumulative deficit is now projected to be $167.4 billion over the five-year period 2009-10 to 2013-14, compared to $155.9 billion in July (Table 2-1). The deficit is projected to peak at $54.2 billion (3.6 per cent of GDP) in 2009-10, improving over the medium term to reach $19.0 billion (1.0 per cent of GDP) by 2013-14. In the July EFA, PBO projected a peak deficit of $48.6 billion in 2009-10, declining to $16.7 billion in 2013-14.

Table 2-1

Budgetary Revenues, Expenses and Balance

($ billions)

	2008-09	2009-10	2010-11	2011-12	2012-13	2013-14
Revenues	233.1	219.7	234.1	250.6	265.1	280.7
Expenses	238.8	273.9	277.2	278.5	288.3	299.7
Budgetary Balance	**-5.8**	**-54.2**	**-43.1**	**-27.9**	**-23.2**	**-19.0**
Federal Debt	463.7	517.9	561.0	588.9	612.2	631.2
Percent of GDP						
Budgetary Balance	-0.4	-3.6	-2.7	-1.7	-1.3	-1.0
Federal Debt	29.0	33.9	35.3	35.1	34.5	33.8

Source: Office of the Parliamentary Budget Officer

The larger near-term deficit projection is mostly due to weaker revenues, which, despite the slight improvement in projected nominal GDP, have been revised down due to weaker-than-expected results. Specifically, Goods and Services Tax (GST) revenues have been revised down largely based on very weak results to date (GST revenues are down 19.5 per cent year-to-date as of August). The projection of other revenues has been revised down based on lower 2008-09 results and lower revenue resulting from the Insured Mortgage Purchase Program (IMPP) as use of the facility has been less than anticipated to date. See Table A-2 in Annex A for further details.

Overall budgetary revenues are projected to decline $13.4 billion in 2009-10 largely due to declines in personal and corporate income tax revenues, which are projected to decline by about $5.4 billion and $6.1 billion respectively, as a result of weaker incomes and income tax measures. Employment Insurance (EI) premium revenues are projected to be slightly lower over the projection horizon compared to the July EFA, due in part to improvements in PBO's projection methodology (see Box 2-1).

Box 2-1: Employment Insurance Account

PBO has improved its model of the EI account which is used to produce projections of EI contributions, benefits paid and premium rates based on the EI Chief Actuary's methodology.

Based on PBO's new model and the current legislation, PBO estimates suggest that a cumulative deficit of $5.7 billion will be generated between 2008 and 2014. This estimate includes annual premium rate increases of $0.15 every year (the maximum allowable increase) beginning in 2011 when the Government's temporary freeze of EI premium rates expires as well as the credit of $2.9 billion to the EI account in 2010 described in Budget 2009. Without premium rate increases, PBO estimates would suggest a cumulative deficit in the EI account of $24.8 billion in 2014, with EI premium revenues $6.3 billion lower in 2013-14 than currently projected.

A forthcoming briefing note will provide further detail on PBO's new methodology and implications for EI account balances beyond 2014.

PBO's projection of program expenses is largely unchanged over the forecast horizon from the July 2009 EFA. Major transfers to persons, which includes EI, elderly and children's benefits, are projected to rise sharply in 2009-10, owing largely to increased EI benefits as a result of higher unemployment and measures introduced in Budget 2009. Elderly benefits are projected to rise with inflation and the number of program beneficiaries. Major transfers to other levels of government are projected to be higher in the near term than in the July EFA largely as a result of payments to be made to British Columbia for sales tax harmonization and, in the medium term, due to revisions to PBO's Equalization projection.[1]

Direct program spending (DPS) is projected to be largely unchanged from the July EFA. It is important to note, however, that the DPS component of PBO's fiscal projections is based entirely on Finance Canada's forecast. Ideally, PBO would produce an independent projection of departmental expenditures. Toward achieving this objective, PBO has requested information on the Government's expected expenditure plan. The requested information, however, has been deemed a Cabinet confidence and therefore has not been provided.[2] As a result, as illustrated in Table 2-2, PBO's DPS projection is based on that provided in the Government's September Update of Economic and Fiscal Projections, with two significant adjustments.

First, an adjustment has been made for planned savings that have been included in the Government's projection but have yet to be identified. Although the Government has reversed its decision to include expected profits from the potential sale of assets in its revenue projections, it continues to include approximately $5.8 billion in unidentified savings resulting from the remaining reviews discussed under the "Effective Management of Government Spending" initiative in the 2008 Economic and Fiscal Statement, including $2.0 billion in the current fiscal year.

Table 2-2

Direct Program Spending

($ billions)

	2008-09	2009-10	2010-11	2011-12	2012-13	2013-14
Finance Canada	99.8	120.7	117.2	113.5	117.4	120.0
Adjustments						
Unidentified Savings		2.0	1.5	1.1	0.6	0.6
Lapse Assumption						1.5
November PBO DPS	**99.8**	**122.7**	**118.7**	**114.6**	**118.0**	**122.1**

Sources: Finance Canada; Office of the Parliamentary Budget Officer

Second, the $1.5 billion reduction in projected spending in 2013-14, introduced in the September 2009 update, and attributed to a higher expected "lapse" in departmental authorities, has been reversed. The assumed increase in the lapse is, however, not adequately supported and results in a deceleration in DPS growth, averaging just over 2 per cent per year over the final two years of the Government's projection period (2013-14 and 2014-15), which is well below the historical average.[3]

PBO projects public debt charges to be somewhat higher over the projection period, also contributing to the larger deficits. Public debt charges are up by $1.9 billion in 2009-10 and $0.9 billion at the end of the projection period compared to the July EFA. This reflects higher effective interest rates as well as revisions to PBO's public debt charge model.

PBO's updated projections imply that the federal debt-to-GDP ratio would decline somewhat after reaching its projected peak of 35.3 per cent in 2010-11, although remain well above the 25 per cent medium-term debt objective reaffirmed in the

[1] The Equalization projection in the PBO's July EFA erroneously lagged by one year the moving average of nominal GDP on which Equalization payments are based.

[2] On June 4, 2009 PBO requested the 2009 Annual Reference Level Update for 2009-10 through 2013-14 and a summary of items that have received Cabinet and/or budget approval, but which have yet to be included in departmental reference levels and the Estimates. On July 24, 2009 the Secretary of the Treasury Board responded indicating that the information requested is a Cabinet confidence and therefore would not be shared with the PBO.

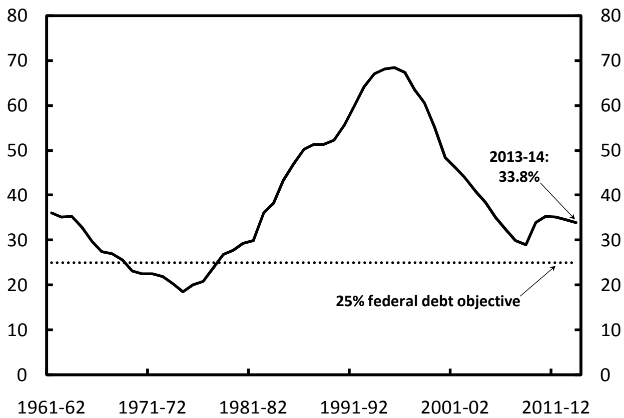
[3] DPS growth has averaged 6.8 per cent over the past three years, in line with its 6.9 per cent average over the past decade.

Government's 2008 Economic and Fiscal Statement (Figure 2-1).

Figure 2-1

Federal Debt-to-GDP

(Per cent of GDP)



Sources: Finance Canada; Office of the Parliamentary Budget Officer

3. Structural Budget Balance Estimates

PBO has improved its approach to assessing the Government's budgetary position over the business cycle. Although considerable uncertainty surrounds any estimate of potential output and the 'structural' or cyclically-adjusted budget balance (CABB), PBO has attempted to refine its methodology to account more precisely for the structure of the tax system and its interaction with the cycle (see Box 3-1). Table 3-1 presents PBO's updated estimates of the Government's structural budget balance over 2008-09 to 2013-14.

Table 3-1

Structural and Cyclical Budget Balance Estimates

($ billions)

	2008-09	2009-10	2010-11	2011-12	2012-13	2013-14
Budgetary balance	-5.8	-54.2	-43.1	-27.9	-23.2	-19.0
Structural balance	-3.2	-12.5	-13.5	-13.1	-16.8	-18.9
Cyclical balance	-2.5	-41.8	-29.6	-14.8	-6.5	-0.1

Source: Office of the Parliamentary Budget Officer

PBO's estimates, based on its new methodology, continue to suggest that the budget is not structurally balanced over the medium term. Although the economy is projected to return to its potential capacity by 2013, based on the September PBO survey (see Figure 1-3), without additional policy actions the budget is not projected to return to balance by 2013-14. Indeed, PBO estimates that the structural balance would deteriorate from essentially a balanced position in 2007-08 (i.e., a $0.3 billion deficit) to an $18.9 billion structural deficit in 2013-14.

Despite relatively minor changes to PBO's fiscal projections, the new estimates of the structural deficit are somewhat larger than calculated in the July EFA. This upward revision primarily reflects a reduced estimate of structural revenues in 2007-08 which, despite an upward revision to the structural growth rate in revenues projected through 2013-14, results in a lower level of structural revenues over the projection horizon.[4]

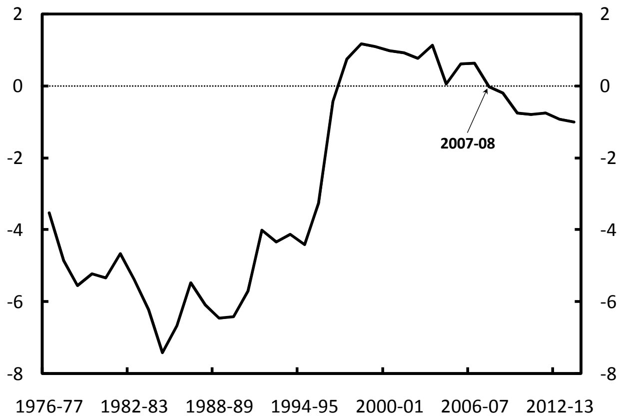
That said, relative to the size of the economy, the structural deficits projected in 2012-13 and 2013-14 are small compared to the structural deficits of the 1980s and early 1990s (Figure 3-1). However, a more thorough assessment of the sustainability of the current fiscal structure requires a longer-term perspective, in particular taking into account the fiscal challenges posed by population ageing. PBO is undertaking such analysis and will release a comprehensive assessment of the sustainability of the Government's finances in the coming months.

[4] In the July EFA, PBO based its calculation on Finance Canada's estimate that the output gap was closed in 2007 (see Fiscal Reference Tables September 2008) and therefore actual revenues in 2007-08 were assumed to be equal to structural revenues. This level of structural revenues was then extrapolated over the medium term assuming underlying growth of 4.0 per cent with adjustments made for legislated tax reductions. PBO's new estimates of potential output however indicate that the economy was 1.2 per cent above its potential in 2007, which therefore lowers the estimate of structural revenues in 2007-08 since the level of actual revenues is unchanged. As a result, based on PBO estimates, the budget surplus of $9.6 billion recorded for 2007-08 was entirely cyclical in nature as opposed to structural as previously assumed.

Figure 3-1

Structural Budget Balance

(Per cent of potential income)



Source: Office of the Parliamentary Budget Officer

Note: Potential income is calculated as the product of potential GDP and the trend trading gain (i.e., GDP price relative to the final domestic demand deflator).

Box 3-1: PBO Structural Balance Estimates

PBO has adopted a new approach to estimating structural budget balances that builds upon the 'standard' two-step approach used by the OECD and IMF in their official CABB estimates for Canada. This approach first involves estimating an economy's output gap. The second step involves identifying the cyclical component of the budget by estimating the responsiveness of actual budgetary components to the output gap. This last step typically involves the use of tax and spending elasticities derived from microdata. The structural components of revenues and spending are then calculated residually as the actual component minus the cyclical component. Following research undertaken at the OECD, PBO builds on the two-step approach by using a GDI (gross domestic income) gap instead of a production-based GDP gap to better capture the cyclical sensitivity of budgetary components. In addition, PBO uses a microsimulation model to estimate the tax and spending elasticities for personal income and unemployment across time (both over history and projection). A forthcoming briefing note will detail PBO's new methodology.

Finally, it is important to note that with the exception of EI benefits, PBO has simply adopted the Government's remaining program spending projection, which by construction, represents structural expenditure.[5] PBO estimates of the Government's structural balance are therefore dependent on relatively conservative projections with spending growth averaging less than 4 per cent in the last four years of the projection period, well below historical growth rates and the projected growth rate of the economy. Further, PBO's structural balance estimates are also conditional on the Government ensuring that none of the time-limited stimulus measures become permanent.

4. Risks to the Outlook

Although the economic situation has stabilized somewhat since the spring, and the September 2009 PBO survey of private sector forecasters is little changed from the June survey, a high degree of uncertainty continues to surround the outlook.

PBO judges that there are downside risks to the private sector near-term outlook for real GDP growth. Specifically, the potential that the emerging U.S. recovery could be weaker than anticipated and the recent strength in the Canadian dollar – appreciating from a trough of 77 US cents on March 3 to 96.7 US cents on October 15 – both pose a risk to Canadian exporters and could delay the Canadian recovery.

PBO continues to judge that the risks to the private sector medium-term outlook for nominal GDP are roughly balanced, reflecting the downside risks to real GDP growth and upside risks to GDP inflation identified in the July Economic and Fiscal Assessment.[6] However, the fiscal implications of

[5] Under the new approach, PBO continues to remove temporary stimulus measures from structural program spending. These measures are included in the cyclical balance and amount to $17.5 billion in 2009-10, $9.0 billion in 2010-11, $0.4 billion in 2011-12 and $0.3 billion in 2012-13.

[6] The main downside risk is that real GDP growth could be weaker than private sector forecasters' current expectations reflecting the possibility that the global downturn, particularly given its synchronized and financial nature, could be deeper or more protracted. On the upside, the outlook for GDP inflation could exceed private sector forecasts reflecting uncertainties in mapping expected commodity price and terms of trade movements into GDP inflation forecasts. Emerging market economies could also recover faster than expected, pushing commodity prices higher.

these risks are not symmetric and therefore not offsetting. That is, lower real GDP growth could be offset by higher GDP inflation leaving nominal GDP growth unchanged; however, the Government's budgetary balance would be (negatively) impacted since shocks to real GDP growth typically have a larger fiscal impact than shocks to GDP inflation.

Although the risks to the medium-term outlook for nominal GDP are judged to be roughly balanced, there remains a wide range of possible outcomes. To help illustrate – but by no means precisely quantify – the fiscal implications of such a range, PBO has prepared two alternative scenarios based on the high and low private sector forecasts in each year of the projection horizon (Table 4-1).[7]

Table 4-1

September 2009 PBO Survey

(Per cent)

	2009	2010	2011	2012	2013	2014
Real GDP growth						
Average forecast	-2.3	2.3	3.3	3.5	3.2	2.8
High forecast	-1.9	2.9	3.8	4.1	3.8	2.8
	(0.4)	*(1.0)*	*(1.5)*	*(2.1)*	*(2.7)*	*(2.7)*
Low forecast	-2.7	1.4	1.7	3.0	2.8	2.8
	(-0.4)	*(-1.3)*	*(-2.8)*	*(-3.3)*	*(-3.6)*	*(-3.6)*
GDP inflation						
Average forecast	-2.3	1.6	2.2	2.3	2.1	2.0
High forecast	-1.9	2.2	3.5	2.7	2.3	2.1
	(0.4)	*(1.0)*	*(2.3)*	*(2.7)*	*(2.9)*	*(3.0)*
Low forecast	-3.4	0.6	1.3	2.0	1.8	1.9
	(-1.1)	*(-2.1)*	*(-3.0)*	*(-3.2)*	*(-3.5)*	*(-3.6)*

Note: Numbers in parentheses represent the percentage deviation of the forecasted level of real GDP/GDP price under the high/low forecast from its corresponding forecasted level based on the average forecast.

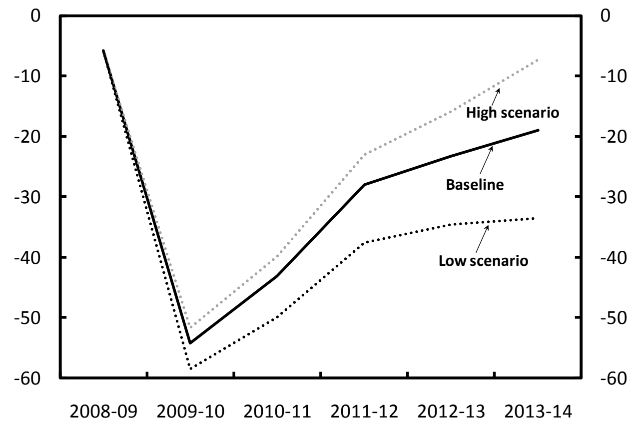
Source: Office of the Parliamentary Budget Officer

Figure 4-1 presents the projections of the budgetary balance under the high and low scenarios, as well as the baseline projection shown in Table 2-1, which is based on the average private sector forecast.

Figure 4-1

Budget Balances under Alternative Scenarios

($ billions)



Source: Office of the Parliamentary Budget Officer

The range of forecasts of nominal GDP, which widens as the projection horizon lengthens, translates into an increasing range of budgetary balance projections. In 2013-14, the projected budgetary balance ranges from a deficit of $7.3 billion under the high scenario to a deficit of $33.5 billion under the low scenario.[8] This range, at $26 billion, is considerably wider than the $15 billion range estimated by the Government but nonetheless suggests that even under the most optimistic private sector forecasts of nominal GDP, the budgetary deficit is – without additional policy actions – unlikely to be eliminated over the medium term.

In addition to the uncertainty surrounding the economic outlook, there remains considerable uncertainty going forward with respect to effective tax rates and revenue bases. PBO has maintained its relatively optimistic assumptions that effective personal income tax rates recover at a pace somewhat faster than the last recession, when the

[7] More specifically, the high (low) scenario includes the highest (lowest) forecasts of real GDP growth, GDP and CPI inflation, interest rates, along with the lowest (highest) unemployment rate forecast.

[8] Under the high (low) scenario, higher (lower) nominal GDP relative to the baseline results in significantly higher (lower) tax revenues. Lower (higher) unemployment translates into lower (higher) EI benefits but this reduction (increase) in spending is offset by higher (reduced) expenditures on Equalization and OAS payments.

rise in effective rates was aided somewhat by the non-indexation of personal income tax brackets to inflation. For corporate income tax revenues, a high degree of uncertainty remains as a result of corporations' ability to carry losses backward and forward, which has the potential to cause a deeper decline and/or delay the rebound in corporate income tax revenues even as the economy recovers.

An upside risk to the fiscal outlook in the near term is the ability of the Government to fully implement its stimulus package, in particular funds set aside for multi-jurisdictional infrastructure projects. Infrastructure Canada has historically lapsed large amounts of this type of planned spending, with one in every three planned infrastructure dollars going unspent in the past two fiscal years for which data is available.

Taking into consideration the risks to the economic outlook, as well as the uncertainty surrounding PBO's effective rate assumptions, the balance of risks to its fiscal outlook over the medium term continues to be tilted to the downside.

Annex A – Economic and Fiscal Outlook Summary Tables

Table A-1

September 2009 PBO survey versus June 2009 PBO Survey

(Per cent)

	2009	2010	2011	2012	2013	2014
Real GDP growth						
June 2009 PBO survey	-2.4	2.2	3.5	3.8	3.3	2.9
September 2009 PBO survey	-2.3	2.3	3.3	3.5	3.2	2.8
GDP inflation						
June 2009 PBO survey	-2.5	1.4	2.1	2.5	2.0	1.9
September 2009 PBO survey	-2.3	1.6	2.2	2.3	2.1	2.0
Nominal GDP growth						
June 2009 PBO survey	-4.8	3.6	5.7	6.3	5.4	4.9
September 2009 PBO survey	-4.6	4.0	5.5	5.9	5.3	4.9
Nominal GDP level ($ billions)						
June 2009 PBO survey	1,523	1,578	1,669	1,774	1,870	1,960
September 2009 PBO survey	1,527	1,588	1,676	1,774	1,868	1,959
3-month treasury bill rate						
June 2009 PBO survey	0.4	1.0	2.7	3.6	4.5	4.6
September 2009 PBO survey	0.3	0.8	2.5	3.7	4.5	4.6
10-year government bond rate						
June 2009 PBO survey	3.1	3.5	3.8	4.3	5.1	5.4
September 2009 PBO survey	3.3	3.7	4.1	4.7	5.1	5.4
Unemployment rate						
June 2009 PBO survey	8.7	9.4	8.9	8.1	7.2	6.8
September 2009 PBO survey	8.4	8.9	8.5	7.7	7.1	6.8
Total CPI inflation						
June 2009 PBO survey	0.3	1.7	2.2	2.1	2.2	2.0
September 2009 PBO survey	0.4	1.8	2.0	2.1	2.1	2.0

Source: Office of the Parliamentary Budget Officer

Table A-2

Federal Revenues, Expenses and Budgetary Balance - PBO November versus July Assessment

$billions

	2007-08	2008-09	2009-10	2010-11	2011-12	2012-13	2013-14
Budgetary Revenue							
Total Revenue							
November 2009	**242.4**	**233.1**	**219.7**	**234.1**	**250.6**	**265.1**	**280.7**
July 2009	242.4	233.7	223.4	235.6	250.3	265.6	280.7
Difference	0.0	-0.6	-3.7	-1.5	0.3	-0.5	0.0
Personal Income Tax							
November 2009	113.1	116.0	110.6	117.3	125.8	134.1	141.9
July 2009	113.1	116.0	110.0	116.6	125.3	133.8	141.7
Difference	0.0	0.0	0.6	0.7	0.6	0.2	0.2
Corporate Income Tax							
November 2009	40.6	29.5	23.4	25.6	26.8	27.0	29.2
July 2009	40.6	30.0	23.7	25.9	27.2	27.6	29.7
Difference	0.0	-0.6	-0.3	-0.3	-0.4	-0.5	-0.5
Goods and Services Tax							
November 2009	29.9	25.7	24.7	27.1	29.4	30.7	32.1
July 2009	29.9	25.3	26.7	27.5	29.0	30.4	31.9
Difference	0.0	0.5	-2.0	-0.4	0.4	0.3	0.2
Employment Insurance Premium							
November 2009	16.6	16.9	16.8	17.8	20.0	22.8	25.9
July 2009	16.6	16.7	16.8	17.7	20.3	23.3	26.3
Difference	0.0	0.2	0.0	0.1	-0.2	-0.5	-0.4
All Other Revenues							
November 2009	42.3	45.0	44.3	46.4	48.5	50.4	51.6
July 2009	42.3	45.6	46.3	47.9	48.6	50.5	51.1
Difference	0.0	-0.7	-2.0	-1.5	-0.1	0.0	0.5
Budgetary Expenses							
Total Program Expenses							
November 2009	199.5	207.9	242.8	245.0	241.5	247.7	257.1
July 2009	199.5	206.2	242.7	244.6	241.1	247.3	255.7
Difference	0.0	1.6	0.1	0.5	0.4	0.4	1.4
Major Transfers to Persons							
November 2009	58.1	61.6	68.5	70.6	71.2	73.1	75.6
July 2009	58.1	61.3	68.6	71.2	71.5	73.1	74.7
Difference	0.0	0.3	-0.1	-0.6	-0.3	0.0	1.0
Major Transfers to Other Levels of Government							
November 2009	46.2	46.5	51.6	55.8	55.7	56.6	59.4
July 2009	46.2	46.5	50.9	55.2	55.3	55.9	58.7
Difference	0.0	0.0	0.8	0.6	0.5	0.6	0.7
Public Debt Charges							
November 2009	33.3	31.0	31.1	32.2	36.9	40.6	42.6
July 2009	33.3	31.0	29.3	32.4	36.8	39.9	41.7
Difference	0.0	0.0	1.9	-0.3	0.1	0.7	0.9
Budgetary Balance							
November 2009	**9.6**	**-5.8**	**-54.2**	**-43.1**	**-27.9**	**-23.2**	**-19.0**
July 2009	9.6	-3.5	-48.6	-41.3	-27.6	-21.6	-16.7
Difference	0.0	-2.3	-5.6	-1.7	-0.3	-1.6	-2.3

Source: Office of the Parliamentary Budget Officer