OFFICE OF THE PARLIAMENTARY BUDGET OFFICER

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An Assessment of the Government's Fiscal Outlook

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The mandate of the Parliamentary Budget Officer (PBO) is to provide independent analysis to Parliament on the state of the nation's finances, the Government's estimates and trends in the Canadian economy; and, upon request from a committee or parliamentarian, to estimate the financial cost of any proposal for matters over which Parliament has jurisdiction.

This report provides a brief assessment of the Government's status quo fiscal outlook presented in its *Update of Economic and Fiscal Projections 2015*.

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Table of Contents

Executive Summary

This report assesses the Government's status quo fiscal outlook in its *Update of Economic and Fiscal Projections 2015*, released on 20 November 2015.

In PBO's judgement, the Government's outlook for the economy and federal budget over the medium term is optimistic.

Based on forecast comparisons and forecast revisions, PBO believes that there is downside risk to the Government's medium-term outlook for the budgetary balance in the fiscal years 2019-20 and 2020-21.

Forecast comparison

On balance, the outlooks for the budgetary balance between 2015-16 and 2018-19 are similar. Finance Canada projects budget deficits averaging $2.7 billion a year while PBO projects budget deficits averaging $2.9 billion.

However, for the fiscal years 2019-20 and 2020-21, the Government projects budget surpluses of $1.7 billion and $6.6 billion respectively, while PBO projects deficits of $4.6 billion and $4.2 billion. Relative to gross domestic product (GDP), the difference in outlooks amounts to 0.3 percentage points in 2019-20 and 0.4 percentage points in 2020-21.

Comparison of outlooks for the budgetary balance

$ billions	2015-2016	2016-2017	2017-2018	2018-2019	2019-2020	2020-2021
PBO	1.2	-3.0	-4.7	-5.0	-4.6	-4.2
Finance Canada	-3.0	-3.9	-2.4	-1.4	1.7	6.6
Difference	-4.2	-0.9	2.3	3.6	6.3	10.8

Sources: Finance Canada and Parliamentary Budget Officer.

The difference in budgetary balance projections over 2017-18 to 2020-21 stems from the Government's more optimistic outlook for revenues from personal and corporate income taxes, as well as the Goods and Services Tax (GST).

Forecast revisions

Finance Canada's downward revision to its planning assumption for nominal GDP from Budget 2015 averages $40 billion a year (-1.8 per cent) over 2016 to 2019. Even so, relative to Budget 2015 the department shows only a modest downward revision to its outlook for revenues from personal and corporate income taxes and GST, averaging $1.1 billion (-0.4 per cent) a year over 2016-17 to 2019-20.

This reflects Finance Canada’s assumption that higher-than-expected revenues observed in 2014-15 and 2015-16 (year to date) carry forward over the entire forecast horizon. In contrast, PBO does not assume that higher-than-expected revenues carry forward over the entire forecast.

Finance Canada’s forecast adjustment

To account for the possibility of lower oil prices or weaker-than-expected global growth in its Update, the Government adjusted downward the private sector forecast of nominal GDP from Finance Canada’s October 2015 survey.

In PBO’s view, the Government’s forecast adjustment would only balance the downside risk to the private sector outlook for oil prices. PBO believes that downside risk remains to the Government’s planning assumption for nominal GDP. This reflects a relatively optimistic private sector forecast of real GDP growth over 2018 to 2020.

1. Outlook for the Budgetary Balance

The following provides a high-level comparison of fiscal forecasts from Finance Canada's *Update of Economic and Fiscal Projections 2015* and PBO's November 2015 *Economic and Fiscal Outlook*.[1]

On balance, over 2015-16 to 2018-19, the outlooks for the budgetary balance are similar. Finance Canada projects budget deficits averaging $2.7 billion a year, while PBO projects budget deficits averaging $2.9 billion (Table 1-1).

However, for the fiscal years 2019-20 and 2020-21, the Government projects budget surpluses of $1.7 billion and $6.6 billion respectively, while PBO projects deficits of $4.6 billion and $4.2 billion. Relative to gross domestic product (GDP), the difference in outlooks amounts to 0.3 percentage points in 2019-20 and 0.4 percentage points in 2020-21.

Table 1-1 **Status quo budgetary balance projections**

$ billions	2015-2016	2016-2017	2017-2018	2018-2019	2019-2020	2020-2021
PBO	1.2	-3.0	-4.7	-5.0	-4.6	-4.2
Finance Canada	-3.0	-3.9	-2.4	-1.4	1.7	6.6
Difference	-4.2	-0.9	2.3	3.6	6.3	10.8

Sources: Finance Canada and Parliamentary Budget Officer.

The Government's outlook for the 2015-16 budgetary balance is lower than PBO's. The Government forecasts a deficit of $3.0 billion, while PBO forecasts a surplus of $1.2 billion.

The two largest sources of disagreement in 2015-16 are other revenues and direct program expenses; together they account for $3.9 billion of the $4.2 billion difference. The Government has more current and detailed data for these budget aggregates. For this reason, PBO cannot assess whether the Government's outlook for the 2015-16 budgetary balance is pessimistic.[2]

The difference in budgetary balance projections over 2017-18 to 2020-21 stems from the Government's more optimistic outlook for revenues from personal income taxes (PIT), corporate income taxes (CIT) and the Goods and Services Tax (GST) (Table 1-2). Combined, PIT, CIT and GST revenues account for 76 per cent of the Government's total projected revenues over this period.

Table 1-2 Projected PIT, CIT and GST revenues

$ billions	2015-2016	2016-2017	2017-2018	2018-2019	2019-2020	2020-2021
PBO	212.4	218.7	228.1	237.0	247.2	258.1
Finance Canada	211.8	224.1	234.8	244.0	254.7	266.5
Difference	-0.6	5.4	6.7	7.0	7.5	8.4

Sources: Finance Canada and Parliamentary Budget Officer.

The more optimistic outlook over 2018-19 to 2020-21 for PIT, CIT and GST revenues reflects both higher effective tax yields (tax revenue divided by income) and higher levels of income (proxied by nominal GDP) (Table 1-3).[3]

Table 1-3 Comparison of tax yields and nominal GDP

Tax yields, %	2015-2016	2016-2017	2017-2018	2018-2019	2019-2020	2020-2021
PBO	10.67	10.60	10.57	10.57	10.60	10.64
Finance Canada	10.68	10.91	10.92	10.86	10.88	10.92
Difference	0.01	0.30	0.34	0.30	0.27	0.28
Nominal GDP, $ billions	**2015**	**2016**	**2017**	**2018**	**2019**	**2020**
PBO	1,990	2,063	2,157	2,243	2,331	2,425
Finance Canada	1,983	2,055	2,151	2,246	2,342	2,440
Difference	-7	-8	-6	3	11	15

Sources: Finance Canada and Parliamentary Budget Officer.

Note: The tax yield is calculated as the sum of PIT, CIT and GST revenues divided by nominal GDP.

2. Forecast Revisions

Despite a downward revision to its planning assumption for nominal GDP averaging $40 billion (-1.8 per cent) a year over 2016 to 2019, Finance Canada's downward revision to its outlook for PIT, CIT and GST revenues is modest. It averages $1.1 billion (-0.4 per cent) a year over 2016-17 to 2019-20 (Table 2-1).

In 2019-20, despite a $33 billion (-1.4 per cent) downward revision to nominal GDP, PIT, CIT and GST revenues combined were revised down by only $0.2 billion (-0.1 per cent).

In comparison, PBO revised down its outlook for these revenues by an average of $2.2 billion a year (-0.9 per cent), even though PBO's revision to nominal GDP was significantly smaller: $24 billion a year (-1.1 per cent), on average, over 2016 to 2019.

Table 2-1 Finance Canada's forecast revisions

Nominal GDP, $ billions	2015	2016	2017	2018	2019
Budget 2015	2,000	2,098	2,196	2,285	2,375
Update 2015	1,983	2,055	2,151	2,246	2,342
Difference	-17	-43	-45	-39	-33
Difference (%)	-0.9%	-2.0%	-2.0%	1.7%	-1.4%

PIT, CIT and GST revenues, $ billions	2015-2016	2016-2017	2017-2018	2018-2019	2019-2020
Budget 2015	212.9	225.9	236.2	244.8	254.9
Update 2015	211.8	224.1	234.8	244.0	254.7
Difference	-1.1	-1.8	-1.4	-0.8	-0.2
Difference (%)	-0.5%	-0.8%	-0.6%	-0.3%	-0.1%

Sources: Finance Canada and Parliamentary Budget Officer.

Note: For Budget 2015 and Update 2015, the nominal GDP projection used is the Government's assumption for fiscal planning purposes. The Budget 2015 nominal GDP planning assumption has been restated for historical revisions from Statistics Canada. Difference (%) is calculated as the difference in billions of dollars divided by the Budget 2015 level.

The modest revisions to PIT, CIT and GST revenues in light of the significiant downward revisions to nominal GDP imply that Finance Canada's tax yields have been revised upward relative to Budget 2015 (Table 2-2).

In the Government's Update, Finance Canada does note that "[t]he overall projected decline in revenues is somewhat lower than the weaker economic outlook would imply, due to the offsetting impact of better-than-expected tax revenue results for 2014–15 and 2015–16 (on a year-to-date basis), which carry forward across the forecast horizon."

In contrast, PBO does not assume that higher-than-expected revenue yields carry forward across the remaining five years of the forecast horizon. Instead, PBO assumes that revenue yields return close to levels projected in its previous (April) outlook.

Table 2-2 Revisions to tax yields

%	2014-2015	2015-2016	2016-2017	2017-2018	2018-2019	2019-2020
Budget 2015	10.31	10.65	10.77	10.76	10.71	10.73
Update 2015	10.45	10.68	10.91	10.92	10.86	10.88
Difference	0.14	0.04	0.14	0.16	0.15	0.14

Sources: Finance Canada and Parliamentary Budget Officer.

Note: The tax yield is calculated as the sum of PIT, CIT and GST revenues divided by nominal GDP. The 2014-15 value for Update 2015 is actual data.

In summarizing the impacts of economic and fiscal developments since Budget 2015, the Government changed the way the forecast adjustment (previously defined as the "set-aside for contingencies") is presented. This presentation conflates the impact of economic developments and changes to the forecast adjustment on revisions to the budgetary balance.

The revised budgetary balance presented in Table 3.1 of the Government's Update included the impact of the forecast adjustment. However, the comparison was made to the unadjusted balance in Budget 2015 (i.e., the balance before the set-aside for contingencies, as identified in Note 1 to Table 3.1). Past comparisons have presented the set-aside for contingencies as a separate line item to isolate the impact on the budgetary balance from changes to the set-aside.

PBO has restated the Update's summary of economic and fiscal developments since Budget 2015 to provide a clearer picture of the Government's forecast revisions (Table 2-3).

Table 2-3 Restated summary of economic and fiscal developments in Update 2015

$ billions	2015-2016	2016-2017	2017-2018	2018-2019	2019-2020
Budget 2015 budgetary balance	1.4	1.7	2.6	2.6	4.8
Add: forecast adjustment	1.0	1.0	1.0	2.0	3.0
Budget 2015 budgetary balance before forecast adjustment	2.4	2.7	3.6	4.6	7.8
Total economic and fiscal developments	-3.9	-3.6	-3.0	-3.0	-3.1
Update 2015 budgetary balance before forecast adjustment	-1.5	-0.9	0.6	1.6	4.7
Less: forecast adjustment	1.5	3.0	3.0	3.0	3.0
Update 2015 budgetary balance	-3.0	-3.9	-2.4	-1.4	1.7

Sources: Finance Canada and Parliamentary Budget Officer.

3. The Government's Forecast Adjustment to Nominal GDP

For fiscal planning purposes, to account for the possibility of lower oil prices or weaker-than-expected global growth, the Government adjusted downward the October 2015 private sector outlook for nominal GDP by $10 billion in 2015, and $20 billion a year over 2016 to 2020. According to the Government, this forecast adjustment translates into a fiscal impact of $1.5 billion in 2015-16 and $3.0 billion a year between 2016-17 and 2020-21.

In PBO's view, the Government's forecast adjustment would only balance the risks to the private sector outlook for oil prices.

PBO estimates that the $20-billion annual forecast adjustment to nominal GDP over 2016 to 2020 would be broadly consistent with lower West Texas Intermediate (WTI) oil prices that are in line with the futures prices presented in the Update ("November 13 futures") (Table 3-1).[4]

Table 3-1 WTI oil price projections

$US/barrel	2015	2016	2017	2018	2019	2020
Finance Canada	49	54	64	68	70	74
November 13 futures	-	46	50	53	55	57
Adjustment consistent	-	41	49	52	55	58
PBO	50	49	53	55	57	59

Sources: Finance Canada and Parliamentary Budget Officer.

Note: PBO's November projection was based on average WTI futures prices from 12 October to 29 October 2015.

Despite this forecast adjustment, PBO believes that downside risk remains to the Government's planning assumption for nominal GDP. This reflects a relatively optimistic private sector forecast of real GDP growth over 2018 to 2020 (Table 3-2).

Table 3-2 Comparison of real GDP growth projections

%	2015	2016	2017	2018	2019	2020
PBO	1.1	2.0	2.3	1.8	1.8	1.8
Finance Canada	1.2	2.0	2.2	2.2	2.0	2.0
Difference	0.1	0.0	-0.1	0.4	0.2	0.2

Sources: Finance Canada and Parliamentary Budget Officer.

4. Conclusion

In PBO's judgement, the Government's status quo outlook for the economy and federal budget over the medium term is optimistic. Based on forecast comparisons and forecast revisions, PBO believes that there is downside risk to the Government's medium-term outlook for the budgetary balance over 2019-20 and 2020-21.

Notes

1. See http://www.budget.gc.ca/efp-peb/2015/pub/efp-peb-15-en.pdf and http://www.pbo-dpb.gc.ca/web/default/files/Documents/Reports/2015/EFO%202015/EFO_2015_EN.pdf.
2. In other revenues, the Government has access to information on in-year bond issues, revenues from consolidated Crown corporations, investment returns, transactions and revaluations in the Exchange Fund Account, and interest and penalty revenues, among others. For direct program expenses the Government has access to detailed departmental spending plans, most importantly earned benefits related to pensions, which led to the revision in the Update.
3. Nominal GDP provides a broad measure of the Government's tax base. Ideally, tax yields would be constructed using revenues and actual tax bases (e.g., taxable personal or corporate income). In the absence of projected tax bases (or projected income and expenditure components of GDP), we are using nominal GDP as a proxy of the combined PIT, CIT and GST tax bases underlying Finance Canada's projections. The nominal GDP projection used for Finance Canada is the risk-adjusted private sector forecast (i.e., the forecast of nominal GDP used for fiscal planning purposes).
4. PBO's estimate of WTI oil prices consistent with the Government's forecast adjustment to nominal GDP is based on reduced-form simulations of GDP inflation projections under alternative paths for WTI oil prices given the Update's projection of real GDP growth.