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OFFICE OF THE PARLIAMENTARY BUDGET OFFICER
BUREAU DU DIRECTEUR PARLEMENTAIRE DU BUDGET

The Parliamentary Budget Officer (PBO) supports Parliament by providing economic and financial analysis for the purposes of raising the quality of parliamentary debate and promoting greater budget transparency and accountability.

This report provides a real-time estimate of growth in Canada's gross domestic product (GDP) and the Government of Canada's budgetary balance in 2019-20 based on data released since our November 2019 Economic and Fiscal Outlook, up to and including 7 February 2020. All rates are reported at annual rates unless otherwise noted.

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Summary

Growth in the Canadian economy slowed sharply in the fourth quarter of 2019—significantly weaker than projected in our November 2019 Economic and Fiscal Outlook.

- PBO estimates that real GDP advanced by 0.3 per cent (at an annual rate) in the final quarter of 2019 as a number of temporary disruptions weakened business activity.
- We expect real GDP to grow by 1.5 per cent in the first quarter of 2020. While some of the impact of the disruptions is expected to be reversed, we project slower growth due in part to the coronavirus and weaker business investment.

The slowdown in the fourth quarter stems from temporary disruptions in the mining, oil and gas, motor vehicle and rail transportation sectors. We assume that the coronavirus (2019-nCoV) will lower real GDP growth by 0.3 percentage points in the first quarter of 2020. That said, estimates of the overall impact of the coronavirus are highly uncertain at this time.

For fiscal year 2019-20, we project that the Government's budgetary deficit will be \$23.5 billion (1.0 per cent of GDP). Our updated projection of the budgetary deficit in 2019-20 is:

- \$2.3 billion higher than our estimate in the November 2019 Economic and Fiscal Outlook; and
- \$3.1 billion lower than Finance Canada projected in its December 2019 Economic and Fiscal Update (EFU). Excluding the Government's risk adjustment, our current estimate is \$1.6 billion lower.

Our updated projection includes \$1.6 billion in additional policy measures that were announced in the EFU but were not accounted for in our November outlook. An additional \$0.8 billion in fiscal developments adds to the budgetary deficit due to higher operating expenses, which are partially offset by stronger revenues.

Our upward revision to the Government's operating expenses reflects higher current service costs for pension and other future benefits, resulting from new information provided in the EFU.

1. Economic developments

Growth in the Canadian economy slowed sharply in the fourth quarter of 2019 following real GDP growth of 1.3 per cent in the third quarter. PBO estimates that real GDP advanced by 0.3 per cent in the final quarter of the year—significantly weaker than projected in our November Economic and Fiscal Outlook (Table 1-1).¹ This slowdown was largely driven by temporary disruptions in the mining, oil and gas, motor vehicle and rail transportation sectors.²

Table 1-1 Quarterly real GDP growth

% , quarter-over-quarter at annual rates	2019Q1	2019Q2	2019Q3	2019Q4	2020Q1
PBO November 2019	0.5	3.7	1.3	1.6	1.8
PBO February 2020	0.8	3.5	1.3	0.3	1.5

Sources: Statistics Canada and Parliamentary Budget Officer.

Note: Highlighted values represent PBO estimates/projections. Differences in historical values reflect data revisions.

We expect real GDP to grow by 1.5 per cent in the first quarter of 2020 compared to 1.8 per cent projected in our November outlook. While some of the impact of the temporary disruptions weighing on growth in the fourth quarter is expected to be reversed, we project slower growth in the first quarter due in part to the coronavirus (-0.3 percentage points)³ and weaker business investment.

We have also revised down our projection for GDP inflation (Table 1-2). The downward revision reflects more moderate consumer price inflation as well as lower commodity prices due in part to the coronavirus. Based on current spot prices⁴ West Texas Intermediate (WTI) crude oil is US\$5 per barrel lower than our November outlook; Western Canadian Select (WCS) is US\$5 lower.

Table 1-2 Quarterly GDP inflation

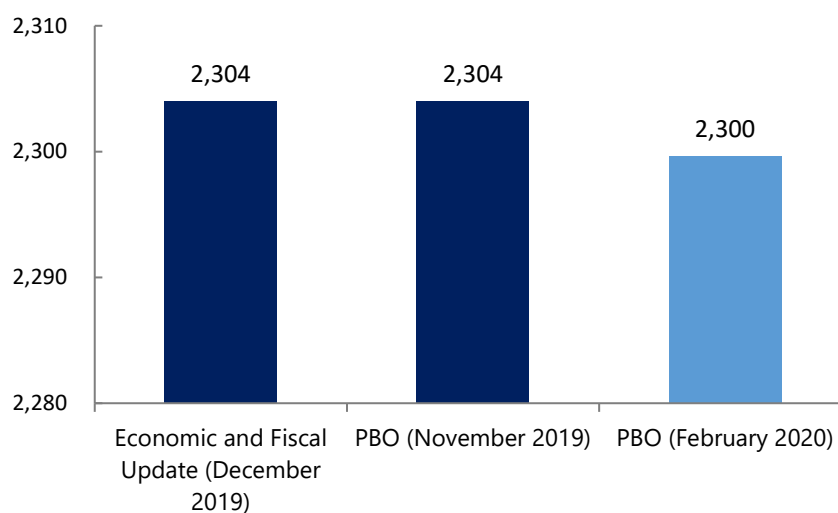
% , quarter-over-quarter at annual rates	2019Q1	2019Q2	2019Q3	2019Q4	2020Q1
PBO November 2019	5.1	4.4	1.0	1.1	1.5
PBO February 2020	4.7	4.4	0.3	0.9	1.2

Sources: Statistics Canada and Parliamentary Budget Officer.

Note: Highlighted values represent PBO estimates/projections. Differences in historical values reflect data revisions.

Given our downward revisions to real GDP growth and GDP inflation in the fourth quarter (as well as weaker-than-expected GDP inflation in the third quarter), we project that nominal GDP—the broadest measure of the Government's tax base—will be \$4 billion (0.2 per cent) lower in 2019 than projected in our November 2019 Economic and Fiscal Outlook.⁵

Figure 1-2 Nominal GDP level in 2019 (\$ billions)



Sources: Finance Canada and Parliamentary Budget Officer.

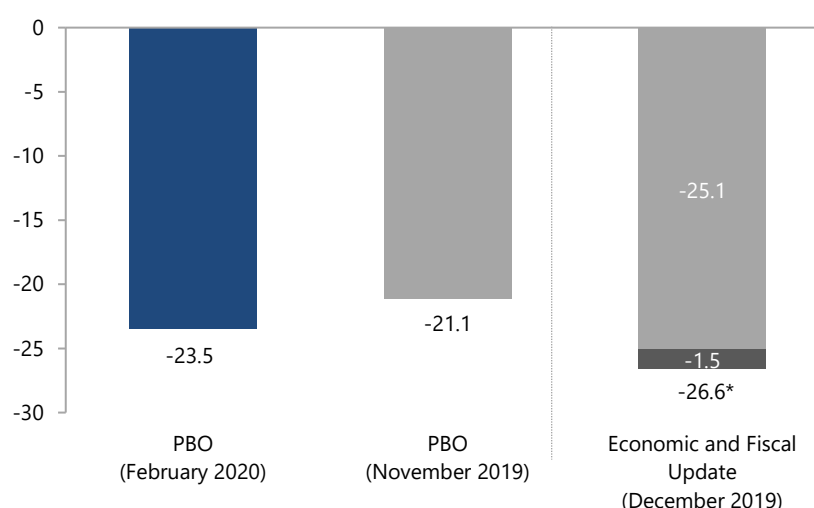
Note: PBO's (November 2019) nominal GDP level has been restated for historical revisions.

2. 2019-20 budgetary balance

We project that the Government's budgetary balance for 2019-20 will be a deficit of \$23.5 billion (1.0 per cent of GDP). In comparison, our current projection for the 2019-20 budgetary deficit is:

- \$2.3 billion higher than our estimate in the November 2019 Economic and Fiscal Outlook (Figure 2-1); and
- \$3.1 billion lower than Finance Canada projected in its 2019 Economic and Fiscal Update (EFU). Excluding the Government's risk adjustment, our current projection is \$1.6 billion lower than the EFU.

Figure 2-1 Budgetary balance in 2019-20 (\$ billions)



Sources: Finance Canada and Parliamentary Budget Officer.

Note: *Finance Canada's 2019-20 budgetary balance includes a \$1.5 billion adjustment for risk.

We are projecting a higher deficit compared to our November outlook partly owing to new policy measures proposed in the EFU. In EFU 2019, the Government detailed \$4.1 billion of measures, some of which (\$2.5 billion) were previously accounted for in our November 2019 Economic and Fiscal Outlook.

New tax and spending measures totalling \$1.6 billion add to our forecasted budgetary deficit for 2019-20. An additional \$0.8 billion in fiscal developments adds to the budgetary deficit because of higher operating expenses, which are partially offset by stronger revenues (Table 2-1).

Table 2-1 Changes to PBO's 2019-20 budgetary balance outlook

\$ billions	Budgetary balance
PBO November 2019 projection	-21.1
<i>Additional policy measures since Budget 2019 including 2019 Economic and Fiscal Update measures</i>	<i>-1.6</i>
PBO November 2019 projection, with new measures	-22.7
<i>Economic and fiscal developments since the November 2019 Economic and Fiscal Outlook</i>	<i>-0.8</i>
PBO February 2020 projection	-23.5

Source: Finance Canada and Parliamentary Budget Officer.

We are projecting \$340.9 billion in budgetary revenues in 2019-20, which is \$0.5 billion higher than our November outlook (Table 2-2). The upward revision reflects stronger-than-expected year-to-date personal income tax revenues and also accounts for the Government's EFU announcement to increase the Basic Personal Amount.⁶ Personal income tax revenues are \$1.2 billion higher compared to our November outlook.

Higher personal income tax revenues are partly offset by lower excise taxes and duties, particularly customs import duties reflecting a lower-than-anticipated effective tax yield following the removal of retaliatory tariffs on U.S. steel, aluminum and other products.

We are projecting \$340.9 billion in program expenses in 2019-20, which is \$3.1 billion higher than our November outlook. Higher program expenses are primarily due to an increase in operating expenses.

A key factor behind the increase in operating expenses is a higher estimated cost of pension and other future benefits earned by employees in 2019-20 based on new information on current service costs presented in the EFU. Direct program expenses also increased by \$0.9 billion due to additional policy measures announced in the Government's 2019 Economic and Fiscal Update.⁷

Table 2-2 Fiscal outlook for 2019-20

\$ billions	Current PBO Feb. 2020	Change	Prior PBO Nov. 2019	Finance Canada Dec. 2019	PBO vs. Finance
Income taxes					
Personal income tax	171.1	1.2	169.9	171.6	-0.5
Corporate income tax	49.3	-	49.3	46.8	2.5
Non-resident income tax	8.6	-	8.6	9.7	-1.1
Total income tax	229.0	1.2	227.8	228.0	1.0
Excise taxes/duties					
Goods and Services Tax	39.1	-0.2	39.2	39.6	-0.5
Custom import duties	5.5	-0.5	6.0	5.7	-0.2
Other excise taxes/duties	12.7	-	12.7	12.5	0.2
Total excise taxes/duties	57.3	-0.7	57.9	57.9	-0.6
Fuel charge proceeds⁸	2.8	-0.1	2.9	2.6	0.2
El premium revenues	22.7	-	22.7	22.6	0.1
Other revenues	29.1	-	29.1	29.0	0.1
Total budgetary revenues	340.9	0.5	340.4	340.1	0.8
Major transfers to persons					
Elderly benefits	56.2	0.1	56.1	56.1	0.1
Employment Insurance	19.6	-	19.6	19.3	0.3
Children's benefits	24.2	-	24.2	24.1	0.1
Total	100.0	0.1	99.9	99.5	0.5
Major transfers to other levels of government					
Canada Health Transfer	40.4	-	40.4	40.4	-
Canada Social Transfer	14.6	-	14.6	14.6	-
Equalization	19.8	-	19.8	19.8	-
Territorial Formula Financing	3.9	-	3.9	3.9	-
Gas Tax Fund	2.2	-	2.2	2.2	-
Home care and mental health	1.1	-	1.1	1.1	-
Other fiscal arrangements	-3.3	-	-3.3	-5.7	2.4
Total	78.7	-	78.7	76.3	2.4
Direct program expenses					
Fuel charge proceeds	3.4	-0.2	3.6	3.0	0.4
Transfer payments ⁹	54.2	0.3	54.0	55.8	-1.6
Operating and capital expenses	94.0	2.9	91.1	95.4	-1.4
Employee future benefit plan losses	10.5	-	10.5	10.8	-0.3
Total direct program expenses	162.1	3.0	159.1	165.1	-3.0
Total program expenses	340.9	3.1	337.7	340.8	0.1
Public debt charges	23.5	-0.3	23.8	24.4	-0.9
Total expenses	364.3	2.8	361.5	365.2	-0.9
Budgetary balance	-23.5	-2.3	-21.1	-26.6	3.1

Sources: Finance Canada and Parliamentary Budget Officer.

Notes

1. Available at: <https://www.pbo-dpb.gc.ca/en/blog/news/RP-1920-022-S--economic-and-fiscal-outlook--perspectives-economiques-financieres-nov-2019>
2. For example, a strike by the United Auto Workers in the United States resulted in Canadian plants lowering their production as well as a temporary decline in wholesale trade. See: <https://www150.statcan.gc.ca/n1/daily-quotidien/191223/dq191223a-eng.htm>

A rail transport strike contributed to lower export shipments, particularly for energy products which were also weakened by a pipeline rupture. See: <https://www150.statcan.gc.ca/n1/daily-quotidien/200107/dq200107a-eng.htm>

3. The impact of the coronavirus on the Canadian economy could be different than the SARS experience. Unlike the SARS outbreak in 2003, Canada is not one of the countries most affected by the coronavirus, which suggests the impact on travel and accommodation industries could be smaller. The medical community is also better prepared to deal with the coronavirus than it was during SARS.

That said, China is much more important to the global economy than in 2003. Disruptions to China's production could cause wide-ranging shortages and delays in global supply chains. Faster transmission of information through social media could also cause larger negative impacts on consumer and business confidence.

We assume that the coronavirus will reduce real GDP growth by 0.34 percentage points in the first quarter of 2020 through direct (e.g., air transportation, accommodations) and indirect (e.g., supply chain disruptions, commodity prices, confidence) channels. This assumption is informed by our estimate of the direct impact on the air transportation and accommodation sectors during the SARS outbreak in 2003.

Our assumption is consistent with Scotiabank's estimate of the possible impact of the coronavirus on the Canadian economy. See: https://www.scotiabank.com/content/dam/scotiabank/sub-brands/scotiabank-economics/english/documents/insights-views/2020-01-27_I&V.pdf

4. Current spot prices as of 7 February 2020.
5. For the year as a whole, nominal GDP growth in 2019 is estimated to be 3.4 per cent. This reflects annual real GDP growth of 1.6 per cent and GDP inflation of 1.7 per cent.

On a fiscal-year basis, our outlook for the level of nominal GDP in 2019-20 is \$8 billion (0.3 per cent) lower compared to our November outlook.

6. PBO estimates the increase in the Basic Personal Amount will decrease personal income tax revenues by \$783 million in 2019-20. See: https://www.pbo-dpb.gc.ca/web/default/files/Documents/LEG/LEG0001/LEG0001_en.pdf
7. PBO's 2019-20 estimate includes all new measures up to and including the Government's 2019 Economic and Fiscal Update, adjusted for PBO's internal estimate for the cost of increasing the Basic Personal Amount tax credit and PBO's internal estimate of the impact of fuel charge proceeds and output-based pricing system (OBPS).
8. The fuel charge proceeds estimate includes PBO's revenue and expense assumptions associated with the OBPS.
9. The \$1.9 billion expense for the Hibernia Dividend Backed Annuity Agreement with Newfoundland and Labrador is categorized as an other fiscal arrangement in our projection and as a transfer payment in direct program expenses in the EFU. The categorization differences have no effect on overall expenses or the budgetary balance.