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

PRE-BUDGET OUTLOOK

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www.pbo-dpb.gc.ca

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.

Projections presented in this report include only fiscal measures that have been announced prior to Budget 2015. PBO will update its economic and fiscal projections for new measures in the 2015 budget and provide related analysis in a future report. Projections presented in this report are based on data up to and including April 10, 2015.

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Correction notice: the Pre-Budget Outlook published 17 April 2015 has been revised to correct a model error in the Public Accounts projection of Children's benefits that increases the budgetary balance by $1.4 billion per year, on average, over 2015-16 to 2019-20. Typographical errors in Table 3-6 and Table 3-7 have also been corrected.

Any errors or omissions are the responsibility of the authors. We thank PBO colleagues for helpful comments and assistance in preparing this report.
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SUMMARY

PBO provides the Standing Committee on Finance with an economic and fiscal outlook in April and October. Given the timing of the Government's budget this year, PBO is providing the Committee with a pre-budget economic and fiscal outlook, which is constructed on a status quo basis. That is, it shows what the Government's budgetary position would be under PBO's current economic outlook, including only fiscal measures that have been announced prior to Budget 2015. PBO will update its outlook for new budget measures and provide related analysis in a future report.

In the absence of new policy measures, PBO projects that the Government's budget would be in surplus in 2014-15 and roughly balanced over the remainder of the outlook. PBO projects that the federal debt ratio will continue to decline over the medium term, on track to meet the Government's commitment to reduce federal debt to 25 per cent of gross domestic product (GDP) by 2021.

Status Quo Fiscal Outlook

$ billions

	2014-2015	2015-2016	2016-2017	2017-2018	2018-2019	2019-2020
Budgetary revenues	279.4	289.9	300.4	308.4	320.9	332.9
Program expenses	249.0	263.7	273.1	280.9	291.0	297.9
Public debt charges	27.0	25.1	25.5	28.2	30.6	32.7
Budgetary balance	3.4	1.2	1.8	-0.8	-0.7	2.2
Federal debt	608.5	607.3	605.5	606.3	607.0	604.8
% of GDP						
Budgetary revenues	14.1	14.5	14.4	14.2	14.2	14.2
Program expenses	12.6	13.2	13.0	12.9	12.9	12.7
Public debt charges	1.4	1.3	1.2	1.3	1.4	1.4
Budgetary balance	0.2	0.1	0.1	0.0	0.0	0.1
Federal debt	30.8	30.4	28.9	27.9	26.9	25.8

Source: Parliamentary Budget Officer.

The status quo fiscal outlook is based on PBO's current economic outlook which, consistent with recent futures prices, assumes that crude oil prices increase gradually over the medium term from around US$50 per barrel for West Texas Intermediate (WTI) to US$66 per barrel by the end of 2020.

PBO projects that real GDP growth will slow from 2.5 per cent in 2014 to 2.0 per cent in 2015 and then average 1.8 per cent over 2016-2020. Although real GDP growth is projected to be relatively stable over the medium term, the overall outlook masks a significant rebalancing in the Canadian economy, with the composition of growth shifting away from consumer spending and housing to exports and business investment.

Economic Outlook

% unless indicated otherwise

	2014	2015	2016	2017	2018-2020
Real GDP growth	2.5	2.0	2.1	1.8	1.8
GDP inflation	1.8	-0.8	2.5	2.1	2.0
Nominal GDP ($ billions)	1,976	2,000	2,093	2,175	2,347

Sources: Statistics Canada, Parliamentary Budget Officer.

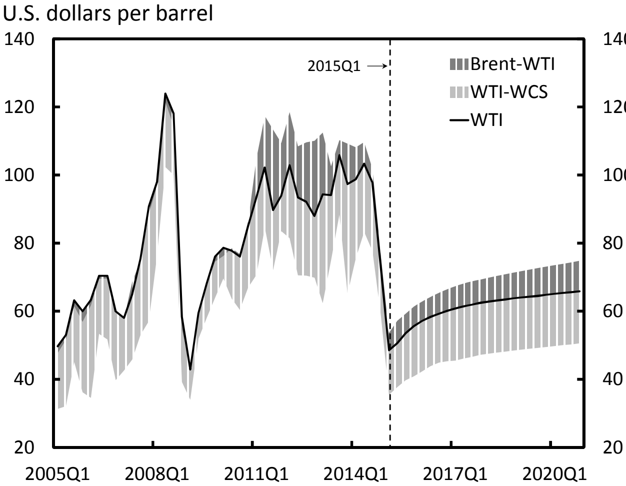
As a result of the decline in oil prices, PBO expects Canada's terms of trade (export prices relative to import prices) to deteriorate by 8.5 per cent in 2015Q2 (year-over-year). This decline results in lower economy-wide prices as measured by the GDP deflator and is estimated to reduce nominal GDP by $66 billion annually, on average, over 2015-2019.

PBO has simulated the impact of lower oil prices on the Canadian economy using its macroeconomic model. The results indicate that the impact on real GDP is ultimately negative, albeit relatively modest, reducing real GDP by 0.4 per cent in 2016 and 0.5 per cent in 2017. However, real gross domestic income (GDI), which measures domestic purchasing power and is a more relevant indicator of economic well-being, is estimated to decline by 2.6 per cent annually, on average, over 2015-2019.

1 ECONOMIC IMPACTS OF LOWER OIL PRICES

Crude oil prices have fallen sharply from around US$100 per barrel for West Texas Intermediate (WTI) in the second quarter of 2014 to US$49 per barrel in the first quarter of 2015. Analysis conducted by International Monetary Fund (IMF) staff and the Bank of Canada suggests that supply factors, such as the "shale revolution" in the U.S. and the Organization of the Petroleum Exporting Countries (OPEC) decision to maintain production targets despite falling prices, are primarily responsible for the decline in oil prices. Based on recent futures prices, PBO assumes that WTI oil prices will increase gradually to US$66 per barrel by the end of 2020 (Figure 1-1).[1]

Figure 1-1: WTI oil prices and Brent, WCS differentials



Sources: Baytex Energy Corp, CME Group, Bloomberg L.P., Parliamentary Budget Officer.
Note: WTI refers to West Texas Intermediate; WCS refers to Western Canadian Select.

To construct its estimates of the impacts of lower oil prices on the Canadian economy, PBO first simulates its macroeconomic model under the assumption that oil prices would have remained at their 2014Q2 level.[2] The model is then simulated again using the path of oil prices projected in Figure 1-1. Estimates presented in Table 1-1 are based on the assumption that the decline in oil prices stems mainly from supply factors and that there is no monetary or fiscal policy response. Moreover, these estimates are based on model simulations and broadly represent economic responses consistent with historical experience. As such, the actual impact on the Canadian economy could differ both in terms of its timing and magnitude.[3]

Table 1-1: Economic impacts of lower oil prices based on model simulation results

% and $ billions difference

	2014	2015	2016	2017	2018	2019
Real GDP (%)	0.1	0.4	-0.4	-0.5	-0.3	-0.3
GDP deflator (%)	-0.5	-3.3	-2.9	-2.6	-2.5	-2.4
Real GDI (%)	-0.3	-2.3	-2.9	-2.8	-2.6	-2.4
Nominal GDP ($)	-8	-61	-70	-69	-66	-64
WTI oil price ($)	*-9*	*-51*	*-45*	*-42*	*-40*	*-39*

Source: Parliamentary Budget Officer.
Note: Model simulations begin in 2014Q3.

PBO's simulations indicate that the impact of lower oil prices on the Canadian economy is ultimately negative, albeit relatively modest. The impact on real gross domestic product (GDP), however, masks significant adjustments across the household, business and trade sectors of the economy.

Simulation results indicate that the initial impacts are also modest yet positive with real GDP increasing by 0.1 and 0.4 per cent in 2014 and 2015, respectively. Although lower oil prices lead to lower business investment—initially and over the medium term—the ensuing depreciation in the Canadian dollar provides a boost to non-energy exports and reduces imports, which initially more than offsets this negative impact.[4] However, as household income and wealth deteriorate over time, consumer

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[1] Projected oil prices are based on average futures prices from March 20, to April 10, 2015.

[2] PBO uses the Bank of Canada's commodity price framework, first presented in the April 2011 Monetary Policy Report, to identify the channels through which a change in oil prices affects the Canadian economy. See Box 1 in *Fiscal Impacts of Lower Oil Prices* available at: http://www.pbo-dpb.gc.ca/files/files/LowOilPrices_EN.pdf.

[3] Indeed, in its January 2015 *Monetary Policy Report*, the Bank of Canada noted that "Given the speed and magnitude of the oil-price decline, there is substantial uncertainty around the likely level for oil prices and their impact on the economic outlook for Canada."

[4] Model simulations are based on the assumption that any reduction in oil sector production and energy exports is offset by increased demand for Canada's non-energy exports resulting from the boost to U.S. economic activity provided by lower oil prices.

spending and residential investment decline, reducing real GDP by 0.4 and 0.5 per cent in 2016 and 2017, respectively.

In contrast, the impact on economy-wide prices, as measured by the GDP deflator, is stark. The decline in oil prices lowers Canada's terms of trade (export prices relative to import prices) by 9 per cent, on average, over 2015-2019, driving economy-wide prices down by 3.3 and 2.9 per cent in 2015 and 2016, respectively. Consequently, nominal GDP is reduced by $66 billion annually, on average, over 2015-2019.

While real GDP measures the volume of production in Canada, real gross domestic income (GDI) measures the domestic purchasing power of income generated by production and is a more relevant indicator of economic well-being than real GDP.[5] In line with the impact on the GDP deflator, the sharp decline in the terms of trade reduces real GDI by 2.6 per cent annually, on average, over 2015-2019.

PBO's model is constructed at the national level and therefore cannot provide a regional breakdown. Given the uneven distribution of oil production in Canada, the economic impacts would vary significantly across regions.

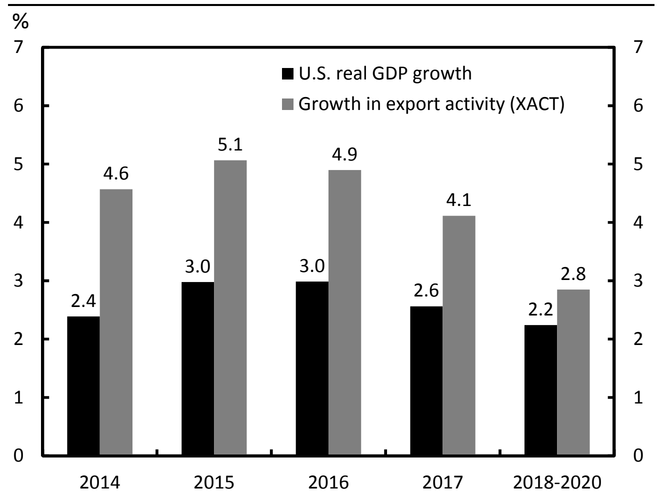
2 THE ECONOMIC OUTLOOK

2.1 The external environment

U.S. real GDP grew by 2.2 per cent in the last quarter of 2014 following robust growth in the second and third quarter. Continued solid employment gains as well as low interest rates and oil prices are expected to support domestic demand in the near term but export growth will be restrained somewhat by the stronger U.S. dollar and modest recovery in global activity. PBO projects U.S. real GDP to grow by 3 per cent annually in 2015 and 2016 before settling around 2.2 per cent toward the end of the projection period (Figure 2-1).

The composition of U.S. growth is expected to be highly favourable for Canadian exporters. Robust consumer spending and the fading impact of government tightening in the U.S. are expected to boost demand and spur business investment as firms increase their productive capacity. U.S. business investment is relatively high in terms of import content, which should help bolster Canadian non-energy export performance. PBO's export activity measure ("XACT") is constructed to capture the composition of U.S. demand and is projected to outpace U.S. real GDP growth over the projection period.[6]

Figure 2-1: Growth in U.S. real GDP and export activity



Sources: Bureau of Economic Analysis; Parliamentary Budget Officer.

As the U.S. economy strengthens, PBO assumes that the Federal Reserve will gradually increase the target federal funds rate beginning in September 2015, reaching its assumed neutral rate of 3.7 per cent by mid-2018. PBO expects a smooth normalization in U.S. monetary policy during which trade gains to Canada from a stronger U.S. economy offset spillovers from higher U.S. long-term interest rates.

Based on the April 2015 IMF World Economic Outlook, moderate growth is expected in advanced economies in the near term supported by low official interest rates, the fading impact from government tightening and cheaper oil. Emerging market

[5] In nominal terms, GDP is equivalent to GDI. PBO calculates real GDI as nominal GDP divided by the price deflator for final domestic demand.

[6] PBO's activity measure for Canadian non-energy exports is constructed by weighting U.S. GDP expenditure components by their relative import propensities.

economies are expected to grow at slower rate than in recent years but still account for the majority of global growth in the near term.

2.2 Outlook for the Canadian economy[7]

The decline in oil prices that began in July 2014 appears to have coincided with a rebalancing and recovery in the Canadian economy that was under way, with the composition of economic growth shifting away from household spending towards exports and business investment. PBO estimates that the output gap (real GDP relative to potential output) narrowed from -1.1 per cent in the first quarter of 2014 to -0.2 per cent in the fourth quarter. PBO expects real GDP growth in the first quarter of 2015 (0.5 per cent) to fall short of growth in potential output (1.9 per cent). The expected first-quarter weakness largely reflects PBO's assumption that given the speed and magnitude of the decline in oil prices, business investment will respond more quickly, as a result of increased uncertainty, than suggested by the model simulation results shown in Table 1-1.[8]

PBO projects that real GDP growth will slow from 2.5 per cent in 2014 to 2.0 per cent in 2015 and then average 1.8 per cent over 2016-2020 (Table 2-1). Although real GDP growth is projected to be relatively stable over the medium term, the headline growth outlook masks a significant rebalancing in the Canadian economy with the composition of growth shifting away from consumer spending and housing to exports and business investment. On balance, the shock to the terms of trade from lower oil prices hinders the rebalancing process as the expected pick up in business investment is delayed.

Table 2-1: Canadian economic outlook

Contributions to real GDP growth

Percentage points	2014	2015	2016	2017	2018-2020
Consumption	1.5	1.1	0.9	0.9	1.0
Housing	0.2	0.0	-0.1	0.1	0.1
Business investment	0.0	-0.2	0.3	0.4	0.4
Government	0.0	-0.1	-0.1	-0.2	0.1
Exports	1.7	1.8	2.0	1.3	1.0
Imports	-0.5	-0.2	-0.6	-0.9	-0.9
Inventory investment	-0.3	-0.4	-0.2	0.2	0.1
Real GDP growth	2.5	2.0	2.1	1.8	1.8
Additional indicators, %					
GDP inflation	1.8	-0.8	2.5	2.1	2.0
Real GDI growth	2.2	-0.4	2.5	1.9	1.8
Nominal GDP growth	4.4	1.2	4.6	3.9	3.8

Sources: Statistics Canada, Parliamentary Budget Officer.
Note: Consumption includes spending by non-profit institutions serving households. The contribution to growth from the statistical discrepancy (assumed to equal zero over the projection horizon) is not shown.

PBO projects that growth in consumer spending will moderate from its recent pace as households adjust to reduced income and wealth gains as a result of the deterioration in the terms of trade and ultimately increase their savings rate, returning household debt-to-income to below current levels. As growth in household income slows and interest rates rise from low levels, residential investment is projected to decline through the first half of 2016 and remain moderate thereafter, returning the share of residential investment in the economy to more sustainable levels.

[7] PBO has recently expanded its macroeconomic model to explicitly include the household, business, government and trade sectors of the economy. In addition, PBO has changed its approach to estimating trend labour productivity, which combined with trend labour input determines potential output. These changes will be described in more detail in a forthcoming technical report.

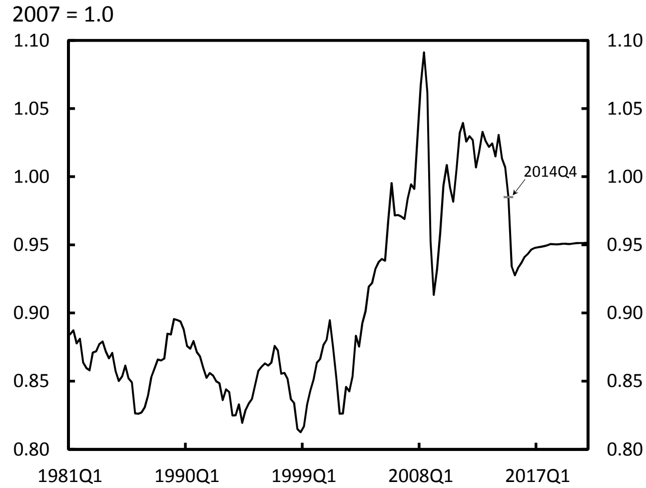
[8] The balance of opinion (the percentage of firms expecting higher investment minus the percentage expecting lower investment) fell sharply in the Bank of Canada's Winter 2014-15 *Business Outlook Survey* and continued to decline in the Spring 2015 survey, reaching its lowest level since the third quarter of 2009. The spring survey also indicated that weakness in investment intentions was "often associated with higher levels of uncertainty".

Business investment is expected to decline sharply in the near term in response to the drop in oil prices but recover over the medium term as export growth picks up and remains solid. Exports are expected to be a key growth driver over the medium term as the composition of U.S. activity remains favourable and the Canadian dollar stabilizes near current levels. Although the lower Canadian dollar helps to shift spending away from imports towards domestically-produced goods and services, the recovery in investment spending, which itself is relatively high in imported content, supports import growth. Inventory investment is expected to subtract from real GDP growth in 2015 and 2016 as firms moderate increases in production and draw down inventories to meet demand.

Based on federal and provincial budgets, PBO projects that government spending on goods and services, as well as investment, will decline through 2017. Over the medium term, subnational government expenditure is assumed to grow in line with population growth and federal expenditure is based on the Government's projected operating expenses.

PBO expects the terms of trade to decline by 19 per cent and 3 per cent (at annual rates) in the first and second quarter of 2015, respectively. These declines would result in a deterioration of 8.5 per cent in Canada's terms of trade relative to 2014Q2 levels (Figure 2-2). The decline in the terms of trade results in lower economy-wide prices as measured by the GDP deflator. Consequently, GDP inflation is projected to be -0.8 per cent in 2015, rebounding somewhat to 2.5 per cent in 2016 as energy prices increase, before stabilizing around 2.0 per cent. Growth in nominal GDP (a broad measure of the Government's tax base) is expected to fall to 1.2 per cent in 2015 and then average 4 per cent growth annually over 2016-2020. Real GDI is projected to decline in 2015 by 0.4 per cent and average 2 per cent growth annually thereafter.

Figure 2-2: Canada's terms of trade



Sources: Statistics Canada, Parliamentary Budget Officer.

PBO projects that the Canadian economy will continue to operate slightly below its productive capacity, or potential output, through 2017 as the labour market underperforms relative to its trend (that is, a negative labour input gap). Thereafter, PBO projects that the output gap will remain essentially closed as real GDP grows in line with potential output. Growth in potential output is projected to remain relatively stable at around 1.8 per cent as slower growth in trend labour input (total hours worked) is largely offset by faster trend labour productivity growth.

Table 2-2: Projected growth in potential output

%

	2014	2015	2016	2017	2018-2020
Potential output	1.9	1.8	1.8	1.8	1.7
Trend labour input	0.9	0.7	0.7	0.6	0.4
Trend labour productivity	1.0	1.1	1.1	1.2	1.3
Output gap (level)	-0.5	-0.3	0.0	-0.1	0.0
Labour input gap (level)	-0.7	-0.7	-0.3	-0.2	-0.1

Source: Parliamentary Budget Officer.
Note: The output gap is calculated as the percentage difference bewteen real GDP and potential output. The labour input gap is calculated as the percentage difference between total hours worked in the economy and its estimated trend.

PBO projects that the unemployment rate will remain elevated (above its estimated trend) in 2015 and 2016 and gradually converge to trend by the end of 2018. The participation rate is expected to continue to decline over the projection horizon, primarily as the baby-boom cohort continues its transition into retirement. Employment growth is projected to edge higher in 2015 and 2016 but remain below growth in the source population, resulting in a decline in the employment rate. Average weekly hours worked are expected to increase only slightly from current levels as the economy reaches its level of potential output.

Table 2-3: Labour market indicators

% unless indicated otherwise

	2014	2015	2016	2017	2018-2020
Unemployment rate	6.9	6.8	6.6	6.5	6.3
Participation rate	66.0	65.7	65.5	65.2	64.4
Employment growth	0.6	0.7	0.8	0.6	0.3
Average hours worked (hours per week)	33.9	33.9	34.0	34.0	34.1

Sources: Statistics Canada, Parliamentary Budget Officer.

Monetary policy is expected to remain highly accommodative over the projection horizon, which should help facilitate rebalancing in the Canadian economy and the adjustment to the lower terms of trade. PBO projects that the Bank of Canada will gradually increase its policy rate from current levels beginning in the fourth quarter of 2016. With short-term interest rates in Canada remaining below U.S. levels, this puts downward pressure on the exchange rate essentially balancing the upward pressure from rising oil prices. As a result, the Canadian dollar is expected to remain near current levels, averaging around 80 cents U.S. over the entire projection horizon. 10-year Government of Canada benchmark bond rates are expected to move higher in line with U.S. long-term rates and increases in short-term rates in Canada.

Table 2-4: Interest and exchange rates

% unless indicated otherwise

	2014	2015	2016	2017	2018-2020
3-month treasury bill rate	0.9	0.7	0.8	1.8	2.8
10-year benchmark bond rate	2.2	1.8	2.6	3.3	4.3
Exchange rate (US cents/CAN$)	90.5	80.0	80.2	80.0	79.7

Sources: Statistics Canada, Parliamentary Budget Officer.

2.3 Key risks to the economic outlook

PBO judges that the risks to its economic outlook are roughly balanced. In terms of downside risks, PBO believes that the most important risk is weaker non-energy export performance. Although the outlook should be highly favourable for Canadian non-energy exports going forward, reduced productive capacity and/or competitiveness issues could result in a weaker-than-expected performance. In terms of upside risks, PBO believes that the most important risk is that government spending and investment are stronger than suggested by federal and provincial budget plans to date. Higher-than-expected current and capital expenditure by governments over 2015-2017 could push the economy closer to its potential and also raise its productive capacity by increasing the (non-residential) capital stock.

3 FISCAL OUTLOOK

The budget will be in surplus in 2014-15. The surplus that was previously forecast over the 5-year outlook has been eliminated by a combination of policy announcements and the impact of lower oil prices on nominal tax bases (Table 3-1).

Under PBO's status quo forecast, a small surplus is expected in 2015-16 and 2016-17 with revenues growing faster than total expenses. Small deficits are expected in 2017-18 and 2018-19. The deterioration is a result of the decrease in the 2017 Employment Insurance premium rates required to eliminate the balance in the operating account that was accumulated by the 2015 and 2016 rate freeze. The budget returns to balance in 2019-10.

The deficits in the later years of the outlook are immaterial for the sustainability of public debt and negligible as a share of the overall economy.[9] The Government's target of balanced budgets could be achieved with only minor tax changes or spending restraint. The deficits are also within the requirements to achieve the Government's 25 per cent debt-to-GDP target.

Table 3-1: Summary outlook

$ billions

	2014-2015	**2015-2016**	**2016-2017**	**2017-2018**	**2018-2019**	**2019-2020**
Budgetary revenues	279.4	289.9	300.4	308.4	320.9	332.9
Program expenses	249.0	263.7	273.1	280.9	291.0	297.9
Public debt charges	27.0	25.1	25.5	28.2	30.6	32.7
Budgetary balance	3.4	1.2	1.8	-0.8	-0.7	2.2
Federal debt	608.5	607.3	605.5	606.3	607.0	604.8
% of GDP						
Budgetary revenues	14.1	14.5	14.4	14.2	14.2	14.2
Program expenses	12.6	13.2	13.0	12.9	12.9	12.7
Public debt charges	1.4	1.3	1.2	1.3	1.4	1.4
Budgetary balance	0.2	0.1	0.1	-0.0	-0.0	0.1
Federal debt	30.8	30.4	28.9	27.9	26.9	25.8

Source: Parliamentary Budget Officer.

3.1 Year-to-date performance

PBO estimates that the budget will be in surplus in 2014-15, barring any adverse year-end accounting or accruals adjustments (Table 3-2).[10]

Table 3-2: In-year estimate for 2014-15

$ billions

	2013-2014	Growth (%)	PBO estimate	EFP 2014
Personal income tax	130.8	2.6	134.2	134.2
Corporate income tax	36.6	5.9	38.8	38.3
Non-residents income tax	6.4	-5.5	6.1	6.4
GST	31.0	3.1	31.9	31.8
Customs	4.2	6.3	4.5	4.5
Other excise duties	10.9	4.2	11.4	11.5
EI premiums	21.8	3.3	22.5	22.6
Other revenues	30.0	0.0	30.0	28.3
Total revenues	271.7	1.6	279.4	277.6
Elderly benefits	41.8	4.3	43.6	43.9
EI benefits	17.3	1.7	17.6	17.6
Children's benefits	13.1	8.4	14.2	14.5
Transfers to governments	60.5	3.9	62.7	62.6
Direct program expenses	115.9	-4.4	110.8	114.1
Public debt charges	28.2	-4.4	27.0	27.7
Total expenses	276.8	-0.3	276.0	280.5
Budgetary balance	**-5.1**		**3.4**	**-2.9**

Source: Parliamentary Budget Officer.

Budgetary revenues in 2014-15 are expected to be roughly the same as the Government expected in its 2014 *Update of Economic and Fiscal Projections* (EFP). Customs duty is expected to grow in 2014-15 with the removal of tariff preferences announced in Budget 2013, but is otherwise on a long-term declining trend. Non-residents income tax declined and other revenues were flat as a result of one-time windfalls in the previous year, but are otherwise growing as expected.

Year-to-date transfers to persons and other levels of government are consistent with forecasts; however, direct program expenses are expected to lapse again by around $3 billion more than budgeted. Total expenses are expected to fall in 2014-15. This is due to both program spending restraint, as well as lower public debt charges resulting from lower effective interest rates.

[9] PBO's Fiscal Sustainability Report 2014 estimated that the Government could introduce permanent tax reductions or spending increases amounting to $28.2 billion in 2014 while maintaining a stable path of debt-to-GDP over the long run. The Government introduced subsequent measures amounting to $5 billion of this room.

[10] This is based on ten of twelve months of Fiscal Monitor data, which have been annualised and adjusted for policy measures, irregular revenues, the economic cycle, and the expected value of year-end adjustments and one-time factors.

Since its peak in 2009-10, the deficit has fallen by over $50 billion. The main contributions to the fiscal consolidation have been rising personal income tax revenues, the Government's control of direct program expenses, and lower-than-expected interest rates on public debt. If there are no significant year-end surprises, the Government will achieve its target of a reduction in direct program expenses in 2014-15. This will be the fifth consecutive year that direct program expenses have declined. This sustained restraint has never been achieved in records dating back to 1966-67.

3.2 Policy decisions

Following PBO's October 2014 outlook, the Government announced a package of benefits and tax credit changes targeted at families with children.

The measures are expected to increase revenues from personal income taxes by an average of $0.4 billion per year from 2015-16 and beyond, and increase program expenses by $5.2 billion per year over the outlook (Table 3-3). Because Employment Insurance premiums are set in order to balance the notional operating account over time, the Small Business Job Credit will be revenue neutral.

Table 3-3: Fiscal impact of announced measures

$ billions

	2014-2015	2015-2016	2016-2017	2017-2018	2018-2019	2019-2020
Personal income taxes						
Family tax cut	-2.4	-1.9	-2.0	-2.1	-2.1	-2.2
Eliminate Child Tax Credit	0.4	1.8	1.9	1.8	1.8	1.9
PIT on taxable UCCB	0.1	0.6	0.6	0.6	0.6	0.6
Making CFTC refundable	0.1	0.1	0.1	0.1	0.1	0.1
Increase in CCED	-0.0	-0.1	-0.1	-0.1	-0.1	-0.1
Total	-1.8	0.4	0.4	0.4	0.4	0.4
Employment Insurance						
Small Business Job Credit	-0.1	-0.3	-0.2	0.2	0.1	0.1
Program spending						
Expanding UCCB	-1.2	4.9	5.0	5.0	5.0	5.1
Making CFTC refundable	0.1	0.1	0.1	0.1	0.1	0.1
Doubling CFTC	0.0	0.0	0.0	0.0	0.0	0.0
Total	1.4	5.1	5.1	5.2	5.2	5.2

Source: Finance Canada.
Note: UCCB = Universal child care benefit, CFTC = Children's fitness tax credit, CCED = Child Care Expense Deduction.

On April 6, 2015 the Government sold its remaining shares in General Motors for an estimated $3.3 billion (CAD) against a book value of $1.1 billion. As the fiscal plan for 2015-16 already budgeted for asset sales of $1.2 billion, the contribution to the budgetary balance is only the gain in excess of this amount, which is expected to be roughly $1 billion.

3.3 The outlook for 2015-16 to 2019-20

PBO projects that under current policy, revenues will increase from $289.9 billion in 2015-16 to $332.9 billion by the end of the outlook. However, as a share of GDP, revenues are projected to fall from 14.5 per cent in 2015-16 to 14.2 per cent in 2019-20, which are among the lowest levels in records to 1966-67.

Table 3-4: The outlook for revenues

$ billions

	2015-2016	2016-2017	2017-2018	2018-2019	2019-2020
Income taxes					
Personal income tax	142.5	148.9	155.4	162.5	170.2
Corporate income tax	33.6	37.4	39.1	40.5	41.3
Non-residents income tax	6.2	6.7	6.9	7.2	7.5
Total	182.3	193.1	201.4	210.2	219.0
Excise taxes/duties					
Goods and Services Tax	33.6	34.7	35.9	37.1	38.5
Customs import duties	4.8	4.6	4.7	5.0	5.2
Other excise taxes/duties	11.5	11.5	11.4	11.4	11.3
Total excise taxes/duties	49.9	50.8	52.0	53.5	55.0
EI premium revenues	23.6	22.9	19.7	20.4	20.6
Other revenues	34.1	33.7	35.1	36.8	38.2
Total budgetary revenues	289.9	300.4	308.4	320.9	332.9

Source: Parliamentary Budget Officer.

Under the status quo spending plan, PBO forecasts that program expenses will increase from $263.7 billion in 2015-16 to $297.9 billion by the end of the outlook. As a share of GDP, this is a decline from 13.2 per cent to 12.7 per cent.

Table 3-5: The outlook for expenses

$ billions

	2015-2016	2016-2017	2017-2018	2018-2019	2019-2020
Major transfers to persons					
Elderly benefits	45.8	48.5	51.2	54.1	57.3
EI benefits	18.3	19.3	19.9	20.3	20.4
Children's benefits	18.3	18.5	18.7	19.0	19.3
Total	82.4	86.2	89.8	93.4	97.0
Transfers to other levels of government	65.5	68.4	70.5	72.6	75.3
Direct program expenses	115.8	118.5	120.6	125.0	125.6
Public debt charges	25.1	25.5	28.2	30.6	32.7
Total expenses	288.8	298.6	309.1	321.7	330.7

Source: Parliamentary Budget Officer.

3.4 EI Operating Account and premium rates

PBO's latest forecast for breakeven rates is given in Table 3-6. The forecast breakeven rate for 2015 has been reduced relative to PBO's October outlook as a result of lower monthly unemployment and the latest administration data.

Table 3-6: EI Operating Account and premium rates

dollars per $100 of insurable earnings, unless noted

	2015-2016	2016-2017	2017-2018	2018-2019	2019-2020
Premium revenues ($B)	23.6	22.9	19.7	20.4	20.6
Benefits	18.3	19.3	19.9	20.3	20.4
Administration expenses	1.7	1.7	1.8	1.8	1.9
Balance	3.6	1.9	-2.1	-1.7	-1.6
	2015	2016	2017	2018	2019
Rate (EFP 2014)	1.88	1.88	1.47	1.47	1.47
Rate (breakeven forecast)	1.66	1.59	1.58	1.58	1.57
Difference	0.22	0.29	-0.11	-0.11	-0.10

Sources: Parliamentary Budget Officer, Update of Economic and Fiscal Projections 2014.

The setting of the EI premium rate in 2015 and 2016 continues to be a concern. The rate freeze was presented as necessary to avoid further increases, although lower breakeven rates were forecast by Finance Canada at the time.[11] This acted against the Government's objective of ensuring EI premiums are set transparently and used only for EI benefits and administration expenses. In effect, much of the immediate fiscal room for the recent tax and spending measures is available only by ignoring these objectives.

Further, because of the surplus that will accumulate in the operating account over 2015 and 2016, the required rate change to move to the 7-year breakeven framework in 2017 is much larger than would have been required had the rate not been frozen. This acts against the Government's objective of providing stability for businesses and employees.

3.5 The structural budget balance

The budgetary outlook is the product of both the Government's tax and spending policies and the economic environment. To assess the Government's underlying financial position, it can be useful to remove the effects of the economic cycle and one-time irregular transactions by calculating the Government's *structural* budget balance. The structural balance is the difference between the revenues and expenses that would be realized if the economy were operating at potential output, net of any contributions of irregular revenues such as large asset sales and temporary contributions of EI operating account surpluses, or expenses such as flood assistance for natural disasters.[12] After adjustment, surpluses are larger and persist until 2019-20 (Table 3-7).

Table 3-7: Outlook for the structural balance

$ billions

	2014-2015	2015-2016	2016-2017	2017-2018	2018-2019	2019-2020
Budgetary balance	3.4	1.2	1.8	-0.8	-0.7	2.2
Adjustments:						
Economic cycle	2.8	6.5	3.5	2.2	0.7	0.1
Sale of GM shares		-2.2				
EI account	0.0	-3.6	-1.9	2.1	1.7	1.6
Structural balance	6.2	1.9	3.4	3.5	1.7	3.9

Source: Parliamentary Budget Officer.

3.6 The Government's fiscal targets

Budgetary balance. Projected status quo budget deficits are small and do not threaten the wider economy or fiscal sustainability. The Government has mostly achieved its fiscal consolidation targets following countercyclical fiscal policy during the global financial crisis.

The Government has stated that the fiscal plan in Budget 2015 will be balanced; this will be readily achievable with minor changes to tax policy or the spending plan.

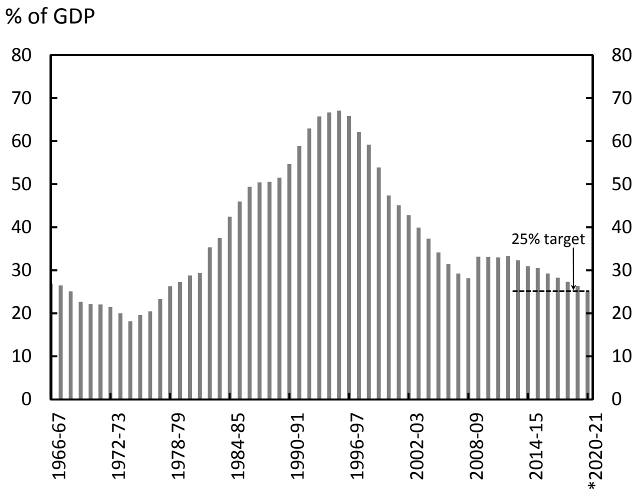
Debt-to-GDP ratio. Even if small deficits are realized under the status quo forecast, federal debt will shrink as a share of GDP. Barring any unforeseen economic or fiscal crisis, the Government will

[11] See for example, Update of Economic and Fiscal Projections 2013 (http://www.fin.gc.ca/efp-pef/2013/pdf/efp-pef-13-eng.pdf). The problems associated with the EI rate for 2015 and 2016 are discussed further in PBO's October 9, 2014 report *Response on the Financing of Employment Insurance and Recent* Measures, available at http://www.pbo-dpb.gc.ca/files/files/EI_response_EN.pdf

[12] PBO's structural balance also accounts for terms of trade or "trading gain" effects (see http://www.pbo-dpb.gc.ca/files/files/Publications/Potential_CABB_EN.pdf). PBO adjusts all major tax revenues, as well as Employment Insurance benefits expenses.

achieve its target of an accumulated deficit of 25 per cent of GDP in 2020-21 (Figure 3-1).

Figure 3-1: Declining federal debt-to-GDP ratio



Source: Parliamentary Budget Officer.
Note: The federal debt-to-GDP ratio in 2020-21 is based on the assumption of a balanced budget in 2020-21.