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ECONOMIC AND FISCAL SNAPSHOT 2020: ISSUES FOR PARLIAMENTARIANS

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 identifies key issues arising from the Government's Economic and Fiscal Snapshot published on 8 July 2020.

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Summary

To assist parliamentarians in their budgetary deliberations, this report identifies key issues arising from the Government's Economic and Fiscal Snapshot (EFS) published on 8 July 2020.

Economic outlook

The annual outlook for 2020 in the EFS is very much in line with the June 18 PBO economic scenario. Both show a decline of 6.8 per cent in real GDP in 2020. The private sector forecast of nominal GDP—the broadest measure of the Government's tax base—is only $9 billion (0.4 per cent) lower than PBO assumed in its June 18 scenario.

Based on the average private sector forecast in the EFS, the economic downturn in the second quarter will not be as steep, and the recovery in the second half of the year will not be as strong, compared to PBO's June 18 economic scenario.

Fiscal outlook

Finance Canada's estimate of the budgetary deficit in 2019-20 is $10.6 billion higher compared to PBO's June 18 fiscal scenario. For 2020-21, the projected deficit in EFS 2020 is $87.2 billion higher. Larger budgetary deficits in the EFS are primarily due to the inclusion of additional policy measures and higher cost estimates of COVID-19 policy measures.

Differences in economic and fiscal developments, mainly related to enterprise Crown corporations, also account for a significant portion of the discrepancy in the outlook for the budgetary deficit.

Enterprise Crown corporations

In EFS 2020, Finance Canada projects that enterprise Crown corporations will collectively record net income losses of $12.0 billion in 2020-21, which is a significant reversal compared to gains of $7.3 billion recorded in 2019-20. Losses for these corporations are unusual.

Parliamentarians should have access to up-to-date projections of program size and estimates of expected gains or losses by enterprise Crown corporations. Each enterprise Crown corporation possesses key data and expertise and they should furnish projections of program size and gains (or losses) to Parliament as soon as possible.

Borrowing Authority Act

Parliament granted its approval of a maximum borrowing amount of $1,168 billion via the *Borrowing Authority Act* (BAA), which came into force on 23 November 2017. Under the BAA, the Minister must table his first triennial report in Parliament by 23 November 2020 on this debt aggregate and indicate whether the maximum amount of borrowing should be increased or decreased.

Based on Finance Canada's projection in EFS 2020, and assuming that only borrowing for COVID-19 measures is excluded from the BAA, we estimate that total borrowing could surpass the maximum amount under the *Borrowing Authority Act* by at least $150 billion.

Debt Management Strategy

The current Debt Management Strategy emphasizes the Government's intention to "borrow at longer maturities and lock in historically low interest rates, as well as enhance the predictability of debt servicing costs".

PBO estimates that the Government's planned 2020-21 gross debt issuance of $713 billion will cost $2.2 billion in annual interest expense. By comparison, the same amount of debt issued using the 2019-20 maturity structure would cost $1.9 billion. If the entire increase in gross issuance relative to 2019-20 ($437 billion) were funded via Treasury bills, the annual interest expense would be $1.6 billion.

Off-cycle measures

EFS 2020 includes the Government's non-COVID-19 policy measures taken since its December 2019 Economic and Fiscal Update (that is, "off-cycle"). Over 2019-20 to 2024-25, off-cycle measures in EFS 2020 total $21.4 billion. Off-cycle measures are typically smaller and are reserved for any funding that may be required outside of the budget cycle.

About half ($4.4 billion) of the off-cycle measures in 2020-21 are non-announced measures. PBO has flagged these measures in previous reports. While there are legitimate reasons for not disclosing these amounts (such as, due to national security, commercial sensitivity, contract negotiations and litigation issues), provisions for anticipated Cabinet decisions deserve greater scrutiny. Parliamentarians may wish to seek additional detail regarding these measures.

Fiscal anchors

In its December 2019 Economic and Fiscal Update, the Government detailed its fiscal plan. One of the key elements of this plan was the Government's fiscal anchor—its commitment to continue to reduce federal debt relative to the size of the economy. In addition, the Government committed to preserve Canada's "triple A" credit rating.

While EFS 2020 details the Government's COVID-19 response plan, it does not mention or reaffirm the Government's commitment to (ultimately) reduce the federal debt-to-GDP ratio.

Fiscal transparency and accountability would be enhanced if the Government identifies its fiscal anchor. Further, this commitment should be supported with the Government's detailed economic and fiscal projections over a medium- and longer-term horizon.

1. Economic outlook

The economic outlook presented in Economic and Fiscal Snapshot (EFS) 2020 was based on Finance Canada's May 2020 survey of private sector forecasters. Table 1 provides a high-level comparison of the average private sector forecast in EFS 2020 and PBO's June 18 economic scenario.[1]

The annual outlook for 2020 in the EFS is very much in line with PBO's June 18 scenario. Both show a decline of 6.8 per cent in real GDP in 2020. GDP inflation in the EFS is slightly lower compared to PBO's assumption. The private sector forecast of nominal GDP—the broadest measure of the Government's tax base—is only $9 billion (0.4 per cent) lower than PBO assumed in its June 18 scenario. Average private sector forecasts of other economic indicators in the EFS are broadly in line with PBO's scenario.

Table 1 Economic outlook comparison

	2020Q1	2020Q2	2020Q3	2020Q4	2020
Real GDP growth (%)					
Snapshot 2020	-8.2	-40.6	32.2	13.8	-6.8
PBO June 18 scenario	-8.2	-44.1	38.6	23.9	-6.8
	0.0	3.5	-6.6	-10.1	0.0
GDP inflation (%)					
Snapshot 2020	1.8	-8.3	3.7	4.3	0.5
PBO June 18 scenario	1.8	-6.8	4.7	3.1	0.8
	0.0	-1.5	-1.0	1.2	-0.3
Nominal GDP growth (%)					
Snapshot 2020	-6.5	-45.5	37.1	18.6	-6.3
PBO June 18 scenario	-6.5	-47.9	45.1	27.7	-5.9
	0.0	2.4	-8.0	-9.1	-0.4
Nominal GDP level ($ billions)					
Snapshot 2020	2,297	1,973	2,135	2,228	2,158
PBO June 18 scenario	2,297	1,952	2,142	2,277	2,167
	0	21	-7	-49	-9

Sources: Finance Canada and Parliamentary Budget Officer.

Note: Quarterly figures are expressed at annual rates.

While the annual outlooks for real GDP growth in 2020 are the same, the quarterly profiles differ.[2] Based on the average private sector forecast, the economic downturn in the second quarter will not be as steep and the recovery in the second half of the year will not be as strong, compared to PBO's June 18 economic scenario.

2. Fiscal outlook

Finance Canada's estimate of the budgetary deficit in 2019-20 is $10.6 billion higher compared to PBO's June 18 fiscal scenario. For 2020-21, the projected deficit in EFS 2020 is $87.2 billion higher (Table 2). Larger budgetary deficits in the EFS are primarily due to the inclusion of additional policy measures and higher cost estimates of COVID-19 policy measures. Differences in economic and fiscal developments also account for a significant portion of the discrepancy in the outlook for the budgetary deficit.

Table 2 Fiscal outlook comparison

$ billions	Snapshot 2020		PBO June 18 scenario		Difference (Snapshot - PBO)	
	2019-2020	2020-2021	2019-2020	2020-2021	2019-2020	2020-2021
Pre-COVID-19 budgetary balance	**-25.1**	**-25.1**	**-22.8**	**-25.6**	**-2.3**	**0.5**
Economic and fiscal developments*	0.1	-81.3	-0.3	-44.8	0.4	-36.5
COVID-19 policy measures*	-8.1	-227.9	-0.8	-185.6	-7.3	-42.3
Policy measures since EFU 2019	-1.3	-9.0	0.0	0.0	-1.3	-9.0
Budgetary balance	**-34.4**	**-343.2**	**-23.8**	**-256.0**	**-10.6**	**-87.2**

Sources: Finance Canada and Parliamentary Budget Officer.

Note: The pre-COVID-19 balance is presented on a comparable basis. PBO's pre-COVID-19 balance is the November 2019 Economic and Fiscal Outlook adjusted for policy measures in Finance Canada's December 2019 Economic and Fiscal Update (EFU). Finance Canada's pre-COVID-19 balance is taken from the 2019 EFU, excluding the risk adjustment.

* For comparability, PBO estimates of COVID-19 policy measures are presented on a gross basis. Consequently, revenue recoveries from COVID-19 measures are included in economic and fiscal developments. The gross estimate of $185.6 billion in 2020-21 corresponds to the net estimate of $169.2 billion in PBO's June 18 scenario.

Economic and fiscal developments

In 2019-20, economic and fiscal developments account for only a small portion of the difference between the budget deficit estimated in the EFS and our June 18 scenario.

In 2020-21, economic and fiscal developments account for $36.5 billion of the difference in projected budgetary deficits. This is largely due to our assumption of higher net income from enterprise Crown corporations (see Section 3). In addition, we project higher tax revenues compared to EFS 2020.

COVID-19 policy measures

COVID-19 policy measures account for most of the discrepancy between the budgetary deficit projected in the EFS and our June 18 scenario: $7.3 billion in 2019-20 and $42.3 billion in 2020-21 (Table 3). This is largely due to differences in cost estimates, both in terms of magnitude and timing, between the two largest COVID-19 support programs—the Canada Emergency Response Benefit (CERB) and the Canada Emergency Wage Subsidy (CEWS).

Table 3 Key differences in COVID-19 policy measures

$ billions	2019-2020	2020-2021
Differences in cost estimates (EFS - PBO)[3], of which:	**7.4**	**9.7**
Canada Emergency Response Benefit (CERB)	7.4	-8.5
Canada Emergency Wage Subsidy (CEWS)	-	11.1
Other measures	0.0	7.1
Measures not included in PBO's June 18 scenario, of which:	**-**	**27.9**
CERB 8-week extension	-	20.5
CEWS re-design	-	6.9
Other measures	-	0.5
Other differences	**-0.1**	**4.7**
Total difference in COVID-19 policy measures	**7.3**	**42.3**

Sources: Finance Canada and Parliamentary Budget Officer.

Note: For the CEWS, the Government set aside an additional $37.3 billion in the EFS for the program's redesign and 12-week extension. For simplicity and comparability, we have assumed that the cost of the extension is identical to our own internal estimate, while the remainder was set aside for the program's redesign. PBO estimates of COVID-19 policy measures are presented on a gross basis.

In 2019-20, the timing of CERB retroactive payments (from March 15 to March 31) accounts for virtually all the difference between the COVID-19 policy measures in EFS 2020 and our June scenario, contributing $7.4 billion to our (lower) estimate of the budgetary deficit in that year.[4] In 2020-21, the CERB and the CEWS account for $30.0 billion of our lower budgetary deficit.

Our June 18 scenario did not include a cost estimate for the 8-week extension of the CERB that was announced on June 16. Following the publication of our scenario, we estimated that this extension would cost $20.5 billion (on a gross basis). Including this extension would increase the size of the budget deficit in 2020-21 by $17.9 billion (that is, the net cost) in our June scenario.[5]

The CEWS accounts for $18.0 billion of the difference in the budgetary deficit in 2020-21. This reflects differences in cost estimates as well as the additional measure related to its redesign that was announced in the EFS.[6]

Differences in other measures account for $0.1 billion in 2019-20 and $4.7 billion in 2020-21. It is difficult to pinpoint the exact nature of these differences since the Government does not provide the accrual cost of all the COVID-19 policy measures for each fiscal year.[7] Rather, in Table A2.8 of the EFS, the Government summarizes the total “impact value” of these measures which spans over multiple fiscal years ($403.4 billion in total). The impact value is then reduced by $175.5 billion—an adjustment factor that reconciles to the accrual cost in 2020-21 of all COVID-19 measures in EFS 2020 ($227.9 billion).

Parliamentarians may wish to ask the Government for the fiscal impact of each announced COVID-19 measure.

Policy measures since the December 2019 Economic and Fiscal Update

EFS 2020 also includes $1.3 billion and $9.0 billion in off-cycle measures in 2019-20 and 2020-21, respectively. These measures were not accounted for in our June 18 scenario and will be added in our forthcoming update. Section 6 provides a more detailed discussion of the off-cycle measures in EFS 2020.

3. Enterprise Crown corporations

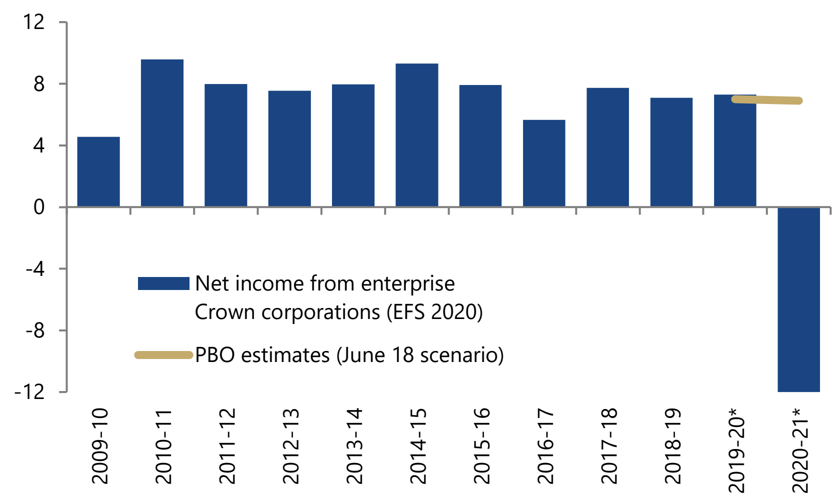
Finance Canada projects other revenues to decline by $27.7 billion in 2020-21. The bulk of this decline is due to net income losses by enterprise Crown corporations.

The Government estimates that enterprise Crown corporations are providing $386 billion worth of liquidity support, mainly through the largest financial Crowns—the Bank of Canada, Canada Mortgage and Housing Corporation, Business Development Bank of Canada and Export Development Canada.

As a result of these actions, Finance Canada projects that enterprise Crowns will collectively record losses of $12.0 billion in 2020-21, which is a significant reversal compared to the gains of $7.3 billion recorded in 2019-20 (Figure 1).

Figure 1 Enterprise Crown corporations' gains/losses

$ billions



Sources: Finance Canada and Parliamentary Budget Officer.

Note: * Estimates for 2019-20 and 2020-21. Enterprise Crown corporations include government business enterprises.

While some of these losses are real, the majority merely pull forward future expenses into the current year, temporarily suppressing revenues.

For example, Bank of Canada purchases of Government of Canada bonds in the secondary market results in financial losses, as these bonds are generally being purchased at more than their face value, owing to the decline in interest rates since they were issued. Consistent with Public Sector

Accounting Standards, federal interest expenses that would have ordinarily been spread over many years are being entirely recognized in 2020-21. As such, the larger resulting deficit in 2020-21 will be offset by lower deficits in 2021-22 and onward.

Taking a longer-term perspective, accounting for premiums and discounts on the Bank of Canada's purchases of Government of Canada bonds in secondary markets would have no effect on the accumulated deficit.

Expected losses in other enterprise Crown corporations have not been well-substantiated. Enterprise Crown corporations, by definition, should be profitable. They operate on commercial terms and are financially self-sustaining without budgetary support. Losses for these corporations are unusual.

As standard practice, these profit-generating corporations operate at arm's length from the Government and report to Parliament in an annual report and a summary corporate plan. Recently, the Government has supplemented this standard reporting with bi-weekly updates on the status of COVID-19 liquidity supports, but the liquidity program information consistently lacks detail on possible budgetary costs. Liquidity program backgrounders and reports to the House of Commons Finance Committee have all provided upper limits for each program, and with status updates for select programs. This information is only a starting point.

Parliamentarians should have access to up-to-date projections of program size and estimates of expected gains or losses by enterprise Crown corporations. PBO has provided estimates of several liquidity programs' gains and losses based on historical precedents and publicly available information. PBO has not forecast large losses on liquidity support programs.

That said, PBO lacks essential detail on the credit risk of borrowers and the quality of collateral. Each enterprise Crown corporation possesses key data and expertise—they should furnish projections of program size and gains (or losses) to Parliament as soon as possible.

4. Borrowing Authority Act

The *Borrowing Authority Act* (BAA) provides the Minister of Finance with the authority to borrow in debt markets and sets the maximum amount that may be borrowed. The maximum amount defined in the BAA combines two debt aggregates: 1) unmatured debt of the Government of Canada, and 2) borrowings of enterprise Crown corporations designated as agents of Her Majesty outside of the Crown Borrowing Program.[8]

As EFS 2020 notes, Parliament approved a maximum borrowing amount of $1,168 billion via the BAA, which came into force on 23 November 2017. In addition, under the BAA, the Minister must table his first triennial report in Parliament by 23 November 2020 on this debt aggregate and indicate whether the maximum amount of borrowing should be increased or decreased.

Borrowing to finance the $227.9 billion in measures related to the Government's COVID-19 Economic Response Plan, however, is not subject to the maximum amount of borrowing under the BAA. The borrowing authority for these measures was granted through the *COVID-19 Emergency Response Act* (Bill C-13), which enacted section 47 of the *Financial Administration Act* (FAA).

Under section 47(b) of the FAA, the Minister may borrow "…in the event of a natural disaster or to promote the stability or maintain the efficiency of the financial system in Canada, if the Minister is of the opinion that the borrowing of money is necessary in those circumstances."[9] This authority ends on 30 September 2020.

Given Finance Canada's projection of total market debt of $1,236 billion in 2020-21 in EFS 2020, it is likely that total borrowing (unmatured debt plus agent Crown corporation debt) will exceed the maximum amount under the BAA, even if borrowing to finance the COVID-19 measures is excluded.[10]

Based on Finance Canada's projection and assuming that only the $227.9 billion in COVID-19 measures is excluded, we estimate that total borrowing could surpass the maximum amount under the BAA by at least $150 billion.[11]

5. Debt Management Strategy

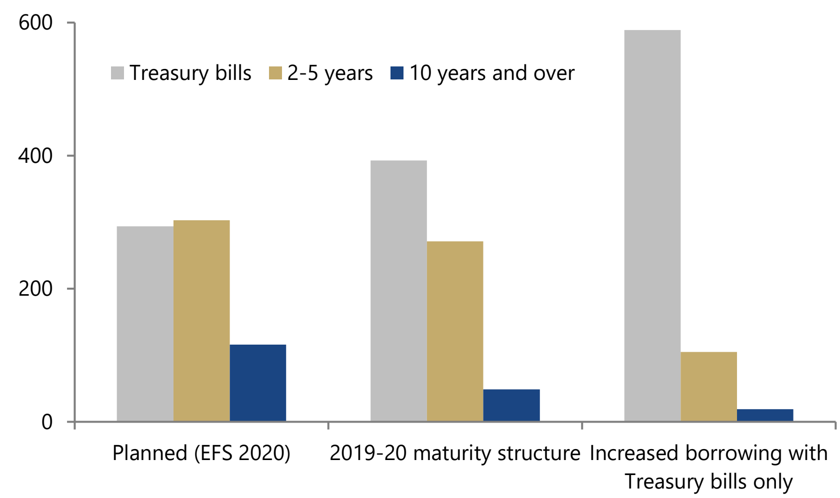
The Government published its annual Debt Management Strategy in the EFS. The current strategy emphasizes the Government's intention to "borrow at longer maturities and lock in historically low interest rates, as well as enhance the predictability of debt servicing costs". The Government intends to increase its issuance of bonds with maturities of 10- and 30-years from 14 per cent of total issuance to 26 per cent.

Long-term certainty comes at the trade-off of cost.[12] Shorter maturities typically have lower interest rates than longer maturities, so longer-term debt issuance will have higher effective interest costs (Figure 2).

Figure 2

Interest costs in 2020-21 under different maturity structures

$ billions



Sources: Finance Canada and Parliamentary Budget Officer.

PBO estimates that the Government's planned 2020-21 gross issuance of $713 billion will cost $2.2 billion in annual interest expense.[13] By comparison, the same amount of debt issued using the 2019-20 maturity structure would cost $1.9 billion. If the entire increase in gross issuance relative to 2019-20 ($437 billion) were funded via Treasury bills, the annual interest expense would be $1.6 billion.

6. Off-cycle measures

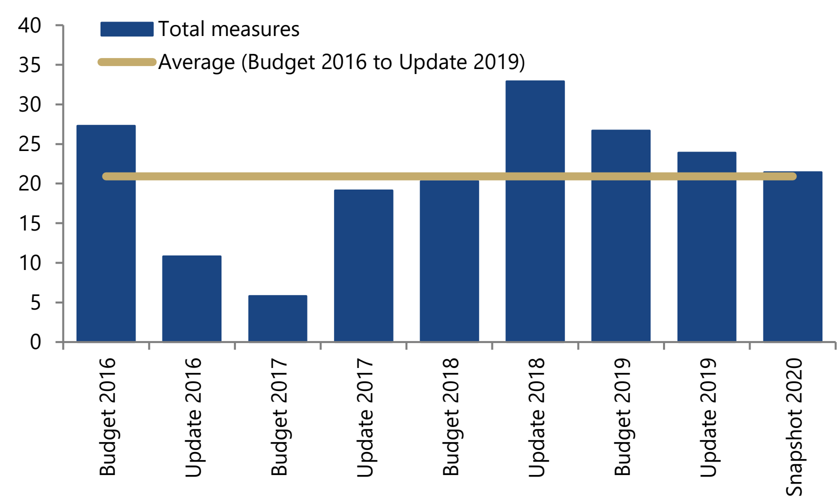
EFS 2020 includes the Government's non-COVID-19 policy measures taken since its December 2019 Economic and Fiscal Update (that is, "off-cycle"). Table A2.9 in the EFS details these policy measures over 2019-20 to 2024-25.

Over the 6-year projection horizon, off-cycle measures in EFS 2020 total $21.4 billion. Off-cycle measures are typically smaller and are reserved for any funding that may be required outside of the budget cycle.

Due to the pandemic the Government did not publish a budget this year. Consequently, the off-cycle measures in the EFS are on par with spending amounts typically presented in a budget or update (Figure 3). This is in addition to the $236 billion in COVID-19 measures included in the EFS for 2019-20 and 2020-21.

Figure 3 **Total measures in recent budgets and updates**

$ billions



Sources: Finance Canada and Parliamentary Budget Officer.

Note: EFS 2020 measures include only non-COVID-19 off-cycle measures. Total measures in recent budgets and updates include off-cycle measures and announced policy measures as well as non-announced measures.

Additionally, about half ($4.4 billion) of the off-cycle measures in 2020-21 are non-announced measures. PBO has flagged these measures in previous reports, stating that while there are legitimate reasons for not disclosing these amounts (such as, due to national security, commercial sensitivity, contract negotiations and litigation issues), provisions for anticipated Cabinet decisions deserve greater scrutiny from parliamentarians.

Non-announced measures are reported as a net fiscal amount, as such they could include decisions that increase revenues or reduce expenditures, which would partially offset additional expenditures or contribute to reducing the deficit (particularly in fiscal years where the non-announced measures are negative).

Given the magnitude of these amounts and their contribution to the deficit in 2020-21 ($4.4 billion), parliamentarians may wish to seek additional detail regarding these measures.

7. Fiscal anchors

In its December 2019 Economic and Fiscal Update, the Government detailed its fiscal plan. One of the key elements of this plan was the Government's fiscal anchor—its commitment to continue to reduce federal debt relative to the size of the economy. In addition, the Government committed to preserve Canada's "triple A" credit rating.[14]

The Government's response to the COVID-19 pandemic combined with the sharp deterioration in the economy have boosted to federal debt ratio well above its 2018-19 level of 30.8 per cent of GDP.

Based on the EFS 2020 projection, federal debt will increase to 31.1 per cent of GDP in 2019-20 and then reach 49.1 per cent of GDP in 2020-21. Maintaining a stable or declining debt-to-GDP ratio over a longer-term horizon is necessary to ensure fiscal sustainability.

While EFS 2020 details the Government's COVID-19 response plan, it does not mention or reaffirm the Government's commitment to (ultimately) reduce the federal debt-to-GDP ratio. That said, EFS 2020 does note that the projected deficit of $343.2 billion in 2020-21 is "the challenge of our lifetime. As temporary investment measures come to an end and GDP recovers over time, deficits are expected to retreat."

Fiscal transparency and accountability would be enhanced if the Government identifies its fiscal anchor. Further, this commitment should be supported with the Government's detailed economic and fiscal projections over a medium- and longer-term horizon.

Notes

1. PBO's June 18 Scenario Analysis Update is available at: https://www.pbo-dpb.gc.ca/web/default/files/Documents/Reports/RP-2021-009-S/RP-2021-009-S_en.pdf.
2. The annual growth rate does not represent an average of the (annualized) quarterly growth rates. Given that the annual growth rate is calculated as the average level of GDP in one year (that is, over four quarters) divided by the average level in the previous year, growth rates observed in the initial quarters are weighted more heavily.
3. Differences in cost estimates only compare estimates that were explicitly detailed in the EFS. PBO has costed several measures for which the cost estimate is not explicitly provided by the Government. For example, the filing extension of income tax returns, deferrals of sales tax remittance and customs duty payments, and the suspension of audit activities. These differences are included in the "other measures" category.
4. The CERB was launched on April 6 shortly after the close of the 2019-20 fiscal year. However, individuals eligible for the CERB were able to receive payments retroactive to March 15, which cost the Government $7.4 billion in 2019-20. PBO's upcoming updates will revise the fiscal outlook to account for the timing and expensing of these payments. This should not impact the overall cost of the program.
5. Our upcoming updates will revise the budgetary balance in 2019-20 and 2020-21 to account for CERB's retroactive payments and its 8-week extension.
6. For the CEWS, the Government has set aside an additional $37.3 billion for the program's redesign and 12-week extension. For simplicity and comparability, we have assumed that the cost of the extension is identical to our own internal estimate, while the remainder was set aside for the program's redesign.
7. For example, the Government does not provide detail regarding the fiscal cost of deferrals of sales tax and customs duty payments, filing extension deadline for income tax returns and paying income taxes, as well as the accrual cost of other credit and liquidity support.
8. Beginning in 2008, the Government directed lending to the Business Development Bank of Canada, the Canada Mortgage and Housing Corporation and Farm Credit Canada, under the Crown Borrowing Program. Export Development Canada was excluded at that time because the majority of its borrowing is in foreign denominations. Borrowing undertaken by the Government of Canada on behalf of enterprise Crown corporations generates loans receivable for the Government, which are recorded as assets. The Treasury bills and bonds issued to fund these loans appear as part of unmatured debt, a liability on the Government's balance sheet.
9. Available at: https://laws-lois.justice.gc.ca/eng/acts/f-11/page-11.html.

10. Unmatured debt primarily consists of market debt. In 2018-19, unmatured debt amounted to $736.9 billion, of which market debt accounted for $721.1 billion (98 per cent). Market debt value adjustments and non-market debt accounted for the remaining $15.8 billion in unmatured debt. In 2018-19, agent Crown corporation borrowing amounted to $294.7 billion.

11. Table A3.2 in EFS 2020 indicates that total market debt in 2020-21 will amount to $1,236 billion.

    Assuming that market debt value adjustments, non-market debt and agent Crown corporation borrowing remain at their 2018-19 levels, total borrowing before excluding borrowing for COVID-19 measures would reach $1,547 billion in 2020-21. This figure is likely to be an underestimate given that borrowing by agent Crown corporations has likely increased since 2018-19.

    Excluding the impact of COVID-19 measures ($228 billion), total borrowing under the BAA would reach $1,319 billion, which is $151 billion above the maximum amount ($1,168 billion).

12. Beyond keeping funding costs low and mitigating rollover risk, the Government also considers the preferences of financial markets in setting its debt issuance plans.

13. Based on benchmark rates on 26 June 2020.

14. EFS 2020 indicates that Canada "continues to hold a AAA rating, with a stable outlook, from all major credit rating agencies except Fitch."