OFFICE OF THE PARLIAMENTARY BUDGET OFFICER
BUREAU DU DIRECTEUR PARLEMENTAIRE DU BUDGET
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An update of the Budget 2015 fiscal outlook

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The Honourable Scott Brison (Kings-Hants) and Mr. Nathan Cullen (Skeena-Bulkley Valley) have submitted requests that the PBO provide an update of the Government's fiscal projections in Budget 2015 using the Bank of Canada's outlook in its July Monetary Policy Report. PBO will update its own Economic and Fiscal Outlook in the fall.

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The Government's updated fiscal outlook

Using the Bank of Canada's July projection of real GDP growth, PBO estimates that an updated Budget 2015 outlook would show deficits of $1.5 billion in 2015-16 and $0.1 billion in 2016-17, and a surplus of $1.5 billion in 2017-18.

However, the impact of weaker real GDP growth in 2015 would be partially offset by higher realised GDP inflation than assumed in Budget 2015 and by lower projected interest rates following the Bank of Canada's July 15th lowering of its target for the overnight rate. Accounting for revisions to real GDP growth, GDP inflation, and interest rates would result in a deficit of $1.0 billion in 2015-16, and surpluses of $0.6 billion in 2016-17 and $2.2 billion in 2017-18. Including a new set-aside for contingencies would reduce the budgetary balance further.[1]

Table 1: Updated Budget 2015 budgetary balance outlook ($ billions)

	2015-16	2016-17	2017-18
Budget 2015 outlook	1.4	1.7	2.6
Updated outlook (revised real GDP)	-1.5	-0.1	1.5
Updated outlook (all revisions)	-1.0	0.6	2.2

Sources: Finance Canada; PBO calculations.

Motivation and analysis

Budget 2015 on April 21st projected surpluses in 2015-16 and over the following four years.[2] Economic data has since indicated declines in real GDP that were not reflected in the Government's assumptions.

On July 15th, the Bank of Canada released its updated economic projection in its quarterly Monetary Policy Report.[3] As requested, PBO has updated the Government's fiscal outlook using the Bank of Canada's projection and the Budget 2015 fiscal sensitivities to real GDP growth.[4] PBO has also updated the budget outlook for changes to GDP inflation and interest rates.

Real GDP declined by 0.6 per cent in the first quarter of 2015, compared to the forecast of 1.2 per cent growth in Budget 2015.[5] The impacts of this decline and the Bank of Canada's real GDP growth projection reduce the budgetary balance by $3.9 billion in 2015-16, $2.8 billion in 2016-17, and $2.1 billion in 2017-18, reflecting lower personal income taxes and higher employment insurance benefits. However, these budgetary impacts do not consider the $1 billion set-side for contingencies in Budget 2015.[6] After accounting for the set-aside, the budgetary balance would be reduced by $2.9 billion in 2015-16, $1.8 billion in 2016-17, and $1.1 billion in 2017-18. The impact on the budgetary balance declines over time as a result of higher projected real GDP growth in 2016-17 and 2017-18, which partially offsets the initial impact.

Table 2: Impact of revised real GDP growth

	2015-16	2016-17	2017-18
Assumptions (%):			
Budget 2015 real GDP growth	1.9	2.3	2.3
Bank of Canada real GDP growth	1.0	2.7	2.4
Impact ($ billions):			
Revenues	-3.3	-2.3	-1.8
Expenses	0.7	0.5	0.3
Budgetary balance	-3.9	-2.8	-2.1
Set aside for contingencies	1.0	1.0	1.0
Impact in excess of set aside	-2.9	-1.8	-1.1

Sources: Finance Canada; Bank of Canada; PBO calculations.
Note: Growth rates have been adjusted for fiscal years using published quarterly rates.

While the budget forecast for real GDP growth in 2015 was optimistic compared to the Bank of Canada's projection, the budget forecast for GDP

[1] Budget 2015 states that "the Government will continue to evaluate economic developments and risks to determine whether or not it would be appropriate to maintain this adjustment for risk in the future."

[2] Available at http://www.budget.gc.ca/2015/docs/plan/budget2015-eng.pdf.

[3] Available at http://www.bankofcanada.ca/wp-content/uploads/-2015/07/mpr-2015-07-15.pdf.

[4] The Bank of Canada's projection is only to 2017Q4. PBO has assessed the three-year outlook to 2017-18 by assuming that real GDP growth in 2018Q1 is the same as projected in 2017Q4 in the July Monetary Policy Report. The Government's fiscal sensitivities are provided in Budget 2015 Table 5.2.8, Table 5.2.9, and Table 5.2.10.

[5] All figures are seasonally adjusted at annual rates and have been adjusted to account for National Accounts revisions in 2014.

[6] The $1 billion annual set-aside for contingencies in Budget 2015 is a result of the Government's downward adjustment of $7 billion annually to the private sector forecast of nominal GDP over 2015-2017.

inflation was pessimistic compared to outturn data in the first quarter of 2015. The GDP deflator declined by 2.3 per cent in the first quarter of 2015, compared to the budget forecast of a 3.1 per cent decline. This is expected to act against the budgetary impact of lower real GDP both in the first quarter of 2015 and through 2015Q3. Revised GDP inflation increases the budgetary balance by $0.4 billion in 2015-16, $0.4 billion in 2016-17, and $0.3 billion in 2017-18.[7] This increase is attributable to an increase in personal income taxes, which is partially offset by an increase in elderly benefits, direct program charges, and public debt charges.

Table 3: Impact of revised GDP inflation

	2015-16	2016-17	2017-18
Assumptions (%):			
Budget 2015 GDP inflation	0.4	2.7	2.2
Revised GDP inflation	0.6	2.7	2.2
Impact ($ billions):			
Revenues	0.7	0.6	0.6
Expenses	0.3	0.2	0.2
Budgetary balance	0.4	0.4	0.3

Sources: Finance Canada; PBO calculations.
Note: Inflation rates have been adjusted for fiscal years using published quarterly rates.

The budgetary consequences of lower real GDP growth are also partially offset by lower borrowing costs as a result of the Bank of Canada's recent reduction of its target for the overnight interest rate, which was not anticipated in the Budget 2015 forecast. Assuming that short- and long-term interest rates fall by the full 0.25-percentage point reduction in the target rate, the Budget 2015 fiscal sensitivities suggest the budgetary balance would increase by $0.1 billion in 2015-16, $0.3 billion in 2016-17, and $0.4 billion in 2017-18. The savings from lower public debt charges are partially offset by lower returns to the Government's financial assets.

Table 4: Impact of lower interest rates

	2015-16	2016-17	2017-18
Assumptions (percentage points):			
Reduction in interest rates	0.25	0.25	0.25
Impact ($ billions):			
Revenues	-0.3	-0.4	-0.5
Expenses	-0.4	-0.7	-0.8
Budgetary balance	0.1	0.3	0.4

Source: PBO calculations.

In total, the Government's fiscal sensitivities suggest that after accounting for the combined revisions to real GDP growth, GDP inflation, and interest rates, the Budget 2015 outlook would show a deficit of $1.0 billion in 2015-16 and surpluses of $0.6 billion in 2016-17 and $2.2 billion in 2017-18. This outlook does not account for the operating budget wage freeze that would be implemented as a result of the *Federal Balanced Budget Act*.

Table 5: Updated Budget 2015 budgetary balance outlook ($ billions)

	2015-16	2016-17	2017-18
Budget 2015 outlook	1.4	1.7	2.6
Impact of revised real GDP growth	-3.9	-2.8	-2.1
Set aside for contingencies	1.0	1.0	1.0
Updated outlook (revised real GDP)	-1.5	-0.1	1.5
Impact of higher GDP inflation	0.4	0.4	0.3
Impact of lower interest rates	0.1	0.3	0.4
Updated outlook (all revisions)	-1.0	0.6	2.2

Sources: Finance Canada; PBO calculations.

[7] For GDP inflation, only the revision to the first quarter of 2015 is incorporated. Remaining quarters are unchanged from Budget 2015 assumptions.