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2021 ELECTION PROPOSAL COSTING BASELINE



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 presents PBO's economic and fiscal baseline projection for the 2021 election proposal costing period.

Lead Analysts:

Kristina Grinshpoon, Advisor-Analyst
Caroline Nicol, Senior Analyst

Contributors:

Robert Behrend, Advisor-Analyst
Étienne Bergeron, Senior Analyst
Mark Creighton, Analyst
Eskandar Elmarzougui, Senior Analyst
Jamie Forsyth, Analyst
Jill Giswold, Analyst
Raphaël Liberge-Simard, Analyst
Sarah MacPhee, Analyst
Katarina Michalyshyn, Analyst
Ben Segel-Brown, Analyst

This report was prepared under the direction of:

Chris Matier, Director General
Trevor Shaw, Director

Nancy Beauchamp, Carol Faucher and Rémy Vanherweghem assisted with the preparation of the report for publication.

For further information, please contact pbo-dpb@parl.gc.ca.

Yves Giroux
Parliamentary Budget Officer

2021 Election Proposal Costing Baseline

Consistent with the PBO's general election mandate, this report presents an economic and fiscal baseline projection. The baseline projection and its underlying assumptions will be used to prepare financial cost estimates during the 2021 election proposal costing (EPC) period. Political parties may use these assumptions and projections to prepare their own cost estimates.

To assist political parties and the public with estimating the potential revenue impacts that would arise from adjusting various federal tax rates, credits, and brackets, we have updated our online Ready Reckoner tool.¹ In addition, our public debt charge calculator² can be used by political parties and the public to estimate the potential impact of policy measures on public debt charges.³

The EPC baseline projection presented below incorporates Budget 2021 measures, as well as measures announced after the budget, up to and including July 30, 2021. The following provides a brief overview of the baseline projection.

EPC economic baseline projection (Table 1)

PBO projects growth in the Canadian economy to rebound sharply in the second half of 2021 and remain strong through 2022 as remaining public health measures are lifted and widespread immunity to the coronavirus is achieved.⁴ The rebound and recovery in the Canadian economy also reflects stimulative monetary and fiscal policies, as well as robust U.S. growth.⁵

We project that real GDP will surpass its pre-pandemic level in the third quarter of 2021. Following the economic recovery, we project real GDP growth to moderate, averaging 1.7 per cent annually over 2023 to 2025, which is in line with our estimates of potential growth.

With the pickup in economic activity and lifting of remaining public health measures, we project strong employment gains through mid-2023. We project the unemployment rate to decline sharply from current levels, falling below its pre-pandemic level of 5.7 per cent in the third quarter of 2022 and settling at 5.4 per cent thereafter.

Based on futures prices, we project crude oil prices to pull back from their recent highs, but remain elevated over the medium term, with West Texas Intermediate crude averaging US\$66 per barrel. Non-energy commodity prices are also projected to recede from recent highs but remain well above historical levels.

Given the trend increase in commodity prices and strong economic recovery, we project robust growth in nominal GDP—the broadest measure of the Government’s tax base. Nominal GDP growth is projected to average just over 10 per cent annually over 2021 to 2022 and then moderate to 3.8 per cent, on average, thereafter.

In the near term, we expect year-over-year increases in the Consumer Price Index (CPI) to remain temporarily above the Bank of Canada’s 1-to-3 per cent inflation target band, due mainly to higher gasoline prices and the impact of supply constraints.

Based on our outlook for inflation and potential GDP, we assume that the Bank of Canada will increase its policy interest rate by 25 basis points in both the third and fourth quarters of 2022. Thereafter, the policy rate gradually increases until it reaches the (nominal) neutral interest rate of 2.25 per cent at the end of 2025. Long-term government bond yields are projected to reach their neutral or steady-state levels by the end of 2025.⁶

EPC fiscal baseline projection (Table 2)

The budgetary balance in 2020-21 and 2021-22 is impacted by extraordinary, but temporary factors—a record decline in economic activity and large-scale income support measures. Based on Finance Canada and PBO estimates, we calculate that total federal COVID-19 direct support measures will amount to \$352 billion over 2019-20 to 2025-26.

Based on monthly Fiscal Monitor results, we estimate that the budgetary deficit in 2020-21 will amount to \$334.7 billion (15.2 per cent of GDP). Despite the 2020-21 fiscal year ending in March, post-March adjustments are highly uncertain and may have a material impact on the budgetary balance.⁷

With the expiry of several COVID-19 measures and rebound in the Government’s tax base, we project the budgetary deficit to decrease sharply in 2021-22 to \$138.2 billion (5.5 per cent of GDP)—even after Budget 2021 and recently announced measures are included.

As growth in tax revenue tracks the gains in economic activity, growth in program spending remains constrained, averaging 2.8 per cent annually over 2023-24 to 2025-26. We project public debt charges to nearly double from their 2020-21 level, reaching \$37.6 billion in 2025-26 due to record debt accumulation and higher interest rates.

That said, we project that the Government’s debt service ratio, that is public debt charges relative to tax revenues, will rise only modestly (1.4 percentage points) above its 2019-20 level to 10.1 per cent by the end of our projection horizon in 2025-26.

Over the medium term, we project the budgetary deficit to decline to \$24.6 billion (0.8 per cent of GDP) in 2025-26 and the federal debt-to-GDP ratio to reach 44.2 per cent of GDP by the end of our projection horizon. Prior to the pandemic, the last time the federal debt-to-GDP ratio was above 44 per cent occurred in 2001-02. This level, however, remains well below the peak ratio (since the beginning of the series in 1966-67) of 66.6 per cent of GDP in 1995-96.

Uncertainty surrounding the EPC baseline projection is high. That said, setting aside future fiscal measures, we judge that risks to our baseline projection are roughly balanced.

Summary of Budget 2021 measures and new measures (Table 3)

Table 3 below presents a high-level summary of Budget 2021 measures, as well as recently announced measures that were not reflected in budget projections. Political parties may use these data to adjust the baseline for their fiscal planning purposes.⁸

PBO is also providing a line-item costing of post-Budget 2021 measures based on Finance Canada and PBO estimates. The data file for this report, including the line-item costing of post-Budget 2021 measures, can be accessed at: <https://www.pbo-dpb.gc.ca/en/>.

Table 1 2021 EPC economic baseline projection

% unless otherwise indicated	Projection						
	2019	2020	2021	2022	2023	2024	2025
Economic indicators							
Real GDP growth	1.9	-5.3	6.1	4.2	1.9	1.6	1.6
Potential GDP growth	1.9	1.5	1.0	1.5	1.7	1.8	1.9
GDP inflation	1.7	0.8	6.9	2.7	2.0	2.1	2.1
Nominal GDP growth	3.6	-4.6	13.4	7.1	3.9	3.7	3.8
Nominal GDP (\$ billions)	2,311	2,205	2,501	2,677	2,781	2,833	2,992
3-month treasury rate	1.7	0.4	0.1	0.4	1.0	1.5	2.0
10-year government bond rate	1.6	0.7	1.3	1.4	1.8	2.3	2.8
Exchange rate (US cents/C\$)	75.4	74.6	80.0	81.5	83.3	84.1	84.4
Unemployment rate	5.7	9.5	7.6	5.8	5.4	5.4	5.4
Labour force participation rate	65.6	64.1	65.1	65.4	65.1	64.7	64.4
Employment rate	61.8	58.0	60.2	61.6	61.6	61.2	61.0
Average weekly hours worked	33.5	31.9	33.3	33.5	33.4	33.3	33.3
CPI inflation	2.0	0.7	2.9	2.6	2.1	2.1	2.2
U.S. real GDP growth	2.3	-3.4	6.5	4.9	2.0	1.9	1.8
WTI oil price (\$US per barrel)	57	39	67	66	65	66	67
Expenditure shares of GDP (%)							
Household consumption	57.9	57.5	54.4	55.2	56.0	57.0	57.5
Government expenditures	24.8	26.9	25.5	24.0	23.6	23.0	22.8
Residential investment	7.3	8.4	10.0	9.3	8.7	8.5	8.5
Business investment	11.0	10.2	9.6	10.2	10.7	10.9	11.0
Inventory investment	0.7	-0.9	-0.4	0.2	0.4	0.3	0.2
Exports of goods and services	31.9	29.0	31.1	31.8	31.4	31.3	31.2
Imports of goods and services	33.5	31.0	30.2	30.7	30.8	31.0	31.2
Statistical discrepancy	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Income shares of GDP (%)							
Compensation of employees	50.9	52.5	49.4	50.0	50.7	50.7	50.9
Net mixed income	8.9	9.5	9.0	8.8	8.8	8.7	8.7
Corporate profits before taxes	10.0	10.0	13.8	11.9	11.0	10.8	10.2
Investment income	2.6	2.7	2.5	2.4	2.5	2.6	2.6
Consumption of fixed capital	16.5	17.6	16.3	16.0	15.8	15.7	15.7
Taxes less subsidies	11.1	7.6	9.0	10.9	11.2	11.5	11.8
Statistical discrepancy	0.0	0.0	0.0	0.0	0.0	0.0	0.0

Sources: Statistics Canada and Office of the Parliamentary Budget Officer.

Table 2 2021 EPC fiscal baseline projection

\$ billions	Projection						
	2019-2020	2020-2021	2021-2022	2022-2023	2023-2024	2024-2025	2025-2026
Income taxes							
Personal income tax	167.6	168.0	183.8	196.5	205.3	213.6	223.0
Corporate income tax	50.1	50.7	57.3	58.2	60.8	63.5	65.9
Non-resident income tax	9.5	8.8	10.4	11.2	11.7	12.1	12.7
Total income tax	227.1	227.5	251.5	265.9	277.8	289.2	301.5
Excise taxes/duties							
Goods and Services Tax	37.4	29.7	40.0	44.4	46.8	49.6	51.9
Custom import duties	4.9	4.2	5.4	6.1	6.3	6.6	6.9
Other excise taxes/duties	11.6	10.4	11.6	12.7	12.8	12.9	13.1
Total excise taxes/duties	53.9	44.3	57.1	63.1	65.9	69.1	71.9
Fuel charge proceeds	2.7	5.0	6.8	8.6	11.1	13.4	15.6
El premium revenues	22.2	22.4	23.3	25.5	27.4	28.7	29.9
Other revenues	28.3	3.3	28.6	31.3	33.1	33.3	33.2
Total budgetary revenues	334.1	302.6	367.2	394.5	415.3	433.8	452.1
Major transfers to persons							
Elderly benefits	56.2	58.8	62.0	67.8	72.3	76.5	80.9
Employment Insurance	21.8	61.7	41.1	27.0	23.0	22.2	22.7
Emergency and recovery benefits	4.7	57.6	15.7	0.0	0.0	0.0	0.0
Children's benefits	24.3	27.4	27.9	26.9	27.5	27.9	28.5
Total	107.1	205.6	146.8	121.6	122.8	126.6	132.0
Major transfers to other levels of government							
Canada Health Transfer	40.9	45.9	43.1	45.4	49.1	51.5	53.4
Canada Social Transfer	14.6	15.0	15.5	15.9	16.4	16.9	17.4
Equalization	19.8	20.6	20.9	22.0	23.8	25.0	25.9
Territorial Formula Financing	3.9	4.2	4.4	4.6	4.8	5.0	5.2
Other transfers to government	-0.1	20.4	1.7	-3.7	-4.0	-4.3	-4.5
Total	79.2	106.1	85.6	84.3	90.2	94.1	97.5
Direct program expenses							
Other transfer payments	57.0	185.8	122.6	91.7	95.3	95.4	98.3
Operating and capital expenses	95.2	103.9	118.1	106.2	106.3	107.0	110.2
Total direct program expenses	152.2	289.7	240.7	197.8	201.6	202.4	208.5
Total program expenses	338.5	601.3	473.0	403.7	414.6	423.1	438.0
Public debt charges	24.4	20.9	21.7	23.5	27.5	32.4	37.6
Total expenses	362.9	622.2	494.7	427.2	442.1	455.5	475.6
Budgetary balance before net actuarial losses	-28.8	-319.6	-127.4	-32.7	-26.8	-21.7	-23.5
Net actuarial losses	-10.6	-15.1	-10.7	-10.0	-8.7	-3.1	-1.1
Budgetary balance	-39.4	-334.7	-138.2	-42.7	-35.6	-24.8	-24.6
Federal debt	721.4	1,056.0	1,194.1	1,236.9	1,272.4	1,297.2	1,321.8

Sources: Finance Canada and Office of the Parliamentary Budget Officer.

Note: Totals may not add due to rounding.

Table 3 Summary of Budget 2021 measures and new measures

\$ billions	Projection					
	2020- 2021	2021- 2022	2022- 2023	2023- 2024	2024- 2025	2025- 2026
Measures since Fall Economic Statement 2020	-0.2	-0.3	-0.9	1.1	0.7	0.3
Budget 2021 measures						
Chapter 1	5.0	1.2	1.0	0.9	0.8	0.7
Chapter 2	0.2	27.0	4.2	1.0	0.7	-0.7
Chapter 3	0.5	3.9	9.0	7.5	7.6	8.8
Chapter 4	0.0	3.7	4.5	5.0	2.4	0.8
Chapter 5	0.0	1.2	1.9	2.0	1.8	1.9
Chapter 6	2.2	4.6	3.3	2.3	2.0	3.1
Chapter 7	0.0	1.8	1.6	2.1	2.2	2.4
Chapter 8	0.0	4.3	3.5	3.0	1.3	1.0
Chapter 9	0.1	1.9	1.1	0.7	0.5	0.4
Chapter 10	0.0	0.2	-0.7	-1.8	-2.4	-2.5
Total Budget 2021 measures	8.0	49.8	29.4	22.7	16.9	15.9
New measures (as of July 30, 2021)	-0.1	3.5	0.1	0.0	0.0	0.0

Sources: Finance Canada and Office of the Parliamentary Budget Officer.

Note: A positive number implies a reduction in the budgetary balance (lower revenues or higher spending).
A negative number implies an increase in the budgetary balance (higher revenues or lower spending).
Totals may not add due to rounding.

Notes

1. Available at: <http://www.readyreckoner.ca/>.
2. Available at: <https://pdcc-cfdp.pbo-dpb.ca/>.
3. For example, the baseline fiscal projection could be adjusted by removing certain Budget 2021 measures, which would have a direct impact on the fiscal room available for planning purposes. However, there would also be a secondary impact on public debt charges that could increase or decrease (depending on the measure) the amount of fiscal room. Our online tool can be used to provide an estimate of this secondary impact.

Budget 2021 measures are detailed by theme in chapters 1 through 10 at: <https://www.budget.gc.ca/2021/report-rapport/toc-tdm-en.html>.

PBO cost estimates of selected Budget 2021 measures are available at: <https://www.pbo-dpb.gc.ca/en/budget-2021>.

4. We have assumed there will not be a severe fourth wave of infections from the coronavirus and variants, and that widespread immunity will be effectively achieved in the coming months.
5. PBO's May 2021 report provides estimates of the economic impact of Budget 2021 stimulus measures. Available at: <https://www.pbo-dpb.gc.ca/en/blog/news/RP-2122-007-S--impact-assessment-budget-2021-measures--evaluation-incidence-mesures-budget-2021>.
6. The (nominal) steady-state levels of the 10-year government benchmark bond and long-term benchmark bond (30-year maximum) are 3.00 and 3.25 per cent respectively. The steady-state 3-month treasury bill rate is 2.20 per cent.
7. The March 2021 Fiscal Monitor indicated that the Government posted a budgetary deficit of \$314.0 billion for the 2020-21 fiscal year (<https://www.canada.ca/en/departement-finance/services/publications/fiscal-monitor/2021/03.html>).
8. Estimates of measures announced after Budget 2021 (that is, "off-cycle" measures), were obtained through Information Request IR0604 (<https://www.pbo-dpb.gc.ca/en/information-requests--demandes-information?ir=IR0604>).

The baseline projection incorporates economic data up to and including August 6, 2021.