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The Honourable Wayne Easter

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● (1530)

[*English*]

The Chair (Hon. Wayne Easter (Malpeque, Lib.)): I call the meeting to order. Pursuant to Standing Order 108(2), today we have a study of the report of the Bank of Canada on monetary policy.

We have with us the Governor of the Bank of Canada, Mr. Poloz, and the senior deputy governor, Ms. Wilkins.

Welcome both, and the floor is yours. I understand you have an opening statement.

Mr. Stephen S. Poloz (Governor, Bank of Canada): Thank you, Chair, good afternoon. Good afternoon to committee members. Senior Deputy Governor Wilkins and I are happy to be before you today to discuss the bank's monetary policy report, which we published just last week.

When we were last here in April, we were celebrating the fact that we had upgraded our economic forecast. That was following a long period of disappointment. I'm pleased to tell you that many of the positive trends that we saw then have continued. Sources of economic growth have broadened across sectors and across regions, and the process of adjustment to the oil price shock is essentially complete.

[*Translation*]

The bank raised its policy interest rate twice since our last visit, in July and September. We did this in the context of very strong economic growth over the first half of the year and solid progress in the labour market.

Over the summer, we saw evidence of firming inflation and an economy that was rapidly closing its output gap. With these two rate increases, we have taken back the cuts we made in 2015, which were crucial in helping the economy adjust to the oil shock.

[*English*]

Growth in the first half of the year averaged just over 4% at an annual rate. This reflected strong consumer spending, backed by rising employment and income, together with increased business investment and a jump in energy exports. We are now starting to see signs of a moderation in the second half, which we forecast in July. Growth in consumption and investment is expected to ease and growth in housing is projected to slow further, in part because of the measures introduced by the Ontario government in April.

All told, we forecast that the economy will expand by 3.1% this year before slowing to 2.1% in 2018. This is still faster than the growth rate of potential. We estimate that the economy is now operating close to its capacity. Inflation should reach our 2% target in the second half of next year. That's a little later than we projected earlier because of the temporary impact of the stronger Canadian dollar this year.

We're at a crucial spot in the economic cycle and significant uncertainties are clouding the way forward. In our MPR, we identified the four most important sources of uncertainty, and I'll just touch on those now.

The first source of uncertainty is inflation itself. There have been several conjectures about the apparent softness of inflation in Canada and in many other advanced economies. Some have argued that globalization is restraining inflation. This could be due to increased imports from lower-cost countries, for example, or the effect of Canadian companies participating in global supply chains. Others point to the impact of digitalization on the economy. They suggest that digital technologies could lower barriers to entry in some sectors and lead to more competition. The rise of e-commerce may be changing price-setting behaviour, and digital technologies could promote innovation and higher productivity, which could create disinflationary pressure.

The second source of uncertainty is the degree of excess capacity in the economy. We note several signs that point to slack remaining in the labour market. For example, the participation rate of young workers is still below trend and average hours worked are less than we would expect. With the economy now operating close to capacity, we expect to see investment by companies, together with job creation by new and existing firms, and rising productivity. This should serve to raise the economy's potential output, increasing the amount of non-inflationary growth that is possible. However, this process is highly uncertain and not at all mechanical, so we have built it into our projection in a conservative way.

● (1535)

[*Translation*]

The third issue is the continued softness in wage growth. While employment growth has been strong in Canada, wages have not kept pace. The slack in the labour market is certainly responsible, in part, for this effect and there will be a lag between the time the slack is used up and when we see stronger wage growth. However, other factors, including globalization, may also be affecting wage dynamics.

[*English*]

Finally, the fourth issue is the elevated level of household debt and how that might affect the sensitivity of the economy to higher interest rates.

Bank staff have recalibrated our main economic model used for projections to capture key information about housing and debt. This work tells us that the economy is likely to respond to higher interest rates more than it did in the past. However, we will watch incoming economic data closely for evidence to support this idea. We will also look to see how the household sector is responding to the new rules about mortgage underwriting.

We also outline several other risks in our MPR. Taken together, these give us a balanced outlook for inflation. We have not incorporated into our projection the risk of a significant shift toward more protectionist trade policies in the United States, given the range of potential outcomes and the uncertainty about timing. However, we acknowledge that uncertainty about future U.S. trade policy is having some impact on business confidence now and on investment spending as well, and this impact is reflected in our outlook.

In this context, governing council judged that the current stance of monetary policy is appropriate. We agreed that the economy is likely to require less monetary stimulus over time, but we will be cautious in making future adjustments to our policy rate. In particular, the bank will be guided by incoming data to assess the sensitivity of the economy to interest rates, the evolution of economic capacity, and the dynamics of both wage growth and inflation.

[*Translation*]

As this is a very important message, allow me to repeat it.

In this context, governing council judged that the current stance of monetary policy is appropriate. We agreed that the economy is likely to require less monetary stimulus over time, but we will be cautious in making future adjustments to our policy rate. In particular, the bank will be guided by incoming data to assess the sensitivity of the economy to interest rates, the evolution of economic capacity, and the dynamics of both wage growth and inflation.

● (1540)

[*English*]

With that, Mr. Chairman, Senior Deputy Governor Wilkins and I would be happy to answer questions.

The Chair: Thank you very much, Governor.

For the committee's information, we'll go until about 4:53 in this session. Because the committee business could take a little time, we're going to move it up in between the Governor of the Bank of Canada and the parliamentary budget officer and allocate 15 minutes there. We might not need it, but that should give us enough time.

We'll start with Mr. Fergus for seven minutes.

[*Translation*]

Mr. Greg Fergus (Hull—Aylmer, Lib.): Thank you very much, Mr. Chair.

Mr. Governor, Madam Deputy Governor, thank you for being here.

Since I have been on this committee, this is the second time that you have appeared before us, and I am delighted about it. I would first like to congratulate you for your work in guiding our economy and our monetary policies.

My question is about the consumer price index. It must be more and more difficult for you to know which basket of goods and services to examine in order to establish the rate of inflation. In this modern era, is it much more complicated than 15 or 20 years ago?

Mr. Stephen S. Poloz: Fortunately, that is up to Statistics Canada.

I will let Ms. Wilkins give you more details.

Ms. Carolyn A. Wilkins (Senior Deputy Governor, Bank of Canada): I believe that Statistics Canada tries to have a basket that represents goods and services consumed by Canadians. Statistics Canada tries to weigh those goods and services dynamically, because it changes over time, although not on a daily basis, according to the way in which they investigate how consumption standards change. That is what Statistics Canada does.

Our task is to explain the process of inflation, which could well be influenced by globalization as well as by digital technologies. In fact, many more goods and services are sold on the Internet, thanks to e-commerce. A number of goods are imported from countries that have a different productivity rate than ours, which could influence the dynamics of inflation.

In our monetary policy report, we try to study it in more depth. At the moment, we see little evidence indicating that the dynamics of inflation have changed a lot in Canada. We can certainly explain that with our standard tools, but we are keeping an open mind, because, with more data and with more experience, we may well find more factors.

Mr. Greg Fergus: I noticed that you use a combination of different kinds of baskets to calculate the inflation rate or the consumer price index, the CPI. You weigh it all differently.

Does Canadian geography pose a problem for you, in that the basket for the east of Canada is not the same as the one in Toronto or in the regions of Quebec?

Mr. Stephen S. Poloz: Yes, there are differences between the various regions of the country. The main differences are in the cost of housing. The inflation rate does indeed vary with the large cities in the country. When there is a migration to other regions, there has to be a period of adjustment. For example, in Toronto, the cost of housing is going up more quickly than in Calgary. The two inflation rates differ during the adjustment period, reflecting the real cost of living in those cities.

For the most part, the indices seem to be the same for the products traded across the country. As I often say, the differences are in housing and haircuts.

● (1545)

But the other things are very interchangeable.

Ms. Carolyn A. Wilkins: In some regions of the country, like the north, price dynamics can be influenced not only by supply and demand, but also by sporadic changes in transportation costs, for example, which influences all the goods and services that have to be transported. That is another example showing how the inflation rate can vary in the country.

Mr. Greg Fergus: The burning question is about the very high level of Canadians' debt. In the best case, how could we adjust the Bank of Canada policy rates in order to reduce Canadians' debt, but without setting rates so low that Canadians would go more into debt or be tempted to do so?

Mr. Stephen S. Poloz: That really is a question of balance.

Our objective is to have another target for inflation. We have no other tools with which to adjust the specific consequences. However, we are certainly aware of the factor as we try to achieve a balanced interest rate.

As I mentioned earlier, we have adjusted the models to include the fact that the level of debt increases the economy's sensitivity to changes in interest rates. That is one of the key questions that we have studied very carefully. It is why we will be prudent with the adjustments we make in the future.

[*English*]

The Chair: Thank you.

I'll turn now to Mr. Poilievre.

Hon. Pierre Poilievre (Carleton, CPC): Thank you, Governor and Deputy Governor.

You identify in your report, as one of the risks, that Canadian households are taking on high levels of debt. These levels, in relation to income, are among the highest in the developed world. You have publicly spoken about the dilemma you face, that if you raise rates to discourage more borrowing, you may ultimately cause stress and strain on existing households, given the debt levels they already have.

How much of an interest rate increase could households absorb, given their existing levels of indebtedness?

Mr. Stephen S. Poloz: Certainly, the risk you're discussing is one that's foremost in our minds and has been for quite some time. The elevated household debt not only poses this challenge about how interest rate adjustments occur, but of course actually represents an ongoing vulnerability of the economy to other shocks, such as a new global recession out in the world. What happens is that high levels of debt act as an amplifier. They make the shock have a larger effect on the economy than it otherwise would.

For example, let's say there was a recession in the United States. The sequence would be that unemployment in Canada would rise, folks would have difficulty keeping up with their mortgage payments, and that would cause bigger cutbacks in spending than we otherwise would have.

We have always known that this would be, if you like, a second-order consequence of the primary objective, which is to get the economy back on track, get the economy back to our 2% inflation target, which means full employment. That is the best contribution that monetary policy can make to ensuring that in the long term, these debts are sustainable and serviceable. The fact is that given the shocks we've been through since 2007....

I remember that in 2008 every country in the G20 cut interest rates very low and had a large fiscal expansion in order to offset the consequences of the global recession. I think, too, this was an unqualified success. It certainly averted what I think we all would be calling by now “the second great depression”. All the ingredients were present.

By 2010, it looked as though we had most of the bad news behind us, so fiscal consolidation began to emerge as a priority in lots of countries, but as it turned out, the world delivered a bit of a slowdown, which progressed, and interest rates needed to stay low longer, so we have these consequences of higher debt.

I just want to assure you that we take this fully into account and will be monitoring how households are reacting to those debt levels and interest rates. It's not a simple arithmetic calculation about what they can absorb. The economy will moderate, compared to the levels we have seen, as this process unfolds.

● (1550)

Hon. Pierre Poilievre: In a section of your report entitled “Risks to the Inflation Outlook”, you also identify, on page 28, a larger impact of structural factors and prolonged excess supply on inflation. In that section, you also talk about the possibility that housing prices may drop.

If that were to occur, the collateral against which household debt is secured would be reduced in value. How much risk does that pose to financial institutions or to the insurers that back up those institutions?

Mr. Stephen S. Poloz: It's exactly one of the scenarios that we considered carefully and have analyzed in some depth.

In our FSR, the financial system review, where most of this risk assessment takes place, we consider risks that have large drops in housing prices, much larger than one could anticipate along with a recession. In other words, the recession causes the housing prices to fall, so the economy has a double layer of shocks on it. In scenarios even as grave as this, the financial system remains highly robust.

It's true that collateral against which people have borrowed is reduced in value, but the financial system itself is very well provisioned against shocks of this sort. Of course, the new Basel accord brings us into that zone. Canada has not had to adjust much to those new accords because we've always had a more robust provisioning system than in many other countries. As a result, we're confident that the financial system itself is not a source of risk, but we consider these to be vulnerabilities, which are more likely, as I was describing a moment ago, to magnify the impact of shocks on the economy.

Carolyn, did you want to add anything to this?

Ms. Carolyn A. Wilkins: I would just add, aside from the fact that our banks are highly liquid, capitalized, and diversified, there have been other measures aside from interest rates. We've talked a lot about the role of interest rates, but there's a role for macroprudential policies as well.

OSFI, last fall, and then most recently this fall, has taken moves to improve the quality of debt that's out there by providing clarified guidelines to financial institutions that are lending to households about what kinds of criteria they should put in place to make sure the household can withstand increases in interest rates. Here I'm talking about the new stress tests that they put in.

What they did last fall was aimed at the insured space. In the data, you can now see that the share of households that are very highly indebted—those are households that have a loan-to-income ratio of over 450%—has fallen from about 18%, to a little less than half of that now. What they did this fall, most recently, was to look at the insured space—that's quite a growing area—and applied very similar kinds of tests there. It's too early to say what the effect is going to be on that, but over time it will improve the quality of debt so that it will be more resilient to the shocks that the governor was talking about.

● (1555)

The Chair: We'll go a little over the time, because I think the answers require a fairly in-depth discussion.

Go ahead, Mr. Poilievre, the floor is yours.

Hon. Pierre Poilievre: That's greatly appreciated, Mr. Chair.

Madam Vice-Governor, you mentioned the macroprudential measures that OSFI has instituted for mortgages that are low loan-to-value; that is, where down payments of greater than 20% are made.

I met today with mortgage brokers who made the point—a point that was also made in the *Globe* business report earlier this week—that these measures, combined with the uninsured nature of higher down payment mortgages, in many cases lead to higher interest rates for those with bigger down payments than they would pay if they made smaller down payments. That creates a strange perverse incentive to put fewer dollars down on one's house.

I think all of us would agree that we should be promoting bigger down payments because they're less risky to the system and to the borrower.

Do you worry at all about some perverse incentives that may result from OSFI's recent regulations?

Mr. Stephen S. Poloz: What in fact is happening there is that if your down payment is less than 20%, the rules dictate that it must be insured. A mortgage loan which is insured is, of course, a lower risk to the financial institution, so generally it's possible—it's not necessarily the case—that you'd have a lower rate of interest on that.

However, the borrower must pay for the insurance—it's not zero cost, it's actually quite a significant cost—which is rolled into the upfront value of their mortgage, so they are paying for it in a different way. Those folks who have more than a 20% down payment then go to an uninsured mortgage. It's possible that their interest rate will be a few tenths higher, but they're not paying for the insurance, which is a pretty big upfront cost.

I think, in that sense, there's no perverse thing in the space around the decision, and it's a stretch to create a case where you're actually better off in the first case.

The Chair: Mr. Dusseault, go ahead.

[*Translation*]

Mr. Pierre-Luc Dusseault (Sherbrooke, NDP): Thank you, Mr. Chair.

My thanks to the governor and the senior deputy governor for being here.

I was also thinking of spending time on the matter of household debt, but I feel that it has been well covered.

So I would like to go back to the relationship between two curves that, in my opinion, can be linked. They are the salary increases in Canada, or rather, as you said, the salaries that are basically stagnant, and inflation. Those two items can be linked because Canadians see increases in the inflation rate, and for basic products, but they also see that salaries are not increasing at the same rate.

Do you see that as a long-term problem for the Canadian economy? Do you have any data on those two issues and the relationship between them?

Ms. Carolyn A. Wilkins: That is a very interesting question because we are focusing a lot on salaries. It is one of the indices that we are examining to determine whether the pressures on inflation are upwards or downwards.

For salaries, using a number of sources, we can see that the increases are quite small, as you said. In addition, as you can see in figure 2 in the monetary policy report, we have tried to go into the issue a little more deeply. We have seen that we can explain a part of the weakness in salaries by the shock caused by the drop in petroleum prices that we have experienced. That brought about a change in a sector where the jobs came with salaries that were high when compared to other sectors, such as services, where salaries are lower.

In addition, the adjustments in the energy sector itself required small salary increases, and that continues. If you combine that with the labour market indicators, where supply exceeds demand, you can see that salaries are lower at the moment. However, we expect that, as the economy continues to grow, salaries will continue to rise. So there should then be an increase in those rates over time. However, the pressures on inflation coming from the labour market mean that the price of goods and services is lower than it would otherwise be.

• (1600)

Mr. Pierre-Luc Dusseault: Thank you. Some public policies at provincial level could perhaps help to increase salaries in general.

As for interest rates, the policy rates have increased, as you have clearly explained. I was wondering if a link can also be made with the federal debt, which is increasing, as we know. Everyone is aware of the recent economic statement. Do you consider public finances as a problem for Canada? Interest rates are increasing, which also means an increase in the costs of the debt.

Mr. Stephen S. Poloz: At the moment, we still really have no budget for 2018. We only know the items that the Minister of Finance mentioned would be added to the budget. That is why it is not possible for us to analyze the net consequences of the debt on the budget before it is introduced. In fact, the Bank of Canada incorporates tax exemptions only when the budget becomes law. We do not add them when they are simply announcements.

More generally, it is our hypothesis that the relationship between the debt and the economy is going to continue to decrease slightly. It is at a very low level in comparison with a number of other countries. In that sense, it is not really a major concern.

Mr. Pierre-Luc Dusseault: I understand. These are actually the Department of Finance's current figures on the level of private debt.

On another matter, in your report, you also talked about Canada's trade deficits in comparison to that of other countries. Do you have any additional comments about its possible impact on the Canadian economy? Are you expecting a trade surplus? My question is in order to get an idea of the impact of the deficit on the economy. Economically, is it a problem or is it a situation that is sustainable in the long term?

Mr. Stephen S. Poloz: The balance of trade is not really a very important variable in itself. It is a structural question rather than a cyclical question. I would say that our balance decreased 50% with the drop in the price of oil. That deprived our country of income of about $60 billion per year. Since that time, there have been adjustments in other sectors. Exports have increased in some sectors. Even the volume of exported oil has increased by about 25%. These factors are always in motion. Usually, it is a cyclical problem that is not permanent.

In any event, it does not represent a weakness for the country. At the moment, for example, it reflects a very strong economy, because we are receiving a lot of requests. Exports are beginning to reach a second level of growth. Basically, I can say that it is not a critical variable, to the extent that it is constantly changing.

• (1605)

Mr. Pierre-Luc Dusseault: You talked about the price of housing. Do you have statistics or data on the percentage of income that Canadians spend on their housing? I know that the percentage spent on housing is higher in some parts of the country. Do you have any data on the situation, any comments to make on it, or even any forecasts for the coming year?

Ms. Carolyn A. Wilkins: The data I have in my head are more about the regional distribution of debt. In total, we know that about 80% of Canadian household debt goes to mortgages and home equity lines of credit.

So it is very significant. Across the country, we see that the most indebted households, those whose debt is more than 450% of income, which is very high, are concentrated in regions where house prices are still very high, like Toronto, Vancouver and the surrounding areas. That is not surprising. It is also the case in Alberta because, beforehand, house prices were high there too. It is the case in a number of regions of the country where house prices are very high, and it comes as no surprise.

Certainly, in those regions, income could be higher too, because it corresponds to the cost of living. But when you look at the debt compared to income, it really is concentrated in those regions.

[*English*]

The Chair: Thank you, all.

Ms. O'Connell.

Ms. Jennifer O'Connell (Pickering—Uxbridge, Lib.): Thank you, Mr. Chair.

Thank you, both, for being here again.

Several of my questions are from the fall economic statement, which I know is not your report, but the Bank of Canada is quoted in it in terms of the Bank of Canada's business outlook survey. That's where some of my questions are coming from.

I want to talk specifically here with regard to investments. The fall economic statement talks about the Bank of Canada's business outlook survey showing there's a strong improvement in business investments in terms of intentions over the last year, and that the intentions remain in a solid, positive territory with capacity utilization rates of several industries currently close to their pre-recession peak.

I'm not saying that's what the bank said, but I'm assuming it's based on.... Well, they're saying it's based on your survey. Can you speak to that as well as the fact.... The statement in here is that business investment improvement may prove to be more long term and enduring in terms of continuation.

Mr. Stephen S. Poloz: Yes, the situation as I described earlier is one where we have the economy now, for the first time in many years, operating close to its potential. What one expects to see at this stage of the cycle, then, is firms that find themselves right at their full potential. In some cases, in fact, some 75% of those surveyed in the manufacturing sector say they're operating above their normal capacity level. That would be overtime, and that sort of thing.

When we get to that stage, companies generally begin to invest more, not just to replace equipment but to actually expand their capacity. It could be an upgrade in technology, in which case they might be able to expand their capacity without adding more workers, but very often it's not the case. What happens is that they actually add more workers too.

It is a really important stage of the business cycle for us. We haven't been here for some time. In most business cycles, when you have that upturn, you reach that capacity stage and the forecasters, ourselves included, have a trend line that's the economy's potential. We're saying that we're about at that trend line now.

However, what happens at this late stage is that companies add more capacity and the trend line tilts up for a while and gives us more capacity. When we say there's excess capacity in the labour market, that's where the economy has more room to grow. It means that those people, the discouraged workers, such as those who are working part time, can get a full-time job and those kinds of things. That adds to the economy's capacity.

By our surveys, the economy is primed and ready for this phase. We thought we saw the early signs of it in the first half of this year, and it's very reassuring to see. Despite the concern expressed almost universally about the uncertainty, going forward, about trade arrangements, despite that layer of uncertainty, companies nevertheless are prepared to invest. We take from this that their intentions would be even higher were it not for that uncertainty.

● (1610)

Ms. Jennifer O'Connell: Thank you. Actually, trade is exactly my next question, so that works out well.

Obviously, there is trade uncertainty and protectionist kinds of attitudes, certainly in the U.S. It's not only in the U.S., but in the U.S. it certainly impacts Canada.

This isn't your graph. It was provided by the OECD. It talks about labour productivity growth. Certainly in terms of aging population and demographics, Canada has concerns and we've talked about that here, but then I look at the United Kingdom and it's below 0.5%. It's probably 0.3%, but I don't know because it doesn't show all the numbers. Isn't there a huge opportunity through CETA, and I get it with Brexit with the U.K. specifically, but if there is a specific trade deal between Canada and the U.K.?

I see their labour productivity growth being extreme. If I were in the U.K., I'd be very concerned. Although there's uncertainty, is there not a huge level of opportunity and optimism, given the fact that Canada has changed between 2000 and 2007, and now it's not as significant when you look at the U.K. as one example?

Mr. Stephen S. Poloz: Right. It's a more complex question than it sounds, because productivity as measured there captures a lot of things in the economy. You could imagine if the U.K. was creating a lot of new jobs, but let's say the average job being created was in the service sector at a lower productivity level than in the financial sector, which is a high-productivity sector, or in manufacturing, which is high productivity. The mix of jobs can affect those numbers quite significantly.

I'm happy to say that Canada's labour productivity has picked up very strongly over the past year and a half to two years. Part of this is, no doubt, cyclical because it is the economy shaking off the collapse in oil prices and moving on to growth in other sectors, but it's also probably related to the thing I was mentioning a moment ago to your earlier question, which is that investment is picking up. If a company hasn't been investing, say, for five, six, or seven years, making their capital last, now every dollar they spend can have a big impact, because it's new technology or just upgrading things.

In addition, we now know that some companies can invest without there really appearing to be any investment. They do something in the cloud. They buy a service in the cloud instead of investing in the equipment themselves, and it looks as though the investment hasn't gone up, but we get the impact as if they had invested. The data are going to be increasingly difficult to interpret. StatsCan is all over this to help us understand it, but all that to say, we are at an encouraging stage here in Canada.

Ms. Jennifer O'Connell: Thank you. I actually have a short one.

This is not from your statement, but the fall economic statement talks about interest rates, which we've talked about here. One of the comments in the statement is that although interest rates are a risk—and we've talked about that here—most borrowers have fixed-rate mortgages so that can be absorbed easily.

I'm just curious. Does the Bank of Canada actually track and know and receive information from all of the banks in terms of how many in 2017 signed a five-year rate and how many in 2016 signed at that rate, so that you actually know how many people would be impacted in that given year by that given increase?

● (1615)

Ms. Carolyn A. Wilkins: The short answer is that, yes, we have fairly detailed data based on that. In fact, we've incorporated that in our model. Of course there are always behavioural differences, because some people still choose to keep variable. They don't always lock in. You have to think about the new homebuyers, who get hit immediately with changes in interest rates, but we're able to model that. You're quite right that about 70% of mortgages are fixed rate.

Ms. Jennifer O'Connell: Thank you.

The Chair: Thank you, all.

Mr. Albas.

Mr. Dan Albas (Central Okanagan—Similkameen—Nicola, CPC): Governor and Deputy Governor, thank you for being here today and presenting to this committee.

I'd like to start with the sections in your report that talk about growth prospects particularly in the United States and their impact here in Canada in terms of both the general economy and monetary policy.

Governor, in December you raised the spectre of divergence. You were prepared to use different tools at different times in order to differentiate between and navigate the different effects on the Canadian economy vis-à-vis that of the United States. Obviously, you mentioned animal spirits in the United States right now, whether that be from increasing oil prices—they're much more stable in their energy security—or in reference to possible tax reform. Right now the American economy seems to be picking up.

Do you feel that American interest rates are going to remain the same or increase in the short to medium term?

Mr. Stephen S. Poloz: Central banks never comment on one another's policies. It's just not done.

But the Federal Reserve has telegraphed its intention over time to move interest rates higher, and it has these dots, which are essentially the forecasts of the members of the committee, which suggest that interest rates would rise over time but at an undetermined pace.

We have discussed divergence in the past precisely because conditions changed so much in Canada relative to in the United States. In particular, when oil prices fell, that was of course a negative for Canada but it was actually a positive for the United States, because even though they have an oil sector, they're a net oil importer, whereas we're an exporter. In those conditions, in 2015 the Bank of Canada cut rates twice while the Federal Reserve actually raised rates that year.

That's about as sharp a point of divergence as one can imagine, and that's why we have flexible exchange rates to deal with those kinds of shocks.

Moving forward, I would say, roughly speaking, that Canada has just now gotten to the stage it was at before the oil price collapse, almost three years ago now. The end of 2014 was when oil prices really started to crumble.

I think that over that two and a half years or so, the U.S. economy has gotten out in front of us, whereas we were roughly in the same place when the oil price did go down. Now we're that couple of years behind in the cycle, if you like, compared to where they are. That's why I was expressing the hope before that we will do something similar to what's happened in the U.S. They were able to grow beyond what most people thought was their capacity limit by pulling people back into the workforce, and that's exactly what we think will happen here. It's very hard to quantify. We just have to continue to watch it happen in real time.

Mr. Dan Albas: In terms of business investment, this committee, at least the subcommittee, travelled across the country on pre-budget consultations. We heard a lot about the government's small business tax changes, but another thing we heard is that business investment would flow out of Canada into the United States.

Do you feel that tax reform in the American context might cause the Canadian economy not so much costs but that you would see more flows out of the country? What kind of effect would that have?

● (1620)

Mr. Stephen S. Poloz: This was a risk that we highlighted in our January monetary policy report, very soon after the U.S. election. At that time, the talk was about very significant changes in U.S. tax policies, and the market had absorbed that more or less as fact. What happened over the course of the next six or eight months was that the market reaction was gradually peeled back as the realities of the political process unfolded.

We, of course, acknowledge that there is potentially a risk that there will be a tax change that somehow makes it, on the margin, more attractive for a company to expand its operations or create a new operation in the United States. This is exactly the same strategy that companies are mentioning to us today in response to the risk around NAFTA—that if NAFTA were to cease to exist or be dramatically changed, one way for them to hedge against that risk, since it may take quite a long time for it to become clear, is for them to expand their operation in the United States instead of expanding in Canada.

This is a risk that we face today. In our forecast, we have lower investment spending expected for this reason, this uncertainty, yet as I said before, on top of that there still seems to be a strong willingness to invest, and the actual numbers are showing it.

It's a mixed kind of picture. That's all I have for you.

Mr. Dan Albas: I am almost out of time, Governor. I appreciate your being here.

I just have a quick question in regard to different markets and how that works with inflation. Do you think that a lower cocoa bean price will cause more consumption of chocolates by Canadian households, and in turn create inflation in the job market for dental hygienists, increasing inflation and ending up with kids with cavities? Do you think we should cancel Halloween?

Voices: Oh, oh!

Hon. Pierre Poilievre: That's a policy matter.

Mr. Stephen S. Poloz: I really don't think it's a good idea to cancel Halloween. I even brought a mask because I'm going to see my grandchildren afterwards.

The Chair: Is that it, Mr. Albas?

Mr. Dan Albas: Was that a trick or a treat?

Mr. Stephen S. Poloz: I'll leave that to you, sir.

The Chair: Okay. Next on my list is Mr. Sorbara.

Mr. Francesco Sorbara (Vaughan—Woodbridge, Lib.): Thank you, Mr. Chair. I'll try to return some civility to the meeting.

I have a couple of questions. First of all, the October monetary policy report, on page 11, talks about consumption growth and what the Canada child benefit has meant for Canadian families since the report was released, or near the same term. In the fall economic update, we introduced the indexation of the CCB, which will give Canadian families $5.6 billion of extra spending out to 2022-23, and about half a billion dollars a year invested in the working income tax benefit. I think this is wonderful, because it will hopefully draw in people who are not in the labour force to come into the labour force, and provide a cushion to folks whose marginal propensity to consumer-invest is actually pretty high.

I was wondering if you could comment on what it could do to the Canadian economy in terms of firming up consumption going forward.

Mr. Stephen S. Poloz: Given that the announcement is not part of a formal budget, we have not worked the indexation move or the income tax changes into our forecast for the economy. That would be something we do after a budget actually occurs.

We can talk about what the CCB that was put in place last year has done. We have estimated that it has added approximately 0.5 percentage points on the economic growth over the past year. This is something that raises the level of GDP but does not continue to contribute to growth. We believe that the effect is over. To put the 0.5 percentage points in context, when the economy was at its weakest point and we had excess capacity, it was on the order of two percentage points of GDP. Having that contribution from consumers meant that during the adjustment to the oil price shock, interest rates did not have to go lower, which was a beneficial effect.

● (1625)

Mr. Francesco Sorbara: Governor, we all know how hard it is to time fiscal policy or monetary policy, and monetary policy tends to operate on more of a lag, but fiscal policy, done right, is right. I think the CCB, from my view, was a timely measure introduced by our government.

I'm going to ask two questions together just so I can have the answers and not run out of time. First off, they say the Lord giveth and the Lord taketh away. There was some monetary policy that was removed through your actions. I'm just curious about the monetary transmission mechanism in terms of the time frame that we're looking at to see how the rate increases are impacting or working on the economy. With that, in your introductory comments, you talked about elasticity. We understand elasticity to a price change in terms of where household debt levels are and how there may have been a structural adjustment in terms of how households respond to changing rates.

I was wondering if you can comment, more on the latter than the former, because that is important. A small change in rates may have a larger impact than in prior years.

As for my second question, you commented about the economy operating at close to capacity, but your preferred measure for the labour market indicator demonstrates some slack. If you can square the "close to capacity", because I think the Canadian economy has grown in capacity or output potential, and you can comment on that as well.

Mr. Stephen S. Poloz: Okay, I'll take the second question, and then I'll turn it over to Ms. Wilkins.

When we talk about the output gap or the economy's capacity, one is a broader concept than the other. The output gap refers to output, production, and we believe we are operating more or less at that level at this stage. Economic potential is a broader concept that includes using all of your existing labour supply.

What we see—and our labour market indicator in particular shows—is that it is still a percentage point higher than it was in 2007, whereas the unemployment rate is where it was in 2007. That shows that those secondary measures of capacity and labour market still have slack, and we won't be fully at our capacity until we've re-employed those resources through stronger investment. That's the process I was talking about before.

For a while we'll have a gap between those two measures. It's as simple as that.

On to the interest rate elasticity, I'll ask Madam Wilkins to comment.

Ms. Carolyn A. Wilkins: We made quite a bit of modelling changes to make sure we could capture the main channels. The intuition behind why interest rates have a stronger impact when we're highly debted is pretty clear. If you have a $500,000 mortgage, 25 basis points is about $60 a month, and that's going to be taken out of the money that you have to spend on other things. All else being equal, consumption is going to go down a bit, or be less strong than it was. If you had $100,000 mortgage, that would be $12. It makes a really big difference.

It may be that it affects people differently over time, depending on whether they have a variable rate mortgage or a fixed rate mortgage, but eventually that transmission gets through the system. In general, it's six to 18 months, a 24-month process, and it flows, not only through consumption but also through the price of houses, because again, if you're spending more of your income on something else, like interest rate payments, maybe you're not as inclined to buy a bigger house than you were. Maybe other people need to wait longer to buy a house, so all these channels come together to mean that, when people are more highly indebted, it's going to have a larger impact.

With our new model, we are more confident than we were in the past that we've been able to capture those effects.

The Chair: Thank you all.

We'll go to Mr. Kelly, and then Mr. Grewal, and we will have time for a couple more, if there are others.

Mr. Kelly.

Mr. Pat Kelly (Calgary Rocky Ridge, CPC): Thank you.

I'm going to continue discussing some of the mortgage related parts we've already begun today. When it comes to housing, Canadians don't choose to be heavily in debt from mortgages. They participate in the market they live in, and the price is the price. We know that in many centres the prices are very high, and if a person is going to own their own home they must take on these large debts.

I want to make a comment about a point, Governor, that you spoke about, the trade-off between a consumer choosing to pay the insurance fee for a high-ratio mortgage as opposed to putting the additional money down. I've been a mortgage broker for over 20 years. When a borrower is confronted with the choice between a lower interest rate, paying an insurance fee that's amortized over the life of the mortgage, and the option, then, to put less money down, almost every borrower chooses the lower down payment. That's just a human nature type of decision that most people will make. This business about perverse incentives, I think, maybe ought to be a concern over what behaviours are being encouraged.

● (1630)

Mr. Stephen S. Poloz: There are more constraints than that on a system. For instance, the insurance market only operates up to $1 million. I know that sounds like a lot for a house, but in certain markets it is not. The other thing is that if we're faced with a choice like that, which way will people go? The data suggests contrary to your presumption, which is that a lot more people were trying to have larger down payments, it has more to do with their ability to qualify for rather expensive houses.

It's very hard to know exactly what's going on, but we have a really big cluster of people at 79% mortgages, so they've just made the 20.5% or the 21% down payment. Some people are highly motivated to do the opposite of what you say, but then of course we have lots of people who are also at the other end. I guess that tells us it's a pretty personal choice.

Mr. Pat Kelly: I think in terms of the first-time buyer, who typically has to put together everything they can just to make the minimum. If they are told that if they have their 20% or their 21% but they could go with a bit less down and they would get an interest rate that, right now, in some cases is up to 40 basis points better than the conventional rate, they would opt to do so if they had that incentive as well.

Is there any concern about the extent of some of the changes that have taken place, that the competitive pressures will eventually drive borrowers away from lenders who are regulated by OSFI, the federally regulated financial institutions, and into other types of credit, which will be higher interest rate credit, and with all the consequences we've already talked about in the spillover into the rest of the economy?

Ms. Carolyn A. Wilkins: Having alternatives to the traditional banks for a mortgage allows a market to be served that may not otherwise be served, and maybe at the right price. That market is related to people who don't have a long credit history but over time could get one. I think it's a very important market.

It is true that the more constraints you put on the space regulated by OSFI, there is the possibility that it would spill over to other forms of lenders. I think the question there is whether or not those lenders have as rigorous underwriting processes. That's a question sometimes for provincial regulators that are well-equipped to answer that question, not us, and as well, the institutions themselves.

The fact that the price is higher may reflect the fact that the risk there is also higher. Sometimes we think about, what's the right decision for me as a homebuyer today? What makes sense? What price do I have to pay? Some of these ways of thinking about what you can afford over time take into account situations where things don't happen the way you'd like: interest rates rise or the price of your house falls. I think these longer-term rules can serve to help households over the longer term in having a sustainable level of debt.

● (1635)

Mr. Pat Kelly: I have a quick question then about regional differences in not only the housing market but in the greater economy. I'm a member from Calgary, where unemployment is still uncomfortably high and many people are very concerned about their jobs.

How do we address the regional differences that exist either within housing or throughout the broader economy?

Mr. Stephen S. Poloz: The short answer would be not with monetary policy, since we only have one tool and that's the interest rate. It's the same interest rate for everyone. This is almost always the case, in that there are areas or sectors in the Canadian economy that are weak, while others are stronger than normal and there's absolutely nothing we can do except to pay attention to those details, in terms of figuring out how things are evolving at the macro level.

For us, it's one macro economy and that's essentially the way we look at it. Of course, there are other tools in the policy space to try to address developments in individual sectors or individual parts of the economy.

The Chair: Thank you all.

Mr. Grewal is next. Pierre, we'll come back to you for a question as well.

Go ahead, Mr. Grewal.

Mr. Raj Grewal (Brampton East, Lib.): Thank you, Mr. Chair.

Governor, you're way too young to be a grandfather.

Mr. Stephen S. Poloz: No, I'm not.

Mr. Raj Grewal: I know. Having the governor as a friend is never a bad idea.

Governor, you mentioned that your number one tool in terms of monetary policy is the interest rate. Even if they don't have a finance degree, a lot of Canadians recognize that when the Bank of Canada reduces the interest rate, it's generally to help stimulate the economy. Why would the Bank of Canada increase the interest rate?

Mr. Stephen S. Poloz: I think it's better to start the story with why we reduced interest rates in 2015. We did so because the economy was hit by a very significant negative shock, which was the fall in oil prices. As I mentioned earlier, it had the effect of taking $60 billion a year of income out of our economy. It was a very significant shock, so the adjustments to that would mean cutting back on investment and cutting back on consumption spending in the affected areas in particular. By cutting interest rates, we were able to smooth out that process. It didn't make it that much easier for folks in Newfoundland and Labrador or Saskatchewan or Alberta, but it did make the rest of the economy adjust more quickly. The exchange rate fell more than otherwise would have been the case, and speeded up export growth in other sectors, and so on. That's the full story.

The next question is, why would you raise interest rates? We raise interest rates because the adjustment that was going on in the macro space is complete, not in every region but macro. We did that because we would have undershot our inflation target significantly had we not reacted. By cutting rates, we were able to project that inflation would be back to our target, by some time in 2018. If we did not move interest rates back to a more normal level, then we'd be at higher risk of exceeding our target.

Mr. Raj Grewal: Thank you, Governor. You said in your testimony today that growth in housing is projected to slow further, in part because of the measures introduced by the Ontario government. We also have the new mortgage rules coming through from OSFI, which a lot of my colleagues on the committee addressed. The anticipation in the market is that this is going to further slow down housing.

How will that impact growth in the Canadian economy on a macro level?

Mr. Stephen S. Poloz: The changes to OSFI's rules and other changes are not the normal things that are in macroeconomic models, whereas interest rates are obviously in our models. It requires a little extra and more innovative analysis. We have microdata, which was alluded to earlier.

We know, for example, how many people who qualified for mortgages in 2016 will not qualify for them under the new rules and how much less they can borrow. We were able to do almost a simulation, as if we had put the rules in place earlier. We can do that and we can then translate it into an approximate effect on the economy, on the order of 0.2 or 0.3 percentage points in the subsequent year or two of GDP. If it's growth, then it might be half that over two years, or if it's faster it will be all in one year.

Importantly, the way one reacts is an individual decision. Here are the new rules; what do you do? This is the house you wanted to buy, and now you don't qualify. Is your reaction to postpone for a year? Possibly. Is your reaction instead to say, “I think the house next door, which is a little smaller, suits my needs as well, so I'll buy that one instead”, in which case you still go ahead with the transaction.

It's very hard to know how it actually translates into GDP impacts. This is exactly why we say, with the new level of interest rates today compared with those of six months ago, that we need to monitor very carefully how people are actually behaving in real time. We can't just rely exclusively on our models to do that.

● (1640)

Mr. Raj Grewal: I agree with you, Governor, that it very much could be reactionary. It could be positive in certain markets. It could be negligible in certain markets, as most assumptions are. There are assumptions that in Vancouver and in Toronto the changes won't have too great an impact because demand in housing will keep pushing it along.

Because Canada's economy is very much regionally based, however, it will differ. It will have disproportionately negative impacts upon the east coast provinces and some of the prairie provinces because of housing. People won't qualify for mortgages anymore. I think this is something that only time will tell as the policy is rolled out.

Deputy Governor, my colleague asked a question on data concerning fixed-rate mortgages. I'm assuming you also track the default rates on mortgages across the country.

Ms. Carolyn A. Wilkins: Yes.

Mr. Raj Grewal: Has there been significant movement in the last 12 months, after the measures by the provincial governments in Ontario and B.C. and the federal measures were announced?

Ms. Carolyn A. Wilkins: They're very low.

Mr. Raj Grewal: They're minimal. Has Alberta recovered? There was a spike in defaults after energy prices fell in the province of Alberta—

Ms. Carolyn A. Wilkins: Actually, they edged up a bit to—

I'm sorry. I interrupted you.

Mr. Raj Grewal: That's okay.

Ms. Carolyn A. Wilkins: They edged up to meet the national average, in fact, because they were lower before.

Mr. Raj Grewal: What is the national average?

Ms. Carolyn A. Wilkins: The actual number...? I have 0.3% or something in my head. It may be slightly higher, but I think it's under 1%. I can get back to you with the actual number.

Mr. Raj Grewal: Perfect. Thank you.

Mr. Stephen S. Poloz: It's a decimal point of 1%. It's a low number.

Mr. Raj Grewal: Then why is there so much proactive regulation of mortgages?

Mr. Stephen S. Poloz: Our concern is, as I've described before, with the vulnerability of the economy. It's not that there's some form of wall there, but the problem is that the economy is more vulnerable to future disturbances like the oil shock, the kind of shock that's unforeseen. It's the vulnerability we've characterized in the past as being like a crack in a tree. The tree looks fine. It's all fine except when just the right storm comes along. Then the tree is on your neighbour's house when you come home. That makes for a bad day.

The point is that the economy magnifies those shocks, and we get even bigger rises in unemployment and financial stress in the financial system when debt is high. The main point of these things is to make sure that the economy is more resilient in the future, so that if you've been tested for a two-percentage point higher rate of interest and your circumstances would allow you to ride through a two-percentage point increase at renewal, then we can be confident that things that transpire between now and then are not going to upset the system.

It means that all the new debt that is arriving in the system now is making the system much more resilient than it was in the past.

● (1645)

The Chair: Okay, we'll have to leave it—

Mr. Raj Grewal: Ten seconds...?

The Chair: Let's take your 10 seconds.

Mr. Raj Grewal: Thank you, Mr. Chair.

It's my last question. That was the positive angle of having proactive regulations on mortgage. The negative angle, many people would argue—especially my former colleagues on Bay Street—is that it slows the ability, especially for first-time homebuyers, to qualify and make that leap into the housing market.

Mr. Stephen S. Poloz: Yes, it does.

The Chair: We have three minutes, time for about three more questions.

Before we move on—and you partly answered this question earlier to Ms. O'Connell—you said in your remarks, “The second source of uncertainty is the degree of excess capacity in the economy” and “slack remaining in the labour market”, and you used the example that “the participation rate of young workers is still below trend and average hours worked are less than we would expect.”

When we were on the road, as we have been for two or three weeks with the pre-budget consultations, we heard everywhere about the need for greater education, more skills training, matching skills to meet jobs, etc. I'm not asking you to suggest policy, but I'm asking you for your analysis. Is there a problem with skills in the labour market that you're seeing in your analysis? Is there more part-time work than there is full-time work? What analysis does the Bank of Canada have there?

Mr. Stephen S. Poloz: All of these things may be true, Mr. Chairman. We know there are structural changes in the economy and that there's extra growth in part-time working arrangements as opposed to full-time arrangements. Taking account of those things, it still appears to us there is excess capacity in the labour market. It is primarily a youth thing, but not entirely. We have five percentage points lower participation in the workforce by youths aged 15 to 25 than we had prior to the great financial crisis. Now I realize we're talking about different people now, because 10 years have gone by and they may be staying in school longer—which is all well and good, and the effect of a recession is often that people spend more time at school—but the fact of the matter is that we believe there's extra capacity there.

We've tried to quantify that in a separate paper, which was published alongside our monetary policy report. In fact, we simulate the effect. If we're able to get an extra one percentage point of extra economic capacity by this reintegration into the workforce—more conversion from part time to full time and reparticipation by those youths—that is a very significant thing for us to achieve, whether it's done by helping through other policies to make it easier, re-skilling them, or by other means.

All those things can help us, but it also means, to the extent that it occurs, that we will undershoot our inflation target one and a half to two years from now. Therefore, we have to watch for it happening, and hope that it will happen to a certain extent and that we can allow it to occur by watching it unfold and not nipping it in the bud.

The Chair: Okay, thank you.

Mr. Dusseault.

[*Translation*]

Mr. Pierre-Luc Dusseault: Thank you, Mr. Chair.

Earlier, I think you alluded to e-commerce and to the share of the economy it is taking. In the digital era, that goes without saying. E-commerce is profitable for Canadian companies, but it is also profitable for foreign companies that are flooding the market with poor-quality, low-cost products.

Do you have any data on e-commerce, specifically in retail but also in the cultural area, and on the extent it occupies in our economy today?

Are there any forecasts or concerns that you would like to share with us about the scale of it and the fact that our Canadian companies must compete with those companies?

China comes to mind, which sends cheap products to Canada at very little shipping cost.

Are you going to be watching these situations on your radar screen?

● (1650)

Ms. Carolyn A. Wilkins: We are certainly monitoring that type of situation closely.

Given our mandate, it will come as no surprise that we are more concerned with the effects and the process of inflation. But we are also looking at the possibility of transition costs in a labour market where the nature of employment changes with use, or even with the effects on people's income.

As for inflation, we conducted several studies that have been published for a week. They are interesting because they show that the effect of e-commerce on inflation in Canada does not seem to be very visible at the moment, even though, anecdotally, we might be led to believe the opposite. The number of Canadians embracing e-commerce is lower than in other countries, such as Sweden or other European countries. However, that could change, and it is true that it represents another kind of competition for Canadian companies.

As for employment, we are not currently seeing the effects of the digital revolution on productivity. It is yet to come, but we can well imagine that the nature of employment will change greatly and we have to be ready for it, both for people coming into the workforce and for those who are already in it. Training and education are very important factors. However, that is not part of the Bank of Canada's mandate. We just do studies in an attempt to better understand it all.

Mr. Pierre-Luc Dusseault: Thank you.

[*English*]

The Chair: Thank you.

Mr. Poilievre.

Hon. Pierre Poilievre: Governor, you spoke about some of the reasons that inflation has been so moderate for so long. I think two examples you gave were low-cost imports and technology.

These factors are unpredictable. We don't know exactly what technology will do to our costs into the future because, by definition, all technological developments involve introducing something new and unknown. Over time, the low-cost imports may become more expensive as labour costs rise in the developing world.

Do you have any concerns at all that inflation in the medium term might be higher than the consensus view?

Mr. Stephen S. Poloz: Those, of course, are exactly the questions that keep central bankers awake at night, so I won't deny this. Most of the history of technological improvements—or, if you like, the effects of globalization or supply-chaining—on the inflation process has been to reduce inflation below what its trend line had been. This is what we call positive disinflation. It means that people are getting things for less money.

It would be odd for a central bank to try to boost inflation in other parts of the economy to try to average it out to be exactly 2%. It's the kind of thing we would normally see through precisely for that reason, and because it's unforeseeable, as you say. It's quite similar to an exchange rate effect on inflation, which is transitory one way or the other. We would see through it.

Our greater concern—and this is how the risks become balanced—is that we are now in a place where we're operating more or less at capacity. We believe there's extra capacity, but it has to occur for it to be relevant. If there isn't, it means that we'll be into the excess demand space, and inflation fundamentally will begin to pick up. We would see that in the labour market first. This is why we watch each of these things as we go along.

We're in that zone where those risks are truly two-sided, up or down on inflation, so of course we worry about both sides, but given our history—where we've been for the last number of years—we're much more preoccupied with the downside risks.

● (1655)

Hon. Pierre Poilievre: One of the drivers of growth in the last couple of quarters has been residential construction. As consumers become tapped out and are no longer able to add debt in order to purchase housing, and as prudential measures pile on one another from both provincial and federal governments, resident housing prices are expected to moderate.

What impact do you expect that will have on the very large segment of our growth that has relied on residential construction?

Mr. Stephen S. Poloz: Sir, you're absolutely right that residential construction has been our leading growth sector throughout this very low interest rate period since the crisis, but our forecast is exactly that. It would become a much less important contributor over time to growth, and instead what we get is leadership from investment as firms expand capacity, as discussed earlier, and of course with that, the export behaviour, which is picking up in new export sectors.

That's exactly the shift in growth leadership or the rotation, if you prefer the term, in demand that we're expecting to see, and we have begun to see it this year. Housing was a negative contributor to economic growth in the second quarter, and we expect it would be probably flat again in Q3.

But the big numbers you saw were from all the other things that are growing.

Hon. Pierre Poilievre: Finally, you commented on the ability of Canada's interest rates to diverge from American interest rates, but your commentary, I noticed, was on the divergence of trajectory and not on the actual numeric rates themselves.

How big a divergence is sustainable, given the massive integration of the Canada-U.S. economies?

Mr. Stephen S. Poloz: This is a question that depends on the divergence in the inflation paths in the two countries. In the example that I gave there was a swing of some 75 basis points between Canada and the United States during 2015. There have been other episodes similar to that.

The truthful answer is that it only depends. I couldn't speculate on what is the maximum divergence we could sustain, but it would just depend on the underlying shocks.

I remember studying the early 1970s when Canada first went back to a flexible exchange rate. There was a massive divergence between the Canadian and U.S. economies at that time, and the exchange rate, as soon as it was unleashed, rose by some 10¢ in a very short space of time because of that divergence.

Really, I think the most important thing that helps us equate when there is a divergence is the exchange rate. Interest rates are less the engine of correcting that. They're more of a facilitator, if I can put it this way.

The Chair: Thank you.

Mr. Sorbara, you have the last segment.

Mr. Francesco Sorbara: Thank you, Mr. Chair.

Governor, you had commented, or the deputy governor commented on the labour force productivity in the last year or so, showing some pickup in trajectory. I was just wondering what you think is behind that pickup. How important is it to raise the standard of living for all Canadians to get that labour force number going in that way?

Mr. Stephen S. Poloz: Productivity in Canada is growing sufficiently strongly now, in aggregate somewhere around 3%, and in the goods sector, more than 4%, which is quite unusual. That suggests to me that it's for the most part a cyclical thing that will slow down to something more normal in the near term, but that remains to be seen.

What I think it reflects is the transition of the economy in the wake of the collapse in oil prices, the shrinkage of the oil sector, and then the expansion in other sectors coming in high-productivity areas. That's something that will continue, provided that those two growth tracks remain in place.

It's crucial that we get that behaviour because that is the basis for expanding incomes. Right now, Canada's unit labour costs are actually falling relative to the United States, but falling in absolute terms because productivity is outpacing wages. What we would expect to see in the near term is that things will pick up. As the excess labour is being picked up out of the labour market, wage growth is going to pick up because companies can afford it.

● (1700)

Mr. Francesco Sorbara: Thank you.

The Chair: That will end this session with the governor and the senior deputy governor. Thank you very much for your responses to questions.

Committee members, we will suspend for about a minute and then deal with the committee business before we start with the PBO.

Thank you, again, Governor. The meeting is suspended.

● (1700)

(Pause)

● (1705)

The Chair: We shall reconvene. Before we start with the parliamentary budget officer, we have some committee business to deal with. Members have a report from the subcommittee on committee business going forward. I'll just go through it and then we'll see if there are questions.

Point one we talked about this morning. We had a little difficulty figuring out how to deal with embargoed copies. We agreed that an embargoed copy of a report from the parliamentary budget officer, 24 hours before it is made public, be distributed to members of the committee, and the report remains confidential until it is made public by the PBO.

Point two, the pre-budget consultations are explained in the report. People may not be aware of a couple of things. We agreed that the draft report contains an executive summary describing the main themes of the report, and that the committee include a statement in the report from the trip to Washington, D.C., and New York; that the parties submit their proposed recommendations to the clerk in both official languages, no later than 5:00 on Thursday, November 30; the committee meet on Monday, December 4, and Tuesday, December 5, from 3:30 to 5:00 to consider the draft report; and the committee meet on Wednesday, December 6, from 3:30 to 5:00, if necessary, for further consideration of the report. That is all on the calendar and it's marked in yellow.

Point three, we agreed that the clerk proceed with planning the committee trip to Washington and New York, according to the draft itinerary, as discussed by the subcommittee.

Then point four, turning to Bill C-63, the budget implementation act, I think it would be better to explain this by the calendar rather than going through the recommendations. It's there before you. On November 2, the committee would meet with departmental officials, and that 5:00 p.m. would be the deadline to submit to the clerk the witness lists for Bill C-63.

On Tuesday, November 7, the committee would meet and hear from 12 witnesses or thereabouts. On Wednesday, November 8, and this relates, Pierre, to the motion that you tabled, we would meet with the minister from 3:15 to 4:15 on supplementary estimates; we would have the minister before us from 4:15 to 5:15 on the bill itself, Bill C-63; and if necessary, from 5:15 to 5:45 we would deal with the remaining representatives from the departments.

On Thursday, November 9, we would again hear from witnesses from 3:30 to 6:30, related to Bill C-63. That would be in the range of two panels, six witnesses each. November 16 at 12 p.m. would be the deadline to submit amendments for Bill C-63. Then on Tuesday, November 21, we would go through clause-by-clause consideration of Bill C-63, and be in a position to report it back to the House. That deals with the Budget Implementation Act.

● (1710)

Mr. Greg Fergus: Mr. Chair, I just want to confirm that it would be all day or as long as is necessary.

The Chair: We have to finish by what it says in the motion here, nine o'clock that night. I'll read this into the record so we're clear:

> if the Committee has not completed the clause-by-clause consideration of the Bill by 9:00 p.m. on Tuesday November 21, 2017, all remaining amendments submitted to the Committee shall be deemed moved, the Chair shall put the question, forthwith and successively, without further debate on all remaining clauses and proposed amendments, as well as each and every question necessary to dispose of clause-by-clause consideration of the Bill, as well as all questions necessary to report the Bill to the House and to order the Chair to report the Bill to the House as soon as possible;

That would be the end on the bill.

I mentioned point five. That would be dealing with the supplementary estimates (B). The Minister of Finance, as I mentioned, would be before the committee on supplementary estimates on Wednesday. As well, the Minister of National Revenue and department officials would appear before the committee on Thursday, November 23, on the estimates for that department.

That's the report.

(Motion agreed to)

The Chair: Thank you, PBO officials, for your indulgence while we dealt with that matter.

Pursuant to Standing Order 108(2), we have a study of the economic and fiscal outlook. We have before us, for this panel, the Office of the Parliamentary Budget Officer, Jean-Denis Fréchette, PBO.

I'll let you introduce your people. The floor is yours. I know you have an opening statement. Welcome.

Mr. Jean-Denis Fréchette (Parliamentary Budget Officer, Office of the Parliamentary Budget Officer): Thank you, Mr. Chair.

[*Translation*]

Good afternoon, Mr. Chair, Vice Chairs, and members of the committee.

I am joined by my colleagues Mostafa Askari, Deputy Parliamentary Budget Officer, Chris Matier, Senior Director, Economic and Fiscal Analysis, and Trevor Shaw, Economic Analyst, also with the Economic and Fiscal Analysis team. We are grateful for your invitation to appear to discuss our economic and fiscal outlook for October 2017. As you know, these are part of the PBO's legislated mandate, in order to promote greater budget transparency and accountability.

[*English*]

As members of the committee may know, this report was prepared in response to the motion adopted by this committee on February 4, 2016. However, since then, the PBO legislation under the Parliament of Canada Act was amended. It is therefore in accordance with that legislation that yesterday we provided a copy of the report to the chair and the clerk. We made the report available to the public one business day after, that is, this morning.

Going back to the report, regarding the economic outlook, the Canadian economy advanced at a robust pace in the first half of 2017. However, beginning in the second half, we project that growth and consumer spending will moderate and residential investment will continue to decline as borrowing rates rise and disposable income gains diminish.

We project real GDP growth to slow from 3.1% in 2017 to 1.9% in 2018, and then average 1.7% annually over 2019 to 2022. Nominal GDP, which is the broadest single measure of the tax base, is projected to grow at 4.1% annually, on average, over 2017 to 2022. Compared with our April outlook, the projected level of nominal GDP is broadly unchanged.

● (1715)

[*Translation*]

We assume that the Bank of Canada will maintain its policy interest rate at 1% until January 2018. As core inflation continues to firm through 2018, we project that the Bank of Canada will gradually increase its policy rate by 25 basis points each quarter until it reaches its neutral level of 3% by the end of 2019.

Our economic outlook reflects the view that possible upside and downside outcomes are, broadly speaking, equally likely. In terms of downside risks, we maintain that the most important risk is weaker business investment. In terms of upside risks, we maintain that the most important risk is stronger household spending.

[*English*]

On the fiscal outlook, the budgetary deficit in 2016-17 was $17.8 billion. This is $2.8 billion lower than we projected in April, reflecting lower than expected direct program expenses, due in part to an estimated $2 billion in unspent infrastructure funding.

For the current fiscal year, 2017-18, we expect that the budgetary balance will show a deficit of $20.2 billion, which is 0.9% of GDP. We project that budgetary deficits will decline gradually, falling to $9.9 billion, which is 0.4% of GDP, in 2022-23. Lower direct program spending accounts for most of the reduction in the deficit over the projection horizon.

Compared with our April outlook, we are projecting budgetary deficits that are $2.2 billion lower, on average, from 2017-18 to 2021-22.

In budget 2016, the government committed to reducing the federal debt-to-GDP ratio to a lower level over a five-year period ending in 2020-21. This translates into a fiscal target of 31% or lower for the federal debt-to-GDP ratio in 2020-21. Under current tax and spending plans, we project that the federal debt-to-GDP ratio will be 29% in 2020-21, which is two percentage points of GDP lower than the government's target.

[*Translation*]

Given the possible scenarios surrounding our economic outlook, and on a status quo basis, it is unlikely that the budget will be balanced, or in a surplus position, over the medium term. However, it is likely that the federal debt-to-GDP ratio will fall below its target level of 31% over 2017-18 to 2022-23. We estimate that there is, approximately, a 70% chance that the federal debt-to-GDP ratio will be below its target.

Lastly, in our report published today, we also provided some tables comparing our economic and fiscal projections to the government's projections presented in the fall economic statement. Consistent with the PBO's legislated mandate, we plan to publish an analysis of the fall economic statement in the coming weeks.

Once again, my colleagues and I would be pleased to answer any questions you may have about our economic and fiscal outlook or any other analysis.

● (1720)

[*English*]

Thank you, Mr. Chair.

The Chair: Thank you very much, Mr. Fréchette.

I think we have time for the first round at seven minutes. We'll recalculate after that.

Mr. Sorbara.

Mr. Francesco Sorbara: Thank you, Mr. Chair, and welcome everybody.

In your opening remarks, sir, you make the comment of possible upside and downside risks, and you mentioned the downside risks on business and weaker business investment. In the monetary policy report at the Bank of Canada—and we just had the governor and deputy governor here—the Bank of Canada has business investment firming and stabilizing, and contributing positively to Canadian GDP, less so on the residential investment side.

Could you comment on that business investment comment you have there? If you had to pick, what would be your top three downside risks and top three upside risks for the Canadian economy?

Mr. Jean-Denis Fréchette: Thank you for the question.

Mr. Chris Matier (Senior Director, Economic and Fiscal Analysis, Office of the Parliamentary Budget Officer): Thanks for the question.

On business investment, our outlook over the first three years is a bit stronger than the Bank of Canada's. We have a bigger rebound in business investment growth. At the same time, we also have a more, let's say, negative outlook on the residential sector, so we have a bigger decline in residential investment over that period. Part of that, as the governor mentioned—I caught the last couple of comments—is that investment helps to increase the productive capacity of the economy and boost potential growth, so that's being reflected in our outlook.

The risks that we identified are definitely what we see as the most important upside and downside risks. I'm not sure I can give you a top three and bottom three, but the others that are definitely under consideration relate to U.S. trade policies. Again, this is something that several other forecasters have pointed out, based on the uncertainty around NAFTA, of course. Then on the opposite side of that, coming from the U.S., is U.S. fiscal policy and talks about tax reform and tax reduction, so we see that as a possible upside. The way that we treated that in our forecast is that we just assume that they would be offsetting. That's definitely a judgment call and we're open to that.

There are some others, both global and domestic. On the domestic front, we could see a sharper correction in the residential sector than we currently have. We think that it's considerable, but given some of the recent changes on the mortgage underwriting guidelines and maybe a larger impact of the expected increase in interest rates, that could have a more negative impact on the housing side.

Our export outlook is also, I don't want to say, very optimistic, but we do see bigger pickup in terms of growth in export volumes, at least relative to the Bank of Canada's outlook. Maybe on the downside, if we do see another persistence in competitiveness issues for Canadian exporters, we might not see that rebound.

Those are probably the top two and bottom two.

Mr. Francesco Sorbara: Thank you for that commentary.

Regarding Canada's fiscal position or capacity, when we talk about the deficit, what percentage of GDP is that at currently?

Mr. Chris Matier: In the current fiscal year...?

Mr. Francesco Sorbara: Yes.

Mr. Chris Matier: It's 0.9% of GDP.

Mr. Francesco Sorbara: It's 0.9%.

Mr. Chris Matier: It's less than 1%, yes.

● (1725)

Mr. Francesco Sorbara: As a percentage of GDP on an annual basis, the trajectory is continuing to decline. That's is how I would take that.

Mr. Chris Matier: We're projecting it to decline to 0.4% of GDP by 2022-23.

Mr. Francesco Sorbara: What is the U.S.'s position? What does the U.S. use as a deficit as a percentage of their GDP?

Mr. Chris Matier: Off the top of my head, I believe it's roughly around 3% or 3.5% of GDP currently.

Mr. Francesco Sorbara: Okay. Thank you.

When we look at fiscal anchors, it's great to see that we have the debt-to-GDP number declining in this current projection and potentially hitting below 30%. Is that correct?

Mr. Chris Matier: Yes. We have the debt-to-GDP projected to decline to 29%.

Mr. Francesco Sorbara: I say that because, as the debt-to-GDP is declining and as the deficit as a percentage of the GDP is declining, we're obviously undertaking strategic investments in our economy, including the Canada child benefit, which in the last testimony provided a 0.5% increase to GDP. Have you any estimates on what the impact was of the Canada child benefit in your modelling on the Canadian economy?

Mr. Chris Matier: Unfortunately, in this outlook we don't have an estimate of the impact, but we have incorporated it into our outlook for consumer and household spending, so it's in there but we haven't isolated it. I believe the last time we provided an estimate of this was back in our April 2016 economic and fiscal outlook. I forget off the top of my head what that impact was.

Mr. Francesco Sorbara: Thank you for that analysis, and I take it that, once the legislation comes out with the indexation of the CCB and the working income tax benefit, the PBO will be providing a more thoughtful analysis on that front.

I'm finished, sir.

The Chair: Okay.

Mr. Poilievre.

Hon. Pierre Poilievre: Thank you for being here.

Between now and 2022, a five-year period, public debt charges, that is, interest on the national debt, are expected to grow from $24 billion per year to $38.5 billion, which is an increase of $14.5 billion or 58%.

Can you confirm that this annual expenditure of $38.5 billion for debt interest is money that the government cannot allocate to fund health care or other valuable services that Canadians use?

Mr. Mostafa Askari (Deputy Parliamentary Budget Officer, Office of the Parliamentary Budget Officer): Yes, of course, you're correct. That's the expense of the government and they have to manage that within the envelope they have in terms of revenues and the amount that they borrow.

Hon. Pierre Poilievre: This $14 billion is the increase in debt interest that the government will have to shoulder, that taxpayers will have to cover. Is that a significant amount of money in the context of the overall Government of Canada budget?

Mr. Mostafa Askari: In terms of the overall size of the economy and where we are going, no, it is not a big amount. The reason for that is twofold, actually. One is that interest rates are rising in our projection. That's obviously one impact on the public debt charges. The other one is that the government continues to have a deficit over that period. That accumulates over time with the higher debt level, so that will increase the public debt charges.

Hon. Pierre Poilievre: You mentioned that interest rates are rising. How much would interest rates need to rise before heavily indebted Canadian households begin to feel financial distress?

Mr. Mostafa Askari: We did a study earlier this year in which we looked at Canadians' household debt and their debt service ratio and we showed that over the next five years the service ratio will increase. That is obviously a pressure on households in terms of their finances, because as the debt service ratio goes up, it means they cannot spend the money on other things that they normally spend it on.

There is certainly an increase and more pressure on households. Whether that's a crisis or not, that's a different issue. I can't really say whether that would lead to a crisis for households, but certainly, it would increase the pressure on households.

Hon. Pierre Poilievre: How much could these households absorb in the way of interest rate increases?

Mr. Mostafa Askari: How much would they be able to absorb? That's hard to tell.

Chris, do you have any views on this?

● (1730)

Mr. Chris Matier: No. We don't have an estimate of what the maximum threshold is, but what we provided in that report was basically a comparison over the last, I think, 25 years. We projected that if, as expected, the Bank of Canada's interest rate rises back up to about 3%, which is the mid-point of its estimates for the neutral rate of interest from current levels, we would expect to see household debt servicing rise from about 14.2% of disposable income to 16.3%. Relative to the long-term historical average, that's roughly 3.5 percentage points above its long-term historical average.

Hon. Pierre Poilievre: Have we ever seen household debt service ratios that high in the past?

Mr. Chris Matier: No. Historically speaking, I think the highest was around 15% of disposable income, and that was during the global financial crisis when incomes really collapsed.

Hon. Pierre Poilievre: Let's just get this straight. By 2022, is that the year?

Mr. Chris Matier: Roughly.

Hon. Pierre Poilievre: By 2022, in five years, interest rates are estimated by your office to be at 3%, and that will lead to the highest levels of household debt service costs on record.

Mr. Chris Matier: According to our projection, yes.

Hon. Pierre Poilievre: At that very moment, those same households will be bearing the burden of the $14 billion in additional interest costs that their government will pay for its growing national debt.

Mr. Chris Matier: They will not be paying the debt charges themselves. That will be the government issuing debt on financial markets.

Hon. Pierre Poilievre: Right, but government doesn't have any money. Somebody is going to have to pay for it and that means taxpayers. They can issue new bonds, but ultimately somebody has to pay interest on those bonds.

Mr. Chris Matier: Yes. They will be rolling over their debt as it becomes due, unless they stop issuing new debt.

Hon. Pierre Poilievre: Right, but whether they issue new bonds or treasuries, can somebody tell me where the money comes from to pay interest on government debt?

Mr. Chris Matier: It partially comes from current revenues, and partially it comes from the issuance of new debt. In our—

Hon. Pierre Poilievre: Where do the revenues come from?

Mr. Chris Matier: Ultimately, they come from the national economy.

Hon. Pierre Poilievre: Who in the national economy pays those revenues?

Mr. Chris Matier: Households and the business sector.

Hon. Pierre Poilievre: Right, so the same households that are going to be faced with record-high interest payments on their own debt will also be paying $14 billion in additional taxes on the government's debt.

Mr. Chris Matier: Sorry to go back, but their taxes aren't going to be rising. The government is borrowing to finance, partially, those expenses.

Hon. Pierre Poilievre: I think we're coming to the same conclusion, one that the current government is having a hard time accepting. All the money that funds the government, literally 100% of it comes from taxpayers, and there is no other ultimate source of funding. There are temporary sources of funding in the way of borrowing. The government might find this surprising, but debt actually has to be repaid.

The Chair: I guess that's a point and not a question.

We'll turn to Mr. Dusseault.

[*Translation*]

Mr. Pierre-Luc Dusseault: Thank you, Mr. Chair.

My thanks to all the witnesses for being here.

I saw a picture posted by my friend Jason on Facebook, which put into perspective the difference between a million and a billion. When we talk about billions, as in the case of the public debt charges my colleague was referring to, my friend was comparing one million seconds versus one billion seconds, one million seconds being the equivalent of 11 days, and one billion seconds being 31 years. So this puts into perspective the scale of the numbers we are talking about here and the increase in public debt charges from $24 billion to $38 billion.

My first question is about table 5 on revenues, particularly about the corporate income tax. Did you take into account the recent announcement reducing the tax on small and medium-sized businesses from 10.5% to 9%?

● (1735)

Mr. Jean-Denis Fréchette: No, we did not consider that factor in the budget.

[*English*]

Trevor, do you want to answer that?

Mr. Trevor Shaw (Economic Advisor, Analyst, Office of the Parliamentary Budget Officer): Yes. All the policy announcements that were included in the fall economic statement have been included in our overall revenue and expense projection.

[*Translation*]

Mr. Pierre-Luc Dusseault: Okay.

Has the fact that the tax on small and medium-sized businesses will be reduced to 9% been provided for by the government in the economic outlook included in its last two budgets?

Mr. Jean-Denis Fréchette: Are you talking about its last budget or its economic statement?

Mr. Pierre-Luc Dusseault: In the previous economic outlooks, was it projected that the small and medium-sized business tax would decrease?

Mr. Jean-Denis Fréchette: No, not in the last one. It was mentioned in the fall economic statement, but not prior to that.

Mr. Pierre-Luc Dusseault: That's quite surprising, given that the government would have us believe that the reduction in the small and medium-sized business tax rate was planned from the outset, that it was an election promise and that there was nothing surprising about it, even though the economic outlook did not take this reduction into account. It is therefore a surprise that we must commend, since the NDP has been asking for it for a long time.

Let's turn to table 7 on employment insurance. It refers to the outlook for employment insurance. My question is about the fact that there is a continued increase in contributions.

How do you explain this increase since the unemployment rate is decreasing? We also see that the costs of the benefits are increasing from 20.7% to 24.9%. How is it possible to come up with those forecasts, given that the unemployment rate is going down?

Mr. Jean-Denis Fréchette: I will let my colleague Mr. Shaw answer, but I can tell you that there has been a change in the legislation. There was a surplus of $2.5 billion until the end of 2016. Subsequently, according to the legislation, a break-even rate must be set that exactly matches the payments required until the end of the period in question.

[*English*]

Trevor, do you want to add something to that?

Mr. Trevor Shaw: Not only is it the current unemployment rate and eligibility of unemployed people for EI benefits, but we also need to forecast this into the future because of the seven-year break-even rate. Based on our economic projections, if the unemployment rate is set to decrease this is going to have an influence on our seven-year break-even rate. Our anticipation for benefit payments as part of the EI program going out to 2023-24, all of this is going to affect the break-even rate, not only for the next year but all the subsequent years as well.

[*Translation*]

Mr. Pierre-Luc Dusseault: Okay.

I will now move to table 6, to which I referred earlier and which deals with expenses. I am interested in this issue because program expenses are up 1.2%. I am referring to the 1.2% increase in direct program expenses, while we know that, according to a number of public service collective agreements, there are wage increases exceeding that percentage.

How do you come up with those numbers, when it seems that a more significant increase is expected in public service salaries?

Mr. Jean-Denis Fréchette: The answer is quite simple. To achieve those results, either the number of employees must be reduced—precisely because public responsibility is essentially for salaries and benefits—or employment in the public service itself has to stagnate, meaning that positions will simply not be filled.

● (1740)

Mr. Pierre-Luc Dusseault: Does the government corroborate and admit that, as you say, the plan is to reduce the number of employees or not to fill vacated positions?

Mr. Jean-Denis Fréchette: Not yet. All we are noting is that the decrease in the deficit we are seeing comes in part from this decrease in expenses related to public functions. This has not been said yet, but not all the collective agreements have been signed yet. So I think there will be an announcement at some point.

Mr. Pierre-Luc Dusseault: We must therefore expect the debt to increase as the collective agreements are being signed. If program expenses increase because collective agreements are signed, we must expect the debt to ultimately continue to increase.

Mr. Jean-Denis Fréchette: That could be the case if we maintained the same level of employment or increased the number of public service jobs.

Mr. Pierre-Luc Dusseault: Okay,

Is there anything you would like to add, Mr. Askari?

Mr. Mostafa Askari: The government has to find the funds in the other areas of operating expenditures, but that's something we talked about, an issue we raised in our April report. Managing operating expenditures is therefore a challenge for the government since collective agreements show that the wage increase is about 1.5%. Right now, the growth rate in operating expenditures is about 0.8%. So there is a difference between the two. It is a challenge for the government to manage operating expenditures.

Mr. Jean-Denis Fréchette: In other words, for the moment, it is not viable for this period.

Mr. Pierre-Luc Dusseault: No, of course. In addition, it probably raises concerns too.

The Vice-Chair (Hon. Pierre Poilievre): Your time is up, Mr. Dusseault. Thank you.

Mr. Grewal now has the floor.

[*English*]

Mr. Raj Grewal: Thank you, Mr. Chair.

You've aged considerably since the last time.

The Vice-Chair (Hon. Pierre Poilievre): I'll try not to take that personally.

Mr. Raj Grewal: Thank you to the witnesses for coming. I really appreciate it.

Our government committed to reducing the federal debt-to-GDP ratio. In our economic forecast, we had it getting to 31% in 2020-21, and your office is projecting it will fall to 29%.

What is the reason for the 2% difference?

Mr. Mostafa Askari: The trajectory for the fiscal deficit has changed. It's lower now than what the government was forecasting at the time and what we are forecasting right now. This translates into a lower debt-to-GDP ratio relative to what was predicted before.

Mr. Raj Grewal: You commented in your report that the government has the flexibility within its current fiscal plan to reach its medium-term debt-to-GDP target.

Can you expand on that a little bit?

Mr. Mostafa Askari: The only thing that means is that mathematically, since the target was 31% and now they have 29%, they have reached it, so there is that gap. The gap between 29% and 31% is the extra room, in the sense that if they want to maintain that 31%, then they have this room.

This is not a recommendation or anything like that. It's just explaining mathematically the difference between the two.

Mr. Raj Grewal: What do you see as the biggest challenges for growth in the Canadian economy over the short term and long term?

Mr. Mostafa Askari: The biggest challenges...? That's a very good question.

Mr. Jean-Denis Fréchette: Productivity gains...?

Mr. Mostafa Askari: Of course, yes, productivity gains. Productivity is always an issue for the Canadian economy.

As you heard from the governor, recently we have seen an increase in productivity. Whether it is sustainable over time or not is the major question. Certainly it's not sustainable at the rate we have seen in the past few quarters, but definitely this is a major issue for the economy. It requires investment and better export performance in the economy. All those things, obviously, are challenges that any economy faces. How you resolve them, how you achieve that growth, is another question that I cannot answer.

● (1745)

Mr. Raj Grewal: The economy has grown really well, at a higher rate than expected this year, so the government is obviously considering that there will be a bit of a slowdown going into the balance of this year and into 2018. Will trade and the uncertainty with our partners down south have an impact on the Canadian economy, or is the uncertainty creating an impact on the Canadian economy already? What do you think?

Mr. Mostafa Askari: As Chris mentioned earlier, we haven't taken into account explicitly in our projection the issue of trade and uncertainty with NAFTA and the negotiations with the United States, because it's very hard to know exactly what is going to happen and how the negotiations are going to end finally. There is certainly a downside risk, if the negotiations don't go in our favour.

On the other hand, there are other things that we have not taken into account in that regard. The U.S. economy may actually perform much better than we are assuming in our projection, given that they are planning to significantly reduce their taxes and invest in infrastructure. Those things are on the two sides of this, and we haven't taken them into account.

Trade, though, is always an important issue for Canada, given that we are a small, open economy. While that uncertainty is important, we are expecting, as I said, that trade will contribute to growth over the next five years. This expectation is always subject to some risk and uncertainty, naturally.

Mr. Raj Grewal: You mentioned a strong U.S. economy. How does that benefit the Canadian economy? Is a stronger U.S. economy good for the Canadian economy?

Mr. Mostafa Askari: Certainly. The stronger U.S. demand will certainly boost our exports. That's always the case. We are highly integrated with the U.S. economy, so any positive change in the U.S. will affect us positively.

Mr. Raj Grewal: What about the Canadian dollar relative to the U.S. dollar? Is there going to be a happy medium there, in terms of Canadian dollar strength?

Mr. Mostafa Askari: The Canadian dollar has some impact, certainly, on our trade. Where it goes and how it evolves over time will have an impact. The Canadian dollar, however, always fluctuates. Our projection is a very conservative, prudent projection for the Canadian dollar. It underlies our projection. This is not a major factor, in that sense.

Mr. Raj Grewal: There was a report in a book issued last week on productivity that said Canada is not meeting its productivity potential because of a shortage of people—there's a shortage of Canadians—and that if we were to increase immigration levels, productivity would also increase and be very good for the Canadian economy. This may be outside the scope of the parliamentary budget officer's mandate, but I would love your comments on that.

Mr. Mostafa Askari: In general, I think linking productivity growth to immigration is a stretch because it depends on what immigrants will do. That requires investment and other factors that will boost productivity.

Productivity is a complicated issue that is very hard to track and understand. If you look at what different governments have done over the past 20 to 25 years, many things that are considered to be the right things to do to boost productivity have been done. Unfortunately, except for the last few quarters when we have seen a boost in productivity, we haven't seen the results of those policy measures. We have seen tax cuts, investment in innovation, those kinds of things, but we haven't seen the result. In one sense it's a puzzle for policy-makers in terms of how to deal with it.

Mr. Raj Grewal: Thank you.

Thank you, Mr. Chair.

The Chair: Thank you.

Turning then to Mr. Albas. We'll go at least six minutes, Dan.

Mr. Dan Albas: Thank you, Mr. Chair.

Thank you to the work that all of you do for Canadians and for parliamentarians especially.

With regard to the report, I'd like to follow up a little with Mr. Grewal because obviously a shortage of skilled people can have a bit of a drag on projects and business moving forward. However, as important as it is to have people, whether it be intellectual property or whatnot, you also need to have capital. We've seen in the past few years a precipitous drop in investment in Canada.

Could you start us off with where we are right now as far as business investment? I'd like to find out if this is simply business investment that is replacing old equipment or maintaining current capacity rather than expanding capacity.

● (1750)

Mr. Chris Matier: In our current report, our view would be that right now capacity is relatively high, historically speaking, for the goods-producing sector. I believe it's around 85% of their estimated capacity. Going ahead we think that a lot of the investment that firms are going to be undertaking isn't just to replace old. It's adding to the capital stock. In our outlook, that provides a key driver to expanding the capacity for the economy and increasing potential output.

Mr. Dan Albas: You're speaking in aggregates so it's spread over the whole country, but we obviously know that certain regions are probably experiencing some ups and some are facing downs. Could you clarify where you see some of this productive capacity going?

Mr. Chris Matier: I can't speak to the outlook on a regional basis. We prepare our projections at the national level, but we see it broadly across the components of business investment. We see the increase in investment levels in machinery and equipment. We also see it in the non-residential sector, mining and engineering structures, as well as investment in intellectual property and products. It's very broad-based across those sectors, and the extent to which those sectors would be located across the country, we would think it would probably be fairly broad-based.

Mr. Dan Albas: In your report, though, you say one of the downside risk factors is business investment. Could you clarify that because it sounds to me that you're painting a slightly different picture than the risk projection.

Mr. Jean-Denis Fréchette: Before Chris answers your question.... You asked a specific question. For those of you who are interested, what's going on in Montreal in artificial intelligence is quite impressive because you have both immigration and capital investment in something totally new, if you were looking for an example. Montreal is now considered one of the world centres for artificial intelligence. Why? Stability and whatever the reasons are, but this is an example of something totally new. These kinds of investments were not known in Canada before.

Mr. Dan Albas: Yes. Again, I think it's too early to be saying what that's going to do. As you said earlier, whether or not these innovations actually have.... Tyler Cowen in his book *The Great Stagnation* points out that many improvements in IT, such as Twitter and Facebook and whatnot, actually may be negative draws on productivity. I appreciate that.

Mr. Matier, were you going to continue?

Mr. Chris Matier: Sure. We flag it as a downside risk, and that's because our baseline for business investment is a very robust increase in its growth rate and its contribution to the Canadian economy. Over 2018 and 2019 we have business investment contributing almost a full percentage point to GDP growth. It's very high, especially relative to the past few years.

Underlying that we see an economy that is operating above its potential, so firms really need to expand their capacity to produce. At the same time, we've seen high levels of business confidence and business sentiment, and relatively low, at least historically low, interest rates still. Everything seems to be in place for this takeoff, and our baseline is that it is going to advance that way.

Again, we've been disappointed in the past, and that's why we flag this as a downside risk to that baseline.

Mr. Dan Albas: Just about six or nine months ago, though, there were a number of reports about business investments being at an all time low since 1981. Is it because there was a hard contraction and now we're starting to see some growth?

Because when you actually contract an economy and then start to see some green shoots, people have a much larger view of it. Is this regaining ground or is this actually increased capacity?

● (1755)

Mr. Chris Matier: No. In our view it would be adding to capacity. Some of it would be making up for that lost sort of...that rebound, but also a large part of it would be adding to the capital stock of the economy going ahead.

Mr. Dan Albas: As the budget officer said, there are some new shoots as well, the new AI technology and whatnot.

Mr. Chris Matier: I would just add that we have been pleasantly surprised on the upside on business investment in the last few quarters. Again, it could be green shoots in too early, and that's why we flagged it as a downside risk.

Mr. Dan Albas: Thank you.

This is a question I did ask the Governor of the Bank of Canada was. If you see what's happening in the United States, the stock market going up, and you see a lot of investment pouring in, higher bond yields, all those things, how do we look at the investment that the Americans are drawing in vis-à-vis Canada?

Does Canada, in your opinion, still look like a good place to invest? I know we benefit from being a small open economy just north of the Americans, but they're also competitors. Do you have any views?

Mr. Mostafa Askari: Whether we are going to pull as much investment as the Americans is very hard to say. That depends on many different factors.

Mr. Dan Albas: Would we be seen as being a good place?

Mr. Mostafa Askari: We certainly, as Chris mentioned, have been pleasantly surprised by the rise in investment in Canada in the past few quarters. Hopefully that will continue, but again these kinds of things depend on many different factors. Global factors are most definitely one of them, but typically also if the U.S. actually grows faster and the economy in the U.S. becomes more prosperous, it always has some positive benefits for Canada, both on the investment side and other parts of the economy.

That's as much as I can say about this without actually working the numbers, which we haven't really done.

Mr. Dan Albas: Thank you.

The Chair: Are you okay with that?

Mr. Dan Albas: Yes. That's good.

The Chair: Ms. O'Connell.

Ms. Jennifer O'Connell: Thank you, Mr. Chair.

Thank you all for being here.

I want to talk about your fiscal sustainability report that was released in October as well. In it you talk about a number of things, but one of the key points is that you talk about the federal government and that the current federal fiscal policy is sustainable over the long term. As well, it says that the PBO estimates that the federal government could implement permanent tax reductions or spending increases amounting to 1.2% of the GDP while still maintaining fiscal sustainability.

What are some of the factors that have led you to come to that conclusion in terms of the long-term sustainability?

Mr. Mostafa Askari: We do this exercise every year just to show what happens in the long run if the current fiscal structure is maintained over a very long period of time, 75 years. We impose on that the demographic projections that essentially show the aging of population in Canada, both for the country as a whole and also for different provinces. That exercise essentially looks at this fiscal structure and then moves that forward for 75 years and sees what happens to debt, and debt as a share of GDP. That's how we calculate this number of 1.2%.

Over time the current fiscal structure in Canada at the federal level is such that you are going to have this fiscal room of 1.2%, which means that the debt-to-GDP ratio, based on the current projection that we have done over a long period of time, continues to decline. In order to maintain that at the current level, then you can still spend more money, as we mentioned, $24.5 billion, or 1.2% of GDP, or reduce taxes by that amount. What that does is it maintains the current debt-to-GDP ratio at that level for 75 years.

If you don't do that and you leave the current structure unchanged, then the debt-to-GDP ratio will continue to decline. As we show in our report, the debt, eventually, will be eliminated.

● (1800)

Ms. Jennifer O'Connell: Thank you.

In this report, you go on to look at the fiscal health of the provinces and territories as well. In a lot of those instances, the fiscal sustainability is not so good. My question is in and around what happens if, for example, in a certain province or territory where a lot of it is aging demographics, especially in Atlantic provinces, that fiscal sustainability is not there. That means either the federal government steps in, or there are risks even if the federal government isn't directly impacted through injections of money, essentially. Then the tax base that is contributing to the overall federal situation would be impacted.

Have you built into your macromodels those types of risks we're seeing provincially on fiscal policies?

Mr. Mostafa Askari: What this study does is that it provides a scenario. If you maintain the current fiscal structure for those provinces that are not sustainable, then you are going to see an increase in the debt ratio over time—in some cases significantly. Again, this is a scenario. It's not necessarily going to happen. If you get to that point where the governments see that it is going to happen, they will have to do something about it. There could be something internal that a province would do in terms of their spending or taxes or revenues, or some of it could come from help from the federal government. There are different sources, as I said. Those provinces can raise their revenues' potential or they can reduce their spending, or a combination of those two, or they can convince the federal government to provide more transfers to them to help them out. These are all different possibilities for them.

The idea is not that we are going to actually see those crises or those debt levels or that debt ratio level. What the study shows is that there is a challenge for those provinces, and they have to think about solutions for those now or over the next few years to prevent that from happening over time.

Ms. Jennifer O'Connell: Thank you.

This might seem like a somewhat silly question, but I find it interesting that we're looking at our debt-to-GDP ratio. That's the measure we always use. Canada's in a very good position, especially compared with other countries. When you talk to the average Canadian or regular person in terms of that scenario, it's really hard to explain what that means and why Canada is seen as being in a very good position on that measurable.

My somewhat silly question is this. How would you explain, or how do you really talk about the debt-to-GDP ratio and what that means, to the average Canadian, in the sense of how most Canadians look at debt as something you want to pay off? That is your goal, to pay it off. As governments go, that's ultimately the goal as well, except that being in this low debt-to-GDP ratio is really a good scenario.

Is there a simplified way of how we explain this to Canadians in terms of Canada's current position, and why it is seen to be in such a good ratio, and why this ratio is seen as a positive element?

I ask that question. I say it might be silly in the sense that we talk about it very clearly here, but I find that when I go back to the riding and you say that statistic, well, what does that really mean?

Mr. Chris Matier: I think part of that reaction stems from the linkage between a household's budget constraint and the government's budget constraint. Really there isn't a linkage. Unlike households, the government doesn't have to repay ultimately its debt. The way I try to think about it or would explain it is that what you really want to think about is the debt burden. For the debt burden, the most commonly used measure is the debt relative to the economy.

What typically governments wouldn't necessarily want to do is to undertake fiscal policies such that this burden would be substantially increased for future generations. You can think of the idea of keeping a stable debt-to-GDP ratio as basically not passing on an increased debt burden. It's important to think about it in a ratio, because the incomes of future generations will be a lot higher than they are today. Their ability to service debt should be commensurate to what the burden is based on current taxpayers.

Maybe unfortunately, some economists have linked the balanced budget or debt elimination as the best indicator of sound financial management, when I think a much better one, and one that is most commonly used by budget offices and I would say most economists, is the debt-to-GDP ratio.

● (1805)

Ms. Jennifer O'Connell: Thank you.

The Chair: Thank you, all.

I'll turn to Mr. Kelly.

Mr. Pat Kelly: Thank you.

I do just also for the record, Mr. Chair, want to comment on what Mr. Grewal had said earlier. In commenting on the debt-to-GDP ratio being projected perhaps to drop to 29% versus 31%, he characterized that as a commitment that they had made. I want to remind the committee that the commitment that was made in the election campaign was not a 31% debt-to-GDP ratio. It was in fact to run a maximum $10-billion deficit with a return to surplus by 2019.

Having said that, I'll go to the questions and pick up perhaps on a theme arising from a response to the very first questions that my colleague, Mr. Sorbara, raised, and this was in regard to the negative impact on the housing market and on Canadian households when interest rates rise as they're expected to do.

We have heard throughout, in this panel and in the earlier one, about just how difficult it is to forecast the future and all of the different factors. We've heard repeatedly that there are an infinite number of variables and so it's very hard to know for certain what is ahead of us.

How much risk is there to projections of a reduced debt-to-GDP ratio and indeed to continue increased deficits that are ultimately, as my colleague, Mr. Poilievre, pointed out, borne by Canadian households through taxes? What are the risks of these projections not being made if, for example, there was even a slightly larger rise in interest rates than what you have already included in your projections?

Mr. Chris Matier: We've tried to quantify this risk in our last two reports. In figure 7, we provide an estimate of the probability that the debt-to-GDP ratio would be above its target in 2021, that 31% target. It would be about a 25% chance. That's based on the assumption that we're basically about as accurate going forward as, let's say, on average, private sector forecasters have been in the past.

If we miss on interest rates and growth rates, all else equal, no policy changes, this is what we would expect as that amount of risk.

Mr. Pat Kelly: Any of a number of factors could throw this off including a failure to predict a significant downturn in the global economy, something that very few forecasters ever predict accurately.

Mr. Chris Matier: That's true and our estimate would reflect that. To the extent that in history we've missed those downturns, we've built that into our estimate of the probability going forward. If we continue to be as bad at forecasting as we were during the past, roughly 25% of the time we would still miss this debt-to-GDP target.

Mr. Pat Kelly: I'm not sure how much reassurance that was intended to convey.

All this uncertainty is part of why many commentators and many people would say it is so unwise to run large deficits during non-recessionary times. If you're in an expanding economy and times are, relatively speaking, at least not recessionary, ought not the government run a balanced budget as promised or at least try to come as close as they can so that, if there is an unforseen downturn, there is fiscal capacity to deal with it?

● (1810)

Mr. Chris Matier: I'm not going to comment on what the government's fiscal target or policy should be with respect to having a balanced budget or not. That is a political choice.

Economically speaking, there is nothing requiring a government to run a balanced budget year after year or only in certain periods. In our longer-term framework what we've tried to stress is that, at least according to conventional economics, it's the debt-to-GDP ratio. Even with a relatively stable debt-to-GDP ratio, that would imply or be consistent with relatively small budgetary deficits, on balance, over the cycle.

In terms of the shock absorber, to respond to your question about what would happen in the event of a severe downside shock, that's simply the case where the government would have to go and borrow and absorb part of that shock. Again, if it's a very extreme financial market shock where the government couldn't go and issue debt, that's a very extreme scenario. In all other cases of relatively slower growth or weaker oil prices or something, that probably would be absorbed with just issuing more debt and running larger deficits temporarily.

The Chair: Mr. Fergus.

[*Translation*]

Mr. Greg Fergus: Thank you, Mr. Chair.

Mr. Fréchette, my thanks to you and your team for your hard work. It is very much appreciated. I enjoyed the work of the Parliamentary Budget Officer before I became a member of Parliament and I appreciate it more as a member of Parliament.

I would like to come back to your report on the economic and fiscal outlook. I am referring to Figure 6. My colleague Mr. Dusseault talked a bit about it and I would like to ask you a few more questions.

With the 70% confidence interval—I know this is the least accurate interval—we can see the possibility of accumulating a deficit of about $30 billion or having a surplus budget just over $10 billion by the end of the 2021-22 fiscal year.

It may seem a bit crass to you, but can you explain how it is that your forecasts present us with both the worst and the most optimistic of situations?

[*English*]

Mr. Chris Matier: Unfortunately I don't have that with me, but I can follow up on what real GDP growth, nominal GDP growth, and interest rates would be.

Typically, in those outer years, you would see, in terms of nominal GDP, our 70% confidence interval is plus or minus a full percentage point, or 1.1 percentage points. On interest rates, I don't recall what the range would be, but at least in those intervals you would see low growth-high interest rates, high growth-low interest rates. I can follow up with the exact range for the interest rates.

● (1815)

[*Translation*]

Mr. Greg Fergus: Let me ask a more specific question.

You said that the Bank of Canada's key policy rate could eventually be at 3%, which is much higher than the current rate. Why do you think it is likely that the Bank of Canada's policy rate will be at that level? It has been a long time since it was at that level.

[*English*]

Mr. Chris Matier: The 3% level that we have assumed in our base case is consistent with the Bank of Canada's estimate of its policy rate when inflation is at its target, when the economy is at its potential capacity, and when there aren't any temporary shocks.

In putting this together, essentially we've looked at the Bank of Canada's monetary policy report and at current levels of interest rates. We know, according to the bank, that inflation will be at its target in, I think, the first half of 2018. The economy will essentially be at its productive capacity or potential output. I don't think the bank has flagged any temporary shocks, so, implicitly underlying the Bank of Canada's forecast, our conclusion is that interest rates are going back up to 3%. They're the ones who set the policy rate, and if their judgment is that 3% is the right number, we're going to take them at their word and that will be in our forecast.

Of course there will be shocks, going ahead. Some of our underlying assumptions won't pan out, and interest rates could be higher or lower than we're projecting on our way to 3%, or its neutral rate. It would obviously be helpful if the Bank of Canada were to publish its policy rate path, going forward, but you can read between the lines. It's clearly indicated in the report that 3% is what they believe is consistent when inflation is at its target and the economy is at its productive capacity or potential output.

[*Translation*]

Mr. Greg Fergus: Once again, I do not want to question the merits of the Bank of Canada's decisions. It's almost the end of the year. The policy rate has been low for nine years. During the crash of 2008, the rate was lowered at the outset and it has remained low for a significant period. Earlier this year, there were two small increases in the policy rate.

Now, we recognize that, given the debt of Canadians, the competition in the digital technology sector and the economic slack, the policy rate will continue to be low in the short term. It seems to me that it will take quite some inflation or quite some economic growth—which I would like to see— for the rate to reach 3%. Once again, we rely on the data provided to Canadians by the Bank of Canada, but does your instinct for economics not make you think about the possibility of a 3% policy rate?

[*English*]

Mr. Chris Matier: You're correct that we're going back to 3% as our estimate of the neutral rate. The one point I would make is that this estimate of the neutral rate has been revised downward significantly just over the period you mentioned, following the global financial crisis. I believe the Bank of Canada previously estimated that rate at around 4.75% and 4.5%, so there has already been a very large reduction. We're not going back to levels that we're used to seeing.

When you're at 1%, 3% does seem like a big increase, but in the Bank of Canada's framework, they see inflation coming back. They see the excess capacity of the economy tapering off, so those conditions are consistent with a 3% policy rate.

● (1820)

The Chair: I have a couple of questions before I go to Mr. Dusseault, followed by Mr. Picard, and then back here.

In your EI section, table 7, next year you're anticipating that the benefits will go up by $1 billion. On what do you base that estimate?

Mr. Trevor Shaw: Our benefits projection is mostly a function of our forecasts for the rate of unemployment and eligibility. If program rules change so that unemployed persons are eligible for benefits where they might not have been in the past, it's going to increase the ratio of EI beneficiaries relative to the number of unemployed.

I'll also highlight that as part of budget 2017, and even in the interim, between budget 2017 and the last update, there were a number of temporary changes to the EI program that increased the ratio of beneficiaries to the unemployed. That helps explain some of the increase in our EI benefits forecast over the medium term.

The Chair: With the premium rate at $1.88, or $1.63 now, how does that compare going back in time? It seems to me that it was considerably higher.

Mr. Trevor Shaw: Just off the top of my head, the EI premium rate was higher than $1.88 in the past. In previous years, it had been in excess of $2. I could get you the historical series.

The Chair: We can probably find it anyway.

In your table 6, under children's benefits, does that include the economic update, the increase?

Mr. Trevor Shaw: Yes.

The Chair: Okay. In table 5, where does the small business tax fit into your chart? Is it under the corporate income tax?

Mr. Trevor Shaw: Yes. It's corporate income tax.

The Chair: Does that include the economic update going out?

Mr. Trevor Shaw: Yes, exactly.

The Chair: I'm looking at 2016-17 versus 2022-23. Just to tell you where I stand, I'm one who feels that personal income tax is too high and corporate income tax is too low. This year, corporations are paying 22.7% as much tax into the system as personal income tax is.

Five years out, the corporate income tax is going to go up a bit, from 22.7% of the share to 26.3%. Do you know why that is?

Mr. Trevor Shaw: A major reason our corporate income tax profile is, let's say, flatter as a share of GDP compared with personal income tax has to do with the fact that the proxy we use for the corporate income tax base is corporate profits before tax in the system of national accounts, and this has been very weak throughout the past two or three years. What's somewhat of a puzzle is that the taxable income base, as we see on CRA's T2 forms, has held very strong. Commensurate with that, corporate income tax revenues have been very strong as well.

Given that there has been very low profitability in recent years, we think this is going to lead to, let's say, great loss carry-forwards in subsequent years, which has led to us having a slightly weaker corporate income tax revenue profile over the next two or three years of our forecasts.

The Chair: I have one other quick question.

How do we compare with the rest of the world in terms of business tax versus personal tax as percentages? Do you have those figures?

Mr. Trevor Shaw: I don't know off the top of my head but certainly that's data I can get for you.

The Chair: That's great.

Mr. Dusseault.

[*Translation*]

Mr. Pierre-Luc Dusseault: Thank you, Mr. Chair.

I would also like to have those data, which clearly show that government revenues are increasingly coming from individuals rather than corporations.

Let me go back to table 6, which deals with elderly benefits. My question is about what I consider a demographic problem, which we will be facing in the future. According to the table, elderly benefits were $48.2 billion in 2016-17 and will increase to $66.9 billion in 2022-23, which is significant. I, for one, wonder how significant it is if we consider the big picture.

In your opinion, are demographics and the continued increase in elderly benefits problems that will eventually come up in Canada? What percentage of the total government budget do elderly benefits represent? Is there an increase in those benefits compared to the total government budget? If so, is that a problem?

● (1825)

[*English*]

Mr. Chris Matier: It's a really good question because I think it ties naturally into our fiscal sustainability report where we look out over the long term so we're able to see the impacts of population aging and the OAS and elderly benefits programs. We project a sizeable increase in them relative to the size of the economy out to its peak in 2032 or so.

One of the compensating factors is that these payments to seniors are indexed only to inflation. Over time, yes, as the baby boom cohort goes through and collects OAS benefits, as they depart, there will be less pressure, at least relative to the size of the economy. This is unlike, let's say, health care spending at the provincial level where spending is growing at the rate of the economy plus the aging that's going on. The federal government doesn't face this pressure. Once beyond 2032 we'll have more fiscal room.

The Chair: Mr. Picard.

[*Translation*]

Mr. Michel Picard (Montarville, Lib.): Thank you, Mr. Chair.

Mr. Matier, you said that the debt service ratio will be as high as it was when Canada went through a financial crisis. I do not have the exact year, but it was a few years ago. Is it not true that, when our country is in a financial crisis, debt servicing is a considerable burden, putting the country in a more precarious situation?

[*English*]

Mr. Chris Matier: I apologize if I misspoke. I didn't mean to say that the federal government was facing a fiscal crisis going ahead because of rising debt charges. If anything, even though we are projecting an increase in the level of public debt charges, these are manageable within the government's current fiscal policy. If the measure or benchmark is maintaining a debt-to-GDP ratio on a downward path it's not a crisis per se.

Mr. Michel Picard: What I wanted to say is that if we're going to face a crisis, the height of this percentage that we were looking at seems to be similar to the one we got years ago when we faced a decline, a financial crisis. Therefore, at the time the country must have been in a more delicate situation than obviously the one we're looking at, considering there seems to be some positive trends to inflation, productivity, and revenue in general.

Mr. Chris Matier: I think the one important distinction that you really have to make relative to that period is that, yes, debt charges were high but our debt-to-GDP ratio was also at its peak, at least according to Finance Canada's fiscal reference tables. Around that time the peak of the debt-to-GDP ratio was about 67%. Right now it's 30%, I believe, so it's less than half of that.

In comparison to that previous fiscal crisis period, public debt charges are only around 8¢ per revenue dollar whereas previously 30¢ of every revenue dollar went to debt charges. Even though the level of debt charges might be comparable to that period, the broader context of the government's federal debt, relative to the size of the economy, and debt charges relative to revenue are very different.

● (1830)

Mr. Michel Picard: And therefore very encouraging.

The Chair: Thank you. We'll have to leave it there.

We have a split question over here from Mr. Albas and Mr. Poilievre, and that's it. We're a little over time.

Mr. Dan Albas: Thank you, Mr. Chair.

This is again in reference to last week's economic update, which quoted about an $18.4-billion deficit projected for this year. Your numbers are saying that it's higher than $20 billion. Why the difference?

I have a very short question after that.

Mr. Trevor Shaw: First, for the 2017-18 fiscal year, the major difference between our view and Finance Canada's was in our view on corporate income tax. We think that corporate income tax revenues will be lower than Finance Canada viewed them as being as part of the fall update. That explains much of the difference in our views on the budget balance.

Mr. Dan Albas: Expand on the reason for that, if you could. Also, I have a further question. In previous years there's been a contingency fund, and now it's called a risk fund or whatnot—the name keeps changing.

Can you comment on whether it is helpful public policy to have a constantly renamed fund and whether it's appropriate for the Minister of Finance to cancel something one year and then bring it back under a new name the next year, in terms of profiling?

Mr. Mostafa Askari: Concerning the contingency fund, or whatever—the prudence factor—you're right. The name has changed over many years. There have been different definitions of this, but the bottom line is that it is just to protect against any kind of downside risk for the economy and possible changes in the global economy or fiscal structure. It's just a cushion that governments provide for themselves for unforeseen events over time.

For this update, it was $1.5 billion for 2017-18 and $3 billion for the rest of the projection period. The difference between our bottom line fiscal balance projection and the finance department's is essentially that we do not include a prudence factor in our projection, but they do. On average, that really explains the difference between the two projections.

The Chair: Here is the last quick question.

Hon. Pierre Poilievre: The chairman was asking about the relative share of the tax burden on corporations versus individuals. We have in this country a system of tax integration whereby companies pay the same tax on corporate profits as individuals pay on income, when the tax on dividends is included.

When corporate taxes go down, the tax on dividends automatically goes up. Is that correct?

Mr. Trevor Shaw: That's correct.

Hon. Pierre Poilievre: The question I have, then, is, ought we, all of us—Finance Canada, PBO, and everyone else—not include the dividend tax that is paid on corporate profits flowed to shareholders? Should it not be included when we calculate the share of the tax burden paid by companies as compared with the share paid by individuals?

Mr. Trevor Shaw: My understanding of this is that dividends are a form of income to an individual, much as labour income would be, and that ultimately the owners of all corporate income are individuals themselves. Income is taxed either at the personal level or at the corporate level, and it's the desire, I think, of the Canadian tax system to ultimately have some harmony between those two systems. I don't think it's the role of our office to comment on the relative split between those two.

● (1835)

The Chair: Is there a place in which those figures are accessible? It would give a fairer comparison.

Mr. Trevor Shaw: The OECD, the IMF—these international bodies—have comparable statistics on taxation. I'll send the committee this data.

The Chair: Okay.

Thank you very much to the parliamentary budget office and the four witnesses.

The meeting is adjourned.