HOUSE OF COMMONS
CHAMBRE DES COMMUNES
CANADA

Standing Committee on Finance

FINA • NUMBER 144 • 1st SESSION • 42nd PARLIAMENT

EVIDENCE

Monday, April 23, 2018

Chair

The Honourable Wayne Easter

Standing Committee on Finance

Monday, April 23, 2018

● (1530)

[*English*]

The Vice-Chair (The Honourable Pierre Poilievre (Carleton, CPC)): Pursuant to Standing Order 108(2), today we are studying 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, Madam Wilkins.

Welcome to both of you. The floor is yours.

Mr. Stephen S. Poloz (Governor, Bank of Canada): Thank you very much.

Good afternoon, Mr. Chairman and committee members. Senior Deputy Governor Wilkins and I are pleased to be with you today to discuss the bank's monetary policy report, which we published just last week.

At the time of our last appearance in October, we saw signs that the Canadian economy was moderating after an exceptionally strong first half of the year. Now that moderation turned out to be greater and to last a bit longer than we expected at the time. Still, it's important to recognize that inflation is on target and that the economy is operating close to potential.

Now that statement alone underscores the considerable progress seen in the economy over the past year. The slower than expected growth in the first quarter just passed reflected two main issues.

First, housing markets reacted to announcements of new mortgage guidelines and other policy measures by pulling forward some transactions into the fourth quarter of last year. That led to a slowdown in the first quarter that should naturally reverse.

Second, we saw weaker than expected exports during the first quarter. This weakness was caused in large part by various transportation bottlenecks. Some of this export weakness should also reverse as the year goes on. So, after a lacklustre start to 2018, we project a strong rebound in the second quarter. All told, we expect that the economy will grow by 2% this year, and at a rate slightly above its potential growth rate over the next three years, supported by both monetary and fiscal policies.

[*Translation*]

The composition of growth should shift over the period, with a decline in the contribution from household spending and a larger contribution from business investments and exports.

Inflation should remain somewhat above the 2% target this year, boosted by temporary factors. These factors include higher gasoline prices and increases to the minimum wage in some provinces. Their impact should naturally unwind over time, returning inflation to 2% in 2019.

Of course, this outlook is subject to several important risks, and a number of key uncertainties continue to cloud the future, as was the case in October.

[*English*]

The four main uncertainties around the outlook for inflation are the same as we mentioned six months ago, but good progress has been made on some of them.

First, in terms of economic potential, our annual review led us to conclude that the economy currently has more capacity than we previously thought. As well, this capacity is growing at a faster pace than we expected. This means that we have a little more room for economic demand to grow before inflationary pressures start to build. That said, some firms, particularly exporters, are operating at their capacity limits, but are hesitating to invest. This hesitation may be due to trade uncertainty, the transportation bottlenecks, shortages of skilled workers, or other reasons. Regardless, it is limiting growth of our exports and economic capacity.

The second source of uncertainty concerns the dynamics of inflation. Here, recent data have been reassuring. Inflation measures, including our various core measures, have been behaving very much as forecast, and they are consistent with an economy that is operating with very little slack. This gives us increased confidence that our inflation models are working well.

The third area of uncertainty concerns wages, and the data here are also all encouraging. Wage growth has picked up significantly over the past 18 months. It is now approaching the 3% growth rate that one would expect from an economy that's running at capacity. However, the most recent figures are being boosted temporarily by the minimum wage increases in some provinces.

The fourth source of uncertainty is the increased sensitivity of the economy to higher interest rates, given elevated levels of household debt. The concern is that as interest rates rise, the share of household income going to service debt will also rise. This will leave less to spend on other goods and services and put downward pressure on inflation. It will take more time for us to assess this issue, particularly because new mortgage guidelines are currently affecting the housing market and mortgage lending. However, the growth of household borrowing is slowing, which is consistent with the idea that consumers are starting to adjust to higher interest rates and new mortgage rules.

● (1535)

As you can see, there has been some progress on these four key areas of uncertainty in the economy, particularly the dynamics of inflation and wage growth. This progress reinforces our view that higher interest rates will be warranted over time, although some degree of monetary policy accommodation will likely still be needed to keep inflation on target. The bank will continue to monitor the economy's sensitivity to interest rate movements and the evolution of economic capacity. In this context, the governing council will remain cautious with respect to future policy adjustments, guided by incoming data.

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

The Vice-Chair (Hon. Pierre Poilievre): Thank you very much, governor.

Mr. Fergus.

[*Translation*]

Mr. Greg Fergus (Hull—Aylmer, Lib.): Thank you, Mr. Chair. It's nice to have you chairing the committee.

Mr. Poloz and Ms. Wilkins, thank you both for your presentation. My question has to do with housing, which is very important to the people in my riding and, of course, the Canadian economy as a whole.

You said you were in the midst of assessing Canada's housing market, particularly as regards mortgage rates. Could you elaborate on how higher interest rates could affect Canada's housing market in the short and medium terms?

Mr. Stephen S. Poloz: As I mentioned earlier, it's definitely an issue that's very important to us.

I will let my colleague answer your question.

Ms. Carolyn A. Wilkins (Senior Deputy Governor, Bank of Canada): Thank you for the question.

A number of factors are currently impacting the housing market, namely monetary policies and higher interest rates, as you mentioned.

Obviously, interest rate increases go hand in hand with mortgage rate increases. As people start to feel the effects of the increases, their capacity to purchase a first home or enter the housing market will become limited. The increases will also influence the decisions of those looking to purchase a larger home.

This is something we can capture in our modelling. The housing market can clearly support higher interest rates. The new mortgage lending guidelines seem to be having an effect as well. They basically serve as a stress test for borrowers. It's important to make sure borrowers are able to handle higher interest rates.

The data show that, prior to the guidelines coming into effect on January 1 of this year, people decided to purchase a home during the fourth quarter of last year to avoid being subject to the guidelines. That led to a slowdown in the first quarter of this year, as resale housing data show. Right now, we're trying to figure out just how temporary that effect is. The data show that resales peaked in March. According to our projections, the housing market should start to pick up in the second quarter. As far as household debt is concerned, our hope is that a more favourable composition will emerge as the economy begins to reflect the impact of these guidelines.

● (1540)

Mr. Greg Fergus: My next question is on that very topic.

Do you have any indication that the guidelines meant to cool the housing market have had the desired effect? Have we avoided the crisis we were anticipating, or fearing, a year or a year and a half ago?

Ms. Carolyn A. Wilkins: The main purpose of those measures was not to cool the housing market but, rather, to improve the composition in terms of household debt. A year ago, we introduced a series of measures applicable to mortgages insured by the government. We have seen a significant drop in the percentage of highly indebted individuals. Those measures have had the desired effect. We've also seen speculation in the housing market seemingly decline.

In our view, both of those effects are desirable. That said, it's too early to say what impact the measures that came into effect on January 1 will have. We'll have a better idea this summer and in September, once the data come out.

Mr. Greg Fergus: I'd like to thank Ms. Wilkins for correcting me. The measures were not, in fact, intended to cool the housing market, but, rather, to change the composition. The goal was to foster a more resilient mortgage environment, in response to externally motivated economic changes, to ensure people could cope with problems tied to changes in the economy. That brings me to what may be my last question, depending on the answer.

You talked about keeping the interest rate at 2%.

How would a rate increase affect Canada's economic growth?

Would that impact be spread evenly across the country, or would it be felt more in certain regions?

Mr. Stephen S. Poloz: That comes back to the most important issue, which I mentioned earlier. We are certain that the economy is more sensitive than before to interest rate fluctuations, and that is due to the level of household debt. In the fall, we re-evaluated our model and found the economy to be about 50% more sensitive than before to interest rate fluctuations. It's important that the impact be symmetrical, meaning, that the economy needs to be just as sensitive to interest rate reductions, since changes in monetary flows will work both ways.

That said, it's an issue we examine. Every month, in Newfoundland and Labrador, we check the data to determine whether the state of affairs is more or less in line with our modelling projections. As Ms. Wilkins mentioned, the situation is a bit complicated because we've made other changes at the same time. We'll probably have to wait a few months before we are able to define the key changes. Basically, the economy is just as sensitive, if not more, than it was before, and that could yield the same effect as in the past. The impact, however, could also be more significant. That is the current situation.

● (1545)

[*English*]

The Vice-Chair (Hon. Pierre Poilievre): Mr. Kmiec.

Mr. Tom Kmiec (Calgary Shepard, CPC): Thank you, Mr. Chair.

On page 19 of the monetary policy report you say that “limited pipeline and rail capacity out of Western Canada could discourage longer-term investment in the oil sands”.

Can you give me an idea of how much pipeline rail capacity problems are hurting the Canadian economy? Could you include some GDP numbers and some job numbers too?

Mr. Stephen S. Poloz: That sounds like a fairly straightforward question, but it's not. Our focus there, as you mention, is that the lower net price received by Canadian producers of new oil from the oil sands in particular, heavy oil, is a factor that is constraining investment in new projects in that particular sector. For us, for forward-looking purposes, that's the most important channel of effect.

The question about the gap between WCS and WTI and the effect it's having on the economy has a lot of complicated calculations in it. Not all of Canadian oil production, of course, is paid that price. Some of it is already committed on a pipeline. Other companies have a full upstream and downstream system so aren't hit by the same issue. As well, part of the premium is paid to the transportation companies, so some of that money stays in Canada.

It's very hard to isolate that number. It's not that important to us in the sense of how to make a forecast. It's important that GDP is what it is. The question is, how will it grow from here? In that case, we believe that investment in that sector will remain flat in our forecast because, of course, one of our assumptions is that oil prices stay constant in our forecast.

Mr. Tom Kmiec: Okay. Just for a change of pace, I'm going to refer to a report by the Bank of Canada, the financial system review from December 2016, because I have a question about mortgages. You've mentioned this several times here.

Under the heading “New policy measures will change the behaviour of lenders and borrowers”, there's a section on page 8 that says, “All else being equal, 43 per cent of their high-ratio mortgages and at least 59 per cent of their portfolio-insured mortgages issued over the 12 months ending in September 2016 would not have qualified for mortgage insurance under the new rules.”

Those are the rules that at the time were changed in September 2016, and by December 2016 the Bank of Canada was able to provide information on what the impact would be in terms of a comparison and who would qualify and who wouldn't. Do you have the assessment done for the changes to the B-20 rules?

Ms. Carolyn A. Wilkins: Yes. Just to put that assessment in context, the assessment is really done so that we can figure out how much it's going to affect GDP. Okay? We need to know that to forecast inflation, so the assessment is really an estimate, a rough estimate.

The way we calculate that is to look at the prior year. In that case, it would have been the year before. For this particular change, it's the prior year as well. We calculate, if the profile of the people who applied for mortgages was exactly the same, how many wouldn't have met it. What we find in the work we published in our November 2017 FSR is that about 10% of uninsured borrowers would have failed the test. Many of those would have been in Toronto and Vancouver. It's not surprising, because that's where house prices are the highest on average.

That doesn't mean that all those borrowers would no longer buy a house. What they could do is decide to wait a bit and then buy a house once they've saved more, or they could decide instead to buy a less expensive house; that's what we need to wait and see for these current changes. What we noticed from the changes from a year ago that were acting on the insured space was that about half of the people who didn't qualify decided to just wait a really long time and not buy a house for a while. The other half decided to adjust and purchase a less expensive house.

Mr. Tom Kmiec: How long does it take the Bank of Canada to do that type of assessment? How many months of data do you need before you can provide a good assessment on the impacts of the B-20 mortgage rule changes?

● (1550)

Ms. Carolyn A. Wilkins: I think it's going to take about a year.

Mr. Tom Kmiec: One year? Twelve months?

Mr. Stephen S. Poloz: Something like that.

Ms. Carolyn A. Wilkins: Yes.

Mr. Tom Kmiec: In your—

Ms. Carolyn A. Wilkins: We'll have a better idea by September, as I said in response to the previous question, to get a really full assessment. Even then, you have an identification problem because there are more things changing at the same time—for example, our past interest rate increases. We should have a better idea in a few months.

Mr. Tom Kmiec: In 12 months?

In your statement, Governor, you said that there's this slowdown down in the first quarter that should “naturally reverse”. What did you mean by “naturally reverse”? Also, in your opinion, when will the real estate market reach the new volume equilibrium?

Mr. Stephen S. Poloz: We have three things happening to the housing market at the same time. One is that interest rates have risen since last year, and so we're watching for that effect. That would have a longer-term effect on the market. Second is that we have the change to B-20, which would also have a longer-term effect on the market. The third thing is the pull-forward part, which brought sales from the first quarter into the fourth quarter, and that part we would expect to regularize. We have low sales in the first quarter because of the high sales in the fourth, but by the time we get into the second quarter or certainly into the third, we should see things reaching a more stable place. That stable place will include all three of the effects I mentioned, not just the one. The big fluctuation we've seen will naturally reverse itself just because fundamentals remain very strong.

Mr. Tom Kmiec: Mr. Governor, what baseline do you expect to see in the third quarter?

Mr. Stephen S. Poloz: That's the one that we have in our forecast. When we go through.... There's a table in the monetary policy report, which I don't have at my fingertips. It's about a 0.2% contribution to GDP as a baseline. This of course is less than we've had in the past because of the moderation we're forecasting in the housing market.

Mr. Tom Kmiec: On the question of mortgage changes, you said “naturally reversed”, and I still don't feel as though I understand what you mean by this. You're taking into account the lower volumes, because people will defer or make different housing decisions on their own, but also, some individuals simply will never be able to qualify again. With this “naturally reversed”, you're just saying that people will make decisions in the first six months, and then by the time we reach the third quarter, which is at about September, we'll see the impacts that the change to B-20 has had, all other things being equal.

Mr. Stephen S. Poloz: That's essentially it, bearing in mind that our narrative is primarily around the growth of the economy, rather than the levels. In the back of that is a strong sense that the fundamentals of the housing market remain very solid, that demand will remain solid through this, and that higher interest rates and the new B-20 are going to slow that growth rate, although it won't cause a permanent decline in that growth. It's a moderation as we go through, and a smaller contribution to GDP than what we saw during the very low interest rate period.

The Vice-Chair (Hon. Pierre Poilievre): Mr. Julian.

Mr. Peter Julian (New Westminster—Burnaby, NDP): Thank you, Mr. Chair.

Thank you, Governor and Deputy Governor. I appreciate your being here today.

I want to continue the questions around the impacts on housing of a rise in interest rates, particularly variable interest rates, because they're going up. People in some areas of the country.... You mentioned Toronto and the Lower Mainland. I can tell you, as a Lower Mainland B.C. MP, that the housing crisis is profoundly acute and the difficulties people are experiencing are monumental. We have pensioners who have paid into pensions for their entire lives who can no longer afford housing. As the deputy governor mentioned, there are a number of factors, including a problem of supply. We simply haven't been building affordable housing for decades, and with that it has all come to a crisis.

My first question is around the impacts of monetary policy and the rise in interest rates. With your model, do you also look at the number of bankruptcies and foreclosures that come from every quarter-point rise in interest rates? Is that part of the overall model?

● (1555)

Mr. Stephen S. Poloz: Yes.

We have access to very granular data on household borrowing, on mortgages. We're able to model this quite closely. Where we begin to get more uncertainty in the picture is with how people actually respond. We can do the arithmetic on it, but the economics are more complex, because it concerns behaviour. For instance, as Ms. Wilkins said, we have people deciding to buy a smaller house. It still comes up as a sale, yet they managed to meet the criteria, and there are others who delay, and so on.

It's in the behavioural differences where the more statistical, historical modelling comes into play and where you have a zone of uncertainty around those kinds of predictions. It's why we can't be so definitive about how the thing unfolds. As it unfolds this year, we have three things happening at once. It's going to take more than a few data points to be able to figure out how much is due to the revised B-20 guideline, how much is just due to higher interest rates, and how much is just that pull forward and then the return to quasi-normal.

I accept your point that it is a difficult situation for people. As for the price level of housing, none of these things we've talked about are aimed at somehow controlling the price of housing. They're aimed at improving the sustainability of debt so that our financial system is less at risk. The price of housing is fundamentally driven by demand and supply, and the biggest thing there is that we have strong demand and relatively weak supply.

Mr. Peter Julian: I realize it's beyond your purview to comment on the supply of social housing or affordable housing or co-operative housing. That's not your role or your mandate. Obviously, it is one of the factors that the deputy governor just cited in replying to Mr. Fergus's question. It's something that people feel acutely.

When we move to these new rules, there are impacts on people who perhaps have a higher level of income, or at least a higher level of debt, and are able to afford a mortgage. Many of the people who are impacted most profoundly would not be able to afford a mortgage when average prices are over seven figures in most parts of the Lower Mainland for single family homes and, hundreds of thousands of dollars even for condos. It's a real problem.

What I'm trying to get at is whether in the modelling itself you track this. The modelling doesn't necessarily seem to indicate that you do—or you look at the figures afterwards. Do you take into consideration foreclosures and bankruptcies as part of the overall impacts of monetary policy?

Mr. Stephen S. Poloz: We track those data, as everyone does. In terms of the actual forecast, there is a degree of judgment because B-20 is not the sort of thing that changes often, so it's not as easily modelled, but it's modelled in the way we've described, on a granular level, and then scaled up to make a good estimate. The effective interest rate, however, is more behavioural and more historical, and we think it's enhanced somewhat because of the level of debt.

Would you like to add something?

Ms. Carolyn A. Wilkins: I think you can be confident that we look at the micro-data, the segregated data, when we try to understand what the interest rate effect is, because the distribution of who is indebted and what kind of assets they have really matters. It matters to the macroeconomic outlook. We've tried to do that in our model changes.

What we also look at in the context of the financial system review are scenarios where it's not just interest rate increases that are happening; it's also perhaps a context in which instead of interest rate increases you end up with a spike in unemployment and things like that. It's there that you see other reactions such as defaults and arrears that would have stronger macroeconomic impacts. According to our modelling, the kinds of interest rate increases we look at in a cycle like this one don't have enough of a reaction in arrears and bankruptcies to create a macroeconomic issue.

That's not to say we don't take it into account, but it's just not big enough. It's really in the tail event, a recessionary situation, or something like that where you would see a remarkable aggregate increase in arrears. That doesn't mean it's not difficult for individuals who are facing that situation. It's just that when you're targeting inflation, it's something that we take into account, but it's not driving the results.

● (1600)

The Vice-Chair (Hon. Pierre Poilievre): Mr. Julian, a quick question.

Mr. Peter Julian: Do you track, as well, the impacts of measures, for example, that the new B.C. NDP government has taken to counter speculation in the housing market?

Mr. Stephen S. Poloz: Yes, we track the results of that, and note that it seems to have a temporary effect in B.C. We're still watching the experiment, or the change in Toronto. Also, the experiences in other countries with similar situations is helping us to understand that.

When the laws of demand and supply are operating strongly, then these things don't invalidate them. They can delay them, and if there is a speculative run happening, it can break that psychology, in that it does seem to have some effect on that.

The Vice-Chair (Hon. Pierre Poilievre): Mr. Sorbara.

Mr. Francesco Sorbara (Vaughan—Woodbridge, Lib.): Thank you, Mr. Chair, and welcome, Governor and Senior Deputy Governor.

Obviously, this afternoon our thoughts are with the folks back in Toronto, after the incident that happened earlier today. Our thoughts and prayers are with them, and our thanks go out to our first responders.

Going to the subject at hand, Governor, I thank you for your introductory comments. You commented on the considerable progress the economy has seen over the past two years; the wage growth that's circa around 3%, which is great; and the pace of household growth, which is slowing year-to-year, which is a healthy indicator. I don't think you can binge, if I can use that word, on credit for too long. You need to do that.

There was a correction in the housing market as a result of the corrective measures we have undertaken and OSFI undertook with B-20 and B-21. In the April monetary policy report you increased our potential growth rate in Canada.

As an economist myself, what would cause a central bank to increase a country or nation's potential growth rate?

Mr. Stephen S. Poloz: We don't do that ourselves, but we are acknowledging that the economy's potential has evolved in a positive way since one year ago. We do a full job on that only once a year, in the springtime, for our April MPR.

What we need to take into account, then, are the latest long-term data from StatsCan, which are published late in the year and give the historical revisions. The last historical revision raised estimates of investment quite a lot back in 2014, 2015, and 2016. That means that Canada has been operating with a higher capital stock than we believed before and, therefore, potential output has been higher. Furthermore, its growth rate is slightly higher. That, of course, is good news.

We speculated the last time we were here that as the economy reaches its level of capacity, investment would begin to pick up more and build more capacity. That is happening too, but, as I indicated, less than we would otherwise expect, because of the uncertainty companies face, particularly around NAFTA.

Mr. Francesco Sorbara: My second question refers to the labour market.

As I often go around the riding that I'm blessed to represent, a number of employers have remarked on labour vacancies and the difficulty of finding labour. On page 13 of the April monetary policy report, it says that job vacancies have risen by nearly 25% in the past year, with 470,000 job vacancies from coast to coast to coast. There's a little catch-22 there, in the sense that the Bank of Canada has identified that we still have a long-term unemployment rate issue.

I want to make this plug. One of the measures we brought in the budget was the Canada workers benefit, which hopefully will pull more folks into the labour force.

With the idea of wage growth following-in, could you talk about how we can continue to attempt to attract people to enter the labour force, whether they are retired or have taken themselves out, and how important that is to increasing our potential output even more?

● (1605)

Mr. Stephen S. Poloz: It's true that one can't really build too much more potential output without the people. That process I described of higher investment usually means an expansion in a company, and therefore also more jobs.

It's true that the statistics on vacancies—and 470,000 is a lot of vacancies—are up a lot over the past year. That is, of course, a symptom of a very strong job market, but it's also a symptom of.... When I talk to companies, they tell me they're having trouble finding people with the skill set they're looking for. It can be a geographic mismatch, or it can be just an absolute shortage mismatch.

Mr. Francesco Sorbara: Do I have a couple of minutes left, Chair?

The Vice-Chair (Hon. Pierre Poilievre): You do.

Mr. Francesco Sorbara: Thank you.

One question I had is on the business loan survey that came out, I think, last week. The “Business Outlook Survey”, I think it's called, is an indicator I looked at. It seemed pretty robust. The overnight rate is at 1¼% versus where it was even in 2010 at above 4%. When inflation came in at 2.3%, you identified some transitory factors in play. It was the highest rate in four years, I believe, on a year-over-year measurement.

Should we be worried about inflation, especially on the wage side, but also on the cost side at all? Rates have been low for a very long time, since the financial crisis in 2008. We see U.S. yields now backing up to around 3%.

Should we be concerned, Governor and Senior Deputy Governor?

Mr. Stephen S. Poloz: No. Our forecast is for inflation to be 2% in the window that we have some influence over, which is 18 months to two years from now. Over this year, it will be above 2% because of the short-term factors that we've identified, primarily energy costs. Those things will come out in a year-over-year basis by the end of next year.

As it connects to your previous question, what we're really watching is the pickup in wages as those job vacancies continue to grow. As wages pick up, this will encourage more people to re-enter the workforce.

We are just now, in the last six months, reaching wage movements that are positive in real terms—above 2%. That's an important bridge to cross. As we said, when we get up into the 2.5% to 3% zone, then we have more scope for getting faster reintegration of people back into the workforce.

Mr. Francesco Sorbara: I have a very quick one on trade, because trade is obviously very important for a small open economy such as Canada, with the ongoing NAFTA negotiations.

There have been some green shoots on trade. In the last couple of days, Mexico has signed a trade investment accord with the European Union. We've joined CPTPP. We've concluded our CETA agreement. The European Union has also made the same agreement with Japan. There is some protectionist hubris at the top. We've also entered into negotiations with Mercosur. I think that's important for Canada and further trade liberalization for the global economy.

I know in the MPR that you comment on measures in the States. You comment on global trade patterns and identify them as a risk for the Canadian economy, which I understand. However, suffice to say, there are some policies being put in place by governments around the world for trade liberalization.

Mr. Stephen S. Poloz: That's correct. There are, and Canada is taking advantage. I'm quite certain that our export growth is higher today than it would be without those extra opportunities. However, it's still a little on the lacklustre side because of our uncertainty around our principal trade partner. These are as you call them, “green shoots”. These are promising changes.

In some sectors, we're doing quite well, especially in IT services, transportation services, and tourism, which are the fastest-growing areas of our economy, and goods sectors, things like aerospace, heavy trucks, machinery and equipment. So we have encouraging effects. I'm hopeful that when we get past the bottlenecks we saw during the wintertime, we will get some clearing of inventory out. Exports will rebound, and we will feel more comfortable of our baseline.

● (1610)

Mr. Francesco Sorbara: Thank you.

The Vice-Chair (Hon. Pierre Poilievre): Mr. Albas.

Mr. Dan Albas (Central Okanagan—Similkameen—Nicola, CPC): Thank you, Mr. Chair.

I also want to thank the governor and the deputy governor for being here today, and the work you do for Canadians every day.

Governor, during the pre-budget consultations that we did across the country, there were concerns around NAFTA and competitiveness. I certainly appreciate members raising the need to continue to open up free trade market access for Canadian producers. The challenge, as you know, is that we may be able to open up new markets, but if we do not have competitive products at a competitive price, then we may not be able to succeed in the world.

In the report, on page 19, you mentioned concerns around being able to access global growth in areas like trade specifically because of competitiveness. Is investment going to the United States instead of here, and what steps can we take, as parliamentarians, to encourage the government to do what it can to encourage more investment in this country?

Mr. Stephen S. Poloz: Our primary source on questions like these is our BOS, our business outlook survey, which is quarterly and quite thorough. Companies for quite some time have been talking about the uncertainty around NAFTA giving them pause in their investment decisions. A pause is one thing; another is a step further, where in a handful of cases, companies that straddle the border and have capacity on both sides of the border may be focusing more of their attention on their U.S. presence because of that uncertainty. It's very early days for this because these are long-term decisions.

Nevertheless, as we say, there are competitiveness challenges, which are, by the way, not actually that new. They've been with us for quite some time. They are often spoken about by the companies we talk to. Their investment, in fact, is doing all right but we think would be stronger without that uncertainty around NAFTA. The sooner it becomes clearer to people, I think, the better it will be for business decision-making

In terms of what happens to other sources of competitiveness, those are obviously very structural things in the Canadian economy, such as energy costs or regulatory burdens. Those are other things that companies mention to us.

Do you want to add something?

Mr. Dan Albas: I appreciate that. In your opening statement, you talked about animal spirits in the United States and how there could be a good as well as a negative side. I guess I would refer to how, while investment is going to the United States because they see opportunities there, and we look at our own lack of business investment or reinvestment and at some of these investment decisions being put off, compounded further by our regulatory structures, whether they be new or higher taxes or new regulatory regimes like Bill C-69 while the energy industry, for example, has said there will be no further pipelines, complicated by the fact.... Speaking of pipelines, there's quite a discussion happening around those things.

That kind of says to Canadian and international investors that we may not have.... Are you concerned that these imposed taxes and regulatory structures may dissuade people from investing here and now in this great country?

Ms. Carolyn A. Wilkins: You talked about the report. There's an interesting chart in the report that looks at the different sectors in which you can measure capacity. You can see that a lot of companies in different industries are actually at or above their historical capacity constraints. You would think that, given the growth of the U.S. economy, there would be an incentive to invest. In part, that's why businesses, when you look at our survey, say “yes, it is the right time to invest” because of the capacity, but at the same time, we're not seeing it as much in the numbers as you would expect this time in the cycle given what is going on.

Part of what businesses are saying is related to NAFTA and part of it is just related to longer-term structural issues with the Canadian economy. In our outlook, we've decided to take on board some of that uncertainty with respect to investing and to mark down our investment profile. It's still going up but by less than it would have otherwise. We've also done that with our profile for exports, because if you don't invest, you don't have the capacity, and you don't have a market to sell to. You can't sell to a market.

These are things we've taken on board. We still have a positive profile for investments and exports but less so than we would have had otherwise.

● (1615)

Mr. Dan Albas: You say “we still have”. I say that we are putting in place further regulatory measures. It says in the very report that there are concerns around regulatory competitiveness issues, but I don't hear you saying that.

Could you please elaborate on it?

Mr. Stephen S. Poloz: Competitiveness is a very broad kind of concept. Economists usually measure it in terms of unit labour cost measured in a single currency. That's the narrowest version of it. Of course, from a company's point of view, anything that costs them money is part of their competitiveness equation. It could be, as Carolyn mentioned, a regulatory burden or it could be taxes or it could be any of those things. Electricity costs are often mentioned to us. What we're saying is that these are things people are mentioning to us in our survey. We don't have a measure of these things except to look for reasons why the data on exports or investment show that they are not performing as well as our model suggested they would.

Mr. Dan Albas: Thank you.

The Vice-Chair (Hon. Pierre Poilievre): Mr. McLeod.

Mr. Michael McLeod (Northwest Territories, Lib.): Thank you, Mr. Chair.

To the presenters here today, I'm very impressed, as always, that you're able to take a snapshot of where we're going as a country and how well we're doing.

In the north, we've been very happy to see the number of investments being made in infrastructure, housing, and other things, which have really helped us move forward. That includes transportation. However, until we get certainty in our land claims and self-government for our indigenous peoples, and further investment to lower the cost of transportation infrastructure, we will continue to be challenged. We're probably not growing quite as fast as the rest of the country, but it's good to see that the country is doing well.

In your opening comments, you admitted that things were not going as you had forecast. In your first paragraph, you said that some things are taking longer, and in another place, you said that the capacity is growing faster than you expected. I guess it's a hard read at the best of times.

I want to ask if you could elaborate more on the measures in this year's budget that are really leading to the improved economic outlook. Could you tell me that first?

Mr. Stephen S. Poloz: We don't comment on individual measures, but what we do is take the budget in its entirety and seek out or distill just what its macro effect will be.

Mr. Michael McLeod: Maybe I could be a little more specific. In January you had some comments and you have since revised them. Why did that happen?

Mr. Stephen S. Poloz: Oh, I see. Well, what happened since January was that everybody had a budget. So we update the fiscal stance for all the provinces and the federal government together in one line. What is that adding to the economy? I'd say the biggest contributor to that difference is the Ontario budget. It's significant. Of course, there are budgets in lots of other provinces. The point is that we update that. There is a factor in our model that contains the fiscal stance for all levels of government in Canada, and that has increased since we were last here. It has increased since January.

Yes.

Mr. Michael McLeod: My next question is about a recurring theme in your report, that the economy is currently operating at near capacity. I want to know how we got to this level, the implications of being near capacity, and how or if that needs to be addressed.

● (1620)

Mr. Stephen S. Poloz: Our objective is to get inflation on our target of two per cent. The only time it will sustainably be at two per cent is when the economy is also operating at capacity. If the economy were operating below capacity, there would be downward pressure on inflation, and if it were operating above, there would be some upward pressure on inflation. For quite some time we have been below Canada's capacity and inflation has been struggling to get up to our target. It's only in the past year that we have converged quite close to capacity, and inflation is now at 2.3%, according to the latest data. So we got there, of course, with a combination of a healing economy, after all the damage that we had before and the subsequent damage that came from the oil price shock. Those are the two major things, the global financial crisis and then the oil price shock, that set us back over the last decade. What has brought us back is healing in the various sectors, promoted by both monetary and fiscal policies throughout.

The Vice-Chair (Hon. Pierre Poilievre): You have 35 seconds.

Mr. Michael McLeod: I don't see anywhere in your report that you have measured the impact of the government's investment in infrastructure. Is that something you look at, at all? For us in the north, the phase one progress of the investment has been significant. I'm not sure how that factors into what you were....

Mr. Stephen S. Poloz: Yes, it's definitely there, very carefully.

Do you have anything to add?

Ms. Carolyn A. Wilkins: I don't have infrastructure separated out by itself, but the federal-led spending, of which infrastructure is a big part, adds 0.1 percentage point to growth in fiscal years 2018-19 to 2020-21 each year. What it does every year is to lift growth somewhat, and the level of GDP at the end of the forecast is higher because of that. It's just not much different from what it was in January. That's all, but it doesn't mean it's not contributing to growth.

Mr. Michael McLeod: Thank you.

The Vice-Chair (Hon. Pierre Poilievre): Thank you very much.

With the committee's approval, I have a few very quick questions on a similar subject.

Does the bank do any research on the composition of lenders to Canadian governments?

Mr. Stephen S. Poloz: Yes, we do. We have a good touch on where our major debt holders are throughout the world. That's quite well known.

The Vice-Chair (Hon. Pierre Poilievre): What percentage of them are Canadian? What percentage, I should say, in dollars of the debt we're raising on an average year is raised domestically?

Mr. Stephen S. Poloz: I'm afraid I don't know the answer to that.

We enjoy a very strong demand for our product abroad. It's seen as a very high-quality product. No doubt it fluctuates. I know we can certainly get you data on that and pass it back.

The Vice-Chair (Hon. Pierre Poilievre): The share of the government's borrowing that comes from inside our borders, do we know where that money would be if it were not lent to the government?

Mr. Stephen S. Poloz: Well, it would be saved in some other form. It would be perhaps saved in the stock market. More likely, a typical investor would have made a decision about fixed income versus non-fixed income, so the government debt would be competing in the fixed income space, rather than against stock market investment.

The Vice-Chair (Hon. Pierre Poilievre): So, it would be lent to other governments if it wasn't lent to ours.

Mr. Stephen S. Poloz: Or bank deposits.

The Vice-Chair (Hon. Pierre Poilievre): The reason I'm asking is that we always assume that deficit spending is stimulative in nature, but we forget sometimes that this money came from somewhere and that if it weren't lent to and then spent by government, it would have been invested somewhere else. Perhaps it would have been invested elsewhere in the world, but with home bias. Probably a large share of it would have been invested here.

I know that, for example, in the Israeli context, one of the great stimuli of the start-up nation, as it's called, was that the government just stopped borrowing so much money. Pre-institutional investors couldn't get 6%, 7%, or 8% by simply buying government bonds. They actually had to invest in productive assets. That's one of the reasons there is an enormous tech boom in that country.

Have you thought at all about the substitution effect of lending to governments?

● (1625)

Mr. Stephen S. Poloz: Of course, I've thought of that. I think that one of the premises that lies behind that analysis is that the economy is operating at its capacity already. The difficulty that we've had for some ten years now is that the economy has been falling well short of its capacity. Therefore, inflation has been drifting lower below target. Monetary policy has been stimulative throughout that period. Fiscal policy has also, in the last few years, been making a contribution to the overall level of demand in the economy.

We would just say that this is an accounting phenomenon. That's one of the reasons that we got to where we are.

The Vice-Chair (Hon. Pierre Poilievre): In the business cycle, is there any point where it's appropriate for the government to balance its budget?

Mr. Stephen S. Poloz: I won't pass a judgment on that.

One thing that we have talked about, and I've talked about myself, is the question of what different mixes of fiscal and monetary policy do. If the economy is facing shocks—which we have, of course, and not just shocks, but the legacy of those shocks—it means that the economy is like riding a bike up a hill. It's hard work to get up the hill. In that context, some form of stimulative policy is advisable in order to get the economy back to its potential.

While monetary policy does it through interest rates, it's the household sector that does most of the borrowing for houses and cars, etc. If it's the government that provides the extra stimulus, then it's the government that does the extra borrowing. You can picture two stocks of debt: fiscal debt and household debt. You face a choice by choosing a mix between the policies about who is actually doing the borrowing. Over the past ten years for us, it's been mostly a matter of households, and we have a household debt problem, which is well known.

The Vice-Chair (Hon. Pierre Poilievre): Aren't they the same people?

Mr. Stephen S. Poloz: Well, they are the same people, but there's a difference between them. I'm just saying that you would have debt one way or the other. I'm not saying what the optimal distribution is. I'm just saying that the choices between those two policies do give this outcome, and it's something we have to acknowledge. That's how we got here.

The Vice-Chair (Hon. Pierre Poilievre): I'd just make the observation that households pay for the government, so when the government's adding debt, we might have the mirage of having a special fund with which we can repay that, but all of the interest costs—which are going to rise spectacularly over the next five years by two-thirds according to the PBO's report just today—are on the shoulders of the very same households that you say are overburdened with their own debts.

Mr. Stephen S. Poloz: Right, but to go back to your original question, when the economy is in a place where there's a lot of savings but not enough spending or investment, the stabilization of the economy usually demands some form of stimulus. Low interest rates can only do so much of the work, and we still would have had a gap between where we are today and the economy's capacity were it not for some of the fiscal measures that were taken. That's part of the reason we are where we are today.

The Vice-Chair (Hon. Pierre Poilievre): Mr. Albas.

Mr. Dan Albas: Thank you.

To what extent has investment decreased in Canada since the third quarter of 2017?

Mr. Stephen S. Poloz: How much has...?

Mr. Dan Albas: How much has it decreased?

Mr. Stephen S. Poloz: Decreased?

Mr. Dan Albas: Yes.

Mr. Stephen S. Poloz: Investment in Canada? It did not decrease in the fourth quarter. We think it was soft in the first quarter.

● (1630)

Ms. Carolyn A. Wilkins: It was actually high in the fourth quarter.

Mr. Stephen S. Poloz: It was very strong in the fourth quarter. What happened is that at the end of the year a number of significant projects in the energy sector reached their natural conclusion. So you have a bulge in spending, which of course only began, I'd say, two years ago, after the oil shock kind of got behind us. There was a bunch of spending that went through over the course of 2017 in particular, and that reached its conclusion. Spending in that sector fell, we think, in the first quarter. It's not because something has gone wrong. It's just that they finished, and the price of WCS is such that people are rethinking longer-term plans in that sector.

Investment in other sectors has continued throughout this piece, and actually, our imports of machinery and equipment continue to be quite strong, which suggests that investment is good, and we have good sentiment indicators in our survey. We're hopeful that whatever lull we're seeing is just a result of the uncertainty around NAFTA that is causing people to delay.

Mr. Dan Albas: Thank you for that.

Just switching gears, I'd like to follow up MP Julian's specific concerns around Vancouver—although the B.C. government has put forward a speculator's tax. As you said, if we're talking about affecting material supply and demand, that may be the intention behind the policy. You said you've done some tracking or an experiment on it. When will that be available to the public?

Mr. Stephen S. Poloz: When I used the word “experiment,” I was calling these policies a sort of experiment because no one really knew how they would turn out—putting a tax on foreign buyers and that sort of thing. There have been other cases around the world where the same thing has been done and it has had only temporary effects.

Mr. Dan Albas: There is a foreign buyer's tax in British Columbia, and that has been spread out to the interior and to some parts of the island. Also, there is a speculator's tax. I've had a tremendous number of phone calls from Albertans and people in West Kelowna who will be affected; developers aren't bringing their projects forward because they don't feel there may be a market.

Are these kinds of policies something you think the Bank of Canada will track, or are they policies that you don't think have enough national substance to track?

Mr. Stephen S. Poloz: We will certainly track those developments closely, because we're intensely interested in how the housing sector is evolving and, in particular, in those markets where these things are happening. By the way, it's something like 40% of our housing market in Canada when you just take those two places. It's not just a city thing; it has a macro impact.

Mr. Dan Albas: When will some of that analysis be publicly available?

Mr. Stephen S. Poloz: We analyze that on a regular basis in our FSR, which will be coming out in June, so there will be supporting analysis there.

Mr. Dan Albas: Will there be some piece to outline that particular policy?

Mr. Stephen S. Poloz: What we do is we track to see what its implications are. This is what we did when it first happened in Vancouver, and we did it in our last FSR right after the changes in Toronto, and the same thing with B-20, the other thing we talked about today. These are, to the very best to our ability, analyzed in granular data by segment of the population and by segment of the country to make sure we understand as well as we can.

Mr. Dan Albas: I just want to touch upon employment. Monthly employment gains averaged 22,000 from October to March, with full-time employment increasing by 37,000 and part-time employment declining by 15,000 jobs. Now, roughly 40% of the job gains during this period came from private sector employers. Does it concern you that 60% of the job gains are not in the private sector?

Ms. Carolyn A. Wilkins: We care about how many people are employed, how many hours they're working, and what's happening to their income from a macroeconomic point of view. That job growth in the labour market has looked fairly healthy to us, and you do see from our surveys that employers in many sectors are finding it more difficult to find the right employees.

Nonetheless, if you take those numbers and dig into them, so you abstract from the public service versus private sector, and you look at hours worked—are they still working part-time but rather be working full-time?—and [*Inaudible—Editor*] of employment, you see that our summary labour market indicator, which is an adjusted unemployment rate, is still 0.5 percentage points higher than the actual measured unemployment rate, which is now 5.8. It's come down with the unemployment rate, but there are still indications of slack in the economy in some areas.

● (1635)

The Vice-Chair (Hon. Pierre Poilievre): Madam Dzerowicz.

Ms. Julie Dzerowicz (Davenport, Lib.): Thank you, Mr. Chair.

Thank you to both of you for your wonderful presentations.

I have two questions. The first is tying productivity labour market and immigration. My riding of Davenport in downtown west Toronto has a lot of people in the building trades. Consequently, I get a lot of employers in construction saying to me, “Julie, it's wonderful that we have so much investment in infrastructure and affordable housing, but we have a great number of vacancies that we are just not able to fill.” I'm going to follow up my colleague's comments about the 470,000 vacancies. I wonder whether or not you're able to break down that 470,000 between skilled workers and maybe highly skilled workers, etc. That's part one of my question.

Second, I read from a very credible source that a lot of Canada's productivity has come from immigration. I want to know whether that's true and whether our current immigration levels are right in order for us to continue to support growth here in Canada. If we're not able to fill the 470,000 vacancies, what will the impact be on our economy?

Mr. Stephen S. Poloz: Those are a lot of interesting questions.

Companies are telling us is that the vast majority of vacancies are for skilled workers, and it's the lack of supply of workers with the appropriate skills that is causing that to be the case. As I said before, it's possible that it can be a geographic imbalance. We could have pockets of very skilled workers still in oil-producing provinces—Alberta, in particular—who have not moved to where the jobs are. This, of course, can be one of the reasons.

It sounds to me that it's become more general. If we look to where the growth has been, the highest growth rate and job creation has been in IT services—financial firms with 600 or 700 IT workers in them, whereas it was 200 before. There's been really big growth, and these are, of course, very high-skilled, very well-paying jobs. It may just take longer for the supply of workers to meet that demand.

One of the solutions, as you suggest, is immigration. Immigration levels, of course, are higher than they were before, and everybody knows where there are skills shortages in the market, and so there's a guidance thing that's happening there. I'm not sure what you mean by productivity from immigration, but in terms of how much our potential output is growing, it's true that a lot of our workforce growth is coming from immigration. It is very important to our growth and potential. There also tends to be a higher percentage of entrepreneurs among immigrants. They start their own businesses, etc.

That's all I have in terms of big statistics, if you like. I really couldn't comment specifically on your hypothesis.

Ms. Julie Dzerowicz: Is there a difference between skilled workers and skilled trade workers, or are skilled trade workers part of skilled workers?

Mr. Stephen S. Poloz: I think skilled trade workers have specialty skills too, and so you often may need certification of some kind. If you're an immigrant who may be a qualified carpenter and you don't have a paper for Canada, you might have to go to community college for a refresher and get your certificate, or go through an apprenticeship. We have the means to bring these things about, to make supply more equal to demand, but the sorts of skilled workers who can create an app for your bank have a whole other set of skills. I hear about vacancies in skilled trades, and it's understandable given the infrastructure spending and a busy housing sector and so on. Those skilled trades matter a great deal, but they're not a giant leap away from many of the other jobs that are under pressure, in manufacturing and so on. What I like about the skilled trades is that it's possible for re-skilling to happen in a relatively short time. I'm optimistic that with the right dynamics and economy, we'll get there.

● (1640)

Ms. Julie Dzerowicz: Thank you.

[*Translation*]

The Vice-Chair (Mr. Peter Julian): Thank you.

Since the first vice-chair had to leave, I'm going to take over, as the second vice-chair.

It being the NDP's turn to ask questions, I'll ask my questions from this seat.

[*English*]

Thank you very much, Governor.

I wanted to come to the issue of wage growth and the overall family debt load, which you noted a number of times in your presentation. I thought that two of most interesting graphs in monetary policy report dealt with the following. Number one, in the English version on page 13, it speaks of wage growth, which appears to be just shy of 3%. Second, it then looks at slowing household credit growth, which continues to be remarkably higher than wage growth. I think that continues to be the dynamic we've seen in this country over the last decade or so, with family debt at profoundly record levels, but wage growth not in any way seeming to compensate for that high level of family debt. Despite the fact that household credit growth is slowing and wage growth is increasing, we're still seeing a worrisome gap, I would assume, between the level of family debt and overall wage growth. I'm wondering if you could comment on that overall.

Ms. Carolyn A. Wilkins: What we are seeing is a firming of wages, and as the governor explained earlier, it's a product of a labour market that is growing, and it's more in line, although still a little bit less than one would expect, given where we are in the business cycle.

You're right that what we've seen over the past few quarters is a continued slight uptick of household indebtedness as a relationship to disposable income, which is a function of both wages and the number of hours that people are working.

We don't just look at wages; we also need to look at hours worked, to get that number that we care about, and what we're seeing is a slowing in household credit. A lot of it is coming from the mortgages side, but there are also other forms of household debt, and that's slowing at a somewhat slower pace than labour income is increasing. But what you would expect with the economy continuing to grow is that those would become more in line, so we expect credit should continue to keep slowing, while labour income is continuing to rise.

Over time, over our projection, and over the next few years, we should observe that ratio of household debt to disposable income stabilizing.

The Vice-Chair (Mr. Peter Julian): You're expecting that is more an issue of years, in terms of turning around what I would describe as a toxic situation, where family debt increased and wages did not keep up.

Ms. Carolyn A. Wilkins: If you look at that chart over a longer period, you see that household debt to income has been rising for quite a number of years—in fact, since the early 2000s—and so what took such a long time to build up is going to take a bit of time to wind down. You have to remember that the buildup is accompanied by the purchases of assets—housing, for the most part—and so there's another side of that balance sheet that households have, and the net worth numbers would show a slightly more reassuring story.

[*Translation*]

The Vice-Chair (Mr. Peter Julian): Thank you very much.

I have to interrupt myself, since my time is up.

Mr. Sarai, it is over to you.

No, actually, it is Mr. Sorbara's turn.

● (1645)

[*English*]

Mr. Francesco Sorbara: Actually, Mr. Sarai will go first, and then I'll follow.

Mr. Randeep Sarai (Surrey Centre, Lib.): Thank you, Chair.

Thank you, Governor.

I'm a member of Parliament from British Columbia, and as you may appreciate, B.C. has been flooded with foreign investment, particularly in the housing sector, to the tune of almost a billion a month. That's the number that was recorded before. There are now several federal and provincial measures designed to slow the rapid rise in home prices. I'm wondering how the adverse effect of that starts slowing things down. It seems that it's having some effect but not as much as it has had in Toronto.

Would there be an economic impact in terms of job losses in the construction sector and related fields outside of that, or is the demand so exceeded that it will actually bring an equilibrium?

Mr. Stephen S. Poloz: My perception is that demand for housing remains very strong, throughout Canada, actually, not just in those markets, and therefore, the pace of construction and the jobs in construction are basically determined by the demand. The supply is the constraint that prevents it from being faster.

I think the main result of the interventions that have happened to the market itself has been to take some of the extrapolative expectations out of the market. For us, it's very unhealthy to hear people say they've got to buy a house because they're afraid of missing out. They wanted to buy one in two years but they need to do it now. And they can.

Even worse are folks who have paid down enough of their mortgage that they can then borrow enough to buy another house while it's being built and then plan to sell it when it is built. That's just to earn a return. That's speculative.

When people think there's nothing that can go wrong in that, then you know expectations have become extrapolative, and that's a very unhealthy place for people to make lifetime decisions.

In that sense, at the time I thought that could be just a temporary effect on the market, but at the same time it has an important disruptive effect on those expectations, and therefore it has a longer term positive impact.

Mr. Randeep Sarai: I'll pass to my colleague Mr. Sorbara.

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

Thank you, Mr. Chair.

Governor and Senior Deputy Governor, along with OSFI, our government has put in place a number of measures for the housing market. I like to think that the quality of debt now being assumed by consumers in purchasing a home has improved. I look forward to reading and seeing the June financial system review. Can you comment on measures to date or what you're seeing in colour commentary, if I can use that term, of the quality of indebtedness Canadians are assuming *ex post* the measures we and OSFI have introduced?

Ms. Carolyn A. Wilkins: What we have the clearest view on are the changes that were made in 2016 that affected insured mortgages. It was the same kind of change that we saw put in place in January of this year, with major part being that households looking for a new mortgage loan would have to pass a stress test of increased interest rates so you could tell that they could withstand that. One of the indicators we looked at, which had been giving us cause for concern, was the share of mortgages that had a loan-to-income value greater than 450%. If you're leveraged greater than 4.5 times your income, you're less resilient if interest rates increase or you lose income because you're working fewer hours.

We saw this ratio, which was around 18% at the time of the measure, fall to well under 10%. I think it's probably now between six per cent to eight per cent. That change in the composition of debt, in the new mortgages that are written, means that over time the quality of the debt out there should continue to improve. We expect a similar effect from the most recent changes, which, as you know, are related to uninsured mortgages. It's too early to have those data, but we expect to get them as the year progresses and to be able to follow them over the coming months.

● (1650)

[*Translation*]

The Vice-Chair (Mr. Peter Julian): Thank you, Mr. Sorbara and Mr. Sarai. Thank you, Ms. Wilkins.

Mr. Albas, you get the last word.

[*English*]

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

I certainly appreciate the conversation we've been having thus far. Obviously, the bank was established to ensure price stability and stable economic growth, so, again, there have been some changes in the way the bank looks at inflation. I believe that recently there's been different way of approaching it to see what indicators better track inflation over a longer period of time. Obviously inflation is up in certain areas, and yet interest rates have not gone up.

For the people at home, could you please reiterate why the Bank of Canada made its decision the other day, and why this new method is going to benefit Canadians?

Mr. Stephen S. Poloz: As you know, the inflation rate tends to be very variable. It's influenced by many short-term things. We're always looking for a better way to filter out those variations, especially since, as a policy-maker, I know that we can only affect inflation 18 months to two years from now. It's our forecast of where it will be two years from now that determines whether or not we need to do something now. We have to see through all the noise and the data, so we created some core measures, which were intended to strip out the noise, and we published them and said we're going to follow them, and they promptly fell well below two per cent and, of course, gave rise to concern that maybe our modelling was off.

So we did a lot of extra modelling over the past 18 months or so, and sure enough, as expected, those measures have converged very close to two per cent over the last six to eight months. That has confirmed for us that we have the right models and the right framework. That means our forecast for inflation, which two years from now is two per cent—exactly on target, or within 0.1 per cent of target—is well within the range of one per cent to three per cent. This means, given what our outlook is, that we have monetary conditions roughly where they should be. In that context, the fact that inflation is rising above two per cent for now is due to temporary factors, and we can see through them. We explain that to people so they can keep their expectations firmly at two per cent, and the economy should continue to run nicely on that.

Mr. Dan Albas: When I return to my riding, one of the benefits of being able to go home and chat with people is that I hear where they're at.

For the first time, Governor—and I'm actually going to direct this question to the deputy governor—I've had different conversations with constituents, different people with different backgrounds, about cryptocurrencies.

I do know you've made some statements recently and that there is a need to have a broader contextual look at it, not just from a Canadian viewpoint but also from an international one. You also made a distinction between a cryptocurrency itself, or what's broadly referred to as a “cryptocurrency”, and have called them “crypto assets” instead.

Could you please give an explanation to the Canadian public why you're using those terms and what, from the Bank of Canada's position, should be the proper way to start discussing these things? Many people are talking about them in terms of speculation or gambling. Some people are looking at them in terms of investments. It would be helpful to have some context for them.

Ms. Carolyn A. Wilkins: Sure.

It's really important that people who purchase these kinds of assets know what they're purchasing and know what an asset is. When you think of a currency, a currency is something that you can store value in; you can use it at a store to buy goods and services; and you can be reasonably sure of what the value is going to be from one day to the next, as you can with the Canadian dollar. That's why we target inflation, so that households don't need to worry about that kind of fluctuation in the value of the holdings they have.

If it's an asset, you may hold it for a variety of other reasons, as you hold other investments. You may hold it because you think you have a stake in a company. I'm thinking about an initial coin offering, on which I may earn a high return over time. I might hold something like Bitcoin, and I may hold a return on that over time as well. When you're a purchaser of that and you're a household, you need to know what kind of risk is associated with that and you need to know also that you have the same guardrails that are in place for investor protection and consumer protection with respect to other assets.

What I have been saying, as have the governor and the G20 countries, in fact, is that it's really the right time to start to put in place a regulatory structure that provides those guardrails, whether it's guardrails against anti-money laundering or terrorist financing, or just guardrails to make sure that investors know what they're getting into.

In order to do that, the best approach is for regulators and concerned parties in Canada to get together and think about how we're going to define these things, how we're going to treat them in our current regulatory environment, and also to do that internationally, because these are cross-border assets. They're being traded all over the world, so if we're not consistent across the world, then we're likely to be faced with regulatory arbitrage.

● (1655)

[*Translation*]

The Vice-Chair (Mr. Peter Julian): Thank you very much, Mr. Albas and Ms. Wilkins.

[*English*]

Governor and Deputy Governor, thank you for appearing before us today. We've had a very interesting discussion. We hope to have you back before the committee again soon.

[*Translation*]

We are going to take a five-minute break to bring in our next panel of witnesses.

We'll resume in five minutes.

Thank you.

● (1655)

——— (Pause) ———

● (1705)

[*English*]

The Vice-Chair (Hon. Pierre Poilievre): We will proceed with our next panel of witnesses.

Mr. Fréchette, the Parliamentary Budget Officer, cannot be with us today, I understand for reasons of illness, but we do have with us the deputy Parliamentary Budget Officer, Mostafa Askari. With him on the panel is Chris Matier, senior director of economic and fiscal analysis; Trevor Shaw, economic adviser and analyst; Tim Scholz, economic adviser and analyst; and Carleigh Malanik, financial analyst.

Without further ado, please begin.

Mr. Mostafa Askari (Deputy Parliamentary Budget Officer, Office of the Parliamentary Budget Officer): Thank you, Mr. Chair.

[*Translation*]

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

Thank you for inviting us to appear before the committee to discuss our April 2018 economic and fiscal outlook. The parliamentary budget officer, or PBO, supports Parliament by providing economic and fiscal analysis to parliamentarians. Pursuant to section 79.01 of the Parliament of Canada Act, the parliamentary budget officer provides analysis “for the purposes of raising the quality of parliamentary debate and promoting greater budget transparency and accountability.” In addition, consistent with the legislated mandate of the parliamentary budget officer, our office provides economic and fiscal outlooks.

[*English*]

Since October there have been external and domestic policy developments that will impact the Canadian economy over the medium term. These include changes to fiscal policy in the United States, implementation of Canada's carbon pricing levy, as well as an expected fallout from ongoing NAFTA negotiations. We have incorporated into our April outlook assumptions with regard to the impact of these developments.

We project real GDP growth in Canada to average 1.7% annually over 2018 to 2022. Over the medium term, we expect the Canadian economy to rely less on consumer spending and the housing sector as business investment and exports make a greater contribution to economic growth.

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

Compared with our October outlook, the projected level of nominal GDP, the broadest single measure of the tax base, is on balance unchanged, with upward revisions to GDP price levels offsetting downward revisions to real GDP.

On the fiscal side, revisions to our outlook for the Canadian economy have modest impacts on our medium-term projection of the budgetary balance. Incorporating our new projection of direct program expenses along with new year-to-date financial results contributes to reducing projected budgetary deficits on a status quo basis—that is, prior to policy actions since October 2017.

We estimate that policy actions taken since the government's 2017 fall economic statement amount to $22 billion over 2017-18 to 2022-23. These new measures more than exhaust the projected increase in fiscal room, resulting in a somewhat larger budgetary deficit compared with our October outlook.

[*Translation*]

That said, we project that budgetary deficits will decline gradually, falling to $10.6 billion in 2022-23. This projected reduction is essentially due to restrained growth in the government's operating expenses, resulting from declines in future benefits for federal employees and slight decreases in the number of federal personnel through 2019-20.

In light of the various assumptions included in our economic outlook and in the absence of other strategic measures, it is unlikely that the budget will be balanced or in surplus in the medium term. However, we estimate that, in 2020-21, there is approximately a 75% chance that the federal debt-to-GDP ratio will be below the government's anchor of 30.9%.

● (1710)

[*English*]

I would also like to draw your attention to another report we published today that provides the PBO's independent costing of 10 large revenue and spending measures announced since October 2017.

These measures are fully reflected in our April fiscal outlook. All together, PBO's costing of these new measures is $1.4 billion higher than the government's estimates provided in budget 2018.

[*Translation*]

My colleagues and I would be pleased to answer any questions you have on our economic and fiscal outlook or any of the parliamentary budget officer's other analyses.

[*English*]

The Vice-Chair (Hon. Pierre Poilievre): Mr. McLeod.

Mr. Michael McLeod: Thank you, Mr. Chair.

Thank you to the presenters today.

I'm very happy to see the presentation here today. In your economic and fiscal outlook you analyzed the impact of the carbon pricing levy. This is a very important issue for me and the people I represent in the Northwest Territories. Climate change has been impacting us more than any other jurisdiction in Canada. We really never had the opportunity to invest in alternative energy or infrastructure that would allow us to reduce our greenhouse gas emissions. We're hoping that this program is going to do this for us. A lot of the communities I represent still have noisy generators, sometimes right in the middle of the community, running 24 hours a day every month of the year. Most of our communities are built on permafrost, which is now melting. I just came from a meeting in our coastline communities. Some of the communities are forced to now start moving houses. We have graveyards that are falling into the ocean, and many serious issues.

This is an important issue for me, but it's also an important issue for the committee because we're starting to study the measures in the budget implementation act this week. It was really interesting that you said in your analysis that it would be more beneficial for the Canadian economy and for the provinces and territories to use revenues from the levy to cut corporate or personal income taxes than to return the revenues as lump sum payments to households. Could you explain how you arrived at that and why it would be better to do in that fashion?

Mr. Mostafa Askari: We have looked at the study that was done by the Ecofiscal Commission. In order to estimate the impact of this, we used some of its calculations. What we are assuming in our calculation is that this tax will be essentially going back as a lump sum to households in any form. That is not the most effective way of using the tax in that form. There are other ways, such as corporate tax reduction or income tax reduction, that would deal with that. On that basis, we have estimated our impact, which starts at 0.1% in the first year and goes up to about 0.5% by the last year. That's the negative impact on the economy.

That's how we have come up with this estimate. There are many ways of looking at this. If the provinces decide instead to reduce corporate taxes in response to this, then the benefits of that for the economy would be large, or the negative impact would be lower than if you just did that kind of lump sum payment. That's the way we have come up with it.

● (1715)

Mr. Michael McLeod: One of the other concerns that we had in the north was the impact on our fiscal arrangements, our formal financing arrangements. Some of our agreements have a clawback, wherein there is a requirement to reduce your revenues from the federal government if there is another source of revenue. We've really been monitoring that and trying to make sure it doesn't impact us. It looks as if we're going to have that resolved, and I think the Northwest Territories is ready to move forward with its program.

I wanted to talk about the federal debt-to-GDP ratio. You said there's a high likelihood that it will be below 30.9% in 2020–21, which was a target set in 2016. Can you talk about the importance of using this measurement as a fiscal anchor and the significance of meeting that goal?

Mr. Mostafa Askari: There are certainly different fiscal anchors one can use. There is the adjusted deficit, the deficit as a percentage of GDP, debt as a percentage of GDP—these are all different measures that people use. In our case, we are looking at this because the government is using this measure to report on it.

Mr. Michael McLeod: Thank you.

I'm good.

The Vice-Chair (Hon. Pierre Poilievre): We will move on to Mr. Albas.

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

The Vice-Chair (Hon. Pierre Poilievre): I thought I saw your hand go up.

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

I want to thank all of the public servants who are here today to help us better understand the reports.

I would like to start where Mr. McLeod left off. Some on this committee may remember that we actually had all three premiers of the territories, either in person or through teleconference, comment on the carbon tax. I specifically remember the testimony of the Premier of Nunavut, who stated that 80% of the costs of diesel are subsidized by the government. I asked him how a carbon tax would work under that kind of system, because most of the money was being recycled from the government's own revenue. He said he imagined that it didn't work.

I want to state categorically for the record that I believe that the Northwest Territories as well as Nunavut...I guess Yukon already has instituted its own carbon tax. But the territories that are not in favour, those premiers, I believe we should be exempting. I think we should be working with members of Parliament to remove diesel through other means.

Anyway, I'll come right to the same question. The report on page 8 says specifically that "we assume that federal revenues returned to provinces and territories will be transferred to households as lump-sum payments."

Were you unable to get any kind of indication from the government as to whether or not it will be a tax-and-dividend-like system? You mentioned earlier that the preference would be through a decrease in income taxes, whether corporate or personal. Could you go over that, please?

Mr. Mostafa Askari: This is an assumption we made to be able to do this calculation, but different provinces have different systems now. There is a carbon tax in some areas and there are different ways of dealing with that. We didn't really want to do separate calculations for each province. We assumed that on average the carbon tax would be $10 to $50, and that it would be applied all over the country in the same way. We did this just to come up with some estimate of overall impact.

● (1720)

Mr. Dan Albas: I had thought this was a system that the federal government would be imposing upon provinces or territories that have not yet done it. I thought the government might at least have indicated if it would be returning the money directly to households, or if it would be through a reduction in taxes for those areas by giving it to the provinces or territories that were responsible. So I appreciate that.

I'd like to go to employment. I raised this with the Governor of the Bank of Canada. Page 6 of your report says that "Roughly 40 per cent of jobs gained during this period came from private sector employers."

Obviously, public servants play an important role in facilitating important services that can facilitate a stronger economy, but 60% seems to be a rather high ratio. Is there any concern about job creation only being from the not-private-sector side? Again, the government can only tax. You cannot have a government that is larger than its economy. It relies on a strong private sector to be able to pay for those things. Are there any concerns from anyone here in regard to 60% of it being non-private?

Mr. Tim Scholz (Economic Advisor, Analyst, Office of the Parliamentary Budget Officer): I think that over a long time horizon this would be something we'd monitor and maybe become concerned about if the private sector job growth were not strong. One thing I'd caution about regarding six months of monthly labour survey data is that it is quite volatile and subject to revisions. Is this something we'd be worried about from a macroeconomic perspective over six months? Probably not, but it's something we would definitely monitor.

Mr. Dan Albas: Further to that, it points out that the unemployment rate has continued to trend lower from 6.2% in October to 5.8% in March. The next statement, however, says that this decrease largely reflects a decline in labour force participation. Therefore, fewer people looking for work lowers the unemployment rate. Is that what you're saying here?

Mr. Tim Scholz: Yes.

Mr. Dan Albas: They could be not looking for work, because they have decided to retire instead, or they have given up looking for work and gone onto social assistance.

Can you give any indication as to why that is the case?

Mr. Tim Scholz: We haven't done a deep dive into why that is the case or why there has been—

Mr. Dan Albas: I'll take a shallow dive.

Mr. Tim Scholz: We're in the process of working on a labour market assessment report that is possibly slated for this summer, and that's something where we actually go into a deeper dive on things like private versus public sector job creation, or the composition of the flows to and from the unemployment rate. I wouldn't be able to comment further. It's possible that we could go back to the office and take a look.

Mr. Dan Albas: I do hope there's some follow-up on that, and that this is looked at specifically, because many people would be surprised to know that we see this number dropping because of the decrease in labour participation, rather than because of other factors that some government members have spoken about.

On page 7 it states that "We also expect that the Federal Reserve will increase its policy rate at a faster pace over 2018 to 2019 than we projected in October." I believe it was last year that I tried to talk to the Minister of Finance regard rising interest rates of bonds.

Right now a lot of people are looking to invest in the United States versus other places. Obviously, Canada has a very strong process for foreign bondholders, for example, or even for domestic investing in the notes of the Government of Canada.

Will this mean that we will have to pay higher interest rates down the road to attract those bonds?

Mr. Tim Scholz: In terms of our economic model, when U.S. interest rates increase, and particularly those at the long end, like the 10-year rate—and of course those are influenced by expectations about what the Federal Reserve will do—they have a direct influence on household rates and business borrowing rates.

What you're talking about is higher rates on Government of Canada securities. That is also how our public debt charges are modelled, and the government would pay a higher interest rate. However, we haven't done any work necessarily on global capital markets, and whether we would expect to be—

Mr. Dan Albas: Again, the expectation would be that if interest rates are going up in the United States, that's going to track higher prices, and that may draw money away.

Do I have much more time?

● (1725)

The Vice-Chair (Hon. Pierre Poilievre): I'm afraid not, you have exhausted your time.

On the same question, I do note that in the report the interest expense of the Government of Canada by 2022 rises to $39.1 billion from last year's $24 billion. This is a $15 billion increase, which is roughly a two-thirds increase, in the cost of interest to the Government of Canada. It's also significantly higher than the government anticipated in its recent budget.

For 2022, interest expenses were supposed to be $32 billion, so the gap between the two is $7 billion, or over 20%, and you're only about a month apart in making your projections.

Why is there such a difference between the government's projection and your projection?

Mr. Mostafa Askari: Two things affect that, and one is the level of interest rate. In our projection we have a higher short-term and long-term interest rate relative to what the government is assuming. Also, there is the amount of deficit that will add to debt. If you look at ours, in the short-term we have a larger deficit in the first two or three years than what the government has, and then gradually over time we actually reduce the difference between us and the government. These two factors together will essentially lead to higher debt charges.

The Vice-Chair (Hon. Pierre Poilievre): To what do you attribute the very large disagreement between your projection and the government's on the deficit for this fiscal year? You project that it will be $22 billion, and Finance Canada projects it will be $18 billion. What gives?

Mr. Mostafa Askari: The big difference, in the first couple of years especially, is essentially on government operations. That is really something that we have arrived at by doing our own calculations, and we have a significant difference from what the government has on that.

Trevor, do you want to add to that?

Mr. Trevor Shaw (Economic Advisor, Analyst, Office of the Parliamentary Budget Officer): I'd like to point out that the biggest difference between our point of view for the budget balance in 2018-19—so the current fiscal year—and the figures published in budget 2018 is that line in operating and capital expenses. This report marks the first time that our office has actually published its own independent projection for the operating and capital expense components of direct program spending.

You'll see that, earlier in the report, on page 21 of the English version, we provide a breakdown of exactly how we construct our estimate of the operating and capital components of DPE. You'll see that in 2018-19, there's considerable growth in expenses attributed to future and other benefits. These benefits include future benefits for veterans, payments for pensions, etc. They're highly sensitive to interest rates. Interest rates over the past eight or 10 years have been declining, and the relationship between future benefits and the interest rates is inverse. As interest rates fall, the expenses attributed to future and other benefits start to rise. That peaks in 2018-19, so this is—certainly as part of our direct program expense forecast—a source of cost growth.

I can't comment on whether that's consistent with estimates in budget 2018 because, unfortunately, the government does not provide a decomposition, as we do here in table 9, of its direct program expense forecast. It summarizes transfer payments and then operating and capital expenses just in two summary lines. Hopefully with table 9 we're able to depict exactly how we're putting our direct program expense forecasts together. Unfortunately, I can't compare that to the estimates of the government because that information is not public.

The Vice-Chair (Hon. Pierre Poilievre): You said that as interest rates go up, the future and other benefits go down. However, you anticipate both interest rates going up and future and other benefits going up.

Mr. Trevor Shaw: That's a very good point. I should add that this occurs with some delay. Because of the way accounting losses or revisions occur, accounting adjustments for the prior fiscal year will be recognized this year, but they'll start to accrue as expenses in future years. They're amortized over many years. It actually takes the accumulation of many years of re-evaluation of future benefits to actually start to accrue changes on the expense line. This is a phenomenon that happens with some delay.

While interest rates are already starting to increase, the decline in the future and other benefits expense will also decline throughout time with some delay, relative to our projected increase in interest rates.

● (1730)

The Vice-Chair (Hon. Pierre Poilievre): All right.

Mr. Julian.

Mr. Peter Julian: Thank you, Mr. Chair.

Thank you very much for being here. It's a very interesting and detailed report. You do a lot of work without a lot of resources. Hats off to you for all of the work that you do.

You're also heroes, I think, in the Canadian mind in that you pushed the government. It took five years to finally get from the CRA an acknowledgement that tax gap information should be shared with the Parliamentary Budget Officer. That is fight that you had to have with the former Conservative government and now with the current Liberal government. It's a fight that you never should have to go through on behalf of Canadians, but thank you for pushing the government to do the right thing and to provide that information.

My first question is really around that. The tax gap has remarkable impacts in terms of the deficits, in terms of what programs and investments we can make as a country. It's been estimated at anywhere from $10 billion to $40 billion a year. It's money that goes to overseas tax havens. It's money that wealthy and the well-connected are able to simply not pay when everyone else, tradespeople and small business people, all pay their taxes. A lot of very wealthy people don't have to. That tax gap has enormous implications.

What I'd like to know is how the PBO intends to use that information. Are you getting it now from the CRA? Have you gotten it yet? Do you have a plan laid out in terms of publishing that very important information about Canada's tax gap, about the difference between what government should have in common to invest and to support programs and job creation, and what the federal government is actually getting to make those investments because of these offshore tax havens and massive tax loopholes?

Mr. Mostafa Askari: You can imagine that we have received a huge amount of information from the CRA. It takes time to study that and figure out exactly how we are going to use it. I think we have received all the information that we asked for, but it will take time for our staff, my colleagues, to go through all of it and figure out exactly how that would impact the overall assessment of the tax gap.

We are working on it. I can't really give you a time frame right now for exactly when we are going to have a report on this. My colleagues are working hard on it, and hopefully we will have something after this summer, a report that will essentially estimate the tax gap based on all of that information we have received.

Mr. Peter Julian: Thank you very much. We look forward to having you back before committee when you do publish that tax gap information. It's something that governments should have been providing for decades and have refused to. I again thank you, because even though you had to push the government and threaten to take them to court, you stuck to your guns. On behalf of all Canadians, thank you for that valuable work. Canadians need to know what the wealthy and the well-connected take offshore rather than investing in all of those programs that we need.

One of those programs, of course, is pharmacare. This is something that's been promised for decades. The PBO did an excellent report last fall around the federal cost of a national pharmacare program. You did very detailed work about what the overall savings are to Canadians, and I'd like you to speak to that: what we as a society spend currently for medication when one in five Canadians can't afford the medication they need, what the overall costs are, and what could be saved if we had a national pharmacare program.

Just to add a last note on this, we know that we're losing anywhere from $2 billion to $5 billion a year for the costs to our emergency rooms and our hospitals by not having a pharmacare program. In other words, somebody who can't afford their medication ends up in the hospital or in the emergency room, and it costs Canadians a lot more not to have pharmacare than it would to have pharmacare in place. I'm interested in why that wasn't calculated in terms of the PBO report on the federal cost of a national pharmacare program.

● (1735)

Mr. Mostafa Askari: My colleague Carleigh was the main author of that report we did, so I'll let her speak to that.

Ms. Carleigh Malanik (Financial Analyst, Office of the Parliamentary Budget Officer): In the report, we basically saw that we could have overall savings of $4.2 billion, but again, this whole estimation was based on a very specific formulary provided to us by the House of Commons Standing Committee on Health, and that was only looking at the drugs on Quebec's public formulary. You can imagine that even if we're using a different set of drugs, the costs or the savings that we could find would change. It also excludes any drugs that were administered in hospitals.

Also, of course, it does assume that by having a single payer for these drugs in Canada we would be able to achieve a lower price from drug manufacturers. Because the request from the standing committee was part of their study, they did provide to us a very specific scenario. It is not yet a policy, so we didn't really include that in our outlook here.

Mr. Peter Julian: The cost for us as a society is over $4 billion a year by not having pharmacare in place. That would not include the additional charges, the estimated billions of dollars that we spend in hospital stays and visits to emergency rooms for those one in five Canadians who cannot afford medication and, as a result, end up having to be treated in the hospital or in the emergency room. Is that correct?

Ms. Carleigh Malanik: That is correct, with one caveat, and that is the cost to Canadians using this specific pharmacare plan, so again, the drugs that are on Quebec's public formulary and assuming that we could as a nation achieve these savings on those medications.

Mr. Peter Julian: On the savings to small businesses, for example, Canadians would be able to afford their medication and, of course, would have cost savings. In reading through the report, I didn't see a specific estimate of the savings to small businesses. Is that because it's difficult to estimate? Or do you have some sense of it? Small businesses that care about their employees finance health care plans that include medication. Some of the figures I've seen from other sources indicate that small businesses would save billions of dollars if we had a national pharmacare plan, which actually means that this would be a very smart, competitive advantage to Canadians.

I have a final point I'd like to make. In terms of our medicare, I've seen estimates that for a Canadian company the average competitive advantage of our universal medicare system is about $3,000 an employee, as compared to their United States competitors. In other words, with medicare, a Canadian company saves $3,000 that a U.S. company would have to pay in employee health care plans to make sure they're balancing it off. Is that something you examined as well, that overall competitive advantage for Canadian businesses to have a national pharmacare program?

Ms. Carleigh Malanik: I will answer your second question first. It isn't something we included in the report. To answer your first question about whether or not we looked at small businesses, no, we didn't. It's partly that it would be difficult with the specific data we requested. We didn't really track beyond whether it was paid out of pocket, covered by a private plan, or covered by a public plan.

It's more to the point that we wouldn't be able to track exactly how much those businesses are paying as a share, because sometimes the employees pay half or split it with the employers.

The other big point I would like to make is that we don't exactly know how this pharmacare plan would be rolled out or implemented, exactly how it would to play out. We just had the parameters provided to us by the Standing Committee on Health.

The Vice-Chair (Hon. Pierre Poilievre): Mr. Sorbara.

Mr. Francesco Sorbara: Thank you, Mr. Chair, and welcome gentlemen from the PBO.

In the projections that are used you noted the sensitivity to interest rate increases in terms of discount rates. For the last 10 years, the other side racked up a lot of debt—I think it was over $150 billion—but actually benefited because rates fell or declined quite a bit. If you look at past budgets, they always overshot what they said their interest expense number would be, because a lot of the debt that was rolling over was rolling over at much cheaper rates due to a very weak economy that the Conservatives presided over for a number of years.

Our situation is a little different. Rates are going up because the economy is doing a lot better. You guys have looked at some of those numbers. When debt, whether new or old debt, matures, and the government goes out to market, it's refinanced at a higher rate, unfortunately, but due to a very good thing because the economy is doing well, and rates are going higher.

I'm glad you also made the observation that with higher rates, the present value of future liabilities declines, so your direct program expenditures fall, which is a benefit for us. I'm very glad that the PBO has highlighted that. It's something I'm proud of because our government has worked with the unions representing those hard-working government workers who work day in and day out to serve all of our residents, whereas the prior government did not and just forced collective bargaining agreements on them.

That was my statement. My my question is on the pricing of carbon. It is a fact that each province will be allowed to do what it sees fit with funds that are collected from pricing pollution. Going to your comment in the report, if the funds, for example, are in B.C. where one of my honourable colleagues is from, those funds can be used for taxation purposes, i.e., to reduce personal and corporate tax rates. If that is done, it will largely offset any sort of impact.

Is that a fair assessment from one of the pages in the report?

● (1740)

Mr. Mostafa Askari: As I said, we are assuming that the lump sum is going to go back. In our view, in looking at different options of reducing corporate taxes or reducing income taxes, the least efficient is the one you mentioned, namely, its going back as a lump sum to households. From an economic perspective, that would be the least efficient way of doing it. That's why we showed this negative impact that's going from 0.1% to 0.5% by the end of the projection. If we use any other method that is more efficient from our point of view, through corporate taxes or income tax, the negative impact would be lower than that.

Mr. Francesco Sorbara: Over the projection period you provided, there are differing fiscal anchors, but the fiscal anchor I like to look at is the federal debt-to-GDP ratio. You actually have a declining federal debt-to-GDP ratio over the fiscal period. Correct?

Mr. Mostafa Askari: That's correct.

Mr. Francesco Sorbara: I know the sensitivities to various macroeconomic models are immense. What would you folks at the PBO say is the greatest sensitivity with regard to the estimates? I really like your research. I have all of the reports from this morning, and I look forward to reading them a little more in depth when I have an opportunity.

In terms of sensitivities, I look for Canadian real GDP growth. Where do you see the largest sensitivity with relation to our economy?

Mr. Trevor Shaw: Just to provide a little bit of context around our baseline estimates, we provide three sensitivity scenarios. One is a shock to real GDP, another to GDP inflation, and lastly, to interest rates. You'll see in appendix F on page 33 that the shock to real GDP has the most detrimental impact on the budget balance. A negative shock to real GDP would have roughly an $3.8-billion impact on the budget balance in the final year, whereas, conversely, a 1% increase in real GDP would have, roughly, a mirror effect, or about a $3.8 billion improvement in the budget balance by year five.

Mr. Francesco Sorbara: May I ask about your projection on housing for 2019? I think there may be some difference with other projections out there. You are using a -0.3 percentage point impact on real GDP growth. Given the demographic trends and immigration, B-20 and other measures that have been instituted, do you think that's a slightly bearish housing forecast compared to others out there?

● (1745)

Mr. Chris Matier (Senior Director, Economic and Fiscal Analysis, Office of the Parliamentary Budget Officer): I'll start, and my colleague Tim will probably follow up.

You're correct. Our outlook is a bit more negative than, let's say for instance, the Bank of Canada's outlook, where I think they probably have it making a zero contribution to GDP over that period. Our view really is that the impact of rising interest rates and the slowdown in disposable income in the economy will hit the housing sector a bit more directly and significantly than others. We're not calling for a housing market crash or anything like that by any means, but the level of residential investment in the Canadian economy is at historic highs. This is more of a natural adjustment to a more sustainable level.

My colleague Tim can follow up.

Mr. Tim Scholz: Maybe the only thing I'd add is that we're projecting that real house price gains will average 1.5% over 2018-22. While this is positive, it's well below the average of 5% that we've seen from 2010-17.

Mr. Francesco Sorbara: My personal feeling and my conjecture would be that it would be somewhere between the -0.3 and the zero from the Bank of Canada. There are pockets of housing where there's obviously been some pull forward from the changes that were made last year versus this year, but the spring housing market in overall home ownership levels will remain pretty strong.

You guys have done some work, and I'm very glad to see it, on the effect of fiscal developments in the U.S. on Canadian real GDP. Can you talk about the pull-through effects, please?

Mr. Tim Scholz: There are two major fiscal developments. There is the Tax Cuts and Jobs Act that was passed into law on December 22 last year, then there was also the Bipartisan Budget Act that came into force on February 9.

For the former, with respect to the tax cuts, we've taken an estimate by the staff of the Joint Committee on Taxation and basically taken their estimated economic impact on U.S. GDP of about 0.7% over the course of our projection. Then, with respect to the Bipartisan Budget Act, we've looked at what the Congressional Budget Office has predicted in terms of additional government spending over the medium term by the U.S. We've used their fiscal multipliers, essentially meaning how much they estimate that government spending will translate into economic activity.

We've come up with two impacts on the level of U.S. real GDP. Once we had those impacts, we brought those into our Canadian macroeconometric model. We estimate that this would lift Canada's real GDP by 0.1% in 2018, which will rise by 0.25% by the end of our projection period, primarily through higher exports.

The Vice-Chair (Hon. Pierre Poilievre): Thank you, Mr. Sorbara.

Concerning the $10-billion cost to the Canadian GDP that you associate with carbon pricing, is that net of the lump sum payment you're anticipating will be made to recycle the dollars?

Mr. Mostafa Askari: No. That's the gross impact, as far as I know.

The Vice-Chair (Hon. Pierre Poilievre): You say here, “we assume that federal revenues returned to provinces and territories will be transferred to households as lump [sums]”. Is that transfer then calculated into the final economic impact?

Mr. Mostafa Askari: That's right.

The Vice-Chair (Hon. Pierre Poilievre): It is. Okay. That's great.

Thank you, Mr. Kmiec.

Mr. Tom Kmiec: I was going to continue on the carbon tax and then talk about table 9 on page 21 again, which Mr. Shaw mentioned.

You're showing a $22-billion deficit, whereas in the previous campaign, the Liberals talked about a $6-billion deficit at this point. You have an estimation of half a GDP point loss because of the carbon tax on the economy, and in the projections you have on table 1, it shows exports are halved, post-2019. It goes from 1.5% to 0.7%, and then it's 0.7% again in 2021-22.

What other government policy measure in the past, since as many years ago as you can remember, has cost the economy, basically, half a point of GDP growth? Is there anything like it?

● (1750)

Mr. Mostafa Askari: I'm sure there are many things that could cause that, such as a financial crisis or anything else, any kind of—

Mr. Tom Kmiec: But this is within the government's control.

Mr. Mostafa Askari: Within government control, I can't come up with something right now on that, whether there was something that big or not—

Mr. Tom Kmiec: It's kind of a unique, self-imposed penalty.

Mr. Mostafa Askari: I wouldn't call it that until I look at the last 10 years and see what other things have happened that could cause that kind of impact.

Mr. Tom Kmiec: The provincial governments are responsible for the administration, because they're going to be punished on January 1, 2019, if they don't have some type of carbon tax. If a government chooses not to do lump sums, and it does something else, what would the impact be?

Mr. Mostafa Askari: Well, then, we would have to take that into account and do another study, because this is the one we did. This is the lump sum. This is the simplest way of doing it, because we don't really have full information about exactly how different provinces are going to do this, and based on the information we have on the provinces—Ontario, British Columbia, and Quebec—we thought this was the closest to where the provinces are going, given the way they are handling this.

That's why we chose this, but if we were to do a full study, we would have to have the full information about what all the provinces are going to do and then take that into account.

Mr. Tom Kmiec: Could you tell me then, on page 11, table 1, “Outlook for Canadian real GDP growth”, why exports go down literally by half? You're talking about an 0.8% loss to real GDP growth. Is it related to the carbon tax making our exports less competitive, or is that simply a projected loss of some sort? It literally cuts it in half.

Mr. Chris Matier: Yes, that's reflecting a few factors.

First of all, it's really the slowdown in foreign activity, so the U.S. demand for our exports. If you refer back to the slide, figure 4, you'll see that the U.S. economy is slowing down to about 1.8% in the medium term, so the growth in our exports would be roughly in line with the U.S. economy at that time. It's really the strong U.S. growth that's lifting it up, and then the moderation in U.S. growth that is bringing it down.

At the same time, we're seeing that some of that initial pickup in exports is coming from the dollar remaining around 77 or 76 cents, so there's still some benefit from the lower dollar.

Mr. Tom Kmiec: The way our interest rates go up in your model, I think you have 25 basis points each quarter up to the nominal neutral level of 3% by the first quarter of 2020, but we just had the Bank of Canada's governor come in and say that it's his expectation they will keep interest rates pretty much where they are. He obviously can't tell us what the future is like, but then that leads me to table 9 on page 21, which was mentioned before.

Specifically, that line, “Personnel—future, and other benefits”, is heavily influenced by interest rates—correct me if I'm wrong. When interest rates go up, the government earns more money on the side, so these costs would then go down. Is that correct?

Mr. Trevor Shaw: Specifically speaking to table 9, yes, the future and other benefits line on personnel is highly sensitive to interest rates, so as interest rates start to increase, you're going to see the expense line on future and other benefits start to decline over time. As I mentioned in a previous response, this happens with some delay, but certainly for those two, as interest rates increase, that expense should start to decline.

Mr. Tom Kmiec: If interest rates don't go up by as much as you're predicting, then you're talking about a gap between 2018-19 and 2022-23. That's an almost $9-billion gap that forms, just based on interest rates.

Mr. Trevor Shaw: Certainly that aspect of our fiscal forecast is sensitive to interest rates, as are others, namely our public debt charge forecast. For a good depiction of precisely how interest rates affect our fiscal forecast overall, I'll point you to appendix H on page 35 of our report, which shows that direct program expenses, which are concentrated on those future and other benefits, with a permanent 100-basis point increase, would come down by roughly $4 billion per year. On the other side of the ledger, public debt charges would start to increase with a 100-basis point increase, up to about $7 billion higher than our baseline projection by year five. So you have these two opposing forces; and on net, higher interest rates would result in a higher budgetary deficit.

● (1755)

Mr. Tom Kmiec: How much time do I have, Mr. Chair?

The Vice-Chair (Hon. Pierre Poilievre): You are out of time, so we are now on to Mr. Sarai.

Mr. Randeep Sarai: Thank you, Chair.

Thank you to the PBO office.

I don't get the chance to be in this committee often, so I'll take advantage of it.

I have a riding that is a “Main Street” type of riding. It's a growing economy—Surrey Centre. We have high levels of immigration. In the just over two years that I've been the member, I've yet to have anybody come to me to say they can't find a job. It's usually been the opposite. I get employers who are asking, “How do I get more workers? I'm not getting enough.” We've noticed an increase in immigration levels, and I want to know whether that increase has had a positive impact on the economy, particularly the employment rate, as it does not appear to have any adverse effect. I want to know if there has been any analysis on the impacts of increased immigration on our economy as a whole.

Mr. Mostafa Askari: No, we haven't done any studies specifically on that.

Mr. Randeep Sarai: Do you plan on doing any of that? It's always something that you have to be cognizant of when a government does immigration planning. Government needs to know the impact on the economy, particularly on unemployment rates, before an argument goes in the reverse direction to the effect that immigrants are taking jobs away from Canadians, which clearly, in my assessment, is not the case. Do you have any plans to study that?

Mr. Mostafa Askari: We have no plans to do that at the moment.

Mr. Randeep Sarai: Okay.

Second, have you factored in the effects of NAFTA, or the uncertainty around NAFTA, as well as the ongoing American trade war with China, and the economic impact of that on the Canadian economy?

Mr. Mostafa Askari: Yes, we have looked at this in detail, but it looks like, given what has happened over the past couple of months, that there is more optimism that there will be an agreement. On that basis, what we are assuming in our projection is that there will be a slight negative impact from the new agreement, but that slight negative impact will essentially be offset by the positive impact that we are getting from the higher growth in the United States. Those two will offset each other.

We also looked at a scenario where an agreement could not be reached, and the impact on the Canadian economy of that. I believe we reached a point of about 0.7% on Canadian GDP.

Mr. Randeep Sarai: Thank you.

Again, my questions are maybe in a different pattern. To what has the PBO attributed the strong growth and employment numbers in GDP? Has it been infrastructure spending? Has it been increased immigration? I think you haven't looked at that particularly. What are the particular reasons for the strong growth in the last two to two and a half years?

Mr. Mostafa Askari: We haven't really looked at it in that fashion. I think we are going to release a report on the labour market in the fall, which may look at some of these aspects, but overall, the Canadian economy is operating very close to its potential level. In that sense, you would expect that employment would do well in those conditions, but we haven't really looked in detail as to why exactly employment is doing that well and why the unemployment rate has gone down that much. It's part of our overall assessment of the Canadian economy.

Mr. Randeep Sarai: Lastly, do you watch international economies and how they monitor themselves, as the you the PBO do here. If so, are there any suggestions on what we could do better? I consider the PBO a kind of sober second thought to some of the policies, just as the Senate is the sober second thought to legislation. Are there ways that we can make it a better tool to monitor that and be a second check or a second set of eyes the public can rely on?

Mr. Mostafa Askari: Well, we are a sort of second eye, in the sense that we are providing this service to Parliament and to Canadians by using our expertise to look at the economy and the fiscal situation. This is as much as we can do.

I don't know whether there is anything else I can add to that.

● (1800)

Mr. Randeep Sarai: Thank you, Chair.

The Vice-Chair (Hon. Pierre Poilievre): Mr. Albas.

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

I want to go back to an earlier point that Mr. Kmiec raised in regard to the fiscal framework of the government. At some point, the PBO will be asked to look at electoral platforms, etc., and I want to put it on the record one more time.

You don't have to say anything in regard to this, but we know from the last election that the government had a costed framework wherein it was going to apparently invest in infrastructure, $10 billion a year, and run for the first two years a deficit, and then a return back to balance. This, I am sure, will be the challenge. If someone doesn't honour that, then what is the point of having you investigate this in the first place and approve that those fiscal frameworks are there? That's a bit of a side note.

On page 17, you stated that “Our downward revision mainly reflects a lower estimate for direct program expenses, due in part to infrastructure spending delays, that more than offset $4.0 billion in new policy actions in 2017-18.”

Could you go through the explanation of that? I know you had a report recently that talked about the rationale for some infrastructure not being funded. Could you please give the explanation of what exactly you meant in this paragraph?

Mr. Mostafa Askari: Well what it means is that there are obviously some gaps in what the government planned to spend on infrastructure and what has actually happened over the past two years. That in itself means there will be less spending by the government, where it will help the bottom line in that sense, for that period of time. Obviously, based on what we know, the government plans to spend that money over time. Again, it's a shift of the expenses from that period to future years.

Mr. Dan Albas: Okay.

The fiscal framework presented here—I believe there are a few different charts—doesn't take into account the purchase of any interim fleet for any kinds of fighters. There was some talk about a purchase from Australia, or even the Super Hornets. None of those are in the fiscal framework presented here.

Mr. Trevor Shaw: What's included in our baseline forecast is all of the announced policies up to and including budget 2018.

Mr. Dan Albas: Okay, so because there was no mention of them, that's not in there either. That's helpful.

Mr. Kmiec, did you have anything? I was going to talk about the WTI.

Mr. Tom Kmiec: Go ahead.

Mr. Dan Albas: Again, I am not from Alberta, but am very supportive of it. On page 10, you say, “we project [West Texas Intermediate] oil prices to fall from current levels of US $64 per barrel to around US $56 per barrel by the end of 2022.” At another point you say, “The spread between WTI and Western Canada Select...has widened from US $12 in October to US $20 in April, as supply outstripped existing pipeline capacity.”

This says to me that there's a current gap that can be closed with pipeline projects, whether they be the Trans Mountain pipeline or the Keystone XL, but this problem will only get aggravated as we go further.

Is that the case? Is that the point that's being raised here?

Mr. Mostafa Askari: Well, certainly what we are saying is that one of the issues here is that the capacity to get that oil to market is limited now because of the lack of pipeline, and that certainly affects the price.

Mr. Dan Albas: Okay.

This metric is important enough to our economy that you've included it in here. Again, when politicians such as the Prime Minister and the Leader of the Official Opposition state that this project is in the national interest and has considerable revenues, that is a factual statement of the deep economic impacts if those pipelines do not proceed.

Is that correct?

Mr. Mostafa Askari: What I said was that it has an impact because of the lack of capacity to get that oil to the market, so it certainly affects the price of that oil.

● (1805)

Mr. Dan Albas: Okay.

I'm done, Mr. Chair. Thanks.

The Vice-Chair (Hon. Pierre Poilievre): Has the PBO calculated the total cost of the discount that Canadians suffer on the portion of our petroleum that goes at the Western Canada Select price rather than at the price for WTI?

Mr. Mostafa Askari: We have not done that, no.

The Vice-Chair (Hon. Pierre Poilievre): Your bureau says there's a $20 difference, or there will be, between Western Canada Select and WTI. I think you also said that roughly half of Canadian oil goes for Western Canada Select prices because it's a heavy crude. I think we produce something like 3.5 million barrels a day, so if we multiply $20 times 1.7 million barrels, we're talking about tens of millions of dollars that the Canadian economy loses every single day. I'm not asking you to do instant math, but is that a generally fair statement?

Mr. Mostafa Askari: With regard to the $20 difference between the Canadian price and the international price, not all of it can really be reduced by having the pipeline. Historically, there's something like a $10 or $12 difference between those two, so the additional amount, maybe the $8 to $10, is due to the problem with the pipeline and the lack of capacity to get that oil to the market.

The Vice-Chair (Hon. Pierre Poilievre): Brent is typically but not always higher than WTI. Right now I understand that the gap between Brent and WTI is very small. Three years ago it was quite large. It was, I want to say, $8 or $9, which is significant on a $50 barrel. Is Brent not typically higher than WTI?

Mr. Mostafa Askari: I assume so, yes.

Mr. Tim Scholz: Throughout our projections, which are based on energy futures, it looks as though—and I'm just looking at the table —on average it's about $5 per barrel higher in U.S. dollars.

The Vice-Chair (Hon. Pierre Poilievre): Right.

Mr. Tim Scholz: That's a projection. I can't comment on the historical behaviour. I don't have it.

The Vice-Chair (Hon. Pierre Poilievre): But presumably we'd be able to get Brent if we could get to markets other than the United States.

Mr. Tim Scholz: We haven't done that analysis.

The Vice-Chair (Hon. Pierre Poilievre): I have a question about the main estimates, which are linked directly to the budget. I don't know whether you or your representatives will be back here before the main estimates are considered by this committee. Your office has raised some concerns about vote 40, which is a central vote allocation of $7 billion, and the ability to enforce parliamentary will on limitations with regard to how that money is spent. Does the PBO have a view on whether the wording in the main estimates bill binds the government legally to spend dollars on the purposes laid out in the budget, and only in the amounts laid out in that budget?

Mr. Mostafa Askari: We are actually working on a report on the main estimates that should be out probably in about 10 days. We are looking at that. The way we understand it is done, there isn't a lot of constraint on the government in terms of how they use that $7 billion. The language that is used will give the government significant amounts of leeway in terms of how they're going to use that.

At the same time, the government is saying that they are going to report on a monthly basis on how that $7 billion is going to be used. We'll have to see how that reporting is going to be done, and then we'll make a judgment on that basis. For the time being, what is in the main estimates does not really provide a huge amount of constraint on the government's intent with regard to how they're going to use that $7 billion.

The Vice-Chair (Hon. Pierre Poilievre): Will your report contain any conclusions as to whether you think the wording in the main estimates binds the government to the amounts and the purposes laid out in budget table A2.11?

● (1810)

Mr. Mostafa Askari: Well, I guess it will bind the government to the total amount. It's not clear that they will have restrictions on the specific components of that.

The Vice-Chair (Hon. Pierre Poilievre): Madam Dzerowicz.

Ms. Julie Dzerowicz: Thank you, Mr. Chair.

Thank you so much, Mr. Askari and your team, for being here today.

I want to start by talking a little bit about labour force participation. On page 6 you say, “The unemployment rate has continued to trend lower”. It's at 5.8%. Then you say, “This decrease, however, largely reflects a decline in labour force participation.”

When you are talking about labour force participation, is this due to the natural birth rate falling fairly rapidly, as well as our retirement rate?

Mr. Chris Matier: We haven't decomposed where that decline is coming from, so we would have to look more closely at the different age groups, gender groups, and sectoral composition. We really haven't looked at it. We just looked at a higher level, the aggregate level, and accounted for that decline.

I would just add that we shouldn't be too surprised that the labour force participation rate has been declining, just given the aging of the population. That trend is going to continue through time. As my colleague said, looking at a period of six months, there could be more cyclical fluctuations that would have influenced those, but that trend decline there would largely reflect a lot of the aging—let's say, baby boomers exiting the labour force and retiring, which is not being offset by younger entrants.

Ms. Julie Dzerowicz: Do you look at the impact of labour shortages on the economy? For example, previous to you, our Bank of Canada governor indicated that there are 470,000 vacancies. People like me hear quite a bit from employers that they are looking for skilled workers. In my case it's mostly skilled trades workers. That seems to be a huge need. Do you look at any of that in terms of impact on the economy?

Mr. Mostafa Askari: We haven't much recently but—as my colleague mentioned—we are working on a labour market report for the fall, and those are some of the things we may be looking at.

Ms. Julie Dzerowicz: I think it's very important to do that labour market assessment, because I know that my colleagues and I talk quite a bit about this. What are the right numbers? We have increased our immigration numbers in an attempt to deal with the fact that we do know there's an increase in retirement. Our natural birth rate is decreasing. Then I think there's always a worry about the disconnect between the skills we have and the jobs that need to be filled with specific types of skills. I think it is very important.

You have a section on policy actions and implications around budget and economy. When Christine Lagarde came here from the IMF, she said that a low-hanging fruit for us here in Canada was to increase women's participation in the workforce. That would result in a 4% difference to our GDP and have a $150 billion impact.

I know that our Minister of Finance, our government, has made a huge effort to put in some gender equity measures. Is the positive impact of that on the economy moving forward reflected anywhere in this report?

Mr. Mostafa Askari: We have not taken that specifically into account. We haven't really done that kind of a disaggregated labour market assessment for this projection.

Ms. Julie Dzerowicz: Do you just pick some policy actions versus all the policy actions we have in the budget? How did you select these ones? You have tobacco taxation, the cannabis taxation, child benefits, and the clean energy. Is it just that you pick some of them versus all of them? Can you explain that?

Ms. Carleigh Malanik: I think what you're referring to is our costing exercise. We looked at the equal parenting employment insurance measure. In general—just to walk you through it—in preparation for the electoral platform costing where we will have to cost various requests from political parties, we took budget 2018 as an opportunity to undertake an exercise. We went through the budget and identified roughly 160 new measures. Then we classified these into two types. One is where the government is just saying they are going to increase spending on something or to commit dollars to a specific organization, and we determined that a cost estimate would not be required by the PBO. The other is these measures where stakeholders would be affected, some benefits going out, and things like. That's where we would need to do a cost estimate. We identified 17, and we had the capacity to undertake cost estimates of 10 of those. That's how we got down to this list of 10 budget measures that we actually included.

With respect to the labour force participation rate of women, there was a budget measure, the equal parenting employment insurance measure, where the other spouse—and the literature and information tells us this is typically the fathers—does not necessarily partake in employment insurance or share parental leave with their spouse. With this measure, because it was one that we identified, we could include it and provide a cost estimate. We did include it in the EFO, but, more generally, we don't include this gender aspect in the underlying labour force impact on the economy.

I hope that answers your question.

● (1815)

Ms. Julie Dzerowicz: Okay.

The Vice-Chair (Hon. Pierre Poilievre): It is time on that.

We're off to Mr. Julian.

Mr. Peter Julian: Thank you very much, Mr. Chair.

I want to come back to the tax gap examination that you're going to do, and force the CRA to provide information on, because the massive amount of money that goes overseas rather than serving a common purpose for Canadians to make those kinds of investments has real implications. I'm interested in two aspects of the study that you'll undertake on the tax gap. The first is whether or not you're going to come up with a figure on the real effective tax rate for large Canadian corporations. The Canadian Centre for Policy Alternatives has estimated that the effective tax rate for large, very profitable Canadian corporations is less than 10%—in fact, 9.8%. Will it be part of your study to determine to what extent these overseas tax havens and massive tax shelters are allowing some of the most profitable companies in Canada to get away without paying their fair share, which contributes to a profoundly unequal tax system?

The second aspect is the implications for the deficit. If we have this significant tax gap, is our deficit—and the additional spending or investments that we could make in people—due in fact to what has been a growing tax gap over the last few decades that neither the former government nor the current government has been willing to take on?

Those are my two questions around the tax gap study that you're doing.

Mr. Mostafa Askari: You have very good questions. Unfortunately, until we actually do a further study on this and see exactly what we can find in the data from the CRA, it will be very hard to answer your questions and say exactly what the conclusion will be. We know that there is a tax gap, no doubt. Knowing how big it is will have to wait until we have a better analysis of the data that we have.

Mr. Peter Julian: Okay. I'll be awaiting that study, and I think a lot of Canadians will be awaiting with a lot of interest too. It's long overdue. Thank you, again, for your fight against the new Liberal government so that you could actually get that information.

The other issue is around the impact of climate change. We have the economic and the fiscal impacts around pricing carbon. What has not been done in any fulsome way is an evaluation of the economic and fiscal costs of the increasingly dramatic and catastrophic climate change events that we're seeing in this country. The Insurance Bureau of Canada has now estimated that insurance costs related to catastrophic climate change events are more than $1 billion. I've heard estimates of up to $4 billion a year, and growing, of the costs related to climate change. For those who feel that the current structure of our economy doesn't come with a cost, there's that $4 billion estimated cost, or some $10 million a day in economic costs of our not dealing with climate change. Is that something the PBO is now looking at? Are you looking to see, given the increasing number of catastrophic climate change events, what the cost to the Canadian economy is of not dealing in any real way with climate change?

● (1820)

Mr. Mostafa Askari: This is not something that we have done recently, or looked at. Obviously, the impact on the Canadian economy is an interesting topic. It's something that we can consider in the future and take a look at, and see if we have the capacity or instruments to actually do that kind of analysis internally.

Mr. Peter Julian: This begs my last question. Do you have the resources you need? You do very valuable work. Do you have all of the resources you need to do that work on behalf of Canadians?

Mr. Mostafa Askari: With the changes that were made to our office in terms of our independence, we were provided with a larger budget and are in the process of hiring new people and expanding the office. Hopefully, we'll be ready to answer many of these questions over the next 12 months.

We are getting ready for the next election. We have to do the platform costing for the parties. That will take up a lot of time, but we are getting ready for that.

The Vice-Chair (Hon. Pierre Poilievre): Peter, we are out of time for your intervention. We do have 10 more minutes. I propose that we allow two-to-three-minute interventions to get the maximum number of opportunities.

Does that sound fair? Perhaps we'll go one to each party.

Mr. Fergus, for three minutes.

Mr. Greg Fergus: Thank you very much.

Once again, I'm very grateful to the PBO for coming forward. I do appreciate the modelling exercises that you do. Over the years, you've proven to be quite accurate.

From what I understand how the Office of the PBO works, and the information you gather to make these assessments, do you rely on the same set of data that the Department of Finance would have? Let's take a look at schedule B, in terms of the economic outlook. Your modelling is different, which seems to produce different results.

For my benefit and that of Canadians, could you explain why the modelling ends up being slightly different? What variables are you placing greater weight on, or for what reasons do you feel that the great folks we have over at the Department of Finance have different results than your shop does?

Mr. Mostafa Askari: We have a highly dedicated staff. They have a significant amount of experience in doing this kind of work, some of it for the government, in the past for the Department of Finance, the Bank of Canada, and other organizations. That's part of it, obviously, but we have the expertise.

The other part is that we have no prejudgements on what should come out of our results. We go into these studies trying to do what we think is the right way of doing it mechanically. There are no preconceived results that we want to achieve, in terms of the impact on the deficit or any other kinds of issues.

Maybe that's one of the reasons you see our work as being more accurate than other organizations', but that's all I can say. I don't really know exactly; I can't compare them.

Mr. Greg Fergus: I wouldn't imagine there would be a preconceived notion, for example, on the exchange rate, and taking a look at the four-year approach. Mind you, you have more recent figures to base it on, but, nonetheless, the almost 5¢ gap is significant. I'd imagine that would also influence the figures for how many exports the Canadian economy would be able to produce, or to what degree it would be able to produce exports.

Why is there such a huge difference on that? I don't know if Mr. Matier wants to get in on this.

● (1825)

Mr. Chris Matier: Sure, I'll follow up with a little more technical detail that can address your second question.

Our projection is model-based, so we have an estimated macro-model, in conjunction with assumptions and outlooks for the U.S. economy and commodity prices. These are key inputs. This contrasts with the Department of Finance's approach, which uses a survey of 15 or so private sector forecasters to prepare its outlook. One of the key weaknesses of this approach is that it doesn't necessarily ensure consistency in the forecast. You can have divergent views on, let's say, the exchange rate and commodity prices that you wouldn't have to reconcile in a single model, which we have to do. Some forecasters may not provide an outlook for certain variables. The survey itself doesn't ensure internal consistency as a macroeconomic model would.

The last point I would make is that we did look at forecast performance and quality in a report last year, and we found that in terms of accuracy, at least for the headline macroeconomic variables such as nominal GDP, we were in line with the survey-based outlooks from the Department of Finance. But one of the key differences was that our forecasts were less biased, so that when we did make an error, it wasn't typically over- or under-predicting the economy. That's another key difference.

How do you explain that? Why are we less biased than a survey-based result? As Mostafa said, maybe it's because we're not working for a chartered bank with incentives to talk about a bullish outlook, for instance. We don't have that kind of sentiment in the background.

The Vice-Chair (Hon. Pierre Poilievre): Unfortunately, we are over time.

We'll now turn it over to Mr. Albas, and then back to Mr. Julian.

Mr. Dan Albas: Picking up from where MP Fergus left off, I certainly do appreciate that. It's helpful to have competing models side by side, and then find out from Stats Canada, after the relevant data has been accumulated and we can look at it, who's closer. Certainly, I think it's good to have a variety of models, because we shouldn't just be thinking one particular way.

In regard to that, there's been a lot of discussion in the last few years about balanced budgets. Obviously, the Conservatives favour them; other parties have various views. In the report you estimate that the probability of the budget being in a balance or a surplus position in 2017, 2018, or 2019-20 is effectively nil. I appreciate that you've modelled that.

You've also talked on page 25 about the net debt-to-GDP ratio and where that might go in several years. These are the two most common references when we talk about the fiscal framework, and I understand why, because you have to start with something, and it's easy to count numbers.

What other metrics should parliamentarians be looking at? For example, that net debt-to-GDP ratio may tell one story, but again, as we know, we have a long-term demographic issue that may skew the effects in certain areas, where certain provinces are far more exposed than others. Where should we be looking to, as Wayne Gretzky used to say about the direction of a puck?

Mr. Mostafa Askari: I'll start, and maybe Chris can add something.

You're aware that we do a long-term projection that we call a sustainability report. There, we look at the federal situation, and we show that on that basis, the federal government's fiscal position is actually in a very good position over a long period of time, whereas most of the provinces have some issues. That's the difference between the two levels of government.

Chris, do you want to add something?

Mr. Chris Matier: [*Inaudible—Editor*].

● (1830)

The Vice-Chair (Hon. Pierre Poilievre): Mr. Julian.

Mr. Peter Julian: Thank you very much, Mr. Chair.

I have two quick questions to finish off.

First, I was in Alberta last summer, going to town halls and meeting with energy workers. Their question was always about why the federal government isn't providing any supports for clean energy. They see their skills as eminently transferrable, and they're absolutely right. I notice from the economic and fiscal update how miniscule the support is for clean energy by this federal government.

This is my first question—and I'll ask both. To what extent are you studying the economic impacts of substantial investments in clean energy and how that could lead to job creation in this country? If you're not looking at it, what would parliamentarians be required to do to enable you to do that? Would it take a motion through a committee, for example, finance?

My last question is on the government providing information that is relevant to your work. With the CRA you had to battle five years under the former Conservative government and the current Liberal government, and had to threaten to take them to court before the CRA and the government finally said they would provide the information on this massive tax gap and wealthy tax cheats. Is there any other information the PBO is looking for right now that the government is withholding?

Those are my two questions.

Thank you for your very valuable work on behalf of Canadians.

Mr. Mostafa Askari: Thank you.

On the first one, we haven't really done anything on what you mentioned in terms of clean energy. If there is some kind of motion or request from Parliament, then we would certainly look at that and see whether it is feasible for us to do it, given our resources and the expertise we have in the office.

On the issue of the tax gap and the CRA, I assume that's something we can look at, but I can't really tell you exactly what the impact is right now.

The Vice-Chair (Hon. Pierre Poilievre): I think that's the time, and I have a closing question.

The reference to net debt to GDP refers only to the federal government's debt. Typically, this government has used as its anchor the federal debt-to-GDP ratio. As you point out, provinces have their own debts, and as we all know, households are extremely indebted. If the economy is a workhorse that is pulling a wagon up a hill, and that wagon has debt to pull, it's not just the federal government's debt that's in that wagon. That one horse has to carry federal and provincial debt, plus corporate debt, plus personal debt, because we only have one Canadian economy, one GDP of roughly $2 trillion.

When we're judging the ability of governments to borrow more, do you think we should consider the total debt load of the nation, rather than that of just one level of government?

Mr. Mostafa Askari: To be honest with you, I haven't really thought about this question, so I don't know exactly how to respond. Maybe my colleagues have an idea.

Chris.

Mr. Chris Matier: Again, I think the question is focused on whether you're looking at it from a fiscal sustainability perspective, or you're looking at it in terms of economic capacity and private sector job growth. I think the question really has to be focused along those lines.

In terms of overall sustainability in the government sector, part of those high debt loads in the public sector could be captured indirectly through the risk premium that a government would have to pay in financial markets. Financial markets are aware of the government's ability to raise revenue from heavily indebted households. They will charge an additional premium, because they know that the probability of a credit risk is higher. That will be picked up through there.

Really, the signal should be coming from financial markets, and right now, at least for Canada, the Government of Canada can issue 10- or 30-year bonds at about 2.5% to 2.75%. Right now, at least from a financial-market perspective, those concerns aren't there. In contrast, the U.S. government over a similar period is facing interest rates that are probably about 50 to 60 basis points higher. There might be some concerns about both fiscal sustainability and U.S. debt levels, and maybe not so much on the household side. But those financial markets should be able to—should, I say—price that credit risk appropriately.

● (1835)

The Vice-Chair (Hon. Pierre Poilievre): Thank you very much, and thank you for your testimony. This has been very helpful to us as parliamentarians.

Mr. Mostafa Askari: Thank you.

The Vice-Chair (Hon. Pierre Poilievre): The meeting is adjourned.