

The **Economic** and **Fiscal Update**



November 3, 2003

Overview

Canada 

“We can be certain that the fiscal path we are on is the right one. It has taken us far. And it will take us even further as we build an even better Canada for all Canadians.”

John Manley
Deputy Prime Minister and Minister of Finance
Economic and Fiscal Update speech
November 3, 2003

Highlights

- The Canadian economy posted a weak performance in the first half of 2003 due to a series of unprecedented economic shocks. However, growth is expected to rebound during the second half of this year and in 2004.
- Canadian economic growth is projected to average 1.9 per cent in 2003, climbing to 3 per cent in 2004. These forecasts are substantially below what economists anticipated at the time of the February 2003 budget.
- Slower-than-anticipated economic growth in 2003 and 2004, combined with new spending announced since the February 2003 budget, will result in smaller budgetary surpluses.
- Private sector economists believe the rapid appreciation of the Canadian dollar represents a significant risk to their forecasts.

Weaker Global Economy

Global economic growth remains unbalanced, with continued weakness in a number of European countries. In Japan, however, there are several indications that conditions for growth are improving.

In the United States there are signs of a robust economic recovery. Economic growth picked up in the second quarter and accelerated further to a very strong 7.2 per cent in the third quarter, supported by strong consumer demand and business investment.

Canada Confronts Economic Shocks

After posting strong growth in 2001 and 2002, the Canadian economy was hit by a unique combination of shocks in 2003:

- The outbreak of severe acute respiratory syndrome (SARS) in Toronto led to a 15-per-cent decline in the number of visitors to Canada in the second quarter.
- The export ban on Canadian beef caused by a single case of mad cow disease resulted in a 10-per-cent output drop in the slaughtering and meat packing industries in the second quarter.
- The Ontario power blackout was the main reason for a large decline in real exports and gross domestic product (GDP) in August.
- The Canadian dollar has risen by more than 20 per cent since the beginning of 2003. A higher dollar will affect the profits of exporters and reduce foreign demand for Canadian goods and services.

These economic shocks caused the Canadian economy to contract in the second quarter. However, in the third quarter, which included the blackout in Ontario, economists estimate that growth rebounded to about 2 per cent.

Job creation numbers reflect Canada's challenges. In the first nine months of this year, our economy created 98,000 jobs compared to more than 500,000 last year.

Global Economic Outlook

The International Monetary Fund (IMF) forecasts that the economies of the world's industrial nations will rise by 1.8 per cent this year and 3 per cent in 2004.

While growth will remain weak in the euro zone and Japan next year, the U.S. economic recovery seems to be on a solid footing.

In the U.S. fiscal stimulus and low interest rates continue to support strong consumer demand. This, along with improved profitability and increased competitiveness from the depreciation of the U.S. dollar, will boost business investment and jobs. The American economy is forecast to expand by 2.7 per cent in 2003 and 3.9 per cent in 2004.

Canadian Economic Outlook

Private sector economists surveyed by the Department of Finance believe stronger U.S. economic growth, coupled with a variety of other factors, will lead to an increase in Canadian economic growth over the balance of this year and through 2004. They are forecasting GDP growth of 1.9 per cent in 2003, rising to 3 per cent in 2004.

There are, however, two risks to this outlook:

- First is the sustainability of the U.S. economic recovery, which depends on a return to job growth. Without this, consumer demand could weaken, and investment would slow as companies lose faith in the durability of the recovery.
- Second is the impact of the appreciation of our dollar on the economy. Because of the extent and speed of the appreciation of the Canadian dollar, economists believe the impact of the appreciation may be greater than they have predicted.

For the four years after 2004, private sector economists expect average growth of 3 per cent, largely unchanged from the February 2003 forecast.

Strong Fiscal Track Record

2002–03

In 2002–03 the federal government recorded a fiscal surplus of \$7 billion, marking the sixth consecutive budget surplus. Taking all levels of government together, Canada was the only Group of Seven (G-7) nation to record a surplus in 2002, according to the Organisation for Economic Co-operation and Development and the IMF.

Budgetary revenues were lower than anticipated, reflecting the weaker economy in the first three months of this year. This decline was more than offset by lower-than-anticipated government spending, which was principally the result of a series of one-time factors.

The federal debt has been reduced by \$52.3 billion during the past six years, saving \$3 billion each year on interest payments—savings that can be spent on other priorities for Canadians.

The debt-to-GDP ratio, which represents an important measure of fiscal health, has declined by almost 25 percentage points to roughly 44 per cent from its peak in 1995–96.

2003–04

Despite the challenges caused by the economic shocks, the Government is still forecast to have a balanced budget in the current fiscal year.

Since the February budget, the \$4-billion surplus forecast at that time has been reduced to \$3.5 billion, reflecting the impact of the weaker-than-expected economy on government revenues. In addition, new spending measures totalling \$1.2 billion have been announced. This includes measures to assist those most affected by SARS and mad cow disease. It also includes additional costs associated with Canada's international obligations, such as our role in Afghanistan.

As a result, there is \$2.3 billion left in what was a \$3-billion Contingency Reserve to protect the balanced budget target.

In February 2003, the Prime Minister agreed to give the provinces and territories additional funding for health care of up to \$2 billion, provided the federal surplus was more than the \$3-billion Contingency Reserve this fiscal year—a level that is now unlikely to be exceeded.

In spite of this fact, and in the interest of promoting the spirit of co-operation central to the accord on health, the federal government will provide up to \$2 billion of any federal surplus this year for health spending, when the books are closed next fall.

This is a one-time change in policy in regard to the Contingency Reserve. Our commitment to balancing Canada's books remains the cornerstone of our fiscal planning.

Five-Year Projections

Average Private Sector Projections

After adjusting for measures announced since the 2003 budget, but before any allocation for prudence, the average private sector projections for the federal government's budget surpluses over the next five years are as follows:

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|----------|---------------|
| 2004–05: | \$3.0 billion |
| 2005–06: | \$3.0 billion |
| 2006–07: | \$4.0 billion |
| 2007–08: | \$6.0 billion |
| 2008–09: | \$9.5 billion |

These show that the Government faces a period of relatively modest fiscal surpluses due to a somewhat weaker economic outlook.

These surpluses will allow the Government to set aside the normal \$3-billion Contingency Reserve every year. However, they are not sufficient to permit any additional economic prudence until 2006–07.

A Decade of Progress

The federal government faced significant economic and fiscal challenges in the early 1990s.

Our annual deficit in 1993–94 was \$38 billion and we faced a crushing debt burden that had risen sharply after 27 consecutive years of budget deficits. Now, 10 years later, Canada is among the economic and fiscal leaders of the G-7.

- We have eliminated our deficit, reduced our federal debt by \$52.3 billion and have led the U.S. and the world's other major economies in average growth over the past six years.
- Personal and corporate taxes have been reduced by more than \$100 billion over five years, spurring increased consumer spending and investment, while providing a competitive advantage for Canadian businesses.
- The federal government is providing \$63 billion in additional funding to strengthen the health care system based on accords with the provinces and territories.
- Canada has enjoyed one of the world's best records on job creation—3 million more Canadians are now working than in 1993.
- Canadians' standard of living has grown by 20 per cent in the last six years—faster than that of any other G-7 country.
- Thanks to substantial increases in the National Child Benefit, the number of children living in poverty has been substantially reduced.

Building an Even Greater Canada

While Canada's financial situation remains among the best in the industrialized world, the Government continues its efforts to strengthen the nation's economic and fiscal framework, including:

- Ongoing examination of all non-statutory spending and a permanent \$1-billion reallocation of spending.
- Establishing a new rate-setting mechanism for employment insurance premiums for 2005 and beyond.
- Encouraging reform in Canada's system of securities regulation.
- Ongoing discussions with the provinces and territories to renew the equalization program and the Territorial Formula Financing agreement by the end of March 2004.
- Developing a new policy on financial sector mergers to be made public in June 2004.

How can I get more information on the 2003 Economic and Fiscal Update?

Information is available on the Internet at:
www.fin.gc.ca

You can also obtain copies of this brochure or other Update documents from:

Distribution Centre
Department of Finance Canada
Room P-135, West Tower
300 Laurier Avenue West
Ottawa, Ontario K1A 0G5
Phone: (613) 995-2855
Fax: (613) 996-0518

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