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A Canadian perspective on the IMF's *World Economic Outlook*

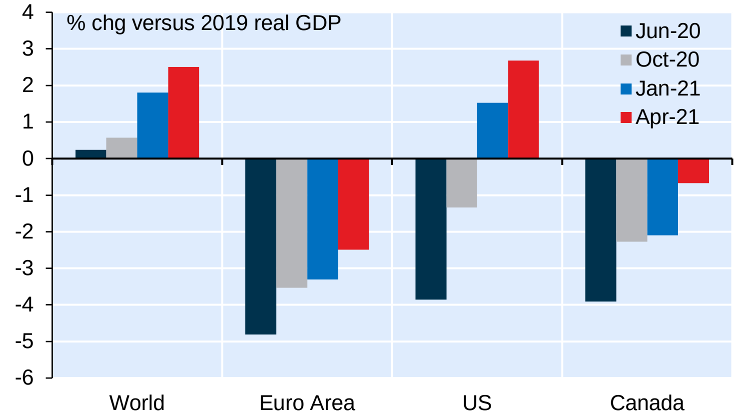
By Taylor Schleich

As part of the IMF's Spring 2021 meetings, we've got a new *World Economic Outlook* to pour over. Importantly, it's the first full update since back in October when the virus was beginning to resurge, and vaccines still seemed like a world away. Safe to say the outlook looks a lot different nowadays. Even relative to the IMF's "mini" update in January, growth prospects are way up across the world aided by the vaccine rollout and a thrust of fiscal support in the world's largest economy. We've taken the time to pull out some of the more interesting takeaways from the IMF's latest projections, with a focus on Canada. And we'll have more reflections later this week when a fresh *Fiscal Monitor* drops.

Breaking down the IMF's April *World Economic Outlook* with a focus on Canada

Chart 1: Revisions move growth prospects higher… again!

2021 GDP relative to 2019 GDP by IMF WEO projection date

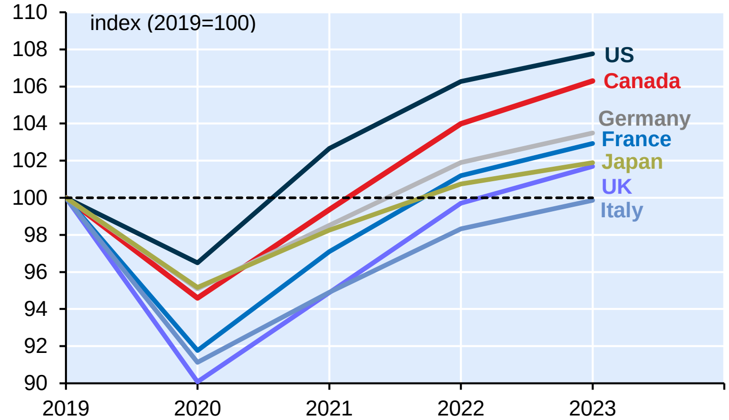


Source: NBF, IMF

Despite hiccups along the way (i.e. virus variants, case count spikes), the IMF's view on growth around the world has grown increasingly rosier. The recovery is still expected to be highly uneven across jurisdictions (the Euro area recovery to 2019 GDP looks to lag the US by ~5%-pts in 2021) but nonetheless, a rising tide lifts all boats. For Canada, the IMF had seen 2021 output remaining ~4% below 2019 levels in June. Its outlook has improved by over 3%-pts in ten months as 2021 real output is on pace to settle less than 1% shy of 2019 levels.

Chart 2: North America to lead the G7 recovery

Forecasted path of real GDP through 2023 relative to 2019 levels

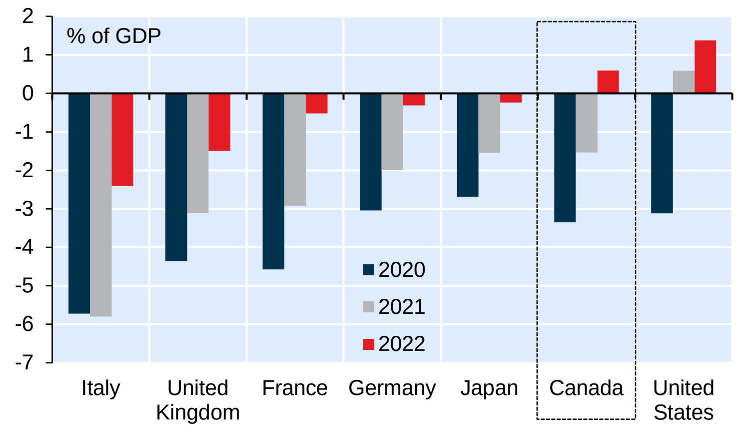


Source: NBF, IMF

The US is in a league of its own when it comes to G7 recoveries. Output is on pace to move above 2019 levels this year and by 2023 should be almost 8% above pre-COVID output. That's an annualized growth rate of nearly 2%—not bad considering there was a once-in-a-lifetime global pandemic sprinkled in there. Canada, benefitting from the fiscally-charged recovery south of the border, looks to also rebound strongly and easily outpace its European and Japanese G7 peers.

Chart 3: Canada's output gap closed in 2022; US even earlier

Output gap as a percentage of GDP by year, country

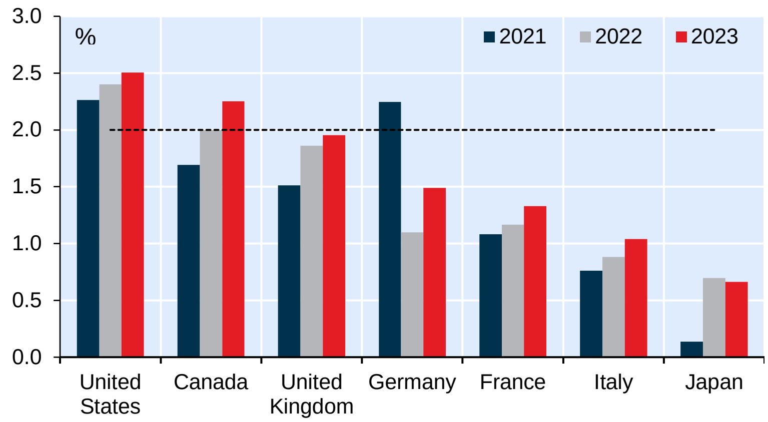


Source: NBF, IMF

The US looks to be above potential GDP later this year—a remarkable development given that the IMF had assumed slack persisting through 2025 six months ago. The output gap is particularly important in a Canadian context given that the BoC's forward guidance is linked to its closure. While earlier BoC (and IMF) assumptions saw this occurring in 2023 (or later), the IMF now sees slack absorbed in 2022. We'll see how the BoC's projections change on 21-Apr but it's likely its baseline outlook will show the same. The question then becomes: will the BoC resist or tolerate markets' 2022 rate hike expectations?

Chart 4: Inflation remains tame outside the US

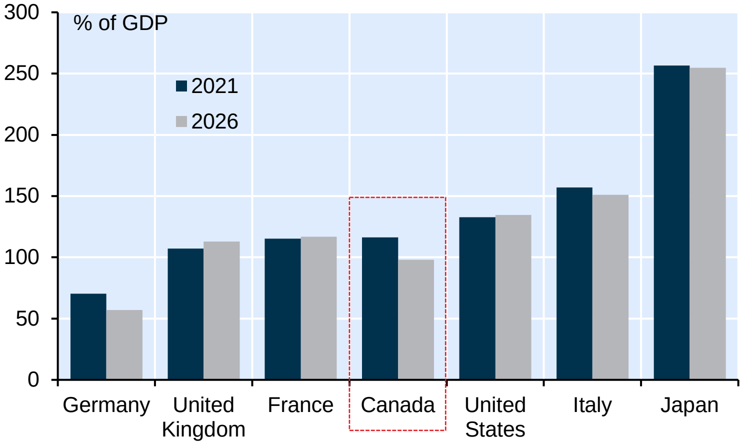
Y/Y consumer price index growth by year, country



Source: NBF, IMF

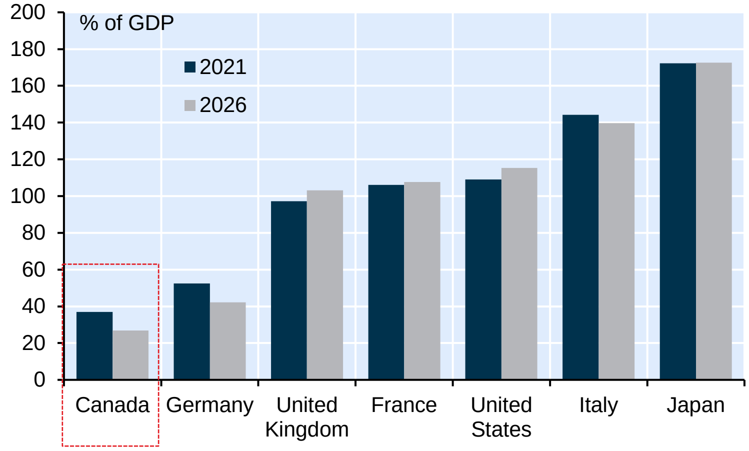
Part and parcel with persisting output gaps, inflation is expected remain stubbornly below 2% in the Euro area and Japan. The US, meanwhile, should see above-2% inflation in 2021, 2022 and 2023. Consistent with the Fed's more flexible mandate, this likely won't result in rate hikes for at least 18-24 months. In Canada, despite output gap closure in 2022, inflation isn't expected to exceed 2% until 2023. This may allow the BoC to hold off from policy rate tightening until early in 2023. That's the view we're of for now but we'll see how/if that changes when the BoC meets in two weeks.

Chart 5: Canada middle of the pack on gross debt
Gross debt as a share of GDP by G7 country: 2021 vs. 2026



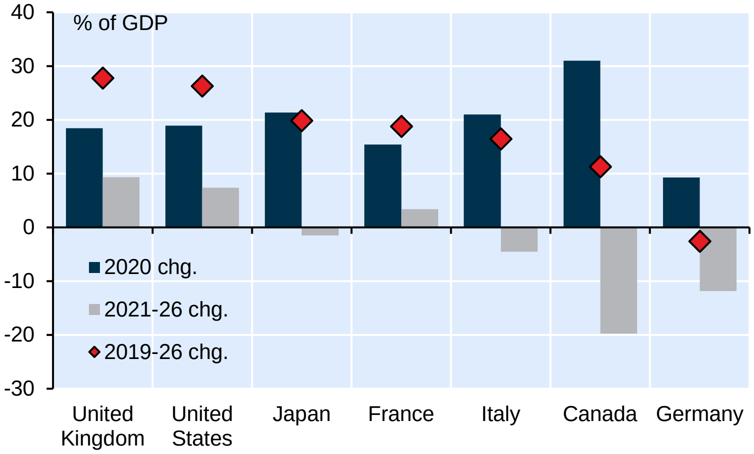
Source: NBF, IMF

Chart 6: …but still leads the way on *net* indebtedness
Net debt as a share of GDP by G7 country: 2021 vs. 2026



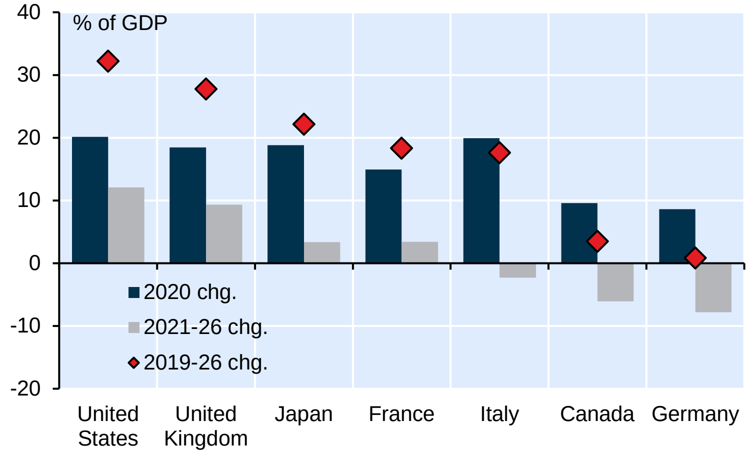
Source: NBF, IMF

Chart 7: Different approaches to debt mgmt. post-COVID
Change in gross debt over various time periods, by country



Source: NBF, IMF

Chart 8: Canada's net debt may be relatively well contained
Change in net debt over various time periods, by country



Source: NBF, IMF

All G7 countries, even the fiscal hawks in Germany, saw debt burdens rise in 2020 as nations hurried out fiscal supports to businesses and households impacted by the pandemic. But beyond 2020, it's a bit of a mixed bag when it comes to the trajectory of indebtedness. The US and UK look to keep the debt floodgates open, albeit at a slower pace with gross debt ratios in 5 years nearly 30%-pts above pre-COVID levels (Chart 7). For Canada, the IMF assumes considerable consolidation over the next half decade with the result being an aggregate medium-term rise in indebtedness only exceeding Germany. When it comes to net debt, Canada's rise is even less concerning. As a share of GDP, net debt looks to be reigned in over the next five years and by 2026 should stand just a few percentage-points above pre-COVID levels (Chart 8). Of course, these debt *ratio* forecasts are also partially a function of the resumption of positive growth and the winding down of emergency virus supports. There are still non-trivial deficits and growing *absolute* levels of debt for the coming years.

In any event, your view on whether Canada's indebtedness is of concern depends on the metric you favour. In gross terms, Canada doesn't look all that impressive, in/around the same levels as some of its non-AAA-rated peers (Chart 5). Fitch clearly favours this view, having cracked the sovereign with a rating downgrade last year citing concerns of a burgeoning debt load. But on net debt (i.e. after accounting for financial assets, which in Canada's case includes the CPP), Canada continues to stand above—rather, below—the rest (Chart 6). It's no wonder why this has long been the preferred measure for the Federal government. That said, the IMF's WEO was released *before* Canada's 2021 Federal budget. It remains to be seen if Trudeau and company opt to strap on additional borrowing in the coming years, perhaps funding a rumoured universal daycare initiative. Stay tuned as more clarity is coming on April 19.

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