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Economic Flash!

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Canadian Fiscal Stimulus

Announcements from Canada's Prime Minister and Finance Minister today are the latest steps taken that should cushion the blow, but which cannot prevent, a coronavirus recession that is now underway. On the fiscal side, a package worth $82 bn, or roughly 4% of GDP, will be aimed at shoring up payments across the economy on a temporary basis, including $55 bn in deferred tax payments (until after August 31) and $27 bn (more than 1% of GDP) in direct assistance. That latter tally could run up if this situation lasts longer than expected, consistent with the Finance Minister emphasizing that this is the first phase of the response.

The measures seem better targeted than a US plan under discussion that would send a cheque to all, given that income disruptions aren't evenly spread. Some are designed to help insure against a wave of household and business defaults, including extending benefits to those losing jobs who wouldn't currently qualify for employment insurance payments, such as part-timers, those in quarantine not able to report to work, those looking after someone who is ill, and the self-employed. Small businesses will get a wage subsidy to encourage retention of employees, student loan payments will be on a 6-month moratorium.

The impact on the deficit from these measures, as well as the tumble in tax revenue in a slowing economy, won't be pretty, even allowing for the fact that deferred tax revenues will still come in later. The costs of these new offers will depend on just how many people end up qualifying due to job losses or other reasons. Provinces are also stepping up on various fronts, and could face soaring health care costs (potentially extending to emergency measures to add to the capacity of the system where possible).

But at this point it makes much more sense for the federal government, which can borrow on our collective behalves at rock bottom interest rates, to go deeper into debt, than to rely on business and households to have access to even more credit than they will already need to stay afloat. In a flight-to-safety environment, the bond market will have a huge appetite for federal government paper. The same wouldn't be true for private sector issues, as we've already seen in soaring spreads on such debt.

For its part, other than a massive QE program, or less likely, negative rates, the Bank of Canada still has one conventional bullet it chose not to fire off today, which would entail cutting the overnight rate to 25 bps, the low in the last recession. We still expect it to deliver that final rate cut in the coming month or so.

That would follow a flurry of other measures, from the Bank of Canada, the bank regulator, and the government to support the functioning of credit markets, including support for bank funding through an insured mortgage purchase program, a backstop for the BA market, an important source of short-term business funding, and other measures. Note that if the Bank of Canada does eventually need to launch into a QE program, it could buy spread product, including corporate debt, to target those efforts at segments that might need it.

A recession is still inevitable, with a deep dive coming in Q2 due to near-mandated cuts in household spending here and in our export markets, an oil industry shock, and potential supply disruptions from domestic and foreign producers. While a further contraction in Q3 would likely be more modest, we will still feel the spillover impacts from layoffs and the energy sector's troubles. But the measures announced today support the likelihood of a V-shaped bounce back once the disease issues have crested. We'll leave it to the health policy and medical experts to opine on when that will be, as we're hearing various views on that front without the expertise to choose among them.