Extraordinary Measures for Extraordinary Times

CANADIAN GOVERNMENT ANNOUNCES MAJOR FISCAL STIMULUS

- **Today Prime Minister Trudeau announced substantial fiscal support amounting to $27 bn (or 1.1% of GDP) as part of a broader stabilization effort as the Canadian economy comes to a halt in light of the COVID-19 outbreak.**
- **Finance Minister Morneau followed up the announcement with details of a package that will largely target households through direct payments to those most affected by the immediate impacts of the unfolding crisis.**
- **They also announced $55 bn in tax deferrals to help businesses and households weather the hopefully-transitory impact of the slowdown.**
- **The key message, however, was that Canada not only has the fiscal firepower to do "whatever it takes", but it also stands ready to use it.**
- **Further federal fiscal stimulus can be expected as the situation evolves.**

A COMPLEX CRISIS

The nature of the ongoing crisis is unprecedented in modern history. The health crisis is extraordinarily bringing economic activity to a halt around the world (not to mention taking a significant human toll). This is creating a challenging dynamic of negatively-reinforcing supply and demand shocks as workers stay home, production halts, borders shut down, and consumers are home-bound.

The Canadian economy will be hit through a variety of channels. In the near term, retail, manufacturing, travel, cultural and other service-oriented industries face a sharp contraction, while reduced global demand and the oil shock will feed through the broader economy with a lag. While the unprecedented nature of events, including the speed of evolution, renders forecasting directional at best, latest information indicates the Canadian economy will slip into modestly negative territory in the first quarter of this year, before falling precipitously in the second quarter. A slow rebound could begin thereafter—with appropriate policy supports.

ALL HANDS ON DECK

The Canadian government is providing an exemplary model of policy coordination. There has already been a steady stream of substantive measures over the past weeks, including policy rate cuts, new (or expanded) credit and liquidity facilities, lowering of financial institutions' capital buffer requirements, and other market interventions to ensure that markets are functioning adequately under pressure. The government had also earlier provided a quick, $1 bn package largely directed at provinces at the onset of the pandemic. A striking feature of each announcement has been the coordination across institutions and layers of government in recognition that there are no simple solutions to the complex crisis.

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A substantive fiscal response is a critical component of the broader Canadian response. It is essentially the only tool that can target the demand shock. As households and businesses face unknown income and revenue shocks, additional money in pockets is really the only means—if any—that will enable or induce stronger spending. Even then, this tool will face headwinds given Canadians are largely homebound in the foreseeable weeks ahead. So while not a perfect tool, it is arguably the only tool available.

TURNING ON THE TAPS

Prime Minister Trudeau couched today's announcements as "extraordinary measures" to support the Canadian economy. This included $27 bn in direct fiscal support for Canadian households and businesses (chart 1), as well as $55 bn to meet business and household liquidity needs through tax deferrals. Finance Minister Morneau followed up this announcement with further details on the package amounting to more than 3% of GDP.

The true 'stimulus' package is $27 bn. Tax deferrals reflect an important bridging solution for households and businesses with outstanding tax obligations, thus can relieve cash flow pressures, but will not provide *additional* spending impetus as these obligations would eventually be payable.

Nevertheless, the $27 bn spend is substantive on its own. It represents 1.1% of GDP, or 1.3% if last week's $10 bn loan provisioning measures are included. These measures, combined with earlier-planned deficit spending, will likely bring annual deficit spending above 3% (or approaching $80 bn) in FY21 after taking into account the impact of lower GDP (chart 2). This is comparable to past recession spending including most recently the Global Finance Crisis (GFC) when first-year spending totalled $22 bn (FY10), or 1.4% of GDP at the time under the *Economic Action Plan*.

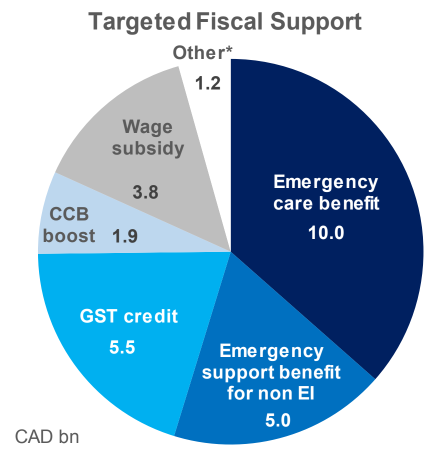
Furthermore, it is only the starting point. While the stimulus was prefixed with "up to" $27 bn, Minister Morneau clearly indicated this was only the first phase and that the government remains committed to doing "whatever it takes". The majority of measures announced today are scalable in size and duration.

ON TARGET

The package is highly targeted to households. Despite a relatively long list of measures, more than 80% of today's stimulus will go directly to households (chart 3). This contrasts with the government's response to the GFC where it banked on significant public investment, notably in infrastructure and housing, to shoulder a substantial part of the stabilization efforts. While theoretically these have higher 'fiscal multipliers', lessons from the GFC highlighted significant practical challenges to getting funds out the door quickly. So while today's stimulus package is comparable in quantum, its relative impact should be more substantive in the near term to the extent funds flow expediently.

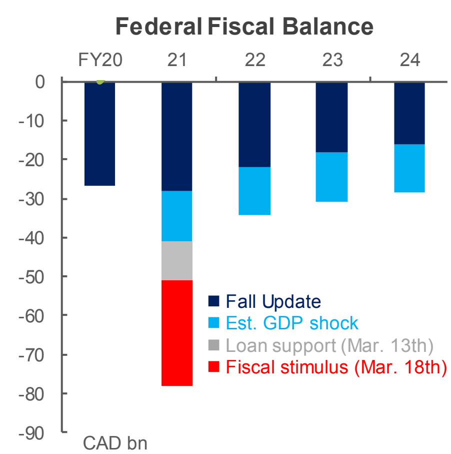
Spending is also largely targeted to those most directly affected by the immediate crisis. This includes those facing job and income insecurity in light of the crisis, as well as caregivers confronted with additional burdens. Other vulnerable populations are also targeted including lower-income Canadians, students, and Aboriginals. These households and individuals have the highest need—and the highest propensity—to spend additional funds which should support a faster economic rebound.

Chart 1



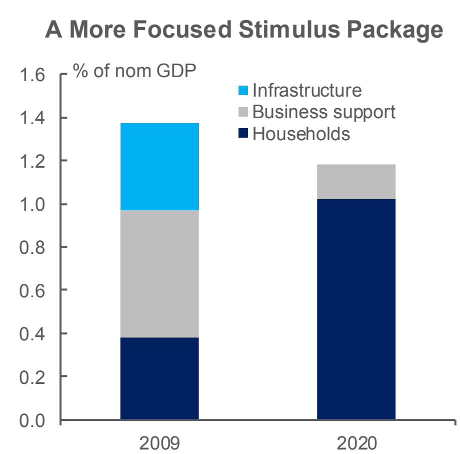
Sources: Scotiabank Economics, Department of Finance Canada.

Chart 2



Sources: Scotiabank Economics, PBO, Finance Canada.

Chart 3



Sources: Scotiabank Economics, Department of Finance Canada.

THE NEED FOR SPEED

The stimulus is balancing expediency against existing gaps in Canada's social safety nets. About 15% of Canadian workers are currently excluded from income security programs such as Employment Insurance. This is an important gap in today's crisis where shutdowns and quarantines can be in the broader public interest, but at significant personal costs to these workers. Consequently, the government intends to close this gap with two new transfer mechanisms—the *Emergency Care Benefit* and the *COVID-19 Emergency Support Benefit*—with more expansive eligibility thresholds. More than half of the spending ($15 bn) will eventually flow through these mechanisms. Needless to say, there will be a premium on getting these new programs up and running quickly.

About a quarter of payments will flow through tried-and-tested channels. This includes boosted payments under the *Canada Child Benefit* and the GST rebate programs. Support through these existing mechanisms can credibly be expected "within weeks".

This targeted approach contrasts to the rumoured US approach that would prioritize expediency above all else. In particular, one suggested means south of the border (and already introduced by Hong Kong) is to simply distribute payments to *all* citizens. There would be some 'loss' as high-income households might save the windfall, but in theory the administrative efficiency and hence expediency could outweigh this drawback. In Scotiabank modeling, we attribute higher fiscal multipliers to the more targeted approach of the Canadian government (in the order of 0.5) relative to the broader American proposal (in the order of 0.3), but this hinges on the timely execution of Canada's slew of new measures.

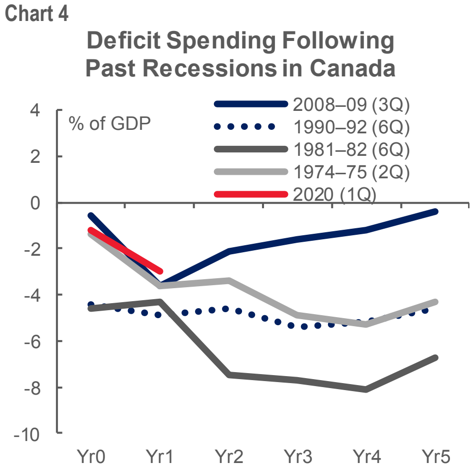
Any delays would further exacerbate the potential lag between the anticipated peak in economic hardship and the flow of financial support. While some fiscal support will start flowing within a couple of weeks, the bulk of support will likely flow in the third quarter of the year relative to the sharp contraction expected in the second quarter.

NO CEILING ON STABILIZATION

The resounding message is that today's fiscal package is only a start. The Finance Minister indicated that his main priority is not fiscal discipline but "keeping food on the table" in Canadian households. He also acknowledged that this first phase largely targets those acutely and immediately affected in an otherwise complex and evolving environment, while recognising that more support will likely be needed. This includes the potential for additional household support (or longer durations), as well as more provisions for businesses as impacts reverberate through the broader economy. Minister Morneau also alluded to potential support for provinces with an explicit reference to substantial investments in Alberta in the coming days.

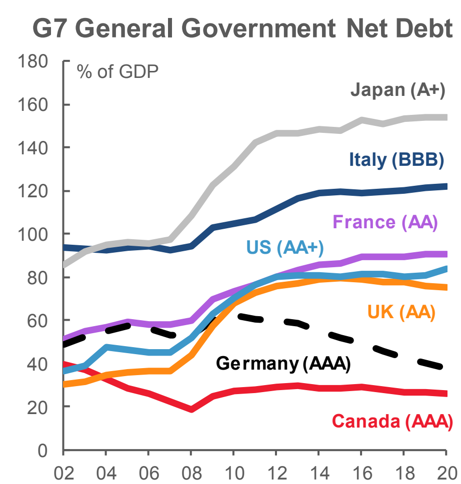
Given the nature of the crisis, the government is rightly humble in leaving the door open. Measures such as tax deferrals and payroll support can partially alleviate critical cashflow crunches for businesses over defined periods of time, but the longer the downturn, solvency rather than liquidity becomes a more pressing concern. But in the short term, focused support on demand-revival is appropriate as this will ultimately help businesses. The government will no doubt be evaluating the situation with a view to providing additional support as required. Overall deficit spending relative to historic recessionary periods is still modest (chart 4).

Chart 4



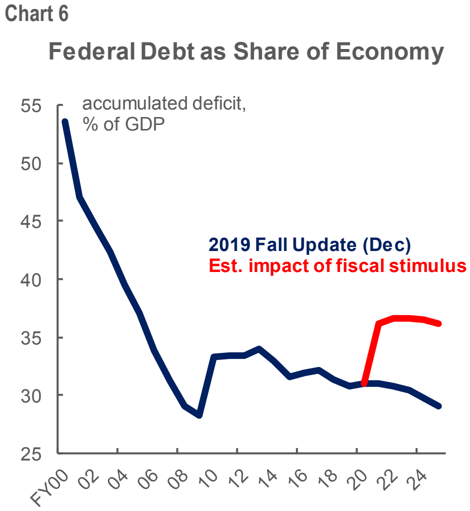
Sources: Scotiabank Economics, Statistics Canada, Department of Finance, CD Howe

Chart 5



Sources: Scotiabank Economics, IMF, S&P.

Chart 6



Sources: Scotiabank Economics, Finance Canada.

AN ENVIABLE FISCAL POSITION

Canada's finances are in a solid position to do 'whatever it takes'. Its relative fiscal stance remains among the best in the world. Total debt across all levels of government after netting out financial assets amounted to about 27% last year. That positions Canada the best (or least worst) among peers and in some cases by a long shot (chart 5). Meanwhile, the federal net debt as a share of the economy has hovered just above 30% in recent years.

Today's additional spending will result in a material uptick in the federal government's net debt-to-GDP. The additional $27 bn, along with a contraction in GDP and associated impacts, could easily push debt levels to the mid-30s range (chart 6). This is still relatively low compared with peers, and importantly, by design, the additional fiscal pressure is temporary. The fiscal impact of a steeper and more prolonged recessionary environment would likely have a bigger (negative) impact on Canada's debt levels over the medium term absent strong fiscal action today.

The Finance Minister has rightly abandoned his soft fiscal anchor. He had been mandated to keep debt as a share of the economy on a downward trajectory, while preparing for the next recession among other (sometimes conflicting) objectives. As monetary responses are maxed out around the world, Canada's capacity, ability, and willingness to use its fiscal firepower puts it in an enviable position while it still has further monetary room to maneuver. With the Canadian economy particularly exposed to the present shock through oil channels there is arguably even more pressure to stand above peers on the fiscal front. While Canada has lost some of its negative bond rate differential to the US as Treasuries capture a disproportionate share of safe-haven flows amidst the crisis, Canada's relatively more conservative fiscal management should restore this differential as a global recovery takes hold over time.

THE BOTTOM LINE

The bigger risk in today's context is that Canada does too little, not too much. The government has hedged against this risk by turning on the taps quite freely today, while indicating a willingness to keep them on for as long as necessary. There is no panacea to fiscal stimulus under present circumstances. The package today largely reflects a solid effort to make the best of the tools we have, while introducing minimal new ones to address important gaps. Overall, the announcement should be viewed as a positive development in an otherwise complex environment.