Canada's Fiscal Response to COVID-19

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Highlights

- Canada's federal government has stepped up with a historic fiscal response in recent weeks. It has committed to measures totaling around $260 billion (11% of GDP), of which about two-fifths constitutes direct spending.
- Provinces have followed suit with about $40 billion in overall supports, bringing the total to about $300 billion (13% of GDP).
- Relative to that undertaken during the 2008/09 Global Financial Crisis, this fiscal response by Canadian governments is much larger, swifter and more oriented towards temporary measures for households and businesses.
- The fiscal spending underway will no doubt leave an enormous debt overhang, the extent of which will depend on several factors, notably the shape of recovery and to what degree temporary measures may become permanent. In addition, further supports may be forthcoming if the crisis deepens.

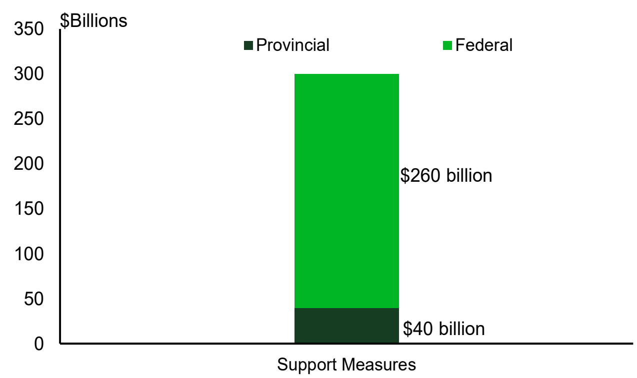
After initially moving cautiously, Canada's federal government has stepped up with a historic fiscal response in recent weeks. It has committed to measures totaling around $260 billion (11% of GDP), about 40% of which constitute direct spending. With provincial measures, this tally grows to about $300 billion, or 13% of GDP (Chart 1).

Relative to that undertaken during the 2008/09 Global Financial Crisis (GFC), this fiscal response by Canadian governments is much larger, swifter and more oriented towards temporary measures for households and businesses. This reflects the different nature of the shocks. COVID 19 struck economies across the country in a matter of weeks whereas the GFC took months to unfold. During the GFC, the federal and provincial governments dedicated around 4% of GDP to direct crisis measures, divvied up fairly equally across both levels of government. Further, governments during the 2009-10 period generally allocated the spending over a 2-year window.

The bulk of the measures unveiled during the current crisis are aimed are bridging households and businesses until the time that virus-related disruptions dissipate and economies rebound. The design of some of the current suite of programs is also conducive to helping speed up the pace of recovery post-crisis.

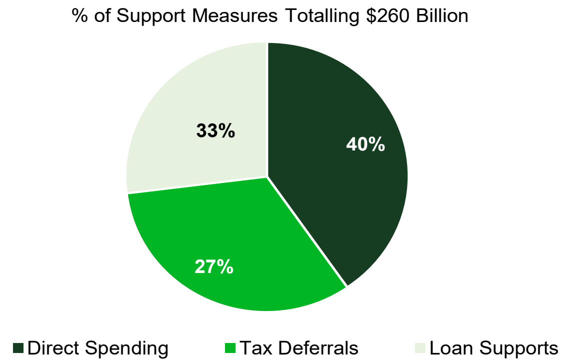
The fiscal spending will no doubt leave an enormous debt overhang, the extent of which will depend on many factors. For one, governments seem inclined to 'do what it takes' to support residents during this time of need, which may necessitate additional measures down the road. Other major drivers of near-term defi-

Chart 1: Provinces Step up, but Most of the COVID-19 Relief Coming from the Federal Government



Source: Federal and Provincial Governments, TD Economics

Chart 2: Multi-pronged Approach to Federal COVID-19 Support Measures



Source: Federal Government, TD Economics

cits and debt include the shape of recovery and to what degree temporary measures may become permanent.

Federal government goes from laggard to leader in terms of response

With this past week's measures, Canada's overall fiscal policy response has gone from laggard to one of the most aggressive of major industrialized economies. The U.S. government made waves the week before last by passing its massive $2+ trillion spending package. In terms of overall magnitude, Canada's federal response is now roughly comparable to the US response relative to the size of the economy.

Compared to Canada's own experience during the 2008-09 GFC, the federal response today is both several times larger and significantly different in terms of policy choice. During the GFC, direct federal spending was in the order of 2% of GDP, with Canada receiving kudos from international organizations for its "diversified" crisis response that was "designed for maximum efficiency." Federal direct support was sprinkled across a range of areas – tax cuts, infrastructure, direct industry support, EI and training and research and development. Credit supports and liquidity measures were also adopted for the financial sector and some other key industries (i.e., autos). However, Canada's relatively healthy banking industry during a banking-oriented global crisis mitigated the need for indirect lending supports.

Relative to the GFC actions, the federal response this time around is more targeted and less tilted towards direct spending measures. Of the roughly $260 billion in support (Chart 2), about two-fifths represent temporary direct assistance in the form of household emergency benefits (CERB, expanded child support) and business wage subsidies (CEWS). Of the remaining three-fifths, the bulk has been dedicated towards tax payment deferrals ($85 billion) and temporary credit supports notably for small and medium-sized enterprises ($70 billion). These numbers will likely change in the near term, as the federal government is currently facing heightened pressure to up financial assistance to hard hit industries, such as oil and gas.

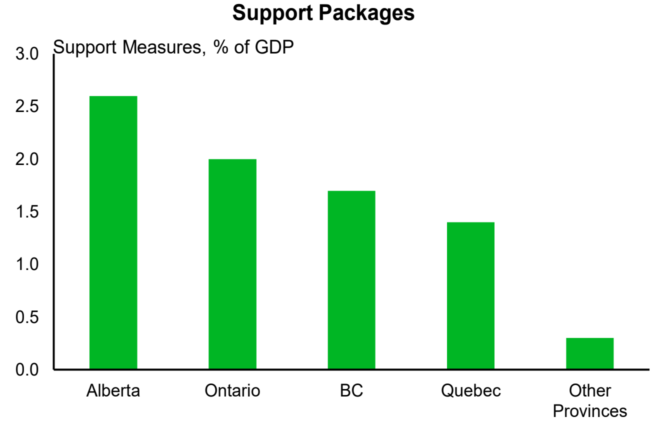
Unlike the GFC, there has been greater efforts to speed up the response. Household benefits are expected to start flowing this week, while rollout of the small business loan program is not far behind. Payments to businesses through the federal wage subsidy program are likely to take a little longer – around 3-6 weeks – however, that is still historically fast in light of the expansiveness and cost of the program.

Provinces also step up with temporary supports

Provincially, measures have been more modest, at about 2% of GDP in aggregate. Provinces have generally been looking to the federal government to do much of the heavy lifting, partly given its relatively low debt burden – especially relative to other countries – and strong fiscal flexibility.

That said, we have been seeing some variability in provincial fiscal responses, with the larger provinces – all of whom have been among the hardest hit by COVID 19 – having unveiled more significant packages amounting to 1.5% of GDP or more, while the other provinces have moved ahead with targeted measures of amounting to around 0.5% to GDP (Chart 3).

Chart 3: Bigger Provinces Roll Out Larger Support Packages



Source: Provincial Governments, TD Economics

For the most part, these responses follow in the same vein as that of the federal government, structured in a way to provide temporary 'bridging' supports. This is in stark contrast to the GFC, when the Provinces skewed stimulus programs towards infrastructure with longer lead times. Still, it is important to point out that a number of Provinces had ambitious infrastructure programs in progress pre-virus (including Nova Scotia, Quebec, Prince Edward Island, and B.C).

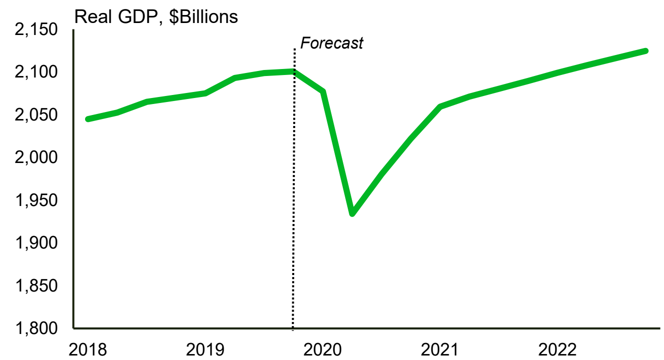
In terms of the measures undertaken by the Big 4 provinces, some key highlights are:

- Ontario (2% of GDP): announced temporary payments to low income seniors and parents, a temporary health tax deduction and support to municipalities. Matching the federal government, a large share of Ontario's assistance will come in the form of temporary tax deferrals (of around 6 months). In addition, significant funding will go to meeting the demand for services in the health and long-term care sector, among other measures.
- British Columba (2% of GDP): released a $5 billion action plan, split fairly evenly between household and business supports. This included a top up to federal household EI or emergency benefits, rent supports and public services investments.
- Quebec (1.5% of GDP): also deferred tax deadlines and provided some stopgap relief to individuals who are in self isolation that can't access federal assistance. A key component of the measures is credit assistance to businesses, partly through the Caisse de dépôt. Of note, the economic toll of the virus appears to be hitting Quebec especially hard, as the province has enacted severe social distancing measures and has the highest number of confirmed cases.
- Alberta (2.5% of GDP): similar to Quebec, the government is providing short-term stop gap payments, and last week, announced it would be making an investment and providing loan guarantees to support the development of the Keystone pipeline.

Economic forecast implications

While the term "stimulus" gets bandied about quite frequently to describe the desired impact of these fiscal responses, a more apt characterization would be near-term downside risk mitigation. Measures are more tailored to stopgap households and businesses until containment measures are lifted and economies recover. At the same time, it is likely that some longer-term economic scarring cannot be avoided. In our recent forecast, which assumes that disruptions start to subside by mid-May, real GDP and unemployment rates are not likely to return back to pre-virus levels until 2022 at the earliest (Chart 4). See our recent Forecast Update.

Chart 4: Output Won't Return to its Pre-crisis Level for a Few Years

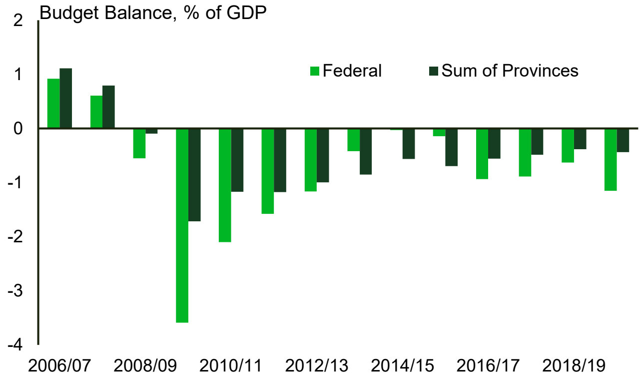


Source: Statistics Canada, TD Economics

The government benefits – notably the federal CERB and CEWS – will provide some cushioning effect on nominal personal disposable incomes and employment in the current quarter. Still, there are limits to what governments can do to offset the historic impact of a sudden stop in the economy. Overall GDP/income declines are still likely to be dramatic, while the unemployment rate will surge well into double-digit territory by April. The wage subsidy and small business lending program should go some distance in mitigating layoffs in the near term, though take-up rates remain highly uncertain (for more, please see report).

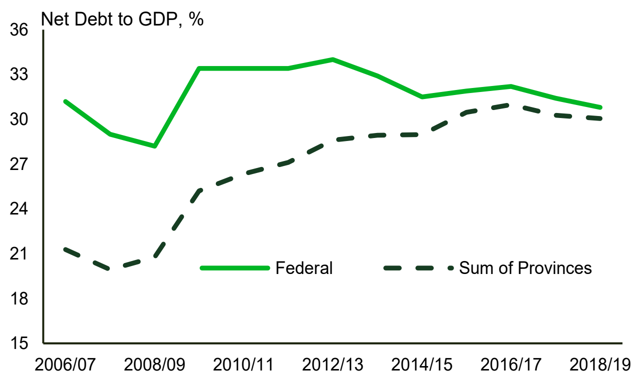
There is also the question of how the measures could help to support recovery once it takes root. Some of the measures – notably the federal wage subsidy – have been designed with this in mind. To the extent that workers remain attached to their jobs, it will be easier for companies to scale up once demand revives. On the other side of the coin, tax deferrals are one specific measure that will help to preserve cash during the crisis, but will provide a counterweight on a spending recovery as tax payments become due.

Chart 5: Federal Government Carrying a Relatively Modest Deficit Heading into COVID-19 Crisis



Source: Federal and Provincial Governments, TD Economics

Chart 6: Provincial Debt-to-GDP Ratios Have Risen Since the Financial Crisis



Source: Federal and Provincial Governments, TD Economics

Implications for deficit and debt

This response by governments will clearly have important implications for federal/provincial deficits and debt burdens. Government balance sheets in the near term will be facing deterioration, not just from the program costs themselves, but from the automatic stabilizers that kick in on both the revenue and spending sides in response to economic contractions.

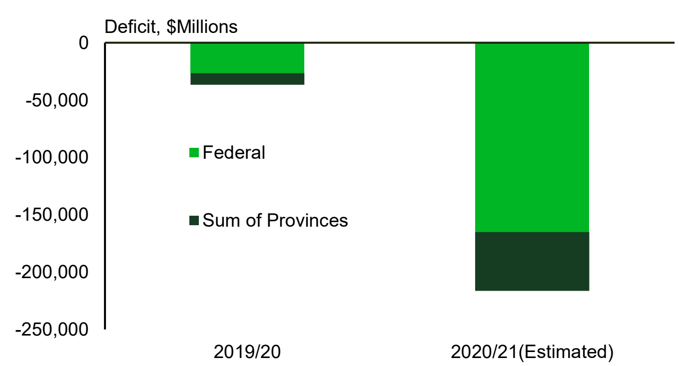
In this regard, there is some good news. Unlike the US federal government, Canada's federal government is entering the crisis with a relatively low deficit and debt to GDP ratio of just over 1% and 31%, respectively (Chart 5). This is not far off its position heading into the GFC, when it ran a small surplus and a debt ratio of around 29%. At the provincial level, the story is somewhat different, with the aggregate debt-to-GDP rising from around 20% prior to the 2008/09 crisis to around 30% today (Chart 6). This hides some significant shifts under the surface, whereby Ontario and Alberta have seen significant deteriorations in their balance sheets, while Quebec and B.C. have held up much better.

While it is difficult to pin down with any precision the near-term erosion in fiscal balances, the federal government appears to be on track for a deficit of at least $165 billion (7% of GDP) this year (Chart 7). Such a shortfall would imply a jump in the debt burden (as measured by accumulated deficits) of more than 10 ppts, to approximately 40% of GDP.

The combined provincial shortfall this year could jump from around $10 billion (0.5% of GDP) pre-virus to at least $50-60 billion (2.5% of GDP). These shortfalls are consistent with jump in the aggregate net debt burden, to around 35%. Much of the erosion reflects Ontario, where the deficit is expected to more than triple this year from the $9 billion posted last year. Ontario's recent fiscal update in late March projected a deficit of $20.5 billion in fiscal 2020-21, but that was based on GDP assumptions that have since come down. The province's debt to GDP ratio could jump to around 45%, well above its 40% level pre-virus.

Elsewhere, erosions will be even sharper in the oil producing provinces that have also been hit by the collapse in crude prices. For instance, Alberta's government has warned that its deficit could virtually triple from last year's estimated $7.5 billion level (2.2% of GDP). B.C. and Quebec are on the list of provinces that have been recording steady surpluses in recent years, but those jurisdictions are poised to move significantly into deficit territory. Ditto for the Maritime provinces.

Chart 7: Recessions and Relief Measures to Lead to Ballooning Government Deficits This Year



Source: Federal and Provincial Governments, TD Economics

Most projections would have deficits and debt burdens falling back closer to pre-virus levels once economic activity converges on its pre-virus levels in 2021-2022. However, risks are skewed to more persistence in budget shortfalls and borrowing requirements given the likelihood that:

1. further fiscal measures will be necessary;
2. economic recoveries underperform our expectations due to delays in containment and lingering scarring from the crisis;
3. some of the temporary measures are made permanent.

All things equal, an unsustainable path of deficits and debt tend to crowd out private investment, weigh on living standards, and ultimately necessitate higher taxes and/or spending cuts in the future.

One upshot of the equally-dramatic responses by central banks to support economies is that borrowing rates will likely remain extraordinarily low over the medium term, helping to keep the debt service ratios of most Canadian governments within an affordable range. In addition, what matters is not absolute debt levels but rather those in comparison to jurisdictions abroad. And on that count, Canada's fiscal position continues to stack up quite well relative to the US and much of Europe.