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1. Weekly Markets Changes

[May 29, 2020]

S&P TSX	S&P 500	Dow Jones	NASDAQ	CAD/USD	Gold	WTI Crude
15,192.83 +279.19 +1.87%	3,044.31 +88.9 +3.01%	25,383.11 +918.0 +3.75%	9,489.87 +165.3 +1.77%	\$0.7253 +1.18c +1.65%	\$1,730.27 -4.41 -0.25%	\$35.32 +2.07 +6.23%

2. GDP fell 8.2% in Q1 on back of pandemic

[May 29, 2020] Canada's economy had its worst quarterly showing since 2009 through the first three months of 2020, and may be headed to an even steeper drop, as steps taken to slow the spread of COVID-19 forced businesses to close and lay off workers.

Gross domestic product fell at an annualized rate of 8.2% in the first quarter, including a 7.2% drop in March as restrictions by public health officials began rolling out during the month, including school closures, border shutdowns and travel restrictions.

Events earlier in the quarter also had a drag on GDP with Statistics Canada pointing to the Ontario teachers' strike and rail blockades in February, as well as a drop in oil prices.

The drastic drop in gross domestic product likely doesn't fully reflect the experience of every Canadian through this episode, said BMO chief economist Douglas Porter.

"You don't get the entire picture just from GDP and even from employment because policymakers have stepped up with such unusual and aggressive

actions that a lot of the common metrics just don't apply 100% in this episode," Porter said in an interview.

A preliminary estimate released by the Finance Department says the federal government posted a deficit of \$21.8 billion for the fiscal year that closed in March. The figure will still be subject to revisions, which may land it closer to the government's last estimate of \$26.6 billion, up from the \$19.8 billion forecasted in last spring's budget.

The Finance Department's fiscal monitor says revenues hit \$334.3 billion, a 1.8% increase, compared to the previous fiscal year. Spending was up 4.7% to over \$331.4 billion, while public debt charges increased by 5.1% to almost \$25.9 billion.

The net federal debt pushed past \$794.4 billion.

Additional spending rolled out in recent weeks is likely to push the debt even higher as the budget office has warned the deficit for this fiscal year could hit \$260 billion as the government flows income supports to Canadian households.

Statistics Canada said household spending, a backbone of the Canadian economy, was down 2.3% in the first quarter of 2020, the steepest quarterly drop ever recorded.

The drop in household spending was broad, affecting goods and services.

Statistics Canada said new car purchases were down 8.8%, trucks and vans by 9.4% and used cars by 10.1% owing to "income uncertainty," more people working from home and the closure of dealerships in some provinces, including Ontario and Quebec.

Housing spending on clothing and footwear dropped as well by 16.4%, as did spending on food, beverage and accommodation services — by 10.9% — and air transport — by 15.7% — as bars and restaurants were ordered closed and travel restrictions kicked in.

Instead, spending on going out became money spent staying in, Statistics Canada said.

Spending on food and non-alcoholic beverages increased by 7.2% in the first quarter, while there was a 6% rise in spending on alcoholic beverages.

As a result of less spending overall, the savings rate rose for the quarter to 6.1% from the 3.6% recorded in the fourth quarter of 2019 with higher rates recorded at higher income levels.

The savings some households have built up during the shutdown period could translate into extra spending as restrictions are eased and businesses reopen, says CIBC senior economist Royce Mendes.

"Overall, the economy has likely troughed at least for now, with businesses beginning to reopen," he wrote in a note. "Look for the economic data to begin

showing signs of revival over the summer months, even if it only represents the low-hanging fruit of eased restrictions.”

Similarly, TD senior economist Brian DePratto wrote in a note that it isn’t unreasonable to think a modest recovery may already be forming.

“The key question is what kind of recovery? Given the significant hits to incomes and longer-lasting impacts on some industries, a marathon appears more likely than a sprint,” he wrote.

The national statistics office said preliminary information indicates an 11% drop in GDP for April, but that figure is likely to be revised as more information becomes available.

“Nonetheless, the March and April decreases are likely to be the largest consecutive monthly declines on record,” the agency said in an online post this morning.

Similarly, the agency said first-quarter figures are likely to have larger than usual revisions in subsequent data releases as some numbers had to be estimated because they were not available on time.

3. April’s U.S. spending drop worse than revised March figures

[May 29, 2020] U.S. consumer spending plunged by a record-shattering 13.6% in April as the viral pandemic shuttered businesses, forced millions of layoffs and sent the economy into a deep recession.

Last month’s spending decline was far worse than the revised 6.9% drop in March, which itself had set a record for the steepest one-month fall in records dating to 1959. Friday’s Commerce Department figures reinforced evidence that the economy is gripped by the worst downturn in decades, with consumers unable or too anxious to spend much.

Even with employers cutting millions of jobs, personal incomes soared 10.5% in April, reflecting billions of dollars in support through government payments in the form of unemployment aid and stimulus checks. Wages and salaries, normally the key component of overall income, sank by an annualized \$740 billion in April. By contrast, income in the form of government support jumped by an annualized \$3 trillion. That form of income, though, will likely fade in coming months as certain forms of government aid expire.

Friday’s report showed sharp declines in consumer spending across the board — from durable goods like cars to non-durable items such as clothing to services ranging from doctor visits to haircuts. Spending tumbled 17.3% for durable goods, 16.2% for non-durables and 12.2% for services.

The depth of the spending drop is particularly damaging because consumer spending is the primary driver of the economy, accounting for about 70% of economic activity. Last month's figure signalled that the April-June quarter will be especially grim, with the economy thought to be shrinking at an annual rate near 40%. That would be, by far, the worst quarterly contraction on record.

The report showed that an inflation gauge preferred by the Federal Reserve fell by 0.5% after a 0.2% decline in March. The Fed has cited the absence of inflation pressures as one reason they are able to be as aggressive in providing support to the economy by cutting its benchmark interest rate to a record low near zero and pumping billions of dollars into credit markets to keep them from freezing up.

In April, the nation's jobless rate was 14.7%, the highest since the Great Depression, and many economists think it will top 20% for May. States are gradually restarting their economies by letting some businesses reopen with certain restrictions, and some laid-off employees are being recalled to work. Still, the job market remains severely depressed, and the outlook for the rest of the year is still bleak.

Some financial support for the tens of millions of consumers who have been laid off over the past two months is coming from weekly unemployment benefits. Besides whatever unemployment aid states are providing to laid-off workers, the federal government is providing \$600 a week in additional benefits.

A debate in Congress over whether to extend the \$600 a week in federal unemployment aid looks sure to intensify, with the number of people receiving that aid now topping 30 million — one in five workers. The money is set to expire July 31. Yet with the unemployment rate widely expected to still be in the mid-teens by then, lawmakers will face pressure to compromise on some form of renewed benefits.

The Trump administration asserts that the economy will begin to regain its health in the second half of the year, with businesses increasingly reopening and restoring jobs and consumers increasing spending. Most economists say, though, that the lingering effects of the job losses and likely business bankruptcies will take longer to overcome, especially if a second wave of the coronavirus erupts. Analysts generally believe the economy won't manage to sustain a solid recovery until a vaccine is widely available.

And until Americans resume spending at something close to their previous levels, jobs won't likely return in a significant way. Data from Chase Bank credit and debit cards shows that consumers have slowly increased their

spending since the government distributed \$1,200 stimulus checks in mid-April.

But most of that increase has occurred in online shopping. Spending in regular brick and mortar stores, which makes up the vast majority of consumer spending, is still down 35% from a year ago, according to Chase, after having plummeted 50% at its lowest point.

4. TD's Q2 credit losses top \$3B

[May 28, 2020] TD Bank Group reported its provisions for credit losses soared to nearly \$3.22 billion in its second quarter as it booked a profit of nearly \$1.52 billion.

The bank's provisions for credit losses were up from \$633 million in the same quarter last year as the Covid-19 pandemic tore through the economy.

TD reported Thursday its profit for the quarter ended April 30 totalled 80 cents per diluted share, down from \$3.17 billion or \$1.70 per diluted share a year ago.

On an adjusted basis, the bank says it earned 85 cents per share in its most recent quarter, down from \$1.75 in the same quarter last year.

Analysts on average had expected an adjusted profit of 89 cents per share for the quarter, according to financial markets data firm Refinitiv.

TD chief executive Bharat Masrani said the bank began the crisis from a position of strength, with a high quality balance sheet and strong liquidity and capital positions.

"The bank will continue to help our customers, colleagues and communities as we work to recover from the current crisis and work with governments, regulators and other stakeholders to rebuild our economies," Masrani said in a statement.

TD said its Canadian retail banking operations earned \$1.17 billion in the quarter, down from nearly \$1.85 billion in the same quarter a year ago.

Provisions for credit losses in the Canadian retail business totalled \$1.15 billion, up from \$280 million a year ago as the economic outlook deteriorated. The bank's U.S. retail income, which included its U.S. retail bank and its investment in TD Ameritrade, totalled \$336 million, down from \$1.26 billion in the same quarter last year.

Wholesale banking, which includes the bank's capital markets and investment banking operations, earned \$209 million, down from \$221 million a year ago. TD's corporate segment lost \$202 million for the quarter compared with a loss of \$161 million in the same quarter last year.

5. U.S. GDP falls faster than expected in Q1

[May 28, 2020] The U.S. economy shrank at an even faster pace than initially estimated in the first three months of this year, with economists continuing to expect a far worse outcome in the current April-June quarter.

The Commerce Department reported Thursday that the gross domestic product, the broadest measure of economic health, fell at an annual rate of 5% in the first quarter, a bigger decline than the 4.8% drop first estimated a month ago.

It was the biggest quarterly decline in more than a decade, since an 8.4% fall in the fourth quarter of 2008 during the depths of the financial crisis.

The downward revision to first quarter GDP reflected weaker investment by businesses in their inventories which was partially offset by slightly stronger consumer spending.

Economists believe the lockdowns that shut wide swaths of the economy and triggered the layoffs of millions of workers will send the GDP sinking at an annual rate of 40% in the current quarter. That would be the biggest quarterly decline on records that go back to 1947. It would be four times the size of the previous decline set back in 1958.

Many forecasters believe growth will rebound sharply in the July-September quarter with the Congressional Budget Office predicting GDP will rise at an annual rate of 21.5%. Still, that gain would not be nearly enough to make up for the economic output that was lost during the first and second quarters.

And many economists worry that the positive GDP performance being forecast for the second half of the year may not come about if the current efforts to re-open the economy do not go well. If the relaxing of stay-at-home rules results in a second wave of the coronavirus that could be a serious setback to efforts to get consumers out shopping again in stores and eating in restaurants.

Sung Won Sohn, a business and economics professor at Loyola Marymount University in Los Angeles, said he was forecasting GDP would grow at an annual rate of around 9% in the third quarter and 15% in the fourth quarter of this year if there is no second wave of the virus.

But he said even with those gains, GDP for the whole year will be down 5.3%. Sohn said it will take years to make up the lost GDP, noting that it took over six years for the economy to climb back to where GDP output was before the start of the last years.

The Trump administration, which had been counting on a strong economy to give President Donald Trump a big boost in his re-election battle, has been talking up the coming rebound.

Calling it a “transition to greatness,” the president envisions strong growth in the second half of the year.

“You’re going to see some great numbers in the fourth quarter, and you’re going to end up doing a great year next year,” Trump said recently.

But Sohn and other economists say that the economy will likely not achieve sustained GDP gains until a vaccine has been found and it is widely available, something that could still be a year or more away.

“I think there is a pretty good chance there will be a second wave of the virus,” Sohn said. “Just because we have a vaccine doesn’t mean we will stop the virus in its tracks because of the amount of time it will take to get people vaccinated.”

The GDP report Thursday was the second of three estimates for the first quarter. The 5% decline followed a 2.1% gain at an annual rate in the fourth quarter of last year.

For the first quarter, consumer spending, which accounts for 70% of economic activity, fell at an annual rate of 6.8%. It was the biggest quarterly decline since an 8.7% fall in the second quarter of 1980 but was still a slight improvement from the government’s first estimate of an even bigger 7.8% decline.

Businesses decisions to slow their inventory restocking trimmed 1.4 percentage-points from GDP in the first quarter, three times the initial estimate of a 0.5 percentage-point drag from restocking cutbacks.

Business investment in new plants and equipment fell at an annual rate of 7.9% in the first quarter, a slightly smaller decline than first reported, while residential construction increased at an 18.5% rate, slightly slower than first estimated.

6. When will federal relief programs end?

[May 27, 2020] The federal government is in talks with business and labour groups to figure out the future of billions in emergency aid, Prime Minister Justin Trudeau said one day after a warning that current spending was sustainable for only so long.

Emergency federal aid to date is approaching \$152 billion in direct spending, which has pushed the deficit to an estimated \$260 billion this fiscal year.

Parliament’s spending watchdog told a Senate committee Tuesday that current spending levels would limit the government’s ability to provide needed stimulus money during a recovery.

Budget officer Yves Giroux also said emergency programs had to sunset or else the country could be looking at tax levels not seen for generations.

Speaking outside his Ottawa residence Wednesday, Trudeau said some of the aid programs will have to be phased out.

Others, he said, would need to continue or be tweaked to aid in a recovery.

“We are still very much in the emergency phase, in the crisis phase of this, even as we’re seeing careful reopenings,” Trudeau said in response to a reporter’s question.

“We will, however, look very carefully at how we end certain programs, how we modify others in order to get our economy going again to where it was before (the pandemic) or even better.”

In his opening remarks, Trudeau seemingly previewed his thinking on the issue. He said fewer people would need help through the Canada Emergency Response Benefit as businesses reopen and workers are rehired, possibly with help from a federal wage subsidy.

The most recent CERB figures show more than \$41 billion in benefits paid to 8.25 million people, pushing further beyond its \$35-billion budget.

The first cohort of CERB recipients will max out their benefits the first week of July, raising questions about what to do with those who still don’t have a job, or those who can’t qualify for employment insurance.

“The focus of the next phase of the CERB has to be about those individuals and also create incentives to work for those individuals where some job may be available for them,” said Parisa Mahboubi, a senior policy analyst with the C.D. Howe Institute.

“The way that the CERB is designed may discourage them from accepting the job or looking for any job.”

A group of experts convened by the think tank recommended the government consider extending CERB eligibility beyond the July cutoff, but turn it into an income-tested benefit for those who go back to work.

Treasury Board President Jean-Yves Duclos told a midday press conference the CERB would likely lead to another support measure because something new will be needed to create a smoother recovery phase. What that might look like, he didn’t say.

Having greater transparency about support programs would help Canadians determine if money is being spent well, and maintain the credibility of aid programs while deterring fraud, said Toby Sanger, director of Canadians for Tax Fairness.

“You would just have better designed programs,” he said. “There could be better third-party judging of how well these programs have worked or haven’t worked.”

He cited a request from his group and others for public details on companies that receive federal support, such as through the \$73-billion wage subsidy program.

Federal figures showed there have now been 181,883 unique applicants approved for the wage subsidy, which covers 75% of wages up to a maximum of \$847 per week for each eligible employee.

The total value of benefits paid stands at \$7.9 billion.

Trudeau urged companies to sign up for the wage subsidy during his opening statement, echoing his request for landlords to use a commercial rent assistance program that opened for applications this week.

That program offers forgivable loans to cover half of monthly rents in April, May and June, as long as landlords drop rents by at least 75% over the same period for eligible small businesses.

Giroux estimated the net federal cost of the program at \$520 million this fiscal year. The budget officer's report released Wednesday morning put caveats on that estimate, owing to the lack of clear precedent for this kind of program.

His report said that means the assumptions about industry eligibility and uptake by landlords "rely heavily on judgment."

7. CMHC forecasts big declines in house prices, sales

[May 27, 2020] Canada's housing sector will see a retreat in prices, sales and building in the months ahead and likely won't see a return to pre-pandemic levels until at least the end of 2022, said Canada Mortgage and Housing Corp. in an outlook released Wednesday.

The federal housing agency sees pressure on the sector as it doesn't see any quick 'V' shaped recovery. Instead, in a best case, CMHC said it could come back in a somewhat slower "U" shape while its more pessimistic scenario is a more flat, prolonged "L" shape.

"We don't expect this to be a very quick recovery," said Bob Dugan, chief economist for CMHC in a conference call.

CMHC said average housing prices could fall anywhere from 9% to 18% in its forecast, and as much as 25% in oil-producing regions. In the faster recovery scenario, prices could start to recover by mid-2021, while a slower recovery prices might not be back to pre-Covid-19 levels at the end of 2022.

The more pessimistic scenario could see deferred mortgages turning into foreclosures if the job market doesn't recover and bank loan losses increase, Dugan said.

“If there’s enough foreclosures and banks are taking losses because of this, it could affect their willingness to lend and it could lead to a bit of a freezing up of liquidity in lending markets,” Dugan said.

Pressure on prices will come as sales drop, with an expected 19% to 29% decline in sales from pre-COVID levels this year as job losses affect buying decisions.

“Households, when there’s so much uncertainty, they tend to be more cautious on purchases,” said Dugan.

He noted that job losses are already worse than perceived in the official 13% unemployment rate for April, as it would be closer to 20% if all the people who have left the job market since the outbreak began were factored into the rate.

Uncertainty in the housing market will also affect new home building, which could see declines of between 50% and 75% this year compared with pre-Covid-19 levels before starting to rebound next year.

The forecast is more pessimistic than what Canadian banks have forecast.

National Bank said Wednesday that it expects a drop of about 10% in prices. Home price declines will be somewhat limited because the job losses are concentrated in sectors that generally have lower rates of home ownership, a report said

The bank does, however, see pressure on the market because interest rates were already so low before the crisis started that central banks have little policy room to manoeuvre, while drops in tourism could also put pressure on the economy and push what had been short-term rentals onto the housing market.

Other banks have provided a range of forecasts since the pandemic hit Canada in mid-March.

CIBC said in early May that it expects home prices to have fallen between 5% and 10% compared with 2019 levels before starting to recover, while TD Bank said in late April that it still expected home prices to rise by 6.1% this year.

Dugan said there is a great deal of uncertainty overall so it’s hard to give a precise forecast and CMHC may be basing its forecast on different data than used by the banks.

“Our forecast is a little on the pessimistic side...it is just a very tough time for the economy,” Dugan said. “There are a lot of mortgage deferrals, there’s a very high level of unemployment, so I don’t know if our forecast factors in more recent data on the economy.”

8. New pandemic measures to result in larger federal deficit

[May 26, 2020] Parliament's spending watchdog says the estimated deficit for the year has likely risen to about \$260 billion, leaving the government with little fiscal firepower to stimulate an economic rebound.

Budget officer Yves Giroux previously estimated the federal deficit at \$252.1 billion this fiscal year on account of a sharp increase in spending on emergency aid and a subsequent drop in economic activity related to the COVID-19 pandemic.

Speaking to the Senate finance committee Tuesday, Giroux said the government has added about \$7.6 billion in spending since his last report, pushing the potential deficit ever deeper.

Giroux said that level of spending isn't sustainable for more than a few years. He said emergency aid would have to eventually sunset; "otherwise we'll be looking at a level of taxation that's not been seen for generations in this country."

Federal finances could be helped by an economic recovery that would lower the deficit, which Giroux said is feasible alongside balanced, or close to balanced, budgets.

But to get the economy to lift-off speed, as Giroux has said, will require stimulus spending because of the number of businesses already saying they won't survive the pandemic.

"It's quite clear right now that there will be some need for stimulus measures. We just don't know their magnitude, their scope and which sectors will need more particular assistance," Giroux told the committee.

Spending would have to be very targeted because, he said, "there's not that much firepower left without incurring significant, structural deficits."

Federal spending to date has topped \$151.7 billion, with \$40.33 billion going to 8.21 million people through the Canada Emergency Response Benefit. There is \$5.7 billion more flowing through a wage subsidy program, according to the most recent figures posted online.

The federal New Democrats have used the \$2,000-a-month CERB as an example of why the country should move to a basic income program. Bank of Canada governor Stephen Poloz in a recent interview suggested a CERB-like measure could help the country more easily respond to economic shocks in the future, particularly with little room for the bank's monetary policy to help. Giroux said a basic income program — generally a no-strings-attached transfer to citizens, often in lieu of myriad targeted benefits — could have lessened the need for the CERB, though not the wage subsidy.

The last time the PBO looked at basic income, it estimated the federal cost at between \$76 billion and \$86 billion annually.

Giroux said his office will provide an updated cost for the concept in the coming weeks. A basic income would make some federal programs redundant, leading to some savings, but Giroux said early analysis suggests the net cost to be in the billions of dollars.

Poloz was scheduled to testify before the same committee.

The bank has not put a firm number on its economic outlook, providing a best- and worst-case scenario for the foreseeable future, citing uncertainty about the course of the pandemic.

Giroux said the federal government could easily do the same thing so Canadians would have an idea about the course of federal finances. He urged the Liberals to table a fiscal update.

He added that his office will update its estimates of federal finances, including the deficit and debt, sometime in June.

9. Economic collapse may be close to bottoming out: report

[May 26, 2020] Economic forecasts for 2020 continue to deteriorate, but there are signs that the worst may be over soon, Fitch Ratings says.

In a new report, the rating agency cut its forecast for global GDP in 2020, citing continued deterioration in the data flow for a number of major economies.

“World GDP is now forecast to fall by 4.6% in 2020 compared to a decline of 3.9% predicted in our late-April [forecast],” Fitch chief economist Brian Coulton said.

“This reflects downward revisions to the eurozone and the UK and, most significantly, to emerging markets excluding China,” he added.

Fitch now expects Canada’s GDP to drop by 7.1% this year, before rebounding by 3.9% in 2021.

Its forecast for the eurozone now sees GDP falling by 8.2% in 2020, down from its previous call for a 7.0% decline.

For the U.K., Fitch now sees a 7.8% contraction this year, and it expects output in the emerging markets (ex. China) to fall by 4.5% this year.

Fitch said that its forecasts for 2020 GDP growth for China, the U.S. and Japan are unchanged, and that there are now signs that “the collapse in global economic activity may be close to bottoming out.”

In particular, Fitch reported that initial monthly indicators for May point to improvements as lockdowns started to be eased.

Fitch noted that global macroeconomic policy stimulus has increased over the past month or so.

“We predict that global quantitative easing (QE) will reach US\$6 trillion in 2020, equivalent to half of the cumulative QE purchases by the Fed, ECB, Bank of England and Bank of Japan combined in 2009-2018,” the rating agency said.

“This explosion in central bank liquidity has helped to secure a pick-up in bank credit to the real economy (specifically, to firms) in the past couple of months, a development that contrasts with the pattern in 2009.”

While the recovery will likely prove bumpy, Fitch expects a rebound in global GDP in 2021.

“We foresee a ‘technical’ pick-up in global GDP growth to 5.1% in 2021 — with U.S. and eurozone output rising by around 4% — but pre-virus levels of GDP are unlikely to be reached until mid-2022 in the U.S. and significantly later in Europe,” Coulton said.

However, Fitch also warned that an aggressive second wave of Covid-19 that results in renewed lockdowns “would lead to an even worse outcome.”

“Our downside scenario sees GDP falling by 12% in the U.S. and Europe in 2020 and global GDP down by more than 9%,” Fitch said.

10. Pandemic relief efforts creating economic trade-off, warns Poloz

[May 25, 2020] Canada’s response to the Covid-19 pandemic will “clearly lead to higher indebtedness” once the economic shock has passed, Bank of Canada governor Stephen Poloz warned Monday.

Poloz pointed to a drop in interest rates that would normally boost near-term economic growth through greater borrowing — but such borrowing will add to debt levels the central bank has previously warned about.

That can lead to slower economic growth and make it more difficult for the central bank to hit its 2% inflation target in the future.

It can also increase the risk that a future negative shock will have a magnified effect on the economy, Poloz says.

He says the bank is developing new tools to evaluate this trade-off between faster growth today and slower growth down the road.

Poloz made the comments as part of a speech looking back on his time as Canada’s top central banker, which officially comes to an end next week, and look ahead at the economic climate his successor, Tiff Macklem, will face.

“Some of the financial vulnerabilities already present in the economy will have grown worse, and other sources of vulnerability are likely to emerge,”

Poloz said in the speech, the text of which was released by the bank Monday afternoon.

“We are truly entering unknowable times.”

It wasn't long after Poloz first took over from Mark Carney, who had Macklem as his second-in-command, that the bank's key interest rate in 2015 dropped to 0.5% in response to an oil price shock.

The rate started to rise again two years later, eventually hitting 1.75%.

Then the pandemic struck Canada hard in March, compounding declining oil prices.

Over the course of the month, the central bank cut its policy interest rate to 0.25% — the lowest Poloz says it can go — and began an unprecedented purchasing spree to help ease constraints in financial markets and allow governments to fund massive support programs.

Poloz says the dominant concern at the bank was the risk that deflation could emerge without such aggressive actions, then combine with existing debt to fuel an economic depression.

“The downside risks were sufficiently dire that there were no relevant trade-offs for monetary policy-makers to consider,” the text of his speech reads.

“Picture the pandemic creating a giant deflationary crater in the middle of the economy; it takes what looks like inflationary policies to offset it.”

Things seem to be working well, he says.

Poloz says the central bank will have to provide “significant monetary stimulus” as the economy begins to rebuild, although it's unclear how much and for how long.

“The actions taken to counter the effects of the pandemic will clearly lead to higher indebtedness, for governments in particular,” he says.

“Getting the economy back onto its growth track — which is what is required if we are to hit our inflation target — is the surest means of servicing those debts over time.”

11. Return to fiscal stability is critical for investor confidence, report says

[May 25, 2020] Like many countries, Canada has opened the spigots on spending to help cushion the economic impact of the Covid-19 outbreak.

Now, as the economy begins restarting, it's critical that policymakers plan out a return to fiscal stability and commit to maintaining low, stable inflation, says the C.D. Howe Institute.

A report from the Toronto-based think tank's Covid-19 crisis working group said that, while the federal government rightly abandoned its fiscal anchors to

address the immediate, severe effects of the pandemic, Canada will emerge from the first wave of the crisis with very high public and private debt levels — and will be increasingly dependent on investors to finance that debt.

As a result, the working group said it will be critical to maintain investor confidence so debts can continue to be financed “at a reasonable cost.”

To that end, it said, “measures to stabilize finances and restore fiscal sustainability in the medium to long-run are critical.”

If the economic recovery proves sluggish as the economy starts reopening, there’s a risk that temporary, emergency programs will become viewed as more permanent, “turning one-off deficits into structural deficits”.

“Should that be the case, investors will become concerned with fiscal sustainability, Canadian dollar denominated debt will become riskier, and borrowing costs could increase rapidly,” the report noted.

To mitigate that risk, the report recommended that governments set out how they intend to wind down the temporary support programs that were adopted in the face of the pandemic, “as part of a transparent plan to stabilize public finances over the medium term.”

The group also recommended that if the country faces a second wave of Covid-19, comprehensive lockdowns should not be repeated.

“Placing the economy in a partial coma made sense during the first wave of the pandemic, but if there is a second wave, a second economy-wide shutdown should be avoided in favour of more targeted approaches that are effective and avoid further erosion of public finances and the risk of hitting debt walls and loss of borrowing capacity,” it said.

Additionally, the report indicated that, on the revenue side, governments will likely need to look beyond tax hikes to ensure a return to more sustainable finances.

Longer term, the revenue-sharing arrangements between the various levels of government (federal, provincial and municipal) should also be reviewed, the report said, “to promote a closer alignment of revenue generating powers with the delivery of public services.”

Alongside fiscal rehabilitation, the report also stressed the importance of reaffirming Canada’s low and stable 2% inflation target.

By recommitting to the inflation target, the Bank of Canada “would retain ample latitude to increase its balance sheet over the next couple of years to support the economy and the financial system in a deflationary environment but provide assurance that it will promptly move to deal with any inflation that may emerge later as global supply chains are reorganized,” it said.

Have a nice and fruitful week!

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