

A Primer on the Federal Fiscal Response to COVID-19 in Canada

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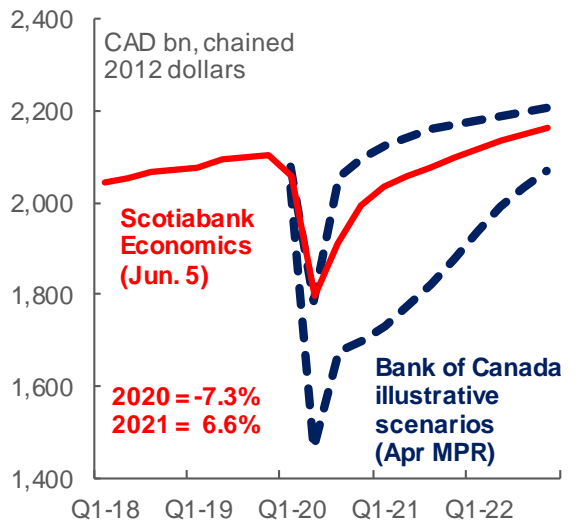


Anticipating the Federal Economic & Fiscal Update

- On July 8th, Federal Finance Minister Morneau will provide the first economic and financial update since the onset of the pandemic
- A “V” shaped recovery is the likely baseline as the Ministry relies on private sector forecasters
 - ...but with an abundance of downside risks flagged, ranging from growing COVID-19 cases in the US to renewed trade tension, and other geopolitical risks
- Discretionary pandemic-related spending (last tallied at \$174 bn) likely to surge above \$200 bn against a variety of pressures and contingencies
- Deficit likely to surge above 14% of GDP (versus PBO projections at 12%) for 2020
- Federal net debt (accumulated deficit) likely closer to 48% of GDP (relative to a pre-crisis 30.6%)
- No fiscal anchor likely beyond downward debt as a share of the economy...for now
- In short, nothing expected to move markets

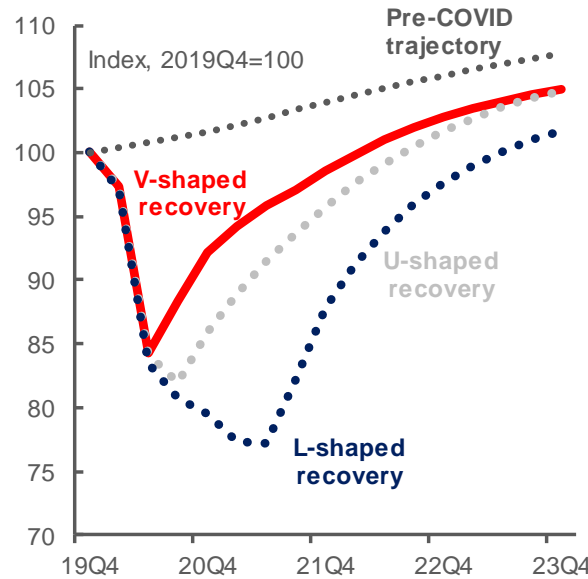
Calibrating Fiscal Policy to a Range of Potential Outcomes

Range of Scenarios for Canadian GDP



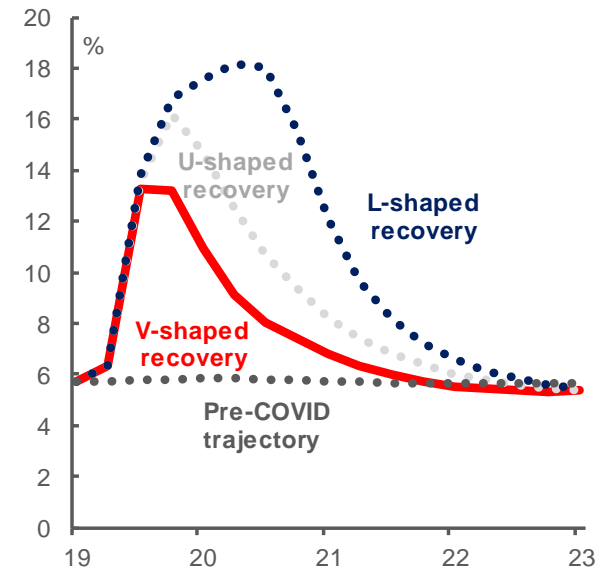
Sources: Scotiabank Economics, Bank of Canada.

Canadian Real GDP



Sources: Scotiabank Economics.

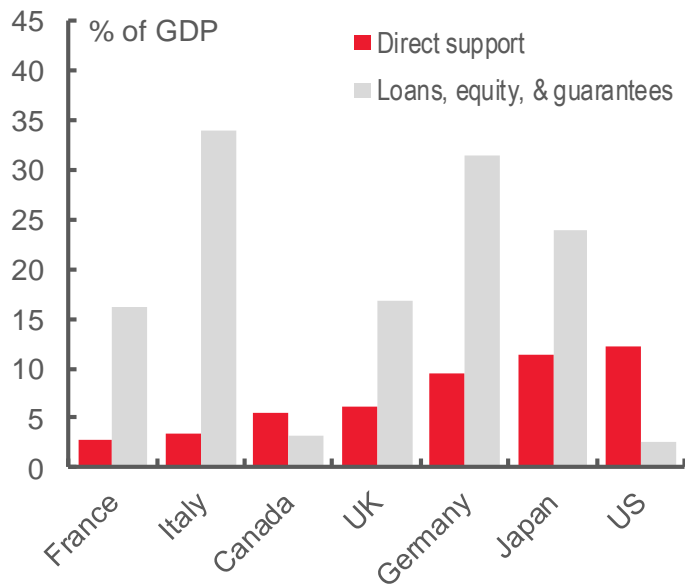
Canadian Unemployment Rate



Sources: Scotiabank Economics.

Federal Response Middle-of-the-Pack

G7 Fiscal Response to COVID-19



Note: Fiscal response data up to June 12th. Loan deferrals not included.

Sources: Scotiabank Economics, IMF.

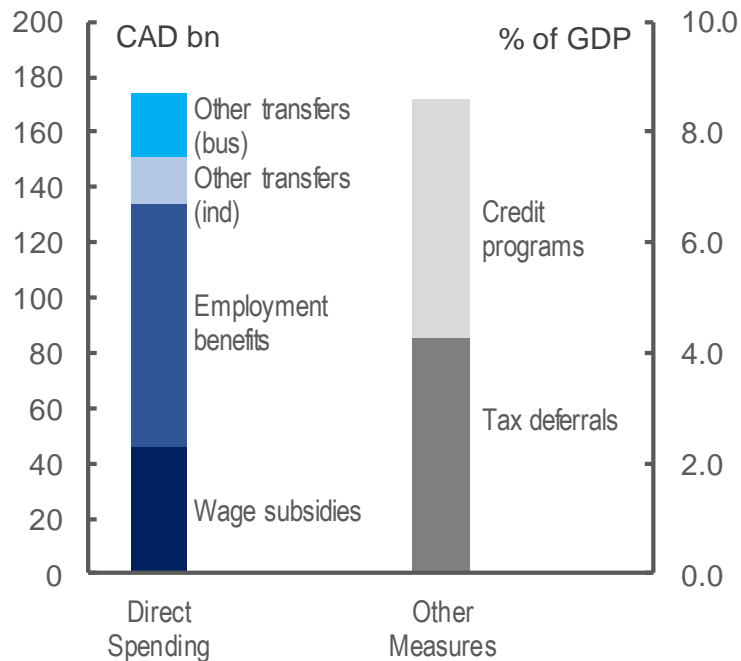
- Canada's federal fiscal response more heavily weighted towards **direct transfers** to business and households relative to most G7 (except the US)

	CAD (bn)	% of GDP
Health supports (incl. \$14 bn to P/T still under negotiation)*	\$19	0.9%
Direct transfers to households & businesses*	\$174	8.3%
Tax deferrals	\$85	4.0%
Credit support (not incl. BoC, CMHC, OSFI, FIs)	\$86	4.1%

* deficit-financed est. (CAD193 bn)

Bulk of Support Targeting Employment

Federal Government Fiscal Support

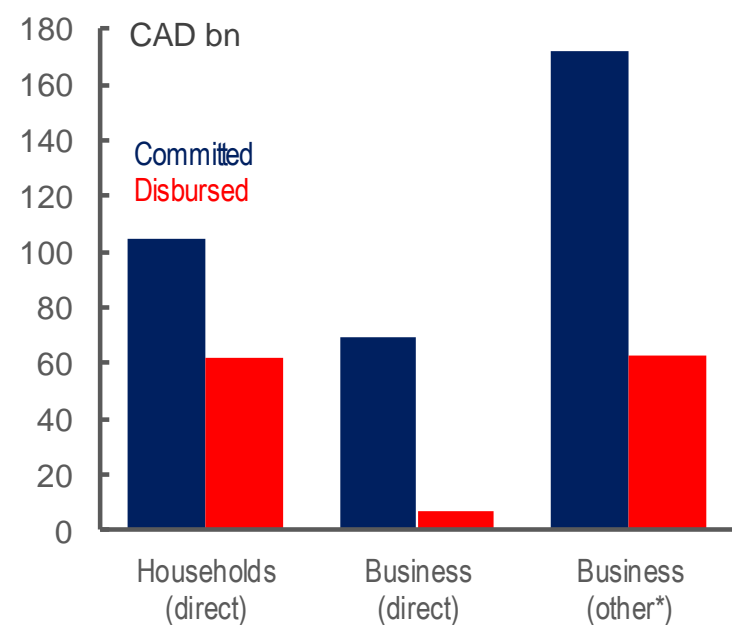


Sources: Scotiabank Economics, Government of Canada.

- Three quarters of direct spending supporting employment:
 - \$80bn in employment benefits (Canada Emergency Response Benefit - CERB)
 - \$45 bn in wage subsidies (Canada Emergency Wage Subsidy - CEWS)

Disbursement well-underway (~50%)

Federal Government Disbursements



*Includes credit, liquidity and deferrals. Disbursements highly uncertain given limited reporting.

Sources: Scotiabank Economics, Government of Canada.

Household transfers deployed rapidly:

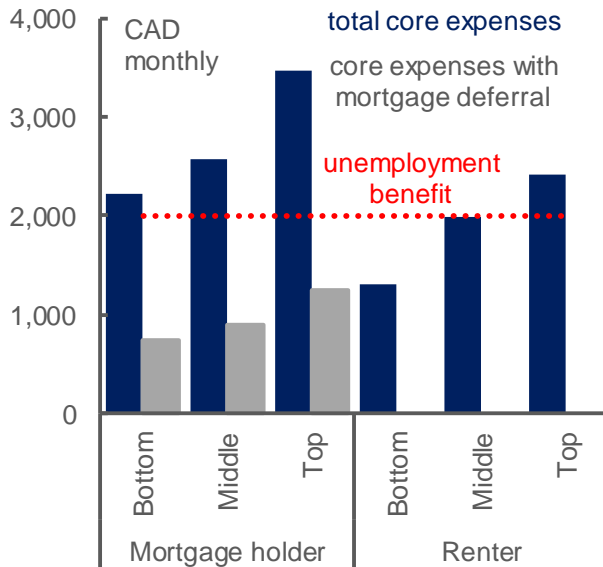
- Effective mid-March
- 8 mn Canadians received CERB (of a workforce of 19 mn)
- \$52 bn disbursed against \$80 bn planned
- Likely upward pressure on revamped income support and/or further CERB extensions

Slower uptake on wage subsidy program:

- Effective end-April
- \$16 bn paid out (to 500k businesses) against \$45 bn planned
- Uptake likely to increase with re-openings
- *Limited data on other programs but general sense is strong uptake for tax and payment deferrals; mediocre uptake for concessional loans; low uptake for non-concessional loan/equity programs*

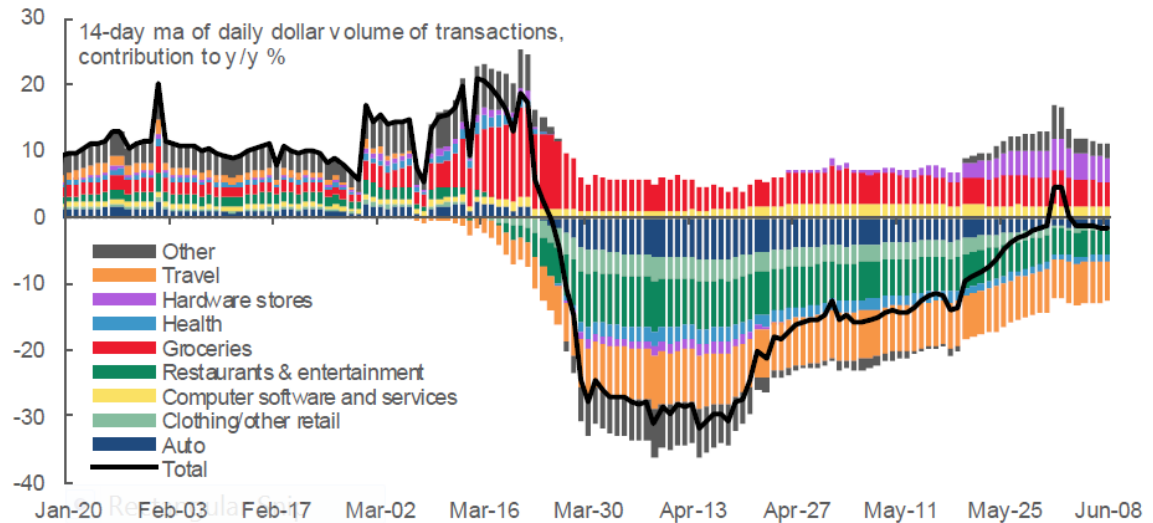
Income Support Underpinning Rebound in Consumption

Core Expenses Across Canadian Households



Sources: Scotiabank Economics, Bank of Canada.

Household Purchases (BNS Debit and Credit Patterns)



Sources: Scotiabank Economics, Customer Insights, Data & Analytics.

Fiscal Multipliers to be Amplified

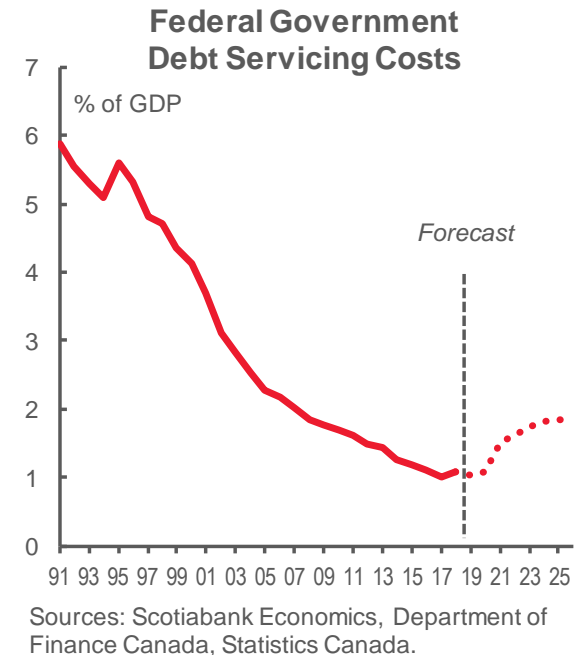
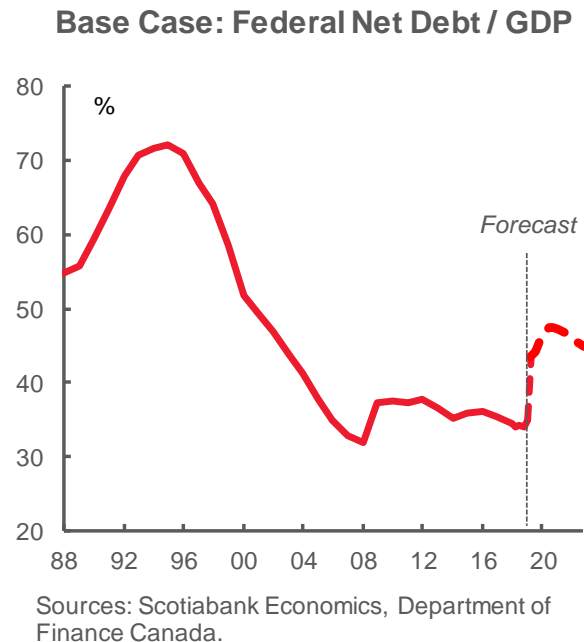
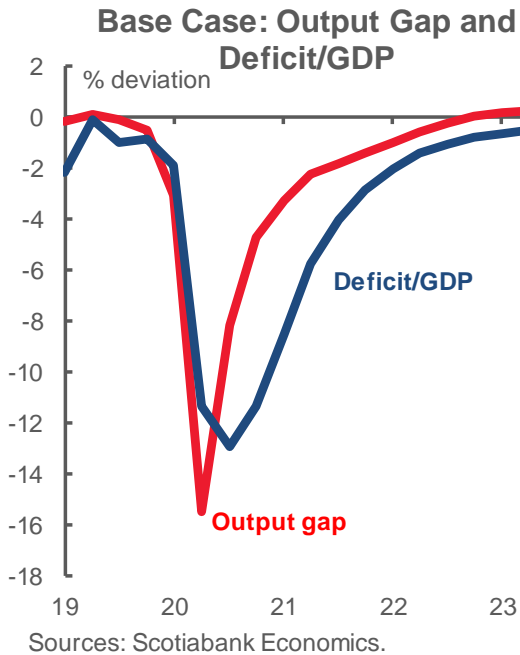
- Wide range of estimates for fiscal multipliers in Canada
- Current spending expected to have reasonable multipliers: 0.67 in 2020 and 0.80 in 2021 according to Scotiabank Economics modeling
- Income replacement in particular well-targeted to households facing income loss (& three-quarters of job losses have occurred in low-wage sectors) suggesting higher propensity to spend (as economies re-open)
- Inflation outlook suggests policy rate to remain at lower bound over course of recovery which will amplify fiscal multipliers via a lower *real* policy rate

Fiscal Multipliers: Timing, Targets and Tools Matter

% impact on real GDP	Recession (Budget 2009)		Stable (Budget 2016)	
	Yr 1	Yr 2	Yr 1	Yr 2
	FY10	FY11	FY17	FY18
Infrastructure investment	1.0	1.5	0.2	0.4
Housing investment	1.0	1.4	0.1	0.1
Measures for low-income households	0.8	1.5	0.2	0.4
Personal income tax measures	0.4	0.9	0	0
Corporate income tax measures	0.1	0.2	0	0

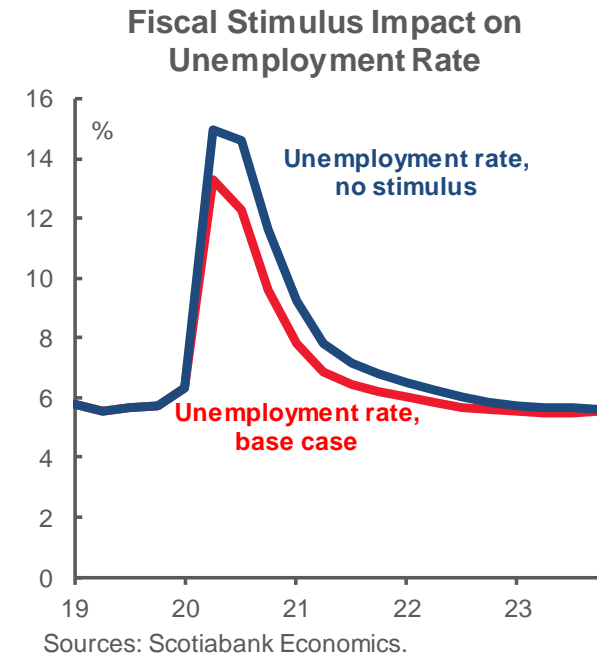
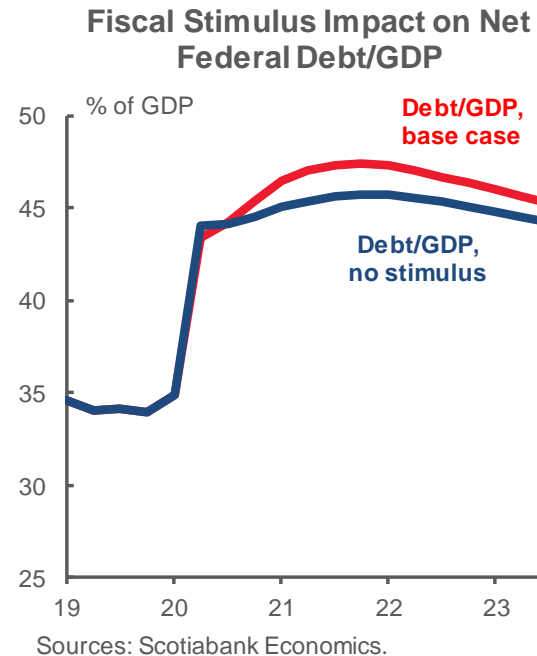
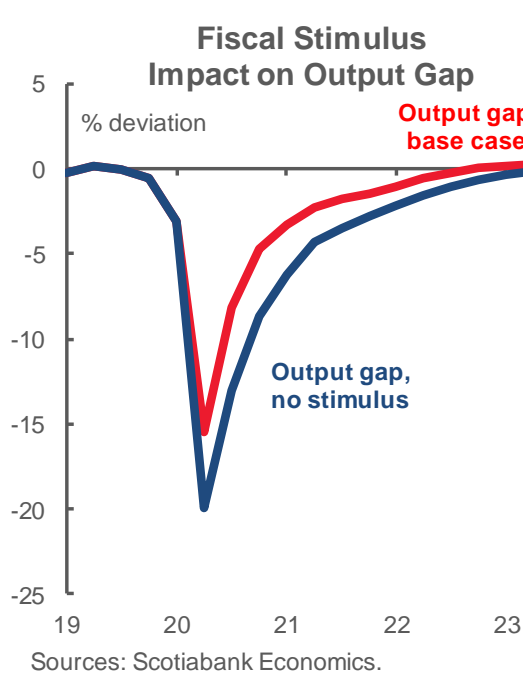
Source: Scotiabank Economics, Finance Canada.

Fiscal Position Consistent with Economic Conditions (so far...)



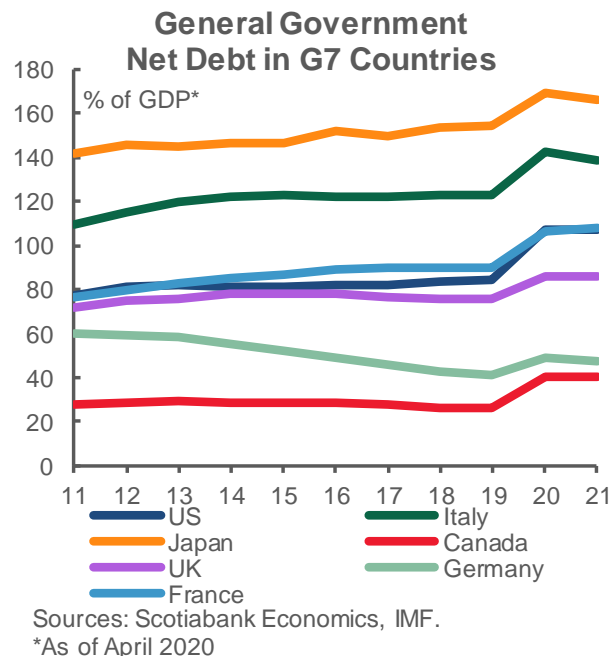
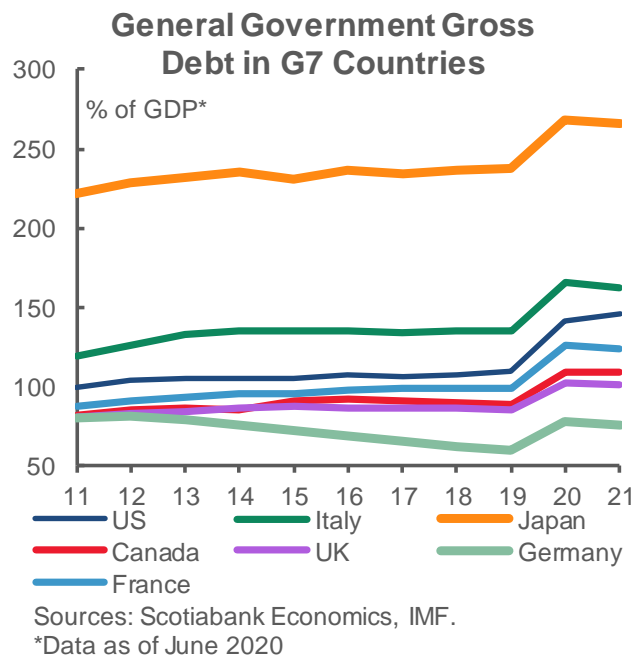
- Parliamentary Budget Officer (PBO) projects a deficit of 12.3% of GDP for FY21
- Scotiabank Economics assessment concurs, while projecting a 5% deficit in FY22 taking into account automatic stabilizers (but no additional discretionary spending)
- Current fiscal position is broadly consistent with economic conditions, i.e., anticipated path for output gap
- Step-change in federal net debt (and debt servicing) in near term, but should stabilize at relatively low levels in medium term

Federal Spending Avoiding Potentially Worse Outcomes



- Scotiabank Economics estimates a real GDP decline of -10.3% would have been likely absent current discretionary fiscal spending by the federal government while unemployment would have peaked higher
- Debt as a share of GDP would only settle on a modestly lower trajectory over the medium term (numerator and denominator effects)

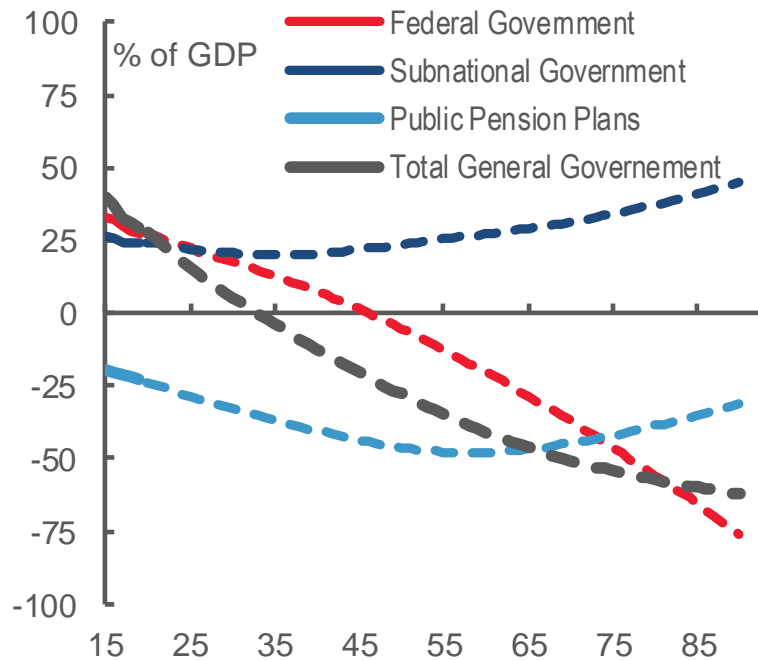
Comparative Debt Metrics Underestimate Canada's Assets



- Canada's general government gross debt (i.e., central and sub-national governments) is broadly in line with peers
- Canada's general government net debt the lowest among the G7 (notably, public pension assets including CPP and QPP offset gross debt)
 - *About half of Canada's financial assets are considered liquid according to IMF*
- Furthermore, public sector pensions (separate from public pensions) are not incorporated in gross/net debt metrics given limited data
 - *Canada broadly funds its public sector pension plans whereas it represents a liability of 50%+ GDP for some European countries such as Germany and the UK*

Federal Fiscal Outlook on Stronger Footing

Government Net Debt to GDP*

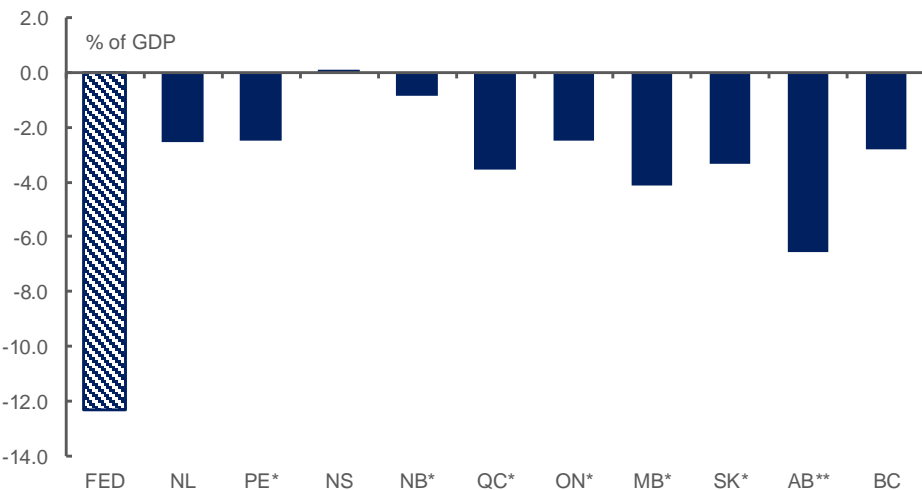


Sources: Scotiabank Economics, Statistics Canada, Parliamentary Budget Officer. *Projections as of Feb. 2020 (does not include COVID-19 fiscal impacts).

- Provinces hold more than half of Canada's general government gross debt
- Pre-pandemic projections by the PBO suggest federal fiscal position sustainable in the long run whereas provincial positions to come under pressure in light of aging demographics and health-related costs
- General government projections sustainable in the long run

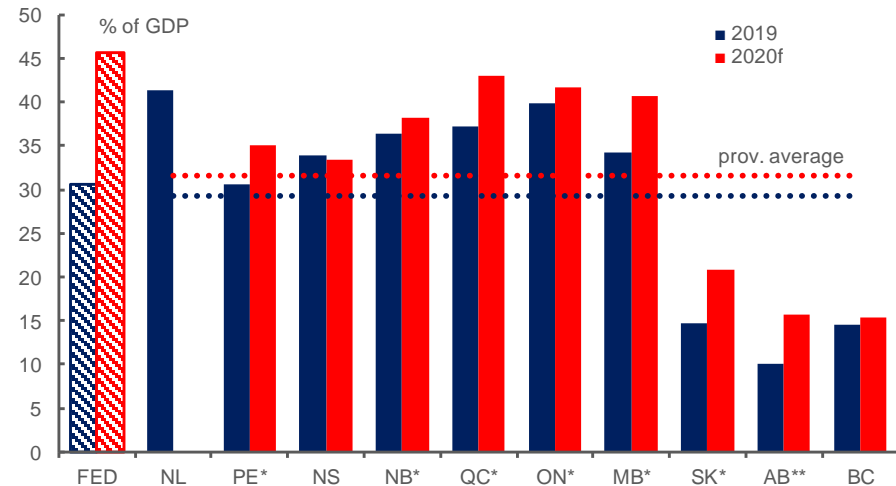
Federal Government Shouldering Brunt of COVID-19 Response

Budget Balance Projections for FY21 (% of GDP)



* Reflects fiscal updates provided by provinces where available. **Premier has stated up to a \$20bn deficit in media. Sources: Scotiabank Economics, Budget Documents, PBO

Net Debt to GDP by Province



* Reflects fiscal updates provided by provinces where available. **Premier has stated up to a \$20bn deficit in media. Sources: Scotiabank Economics, Budget Documents, PBO.

- Provinces expected to run deficits in the order of 3-4% of GDP (less or more in some cases) as a result of extraordinary federal support
- Net debt levels to increase more modestly as a share of GDP
- Active negotiations ongoing with respect to further direct transfers to provinces (with federal starting position \$14 bn), not including potential additional amounts under the Fiscal Stabilization Fund (for provinces facing large resource revenue shocks)
- Indirect support foreseeable through potentially ramped up federal infrastructure funds

Other Fiscal Pressure Points

Pressure to spend:

- Pressure to extend income support with unemployment to remain high (and old EI scheme with too many gaps)
- Pressure for larger provincial transfers (including Fiscal Stabilization Transfers)
- Possible further stimulus measures (phase 2) to secure the recovery
- Pre-pandemic election commitments still unfunded (e.g., universal pharma among others)

Versus pressure to consolidate:

- A stronger recovery could warrant a faster pace of consolidation
- Nature of fiscal supports should evolve to support stronger growth potential (versus shorter term stimulus)

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