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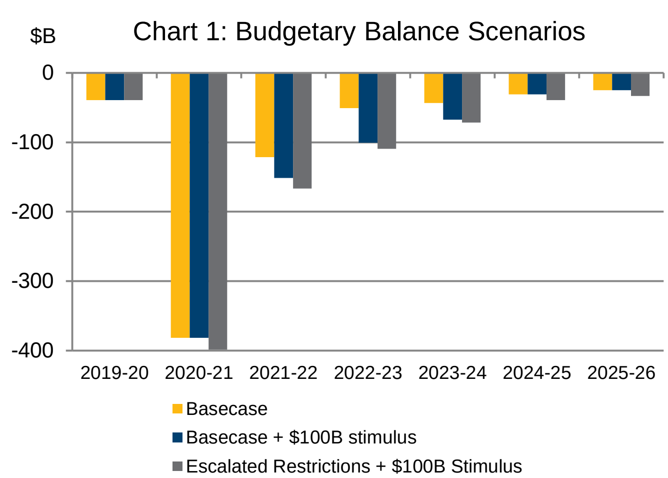
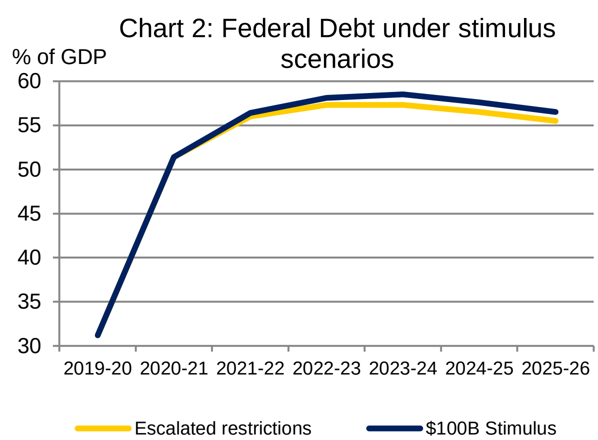
Canada Fall Economic Statement – More Emergency Support and Sizeable, Time-Limited Stimulus Post-COVID

There is a lot to talk about in the 237 pages Fall Economic Statement released today: higher deficits and debt figures, green bonds, modernization of the Fiscal Stabilization Program to Provinces, digital taxes, stock options, etc.

The federal government's central scenario based on a private sector survey conducted in September pegs the deficit for FY 2020-21 at $382B (18% of GDP), compared to the $343B estimate unveiled in July. Previously announced COVID-19 measures will end up costing $27B less-than-expected; new policies announced today will add $25B to the deficit on top of the $55B announced since July. These estimates have to be taken lightly because of the difficulty assessing the health, fiscal and economic costs associated to the pandemic. For instance, one of the two alternative downside scenarios proposed escalated restrictions leading to a real GDP contraction in 2021Q1 and a $399B deficit in FY 2020-21 (chart 1).

According to the central scenario, the deficit shrinks to $121B (5.2% of GDP) next year and $51B (2.1% of GDP) the following year. But it does not take into account the most important development of all: a $70B-to-$100B stimulus plan for the recovery after COVID-19 is under control. The time-limited amount of fiscal stimulus will depend on existing needs, guided by the labour market recovery. The newly defined "fiscal guardrails" consist of labour market statistics including hours worked, unemployment and the employment. How quickly those metrics reach pre-coronavirus levels will guide the government on the size and timing of the stimulus tailwind required. In other words, Finance Minister Chrystia Freeland will use fiscal forward guidance based on labour market outcomes, an approach similar to the inflation outcome-based forward guidance used by central bankers. We think deficits could end up modestly or moderately higher relative to the central scenario. Similarly, the federal debt-to-GDP ratio could reach close to 60% over time (chart 2).





Source: Governmentof Canada and LBS Econ. Resarch and Strategy.

Besides spending associated to vaccines purchases, medical equipment and fiscal transfers to Provinces, the other short-term priority is to provide reliable financial support to individuals and businesses. For instance, the previously announced extension of the Canada Emergency Wage Subsidy (CEWS) and the Emergency Rent Subsidy until mid-2021 will cost nearly $15B in both FY 2020-21 and FY 2021-22. The update increases the maximum CEWS rate, back to 75%.

Homeowners will benefit from a new home energy retrofit program, starting in December. Also, the government plans to create a new lending program for companies with 100% government-backed loan support: "*The government will work with financial institutions in the near term to create the Highly Affected Sectors Credit Availability Program (HASCAP) – a new program for the hardest hit businesses, including those in sectors, like tourism and hospitality, hotels, arts and entertainment.*" The program "*will provide low-interest loans of up to $1 million over extended terms, up to ten years. Rates will be lower than those offered in BCAP and beneath typical market rates for hard hit sectors*".

In terms of tax policies, Ottawa targets foreign-based big tech companies. Ottawa will notably collect the GST/HST on all kinds of digital products and services sold online starting July 1st, 2021, as well as on short-term accommodation booked on digital platforms. Ottawa expect to collect more than $6B over 5 years by taxing the digital economy. Also, effective July 1st, 2021, a $200K annual limit will apply on employee stock option grants. Start-ups companies with annual gross revenues of $500M or less will not be subject to the new limit. Also, Ottawa intends to implement a vacancy tax on unused properties owned by foreigners; the objective is to boost housing supply. Finally, the update does not include specific aid for the air transportation industry, as ongoing talks that began in early November are still underway.

More T-Bills, Green Bonds and fresh changes to the Fiscal Stabilization Program

T-Bills issuance for FY 2020-21 was revised up from $294B last July to $329B today. Fewer bonds ($374B instead of $409B) are projected to be issued. Ultra-longs will return in order to lock-in lower long term rates. Ottawa intends to issue its inaugural federal green bond during FY 2021-22. A complete debt management program will be published in Budget 2021, likely following a new round of consultations with market participants.

For provincial bond holders, the biggest single measure relates to changes to the Fiscal Stabilization Program. The per capita maximum cap jumps from $60 to $170, effective FY 2019-20. Assuming all provinces would qualify in FY 2020-21 under the 5% decline in total revenue criterion, Ottawa is poised to transfer an additional $6.5B, on top of the $24B support already offered. This modification to the fiscal stabilization program will be particularly beneficial to Alberta, Saskatchewan and Newfoundland and Labrador.

Ottawa will give $1B to Provinces to help provinces dealing with challenges in long-term care facilities. Several Premiers also seek additional health care transfers, a topic on the agenda of the November 13th meeting with Prime Minister Trudeau.

No Fiscal Anchor = Downside Risk to Canada's Credit Rating

Overall, the Fall Economic Statement focuses on handling the pandemic in the short-run by 1- supporting the economy with emergency programs; 2-announcing a time-limited $70B-to-$100B stimulus during the post-COVID recovery. If the pandemic ceases rapidly, the government will be able to use some of the untapped money to implement structural spending, namely national pharmacare and daycare programs. In a report released last year, we estimated the incremental cost related to the complete implementation the pharmacare program at $15B in FY 2027-28.

Pandemic uncertainty reduces the imminent need to set a medium-term fiscal anchor, a target guiding a responsible government for the future path of deficits and debt. However, the lack of a transparent commitment to fiscal responsibility post-pandemic may hurt Canada's credit profile. Depending on the evolution of the pandemic and the recovery, the federal debt-to-GDP ratio may end up close to the 66% record high figure observed during the challenging financial period of the early 1990s. The silver lining, for now, resides in the low financing rates available, making this $1.1T debt – and counting - a lot more affordable. Debt servicing costs represent less than 1% of GDP this year.

However, low debt servicing costs are unlikely to appease concerns from credit rating agencies. On November 19th, Moody's reaffirmed the nation's triple-A rating with a stable outlook but nonetheless had a warning: "*Diminishing confidence that Canadian policymakers will take effective action to achieve fiscal consolidation would weigh on the sovereign credit profile*". Fitch Ratings downgraded Canada last June, based in part of the compilation of debt from all government levels. Indeed, the latest IMF Fiscal Monitor estimated Canada's general government gross debt burden at 115% of GDP, not far from the average 126% ratio for advanced economies; most of them are not rated AAA. Furthermore, Fitch notes factors that could lead to additional negative rating actions, including "*failure to place consolidated gross general government debt/GDP on a downward path over the medium term*" and the "*absence of post-coronavirus fiscal consolidation strategy or weaker GDP growth*". Some of these concerns, not discussed in today's update, will hopefully be addressed in the 20201 budget.

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