Federal Economic and Fiscal Snapshot

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Highlights

- COVID-19 recession hits federal finances hard
- Post-war record high budget deficit
- Economic recovery expected but uncertainty prevails

The *Economic and Fiscal Snapshot 2020* released by the federal government outlined its financial state in the current fiscal year along with the economic backdrop. The severe economic shock from the COVID-19 pandemic made the existing budget plan obsolete. This snapshot provided a status report on the current economic and fiscal outlook to the end of 2020-21 only and was not the usual inter-budget update. Apparently, the government plans to release a full budget update in the fall.

Deficit and debt figures tend to receive the most attention and the unprecedented COVID-19 recession generated some stunning results. The budget deficit for fiscal 2020-21 will shoot up tenfold to 343.2 billion from $34.4 billion in the previous fiscal year. Relative to Gross Domestic product (GDP), the deficit surges to 15.9 per cent from 1.5 per cent in fiscal 2019-20. This is the highest share of the economy in the post-war era though below 21.2 per cent seen in 1944 and 1945.

Summary Statement of Transactions, billions of dollars

	2018-19	2019-20	2020-21
Budgetary revenues	332.2	341.0	268.8
Program expenses	322.9	350.8	592.6
Public debt charges	23.3	24.5	19.5
Total expenses	346.2	375.3	612.1
Budgetary balance	-14.0	-34.4	-343.2
Federal debt*	685.5	716.8	1,060.0
Per cent of GDP			
Budgetary revenues	14.9	14.8	12.5
Program expenses	14.5	15.2	27.5
Public debt charges	1.0	1.1	0.9
Budgetary balance	-0.6	-1.5	-15.9
Federal debt	30.8	31.1	49.1

Source: Economic and Fiscal Snapshot 2020. *Accumulated deficit

The cause of the deficit is due to lower tax revenue from the shutdown of many segments of the economy to slow the spread of the virus and the large drop in consumer spending combined with new government spending to support the economy and population. The federal government has announced $317 billion in pandemic-related spending measures.

The federal debt will break through one trillion dollars or 49.1 per cent of the economy in the current fiscal year, up from 31.1 per cent in fiscal 2019-20. Relative to GDP, the current fiscal year projection would be the highest since 1999. The post-war high was set in 1995-96 at 66.8 per cent though it was more than 100 per cent following WWII. Canada's pre-pandemic fiscal capacity was at a favourable starting point, and with very low borrowing costs, the fiscal situation is not as dire as it may appear.

Public debt charges decline in the current fiscal year to $19.5 billion, or 0.9 per cent of GDP, compared to $24.5 billion or 1.1 per cent of GDP in the prior fiscal year. The government forecasts current low interest rates to prevail through the projection period.

Economic Outlook

Canada's real GDP is projected to contract by 6.8 per cent this year before rebounding 5.5 per cent next year. This would be the worst economic recession since the Great Depression and more than twice as severe as in 2008-09 due to the Great Financial Crisis. The average of private sector economic forecasts is used as the basis for fiscal planning.

In the second quarter of 2020, their forecast expected real GDP to fall by 41 per cent on an annualized basis

Economic Forecasts for Fiscal Projections

	2019	2020	2021
Real GDP growth	1.7	-6.8	5.5
GDP inflation	1.9	0.5	2.2
Nominal GDP growth	3.6	-6.3	7.9
Nominal GDP level (billions of dollars)	2,304	2,158	2,328
3-month treasury bill rate (%)	1.7	0.5	0.3
10-year government bond yield (%)	1.6	0.8	1.0
Exchange rate (US cents/C$)	75.4	72.4	73.8

Source: Economic and Fiscal Snapshot 2020 with a 32 per cent annualized rebound in real GDP in the third quarter. However, third quarter growth forecasts diverge widely, reflecting uncertainty around the pace of rehiring and investment, rebound in consumer and housing activity, and a pickup in global trade.

The Snapshot stated that GDP would have contracted by more than 10 per cent in 2020 and unemployment would have risen by another 2 percentage points had the government not enacted its support measures.

Alternative Scenarios

Scenarios based on alternative paths of COVID-19 transmission and economic recovery were presented. A more uneven and gradual recovery scenario than the private sector forecast average has GDP contracting 9.6 per cent this year and the virus resurgence scenario later this year results in an 11.2 per cent decline in real GDP in 2020.

Main Support Measures

Canada Emergency Response Benefit (CERB)

As of June 28, the CERB has provided over $53 billion in benefit payments to 8.16 million Canadians. That amount is expected to rise to $80 billion based on the eight-week extension and significant take-up of the program. Total budgeted amount for 2020-21 is $80 billion.

Canada Emergency Business Account (CEBA)

The CEBA provides interest-free, partially forgivable loans of up to $40,000 and is offered through financial institutions in cooperation with Export Development Canada. As of July 3, 688,000 applicants have been approved for CEBA for a total of $27.41 billion in cumulative funds disbursed, including $7 billion which is forgivable if the loan is paid back before December 31, 2022. Total budgeted amount is $13.75 billion.

Canada Emergency Wage Subsidy (CEWS)

The CEWS provides a wage subsidy for eligible employers covering 75 per cent of an employee's wages, up to $847 per week. Total estimated spending is $82.3 billion in the current fiscal year. However, program take-up is reported to be around $14 billion to date due to timing and eligibility issues.

Canada Emergency Student Benefit (CESB)

The CESB is intended for students and new grads who do not qualify for the CERB or EI, and who are unable to find employment or unable to work because of COVID-19. The CESB is available for four months (from May to August 2020), and as of July 2, 2020, there were 601,356 unique applicants with $1.42 billion in benefits paid.

Additionally, 165,008 applications have been received for the enhanced benefit amount, which provides an additional $750 per month on top of the $1,250 base benefit amount to eligible students with dependents or a disability.

Total CESB budgeted amount is $5.25 billion over two years. Other programs aimed at students amount to another $4 billion.

Health and Safety

Numerous programs amounting to approximately $19.8 billion.

Tax Deferrals

Personal, business and GST/HST tax deferrals amount to $85 billion.

Credit and Liquidity Support through the Bank of Canada, CMHC and Commercial Lenders

Measures to support financial sector liquidity and market functioning to facilitate continued lending to individuals and businesses. Includes Bank of Canada actions to respond to financial system liquidity pressures and restore functioning of core funding markets. Impact is estimated at $300 billion (no fiscal implication).

Capital Relief (OSFI Domestic Stability Buffer)

Reduction by the Office of the Superintendent of Financial Institutions of the Domestic Stability Buffer by 1.25 per cent of risk-weighted assets, which has allowed financial institutions to inject up to $300 billion (no fiscal impact) in additional lending into the economy.

Commentary

The severe economic shock required a substantial and swift government response to support the population and the economy. When combined with a large drop in government revenue, the deficit and debt surged to no one's surprise. These pandemic-related spending measures are temporary, and the economy will recover and generate more revenue for the government leading to smaller budget deficits and debt increases. The time frame for this development is uncertain but likely to play out in fiscal year 2021-22 or possibly the following year should one of the alternative scenarios materialize.

Some changes to the CERB and CEWS programs are likely to make them more effective. The CERB $2,000 payment may be modified to a sliding scale that provides more incentive for recipients to return to work. Modifications to the CEWS program to encompass more businesses are also expected. Should one of the alternative economic, or virus, scenarios materialize, current government spending programs will be extended, adding to deficit and debt levels.

There is upside risk to the current fiscal plan and downside risk to the economic forecast under the base scenario due to uncertainty related to the pandemic. The fiscal plan presented did not have a forecast allowance or a contingency reserve amount, which could be $10 billion or more each. The fall budget update will present fuller budget details and a five-year fiscal plan.

The trillion-dollar debt is a record in dollar terms and garners much attention. Debt is more manageable when servicing costs are lower than the economy's growth and when tax revenues increase faster than expenses, i.e., running budget surpluses. In the medium term, smaller budget deficits are likely adding to debt. Low interest rates are expected as well. The longer-term outlook is clouded by growing demographic-related payments and a lower potential economic growth rate due partly to the pandemic and to demographics. The best remedy for long-term debt management is economic growth.

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