# Canadian Federal Government Opens the Taps (Further)

- **Today Prime Minister Trudeau announced substantial new fiscal support for the Canadian economy that builds on earlier-announced measures that had largely targeted households.**
- **Finance Minister Morneau offered further details on new measures that focus exclusively on small and medium size businesses. This includes a hefty 75% wage subsidy, $65 bn in credit provisions with concessionality, and another $30 bn in further tax and duty deferrals.**
- **The government has yet to put a price tag on the expanded wage subsidy—it could conceivably cost over $35 bn—while uptake remains unclear and it may do little for seriously stretched businesses.**
- **Furthermore, a sudden-stop removal of wage support will be challenging in three months even if business activity resumes as the stronger rebound would only take hold in the final quarter of the year.**
- **The cumulative price tag on deficit spending could surpass $140 bn, or almost 7% of GDP in FY21 with debt levels approaching 40% of GDP.**
- **Not surprisingly, this expensive price tag comes on the heels of an extraordinary monetary policy expansion announced by Governor Poloz hours earlier (see our take here).**
- **Overall, Canada is getting pretty close to doing "*whatever it takes*". But will it be enough?**

## THE MISSING PIECE OF THE PUZZLE

**Business measures had been relatively modest prior to today.** Earlier-announced fiscal measures—a $27 bn package that was later revised up to $52 bn—largely targeted households with only $3.8 bn of this prior amount supporting businesses through a 10% wage subsidy. The earlier package also offered $55 bn in tax deferrals to both households and businesses (chart 1), but the overall impact for business was arguably small relative to the size of the shock.

**Today's measures offer substantial support to small and medium size businesses.** Specifically, it acknowledges that credit alone is insufficient for many businesses facing a shutdown of an unknown duration. While yet uncosted, the 75% wage subsidy for small businesses will be substantial and match several European countries' measures. Businesses are also offered an equivalent-to-$30 bn in tax deferrals (GST/HST, import duties) through June.

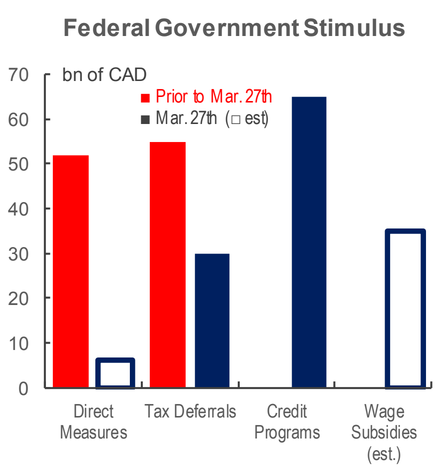
**Business will also have access to new credit sources, including some on highly concessional terms.** Small businesses will have access to interest-free loans of up to $40k, with 25% loan forgiveness if paid before the end of 2022. This will be administered by major financial institutions through the new *Canada Emergency Business Account,* with loans backed by the government. Furthermore, small and

**CONTACTS**

**Rebekah Young**
**Director, Fiscal & Provincial Economics**
416.862.3876
Scotiabank Economics
rebekah.young@scotiabank.com

**Marc Desormeaux, Senior Economist**
416.866.4733
Scotiabank Economics
marc.desormeaux@scotiabank.com

Chart 1




Sources: Scotiabank Economics, Government of Canada.

medium size enterprises will have access to up to $40 bn in additional credit through the new *Small and Medium-sized Enterprise Loan and Guarantee Program*, supported through Export Development Canada and Business Development Bank. These measures are intended to address serious cash flow constraints that businesses are facing as revenues evaporate and tightened financial conditions have fueled spikes in funding costs.

## PUTTING EMPLOYEES FIRST

**The unprecedented nature of today's shock will drive up unemployment levels—short term at least—at an unprecedented pace and magnitude.** By its own admission, the explosive uptick in employment insurance claims last week took the government by surprise. Almost one million new claims last week overwhelmed the system (chart 2), rightly prompting a rewrite of its new programs. Earlier this week, it simplified its plan for two new employment insurance programs (totaling $15 bn) into the new Canadian *Emergency Relief Benefit,* along with a $25 bn top-up. Furthermore, it will now be delivered through existing tax infrastructure (by the Canada Revenue Agency) which should simplify and expedite its delivery.

**The longer the crisis, the more likely employer-employee attachment would be severed.** At present, many laid-off employees are maintaining their attachment with their employer with a view to returning to work when business activity resumes, while tapping into new employment insurance benefits in the meantime. With today's significant wage subsidization, the government aims to strengthen the employer-employee tie over the duration of the shutdown to facilitate a return to normalcy at the earliest when the outbreak stabilizes. This wage subsidy should also help stem the massive layoffs that have been taking place and would otherwise continue as long as the shutdown persists with the recent small business surveys showing a serious plunge in hiring intentions (chart 3).

## AT ANY COST

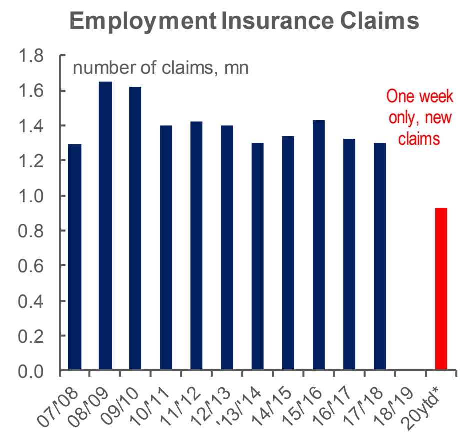
**The price tag for the wage subsidy will be hefty.** The government has not provided costing detail for this new measure, but it has indicated it will be for small and medium size businesses facing a large revenue shock and would apply for three months. The earlier-announced 10% wage subsidy for a three month period (with a $25 k per employee cap) was costed at $3.8 bn. A simple scale-up of this would bring the three-month cost to almost $35 bn.

**Alternative assumptions land in the same ballpark.** For example, the government assumes about 5 million Canadians will apply for new unemployment benefits as a result of the crisis. Annualized wages and salaries in Canada totaled about $1 tn late last year, while about 90% of the workforce is employed by small and medium enterprises. A program that targeted its presumed at-risk workforce for three months would come at a cost of around $42 bn over three months.

**In any case, it will be a challenge to design a program that minimizes the incentives for *all* small businesses to take advantage of the subsidy when it is intended to target only those facing "significant revenue reduction" according to Minister Morneau.** Exiting will also be challenging in three months. Even if the outbreak has leveled off and business activity is resuming by the summer, Scotiabank Economics' latest forecasts anticipate headwinds on a third-quarter rebound owing to lags from the serious second-quarter contraction in the US. Any extension would put a far greater price tag on the measure.

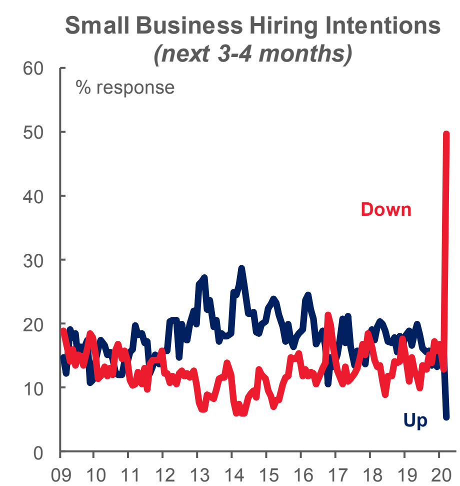
**Meanwhile, for those businesses that are *really* stretched, 25% wage costs may still be unaffordable.**

Chart 2



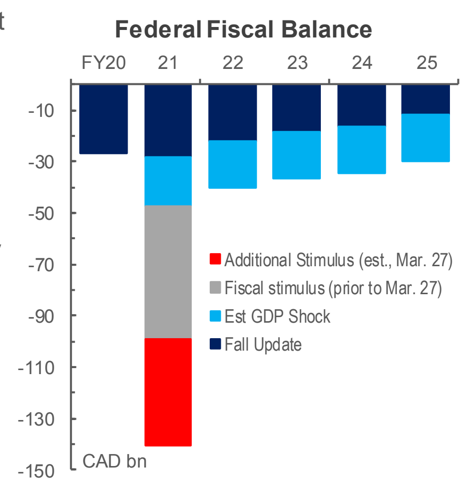

*Only reported new claims for week of March 16th
Sources: Scotiabank Economics, ESDC, CEIC.

Chart 3




Sources: Scotiabank Economics, CFIB.

Chart 4




Sources: Scotiabank Economics, PBO, Finance Canada.

## ADDING IT ALL UP

**We estimate the stimulatory component of today's package to be around $41 bn, or an additional 2% of GDP.** This includes our $35 bn estimate for the wage subsidy, along with another $6 bn in loan forgiveness on the new small business loan program. This would bring total stimulatory measures announced to date to over $90 bn, or 4.5% of GDP. Total stimulatory measures, combined with earlier-planned deficit spending, could bring annual deficit spending above 7% of GDP (or over $140 bn) in FY21 after taking into account the impact of lower GDP (chart 4). This is of course subject to considerable uncertainty given few details to date on key policy measures or current health of federal finances in light of the shock.

**This would reflect serious stimulus spending.** It would exceed deficit spending in past recessions while far exceeding spending during the Global Financial Crisis when first-year spending totalled $22 bn (FY10), or 1.4% of GDP (chart 5). It also brings it on par with some other advanced economies that are setting aside prior playbooks to provide much larger fiscal packages in response to today's shock.

**Tax deferral measure and provision for credit losses may add to the deficit down the road.** The more prolonged the outbreak (and policy-induced shutdowns), the higher probability that a portion of these items will not be repaid. On the other hand, the current shock is expected to be short-and-sharp relative to past economic retrenchments with a stronger-and-faster rebound which should moderate this risk. For our calculations, we have not included them in the fiscal balance.

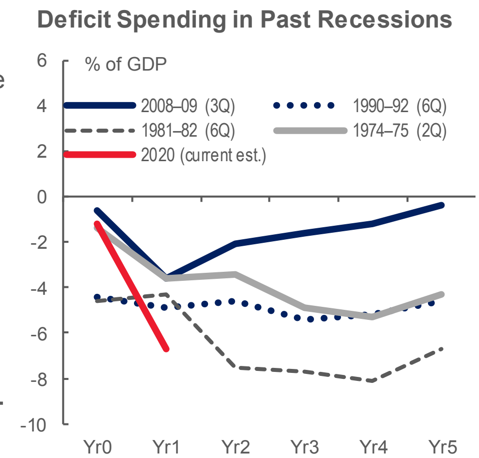
**New spending will result in a material uptick in the federal government's net debt-to-GDP.** Total estimated stimulatory spending, along with a contraction in GDP and associated impacts, could easily now push debt levels close to 40% of GDP (chart 6). This is still relatively low compared with peers, and importantly, by design, the additional fiscal pressure is temporary. The fiscal impact of a steeper and more prolonged recessionary environment would likely have a bigger (negative) impact on Canada's debt levels over the medium term absent strong fiscal action today.

## BOTTOM LINE

**The government is living up to its promise to do "whatever it takes".** Today's measures will deliver another sizable injection into the economy (even if the actual numbers are still to be revealed). Furthermore, Minister Morneau referenced "more to come" including sector-specific support for airlines and the oil industry, while additional support for provinces is not off the table.

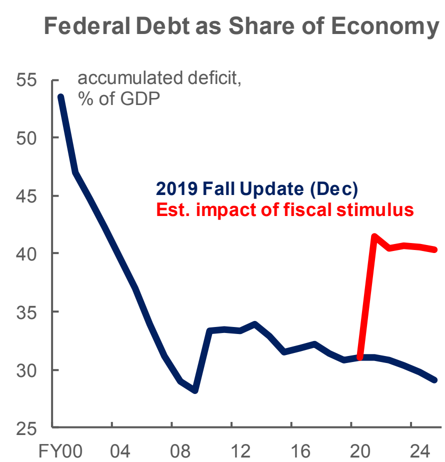
**Overall, Canada is putting serious money on the table today, complemented with unprecedented measures by the Bank of Canada to shore up the economy.** The big question is whether it will be enough in the face of a very serious (economic and health) shock.

Chart 5




Sources: Scotiabank Economics, Statistics Canada, Department of Finance, CD Howe

Chart 6




Sources: Scotiabank Economics, Finance Canada.