At a high level, how has the COVID-19 pandemic affected Canada’s economy? And what can we expect?

by Dr. Michael King

PHASE I: STOP THE PANIC IN FINANCIAL MARKETS
As the pandemic spread to North America and the World Health Organization declared a global pandemic on March 11, we saw a baring drop in stock markets. The Toronto Stock Exchange (TSE) Composite Index, which peaked on February 20 following an 11-year bull market, fell as much as 43% by March 23. The sell-off began on March 12 with a drop of 12%—a post-war record—followed by a 10% rise the next day, followed by another 10% drop. This volatility has not been seen before. Both the price of oil and the exchange rate for the Canadian dollar were hit hard as well. The Bank of Canada’s stock market index—the Standard & Poor’s (S&P) 500 Index—also fell by as much as 38%. To provide some historical perspective, the S&P 500 Index fell by more than 50% during the Global Financial Crisis from late 2007 until early 2009, then took 49 months to recover that loss. This volatility has not been seen before. Both the price of oil and the exchange rate for the Canadian dollar were hit hard as well. The Bank of Canada’s stock market index—the Standard & Poor’s (S&P) 500 Index—also fell by as much as 38%. To provide some historical perspective, the S&P 500 Index fell by more than 50% during the Global Financial Crisis from late 2007 until early 2009, then took 49 months to recover that loss.

PHASE II: ENDING THE GLOBAL LOCKDOWN
Based on the simulations from epidemiologists, up to 25% of the population was forecast to contract COVID-19 within several months, overwhelming hospitals and leading to thousands of needless deaths unless strong health measures were taken. Heeding this advice, Canada’s lockdown began mid-March with advisories to shelter at home, practice physical distancing, avoid non-essential travel and business trips, all the way to closing the border. The cost was an immediate economic shutdown for businesses and restaurants, and travel, bankruptcies and widespread job losses for millions. As public confidence collapsed, the Bank of Canada cut the overnight interest rate by 0.25%, and intervened in fixed-income markets to restore liquidity and to provide emergency funding. Canada’s government announced fiscal support of $200 billion through the Canada Emergency Response Benefit (CERB), the Canadian Emergency Wage Subsidy (CEWS) and many more fiscal stimulus programs. These actions supported confidence and put a floor under the stock market and the economy, halting the panic.

PHASE III: RECESSION AND RECOVERY
Phase III is a recession (which is certain) and a recovery (which is uncertain). The IMF has provided two sets of forecasts. Advanced economies are expected to drop by 6.1% over 2020, followed by a recovery of 4.5% in 2021. The comparable forecasts for emerging markets are -1.0% and +4.6%, respectively. The range of uncertainty is huge in any chart you might see on this subject. Confidence is a big part of that. If people believe things are getting better, their behavior could make it a self-fulfilling prophecy.

WHAT ARE THE SOURCES OF UNCERTAINTY?
Variables, such as government spending, behavioural changes, consumer demand for things like restaurants and travel, bankruptcies and unemployment—all these things could affect the shape of the recovery.

What is certain is that government debt levels will increase, creating a drag on the economy for years to come. Canadian federal debt levels are around 50% (with provincial debt pushing it to 100%). Past fiscal frugality and balanced budgets gave us the luxury of spending on the unemployed and growing public health without raising taxes. Now we are waiting nervously to see if there will be a second wave of infections, in which case the lockdown may be reimposed. Only time will tell. But we will likely have to open up and shut down multiple times in the coming months.