March 27, 2020

Economics Group

Special Commentary

Jen Licis, Economic Analyst
jennifer.licis@wellsfargo.com • (704) 410-1309
Nick Bennenbroek, Macro Strategist
nicholas.bennenbroek@wellsfargo.com • (212) 214-5636

Canada Fighting Economic War on Multiple Fronts

Executive Summary

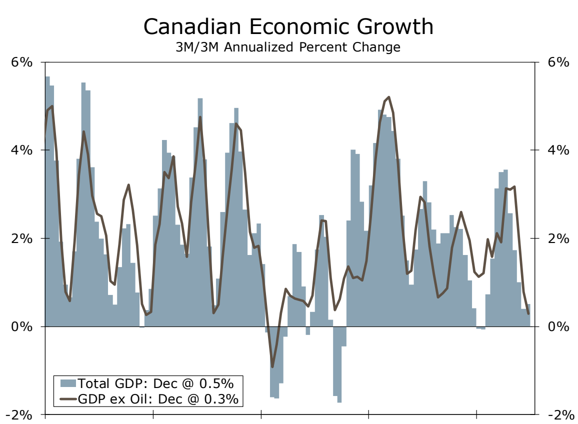
- The Canadian economy is facing a challenging economic environment as it has been hit with a one-two punch from the outbreak of the coronavirus and the plunge in oil prices. The ongoing oil price war between Saudi Arabia and Russia exacerbated an already existing over supply of oil, pushing Western Canadian oil prices to their lowest level on record. Meanwhile the economic effects of the coronavirus pandemic have created another shock to the Canadian economy.
- The Bank of Canada (BoC) slashed its policy interest rate a cumulative 150 bps during March, bringing the rate to 0.25%, and undertook a range of non-interest rate actions aimed at improving the functioning of markets or providing liquidity. Despite these efforts, we still believe the economy faces significant downward pressure and believe the risks are tilted toward further BoC easing.
- Given the current environment, we have significantly downgraded our forecast for the Canadian economy. We now expect a 3.6% contraction for the full-year 2020. In addition, we maintain a subdued outlook for the Canadian dollar, and see the risks as tilted towards further weakness.

We now expect the Canadian economy to contract 3.6% in 2020.

Outlook for Canadian Economy Darkens

The outlook has darkened for the Canadian economy given combination of the coronavirus outbreak and sharply lower oil prices. Oil prices have dropped significantly after Saudi Arabia and Russia failed to reach an agreement on oil production limits earlier this year, as well as a slump in global oil demand. As the world's fifth largest oil producer, the plunge in oil prices will likely have a significant influence on Canada's economy. The Western Canada Select grade oil price is now trading around just US$5.00 a barrel, the lowest price since at least 2008. As a result, oil companies are reducing their capital spending plans, while some have also signaled new layoffs are coming as the oil industry tries to stave off the dual threat.

Figure 1



Source: Datastream and Wells Fargo Securities

Together we'll go far

Although there is limited concrete data so far on the severity of the coronavirus outbreak on the Canadian economy, the pandemic will most certainly weigh on the growth prospects of the economy. With over 4,000 confirmed cases across the country and around 40 fatalities, the government has already taken preemptive measures such as temporarily closing its border to non-essential traffic in an effort to contain the spread of the virus.

Given the current economic environment, we now expect the Canadian economy will slump at an annualized rate of about 16% in the second quarter. In addition, we are likely to see the economic weakness in the United States contribute to the significant contraction that we expect for the Canadian economy for the full-year 2020 given that the U.S. is the most important trading partner for Canada. The economy may begin to stabilize late in 2020, though given the likelihood of persistent low oil prices any recovery in the Canadian economy is likely to be relatively gradual.

Policymakers Respond with Large Stimulus Measures

The Canadian Minister of Finance announced a large stimulus aid package.

The coronavirus outbreak, along with low oil prices, have created a serious shock to the Canadian economy. In an effort to support the flow of credit in the economy and minimize any permanent damage, the Canadian Minister of Finance announced a large stimulus aid package designed to help workers and businesses affected by the pandemic. The program includes C$55B through tax deferrals and C$52B in direct spending, which together combine to around 4.5% of GDP. Among some of the specific measures are a boost to Canada Child Benefit payments, a pause on the repayments of Canada student loans, introduction of an Emergency Response Benefit—a taxable benefit of C$2K a month for up to four months to support workers who will not receive an income as a result of the coronavirus pandemic. Some other measures include, extending the tax filing deadline for individuals to June 1, providing eligible small employers a temporary wage subsidy for a period of three months to help businesses keep their employees and providing additional assistance to low and modest income individuals and families under the Goods and Services Tax (GST) credit, delivering C$5.5B in support. That said, some of these policy measures build on action that were already taken to address the effects of the outbreak on the Canadian economy. We expect to see additional stimulus measures from the government given that it stated that it will continue to carefully monitor all developments relating to the spread of the virus, and is prepared to implement further action as required.

Bank of Canada Also Eases Policy Aggressively

The BoC slashed its target for the overnight rate a cumulative 150 bps over March.

In addition to the fiscal stimulus, the Bank of Canada (BoC) also acted to try to cushion the economy against the negative effects from the coronavirus. Most importantly, the BoC slashed its target for the overnight rate a cumulative 150 bps, including two unscheduled announcements, over the month of March to bring the policy rate to 0.25%, which the central bank has described as the effective lower bound. In addition, through most of March the BoC announced a range of steps to ensure that the Canadian financial system has sufficient liquidity through several of these programs. Among the measures the central bank adopted are:

- The expansion of its bond buyback program and term repo operations.
- Introduced a new Bankers Acceptance Purchase Facility to help support the funding market for small and medium-sized businesses.
- Acted in co-ordination with other major central banks to enhance U.S. dollar swap lines.
- Announced a new Standing Term Liquidity Facility to provide temporary liquidity support to eligible financial institutions, which will take effect from March 30.
- Introduced a new Provincial Money Market Purchase facility.

Finally, in perhaps among its most significant moves, the central bank on March 27 announced it will begin outright purchases of Canadian government securities, in line with other major central banks, to address strains in the debt market and to complement other actions taken by the BoC. While no precise total was specified for the asset purchase program, purchases will begin with a minimum of C$5B per week across the yield curve, and will continue until economic recovery is well underway. Also in late March, the BoC announced a new Commercial Paper Purchase Program (CPPP) to help alleviate strains in short-term funding markets.

Despite this broad range of policy actions, we believe the economy still faces significant downward pressure. As a result we believe the risks remain tilted toward further monetary easing, perhaps for example through increasing the pace of government bond purchases.

Canadian Dollar Slumps, Downside Risks Remain

The Canadian dollar has fallen sharply over the past month, driven in particular by the slump in oil prices and weakening global growth outlook, and to a lesser extent monetary easing measures from the BoC. Considering the dire Canadian growth outlook, and with the risks of further monetary easing, we believe the risks around our subdued Canadian dollar outlook remain tilted towards further weakness. A re-emergence of the recent U.S. dollar funding strains could be another downside risk for the Canadian currency. An eventual stabilization of oil prices and the Canadian economy could help to stabilize the Canadian currency, although we expect any recovery in the Canadian dollar to be eventual and gradual in nature.

The risks around our subdued Canadian dollar outlook remain tilted towards further weakness.

Wells Fargo Securities Economics Group

Jay H. Bryson, Ph.D.	Acting Chief Economist	(704) 410-3274	jay.bryson@wellsfargo.com
Mark Vitner	Senior Economist	(704) 410-3277	mark.vitner@wellsfargo.com
Sam Bullard	Senior Economist	(704) 410-3280	sam.bullard@wellsfargo.com
Nick Bennenbroek	Macro Strategist	(212) 214-5636	nicholas.bennenbroek@wellsfargo.com
Tim Quinlan	Senior Economist	(704) 410-3283	tim.quinlan@wellsfargo.com
Azhar Iqbal	Econometrician	(212) 214-2029	azhar.iqbal@wellsfargo.com
Sarah House	Senior Economist	(704) 410-3282	sarah.house@wellsfargo.com
Charlie Dougherty	Economist	(704) 410-6542	charles.dougherty@wellsfargo.com
Michael Pugliese	Economist	(212) 214-5058	michael.d.pugliese@wellsfargo.com
Brendan McKenna	Macro Strategist	(212) 214-5637	brendan.mckenna@wellsfargo.com
Shannon Seery	Economic Analyst	(704) 410-1681	shannon.seery@wellsfargo.com
Matthew Honnold	Economic Analyst	(704) 410-3059	matthew.honnold@wellsfargo.com
Jen Licis	Economic Analyst	(704) 410-1309	jennifer.licis@wellsfargo.com
Hop Mathews	Economic Analyst	(704) 383-5312	hop.mathews@wellsfargo.com
Coren Burton	Administrative Assistant	(704) 410-6010	coren.burton@wellsfargo.com

WELLS FARGO SECURITIES