Intelligence MEMOS

From: Don Drummond

To: Bill Morneau, Minister of Finance

Date: April 20, 2020

Re: **Debt Could Choke a Post-COVID-19 Economic Recovery**

Canadian public policy is understandably focusing on mitigating the near-term losses the shutdown associated with COVID-19 is causing to employment, income and business. And high marks must be assigned to the swiftness and breadth of action and the sensitivity to adjust policy when deficiencies surface.

At the same time, however, the policy challenge is to create the conditions to foster a strong, sustained economic recovery once the pandemic subsides. The private sector debt resulting from the policies to deal with the present may compromise the prospects of recovery. Unless carefully designed, the pending program to assist with commercial rent issues may amount to piling on.

Addressing the sharp loss in economic activity will inevitably result in debt accumulation.

There should be a debate between the balance in the public and private sectors. The pubic sector is taking on a massive amount of debt. It is generally considered that this is appropriate. The federal government at least has the borrowing capacity and interest rates are low. With a moderate debt load, it has some flexibility to work off the extra debt over time.

Many corners of the private sector have neither that borrowing capacity nor the luxury of time. The household sector is already heavily indebted, with a debt-to-income ratio over 175 percent, requiring households to devote about 15 percent of income to service that debt. The mortgage interest deferral option offered in the wake of COVID-19 is proving popular with about 500,000 Canadians applying in the first two weeks alone. The deferrals will help families cope with income losses, but there will be a reckoning. A six-month deferral on a $300,000 mortgage at three percent increases overall interest payments to $12,346, which might be worked off at a rate of $41.99 per payment.

The Canada Emergency Business Account offers an interest-free loan of $40,000 but in order to be eligible for up to $10,000 of that amount being forgiven, $30,000 must be fully repaid on or before December 31, 2022.

Despite this program and the Canada Emergency Wage Subsidy that covers up to 75 percent of certain labour costs, Canadian businesses have made it clear that commercial rent payments are a clear and present danger to their survival. This is coming from the perspectives of both landlords not getting paid and tenants unable to pay.

Disappearance of either party over the coming months would greatly hamper the prospects of economic recovery. It appears the Government of Canada is again sensitive to gaps identified in their support programs and has indicated some sort of relief will be announced soon. From the vaguest of descriptions available, it appears it may have a similar structure to the Canada Emergency Business Account. That is, the rent support for landlords and tenants will be largely in the form of loans. Again, the support will be welcome and helpful. But again, it will add to the debt burden and the payments required as the economy struggles to regain its footing.

Increased debt is inevitable as the public and private sectors of Canada grapple with the economic effects of COVID-19. As policies are rolled out, governments should be mindful not to load too much of that debt onto the private sector or prospects of eventual economic recovery will be compromised. The next opportunity to pay heed to such concern is with the design of the forthcoming assistance on commercial rents. The support should go easy on the loan component.

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