Intelligence MEMOS

From: Glen Hodgson

To: Canadians Concerned about COVID-19

Date: March 17, 2020

Re: **The Role of Crown Financial Institutions During a Pandemic**

COVID-19 has quickly become a global threat, causing a massive public health response and economic dislocation. Crown financial institutions, notably Business Development Bank of Canada (BDC) and Export Development Canada (EDC), can play an important role in these exceptional times.

Economic impacts

The spread of COVID-19 is affecting specific sectors, including hospitality, hotels and tourism; airlines and cruise ships; the meetings industry; and large public sporting and entertainment events. More broadly, significant uncertainty has been created for all economic actors. This uncertainty has quickly turned into a reluctance to take economic decisions and action today, let alone plan for the future. Uncertainty amplifies the economic slowdown and makes it harder to see a positive turning point.

Based on the pattern of past epidemics, we anticipate an economic pathway over the next quarter or two that would likely resemble a downward "V". This would mean a pronounced drop in GDP for a quarter or two, leading to a recession in many jurisdictions. If the epidemic is brought under control as hoped, a quick bounce-back to trend growth is possible. There would be a loss of GDP during the "V" period but a quick return to a normal growth trend by mid-year.

However, a more difficult economic pathway, with a more prolonged recession and slower recovery, is also a realistic scenario.

An added factor for Canada is the concurrent steep drop in oil prices, which benefits consumers but puts regions and firms in the oil sector under added pressure, with a related negative impact on investors and investment.

Financial markets are feeling the combined effects of pandemic risk, heightened uncertainty and lower oil prices via a sharp drop in equity prices and lower interest rates across the yield curve. Policy intervention is now taking place with interest rate cuts and fiscal action. Ideally the policy intervention would aim to address both uncertainty and affected sectors and firms; but there may be a limit to what traditional stimulus policies can do.

The role for BDC and EDC

BDC and EDC each have a public policy mandate to meet the credit needs of Canadian businesses in their respective markets, and specifically to help fill market gaps. During the 2008-09 global financial crisis, BDC and EDC's direct lending capacity was used actively to provide credit to clients when the financial system became constrained and where commercial lenders and insurers pulled back from the market. The federal government announced last Friday that they are being given a similar role during this period of heightened turmoil and uncertainty.

A rapid economic slowdown caused by COVID-19 will quickly translate into disruption in business cash flow, imperiling business balance sheets for highly leveraged and small businesses, particularly in exposed sectors. BDC and EDC are being asked to take a number of steps to ease such cash flow pressure. They can help existing clients to maintain access to liquidity in order to keep operations active. They could also develop new facilities as required and serve new clients. In some cases, there may be a need to address a client's debt service payment capacity, including restructuring payment terms if necessary.

Moreover, BDC and EDC may be asked to play a larger role in the Canadian national financial system, as they were in 2008 and 2009. They could examine structural gaps that have been exposed in financial markets, stepping in to help fill those gaps as required. To ensure BDC has the requisite financial strength to take on larger volumes and added risks, it may require additional financial backing from its shareholder, the government of Canada. EDC may be similarly called upon as it relates to trade finance.

Maintaining access to liquidity for their clients is an important first step, and these Crowns can do much more to help the economy stabilize and return to growth while efforts are undertaken to tame COVID-19.

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