

Intelligence MEMOS



From: Paul Jenkins and Jeremy M. Kronick
To: Canadians Looking to Understand the Times
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Re: **COVID-19: A MACROECONOMIC NARRATIVE**

These are highly uncertain times, as we individually and collectively face the challenges of COVID-19. With the many complexities – both health and economic related – is there a simple narrative that can help in bridging us through the uncertainty and out the other side?

First and foremost, what we are facing is a major shock to the health of the world's population. This of course has many dimensions, including the spread, testing, treatment, and containment of the virus, and recovery from it. In financial parlance, this is going to have a long “tail,” and its length is subject to a number of variables, including some not even identified yet.

But how would one describe what is happening in macroeconomic terms? The answer does not lie in the 2008-2009 global financial crisis (GFC), which was essentially a financial crisis in which a shock to the financial system had knock-on effects for the demand-side of the economy.

Today's situation is much different. From an economy-wide perspective, we are confronted with both a major supply and demand shock to the real (i.e., non-financial) sector of the economy – supply, in that the production of goods and services (especially the latter) is being directly affected as businesses are shut down, and demand, as the restrictions to contain the virus prevent spending by both businesses and households from taking place.

These two forces working together are resulting in a severe downturn in the Canadian and global economies.

The central policy response has been, and must continue to be, the eradication of the virus. Worldwide, healthcare systems are in overdrive in confronting the virus and in finding a vaccine.

In terms of economic policy, there are two basic pathways of response in Canada.

First, are policies to provide ongoing liquidity to the economy – keeping the flow of money circulating to support basic day-to-day transactions. And second, policies, mainly monetary and fiscal, to help stabilize the economy, lessening the negative impacts of the virus and speeding recovery.

In terms of [liquidity support](#), the Bank of Canada has introduced an impressive array of initiatives to keep dollars flowing, the Superintendent of Financial Institutions (at OSFI) has reduced the capital [buffer](#) for banks to free up capital to make more available, and the government, working with Canadian banks, BDC and EDC, has engineered various forms of [credit facility support](#), including direct government loan guarantees.

In terms of stabilization policies, the Bank has lowered its overnight policy rate to its effective zero lower bound of 0.25 percent – the same as during the GFC. And under the name Large Scale Asset Purchases, of Government of Canada bonds, it is taking its first foray into quantitative easing. In addition, the federal government has taken wage support and other measures that are estimated at about 10 percent of GDP. This is large. The challenge now is getting money into the hands of businesses and households quickly.

Many excellent and timely policies have been taken, but more will be needed. As a base-case scenario, in pure statistical terms, we will likely see at least two quarters of negative growth in the Canadian and global economies with no leveling out until the summer. That would imply that we will not see the start of recovery until the fall. This scenario would be predicated on the virus having been contained and new cases falling significantly by mid-year. Clearly this is a scenario with the same degree of [uncertainty](#) that makes it difficult to calibrate risks in the first place.

But there is every reason to be confident that we will see economic recovery, and a strong one when it takes hold.

One of the lessons of the GFC was that working together helped turn things around. Coordinated actions on the monetary, fiscal and financial regulatory fronts proved very effective. We have lost some of that spirit of multilateralism in recent years; one hopes the reality of our interconnectedness is being better understood among national leaders. The recent, virtual, [G20 meeting](#) of leaders provides some hope in this regard.

Ultimately, it will be our collective efforts that will bring us out the other side.

The key will be to ensure that the economy is ready to hit the ground running. It is not too soon to begin to think about what workplace protocols will be needed and what pro-growth policies will put the economy back on a balanced, sustained path.

Paul Jenkins is a former senior deputy governor of the Bank of Canada and a senior fellow at the C.D. Howe Institute, where Jeremy M. Kronick is associate director, research.

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