Crisis Working Group Report

Communiqué

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Crisis Working Group Report: Monetary and Financial Measures

The C.D. Howe Institute has initiated a special project to provide rapid expert insights to help Canadians and Canadian policymakers navigate the COVID-19 crisis. Several working groups will address challenges in the monetary, fiscal and financial policy domains. One such group is the Monetary and Financial Measures Working Group, co-chaired by David Dodge, former Governor of the Bank of Canada, and Mark Zelmer, former Deputy Superintendent, OSFI, and supported by a group of financial market experts and economists. Meeting weekly, this group debates policy ideas, and communicates the results of its discussions in a public Communique. The group's second meeting was held on Monday, March 30, 2020.

The meeting began with a discussion centered on three questions:

1. How to operationalize the Canada Emergency Business Account (CEBA) facility to ensure the money gets quickly to those that need it the most?
2. As long as business loans are backed by a government guarantee, do financial institutions have the funding capacity to support this program?
3. If funding capacity is an issue, will financial institutions need more access to Bank of Canada facilities? Are the facilities that exist sufficient, and, if not, what would another facility look like?

As oft-repeated throughout the policy response to the COVID-19 crisis, the most important issue is putting these new facilities in place as quickly as possible. One concern members raised was whether financial institutions will be able to get these loans out quickly with many of them operating at reduced capacity. On this point, the group discussed a series of ideas, including:

- Digitizing as many of the processes as possible. This would help both small and large financial institutions;
- A public-private partnership, with financial institutions using their pre-existing relationships with clients to administer and adjudicate the credit, while the Canada Revenue Agency (CRA) database, with its unique ID system, supports a safe, secure, and speedy process;
- As the facility is being ramped up, using the GST register at CRA to quickly get loans out the door;
- Making the first $10,000 of CEBA a grant, since this amount is forgivable under the terms and conditions of the facility in any event. A grant would make for a simpler application checklist for businesses through their financial institutions.

- For smaller loans, implementing a simplified approval process, either through auto-adjudication, or through basic credit criteria.

Members raised the possibility of an increase in fraud cases, if, for example, businesses have accounts at multiple financial institutions, or if businesses shut down and re-open under different names. The group felt that while these are realistic possibilities, they should not prevent the implementation of this facility. An ex-post review could be announced up front, discouraging attempts at fraud. Use of the CRA's digital ID will help catch some attempting to defraud the system.

On whether financial institutions were able to fund the likely scale of this credit facility, it was largely felt that they were, with those in the provincial domain more likely to be subject to some additional pressures. To the extent that provincially-regulated financial institutions do face funding pressures, they would want to turn to the Bank of Canada for liquidity support. Critical here, then, is to ensure these financial institutions are able to access Bank of Canada liquidity facilities.

On whether the scale of the facility itself was sufficient, members looked at it in the context of other policies introduced to date, notably the 75% wage subsidy, which now applies to all businesses who have experienced at least a 30% drop in revenues. The 30% number was raised as a potential concern, given that the focal point should be the individual. More positively, the wage subsidy provides the critical assurance that many businesses will be ready to hit the ground running once allowed to re-open.

The remaining discussion focused on how this massive increase in fiscal stimulus was going to be funded. Would it all be funded through the sale of bonds to the market, through financial repression where financial institutions might be compelled to hold government debt, or would the Bank of Canada finance much of it?

Members determined that this is not a central short-run issue. Governments are acting appropriately to contain this large negative shock through extensive liquidity provision. Moreover, the introduction by the Bank of Canada of quantitative easing, i.e. buying government securities in the secondary market to lower interest rates across the yield curve, would ease pressure on servicing the debt, and with the economy shut down, inflation was not an immediate concern.

In the longer-run, if inflation does increase because the Bank of Canada expands its balance sheet, putting additional money into the economy, nominal interest rates might increase, putting upward pressure on government debt financing costs. Asking whether nominal GDP growth would outpace any increase in interest costs, members pointed out that the macroeconomic recovery will not be determined only by the effects of Canadian fiscal and monetary policy, with concern centered around the situation in the US. Members reinforced again, however, that these long-term concerns should not prevent governments from taking action now.

In summary, the Monetary and Financial Measures Working Group recommends the following:

- Of first-order concern is quickly operationalizing CEBA and ensuring credit flows to businesses most in need;
- Support financial institutions in this regard by a) finding ways to digitize processes through, for example, using the CRA's digital ID system and GST register, b) by making the first $10,000 of CEBA a grant, and c) by simplifying the credit approval process;
- Announce up-front that an ex-post audit will happen to discourage fraud;
- While funding is not a concern for most financial institutions, these pressures might be more acute at the margin for provincially-regulated financial institutions, and the Bank of Canada should ensure these financial institutions have access to its liquidity facilities; and
- Despite the need for governments and central banks to monitor the impact the increase in debt will have on inflation, and, therefore, interest costs, this should not come at the expense of the immediate term need for large-scale fiscal stimulus.

The Monetary and Financial Measures Working Group will meet again Monday, April 6th, 2020 at 3pm. The group will continue to monitor policy actions taken over the course of the next week, and from here determine the most relevant topics for our April 6th meeting. The group will consider both the immediate needs of the country, as well as important monetary and financial considerations for both the medium and longer-term.

Monetary and Financial Measures Working Group members include:

David Dodge, Co-Chair, former Governor of the Bank of Canada

Mark Zelmer, Co-Chair, former¬ Deputy Superintendent, OSFI

Riaz Ahmed, TD Bank

Steve Ambler, Université du Quebec à Montreal

Dwight Duncan, McMillan LLP

Paul Jenkins, Former Senior Deputy Government, Bank of Canada

Phil Howell, Former Superintendent, FSCO

Thor Koeppl, Queen's University

Andrew Moor, Equitable Bank

Tamara Vrooman, VanCity

Jeremy Kronick, C.D. Howe Institute

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