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. Its working groups on monetary and financial measures is 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. The group's third meeting was held on Monday, April 6th, 2020.

The focus of the meeting was on options for dealing with the funding pressures faced by provincial governments. Members indicated that so far, both the federal and provincial governments have been successful in financing the revenue gaps and spending demands related to the crisis and their responses. But yields on provincial debt have widened relative to yields on federal debt, and investors do not have unlimited appetite for Canadian debt. While tax deferrals will not necessarily lead to an increase in debt loads for both federal and provincial governments to the extent they are paid back, they do represent a loss of revenue for governments in the immediate term. This loss of revenue will require an increase in borrowing, putting additional funding pressures on governments whose financial positions are already precarious. Separately, but not less importantly, provinces need to continue to provide services such as health care and education. The group focused on the following potential policy responses:

1) Increased revenue sharing between federal government and provinces;
2) The federal government accessing credit markets on behalf of provincial governments to take advantage of its lower interest costs and higher credit rating;
3) The federal government guaranteeing provincial government borrowing; and
4) The Bank of Canada intervening through increased purchases of provincial debt securities across the maturity spectrum.

Members recognized that each of these options runs up against the same problem: provincial governments are not starting from the same fiscal position (see figure below and here), nor do they have the same revenue collection tools. Questions of equity would be critical to any solution.

It was also pointed out that provinces are in worse shape going into this crisis than they were in advance of the 2008 financial crisis (again, see figure below). Their debts are generally higher relative to their revenues and economies, and unlike the last financial crisis when energy producing provinces

fared relatively well, each province will experience a substantial economic hit as a result of COVID-19. Energy provinces are in fact worse off this time with the oil price collapse.

Demand for provincial debt was also raised as a potential issue. Some felt that Canada's debt relative to the size of global capital markets was small so demand might not turn out to be much of a concern. Others, however, felt that the fact that countries the world over are issuing massive amounts of debt will make it more difficult for sub-national borrowers.

Responses to these immediate-term issues need to avoid undue medium-term concerns. The fact that yield spreads reflect governments' fiscal positions is usually appropriate. Federal government guarantees might distort the market view of provincial borrowing moving forward. The group also expressed concern about conditionality related to federal support for provincial borrowing, which could undermine provincial autonomy in the longer term.

As a result, members focused on the need to first and foremost support the functioning of markets for provincial debt more generally. The Bank of Canada is already purchasing provincial money-market securities, but will likely also need to purchase longer-term debt. However, the Bank must not be seen to support one province over another, and this will require a clear, simple, rules-based approach to Bank of Canada interventions. Some members noted that the Bank cannot expand its balance sheet to the extent some advocates of supporting provincial debt might wish without compromising its inflation objective.

If specific provinces require additional support beyond these central bank interventions, the group felt that the most appropriate response would be to make use of the fiscal stabilization fund, which is designed to help provinces whose economies are experiencing large negative shocks. Doing so will avoid the federal government guaranteeing provincial debt, and distorting the market's view of future provincial borrowing.

The Monetary and Financial Measures Working Group will break for Easter Monday and reconvene on Monday, April 20th, 2020 at 3pm. In addition to a focus on how best to finance government interventions in the medium-term, the group will continue to monitor policy actions taken over the course of the next two weeks, and from here determine the most relevant topics for its April 20th meeting.

Provincial Net Debt Between 2007-08 and 2018-19 Fiscal Years, $ Millions										
	BC	AB	SK	MB	ON	QC	NB	NS	PE	NL
2007-08	23,811	-39,410	5,873	10,561	156,616	124,681	7,069	12,115	1,347	10,188
as % of GDP	11.9	-15.1	11.2	21.2	26	40.6	24.9	35.6	29	36
2018-19	42,681	27,477	11,834	24,999	338,496	172,558	13,959	15,010	2,124	15,374
as % of GDP	14.4	8	14.7	34.4	39.5	39.3	37.8	33.8	30.4	46.3
Difference	18,870	66,887	5,961	14,438	181,880	47,877	6,890	2,895	777	5,186
Percentage Points	2.5	23.1	3.5	13.2	13.5	-1.3	12.9	-1.8	1.4	10.3

Source: RBC Economics, Canadian Federal and Provincial Fiscal Tables, March 20 2020.

Monetary and Financial Measures Working Group Members Include:

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