Q1 slowdown will pale in comparison to Q2 GDP hit

We’ve marked down our macroeconomic forecasts for Canada and the US to reflect the growing scale and expected duration of containment measures in the economies we track. Our projections are now based on an assumption that current shutdowns and social distancing policies will remain in place for at least another two months and will only gradually be scaled back in June and July. These measures that were generally put in place in mid-March were likely enough to drag first quarter growth into negative territory. The hit to activity in the current quarter will be much more significant (indeed, record-breaking) with some sectors effectively shut down throughout the spring.

In both Canada and the US we think GDP declines in Q2 will exceed 30% on an annualized basis. For reference, neither country has seen a quarterly decline or more than 10% in over half a century of record keeping. The unprecedented scale of this disruption is already showing up in higher-frequency labour market data. In Canada, more than 3 million people have reportedly filed for employment insurance and other benefits in the last three weeks. That suggests the country’s unemployment rate is nearing 20%—an increase that won’t be fully captured in March’s jobs numbers. In the US, some 10 million Americans made new unemployment insurance claims in the second half of last month. The country’s jobless rate is likely now in double digits, rather than the 4.4% reported for March. Even that understated number marked one of the largest monthly increases on record.

Monetary policy support has come fast and furious

Having already added to its balance sheet with term lending and smaller purchase programs, the BoC launched its first QE program by pledging to buy at least C$5 billion of Government of Canada (GoC) securities each week “until the economic recovery is well underway.” Over a year, that would more than double the size of the BoC’s balance sheet relative to early-2020, but still wouldn’t be on the scale of larger central banks’ programs. Governor Poloz characterized large scale asset purchases as a liquidity-providing measure rather than an attempt to keep longer-term interest rates low—though the program’s goal could shift to the latter over time. We also think there’s potential for purchases to be expanded to other asset classes if GoC buying doesn’t do enough to reduce interest rates for a broader range of borrowers.

One monetary policy tool that isn’t getting much love is negative interest rates. It’s notable that none of the central banks that entered the current crisis with a positive policy rate have moved into negative territory (the 0-0.25% range generally seen as the positive lower bound). And those with negative rates to begin with haven’t ventured further down that road. The Fed has rarely entertained the idea of a negative policy rate, and BoC Governor Poloz threw cold water on the idea, noting that other central banks’ experiences suggest negative side-effects on the financial system are significant. That point is particularly salient at a time when central banks are doing all they can to ensure the smooth functioning of the banking system.

‘Wartime’ fiscal response will support households and businesses

We think the significant fiscal support that has been announced (generally 2-5% of GDP, and in some cases even more) will prevent a worst case scenario from materializing, and underpin an eventual economic recovery. But we don’t think it will be the hoped-for V-shaped recovery—that is, a quick and nearly full rebound in activity. Most businesses will eventually reopen their doors, but there are likely to be some permanent closures that will disrupt supply chains and at least temporarily reduce the economy’s potential GDP. Wage subsidies and a relatively short period of large-scale economic disruption should make it easier for individuals to get back to work, but we doubt unemployment will snap back to its earlier lows (which were multi-decade lows in many countries). Many households facing a loss of income and savings, or having to take on more debt, are likely to be cautious in their spending decisions—and many others might be cautious in their behaviour. So while we are projecting a sizeable rebound in GDP over the second half of the year as containment measures are lifted, all of the economies we track are expected to close the year with significantly more slack than they entered with.