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.

Monetary policy support has come fast and furious

Central bankers are often able to react faster than their fiscal counterparts, and that was the case in March with significant stimulus being added even before the scale of economic disruption became clear. Central banks with positive policy rates lowered them toward zero, asset purchase programs were expanded (or launched by those new to QE), financial crisis-era liquidity programs were resurrected, and in some cases monetary policy teamed up with fiscal authorities to provide funding for loans. Many of these moves happened outside scheduled policy decisions, and coordination between central banks generally occurred behind the scenes—we didn’t see any joint rate cuts (as in October 2008) though bilateral US dollar facilities showed bank governors were working together.

For broader liquidity provision, central banks have turned to a now familiar tool: quantitative easing. The Fed initially pledged to increase its Treasury and agency MBS holdings by $700 billion (roughly 18%) in the coming months but eventually made purchases open-ended.

‘Wartime’ fiscal response will support households and businesses

The fiscal response to the coronavirus pandemic has generally been three-pronged: providing additional funding for health care, enhancing the social safety net for those out of work, and getting money to affected businesses to prevent otherwise healthy firms from going under. Support for individuals and families is standard operating procedure during a recession, from automatic stabilizers like unemployment benefits to direct transfers and tax cuts. Enhancements to those types of programs have made up the bulk of aid to households.

In the US, eligibility for unemployment insurance has been expanded and the federal government will provide a $600 weekly top-up that will more than double the size of regular state benefits—and will fully make up for lost income of lower-wage workers.

Some countries are offering generous wage subsidies to help cover a large chunk of payroll costs, even if workers are laid off. It’s hoped that maintaining a strong link between employer and employee will make for a faster economic recovery when containment measures are lifted. In some cases, support for businesses has come in the form if direct cash transfers to smaller firms and those in the most affected industries. Tax deferrals have been a common measure to provide liquidity. A number of governments are also lending directly to businesses (and offering to forgive some of that debt if certain conditions are met) or offering to guarantee billions of dollars in private sector lending.