# Pandemic Spurs Epic Economic/Policy Response

*A Publication of BMO Capital Markets Economic Research • Douglas Porter, CFA, Chief Economist, BMO Financial Group*

- The **number of new coronavirus cases and deaths worldwide continues to rise with no clear sign of slowing**, surpassing one-half million and 26,000, respectively. There are now more cases in the U.S. than China, and cases have mounted quickly across Europe as well. While the rate of increase in Canada has been slower than in many other countries, the nation is far from immune to the pandemic.
- Although the **rapidly devolving economic situation implies an historic contraction in the first half of the year**, the equally unprecedented policy response has raised the odds of a substantial snap-back, assuming the number of new coronavirus cases begins to fade by late April.
- **The policy response, of course, can't prevent the massive economic trauma now unfolding.** COVID-19 is a hurricane sweeping not just one or two regions of the country but the entire global economy. Non-essential businesses have been ordered shut in California, New York and many other states, comprising 40% of GDP, while one in five workers and one in three persons are encouraged to stay home. In Canada, the two largest provinces, Ontario and Quebec, have undertaken similar measures.
- All analysts have struggled to assess the trauma caused by the unprecedented scale and speed of the dislocations. **However, in the past week, the broad contours of this instantaneous recession and the inevitable recovery are starting to take shape.** With activity in hard-hit industries such as travel, accommodation, restaurants and entertainment plunging by more than 60% according to high-frequency data, the U.S. economy is estimated to contract by one-fifth in March and April. Consequently, **real GDP could shrink 5% annualized in Q1 and by 25% in Q2**. To put the latter in context, the worst quarterly contraction in the post-war era was a 10.0% dive in 1958. The peak-to-trough contraction unfolding now could be on the order of 8%, or double what we saw in the Great Recession. For all of 2020, GDP could contract 2.5%, matching that in 2009, though paling in comparison with 1932's 12.9% plummet and 1946's 11.6% tumble. Broadly similar declines are expected in Canada, though plunging oil and other commodity prices suggest a deeper 3.0% contraction this year. At under $10, the price of Western Canada Select crude is at historic lows, causing some producers to shut-in production.
- The **economic downturn could lead to over 8 million job losses in the U.S.**, compared with 8.7 million in the Great Recession. The unemployment rate is expected to push toward 9% from the current half-century low of 3.5%, shy of the 10% peak in the Great Recession. The largest single-month spike in the post-war era was 1.3 ppts in 1949. **Nearly one million Canadians could lose their jobs, sending its jobless rate to 10%**.

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### Key Messages

**The pandemic will trigger a historic contraction in the economy in the second quarter**

**The equally unprecedented policy response will spur a sizeable recovery in the third quarter, assuming the pandemic subsides by late April**

**After slashing policy rates by 150 bps in March and unleashing nearly every emergency measure in the playbook, the Fed and the Bank of Canada will likely hold rates steady until 2022**

- In the absense of a vaccine, the social distancing and business closures now causing this unique recession will ultimately help to stem the outbreak. China's Hubei province and South Korea managed to control the number of new cases after about five weeks of strict precautionary measures. If other nations, including the U.S., can successfully bend the outbreak curve by late April, activity could begin to recover by mid-May.
- **While this downturn will be both sharp and painful, the recovery could be equally forceful, teeing up a 30% annualized rebound in Q3 GDP.** After weeks of near social isolation, people will be itching to make up for lost time when the panic ebbs. Most importantly, the policy response has been equally swift. An unprecedented $2.2 trillion of U.S. fiscal measures, weighing in at 10.3% of GDP (and about $1.6 trillion in direct support or 7.5% of GDP) could eclipse the expected peak-to-trough decline in GDP. The fiscal measures, including cash payments to households, increased unemployment insurance benefits, forgivable loans to small businesses that retain staff, and loans to hard-hit industries such as airlines, should help to contain insolvencies. The Canadian Government has announced more than $100 billion in measures (or 5% of GDP), including direct payments to households, enhanced employment insurance, a 75% wage subsidy and loans for businesses, and deferred taxes. The provinces have also announced support measures.
- With its no-holds-barred monetary policy response, including a plethora of liquidity facilities, unlimited QE and unprecedented purchases of corporate bonds, the **Fed has become the lender of last resort to nearly all borrowers**. And, with core inflation likely to ease toward 1%, the prospect of returning to the 2% goal is now pushed farther into the future, suggesting that policy rates could remain near zero until 2022. The Bank of Canada has also quickly returned policy rates to near zero, while pledging to buy BAs and commercial paper to lend to businesses, Canadian Mortgage Bonds, and even government debt securities, a crisis measure deemed unnecessary during the last recession.
- Of course, there are still big questions about the course of the outbreak and the number of smaller businesses that will survive to be in position to rehire. Much will depend on how aggressively lenders, landlords and governments grant payment forbearance on loans, rents and taxes. Even if all goes as well as can be expected, **the economy likely won't recover its output and job losses for some time.** Even with expected 3.5% growth for the U.S. and Canada in 2021, the unemployment rates could still hover around 5.0% and 7.0%, respectively, next year, dialing their labour markets back to 2016.
- Still, given the strong policy tailwind, there is at least hope now that another lengthy expansion can resume once this hurricane passes.

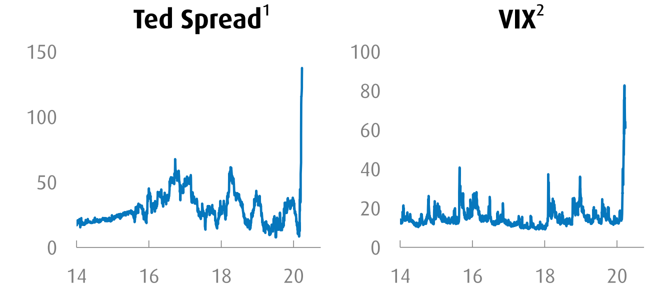
## Forecasts

| | | 2019 | | | | 2020 | | | | Annual | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | | Q1 | Q2 | Q3 | Q4 | Q1 | Q2 | Q3 | Q4 | 2019 | 2020 | 2021 |
| **CANADA** | | | | | | | | | | | | |
| Real GDP | (q/q % chng : a.r.) | 1.0 | 3.4 | 1.1 | 0.3 | -6.5 | -25.0 | 30.0 | 4.1 | 1.6 | -3.0 | 3.5 |
| Consumer Spending | | 2.4 | 0.4 | 2.0 | 2.0 | -8.8 | -32.4 | 42.2 | 3.4 | 1.6 | -4.2 | 3.8 |
| Business Investment (non-res.) | | 18.3 | -7.7 | 5.6 | -6.3 | -5.0 | -40.0 | 25.0 | 5.0 | 0.0 | -8.3 | 1.9 |
| Consumer Price Index | (y/y % chng) | 1.6 | 2.1 | 1.9 | 2.1 | 2.0 | 0.3 | 0.8 | 0.9 | 1.9 | 1.0 | 1.9 |
| Unemployment Rate | (percent) | 5.8 | 5.6 | 5.6 | 5.7 | 6.4 | 9.3 | 8.4 | 8.0 | 5.7 | 8.0 | 7.0 |
| Housing Starts | (000s : a.r.) | 187 | 224 | 223 | 202 | 208 | 160 | 190 | 203 | 209 | 190 | 225 |
| Current Account Balance | ($blns : a.r.) | -69.4 | -33.7 | -43.5 | -35.0 | -54.3 | -74.5 | -72.1 | -67.3 | -45.4 | -67.0 | -65.0 |
| **Interest Rates** | | | | | | (average for the quarter : %) | | | | | | |
| Overnight Rate | | 1.75 | 1.75 | 1.75 | 1.75 | 1.25 | 0.25 | 0.25 | 0.25 | 1.75 | 0.50 | 0.25 |
| 3-month Treasury Bill | | 1.65 | 1.67 | 1.64 | 1.66 | 1.30 | 0.25 | 0.20 | 0.20 | 1.65 | 0.50 | 0.20 |
| 10-year Bond | | 1.86 | 1.62 | 1.36 | 1.52 | 1.20 | 0.65 | 0.70 | 0.80 | 1.59 | 0.85 | 1.15 |
| **Canada-U.S. Interest Rate Spreads** | | | | | | (average for the quarter : bps) | | | | | | |
| 90-day | | -79 | -68 | -38 | 5 | 17 | 8 | 3 | 3 | -45 | 7 | 3 |
| 10-year | | -80 | -72 | -43 | -28 | -18 | -5 | -5 | -4 | -56 | -8 | -3 |
| **UNITED STATES** | | | | | | | | | | | | |
| Real GDP | (q/q % chng : a.r.) | 3.1 | 2.0 | 2.1 | 2.1 | -5.0 | -25.0 | 30.0 | 2.0 | 2.3 | -2.5 | 3.5 |
| Consumer Spending | | 1.1 | 4.6 | 3.1 | 1.8 | -6.5 | -31.6 | 36.6 | 1.6 | 2.6 | -3.6 | 3.5 |
| Business Investment (non-res.) | | 4.4 | -1.0 | -2.3 | -2.5 | -5.9 | -22.6 | 23.7 | 2.0 | 2.1 | -4.3 | 3.1 |
| Consumer Price Index | (y/y % chng) | 1.6 | 1.8 | 1.8 | 2.0 | 2.1 | 0.5 | 0.5 | 0.5 | 1.8 | 0.9 | 1.6 |
| Unemployment Rate | (percent) | 3.9 | 3.6 | 3.6 | 3.5 | 3.6 | 8.0 | 6.3 | 5.9 | 3.7 | 6.0 | 5.0 |
| Housing Starts | (mlns : a.r.) | 1.21 | 1.26 | 1.28 | 1.44 | 1.53 | 1.22 | 1.33 | 1.35 | 1.30 | 1.36 | 1.36 |
| Current Account Balance | ($blns : a.r.) | -548 | -505 | -502 | -439 | -427 | -353 | -342 | -340 | -498 | -365 | -340 |
| **Interest Rates** | | | | | | (average for the quarter : %) | | | | | | |
| Fed Funds Target Rate | | 2.38 | 2.38 | 2.13 | 1.63 | 1.13 | 0.13 | 0.13 | 0.13 | 2.13 | 0.38 | 0.13 |
| 3-month Treasury Bill | | 2.44 | 2.35 | 2.02 | 1.61 | 1.15 | 0.20 | 0.20 | 0.20 | 2.10 | 0.40 | 0.20 |
| 10-year Note | | 2.65 | 2.33 | 1.79 | 1.79 | 1.40 | 0.70 | 0.75 | 0.85 | 2.14 | 0.90 | 1.15 |
| **EXCHANGE RATES** | | | | | | (average for the quarter) | | | | | | |
| US¢/C$ | | 75.2 | 74.8 | 75.7 | 75.8 | 74.3 | 68.4 | 69.8 | 71.0 | 75.4 | 70.9 | 72.8 |
| C$/US$ | | 1.33 | 1.34 | 1.32 | 1.32 | 1.35 | 1.46 | 1.43 | 1.41 | 1.33 | 1.41 | 1.37 |
| ¥/US$ | | 110 | 110 | 107 | 109 | 109 | 101 | 104 | 106 | 109 | 105 | 111 |
| US$/Euro | | 1.14 | 1.12 | 1.11 | 1.11 | 1.10 | 1.07 | 1.09 | 1.10 | 1.12 | 1.09 | 1.11 |
| US$/£ | | 1.30 | 1.29 | 1.23 | 1.29 | 1.28 | 1.17 | 1.19 | 1.20 | 1.28 | 1.21 | 1.25 |

*Blocked areas mark BMO Capital Markets forecasts*

## Chart 1
### Risk and Volatility Spike Higher

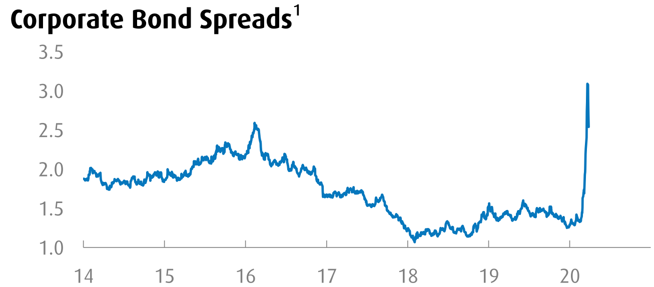
United States (as of March 26, 2020)




[1] 3-mnth Eurodollar minus 3-mnth T-bills (bps); [2] CBOE market volatility index
Sources: BMO Economics, Haver Analytics

## Chart 2
### Credit Spreads Surge

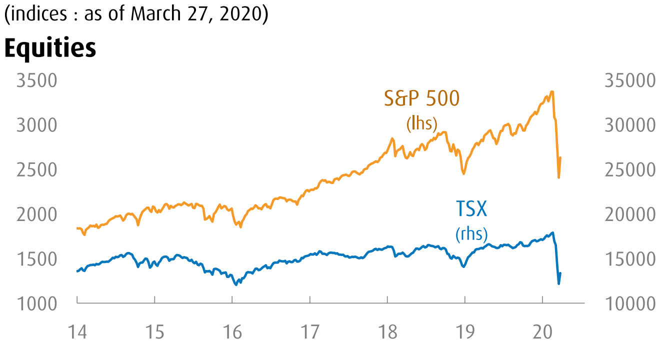
United States (ppts : as of March 26, 2020)




[1] 15-year BoA Merrill Lynch AA Corporate Yield less 10-year Treasury Yield
Sources: BMO Economics, Haver Analytics

## Chart 3
### Equity Bear Market

(indices : as of March 27, 2020)




Sources: BMO Economics, Haver Analytics

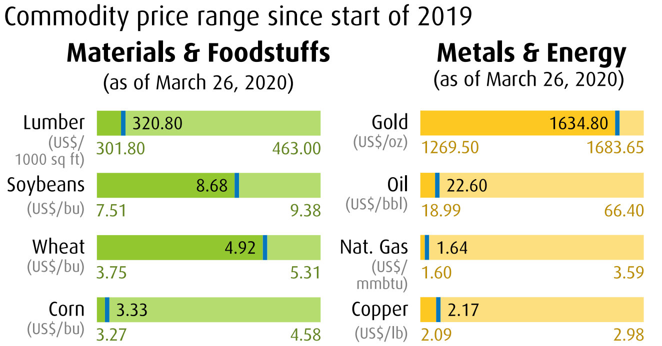
## Chart 4
### Loonie Laid Low

(US¢ : as of March 27, 2020)


Sources: BMO Economics, Haver Analytics

## Chart 5
### Many Commodities Hammered

Commodity price range since start of 2019




Sources: BMO Economics, Haver Analytics

Line indicates current value

## Chart 6
### Oil Hits Two-decade Low

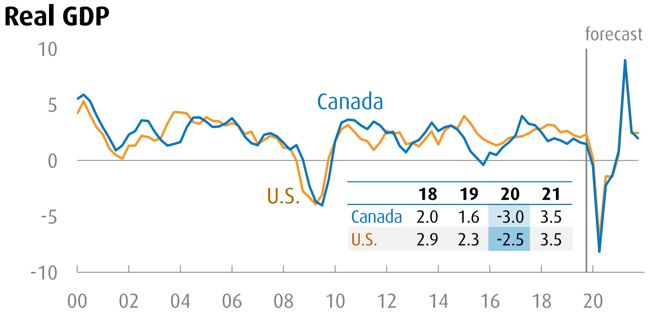
(US$/bbl : as of March 27, 2020)


Sources: BMO Economics, Haver Analytics

## Chart 7
## Growth Plummets

(y/y % chng)

**Real GDP**

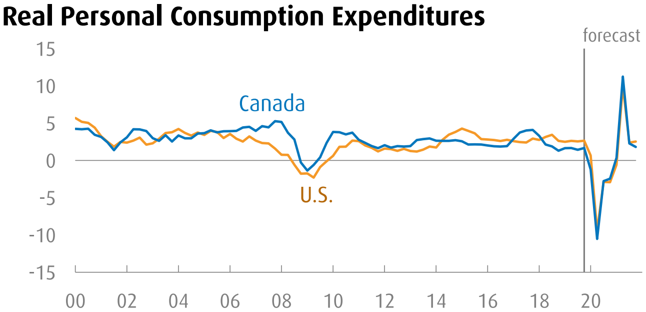



Sources: BMO Economics, Haver Analytics

## Chart 8
## Consumers Stay Home

(y/y % chng)

**Real Personal Consumption Expenditures**

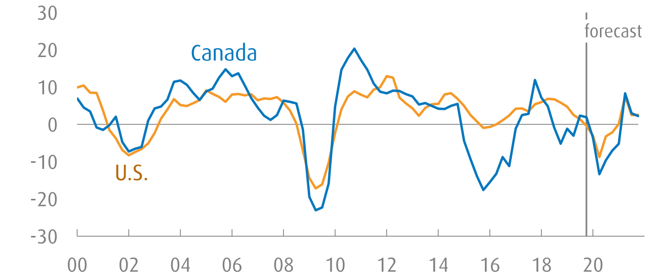



Sources: BMO Economics, Haver Analytics

## Chart 9
## Investment Plunges

(y/y % chng)

**Real Non-Residential Business Investment**

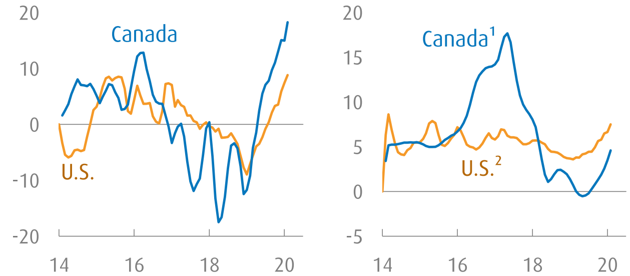



Sources: BMO Economics, Haver Analytics

## Chart 10
## Housing Markets Were Rising

Existing Homes (y/y % chng : 3-mnth m.a.)

**Sales** **Prices**

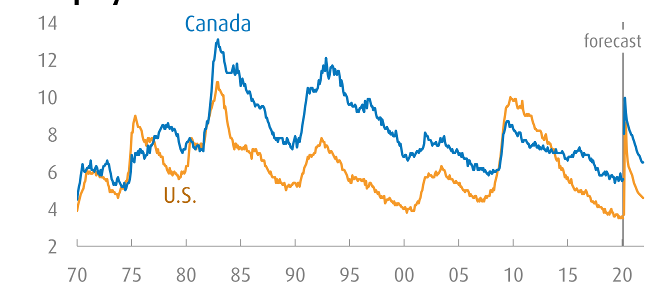



Sources: BMO Economics, Haver Analytics [1] MLS HPI; [2] NAR Median Sales Price

## Chart 11
## So Much For Worker Shortages

(percent)

**Unemployment Rate**

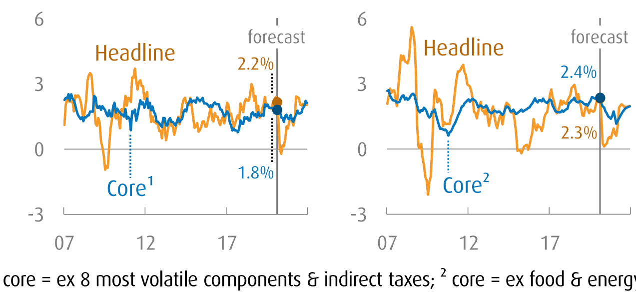



Sources: BMO Economics, Haver Analytics

## Chart 12
## Inflation To Fall Further

**Consumer Price Index** (y/y % chng)

**Canada** **United States**



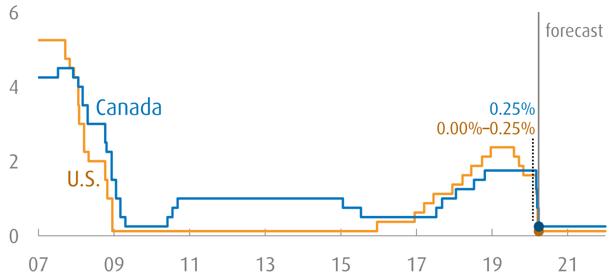

[1] core = ex 8 most volatile components & indirect taxes; [2] core = ex food & energy

Sources: BMO Economics, Haver Analytics

Chart 13
## Monetary Medicine

(% : as of : March 27, 2020)

**Overnight Rate**

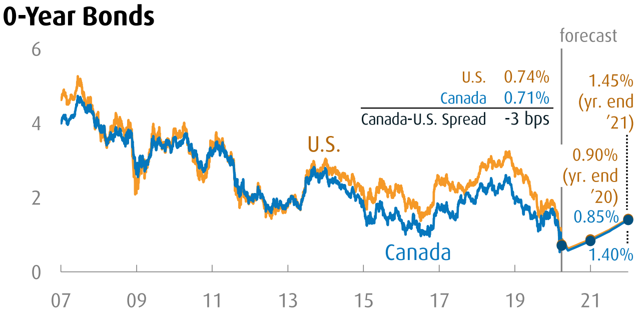



Sources: BMO Economics, Haver Analytics

Chart 14
## U.S. Treasury Rates Hit All-time Lows

(% : as of March 27, 2020)

**10-Year Bonds**




Sources: BMO Economics, Haver Analytics

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