Preface

The Canadian Outlook Economic Forecast was prepared by the Forecasting and Analysis team under the direction of Matthew Stewart, Director, Forecasting and Analysis.

The report examines the medium-term economic outlook for Canada—all major components including consumer expenditures, housing, government, non-energy business investment and trade. The outlook for the financial, labour and energy markets is also given along with costs and prices.

The Canadian Outlook is updated each quarter using the Conference Board’s large econometric model of the Canadian economy. The publication can be accessed online at www.e-library.ca and the data can be downloaded for clients subscribing to e-Data, at www.conferenceboard.ca/edata.htm.

For more information, please contact our information specialist at 613-526-3280 or 1-866-711-2262, or e-mail contactcboc@conferenceboard.ca.

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The article was written by Matthew Stewart, Director, National Forecast, Forecasting and Analysis.
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Key findings

• The Canadian economy is reeling as the impacts of the COVID-19 pandemic ravage consumer and business spending and cratering oil prices have put a halt to the expected rebound in the energy sector.

• The economy came to a near-halt at the end of last year. Growth has not been much better in the first quarter and is set to contract in the second. Overall, we expect real GDP to expand by just 0.3 per cent this year before bouncing back with 2.5 per cent growth next year.

• Exports and non-residential business investment are expected to fall this year.

• The Bank of Canada has responded to the deteriorating economic outlook in an unprecedented way. In a period of just over one week, the Bank slashed its overnight rate by 100 basis points.

• Lower interest rates will throw more fuel onto the fire that is Canada's housing market, leading to a strong increase in resale home prices and residential investment this year.

• Encouragingly, given the historically tight labour markets and the short-term nature of the economic shocks, businesses are expected to retain workers as much as they can, and employment should recover along with the economy.
Canada Teeters on the Brink of Recession

Canada’s economic growth ground to a halt in the fourth quarter of 2019. With the economy already on precarious footing, the added shocks of the recent rail blockade protests, the arrival of COVID-19, and a collapse in oil prices have brought the country to the brink of recession.

The Canadian economy grew by just 0.3 per cent in the fourth quarter of 2019, its weakest performance since the second quarter of 2016. The sluggishness was the result of declines in business investment and exports, which were only partially offset by continued strength in consumer spending. Now, with the economy being hit by a slew of additional shocks, we expect business investment and exports to post substantial declines and consumer spending to ease. As a result, economic growth will contract by a projected 2.7 per cent in the second quarter. However, growth should resume in the third quarter, allowing the economy to avoid a technical recession. Unfortunately, there are huge downside risks to our outlook due to the unpredictability of the coronavirus pandemic. Overall, we expect growth of just 0.3 per cent in 2020 followed by a rebound to 2.5 per cent growth in 2021. (See Chart 1.)

The impact of recent shocks on economic growth

Rail blockades launched by Indigenous and environmental protestors in February are projected to knock 0.3 percentage points off growth in the first quarter. The impeding of the transport of goods has repercussions for Canadian industries all along the supply chain. Today’s transportation logistics are extremely efficient, allowing industry to manage production and keep costs low with “just in time” delivery. Companies tend to maintain low levels of inventory and, as a result, even short disruptions can lead to production stoppages. This is what happened during the CN rail strike last November. Despite lasting just over a week, the strike led to declines in manufacturing and in other industries. While we think the immediate impact of the blockade was modest, the longer-term risk to business investment decisions, especially with
respect to the investment climate in the resource sector, may be much larger. For example, the rail blockade likely contributed to the decision by U.S. investment giant Berkshire Hathaway to pull out of GNL Quebec’s $14-billion liquefied national gas plant and related pipeline project.

The first case of COVID-19 was confirmed on December 31. On January 30, the World Health Organization declared a public health emergency of international concern, and on March 11, it upgraded the outbreak status to a pandemic. By then, there had been more than 100,000 cases. While the majority of these cases are still in China, the number of new cases elsewhere around the world is soaring. Although projecting the economic impact in quickly changing circumstances is extremely challenging, our base case outlook assumes that current measures will avoid the spread of the virus throughout Canada, sparing us the need for the kind of mass quarantine that we have seen in Italy. That being said, the impact to Canada’s economy will be significant.

We project large declines in the number of tourists coming to Canada in 2020. Canada had 753,000 tourists from China alone last year, and they spent $1.8 billion. Overall, we expect the number of visitors to Canada to decline by over two million in the second quarter of this year. Canadian’s are also expected to avoid public places as they maintain social distancing. Many bars, restaurants, theaters, and sporting facilities are closed. Spending on travel and food and accommodation will, consequently, plunge.

Far weaker industrial production in China and in Canada’s other trading partners will impact global supply chains and result in a decline in Canadian exports. Also, weaker global growth is lowering demand for raw materials, and this will result in weaker business investment in the mining sector. Outside of mining, lower demand and reduced business confidence will lead to a substantial decline in business investment.

Just when we thought that the economic news for Canada couldn’t get any worse, OPEC and Russia failed to reach an agreement on oil output cuts, triggering an all-out price war in early March. By mid-March, oil prices were hovering just above US$30 per barrel, down from a recent high of $53.88 on February 20. Although both sides are claiming that they can withstand the damage to their state oil revenues for as long as they need to, we suspect that they will return to the bargaining table and agree on output cuts by May. This should bring the benchmark West Texas Intermediate (WTI) price back to the US$45–US$50 per barrel range, with a gradual recovery expected throughout the remainder of the year. But, facing low prices, oil producers are expected to reduce their investment spending and scale back production across Western Canada until the fourth quarter of 2020. The past winter drilling season was an improvement over last year, but we expect most conventional drillers will shut down activity at wellheads until prices shore up.

Global and U.S. outlooks

At the beginning of the year, a combination of cooling trade tensions between the United States and China, greater clarity around Brexit, and a rebound in some global business confidence indicators suggested that global growth was on the mend. We expected the global economy to expand by 2.5 per cent this year, close to the gain recorded in 2019, and to follow that up with
2.7 per cent in 2021. The global outbreak of COVID-19 has significantly altered these projections.

While the draconian measures put in place by the Chinese government have succeeded in reducing the number of new cases there, the virus continues to spread in other parts of the world. The spread of the virus has led to a sharp increase in containment efforts in Europe. The Italian government has essentially placed the entire country under lockdown and banned public gatherings, limited travel within and outside the country, and implemented a curfew on shops and restaurants. Austria, Poland, the Czech Republic, Denmark, and Spain, among others, have also imposed restrictions (although, to date, not as strict as those in Italy). The United States has also taken steps to quarantine parts of New York state as “containment areas,” and restrictions have been put in place around areas with a high number of infections.

The disruption to businesses and households in China will likely cause economic growth there to turn negative in the first quarter, and growth for the entire year will be closer to 4.0 per cent, down from the 5.8 per cent gain expected at the beginning of this year. The damage to global growth won’t, however, be limited to China, as its manufacturing sector is deeply integrated into global supply chains and accounts for around 20 per cent of international manufacturing output. The European Union won’t come close to attaining the 1.2 per cent gain in real GDP we were anticipating in early January, as Italy will slip back into recession, and the German economy could as well. German exports were already hurting due to the slump in the U.K. economy.

For the United States, the slump in the Chinese economy will impact the economy in three different ways. U.S. exports to China will drop as domestic demand in the world’s second-largest economy declines sharply. Travel from China to the United States will take a huge hit, as will the travel and tourism businesses that depend on these visitors—around 3 million Chinese visit the United States every year, and they tend to spend more than other visitors. And domestic production will suffer as firms dependent on supply chain linkages with China and other countries in Asia face increasing shortages of parts required in the production process. This will impact exports, investment spending, and profitability in the U.S. economy. These challenges will only be reinforced by the downturn in household spending linked to the ever-growing cancellation of sporting and entertainment events, as well as the closure of restaurants and shops in some states in an attempt to limit large gatherings of people. We expect the U.S. economy to expand by 1.3 per cent in the first quarter of this year, before the full impact of the crisis hits and results in a second-quarter decline of close to 4.0 per cent (annualized). At this point, we assume that the impact of the pandemic will gradually start to fade in the summer months, leading to a return to economic growth in the final half of this year. Overall real GDP growth is expected to come in at 0.7 per cent in 2020, down from the 2.3 per cent growth in 2019. (See Chart 2.)
The world’s major central banks, including the U.S. Federal Reserve, have responded to the crisis by cutting interest rates. The Fed implemented an unexpected 50-basis-point cut in early March and followed it up with another emergency 50-basis-point cut and resumed its quantitative easing program. We could well see additional measures in the coming weeks and months. However, there are doubts about the effectiveness of interest rate cuts, as the current difficulties in the economy are closely linked to supply disruptions from China, and lower interest rates don’t help with supply shocks. Also, declining interest rates won’t help convince people who are staying home because they are terrified of getting sick to go out and spend. On the fiscal front, the U.S. Congress passed an $8.3-billion emergency package to fund diagnostics and the development of a vaccine, among other things. As well, President Donald Trump recently announced several new measures, including deferred tax payments and paid leave for hourly workers impacted by the virus. Then, he declared a national emergency that opened up $50 billion in additional funding. Other initiatives included the waiving of interest on all student loans. On the energy front, the President announced that the government will buy oil to fill the Strategic Petroleum Reserve in an attempt to prop up world oil prices. More initiatives will be required to prevent an even greater downturn in the economy.

**Business sector**

**Trade faces another difficult year**

After enduring a tough year in 2019, there was hope that Canada’s trade sector would turn the corner in 2020 as the trade wars and protectionism that have caused the global economic turbulence that dominated much of 2019 started to taper off. However, trade data show that Canada’s trade sector is still vulnerable, with exports plummeting in January. And then came the economic shocks that have effectively dimmed any hope of a turnaround this year for Canadian exporters.

The emergence of COVID-19 and its rapid spread across the globe, combined with plummeting crude oil prices, has shaken the global economy to its core. With concerns over the coronavirus growing daily, Canada’s trade flows are expected to be severely disrupted for a good part of 2020, particularly now that the spread of COVID-19 has started to gain traction in North America. We assume COVID-19 will be largely contained by the end of the third quarter of 2020. But until that point is reached, disruptions to global supply chains, dwindling business confidence, scaled-back business investment, and a major slowdown
in U.S. economic growth will exact a heavy toll on trade flows and dim the growth prospects for Canada’s export sector this year. The upheaval will not be restricted to the trade in goods. Non-merchandise trade will also be hit hard, particularly exports of travel and transportation services. But as these extraordinary events start to wane, we should start to see a bounce-back in trade activity next year. Overall, export volumes are forecast to contract by 1.6 per cent in 2020 before rebounding with 2.2 per cent growth in 2021. (See Chart 3.)

**Chart 3**

Exports falter as slower global growth reduces demand for Canadian goods and services (Canadian exports, percentage change)

At the same time, imports won’t fare much better, as the domestic economy is forecast to turn in another sluggish performance in 2020. Lower interest rates in 2020 will not be enough to halt the slowdown in consumer and business investment spending this year. Consequently, import volumes are forecast to decline by close to 1.2 per cent in 2020, pulled down in large part by COVID-19 and the significant disruptions it is causing to imports of travel and transportation. With the pandemic expected to be largely contained by the end of the third quarter of this year, import activity is expected to bounce back in 2021 with 2.0 per cent growth as the domestic economy picks up steam. Despite that tepid performance, the import sector will outperform the struggling export sector by a small margin this year. Consequently, net trade will be a drag on the Canadian economy, chopping around 0.2 percentage points off real GDP growth in 2020. In 2021, with both exports and imports slowly getting back on track and expanding at roughly the same pace, the trade sector will be a neutral force in the economy.

A deterioration in the real trade balance does not bode well for the current account balance, which will see its deficit widen significantly this year. However, as exports and imports expand more in line with each other in 2021, that deficit will shrink. Overall, the current account deficit is forecast to worsen from $45 billion in 2019 to over $54 billion this year, before narrowing to around $40 billion next year.

### Tough year ahead for non-resource business investment

In addition to trade, investment has been a recent source of weakness for the Canadian economy. Real investment spending increased by just 0.4 per cent in 2019, and growth over the past few years has not been enough to offset the sharp declines caused by the crash in commodities prices that began in 2014. Last year, Canadian companies invested $45 billion less in...
their operations than they did in 2014. While that decline is largely attributable to the energy sector, investment in the non-energy sectors has been tepid at best. In 2019, real non-energy investment was at about the same level it was five years ago, indicating that the weakness in business investment has spread across most sectors of the Canadian economy.

Looking ahead, non-resource investment will decline further in 2020, as uncertainty surrounding the COVID-19 outbreak will cause many firms to delay their investment decisions. The recent rail blockade protests also play a role in our subdued outlook for this year, though the effects are small compared with the impacts of the pandemic. With domestic and global demand expected to pick up toward the end of this year and the worst of the COVID-19 pandemic assumed to be behind us by then, investment outside of the energy sector will begin to increase in the fourth quarter and continue to increase over the rest of our forecast. (See Chart 4.)

Chart 4
Outlook for non-resource investment is weak
(real non-resource, non-residential business investment, percentage change)

Price war throws a wrench into Alberta’s turnaround hopes

Just a few weeks ago, we were assuming that 2020 would be the year that energy investment bounces back strongly. West Texas Intermediate averaged US$58 per barrel in January. Supply and demand pressures were stable as U.S. shale production showed signs of decelerating and the first phase of a trade deal between China and the United States was announced.

The spread of COVID-19 in late January quickly dimmed the prospects for global oil demand, as a number of regions in China and, soon after, Italy came under quarantine, severely limiting travel and other economic activity. WTI prices settled at just over US$45 per barrel at the start of March as fears of a global economic recession swelled. A meeting in Vienna on March 4 between OPEC members and Russia was expected to result in additional output cuts aimed at bringing greater balance to an over-supplied oil market. But disagreements at the negotiation table sparked an all-out price war by OPEC against Russia. Led by Saudi Arabia, OPEC opened the taps, sending oil prices plunging faster than at any time since the Gulf War in 1991. Within a matter of days, the WTI price fell to just above US$30 per barrel.

Both Saudi Arabia and Russia say they are prepared to live with these low levels indefinitely despite the significant damage to their oil revenues, and we don’t expect either side to change their stance in the next couple of months. Ultimately, however, we think that after inflicting significant damage on each other, OPEC and Russia will re-open talks, which will likely lead to an agreement by the end of May. This should bring WTI back to the US$45–US$50 per barrel range.
range, with a gradual recovery expected to take place throughout the remainder of the year as containment efforts eventually halt the spread of the coronavirus and the global economy begins to heal.

Until that happens, the hit to Canadian oil and gas producers will be hard. The price for a barrel of Western Canadian Select averaged US$44 last year but is forecast to average just US$32 over the first three quarters of 2020. (See Chart 5.) Large-scale energy projects, such as LNG Canada and the Trans Mountain Expansion, will stay on schedule and keep overall oil and gas investment growth positive this year. But the expected turnaround in oil sands investment will be postponed, pending a resolution to the vicious price war currently plaguing the market and a containment of the COVID-19 virus. Over the next six months or so, conventional drillers across Western Canada will shut in a significant portion of their production at active wells as they struggle under the impact of weak prices. We expect the WTI price to recover to US$53 per barrel in the fourth quarter as the residual impacts of the COVID-19 outbreak dissipate. In 2021, construction of the U.S. portion of Enbridge’s Line 3 project will wrap up and the line will open for business, offering a full 370,000 b/d of export capacity to oil sands producers in Alberta. We expect a large portion of the forgone oil sands investment in 2020 to resurface and add on to investment already expected for 2021, setting the oil patch up for a busy year next year.

With producers operating rigs across Western Canada suffering from the fallout of the price war between OPEC and Russia, oil production will be scaled back over the next two quarters, eating away at razor-thin profit margins and, in some cases, leading to negative cash flows. Production from offshore platforms in Newfoundland and Labrador will buoy production at the national level as the Hebron platform nears its full nameplate capacity. Oil sands production growth won’t be as strong as previously forecast, but we should still see at least some growth this year. Energy stocks in Canada took a significant hit as a result of the price crash, and with lower revenue forecast for 2020, the urge to expand and increase production volumes just won’t be there until the climate improves. But with Alberta’s production cap still above its 2019 level on a year-over-year basis, and with more pipeline capacity, there is room to grow. Some of the larger oil producers that opposed the implementation of curtailment may use this opportunity to boost production if it means that they benefit from better refining margins downstream. The downside risk to this outlook is significant. If the dispute between Russia and OPEC drags on, oil prices won’t recover as forecast, energy companies will be

![Chart 5: Soft global demand weighing on energy prices and investment](chart.png)

(WCS oil, US$ per barrel; oil and gas investment, 2012 $ billions)

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forced to slash investment and production even more than anticipated, and the Alberta government could tighten its oil production curtailment in order to provide some relief for struggling oil and gas companies. If that happens, Canada could easily enter recession in the third quarter.

**Household sector**

**Job market to face modest downturn**

With COVID-19 weighing on the Canadian economy, Canada's labour market won't go unscathed. Canada has added over 24,000 jobs in each of the first two months of 2020, which is all the more impressive given that the increases came on the heels of a strong 2019. While many employers will work to retain their employees, other industries—particularly food and accommodation, culture and recreation, and the oil and gas industries—face a decline in employment. Overall, we expect close to 138,000 jobs to be created this year, down from 391,000 last year.

The main reason why Canada's job market will not experience a further decline in employment is the tightness of its labour markets. The near record-low unemployment rate means that firms are already fighting for workers. And because the effects of the coronavirus are expected to be temporary, most firms will do their best to hold on to their workers in order to be well positioned for the resumption of growth in the second half of this year. (See Chart 6.) While industries such as those related to travel, large events, or the oil industry will see substantial declines in employment growth in the second quarter, we expect the losses in most other industries to be minimal.

**Chart 6**

**COVID-19 will weaken labour market in second and third quarters**

(job growth, 000s; wage growth, annualized, per cent)

$f = \text{forecast}$

Sources: The Conference Board of Canada; Statistics Canada.
The decline in employment will have a minimal effect on wage growth. Wages in Canada grew at more than double the pace of inflation last year, providing a major lift to spending power. While we don’t expect wage growth to be as strong in 2020, we do expect it to come in at 3.1 per cent for the year as a whole, still well above the rate of inflation.

The modest employment and solid wage gains will be a boost to incomes in 2020. Labour income will rise by 4.2 per cent in 2020, just short of the 4.5 per cent growth last year. Solid labour income gains will lead inflation-adjusted disposable income to rise by 2.0 per cent this year and support the highest savings rate since 2015. Robust growth in disposable income and a better savings rate suggest that Canadian households are in a position to weather the current downturn despite record-high levels of household debt.

Consumer spending will slow this year

Despite the strength in the labour market, consumer spending will ease in 2020, due mainly to the global COVID-19 outbreak. We expect the pandemic to take a toll on household services spending in the second quarter of 2020. Especially hard hit will be transportation services, food and accommodation services, and recreation and culture services, as Canadians have been encouraged to do their part in containing the spread of the virus by practicing social distancing. So far, we’ve seen Air Canada suspend flights from Canada to mainland China and Italy, the federal government encourage all Canadians to avoid non-essential international travel, and a ban until at least July on visits by any cruise ship that carries more than 500 passengers. As a result, we expect spending on transport and food services to plunge in the second quarter of 2020. Likewise, the cancellation of sports games, concerts, and conferences will hurt spending on recreation and sports activities as well.

The pandemic—coupled with the stock market crash that was sparked by the virus, the oil price war, and mounting fears of a global recession—will erode consumer confidence in the near term. March’s Consumer Confidence number fell by an all-time record 32 points. As a result, many people will hold off on making any major purchases, such as vehicles and semi-durable goods, until the economic uncertainty has passed. While the Bank of Canada’s decision to cut the interest rate by 100 basis points in March was good news for households, it will take several quarters for consumer confidence to pick up.

Fortunately, the economic impact of COVID-19 on consumption will be temporary. Overall, we expect growth in real consumer spending to ease to 1.0 per cent in 2020 but then rebound to 2.3 per cent in 2021. (See Chart 7.)

Housing markets set for a big year

While recent interest rate cuts by the Bank of Canada are meant to cushion Canada’s softening economy, they will only add fuel to Canada’s already hot housing market. Interest rates were already low and recent cuts will make it even cheaper to finance a new home purchase. The two other main underpinnings for
housing—employment gains and population growth—have also been strong and have driven many resale markets, most notably in Ontario and Quebec, to the point of overheating. While we expect Canada’s housing market to buck the downward trend facing much of the rest of the economy, two main risks lurk. First, the economic fallout from COVID-19 could create a recession that derails housing demand. And second, potential homebuyers might flinch at the eye-watering prices in many cities and lose confidence that the value of their potential new homes will continue to rise in the future.

The state of the country’s housing markets varies greatly by region. Markets are generally much stronger in the eastern half of Canada and weaker in the west (although Vancouver’s market is bouncing back). Most markets in Southern Ontario and some in Quebec are red-hot and have long since overwhelmed the regulatory changes, such as the mortgage stress test and the foreign buyers’ tax, that policy-makers implemented to cool them. Both new and existing markets appear to be undersupplied. On the new home side, builders frequently cite a scarcity of available land and local objections to higher density as obstacles to construction, while resale markets face falling listings of existing homes. Both factors constrain homebuyer choice and boost prices. High levels of consumer debt continue to lurk as a background threat, and the recent interest rate cuts threaten to boost debt even higher.

Housing starts eased slightly in the fourth quarter of 2019, ending the year at 208,500 units. That was down 2 per cent from 2018, but still a historically strong showing. We expect a rebound to just under 213,000 units in 2020 and a modestly higher 213,700 units in 2021. (See Chart 8.) Since new and resale homes are
generally substitutes for each other, the new home market is being fuelled by the same cyclical factors as its resale counterpart. This has yet to produce enough homes, though. Canadian housing starts have trailed our estimate of national household formation in seven of the past eight years. The ramp-up in housing starts will boost real investment in new homes by nearly 9 per cent in 2020, while a strong resale market will lift ownership transfer costs by just over 13 per cent. We expect little change in renovation spending this year. All told, real residential investment is slated to rise by 6 per cent in 2020, following two years of modest easing. For 2021, we expect a 2 per cent increase in real residential investment, thanks to a small increase in housing starts, continued strength in the resale market, and a return to growth in renovation spending.

Canada’s average resale price is poised for a big jump in 2020. Falling listings and rising sales have pushed many markets into sellers’ territory, and prices are surging. Canada’s national average resale price rose 2 per cent in the fourth quarter, placing it nearly 8 per cent above its year-earlier level. The gain followed two straight quarterly increases above 4 per cent. Canada’s strongest markets continue to be those in the east, but values are beginning to edge higher in Vancouver, as well. While many eastern Canadian markets were unaffected by demand-limiting government policies and remained tight through much of 2019, markets in and around Toronto that were targeted by regulations appear to have shrugged off the effects of these rules and are experiencing accelerating price growth. Moreover, prices for single-detached homes (a particular target of the federal government’s mortgage “stress test”) are rising more strongly. All this supports our forecast that Canada’s resale price will rise by just under 14 per cent in 2020. In 2021, lingering strength will push this price up a further 5.4 per cent.

**Provinces keep government spending growth contained**

Despite solid economic growth over the last few years, the federal government is dealing with a significant fiscal deficit. In its *Fall Fiscal Update*, the federal government pegged its operating shortfall for the 2019–20 fiscal year at $26.6 billion. Since then, economic growth has come in weaker than expected and, as a result, we will likely see the deficit for the year ending on March 31 come in a bit higher.

While there is a small amount of risk around the 2019–20 deficit, much greater risk exists for the 2020–21 fiscal year. With economic conditions...
deteriorating so quickly, revenue growth for fiscal 2020–21 will come in much weaker than the government was expecting in its December update. At the same time, there have been increased calls for a simulative package to help workers and boost economic growth. On March 12, the government announced $1.1 billion in new funding to combat the impacts of COVID-19. The additional funds are to be allocated largely to the provinces for increased health care costs and for more research into dealing with the virus. The next day, the government announced that a much larger fiscal stimulus response was in the works. While the exact nature of the stimulus was unknown at the time this forecast was completed, the combination of weaker revenue growth and much higher spending has a predictable outcome—the federal deficit will be much larger than previously expected. With the government already planning to run deficits before this series of shocks hit the economy, there is no chance that we could see the federal government return to surplus at any point in our projection period.

While the federal budget has been delayed due to COVID-19, some provinces had already released their budget projections before it became evident that the virus was going to become a global pandemic. All provinces will be hurt by the shocks hitting the economy, and any budgets that have been released before mid-March will need to be updated to reflect the new economic outlook. When those revisions happen, we expect to see the collective provincial deficit swell.

Our forecast was built under the assumption that the provinces would continue to rein in spending to tackle their deficits and was completed before any fiscal stimulus measures were announced. Therefore, the forecast data show relatively weak government spending over the near term. (See Chart 9.) Given that governments are now expected to respond to the COVID-19 pandemic with aggressive stimulus measures, this represents an upside risk to our projection.

**Central banks respond with aggressive monetary easing**

It has been a dramatic few weeks for markets and central banks. With markets panicking over the spread of COVID-19, the U.S. Federal Reserve took the extraordinary step of making an unscheduled double cut (50 basis points instead of the usual 25 points) in interest rates on March 3. The Bank of Canada followed suit with its own 50-basis-point cut at its scheduled rate announcement the next day, and then announced another cut of 50 basis points at an unscheduled
press conference on March 13. The Federal Reserve then announced on March 15th it would drop interest rates another 50 basis points and buy at least $700 billion in government and mortgage-related bonds. Both central banks will then cut rates a further 50 basis points in April, bringing the key rates down to just 0.25 per cent. (See Chart 10.)

Central Bank surprised markets by holding its policy rate steady at –0.5 per cent, although it did increase its asset purchase program by €125 billion and provide more liquidity to banks. The Bank of Japan held off on any new measures, saying it would wait until its regularly scheduled meeting in the third week of March. Like the ECB, the Japanese central bank’s options are limited by a policy rate that is already negative, at –0.1 per cent. Even if it opts not to cut rates, we expect it to introduce other stimulative measures.

With the Bank of Canada and the Federal Reserve moving in tandem, rate differentials will not be a major driver of the exchange rate. Yet, at the same time that the world has been sent reeling by the COVID-19 outbreak, the loonie has also been hit by the oil price war between Russia and Saudi Arabia. From a February peak of US$53.88, West Texas Intermediate fell to a low of US$31.13 in early March and has remained in the low $30s since then. Although the price of oil does not drive the value of the Canadian dollar as strongly as it recently did, the loonie quickly dropped to just above US$0.72 within days of the oil price war breaking out. Overall, we expect the Canadian dollar to see some small improvement as oil prices and economic growth recover. Still, we don’t see the dollar exceeding US$0.75 at any point over the next two years.
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The Conference Board of Canada