The Conference Board of Canada

Economic Implications of Social Distancing

Alternate Canadian Outlook Scenario

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Key findings

- In this alternate scenario, we assume that the travel bans and social distancing measures now in effect continue until the end of August in both Canada and the United States.
- The result is a much deeper and longer-lasting hit to economic activity in Canada. Instead of growing 0.3 per cent as in our baseline forecast, real GDP is now forecast to contract by 1.1 per cent in 2020.
- In this scenario, the economy sheds over 330,000 jobs over the second and third quarters of 2020, boosting the unemployment rate to 7.7 per cent.
- Industries servicing tourism, household services, and resource sector construction will be hit hard, with many suffering double-digit declines in the second and third quarters.
- A consumer-led recession in the United States is assumed, with real GDP there declining by 1.0 per cent. With diminished demand from our most important trading partner, Canada's exports of goods and services are forecast to decline in real terms by 2.2 per cent in 2020.
- Weak U.S. and global growth will result in a more prolonged drought in commodity prices, hurting investment in the resource sector.
- We further assume that Saudi Arabia and Russia will be slow to reach an agreement to curtail oil production. Oil prices will remain low and investment in the oil patch will continue to contract.
- Government transfers to people, lower interest rates, and other measures to increase liquidity will help stave off household and business bankruptcies—keeping Canada's financial institutions in relatively good shape.
- Real estate markets will cool significantly from the frothy activity reported in February, but new home construction is expected to hold up through the downturn.
- With the COVID-19 pandemic contained by this coming September, a rebound in household spending is forecast to occur in the fourth quarter and into 2021.
- Pent-up consumer demand will help economic activity rebound, with real GDP growth of 3.3 per cent forecast in 2021.

Compare this outlook to our baseline forecast, the Spring 2020 Canadian Outlook.

Introduction

The spread of COVID-19 is a humanitarian emergency that is causing a change in global behaviour unlike anything that most of us have ever seen in our lifetime. Countries around the world are closing their borders and imposing quarantine measures on their citizens.

With the situation evolving rapidly and the unpredictability of the response from businesses, consumers, and governments, it is challenging to prepare economic forecasts. Given these circumstances, we decided to produce an alternative scenario to our forecast, one that considers a deeper and more prolonged economic impact than that contained in our Canadian Outlook Spring 2020. While we believe that our baseline projection still represents the most likely outlook, it is useful to look at alternative economic scenarios to better understand the range of possible economic outcomes as this pandemic unfolds.

Over the last few weeks, growth in the number of COVID-19 cases in Canada has followed the typical exponential curve that is the pattern of such highly contagious viruses. In our baseline forecast, we assume that a six-week shutdown of many economic sectors will successfully contain the virus's spread in Canada. Despite the short duration, the negative hit to our economy in the second quarter is steep, such that real GDP is held to just 0.3 per cent growth in 2020 (down from the 1.8 per cent growth forecast in our Winter 2020 Canadian Outlook). Our alternative scenario assesses the path the economy would take should the virus continue to disrupt daily lives for a longer period of time.

Assumptions

Synchronized slowdown among world economies

The world is facing an extraordinary challenge in the form of a rapidly growing contagion. First and foremost among the responses are the efforts to stem the pandemic, with drastic measures being imposed in many countries to limit travel and human interaction and thereby slow the spread of COVID-19. Second, leaders around the world are leveraging policy measures to try to mitigate the unprecedented impact on the global economy. Despite their efforts, real global GDP is forecast to grow by roughly 1 per cent this year—down sharply from the 3 per cent growth pace in 2019.

In this alternative scenario, we assume that both Canada and the United States struggle to contain the virus. Travel bans and social distancing measures continue over 24 weeks, from mid-March through to the end of August.

The United States falls into recession, posting a decline in real GDP of 1.0 per cent in 2020. The alternative scenario does not include a potential US$2-trillion fiscal package—worth a massive 9.3 per cent of GDP—being negotiated by the U.S. Congress, which we believe would help the United States avert a recession.

Foreign and domestic demand falter

Canada's international inbound and outbound tourism is expected to grind to a halt and recover more slowly than other segments of the economy. In addition, household spending on bars, restaurants, arts, entertainment, and other personal services drops by nearly $20 billion (in current $) over the second and third quarters of 2020. The combined reduction in spending results in drastic revenue cuts for the air transportation, accommodation and food services, and arts and entertainment industries.

In a typical year, Canadians tourists spend more abroad than international travellers spend in Canada. The net annualized addition to discretionary income in Canada is roughly $10 billion, although it is unlikely that Canadians will travel even within Canada in the coming months.

The decline in spending by households on services is partially offset by purchases of durable goods and spending on home renovations.

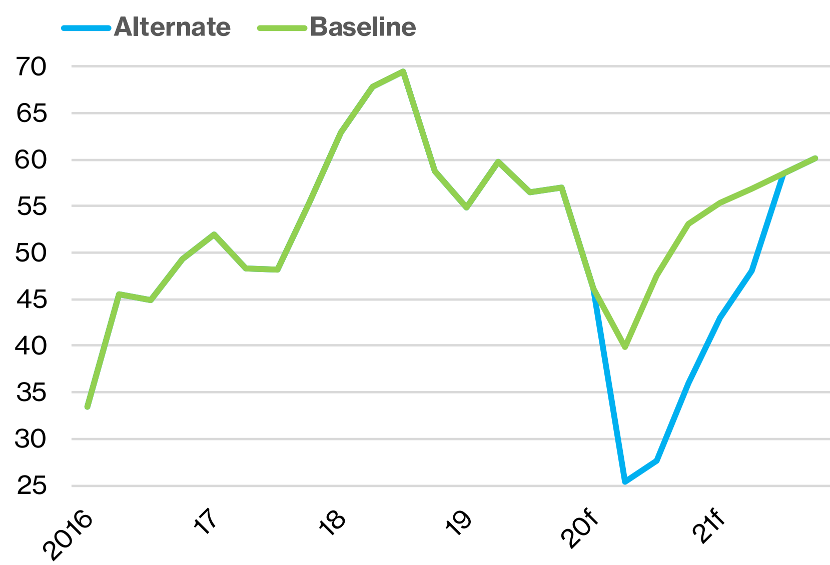
Oil prices in freefall

The combination of collapsing demand linked to COVID-19 and a fight for market share between Russia and Saudi Arabia sent world oil prices plunging. Russia has promised to boost production by 500,000 barrels per day (bpd), while the Saudis plan to bring full excess capacity of 2.3 million bpd online—an incredible surge in supply amid collapsing demand. We assume the situation is not resolved quickly and that oil prices remain weak, with the West Texas Intermediate (WTI) oil price averaging just US$26.50 over the second and third quarters of 2020, or less than half the 2019 average price. (See Chart 1.) Canadian light and heavy oil producers will suffer a significant hit to revenues, putting the brakes on conventional production and new capital investment.

Chart 1

OPEC and Russia flood the market

(West Texas Intermediate oil price, US$ per barrel)



f = forecast

Sources: U.S. Energy Information Administration; The Conference Board of Canada.

The extended social distancing measures, now seen as lasting through to the end of August, result in a much deeper and longer-lasting hit to economic activity in Canada.

Extraordinary monetary and fiscal policy measures

In addition to several measures put in place to loosen monetary conditions, the Bank of Canada cut its overnight rate by 50 basis points on March 4, and then by another 50 basis points on March 13. Our baseline forecast assumes that the overnight rate sinks to 0.25 per cent. But in this alternative scenario, the Bank of Canada enters the realm of negative policy rates, with the overnight rate falling to –0.25 per cent.

On March 18, the federal government announced an $82-billion rescue package amounting to 3.3 per cent of GDP. The spending includes $27 billion in direct transfers to workers and businesses. For workers, the government intends to boost Employment Insurance (EI) payments, insure workers that do not qualify for EI, top up child benefits, and increase the GST credit to help support low- and modest-income families. Small businesses will get a 10 per cent wage subsidy for three months.

The lion's share of the federal measures—$55 billion—goes to tax deferrals for businesses and households. Federal tax payments are deferred until August, and student loan payments are also deferred for six months, with no interest.

Provincial/territorial/municipal governments and Crown corporations have also announced various support measures for businesses and households.

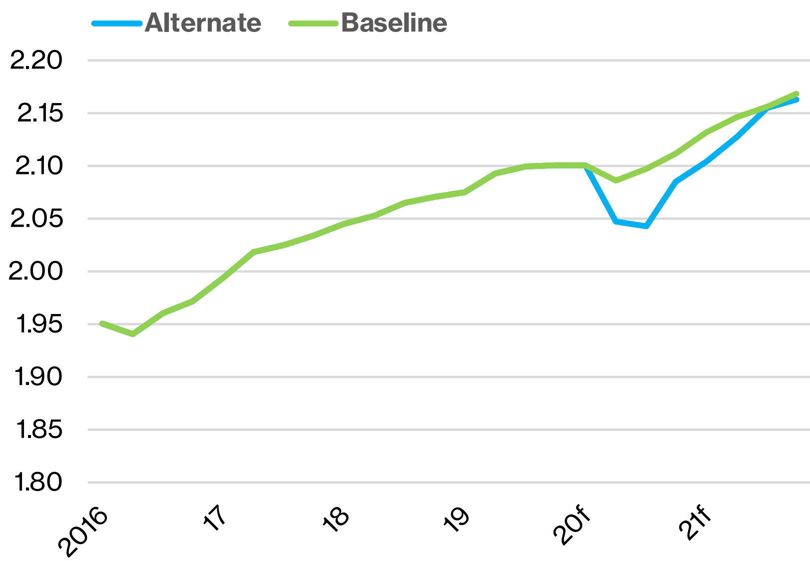
Results

Decline in household spending reverberates throughout the economy

In comparison with our baseline scenario, the bigger negative impact on the Canadian economy is the result of lower energy and resource investment, weaker exports, and a drastic decline in household spending. The extended social distancing measures, now seen as lasting through to the end of August, result in a much deeper and longer-lasting hit to economic activity in Canada, with real GDP declining at an annualized rate of 9.6 per cent in the second quarter. (See Chart 2.) Real GDP is forecast to contract by 1.1 per cent in 2020, down from the 0.3 per cent growth in our baseline forecast. By way of comparison, Canada's real GDP declined 2.9 per cent in 2009, during the global recession.

On a percentage basis, the most significant job losses occur in resource extraction as rock-bottom oil prices sink conventional drilling for oil and gas. Employment in construction is also hit hard because of weaker resource sector investment, with the sector shedding over 80,000 jobs in the second and third quarters. Commercial services (which includes sectors such as accommodation, food and beverage services, arts, entertainment, and other personal services) accounts for the lion's share of the job losses—230,000 over the second and third quarters. Overall, the economy sheds over 330,000 jobs over the second and third quarter of 2020, boosting the unemployment rate to a peak of 7.7 per cent in the third quarter. Still, thanks to a solid start to the year, employment is down by just 0.2 per cent for 2020 as a whole. (See Table 1.)

Chart 2
Hit to real GDP would be deeper and longer
(real GDP, 2012 $ trillions)



f = forecast
Sources: Statistics Canada; The Conference Board of Canada.

A consumer-led recession is similarly assumed in the United States, with real GDP there declining by 1.0 per cent. With diminished demand from our most important trading partner, Canada's real exports of goods and services are forecast to decline by 2.2 per cent in 2020.

The decline in resource sector investment and exports, plus the job losses, will have knock-on effects throughout the economy. Household and business demand for goods and services is significantly altered by the crisis, with some segments benefiting while others are hurt by declines in demand. Overall, corporate profits are forecast to drop by over 50 per cent in 2020, taking

Table 1
Key economic indicators
(level and percentage change, unless otherwise indicated)

	2019	2020f	2021f
Canadian real GDP (2012 $ billions)	2,092	2,068	2,137
	1.6	–1.1	3.3
U.S. real GDP (2012 $ billions)	19,073	18,889	19,355
	2.3	–1.0	2.5
Employment (000s)	19,050	19,006	19,354
	2.1	–0.2	1.8
Unemployment Rate (per cent)	5.7	6.8	5.9
Consumer price index (2002 = 1.0)	1.36	1.38	1.41
	2.0	1.6	2.1
Crude oil (WTI, US$/bbl)	57.0	33.8	52.4
	–12.0	–40.7	55.1
Corporation profits before taxes (GDP basis, $ billions)	154	74	132
	–10.2	–51.7	76.8
Housing starts (units, 000s)	209	214	215
Bank of Canada overnight target rate	1.75	0.20	0.35
United States federal funds rate (per cent)	2.16	0.57	0.33
Exchange rate (US$ per C$)	0.754	0.748	0.755

f = forecast
Sources: Statistics Canada; U.S. Energy Information Administration; Bank of Canada; The Conference Board of Canada.

$80 billion out of nominal GDP. The broad-based decline in investment, consumption, and exports results in reduced manufacturing output. Following a weak start to the year, real manufacturing output is forecast to suffer further hits in the second and third quarters, and will post a 4.2 per cent decline in 2020.

Massive fiscal and monetary stimulus will help economy rebound

A huge decline in corporate revenues will put severe financial stress on Canadian businesses. The Bank of Canada and all levels of government have put in place a collection of measures that are expected to limit the number of business bankruptcies and maintain confidence in the country's financial system. This is crucial to keeping the negative economic repercussions from intensifying and to ensure that Canada's economy can rebound quickly once the COVID-19 pandemic is brought under control.

Households will also be supported through this crisis through numerous initiatives put in place, especially by the federal and provincial levels of government. This will help stabilize household spending on staples such as food and rent, but will do little to spur consumer spending through the second and third quarters. As is typical of prior business cycles, households are expected to hold off on discretionary spending until the economic crisis is past. Overall, real consumer spending, a pillar of Canada's economic growth in recent years, will stall in 2020, with a gain of just 0.3 per cent. With the COVID-19 crisis contained by September, consumer confidence and spending will rebound in the fourth quarter. This will help spur 2.6 per cent growth in real consumer spending in 2021.

Canada's housing markets were heading upward through the end of last year and in January and February of this year. High sales and low levels of new listings were pointing at solid price increases in many markets across Canada (though the oil-producing provinces were notable exceptions). Over the coming months, real estate markets will cool significantly from the frothy activity reported in February, especially as the number of job losses swells.

However, the COVID-19 crisis is expected to be temporary, and lower interest rates will increase affordability for homebuyers. These factors will help support home sales and hold up prices. This should also help to maintain new home construction, which, in some areas, was being held back by lack of capacity. As such, housing starts are expected to remain stable over the second and third quarters, before gaining momentum into next year.

Overall, after contracting by 1.1 per cent this year, economic activity will rebound next year with growth of 3.3 per cent.

How COVID-19 might change the world

The COVID-19 pandemic we're currently living through is unlike anything the world has seen since, arguably, the Spanish flu pandemic of 1918. It will have lasting impacts on the lives of people all over the world as it ravages economies everywhere.

COVID-19 could result in lasting changes in the way we socialize, or the way we deliver education, health care, and business services. China's experience has led to greater online consulting among health care providers and a ramping-up of online commerce. Telework may be more broadly embraced as firms learn, through this crisis, to adopt technology in order to conduct their business while their employees are working from home.

Some of these measures may be positive for productivity and the environment. But we may also see the benefits of globalization eroded if supply chains are shortened and moved to remain within the domestic economy.

In the coming years, Canada and many other countries will need to deal with the economic fallout of COVID-19, which will likely leave households, governments, and businesses deeper in debt than they were prior to the crisis.

Download the Forecast tables

Methodology

This alternate scenario to our regular Canadian Economic Outlook builds on The Conference Board of Canada's national forecasting model, known as the Medium-Term Forecasting Model (MTFM). The MTFM is a quarterly model of the Canadian economy that differs from many other quarterly macroeconomic models in its emphasis on factors that are important for forecasting the medium-term prospects for the economy. These factors include a detailed consideration of the population and its age structure, a disaggregated modelling of prices, employment, and investment expenditures. The government sector is also treated in great detail in the MTFM and reflects the most recent institutional environment.

For our alternate scenario, we added to the model the shocks that we can largely assume could be the result of the COVID-19 pandemic and its impacts on the Canadian and global economies.

Acknowledgements

The spread of the novel coronavirus disease (COVID-19) has created uncertainty in all global markets. We're doing our best to provide timely updates, but information can fall out of date quickly. All products related to our COVID-19 coverage will be available for free on our website. To access them, go to conferenceboard.ca. The Conference Board of Canada reserves the right to adjust content as necessary.

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