

Market View – Putting Canada’s shifting fiscal fortunes in perspective

By Warren Lovely / Taylor Schleich

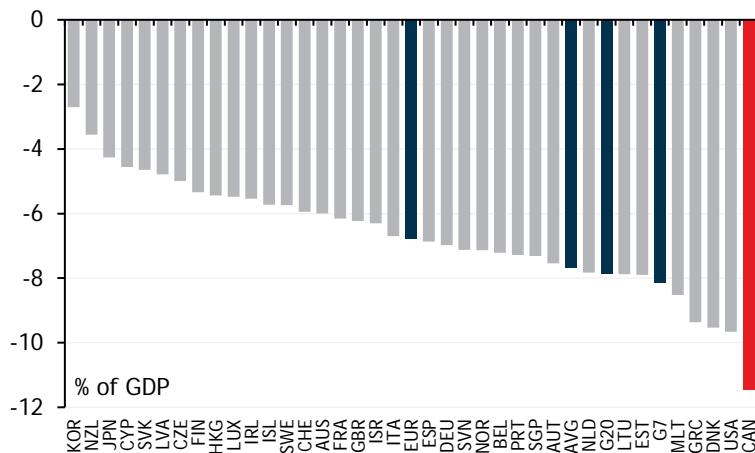
For its part, Canada has gone “all in” when it comes to using its fiscal firepower to fight the coronavirus. Fresh data from the IMF’s *Fiscal Monitor* put the resulting shift in our country’s fiscal position into broader perspective. The IMF now pegs Canada’s 2020 general government deficit at just under 12% of GDP. That’s not necessarily that remarkable vs. the average advanced economy deficit. But it’s the year-over-year change that really stands out in Canada. No advanced economy is expected to suffer as large a one-year fiscal deterioration as Canada (Chart 1).

A portion of Canada’s larger deficit captures a sharp economic downturn. But the outsized year-over-year fiscal swing is also picking up an unprecedented aid package, spearheaded by the feds in Ottawa but with provincial governments adding unique and non-trivial elements to the overall response. Canada isn’t done when it comes to the fiscal action plan, but the fiscal red ink spilled so far adds meaningfully to the debt burden (Chart 2). We’re duty bound to highlight a key balance sheet distinction in Canada, that being between *gross* and *net* debt. Canada still looks pretty good on the latter count; at just over 40%, Canada’s net debt ratio in 2020 would still be miles below the G7 average (107%) (Chart 3). Moreover, fiscal authorities would surely emphasize that a lot of measures are designed to be temporary. For Canada then, the largest fiscal deterioration in the advanced world in 2020 could give way to an unmatched year-over-year fiscal improvement in 2021.

Let’s hope so, because sustained fiscal pressure could put the nation’s coveted ‘AAA’ rating in jeopardy. Another top-rated peer, Australia, just had its rating put on “negative” outlook at S&P due to a virus-related weakening in debt metrics. To be clear, debt is hardly the sole determining factor when it comes to a country’s credit rating. But Canada is already flying close to the sun on this component of rating scorecards, particularly vis-à-vis top-rated peers (Chart 4). Consider eight other ‘AAA’ rated sovereigns in 2020: median *gross* debt = 44%, or less than half of Canada; median *net* debt = 23% which is also well below Canada. Even if Canada’s sovereign escapes unscathed, fiscal sustainability concerns in some provinces (made more acute by COVID-19 and/or oil price slump) can be expected to weigh on credit ratings this year.

Chart 1: Big-time fiscal deterioration in Canada

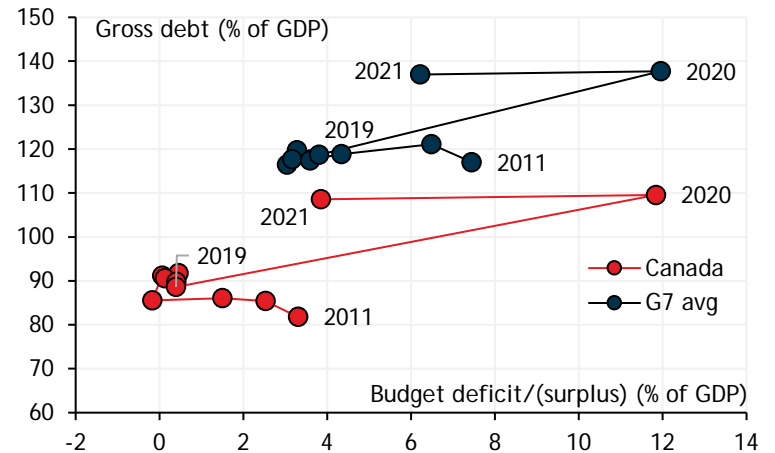
Change in general government budget balance: 2020 vs. 2019



Source: NBF, IMF | Note: EUR = Euro Area. Country aggregates shaded blue, Canada red.

Chart 2: Shifting fiscal positions

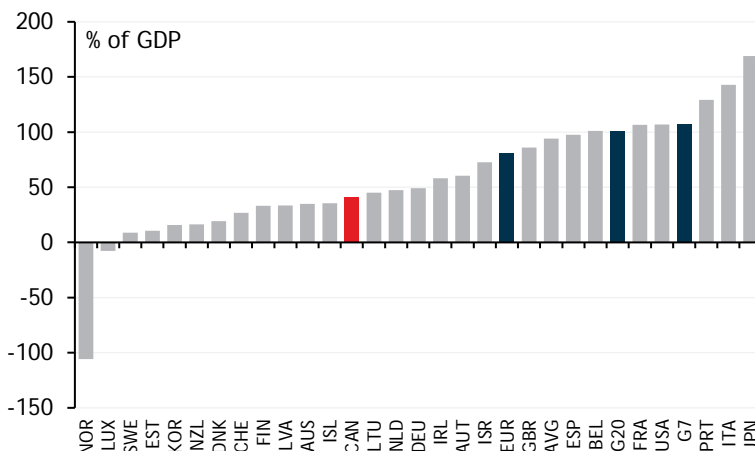
Evolution of budget balance and debt burden: Canada vs. G7 average



Source: NBF, IMF

Chart 3: Canada still has an edge on net debt

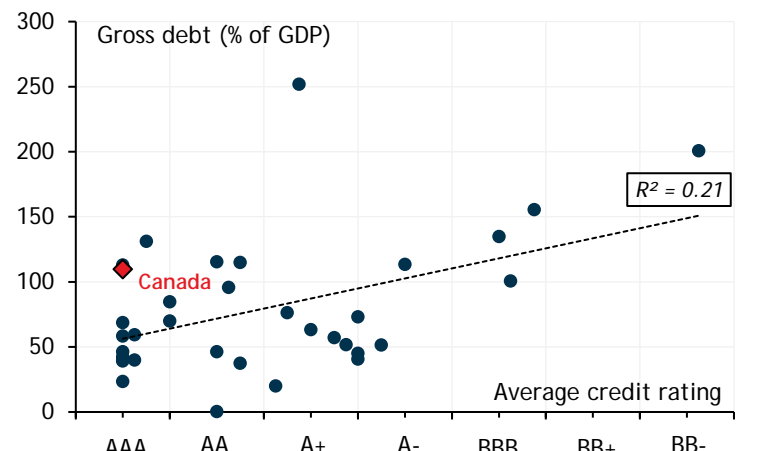
General government net debt: 2020



Source: NBF, IMF | Note: EUR = Euro Area. Country aggregates shaded blue, Canada red.

Chart 4: Canada heavily indebted for a AAA

General government gross debt burden & average credit rating: 2020



Source: NBF, IMF, S&P, Moody's | X-axis is avg. of S&P/Moody's converted to number scale



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