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Notes for remarks to the C.D. Howe Institute
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Bridge to Recovery: The Bank's COVID-19 Pandemic Response

It's a pleasure to participate in the C.D. Howe webcast today. I wish the circumstances were better.

So much has happened so quickly. In the early days of March—just eight weeks ago—Canada had fewer than 30 COVID-19 cases and no community transmission. Now there are almost 60,000 cases.

It will be a while before I forget where I was at the outset of all this: Baltimore at a G7 meeting of deputies from finance ministries and central banks. We discussed our growing concerns about what was to come for many people and practical ways that we could move quickly to cushion the blow while complementing each other's actions. Oil prices had already plummeted 35 percent since early January, and financial markets were showing increasing signs of stress. Our sense of urgency was palpable, and we knew that decisive actions were critical to building a strong bridge to the other side.

This is what has happened around the world since then:

- fiscal authorities took the lead because they are best-placed to mitigate the economic impact of unprecedented containment measures;
- regulatory authorities eased up on capital buffers to create balance sheet space for banks to meet increased demand for credit; and
- central banks reduced policy rates and implemented programs to help mitigate the economic fallout and lay the groundwork for recovery.

In Canada, these actions have been highly complementary.

Today I'd like to walk you through the main policy initiatives that the Bank of Canada has taken—our objectives, the benefits we're seeing so far, and how we're managing risks. I'll also talk a little about factors that will shape the recovery.

Reinforcing the bridge to economic recovery

Let me start with the context. The COVID-19 pandemic is a serious health threat, and public health actions are needed to contain the spread of the virus. These actions are impacting the global economy right now. Every sector of the Canadian economy is affected—energy, travel and hospitality, and service industries are being hit particularly hard.

We expect this situation will cause Canadian gross domestic product to plunge as much as 15 to 30 percent in the second quarter from its level in late 2019. We haven't published a full forecast yet because so many factors are still unknown. But even in a good scenario, lost output will be made up only gradually as containment measures are lifted, people return to work and production ramps up.

Canadian governments at all levels have taken extraordinary actions to build and reinforce a bridge to recovery by limiting hardship and minimizing any lasting damage that could impair a return to growth. That's why many actions are designed to help tide businesses over and maintain relationships between people and their employers so they can restart quickly. There are, for instance, wage subsidies, commercial rent assistance and important loan programs led by Export Development Canada and the Business Development Bank of Canada.

The Bank of Canada's initiatives are reinforcing this bridge. Actions to date have been in two classes.

The first is monetary policy actions:

- We have lowered the overnight rate by a cumulative 150 basis points since early March to 25 basis points—we've said that this is the effective lower bound.
- The speed and magnitude of these cuts reflect Governing Council's view of the severity of the situation and its impact on inflation pressures. The oil price shock since the beginning of the year, with WTI now around 70 percent lower, justifies much of this; its effects will be strongest in energy-intensive regions and will ripple across Canada.
- Lower rates may not spur much demand right now, but they are laying the foundation for when the recovery gets underway, once containment measures are lifted.

The second class of actions is to repair market functioning so that lending channels continue to function.

The World Health Organization (WHO) declared COVID-19 a global pandemic on March 11. By then, the gravity of the situation was sinking in. Stress was radiating throughout core Canadian funding markets, and we had seen the three largest point declines in the stock market in US history.

I was on more calls than I can count—with financial institutions, counterparts from other central banks, domestic colleagues from the Department of Finance, the Office of the Superintendent of Financial Institutions and the Canada Mortgage and Housing Corporation (CMHC). These conversations helped us design a strategy that targeted the most pressing issues and could be implemented quickly.

Our priority was to restore the functioning of core short-term funding markets, which are even more critical to businesses and individuals experiencing temporary disruptions to their income. We had understood from our calls with banks that draws on lines of credit were coming at lightning speed, and that their expected loan payment deferrals would add to funding requirements. One lesson I learned from the 2007-09 global financial crisis was that banks will scale back lines of credit when sources of funding become too uncertain.

Our programs are therefore aimed squarely at:

- *Short-term funding markets for banks so that they can continue to serve businesses and individuals.* This includes term repo operations conducted against a wide range of high-quality collateral for terms of up to two years. There's also a Standing Term Liquidity Facility open to a broader set of financial institutions. It's good to see banks using these facilities so that they can provide loans to households and businesses.
- *Markets that provide working capital for Canadian companies and public authorities.* For instance, we are purchasing bankers' acceptances (BA), commercial paper and short-term debt from all provinces. The markets for these securities are critical to meeting business needs: unexpected expenses, disruptions to receivables, even payroll.
- *The Government of Canada (GoC) treasury bill (T-bill) market.* The Bank has temporarily increased take-up of T-bill auctions from a maximum of 25 percent to 40 percent. There are increased demands for cash from fiscal actions taken to support the economy through this difficult time. Two examples of this are the 75 percent wage subsidy program and the delay in cash flow from deferring tax payments until the end of August.

It's early days, but we can already see the benefits of these programs. Activity has resumed and spreads have narrowed across the markets we are operating in. One example is the BA market, where spreads relative to overnight index swaps have come in from a high of 120 basis points to around 20 basis points. We're seeing reduced take-up on our BA purchases and some of our other operations as a result. This is good news.

There is, nonetheless, still considerable uncertainty. Market makers for fixed income and other financial assets have pulled back. That's understandable. Market making becomes prohibitively risky when the prices of securities are

fluctuating widely. Buyers and sellers are finding it difficult to trade at a time when there is a heightened desire to rebalance portfolios.

This dynamic is particularly problematic when it occurs in the market for GoC bonds because they are held as the safest Canadian-dollar asset and are a benchmark for other asset prices. If the GoC bond market isn't functioning well, no other Canadian-dollar market will either.

We decided to implement a GoC Bond Purchase Program to address the strains we were seeing in that market. We've committed to purchasing a minimum $5 billion of GoC securities in the secondary market each week until the recovery is well underway.

We also were seeing strains in other longer-term funding markets that could make it harder for other government authorities and companies to execute stable longer-term financial plans. Although the current situation will be temporary, business people here know that you cannot adequately manage risks based on short-term funding alone. That is why we are implementing programs to buy a wider range of bonds in the secondary market. We've committed to buy up to $50 billion in provincial debt across all provinces and up to $10 billion in high-quality Canadian-dollar corporate debt. We are purchasing Canada Mortgage Bonds (CMBs) to support the functioning of the CMB market, which is an important source of financing for mortgage lending to Canadian homeowners. This also complements CMHC's Insured Mortgage Purchase Program.

Keeping our eye on the ball

While each of these programs is tailored to address a specific issue in lending markets, they have something in common: they all increase the size of the Bank's balance sheet because they involve acquiring financial assets. We have funded these activities through settlement balances—these show up as deposits by banks on our balance sheet.

- Our balance sheet has grown from around $120 billion at the beginning of March to around $385 billion as of last week.

It's not novel for central banks to expand their balance sheets to satisfy an increased need for liquidity. This traditional role is consistent with our inflation objective because an economic recovery cannot be sustained without a well-functioning financial system.

Some worry about how we'll be able to ensure that the expansion of the Bank's balance sheet doesn't lead to runaway inflation as economic activity recovers. As a fan of Western University professor David Laidler's work, I could never dismiss this worry out of hand.

There are several factors that reassure me:

- First, and most important, inflation-control objectives will continue to guide our actions.

- Second, a good part of the increase in the balance sheet will run off naturally as liquidity measures and purchases of short-term assets are wound down, much like we saw after the global financial crisis. Right now, close to 90 percent of the increase in our balance sheet is set to mature within a year. Although this proportion will decline as our bond purchases progress, most longer-term securities acquired will be available for sale.
- Third, we have the means to control the amount of monetary stimulus in the economy even if our balance sheet remains larger than it was. We can raise the overnight rate and, with it, the remuneration on deposits. We can conduct reverse repos or sell assets as needed to drain liquidity and reinforce the target for the overnight rate.

These factors are what distinguish our actions from a "helicopter drop."

Others are worried that the current situation poses the opposite risk—deflation. Given the high level of indebtedness, there's no doubt this would be a destabilizing situation for many because incomes would fall but the value of debt would not. As the Governor has pointed out though, comparisons to the deflation seen in the Great Depression are not helpful. For one thing, the banking sector is in much better shape than it was at that time. For another, we will not make the same policy errors.

Whether it's a risk of inflation or deflation, central bank credibility is critical. This requires keeping our eye on the ball in terms of our mandate and retaining the operational independence to achieve it.

The inflation-control target agreement between the Bank and the federal government has been the cornerstone of our operational independence for almost three decades. Our new programs align with this agreement because they are helping to lessen financial hardship today and paving the way to a sustainable recovery.

The Bank has been attentive to designing these programs in a way that prudently manages the risks.

- Financial risk to taxpayers is low because the programs are defined with risk mitigation in mind: term-to-maturity limits, minimum credit ratings, counterparty limits and concentration limits.
- Operational risks are reduced because our team is executing the transactions from three different sites, one of which is in Calgary. And we have hired established asset managers for three of the purchase programs. These managers are subject to strict conflict-of-interest requirements, well-defined mandates with limited discretion and strong Bank oversight.
- We have collaborated closely with the federal government to obtain indemnity agreements on the major purchase programs.

  - This provides additional assurance that our use of these programs will remain closely tied to the Bank's inflation control objective.
  - Some form of government indemnification against losses is a common approach taken by other jurisdictions for these types of central bank programs.

We will be transparent about our operations—that includes being clear on the parameters of our programs and reporting on our holdings on a regular basis. It is important to strike the right balance between transparency and too much trade-specific detail so that the Bank can deliver the best results for taxpayers.

Looking forward will keep us on track

It has been almost eight weeks since the WHO declared COVID-19 a global pandemic. Progress has been made on many fronts, but there is more to be done. So, let me conclude with a few brief remarks in this regard.

In our April Monetary Policy Report (MPR), we outlined two possible scenarios for the Canadian economy:

- The most favourable scenario assumed that measures to slow the spread of the virus would start to be lifted in May and June. This would herald a firming of foreign and domestic demand and, with it, consumer and business confidence. This is still within reach, but by no means assured.
- A recovery could take longer, resulting in a more severe scenario. Containment measures could remain in place for longer, confidence effects could linger, and production could ramp up more slowly if damage to supply chains is more profound.

We'll be in a better position to consider more precise scenarios as the plans for a restart become more concrete.

- As emphasized when we published the April MPR, we can recalibrate our asset purchase programs to monetary policy objectives, rather than solely market functioning, if needed.

We all know that Canada will be left with more debt than when we started—both government and private. And there will likely be other headwinds, such as low energy prices. Dealing with this situation will take careful planning, smart macroprudential policies and sustainable economic growth.

Let's remember: there are opportunities to achieve strong and sustainable growth over the longer run that won't disappear because of COVID-19. I discussed a number of these in a speech in February, which seems like light years ago.

- Some may become even more promising—digital transformation, investments to shift to a low-carbon economy.

- Reshoring and securing supply chains will become important new factors, so reducing barriers to doing business across the country makes even more sense.
- Many of these opportunities will need private and public sector collaboration, as well as equity capital.

The Bank will do its part to bridge this period and support a lasting recovery.

Canada will see the other side of this crisis.