Queen's Budget Seminar – Outline

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A. The General Economic Context, January 2009

1. **Financial-market origins.**
   - collapse of U.S. housing market led to financial crisis which spread internationally
   - failures (and takeovers) of large US and European banks
   - interruption in the flow of credit in most countries, including Canada

2. **Slowdown in the real economy.**
   - the interruption in credit flows led to significant slowdown in real activity
   - led central banks around the world to loosen policy significantly, and to take "unconventional" actions designed to restore the flow of credit
   - still, there was a remarkably synchronized global recession

3. **An internationally coordinated policy response.**
   - IMF and G20 called for collective action in November in Washington
   - agreement to re-examine financial-market regulations
   - agreement to provide fiscal stimulus of 1-2 percent of GDP

B. The Canadian Economic Context, January 2009

1. **Canada's relative position was better than most others.**
   - our public fiscal position was far stronger
     - thus we were more able to consider stimulus spending without LR problems
   - our banks were more capitalized and less leveraged
     - but non-bank financial markets were still not functioning well (eg., ABSs)
   - our households were less indebted
     - but there was nonetheless some deleveraging to do and confidence was quickly shattered

2. **Canada's openness implied that we could not avoid the coming recession.**
   - our strong starting position did not mean we could avoid a downturn, but it did suggest that we were well positioned to weather the coming storm
   - our credit and financial markets are closely integrated with those abroad
     - ➔ interruptions elsewhere spillover into Canada, inhibiting the flow of credit
   - we sell ~ 40% of our goods and services to other countries
   - Canadian business and households rely on foreign production for crucial products
     - ➔ recession elsewhere (especially in US) will cause one here

C. An “Economic Action Plan” Designed to Fit the Context

1. **More than “just” a budget, because the problems were more than fiscal.**

2. **The government’s starting point was to ensure a sound and well-functioning financial system.**
   - this is essential to operation of all monetary and fiscal policy, and recognizes that credit is the lifeblood of a modern economy
   - much progress was made in previous year, but more needed to be done
     - expanded IMPP to encourage banks to improve lending
     - new credit facility to encourage non-bank credit provision
     - expanded role of financial Crowns

3. **Even with well-functioning financial markets, monetary policy probably could not do all of the heavy lifting.**
   - credit markets were still sub-par
   - confidence had been badly shaken
   - some deleveraging of households and firms would be needed
   - thus, both linkages for monetary policy were under strain:
     - link between policy rate and other LR rates
     - link between LR rates and aggregate demand
     - ➔ reduces elasticity of spending with respect to the <u>policy</u> rate

4. **So there was a clear perceived need for fiscal stimulus.**
   - to dampen the economic slowdown by adding to AD
   - and to protect the most vulnerable Canadians
     - ➔ this required some targeted spending and tax measures

5. **There was a recognition that spending is generally more stimulative than tax cuts.**
   - so the budget had considerable new spending in infrastructure and housing
     - a focus on projects that could be implemented quickly
     - “infrastructure” was broadly construed – including broadband, universities, medical health records, etc.
     - some was aimed at enhancing LR productivity and improving environmental performance
     - new spending was designed to leverage provincial investments, thus scaling up the size of the overall fiscal stimulus

6. **But there are constraints on quick spending, so the stimulus also contained targeted tax cuts designed to assist Canadians who most urgently need help.**
   - increase in basic personal amount – helps all taxpayers
   - increase in WITB – helps low-income earners
   - extended EI benefits – helps the most vulnerable workers
     - some of these changes are permanent, others temporary

7. **Finally, the government needed to be mindful of excessive debt accumulation.**
   - balance needs for SR stimulus versus LR fiscal prudence
   - plan to get back to balanced budgets within 4-5 years
     - at which point the debt ratio will continue its decline
   - this is necessary so that Canada can squarely face its coming fiscal challenges (caused by demographic changes)

C. Summary

1. **Overall, the budget was designed to:**
   - improve Canadians' access to credit and restore their confidence in the financial system;
   - dampen the slowing effects of the global recession;
   - protect and assist the most vulnerable individuals during these challenging times;
   - improve the LR foundations for a strong economy (fiscal, productivity, environmental).

2. **Actions to Implement in a Timely Manner**