GUARDIAN CAPITAL | PRIVATE WEALTH

PERSPECTIVES

August 2020

Debt & Taxes

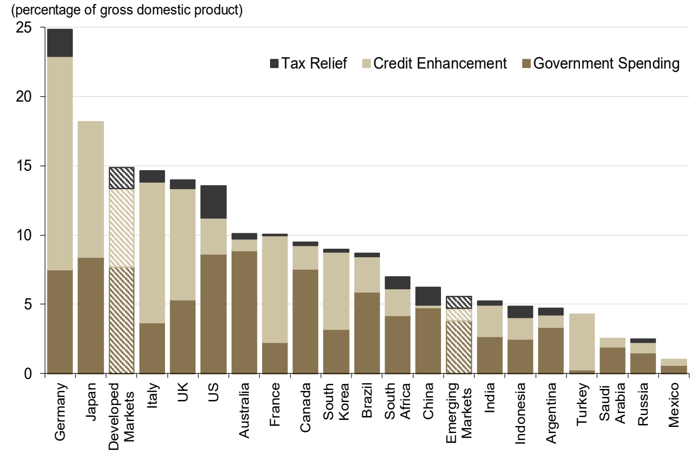
In times of economic crisis, policymakers on both the fiscal and monetary side typically step in to try to blunt the impact of the collapse of private demand and provide a general backstop for the economy. This time is no different — though it has been in terms of the speed and magnitude with which these official bodies have acted.

Since March, governments across the G20 economies have pledged nearly $8 trillion (equivalent to 11% of the G20's 2019 GDP) in fiscal support from programs, including direct payments to individuals, loans for businesses, and infrastructure investments. There is considerable variation across countries though, with the major Developed Market committing nearly 10 percentage points more of their GDP in support than their Emerging Market counterparts.

While emergency measures are warranted to help keep economies afloat through the forced sidelining of activity, the associated substantial deterioration of fiscal balances, and resultant surge in public debt, will undoubtedly prove to be a burden that will need to be addressed down the road.

CHART 1: LET'S GET FISCAL

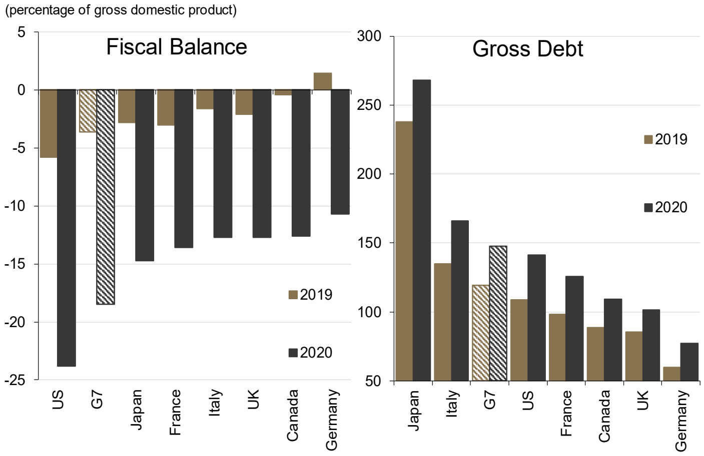
Announced COVID-19 Fiscal Response, G20
(percentage of gross domestic product)



Source: Center for Strategic & International Studies, IMF, Guardian Capital

CHART 2: IMBALANCED BUDGETS

General Government Fiscal Balance & Debt
(percentage of gross domestic product)



**2020 forecasts from IMF's June 2020 World Economic Outlook*
Source: Bloomberg, International Monetary Fund, Guardian Capital

That means either reduced public spending or increased taxes or both — and given the growing civil unrest related to inequality, there will likely be increased pressure on politicians to raise revenues through measures that target areas such as investment gains and overall wealth.

Such policies will have material implications for investors and provide a drag on overall economic growth – but that will be a bridge to cross at a later date as policy is likely to remain stimulative until this public health and economic crisis has passed, and probably well beyond.

For the foreseeable future, however, the cost of carrying that growing debt burden is far from onerous thanks to central banks worldwide slashing interest rates to never-before-seen levels.

The US Federal Reserve, Bank of England, Bank of Canada, Reserve Bank of Australia, Reserve Bank of New Zealand, and Norway's Norges Bank have all cut their policy rates to their effective lower bounds. The net result has been that the weighted-average short-term interest rate for the group has fallen by nearly 100 basis points from February's levels and into previously uncharted negative territory.

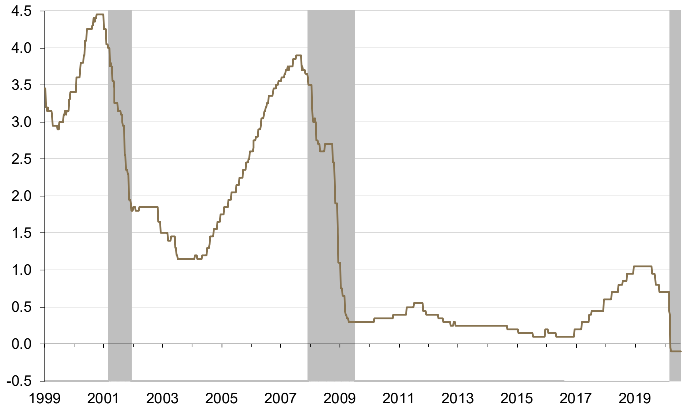
Monetary authorities have also re-opened their unconventional policy toolkits, implementing numerous lending facilities and restarting (or introducing for the first time) asset purchase programs. They also broadened the scope of those programs. These programs pumped liquidity into the financial system, and eased dislocations in funding and credit markets, helping prevent the public health crisis from turning into a financial crisis.

As a result, central bank balance sheets have expanded by nearly $6 trillion since February — for some context, it took more than five years for balance sheets to expand by this magnitude in the aftermath of the Financial Crisis.

CHART 3: LESS THAN ZERO

Aggregate Central Bank Short-Term Policy Rate*

(percent)



*GDP-weighted average policy rate of 11 Developed Market central banks

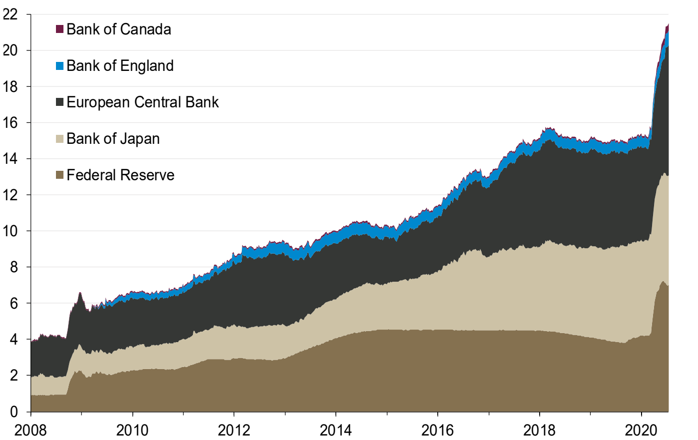
Shaded regions represent periods of US recession

Source: Bloomberg, International Monetary Fund, Guardian Capital

CHART 4: HERE WE GROW AGAIN

Central Bank Balance Sheets

(trillions of US dollars)



Source: Bloomberg, Guardian Capital

Taken together, this represents an unprecedented degree of policy stimulus that has so far created an unambiguously positive effect on economic activity, and at a time when there was a desperate need.

Unfortunately, however, these actions will require an equal and opposite reaction later on down the road, and to tweak the famous quote attributed to Benjamin Franklin, nothing is certain except for government debt being met with taxes.

The most obvious target, on the other side of the pandemic, will be asking the wealthy to pay an even greater share. Income taxes are likely headed higher, and capital gains inclusion rates are almost certain to rise; Canada sits in a reasonably strong position among the G20 in terms of projected debt to projected GDP, but the bill will eventually have to be paid.