The Coronavirus and Oil Price Collapse Could Decimate Canada's Economy, But Don't Panic

Description

There are signs that the outbreak of the coronavirus pandemic and the oil price war will sharply impact Canada's economy. This includes fears of not only a recession but that a depression could emerge that could be worse than the 2008 Great Recession. Such an event would push Canadian stocks even lower, despite the **S&P/TSX Composite Index** already losing 29% since the start of 2020.

Worsening short-term outlook

The reasons are quite simple: the production of commodities, notably oil, generates a significant portion of Canada's gross domestic product (GDP). The oil patch was responsible for almost 6% of Canada's 2019 GDP, while mining metals and other commodities contributed another 3%. Both sectors have been hit hard by the commodities crash.

Oil prices are down by around 54% since the start of 2020. The North American West Texas Intermediate benchmark is selling for US$24 per barrel. There are claims that it could fall to as low as US$10 a barrel, which would be disastrous for the oil patch. It is estimated that if oil prices stay at current levels, it will shave around 0.5% off Canada's estimated 2020 GDP growth rate of 1.8%.

Other commodities have also plunged. Copper, which is a leading indicator of economic health, is down by 21%; so too is zinc, while nickel has shed 20% and silver has plummeted by a whopping 32%. Prices will soften further as the fallout from the coronavirus causes consumption and business activity to wane, leading to a sharp decline in manufacturing activity.

As growth in the U.S. and China declines, demand for Canadian exports will fall**,** weighing further on the economy. Domestic measures taken to curb the spread of coronavirus will also harm economic growth. Moves to close borders to all nonessential travel, the banning of large public gatherings and closure of many entertainment related businesses will further magnify the economic distress.

Economic stimulus

It is unlikely that recently announced stimulus will provide relief, because strategies aimed at curbing the spread of the virus will curtail consumption and business activity. **Royal Bank of Canada** is predicting that GDP will contract during the second and third quarters of 2020 before returning to growth during the final quarter of the year.

While a recession, which is defined as two consecutive quarters of negative growth, is looming, the economy is unlikely to fall into a deep slump. Despite the severity of the short-term impacts on the economy, there are signs that the downturn will end sooner than the Great Depression did. Ottawa's economic stimulus will also assist over the longer term, helping to avert a deep and prolonged economic decline.

Nonetheless, there will be considerable pressure on financial markets and stocks for the remainder of the year. Already, financial markets are overplaying any good or bad news, causing stocks to whipsaw wildly and incur further losses. The emergence of a recession will hit markets hard, sparking a further decline of the S&P/TSX Composite, which has already entered a bear market.

Looking ahead

This means that while there is further short-term pain ahead, the economy and hence stocks will ultimately recover. That means it is time to be greedy, because many quality dividend-paying stocks boasting solid fundamentals are attractively valued. This includes Canada's big banks, which pulled through the 2008 Great Recession relatively unscathed.

Toronto-Dominion (TSX:TD)(NYSE:TD) has lost 26% for the year to date, leaving it attractively valued. The bank is trading at just under 10 times forecast 2020 earnings and 1.5 times its book value. That large decline means that if bought today, you will lock in a juicy 5.9% dividend yield. The payout ratio of a conservative 45% makes the payment sustainable, even if earnings deteriorate because of a recession.

Toronto-Dominion possesses solid fundamentals, including being well capitalized with a common equity tier one capital ratio of 13.1%. Credit quality remains high, as evident from the bank's fiscal first-quarter 2020 gross impaired loans ratio of 0.47%. There were signs that credit quality was improving.

Toronto-Dominion will weather the current crisis and rally strongly once fear subsides. Until then, patient shareholders will enjoy that tasty 5.9% yield.

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