The Expensive CRA CERB Might Have Cost Canada its AAA Credit Rating

Description

Millions of people in Canada are benefiting from the country's COVID-19 Response Plan. The Canada Emergency Response Benefit (CERB) is the pillar and lead program.

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The Canada Revenue Agency (CRA) has been handing out $2,000 monthly to affected individuals since March 2020, and the cost will magnify further with the program extension in mid-June.

The total cost is likely to reach more than $70 billion based on estimates by the independent Parliamentary Budget Officer (PBO). While the federal government is taking fiscal responsibility for introducing the program, the expensive CERB has long-term consequences.

Credit rating downgrade

Fitch Ratings, one of the "Big Three" credit rating agencies, says that Canada's stimulus package will raise its debt to 115.1% of GDP from 88.3% in 2019. Hence, Fitch had to strip Canada of its AAA credit rating and downgrade it to AA+ with a stable outlook.

The downgrade doesn't mean the outlook for Canada is foreboding. Fitch clarifies that the country's debt-to-GDP would stabilize over the medium term. Although the rating is still high, if not investment grade, alarm bells will ring should Moody's and Standard & Poor's follow with a similar downgrade.

Not a big deal

Canada's PBO Yves Giroux opines the downgrade is not a big surprise. Also, the rating of one rating agency is not that big of a deal. He said, "It's one thing to have one downgrade, but if it's all agencies downgrading us and leaving other G7 countries at the same rating as they currently are, that will send a strange signal to the markets that Canada is riskier relative to these other countries."

The rating agency should look at how Canada compares with other countries in managing spending. These countries are equally affected by the pandemic. Finance Minister Bill Morneau adds, “Canada’s COVID-19 response ensures workers and businesses have the financial support they need to weather this crisis and come back strong.”

Buy rating

On the investment side, market analysts recommend a buy rating for **Cargojet** (TSX:CJT). This $2.53 billion provider of air cargo services is one of the profitable investment options today. The growth estimates for this year and the next are 104.7% and 73%, respectively.

As of this writing, the industrial stock is up 57.5% year to date. After tanking to $75.16 on March 18, 2020, Cargojet shares are now trading at $162, or a surge of 115.5%.

The global air freight market is rising at a considerable rate during the pandemic. Cargojet reported impressive financial results in Q1 2020 (quarter ended March 31, 2020). Total revenues grew by 11.4% (from $110.4 million to $123 million) versus Q1 2019, while adjusted EBITDA rose by 24.5%.

All business segments are surging. Ajay Virmani, Cargojet’s president and CEO, said, “The company is working hard and is well-positioned to successfully support this new environment both in short as well as in the long run.”

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Signal to limit fiscal policy

Canada did the right thing by introducing CERB and other COVID-19-related financial relief programs. Fitch’s one-notch credit rating downgrade is a signal for the government to keep spending in check to ensure that the economy will be able to recover.

CATEGORY

1. Coronavirus
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TICKERS GLOBAL

1. TSX:CJT (Cargojet Inc.)

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