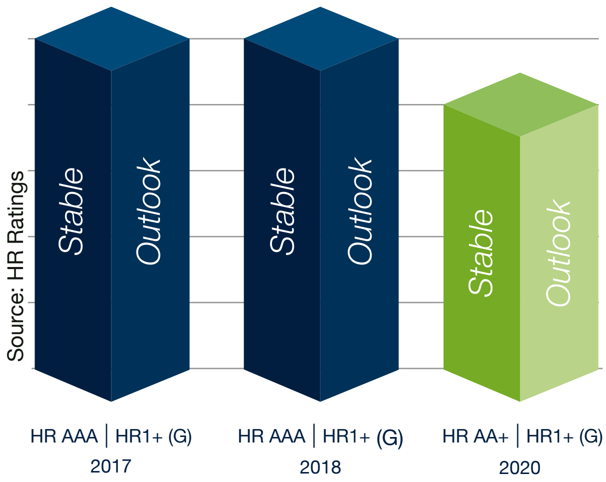
Canada

Sovereign Debt

Credit Rating Evolution



Ratings

- Long Term
  - Foreign Currency — HR AA+ (G)
  - Local Currency — HR AA+ (G)
- Short Term
  - Foreign Currency — HR+1 (G)
  - Local Currency — HR+1 (G)

Stable Outlook

Definition

The rating of HR AA+ (G) indicates that the issuer or issue with this rating is considered to have high credit quality and offers high safety for timely payment of debt obligations. Maintains very low credit risk on a global scale basis, under adverse economic scenarios. The rating of HR1+ (G) indicates that the issuer or issue with this rating exhibits high capacity for timely payment of debt obligations in the short term and maintains the lowest credit risk on a global scale basis.

HR RATINGS DOWNGRADES THE LONG-TERM RATING FOR THE SOVEREIGN DEBT OF CANADA FROM HR AAA (G) TO HR AA+ (G) WITH STABLE OUTLOOK AND REAFFIRMED THE SHORT-TERM RATING OF HR+1 (G)

Canada's sovereign downgrade for the long-term sovereign debt reflects the significant deterioration in the economy's fiscal and economic outlook as a result of the novel coronavirus pandemic and the supportive measures implemented to deal with it. HR Ratings expects a severe economic contraction of 7% during 2020, led by the containment measures carried out during March and April and resulting in an estimated decline in second quarter GDP of 39% (SAAR). This contrasts with HR Ratings' previous forecast of 1.8% growth for 2020. As an oil-exporting country, Canada will face more challenges due to the compounded effect of the COVID-19 economic crisis and the shock to oil prices. Furthermore, the Federal Government's measures to support the economy will translate into a substantial deterioration of the budgetary balance. HR Ratings estimates the primary balance to reach a deficit of 15% of GDP for fiscal year 2020-21, compared to the surplus of 0.64% estimated in HR Ratings' last sovereign rating revision. As a result, we expect to see an increase in our net debt metric to 31.6% of GDP, more than twice the 15.04% estimated for FY2019-20 and HR Ratings' previous forecast of 14.8%. The Government of Canada has reaffirmed, on several occasions, its stance regarding the deterioration of the budgetary balance. The priority for the Government is to support Canadian businesses and individuals without limiting the fiscal stimulus. HR Ratings considers that this will lead to a rapid economic rebound but also means an increased risk of further deterioration in the Debt to GDP ratio. The risk is intensified given the uncertainty created by the pandemic in the absence of a vaccine and the reopening of the country's borders. Should an unacceptable increase in COVID-19 cases occur, the government will probably reimpose lockdown measures which could still further compromise its fiscal space and postpone the route to fiscal consolidation. The following table presents HR Ratings revised base case scenario, showing a more negative outlook than our previous revision. The projections consider the more significant impact of the shocks mentioned on both economic growth and net debt to GDP during 2020, which also impacts the expected performance of the macroeconomic and public finance metrics on the projected horizon. The Stable Outlook is supported by Canada's economic and institutional strengths, well-capitalized and developed financial markets, and monetary and fiscal buffers, which underpin its resilience to economic shocks.

Year	Real GDP Growth	Nominal GDP (USD billions)	Primary Fiscal Balance** (share of GDP)	Interest Costs** (share of GDP)	Net Debt*/** (share of GDP)	Inflation (average)	Current Account (share of GDP)
2020	-6.99%	1,591	-0.43%	1.06%	15.04%	0.66%	-3.05%
2021	5.52%	1,770	-15.03%	0.90%	31.59%	1.63%	-2.69%
2022	2.72%	1,871	-1.04%	0.91%	30.45%	1.59%	-2.26%
2023	2.06%	1,956	0.12%	0.89%	29.61%	1.87%	-2.18%
2024	1.82%	2,036	0.35%	0.88%	28.57%	1.83%	-2.18%
2025	1.80%	2,123	0.54%	0.87%	27.47%	1.98%	-2.34%
2026	1.80%	2,207	0.63%	0.85%	26.21%	2.00%	-2.52%
2027	1.80%	2,285	0.67%	0.84%	25.04%	2.01%	-2.67%

Source: HR Ratings Forecast with data from Canada's Department of Finance, the Central Bank & Statistics Canada.
*Net Debt, as defined by HR Ratings, considers the unmatured debt of Canada minus the financial assets.
**Fiscal accounts are expressed in Fiscal Years so for this table 2020 represents Fiscal Year 2019-20 (FY20).

Main Factors Considered

Elements Considered for the Rating

Canada entered the COVID-19 crisis in a strong fiscal position after a couple of years of sound economic growth and outperforming top rated countries in the G7 group. Additionally, the new USMCA agreement, led to a positive trade perspective in the North American region for the next years. In 2019 the pace of growth of the Canadian economy moderated to 1.7%, below the 2% for 2018, and HR Ratings' previous estimate of 1.85%. Nevertheless, it was in line with the 1.7% average growth for the advanced economies according to the Internationally Monetary Fund (IMF). The economy's dynamism was affected by the challenges faced by the oil and gas sectors, with a decrease in the average price of oil[1] and depressed energy demand amid the escalation of trade conflicts between China and the United States.

Additional elements considered for the Rating

Covid-19 situation. As of July 8, 2020, there were a total of 106,434 confirmed cases[6], 70,247 recovered (66%), and 8,737 deaths. Although Canada is among the 25 countries with the most confirmed cases, new daily reported are on a downward trend, totalizing 267, far below the peak reached during the first week of May. With daily new cases and deaths steadily subsiding as well as the number of cases in hospitals and intensive care units (ICU), Canada is loosening restrictions and initiated the reopening phase in May. Numbers till June show a controlled situation with the partial reactivation in most provinces and territories. This has led to an expectation of a rebound in economic activity and employment.

Future Assumptions

GDP growth. HR Ratings projects a strong GDP contraction of 7.0% in 2020 for the Canadian economy. For 2021 a recovery of 5.5% is anticipated due to the rise in personal spending, exports and business investment, supported by low-interest rates and fiscal stimulus. However, we expect that fiscal stimulus will gradually be withdrawn as the necessity for budgetary consolidation emerges. HR Ratings' recent forecasts diverge considerably from our last revision when we expected GDP growth of 1.8% and 1.74% in 2020 and 2021, respectively. From 2022 onwards, HR Ratings expects growth to gradually stabilize at 1.8% by 2024.

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See full report: https://www.hrratings.com/pdf/0Canada%20Rating%20Report%202020.pdf

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