



R&R Weekly Column
By Brunello Rosa



Is The Overall Policy Response To The Pandemic Correct?

The Covid-19 pandemic has now entered its second year, and its second wave that began in the autumn is now mixing with the expected third wave, which was forecast to peak in the spring of 2021 (following [the example of the Spanish flu of 1918-19](#)). The vaccination campaign has started, but [the recent delays experienced in Europe in particular](#) mean that herd immunity may not be reached before the autumn of 2021, at the earliest.

After a year of the pandemic, we are now in a position to start evaluating the effectiveness of the overall policy response that has been employed against it. By way of comparison, during the Global Financial Crisis, which originated with a banking crisis in 2007-2009, [the policy response was initially inadequate](#), as the policy arsenal available at the time was incomplete, and even the theoretical framework employed by policymakers was shaky at best. The knee-jerk reaction by public authorities at the time consisted of the nationalisation of troubled lenders, unlimited liquidity provisions and timid cuts in the policy rates by central banks. Only later in the process did central banks develop [their full arsenal of tools](#), consisting of zero or negative rate policies, purchases of public and private assets, forward guidance on policy rates, asset purchases and reinvestment policies, and credit easing through the introduction of funding-for-lending schemes.

It took years for many governments to realise that fiscal policy had to be part of the policy mix as well, and that a level of government coordination with monetary policy would not imply fiscal dominance. It took even longer to develop macro-prudential instruments to control financial imbalances in the economy and adopt smarter ways of stabilising troubled financial institutions than simply using taxpayer money (which later fuelled anti-establishment movements and populism).

Because of the lessons learned from the Global Financial Crisis (GFC), at the beginning of the current pandemic the economic policy response was quick, adequate and effective. [Central banks immediately reactivated their entire arsenal of policy tools](#), plus some additional innovations (for example [the Reserve Bank of Australia's](#) yield curve control at the shorter end of the curve, to reinforce forward guidance). Governments meanwhile realised that ideology-driven fiscal budget constraints could not be accepted in a pandemic, and so launched large fiscal stimulus packages that drove deficits and debt into territories generally seen during wartime. Banks were little affected by the shock, as they had become more resilient after the GFC.


The *economic policy* response was, therefore, adequate for the most part, and has been partially effective in alleviating the worst impacts of the pandemic. The *healthcare* response was, however, suboptimal, especially in Western countries. In China, where the pandemic originated, the overall healthcare response was more forceful (in part, thanks to reduced sensitivity to citizens' privacy as well as social rights by the government), and, as a result, more effective. In Western countries, the policy responses were more erratic and less effective. Vaccination campaigns started much later in Western countries than in China and Russia; though, of course, that may have been largely because the vaccine trials followed standards that were probably more accurate.

Still, the concern remains that, as during the GFC, the initial policy response has been too conservative, and [driven by questionable metrics](#). The measures that have been adopted, such as social distancing and lockdowns, derive from the medieval age. Policymakers have adopted the minimisation of deaths as the objective function, as opposed to considering it a constraint for the maximisation of true objective function, which is social welfare across the spectrum of social, economic and age groups. This conservative approach has resulted in disastrous repeated lockdowns, which will likely have massive long-term social and economic consequences that will be hard to manage once the pandemic emergency is over.


As happened after the GFC, it will take years to realise what the best policy mix would have been. And, when this realisation finally happens, it will probably already be too late.

Our Recent Publications

 [Flash Review – Bank Of Japan Stands Pat But Eyes the March Policy Review](#), by Brunello Rosa and Karmen Meneses, 21 January 2021

 [Flash Review: ECB Starts Focusing On “Favourable Financing Conditions”](#), by Brunello Rosa, 21 January 2021

 [Flash Review: BoC Remains on Hold With A Slightly Hawkish Undertone](#), by Brunello Rosa, 20 January 2021

 [ECB Flash Preview: Assessing The Impact of December's Stimulus](#), by Brunello Rosa, 15 January 2021



Looking Ahead

The Week Ahead: Economic Sentiment To Decline In EZ And Japan While US Durable Goods Are Expected To Increase

In the US, December's 'durable goods orders' are likely to increase by 1.0% m-o-m (*p*: 0.9%) and Q4 GDP growth is expected at 3.9% y-o-y (*p*: 33.5%). December's PCE price index is likely to remain unchanged at 1.1% y-o-y and core PCE price index is expected at 1.3% y-o-y (*p*: 1.4%).

In the EZ, in January, 'economic sentiment' is likely to decline to 89.7 (*p*: 90.4).

In Germany, Q4 GDP growth is expected to decline to 0.0% q-o-q (*p*: 8.5%) and remain unchanged at -0.4% y-o-y. January inflation is expected to rise to 0.7% y-o-y (*p*: -0.3%).

In Japan, December's retail sales are likely to decline by -0.4% y-o-y (*p*: 0.7%), unemployment to remain at 3.0% (*p*: 2.9%) and IP to decline further, by -4.2% y-o-y (*p*: -3.9%).

The Quarter Ahead: Global Growth To Suffer Uneven Vaccine Rollouts; Central Banks To Maintain Their Easing Bias

In most DMs, the: 1) recent surge in COVID-19 cases; and 2) ensuing government restrictions are creating a 'near-term drag on activity', increasing the risk of 'double-dip', i.e. a second 'pandemic-induced recession'. Yet, by H2-2020 economic growth is likely to gather pace, supported by: *i*) vaccination efforts reaching critical mass; and *ii*) additional fiscal stimulus, especially in the US.

Over the next 12 months: 1) COVID-19 should be largely contained in DMs; and 2) GDP will likely return to its pre-virus trend, without major lasting impacts on economic activity. Yet, the pandemic will leave a legacy in terms of: *i*) higher public debt burdens; and *ii*) lower real interest rates. Further, rising commodity prices could lead to higher inflation.

In the US, Mr. Joe Biden - sworn in as the 46th President - began to implement his agenda on: *i*) fighting against climate change; *ii*) supporting immigration and racial equality; *iii*) halting the US withdrawal from the WHO; *iv*) broadening access to food stamps and unemployment benefits; and *v*) increasing pressure on Congress to pass a USD 1.9tn stimulus bill.

In EZ, Oxford/AstraZeneca warned about lower deliveries of vaccine supplies.

In China, 28 US individuals - including former Secretary of State Mike Pompeo - were sanctioned over "actions that gravely interfered in China's internal affairs", and restricted "from doing business with China".

In the upcoming MPC meetings in February both BoE and RBA will likely keep their policy rates unchanged, at 0.10%.

Last Week's Review

Real Economy: COVID-19 Cases Rise, Slow Vaccine Distribution; US Stimulus In The Cards

In the US, *i*) manufacturing PMI rose to 59.1 (*p*: 57.1); and *ii*) services PMI rose to 57.5 (*p*: 54.8). In 2020, 'sales of previously owned homes' reached the highest level in 14 years, as low interest rates and remote work increased home-buying demand. Prices for corn, soybeans and wheat soared to their highest levels in more than six years, driven by: 1) dry weather; 2) strong export demand from China; and 3) a reduction of US stockpiles.

In the EZ and the UK, business activity fell, due to tighter restrictions to contain rising viral infections.

In the EZ: *i*) manufacturing PMI was resilient at 54.7 (*p*: 55.2); while *ii*) services - hit by lockdowns - remained subdued, at 45.0 (*p*: 46.4). Activity slowed sharply in Germany and France.

CBs remained accommodative: *i*) ECB (-0.5%); *ii*) BoJ (-0.1%); and *iii*) Norges Bank (0.0%) kept their key policy rates unchanged.

Financial Markets: Global Stocks Hit Record Highs; Bonds Flat; Oil And Gold Rise

Market drivers: a solid start to the corporate earnings season encouraged investors. Going forward, as long as: 1) companies keep weathering the pandemic; and 2) vaccines enable the gradual relaxation of restrictions around the world, the prices of most 'risky assets' have the potential to rise further.

Global equities closed higher w-o-w (MSCI ACWI, 1.6%, to 667). In the US, the S&P500 rose (1.9%, to 3,841), as investors weighed the likelihood of further stimulus under the Biden administration against a worsening coronavirus outlook. In the EZ, Europe's shares remained flat (Eurostoxx 50, 0.1%, to 3,602) as investors focused on the economic impact of COVID-19 surges, across most countries.

Fixed Income: w-o-w global bonds remained flat (BAML Global, -0.1% to 297.8), as well as USTs (-1 bp, to 1.09%).

FX: w-o-w, the USD traded lower against other currencies (DXY, -0.6%, to 90.238) on US Treasury secretary nominee Janet Yellen's call to "act big" on measures to help the economic recovery; the EUR/USD gained (0.7%, to 1.217).

Commodities: Oil prices rose (Brent, +0.6% to 55.4 USD/b), on hopes that Biden's proposed stimulus will lift global growth. Gold rose (1.4% to 1,853 USD/Oz.) as the USD weakened and investors turned to safe-haven assets.



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Abbreviations, Acronyms and Definitions

a	Actual	LN	Northern League, Italy
AKP	Justice and Development Party, Turkey	MSS	Five Star Movement, Italy
ann.	annualized	m-o-m	Month-on-month
ARS	Argentinian Peso	mb	Million barrels
avg.	Average	mb/d	Million barrels per day
bn	Billion	MENA	Middle East and North Africa
BoC	Bank of Canada	MHP	Nationalist Movement Party, Turkey
BoE	Bank of England	mn	Million
BoJ	Bank of Japan	MPC	Monetary Policy Committee
bpd	Barrels per day	NAFTA	North-American Free Trade Agreement
bps	Basis points	NATO	North Atlantic Treaty Organization
BS	Balance sheet	OECD	Organization for Economic Cooperation and Development
c	Consensus	Opec	Organization of Petroleum Exporting Countries
C/A	Current account	p	Previous
CB	Central bank	P2P	Peer-to-peer
CBB	Central Bank of Bahrain	PBoC	People's Bank of China
CBK	Central Bank of Kuwait	PCE	Personal Consumption Expenditures
CBT	Central Bank of Turkey	PE	Price to earnings ratio
CDU	Christian Democratic Union, Germany	PM	Prime minister
CNY	Chinese Yuan	PMI	Purchasing managers' index
CPI	Consumer Price Index	pps	Percentage points
DJIA	Dow Jones Industrial Average Index	pw	Previous week
DJEM	Dow Jones Emerging Markets Index	QCB	Qatar Central Bank
d-o-d	Day-on-day	QAR	Qatari Riyal
DXY	US Dollar Index	QE	Quantitative easing
EC	European Commission	q-o-q	Quarter-on-quarter
ECB	European Central Bank	RE	Real estate
ECJ	European Court of Justice	RBA	Reserve Bank of Australia
EIA	US Energy Information Agency	RRR	Reserve Requirement Ratio
EM	Emerging Markets	RUB	Russian Rouble
EP	European Parliament	SWF	Sovereign Wealth Fund
EPS	Earnings per share	tn	Trillion
EU	European Union	TRY	Turkish Lira
EUR	Euro	UAE	United Arab Emirates
EZ	Eurozone	UK	United Kingdom
Fed	US Federal Reserve	US	United States
FOMC	US Federal Open Market Committee	USD	United States Dollar
FRB	US Federal Reserve Board	USD/b	USD per barrel
FX	Foreign exchange	UST	US Treasury bills/bonds
FY	Fiscal Year	VAT	Value added tax
GCC	Gulf Cooperation Council	VIX	Chicago Board Options Exchange Volatility Index
GBP	British pound	WTI	West Texas Intermediate
GDP	Gross domestic product	WTO	World Trade Organisation
IMF	International Monetary Fund	w	Week
INR	Indian Rupee	w-o-w	Week-on-week
IPO	Initial public offering	y	Year
IRR	Iranian Rial	y-o-y	Year-on-year
JPY	Japanese yen	y-t-d	Year-to-date
k	thousand	ZAR	South African Rand
KSA	Kingdom of Saudi Arabia	2y; 10y	2-year; 10-year



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