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R&R Weekly Column
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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 heard 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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The picture in the front page comes from this website

Abbreviations, Acronyms and Definitions

a	*Actual*
AKP	*Justice and Development Party, Turkey*
ann.	*annualized*
ARS	*Argentinian Peso*
avg.	*Average*
bn	*Billion*
BoC	*Bank of Canada*
BoE	*Bank of England*
BoJ	*Bank of Japan*
bpd	*Barrels per day*
bps	*Basis points*
BS	*Balance sheet*
c	*Consensus*
C/A	*Current account*
CB	*Central bank*
CBB	*Central Bank of Bahrain*
CBK	*Central Bank of Kuwait*
CBT	*Central Bank of Turkey*
CDU	*Christian Democratic Union, Germany*
CNY	*Chinese Yuan*
CPI	*Consumer Price Index*
DJIA	*Dow Jones Industrial Average Index*
DJEM	*Dow Jones Emerging Markets Index*
d-o-d	*Day-on-day*
DXY	*US Dollar Index*
EC	*European Commission*
ECB	*European Central Bank*
ECJ	*European Court of Justice*
EIA	*US Energy Information Agency*
EM	*Emerging Markets*
EP	*European Parliament*
EPS	*Earnings per share*
EU	*European Union*
EUR	*Euro*
EZ	*Eurozone*
Fed	*US Federal Reserve*
FOMC	*US Federal Open Market Committee*
FRB	*US Federal Reserve Board*
FX	*Foreign exchange*
FY	*Fiscal Year*
GCC	*Gulf Cooperation Council*
GBP	*British pound*
GDP	*Gross domestic product*
IMF	*International Monetary Fund*
INR	*Indian Rupee*
IPO	*Initial public offering*
IRR	*Iranian Rial*
JPY	*Japanese yen*
k	thousand
KSA	*Kingdom of Saudi Arabia*
LN	*Northern League, Italy*
M5S	*Five Star Movement, Italy*
m-o-m	*Month-on-month*
mb	*Million barrels*
mb/d	*Million barrels per day*
MENA	*Middle East and North Africa*
MHP	*Nationalist Movement Party, Turkey*
mn	*Million*
MPC	*Monetary Policy Committee*
NAFTA	*North-American Free Trade Agreement*
NATO	*North Atlantic Treaty Organization*
OECD	*Organization for Economic Cooperation and Development*
Opec	*Organization of Petroleum Exporting Countries*
p	*Previous*
P2P	*Peer-to-peer*
PBoC	*People's Bank of China*
PCE	*Personal Consumption Expenditures*
PE	*Price to earnings ratio*
PM	*Prime minister*
PMI	*Purchasing managers' index*
pps	*Percentage points*
pw	*Previous week*
QCB	*Qatar Central Bank*
QAR	*Qatari Riyal*
QE	*Quantitative easing*
q-o-q	*Quarter-on-quarter*
RE	*Real estate*
RBA	*Reserve Bank of Australia*
RRR	*Reserve Requirement Ratio*
RUB	*Russian Rouble*
SWF	*Sovereign Wealth Fund*
tn	*Trillion*
TRY	*Turkish Lira*
UAE	*United Arab Emirates*
UK	*United Kingdom*
US	*United States*
USD	*United States Dollar*
USD/b	*USD per barrel*
UST	*US Treasury bills/bonds*
VAT	*Value added tax*
VIX	*Chicago Board Options Exchange Volatility Index*
WTI	*West Texas Intermediate*
WTO	*World Trade Organisation*
w	*Week*
w-o-w	*Week-on-week*
y	*Year*
y-o-y	*Year-on-year*
y-t-d	*Year-to-date*
ZAR	*South African Rand*
2y; 10y	*2-year; 10-year*