MAKING SENSE OF *THIS* WORLD

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R&R Weekly Column
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To Counter The Covid Crisis, Government Policies Are Taking The Baton From Monetary

During the Global Financial Crisis (GFC), central banks took centre stage in the policy response, while most governments opted for fiscal austerity, which made the economic contraction induced by the crisis longer and deeper than was necessary. Central banks deployed a number of innovative policy tools such as forward guidance, negative policy rates, credit easing, and quantitative (and qualitative) easing – in some cases accompanied by yield curve control. Especially with the adoption of large-scale asset purchases (LSAPs) the distinction between monetary and fiscal policy became quite blurred, yet a formal distinction was always kept.

Now, during the pandemic crisis, the real economic policy innovation has been the increased coordination between monetary and fiscal policy, intended to make sure that financial conditions always remain favourable. The coordination has been such that some economists have openly spoken about "helicopter money", and central banks have re-started LSAPs, partly to monetise the huge deficits and debts that have been created to soften the economic impact of the crisis.

In the aftermath of the pandemic crisis, the role of central banks is destined to change further, and most likely will become ancillary to other government policies. In the last few decades, central banks have been asked to get inflation back under control as their primary objective. As a secondary goal, all central banks have the wider mandate of supporting government policies such as full employment and low long-term interest rates. (In the case of the Fed's dual mandate, full employment and low inflation are equally important goals). To achieve this objective, central banks have been granted operational and, in some cases, institutional independence. Going forward, the situation will likely evolve further.

The main job of central banks in coming years will be to monetise the huge fiscal deficits and debts created during the pandemic, by adopting various forms of financial repression (including keeping long-term rates low for longer, with explicit or implicit forms of yield curve control). Controlling inflation will be less important: the Fed's new strategy explicitly allows inflation to overshoot the target by a limited amount and for a short period of time, to make up for inflation undershooting during the previous few years. A limited amount of inflation accompanying a recovery in economic activity, along with some targeted tax increases, are the other two key instruments to "digest" the fiscal imbalances created during the pandemic.

Recently however, central banks have been given goals that typically belong to the government's sphere, such as pursuing or accompanying environmentally friendly policies to counter climate change, as part of a broader push to achieve Environmental, Social, and Corporate Governance (ESG) objectives and financial sustainability. In this respect, the new remit of the Bank of England is the most advanced in the G10 area, with the ECB being a close second. In the case of the Fed, the FOMC has decided upon quality of employment (across states, social classes, ethnic groups and genders) as the key variable for its forward guidance.

Given these new goals, central banks will remain formally independent in most cases, but *de-facto* their actions will be determined by government policies. Governments will become the real centre of action in coming years, taking the baton from central banks. And perhaps, for this reason, some of the more notable central bankers of the last few years are now in government, or in similar positions. For example, the former Chair of the Fed, Janet Yellen, is now Secretary to the Treasury in the US. Former ECB President Draghi is now Italy's Prime Minister (after being for many years Director General of the Italian Treasury). The former BOE Governor Mark Carney, who was also at the Treasury before joining the Bank of Canada, was recently appointed UN Special Envoy on Climate Action and Finance, and there's speculation about him entering Canadian politics in coming months.

Our Recent Publications

Democracy Eroding Fast in South East Asia, *by Mirko Giordani, 8 April 2021*

GEOPOLITICAL CORNER: A Tale of Two Futures: The Present State of the Sino-American Cold War, *by John C. Hulsman, 7 April 2021*

Looking Ahead

The Week Ahead: Retail Sales To Ease in US And EZ, While RBNZ and CBT Are Expected To Remain On Hold

In the US, March's retail sales are projected to expand by 7.9% y-o-y (*p:* 6.3%), while IP is expected to ease to -1.4% (*p:* -4.2%).

In the EZ, February's retails sales are anticipated to ease to -4.7% y-o-y (*p:* -6.4%), and IP is seen increasing to 1.5% y-o-y (*p:* 0.1%).

In New Zealand and Turkey, both CBs are expected to keep their policy rates unchanged at 0.25%, and 19.0%, respectively.

The Quarter Ahead: Vaccination Campaign Reach 154 Countries, But Many Face Supply Issues; CBs To Maintain Dovish Tone

Over the next two years, the global economy is likely to recover faster than expected, as the US will lead both: *1)* progress made in containing the coronavirus; *2)* fiscal and monetary stimuli in most DMs. The IMF lifted its global growth forecast to 6.0% this year – the most since 1980 – compared to 5.5% projected in January. The upgrade in projections was boosted by: *i)* stimulus spending in advanced economies; and *ii)* accelerating COVID-19 vaccine rollouts.

Over the past two weeks, fewer than two million COVAX doses were cleared for shipment to 92 countries in the developing world. As many as 60 countries, including some of the world's poorest, might see their coronavirus vaccinations deliveries – to be received through the global program – on hold until as late as June.

In the US, the COVID-19 new cases are trending upward and Public health officials have warned in recent weeks that "*there could be another wave of the disease before the country reaches so-called herd immunity*" — the point where most people have antibodies so the virus cannot easily spread.

Still in the US, the Fed chairman Powell: *1)* urged all Americans to get vaccinated, as "*the recent rise in COVID-19 cases in the country poses a risk to the economic outlook*"; and *2)* stated the Fed needed to "*see actual evidence of a strong economy before it would consider pulling back*" from its loose policy stance.

Amid rising tensions, the US state department issued new guidelines to ease "*decades-old restrictions that have hindered meetings between US and Taiwanese diplomats"*. China believes the US is colluding with Taiwan to: *i)* challenge Beijing; and *ii)* provide support to *"those who want the island to declare formal independence"*.

Last Week's Review

Real Economy: DM Composite PMIs > 50-Benchmark; CBs On Hold, Growth Rebound Ahead

In the US, March's Markit composite PMI climbed to 59.7 (*c:* 59.1; *p:* 5.95), signaling the fastest upturn in private sector business activity since August 2014, as: *i)* manufacturing PMI rose to 59.1 (*c:* 59.0; *p:* 58.6), the second-highest growth in factory activity on record; and *ii)* services PMI rose to 60.4 (*c:* 60.0; *p:* 59.8), marking the fastest output growth since July 2014.

In the EZ, the Markit composite PMI increased to 53.2 in March (*c:* 52.5; *p:* 48.8), signaling the second-fastest increase in private sector output in two-and-a-half years, as: *i)* manufacturing output grew by the most in nearly 24 years (*a:* 62.5; *c:* 62.4; *p:* 57.9); while *ii)* services output fell at the slowest rate in the ongoing seven-month sequence of contraction (*a:* 49.6; *c:* 48.8; *p:* 45.7). The seasonally-adjusted unemployment rate stood at 8.3% in February (*c:* 8.1%; *p:* 8.3%), but the number of *unemployed* increased by 48k from the previous month, to 13.6m.

In Australia, the RBA left its cash rate unchanged at a record low of 0.1% during its April meeting, as widely expected.

Financial Markets: Major Stock Indexes Rally, To New Record Highs; USD Falls As Gold Rises

Market drivers: investors grew optimistic on: *1)* a global economic rebound; and *2)* rising earnings, spurred by both the US fiscal stimulus and dovish CB policies.

Global equities rose w-o-w (MSCI ACWI, +2.0%, to 695). In the *US*, the S&P 500 Index hit a new high (+2.7%, to 4,129), driven by expectations of a swift economic recovery. In the *EZ*, shares rose to record highs (Eurostoxx 50, +0.8%, to 3,979) on economic optimism.

Fixed Income: w-o-w global bonds remained flat (BAML Global, 0.1% to 292.2), as the yield on the 10-year UST fell slightly (-1 bps, to 1.67%).

FX: w-o-w, the USD fell against other currencies (DXY, -0.9%, to 92.163; EUR/USD +1.1%, to 1.190).

Commodities: Industrial metals prices will likely fall from multi-year highs, as China's stimulus is withdrawn. Oil prices fell (Brent, -2.9% to 63.0 USD/b) amid concerns about the pace of recovery in demand. Gold rose (+0.8% to 1,743 USD/Oz), the first rise in 3 weeks, as both the USD and 10-year UST yields retreated, and initial jobless claims unexpectedly rose for the second week.

Farah Aladsani *contributed to this Viewsletter.*

Abbreviations, Acronyms and Definitions

a	*Actual*	*LN*	*Northern League, Italy*
AKP	*Justice and Development Party, Turkey*	*M5S*	*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*