Coronavirus, the Economic Outlook and Equity Markets
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We don't really have at our disposal the normal tools we would use to analyze the economy. The data that we would rely on to generate forecasts or to do analysis, simply aren't available. And it won't be for a period of weeks or perhaps even a few months. The economy is simply moving too fast for the data to keep pace with it. And so, we're left using these analytical tools—the public health channel, the monetary and liquidity policy channel and the fiscal policy channel—which necessarily makes what we're saying a little bit more speculative than it otherwise would be. But that's the circumstance in which we find ourselves.

So the starting point is, as it has been, the public health policy channel and the public health response to the Covid outbreak. Here, we don't have and I don't have any expertise that, that goes beyond what any of you are likely to have. It seems from reading recent headlines that the situation might be improving, that there might be some green shoots. We certainly hope that that is the case and that over the course of the next few weeks, those green shoots will take root and we will be in a better position socially. We'll be in a better position economically. And we'll be able to talk a little bit more tangibly about what a recovery would look like.

But again, that's down to a public health response and the evolution of the virus, which is something that we don't have any particular expertise on. So, where we've been spending our analytical time over the course of this period has been along the monetary and liquidity policy channel and the fiscal policy channel. And over the course of the last week, there have been some developments on both fronts, although I have to say that the pace of change there has slowed a little bit. I think that that has been generally a positive for financial markets. And I'll circle back and talk a little bit more about financial markets and what I think matters to them at this point when we get toward the end of my remarks.

But first to sort of recap what has happened over the past few days along the monetary policy, liquidity policy and fiscal policy channels. For monetary and liquidity policy, the Fed has continued its practice over the past few weeks of launching new programmes to support different parts of financial markets and the financial system. Its job here is something like a plumber: it needs to keep the plumbing working so that money is flowing through the system and reaches those who need it. Obviously, from a humanitarian perspective, that's important, but from an economic perspective that also lays the groundwork for the system to reboot once we're in a better position from a public health perspective.

Over the course of this week, it’s focused on filling a few of the gaps that emerged in its initial programmes. High-yield credit had not previously received any support and the Fed has now clarified that it is willing to provide support to companies that were investment grade before the crisis started, even if it get downgraded during the crisis. It’s also expressed a willingness to buy some high-yield funds, which are likely to be ETFs rather than mutual funds, but the idea is to provide support to a sector of the market that the Fed has previously not reached.

Similarly, it’s expanded its asset backed security purchase programmeme to include high grade commercial mortgage backed securities and collateralized loan obligations. So again, bridging gaps that had emerged in its previous programmes. It also gave us the start of the roll out of the Main Street lending programme, which didn't exist in the previous crisis. You'll recall that Congress had, as part of the CARES act provided to the Fed $425 million that the Fed could then lever up to use for this programme. The Fed has now announced that it intends to use that programme to provide additional support to the small business sector, to purchase from banks some of the Small Business Payroll Protection Program loans that have started to be issued. And I'll speak a little bit more about that programme in a moment. But the idea here is to make sure that banks continue to issue those loans almost without regard to risk in the sense that the Fed is willing to bear 95 percent of the risk of those loans to take them off of the bank’s balance sheets. It also enhanced some of its existing commercial lending support programmes, to the tune today of providing roughly an additional US$2.3 trillion worth of support to financial markets.

The Fed does still have dry powder. It' only used about half of the of the US$425 billion that Congress allocated to it. And we would expect in the coming weeks that it will continue to use additional resources, engaging in using leverage again to enhance the amount of money available to it to provide additional support. I should mention here that there has also been a specific provision to provide support to states and municipalities, which is another potential gap that had emerged. So the Fed is paying close attention. It's very sensitive to and very aware of what's going on in financial markets and in the financial system. And it's using its entire toolkit to make sure that it provides support where appropriate. Fed Chair Powell has given a speech in which he reiterates that point. And I think that that really is the key. The mechanics and the minutiae of the programmes are relevant to specific sectors. But from a macro perspective, the key thing remains that the Fed is willing to do whatever it takes to keep the financial system working.

Now, on the fiscal policy front, after having passed a US$2 trillion stimulus bill, Congress has not taken specific additional action. However, it is discussing doing so. And the likely place where we would expect to see that first is the expansion of the paycheck protection programme through the Small Business Administration, in which businesses can borrow money from banks and use that money to meet payroll. And as long as they keep their staff employed or rehire workers who had been laid off, those loans convert into grants later in the year. It is, of course, true that there are bottlenecks and that there have been hiccups with the rollout. This is a big government programme launched with almost no notice and launched very quickly. There is no way that that was ever going to rollout smoothly on day one or even on week one. So, I have no doubt that there have been bottlenecks and roadblocks and impediments to making this programme work smoothly and there will continue to be. And yet, out of the original US$350 billion, more than US$100 billion has already been dispersed. So, while it may not be smooth and efficient, the money is getting out the door. There is clearly a demand for it, and that is likely to see the programme increased in the next fiscal package. Congress is currently discussing whether that should be $250 billion just for that programme or $500 billion for that programme, plus a few additional programmes. I expect it'll resolve those differences in fairly short order. But either way, I think it's good news that whatever the roadblocks are, that money is making its way out into the system and hopefully that will help to keep people employed and allow for small businesses to restart operations when the public health situation has eased.

Now, against that backdrop. Financial markets have performed much more strongly over the course of the past two weeks than it did at the beginning of this. And no wonder, right? At the beginning of this crisis, we were plunging into the unknown. We had not received information from the Fed or from fiscal policymakers about what their response would be. All we knew was that the economy was collapsing. And so at the outset, I think it's fair to say that financial markets responded only to the public health channel. And we saw what the impact of that was in a significant drawdown in equities. As things evolved, I think the focus shifted to the policy response. The market began to take as a given, the idea that the economy was in freefall and the question became what will policymakers do about it?

Now we have our answer. The Fed has told us that it will do whatever is necessary to keep the plumbing working and to provide the groundwork for an eventual recovery. Congress has stepped to the plate, quickly and aggressively and indicated a willingness to do more. So, I think that now the market takes those things as given. We know that the economy collapsed. We know the policymakers have responded aggressively. And so, the information that is most likely to move the market has to do with the public health channel.

We need to see progress in terms of fighting the virus in order for markets to continue to perform well. As long as we see that progress, as long as markets perceive progress is being made, I think that the policy support and the confidence that policymakers will continue to act as necessary should provide support to financial markets. But if the public health situation deteriorates, then it flips again. And we need to see policymakers demonstrate, again, their willingness to do more.

So that's the dynamic. The question from a market perspective is what do we know and what do we have questions about? Right now, we know or believe that we know that policymakers will do whatever is necessary. So, we're back to monitoring the public health situation to take guidance in the shorter term.