RBC Global Asset Management

INVESTOR INSIGHTS

How governments and central banks are working to stabilize the economy

The past few weeks have brought their share of tumultuous events. The shock of COVID-19, extreme public shutdown measures and the resulting economic slowdown have been a big adjustment for all of us. Governments and central banks across the globe are stepping in to do their part in providing help for the economy, its citizens, and our financial systems. Indeed, countries are now taking big steps to support the global economy, and the situation continues to evolve quickly.

Help from central banks

Managing today's complex global economy is no easy feat. In the midst of the COVID-19 pandemic, central banks can use various tools, referred to as monetary stimulus, to control the country's money supply and support the global economy. The sheer amount of stimulus now being pushed into the system is extraordinary. This is true both in terms of magnitude and breadth. This arguably makes up for the fact that central banks have less room to cut their policy rates due to the low starting point.

Actions to date:

- Many central banks have now cut policy rates to zero, and in some cases even below zero. Policy rates are the interest rates that apply when banks loan their excess reserves of cash to each other. Given the historically low levels of these rates right now, there's not a lot of room for additional cuts.
- Central banks have also increased quantitative easing (QE) efforts – as detailed below. QE in the U.S. now adds up to more than US$1.5 trillion a month -- eleven times more than during the 2008/09 global financial crisis on a yearly basis.

CDN $5 billion / week

The amount of government bonds the **Bank of Canada** is buying each week. It's the bank's first leap into QE. The bank says this will continue until the economic recovery is well underway.

€750 billion by end of 2020

The **European Central Bank** never stopped QE, and has now committed to even more. Under the new Pandemic Emergency Purchase Programme, the ECB will purchase €750 billion of private and public sector securities through the end of 2020.

USD $1.56 trillion / month

Amount of U.S. QE. This is an amazing eleven times larger than the equivalent annualized action taken during the global financial crisis. Purchases by the **Fed** are not just supporting Treasuries and mortgages as was the case a decade ago, but segments of the ETF market, municipal bonds, commercial paper, student loans, auto loans, credit card loans and even small business borrowing. As a result of the new actions, the Fed's balance sheet has now surpassed $5 trillion.

In terms of timing, it took central banks more than a year into the global financial crisis before implementing QE, so they deserve full marks for the nimble response this time around. From a size perspective, the Fed printed US$3.7 trillion of money (and bought an equivalent amount of bonds) in response to the global financial crisis. That is still significantly beyond the current plan on a week-to-week basis. But it won't take long to catch up if the COVID-19 effort is sustained at the announced pace.

The aggressive measures of the U.S. Fed have evoked some inflation fears. While possible, the risk of inflation is arguably no higher than before. Even if the Fed's balance sheet doubles over the next year to $9 trillion – not an unreasonable expectation – that only puts the U.S. in line with the Eurozone, where inflation remains hard to see.

In addition, central banks have also learned another important lesson from the financial crisis: the importance of a wide range of measures designed to make sure banks have enough cash for lending and other operations. These efforts already add up to trillions of dollars, though they are only temporary. This means that these measures are less likely to have long-lasting effects on inflation or asset valuations than more enduring measures like QE.

Help from governments

The relief spending from governments – called fiscal stimulus – is also huge. The U.S. has now put together a package worth more than US$2 trillion. That's equal to 11% of Gross Domestic Product (GDP – a measure of the size of the economy). This response is similar to the size of the fiscal effort during the global financial crisis.

The U.S. is hardly alone in delivering large-scale stimulus. The effort by country can be seen in the table below.

	Help from central banks		Help from governments	Relief packages
Country/Region	Policy rate cut (bps)	Asset purchase (% of GDP)	Government outlay (% of GDP)	Outlay and others (% of GDP)
U.S.	150	Unlimited	6.9	10.8
Canada	150	Unlimited	2.3	4.7
ECB	0	7.3	N/A	N/A
Germany	0	See ECB	3.6	44.9
France	0	See ECB	0.4	14.3
Italy	0	See ECB	1.1	20.7
Spain	0	See ECB	9.2	17.2
Netherlands	0	See ECB	1.8	2.0
Sweden	0	6.0	3.0	6.0
U.K.	65	9.0	1.4	16.3
Switzerland	0	0.0	3.1	6.0
Japan	0	1.0	2.1	2.2
Australia	50	0.0	4.3	4.3
China	10	0.0	1.2	1.2
India	75	0.0	0.0	0.0
South Korea	50	0.1	3.2	3.2
Mexico	25	0.0	0.0	0.0
Brazil	100	0.0	2.1	2.1
Russia	0	0.0	0.3	0.3

Note: As of 03/27/2020. No specific end date designated for Bank of Canada asset purchase program. New relief package that is still in the works included in estimates for Japan. Government outlay in column 3 only includes spending and tax cuts by the government. Does not include relief measures such as tax and fee deferral, loans and loan guarantees, and equity investment, etc. These are added together in the final column, Relief packages. Source: National central banks, national government websites, ING, UBS, RBC GAM.

A key theme emerging across governments is the multi-phase approach to delivering relief:

- **Phase 1:** Targeted spending on emergency programs, health spending and drug research.
- **Phase 2:** Targeted at getting thousands of dollars per month to sidelined workers and shuttered businesses. This helps to prevent foreclosures and bankruptcies from stacking up, which could turn a short-term shock into a lengthy crisis.
- **Phase 3:** Governments are encouraging companies to keep their workers on the payroll as opposed to laying them off. They are providing support through large wage subsidies and loans that don't need to be repaid if certain conditions are met. If successful, this will help limit the economic damage.

By virtue of the speed and reasonably good aim of announced government measures, it is likely that the money being spent will benefit the economy by more than the actual amount being spent. Of course, it won't be possible to directly observe the effect because it is difficult to say how many businesses and households would have gone bankrupt without the assistance.

Bottom line: During the global financial crisis, relief spending came in multiple waves spanning more than a year. As such, there is a strong chance that even more spending is coming to provide relief in the COVID-19 crisis. This would result in a total response that's even larger than that delivered during the financial crisis. But for a global economy reeling from the COVID-19 pandemic, and financial markets struggling to come to terms with the implications, the measures already announced have been welcomed by investors, businesses and consumers alike.

Publication date: April 15, 2020.