Comparing Policy Responses

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As the coronavirus surges across the world, governments are taking unprecedented measures in order to protect their citizens and their economies and reduce its potential long-term effects on society as a whole. Elsewhere in this quarterly, we focus on the social distancing measures taken to limit the spread of the virus. In this piece, we focus on the major developed economies and the extraordinary measures they have taken in order to protect themselves from the economic impact of the coronavirus. Major events have been plotted on a timeline by country, alongside key referral points which shows the speed and the strength of each government’s response. The countries covered in this report are the United States, Japan, the United Kingdom, France, Germany, Spain, and Italy.
COVID-19 is already having a profound impact on the US jobs market, with over 33 million workers filing for jobless benefits over the past six weeks ending April 25. This already represents around 22% of the labor force. With unemployment around 3.5% before the crisis, that means unemployment is most likely already above 25% and potentially headed to over 30%. The International Monetary Fund (IMF) sees the US economy contracting -5.9% this year, followed by 4.5% growth next year.

The Fed quickly cut the Fed Funds rates by 150 basis points (bp) to the effective lower bound of 0.0-0.25% over the course of two emergency meetings on March 3 and 15. Prior to the pandemic, the Fed had already started buying T-bills starting in October 2019 at a rate of $60 billion per month to address dislocations in the repo market. Once the pandemic hit, the Fed ramped up quantitative easing (QE) on March 23 to effectively run with no limits until the economic outlook improves.

The Fed has also engaged in a series of major asset purchase programs to improve liquidity in the government and asset ABS market, along with facilities to support money markets. Some sub-investment grade bonds and municipal bonds are now seeing Fed support as well. All of these measures have led the Fed’s balance sheet to explode from around $4.2 trillion at the end of 2019 to $6.7 billion at the end of April. The Fed also announced (and later expanded) its so-called Main Street Loan Program designed to keep credit flowing to US businesses. Finally, like other central banks around the world, the Fed has loosened up some regulatory measures that should help finance additional lending by the commercial banks.

The fiscal offensive by the US government was swift and decisive, with mostly bi-partisan support. We have seen several main sets of measures so far, and another one is becoming increasingly likely that will help support states and municipalities directly. All told, the fiscal measures so far amount to nearly $3 trillion, or 15% of GDP. Here is the breakdown:

- **Paycheck Protection Program and Health Care Enhancement Act** – originally part of CARES Act and later increased by $484 billion; this provides mainly for loans and guarantees for small businesses to retain their workers
- **Coronavirus Aid, Relief and Economy Security Act (“CARES Act”)** – $2.3 trillion; this provides mainly for the one-time payments for individuals, expanded unemployment benefits, aid for hospitals and healthcare, and providing food for the most needy.
- **Coronavirus Preparedness and Response Supplemental Appropriations Act** – $8.3 billion; this provides mainly for virus testing
- **Families First Coronavirus Response Act** – $192 billion; this provides mainly for paid sick leave for workers
Japan

Japan had been relatively less affected by the virus than the other developed markets covered in this report, but this has been changing. The spread in Japan is now accelerating, with Osaka and Tokyo becoming the main Japanese epicentres. Japan is now in a state of emergency declared by the government, and it was just extended to May 31. The Japanese economy was already contracting in Q4 due to the ill-timed consumption tax hike back in October. This year, it is likely to suffer significant contraction in the first two quarters. Because the pandemic intensified at a relatively later date compared to other countries, Japan could see weakness potentially carrying over into Q3 as well. The IMF forecasts Japan to contract -5.2% this year, followed by 3% growth next year.

The Japanese government has passed three emergency aid packages, and more seems likely. The first came on February 13, worth the equivalent of $4.6 billion, and the second on March 10 worth $15 billion. The funds were aimed at boosting medical supplies and helping small and medium size enterprises as well as self-employed workers. It also extended the tax return deadline and create a special COVID-19 loan program to provide further unsecured financing to micro, small and medium sized business. The third and largest package was the Emergency Economic Package Against COVID-19 that Abe proposed. It first came on April 6 and was revised higher April 20 to JPY117.1 trillion ($1 trillion), or over 21% of GDP. It can be broken down into five objectives: (1) develop preventive measures against the spread of infection and strengthen treatment capacity (expenditure of 0.5% of GDP), (2) protect employment and businesses (16.0% of GDP), (3) regain economic activities after containment (1.5% of GDP), (4) rebuild a resilient economic structure (2.8% of GDP), and (5) enhance readiness for the future (0.3% of GDP).

However, government documents suggest that once private sector contributions and government loan programs are stripped out, actual fiscal spending only totals about JPY27 trillion. Funding will come from an extraordinary budget of JPY16.8 trillion, which will be financed by issuance of JPY14.5 trillion of standard bonds and JPY2.3 trillion of construction bonds. The IMF puts total Japan fiscal stimulus at around 5% of GDP. Not too shabby, but not as large as the headlines would suggest.

On the monetary front, the BOJ introduced a series of liquidity measures and increased its QE program. On March 15, the BOJ revived the dollar swap lines with the Fed and later increased the frequency of these operations to improve domestic funding markets. On March 16, the BOJ announced target liquidity provisions through increased JGB purchases and doubled the rate of ETF purchases and increased its purchases corporate bonds and commercial paper. It also created a new program to boost lending to impacted companies. Finally, the Bank of Japan dropped its bond buying limit at its April 27 meeting and reaffirmed its commitment to yield curve control for the foreseeable future.

Mar 10
- Package for Small/Medium Business
  - Extended Tax Return Deadline
  - Covid-19 Loan Programmes
  - Subsidies for Business and Family Support

Mar 15
- Purchase of Corporate Bonds and Commercial Paper
  - Auction for US Dollar Funds
  - Purchase of ETF’s and REITS

Mar 16
- Increased Frequency of US Dollar Swap Lines
  - Enhanced US Dollar Swap Lines

Mar 20
- Bilateral Currency Swap with Bank of Thailand

Mar 31
- Enhanced US Dollar Swap Lines

Apr 6
- Bond Buying Limits Dropped

Apr 27
- $980 Billion Package Launched – State of Emergency Announced

= Fiscal Policy
= Monetary Policy
The United Kingdom

The impact of the pandemic has greatly compounded the already uncertain post-Brexit economic outlook for the UK. The IMF is forecasting a contraction of -6.5% this year, followed by 4% growth next year. The next round of Brexit negotiations with the EU recently started, with UK officials already taking a hard-line stance by saying there will be no extension of the transition period beyond December 31. Yet most are skeptical that such a complicated trade deal can be completed in seven months whilst also coping with the pandemic, and so many are pricing in an extension into 2021 as the most likely outcome. If the UK stance does not change, then markets will have to reassess the odds of a hard Brexit and the economic outlook for 2021 becomes even cloudier.

The fiscal reaction to the virus has seen new chancellor Rishi Sunak take unprecedented levels of government intervention. Stimulus packages were announced early, and further updates added. The coverage is vast with protection for jobs and businesses. The March 11 budget was set at £30 billion to support families and business, as well as to provide funding for the National Health Service (NHS). This was supplemented by a series of other measures ranging from grants, loan guarantees, tax cuts, support for renters, and VAT deferral. It also announced a program to protect jobs though the coronavirus job retention scheme covering 80% of furloughed employees’ salaries up to a limit of £2,500, along with cover for self-employed based upon 80% of their salary calculated through their past 3 years tax returns. All told, the fiscal measures so far amount to around £81 billion, or 3% of GDP.

The Bank of England (BOE) cut interest rates by 50 bps to 0.25% on March 11, which totally reversed its limited tightening cycle. At that meeting, the bank also set up a new Term Funding (TFSME) scheme to provide cheap liquidity over four years. It also lowered the counter-cyclical capital buffer from 1% to zero and encouraged banks to use reserves for lending. On March 17, Treasury announced its COVID-19 Corporate Financing Facility (CCFF), for which the Bank of England will act as its agent. By purchasing commercial paper under the CCCF, policymakers will provide funding to non-financial businesses that come under stress.

The bank then followed up with a 15 bp cut to 0.1% at an emergency meeting March 19. It also increased its holdings of giltls and investment grade corporate bonds by £200 billion to a total of £645 billion. It also voted to increase its TFSME scheme. To help with dollar funding strains, the BOE revived the swap line with the Fed and later increased frequency of these operations.

At its May 7 meeting, the Bank of England delivered a dovish hold. Officials underscored their readiness to “take further action if necessary.” The bank slashed its 2020 forecasts but looks for a robust recovery in 2021. The vote to hold steady was 7-2, with the two dissenters favoring an immediate GBP100 billion increase in its QE. This sets the stage for an increase in QE if their optimistic outlook fails to materialize and will absorb rising debt issuance that could increase yields and tighten financial conditions.
European Central Bank

The European Central Bank (ECB) has provided a range of stimulus to aid the European countries suffering with the pandemic. Currently, interest rates are set at -0.1% and it is unwilling to move rates further into negative territory. That said, the bank has been willing to expand its unconventional policies to address the strains in the eurozone economy.

The ECB first expanded its existing Asset Purchase Program (APP) on March 12 by a pledging to buy an additional €120 billion of bonds by end-2020. At the same time, the terms for existing Targeted Longer-term Refinancing Operations (TLTRO III) between June 2020 and June 2021 were loosened in an effort to boost system-wide liquidity.

Days later on March 18, the ECB announced its new EUR750 billion Pandemic Emergency Purchase Program (PEPP) that would be conducted until end-2020. Both public and private securities would be purchased, with the former conducted under the capital key and the latter in a manner that “allows for fluctuations in the distribution of purchase flows over time, across asset classes and among jurisdictions.”

On April 22, the ECB announced a temporary easing of its collateral requirements. It now allows banks to post collateral with sub-investment grade ratings as long as that entity held investment grade status as of April 7 and remains in the upper tier of sub-investment grade. This was clearly a pre-emptive move to ensure that Italian debt could still qualify for ECB operations. Italy is on the cusp of sub-investment grade, and our own sovereign ratings model suggests downgrades are warranted.

On April 30, the ECB introduced its new liquidity facility, the Pandemic Emergency Longer-Term Refinancing Operations (PELTRO). Seven PELTROs will commence May 2020 and mature in a staggered sequence between July and September 2021 and will be made at a rate of 25 bp below the average Main Refinancing Operation (MRO) prevailing over the life of the operation. The ECB effectively delivered a 25 bp rate cut with this move.

At its April 23 video summit, the EU approved a €540 billion package for the region that fell short of any more ambitious goals. About half of the funds (€240 billion) will be made available through the European Stability Mechanism, but with limited conditionality as it has to be used for healthcare, either directly or indirectly. €200 billion will be allocated through the European Investment Bank and national banks for loans to struggling businesses. The last component is the SURE (Support to mitigate Unemployment Risks in an Emergency), worth €100 billion, granted through loans. Yet more work needs to be done. German Chancellor Merkel continues to push for larger EU budgetary contributions from its member states. However, the sides are split as to whether the aid is in the form of grants or loans.
Germany

To its credit, the German cabinet quickly overcame its traditional resistance to deficit spending and announced an aggressive fiscal response on March 23. A supplementary budget worth EUR156 billion (5% of GDP) was passed. Furthermore, Germany announced financial emergency aid grants for small companies applying to all economic sectors as well as self-employed. Alongside this the economic stabilization fund launched, aimed at large companies and can provide large scale aid in the form of €100 billion for corporate actions, €400 billion for loan guarantees and access to refinance programmes through the KfW. All told, Finance Minster Scholz put the entire package at around €750 billion.

The IMF forecasts that the German economy will contract -7.0% this year, followed by 5.2% growth next year. As the largest economy in the EU, Germany is critical to the performance of the wider bloc. As a major exporting country, the economy depends in large part on how its trading partners perform too. China is Germany’s third largest export market, and German exports were already reeling from the impact of the US-China trade war on global trade.

France

France has announced several programs to support the economy. On March 12, France announced an expansion of Bpifrance guarantee scheme for small medium enterprises. Further to this on March 13, a plan to delay tax without penalty was brought in to boost cashflow of companies in the short term. Additional measures announced on March 19 saw the government implement an exceptional guarantee scheme to support bank financing for businesses up to €300 billion whilst simultaneously cutting the counter cyclical bank capital buffer from 0.25% to 0% for the foreseeable future.

Further help for start-ups was announced on March 24, with state guaranteed cash loans and credit facilities in the form of the bridge loan scheme which offers €80 million funded by investments for the future program (PIA) in the form of bonds. Further to this bills for small businesses were drastically reduced with the suspension of gas electricity and rental bills.

Fonds de Solidarite announced a €1.2 billion scheme to support small and micro businesses enterprises who are suffering through the corona virus pandemic. Further to this was the announcement of an unemployment scheme whereby a company pays compensation equal to 70% of salary, the company will then be fully reimbursed by the state for salaries up to 700 euros gross monthly. All told, the IMF estimates that these fiscal measures account for around 2% of GDP.
Italy

Italy remains one of the worst hit European countries, with one of the largest death tolls in the world from the pandemic. Italy seems now to be reaching its peak with successive downturns in both the infection rate and the mortality rate. However, the financial package on offer is much weaker than its European counterparts due to its already weak finances. The Italian economy was already fragile and with a high unemployment rate, not just amongst the youth population. This means the financial effects in Italy will be far more severe than other countries analysed in this report.

Initially Italy suspended loan payments for people within the Red Zone, referring to the Lombardy region of Italy which was hit especially hard in early March. This allowed for suspension for up to one year as well as stopping tax payments due and offered on state guarantee of up to 80% of SME loans for a 12-month period. Extending the credit facilities is a large part of the stimulus package, with the ceiling for the financing of banks raised from €1 to €3 billion.

The main stimulus came on March 16 in the form of a €25 billion stimulus package that was coupled with up to €350 billion of liquidity provisions to the economy. Around €10 billion of the package was used to strengthen the social security net with temporary unemployment benefits and an allowance for the self employed of €600 a month, provisions to allow for suspension of mortgage repayments and extended parental leave to 12 days as of 50% of their salary. €3.2 billion was injected into the medical and nursing sector to reinforce units of the military health service. All told, the IMF estimates that these fiscal measures account for less than 2% of GDP.

In whole the package is vastly surpassed by its counterparts. Yet this will still come with a cost, as our own sovereign ratings model shows Italy’s implied rating slipping to sub-investment grade BB+. Fitch recently downgraded Italy a notch to BB-, while S&P inexplicably affirmed its BBB rating last month. Moody’s will review its Baa3 rating in early May. While we think it is only a matter of time before Italy is cut to sub-investment grade, Moody’s may give Italy the benefit of the doubt for now.

Spain

Spain rapidly became one of the European epicentres, with an accelerating infection and death rate that matches and perhaps even exceeds Italy. Like Italy, the stimulus measures are not as aggressive as many other countries covered in this report.

Spain has rapidly increased their credit facilities in the form of a credit line of €400 billion being made available on March 12 that was aimed at businesses and individuals who work within the tourism sector as they take a huge hit from the reduction in travel and tourism over the course of this pandemic. For the self-employed and small businesses further measures to allow them to defer tax payments have also been introduced.

On March 17, Spain suspended the revision of the maximum sale prices to the public for bottled liquified petroleum gases to prevent them from rising. Current prices will be maintained for the next 6 months. Additional to this utility bills for societies most vulnerable have been suspended allowing them to maintain their social distancing. The counter cyclical buffer continued to be held at 0% for the foreseeable future in order to provide more liquidity into the banking system. All told, the IMF estimates that these fiscal measures account for around 1% of GDP.
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