Macro Insight

19 March 2020

COVID-19: Whatever it takes

The COVID-19 poses an extraordinary threat to the global economy

The COVID-19 outbreak is a public health emergency that is posing an extraordinary threat to the global economy. With acute risks to business activity and household income, policymakers have understood the need to find innovative solutions and deploy them at speed, but they still need to do more.

Early signs suggest that COVID-19 is hitting global economic activity substantially on both the supply-side and the demand-side. On the supply-side, containment measures have led to factory shutdowns and supply-chain disruption. On the demand-side, travel and leisure industries have suffered greatly, while consumers are likely to postpone buying big-ticket items amid fears of a drop in household incomes.

Policymakers have understood the need to deploy innovative solutions at speed

We see four key objectives for policymakers right now: (i) **offering direct assistance to businesses**; (ii) **supporting household incomes**; (iii) **stabilising overall demand**; and (iv) **minimising the general supply impact of COVID-19**.

These new policy objectives cut across the monetary, fiscal and regulatory tools which in normal times are typically seen as serving distinct roles. Governments so far have pledged to use some of the tools outlined in our policy toolkit guide (Figure 1) to limit the damage of COVID-19 to their economies.

1. **Offering direct assistance to businesses**

Policymakers have quickly realised that a key priority is ensuring that **viable businesses do not face a cash crunch that leads to avoidable closures and bankruptcies**. The first column of Figure 1 shows the types of policy measures that can meet this task, such as liquidity support for banks facing a temporary halt in loan repayments, and public sector loans or loan guarantees for small- and medium-sized businesses (SMEs).

Figure 1: The HSBC Global Asset Management toolkit for global policymakers

	Businesses	Households	Demand	Supply
Fiscal	**Subsidies** to key firms and industries Public sector **loans or loan guarantees** **Tax cuts**	**Cash transfers** Payroll **tax cuts** **Vouchers** for essential purchases	**Infrastructure spending** **'Short-time' working policies** to limit unemployment	**Spending on healthcare**, including test kits, medical supplies and temporary hospitals
Monetary	**Long-term, low-cost uncollateralised loans** **Liquidity support for banks** **Corporate bond purchases** by the central bank	**Cash transfers** from the central bank **Negative borrowing rates**	**Interest rate cuts** **Asset purchases** in bond and equity markets **Direct monetary financing** of government spending	**Safeguarding domestic financial stability** **'Swap lines'** to ensure sufficient global access to US dollars
Regulatory	**Moratorium on loan repayments** Permitting **delays in tax payments and other business costs**	**Moratorium on mortgage and rent payments** Permitting **delays in tax returns**	Rules for **monetary-fiscal coordination** Rules for **international policy coordination**	**Early and effective containment measures** **Protecting critical supply chains**

Source: HSBC Global Asset Management

Our views

Global policy action is increasingly innovative and aggressive.

However, with the economic outlook so uncertain and risks skewed to the downside, we advocate a cautious tactical view

China, the first country to face difficulties from COVID-19, led the way in this space. Regulators permitted distressed firms to delay repaying loans while the People's Bank of China (PBoC) offered CNY300bn (USD42.7bn) in funding to banks, provided that they re-lend the money to affected firms at preferential interest rates.

Other countries have followed suit. Japan is making JPY1.6trn (USD15.0bn) available for zero-interest, uncollateralised loans to small and medium sized companies, while South Korea committed KRW3.0trn (USD2.5bn) to support firms struggling to meet wage costs. Malaysia, Indonesia and Singapore have proposed similar measures.

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However, **offering cheap funding to banks to pass onto firms is likely to be more effective if banks are insured against much of the default risk through state-guarantee of loans.**

Offering public sector assistance to businesses is a key priority

After the Bank of England announced a new funding facility that encourages banks to pass on lower interest rates to firms, the UK government pledged a GBP330bn (15% of GDP) loan guarantee fund and tax cuts for firms in heavily-affected sectors.

French president Emmanuel Macron followed up a commitment that "no business will be allowed to fail" with a EUR300bn (12% of GDP) fund to guarantee business loans and a suspension of utility bills and rent payments. Spain has announced similar measures, while Germany has beefed up capacity at a major state-owned bank to offer at least EUR500bn (about 15% of GDP) in loans to SMEs and has allowed companies to delay tax payments.

In coordination with national banks, Italy has been planning a moratorium on small business loan repayments. In addition to state-guarantees of existing loans, this is likely to require a relaxation of rules on recognising non-performing loans.

To facilitate these plans, the European Central Bank (ECB) has taken steps to support the banking system, including pushing borrowing rates below deposit rates and offering liquidity on more favourable terms to banks that increase loans to businesses.

Meanwhile, the US has raised the prospect of at least USD50bn in federal support for exposed industries such as airlines as well as shale producers hit by the recent sharp falls in the oil price. The Federal Reserve has offered up to USD1.0trn in support to the commercial paper market, which plays a significant role in raising short-term credit for businesses.

Direct cash transfers, tax cuts and mandated delays to key payments are among the main policy measures to help support household incomes

2. Supporting household incomes

Another immediate objective for policymakers is to limit the impact of COVID-19 on consumer incomes and ensure that households can meet core outgoings such as mortgage repayments and food and utility bills. Direct cash transfers, tax cuts and mandated delays to key payments are among the main policy measures available for this objective.

In February, the Hong Kong government put direct cash payments of HKD10,000 (USD1,280) to each adult at the centre of its fiscal stimulus plan to cushion the impact of COVID-19 on wages. Thailand, Singapore and Australia proposed similar schemes for low income households. At the time of writing, the US government, as part of a mooted USD1.2 trillion (6% of GDP) fiscal stimulus package, is considering cash payments of at least USD1,000 each to millions of American adults, the deferral of federal taxes and a boost to sick pay.

Italy's plan for a moratorium of loan repayments extends to mortgages, while Japan and South Korea will compensate working parents who have to stay at home due to school closures.

3. Stabilising overall demand

The third objective concerns traditional measures to stabilise employment and overall demand and goes beyond targeted support to businesses and households. Fiscal packages announced by the UK and Malaysia have provisions for increased infrastructure spending, while a decision by the Chinese authorities late last year to encourage local governments to issue CNY1trn (USD142bn) of infrastructure bonds ahead of schedule, looks timely.

A number of fiscal and monetary policy measures have been rolled out to stabilise employment and overall demand

In Germany, authorities are planning to reintroduce a "short-time working" policy used successfully after the 2008 financial crisis, which encourages businesses with spare capacity to keep on staff by subsidising up to two-thirds of the fall in their wages.

In the monetary policy space, many central banks have cut interest rates this year, particularly in Asia. The US reduced its policy rate by 150bp this month to near-0%, providing significant headroom for emerging market economies to ease monetary policy further (see Figure 2).

This move along with a new USD700bn programme of bond-buying by the US Federal Reserve puts downward pressure on long-term real interest rates and makes possible a larger US fiscal package by lowering government borrowing costs. Meanwhile, the ECB's new EUR750bn bond-buying scheme could help keep borrowing costs down for countries with high levels of public debt relative to GDP, such as Italy, Spain and Portugal. On Thursday, the Bank of England cut interest rates to 0.1%, their lowest on record, and pledged to buy GBP200bn in government and corporate bonds. The Monetary Policy Committee also increased the funding facility offering cheap loans to banks, noting that the initial quota of GBP100bn was already not sufficient.

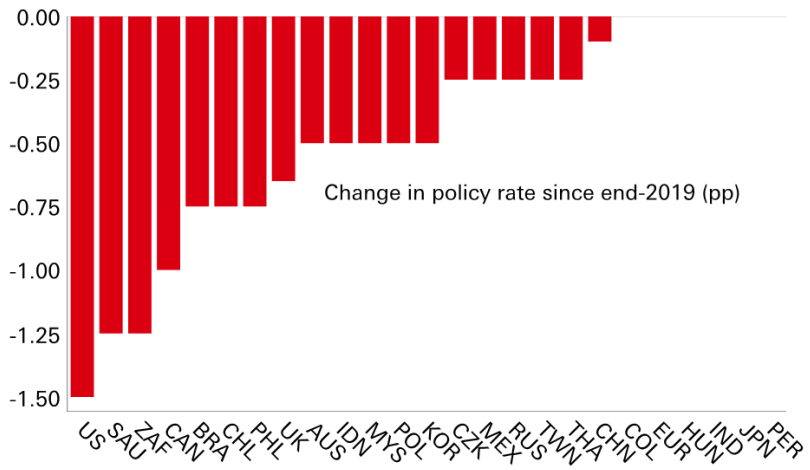
In a sign of an important emerging trend, the UK has taken the unusual step of coordinating monetary and fiscal policy announcements in an effort to maximise their impact on aggregate demand. There are also attempts at the international level to coordinate a response, with G7 leaders of developed nations recently pledging to work together.

In Asia, authorities have intervened directly in equity markets to support valuations and cushion the impact of recent market re-pricing on household wealth. For example, the Chinese

authorities have propped up onshore equities while the Bank of Japan recently increased its asset purchases of Exchange Traded Funds (ETFs).

Getting on top of the disease early and safeguarding domestic financial stability can help reduce the supply-side impact

Figure 2: Interest rate cuts in 2020



Source: Macrobond, HSBC Global Asset Management, as of 19 March 2020

4. **Reducing the general supply-side impact of COVID-19**

If the economic impact of COVID-19 intensifies in the near term, policymakers will need to take further steps

The last objective surrounds reducing the overall supply-side impact of COVID-19. One of the most effective ways to reduce the economic impact of COVID-19 appears to be getting on top of the disease early, minimising and delaying its spread and therefore lowering the need for lengthier and more economically damaging containment measures.

South Korea, for example, devoted much of its fiscal package to boosting healthcare spending, and early indications suggest it is managing to contain the spread of the virus in the country. By contrast, the low rate of COVID-19 testing in the US may mean cases there have been under-recorded, increasing the likelihood that the US authorities need to adopt more stringent containment measures, as have been seen in Europe.

Other measures reflect efforts to minimise effects on supply, such as ensuring banks have sufficient liquidity to maintain stable financing conditions. With market volatility elevated, central banks in China, Japan and the US have taken steps to boost liquidity. Meanwhile, the US Federal Reserve has offered so-called 'swap lines' to other central banks, which help to ensure that companies and banks in other countries have sufficient access to US dollars.

More may need to be done

Even in this new era of ever more accommodative policy, the economic outlook remains very challenging and uncertain, while financial market volatility is elevated

At the time of writing, many major countries have announced significant packages to meet the extraordinary challenge of the COVID-19 pandemic. Policymakers so far have relied on monetary policy measures to do the heavy lifting, while the slow progress towards a comprehensive US fiscal package is a cause for concern. **If the economic outlook deteriorates dramatically, policymakers will need to take further actions to stabilise economies and markets**, some of which could mobilise considerable resources.

In a worst-case scenario, governments need to be prepared to play the role of "buyer of last resort", covering business expenses across the economy to allow firms to keep hold of staff and avoid unnecessary bankruptcies. An era of ultra-low global interest rates and subdued inflation has provided many governments with the space to scale up fiscal spending measures with confidence, but if necessary with carefully considered support from their central banks.

Investment implications

Global policymakers are clearly pushing the boundaries to help mitigate the economic damage of the outbreak. However, even in this new era of ever more accommodative policy, the economic outlook remains very challenging and highly uncertain, while financial market volatility is elevated. We believe a more cautious investment strategy is warranted in the short term.

Investor psychology remains caught between concerns over the impact of COVID-19 on corporate fundamentals and optimism that policy measures – both fiscal and monetary – can mitigate the economic costs. We believe an aggressive and innovative mix of policy action could allay some of the fears about the economic effect of COVID-19, while setting the stage for a rebound in economic activity once the pandemic subsides. Meanwhile, amid hugely improved valuations for risky asset classes following recent market action, we want to maintain a pro-risk investment strategy on a strategic (6-month+) basis.

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