25 March 2020

RESEARCH NOTE

Governments Stepped Up To The Plate, Grand Slam Or A Bunt?

The coronavirus pandemic will cause a global recession in 2020. To limit the economic damage, the public sector is taking extraordinary action in many countries. Governments are directing large fiscal spending to boost health systems and protect affected companies and workers. Central banks are aggressively easing monetary policy and signaling regulatory forbearance (see Appendix). This note reviews the measures announced in Europe and the United States.

In Europe, governments understand the importance of avoiding the fall in demand that is associated with a near-complete lockdown, as it can have a permanent effect on the economy once the epidemic recedes. A number of measures have been deployed:

- Cash support to households, most often through wage subsidies (including in Germany, Italy, Spain, U.K.), one-off grants (Italy, Poland) and the deferral of mortgage and other payments (France, Italy, Spain).
- The main instrument for state support to companies is through the provision of public guarantees to companies' debt in all countries, together with the deferral of tax and social security payments (France, Italy, Spain, U.K.) and direct loans (Germany).
- Many governments have hinted at the possibility of nationalizations (Italy, France) and recapitalizations (Germany) or a "national shield" to protect firms from foreign takeovers (Spain).
- Support and investment within the health sector and the rest of the economy (most countries).

At the European Union level, joint fiscal efforts are present but small. The European Commission (EC) has, in a historic move, removed all fiscal deficit constraints on its members, giving each government the freedom to think about how much it wants to spend to support their economy. The EC has also committed a small part of its budget (0.3% of the EU's GDP) for still undefined support measures. The lending arm of the EU, the European Investment Bank, has announced an even smaller amount of resources to support SMEs. In the absence of a common budget, fiscal measures remain national with little direct spillover across borders. Thinking the unthinkable, there are mounting calls for the issuance of a "coronabond", with joint liability for euro area members. This would change the architecture of the euro area forever and pave the way for a much deeper, more solid integration. Alternatively, a common EU budget could be designed to pool resources to finance health research and reduce future fiscal costs of fighting the impact of the virus. Developing the fiscal union would prevent having to ask monetary policy to carry the entire burden of the adjustment and make the region more resilient to shocks.

To address risks of the economic collapse transforming into a large financial crisis with massive cascading failures, monetary policy has engaged in whatever-it-takes action. In the euro area, the European Central Bank (ECB) launched a quantitative easing program, through a €750 billion Pandemic Emergency Purchase Program (PEPP); the size could be increased as needed, where country shares in bond purchases are loosely defined, and all countries including Greece are targeted. ECB President Christine Lagarde has made clear she is "fully prepared to increase the size by as much as necessary and for as long as possible", helping to stabilize the widening in sovereign spreads, in particular in Italy—where the virus contamination has spread the fastest and farthest in Europe, so far. The ECB is also providing unlimited liquidity to the money market and reduced banks' regulatory ratios to release capital for lending.

In the United States, the Fed had its own "whatever it takes" moment on March 23rd, taking the unprecedented step of announcing an open-ended QE program that broadens monetary support well beyond Treasury and MBS markets. In an effort to shore up liquidity conditions across credit markets and restore stability to funding and financial markets, the Fed announced several new measures. The facilities are aimed at helping corporates, households and municipalities.

Last week, the Fed announced it would purchase at least $500 billion of Treasuries and $200 billion of agency MBS. These purchases will now be unlimited, thus removing any constraints on QE, and also include agency CMBS. Other highlights of the announcement include:

TABLE 1: FED MONETARY POLICY ACTIONS

Beneficiary	Program
Corporates	Primary Market Corporate Credit Facility for new IG bond and loan issuance; Secondary Market Corporate Credit Facility to provide liquidity for outstanding IG corporate bonds (directly and via ETFs)
Households	Term Asset-Backed Securities Loan Facility to facilitate the issuance of ABS backed by student loans, auto loans, credit card, loans guaranteed by the SBA and certain other assets
Municipals	Expand the existing Money Market Mutual Fund Liquidity Facility to include a wider range of securities, including municipal variable-rate demand notes and expand the existing Commercial Paper Funding Facility to include high-quality municipal debt

Source: Federal Reserve. As of March 23, 2020.

Of particular interest are the corporate and ABS credit facilities, as those will be levered 10x to provide up to $300 billion in new financing. The Treasury Department, via the Exchange Stabilization Fund, will provide $30 billion in equity in a SPV for these facilities. Persistent and high volatility in bond markets has dampened the arbitrage trade which keeps ETF prices in line with underlying net-asset values. The Fed facilities should help alleviate these price inconsistencies and improve liquidity. We should look to measures like compressing ETF-NAV discounts and CDX spread tightening to gauge that signs of stress in corporate debt markets are easing. Combined, these facilities are aimed at creating smooth functioning credit markets and fostering an environment for a robust recovery.

Fiscal stimulus needs to be big, all-encompassing, and happen quickly if the government wants a recovery that resembles a 'V.' While the U.S. government has passed two relief bills, these were aimed at preventing the spread of the virus, providing medical and food aid, and strengthening unemployment insurance, rather than providing stimulus to keep the economy afloat. A $1-2 trillion bill is being discussed among lawmakers (Table 2 summarizes these measures), but is being delayed largely due to disagreements surrounding industry-specific relief.

There are a number of measures designed to help corporations, but they fall short of companies' many demands. In terms of industry-specific relief, airlines are pushing for direct aid, while the bills being discussed are outlining loans—the bill that failed in the Senate allocated $50 billion of direct lending for passenger airlines, $8 billion for air cargo, and $17 billion for businesses critical to "maintaining national security." These loans would not be able to be forgiven and buybacks are disallowed. Changes to this are likely as Democrats push for greater oversight.

TABLE 2: PROPOSED U.S. FISCAL SPENDING BILL
BILLIONS USD

Item	Senate Bill That Failed	McConnell's Bill
Rebates	300	250
Corporate Tax Relief	~200	~200
Small Business Loan Forgiveness	350	300
Airlines/Cargo Carriers	58	58
Distressed Industries	425	150
Unemployment Insurance	250	0
Public Health Spending/Appropriations	242	~0
TOTAL	**1,842+**	**958+**

Source: Cornerstone Macro, Tax Foundation, and Senate Republicans. As of March 23, 2020.

Funding for SMEs will be vital for the U.S. economy to bounce back after the virus is in the rearview mirror. While small businesses account for about 50% of U.S. employment, half of small businesses don't have enough of a cash buffer to cover a full month of expenses if they stop making money. This means that, if there is not adequate support, many SMEs would not be able to reopen on the other side of this "transitory" impact on the economy, and thousands of Americans would be unemployed.

A number of other measures could be added to the final bill that would help alleviate the economic impact of the virus:

- More money for hospitals
- Money for state and local governments
- Employee retention tax credit
- Greater oversight for the Corporate Loan Facility
- Measures to protect individuals from foreclosure, evictions, and forbearance
- Relief for student loans
- Greater SNAP funding (some funding was included in the second relief bill passed)

A hefty fiscal stimulus bill will be delivered soon and help aid the U.S. economy from the impact of the pandemic, but it will take longer for the economy to recover if it doesn't give enough relief to businesses and the unemployed.

The determination of governments and central banks brings hope that the economic and financial impact of the virus can be mitigated. The most important factor, however, is how fast the pandemic can be contained so people can return to work. In this goal, the fiscal stimulus should continue to target the health sector and the most vulnerable parts of the economy and those populations that are suffering the most from the shock, to avoid depressionary long-term effects. Monetary policy should continue to arrest the transformation of the economic crisis into an even worse financial crisis, with a potential feedback loop that would reduce the fiscal space for sovereigns to protect their economies.

APPENDIX: POLICY DEVELOPMENTS IN EUROPE

Region	Fiscal Policy	Monetary Policy
Euro Area	-2020 fiscal measures add up to 1% GDP -37bn from EC budget (0.3% GDP) o/w 7.5bn fresh -EIB to mobilize 20bn euro to support 100,000 firms	ECB Governing Council 12/3/20 -**TLTRO3**: liquidity at -75bps if on lend, -25bps othw (to 50% loan book) -**LTROs**: Full allotment at 0% -Fed USD swap line **120bn QE** for corp+sov bonds (adds up to 360bn) -Relaxation of regulatory capital Midnight call 18/3/20 -750bn Pandemic Emergency Purchase Program (incl Greece, corp bonds, loose keys) -QE adds up to 1.1 trillion for 2020), liquidity measures to 10% GDP *Regulatory forbearance measures*: -Pillar 2 cancelled (12/3) and capital freed totals - 120bn CET1 to absorb losses/provide 1.8tn loans -Flexible prudential treatment of NPL backed by pub guarantees (20/3)
Italy	-Suspension of mortgage payments (**2bn**) -State coverage of suspended workers' wages, short term work scheme, suspension of firing until 18/5 -1bn support to families, 2bn support for health system -Deferral of all tax and SS payments for SMEs, sectors impacted -Debt service moratorium for SME and households -3bn guarantee fund for SMEs, 4bn exporters liquidity support -Guarantees cover up to 330bn loans. Nationalization of Alitalia -**25bn** package at **1.5% GDP** (17/3)	
France	-Suspension of tax (12bn) and social security payments (22bn) by corporates, tax cuts for most affected firms -Debt service moratorium for SME and Households -Public guarantee (BPI) on SME and mid-sized Co loans (90%) "We are at war" statement (**300bn = 12% GDP**, 16/3) -Rent and utility bills suspended -All firms can put employees on state-supported unemployment -No business of any size allowed to go bust -**45bn** fiscal stimulus in Parliament -Nationalization of companies not excluded (16/3)	

Source: Deutsche Bank Research. As of March 23, 2020.

Region	Fiscal Policy	Monetary Policy
Spain	-Mortgage payment moratorium for vulnerable households -**117bn** public spending (100bn guarantees) and 82bn private spending for direct support to the economy **-20% GDP** (17/3) -Short term work compensation scheme, no SS contribution for SME, 25% for other firms -unemployment benefits to 75% salary for everybody -Gov shield to protect strategic companies to avoid takeovers due to fallen stock market valuations	
Germany	- "Whatever it takes" to counter the effect of the crisis (**10% GDP**) -12.4bn investment for 2021-24 (roads, housing) at **0.4% GDP** -**460bn** (+93bn) guarantee on SME and mid-sized firms debt -60-67% state coverage of part time employment for 2 years -**€50bn** fund for SMEs and self-employed, o/w 10bn grants (19/3) -**100bn** loan to KfW for unlimited loans to companies -The WSF underwrite companies' debts & recapitalize those experiencing financial difficulties due to the coronavirus turmoil, paving the way for a wave of partial state takeovers	
Poland	-7.5bn spending from EU budget (**9% GDP**) covering cash support, loan guarantees, liquidity easing. -State financed 2-week comp leave for parents	-50bps cut to 1% (17/3) -QE in sov bonds (no limit), corporate loans refinancing facility for banks
U.K.	-**£330bn** package of guarantees for all companies (17/3) -3-mths public support of 80% of wage of furloughed workers, statutory sick pay, **£500mn** welfare for self-employed, **£500mn** hardship fund -Cash grant to businesses in retail, leisure and hospitality -3-month mortgage holiday, 3-m VAT deferral -**£5bn** emergency NHS fund	-50 bps cut to 0.25% (11/3) and 15bps cut to 0.10% (19/3) -4-year funding for bank loans to SME (11/3) -Elimination of banks countercyclical capital buffer but required to rise to 2% from end-20 (11/3) -**£200bn** QE (total £645bn) in Gilts and corp bonds (19/3)

Source: Deutsche Bank Research. As of March 23, 2020.

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*As of December 31, 2019

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