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AB GLOBAL MACRO Q&A

Guy Bruten

Chief Economist—Asia-Pacific ex China

Guy Bruten joined AllianceBernstein (AB) in 2004 and is a member of the firm's Global Economic Research team. In that role, he provides macro research coverage for a number of countries in the Asia-Pacific region, and is also responsible for conducting thematic research—looking at the impact, for example, of demographic change, the commodity price supercycle and the global surge in populist politics on the outlook for economies and asset prices. Prior to joining AB, Bruten worked in economics and market strategy roles for Macquarie Bank's Funds Management Group and for SBC Warburg. He started his career in the early 1990s at the Commonwealth Department of the Treasury in Canberra. Bruten holds a BEc from the University of Adelaide and an MEc from the Australian National University.

Q: THE COVID-19 OUTBREAK IS DOMINATING THE DISCUSSION ABOUT THE GLOBAL ECONOMIC OUTLOOK. HOW ARE WE TRYING TO FRAME ITS IMPACT?

In the near term, we are clearly looking at a substantial—perhaps unprecedented—decline in global economic activity. Social distancing policies, for example school closures and travel restrictions, are proving to be effective at flattening the curve of infections, thus slowing the spread of the virus through the community. These policies are now in place across most major economies; the severity and length of these restrictions is, however, yet to be established. Countries that had early success in controlling the spread—Singapore, Japan, Hong Kong, among others—are now having to impose additional measures.

What is clear, though, is that most countries are going to face a substantial decline in economic activity over the next three months. The precise magnitude is always going to be difficult to quantify and will depend on how quickly restrictions can be lifted. But it's quite plausible that GDP could be down somewhere in the order of 10% (non-annualised) in many economies in the second quarter.

The contours of that economic hit—which have been visible in China for a while—are starting to show up in the economic data elsewhere with record unemployment claims in the US and a record drop in Australia's business confidence index, to give two examples.

Q: BEYOND TRYING TO ESTIMATE THAT INITIAL HIT, WHAT HAVE YOU BEEN USING TO MONITOR COUNTRIES' PROGRESS SO FAR?

We have been focused on five policy markers to try to frame the underlying economic impact, and to give us a guide as to how things may look once restrictions begin to be lifted:

+ First, are we seeing the sort of health policy response that we would like to see? By and large this requires shutting down a significant amount of economic activity to try to flatten the curve of infections and prevent health systems from being overwhelmed.
+ Secondly, is there the necessary fiscal response to offset the economic impact of trying to flatten the curve? For example, measures to support incomes by businesses and workers to get through the shutdown phase.
+ Thirdly, are we seeing measures to stop this becoming a substantial credit stress episode? Essentially, are central banks putting in place measures to backstop the financial system?
+ The fourth marker centres on whether we are seeing an "all-in" approach to monetary policy—getting to a point where "unconventional" monetary policies are pushed to their limit—where quantitative easing (QE) is unlimited and/or there are yield curve control programs in place?
+ And the fifth marker has an eye on the post-lockdown-phase environment. Is there enough fiscal stimulus to kickstart the economy once restrictions start to be lifted?

Q: BASED ON THESE MARKERS, HOW DO YOU VIEW THE PROGRESS SO FAR?
Against most of these markers, the progress has been encouraging, although there's been variation in terms of the speed, consistency and coordination across countries.

Most developed-market economies are at the point where there are comprehensive shutdowns and other social distancing measures in place, along with substantial fiscal support—for example, wage subsidies and extended unemployment benefits. In other words, every country to a greater or lesser extent is making progress on the first two channels—the health policy and economic policy legs of "flattening the curve".

Similarly, we've seen encouraging progress against the third marker with almost the entire global financial crisis (GFC) toolkit effectively being rolled out in terms of backstopping the financial system in a matter of days or weeks, rather than the months that it took during the GFC. Consequently, we are seeing more liquidity come back into the market and markets are behaving better than they were in mid-March.

As to the fourth marker, central banks are clearly close to being "all-in" in terms of monetary policy, as policy rates have been cut to their effective lower bound and QE programs have been implemented (or restarted).

Which just leaves the open question of how much fiscal support there is going to be during the recovery phase. This will be key and links to one of our long-running themes: that as monetary policy reached the limit of its effectiveness, it would fall to fiscal policy to provide stimulus. And, in parallel, that fiscal stimulus would require the cooperation of monetary policy. i.e. central banks aiding in some form to keep bond yields low. In fact, this concept of monetary and fiscal policy being joined at the hip is the only way this hangs together and we're clearly heading quite rapidly down that path.

THE SIZE AND SPEED OF POLICY RESPONSE HAS BEEN UNPRECEDENTED

Q: SO, DO YOU SENSE WE HAVE MAYBE NOW TURNED A CORNER FROM WHERE WE WERE JUST A MONTH OR SO AGO?
I think you could say that two months ago markets—and many policy makers—weren't concerned enough about the potential impact of COVID-19. But that's clearly changed. We've seen large adjustments in asset prices and it's now widely understood that the economic numbers over the next three months—unemployment, for example—are going to be bleak. Encouragingly, however, the size and speed of policy response has been unprecedented.

Now the focus is shifting to an additional set of challenges—a couple of which stand out for me in terms of importance.

First, how effectively will different economies navigate the next phase of health policy implementation: a staggered lift in lockdowns and other restrictions; introduction of comprehensive mitigation measures (e.g. testing, case tracking, isolation protocols); a potential retightening of restrictions if a second wave of infections emerges? This underscores the idea that the return to "normal" will be a rocky one.

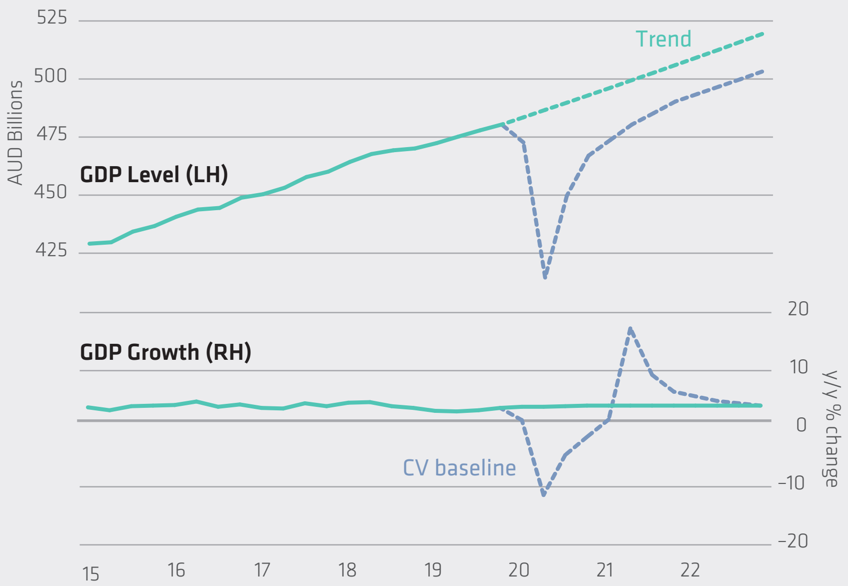
Indeed, the second challenge will be to start thinking about what "normal" means in the post-shutdown world. The virus crisis has exposed several vulnerabilities. Some of those are related to globalisation such as links in manufacturing supply chains and availability of medical supplies; some are more domestically oriented: Is there enough of a social safety net? Is the health care system robust enough, with sufficient spare capacity? For households, the question will be whether they have enough precautionary savings? Finally, how do governments deal with the huge addition to debt on their balance sheets that the crisis response has necessitated? The answers to these questions are crucial—and will shape the economic and investment landscape for years to come.

Q: WHAT ABOUT AUSTRALIA? WHAT DO YOU THINK OF THE LOCAL IMPACTS AND WHERE ARE WE IN TERMS OF OUR POLICY RESPONSE?

The route may have been a bit circuitous, but we are moving in the same direction as most other countries with respect to the curtailing of economic activity and putting in place significant social distancing measures. The monetary policy measures—including the Reserve Bank of Australia's (RBA) roll out of a QE programme with a version of yield curve control—meets our definition of "all-in". While there may still be a few cracks, the scale and scope of the fiscal support response, with programs such as JobKeeper, is encouraging.

RECOVERY WON'T BE TO "NORMAL"

Australia Real GDP Baseline (Illustrative)



As of 31 March 2020
Source: Australian Bureau of Statistics and AB

THE TEMPORARY SLUMP IN ECONOMIC ACTIVITY WILL HAVE A PERMANENT IMPACT ON THE MACRO LANDSCAPE

As is the case elsewhere, the tentative success in flattening the virus curve in Australia is generating calls for a relaxation of the social distancing policies. How that is managed will be the next crucial policy challenge. Even as those restrictions are lifted, it's clear that for a big chunk of the Australian economy activity is not returning to "normal" any time soon and Display 1 shows the approximate effect this will have to GDP. Foreign students won't be back in Australian universities in second semester (and, potentially, not in 2021 either). International tourism will be slow to restart and, as long as there is not an effective vaccine, some form of social distancing behaviour will be a semi-permanent feature.

With that backdrop it's very difficult to see a speedy reversal of economic policy. Large fiscal deficits at both the Commonwealth and state governments will remain. The RBA will continue to play a role in facilitating the funding of those deficits. A cash rate anchored at the "effective lower bound" will likely be with us for an extended period. As was the case with the post-GFC environment, the temporary slump in economic activity will have a permanent impact on the macro landscape.

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