How central banks and governments are stabilizing the economy

Managing today's complex global economy is no easy feat.

In the midst of the COVID-19 pandemic, central banks can be thought of as the plumber. They use various tools to control a country's money supply and ensure the pipes underpinning the global economy don't burst. To ensure water continues to flow through the pipes, we look to action taken by governments in the form of fiscal policy. The ultimate goal: maintain a healthy economic environment.

On aggregate, central bank officials and government policymakers are doing more than they did during the financial crisis to achieve this outcome. Let's take a look at the various steps that are currently underway.

1. Policy interest rates

This interest rate applies when banks loan excess reserves to each other.

Why it's changing: Lower rates make loans cheaper and also make banks more likely to borrow from each other. In turn, this makes more funds available for businesses and consumers to borrow.

Lower rates stimulate economic activity by making it easier for businesses to buy equipment, hire employees and expand operations.

They also make it easier for households to make big-ticket purchases such as cars and homes.

Comparing current response on policy rates to the global financial crisis:

	Global financial crisis: Slower response but bigger moves over time			COVID-19: Fast action but little room to lower rates		
	Policy rate January 2007	Policy rate December 2009	Policy rate cut (bps)	Policy rate January 2020	Current policy rate	Policy rate cut (bps) YTD
Bank of Canada	4.25%	0.25%	400	1.75%	0.25%	150
U.S. Federal Reserve*	5.25%	0.00%	525	1.50%	0.00%	150
European Central Bank	3.50%	1.00%	250	0.00%	0.00%	0
Bank of England	5.25%	0.50%	475	0.75%	0.10%	65

*lower bound

Source: RBC GAM, Bloomberg. Data as of March 31, 2020.

2. Quantitative easing (QE)

QE increases the amount of money flowing through the economy. It is carried out when a central bank purchases bank assets, typically government bonds and related securities. After selling assets to the central bank, banks are left with more funds available for lending, making it easier for companies and households to access credit at lower levels of interest rates.

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.

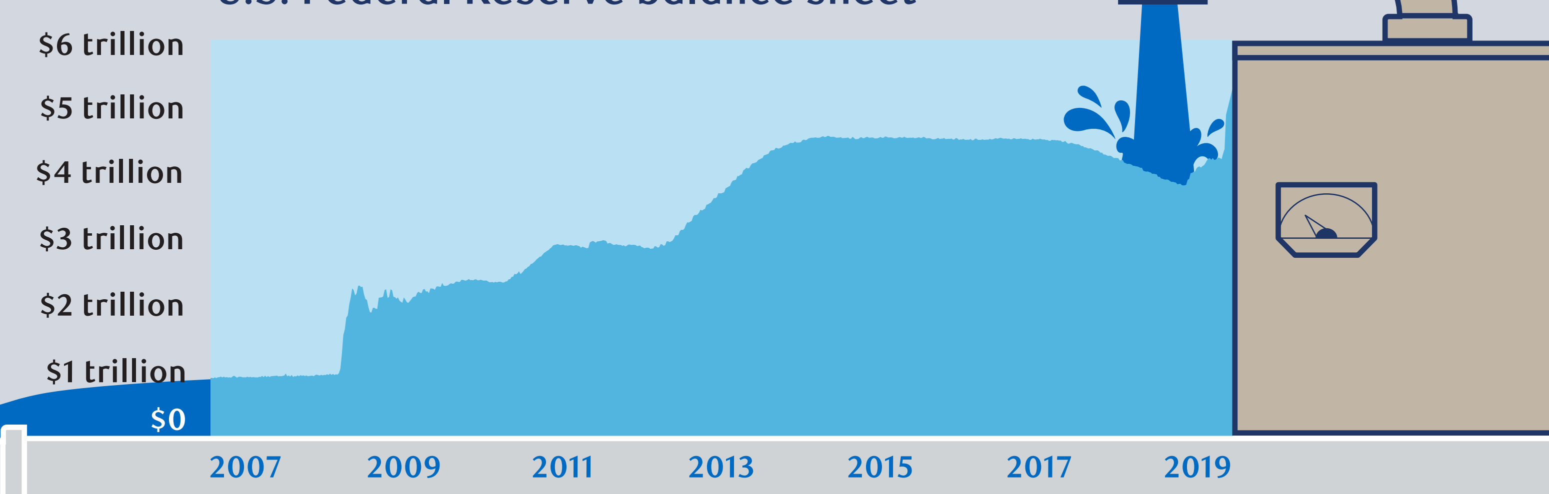
€750 billion by end of 2020

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.

U.S. Federal Reserve balance sheet



Source: RBC GAM, Bloomberg, U.S. Federal Reserve. Data as of March 25, 2020.

3. Other central bank measures:

Bank reserve levels: these are cash levels that large banks must keep on hand to meet demand for customer withdrawals. The U.S. Federal Reserve announced this limit would be reduced from 10% of deposits to 0%, as of March 26. This increases available funds for loans to households and businesses.

Liquidity measures: central banks have announced a wide range of programs designed to keep banks liquid and critical corners of the credit market functioning. These figures already sum into the trillions of dollars, though they are temporary in nature – meaning they are less likely to have long-lasting effects on inflation or asset valuations than more enduring measures such as QE.

The amount of monetary stimulus now being pushed into the financial system is truly extraordinary. Arguably, both the magnitude and breadth of QE measures announced to date make up for the fact that central banks had less room to cut their policy rates due to the low starting point.

Keeping the water running

Now the market's attention has shifted to governments and the fiscal policy required to keep the water running. The response has also been significant, with countries taking a multi-phase approach:

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 – aimed at preventing foreclosures and bankruptcies from stacking up.

Phase 3 Targeted spending to encourage companies to keep their workers on the payroll as opposed to laying them off. Governments 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.

These waves of fiscal stimulus are likely to continue, as we saw during the 2008/09 global financial crisis. If so, we'll see a bigger fiscal response overall to keep the economic waters running. For a global economy reeling from the COVID-19 pandemic, and financial markets struggling to come to terms with its implications, these developments have been welcomed by investors, businesses and consumers alike.

Fiscal stimulus – Government outlay (% of GDP)

Canada	U.S.	U.K.	Spain
4.5%	6.9%	2.2%	9.2%

Relief package – fiscal stimulus plus loans, loan guarantees, and others (% of GDP)

Canada	U.S.	Germany	Italy
9.8%	10.8%	44.9%	20.7%

Note: as of April 7, 2020. Fiscal stimulus only includes spending and tax cuts by the government and does not include relief measures such as tax and fee deferral, loans and loan guarantees, and equity investment, etc. Source: National central banks, national government websites, ING, UBS, RBC GAM

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All data as of April 7, 2020 unless otherwise stated.