Central Banks: What are they doing?

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As policymakers seek to soften the economic blow of the Coronavirus, a range of policy actions have been announced by central banks around the world. We outline the major changes in this piece.

Reserve Bank of Australia

The RBA has cut the cash rate to the lower bound of 0.25%, and committed to leaving the cash rate unchanged until it is on track to meet its objectives of full employment and inflation in the target 2-3% band. It envisages this process will take "some years" (a piece of forward guidance inspired by the US Federal Reserve). It has also undertaken yield curve targeting (inspired by the Bank of Japan), noting that trades will be undertaken in the market to (i) ensure that the 3-year bond trades at around 0.25%; and (ii) address market dislocations along the yield curve. Importantly, a term funding facility has been set up to support new bank loans (inspired by the Bank of England), especially to small- and medium-sized businesses.

Reserve Bank of New Zealand

The RBNZ cut the cash rate to 0.25% ahead of the RBA, and has since also announced term funding facility to enhance liquidity in the banking system. Unlike the RBA it has not gone down the QE path, but remains ready to do so. It had espoused negative rates as a possible policy option, but seems to have cooled on this.

US Federal Reserve

The Fed has cut rates to zero and re-started QE in an amount of at least USD700bn. It also announced a range of measures to assist US banks while re-opening swap lines with a range of other central banks around the world to ensure sufficient availability of US dollars in the system. Money market fund liquidity has also been backstopped to free up the flow of short-term corporate credit.

European Central Bank

The ECB has launched a EUR750bn Pandemic Emergency Purchase Program, in addition to EUR120bn of asset purchases already announced. It has promised to do more if required, and more is indeed likely to be required because at present the buying program is still skewed towards northern Europe, whereas it is sovereign bonds of southern European countries that will come under most stress.

Bank of England

The BoE cut policy rates by 50bp and announced a range of measures to support credit provision and help firms experiencing disruption to their cash flows.

Bank of Japan

The Bank of Japan announced a special lending facility to facilitate corporate financing as well as more proactive purchases of both ETFs and J-REITs. Increased purchases of both commercial paper and corporate bonds were also announced.

Summary

The actions noted above are welcome. In the case of Australia, they are unprecedented (but do mimic policies delivered in other jurisdictions in past years). In the case of other jurisdictions, Europe in particular, we may yet see truly unprecedented action as the ECB is further called upon to relieve pressure on the yields of peripheral European bonds. It would not surprise us to see the ECB taking pages from the BoJ playbook.

Of course, though, the nature of the shock hitting the global economy as we speak is quite unprecedented as well and herein lies the problem: Central bank action cannot replace jobs lost as companies and indeed whole industries drastically scale back production. Whilst lower rates can soften the blow, they can't stop or reverse it. Fiscal stimulus is required and has now been delivered in the US and China to an extent not seen since the GFC. In other jurisdictions though, the stimulus lags that delivered in the 2008-2010 period. For this reason, we expect further fiscal stimulus. By its nature though, fiscal stimulus is implemented more slowly than monetary stimulus. With monetary policy almost entirely spent around the world, we hope that governments around the world can deliver, as quickly as possible, coordinated fiscal packages tailored in terms of both size and broader design to effectively offset the coming sharp drop in global demand. Markets have already shown plenty of signs of capitulation over the last few weeks, and this will continue until policymakers capitulate as well.