

WHAT'S TO COME?

With the global pandemic surging anew, governments around the world are developing additional measures to counteract the macroeconomic strain wrought by widespread illness and restrictive measures implemented to counteract its spread. Meantime, though still volatile, the domestic equity market sits just a few steps below its February peak. That apparent mismatch begs some questions we thought worthy of an address in this and upcoming commentaries. While our “answers” to these questions may not be what readers might expect or desire, we hope that they provide means for parsing ongoing trends in the outbreak and the market’s reaction to them.

Have We Done Enough?

When markets destabilized in March, the Federal Reserve acted quickly and with grand effort to stabilize investible markets through direct purchases of government and corporate debt. The U.S. central bank’s follow-on efforts have sought to provide ongoing liquidity directly to companies and non-profits. Meantime, Congress has bolstered unemployment programs. Though efforts varied widely in size and shape, monetary and fiscal programs around the world have been similarly unprecedented.

Regarding the ongoing spread of the virus, clearly some regions have found greater success than others. The reasons are yet indefinite and likely many, though it would seem that the most obvious positive impact comes from keeping folks apart from each other. The drivers of resurgence in the virus are very likely due to the opposite. While arguments that mistakes have been made in either direction may be defensible, at least we may be learning how better to modulate the economic restart. Importantly, it would seem that we are moving from one-solution-for-all to regional- and situation-specific approaches to balancing protection of health against protection of wealth, even as we also are learning those objectives need not be mutually exclusive.

But how much is enough? The answer to this question is an unfortunate “wait and see”. As offered earlier, we seem to be learning more and more about the nature of the virus’ spread and effective treatment. We retain the belief that the cycles between shutting down and opening up will begin to favor the latter, with the broader economy finding a more stable, back-to-growth trajectory.

Still, as we cycle between surges and retreats in the global viral load, we likely will hear further calls for additional fiscal and monetary support. It’s very clear that the Federal Reserve’s quick resolve to stabilize markets were effective. Given the continued repression of macroeconomic activity; however, we may come to find that initiatives to provide interim financial support through various direct-lending programs may not prove sufficient. And we already see Congress debating another round of extended unemployment benefits.

While Congress presently debates, we imagine—it being a Presidential election year—some additional support will be forthcoming. We further doubt much that the Federal Reserve will dither when it finds

additional accommodation is required. The upshot is that when either group decides more is necessary, more will be provided.

At What Cost the Cure?

Trouble is, money doesn't grow on trees. If it did, the Fed wouldn't have to try so hard to spur inflation. But, the presses have been running full tilt to "print" the monies required to finance pandemic support programs. It should be no surprise that those dollars are not funded by recent tax receipts. Rather, the domestic governmental debt load is ballooning. Meantime, arguments for fiscal restraint are now barely audible echoes of calls for austerity seen even during the Great Financial Crisis of 2008-09, let alone years prior.

The nation eventually will have to resolve the repercussions of the expanded debt load. Interest rates may be low now, but might not be forever, if solvency becomes a greater concern for investors in U.S. debt (other than the Fed). Of course, the U.S. may simply print additional dollars to fund the debt, but history has shown that the consequences of efforts to inflate away national debt can be dire for domestic macroeconomic and even geopolitical stability.

Rubicon Crossed?

Perhaps more concerning is the observation that monetary and fiscal policies may be merging to an extent that may pressure the Federal Reserve to fund incremental spending, even outside of times of crisis. It helps none at all that Federal Reserve decisions have become increasingly and more publicly politicized. Reassuring is the fact that the Federal Reserve had been unwinding support offered during, and shortly after, the Great Recession. One wonders what that unwind will look like now that we may have grown too comfortable with the predictable impact of Fed accommodation on the equity market.

That is, for some time now it would seem investors look too quickly to the Fed not just to calm the market, but directly support the prices of risky assets. However, equity market stability is not an explicit Fed objective. And it's an only vaguely arguable indirect objective. It's been difficult to find empirical support for the idea that paper wealth fosters macroeconomic growth. Put more bluntly, investible market success are not indicative of macroeconomic success.

And worse, perhaps, is the fact that the Federal Reserve is indiscriminate in its purchases. Of course, we'd want it to be. But, the magnitude of the purchases, when coupled with that lack of sensitivity to price, distorts the ability of the broader market to set proper prices. Same in the private market, too, both for debt and equity. Take the Fed's decision to include corporate bonds and direct lending among its asset-purchase and other programs. Among the companies receiving that support, many likely might have been found lacking in creditworthiness, even prior to the crisis, such that incremental funds only delay an inevitable existential reckoning. That surplus may have been seen as a necessary cost to the expediency that was required to address the severity and suddenness of the pandemic. But, as we begin to shed the effects of the virus, one can't help but think struggling companies will ask for another round of help. Just as the virus may have longer-term health effects, its macroeconomic effects are likely to linger. Judicious denial of non-crisis support may prove

tough without an existing framework that established what specific situations warrant Federal Reserve intervention.

The “It”, Not the Size of the “It”

And therein lies our greater worry. Top of mind for many folks with whom we have met is the longer-term repercussions of the largesse brought to bear against the impacts of the virus. We think folks should focus less on the amount, though, and more on the process, even the very idea of these novel monetary policy efforts. Forgiven what may have been the perceived need for immediacy with regard to programs instituted so far during the pandemic, the decisions regarding monetary policy seem to have had few driving principles outside of plug-the-holes to save the ship. That expedience might not limit the defensibility of the actions taken. But, we should consider that we looked immediately to the Federal Reserve because we’ve been accustomed to for more than a decade now. And though the Federal Reserve, prompted by the Taper Tantrum of 2013 learned that it needed to describe for investors well in advance how it might unwind accommodation, it failed to develop a framework to describe when and how it might again ramp emergency support. Without such a framework, the lack of a broadly principled approach may leave it more difficult for the Federal Reserve to defend not taking similar measures in the future, in times of crisis and otherwise.

Meantime, fiscal policy has been weak, broadly lacking in leadership, courage and creativity. No wonder, then, the Fed has responded in the way it has. So monetary policy is looking more and more like fiscal policy. That’s a trend we hope will reverse as we move beyond the pandemic.

What the Unwind Will Look Like

Critical, we think, will be the path the Federal Reserve takes to unwind these programs over the next five to ten years (or longer...). First obvious steps will be the gradual reduction in support mechanisms, with specific actions being widely telegraphed in advance. We imagine the Fed will begin to provide more clarity on its intentions once the state of affairs become less tense. Much as was the case after the Financial Crisis, that path could see the Federal Reserve allowing debt it has purchased to mature and otherwise retire. Next up we hope will be the recognition that there needs to be a larger discussion focused on developing a framework that establishes more obvious limits to central bank support of debt-financed fiscal policy. Such a discussion would require at least as few folks in Washington speaking more boldly about the rather bad potential outcomes that we might see if blank-check spending continues unabated. No time like the present, fortuitously an obviously high-profile, high-participation election year, to lift the issue in public discourse.

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