EDITORIAL

FISCAL POLICY TAKES CENTRE STAGE (AND WILL STAY THERE)

Market action last week largely reflected expectations of how the result of the US elections would shift the balance between fiscal and monetary stimulus. Federal Reserve Chair Powell insisted on the need for more fiscal policy support but also hinted that, if need be, more monetary easing would occur. In the UK a coordinated approach has been adopted. The Bank of England will increase its purchases of government bonds and the government will prolong its income support for employees being out of work. Fiscal policy will remain centre stage for many years to come.

If anybody was still in doubt about fiscal policy having taken centre stage this year, events last week should be sufficient to change his/her mind. It was a key factor in the market action following the US elections. As the votes were being counted, speculation about a Biden win and a Republican majority in the Senate led to a bond market rally and significant dollar weakening. This reflects an expectation that, under such an outcome, the fiscal stimulus package would be smaller, forcing the Federal Reserve to ease more. Equity markets – as always - liked the idea of more monetary accommodation and rallied, although the outperformance of the Nasdaq versus the S&P500 suggests some unease about the growth outlook[1]. Such a feeling is warranted. The pace of job creation has been slowing – although the labour market report for October surprised favourably -, new Covid-19 infections are rising fast and there should be some impact on US exports from the new lockdown in several European countries. In his press conference after the FOMC meeting, Federal Reserve Chair Jerome Powell emphasized the necessity of continued monetary and, in particular, fiscal support: "*fiscal policy is absolutely essential here*"[2] . In reply to a journalist who was wondering whether the lack of fiscal support would compel the Fed to do more, he said that all external factors are taken into account. This is an implicit reference to the stance of fiscal policy and in line with market expectations that less fiscal support would mean more monetary support. However, with rates already very low, the net effect of such a switch risks being negative. This echoes IMF chief economist Gita Gopinath's op-ed in the Financial Times, in which she argued "*the world is in a global liquidity trap, where monetary policy has limited effect. We must agree on appropriate policies to climb out(-). Fiscal policy must play a leading role in the recovery*"[3]. The case for fiscal stimulus is not only a matter of directly increasing final demand. It also rests on a fiscal multiplier that is bigger when the economy is in a liquidity trap. Moreover, accommodative monetary conditions facilitate the financing of the fiscal impulse at very cheap conditions. The UK saw a demonstration of coordination between monetary and fiscal policy with the Bank of England announcing on Thursday morning a GBP 150 billion increase of its government bond purchases and the Chancellor of the Exchequer later that day bringing an extension of the furlough scheme until end March 2021[4]. Fiscal policy will remain centre stage for a long time to come, albeit in various guises. In the short run, it is a matter of cushioning the impact on the economy of restrictive measures taken to keep the number of new infections under control. Gradually, the emphasis will shift towards supporting the recovery. Eventually, within a couple of years, the debate will shift towards the need of reducing public sector indebtedness.

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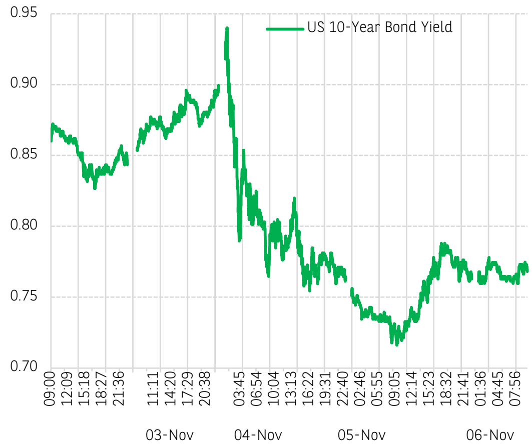
UNITED STATES : 10-YEAR BOND YIELD (INTRADAY)



SOURCE: BLOOMBERG, BNP PARIBAS

1. The rationale is that many companies on the Nasdaq have structurally better earnings growth prospects, irrespective of the economic environment, so mounting doubts about the economic outlook may push investors to prefer companies listed on the Nasdaq to companies listed on the S&P500.
2. Press conference of Federal Reserve Chair Jerome Powell, 5 November 2020
3. *Global liquidity trap requires a big fiscal response*, Gita Gopinath, Financial Times, 2 November 2020

4. Under this scheme, employees receive 80% of their usual salary for hours not worked, up to a maximum of GBP 2500 per month. the government pays 80% of wages for those unable to work (source: www.gov.uk).

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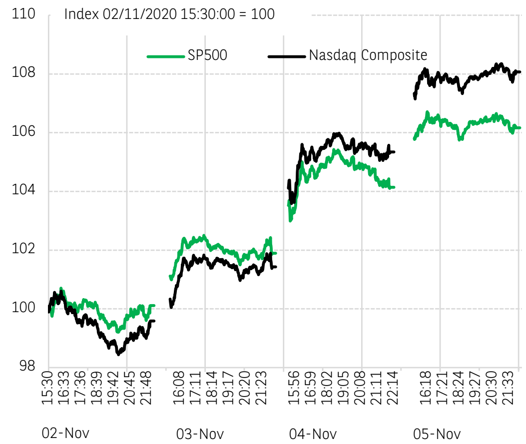
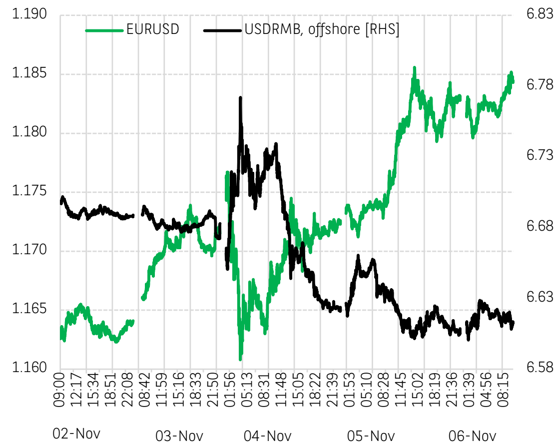
S&P500 VS NASDAQ (INTRADAY)



SOURCE: BLOOMBERG, BNP PARIBAS

EURUSD/USDRMB (INTRADAY)



SOURCE: BLOOMBERG, BNP PARIBAS