

# Policy and Portfolio Impact: A Talk with Dr. Ben Bernanke, PIMCO Senior Advisor

Ben Bernanke, former Chairman of the Federal Reserve, PIMCO senior advisor and chair of PIMCO's Global Advisory Board recently discussed why policy moves by the Fed and other central banks will be critical to a more stable future for the global economy and financial markets. Marc Seidner, CIO Non-traditional Strategies, led the discussion and commented on how PIMCO is managing portfolios for the environment ahead.

## POLICY AND PERSPECTIVE

As people try to make sense of the current environment, parallels are being drawn between today's crisis and the global financial crisis of 2008. Certainly, some aspects of the two crises – the stress, the volatility – feel the same, but the chain of causality is very different. In 2008, the problem stemmed from a dysfunctional financial system weighing on the economy. Today the cause is a natural disaster bringing the global economy to a near stop. The good news is that we came into this crisis with a very healthy banking system, which should ultimately be a source of strength.

Given the environment today, policy response must first focus on public health to promote recovery. The role of monetary and fiscal policy during this time is to support the economy, to make sure that people are able to pay their bills and to help businesses position for an operational return.

That said, if the shutdown is short-lived, the economy can come back without too much permanent damage and we should see reasonably strong growth for a while. If it lasts for a longer time, a much more disruptive global recession is likely, and a longer period will be needed for recovery. The length of the shutdown depends fundamentally on the effectiveness of the public health response.

Coordination between the Fed and other central banks is imperative with continual communication, cooperation and sharing of ideas. This is especially important given that the dollar remains the dominant currency in the world and the Fed is acting as global lender of last resort. Swap lines have also proved to be a vital lifeline for many central banks around the world and for many other financial institutions as well.

## THE FED'S TOOLKIT

The Fed has acted proactively and quickly in the current crisis to support liquidity in the capital markets, making sure financial institutions have access to cash and keeping credit flowing to the real economy. The size of the Fed's balance sheet has neared \$6 trillion, the highest it has ever been. Many of the programs, however, are self-liquidating – like loans being paid back – and over a period of time they will automatically reduce the size of the balance sheet to a more normal level.

The Fed will also provide a backstop to credit markets, offering substantial protections to banks and liquidity to make loans. It has opened a wide range of facilities aimed at this to make sure that businesses have access to credit to help them get through this period of shutdown while their revenues are reduced.

Current monetary policy – cutting rates to close to zero, buying securities and providing forward guidance – has calmed markets and offered relief during this critical period of economic lockdown. Stronger guidance is likely to come after the public health emergency has subsided and people return to work. Negative interest rates can be a useful policy tool in some circumstances, but they are unlikely in the U.S. over the near term. Rather, the Fed will likely strengthen its monetary policy guidance in order to make a more powerful contribution to the recovery once the public health crisis passes.

## THE POLITICAL ENVIRONMENT AND DEBT

In 2008, saving the economy meant saving the banks, and it was easy to be politically opposed to rescue packages or bailouts. Today the virus is the common enemy and there's been a lot more cooperation in Congress. The fiscal program is much more like a disaster relief package than the 2008 crisis, leading to a much quicker and more effective fiscal response.

The U.S. has a tremendous debt capacity and substantial borrowing is appropriate and necessary to support the economy and to help it recover once the health crisis has moderated. With interest rates close to zero, and likely to remain low for some time, and despite the big increase in the deficit and the debt, the burden on the federal budget to make the interest payments is still fairly moderate.

## OUTLOOK AND RECOVERY

Domestically and globally, recovery will depend on public health, science and confidence. It will likely be slow with false starts, and it will be different across regions, industries and businesses. While it will be a down year, our best hope is that the economy will open up by the latter part of the year, especially as the medical situation improves.

Implications could be extensive, including increased savings rates and caution by households and businesses. There will be dimensions in which the economy looks different, for example, industry concentration may increase if many smaller businesses close.

## PORTFOLIO IMPACT

At PIMCO, our base case is for a deep, but short-lived, recession and a U-shaped recovery, although we are cognizant of the potential for a "W" shape or uneven recovery and of permanent capital impairment in some areas. We continue to emphasize strongly that this is a highly uncertain environment and one that warrants extreme caution and care.

In terms of interest rates, the path to normalization will likely be slow. Interest rates have been extraordinarily low, and we would expect them to continue to be extraordinarily low, even more than they have been or that many may anticipate.

PIMCO continues to act on lessons learned from past crises. It is critical to get through a period that may seem dark from an economic perspective to a brighter future. That bridge, from a policy perspective, is liquidity. It is also the bridge for portfolio construction and for portfolio management.

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