The US policy response to COVID-19 stands out in international comparisons. Fiscal stimulus is likely to take government debt from 80 to 110 percent of GDP, with wider budget deficits close to fully financed by substantial Fed QE purchases, which in April alone already surpassed Treasury purchases under QE1, QE2 or QE3. This Global Macro Views compares the US policy mix to the Euro zone and Japan. Neither Japan nor the Euro zone are expected to use fiscal stimulus as aggressively, while their central banks are also taking a more conservative approach to purchases. Greater US policy activism is likely to dampen adverse fall-out from COVID-19. Japan and the Euro zone may see deeper recessions and slower recoveries.

The COVID-19 shock is a vivid illustration of the “exorbitant privilege” the US enjoys. Fiscal deficits will likely take government debt from 80 to 110 percent of GDP, even as Fed QE purchases keep interest rates close to record lows. Through all this, the Dollar in trade-weighted terms is the strongest currency globally, giving policy makers confidence that foreign demand for US assets will remain healthy, even with a record rise in Treasury issuance ahead. Last week’s Global Macro Views contrasted this picture with emerging markets, where falling currencies and rising bond yields constrain governments’ policy space. Partly as a result, a debate on QE in emerging markets has begun, though we expect central banks to avoid pursuing this in any material fashion, given that this could set off a second round of currency weakness. This Global Macro Views compares the US policy response to that in the Euro zone and Japan. Neither Japan nor the Euro zone are expected to use fiscal stimulus as aggressively, while their central banks at the present time are also taking a more conservative approach to financing deficits. Greater US policy activism is why we forecast the COVID-19 recession to be less severe, while the Euro zone and Japan will see activity fall more and recoveries will be slower.

Fed purchases of Treasury securities over the last month amount to $931 bn, exceeding the pace of buying in QE1 ($300 bn), QE2 ($600 bn) and QE3 ($790 bn) by a substantial margin (Exhibit 1). It’s also clear that Fed purchases substantially exceed what the ECB and BoJ are doing, though both – for the time being at least – hold a greater share of government debt relative to total issuance (Exhibit 2). Of course, it is also true that the US is pursuing a much larger fiscal stimulus than any other country. Exhibit 3 illustrates this by contrasting projected deficits in 2020 with 2009. We use the flow of funds for the US, the Euro zone and Japan to assess how important monetary policy has been in absorbing fiscal deficits historically and at the current juncture. Exhibit 4 shows this decomposition for the US, where Fed purchases through Q2-to-date – the four weeks from March 25 to April 22 – are close to financing the entire budget deficit. This is a break from the past, when Fed QE was a complement to other sources of demand for US Treasuries.
The picture is quite different for the Euro zone (Exhibit 5) and Japan (Exhibit 6). Not only does the IMF’s latest Fiscal Monitor project far narrower budget deficits, it is also the case that central bank purchases of government bonds constitute a more modest portion of total issuance. As a result, the degree of policy activism in the US looks far bolder than in the Euro zone and Japan, which is why our growth outlook for the latter two anticipates deeper recession and slower recovery.