Macro Salon Session Notes

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Important Disclaimers

Questions from our BNYM moderators are in **blue**. Answers from panelists are in **black.**

Europe Outlook: Still Waiting to Get Something Right

Panelist:
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Moderator:
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Assuming that vaccinations gradually pick up and Europe does not face a fourth wave, we expect the narrative to quickly move towards fiscal and investment. Heralded as a bit of a game changer when first announced, we are still waiting for NGEU to be deployed and its size now looks less impressive compared to the US stimulus and impending infrastructure plan. Has Europe missed an opportunity here or will we be surprised to the upside?

- NGEU and US stimulus is not directly comparable. NGEU is not just stimulus but a change in the architecture of the EU financial system. While the size of NGEU is not negligible, what makes it a game changer is the shifts in two areas: (1) money directly raised by the EU – not a complex financial engineering, but EU bonds are at a completely unprecedented scale. EU currently has the largest sovereign debt market and EU bonds will augment that. (2) Financial direct transfers to member states. This taboo has been broken and it is no longer just about each member state getting a return on what they contributed directly.
- The baseline scenario remains that the NGEU will be implemented as planned. Delays are not surprising as there is a ton of paperwork that needs to be done. Also, NGEU has to be ratified to its decision by all member states. From a financial perspective, there shouldn't be a difference as long as there is no financial uncertainty. Markets have already lowered spreads of high yield member states – Italian spreads are lower although the finances of the Italian government haven't improved.

Should EU raise the bar a bit? Any whiff of stimulus talks in the US and you get a move in inflation expectations. NGEU is a game changer and inflation expectations haven't changed. What will jolt the market out of its complacency or disprove market expectations?

- The EU is not in a position to impose its narrative to the global investor community the way the US can and that probably won't change anytime soon. NGEU will be a major change if implemented.
- The US institutional system is resilient, but the EU is far more hostage to fortune.
- Markets need to digest that the EU has gone through major existential crisis (Brexit and COVID-19) and in the end, the EU has shown resilience. The EU is here to stay, as well as the euro, but there are still many adjustments to come. This is a more complex story than what can be painted from Washington or New York.
- German Constitutional Court is a risk to NGEU. Most likely, GCC will wave the program through without disrupting things. Not expecting reversal in any plausible scenario but some big bumps on the road cannot be ruled out.

Staying along the lines of fiscal – we know that at the end of the day fundamental change in the European capitals is needed for concrete moves toward greater fiscal integration. With Mario Draghi at the helm in Italy for at least until early next year, combined with a strong Green presence in the next German government, do you see a viable path towards building the foundations to fiscal union (we are realistic that achieving it is a long way off, if at all).

- The foundations of fiscal union are a matter of implementation of NGEU. How the bonds will be reimbursed, and other factors will be based on own resources. This was the right move to not get the package fully defined because it will be continuous, so ambiguity/flexibility is helpful.
- Not expecting anything else at the EU level for implementation of NGEU. One could hope for decisions of the banking union but not particularly optimistic that this will happen this year.
- The political climate is much more favorable but in the longer cycle. Looking back 5 years – Brexit, coalition of Italian government which was heavily Eurosceptic, the rise of populist parties in many countries – the political environment is much more benign now. Resilience of broad political mainframe center has been greater in the last 5 years and the outlook is even greater.

Moving on towards the financial architecture of Europe. The pandemic will inevitably add to the Eurozone's contingent liabilities and once below-the-line support is withdrawn, it is possible that Europe will be left with a raft of zombie companies which will continue to weigh on a banking system struggling to clean up legacy assets. Do you see a further slide towards Japan's experience for Europe's banking sector?

- There already seems to be a benefit from tighter banking regulations. The fact that COVID-19 didn't trigger financial instability was a success.
- Going forward, with vaccination rollout and positive outlooks, there doesn't seem to be worries about financial turmoil and system wide banking crisis. It's more a matter of corporate insolvency and the increased risk of banks carry large amounts of bad debt.
- A current and pre-COVID concern is the general lack of strong business models. There are too many banks that haven't restructured as much as they should have in the last 10 years. Supervisors are pushing for consolidation cross border.
- The general view is that the ECB and authorities are correctly prioritizing the EU banking sector. This will take time.

As a follow-up question to that, is there any scope for a revival of securitization in Europe such that disintermediation relies less on the banking system and simple loans? Is this just not achievable without a capital markets union?

- The US has a very particular housing market – It is unique for historical reasons, GSEs, it has securities financing for a long time. The structural gap is not something you can easily close.
- Credit support in Europe has been successful, especially for small companies. It has worked the way it should have worked.

It is increasingly apparent that London will be less dominant in the European financial sector as the Brexit dust begins to settle. However, it seems that the sum of the parts of the EU may not be greater than the whole of what London lost, due slow progress on further market integration and banking union. Do you sense that opportunity is slipping from the EU's grasp on financial markets or is the current direction (or lack of) intentional?

- It is no longer obvious that London is central to serving EU investors. There is large disintermediation going on in which the rest of the world interacts with the EU more directly and less through intermediation through London. While that is a loss for the UK, the EU won't get all of what the UK is losing.
- There are challenges that lie ahead for EU policy makers. ECB is reasonable ready to manage banking supervision. Non-bank finance has more difficulties along the way.
- For the UK itself, it is not necessarily obsolete. There may be some offsetting of lost financial business in other sectors.

The EU / China Comprehensive Agreement on Investment. Do you think it'll be ratified and any tangible benefits for the EU?

- The CAI is seen as a statement of the EU's refusal to go the way of decoupling. This message was sent irrespective if the agreement is ratified or not. This will really be up to China.
- The substance of the agreement should not be dismissed, it has a number of clauses which would open the Chinese market.
- The difficulties that the CAI may create between the EU and US may have been overestimated at the time the agreement was announced. Now, there is greater alignment between the EU and US administration on economic and geopolitical issues.

And finally, we come full circle and return to your native France. The run-up to the first round in 2017 was one of the most serious episodes of Eurozone-specific risk aversion since the sovereign debt crisis. The way things are going in the polls, should markets start looking at the implications of President Le Pen? If so, what are they?

- During the 5th republic, apart from Cohabitation Presidents, there has been no successful two-term presidents. The baseline scenario would be for Macron to not be re-elected, but it is too early to be certain of anything.
- The defeat of Macron should not be equated with the victory of Le Pen.
- The likelihood of President Le Pen is low. Assuming it does happen, (1) parliamentary election after that and she will fail to get a majority. System is designed to prevent extreme parties. Prime Minister will have most executive power under Cohabitation and lead financial and economic policy. It won't be that disruptive.

With Brexit, there is now a precedence for a member state exiting the EU. Meanwhile, NGEU is strengthening the Eurozone itself. Will we reach a point where the EU countries who don't use the euro could be squeezed out? Do you see something like that happening? Either you are an EU member and use euro as currency, or you should be out? Or, do you think we will continue to see wishy washy-regime with 3 tiers: EU members, EU members that don't use EU as currency, and EEA?

- Non-Eurozone members are 15% of Eurozone GDP and more member states would like to join. It's getting cold outside of the Eurozone, one of the reasons behind the referendum. Treaty provisions (except Denmark) means you have to join the Eurozone.
- What happens in Poland / Hungary will be important.

In the short-medium term, do you see any re-alignment between EU-UK on financial services (e.g. regulatory) issues or is the emerging competitive dynamic between the two sides here to stay?

- The EU and UK will engage in strategic competition. There are still false expectations on both sides, we have seen with the vaccine story. There will still be difficult conversations on Ireland and others going forward. Even things such as cross-channel cooperation, such as BoE versus ECB cooperation has changed. More due to political pressure rather than individuals, on things such as banking supervision, critical functions etc. Things are not looking good, won't be good for an extended period of time. Euro clearing has been excessively politicized.
- Euro clearing – it can be orderly, and we need not see systemic issues. One of the remarkable things about Brexit is that the financial system has remained remarkably orderly, such as [the migration of] share trading away from the UK. Question is more of efficiency of the system as a whole, and what it means for financial globalization in general. Renationalizing financial infrastructure. Should not impact cost of funding for EU firms.

Digital Currencies

Panelist:
Philip Middleton, Deputy Chairman, OMFIF

Moderator:
Geoff Yu, Senior EMEA Markets Strategist, BNY Mellon

OMFIF's DMI has been at the cutting edge of CBDC research. However, it's best for us to start with the basics. If you had to explain what a digital currency and a digital currency wallet is to an elderly pensioner who is still sore over the fact that we don't use shillings and farthings anymore, how would you do it?

- Getting to grips with digital currencies is important and the pandemic has accelerated this need.
- There are broadly four types of money:
    - Fiat money – sovereign money issued by a nation state that is guaranteed and backed by that states ability to raise taxes. This is decreasingly a paper currency with the head of state on it.
    - Private money – Federal reserve banking which is guaranteed up to a certain limit. Private money is not fiat, and theoretically if a bank goes under, you lose your money.
    - Central Bank Digital Currencies (CBDC) – instead of, or complementary to, issuing notes and coin, CB will issue digital currency which will be held in an account in which you put a deposit from X currency and have a digital credit up to a specific limit. Other characters include stable coin backed crypto currencies – private currency that is backed by real assets (USD, gold) to guarantee the payment of those tokens.
    - Crypto currency – computer algorithms with no backing whatsoever. Host of 1,500 other cryptocurrencies with the most popular being Bitcoin.

A lot of the headlines these days seem to be generated by China, which is perceived to be well ahead of the rest of world in introducing its digital currency. However, the reports often miss the retail-heavy aspect of it, whereas central banks and commercial banks equally, if not more focused on the implications of wholesale CBDCs and its implications for payments systems. Is the divergence intentional, and where do you think the broader direction is for these different blocs? Do you also see a general convergence towards value-based systems for wholesale CBDCs? I can imagine my colleagues in asset servicing and custody will be very interested in the answer to this as it will likely define their jobs for the next couple of years!

- China has a digital Renminbi while American authorities sent paper relief checks to its citizens ($1bn of that was sent to dead people). This was an interesting contrast in means of distributing helicopter money. The Chinese have been well ahead of the rest of the world as they have been looking into digital currency since 2004. It's a long-term plan which has 3 objectives:
    - Put modern efficient electronic payment system into China. Although they deny it, the Chinese government may eventually want to get rid of physical cash which is expensive, inconvenient, and not particularly transparent.
    - Wish to bring on the control of the private sector (financial firms and nonbank financial institutions and in particular mobile providers). China doesn't want anyone to get away with feeling that the issue of currency resides anywhere else but the PBoC.
    - Once successfully tested internally, China may want to move the digital currency down the Belt and Road to challenge the USD as a major instrument of payment outside of the national borders.

PBoC CBDC is an account-based currency – you will have renminbi acct directly with the PBoC. separate framework which is value based and you have actual tokens. Ownership of currency is based on who has the tokens, not who owns the accounts. China is not utilizing, but Riksbank is shifting towards value based. What are the general trends you are seeing globally? Are you seeing a broad shift towards value based CBDC?

- No, people are experimenting. Sweden is a halfway house between cash and an account based CBDC largely because there is social pressure on the bank to produce a physical fiat currency. Although central banks want to get rid of cash, there is demand for physical, so it is the duty of central banks to provide physical as well
- Simple account-based tokens are a less destructible form of cash. Interoperable digital wallets – universal user based electronic device in which sits multiple currencies – could be digital fiat, digital GBP, digital EUR, digital RMB, but also various forms of crypto coins. The possibilities are very open. Central banks have concluded that accounts with the central bank won't actually be with the central bank, but with a retail bank that shadows the central bank to avoid the complexity of mass retail banking.

There are massive CB policy innovations directly with accounts with the CB. If we have a proliferation, that removes the zero lower bound constraint – if any CB goes negative, there's a fear that CB will have to pass negatives rates onto the customers. However, if people have CB wallets, you can apply negative rates directly and bypass the commercial site. Is this a way for CB to encourage CB wallets?

- There is a host of reasons why central banks might want to see CBDC put into practice.
    - You can practice monetary policy via accounts or wallets. An account with a central bank, even though managed by a private retail bank, is still a central bank account.
    - CBDC is also incredibly more convenient. Many people have smart phones but not everyone has bank accounts. Releasing wallets via smart phones will bring people into the banking system that were not previously there and enhance financial inclusion.
    - Some of the biggest advocates for CBDC are the revenue authorities, the customs authorities, the police, and the central banks because it allows greater transparency over transaction information.
    - CBDC could make monetary policy much easier – if you don't have to worry about people taking money out of the banking industry and holding it as cash.
- However, CBDC could destabilize the banking system. The moment when there are practically zero interest rates it becomes irrelevant to where we keep our money. Since you can't currently keep money at the central bank and keeping it under your mattress is dangerous, there is concern that once CBDC is available, in times of crisis people will move money to the central bank via CBDC. This could potentially reduce the amount of credit within the economy. There could be an economic contraction with the introduction of CBDC.
- There are also concerns about the profitability of the banking system by introducing CBDC. In Europe it is estimated that 45% of commercial bank profitability arises from payments system. There is practically zero cost for a digital based system, hence you are carving out massive chunk of money from banking system. This is exactly why ECB is going to slowly and exploring all options around CBDC.

Outside of China, we also hear about Sweden being relatively advanced with a CBDC but there is close to zero appetite in Europe for a launch. Even the Riksbank's pilot was in a closed environment, unlike China's. However, in our conversations you brought up the fact that one country already has a fully-fledged digital currency: Bahamas and the Sand Dollar. Could you tell us about it, why it is unique and is it a glimpse of our digital future?

- Bahamas operates 2 currencies: Bahamas dollar (the local ccy), and the USD which is usually done to make large purchases.
- Majority of citizens don't have bank accounts, so it was very much a policy decision to take a step ahead. As we found with the introduction of mobile phones where some countries went from no phones to cell phones without ever going through landlines, we may see some countries jumping straight to a digital currency based around a smartphone.
- This is policy led, not technology led. The drivers of digital currencies go in the following order: Policy first, functionality requirements second, rules of the game third, and lastly think about technology.

Technology is usually framed around a disruption that becomes a turning point for that new technology to kick in. The pandemic has triggered a new type of demand for policy response that has never been seen before. Is the pandemic a trigger for the advancement of digital currencies, or will it continue to be a sluggish development?

- There is not going to be one single answer to all of this. Instead, there will be more digital means of payment and fewer physical means of payment. Cash won't disappear entirely, but the likelihood is towards electronic and digital payments.
- Part of the digital economy has accelerated due to the pandemic. The fact that majority of the world is stuck at home and do majority of our purchases online has accelerated the decline in the usage in cash. However, the holdings of physical cash in England has increased drastically – there are roughly 78bn pounds of cash sitting under mattresses.

The IMF has recently approved an SDR allocation increase. In a 2017 Speech, Madame Lagarde said the Fund will also be open to a role for a digital version of the SDR, or eSDR. We haven't heard much since, but could this be the antithesis of bitcoin, a proper digital currency which is backed and accepted by every single central bank?

- The average citizen is not going out protesting for SDRs. Not sure what advantage SDR has over existing exchanges. eSDR is not a driving force.
- This is going to be a battle ground. The struggle for dominance in global currencies and the players -- USD, EUR, JPY, GBP, CNH.
- Bitcoin could end up as a major store of speculation or value but not of a major form of payment.

When this is implemented, it will impact the commercial banks adversely in a major way. This will be the disruptor of the banking industry. Your view?

- Digital currencies will certainly put some commercial banks out of business. Those who are more innovative and technologically advantaged will adapt to this. Globally, there are arguably too many banks with too little capital and too little expertise. Payments business will accelerate move towards fewer banks.
- The trick for regulators will be to manage this situation as to not disrupt the totally financial system.

CBDCs are seen as a tool for central banks to take back control over cryptocurrencies: it is well known that the PBoC established its own research center on digital currencies partially in reaction to Bitcoin's proliferation in China at the time. Large, private institutions are also doing their own thing and Diem (a.k.a. Libra's reincarnation) will launch soon. On the other hand, decentralized financed is one of the hottest areas of tech these days, pulling payments in the opposite direction. Is it winner takes all, or can they all coexist?

- There will probably be a variety of payment instruments available to us.
- Some believe that probably be better if private digital currency didn't emerge. It should be regulated and supervised in a way that reduces the possibility of major financial instability and police against fraud, money laundering, etc.
- Discussions are around how digital currencies should happen in a stable manner. Corporate treasurers will soon become adept at managing multiple assets and multiple payment instruments. Only 25 years ago there was handling of 27 different European currencies. This won't be an enormous difficulty to manage half a dozen forms of electronic payment.

What is the chance that the US or Europe ban the Bitcoin like it did holding gold? Is there is risk for forcing digital fiat control over distributed legers?

- It is unlikely that the US will outright ban crypto but will instead look to regulate it very strongly. If you deal in certain crypto assets, they are assets, not types of payments.
- the government won't likely accept them as payments for taxes as they are not recognized currencies.
- The idea is that you can trade if you want but there will be rules on who can buy and sell, how they are bought and sold, and further regulation.

US Policy and Politics

Panelist:
Charles Myers, *Chairman,* Signum Global Advisors

Moderators:
Jennifer Xi, *Deputy General Counsel and Global Head of Public Policy and Government Affairs, BNY Mellon*
John Velis, *PhD, FX and Macro Strategist, Americas,* BNY Mellon

What is proposed on a high level?

- The Biden administration would like to do $3 trillion in infrastructure, broken into two parts. First tranche, $2 trillion for traditional infrastructure (green renewable priorities included). Second tranche, $1 trillion for social infrastructure (education, healthcare, etc.). Both will be difficult to get done, but the second tranche more so.
- They plan to pay for some of this with their tax plan, which is ambitious on corporate and personal tax increases. In total, they are hoping to raise $2.5 trillion in the next 15 years to help pay for it—some of it will pay for itself by creating higher GDP growth over time.

What are they key areas that may change?

- The Senate Parliamentarian ruling in the last 48 hours was extraordinary. It was a historic decision that breaks away from decades of precedents in the Senate and further erosion of the filibuster. It was a power grab by the Democrats and will help push their agenda through faster.
- They will try to fast track the first tranche—Nancy Pelosi wants to get it drafted and passed July 4th. The Senate will try to get it done before August recesses and it may spill over September.
- In the final package we will end up seeing something that looks close to what has been proposed. This is entirely a negotiation within the Democrats, not in Congress between the two parties. Not one Republican would vote for this. The Democrats are making strong statements, such as "we will not vote unless XYZ," but don't take those at face value. We will see some scale back in the final bill—proposal to eliminate subsidies for fossil fuels will probably be watered down. Overall, what has been proposed will likely be in the final package. The tax package could be very different.

The Tax Package: What's in it? What should we be looking for?

- Without this ruling from the senate parliamentarian (allowing for second spending option) the earliest infrastructure could have happened was in the new fiscal year. With reconciliation you can only use it three times a year: 1) spending bill, 2) revenue bill, 3) raise debt ceiling. They are trying to wrap the tax increases into the infrastructure package. It'll probably be two separate bills but will happen around the same time.
- Biden's tax plan is ambitious and mostly just a wish list and open to negotiation. The plan proposes raising taxes in multiple ways. What will make it through Congress is:
    - Corporate rate going from 21% to 28%-- consensus today is it'll go to 25%, maybe 27-28%
    - Increase in GILTI tax on foreign earnings to 18%, not 21% like Biden wants
    - Global minimum tax, tied into digital tax negotiation—Yellen taking the lead
    - Personal: Top marginal rate goes back up to 39.6% on households or individuals who make over $400K
    - Changes to estate tax rate going up to 45% and exemptions being reduced by 30-40%
- Don't expect capital gains or dividends to be in the final negotiation. Good news is that these look like the only ones that will go through (excluding global min tax). Bad news is that these still need to be priced in. Could be a 3-5% EPS hit of S&P500 companies, hit to earnings estimate. No company analysts have factored this in because there is no final tax plan yet.
- Believe there could be some retroactivity on corporate tax part of it. In other words, being applied to this year, not starting Jan 1 of 2022.

Some corporate tax discussions are against the consensus view. Walk us through that.

- Corporate Tax: There will be pushback to not go all the way to 28%, but it will be close to that. 1) Biden feels strongly about this. His administration thinks it's a gift since it used to be 35% (pre-Trump). 2) Corporate tax is the biggest generator— if we go to 28% it raises $1 trillion alone over the next 15 years. Congressional leadership will put the most pressure on this to get it to 27-28%.

- GILTI Tax: Biden wants to double it to 21%. It could go to 18% after negotiations.
- Retroactivity piece: the only reason we're saying it could happen. Everyone on Biden's team refuses to accept or deny that it will not be retroactive. Refuse to rule it out is concerning.

Global minimum tax and OECD negotiations: How does that tie into US tax negotiations? Is one contingent on the other?

- On global minimum tax, digital tax is wrapped in there-- the intent is good. No country wants their companies shopping for lower tax jurisdictions. The challenge is getting countries to agree on a number and then actually implement it. Then you have to convince 140+ countries to sign onto it. Give Yellen credit, but skeptical if it will actually get done in time for this year tax legislation.

How transformative would the American jobs Act be in this economy. Is it really all its advertised to be?

- It will be transformational, spending $2 trillion over 8 years with the goal to frontload as much as possible in the first couple of year. This is clearly an electoral strategy for the Democrats who are in a unique position right now. The three most powerful people: President, Speaker, and Senate leader are all from the same party and colleagues and friends. This gives them an unusual amount of coordination on policy and agenda. This situation will help them get more through.
- Why it's transformational:
  - The sheer scale of it makes it transformative. Emphasis on upgrading existing infrastructure. Significant because 1) the country needs it, 2) upgrading existing infrastructure has a more immediate economic impact because it happens faster than building something new.
  - This plan has big ideas. On the renewable side, want to build a nationwide electric vehicle charging network. In addition to supplying physical infrastructure there will also be meaningful and substantial incentives to accelerate the adoption of renewable tech.
  - Labor Force: A large chunk of the bill will be going to childcare, elderly care, disabilities, etc. this will also have a huge impact.
- The electoral strategy of this plan: No one thought we needed an extra $1.9 trillion in stimulus given where we stand economically. In fact, a third of the stimulus bill will be spent next year and beyond-- intentional by Democrats. Not all emergency covid relief. Biden and Democrats want the economy to be strong—ride the Biden Boom. A booming economy into midterms helps them win seats and the future presidency.
- That being said, the Biden administration doesn't obsess over how the stock market does, they generally want it to go up, but most elected officials don't worry about it. They want a strong inclusive economy, any collateral damage (increase in deficit or inflation) matters less. It was unique for the Trump administration to focus on the stock market.

Sequencing: Does the construction part of the infrastructure package come in early or will they aim for things that won't be inflationary immediately? When it comes to green energy, inflation comes from all angles. Are they considering those factors?

- Sequencing and inflation vs deflation – it is a timing issue. In short and medium term, we are going to see an impact on inflation: 1) meaningful pickup in transitory inflation and 2) structural inflation pick up in Q4 as result of a lot of spending going on. Structural inflation is predicted to be at 2.4% by EOY by the Fed – usually people would worry about this, but not today. Two reasons: 1) inflation has been low for so long it won't be permanent and 2) people have enough trust in the Fed that they will do the right thing.
- Highlighting inflation as the single largest market risk this year. Consensus is that we are at the beginning of the strongest recovery out of all recessions in modern history—7-8% growth predicted this year. Inflation will rise given the factors below:
  - We have a fast roll out for vaccines—will lead to faster reopening. beginnings of the strongest recovery in the history of recessions in modern history.
  - Faster roll out of vaccines means the faster the economy opens back up—pent up consumer demand
  - Fiscal and monetary stimulus still is working its way into the economy. With have additional $2 trillion for infrastructure on to of near 0% interest rate.
- The biggest macro surprise this year is whether or not we get full employment faster than expected. That will force the bond market and Fed to act.

- Green energy: targets are long term includes Biden's. All ESG targets are objectives they want to work towards. Understand they will miss some targets and need to build out infrastructure. This should be viewed over a longer time horizon. Fossil fuels aren't going anywhere—this is a multi-decade transformation.

What will happen to the Fed, assuming we get 2% inflation this year and unemployment does not improve? Will Powell survive and how will a transition in the Fed take place?

- We are already seeing signs of companies struggling to hire, in part because the childcare issue is yet to be resolved (the second tranche of $1bio should help with this). People are also getting generous unemployment benefits which are more lucrative than working.
- Assuming inflation is running 4%, the bond market would go crazy and be destructive to the US equity market. This will catch policy makers' attention.
- Have faith in central banks to engineer a soft landing. Powell has a lot to do given he said we'll live with higher inflation to manage unemployment.
- If the Fed is behind the curve and doesn't handle the situation well, Powell may not be asked to serve a second term. Front runners would be Bostic and Brainard. IF Fed does a great job, Biden will probably offer second term to Powell—presidents like continuity within the Fed.

The Infrastructure pack is dealing with supply chains. Explain the supply chain component of this package? This is the most bipartisan piece of things; how will it impact the economy going forward?

- Covid brought the issue of our supply chains more into focus—shocking Americans and politicians and highlighted our vulnerabilities. We are too dependent on China and other countries. The bill in part is to address these issues. Critical supplies need to be made in America (ie healthcare). The hard part will be to produce non-essential goods domestically due to the inefficiencies and cost.
- In the short term the infrastructure bill will potentially have a positive inflationary impact.

The debt ceiling: Suspend it or lift it? How will it play out?

- Not on people's radar right now because it's on July 31st. Last time it was a major issue was 2011. Politics are shaping up today to be a very difficult vote.
- There are only two ways to raise debt ceiling: 1) suspend it 2) lift it. Democrats in red states will have pressure to hold out vote and try to get spending cuts. In the end, the debt ceiling today is in a state of suspension. It was suspended in 2018 by both parties, suspended at $22 trillion. That suspension expires on July 31st and by then our outstanding debt with by $27 trillion. To raise it Congress would have to do so by $27 trillion or greater and that would cause ticker shock. May raise it to $35 trillion to add enough cushion so they don't have to vote again next year. The politics around this and the Republican pushback will be loud.

Taxation: How high is too high for corporate tax rates before it starts to have an impact globally?

- NY state just passed budget that is alarming. Taxes on people making over a $1mio in NY is very high.
- Evidence isn't there yet that the US will go up to 28% on corporate tax. If Biden tried to raise it to 35% we might see companies try to escalate. However, 28% is not enough to promote exodus.

What do you see as the biggest regulatory change coming out of this crisis?

- Green space: Biden has promised to undo all the changes the Trump administration made on this front. Trump rolled back decades of environmental policy. Biden will work to get them back. Agencies will also go further—fossil fuel fracking, drinking water, etc.
- Financial services: Banks and insurance companies didn't get themselves into trouble this time around. SLR not being renewed was the Fed and Treasury acknowledging things have gotten better. Scrutiny is now with fintech—regulators tend to be reactive. Covid produced a huge acceleration towards fintech and a number of these platforms are not properly regulated. Retail platforms need to be tightening access to margin and margin requirements. This is coming.

Global Vaccine Race

Panelist:
Andrew Bishop, *Partner and Global Head of Policy Research,* Signum Global Advisors

Moderators:
Ben Pott, *Head of Public Policy and Government Affairs, EMEA*, BNY Mellon
John Velis, *PhD, FX and Macro Strategist, Americas,* BNY Mellon

How do you see the vaccine roll out globally – who is ahead and who is behind?

- UK will have to slow down things a bit given their first dose approach.
- Europe is very far behind. The question is whether the second half of this year sees a bounce back and take-off. Unfortunately, this may not happen as there is challenges with vaccine hesitancy. Additionally, Italy reshuffled their approach, which a lack of consistency makes it tough to implement rollouts.
- The issue is if these countries will catch up in time. At this stage, the US is 6 months ahead, but continental Europe has not vaccinated enough people to avoid further restrictions. This will lead to a slowdown in population eagerness to get vaccinated. Additionally, AstraZeneca is not particularly well resistant to the South African variant and therefore may not be resistant to future variants. The difference between the UK, which also relies heavily on AstraZeneca, and the EU is that the UK will have already distributed enough vaccines that by the fall they can give a third vaccine – whether than is another jab of AstraZeneca or one that specifically targets the South African variant is yet to be determined. The point is, there is an element of path dependency. If a country underperforms at one stage, that puts it at a worse position for the next step in the vaccination process.

What are implications for carving out certain age groups from receiving the AstraZeneca vaccine? Will this have any knock-on consequences or is there enough vaccines to make up that gap?

- This shouldn't matter. The vaccine orders on paper are substantial enough that with J&J, CureVac, etc., there is no shortage of vaccines that should work with all ages. There are issues with delaying the vaccine for other reasons:
  - Controversies drive up hesitancy. There has been a general lack of consistency and some fumbling on communications.
  - There is some truth that AstraZeneca results have been less impressive than the others. The US was able to avoid this with Moderna/Pfizer, but some Europeans may want to hold off until they can get a 'better' vaccine.

Looking at Asia, they did good job at controlling the virus vs the west. In a way this caused a slower vaccination push. China is now gearing up to rolling out vaccines. What do you see for China? Can they catch up?

- There were a lot of questions earlier in January about China promising 450mm doses internationally with production capacity at 1.6bn. There are roughly 1.5bn Chinese citizens so the math didn't add up. China made a conscious decision to maximize soft power and openly say they aren't vaccinating everyone at home. Borders closed and less global interaction didn't bother them as much as expected so there was no sense of urgency.
- In January there was a large resurgence of Covid-19 in China. Consumption managed to be resilient which led to rethinking that they need to reconsider vaccine doses to domestic use which led to delays in shipments to countries abroad. This is a cause for concern for emerging market prospects. Countries that seem to be doing well on vaccine rollout on paper but are vulnerable to their dependency on China. For example, Turkey was doing well with their vaccination rollout, but they were giving out 100% doses they had and were extremely reliant on Chinese exports. Once Chinese shipments stopped, Turkey stopped giving doses.
- There are some countries that did worse in the first wave but could do well going forward. Brazil handled the actual pandemic catastrophically but over the course of this year, Brazil has had roughly seven different company contracts as well as some domestic capacity to produce vaccines.

Looking at the 'vaccine leaders' in EMEA, Israel, and the UK, are they reaping the benefits politically?

- At a macro level, relief from vaccine rollouts and politics is tough. Politicians are punished if they don't do it well but don't necessarily get a tailwind if they do well. As countries emerge out of Covid-19, they will start judging politicians in unrelated issues. For example, in France, as soon as things got better there was an immediate shift of political discourse onto security, national cohesion, values, etc.

- In the case of Israel, the vaccination rollout reinforced the image that Netanyahu is the state and will be for the foreseeable future, although Netanyahu still "underperformed" in coalition talks.
- In the UK, Johnson has benefited from vaccine success but is aware that his political benefit is vulnerable, which explains why the UK is slow to open the borders. Boris is on a positive trajectory and he is better to pay the price of a delayed easing of restrictions rather than reopening and facing onslaught of variants. For once, Johnson is acting cautiously.

Sticking with the UK for a moment – when Boris Johnson did a 'bad job' in phase one of the COVID-19 crisis, it seemed that his polling was remarkable stable. North of the border, in Scotland, that's almost the inverse. Cause of Scottish independence hasn't dampened despite Johnson doing well. What does it mean for Scottish elections coming up, and more specifically for Scottish independence?

- There is a lot of speculation or fears of Nicola taking a hit from recent judicial trouble. She is more resilient than many people appreciate. As a consequence, we will be in situation where over the year there will be renewed discourse and fears over concerns.
- In a strange twist the Brexit Longshadow is not going to be over anytime soon, but it will be a continuation from that debate.
- Looking at it from a pro status quo perspective, the good news is (1) a referendum is several years away, (2) the Alba party will probably hurt the independence cause a bit because it's going to make pro-independence camp unwieldy and less strategic and maybe even less threatening. The cause may lose some of its glamour even as it continues to be a headline issue.

Governments are being punished if they are doing poorly but not seeing any upside. In Germany, the polls are going from 40% to 27%. There is clearly a lot of debate on who should succeed Merkel. Assuming Germany manages a little better with the vaccination rollout, what do you think is expected from the Union in the upcoming elections and what is the most likely outcomes for coalition building come September?

- Appreciate CDU has taken a hit of late and not at the top of their popularity. Indeed, it will be tough for the union in the next election. However, the party is more resilient that in has been given credit for as of late, especially following the two recent elections. Some are 'jumping the gun' for thinking the next coalition will exclude them from power. If they do come in first, which is likely, it will be incumbent on the greens to appear constructive around the discussion around a potential coalition. At this early stage, this is still the most convincing scenario.
- From a market's standpoint, there is going to be some nail-biting and continuation of a much looser fiscal approach. However, there is no reason to get too worried about a rise from the left or a red-red-green coalition.
- A lot of focus is on the conservative slump. Pre-covid, we were at a very similar stage with the greens at 20-22% and the conservatives in the high 20's.

What are Macron's chances of winning the election, and how much do his chances depend on who the French conservatives pick as a potential challenger?

- Taking a step back, there is probably already too much pessimism around the French Election. There is a tendency in the media to say it looks like it's going to be another Macron / Le Pen. The election is likely going to be a dead heat so there is a 50% chance of having Le Pen as President.
- This is a bit hasty for a few reasons: (1) even if it were to be Macron / Le Pen, despite the fact that it would be the third time, it would still probably be a Macron victory. (2) The odds that Macron will still run if he is doing catastrophically are low. He won't be eager to step aside, but if he is guaranteed to lose, he will allow the former PM to run. (3) At this stage, it seems like the whole left is completely decimated.
- It is too early to have a definitive election outcome, but the balance of risk is less worrying than the media has portrayed it so far.

When would it be ok for Vaccine Tourism, do you feel this is more of an opportunity to reactivate the economy or you see this as an issue for local residents?

- This is a nonissue. Not that it won't happen, but it will remain so niche it won't have a large impact. If you think of the income it requires to travel from the US to Abu Dhabi or from Thailand to India, it is not within reach of many populations.
- Not only do you have to worry about travel restrictions, but you have to worry about getting placed on an actual vaccination list.

Emerging markets are starting to step up vaccination very quickly. What are you seeing on the supply side? Were there bottlenecks that are smoothing out? Is this something we can trust long term?

- This depends on the country. In terms of countries we expect to do well (diversity of supply, local manufacturing), India, Thailand, Indonesia, Mexico, and Brazil will do well. On the more disappointing side, South Africa, Argentina, and Russia will do poorly. South Africa didn't order enough vaccines early enough. Argentina and Turkey are reliant on Russia and China, respectively, for vaccines. Russia, ironically, doesn't want their own vaccine.
- There will be a slowdown in Emerging Markets vaccinations. There were originally delays in the delivery of doses initially promised (Brazil regulatory approvals, Covax delays).

Looking across EMEA jurisdictions, how divergent do you expect economic performances to be given the variances in fiscal packages and vaccine roll outs?

- Countries that rely on tourism will struggle.
- Counterintuitively, summer travel in Europe is quite optimistic. Demand for vacations will be too strong for politicians to oppose, and on the supply side, countries like Greece and Portugal will need the revenue.
- If you look at countries that are heavily reliant on tourism (Turkey and Egypt) will struggle over the long run. It was obvious tourism would drop due to Covid-19, but it's doubtful it will have a V-shaped recovery.
- Countries that rely heavily on mobility or trade will take a while to recover, particularly business travel.
- Countries that had pre-existing economic vulnerabilities (Spain, Italy, France to some extent) will have less of a consumer driven bounce back due to precautionary savings.

What is the risk of vaccines not being rolled out fast enough before we see variants or worse mutations lead to more virulent and deadly strains? Is there a timeline that matters? Or are we just in a lagged global recovery story?

- The summer will help the Northern Hemisphere in reducing odds of higher cases.
- Despite comments about AstraZeneca, overall, vaccines have impressed people in how effective they have been. Interestingly, often time, the real-world results have been better than lab or trial results including resistance to new variants.
- The risk lies in the pace of the vaccine, not the mutations. If the vaccination rollout is too slow countries will have huge issues even without new mutations. Conversely, if they do well on the vaccinations, they won't likely get overrun by mutation.

What lasting damage (if any) do you expect from the EU-UK vaccine spat and what does it tell us about the post-Brexit relationship between the two?

- Not bullish Brexit but would argue vaccine pace could have slightly positive ramifications for long term relationship. There may have been some sort of wake-up call.
- On UK side, during the second wave, Johnson showed he could act as a statesman and moderating voice and underscored the fact that there is interdependence. If anything, it may be counterintuitively thumbs up.

US Investor Panel: Active v. Passive Portfolios

Panelists:
Daniel Janis, *Head of Global Multi-Sector Fixed Income,* Manulife
Mohsen Fahmi, *Managing Director,* PIMCO

Moderator:

Robert Savage, *Head of FX Americas Sales,* BNY Mellon

Equities have been more e-trading focused than bonds – making passive factor style investing strategies cheaper and easier to implement over the last decade. Will this change for bonds as they become more electronically traded? Or to put it another way - How much of the "alpha" generated by active investors is about better price discovery?

- From a bond perspective, there was some price discovery initially when you had limited information on credit. Now that everyone has access to information it will become more technology involved, but in the short run that's not the case for price discovery. The key is that you have to make right decisions when entering credit – does the macro environment meet the credit environment and will that company flourish? And that is a 1-3-year decision. To initiate a position, you won't get price discovery as much when tech comes around. Overall, from a credit perspective it is more of a longer-term trade cycle.
- There seems to be structural alpha opportunity in the bond market, but not in equities. There are multiple reasons that lead to the differentiation between equity and bond active management. Many of these factors are structural and here to stay— that is not about electronic trading. For example, if you ask BBG how many classes of shares a large company has, it has 1, maybe 2 or 3. For the same company, if you see how many bonds they have it could be +10K. That tells you the bond market is different. Each bond has different credit based on structure. Also, each has a different maturity. Complexity, inefficiency, and liquidity that comes with +10K different issues implies that there is a different source of alpha opportunity which will continue.

FX seems to be a key part of the returns for international bond investors as rates over the last decade converged after 2009 and the QE from FOMC and others. The pandemic seems to have repeated this – will FX risk remain a key factor for bond returns?

- When you're in a low interest environment, currency volatility impacts your total return as it is not a zero-sum game. A wide array of situations that can add alpha, insulate the downside, and add tail risks where you have negative correlation of a currency compared to a credit market. For example, in 2008 JPY moved opposite from high yield bonds. Fundamentals have to be looked at—political, countries, etc. It's not a zero-sum game: using technical and good banker search, that really helps you get clarity of where to get added value or help protect on the downside using the currency market.
- This was a debate 30 years ago and has been put to bed. In general bonds and FX (G10) go hand in hand in the opposite direction. If the US is in a recession, they would likely be cutting rates and the currency would go down, bonds would go up. Same applies for all developed markets—e.g., short EUR when easing aggressively but long the bond. In emerging markets (EM), until very recently, it was the opposite conclusion—when things are going right don't hedge the currency. In most cases, if you like BRL or MXN you like the FX and fixed income (FI) as a package. One needs to be aware of changes in correlation—changes in regime shifts. The pandemic brought on important shifts – EM currencies came under pressure and instead of tightening like 2009, EM central bank's (CB) eased significantly. This change in behavior is now more similar to what you'd expect from G10 FX and bonds.

How do you think about risk in a portfolio post the pandemic? Are there some lessons learned about volatility, policy responses, correlation risks that are different from 2008? Is Turkey, Brazil inflation at breaking point?

- The number one in macroeconomics is politics. Politics decided to deal with the pandemic in a certain way and are important in G10 and EM (Brazil and Turkey). Turkey would not have devalued by -16% if there had not been a political decision coming from the top of the government. Five minutes before the decision to devalue TRY and denounce the central bank governor, bullish sentiment was high because of economic fundamentals. You can't analyze and act upon these fundamentals in isolation without understanding what is happening in politics—focus on the path of least resistance for politicians.
- EM (TRY, ZAR) has a lot of political uncertainty and volatility dissuading investments. Argentina defaulted 12 x in 200 years. As a steward of money, we don't want to wake up and have a surprise. Avoiding those markets due to political instability has helped. We need to pay attention to political avenue more now than we did 5-10 years ago—risk parameter. Key factor, how do you get out of a position before you get in it? Politics ultimately can determine the fate of total return.

Modeling for the election in 2016 was wrong. The polls weren't clear. Brexit wasn't clear from polling either. Does this make trading markets in G10 and EM more difficult? The big political event is in Germany. Is this

going to be a problem for the Euro? Active portfolios can be changed at will, but passive have a structured approach. Can you create a model that will take into account what the German election will do? What does this mean for how we think about risk?

- Don't predict elections, rather manage the portfolio risk. With new regime changes, need to look at the catalyst that could change the environment from a fundamentals standpoint which will impact the long term efficiency of a currency. How you weigh and scale that impact depends on your opportunities around the globe-- not a singular context but global context.
- Not about predicting outcome of election but managing risk and analyzing institutional framework of a country. A country like Germany might move from slightly right of center to slightly left—who cares. If Italy was running on a platform to leave the EU the implications would be huge for the Euro. If the institutional framework is not acting as a balance and the election could have a serious impact you need to manage the risk. Don't want to make money on election outcome but going into it and after the fact.

What makes a good discretionary trader? Could those attributes become algorithmic or can AI approach that level of success? Can you both be replaced by a machine?

- You need a model for how you think the markets are operating, then act upon that model. Computer or AI generally are using historical information to build that model—can't adapt and change rapidly enough. In times when you get a large regime shift, discretion will likely outperform the model. In 2020 you saw that the old fashioned, "gut-feel" macro trading outperforms models because it could change on a dime. However, regime shifts don't happen that often. Usually, we overestimate regime shifts because we know if it materialized it would be very significant. For example, how many times did we estimate if the Euro breaks up, how many time did it actually happen.
- Experience element is very important. The ability to react quickly can be more from the experience side. On a long-term trend, models probably get it right. In setbacks, experience corrects that and should be able to trade around it. In lower trending markets of rates it is easy for models to win but on rising rates I am not sure if a model could adjust as quickly. We believe active managers, with experienced teams that can make tough decisions, should win over time.

When it comes to FI and inflation we are in a game changer. The most recent bear steepening in the curve in US is part of a regime change. We're seeing material change in microstructures in financial markets over the last 10 years with liquidity providers are no longer the providers of last resort. Moving away from the sell side towards the buy side which is also functioning as price takers. Do you feel from a tracking error perspective, you have room to step in if an opportunity arises or do you feel more constrained?

- Have a better ability to step in because you identify a market that is mispriced. Consider, what is the size you delegate to that position? How much volatility do you want to have in one position? If something is undervalued step in. As a liquidity provider we have done that a lot more over the last 8-9 years.
- Dislocations that happen from time to time are a great opportunity for investors that can commit the capital. It has to be done in the context of clients that allow for that flexibility. Most important thing between asset managers and clients is transparency about expectations, risk management, etc.

But are we in a regime change with the steepness of the yield curve coming back? More specifically the yield premium. Is there something wrong with central banks? We've been doing QE, yet something has changed. How is this different?

- We haven't experienced a regime shift yet. Changes in the yield curve have been modest compared to 2009 and 2013—nothing unusual happening yet. The market is expecting a regime shift because the Fed told us they are changing their reaction function—they are sending a message that a regime change is happening. But we haven't observed them acting on what they say yet. We also don't know how the market will react if the Fed behaves as they promised. The regime change has not materialized yet.
- Worry about liquidity around regime shift—does it reprice all the markets surrounding it and does liquidity in those markets start to go away? That leads to price discovery and then you don't have a clear view of what is going to happen—risk profile increases dramatically. Currently, don't see a regime shift. Rather we had a growth problem, rates were cut, did fiscal stimulus, other central banks came in, had an adjustment of rates back to pre-Covid-19 levels, extra stimulus, lower rates, financial conditions easing across the globe. Do they see a wage push that is embedded in the price yet? If that happens then we might have a regime change.

Self-learning AI Engines that are fed will have all the scenarios as well as various formulations which can spit out the probability of the different scenarios, assisting the practitioner to narrow down. The decision will still be with the human but narrows down the possibilities. What do the practitioners think about this approach? Works well in medicine!

- Any model that helps capture alpha would be beneficial. Some systems currently being used, scenario analysis, yield curve shift, currency movement, inflation, etc. and its impact relative to asset allocation—run best, worst, neutral case scenario. Pay attention to four major risks: Interest rate, credit, currency, and liquidity. Will AI help us? Yes, but it won't be the ultimate decision maker.
- Using some systematic strategies that are 'AI'. The argument can be made that nothing in finance is new. Concepts such as, "Greedy when others are fearful and fearful when others are greedy" and "buy when blood on streets and sell on the sound of trumpets" haven't changed in hundreds of years. Bring in computing power and ask how to know when the market has excessive fear makes things more interesting. If you asked a dozen discretionary managers this questions you get different answers. Ask a computer and it uses data to try to get a better idea. If you apply systematically, you can seek returns in a consistent way.

April has statistically been a month where bonds do poorly along with the USD while equities outperform. What about this year? Are seasonal factors broken by the pandemic and the recovery from it? Are we going to be able to see through the base-effects of economic data like inflation as the FOMC promises?

- A result of the pandemic and recovery is huge volatility in economic numbers. This makes the market resistant against misses on particular numbers. For example, if GDP growth is around 6.5% the market likely won't care if it ends up at 5.5% or 7.5%, both are big numbers. Markets care more about what will happen next—will look past the numbers and try to figure out post 2021 trend and outlook economically for the Fed and politicians.
- We're in a global market and need to pay attention to everyone. Catalyst is to see stability in European vaccination. Once we see stability in vaccination across the globe then we can focus on the numbers and what they mean.

Government spending is bigger than we've seen in a lifetime. When will government spending matter? Who is going to pay this bill and does it matter for how you put together a portfolio today and 5 years from now?

- Pragmatic approach, as long a debt servicing is manageable you are ok. Chicken and egg problem, as long as real rates are low or negative servicing debt is possible. But you can't conclude that real rates can never go up. Can state with confidence that most G10 debt is not sustainable if rates ever go up. Government will have flexibility, but other variables will have to take the slack--- currency collapse, rise in inflation, etc. Price to pay but not clear if that means rates will never go higher.
- When look at fundamentals you can make the case, if debt spirals and prices go higher things could blow up (we are not at that stage. But if unabated that could be the end result. We can sustain higher rates but there will be pain. Psychology might change in terms of discipline.

What keeps you awake at night? What risks are being underappreciated by the market now?

- Liquidity element concerns us. When we don't have transparency in the use of derivatives. Banks not understanding the leverage risk of products embedded in their system—not having proper risk management system. Need a reporting element to the powers that be so they can understand how some of these can be localized or systemic—need a better understanding of that. Always something on the horizon, we can do better.
- Regime shifts that may be result of political change-- No time to react, implications can be huge. Beware of narrative economics because it's very valid. Markets embrace certain markets and can move in certain direction. Be careful, do your homework, look to fundamental value not what's popular.