Q&A-ECB may have to follow Fed policy on junk bonds; V-shaped global recovery possible: Jim O'Neill

British economist Jim O'Neill expects a V-shaped recovery in the global economy once the coronavirus-related lockdowns have been lifted on the back of even more expansive monetary and fiscal policy than 2008.

"Central banks [should] go one step further, and shift from inflation targeting to Nominal GDP targeting," O'Neill, who is former chairman of Goldman Sachs Asset Management and former UK Treasury Minister, told the Reuters Global Markets Forum on Wednesday, May 6.

"This would help [recovery] even more," he said.

O'Neill added the ECB may have to follow Fed policy on junk bonds, without elaborating on the exact measures or timing. "If you do NGDP targeting, that is the sort of thing you would have to do," he said.

Following are edited excerpts from the conversation:

Q: What sort of recovery do you see in the global economy as the lockdowns ease down?

A: A V-shaped recovery is more possible than I see many talk about. It was a strong consensus back in early February. Now there is an even bigger consensus that it is impossible.

Reasons: 1. This lockdown has been the main reason, and as it comes off, large parts of activity will come back; 2. the speed and agility for treatments and vaccine research is astonishing; and 3. monetary and fiscal policy is even more expansive than in 2008.

Central banks [should] go one step further, and shift from inflation targeting to Nominal GDP (NGDP) targeting. This would help [recovery] even more.

Q: Why do you think the ECB would be any more successful in hitting an NGDP target than an inflation target?

A: If the ECB were to adopt an NGDP target, it would be fantastic. I doubt the ECB would do it, especially as they shifted their own procedures recently. But I wouldn't rule out other countries.

It would oblige them to do more expansive things, and force many conservative European policymakers to stop obsessing about 2% inflation.

Ultimately Euro Area is- at least economically- incomplete without proper fiscal union, at least shared fiscal issuance and support. But NGDP would make a huge difference.

One of Italy's problems since it started, is that Italian NGDP is the same as 20 years ago. Italy is massively constrained by EU rules on fiscal and monetary policy, even without this crisis.

German reluctance to allow inflation above 2% in Germany, by definition, confines much of the rest to something close to permanent weak nominal GDP, irrelevant of their own productivity problems, and demographic challenges.

Q: On the ECB, what are your thoughts on yesterday's judgement by Germany's top court on the Bundesbank bond-buying? Is it a challenge to the ECJ or the ECB?

A: It sort of seems a bit of a cop out, giving the ECB plenty of time to justify its decisions. But i should also add, that the very idea that German lawyers still have this kind of superpower is weird.

Q: Moving to the Fed, the announcement to begin buying corporate bonds sparked rallies across the spectrum and improved market functioning. But, over the longer-term, do you see a significant increase in downgrades, defaults and bankruptcies? What sectors/companies would be most vulnerable?

A: What they did, is one of the consequences of a defacto Nominal GDP target. If they get the economy back quickly, there will be less defaults ultimately.

Q: Do you think the ECB could make a similar move to the Fed's in the European junk bond market?

A: I think the ECB may have to follow Fed policy on junk. No idea [on the exact measures or timing], but if you do NGDP targeting, that is the sort of thing you would have to do.

Q: What is your view on the GBP?

A: GBP, not confident ones. It will go up and down!! Unless it goes down and up!
I do think the GBP is cheap, so in terms of major FX moves, it is certainly the more interesting of G7 currencies. And it is better to explore times to get long than the reverse, I suspect.

Q: Any change in Brexit dynamics in the midst or post-coronavirus for both UK and EU?

A: I think they will have a fudge agreement that allows both sides to claim what they want, but real trade agreement takes years.

Q: Do you see a change in world diplomacy post-COVID?

A: Clearly the U.S. is accelerating its decline of global leadership of post WW2 order. Seems silly, but maybe it was inevitable anyhow. Trump and his advisors have no interest, or even more, no awareness of global co-operation. it is quite a medium-term negative for the U.S., to put it mildly. Yesterday there was a donor funding day organised greatly by the Wellcome Trust, and they reached a target circa $8 billion with no U.S. (or little Chinese) involvement. This could be the beginning of a new era of global co-operation of the willing.

Q: How do you see the coronavirus-led trade war between the U.S. and China developing? Will the guessing game keep equities markets under pressure, and dollar supported?

A: I think the U.S. is digging itself a huge whole. This stance on China serves no sensible purpose other than damaging the medium-term U.S. economic and global diplomatic interests. For all its faults, China remains the biggest consumer growth market in the world, including for U.S. multinationals. Trying to pursue the blame game is rather pointless. nobody demanded money from the U.S. after the 2008 housing bubble burst. Obviously, an election ploy, but causing lasting damage for the U.S.

Q: How will the supply chain China be affected in this? How do you see trade changing post-coronavirus, and what will be impact on China?

A: I am sceptical that this is the end of globalisation/i think it is a very simplistic view. So long as consumers want the best things, and at the most affordable prices, globalisation will continue to evolve and change. It probably will mean less firms use China so much as sole supply source, but I suspect this argument is overhyped linked to U.S. politics.

Q: Moving to emerging markets -- EMs can't possibly copy the developed markets' template to fight COVID-19. How do they balance supporting their economies and people with prudent fiscal responsibility?

A: One of the big surprises so far, is that with the exception of a couple of obvious places, COVID-19 hasn't spread in many EM the way experts expected. So, if this- pleasant surprise persists- the biggest thing for them is getting DM economies going again.

Q: What is your view on central banks in emerging economies (like Bank Indonesia) planning to buy government bonds in the primary markets? That appears more driven by financing the government's borrowing plan rather than keeping markets supported. Is that a risky proposition considering concerns about rising inflation, which in turn could prompt a selloff in local currencies?

A: Not so familiar with Indonesia situation, but I think extraordinary circumstances demand extraordinary responses. So I don't see it as so silly.

Q: Do you see Central banks in EMs backstopping corporate bond market as well? If they do, won't it be like putting a band aid on a festering wound, given the structural inefficiencies and supply chain bottlenecks that many companies are facing?

A: I see the underlying problem, but if they have seen the U.S. central bank do it, and it helps ease financial conditions, then why would they not? As I say, extraordinary times require extraordinary responses.

Q: What is your view on the Indian economy and rupee, and specifically how it's been coping with COVID-19?

A: India's advantage of being more a domestic driven economy should help them more than many. They are less vulnerable to others about the trade fall out. India has coped with this lockdown- so far- better than I would have thought. India is quite intriguing because if it turns out they have not embedded massive infection spread, then India could bounce back. INR seems cheap.