BANK OF AMERICA

Global Liquidity Speaker Series
Post US Election – Impact of a new administration
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Coordinator: Good day, everyone, and welcome to the Bank of America 2021 Global Liquidity Speaker Series titled Post-US Election Impact of a New Administration conference call, hosted by Adam Glassman. My name is Patrick, and I'm your event operator. During the presentation, your lines will remain on listen-only. [Operator instructions]. I would like to advise all parties this conference is being recorded for replay and transcription purposes.

Now, I'd like to hand over to Adam. Please go ahead.

Adam: Thank you, Patrick. Hello, and welcome to everyone to this TTS Liquidity Speaker Series, where we'll attempt to measure some of the potential impacts of a new administration and a new Congress. Again, my name is Adam Glassman, I am Head of Deposit, Balance, and Rate Strategy for GTS at Bank of America. I'm joined here today by Mark Cabana, Head of US Rate Strategy at Bank of America Global Research, and Edward Hill, Public Policy Executive, also here at Bank of America.

I think if some of you were on the last call, the last time we were together on a call like this was on election day. We had some great conversation about the possible outcomes and potential changes in policies and approach for each administration. Here we are, and a lot has happened since.

Since this is only a 30-minute call, I guess we'll jump right in. We, again, have seen, obviously, the Biden administration come in, and sort of a blue wave in both the Senate and the Congress. The last week or so, we saw a lot of executive orders come from President Biden, and I think the administration is positioning for a lot more changes. I think there's a lot of noise about whether the filibuster will remain in Congress or not.

Ed, can you spend a couple of minutes telling us how to think about where the executive orders that we've seen, what we think the priorities might be in the first hundred days, and maybe a refresher on the filibuster in the Congress, and what that might mean for policies moving forward?

Ed Great, yes. Thanks, Adam. Thanks for having me again here. Yes, a couple of thoughts. We've seen a bunch of executive orders. President Biden put up 17 on his first day; he has a series coming out this week. They're going to be in a host of areas, but I think two areas that are getting quite a bit of attention are climate sustainability-related, as well as racial justice and equity-related, and those could have some business consequences.

Remember, executive orders oftentimes aren't, in themselves, they don't have the force of law or even the force of regulation. A lot of times, they are directives to agencies to pursue certain policies, so the actual policy changes will follow. In some cases, like to re-join the Paris Climate Agreement, they do lead to immediate action, but even in that case, the Paris Climate Agreement in of itself doesn't have the big impact; it's the policies that will come out of the US being a part of the Paris Climate Agreement, which takes time.

Remember, our legislative process is fraught with uncertainty and takes time. Our regulatory process requires issuing proposed regulations. You have to write those; you have a comment period; you get feedback from impacted industries and persons. You have to consider all of that; you have to do cost-benefit analysis; you have to finalize the rules. You have to provide a time frame for the rules to be complied with. Oftentimes, if they're controversial, there's legal challenges around them. Actual policy change comes slow.

So while I think the executive orders give us some thought to the direction of policymaking that the Biden administration is interested in—and for instance, tomorrow, we're going to see one, I think, where they're going to direct about $500 billion in federal procurement spending towards a more sustainable—finance things like cars in the purchase of federal government—those sorts of things, again, can take effect quicker, but in terms of policy changes that have direct impact on the private sector, oftentimes takes much, much longer.

You talked about the filibuster, too. The filibuster is important. After the Georgia elections, Democrats—the Senate is 50/50, with Democrats controlling the White House and the Vice Presidency, meaning Vice President Harris will cast the tie-breaking vote in the Senate—but that's only if there's a 50/50 tie. Generally, even if the filibuster were to go away—and it looks like it won't, at least any time in the near future, with two Democrats coming out saying they won't support changes, certainly for now, to the filibuster—passing things on a 50/50 margin is very difficult. Getting, say, a Bernie Sanders and a Joe Manchin from West Virginia to agree on things would be challenging. Likely, they're going to [indiscernible - 42:56], and require at least some bipartisan support for anything they want to do.

The first three months of this administration—and we're going to talk about this a little bit more, I think later, Adam, but—are going to be tied up on three things. One is getting appointments confirmed. They're working through the cabinet secretaries. We saw Secretary Yellen get confirmed yesterday at Treasury, but you have not just cabinet posts, but subcabinet posts and independent regulatory agencies.

The second thing is we're going to spend a number of weeks, perhaps two, perhaps longer on the impeachment of former President Trump. Then, the third thing is—and I think we're going to talk about this a little bit—but is working through some sort of fiscal bill. Regardless of what happens to the filibuster, I think that a good percentage of the Senate's time is going to be taken up on those three things here for the first quarter.

Adam — Great. Thanks, Ed. Mark, with all that being said, and knowing that the first hundred days will have those types of directives, how do we think about the investor community and how they'll look to navigate through some of those changes?

I know at the beginning of the last administration, there was a lot of bullishness in the market and from the investment community on possible regulatory pullbacks and whatnot. What is the expectation, or what do you see as the expectation as it's being portrayed today?

Mark — Yes. I think that what, at least the signal the market is hearing from the Biden administration, is that the top order of business is to try and deal with COVID, both in terms of containing the virus as well as trying to get the economy back on track. Some of the early executive actions from the Biden administration were targeted in that direction.

Other executive actions, whether it be on environmental or climate policy, or manufacturing, and buying American, I think that the market largely anticipated, and doesn't really see as having a meaningful market impact, at least, at this stage. It's really those actions related to COVID, and it's the signals about the vaccine plan, whether the Biden administration can achieve their somewhat lofty objective of 100 million shots in the first hundred days, or jabs in arms—given that some of those shots will be the second doses that are received. I think that that's where the market is focused on.

On regulatory policy, that hasn't been a big thrust thus far, although certainly, the market—at least in my view—has taken notice of the fact that Gary Gensler is likely to be nominated for the SEC. We know that he had a pretty prominent role in the Obama administration, and he's generally seen as being a bit less reg-friendly. The market, I think, anticipates that this will just be a less-friendly, financial in particular, regulatory environment or less-friendly regulatory environment for markets broadly.

I don't think that the market is really too focused on some of these initial actions on the regulatory front just because the focus is really on how is COVID going to get under control and how is the economy going to get back on track? That very much seems to be where the market's attention is, at least in these early days of the Biden administration.

Adam No, thanks, Mark, that's helpful and leads in nicely as we talk about COVID being first on the list. We saw a large, obvious CARES Act being passed last year and a second stimulus that was passed not too long ago. A third stimulus is now being talked about; however there's not too much detail as to how and how big it might be. I think the current proposal of about $1.9 trillion has a lot of debate about both the size and where the money might flow into the system directly.

Ed, could you give us a sense on how you think about how this next stimulus might shape up, both in terms of size and possibly the areas where we think it will be pointed?

Ed Yes. As you pointed out, Adam, correctly that the Biden administration has proposed a $1.9 trillion bill; now I don't think they set out necessarily to have a $1.9 trillion bill. I think they put together a collection of things they were hoping to spend money on so totalled $1.9 trillion. That included what they proposed was additional unemployment benefits $400 after the March 14th, when the current extended unemployment benefits expire; they have money for vaccine distribution and testing; they have money for state and local governments.

They have these additional $1,400 economic impact payments, these direct checks on top of the $600 that have mostly been sent out so far, to total $2,000. Again, that $2,000 is not a magic number; it's a number that actually Donald Trump seemed to have come up with, and many Democrats enthusiastically agreed with him, but again, I don't know that that's a magic number.

If you step back and look, there were two deals announced in December before they passed the $900 billion or so package at the end of the year that you referenced. There was a bipartisan deal by the so-called Problem-Solvers Caucus, 25 Democrats and 25 Republicans in the House, that had proposed a $1.8 trillion package, and then there was a bipartisan deal in the Senate for $1.5 trillion. If you back out the $900 billion they did, that leaves about either $600 billion according to the Senate package or another $900 billion according to the House package of things that folks had agreed to, but weren't really included in the most recent package. With that, I would say I'd look as perhaps another $900 billion, maybe another $1 trillion as maybe the ceiling for what is possible to pass here in the first quarter or early in the second quarter of 2021.

Sue Collins, a noted Republican moderate, has referenced that. She has pointed out that $1.9 trillion seems excessive to here. Again, she's probably as moderate a Republican as are out there. She has a hard time going for a $1.9 trillion figure and would prefer something closer to that total—including the $900 billion that's already passed—$1.5 trillion, I think you really have to set your expectations much lower.

I think some things are must-have probably for Democrats are some money for state and local. Again, everyone agrees on the vaccine money, some money for schools, and extending that unemployment benefit past March 14th. We'll see how it all plays out, but I think those are some things in the package that likely have to be included.

Adam — Yes, I think that makes sense. Mark, possibly the question from a little bit different of an angle, how do you, or how should we start to think about how both the government, and the Treasury, and the Fed will start to think about the balance of stimulating an economy during the pandemic and the long-term risks of going too far? How do you think the Fed reacts to that if we do, in fact, see any signs of inflation? What do you think their tolerance is?

Mark — Yes, great questions. Well, right now, I think about this from a fiscal and monetary perspective. The bottom line for both of them is that they're not worried about going too far. What they are worried about right now is doing too little, not doing too much.

I think that's clear on the fiscal side from what Ed was just talking about, from the highly aspirational $1.9 trillion program that Biden led off the stimulus discussions with. Some of the elements and the proposals in his plan, again, I think that they are worried that right now, policymakers are doing too little, not too much. I think it would take a major shift to convince at least the Democrats that they are doing too much.

Republicans are naturally a little bit more hesitant about this. You've heard some moderate Republicans, Romney, Susan Collins, talk about how they're wondering why do we need more money right now, when we just passed a stimulus, and we're still waiting to see how this works its way through the system? Obviously, it's the Republicans in the minority party right now, and the Democrats see a completely different risk to the outlook; again, too little too late, not too much too soon.

From the monetary policy side and the Fed, I think that it's a similar take that they have right now. The Fed is worried that they may not be doing enough, given that we have seen a bit of softening in the labour market, at least over the last few months. They are worried that you could have long-lasting scars from COVID that impact the labour market and the recovery for years to come. From where they sit right now, they want to err on the side of doing too much as opposed to doing too little, so you have both fiscal and monetary policy moving in this direction right now.

Now, I anticipate that this leaning, especially from the monetary policy side, will begin to shift likely in Q2. I say Q2 because maybe I'm overly optimistic, but what I'm anticipating in Q2 is that we are going to see a more sustainable bending of the COVID curve as far as new cases, and hospitalizations and mortality go in Q2 as the vaccine rollout increases, and as folks can more safely engage with one another outdoors, and especially in colder weather climates where that's more difficult in the US.

I also anticipate that we're going to see an acceleration of economic activity, again, as people are able to more safely engage outside, whether it be outdoor dining or things of that nature. I also anticipate that there will likely be more stimulus that's been provided at that point in time, and that will begin to work its way through the economy.

In Q2, I do think that you could see a Fed that becomes a bit more optimistic and begins sending signals that they might not need to have this ultra-ultra-accommodative stance or policy for as long. They may start to more seriously talk about tapering in the future. We think that they'll likely start to taper their asset purchases in the first half of next year, and they'll probably start setting that up.

Now, what will it take for the Fed to think that wow, the economy is just materially over-heating, and they really need to fight against this? Well, it's a high bar. What the Fed has told us is that they want to see inflation sustainably at or above 2% on a core PCE basis and that they want to see that essentially for one year and believe that it will remain sustainably high.

They want to run the economy hot. They want inflation to increase, and we're a long ways away from that right now. I think that they need to see a lot of change before they shift their stance, at least with regards to the federal funds target and the primary monetary policy implementation tool.

At what level does it go too far for the Fed? Probably 2.5% inflation or higher, but given where we are today, we're a long ways away from that. There's a lot of ground that they need to make up before I think that they're going to get worried that they've gone too far.

Adam: Thanks, Mark. Just as a slight follow-up to that, I think if anybody would have told me prior to this year that we could add $4 trillion to the money supply in this country and not see inflation, I probably would have made a face, but that's exactly what happened. What do you attribute that to?

Mark: The fact that I think our textbook view of monetary policy, meaning that if you provide a certain aggregate amount of money, the velocity of the money will then pick it up, and put it into the economy. I think we've generally seen that break down because what we've realized is that the velocity of money can slow materially, and it doesn't matter the quantity of money that's outstanding. What matters is, again, how willing banks are to make loans off of that.

What we have seen is that banks have really pulled back from loan-making. You see that in their statistics, you hear about that in their quarterly earnings calls. Banks are very reluctant to make loans right now, despite the fact that they're sitting on trillions and trillions of reserves or cash that they're just keeping at the Fed.

They're reluctant to make loans because they want to make high-quality loans. They want to make loans to individuals and businesses that they believe have the potential to repay them. We all know that in the midst of a very sharp economic downturn, with high, high uncertainty, that they are going to be more reluctant to do that. They're going to be less willing to lend.

I think that that's why we haven't seen such an impact to the economy or such an impact to inflation. Again, it's due to the fact that there's still a lot of uncertainty in the economic outlook right now. Businesses are reluctant to invest and expand because they don't know exactly what the post-COVID world will look like. Who knows where we will all be working in another two years or three years? I think that similarly, the banks are reluctant to lend to consumers because they don't know necessarily about their credit quality.

Now, I do anticipate that as the COVID curves bend, and let's just assume that the vaccines remain effective against any one of these COVID mutations that are occurring. As long as that's the case, I do anticipate the second half of this year, and the first half of next year, that there's going to be a very different environment. I think banks, and businesses, and consumers are going to have a lot more confidence to go out and spend, and invest, or borrow or lend, but until we get to that point, I think that you're going to see, again, a lot of reluctance to do that. I think you're going to see the massive increase in the money supply have a limited impact on inflation.

Adam — That's helpful, Mark. Thanks so much for that. Ed, maybe I'll direct this final question since we're heading to the last minutes here of this call to you. If you could talk a little bit about what your expectation might be when, in the light of all this stimulus that, obviously, comes with some government debt, and the government will have to service that debt.

Do we think any of the prior administration's progress with tax reform, specifically on corporate tax reforms and other changes to ease the repatriation into this country, do we see that as an agenda item for the current administration in the next two to four years?

Ed — Yes, thanks. I think the administration has told us, and has made clear they don't want to do anything that would harm the economy in the short-term, but that tax increases could very well be on the table, perhaps on a going-forward basis. Perhaps that means the tax year 2022, perhaps that means further years out.

The problem they have is—the columnist, the late Robert Novak once wrote, I think maybe two decades ago, "The only thing the Republican Party stands for is lower taxes." I think that still remains true; at least, Republicans that we've seen, splits in the party between the Trumps and the non-Trumps, but one thing that generally unites Republicans of all stripes is this belief that you shouldn't be raising taxes. That means if the Biden administration does want to raise taxes, they're going to have to rely on 50 Democratic votes plus 1 in the United States Senate and the other narrow margin in the House as well.

They can't lose a lot of people, and that means deals are going to be very hard to come from. Like I said, a Bernie Sanders and a Joe Manchin agreeing on things from the more liberal to the more conservative side of the Democratic Party, is not easy. Does it mean it can't happen? No, I can't tell you that we won't see any tax increases, but I don't think they'll be effective this year because of the administration's desire to, again, not do anything to harm the economy in the short-term.

Even in 2022, I'd say that it's probably less likely rather than more likely, given the fact that it would require every Democrat to agree on everything, if they, in fact, can't get any Republican votes for tax increases which I think is difficult.

I'd like to sit here and tell our clients here that taxes aren't going up next year. I can't say that will full assurance, but I don't think it's the most likely outcome, and it's not something I'm predicting for next year, either.

Adam — Thanks for that, Ed. I'd guess it's a careful hedge there. I know we've had former presidents that promised no tax increases that affected their re-elections.

Ed — Read my lips, Adam.

Adam — Well, with that, I thank everybody for dialling in. Thank you, Ed, and thank you, Mark, again, for coming to share your thoughts with us and I'll hand the call back over to Patrick.

Coordinator — Thank you very much. Thank you to all our speakers. That concludes your conference call for today. You may disconnect. Thank you for joining, and enjoy the rest of your day.

[END OF CALL]