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Corona Crisis: Causes, Effects and Macroeconomic Policy Requirements

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IPE Political Economy Forum
Corona Crisis: Macroeconomic and Ecological-Political Implications

29 May, 4 – 6 pm, online

1. **Deepest recession since the Great Depression – but quick recovery (although some risks are conceded)?**
2. **Economic policy responses: We are all Keynesians now – aren‘t we?**
3. **Any risks? For the world economy and the Eurozone?**
4. **Economic policy lessons to be learnt**

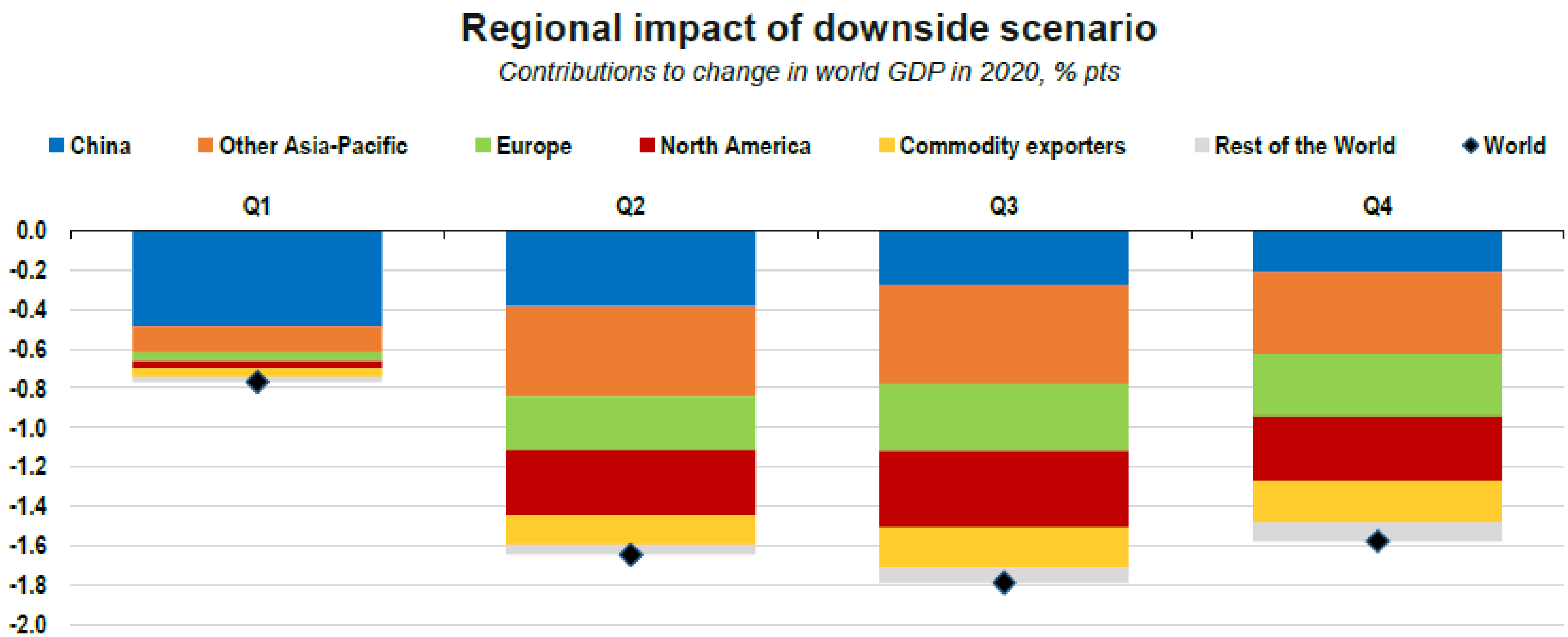
1. Deepest recession since the Great Depression – but quick recovery (although some risks are conceded)?

Economic channels

Containment measures	Supply	Demand
Quarantines	Factory closures	Loss of confidence
Travel bans and restrictions	Cutbacks in service provisions	Business and tourism travels
Closure of public places	Supply chain disruption	Education and entertainment services

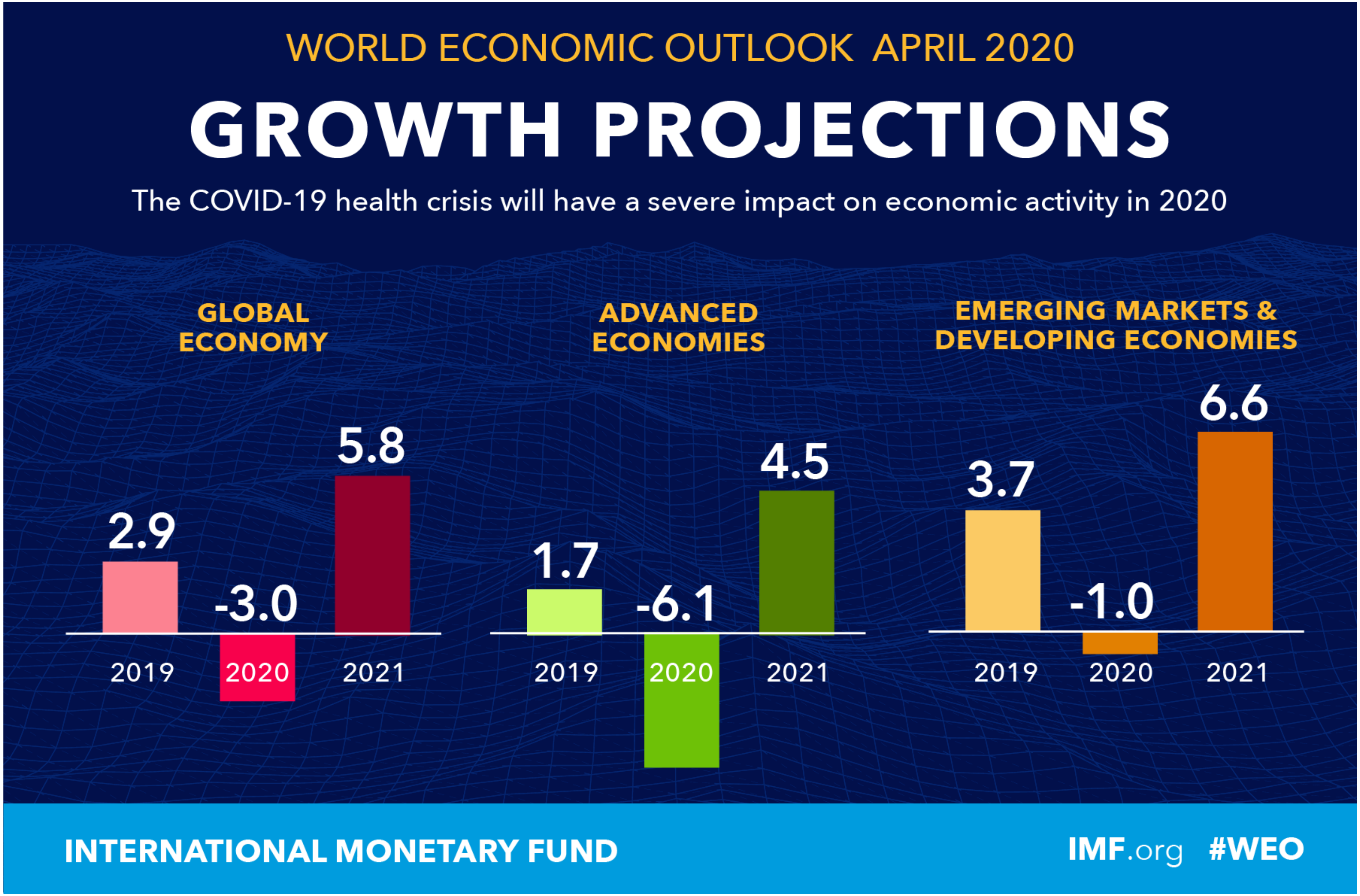
Source: OECD (2020)

The decline in global growth hitting all affected regions

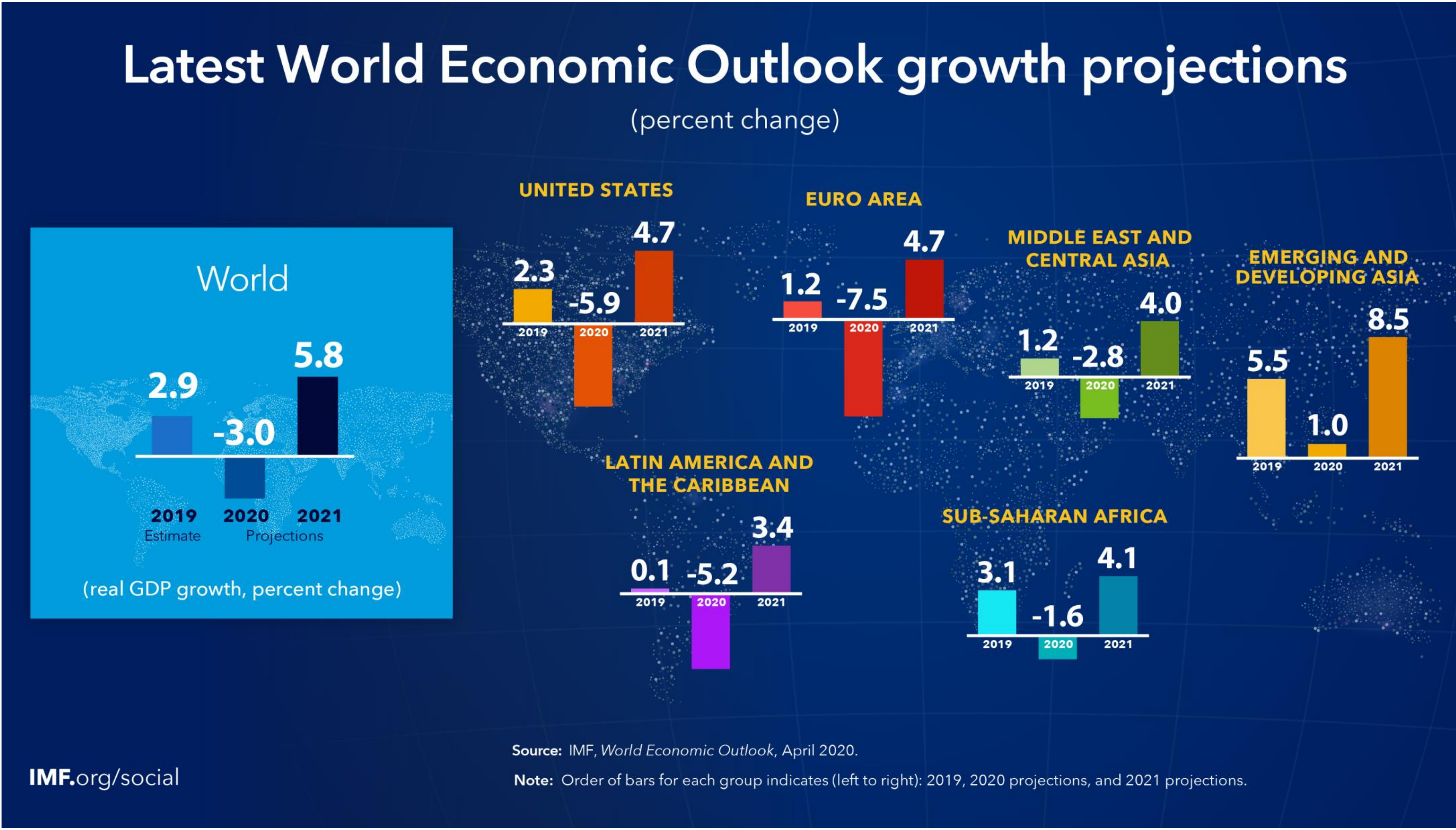


Note: This simulation shows the impact of a 4% fall in domestic demand in China and Hong Kong-China - in 2020Q1 and a 2% decline in 2020Q2, plus a 2% domestic demand fall in most other Asia-Pacific countries and advanced Northern hemisphere countries in 2020Q2 and 2020Q3, plus declines of 20% in global equity and non-food commodity prices in 2020, and a 50 bps rise in investment risk premia in all countries in 2020. These shocks are assumed to decline gradually through 2021. Commodity exporters include Argentina, Brazil, Chile, Russia, South Africa and other non-OECD oil-producing economies.
Source: OECD calculations using the NiGEM global macroeconomic model.

Source: OECD (2020)



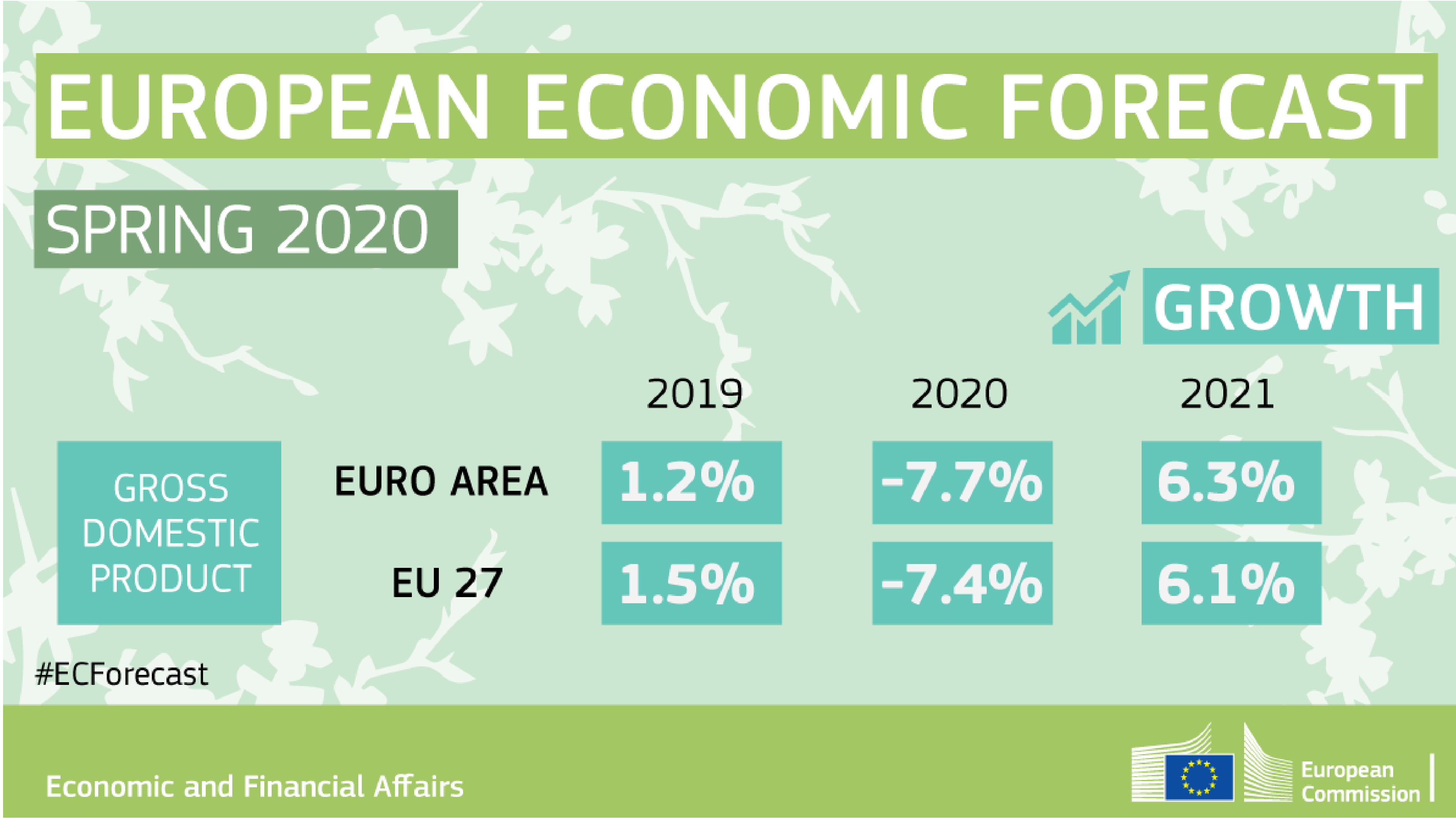
Source: IMF (2020)



Source: IMF (2020)

	Year over Year			
			Projections	
	2018	2019	2020	2021
World Output	**3.6**	**2.9**	**–3.0**	**5.8**
Advanced Economies	**2.2**	**1.7**	**–6.1**	**4.5**
United States	2.9	2.3	–5.9	4.7
Euro Area	1.9	1.2	–7.5	4.7
Germany	1.5	0.6	–7.0	5.2
France	1.7	1.3	–7.2	4.5
Italy	0.8	0.3	–9.1	4.8
Spain	2.4	2.0	–8.0	4.3
Japan	0.3	0.7	–5.2	3.0
United Kingdom	1.3	1.4	–6.5	4.0
Canada	2.0	1.6	–6.2	4.2
Other Advanced Economies[2]	2.6	1.7	–4.6	4.5
Emerging Market and Developing Economies	**4.5**	**3.7**	**–1.0**	**6.6**
Emerging and Developing Asia	6.3	5.5	1.0	8.5
China	6.7	6.1	1.2	9.2
India[3]	6.1	4.2	1.9	7.4
ASEAN-5[4]	5.3	4.8	–0.6	7.8
Emerging and Developing Europe	3.2	2.1	–5.2	4.2
Russia	2.5	1.3	–5.5	3.5
Latin America and the Caribbean	1.1	0.1	–5.2	3.4
Brazil	1.3	1.1	–5.3	2.9
Mexico	2.1	–0.1	–6.6	3.0
Middle East and Central Asia	1.8	1.2	–2.8	4.0
Saudi Arabia	2.4	0.3	–2.3	2.9
Sub-Saharan Africa	3.3	3.1	–1.6	4.1
Nigeria	1.9	2.2	–3.4	2.4
South Africa	0.8	0.2	–5.8	4.0

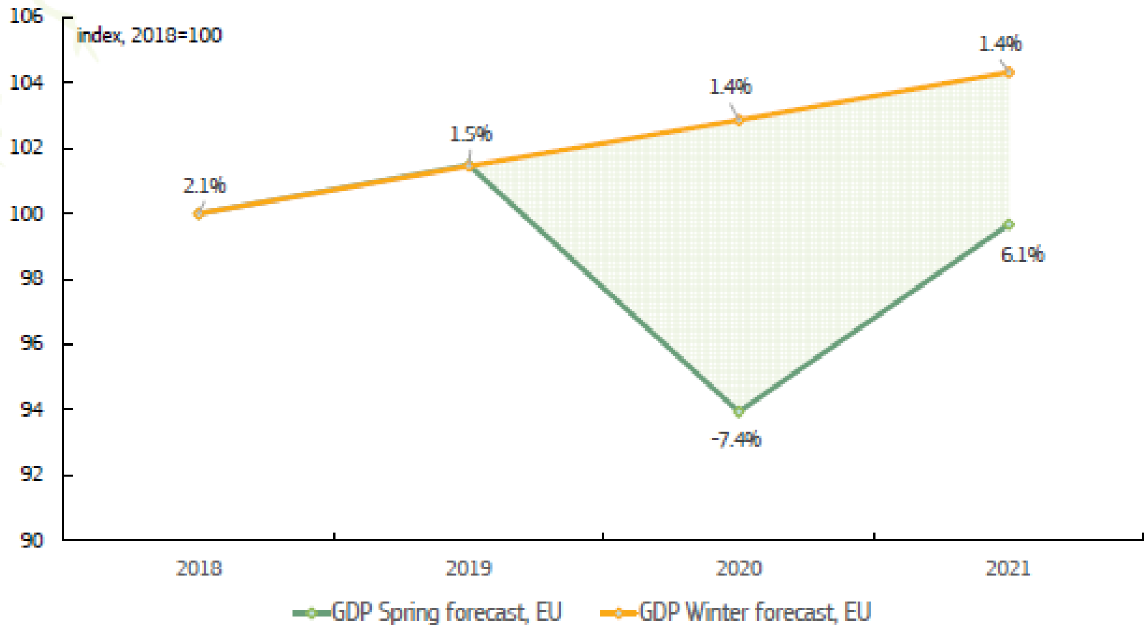
Source: IMF (2020)



Source: European Commission (2020a)

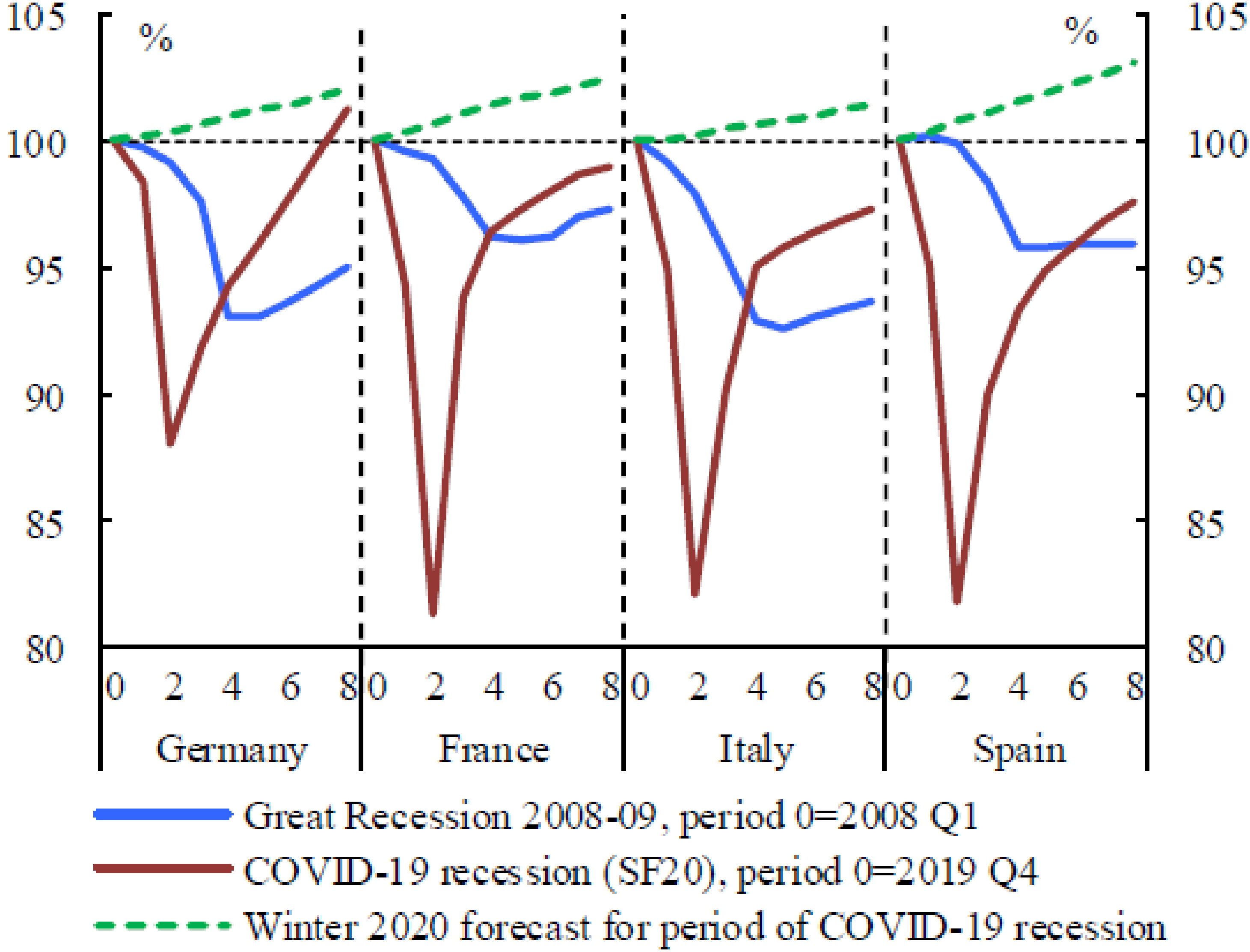
A deep recession followed by a partial recovery

GDP in 2021 to remain far below the level expected in the Winter Forecast

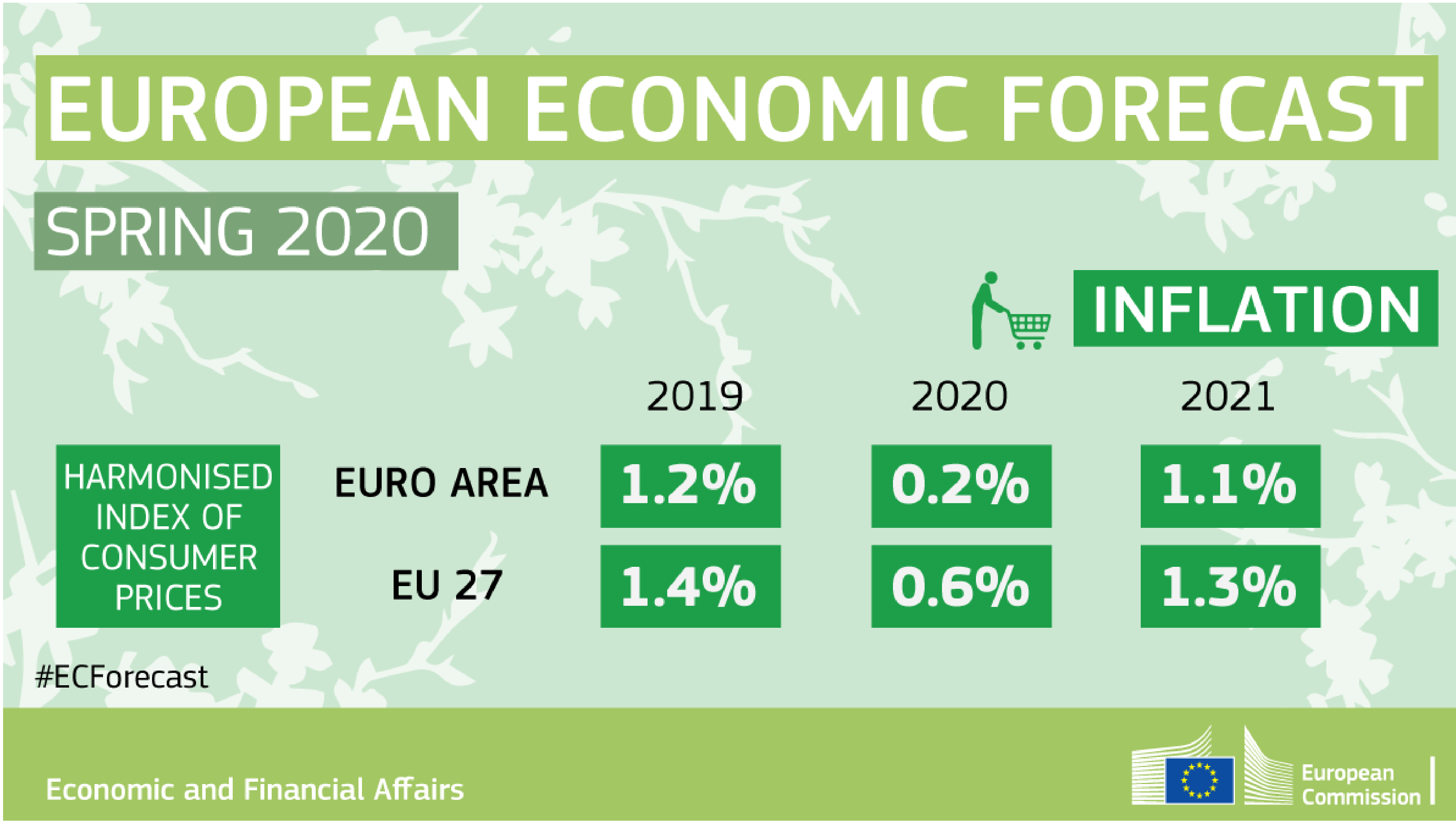


Source: European Commission (2020a)

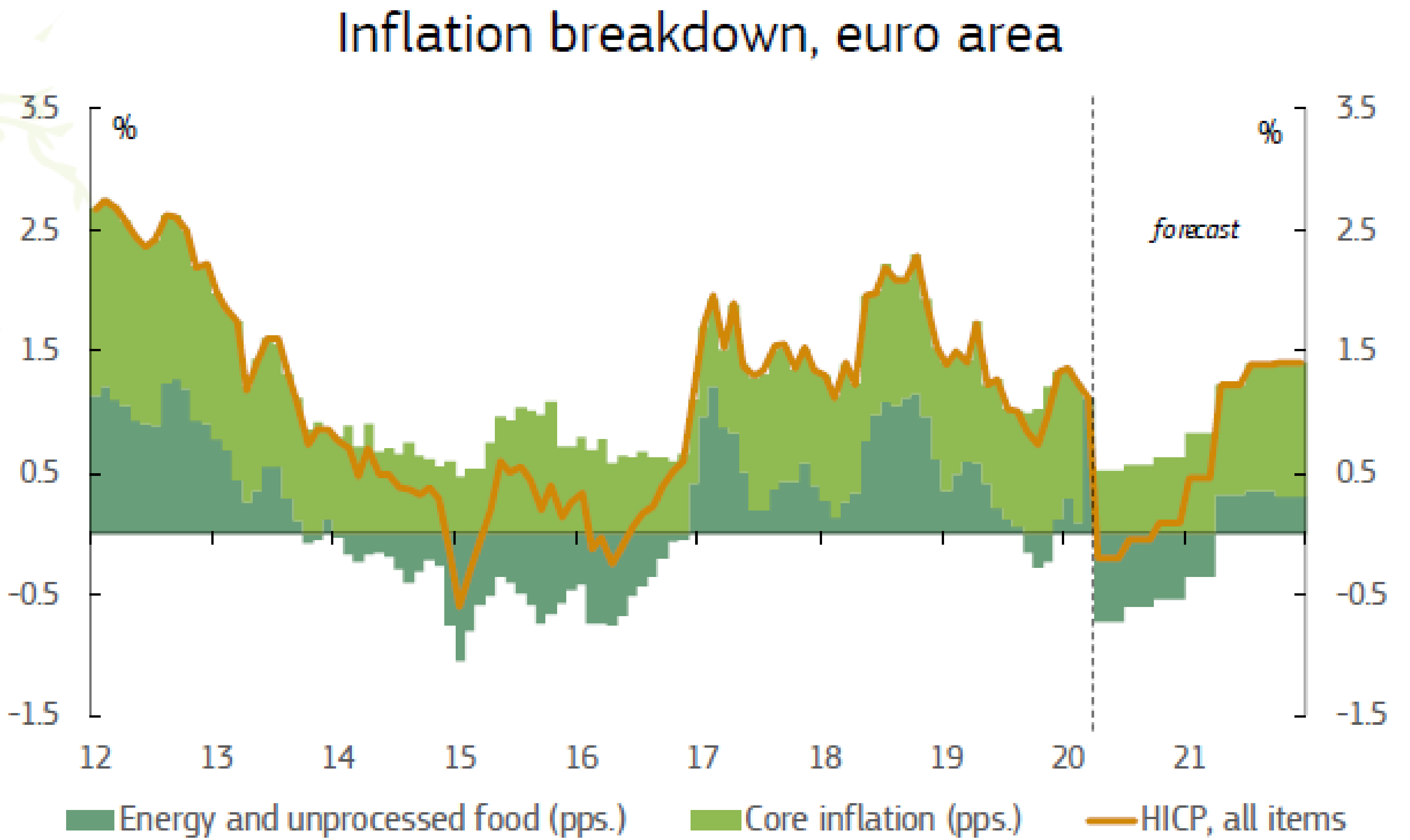
Graph I.1.25: **Comparing recessions, 2008-09 crisis vs. COVID-19 recession, Member States**



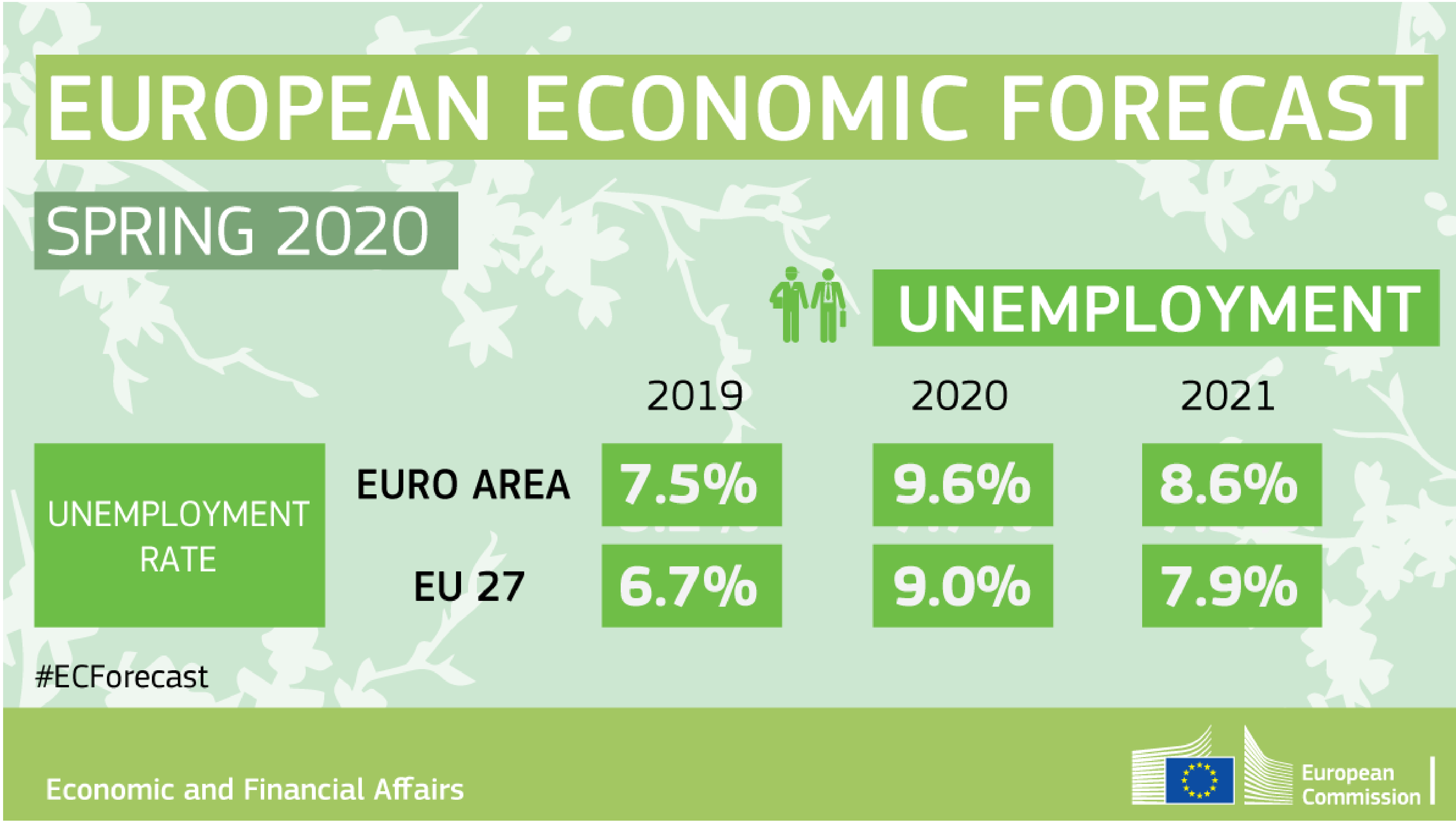
Source: European Commission (2020a)



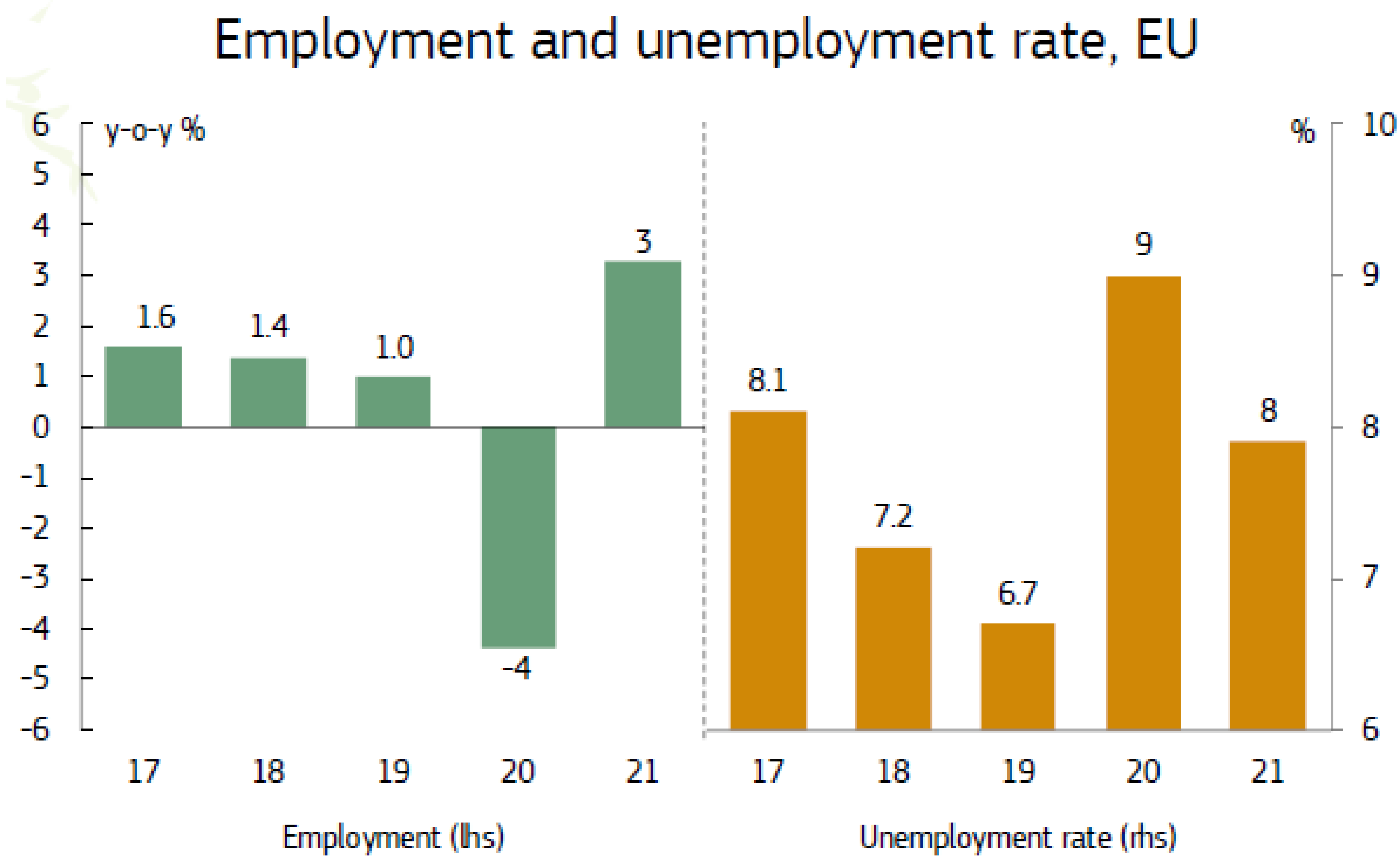
Source: European Commission (2020a)



Source: European Commission (2020a)

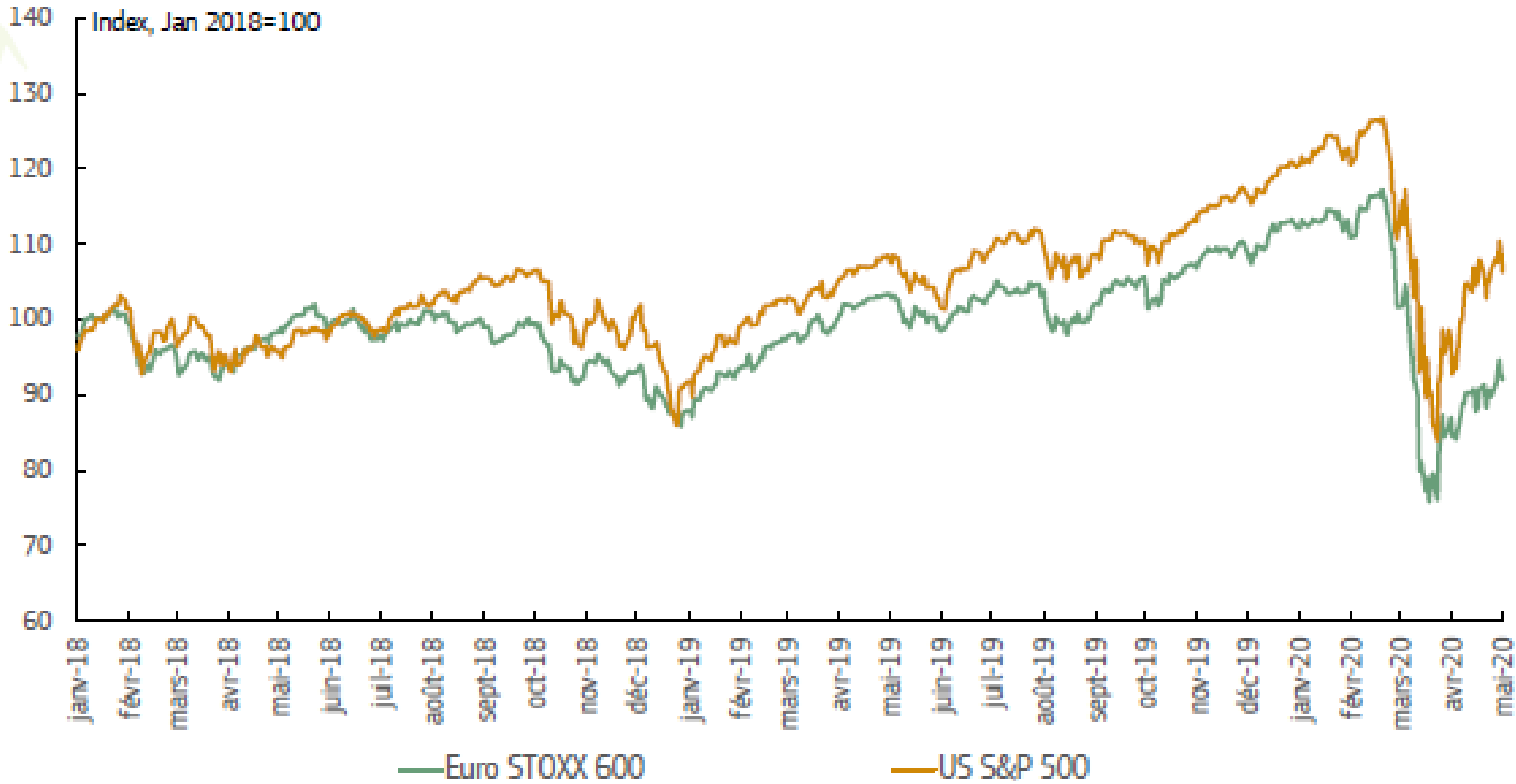


Source: European Commission (2020a)



Source: European Commission (2020a)

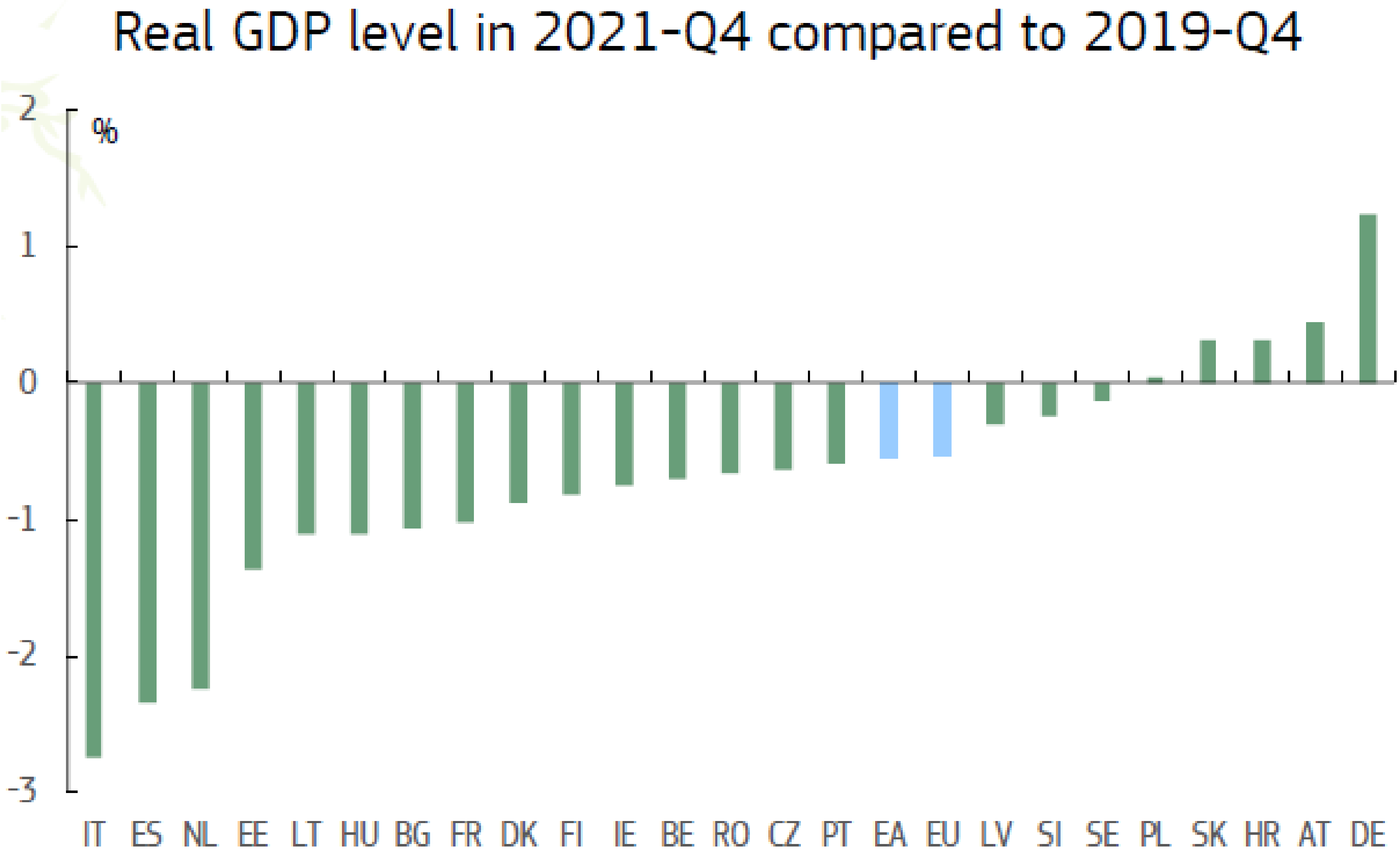
Stock exchange indices



Source: Macrobond

Source: European Commission (2020a)

Asymmetric recovery: GDP



Source: European Commission (2020a)

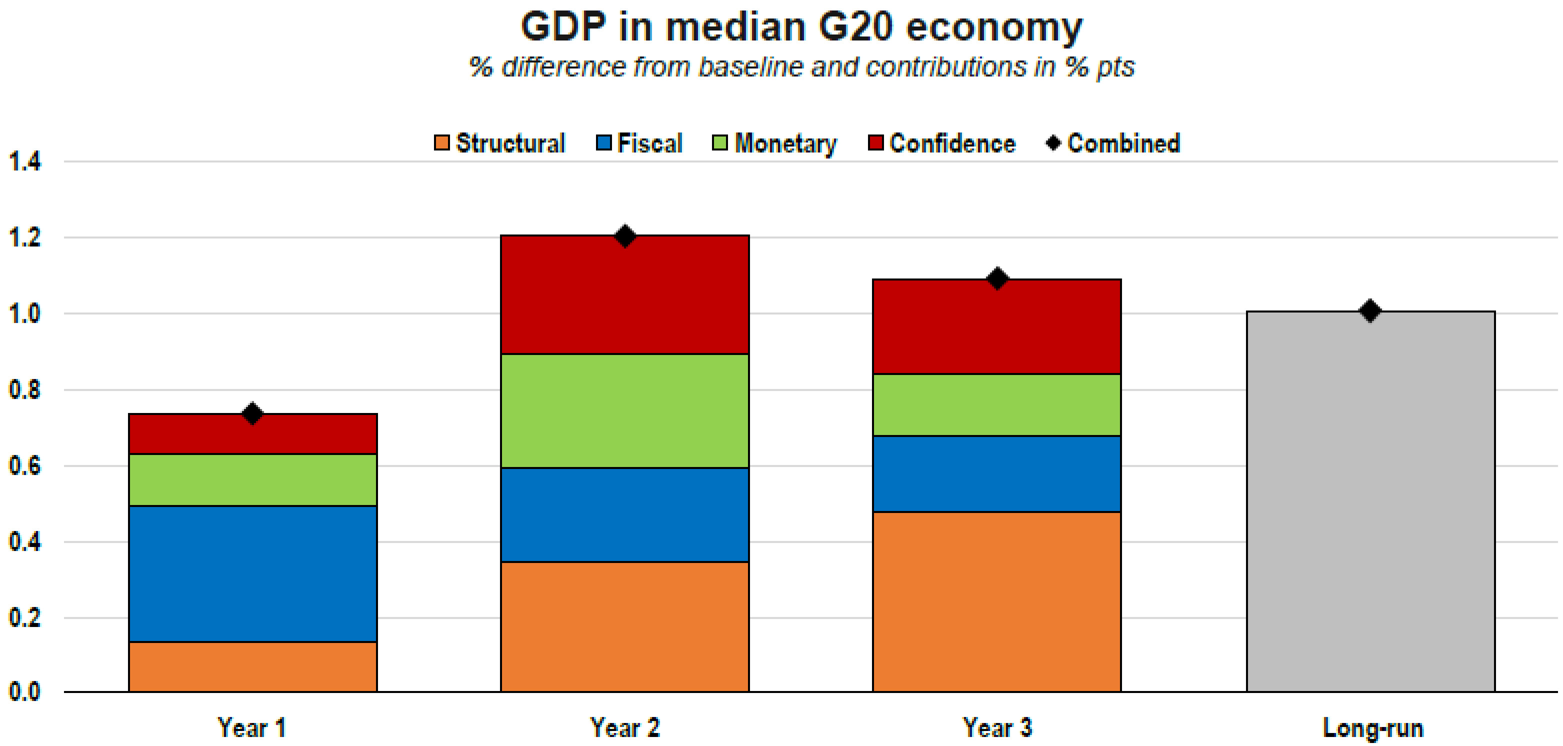
2. Economic policy responses: We are all Keynesians now – aren‘t we?

Policy options to address economic implications

People	Firms	Macro policy
Increase resources to the health sector	Reduce or delay tax payments for most affected sectors	Expand liquidity to banks
Step up temporary cash transfers to vulnerable households	Expand liquidity and availability of credit to firms	Ensure monetary policy responds to extreme market conditions
Expand short-time work schemes	Reduce public sector arrears to firms	Let automatic stabilisers fully work and boost public investment

Source: OECD (2020)

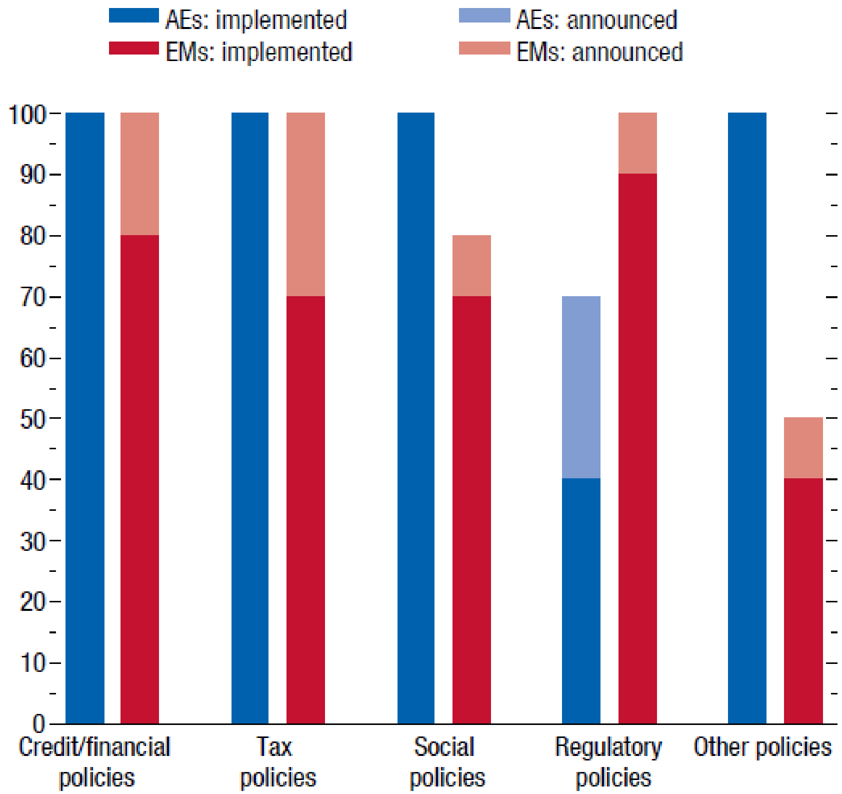
Policy coordination would provide the most effective stimulus



Note: Scenario with all G20 economies simultaneously undertaking changes to fiscal, monetary and structural policies. Countries undertake additional debt-financed public expenditure of 0.5% of GDP for three years, monetary policy becomes more accommodative in economies with policy interest rates above zero (all countries excluding Japan, France, Germany and Italy) and productivity-enhancing structural reforms raise total factor productivity by 1% after five years. Confidence is modelled by a 50 basis point reduction in investment and equity risk premia for two years.
Source: OECD calculations using the NiGEM global macroeconomic model.

Source: OECD (2020)

Figure 1.7. G20+: Economic Policy Responses to COVID-19
(Percent of countries)

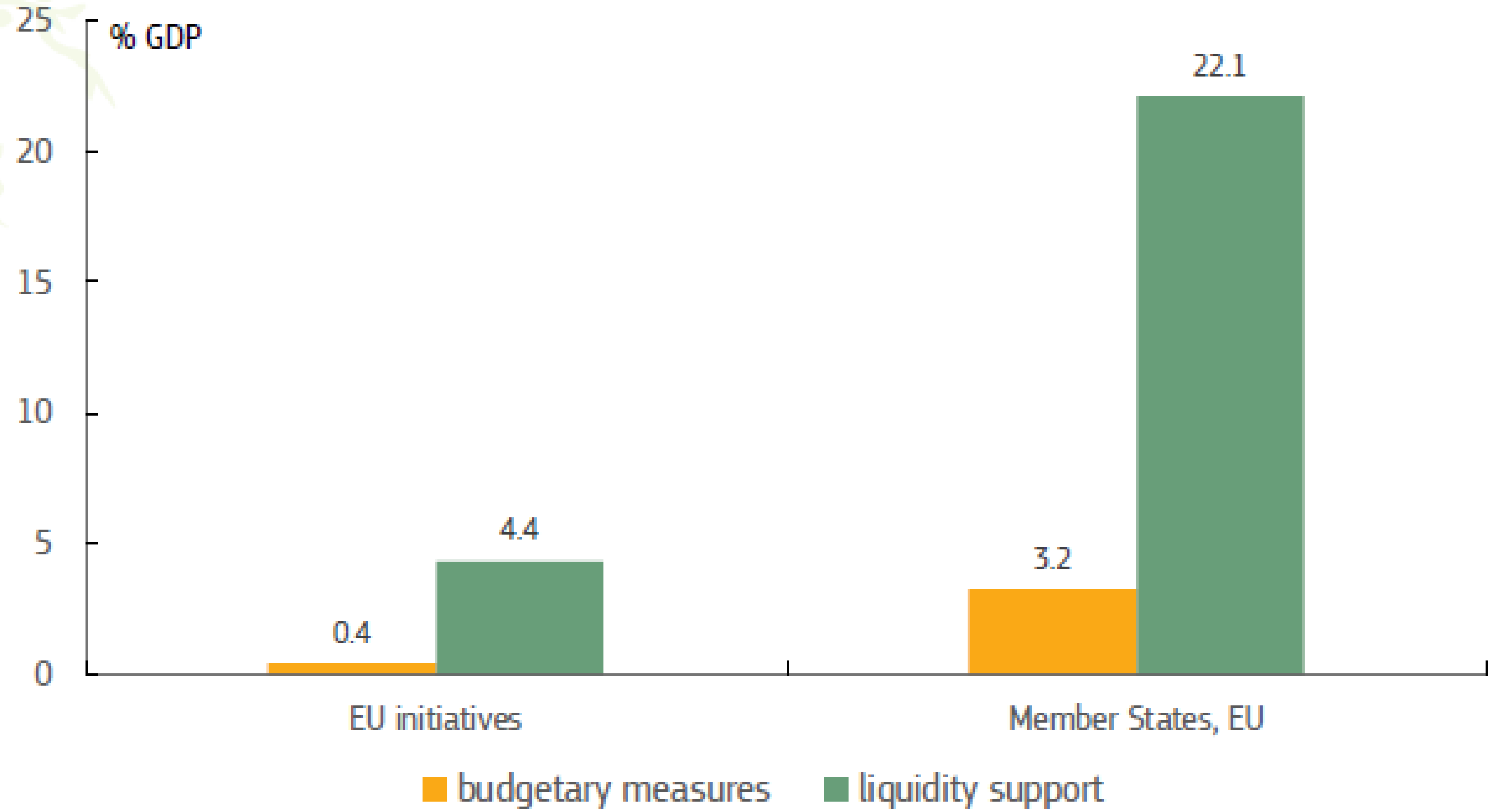


Source: IMF staff calculations.
Note: G20+ refers to the Group of Twenty countries, including Spain, which is a permanent invitee. Measures as recorded as of April 1, 2020. Credit/financial policies include government guarantees, loans to businesses/households from government entities, forbearance (including deferral of payments and loan reprofiling), and easing of credit regulation; tax policies include tax cuts/waivers/deductions and extensions of payment deadlines; social policies include unemployment benefits, sick leave assistance, cash transfers, and vouchers/in-kind support; regulatory policies include price controls, employment, and trade restrictions; other policies include public investments and firm subsidies. "Implemented" counts the number of countries where at least one measure from the relevant category has been implemented; "announced" counts the number of countries where measures from the relevant category have been announced but not yet implemented. AEs = advanced economies; EMs = emerging market economies.

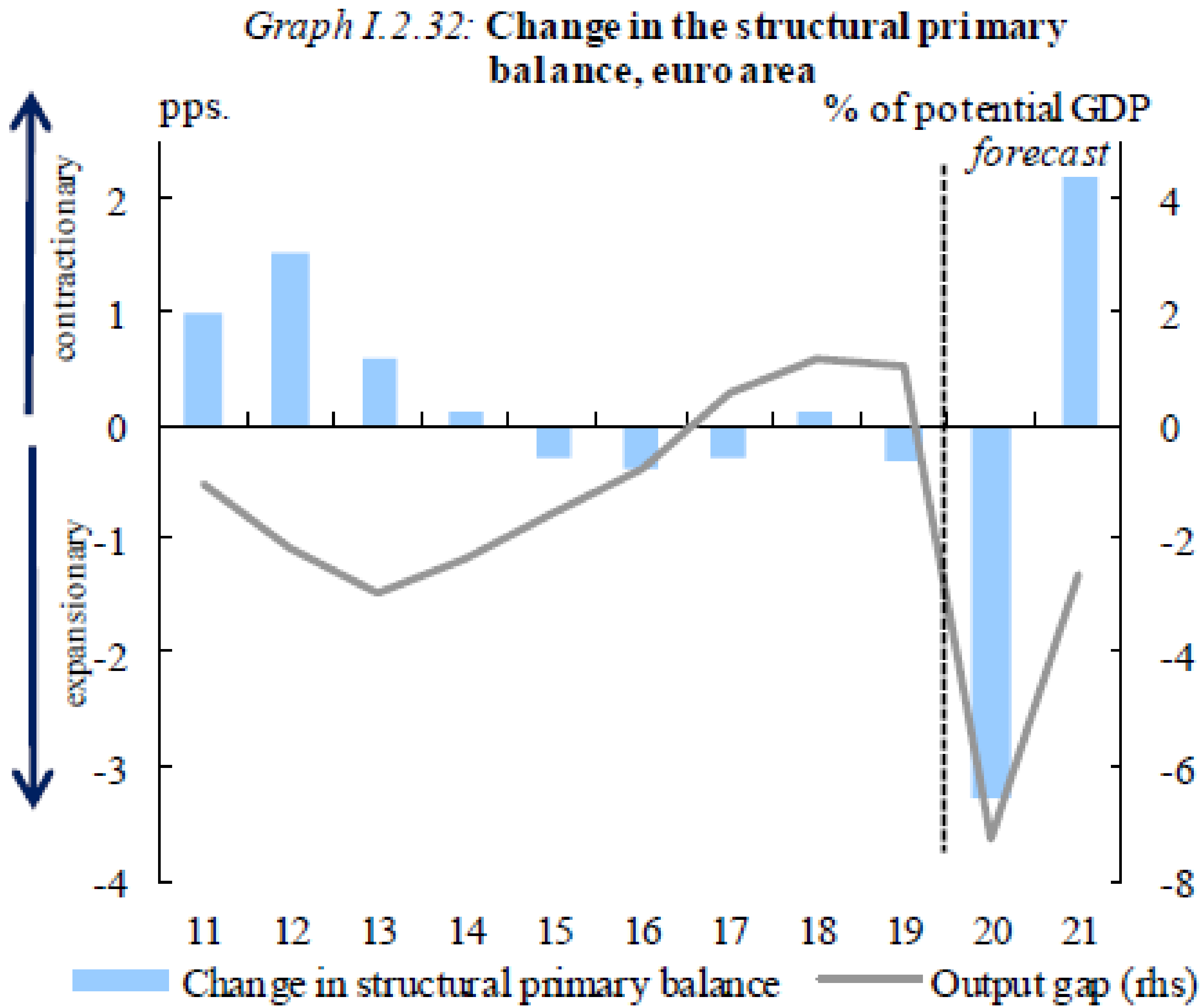
Source: IMF (2020)

Sizeable fiscal policy support

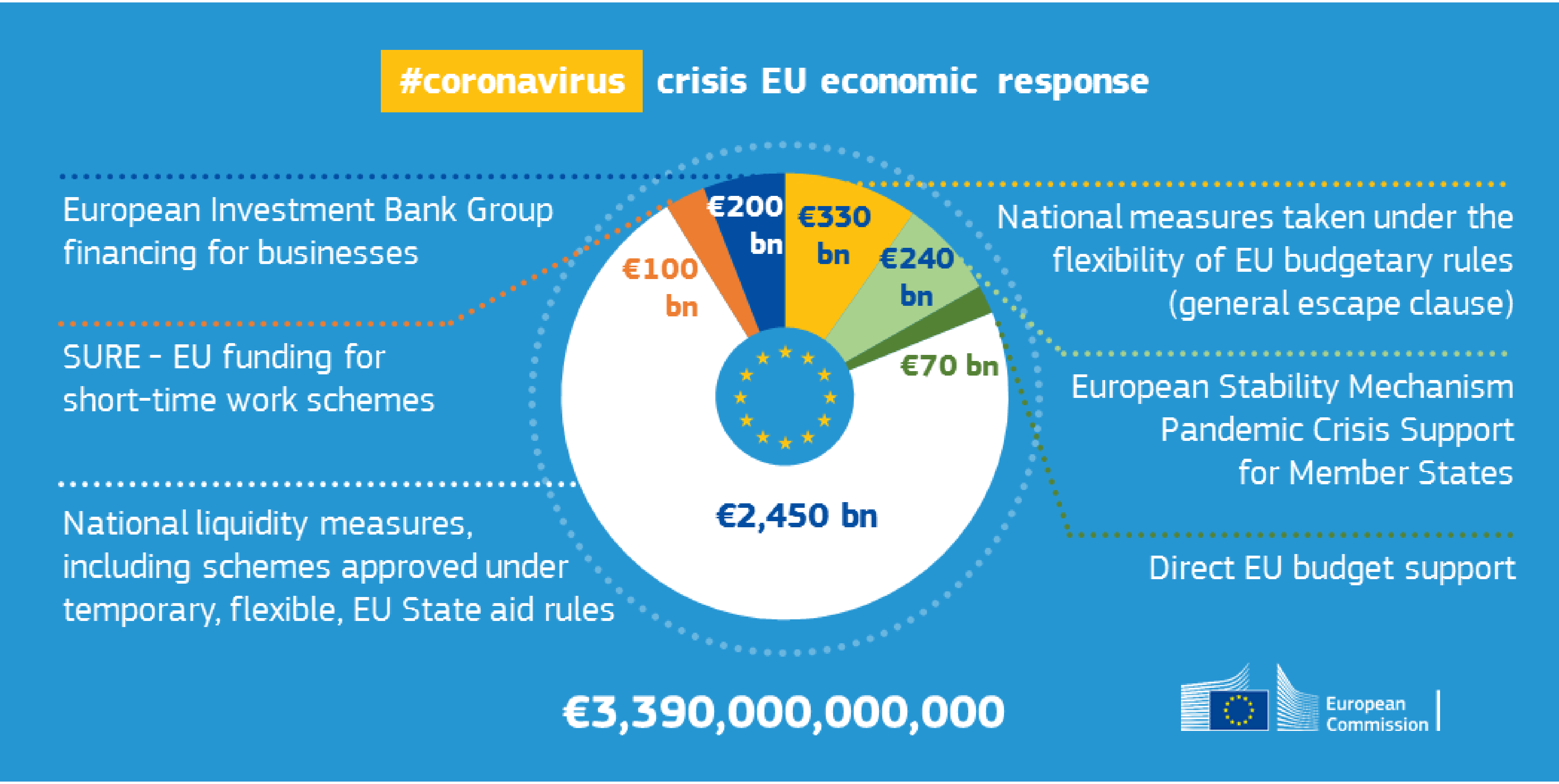
Discretionary fiscal policy and liquidity measures, in % of EU GDP



Source: European Commission (2020a)

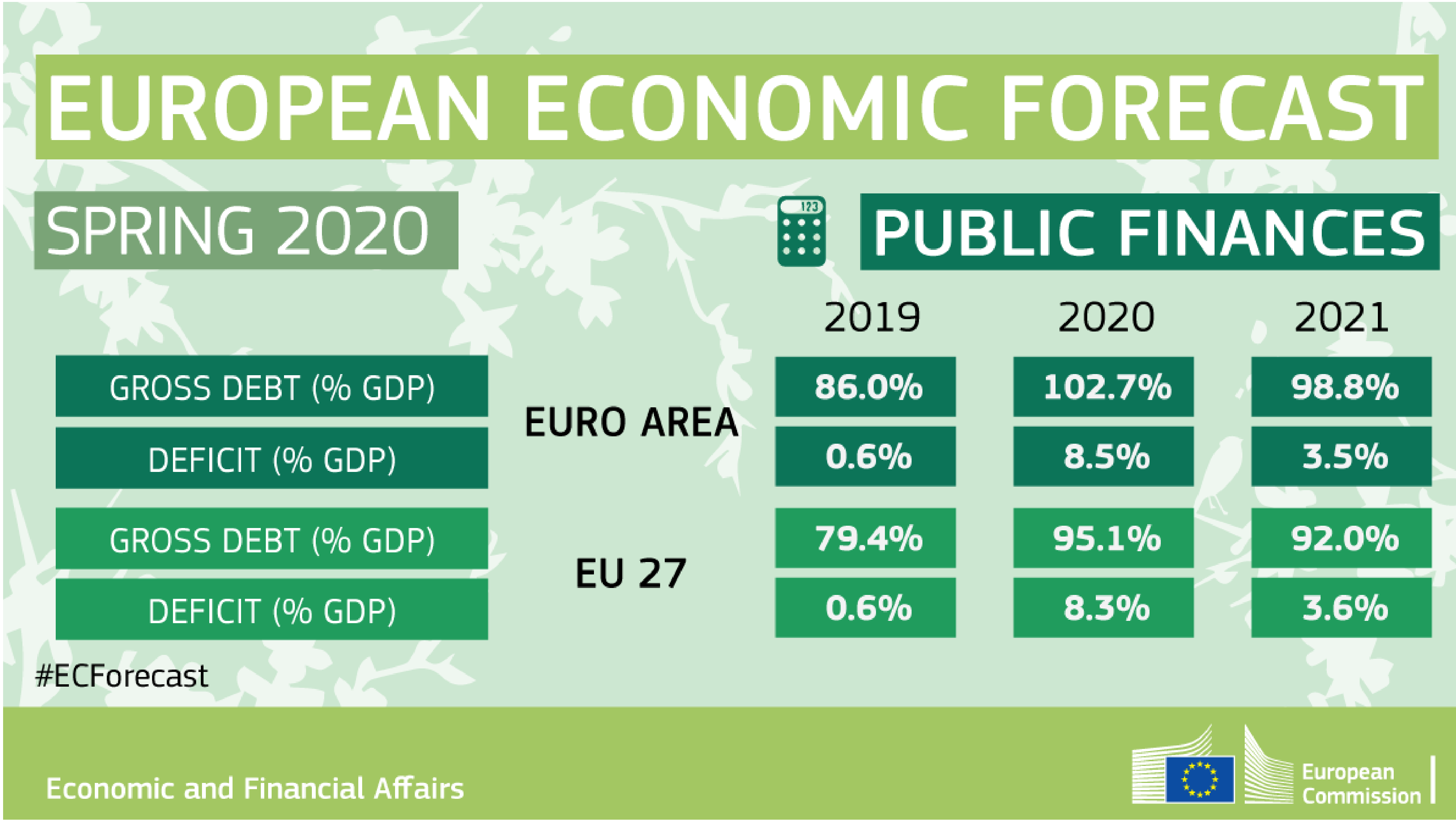


Source: European Commission (2020a)



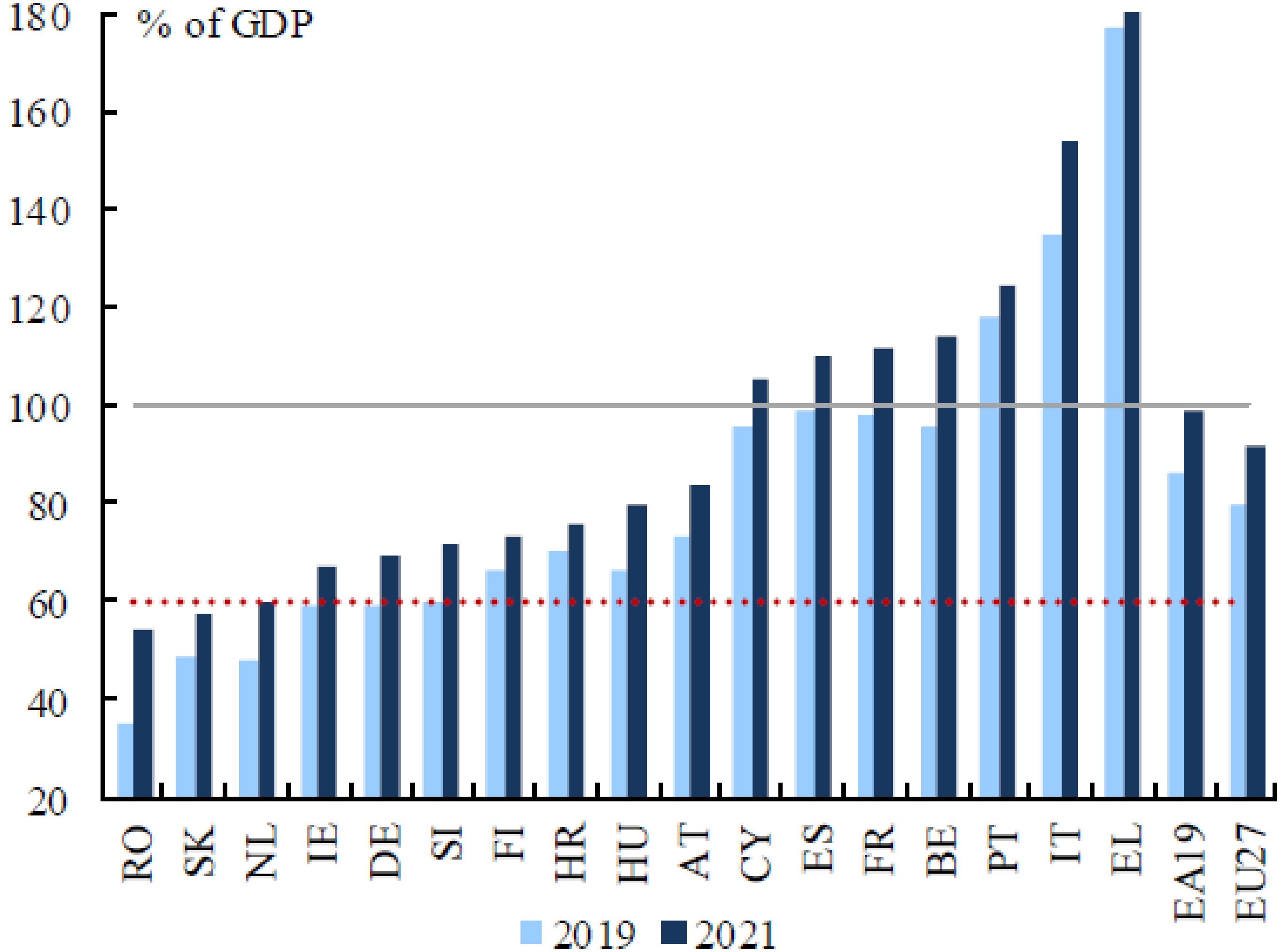
Source: European Commission (2020b)

\+ Recovery fund € 500 billions over several years (Macron, Merkel) or even € 750 billions (European Commission 2020c)



Source: European Commission (2020a)

Graph I.2.29: **Public debt development in selected Member States**



Source: European Commission (2020a)

ECB Council on 30 April 2020:

- Pandemic Emergency Longer-term Refinancing Operations (PELTROs), with collateral easing measures, interest rate will be 25 basis points below the average rate applied in the Eurosystem's main refinancing operations (currently 0%) over the life of the respective PELTRO
- Interest rate on all targeted longer-term refinancing operations (TLTRO III) reduced by 25 basis points to -0.5% from June 2020 to June 2021 For banks meeting the lending threshold of 0% introduced on 12 March 2020, the interest rate can be as low as -1%
- Pandemic Emergency Purchase Programme (PEPP), which has an overall envelope of €750 billion
- Asset purchase programme (APP) will continue at a monthly pace of €20 billion, together with the purchases under the additional €120 billion temporary envelope until the end of the year.
- Interest rates remain at -0.5, 0, +0.25

Source: ECB (2020)

3. Any risks? For the world and the Eurozone?

- Crisis has hit the world economy in a highly fragile situation, persisting after the Great Financial Crisis & the Great Recession

➢ High, persistent and partly rising inequality

➢ High and persistent current account imbalances

➢ Weak recovery (secular stagnation)

➢ Weak investment and capital stock growth

➢ Low productivity growth

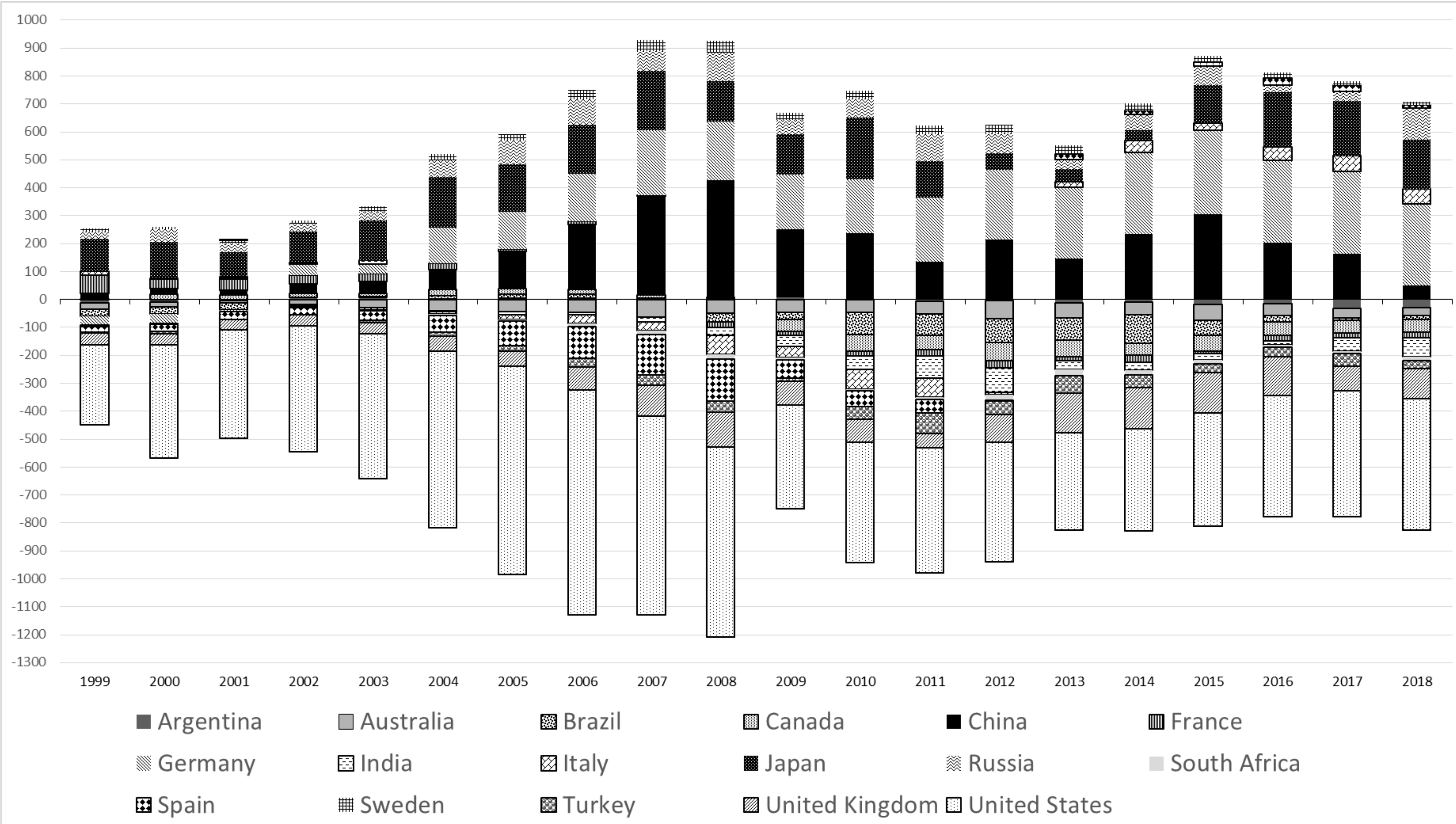
(see Hein 2019, 2020)

Table 1: Distribution trends for selected OECD countries before and after the financial and economic crisis 2007-9								
			US	**UK**	**Spain**	**Ger-many**	**Swe-den**	**France**
Distribution trends	Adjusted wage share	Before	–	0	–	–	–	–
		After	–	–	–	0	0	+
	Top income share	Before	+	+	+	+	+	+
		After	+	–	–	?	0	0
	Gini coefficients	Before	+	+	0	+	+	0
		After	+	0	+	+	0	–

Notes: + tendency to increase, – tendency to decrease, 0 no tendency, ? no data
Before: early 1990s until the crisis 2007-9, After: after the crisis 2007-9
Source: Hein et al. (2017a, p. 164)

Source: Hein (2019)

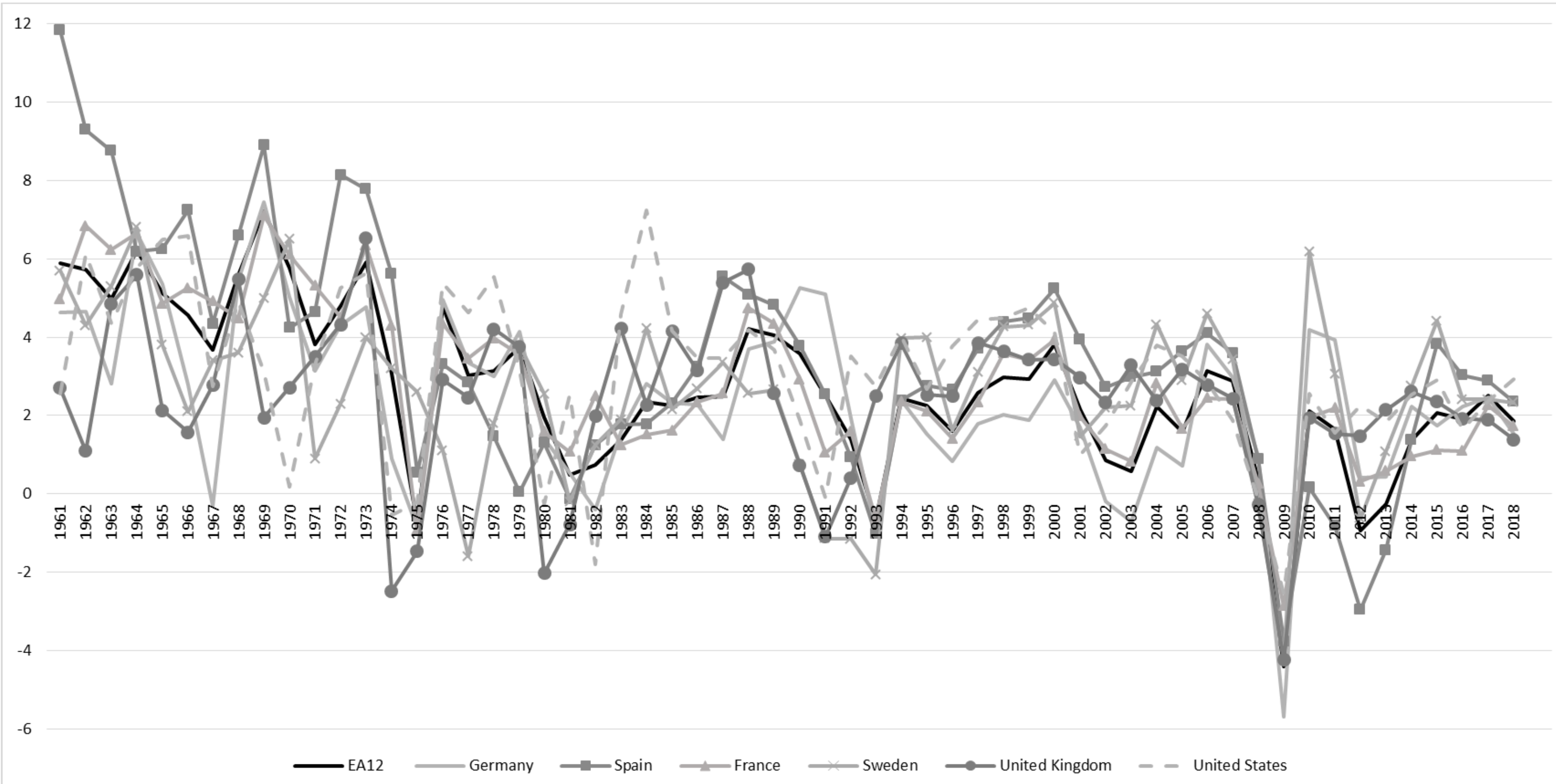
Figure 1: Current account balance, major countries, 1999-2018, in billions of US dollars



Source: IMF (2019), author's presentation

Source: Hein (2020)

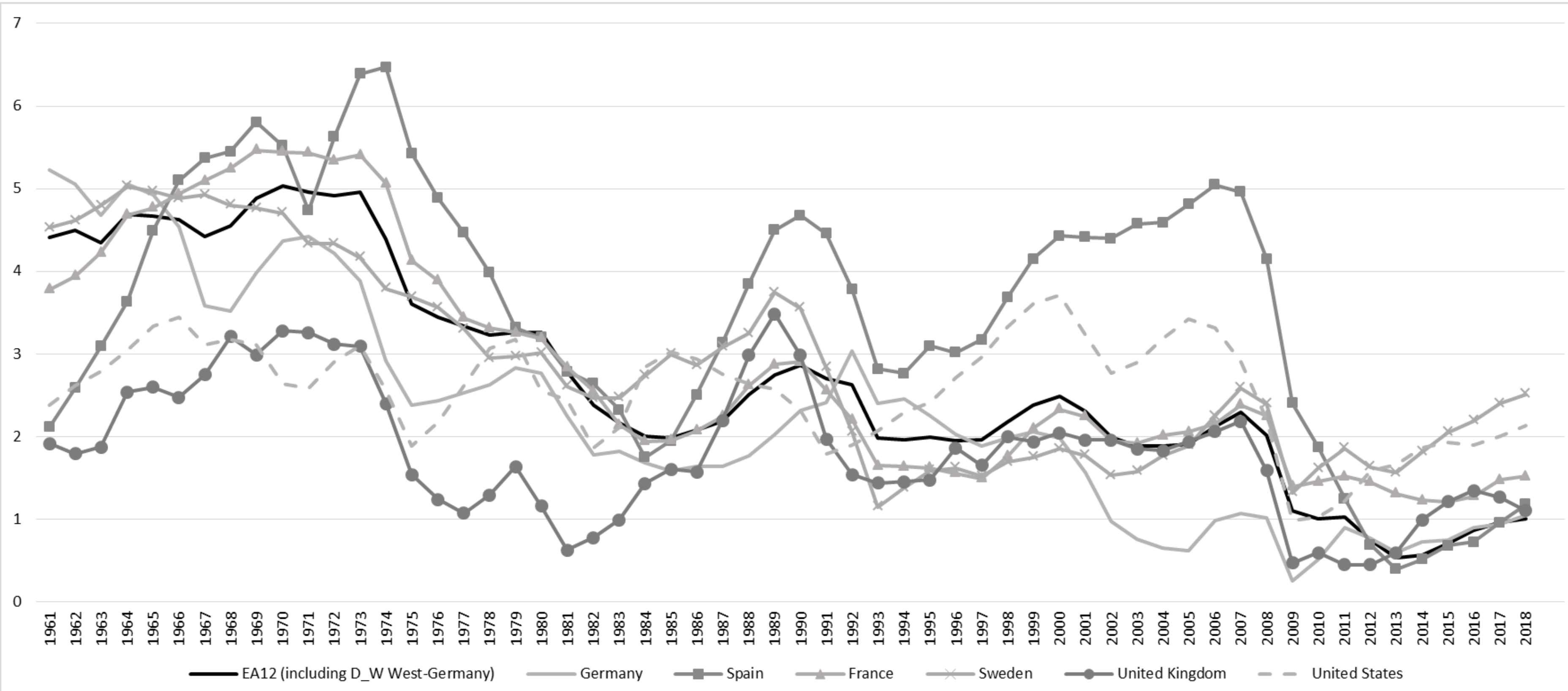
Figure 2: Growth rate of real GDP (at 2015 prices), selected countries, 1961 – 2018, in per cent



Source: European Commission (2019), author's calculations

Source: Hein (2020)

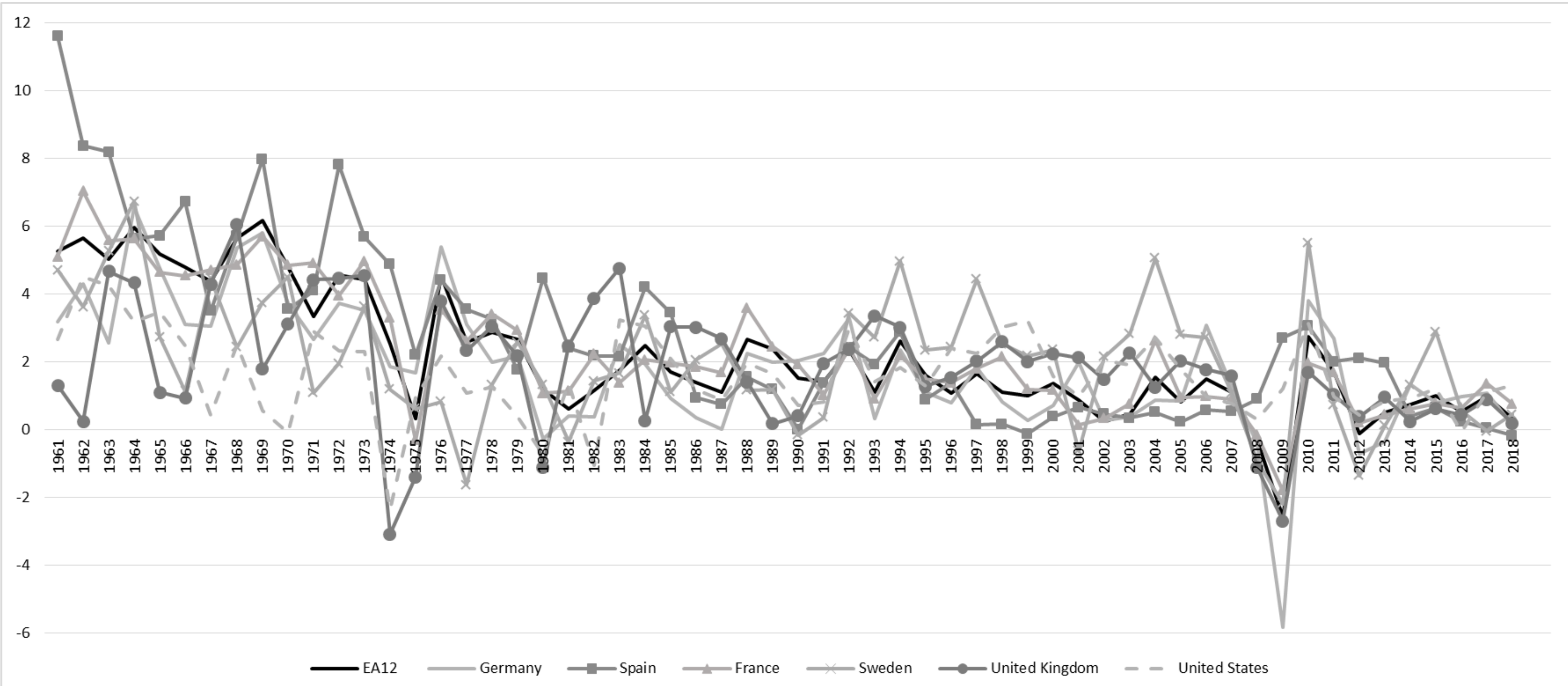
Figure 3: Growth rate real net capital stock (at 2015 prices), selected countries, 1961 – 2018, in per cent



Source: European Commission (2019), author's calculations

Source: Hein (2020)

Figure 4: Growth rate of real GDP (at 2015 prices) per person employed, selected countries, 1961 – 2018, in per cent



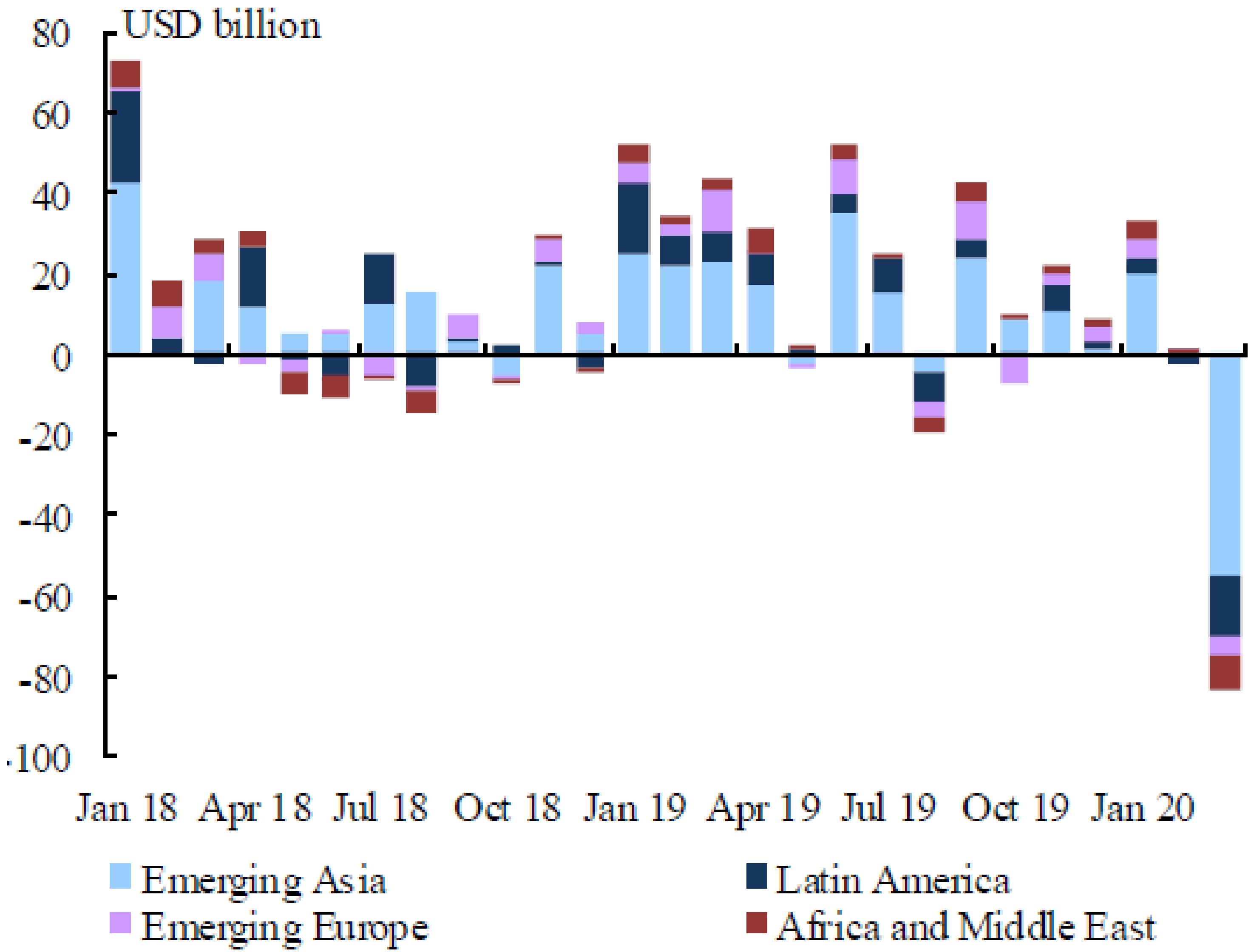
Source: European Commission (2019), author's calculations

Source: Hein (2020)

Major future risks:

- 2nd wave of the pandemic (acknowledged as risks in OECD, IMF, EC forecasts)
- Permanent disruption of supply chains, lasting effects on supply side (capital stock, human capital)
- Rising inequality
- Precautionary saving
- Permanent fall in animal spirits
- Financial instability – the government debt story in the Eurozone & sudden stops in EME
- Fiscal exit and austerity again
- Falling nominal unit labour costs → deflation

Graph I.2.5: **Portfolio flows to emerging markets**



Source: *IIF.*

Source: European Commission (2020a)

- Eurozone has not finally resolved its institutional problems, although there have been gradual improvements (ECB, EIB, ESM, EU funding for short time work, Macron-Merkel initiative, EC 750 billion € plan, …)

➢ lack of an unconditional guarantee of public debt of member states (further questioned by German Federal Constitutional Court recently)

➢ lack of a federal fiscal authority

➢ deflationary macroeconomic policy mix, future risks of austerity

(see Hein 2013/14 , 2018)

4. Economic policy lessons to be learnt

Global (and European) Keynesian New Deal to fight

- ➢ Inequality
- ➢ Unemployment
- ➢ Financial instability
- ➢ Ecological degradation

is still on the agenda:

- Re-regulating and downsizing of the financial sector,
- Re-distribution of income (and wealth) from top to bottom and from capital to labour
- Re-orientation of macroeconomic policies towards stabilizing domestic demand at non-inflationary full employment levels with a focus on fiscal policies in the **short and the long run** ➔ functional finance!
- Re-creation of international monetary and economic policy coordination.

(See Hein 2019)

In particular:

- Increase economic, social and ecological resilience of the system
- Buffers in order to dampen supply shocks
- Public provision of basic needs (including health care, education, infrastructure, in particular digital infrastructure)

➢ Public investment programme for the ecological transition (Dullien et al. 2020 for Germany)

- Generally: re-adjust relationsship between public, cooperative, and private (market) activity, extended role for public sector

Fundamental role for fiscal policies – in the short and in the long run

- Is government debt a fundamental problem?
- Do we need someone to pay for current government deficits?
- No, if government debt is in own currency and is backed by central bank (➔ MMT) and if we avoid persistently high current account deficits
- Wealth tax & progressive income taxation is important to tackle inequality, for social cohesion, for macro stability (automatic stabilisers) but not for funding government expenditures

Sectoral financial balances

- $S - I = G - T + Ex - Im$
- $FB_{PS} = - FB_{ST} - FB_{FS}$
- $FB_{PS} + FB_{ST} + FB_{FS} = 0$

➢ Private sector surplus requires government sector deficit (or foreign sector deficit)

➢ Government deficits/debt provides ‚safe haven' for private saving

With positive nominal GDP growth, debt-GDP ratio converges to a stable!

Higher growth reduces debt-GDP ratio for given deficit-GDP ratio:

$$\hat{B} = \frac{\Delta B}{B} = \frac{D}{B} = \frac{\frac{D}{Y^n}}{\frac{B}{Y^n}} = \hat{Y}^n \qquad \Rightarrow \qquad \frac{B}{Y^n} = \frac{\frac{D}{Y^n}}{\hat{Y}^n}.$$

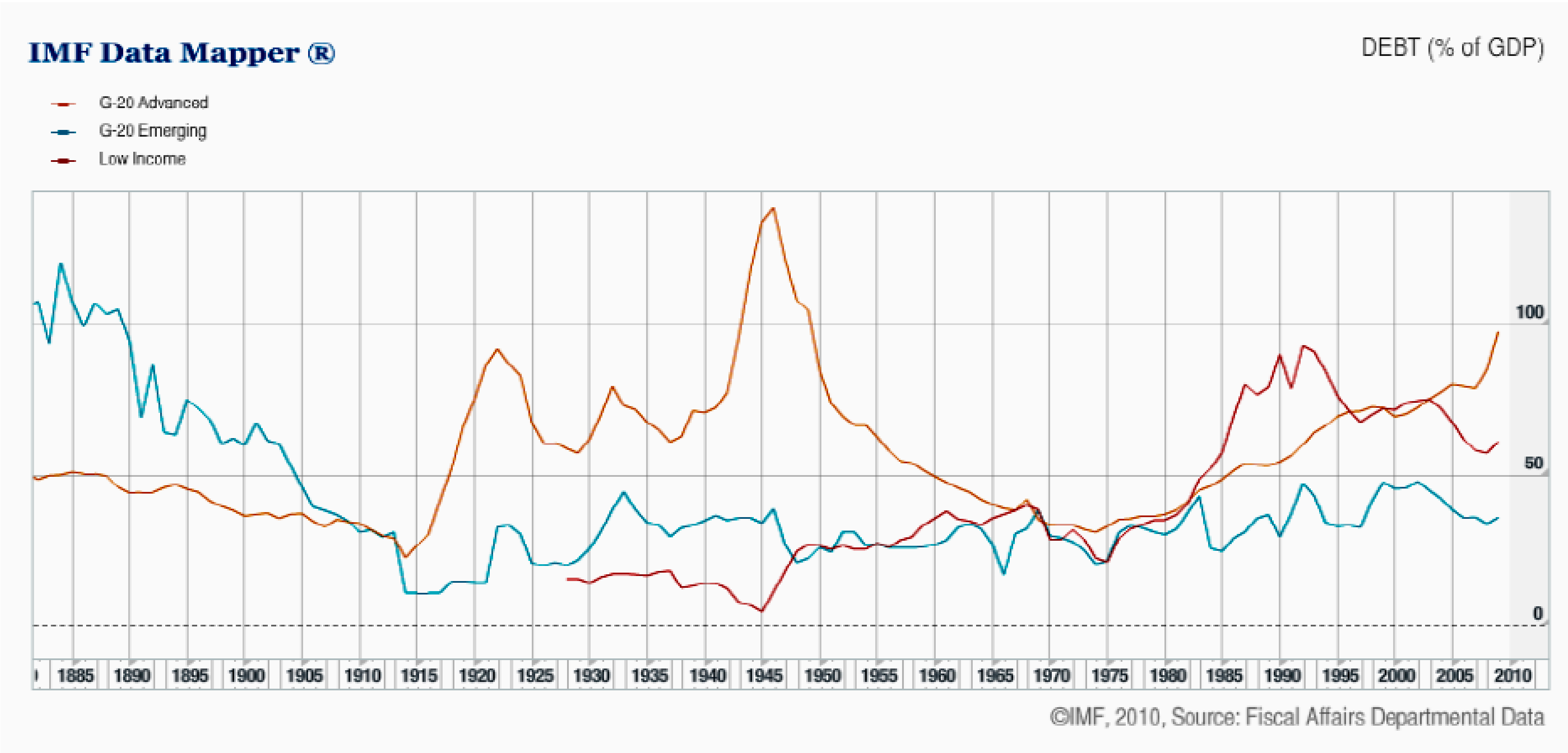
With a zero primary deficit, governments can service their debt by their current government deficits and stabilise the government debt-GDP ratio. Government debt 'pays for itself'.

$$\frac{B}{Y^n} = \frac{\frac{D'+iB}{Y^n}}{\hat{Y}^n} = \frac{\frac{D'}{Y^n} + i\frac{B}{Y^n}}{\hat{Y}^n}.$$

With nominal GDP growth exceeding nominal interest rate, governments can even afford to run a primary deficit without raising debt-GDP ratio:

$$\frac{B}{Y^n} = \frac{\frac{D'}{Y^n}}{\hat{Y}^n - i}.$$

Government debt-GDP ratios in historical perspective



Source: Abbas et al. (2020)

THANK YOU

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