Economic Policy During the Pandemic Recession and Recovery

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Oxford PPE Society
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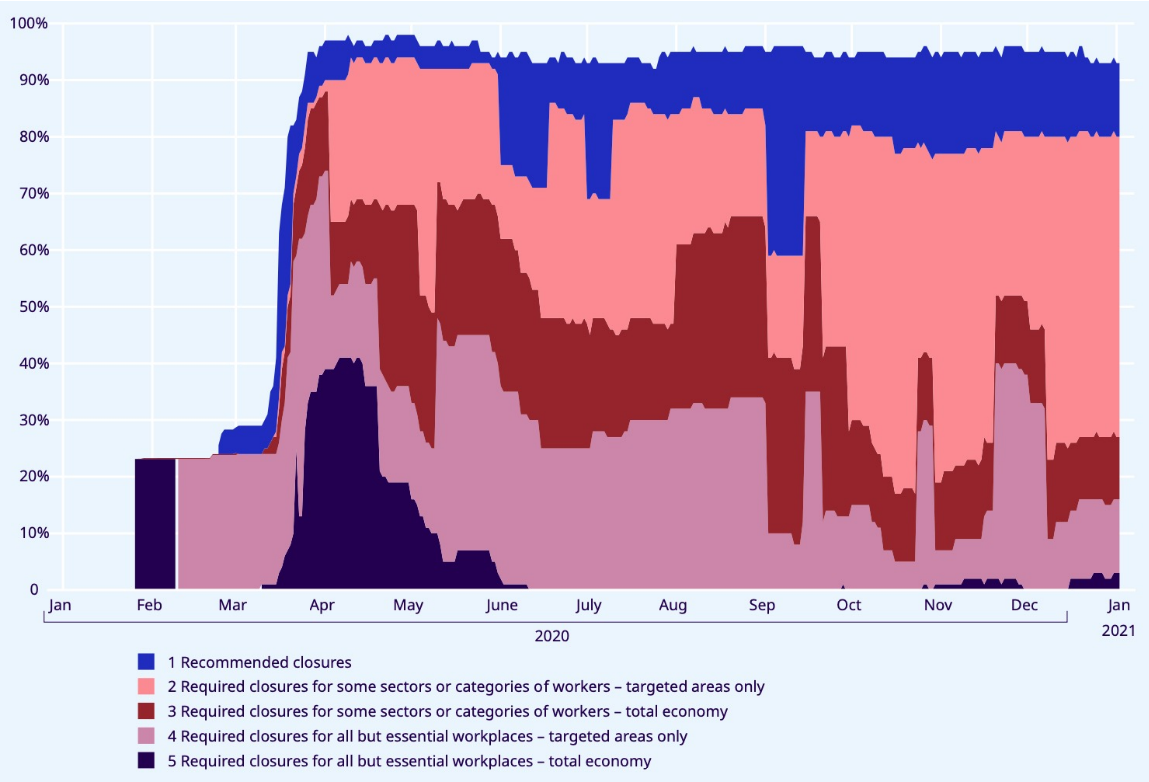
The COVID-19 pandemic led to the second devastating global economic crisis of the 21st century

Share of Workers in Countries with Workplace Closures
Percent



Screenshot from International Labour Organization (2021)

The International Labour Organization estimates that working hours fell by the equivalent of 255 million full-time jobs in 2020—**four times greater than during the financial crisis of 2009**

This talk will focus on how we used economic policy to mitigate the economic fallout from the pandemic

Important policy Insights in the years leading up to the pandemic

Key features of the COVID-19 recession

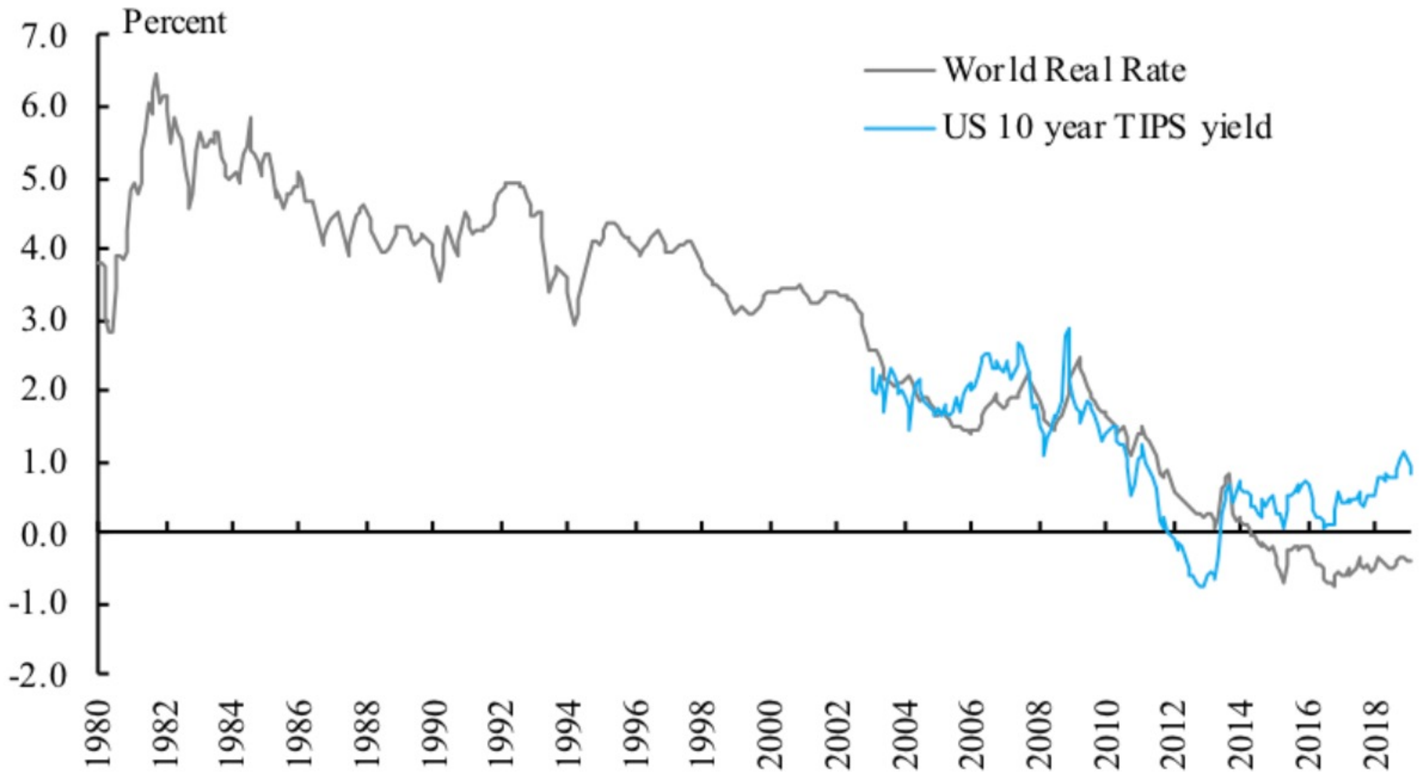
Economic policy steps taken

Risks going forward

Important policy insights in the years leading up to the pandemic

Insight 1: Real interest rates on safe assets had gotten really low

Real Interest Rates on Government Bonds in Advanced Economies



Screenshot from Rachel and Summers (2019); rates implied by inflation-linked government securities

Interest rates had fallen markedly since the early 1990s

Economists believe this decline has stemmed from trends related to the supply and demand for savings (demographics, technology, income inequality, …) that are not likely to reverse any time soon

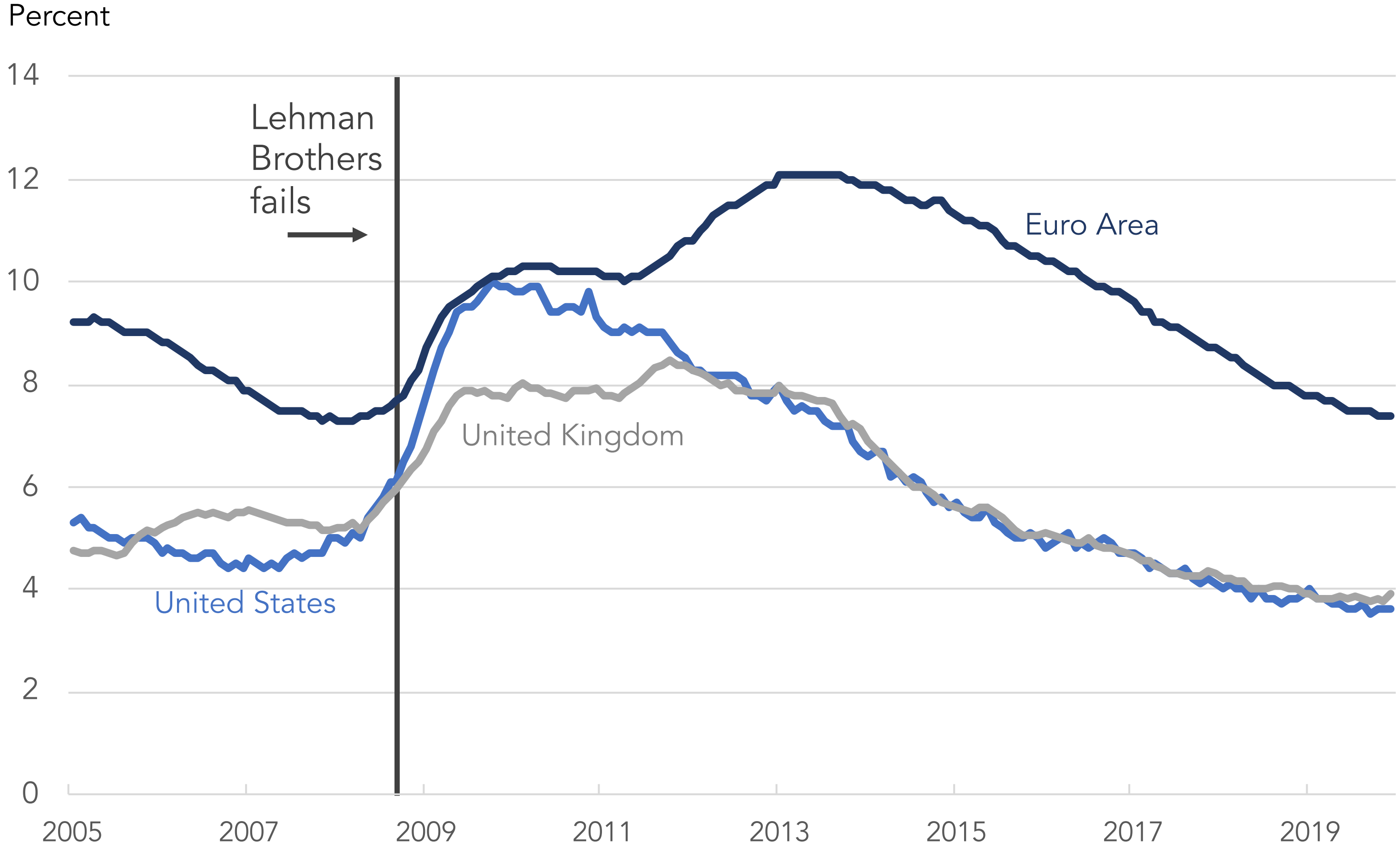
Some key implications

Monetary policy, which had been many governments' main tool for fighting recessions, was no longer as useful because "jumping off point" for cutting interest rates when the economy weakens is much lower (the "zero lower bound" problem)

Fiscal policy was less costly as a tool for fighting recessions

Insight 2: It can take a long time to recover from a bad recession

Unemployment Rates, 2005-2019



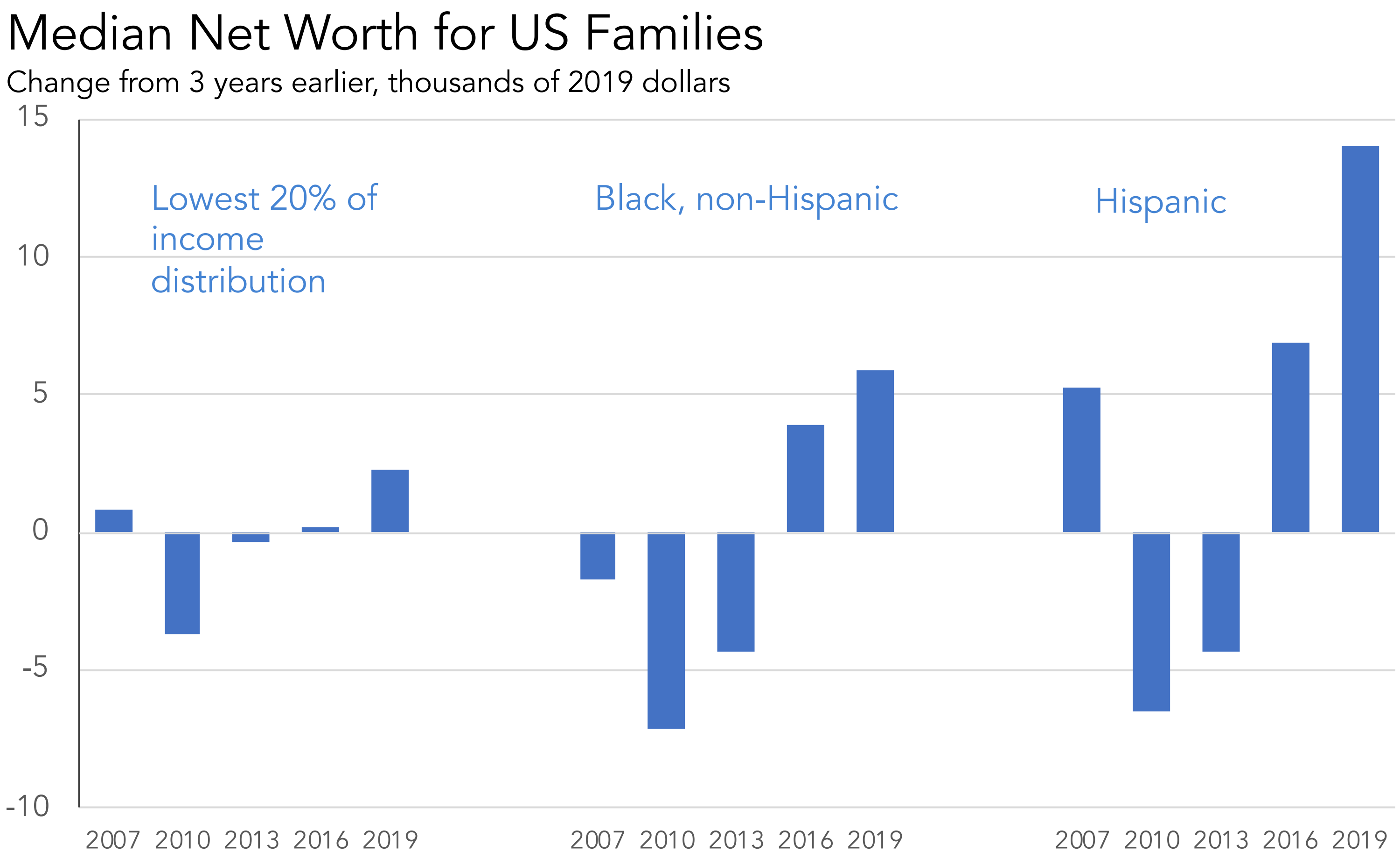
After the financial crisis, it took **about a decade** for the UK and US unemployment rates to revert to their pre-crisis levels

It took a dozen years for the Euro area to do so

Data from FRED (here, here, and here)

Insight 3: "High pressure" (robust) economies have important distributional benefits

For example, the robust US labor market of the late 2010s led to **measurably stronger family finances for traditionally low-wealth groups**

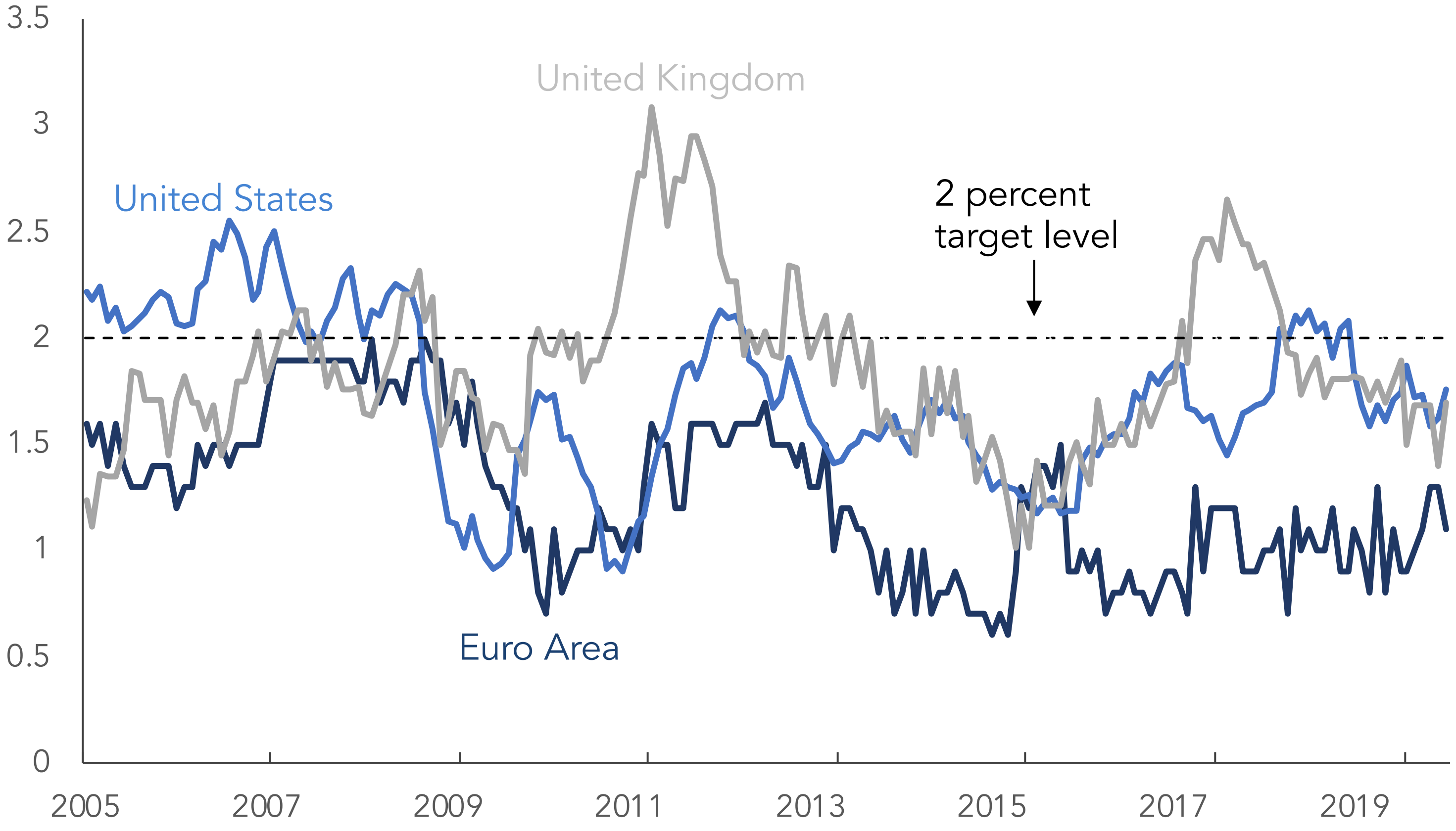


Data from Survey of Consumer Finances

Insight 4: "High pressure" economies don't have to have high inflation

Core Consumer Prices, 2005-2019

Percent change from year earlier



Even as labor markets heated up in some economies in the late 2010s, inflation was mostly below central banks' targets

Economists think inflation depends not only on the strength of labor markets **but also importantly on inflation expectations**

Data from FRED (here, here, and here)

Key features of the COVID-19 recession

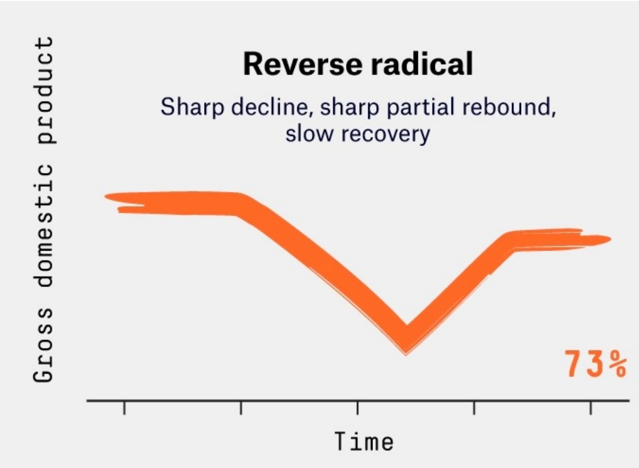
Common themes across countries

Deep plunge in economic activity as countries shut down in spring 2020

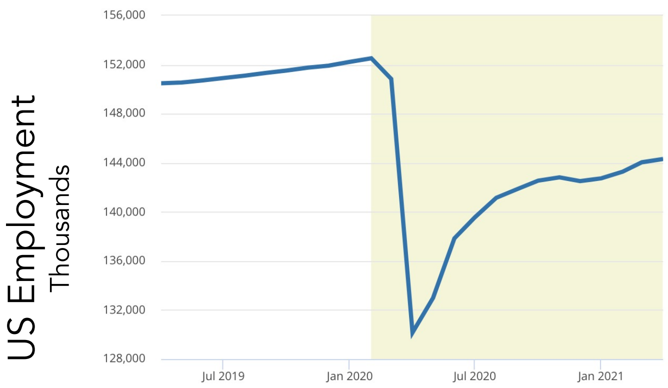
Sharp partial economy recovery as businesses that could safely reopen did so

Sub-normal pace of economic activity thereafter (weakness concentrated in high-contact services industries)

***Robust recovery** only after a large share of population vaccinated*



Screenshot from [fivethirtyeight.com]

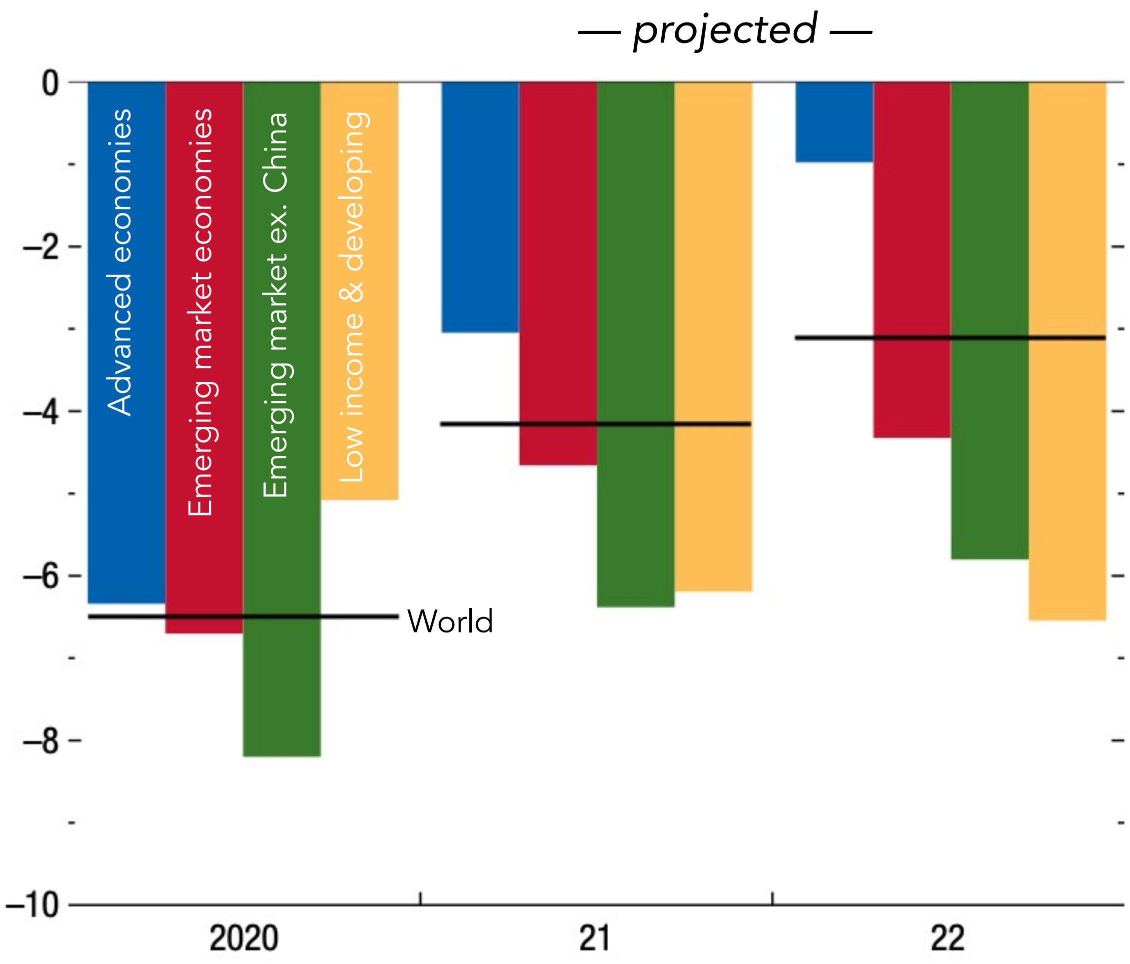


Screenshot from [FRED]

But some countries have been hurt much more than others

Revisions* to Level of Per Capita GDP

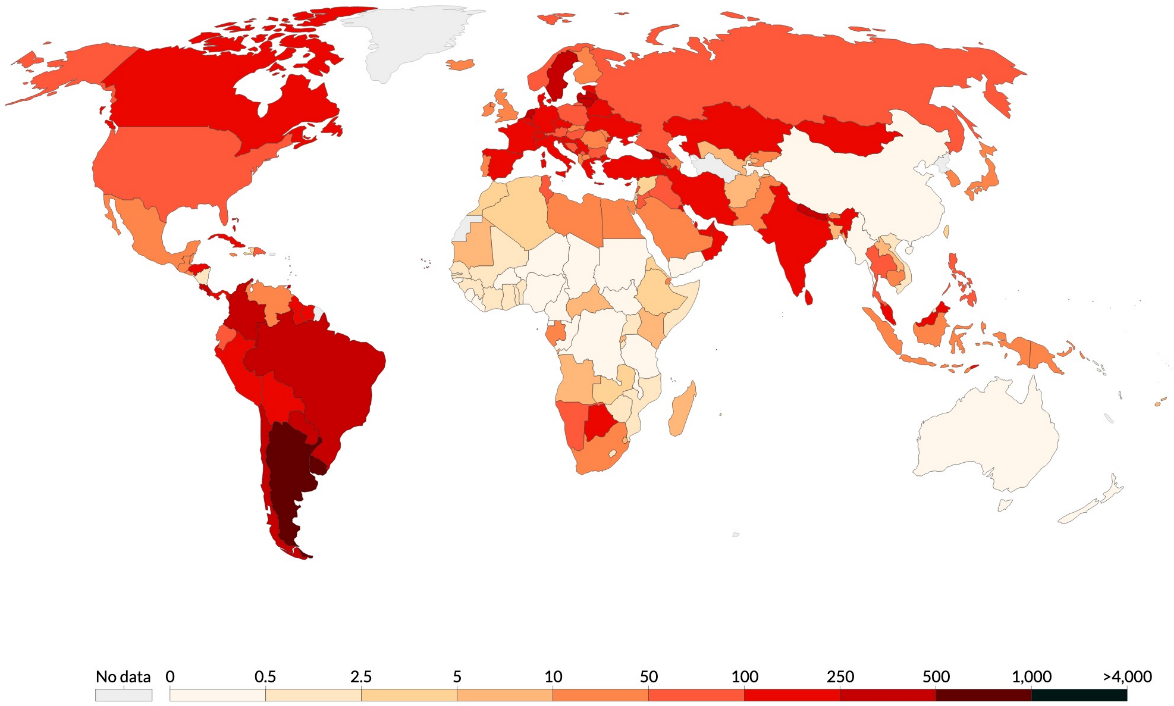
*April 2021 forecast relative to January 2020 forecast



Screenshot from the [IMF]

Country disparities reflect in large part the path of the virus (and, relatedly, the availability of vaccines)

New Confirmed Virus Cases per Million
Average over week ending May 17, 2021



Screenshot from Our World in Data; numbers understated in countries where testing is limited

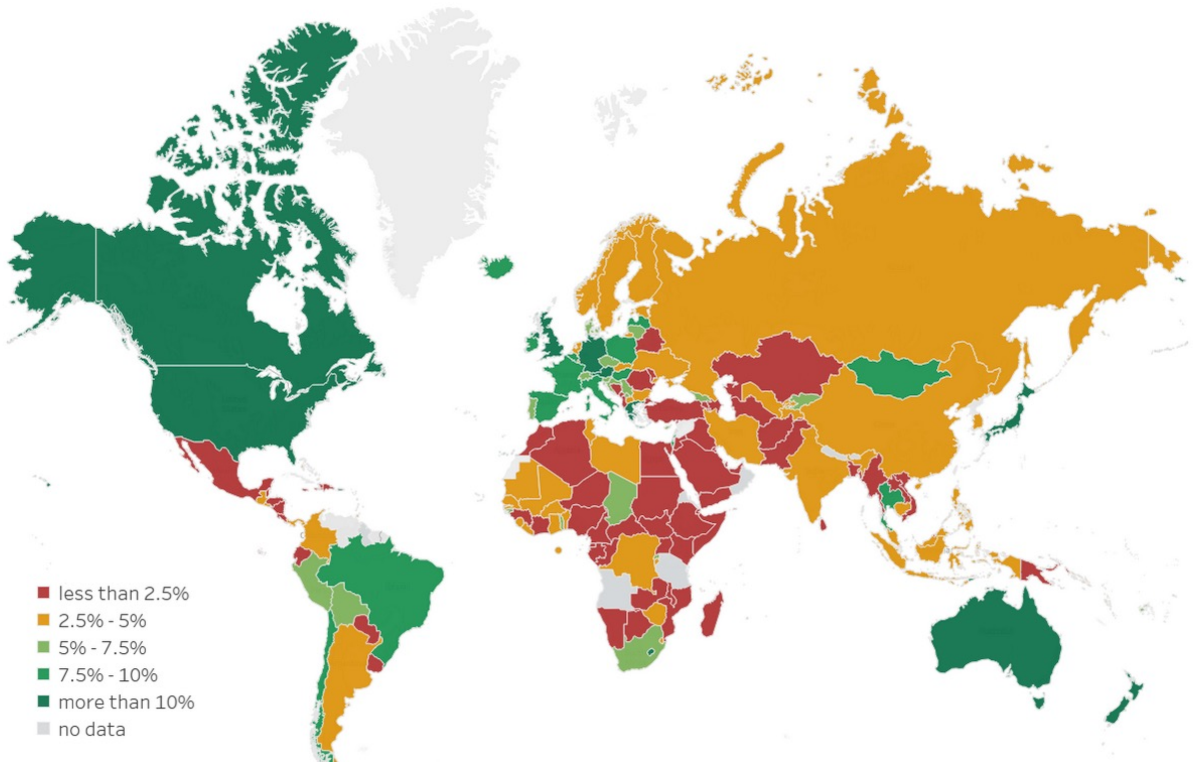
*In emerging market and developing economies, vaccine procurement data suggest that **effective protection will remain unavailable for most of the population in 2021**.*

IMF (2021) p. 11

Country disparities reflect in large part different amounts of fiscal support

Enacted Fiscal Policy Response

Percent of 2020 GDP

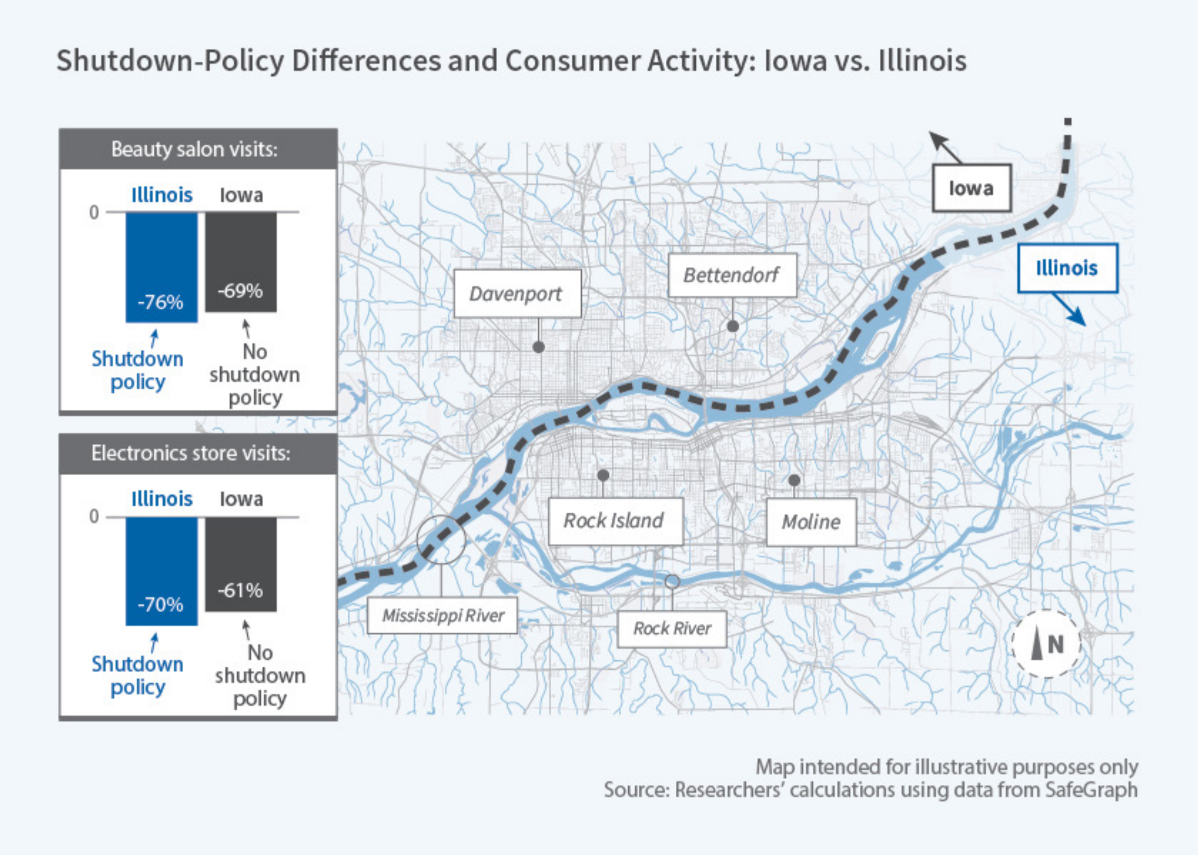


It's difficult to quantify the responses on a consistent basis because enacted fiscal policy has taken different forms, has different timing, and some is open-ended; but this map gives you a general idea

Countries spent different amounts because of different needs and, importantly, different ability to borrow to finance spending

Screenshot from IMF

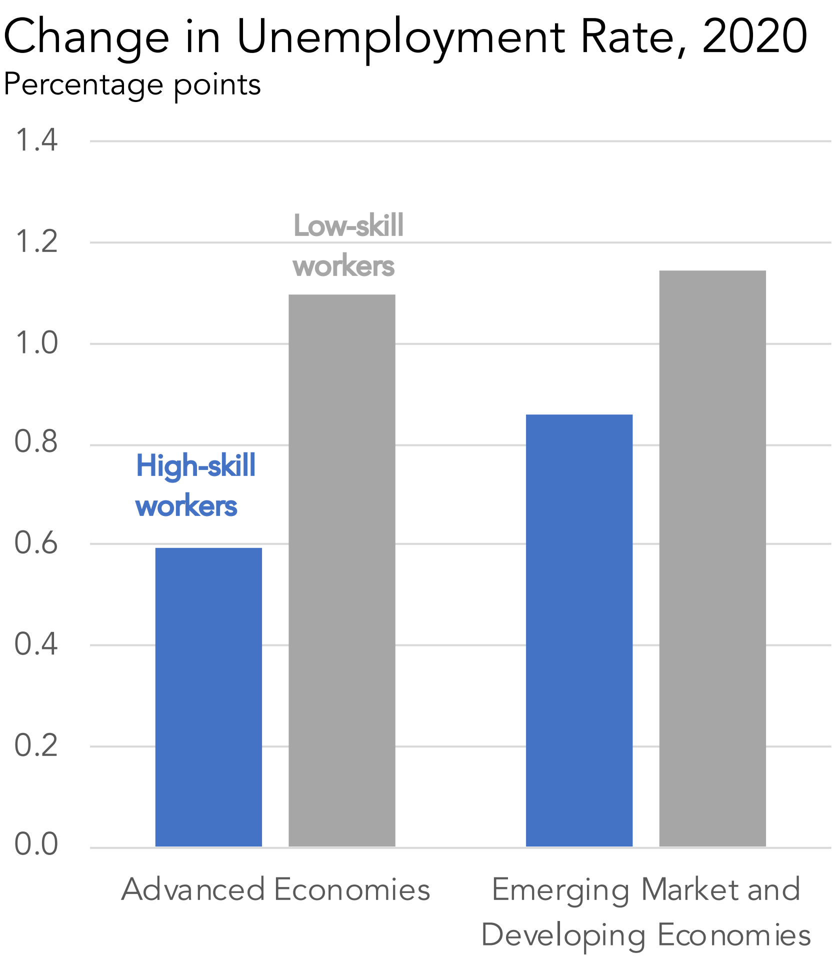
The degree to which formal restrictions have contributed to regional disparities is unclear

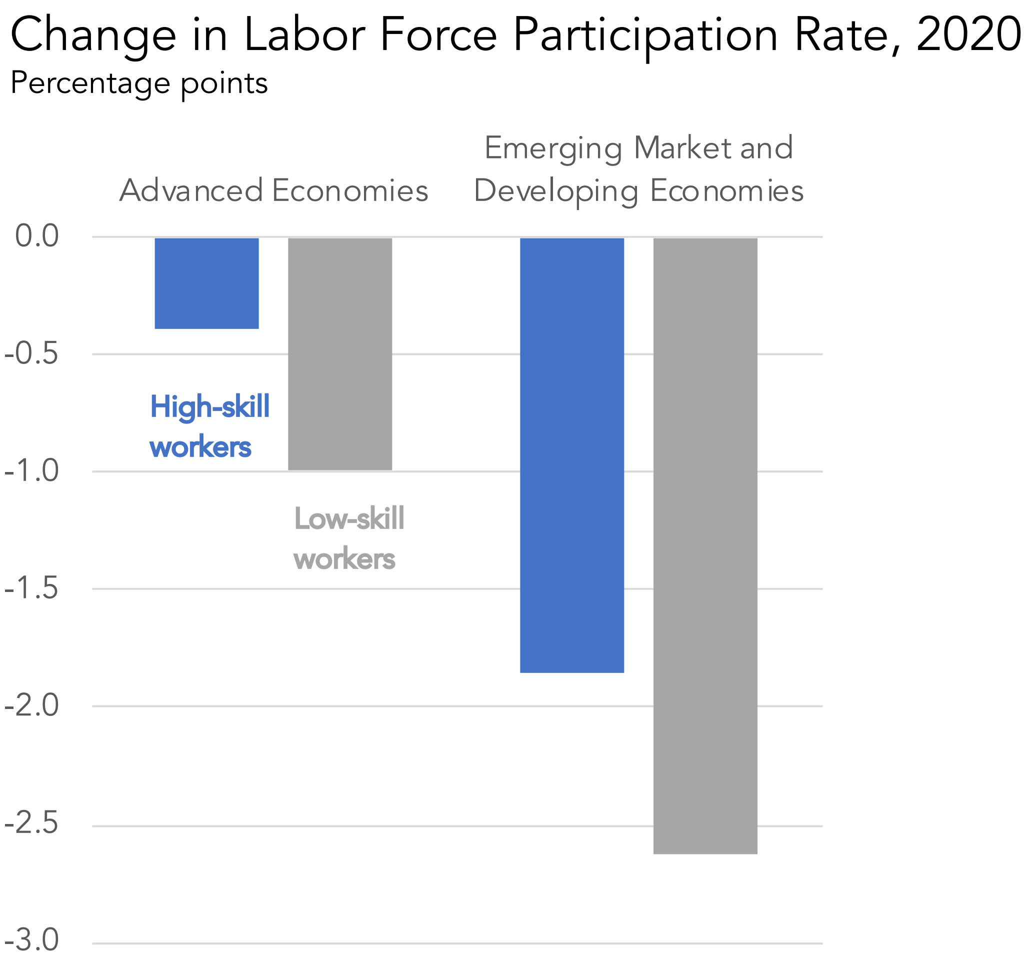


Screenshot from NBER (2020)

Some studies, like Goolsbee and Syverson (2020), have compared neighboring areas with different lockdown policies and found very similar declines in economic activity

Some types of workers have been hurt more than others





Data from IMF *World Economic Outlook* (2021)

Economic policy steps taken

Monetary policy may have been limited by low interest rates, but central banks played an important role

Do you remember the financial crisis of 2020?

(Hint: March 2020 saw severe financial market dysfunction around the world)

Bloomberg

Deals

Dash for Cash On as Corporate Titans Draw Down Credit Lines

By Sridhar Natarajan and Yalman Onaran
March 11, 2020, 9:47 PM EDT *Updated on March 12, 2020, 9:24 AM EDT*

- Blackstone, Carlyle advise portfolio companies to tap loans
- Wave of borrowers include businesses hit by virus, oil slump

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Monetary policy may have been limited by low interest rates, but central banks played an important role

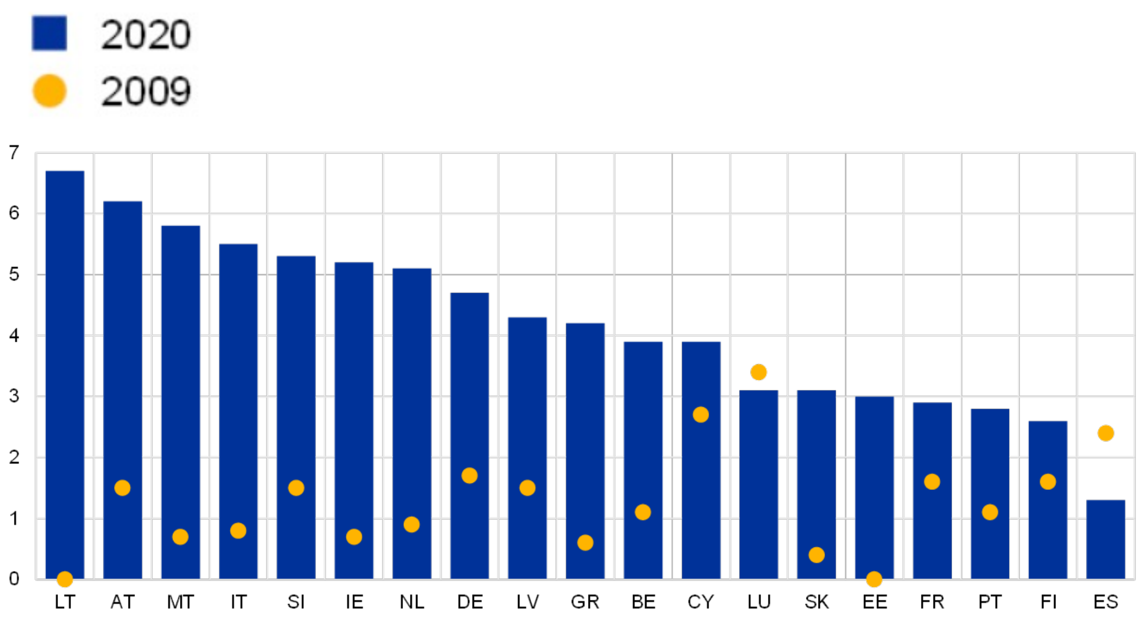
Most people don't remember the financial crisis of 2020 because central banks stepped in swiftly to provide trillions of dollars of liquidity to markets

Central banks followed up with various lending programs to make sure that credit continued to flow to key sectors of the economy

In the absence of such steps, we might have seen a much more severe and lengthy financial crisis that greatly amplified the pandemic economic crisis

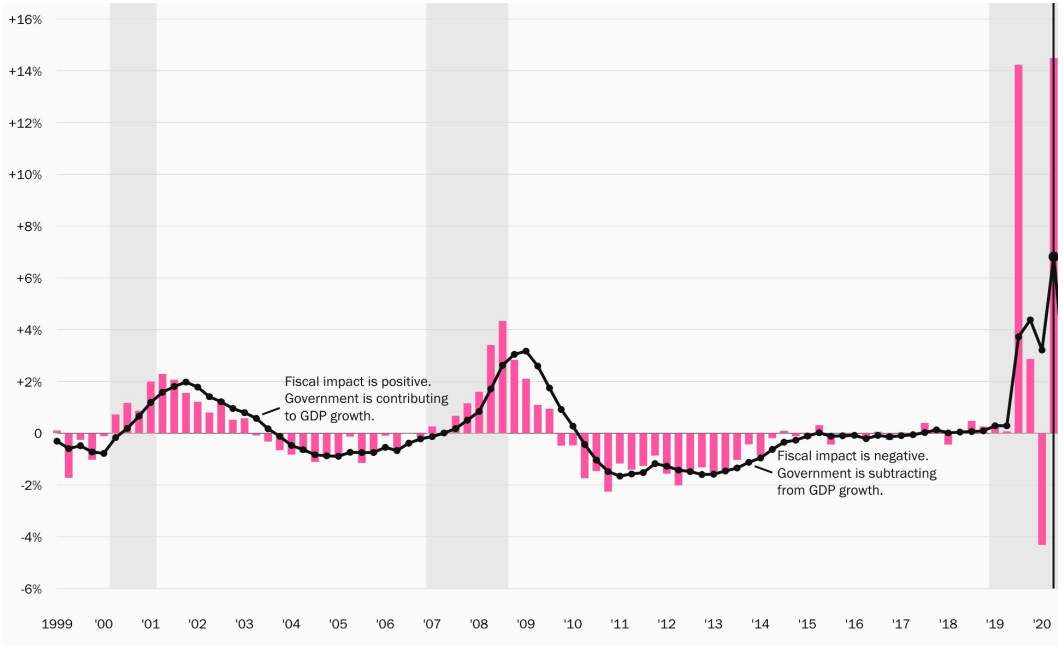
The fiscal policy response (for the countries that could afford it) has been larger than after the financial crisis

Discretionary Fiscal Policy in Europe
Percent of GDP



Screenshot from ECB (2021)

Impact of Fiscal Policy in the United States over Time
Contribution to GDP Growth (percentage points)



Screenshot from Brookings (2021)

Fiscal support has taken different forms

Measures to **protect households**—e.g., "COVID checks," payments to businesses to retain employees, household tax credits, expanded unemployment benefits, enhancements to other safety net programs, in-kind support

Measures to keep **businesses from failing**—e.g., tax breaks, grants, loan guarantees, subsidized loans

Measures to **fight the virus** and **support the health care system**—e.g., money for PPE, testing, vaccine procurement, hospitals

What should the goals of fiscal policy be under these circumstances?

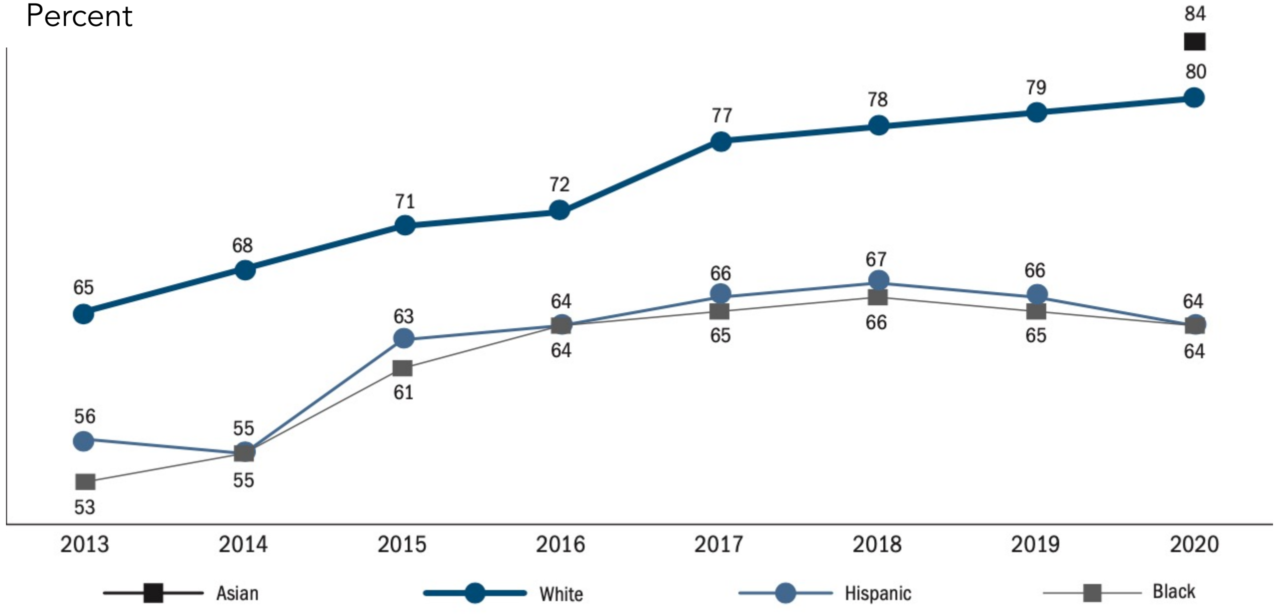
1. Fight the virus—money to support the health care system, PPE, vaccine development and distribution
2. Relieve hardship—avoid huge cuts in consumption in the face of enormous job loss

Did fiscal policy relieve hardship?

Hardship has occurred, and it will be years before we understand the full extent of it in countries around the world

However, it would appear that fiscal measures blunted the effects of the massive job and earnings losses (albeit for some groups more than others)

US Households Doing "At Least Okay"
Percent



Screenshot from Federal Reserve (2021)

What should the goals of fiscal policy be under these circumstances?

1. Fight the virus—money to support the health care system, PPE, vaccine development and distribution
2. Relieve hardship—avoid huge cuts in consumption in the face of enormous job loss
3. Avoid scarring—minimize damage to economic structures that will weigh on the recovery or cause a permanently lower level of output over the longer run

Scarring is what made the last recession the "Great" Recession

Households	Businesses	Governments	Financial System
Erosion of skills, loss of labor market attachment due to prolonged unemployment Foregone skill development because of closed schools Household debt overhang because of limited income	Loss of organizational capital when businesses fail Business debt overhang because of limited revenues	Sub-national budget strains because of higher spending + reduced tax revenues + balanced budget requirements Unsustainable debt positions for countries hit especially hard	Weakened or failed financial institutions leading to credit crunch

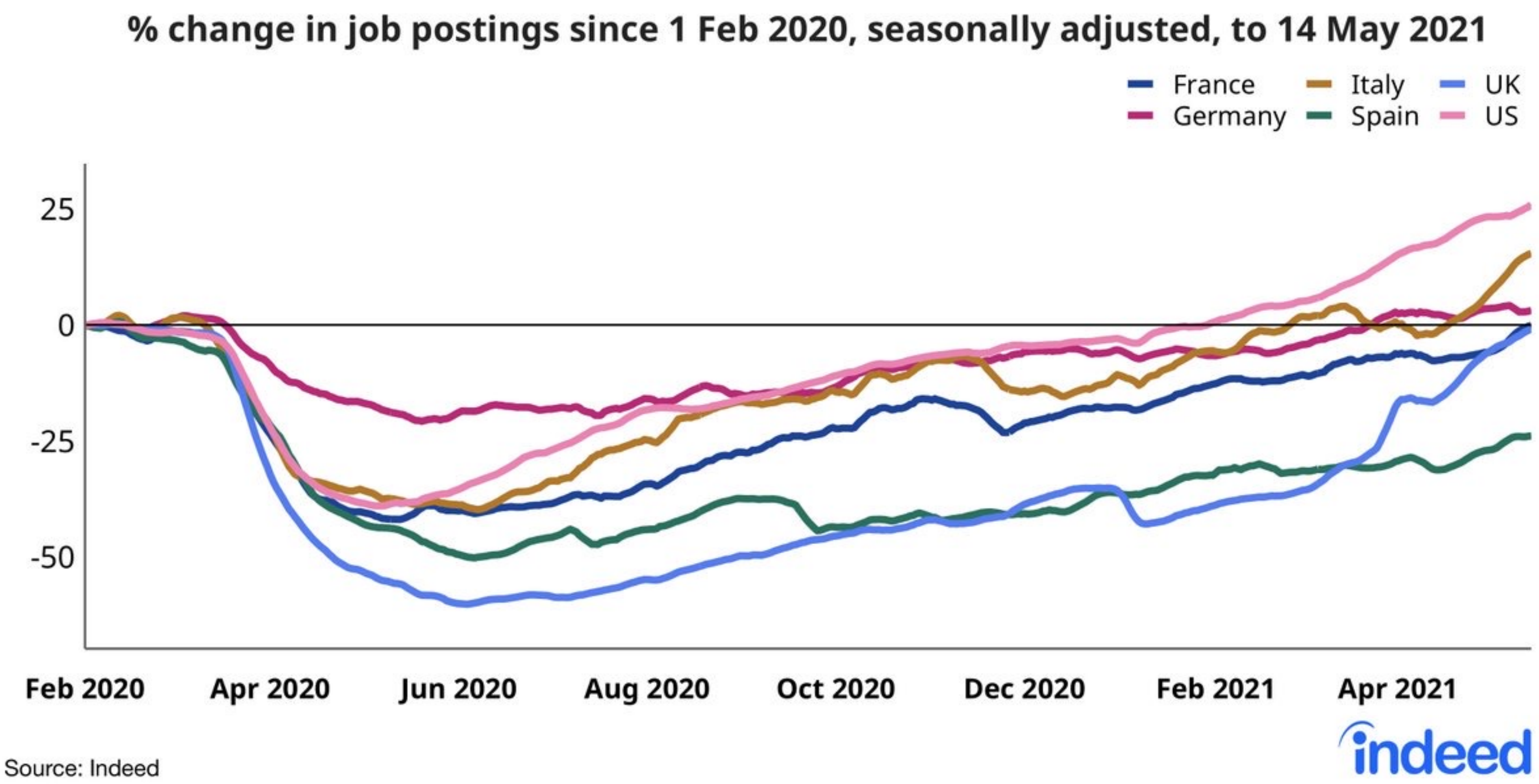
What should the goals of fiscal policy be under these circumstances?

1. **Fight the virus**—money to support the health care system, PPE, vaccine development and distribution ✓
2. **Relieve hardship**—avoid huge cuts in consumption in the face of enormous job loss ✓
3. **Avoid scarring**—minimize damage to economic structures that will weigh on the recovery or cause a permanently lower level of output over the longer run ✓
4. **Fiscal stimulus**—the traditional goal; restore aggregate demand to its pre-pandemic levels ←

Do we really want this while supply is constrained? I will return to this question in a minute

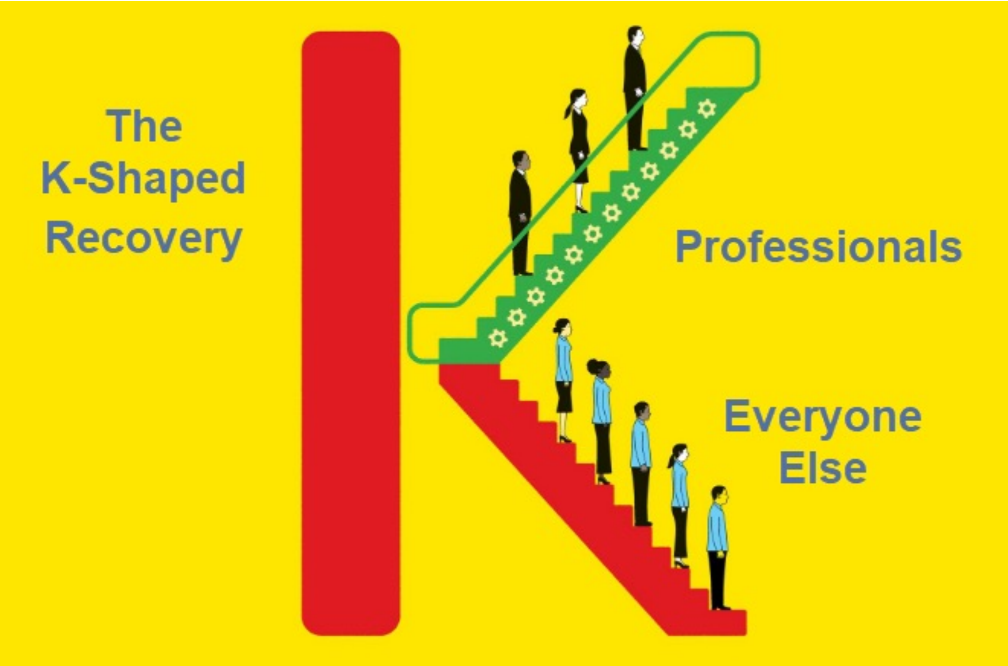
Risks going forward

Pent-up demand is expected to power strong economic recoveries once populations are vaccinated



Source: Indeed

Risk 1—An ongoing K-shaped recovery



Screenshot from thestreet.com

As already discussed, job losses were concentrated among lower-income workers

Prospects are looking brighter for these workers, but **how long will it take to put tens of millions of them back in jobs**—particularly as surviving businesses emerge leaner and with more automation?

Economies may emerge from the pandemic with even higher income inequality

Policy priorities

Focus now on **worker reallocation measures** (a pivot if previous focus was job retention policies)

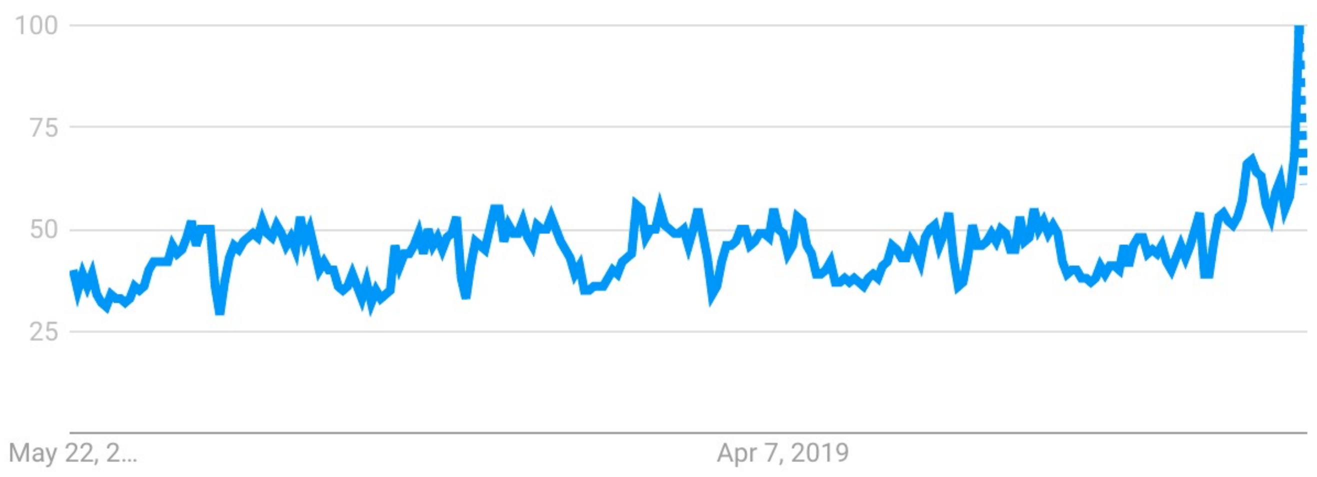
- Deploy "active labor market policies" such as training and assistance with job search

For the longer-term:

- Create **stronger social safety nets**—particularly in countries with weak ones
- **"Invest" in poor children** and their families—address basic needs (food, housing, health care) and provide access to high quality education (pre-K and college)

Risk 2—A rise in inflation to undesirable levels

Google Searches for "Inflation" over Past Five Years



Screenshot from [Google Trends]

Yes, everyone is talking about it

How to think about inflation

Economists think **one key determinant of inflation is "slack" in the economy**

It's not hard to see why people think slack is diminishing sharply—the pickup in aggregate demand in coming months may well exceed the pace at which economies are able to open up (the increase in aggregate supply)

But to have a sustained rise in inflation, **it's necessary for inflation expectations to rise**

Inflation expectations have risen in recent weeks, but **the level is not particularly high**

US Long-term Inflation Expectations

Percent

Screenshot from FRED

Policy priorities

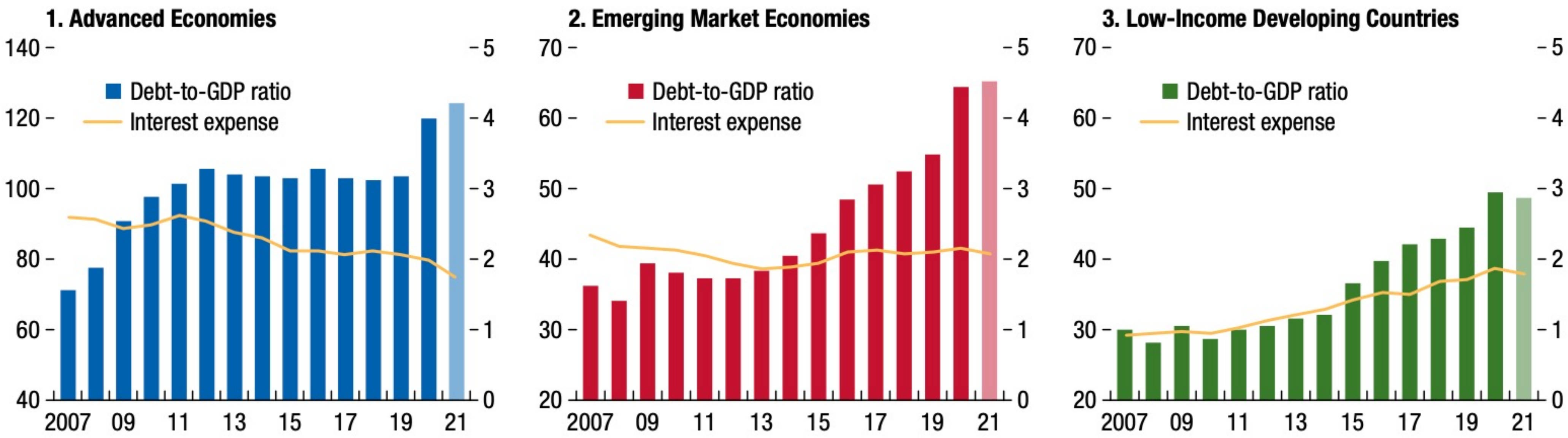
Central banks need to **vigilantly monitor inflation indicators**—especially inflation expectations

Tighten monetary policy **but only if it becomes clear that inflation is undesirably high on a sustained basis** (in the United States, that likely means rising above 2½ percent for a sustained period)

- Communicate likely central bank actions well so as not to unsettle financial markets with the move (i.e., try to avoid a "hard landing")

Risk 3—High levels of government debt

Low government borrowing rates have reduced concerns about the pandemic-drive rise in debt in richer countries but there are more concerns about the rise in debt in emerging market and low-income countries



Sources: IMF, World Economic Outlook database; and IMF staff calculations.

Concerns about emerging market and developing economies

Already, it's clear that many lower-income countries are experiencing slow recoveries and humanitarian crises from fiscal constraints

But, also, there's potential for sovereign debt crises—and ripple effects on the global financial system if borrowing rates for these countries rise, defaults increase, and lenders take losses

FINANCIAL TIMES

Prepare for emerging markets debt crisis, warns IMF head

Georgieva says global recovery and rising rates will draw capital from vulnerable countries

Shoppers in a plaza in Nigeria. The IMF has urged member countries to support efforts to relieve financial pressures in middle- and lower-income countries © Bloomberg

Chris Giles in London MARCH 30 2021 17

Read the article here

Policy priorities to address high debt and fiscal constraints in lower income countries

International cooperation is essential

- Higher-income countries need to support that expansion of vaccines in the rest of the world
- International institutions need to provide financing and grants for these countries
- Government debt payments are eligible for suspension in some countries, but debt restructuring may be needed if the rates at which their governments can borrow rise significantly

Thank you!