# The Macro-Economic Implications of COVID-19 in our partner countries

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# Preliminary remarks

- Welcome
- Who is on the call?
- Countries the Growth Lab is working with, has worked with, is planning to work with
  - Albania, Bolivia, El Salvador, Ethiopia, Jordan, Namibia, Oman, Panama, Peru, Saudi Arabia, South Africa, Sri Lanka, Venezuela, Western Australia
- About Zoom
  - New to the technology
  - Participants window
  - I will mute all
  - You can raise your hand
  - You can unmute yourself to speak
  - Also a chat window: public, private
  - Instability in the transmission: I may temporarily stop when I get a signal of low speed
  - I will be recording the talk
- We are planning to schedule bilateral conversations for any country that wants it, to talk about your specific issues

# Introduction

- We are in uncharted waters
- Governments are having to make decisions at a very fast pace, without much time to think
- They are facing difficult moral trade-offs
- There are two elements that make the discussions difficult
- The connection between public health and macroeconomics is weak
  - The virus and the health policies have economic implications that are poorly understood
  - We are now having the first models that combine the two elements
- Macroeconomic policy discussions are centered on the US and advanced countries
  - They do not consider the constraints that are typical in other countries
- In this talk, I want to connect the macroeconomics of developing countries to the COVID-19 shock and derive courses of action for domestic and international policy

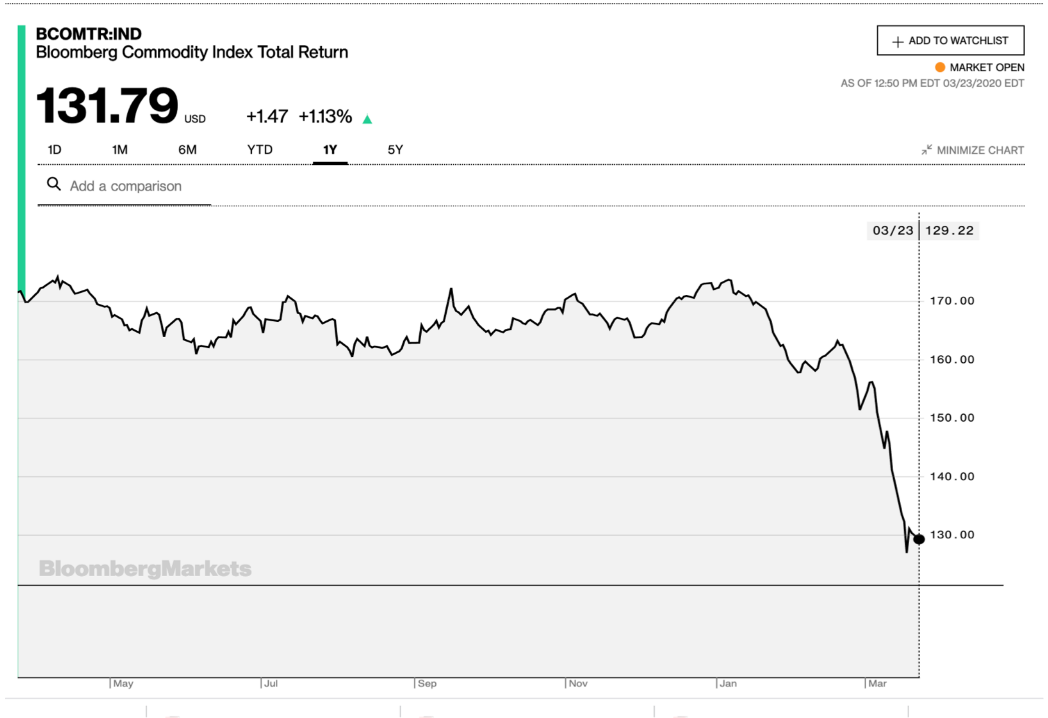
# What is happening?

- When it rain, it pours: three simultaneous shocks
- Coronavirus COVID-19
  - How to think about it from an economics perspective?
- Collapse in access to foreign income
  - Collapse in commodity prices
  - Collapse in tourism
  - Expected collapse in remittances
- Collapse in access to capital markets
  - Some countries have no access, others are used to have ample access
    - E.g. Ethiopia vs. El Salvador vs. Australia

# Let us look at the other shocks first

- Commodities
- Tourism
- Remittances
- Capital markets

# Commodity prices have taken a large hit

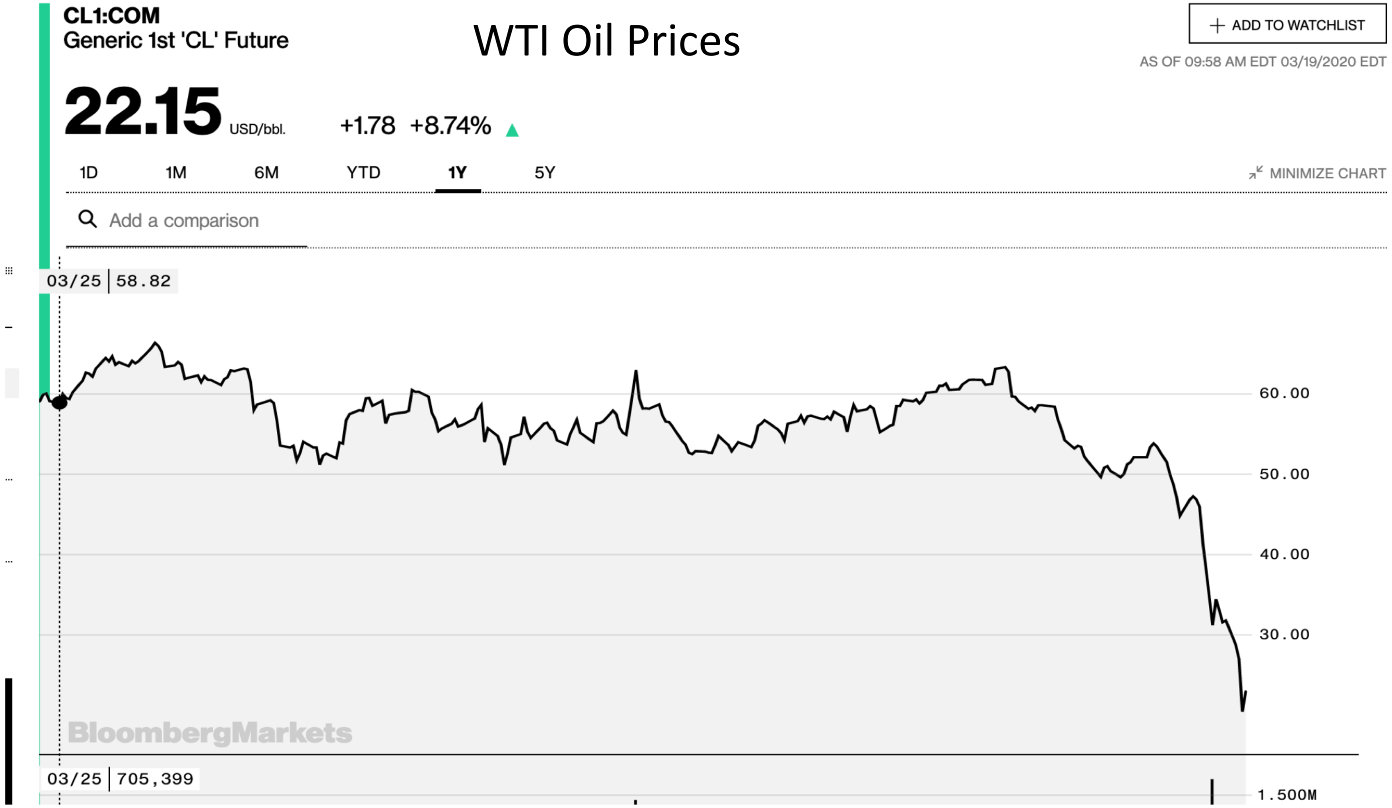



Aggregate commodity index

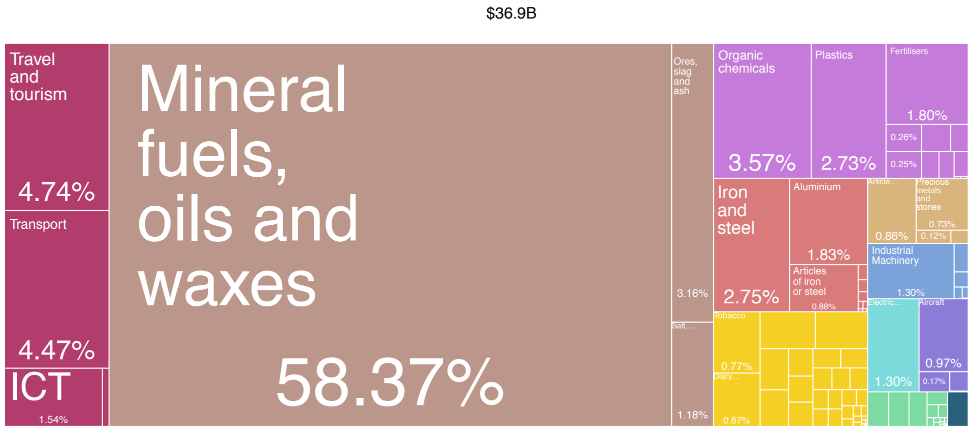

Copper

# Oil prices have been hit especially hard

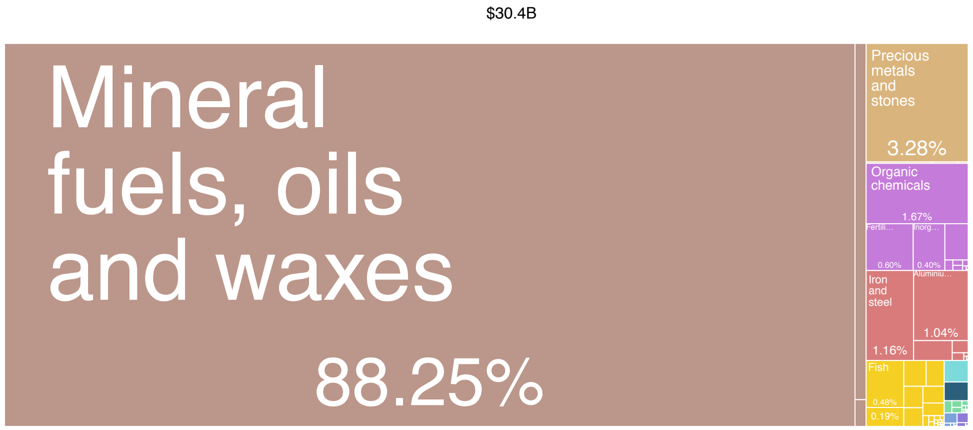
- Oil prices declined to the lowest levels since 2003!!!
- Bad news for oil exporters
- Good news for oil importers



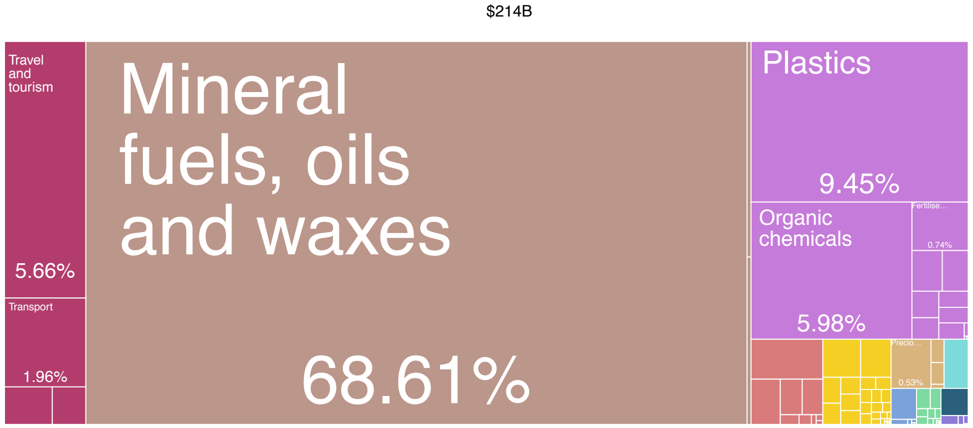
# Oil exporters in the call




Oman



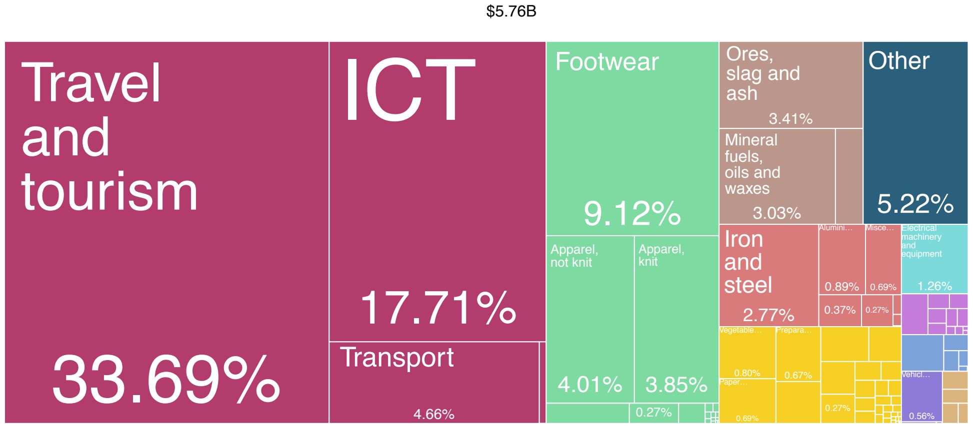

Venezuela




Saudi Arabia

# Tourism is an important activity in some of countries

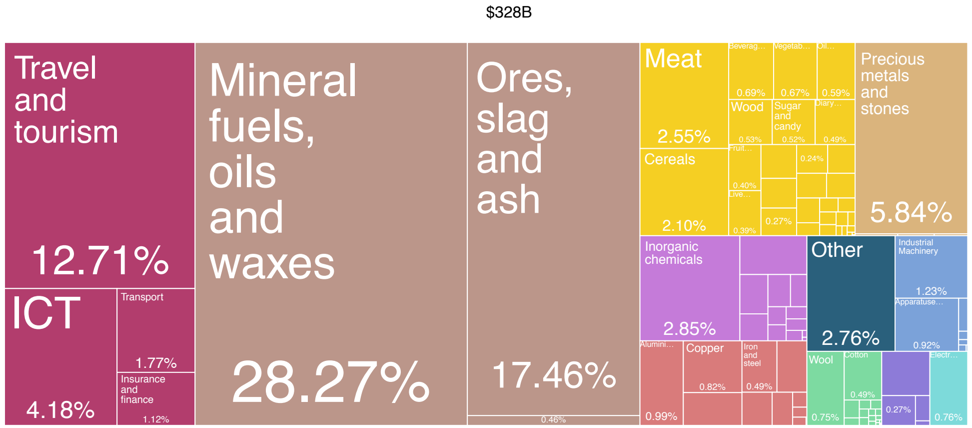
Albania




Panamá

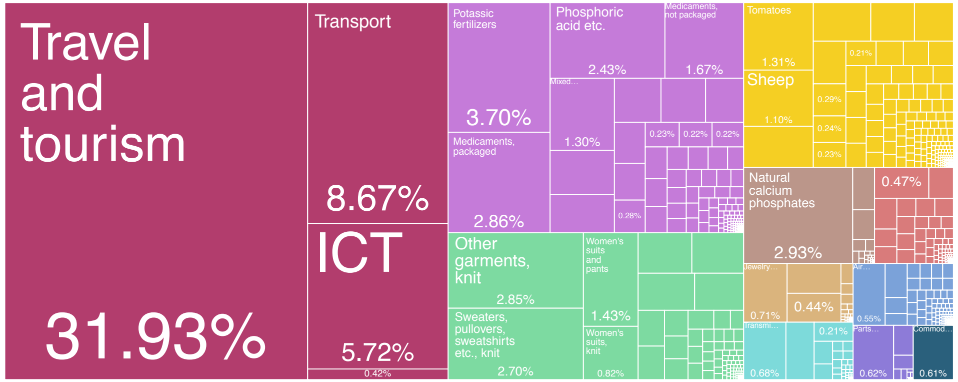

# Australia has a mix of mining and tourism

Australia



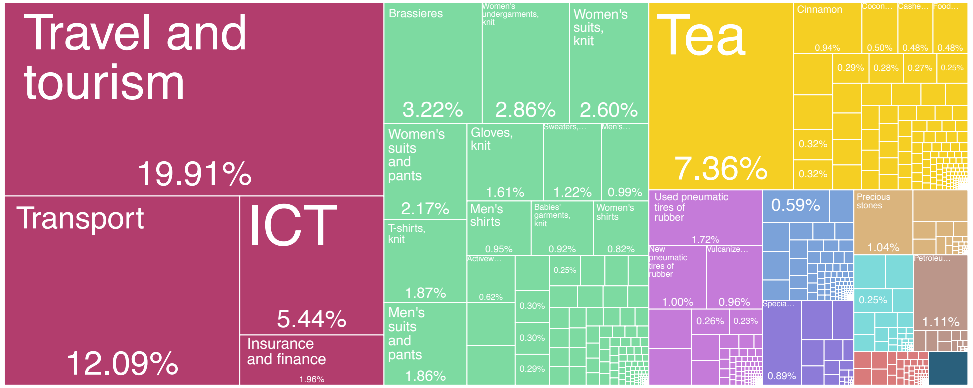
Jordan

$14.5B

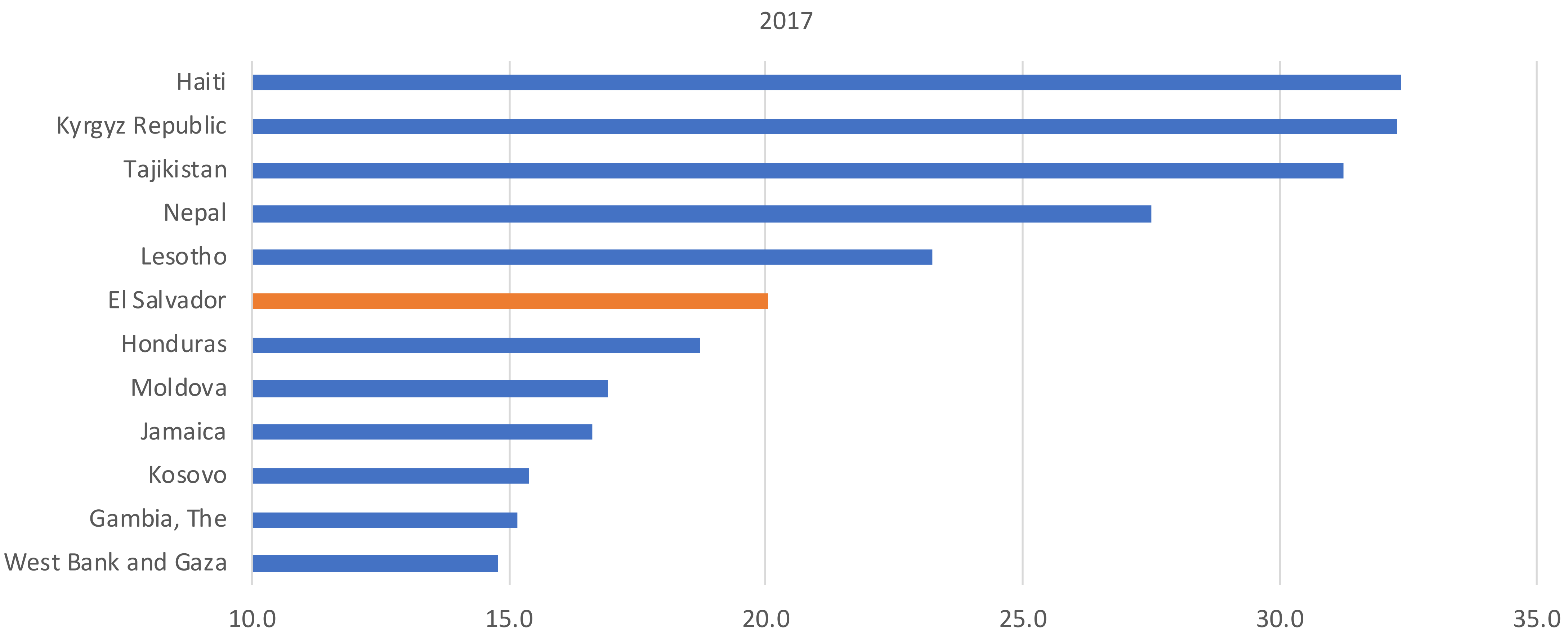



Sri Lanka

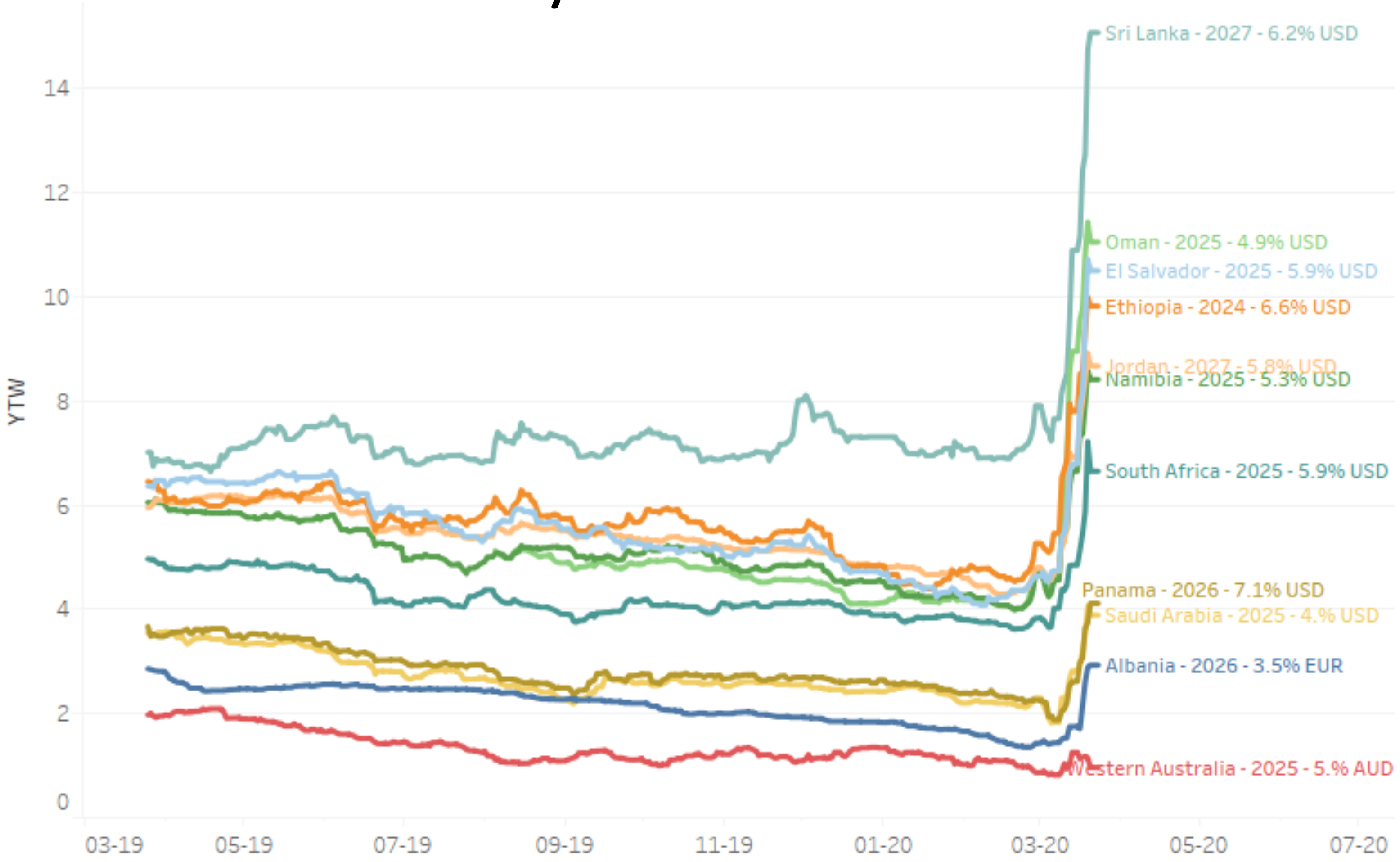
$19.7B



# Some countries are highly dependent on remittances



# Bond yields have sky-rocketed




Source: S&P Capital IQ

# Bad temporary shocks to the current account call for more borrowing from abroad

So the capital market shock (sudden stop) comes at a very bad time

# All of these are shocks we have seen before

- We know, in principle, how to handle them
- Three ingredients
- Increased external (official) finance
  - Especially if the shock is temporary, as we hope this one will be
  - This facilitates making needed adjustments more gradually
- Adopt expenditure reducing policies
  - Cuts to public and private deficits through fiscal and monetary contraction to bring spending in line with lower long-term income
- Expenditure switching policies
  - To make more of the spending go to local output through e.g. real exchange rate depreciation
- Typically, no room for fiscal stimulus to cushion the decline in output, as the deficit will grow because of the negative shocks, which would
- This approach is much less efficient when many countries are in the same boat
  - Like now, which is why we need more external official finance

# Countries with flexible exchange rates have seen automatic an fairly large adjustments


Chile

~15%


Colombia

~25%


Australia

~15%


Albania

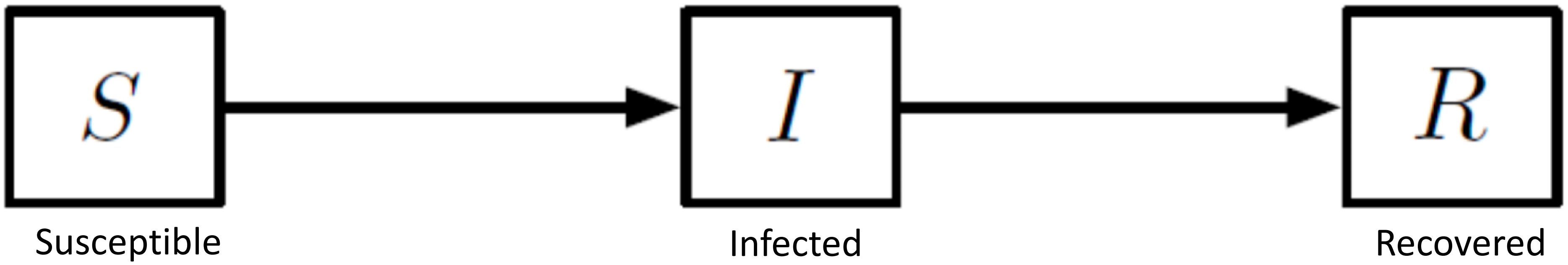
~2%

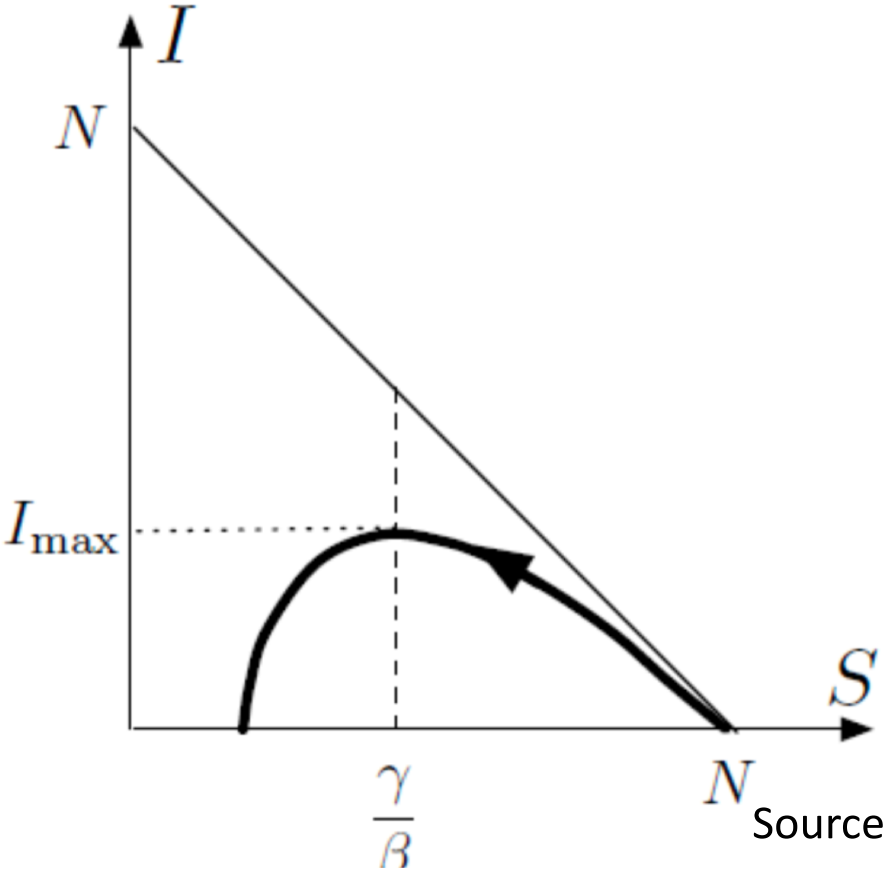
# Other countries have less flexible rates

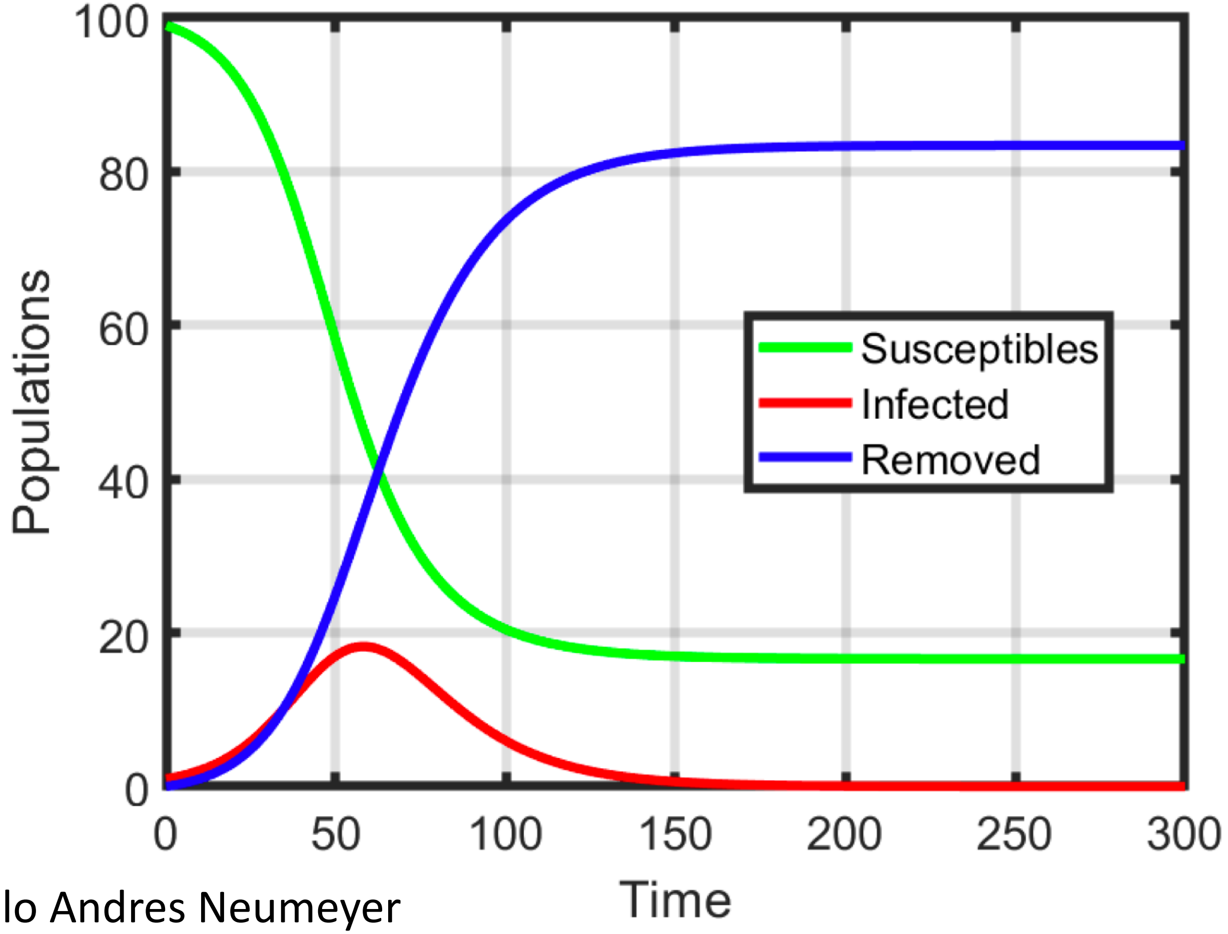
- Ethiopia and Sri Lanka have crawling pegs
- Jordan, Oman and Saudi Arabia have pegged exchange rates
- El Salvador and Panama are dollarized
- Strategies have to be reflective of this rigidity

# But what about Coronavirus COVID-19?

What kind of a shock is this?




Source: Pablo Andres Neumeyer

# The logic of flattening the curve

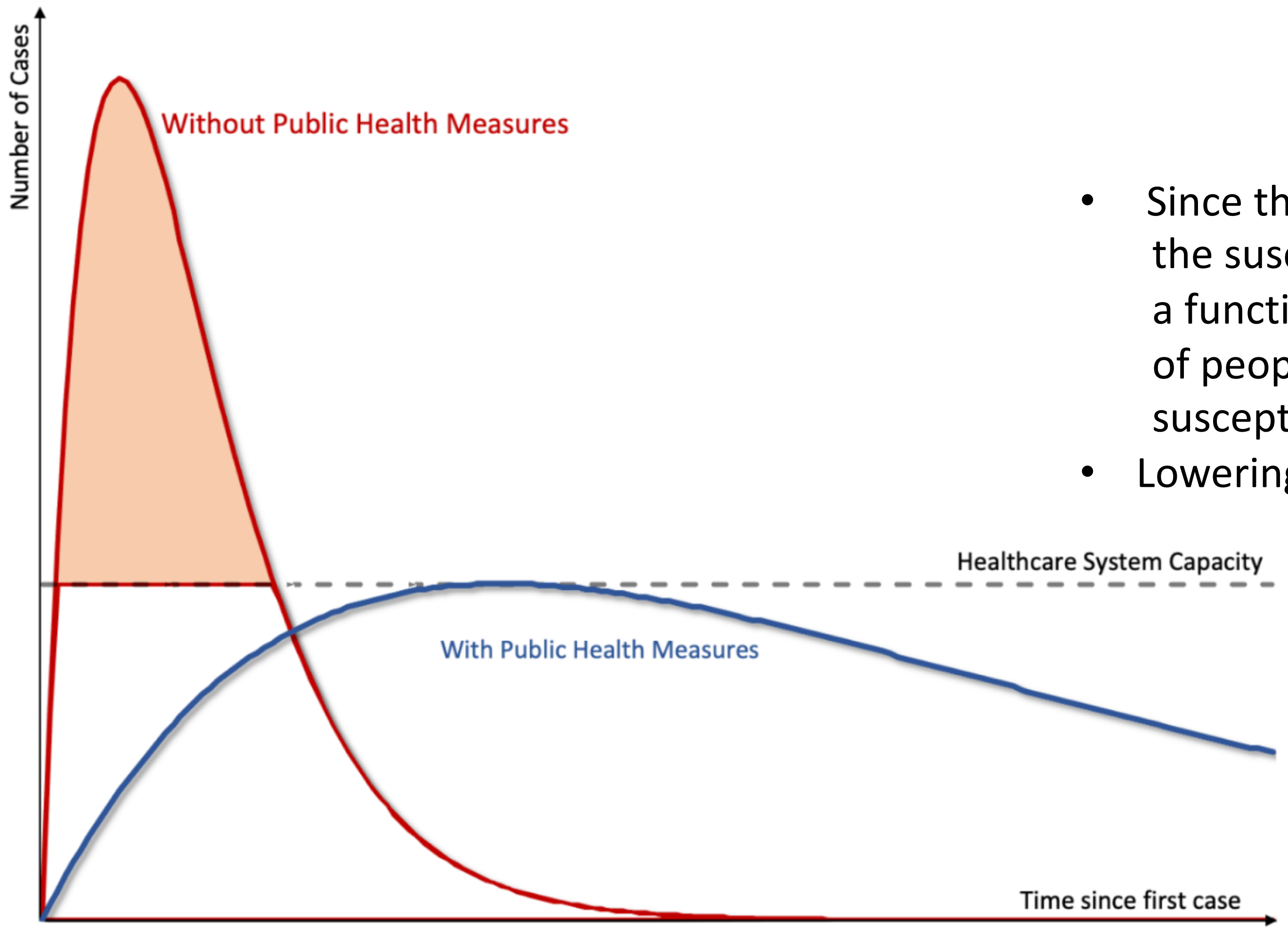



*Figure 1: Flattening the Pandemic Curve*

- Since the infected are the ones who contaminate the susceptible, the number of infected grows as a function of the number of infected times the number of people they infect Ro that are not immune (the susceptibles)
- Lowering Ro flattens the curve

Source: Pierre-Olivier Gourinchas

# Things to notice

- Flattening the curve means that there will be fewer cases at any point in time
- …but it is not clear what it does to the total number of people who eventually get the disease
  - Unless it gives time to develop a vaccine
- Prevents the health care system from being overwhelmed
  - This should lower the death rate, as patients that need them, would have ventilators and ICUs
- It delays the peak of the crisis
  - Makes the process longer
- Increases the chances that by then we would have better treatment and/or a vaccine

# But how do you flatten the curve?

- By restricting human activity
- Selective closures restrict parts of GDP
  - Harvard (especially Executive Education)
  - Theaters
  - Airlines
  - Bars, restaurants, gyms
- Lockdown impacts all activities
- But these decisions percolate through the economy amplifying the initial effect
  - Lay-offs, bankruptcies, non-performing loans in the banking system, supply-chain disruptions
  - Precautionary savings, delayed investment decisions cause a negative demand shock

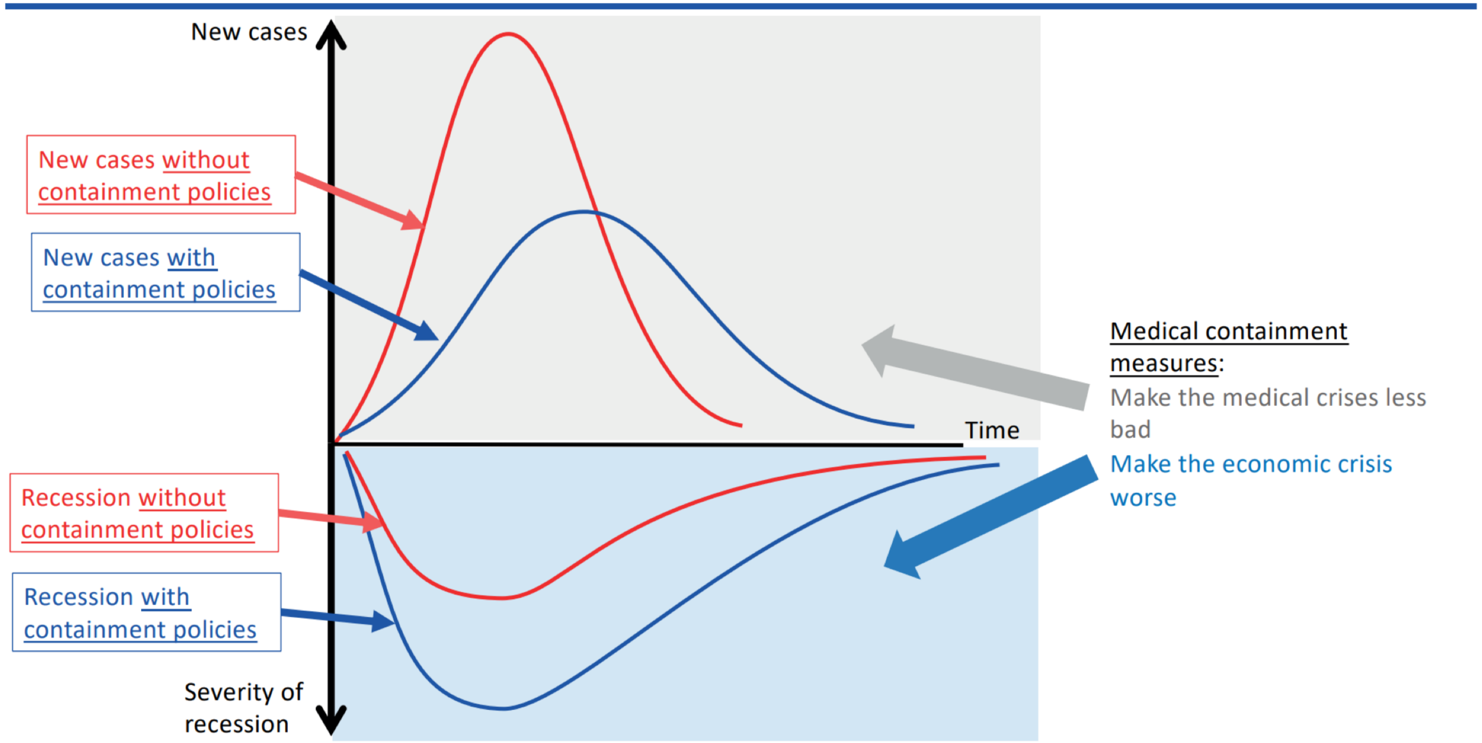
# What does this mean?

- The fight against COVID-19 starts as a supply shock
  - You cannot produce
- But as it percolates through the economy, some are hit by supply shocks
  - You cannot make X because somebody did not make input Y
- Others are hit by negative demand shocks
  - Laid-off workers spend less
  - Bankrupt firms will not invest and will not be there when the crisis is over
- This amplifies the initial contraction
- While the initial shock may be hard to avoid, this amplification could be addressed
  - Protect workers, firms, banks
- …using fiscal (i.e. public resources, capacity to borrow)

# This is different from a garden-variety recession

- It is a supply shock, not a demand shock
- It percolates through both supply and demand channels
- Traditional Keynesian policies have limited effectiveness
  - More demand for theater plays does not cause more plays in a lockdown
  - These activities are not lacking in demand
- Lay-offs and bankruptcies make the recovery much slower
  - Hard to hire, hard to form new ventures
- So fiscal policy can help but not through the standard channels
  - By helping people and firms withstand the shock

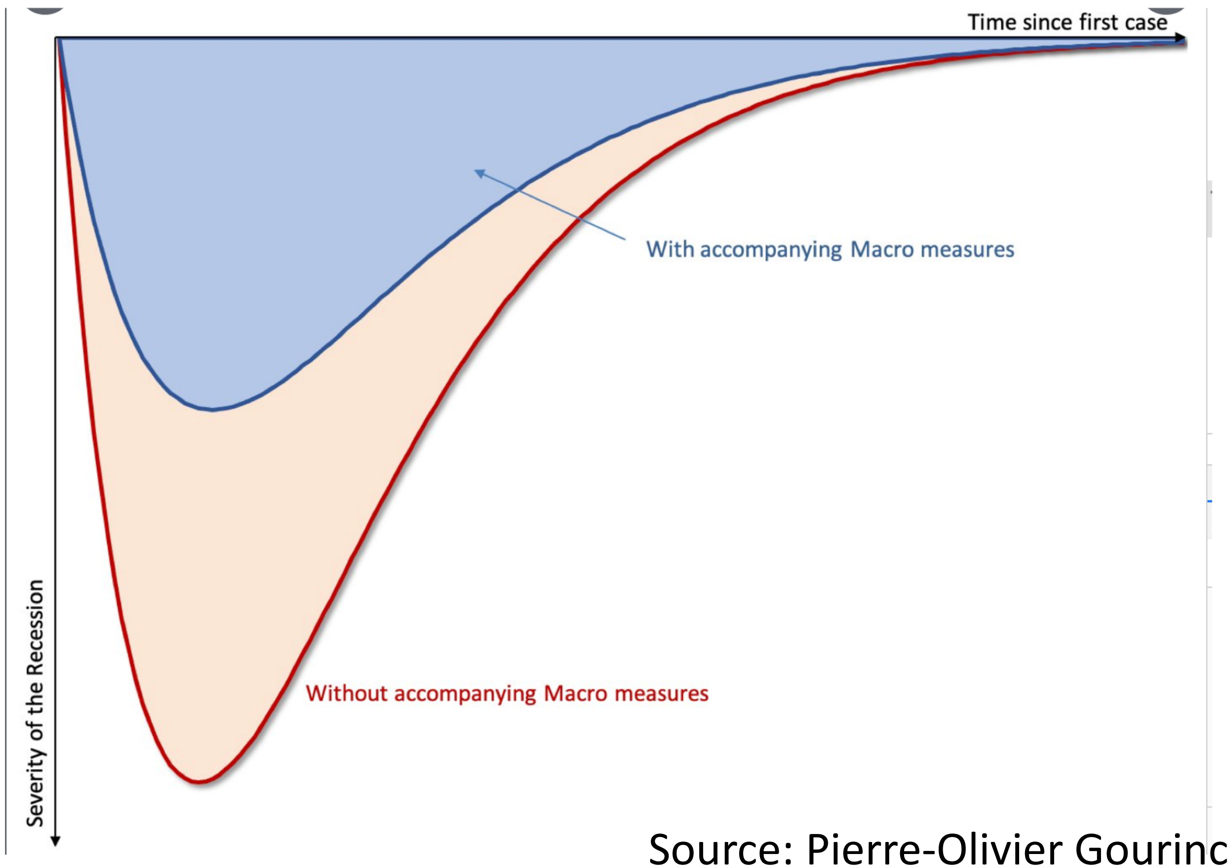
# Flattening the epidemic curve worsens GDP




*Source:* Author's elaboration, inspired by illustrations in the chapter by Gourinchas.

Source: Richard Baldwin

# The difference between the shock with and without fiscal protection




Source: Pierre-Olivier Gourinchas

# So the solution seems to be clear

- Social distancing and lockdown to prevent infections
  - Bad for GDP
- Fiscal action (with monetary accommodation) to prevent the amplification and long term damage of the lockdown
  - Good for people short term
  - Good for the eventual recovery of the economy
- Typical instruments
  - Maintain payment of payroll or provide unemployment insurance
  - Provide special loans to business
  - Provide central bank loans and regulatory forbearance to banks so that they can reschedule loans

# But what if countries have no fiscal space?

- Many countries are fiscally weak in good times
- With the COVID-19 shock, their fiscal space may have completely disappeared
  - tax revenues decline
  - Especially if they get a terms of trade, tourism or remittance shock
  - The crisis requires more health expenditures and ideally spending to cushion the blow
- None of this is good for the country's creditworthiness
- But if, in addition, financial markets shut down, the government may be even forced to cut back previous spending plans
- So fiscal policy cannot play the same role as in the standard recommendation, say for the US

# In other words

- Without fiscal space, flattening the epidemic curve is costlier
- So countries may be forced to / “choose” not to fight the virus by as much
- …leading to faster spread,
- …more deaths because of lower capacity to treat
- … and a faster end to the epidemic, assuming no re-infection
- In other words, lack of fiscal space costs lives

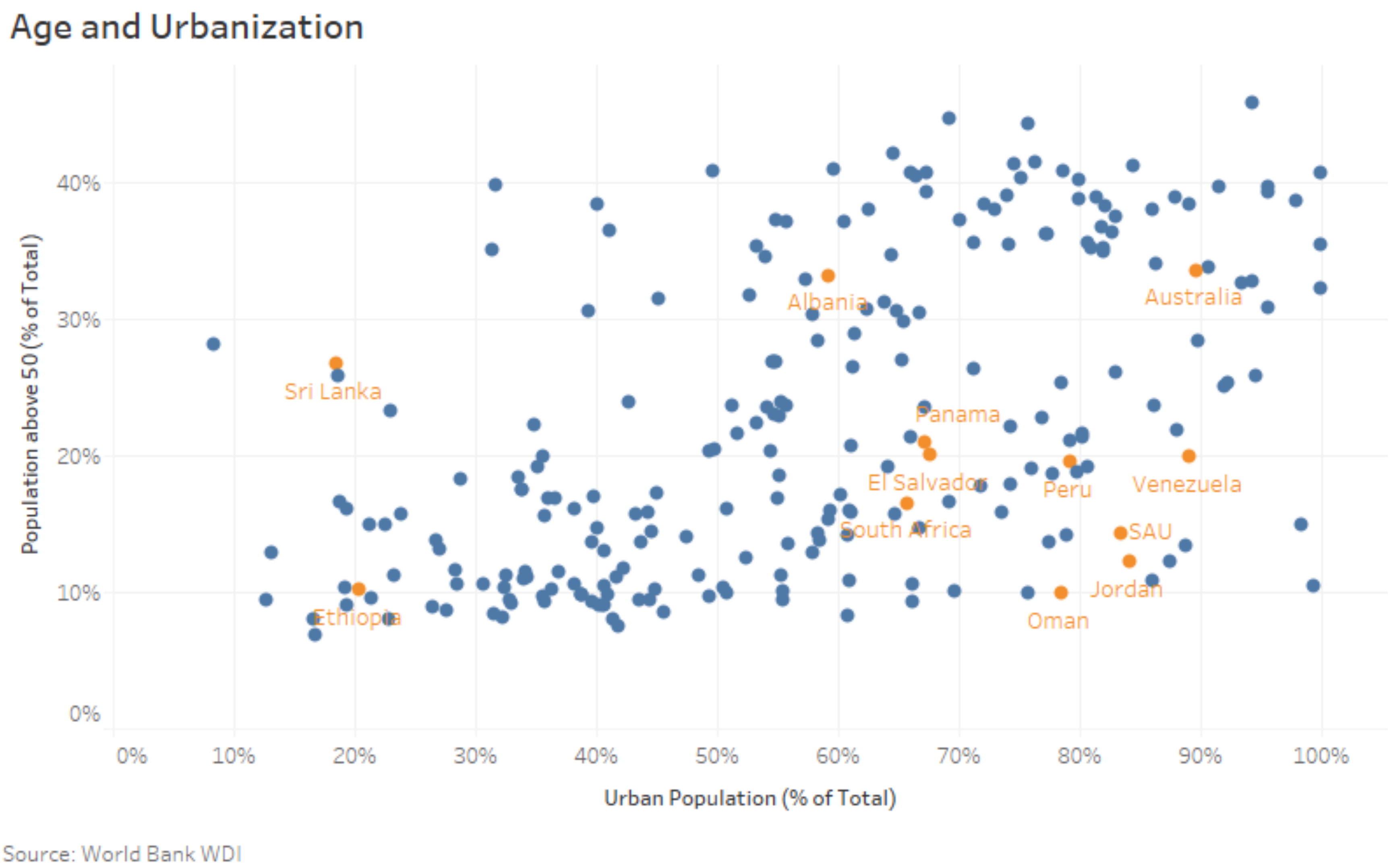
# Developing countries also differ in important health-relevant dimensions

# Developing countries tend to be different in demographic and health dimensions

- Younger
- Less urbanized
- Smaller service sectors
- Have less complex economies
  - Smaller networks of human interaction

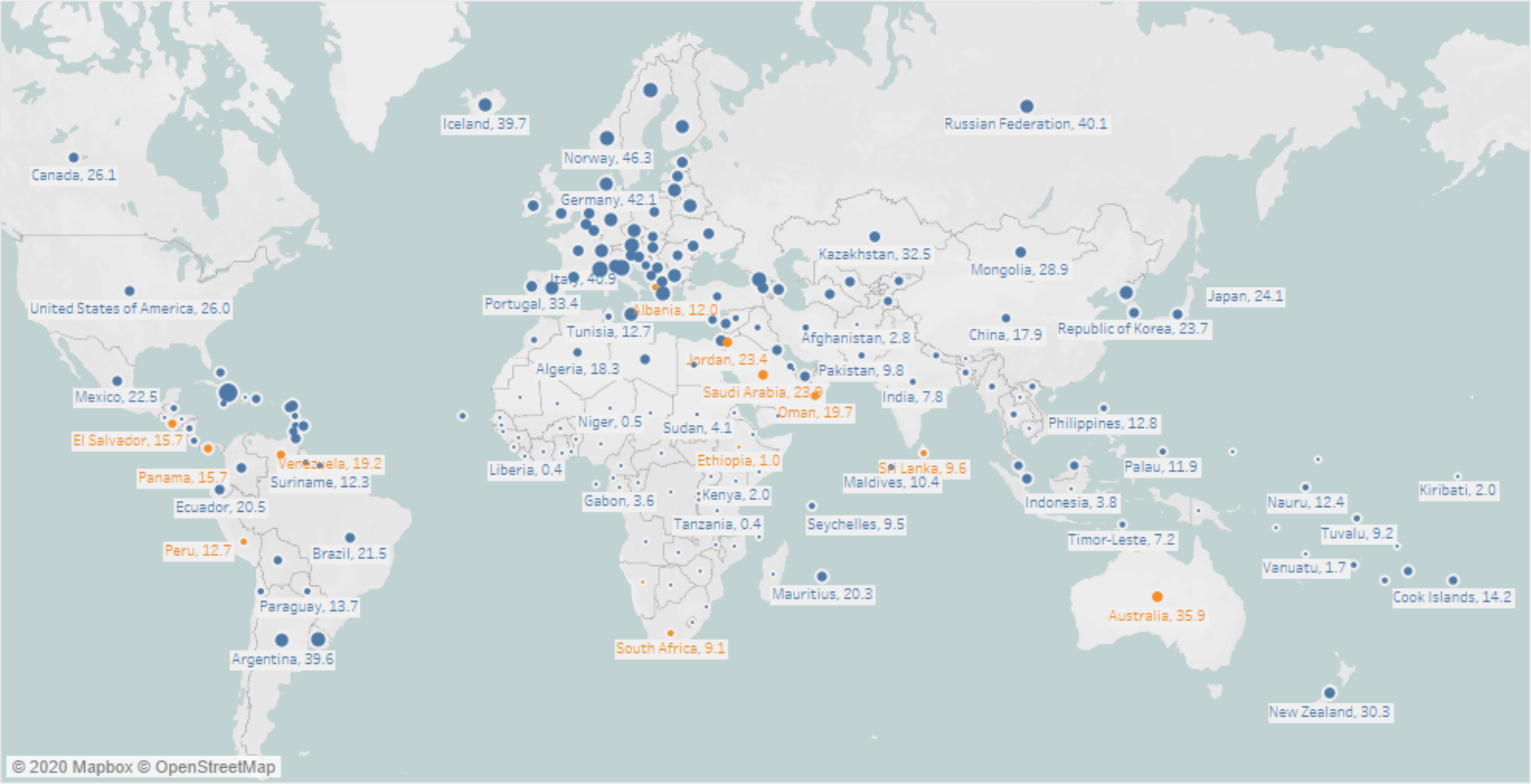
- Have much lower GDP per capita
- Have much lower health expenditures as % of GDP
- Fewer doctors, hospital beds
- And dramatically fewer actual resources per capita
- Have less access to clean water
- Have weaker border controls

# Great variations in urbanization rates and the older age %



There is an immense gap between the health systems of developed and developing countries that will response capacities: *(1) medical doctors*

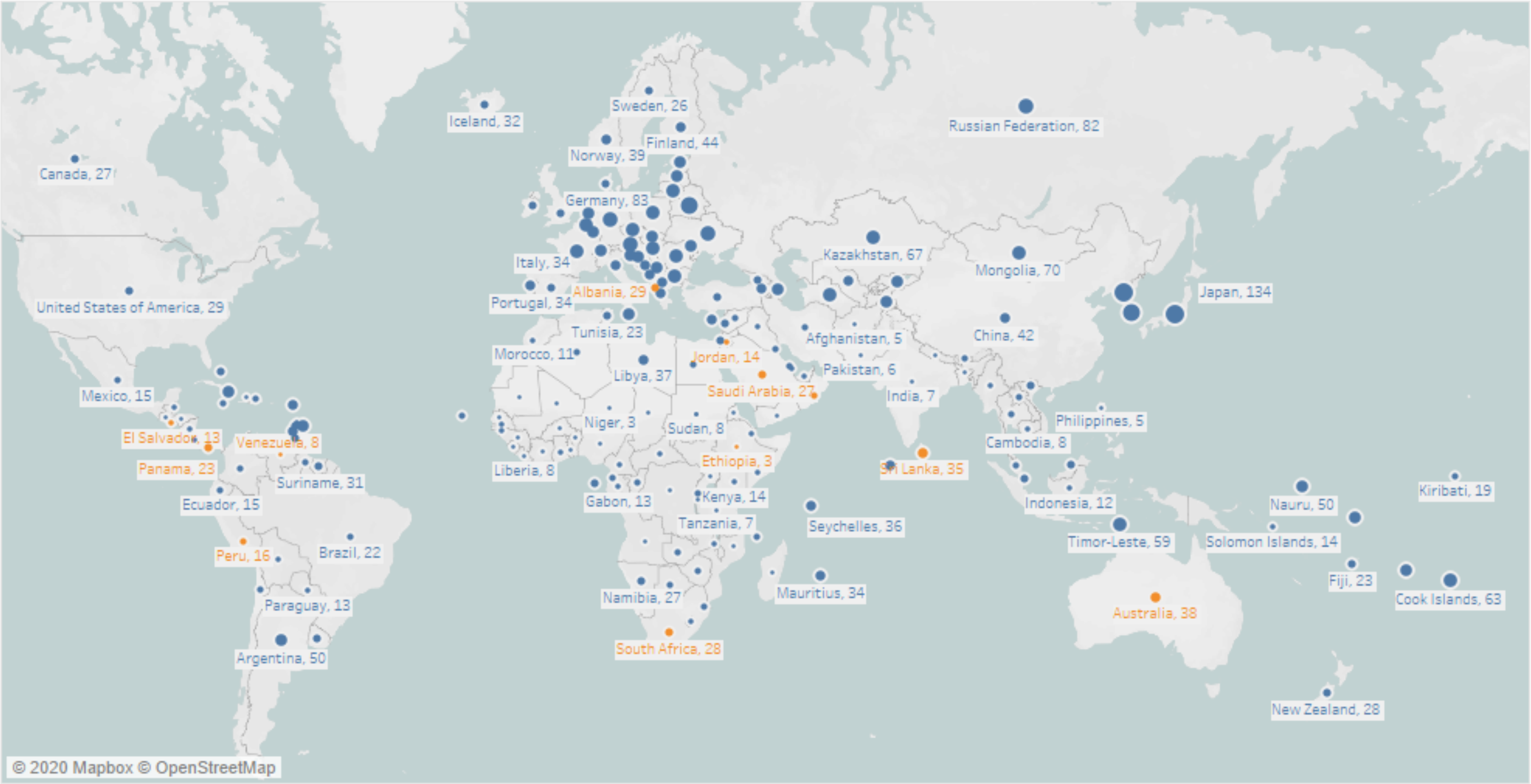
**Medical Doctors** (per 10,000 inhabitants)




Source: WHO

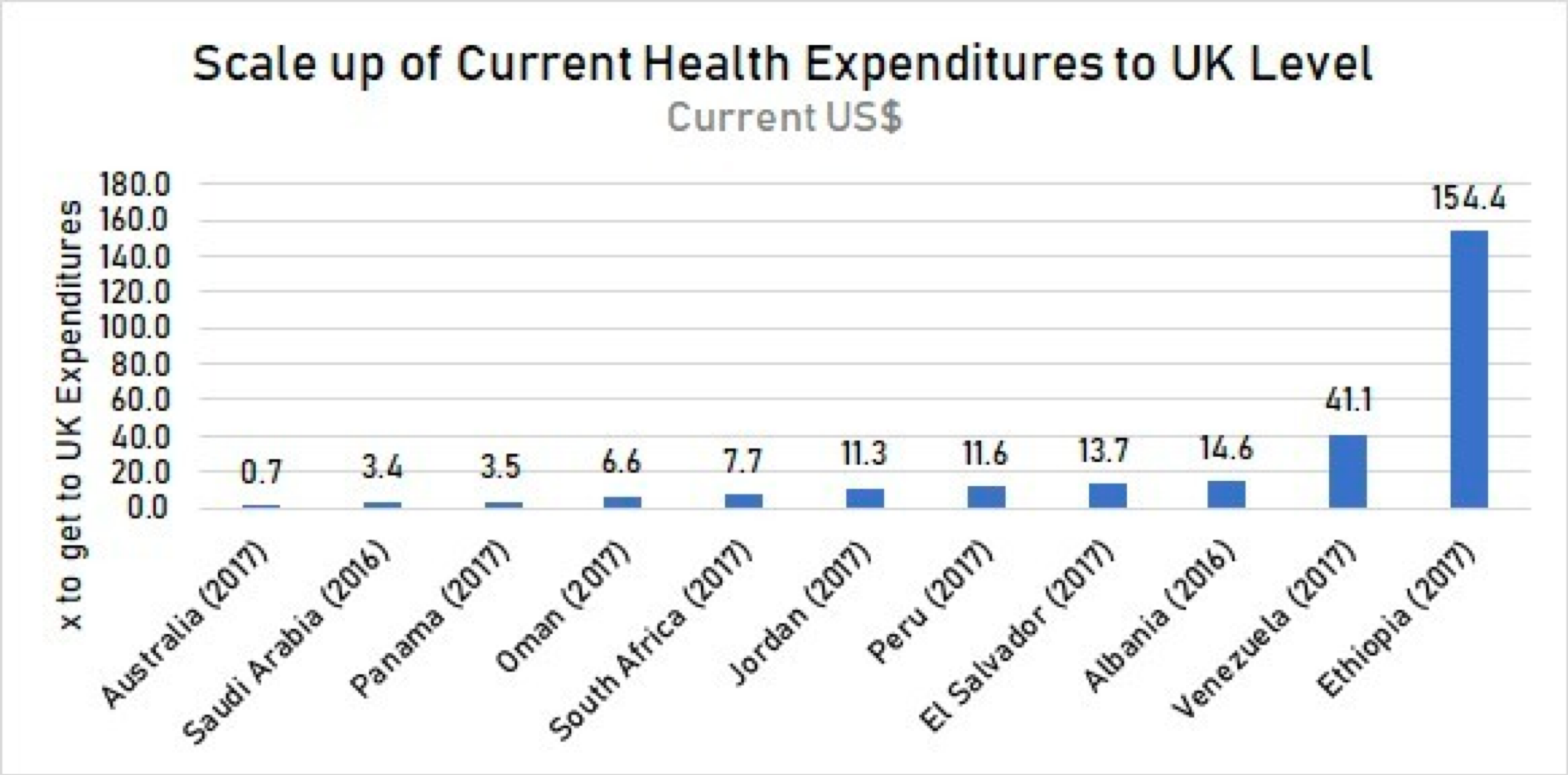
## There is an immense gap between the health systems of developed and developing countries that will response capacities: *(2) hospital beds*

**Hospital Beds** (per 10,000 inhabitants)




Source: WHO

# How much more would countries need to spend in order to reach UK spending levels?



# Most countries are fighting the disease

- Countries, in spite of their small or evaporating fiscal space have nevertheless opted for lockdowns and social distancing
- How should they manage them?
- What non-pharmaceutical internventions (NPI) should they adopt?
- How should they plan to get out of the lockdown phase?
- How should they prioritize the use of their fiscal space?
- How should they think of fiscal policy in this period?

# What to use the lockdown for?

- A lockdown promises to bring the trajectory of cases / deaths down, ***<u>relative to a counter-factual</u>***
- But a lockdown is not sustainable
  - At the limit, people will have to decide between a 10% chance of dying from the virus and a 100% chance of starving to death
- Unsustainable situations cannot last
- So you will eventually need to resume production, but how?
- How can the cost of the lockdown be lowered?
- … and how should it be shared?

# Non-pharmaceutical interventions

- Generalized lockdowns are very costly because they lack or do not use information about who is susceptible, who is infected and who is immune
- They can bankrupt the economy. Countries need more information-intensive strategies
- One “poor man’s” strategy is to isolate the elderly
  - Suggested by Israel
- Other smarter strategies would require much more testing
- They would allow to:
  - 1. test a representative samples of regions, not suspicious cases
  - 2. Use this info to track the epidemic in real time
  - 3. Do serology tests to detect immunity and clear these people.
  - 4. Trace contacts of the infected and test them
- Relaxation measures should be gradual, to allow for more information to be revealed

# How do you get out of a lockdown?

- Use lockdown period to invest in testing capacity and treatment capacity
  - Markets for medical inputs may become congested
- Isolate the elderly before you re-open
- Re-open activities gradually
  - Test a lot, quarantine the affected and allow others to work
  - Starting with the most critical and least “networky” activities
- Adjust speed of the re-start as more information is revealed
  - On cases, treatments, capabilities
  - Give yourself the flexibility to respond to events, do not over-commit

# What to do about macroeconomic policy?

# Macroeconomic policies

- COVID-19 is a short term situation, not a permanent shock
- Create all the short-term fiscal space you can
- Your tax revenues are bound to surprise on the down side by big margins
    - …accentuated by policies you will adopt to make the lockdown manageable
- No time to worry about prudential norms
    - Debt/GDP, rating agencies
- But know your limits and work around them
- Mobilize the maximum amount of fiscal resources you can get your hands on so you can fight COVID-19 and help people cope with it
- Ergo, borrow all that you can
- Use all the monetary sovereignty you can muster
    - Easier in countries with floating inflation-targeting regimes
    - Colombia just announced QE in spite of the oil shock and the collapse of its US$ bonds

# Creating maximum fiscal space

- Borrow all you can now with a 2-year maturity
  - If you can, from domestic markets, even if it requires monetary easing and central bank support
  - If you can, from international capital markets, 2-year duration
  - Get all the money you can from the IMF, the other IFIs are just too small
- If you are an oil importer, capture part of the oil price collapse for the government
  - Let consumers see part of the decline, but not all
- Postpone capex and other non-essential expenditures
  - Having a road 1 year later to help people in need sounds like a good trade-off

# Using that fiscal space

- Health-care first and foremost
  - Make sure that the expansion is not restricted by lack of money
  - There will be plenty of other bottlenecks (doctors, imported inputs, facilities)
- Support people first, then firms. Support banks through the Central Bank
  - Make clear that these are not entitlements but emergency expenditures
- For people: no time to design new schemes, leverage the ones you have, even if they are imperfect
- Focus in particular on the informal sector
  - Learn from the El Salvador's approach: restructure payments between the informal and the formal sector (electricity, water, consumer loans)
- Leverage the banking system to support firms
  - Make it advantageous to keep workers on the payroll vis a vis firing them
  - Consider partial guarantees for banks to lend for the payroll, especially for firms affected by lockdown measures

# Monetary and financial policies

- Highly dependent on exchange rate regime
- Reserves are for emergencies
  - This is an emergency
- Use the reserves to support fiscal space, even in fixed exchange rate regimes
  - With fixed XR regime, the expansion of CB domestic credit will go into lower reserves
- … and loans to firms
  - Easier if you have state-owned banks,
  - Otherwise, negotiate partial credit guarantees for loans to firms that preserve the payroll
- Regulatory forbearance on loans that are restructured to delay payments

# What should the international financial community do?

# Increase fiscal space by expanding the availability of official finance

- Recirculate the flight-to-safety money that is flowing to the US
  - And causing undesired US$ appreciation
- Quantitative Easing
  - Should Central Banks buy IFI bonds? Emerging Market  bonds?
- Increase the number of countries with access to FED swap lines
  - The FED announced this policy this morning but it included only Australia, Brazil, Denmark, Korea, Mexico, Norway, New Zealand, Singapore and Sweden.
- Why only those?
  - If the concern is credit risk, maybe have those swap lines intermediated by the IMF
  - Or can the chosen countries triangulate Fed swap lines? Brazil, Australia, Sweden?
- Expand the use of existing credit facilities
  - IMF's Rapid Finance Instrument, Stand-by arrangements
  - Other IFIs are very small
- Support for dollarized economies
  - They do not have a lender of last resort
  - El Salvador, Panamá, Ecuador in my part of the world
- International fund to pay for testing, equipment and eventually vaccines (Norway)

# Time is of the essence

- Let’s focus on pressuring the G-7 and the G-20 for rapid financial solutions through the IMF, the Fed and the BCE
  - The others are just too small
- Let’s make a big fuss about the availability of tests and treatments
  - It is the smart thing to do, to make domestic efforts more efficient and avoid re-infections
- Let’s learn as quickly as we can about prevalence, treatment, monitoring and policy actions and outcomes of others

# Thank you!

Raise your electronic hand to ask a question.