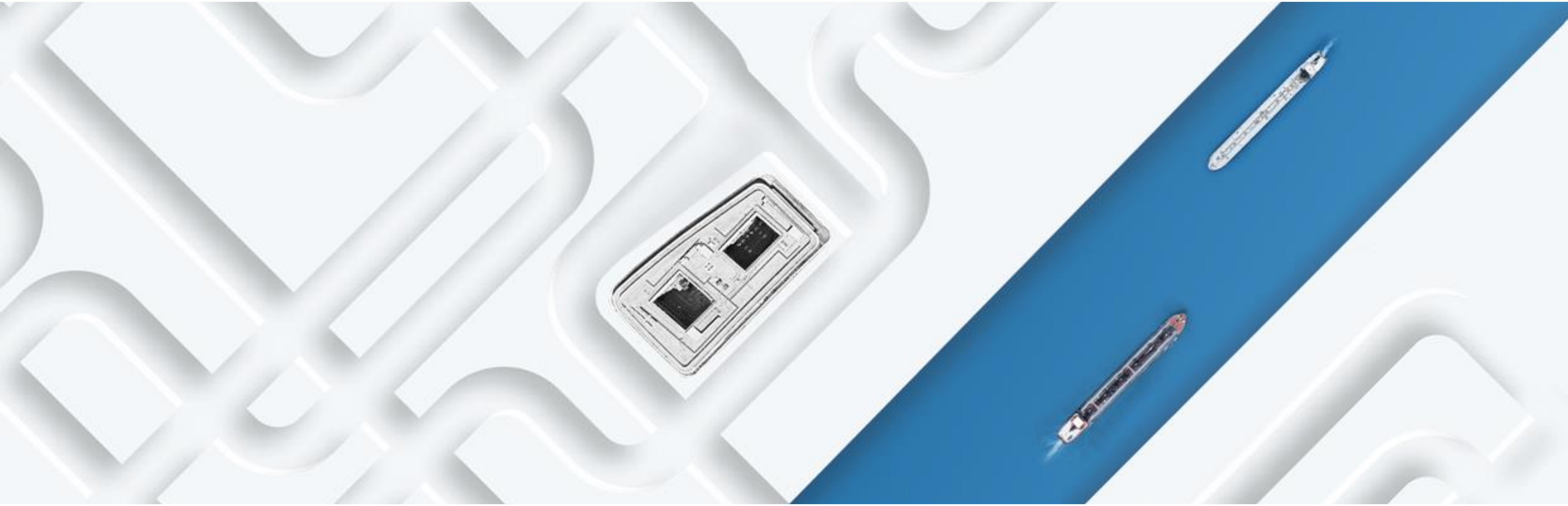
Different proposals to tackle the current crisis

IOE Web-Lab

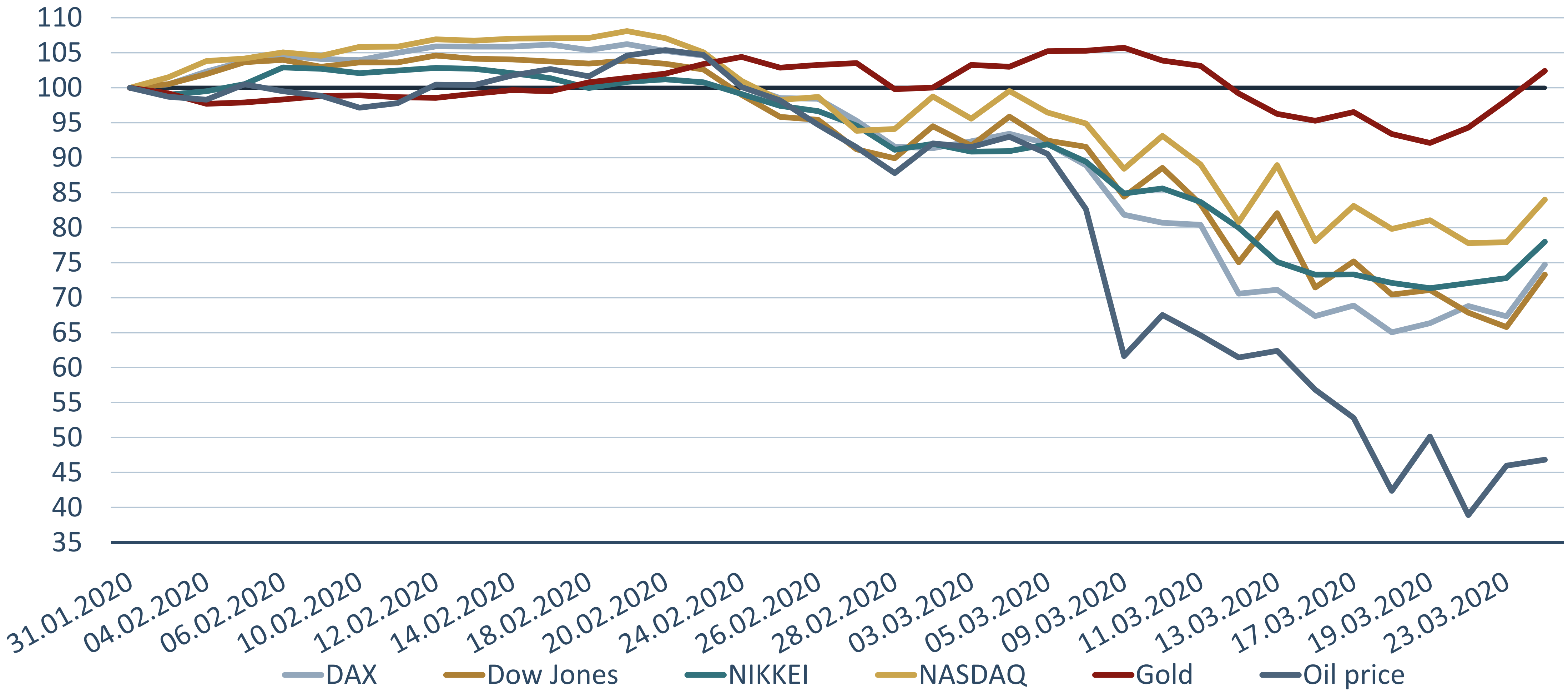


INSTITUT DER DEUTSCHEN WIRTSCHAFT

Dr. Thomas Obst, 25. March 2020

Corona-Virus shakes up stock markets

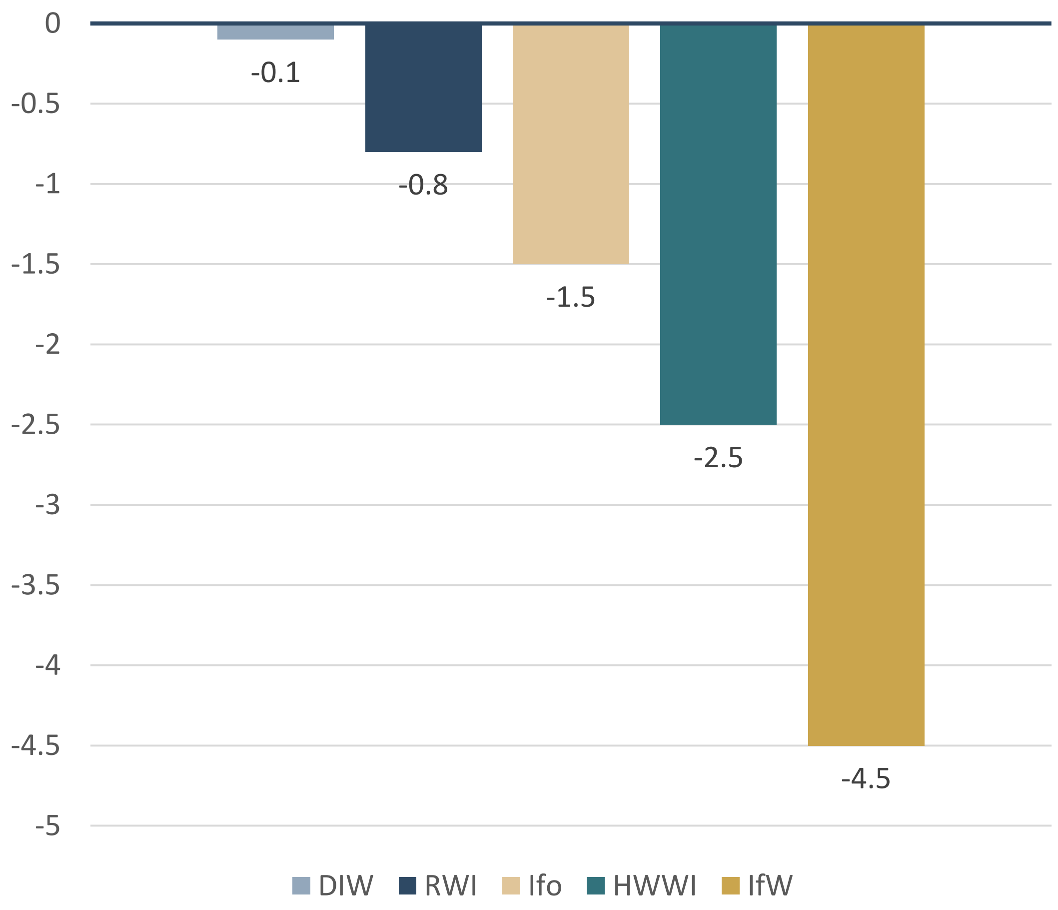
Volatility in the markets; Jan. 31 = 100



Source: Onvista, own illustration

Predicted German GDP growth 2020

Forecasts for real GDP growth in 2020 (in %)



Source: Institut der deutschen Wirtschaft

Remarks

- Depending on the scenario, a recovery of GDP is believed to begin after Q2
- The ifo-Institute predicts that depending on the duration of the shutdown and the intensity of the scenario, the GDP's annual growth rate could shrink by 5 to 20 percentage points

What crisis are we dealing with?

Supply- and demand side recession in the real global economy

Supply side shock

- **Global supply chains** are interrupted (Peak of loss of production still ahead)
- Reduction in employment and income
- Shutdown of factories and offices

Demand side shock

- Breakdown of global demand
- Psychological effect **'wait-and-see shock'**: investments and consumption postponed
- Breakdown in **tourism** as well as **social and cultural consumption**
- **Increased temporary demand for specific goods**

Crisis Responses

Monetary Policy in comparison

FED

- Interest rates cut to 0-0,25%
- Quantitative Easing Program with purchase of treasuries, mortgage-backed securities, short-term municipal bonds and corporate bonds
- No specific amount of purchases

ECB

- Quantitative Easing (Pandemic Emergency Purchase Programme, PEPP)
- €750 billion (March 19) + €120 billion (March 12) until the end of 2020

Bank of Japan

- Quantitative Easing – pledge to buy risky assets at double the current pace
- Setting aside of €16.6 billion for additional purchases of commercial paper and corporate bonds
- Interest rate remains unchanged at -0.1%

Bank of England

- Interest rates cut to new all time low of 0.1%
- Quantitative Easing: £200 billion in bonds

Own illustration

Crisis Responses

Fiscal Policy in comparison

USA

1) $1200 in cash transfers to "many Americans"; $500 to most children
2) $367 billion loan program for small companies
3) $500 billion fund for industries, cities and state
4) $150 billion for state and local stimulus funds
5) $130-150 billion for hospitals

Hong Kong

Cash Transfer to each person (1,200 Euro per person)

→ €8.5 billion

Germany

1) Short-time work schemes
2) Liquidity support
3) Tax deferral
4) Subsidies for companies
5) Simplified access to social security systems

→ €156 billion of new debt

UK

1) Subsidies for companies (retail, restaurant, tourism)
2) Tax deferral

→ £20 billion (€21 billion)

Plus substantial credit lines (e.g. guarantees): £330 bn in the UK; €400 bn in Germany; €300 bn in France etc.
Europe general escape clause of the EU fiscal framework (3% government budget deficit / 60% debt to GDP ratio)

Own illustration

Helicopter money as a viable alternative?

- Milton Friedman‘s (1969) idea to drop an additional $1,000 from the sky
  - Unique event to stimulate demand and increase inflation
  - Financed by the central bank
- Gali (2020) “a money-financed fiscal stimulus is needed now”
  - However, proposing liquidity for firms
  - Avoid raising taxes and/or increasing debt levels to finance fiscal programms
  - Inflation bias and adaptive behavior might undermine effectiveness
  - It is an emergency tool only
- Helicopter money is a radical option
  - There are other monetary and fiscal tools which should be utilized
  - Unrepayable debt and cash transfers have some merits
  - International cash transfers are not helicopter money

Conclusion

What policies seem promising

- Policies need to be comprehensive, resolute, ambitious and coordinated
  - Avoid **permanent** economic damage
  - Debt sustainability in the medium term (unrepayable debt)
  - Timely, temporary and targeted
  - Stabilize expectations
- Insolvencies might be unavoidable, but healthy businesses should be saved
- Demand stimulus would not work in the current environment (Crisis started in the real economy)
- Big question: Tradeoff between health management and economic damage
- **Starting point for any proposal**: managed and combined supply side and demand side recession
- Helicopter money is temporary but timely? **It is not targeted**

Open Issues

- How will these ‚temporary‘ measures be rolled back in the aftermath?
- Increasing firm indebtedness weaken their balance sheets permanently
- Targeted cash transfers need the ‚right‘ timing
- Governments with high debt to GDP ratios may face a sovereign debt crisis
- How will countries roll back production while keeping the spread of the virus contained?
- Supply side shocks difficult to tackle with standard fiscal and monetary tools