Different proposals to tackle the current crisis
Corona-Virus shakes up stock markets

Volatility in the markets; Jan. 31 = 100

Source: Onvista, own illustration
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

<table>
<thead>
<tr>
<th><strong>FED</strong></th>
<th><strong>ECB</strong></th>
<th><strong>Bank of Japan</strong></th>
<th><strong>Bank of England</strong></th>
</tr>
</thead>
<tbody>
<tr>
<td>➢ Interest rates cut to 0-0.25%</td>
<td>➢ Quantitative Easing (Pandemic Emergency Purchase Programme, PEPP)</td>
<td>➢ Quantitative Easing – pledge to buy risky assets at double the current pace</td>
<td>➢ Interest rates cut to new all time low of 0.1%</td>
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<tr>
<td>➢ Quantitative Easing Program with purchase of treasuries, mortgage-backed securities, short-term municipal bonds and corporate bonds</td>
<td>➢ €750 billion (March 19) + €120 billion (March 12) until the end of 2020</td>
<td>➢ Setting aside of €16.6 billion for additional purchases of commercial paper and corporate bonds</td>
<td>➢ Quantitative Easing: £200 billion in bonds</td>
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<tr>
<td>➢ No specific amount of purchases</td>
<td></td>
<td>➢ Interest rate remains unchanged at -0.1%</td>
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</tbody>
</table>

Own illustration
## Crisis Responses

### Fiscal Policy in comparison

<table>
<thead>
<tr>
<th>USA</th>
<th>Hong Kong</th>
<th>Germany</th>
<th>UK</th>
</tr>
</thead>
<tbody>
<tr>
<td>1) $1200 in cash transfers to “many Americans”; $500 to most children</td>
<td>Cash Transfer to each person (1,200 Euro per person) (\Rightarrow) €8.5 billion</td>
<td>1) Short-time work schemes</td>
<td>1) Subsidies for companies (retail, restaurant, tourism)</td>
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<tr>
<td>2) $367 billion loan program for small companies</td>
<td></td>
<td>2) Liquidity support</td>
<td>2) Tax deferral</td>
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<td>3) $500 billion fund for industries, cities and state</td>
<td></td>
<td>3) Tax deferral</td>
<td>(\Rightarrow) £20 billion (€21 billion)</td>
</tr>
<tr>
<td>4) $150 billion for state and local stimulus funds</td>
<td></td>
<td>4) Subsidies for companies</td>
<td></td>
</tr>
<tr>
<td>5) $130-150 billion for hospitals</td>
<td></td>
<td>5) Simplified access to social security systems (\Rightarrow) €156 billion of new debt</td>
<td></td>
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</tbody>
</table>

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)
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 programmes
  ❖ 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