Webinar: What it will take to save the economy from COVID-19

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Pre-registration Required

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Mo/Fri Lunch Webinars

- From Paul Romer’s webinar
  
  Another 6.6 million joined the U.S. unemployment rolls last week.

  Initial jobless claims, per week
  Seasonally adjusted

  6,648,000
  Claims were filed last week

  The week before was revised up 24,000 to 3,307,000


- Testing model
  Bring $R(0) < 1$

- Speakers coming up + more
  Tyler Cowen, Agnus Deaton, Penny Goldberg, Hyun Shin, Joe Stiglitz,
Fiscal policy

- Health crisis

- Monetary policy at negative rates already
  - Exchange rate depreciation not very helpful
    - In case of lock down (no global demand)
    - All countries are weakened

- Fiscal policy
  - Tax revenue collapse
  - Gov. expenditures skyrocket

One key question:
What will happen with interest rate?
Fiscal policy & Interest Rate

- Interest rate during shift from risk-on to risk-off regime
  - $i \downarrow$ for Safe asset issues (US, Germany, ...)
  - $i \uparrow$ for Non-safe asset issues (EME)

Flight-to-safety
Fiscal policy & Interest Rate

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THE BIG DIVIDE is getting wider

Flight-to-safety
Fiscal policy & Interest Rate

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THE BIG DIVIDE is getting wider

- Characteristics of a safe asset (≠ risk-free asset)
  - Good friend analogy: “valuable and liquid when you need it”
  - Safe asset tautology: “safe because it is perceived to be safe”
    - Multiple equilibrium/bubble feature
      - Brunnermeier & Sannikov

Flight-to-safety
Safe asset for EME

- New Element for Global Financial Architecture
- GloSBies (based on ESBies/SBBS idea)
Economic policy: Second fiddle to pandemic dynamics
Virologists > Economists

Main economic tool: Fiscal policy.
More generally: Role of the state versus markets in response to very large shocks.

Focus of the talk: Mostly normative
Comparative disadvantage in keeping track of actual policies

Caveat: One-man team (with a lot of friends/colleagues)
Gone are the good old Chief Economist days...
Epidemic. Phase 1. Decreasing the infection rate (AEs)

Largely baked in. Relatively little uncertainty about timing, more about height.

Estimates with 95% CF for US (as of Friday) (not the only model)
Heterogeneity across countries, states. Initial date, lockdown intensity
Peak hospitalization needs: April/May. Down by June/July
Epidemic. Phase 2. Keeping the infection rate low (AEs)

Much more uncertainty about length and required degree of lockdown.
Good and bad news.  Beijing traffic:

![Congestion Level Graph](image)

Depends very much on availability of tests,
Likely to be progressive. Rankings:
  People: Immunized, negative, others by age.
  Type of work: in person, telecommuting
  Sectors: From more to less essential (schools/manufacturing/planes...)
(Work for economists: Converse analog to bombing choices in WWII...)
Epidemic. Developing and emerging market countries

Poorer health system.
Harder to impose lockdown

Example of Nigeria
    So far, few reported cases. 0 on March 16, 200 on April 3
    But 0.5% bed per 1000 people (US: 2.3%)
    169 ventilators (for subset of states accounting for 80 million people)
    600 tests performed as of March 30

Higher likelihood of herd immunity dynamics
    Much larger number of deaths.
    Perhaps small short run economic cost.
        (Pandemic of 1918, Eichengreen, Correia et al )

The three roles of fiscal policy (AEs)

1. Infection fighting
2. Disaster relief. People, firms---eventually financial institutions?
3. Aggregate demand management.

In normal recessions, just the third. Here the first two dominate.

Each of the three with its own challenges, and its own time dimension
1. Infection fighting

Phase 1. Physical constraints and non fiscal measures dominate: Lockdown.

Phase 2. Give incentives to produce tests, explore drugs, find vaccines.
   How to give the right incentives to the private sector? (Kremer 1995)
   Trade-off tests/lockdown

The P Romer computation. Argues that:
   Daily tests of 7% of population (22 m if US) => R<1
       with no confinement measures
   Potential cost: 200 billion (likely seat of the pants)
   Production cost : Currently cost of virus test: 50. (antibody test: 10)
   Assume cost down to 25. Daily cost: 0.6b
   If increase in output of 20%: 10b a day

Useful as discussion starter. Reality check: Abbott’s production 100,000 a day. Roche: 60,000. Total tests in the US todate: 1.2m.

In any case, realistic cost very large, but small by macro standards <1% of GDP
2. Disaster relief

Provide funds to liquidity constrained households/liquidity constrained firms.

Challenge: Trade-off speed/targeting. (more so than in normal recession)
Initially, poor. Better over time. Makes sense to have bridge programs.

Different approaches: US: Unemployment offices, plus checks, tax breaks
France: Through firms/banks/fiscal backstop, tax breaks
Less different than it looks. SBA loan/grant conditionality

Need to err on the generous side (cash payments in the US, replacement rate in France)
Grants or loans? To be assessed ex post? Risky ex ante.
Can do better over time. Do it for two months and improve

Upper bound on the cost? Decrease in output: 35% of baseline under lockdown.
Assume 2 months at lockdown. 6 months at half lockdown
Liquidity constrained: 40%. Replacement rate: 80%. All grants: 5% of GDP.
3. Control of aggregate demand

Distinguish between phase 1 and phase 2.

Phase 1. Lockdown implies potential output down by 35%. Cannot produce more.

Could disaster relief lead to too much demand? It could (Werning et al)

Not a major issue however
  Spending on food, repaying mortgage. No supply constraints.

And if rationing, some inflation, not a major issue

Phase 2. As lockdown is relaxed, will private demand go up or down?

Pent up demand, may dominate at the beginning

But also, precautionary saving and uncertainty and low investment?

Bottom line: Contingent commitment (No major investment plan for example)
Debt sustainability

Is debt sustainable?
If the crisis leads to an increase of say, 30%-40 of GDP?

Answer for AEs: Yes  (Hedging a bit: Unless the virus wins)

Back to the pre-crisis discussion of R< G. (Now two competing Rs. R0 and R*)

R* was low before the virus crisis
   Likely to be even lower after:
      Precautionary saving.
      Uncertainty and investment

What about the effect of higher public debt on R?
   2-4bp per 1%: so 60bp-160bp.
   Still lower than or close to G

Lower G? 2020 for sure. Thereafter?
The important fiscal role of central banks

Discussion about monetization of deficits: Largely confused.

Monetization at zero interest rate has no effect (to a first order)
Two nearly identical assets, paying zero

What matters is what central bank will do if and when R*>0
Increase R and pay interest on money:
   Then money = debt
Keep R=0, and allow for overheating and inflation

But important role of central bank in avoiding multiple equilibria
   “Good equilibrium:” debt sustainable at the safe rate
   “Bad equilibrium:” worries, higher rate, debt unsustainable

Maintaining the good equilibrium: yield curve control

Prologue: Italian yields and the ECB.
Risks in the future: If and when “good equilibrium” looks less good.
Back to EMDEs

Similarities
   Fighting the same virus
   Same three goals for fiscal policy

Differences
   Not equipped to fight the virus.
      Risk of catastrophic immunity herd dynamics
   Large capital outflows due to repatriation of liquidity
   FX denominated debt, and steeper demand curve for gvt bonds
   Drop in commodity prices, tourism

So much more limited fiscal space
   Existing debt may have become unsustainable
   Additional borrowing may not available.

Put another way: Liquidity issue and solvency issue.
The role of central banks and international institutions

Dealing with the short run: (Debt service: 2018. 3.6 tr. Outflows in March: 100b)
  Provide liquidity. Extension of swap lines, size and reach.
  Allowing private creditors an out? (Argentina redux)
    Capital controls on outflows?

    Finance infection fighting through grants, not regular loans.
      World Bank IDA. IMF concessionary loans (RCF).
      SDR allocations, with gifts from AEs.

Dealing with medium run:
  Uncertainty and debt sustainability. Too early to tell for sure.
  A clear case for a debt standstill
    Usual problems of coordination between creditors
    CACs not sufficiently prevalent.
  How much conditionality to impose in programs?
Role of coordination?

Coordination in mobilizing and getting funds to EMDEs

Coordination in sharing information about pandemics and fiscal measures

Coordination in determining size of fiscal programs?
   Not obviously. Different from 2009.
   Infection fighting; disaster relief. Spillovers not relevant.

An issue which will become a source of major tensions:

   Fighting for tests, vaccines. (Today, fighting for masks. US/France/China)
   If let markets decide, rich countries will get the tests/vaccines first

   Ideally, agreement both to subsidize and to allocate across countries?
   Highly desirable/highly unlikely...
Sources

US epidemic dynamics. https://covid19.healthdata.org/projections?fbclid=IwAR3mQK1I2WFfAFAlr_noujPQXtx1gFr5p5xp93U6VfM1SABhg7Mts69T6NWM
