Webinar: The great lockdown through the global lens of the IMF

WITH GITA GOPINATH
CHIEF ECONOMIST, IMF

Friday, May 29, 12:30 PM ET

Intro: MARKUS BRUNNERMEIER

Twitter: @MarkusEconomist
Markus’ Zoominar intro

- Previous/future webinars
  - Larry Summers: Vaccine acceleration, US-China, Resilience...
  - Bill Dudley: The Fed’s longer-term challenges

- Speakers
Global Symmetry to Asymmetry

- Global Symmetric shock ➔ Asymmetric – worse for EMDE?
  - How to reduce asymmetric amplification for EMDE?
Capital outflow from EMDE

- Why did it stabilize in April?
- Should EMDE borrow from IMF to stem against them?
Integrated Policy Framework: SA

- Asset Price = $E[PV(\text{cash flows})] + E[PV(\text{service flows})]$ 
  dividends/interest

- Service flows
  a. Relax collateral constraints (Lagrange multiplier)
  b. Safe asset: [good friend analogy]
     - When one needs funds, one can sell at stable price ... since others buy
     - Partial insurance through retrading - market liquidity!
  c. Money (narrow): relax double-coincidence of wants

Integrated Policy Framework: SA

- Asset Price = E[PV(cash flows)] + E[PV(service flows)]
  dividends/interest

- Service flows
  a. Relax collateral constraints (Lagrange multiplier)
  b. Safe asset: [good friend analogy]
     - When one needs funds, one can sell at stable price ...
     ... since others buy
     - Partial insurance through retrading - market liquidity!
  c. Money (narrow): relax double-coincidence of wants

Gov. bond
Narrow money
Integrated Policy Framework: SA

- Asset Price = E[PV(cash flows)] + E[PV(service flows)]
  dividends/interest

  Service flows
  a. Relax collateral constraints (Lagrange multiplier)
  b. Safe asset: [good friend analogy]
     - When one needs funds, one can sell at stable price ...
       since others buy
     - Partial insurance through retrading - market liquidity!
  c. Money (narrow): relax double-coincidence of wants

- Higher Asset Price = lower expected return

- Problem: b, c might burst like a bubble
  - Multiple equilibria: [safe asset tautology]
Can EMDE offer safe asset?

- With capital controls

\[ r^f = \rho + E[g_c] - \sigma_c^2 \]

Risk-free rate = time preference rate + growth - volatility

- For log utility
  - For log utility
  - If primarily idiosyncratic risk, \( g = E[g_c] \)

\[ r - g = \rho - \bar{\sigma}^2 \]

safe asset service flow

\[ r < g \iff \rho < \bar{\sigma}^2 \]

run gov. debt PONZI SCHEME but limit expansion

5/29/2020
... but if safe asset status is wobbly

- With capital control
  
  \[ r + \text{risk premium} < g \]

- Negative if safe asset appreciates in times of crisis
- Positive if safe asset status might burst
  - EMDEs’ challenge!

- Next without capital controls
  - US Treasury competes as safe asset
Competition with US Treasury

- EMDE safe asset status is even more wobbly

\[ r + \text{RISK PREMIUM} < g \]

\[ r > r^\$ \]

- Note: risk is endogenous due to self-fulfilling expectations
  - So is the price of risk
  \[ \Rightarrow \text{risk premium} = \text{price of risk} \text{ (exog. + endogenous risk)} \]
  - Multiple equilibria (invites speculative attacks)

*Jammed in between!*
Measures to defend safe asset

- Policy measures to defend EMDE safe asset status
  a. US Fed rate cut $r$ reduces jamming!
     - 2020-03-03  Fed cut $r$
  b. Counteract possible (synchronized) speculative attacks
     - 2020-03-23  Swap lines (Fed, ECB, ...)
     - 2020-04-06  FIMA Treasury Repo facility (for EMDE)
     - 2020-04-22  IMF short term liquidity line (SLL)
  c. Capital control (outflow) & MacroPru measures
IPF & Dilemma

- IPF
  - To assess consistency of policy mix
    - Monetary, MacroPru, FX Intervention, Capital Controls

- Dilemma not Trilemma
  - Theoretical foundation for Rey (2017)
  - Monetary policy is constrained/jammed despite flexible exchange rates (unlike in Mundell-Fleming Trilemma)
In sum

- Health shock may be symmetric across the globe but due to safe asset fragility – becomes asymmetric

- Calls for different global financial architecture (GloSBies)
  - Less ex-post intervention required
  - More automatic self-stabilizing system
Poll 01:

1. EMDE (grants vs. liquidity support)
   a. EMDEs need grants not liquidity due to debt overhang problem
   b. Liquidity support is essential since liquidity problems morph into solvency issues

2. EMDE should
   a. Should defend their currency and safe asset status (using their reserves/IMF liquidity life lines)
   b. Let currency go and make foreign investor take the hit?

3. Debt to EMDEs should be
   a. Bailed out
   b. Restructured
End of MARKUS’ INTRODUCTORY REMARKS

Now

Please ask questions in Q&A box

Webinar: The great lockdown through the global lens of the IMF

WITH GITA GOPINATH
CHIEF ECONOMIST, IMF

Friday, May 29, 12:30 PM ET
Truly Global Crisis
Global Health Shock

**AE: Cumulative confirmed cases**
(log scale; Last update: May 20)

- Cases double every day...
- ...every 2 days
- ...every 3 days
- ...every week

Source: John Hopkins University.

**EMDE: Cumulative confirmed cases**
(log scale; Last update: May 20)

- Cases double every day...
- ...every 2 days
- ...every 3 days
- ...every week

Source: John Hopkins University.
Sources: Hale, Thomas, Sam Webster, Anna Petherick, Toby Phillips, and Beatriz Kira (2020). Oxford COVID-19 Government Response Tracker, Blavatnik School of Government; and IMF staff calculations.
A Multi-faceted External Shock

Commodity prices
(Jan 2, 2020 = 100)

- Metal
- Oil
- Natural Gas

Sources: Bloomberg, L.P., Argus, IIF, Haver Analytics, Thomson Reuters Datastream, and IMF staff calculations.

Oil price decomposition
(cumulative log difference*100)

- Demand (74%)
- Supply (26%)
- Oil price

Portfolio flows to EMs 1/
(percent of GDP; days since crisis start)

- GFC (Sep, 2008)
- COVID-19 (Mid-Feb, 2020)
- Taper Tantrum (May, 2013)

Sources: Bloomberg, L.P., Argus, IIF, Haver Analytics, Thomson Reuters Datastream, and IMF staff calculations.
Deeper & Broader than the Global Financial Crisis

Real GDP growth
(Y/Y, percent)

-7 -6 -5 -4 -3 -2 -1 0 1 2 3 4

Great Lockdown 2020 Global Financial Crisis 2019

Source: WEO and IMF staff calculations

No country spared

- PPP weight of countries in recession
- Countries with per capita growth <-4%

Source: WEO and IMF staff calculations
Common Features of the Economic Impact
Uniquely Large Hit to Services

PMI: Manufacturing
(index; February-April 2020 changes)

PMI: Services
(index; February-April 2020 changes)

Sources: Markit; Swedbank; Haver Analytics; and IMF staff calculations.
A Worldwide Drop in Services

PMI: Manufacturing - output
(index; >50 = expansion; sa)

PMI: Services - business activity
(index; >50 = expansion; sa)

Sources: IMF, World Economic Outlook; IMF, Global Data Source; and Haver Analytics.
Large Supply Shocks, Muted Inflation

Core CPI inflation
(percent change; year-on-year)

Headline CPI inflation expectation: 1-year forecast
(percent change; year-on-year)

Sources: IMF, World Economic Outlook; IMF, Global Data Source; Consensus Economics; Haver Analytics; and IMF staff calculations.
Financial Markets: Disconnect?

Equity market index

(Jan 1 2020 = 100)
Change in Sovereign Bond Spreads

![Graph showing change in sovereign bond spreads for various countries.](image)

Source: IMF, World Economic Outlook, IFS, Bloomberg. Ecuador Change in Spread under Covid is 3250 bps.
Exchange Rate Movements

Exchange rates
(percent change vis-à-vis USD, + is depreciation)

Source: IMF, World Economic Outlook, IFS.
Monetary Policy: Accommodative Across the Board

G-20+: Monetary policy measures
(percent of countries)

AE and EM with Policy Rate <=0.5%
(percent) 1/

Sources: IMF, World Economic Outlook; IMF, Global Data Source; IMF Covid Tracker; IFS; Haver Analytics; and IMF staff calculations.

1/ Total of 66 emerging markets and 33 largest advanced economies.
G20 fiscal policy: Announced fiscal measures in G-20 economies (percent of GDP)

Informality: Proportion of informal employment in non-agricultural employment (percent; harmonized series)

Fiscal cost of a 2-month transfer to informal workers will be 2.2-5.7% of GDP.
Multilateralism

• Health Externalities
  - Vaccine production and distribution

• Beggar-thy-neighbor

• The Great Lockdown – could it lead to Great Protectionism?
Looking Forward, Next steps
Profound Uncertainty about the Recovery

Global: Real GDP path
(index; 2019 Real GDP normalized to 0)

Source: IMF staff estimates.
Policies for the re-opening phase

- **Minimize health uncertainty**
  - Widespread testing, contact tracing, masks: least economically disruptive
  - Phased re-opening; well-communicated, targeted approach to reopening
  - Countries should be open to different strategies and tradeoffs
  - Global effort for production and distribution of medical supplies, vaccines.
Policies for the re-opening phase

• **Support to workers and firms will need to evolve**
  – In peak crisis - keep firms and workers matched: Short-term work subsidies (Germany), grants to firms conditional on maintaining employment.
  – In reopening/recovery:
    » Ease reallocation: This requires labor market flexibility
    » Wage/Hiring subsidies
    » Case for corporate solvency support will also weaken; with the possible exception of strategic or systemic firms and industries
    » Public investment that is job rich: Infrastructure investment that is green can both be job rich and benefit the planet.
  – A new generation of temporary automatic stabilizers
Policies for the re-opening phase

- Continue to ensure stability of financial system; critical spending needs of developing economies are met; adequate international liquidity
  - IMF: Emergency financing for 59 countries so far (over 100 countries requesting); debt service relief, short term liquidity line; precautionary credit line
  - G20 debt relief initiative
  - FX swap lines
  - More will likely be needed
Opportunities and challenges

- Technology and innovation to raise productivity
- Climate change
- Inclusive growth
- Fintech/Digital economy
- Mainstream epidemic preparation
- Global Cooperation
THANK YOU