

2020 

COVID 19 Economics Lesson Towards a **Resilient Society**

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*Based on
New Booklet*

*Based on webinars + beyond
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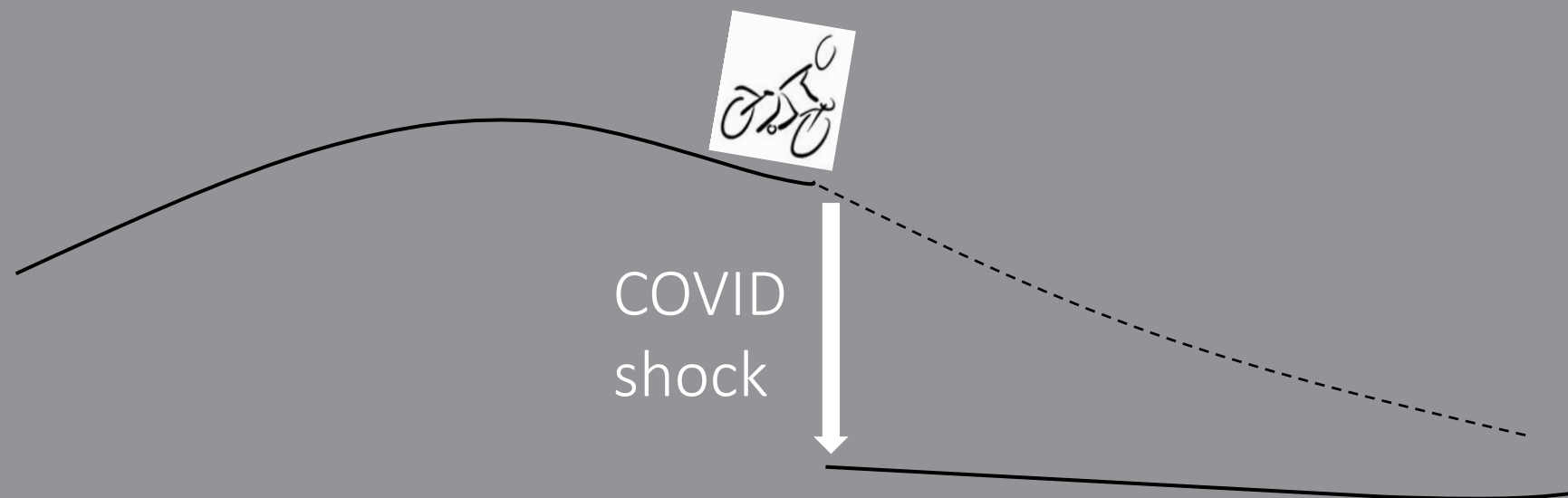
Webinar speakers 2020 ... and beyond



Thank you for your questions and for being part of it!

COVID as **Naked Swimmer Moment** and **Trend Accelerator**

- Health externalities
 - No universal health care
 - No sick leave
 - Higher death rate across minorities
- Trend accelerator
 - Optimal speed – growth vs. disruption (human capital)



- **Risk** management - squeezed between concrete wall

- Variance
- *Tail Risk Analysis*

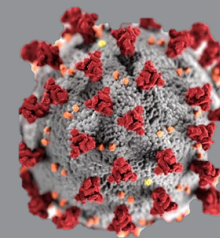


- **Resilience** management - squeezed between rubber wall

- Mean-reversion
bounce back



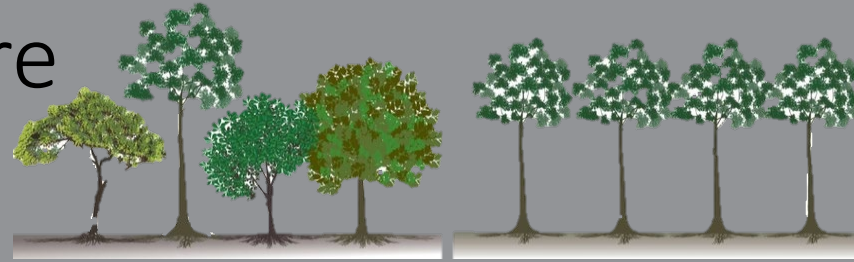
roly-poly toy



- *Trap Avoidance Analysis*

Resilience: Diversity, Flexibility, Growth

- Diversity vs. Monoculture



- Shocks are more idiosyncratic than symmetric
- Reduced willingness to insure each other (Alesina)

- Flexibility



- Growth

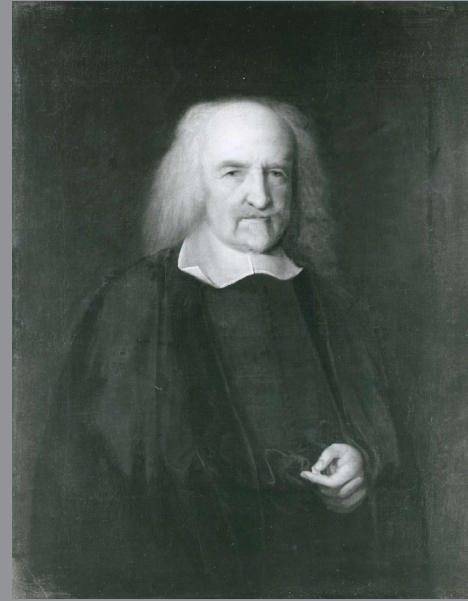
- Bicycle analogy



“A social contract that boosts inclusive growth stabilizes the social contract.”

Social contract

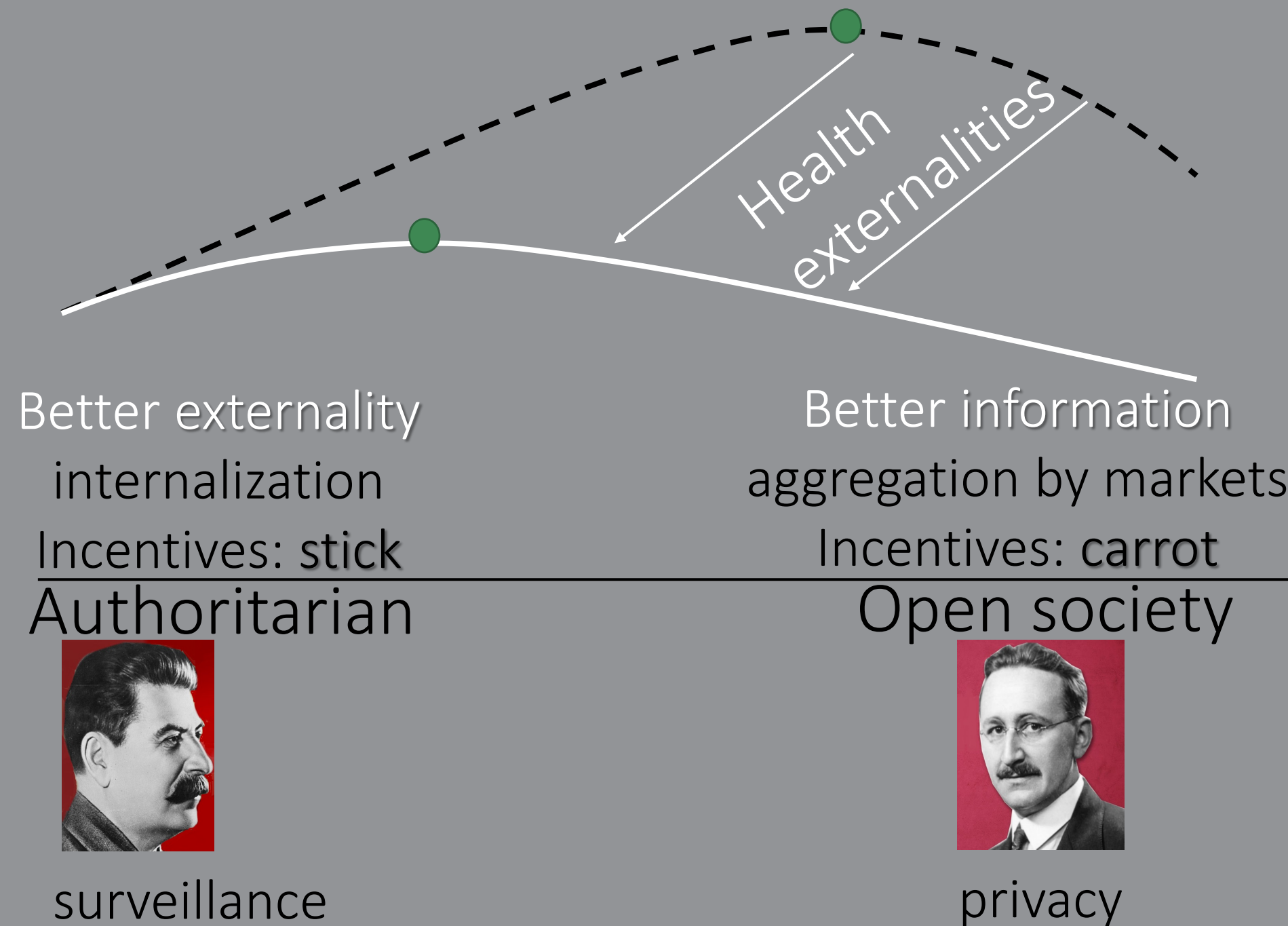
- Thomas Hobbes, (*Leviathan*, 1651),
John Locke,
Jean-Jacques Rousseau
- An externality interpretation



- Social contract to limit/make us resilient to
 - Externality from others
 - Shocks (externalities from mother nature)
 - John Rawls and the “veil of ignorance”
 - Not insure, but provide resilience
 - Ladder to get out of the hole – not universal basic income
 - Dignity and limits moral hazard

Temporary or permanent shift?

- Will we return to the pre-COVID social order?



- Role of Social Norms (Japan, ...)

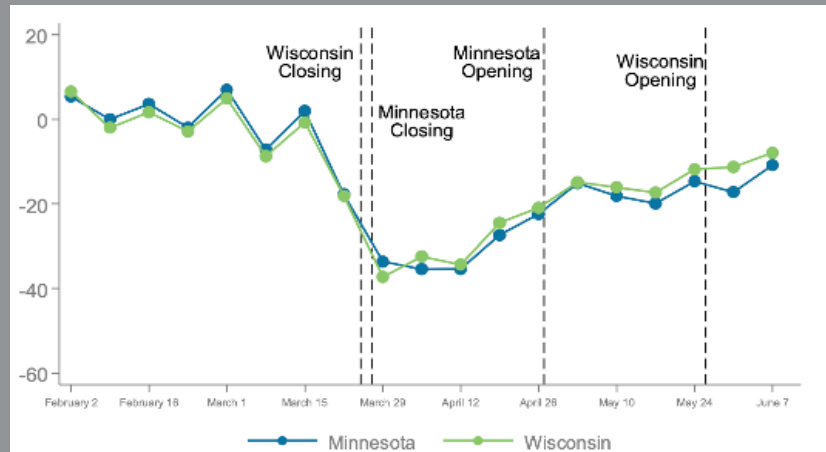
Overview: Resilient Society

- Social contract
- COVID Health Resilience management
- Long-run effects: Innovation and Scarring
- Macro, Money and Finance
 - Financial Whipsaw (IPO boom)
 - Public Debt challenge
 - Inflation Whipsaw: Deflation/inflation traps
 - Inequality
- Global Resilience

What changes people's behavior (social distancing)?

1. Wave: COVID Fear

- Sweden vs. Denmark
- Wisconsin vs. Minnesota



Chetty et al. (2020)

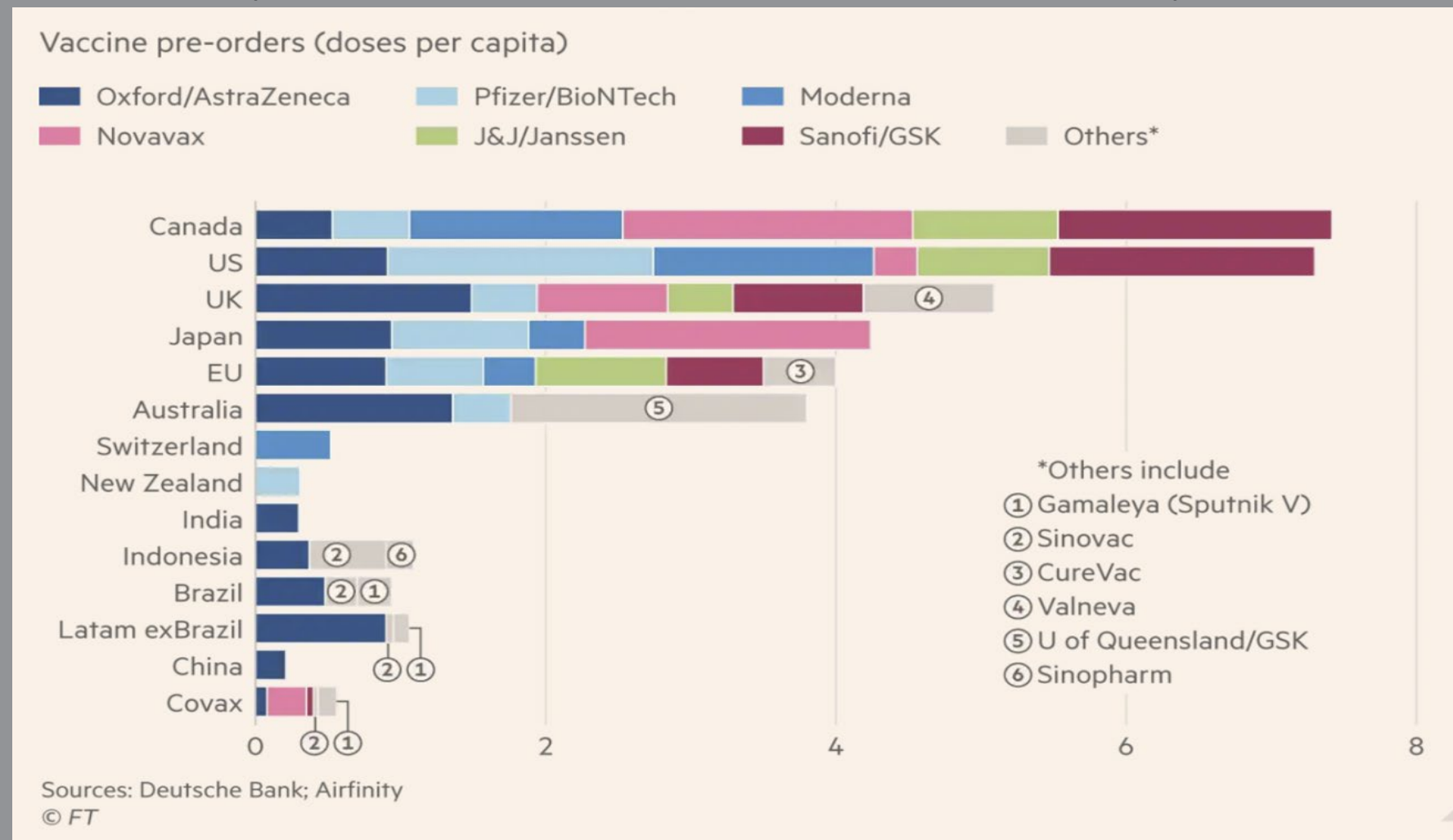
Government
communication

2. Wave: COVID Fatigue/Denial

- Endowment effects
- Optimal Expectations (Brunnermeier & Parker, 2005)
 - Optimistic beliefs if it doesn't distort behavior
 - Government limits choice
 - Externality

Testing/Vaccine production

- Cost of testing is **tiny**
- Vaccine costs are tiny compared to lockdown
 - Develop 14 in parallel – redundancy
 - Develop vaccines with low correlation - portfolio approach

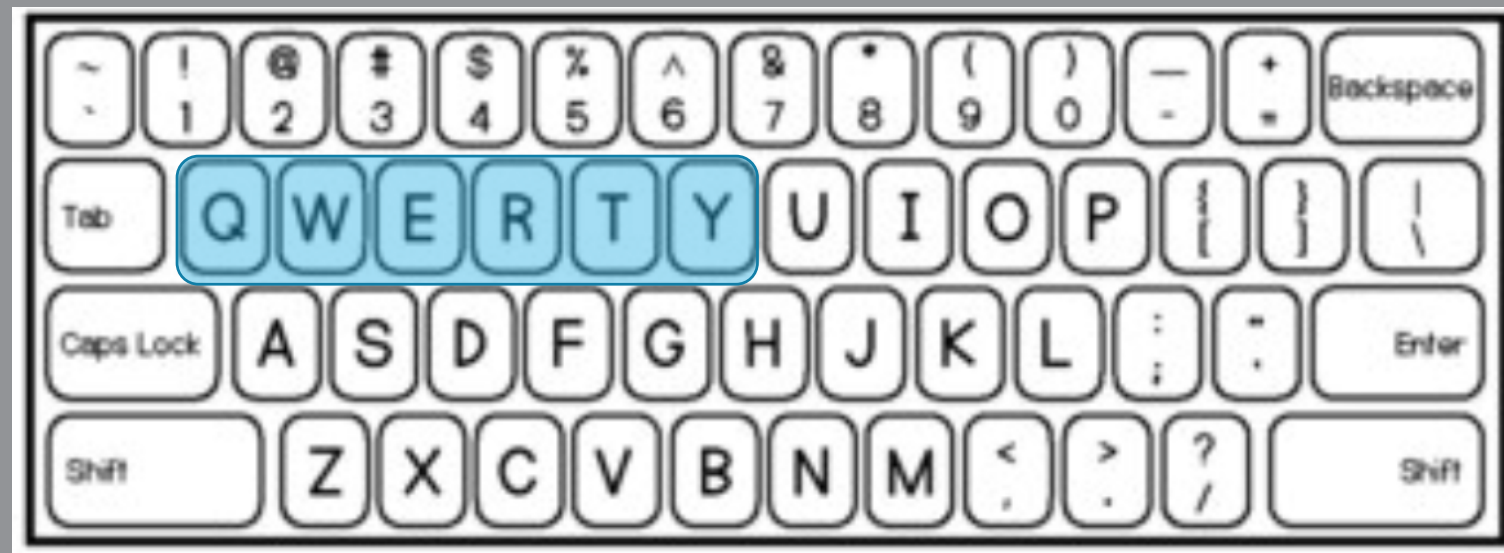


Innovation boost: trend accelerator or QWERTY jump

■ Innovation

Overcoming cannibalization, QWERTY problem, and regulatory shackles

- Tele medicine
- Home office and real estate donut effect
- Online learning/conferencing
- Digital Money
- Virtual world



Scarring → slow recovery

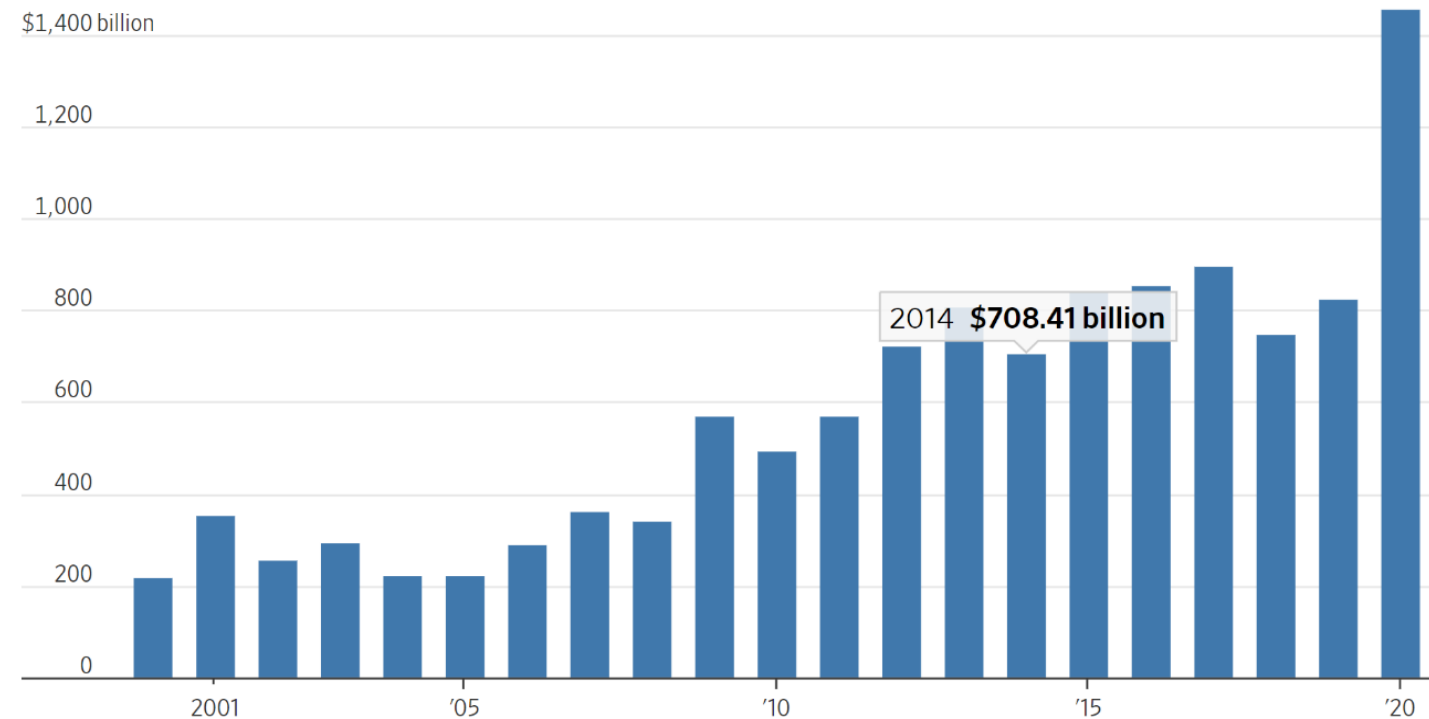
- Belief scarring
 - Less risk taking, more savings
- Labor market scarring
 - Women > men (unlike previous recessions)
- Firm scarring
 - Debt overhang problem
 - SME (chapter 7) vs. large firms (Chapter 11)

“Financial Markets Whipsaw”

- March 2020 shivers followed by strong recovery
 - **Stock market** record heights – IPOs like during NASDAQ bubble
 - **Gov. bond market** shivers CB: Market maker of last resort
 - **Corporate bond market** CB: Tail risk removal

Bond Blowout

Value of investment-grade and high-yield bonds issued in first nine months of each year

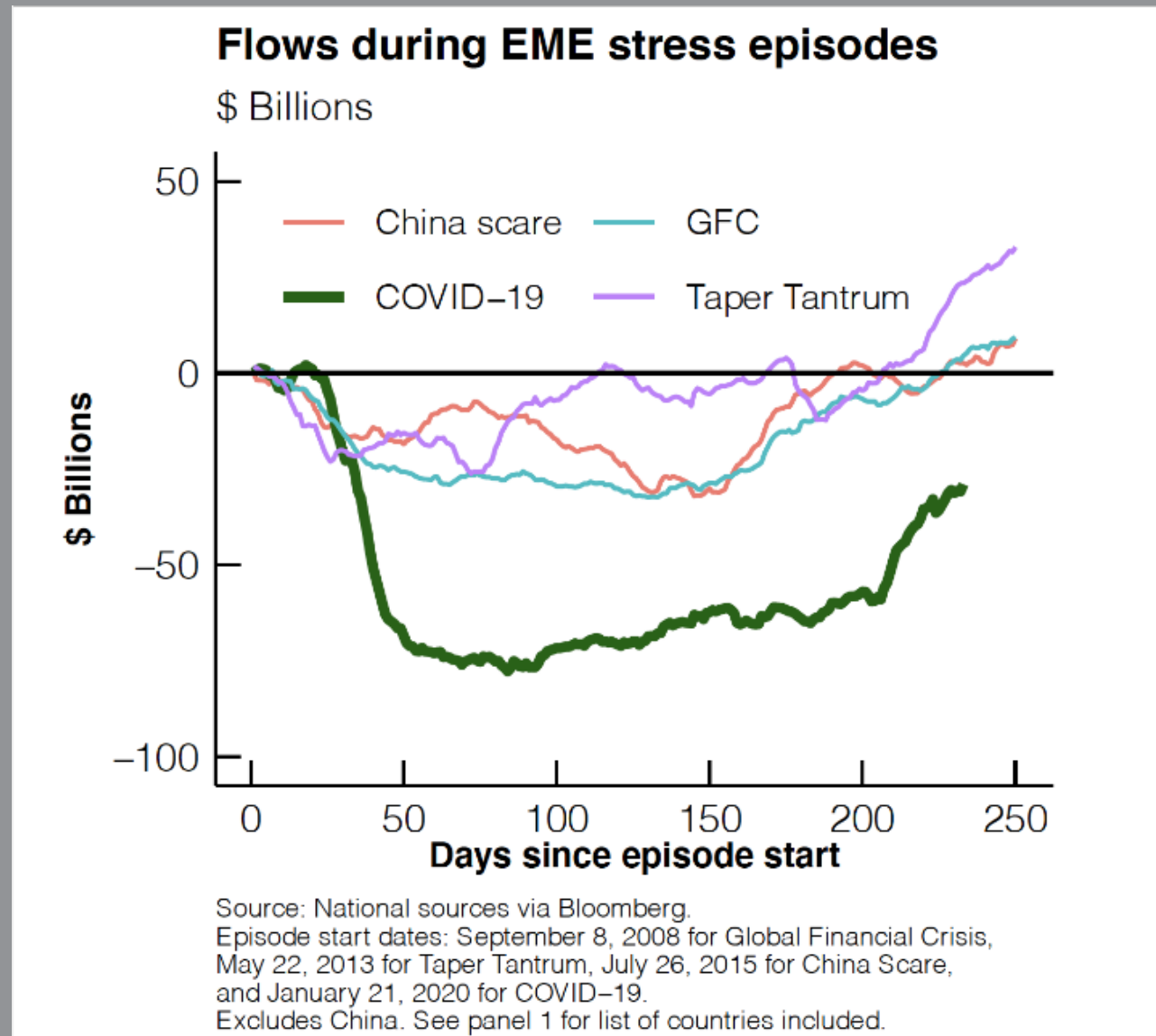


Note: U.S. companies
Source: Dealogic

Source: WSJ

Global Financial Crisis – averted in March 2020

- Flight to safety in the US dollar



- Fed interest rate cut and repo facility

High Public **Debt** Levels, but **low** interest **rates**

- Debt/GDP vs. Value at Risk (Debt servicing cost | ·)

- Asset pricing formula with second term

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

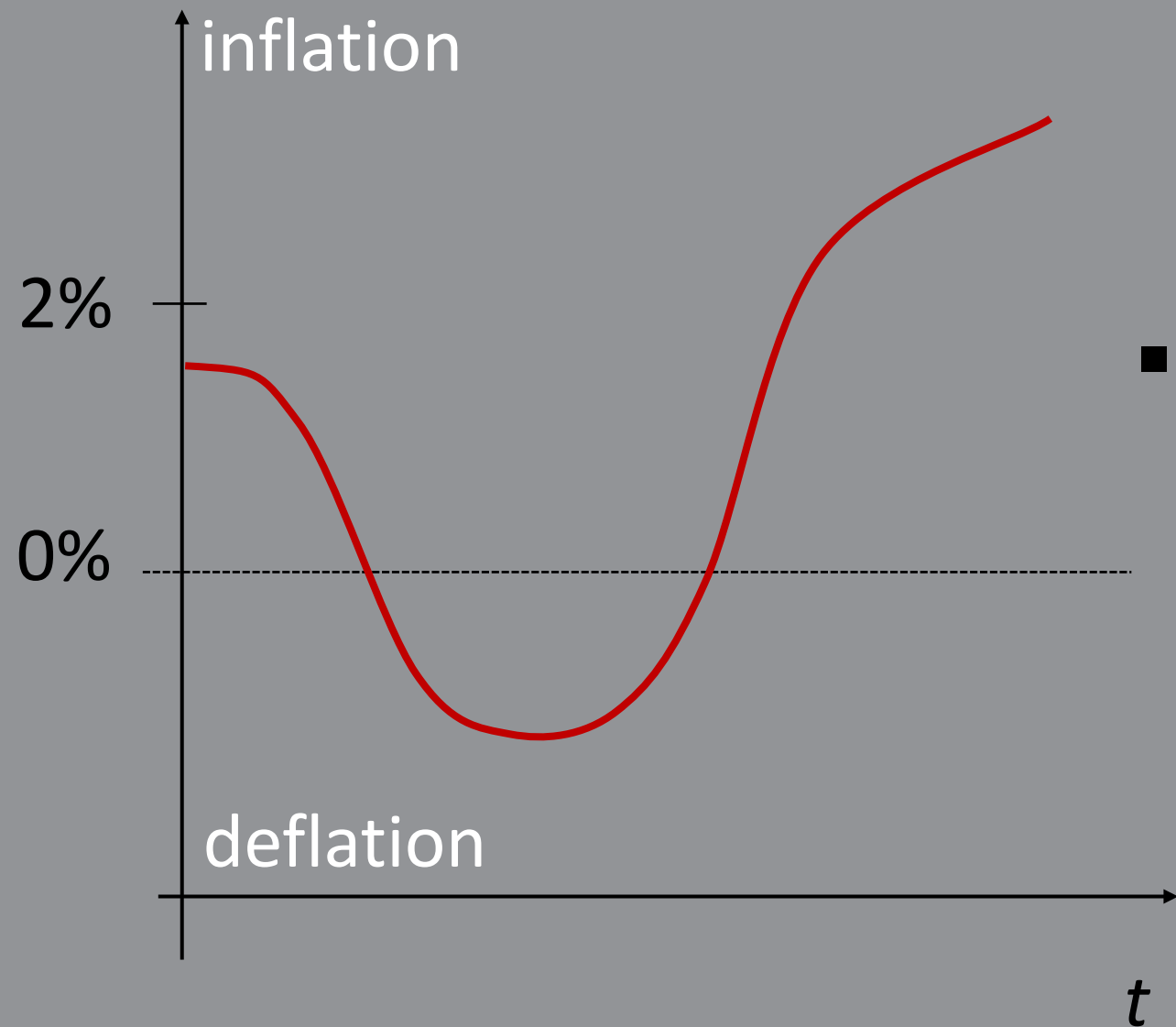
- Safe asset service flow:

Precautionary savings + retrading (to partially insure idio risk $\tilde{\sigma}_c^2$)

$$\Rightarrow \text{low real interest rate } r^* = \rho + \gamma g - \frac{1}{2}\gamma(\gamma + 1)\sigma_c^2 - \Delta i$$

- Safe asset status of gov. bonds – bubble feature that can pop
 - Fiscal space to “defend bubble”

Tail/Trap Risk: “Inflation whipsaw”



- **2 traps** (“resilience killers”)

- Deflation trap
- Inflation trap (fiscal + financial dominance)

- **Independence** central bank
+ **MacroPru**

- Accelerator and breaks

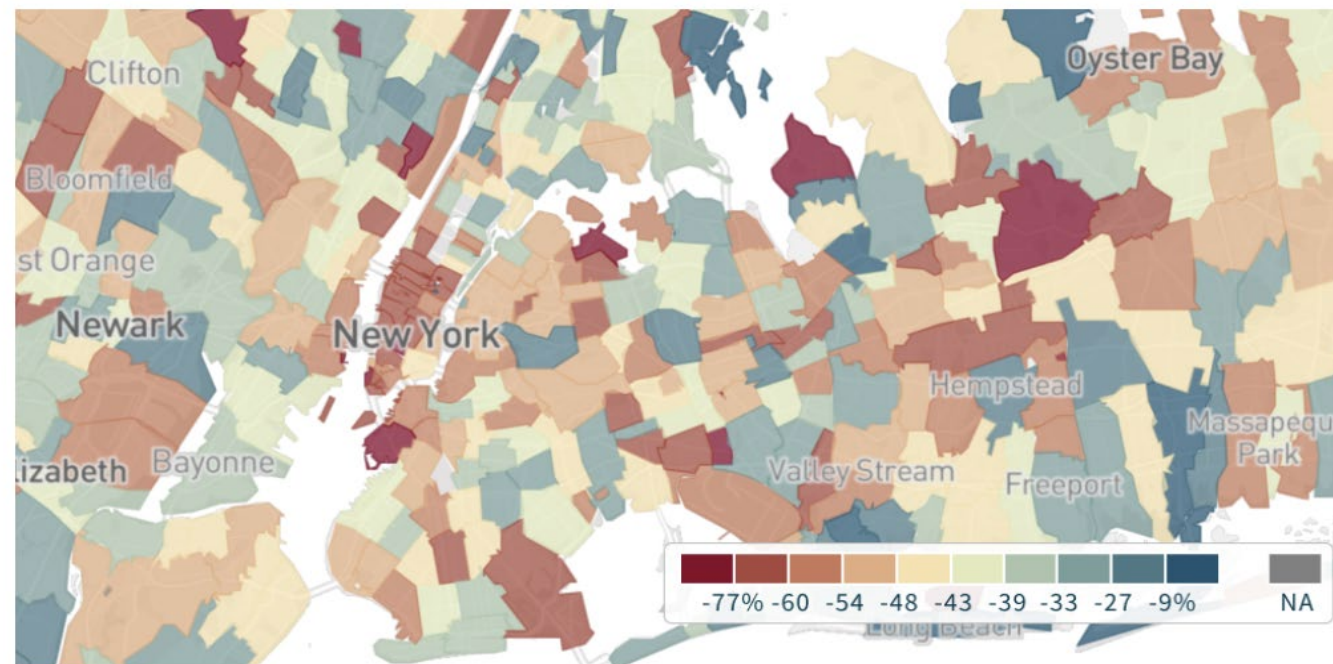


Inequality of Resilience

- Households' savings too small to be resilient
- Regional inequality: Poor in affluent neighborhoods

Low-Income Employment Down in Affluent Areas

Declines in high-income spending led to significant employment losses among low-income individuals working in the most affluent ZIP codes in the country, as shown in the map below of employment declines in early June in New York City.



- Racial gap
- Online education gap
- Income vs. wealth: valuation effects

- EMDE: Visible vs. invisible Health, Life vs. livelihoods
 - Limited policy space: crisis and recovery phase
 - Fiscal response: 20%, 6%, 2%
 - Debt restructuring
 - “Slowbalization” only (in trade)
but deglobalization (in services, technology transfers)
 - Global value chains
 - From cost minimization to
 - Just-in-Time
- Resilience

Just-in-Case, dual sourcing



THANK YOU
&
HAPPY HOLIDAYS
see you in 2021!