Box 2.2

Global Economic Policies Against the Pandemic

With the spread of the coronavirus outbreak worldwide, the global economy has been experiencing a downturn that, in many ways, is even more severe than the 2008 financial crisis. The "social distance" and "quarantine" measures implemented as the most effective way to slow the outbreak have brought economic activity to a halt in several countries. While the economic effects of the pandemic have been visible in a wide geography and deeper than the global financial crisis (Box 2.1), the policy responses have been varied and unprecedentedly strong.[1]

What do the policies aim for?

Since the main reason for the economic contraction is the measures taken towards maintaining public health, the key to the exit from the stagnation will be solving the health issues to allow the gradual easing of the quarantine conditions. Until then, the role of economic policy is to support those who have lost their jobs and income, to take measures to help maintain the balance sheets and employment capacity of companies that cannot continue working, to ensure the functioning of financial markets, and to prevent any permanent damage to supply chains or any contraction in the production capacity. These policies are critical both to minimize the costs incurred during the period of quarantine measures and to ensure rapid recovery when these conditions are eased or lifted.

The experience that policy-makers have built up in unconventional monetary policy after the 2008 crisis and the expansion of the monetary policy tool kit have been positive factors in terms of the policy response to the pandemic. Central banks, in particular, were able to respond quickly as soon as the problem arose (Table 1). However, the policy room seems to be rather limited due to the failure to achieve policy normalization in the post-crisis period.

Monetary Policy

The first response was to rapidly cut policy rates on a global scale and to ease the monetary policy with other available instruments. The policy rate, which was already low in advanced economies, has rapidly approached the zero lower bound, and central banks have used the available policy room without hesitation.

Central banks have also resorted to the bond purchases aimed at lowering long-term interest rates in the post-crisis period once again. In addition to four major central banks, central banks of Australia, Sweden and Canada also started buying bonds. The Fed and ECB purchased a substantially high amount of bonds in less than a month. The Fed has expanded its balance sheet, which had grown by USD 3.5 trillion in approximately six years after the 2008 crisis, by about USD 2.3 trillion since March 11. In addition to treasury bills, purchases of commercial papers and stocks were also used as a post-crisis policy instrument by the ECB, the Bank of England, and the Bank of Japan in particular. Recently, the Fed has also joined these central banks. Central banks are expected to make more of these purchases now compared to the post-2008 period. The purpose of this policy is to help companies survive the quarantine period with minimal losses and without bankruptcies by preserving their capital value and reducing their financing costs.

[1] The IMF has compiled a comprehensive list of policy responses to the pandemic by countries (IMF Policy Tracker: https://www.imf.org/en/Topics/imf-and-covid19/Policy-Responses-to-COVID-19).

Table 1: Monetary and Financial Policy Measures of Selected Countries

		Euro zone	USA	Japan	UK	Canada	Avustralia	Sweden	China	S. Korea	Russia	India	Indonesia	Brazil
Monetary Policy	Rate Cut		✓		✓	✓	✓	✓	✓	✓		✓	✓	✓
	Bond Purchases	✓	✓	✓	✓	✓	✓	✓				✓	✓	✓
	Additional Liquidity Measures	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓
	Swap Agreements	✓	✓	✓	✓	✓	✓	✓		✓				✓
Financial Policy	Capital Buffers or Reserve Requirements	✓	✓	✓	✓	✓	✓		✓	✓				✓
	Credit Refinancing and Deferrals	✓*	✓			✓	✓	✓	✓	✓	✓		✓	
	Credit Support Programs	✓	✓		✓					✓		✓		

Source: IMF.
*This measure is not applied in some Eurozone countries such as Germany, Austria and Holland.

In order to prevent a credit crunch in the money markets and facilitate access to liquidity, some central banks, particularly the Fed and the Bank of England, have increased their funding via repo transactions and/or extended the maturity of funding. In addition, the Fed made swap agreements with many central banks to meet the increasing global demand for the US dollar.

Financial Policy

The objective of these policies that provide liquidity to the banking sector is both to maintain the current fiscal structure of the financial sector and to secure the flow of credit to the private sector. Banks have been provided with additional liquidity by easing the reserve requirement conditions and/or expanding the collateral pool. In addition, it was projected that loosening the capital and liquidity buffers would release liquidity that would increase the supply of loans. The Bank of China, which routinely employs these tools, actively used them during the pandemic period as well. The Fed has also eased the collateral conditions of banks.

In addition to supporting banks in terms of liquidity, policies to reduce the financing cost of the real sector, which is in a debtor position, have also been introduced. In order to minimize the costs incurred by firms during the pandemic period, postponing or restructuring existing credit payments has also been widely used (Table 1).

On the other hand, credit incentive programs are intended to ensure that liquidity is used in a way to prevent a possible destruction in the real economy. The financing advantages provided to the banking sector so that they can expand the volume of credits extended to the real sector are among the policies that the ECB and the Bank of England have also applied after the 2008 crisis. With the latest developments, the two central banks have significantly increased the limits of this program. It is seen that the Fed is also encouraging banks to sustain their credit flow through a comprehensive support program. The Reserve Bank of India has also announced a similar program.

Fiscal Policy

The fiscal policy measures introduced can be examined under several main headings such as new credit channels and state guarantees for loans, tax exemptions and reductions, and direct expenditures (Table 2). Loans and state guarantees include support for sectors and individuals affected by the crisis, particularly small and medium-sized businesses. In this context, while the USA passed the biggest stimulus package in its history with approximately USD 2.2 trillion, Germany, France and Spain announced a total of approximately EUR 1.1 trillion support through this channel. Due to the high government debt stocks, it is noted that the incentive packages announced in other G20 countries are also predominantly through this channel. Tax reductions in the form of discounts, deferral opportunities and exceptions in income taxes are mostly put into practice to support firms that are struggling due to the crisis and prevent unemployment. Finally, within the scope of direct expenditures, supportive steps such as those related to health expenditures, social benefits, and direct money transfers to individuals (as in the USA and Japan) were announced.

Table 2: Public Finance Policy Steps By Selected Countries

	USA	Germany	UK	France	Spain	Italy	Japan	China	Australia	Canada	Russia	India	Indonesia	S.Korea
Health and Social Spending	✓	✓		✓	✓			✓	✓			✓	✓	✓
Infrastructure Spending	✓													
Cash Transfers to Households	✓						✓							
Credit	✓							✓						✓
Credit Guarantees	✓	✓	✓	✓	✓			✓	✓		✓			
Tax Cuts and Exceptions	✓						✓	✓	✓	✓			✓	
Labor Market Support	✓			✓				✓						

Source: IMF.

Policy Effectiveness and Costs

The effectiveness of the economic policies implemented to counter the effects of the pandemic may be more limited compared to the case during the 2008 crisis, since the main source of the problem is neither financial nor economic. It is considered that the steps taken will help maintain the functioning of the financial system and mitigate the effects of tightening financial conditions on households and the real sector. The actions that the economic units have taken to minimize their own losses cause the loss to be transferred from one unit to another. For example, when a firm in the non-financial private sector dismisses an employee due to the disruption in its cash inflow, this results in an improvement in the income statement of that firm but a deterioration in the income statement of households. In return, the payment of unemployment benefits by the state improves the income statement of households while disrupting the income statement of the state. In such an ongoing process, if the majority of the economic loss caused by the cessation of economic relations as a result of health measures is covered by the state, large increases in the public borrowing requirement will be observed. If the resulting public debt is financed with central bank resources, and if the increased central bank liabilities are not sterilized in the post-pandemic period, there may be an acceleration in inflation and an increase in asset prices - for example real estate prices, with the revived economic activity. In sum, correcting for the pandemic-driven deterioration in the cash flow of economic units may be deemed to be important for the proper functioning of the economy in the post-pandemic period, but it may also bring some additional costs to the society.

It is considered that these incentive packages will increase the budget deficits in advanced economies and cause a further increase in the already high level of public debt. As is the case for the monetary policy, the fiscal policy room is also limited in advanced economies compared to the 2008 crisis, but public debt is nevertheless expected to increase rapidly starting from the first quarter of 2020. On the emerging economies front, although the public debt is lower, fiscal policy space is considered to be limited due to risks arising from exchange rates, risk premiums and capital outflows.

To sum up, it is seen that the policies implemented have economic costs that cannot be ignored. However, permanent damage that the pandemic may cause to employment, supply chains and production capacity will result in much higher costs. For this reason, policy makers are in consensus around the world as they take supportive steps on an unprecedented scale.