Higher School of Economics
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ICEF, HSE University https://icef.hse.ru/en/

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This Time is Different: Economic Policy Challenges in the time of COVID-19

Moscow, Russia. Wednesday June 3, 2020.

Today, a virtual panel discussion was held to discuss the economic consequences and policy responses to Covid-19 with economic experts from academia, central banks and commercial banks, based in Russia, UK, and Austria. As a result of COVID-19 the global economy is experiencing challenges rarely seen out of times of war. At a national level these challenges stem from efforts to ensure political-financial-economic stability whilst preserving the health and safety of citizens. The consequences and trade-offs in the decisions that are being made will have repercussions that will affect the world for many years to come.

This panel discussion focused on the economic policy responses that have been or may be made and the consequences and implications for political-financial-economic stability. Our expert panel of acclaimed economists from academia, policy institutes and the private sector discussed both the global impact as well as the impact within Russia. In addition to presenting their views, the panel fielded questions from an online audience in an interactive Q&A session. The event was attended by participants from academia, central banks and policy institutes, the private sector, and the press, from Russia and abroad.

The entire event can be found online at: https://www.youtube.com/watch?v=aOMUMz0w8kg

The panel composed of (and the summaries of their talks)

- host and moderator, **Professor Udara Peiris (ICEF, HSE University),**
  - **Summary:** COVID-19 outbreak caused a crisis that the global economy has never experienced before outside of wartime
- **Professor Martin Gilman (HSE University)**, a former Assistant Director of the IMF policy department who spoke about "*US policy and spillovers to global markets*"
  - **Summary:** The current crisis is very unusual, because it was caused by a decline in the real sector than in the financial one, unlike in previous crises. The expectations for the US economy appear optimistic, but there is an uncertainty about the recovery of consumption — this will be a crucial point in after-virus recovery
- **Professor Dimitrios Tsomocos**, the Chair of Financial Economics at the Said Business School and St Edmund Hall at the University of Oxford spoke about "*European political and fiscal actions and effects*"
  - **Summary:** The divergence between countries of southern and northern Europe is exacerbated by the coronavirus outbreak — the South is more dependent on tourism and has more nuclear structure of enterprises, meanwhile the impact of the ECB support may be overestimated for these countries.

- **Dr. Reiner Martin**, Lead Economist at the Joint Vienna Institute and former Deputy Head of the European Central Bank's Macroprudential Policy Division spoke about "*European monetary and supervisory response*"
  - **Summary**: The ECB's broad measures of financial and supervisory support are likely to ease the negative impact of COVID-19 outbreak on the euro area.

- **Dr. Alexander Morozov,** the Head of the Research and Forecasting Department and the Central Bank of Russia, spoke about "*Russian Policy Response*"
  - **Summary**: The Russian economy has been acting in the same manner as economies of the EU and US during the lockdown, even under policy constraints intrinsic to emerging markets. After the inflation spike, the main point of concern now is the risk of deflation.

- **Dr. Oleg Zamulin**, Director of the Centre for Macroeconomic Research at Sberbank and Former Dean of the Faculty of Economic Sciences at HSE University, spoke about the "*Outlook for the Russian Economy*"
  - **Summary**: Russia was prepared better for the crisis than five years ago due to better macroeconomic policy. Direct measures of support in Russia are as large as in some developed economies, but there is still a huge fall in personal income and decline in demand caused by coronavirus outbreak.

Other interesting points raised during the Q&A session include:

- (R. Martin, for Europe) There are options to make quantitative easing more effective (vary types of assets that central banks can buy, repo operations). But there is a risk that unviable banks will be will remain in business only because of monetary stimulus, which is problematic in the long run;

- (A. Morozov) (In Russia) Support was given to people more vulnerable to coronavirus outbreak than the others, estimate of bailout is 4,5% of GDP

- (D. Tsomocos) The issue of hyperinflation is not in the radar of policymakers and academic economists. The main issue is asset price inflation and the associated potential asset price bubble, hence, the liquidity trap. The leverage is another concern but it has been reduced substantially due to Basel III;

- (M. Gilman) The world will be moving to a more fragmented, uncooperative, deglobalized framework.

- (O. Zamulin) This pandemic won't change the world in a very substantial way, but there will be a period of less international integration, the role of state in health care and social safety net will probably increase; for Russian government it is important to keep conservative fiscal policy in the long run, but currently there is room and need to increase debt-to-GDP ratio.

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We summarise the key points of each speaker throughout the event.

- The host and moderator, **Professor Udara Peiris (HSE University)** pointed to parallels in the declines in GDP and rise in government debt this year to times of war. He mentioned that households are as financially fragile as during the Global Financial Crisis.

  Summary: COVID-19 outbreak caused a crisis that the global economy has never experienced before outside of wartime.

- **Professor Martin Gilman (HSE University)**, a former Assistant Director of the IMF policy department spoke about "*US policy and spillovers to global markets*" and noted that

  - US financial market expects V-shaped recovery;
  - COVID-19 is like an alien invasion — it was sudden, global and real compared to the earlier financial crises;
  - US households sudden increase in savings may be not temporary;
  - US unemployment rate increased sharply, and the situation can be even worse because of decline in labour force participation;
  - The main point of concern for the US is the path of consumption constrained by massive unemployment, investment threatened by bankruptcies, and lower demand in service sectors such as travel.

  Summary: The current crisis is very unusual, because it is caused rather by a decline in the real sector than in the financial one as during previous crises. The expectations for the US economy are optimistic, but there is an uncertainty about recovery of consumers' behavior — this will be a crucial point in after-virus recovery.

- **Professor Dimitrios Tsomocos**, the Chair of Financial Economics at the Said Business School and St Edmund Hall at the University of Oxford spoke about "*European political and fiscal actions and effects*":

  - Low- and middle-skilled jobs were the most exposed to the COVID-19 outbreak;
  - Retail and real estate services drive the output collapse in developed countries;
  - There is not much room for actions of central banks of developed countries due to the persistence of the effective lower bound;
  - There is a huge and unprecenental financial run from emerging markets due to coronavirus outbreak;
  - In Eurozone, countries that have greater debt-to-GDP ratio are more dependent on tourism;

– Southern Europe countries have more small and medium enterprises;

– Southern and northern Europe are diverging from each other;

– Given fiscal multipliers in southern Europe and the implementation length of the fiscal stimulus, the effect of latter will be not as substantial as one can expect.

Summary: The divergence between countries of southern and northern Europe is exacerbated by the coronavirus outbreak — the South is more dependent on tourism and has more nuclear structure of enterprises, meanwhile the effect of ECB support may be overestimated for these countries.

- **Dr. Reiner Martin**, Lead Economist at the Joint Vienna Institute and former Deputy Head of the European Central Bank's Macroprudential Policy Division spoke about "*European monetary and supervisory response*":

  – ECB's 'Pandemic Emergency Purchasing Programme (PEPP)' injected initially up to 750 billion. euros liquidity into euro area financial markets; in the meantime, this has been increased by a further 600 billion euros;

  – There is a significant temporary easing of regulatory and supervisory requirements for the banking system in the euro area;

  – Recommendation not to pay dividends for 2019–2020 and refrain from share buy-backs for the banks;

  – ECB reacted swiftly and in a comprehensive manner to the crisis;

  – This crisis is more likely to have for V-shape — there are no structural changes needed like after the Global Financial Crisis – but uncertainty is high;

  – Eurozone tension — German Constitutional Court ruled that ECB was not providing 'proportionality assessment' in its (2015) Public Sector Purchase Programme. This issue should be resolved going forward, also in view of the new PEPP .

  Summary: The ECB's broad financial and supervisory support is likely to ease the negative impact of COVID-19 outbreak on the euro area.

- **Dr. Alexander Morozov,** the Head of the Research and Forecasting Department and the Central Bank of Russia, spoke about "*Russian Policy Response*":

  – Russia had an advantage in terms of COVID-19 outbreak dates relative to other countries;

  – The Bank of Russia has developed an analytical tool to monitor dynamic of inter-sector financial inflows in the Russian economy;

  – During the lockdown the economic situation in Russia was comparable to the EU and US;

– Simulations show that first-round effects (due to lockdown) and second-round effects (changes in supply chain) are likely to decrease rapidly;

– nflation spike in Russia is behind, the point of concern now is deflation risks;

– Emerging market economies have more policy constraints comparing to developed economies (currency stability, credit rating, local financial markets).

Summary: Russian economy has been acting in the same manner as economies of the EU and US during the lockdown, even under policy constraints intrinsic to the emerging markets. After inflation spike, the main point of concern now is the risk of deflation.

- **Dr. Oleg Zamulin**, Director of the Centre for Macroeconomic Research at Sberbank and Former Dean of the Faculty of Economic Sciences at HSE University, spoke about the "*Outlook for the Russian Economy*":

– Three challenges for the Russian economy during COVID-19 outbreak: oil price decline, lockdown restrictions and aggregate demand decrease;

– Russia was better prepared for this crisis (fiscal rule, international reserves, flexible exchange rate, low government debt);

– Lockdown restriction effects are smaller than in the European countries;

– Huge fall of demand in Russia — -21% YoY in retail sales;

– Decline of personal income — 76% of respondents say that their income fell, but big unemployment spike is less likely;

– 'A crooked V' recession —a quick economic rebound to a level below normal followed by a more gradual recovery to pre-crisis level;

– Most measures of policy response in Russia came late, but direct support in Russia is comparable to most developing countries, as well such developed countries as Italy and France, although much lower than in countries such as USA and Germany;

– After lockdown, the usual measures of aggregate demand policy, such as fiscal and monetary policy should be applied.

Summary: Russia was prepared better for the crisis than five years ago due to better macroeconomic policy. Direct measures of support in Russia are as large as in some developed economies, but there is still a huge fall in personal income and decline in demand caused by the coronavirus outbreak.

Q&A session:

- *What if there is a second wave of pandemic*?

- (O. Zamulin) No need for a severe economic lockdown during next anticipated waves of pandemic;
- (D. Tsomocos) Some southern European countries had high unemployment rates before pandemic.

- *Why not just to start printing money/exotic policy instruments*?
  - (M. Gilman) The global problem now is that liquidity is given to highly indebted institutions (governments, corporates), which may potentially have insolvency problem.
  - (A. Morozov) Russia still has more room in policy actions that developed economies, so instead of 'helicopter money', the Central Bank can manage economy by interest rate and other kinds of 'orthodox' monetary policy;
  - (A. Morozov) Russian banks have capacities to buy the government debt without administrative obligations, yield for bonds of federal debt are quite low, which reflects the fact that it's an attractive instrument for both residents and non-residents
  - (R. Martin, for Europe) There are options to make quantitative easing more effective (vary types of assets that central banks can buy, repo operations). But there is a risk that unviable banks will be will remain in business only because of monetary stimulus, which is problematic in the long run;
  - (R. Martin) Usage of negative interest rates is limited by negative side effects of it and political reception;
  - (R. Martin) Giving grants rather than loans in response to the pandemic may be beneficial.

  Summary: for Russia, there is enough room to use orthodox policy instruments; the developed economies have less room, but the cost of usage exotic instruments may be high. Moreover, fiscal policy can be applied to agents that lack of liquidity and have solvency issues.

- *What are the fiscal and budget support estimates/direct support to households in Russia is small and speed of recovery/shape of recovery*:
  - (A. Morozov) Support was given to people more vulnerable to coronavirus outbreak than the others, estimate of bailout is 4,5% of GDP;

- *What does the effective lower bound mean in the context of Russia/how do the policymakers weigh the pros and cons of using monetary stimulation and balancing between hyperinflation and popping up aggregate demand/parameters that CB keeps an eye on*:
  - (A. Morozov) The main parameters of the economy in Russia are inflation target, macroeconomic strength (credit ratings, sovereign credit spreads, risk premium);

- (D. Tsomocos) The issue of hyperinflation is not in the radar of policymakers and academic economists. The main issue is asset price inflation and the associated potential asset price bubble, hence, the liquidity trap. The leverage is another concern but it has been reduced substantially due to Basel III;
- (M. Gilman) If there is disruption in supply chains and in aggregate demand, these problems should be solved first, and, after that, any inflation issue (i.e., resolve problems sequentially);

Summary: the hyperinflation is not a problem by itself, it is an evidence of bad economic situation. What is really important is asset prices and leverage.

- *How has monetary policy compensated for a relatively weak response from fiscal side in Russia to help small and medium enterprises, and how will it affect the competition in real sector there*?
  - (A. Morozov) One should not think of monetary and fiscal policy as substitutes; providing loans for SMEs does not solve the problem due to insolvency, hence, fiscal policy (grand and non-returned money) is preferable here;
  - (O. Zamulin) Fiscal policy during the lockdown is much more important — it's more necessary to keep employment and keep companies from going bankrupt, but once the lockdown is over, monetary policy becomes more important;
  - (O. Zamulin) In the short run there may be a negative effect on competition due to bankruptcies and consolidation in certain sectors.

Summary: Monetary and fiscal policies are not substitutes and should be applied under particular conditions. Fiscal policy, by itself, is intended to keep employment and preserve agent from going bankrupt.

- *How can we measure what is enough support provided in different countries for both fiscal and monetary policy?*
  - (D. Tsomocos) Enough support is the support that resolves the problem (leads to V-shaped recovery);
  - (A. Morozov) In Russia the share of services sector in GDP is significantly less than in developed economies, and this sector was hit hard by lockdown (especially tourism) — for Russia it is not the case. Hence, it should be smaller than in EU/US;
  - (O. Zamulin) Right now we see a big experiment with different measures in different countries and policymakers choosing different responses. It will be important to analyze this experiment later, but now it is too soon to tell which strategy worked best;
  - (R. Martin) Monetary policy can solve liquidity issues only in certain periods of crises, but it can't solve solvency problems, it's too early to say what is the right amount of support;

Summary: Now it's too early to give estimates of proper amount of support, but a really enough support is such a support that leads to swift V-shaped recovery.

- *What is the role of government in post-pandemic world*?:
    - (M. Gilman) World will be moving to a more fragmented, uncooperative, deglobalized framework.
- *Can we see that Russia is going to the debt-to-GDP ratio as it was in 90's, and how the economy will be organized*?
    - (O. Zamulin) This pandemic won't change the world in a very substantial way, but there will be a period of less international integration, the role of state in health care and social safety net will probably increase; for Russian government it is important to keep conservative fiscal policy in the long run, but currently there is room and need to increase debt-to-GDP ratio.