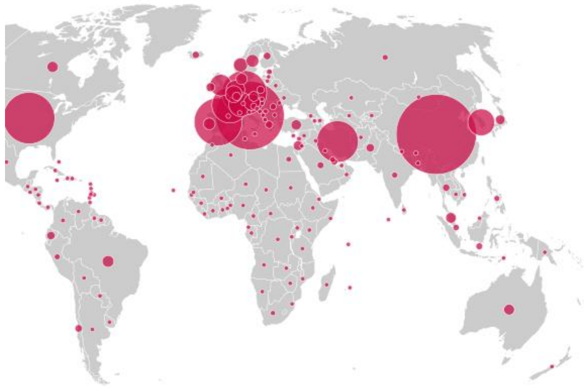
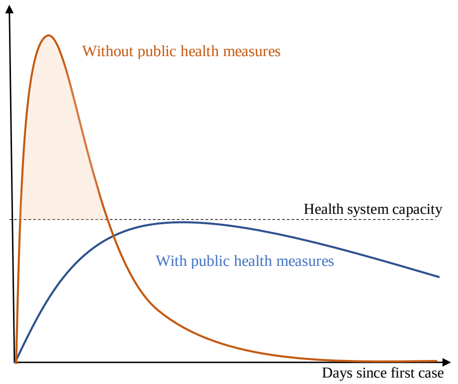
East Asia and Pacific
Economic Update, April 2020





East Asia and Pacific in the time of COVID-19

EAP Chief Economist's Office

April, 2020

East Asia and Pacific in the time of COVID-19

- Developing economies in East Asia and the Pacific (EAP)
  - recovering from trade tensions,
  - struggling with a viral disease,
  - now face the prospect of a global financial shock and recession.
- The shock could bring growth to a halt and increase poverty.
- This exceptional shock needs an exceptional response
  - Bold national action,
  - Deeper international cooperation,
  - High levels of external assistance.

East Asia and Pacific in the time of COVID-19

I. The human costs of COVID-19

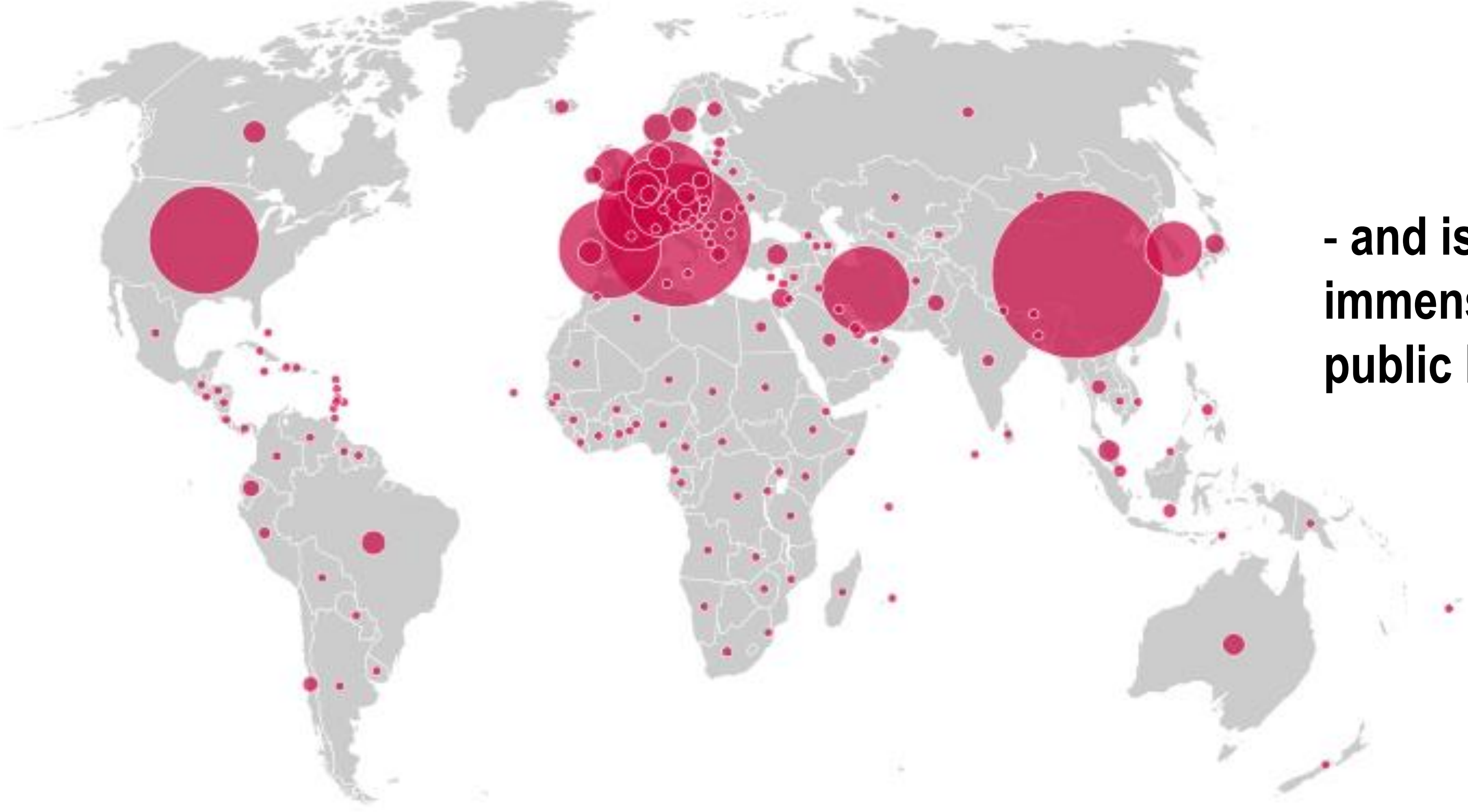
II. The economic costs of COVID-19

1. Nature of the shock
2. Channels of impact
3. Consequences

III. The policy response

I. COVID-19 is inflicting a high human cost

COVID-19 has spread rapidly across the world



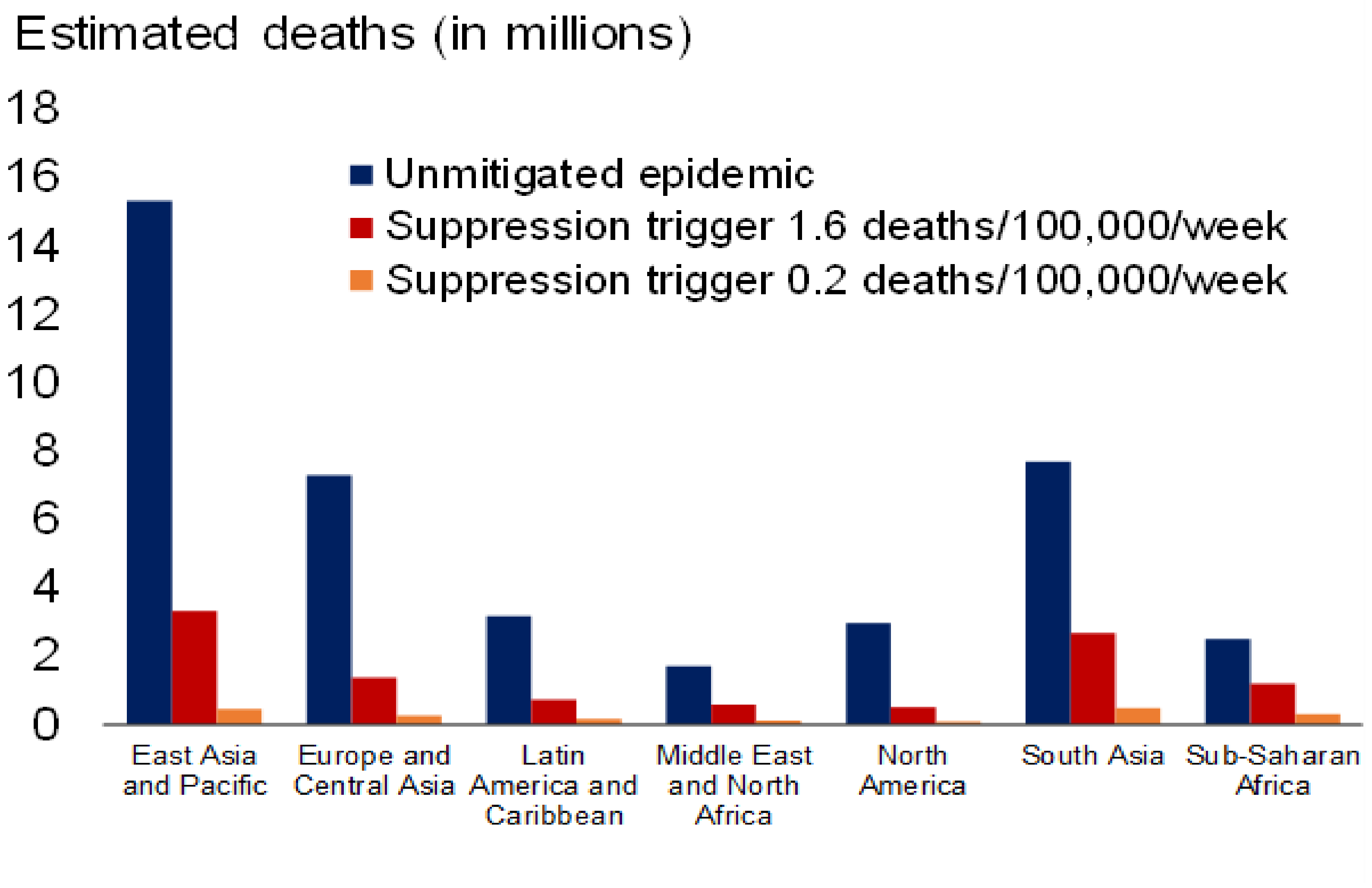
- and is putting immense pressure on public health systems.

Sources: World Health Organization and the National Health Commission of the People's Republic of China.
Note: As of March 23, 2020.

Governments must contain the disease and create the capacity to treat its victims

- Better prepared countries have relied more on testing, tracking and targeted isolation/quarantines.
- Less prepared countries have relied on stringent social isolation measures.

Suppression measures can help lower the death rate

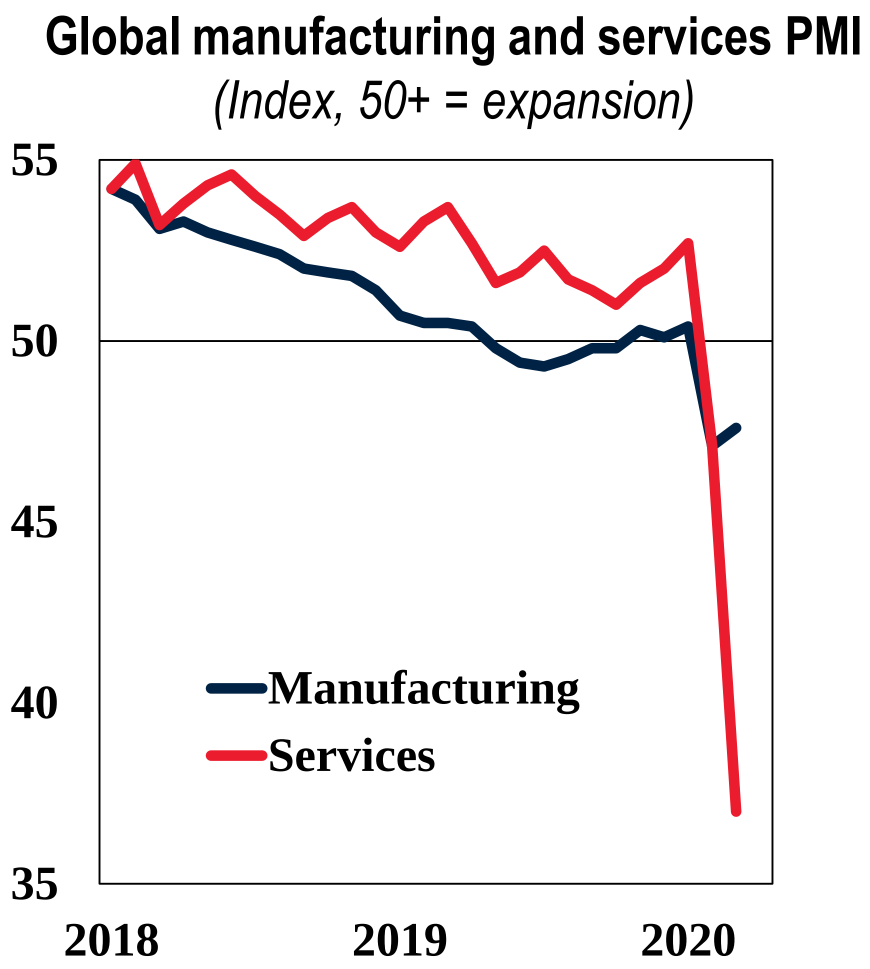


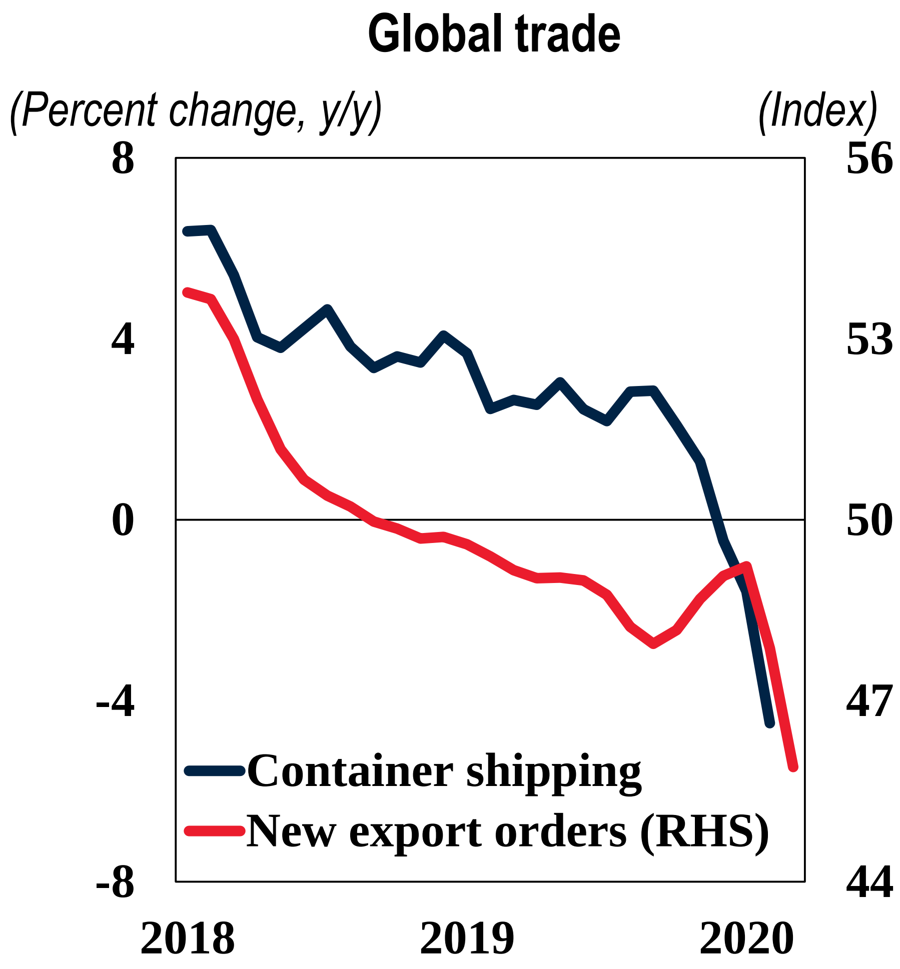
Sources: Imperial College COVID-19 Response team microsimulation prediction under different scenarios.

II.1 The economic costs arise from an unusually severe shock

- Social isolation implies both a ***supply shock*** and a ***demand shock***, preventing collective high density production, consumption, and face-to-face contact.
- Because depth and duration of the shock is unusually uncertain, it is also becoming a ***financial shock***.
- Unlike previous shocks it is originating not in one country but hitting ***all countries simultaneously***.

Global economic activity is contracting sharply because of demand and supply shocks

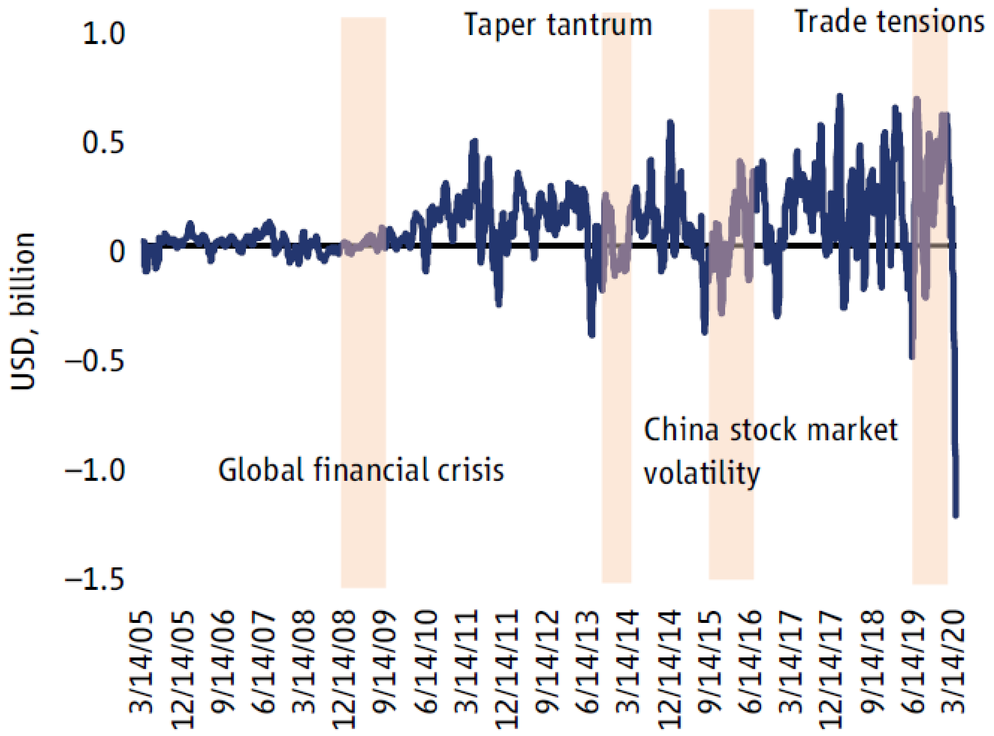




Source: Haver Analytics, Institute of Shipping Economics and Logistics.
Left Panel. Manufacturing and services are measured by Purchasing Managers' Index (PMI). Last observation is March 2020. Center Panel. Figure shows 3-month moving averages. New export orders are for manufacturing and measured by PMI. Last observation is March 2020 for new export orders and February 2020 for container shipping.

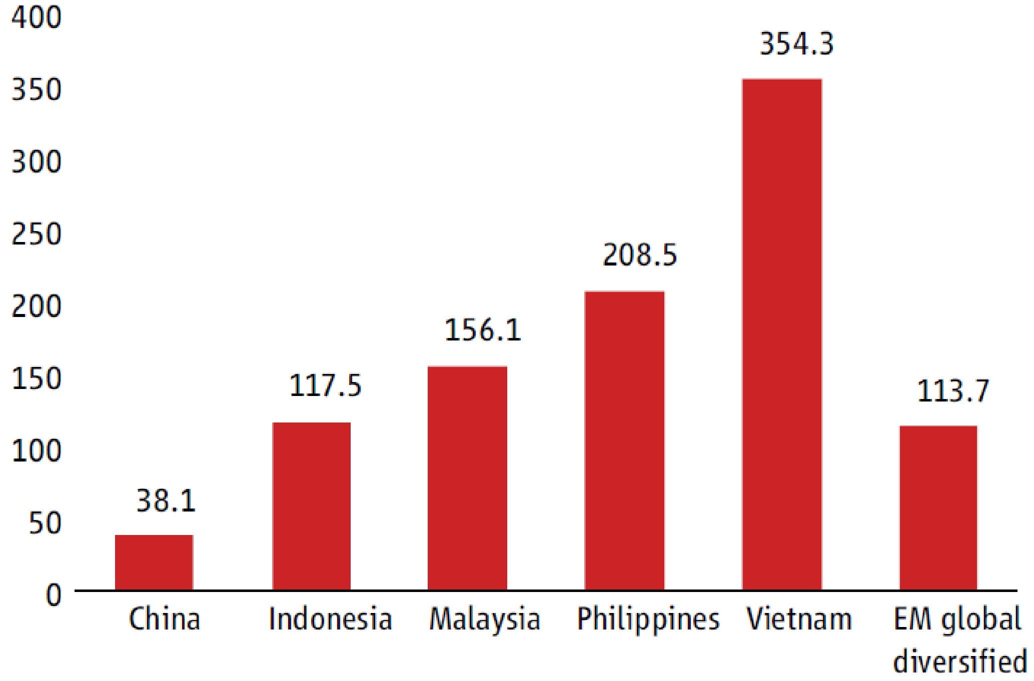
Declines in investor confidence are leading to tighter financial conditions

Non-resident net purchases of equity and bonds



Regions spreads

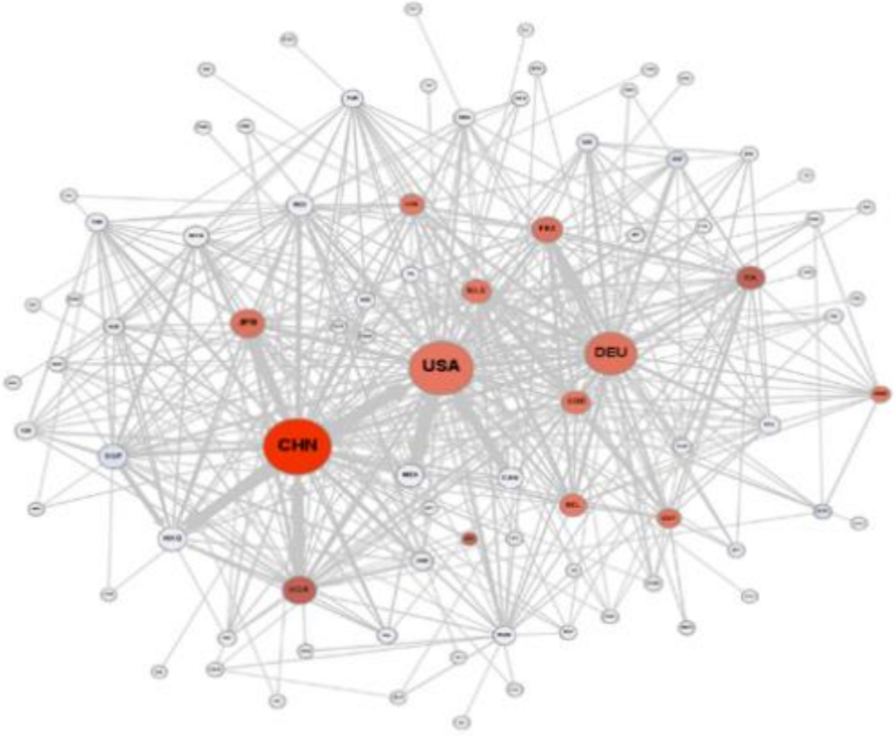
(percent change Jan 2 versus March 27, 2020)



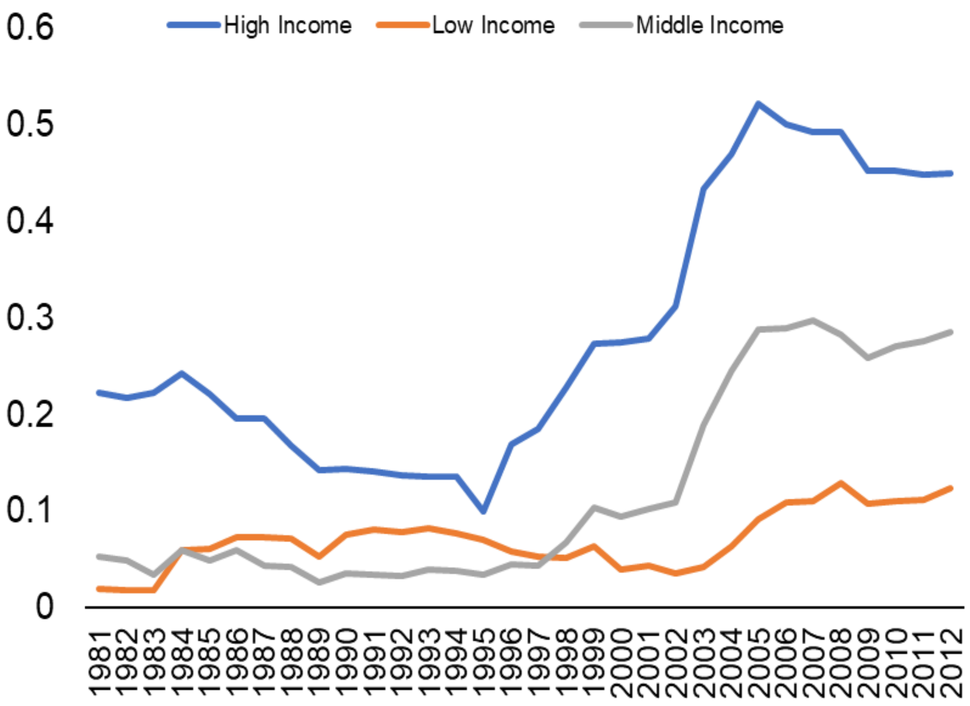
Source: Institute for International Finance, Bloomberg; Institute for International Finance; BIS; Haver Analytics.
Note. 28-days moving average. Includes CHN, IDN, MYS, PHL, THA, VNM. Global Financial Crisis: September 2008; Taper tantrum: May 2013; China stock market volatility: August 2015; Trade tensions: May 2019.

The shock is hitting vital global nodes simultaneously

17 countries with highest COVID-19 cases are critical nodes in the global trade network



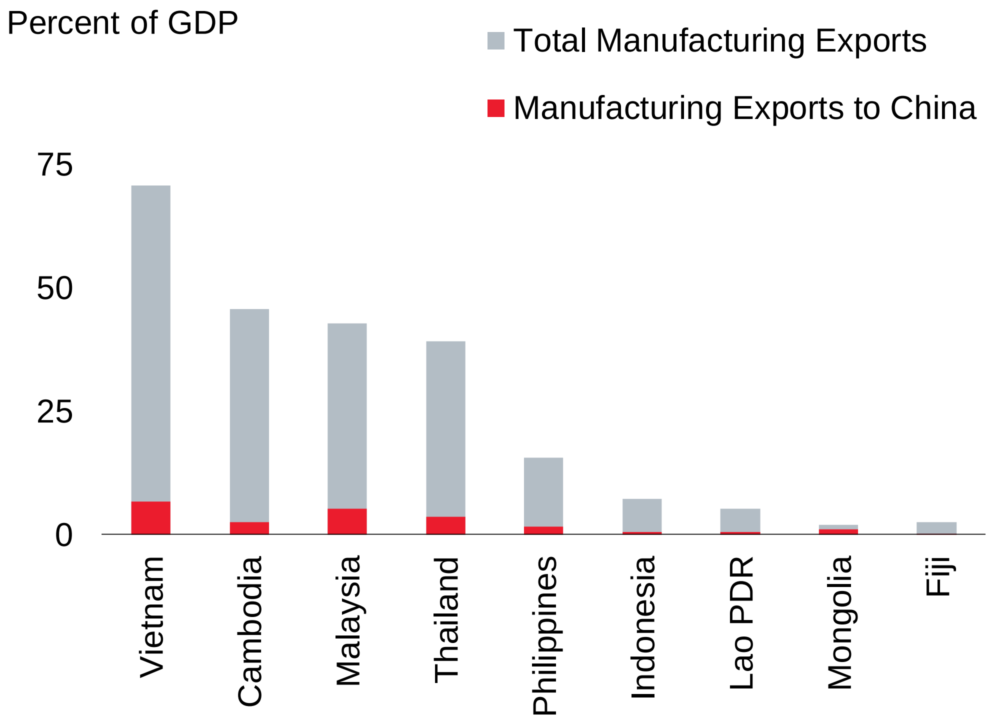
Economic activity has become more synchronized since mid-1990s



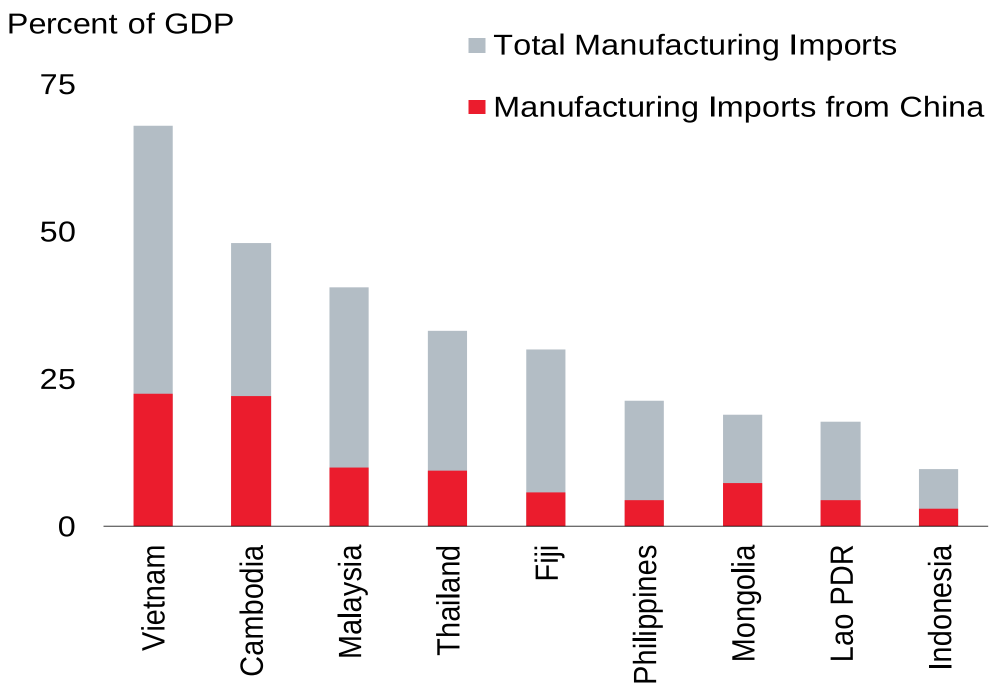
Source: WDR 2020; Comtrade database

II.2 Channels: Trade transmits demand and supply shocks to the region

Manufacturing exports



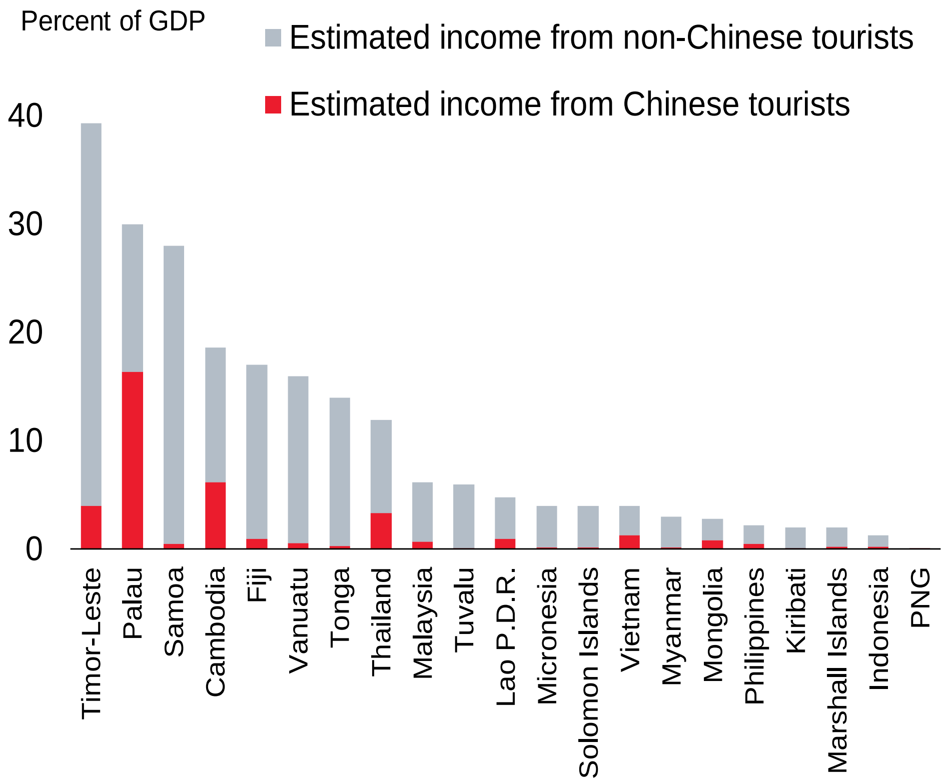
Manufacturing imports



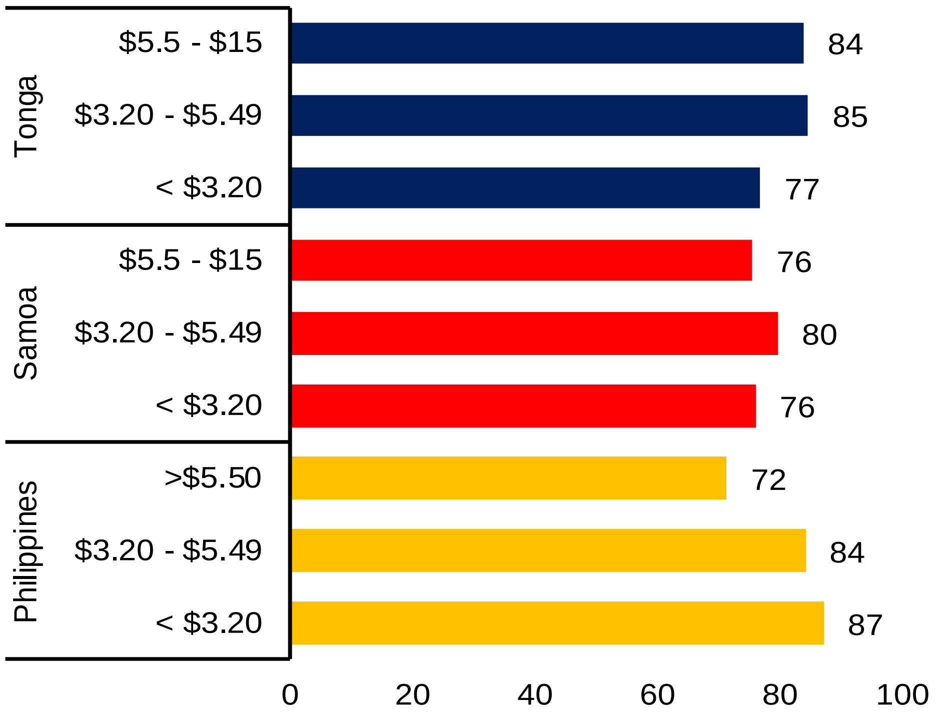
Source: World Development Indicators; World Integrated Trade Solutions

Tourism and remittances also channel shocks to the region

Tourism dependence



Remittances dependence

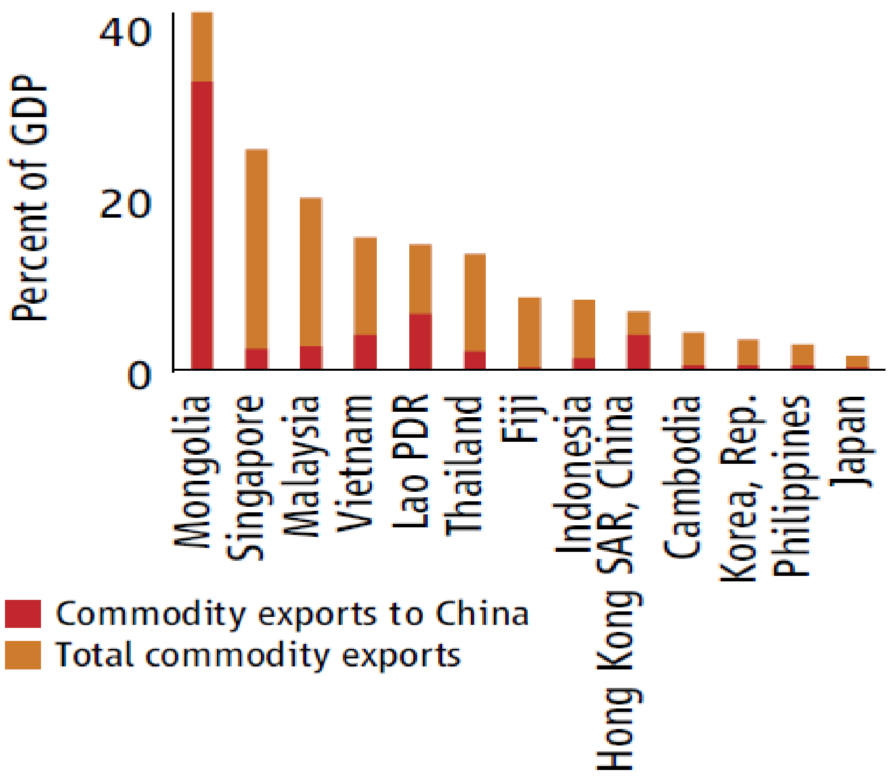


Source: World Development Indicators; World Travel and Tourism Council Data; Authors' calculations based on 2012-13 Samoa HIES, 2015/16 Tonga HIES, and 2018 Family Income and Expenditure Survey for Philippines.

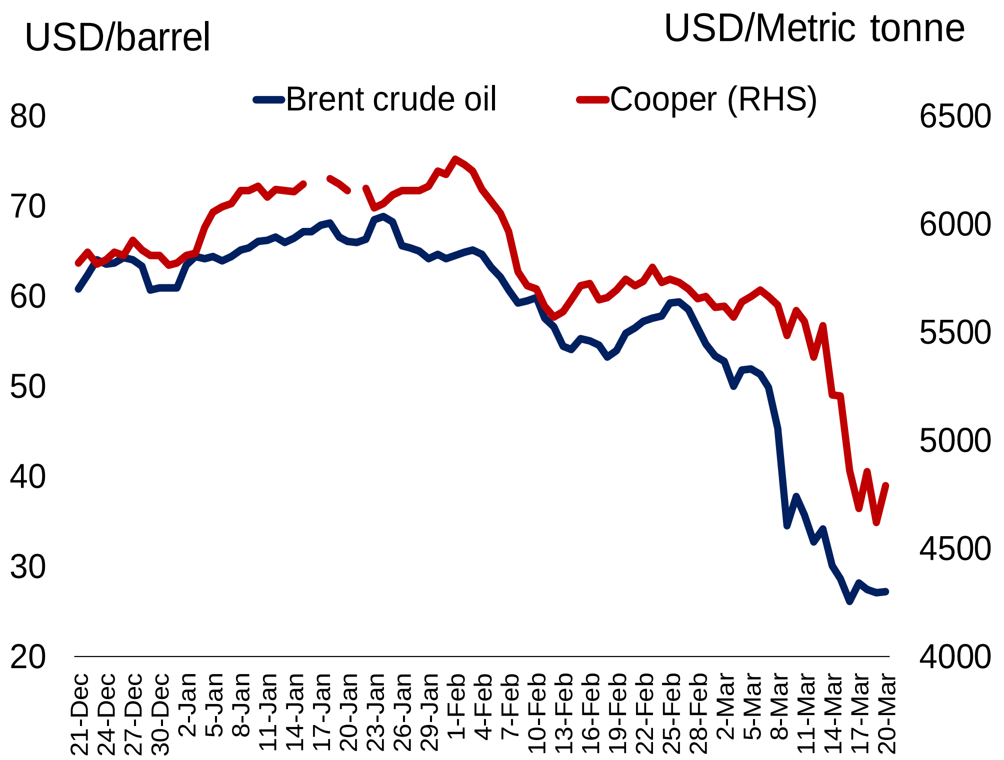
Note: For Samoa and Tonga, share of income from remittances are calculated over total household expenditure, while for Philippines, it is the share of total household income.

Commodity dependent countries are vulnerable to declining commodity prices

Commodity Exports



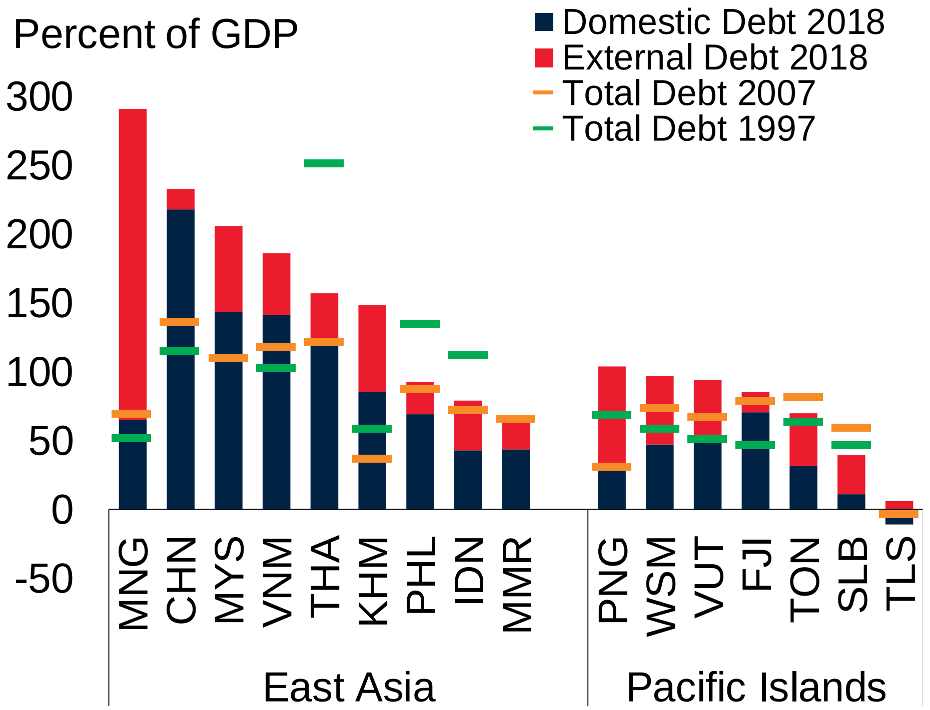
Commodity Prices



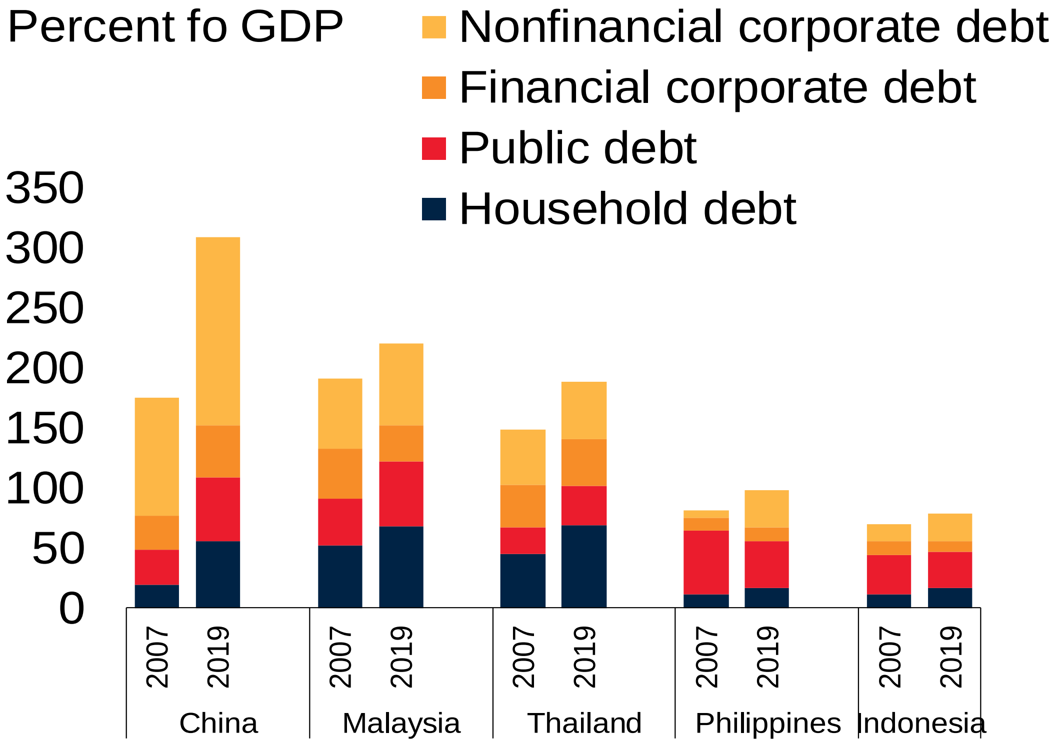
Source: CEIC; World Development Indicators; World Travel and Tourism Council Data; World Integrated Trade Solutions

High indebtedness, foreign holdings and foreign denomination of the debt are sources of concern

Total debt



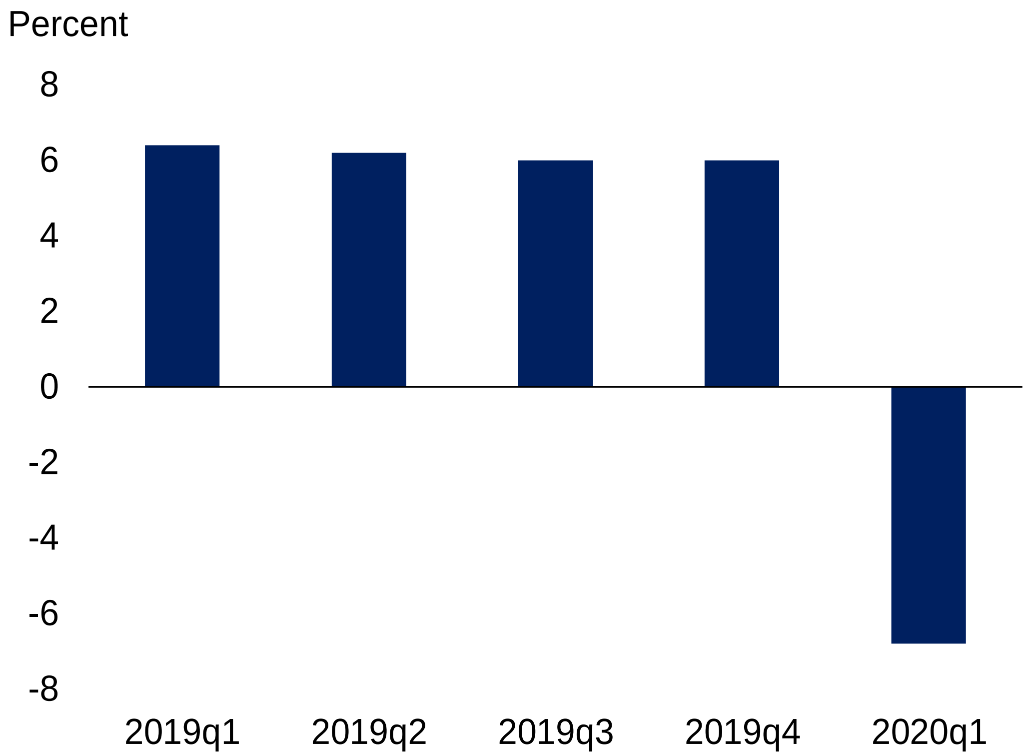
Debt by sector, selected economies



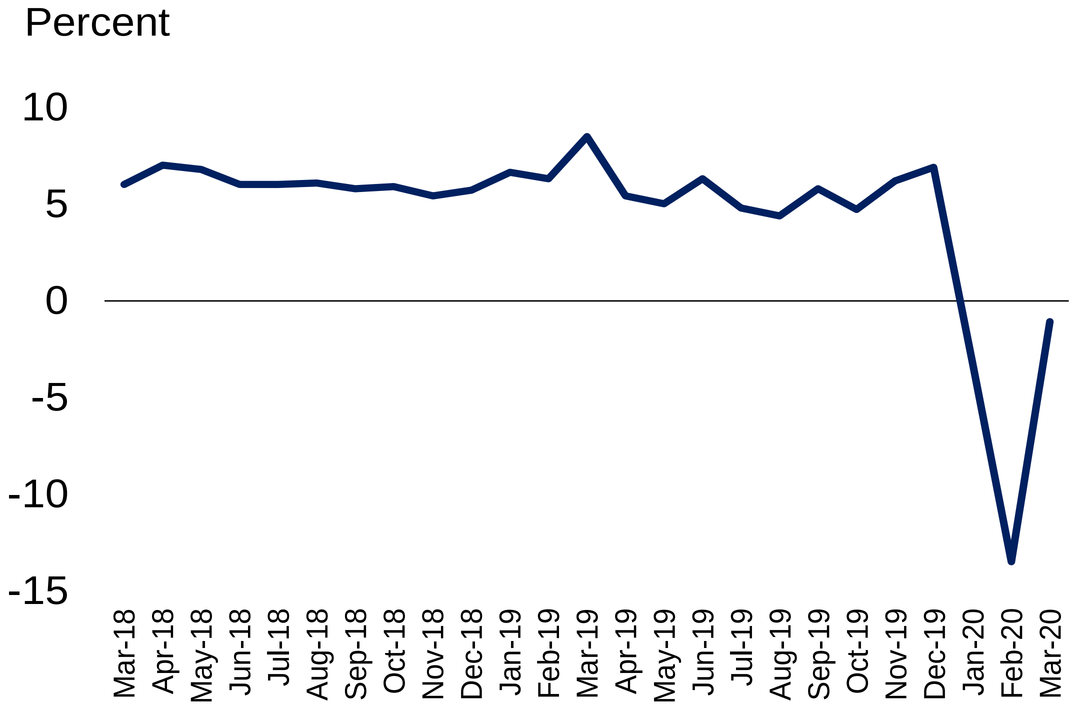
Source: Institute for International Finance, IMF; World Bank.

III.3 Consequences: China saw a precipitous decline in economic activity, but production is recovering

Gross domestic product

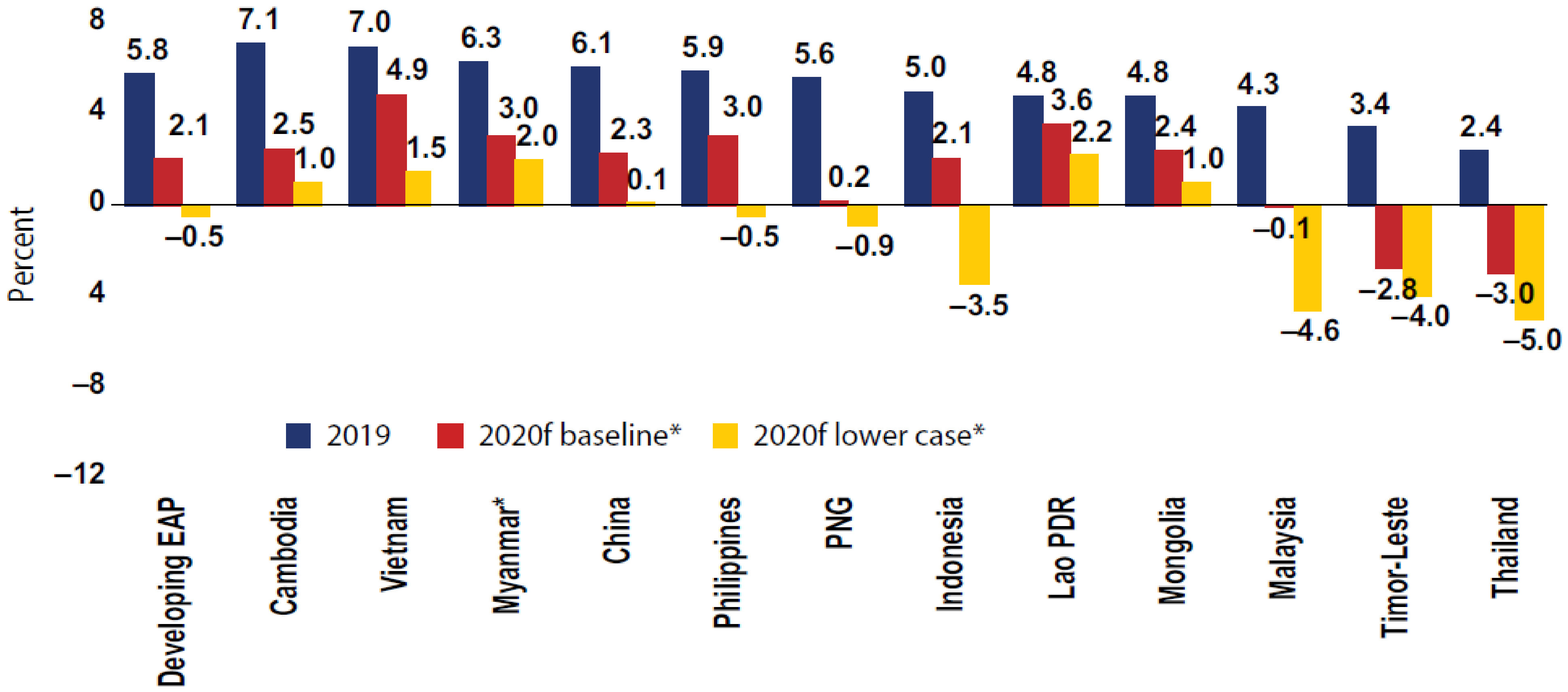


Industrial production



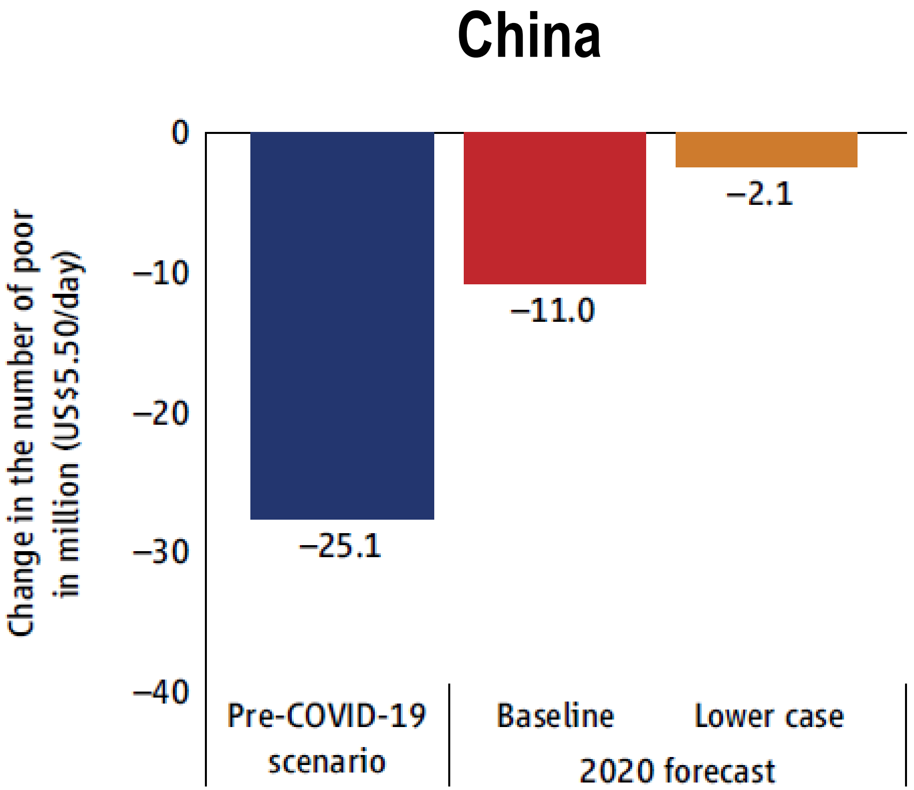
Source: Haver Analytics

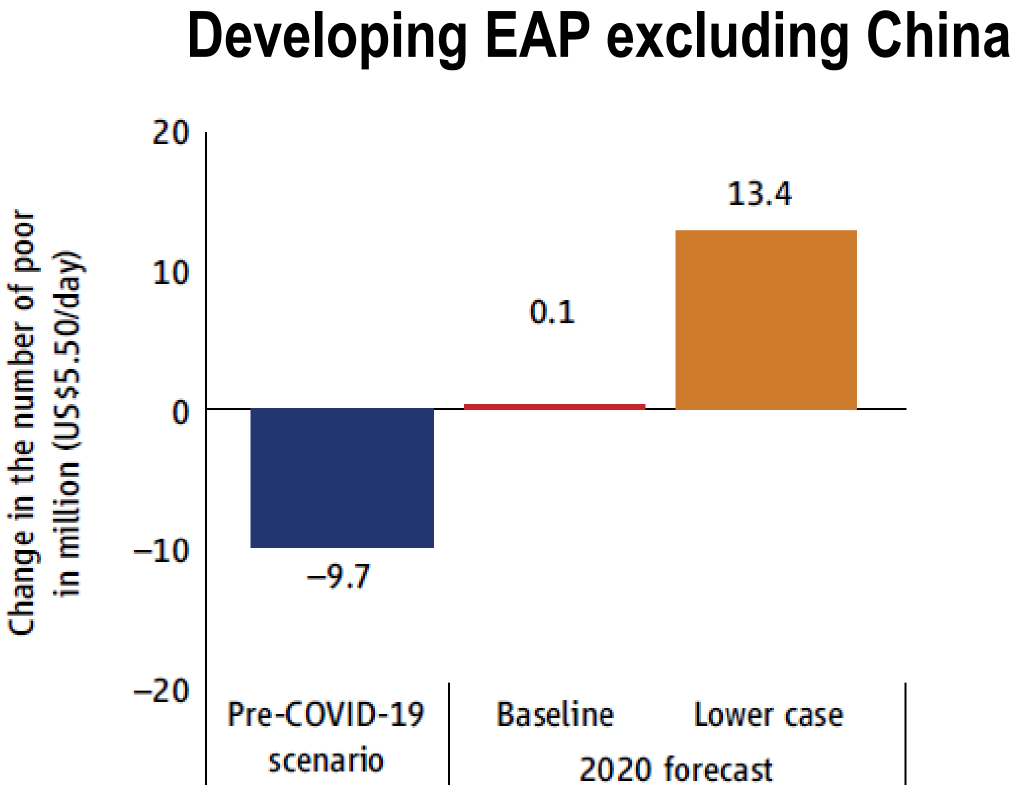
In all countries, growth is forecast to decline sharply in the region in 2020



Source: World Bank. World Bank staff calculations.
Notes *Myanmar growth rates refer to the pre- and post-pandemic period for fiscal year from October to September. Baseline refers to a scenario of severe growth slowdown followed by a strong recovery. Lower case refers to a scenario of a deeper contraction followed by a sluggish recovery. Weighted averages are calculated for developing EAP

COVID-19 will undermine efforts to reduce poverty

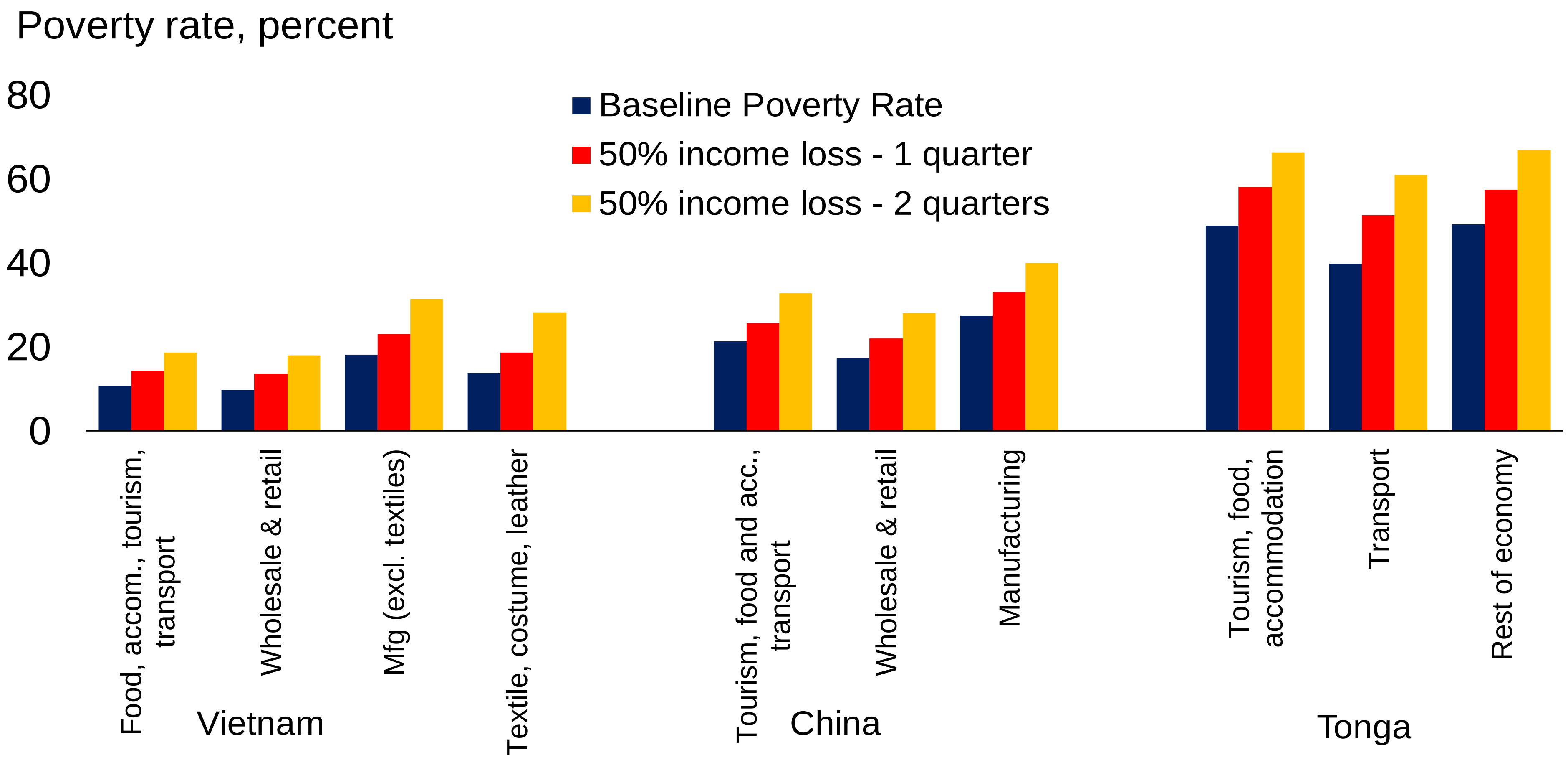




Number of poor expected to be lifted out of poverty in 2020 under alternative scenarios

Source: World Bank East Asia and Pacific Team for Statistical Development.
Notes: Poverty rate measured using a poverty threshold of US$5.50 per person per day (2011 PPP).

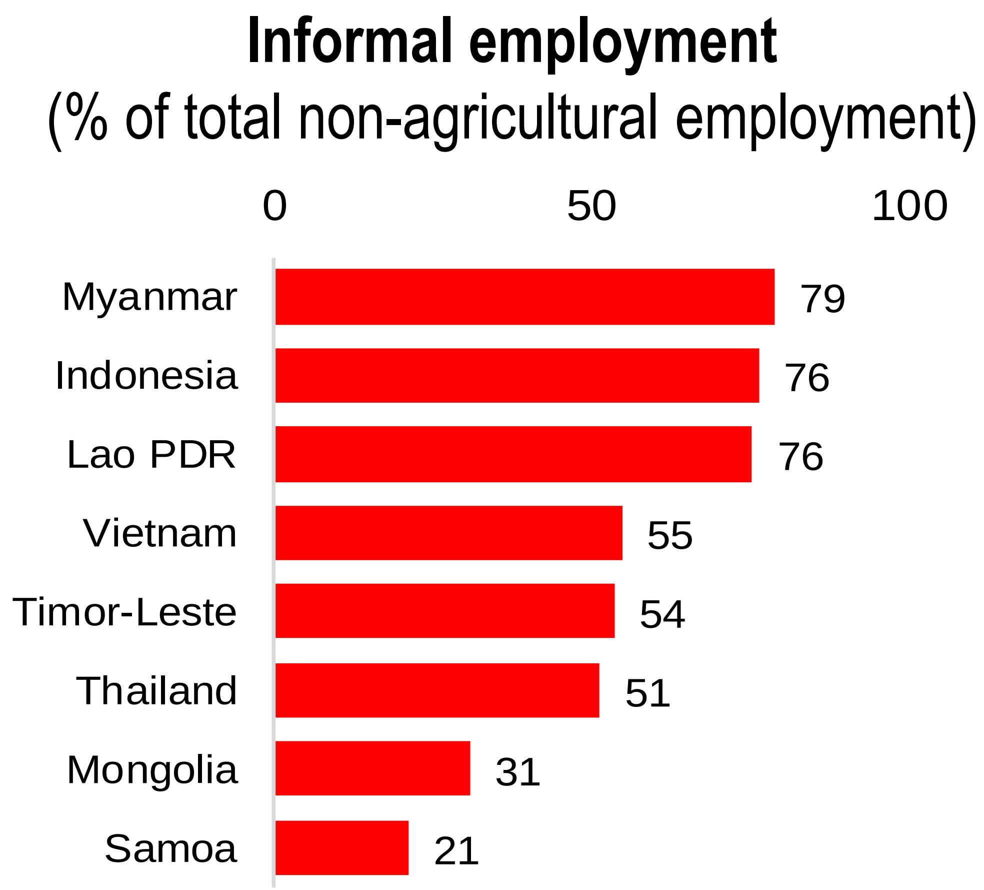
Households linked to affected sectors face a higher risk of falling into poverty …

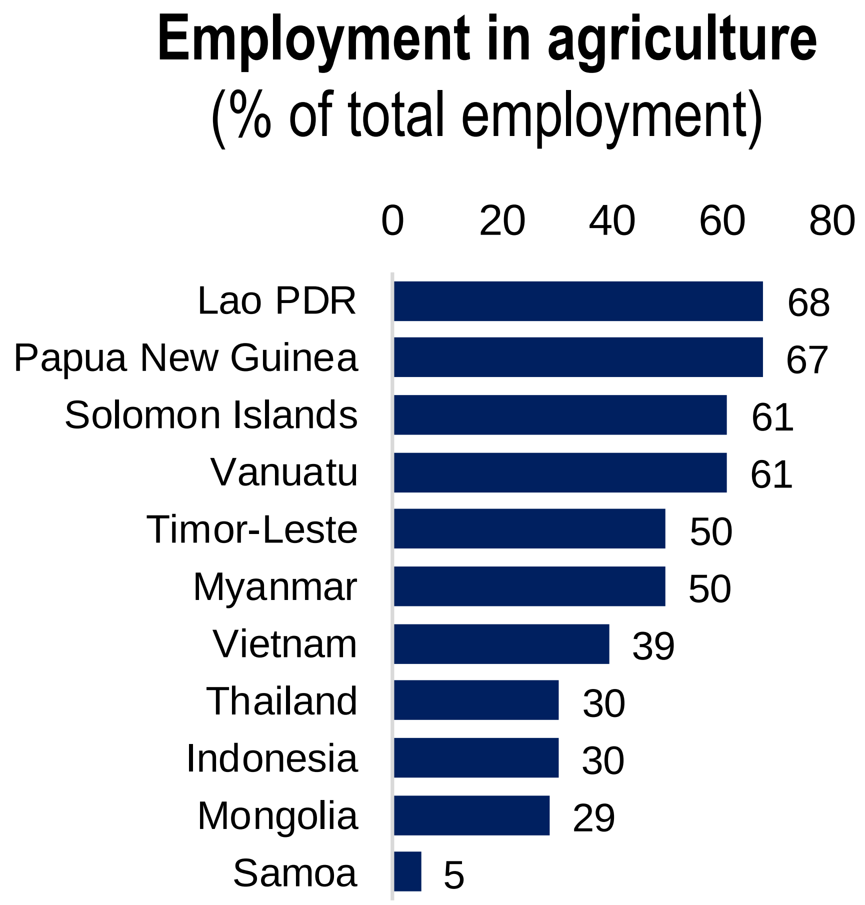


Source: Projections based on Vietnam Living Standard Survey, China Household Income Project, and 2015/16 Tonga Household Income and Expenditure Survey data. For China, total household incomes and consumption levels are extrapolated to 2018, based on the reported growth rates of per capital household disposable income and per capita household expenditure between 2013 and 2018, as reported in 2019 China Statistical Yearbook (National Bureau of Statistics).

Note: Estimated poverty impacts of income shocks in selected sectors in Tonga, Vietnam and China poverty rates measured using a poverty threshold of US$5.50 per person per day (2011 PPP).

… as do those in the informal and agricultural sectors

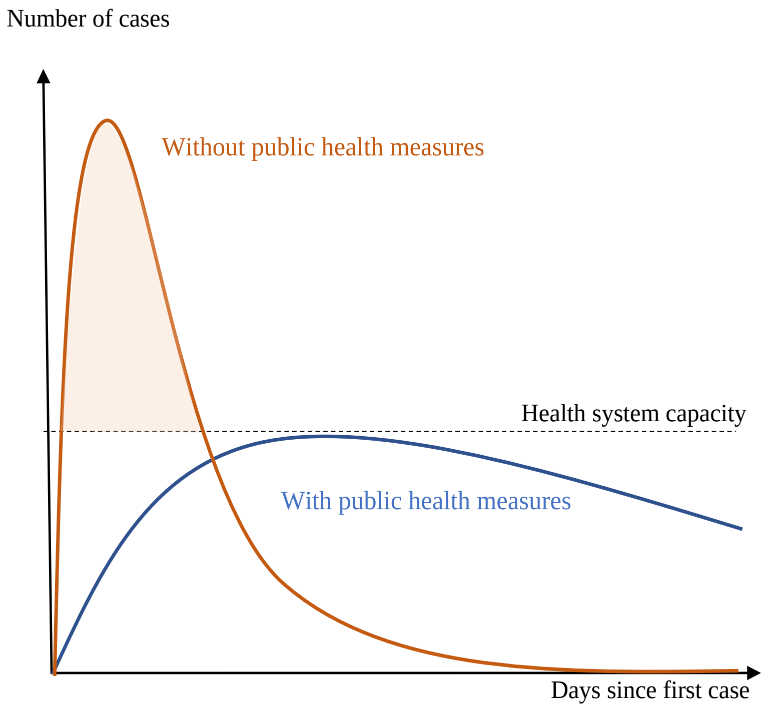




Source: WDI based on ILO.
Note: Informal employment includes unregistered and/or small-scale private unincorporated enterprises, including self-employed such as street vendors, taxi drivers and home-based workers that produce goods or offer services for sale or barter. Informal employment statistics are not available for Papua New Guinea, Solomon Islands and Vanuatu. Employment in agriculture is the ILO modeled estimate

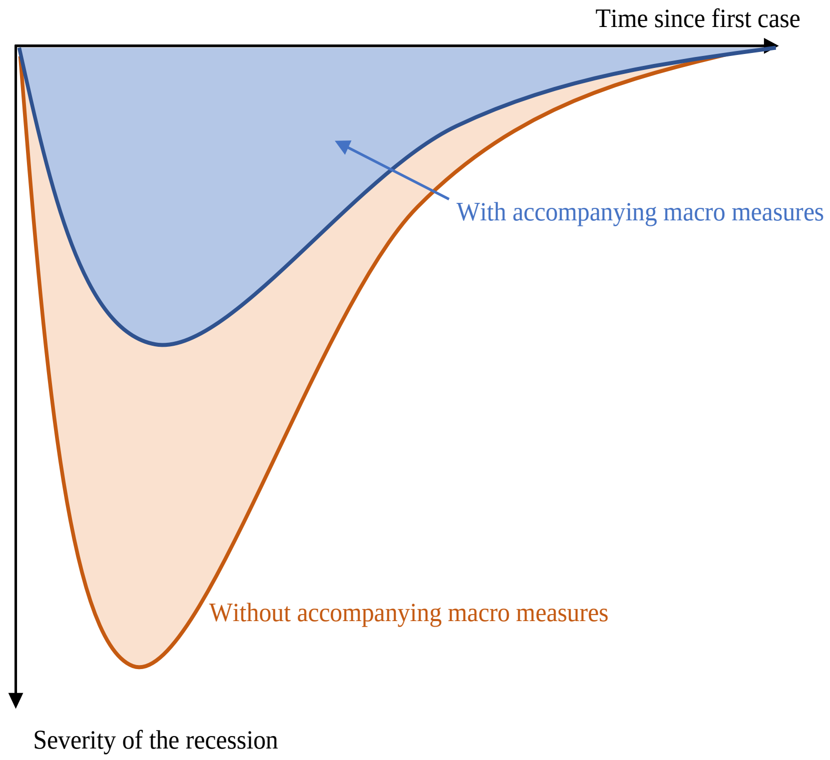
III. Policy: COVID-19 requires an integrated and intertemporal policy response

Flattening the pandemic curve through containment policies is the first objective

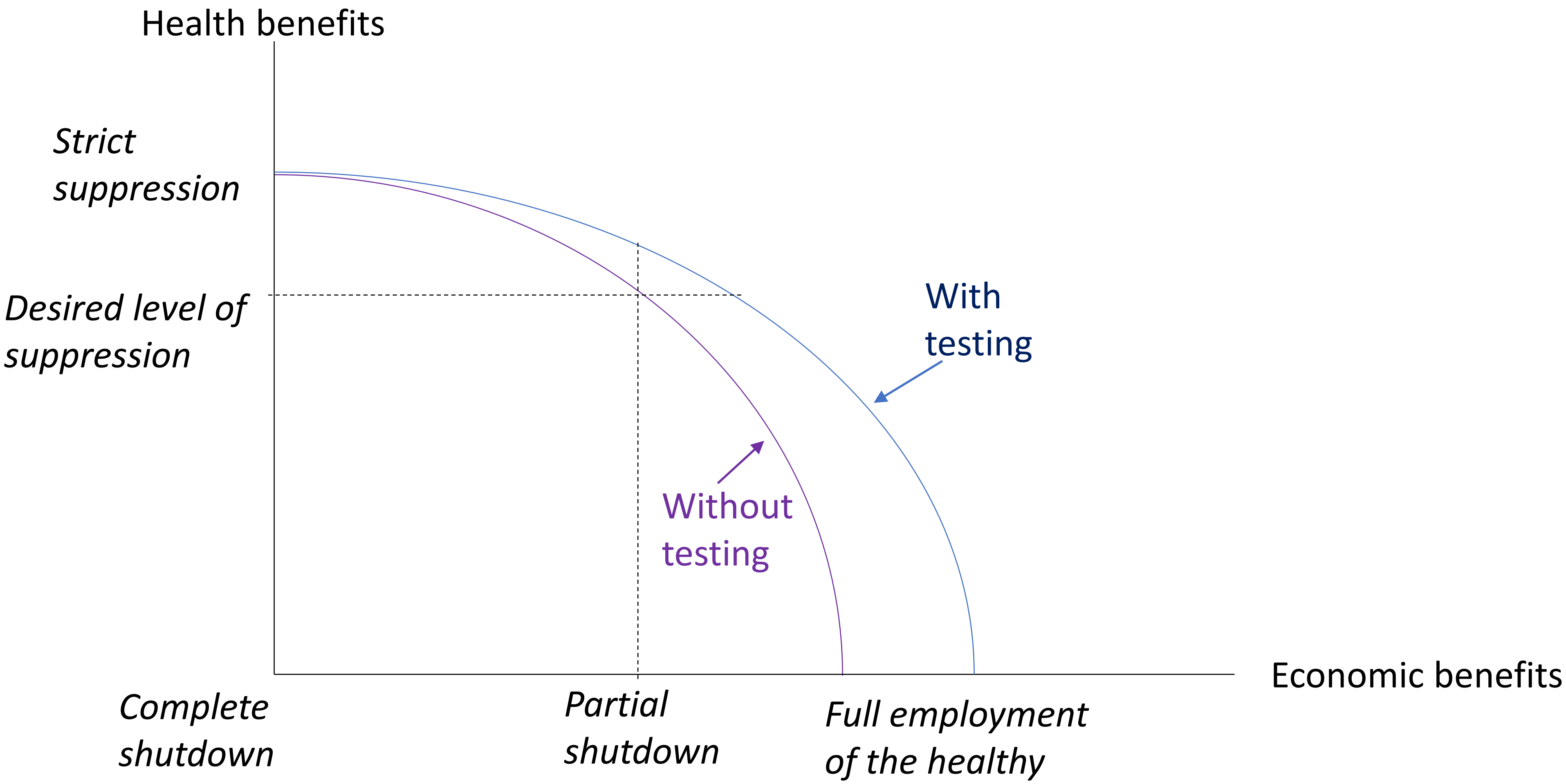


Source: Staff illustrations based on Gourinchas (2020)

Flattening the recession curve through macroeconomic policies is the second objective



As the government chooses optimal strategy, information from testing can ease tradeoff between health and economic benefits



The new tool-kit for macroeconomic and financial policy: prevent a temporary shock from having permanent effects

	Challenges and Needs	Selected Responses So Far
Households	*Smooth consumption*: Loss of jobs and income (including remittances); loss of wealth amid asset price collapse; *need to cover basic expenses, and service debt*	Paid sick and family leave, wage subsidies, unemployment benefits, debt relief and moratorium on utility bills for distressed households, cash transfers, in-kind vouchers, and simplified administrative requirements for benefits
Firms	*Avoid bankruptcy*: Loss of revenues and access to capital (including FDI); *need to pay employees, cover basic expenses, and service debt; need to moderate liquidity pressures that could turn into solvency pressures*	Loan guarantees, deferral of tax and social contributions, debt relief for distressed borrowers, import duties waived on selected imports, and subsidies to maintain employment
Financial institutions	*Avoid financial instability*: Loss of funding access and deterioration of credit portfolio; *need to pay employees, cover basic expenses, and service debt*	Monetary policy rate cuts and asset purchases, targeted lending facilities, lower reserve requirements, swap lines for dollar liquidity, regulatory forbearance and flexibility, changes in capital flow management measures, and postponement of planned regulatory changes

How far must fiscal and monetary policies be recast in a COVID-19 mold?

- The optimal economic policy response too will change over time and depend on the precise nature and evolution of the shock—to labor supply, aggregate demand or finance.
- Standard stimulus may be less effective than usual because some sectors are shut down, muting the Keynesian multiplier:
  - Propensity to consume low
  - Elasticity of supply (social distancing and supply chain disruptions
- But supply shocks can trigger changes in aggregate demand larger than the shocks themselves.

Easing financial conditions to help households and firms cope

- Help households to smooth consumption through easier access to credit
- Help firms survive the disruption through easier access to liquidity.
- But regulators must ensure risk disclosure and clearly communicate supervisory expectations to avoid financial instability, especially in economies with high levels of private indebtedness.
- Intervention should be accompanied by measures that ensure that financial institutions retain all residual resources to shore up capital - not distribute them as dividends and share buybacks or as bonuses to management.

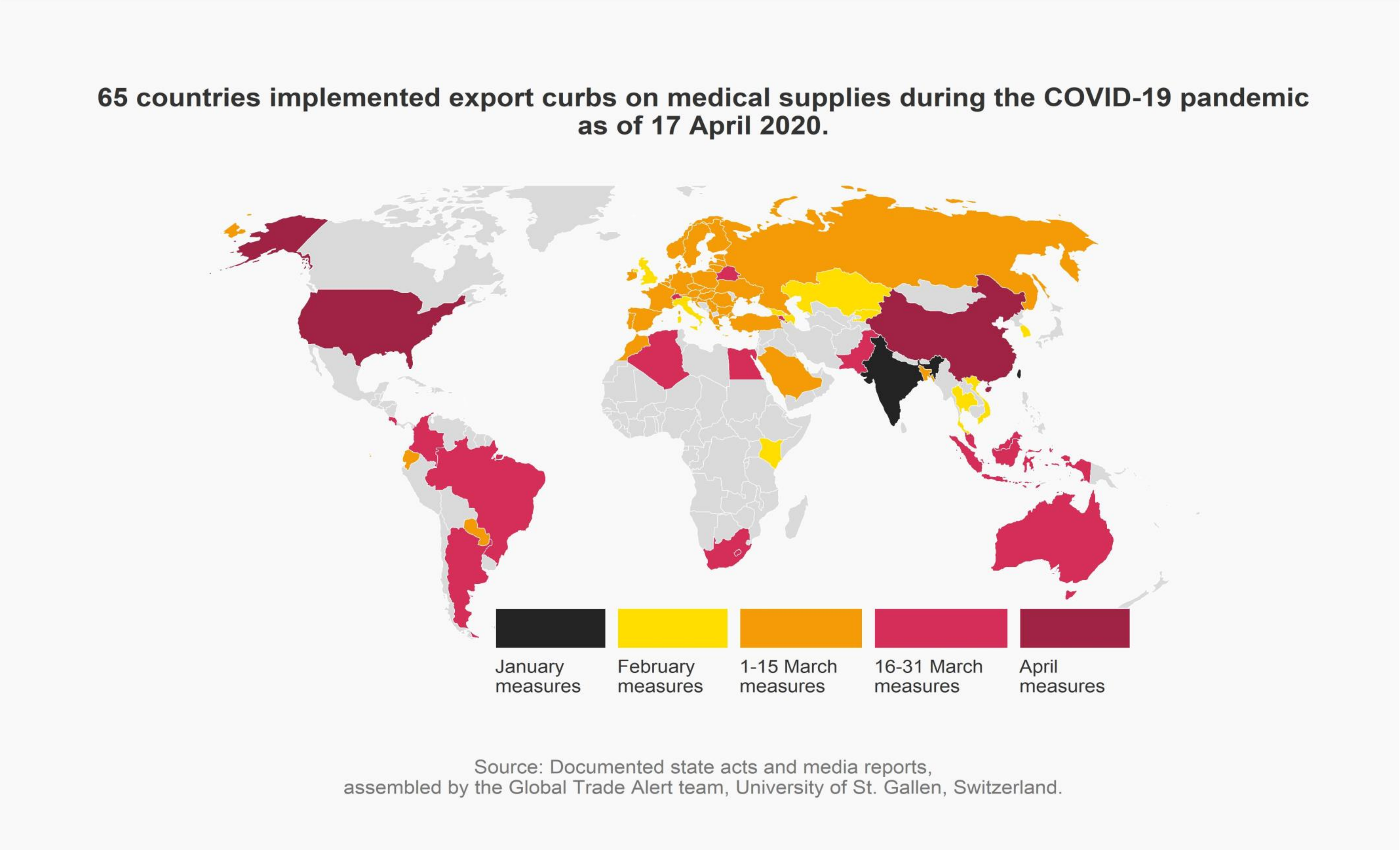
Targeted support for firms

- Crises do not catalyze creative destruction. Support is needed to promote survival of productive firms, minimize downturn and facilitate recovery.
- Try to protect worker and firm relationships where the match has value by helping firms maintain employment
- Cash grants can SMEs survive and wage subsidies speed up firms' recovery
- Directed credit may not reach the smallest firms
- In the informal sector firms and workers are harder to trace and forcing firms to formalize may not lead to longer term benefits
    - Focus on providing direct assistance to informal workers

Relying on existing schemes is preferable: it's easier to scale up than set up

- Tailor support to the type of firms and risks.
  - **Formal firms**:
    - Against liquidity risk: credit lines, tax deferrals etc. They can be broad-based measures.
    - Against solvency risk: short-time work or wage subsidies, subsidized loans, cuts in turnover-based taxes. Fiscal considerations impose that transfers should be targeted, for example only for most affected and systemically important industries. Sunset provisions to be included to limit moral hazard.
  - **Informal firms**:
    - where social cash transfer systems already exist, consider increasing transfer amounts, easing eligibility criteria and making them unconditional;
    - where social cash transfer systems don't exist and administrative capacity is weak, consider subsidizing utility (or other basic spending items') bills
- Support could be conditional on preserving jobs and not being tunneled to management or shareholders

Trade policy must stay open



The international community must provide support to combat pandemic and mitigate consequences

- One immediate contribution could be to help expand the supply of key medical products by facilitating public-private partnerships .
- The response must include financing, policy advice and technical assistance to help countries cope with the health and economic impacts of the pandemic. The World Bank Group is rolling out a $14 billion fast-track package and will deploy up to $160 billion over 15 months to protect the poor and vulnerable, support businesses, and bolster economic recovery.
- For poorer countries, debt relief will be essential, so that critical resources can be focused on managing the economic and health impacts of the pandemic.