The Macroeconomics of COVID-19

Introductory course:
The Economics of COVID-19 in Developing East Asia and the Pacific
November 2021
Roadmap of the Presentation

• The COVID-19 shock

• Monetary and fiscal policy response.

• Monetary and fiscal policy challenges.
Slow recovery and a reversal of fortune

GDP, 2019Q4 = 100

- China
- Indonesia
- Malaysia
- Philippines
- Thailand
- Vietnam

COVID-19 outbreak
Delta variant
Declining employment and exit from the labor force

Employment to population and Labor Force Participation

- Employment to labor force
- Labor force to population

Percentage points

-6 -4 -2 0 2

Mongolia
Solomon Islands
Timor-Leste
Papua New Guinea
Thailand
Samoa
Lao PDR
Malaysia
Vanuatu
China
Fiji
Indonesia
Vietnam
Tonga
Cambodia
Philippines
Myanmar
COVID-19 is both a supply and demand shock

- Businesses closed (shock to supply)
- Households lost livelihoods (shock to demand)

Keynesian stimulus may be ineffective

Fiscal policy needed to help households (demand) and firms (supply).
Monetary policy needed to ensure flow of credit in the economy (supply).
Policy emphasis depends on the state of the recovery

Note: The horizontal line indicates the level of GDP in December 2019.
Risk of inflation and unsustainable debt

• Expansionary monetary policy can lead to higher inflation

• Increased borrowing to support fiscal expansion can lead to financial instability
Central banks cut interest rates to support their economies

Source: East Asia and Pacific Economic Update, October 2021.
Supportive monetary stance has not yet provoked inflation
The increase in producer prices hasn’t been passed to consumers, in part because of well-anchored expectations.

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Fiscal support increased significantly in response to COVID-19. Output gaps suggest that fiscal support remains critical.

A. Government support

Source: World Bank staff estimates.
Notes: A. Figure shows fiscal support excluding health measures, below-the-line measures, and contingent liabilities.
All EAP countries have experienced an increase in public debt

r < g is not a license to spend in part because high deficits and debt can raise r and lower g.
What can be done?
Fiscal support today without instability tomorrow

• Increase efficiency of expenditure and investment.
• Introduce fiscal rules.
• Credibly commit to future fiscal reforms.
Coping with the challenge from monetary policy actions abroad

• Central banks are likely to face trade-offs between continuing expansionary monetary policy, containing inflationary pressures, and maintaining exchange rate stability.

• Trade-offs can be softened if inflation expectations are well anchored, foreign reserve levels are significant, and there’s limited foreign currency debt.
References

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