Corona and the Economy

Macroeconomic explanations and economic policies

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What kind of crisis?

- Largest and most synchronized fall in GDP seen in history of national accounting.
- Direct causes of crisis quite special but also well known:
  - Social distancing required. Some goods and services can no longer be produced or need to be produced/consumed in alternative ways.
  - Disruptions of international supply chains.
- Consumption of social goods down both due to new restrictions and voluntary individual changes in behavior.

Standard recession policy

- In the short run, output largely determined by demand.
- Sometimes, demand is not sufficient. Typically, a central element of recessions.
- Stimulus though increased government spending and tax reductions then the right policy.
- Now, not appropriate to undo the direct effects of the chock on income (GDP). Stimulus not the right policy.

What policy is appropriate?

- Three central policy goals:
  1. Short circuit feedback mechanisms that can amplify the fall in production and income. Mechanisms via financial and housing markets powerful and dangerous.
  2. Prevent that crisis leads to long-run damages on the economy. Accept reduction in hours and production in affected sectors, but minimize layoffs and bankruptcies.
  3. Redistribute the very uneven income losses.
- Tools to reach second goal not good in normal times (e.g., paying people to be home, massive subsidies to unprofitable firms). Need to be temporary.
- Cleansing effect of the crisis?

What has happened?

- Hugh falls in GDP 2020:q2 relative to 2019:q2.
  - Sweden 7.7%, Denmark 8.2%, Finland 6.3%, Norway 5.3%.
  - Germany 11.3%, France 18.9%, Italy 17.7%, UK 21.7
  - EU 13.9%.
  - USA 9.1%, India 23.9%, Brazil 11.4%.
- About equally large reductions in worked hours.
- Despite dramatic dips, fall in GDP in many countries smaller than what one could have expected given corona measures.
- Perhaps our globalized economies are more robust than we thought?

Has economic policy worked?

- Fear of self-reinforcing feedback has not (yet) materialized.
- Massive and immediate asset purchases from central banks have been key, not interest rate cuts.
- In Europe, number of worked hours down at par with GDP,
- but reduction in employment much smaller. In EU hours down 10.7% Q2 relative to previous quarter but number of employed down by only 2.7%.
- Different in the US, 10.9 vs 12.9%.
- No flood wave of bankruptcies (yet).

Expectations and hopes

- Indications that our economies are coming back. But regulated and voluntary measures against the virus will remain/come back.
- Bridging policies must remain and be more focused. Layoffs and bankruptcies can increase fast.
- Use hours not worked for something useful.
- Abstain from using crisis as argument for favorite.
- Crisis not a good time for creative destruction.
- Government debt can become a problem in many countries.
- Restart international coordination and cooperation.