Macro-policy Responses to COVID 19 in Emerging Economies: Recent Outcomes and Evolving Challenges

Presented on behalf of SANEM, Dhaka, Bangladesh

By

Yan Islam

Adjunct Professor, Griffith Asia Institute, Brisbane, Australia

Former Branch Chief, Employment Policy Department, ILO, Geneva

Email: i.islam@griffth.edu.au and yanislam53@gmail.com

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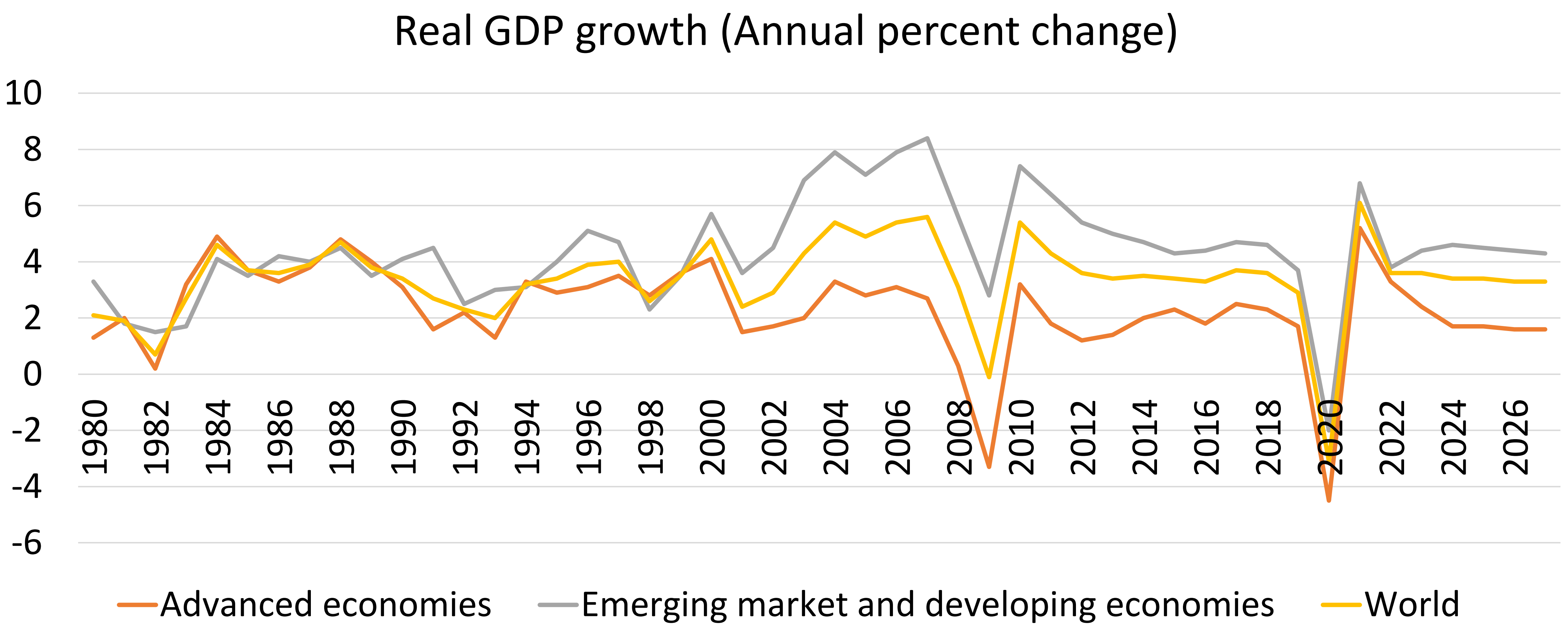
Preamble

- COVID-19 among the ten worst pandemic in human history going back to 165 AD
- COVID-19 has, so far, claimed 6.4 million lives (1 August 2022/ Johns Hopkins)
- Caused a short – but sharp – recession in 2020 which was the worst since 1980 (see graph)
- Unprecedented utilization of core macro-policy instruments to respond to the COVID-19 recession
- Fiscal stimulus, monetary policy easing, labour market and social protection policies

COVID-19 recession in historical perspective

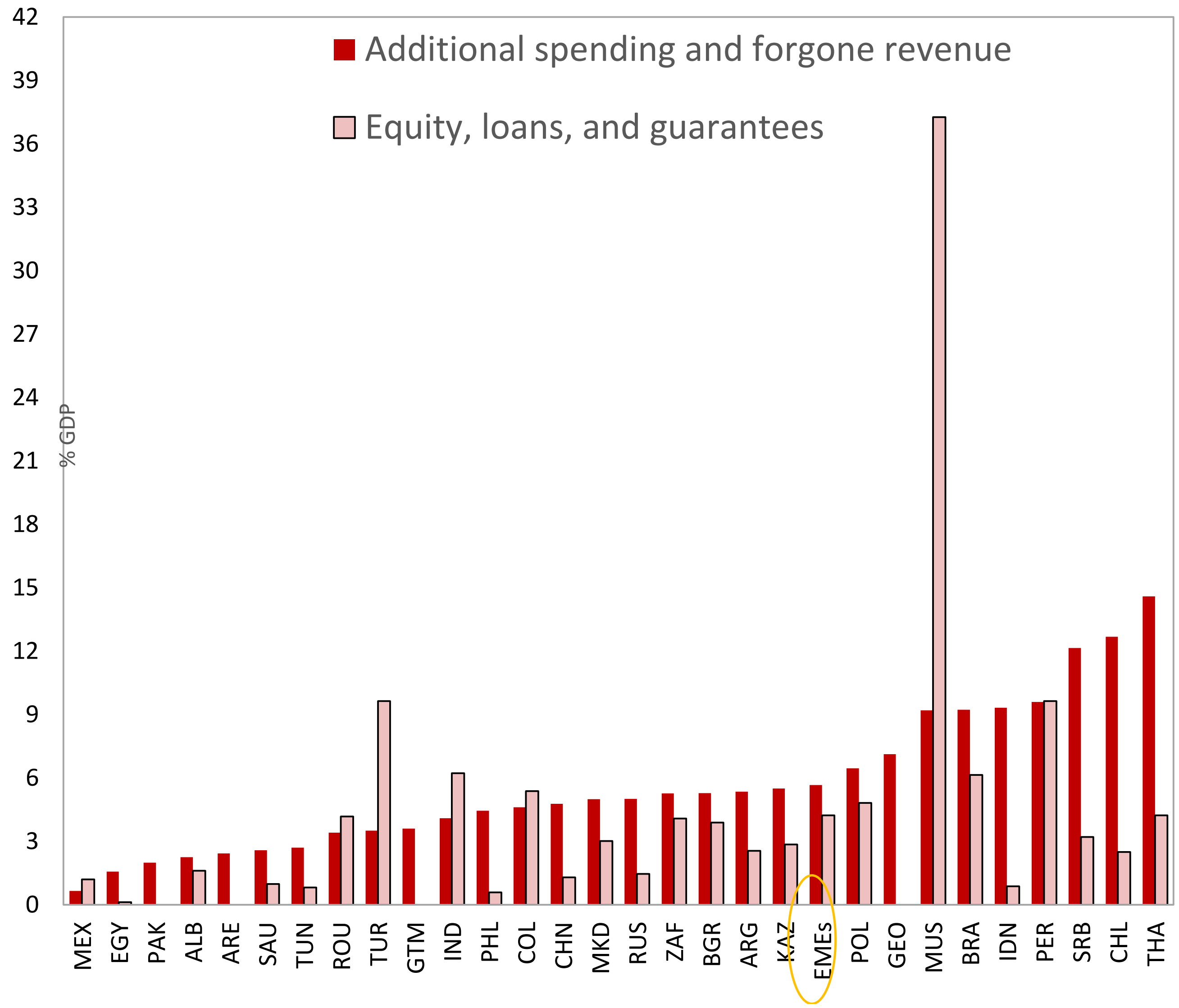


Fiscal policy response in EMEs (% of GDP)

Average: Direct fiscal support: 5.67 % of GDP (end-September 2021)

Considerable variation

Direct fiscal support most generous in Thailand and Chile, least generous in Mexico



Fiscal stimulus in Bangladesh during COVID-19: how does it compare with other EMEs?

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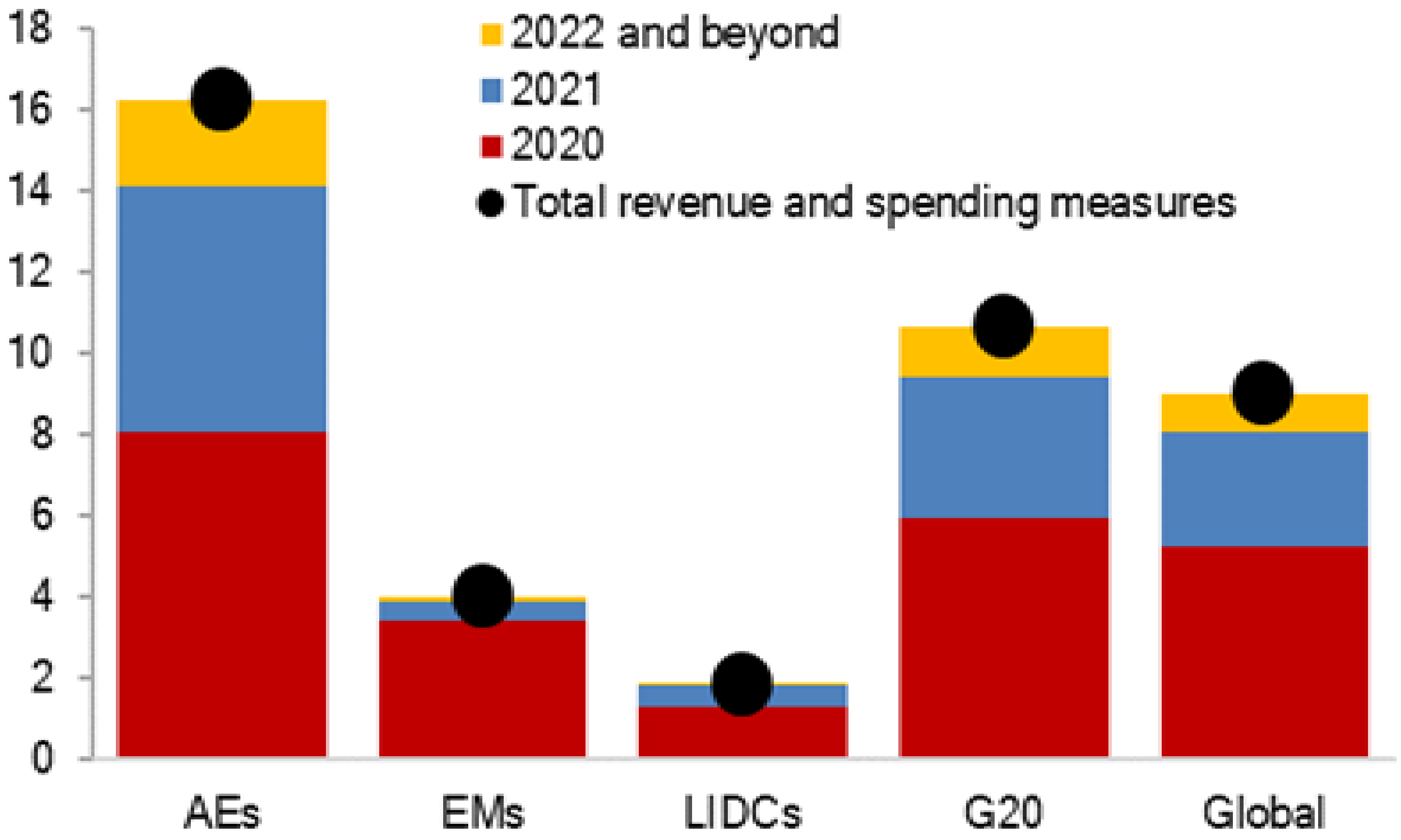
- IMF (March 2022), Country Report based on Article IV consultation
- **‘The authorities announced support packages worth Tk 1.9 trillion (or 6 percent of GDP) with space from curtailing non-priority current spending and suspending low-priority capital projects.’**

Outlook for fiscal policy in 2022 and beyond

- The outlook for 2022 and beyond suggest that fiscal stimulus has been withdrawn or at least scaled back across all regions of the world
- See graph below


18
16
14
12
10
8
6
4
2
0
2022 and beyond
2021
2020
Total revenue and spending measures
AEs
EMs
LIDCs
G20
Global

Monetary policy responses and COVID-19

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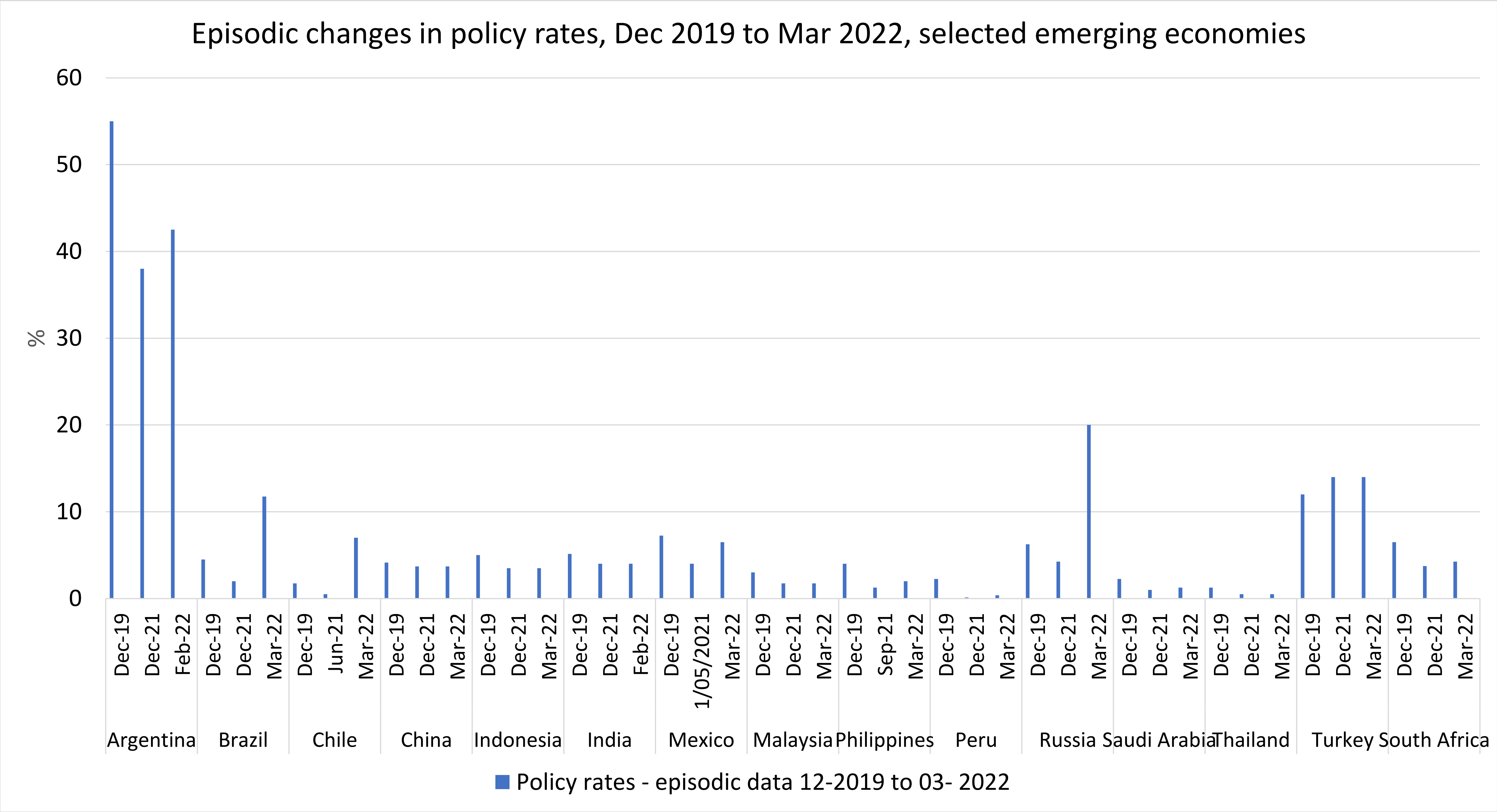
- EMEs have also responded to the economic consequences of COVID-19 by engaging in significant cuts in policy rates as well as asset purchase programs
- Now, many central banks in EMEs have significantly increased policy rates (e.g. Argentina, Brazil, Chile, Mexico)
- But, as of end-May 2022, either stable or marginal increase some cases (e.g. China, Thailand, India)
- Concerns about heightened inflation are likely to persuade most central bankers to become inflation-averse
- The challenge is to strike the right balance between controlling inflation and safeguarding employment

Monetary policy responses – cont'd

- As a BIS report (Boisse and Fiore, July 2022) points out:
- **'Central banks need to steer a narrow course between tightening too much or too quickly, which could precipitate a hard landing, and tightening too little or too late, which could lead to inflationary pressures becoming ingrained, necessitating more costly measures down the road'.**
- Monetary policy tightening in a context of high inflation and low unemployment (typical situation today in many AEs and EMEs) entails heightened risk of hard landing

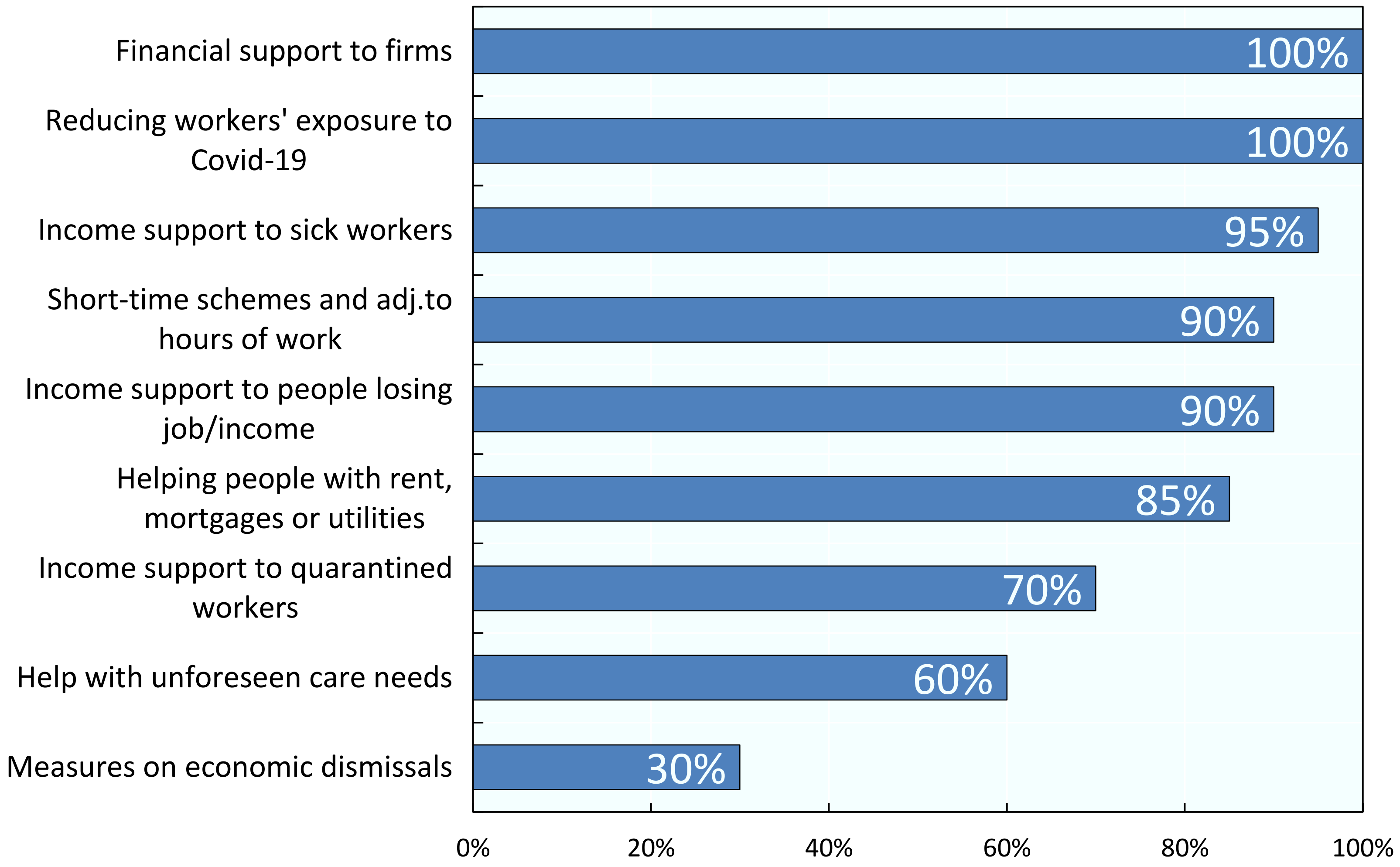

Episodic changes in policy rates, Dec 2019 to Mar 2022, selected emerging economies
%
60
50
40
30
20
10
0
Dec-19
Dec-21
Feb-22
Mar-22
Jun-21
1/05/2021
Sep-21
Argentina
Brazil
Chile
China
Indonesia
India
Mexico
Malaysia
Philippines
Peru
Russia
Saudi Arabia
Thailand
Turkey
South Africa
Policy rates - episodic data 12-2019 to 03- 2022

Monetary policy responses: Bangladesh

- Policy rate held steady at 4.75% between July 2021 and April 2022
- Now, increased to 5.50%
- Still low relative to historical average (6.75% between September 2009 and June 2022)
- No systematic evidence of asset purchase programmes
- No systematic evidence of forward guidance
- Current policy approach as stated by BB:
- **‘BB's monetary and credit programs for FY23 will pursue a cautious policy stance with a tightening bias to contain inflation and exchange rate pressures while supporting the economic recovery process, ensuring the necessary flow of funds to the economy's productive and employment generating activities for long-term economic growth.’**

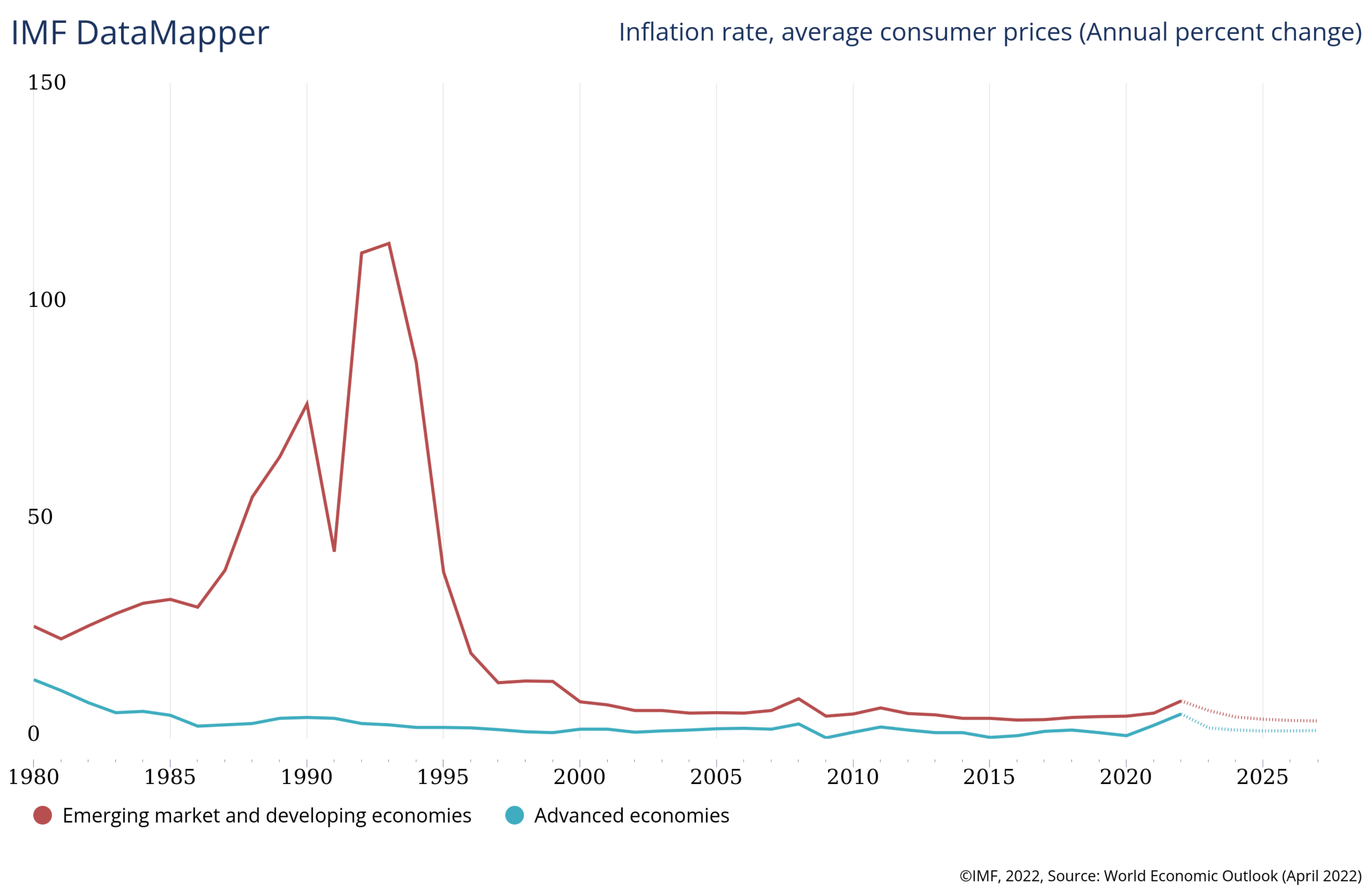
Labour market and social protection policies also used extensively in G20 countries, but employment protection regulations used sparingly

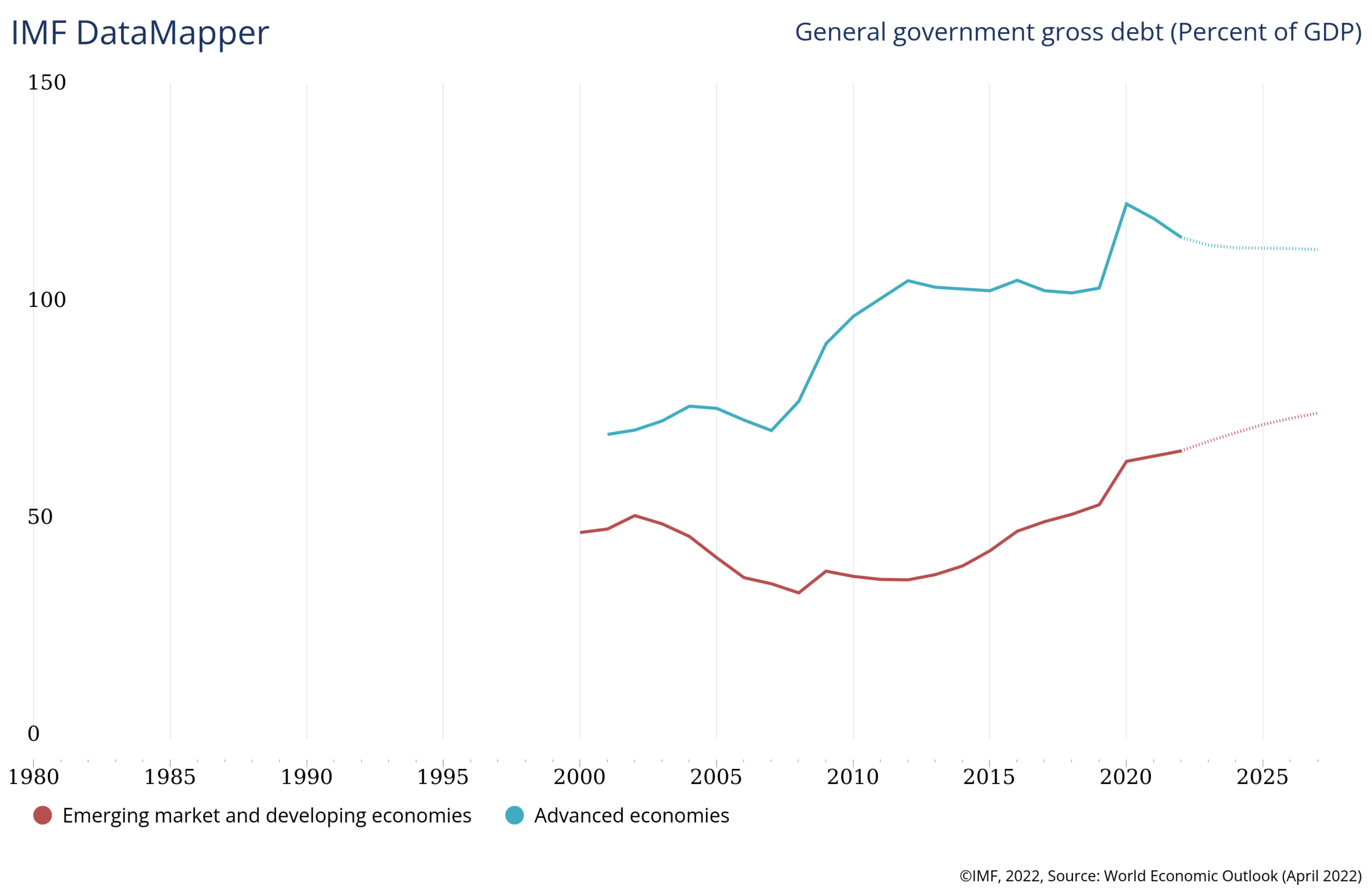
Share of G20 countries that have introduced (or announced) new measures or expanded existing ones in response to Covid-19



Should we worry about rising inflation, debts and deficits?

- Short-term spike in inflation (>5%), but IMF's projection for 2022-2027 more benign (April 2022)
- Similar forecasts by BIS for sample of AEs and EMEs
- Estimates of medium-term inflationary expectations still stable
- Higher debts and deficits in EMEs, but deficits tapering off by 2027 (from -9.5% of GDP in 2021 to -5.7 % by 2027)
- Debt-to-GDP ratios remain elevated (68%) – above prudential thresholds suggested by OECD for middle income economies (30-50% of GDP)
- Is there a clear prospect of rising borrowing costs?
- Borrowing costs would rise if GDP growth < interest rate
- Borrowing costs on a secular downward trend in AEs
- In EMEs as a whole, growth > interest rate given moderate inflation outlook and return of growth in 2022-2027 period
- There may not be a sharp increase in borrowing costs across all EMEs – but new cycle of aggressive increases in policy rates might change this benign scenario
- There are also multiple cases of fiscal distress (e.g. Sri Lanka a conspicuous case)


IMF DataMapper
Inflation rate, average consumer prices (Annual percent change)
150
100
50
0
1980
1985
1990
1995
2000
2005
2010
2015
2020
2025
Emerging market and developing economies
Advanced economies
©IMF, 2022, Source: World Economic Outlook (April 2022)



IMF DataMapper
General government gross debt (Percent of GDP)
150
100
50
0
1980
1985
1990
1995
2000
2005
2010
2015
2020
2025
Emerging market and developing economies
Advanced economies
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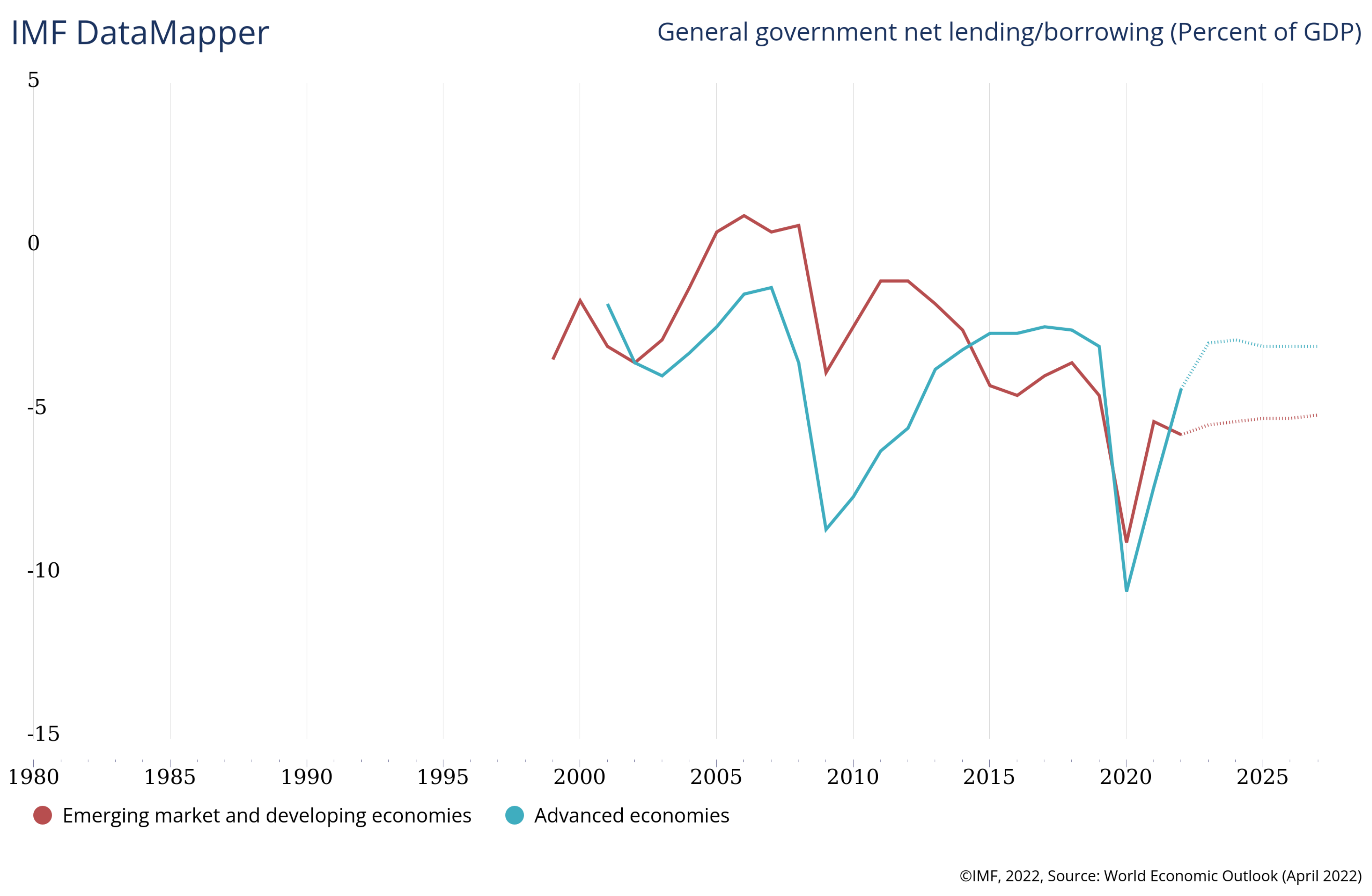
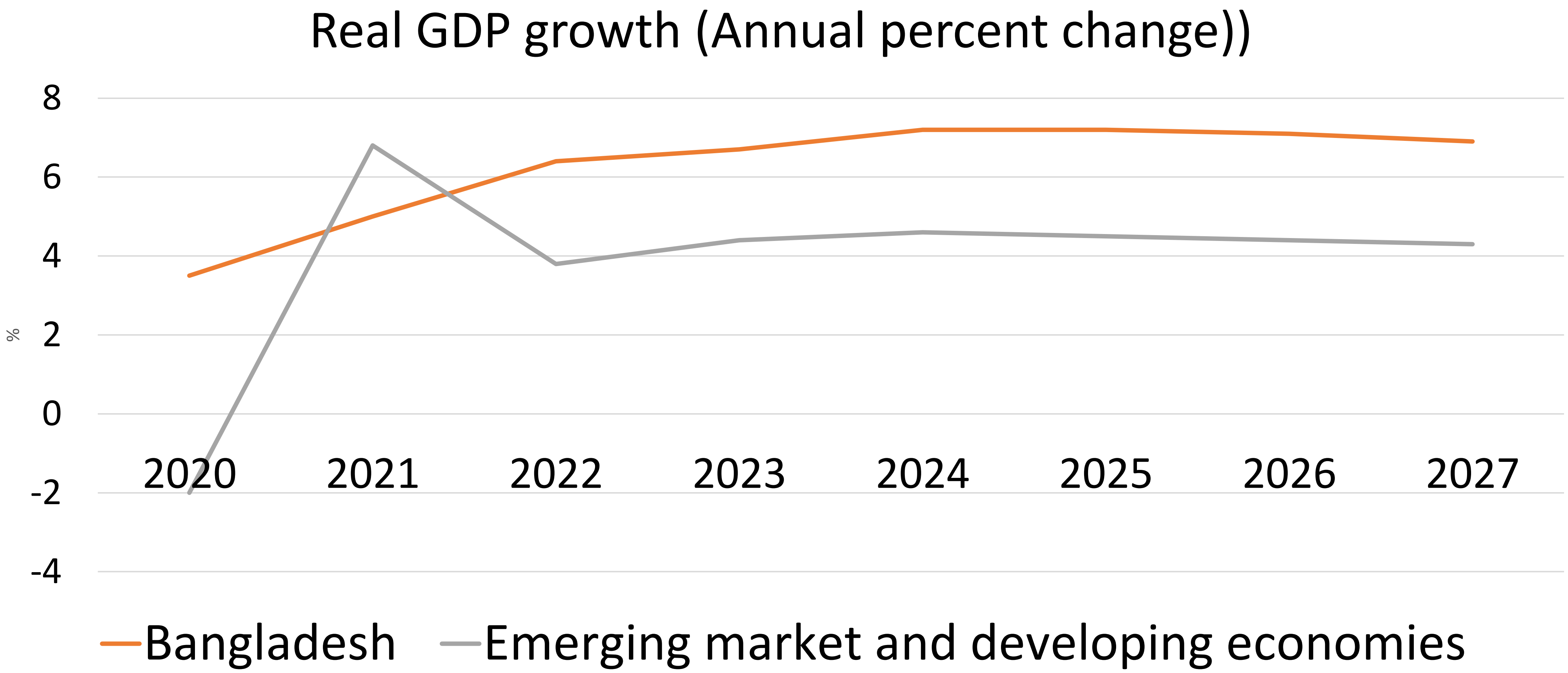

IMF DataMapper
General government net lending/borrowing (Percent of GDP)
5
0
-5
-10
-15
1980
1985
1990
1995
2000
2005
2010
2015
2020
2025
Emerging market and developing economies
Advanced economies
©IMF, 2022, Source: World Economic Outlook (April 2022)

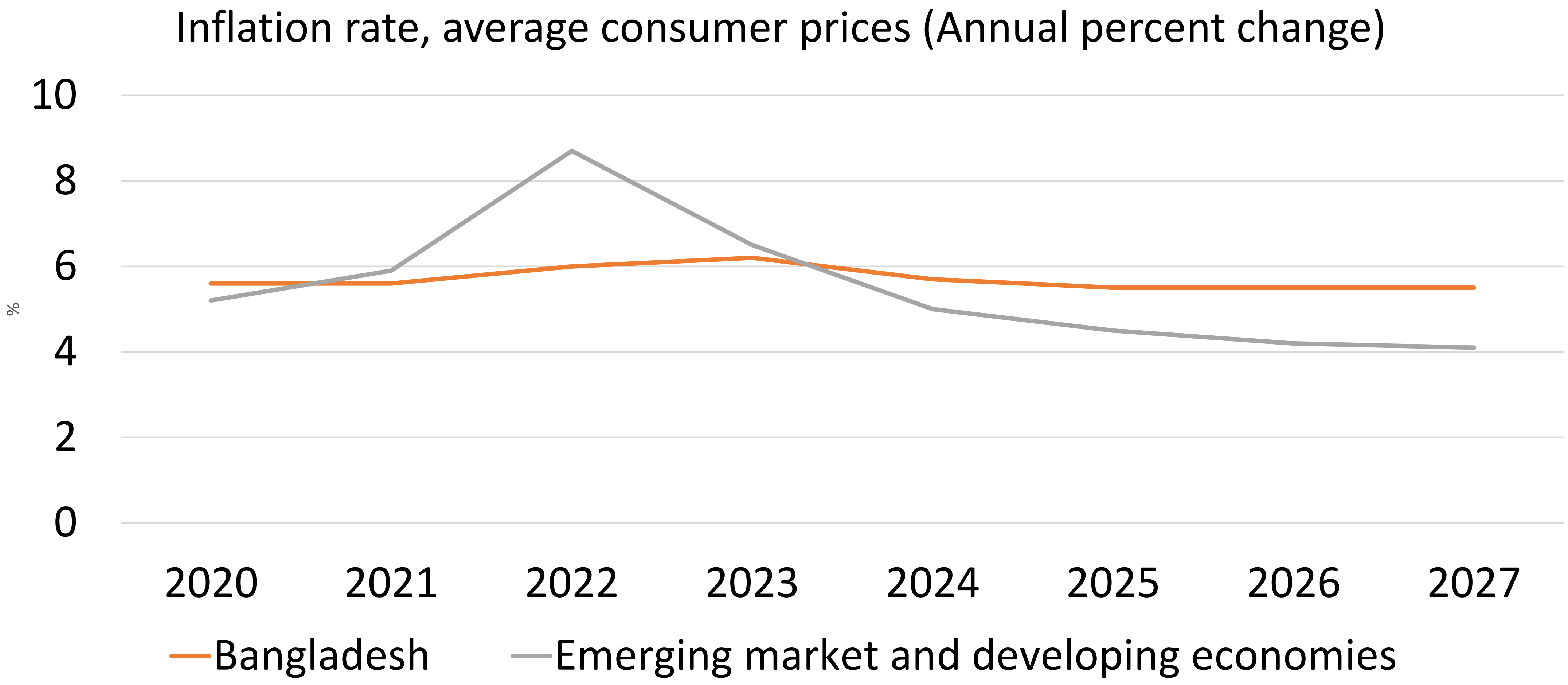
Debts, deficits and inflation: Bangladesh

- IMF assessment (March, 2022)
- *"Directors commended the authorities for exercising fiscal prudence and maintaining a low risk of debt distress, while noting that Bangladesh's capacity to repay the Fund remains sound."*
- See graphs …

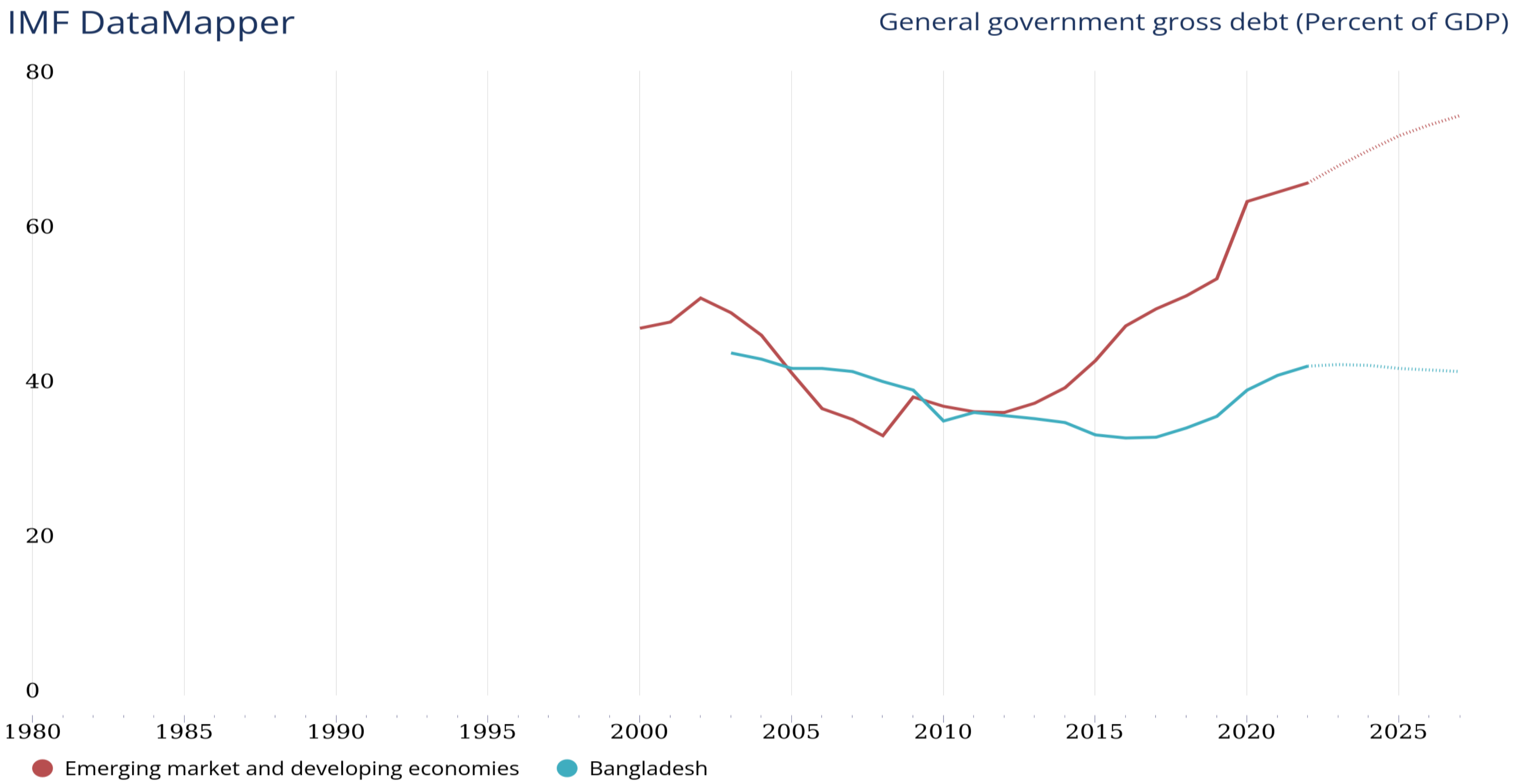
Bangladesh – core macro indicators, 2020-2027/GDP growth



Bangladesh – core macro indicators, 2020-2027/inflation



Bangladesh – core macro indicators, 2020-2027/public debt



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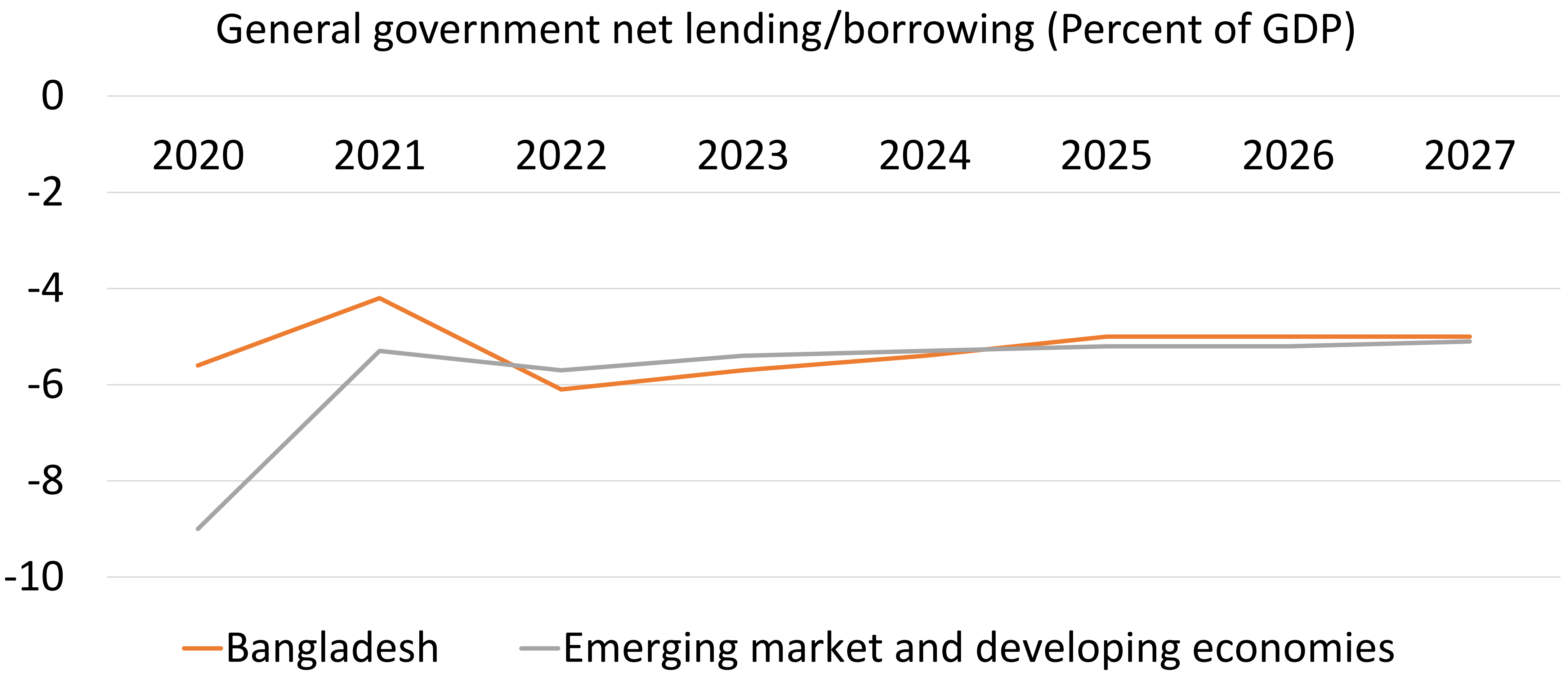
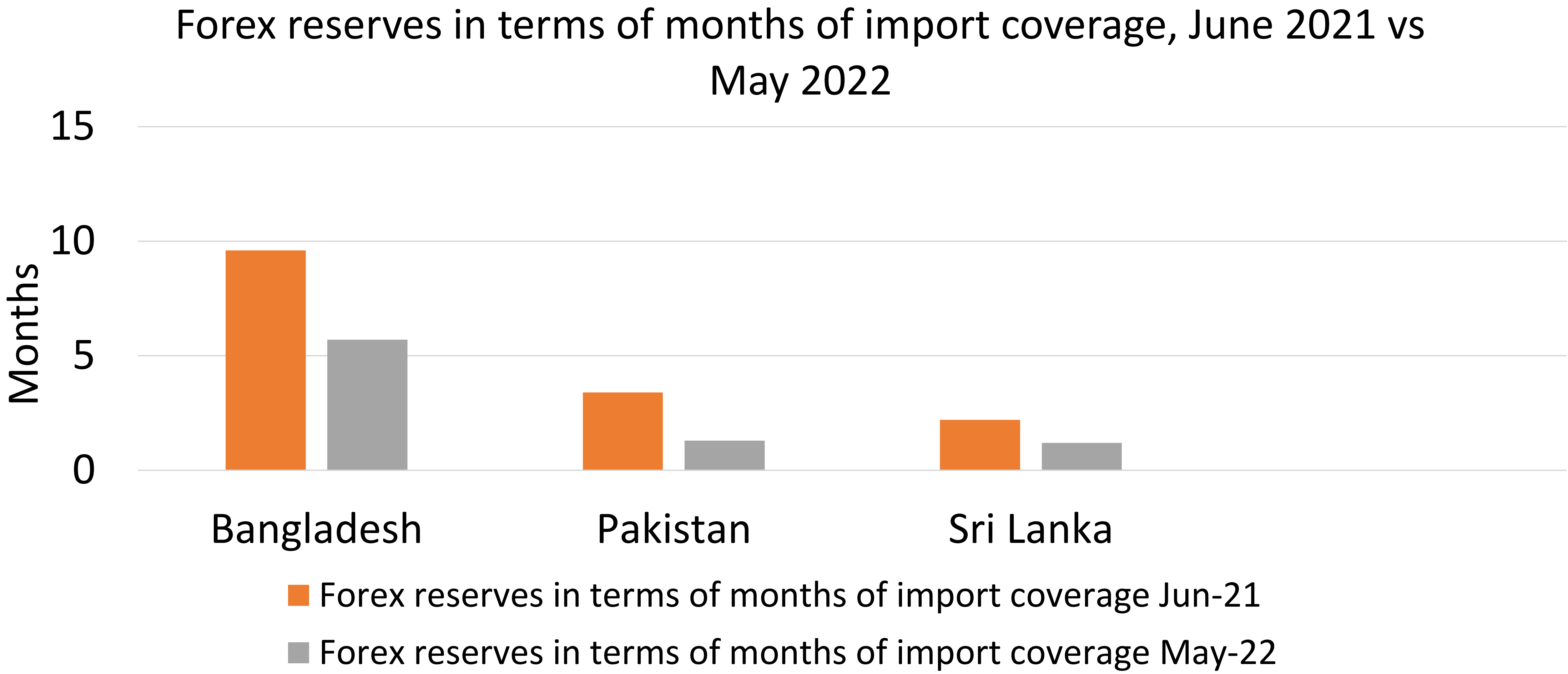
Bangladesh – core macro indicators, 2020-2027/fiscal deficit



Bangladesh – core macro indicators, 2020-2027/forex reserves in months of import coverage



Coping with immediate and long-term challenges facing EMEs in age of COVID-19

- Immediate challenge: resolving vaccine inequality
- 72% of the population in high income countries had at least one dose of available vaccines, with upper middle income countries also at par(April 27, 2022)
- Lower middle income countries lag behind
- Just 20% of the population in low-income countries had one dose (end-July, 2022)
- **Note that Bangladesh has exceeded global standards – 73% vaccination rate vs 67% worldwide average**
- Massive increase of 57% of health-care spending for low income countries to reach 70% vaccination target by 2022
- AEs only need 0.8% in health-care spending to reach same target
- Global fund of USD 50 billion needed to reach 60% vaccination rate plus other COVID-safe measures

Long-term challenge: attaining and financing SDGs

- SDGs financing gap now more than USD 4 trillion
- This will require a new domestic resource mobilization drive
- Enhanced national policy implementation capacity, esp., on labour market and social protection policies
- Vastly improved global cooperation
- New allocation of SDRs (USD 650 billion) a promising beginning
- BUT…major share (approx. 55%) will go to AEs, given distribution based on existing quotas
- Perhaps there is a case for placing the new SDRs in a COVID-19 trust and recycling them through regional development banks
- IMF and G20 seem to be moving in that direction

A new threat to growth, inflation and poverty in emerging economies: The Russia-Ukraine war

- The war in Ukraine that commenced with Russia's invasion in late February, 2022 poses a new threat to global growth, inflation and poverty
- This is compounded by especially severe sanctions imposed on Russia by US and NATO allies
- Ukraine is the worst hit (35-45% fall in output in 2022, IMF and World Bank)
- Nearly 25% of the population have either become external refugees to neighbouring countries or are internally displaced (UN agencies)
- Poverty to affect more than 30% of the population, while an additional 64% are likely to be at risk of poverty (UNDP)
- Massive damage to infrastructure (USD 750 billion reconstruction cost)
- Russia will experience a steep recession (10-11% and double digit inflation in 2022, World Bank and IMF)

A new threat ….

- Other emerging economies will suffer too, especially in Europe and Central Asia (ECA)
- The region as a whole is expected to contract by 4.1% in 2022 (World Bank)
- This is twice as steep as the COVID-19 recession of 2020
- This is because ECA is strongly linked to Russia and Ukraine through trade, financial and migration flows
- Both Russia and Ukraine are large suppliers of food grain to ECA and other parts of the world
- Surge in food, energy and fertilizers prices are already underway intensifying food insecurity in low and middle income economies
- Northwest Europe is heavily dependent on Russian energy and gas
- Advanced economies as a whole are expected to experience a sharp growth slowdown in 2022 and beyond
- These new challenges can only be met through determined global cooperation and national commitments to end the war and mobilize adequate financial and humanitarian assistance to the affected countries