EDITORIAL

ADDRESSING THE ECONOMIC CONSEQUENCES OF THE CORONAVIRUS: WAITING FOR THE FISCAL POLICY IMPULSE

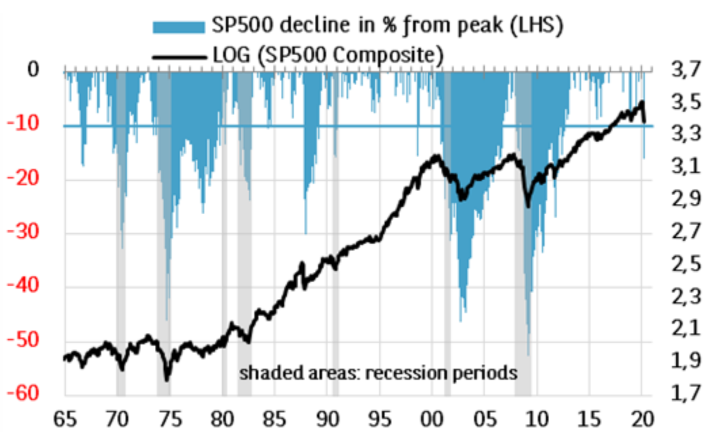
Wall Street has entered a bear market, having declined more than 20% from its high. Equity markets globally have seen huge declines this week and corporate bond spreads have widened significantly.Despite the positive news from China, the combination of an uninterrupted international propagation of the coronavirus has dealt a blow to expectations about the growth outlook for the next several months. The oil shock has made matters worse.Central banks have reacted. After the Fed rate cut last week, the Bank of England cut rates as well and the ECB also took several measures to support activity.The instrument of choice at the present juncture is fiscal stimulus of a sufficient size. Both in the US and the eurozone, we are still waiting for this impulse.

When on the day that the European Central Bank announces a carefully crafted package of easing measures, European equities experience their biggest decline in history and the Euro Stoxx 50 index finishes the session 12.4% down, one thing is clear: monetary policy will not be able to boost growth expectations to any sufficient degree. This does not imply that the Governing Council decisions were useless, quite on the contrary. The additional longer-term refinancing operations address possible bank funding strains. The new conditions on the TLTRO III -where the interest rate can be as low as -0.75%, i.e. 25 basis points below the deposit rate; banks will be able to borrow from the ECB up to 50% of their stock of eligible loans- provide a clear incentive for banks to meet the loan demands of their clients. The extra EUR 120 bn envelope for asset purchases, with a specific focus on corporate paper, will hopefully limit the rise in corporate bond yields on the back of investor concerns about the growth outlook.

This last point has become the dominating issue. In a "buy on dips" world, equity market declines are limited and short-lived because the growth outlook is barely dented. In addition, bond yield declines push investors back into "risk on" mode. Today, the situation is totally different and the investor attitude as well. Confidence in the growth outlook has dropped. ECB President Lagarde acknowledged that the ECB staff forecasts published this week are already outdated following the latest news on the epidemic. The recent OECD interim economic assessment of the coronavirus impact distinguishes between a base scenario and a "domino" scenario of broader contagion. Clearly, the latter has become the more relevant one for today's situation. It's a scenario of barely 1.5% growth for the world economy, which corresponds to a recession. The ever broadening reach of the epidemic means that more and more countries are faced with the decline of demand and disruption of supply earlier seen in China and hence a worsening of their economic outlook.

In a matter of 10 days, the Federal Reserve implemented an inter-meeting rate cut of 50 basis points, the Bank of England proceeded likewise and the ECB adopted a three-pronged approach to provide more monetary accommodation. Yet, over the same period financial conditions tightened: Wall Street entered a bear market, declining more than 20% from its highs, European equities dropped even more, credit spreads widened significantly, market liquidity is becoming an issue. Obviously, the oil shock has made matters worse, putting pressure on producers whilst the reaction of demand will remain subdued due to travel bans, lockdowns and, more generally, a drop in confidence and a feeling of uncertainty. This is a situation where fiscal policy needs to step in. Several European countries have already taken measures. Italy is preparing a fiscal stimulus of about EUR 12bn, has extended financial support for part-time unemployment and increased a guarantee fund for SMEs. There will be financial compensation for companies which are confronted with a decline in sales of more than 25% and a moratorium for loans from households and companies. France is allowing for delays in paying social charges or taxes, guarantees on short-term company loans have been introduced, rules concerning part-time unemployment have been simplified, the coronavirus is considered as force majeure for public sector purchases. In Spain, discussions are ongoing but one measure has already been taken: the moratorium on repaying loans for financially fragile households has been extended from 2 to 4 years.

THE DECLINE OF S&P500 IN A HISTORICAL PERSPECTIVE



SOURCE : STANDARD & POOR'S , FEDERAL RESERVE, NBER, BNP PARIBAS

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In Germany, the government aims that no German enterprise will go bankrupt and no job will be lost because of the coronavirus. To this end two temporary measures have been taken: increased access to the government-subsidised short-time work scheme (Kurzarbeit) and providing liquidity to companies suffering a virus-related cash crunch through the state investment bank KWF. In the Netherlands measures have been taken in terms of the short-time work and self-employed people without employees may call on the social assistance scheme for self-employed. Credit conditions have been loosened for SMEs that are partly guaranteed by the State: the State guarantee of the loan will be temporarily increased from 50% to 90% and the maximum credit amount has been increased. In the Netherlands, enterprises pay tax on their expected profits. They can now ask for a lower tax assessment if their profits are affected by the coronavirus.

These and other measures are of a more microeconomic nature. They are very much targeted and essential to alleviate the shock for households and companies which are impacted the most, but will be insufficient to compensate for the shortfall in demand. This calls for macro fiscal policy, i.e. giving a sizeable boost to demand. In the US, after the promises of President Trump to come up with something big, we're still waiting for anything concrete. Promises were followed by disappointment and contributed to the decline of the equity markets. For the eurozone, the urgency was emphasized by Christine Lagarde "It's fiscal first and foremost. So if you look at the fiscal measures that have been announced for the moment in the euro area, which we have done yesterday, if you recap all that has been announced - not including the European Commission - you arrive at a total of about €27 billion, which is more or less a quarter of 1% of the GDP of the euro area. Hence the reason why we are calling in our introductory statement for an ambitious and collective fiscal response."[1].One should add that, the importance of being able to deliver a significant, collective response in terms of fiscal policy goes well beyond the current crisis situation. It's about the credibility of, when necessary, to be able to act collectively.

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1. Source : *ECB, Introductory statement and press conference by Christine Lagarde, President of the ECB,* Luis de Guindos, Vice-President of the ECB, Frankfurt am Main, 12 March 2020