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Time for policy to go direct

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The need for a decisive, pre-emptive and coordinated policy response

The future evolution and global spread of the coronavirus outbreak is highly uncertain. What we know is that containment and social distancing are ultimately achieved by reducing economic activity. Faced with resource constraints in healthcare systems, there are strong incentives to take aggressive containment measures to slow the spreading. The impact on economic activity will likely be sharp – and could be deep.

The depth and duration of the economic impact is uncertain but should be temporary as the outbreak itself will eventually dissipate. That requires a decisive, pre-emptive and coordinated policy response to avoid the disruptions to income streams and financial flows that could cause persistent economic damage – and end the cycle.

We wrote in August 2019 about the nearly exhausted monetary policy toolbox and the challenges it poses for dealing with the next downturn. This has now come to the fore – and that's why it is time to go direct with policy support. Simply using up the limited monetary policy space remaining – interest rates, forward guidance or even quantitative easing – could quickly put the macro focus on the lack of tools left and thus backfire. The only way to address this is to add further lines of defense and make fiscal policy an explicit part of the crisis response toolkit.

The first step is to provide frontline public health agencies with necessary financial resources. But a joint effort between monetary and fiscal policy is required to avoid a raft of financial failures at the grassroot level due to demand shortfalls, production disruptions or payment delays that can all lead to cash flow squeezes. Small- and medium-sized enterprises, for example, risk having cash flows cut off if they have to rely solely on support through financial markets. That is why any solutions will need to involve "going direct" with policy – that is, more directly relieving the cash flow pressures facing some sectors of the economy.

Authorities in all major economies have to fast-track sizeable, comprehensive and flexible support programs to pre-emptively provide direct financial support to companies and households facing a short-term loss of income. That would prevent these temporary disruptions from turning into a full-blown global recession. Deploying these programs will involve coordination of monetary and fiscal policy. Recognizing that these measures will be temporary justifies an aggressive policy response. The experience of the global financial crisis and aftermath shows that the policy effectiveness would be greatly enhanced if the international community approached these measures as a deliberate package delivered in a coordinated fashion.

A comprehensive global response should have the following elements:

First, to support households, fiscal measures could also include generous sick-pay support and short-time work schemes to stabilize incomes and to limit job losses – especially where such arrangements were not available before. Several countries are already preparing such measures. Income support can come via adjustments to welfare and labor market programs, such as unemployment insurance. Welfare programs could also be tweaked by temporarily enhancing benefits and reducing waiting times until citizens become eligible. Direct payments to affected households are also an option.

Second, to support companies, fiscal authorities could suspend collection of tax revenues and social security contributions to provide temporary cash flow relief to firms and the self-employed while at the same time accelerating outgoing public payments and reducing unpaid bills to the private sector. In some instances, cash grants via local governments and natural disaster relief agencies might be required beyond loans. These are ways to directly provide some relief to company balance sheets that can be quickly implemented within current government programs. Automatic fiscal stabilizers should be allowed to work fully and, if needed, existing fiscal rules could be temporarily suspended.

Third, monetary authorities should also be ready to deploy more direct and targeted liquidity support, including expanding funding-for-lending facilities – providing liquidity to commercial banks that is earmarked specifically for lending to corporates hurt by the virus outbreak. Government guarantees can help cover any bank lending at preferential rates to meet the corporate sector's need for additional working capital. Alternatively, state-owned development banks could be used as a conduit for such lending. In countries with weaker public finances, asset purchase programs could safeguard the government's funding conditions.

A decisive and pre-emptive policy response is essential given the uncertainty around what will likely be material near-term disruptions due to the coronavirus outbreak. For the most part these measures will be fiscal in nature – and some will require coordination between fiscal and monetary authorities. Monetary policy should focus on preventing an unwarranted tightening in financial conditions and ensure the functioning of financial markets. Central banks going it alone with interest rate cuts risk wasting precious policy ammunition. We believe decisive policy action now would help avoid opening the door to more radical ideas and uncontrolled fiscal spending.

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