MONETARY AND
CAPITAL MARKETS

Macrofinancial Considerations for Assessing the Impacts of the COVID-19 Pandemic

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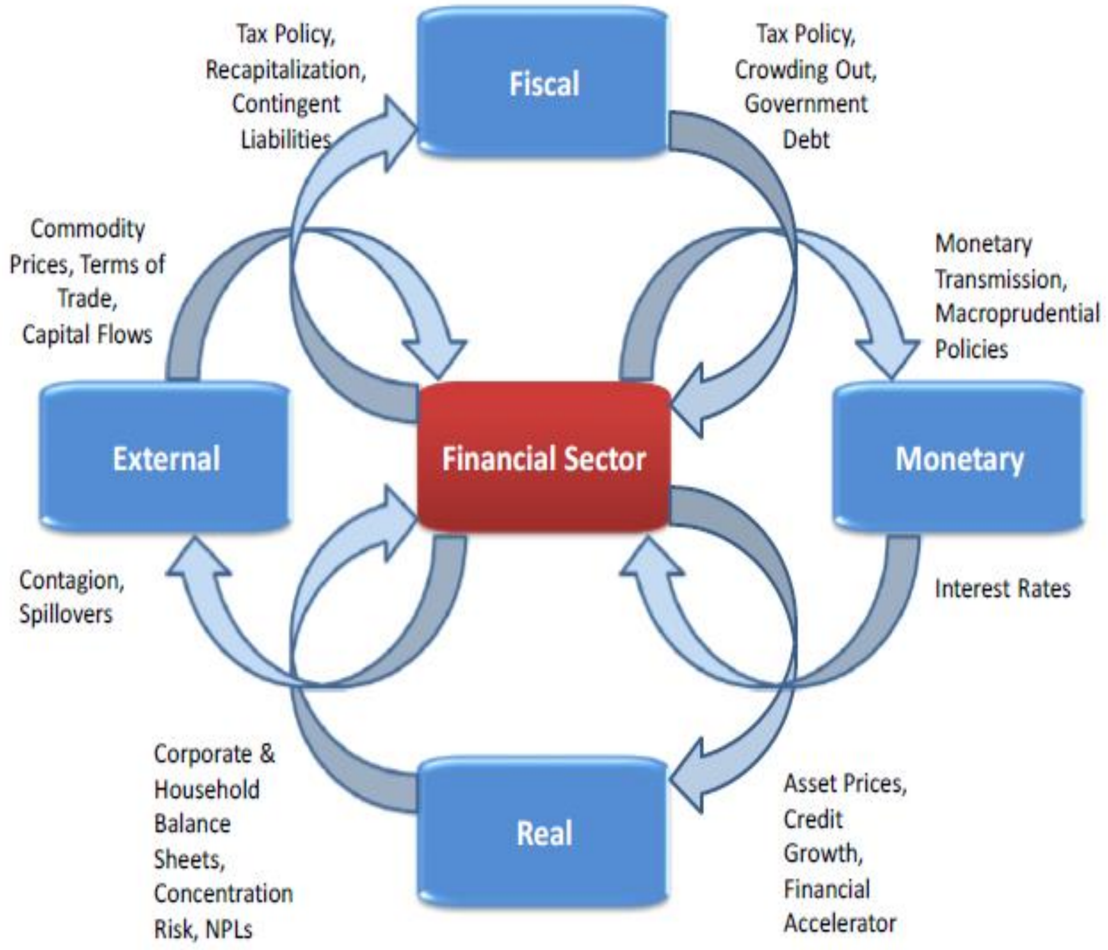
Why should we care about "macrofinancial" analysis?

1. Comprehensive assessment of the macroeconomic impact of the pandemic in the short and medium run

2. Early signs of warning: emerging risks and avoiding unintended build-up of risks

3. Device and calibrate policy responses appropriately and in a timely manner

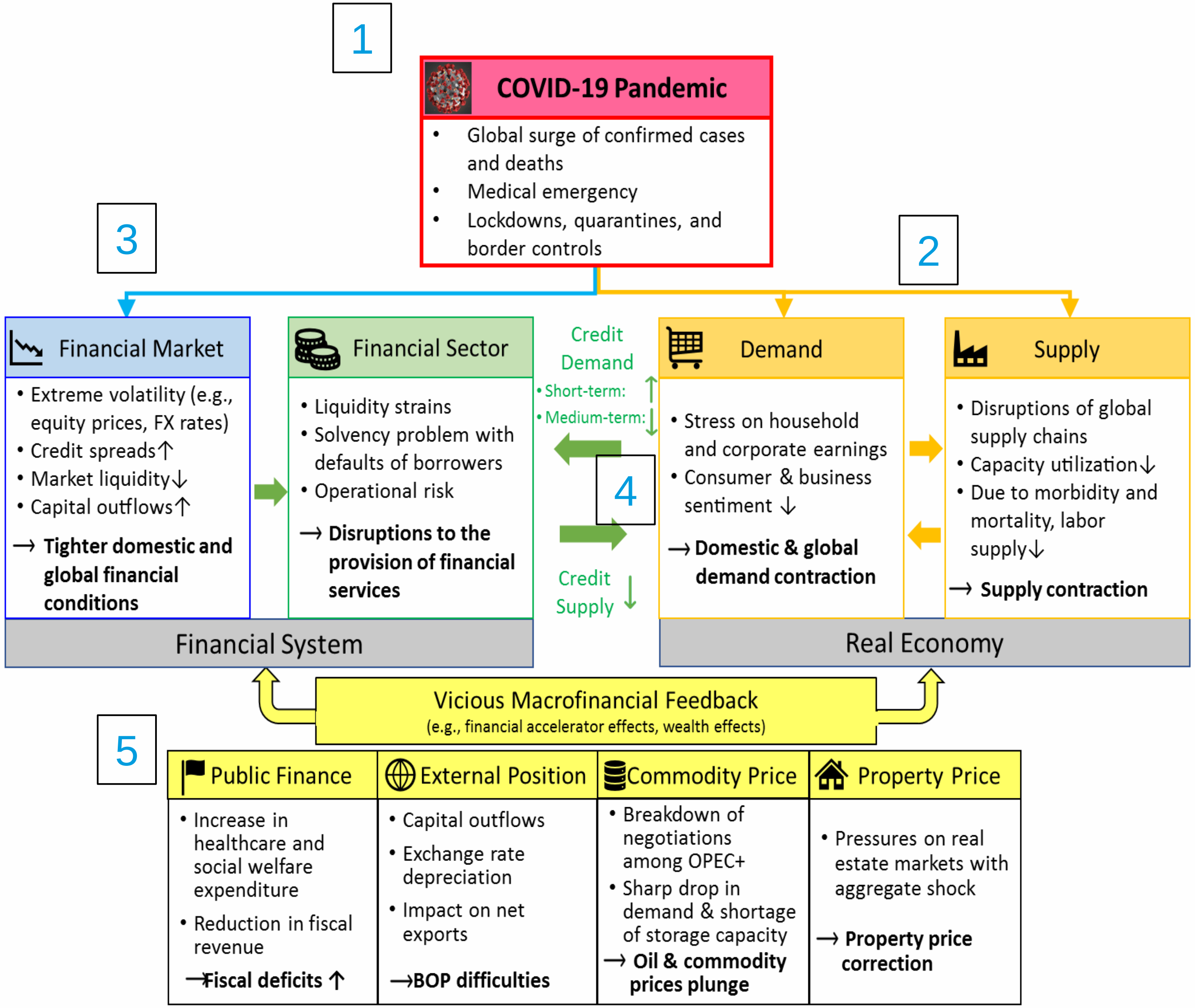
4. Exit strategy



Agenda

1. What is the COVID-19 crisis?
2. Macroeconomic impact
3. Financial market volatility and stress
4. Impact on the financial sector and credit intermediation
5. Spillovers and amplification through structural macrofinancial linkages

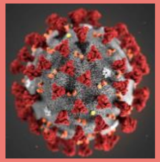
Transmission Channels of the Macrofinancial Impact of the COVID-19 Pandemic



What is the COVID-19 crisis?

- A pure health shock
- Exogenous to the economy and the financial system
- Containment measures are imposed
- Unprecedented repercussions for the global economy

⟶ Morphing from a health crisis to an economic crisis



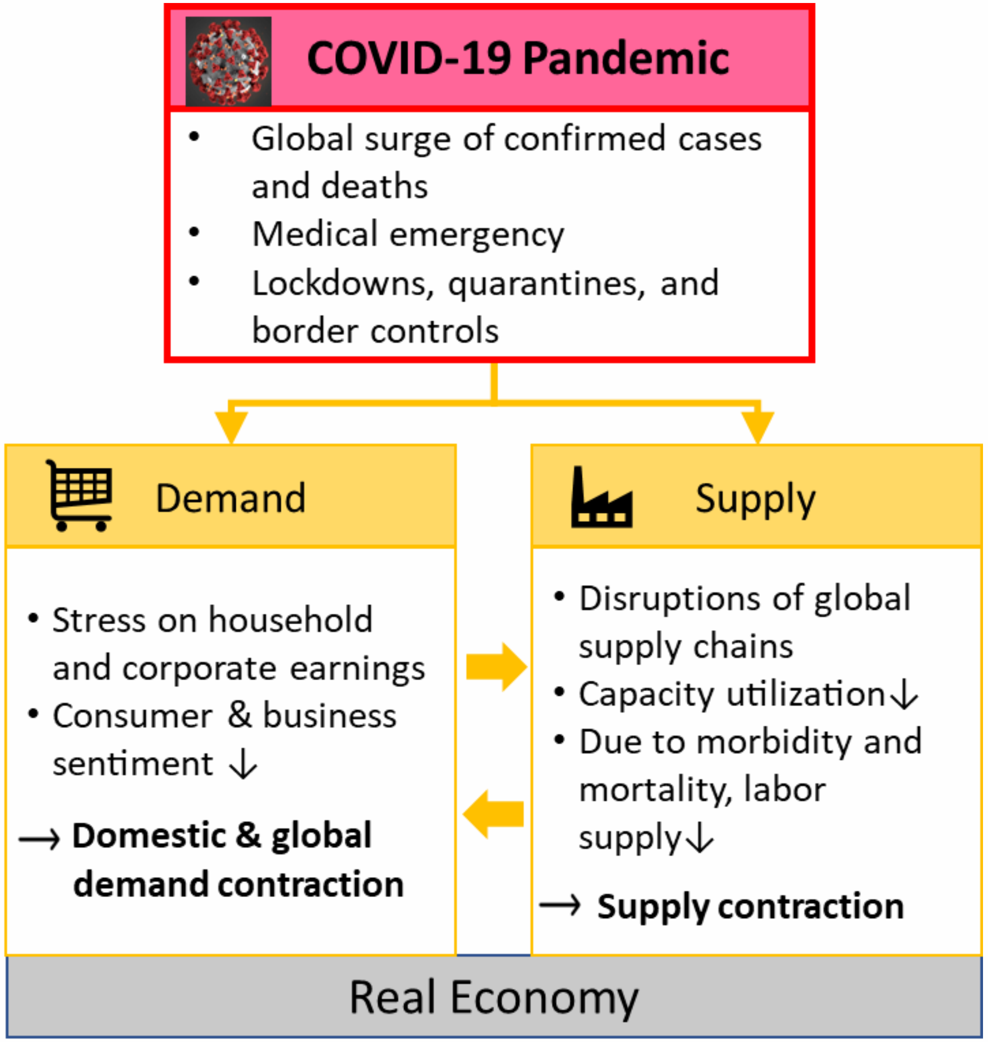
COVID-19 Pandemic

- Global surge of confirmed cases and deaths
- Medical emergency
- Lockdowns, quarantines, and border controls

Macroeconomic Impact of COVID-19

- Supply-side disruption
- Demand-deficient economic contraction
  - Severe impact on firms in retail, leisure, hospitality, and travel sectors
  - Falling household income and rising unemployment
  - Broad-based reduction in private consumption and investment
- Potential output loss due to impaired human capital and reduced productivity

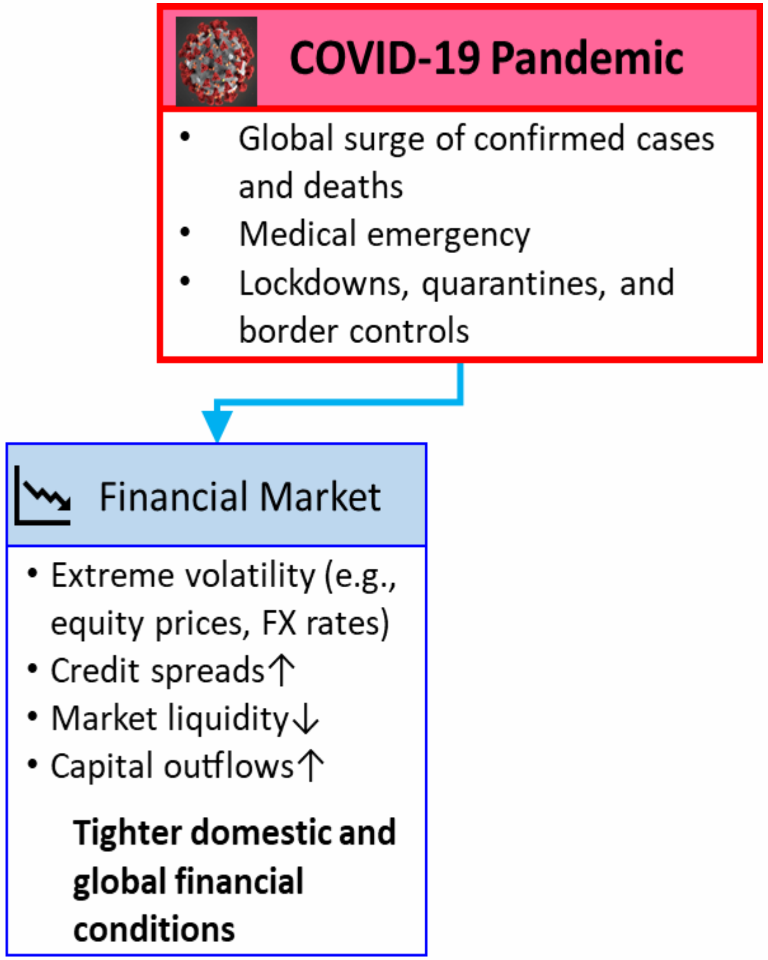
⟶ It is important to reflect the transmission of these effects in the baseline outlook and risk assessment.



Financial Market Volatility and Stress

- Sharp tightening of financial conditions at the onset of the COVID-19 crisis
  - Rising risk premia and falling asset prices with an increase in risk aversion
  - Market liquidity pressures and capital outflows from EMDEs
- Substantial easing of financial conditions in recent months with central bank support
  - Disconnect between asset prices and the economic performance

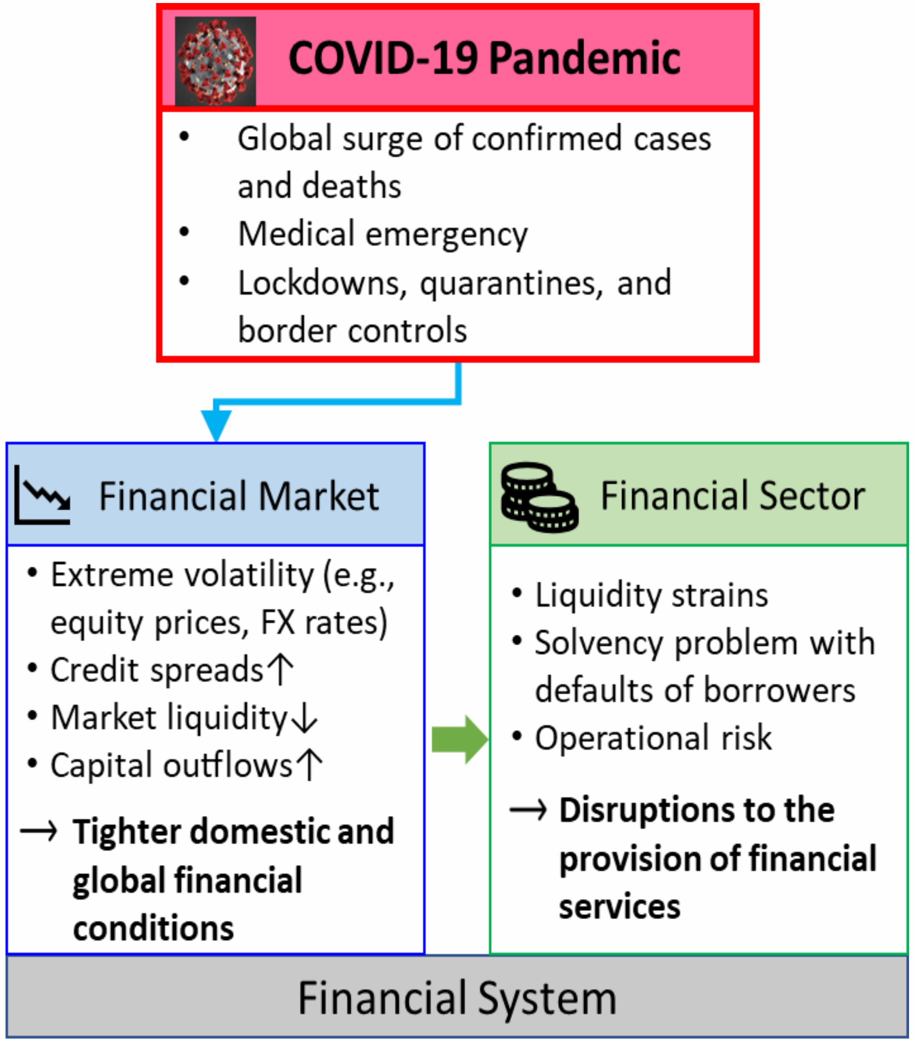
⟶ Useful to assess downside risk to economic growth with the growth-at-risk framework



Impact on Financial Institutions

- Credit events: bankruptcies and higher default on debt
- Low profitability: low for long, increase in provisioning
- Liquidity pressures
- Nonbank financial sector: sharp correction in asset prices and fire sales of assets

⟶ Forward-looking analysis of FIs' solvency and liquidity (e.g. stress tests), considering "lower-for-longer" recession scenarios



Impact on Credit Intermediation

- Prior to the pandemic, corporates and households have become more leveraged on the back of low interest rates.

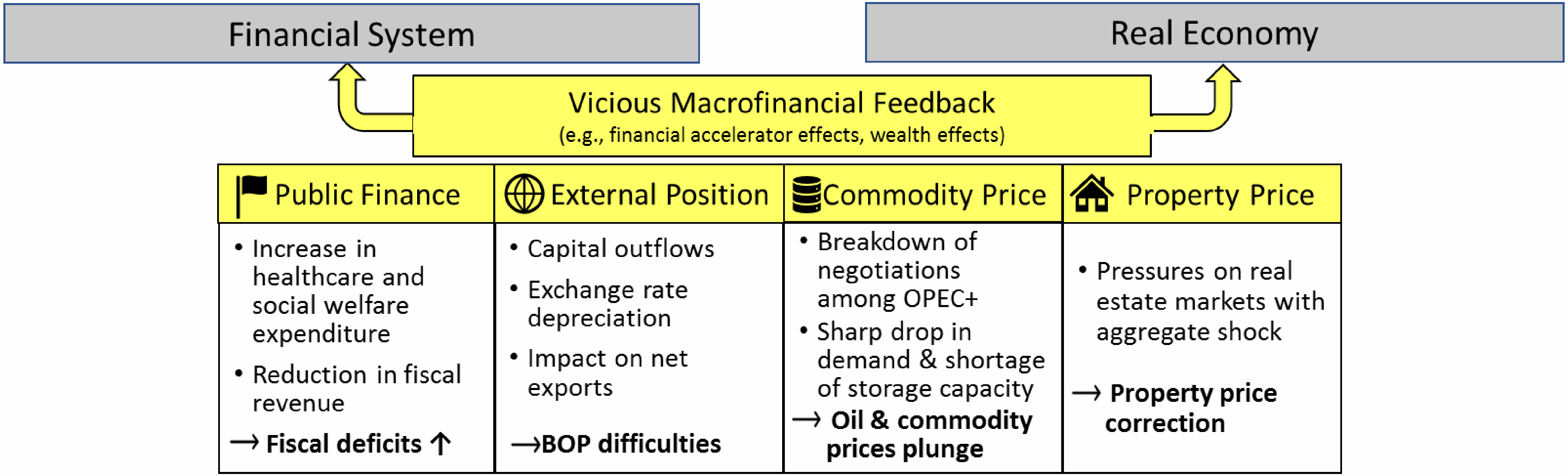
- Sharp tightening of financial conditions + income shocks
  - Credit demand: short-term ↑, medium-term ↓
  - Weakening debt-service capacity of firms and households

- Financial institutions (FIs) would take a significant hit
  - Credit supply ↓

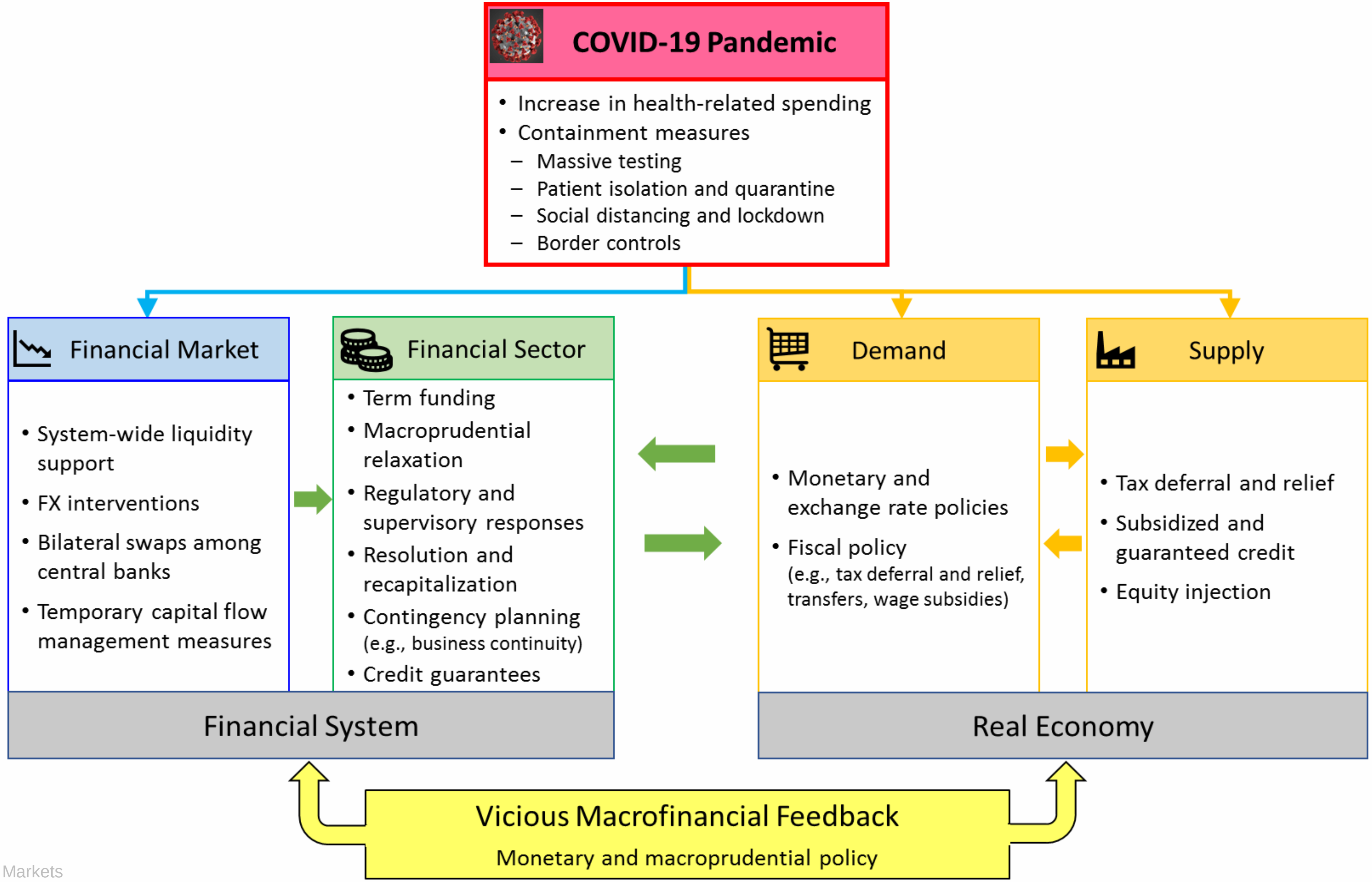
⟶ Debt-at-risk analysis for corporates can give insight about their financial distress

Amplifications through Structural Macrofinancial Linkages

- Structural macrofinancial linkages:
  - Sovereign-financial nexus;
  - Reliance on external financing;
  - Dependence on commodity exports amid falling commodity prices; and
  - Exposure to real estate markets.



Macroeconomic and Financial Sector Policies So Far



Conclusions

- Policy priority: saving lives.
- Be careful: The reopening should proceed **carefully**.
  - Threat of second-round outbreaks remains a main risk
  - Approach: large-scale testing, case tracing, quarantines of infected and suspected cases, social distancing, and public participation
- Be supportive: Policy actions should be **supportive** to the most vulnerable businesses and households.
  - Macrofinancial policy measures should mitigate liquidity and solvency stress
  - Mitigate moral hazard with adequate safeguards
- Be ready: Policymakers should stand **ready** to do whatever it takes to safeguard macrofinancial stability in the post-pandemic era.

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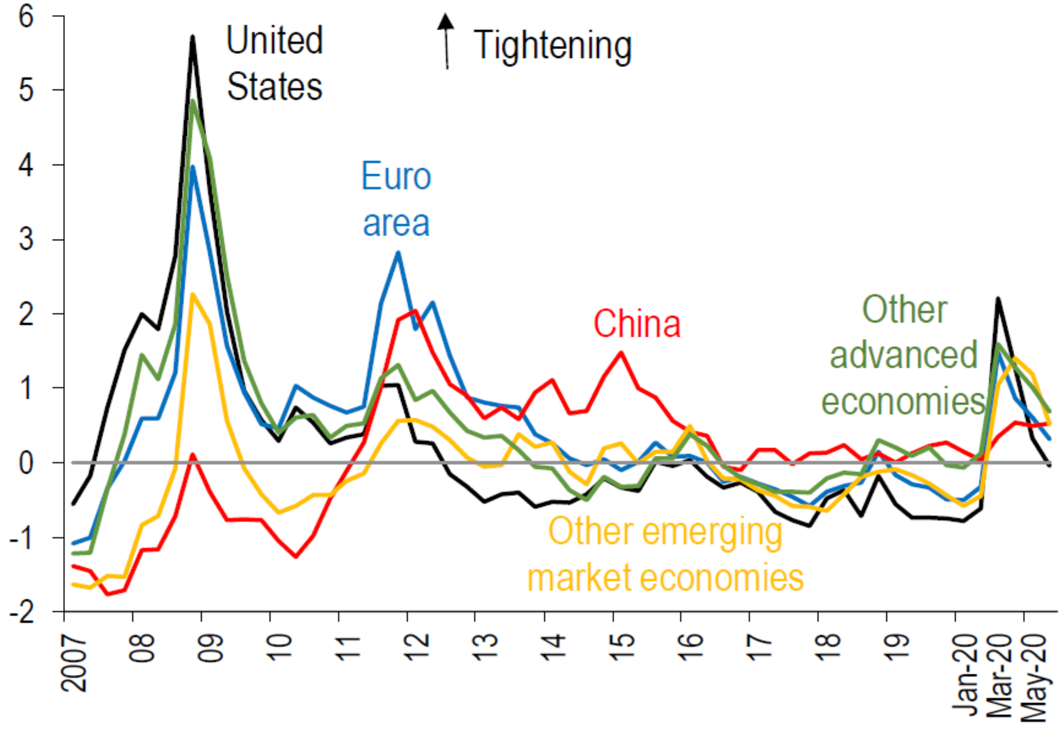
Additional Chart

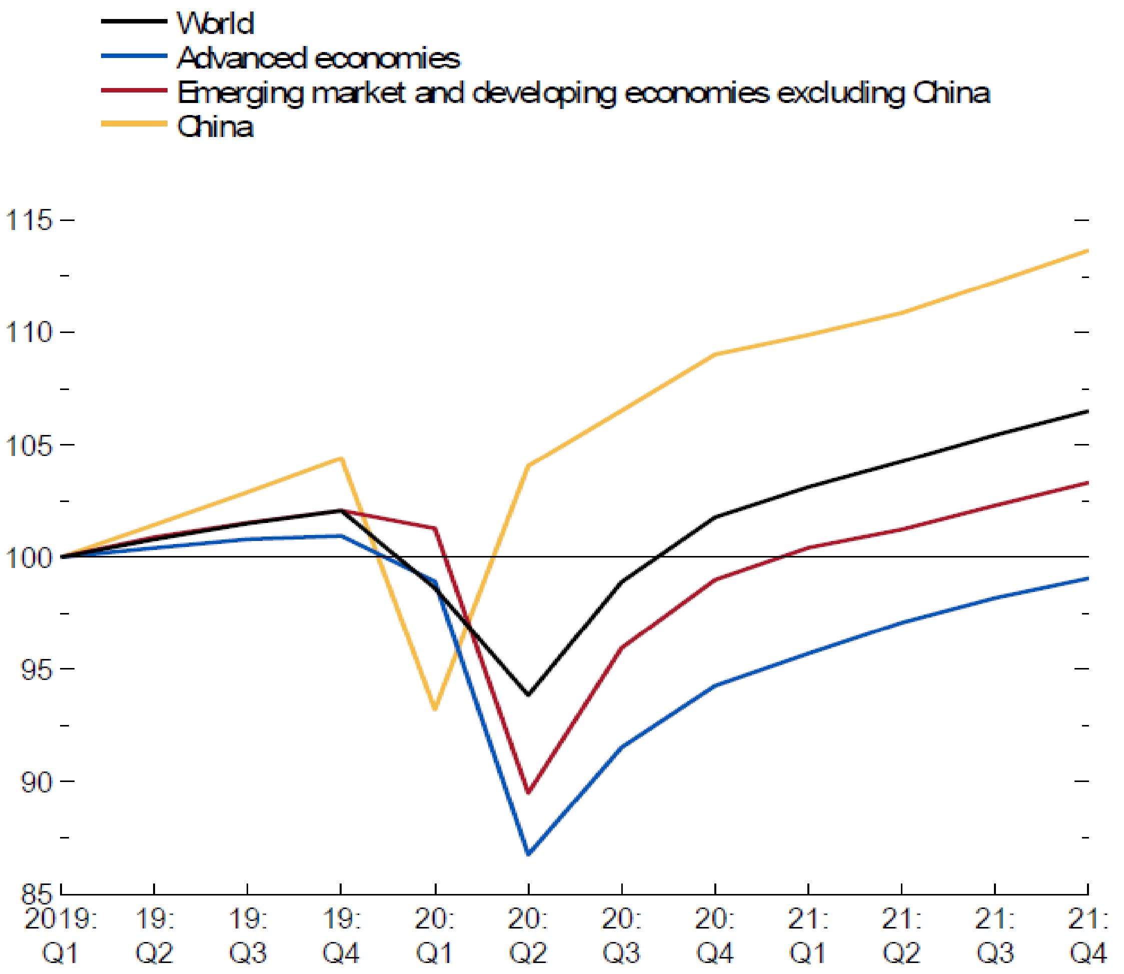
Disconnect between financial markets and the evolution of the real economy

Figure 1. Global Financial Conditions Indices
(Standard deviations from mean)



Sources: Bank for International Settlements; Bloomberg Finance L.P.; Haver Analytics; IMF, International Financial Statistics database; and IMF staff calculations.

Figure 1. Quarterly World GDP
(2019:Q1 = 100)



Source: IMF staff estimates.