Bank of Albania

COVID-19:
IMPACT ON THE ECONOMY AND CENTRAL BANK POLICIES

Proceedings of the virtual Conference co-organised by the Bank of Albania and the London School of Economics and Political Science (LSE)

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FOREWORD AND SUMMARY

I am pleased to present the book volume of the 3rd Bank of Albania – London School of Economics and Political Science (LSE) conference titled "COVID-19: Impact on the Economy and Central Bank Policies", which took place in late October 2020.

The conference was thus held more than a year ago as the COVID pandemic was entering its second wave in Europe and the whole world. While the extraordinary policies that governments and central banks deployed from the spring of 2020 managed to bring the world back from the brink of economic precipice, there was still unprecedented uncertainty and the fear of the unknown.

Yet, as a testament to the quality and engagement power of our conference, even under such uncertainty our speakers made impeccable analyses and predictions. Today many policy makers argue that back a year ago no one could predict, for example, that the pandemic would last multiple years, that high inflation would emerge, or that global value chains get under hitherto unforeseen pressure.

Our conference participants however made a number of eye-opening points and forecasts, including at our traditional Governors' Panel:

- **Erik Berglof** of LSE and AIIB considered multiple scenarios, each suggesting that the virus would stay with us long. Looking back, a striking result is that while the world has miraculously ended up with an almost the "best case" scenario where vaccines and antiviral treatments are available, but weak implementation capacity for – and interest in - world-wide distribution has prolonged the crisis, as Erik warned.

- **Mario Blejer** of LSE and veteran central banker predicted the return of high inflation as a result of the mismatch between extraordinary expansion in demand and pandemic-constrained supply, proving wrong those who claim that inflation today has come as a "surprise".

- **Yan Sun** of the IMF warned, correctly, that economic recovery will be crucially driven by progress in addressing the medical emergency.

- **Natasha Ahmetaj** of the Bank of Albania and **Riccardo Crescenzi** of the LSE highlighted strains in global value chains and that geopolitical fragmentation and heterogeneity of GVCs and related FDI flows need to be better understood for emerging Europe to be able to take advantage of needed GVC transformations.

- **Adnan Khan** of LSE proposed a new, evidence-based, policy approach of Smart Containment with Active Learning (SCALE) with locally-rooted flexible policies. Such policies have later proved truly helpful in several countries around the world during the pandemic.

- Governor **Boris Vujcic** of the Croatian National Bank and Deputy Governor **Leonardo Badea** of the National Bank of Romania assessed the foreign currency swap and repo operations of the European Central Bank (ECB), which was offered to all non-euro zone emerging European economies and even to countries which are not yet members of the European Union. These facilities were instrumental in dealing with foreign exchange market stresses and overreaction at the height of the crisis. Boris

Vujcic also explained emerging markets' limited policy scope and proposed ways to expand those limits. He also warned, rightly, of soft budget constraints created by expansionary monetary policy.

- Governor **Anita Angelovska Bezhoska** of the National Bank of the Republic of North Macedonia, First Deputy Governor **Luljeta Minxhozi** of the Bank of Albania and Director **Doris Ritzberger-Grunwald** of the Austrian Central Bank gave deep analyses of what policies had worked during the the COVID crisis response in the areas of monetary policy as well as banking supervision in their respective countries; they also offered helpful lessons for the future.

- **Martin Wolf,** chief economic commentator of the Financial Times and, I may add, a thought leader on macroeconomic policies, put all this in a historical context: the COVID pandemic is still a relatively "insignificant" health event which, however, have had an enormous negative real economy impact. Going forward, this highlights our societies' and economies' enormous vulnerability to disruptions. Martin also warned that fiscal dominance on central bank policy is making a come-back.

Finally, I would like to express my special thanks to the many who attended our virtual conference across the globe. I trust that reading the analysis and policy proposals from the conference will prove the enormous benefit of dialogue and cooperation between policy makers and academia and the unique strength with which our joint Bank of Albania – LSE collaboration has contributed to this important endeavour.

Gent Sejko

Governor,
Bank of Albania

WELCOME AND GREETING ADDRESSES

WELCOME ADDRESS

*Luljeta Minxhozi**

Dear Guests,
Ladies and Gentlemen,

For a few years now, the Bank of Albania and the Institute of Global Affairs (IGA) of the LSE have been co-organizing a series of joint conferences. These annual events are aimed at encouraging an open discussion amongst academics and policymakers, in order to promote new thinking and policy-based approaches to the most pressing challenges we face.

The Bank of Albania is proud to associate itself with the Institute of Global Affairs, an institute which is positioned as a leading academic centre for exploring research-based strategic approaches to policy challenges. On its behalf, the Bank of Albania strives to adopt the emerging academic consensus, while tailoring it to the idiosyncrasies of the Albanian economy and its financial markets.

Being said that, it is a special my pleasure to address this conference, focused on "Covid-19: The Impact on the Economy and Central Bank Policies".

The ongoing pandemic has the undoubted potential to re-shape our way of life for the foreseeable future. As the health emergency is still

* *Luljeta Minxhozi, First Deputy Governor, Bank of Albania*

unfolding, its implications might have far-reaching impacts in our social and economic fabric. For policy-making institutions, particularly in emerging economies, the challenge to fulfil key objectives like price stability, sustainable growth and financial stability is driving them into uncharted operational territory.

I take this opportunity to touch upon some of the most pressing issues at stake.

Dear Guests,

Life with the Sars-Cov2 virus continues to be an unprecedented health and social challenge. Fortunately, health institutions today know more about the virus and which policies serve best to contain it. Unfortunately, we are still far from a definite and practical epidemiological solution.

Against this background, the economic fallout from the pandemic is still unfolding. The strict lockdown in the second quarter paved the way towards a synchronized global recession; the economic activity in most emerging and advanced economies shrunk rapidly while unemployment jumped sharply. However, the easing of lockdown measures in the third quarter and the quick deployment of both fiscal and monetary policies at national level, have started to pull up the global economy from the brink of collapse.

The scale of the two key support measures at national level, fiscal and monetary policy, reached unprecedented levels in many economies, not seen even during the recent global crisis of 2008. The aggregate fiscal support at global level has reached almost 12 trillion USD. Key policy rates have declined to zero and in some cases have pushed through that boundary and into negative territory. Old-style central bank balance-sheet expansion coupled to ever higher risk-taking, operations that were considered unthinkable until a decade ago, has become almost a mainstream instruments.

The pandemic has tested the resilience of the Albanian economy and of our banking system. It has put an immense social and financial strain on households and businesses and has forced the authorities to act swiftly to address the health crisis and to introduce major policy initiatives in order to contain its impact.

The Bank of Albania has used a wide range of policies to support financial activity and aggregate demand. We reduced the policy rate to a historical low of 0.5% and increased the amount of liquidity injected into the system. These actions were aimed at reducing the debt servicing costs across the economy and at supporting continued financial intermediation. In addition, in close consultation with the banking industry, we applied targeted – though temporary – regulatory reliefs, designed to encourage both the temporary deferral of loan payments and the consensual restructuring of loans for borrowers in difficulties, but with sound business prospects. Finally, we took both macro and micro prudential measures in order to strengthen the banks' balance sheets and preserve their lending capacity.

On the fiscal side, the Albanian government delivered fiscal accommodation through:

- Allocating additional funds to support the health sector;
- Increasing social transfers to compensate for the households' loss of income;
- Offering temporary tax relief to businesses and introducing sovereign credit guarantee schemes to improve their access to finance.

These timely, coordinated and comprehensive set of measures, were ultimately aimed both at containing the adverse economic impact and at preserving monetary and financial stability, as a precondition for the future recovery of the economy.

I believe we got the balance right.

So far, Albania managed to avoid both a spike in unemployment and major business failures, despite the financial difficulties they faced. Furthermore, our financial system remains solid, with little volatility across financial markets, low lending rates, a stable exchange rate, and a liquid and well capitalized banking sector. Just as importantly, our stress-tests indicate the banking sector's resilience to additional shocks.

Under these premises, I believe the Albanian economy enjoys sufficient preconditions for a gradual recovery. However, challenges remain. For the remainder of my speech, I would like to briefly share with you our perspective on them.

Ladies and Gentlemen,

While most baseline economic projection scenarios remain positive, it's clear the ongoing global recovery remains fragile. Policy challenges still present, both in the short and in the mid to long run.
The first challenge is to ensure the sustainability of the ongoing recovery and to safeguard it against downside risks, such as potential second lockdown.

At the Bank of Albania we believe the overall policy stance should remain accommodative over the foreseeable future. Any policy normalization should be coordinated and data-dependent. A coordinated normalization means an ideal sequencing of macroprudential policy stance first, followed by fiscal and monetary policy later. A data-dependent normalization means policymakers need to see tangible evidence of a solid recovery, prior to any policy tightening. Given the fragile recovery policymakers would be best advised to lean on the side of caution.

Faced with additional shocks, we believe our priority should be to offer additional accommodation to the economy. However, policy makers should be careful in getting the policy mix right so that potential long-term costs do not outweigh short term benefits. To that extent, we believe:

Fiscal policy should provide additional support, subject to existing fiscal space. So far, public sector sin the developed economies have little financing constraints, partly on account of massive injections of liquidity from central banks. The same appears to be true also for the emerging market economies, such as Albania, which continue to enjoy both market access and relatively low financing costs. However, the fiscal authorities of emerging market economies should be mindful on the need to preserve market credibility on the sustainability of their finances.

- Financial intermediaries – such as banks – have also shared their fair share of the burden. They would naturally absorb a large part of the additional financial costs incurred in case of further shocks. However, financial and macroprudential policies should avoid the temptation of shifting an ever increasing part of the cost on the banks' balance sheets. Financial stability and a robust banking sector remain paramount for the long-term growth.
- Finally, monetary policy should offer additional stimulus. Liquid financial markets are not the cure to the crisis, but they remain a necessary precondition to any solution. Unconventional instruments are fast becoming a natural part of the policy toolkit of major central banks. Central banks across emerging markets – including Albania – are also exploring the possibility of employing unconventional instruments. However, it is not without risks and it might not be easily implemented in emerging economies. In particular, we believe emerging markets' central banks should avoid raising the risk profile of their balance sheets and should strive to preserve the credibility of their policy frameworks and independence.

The second set of challenges is to acknowledge the long-term impact of the pandemic on our economies and societies, and to account for them in our policy frameworks. The spectrum of potential implications is wide but I will try to concentrate my remarks on a few items:

- The pandemic may drive a greater gap in terms of inequality, both among the advanced and developing economies as well as within an economy. An economic consequence of this pandemic is that it may slow down the catch-up process of developing economies relative to advanced ones. An additional one may be inequality within an economy, given that unemployment hits more the young population and those less educated. How these divergences may shape the future of social and economic policies aiming at addressing these divergences, this remains to be seen.
- The enforced limited social interaction due to the risk from coronavirus has accelerated the shift towards digital business and digital finance. While financial technology (or FinTech) has been on the rise prior to this pandemic, the lockdown and limited social interaction has promoted further growth of this

sector which may change the landscape of financial industry in the future.

- The pandemic may well trigger permanent shifts to the work-life balance. Remote working can become a permanent option in the future as some global companies may have already predicted.
- A final issue, is how the pandemic may affect the current climate crisis in the long run. Besides the short-term impact of the lockdown on the climate issue, an optimistic view holds that the lockdown may trigger e new momentum towards a cleaner economy.

Honourable participants,

I am looking forward to an open discussion and your fruitful feedback on these issues.

I am confident a frank exchange of ideas will enrich our joint understanding on the nature of challenges we are facing as well as on the best policies and instruments we should deploy to tackle them.

Let me close by thanking you for being with us today!

WELCOME ADDRESS

*Piroska Nagy Mohacsi**

Dear Guests, Honorable Audience, Governor Sejko,

Thank you for joining us for our third conference organized jointly by the Bank of Albania and the Institute of Global Affairs at the LSE and London School of Economics' School of Public Policy.

On behalf of the LSE and its leadership, I would like to welcome you to this conference.

This conference is the outcome of our ongoing extensive collaboration. We started three years ago, charting out the "new monetary policy normal", the new monetary theory following extraordinary policies of lead central banks in the wake of the global financial crisis. We brought the best of minds in the profession to your wonderful capital Tirana.

Last year we focused on financial sector transformation, under the title "The new brave world". It dissected issue related to financial sector ownership changes, new players including from the non-bank financial sector, new ideas, new products, and the impact of digitalization on the sector.

* *Piroska Nagy Mohacsi, Interim Director, Institute of Global Affairs, LSE School of Public Policy*

We were quite optimistic just a few months ago – then the COVID pandemic hit. When considering the theme of this year's conference, we could not but consider to look at the impact of COVID, again with the benefit of engaging the best of minds. This year conference is virtual by the necessity from health safety, but its global nature via virtual web access ensures an even wider reach both in Albania, in the Souther European region and globally.

We hope that this conference will contribute to our understanding of how to handle the COVID pandemic; what we know and what we do not know in terms of what works and what does not in this extraordinary crisis. Our special focus is, naturally, on the impact of this pandemic on small, open economies in emerging Europe, and in particular in countries who are on the way to the EU membership in the Southern Eastern European region.

We hope that our understanding will inform policymakers in Brussels and in Frankfurt at the ECB, to reinforce good efforts that they have already been making to support the crisis response in this particular region. We will have two fantastic panels at this virtual conference: one setting the stage on the context for our understanding the impact of Covid-19 on the real economy and everything we can think of outside monetary policy, as the latter will be picked up by the second panel: the traditional Governors' panel. We will have the presence of some of the leading European governors on the panel, as well as thought leaders for our discussion. We hope that in the end we will emerge with more knowledge and the prospect of being more prepared of what is now coming, which seems to be a new wave of the pandemic, and a new set of stimulus measures.

With that said, I would like to give the floor to my friend and fellow colleague Erik Berglof, who has been one of the godfathers of this joint conference effort. Erik is still with LSE, but his day job now is with Asian Infrastructure Investment Bank (AIIB) based in Beijing.

GREETING SPEECH

*Erik Berglof**

Thank you very much, Piroska!

I don't want to take too much of your time, but I just wanted to say that we follow what happened in Albania - and of course what has happened since last year – with very strong emotions. You have gone through a lot, and we wish you all the best.

As I was watching the pictures from last year's conference, they really brought back a lot of pleasant memories, also memories of very interesting discussions. Little did we know at the time what would hit the world over the coming year. And on top of that you had the earthquake and a lot of other things happening as well.

When you go through something like this, it is very humbling; you realize that there is only so much you understand about the economy, and about the interaction between, in this case, a medical emergency, and the economy. We now have an opportunity to look at what we learn from this experience and do so in the context of Albania and Southeast Europe. I am sure that we will have the same interesting discussions as last year and I very much look forward to it.

* *Erik Berglof, LSE & Chief Economist, Asia Infrastructure Investment Bank (AIIB).*

The description that the finance minister gave of the situation is representative of many emerging economies that have done reasonably well under the tremendous pressure of the pandemic. They benefited from the spillovers from the enormous expansion undertaken by the systemically important central banks, but their resilience also reflects long experience and many years of important work to build more resilient institutions, more resilient and more responsive policy-formation in many emerging economies. I have had the pleasure to follow this process in Albania and it is very impressive to see how gradually the ministry of finance and the central bank have been strengthened as institutions.

We will go into our discussions and thank you very much for hosting us again; this is a very important tradition and cooperation, so I look forward to the rest of the proceedings.

Thank you!

GREETING SPEECH

*Anila Denaj**

Dear governors of central banks,
Dear guests,

It is a pleasure to participate in the annual conference co-organised by the Bank of Albania and the London School of Economics and Political Science).

I feel great to see that this tradition has succeeded to overcome the today challenges and is maintaining a high level of communication and consultations to identify and find the solution to this unprecedented crisis.

The Covid-19 has posed simultaneous challenges to both governments and economic theory in a very short time. It is a fact that policy making has shifted and several aspects of the economic activity will change or have already changed. The major objective to support citizens, businesses and the economy overall, will lead us to new approaches, to manage this have helped to tackle this hard situation.

The high cooperation between the Government and the Central Bank was crucial to address the immediate need in this situation of emergency. Here, I would like to assess the work and commitment of

* *Anila Denaj, Minister of Finance and Economy*

the Bank of Albania during the pandemic, by preserving its primary role in the Albanian economy.

Absolutely, in terms of economic growth, this year was the most difficult one in decades. Nevertheless, in the framework of the main economic fundamentals stability, there are no sign of large deficiencies, and most of the economic parameters have remained solid, the relative forecast at the outbreak of the pandemic.

GDP contracted by 10.2% in the second quarter and -6.6% in the first half of 2020, compared with the respective period in the previous year. We forecast economy contracts by 6.1% at the end of year. In case the pandemic situation would not deteriorate in the forthcoming period, the growth projection for the next year is 5.5%. Unemployment rate stood at 15.5% in the second quarter, from 11.6% at the end of 2019. Employment contracted by around 4% compared with the end of 2019. We forecast an increase of unemployment at 13.9% at the end of this year, then to reduce at 12.2% at the end of 2021.

We remain at a relatively good position. There is an expansion of current account deficit, due to the strong contraction of inflows from tourism and the exports of good. Also remittances have been reduced. Nevertheless the expansion of current account deficit was contained.

At the same time, the stability of the external position of economy, there have been some positive developments in the financial accounts. Over this year, the expected reduction in foreign direct investments was offset by the increase in the financial inflows, mainly in the form of foreign government borrowing.

Thanks to our partners, the IMF, the EU and the WB, which assisted us immediately through soft credit instruments, we have managed to inject or we will inject further, during the rest of year, a significant amount of hard foreign currency inflows.

So, there was no a sharp decline as expected at the beginning of year when the pandemic started. In contrary, foreign currency reserve increased, being clearly reflected in foreign exchange market.

Another important fundamental, which overall has remained sufficiently stable, over this period, is the financial system and intermediation. Considering the available liquidity so far in the system (also due to the accommodative monetary policy stance) these indicators are more prominent that the expectations.

We have undertaken some measures, during this year, to provide liquidity to business, particularly through public guarantees schemes amounting to USD 250 million. The implementation of these guarantees was something new, like the assessment on the broad impact they have in crisis situation like this one.

Next year will be the real challenge to us, as none could preview the final effects of the pandemic. In this regard we have enhanced our efforts to supporting the economic growth.

The Albanian Government is committed to return to the clear fiscal consolidation in the medium term horizon once the effects from this severe shock will be reduced. We foresee to return to a positive primary balance, from 2020, but positively in 2023 and further a decreasing public debt, reaching 68.5% till 2025.

Without jeopardising none of the main parameters of public finances stability and in fully in compliance with our fiscal rules, in the next year budged we are planning to support the required expenses in the two main sectors. Two sectors related to human capital: health and education.

The support to infrastructure includes the efforts for reconstruction, leaving none behind, or none unsheltered. Investments in human capital and infrastructure are crucial in our plan for reconstruction. The latest Report by the IMF shows that for each investment of 1% in infrastructure, we will have, in return 2% growth in the medium term. We are ready to invest in order that the business may benefit and financial markets develop.

Albania is working on the 7-year Strategy "Development of Businesses and Investments Strategy" and we are committed in our path towards a functional financial market.

The legal framework for the regulation and supervision of the Albanian capital and investment funds market has been improved. This year, three important laws on: (i) capital market; (ii) collective investment undertaking; and (iii) financial markets; have been adopted.

The inclusion of "Fintech" in the new legal framework is an important step towards a developed capital market. We wish that these legal amendments and steps towards a stronger economy would be the main developments in the economy of Albania, which would enable the use of its entire potential. Anyhow, year 2020 will be the one dividing two eras: pre and post Covid-19.

We will strongly continue our efforts for reforms and for a future which provides for rather positive changes.

Thank you again!

I am very much looking forward to today's discussions and suggestions to address our common target for a prosperous local and global economy.

FIRST SESSION:

MANAGING THE RISKS OF COVID-19: IMPACT ON THE REAL ECONOMY

This panel of renowned experts discussed the short and longer-term impact of the COVID pandemic beyond central bank policy: the impact on the real economy, growth, employment, work practices, digitalisation, trade, de-globalisation/regionalisation, the rising role of the state, and populism. The panel also considered "smart ways" to address COVID's twin health and economic crises and likely scenarios for recovery.

Chair: Piroska Nagy-Mohacsi, Interim Director, Institute of Global Affairs, LSE School of Public Policy

LIVING WITH COVID-19: FOUR FUTURES, FIVE SETTINGS

*Erik Berglof**

We learned a lot from these last few months living with Covid-19. What I am going to try to do in a very short period of time is to give a longer term view.

A lot of what we are seeing so far focusses on what to do in response to the pandemic: different health measures and different economic policies to respond to them and deal with social and possibly political impact from the pandemic. I had the pleasure of being part of panel that put together epidemiologist, virologist and economist, and also anthropologists. The idea was to try to what in natural sciences we call "horizon scoping" seeing what can you think will happen in different scenarios using a multi-disciplinary approach. Based on the panel's work set to be published in the scientific journal Lancet, I am going to outline 4 futures and applying them to 5 settings. The conclusions will be at very high level, but hopefully they help us as we think a little more about medium and long-term of the pandemic.

We know there is a lot of uncertainty about almost every aspect of this crisis, and most importantly that is a combined crisis medical emergency and economic crises.

* *Erik Berglof, Chief Economist, AIIB, and LSE*

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Highly uncertain outlook for global economy

- Radical uncertainty, but most likely an uneven and fragile recovery, with COVID-19 casting a long shadow, particularly over much of the emerging and developing world (even with an effective vaccine)
- Upside scenario would be a synchronous recovery in 2021, supported by policy measures (monetary and fiscal) and constructive policies from next US administration
- Downside scenario would be growth disappointment, and a more widespread level of sovereign distress, with financial market disruptions

There is uncertainty about so many aspect of the medical emergency, but there is also great uncertainty about the economic impact, and of course the interaction between the medical emergency and economic impact. And what is becoming clearer and clearer is that Covid-19 will cast a long shadow over many economies, particularly in emerging and developing world.

There are of course upside scenarios, but, to be realistic, we are much more likely to see downside scenarios to this uneven and a fragile or uneven recovery. I won't go into the details of the economic outlook, which is covered in other lectures at this conference. Suffice to say that since COVID had started, every economy in the world has had their growth numbers reduced, and in some cases very significantly.

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Growth likely to disappoint, almost everywhere

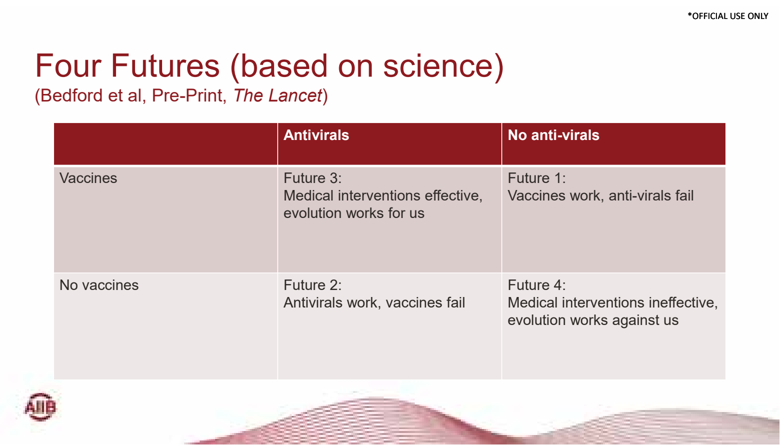
Projections	October 2020 WEO		Change from April 2020 WEO		Change from October 2019 WEO	
	2020	2021	2020	2021	2020	2021
Emerging Markets and Developing Economies						
GDP Growth	-3.3	6.0	-2.2	-0.6	-7.8	1.3
Inflation	5.0	4.7	0.3	0.2	0.2	0.1
Fiscal Balance*	-10.4	-8.8	-1.5	-1.6	-5.5	-4.0
Current Account*	-0.1	-0.4	0.8	0.1	0.2	0.1
Advanced Economies						
GDP Growth	-5.8	3.9	0.3	-0.6	-7.5	2.3
Inflation	0.8	1.6	0.3	0.1	-1.0	-0.2
Fiscal Balance*	-14.2	-6.8	-3.7	-1.4	-11.4	-4.1
Current Account*	0.5	0.6	0.4	0.4	0.0	0.1

Note: * % of GDP
Data Source: IMF World Economic Outlook, October 2020, April 2020, October 2019

So, there is Covid-19 uncertainty with a potentially very long shadow. Some countries in east Asia has shown the way and the most effective economically the cheapest way out of the pandemic, which is a combination of testing, tracking and tracing and treating of course cases that you have. But, it is clear that quite a few economies have not been capable of implementing such policies.

Exports and global value chains seem to be recovering, and part of this relates in my view to the part of the world I am now, Asia, which has done comparatively well during this pandemic. These are countries in East Asia, China, Vietnam, Cambodia, South Korea, and Taiwan. A number of these countries that have done this well are important for global value chains, and China of course being the main example. Yet when I look at how to deal with the future consequences, these counties appear to have reduced fiscal space with clear dangers, in that some of the liquidity issues that we have seen will go from the real economy and the financial sector, creating real solvency issues.

Are we ready, in terms of policy response capacity? Well, so far there are supportive monetary policies and in many cases fiscal stimuli have been supportive. But how sustainable is this is the fundamental question. In our 'horizon scoping' expertise we started from science, looking at a number of different parameters, then simplifying them dramatically into 4 futures, in one dimension vaccines/no-vaccines and on another dimensions anti-viral/no-anti-viral medicine availability.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Four Futures (based on science)

(Bedford et al, Pre-Print, *The Lancet*)

	Antivirals	No anti-virals
Vaccines	Future 3: Medical interventions effective, evolution works for us	Future 1: Vaccines work, anti-virals fail
No vaccines	Future 2: Antivirals work, vaccines fail	Future 4: Medical interventions ineffective, evolution works against us

In the case of vaccines/no vaccine scenarios, vaccines give us immunity, or at least for some time immunity to the virus. In the case of antivirals/ no antivirals scenarios, this is about the capacity (or lack of) treating the virus:

- Under Future 1 scenario, the vaccines work but the anti-virals fail.
- Future 2 has anti-viral treatments work but vaccines are not available.
- Future 3 is the best, where both vaccines and antiviral treatments are available so medical interventions are effective, and evolution works for us, ie., the virus does not change all the time to evade medical effectiveness. Yet there is increasing evidence that the virus is changing, the question is will it change in our favour of us, or, as it has done in some cases in the past, will it change in a more less advantageous way for the virus itself, forcing the heroic efforts to provide both vaccines and anti-virals play a catch-up. We have not focussed on such outcome yet.
- Future 4 is the worst, with both medical interventions don't really work for us and evolution works against us.

What we did then was look at these 4 different futures in the context of 5 economic and social settings, simplified into high-income, middle-income, low-income, conflict zones with very weak local institutions, and finally specific environments: very dense populated environments,

such as prisons and refugee camps, where the impact of virus is typically strong.

Our ‘horizon scoping’ has produced six main findings. Chief among them is that in all four scenarios, including the most benign one, the virus is not globally eradicated, it is likely to be endemic in one or more parts of the world, which means as long as that’s the case, all parts of the world remain vulnerable to new infections when outbreaks occur. The critical importance of vaccines is also clear from the scenarios, and so is the need to plan for global coordination in this regard.

These scenarios can help us understand the long shadow that this pandemic will cast. We also must be alert and remember that the overall assumption on vaccines is that when they work, there will be capacity and cooperation regarding distributing them. Even if we manage to distribute equally, which is a big important assumption, we will not reach all communities. And, there is a very real risk that communities, even in the most advanced ones, will not be receptive to vaccines and reject them. The more the vaccines become politicized, the more real is this fear that we will actually not be able to vaccinate fast enough.

This means that we will not be able to relax, we need a global real-time surveillance of viruses, and there are some really interesting ideas and a lot of work trying to make this possible, looking at some very interesting collaborations between the public sector and private sector on how to monitor viruses. But, for this to work, we need massive international cooperation and collaboration, and we know that this is not the context we are living at the moment. There are a lot of question marks on whether we will be able to achieve the required real-time surveillance.

Obviously, getting the vaccines will be a crucial importance, and issues on how to prioritize vaccines will emerge. But we also know from previous pandemics that once some part of the world has been vaccinated, immunized and protected, and likely it is the rich countries that get this first, their interest for extending vaccination to the more vulnerable countries and less developed countries can drastically go down.

We therefore need to keep up the pressure on getting a fair distribution of vaccines, making sure that they reach every part of the world to best of our abilities. There are a lot of obstacles to fair distribution, some of them are technical around how you distribute vaccines, as different vaccines require different logistics. But, even for those that have the simplest requirements it is going to be a challenge to distribute. And, as I said, there is an issue with resistance to immunization in parts of the world. The ability to deliver protective equipment and having open borders in the world remain therefore critically important.

Let me summarize some of the implications of what I have said.

COVID 19 is the largest global shock that we have seen since World War II, radically affecting all the economies and societies in the world. The ones that will come out of it best will be those which have addressed the pandemic upfront, took a lot of the front-loaded efforts and undertook very harsh or targeted measures.

Of course, there are countries that have often had the experience of going through pandemics. Most of emerging and developing economies had stricter preventative public measures than advanced economies, and there is actually surprisingly strong support for that. But this will be very hard to sustain because the sacrifices that the people are making will be too great. In countries with multiple fragilities, governments really lack the ability to spend for both medical emergency and its economic impact, we need to come in with support from the international financial institutions. And there will be scarring, there is already evidence of scarring of economy everywhere. And this can undermine trust in governments. Ultimately we need the multilateral system to work, and politics to support it.

MANAGING THE RISKS OF COVID-19: IMPACT ON THE REAL ECONOMY

*Natasha Ahmetaj**

Dear panelists and participants,

I am very happy to be here today and share some thoughts on the topic of this first panel. As Piroska mentioned, we in Albania last year have witnessed a revolution in macro-economic policy in response to the pandemic shock. Actually, the reason why I am saying that it was a revolution, stands on the fact that because policy response, policy framework and market have been and continue to be fundamentally transformed. The speed and the size of intervention of policy, both monetary and fiscal one, were significantly higher than it used to be before, especially comparing with last financial crises. In terms of economic point of view, the pandemic might be the model as a sudden stop in the contact-intensive services activity. Then, due to aggregate demand connections, this shock from service activity used to be transferred to non-service activity. Furthermore, due to balance sheet connection the shock might be transferred to the financial sector, which is very important for managing the recession size.

Given this economical view of the pandemic, which was very much understood by both politics and authorities that managed those policies, there has been designed the packages for stimulus both from fiscal point of view and monetary one.

* *Natasha Ahmetaj, Second Deputy Governor, Bank of Albania*

How do we decide to design these packages and which instrument to employ within those packages?

First, we understood that the first reaction was to stop the further fall in both households and businesses' economies. With a view to curtailing this sharply downturn, it was very important to intervene through the stimulus in two directions.

First, to help households maintain their consumption level in order for this consumption to have a kind of multiplication effect to the economy overall. We keenly understood that the economic downfall was not due to previous crises reason, but was intentionally aiming to manage the pandemic effects. Therefore, we should not focus on keeping the stability of GDP, but we should focus on better preserving the stability of consumption, both to firms and households, so they can survive through this shock. That was the reason why the instrument that has been employed in the fiscal stimulus was unemployment payment which used to have been targeted to the people newly unemployed by this shock in services and contact-intensive sectors.

Second, to provide enough liquidity to businesses in order for them to survive and not to lose other assets from this pandemic. Because the risk of losing assets could have long-term impact on the Albanian economy.

This was the first focus of the swift intervention of macro-economic policy to manage this pandemic effect.

The second intervention had another target, which was to keep the access of the businesses and the households to the financing. In order this access to finance to be maintained and managed, it was very much helped by the second part of the fiscal stimulus, which was government guaranteed, and here I have to point out that by this instrument, maybe for the first time, we have noticed a new combination between monetary and fiscal policy. The frontier between them became a little blurring, given that, in one side we have standard credit risk management and on the other hand this risk has been backed by government guarantee.

Both these two instruments have tried to manage the falling to be stopped or the falling not to turn into a long-term damage to Albanian economy. I don't want to mention again all the instruments that we have used during this time as the monetary authority.

However, these instruments, somehow, have short-term effects or, in the best case, medium-term effects. This is not enough, because when it comes for pandemic, we cannot foresee how long it is going to last. We do not even know if any other pandemic can be repeated later on maybe in a different shape and form that we cannot even imagine today.

So, what we can do in order to give another context for the economy to self-adapt to any similar shock like this pandemic or any other shock, given that the policies we use in such situation, provide just medium-term contribution for managing the consequences and, moreover, cannot be always effective.

What we have done resulted to be suitable in terms of instruments we choose. We did manage stimulus packages with proper instruments and we also improved further these instruments. But, when it comes to the size of the stimulus we can never be happy and we are not enough confident to say that the size was sufficient to manage the damage and will not be activated again.

I am coming to the question that Erik has raised in his presentation. Ok, those measures help but can sustainability be satisfied with those?

Here, I want to remind the time when the economists started to talk about secular stagnation. They tried to understand why the economic growth was so sluggish during this recovery period, which was also prolonged comparing with the past experiences. While trying to understand that, they point out as a part of answer one very important factor which was productivity.

The labor productivity as one of the good indicators of the total factor productivity have been tracing downward trend during last year and the economies again try to understand why this is happening lately. This was one of some factors they used to mention, such as decrease in aggregate demand, changes in population structure, higher savings than consumption and some others as well.

Amongst them, there is one factor that have been mentioned more and more in our days, which is the assumption that new technology has not the same transformation power that it used to have 100 years ago in productivity growth.

Now, as many other after 2007 crises, we agree that we are living in a “new normal”. That said we also have to understand that within this new normal, among many new characteristics, it is also the new method of production, which is provided by so-called “Economy of Knowledge”. The Economy of Knowledge is considered to be the last phase in the manufacturing methods development of 21st century.

What does it mean in Albanian? Can we talk for economy of knowledge in Albania? Because it seems to be kind of property of advanced economies or rich countries.

Actually, the economy knowledge paradoxically might be more helpful or useful for economies of emerging markets or economies like Albania, because of two very important elements it bears.

First, knowledge economy is not anymore linked solely with advanced economy. It can be placed everywhere, and it is mostly placed in emerging market. The technology it provides, such as robotic and artificial intelligence might be very suitable to increase the productivity, not only in mass production, but also small businesses, which is the nature of most businesses in a country like Albania.

Thus, it might be very helpful to increase productivity in Albanian businesses.

Second, it is more and more noticed a kind of reallocation of the global chain of production from advanced economies to emerging economies. Thus, Albania should plan, should look for, and should struggle to take our part in this global chain, in order to have access to this global chain of production, which might be possible due to the economy of knowledge we have to be prepared for that. In this regard, there are two pre-conditions to be fulfilled: first, proper institutional framework and second enough qualified workers.

Here we come to the next point, which is: what should we do in order to be prepared for this longer-term adaption of our economy, which cannot be maintained or cannot demonstrate enough resilience to the pandemic only through stimuli. Instead, education and qualification should be our keywords from now on.

If you look to the budget of businesses in general in Albania, it is very difficult to see in any of them the R&D (Research and Development) item. Almost none of them have budgeted for R&D. And it is time for them to plan, even at small size. The R&D item has to be in their balance sheets. If they start to employ some R&D, if our academician starts to commercialize their knowledge and innovation, then we slightly and slowly move to our economy of knowledge.

What I mean is that our businesses should start to be prepared, to be encouraged towards innovation, because innovation can prepare them to get access to the global chain. For this to be possible, education has to be adapted and to be commercialized in order for this innovation to become part of economy and production. Economy of knowledge doesn't mean only creating and disseminating. It is also the usage of the knowledge you already have in your country.

Concluding, whatever macro-economic policy does in order to manage this kind of suddenly shocking economy, it cannot be for long term. The economy itself should change mindset and ways in order to be more capable to face these shocks and be more prepared to play its part in the global chain of economic production.

MANAGING THE RISKS OF COVID-19: IMPACT ON THE REAL ECONOMY

*Yan Sun**

I would like to talk as a practitioner to give an overview of how we see the macro-economic and financial outlook for the Western Balkan countries, to assess their policy responses so far and what we have learned. I would also be forward-looking regarding what our advice is for the period ahead.

First of all, for, the western Balkan economies we expect them to contract by around 5% in 2020. The contraction is lower than what we projected for advanced Europe. However, there is a large variation within the region. For economies that rely more on tourism and remittances, we expect them to see a larger contraction.

This is the case for Albania and Montenegro, the counties that rely more on tourism. And Albania has been hit not just by one shock, the pandemic, but also the earthquake in November 2019. In terms of recovery, we expect the recovery to be gradual, and also fragile given the uncertainties related with the pandemic. The risks continue to be on the downside. In terms of fiscal response we expect fiscal deficits in the region to rise sharply in 2020. However, the increase of deficit is smaller than in advanced Europe. One reason is that the fiscal packages introduced in the Western Balkan countries have been smaller than in

* *Yan Sun, Mission Chief for Albania, International Monetary Fund*

advanced Europe. This primarily reflects their financing constraints. The increase in deficit is mainly driven by lower revenue due to automatic stabilizers and also policy responses such as tax deferrals. Expenditure in nominal terms is projected to increase, but a large share of fiscal package in the region has been financed by cutting non-priority spending given financing constraints. The fiscal financing needs in all the six Western Balkan countries, in 2020, are expected to be fully covered in our baseline.

The pandemic has primarily manifested in the form of reduced consumption and also investment. As a result, private savings are increasing and private investments are down in the region. The banking system is very liquid with plenty of domestic funding available for the government. In terms of foreign reserves in 2020, we expect them to remain broadly stable in the region, despite larger fiscal and balance of payments financing needs, lower remittances, lower tourism receipts, and FDI. One factor behind this is that these countries in the region have received financial assistance from EU, IMF and the World Bank. As of to date, 5 out of the 6 countries in the region have received rapid emergency assistance from the IMF earlier this year. Also, a number of countries in the region have been able to place large-scale euro bonds in the market during the pandemic, including Albania, North Macedonia and Serbia. So this helps with maintaining the level of foreign exchange reserves in the region. The Western Balkan countries have benefited from significant monetary easing in the Euro area, which has helped to maintain liquidity in the market and keep borrowing cost relatively low.

Turning to our financial system and very briefly the monetary easing. Ample liquidity in the system has helped to maintain credit growth in most of the Western Balkan countries. Deposits also continue to increase. And it is worth mentioning the ECB has established a bilateral REPO line with a number of countries in the region, including Albania, North Macedonia and Serbia. This may also have contributed to the confidence in the region. In terms of the balance sheet impact from the pandemic on the banking system, this remains to be seen because many of the supportive measures are still in place such as loan moratoria. The full impact of the pandemic will be seen as supportive measures are phased out over time.

Regarding our assessment on policy responses to the pandemic. Overall, the type of measures introduced and implemented in the Western Balkan countries have been very similar to those in other parts of Europe, with probably one exception, the short-term work scheme is less prominent in the region than in other parts of Europe. Also, as I mentioned earlier, the scale of support is much smaller in this region, reflecting the more limited fiscal and monetary policy space. The way we look at the policy responses includes whether the responses are timely. In terms of containment measures, responses have been very timely in the region, which have helped contain the spread of the virus during the first wave. And also policy measures have been implemented rather swiftly, once they are approved by the Parliament. Secondly, we look at whether the responses have been targeted. The measures in the region have been mostly targeted with some exceptions. And thirdly, we look at whether the measures are temporary. Most of the measures were temporary, but many of them have been rightly extended as the pandemic continues. For example: the debt moratorium and the deadline for restructuring loans have been extended for a limited period of time in light of the evolution of the pandemic. At this point it is still early to assess the temporariness of the measures, as we don't know how long the pandemic will last. Finally, on transparency, at the IMF we say "spend, but keep the receipt". Transparency and accountability of spending is very important. Countries in the region have started to release information on the use of their support packages, including fiscal spending, government guarantees, and loan moratorium. We think there is scope for further improvement in this regard.

Now, what have we learned so far? First of all, policies at both international and domestic fronts are very important. They have helped so far; international and domestic policies have helped to cushion the economic and financial impacts of the pandemic on the Western Balkan economies and people. We learnt that countries need to have all the tools available to deal with increased households, financial sector, and government balance sheet risks; we need for example well-functioning bankruptcy procedures, bank resolution frameworks, and public debt management. Also, countries need to have sound social safety nets and deposit insurance schemes to cushion the impact of fallouts. For countries in the region that do not have those frameworks in place, there needs to be accelerated reforms in those areas. Of course, we are facing very large unprecedented uncertainty, and downside risks given the nature of the shock, so we also place a lot of importance on contingency planning ("What if" scenario) – to increase our preparedness for uncertainties.

My last point is on the way forward. First of all, addressing the health crisis should be the top priority and global coordination in this front is very important. As our Managing Director said: "The global economy is only as strong as its weakest economy". I cannot stress enough the importance of global coordination to address the health crisis". As the economy re-opens amid large uncertainty, countries should be able to use their available fiscal and monetary policy space to support the economy, but in a targeted way, until the recovery is firmly in place. In countries where there are financing constraints, for example some countries in the region might face financing constraints down the road if the pandemic prolongs, they need to better target their support to the economy and may resort to international financial assistance as they have done earlier this year. Once the recovery is secured, countries should start to rebuild their policy buffers and also clean up balance sheets. I would like to note that the recovery should also be used to achieve other important objectives, for example to green the economy. There is still a lot of catch-up potential in the region including improving equality. Closing the still very large infrastructure and human capital gaps in the region is needed to support income convergence with the rest of Europe.

MANAGING THE RISKS OF COVID-19: IMPACT ON THE REAL ECONOMY

Adnan Khan *

The question I am tackling is that given we have a huge pandemic, is there anything that social sciences particularly from economics and public policy have to say regarding how the crises are managed in terms of the public policy. In other words, can theory and data add something to how the crisis is managed? This is a global pandemic with many uncertainties; there are still many things we don't know. What level of immunity we get, how the pandemic response would evolve in terms of medical sciences, but also in terms of social and policy responses. The perennial question of a potential tradeoff between lives and livelihoods is still a key question in many countries. Also is the question how do we tailor and refine our response, first of all how do we enact upon a response, do we copy response from others and the first thing that we know already experience Covid-19 policy response copying solutions from other places doesn't work, both for this pandemic and other things as well. So we have to tailor our response in each context but then the question is how we know if our response is working. How do we learn, and how do us error correct and improve policy response over time. And how do we proactively respond to new challenges that are emerging, right now it is the public health challenge, in the future we have many more challenges and I will come to it at the end. The underlining context is also does economic and public policy, does query

* *Adnan Khan, Professor, LSE School of Public Policy*

and data have particularly something to say about these questions. One of the first policy questions that emerged in this pandemic that unfortunately is still a live question in many countries given the different waves that each country is experiencing is whether to have some degree of lockdown, or to open up the economy. Both carry risks, with some degree of lockdown we can prevent Covid-related mortality and morbidity but risk economic collapse, and increase non-Covid health morbidities. We already have data from some countries about non-Covid shocks, in terms of missed vaccination, immunization and many other non-Covid related outcomes because of the shutdown of the economy. If we open up, maybe we can minimize up social economic trauma, but risk much more Covid related morbidity and mortality.

This is the way this dilemma has traditionally been posed, thus imposing a binary choice. One of the first things to say is that we need to go beyond the curse of the binary choice and carefully choose how we decide on these policy matters. This problem is exacerbated particularly in emerging and developing countries where there are capacity constraints, although this is not just a problem of developing countries or emerging economies, even in developed countries like UK and US and many other countries which in theory have much more potential capacities, but I think realized capacity is a function of not just potential capacity but something else, maybe competence - how best that potential capacity is utilized? In developing countries where there is low capacity they can perform differently in terms of how to utilize that capacity. Modelling is useful but still inadequate for both public health and economic models that we utilize. Data, we always complained for lack of data but in this particular context there is definitely insufficient data to decide upon these questions in an empirical manner. We cannot rely on generic policies on the sense of having the same policies, we need policy response to vary across space and time and I would say phases of the pandemic, to better match the context. That is a unique challenge. And that is a challenge not to be decided just by people at the top, they decide about optimal policy, but to respond to a pandemic like this also requires community response. Individuals and communities ensuring voluntary compliance; that is a function of trust in the state social norm desirable behaviour. So this pandemic is reflected on many other challenges that countries are going to face. It is not just the question of finding the right policy but also finding the right combination of customizing policies and ensuring individual and community response. Some months ago we started collaboration on this multi-disciplinary people from public health, epidemiology, economist, data scientists, LSE, Harvard and other top universities, but also local partners from India, Pakistan and Africa.

So we developed some approaches that I am going to share. This is a work in progress involving a large group of people out there. We call this approach Smart Containment with Active Learning, or SCALE. The idea was to partner with implementers, collaborators, policy partners to design, implement and update policy response leveraging the capacity that we have and not the capacity that we would like to have. In other words, helping trigger building the state capacity through this collaboration through creating operational documents, research, and proof-of-concept implementation. And I will give an example of some of these things. What does SCALE mean? The first principle of SCALE is how you decide when you have limited information and radical uncertainty. These policy principles come from economic and decision sciences which are principles of decision making under uncertainty. The basic principle is that you need to take decisions based on the information and the data that you have today. But you also take action that speed up the learning needed and refine actions based on the actively gained new knowledge. In other words the concept of active learning to create a virtuous policy cycle, which is when to address knowledge failures in real time and break decision deadlocks. I will give examples of some of these.

How do we do this in practice? In practice it means deciding on this question of what policy measures to take, where to go in terms of the deadlock of the economy and any other policy measures based on data. And some of that data is already existing, cell phone data, google data, mobility and many other data sources, but other data we can actively collect on Covid and non-Covid health outcomes and socio-economic impact- data that we can collect from smart testing, robocalls, phone surveys, cell phone/google. This is exactly what we did in a couple of countries, I will give examples. And refine and change response based on how outcomes change because this is not one-time exercise, as outcomes change you need to tailor and refine your response. The other principle which was novel like 9 months ago when we first set this, now it is common, it is gridding, allowing for different localized and targeted responses at a local level, not just to have one policy at the national level. Now it is known by different names, smart lockdowns, local lockdowns, at that time there were a lot of push backs against this. In other words, partition the region into smallest possible isolatable grids - this could be urban neighbourhoods, villages – and tailor the policy response to each grid situation. We implemented this in a few places and did this exercise at the local level, at the level of the census block; it is the smallest possible unit of 200 or so households where we collected this data and graded, grading went through the third principle, which is simply by implementing a differentiated response and also providing a focal point for policy response and public communication, in other words having a graded response not just zero or a binary choice, response that depends on the underlying status as determined by data and doing it at the smallest possible level. In the census blocks, the smallest possible units are 200-300 households in a city with a size of more than 10 million people. The colour coding is in terms of the disease status in that as done through random testing, representative testing. The red ones are the most highly affected and then there are regions close to that and then there are regions where we don't find anything, which are less serious, and the idea was to have differential responses in each of those cases.

This is an example of operational plan of how different things could be implemented at each level and each different grid. This is just a snapshot of a large document at the back-end, you can google Smart Containment with Active Learning and find this document of LSE and Harvard websites. This is just one example, there are many other documents.

Let me end by mentioning how we utilize this knowledge going forward. I hope I have given one example of how theory and data and multidisciplinary approach, based on collaboration between researchers and policy actors in real time, can add value in terms of determining an effective policy response now, but also in terms of refining the policy responses as we go forward. There are similar approaches which are based on this principles could also be effective in terms of responding to new challenges. So, Covid19 unfortunately we must live with long-term health consequences, but also educational consequences. We know from other disasters that short-term shocks have long-term consequences. How to we prevent and address those in terms of employment, health, education, and other factors. For example, literature shows that an earthquake in the past had severe effect on educational learning outcome of kids a decade later in that area. Importantly, the effect was heterogeneous in terms of putting more burdens on sections of society that were least able to withstand it, the poorest. In other words, the impact of the shock was greatest on kids from poorer backgrounds who were least able to withstand it; they basically suffered several years of lost educational outcomes. How do we address this knowing that this will be the case in the future? Then how do we ensure in the future that if we have similar pandemics and other shocks, we are better prepared, we have greater resilience and that our response to the shocks helps triggers increase in state capacity, both in potential capacity but in ways in which we can use potential capacity through competence to actually build stronger state capacity. That has happened in the past, many shocks also triggered building state capacity, think Second World War, think Great Depression in the US, how we ensure similar things happen in emerging and developing countries. And last it is something that Piroska and Erik and School of Public Policy are engaged in, how we ensure that we create global public goods that enable us to better deal with these shocks, not just at the national level, but at the global level. Think of data protection systems, learning mechanisms thereby learning from both successes and failures across countries.

RESPONSE TO COVID-19: INTERNATIONALISATION, GLOBAL VALUE CHAINS AND FDI

*Riccardo Crescenzi**

I will try to keep this short because what I have to say is closely recalling of what other speakers have mentioned before me. I will focus in particular on how to leverage global value chains as a means to relaunch the economy and establish new recovery patterns in the region.

Covid-19 has accelerated a number of pre-existing trends. Many of the things we are currently experiencing are not really new. Geo-political fragmentation is something that has been ongoing for a long time and that Covid-19 has exacerbated. The negative economic

Covid-19 and global fragmentation

Acceleration of pre-existing trends: geo-political fragmentation, global re-organisation of value chains and technological change

New processes and challenges mostly linked with the consequences of social distancing and other public health measures

Global trade flows and GVCs relatively resilient. FDI already in decline before Covid

Unprecedented impact heterogeneity across sectors, GVC segments and regions within countries

Data still limited to capture more fundamental changes in the global division of labour and value added

Pre-Covid-19 data informative on challenges and response options linked with the 'international channel'

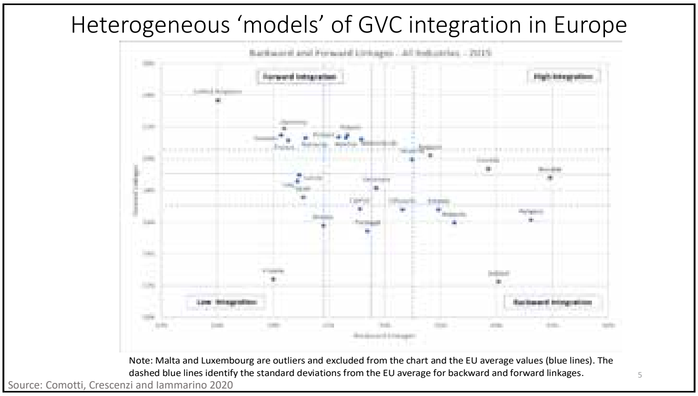
* *Riccardo Crescenzi, Professor, LSE Department of Geography and Environment*

impacts of Brexit would have materialized in any case: Covid-19 has made just stronger and quicker. A similar story applies to the re-organization of global value chains. Many indicators were already suggesting a process of re-organization of global value chains, changes in their spatial structures and nature. The stagnation of, for example, FDI over the 5 years that preceded the Covid-19 crisis suggests that a longer-term process of adjustment was already in place. And this is paired with the underlying process of technological change (e.g. the use of artificial intelligence or the current reliance on work-from-home). Some early movers were already using work-from-home, not as extensively as during the pandemic, but some lead companies were already experimenting with this well before the Covid-19 crisis. So Covid-19 has accelerated a number of pre-existing patterns also in terms of technology adoption and innovation. Of course there are also new processes and unprecedented challenges, mostly linked with social distancing and other public measures that were not there before, that pose new challenges to the global economy.

What I think is very interesting is the unprecedented impact heterogeneity of these fundamental changes and shocks and I think this applies to all the forces that I mentioned before. The more we study these trends, we see that there is significant impact heterogeneity across sectors, across GVC stages and sections and across regions within countries. The economic impacts of Covid-19 are incredibly heterogeneous and they are heterogeneous also across firms.

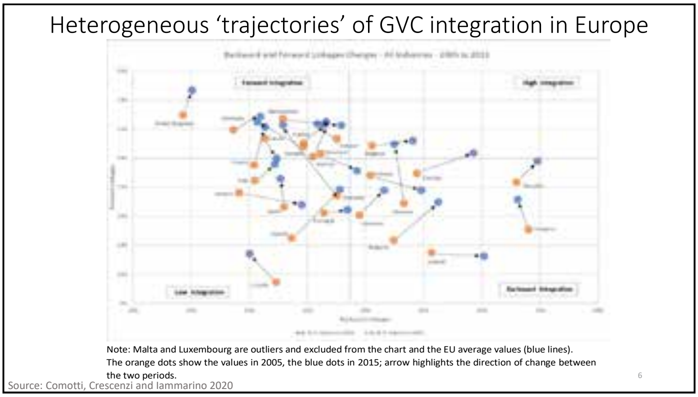
There are some big winners whose value has increased remarkably over Covid-19, and there are firms that were very strong before Covid-19 that are now in serious financial trouble. So, at the moment what we see is an incredible polarization of impacts. As it was mentioned in previous talks, data at the moment are very limited to capture the fundamental changes in the global division of labor and global value added.

However, we might be able to look at some pre-covid data on global value chains integration to try and capture what heterogeneity might look like, by looking at pre-existing conditions, sort of 'resistance capacities', the response capabilities that Natasha mentioned in the previous presentation. Just very quickly, to give you some highlights that come from a recent report produced for the European Commission.



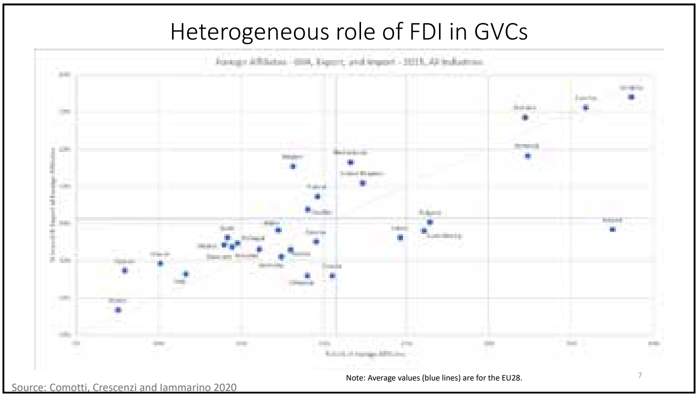
We plot two simple indicators of backward and forward integration of different countries into global value chains by relying on the TVA indicators from the OECD. Albania unfortunately is not in the chart because it is not covered by these OECD indicators. But I think this chart can give you an indication of the position of the different countries in the region when it comes to their backward linkages in global value chains, so the extent to which foreign value added enters the exports of a certain country. To what extent the country is exporting incorporates value that comes from other countries. The value added in my export that comes from other countries, defines my backward integration into global value chains. Forward integration (the y-axis in the chart) is captured by assessing to what extent the value that is produced by the country is embedded into products that are then exported into other countries and then re-exported as intermediates. So that enters the global value chains, that is the contribution the country is making in forward terms to the value chain. That is the value added that the country is injecting into global value chains, for goods that are re-exported by a third country. And you can clearly see the different positons of major European economies.

But you can see in a position close to the United Kingdom or Germany countries like Romania or Poland. It is something interesting there when it comes to the region. Why is that? What are the differences? Heterogeneous models of global value chains integration, where some countries in Central and Eastern Europe have a strong forward projection, others much less so. If you look for example at Bulgaria, a significant share of its exports' value added comes from other countries, not a lot of value added is produced domestically which is then projected into global value chains. Already before Covid-19 different countries had different positions in terms of their contribution to the global generation of value.



This is the mobility between 2005 and 2015, so before the Great Recession (2005) and before Covid-19 (2015). So we can see that there is limited mobility in the big actors, but there is some mobility in some of the countries of Central and Eastern Europe. The blue lines are the EU averages. These things tend to be sticky, but when they move, they move in ways that are highly heterogeneous and highly specific to the country's industrial structure and capabilities, like Natasha was mentioning also. Key points are in terms of heterogeneity in global value chains positons, but also heterogeneity in trajectories, in changes over time in terms of global value chains' positions in different countries. However, another important part of the story is linked with the role of foreign firms. In the following chart you can see the contribution of foreign subsidiaries to the generation of value added in different countries.

The chart shows imports and exports of different countries, accounting for foreign subsidiaries of international firms located in those countries. It gives us an idea about exports that are not generated by the domestic economy, not by domestic firms, but by subsidiaries of foreign firms. For example if you look at the case of Romania, that we mentioned before, it's very different from having strong forward integration like

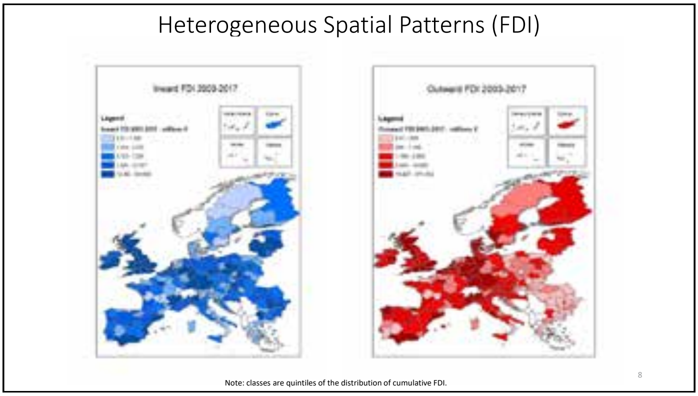


for example in Poland or Germany. Because an important part of the contribution in terms of global value chains in a country like Romania comes from foreign subsidiaries, from subsidiaries of foreign firms than re-export from the country.

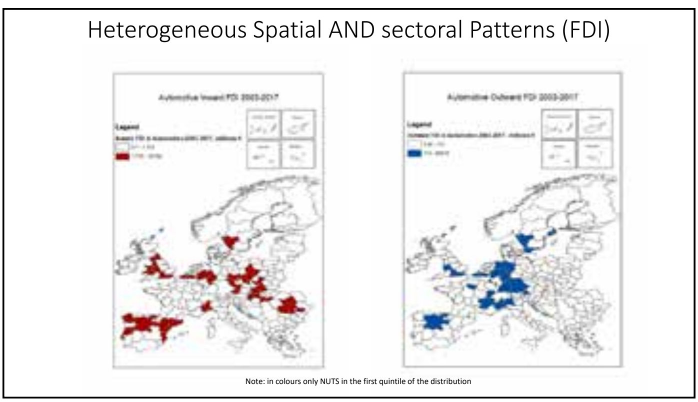
Integration in global value chains in some Central and Eastern European countries is crucially dependent on the role of foreign firms, on the strategy of international firms. When we think about policies to leverage global value chains for recovery, we need to take into account the heterogeneity in terms of what part of corporate structures and what kind of corporate strategies are shaping the position of the countries into global value chains. They are important counterparts when thinking about strategies for recovery that leverage global value chains.

There is heterogeneity in terms of position, heterogeneity in terms of trajectories, heterogeneity in terms of key actors responsible and accountable for the global value chains positioning of countries. The spatial heterogeneity that I mentioned before, here on global value chains we don't have reliable comparable indicators at a subnational level that can give the full picture of the positioning of sub-national regions in global value chains.

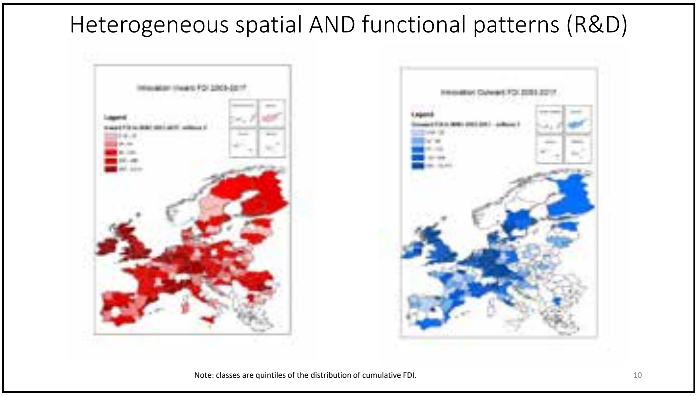
What I did here is show and present some data on FDI indicators that allow us to geo-localize very precisely individual investments, inward and outwards foreign direct investments, at the sub-national level. And we can see that if foreign firms, multinationals, play a key role in controlling value added through global value chains, we can see how the heterogeneity in FDI patterns suggests that this integration in global value chains is highly heterogeneous when you look within countries. Some regions within countries have different global value chain positioning vis-à-vis other subnational regions. This is true also if you identify specific value chains, looking at specific industries.



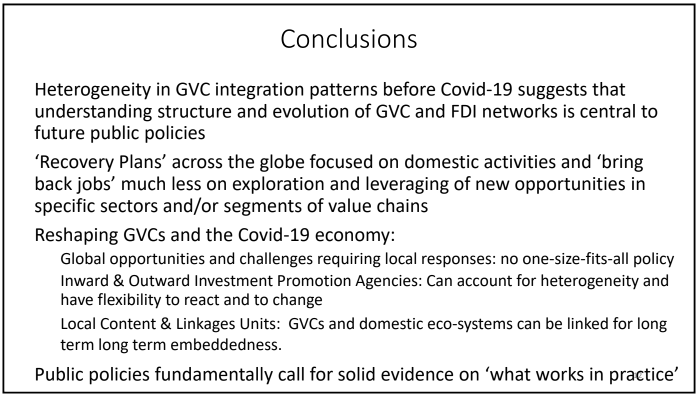
The maps show the geography of the automotive industry in terms of inward and outward FDI. The integration in a particular value chain in a particular sector, automotive for example, is particularly important now discussing about batteries etc., is about very specific subnational areas, clusters, and regions within countries.



The heterogeneity of value chain participation before Covid-19 suggests that understanding the structure and the evolution of global value chains and FDI networks is essential to design evidence-based public policies for recovery.



The striking feature of the recovery plans of many countries across the globe, not only the EU Recovery Plan, is that they are strongly focused on domestic activities and in some cases, think about Japan, on explicitly brining back jobs, on reshoring foreign economic activities of domestic companies back to the country.



There is much less attention on the need to explore and leverage new opportunities for specific sectors and specific segments of the value chain associated with re-shoring and near-shoring trends that can offer significant opportunities to be leveraged for recovery. So what we need is more evidence of what works and what doesn't in these fields; there is some emerging evidence on the importance of national and subnational investment promotion agencies and local content and linkage units. A big issue in this area is how to link global value chains to establish new connections but also to make sure that domestic firms can evenly benefit from global value chain integration.

These are very important challenges that call for new evidence in order to design evidence-based tools that work and can deliver in times of recovery.

SECOND SESSION:

THE GOVERNORS' PANEL

The traditional Governors' Panel discussed how central banks have reacted to challenges and changes imposed upon the economy and the financial system by the pandemic; how emerging markets have been able to conduct expansionary policies, increase policy space and expand their policy toolkit while preserving the financial stability of the economy. Governors discussed the economic outlook beyond the pandemic and explore its long-term consequences including on inflation, financial stability and the transformation of the financial sector.

Chair: Danae Kyriakopoulou, Chief Economist and Head of Research, OMFIF

THE GOVERNORS' PANEL

*Luljeta Minxhozi**

The health crisis caused by the Covid-19 Pandemic has impacted all aspects of life. Health emergencies and measures taken in response to the restriction of economic activity as a result of quarantine, social distancing and other measures to slow down the spread of the virus have caused strong negative shocks affecting economic activity, production, employment, financial system and intermediation, global trade among many other aspects of economic and social life.

In response to the negative and strong shocks suffered by the economy and society, central banks have given an immediate and extraordinary response to support consumers, private sector, all economic activities and the financial sector. The exceptional fiscal and monetary measures have alleviated the impact of pandemic, but the recovery outlook remains surrounded by uncertainty. The focus of policy response has been to reduce costs of financing, provide ample liquidity and keep the markets running as smoothly as possible.

For small open emerging economies of the South East Europe which are highly euroized on both asset and liabilities, the challenges are more complex. Due to such characteristics, interest and exchange rates play an important and simultaneous role in price and financial

* *Luljeta Minxhozi, First Deputy Governor, Bank of Albania.*

stability, frequently pitching monetary and financial stability policies one against the other. Therefore policy responses must consider potential adverse effects; and seek coordination whenever monetary policy affects financial stability (and vice versa) via its direct impact on interest rates or indirectly via its effects on exchange rates.

Once the pandemic hit, it was clear that it would have a significant negative effect on economic and financial stability as well as on the business and consumer confidence. In response to these negative shocks, Bank of Albania launched a series of monetary and macro prudential measures aimed at reducing the negative effects caused by the crisis.

On 25 March 2020, the supervisory council of the Bank of Albania has reduced the policy rate from 1% to 0.5%, as well as reduced the overnight lending facility rate by narrowing the interest rate corridor in the money market.

In addition, as banks may find it harder to secure funds for short-term needs, the central bank aimed to help smooth their needs through injecting additional and unlimited liquidity, through unlimited and fixed price auctions. In this way, the Bank of Albania managed to avoid the stress on providing liquidity not only to the banking system, but to all market operators, in order for the entire economy to have sufficient liquidity to operate normally.

Bank of Albania launched prudential measures and regulatory amendments, which aimed at easing the burden of borrowers' who were affected by the pandemic, increasing banks' financial resilience and supporting the continuation of the lending activity in the banking sector. In more details, these measures included (i) approving a moratorium, which enabled the temporary suspension of debt payments for borrowers affected by the pandemic, initially until June 2020 and then extended until August 2020 (ii) adoption of temporary regulatory amendments which enable banks to ease the terms on the classification of loans and the provisioning levels for non-performing loans during this period (iii) the suspension of the distribution of banking sector profits till the end of year, in order for banks to have adequate capital not only to absorb their potential financial losses but also to support new lending.

In terms of preserving financial stability, on July 17, Bank of Albania signed a repo line with the ECB of euros 400 million, until June 2021, unless an extension is agreed upon. This complements another repo line of around euros 500 million we already had with the BIS. They aim to provide enough liquidity in euro to Albanian financial institutions in order to prevent shortages from morphing into financial stability risks.

Bank of Albania has also increased its communication with the public through press releases, interviews, articles, reports in order to inform the public for all the measures taken and the stance of the bank for the economy in the future.

The measures implemented by the Bank of Albania to support the economy and the financial system complement the fiscal measures, which are considered to have a major and more direct role in addressing the situation. Together, they aim at minimizing the economic costs triggered by the pandemic, restricting the impact of shocks, and creating the premises for a rapid recovery of the economy after the end of the pandemic.

Our monetary, fiscal and financial measures have provided the necessary monetary stimulus to support the normal functioning of financial markets and ensure credit flow to the economy. Interest rates for households and businesses are low and liquidity pressures are under control, while the exchange rate is stable. The Albanian Banking sector proved resilient, despite the challenges posed by the pandemic. The measures undertaken have proven effective. Real and nominal data show that the simultaneous fiscal, monetary and financial stimulus has been successful to avoid the most negative consequences of the shock. Bank of Albania estimates that negative effects of pandemic on the economy will dwindle in the forthcoming quarters and the baseline scenario for economic activity improves. We expect economic growth to be positive in 2021 and 2022, supported by macroeconomic stimulus, reducing reduction in uncertainty and the recovery of the global economy. The return of economic activity to pre-crisis levels and, further, its growth towards potential will create the conditions for the return of inflation to target within 2022. Structural reforms in the economy, targeting a solid, broad and sustainable economic recovery from the Covid-19 pandemic recession, are of utmost importance going forward.

A few tentative lessons we have learned through our experience can be summarized as follows:

- First, unprecedented shocks require timely and unprecedented measures, measures which should critically question conventional thinking of economic policy.
- Second, the complexity of the crisis requires careful policy coordination, in order to deliver targeted relief to key economic sectors.
- Third, international cooperation – in the form of financial assistance and policy guidance – is crucial for alleviating costs to emerging economies and avoiding negative spillovers on a regional and global scale.
- Fourth, sound monetary and financial fundamentals are the best insurance policy and investment we can make to sustainable long term growth. These fundamentals can most efficiently be constructed through careful policies and structural reforms during 'good times'. Hence, a degree of perspective should be retained when designing solutions to any short term challenge we face.

Despite this optimistic view, it is important to understand that future developments are dominated by downside risks, depending on the evolution of the pandemic and the lasting impacts of potential unknown structural transformations imposed on the economy by the pandemic.

It was discussed in the first session that adjustment to pandemic is triggering significant changes in many aspects of life. These changes would likely have noteworthy effects on the economy and most likely on the Central bank itself, its policies and objectives.

It is a fact that central banks in the large and developed countries have initiated a review of their monetary policies to address fundamental challenges posed by the pandemic. Challenged by the pandemic and constrained by the zero lower bound, monetary policy and its tools have adopted. Central banks in advanced economies have relied heavily on the expansion of their balance sheets to support economy with quantitative and credit easing policies. The size, the scope and the coverage of such policies has ventured beyond what was thought possible just a few years ago. This way, they have shattered established consensuses on monetary economics. Following the global financial crisis, the central bank balance sheet, was understood as an extraordinary and temporary tool of monetary policy. After the pandemic, the balance sheet expansion is considered a permanent tool of monetary policy by the leading central banks.

This is simultaneously changing established consensuses and long held believes on sustainability of public debt, central bank independence, currency credibility and hyper inflation fears. One year ago, our keynote speaker Ricardo Reis, observed that central banks and their balance sheet policy experiments were leading the development of monetary economics, eventually showing the way to academia. Following the pandemic, prominent voices in academia push for even more change, and require adoption of policies that until few years back were considered pure theoretic and illustrative concepts.

The history tells us that developments in leading central banks like FED and the ECB have the tendency to become the norm and spread to other central banks. This might happen in the form of a "quiet revolution" - to quote our dear Piroska's excellent article.

This adoption might seem tempting and very likable form the authority's point of view in the short run. However, it is important to understand that these policies are not riskless as we are warned by Issing (Otmar) and other prominent central bankers and academics.

Such risks are even more elevated in our small open and euroized emerging economies. The interlinked monetary and financial stability challenges and the inability to issue reserve currencies might pose potential risks to large scale adoption of the central bank balance sheet as a policy instrument. On one hand, debt and balance sheet problems in the private and public sectors might constrain central banks' ability to use these policies, and can puts at risk their credibility and independence. On the other hand, practical adoption of balance sheet policies is limited by the development, the size and depth of financial and capital markets in our economies.

I would like to close by saying that pandemic has challenged us all. Bank of Albania has acted swiftly to address these challenges. We have adopted a set of expansionary monetary, macro and micro financial measures to support the economy and make sure that families, business and banking sector can continue their activity as normally as they can and with lowest possible costs. The data shows that such measures are working as intended and are generating positive impact. Bank of Albania evaluates that current expansionary stance of monetary policy is adequate and will remain so for the midterm horizon.

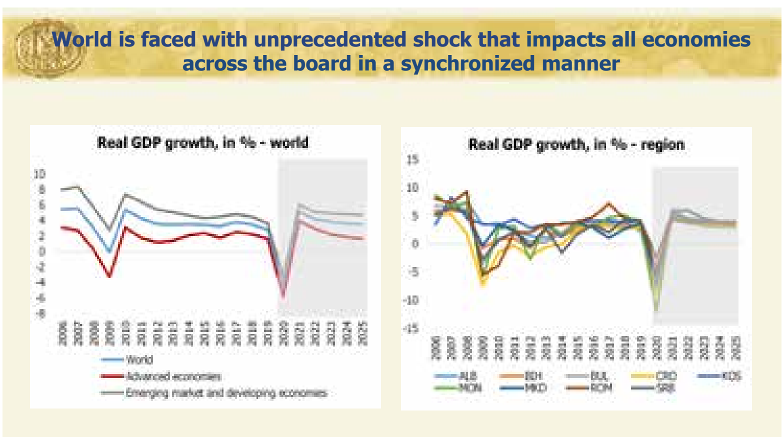
However, in the presence of high uncertainty and increased downward risks, we follow closely the events and developments to evaluate the suitability of our monetary policy; and will react without hesitation, if the materialization of downside risks were to require further easing of the policy stance.

THE GOVERNORS' PANEL

*Anita Angelovska Bezhoska**

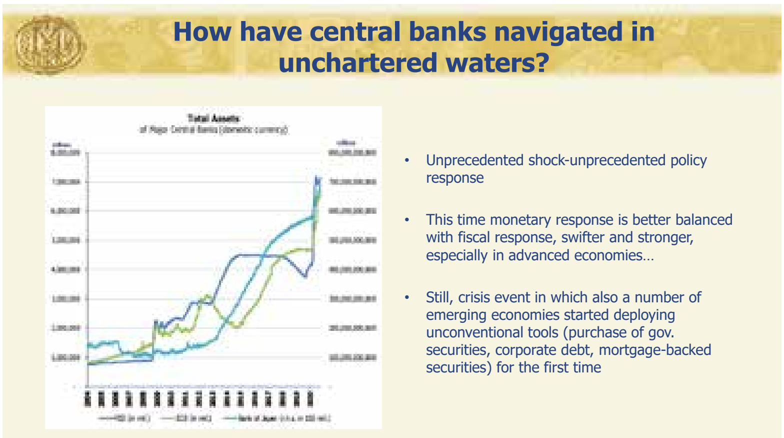
Central Bank Policies as a response to COVID-19 Focus on the region

I would like to shed some light on a couple of aspects, which refer to the policies that the central banks in the region have deployed facing this crisis. First, how have central banks in the region responded to the challenges related to the pandemics; second, have the responses been effective; third, is there still room for loose monetary policy; and last but not least, what are the possible side effects of these policies.

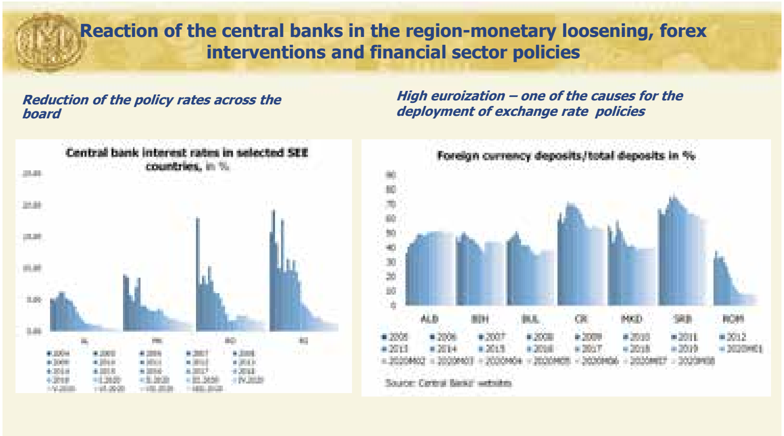


* *Anita Angelovska Bezhoska, Governor, National Bank of the Republic of North Macedonia.*

As we are all aware, world is faced with unprecedented shock that affects all economies across the board, in a synchronized manner. According to the most recent economic outlook, only 26 countries in the world are expected to be in the positive growth territory this year. Unfortunately, none of them is countries from our region, as all economies are expected to experience decline of GDP in the range of -2.5% in Serbia to -12% in Montenegro. How have central banks in this region navigated in unchartered waters?



In principle, unprecedented shock required unprecedented responses on the side of the monetary and fiscal authorities. Given the severity of the shock, the lessons learned from the global crises and the already available unconventional toolkits created during the previous crises, this time monetary reaction was better balanced with fiscal policy. We can draw as a conclusion that it has been swifter and stronger, visible through further cut in policy rates from the already historically low rates and huge increase of assets of CB, and especially the case in the advanced economies. Still, one of the features of this crisis is that it is also an event where a number of emerging economies started deploying unconventional measures for the first time. We already mentioned the case of Croatia. There are also other countries, like Poland, where measures reached up to 4.5% of GDP, in Hungary, Romania as well. So, let us look closely how central banks in the region reacted.



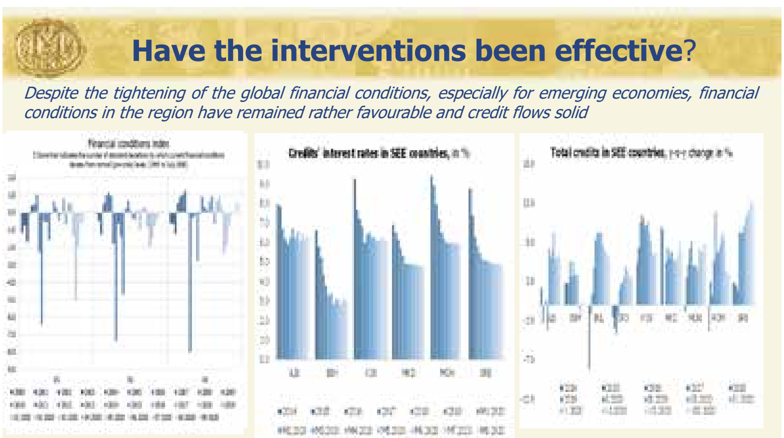
I would say there have been three key pillars in the response to the crises. The first pillar is monetary response, the second is foreign exchange interventions, especially in countries with some form of stable exchange rate policies, and the third is financial sector policies. It is important to mention, especially after hearing Natasha's discussion from Albania, that communication with the public has played a very important role, at least in our cases, especially having in mind that we had to close an insolvent bank during the corona crisis, which really posed a huge challenge to us. So the monetary accommodation continued, aimed to prevent tightening of the financial conditions and interruption of credit flows. Broadly speaking though, all central banks of the region mostly relied on conventional measures, which was visible through cuts in the main policy rate (the cuts were in the range of 0.5 – 1 percentage point). This was followed by injection of liquidity, though it is clear that it was done through different types of instruments, having in mind the specifics of monetary strategy and the specifics to our particular economies.

Exchange rate policies were heavily deployed to stabilize exchange expectations and exchange markets, against the serious pressures that economies in the region faced. Where this pressure came from? First, euroisation is high by definition and on average about 50% of the assets of the banking system are euro assets. In principle, if there is no intervention it can also result in financial stability challenges.

The third pillar is financial sector polices that are used to provide regulatory flexibility, stimulate credit flows and alleviate burden on real sector, resulting in favorable financial conditions, and in many cases, in moratoriums or rescheduling of debt repayments which directly alleviated the debt burden. In Croatia, Boris mentioned that practically part of the households' portfolio that was covered by moratorium was only around 7%, if I understood correctly. In our case, around 60% of the households' credit portfolio was covered by the moratorium, while the part that refers to the companies was about 35%.

In our case, given the fixed exchange rate regime, the main "unconventionality" probably lies in the initial monetary policy response - this is the first crisis episode when our initial response is policy loosening rather than tightening. In the past crisis episodes, given the sizable exchange rate pressures that we faced, our first policy reaction was tightening the monetary policy. For example, during the global crisis, lower capital inflows and increased preferences of domestic agents for euro, warranted increase in the policy rate to stabilise expectations which led to increased interest rates on loans and significant deceleration of credit flows. This time was different, the pandemic crisis caught us amidst strong buffers in foreign reserves, stronger fundamentals, and absence of disequilibria mirrored in the favourable external position and contained inflation.

Have the interventions been effective?



Initially, financial conditions on global markets have significantly tightened. Yet, despite the tightening of the global financial conditions, which was particularly the case with the emerging economies, the conditions in the region have remained favorable and credit flows solid. Cost of credits in the region on average declined, so it did not reverse, but continued its favorable downward trend - on average it declined by 0.2 percentage points. The credit growth continued to be solid. Credits continued to grow steadily in almost all countries - in our case it even accelerated. Average credit growth in the region is about 6.2%, very similar to the credit growth last year, of 6.8%.

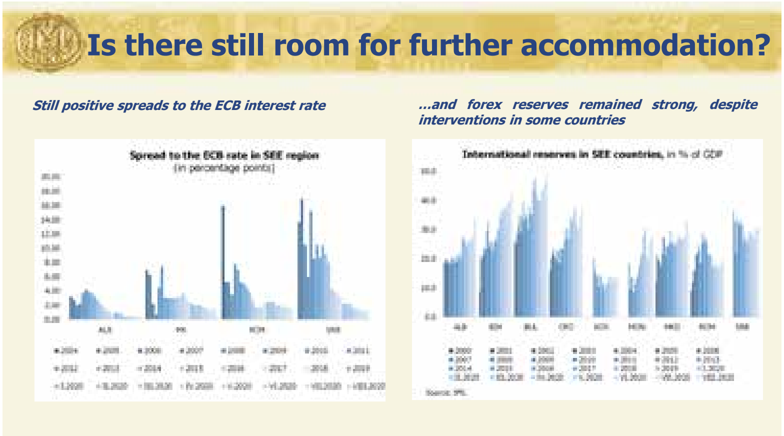
This rather favorable development in the financial system and financial conditions is underpinned by good buffers that the banking systems in the region had during the crises, in terms of liquidity, capital profitability and so forth.

Looking forward, the question is if there is still room for further accommodation? Despite the reduction, policy rates in the region and the spread to ECB remain positive (on average 1.2 percentage points), which is also very important, because it determines our room for accommodative market developments, and in principle suggests some room for further use of conventional instruments. Here I would say that depending on the country specifics, the lower bound in the region definitely is not zero, so we have to be very vigilant and careful.

As Boris also mentioned, since we are having similar monetary strategy, I would also say that for countries with some form of stable exchange rate, foreign exchange market developments, official reserve buffers, as well as access to euro liquidity to IFIs or to ECB in some form, will definitely determine the room for policy manoeuvre, i.e. for further monetary accommodation or sustaining the current relaxed monetary stance.

What are the possible side effects from this prolonged accommodative monetary policy?

First of all, this is not a new question, but nowadays, loose policy mix is becoming even looser, and currently it takes on greater importance, but not enough attention, because we are still extinguishing fires. For

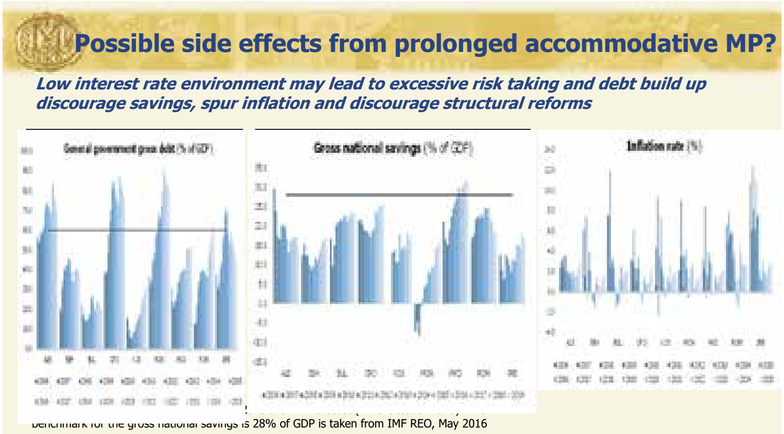


the sake of time, I will just mention a couple of aspects of questions that were widely discussed along those lines, some of them already mentioned.

First, to what extent can low interest rate environment lead to excessive risk taking and debt build up, especially public debt, given that despite the declining trend in the last 5 years preceding this crisis, in all countries in the region debt remains significantly higher in comparison with 2008, and in some countries even above the determined criteria? Hence, this is a question that definitely requires vigilance.

Second, can further policy rate cut adversely affect savings in the region? Although there has been some pick up, savings in the region in principle, remain relatively low, below some traditional benchmarks based on previous fast convergence episodes.

Third, given the strong monetary and fiscal impulse and its visible effect on the monetary aggregates - not only on the monetary base as was the case with the global crisis, but more importantly on the broad money, that in principle tends to better correlate with the inflation (which means that the money is not stuck in the financial system but has found its way to the real economy) - the question is if we are going to face a higher inflation in the medium-term horizon or maybe some complacency on the side of policy makers, which will preclude public finance consolidation.



And, last but not least, how can all these aspects affect incentives for implementation of the structural reforms which are key for increasing long term potential of the region and speed up income convergence, as we are all aware that there is huge income gap, a gap concerning the long-term factors of production and a delay in catching up in productivity – just for illustration, on average, productivity in the region is about 40% from the German productivity, so we have a long way to go.

THE GOVERNORS' PANEL

*Boris Vujčić**

I'll share with you what we did during the crisis in Croatia, which should not be very different from what you have heard others were doing. When this crisis started, I must say that in our case it was worse than the great financial crisis, given the amount of uncertainty at the end of the March and the beginning of April.

We had a situation where we first had an immediate attack on the currency, which was driven by various sources. One was that Croatians, being traditionally inclined to save in euros, started to convert their

CNB's reaction to the crisis

- When the crisis started in March, the **CNB reacted by releasing liquidity reserves**, with several main goals:
  - preserving EUR/HRK stability,
  - ensuring Kuna and FX liquidity of the domestic financial system and
  - preserving stability in the government securities market.
- Up to now - **no need for classical macroprudential instruments** - monetary and supervisory measures sufficient for preserving financial stability.

* *Boris Vujčić, Governor, Croatian National Bank*

assets, so that part of kuna deposits was converted to euro. This is a typical response of economic agents in Croatia when they are faced with a high level of economic uncertainty. Then we had, needless to say, currency speculators coming into the game, including even some financial institutions that started to hedge their equity positons in the domestic currency, thus also contributing to quite strong depreciation pressures on the kuna.

Our first goal at that time was to preserve the currency stability, which we did through large intervention in the foreign exchange market. The second goal was to stabilize the bond market as asset management funds were faced with substantial redemption requirements within a period of 5-6 weeks. The only way to stabilize financial markets was to start to intervene in the government bond market, because that market then became a source of instability. But that meant that for the first time in our history we started purchasing government bonds in the secondary markets. People say that we started doing QE – no, we didn't do QE, we actually intervened in the government bond market to ease the pressures which were building up in a very short period of time while the only game in town at that moment, as already mentioned at this conference, was the central bank. So we also did that on a massive scale: we purchased government bonds in a matter of weeks to the tune of a regular annual volume of central bank interventions in the countries pursuing QE.

That was enough in our case to stabilize the government bond market at all maturities. But, doing that in the emerging market economy is not that easy, given the fact that when we intervene in the government bond market we create additional kuna liquidity, which then goes back to the foreign exchange market. By intervening in the government bond market we basically add fuel to the foreign exchange market pressure.

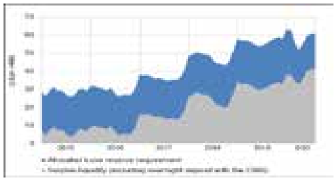
So, in such a situation, this is a typical emerging market problem. As for macroprudential instruments, there was no need for them, and, anyway, as they don't work that quickly, in this crisis they were not part of the game.

We intervened to the tune of 5.7% of GDP in the foreign exchange market and that was done basically over a period of 6-7 weeks. We

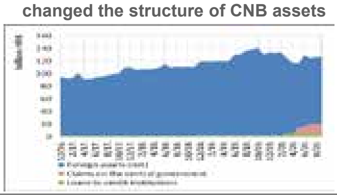
Most relevant monetary measures

- FX interventions (5.7% of GDP)
  + arranging currency swap line with ECB – 2 EUR bn
- Lowering GRR from 12% to 9%
- Government bond purchases (5.6% of GDP)
- Expanding the list of participants in operations of sale and purchase of securities to pension and investment funds and insurance companies
- Weekly and long-term open market operations

High liquidity of financial system has been preserved



Pandemic-related measures have changed the structure of CNB assets



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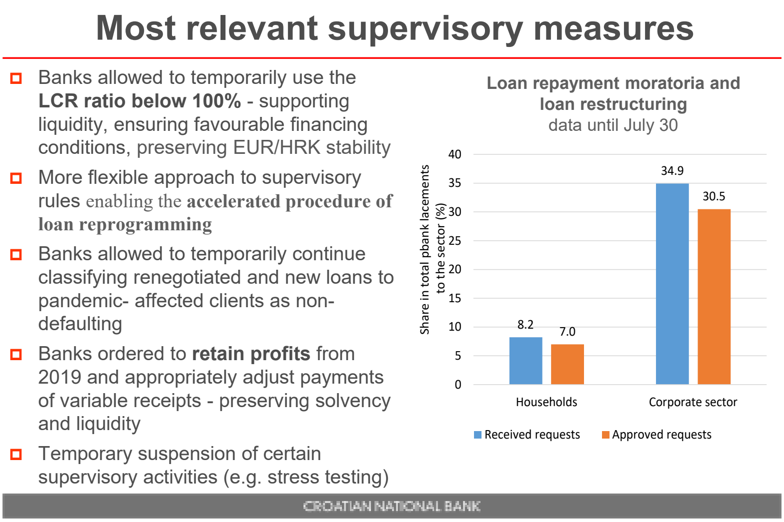
lowered the general reserve requirements from 12% to 9%, which is actually something that we had intended to do anyway on our road to euro introduction.

And most importantly, for the first time we started purchasing government bonds and we did that on a massive scale too. We purchased 5.6% of GDP of government bonds, also in a matter of a month and a half or two months, and you can see here that for the first time the structure of the central bank balance sheet changed in a way that we didn't expect it would change before we entered the euro area. Also, we expanded the list of eligible participants in monetary operations to include pension and investment funds and insurance companies. It was particularly important to include pension funds because we have a relatively large second pillar and pension funds are important players, they are actually the main players in the domestic bond market and also important players in the foreign exchange market. And they basically then helped the government to provide the support to the economy in the spring. And of course, we also kept our weekly REPOs and did a number of LTROs, which were also well-received and helped, maintain ample liquidity in the market.

The most important thing though was probably the arrangement of a currency swap line with the ECB, because at the moment when the ECB announced the swap line, the exchange rate of the kuna immediately appreciated and speculators corrected their positions. From that moment on, the pressures on the exchange rate basically disappeared, particularly given the way the announcement was phrased by the ECB, saying that the agreed currency swap line amounts to 2 billion euro, but if necessary, it may be expanded. I think this was a very clear signal to the markets that the firepower of the Croatian National Bank to intervene in the foreign exchange market was from then on much greater. So, this is one more typical example of how you can steer the market with an announcement. After the announcement market participants became aware of how much firepower the central bank had.



In the supervision area we did a number of things similar to those other European central banks did. We allowed banks to temporarily reduce liquidity coverage ratios below 100% to support the liquidity. Then we deployed a flexible approach to supervisory rules, enabling banks to accelerate the procedure of loan reprogramming. We also allowed banks to continue to treat renegotiated loans to pandemic-affected clients as performing loans if those clients were considered sound on the 31st of December of 2019. And this amendment to the loan classification rule remained in place until the spring next year. What we saw, though, was that banks already by June started to recognize the increased risks by increasing the provisioning. In spite of our relatively flexible approach, we expect banks to continue with higher loan provisioning by the end of this year. Also, banks were ordered to retain profits from 2019 and appropriately adjust payments of variable compensations in order to preserve their solvency and liquidity. This measure was also prolonged in 2021, and we are most likely to align our further decisions with the recommendations of the European Systemic Risk Board, expected in September this year. And we have temporarily suspended certain supervisory activities, such as stress testing.

What have the banks done? Banks have granted moratoria and restructured a lot of their corporate loan portfolios, but not that much of loans to households. Households requested moratoria on 8.2% of their loans, while banks finally accepted 7%. On the other hand, 1/3 of all corporate loans were subject to restructuring or moratoria, which is quite a lot. In addition, not all corporates were treated in the same way, and the treatment greatly depended on the industry from which a corporate came, because this type of a crisis has highly asymmetric effects across different sectors. In the global financial crisis, the decline across different activities was pretty much correlated, while now we have seen a very rapid recovery of the manufacturing and construction sectors, with prolonged weakness in the hotel industry, restaurant, bars, and all the activities that are more sensitive to social distancing.

Looking forward, what is the perspective for unconventional policies, such as the ones that I have described, in the emerging markets? As you well know, this scope is much more limited than the one in the developed countries that issue reserve currencies. We do not issue reserve currencies and therefore we cannot do exactly the same as large central banks. The room for action is particularly limited in the countries that have a higher level of dollarization/euroisation and currency substitution. This is also the case in Croatia, as we still have a high degree of euroisation. Also, if local financial markets are underdeveloped and local banks already have high sovereign exposures, they have little additional capacity to absorb the government bonds

Monetary policy in emerging markets going forward

Scope for unconventional policies in EMs limited:

- we do not issue reserve currencies
- exchange rate considerations are usually an import factor, especially in countries with high dollarisation/euroisation
- underdeveloped local financial markets – low capacity to absorb large issuances of government bonds
- banks have high sovereign debt exposure

Policy space widens with:

- lowering of dollarisation/euroisation and twin deficits
- increase in sovereign bond issues in domestic currency
- maintaining ample FX reserves
- swap and repo lines with reserve currency issuers can help

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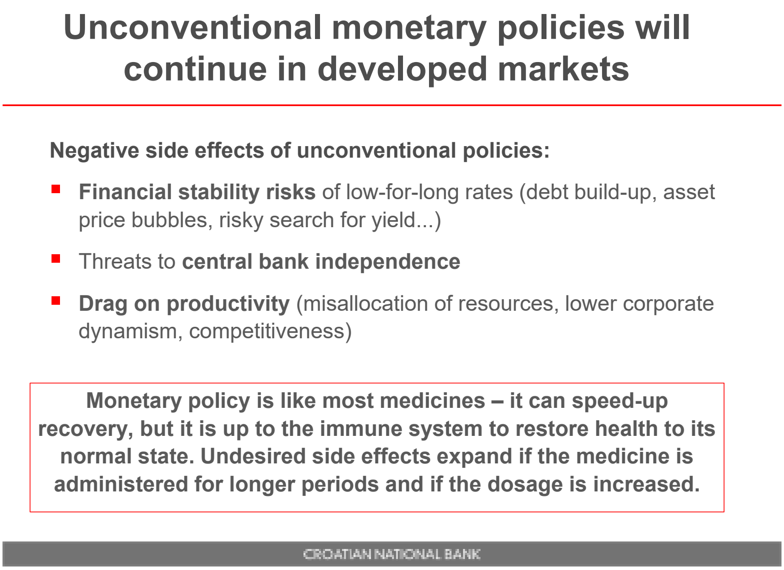
issued and the government usually borrows abroad, which also limits the scope for these policies. A lower currency substitution, better fiscal situation and favourable external position or predominance of sovereign borrowing in the local market as well as a lot of foreign exchange reserves, all this increases the monetary policy space. Also, as we have conveniently learned through the crises, establishing currency swap and REPO lines with reserve currency central banks also help a lot. Emerging markets differ a lot on the basis of all these criteria. As for Croatia, I would say that we are now in a comfortable position, because we have joined the exchange rate mechanism in July and we are now in the process of meeting the nominal conversion criteria and entering into the euro area. With a view to our participation in the ERM II, we opened the currency swap line with the ECB, which basically widens the scope for unconventional policies if they are needed again this year or maybe next year. We hope they won't be needed, but in this situation it is certainly better to have a larger monetary policy space than the opposite.

As for developed markets, as for developed central banks, I think that it is clear at the moment that the low-for-long policies will continue. In the situation of a prolonged period of very low interest rates, we have to be very careful about the side effects of these unconventional policies, as part of them is tied to financial stability risks that build up as surprise bubbles.



Another matter of concern is probably the threat to the central bank's independence. The further we go with unconventional policies, the greater is the risk and the more difficult it will be to go back to a normal central bank policy. Third, I think maybe the main worry is a possible drag on productivity that a very, very loose monetary policy will have in the long-term due to the misallocation of resources, because of a lower corporate dynamism, because of the zombification of companies that in normal times would go through restructuring with a negative impact on overall competitiveness.

Some of us remember the old times of communism, when we talked about soft budget constraints; there is a nice book written on soft budget constraints by János Kornai, a Hungarian economist, and it would be useful to reread it, because the soft budget constraint created by monetary policy is not only impacting inflation, but it is also impacting the incentives of economic agents in the market.

These impacts can be perverse or negative in terms of the allocation of resources and therefore create a long-term drag on the productivity growth. Monetary policy is like most medicines, it can speed up recovery, but it is up to the economy, or the immune system, to restore health to its normal state. If you administer a medicine for too long, or in too high a dosage, than you might have negative side-effects.

THE GOVERNORS' PANEL

*Leonardo Badea**

The impact of the current pandemic on the economy and central bank policies was an unprecedented one from what was so far experienced by valuable economists and decision makers. Following eight consecutive years of high economic growth, the pandemic drive on the recession, Romania was much better prepared than it was before the global financial crises; the GDP per capita reached 2/3 of the EU average compared to only 1/3 at the time of the EU recession in 2007. International reserves were significantly higher, the financing were lower and access to international markets has been validated by the inclusion of the Romanian banks in the emerging markets bond indexes. And public debt was at a comfortable level of 35% of GDP.

However, memories of the previous crises have been paving the way and after reaching primary surpluses in the immediate decades some domestic vulnerabilities have been raising again, especially regarding the increasing deficits on the back of the fiscal losing the real domestic demand, which prompted gradual tightening of monetary policy prior to the pandemic. Since March 2020 things have changed dramatically for the worse. Like everywhere else, the growth rate was negative to a lower extent that in the most EU countries and the monetary policy reversed to an accommodative stance and stabilizing the financial markets,

* *Leonardo Badea, Deputy Governor, National Bank of Romania*

providing the necessary liquidity and stimulating credit activity. We forecast a gradual recovery starting next year but our projections are less optimistic in comparison with ones from a couple of months ago given the unexpected severity of the second wave of the pandemic. We estimate percentage impact of the potential GDP; under the circumstances we are very prudent regarding the shape of the recovery; the v-shaped scenario although it is still possible it is far from certain, especially if we do not manage to improve our management of the medical crisis without which in my view it is impossible to establish the trust of the people and indirectly the confidence of the consumers and investors. After initial inflationary pressure determined by short-term crunch in the demand for the product the lockdown imposed and thereafter led to the inflationary impact of aggregate demand. The annual inflationary rate was 2.4% in September compared to 4% in December last year. Fiscal measures to support the economic short run only compensate for the losses, therefore they do not yet have inflationary effect. Taken together the fiscal and monetary action have prevented the worst outcome of the pandemic.

The national bank of Romania acted decisively and effectively by a mix of monetary macro and micro prudential measures. We cut the interest rate from 2.5% in March to 1.5% currently; we cut the deposit rate to 1%; we cut the minimum reserve requirement from 8 to 6%; we provided liquidity to banks against required collateral by a range stating regular REPO operations; we purchased government bonds on the secondary market; we allowed banks to use additional capital buffers, conditional on the restriction of distributing the dividend; we allowed banks to temporarily deviate from the minimum of debt to liquidity coverage ratio; we postponed contribution to the resolution fund. Still, we closely monitored the evolution of non-performing exposures and asked banks to fully provision when the ration exceeded 5% as well as required banks to perform regular assessments and reporting the largest exposures.

Many of these measures have been common to all central banks of the region and maybe in the world, however we have the lowest increase in the balance sheet from asset purchasing. Our peers indicate that the markets are functioning well if you provide them at the right time and that exit from these measures will not be as cumbersome as for others. Therefore the contribution to price and financial stability of our policy intervention has been outweighed by potential side effect. I conclude with the remark then, in my view implementing an adequate monetary policy will actually avoid other shooting and preserving financial stability can only buy time for structural reform which perhaps Romania needs now more than ever.

Regarding the REPO arrangements with the ECB, very early in the pandemic crises, National Bank of Romania with a few others central banks in our region had the initiative to begin discussions with the ECB, aiming to set up collateral REPO line arrangements, to provide liquidity to address possible needs in the presence of probable market dysfunction due to the Covid-19 shock. Later, the measures to provide gradual liquidity for the REPO arrangement were extended by the ECB to all non-euro member countries. In in our view such precautionary arrangement could prove useful, especially in non-euro countries, which were part of the economy in link to euro and euro denominated capital flows are significant. In our case, the ECB provides euro liquidity to NBR in exchange for high-quality denominated collateral which NBR has as most of our following foreign exchange reserve rates is managed using this types of instruments. Although, we did need to use until now, it is a safety measures to have it and could prove effective in response to unexpected increase in rates volatility and possibly liquidity pressures in the local financial markets. It also discourages short-term speculative initiatives that some place might have in the past crises, which would not be justified if we look at the fundamentals.

Regarding your last question I would refer to the status of the banking system in Romania, both foreign local banks are in good shape. I would refer to the situation of the financial stability indicators and the measures to consolidate the capital and to preserve the bank ability to credit and to contribute to recovery. National Bank of Romania implemented a mix of policy measures: monetary, macro-prudential, and supervisory as to provide flexibility for the banking sector in accommodating the shocks of the current crises. The risks related to financial and the real sectors are closely monitored and periodical assessment of the macro-prudential instruments along with stress tests performed. A particular focus of monitoring is indebtedness of the household with moratoria as well as the financial stance of the companies with different moratoria.

The financial and the prudential statement of credit institution in Romania remain adequate plus the solvency and liquidity indicators and the financial result as well as the leverage effects were comparable or slightly better levels compared to the low time average giving good shock absorption capacities.

However, asset quality indicators of Romania banking sector in the area of intermediate risk at August 2020, several months after the shock induced by the Covid-19 and the level of financial soundness indicators of the banking sector indicate a good risk absorption capacity, increasing the total capital ratio 20.8% in June 2020; increasing the liquidity coverage ratio 2076.6%, stable non-performing loan ratio stood at 4.3 %, very good coverage ratio in non-performing loans by definition 63.1% , only slowly decreasing the return on asset but still at a very comfortable level, 1.3% also only slowly decreasing the return on equity 11.7%.

The indicators comparison shows just the slight increase in profitability and compared to march 2020 the non-performing loans ratio slightly increase. In conclusion to the answer of your last question.

Regardless of eventual unavoidable move of capital between local banks and foreign group, the financial account remain very strong and the statistics for the system or the role are in the most case at good levels, and also in some cases in better level comparing it to other banks in our region for the same indicants.

THE GOVERNORS' PANEL

*Martin Wolf**

The first point I would like to make is that it is extraordinary what damage this pandemic has done. This is a very mild pandemic. So far, it has killed 1 million people and it is currently killing about 1.5 million people a year. Nobody knows exactly how many people Spanish flu killed, but it may have been between 50 and 100 million over a couple of years. The population of the world today is four times as big. So, scaling it up, that would be equivalent to 200-400m today. This then is relatively minor health event. I have looked back at the longer history of pandemics for a book I am writing. By those standards, this is even more insignificant. Yet it has inflicted the sharpest recession on the world economy, at least for 90 years. It has also caused a massive explosion of fiscal deficits and an extraordinary monetary response. And we are not near to being through it. The most important thing I take from this experience is how vulnerable we are to disruptions of this kind, which are likely to be repeated. So, this is the first really big point that we should bear in mind. It is really extraordinary what the pandemic has done.

I would like to add a footnote. There is a view that the monetary policy response is unprecedented. For anyone familiar with British history, it's not at all unprecedented: it's what happened in the Second World

* *Martin Wolf, Chief Economics Commentator, Financial Times*

War, with monetary and fiscal policy supporting each other in just this way. We have adopted a war-time economic policy — that's what it looks like to me. These fiscal deficits and these monetary policies, done this quickly and on this scale are what we would expect in a war. So, this is a remarkable combination: this relatively mild pandemic with this massive response.

I would add two things about today's policy environment, which were brought up in the earlier discussion: first, the fiscal and monetary response has been much faster and much bigger than ever before in peacetime; and, second, global co-operation has been almost grotesquely limited — a point Andres has made very well. So, we have a global crisis to which the response has been overwhelmingly national. This reflects a very important feature of the world environment that I would like to stress it, which is in all major world crises of this kind since the Second World War the leader in managing the response would have been the US. But it is absent; that's decisive. Moreover, there is a second superpower, China, which is also absent, though for different reasons. Moreover, cooperation between the two of them is largely absent.

In that context then it is reasonable to say that the Europeans have done remarkably well. Whether it will be enough is a big question. But one would have to say — it is surprising to me — that they have managed some serious cooperation within the Eurozone and within the EU.

So, these are my views on the broad context.

In the second part of my comments, I would like to talk about what has happened on the monetary side as well as some of the questions it raises.
The first question obviously is raised by the scale of monetary policy action, in terms of balance sheet expansion, other interventions, financial sector interventions and all the rest of it, particularly by the big central banks and especially by the Federal Reserve. The crucial point is that all this — and the fiscal expansion, too — have been possible only because we were in an environment of credibly low inflation, together with ultra-low interest rates. We had very low interest rates even before the crisis started. So, we were actually rather

lucky. It was fortunate that we got into this pandemic crisis with a relatively favorable macroeconomic environment, which allowed the authorities to respond so aggressively.

That raises the question: are we not at the limits of the monetary policy? Well, as long as the environment remains the one I have described, my answer would be: no.

Central banks are always going to find ways of creating and using monetary policy, as long as the environment remains as accommodative as it is now. There is in some sense no limits to what central banks can do as long as people are happy to hold their money. The great proof to me of this is the Japanese situation. They have been operating at near zero interest rates and using quantitative easing for 25 years in the first case and 20 years in the latter case, and their only problem is that they can't get inflation up. So, as long as that environment exists, we can go on sort of forever.

So, the crucial question is: will these conditions last?

There is also a prior question about how monetary and fiscal policy relate to each other. An obvious issue is whether these huge balance sheet expansions (particularly purchases of government bonds) monetary financing of fiscal deficits. Are we actually seeing massive monetary financing? The answer is: quite possibly.

It is quite possible that these balance sheet expansions are permanent and so they will turn out ex post to have been monetary financing. I have lots of friends who wonder whether the Japanese central bank will be able to reverse its monetary expansion. I wonder about that in this case, too. Are we already on the way to fiscal dominance? And again, I think the answer is: quite possibly.

The fundamental question is who will decide on the central bank's balance sheets? Will it be left to the central bank? In the ECB case, maybe, but I fear that the FED or the Bank of England will not be permitted by their governments to inconvenience their debt management. Thus, I think we are very close to, or already at, fiscal dominance.

And that obviously raises very profound questions about central banks in the future and the nature of their cooperation with the fiscal authorities. And I am talking here about major monetary authorities. I think this problem is likely to arise elsewhere, too, in this environment. That's my comments on the relation between monetary and fiscal policies: we are already quite close to fiscal dominance.

And my final concern is — it is the big one in a way — how long will this low interest rate, low inflation environment last, and will we ever return to "normal"? After all, as I mentioned, Japan has not been somewhere we would have called "normal" for about a quarter of a century.

An interesting book has just come out by Charles Goodhart and Manoj Pradhan arguing that demographic factors will lead to fundamental transformation of the global environment in terms of real interest rates, which would affect long-term fiscal solvency. And I suppose some people are already worried that the monetary policy actions we have seen will spill over into inflation at some stage in the future.

My own view is that neither of these seems at all imminent. But if real interest rates were to rise dramatically, and the spending was to continue much as it is now, with much of the debt relatively short term, too, rollover problems would arise quite quickly. Fiscal dominance might then become very real, very soon.

So, the crucial point I would make to monetary policy makers in emerging market countries is that they should worry about whether the global economic environment, in particular the global monetary environment, will remain reasonably stable in the medium term. There is nothing they can do about this directly. But they need to prepare for this possibility. We are in unchartered territory. There are some interesting questions about what the world economy and especially the global monetary system will look like in just a few years from now.

THE GOVERNORS' PANEL

*Dr. Doris Ritzberger-Grünwald**

Let me start with an overview of the different measures policy makers adopted in the euro area and in Austria to cushion the impact of the COVID-19 containment measures. I will then move on to present new analytical tools which economists at Austria's central bank developed for an enhanced monitoring of the pandemic-related conditions. These measures and tools were both triggered by the lockdown in spring 2020 and the weeks thereafter and characterize the exceptionality of the situation very well.

COVID-19 and the Eurosystem's reaction to its economic fallout

The impact of COVID-19 on Eurosystem policymaking was a significant one, as the Eurosystem reacted with a comprehensive policy package, using old but also creating new monetary policy instruments to help banks and businesses weather the crisis (chart 1). The Eurosystem offered euro area banks central bank loans at very favorable conditions: Under the TLTRO III program, banks were able to take out loans at an interest rate of -0.5% (or -1.0% if their net lending were to reach the lending performance threshold); under

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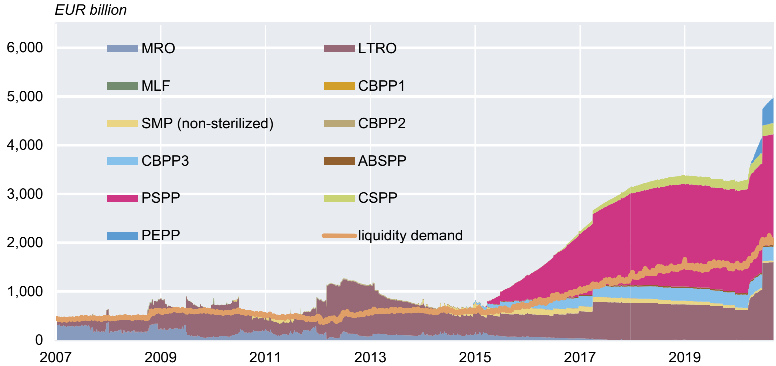
This contribution reflects the situation at the end of October 2020, when the conference took place. Selected new literature on the latest developments is presented at the end of this contribution.

the newly created PELTRO program, they got access to longer-term emergency liquidity at -0.25% of interest. This was complemented by an easing of collateral requirements. The Eurosystem's ongoing asset purchase program (APP) was extended by EUR 120 billion to the end of 2020; and the pandemic emergency purchase program (PEPP) made available EUR 1,350 billion for additional asset purchases until June 2021. As a result, money markets didn't see a liquidity shortage as in 2008, and banks were able to keep lending, to support business investment – but even more so simply to extend bridge loans and provide liquidity urgently needed to pay outstanding bills and wages in particular.

Chart 1

The Eurosystem's monetary policy operations



Source: ECB.

Are there more differences to the crisis in 2008? Obvious differences can be found in the synchronicity of the policy response (this time, monetary and fiscal policy reacted simultaneously) and the speed (much quicker) but also the amount of support provided (much more). In 2008, national fiscal policies entered the stage with a delay, and EU institutions were very hesitant to offer support. At least initially, the 2008 crisis was seen as a financial crisis only, where neither national fiscal policies nor EU institutions had a role to play.

This time is different, as the origin of the crisis is a health crisis; and with a view to shielding the health sector, some parts of our economy have had to be closed at least temporarily.

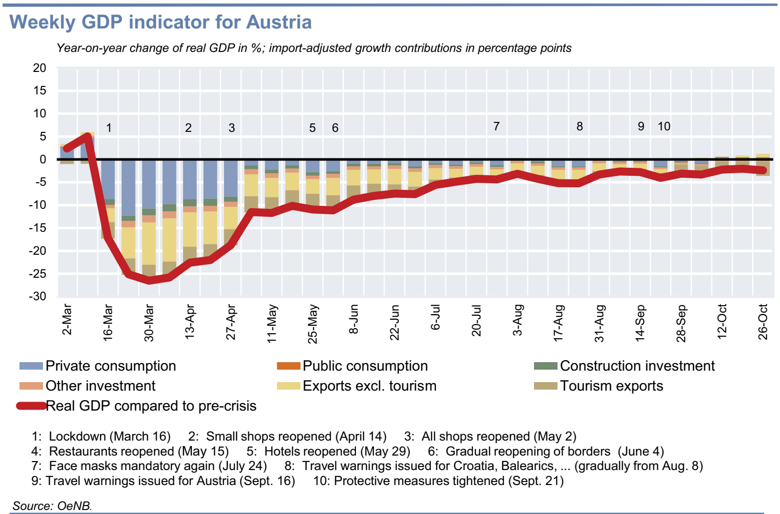
COVID-19 effects on Austria's GDP

The reactions of different EU bodies, like the European Commission, are well known, so I will not describe them in detail. Instead, I will present some of our own work, indicators which were created in the early days of the crisis, and which have helped Austrian politicians to analyze the situation and to implement appropriate policy measures.

At the beginning of the lockdown, when we all had to stay at home, we could do little more than a "visual inspection" of what was going on outside. Had the workers shown up on the construction site next door? Were supermarkets, which had been kept open, being frequented? Were the shelves full or empty? And on a more aggregated level: What was going on with the economy? What kind of measures should be created? Which firms were affected most and therefore in pressing need of support?

As monthly or sometimes even quarterly data come in much too late and/or seldom, we started to collect weekly, sometimes even daily data, to find out what was going on in real time. Our estimations were based on a set of high-frequency real-time indicators from various areas: data on the labour market, payments, cash withdrawals, transportation volume, mobility data, electricity consumption, etc. Some of these data are public, for others we contacted the infrastructure providers and asked for help. The response we got was always positive and supportive. Based on these data, we created a real-time indicator, which we have been published regularly since May 2020. This indicator was most welcomed not only by the public and the media, but also by policy makers. After all, the possibility to estimate the main demand components of GDP in real time allowed for more detailed story telling.

Chart 2



This real-time indicator showed a sharp drop of GDP by minus 25% in the first two to three weeks of the lockdown. Shortly after that, the recovery started and resulted in a V-shaped curve, which characterized the first two months. After that, the recovery became clearly flatter over time, disrupted by several (sometimes regional) lockdown measures, which affected restaurants, tourism, personal services or cultural events. In the summer of 2020, tourism came as a positive surprise. Due to partially closed borders, many Austrians did not go abroad but rather enjoyed vacationing in the Austrian countryside. In addition, many German tourists detected Austria as a new holiday destination. Overall, in the summer of 2020, we actually counted more German tourists than in the pre-pandemic years.

As infection rates have been going up again in Austria and other countries in our neighborhood too, the real-time indicator may start to deteriorate. Currently, the indicator signals a loss of 3.5% of GDP compared to GDP in 2019 on a week-by-week basis. For 2020, the forecast of annual real GDP growth in Austria stands at minus 7%.

Impact of the COVID-19 pandemic on Austrian firms and branches

It is interesting to see what the economy as a whole is doing, but the even more important question, especially for those who have to create policy measures, is: which branch, which sector is affected most, and who needs immediate financial support to survive economically? Table 1 shows that the impact of COVID-19 on Austrian firms has been highly mixed. The underlying concept was to select indicators which highlight sector-specific differences.

One of the indicators reflects the consequences of a lack of demand and tries to answer the question: Is delaying consumption an option or not? Consider the following situation: If you can't get a coffee today because the coffee house is closed, you won't drink it two weeks later, as people won't want to order two coffees instead of one. But if you can't buy a coat today, you can and will buy it two weeks later (but perhaps not six weeks later, as spring and higher temperatures may have arrived by then). Other, more supply side-oriented indicators cover the specific situation on the labor market. For instance, a high share of foreign workers, in combination with closed borders, leads to a shortage in labor supply, which becomes an issue not only in the health sector, but also in tourism. Last but not least, several financial indicators, like solvency and liquidity ratios, are used to monitor the financial situation of the firms in the different sectors.

Table 1

Impact of the COVID-19 Pandemic on Austrian firms

Code	Sector	Demand		Labour market	Supply				Solvency		Liquidity		Total
		N1 Decline of demand in %	N2 Possibility of catching-up	L 1 Increase un-employment (% of employment)	A1 Intensity of shutdown	A2 Employment intensity (per Mio. € value added)	A3 Share of foreign workers (in %)	A4 Dependency on imported intermediaries (II per unit of gross output)	F1 Equity ratio (invers)	F2 Probability of default (%)	F3 Sharp ratio (invers)	F4 Unused credit lines (% of gross output, invers)	G Total score (0-1)
I	Accommodation and food service activities	80	0	25.9	1.00	12.9	55.0	7.1	15.8	3.2	2.1	2.8	1.00
N79	Travel agency, tour operator, …	88	0	4.7	1.00	25.7	16.4	41.3	18.1	1.0	30.0	2.6	0.87
S96	Other personal service activities	74	13	17.3	0.88	15.5	29.6	4.4	29.5	1.4	20.9	4.2	0.83
H51	Air transport	90	10	0.6	1.00	10.8	24.7	29.0	22.4	1.6	27.4	0.4	0.81
R93	Sports activities, amusement, …	80	0	11.2	1.00	9.4	30.0	6.9	24.3	2.4	12.2	2.2	0.81
C31-C32	Manufacture of furniture; other manufacturing	81	50	1.1	0.00	13.9	16.8	38.8	32.3	0.8	17.5	3.7	0.74
R90-R92	Creative, arts and entertainment activities, ..	82	0	1.6	1.00	8.6	25.1	5.9	44.8	0.6	30.2	4.0	0.67
C29	Manufacture of motor vehicles,..	66	50	0.7	0.00	9.1	19.7	55.8	35.9	0.8	8.7	2.4	0.65
C13-C15	Manufacture of textiles, …	70	50	0.7	0.00	14.9	31.2	41.1	34.0	2.6	19.7	4.7	0.65
G47	Retail trade, except of motor vehicles..	51	25	4.0	0.85	20.7	21.8	6.4	24.6	1.8	10.1	6.1	0.58
C18	Printing and reproduction of recorded media	57	50	2.0	0.00	11.0	15.5	34.0	23.3	1.7	11.8	3.1	0.58
C19	Coke and refined petroleum products	38	50	0.9	0.00	1.5	13.8	98.2	0.0	0.2	0.0	5.1	0.54
H49	Land transport and transport via pipelines	45	20	11.1	0.00	12.2	31.6	6.9	27.3	1.2	-0.2	3.5	0.54
N78	Employment activities	46	13	15.0	0.00	20.2	45.0	1.4	24.5	1.0	68.9	1.7	0.52
C30	Manufacture of other transport equipment	54	50	0.7	0.00	10.5	20.1	22.3	31.6	0.6	15.3	9.4	0.51
C33	Repair of machinery and equipment	45	50	1.6	0.00	9.9	14.6	24.0	29.5	1.2	9.7	1.5	0.49
N	Administrative and support service activities	30	20	10.0	0.75	14.0	45.2	8.1	28.3	0.7	30.1	4.9	0.49
G	Wholesale and retail trade; repair …	44	25	3.4	0.75	13.8	20.1	11.3	28.0	1.2	21.1	8.8	0.48
F	Construction	37	25	11.5	0.25	10.7	30.1	11.0	24.7	1.6	11.1	10.3	0.47
TOTAL	Total - all NACE activities	29	29	5.3	0.50	11.0	21.6	15.6	26.8	1.1	11.1	5.5	0.41

Source: OeNB

One of the main questions was and still is: how long can firms in a given sector survive a lockdown? Equity ratios, profitability rates, NPL ratios, or unused credit lines are indicators which feed into a financial survival rate.

Sectors colored in red (table 1) are those which are really suffering, which need extensive financial help and which need it immediately. Not surprisingly, these are tourism and transport, sports and cultural activities. Theaters and concert houses have been closed for a long time, and a cultural program is of eminent importance for tourism in Vienna. In addition, many congresses had to be cancelled, so another important source for tourism in Vienna was lacking.

ONB

COVID-19: national fiscal measures in Austria

- **Focus on targeted measures for those most heavily hit by the pandemic**
  1. Short-term work („Kurzarbeit“, envelope of 12 bn)
  2. Subsidies for fixed costs (envelope of 12 bn)
  3. Fund for severely affected small enterprises („Härtefallfonds“, envelope of 2 bn)
  4. Fund for NPOs (incl. sports) affected by the crisis (envelope of 0.7 bn)
  5. Other one-off social transfers to unemployed and to families (~1 bn)
  6. Additional federal health expenditures (testing, information, equipment, …) so far less than 1 bn
  7. Tax deferrals and guarantees to improve the liquidity situation of enterprises (each amounting to about 6½ bn in mid-September)
- **At the same time, some “classical” stimulus measures have also been passed**
  1. Temporary cut to VAT for hotels and restaurants to 5%
  2. Small income tax cut (lower entry rate for all incomes and higher tax credits for low incomes)
  3. Investment incentives for municipalities and private enterprises

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Austria’s fiscal measures to mitigate the economic impact of COVID-19

In Austria, like in many other countries, a package of quite sophisticated fiscal measures was implemented quite quickly (see table 2). Some of these measures were newly created; others had been developed earlier, like for instance short-time work. All of them were (re)designed to address this very special pandemic situation. The very successful ones have since been prolonged. Short-time work, for instance, was first implemented for three months only. Then it was extended over the summer. In September 2020, it became pretty clear that the pandemic was not over and therefore the scheme was extended further.

Table 2

National Fiscal measures in Austria

Focus on targeted measures for those most heavily hit by the pandemic:	
1. Short-time work	Envelope of EUR 12 billion
2. Subsidies for fixed costs	Envelope of EUR 12 billion
3. Fund for severely affected small enterprises	Envelope of EUR 2 billion
4. Fund for NPOs (including sports) affected by the crisis	Envelope of EUR 0.7 billion
5. Other one-off social transfers to unemployed and to families	EUR 1 billion
6. Additional federal health expenditures (testing, information, equipment)	So far less than EUR 1 billion
7. Tax deferrals and guarantees to improve the liquidity situation of enterprises	Each amounting to about EUR 6 1/2 billion in mid-September 2020
Supplemented by some "classical" stimulus measures:	
1. VAT cut	temporarily to 5% for hotels and restaurants
2. Small income tax cut	Lower entry rate for all incomes and higher tax credits for low incomes
3. Investment incentives for municipalities and private enterprises	

Source: OeNB.

The amount of money it would take to keep the economy going has since been recalculated several times, as the related needs were underestimated initially. According to Austria's Fiscal Council latest estimates, the domestic budget deficit is likely to reach 9.2% in 2020, and 5.8% in 2021. This is not problematic at present, because all EU fiscal rules have been suspended for the moment. We are, after all, dealing with a completely special situation, like an earthquake. When the crisis is over, however, the fiscal rules will be re-implemented. While low or even negative interest rates are now helping to rein in these huge public deficits and debt figures, we will face a consolidation phase in the medium term.

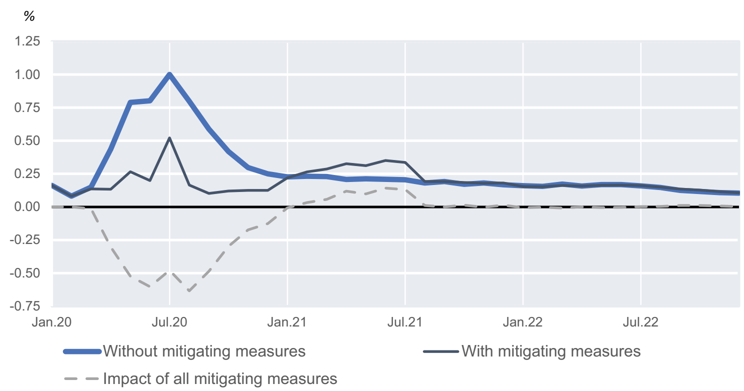
How the government's measures will result in fewer bankruptcies in Austria

Another interesting question is: How effective have all these measures been? Do they really help? Good indicators for the success of a program include credit growth, interest rates, or the development of unemployment rates. Another one is the insolvency rate, as one of the policy aims is to prevent insolvencies, especially when the economy in general or firms in particular functioned pretty well before the crisis and productivity and profitability were high. Then the problem is not firm-inherent; it came from a totally different angle, from the health angle, and it would be inefficient not to try to keep these firms alive.
The basic idea of our insolvency model is the following: a

macroeconomic scenario generates stress for firms. Over time, both equity and liquidity positions deteriorate, causing firm insolvencies if these positions fall under a certain threshold. Without mitigating measures, the insolvency rate would rise to 5.5% by the end of 2020. By the end of 2022, 9.8% of all Austrian firms would have failed, corresponding to an annual insolvency rate of 3.3% (see chart 3). Mitigating government measures thus reduce additional insolvencies resulting from the impact of COVID-19 crisis by two-thirds in 2020 and by one-third until 2022.

Chart 3

Monthly insolvency rates



Source: OeNB.

In the long run, credit guarantees seem to be the most effective instrument, followed by fixed-cost support and short-time work. Short-term deferrals of payment obligations help to prevent insolvencies in the short run only.

Summary

This overview of different monetary policy instruments, fiscal measures and new analytical tools shows how much flexibility was required from policy makers and economists alike to come up with an adequate response to this new and challenging situation. My overall assessment is that both have done very well, although it was and still is an experiment which I had rather not experienced.

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THE GOVERNORS' PANEL

*Mario Blejer**

I will discuss two main points:

- First, the impact of the crisis on, and the reason for difference in crisis impact between, emerging market economies and advanced countries.
- Second, as necessarily as it is, the likely highly inflationary impact of the ongoing COVID crisis response and, related, the 'fetish' of central bank independence.

I find it interesting that we have to question how emerging markets will react to the ongoing COVID crisis. What is the difference today between emerging markets and advanced countries? The definition of what is an emerging market and what is an advanced country need to be revisited because for crisis policy responses to be effective, we need an updated assessment. Historically the distinction between advanced industrial countries and less developed countries was not really necessary. But it turned out that the proposed 'less developed' category at some point was insulting to the more 'advancing developing countries' so that the term of 'emerging markets' was coined about 40 years ago by an economist at the World Bank's private sector lending arm, the IFC.

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Yet these countries have been 'emerging' now for 40 years and most of them do not appear to have completely 'emerged' into an 'advanced' country status. What is really at the core of the distinction today? At the time when this distinction was made, the focus of the policy for these countries was to try to achieve fast and sustainable growth. The core of these policies was the ability of these countries to attract and to retain capital and investment. Growth was to resolve much of the problems in these countries.

Then, the argument went, the main issue was how profound and deep local capital markets were. That is what was needed for a country to attract and transform savings into investments, and then into growth. There were a handful of countries that fulfilled this criteria successfully over time, like South Korea, Israel, and Singapore. They were all taken out of the list of 'emerging markets'. But then came a string of crises, most recently the mother-of-all-crisis, the COVID one.

Nowadays, I think the distinction is different.

To start, let's look at a few countries in the world – some 20 or so - that continue to have same problem as before in terms of capital availability, price, evaluation of the price level, and inflationary pressures. My own country, Argentina, is always used as an example, but it is not the only one – there are some more countries with continued basic imbalances, in South America and in Africa in particular.

The question to be asked is what distinguishes these countries that have not been able to avoid the very deep impact of the string of crises in the past decades, from those that were able to avoid that and even to prosper.

The key issue that we have to look at in order to distinguish emerging markets from really advanced markets is the quality of the institutions that were created during their economic disaster. It is not the quantity of savings, it is not the sophistication of the instruments that are used in this market, but it is the strength of the institutions that created the necessary attraction of capital and increased direct investments. Our conference this morning has touched upon the issue of the "economy of knowledge" and the "ability" of a country in South-Eastern Europe to be able to transform the economy into a "knowledge economy". But the main issue is to get one way or another financing to make knowledge available and make it perform efficiently and on a large scale in the economy. But how do you do that?

You do that by having key institutions that are both solid and strong enough. This is what is lacking in the mot emerging markets – this is the major distinction today, and not the ability to attract capital.

In longer term, the countries that have missed out on building institutions, or are not good at preserving and protecting them, will not be able to grow and would be the ones that will remain in that traditional 'emerging market' category.

Most of the advanced emerging markets today are not different quantitatively from advanced countries. And we see indeed that they have been able to engage in what used to be the privilege of only advanced country: quantitative easing programmes to fight the COVID crisis. As such, making use of the available capital in the market is not the issue today. The issue is the extent to which intermediation is effective and efficient.

If we look at some countries, for example my own country Argentina, the problem is not only the quality and the quantity of the capital. In reality it is the quality and quantity of the institutions. Weak institutions mean, for example, risks from nationalisation of industry, and lack of respect for courts and the judicial system. Formally the institutions are there, but a lack of respect for the institutions creates a tremendous risk in Argentina.

Now, in the same context we can add the issue of the central bank. Central banks of course are very important institution in terms of monetary policy and in terms of macroeconomic policy. What the crisis is showing us is that the issue of central bank's independence is not relevant at all.

I was with the governor of a large central bank recently and I asked him what he thought about the independence of central banks today. He said: "Look, this COVID crisis has shown one very important thing:

the independence of central banks is important, because if they are independent they will do what their government wants them to." In fact this is what we have been seeing.

There were times when the central bank was under direct political pressure even in the United States. The idea was then to separate the political from the economic front in the 1980s, and this has become a "fashionable thing" to do. The independent central bank is considered today some sort of sacrosanct element in the economy. But what we see today under the COVID crisis is that coordination between the central bank and the ministry of finance is more important than independence. The issue today is that the policies are much undefined, and the consequences of the policies are much undefined. As Martin Wolf rightly said today, we cannot not imagine what would happen next. In other words, we don't have a clue in this world of extreme pandemic uncertainty.

What we are saying is that we really don't have a clue about how long this crisis is going to last, and then what would be the way of withdrawing from it, if we will withdraw at all. When you talk about the "normalization" of policies after the crisis, you should know what some normal state is. We don't know any of these things today and may not know for some time. This high level of uncertainty is universal in advanced and emerging markets.

Under such setting, emerging markets cannot really "learn" from advanced countries, which also have no clue. Many economists claim that this is not true in America, as long as people want to hold money as they do now. However, I am certain that this will not last for long and we will see another episode of inflation soon. I have no doubt in my mind that current monetary policy will end up with high inflation. This is our big next threat.


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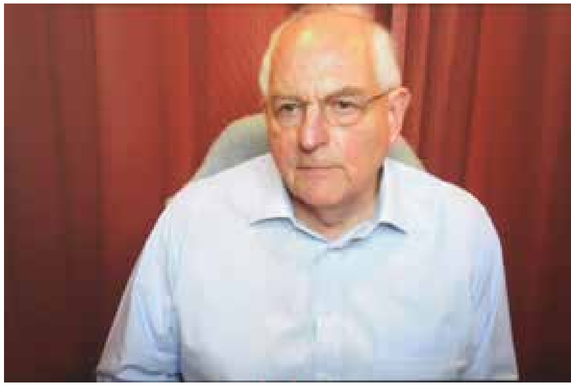










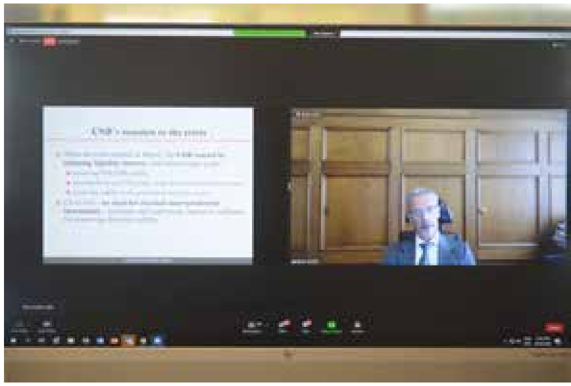

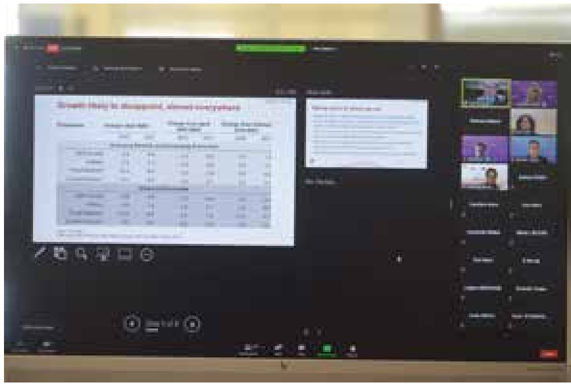

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