

COVID 19 and Recession. Mitigating The Economic Cost.

It is becoming evident that if not the virus, the response to it, will cause recession. Fighting the virus is the responsibility of health authorities, not central banks and treasuries. Treasuries can help financially of course.

Central banks and treasuries should concentrate on mitigating the economic costs of the virus and our containment measures. There are many ways to do this of varying efficacy.

We have already seen the US Fed's response: a 50 basis point rate cut in between FOMC meetings. Investors are asking for more rate cuts. The Fed was right to cut rates, but for a specific reason, and perhaps not the reason hoped for by many asset owners. The Fed needed to mitigate yield curve inversion which clogs the bank credit channel. At least some investors will hope it props up the stock and corporate bond markets. The Bank of England has also cut rates. At this time the ECB has yet to act.

The risk is that governments act to boost the economy from the top down yet again. That would involve rate cuts and bond buying, a campaign that lifts the economy from the richest to the poorest. At a time of high inequality, and when a pandemic threatens a sort of healthcare apartheid, this is not efficient. What is needed is a bottom up policy of supporting the economy. Buying bonds, stocks, ETFs, assets, will not help. We need two things. Universal basic income and loan support for SMEs.

Universal basic income has high impact as the poor consume more of their incremental income. It will not exacerbate the existing income inequality. Wealth inequality is being addressed somewhat as asset markets fall.

SMEs are the marginal employer and driver of economic development and growth. They will require support as credit tightens as it has and will continue to do in this pandemic. The ECB's TLTRO is a good example of how to do this, but collateral standards must be relaxed.

Budget deficits will result. Late last year, central banks implored their treasuries to turn on the fiscal taps. Political realities stood in the way that are now moot. The path is paved for fiscal stimulus. The opportunity presents to have a progressive program to mitigate against the economic cost of the COVID 19 pandemic.