

Chapter 4

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CORONAVIRUS AND THE EVOLVING ROLES OF CENTRAL BANKS: AVOIDING A “CLIMATE MINSKY MOMENT”

Central banks took the dominant financial role in many countries' efforts to deal with the economic fallout from coronavirus, using conventional and so-called 'alternative' monetary policy measures to cope with the effects of social distancing and lockdown. This chapter shows how banks in different countries used instruments such as zero or negative interest rates, differential changes in the regulation of commercial banks, capital guidance to desired end-users, exchange rate management and large-scale purchases of corporate and government bonds, or Quantitative Easing on a massive scale. The gap between what countries could do however is massive – many countries had only a fraction of the capacity needed to respond. Moreover, monetary policy was not often backed up by strong fiscal expenditures to boost demand and support the economy beyond what monetary policy alone can possibly achieve. This should be a concern for future contagions, whether viral or economic, because when one country remains vulnerable then all are vulnerable. Covid-19 has reminded us that national efforts alone can never be enough and multilateral cooperation is essen-

tial. This chapter also shows that coronavirus should not have been such a surprise, because its unfolding has followed astonishingly closely the path of a “climate Minsky moment.” This chain of events was identified by central bankers and development experts several years ago as a threat from global warming and climate change and Covid-19 is unlikely to be the last shock of this nature.

INTRODUCTION

Central banks took the dominant financial role in many countries’ efforts to deal with the coronavirus crisis, especially those that were constrained in their use of fiscal policy. This chapter describes some of the conventional and so-called ‘alternative’ monetary policies they used to cope with the sudden stop to economic life. It situates their actions within the broader debate about what central banks can do, or should do, which has evolved over recent decades and is being reappraised. This will have important resonances, not only for central banking’s role in the immediate Covid-19 relief and recovery efforts, but also for the post-Covid rebuilding that lies ahead – in particular with respect to how central banks respond to the wider issue of global warming and climate change.

The chapter begins with a brief overview of the evolving role of central banks, highlighting aspects that have been illuminated by the Covid-19 emergency. It then describes the main tools used during 2020 by central banks around the world, including zero or negative interest rates, differential changes in bank regulations, guiding capital to desired end-users, managing exchange rates and the use of large-scale asset purchases or Quantitative Easing to finance government and corporate debt. It shows that central banks in some countries had only a fraction of the capacity to respond compared to those in rich countries – with average rescue packages of only 8% of Gross Domestic Product (GDP) compared to 27% on average for the advanced economies. This chapter also argues that

the economic fallout from coronavirus should not have been such a surprise because its unfolding follows astonishingly closely the path of a “climate Minsky moment” identified by central bankers and development experts several years ago, even to the extent that havoc is caused as much by the policies put in place as with the shock itself. The chapter concludes that Covid-19 is not likely to be the last Minsky moment and further debate is needed not so much about *whether* central banks should be supportive of government policy goals but rather *how*.

COVID-19 AND THE EVOLVING ROLE OF CENTRAL BANKS

Historically, especially following the Great Depression and the Second World War, central banks had broad and powerful roles holding the reins of the economy (Tooze 2020a; UNCTAD 2019; Epstein 2015). They acted as guarantors of their national banking systems; the “banker of bankers”, taking whatever steps were needed to ensure financial stability, to finance government expenditures and debts and to backstop governments’ commitments to creating an economy that would support full employment. They were closely linked with government development goals and macroeconomic policies and used a wide range of techniques to support them, creating credit and guiding it to sectors and activities that the market would not have generated on its own. These included financing government debt at low interest rates, reducing the flow of credit to less desired activities and increasing it for those that were deemed important, and generally promoting the allocation of finance to where government priorities lay. They could be particularly powerful because, unlike governments, which must set taxes and determine expenditure according to budgets that are decided by voters or on their behalf by parliamentary or government committees, central banks are participants in the market, as well as being its regulators and leaders (Tooze 2020a). Being ‘in’ rather than ‘above’ the mar-

ket gave the ability to create credit without having to raise taxes or without having to find buyers for their debt, which is a tremendous potential power. Similar roles and mandates were taken up by developing country central banks too as they became independent in the post-colonial world. As had been the case in Europe, the United States and Japan, central banks were agents of economic development, vested with “wide and flexible powers” and using tools that had been tried and tested in the north (Bloomfield 1957).

However, the neoliberal revolution of the 1980s changed this (for most, if not all, countries), and the more active link between central banks and government was broken. Central banks were to be “independent” of central government and not to finance government deficits or specific activities; their mandates (either explicitly or implicitly) were narrowed to focus on price stability alone, with inflation targets to guide their course and measure their performance, and they were supposed to use indirect methods of monetary policy such as short-term interest rates rather than the direct methods of the past (Garriga 2016). All across the world, banks narrowed their mandates and tightened the scope of their responsibilities and tools. Central banks became more similar, whereas before they had differences reflecting historical context or economic size. The majority made the conduct of monetary policy their dominant role, with the specific goal of maintaining price stability as measured by a target for inflation (UNCTAD 2019; BIS 2009; Garriga 2016). In a few cases, central banks kept some additional macroeconomic objectives – such as the United States where the Federal Reserve was mandated by law to maximize employment as well as ensuring price stability. In most with diverse mandates, whether by law or statutory practice, the goal of price stability was primary. There were some exceptions to this, in particular, the rapid industrialisers of East Asia during the middle of last century and more recent examples can be found in both the developed and the developing world – for example, the central bank of China always aimed to consider government industrial policy objectives alongside monetary

ones (see MPAG 2019:2 for a recent reiteration of this principle). Generally, though, central banks trod a narrow path, focusing on setting interest rates and keeping prices stable.

This changed during the Global Financial Crisis (GFC) of 2008-09, when massive blow-outs in the financial markets (starting from the overloaded United States mortgage and junk bond market) spread rapidly throughout the world, impacting on trade, employment, incomes and aggregate demand virtually everywhere. Central banks showed they could adapt and change dramatically when times were tough and political will was forthcoming. Even those with narrow mandates for inflation targeting were able once again to make the link between monetary and financial stability, and the real economy. They created new money on a vast scale (or what seemed like a vast scale in those days), justifying the use of “unconventional measures” such as large-scale asset purchases (otherwise known as Quantitative Easing or QE) to buy government and corporate debt in an effort to boost aggregate demand and promote recovery.

These actions reminded people that the tasks of central banks have never been purely technical nor independent, even for those with narrow mandates restricted to just one goal and one instrument. For one thing, much depends on the underlying models of the economy and how different elements are forecast to respond when parameters change. Altering assumptions or altering parameters can yield entirely different results, and this kind of modelling is always as much an art as it is a technical science. Second, even the smallest monetary policy decision has never been neutral because different groups of people are always affected differently. Importers prefer high value currencies while exporters prefer low ones; borrowers want low interest rates, but savers want high ones. Trading off or balancing these decisions requires political decision-making and consideration of national goals; again something that is not technical.

In the years following the GFC, central banks were asked to re-appraise their role still further as people became more concerned about the challenge of global warming and climate change. The for-

mer Governor General of the Bank of England in 2015, in a speech to the Bank of International Settlements (sometimes called the central bank of central banks) said that climate change was a “tragedy of the horizon” for which central banks needed to prepare themselves (Carney 2015). He reminded his audience that the horizon for monetary policy was typically two years and the horizon for financial stability policy at most 10 years, while the horizon for climate change was very much longer. Once climate change became a defining issue for financial stability, it would already be too late to change it – so the sooner central banks started taking into account its physical, financial and transitional risks, the less costly and destructive it would be.

Carney warned in particular that climate change could cause another Minsky Moment – referring to the inexorable vortex identified by the late Hyman Minsky whereby financial instability and uncertainty created a general economic meltdown. This described what happened in the Great Depression of the 1930s and the GFC of the 2000s, and Carney extended the analysis to warn that climate change would similarly cause melt-downs of first financial markets and then the whole economy. This fell squarely into central banks’ undisputed basic responsibility of maintaining financial stability. As global warming leads to physical impacts such as rising sea levels, rising temperatures, extreme weather events or the loss of existing agricultural and habitable lands, this could be transmitted as a financial shock – for example, through the failures of insurance companies and markets, a fall in the value of pension funds whose investments were affected, and a rise in loan defaults and bank failures. Making matters worse, a powerful second, indirect route to financial instability could be caused by government policies designed to combat the threat of climate change – unless these were organized in a coherent and coordinated way. Even just the informal and spontaneous changes in behaviour on the part of firms and households could create destabilizing impacts if consumers abruptly started to eschew polluting products or equities and pension funds that invest in them (UNCTAD 2020, chapter 6).

A central bankers' Network for Greening the Financial System was established in December 2017 and quickly gained more than 70 member banks and financial authorities. Debate switched from being about *whether* central banks should use their role to support government policies for the shift to a more sustainable path, to *how*. It was argued that, as a minimum, even the narrowest mandate of ensuring financial stability means central banks need to do a lot to reduce the financial and economic risks associated with climate change and global warming. They needed at the least new approaches to macroeconomic modelling to accurately include corporate and financial exposure to climate change risks. Some also insisted that banks and financial institutions should disclose these risks.

But many observers went further, arguing central banks should take a considerably broader responsibility, harking back to their pre-1980s role. They could create and guide capital in ways that would no longer favour the largest corporations and enterprises (which were often polluting) and rather promote green and more sustainable ones, issuing green bonds and green finance (Camigliolo et al. 2018; Tooze 2019; UNCTAD 2019). Some central banks were already doing this, issuing green bonds, doing 'green' quantitative easing and differentiating the reserve requirement ratios for commercial banks in the system according to how much of their lending was directed to green activities. Bolder moves were also possible, such as central banks adjusting the list of corporate assets they define as 'eligible' for purchase as part of their standard portfolio management to include more corporations that are green, and further requiring that the list of assets that financial institutions are allowed to pledge as collateral when they borrow from the central bank should also include more 'green' enterprises. Some central banks already require commercial banks to incorporate environmental risk into their governance framework and adopt green lending targets. Across geographical and political jurisdictions, central banks from countries of all levels of income were trying these policy experiments, including the Central Bank of Lebanon, the Banque

de France, and the People's Bank of China (Dikau and Volz 2020).

Such a potential willingness to consider green finance arguments suggests there was already more policy space for central banks to use so-called alternative and other tools than many imagined – even before the coronavirus crisis in 2020 reinforced this message. Nobody thought the private sector would provide the support that was needed – this was the role of public banks and in particular should be led by the central banks. With the sudden stop in economic activity in March/April 2020, urgent meetings were held between ministries and bankers everywhere, turning over long-held assumptions and restrictions. Central banks took on new and experimental roles, with the implicit and explicit backing of their governments. In some cases, this required changes in the law.

One case has particular symbolic value, because it had been the first central bank in the world to narrow its role to just targeting inflation. Since 2019, it had already changed its mandate to include the goal of supporting maximum sustainable employment as well as price stability. Following Covid-19, it seemed the ground was shifting in other ways as well. On March 21, 2020, the Reserve Bank of New Zealand signed a Memorandum of Understanding with the Minister of Finance granting an indemnity to insulate the bank from financial risks associated with the use of “alternative monetary policies” including large-scale asset purchases. Moreover, an accompanying letter from the Minister reiterated that government was neither specifying nor limiting which tools the bank could use – operational independence meant the bank could use whatever tools it chooses.

This is a long way from the monetary straitjacket envisaged in the 1980s. It shows an evolving role for central banks that was starting to be thought about in the climate change context and has now been made possible by the Covid-19 crisis. In fact, Covid-19 can be seen as a classic example of the kind of Minsky Moment described above. Both the direct and indirect Minsky transmission routes have come to play – through the coronavirus and its attendant health impacts, and through the consequence of govern-

ments' policies of social distancing and lockdown to contain it. The link with a Minsky Moment was explicit, and Covid-19 was seen to bring the "tragedy of the horizon" into sharper focus (Horton 2020; Reguly 2020). As the pages below show, and as is summarized in Table 4.2, central banks everywhere pulled out whatever monetary policy stops they had to deal with it.

CENTRAL BANKS LAUNCH THE CORONAVIRUS LIFE-RAFT

One of the first warnings that this health crisis was different from previous ones – such as SARS, Ebola and H1N1 – was that crude oil prices fell precipitously as lockdown killed the demand for travel, transport and production of goods and services generally. The bellwether indicator, Brent crude oil, fell from US\$70 per barrel on January 5 to US\$30 by early March, even before lockdown had started for many countries in the West but some months after it had begun in Asia. It dropped as low as US\$24 in mid-April, even going negative in some markets, before recovering somewhat by mid-year but nonetheless still at its lowest for 20 years (Trading Economics 2020). The shock-waves swept financial markets, contributing to nervousness already growing about lockdown and the spread of the pandemic. Exchange rates whipped up and down, equity markets followed suit, and as much as US\$84 billion fled out of developing countries in just a few months, seeking a haven in seemingly safer countries and currencies, and in so doing, further exacerbating the downward spiral. Automatic trading and synchronized, index-driven portfolio investment strategies piled in on the sell side and the swift downgrading of developing country debt by the major credit rating agencies exacerbated the size and spread of the shock. According to the Bank of International Settlements as much as US\$20 billion fled out of developing economies on just a single day in mid-March (BIS 2020). Outflows were three times larger than those recorded for a similar time period during the GFC.

This shock to the financial markets played havoc with domestic prices as well as international ones – which is the narrowest definition of the area of responsibility for central banks in the neoliberal model. They leapt quickly into action with the usual tools, trying to keep the financial markets liquid to avoid a credit crunch and debt deflation. However, the bleeding was worse than this, as the policies of social distancing and lockdown hit the whole of the economy and not only the financial sector. Consumer demand and supply dried up simultaneously even in countries that did not go into lockdown. This meant that even those central banks with mandates restricted to inflation targeting once again linked monetary and financial stability with stability in the real economy. They tried to restore confidence, boost demand and spending power as well as helping governments pay for the medical supplies and keeping hospitals, firms and households afloat. Central banks tried many different monetary tools, which can be broadly categorized in the following four groups:

Reducing interest rates: For modern, inflation-targeting central banks the main (often the only) tool is the short-term interest rate and in the early days of the coronavirus crisis this was the first lever many tried. Cutting interest rates is quick to do, and has the effect of lowering the cost of money across the board, which helps soften the blow to firms and households reeling from the burden of debt repayments and also to keep up aggregate demand. Most did this very quickly, cutting rates as soon as coronavirus-related policies began (with the exception of countries where interest rates were already at zero or close to it). As shown in Table 4.1, in some countries these rate cuts were not only rapid, they were very large indeed. For South Africa, the prime rate was reduced to a 55-year low; Indian bank rates fell from 5.15% in February to 4.4% in March and down to 4% by May; similarly for other countries such as Indonesia and others. China stands out because it cut rates by only a small amount, but its large public banking sector took other actions to confront the crisis. Taken together, this has significantly reduced interest rates globally and framed a new baseline for monetary policy everywhere (Lilley and Rogoff 2020).

Table 4.1: *Interest rate declines in the early stages of Covid-19*

Country-region	Official rate April 2020 (%)	Last quarter point change
Global average	1.22	-134
Developed countries	-0.02	-132
Developing countries	3.16	-146
Latin America	3.60	-277
Developing Asia	2.87	-70

Note: Central bank official rates variously provided as Fed Funds rate, repo rate, discount rate, Selic ON rate, depending on country. See also BIS compilation of Covid responses at <https://www.bis.org/ifc/covid19.htm>.

How low can interest rates go? Negative interest rates might have been unimaginable once but now they are already a stick being used by some central banks to try to get commercial banks to lend rather than hoard capital. The European Central Bank (ECB), Switzerland and Japan had negative interest rate policies (usually linked to some minimum threshold of deposit), even before the coronavirus crisis, which suggests there is not so much a shortage of capital available in the world, but rather a lack of incentive to deploy it. Supporting this argument, the International Monetary Fund (IMF) estimates that at least US\$16 trillion is held in negative-interest accounts in Europe. In Denmark, when the central bank imposed negative interest rates, the commercial banks passed it on through offering negative interest rates mortgages – meaning the sum households owed fell each month by more than the sum they had repaid. This is more than free money – home buyers are paid to take on debt. Some criticized this as a risky strategy that harms profits for the banks, others complain it is bad for savers and pension funds – meaning a double hit for the elderly. (It is also a threat for today’s workers if their future retirement incomes are not well invested but put at risk).

These concerns aside, negative interest rates are on the radar screen for central bankers elsewhere too, as low interest rates are failing to boost borrowing and lending. As early as March 2020, the central bank in New Zealand put negative interest rates as a possibility on the table for the first time. By October, as a second wave of Covid was coursing through Europe, the Bank of England told its commercial banks to check their “operational readiness” for what in the UK would also be a ground-breaking move. It had cut rates to 0.1% at the start of the crisis and the message was couched as a technical IT issue; also, such a move would require a majority vote on the monetary policy committee. Nonetheless, markets view it as sign that “desperate measures” to nudge banks to lend more are being contemplated (Elliott 2020). For emerging markets and developing countries, where interest rates are still over zero, this has never been on the cards. The Central Bank of Brazil already noted in mid-2020, when its interest rate was closer to 4%, that for them to be at 2% was like being at zero for other countries. Commentators perceived this to be a warning the bank would not cut rates further nor could it try other monetary measures being used elsewhere when interest rates were no longer working to stimulate the economy.

Increasing lending: When interest rates are at close to zero (or what stands for zero in countries where higher rates are the norm) and when even the stick of negative interest rates are not inducing more lending on the part of banks (or demand to borrow from households and business), central banks tried more direct monetary measures. Most central banks did this through a myriad of schemes using their role as regulators to ‘re-regulate’. They reduced the reserve and capital requirements of other banks and financial institutions to reduce the risk of a credit crunch coming at a time of increased risk of loan defaults, or capital losses in the financial markets. The central bank of China freed up US\$265 billion this way by cutting the reserve ratio three times in just a few months and it further encouraged new lending by increased guarantees for loans (as high as 80% of the loans, compared to more like 60% in other countries) (MPAG 2020).

Other policies central banks used included increasing repurchase agreements and lengthening the maturities of their loans to other banks in the financial sector; sometimes relaxing the provisions for non-performing loans. They tried to make it easier for long-term lending to households and the non-financial sectors, by changing the regulations governing commercial banks loan-to-value (LVR) restrictions that determined the level and number of household mortgages banks could offer. The central banks in some countries imposed a rule that commercial banks should offer debt standstills for firms and households most affected by the Covid shock; some imposed a freeze on loan repayments (Bank of Bangladesh did this as early as January 2020). Others refused to allow banks to pay out dividends and encouraged mortgage holidays to beleaguered households.

Some banks also used credit guiding policies to increase lending to regions in need or where economic activities were deemed particularly necessary, using monetary policy to do what in other times governments could do through expenditure and fiscal policies. Often this was focused on health but also towards micro-, small- and medium-sized enterprises (MSMEs), or sectors in trouble such as tourism and the hospitality trade. As early as January 2020, the People's Bank of China (PBOC) instructed its state-owned commercial banks to lend up to 30% of loans to small- and medium-sized enterprises (SMEs) and a month later it reduced the interest rates for banks that on-lent to agriculture, farming and SMEs (MPAG *ibid*). In March, the central bank of Argentina offered particularly favourable conditions to the commercial banks in its system that lent to SMEs, as well as the 'stick' of reducing its holdings in those that did not; the central Bank of Egypt offered special loans to the tourism sector, manufacturing and agriculture, supported by government guarantees. In Nigeria, the central bank injected additional liquidity into the banking system worth as much as 2.4% of GDP, to support loans to the health, manufacturing and other impacted sectors.

Quantitative easing: Most interesting are central banks' use of large-scale asset purchases – an instrument that is more difficult than the lending schemes or interest rate changes described above because they cannot be reabsorbed quickly once the economy starts to recover. When central banks buy assets on a large scale – usually government bonds but in some cases corporate bonds from the private sector as well – it is harder to unwind and the massive purchasing sits as an asset on the central banks' balance sheets for a long time. It also reaffirms the view that the independence of central banks is a chimera.

For the five largest advanced economies, asset purchases were worth some 35-45% of GDP by the middle of the year (the United States, Eurozone, United Kingdom, Canada and Japan), dismaying critics who had been hoping central banks would get back to their pre-GFC slim lines. To get a sense of how big this is, consider that during the GFC the Fed's balance sheet in 2009 had risen by less than 10%. Some predict that ECB asset purchases will be up by 60% by the end of 2021 (Cavallino and De Fiore 2020). The Bank of England bought £226 billion of gilts issued by the government by September, meaning it had indirectly created and lent most of the finance needed for the government's new Covid-related expenditures (Office of Budget Responsibility 2020). It now owns just under half the total government bonds issued, double the level of the Fed Reserve in the United States and leading to debate about what it can pull out of the hat next, given that QE is not having the expansionary results its proponents expected (Stubington 2020). These figures would have been unimaginable just a year ago when austerity was still being recommended as the only solution to a stagnating post GFC economy.

Central banks in emerging economies also purchased bonds, including Colombia, India, Indonesia and South Africa. While the central banks in the north mostly aimed to avert a credit crunch, in the south their task was more about boosting confidence, acting as 'buyer of last resort' to plug the holes left as foreign owners of local cur-

rency sovereign bonds fled for seemingly safer shores. After years of extreme conservatism, they gave narrow and clearly defined explanations that focused on restoring market confidence as opposed to monetary stimulus or monetary financing of fiscal deficits (although one could argue this would be perfectly justifiable given the low cost of capital, urgent context and development benefits). South Africa purchased 30% of its government's gross issuances of bonds in April, citing the need to "ease dislocation" in the market, rather than calling it QE (SARB 2020 a,b). For many, this was the first time they had ever carried out such alternative measures and in some it required an explicit change in the law (e.g. Brazil, Czech Republic). Most used their foreign exchange reserves to pay for the bonds (as opposed to the central banks in reserve currency countries, which can buy bonds simply by injecting electronic money into the system). Few said exactly how big their buying programmes were, although those that did were small compared to the advanced economies (0.1% of GDP in the case of Korea, 2.8% in the case of Chile).

Exchange rate management: As predicted in the "Climate Minsky Meltdown" scenario of financial market instability described above and in Table 4.2, currency markets lurched in the rush to safety. Just as during the GFC, the hardest hit currencies were the hot and carry trade Brazilian Real, South African rand, Russian ruble and Turkish lira, with the exodus of sellers compounded by the interest rate falls, which were more pronounced in developing economies compared to the main reserve currency countries. However, advanced economy currencies were highly volatile too – the US dollar at first appreciated against the other major currencies Euro, Yen and Pound Sterling but as happened in the last crisis, this also rebounded and then depreciated again.

Central banks responded by trying to smooth the waters through buying and selling currencies in the spot and derivatives markets, especially in developing economies where their currencies were pummeled in the rush to buy reserve currencies. Their purchases were paid for by international reserve holdings or by

multilateral emergency credit lines offered through some of the regional liquidity funds (e.g. the Latin American Reserve Fund – FLAR and the European Stability Mechanism – ESM), and in a few cases through special swap agreements with central banks from the advanced economies. These actions can happen quickly. In the month of March 2020 alone, the US Federal Reserve (or ‘Fed’) offered swap lines worth US\$30 billion to US\$60 billion to 14 countries to ensure they had access to US dollar liquidity. This enabled central banks to use their holdings of US dollars, which were currently on their balance sheets as foreign reserves, as collateral for borrowing – anything rather than sell them. Others worked bilaterally. For example, the Bank of Japan offered a swap to Thailand of JPY 800 billion. These swap arrangements between central banks were incredibly important, not least to help countries avoid falling into a balance of payments crisis simply because of a shortage of foreign exchange (which happens quickly for countries dependent on commodities exports, tourism or remittances, all of which were hit by lockdown). Having access to the US dollar in particular is essential because 80% of total debt in the world is denominated in US dollars (UNCTAD 2020). On the other hand, of the 14 countries with whom the Fed negotiated credit swaps, only a few were developing countries (Brazil, China, Korea and Mexico) – some of these with very high needs even at the best of times. Once again, the exchange rate crisis revived debate about ending the hegemony of the US dollar and replacing it with other alternatives such as a bundle of currencies (Tooze 2020a).

Summing up, and as shown in Table 4.2, central banks pulled out an unusually wide range of monetary instruments and tools and used them to a very large scale in their efforts to bolster firms, households and even governments from the effects of lockdown. Some of these measures were squarely within their conventional role of ensuring price stability; others reflect the new understanding that is emerging about the central banks can play with respect to climate change, of which Covid-19 may be just one, very painful, example.

Table 4-2: Covid-19 economic impact as potential “climate Minsky Moment” and Central Bank responses

Physical shock and policy risk drivers	Economic shock	Financial system shock
<ul style="list-style-type: none"> • Coronavirus victims ill or dying • Essential workers exposed to health risks • Social distance and lockdown for everyone else... • Closed airports, factories and shops • Work from home or no work • “Nowhere to spend it” 	<ul style="list-style-type: none"> • Rapid shock to demand and supply • Collapse in trade • Unsold goods and services, drying up of new orders • Workers are laid off, self-employed are unpaid • Loan defaults, businesses go bust • Increased poverty • Reliance on government income support • Government revenues fall; budget deficits rise • Some pockets of new business and new jobs emerge to serve new demands – internet and digital economy providers rises, health technology etc., production of health products etc • Asset bubbles for those with capital • Inequality rises 	<ul style="list-style-type: none"> • Immediate and unexpected shortage of cash-flow • Fall in remittances • Liquidity shortage • Credit providers tighten conditions further • Equity markets collapse in the rush to cash • Failures of insurance markets and companies • Loan defaults – businesses and banks go bust • Fall in value of pension funds • Debt deflation (debt is greater than asset value) • Capital outflows to “safe” havens • Rapid collapse in exchange rates for many countries • Fall in investment including FDI • Search for yield – rising risks • Asset bubbles as interest rates fall
Central bank responses	<ul style="list-style-type: none"> • Lower interest rates, negative interest rates to boost lending • Regulatory changes to encourage increased lending by commercial banks • Large-scale purchases of government bonds to finance government expenditure • Large-scale purchases of corporate assets to finance corporate debt • Some guidance of credit to selected activities to encourage special sectors/regions • Intervention in exchange rates to support the currency • Credit swaps, support to foreign exchange liquidity reserve funds to support the currency and resolve balance of payments shocks 	

Source: Expands on UNCTAD TDR2019 (chapter 6).

COVID-19 PACKAGES AND THE ROLE OF MONETARY POLICY – GLOBAL DISTINCTIONS

At the outset of the Covid-19 crisis, many governments pledged to “do whatever it takes” and there was talk of Covid as a “levelling” crisis in the sense that all people and all countries, rich or poor, could be equally impacted. In reality, income made a huge difference, and this was evident not only at the level of household accommodation (who had a comfortable home and who did not) and jobs (who could work from home and who was either unpaid or in paid essential and dangerous work) but at the level of countries and central banks as well. Whether central banks had broad mandates or narrow ones, the disparity is clear when countries of different income levels are compared (see Figure 4.1). Some wealthier countries could put in place massive fiscal and financial packages worth 40-50% of GDP while poor economies had to cut their cloth in single figures. Brazil, a large economy reeling under the economic as well as health impact of coronavirus, was spending only 3% of GDP on its response packages by the middle of 2020 (UNCTAD 2020). Many other developing countries had much less space.

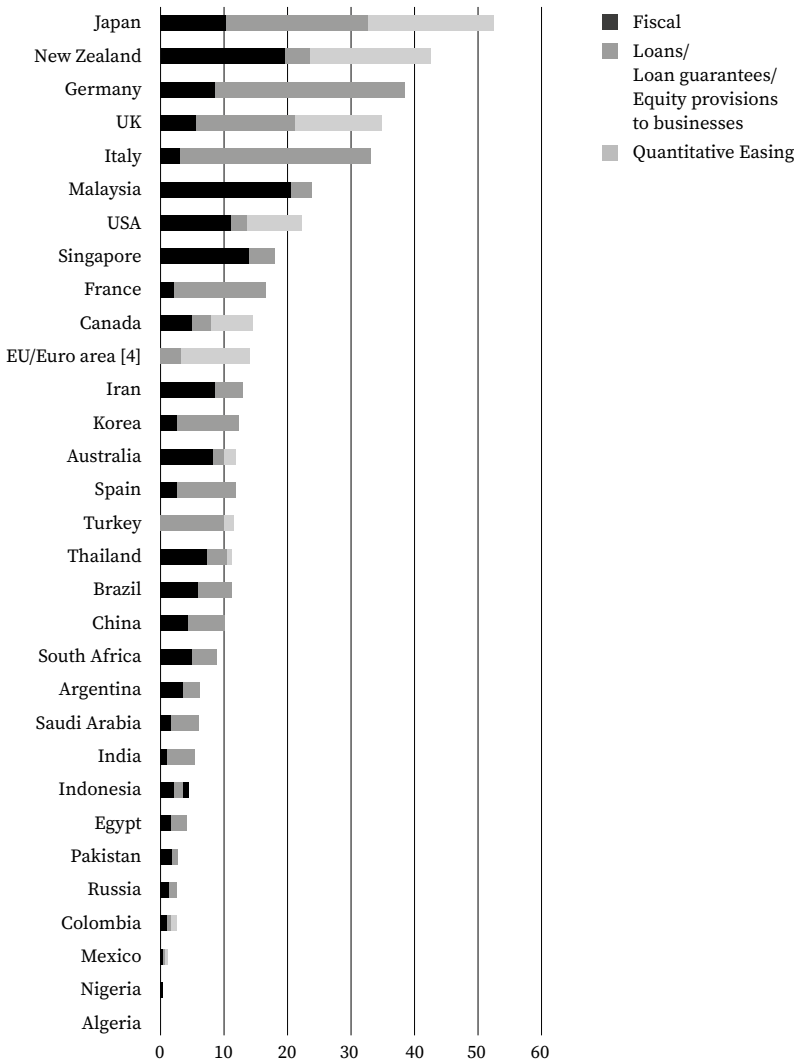
The composition of packages also varies according to national economic size, wealth and fiscal space. QE is a rich country’s tool, and central banks in developing countries are hampered by the fact theirs is not a reserve currency. Japan, which launched a stimulus and relief package worth over 50% of GDP, devoted roughly half of this to the instrument of QE, whereas Malaysia, which also had a significant package worth around 24% of GDP, could not use QE at all. Thailand – also with a sizeable rescue package, especially when compared to other developing countries – experimented with a very small amount of QE but mostly relied on loans to business and loan guarantees, supported by fiscal policy. In South Africa, the Reserve Bank argued it did not have the policy space to purchase government or corporate bonds like those in the United States or Europe could

do; moreover they were charged higher rates for borrowing on international financial markets. Their recourse was rather to the Bretton Woods institutions such as the IMF or World Bank – a choice some other developing countries tried to steer away from because of the conditionalities involved. The differences with regard to what central banks could do for Covid finance in their countries resonated with other long-standing inequities in the world; as noted by the Finance Minister of Ghana on June 3, 2020, at a virtual conference organized by the Harvard University Center for African Studies, “Suddenly the western world can print US\$8 trillion to support their economies in these extraordinary times, while Africans are judged by the old rules... You really feel like shouting ‘I can’t breathe’” (Ofori-atta 2020).

The lack of policy space for central banks in developing countries to provide emergency loans and loan guarantees and other monetary policies is also particularly important because, compared to advanced countries, their governments also had significantly less fiscal space as well. This matters greatly because while central banks and monetary policy can do a lot to create credit and even to guide it, there also needs to be demand for that credit and it is here that fiscal policy plays the essential other side of the coin to what central banks can do, because it gives governments the capacity to boost public expenditure in ways that can support demand. As central bank mandates became more narrow this further broke the link between monetary and fiscal policy and lead to silos of dis-connected policymaking.

Helping to fill this gap in some developing countries where national resources are lacking has been the emergence of strong new Southern-led regional public banks and funds (Barrowclough et al. 2020) and northern development bank aid programmes such as that by the German development bank KfW (see Marois chapter also in this volume), which offer technical assistance as well as finance. However, what is also needed is a concerted effort to restock the fiscal coffers of developing countries – for example, through combatting illicit capital flows. Financial regulation, including managing capital flows, as well as stronger taxation laws, could help in this respect.

Figure 4.1: *Country policy packages in response to Covid-19 (% of GDP)*



Source: UNCTAD 2020.

Note: Fiscal, loan and Quantitative Easing estimates are based on government and central bank announcements in reaction to Covid-19.

CONCLUSION

Coronavirus has ended the illusion that central banks could or should simply enact monetary policy technically, somehow separate from and independent of politics. Central banks everywhere acted to support national political goals, either explicitly or implicitly, and thus 2020 is marked by a willingness and indeed necessity to leave the narrow model of the last few decades behind. The wide range of responses in different countries means central banks are becoming more diverse and complex again, with differing mandates and expectations and using a broader range of instruments. Many central banks have supported their government's fiscal policy, in particular financing government expenditure for healthcare or economic recovery packages through their purchase of government bonds (often on an extremely large scale). They are also not afraid to send strong messages to the commercial banks in their financial systems.

On the other hand, while the urgency of coronavirus has undoubtedly helped to spearhead this move – whether seen as less independence from government, or more independence to take the initiative and act as they choose – a less encouraging reason could be that it is also perhaps a recognition that deflation is now the real problem and not inflation (Tooze 2020b). In part this is because organized labour has been crushed so much it no longer has much bargaining power or ability to impact wages – which leads to the question of the distributive impact of central banks' Covid efforts (see for example Brenner 2020). Their efforts to ensure liquidity are also a way of supporting the financial sector, which does not translate directly into supporting labour or the rest of the economy. Whether households benefit or not is one of the most important yardsticks as to the distributive impacts and it is a worry that already some of the private banks that have been supported by central banks are failing to extend new loans or mortgages, apparently because they are 'overwhelmed' by the demand from

customers (or concerned about weakening shareholder returns). Asset bubbles benefit those who already own assets and the evidence is strong that rich people are getting even richer during the pandemic, while workers, savers and those without capital are getting poorer (Economist 2020).

There is also already starting to be a revival of the austerity mantra, with concerns about rising public debt and how it is to be repaid. Public debt is the inevitable consequence of taking on the debt from the private sector and needs to be seen as an investment in the future not a burdensome cost. This could be very dangerous if it leads to a premature tightening of fiscal policy again, especially as private banks and private finance have not leapt into the Covid recovery. Rather than debating whether central banks should have become so engaged, it would be more useful to critically examine the effects of their different instruments, so as to better evaluate what is most effective. For example, when central banks create and then lend money to governments for spending, can this be seen as a form of the “People’s quantitative easing” that was called for from across the political spectrum after the GFC (see Positive Money 2020). Is this a more democratic measure and is it better for reviving a stagnating economy than QE directed through the purchase of corporate bonds, which can lead to asset bubbles or, as happened last time, a flood of hot money into developing countries without producing investment or lasting benefit? Here decision-making needs to be transparent and the impact of decisions empirically evaluated, for example through the Bank of International Settlements or the UN system. Research is also needed to better understand what would have happened without these initiatives. If governments fail to use fiscal policy and expenditures to support the coronavirus relief efforts, central banks will likely keep on reaching for desperate measures to stimulate the economy – however, will these create the broad-based and expansionary effects needed, and what will be their impact on inequality? These are empirical questions as much as theoretical or ideological and need research.

It is also important that these questions should be answered, not only to ensure the success of today's Covid efforts, but also for the future post-Covid phase. Then, the attention of policy-makers and banks will turn to re-building. Building back better requires nothing less than structural transformation to a financial and economic system that is more sustainable and democratic and central banks have an extremely important role to play. Can Quantitative Easing for the People be a feasible tool as compared to QE directed via banks is an empirical question that could be further researched, to take just one example. More generally, for the financial system as a whole, as well as for central banks' place directing it, Covid-19 can be seen as a warning of what lies ahead if we do not find a more harmonious way of engaging with the environment. It has also made it impossible for us to ignore the inequalities at the heart of the current system, and the fact no country can act alone, especially when it comes to contagion whether economic or viral. The gap in 'response space' between the world's richest and poorest countries is massive, and this is not only inequitable it could hold the seeds of future crises as well. Both these inter-related issues are already on the radar screen of central banks and ideally they would also be in their mandate.

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