



COVID-19 Infection Curve Flattens, Now Getting into the Monetary Policy Changes

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ABSTRACT

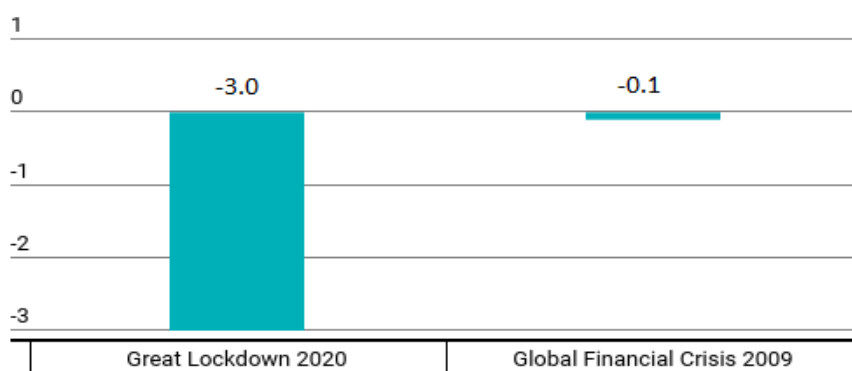
COVID-19 created a situation in which each nation was under pressure to implement strategies in order to stop the spreading of virus and to save human beings life. In the other hand economic activities, financial markets and private sector were collapsing. The lockdown has stopped almost every economic activity, but the nations could not think about healthy economies without healthy people. The end of April and the beginning of May brought the flat curve of COVID-19 infections and the eyes immediately turned up into the monetary policy changes. This study will analyze and will present the monetary policy changes taken from USA and European Union to recover economy from the COVID-19. A focus will be given also to the proposal economic assistance from EU to Western Balkans Countries to combat COVID-19. The study concludes that deflation must be avoided during COVID-19 economic crisis.

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1. Introduction

2020 would be one of the most challenging years of the history. The way this year started has faced the world with a new situation, an unknown one. No one would think that the end of first quarter of 2020 and the beginning of the second one would find the world in the total lockdown due to pandemic COVID-19. While each nation was implementing strategies in order to stop the spreading of virus and to save human beings life, in the other hand economic activities, financial markets and private sector were collapsing. The lockdown has stopped almost every economic activity. Hassan (2020), pointed out that COVID-19 will bankrupt more people than it kills, but in the other hand most of the national leaders have argued that they cannot think about healthy economies without healthy people. As was mentioned above the lockdown has stopped almost each economic activity which will cause the worst recession since the Great Depression and far worse one than the Global Financial Crisis of 2008 (Gopinath, 2020).

(real GDP growth, year-on-year percent change)



Source: IMF, *World Economic Outlook*.

Figure 1. Projection of Global Growth for 2020 and comparison with the Global Growth for 2009

Source: Gopinath, (2020)

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Furthermore, Gopinath (2020), mentioned that if the pandemic will go away in the second half of 2020, the recovery in 2021 would be incomplete. The author projected that the cumulative loss to global GDP for 2020 and 2021 from the COVID - 19 would be approximately 9 trillion USD Dollars.

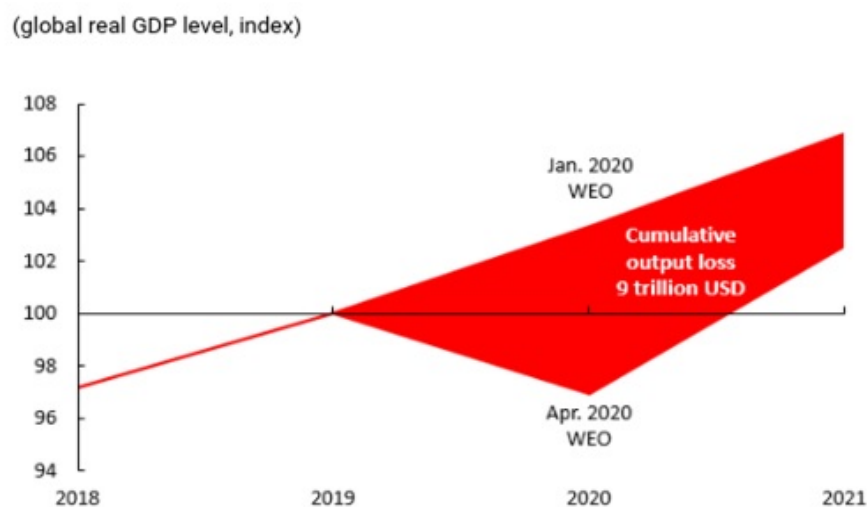


Figure 2. The cumulative output losses over 2020 and 2021

Source: Gopinath, (2020)

This loss is considered greater than the economies of Germany and Japan, combined together (Gopinath, 2020). One is for sure, the COVID-19 will change the nation's long-term economic trends and will lead to a new era of economic activities.

While the end of April and the beginning of May brought the flat curve of COVID-19 infections, the eyes immediately turned up into the emergency economic packages and monetary and fiscal policy changes. Nations need to recover economy after the great losses from the pandemic and the concern is that pandemic is not still over and can be returned greater in any time. Nations and International Organizations have proposed emergency packages in order to fight COVID-19 recession. These steps require urgent changes in monetary and fiscal policies which will lead to a new momentum in the global economy.

Having in mind these urgent steps that need to be taken from the nations, this study will analyze and will present the monetary policy changes taken to recover economy from the COVID-19. The study will focus in the United States of America and European Union. A focus will be given also to the proposal economic assistance from EU to Western Balkans Countries. This study is organized as follows. The next part will bring the existing literature in the changes in monetary policies. In this part are also showed some data about the impact of COVID - 19 to monetary policies. The third part will present the monetary policies used to overcome COVID-19 in USA and EU. The fourth part will have in focus the assistance offered from EU to Western Balkans countries and the fifth part will draw conclusions.

2. Literature review

The impact of COVID-19 in the life of human beings is a very actual topic for study. Besides the impact in human health there is a huge interest to study the effect of the pandemic in global economy. Since the first lockdown measures were taken, there were concerns about the impact of these measures in the global economy. Nations and International Organizations have proposed emergency packages, but there is an urgent need to consider changes in monetary policies. Despite the fact that the COVID-19, is a whole new situation in the world, the changes in monetary policies due to different crisis are not something new. In the literature are found numerous studies and theories about changes in monetary policies. Alcidi & Gros (2011), have brought a paper that has analyzed changes in the monetary policy in USA during the Great Depression. They have also compared monetary policy changes taken during the Great Depression with monetary policy changes taken during the Global Financial Crisis of 2008.

When the monetary policies changes are studied there is not a big debate on it, the conclusions are clear: deflation must be avoided (Alcidi & Gros, 2011). The biggest contributors in the theory of monetary policy changes are Friedman & Schwartz (1963). Alcidi & Gros (2011), mentioned the fact that the work of Friedman & Schwartz (1963) is considered a very important and a very significant one for the academics and policy makers. Friedman & Schwartz (1963), have studied in details monetary policies in USA with a focus in

the period of Great Depression. According to Alcidi & Gros (2011), the work of Friedman & Schwartz (1963), has identified four monetary policy mistakes during the Great Depression:

1. "The tightening between 1928 and 1929 to fight speculation led to the stock market crash;
2. In 1931 the Fed's decision to ignore troubles of the banking system and in order to stabilize the dollar under attack after the collapse of the pound and save the gold standard sharply raised the interest rate;
3. In the spring of 1932, the Fed under the pressure of the Congress decided to ease monetary policy, but in July of the same year the policy was reversed following the argument that the excesses of the pre-1929 period needed to be purged;
4. Banking sector liquidity problems were not addressed and the liquidationist theory according to which wedding out weak banks was a necessary step prevailed" (Alcidi & Gros, 2011 p. 677).

These mistakes lead to the above-mentioned idea that deflation must be avoided. The table below shows the rate of inflation during the years of the Great Depression.

The table below shows that from the first quarter of 1930 until first quarter of 1933 in USA existed a huge deflation rate. In fact, deflation during the Great Depression started to reduce only in the second quarter of 1933 when President Roosevelt devaluated the dollar and suspended gold standard (Richardson et al, 2013). Finally, the end of 1933, brought a positive rate of inflation, in the rate from 0.76%. This trend continued and in the end of 1935 was achieved an optimal inflation rate. It took approximately four years to understand the wrong direction of monetary policy and to take steps to reconsider it.

Table 1. Inflation and Deflation during the Great Depression

Year	Q1	Q2	Q3	Q4
1930	-0.59%	-1.75%	-4.05%	-6.40%
1931	-7.69%	-10.12%	-9.64%	-9.32%
1932	-10.26%	-9.93%	-10.67%	-10.27%
1933	-10.00%	-6.62%	-1.49%	0.76%
1934	5.56%	5.51%	3.03%	1.52%
1935	3.01%	2.24%	0.74%	2.99%

Source: (Inflation Data, 2015)

Similar thoughts with the Friedman & Schwartz (1963), are found also in the books of Bernanke (2000), Bernanke (2012), Lin (2012), and also in the studies of Bernanke (2004), Blinder et al (2008), and Blanchard et al (2010). These authors pointed out that the main goal of monetary policy is to maintain price stability. In all above-mentioned studies is pointed out that mistakes identified from Friedman & Schwartz (1963), during the Great Depression should be avoided in the any case of economic crisis. Alcidi & Gros (2011), argued that the aims of monetary policy are not just to fight deflation, but also to exit outstanding policy measures without hampering the weak upturn.

It seems that lessons from the Great Depression were learnt, because during the Global Financial Crisis of 2008 there was not a significant rate of deflation. According to Investopedia (2020), the deflation during the Global Financial Crisis of 2008 was less critical than was forecasted. Alcidi & Gros (2011), argued that USA & EU immediately after the collapse of Lehman, lowered policy rates and made interventions in different segments of financial markets in order to avoid deflation. The interventions made lead to a low scale of deflation.

The figure 3 shows that the lowest peak of inflation during the Global Finance Crisis in USA was approximately -0.5%. In comparison with the Great Depression where the lowest peak was -10.74% it is obviously clear that the situation was managed very well. The better situation was in EU, because there was not recorded deflation, but just was a fell in inflation. The lowest point recorded was approximately 1%.

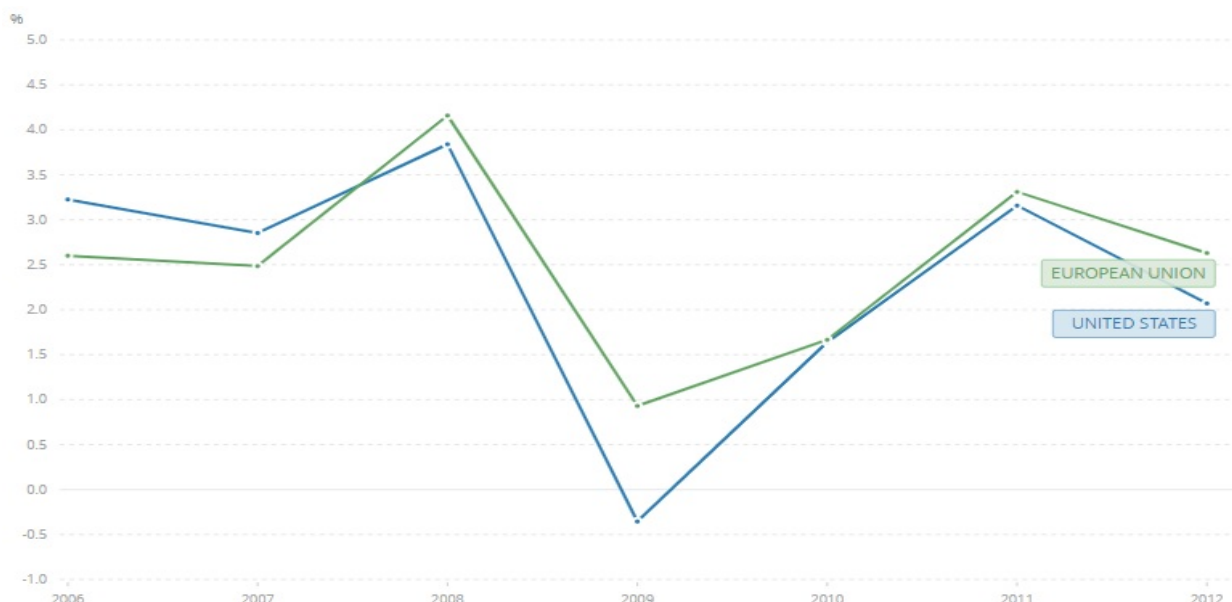


Figure 3. Inflation, USA & EU (2006-2012)

Source: World Bank, (2020)

Bouis et al (2013), brought a study that analyzed the effectiveness of monetary policy incentive in the OECD countries during Global Financial Crisis of 2008. In this study is mentioned that monetary policy measures taken in OECD countries avoided deflation and helped to stabilize financial markets. OECD countries cut interest rates nearly to zero and expanded central banks' balance sheets. It seems that during the Global Financial Crisis of 2008 were taken strong monetary incentives, but according to Bouis et al (2013), these measures did not lead to a strong growth, but it was important that deflation was avoided.

Now the questions are: what about the situation caused by COVID – 19? Will be deflation avoided again, successfully?

In fact, is too early to know the answers for these questions, but what is already known is that COVID-19 is not like the other crisis. There is not a consensus on what steps should be taken in order to avoid major economic consequences. Barmes (2020), make a statement that COVID-19 is a strong deflationary threat. He argued this statement due the fact that inflation in UK in March 2020, fall by 0.2%.

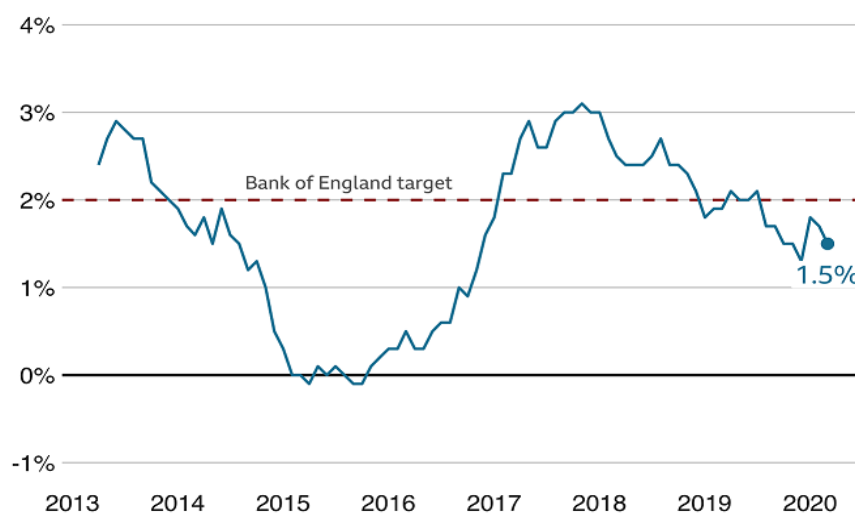


Figure 4. Inflation in UK

Source: (BBC, 2020)

The figure 3 shows that in March, 2020 with no lockdown measures in UK inflation fell to 1.5%, while the target of Central Bank is to maintain it in 2%. In the other hand, USA in April has experienced the largest drop in prices since the December 2008 (Tappe, 2020). The projections show that inflation in UK will drop to 0% until the end of 2020 (Ping Chan, 2020), in EU the drop will be in 0.6% (European Commission, 2020) and in USA the drop will be in 0.62%. These projections for the year 2020 are calculated with an assumption that

lockdown will ease in June 2020, but there is a lot of uncertainty due to the fact that world is facing a pandemic situation and no one would predict for real when this situation will have an end.

This part of the study, brought a brief of existing literature about the changes in the monetary policies due to different economic crisis. COVID-19, besides the fact that has caused a healthy emergency, it will probably cause the worst economic crisis since the Great Depression and nations need to adapt best experiences from the past in order to pass this pandemic without big economic consequences. In this part were also described monetary policy changes taken during Great Depression and the mistakes made that time, which lead to great lessons on how to manage different economic crisis. These lessons seem that were learnt as long as Global Financial Crisis of 2008 was better managed than the Great Depression. Now the nations worldwide are faced with the economic crisis caused by COVID-19. The first signs of a very challenging and incomplete economic recovery have been already shown. Now is the hand of policy makers to propose right changes in policies in order to recover the global economic. Changes in monetary policies as the most important elements to manage an economic crisis are being subject of recovery strategies and the next part will show how this part is managed from USA and EU.

3. Getting into Monetary Policies to overcome COVID-19 Crisis

When COVID-19 shocked almost each economic activity, eyes turned up into the monetary policies changes in order to overcome economic crisis due to pandemic. Bruni & Serrate (2020), pointed out that COVID-19 requires extraordinary monetary policy measures. Furthermore, Bruni & Serrate (2020), argued that monetary authorities need to reconsider in details and carefully evaluate measures from the Global Financial Crisis in order to create a new strategy to overcome COVID-19 economic crisis. It is obviously clear that creating a new monetary strategy due to COVID-19 is one of the biggest challenges for nations, but what is known is that this is an urgent need.

The Federal Reserve of USA has taken measures to respond crisis caused from COVID – 19. First movement through monetary policy changes were recorded in the end of February, in the beginning just as a monitoring process, while the mid of March brought the real measures. According to Cheng et al (2020), these measures include:

- Near zero interest rates;
- Support the functioning of financial markets;
- Stimulation of bank lending;
- Support local governments;
- Hedge U.S. Money Markets from International Pressures.

Near zero interest rates were claimed from the Federal Reserve in the mid of March with the main aim to encourage credit flow. This is done in order to maintain credit market functioning during tough times. The decision to low interest rates was coordinated with European Central Bank and also with the Bank of England. Part of the measures was also the re launch of “Money Market Mutual Fund Liquidity Facility”, which lends to banks against collateral they buy from prime money market funds (Cheng et al 2020). If these monetary policy measures are better analyzed easily can be concluded that the main aim of the Federal Reserve is to increase the supply of dollars. Investors reacted negatively to these measures due the fact that they considered that these measures were taken too late, after the worst week in US Stock Markets for decades. Rushe (2020), argued that before the measures were taken all the major US markets were in the “bear territory”, because their recorded losses for approximately 20%. One is for sure, COVID-19 is not like the other crisis and the Federal Reserve with its capacities cannot cope alone with this situation, for this reason Congress has already approved a financial support up to \$ 2.3 trillion for businesses, households, employers and financial markets (Cheng et al 2020). Having in mind that Federal Reserve has already cut interest rates near to zero, it is obviously clear that there is not too much left undone in the aspect of monetary policies. The Federal Reserve chairman, Jerome Powell has declared that they are not interested to drop interest into negative rates, so the time will show if these measures were adequate or not.

Overseas in European Union, the Central Bank of Europe has also taken monetary policy measures in order to overcome the COVID-19 crisis in the best way they can. Similar with USA the measures of Central Bank of Europe include:

- Helping economy to go through the collapse of this crisis;
- Maintaining the crediting process affordable;
- Encouraging the access to credit for household and businesses;
- Increasing banks’ crediting capacity;
- Sustaining financial capacity through international collaboration;
- Ensuring short term stress does not prevent crediting (ECB, 2020).

The main aim of European Central Bank is to help member countries to manage in the best way economic crisis caused by COVID-19. The European Central Bank has approved Pandemic Emergency Purchase Programme in the amount of 750 billion euros to increase crediting in the EU. Despite the fact that these measures look like adequate ones, in fact the European Central Bank was subject of lot critics. Investors argued that these measures were approved too late. In fact, the COVID-19 situation brought in the light the

fact that EU is a fragile union. Italy and Spain as the most affected countries in EU from COVID-19, have expressed their disappointment with the EU members because the EU was not able to offer the rescue package that these states needed in the right time. The mid of April brought a debate between member countries over a financial rescue package for Italy and Spain that showed that even its members do not trust Europe (Jenkins, 2020). It is the first time that leaders of Italy declared that the existence of the bloc is at stake and that the European Union does not care about the emergency of Italy. Finally, the European Union approved the emergency package for Italy and Spain, but a lot of uncertainty remains about the consistence of European Union. European Union seems to have a lot of challenges in the road, besides the monetary policy ones. As long as this study is focused just in the monetary policies, we are not going to discuss furthermore the other challenges of European Union, but what is important to mention is that European Central Bank are going to keep their interests' rates in the lowest points to support people and businesses to borrow funds.

This part of the study presented the monetary policy measures taken from USA and EU in order to overcome economic crisis caused by COVID-19. All these measures lead to the biggest lesson learnt from the Great Depression that deflation must be avoided in any time of the crisis. Price stability remains one of the main objectives of the nations and the changes made to monetary policies tend to keep inflation according to the target set from the nations.

4. Assistance of EU to Western Balkans countries in the COVID-19 crisis

While the COVID-19 brought in light some disunity between EU members, the case of Western Balkans showed something else. European Union unanimously supports WB not just in the situation of COVID-19, but also in the integration road to the EU. Konxheli Radoniqi (2018), pointed out that Western Balkans represent a very important hub for EU, because of their geo-strategic position and the fact that this region geographically is surrounded by EU member countries. Furthermore, Konxheli Radoniqi (2018), argued that the peoples of the Europe Union and the Western Balkans share common heritage and history. Despite the fact that EU like the whole world is facing with COVID-19, during the pandemic time the EU decided to open membership talks with Albania and North Macedonia. Ursula von der Leyen, the President of European Commission pointed out that Western Balkans belongs to the EU and this support was proved once again in the beginning of May in the Zagreb Summit. The Zagreb Summit reconfirmed the unequivocal support for WBs in the integration road to the European Union. The highlight of the Zagreb Summit was the support of EU to WB to fight COVID-19. According to European Western Balkans (2020), the EU has approved a package of over 3.3 billion euros for the Western Balkans in order to recovery from the COVID - 19. What is important to mention is that in this package, an amount of approximately 750 million euros is dedicated for financial aid of Macro Financial Assistance and also an assistance from approximately 1.7 billion euros from the European Investment Bank. Macro Financial Assistance and European Investment Bank through their grants and loans will offer support especially in the response of economic effects of COVID-19 crisis. European Union through the package offered in Zagreb Summit showed that the economy of Western Balkans is very important factor also for EU. All the monetary policy measures taken from EU, include the assistance for WB and also represents the focus that EU has in WB.

5. Conclusions

This study presented the situation caused from the COVID-19 in the economic aspect. While the virus spread worldwide, the lockdown measures created a whole new economic momentum. Projections show that the economic loss caused from COVID-19 will be approximately 9 trillion dollars, greater than the all the other crisis from the past. While nations are trying to control the virus, in meantime monetary authorities have proposed monetary policies changes in order to support economic activities from the COVID-19 crisis. The study brought the experience from the USA and EU. From the Great Depression the economists have learnt that in time of any crisis the deflation must be avoided and monetary authorities have to create strategies to maintain price stability. USA and EU are working on this part as long as the changes that have proposed in the monetary policy lead to the lesson learnt that deflation must be avoided.

The study also had a focus in Western Balkans countries and the assistance that EU is giving to this region to overcome economic crisis caused by COVID-19. The EU has proved that Western Balkans represent a very important region for EU. It has approved a package in the amount of over 3.3 billion euros mostly to support economic recovery from the COVID- 19. All the monetary policy measures taken from EU represent also the focus that EU has in WB.

No one knows when COVID-19 will end, but what is known is that the monetary authorities worldwide should create and maintain proper strategies to avoid deflation during COVID-19.

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