Quarterly Report on the Economic Environment

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Introduction

Our previous Quarterly Reports on the Economic Environment analysed the factors that had led the global economy to a slump, translated into mediocre economic growth after an expansionary cycle that was dubious in itself. There were both structural and environmental factors at play in this scenario. There was even consideration of the possibility that a single adverse shock (presumably in the form of a heightening of geopolitical tensions or the escalation of protectionism since 2018) could lead to a global recession, albeit limited in intensity and duration.

What was unimaginable was that this negative upheaval would come in the form of a pandemic of historic proportions that will generate, aside from its healthcare and social (and geopolitical) implications, the greatest economic contraction since the Second World War, including unprecedented devastation in the first half of 2020. This situation is already resulting in brutal collapses in levels of activity, employment and the dimensions of the business ecosystem, while extreme increases in central bank balance sheets, already inflated due to the policies applied since 2008, and levels of deficit and public debt and, unless rapid coordinated and global action is taken, poverty indices too.

In the first section of this Quarterly Report, *Economic Climate and Trends*, we will describe the impact of the coronavirus and the policies pursued to attempt to contain it on the situation and the performance of the principal elements that define and/or determine the global economic environment. Certainly, our traffic light assessment will reflect that devastation and the miniscule probability, as we see it, of the optimistic scenario of a V-shaped recovery. In the second section, the *Ten-Point Analysis*, we will analyse the most significant events of the last ten weeks and the decisions adopted in response to this unprecedented and disastrous situation. The world and the economy will never be the same again, but we will reflect on whether we can or should accept the notion nothing will ever be the same. Finally the *Under the Microscope* section will offer an exploration, which will hopefully be complete and balanced, of how to articulate the set of policies necessary to tackle not only these critical current moments of the coronavirus crisis but also the recovery, in the short term and beyond. Among many aspects, it will be argued that now is NOT the time for the Eurozone to issue Eurobonds.

Economic Climate and Trends

Determining factors	Current quarter		*Previous quarter*	
	Status	**Trend**	*Status*	*Trend*
Economic activity		***Negative***		*Positive*
Trade and exchange tensions		***Neutral***		*Positive*
Monetary policy		***Expansionary***		*Expansionary*
Fiscal policy		***Expansionary***		*Neutral*
Commodities markets		***Positive***		*Neutral*
Geopolitical tensions		***Neutral***		*Negative*

Understanding the Economic Climate and Trends Chart:

a. **Economic climate**: defined for each of the determining factors as of the time of writing using a colour-coded scale from the most negative negative/contractionary level for the performance of the world economy (red), up to the most positive/expansive (blue) in the following order:

b. **Trend**: indicates the projected performance, from the time of writing and in the short term (forthcoming 3-6 months), for each of the determining factors, as either positive/neutral/negative (or expansionary/neutral/contractionary in the case of macroeconomic policies)

c. **Determining factors**:

1. Economic activity: assessments based on the latest activity and confidence indicator measurements (World Bank industrial production index; IFO, ZEW, Tankan, Chicago ISM and various PMIs).

2. Trade and exchange tensions: evaluations based on the latest World Bank Merchandise Trade Index and Trade Policy Uncertainty Index measurements (calculated by Economic Policy Uncertainty) accounting for protectionist/free trade oriented measures offered in the Global Trade Alert, and the measures and statements which could be considered exchange rate manipulation by the major countries in the global economy.

3. Monetary policy: assessments based on the weighted global interest rate of the world's major central banks (accounting for about 77-80% of world GDP), and the movements in the reference rates they set in the six months prior to the publication of the report. Forward guidance implemented by managers of these central banks is also considered.

4. Fiscal policy: assessments based on the fiscal position and the ability to implement expansionary

fiscal policies of the world's 40 major economies, with a joint weight of 88% of global GDP between them and individual weight of at least 0.4% of global GDP. Data from the International Monetary Fund's Global Fiscal Monitor database.

5. Commodities markets: assessments based on the latest data from World Bank Commodity Price Data, with five major indices including up to 72 commodities, as well as the events that may significantly alter the behaviour of basic commodity prices in the short term.

6. Geopolitical tensions: assessments based on the latest data from the World Uncertainty Index, (offered by Economic Policy Uncertainty) and events and statements likely to significantly affect the international geopolitical context, potentially significantly affecting the global economy.

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Ten-Point Analysis

In the space of three months, the SARS-CoV-2 virus has transformed the world in all spheres, including the economic. The coronavirus, or COVID-19, declared a pandemic by the World Health Organization on 11 March last, has forced economists to rethink our readings, models and expectations in relation to the global economy Of course, we share this frame of mind with experts from many fields and all stakeholders must make decisions for countries, institutions, financial and non-financial companies and civil society organisations. In this, our third Quarterly Report on the Economic Environment, I kindly request that reader grant me three small licenses. Firstly, and somewhat incongruously, our regular *Ten-Point Analysis* will have more than ten points. Secondly, while this remains a report on the global economy I will make specific reference to the Spanish economy, particularly in relation to forecasts. Thirdly, I must postpone, at least for this quarter, the subject announced for the *Under the Microscope* section (the costs of an ultra-expansionary monetary policy pursued since 2008 in the West) to focus on structuring a series of proposals that might define a complete response to the crisis and boost the recovery, not only in the short term but also in the medium term. Some of these measures are already in place; others are likely to be seen, while it is doubtful whether others will ever see the light of day. Let us begin, then, with our extended *Ten-Point Analysis*.

I. it would be helpful, first of all, to remember that the in the period immediately prior to the outbreak of the coronavirus crisis the global economy was not going through its best moment. The long expansionary cycle (not without localised crises in different regions) was showing signs of burnout in part due to the limits of the main foundation thereof, the extremely expansionary monetary policy of more than a decade. The political and social instability in a number of developing countries, geopolitical tensions, the escalation of protectionism, the lack of contribution from many areas of public policy, concern regarding the profitability of the banking system and, above all, regarding the assumption of excessive risk on the non-banking side of the financial system were all unfavourable factors. And that’s before we mention the crucial structural challenges, from the implications of climate change to the consequences of demographic aging on economic growth and the sustainability of the Welfare State and the bloating of essential production sectors such as the automobile industry.

A difficult 2020 was already anticipated, with mediocre global growth levels (flirting with levels indicative of a mild recession, associated with growth in global production of 2.5% or 3% depending on the institution taken as a reference) and a generalised deceleration. Certain developed countries saw debate as to the likelihood of a recession in the strictest sense (fall in GDP for three consecutive quarters); Germany and Italy for two, and Japan seemed condemned to this recession after the severe response to the slowdown in consumption after the increase in VAT in the last quarter of 2019. The increase in public expenditure in attempt to compensate was unsuccessful, as has proven to be the case so many times with increases in public spending in Japan over the past three decades, in the absence of the structural reforms necessary to feed growth.

II. However, the focus of attention changed drastically from February this year when (after an absolutely unjustifiable delay that that makes the response to the Chernobyl nuclear accident in 1986 look prompt) the Chinese authorities recognised that a medical problem relating to a coronavirus was beginning to take its toll on the city of Wuhan in Hubei province, and it was necessary to adopt draconian measures to halt the spread of the virus causing the problem.

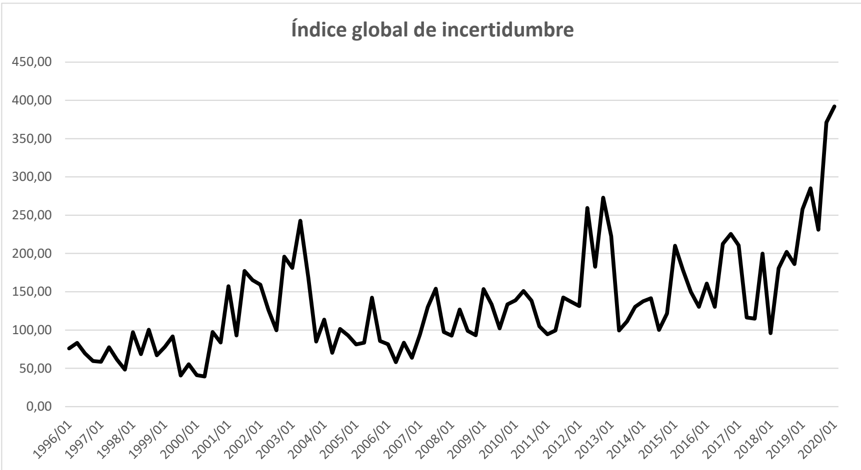
Naturally, this is not the place to reflect on or assess a medical or healthcare response to the crisis or indeed the intensity, velocity, coordination or precision thereof. It would be a foolhardy and would lack all sense in a report such as this. Nonetheless, unquestionably, all of the above has a decisive impact on what happens in the economy from that moment on. And what we see is a succession of shocks, all negative, that are connected in the following manner:

- An initial <u>interruption to supply</u>, centred on China, the “factory of the world”, which significantly reduces production not only of consumer goods but, more importantly, also intermediate components and goods, that threatens to paralyse production in many places faced with limited availability of stock in modern supply chains, configured on the "Just in Time" principle with incoming and outgoing elements and products in almost real time and the lowest storage possible. We are therefore talking about the first global recession caused by China (still thinking about this "recession" in a relatively mild sense). Year-on-year reductions in China of 13% in manufacturing and services or 20% in gross capital formation put the numbers to this initial concern.

- A demand shock, particularly but not only in the West, arising from the progressive spread of the (then) epidemic, which forces authorities to cancel major events with large crowds, and limiting and then prohibiting international travel (and in certain regions, within countries) and restricting movement, especially for leisure, not only in large crowds. Fear, especially when it is perceived that the disease has jumped from Asia to cause destruction in Europe, also reduced consumption, either for precautionary reasons or directly due to fear. The impact of this concentration of demand starts to sink all indicators of activity and confidence with unprecedented intensity, causing, for example, a reduction of 711,000 in the numbers employed in the United States, the largest since 2009 and breaking a period of 113 consecutive months of employment increases. And that was just for starters.

- Secondly, a supply shock, first in Europe but progressively extended on a global scale. The same fall in demand and, above all, the decisions, of the different governments to paralyse much of the productive activity in order to contain what is now a pandemic, with exceptions varying in strictness depending on the country, leading to the collapse of production, both of manufacturing and of services, except where linked to the production and manufacture of essential goods and activities in response to the health crisis and those that can be covered with staff working from home. With global supply and demand in a coma, the sinking of markets on a level similar to the last financial crisis and the conviction that it would be impossible to escape the recession (even for countries that have gone three decades without experiencing one, like Australia) indicate the gravity of the situation. Global uncertainty reaches unprecedented levels (see Figure 1).

Figure 1. Trajectory of Global Uncertainty Index



Source: own calculations Data: Economic Policy Uncertainty

- But there was still a second, global demand shock. Hundreds of millions of workers and millions of companies from all areas of the globe see their sources of income substantially reduced, if not completely wiped out, by the succession of blows described. Private consumption, private investment and exports, in what is now a widespread crisis, fall of a steep, abrupt cliff. The final component of demand, public spending, must respond to the challenge. Financing that, with a private sector in a state of paralysis due to the direct impact of the crisis or the government measures introduced to tackle it, must be assumed by the central banks. We'll return to this presently. But on this point, after these four consecutive shocks, a new Great Depression is upon us.

III. The initial response to this scenario (and so it was maintained for several weeks) from political leaders was highly disappointing. The unexpected and unprecedented nature of the pandemic and the succession of shocks may offer certain justification for the timid response but only partially so. Not only is there no effort to coordinate nor is there any eradication, for example, of the some of the protectionist barriers that had been erected over the last two years, but all manner of accusations abound, some resorting to boorish language and adopting a purely national focus, including the prohibition of the export of certain medical materials and supplies, strict restrictions on the export of food, the unnecessary increase of strategic reserves of these (at a time when, fortunately, unlike 2008, there is no indication of a supply deficit and free trade is the best alternative by some distance) and even the seizing of shipments bound for third countries in what some have referred to as “modern piracy”.

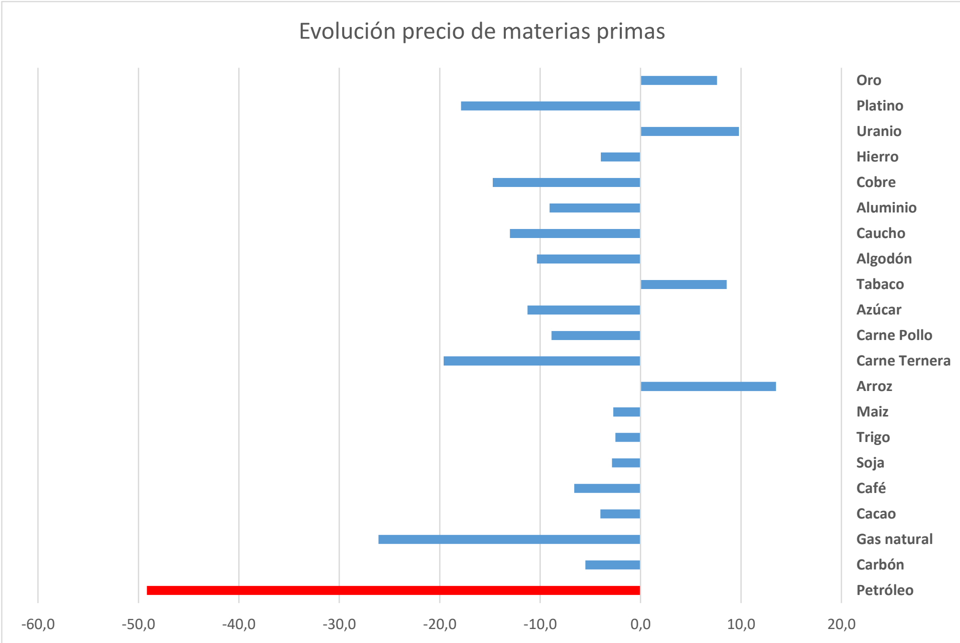
As the days go by, there seem to be fewer examples of more extreme behaviour although some remain (see the Trump Administration’s decision of 14 April to suspend contributions to the World Health Organization) while monetary policy measures first, and fiscal measures second, gain some semblance of coherence. But they are lacking solidity and precision beyond the short term and this is something we shall return to later.

Financial markets, always prone to overreaction, remain faithful to the same stages. March sees a collapse the like of which has never been seen, while the shocks go far beyond the capacity of most countries to response and central bank and government measures prove imprecise and/or too weak, given the scale of the crisis. They rebound with disproportionate enthusiasm in early April, when monetary and fiscal aid seem to be able to stem at least some of the tide. At the time of writing this report, markets are beginning to hesitate again, because they have begun to think beyond the immediate term and begin to factor in the impact of the crisis, over the coming quarters, on profits, public and private debt levels and certain sectors, especially those high-risk, of the financial markets themselves. All while assuming that the crisis will not drag down the banking system which, unlike twelve years ago, is expected to be an essential part of the solution rather than the problem.

IV. It is worth recalling that in assessing the decisions taken (and those that should be taken) it is necessary to balance three priorities that constitute a dilemma. Up to now, only the first two have been considered, but the third should not be neglected. On the one hand, of course, is the imperative need to limit the impact, in terms of cases, deaths and the collapse of health service capacity. The more strict and prolonged restrictions and confinement are, experts seem to agree, the better the results in this area. However, it has precisely the opposite effect on the second priority which is not to prolong the economic (and social) devastation that these restrictions cause any longer than is strictly necessary. But going by what we have learned from previous economic crises, and particularly the recent Great Recession, these situations of mass economic and employment destruction also cause deaths. The concept of “deaths by despair”, coined some years ago in the United States, refers to those processes (increased depression; drug use, particularly opioids; violence and suicide among other medical problems) that accompany economic crises for significant groups of people affected.

V. Turning to the important decisions, one of the most bizarre episodes of recent months, in the middle of the coronavirus crisis, is the open war in the oil market, in an exercise of affirmation (we use the term here so as not to resort to other nouns that come to mind but that would be inappropriate in a report such as this) between Saudi Arabia and Russia, with their gaze set indirectly on the United States. While decisions that can, to a certain extent, be described as coordinated have finally been taken, to undo the damage (and we will refer to this later in this Decalogue), we will describe the episode as an example of the extent to which the relevant leaders disregarded the crisis we are suffering, even when fully aware of its seriousness, and also to explain the differential behaviour of oil prices compared to other raw materials in the last quarter, which we can observe in Figure 2.

Figure 2. Trajectory of selected commodity prices
(Variation in average price March 2020 compared to December 2019)



Source: own calculations. Data: World Bank

Note that, almost without exception, we have seen significant price reductions for all types of raw materials over the last three months (of course, the data are even more marked on specific days, but here we provide monthly averages which are more significant). Metallic/industrial raw materials have suffered from the paralysis of supply; commodities from the fall in consumer demand; and energy from both types of shocks. There are some predictable exceptions, such as gold - long considered, whether for good reason or not - a refuge asset in times of crisis (note, however, that platinum, industrial use of which is much more intense, has seen its price contract clearly); or uranium, as a result of supply problems given the high concentration of supply in a small number of producers. Other increases are not so predictable: rice is a case in point, a staple food, for which some Asian countries have established export restrictions while others jumped to increase their reserves with large purchases; or tobacco, a reflection of how the confinement of citizens can have damaging effects on health.

The exception to the rule, of course, is the freefall in the price of oil. Of course, a reduction in global demand of close to 30 million barrels per day (on the days with the most intense reduction in economic activity), more than 25% of normal consumption, explains part of this fall. But no less relevant is the behaviour of two of the biggest oil producers in the weeks prior to the month of April. Let's tease out the story of the confrontation.

In 2016, an OPEC agreement (organisation that brings together the principal oil exporting countries) with producers not members of the Organisation, especially Russia, allowed for cuts in oil production in line with weak growth in demand in an economy that was growing in tentative steps, and the progressive increase in the weight of renewables in the energy mix. With that, oil stabilised around the 60-70 dollars per barrel mark, apparently favourable for all the main players in the market.

In the transition between 2019 and 2020, however, Russia rejected an extension of the agreement under the argument that third countries that were signatories to it and who therefore had not reduced their crude oil extraction, were benefitting from this effort. Eyes were clearly on increasing production (and even exports) in the United States, arising from the intensification of fracking over the last decade. Saudi Arabia, traditionally the clearing house of the market, increasing and reducing production to maintain prices at the desired levels, refused to continue to fulfil this role, probably sharing the same concerns as Russia, but also in a battle of egos between the Saudi Crown Prince Mohamed bin Salmán (whose expeditious ways are already evident to his country and the world) and Russian president Vladimir Putin. This is the only way of understanding how they maintaining the pace when reviewing the numbers presented below.

Meanwhile, we must not forget a couple of important details; Russia reads this conflict, which could leave the US fracking sector reeling (the enormous expansion of which is based on extraordinary levels of debt), an opportunity to respond to the sanctions imposed by the Trump Administration on Rosneft, the Russian state oil company, for continuing to operate in Venezuela, and companies collaborating on the completion of the Nord Stream 2 project which will bring Russian natural gas directly to Europe, bridging Ukraine. The Saudis, meanwhile, saw the opportunity to further cement their leadership position in OPEC and also punish regional rival Iran which, already subject to American sanctions, can ill-afford a nosedive in the price of crude.

In this scenario, Saudi Arabia injected up to 12.3 million barrels of oil per day onto the market, sold at a considerable discount. Incidentally, this even involved placing on the market some of their stored oil because, in the short term, there was no capacity to increase production in excess of the additional two million barrels per day the Saudis were already supplying. Russia responded with supplies above what was then its usual level, approximately in the region of half a million barrels per day. It is more than feasible that other producers, unwilling to surrender market share, will also increase production, albeit more discreetly. All of this has taken place, we must remember, in a context of falling demand. It should be no surprise when the price of crude falls below 15 dollars a barrel. Let's compare that with the following figures. Saudi Arabia needs the price of crude oil at around 83 dollars a barrel to balance its budget. Multiply the difference of close to 70 dollars by the 12 million or more barrels per day and it gives you an idea of the extent of the problem.[1] However, it is clear that Iran needs a price of 115 dollars to reach the same level of budgetary stability, is subject to a sanctions regime, and does not have the 500 billion dollar reserves that Saudi Arabia has, without even considering the Sovereign Investment Fund.

Russia needs a price of 40-45 dollars per barrel keep the public accounts balanced and so, even with a shorter difference, the numbers just don’t add up. Most oil producers that use fracking require a price in excess of 50 dollars per barrel and as has been indicated, many of these producers are heavily indebted while Russian has a buffer of 700 million dollars between its gold and currency reserves and the assets of its Sovereign Wealth Fund.

Ultimately, it's an entertaining geopolitical and strategic game that is particularly perverse in the midst of a global recession. Luckily, as we refer to later in this Decalogue, a global agreement has put a halt to this encounter. For now.

VI. One final point on the trajectory of commodities prices. Is such a reduction not a positive for the global economy? Why worry and why use the colour red, indicating a negative, in our traffic light system? Ultimately, it has always been stated that even though gains for one (importers) due to lower prices means a loss for others (exporters), because the former generally tend to be developed countries (including China and India) they consume and invest more than the latter, these lower prices reinvigorate the global economy. But there are several arguments to the contrary:

- Extreme fluctuations in the prices of essential materials generated greater uncertainty at a time such as this is a burden on the global economy.
- At a time of paralysis of demand, the extent to which people take advantage of low prices is notably lower, both for industry and for citizen. Think of all the drivers who have complained in recent weeks about how the one time the price of fuel has fallen considerably, they are only allowed use their car under certain circumstances.
- Exporter countries, in general, depend crucially on the export of raw materials as a source of income. Without it, economies already in crisis could simply disintegrate. They make up a significant part of the global economy.
- Raw material extraction and distribution sectors, and particularly the oil industry, have a considerable weight in western and emerging countries, through multinational companies. These sectors usually have significant lines of bank financing in place. Sustainability problems in those sectors could spread to international banking systems, which would be far from ideal in the current circumstances.
- If one of the big producers has to resort to a significant asset sale (of direct reserves of the countries or of Sovereign Investment Funds) in order to sustain its economy, assets usually maintained in western markets (both public and private), additional financial turbulence

[1] The prices offered here are approximate averages based on different types and qualities of crude oil. The prices in the market would vary depending on the type (Brent, WTI, Dubai) and quality (level of sulphur). Saudi petroleum, for example, is generally high quality.

could be generated.

Ultimately, moderate commodity prices are a plus for the global economy; knockdown prices after an abrupt fall are damaging.

VII. The extreme gravity of the situation is hitting much of the global production apparatus hard, particularly in the West. It is worth noting here that, unfortunately, a considerable number of companies and sectors find themselves in an unnecessarily fragile financial situation at the end of an expansionary cycle. This weakness comes from extreme levels of indebtedness (in 2019 debt worth 2.5 billion dollars, an historic record, was issued by non-financial companies). This was not linked to an increase in productive investment (rather it was weak, except in Asia), but an enormous increase in the payment of dividends share buy-backs, as well as merger and acquisition processes often poorly gauged if not an out and out fiasco for shareholders.

Of course, exceptionally low interest rates for practically any term have fostered these debt issues, with special mention for debt considered speculation, commonly known as "junk bonds". This is one of the costs of long-running, increasingly expansionary monetary policies. Another, difficult to define, is that pertaining to the maintenance of companies not viable in normal conditions, sustained artificially with cheap money time and time again. This is known as "evergreening". The problem, aside from the fact that these companies end up failing and the major uncollectibles that go with that, is the fact that they are barriers preventing the emergence of new, more productive and competitive projects in their respective sectors.

It is highly probable that, without these two elements, we would, on the general level, have obtained a more solid business structure than we have at present.

VII. The rule set at the star of last Great Recession, and which has continued uninterrupted since then, is that any economic difficult must be tackled with monetary policy. The coronavirus crisis was never going to be an exception.[2] But this time western central banks have had serious difficulties in convincing that, resorting to now tired expression coined by Mario Draghi that they would do "whatever it takes" to save their respective economies. Furthermore, financial markets forcefully punished what they saw as an insufficient initial response.

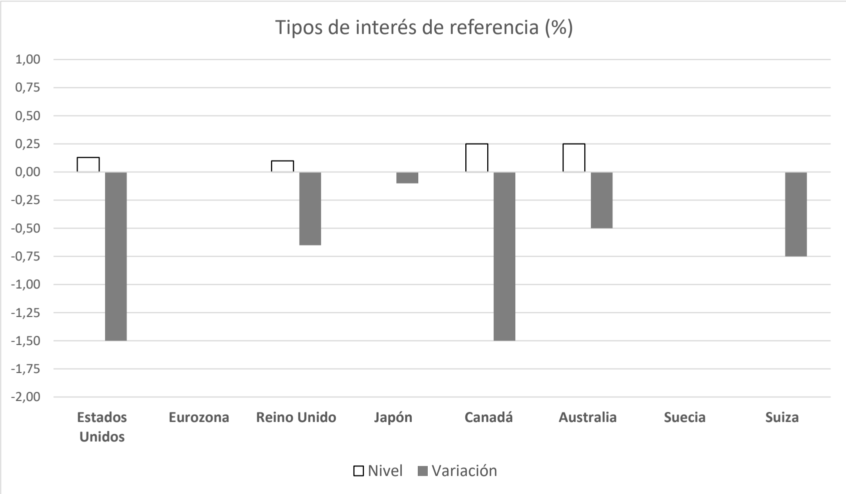
In fact, in the first instance, the decision was taken to reaffirm the tenor of the current policy at the start of the year. On the one hand, extremely low interest rates reinforced with some additional decreases (within an existing margin of almost zero) as shown in Figure 3. Secondly, maintaining or moderately increasing asset acquisitions, public or private of the kind already subject to massive purchases since the Great Recession, and in some cases (Japan, Eurozone) still underway. Thirdly to reaffirm that this markedly expansionary policy would be maintained over time. Fourthly, to request that Governments assume their responsibility through fiscal measures. It all seems fairly logical.

The response in the financial markets? Apocalypse on the stock markets and massive sale of public debt even that of the major countries.[3] What had failed? On the one hand, the problem was not the price of money; interest rate deductions were not the least bit useful. Also, the volume of asset acquisitions envisioned by central banks would not even remotely cover the increase in debt States must issue to tackle the crisis. Moreover, investors expected acquisitions to spread to other segments of the markets critical for the financing of many companies and which, due to the higher risk, had collapsed.

[2] For up to date monitoring of the macroeconomic measures adopted by up to 193 countries, both monetary and fiscal or relating to exchange rates, balance of payments or macro-prudential, see the collation provided by the International Monetary Fund at https://www.imf.org/en/Topics/imf-and-covid19/Policy-Responses-to-COVID-19.

[3] Certainly, it must be borne in mind that some of these were attempts on the part large investment funds to obtain liquidity to cover losses suffered in light of fire sales of positions by retail investors.

Figure 3. Interest rates. Selection of developed economies.
(Rates as of 15 April 2020; variation from December 2019 to 15 April 20202)



Source: own calculations Data: Central Banks

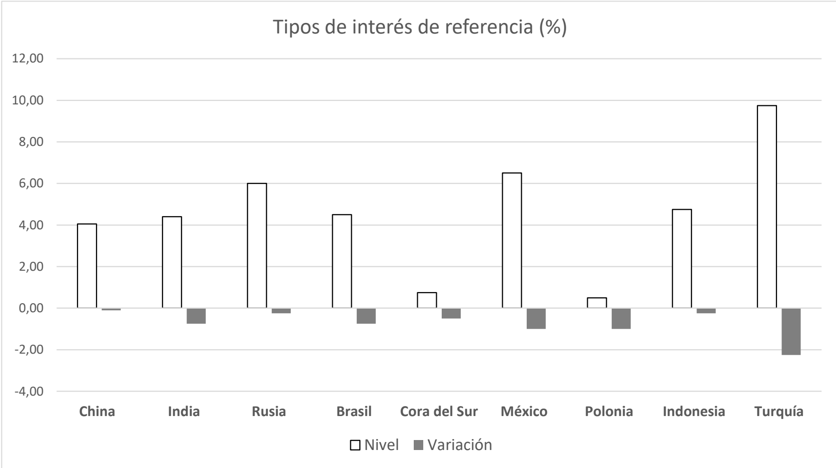
But central bankers of the 21st century, the "heroes" of the last recovery, are not bound subjects who were going to accept their new role as villains. The solution was simple. Any self-respecting central banks would copy the Bank of Japan and every central bank governor would copy Haruhiko Kuroda, the head of the BOJ. And so it was. Everything is bought up, in every market, with little consideration for the medium term risks. And if it's not enough, then price is controlled too, much like public debt even over the long term. Perhaps this last assertion is a slight exaggeration but only a slight one. And so the four principal Western central banks alone (the United States Federal Reserve, the European Central Bank, the Bank of England and the Bank of Japan) have announced asset acquisitions, in 2020 alone, of some 5 billion dollars (more than double the level at the worst moment of the Great Recession). That includes the use of the term "unlimited purchases" on the part of the Bank of England, purchases of commercial paper on the part of English banks, the entry onto the market of municipal bonds, structured products of no lower than moderate risk and even junk bonds on the part Federal Reserve or the unequivocally named "Pandemic Emergency Purchase Program" of the ECB, with public and private debt purchases to the tune of 750 billion euros (in addition to those it continued making and reinvestment on maturity). Just as importantly, if not more so, they removed the limits that until now had prevented the distortion of asset purchasing in some countries, although not without some trouble.

While the complete list of measures adopted in recent weeks would be endless, our *Under the Microscope* section looks at the adequacy of the major lines of this action. Since then, the satisfaction of the markets, expressed in the form of recoveries with little precedent in terms of magnitude and velocity, have shown their conformity with this second wave of crisis action from the Central Banks.

Meanwhile, we mustn't forget that central bankers in the rest of the world also had monetary weapons in their arsenal. The first, of course, was the reduction in reference interest rates, with a margin ostensibly higher than their Western colleagues. But, as Figure 4 shows, for a selection of emerging economies that serve as an example, they have been relatively shy in exercising that option. There are reasons for that, which we shall explore later in this section: haemorrhaging of capital in the first quarter of the year and excessive dollar debt in much of the emerging and developing world would advise against any movement that leads to a distancing of foreign capital and devaluation of national currency. The "original sin" once again crucifies non-developed countries. Let's remember that this concept refers to the problem of indebtedness in a foreign currency, usually the dollar, to benefit from lower interest rates than those possible issuing debt in domestic currency and access to greater "pool" of investors. The problem is that if the dollar appreciates significantly compared to the domestic currency, the ability to repay the debt for countries whose incomes are in that domestic currency becomes rather complicated.

In the case of China, aside from the fact that the influence of the Central Bank on credit is executed more through direct guidelines and reserve requirements than through interest rates, the significant problems of the Chinese financial system with uncollectible loans has forced prudence in monetary expansion.

Figure 4. Interest rates. Selection of developed economies
(Rates as of 15 April 2020; variation from December 2019 to 15 April 2020)



Source: own calculations. Data: Central Banks

In any case in addition to these "moderate" interest rates, we have seen, in what certainly is a new departure in many cases, the initiation of massive public debt acquisition, albeit it dozens of billions rather than the hundreds of billions we have seen in developed countries. This is what we have seen happen from Poland to Colombia, from the Philippines to South Africa, and where such action was not legal (Brazil, Czech Republic), the central banks have asked for the option to be made available. This time, quantitative easing is going global.

VIII. In our report from Q4 2019 we noted a positive trend in relation to the increasing role of fiscal policy, especially in the West, in stimulating then ailing economies. The debate regarding fiscal prudence or the possibility of taking advantage of low interest rates to use public investment (not in current expenditure) to accelerate growth, not only in the short term but the medium term, seemed to be shifting in favour of the latter. And before the coronavirus swept everything away, this approach was offering some signs of materialising in a diverse range of countries, from the $51 billion dollar investment in infrastructure (including housing) in South Korea, to the $1.4 billion over five years allocated to India's programme to improve the country's physical connection networks and Germany's €86 billion investment in the rail network. Although still incipient, there are also the new structural programmes driven by the European Commission, from the programme to tackle climate change (announced investment of one billion euros, although here the leveraging necessary to reach that figure inflates the true committed capital) to the plan to create of new industrial "ecosystems" in the form of clusters, spread across the EU, in cutting edge sectors.

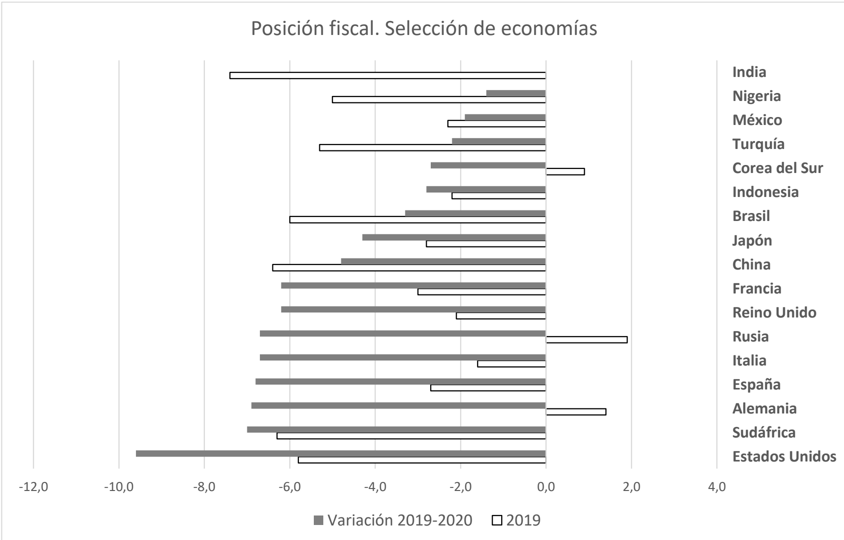
But the succession of negative shocks already explained in the report has forced a complete transformation of the role of fiscal policy. Firstly, there is no debate: with a greater or lesser degree of reluctance, whether it is better to coordinate or to act on an individual basis, most governments in the world, and particularly in the West, have launched an unprecedented peacetime fiscal expansion. In fact, the continued use of wartime metaphors seems comforting to some leaders with the need to break with any rule of fiscal contention. Remember, with consumption, investment and exports in serious decline, where not in complete freefall, only public spending with the aforementioned increasingly steadfast backing of central banks, remains as the last bastion of sustaining demand. Secondly, and this is more difficult, the effort is concentrated almost exclusively on current expenditure without, for the moment and despite the fact that George Marshall's name is being invoked so frequently,[4] attending to the need to establish a programme of investment that would allow for medium and long-term recovery.

The set of actions, which we will aslo assess in our *Under the Microscope* section, includes, in a diverse selection of programmes depending on the countries: direct and indirect subsidies to individuals and

[4] George Marshall, US Secretary of State from 1947 to 1949 was the driving force behind what for the time was a monumental stimulus package of $17 billion, financed by the United States and aimed at the restructuring of the European economy after the Second World War, money invested between 1948 and 1951. Marshall received the Nobel Peace Prize in 1953 for his leadership on this Programme. Perhaps promising this reward would help find a new leader to promote a similar initiative, this time financed jointly by a number of countries.

companies; free provision of essential services for the duration of the crisis, suspension of rents and/or mortgagees or supports for same; tax payment term extensions, granting of special loans and, to a lesser extent, financial aid. These programmes are aimed at employees, the self-employed, SMEs and large companies. They have been established on a generic basis or conditioned upon the productive sector, the impact of the crisis or the nature of activity. The basic objectives are to protect the most vulnerable groups in society, sustaining employment and allowing companies to survive. More indirectly, the aim is to ensure that a barrage of payment defaults does not destroy the banking system, the solidity of which will be necessary for the recovery. A comprehensive list of the measures would, once again, be endless.[5] Measuring their impact is also difficult, both in terms of results and costs. On the latter however, we can turn to the forecasts of the International Monetary Fund (see Figure 5). We shall use them under a number of points of this analysis as they are the most recent at the time of writing. It is likely that the IMF has stopped short somewhat in evaluating the final increase in deficit but it can serve as a reference nonetheless. Note also the unnecessarily uncomfortable fiscal position, with major red figures for several countries (including Spain) considering we are approaching the end of an expansionary cycle. The situation is even worse for most of the principal emerging countries, although it is true that in some of them, even before coronavirus, the general economic situation was not favourable.[6]

Figure 5. Budgetary balance (% of GDP). Selection of economies.
(2019 level; variation between 2019 and 2020)



Source: own calculations. Data: International Monetary Fund Projections (WEO, April 2020)

Note that the intensity of the response is depends on the existing budgetary margin, but also on whether there is a Central Bank with sufficient credibility to purchase debt on a massive scale without placing the value of the currency at risk or causing capital flight. The United States is an obvious case in point, but the economies under the umbrella of the ECB are among those to allow the highest levels of deterioration in public accounts. While China will see what for it is an extraordinary double-digit deficit in 2020 (and possibly in 2021), it has taken less intense fiscal measures than those taken during the Great Recession, mainly due to the exceptionally weak position of regional and local governments. There are cases, such as that of South Africa, where, regardless of whether the country allows it or not, the fiscal deterioration is going to be brutal and the socioeconomic consequences no less so.

IX. This final point leads us to the next issue to cover as part of our *Ten-Point Analysis*. In the overall scheme of the responses to the crisis, forgetting about developing and emerging countries with lower levels of income would be a major error. It seems that the developed countries of the G-20 have joined the World Bank and the International Monetary Fund to begin to enact measures, encompassing both direct aid and

[5] See the International Monetary Fund's collation mentioned in Note 2.

[6] For the observant reader, I must state the author also has trouble understanding how India's atrocious 2019 budgetary balance not going to worsen further, according to the IMF, despite projected economic growth falling by two thirds and despite the aid programmes for citizens and companies announced by Narendra Modi's government, which are much more modest than other countries.

postponement of debt repayment deadlines, with at least partial debt forgiveness possible.

We are talking here about low-middle income and low income countries and countries in out-and-out situations of poverty with health systems for which the use of the adjective “precarious” would be an understatement. Their economies, often dependent on the export of raw materials, are being deprived of income due to the nosedive in global demand. There is no possibility of replacing that with internal demand or via neighbouring countries, which are usually in a similar situation. Servicing external debt absorbs unassumably high percentages of exports even before taking the current reduction of exports into account, and even with dozens of the world's poorest countries having received, or currently receiving, assistance under the Heavily Indebted Poor Countries Programme which has provided some relief, to a greater or lesser extent, from the debt burden. We must also add to this, although this factor affects emerging economies more than underdeveloped ones, capital flight of up to 120-130 billion dollars from the non-developed world in the first three months of the year, a level of flight not seen even during the Great Recession.

In these circumstances, to claim that the virus will have a lower impact due to the warm and hot climate or the lower average age of the population is merely playing to the gallery. Even if the healthcare impact is not as significant, the socioeconomic impact of the global recession is already being felt in these economies. Their quotas they are entitled to as members of the IMF will provide some welcome relief. As will the specific aid approved by the World Bank and some developed countries. But they are not sufficient. Other initiatives can be expected to be formalised soon. We will include some reflections on our own full package of measures to tackle the crisis later. The humanitarian and socioeconomic cost and for those who wish to view it from a more nationalist perspective, the migratory flows that might arise from a total collapse of the developing world, would be difficult to manage.

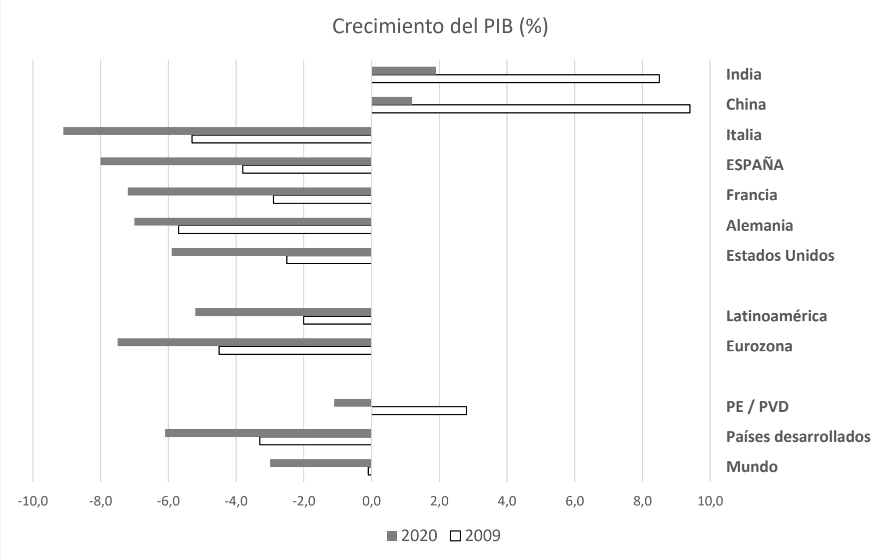
X. Perhaps we should hope for another 3rd of April for that. That day saw, not without multiple debates, accusations and rebuffs, two coordinated actions that were, without doubt, positive for the response to the recession. On the one hand, the agreement between Saudi Arabia and Russia, framed within a global commitment of the G-2O, allowed for the stabilization of the oil markets at price levels of half the rates before the outbreak of the crisis, but double the minimum levels reached. The two countries agreed to take up to 10 million barrels per day off the market and maintain lower, decreasing cuts over the medium term. In addition to the closures of holdings already caused by ruinous prices, some containment commitments on the part of other producers and promises from consumer countries to increase their strategic reserves, the global impact on the market is a correction of supply of 15 million barrels per day. It is some way off compensating for the fall in demand but that can only improve once the maximum extent of measures paralysing activity are reached which, is likely to occur in April 2020.

On the same day, the EU 27 agreed a €540 billion emergency programme to mitigate and reverse the most immediate effects of the crisis, with a special focus on unemployment. A specific fund to compensate countries most damaged (€100 billion) was set up, in addition to the possibility of resorting to the European Stability Mechanism (€240 billion) and increase in the activities of the European Investment Bank (€200 billion). It is true that there is no mutualisation of debt, but the conditions are flexible. There are no national quotas, the money is available immediately and the ECB is absorbing public debt at full throttle, in particular Italian, Spanish and French debt. In the final section of this report, we shall compare this package of measures with other alternatives, in particular the “Coronabonds” (an absurd name, incidentally, if ever there was one). It is certainly strange that arguments against this short-term response have arisen among politicians, media commentators and economists in the countries that benefit most. This set of measures is essential now (or rather it was a short time ago). Once approved, it will be time to discuss the future beyond it.

Nothing is perfect but another 3rd of April, as far as international cooperation goes, would do no harm. Removal of protectionist barriers? Joint rebuilding of healthcare structures and materials? Global assistance programme for less developed countries?

X. So where does all that leave us? In the worst global recession since the Second World War. We shall refer, once again, to the IMF projections as a reference, as they are the latest available as of the time of writing of the report. They offer a baseline scenario that anticipates a drop in global GDP of 3% (it was 0.1 in 2009, in the worst year of the Great Recession). The magnitude of the projected collapse in different economic spaces can be perceived in Figure 6. The expectations for 2021 point to a robust rebound with growth of up to 5.8%, which would double that reached in 2019 and exceed 2010 by 6 decimal points. This equates to a U-shaped recovery and it would take until the last quarter of 2021 to reach the GDP levels of 2019 again.

Figure 6. Real GDP (%). Selection of economic spaces
(2009, worst year of the Great Recession, and 2020, according to IMF projections)



Source: own calculations. Data: International Monetary Fund (WEO, April 2020)

In our opinion, there is no doubt that the profile drawn by the IMF will, in all probability, be the correct one, especially with the progressive improvement of authorities' responses. There is reason to expect an initial reduction in GDP in the first quarter of 2020, a disaster equivalent to a global conflagration in the second quarter, stagnation in the third unless, and it seem improbable, there is some way that the international tourism season (the summer months in the northern hemisphere for almost all the major tourist destinations) is not completely lost and the start of the recovery in the fourth quarter of this year, followed by acceleration of that recovery with what would be year-on-year growth figures with few precedents from the first to third quarters of next year.

That said, the IMF's baseline scenario, for more than a decade, and incomprehensibly for this author from a technical point of view (the policy criteria are another issue), has consistently overestimated the levels of economic growth ultimately seen. To compensate for that, recent years have seen the IMF opt for mostly pessimistic scenarios around its baseline, with some more favourable alternative projections. Meanwhile the April 2020 World Economic Outlook from which the projections have been taken, all the alternative scenarios are more negative than the baseline chosen. That certainly doesn't bode well.

We can therefore expect a more acute fall in global GDP this year than the 3% mentioned, and only if international cooperation is enhanced, there is no resurgence in or reproduction of the virus, we save the developing world from collapse and the international banking system survives the losses arising from default on loans and the recovery reaches the levels anticipated by the IMF, which could perhaps take us as far as 2022 before we recover the pre-crisis levels of GDP. Unfortunately, as is often the case, it will take longer for employment to recover. It also true that this recovery will be very uneven depending on the economy.

And as for Spain? The IMF predicts a drop in GDP of 8% for this year, with a recovery of 4.3% in 2021. Unemployment will rise to 20% this year, falling by some 3 points next year. Spain would be one of the few major countries with a fall in the average prices this year (three decimal points compared to an increase of seven decimal points next year). The public deficit would reach 9.5% of GDP in 2020, compared to 6.7% in 2021. And, interestingly, although it is perhaps lost somewhat between the (negative) growth and deficit figures, the IMF is predicting that Spain will increase its balance of trade surplus both this year and next year.

Let's take a closer look at that. With the touted very gradual return to (relative) normality, the total loss of the tourism season, the impact of the crisis on activities with intensive employment in an already dysfunctional labour market, the loss of income in the informal economy, so significant in the south of Europe, and a business panorama dominated by microcompanies that survive from day to day, we consider the figures offered by the IMF to be rather optimistic. The fall in GDP will likely be in double digits and must be added to the need to extend many measures already in force for many sectors of the economy with extreme direct or indirect dependence on tourism. Then, if we consider the approval of a minimum subsistence income (essential in the short term but which, experience indicates, will, like any subsidy in Spain, be extended beyond the term announced initially[7]) and the extension of some of the social programmes already established, and the truth is that the public deficit figures for both years and 2020 in particular, will be considerably higher than those projected by the IMF.

Inflation will be effectively zero, although a partial recovery of oil prices and some attempts to recover lost time (in terms of income) in specific sectors or geographic areas in which the disappearance of companies could reduce competition could see a decimal point or two above the IMF projection. For unemployment, these projections, as annual averages of 20.8% (2020) and 17.5% (2021), could be reasonable floors, that is, they will not fall any further) but note that that implies months of significantly better rates.

And a final note on the balance of trade. Spain has, unusually in its recent economic history, enjoyed a balance of trade surplus for seven consecutive years.[8] Certainly, tourism is an important part of that record. Its significance in terms of employment and in obtaining income from overseas will be truly appreciated when it is, to a large extent, lost this year. And if the fear that has spread on a global level is not stemmed, the recovery from the end of this year and in subsequent years could be incomplete. On the other hand, experience tells us that, in a major crisis, Spanish imports plummet. That, and the lower price of oil, might compensate to a large extent for the fall in tourism income. Is it enough to sustain or even increase the trade surplus in 2020 and 2021? Probably not. Therefore, what the IMF projects, even in such a complicated international scenario, is that the Spanish export sector, relatively small in number of companies (for the size of our economy) but which has shown to be exceptionally competitive over the past decade (without resorting to the impoverishing method of devaluation of other times) will be the new, critical element of the recovery. We certainly agree on that. What is needed now, among many things of course is the support of all of Spain's Public Administrations for these exporting companies to be as intense as their competitiveness and our economy requires.

To summarise then, for 2020, that's 0% inflation; a 10% fall in GDP; 15% public deficit; 20% average unemployment rate; and, on a positive note, an improved balance of trade surplus not based solely on plummeting imports.

XI. Many elements of the economic environment have, necessarily, been covered here. But while in time it will be necessary to cover them again in future reports, it is necessary to include three brief notes on structural changes that, presumably, will be associated with this crisis:

- Globalised companies will have to rethink the structure of global supply chains (GSCs). Even if, ultimately, the successive shocks have limited the costs of interrupting the supply of components, the initial phase of the crisis has demonstrated that dependence not only on one country but on a single manufacturing location, has gone too far for many companies. The need to double production points must be included in strategic plans. The supremacy of lower costs over security of supply and avoiding production cuts will no longer be unarguable. The eagerness shown by China, including some rather significant public and private subsidies, to accelerate the return of workers to their workplaces (Hubei Province aside) to re-establish activity is not unrelated to this situation. For the overoptimistic, this reassessment of GSCs does not necessarily or generally imply "reshoring", or the return of these activities that have relocated to developed countries. There are emerging spaces in which to relocate and costs becoming less of a determining factor in decision-making does not mean they will stop importing.
- In parallel with the above, the tyranny of the Just in Time principle, on-demand production and the reduction of stocks to a minimum are also in need of review. One might argue that this is even more true of primary and intermediate goods and components than for final goods. Storage costs will remain important but the interruption of production and potential loss of clients might weigh more heavily.
- On a very different level, a crisis of this magnitude wipes out the least prepared in many sectors. It could be understood as an opportunity for new and better companies to emerge. It's true. But in light of what has been happening over the last few years, one fears that it is

[7] It goes without saying, of course, that the problem intensified if the intention is to establish a permanent minimum income, especially if it is as leniently mean-tested as some authors and politicians propose.

[8] See the *Under the Microscope* section from our Quarterly Report on the Economic Environment for the 4th quarter of 2019 for some reflections on the meaning and implications of current account balances. In what follows, we shall ignore the sub-balances of primary and secondary income, as no major changes in relation to the positions prior to the crisis are expected.

more feasible that that the concentration of production in fewer hands, in almost, or indeed out-and-out oligopolistic structures intensifies. That has never been good news for consumers and for small companies who coexist with these dominant firms, be that as purchasers not to mention as competitors. Don't lose sight, for example, of the airline and automobile sectors.

And a curious point: the changes indicated, if they were to materialise, are inflationary. Would the central banks, who continue fighting to raise inflation rates, especially in the West, appreciate it, or would they be concerned by opening the door to the return to a forgotten world when inflation was a problem?

XII. And to the final point of this extended, twelve-point "*Ten-Point Analysis*". The world is going to change drastically as a result of this crisis. Some of the changes referred to above are strictly economic. But I would like to close by asking the question if we are ready to change fundamental aspects of our civilization. More than a few have speculated regarding the extent to which it is possible for Latin peoples to display their traditional day-to-day effusiveness, for example. It is an interesting question. But I prefer to ask others:

- Are we really prepared to abandon liberal democracy in favour of an imported authoritarianism under the presumption (and presumably a false one at that, truth be known, and if Sweden rather than Italy is taken as a reference comparison) that it is "more efficient" in responding to a serious crisis. Do we really think so little of our system?
- Do we truly believe that a little more security justifies the waiving of certain fundamental rights on a continued basis, something that, at least in the West, has always been understood as the surrendering of freedom in favour of presumed greater security?
- Are we really ready to accept the triumph of the tackiest form of nationalism, of turning inwards on oneself, of ignoring problems, not to mention the contempt for the foreign; the other? Are we really going to give up on sharing our ideas, cultures and experiences and the movement of goods, services, capital and people?
- Are we really going to replace mixed capitalism, which has certainly operated under very unequal models in the current international reality, but which share essential principles; the only system that over the course of history has not only generated long-term economic growth but true socio-economic development? And are we going to replace it with statist models, sustained by the extremes of the political spectrum, with results that were abject in the economic dimension and even worse in others?

Yes, the coronavirus is going to change the world but it would be better for everyone, or at least the vast majority, if it did not in certain respects.

Under the Microscope
A Programme of Action in Response to the Coronavirus Crisis

Ideas for tackling the crisis

In this Report's *Under the Microscope* section, we're going to look at some of the options in the many areas of action we see as necessary, or at least potentially useful in tackling this recession of exceptional magnitude that we are facing. Certainly, some of these measures have already been adopted while several more are being debated. Some may seem more novel. In any case, the intention is not only the immediate response to the crisis but also the medium-term recovery. Some of the decisions taken in recent weeks will also be questioned. This Programme, presented succinctly as necessary, covers a number of areas. Let's begin.

- **Monetary policy**

There's a joke going around asking what would be the first measure the United States would take if there were an alien invasion? The punchline? "Reduce interest rates". It is, nonetheless, a representation of the reality of the last thirteen years and it doesn't just apply to the Federal Reserve. Whatever the problem, reduce interest rates to a minimum and, seen as the impact of that at existing levels is null, embark on asset purchasing. In the absence of an alternative, perhaps there was no other solution but to attempt everything with monetary instruments, first those already employed before the crisis and then with innovations. Something along these lines has happened, initially with resounding failure and subsequent success (see point VII of our *Ten-Point Analysis*) over recent weeks.

Nevertheless, a balanced Programme to combat the crisis and foster the recovery would require each pillar of economic policy to play a role, and monetary policy is quite important enough already without trying to make it all-encompassing. To put it another way, the conversion of all Western central Banks into the Bank of Japan involves considerable risks (which we will analyse in greater detail in the next *Under the Microscope*), and the realisation that it is rather doubtful that they will replicate the success of Japanese monetary policy in recent lustra. So, our Programme would establish the following points in the monetary sphere:

1. Central Banks must continue to unequivocally guarantee the availability of liquidity in the economy and maintain the lines of action that stimulate bank credit. Coordination with macroprudential policy is essential.

2. Private asset acquisitions cannot respond to the principle of purchasing in all segments of the market that show signs of panic. Shifting from "Greenspan's put"[9] to "Kuroda's put"[10] constitutes the introduction of an unacceptable "moral hazard" that would allow investors to operate with an asymmetry (with profits much more probable than losses) leading to increased risks. In this regard, central bankers must limit themselves to taking positions, for a limited time, in low-risk areas of the market, where paralysis is penalising non-financial sectors of the economy (for example, structures based on quality mortgages, in the style of traditional Spanish covered bonds). Even the acquisition of debt over the medium and long-term from private companies classified as investment (that is, with a high probability of fulfilling the commitments assumed upon issuing) is debatable, because it constitutes a financing advantage to those companies over those who do not resort to the markets. In Europe where the secondary markets are home to few companies and lack depth, this is an even more important distinction to make.

3. In relation to public debt purchasing, it is certainly true that, with its roots in the Great Recession, the central banks are here to stay. Along with forward guidance (or providing information on future monetary policy intentions), these acquisitions are the unconventional monetary policy measures that are going to become conventional. Nevertheless, that implies that central banks must become an instrument for the removal of fiscal policy restrictions (which, incidentally, it is easy to sustain, is happening in the Japanese case). There must be justification, based on the exceptional nature of the situation in order for these purchases to go ahead.

We are, undoubtedly, currently in a situation that does require it. To the degree necessary to reverse the crisis. In the case of the European Central Bank, its Pandemic Emergency Purchase Programme, encompassing the purchases already planned, would allow it to comfortably absorb all the debt issued by the governments of the Eurozone in the fiscal battle against coronavirus. That said, resorting to indebtedness will be different for each country because of the healthcare, social and economic impact. For that reason, the ECB must ignore, at least for two years, the self-imposed limits regarding the maximum percentage of public

[9] Reference to the continuous interventions of former Chair of the Federal Reserve, Alan Greenspan, to tackle alarming signs in the markets with expansionary monetary policy in an utterly asymmetrical manner (it did not produce equivalent contractions in the signs of excess in the markets).

[10] This is not a common term in the economic literature, unlike the other, but merely an analogy on the part of the author in relation to massive interventions in all markets by the Bank of Japan, especially under the current Governor. The BOJ's balance sheet now exceeds Japanese GDP and continues to grow, making it unthinkable for it to ever withdraw from the public debt market or even the stock market. Such is the dependence of the markets on BoJ purchases.

debt each member of the Eurozone can accumulate, and the capital key in their acquisitions or the fact that the purchases they make must be in line with the weight of each member in the Eurozone.

4. Naturally, if it wants to recognise the exceptional nature of the current situation and this would be a novel approach to the issue of the new debt generated, it could carry out specific debt issues, for the sums required to combat this crisis, structure it as perpetual debt with the interest rate linked to inflation. That would achieve the following:

* Insofar that that capital does not have to be repaid, no government would be punished for an event over which they had no responsibility or control.

* It is likely that the sum of additional money injected would fuel an inflationary surge but, in any case, linking the cost of this debt to the rate of inflation would align the governments with the price stability objective of the central banks.

* With the cost of debt equal to the rate of inflation it would be simple, from the second year, having already overcome the crisis, to generate resources to meet this cost.

* Given the rock-bottom interest rates even over long terms, the public debt of the major economies would be attractive for more than a few private investors, with the commitment of central banks to prioritise such acquisitions over any other government-issued debt.

* With these privileged conditions for debt issue, it would make sense for a body independent from the governments to ensure that the purpose of this debt does indeed correspond to combatting the virus and the socioeconomic consequences directly. In the EU there is no doubt that the European Commission would be the body to fulfil this role and this should be the compliance requirement established for the governments. A term limit would also be applied to the programme.

5. Turning to the developing world, an extension of currency swaps between the Federal Reserve and other central banks for as long as possible in terms of assumable risk would be desirable. Although these lines to guarantee the availability of dollars are already in place with much of the OECD and some emerging countries, and have been extended recently, they could possibly now be extended to monetary authorities hitherto excluded.

6. Finally and staying with emerging countries (and developing countries although their options are limited), central banks must continue to manage reductions in interest rates and public debt purchases prudently. This support is also necessary for these economies, but the urgency of maintaining or even recovering private capital that has taken flight from those economies should not be lost from view and, therefore, the depreciation of their currencies should be avoided where possible. Furthermore, drawing upon currency reserves, where they exist, is always a tricky issue but as has been demonstrated from Russia to Mexico and from Brazil to Egypt, the time to use them, precisely to contain significant depreciation, is in times of crisis, but acting prudently at all times. So if not now, when?

We'll return to the developing economies shortly.

- **Foreign exchange policy**

Every country, whether developed or in development, will act in line with their possibilities in the monetary sphere. The former with few restrictions and the latter with a close eye on the performance of their currency. And that should be all. The last thing needed now is a “currency war” like that described in our first Quarterly Report.

- **Fiscal Policy**

We have already advanced, in point VII of our *Ten-Point Analysis*, the general profile of the fiscal policy from the outbreak of the crisis. This time, the doubts evaporated rapidly, because without major fiscal expanison there is no exit from the abyss in which the world economy is mired. This comes with a preliminary comment which the reader can skip over if they wish to focus on the proposals and their assessment.

As a result of the Great Recession, the notion of just how unacceptable it was for governments to be forced to act to rescue a private sector whose recklessness had led to a monumental became widespread in certain sectors. It didn't seem to matter much that most of the private sector had nothing to do with the crisis other than suffering from it. Nor does it seem to matter that the regulators of the system as a whole, which tolerated the recklessness in the financial systems, and the central banks that fed those excesses with interest rates that were too low, were public institutions. Not to mention the governments themselves, whose fiscal standards (from property subsidies to favourable treatment of debt in respect of capital) contributed to the escalation of certain asset bubbles. Although it is even more ironic that Spain is one of the countries where this myth has been bought into most, precisely once of the places where the segment of the financial system that collapsed, and that generated the most damage to the economy and its international credibility, was in the hands of public rather than private management, as was the case of the *Cajas de Ahorros* or savings banks.

But in recent weeks a new narrative is forming, albeit with certain discretion still; a new narrative, the intellectual poverty of which it is difficult to find precedent for. It is that once again the public sector must come to the rescue of a capitalist system whose private sector has collapsed. That is, that governments, without doubt in the exercise of their legitimate powers conferred by citizens in democratic societies (and their not so legitimate powers self-assigned in non-democratic societies), and in search of what is best for their countries have ordered the closure of much of the private sector. And it takes advantage of this paralysis, ordered by the public sector, to defend the notion that capitalism has failed again and who better than the governments to manage everything! There are no words.

Let us return to the Programme of proposals.

1. It is a priority to sustain the income of all those removed from the labour market due to the crisis, especially the groups in more precarious situations. But, what's more, it is necessary to extend this assistance to those who did not participate in the labour market or who did so irregularly in the black economy. This is a structural issue to be resolved in the south of Europe but now is not the time. When that can be achieved with internal adjustments in employment, and paying a substantial part of the salaries with public money on a sustained basis until activity is resumed, it is a measure that should be pursued. Where this is not the case, a minimum basic income should be introduced although it should be limited, probably for no more than four to six months. In our opinion, a permanent unconditional or leniently means-tested minimum income would constitute a monumental error, devastating in terms of incentive and the message transmitted to society, not to mention the cost. We can argue it, if necessary, in future Reports.

It would be preferable if this minimum basic income were absorbed by the rest of the provisional supports implemented in different countries, with the exception of the cost of housing, for which the payment of rent or mortgages can be postponed for at least one quarter and distributed over a subsequent period of less than one year. Bridging loans for property owners who let apartments would mean that this group would not be penalised until they recover the deferred rent. The short-term deferral of mortgages could be absorbed by the banks, who we shall return to later. Remember that all of the above would be limited to those groups that are especially vulnerable, to a large extent as a result of the crisis.

2. It is no less of a priority to sustain the productive apparatus of the country. If that collapses, there will be no recovery. Companies of all sizes and the self-employed must be allowed to benefit based on the degree of income lost, of fiscal deferral, and the loans guaranteed by the Government, repayment of which should begin within six months of being granted and at interest rates that should not exceed those for the financing of public debt plus a modest differential for the work of the banking system which is essential in the articulation of these loans. Note that access to these loans would be restricted to the companies that were viable before the crisis. In determining this, the banks would play the key role.

As in the case of the first series of measures, the paperwork in this second block must be reduced to the minimum require to prevent fraud. This would undoubtedly be an issue in any country, but it cannot be an insurmountable dissuasive factor in articulating these measures in a flexible manner).

3. Large companies must be able to join these credit programmes, and some of them will even benefit from the asset purchasing of central banks (in Anglo-Saxon countries, even not-so-large companies too). We reject the idea that it might be the time for the State to enter private companies indiscriminately as a shareholder. Any tortuous attempt to increase the control of governments over economies would be a terrible idea. If, in the opposite extreme, it is an attempt to save private companies, often badly managed, with no future, this would be an equally terrible option. To avoid undesirable acquisitions by third parties, as we shall analyse later, there are less distorting options.

4. In the specific case of the European Union, do we not need joint actions to facilitate the work of national governments, especially in the countries most affected by the crisis? Is it not time for

“Coronabonds”? The response to the first question is a resounding yes, politically, from the perspective of the future of the EU, and economically. A debacle in Spain and Italy would leave no one unscathed. But the response must be rapid, with existing or rapidly articulable mechanisms. The conditionality must be limited to verifying that the money requested is actually used in the fight against the coronavirus. And this is what was decided on 3 April last (see point VIII of our *Ten-Point Analysis*) with a longer delay than was necessary. The efforts of some (in the North) to add conditions of structural change, probably necessary but not relevant to this debate, and (in the south) in mixing European collaboration mechanisms, which should also be structural in nature, but at the appropriate time, have led to a delay in the availability of the funds and a crass debate that only serves to increase nationalism and even hatred between Europeans. At least the €540 billion package is now on the way.

And what about “Coronabonds”? They don’t make sense within this framework and not just due to utter absurdity of the term itself, but for three important reasons: Firstly, the question of the mutualisation of European debt has been the subject of intense debate for more than a decade, with little progress. Any attempt to resolve the issue overnight by putting the issue of tens of thousands of deaths on the table is not only repugnant (even more so than the lamentable statements that certain European politicians, particularly the Dutch, are wont to make both during and outside crises) but it is devoid of any arguments, political or economic. The second reason is that the money is needed urgently. A complete programme of a new type of bond requires months of preparation; volumes, the structure of the programme, the body responsible, decision-making mechanisms, link to national debt, guarantees and distribution of same, obtaining ratings, placement formulas, etc. Do those who support the “Coronabonds” argument really want to receive the money in 2021 to tackle the crisis of the first half of 2020? It will be too late. The third argument is that Eurobonds are too important to use them as a joint mechanism.

In effect Eurobonds, the issuing of European debt with the joint backing of all the partners should be a mechanism through which the 27 Member States finance coordinated actions that respond to the future challenges to Europe: new physical and technological infrastructures, new environmentally-friendly growth, new industrial ecosystems in cutting cutting-edge sectors anticipated by Thierry Breton, Commissioner for the Internal Market, a support programme for developing countries and comprehensive, orderly management of migration. These and others are the structural questions for which Eurobonds must be created and expanded. And opening the door to other joint mechanisms, such as European Unemployment Insurance, which addresses deviations in natural unemployment rates in each country (not the current level, as some suggest, because that would lead to the continued transfer of resources from the North to the South of Europe, understandably rejected by many EU countries), especially important when the shocks suffered by EU Member States are asymmetrical in nature. Or to finally complete the European Banking Union, for which the problem of the Single Deposit Guarantee Scheme must be resolved, definitively cleaning up the legacies of the past and proceeding to the constitution of same.

Perhaps it is a dream? It shouldn’t be if Europe wishes to be one of the main powers in a multi-power world, something that no European state can achieve alone.

- **Macroprudential policy**

The movement of some of those responsible for macroprudential policy have been pertinent over recent weeks: offering the carrot in the form of relaxation of some risk weighting criteria such as calculation for capital, the use of countercyclical capital buffers (broadly, this means reducing or removing CCyB in various countries) or deferment of the compliance date for some regulatory aspects in the process of being implemented. The stick comes in the form of limitations (or, directly, prohibitions) of payment of dividends and share buy-backs on the part of banks, and warnings in relation to the payment of bonuses to staff. While that many lead to indignation among some (the noise made by Hong Kong retail shareholders in HSBC due to suspension of dividends ordered by the Bank of England is a poignant case in point), the banks must maintain capital positions as solid as possible to absorb this additional risk, in order to keep credit flowing to a productive system that is going through a critical situation which we all hope will be a short-term one. The support of central banks is, as well its own management, the other support needed so that all entities can weather the storm. A banking crisis is the last thing the global economy can afford at this time.

What remains pending, but would be interesting to begin to intensify, is the more intensive and effective regulation of the non-financial banking sector whose size, taking advantage of regulatory arbitrage (toughening of bank regulation and laxity for the rest of the system under the argument that they do not involve deposit-holders nor have direct access to privileged financing from central banks) has grown from

100 billion dollars to 180 billion dollars between 2008 and 2019. And the risks across diverse segments of the market seem only to grow at the same pace as the money transacted.

- **Labour Market Policy**

Certainly, more than a few countries, Spain among them, require structural reform of their labour markets. But these types of reforms cannot form a response to the current crisis. In this regard, aside from the measures to sustain income already described above, the mechanisms that incentivise internal rather than external adjustment (layoffs) in response to the crisis are the most appropriate, at least from the European perspective. In the United States, for example, another policy that gives absolute flexibility to companies for hiring and layoffs, although even there parts of the assistance measures rolled out by the Trump Administration are conditional upon the companies holding on to the majority of their employees.

The articulation of formulas along the same line as the German "kurzerbeit" system is pertinent here. Working hours (in part used for training) and salaries are reduced, and a percentage of the salary is covered by the State, which saves on unemployment subsidies. Given the unique nature of the crisis, the percentage of these salaries being covered by public funds goes far beyond the traditional percentage in the German scheme (or has reached full coverage) and the reduction of hours has been complete. It is likely that, with activity and demand returning progressively, the design of transition schemes where the increase in hours is gradual, along with the recovery of regular salaries and their payment by the companies, is better than an automatic change, whenever it occurs, from "crisis model" to "normal model". But with no prior experience, it is not easy to articulate these intermediate schemes.

The problem with the absence of a transition mechanism, such as Spain's Temporary Suspension of Employment (ERTE) is that when a period of guaranteed employment comes to an end, there may be a cascade of layoffs. In the case of bogus behaviour on the part of employers, there will be little alternative. If, however, as is more than likely, most of these layoffs arise from an insufficient level of activity, it is likely that these transition schemes to new types of internal adjustment, from ERTEs to normality, could save many jobs. In any case, we hope that domestic and international demand grows sufficiently over the coming months to avoid any deferred crash in employment.

- **Sustainability Policy in the Developed World**

In the European context, the idea that we all exit the crisis or the European Union faces an uncertain future is oft repeated. We can extrapolate that argument to say that, on a global level, either developing countries also exit the crisis or there will be storm clouds hovering above the world economy and society.

As documented in point IX of the *Ten-Point Analysis*, recent weeks have seen a number of different proposals emerge and some actions implemented on the part of international bodies, naturally starting with the World Bank, through the IMF and the G-20, as well as specific countries and private foundations. Below we look at these alternatives and point to a few additional ones:

1. Direct short-term assistance to combat the pandemic and its effects is essential, both in terms of health resources and cash. Insofar as possible, these supports must come in the form of financial aid or, at the very least, at appropriate interest rates for developing countries. This category would include full availability of the International Monetary Fund quotas to which the countries are entitled, in the form of Special Drawing Rights,[11] and no further conditions beyond the funds being used for appropriate purposes. This might prove insufficient, however. It might be quicker and more suitable to extend the volume of liquidity available to these countries (developed countries are not going to use this resource) than to undertake another massive issue of Special Drawing Rights. The IMF has the equivalent of one billion dollars to lend, and it should not be shy in using it in emerging and developing countries that need it.

2. Deferment of interest payments for a period of no less than one year. Of course, official debt, both

[11] Special Drawing Rights, despite the unattractive name is the "currency" of the IMF. Comprised of a basket of the major currencies (US Dollar, Euro, Pound Sterling, Japanese Yen and Chinese Yuan), countries pay their annual IMF quota and, based on this quota, have the right to receive liquidity in this "currency". Obviously, poorer countries have lower quotas in accordance with their income and, therefore, what they can receive is limited.

multilateral and bilateral, must be included. Including private creditors will not necessarily be easy in all cases and it will be necessary to assess the legal possibilities of forcibly doing so, although the moral persuasion of international bodies and governments in major countries can be very convincing. Partial debt forgiveness in some extreme cases should not be ruled out.

3. A type of "probity certificate" issued by the IMF to the financial markets for developing and emerging countries that request it, explicitly recognising their appropriate use and prudent movement of interest rates, asset purchases and use of reserves could be an important signal to international investors, preventing depreciation of the currencies of these countries.

4. The idea of the Bretton Woods institutions creating a Fund for Debt Acquisition for poor countries in the secondary markets, taking advantage of massive discounts on debt in such markets (it is not difficult to find situations where for every dollar, two or three more of live debt can be absorbed) has been floated with some frequency for some time. It is certainly an interesting concept. Nevertheless, there are two problems. The first is an obvious one of anticipation; once the fund is announced, the price of debt for the countries likely to benefit will shoot up to levels approaching the nominal rate, defeating the purpose of the initiative. The second is a political one; there would likely be a major debate around which countries, and under what conditions, should benefit from debt relief under the new mechanism.

5. Perhaps for the moment it would be best to resurrect another idea being touted in different quarters regarding the best way to finance developing countries, especially where several, though not all, have shown a demonstrable improvement in their macroeconomic management. Issuing debt and substituting (part of) the position with bonds linked to economic growth would allow, firstly, international investors, at a time of poor rates in the developed world, to share in the emerging economy bonanza and in development where they grow robustly, something which is not exceptional. Secondly, the countries themselves would be freed from interest payments in the troughs of the cycle (a concept that should not only apply when they are mired in recession).

- **Other Measures**

Although these ideas can multiply, it is now the time to close this working programme of measures to tackle the coronavirus crisis. Allow us to do so with a few additional points:

I. it goes without saying that the healthcare emergency we're experiencing calls for, in addition to making all measures available to combat the virus and subsequently control it (the much sought after vaccine), a revaluation of the resources available, nationally and globally, to tackle any potential re-emergence of the problem, very feasible in such a globalised world. These efforts, in prevention measures, treatment, qualified professionals and research must be global in orientation and rooted in public-private collaboration, two characteristics observed in few fields (aerospace would be one example).

II. There is understandable concern for the possibility that certain players might take significant position in Western companies, taking advantage of the collapse of their share prices. Generally, somewhat euphemistic reference is made, for example, to "non-European companies with state backing" when referring, unequivocally, to Chinese companies. The idea of Western governments taking positions in these companies at risk of suffering these hostile takeovers has aslo been raised.

As briefly mentioned, there is no need whatsoever for such generalised intervention on the part of governments. There are certainly better uses for these funds. The direct prohibition of taking these positions or the re-emergence of "golden shares", which allow governments to temporarily veto the acquisition of a significant number of shares where it deems appropriate, are mechanisms, ranging in forcefulness and less complicated to reverse, thus avoiding the temptation to prolong State involvement in these private companies. Of course, these limitations should also apply to different types of investment funds as well as government-backed companies. Remember that such measures should be strictly temporary, although there should be ongoing control in relation to the behaviour of large companies from emerging countries backed by their governments and benefitting from preferential financing arrangements.

III. What a perfect time to reverse the protectionist tide and resurrect multilateral collaboration as a means of overcoming the obstacles that undoubtedly exist in order to guarantee faithful global trade without perverse mechanisms that generate unfair advantages.

IV. And of course it must be briefly mentioned, because it does not form part of a Programme like that designed here, that structural reforms, differing between each economy, have, to a great extent, been left to one side due to how easy it has been over the past decade to amble on with monumental monetary expansion. They have to be tackled and preferably in the near future.

Some of these structural transformations, including, for example, the fiscal treatment of multinational companies, cybersecurity and data protection and storage, or the reorientation of the economic system towards another more compatible with climate change depend, undoubtedly on international cooperation.

It would however, form part of different Programme of Action and we have already covered what we intended here.

Valencia Containerised Freight Index

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