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Monetary Policy Stance and COVID-19 Pandemic: Global Perspectives

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Abstract

This policy note reviews the stance of monetary policy in global perspective based on some key macro-monetary indicators in order to understand the effectives of the stance and the challenges for growth recovery, employment generation, and containing inflation at desired level. The note finds slower economic recoveries in emerging market economies than that of advanced economies. The note concludes that extraordinary and accommodative monetary policy is likely to continue both in advanced and emerging economies to secure the sustained recovery despite the inflationary pressure and building up inflation expectation may persist. In addition to the intensified inflationary pressure, newly emerged COVID-19 variant Omicron, tightening of US monetary policy, and China's slower growth prospect have been creating new uncertainties in maintaining prudent monetary policy stance.

I. Introduction

The global economy has started to recover propelled by strong fiscal and extraordinary accommodative monetary policy and rapid inoculation against COVID-19. The policies so far have taken globally have impacts on growth, employment and inflation. Bangladesh is not the exception and has taken prudent fiscal and extraordinary expansionary monetary policies since the wake of the COVID-19 pandemic in the country. In this backdrop the policy note reviews the stance of monetary stance in global perspective based on some key monetary and economic indicators. With a view to understanding the policy stance the note also review whether the policies are consistent across the countries and how they be effective to recover growth and employment while controlling inflation.

II. Recent Economic Trend

II.1 Output Growth

The IMF in its latest World Economic Outlook published in 2021 predicted that the global economy will grow at 5.9 percent in 2021, after the estimated contraction of -3.12 percent in 2020 (Chart 1). The 2021 growth projection is revised down 0.1 percentage point relative to the previous forecast, reflecting asymmetric access to COVID-19 vaccines for different country groups despite vast sums of fiscal supports with easy monetary condition, particularly in many large economies. In advanced economies, the growth rate is projected at 5.2 percent in 2021, being contributed by successfully vaccination coverage, significant innovations in macroeconomic policy and massively scaled-up fiscal support, following a severe contraction of 4.5 percent in 2020. Emerging market and developing economies expect 6.4 percent growth in 2021 against -2.1 percent growth in 2020, which indicates a lesser impact towards achieving strong recovery, as effective vaccine protection remains unavailable for most of the population in emerging economies caused disruptions in economic activities

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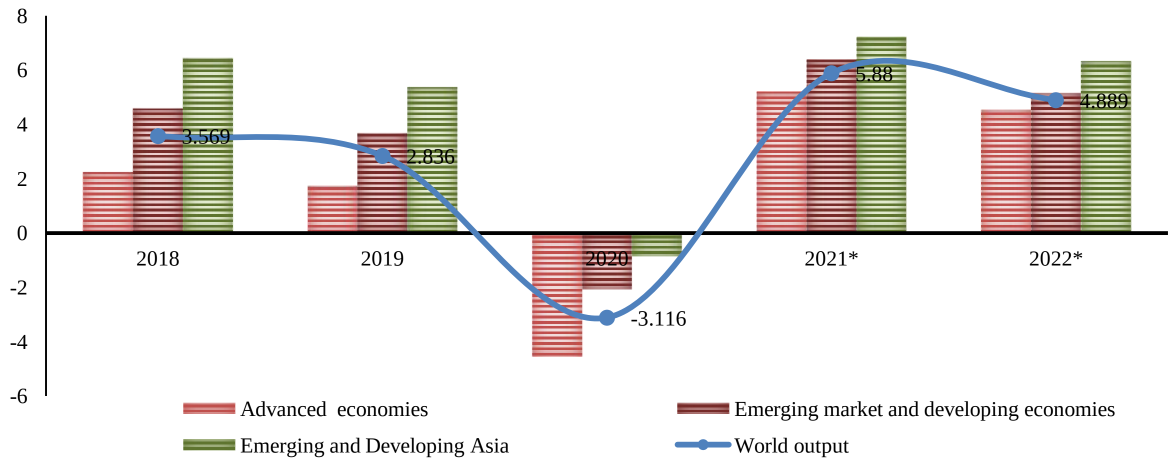
associated with continued lockdown and containment measures. The growth rate for emerging and developing Asia, a regional group of emerging market and developing economies, is projected at 7.2 percent in 2021, revised down by 1.4 percentage points, reflecting weaker than expected recovery followed by eased lockdown in some large countries.

Chart 1: Output growth of global, advanced and emerging economies (in percent)



Source: World Economic Outlook, October 2021, IMF.
Note: * indicates projections.

Overall, the economic recoveries are divergent across countries and sectors, linked to clear differences in the pace of vaccination programme, the extent of policy support, and structural factors such as reliance on tourism and commodity exports. The United States among advanced countries, for example, is expected to surpass its GDP level in 2021, while other advanced countries will achieve their pre-pandemic levels only in 2022. Among emerging market and developing economies, on the other hand, China had crossed already its pre-pandemic level in 2020, while many other emerging countries will need to wait until 2023 for a complete recovery. The divergence may even occur within country as income inequality is likely to increase because the pandemic heavily affected young labor force and those with relatively lower skills both in advanced and emerging economies, whereas severely affected female employment in the latter group of countries worsened the disparity, according to the IMF (Fiscal-Monitor, IMF, October 2021).

Chart 2 reviews the growth rates of selected countries both from advanced and emerging economies. The United States is projected to grow at 6.0 percent in 2021, 0.4 percentage points lower than forecasted earlier, due to large inventory draw downs, supply disruptions, and softening consumption. GDP growth in Euro area has been revised up by 0.6 percentage point to 5.04 percent in 2021 but the activity is expected to stay below pre-pandemic levels until 2022, while experiencing increased costs for public health responses to infection, flexibility and adaptability of economic activity to low mobility, and structural rigidities. China's swift recovery in 2020 to pre-pandemic level helps to project a sustainable growth path, reaching 8.02 percent in 2021, facilitated mainly by effective containment measures, a forceful public investment response, and central bank liquidity support.

Chart 2: Economic growth of selected economies in advanced and emerging countries (in percent)

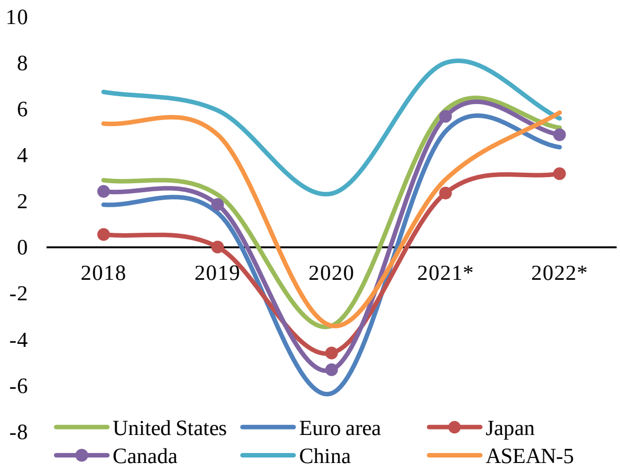
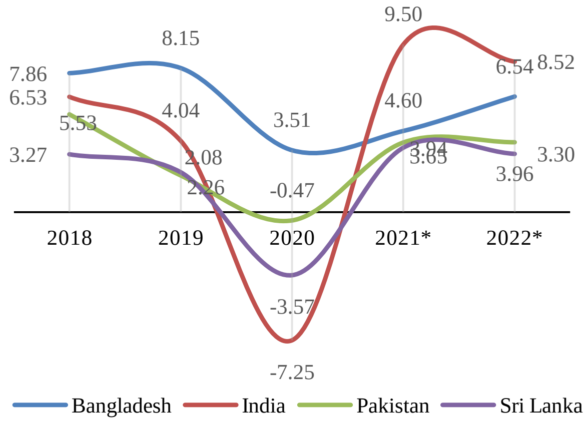


Chart 3: Economic growth of peer countries: South Asia(in percent)



Source: World Economic Outlook, October2021, IMF.
Note: * indicates projections.

While reviewing growth performance of selected South Asian countries as shown in Chart 3, only Bangladesh maintained a positive growth rate at 3.5 percent in 2020, and the following growth projections are 4.6 percent in 2021 and 6.5 percent in 2022, according to the IMF. The Chart also shows that India witnessed a sharp negative growth rate (-7.3 percent) in 2020, but expects a bounce back at 9.5 percent growth rate in 2021, reflecting stronger than expected recovery after lockdowns were eased.

II.2 Commodity Prices and Inflation

Oil price is projected to grow by 59.1 percent in 2021, consistent with the projected global recovery, in part reflecting a temporary tight demand-supply balance maintained by OPEC+ as expected (Chart 4). The IMF in its WEO assumes that the average price of oil will decrease from USD 65.68 a barrel in 2021 to USD 64.52 a barrel (-6.3 percent) in 2022, resulting mainly from a substantial production recovery of higher-cost producers in non-OPEC+ countries who might be induced by persistent oil prices close to USD 60 a barrel. Nonfuel commodity prices are expected to rise faster than previous projections.

A faster-than-expected economic recovery is boosting prices as supply chains have been struggling to keep up the economic trend, persuading inflation projection to be increased from 0.7 percent in 2020 to 2.8 percent in 2021 for advanced economies (Chart 5). However, the inflation is unlikely to increase much, reaching 2.3 percent in 2022, as inflation expectations are well anchored around central banks' inflation target in advanced economies. Inflation expectations are also generally anchored in emerging and market economies as observed in gradual declines to 5.5 percent in 2021 and 4.9 percent in 2022. However, the inflationary developments were not uniform across the emerging countries. Some countries or regions have experienced limited scopes of monetary accommodation, rapidly rising food inflation and temporarily high headline inflation, which could raise inflation expectations in emerging economies.

Chart 4: Global commodity prices, in percent (year on year)

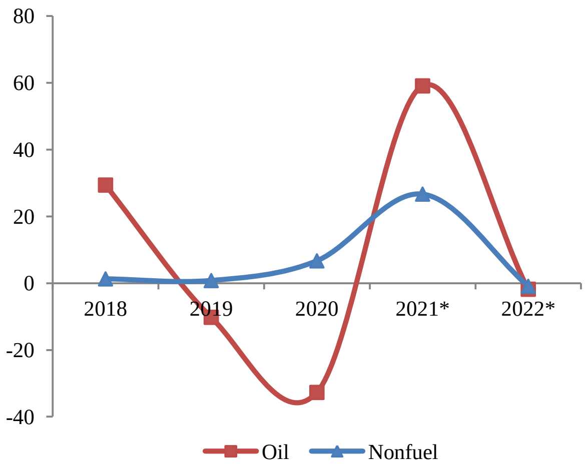
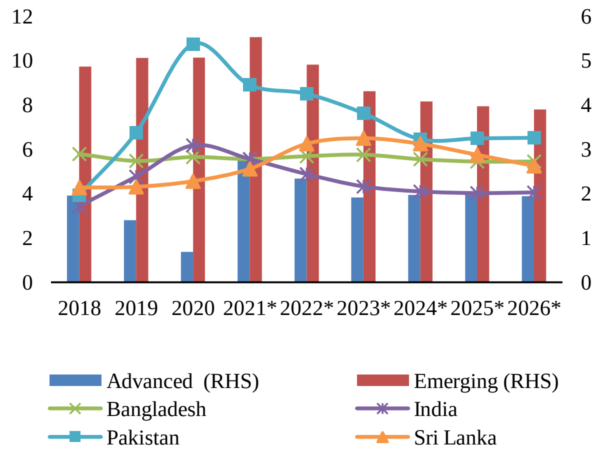


Chart 5:Consumer prices: global and emerging markets and selected peer countries of South Asia (in percent)

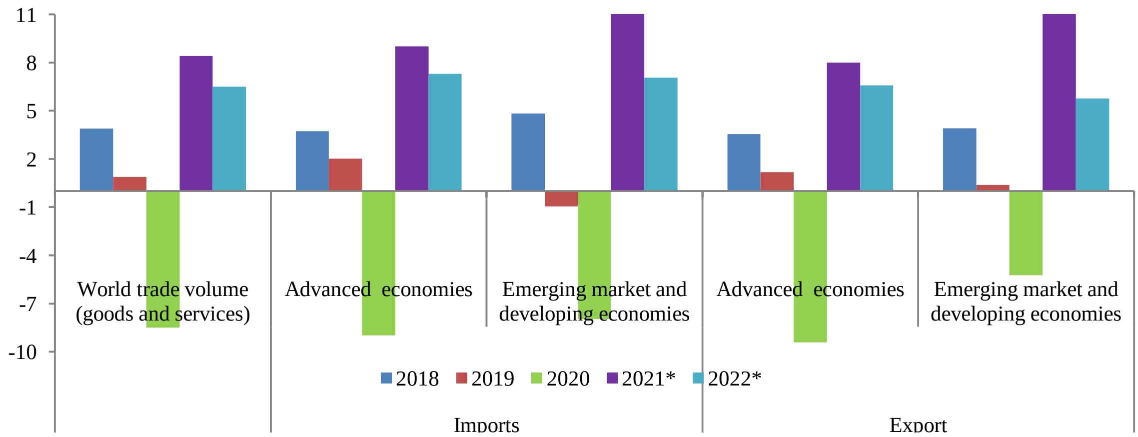


Source: World Economic Outlook, October 2021, IMF.
Note: * indicates projections.

II.3 Global Trade

World trade witnessed a larger contraction of 8.5 percent in 2020 as contact-intensive sectors experienced a sharp fall in activities with much smaller trade intensity than manufacturing. Global trade began recovering in the second half of 2020 and is projected to pick up at 8.4 percent in 2021, reflecting pent-up demand for consumer durables from advanced economies and resumption of supply chains in emerging markets (Chart 6).

Chart 6: Global trade and imports and exports (in percent)

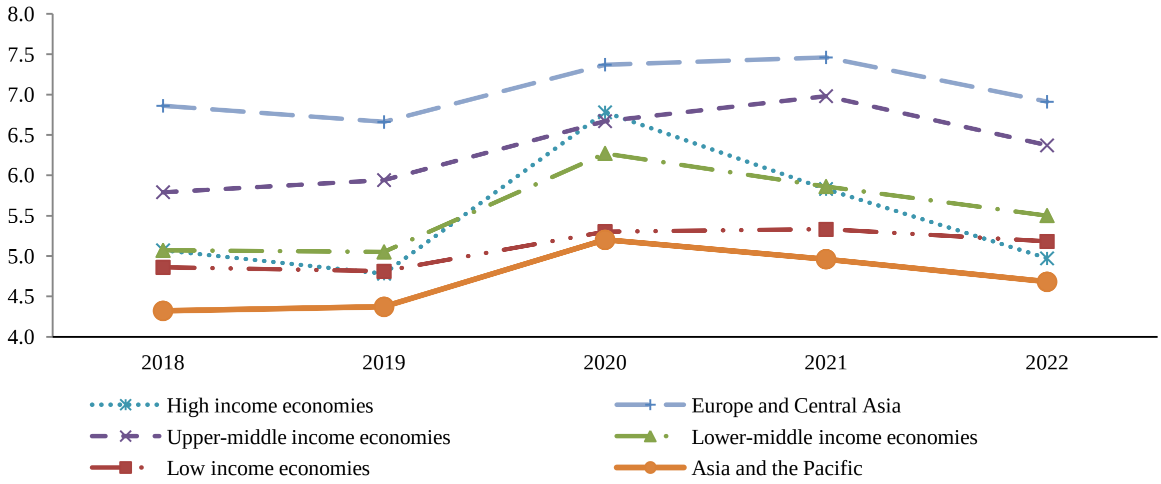


Source: World Economic Outlook, October 2021, IMF.
Note: * indicates projections.

II.4 Labor Market Developments

The COVID-19 pandemic shock continues to generate widespread disruptions in labor markets across the countries, even with extraordinary policy supports already deployed. Average unemployment rates are up during the pandemic periods as compared with pre-pandemic rates in all types of economies as shown in Chart 7, according to the ILO data.

Chart 7: Unemployment rate at age 15 years or above (in percent)



Source: International Labour Organization(https://ilostat.ilo.org/topics/unemployment-and-labour-underutilization/).

The pandemic shock is also accelerating worker relocations, in part shifting away from sectors and occupations that are vulnerable to online based businesses. However, this relocation comes at a high cost because the relocated workers who switch are lower paid. Therefore, the argument is to find out whether job retention policies can help reduce job relocation or supportive measures for worker relocation can gear up job finding prospects. An IMF analysis (discussed in Chapter 3 of the October 2021 WEO) finds that job retention policies are extremely powerful when the current pandemic shock is acute and maintaining high social distancing is inevitable. On the other hand, relocation policies can help ease the adjustment to the permanent effect of COVID-19 shock on labor markets. Therefore, a careful monitoring on the intensity of COVID-19 is critical to understand the appropriate timing to cope with the reduction of job retention policies, or to switch towards greater reliance on relocation.

II.5 Growth Recovery and Uncertainty

Looking forward, the world output growth will decelerate to still a strong 4.9 percent in 2022, up from its April 2021 forecast of 4.4 percent, based on the assumption that vaccines will be accessible in most countries by the second half of 2022. However, the outlook still remains a high degree of uncertainty as new virus mutations including the Omicron variant and the accumulating human losses are growing, particularly in many emerging countries.

Faster recovery and further fiscal support largely by expansion in the U.S. may build up inflationary pressure and could require raising interest rates earlier than expected. Such sustained inflationary pressure along with higher US interest rates could lead to a sharp tightening of global financial conditions. Emerging economies may feel burnt of such higher interest rate and inflationary pressure generated through spillover effects in exchange rate, yield rate and capital flows, while many of emerging countries are still struggling to recover the growth.

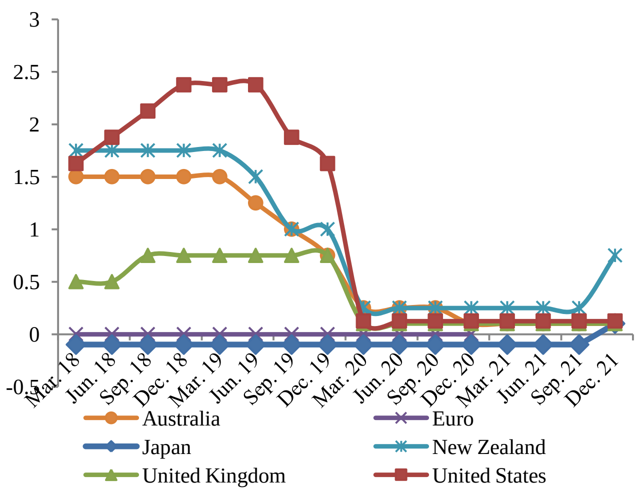
In between the global inflation developments, many countries are also facing rising commodity and food prices, putting low income peoples at risk. Besides, disrupted labor markets because of the pandemic worsened the peoples' purchasing capacity and led income inequality to a significant level, indicating a need for income support for the vulnerable segment of laborer before the market conditions normalize, while in parallel incentivizing job creation initiatives, in addition to job retention or relocation policies.

III. Monetary Policy – Global Developments

III.1 Developed Market Economies

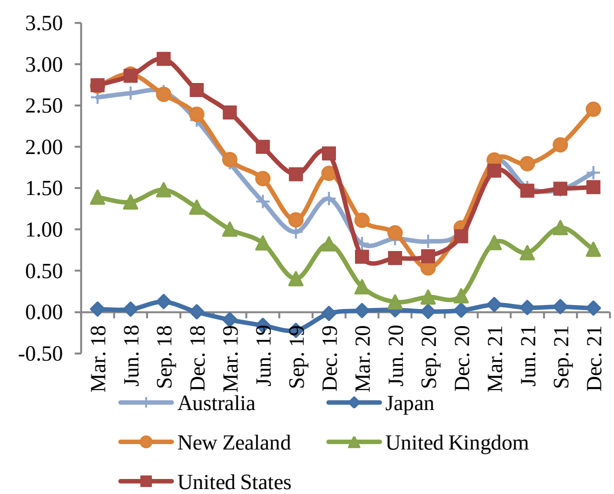
Central banks in advanced economies such as Bank of Australia, Reserve Bank of New Zealand, Bank of England and Federal Reserve of US cut their policy interest rates in March 2020, while Euro and Japan continued to maintain near or at zero interest rates over the years, reflecting considerably lower policy rates in more than 10 years after the global financial crisis. The policy rates in some countries started creeping up from September 2021 and continued till December 2021 (Chart 8). Given that policy rates are already very low in many advanced economies, policymakers needed to rely on unconventional monetary policy tools to stimulate the economy, countering the future downturn.

Chart 8: Central bank's policy rate of selected advanced economies (in percent)



Source: Bank for International Settlements (BIS) till 8 December 2021, (https://www.bis.org/statistics/cbpol.htm).

Chart 9: 10-year government bond yields of selected advanced economies (in percent)



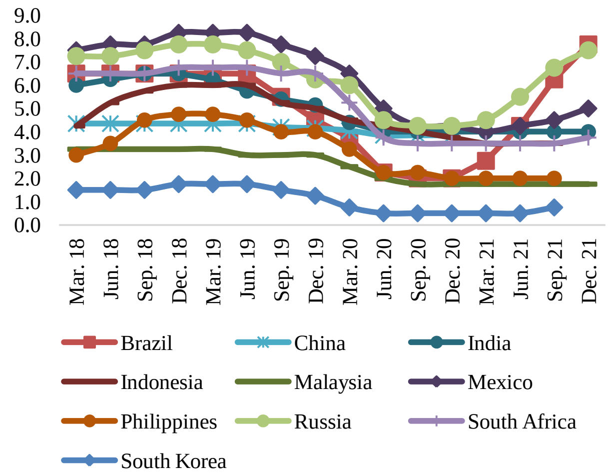
Source: Investing.com till 8 December 2021, (https://investing.com).

Ten-year government bond yields of selected advanced economies have a declining trend since December 2018 until December 2020, reflecting a combination of lower return on safe assets and compression of risk premium (Chart 9). However, the yields on 10-year government bonds increased in March 2021 in all the selected advanced economies except Japan, almost matching their pre-pandemic levels. In December 2021, yield curves showed mixed trends since yields on 10-year government bonds increased in some countries and decreased for some other countries. The increased rates reflect improved prospects for inflation and growth. However, such an increase, if it is rapid and persistent, may result in a re-pricing of risk and a sudden tightening in financial conditions, which may elevate financial vulnerabilities and macro-financial instability on the back of ongoing COVID-19 shock.

III.2 Emerging Market Economies

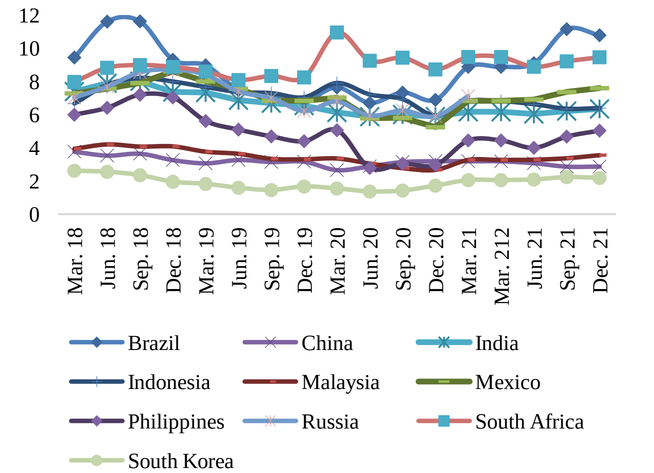
Following the policy rate cut in March 2020 in response to COVID-19 inflicted shocks, overall, central banks in emerging market economies have been maintaining low interest rates throughout the periods of 2020. Afterwards, Chart 10 shows that a tendency of rising the rate is seen in some emerging countries such as Brazil, Turkey, Pakistan, and Russia in March 2021 and the rising trend continued in December 2021. Government bond yields for many emerging market economies have increased since January 2021 though experienced mixed trends till December 2021, reflecting recent increase in market volatility (Chart 11).

Chart 10: Central bank's policy rate of selected emerging market economies (in percent)



Source: Bank for International Settlements (BIS) till 8 December 2021, (https://www.bis.org/statistics/cbpol.htm).

Chart 11: 10-year government bond yields of selected emerging market economies (in percent)



Source: Investing.com, (https://investing.com) till 8 December 2021.

IV. Monetary Policy Stance in Bangladesh

Bangladesh Bank has been pursuing an accommodative and expansionary monetary policy stance from 2020 in order to tackle the pandemic induced economic slowdown. The BB undertook a wide array of investment and employment enhancing policy measures such as; relaxations of various policy interest rates, introduction of low-cost refinance schemes and credit guarantee schemes, allowing moratorium facilities, extended time for realizing export receipts and import payments, supports towards implementing the stimulus packages of the government. All these policy measures were taken to ensure easier and better access to finance for the people as well as CMSMEs. Consequently, Bangladesh economy started showing early signs of a broad-based economic recovery since Q1FY21, reflected by the various macroeconomic and financial indicators which continued in Q3FY22.

V. Conclusion

Advanced economies are expecting to raise medium to longer term yield rates, which may disrupt emerging bond markets and currencies and cause some portfolio outflows. Many emerging countries with slower economic recovery or limited access to vaccines may face daunting challenges, if medium to longer term yield rates continue to rise in advanced economies, which may have adverse spillovers to emerging market and developing economies, inducing them to tighten financial conditions, when they have, in fact, large financing needs. Additionally, with rising prices in the global commodity markets, inflation started behaving abruptly from the third quarter of 2021 and is expected to remain elevated in 2022 in many countries. Therefore, monetary policy has to work with tight situation to tackle inflation and financial risks and support the economic recovery. Consequently, policies should be formulated by mapping contingent actions, announcing clear triggers, and performing in line with that communication to act promptly while encountering uncertainties in this unknown regime of recovery. This clarity and consistency regarding policy stance can be effective to avoid unnecessary policy accidents which might agitate financial markets and delay the speed of economic recovery.

However, extraordinary accommodative monetary policy is likely to continue both in advanced and emerging economies to secure the sustained recovery despite the inflationary pressure and building up inflation expectation. But most central banks are monitoring closely inflation and financial stability risks and they are communicating carefully their policy plans to avoid the risks. Fiscal policy is also required to be well-designed for sustainable and more inclusive growth. Thus, policymakers must cautiously calibrate their responses tailored to the emerging new circumstances to ensure price stability and uphold the strength of recoveries across different sectors of the economies around the world.

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