AT Capital Macro Update

Key Highlights

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- *World Bank slashes growth forecasts for BD to 2-3% for FY 2020 and 1.5-2.9% for FY 20/21. We don't think that they are bearish enough.*

- *The risk of a global depression along the lines of the 1930s are growing. Added to Coronavirus exit strategy uncertainties, we believe that consumer and business confidence will remain fragile after lockdowns are eased.*

- *Accelerated deglobalisation is also a growing risk as global supply chains continue to unravel.*

- *BB should adopt a policy of debt monetization, or what some economists call "Helicopter Money".*

- *This is precisely what the US Federal Reserve, ECB and Bank of England are doing and is warranted by these unprecedented times.*

- *In this report we also analyze different lockdown exit strategies and argue that the only long-term exit from social distancing is when a vaccine is found.*

- *Some researchers at Imperial College in the UK have suggested that a vaccine might be available by September with accelerated human trials. But this is optimistic and getting the vaccine manufactured in sufficient quantities to immunize the mass population will take time, probably not until Q2 2021.*

- *We also discuss some recent academic research on the economics of lockdowns to compare the trade-offs between the Marginal Health Benefits of extended social distancing versus the growing economic costs.*

- *On April 13, PM Sheikh Hasina announced a new package of BDT 95 billion for the agriculture sector, along with one-off cash payments for the urban working class. A list of measures taken by Bangladesh Government is given in the appendix section*

World Bank May Not Be Sufficiently Bearish…
Global Depression Risks Grow

WB revised GDP growth forecast for Bangladesh to 2% - 3% in 2020 and 1.2% - 2.9% in 2021

The World Bank (WB) substantially lowered their growth forecasts for South Asia in their semi-annual GDP economic updates released on Sunday. For Bangladesh they now forecast a range of 2-3% for FY 19/20 and 1.2-2.9 % for FY 20/21 down from 8.15% in FY 18/19. For India, the region's largest economy, the WB forecasts growth for FY 20/21 of 1.5 to 2.8 %. While the immediate response was shock and awe among many economists in Bangladesh, we don't believe that WB is being pessimistic enough. Some commentators reacted somewhat defensively to WB forecasts but the importance of any economic forecast, especially in the current environment, is to give policymakers a better sense of the macroeconomic risks and help guide them on the appropriate policy measures they should take. We are concerned that there is still some legacy "growth complacency" in Bangladesh after record GDP growth last year and the impressive 6%+ annual growth in the past decade. But the Coronacrisis is an unprecedented macro shock to economies around the world and Bangladesh will not be any less vulnerable.

Table 1: Revised Growth Forecast by World Bank (Published on April 12, 2020)

Real GDP at market prices in percent						Revision to forecasts (From October 2019)	
Country	**Fiscal Year**	**2019 (E)**	**2020 (1)**	**2021 (F)**	**2022 (F)**	**2020 (1)**	**2021 (F)**
Afghanistan	Dec to Dec	2.9	-5.9 to -3.8	3.3 to 3.9	5.2 to 6.2	-8.9 to -6.8	-0.2 to 0.4
Bangladesh	July to June	8.2	2.0 to 3.0	1.2 to 2.9	2.8 to 3.9	-5.2 to -4.2	-6.1 to -4.4
Bhutan	July to June	3.9	2.2 to 2.9	2.0 to 2.5	3.1 to 3.5	-5.2 to -4.5	-3.9 to -3.4
India	April to March	6.1	4.8 to 5.0	1.5 to 2.8	4.0 to 5.0	-1.2 to -1.0	-5.4 to -4.1
Maldives	Jan to Dec	5.2	-13.0 to -8.5	6.3 to 7.3	5.0 to 5.5	-18.5 to -14.0	0.7 to 1.7
Nepal	Mid-July to Mid -July	7.1	1.5 to 2.8	1.4 to 2.9	2.7 to 3.6	-4.9 to -3.6	-5.1 to -3.6
Pakistan	July to June	3.3	-2.2 to -1.3	0.3 to 0.9	3.2 to 3.3	-4.6 to -3.7	-2.7 to -2.1
Srilanka	Jan to Dec	2.6	-3.0 to -0.5	0.2 to 1.2	2.0 to 2.5	-6.3 to -3.8	-3.5 to -2.5

Source: World Bank and ATC Research

We recommend a BDT 1 trillion (USD 12 bn) additional fiscal stimulus package

USA, UK and EU are currently doing the Debt monetization

As we argued in the *April 6, 2020 AT Capital Global Macro Update*, all the major components of Bangladesh's GDP apart from agriculture are expected to contract. Even the latter is being affected by supply chain disruptions as well as a lack of workers during the lockdown period. In the past week, the news on the RMG sector remains bleak with the BGMEA forecasting order cancellations of USD 6 bn over a 12-month period coupled with additional pressure for sizeable discounts on current orders that are not being cancelled. The exodus of foreigners from Bangladesh in the past few weeks will also likely impact mega infrastructure project implementation. While the BDT 727 bn (USD 8.6 bn) package announced by PM Hasina on April 5 is a good start, along with a further rate cut by BB on Apr 9, much more needs to be done. In particular, we recommend a BDT 1 trillion (USD 12 bn) additional fiscal stimulus package primarily focused on direct cash transfers to workers to compensate for lost wages as well as an expansion of direct food provision to the poor (A list of Measures taken by Bangladesh Government is given in the appendix section). Given weak tax revenues and limited conventional fiscal space, we think this should be financed by Coronavirus bond issuance that is purchased directly by Bangladesh Bank. Debt monetization, or what some economists call "Helicopter Money" is precisely what the US Federal Reserve, ECB and Bank of England are currently doing. In the next section, we argue why expectations for a strong recovery in G7 economies in the second half of 2020 after historic contraction in the first half, the so called "V-shaped recovery" are mis-placed. Global depression risks are growing which will extend Bangladesh's economic downturn and those of other developing economies.

A Return to 1930s Global Depression?

US unemployment rate might rise to 20%, a level not seen since the Great Depression

Most Wall Street forecasters are predicting an unprecedented contraction in the first half of the 2020 followed by a rebound in the second half of the year as lockdowns are eased and the economy can normalise. JP Morgan in their Apr 9 Global Data Watch wrote that: “Incoming reports emphasize the unprecedented scale of the collapse that began in China in February and extended to rest of the world over March and April. This week’s rise brought the cumulative increase in US initial jobless claims to 17.1 million over the last four weeks; at the same time, national business and consumer confidence surveys plunged. Next week we expect China 1Q20 GDP to decline at a sequential 41% Annualized Rate (ar). We expect US March retail sales to contract a record 8% m/m. Globally we continue to revise 1H20 forecasts lower and now look for declines of 14.7% ar and 12.6% ar in the first two quarters, respectively. We have also dramatically raised our forecast of the US unemployment rate to 20% next month—a level not seen since the Great Depression.”

We project April to represent a bottom for the global economy and there are reasons for encouragement on this front. First and foremost are signs of virus containment in China (along with Korea and Taiwan) that was punctuated by this week’s ending of the 76-day lockdown of Wuhan. Second, the aggressive and quick response of central banks, led by the Fed, has reduced the risk of a seizing up in financial markets that would greatly magnify the initial shock.

Finally, the size and scope of the policy response has increased. With new programs announced this week, our 2020 fiscal thrust estimate has increased to 2.6% of GDP. These measures do not include enormous public sector contingent commitments. This week, Italy announced enhanced loan guarantees (worth up to EUR 400 bn) and the Fed detailed programs scheduled to provide up to USD 2.3 tn in credit to businesses and state and local governments in which the US Treasury provides credit protection.

Their 2020 quarterly annualized forecast for the US economy is -10% Q1, -40% Q2, + 23% Q3 and + 13% Q4. For the global economy, their equivalent forecasts are -14.7% Q1, -12.6% Q2, +25.5% Q3, + 7.9% Q4.

V-shaped recovery not guaranteed

In part the forecasts are predicated on lockdowns in the US and other countries globally being eased by May. The trajectory of the virus and when aggressive social distancing measures will be eased, and indeed whether they will need to be re-imposed is difficult to forecast. We discuss the economics and strategy of lockdowns in the special focus article later in this report. But there are other reasons for being wary of V-shaped growth forecasts and why we believe global depression risks are rising.

Professor Ken Rogoff of Harvard University has noted in an Apr 10 article in Project Syndicate that “To be sure, governments and central banks have moved to backstop broad swaths of the financial sector in a fashion that seems almost Chinese in its thoroughness; and they have the firepower to do a lot more if necessary. The problem, however, is that we are experiencing not just a demand shock but also a massive supply shock. Propping up demand may contribute to flattening the contagion curve by helping people stay locked down, but there is a limit to how much it can help the economy if, say, 20-30% of the workforce is in self-isolation for much of the next two years.”

There are grounds for scepticism about the rebound optimists

President Trump has also argued that once the lockdowns are over and everyone can go back to work, the economy will be “great again”. But there are grounds for scepticism about whether, and if, things will get back to normal so quickly. Can it be argued that the economy took a timeout and that there will be a surge in pent up demand when social distancing lockdowns are relaxed, everyone can go back to work, shops re-open and so on? Will companies that put their investment plans on hold, double-up to position for the recovery. Will households buy the car they have held off from purchasing during the lockdown? There are grounds for scepticism about the rebound optimists.

Firstly, it is likely that both companies and households will increase their precautionary savings balances given the increased uncertainty about whether the virus will return; when a vaccine will be available; and whether it can be relied upon. Business and consumer confidence will remain fragile long after the immediate lockdowns have been eased.

Further deglobalisation is a growing risk

Secondly, further deglobalisation is a growing risk. Global supply chains are likely to restructured as a result of the Coronacrisis, which will mean that production costs will be higher, global GDP lower and inflation higher, all other things being equal. There was already pressure to onshore production for US companies as a result of the US-China trade dispute. This is likely to extended even further as a result of the disruption to China supply chain in January when the Coronavirus triggered the dramatic lockdown in Wuhan. There is a growing and somewhat legitimate need for companies to manage and mitigate their supply chain vulnerabilities and risks. At the same time there is a growing political clamour for national self-sufficiency and reduced reliance on China. This has been most visibly evidenced by the inclusion of around USD 2 bn by Japanese PM Abe to fund the relocation of Japanese company factories from China back to Japan, or indeed other countries in Asia. There has been a breakdown in global governance and co-operation during the Coronacrisis as evidenced by the blame-game US President Trump has pursued in holding China responsible for the Coronavirus. But there have also been frictions between the US and Europe on the competition for medical supplies such as the complaints from Berlin authorities that the US "stole" a consignment of 3M masks from Shanghai and Bangkok due for Germany or the earlier reports of President Trump trying to buy a German vaccine development company. Even within Europe, the recently agreed EUR 500 bn Coronacrisis relief fund revealed large disagreements between Netherlands and Italy on conditionality and terms for access to debt.

Dramatic rises in unemployment is likely to impact labour productivity

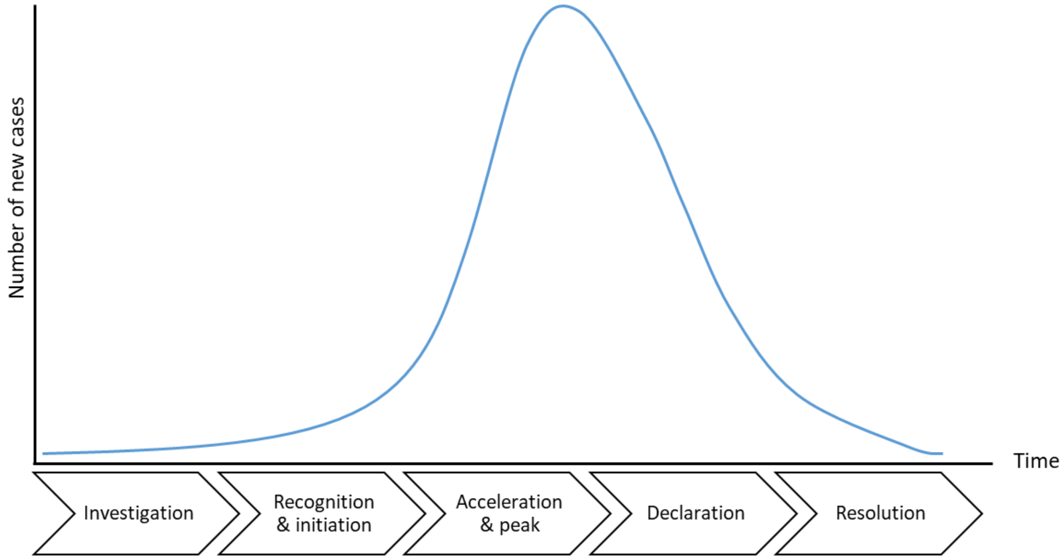
A third reason for pessimism is the impact of the dramatic rises in unemployment and labour productivity. As Prof Barry Eichengreen of UC Berkeley has argued in an April 10 Project Syndicate article: "… while there has been no destruction of physical capital in the pandemic, the risk of damage to human capital is significant. At a time when unemployment in the US is on course to reach 25% and higher, this is a serious concern."

Prof Eichengreen also notes that "Unemployment and hardship can also lead to demoralization, depression, and other psychological traumas, lowering affected individuals' productivity and attractiveness to employers. We saw this in the 1930s, not just in declining rates of labor force participation but also in rising rates of suicide and falling rates of marriage. Here, too, one worries especially about the US, given its relatively limited safety net, its opioid crisis, and its 'deaths of despair."

Special Focus Report: Analyzing COVID-19 Exit Strategies

Perhaps the most important issue for policymakers in North America, Europe and most of Asia, except for China, is when can lockdowns be eased, the so-called "exit strategy". The difficult policy dilemma of balancing health risks with managing the economic damage from social distancing measures is even more acute in developing countries such as Bangladesh or India with limited social safety nets. While there is no precise science or formula to come up with the optimal strategy, we can provide a framework for thinking about the issues more effectively.

Figure 1: EPI Curve with CDC Epidemic "Intervals"



Source: Centers for Disease Control and Prevention

Different phases with resolution only sustained with the development of a reliable vaccine

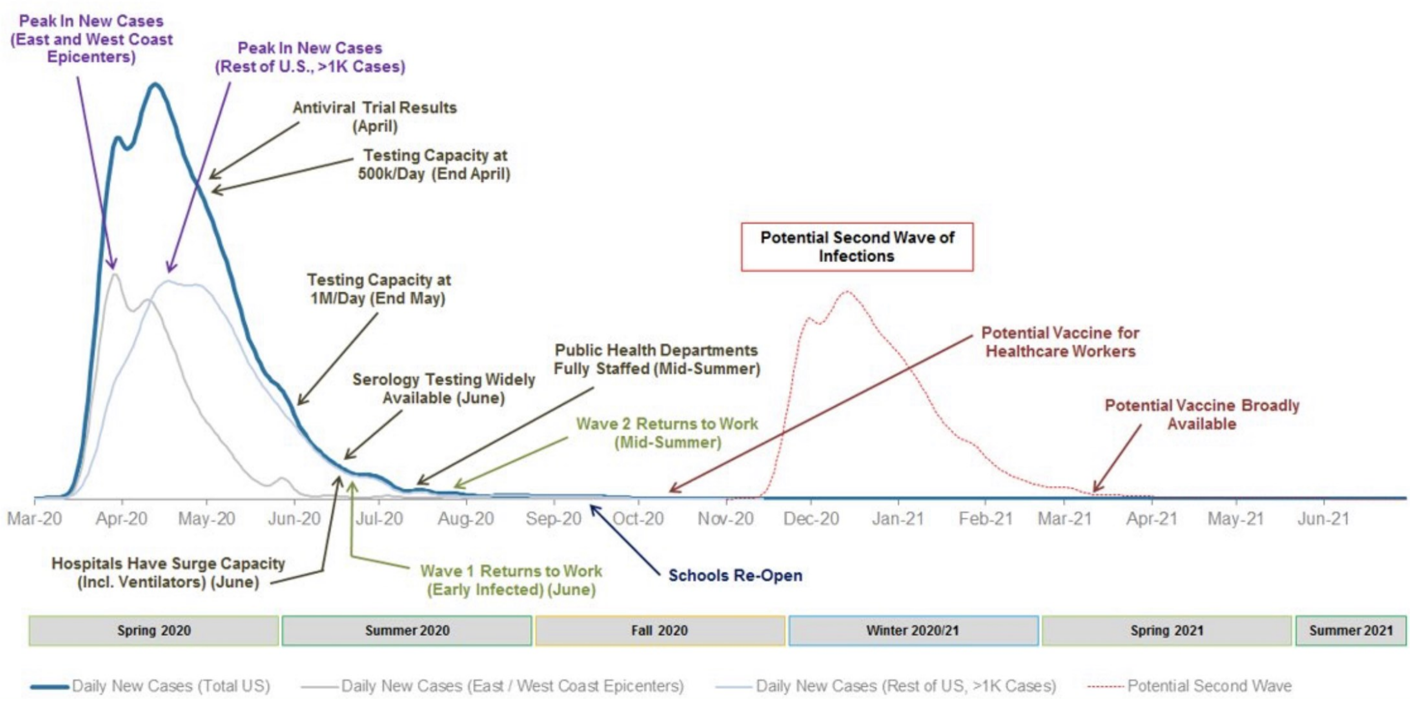
Firstly, it can be argued that COVID-19 is a textbook epidemic so far in following the classic “epi curve” (epidemiological curve) of disease transmission. The figure 1 shows the different phases with resolution only sustained with the development of a reliable vaccine. China is clearly in the “deceleration phase”. The US and Europe are in the mature phase of “Acceleration and Peak” and Bangladesh and India are moving from “Recognition and Initiation” and about to enter “Acceleration and Peak”.

The main reason for lockdowns is to “flatten the curve”, that is, reduce the number of new cases and hospitalizations to avoid overloading health capacity. Once we see the rate of growth of cases decelerating, policymakers can think of staged lockdown exit strategies. This may be, for example, by easing social distancing rules for the less vulnerable members of the community. For example, schools may be allowed to open first and younger workers, say between the age of 18-30 years old may be allowed to go back to work as long as they don’t live with people over 60 who may be more vulnerable.

Under the most optimistic scenario mass immunization could not be done before Q2 2021

Ultimately the only sustainable exit strategy will be the discovery of a reliable COVID-19 vaccine. But in the interim another important element of the exit strategy may be the widespread antigen testing that will give greater clarity on who has the disease and importantly who has recovered from COVID-19 and hence may have immunity. Some researchers at Imperial College in the UK have suggested a vaccine might be available by September with accelerated human trials. But this is optimistic and getting the vaccine manufactured in sufficient quantities to immunize the mass population will take time. First the most vulnerable such as the elderly and frontline health workers would be treated first. Even under the most optimistic scenario mass immunization could not be done before Q2 2021. Bear in mind the usual development time for a vaccine is 3 years. Investment bank Morgan Stanley has created an illustrative scenario for the US Exit Strategy summarized in the figure 2.

Figure 2: Actual/ Estimated New Case Count (United States, Non-Cumulative)



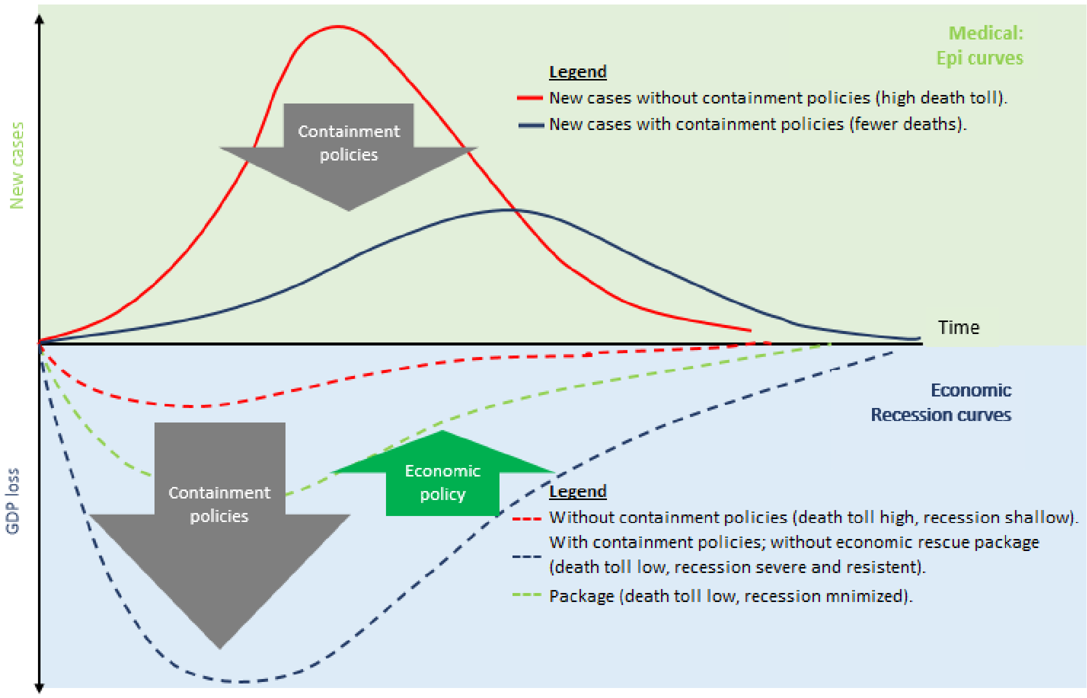
Source: Morgan Stanley

The Economics of Lockdowns

The recession is intentional and unavoidable

As Prof Richard Baldwin has noted in a recent CEPR paper, ("The supply side matters: Guns versus butter, COVID-style", Richard Baldwin, 22 March 2020), because COVID-19 is very infectious but not particularly lethal, the disease itself would have caused a slowdown, but probably not a very large one. The bulk of the coming recession is being caused by the public health measures taken to calm human calamity at the hospitals. Governments are preventing workers from working (deepening the supply-side recession) and consumers from consuming (deepening the demand-side recession). The recession, in other words, is intentional and unavoidable. What is not unavoidable is the longer-term damage that the containment policies are doing to the economy. They have put a 'hard stop' on production, consumption, and investment and these are damaging the economy in ways that will make the recession longer and deeper than it need be for purely medical reasons. Fortunately, many governments are reacting in ways that shield their economies from this sort of long-term damage.

Figure 3: The Recession, Made Worse By Containment Policy, Can Be Mitigated With Economic Policy



Source: "The supply side matters: Guns versus butter, COVID-style", Richard Baldwin, 22 March 2020

Professor Emanuel Ornelas has also noted in a recent paper ("Managing Economic lockdowns in an Epidemic, Emanuel Ornelas, CEPR, 28 March 2020) a number of key observations:

- At the peak of a serious epidemic, a near-full lockdown is better than nothing in unprepared countries. However, the lockdown should not be long-lasting, with its duration being determined by its marginal (health) benefits and (economic) costs.
- Activities to be suspended in the lockdown should be ordered from those that yield higher health benefits and impose lower economic costs to those that have the opposite effect; in serious cases, as with COVID-19, initially a large number of activities will need to be suspended in unprepared countries.
- The optimal extent of lockdown measures changes over time and eventually decreases but does not drop to zero quickly.

- Better health measures to cope with the epidemic allow for more lenient lockdown policies.
- Measures that ease the economic pain during the lockdown pave the way for stricter lockdown policies.
- The economic and health costs of the epidemic will be much higher for developing economies than for rich ones, even though it is generally ambiguous which should have stricter lockdown policies.

Marginal health benefit (MHB) of a lockdown decreases with its duration

Professor Ornelas also notes that, on the one hand, a lockdown brings health benefits for the society as it contains the spread of the virus, reducing the number of infections and allowing the health system to treat those infected (as well as those that require health services unrelated to the epidemic) better. On the other hand, a lockdown hurts the economy, because it prevents mutually beneficial economic activities that would otherwise take place. If the question were simply whether a government should implement a lockdown or not, we would need to compare the benefits and costs. Importantly, these change over time. At the peak of an epidemic, stopping human interaction has a very large health benefit, as it halts contagion (completely, in the case of a perfect enforcement) and prevents additional pressure on an overloaded heath system. After the lockdown is in place for a while, however, these benefits fall as the health situation becomes more manageable. That is, the marginal health benefit (MHB) of a lockdown decreases with its duration.

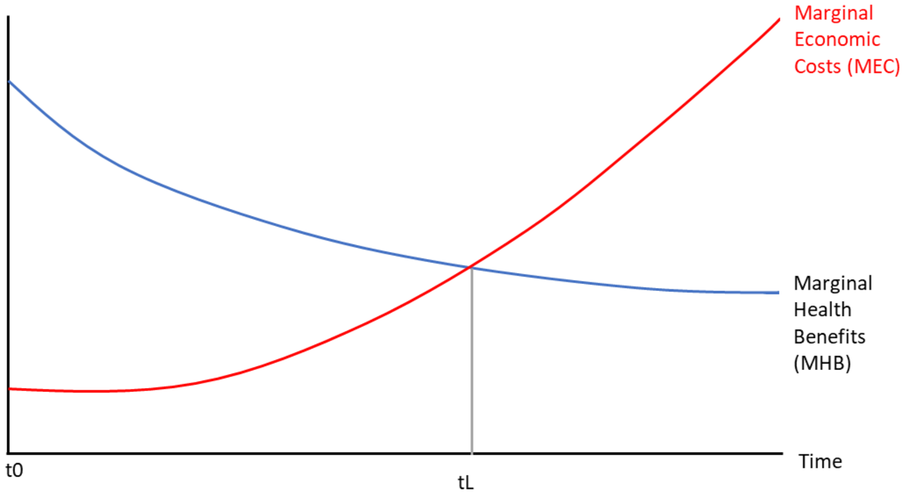
Marginal economic cost (MEC) of a lockdown increases with its duration

At the same time, the economic cost of a lockdown increases over time. We are used to having (partial) lockdowns during weekends and national holidays, but those have little cost because we know they last just a few days. However, maintaining a lockdown for a longer period imposes increasing costs on society, as firms go bankrupt, individuals are laid off and, ultimately, consumption levels (and welfare) drop sharply and continuously. That is, the marginal economic cost (MEC) of a lockdown increases with its duration. During regular times, MHB < MEC at t0, and therefore nobody discusses lockdowns. However, at the peak of an epidemic for which countries were ill-prepared to handle, as now with covid-19, MHB > MEC at t0, so implementing a lockdown (L) is initially better than not implementing it. That changes with time, however, as the health situation becomes more manageable and the economic situation more costly. Eventually (period tL in the figure 4), it becomes better to lift the lockdown and restore economic activities.

Optimal Duration Of A Full-Lockdown Policy

Ornelas also notes that MEC (Marginal economic cost) and MHB (Marginal health benefit) curves vary significantly across regions/countries depending on their socioeconomic characteristics.

Figure 4: Optimal Duration of A Full Lockdown Policy



Source: "The supply side matters: Guns versus butter, COVID-style", Richard Baldwin, 22 March 2020

Starting with the MHB curve, it can be very different depending on cultural traits and the demographics of the country, even for a given stage of the epidemic. For example, if it is common for different generations to live together, or if the elderly share of the population is high, then the MHB curve will be relatively high – compare, say, Italy with Germany. This implies that, for otherwise similar countries in terms of development, one with a high share of elderly who tend to live with younger relatives (Italy) will need stricter lockdown policies than another with the opposite characteristics (Germany). In the current context Sweden has adopted the least stringent lockdown measures. But this may be justified by their demographics and their cultural norms since almost 40% of Swedes live alone at home and/or work from home.

The MHB curve tends to be much higher in developing economies than in rich ones...

Probably even more critical is the structure of the health system of the country. So far much of the focus remains on rich countries, which have relatively solid health systems in place. In developing countries, however, much less strain to the system is required to make it collapse. Therefore, the MHB curve tends to be much higher in developing economies than in rich ones. That, in itself, would push for stricter lockdown policies.

We must also look, however, look at how levels of development affect the MEC curve. It will be relatively low where individuals have access to liquid savings and the government can, directly and indirectly (through incentives for the private sector), keep incomes and payments flowing, limiting bankruptcies and layoffs during the peak of the crisis. On the other hand, in countries where few households have savings, the informal sector (which tends to be more affected) is large, and the government is unable to provide much help to keep incomes and payments flowing, the MEC will be much higher.

Taken together, we have that both curves will be higher in developing countries. The impact on the optimal lockdown policy is therefore ambiguous. It will depend on how good/bad the health system is relative to the economic system. In places where the health system is better equipped to cope with the epidemic than the economic system is to cope with the restriction of activities, a more lenient lockdown would be advisable. The opposite would be true otherwise.

For developing countries, both the economic and health costs of the epidemic will much higher than for rich countries

Ornelas also notes that what is clear is that, for developing countries, both the economic and health costs of the epidemic will much higher than for rich countries. The curves will intersect at a higher level both because the economy is ill-suited to sustain a lockdown and because the health system is ill-suited to deal with an epidemic. The optimal lockdown policy trades off those two costs optimally, but the outcome is nevertheless dire. The drama we have seen in Europe and in the US may be dwarfed by what is about to happen in poorer countries affected by the epidemic.

Appendix

List of Fiscal Measures Undertaken By Bangladesh (Till April 13, 2020)

Date	(BDT bn)	Beneficiary	Fund sourcing	Cost of fund
25 March 2020	50	To pay salaries and wages for employees of export-oriented industries.	BB	2%
5 April 2020	300	To be provided to affected industries and service sector organizations as working capital through banks	The commercial banks would provide the amount as loans from their own funds	9% [4.5% by the beneficiary] [4.5% by the government as subsidy to the bank]
5 April 2020	200	As working capital to SME including cottage industries	The commercial banks would provide the amount as loans from their own funds	9% [4.0% by the beneficiary] [5.0% by the government as subsidy to the bank]
5 April 2020	127.50	To facilitate raw materials imports under back-to-back LC	BB Export Development Fund (EDF) [Enhanced from BDT 2.5bn to BDT 5.0bn]	2% [existing EDF int rate = 2.73% = LIBOR+1.5%]
5 April 2020	50	Pre-shipment Credit Refinance Scheme for local products alongside the export sector	BB	7%
13 April 2020	7.50	Life and Health insurance for frontline workers	Government	N/A
13 April 2020	1.00	Special allowance for frontline workers	Government	N/A
13 April 2020	7.60	One-time cash assistance to bank accounts of urban poor (day laborers, rickshaw pullers, etc.)	Government	N/A
13 April 2020	95	Mixture of subsidies and financing for the agricultural sector	Government / commercial banks through subsidized loans	4% for financing

Source: Daily Newspaper & ATC Research

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