

CSIS-PAHO

Responding to an Influenza
Pandemic in the Americas
The Economic Impact



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Summary of presentation

- Background
- Macroeconomic impact
- The financial sector impact
- Policy considerations
 - Fiscal & monetary policy
 - Regulatory policy



Background

- Avian flu in its present form affects mainly the poultry industry—but these effects can be substantial, particularly for the small farmer.
- The economic impact of a stage 5 or 6 pandemic (WHO criteria) would be many times greater.



Background: vulnerable economies

- Some economies will be more vulnerable to a worldwide pandemic than others. They include:
 - Exporters of tourism.
 - Durable goods exporters.
 - Economies that were already vulnerable to external shocks.



Vulnerable economies, cont'd

- Economies affected by a breakdown of law and order.
- Economies where public health facilities are overstretched, with little capacity to plan.
- Economies where the health of the population is poor to begin with.



Macroeconomic impact

- An AFP would cause large if short-lived shocks to both demand and supply.
- The size of both shocks will depend on:
 - The attack rate
 - The case mortality rate
 - The average period of convalescence
 - The number of waves of contagion
- It will also depend critically on whether basic institutions continue to function properly.



The supply side impact

- The main supply side impact is a reduction in labor supply.
- In the short run, the main impact on labor supply comes from illness and absenteeism, not death.
- The rate of absenteeism will be very hard to predict.



The supply side impact of absenteeism

- Absenteeism can have many causes:
 - The need to stay home to care for a sick family member
 - The result of a policy of social distancing
 - Workers choosing to stay home
- Absenteeism may be less feasible for poorer economies and for small businesses.



The supply-side effect, cont'd

- The loss or temporary indisposition of key employees in the utility and transportation industries is another potential source of supply disruption.
- All businesses need to have a plan that identifies essential functions and provides for replacements for the people that carry them out.



The demand-side impact

- An AFP entails a negative shock to demand: consumption of income-constrained households is reduced, less essential purchases (e.g. most consumer durables) are postponed.
- In poorer economies, “less essential” consumption may be relatively less important.



Overall effects on the real economy

- Both supply and demand-side effects could be large.
- Provided the period of contagion is not prolonged and there is no breakdown of law and order, the resulting drop in output should be short-lived. Both production and demand will rebound.



Overall effects, cont'd

- Estimates of the impact vary widely, depending on the country/region and the underlying assumptions:
 - Canadian Dep't of Finance (for Canada):
-1% (1918 scenario).
 - McKibbin and Sidorenko (for the world):
-12.6% (worst-case scenario).



Financial impacts

- An AFP affects both financial markets and the operations of financial institutions.
- The size of the impact on both assets and FIs will be reduced by adequate preparation.



Impact on financial markets and asset values

- An AFP will increase risk aversion because of uncertainty over the severity & consequences of a pandemic.
- This will prompt:
 - a “flight to quality.”
 - an increased demand for liquidity.



The flight to quality

- The effect is similar to what is observed in periods of heightened international tension.
- The value of “safe” or less risky assets will increase relative to the value of more risky assets.
- It will entail an increase of corporate and emerging market spreads, with a heightened premium for risky assets.
- Insurance/reinsurance could be seriously affected.



Increased demand for liquidity

- By investors:
 - Investors may suffer doubts about the liquidity of markets.
 - To avoid a potential problem, they may start to liquidate their long-maturity assets.
 - This would affect the shape of the yield curve, even for safe assets.



Increased demand for liquidity, cont'd

- By households, who will demand more cash:
 - They may prefer to reduce the frequency of withdrawals to avoid social contact.
 - They may have doubts about the liquidity or solvency of their bank.
 - Checks and credit cards might not be a feasible means of payment should problems arise with the check clearing mechanism.



Increased demand for liquidity, cont'd

- By banks and other FIs:
 - Increased demand for liquidity (esp. stocks of cash) by households and businesses will induce increased demand by banks.
 - Fears of disruption to the market for less liquid assets could have a similar effect.



Vulnerable financial systems

- Three key systems in the financial sector are vulnerable to disruption:
 - Payments
 - Clearing and settlement
 - Trading



The sources of operational disruption in financial inst.

- As with utilities, there is the risk that too many essential employees are absent at the same time.
- The operations of FIs are vulnerable to breakdowns in external telecom networks.
- Because FIs are part of a network, a weak link affects all the rest.



The impact of absenteeism

- Its seriousness depends on the AFP's attack rate. If a firm practices a policy of social distancing, the risk will depend on whether exceptions can be made for key personnel.
- Working from home may be feasible, depending on the functions that are performed. But it has never been tested.
- It may not be an option for many developing economies.



The impact of network breakdowns

- Problems with telecom networks can entail:
 - Interruptions in service.
 - Problems with local internet connections (the “last mile”).
 - Serious disruption if “working from home” does not work (as some fear), and there is no Plan B.



Ill-prepared institutions

- A few ill-prepared institutions can cause problems for the sector or sub-sector as a whole:
 - By slowing down settlement and clearing functions.
 - By their inability to meet counterparty operations.
 - By spreading (financial) contagion.



BCPs for FIs: the basics

- Communication with employees regarding precautionary measures—e.g. hygiene—is essential.
- Essential core activities must be identified (if they have not been already).
- Replacements must be trained.



The policy response— monetary policy

- In principle, the response of monetary policy should depend largely on the relative (absolute) sizes of the negative shocks to supply (S) and demand (D).
- If $S > D$, then the stance should be tightened, and conversely.



The policy response— monetary policy, cont'd

- In practice, this rule will be very hard to apply:
 - The relative sizes of the shocks to supply and demand will not be known in advance.
 - The period of disequilibrium should be short.
 - Given the potential problems from too tight a policy, better to err on side of accommodation.



The policy response—fiscal policy

- The deficit is bound to increase:
 - Public health and related expenditures will increase.
 - Income support may also increase.
 - Revenues—especially sales taxes—will decrease.
 - Revenues may also be reduced by the disruption of tax administration.



The policy response—fiscal policy, cont'd

- The increase should be tolerated, unless a country is verging on insolvency.
- Tax revenues will rebound with output, and expenditures will decline to their former level.



Financial sector policy

- Ensure that all FIs, including central banks and regulatory agencies have adequate BCPs.
- Be prepared for a substantial increase in demand for liquidity.
- Coordination is essential:
 - Between financial institutions and regulatory agencies
 - Between national supervisors
- Regulatory forbearance may be necessary.