The Covid Shock and the New Macroeconomic Landscape: Taking Stock and Looking Ahead

Kollmann, Robert and Roeger, Werner

Solvay Brussels School of Economics Management, Université Libre de Bruxelles, Belgium, ERUDITE, Université Paris-Est Créteil, France, CEPR, UK, VIVES, Katholieke Universiteit Leuven, Belgium, DIW Berlin, Germany

22 July 2022

Forthcoming in: European Economic Review (2023)
https://doi.org/10.1016/j.euroecorev.2023.104541

The Covid Shock and the New Macroeconomic Landscape: Taking Stock and Looking Ahead

Robert Kollmann [a,b,c,*] and Werner Roeger [d,e] ,

[a] Solvay Brussels School of Economics & Management, Université Libre de Bruxelles, Belgium
[b] ERUDITE, Université Paris-Est Créteil, France
[c] CEPR, UK
[d] VIVES, Katholieke Universiteit Leuven, Belgium
[e] DIW Berlin, Germany

July 22, 2023

The unprecedented global recession triggered by the Covid pandemic was met with a broad range of massive monetary, fiscal and financial policy interventions to support households, businesses and financial institutions. The legacy of the Covid crisis includes record public debt, a global inflation surge, and uneven productivity and employment dynamics across sectors and nations. This special issue of the *European Economic Review* consists of twelve papers that offer novel perspectives on the economic effects of the Covid shock, and on economic policy responses. All papers were presented at a conference held at the European Commission in Brussels on October 6-7, 2022, organized by the *European Economic Review*, the European Commission and the Centre for Economic Policy Research (CEPR). The guest editors of the special issue were Evi Pappa, Robert Kollmann and Werner Roeger.

The first six papers of the special issue analyze macroeconomic and financial policies adopted during the pandemic. The paper by **Katharina Bergant** and **Kristin Forbes (2023)** provides a comprehensive overview of monetary, fiscal, macroprudential, and capital control policies used by advanced and emerging market economies during the early stages of the Covid crisis. The authors conclude that pre-Covid policy space was generally an important driver of a

[*] Corresponding author: Prof. R. Kollmann, ULB, CP 114, Av. Roosevelt 50, 1050 Brussels, Belgium, E-mail address: robert_kollmann@yahoo.com

country's response to the Covid shock; however, policy space was *not* a constraint on advanced countries' fiscal stimulus measures.

The Covid recession prompted governments to resort to nonstandard policy instruments. **Dario Cardamone, Eric Sims** and **Jing Cynthia Wu (2023)** analyze one of these instruments, namely direct lending to *non-financial firms* by US fiscal and monetary authorities. Based on a calibrated New Keynesian model, the authors argue that this instrument was highly stimulative during the Covid recession, as nonfinancial firms faced severe liquidity constraints. By contrast, government lending to *banks* was ineffective, during the Covid crisis.

Huixin Bi and **Nora Traum (2023)** analyze another type of unconventional policy used during the Covid crisis: purchases of municipal bonds by the US Federal Reserve. Based on a calibrated model, the authors conclude that, as municipal debt is held by financial intermediaries, Fed municipal bond purchases accelerated bank lending to the private sector, and thereby stimulated private investment.

Ghassane Benmir, Ivan Jaccard and **Gauthier Vermandel (2023)** consider optimal monetary policy in a New Keynesian model where households are exposed to infection risk from both contact intensive consumption and work. The authors show that optimal monetary policy during a pandemic must be complemented by lockdown measures to achieve price stability.

Carlo Altavilla, Francesca Barbiero, Miguel Boucinha and **Lorenzo Burlon (2023)** use micro bank data to analyze the impact of ECB monetary and prudential policy on bank lending, during the Covid pandemic. The authors find that cheaper bank funding provided by the ECB stimulated bank lending to solvent non-financial firms, in the Eurozone, without supporting "zombie" firms.

Òscar Jordà and **Fernanda Nechio (2023)** focus on the inflation surge since the pandemic. Exploiting cross-country differences in the fiscal response to Covid, the authors argue that fiscal policy has been a key driver of (post-)Covid price and wage inflation. That empirical analysis uses a novel dynamic difference-in-differences method based on local projections.

The next four papers focus on sectoral shocks and firm-level dislocations triggered by the Covid shock and on corresponding policy responses. The paper by **Joaquin Garcia-Cabo Herrero, Anna Lipinski** and **Gaston Navarro (2023)** is motivated by the observation that Europe and the US adopted different labor market policies to cope with Covid. The US used unemployment insurance extensions (UI), while most European countries expanded short-time work subsidies (WS). The paper shows that in a Covid-type recession UI policies are preferred in a more flexible US-style labor market while WS policies are preferred in more rigid European labor markets.

Guido Ascari, Andrea Colciago and **Riccardo Silvestrini (2023)** study industry dynamics in the US after the first Covid wave, using a dynamic general equilibrium model with endogenous firm dynamics, and an epidemiological block. Observed productivity dynamics is explained through adjustments within the contact-intensive sector and cross-sector reallocation. The authors argue that monetary policy played an important role in directing resources to less exposed sectors.

Jozef Konings, Glenn Magerman and **Dieter Van Esbroeck (2023)** use firm micro data for Flanders to assess the effect of state-funded firm-level rescue policies during the Covid crisis. The authors find that those policies temporarily raised the productivity of beneficiary firms and reduced market exit (compared to firms that did not receive support).

Liza Archanskaia, Erik Canton, Alexandr Hobza, Plamen Nikolov and **Wouter Simons (2023)** use monthly industry turnover data for EU countries to track the effects of Covid on the liquidity and solvency of non-financial firms. The paper identifies the timing and severity of the pandemic, government support measures, and firms' pre-shock liquidity and solvency as important risk factors for firms.

The remaining two papers in this special issue focus on international dimensions of the Covid crisis and its aftermath. **Scott Davis** and **Andrei Zlate (2023)** show that, in a sample of developed and emerging market countries, the sensitivity of exchange rates and international capital flows to the global financial cycle (GFC) increased sharply during the pandemic; cross-country differences in this sensitivity are tied to changes in local Covid cases and vaccination rates.

Finally, **Roberta Cardani, Philipp Pfeiffer, Marco Ratto** and **Lukas Vogel (2023)** compare the Covid recession and its aftermath across the Eurozone and the US, using an estimated multi-country dynamic general equilibrium model. The authors find that fiscal policy had a stabilizing effect, and they attribute rising inflation to the recovery of both domestic and foreign aggregate demand. Inflation was more supply-driven in the Eurozone, while in the US it had a substantial demand-driven component.

References

Altavilla, Carlo, Barbiero, Francesca, Boucinha, Miguel and Burlon, Lorenzo, 2023. The Great Lockdown: Pandemic Response Policies and Bank Lending Conditions. European Economic Review, Special Issue "The Covid Shock and the New Macroeconomic Landscape: Taking Stock and Looking Ahead".

Archanskaia, Liza, Canton, Erik, Hobza, Alexandr, Nikolov, Plamen and Simons, Wouter, 2023. The Asymmetric Impact of COVID-19: A Novel Approach to Quantifying Financial Distress across Industries. European Economic Review, Special Issue "The Covid Shock and the New Macroeconomic Landscape: Taking Stock and Looking Ahead".

Ascari, Guido, Colciago, Andrea and Silvestrini, Riccardo, 2023. Business Dynamism, Sectoral Reallocation and Productivity in a Pandemic. European Economic Review, Special Issue "The Covid Shock and the New Macroeconomic Landscape: Taking Stock and Looking Ahead".

Benmir, Ghassane, Jaccard, Ivan and Vermandel, Gauthier, 2023. Optimal Monetary Policy in an Estimated SIR Model. European Economic Review, Special Issue "The Covid Shock and the New Macroeconomic Landscape: Taking Stock and Looking Ahead".

Bergant, Katharina and Forbes, Kristin, 2023. Policy Packages and Policy Space: Lessons from COVID-19. European Economic Review, Special Issue "The Covid Shock and the New Macroeconomic Landscape: Taking Stock and Looking Ahead".

Bi, Huixin and Traum, Nora, 2023. Unconventional Monetary Policy and Local Fiscal Policy. European Economic Review, Special Issue "The Covid Shock and the New Macroeconomic Landscape: Taking Stock and Looking Ahead".

Cardani, Roberta, Pfeiffer, Philipp, Ratto, Marco and Vogel, Lukas, 2023. The COVID Crisis on Both Sides of the Atlantic. European Economic Review, Special Issue "The Covid Shock and the New Macroeconomic Landscape: Taking Stock and Looking Ahead".

Cardamone, Dario, Sims, Eric and Wu, Jing Cynthia, 2023. Wall Street QE vs. Main Street Lending. European Economic Review, Special Issue "The Covid Shock and the New Macroeconomic Landscape: Taking Stock and Looking Ahead".

Davis, Scott and Zlate, Andrei, 2023. The Global Financial Cycle and Capital Flows During the COVID-19 Pandemic. European Economic Review, Special Issue "The Covid Shock and the New Macroeconomic Landscape: Taking Stock and Looking Ahead".

Garcia-Cabo Herrero, Joaquin, Lipinski, Anna and Navarro, Gaston, 2023. Sectoral Shocks, Reallocation, and Labor Market Policies. European Economic Review, Special Issue "The Covid Shock and the New Macroeconomic Landscape: Taking Stock and Looking Ahead".

Jordà, Òscar and Nechio, Fernanda, 2023. Inflation and Wage Growth Since the Pandemic. European Economic Review, Special Issue "The Covid Shock and the New Macroeconomic Landscape: Taking Stock and Looking Ahead".

Konings, Jozef, Magerman, Glenn and Van Esbroeck, Dieter, 2023. The Impact of Firm-level Covid Rescue Policies on Productivity Growth and Reallocation. European Economic Review, Special Issue "The Covid Shock and the New Macroeconomic Landscape: Taking Stock and Looking Ahead".