MACROECONOMIC ANALYSIS OF POLICIES ADDRESSING CORONAVIRUS PANDEMIC

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SUMMARY

Before our discussion of the macroeconomic implications of government policies, we would first like to focus on the human factor of the coronavirus pandemic: the people who lost their battle to the pandemic. We would like to express our most sincere condolences to their families.

During last two quarters, active macroeconomic policies have been a significant component of the overall response of the U.S. government to the coronavirus pandemic. An analysis of current government policies addressing this short-term shock and the resulting economic impact would be helpful in developing future policies, should similar circumstances arise down the road. We conjecture that the combination of expansionary macroeconomic policies preceding the coronavirus pandemic likely shifted the level of U.S. aggregate economic

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patients, caused a severe shift in the demand for economic output, along with sharp declines in personal consumption, business investments, and exports of goods and service. The $2 trillion economic relief package known as the CARES Act of March 2020 softened the adverse economic impact of this shock to some extent.[i] The observation in this brief suggests

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change is also evident as the GDP deflator suggests its decline from 113.14 points in Q1 to 112.76 in Q2, 2020.[xi]

Since the economy gravitates towards its long-run equilibrium with the natural level of output and full employment, two possible scenarios can be considered. The economy can either move back to the initial level of equilibrium ( ) or to a new level of equilibrium ( ). In the first scenario the government may possibly continue stimulating the economy through fiscal policies, which in addition to contributing to an increase in aggregate demand will also, as a consequence, further increase the public debt. If those policies offset the nega (s)1 3Tw -27Tga (s)1 7Tga (s)1 7Tga (s)1 through 87la-27.91 -2.3 Td[ne)4 2 (c) (i)-2 (l)-2

Overheated economy: The Tax Cuts and Jobs Act went into effect in 2018. This was a tax reform designed to stimulate individual consumption and businesses investments. According

from September 2019 through February 2020. These levels of unemployment are far below the aforementioned average, which we use as guidance for the natural rate of unemployment ( ). The significant positive deviation of the unemployment rate from its natural level may cause upward pressure on the inflation rate. This is also one of the causes of demand-pull inflation in the short run.

Inflation: Since 2009 the inflation rate, according to both the GDP price deflator and consumer price index (CPI), was on average about 2% annually. These rates led to prices rising by only just over 18% for the period from 2009 to 2019 (as calculated by the percentage change in the GDP deflator).

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than its natural level should have been ( ). Demand was higher than our

economy with existing capacities, physical capi2aFpoint A

expectations, and not having a vaccine or widely accessible treatment plans will most likely keep the demand side of the economy at a lower level. Thus, the economy is more likely to experience the second scenario, under which the contraction will result in an extended period of higher unemployment and underutilized capacities. This decline will eventually lead to lower prices of factors of production, which will slowly contribute to the increase in the production of national output, result in full employment with a lower level of inflation and overall aggregate demand, including consumption and investments.

Main takeaway

The main takeaway from this discussion is we do not recommend implementing another full scale economic shutdown, because it may result in extremely profound damage to the economy. Although the recent shock also caused sharp contractions to the economy, part of that was absorbed by the overheated economy with much higher consumer demand and employment. Now our economy is already in the decline and any additional contractionary policies may cause significant long-term shocks that would require a very long time to recover.

References

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