

COVID-19: The Great Challenge

Quarantine of austerity or the eclipse of the liberal dream?

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Although COVID-19 is a real threat to markets, economies and fundamentally the population, even with examples from China and Italy, it is still very difficult to estimate its full impact on Brazil. The life cycle of the virus is still unknown, our social, demographic and health conditions are specific, as well as the different climate conditions of our territory and insufficient current parameters for clearer prognosis. In any case, the scant information we have indicates a frightening picture of could affect us.

In this vein, the government has taken some measures - however timid and slow in view of the

potential impact envisaged - it remains to be seen whether yesterday's package of measures will be effective and feasible. The commitment and dedication of the healthcare workers are duly recognized, but our limitations are staggering in this segment and, therefore, complementary

actions of a political-administrative nature (closing borders, mandatory confinement, etc.) in order to curb the movement of people and smooth the spread of the virus, need to be implemented. This slowness of recognizing the huge danger and taking preventive action will be very expensive (field hospitals, the purchase of medical equipment, the recruitment of healthcare professionals, as well as extreme measures for the production of essential goods by private companies).

Overseas, things are unraveling exactly as we anticipated: Governments and Central Banks acting strongly in every way to contain the effects of COVID-19.

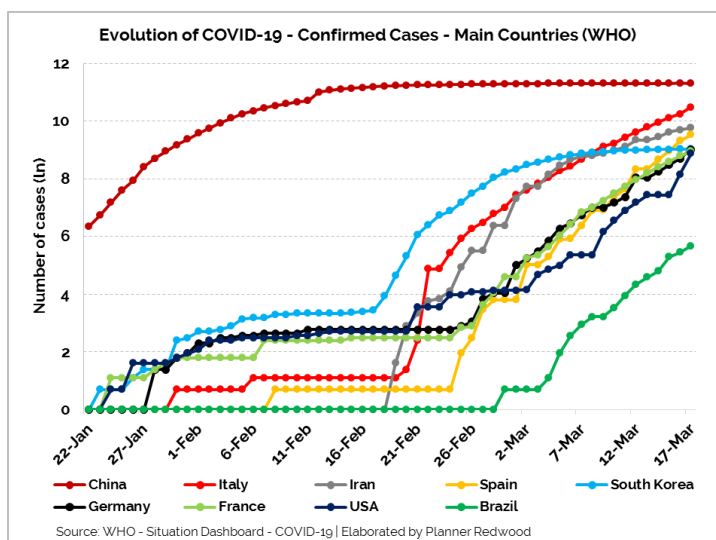
The measures range from social distancing and restrictions on mobility, to substantial monetary easing, Quantitative Easing, Helicopter Money (USA intends to send checks directly to the population) and actions in the fiscal camp (expansion). Is it really the best way? And would it be indicated as suitable for all countries without distinction? Definitely not. The Fed has lowered its interest rates twice, has been unable to wait two weeks for the first interest rate cut and three days, for the second. It bred distrust and uncertainty in markets, compared to what it foresaw that others did not (it signaled that there are unanticipated problems), and dragged other monetary

authorities along this path.

The main tool of a Central Bank is its communication, provided that it has instruments follow suit. We must not forget that we are facing a supply shock (we will have empty groceries stores shelves!), and perhaps, sequentially, a demand-related one. Monetary policy, as a rule,

takes some time to take effect, stimulates demand and dynamically calibrates the interest curve. Being assertive in measures does not mean spending away indiscriminately and launch all of the main tools available (conventional and unconventional) at once. The intensive measures, as well as the dosage that can turn medicine into poison, led to panic in the markets. It is our opinion that the FED was wrong.

In Brazil, also on the economic front, the government can do much more to get in the way of solutions than to actually provide them, if we succumb to the more heterodox bias. The simple fact that our BACEN



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did not overreact (as did the FED) was a good deed in itself. The decision taken yesterday, however, did not escape conventional rule and understanding in the face of crises, reduced the SELIC by 0.5%. There is no doubt that economic activity will take a hit, which Economic Policy may only mitigate with some actions, so that the retraction does not continue for too long. Thus, we believe that we have little to do in terms of fiscal policy (although occasionally necessary), even less as basic interest rates cuts go, and more in the reduction of bank reserve requirements and fundamentally in offering liquidity to the market through various channels. All of this without electing "privileged" sectors in advance and handing out subsidies, but requiring guarantees and providing debt-service payment deferrals and some forms of compensation. There is also no way to ignore the exchange rate devaluation, and BACEN should truly worry about FX market dysfunctionality.

The current situation far outweighs economic and/or financial prospects, we will soon be facing a humanitarian crisis. While we continue to believe that it will be a transitory crisis (in health, economics and finance), it has all the potential to be quite overwhelming. Thus, it is not the time for conservatism or hesitation in actions that can **actually** help. Social distancing and isolation of infected people (just a matter of time) will further reduce demand, companies' revenues and eventually impact unemployment. In this line of reasoning, credit is also restricted and stimulus actions may be necessary. In this way, the request for a state of public calamity is very welcome, and offers extraordinary flexibility. However, this is where danger lies. Confuse specific and well-determined actions and fray the fragile and incipient economic rebalancing. We have no doubt that the challenge is comparable to that of a war, but with the conviction of its transience - for most sectors of the economy and the financial market -, we may see a return to normalcy in a few quarters.

However, be it for real needs or due to opportunisms unfortunately present at this moment, public officials and politicians are strongly committed to launching superpacks and assistance programs. It is essential, especially for economically impoverished countries like Brazil, to monitor very closely the expenses carried out with "freedom" due to pressure from interest groups and the suspension of restrictions set by fiscal targets. Austerity must necessarily be put aside in the face of securing healthcare and employment, but our maturity in this area is still very low and tenuous. Our fiscal irresponsibility was present just a while ago. Our less orthodox economists of a few years back will join the eternal spending and expansionist politicians, scrounging for more public resources. In fact, in times of crisis, as the maxim says, we are all Keynesians.

It is under this analysis that our deepest concerns rise up. We never really had the chance to have a truly liberal government. The

structure of our economy is not yet properly adjusted to face this crisis under such premises. Thus, we hope that political-democratic stability is reassured so that this episode becomes but a quarantine on the path set out by the economic team and escapes major interference from our politicians. After all, these emergency attitudes are not expected to alleviate potential shortages of goods and services caused by closed factories and businesses and the reduced productivity of those forced to work from home.

At times like this, under ideal conditions, it would be appropriate to let the price system work freely, however cruel this may sound. Given such an impossibility, we should aim at the least possible interference on the price structure, preventing misallocation of resources and investments, as well as the waste of productive factors. Only this way, with less intervention, the government can assist in the stabilization of the economy. *Oxalá!*

Country	Govt. Packages (Billion)	% GDP
U.K.	USD 400	15%
Spain	USD 220	20%
Germany	USD 550	15%
Italy	USD 28	2%
France	USD 330	12%
USA	USD 0	5%
Brazil	USD 0	1,8%

Source: CNN.com; Bloomberg | Elaborated by Redwood

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