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NEWS ANALYSIS

Global Health Crisis 1, Economic Policymakers 0

As leaders of the world's wealthiest countries pledged to limit the damage from the coronavirus, they appeared to be operating with limited options.

By **Peter S. Goodman**

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LONDON — The people who worry about money had hoped for so much more. The news that the world's wealthiest countries were convening to orchestrate a response to the deadly coronavirus outbreak had resonated across economies like the sound of whirring helicopters bringing relief to a disaster zone.

But the relief proved underwhelming. As leaders of the Group of 7 nations ended impromptu consultations on Tuesday with only a general expression of solidarity and refrained from concrete action — no pledge to cut interest rates, no promise of coordinated government spending — they underscored an uncomfortable truth animating fears about the virus: Policymakers tasked with limiting its economic damage appear to be laboring under the assumption that their tool kit is nearly empty.

In Washington, the Federal Reserve followed the group's statement with the surprise announcement that it was dropping short-term interest rates by half a percentage point, momentarily delighting stock markets. But investors soon resumed fearful selling amid the realization that cheaper money is of limited use in combating the crisis. Easier loan terms will not restart production at factories whose workers are being kept home to avoid getting or spreading the illness.

Governments have tools that could limit the costs, but have been reluctant to use them, economists said. They could give cash to employees whose workplaces are shut, provide credit to small businesses and offer rescue packages to industries most affected, like airlines and other tourism-related concerns.

Their unwillingness to take such approaches appears to reflect a widespread political aversion to increasing public debt.

In the United States, the Trump administration delivered a $1.5 trillion package of tax cuts two years ago — its benefits overwhelmingly directed at the wealthiest households and corporations — and then began warning of the need to shrink budget deficits while seeking to cut programs that provide health care and housing to poor people.

In Europe, where the coronavirus has renewed worries about recession, the 19 nations that share the euro currency are restricted in how much debt they can amass.

The crisis has offered the latest glimpse of an established truth in the world's largest economies: Public money can frequently be found for tax cuts, but then disappears into a fog of warnings about the dangers of deficits when spending for nearly anything else is discussed.

The New York Stock Exchange floor on Tuesday. The Federal Reserve's interest-rate cut initially sent stocks highers, but selling soon resumed. Richard Drew/Associated Press

"If you don't spend money for people put out of work with no fault of their own when there's a clear public-health virtue in making it in workers' interests to stay home and not spread the virus, then everything else by comparison is a complete waste," said Adam S. Posen, a former member of the rate-setting committee at the Bank of England and now the president of the Peterson Institute for International Economics in Washington.

“We’ve got this notion that we are always overspending,” Mr. Posen continued, “but in the end we do only overspend on things for business, and for very privileged interest groups. We never spend enough for average working people.”

Whatever international leaders propose, they are contending with a nasty feedback loop that appears beyond the traditional economic-policy playbook.

The fundamental threat to the world economy is the continued spread of the coronavirus. The outbreak initially shut down great reaches of manufacturing in China, threatening the global supply chain for a vast array of goods, from auto parts to electronics. Then it went global, assailing industry from South Korea and Japan to Italy and Germany.

Desperate to limit the reach of the virus, governments have imposed quarantines, encouraged workers to stay home and generally frightened people into avoiding travel, restaurants, trade shows and other activities that run the risk of encountering other human beings. All of that has inflicted economic damage, prompting warnings of a potential global recession.

A virtually empty shopping street in Milan. A coronavirus outbreak has chilled northern Italy’s economy. Andrea Mantovani for The New York Times

In seeking to limit the threat to the global economy — the spread of the virus — governments have imposed policies that have damaged the global economy.

Despite the mystical aura that seems to surround their undertakings, central banks have no magical powers to cut through this perilous state of affairs. They traditionally wield one potent tool, their influence over short-term interest rates.

When economies struggle and workers are threatened with joblessness, central banks nudge interest rates lower, making credit cheaper, encouraging businesses and households to borrow, spend and invest. That is a proven approach when trouble hits the so-called demand side of the economy — that is, when people and businesses lose their appetite to consume out of fear of some looming danger, or when wages fall and unemployment increases, diminishing spending power.

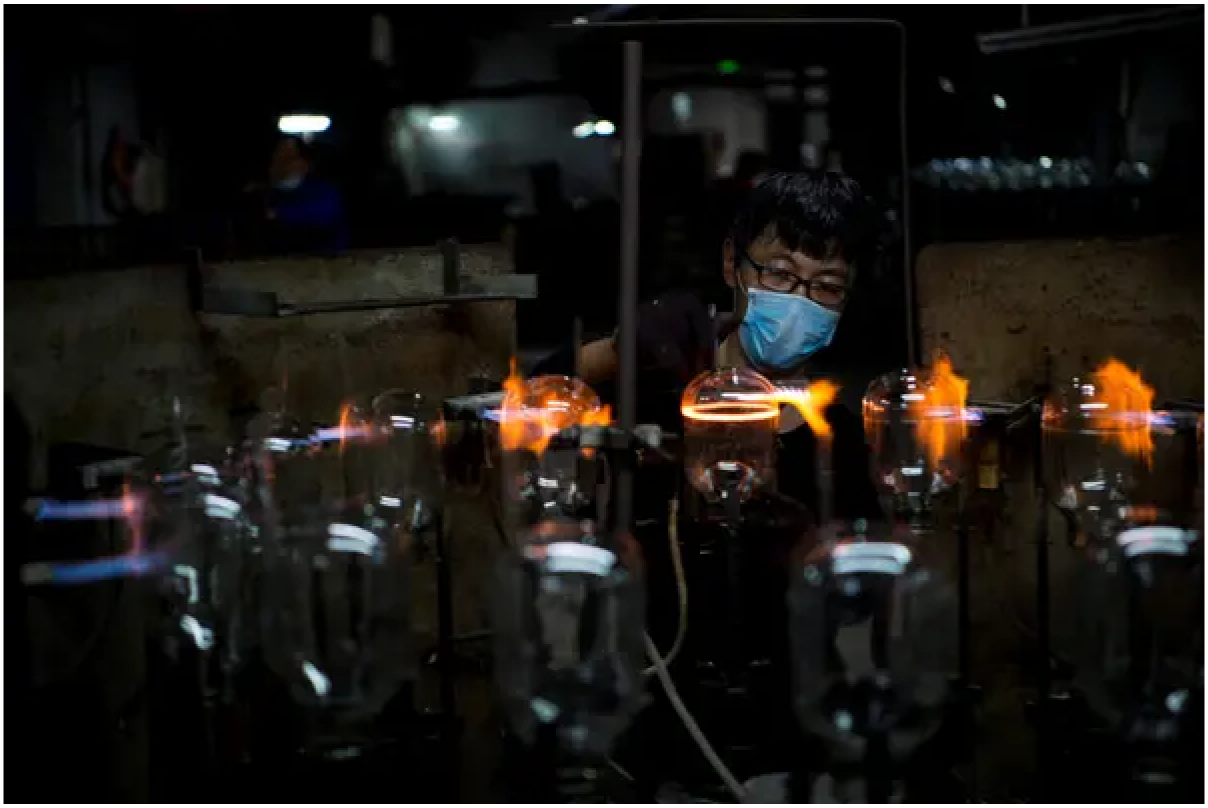
But when the problem hits the supply side — that is, when businesses have difficulty making their goods because they cannot secure raw materials, cannot get their products to market or encounter some other impediment — cutting interest rates tends to be futile. It is like handing coupons to shoppers and sending them to a store that is closed.

As an economic event, the coronavirus episode presents an unusual combination: It is a shock to the supply and demand sides of the economy at the same time. It is limiting industrial production, sowing chaos in the supply chain, while also constraining consumer spending by making a trip to a shopping mall or a journey on an airplane feel like a recklessly dangerous activity.

At the same time, central banks are operating with limited options given that they are still positioned to fight the last great threat, the global financial crisis of 2008. From North America to Europe to Asia, central banks dropped interest rates to zero and even below in a bid to spur commerce.

In many economies, prominently Europe and Japan, rates remain in that vicinity. When rates are that low — meaning credit is cheap for anyone who can get it — dropping them further does not produce much impact.

“Monetary policy is less effective when it’s already super loose,” said Marie Owens Thomsen, global chief economist at Indosuez Wealth Management in Geneva. “Economic theory doesn’t really give us a template for what to do.”



The outbreak significantly impaired manufacturing in China, threatening the global supply chain for a vast array of goods. China Daily/Reuters

The Fed appears to have taken action not out of some misplaced dream that lower interest rates are an antidote to the economic contagion, but in the hope of altering the psychology around it. The rate cut sends the message that grown-ups are looking out with concern.

“Fear is totally capable of causing a recession on its own,” Ms. Owens Thomsen said.

But psychology plays multiple ways. Some saw in the Fed’s action — its first emergency rate cut since the financial crisis — a sign that matters are even worse than feared.

“This move has the benefit of looking like action, but at first glance smells panicky,” Jeremy Thomson-Cook, chief economist at Equals, a money management firm in London, said in a statement. The move “could easily backfire by hinting that something extremely negative is about to come over the hill, possibly a recession.”

The rate cut was essentially priced into stock values. A failure to fulfill that expectation might have been taken as a sign that world authorities are impotent in the face of the outbreak.

But lifting stock prices is not supposed to be the central bank’s concern (even as that frustrates President Trump, who touts stock market rallies while demanding lower interest rates). Rather, the Fed is meant to seek stable prices and full employment.

For years, prominent economists have warned that the world has become addicted to monetary policy and its crisis spawn, low interest rates, as the appropriate response for nearly every economic concern. In this view, governments must unleash the power of their budgets. They must transcend their aversion to spending money and increase taxes on wealthy people to secure the revenue to build more infrastructure and bolster government programs.

Italy, the epicenter of the outbreak in Europe, has long sought relief from the budget strictures attendant to using the euro. But that has collided with the politics of Germany, Europe's largest and most influential economy, where a profound cultural abhorrence of debt has prompted the government to enforce budget austerity across the continent.

As the members of the Group of 7 wrapped up their meeting with only broad promises to take action as needed, and as the Fed delivered the only substantial policy move in the world's leading economy, some argued that public spending was again being neglected.

"The tools available to the authorities are somewhat limited," said Richard Portes, an economist at the London Business School. "But a coordinated fiscal stimulus on the expenditure side, and individually targeted at a national level, that would be a good thing."

Peter S. Goodman is a London-based European economics correspondent. He was previously a national economic correspondent in New York. He has also worked at The Washington Post as a China correspondent, and was global editor in chief of the International Business Times. @petersgoodman

The Coronavirus Outbreak

Answers to your most common questions:

Updated March 2, 2020

- **What is a coronavirus?**
  It is a novel virus named for the crownlike spikes that protrude from its surface. The coronavirus can infect both animals and people and can cause a range of respiratory illnesses from the common cold to lung lesions and pneumonia.
- **How contagious is the virus?**
  It seems to spread very easily from person to person, especially in homes, hospitals and other confined spaces. The pathogen can travel through the air, enveloped in tiny respiratory droplets that are produced when a sick person breathes, talks, coughs or sneezes.

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