



## Special Series on COVID-19

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# Policy Advice to Asia in the COVID-19 Era

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Having been hit by COVID-19 first, Asia is also recovering first. At the pandemic's first anniversary, is the region back to full health? This note focuses on how countries in Asia are (1) adjusting to the COVID-19 shock, (2) using unconventional policies when policy space is limited, (3) dealing with debt, and (4) helping the vulnerable and greening the recovery.<sup>1</sup>

## I. THIS PANDEMIC WILL HAVE LONG-LASTING EFFECTS

As the COVID-19 pandemic spread around the world, the first priority for policymakers was to limit the spread of the virus. While all countries imposed containment measures, exact strategies differed. New Zealand imposed a near complete lockdown, while Korea relied on strong advisories about business closures rather than mandatory shutdowns. Reopening strategies also differed, although most Asian countries reopened only after the first wave of the virus was suppressed. As the pandemic has continued to evolve, countries have increasingly relied on testing and tracing systems and localized lockdowns to contain the virus while minimizing economic costs. Looking ahead, effectiveness and distribution of vaccines will of course play a key role in shaping the infection curve.

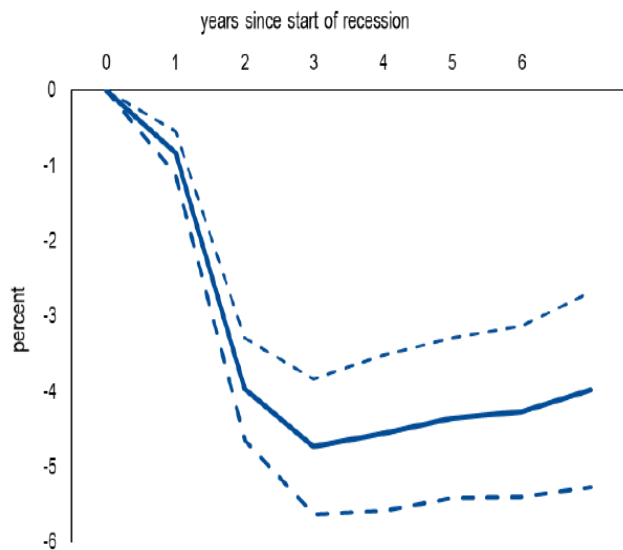
Attention is now increasingly turning to the potential scarring effects of the COVID-19 shock. Past experience teaches us that recessions can have long-lasting effects, with GDP remaining on average 4 percent below trend 5 years after the start of a recession, with lower productivity, reduced capital stock, and high unemployment all contributing to the negative effects. The unique nature of this crisis means that additional channels may be at play. On the one hand, there is hope that the greater focus on digitalization may boost medium-term productivity, providing a silver lining to the crisis. On the other hand, protracted border closures can give rise to

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<sup>1</sup> For a detailed assessment of the key challenges facing Asia at this critical juncture, and a discussion of the policy options to address the current challenges and build the foundations for a more sustainable and inclusive future, see Rhee and Svirydzienka (2021).

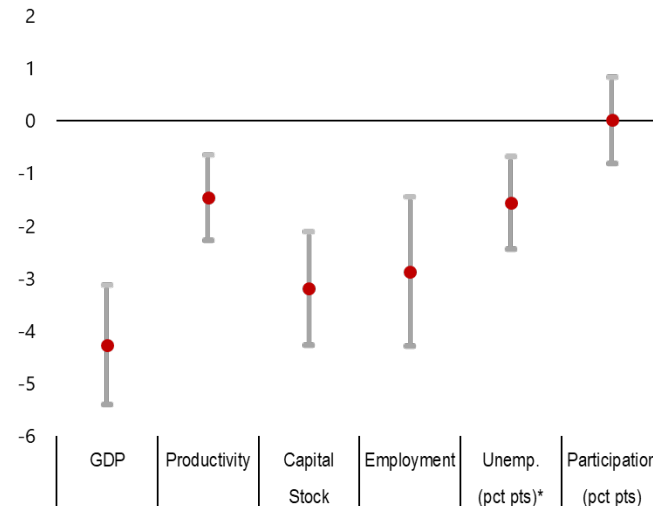
negative effects. For example, in Australia and New Zealand potential output growth may slow down due to a decline in migration flows, which will reduce the growth rate of the labor force.

**FIGURE 1. Impact of Recessions on GDP**  
(Deviation of GDP from trend, percent)



Source: IMF staff estimates.  
Note: Impulse response function based on local projection method.  
Sample consists of 23 advanced economies from 1970 to 2012.

**FIGURE 2. Impact on Factors of Production**  
(Deviation from pre-recession trend after 5 years, percent change)

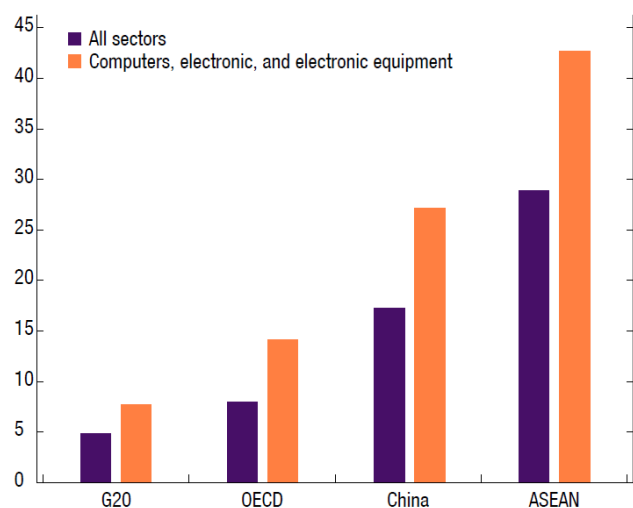


Source: IMF staff estimates.

These scarring effects are likely to be larger in countries that are highly dependent on tourism and other services that require in-person contact. The COVID-19 pandemic has caused global tourism to come to a virtual standstill, a major concern for many Asia-Pacific and Caribbean economies. Tourism is a major economic driver, accounting for more than 10 percent of the global economy and a major employer of youth and women and one of the most interconnected industries with multiple sectors dependent on its performance. Key uncertainties remain regarding the future of the tourism sector. An effective global vaccine rollout can lead to a faster-than-expected recovery, while a delayed or ineffective rollout may lead to downside risks materializing, potentially exacerbating pre-existing vulnerabilities in many tourism dependent countries.

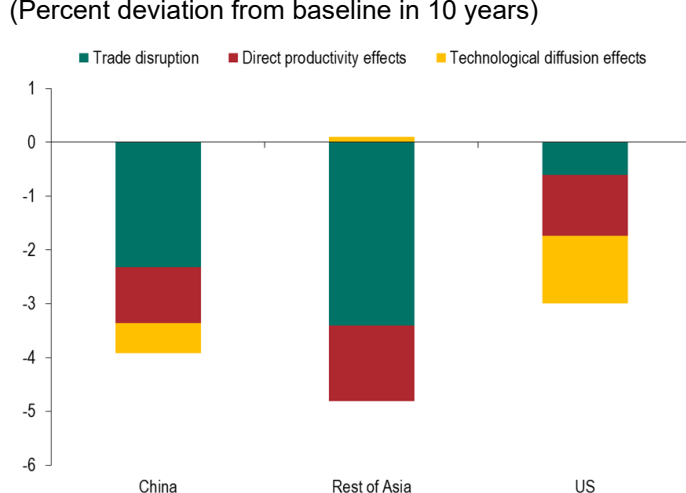
Unlike in past recessions, the prospects for global trade to lead us back to recovery are rather uncertain. If anything, the COVID-19 pandemic has the potential to accelerate the China–US trade and technology tensions and permanently change the landscape of global value chains and international investment flows. Heightened trade tensions between China and the United States, in fact, adds a downside risk to the recovery. This is especially true for the high-tech sector, which is heavily dependent on cross-border trade and where China–US tensions are giving rise to threats of a technological decoupling. Estimates from model simulations show that such a decoupling could reduce real GDP in China by 4 percent, with spillovers to the rest of Asia of a similar magnitude.

**FIGURE 3. Foreign Value Added in Gross Exports**  
(Percent, 2015)



Sources: OECD TiVA; and IMF staff calculations.  
Note: ASEAN = Association of Southeast Asian Nations.

**FIGURE 4. Impact on GDP of Technological Decoupling Scenario**  
(Percent deviation from baseline in 10 years)



Source: IMF staff estimates.  
Note: Simulation based on IMF Global Integrated Monetary and Fiscal Model (GIMF) to estimate real GDP impact in steady state with lower China–OECD high-tech trade. Three channels: loss of trade, lower productivity due to resource misallocation, and forgone productivity gains due to lack of technological spillovers (diffusion channel).

## II. UNCONVENTIONAL MEASURES FOR UNCONVENTIONAL TIMES

Asia-Pacific countries provided significant fiscal and monetary policy support to cushion the impact of the pandemic on their economies. Many, especially the emerging market and developing economies, are running out of policy space and are resorting more to unconventional monetary policies to ease the pressure on banks and borrowers.

The Bank of Japan (BoJ) has been at the forefront of monetary policy innovation for several decades. More recently, the focus has been on yield curve control (YCC) after the BoJ pegged the 10-year Japanese government bond (JGB) yield at about zero percent in September 2016. Japan’s existing quantitative and qualitative easing and YCC framework has worked well throughout the periods of increased financial market volatility and holds lessons for other central banks considering adopting this monetary framework. The choice of the YCC target horizon is subject to a trade-off between stimulating the economy and exposing the central bank’s balance sheet to risk, as well as a trade-off between maintaining price inflation and financial stability. Exiting smoothly from YCC could be challenging. Exiting smoothly from YCC could be challenging; if not communicated well to investors, such monetary policy normalization could trigger a government bond market sell-off. Without an automatic exit strategy, YCC can also expose the central bank to the risk of fiscal dominance.

The turn to unconventional monetary policies (UMPs) in emerging economies has been a surprise, as the circumstances did not resemble those prevalent in advanced economies when they used these tools. In ASEAN-4, Malaysia and Thailand resorted to central bank lending operations to provide extra liquidity to firms, while Indonesia and the Philippines used large-scale asset purchases. Although it is too early for a more definitive assessment, UMP seems to have been effective so far. While warranted, these more aggressive policies inevitably entail risks, which will increase the longer they are used. The large increase in domestic currency liquidity could trigger balance of payments pressures and even affect the integrity of the monetary policy framework.

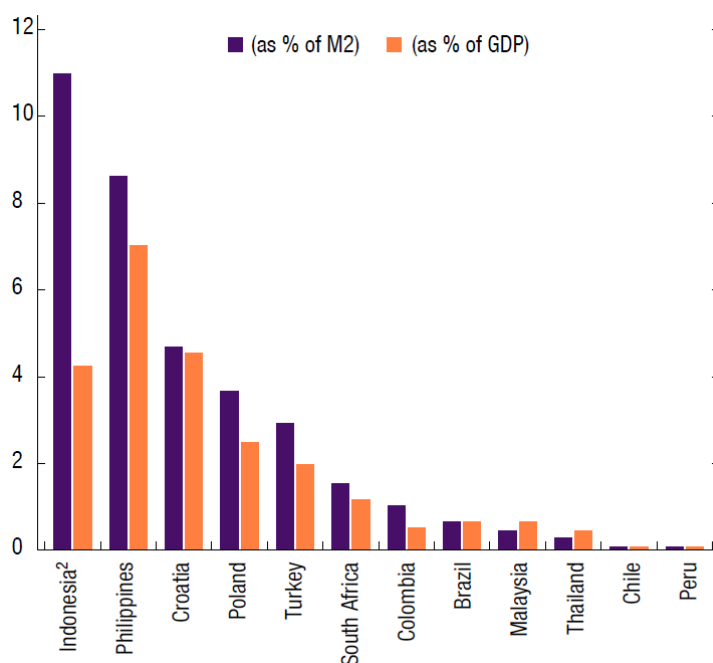
**TABLE 1. Unconventional Monetary Policy Measures Taken during the COVID-19 Crisis**

	AEs		EMs			
	Japan	Australia	Indonesia	Philippines	Malaysia	Thailand
Large-scale asset purchases	Yes	Yes	Yes	Yes	No	No
Yield curve control	Yes	Yes	No	No	No	No
Lending operations	Yes	Yes	No	No	Yes	Yes
Forward guidance	Yes	Yes	No	No	No	No
Negative interest policy rates	Yes	No	No	No	No	No

Sources: National central banks; IMF Departmental Paper on "Policy Advice to Asia in the COVID-19 Era."

In addition to these unconventional policies, many countries—notably in South Asia—also implemented a wide range of financial sector measures to ease pressure on banks and borrowers, such as debt service moratoria and targeted lending schemes to provide relief to households and firms. Macroprudential policy was also loosened in some countries, by no longer requiring accumulation of the countercyclical capital buffer (Nepal), drawing down the capital conservation buffer (Sri Lanka), and reducing the liquidity coverage ratio (India).

**FIGURE 5. 2020 Changes in Central Banks' Claims to Central Government<sup>1</sup>**  
(Percent of M2 or GDP)



Sources: IMF, Monetary and Financial Statistics database; IMF, World Economic Outlook database; and IMF staff estimates. Note: M2 = money supply, sum of money, and quasi-money (see International Financial Statistics).

<sup>1</sup>Changes in claims to central government during period January to August 2020.

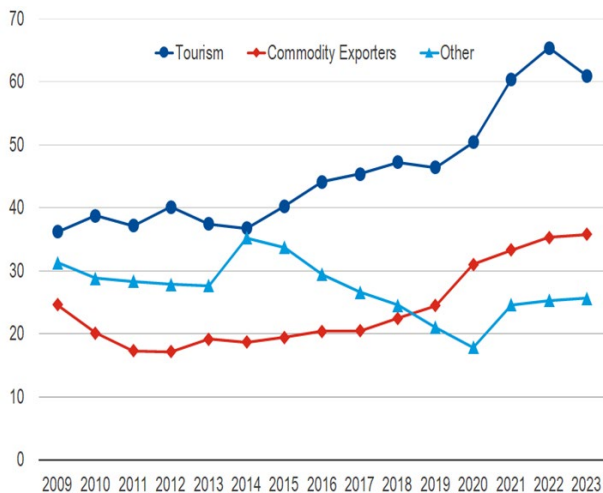
<sup>2</sup>In the case of Indonesia, the figure includes commitments within 2020 burden-sharing agreement.

### III. PUBLIC AND PRIVATE DEBT HANGOVER

In the pandemic's aftermath, many countries will have to contend with high public and private debt burdens—possibly too large for some to manage.

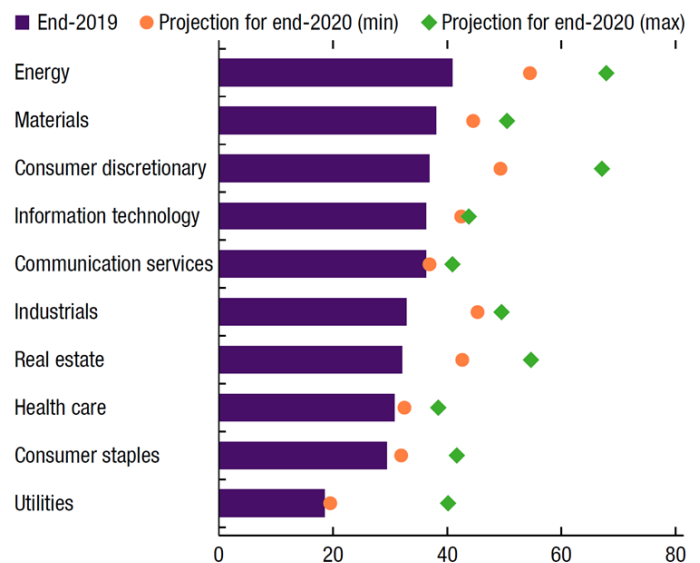
Sovereign debt is an issue in small states. Based on our projections, most countries in this region are expected to see mounting public debt stocks beyond their capacity to manage. The pandemic took a heavy toll on tourism and commodity exports. And as a result, the countries that are relatively more reliant on these sectors experienced larger declines in government revenues and higher increases in public debt ratios. Looking forward, risks to the projected debt paths are significant, mainly stemming from low trend GDP growth, slow and uncertain recovery in tourism and commodities, and natural disasters. The balancing act between supporting the recovery and rebuilding fiscal buffers may simply prove too much for some of these countries.

**FIGURE 6. Pacific Island Countries: Public Debt-to-GDP Ratio, by Subgroup**  
(Percent, median)



Sources: World Economic Outlook database; and IMF staff estimates.

**FIGURE 7. ASEAN-6: Firm-at-Risk by Industry**  
(Percent share of firms generating earnings not enough to cover interest payment)



Sources: S&P Global Market Intelligence; and IMF staff estimates.

In larger emerging markets, the main problem might be record-high private debt. More and more companies are not generating enough earnings to service their debts. Many ASEAN firms encountered the pandemic with a record-high debt service burden, primarily as a result of a sustained decline in profitability since the global financial crisis, and more recently, the rise in financing costs. The expected impact of COVID-19 shock could lead to an unprecedented wave of corporate bankruptcies in the absence of policy interventions, with close to half of sample firms unable to generate enough earnings to cover their interest payments falling due in 2020. The industries that are expected to have been hit the most severely are energy and consumer discretionary, which includes hotels and restaurants.

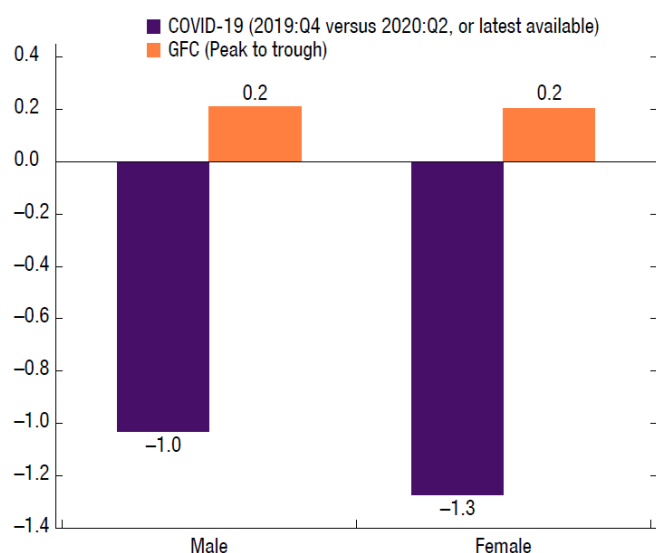
Fortunately, we did not see a noticeable pickup in corporate bankruptcies in 2020, largely thanks to sizable liquidity support measures. As the pandemic is likely to induce structural shifts in consumer preferences and a reconfiguration of global supply chains, this could lead to changes in business models and sectoral restructuring. While government support is helping these companies to keep afloat, a large wave of corporate bankruptcies could follow when that support is withdrawn, and in the absence of other interventions. This vulnerability can be especially acute in Asia, if global financial market conditions tighten in the process of recovery, leading to capital outflows and additional pressure on the corporate sector.

#### IV. HELPING THE VULNERABLE AND GREENING THE RECOVERY

The COVID-19 pandemic took a toll on Asia’s labor markets: unemployment surged, and labor force participation plunged. Job losses were concentrated in industries with lower wages and among women and youth. The pandemic also had a disproportionate impact on the poorest and most vulnerable, exposing severe gaps in social protection and exacerbating already high inequality in advanced and emerging Asia.

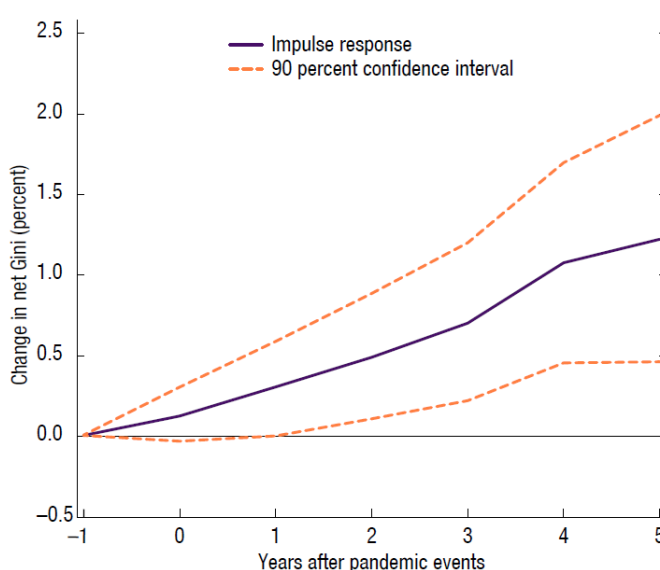
The pandemic is likely to further increase inequality in the medium term. Empirical evidence suggests that major pandemics over the past two decades, even though much smaller in scale than COVID-19, have led to persistent increases in income inequality. One channel through which pandemics may further increase inequality is the acceleration in automation and robotization. Low-skilled workers are more at risk of displacement by robots than high-skilled workers, which reinforces existing inequality dynamics. The resulting higher levels of inequality could lead to a significant increase in social unrest. While there is no one-size-fits-all solution, model-based analysis suggests that targeted policies are effective in mitigating adverse distributional consequences, while also underpinning economic activity and virus containment.

**FIGURE 8. Asia: Female Labor Force Participation Rates Delta**  
(Percentage points)



Source: Jurzyk and others (2020).  
Note: Asia refers to Australia, Hong Kong Province of China, Japan, Korea, the Philippines, and Thailand. Data are seasonally adjusted. For COVID-19, data are up to June 2020 (or latest available). GFC = global financial crisis.

**FIGURE 9. Average Response of Net Gini to Pandemic for 175 Countries, 1961–2017**  
(90 percent CI; change in net Gini; percent)



Source: Furceri and others (2020).  
Note: The figure estimates the average change in net Gini associated with a pandemic (impulse response functions and 90 percent confidence bands estimated using a sample of 175 countries during 1961–2017).

Paradoxically, the COVID-19 shock also provided a glimpse of what a better future could hold for Asia. The temporary reallocation from energy-intensive sectors, such as airlines and transportation, provides an opportunity for job creation in more productive and cleaner sectors. A well-designed carbon tax package and complementary product and labor market policies could support capital reallocation and labor reskilling. This would benefit the global fight against climate change, as Asia-Pacific has some of the largest carbon dioxide emitters and polluters and could lead to improved health conditions for local populations, better jobs, and more resources to meet developmental needs.

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## V. POLICY TAKEAWAYS

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These are difficult times, requiring Asia to navigate multiple challenges. The COVID-19 pandemic comes in the context of longer-running challenges in the region: slowing productivity growth, high indebtedness, population aging, and rising inequality. A renewed bout of tighter global financial conditions could aggravate already weak public and private sector balance sheets, trigger a wave of corporate defaults, and potentially push vulnerable countries into a debt crisis. Redistributive policies in Asia are limited and the informal sector is large, making it difficult to reach and support the most vulnerable. Income and wealth inequality, already increasing before the pandemic, are likely to rise further unless decisive actions are taken.

These are the policy options for the Asia-Pacific to address COVID-related challenges:

- **To flatten the virus curve:** (1) activate containment measures early, when infection rates are still low; (2) exit lockdowns after the virus has been suppressed for better health and economic outcomes; and (3) put in place comprehensive testing and tracing systems to minimize the risk of second waves.
- **To prevent longer-term scarring:** step up economic reforms to boost productivity growth and investment, allow for adequate reallocation of resources across sectors, and support workers affected by the transition. The reform package could include well-targeted hiring subsidies and worker-retraining schemes, infrastructure upgrades, and reforms to simplify business processes and reduce the regulatory and tax burden.
- **To minimize the side effects of unconventional policies:** (1) target liquidity support toward firms that are solvent, (2) ensure that bond purchases are guided by well-defined last resort criteria, and (3) establish clear frameworks for the use of unconventional policy and have an exit strategy.
- **For countries with high public debt burdens:** focus on revenue mobilization, public financial management, and debt management; liquidity support from multilateral partners, the G20 Debt Service Suspension Initiative and the Common Framework, and debt relief and/or debt reduction can provide some relief.
- **To address high corporate debt burden:** reinforce private debt resolution frameworks, ensure the availability of adequate financing, and facilitate access to risk capital to speed up the reallocation of resources into growth sectors.

- **To create more resilient and inclusive economies:** (1) support the vulnerable through targeted policies, including conditional cash transfer schemes; (2) get workers into formal systems that can be activated and scaled up; and (3) in rebuilding the economy, channel support toward cleaner sectors, to reduce emissions and fight climate change.

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