The COVID-19 Crisis

The COVID-19 pandemic poses unprecedented health, economic, and financial stability challenges. The first priority, of course, is to save lives. But the necessary containment measures to limit the spread of the virus are causing a dramatic decline in economic activity. As a result, in only three months, the 2020 outlook has shifted from expected growth of more than 3 percent globally to a sharp contraction of 3 percent—much worse than the output loss seen during the 2008–09 global financial crisis. The ultimate impact of the crisis on the global economy, as well as the timing of a recovery, is highly uncertain.

This crisis presents a very serious threat to the stability of the global financial system. Following the COVID-19 outbreak, financial conditions tightened at unprecedented speed, exposing some “cracks” in global financial markets. Market volatility spiked and borrowing costs surged on expectations of widespread defaults. Signs of strain emerged in major funding markets, including the global US dollar funding market. Historically large capital outflows exacerbated domestic shocks in emerging market economies. These developments have raised the risk that the inability of borrowers to service their debts would put pressure on banks and cause credit markets to freeze up. A prolonged period of dislocation in financial markets could trigger distress among financial institutions, which, in turn, could lead to a credit crunch for non-financial borrowers, further exacerbating the economic downturn.

To safeguard economic and financial stability and to prevent the emergence of adverse macrofinancial feedback loops, countries are taking decisive actions. Central banks have eased monetary policy and are providing liquidity to the financial system, including through foreign-currency swap lines, to maintain the flow of credit to the economy. Thanks to these efforts, funding markets have remained functional and investor sentiment has shown signs of improvement. Supervisors are encouraging banks to prudently renegotiate loan terms for those struggling to service their debts in order to help bridge the period of economic inactivity, and to use existing capital and liquidity buffers, as well as other flexibility in their regulatory and accounting frameworks, to absorb losses. Country authorities are supporting people and companies through sizable, timely, temporary, and targeted fiscal measures to put a limit on defaults of firms and households via payment moratoriums and guaranteed credit. Multilateral cooperation has increased the resources available to support the most vulnerable countries and communities. The IMF, with $1 trillion in available resources, is actively supporting its member countries.

These policies are essential to ensure that a temporary shutdown of production does not lead to more permanent damage to the productive capacity of the economy, to the financial system, and to the fabric of society. Once the virus outbreak is under control, policies should be aimed at fostering the recovery as well as assessing and healing the damage inflicted by the pandemic on the balance sheets of nonfinancial firms, financial institutions, and governments.

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