

Making money for COVID-19

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In early May 2020 David Masondo, South Africa's deputy finance minister commented on the ANC government's pledge of a R500bn stimulus package to support the country through COVID-19:

"The capacity of our government to raise revenue from tax and borrowing is highly limited. Covid-19 and the recent downgrades by the credit-rating agencies have worsened our economic woes. Given our fiscal constraints, I would support the South African Reserve Bank (SARB) if they decide to directly buy government bonds" (Cele, 2020).

Commentators scrambled to voice concerns related to Masondo's assertion that he "would support the SARB". Did this mean quantitative easing? Just how independent was the SARB and did it really matter? Questions over the legality of such action (in terms of section 13f of the SA Reserve Bank Act) of 1989 were also raised (Rossouw, 2020).

A short history of making money

The ancients never actually made (or needed) money; people bartered their labour and their goods. Eventually, gold coinage replaced barter, greatly improving transaction liquidity and doubling as an efficient medium to store value. Moreover, it did not take long for financial engineers to convert consumers to bearer notes, backed by gold. It being easier to print notes than to mine gold, consumers were discouraged from redeeming gold bars with their paper money, and by the nineteenth century the "gold standard" endorsed and legalised the concept of fractional gold "reserves" (Wikipedia, n.d.). The Bretton Woods agreement (1944) birthed the International Monetary Fund and fully adopted fiat money by fixing exchange rates to the US dollar, which in turn was pegged to gold (Wikipedia, n.d.).

In 1971 President Nixon pulled the US dollar's peg against gold, effectively ending Bretton Woods. By 1980 banks were converting their gold vaults into restaurants (Farchy, 2010); after all, gold was expensive to hold and almost never required - consumers had "drunk the kool-aid". As ideas fed upon themselves, cash morphed into cheques, charged-electrons and cryptos. In early 2020 COVID-19 raised awareness that banknotes were little more than virus petri-dishes, thereby sounding their death-knell (Cowen, 2020). After all, in Sweden eighty seven percent of transactions were already digital (Cohn, 2020).

Making money had gotten easier. Gold, once prized for its rarity and intrinsic value, remained “in reserve”; little more than a hold-out awaiting apocalyptic financial market meltdown.

Democratically elected governments have huge incentives to access money, but, are constrained through taxes and borrowing. Taxes being unpopular, governments have been quick to explore the outer limits of debt through the issue of government bonds; which are of course, backed by taxes. To further expand sources, many governments (including South Africa’s¹) force individuals to invest in government bonds through “prescribed asset” regulations. In theory and practice, governments which have issued too much debt are punished by investors demanding higher yields, thereby increasing servicing costs.

War, famine and pestilence

In April 1942, and for a decade thereafter, the US Federal Reserve Bank kept borrowing costs at 2.5%, initially to fund the war effort, and later to avoid a second Great Depression (Federal Reserve Bank, n.d.). Maintaining this long-term peg required the Fed to enter the market as a buyer of government bonds using... nothing. Quantitative Easing debuted and a crisis was averted. However, the vastly increased money supply birthed another crisis; inflation (CPI) reached 18% in 1947. In February 1951, a dispute finally arose between President Truman and the Fed – who, asserting their independence, declined to continue supporting the US war in Korea (Federal Reserve Bank, n.d.).

Economists opine that there are two causes of inflation “demand-pull” (too much money chasing too few goods) and “cost-push” (higher costs pushing up prices). Most developed economies responded to the 2008 global financial crisis with austerity measures, ultimately entrenching “Japanification” (Takeo & Boesler, 2020) or more exactly: economic stagnation and deflation (Kohler, 2020). Now, with record numbers of unemployed on account of COVID-19, helicopter money² and fiscal stimulation were the emerging economic response. On 6th April 2020, Japan for example, announced a \$1000bn emergency fund, of which \$150bn was for families (each of the 58 million people in Japan would receive about \$900) (Bloomberg, 2020). With interest rates at zero in Japan, it would be easy to finance this with increased debt in perpetuity. Already in 2018, the IMF warned of the \$164tn global debt pile at a record of 225% world GDP (Chu, 2018), noting that US debt was higher than it was in WW2 (Flood, 2020).

¹ In South Africa “regulation 28” of the pension fund act requires 25% of value to be invested into “prescribed assets” – largely government bonds.

² Milton Friedman used this term to describe helicopters dropping cash to stimulate buying.

On March 15th 2020 Fed Chairman Jay Powell announced a second rate cut (totalling 150 basis points) and added: "We really are going to use our tools to do what we need to do here" (Dunsmuir & Saphir, 2020). Two weeks later, he elaborated on the Fed's intentions:

... even with interest rates at zero, the Fed's firepower is limitless. "When it comes to lending, we are not going to run out of ammunition, that doesn't happen." (Timiraos, 2020)

Proponents of the (unorthodox) modern monetary theory (MMT) argue that none of this matters (Kelton & Chancellor, 2020). In essence, MMT posits that debt can do no harm, particularly if used to fund education or infrastructure (Ezrati, 2020). As evidence, figure 1 shows central bank balance sheets (before the crisis) as a percent of GDP, with Japan at almost 100%. Japan has, over the last 20 years, spent trillions of Yen on airports, highways, bridges (Japan spent ¥2.89tn to build 15 vast toll bridges between the islands of Honshu and Shikoku – which are little used) and magnetic levitation trains – with no sign of inflation or any other "harm" (Harding, 2019).

South Africa's R500bn stimulus

In his address to the nation on 21st April 2020, President Ramaposa announced a huge R500bn stimulus package, more than 10% of GDP, and relatively high compared with other emerging countries (figure 2) (Duffin, 2020). Brazil, by comparison, had announced a stimulus of approximately 7% of GDP, but with their debt to GDP ratio already at 90% (versus South Africa's at 60%) even this would be hard to fund.

As Deputy Minister Masondo had stated, COVID-19 had delivered simultaneous multiple blows to the economy: tax revenue would drop by R280bn (Ensor, 2020) and debt had finally dropped below investment grade (increasing servicing costs and curtailing new issues), yet limiting COVID-19 related damage demanded significant amounts of capital. Was it possible for the SARB to directly purchase government bonds, and was this a good idea?

Figures

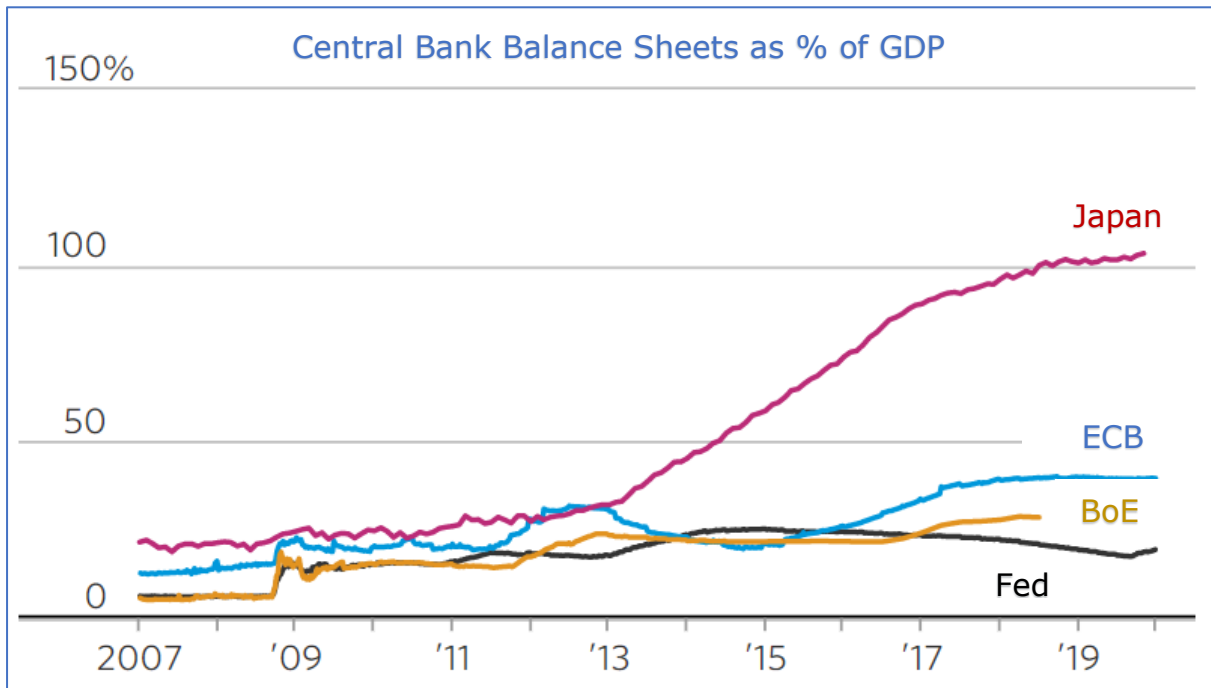


Figure 1: Quantitative Easing as % GDP prior to the COVID-19 crisis (WSJ, 2020)

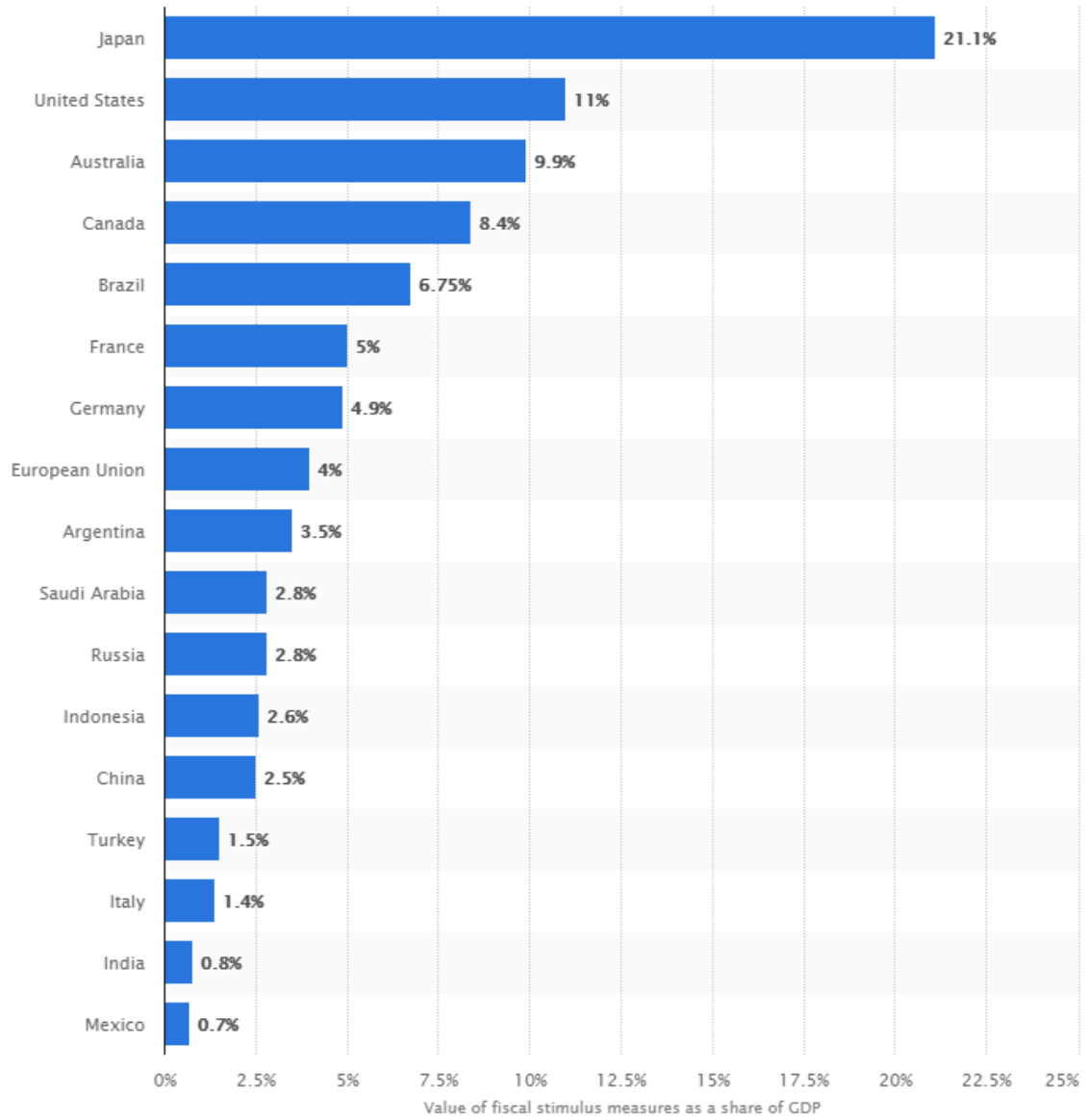


Figure 2: Value of Fiscal stimulus as % of GDP – Statista.com (IMF, 2020)

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