In the face of an unexpected adversary:
The crucial role for central banks

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A unique crisis

Truly exogenous

Output fell more in countries where people stayed at home

Global mobility tracker\(^1,5\)

Change between Jan and May 2020 forecasts for 2020 GDP (\(\%\) pts)
A unique crisis

 Truly exogenous

 Truly uncertain
A unique crisis

Truly exogenous

Truly uncertain

Truly global

Analysts expect a very deep recession in 2020

Year-on-year changes in real GDP, in per cent

Sources: IMF, World Economic Outlook; Consensus Economics.
A unique crisis calls for a unique response

- Unique in terms of scope
  - Unprecedented range of instruments, some known, some new
  - Unprecedented coordination of monetary, fiscal and prudential policies

- Unique in terms of objectives
  - Not so much to boost aggregate demand but to offer a lifeline to firms and households during the lockdown
Measures galore – for example, in Canada

Balance sheet soared – for example, in Japan

Sources: National data; BIS calculations.
## Central banks’ unprecedented response...

<table>
<thead>
<tr>
<th>Type of tool</th>
<th>Measures</th>
<th>Advanced economies</th>
<th>Emerging market economies</th>
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<td>Interest rate</td>
<td>Policy rate cut</td>
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<td>Gen. liquidity provision¹</td>
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<td>Specialised lending</td>
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<td>Commercial paper</td>
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<td>Other private securities²</td>
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<td>FX swap/intervention</td>
<td>USD swap line</td>
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<td>FX intervention</td>
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<td>Prudential rules and regulations</td>
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<td>Payout restrictions</td>
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<td>Market functioning³</td>
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¹ For example, repo and reverse repo operations, standing facilities, modified discount window and lower reserve requirement ratio. ² For example, asset- and mortgage-backed securities, covered bonds and exchange-traded funds. ³ For example, short-selling bans and circuit breakers.

Source: National data.
...facilitating the unprecedented prudential response

Countries taking prudential measures

- Countercyclical buffer release
- Other capital requirements
- Payout restrictions
- Liquidity requirements
- Asset classification and provisioning

Sources: BCBS; BIS calculations.
Banks entered the crisis in a strong position...

The vertical lines in the left-hand and centre panels indicate the median for the respective year.

Prompt and forceful fiscal response has been critical

Pledged fiscal packages

Sources: IMF, Fiscal Monitor; IMF, World Economic Outlook; national data; BIS calculations.
Policies have stabilised markets...

Sources: Bloomberg; BoAML ICE indices; JPMorgan; national data; BIS calculations.
...and bank credit has not fallen

Pre-GFC = 1 year to Aug 2008; Post-GFC = October–December 2008

Sources: national data; BIS calculations.
High debt and rising insolvency pose challenges ahead

Non-financial corporate debt

A wave of downgrades

Sources: S&P Capital IQ; national data; BIS; BIS calculations.
Banks are under pressure...

Provisions spike

Rating outlooks deteriorate

Banks’ stock underperform

Banks’ loan loss provisions:
- United States
- European AEs
- Other AEs
- EMEs

Sources: I Aldasoro, I Fender, B Hardy and N Tarashev, “Effects of Covid-19 on the banking sector: the market’s assessment”, BIS Bulletin, no 12, May 2020; Datastream; FitchConnect; SNL.
...and buffers are limited if the crisis persists

Depletion of capital under a severe stress scenario

Banks’ profitability is structurally low

Sources: Datastream; Datastream Worldscope; BIS calculations.
Fiscal space dwindles

Massive widening fiscal deficits expected for 2020

Public debts likely to undergo steepest increase since GFC

Sources: IMF, World Economic Outlook, June 2020; BIS calculations.
Dealing with restructuring and insolvencies

- Central banks can lend but cannot spend
- So monetary can do little to accelerate restructuring
- Formal and informal mechanisms
- Government can play a variety of roles
  - General guidance, setting the rules
  - Equity stakes in companies, to socialize losses *and* opportunities
  - With regulator: provide incentives for banks to restructure debt quickly
- But public finances need to remain sustainable
Monetary and fiscal interactions will be prominent going forward...

Central banks’ balance sheet (Fed, BoJ, ECB, BoE)

General government debt (US, JP, EA and GB)

Sources: IMF, *World Economic Outlook*; national data; BIS calculations.
...particularly as central banks’ footprints grow

Government bonds held by central banks as a share of total outstanding amount

Sources: ECB; Bank of Japan; Board of Governors of the Federal Reserve System; United Kingdom Debt Management Office; Datastream; BIS calculations.