MIND THE GAP
WHEN AND HOW TO UNWIND COVID-SUPPORT MEASURES TO THE BANKING SYSTEM?

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MARCH/APRIL 2020

• Emergency measures: swift and big – care about costs and proper targeting later
• Fiscal policy: furlough, Kurzarbeit, direct support payments, tax payment holidays, loan payment holidays, loan guarantees, direct lending
• Monetary policy: flood markets with liquidity, market maker of first resort, direct firm support
• Regulatory policies: capital and loan provisioning relief, delay in Basel III implementation, delay in stress tests, but also pay-out restrictions
• Result: delay in corporate and household insolvencies, avoid hysteresis, limited rise in unemployment (in Europe) – it is all about social and economic survival
THE ROLE OF BANKS IN HELPING THE REAL ECONOMY DURING COVID-19

- Heavy draw-down of credit lines and increased credit demand as firms want to hold on to cash
- Relationship lenders can be useful in current situation as they know their clients
- Banks have critical role in transmission of monetary policy and fiscal support measures
- Challenge: procyclicality of bank lending – calls for capital relief and payout restrictions
- Challenge for financial institutions – access to liquidity and solvency concerns
  - Credit lines by central banks to banks and MFIs or purchase of loan packages (e.g., through SPV or DFI)
  - Adjustment of loan provisioning requirements?
- Different policy tools: grants for firms/households, tax and credit holidays
- The role of credit guarantees?
Source: Ehrentraud and Zamil (2020)
Loans and advances under moratoria by sector (June 2020)

(Percentages of total loans and advances to the household, SME and NFC sectors)

Sources: EBA, ESRB calculations.
Notes: Countries are ranked by loans under moratoria as a percentage of total loans and advances to households, SMEs and NFCs. The values are the mean value for banks in a given country.
New loans subject to public guarantees by sector (June 2020)

(percentages of total loans and advances to the household and the NFC sector)

Sources: EBA, ESRB calculations.
Notes: Countries are ranked by loans with public guarantees as a percentage of total loans and advances to households and NFCs. The values are the mean value for banks in a given country.
2022 ONWARDS

- Some/many corporates will be overleveraged; some will be no longer viable
  - How to deal with a wave of corporate insolvencies? Restructuring vs. liquidation
  - Bank-led restructuring process?

- Some/many banks will face loan losses
  - But might have to be forced to recognize them (incentives for evergreening?)
  - How to deal with these non-performing assets? Market in NPAs, AMCs?
  - How to deal with failing banks?

- Some governments will face high deficits and debt burdens?
  - How to deal with this?
  - Monetary policy (fiscal dominance?)
  - Another taper tantrum as Federal Reserve 'normalizes' monetary policy?

- Ukraine shock on top of the unwinding from Covid shock
EXIT STRATEGIES WILL DETERMINE FUTURE PATH

• Keynes vs. Schumpeter/Hayek – avoiding hysteresis vs. allowing for necessary resource allocation

• Remove fiscal support for corporations and households? This has implications for banks who might face non-performing borrowers

• Force banks to recognize losses, reverse capital relief etc.? This has implications for corporate borrowers who might be cut off from lending

• How to manage non-performing assets – fire sales vs. ‘storage’ in AMCs with liquidity support

• Broader question: How to recognize and distribute losses?
  • Create transparency to avoid zombie lending
Exiting from different support policies requires coordinate approach as the following examples illustrate:

• Returning to standard loan classification rules requires remodulation of moratoria
• Exit from guarantees requires being ready to address possible rise in corporate insolvency
• Return to ‘standard’ regulatory requirements requires being prepared for resolving fragile banks

In sum:

• Need for coordinated approach across different policy areas and authorities
• Avoid cliff effects
THANK YOU

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