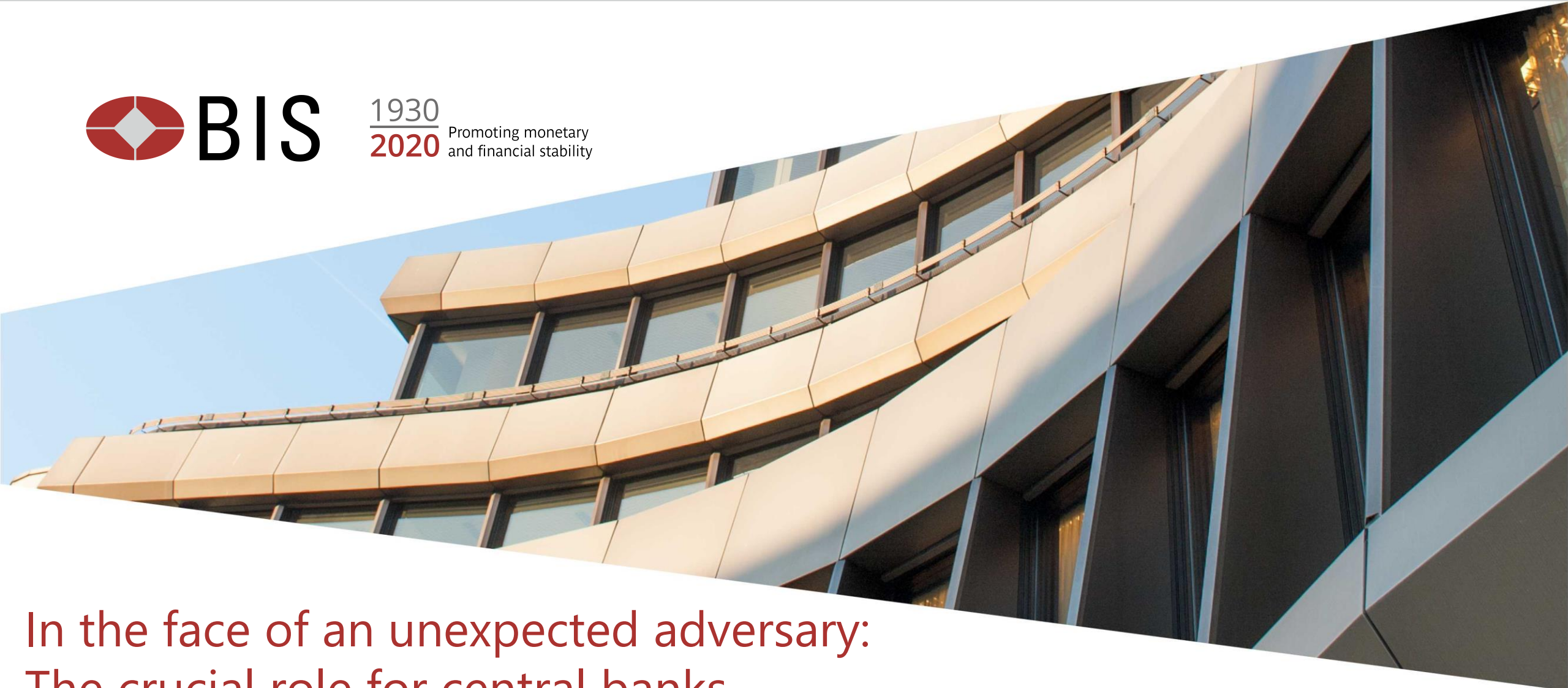




1930
2020

Promoting monetary
and financial stability



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

Christian Upper

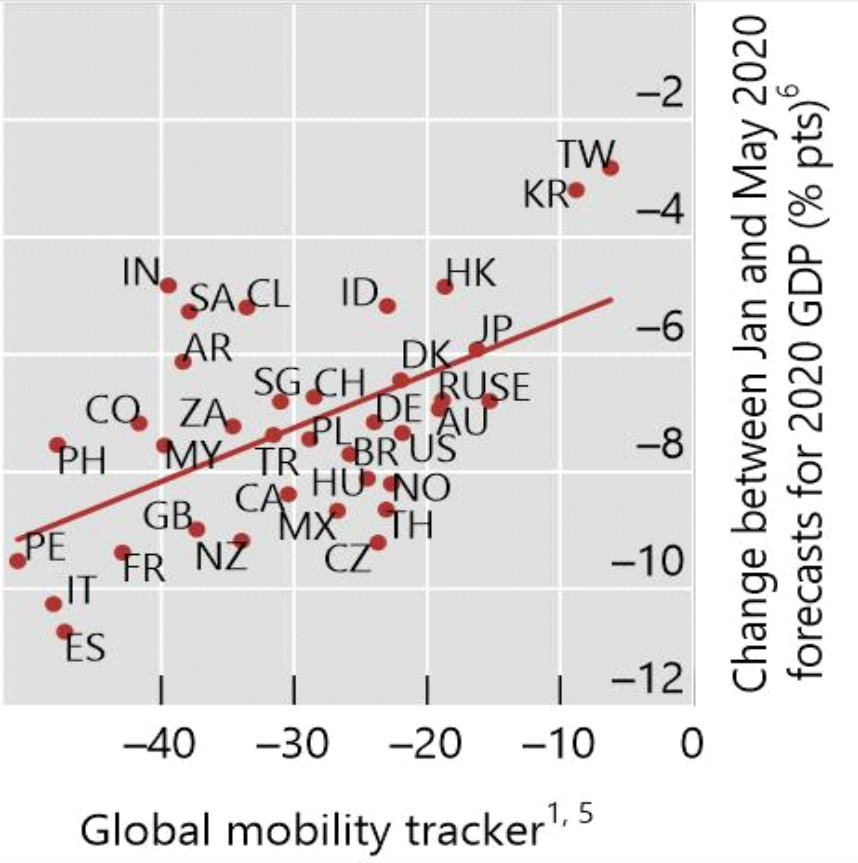
Head of Macroeconomic Analysis

SUERF Webinar, 10 July 2020

A unique crisis

Truly exogenous

Output fell more in countries where people stayed at home



A unique crisis

Truly exogenous

Truly uncertain

A unique crisis

Truly exogenous

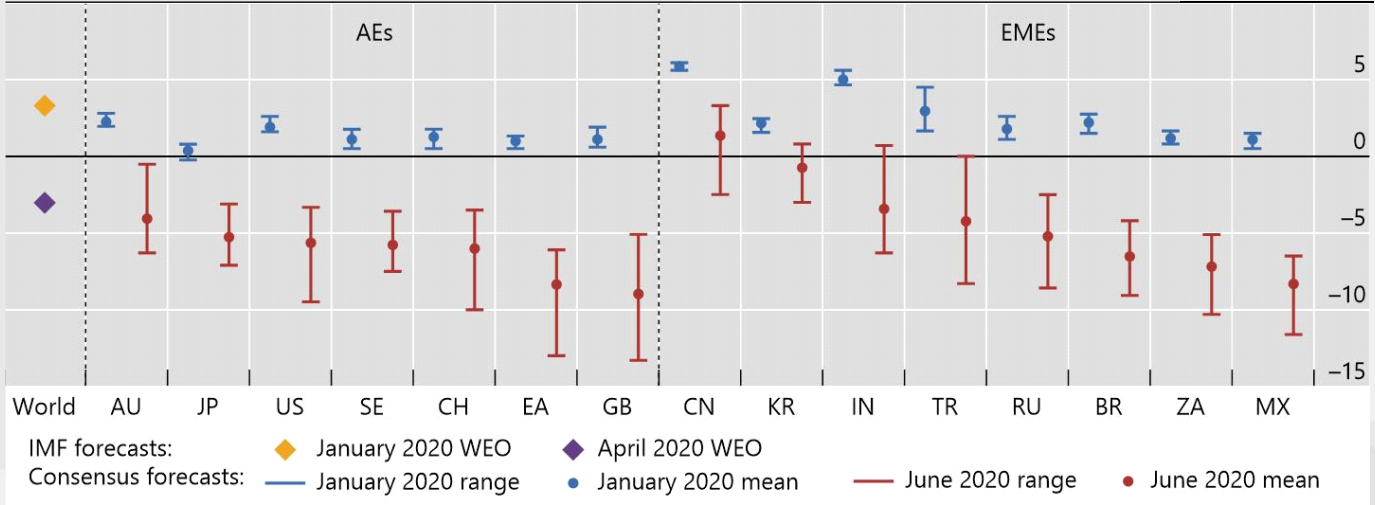
Truly uncertain

Truly global

Analysts expect a very deep recession in 2020

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

Graph I.3



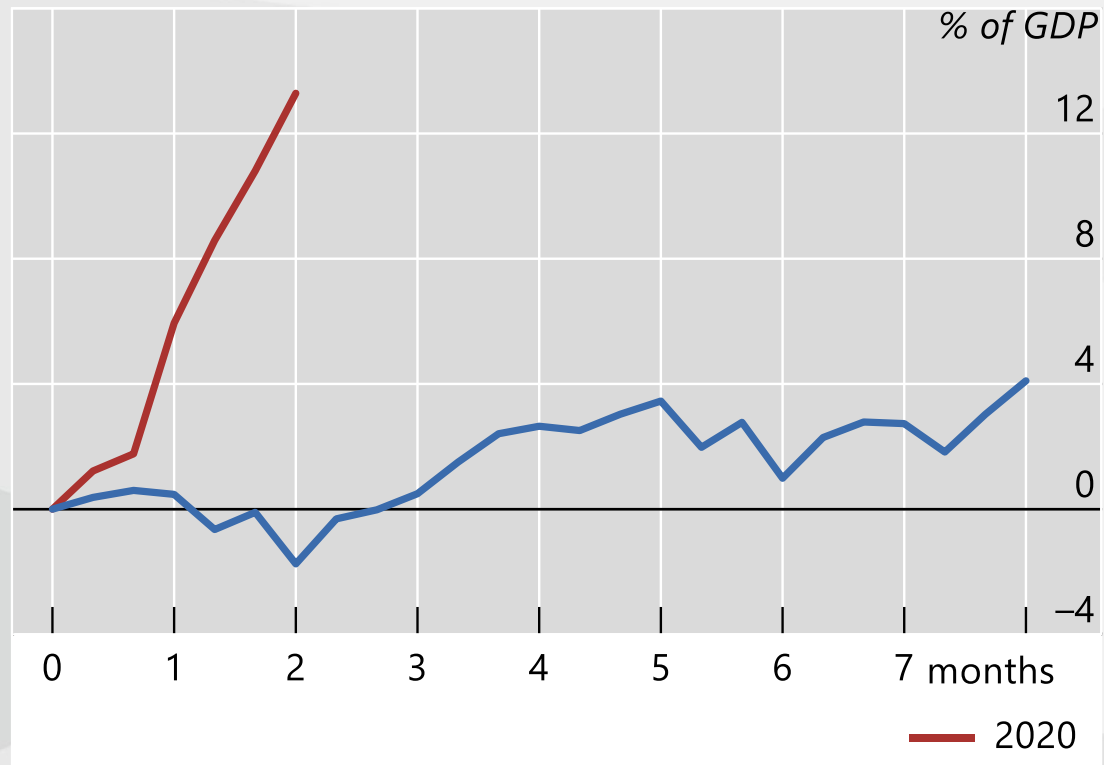
Sources: IMF, *World Economic Outlook*; Consensus Economics.

A unique crisis calls for a unique response

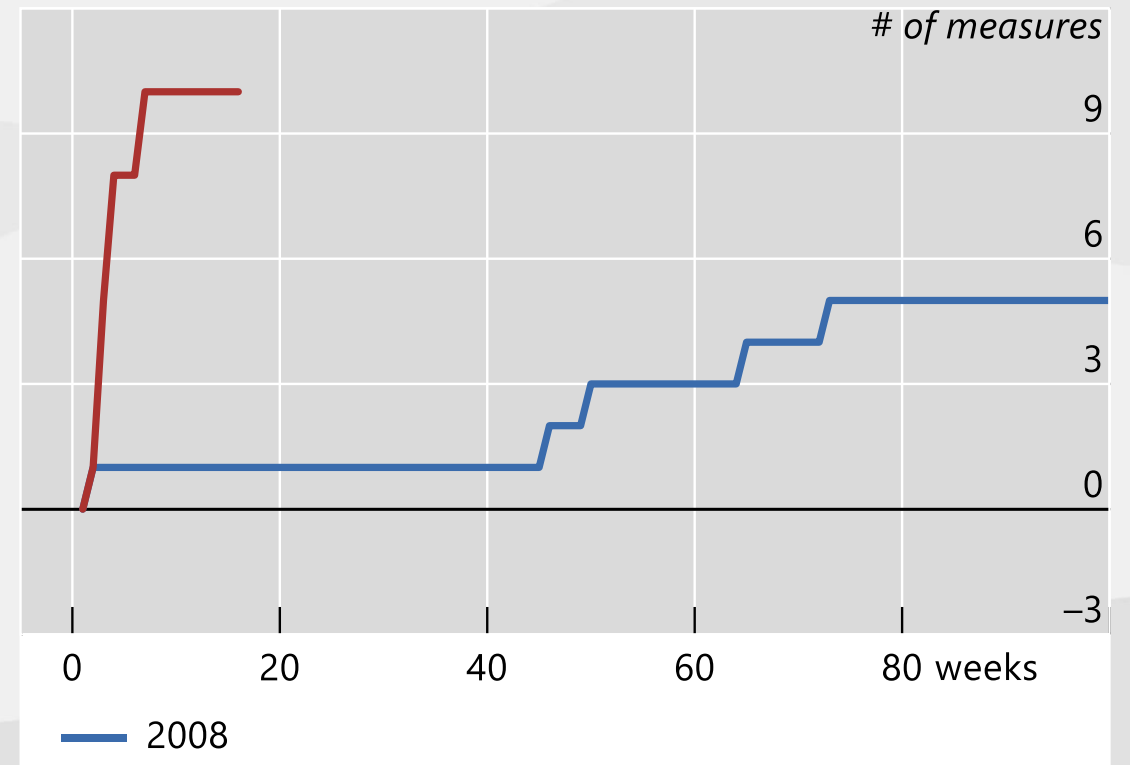
- Unique in terms of scope
 - Unprecedented range of instruments, some known, some new
 - Unprecedented coordination of monetary, fiscal and prudential policies
- Unique in terms of objectives
 - Not so much to boost aggregate demand but to offer a lifeline to firms and households during the lockdown

...in scale, speed and scope...

Balance sheet soared – for example, in Japan



Measures galore – for example, in Canada



Sources: National data; BIS calculations.

Central banks' unprecedented response...

Selected central bank and prudential measures

Table I.1

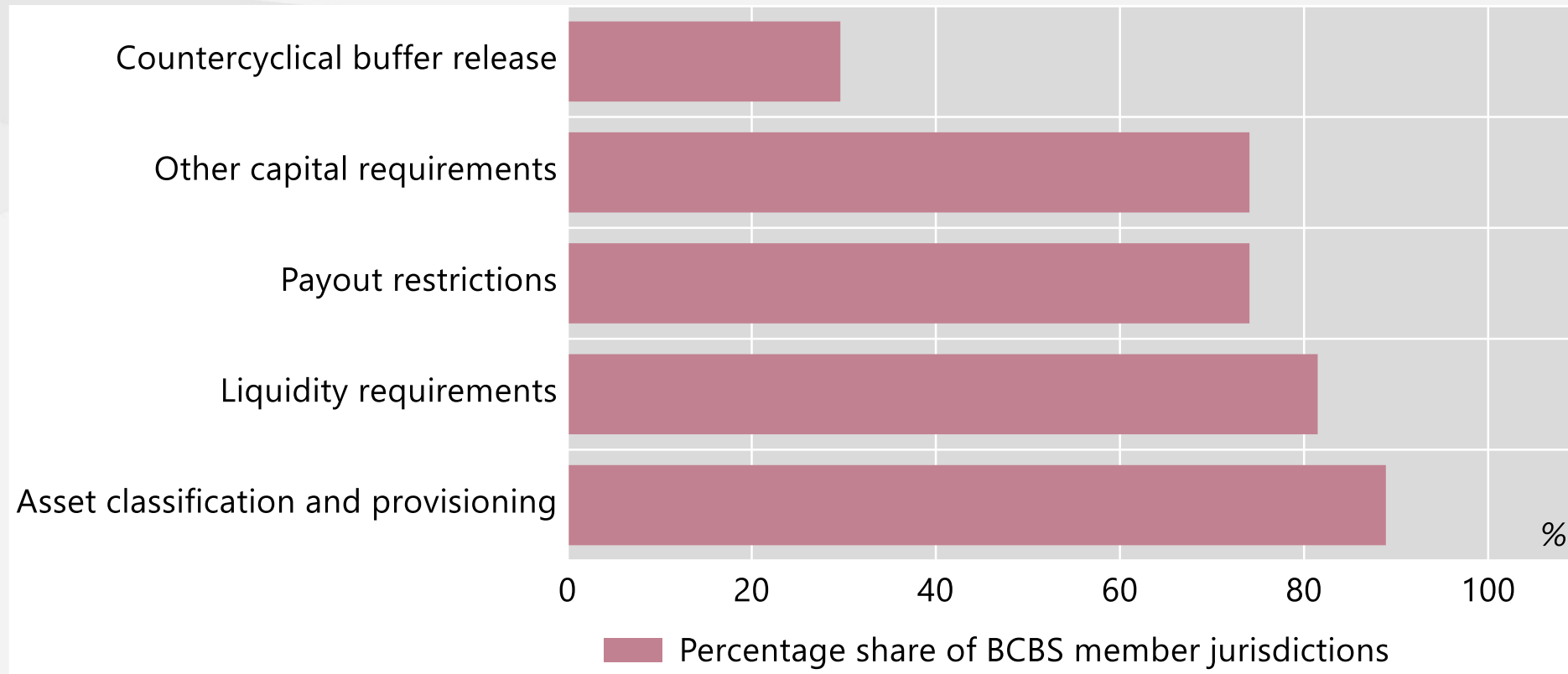
		Advanced economies							Emerging market economies							
Type of tool	Measures	US	EA	JP	GB	CA	AU	CH	BR	CN	ID	IN	KR	MX	TH	ZA
Interest rate	Policy rate cut	✓			✓	✓	✓		✓	✓	✓	✓	✓	✓	✓	✓
Lending/ liquidity	Gen. liquidity provision ¹	✓	✓	✓	✓	✓	✓		✓	✓	✓	✓	✓	✓	✓	✓
	Specialised lending	✓	✓	✓	✓		✓	✓	✓	✓		✓	✓	✓	✓	
Asset purchases/ sales	Government bonds	✓	✓	✓	✓	✓	✓				✓	✓	✓		✓	✓
	Commercial paper	✓	✓	✓	✓	✓							✓			
	Corporate bonds	✓	✓	✓	✓	✓							✓		✓	
	Other private securities ²		✓	✓		✓										
FX swap/ intervention	USD swap line		✓	✓	✓	✓	✓	✓	✓				✓	✓		
	FX intervention							✓	✓		✓	✓	✓	✓		
Prudential rules and regulations	Capital requirements	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓
	Liquidity requirements	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓
	Payout restrictions		✓		✓	✓	✓	✓	✓		✓	✓	✓	✓	✓	✓
	Market functioning ³	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓

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

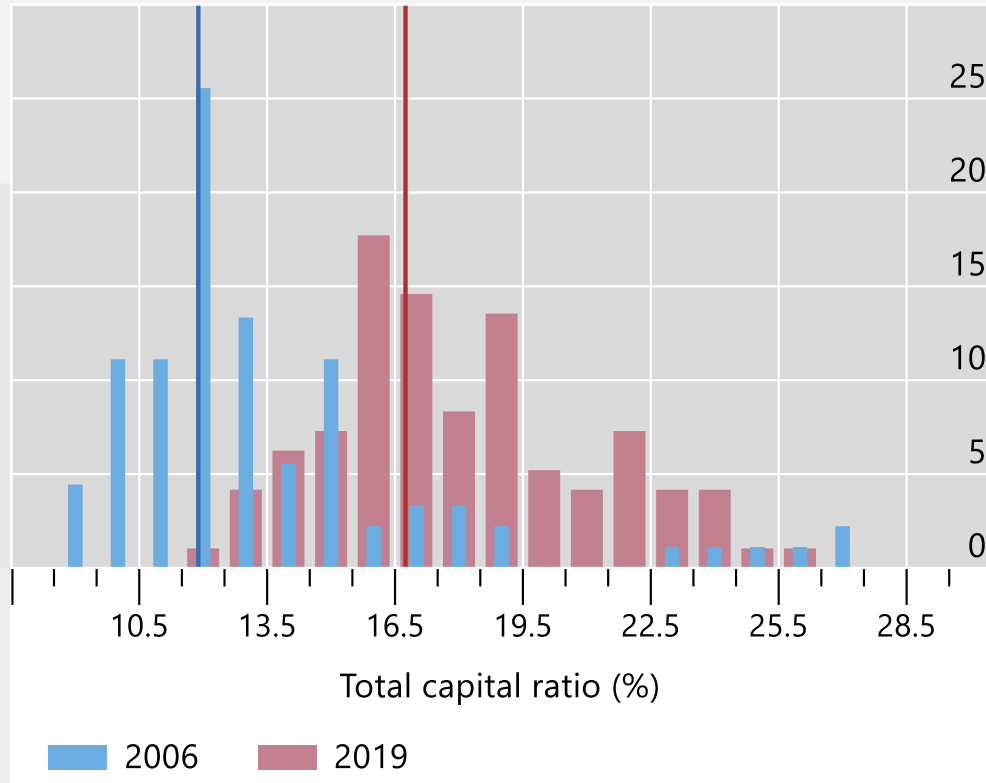
Countries taking prudential measures



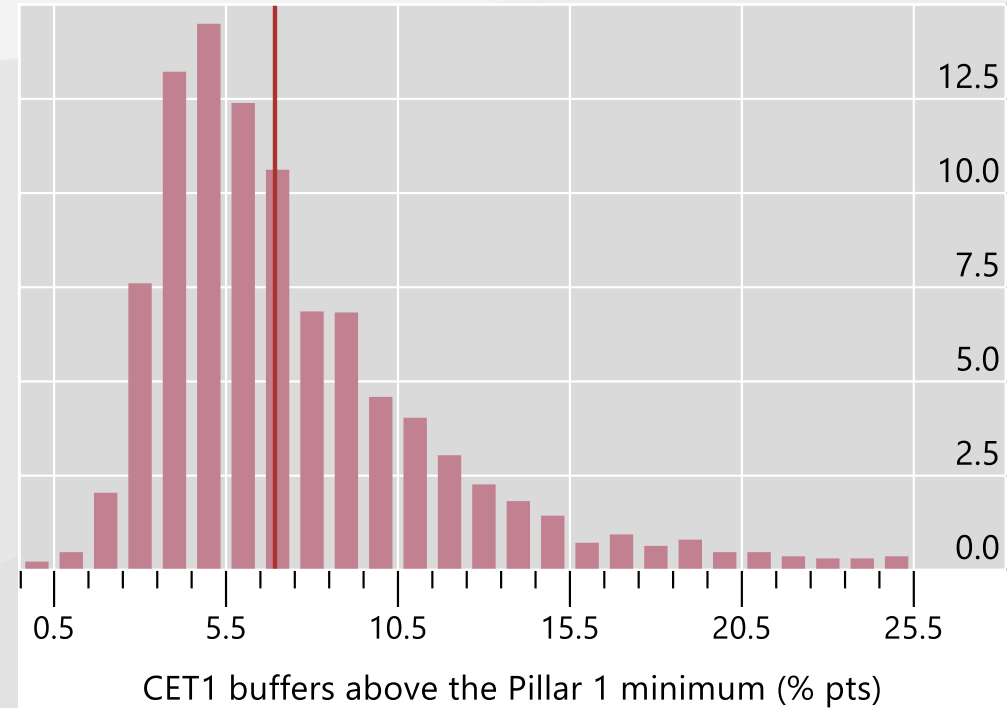
Sources: BCBS; BIS calculations.

Banks entered the crisis in a strong position...

Capitalisation of major international banks¹



Distance from regulatory minima, end-2019²

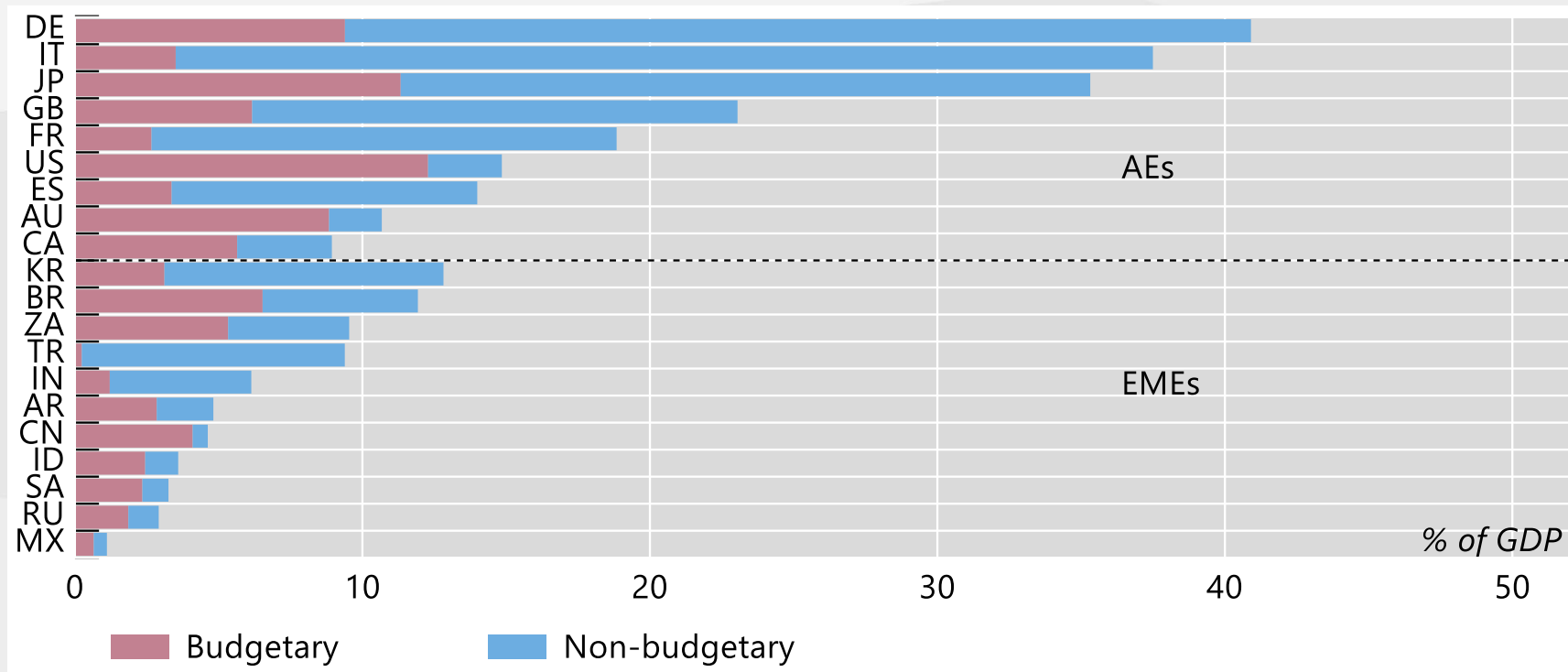


The vertical lines in the left-hand and centre panels indicate the median for the respective year.

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; U Lewrick, C Schmieder, J Sobrun and E Takáts, "Releasing bank buffers to cushion the crisis – a quantitative assessment", BIS Bulletin, no 11, May 2020; FitchConnect; BIS calculations.

Prompt and forceful fiscal response has been critical

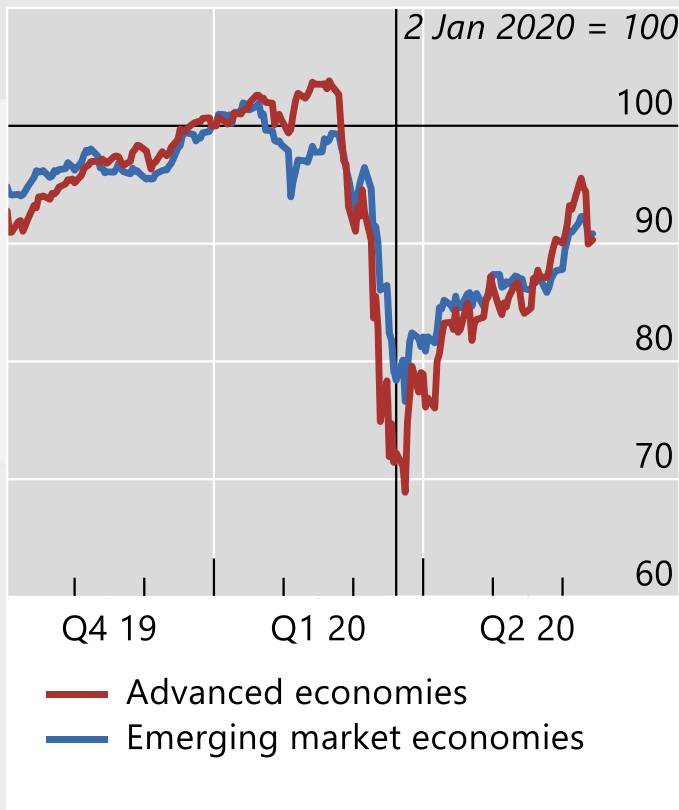
Pledged fiscal packages



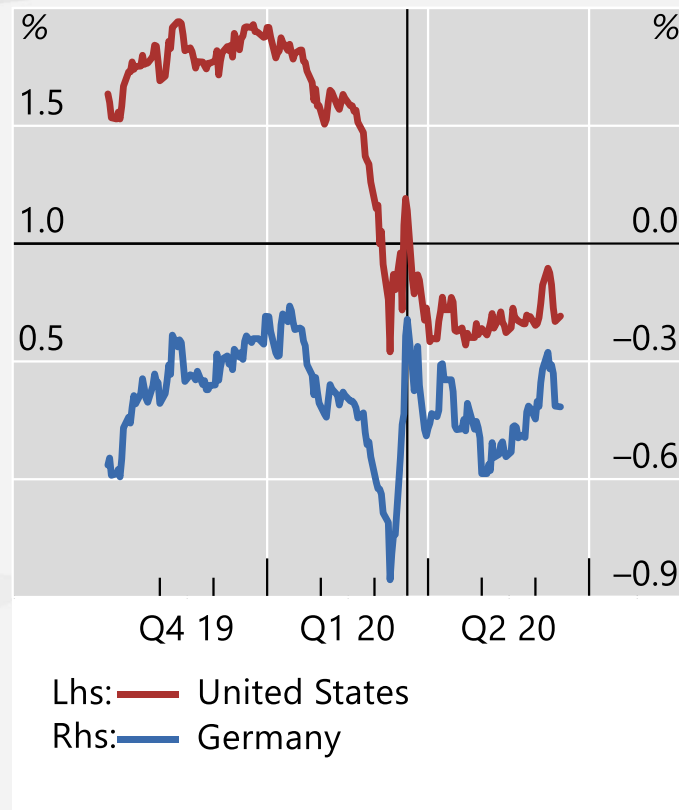
Sources: IMF, *Fiscal Monitor*; IMF, *World Economic Outlook*; national data; BIS calculations.

Policies have stabilised markets...

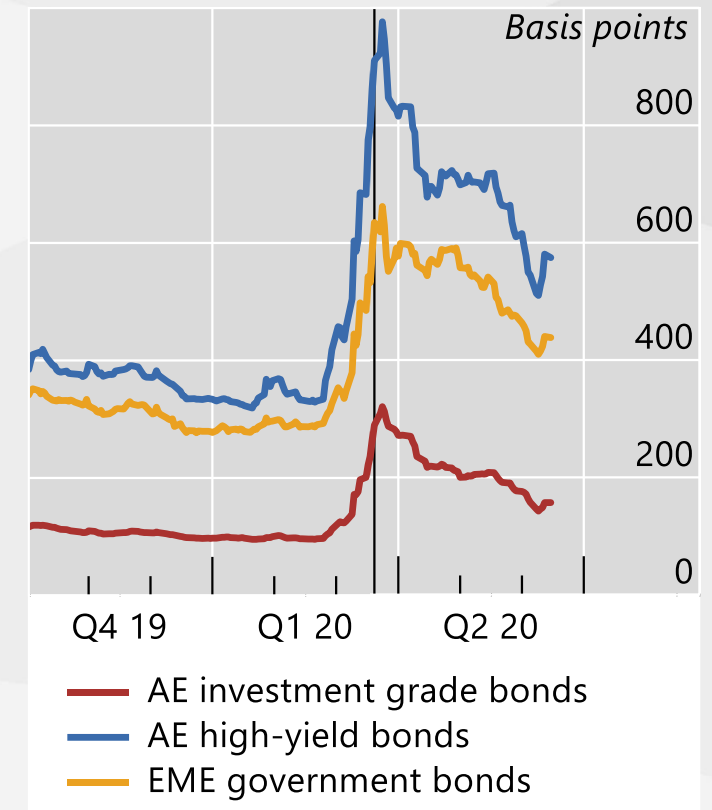
Global equities



Bond yields

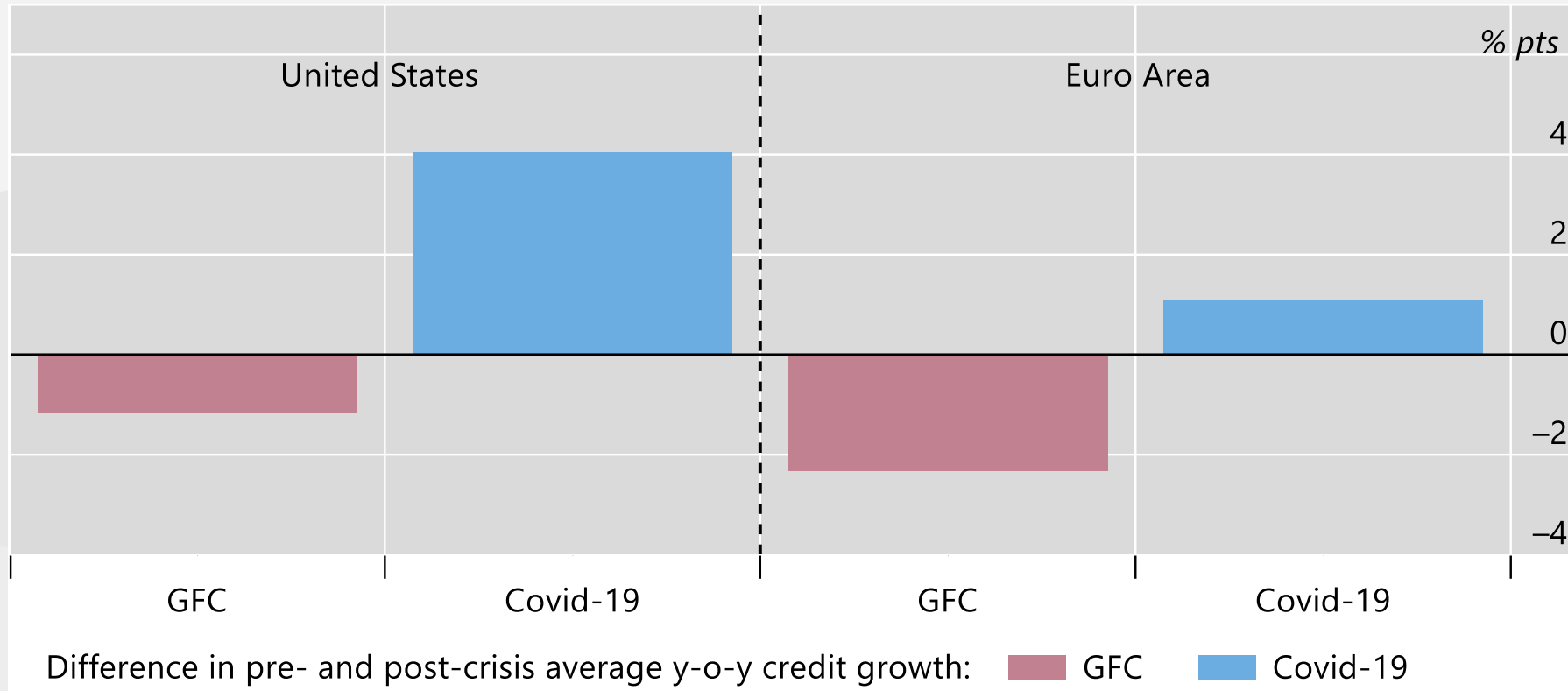


Spreads



Sources: Bloomberg; BoAML ICE indices; JPMorgan; national data; BIS calculations.

...and bank credit has not fallen



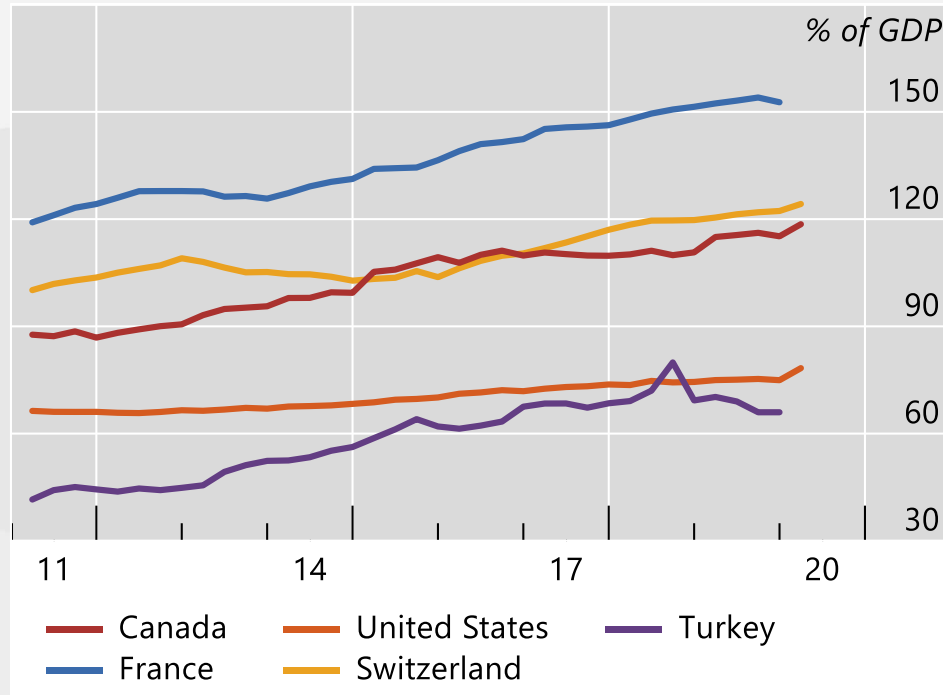
Pre-GFC = 1 year to Aug 2008; Post-GFC = October–December 2008

Pre-Covid-19 = 1 year to Jan 2020; Post Covid-19 = March–May 2020, (for euro area, to April 2020).

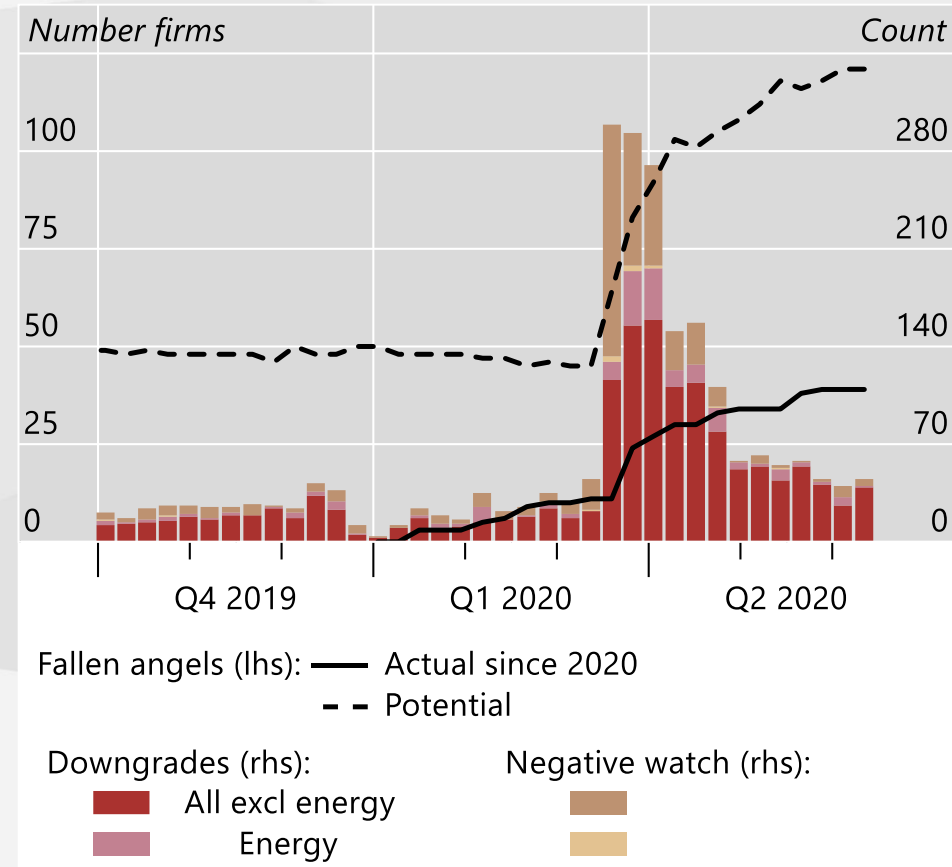
Sources: national data; BIS calculations.

High debt and rising insolvency pose challenges ahead

Non-financial corporate debt



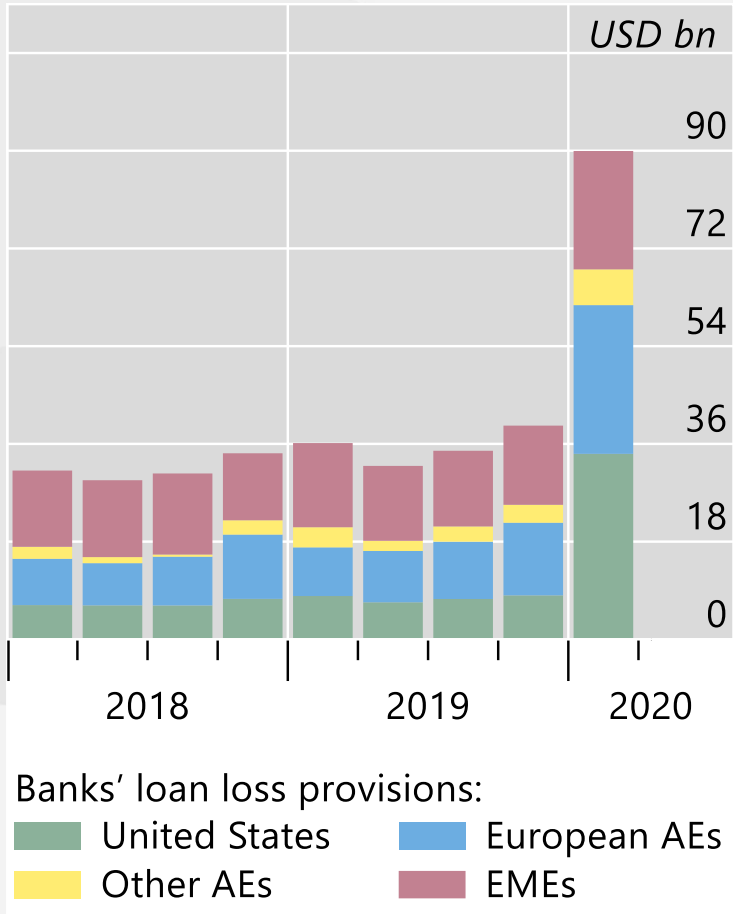
A wave of downgrades



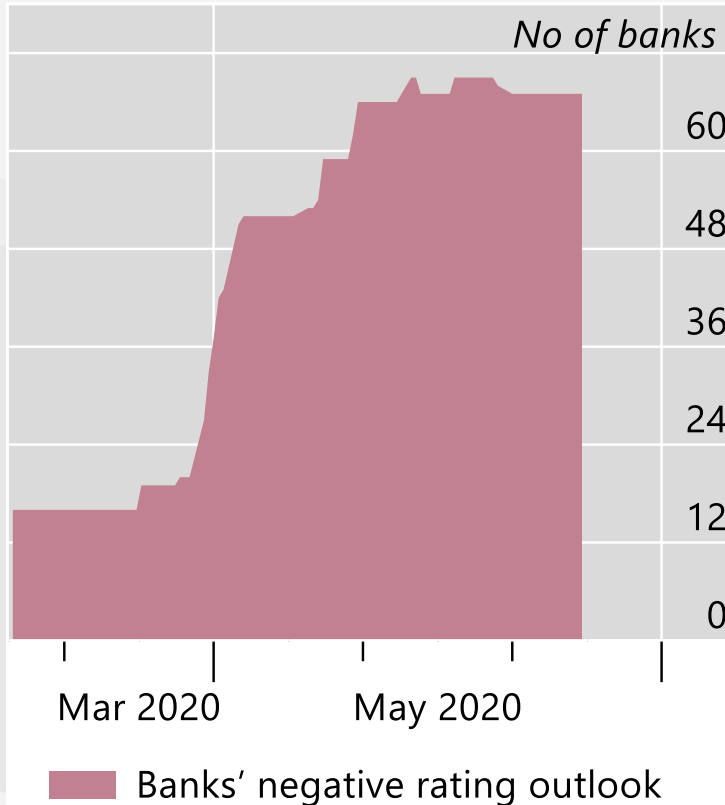
Sources: S&P Capital IQ; national data; BIS; BIS calculations.

Banks are under pressure...

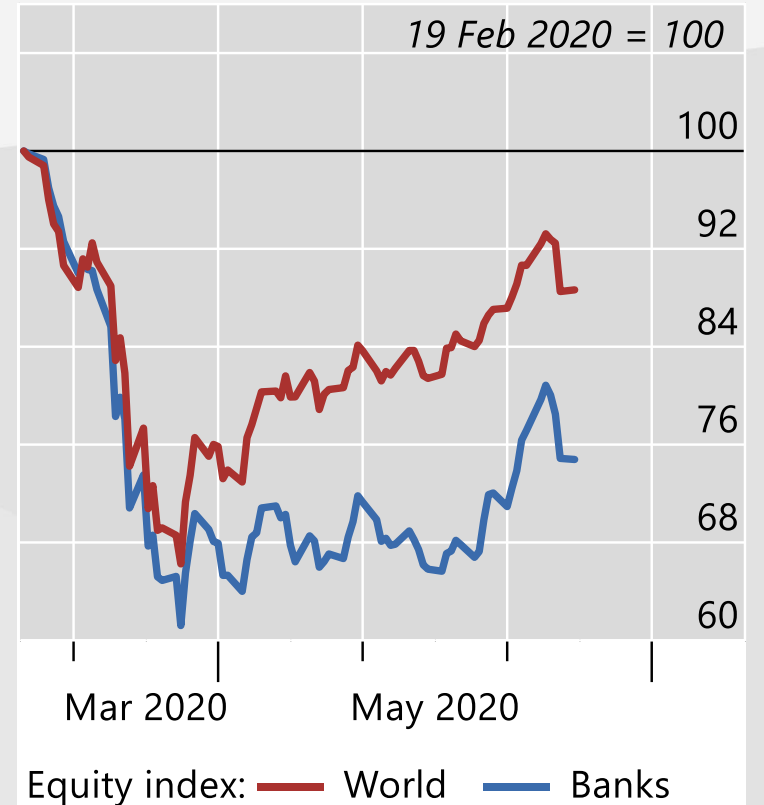
Provisions spike



Rating outlooks deteriorate



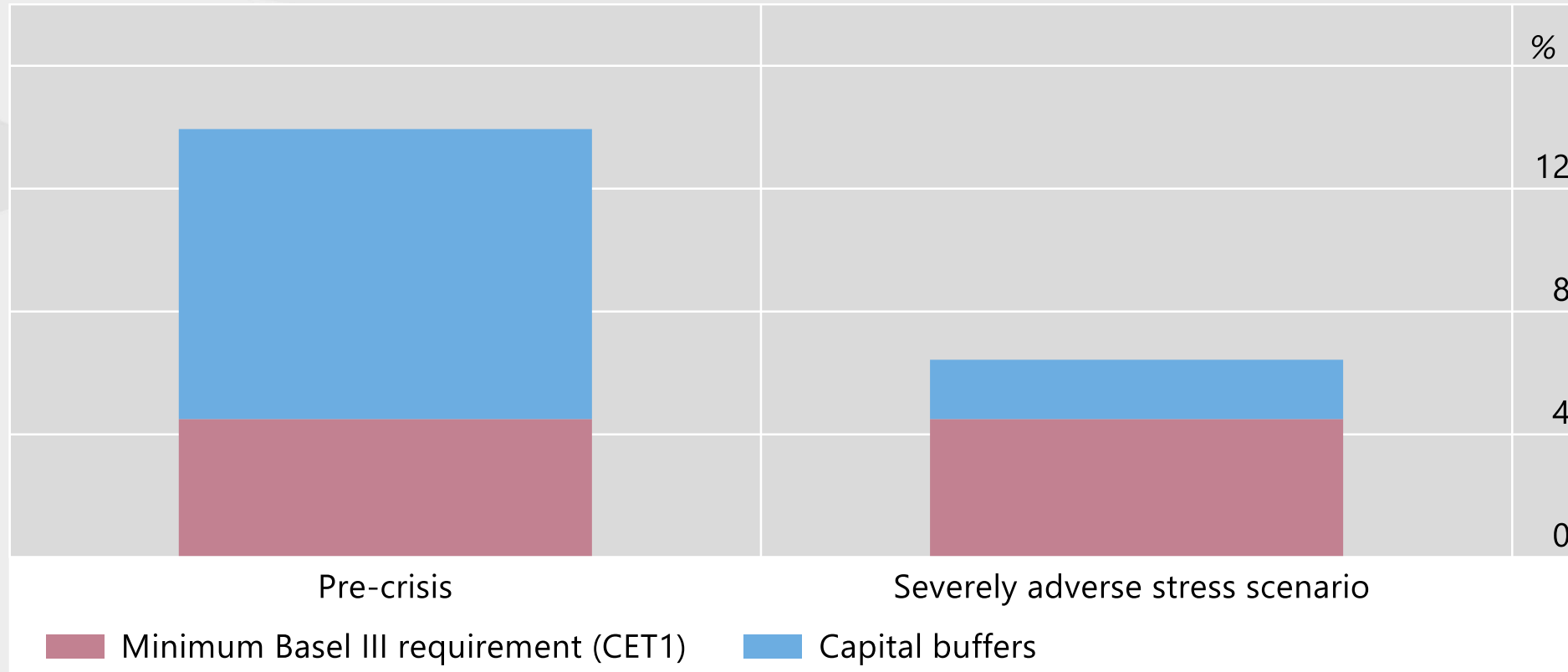
Banks' stock underperform



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.

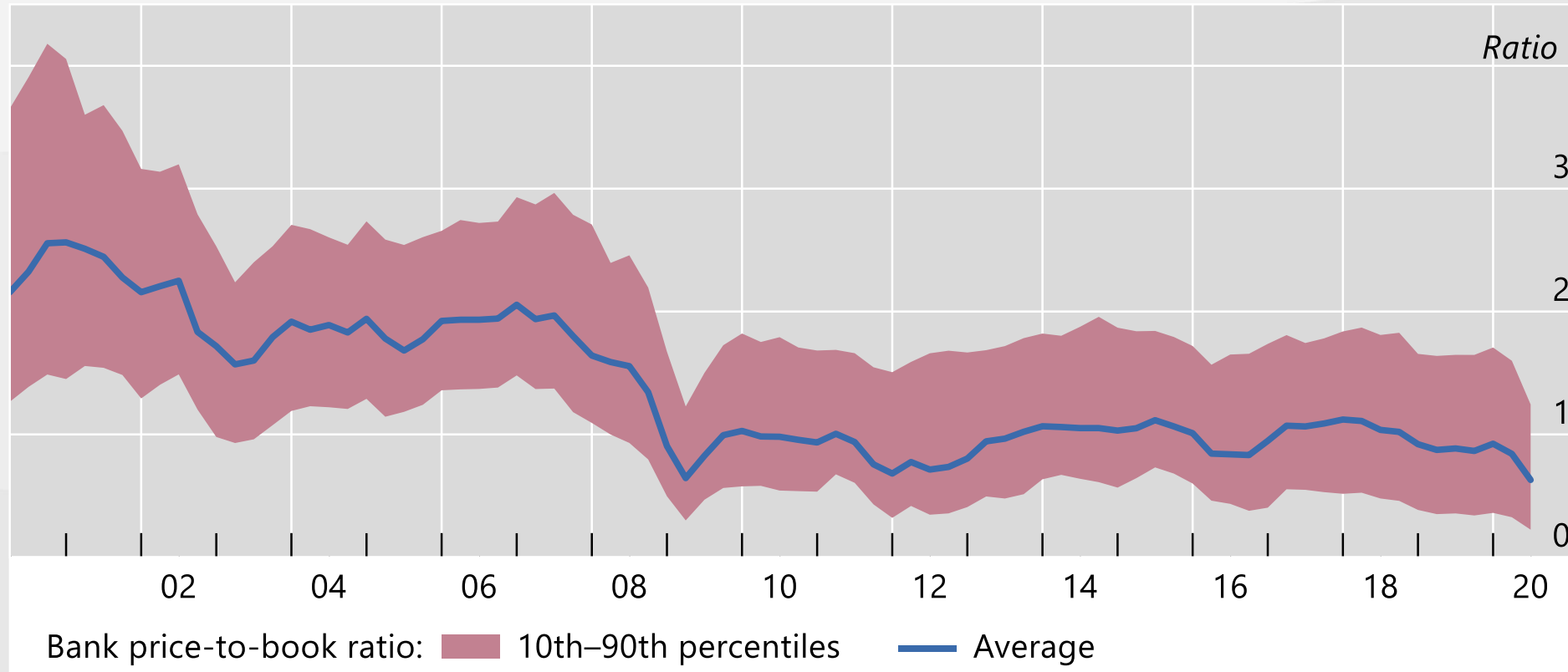
...and buffers are limited if the crisis persists

Depletion of capital under a severe stress scenario



Source: U Lewrick, C Schmieder, J Sobrun and E Takáts, "Releasing bank buffers to cushion the crisis – a quantitative assessment", *BIS Bulletin*, no 11, May 2020.

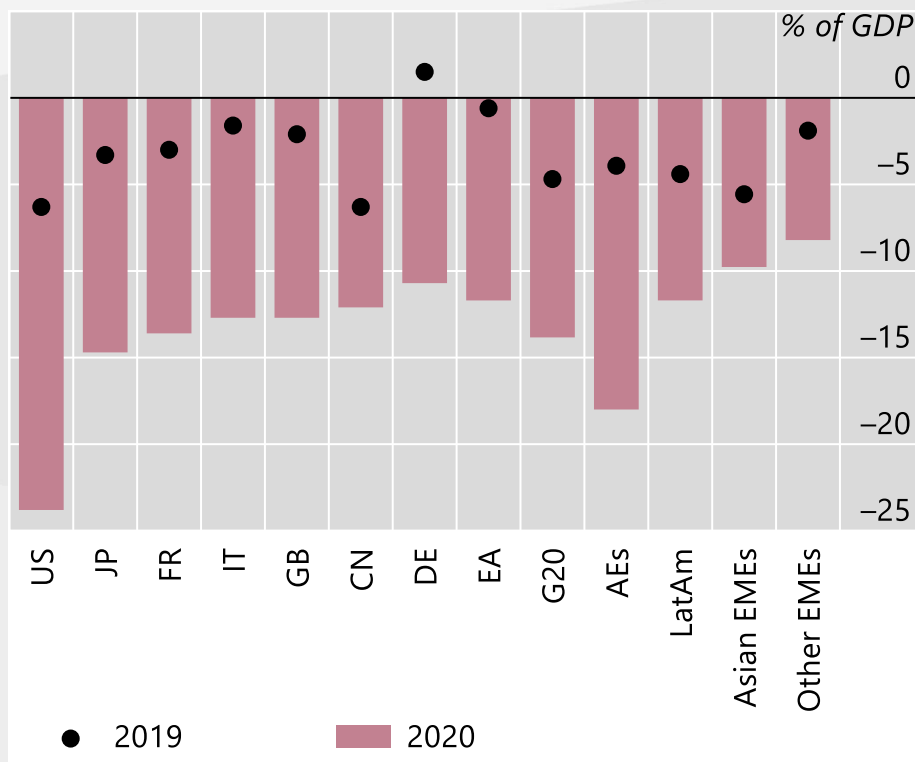
Banks' profitability is structurally low



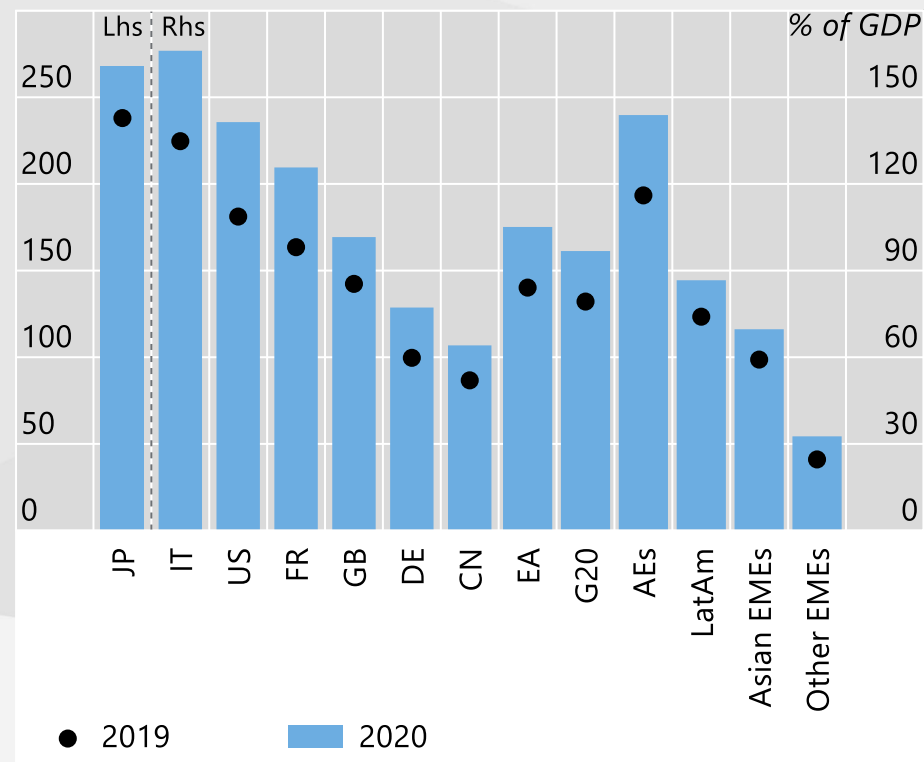
Sources: Datastream; Datastream Worldscope; BIS calculations.

Fiscal space dwindles

Massive widening fiscal deficits expected for 2020



Public debts likely to undergo steepest increase since GFC



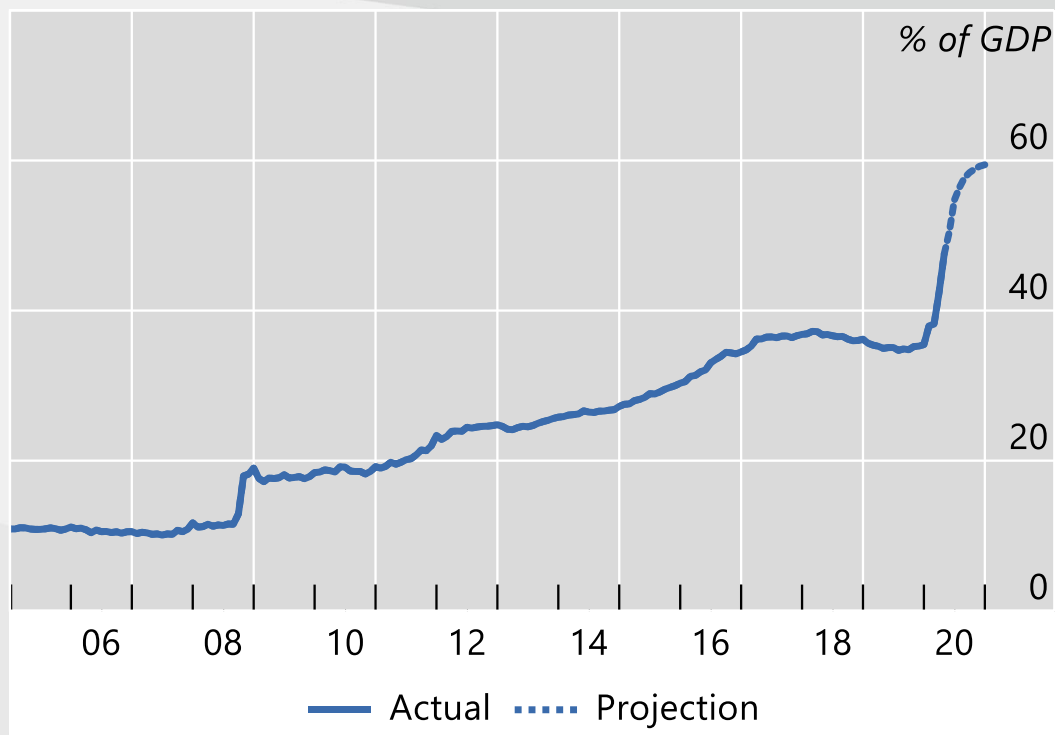
Sources: IMF, *World Economic Outlook*, June 2020; BIS calculations.

Dealing with restructuring and insolvencies

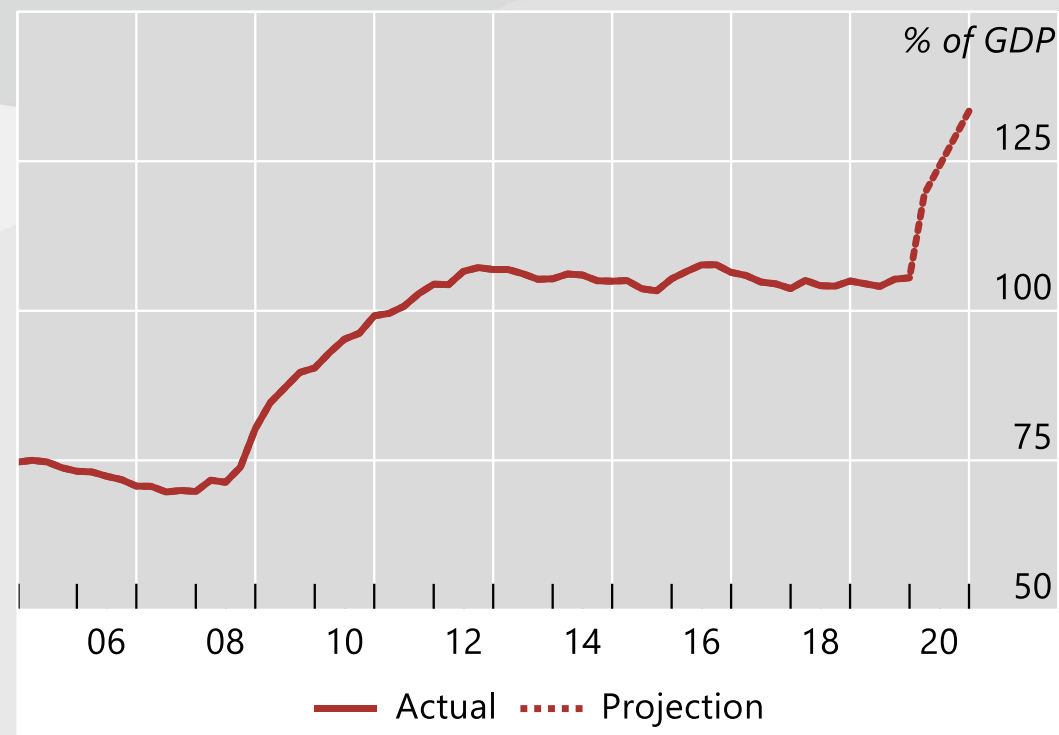
- Central banks can lend but cannot spend
- So monetary can do little to accelerate restructuring
- Formal and informal mechanisms
- Government can play a variety of roles
 - General guidance, setting the rules
 - Equity stakes in companies, to socialize losses *and* opportunities
 - With regulator: 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.