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

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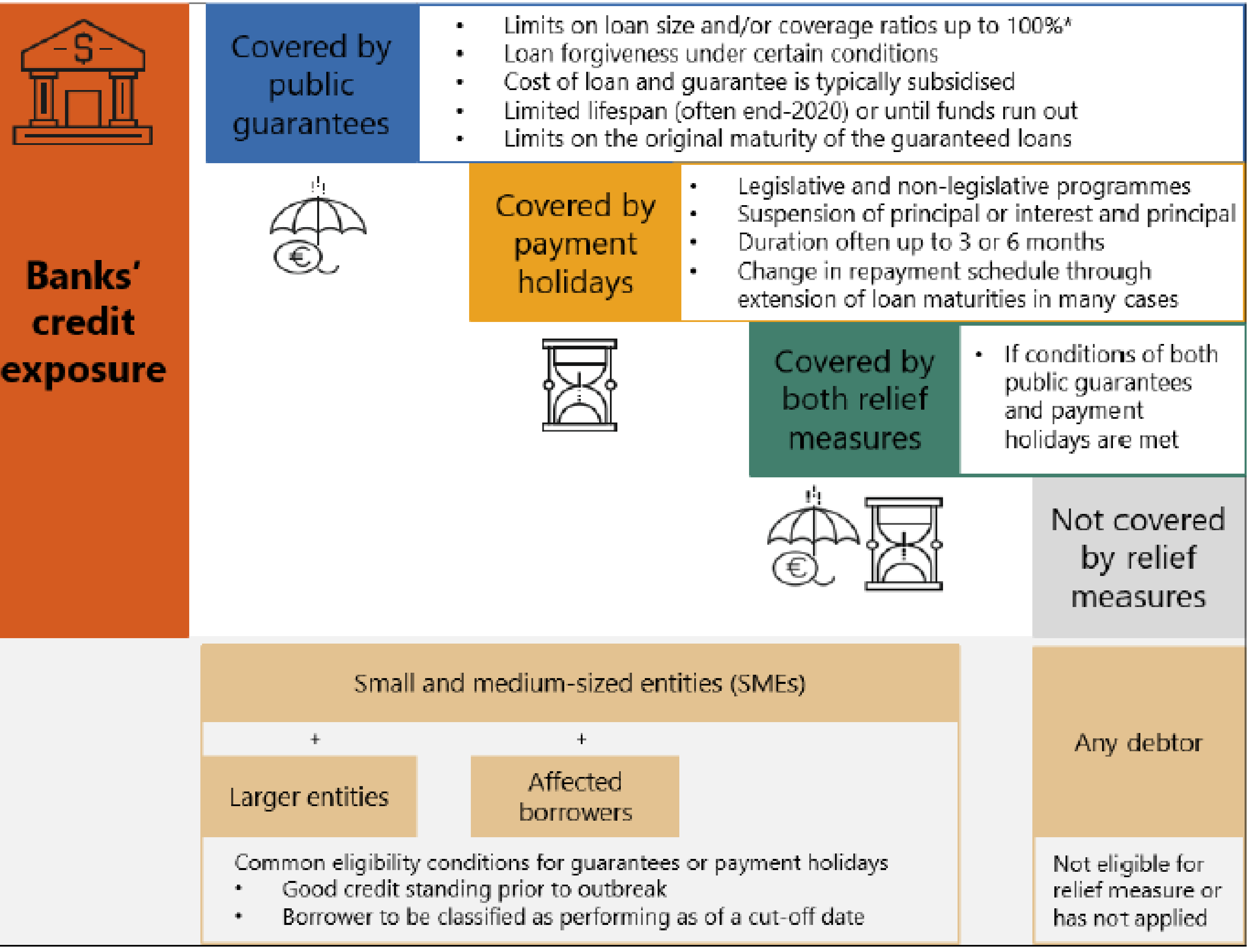
- Emergency measures: swift and big – care about costs and proper targeting later
- Fiscal policy: furlough, Kurzarbeit, direct support payments, tax payment holidays, loan payment holidays, loan guarantees, direct lending
- Monetary policy: flood markets with liquidity, market maker of first resort, 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

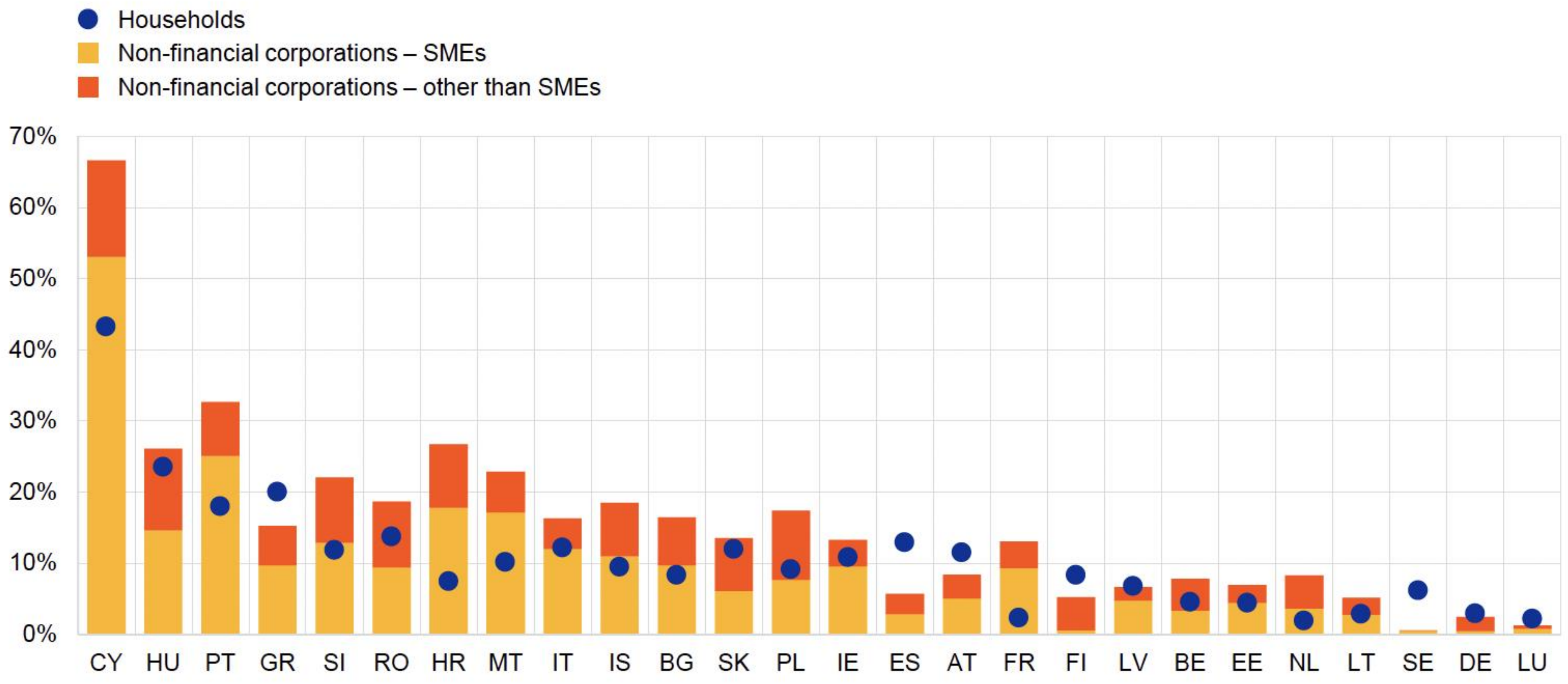
- Heavy draw-down of credit lines and increased credit demand as firms want to hold on to cash
- Relationship lenders can be useful in current situation as they know their clients
- Banks have critical role in transmission of monetary policy and fiscal support measures
- Challenge: procyclicality of 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)

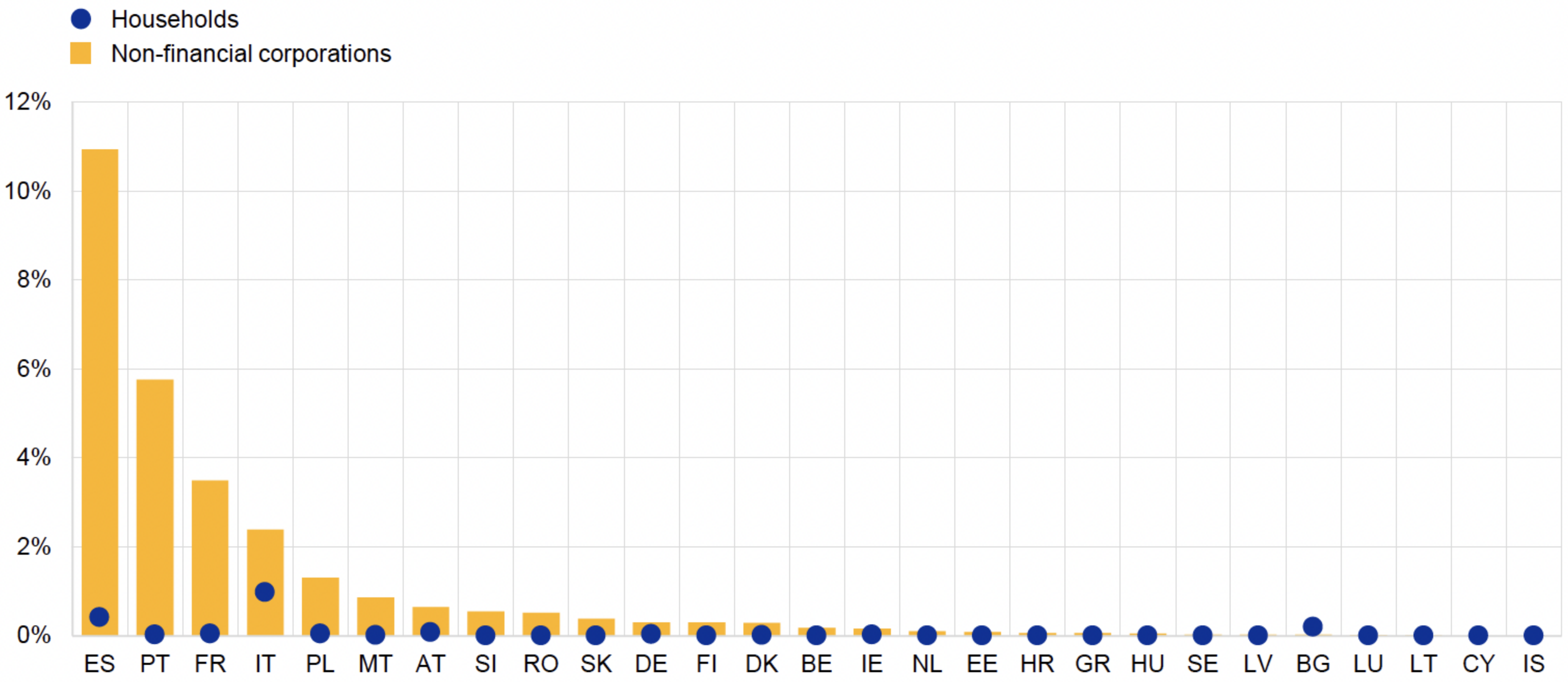


Sources: EBA, ESRB calculations.

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

MIND THE GAP….. WHEN EXITING

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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