COVID Crisis Response: "Evergreening Proposal"

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	2008	2020
Pre-crisis	Build-up of imbalances - run-up of credit - Thinly capitalized (shadow) banks	Well balanced - US gov. debt expansion - Corporate debt
Trigger	Re-evaluation: real estate - correlation	Drop in corporate cash flow
Amplification	HH & banks' balance sheets	Corporate sectors balance sheets
Fin- sector	Shadow banks (part of banks)	FinTechs for mortgages Banks still for SMEs
Structured finance	CDOs	CLOs
Policy objective	Stimulus	Survival

The challenge

- Stop clock = total standstill of all debt/rent/wages/…
  - “Hibernation strategy” for whole economy

- Not possible
  - Essential sector food, …
  - Less essential sector
- Shut down part of economy
  - Supported by other part

Policy actions

- Firm vs. household focused
- Targeted vs. broad brush
  - Mankiw idea: ex-post targeting (precautionary savings)
- Loans vs. grants
  - Risk sharing/moral hazard – pick-up problem
  - Automatic stabilizers
- How to channel government support?
  - Direct to HH CBDC-helicopter money
  - To HH via firms "Kurzarbeit" (short-term work)
  - To firms via banks SME lending (SBA)
- Purely crisis vs. long-term structural focused

Brunnermeier & Krishnamurthy "Evergreening"

Inverse Policy Description

- Dos-and-don'ts are reversed

- Usual recession:
  - Stimulus focused
    - interest rates to stimulate spending and investment
- COVID recession:
  - Survival focused

Inverse Policy Description

- Chapter 11 for large firms works ok, but
- SME need a pause

- Usual recession:
  Avoid evergreening is a problem b/c it crowds out credit to new firms/start-ups (Japan …)
- COVID recession:
  Promote evergreening
  offer banks cheap central bank refinancing
  for rolled-over loans
  - stabilize existing businesses

How to Promote Evergreening?

- **Carrots:** positive incentives for banks to evergreen loans, e.g. central bank provided **cheap refinancing** for rolling over existing loans,
  - eligible as collateral for financing at a rate that is x% less than the discount window rate
  - Such loans include:
    - (1) existing callable loans (which could not be extended)
    - (2) loans that are coming due in the next 3 months
    - (3) credit line commitments
    - (4) current floating rate loans which are repaid/ refinanced with new debt
- **Stick:** punish banks which do not rollover existing loans, e.g. by strictly **enforcing non-performing loan rules**.
  - **act more strictly** in classifying loans as **non-performing**
  - **slow down bankruptcy** proceedings