FINANCE IN THE TIME OF COVID-19

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GREAT FINANCIAL CRISIS VS. GREAT LOCKDOWN

- This crisis did NOT start in the financial sector, but financial sector will be affected negatively as many/most other sectors
- Financial sector can be catalyst for recovery or for prolonged crisis
- Quick monetary and prudential policy reaction reflects better preparation
  - Regulatory reforms have strengthened capital buffers in banking system (but maybe not sufficiently)
  - More data available to monitor situation
  - Experience with crisis management enabled quick policy reaction
  - Framework for international cooperation as good if not better (but is it being used?)
- Biggest risk: economic crisis turns into a financial (e.g., banking or sovereign debt) crisis

THE ROLE OF BANKING IN HELPING THE REAL ECONOMY

- Heavy draw-down of credit lines and increased credit demand
- Relationship lenders can be useful in current situation
- Banks have critical role in transmission of monetary policy and fiscal support measures
- Credit guarantee schemes:
  - Are loans what is needed? Or rather grants? Liquidity vs. solvency
  - Existing loans, new loans or both?
  - Coverage ratio: skin in the game vs. getting cash out quickly
  - How long will guarantees last? How to get private sector off the guarantees?
  - Quick recovery vs. capital reallocation
  - Banks as utility (passing on government support payments) vs. banks as screeners/monitors
  - There will be losses and government will have to bear them?
- Cross-border externalities (e.g., within Single Market)
- How to deal with widespread corporate failure post-lockdown

EUROPEAN BANK REGULATORS IN THE TIME OF COVID-19

- Immediate response of prudential authorities to looming pressures (and losses) in banking during and after the Great Lockdown
  - Release capital conservation buffer
  - Reduce counter-cyclical capital buffer to zero (where positive)
  - Allow banks to reduce capital below pillar 2 guidance
  - Request suspension of payouts (dividends, share buy-backs and, possibly, bonuses)
  - Easing on provisioning rules to mitigate their procyclical effect
  - Moratorium on further regulatory reforms
- Actions aimed at mitigating pro-cyclicality of bank lending
- Central banks have intervened in financial markets, both to maintain liquidity, and to maintain bank lending (asset purchase programs, ease of collateral requirements)
- Less emphasis on interest rate reductions (cost might not be the most important constraint)

LOOKING FORWARD TO THE AFTERMATH

- Losses will incur
  - Recovery will be uneven across sectors and countries (e.g., varying with containment policies)
  - Losses will thus vary across banks and countries
- Capital relief and changes in provisioning standards cannot prevent losses!
- Further sources of bank losses:
  - Low for longer
  - Stronger competition from BigTech companies, which will come out well from crisis with big cash piles
- How to deal with losses
  - Bank resolution frameworks post-2008 (BRRD) can deal with idiosyncratic risks
  - Unlikely that they are able to deal with systemic crises
  - Incomplete banking union
  - Possibly need for bad bank/recapitalization, but on EU/euro area level

CROSS-BORDER BANKING AND CHALLENGES FOR SINGLE MARKET

- Single Market includes principle of free capital movement
  - There should be no profit distribution restrictions within banking groups
  - Banks should have right to allocate resources where needed most and where highest return
- Fear of capital outflows, especially in countries heavily reliant on cross-border banks, negatively affecting financial stability and real sector lending
- Risk of broader regulatory ringfencing actions; flashback to post-2008
- Need for Vienna Initiative 3.0 or a similar framework
- Broader implications for developing/emerging world

FINANCE IN DEVELOPING COUNTRIES IN TIME OF COVID-19

- Often better capitalized than in advanced countries, but: less diversified asset portfolios
  - Focus on natural resource economies
  - For better or worse, financial system less relevant in less developed economies (higher reliance on internal finance) – can be an advantage in current circumstances
- Countries with increasing trend towards consumer credit might be in for shock
- Sovereign default risk has increased substantially – increasing sovereign indebtedness in recent years (with increasing role for Chinese debt)
- On the upside: mobile phone/banking networks allow for:
  - Better risk sharing within families/networks
  - Easier, speedier and more effective push-out of government support programs

IN SUMMARY

- Crisis did NOT start in the financial sector, but financial sector will be critical in determining how this crisis will play out
- Initial policy reaction by monetary, fiscal and prudential authorities very welcome
- Hard work still ahead: how to allocate losses; how to restart economy
- There will be hard political choices coming up:
  - Bail-outs (didn't we say: never again?)
  - State aid for firms headquartered in tax havens?
  - (Indirect) transfer payments across countries?
  - Higher income/wealth taxation?
- Important: decisions to be taken by politicians, as accountable directly to people

THANK YOU

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