

I. VIEWS ON THE COVID-19 CRISIS IMPACTS

Issues at stake

We are experiencing with the Covid-19 pandemic an unprecedented crisis, pushing the global economy into the worst recession since the Great Depression. Central Banks and governments have taken a wide range of measures to sustain the supply of credit to the real economy, support financial intermediation, and preserve the resilience of the global financial system. But this exogenous shock is placing the financial system under considerable strain.

The Covid-19 outbreak is however more a powerful amplification factor of a latent debt crisis rather than a cause in itself of the current situation. Indeed, lasting zero – and even negative – interest rates have allowed businesses, States and leveraged investors to take on unreasonable debts, making them vulnerable to deteriorating economic and market conditions. The resulting excess liquidity in the financial system has generated bubbles of financial assets and their bursting, thus further weakening the financial system and hampering economic recovery.

Strong policy responses and international cooperation are required to tackle the unprecedented health, monetary, economic, and financial stability challenges posed by the Covid-19 pandemic. Fiscal discipline and solidarity will be needed in the euro zone, where the heterogeneity of deficits and public debt, and therefore of tax margins, is particularly marked.

Content

Views on the responses to the Covid-19 crisis 18

Jacques de Larosière - EUROFI

Economic impacts of the Covid-19 crisis and policy responses 22

Klaas Knot - De Nederlandsche Bank • Stipe Župan - Ministry of Finance of the Republic of Croatia • Poul. M. Thomsen - International Monetary Fund • Pervenche Berès - former European Parliament • Andrew McDowell - European Investment Bank • Jordi Gual - CaixaBank • Bernd Spalt - Erste Group Bank AG • Dr. Karl-Peter Schackmann-Fallis - Deutscher Sparkassen- und Giroverband • Jérôme Haegeli - Swiss Re

Implications of the Covid-19 crisis for the financial sector 32

Michael West - Moody's Investors Service • Jean Lemierre - BNP Paribas • José Antonio Álvarez - Santander Group • José Viñals - Standard Chartered Plc. • Markus Ronner - UBS • Susan Revell - BNY Mellon • Alexandre Birry - S&P Global Ratings • Ksenia Duxfield-Karyakina - Google Cloud • Cyril Roux - Groupama • Bjørn Sibbern - Nasdaq • Marc Bayle de Jessé - CLS Group

Monetary policy impacts 44

Ante Žigman - Croatian Financial Services Supervisory Agency • Jean-Jacques Bonnaud - EUROFI • Natacha Valla - European Central Bank (ECB) • Didier Borowski - Amundi



Views on the responses to the Covid-19 crisis

Interview of Jacques de Larosière conducted by Didier Cahen on 14 April 2020

How different is this sanitary crisis from the previous financial and sovereign debt crises of the years 2000?

The present crisis is far worse than the one of 2007 – 2008 because, this time, it threatens the lives of citizens worldwide. Covid-19 has disrupted our social and economic order at lightning speed and on a scale unseen in living memory, and the lockdown needed to contain it has affected billions of people. The common trait between the two crises is the unpreparedness of governments:

In 2007-2008, they underestimated the lack of sufficient equity in the banking sector and the vulnerability on the financial system in the face of huge asset bubbles

This time we are, except for a few countries, unprepared to cope with this massive pandemic because of:

- insufficient preventive and diagnosis devices, which are crucial to limit the confinement measures to people that are affected by the virus,
- insufficient availability of masks and the absence of an effective vaccine, or other medical treatments and
- the very limited capacity in terms of life saving respiratory units.

So, the difference is this: in 2008, the authorities swamped financial markets with liquidity in order to avoid total collapse of the banks and financial markets. This time, governments are closing very significant parts of economic activity because health services are not able to distinguish healthy and non-healthy individuals and therefore have to lock-in most sectors of the economy in order to avoid any contacts between people.

This method is very inefficient compared to the practice of a few countries that have established systematic testing of all individuals and

have kept most their economies functioning. This time it is the public authorities that have decided, given their unpreparedness, to create the conditions for a major depression unseen for 90 years.

How to assess the economic impacts of coronavirus?

The consequence of this global crisis and the lock down measures taken will be huge. Their magnitude will depend on how long it will take to overcome the health problems.

As a very approximative yardstick, if you assume that advanced economies are mandatorily closed at a level of 50%, that means that two months of confinement entails a loss of 8% of GDP. 4 months would amount to 16% of GDP... Some countries will be far worse hit than others.

The collapse of economic output in the second quarter of this year will be the biggest in modern peacetime history. The impact of gradual exit from confinement is yet no forecastable. But the social and economic consequences of the pandemic are extremely serious and will be with us for many years to come.

The coronavirus crisis is developing at a time when the financial system appears weakened. Does monetary policy have a responsibility in this regard?

The minefield of the world economic and financial system is in a far worse state than we have been prepared to admit.

As a result of monetary policies that have been accommodating for too long, the debt ratio of states and corporates compared to GDP has surpassed all peacetime records. We witness that the growth in overall debt has been 50% since the last 2008 crisis. The asset bubble that was favoured by cheap debt - including the so-called risk-free government bond bubble - is now abating.

However, the rot has set in. Risk premiums had virtually disappeared in this environment of low or negative interest rates and we have lived with an illusion that assumed this situation would be timeless. As long as some growth was maintained, mediocre - or even downright bad - signatures of all forms and supposedly adequate ratings were considered by investors to be of sufficient quality and the search for a little yield pushed them to take unwise risks which are concurrently, undervalued by financial markets.

In this context, the risk of a serious crisis was dangerously close even before the virus struck; the slightest sign of economic slowdown was enough to instil fear in the markets that the “good times» were over and the storm was beginning. In fact, the first defaults were already appearing among the most vulnerable borrowers (e.g. issuers of high-yield securities and BBB-rated companies, which account for more than half of investment grade corporate debt - companies whose financial cost/income ratio has deteriorated considerably).

You have been warning of the dangers of monetary policies that have been accommodative for too long. Can you remind us of those dangers?

The impact of excessively accommodative monetary policy - with interest rates at zero or even negative for a long time - on the stability of the financial system is unfortunately too well documented: incentives to borrow more; weakening of the banking system; deterioration of the accounts of pension institutions whose liabilities remain subject to contractual obligations but whose fixed-income assets no longer yield anything; proliferation of zombie companies in an environment where interest rates no longer play their discriminating “quality signal” role that should be theirs; strong disincentive for governments not to undertake structural reforms since borrowing “no longer costs anything»;

Let us not underestimate the importance of this loss of benchmarks - zero interest rates blur risk premiums (one of the characteristics of the 2008 crisis).



What are the potential economic and financial stability consequences of the massive purchases of securities decided by the ECB and the Fed? Are the risks similar in the Eurozone and US?

The huge increase in public expenditures to maintain economies during this pandemic crisis will create a massive increase in public debts. This will inevitably raise questions on the sustainability of public debt levels of those countries whose figures are already very high.

The solution to the problem would normally be to raise more taxes and reduce less essential public expenditure. But given the monumental amounts in question, there may well be a temptation to expect central banks to hold them on their balance sheets thereby monetising public debt by monetary policies.

This is a new source of vulnerability and instability of the financial system.

Business survival justifies central banks' role as lender of last resort during the crisis. Central banks must do everything to support the needs of the people. But doing so should not be in conflict with the core purposes of monetary and financial stability. Increasingly using monetary financing will damage credibility and the role of money as well as weakening future control of inflation.

So the future looks very dark.

Both the US and Europe are pursuing the same policies. But the US has an advantage: they issue the international currency. It is less immediately exposed than other countries who do not benefit from this privilege. But, of course, in the very long run, even that US advantage will tend to dissipate, and the question of the fiscal sustainability of debt will arise even for the dollar.

Can this ocean of public debt on the balance sheets of central banks be reduced over time or are we entering an era of perpetual public debt, with maybe even further demands for State protection?

The answer will depend on the outcome of economic behaviour. If central banks and governments continue to forecast a very long period of low growth and zero or even negative interest rates, I do not see how central banks could start selling their accumulated bonds on the markets. The probability of even an increase for a very long time on central banks' balance sheets looks pretty high.

Consequently, a situation of persistently low interest rate will be very disturbing: in such a monetary environment, the market is no more in a position to discriminate among different types of assets due to the asset purchase of the central bank. Indeed, the universal buying of sovereign securities eliminates the normal functioning of market forces between savings and investment and brings interest rates to levels close to zero which, as we have already seen, encourages the holding of liquidity to the detriment of productive investment.

How can free markets assess value in these conditions? How do productive economic projects distinguish themselves from sheer financial profit opportunities in the search for investment capital?

Ultimately, by taking things to extreme, central banks would eventually hold most of the debt and even shares. But, by dint of being taxed, household savings could decline and central banks could become the main actors in the savings/investment equation.

Continuing such monetary policies is a cause of great concern for the future of our economies and our societies.

Are you concerned that this ocean of debt on the balance sheets of central banks will be a brake on the recovery of investment at the end of the economic depression we are experiencing?

Absolutely. The increase in public debt and unlimited money creation are a dangerous spiral for our economies. They will not only act ►

► as a brake on the recovery of investment but can also undermine the confidence of economic agents in the currency and the value of money.

The core problem of loose monetary policies is that it drives a preference for liquidity. Since investment by purchasing securities is taxed, investors tend to forgo illusory remuneration and retain liquid instruments which, at least, are not affected by the application of negative rates. But such a preference for liquidity (Keynes' "haunting") diverts savers away from long-term investment. They would be taxed if they invested long-term.

In the traditional investor trade-off between return, risk and liquidity, the notion of return loses its importance with low interest rates. The arbitrage is only between liquidity and risk.

Moreover, with lasting and huge asset purchase programmes, central banks are anchoring in the minds of the markets the idea that interest rates will remain low for an indefinite period. The expectation of low rates for a very long period has a "depressing" effect: economic agents conclude that the growth horizon will be low for a long time and therefore will refrain from making long term investments.

The accumulation of very high public debt, negative interest rates and massive repurchases of public and private securities against the backdrop of an accelerating ageing population has been experienced for many years by Japan (47% of outstanding public debt is held by the BOJ), which shows that it is inseparable from a sharp fall in potential growth.

What do you think of the European agreement of 7 April?

I think this is an excellent and fair agreement that provides for concrete actions. More than half a trillion Euros are now available to shield European Union countries, workers and businesses.

The European Stability Mechanism, the safety net for countries, will provide pandemic crisis support, in the form of precautionary credit lines not subject to macroeconomic policy conditionality. A member state that draws under these Enhanced Conditions Credit Line (ECL) will commit to using the money only to cover corona-related costs. Each member state could benefit from this support up to the benchmark amount of 2 percent of GDP.

Second, a temporary solidarity instrument (SURE) will be established to support member states to protect workers and jobs in the current crisis. Loans will be provided to member states up to €100bn, building on the EU budget as much as possible and on guarantees from the member states.

And thirdly, the European Investment Bank will implement its proposal to create a pan-European guarantee fund of €25bn to support €200bn of EU businesses, in particular SME's, throughout this crisis.

It has also been agreed to explore the setting up of a temporary Recovery Fund to facilitate a robust European economic recovery in all Member States. There was broad agreement to disagree on the financing of the fund, with mutualized debt issuance being favored by some and strongly opposed by others.

All this is still pending the agreement of the European Council.

Could the monetisation of public spending by central banks, if not accompanied by control of public spending by Member States, lead to a break-up of the euro zone?

What threatens the break-up of the zone is the disparity of the economic policies of the Member States and their lack of coordination. This heterogeneity is bound to increase with the further increases in public spending in this crisis.

If Member States whose public debts are already excessive do not make a more serious effort to reduce public expenditure not justified by imperative and urgent needs, the problem of the Eurozone' centrifugal forces will only worsen. We can see how much the policy, particularly in Germany, of reducing the public debt-to-GDP ratio to the level prescribed by the Maastricht rules, has paid off. Starting with 60% of public debt, compared to more than 100% in other countries, Germany has been able to embark on a massive programme of aid to the economy while its neighbours do not have the same margin for manoeuvre.

Moreover, the EU countries that have best managed the 2008 crash and the coronavirus epidemic are not those that have accumulated public expenditure and debt - like France, which is enduring a major shortage of gel, masks, screening tests and fans - but those like Germany - that have a modern state, healthy public finances, a powerful and reactive industry, a sustained research effort and strong social cohesion.

Furthermore, those countries that have controlled best their public finances are also those where research and reactivity have been better in terms of responding to the virus crisis.



How can public debt of the most indebted European states be reduced after the crisis? Is it possible to achieve primary budget surpluses?

Primary fiscal surpluses can be achieved to the extent that the debt-servicing burden would continue to be zero. Still, an effort must be made to reduce the least indispensable public expenditure.

Germany has reduced its public debt in relation to GDP from 80% in 2008 to 60% in 2019 (while Italy's has jumped from 126% to 136% and France's from 90% to 99% over the same period).

Countries that are still in primary deficit must take advantage of low interest rates to achieve a primary surplus to public debt over time.

What should be the characteristics of a renewed and effective Stability and Growth Pact once the crisis is over? Should new rules be added?

The first recommendation would be to apply the rules of the Stability and Growth Pact as they exist and as they were modified with more structural objectives after the 2008 crisis. We can always envisage improvements but the reality is unfortunately very simple: when the percentage of GDP devoted to public expenditure is too high, it must be reduced and brought closer to the average for the euro zone if we want to achieve a degree of homogeneity in budgetary performance, which is essential for the proper functioning of any monetary union.

It is all the more important to strengthen the common discipline that the system has put on the backburner during the crisis. Those rules are the cement that keeps together the Eurozone.

On the institutional front, since national budgets are vetted at the Union level, at one point, it would make sense to move toward a politically binding decision-making process with more substantial federal budget and tougher sanctions for non-compliance.

How can we encourage a return to healthy growth in a zero-rate environment, in economies that are often over-indebted, with populations, most of them ageing, asking for more protection from the State?

The first priority is to re-establish financial markets that function on the basis of market forces and not according to the prescription of zero-interest rates. The latter method, which has been practised unsuccessfully for the past decade or so, only encourages savers to hold liquid instruments such as bank accounts and to turn away from long-term securities with negative returns. This liquidity trap, feared by Keynes, largely explains the reduction in productive investment observed in recent years.

The national budget can also be used to promote infrastructure programmes, but to do so, it is necessary to have the means to do so, i. e. to reduce non-productive current public expenditure.

We must stop this psychodrama of so-called austerity, which is said to have weakened certain States of the Union. In fact, it is the fiscally virtuous countries that have best prepared their economies for the challenges of the crisis.

In countries with too much debt, decisions must now be made to stop “walking on their heads”; and to reduce unproductive and inefficient public spending. This is the only way to release the necessary resources to the productive sector. Such a fiscal policy requires a spirit of cooperation among the different political parties and on a bi-partisan basis, examples abound in the Northern European Member States.

Is this Europe's 'Hamiltonian moment'? What is your feeling about 'corona bonds' and /or a separate fund for dealing with the pandemic as suggested by the French government?

Alexander Hamilton understood that a nascent federal state needed a federal budget. Given the heterogeneity of economic performance among the 13 States of the Union, it is understandable that he had great difficulty in imposing this idea. But his vision was that of a federal state in the long term and not that of a group of individual states only weakly bound together only by legal concepts and human rights.

Is it possible to envisage that this American-style late 18th century vision could be born today in Europe?

One possible, Hamiltonian-inspired progress that is not revolutionary, would be to strengthen the Community budget. But the vision of the mutualisation of past or future national debts is of a different nature and is difficult to establish in a political system not united in fiscal terms.

Indeed without a fiscal Federation, it is very difficult to ask the best performers to guarantee the debt of the weakest members because this would be equivalent to a discretionary transfer of resources from some countries to others without the guarantors being able to influence politically the policies of separate states. This is fundamentally different from a fiscal authority. Moreover, Hamilton laid down the principle that the Federation was not responsible for the failure of the States.

Finally a Fiscal Union would be a major political leap that must be explained to the public and which requires democratic accountability and the consent of citizens....



Given the critical situation we face, do you not think that some common, limited financial instrument issued by the Eurozone or the EU as a whole, would be beneficial to the Union?

What could be envisaged in these exceptional times with this huge, exogenous universal shock, is to mutualise exclusively the incremental part of public debt that has to be issued to fight against the pandemic. Indeed, this would not entail a transfer of resources from good performers to more problematic ones. It would just say that to fight this war all countries are in the same boat and that “l'appartenance européenne” counts.

In this regard, the Commission's proposal of the very significantly enlarged common budget is welcome. It entails a borrowing capability in the hands of the European Executive. This would be a “Hamiltonian” step forward. For the first time, such a major budgetary plan would imply a fiscal common entity in charge of issuing euro denominated debt. ●

Economic impacts of the Covid-19 crisis and policy responses



Klaas Knot

President, De Nederlandsche Bank
and Vice-Chair, Financial Stability Board (FSB)

A new impetus for international cooperation

Challenging economic and financial conditions are often a catalyst for stronger international cooperation. The whole history of the European Union is a clear example of this. The EU has faced many challenges in the past, but it has always found a way to overcome them, based on the principle of seeking constructive compromises and joint solutions. This approach of common interests and shared responsibilities has determined the international success of peace and prosperity within the EU.

Likewise, in the midst of the global financial crisis of 2008/2009, the financial sector faced existential threats. At that moment and in a unique atmosphere of joint global effort, the G20 developed a comprehensive international reform programme to stabilize and reform the global financial system. This was key to restoring confidence in the financial sector and global economy. It also led to the creation of the Financial Stability Board, to monitor financial stability and coordinate the implementation of regulatory reforms. Implementation of the post-crisis G20 reforms has made the core of the global financial system more resilient and in a better condition to face the unprecedented current economic shock of COVID-19.

The turbulence on financial markets and the effects of the economic fall-out from the pandemic confront us with new challenges. It reminds us that our economies and financial systems are closely interconnected and that developments in different jurisdictions have important contagion effects across the global financial system.

In this context, the FSB will have a coordinating role to share information, closely monitor risks and coordinate action to maintain global financial stability and keep markets open. In close cooperation with national authorities and the international Standard Setting Bodies, jurisdictions are encouraged to make use of the flexibility within existing international standards to

provide continued access to funding and ensure that adequate capital and liquidity resources are available where needed within the financial system. This will preserve the financial system's capacity to support and finance economic growth. The FSB will focus on the critical nodes of the global financial system, including the functioning of funding markets, international capital flows and unintended effects in different types of intermediaries. The FSB will monitor the policy responses and report to the G20.

For Europe in particular, the current situation should be used as an opportunity to improve international cooperation. Now more than ever, progress towards completing the European banking union is essential to break the interconnectedness between governments and their domestic banking sector. The current unfinished agenda makes the European financial sector fragmented along national lines and vulnerable to idiosyncratic shocks. The unique characteristics of the European Union require further and well-designed steps to foster integration and strengthen the functioning of the single European financial market. In this context, additional measures are also needed to further develop the European Capital Markets Union to support open, integrated and developed capital markets to facilitate private risk-sharing and reduce systemic risks.

The unprecedented experiences of the dealing with the challenge of COVID-19 and resulting economic and financial fallout will test our dedication. Yet, as it has been in the past, it also creates new opportunities. There is ample evidence that policy responses are most effective when they are conducted in a joint and comprehensive approach, based on international standards.

In this spirit, I am convinced that the COVID-19 pandemic will provide a new impetus for international cooperation as the most effective path to ensure global financial stability. ●



Stipe Župan

State Secretary, Ministry of Finance of the Republic of Croatia

Towards a future-proof EU fiscal framework

Member states' fiscal outcomes ultimately emanate from domestic political choices across policy domains and from exposures to exogenous shocks. The financial and the sovereign debt crisis, pointed to the need for a closer coordination of national fiscal policies to address the risk of spill-overs within the Economic and Monetary Union. This resulted in a strengthened Stability and Growth Pact, a review process of euro area countries' draft budgetary plans, and the golden "balanced budget" rule of the intergovernmental Fiscal Compact.

These coordination tools have been instrumental in guiding member states towards sounder fiscal positions. In the context of the EU economic governance review and related public consultation, initiated by the European Commission in February 2020, a reflection has started on whether improvements to the common fiscal rules are necessary based on both a backward- and forward-looking assessment.

However, since the review was launched, the world has changed considerably in the wake of the coronavirus pandemic. The focus of fiscal policy is now squarely on facilitating the resolution of the acute health crisis and mitigating the socio-economic fallout of COVID-19, which has triggered the worst economic downturn since the Great Depression. Member states have acted swiftly and decisively by directing the necessary resources to health and civil protection services, supporting liquidity and credit for businesses, and protecting the incomes and jobs of workers.

As part of a broader European coordinated policy response to complement these national efforts, the European Commission, supported by the Council, activated the SGP's general escape clause to temporarily set aside the budgetary requirements that would normally apply, in order to tackle the economic consequences of the pandemic.

Large-scale national fiscal stimulus coordinated at EU level was undoubtedly the right response to avoid permanent damage to the economy's growth potential and ultimately, to debt sustainability. Nevertheless, it is clear that the public deficit and debt levels relative to GDP will be increasing significantly. These will have to be put on a downward path, which in particular for public debt proved difficult in some countries already before the crisis. At the same time, national fiscal policies should not

become procyclical, but rather provide adequate support for rebuilding the economy. This is also related to the issue of the appropriate aggregate fiscal stance to increase the effectiveness of monetary stimulus. In addition, fiscal policy will have to cater for new priorities such as environmental sustainability and the digital transition.

Looking ahead, it will be important to achieve a common understanding on how to ensure that the EU's fiscal framework remains fit for purpose and is able to reconcile these different objectives. Striking the right balance will require careful consideration but should be feasible. If the fiscal rules were for instance to further promote public future-oriented investment, preferably in areas consistent with EU priorities such as environmental sustainability or the digital transition, this would not only be conducive to the economic recovery, but also constitute an opportunity for increasing the economy's growth potential and competitiveness. This would in turn benefit the long-term sustainability of public debt.

Looking ahead, it will be important to achieve a common understanding on how to ensure that the EU's fiscal framework remains fit for purpose and is able to reconcile different objectives.

Possible trade-offs could also be eased by having a fiscal framework that encourages a more growth-friendly composition of national budgets. This could be achieved through a better prioritisation and targeting of national public expenditure as well as through less distortionary taxation. This in turn underscores the importance of pursuing fiscal and structural reforms.

Finally, it will be important to ensure that possible changes to address the above-mentioned challenges do not come at the expense of the transparency and predictability of the common fiscal rules, which should remain an anchor of confidence for markets and citizens. ●



Poul M. Thomsen

Director, European Department, International Monetary Fund (IMF)

Europe's Response to the COVID-19 Crisis

The COVID-19 shock is unprecedented in recent times, in both nature and size. About half of humanity is under lockdown at the time of writing.

Europe is particularly affected as it accounts for about half of the global total of confirmed COVID-19 cases at present. In Europe, nonessential industries closed by governments account for about one-third of output: that means that each month these sectors remain closed translates into at least a 3 percent drop in annual GDP. Consumer and business confidence are already deteriorating sharply: the composite PMI for the euro area fell in March to levels lower than in the global financial crisis. Financial conditions have tightened sharply, reflecting the extent of the real economic damage. A deep European recession this year is a foregone conclusion. Precisely how deep and how long remain highly uncertain.

Policymakers in Europe have generally responded with speed and tenacity, deploying instruments tailored to both the specificities of the crisis and its scale. The most urgent priority is of course to save lives: a battle to stagger transmission and ramp up critical-care capacity to minimize the number of seriously ill patients that will be denied life support. This requires a massive investment in healthcare, on a war footing, accompanied by macroeconomic policies to ameliorate immediate hardships. Some of these actions will also help limit more persistent effects. In the near term, policies include supporting households and firms directly affected by the crisis, and providing abundant liquidity to offset financial stability risks. If there ever was a time to use available buffers and policy space, this is it.

But policy space for the response differs markedly across Europe. Advanced European economies have been able to launch large-scale fiscal and monetary support. EU fiscal rules have been suspended, bold monetary policy actions taken, and selected prudential norms for banks temporarily relaxed. Most countries in this group have announced large health outlays, employment subsidies, and guarantees, loans, subsidies, or capital to hard-hit businesses, while in some cases allowing tax payments to be deferred or cancelled. Fiscal deficits will balloon, and this is entirely appropriate. In the euro area, the large-scale interventions by the European Central Bank, and leaders' calls for the European Stability Mechanism to provide a supplement

to national fiscal efforts, are particularly critical in ensuring that countries with high public debt will have the fiscal space they need to react forcefully to the crisis. The determination of euro area leaders to do what it takes to fight this crisis should not be underestimated.

Policy makers in Europe have generally responded with speed and tenacity.

Emerging-market economies that are members of the EU but not the euro area should now use the buffers that they have cautiously built in recent years, through sustained reduction of fiscal and external deficits and a continuous strengthening of their bank systems.

Smaller countries outside the EU, however, will find it difficult to finance large budget deficits due to their limited access to external capital, less developed banking systems, and lack of potential access to EU financial support. Excluding Russia and Turkey, most of the nine non-EU emerging economies in Central and Eastern Europe have already applied for emergency assistance from a \$50 billion pool available via the IMF's rapid financial support facilities. In this way and others, the IMF stands ready to help Europe and all of its membership. ●



Pervenche Berès

MEP from 1994 to 2019, European Parliament

The specificities of the Covid-19 crisis and how to respond

When the Covid-19 pandemic exploded, there was a temptation to refer to the Global Financial Crisis (GFC). But these two cataclysms may have little to do with each other.

The differences are huge. This crisis originates from a biological virus and not from toxic subprime mortgages. It is a health crisis and not a financial market one. This crisis spreads at a high speed and Members States or EU institutions have been reacting much faster than in 2007-2008. This crisis is a systemic one, with no place for a debate on moral hazard.

This crisis is deadly, it hits people first and its impact on the real economy is of a complete different magnitude, even though a big open question is its duration.

One way to fight this virus and its spreading is to enhance the surveillance of citizens' mobility. Advocates of full transparency of financial transactions should in democracy ask themselves more questions about the full tracking of individuals. Monitoring financial transactions and jeopardizing the freedom of movement of people are not the same.

But somehow, we observe the same mistakes and lack of solidarity.

Sub-primes were viewed as a US disorder against which EU fundamentals and automatic stabilizers were supposed to resist. This time, Covid-19, like Ebola or SARS, would not hit Europe; even when it arrived in Italy, there was some kind of condescending blindness. Like a reflex, the same group of Member States shot again first rejecting any strong EU solidarity and fiscal stimulus. On the front line a country, known for opposing reforms to rebuild a EU and Members States capacity through a fair corporate taxation regime, notably for platforms.

There is hardly any health coordination at the EU level even if this is mainly an area of national competence and that there have been few cross-border transfers of severely sick patients. But the trading of drugs and medical equipment remains a jungle with no internal market.

We would be much better off today if we had drawn all the lessons of the GFC and the legacy of the latter was a better-equipped EU to face crisis. This is true when it comes to have a revision of the Stability Pact to support long term investment, to establish a euro area budget to absorb symmetric shocks, even though up to now this crisis has no euro area specifying impact, to integrate the European stability mechanism (ESM) into the EU legal framework, to set up an unemployment benefit scheme acting as an

automatic stabilizer or to issue Eurobonds. But, fortunately, one should also recognize that we have learned some lessons from the GFC. Some Members States have quickly put in place partial unemployment schemes, deferrals of tax and loan guarantees. Banks have much thicker liquidity buffers.

Mistakes vis-à-vis Italy were corrected, at least in the wording and after some hesitations, EU institutions reacted much more rapidly, the ECB with its 750 billion euro Pandemic Emergency Purchase Program (PEPP), the Commission with the suspension of the Stability Pact, decisions regarding state aids, structural funds, and the launch of SURE (Support to mitigate Unemployment Risks in an Emergency). While writing this paper, let's hope that Members States will demonstrate the same wisdom to commit to real fiscal solidarity.

What should we worry about for tomorrow? President Trump could for once be right! "We cannot let the cure be worse than the problem itself". In the short term, we need to have at our disposal a complete range of tools to tackle the different dimensions of the crisis, knowing that there is a dilemma: the more we are careful about people's health and smoothening the curb of hospitalized persons, the more we damage the economic situation.

For the future, to respond to the challenge of EU sovereignty and common goods, many EU policies will need to be reshaped; this is true for competition and industrial policies, trade, economy and taxation, notably of digital economy, but also for foreign affairs and development, having in mind the geopolitical implications of such a global pandemic.

No doubt that after this crisis the debt issue will be once more on the table, even though there are still two unknowns, the crisis duration and the debt level. This should only be evaluated at the end of the period as a one-off debt without making the same mistake made with the Greek debt.

Nevertheless, and on top of that, the question of fiscal tools and how to finance public services and public goods will have to be reopened.

The greatest risk would be to rush to restart the economy at any price, ignoring the still-valid urgency to lead the ecological transition. In the aftermath of this crisis, we will have no choice but to rebuild our economy around priorities for people, health and environment. This time, the main answers will not come from financial markets. One should make sure that they remain sustainable and contribute to collective preferences. ●



Andrew McDowell

Vice-President, European Investment Bank (EIB)

A pan-European response to a disease that knows no borders

Even as the spread of Covid-19 slows, and discussions commence on how to ease the economic shutdown, otherwise healthy European businesses are still failing by the thousands, suffocating from a lack of revenues and financing.

This pan-European pandemic calls for a pan-European economic response. This is why EU Finance Ministers have endorsed the European Investment Bank (EIB) proposal for EU Member States to create a €25 billion Guarantee Fund to enable the EIB Group to mobilise up to EUR 200 billion in funding for distressed sectors, as part of the wider EUR 520 billion package of EU crisis response measures agreed on April 9.

How the guarantee fund would work - The €25 billion guarantee fund will – subject to national confirmation and approval processes – be financed by EU Member States pro-rata to their shareholding in the EIB and/or other institutions. It is limited to addressing the Covid-19 shock, but could form a bridge between the crisis and the recovery periods.

With the benefit of a counter-guarantee from the Fund, the EIB Group – the Bank and the European Investment Fund (our specialist SME guarantee and equity subsidiary) – will unlock financing to the real economy by ramping up guarantees to local lenders, national promotional institutions and other financial intermediaries.

The products to be rolled out under the Guarantee Fund will likely be dominated by capped (first loss) and uncapped guarantees on portfolios of SME loans originated by local lenders and other forms of risk-sharing on new and existing corporate loan portfolios. Some of these will provide regulatory capital relief.

Other products will also be considered, including participations in Asset Backed Securitisations to free up lending capacity, as well as equity investments in venture capital and private equity funds supporting innovative firms.

This fund should also allow EIB to counter-guarantee some national guarantee schemes already in place, thus sharing across the EU the risk of these schemes and increasing their firepower. The focus will be on SMEs, though it is proposed that mid-caps and larger corporates will also be eligible for support. All must be viable in the long-run and, in the absence of the Covid-19 pandemic, would meet commercial requirements for financing.

EIB and EIF have years of experience in these products, and through existing network of hundreds of counterparts can quickly channel financing to markets and sectors most in need. While there will be no

quotas for any country, we have proposed upper concentration limits to ensure an equitable allocation of the firepower, always guided by EIB's usual assessment of economic and social impact.

A pan-European response to the pandemic - I see four key advantages of supplementing – at the EU level – the many national guarantee schemes that have already been rolled out.

Firstly, as with the Covid-19 health crisis, we need a co-ordinated approach to managing the economic crisis. No country will recover alone. Even the largest is influenced by what happens in terms of overall EU demand, intra-EU trade, intra-EU value chains, overall EU market confidence and financial market loops.

A study by the European Central Bank shows that 1% symmetric decline in the GDP of each Member State brings, after the initial mechanical effect, an additional 0.6-0.8% decline in the Euro-area GDP growth, due to the direct and indirect spillovers in trade. The EIB's own data shows that 40% of economic growth and growth in jobs from the operations we finance comes from cross-border spill-overs.

Secondly, by pooling credit risk across all of the European Union, the overall average cost of the fund could be reduced, compared to national schemes. Thirdly, the use of the EIB also means that guarantee schemes – and their SME and corporate beneficiaries – across the EU could benefit from the bank's AAA rating, even in financially weaker Member States which lack fiscal space and a top credit rating. With the suspension until December 2020 of normal state aid restrictions, this can help to level the playing field for businesses across EU countries during both the crisis and recovery period.

Finally, Europe's venture capital and innovation ecosystems are trans-national by nature – no individual Member State has adequate incentives to fully protect them, calling for a pan-European perspective and policy instrument.

The broad product mix being proposed will ensure that in every country we will find a way to complement national schemes to best effect.

The economic and financial dynamics immediately ahead of us are approaching a tipping point: we have little time to put in place measures to safeguard the European economy from this unprecedented shock. By responding to this crisis with a spirit of solidarity and enlightened self-interest, we can start to strengthen confidence among markets and citizens in Europe's capacity to weather the storm. Together, Europe can emerge from this crisis even stronger. ●



Jordi Gual

Chairman, Caixabank

Europe's greatest challenge

We are experiencing a global health crisis unprecedented in recent history. The immediate priority must be saving lives: procuring all the resources the health system needs and taking the necessary measures to slow down the spread of the pandemic. In turn, the health crisis and the lockdowns that we are using to fight it have resulted in a deep economic recession that must also be faced resolutely. We have the capacity to manage both crises and lay the foundations for an economic and social recovery.

It is important to keep in mind that we are facing a public health shock that should be temporary if the epidemic is controlled in the near future. The goal of economic policy must be precisely to prevent it from having lasting economic effects, something that would happen if companies go bankrupt, if jobs are permanently destroyed or if companies and families emerge from this situation weakened by a heavy debt burden.

The response must combine policies that satisfy the liquidity needs of companies and families, favor temporary adjustment mechanisms for employment levels, and transfer public resources to companies and families to mitigate income losses. All European governments have already announced different measures in line with these priorities.

There is no doubt that the great fiscal effort implied by all these measures will suppose a significant increase in public debt. Such measures are essential to contain the economic and social impact of the health crisis. In their absence, the recession will be deeper and more protracted and the resulting fiscal costs from it, even higher. Moreover, some of the deterioration in public accounts this year should be reversed automatically with the recovery of economic activity.

These extraordinary times demand a shared fiscal effort by all Eurozone countries. It is not just, or even mainly, a matter of solidarity towards those countries that may end up being most affected. It is the most consistent approach with the fact that we are all members of a single monetary area.

By creating the euro, member countries gave up their monetary sovereignty and thereby gave up the support they could receive from their national central banks as lenders of last resort in exceptional circumstances. Certainly, the European Central

Bank has shown its willingness to intervene in public debt markets to avoid an excessive increase in risk premiums, but this is not comparable, for instance, to the unlimited support that the Federal Reserve is providing the United States Treasury.

The Eurozone needs a single fiscal authority that can counter a shock like the one we are experiencing, an authority with the ability to issue a safe asset and that counts on the central bank as a lender of last resort. Indeed, lacking a fiscal union weakens our capacity to respond. This is the right time to take an additional step to strengthen the European Monetary Union and create it. In this regard, the Recovery Fund to be discussed soon by the European Council provides a unique opportunity to consider different options to start moving in the right direction. The stakes are high: the credibility of the European project in the eyes of the world and, most importantly, of its own citizens. ●



Bernd Spalt

Chief Executive Officer, Erste Group

Coronavirus has the power to transform Europe towards deeper integration

Without question, the coronavirus crisis is the largest threat to public health in living memory. Even though the real economic impact is not fully visible yet, most experts agree that we are facing an unprecedented hit on both the supply and demand side, with a lasting impact comparable only to such major disruptions as the global financial market crisis of 2007/08 or the oil crisis of the early 1970s. Above all, this crisis falls into the category of 'black swan events', which are hard to foresee and even harder to prepare for.

The sheer magnitude and unclear progression of the current crisis have the potential to stun the global economy far beyond the second half of this year, as is now commonly assumed. But there is one element of encouragement as efforts ramp up to address this challenge: despite the world's rather inevitable unpreparedness for this particular black swan, most economies were actually in rather good shape when the coronavirus first hit. Also, central banks and governments have reacted quite swiftly, which may be a lesson from the 2008/9 crisis, when the first round of reactions in parts of the world were too slow and faint-hearted.

As the infection numbers start to peak in Europe and the US, the focus of public debate is shifting from protecting people's lives and livelihoods to restarting the broader economy. That is also why this is the right moment to take a closer look at what has changed in the economy and what this means for the banking sector.

Currently, governments are acting swiftly to keep their economies afloat. There is no doubt that they are guided by the right motivations, even as many details of these measures' implementation are still being worked out. All these measures have bought us some time, but we all know that the relief they offer can only be temporary and efforts to further strengthen the real economy will be needed in the coming months. We as the banking sector stand firmly by our commitment to support the customers and finance the real economy. Banks understand that they are key parts of the critical infrastructure on which societies rely (especially in such crises) and have undertaken massive – and successful – efforts to keep things up and running for their customers. Banks like Erste Group have been able to rely on their sustainable and resilient business model, with its digital offering

and physical branch infrastructure. More generally, banks have shown that they are ready to support society by addressing the needs enterprises have in order to overcome their short-term difficulties. It is in the private sector that jobs are being created, where families generate their income, and where Europe produces its wealth.

Going forward we need a medium-long term framework to organize and coordinate the management of this crisis.

Going forward we need a medium-long term framework to organize and coordinate the management of this crisis – a framework which takes into account the specific roles of politicians, banks and supervisors alike. In some markets we do see first signs of patchwork-like actions at national levels that fail to reflect the need for coordinated responses within the broader European context. We, as banks, need flexibility to be able to help. What is not needed are any additional obstacles to the free movement of capital or ring-fencing measures. What's more, governments should try to remove any unnecessary hurdles in the existing frameworks.

As a strategic investor in Central and Eastern Europe, Erste Group remains strongly committed to its home region. For this reason, we believe that a coordinated response involving all relevant stakeholders at the regional level makes sense and could draw on the successful model provided by the Vienna Initiative. It is astonishing that a virus that does not stop at any border has been treated – from an economic perspective – almost independently by all countries. This virus has the power to transform Europe, either towards more nationality or towards deeper integration. Going forward we remain committed to capital market development, support the European Banking Union and ultimately support any measures to foster deeper European integration. ●



Dr. Karl-Peter Schackmann-Fallis

Executive Member of the Board,
Deutscher Sparkassen- und Giroverband (DSGV)

Solidarity and Stability in Europe

The economic consequences of the Corona Pandemic are tremendous and rapidly deteriorating. After China and Europe, now the US, emerging and developing economies are hit most severely. In the US the initial response has been insufficient and inconsistent for a long time. An aggravating factor for the leading Western economy will be that it has less automatic stabilizers than most European countries.

There is hope that in many European Union countries the further spread of the disease can be controlled. Discussions about the appropriate exit strategy are beginning. Yet, the clear priority still has to be to limit new infections. If containment measures were to be withdrawn too early, a second wave could increase economic damages even further.

The Corona shock is symmetric, hitting the real economy with full force. Everything possible must be done to support and stabilise the economy. Capital stock and labour force potential must be maintained as much as possible. They form the basis for the economic recovery. Europe and the Member States have taken action: fiscal policies are delivering “whatever it takes”. The rules of the Growth and Stability Pact are suspended for the duration of the pandemic, and rightly so. It is now important to make full use of all possibilities via the ESM and the EIB. The 500 billion Euro programme recently agreed by the Eurogroup is a fundamental sign of European solidarity.

A well-functioning financial services infrastructure will be vital to channel funds as quickly as possible to the real economy. That is why we are asking legislators and regulators to lower operational and administrative burdens for the banking sector now and to adjust implementation and application timeframes for all levels of legislation to the impact of COVID-19.

Within just 11 bank working days the German savings banks have had more than 704.000 conversations with their corporate customers. All systems are working to the limit of their capacities. In most cases these contacts involve general advice, utilisation of existing credit lines or fresh loans from the respective savings bank. In 20-30 % of cases it is a matter of suspending interest and repayment of principal or of loan applications to access public support programmes. In total, the savings banks have suspended interest and redemption payments for more than

200.000 clients already and the numbers are increasing. Thus, emergency measures clearly are transmitted via the locally active savings banks.

Once more this is proof of bank finance based on local banking networks being quicker and more efficient than capital markets-based finance.

This crisis of the real economy could certainly become a problem for the euro area, if credit ratings of individual countries are lowered below investment grade, potentially leading to a further downturn of the European financial markets.

European solidarity will therefore be needed. Solutions must be balanced, acceptable and enforceable. A full mutualisation of public debt via so-called “Corona Bonds” does not appear to reach consensus. Without conditionality or other incentives, such a tool could indeed place too high a burden on all member states.

Yet, much more money will be needed. Innovative ways of financing those needs to avoid turbulences on the capital markets are necessary. Using the excellent credit rating of some member states could be made available via a guarantee, limited in time to EU countries with a lower credit ratings or countries having lost market access.

Such bilateral guarantee-relationships between countries of differing credit ratings could be a core element of the European recovery fund without the need of expensive equity. The default risk of such instruments would be lower than that of Corona- or Eurobonds. New or ongoing ECB purchasing programmes would also reduce risks for the guarantor of the bonds.

Based on these “Stability Bonds” solidarity on a European level could be provided. They would strengthen the crisis resilience of the whole euro area and have a stabilising effect on financial markets. The message behind those bonds would be that Europe stands together in times of increased financial pressure. But that Europe, unlike other currency areas, still keeps an eye on managing increased crisis-related debt levels, thus creating a solid foundation for renewed sustainable growth. ●



Dr. Jérôme Haegeli

Group Chief Economist, Swiss Re

Post-crisis recovery agenda: we need it now

None of us have ever experienced anything remotely similar to the ongoing situation, not even post-war generations. Governments globally face a unique health crisis which has seen no borders. Combatting it has meant taking a deliberate, difficult and delicate trade-off versus economic growth. As a result, the Covid-19 induced recession will be one of the deepest on record. The good news is that it may also be one of the shortest on record, however, there will be long lasting ramifications beyond the containment of Covid-19. Such ramifications will result in paradigm shifts that will take societies, policy making and the economic framework into a new era, including the following: 1) further innovation from the ECB, 2) monetary and fiscal policy coordination and implicit debt monetisation, 3) bigger role of governments in capital markets, 4) peak of globalisation and emergence of parallel supply chains, 5) possibility of a stagflationary environment, and lastly 6) accelerated digital transformation.

These paradigm shifts highlight the importance for the Eurozone to adapt and evolve if it wants to remain one of the major global economies. Even more importantly though, the challenges arising from Covid-19 have brought the euro area to a pivotal point where it will either “make it or break it”, with the region at greater risk of falling apart now than during the Greek debt crisis. As such, it is vital for the euro area to witness an upsurge in solidarity if it is to survive. At present, already existing tensions amongst member states risk being exacerbated by the important disparities in the fiscal responses.

Although the massive global fiscal stimulus¹ is cushioning the blow to the economy, it will not absolve countries of all the challenges. This will result in governments not being able to take away the massive fiscal measures any more than they were able to after the GFC. Given the similar demographic profile to Japan, it is critical that Eurozone governments provide support to companies and sectors with strong potential for future growth to avoid replicating Japan's growth trap.

Governments around the world have so far focussed on attenuating the impact of Covid-19 on their economies. Although this is necessary, European leadership should also consider the ongoing disruptions as a window of opportunity to secure higher trend growth, ensure economic resilience and achieve political stability throughout the region. In addition, with Covid-19 being

a temporary, albeit painful, disruption, persistent issues such as climate change will remain at the forefront of global dialogues. The Eurozone could position itself to spearhead the climate change dialogue. We therefore propose the following actions to policy makers:

1. **Common green innovation fund** – establishment of a euro area-wide fund to support innovative technology, with a special focus on low-carbon technologies to meet global climate change objectives all the while increasing productivity.
2. **Common resilience fund** – establishment of a common resilience funding pool that members can draw from in times of shock without the debt mutualisation aspect. The fund would include pre-defined trigger levels for fund access, with proceeds earmarked for targeted investments in alignment with Europe's economic and political ambitions.
3. **Digital alignment** – smoothing of the large digital disparities across member states and the creation of a digital single market. Europe is in some ways in a luxurious position as the Union can start from scratch without a pre-existing, institutional legacy on this front.
4. **Infrastructure spending** – emphasis should be on sustainable infrastructure, with spending done at a national and eurozone level. Transport infrastructure will be key to help the region transition to a low-carbon economy, while supporting the shift to parallel supply chains.
5. **Financial integration** – improvement of the euro area financial system's capacity to channel surplus funds to parties in need of financing for consumption or productive investment. Better integrated asset markets should help smooth income and consumption growth, and hedge against country-specific sources of risk.

Ultimately, the European integration is a peace project which builds on solidarity and a joint future. The Eurozone therefore needs to act now while it still can and before what were once shared values drift further apart from each other. ●

1. Global fiscal stimulus will exceed 3% of world GDP in 2020, which compares to 1.6% in the GFC. This number only reflects stimulus that flows into the fiscal deficit this year, and excludes all loan guarantees

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- Covid-19 crisis impacts
- Economic and Monetary Union (EMU)
- Monetary policy impacts
- International role of the Euro

FINANCIAL POLICIES

- CMU 2.0
- Securities trading and post-trading
- Relaunching securitisation in the EU
- Banking Union
- Brexit & Third-country arrangements
- CEE region funding challenges

NEW TRENDS

- Sustainability investment challenges
- Small & Midcaps ESG challenges
- New technologies (cloud, AI, DLT...)
- Crypto-assets and payments
- Operational resilience

Implications of the Covid-19 crisis for the financial sector



Michael West

President, Moody's Investors Service

Coronavirus exposes global financial market vulnerabilities

Global credit conditions are deteriorating because of the coronavirus outbreak and oil price shock, which will likely lead to an increase in rating downgrades and defaults in the coming months. The economic turmoil, along with significant financial market volatility, is creating a severe and extensive credit shock across many sectors, regions and markets. The combined credit effects of these developments are unprecedented. The sectors with the largest exposure to the coronavirus outbreak are those that are most sensitive to consumer demand and sentiment, including global passenger airlines, lodging and cruises, automotives, and segments of the oil and gas sector, as well as certain commodity exporters. Negative credit effects will be the largest for companies and governments with high debt levels, heavy reliance on external financing and weaker credit profiles. Speculative-grade companies and governments represented close to 40% of all Moody's-rated debt in 2019, up from 16% in 2009. Moody's expects the G-20 economies to experience a major shock in the first half of this year and will contract in 2020 as a whole, before picking up in 2021.

Nevertheless, there remains sizeable downside risk to our forecasts given the significant uncertainty as to the length and magnitude of the coronavirus outbreak. The monetary and fiscal response has been significant and continues to grow, and we expect it to help cushion the economic and financial market impact of the shock. In some cases, these policy measures will allow for a faster recovery once the shock recedes. Fiscal stimulus will also lead to further increases in sovereign debt, which is already high in many countries, including in the European Union. Emerging market currencies have sharply depreciated vis-a-vis the US dollar because of safe-haven flows, increasing vulnerabilities for emerging countries that are dependent on external financing.

While the European Union has been slow to devise a coordinated response, one is emerging that may start to employ some of the policy tools devised during the euro area sovereign debt crisis. However,

more broadly, global policy responses have thus far been disjointed, favouring more nationally focused approaches.

Even before the coronavirus, global economic growth was slowing as a result of cyclical and structural factors, including aging populations, weak productivity, global trade tensions and geopolitical risks. A lasting trade deal between the US and China will remain elusive, with disputes extending into technology, investment and geopolitics. The outcome of US-EU trade talks, potential auto tariffs and Brexit-related uncertainty also remain risks. Lower-for-longer interest rates also increase financial stability risks and weigh on profitability for banks and insurers. They encourage risk taking as investors reach for yield that may have contributed to high financial volatility and sharp asset declines in recent weeks. Low rates can encourage excessive borrowing as evidenced by elevated corporate leverage in the US and Europe.

Many high-yield companies took advantage of easy market access and have successfully weakened investor protections. The increase in low-rated companies with weaker credit profiles will likely lead to more defaults and lower recoveries even if the current downturn were to be milder than the one in 2008. High levels of Baa-rated corporate debt globally increases the risk of downgrades to speculative grade in a recession, although this risk in and of itself is not likely to disrupt the high-yield market. The market for leveraged loans and collateralized loan obligations (CLOs) has expanded significantly, which poses risks during periods of tight credit conditions. In Moody's view, junior tranches of CLOs would be at risk of significant credit quality deterioration under a severe downturn scenario. However, senior tranches would likely avoid impairments because of credit enhancement and other structural features. Investors are increasingly incorporating climate and cyber risks into their decision-making. Moody's expects these areas to become bigger credit considerations that in some cases will weigh on credit availability, putting further pressure on carbon-intensive sectors. ●



Jean Lemierre

Chairman, BNP Paribas

Covid-19: banks are part of the solution

The Covid-19 pandemic is a worldwide public health issue, which has brought a large part of the world's population and economy to a complete stop, leading the global economic activity to decline on a scale we have not seen since the Great Depression, with a drop of 6.1% in GDP for the advanced economies, as estimated by the IMF.

After the deep economic and financial 2008 crisis, and ten years of unprecedented regulatory and institutional overhaul to strengthen financial stability, the European Union is now confronted, with the outbreak of the CoVid-19, and its potential social, economic and financial consequences, to its first pan-european systemic crisis, affecting all Member States albeit with different timing and intensity, and all sectors of the economy.

Contrary to the sub-prime crisis, banks are not the problem, they are part of the solution. A prompt, coordinated and powerful response to this unprecedented challenge has been designed at EU and Member States level. Banks are called to support the economy, and are doing it in every geography and business lines.

Time will come to learn the lessons of the crisis, and to build the foundations of the recovery which is needed in the years to come.

Banks are at the core of public policies, to avoid the massive bankruptcies that characterized previous crisis, with their dire consequences on job losses. Hand in hand with authorities, banks are the backbone of the financing of the economy, to support short term temporary liquidity needs, and to facilitate the recovery. Our staff is mobilized to address clients needs, every day, in branches, business centers, back-offices, risk management units, data centers. Banks are open for their clients, and the financial infrastructure works: payments, settlements, client orders, are processed in millions, across the globe so the economy can function. As an example, Swift transactions are close to their peak in March and April, with a 16% increase y/y. Moratoria and new loans are discussed with clients and granted with an accelerating process in most EU countries. In France, 3 weeks after the implementation of the State-guaranteed loans, 150 000

companies have received approval, for a total of 22 bn€, and the framework is ramping up quickly.

The massive financing that banks will provide to the economy is supported by the liquidity provided by the ECB, and by State Guarantees provided by Member States. Regulators are implementing the flexibility embedded in existing regulations, and, at the margin, adapting regulations to international standard setters guidance. This contracyclical approach is at the core of financial stability: build capital and liquidity buffers in good times, to be well prepared to weather bad times.

Time will come to learn the lessons of the crisis, and to build the foundations of the recovery which is needed in the years to come. Policy makers will also have to adapt the regulatory framework where rigidities may have dampened timely responses to the crisis.

But for the moment, our energy should be fully devoted to fight the virus and its economic consequences, hand in hand with the authorities. ●



José Antonio Álvarez

Chief Executive Officer, Santander Group

This time it's different. Let's keep it that way.

As I write this, many parts of Europe are in their second month of living with the COVID-19 corona virus. To many, the economic disruption and volatility in financial markets recalls the uncertainty and instability of the 2008-9 financial crisis and the Great Recession that followed it, or even the Great Depression of the 1930s.

But we know this time around is very different. In this crisis, triggered by a public health emergency, we in the financial community – banks and other financial institutions, monetary authorities, regulators and supervisors, our customers and employees and shareholders – are very much on the same side. We have all been rowing in the same direction. So far that has enabled us to mobilize huge resources for the economy. It will be very important in the coming months to maintain that shared vision and solidarity, which could come under pressure as the public health crisis wears on. So it is a good time to remind ourselves of some guiding principles as we go forward. We must always remember that our purpose is to support people and businesses, in difficult times as well as good times.

In the last two months, central banks and other authorities have been very quick to act in unleashing huge amounts of liquidity into the system. They did this through market operations and through prudential relief, eliminating the capital and liquidity buffers put in place while economies were growing to make banks more resilient when they are not.

Recognizing that monetary policy could not be the only answer, governments have put in place a series of fiscal and social measures that include direct support for SMEs and other companies, employment and wage protection and loan guarantees and moratoria. Banks, in most instances, are the transmission mechanism for these programs. All this happened in the first weeks of March. Not surprisingly, many of these initiatives took a few days to be activated, but they were mostly activated.

The close coordination among banks, supervisors, monetary authorities, governments and other key actors have led to quick preventive and corrective actions. On issues ranging from accounting and prudential flexibility the eligibility of collateral, I have seen authorities act quickly when the industry has raised concerns. In turn, banks have responded when concerns were raised over dividends and other measures to conserve capital.

Our collective learning curve has been steep. Here are some of the lessons we learned at Banco Santander, both for authorities and ourselves, which may be useful as we continue to navigate this crisis.

- **Be safe.** The first concern of any institution must be the well-being of its employees and customers. Working from home, protective guidance for branches and mental health support all help to keep people well. Maintaining their jobs is fundamental.
- **Be fast.** You can't rescue a company after it has gone under. Banks and authorities have had to work very closely together to get support where it needs to be, quickly.
- **Be big.** Monetary and fiscal measures work best when markets see they are of the scale required to address the problem. Make sure what you do is enough and the conditions are right. Half-way treatments don't work.
- **Be simple.** Applying for loans or benefits should be as paper-free and non-bureaucratic as possible. Include clawbacks and affidavits, if needed, rather than try to impose upfront conditions on support.
- **Be inclusive.** Guaranteed loan programs and moratoria should be for all types of loans and segments of customers, large and small, based on clear criteria.
- **Be ready.** Even as we are implementing the last measures, we have to look forward to the next stage – and the stage after that – to consider how the needs of our customers and governments and authorities may change and be ready.
- **Be open.** Fluid communications with our stakeholders, including authorities and governments, have been essential to our ability to manage so far. That will remain the case.

Going forward, the highest priority for banks will be to manage risk prudently to keep our balance sheets strong. Strong balance sheets will enable us to continue to support people and businesses. Banks must distinguish between what is near-term or transitory, related to the COVID pandemic, and what is not. This distinction, between transitory disruption and long-term unviability, is essential to make sure banks themselves stay healthy. Also, as the transmission mechanism for the public sector, we must assure that public resources are allocated fairly and justifiably, keeping in mind we are lending, not providing subsidies.

At some point, as we emerge from the lockdown phase - I hope in the near future - the financial community will need to work together to revive the economy and support people. This will likely be a gradual process, with many decisions and challenges, as some sectors and segments return to work faster than others. I am convinced that the close coordination we have maintained so far, with the private and public sectors working closely towards the same goals, will be crucial in making sure banks can perform their duty in the coming recovery. ●



José Viñals

Group Chairman, Standard Chartered Plc.

How banks respond to the crisis now is critical to the global recovery

The COVID-19 pandemic has triggered a global public health and economic crisis. Human and societal costs are already significant, and governments have taken unprecedented steps in an attempt to weather the economic impact. Many predict 2020 will see the worst peacetime performance for the global economy since the Great Depression. The International Monetary Fund projects a sharp global economic contraction of -3% in 2020, much worse than during the 2008-09 Global Financial Crisis.

The present crisis is like no other in the extent and severity of its shock, the uncertainty over its duration, and the strength and shape of an eventual rebound. Whereas previous crises required economic policies to stimulate activity, much of the present economic impact is attributable to necessary containment measures. Banks can and have been playing an important role in alleviating the immediate liquidity issues. By providing a reliable source of financing to corporates and individuals, and by being a conduit for delivering many of the public policy measures, we have been helping bridge the cash flow needs of our clients and communities.

In addition, many banks are taking their own initiatives to fight the impact of this virus. At Standard Chartered for instance, we've announced \$1billion of financing at cost for companies that provide goods and services to help the fight against COVID-19. And we have launched a \$50m COVID-19 assistance fund with \$25m allocated to emergency relief in the most affected markets and \$25m to help communities' recovery from the medium-term economic impact of the virus.

This crisis, however, has reminded us that financial markets can go through episodes of 'market illiquidity'. They quickly exhibit extreme volatility as some market participants must sell down their positions to meet their financial obligations. Corporates are also seeking to increase their liquidity buffers to manage their working capital needs, leading to an overall hunt for cash. The European Central Bank has decisively responded to those challenges, including unveiling the Pandemic Emergency Purchase Programme with an overall Euro 750bn envelope to buy government and corporate bonds. To address the global risk of dollar shortages the Fed has put in place, among other measures: dollar swap lines for a number of central banks; and, a special dollar facility for many central banks.

These measures are being used by banks to channel liquidity to the economy thus preventing a liquidity-driven crisis. While the magnitude of the impact of the COVID-19 crisis on financial stability in the medium term is difficult to assess at this stage, the dramatic fall in economic activity and the increase in both public and private sector debt will likely have a significant impact on the financial sector and on banks. For example, the fall in economic activity could contribute to the deterioration of asset quality of banks, leading to a vicious circle of reduced lending, poor profitability and negatively impacting the economy. This is not a new problem in the EU, which faced similar issues following the 2012 EU sovereign debt crisis, leaving banks at the periphery with high-level of non-performing assets and endemic lending. Yet European banks face the present crisis from a much stronger situation, reflected in substantially higher capital ratios, liquidity buffers and improved risk management frameworks. Low profitability nevertheless remains a concern and is likely to become even lower, at least in the short term.

// We can look to the past for useful lessons.

While the present crisis resembles no other since World War II, we can look to the past for useful lessons. In particular, few would argue against the idea that concerted and decisive action is essential now and to prevent the occurrence of a significant "second wave". International cooperation is required in the easing of lock-down measures to harmonise travel restrictions, enable supply chains to operate and facilitate trade. A coordinated global response is also key to adequately allocate protective equipment and medical supplies, collect funds for vaccine research and provide access to all once a vaccine is found.

There is a related, but equally important, need for a paradigm shift to one where we appreciate that no one truly wins unless everyone is helped. We have already seen some of this in the way governments have responded to the crisis. What risks we, as a society, choose to share, and how generous the safety net is that we choose to create for this and future generations, are, of course, some of the key questions that lie before us in the coming weeks and months. ●



Markus Ronner

Group Chief Compliance and Governance Officer,
Member of the Group Executive Board, UBS

Decisive action for a strong European banking sector

The COVID-19 pandemic is hitting the European economy and our financial sector at an already challenging time. Economic growth in many European markets has already been relatively subdued even before the pandemic, while sovereign debt levels in many countries are elevated, if not even at record levels, and monetary policy room to manoeuvre is limited due to low rates and quantitative easing. Authorities across the continent have nevertheless pulled off a remarkable set of economic stabilization measures to instill confidence to employees, corporations, financial markets and society at large. The current economic crisis is also an important test for the European banking sector. It's certainly too early to make a final call but there are some meaningful observations that can be made already today.

Strong and effective collaboration among regulators and authorities has been key to mitigate the effects the pandemic has on the economy to the extent possible. This includes temporary reliefs on capital and liquidity requirements to allow banks to serve the real economy. However, banks will need to demonstrate prudent lending practices and avoid adding on low credit quality. This is particularly important as many European banks are still struggling to adapt their business models and operate a sustainably profitable business, due also to structural issues as well as the expansive monetary policy, which has severely impacted a main income stream of the banking industry for a prolonged period of time.

In other words, the European banking industry enters the COVID-19 crisis period having not even fully digested the consequences of the financial crisis. The longer-term implications of the short-term stabilization measures need to be considered carefully. UBS research shows that only around 25% of the 40+ largest European banks would have earned their cost of capital if you were to adjust their 2019 return on tangible equity for the average loan-loss-provisioning rate of the years 2000-2005. And the 2019 ZEB European Banking Study forecast that, already in the baseline scenario which assumed that interest rates, profit margins and loan loss provisions would remain at 2018 levels, Europe's top 50 banks were expected to see their RoE halve over the next five years, mainly due to higher regulatory requirements.

Particular attention is therefore required in the following areas:

- Expansive monetary policy will add further pressure on the banking systems' Net Interest Income (NII) in an environment where Eurozone NII at the beginning of 2020 was already 45% lower than in 2007.

- Loan losses will be smoothed by public stabilization measures and some adjustments to accounting standards. However, banks, especially those banks with sizable non-performing loan portfolios, must avoid loading their balance sheets with low credit quality and associated future losses, which would further weaken their profile. There will need to be a fine balancing act between supporting the real economy and due risk management in such a highly uncertain environment.
- While central bank liquidity support is needed and welcomed, it should not be the main determinant of bank lending in the short-to medium-term. In an environment in which the ECB's term facilities have been funding around 15% of bank lending in some jurisdictions, this will require a significant broadening of funding sources for many European banks, potentially at a higher cost than that which is currently available.

Decisive action both by authorities and the banking industry will help to translate the threats of the crisis into an opportunity of building a stronger banking industry in Europe.

In addition to these COVID-19-related factors which need to be addressed if and when the circumstances allow, a number of strategic measures by banks and policymakers can help enhance the resilience of the European banking sector in light of these threefold pressures.

On the one hand, banks will need to accelerate the adoption of new business models and, with the appropriate framework set by policymakers embrace the consolidation of the industry, focus on fostering critical size and enabling necessary investments in new technologies to support structural changes.

Decisive action both by authorities, including regulators and central banks, and the banking industry will help to translate the threats of the crisis into an opportunity of building a stronger banking industry in Europe which is crucial to foster a positive economic development in the post-COVID-19 period. ●



Susan Revell

Deputy Chair and General Counsel, EMEA, BNY Mellon

Thoughts on Covid-19 – the importance of people

When I think of the impact of the current Covid-19 crisis on the financial services sector, I think of three things, business continuity, lessons learnt (and to be learnt), and people. And of the three, the most important is people.

From the perspective of the financial services sector as a whole, one major conclusion from the past weeks is that the system has continued to work. In very challenging circumstances, financial markets, market infrastructures, and market participants have continued to operate, and have been able to manage unprecedented volatility and volumes.

This is highly reassuring, and even – despite the sad and tragic circumstances – satisfying. It shows that the enormous efforts that the sector has made in the past years to ensure business continuity have paid off. I think that if the virus had struck even three years ago the outcome would have been very different.

I have seen the view expressed that it is as if we are going through an enormous stress test. And as with every stress test, there are lessons that we can draw from the experience.

I think that once the situation – the humanitarian situation, as well as the financial market and economic situation – has stabilised, there will be many lessons that we can draw.

We shall look at the areas where frictions have occurred. We shall look at the actions of public authorities and we shall see what worked, what worked less well, and why. We shall need to think about how we can better prepare, and ensure that information is available to all. We shall have to look again at the conditions of access to the ECB's asset purchase programmes, and we shall see that not everybody has equal access. We shall say that fragmentation of European market infrastructure, and differences in market practice, are a problem that becomes more acute in times of market stress.

And there will also be broader lessons. We shall need to look at the resilience of the system as a whole, and at how to increase operational and technological resilience and inter-connectedness.

But the biggest lesson of all relates to people.

In the past weeks, the biggest source of resilience has been people. This is true in society as a whole, and it is also true with respect to

financial services. Beyond systems and technology and procedures, all of which are, of course, important, the fact that over the past weeks the financial services sector has been able to continue to process payments, to support the financing of the economy, and to manage radical adjustments in prices and portfolios is due primarily to the adaptability, perseverance and dedication of our people.

In the past weeks, the biggest source of resilience has been people.

As the crisis ends, and as we return to an environment that is closer to our past experience, we shall need to focus on our people. I do believe that the crisis will have shown that we need to focus even more than in the past on the agendas of diversity, inclusion and corporate purpose. ●



Alexandre Birry

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Covid-19 will expose many of European banks' strengths and opportunities

Beside its tragic human cost, the coronavirus' economic cost will very rapidly translate into substantially higher credit cost for European banks. And that is despite the substantial support provided by the authorities to households and corporates. But the capital and liquidity buffers built by banks over the past decade should, this time around, help banks be used as a conduit to support the authorities' monetary and economic policies to address the crisis. The flexibility granted by supervisors for banks to dip into these buffers will—as originally planned by the regulations—allow banks to contribute to minimise the depth of the crisis and build the foundations for a strong recovery.

That said, once the economic rebound takes hold, banks will not reap the financial benefits of their actions through the crisis. They will face customers that may be prone to deleverage, a cost of risk that will likely be well above pre-crisis levels, and the prospect of lower-for-even-longer rates. This will likely durably dent earnings that were already often feeble at the onset of the crisis.

The crisis may reveal the progress banks made after the last crisis in rebuilding their standalone strength.

One of the longer-term questions that will need to be addressed post-COVID-19 is the extent to which regulatory requirements will again be tightened, and how rapidly. The earnings recovery for banks is unlikely to be as sharp as the GDP rebound. Time, and clarity as to the regulatory path ahead, will be required for investor confidence to be preserved. The crisis will also reconfirm how useful it is for banks and supervisors to routinely carry out stress scenario analysis based on non-traditional risks. Climate-related stress-tests—put on hold during the pandemic—may be revisited with a new vigour.

Also, performance pressure and evolving customer needs (for instance around sustainable finance and fintech to name just two areas) may strengthen the argument for fewer banks with greater scale in terms of size, geographic reach, product offering and technological capabilities. This may reignite the debate around consolidation once the dust settles – the main question

being whether it will still lead to predominantly domestic consolidation, or whether we will finally see more cross-border transactions within the European Union. The emergence of pan-European wholesale banks could be key to the success of the Capital Market Union. But it is unlikely to occur in the absence of clear support for this from the national and regional authorities.

Finally, another question will be around the image of banks post-COVID-19, and the perception of their role in the economy. The crisis may reveal the progress banks made after the last crisis in rebuilding their standalone strength. Their resilience through this severe and abrupt crisis would be testament to the substantial transformation they've undergone since the global financial crisis. Their willingness to use it to support customers in times of stress will be scrutinised by many. Therefore, after spending the previous decade strengthening their balance sheets, banks' ability to demonstrate this willingness to support the economy through the crisis and to explain it convincingly will be instrumental in also strengthening their image in the public opinion. ●



Ksenia Duxfield-Karyakina

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Financial Services Policy Lead, Google Cloud

Resilient cloud: supporting the financial sector in a time of uncertainty with Covid-19

As COVID-19 continues to impact the globe, the financial sector is adjusting to the new reality, both in terms of migration of their own operations into the remote working-from-home environment, and sustaining to provide essential, now exclusively digital, services to their customers. Cloud technology has proved fundamentally important to support this transition in a number of ways.

Remote working

As organisations now rely on remote workforces to maintain productivity, using cloud tools is becoming a newly accepted norm for the industry.

The uptake of remote collaboration technology has been remarkable: Google Meet has been adding more than 2 million new users daily, and they're spending over 2 billion minutes together per day. We also made our advanced Meet video-conferencing capabilities available at no cost to all our customers until the end of September.

We introduced Meet more than a decade ago as a secure, easy-to-use collaboration and productivity service (now known as G Suite), as we envisioned a new way of working in the cloud. These tools have proved indispensable in the time of a pandemic.

Resilience of cloud infrastructure

The need for agile, scalable, secure, and resilient infrastructure is not new, but has been underpinned by the global pandemic. Hyperscale cloud providers that build infrastructure and systems resilient by design are well placed to support business continuity of the financial sector, the operational stability of which is critical to the European economy.

Google maintains comprehensive business continuity practices, and we have taken steps to ensure our readiness for COVID-19 from both a technical and personnel perspective. These steps are from our standard playbooks, which were written and have been tested for exactly this type of scenario, well ahead of the COVID-19 outbreak.

Network and compute resources are central to cloud services. At Google Cloud, we plan for these resources to accommodate normal demand fluctuations, long-term growth, and potential unanticipated shocks on supply or demand. The growth we've seen so far in response to the pandemic is within the headroom we've provisioned, and we don't face or foresee a capacity shortfall for either of these resources at this time.

Similarly, with personnel readiness, thanks to the collaboration tools we are using on a day-to-day basis, and with the distributed culture that we've built across the company over the past decades, our teams remain connected and able to execute in the work-from-home environment.

Impact on the use of AI and automation

During times of uncertainty, having access to insightful data is more important than ever. Financial institutions are turning to data analytics and AI to help them make smarter decisions, improve their business operations, and help their customers. Here are a few ways they're doing just that:

- Understanding data with analytics and AI tools to make better decisions in the trading portfolios during the market downturn, improve internal risk management, liquidity, and capital analysis;
- Using data and AI to streamline back office operations, such as trade processing and document management;
- Implementing AI-based agents in call centers to alleviate pressure.

There is a similar trend in the use of these tools by financial services regulators.

Thinking post COVID-19

It is expected that economic recovery will be a continuous process, with many lessons to be drawn across the industry and the regulatory community. These are just a few themes that we anticipate emerging:

- Infrastructure modernisation with public cloud in the financial sector will increase as a key enabler in improving sustainability and reducing operating costs.
- Remote work combined with broader reliance on online platforms are here to stay, encouraging innovative work cultures based on agility and flexibility.
- Today's end-to-end automation could lead to data and AI tools being further embedded in daily operations. This is a positive trend, but regulators would need to think through governance implications.
- Valuable, applicable learnings from other sectors will prevail, including the ability to scale on demand - similar to retailers, or tele-finance advice - similar to the advances in tele-medicine. Increased computational research, importance of data insights, and use of ML will be critical in this space as well.
- Financial services regulators have been increasingly looking into their own cloud-first and multi-cloud strategies, and the current crisis might also accelerate this transition.
- As financial services move online, it will be more important than ever to think about populations already underserved by banks and ensure inclusion. Reskilling, further investment in digitisation, and support for SMEs and innovative startups, will continue to dominate this agenda, which cloud can support.

This unprecedented period in our history gives financial institutions and technology firms the opportunity to work together to support our employees, customers and the wider community. ●



Cyril Roux

Chief Financial Officer, Groupama

Will the financial center hold in the current economic sudden stop?

After the Great Financial Crisis of 2008, the Financial Stability Forum turned into the Financial Stability Board, established as a permanent organization with a broadened focus reporting to the G20. In the European Union, the Barnier agenda was meant to address the multifaceted weaknesses of financial markets, infrastructures and intermediaries.

Dozens of directives and regulations were established, in an alphabet soup of acronyms: BRRD, MAD/MAR, SFTR, MiFID, EDIS, MMF, and many more. The ESRB worked with ESAs, Central Banks, national supervisors and the European Commission to measure financial stability risks, to design supervisory tools to address them, such as stress testing and remediation plans, and to develop macroprudential supervision.

In the US, the 2010 Dodd-Frank act introduced new federal agencies (CFPB, OFR, FIO and the FOSC) and a great many new financial regulations. The latter part of the decade saw a concurrent effort to roll back in part this recently increased regulatory burden.

In Europe, this was the avowed focus of Commissioner Hill, while in the US, the impetus was given by the Trump administration and Republican Congress. This didn't prevent the completion of Basel III, however. All the while, low interest rates combined with the capital and liquidity requirements imposed on banks led to an increase of the indebtedness of public and private actors, and that of the size of non-bank financing over the decade. Although much was feared about the concentration of risk in CCPs, the strains and imbalances of the market and regulatory structures manifested themselves in the repo market from September 2019, especially in the US.

Then came the sudden economic and financial freefall which started in March 2020 after a decade of growth. It is a very stern test of the sufficiency, or otherwise, of the microprudential and macroprudential regulations and monetary instruments developed since the GFC. As in the GFC, money-market funds are among the very first to be hit by severe liquidity strains – but for reasons affecting the other side of their balance sheets. In the US, the SEC has moved swiftly to relax the prohibition of sponsor financing to enable money market funds to meet the large redemptions they face. In Europe, the ability to deploy swing

pricing and redemption gates may be used, despite the stigma which may be attached to these measures.

The current crisis will also test the appropriateness of the CNAV and VNAV bifurcation of money market funds. So will the promise of liquidity underlying the growth of ETFs. ETF redemptions may be met with payment in kind, especially in credit, to the surprise of some subscribers. As in 2008, the CP market has seized, which is only natural when a wave of delinquencies is expected. The rise of counterparty risk in most of the economy, and accompanying credit downgrades, will stress fixed income funds, trigger loan covenants and increase margin calls. Banks would naturally be under critical stress were it not for the unlimited support of Central Banks, together with regulatory relaxation embedded in CRD IV – a relaxation that the European Union singularly failed to provide for under Solvency 2.

The economic freefall is a very stern test of financial regulations.

More generally, the sudden stop of large swathes of the economy is likely to strain most markets and market participants, including corporates and governments. The least and last affected among financials are likely to be mainstream insurers. Provided they haven't invested unduly in riskier assets, nor taken aberrant underwriting risks (such as guaranteed investment returns or failed to exclude pandemic in their casualty coverage), mainstream insurers should weather the economic and financial storm, as long as governments do not default, notwithstanding broken measures of their solvency ratios based on point-in-time volatilities that say precious little about their financial standing. Should that be the case, as it was during the GFC, this would prove once again the futility of EIOPA and IAIS insistence to try to develop for and impose on the insurance sector an additional layer of systemic regulatory burden. ●



Bjørn Sibbern

President, European Markets, Nasdaq

Cooperation Prevails – Through and Beyond Covid-19

While no one with certainty can say when the human and financial impacts caused by the Covid-19 outbreak will start to subdue, it is my sincere belief, and also hope, that we will begin looking toward and discussing our future rather than contemplating our present questions. The financial community across Europe and the world plays an important role in not just mitigating the effects of the current economic downturn – but also when helping the global economy to get back on its feet. And it will get there faster if we work together.

Right now, in the midst of the Covid-19 outbreak, the focus of the financial industry, governments and others are on making sure we are taking immediate necessary actions. For Nasdaq, this means to ensure the health and safety of our employees and also that the markets that we operate stay functional in order to enable investors to get in and out of positions and to provide companies with a possibility to continue raising capital.

Exchanges will also play a key role in the efforts to recover from the effects of Covid-19, as market places but also as hubs for cooperation through our roles as integrated parts of the wider financial and societal ecosystem.

Exchanges are able to facilitate recapitalizing companies through financial markets. More than ever, market financing should be envisaged as a possible tool to solving financing issues. In the Nordics, where Nasdaq operates most of its European markets, many listed small- and medium sized enterprises (SMEs) have been funded through financial markets and have from this way of financing obtained benefits allowing them to grow. And growth is more important than ever before.

Post-Covid-19, we hope that the visibility we support public companies with will allow them to recruit back talent, refinance themselves and in the longer term continue to grow and create more jobs. It is important that the opportunities that exchanges create are fully leveraged to help remedy the adverse consequences of the Covid-19 crisis.

Exchanges can also support recovery by providing financing for initiatives more directly linked to healing the effects of the virus outbreak, for example Covid-19 recovery bonds aimed at recovering the immediate impact of the pandemic on economies

and societies. Even in the current crisis, companies involved in Covid-19 research or hospital supplies may need extra capital.

We expect to also continue working together with governments and regulators to discuss actions to help economies recover. States are crucial to provide support for companies and employees affected by the Covid-19 outbreak, and we would also welcome a discussion on changes to the regulatory landscape that supervises the financial markets to remove barriers for recovery and capital raising for primarily SMEs. The unbundling of research and trading that was part of MiFID II and that has led to decreased visibility for smaller companies is one example of such hurdles.

This unprecedented moment in our history could also see already ongoing trends and shifts in our society accelerate. One such trend is sustainability. Today often discussed in terms of the environment, the social and governmental aspects of sustainability may have an enormous impact on companies' ability to recover and better support the societies in which they operate.

At Nasdaq, we try to do our part by enabling and encouraging companies and investors to make more sustainable choices by, for example, supporting sustainability reporting and data distribution, and also introduce initiatives to increase transparency and comparability between different investment products.

As we one day look back on this time in our history, I hope that we at least are able to say that we did our very best to come out of it as well as possible, and that we did it by working together toward a better and more sustainable future. ●



Marc Bayle de Jessé

Chief Executive Officer, CLS Group

Covid-19 and the importance of resilient financial market infrastructures

The current financial market volatility arising from the spread of COVID-19 has reinforced the need for adequate planning and rapid response by governments and central banks. Stress testing by global systemically important banks is the best example of such planning, requiring adequate capital to withstand sudden shocks while continuing to intermediate credit to households and businesses.

An overlooked lesson of this crisis is the system's reliance on strong, well regulated, and resilient financial market infrastructures (FMIs). Banks, fund managers, corporations and other users rely on FMIs for a variety of critical – if unglamorous – functions that are absolutely necessary to the functioning of financial markets: payments, custody, clearing, and settlement. Such services reduce risks for users (e.g., credit, liquidity) and offer operational efficiency. Simply put, financial markets could not operate smoothly without the key services provided by FMIs.

CLS settles foreign exchange transactions for the largest banks in the world on a payment-versus-payment basis. It thereby reduces settlement risk associated with FX transactions by ensuring that the final settlement of a payment instruction in one currency occurs if, and only if, settlement of the payment instruction for the other currency being exchanged is also final. The funding required to settle is determined on a multilaterally netted basis, reducing the amount of liquidity required for settlement by approximately 96 percent.

During the recent period of extreme volatility in March, CLS volumes increased sharply. The average value of payments settled daily totalled approximately USD7 trillion - about 20 percent higher than normal. CLS processed the added volumes with no issues or delays. As seen in the 2008 crisis, banks turned to CLS knowing their FX trades would settle on time and with finality.

The current crisis is not just a financial test, but also an operational, staffing, and resilience planning one. In the case of CLS, we took early steps to segregate key operational employees, direct other employees to work from home and use technology to maintain the high quality of service our users expect – while communicating regularly with employees, clients, vendors, and regulators.

This crisis is still ongoing, and deriving final conclusions is premature. But some tentative implications can already be drawn. Here are three:

1. Importance of resilience, redundancy and planning

FMIs must not only be operationally efficient, they must be resilient with multiple backups to diversify against a range of scenarios that might affect premises or staff. For example, CLS is diversified across multiple continents, but also has redundant capability. Diversification must be well planned with adequate testing and staff drills to help ensure the service can be delivered without any degradation of service users expect.

An overlooked lesson of this crisis is the system's reliance on strong, well regulated, and resilient FMIs.

2. Introduction of new technologies

In recent years innovations such as blockchain, distributed ledger technology (DLT) and tokenization, among many others, raised the possibility of re-engineering the payments, clearing, custody and settlement space. As service providers and regulators review such technologies, they will want to assure that excitement about potential efficiency gains do not obscure or in any way degrade current levels of resilience and diversification. Indeed the recent environment will reinforce the need for new technologies to demonstrate at least the current level of resilience – and ideally enhance it – before FMI boards and regulators permit the introduction of such technologies for systemically critical services.

3. Expecting the unexpected

Banks typically plan for financial events or physical outages, but the current crisis is directed at human capital. The next crisis might be very different still. Hence, key financial market players, whether banks, asset managers or FMIs are likely to be pushed to plan for an expanded list of scenarios including some that may appear very, very remote. But then, a scenario that has shut down most of the global economy also seemed remote not very long ago. ●

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Monetary policy impacts



Ante Žigman

President of the Board,
Croatian Financial Services Supervisory Agency

It is time to expand macroprudential framework in the non-banking sector

In the view of many investors, the low and even negative interest rate environment (LIRE) has slowly become the most prominent risk that threatens the stability of the financial system in the EU. It has, perhaps, even become the new normal as depressed interest rates marked the entire decade. Although these developments are somewhat lagging in Croatia, as interest rates are relatively higher compared to other EU countries due to national idiosyncratic reasons, they are highly relevant because both banking and non-banking financial sectors are heavily exposed to domestic government bonds, whose long-term yields are rapidly converging towards zero. Insurance companies and pension funds are especially vulnerable to LIRE risks due to their business profiles, which are characterized by negative duration gaps, particularly those that issue products with guaranteed rates and defined benefit pension plans.

While direct risks that negatively affect stability of the financial system are notable, what is more important is the indirect effect that LIRE has on the system through its negative effect on economic activity, which continues to be subdued more than ten years after the global financial crisis. There is a growing consensus that current environment characterized by low interest rates and anemic growth is more determined by structural factors (declining productivity of companies and falling profitability that hinders new investments and contributes to the accumulation of the excess savings, increasing social inequalities, negative demographic trends and risk aversion) than cyclical factors (relaxed monetary policy, over-indebtedness of private and public sectors).

Therefore, the discussion regarding the LIRE should be broadened to emphasize its effect on real economic activity, which eventually impedes the profitability of financial institutions. In order to successfully restart the economic and financial progress in the EU, organized collective effort of all policyholders is needed, such that would focus on long-term and broad-based goals. More specifically, long-term view should take into account sustainability and

environmental impact of long-term investments, while broad-based view should be socially sensitive and inclusive. Some steps in the right direction have been made to reach these goals, but majority of the road still lies ahead.

Since we are finding ourselves in uncharted waters, growing emphasis is, and will continue to be, placed on unconventional policy, more specifically on macroprudential policy actions. Therefore, policymakers should utilize the present relatively stable environment to further improve macroprudential regulation focusing on cross-border and cross-industrial harmonization of macroprudential rulebook. Even though macroprudential regulation in banking sector has made significant leaps following the global financial crisis, progress in non-banking sector is still lagging, which creates possibilities for regulatory arbitrage. The significance of closing this regulatory gap is even more highlighted by the rising importance of the EU non-banking sector as (investment and pension) funds and insurance companies are steadily increasing in size, are becoming highly connected (directly and, more importantly, indirectly) with the rest of the financial sector and are strengthening their relevance as a source of funding for the real economy.

// We are swimming in uncharted waters and growing emphasis is being placed on macroprudential policy.

In other words, policymakers should work proactively to improve their macroprudential toolboxes, following the banking example but also taking into account industries' specificities and the current macroeconomic and financial environment (LIRE), while simultaneously improving the resilience of financial system in order to support sustainable long-term investments. ●



Jean-Jacques Bonnaud

EUROFI

For a new Bretton Woods

The coronavirus pandemic beyond its health aspects, will profoundly disrupt the economies of the planet for a long time to come.

The brutal and widespread recession in the global economy this year will trigger a worldwide wave of public spending to limit the social effects of the recession such as unemployment or the disappearance of cash flow in many companies. It will however increase public and private indebtedness, which risks accelerating imbalances in indebted economies and slowing down structural reforms that have not yet been carried out, while new sources of imbalances are emerging with the violent fall in oil prices, the probable fall in the price of certain raw materials, the financing needs of an inevitable energy transition and the negative effects of geopolitical conflicts such as the Sino-American strategic conflict.

The European Central Bank and Member States have already implemented significant and timely monetary and budgetary measures to deal with this global crisis and to ensure there is ample liquidity across the EU. But Europe must fight the tendencies towards fragmentation accentuated by the national egoism visible in the health crisis. At the moment the EU is facing one of its biggest economic challenges, it needs to make a collective effort in favour of a “shared sovereignty” on the political, economic, industrial and health levels if it wishes to exist in the face of pressure from a China that is filling the void left by the American weakening that has been perceptible since long before the Trump mandate.

More generally, it is the entire system of international economic relations that needs to be the subject of in-depth review because the problems and solutions are cross-borders. Even if this perspective may seem optimistic or even utopian, this crisis is an exceptional opportunity to make progress towards the implementation of stabilization mechanisms that take into account the major challenges common to the entire planet. Fortunately, elements of such a consultation have already been initiated, particularly in the climate field.

But if we want true global collaboration, we must also reorganize the international monetary system. Indeed, the “non-system”; in which we live has a great disadvantage: The absolute freedom that reigns in the exchange rate area raises suspicion. The easing

of monetary policies by some countries is often seen as a disguised way of depreciating their exchange rates. In fact, since the end of the war, we have never been so close to the situation in the thirties (“beggar thy neighbour”).

It is time for the major dominant economies to understand that a minimum of stability is in the common interest.

Consideration must be given to the future pivot of the future system in order to stabilise exchange rates: should we envisage a return to gold, or to a revisable basket of raw materials - which would undoubtedly be better adapted to today's multipolar world, or to Special Drawing Rights additional to the rights stemming from a Monetary Fund with revised quotas? It is also necessary to work on the means of organising and monitoring, around the IMF, effective surveillance of the new system.

This work could be entrusted to a small ‘Group of wise men’ including experts and representatives of the major international financial institutions: BIS, IMF, Central Bank of China, Central Bank of Russia, etc. , in order to take stock in a forward-looking manner of the possible options and possible timetables.

It is time for the major dominant economies to understand that a minimum of stability is in the common interest. ●



Natacha Valla

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Helicopter money: Panacea, shell game or Faustian pact?

Since the GFC, proposals for economic stimulus through the recourse to helicopter money have multiplied. Recently, the measure has been associated with the issuance of a central bank digital currency or the fight against the Covid-19 epidemic. It is thus seen as a panacea. This piece is meant to be factual. It describes the concept and the advantages it is supposed to bring, to show that it is more akin to a shell game, if not a Faustian pact.

The concept of helicopter money

The concept of helicopter money is old. It already appeared in Friedman's essay *The Optimum Quantity of Money* (1969). Friedman describes it as a "thought experiment" in which a helicopter flies over a society that has reached a state of economic equilibrium and drops bills that are hastily collected by members of the community. He shows that the measure has no long-term effect on the level of output, only on the level of prices. In the short to medium term, output can rise or fall, due to opposite effects on demand (part of the helicopter money is spent) and supply (labour supply is reduced).

Only much later did Bernanke (2003) suggest that Japan could combat deflation by pursuing a policy of public deficits financed by permanent purchases of public securities by the central bank. Bernanke (2003) stresses that the central bank's balance sheet is protected, since it holds a claim on the Treasury. However, this protection precisely prevents the measure he suggests from being regarded as helicopter money *stricto sensu*. Indeed, helicopter money is a gift on the part of the central bank: bills are dropped from the helicopter without the central bank acquiring a counterpart and thus correspond to a loss on its books. The gift approach has been rationalized by many, eg Caballero (2010), within a monetary and fiscal policies coordination framework.

Helicopter money and public finances

On public finance side, public debt does not increase. In accounting terms, that is true but, since the aim is to have a public deficit financed by the creation of central bank money, it is the total made up of the general government and the central bank balance sheets that must be taken into account. Indeed, the increase in the Treasury's account at the central bank in the first instance, and the increase in banks' accounts at the central banks in the second instance, following expenditure by the Treasury, increases the liabilities of the central bank by the amount of the creation of helicopter money (Cecchetti and Schoenholz, 2016). The consolidated debt of the central government and the central bank thus increases.

Furthermore, the money created has no cost for public finance. Again, that is accountingly true, at least in the very short term. However, the seigniorage of the central bank, and thus the profits it can pay to the State, are permanently reduced. Indeed, the increase in reserves held by the banks entail a fall in banks' refinancing and/or an increase in banks' excess reserves, which are remunerated. To do otherwise, the interest rate on the excess reserves (the deposit facility rate in the case of the Eurosystem) would for example have to be set permanently at zero, which would be tantamount to abandoning any monetary policy (Borio et al. 2018).

It therefore seems that presenting helicopter money as having no impact on public debt and deficit boils down to a shell game. It is the "free lunch" where Borio et al. (2016) see an illusion.

Helicopter money and the central bank

On the central bank side, helicopter money would first circumvent banking intermediation. This seems self-evident but it would clearly be a "second best" compared to relying on the banking system. Indeed, banks have a better knowledge of their customers' finances than public authorities have of their taxpayers'.

Second, helicopter money would have a substantial impact on demand. In fact, much would depend on how the measure is perceived by the public. In particular, if it were seen to reflect a diminished ability of public issuers to access capital markets, the public might become concerned and increase their savings. In this regard, Bernanke (2016) proposes that the central bank itself should decide, on a legislative basis, on the appropriateness and the amount of helicopter money. However, even under the difficult conditions associated with the Covid-19 epidemic, no government has considered establishing such a legislative framework, perhaps precisely for fear of damaging its reputation.

Third, seen from an ex ante perspective, it should be easy to withdraw once the economic recovery objective is achieved. But its withdrawal should then produce the opposite effect to its implementation. If the measure were to become permanent to avoid this circularity, monetary policy and the central bank's balance sheet would be permanently affected. A Faustian pact would thus have been signed. ●

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The views expressed in this article represent those of the authors and not of their institutions.



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That's one small virus for man, one giant leap for economic policy

The global economy has entered the most severe recession since the 1930s. But this is a new kind of crisis by its very nature. Comparisons with the Great Financial Crisis of 2008 or the Great Depression of the 1930s are misleading because at its source, this is neither a financial crisis (there was no bubble burst) nor a debt crisis (even though the world has entered this recession with historically high levels of private and public debts). The collapse in economic activity has not been triggered by the direct impact of the epidemic but by the global lockdowns, which have brought entire sectors of the world economy to a standstill. Half of humanity are confined to their homes, which is unprecedented in modern history.

Two essential things must be kept in mind. First, an epidemic is by its nature temporary. Second, given the characteristics of Covid-19 (low mortality rate in the labour force), potential GDP growth should not be affected in the medium run.

It was therefore necessary first to prevent the economic crisis from becoming a true financial crisis. Governments and central banks were equal to the emergency. Economic policies implemented on both sides of the Atlantic are unprecedented on both the fiscal and monetary policy fronts, with stabilisation plans equivalent to 10% to 20% of GDP (including loans and guaranties) and an expansion of central banks' balance sheets unseen throughout history.

Stabilisation programmes are being carried out in different ways on each side of the Atlantic, but the spirit is the same: the aim is to maintain macro-financial stability, compensate temporary unemployment, and avoid a full blown credit crunch with cascading corporate bankruptcies and defaults. The common goal is to protect the economy as much as possible during the recession in order to allow recovery once the epidemic is under control.

At the end of the day we are witnessing a *de facto* merger of central bank and Treasury balance sheets. Public debt will *de facto* be monetised. Debt securities will be purchased by central banks in order to keep bond yields at a very low level. The entire yield curve is now under control. Sovereign debt issuance (net of redemptions and central banks' purchases) will be negative in the major advanced economies in 2020. In the United States, it is the first time this has ever happened. Given the scale of the ongoing recession, public debts will rise very sharply, and bond yields would have soared without central banks' asset purchases. Subsequently,

central banks' balance sheets will soar in tandem with public debts. Governments have become the buyers of last resort, while central banks are playing their role as lenders of last resort. Fiscal and monetary policies have become intertwined, and this is not reversible.

A crisis of this nature thus calls for a paradigm shift in terms of economic policy. Historically, economic and financial crises have always given the authorities an opportunity to equip themselves with the appropriate instruments to contain them. Indeed, it was following the crisis of the 1930s that the Fed adopted the statutes that enabled it to deal with the GFC in 2008. And it is thanks to the 2012 sovereign debt crisis that the ECB is today able to support (among other things) the guarantees provided by the governments. Most of the tools mobilised (or that could be mobilised today) in the Eurozone were put in place after 2012 to save the euro.

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How long will central banks be able to monetise debts without causing a general loss of confidence? How long can interest rates be kept so low? Can inflation resurface? All these questions will likely remain unanswered for a while. The only certainty is that fiscal dominance has now become a reality among the major advanced economies. And whether we regret it or not, this process is not reversible.

For those who fear that a global debt crisis is looming, it should be remembered that debts owed to the central bank are unique in that they can be spread over time indefinitely, or even partially cancelled painlessly.

Ultimately, the policies that are put in place will inevitably shape the debate once the crisis is over. In Europe, leaders will at some point be forced to recognise that a single federal budget and a single financing instrument for the Eurozone would probably have been more efficient to manage this crisis. The birth of a European budget and a common debt will perhaps be the institutional traces that this crisis will leave in history: a forced march towards the "United states of Europe". ●