TRANSCRIPTION OF THE VIDEO

Consequences of policies to respond to Covid -19

Boris Vujčić - Governor, Croatian National Bank

17 April 2020 - Zagreb, Croatia

Dear regulators and colleagues from the financial industry,

As we all already got used in this unprecedented situation, let me say a few words in virtual format, instead at the conference that we were supposed to have here in Zagreb.

Turmoil in the financial markets that followed COVID19 spread and stringent lockdown measures prompted policymakers to react without the delay.

World's central banks proceeded in the unprecedented way in terms of scale and speed of action.

Ministries of finance raced ahead with tax reliefs, employment subsidies and loan guarantees.

It all happened in such a way that the big bazookas of the global financial crisis no longer seem so big.

What is the aim? I would say that adopted measures seek to ensure a mere survival of the commercial fabric of our societies throughout the health crisis.

What we do - policy boost - cannot reopen stores that are closed due to the lockdown, or production plants lacking intermediate goods. Nor it can encourage people to get out of their homes and spend beyond necessities.

Policymakers have set their targets at preserving as many jobs and commercial entities as possible in order to enable a swift recovery once the pandemic is resolved.

In the face of the peril, few thoughts could have been given to the potential alternatives or the long term consequences of the adopted radical policies.

However, we are still at an early phase of the crisis and formulating future policies might soon prove to be an act of balancing on a knife-edge.

One potential risk of exceptional stimulus that we are witnnesing is the perennial worry of an outburst of inflation.

Very few analysts at the moment take this risk seriously, but, exactly for that reason, it may be the most underpriced risk of all.

On the other side, more observers are worried about the excessive policy expansion backfiring without providing much of a boost.

The costs of further monetary accommodation could start to outweigh the benefits. Discussion that we had before this crisis.

In many instances high leverage has weakened the ability of both the public and the private sector to cope with the shock.

Getting macro policies right may be the easier part of the policy-making.

More difficult will be to rightly calibrate the relaxation of containment measures as we move forward. That will be the key, but something that no one has experience with. So, we'll have to learn along the road.

Once we get through the crisis, risks are many - policymakers might have to grapple with the reversal in globalization, the increased state presence in the economy or the "zombification" of the part of the corporate sector.

"The great lockdown" might push globalization into reverse, with all the windfalls slowly leaking away.

The rise of the government presence in the corporate sector, either as a big lender, debt guarantor or outright owner, could make corporate governance more complicated.

One thing is for sure – debt levels will further increase, in many instances from already high levels, increasing the sustainability challenge.

All these challenges are intertwined, might be feeding on each other and producing negative feedback loops.

Taken together, they may prove to be of a different order of magnitude compared to necessary structural reforms of the yesterday.

Taking a broader, international perspective, we see many emerging markets with little scope to stimulate their economies.

Huge capital outflows are putting pressure on their exchange rates and financing conditions.

The health crisis could easily morph into the global financial crisis as more and more emerging economies are seeking shelter under the IMF umbrella.

We need to enhance the global governance, mobilize more financial resources and streamline procedures for debt restructuring.

If we fail to do so, problems experienced by the emerging markets could be the "canary in the mine".

"The great lockdown" will test policy frameworks in different areas as policies move further into the uncharted territory. One is banking system regulatory framework.

During the period of elevated uncertainty, banks will still need to find ways to support the economy.

To facilitate this support, financial policies have also started to deviate somewhat from the practices of the prompt recognition of all risks and the quick resolution of underlying exposures.

Forbearance could thus make a come-back, but we need to weigh it carefully and restrict such practices as soon as uncertainty subsides.

The «great lockdown», possibly coupled with lack of policy space, will eventually have to be reflected in the balance sheets of the financial sector and will have to be resolved by it.

With that I would like to conclude and wish us all some luck together with wisdom as we move through this unprecedented crisis.

Thank you