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### Financial stability implications of Covid-19 support measures

During the first phase of the pandemic a liquidity crisis was avoided, and the financial system continued to function. Up to one-third of new bank lending to companies has been subject to crisis-related fiscal measures, and the prompt action taken by governments has been essential to mitigate the impact of the crisis on households and firms. The financial system has benefited from fiscal support programmes as well as from monetary policy. Moreover, a flexible approach within the existing regulatory frameworks has supported these measures, also by temporarily relaxing some bank balance sheets constraints. Overall, spillovers from the real economy to the financial system have so far been contained.

Differences in fiscal measures reflect, to a large extent, different exposures to the pandemic. Countries hit harder by the pandemic tend to have larger programmes with greater uptake, while countries with a higher share of employment in vulnerable sectors rely more on direct grants. The uptake of moratoria is positively correlated with the pre-crisis debt levels of non-financial corporations and households. Macroprudential authorities reported fiscal support packages related to the COVID-19 pandemic of around 14% of member countries' combined GDP (more than €2,400 billion) to the European Systemic Risk Board (ESRB). The packages include public guarantees on loans, public loans, direct grants and tax measures. By September 2020, the reported uptake of these programmes was roughly 4% of member countries' combined GDP. In addition, around 5% of banks' total loans were subject to moratoria.

The longer the crisis lasts and the weaker the economic recovery, the greater the risk that liquidity problems turn into solvency issues and losses in the non-financial sector spill over into the financial sector. During this phase of the pandemic, authorities should focus on (i) targeting fiscal measures to the most affected sectors, (ii) monitoring private debt sustainability, given that some of the measures increase the indebtedness of borrowers, (iii) preparing for a scenario of increased distress in the corporate sector by promptly addressing potential administrative constraints with regard to dealing with non-performing loans and restructuring and insolvency processes, (iv) enhancing financial institutions' balance sheet transparency and upgrading reporting, and (v) coordinating policies across policy areas and countries.

Authorities need to carefully manage the trade-offs related to the duration of the

support measures. The scale of potential future solvency problems depends on the evolution of the pandemic, the performance of the different sectors and the appropriateness of policy responses. Withdrawing fiscal support too soon could exacerbate the effects of the economic crisis and put financial stability at risk. Maintaining fiscal support for too long would increase budgetary pressures and could delay structural change and subsequent recovery. Managing this trade-off effectively requires access to timely and reliable information on the state of the economy and the effects of policy measures.

To provide authorities with accurate information, the European Systemic Risk Board is continuously monitoring COVID-19 related fiscal measures and their financial stability implications. [1] It has a broad mandate, which includes the monitoring and prevention of all risks affecting all types of financial intermediaries, markets and infrastructure. It is in this context that the ESRB considers the overall implications – and in particular the cross-border and cross-sectoral implications – of the COVID-19 crisis. The ESRB is monitoring the measures that are implemented directly through the financial system, such as moratoria, public guarantees on loans and credit insurance, as well as measures of a fiscal nature that could have an impact on the creditworthiness of borrowers, issuers and investors. These include loans by public entities, direct grants, tax measures and public equity participation.

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[1] See Financial stability implications of support measures to protect the real economy from the COVID-19 pandemic, ESRB, February 2021; and Recommendation of the ESRB on monitoring the financial stability implications of measures of a fiscal nature taken to protect the real economy in response to the COVID-19 pandemic (ESRB/2020/8).