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The central bank playbook after Covid-19

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Head of the BIS Innovation Hub

NBER Summer Institute joint ME, MEFM and IFM policy panel,
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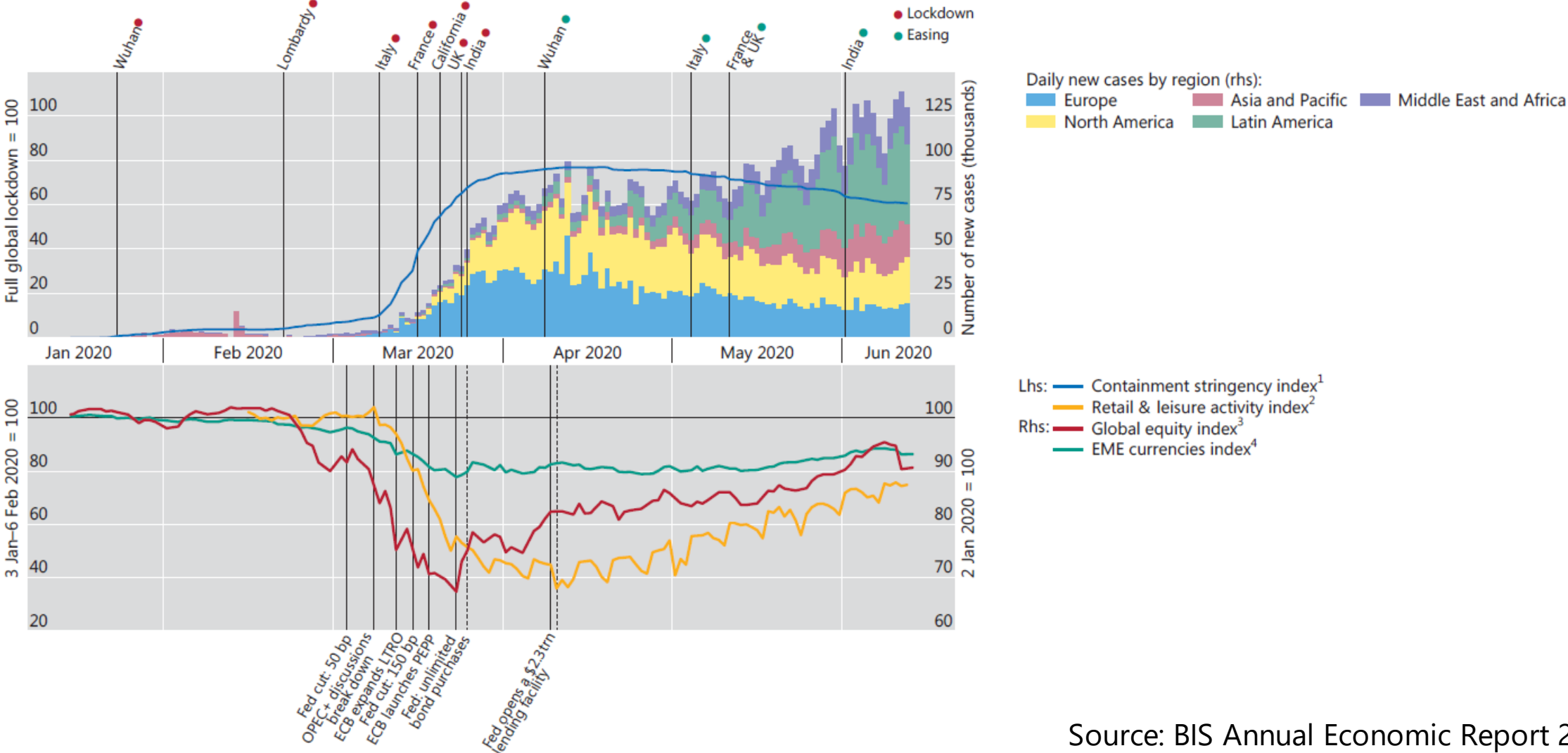


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Central bank responses

Covid-19 pandemic: the timeline

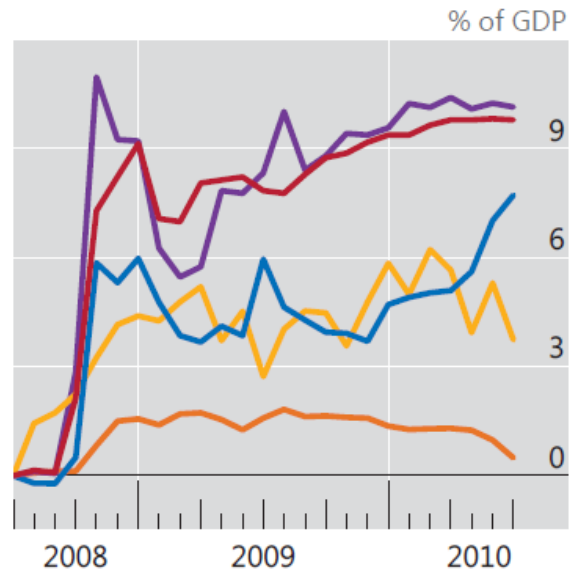


Source: BIS Annual Economic Report 2020

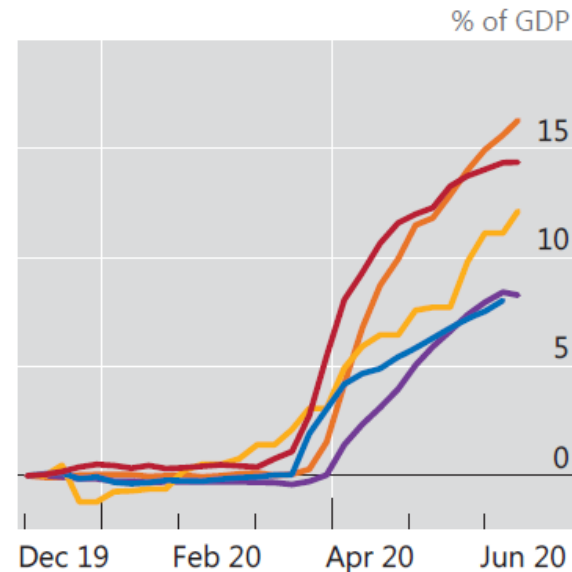
Central banks have responded swiftly and forcefully to Covid-19

Central bank response in AEs: GFC and Covid-19

Balance sheet growth: GFC²



Balance sheet growth: Covid-19²

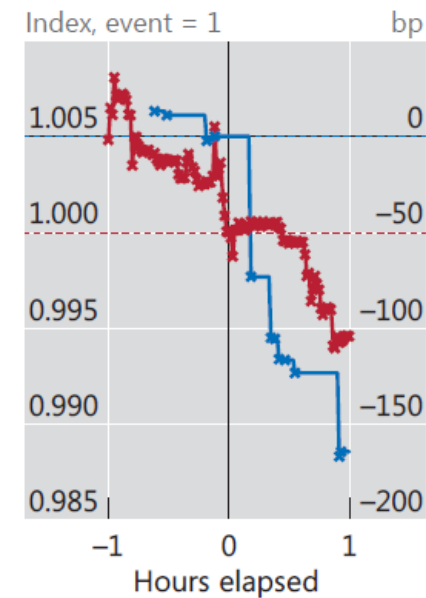


— Fed — ECB — BoJ — BoE — BoC

Central bank response in EMEs

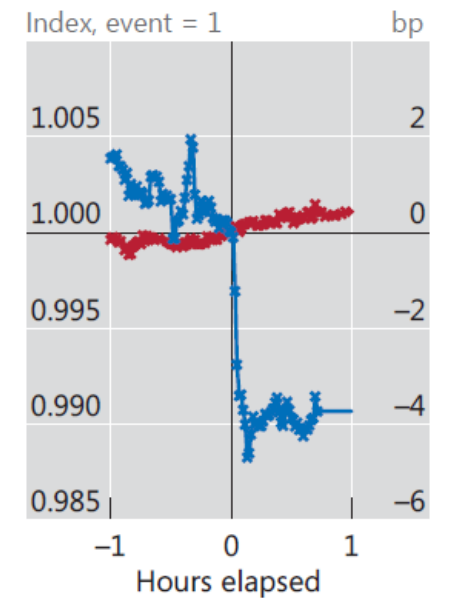
Responses to announcements of bond purchases

South Africa^{1, 2}



— FX rate (lhs) — 10-year gov't yield (rhs)

India^{1, 3}



Source: BIS Annual Economic Report 2020



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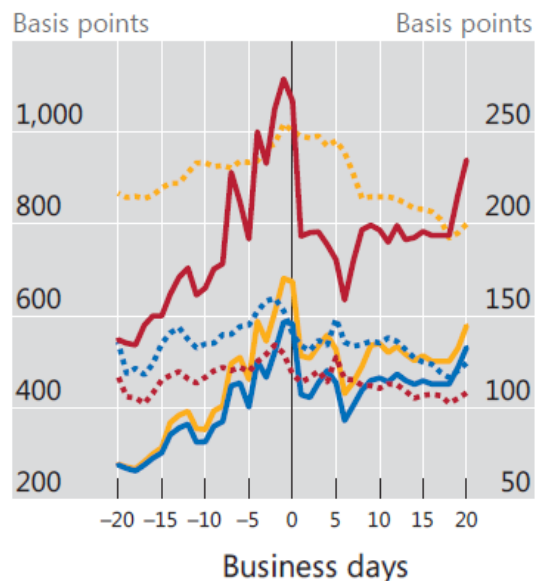
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The new central bank playbook

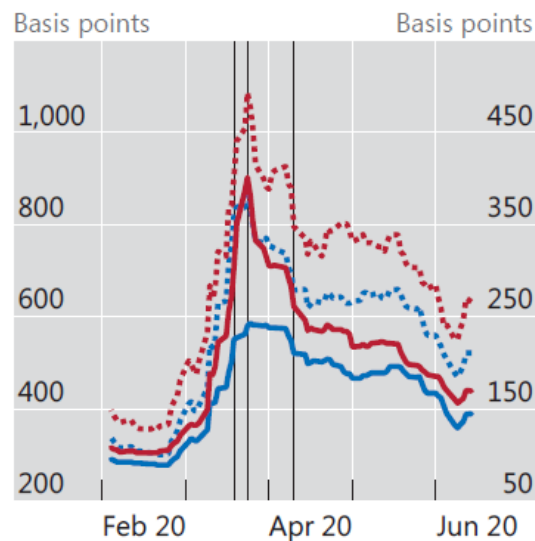
The new playbook (I): market making of last resort

Asset purchases alleviate market strains

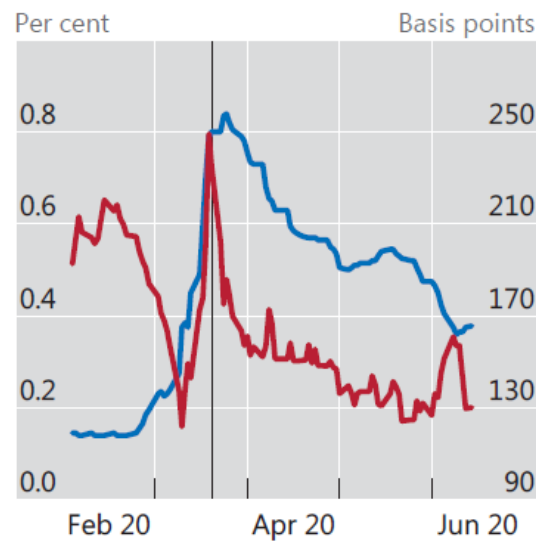
Euro area sovereign spreads¹



Corporate bond spreads²



UK bond market



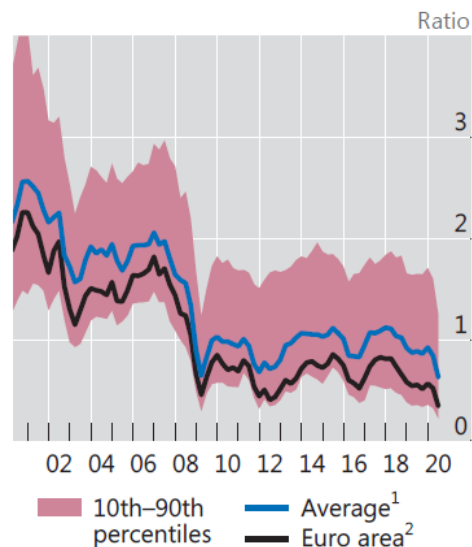
- Flexible government bond purchases
- Commercial paper and corporate bond purchases
- Backstop facilities to money market funds

Source: BIS Annual Economic Report 2020

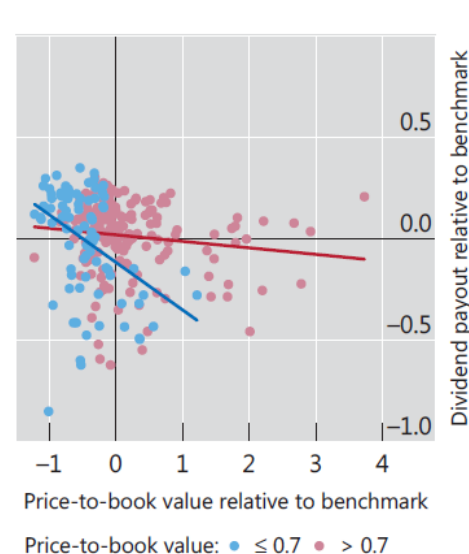
The new playbook (II): pumping money down the last mile

Low profitability and price-to-book ratios hinder banks' willingness to lend

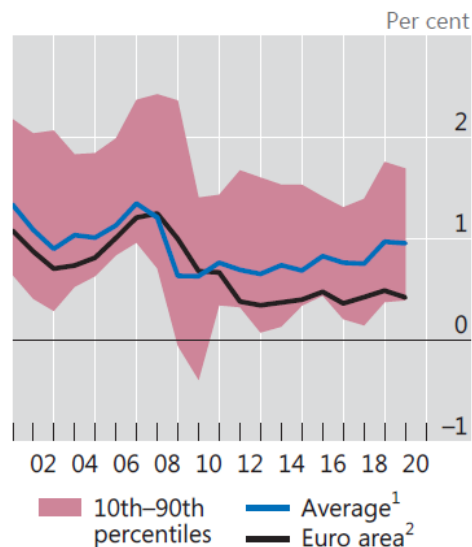
Bank price-to-book-ratios have declined



Low market value creates incentive to pay out equity³



Bank return-on-assets lower after Great Financial Crisis

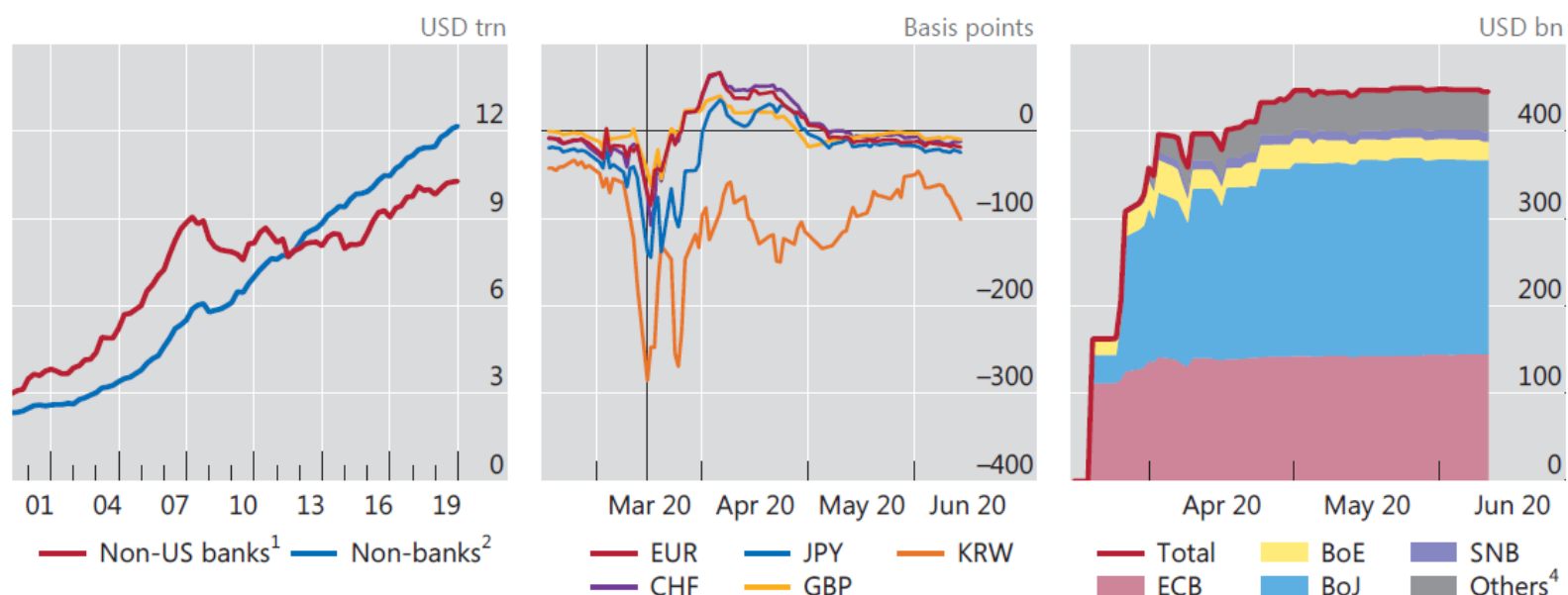


- Commercial paper and corporate bond purchases
- Targeted lending operations
- Expanded collateral (e.g. SME loans)
- Regulatory and supervisory measures to avoid bank deleveraging and support the crisis response
- Role for digital innovation to bring money closer to firms and households

Source: BIS Annual Economic Report 2020

The new playbook (III): extending the reach globally

Global US dollar funding squeeze



The vertical line in the centre panel indicates 15 March 2020 (the announcement of the enhancement of swap lines between the Federal Reserve and five central banks).

- Standing swap network (BoC, BoE, BoJ, ECB, Fed and SNB)
- New Fed and ECB swap and repo lines with regional and EME central banks

Source: BIS Annual Economic Report 2020



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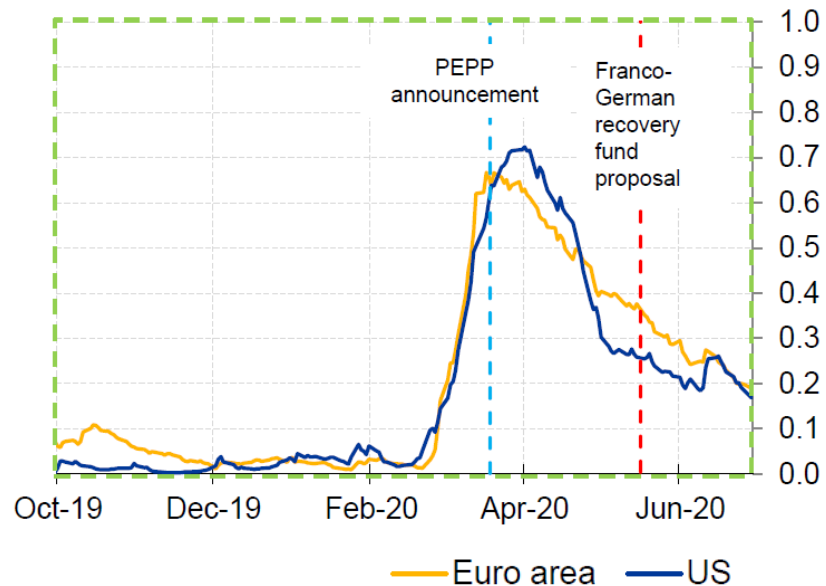
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Focus on Europe

The ECB's new playbook

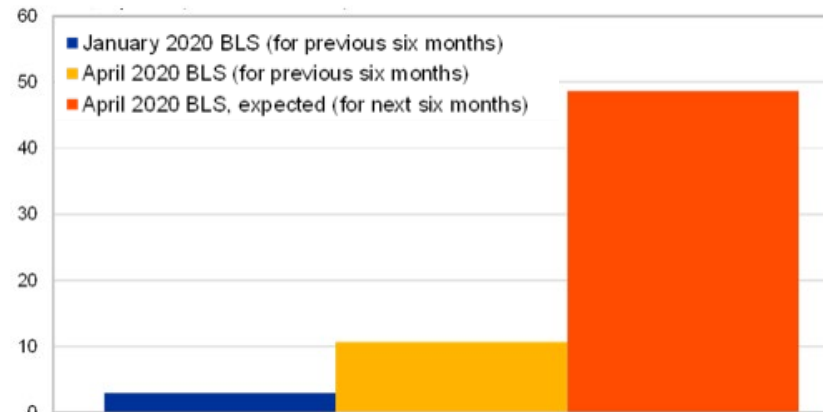
Market making of last resort

CISS Indicator of systemic stress on financial markets



Pumping money down the last mile

Impact of TLTRO III on bank lending volumes to enterprises



Source: ECB bank lending survey (BLS).

Notes: Net percentages are defined as the difference between the sum of the percentages for "contributed considerably to an increase" and "contributed somewhat to an increase" and the sum of the percentages for "contributed somewhat to a decrease" and "contributed considerably to a decrease".

Extending the reach globally

- New EUR swap lines with Denmark, Bulgaria, Croatia
- New EUR repo line with Romania
- EUREP repo facility available from June 2021

Sources: Ph. Lane, "The ECB's monetary policy response to the pandemic", speech, 24 June 2020, and I. Schnabel "The ECB's monetary policy during the coronavirus crisis", speech, 2 July 2020

Open questions

● **Fiscal dominance?**

- Government debt is not a short term issue with $r < g$, but corporate debt is high and rising, and institutional hurdles are high to deliver higher g
- Strong national fiscal responses and the new EU recovery fund are big steps forward, but the political consensus is wobbly and EU fiscal rules are in shambles

● **Financial dominance?**

- Regulatory and supervisory flexibility has helped banks act as shock absorbers, but bank profitability is structurally low and the blessing may become a curse
- Market based finance has risen since the GFC; fragmented capital market supervision creates a risk that the ECB has to pick up the tab

● **International role of the euro?**

- The ECB has been more timid than the Fed as international LLR, but does it matter? The EUR will not become a dominant currency without a single safe asset



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Thank you