The fiscal response to the COVID-19 shock has stabilised lending but risks still lie ahead

Unprecedented and swift support packages

By September 2020 more than 14% of GDP in announced measures and more than 5% of outstanding loans involving uptake of moratoria

Crucial relief to HHs and NFCs

Public guarantees, direct grants and moratoria have helped to prevent losses and have provided liquidity to households and NFCs

Loan losses have remained limited

Increases in non-performing loans and forborne loans have been smaller than expected

Credit markets are strongly supported by fiscal policy

Since March 2020, one-third of new commitments provided by banks to NFCs benefitted from public support

Risk of spillovers to financial sector balance sheets

Eventually corporate insolvencies will increase and banks will face higher losses, which should be timely provisioned

Potential adverse feedback loops

Banks should use available capital buffers rather than deleveraging in order to target capital requirements, thus ensuring that the flow of credit to the economy is not negatively impacted

Cross-border banking activities might be particularly affected

Loans by foreign entities in the euro area amount on average to 40% of total lending to domestic households and NFCs

Trade-off in the length of the support to the economy

Trade-off in the length of time support to the economy is in place

Source: ESRB Report on Financial stability implications of support measures to protect the real economy from the COVID-19 pandemic report, Section 5

Avoid cliff effects

Cliff effects can be avoided by balancing potential extensions of moratoria schemes against spreading the economic effect over time.

Targeted loan restructurings could be, in some cases, a better way to deal with distressed borrowers.

Targeted fiscal measures

Fiscal measures should be applied in a more targeted way.

It is important to support viable businesses and to promote policies that are growth enhancing.

Monitor debt sustainability

Public guarantees for loans and moratoria tend to increase the indebtedness of borrowers.

Elevated debt levels might become unsustainable if the profitability and productivity of borrowers cannot keep pace.

Policy priorities going forward should take into account the high degree of uncertainty that still remains

Prepare for an adverse scenario

Institutions administering the restructuring and insolvency processes should not reach capacity constraints.

The issue of NPLs should be addressed early and decisively.

Enhance transparency and upgrade reporting

Timely and prudent recognition of credit risk increases the transparency of banks' balance sheets. It is important to ensure that banks are recognising borrowers' long-term payment difficulties on their balance sheets without undue delays.

Coordinate policies

Across policy areas: including insolvency legislation, labour and social policies, and competition policy.

Both at the national and the European level.

Source: ESRB Report on Financial stability implications of support measures to protect the real economy from the COVID-19 pandemic report, Section 5