Box 1.1

THE ECONOMIC POLICY RESPONSE TO THE COVID-19 CRISIS

There has been a swift response in terms of monetary and fiscal policy both in advanced and emerging market economies.[1] In the monetary arena, as the pandemic spread, the People's Bank of China cut official interest rates and announced a raft of measures to encourage lending to private agents. In the advanced economies, the US Federal Reserve reduced its federal funds target rate, by 50 bp on 3 March and again by 100 bp on 15 March, to a range of 0%-0.25%. Furthermore, it announced auctions of one- and three-month liquidity in the repo market, new credit lines for SMEs, municipalities and states, the re-establishment of foreign-currency liquidity swap lines with other central banks and its unlimited Treasury purchase plan. Most advanced economies, including the United Kingdom, Canada and Japan, have also taken conventional and unconventional monetary policy measures. Lastly, official interest rates have also been cut and other monetary policy measures have been taken in several emerging market economies, such as Brazil, Chile, Peru and Turkey.

The ECB Governing Council adopted important expansionary measures at its meeting held on 12 March. The package approved by the Governing Council consists of three measures: additional longer-term refinancing operations (LTRO), an easing of the conditions for targeted longer-term refinancing operations (TLTRO III), and an additional envelope for the asset purchase programme of €120 billion in net purchases until the end of 2020. All these measures aim to provide the financial system with sufficient liquidity to ensure that it continues to flow to households and firms, support bank lending – mainly to those segments hardest hit by the consequences of the health crisis, such as SMEs –, and avoid a tightening of financial conditions in the economy.

At an extraordinary meeting held on 18 March, the ECB Governing Council approved a special asset purchase programme of private and public sector securities with an overall envelope of €750 billion. Purchases under the pandemic emergency purchase programme (PEPP) will be conducted until the end of 2020, or beyond if necessary. For the purchases of public sector securities, the benchmark allocation across jurisdictions will continue to be the capital key of the national central banks, although purchases will be conducted in a flexible manner, thereby allowing for fluctuations in the distribution of purchase flows over time. This specific programme also waives the eligibility requirements for securities issued by the Greek government so that under the PEPP the Eurosystem may purchase these assets. As regards the purchases of corporate sector securities, the ECB has also announced an expansion of the range of eligible assets to include non-financial commercial paper of sufficient credit quality. Lastly, the ECB has announced changes to the collateral standards concerning monetary policy operations. It will expand the scope of the asset types that banks can use as collateral in their liquidity providing operations to include claims related to the financing granted to firms, the self-employed and households that are secured by governments. The minimum size threshold for accepting credit claims as collateral is lowered from €25,000 to €0 and collateral valuation haircuts are reduced by a fixed factor of 20%.

In accordance with the global nature of the shock, the fiscal policy response is broad-based across countries. Also, the packages approved tend to share some common elements. First, many of them include increases in health spending, in order to combat the pandemic in the countries affected. Second, in most cases the measures approved include action to support the income and expenditure of those households and businesses most affected by the pandemic, temporarily, while the effects last.

In the euro area, national fiscal policy-makers have reacted swiftly in light of the scale of the challenge. The intensity of the response has, however, varied. Governments in Germany, France, Italy, Spain, Ireland and Portugal, among others, have announced and implemented a broad raft of measures – similar to those adopted in other advanced economies –, which have also been strengthened by the supra-national actions led by the European Commission. Compared with the programmes of other advanced economies, these programmes are based to a greater extent on the provision of guarantees to banks to ensure credit flows to firms and the self-employed. Most countries have included moratoria on tax payments and, in some cases, on repayments on mortgage and other loans to individuals for the groups affected by the macroeconomic impact of the health crisis.

In the supra-national arena, the European institutions have adopted measures to respond to the health crisis. The European Union has approved the easing of budgetary control and rules on its areas of competence for 2020

1 For further details on some of these measures, see Section 5 of the Quarterly Report on the Spanish Economy, 1/2020, Banco de España.

in order to afford countries greater flexibility in their response to the pandemic, in addition to a series of measures comprising the use of surplus funds from the European budget (up to €60 billion) and new financial assistance totalling up to €100 billion for the EU as a whole to cover the costs incurred due to the increase in unemployment in the short term. Various forms of financial assistance have also been launched both for firms, through credit lines of up to €200 billion from the European Investment Bank, and for governments, through a credit line of up to 2% of GDP from the European Stability Mechanism for expenses related to the pandemic. Furthermore, the European Council backed the creation of a Recovery Fund, for a yet-to-be-determined amount, based on the pluriannual EU budget 2021-27. Overall, these measures focus on providing the necessary financial assistance in the short term, and could prove insufficient in view of the scale of the shock, requiring a greater push towards a true pooling of the fiscal efforts made by countries.

Spain has acted on several fronts. Specifically, measures have focused on strengthening the healthcare system, protecting employment and supporting vulnerable households, and providing liquidity to firms. Of these, the only area with a well-defined budgetary cost is the increase in healthcare expenditure, which encompasses budget items amounting to €4.4 billion (0.4% of 2019 GDP).[2,3]

The other measures envisaged will have a potentially significant – but unquantifiable – impact on the budget deficit in 2020. The support measures for employment and for income in the case of vulnerable households include greater flexibility in temporary layoffs and a waiver of the corresponding Social Security contributions, a special unemployment subsidy for temporary workers and domestic help and, lastly, easier access to benefits for cessation of activity by the self-employed. Most of these measures will remain in place until the state of alert ends, which means that the cost will depend on how long the state of alert lasts and on the number of persons within each of the groups affected who take up the measures.[4]

The third key group of measures approved aims to supply liquidity to potentially viable firms. These measures include providing public guarantees for loans to private firms, for up to €102.4 billion, equivalent to 8.2% of 2019 GDP.[5] A moratorium on tax debts has also been approved for a six-month period for SMEs and the self-employed, for up to €22.8 billion, in addition to the deferral of all firms' tax payments until 20 May, for €3.5 billion.[6]

As regards prudential policies, the ECB also announced a series of measures geared towards temporarily relaxing the prudential requirements for banks. Thus, for example, supervised institutions are allowed to operate below the level of capital defined by the Pillar 2 Guidance (P2G), the capital conservation buffer and the liquidity coverage ratio. It has also reduced capital requirements for market risks. Furthermore, the ECB issued a recommendation to credit institutions to refrain from paying dividends or performing share buy-backs aimed at remunerating shareholders at least until 1 October 2020. The purpose of this recommendation is to bolster the capital of these intermediaries so that they can support the economy.

Chapter 2 also discusses the possible effects of the adjustments to fiscal and monetary policies described in this box on Spanish financial intermediaries. Chapter 3 describes in more detail the adaptation of microprudential and macroprudential policies, in Spain and at the European level, in response to the COVID-19 crisis.

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2 The calculation uses nominal 2019 GDP. The figure would be higher if the sharp decline expected in GDP in 2020 were included.

3 This figure includes €2.8 billion for the regional governments, €1 billion managed by the Ministry of Health, €30 million for research into a vaccine against the coronavirus, and €600 million for the regional and local governments to ensure the provision of healthcare services to the most vulnerable population groups.

4 For the purposes of the impact of these measures on the budget deficit and on households' disposable income, it is important to consider that a very significant portion of these amounts would be linked to the normal functioning of the automatic stabilisers (specifically, the unemployment benefits for workers affected by temporary layoffs would also have been received had the job losses been permanent rather than temporary ones).

5 This figure is obtained by adding together the figures corresponding to the public loans and guarantee lines for loans to non-financial corporations (€100 billion) and export firms and SMEs (€2 billion) and Official Credit Institute ("ICO" by its Spanish acronym) loans for the tourism industry (€400 million).

6 These measures will not affect the deficit for the whole of 2020 as they will conclude within the year.