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SYSTEMIC RISK AND PRUDENTIAL RESPONSE TO COVID-19

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This chapter analyses the various vulnerability and systemic risk indicators, focusing in particular on those used in decisions concerning the counter cyclical capital buffer (CCyB), which since the onset of the pandemic have had to be adapted to a context of crisis. Continued adverse activity indicators, in particular a negative output gap, mean that the CCyB has to remain deactivated. Next, the chapter reviews certain prudential measures which have been adopted or are under discussion, both as a result of the crisis and regarding the medium-term development of the macroprudential framework. Worth noting in this connection is the public consultation of the amendment to Banco de España Circular 2/2016 on the supervision and solvency of credit institutions, which will make it possible to activate new macroprudential measures based on sectoral capital requirements and limits on the sectoral concentration of credit risk and on credit standards.

3.1 Analysis of macro-financial vulnerability indicators and their relevance in the environment generated by COVID-19

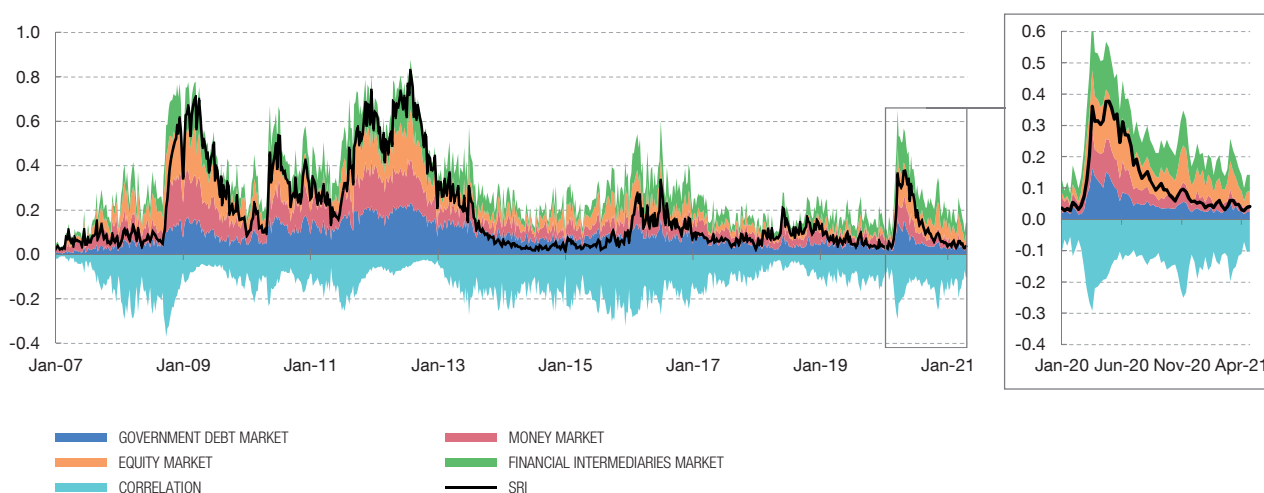
The acute stress unleashed in financial markets in March 2020 with the outbreak of the COVID-19 pandemic continued to abate in 2020 H2 and early 2021, especially owing to ongoing economic policy support and medical advances to combat the coronavirus. This lower financial stress is perfectly reflected in the systemic risk indicator (SRI), which brings together information on the money market, government debt, equity and financial intermediaries segments, and is designed to be particularly sensitive to simultaneous stress across these four segments. This indicator performed highly favourably in the final stretch of 2020 and almost completely reversed its surge between February and May of the previous year (see Chart 3.1). The SRI held at low levels in 2021 Q1. This improvement shows, on one hand, the effectiveness of the measures implemented to stabilise markets which include, most notably, the ECB's monetary policy measures. On the other, the approval of the first vaccines by the pertinent agencies and the progress of large-scale vaccination of the population also had a positive effect on this indicator.

The abrupt year-on-year fall in GDP in 2020 and the economic policy response continue to distort the usual interpretation of the credit-to-GDP gap, which held on an upward path in 2020 Q4 that exceeded warning levels. This indicator recorded highly negative values following the global financial crisis, holding on a rising path thereafter, which was consistently below 2 pp, a level usually considered as showing signs of imbalances. After the outbreak of the pandemic, this indicator has remained above the alert threshold since June 2020. However, this is due to the

Chart 3.1

STRAINS IN THE SPANISH FINANCIAL SYSTEM GRADUALLY EASED TO PRE-PANDEMIC LEVELS (a)

After rising sharply in the early weeks of the pandemic, the SRI has gradually declined since end-April and currently stands at levels similar to those recorded in the period immediately before March 2020.



SOURCES: Datastream and Banco de España.

a Updated with data as at 21 April 2021. For a detailed explanation of this indicator, see Box 1.1 of the May 2013 Financial Stability Report.

stimulus policies and the sharp impact of the shock triggered by COVID-19 rather than new endogenous imbalances of the financial system which are susceptible of treatment by the activation of macroprudential tools (see Chart 3.2), specifically the CCyB. As indicated in previous FSRs, according to BCBS guidance on the CCyB, it is not appropriate to activate this buffer automatically when the credit-to-GDP gap increases owing to an abrupt decline in GDP¹. Nevertheless, the length and intensity of the crisis triggered by COVID-19 increases the risk that the higher degree of leverage in relation to GDP will be consolidated over time and, consequently, it will be necessary to remain vigilant about future developments in the credit-to-GDP gap.

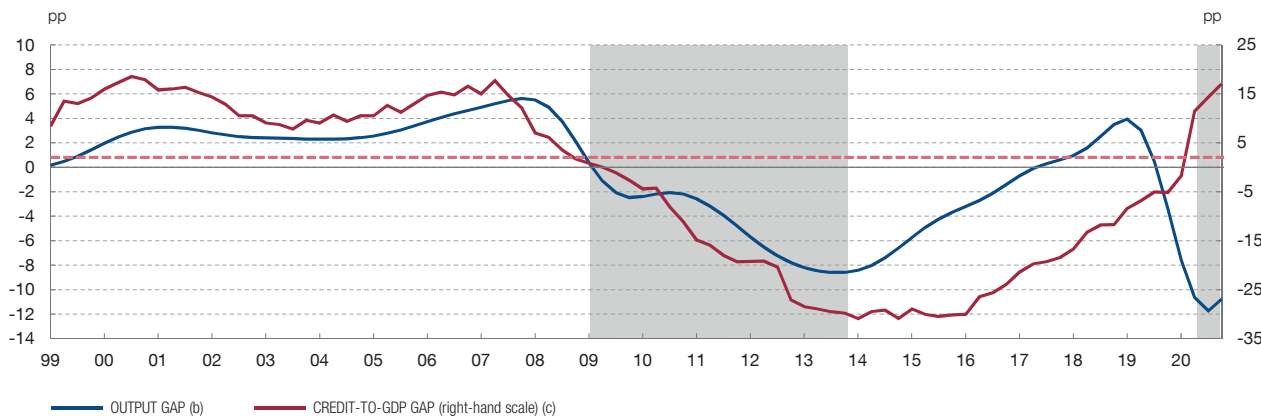
The markedly negative output gap continues to indicate that it is appropriate to keep the CCyB at current levels, whereas the downward path of the SRI indicates that financial markets are operating under no strain. The SRI – a coincident indicator of systemic financial strain – is usually employed to determine when this buffer is released in the face of a significant increase in this strain. The improvement of the SRI in 2020 H2 shows that financial markets are gradually stabilising, which does not necessarily mean that the economic situation is better across the board. The negative performance of the output gap is evidence of this. This variable has fallen to negative values, which are unprecedented in recent history, although it

¹ Basel Committee on Banking Supervision. *Guidance for national authorities operating the countercyclical capital buffer*, December 2020. See Principle 3 (“Risk of misleading signals”).

Chart 3.2

THE CREDIT-TO-GDP GAP CONTINUED TO RISE ABOVE THE CCyB REFERENCE THRESHOLD, WHILE THE OUTPUT GAP HELD AT VERY NEGATIVE LEVELS (a)

At end-2020 the credit-to-GDP gap exceeded the CCyB activation threshold and was higher than in previous quarters as a result of the sharp fall in GDP, which is also reflected in a rapid decline in the output gap, but should not therefore be interpreted as a systemic risk warning. Although corrections are expected in the coming quarters as positive GDP growth rates are observed, such as the output gap is beginning to show, the indicator needs to be monitored continuously to assess the degree of absorption of higher indebtedness by economic agents.



SOURCE: Banco de España.

- a The vertical shaded bands represent the period of the last financial crisis in Spain (2009 Q1-2013 Q4) and the crisis unleashed by the pandemic as from 2020 Q2. The data to December 2020 are provisional. The broken red horizontal line represents the reference CCyB activation threshold of 2 pp for the credit-to- GDP gap.
- b The output gap is the percentage difference between observed GDP and potential GDP. Values calculated at constant 2010 prices. See Cuadrado, P. and Moral-Benito, E. (2016), "Potential growth of the Spanish economy", Occasional Paper 1603, Banco de España.
- c The adjusted credit-to-GDP gap is calculated as the difference, in percentage points, between the observed ratio and the long-term trend calculated using a one-sided statistical Hodrick-Prescott filter with a smoothing parameter equal to 25,000. This value is calibrated to adapt to the financial cycles historically observed in Spain (see Galán, J.E. (2019). "Measuring credit-to-GDP gaps. The Hodrick-Prescott filter revisited." Occasional Paper 1906, Banco de España).

started to recover slightly in Q4 (see Chart 3.2). Notwithstanding the difficulties of estimating potential growth in view of current uncertainty levels, this indicator is at present more informative for guiding decisions in relation to the CCyB than the credit-to-GDP gap.

Indicators of banks' capacity to face adverse systemic shocks are also considered to complement the analysis of macro-financial stress. SRISK² is a notable example of an indicator which quantifies the level of systemic risk in the banking sector overall and individual banks' contribution to such risk, since it assesses the impact of an extreme negative event on each bank. This latent risk indicator provides an estimate at market value of the expected capital shortfall in respect of a bank's prudential ratio over its assets after a hypothetical severe crisis in equity markets entailing an adverse correction of its market capitalisation.

Since the onset of the pandemic SRISK has held at historically elevated levels, associated with the decrease in banks' market valuations, which were

2 See Brownlees, C., R. Engle, 2017. SRISK: A conditional capital shortfall measure of systemic risk. The Review of Financial Studies 30, 48-79.

subsequently corrected by the measures adopted during the crisis (including the easing of prudential requirements). Changes in the SRISK of European listed banks since March 2020, coinciding with the spread of COVID-19, pushed the indicator close to the peak levels observed during the 2012 European sovereign debt crisis and above the levels of the 2008-2009 global financial crisis (see Chart 3.3). As from November 2020, this indicator has clearly decreased, in line with the favourable performance of financial markets, although it clearly remains above pre-crisis levels. This evidence indicates the market's pessimistic view of the distance between banks' capital and the capital required should there be a significant correction in stock prices³. This small distance could have implications for the usability of banks' capital buffers, adversely affecting bank credit supply in that scenario. This underlines the importance of measures which prompt financial markets to return to normal, such as expansionary monetary policy and the relaxation of capital requirements. These measures should, however, be carefully monitored to avoid overvaluations being generated in turn.

The particular nature of the current crisis should also provide guidance for an appropriate interpretation of the SRISK indicator. This risk indicator has not reached alert thresholds as a result of an endogenous increase in the banking sector's leverage or of an abrupt correction of imbalances which have built up in the industry; rather the key factor is the decline in banks' market valuations in the face of COVID-19-related uncertainty.

Stock market performance also reveals a latent worsening of listed European firms' credit quality, which is mixed across sectors. The application of option valuation methods to the data on the prices and the degree of leverage of Eurostoxx 600 firms has shown a significant widespread increase in the underlying probability of default since March 2020, which is particularly pronounced in the sectors hardest hit by the pandemic (e.g. tourism). Recent market developments have corrected the scale of this underlying credit impairment, although the latter remains above pre-COVID-19 crisis levels; it is higher than in the global financial crisis only in specific sectors (see Box 3.1).

House price indicators suggest that prices stand roughly at their equilibrium level in a highly uncertain setting. House price indicators are key to the early identification of potential vulnerabilities which could lead to future systemic problems, since they usually move in line with the financial cycle and could even amplify it. Accordingly, there are currently no signs of overvaluation in this market with respect to its equilibrium level, calculated by using different methodologies, although the subdued volume of transactions during 2020 and the fact that the indicators are more dispersed are grounds for some caution (see Chart 3.3).

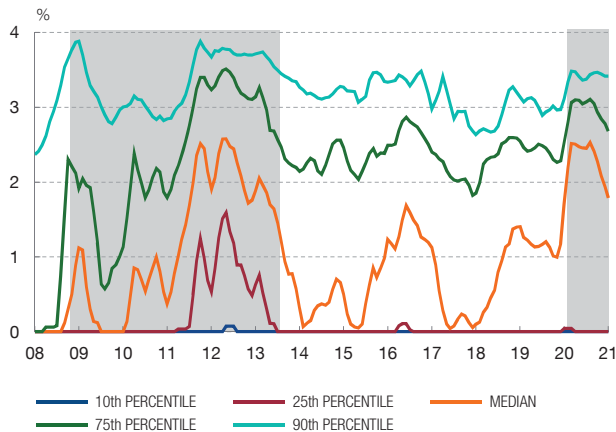
³ This exercise considers the distance between capital at market value and a prudential requirement of 4.5% of asset value (using a book value for debt and a market value for capital), whereas in reality capital requirements are numerous and complex. The SRISK used is, therefore, an informative indicator but not an exhaustive assessment of requirements. The relaxation of the requirements parameter was not examined specifically either.

Chart 3.3

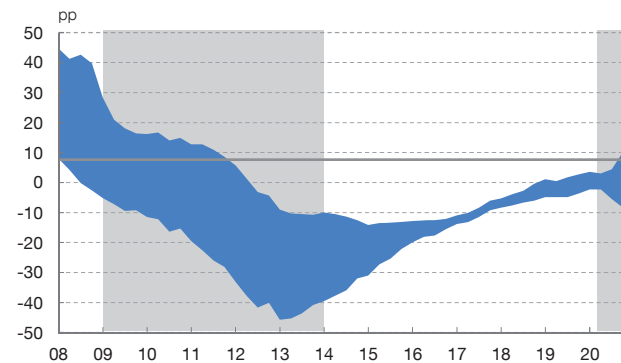
THE SRISK INDICATOR OF BANKING RISK HAS REMAINED ELEVATED SINCE THE ONSET OF THE PANDEMIC, WHILE, AT THE SAME TIME, OTHER INDICATORS, SUCH AS THOSE OF THE REAL ESTATE MARKET, HAVE NOT YET GIVEN ANY WARNING SIGNALS (a)(b)

The systemic risk of listed banks in the euro area – approximated by SRISK as a percentage of each bank’s total assets – increased in March 2020 with the onset of the pandemic. Subsequently, this indicator has corrected somewhat coinciding with the recovery in financial markets. The indicators of imbalances in the real estate market have remained stable on average, although their dispersion has increased since some of them have been affected by the decline in household income.

1 DISTRIBUTION OF THE SRISK SYSTEMIC RISK INDICATOR (a)



2 INDICATORS OF IMBALANCES IN HOUSE PRICES (b)



SOURCES: Datastream, SNL, INE and Banco de España.

- a SRISK is expressed as a percentage of each institution's total assets. The parameters used are $k=4.5\%$ for the capital requirement, $C=10\%$ for the market decline and $h=22$ business days for the period over which the hypothetical decline occurs, see for more details Brownlees and Engle, (2017) "SRISK: A Conditional Capital Shortfall Measure of Systemic Risk, Vol 30, pp. 48-79". The SRISK index for the months of 2021 Q1 is calculated from the values of assets and liabilities of 2020 Q4 with the stock prices data of the corresponding month. The series have been smoothed using a three-month moving average.
- b The shaded area represents the minimum and maximum values of the four indicators of imbalances in house prices. The indicators are: i) the real price gap, ii) the house prices to household disposable income ratio gap, iii) the ordinary least squares model which estimates house prices based on long-term trends in household disposable income and mortgage interest rates, and iv) the error correction model which estimates house prices based on household disposable income, mortgage interest rates and fiscal effects. The long-term trends are calculated in all cases using a statistical one-sided Hodrick-Prescott filter with a smoothing parameter equal to 400,000. The vertical shaded bands represent the period of the last financial crisis in Spain (2009 Q1-2013 Q4) and the crisis unleashed by the pandemic as from 2020 Q2.

Taking this set of macro-financial indicators into account, the Banco de España is maintaining the CCyB at 0% and does not envisage increasing it at least until the Spanish economy has recovered from the impact of the crisis⁴. The various indicators show different signs, but the scale of the negative exogenous shocks inflicted by the pandemic on real activity has seen special consideration given to the output gap criterion and the uncertainty surrounding growth. The Banco de España continues to consider it appropriate to maintain the CCyB at a minimum of 0% to make it easier for banks to be able to sustain the credit flow and thus contribute to alleviating the negative pressure on economic growth. In this respect, this decision is in line with the press releases and guidance on the flexible application of prudential requirements in response to COVID-19 issued by the ECB, ESRB, EBA, BCBS and FSB.

4 See "The Banco de España holds the countercyclical capital buffer at 0%", press release of 24 March 2021.

In November 2020 the Banco de España announced the designation of five institutions as systemically important, together with their macroprudential capital buffers⁵. Each year the Banco de España identifies Spanish credit institutions which are globally systemically important institutions (G-SIIs) and other systemically important institutions (O-SIIs). This designation entails an additional prudential requirement in the form of a capital buffer (see Table 3.1), with the objectives of correcting these institutions' potential competitive advantages in the funding market owing to their systemic footprint, adjusting their risk-taking and building up additional funds to absorb possible shocks to these institutions, whose stability is needed to maintain the stability of the system as a whole. Since 2015, when G-SIIs and O-SIIs first appeared in legislation, the composition and classification of the list of institutions identified in Spain has remained relatively stable. In 2021 the Banco de España will assess again the systemic importance of institutions so as to reflect the changes in the structure of the banking system in 2020.

3.2 Prudential measures adopted and other alternative measures

The coordinated action of macroprudential, micro-prudential and accounting policies continued to facilitate the financing of the real economy, and to mitigate the economic impact of the pandemic, which continued to influence activity in the early months of 2021⁶. Persisting uncertainty and pandemic-related obstacles to the normal functioning of the economy are the reason why the prudential measures approved since spring 2020 have generally remained in place so as to mitigate these negative conditions and complement the monetary and fiscal measures which have also continued to be in force⁷. Each area of measures is summarised and presented in a summarised chronological order to underline their adaptation to the unfolding of an uncertain environment.

The easing of solvency and liquidity requirements for European banks remains in force. As covered in previous FSRs, in the field of solvency and liquidity requirements, European guidance remained in place for banks to release the CCyB, with the possibility of operating temporarily below the P2G level, the capital conservation buffer and the liquidity coverage ratio. Rules on the composition of P2R were also modified so that they could be partially covered with AT1 and AT2, anticipating the entry into force of CRD V.

The presence of other support measures limited banks' recourse to buffers to increase lending further. First, the application of the rapid reform of the EU

5 See "Banco de España updates the list of systemically important institutions and sets their capital buffers", press release of 27 November 2020.

6 See Anguren, R., L. Gutiérrez de Rozas, E. Palomeque and C.J. Rodríguez García (2020) "The regulatory and supervisory response to the COVID-19 crisis", Financial Stability Review, No. 39, Banco de España.

7 See 2020 Spring FSR and 2020 Autumn FSR.

Table 3.1

SYSTEMICALLY IMPORTANT INSTITUTIONS AND ASSOCIATED CAPITAL BUFFERS

Legal Entity Identifier (LEI)	Institution	Designation	Capital buffer requirement in 2021
5493006QMFDDMYWIAM13	Banco Santander, S.A.	G-SII and O-SII	1.00 %
K8MS7FD7N5Z2WQ51AZ71	Banco Bilbao Vizcaya Argentaria, S.A.	O-SII	0.75 %
7CUNS533WID6K7DGF187	CaixaBank, S.A.	O-SII	0.25 %
S15RG2MOWQQLZCXKRM20	Banco de Sabadell, S.A.	O-SII	0.25 %
549300GT0XFTFHGOIS94	BFA Tenedora de Acciones, S.A.U. (Bankia, S.A.) (a)	O-SII	0.25 %

SOURCE: Banco de España.

a The identification and the buffer of this entity were effective until its integration into CaixaBank, S.A. in March 2021.

capital requirements regulation – the CCR quick fix – in June 2020 shored up European banks’ solvency ratios. This achievement was similar to that relating to the restrictions on banks’ dividend payments, which will remain strict in 2021. Furthermore, reining in the negative effects of the pandemic on bank profitability in 2020 H2 (see Chapter 2), particularly through the moderation of impairment provisions, generally avoided capital charges. Expansionary monetary policy, including the enlargement of the asset purchase and bank funding programmes, also contributed to very relaxed liquidity conditions. In the crisis environment, growth of the stock of loans was strongly underpinned by guarantee programmes and moratoria (see Chapter 2).

In order to maximise the impact on economic activity of more flexible solvency and liquidity requirements, it is vital that banks do not face obstacles to the usability of the buffers they have built up. The use of buffers in a context of crisis, which so far has not been observed among Spanish and other European banks, could mean banks experience market stigma if the markets consider that such action means their capital and liquidity ratios are insufficient for maintaining their funding risk at a reasonable level. If this were to happen, using buffers would have a negative impact on market valuations of the banking sector. Furthermore, banks could also be uncertain about when they will be required to rebuild those buffers. In the short term, effective communication of the measures’ objectives and guidance on the future rebuilding of buffers within a reasonable timeframe, once the crisis is over, play a significant role in avoiding these negative effects. In certain regulatory fora, the possibility is under discussion that in the medium term, the macroprudential framework may include more flexible requirements to counter the materialisation of unexpected risks which can be applied to the banking sector as a whole or to broad segments of it to avoid specific banks from being stigmatised. If this reformed framework facilitates the widespread use of buffers by banks during crises, it would make recessions weaker and, as a consequence, loan losses lower.

Different authorities have continued to recommend credit institutions to exercise prudence regarding dividend distribution during the COVID-19 pandemic. In December 2020 the ECB published a new recommendation⁸ on dividend distribution during the pandemic (replacing its previous recommendation⁹) whereby significant institutions are recommended to refrain from distributing cash dividends and repurchasing shares until 30 September 2021 or to limit such distributions. In the latter case, the dividends and share buybacks are expected to remain below 15% of the accumulated profits for 2019 and 2020 or below 20 bp of CET1, whichever is lower. They are also recommended to refrain from announcing the distribution of provisional dividends charged to their profits for 2021. The Banco de España¹⁰ decided to extend the ECB's recommendation to all the less significant institutions under its direct supervision. Along the same lines, the European Systemic Risk Board issued its own recommendation on dividend restrictions for credit institutions, investment firms and insurers throughout the EU¹¹; as did the European Banking Authority¹², the European Insurance and Occupational Pensions Authority¹³ and the Directorate General of Insurance and Pension Funds in Spain¹⁴. The restriction on dividend distribution is having a significant impact (see Chapter 2) on credit institutions' capital and a regulated framework of these interventions within prudential regulations is worth considering in the medium term. Additionally, the empirical analysis undertaken with granular information on bank loans shows that the Spanish institutions which did not distribute dividends last year were more active granting loans and, consequently, helped to mitigate the impact of the crisis on the real economy¹⁵.

Further developments have taken place in the realm of regulation and prudential supervision, both in connection with the response to the crisis and also from a longer term standpoint, which should be considered when assessing the risk outlook for the financial sector. In the area of micro-prudential supervision and accounting regulation, among other developments, progress has been made in applying the quick fix, new supervisory guidelines on bank mergers have been introduced, the operational flexibility measures remain in place and accounting standards have been tailored to this crisis (e.g. the presence of support measures),

8 Recommendation of the European Central Bank of 15 December 2020 (ECB/2020/62) on dividend distributions during the COVID-19 pandemic and repealing Recommendation ECB/2020/35.

9 Recommendation of the European Central Bank of 27 July 2020 (ECB/2020/35) on dividend distributions during the COVID-19 pandemic and repealing Recommendation ECB/2020/19.

10 Banco de España recommendation on dividend distribution and variable remuneration of 15 December 2020. (In Spanish only).

11 Recommendation of the European Systemic Risk Board of 15 December 2020 (ESRB/2020/15) amending Recommendation ESRB/2020/7 on restriction of distributions during the COVID-19 pandemic.

12 EBA press release of 15 December 2020.

13 EIOPA press release of 18 December 2020.

14 Note of the Directorate General of Insurance and Pension Funds of January 2021. (In Spanish only).

15 See Martínez Miera, D., and R. Vegas, 2021, *Impact of the dividend distribution restriction on the flow of credit to non-financial corporations in Spain*, Analytical Article, Economic Bulletin, Banco de España.

with significant updates to EBA guidelines, and proposals have been presented for asset management in Europe. Notable among the long-term developments are the impact of the completion of Basel III on the banking sector, whose implementation was delayed owing to the impact of the crisis, and the introduction of new macroprudential tools in Spain. All these measures are analysed in more detail in the paragraphs below.

The CRR was reformed in line with the quick fix provisions to modify favourably the prudential treatment of certain software programmes, which are recorded as intangible assets. Following the approval of Commission Delegated Regulation (EU) 2020/2176, the deduction of software assets from CET1 shall no longer be required and the difference between the prudential amortisation and the amortisation for accounting purposes, with certain restrictions, should be deducted¹⁶. The main reason for this deduction was the low value of these assets in bank resolution and, consequently, their limited loss absorbing capacity. However, investment in software, databases and their management is considered a basic input for institutions to pursue their activities amid the economy's and society's growing digitalisation, and to be able to better compete with BigTech firms, which are software asset-intensive. Furthermore, European legislation is thus aligned with that of the United States and Switzerland, neither of which deducted these assets from their banks' CET1. By contrast, the UK recently announced that it will maintain the deductions.

The European Central Bank published its final guide on the supervisory approach to consolidation in the banking sector. This guide clarifies the prudential supervision principles followed to determine whether the arrangements applicable to a credit institution resulting from a consolidation ensure the sound management and coverage of its risks. Box 2.4 analyses its implications in greater detail.

The EBA reactivated its guidelines on legislative and non-legislative moratoria in December 2020 and the BCBS also published in 2020 H2 a supplemental note to its 2014 guidance on the external audits of banks regarding the use of expected credit loss accounting frameworks. This reactivation of the EBA's guidelines until end-March 2021 was set up as a support measure for bank borrowers (households and firms) and continues to allow institutions to make timely use of the flexibility in prudential regulations¹⁷. At the same time, it limits the maximum duration of a loan payment deferral to nine months to facilitate that the exit strategy from all of these measures is implemented as gradually and selectively as possible. These guidelines have also been adopted by the Banco de España. The note of the Basel Committee¹⁸ considers that the use of forecasts and forward looking information may be useful for 2020 bank

¹⁶ See Commission Delegated Regulation (EU) 2020/2176.

¹⁷ See EBA/GL/2020/15.

¹⁸ See BCBS Guidelines. December 2020.

audits, as well as the construction of macroeconomic scenarios and weightings and the assessment of internal model performance.

The European Commission also sent a communication to the European Parliament, the Council and the European Central Bank on how to tackle the probable increase in non-performing loans in the aftermath of COVID-19, proposing greater proactivity to anticipate this increase at the same time as it extended the State aid Temporary Framework until end-December 2021.

The communication issued by the European Commission¹⁹ proposes: (i) further developing the secondary market for non-performing exposures; (ii) improving coordination in the operation of national asset management companies to share information, best practices and even take coordinated action against common counterparties; (iii) harmonisation of national legislation on business insolvencies, even proposing that the European Reconstruction Fund include some type of conditionality based on progress in this legislation; and (iv) adapting European legislation on bank resolution and State aid to the extraordinary nature of COVID-19, exceptionally proposing capital injections for solvent institutions to address temporary capital shortfalls as a result of a serious shock.

As part of the response to the COVID-19 crisis, the finalisation of certain aspects of the Basel III framework has been delayed; however, it remains important to analyse its impact sufficiently far in advance and to uphold the commitment to its full and consistent implementation. In the European setting, the EBA has updated its impact study on the full implementation of the Basel III capital framework, including the output floor requirement on internally modelled capital requirements (delayed until 1 January 2028). The EBA also examined the possibility of partially implementing the framework. Box 3.2 provides a more detailed description of this study, which consolidates the findings of previous work that the full and consistent transposition of the Basel III framework, under the new timetable, is desirable.

The measures which support lending to business activities in Spain have adapted to the economic crisis and continue to factor in the need for ongoing monitoring and sufficient flexibility to react to possible future changes in the economic situation. For instance, Royal Decree-Law 34/2020 extends the maximum duration and payment holidays of the guarantee programmes, respectively, by three years (up to a maximum of eight years) and by 12 months. Royal Decree-Law 5/2021 (see Box 1.3) introduces different measures to bolster business solvency: direct assistance to compensate businesses and the self-employed for lower revenue, a toolkit (restructuring, conversion into participating loans, even debt reductions as a measure of last resort) to reduce the

19 See “*Tackling non-performing loans in the aftermath of the COVID-19 pandemic*”, 16 December 2020.

overindebtedness of firms which have loans with State guarantees, and the creation of a recapitalisation fund for medium-sized firms²⁰.

The effectiveness of business solvency support programmes will hinge on them being designed and implemented satisfactorily. The design of the procedures for monitoring and selecting the recipients of funds should be guided by economic principles that maximise the economy's growth potential and reach businesses that really need them. Programmes should be implemented sufficiently rapidly within a well-defined timeframe to boost the productive use of the funds and maintain adequate incentives. As a result of the existing uncertainty, programmes must be monitored continuously in order to potentially recalibrate their various parameters, if needed.

The dynamic assessment of support measures is of a more far-reaching importance, and anticipating the reaction of regulatory and supervisory policies to different scenarios of how the crisis may unfold is particularly necessary. Under the baseline scenarios of economic activity gradually returning to normal, a credible and sufficiently long timetable for the withdrawal of measures (e.g. the relaxation of capital requirements for banks) needs to be considered. This should avoid a sudden increase in the financial pressure on the private sector at a time when medium-term expectations are improving, but agents are somewhat fragile as a result of the pressure exerted by the crisis since March 2020. The timetable should, however, be well defined to avoid perpetuating certain sectors' reliance on support programmes and the possible distortion of incentives, if they were to remain in place over an excessively long horizon. If downside risks were to materialise, the measures should be adapted selectively to maximise their impact on productive capacity and to limit their cost, particularly the increased pressure on public finances.

The strong impact of the current crisis does not diminish the importance of developing sufficiently far in advance a suitable framework of macroprudential tools to absorb future shocks. Worth noting in this connection is the public consultation of the amendment to Banco de España Circular 2/2016 on the supervision and solvency of credit institutions, which makes it possible to impose new measures such as the sectoral CCyB and limits on sectoral concentration and on credit standards. These regulatory tools, which are described in detail in Box 3.3, enlarge the Banco de España's capacity, as the designated authority for applying macroprudential instruments to the banking sector, to act in the prevention and mitigation of systemic risk.

²⁰ The Announcement of the Spanish Council of Ministers of 20 April 2021 (in Spanish only) modified some conditions of the aid programmes, so that they can be applied to a wider group of sectors of activity, and permitted certain selection requirements to be relaxed in exceptional circumstances.

