COVID NPLs: From “tsunami” to optimism & now to “wave”?

JVI-ADB-ECB NPL Webinar

Joint Vienna Institute (JVI)
December 15, 2021

THE LONDON SCHOOL OF ECONOMICS AND POLITICAL SCIENCE

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Phenomenal reading

- Forensic yet still big-picture comparison from recent financial crises in Asia & Europe
- Could not be more timely
- A must-read for policy makers & business & students of financial crisis

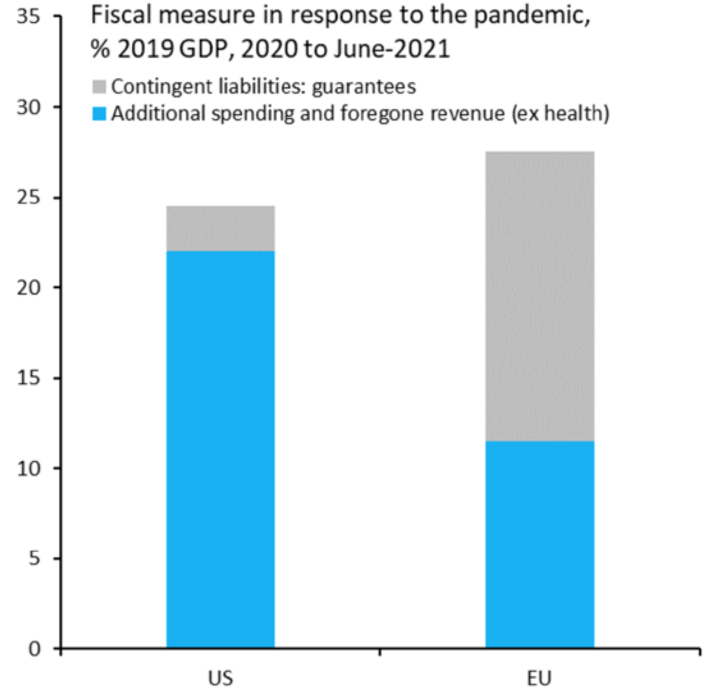
COVID NPLs: “This time *is* different”*

- Crisis not from the financial sector
- Much better preparedness in Europe in the wake of the twin GFC and eurozone crisis (read the book)
- “Whatever-it-takes” policy mix with “European characteristics”:
  - ✓ Massive anti-cyclical policy mix that integrated, for the first time, macroprudential/regulatory policies in a systemic way
  - ✓ EU-level easing: suspension of the fiscal, state aid and competition rules – a real first, WELL DONE!
  - ✓ ECB’s enlightened monetary policy easing extended to non-euro countries through currency swaps, repos - BRAVO!

* Based on joint work by Reiner Martin, Piroska Nagy-Mohacsi, Elina Ribakova, Jonathan Vargas, in *Eurobook 2022* (forthcoming February 2022)

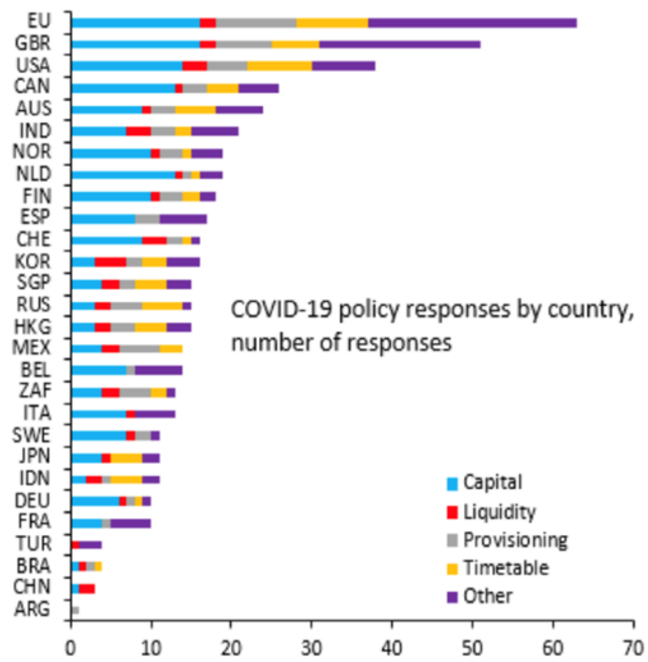
Policy elements

Figure 5: Fiscal support measures in the EU and the US, 2020-21

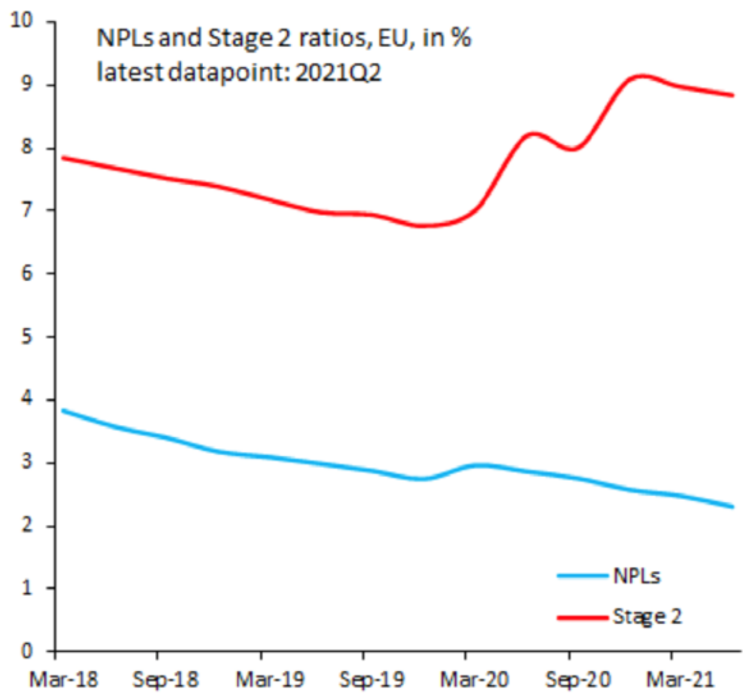


Sources: IMF Fiscal database June 2021 and EIB data.

Figure 6: Total number of bank regulatory measures by jurisdiction and type



Results to date: policies have worked … but change is coming



Source: EBA and authors.

- Divergence between reducing NPLs but rising Stage 2 loans
- Stimulus measures to be wound-down
- Clear risks in a few areas:
  - Asset prices soaring (including crypto)
  - Household and corporate sector debt rising
  - Some risks of "zombification"
- In EMs potential negative spillovers from QE reversal

Particular risks for emerging markets

- NPLs are generally higher than in ADs:
  - ✓ weaker starting position; smaller COVID stimulus packages; higher inflation already
- Monetary policy tightening is underway in many EMs (Brazil, Turkey, Hungary, Russia,…) due to inflation, which however maybe premature for growth —> direct risks to bank asset quality
- Negative spillovers from AD stimulus withdrawal

Policies to avoid an "NPL Wave"

- Speed is of the essence to deal with any material NPL rise
- "Benefit of the doubt" principle
- Fast-track approach on calls on guarantees
- Secondary NPL markets to be strengthened
- Asset management companies (AMCs) need more flexible state aid rules. In case of an NPL wave re-consider EU-level AMC
- "Forward guidance" also on macro-pru/NPL management as uncertainty continues (Omicron)
- For emerging markets in Europe, ECB currency swaps/repos need to remain in place to mitigate market overreaction during forthcoming tapering