

Monitoring the financial stability implications of COVID-19 support measures¹

In 2020, the European Systemic Risk Board (ESRB) established a working group to analyse the effects of the crisis-related fiscal measures on the financial system. In February 2021, the ESRB Working Group on “Monitoring financial stability implications of fiscal measures to protect the real economy in the context of the coronavirus (COVID-19) pandemic” published its final report.² The work has benefited from the combination of different information sources. Based on information collected from national authorities, from the European Banking Authority (EBA), and from the AnaCredit credit registry of the European Central Bank (ECB), the report has three key findings. First, fiscal measures have protected the real economy and therefore the financial sector from the impact of the pandemic. These measures have ensured the continued provision of financial services: up to 35% of new bank lending to non-financial corporations (NFCs) during the pandemic has been associated with those measures. Second, differences in fiscal measures are closely correlated to the exposures of countries to the pandemic. For example, countries hit harder by the pandemic tend to have larger programmes with greater uptake. Third, the report stresses the importance of continued monitoring of the effects of the pandemic on solvency in the corporate and banking sectors.

The ESRB therefore continues to monitor the financial stability implications of the fiscal support measures. This note summarises the analyses conducted after the publication of the final report. It also contains insights from the analyses of the ESRB Drafting Team on corporate insolvencies.³ The analysis is based on data collected on the basis of Recommendation ESRB/2020/8 for Q4 2020 and Q1 2021 and data shared by the EBA and the ECB, in particular AnaCredit data. Note that while the effects of fiscal measures on government debt are closely related, an analysis of the sustainability of fiscal debt is not within the scope of the ESRB Working Group. It is, therefore, not covered in this analysis. This very relevant topic will, however, be under

¹ This document is based on the notes prepared for the 25 March and 24 June 2021 ESRB General Board meetings. It was drafted by a dedicated team led by Claudia M. Buch (Deutsche Bundesbank), with contributions from the ESRB Secretariat (Alexandra Morao and Kristian Horn) and the Deutsche Bundesbank (Esteban Prieto and Benedikt Kolb). Data support from Ana Gloria, Lavinia Forcellese and Nathan Huber (ESRB Secretariat) is gratefully acknowledged, as are comments from Kadi Kaadu (ECB Banking Supervision). A special acknowledgement is also addressed to all national macroprudential authorities for the provision of the information submitted under Recommendation ESRB/2020/8 and for the constant improvement of its quality, as well as to colleagues from the ECB’s Directorate General Statistics who provided aggregated data from AnaCredit.

² See “[Financial stability implications of support measures to protect the real economy from the COVID-19 pandemic](#)”, ESRB, February 2021.

³ See “[Prevention and management of a large number of corporate insolvencies](#)”, ESRB, April 2021.



scrutiny of the ESRB through the recurrent risk monitoring and assessment at the ATC and the General Board.

There are five key results of the analytical work:

- **Fiscal support continues to play a role in sustaining the economic recovery and the functioning of credit markets.** In the first quarter of 2021, the volume and uptake of fiscal measures continued to increase, in particular as regards solvency support. At the same time, moratoria schemes are starting to expire and their uptake has consequently declined considerably. The volume and structure of the measures have affected corporate indebtedness. Generous liquidity support measures are associated with increases in gross corporate bank debt. Such increases are particularly large in sectors strongly affected by the pandemic. Solvency support measures, by contrast, are associated with decreases in corporate debt.
- **While banks are increasingly provisioning for balance sheet risks, they may be underestimating macroeconomic risks.** Banks are increasingly taking into account that loans under moratoria carry an above-average credit risk, for example. Yet, at an aggregate cross-country level, loan loss provisioning has been virtually uncorrelated with GDP losses during the pandemic or with the increase in corporate borrowing from banks. One reason for this decoupling could be that the extent of public support has mitigated pressure on corporates and the fact that corporate insolvencies have hardly increased during the pandemic in most countries. This suggests that aggregate macroeconomic risks are not (so far) fully translating into corporate losses. Monitoring these risks and adequately provisioning for a potential increase in corporate losses once support measures are scaled back thus remain priorities for supervisors and banks.
- **Looking ahead, banks and supervisors need to pay attention to the fact that the link between economic and financial losses has become less tight during the pandemic.** Due to the extraordinary fiscal support, the contraction in real economic activity during the pandemic did not fully translate into losses on banks' balance sheets. Banks and other market participants need to acknowledge that correlations between real and financial risks in data spanning the pandemic might yield a misleading picture of future risks. Risk models calibrated on historical time series may become less reliable in terms of predicting financial losses resulting from future real economic contractions. Certainly, the resilience differs across institutions and countries, depending, among other things, on the magnitude of the initial shock, the fiscal measures that were implemented as well as the way they are withdrawn. Nevertheless, if banks were to experience a further deterioration of asset quality, a cautious approach concerning provisions would be indicated.
- **Addressing financial stability issues that could arise from increased corporate debt in a timely manner is crucial.** Mitigating these financial stability risks requires a distinction between different types of firms: (i) firms with business models that are mostly unaffected by the pandemic and that can raise funding without frictions; (ii) firms with business models that are clearly unviable; and (iii) firms with business models that are fundamentally sound but that face frictions when accessing private funding markets because of heightened uncertainty



related to the pandemic. Targeting fiscal measures at the last two groups of firms requires mechanisms for early debt restructuring, and an adjustment of fiscal measures towards more targeted solvency support for viable businesses. The results of the most recent ESRB reporting show a heightened awareness of authorities of the need to adjust policies accordingly.

- **The policy response of authorities will have to become more differentiated over time.** In response to the pandemic, all Member States reacted swiftly and implemented large fiscal support measures. Yet, different sectoral structures and pre-existing vulnerabilities will contribute to a less synchronised economic recovery. Assessing whether the duration of fiscal measures remains aligned with the pace of economic recovery thus remains important. Moreover, asset and housing prices continue to increase almost unabatedly in many economies, despite the contraction in overall economic activity. Macroprudential authorities have to continuously monitor and assess the different risks to financial stability and stand ready to move from crisis mode to prevention mode as needed.

1 Implications of fiscal measures for credit markets

Governments have continued to support the real economy, while loan moratoria are being phased out gradually (Chart 1).⁴ While some fiscal measures have already expired, others have been extended and, in most cases, the uptake is still far from being exhausted. By the end of 2020, the overall volume of announced fiscal measures stood at 17.5% of pre-crisis GDP. In the first quarter of 2021, this volume increased by around one percentage point to 18.7%, of which 10.9% was in the form of public guarantees. The overall uptake of measures has been lower throughout the pandemic. While total uptake increased from 5.7% to 6.9% of GDP between Q4 2020 and Q1 2021, the announced size remains far from being exhausted. Moratoria schemes are not included in these numbers as they have no predefined envelope. As these schemes expire, the uptake of loan moratoria has declined from 3.3% to 2.4% of 2019 GDP since December 2020.

Solvency support has increased in the first quarter of 2021 relative to liquidity support.

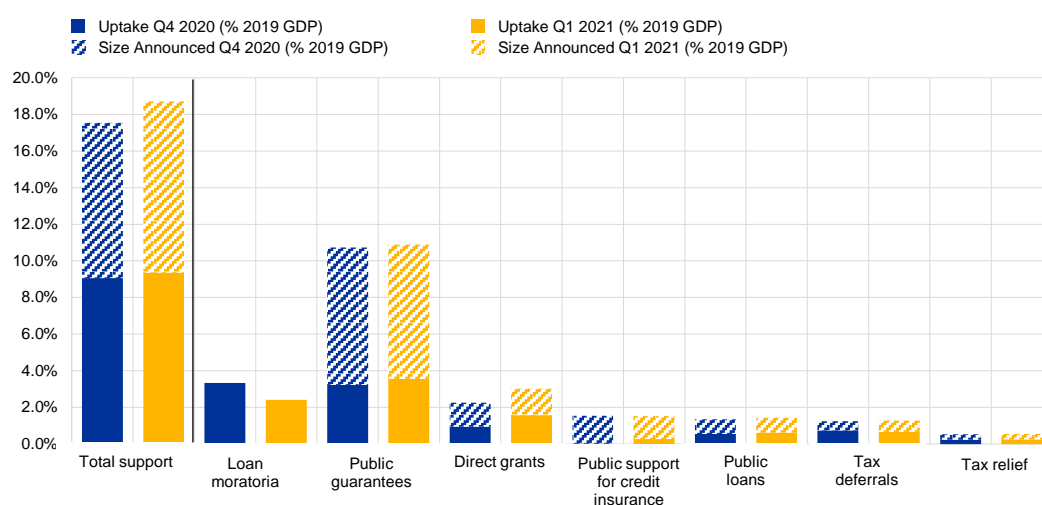
Direct grants make up a considerably smaller share of the total support than public guarantees, but their use has increased over time. In terms of announced size, grants now constitute the second largest measure, increasing from 2.2% of 2019 GDP in Q4 2020 to 3.0% in Q1 2021. Their uptake increased even more strongly from 1.0% to 1.6% of GDP, reflecting increased demand for solvency

⁴ See also Chart 13 as well as Tables A1 and A2 in the Annex. The information is based on data submitted to the ESRB by April 2021. Percentages are given in terms of GDP in 2019.



support as the effects of the pandemic weighed on firms' net worth.⁵ However, compared with the overall size of fiscal support, liquidity measures dominate: public guarantees and loans, tax deferrals and credit insurance support in sum account for 81% of the announced size and 74% of the uptake of measures in Q1 2021. Since March 2020, roughly 36% of new loan commitments provided by banks to NFCs have benefited from public guarantees or have taken the form of public loans.⁶

Chart 1
Announced size and uptake of moratoria and fiscal programmes as at 31 March 2021



*Sources: Recommendation ESRB/2020/8 (reference date: 31 Mar. 2021) and ECB Statistical Data Warehouse (SDW).
Notes: Announced size refers to field 1.1.01; uptake refers to: (i) field 2.2.10 for public guarantees, public loans and direct grants; (ii) fields 2.12.10 or 2.13.10 for tax relief and tax deferrals; and (iii) field 2.14.10 for public support for credit insurance. For moratoria uptake, amount outstanding (field 2.5.10) was considered when available, and in all other cases volume accepted (field 2.2.10) was considered for non-expired measures. For the uptake of tax deferrals, only non-expired measures were considered. 2019 GDP includes all ESRB member countries. There are gaps in the data reported and results should be interpreted with caution, especially for the uptake of direct grants, tax measures and credit insurance guarantees, where reporting was not mandatory.*

The evolution of corporate debt is related to the fiscal support measures. Gross corporate bank debt correlates positively with the size and uptake of public loan and guarantee programmes (Chart 2).⁷ By contrast, solvency support like direct grant measures appears to be negatively correlated with the build-up of indebtedness (Chart 3). Pre-crisis levels of non-performing loans (NPLs) and the use of loan moratoria and public loans and guarantees tend to be positively

⁵ See Chart 1 and Table A1 in the Annex. In the third quarter of 2020, the uptake of direct grants amounted to 0.7% of 2019 GDP.

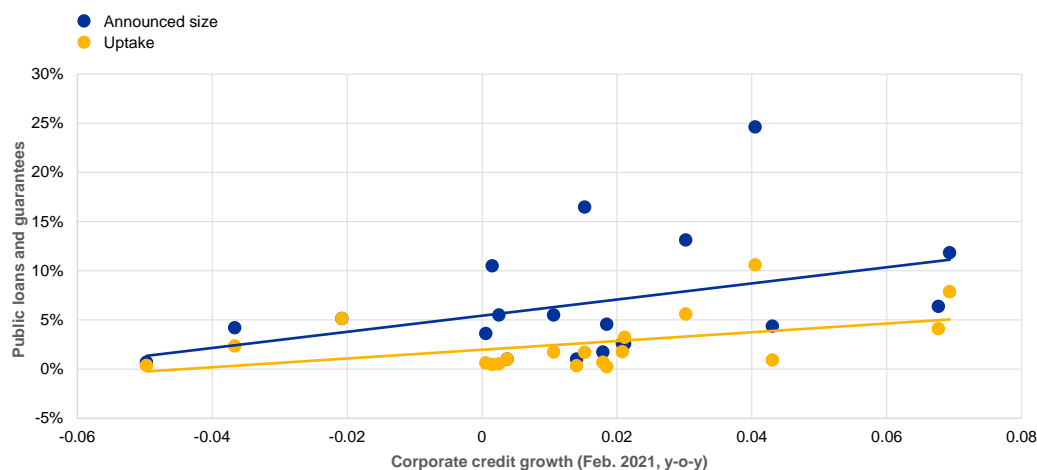
⁶ This number has been calculated by comparing data on measures collected under Recommendation ESRB/2020/8 with information on bank lending taken from AnaCredit.

⁷ The NFC gross bank debt ratio for each firm is equal to the sum of outstanding gross bank debt divided by its total assets, as reported to AnaCredit. Total assets are kept constant at the latest available data (i.e. accounting date), which are usually from 2019.

correlated (Charts 4 and 5). Countries using moratoria more extensively also tend to experience a stronger increase in gross corporate bank debt (Chart 6).

Chart 2

Gross corporate bank debt and liquidity measures

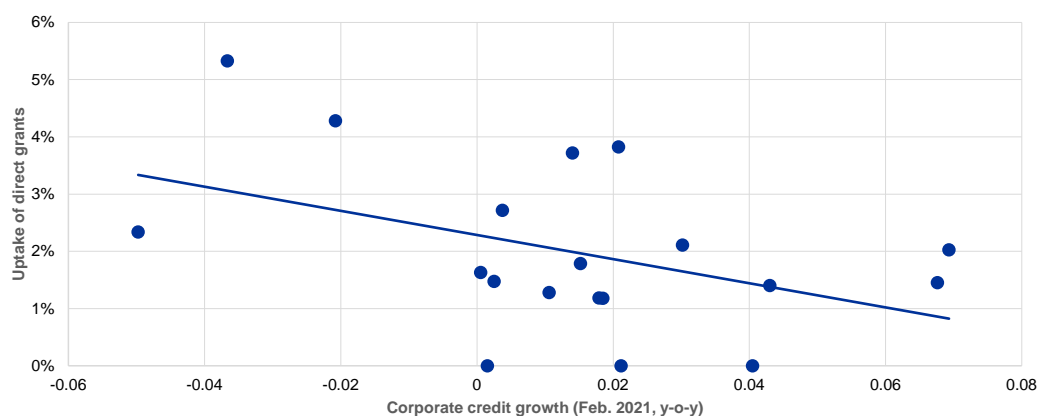


Sources: Recommendation ESRB/2020/8 by 30 Apr. 2021 (reference date: 31 Mar. 2021), ECB main aggregates of national accounts (MNA), ECB AnaCredit and ESRB calculations.

Notes: Change in NFC gross bank debt ratio (cumulated gross bank debt per firm divided by last available firm balance sheet total) from Feb. 2020 to Feb. 2021 on x-axis. Announced size (blue; field 1.1.01) and uptake (yellow; field 2.2.10) of the sum of public loans and public loan guarantees for Q1 2021 over 2019 GDP on y-axis. Based on 19 euro area (EA) countries. There are gaps in the data reported and results should be interpreted with caution. The underlying granular AnaCredit data still have quality issues and all results should be considered experimental first evidence.

Chart 3

Gross corporate bank debt and solvency measures

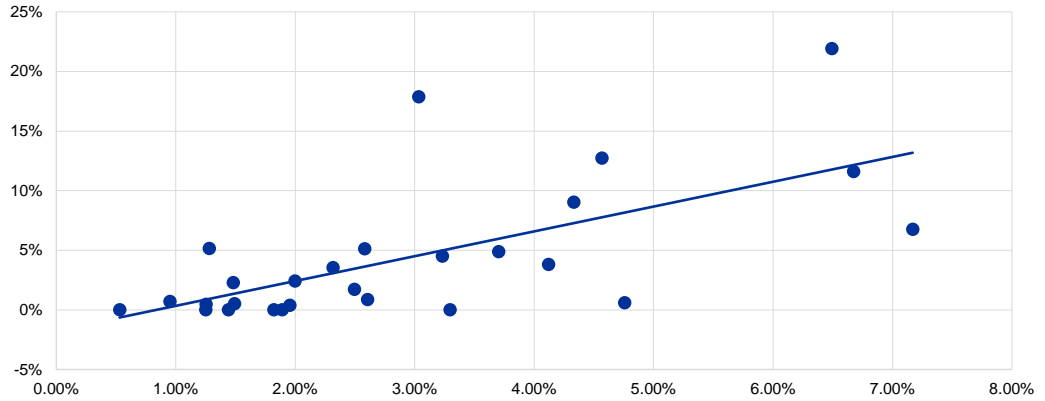


Sources: Recommendation ESRB/2020/8 by 30 Apr. 2021 (reference date: 31 Mar. 2021), ECB MNA, ECB AnaCredit and ESRB calculations.

Notes: Change in NFC gross bank debt ratio (cumulated gross bank debt per firm divided by last available firm balance sheet total) from Feb. 2020 to Feb. 2021 on x-axis. Reported uptake of direct grants for Q1 2021 over 2019 GDP on y-axis. Based on 19 EA countries. There are gaps in the data reported and results should be interpreted with caution, especially for the uptake of direct grants, where reporting was not mandatory. The underlying granular AnaCredit data still have quality issues and all results should be considered experimental first evidence.



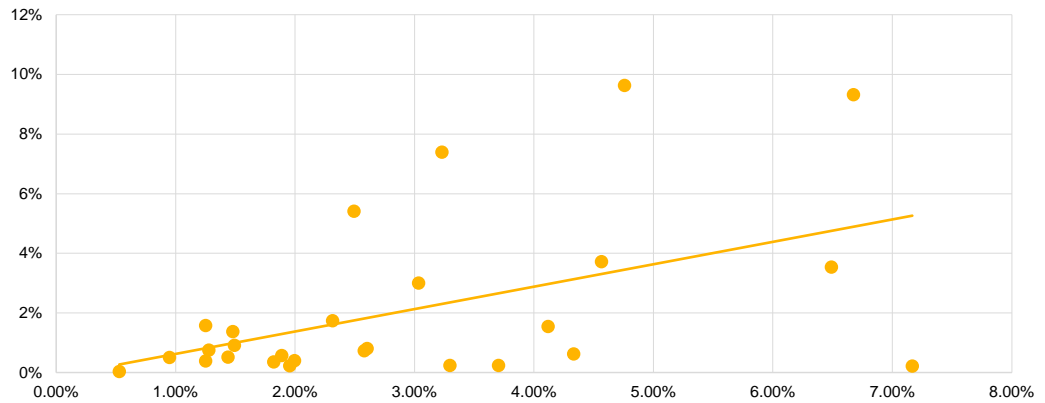
Chart 4
Pre-crisis NPL levels and uptake of moratoria



Sources: Recommendation ESRB/2020/8 (reference date: 31 Dec. 2020) and EBA.

Notes: Share of NPLs as at Q4 2019 from the EBA (x-axis) versus uptake (field 2.2.10) of moratoria as at Q4 2020 and relative to Q4 2019 GDP (y-axis). Based on 27 countries (LI excluded due to lack of EBA NPL data; CY and GR excluded as outliers for the NPL data).

Chart 5
Pre-crisis NPL levels and uptake of public loans and guarantees



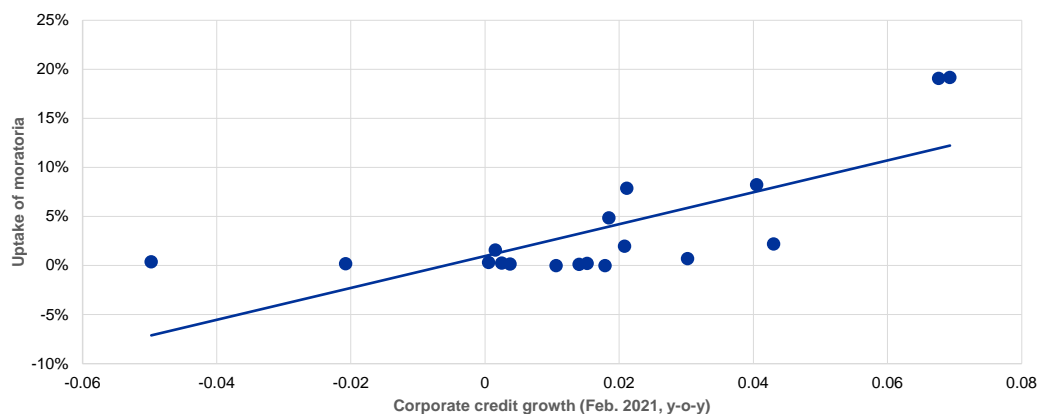
Sources: Recommendation ESRB/2020/8 (reference date: 31 Dec. 2020) and EBA.

Notes: Share of NPLs as at Q4 2019 from the EBA (x-axis) versus uptake (field 2.2.10) of public loans and guarantees as at Q4 2020 and relative to Q4 2019 GDP (y-axis). Based on 27 countries (LI excluded due to lack of EBA NPL data; CY and GR excluded as outliers for the NPL data).



Chart 6

Gross corporate bank debt and uptake of moratoria



Sources: Recommendation ESRB/2020/8 by 30 Apr. 2021 (reference date: 31 Mar. 2021), ECB MNA, ECB AnaCredit and ESRB calculations.

Notes: Change in NFC gross bank debt ratio (cumulated gross bank debt per firm divided by last available firm balance sheet total) from Feb. 2020 to Feb. 2021 on x-axis. Reported uptake of moratoria for Q1 2021 (field 2.5.10) over 2019 GDP on y-axis. Based on 18 EA countries (CY is excluded). There are gaps in the data reported and results should be interpreted with caution. The underlying granular AnaCredit data still have quality issues and all results should be considered experimental first evidence.

Tw tweaking fiscal support measures towards solvency support aimed at viable businesses could reduce the longer-run financial stability implications of the pandemic. Mitigating these financial stability risks requires a distinction between different types of firms: (i) firms with viable business models that can raise funding privately; (ii) firms with sound business models that face frictions when accessing private funding markets because of heightened debt levels and uncertainty related to the pandemic; and (iii) firms with business models that are clearly unviable. In order to target support at the different types of firms, authorities could consider using mechanisms and instruments that enable the differentiation of viable from non-viable businesses, setting up targeted (solvency) support schemes for viable firms with increased indebtedness due to the pandemic, and enabling early debt restructuring and smooth market exits for other businesses.⁸

Risks arising from higher corporate indebtedness and from potential setbacks in the economic recovery call for early debt restructuring. This would be particularly relevant for countries where vulnerable sectors and small and medium-sized enterprises (SMEs) play a prominent role. Liquidity support measures seem to be related to higher corporate indebtedness, while solvency support measures seem to mitigate its increase. These findings underline the need for early debt restructuring and suggest benefits from adjusting fiscal measures towards more targeted solvency support for viable businesses.

⁸ For suggestions on how to exit from support measures, see “**When and how to unwind COVID-support measures to the banking system?**”, Economic Governance Support Unit, European Parliament, March 2021.

2 Exposure of bank balance sheets to macroeconomic risks

Strong loan growth particularly in the early phase of the pandemic has translated into higher corporate indebtedness. Supported by liquidity measures, new bank lending to NFCs in the early stages of the crisis increased substantially (Chart 7). Lending to sectors that are strongly affected by the pandemic temporarily increased by almost 80% year on year in April 2020. Over the course of 2020, lending growth slowed down considerably, suggesting that the most urgent liquidity needs had been met. Nevertheless, the strong increase in corporate borrowing led to a significantly higher ratio of gross corporate bank debt to firms' total assets (in the following "gross bank debt ratio" for short). For the most affected sectors, the gross bank debt ratio increased from around 26% to above 31% over a one-year period across euro area countries (Chart 8). By contrast, in 2019, this ratio had remained stable at a level of around 26%. Across all sectors, the gross bank debt ratio in the euro area has grown by around 10%.⁹

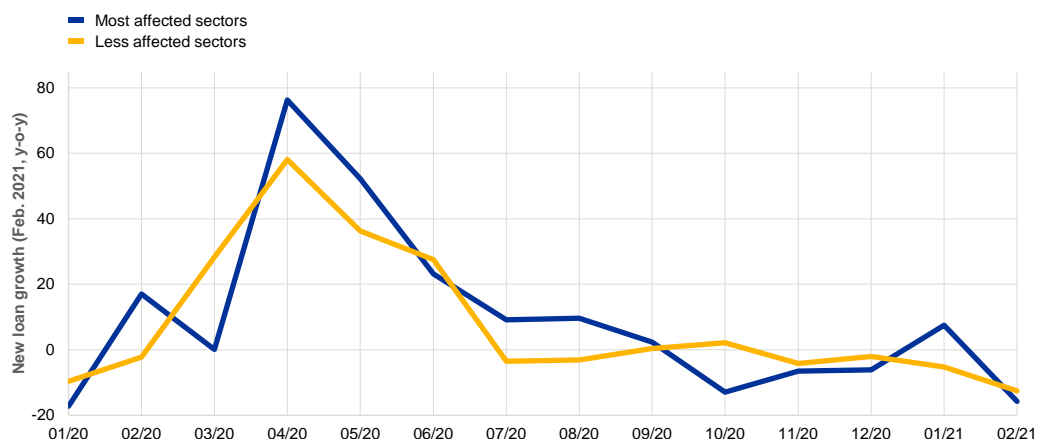
Cash positions of firms have increased considerably during the pandemic, alleviating some concerns stemming from higher indebtedness. Data on loans and deposits of banks from the MFI balance sheet statistics show that net debt of NFCs has decreased or remained stable during the crisis in many economies, in line with trends prior to the pandemic. Even though aggregate net debt for European NFCs has not yet increased, there clearly is a need to continue monitoring whether corporate indebtedness, both in gross and net terms, remains in line with economic fundamentals.

⁹ Note that the absolute levels of the gross bank debt ratio across sectors depend on the methods used to clean the data. Rather than interpreting the absolute level differences between most and less affected sectors, the focus should be on the changes over time.



Chart 7

Loan growth by exposure of sectors to the pandemic

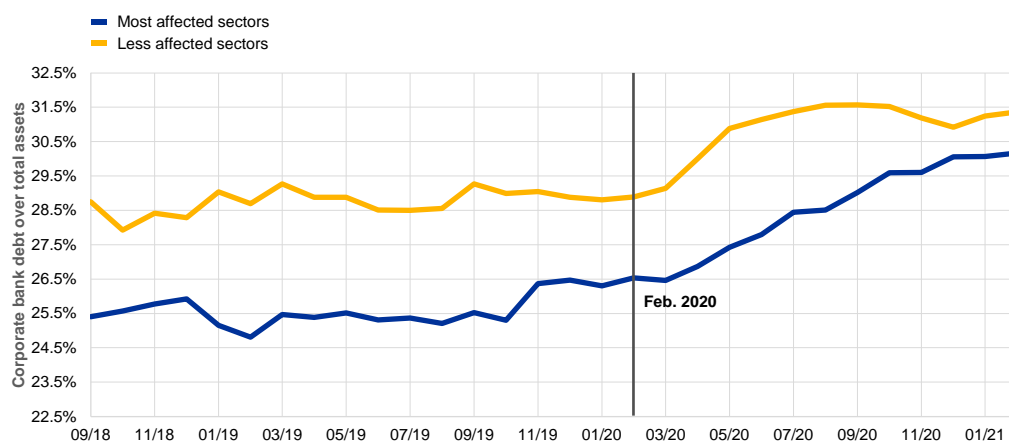


Sources: ECB AnaCredit and ESRB calculations.

Notes: Year-on-year growth rates for new loans; monthly values for Jan. 2020 to Feb. 2021. "Most affected sectors" are those identified by Eurostat to be associated with the largest decline of gross value added and hours worked. These are NACE sectors G to I (which include transport or accommodation and food service activities) and R to U (which include arts, entertainment and recreation activities). "Less affected sectors" are all others (NACE sectors A to F).

Chart 8

Gross corporate bank debt by exposure of sectors to the pandemic



Sources: ECB AnaCredit and ESRB calculations.

Notes: Graph depicts the NFC gross bank debt ratio, i.e. the sum of firms' outstanding gross bank debt divided by their total assets. "Most affected sectors" are those identified by Eurostat to be associated with the largest decline of gross value added and hours worked. These are NACE sectors G to I (which include transport or accommodation and food service activities) and R to U (which include arts, entertainment and recreation activities). "Less affected sectors" are all others (NACE sectors A to F and J to Q). The underlying granular AnaCredit data still have quality issues and all results should be considered experimental first evidence.

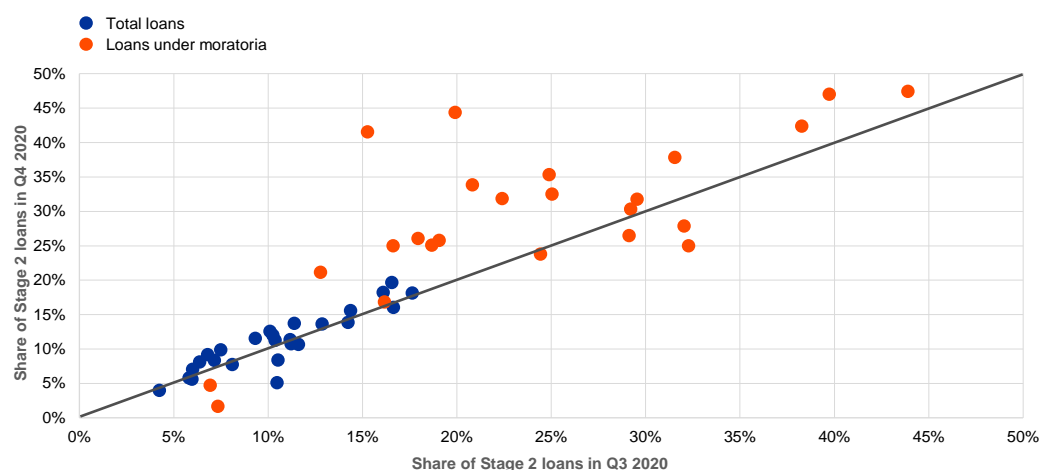
Banks are increasingly recognising higher vulnerabilities and credit risk as they are assigning higher provisions to loans under moratoria. This reflects the build-up of vulnerabilities from growing corporate indebtedness and insolvency risks. While the increase in



provisioning for loans supported by fiscal measures was rather contained up until the third quarter of 2020, data for the fourth quarter show higher increases in provisioning for loans under moratoria than for the total loan portfolio (Chart 9). Hence, banks are increasingly acknowledging risks in their loan portfolios, in line with risk management practices as well as supervisory guidelines and instruments.

The increase in credit risk due to the pandemic is becoming increasingly visible also in the probabilities of default (PDs) assigned by banks using internal models (IRB banks). In the more affected sectors, PD levels have continued to increase, compared with the pre-crisis period (Chart 10). Supervisory authorities are focusing on banks' management of credit risk and on the operational capacity to manage the expected increase in distressed borrowers. The microprudential focus is also on banks' heterogeneous exposures to vulnerable sectors, i.e. sectors that have been materially affected by the pandemic.

Chart 9
Increase in Stage 2 loans for total loans and loans under moratoria



Sources: EBA and ESRB calculations.

Notes: Share of Stage 2 loans in loans under moratoria and total loans in Q3 (x-axis) and Q4 (y-axis) 2020. Based on 26 countries (CZ, DK, IS and NO are excluded due to lack of EBA data on moratoria).

Chart 10
Change in PDs by sector



Sources: ECB AnaCredit and ESRB calculations.

Notes: Volume-weighted average PDs for debtors with new loans for Jan. 2020 (x-axis) and Feb. 2021 (y-axis) per sector; IRB approaches only. The underlying granular AnaCredit data still have quality issues and all results should be considered experimental first evidence.

While bank-level risk provisioning has increased, it may not fully reflect the overall

macroeconomic risks resulting from the pandemic. These macroeconomic risks include higher corporate indebtedness and thus higher costs of potentially rising defaults as well as slower-than-expected output growth. While current macroeconomic projections take into account the plans for the termination of fiscal measures, credit risk models used by banks may not fully capture the extent to which some sectors of the economy could still depend on fiscal support. Factors like unexpected setbacks in the vaccination campaigns and the possibility of the emergence of new virus strains add to this uncertainty.

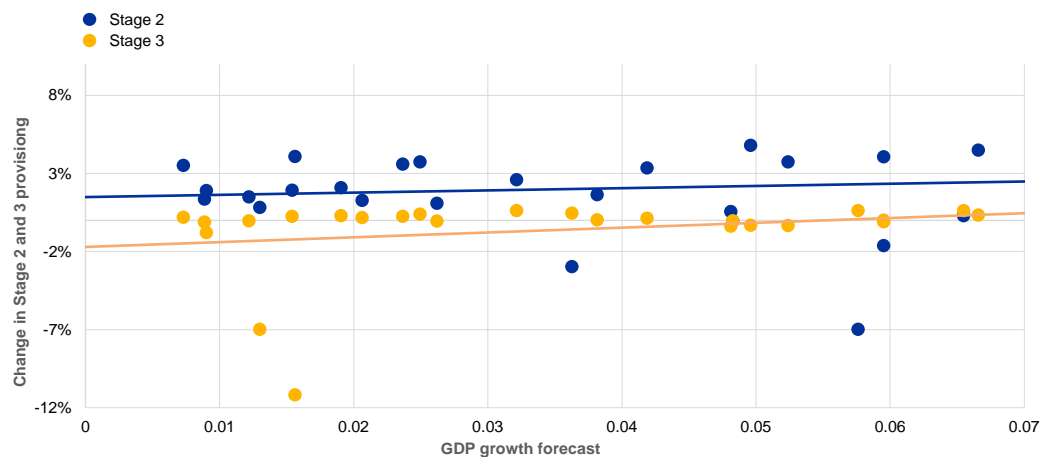
Several indicators can be used to gauge whether current and future macroeconomic risks could be underestimated.

First, one would expect a negative correlation between the speed of the recovery from the crisis and changes in risk provisioning. The longer it takes to fully recover from the crisis, the higher the potential build-up of vulnerabilities in the real economy. However, banks in countries that are expected to take longer to fully recover from the crisis are not increasing risk



provisioning by more than other banks (Chart 11).¹⁰ Second, if macroeconomic risks from higher gross corporate bank debt were more significantly reflected in risk provisioning, one should see more conversion of loans into higher expected loss stages for countries where the rise in the gross bank debt ratio has been particularly pronounced. Yet, neither Stage 2 nor Stage 3 provisioning shows a positive relationship with the increase in gross bank debt ratios (Chart 12).¹¹ Note that the increase in gross bank debt is, in part, a consequence of guaranteed loans that have mitigated liquidity risks and reduced firm defaults as well as the need for provisioning. However, if loans with public guarantee mature and they are renewed with the same characteristics except for the public guarantee, risk weights will increase, and the level of provisioning might turn out to be too low, given elevated gross bank debt ratios and high macroeconomic risks. Finally, lockdowns and other restrictions on economic activity have weighed on firm profits and net worth. Lower firm net worth coupled with higher indebtedness due to fiscal measures reduce firms' creditworthiness. Once fiscal support is withdrawn, banks might be unwilling to meet future credit demand from these firms, even though the firms might have viable business models. Heightened uncertainty about the effects of the pandemic on the solvency of firms might aggravate this effect.

Chart 11
GDP growth forecasts and change in provisioning



Sources: European Commission and EBA.

Notes: Cumulative change of GDP from 2019 to 2022, from the European Commission's Spring 2021 Forecast, on x-axis. Change in provisions for total loans from Q4 2019 to Q4 2020 on y-axis. Based on 27 countries (IS, LI and NO excluded due to lack of EBA data).

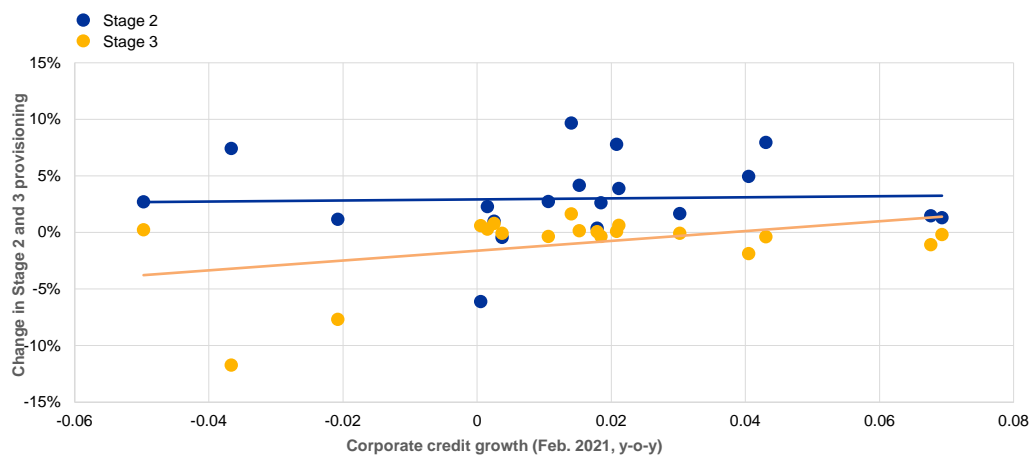
¹⁰ A very similar picture emerges when using the cumulative GDP growth until end-2021 (also from the European Commission's Spring Forecast).

¹¹ Note that the slightly positive slope of the yellow line (Stage 3 loans) in Chart 11 and Chart 12 is driven only by two outliers.



Chart 12

Gross corporate bank debt and change in provisioning



Sources: ECB AnaCredit and EBA.

Notes: Change in NFC gross bank debt ratio (cumulated gross bank debt per firm divided by last available firm balance sheet total) from Feb. 2020 to Feb. 2021 on x-axis. Change in banks' provisioning for Stage 2 (blue) and Stage 3 (yellow) loans from Q4 2019 to Q4 2020 on y-axis. Based on 19 EA countries. The underlying granular AnaCredit data still have quality issues and all results should be considered experimental first evidence.

Gauging the extent to which the macroeconomic risks related to the pandemic are being underestimated is difficult. The correlations shown above can only provide first indications. A more complete assessment should include, in an econometric approach, forecasts of economic performance, the impact of fiscal support on the longer-run viability of firms, and the commonality of banks' exposures to macroeconomic risks, among other relevant factors.

The fiscal support during the pandemic also has implications for the assessment of future credit risks. Due to the extraordinary fiscal support during the pandemic, the contraction in the real economy did not fully translate into losses on banks' balance sheets. Going forward, this may affect the reliability of risk models of banks and other market participants calibrated on historical time series in terms of detecting financial losses resulting from real economic contractions. Moreover, the increase of bank lending during the pandemic resulted in relatively little demand on bank capital as many of the new loans were covered by public guarantees: As clarified by the Basel Committee on Banking Supervision, the capital requirement for these loans should be aligned with that of the corresponding sovereign guaranteeing the loans.¹² Maintaining credit supply while public support is withdrawn would lead to increasing risk weights, and banks would need to have sufficient capital to continue extending credit to the real economy.

¹² See "Measures to reflect the impact of Covid-19", Basel Committee on Banking Supervision, April 2020.



3 Financial stability implications of phasing out fiscal measures

Many fiscal measures are now set to expire by the end of 2021. By December 2020, for example, most liquidity and solvency support was still scheduled to end in the second quarter of 2021. This deadline has been extended to take into account the evolving pandemic situation (Chart 13 and Table A2 in the Annex). Governments have thus been adjusting the fiscal support to avoid that the phase-out occurs before the economy recovers.

Support often remains in place even after the application date has expired. As regards public loans and loans with public guarantees, borrowers will benefit from the measures until the loan matures. In the case of moratoria, the termination dates do not necessarily imply that borrowers must immediately start repaying the principal, for three reasons. First, in some schemes, loans can remain under loan-specific moratoria. Second, banks and borrowers may renegotiate loan terms. Finally, borrowers may benefit from other fiscal support measures, such as furlough schemes and subsidies that allowed them to build some financial buffers. Hence, the effects of phasing out the measures (“ramp effects”) are highly contingent upon country-specific fiscal policies and institutional arrangements, which requires careful monitoring at the national level.

The duration of support measures needs to balance the risks of phasing out measures prematurely against those of maintaining them for too long. On the one hand, withdrawing support measures before the macroeconomic outlook has stabilised could significantly impair financial stability. Premature withdrawal of measures might lead to a procyclical adjustment of lending and lending rates, contribute to rising insolvencies, and trigger sudden adjustments of asset prices. Loan losses may increase and put pressure on banks’ equity capital. On the other hand, financial stability risks may gradually build up if support measures remain in place for too long. Resource allocation and asset prices may be distorted, moral hazard may increase, and the necessary structural adjustment may be postponed. This would increase vulnerabilities in the financial sector through deteriorating credit quality. Moreover, the longer debt-related support measures remain in place, the greater concerns about firms’ debt overhang, which would depress investment and growth.¹³

While the risks from a sudden phase-out of measures at the current juncture seem less acute, maintaining support for too long has risks of its own, including delayed economic restructuring. In this context, the ESRB note on insolvencies highlights three main findings.¹⁴ First, the primary goal for Member States must be to create the right conditions for successful debt

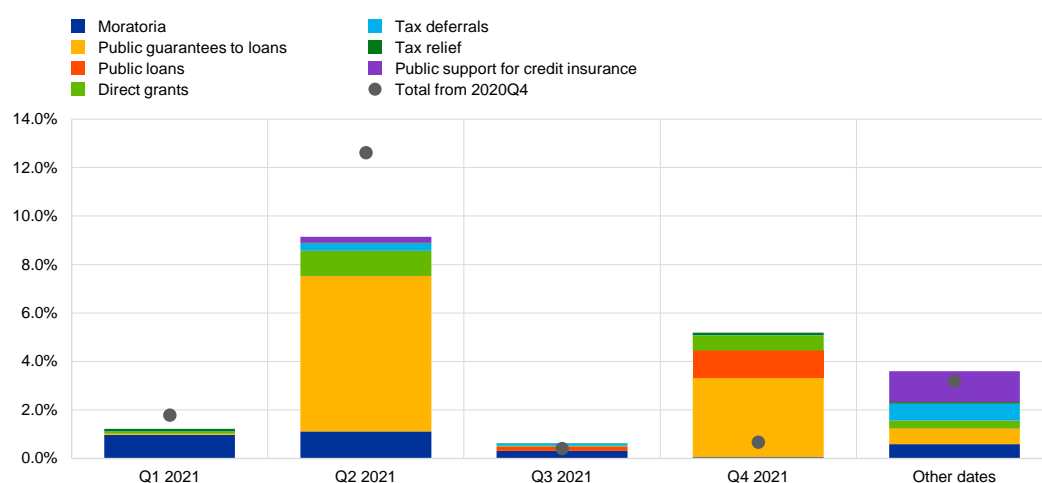
¹³ See also “**Covid-19 support measures – Extending, amending and ending**”, Financial Stability Board, April 2021, for a more in-depth discussion on the different trade-offs faced by policymakers.

¹⁴ See “**Prevention and management of a large number of corporate insolvencies**”, ESRB, April 2021.



restructuring. Second, under the European Commission's State Aid Temporary Framework, loan guarantees and public loans can be converted into grants. This could be a way of providing solvency support in a targeted and cost-effective way to fundamentally viable companies that might otherwise have to be wound up due to the debt overhang accumulated during the pandemic. Finally, for those companies that are found to be unviable in the post-COVID-19 economy, efficient insolvency procedures are crucial.

Chart 13
Breakdown of the termination of measures in 2021 and beyond (% of 2019 GDP)



Sources: Recommendation ESRB/2020/8 (reference date: 31 Mar. 2021) and ECB SDW.

Notes: Values reported as a percentage of 2019 GDP of ESRB member countries, by measure; amounts refer to programme size announced by the government, field 1.1.01 (except for moratoria, for which total volume accepted – field 2.2.10 – was used). "Other dates" include dates beyond 2021 and measures for which no termination date is available. 2019 GDP includes all ESRB member countries. There are gaps in the data reported and results should be interpreted with caution, especially for direct grants, tax measures and credit insurance guarantees, where reporting was not mandatory.

Assessing whether the expiration of measures remains aligned with the economic recovery is important.

According to the latest European Commission projections for the European Union, the pace of recovery across Member States is likely to be uneven.¹⁵ This wide dispersion of recovery reflects country-specific economic structures, including the relative importance of tourism and leisure activities, the degree of openness, the strength and design of economic policy responses, and other institutional features. Economic forecasts assume that COVID-19 support measures put in place by national governments will be unwound in 2022, while there will be strong support resulting from the Recovery and Resilience Facility plans.

¹⁵ See "Spring 2021 European Economic Forecast", European Commission, May 2021.



4 Governments' responses to increased firm-level indebtedness

Preventing insolvencies of distressed but fundamentally viable companies is crucial for preserving economic and financial stability. The ESRB Report on insolvencies¹⁶ argues that the policy mix needs to evolve from liquidity towards more (targeted) solvency support for viable firms in order to contain systemic risk. It identifies four potential policy actions to mitigate the destabilising impact of corporate insolvencies and to support a swift and sustainable economic recovery:

- emergency liquidity support schemes during lockdowns (system-wide);
- solvency support schemes to compensate for losses (more targeted, e.g. sector-wide);
- debt restructuring and/or equity injections to repair balance sheets of companies with viable business models (individual companies);
- efficient insolvency procedures to ensure that non-viable firms are swiftly wound down and resources can be reallocated to productive uses (individual companies).

In March 2021, the ESRB conducted a survey on how governments plan to adjust fiscal measures going forward to address potential negative effects of corporate insolvencies. The qualitative results of the survey together with the usual quantitative reporting on the use of measures show that adjustments are taking place. Yet, information on debt restructuring and expectations about the evolution of insolvencies remain fragmented.

The uptake of both solvency and liquidity measures keeps increasing. While new solvency measures, such as direct grants, tax relief or quasi-equity loans, potentially reduce firm indebtedness, a higher uptake of liquidity measures potentially increases indebtedness. While both types of measures are seeing growing uptake (Table A1), there is no clear trend towards solvency-enhancing measures by firms. Moreover, there is little explicit conversion of liquidity measures into solvency measures.

Almost half of the ESRB member countries have reported that there was a clear adjustment to make solvency measures more targeted. Most countries are focusing on a more targeted use of direct grants. It is worth noting that some liquidity measures are also being more targeted, by extending them only to certain NFCs or by creating new schemes. Several countries mentioned that their measures have been targeted at the most affected sectors since the beginning. The survey also shows that in most countries, the phase-out of measures is being closely monitored.

¹⁶ See "**Prevention and management of a large number of corporate insolvencies**", ESRB, April 2021.

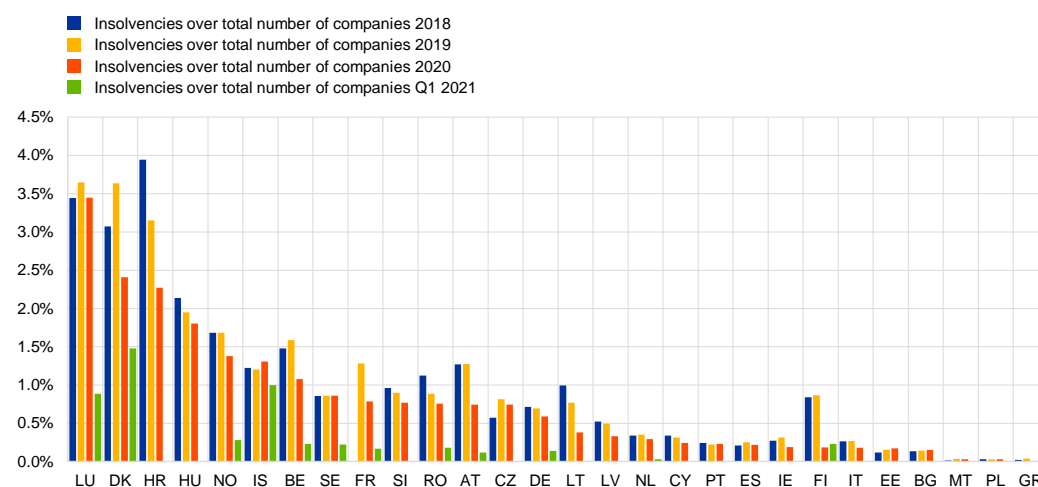
Debt restructuring will be needed to repair the balance sheets of corporates with viable business models.

Less than half of the member countries have evidence that banks are engaging with clients in order to restructure loans ahead of the expiration of moratoria. Some authorities mention that in cases where loan moratoria have expired there were no major issues; others mention some increase in forbearance. Regarding the phase-out of all measures, only some countries reported that banks are preparing for debt restructuring ahead of the expiry of fiscal support.

Member countries largely expect insolvencies to gradually return to pre-crisis levels in 2021, rather than a large increase in insolvencies (Chart 14).

In 2020, insolvencies decreased significantly due to temporary suspensions of notifications, either through insolvency moratoria or the closure of courts. Only a few authorities expect large increases in insolvencies in 2021 and 2022.

Chart 14
Evolution of insolvencies across ESRB countries



Sources: Recommendation ESRB/2020/8 (number of insolvencies in 2018-20), Haver and Trading Economics (number of insolvencies in Q1 2021) and Eurostat (number of companies in 2018).

Given the increase in gross corporate debt, preventive restructuring and efficient court procedures for insolvent firms remain important.

When asked about changes to the legal framework for restructuring that could help mitigate the effects of a large increase in insolvencies, only some member countries mentioned that they have already implemented specific reforms



(other than those deriving from the 2019 Restructuring Directive¹⁷). Some of these reforms take into account the specific characteristics of SMEs.

¹⁷ See **Directive (EU) 2019/1023 of the European Parliament and of the Council of 20 June 2019 on preventive restructuring frameworks, on discharge of debt and disqualifications, and on measures to increase the efficiency of procedures concerning restructuring, insolvency and discharge of debt, and amending Directive (EU) 2017/1132 (Directive on restructuring and insolvency)**.



5 Conclusions

Fiscal measures have played an important role in stabilising the economy and bank lending during the COVID-19 pandemic. These measures have complemented monetary policy measures providing liquidity to the economy as well as supervisory and macroprudential measures that have relaxed balance sheet constraints. The unprecedented support and the reduction of containment measures in response to lower infections have helped the economy regain speed. Notwithstanding, risks to the economic outlook remain, and levels of debt – both private and public – have risen during the pandemic. The resulting vulnerabilities in the financial sector, in particular in countries and sectors with pre-crisis vulnerabilities, call for a sufficient amount of resilience.

Containing financial stability risks due to vulnerabilities in the corporate and financial sectors requires attention. In the non-financial sector, higher levels of gross corporate debt require a distinction between viable and unviable firms. For firms which are in principle viable, more targeted solvency support should be considered. For firms facing more structural problems, mechanisms for early debt restructuring and efficient insolvencies proceedings are needed. At the current juncture, a sudden increase in corporate insolvencies seems less likely than expected during the earlier phases of the pandemic. Still, fiscal support should be phased out only gradually.

As regards the financial sector, banks may still need to increase their awareness of macroeconomic risks. Banks are increasingly provisioning for individual balance sheet risks. Yet, at the country level, there is virtually no correlation between provisioning on the one hand and corporate indebtedness and the pace of economic recovery as proxies for macroeconomic risks on the other hand. This is all the more important because the contraction in the real economy may not have been fully translated into losses on banks' balance sheets. Generally, the link between economic and financial losses has been weakened during the pandemic, given the extraordinary fiscal support. Risk models used by banks and other market participants thus need to acknowledge that correlations between real and financial risks in data spanning the pandemic might yield a misleading picture of future risks.

Finally, policy responses need to account for heterogeneities across countries and sectors and the risk of setbacks to the economic recovery. In response to the initial shock, all Member States swiftly announced and implemented large support measures. Going forward, differences in sectoral structures, in the pace of economic recovery and in countries' pre-existing vulnerabilities require diverging policy responses. This also affects the timing of shifting from the crisis management to the prevention mode. If this can be accomplished, negative long-run consequences of the COVID-19 pandemic for financial stability may be avoided.



Annex

Table A1

Announced size and uptake of moratoria and fiscal programmes as at 31 March 2021

	Q1 2021 (EUR billions)		Q1 2021 (% of 2019 GDP)		Q4 2020 to Q1 2021 (quarterly change in EUR billions)		Q4 2020 to Q1 2021 (quarterly % change)	
	Uptake	Announced size	Uptake	Announced size	Uptake	Announced size	Uptake	Announced size
Moratoria	343		2.4%		-134		-28.1%	
Public guarantees	507	1,549	3.6%	10.9%	46	18	10.0%	1.2%
Public loans	87	204	0.6%	1.4%	8	2	9.9%	0.9%
Direct grants	223	429	1.6%	3.0%	87	114	64.1%	36.3%
Tax deferrals	96	183	0.7%	1.3%	-10	15	-9.6%	9.1%
Tax relief	37	77	0.3%	0.5%	3	2	7.7%	2.5%
Public support for credit insurance	37	216	0.3%	1.5%	33	0	798.4%	0.0%
Total fiscal measures	987	2,658	6.9%	18.7%	166	151	20.3%	6.0%
Total support (incl. loan moratoria)	1,329		9.3%		33		2.5%	

Sources: Recommendation ESRB/2020/8 (reference date: 31 Mar. 2021) and ECB SDW.

Notes: Announced size refers to field 1.1.01; uptake refers to: (i) field 2.2.10 for public guarantees, public loans and direct grants; (ii) fields 2.12.10 or 2.13.10 for tax relief and tax deferrals; and (iii) field 2.14.10 for public support for credit insurance. For moratoria uptake, amount outstanding (field 2.5.10) was considered when available, and in all other cases volume accepted (field 2.2.10) was considered for non-expired measures. For the uptake of tax deferrals, only non-expired measures were considered. 2019 GDP includes all ESRB member countries. There are gaps in the data reported and results should be interpreted with caution, especially for the uptake of direct grants, tax measures and credit insurance guarantees, where reporting was not mandatory.



Table A2

Breakdown of the termination of measures in 2021 and beyond

Measure type	(% of 2019 GDP)				
	Q1 2021	Q2 2021	Q3 2021	Q4 2021	Other dates
Moratoria	0.96%	1.12%	0.31%	0.05%	0.58%
Public guarantees	0.04%	6.39%	0.00%	3.29%	0.63%
Public loans	0.01%	0.02%	0.19%	1.11%	0.02%
Direct grants	0.09%	1.04%	0.02%	0.62%	0.33%
Tax deferrals	0.00%	0.30%	0.09%	0.00%	0.70%
Tax relief	0.11%	0.03%	0.01%	0.10%	0.07%
Public support for credit insurance		0.25%			1.27%
Total fiscal measures	0.26%	8.03%	0.31%	5.13%	3.00%
Total support (incl. loan moratoria)	1.22%	9.15%	0.62%	5.18%	3.59%
Memo (as at Q4 2020):					
Total fiscal measures	0.80%	11.52%	0.09%	0.63%	2.65%
Total support (incl. loan moratoria)	1.78%	12.62%	0.40%	0.66%	3.19%

Sources: Recommendation ESRB/2020/8 (reference date: 31 Mar. 2021) and ECB SDW.

Notes: Values reported as a percentage of 2019 GDP of ESRB member countries, by measure; amounts refer to programme size announced by the government, field 1.1.01 (except for moratoria, for which total volume accepted – field 2.2.10 – was used). “Other dates” include dates beyond 2021 and measures for which no termination date is available. 2019 GDP includes all ESRB member countries. There are gaps in the data reported and results should be interpreted with caution, especially for direct grants, tax measures and credit insurance guarantees, where reporting was not mandatory.



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The cut-off date for the data included in this report was 31 March 2021, unless an earlier date is indicated.

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