What Policy Combinations Worked? Bank Lending during COVID-19

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COVID-19: An unprecedented shock

A. Revisions in expected real GDP growth in 2020-2021 relative to 2019

B. Quarterly credit growth

Source: IMF World Economic Outlook Database; S&P Global Market Intelligence, and authors' calculations.
Countries introduced many policies in response to Covid-19

Number of economic and financial policies announced daily

- New comprehensive announcement-level panel dataset (Kirti et al., 2022)
- Details on 28 granular policies adopted by 74 countries during 2020
  - Covering fiscal, monetary, and prudential policies
  - Information on sizes where available
- About 5,500 policy measures were announced

Source: Kirti et al. (2022), and authors’ calculations.
Countries announced policies in packages

Composition of country policy announcements

- Standalone announcements were rare
  - Few cases of “only prudential” or “only monetary” or “only fiscal”
- Combinations of fiscal, monetary, and prudential policies were observed frequently

Source: Kirti et al. (2022), and authors’ calculations.
Investigate how policy packages affected bank lending

- Bank-level quarterly data for about 1,500 banks in 49 countries

- Cross-country bank-level regressions:

\[
\Delta \ln(L)_{b,c,q} = \alpha P_{c,q-1} + \delta \text{Country controls}_{c,q} + \gamma X_{b,q} + \beta_b + \varepsilon_{b,c,q} \tag{1}
\]

- \(\Delta \ln(L)_{b,c,q}\): q-on-q log change in lending by bank \(b\) in country \(c\) during quarter \(q\)
- \(P_{c,q-1}\): dummies capturing policy packages
- Country-time controls: de facto mobility, health developments, expected economic shock, financial stress
- \(X_{b,q}\): Bank-level controls including size, capitalization, loan and funding ratios
- \(\beta_b\): bank fixed effects
- Sample period: 2020Q1-2021Q1
“All-out” approach was most effective

Effect of policy packages on bank credit

Source: Kirti et al. (2022), IMF World Economic Outlook Database; S&P Global Market Intelligence, and authors’ calculations.
Going big on both scope and size was important

Effect of policy packages on bank credit (less stringent definition of large policies)

Source: Kirti et al. (2022), IMF World Economic Outlook Database; S&P Global Market Intelligence, and authors’ calculations.
Additional results and robustness

- All-out approach more effective for constrained banks

- All-out response more important for large shocks

- Robustness
  - Findings are driven by packages of all three types of policies announced within the same week, not just in the same quarter
  - Findings do not appear to be driven by base effects
COVID experience shows value of going all out

- Packages combining large fiscal, monetary, and prudential policies supported higher bank credit growth

- All-out approach likely to act by
  - Shifting banks’ incentives to lend at the margin
  - Easing binding constraints and providing capacity to lend
  - Raising borrower demand for credit

- All-out approach most effective for
  - More capital constrained banks
  - Very large economic shocks

- Replicating this approach for future shocks would require coordination across fiscal authorities, central banks, and regulators