Liquidity Support to Businesses

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Phakawa Jeasakul
MCM
Corporate Liquidity and Solvency Stress

- The pandemic has caused both liquidity and solvency problems
  - Financially strong
  - Solvent but illiquid
  - Insolvent

- In order to stay alive, viable firms still need liquidity for:
  - Working capital
  - Financial obligations
### Policy Measures to Support Businesses

<table>
<thead>
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<th>Policy objective</th>
<th>Measures</th>
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<tbody>
<tr>
<td>Saving jobs</td>
<td>• <strong>Subsidize wages</strong> of furloughed workers</td>
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| Maintaining business viability | • *Reduce financial burden*: tax relief, grants, debt forgiveness  
   • *Inject equity* (as part of restructuring; in the national interest)  
   • *Restructure debt and business*: effective legal framework and efficient administrative/judicial systems to facilitate bankruptcy and debt restructuring; lenders’ proper asset classification and loss provisioning; well-functioning markets for bad assets; labor market flexibility |
| Alleviating liquidity pressures | • *Provide liquidity support*  
   - *Mitigate credit risk*: credit guarantees, risk sharing with lenders (e.g., acquisition of loans off lenders’ balance sheet)  
   - *Provide financing*: term funding at subsidized costs  
   - *Apply regulatory flexibility* as embedded in prudential requirements  
   • *Postpone payments*: repayment moratorium, tax payment deferral, debt restructuring (i.e., repayment schedule modification) |
Lenders Become Unable or Unwilling to Lend

- Credit risk has increased
- Lenders face funding constraints
- Lenders face capital constraints
Lenders Become Unable or Unwilling to Lend

- Credit risk has increased
  - Governments share credit risk of new lending

- Lenders face funding constraints
  - Central banks ease monetary conditions and support core funding markets
  - Central banks provide term funding to banks

- Lenders face capital constraints
  - Release of macroprudential buffers
  - Regulatory flexibility
How to Provide Liquidity Support to Businesses

Are business viable?

Yes

Do business face liquidity problems?

Yes

Provide liquidity support (in addition to repayment moratorium and tax deferral)

No

Reduce financial burden; inject equity; or restructure debt and business

Credit intermediation is not impaired, potentially supported by:
- Monetary policy easing
- Lenders’ strong capital and funding positions
- Functioning funding markets, benefiting from the central bank’s liquidity provision

Relying on lenders’ balance sheet

- Credit risk mitigation: credit guarantees provided by the government or policy banks
- Financing: in addition to available market funding, the central bank could provide term funding; funding could also be subsidized (including by the government)

Creating SPVs

- Credit risk mitigation: risk sharing by SPVs’ acquisition of loans off lenders’ balance sheet
- Financing: the central bank can finance SPVs that need to be backstopted by the government; the central bank should not bear credit risk
How to Provide Liquidity Support to Businesses

Relying on lenders’ balance sheet

- Credit risk mitigation:
  - Credit guarantees provided by the government or development banks
- Financing:
  - In addition to available market funding, the central bank could provide term funding
  - Funding could be subsidized

Creating SPVs

- Credit risk mitigation:
  - Risk sharing by SPVs’ acquisition of loans off lenders’ balance sheet
- Financing:
  - The central bank could finance SPVs backstpped by the government
Important Aspects for Designing Liquidity Support Schemes

- **Credit risk mitigation**: Government’s responsibility
- **Risk sharing mechanisms**: Lenders should bear some credit risk
- **Eligibility criteria**: Firms should be solvent but have liquidity problems
- **Financing terms**: Generous to support firms through the crisis in terms of maturity, repayment schedule, and interest rate
- **Funding sources**: Central bank can help
- **Prudential treatment**: Relaxing lenders’ capital constraints
- **Exit strategy**: Time-bounded

- **Considerations**: effective support vs. moral hazard vs. administrative/logistics burdens
Coordination is key for a successful liquidity support scheme

- **Government**
  - Should cover credit losses arising from the scheme
  - Recognize fiscal costs and risks

- **Central bank**
  - Should finance the scheme if consistent with its mandate
  - Safeguard central bank independence and credibility

- **Financial sector authorities**
  - Should maintain lenders’ strong balance sheets
  - Could apply regulatory flexibility where appropriate