Liquidity Support to Businesses

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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

Policy objective	Measures
Saving jobs	• *Subsidize wages* of furloughed workers
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)

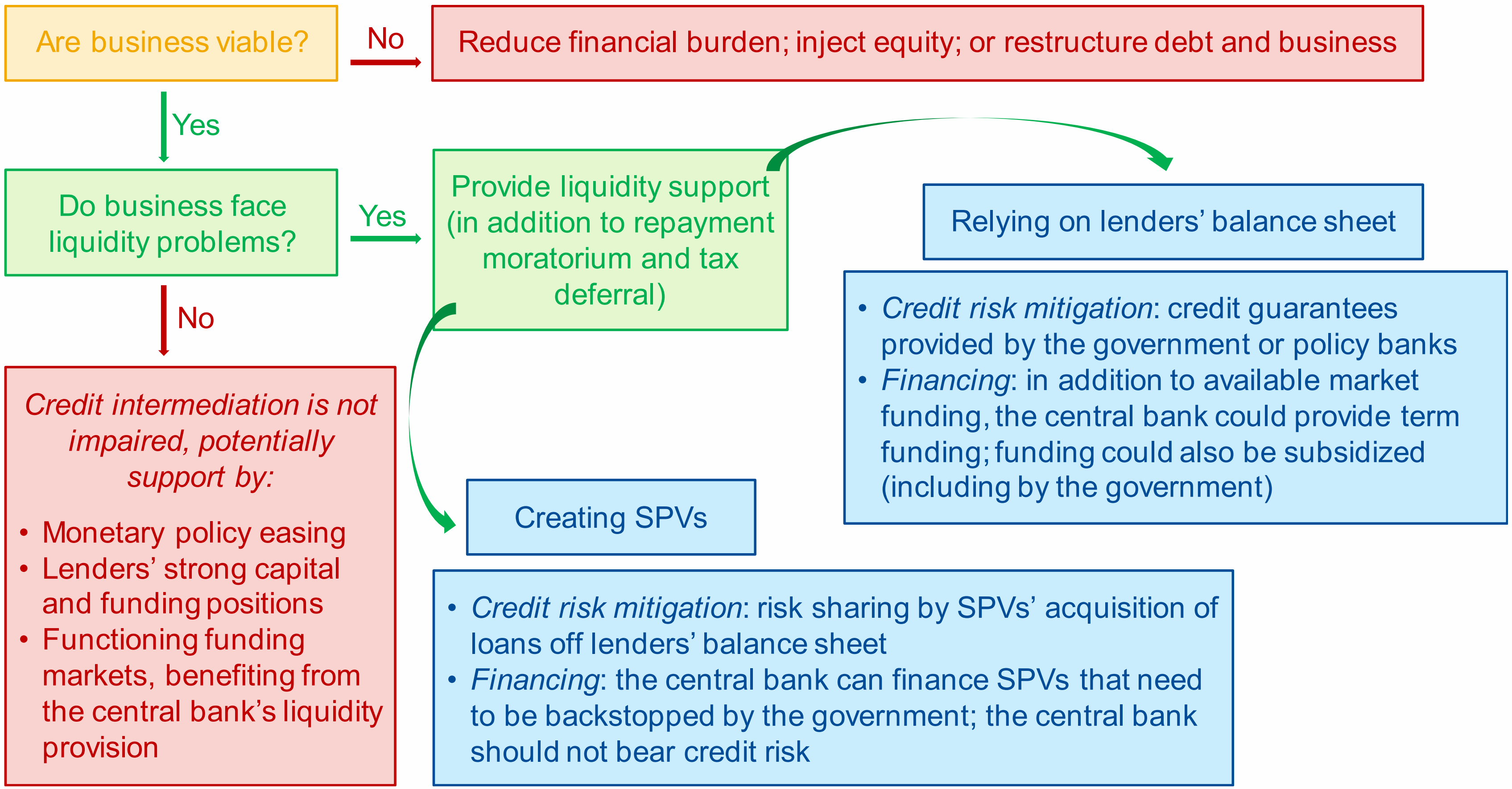
Lenders Become Unable or Unwilling to Lend

- 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



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 backstopped 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