Marja Nykänen: How can banks help Covid-19 resilience and recovery?

Keynote speech by Ms Marja Nykänen, Deputy Governor of the Bank of Finland, at the Sustainable Investment Forum Europe 2021, virtual, 22 April 2021.

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Ladies and gentlemen!

It is an honour to be invited to give this keynote speech on such an important topic in such an interesting forum.

Last spring, giving a virtual keynote speech in an online conference was something new and exciting. Today, over a year later, it is not like that anymore. Hopefully, it won't be too long before we get back to a bit more of a normal situation again.

Today, in this virtual contribution, I will be talking first about the reaction of the authorities to the economic shock from the COVID-19 pandemic. Then I will talk about how banks have been a part of the solution. Finally, I will conclude by looking at the future and talk about how increasing the role of the capital markets can help to increase the resilience of the EU economy.

Central Banks, Supervisors and public authorities support bank lending

In the early spring of 2020, the effects of COVID-19 started to become clearer, and, for a brief moment, it seemed as if the economy would go into freefall. However, the public authorities responded swiftly and decisively in order to minimize the social and economic costs of the pandemic and the lockdowns.

Central banks were among the first responders, with the ECB pandemic emergency purchase programme, PEPP, now standing at 1,850 billion euro. In addition, the ECB has been offering a significant amount of financing to banks through targeted longer-term refinancing operations.

Fiscal authorities around the world made emergency payments and gave support for companies and households. The EU even reached an agreement where the EU itself would secure 750 billion euro from the markets and distribute it among the Member States.

In addition to direct financing, countries in Europe made changes to insolvency laws to prevent companies going bankrupt. In several countries a moratorium was put in place to help households and companies with debt repayments. Furthermore, public guarantees were extended to bank loans to ensure that companies could attain credit.

Supervisors used the flexibility built into the legislative framework and relaxed the available capital buffers, further enabling banks to keep lending. And these are just some of the examples of how the public sector has supported the economy amid COVID-19.

Banks have been part of the solution

The banks have seized the opportunity given by supervisors, central banks and the public authorities to maintain their lending to the real economy. By enabling access to funding, banks have allowed companies in the real economy to keep people on their payroll despite the uncertainty.

At the same time, public support to households, companies – especially SMEs – and the moratoria have kept delinquencies at a record low in many countries. This has meant that bank balance sheets have not seen an increase in NPLs as one would have assumed given the economic shock.

But history has shown that there is a lag between an economic shock and the associated insolvencies. In this crisis, given the moratoria and other public support measures, it is to be expected that this lag might be longer than in previous crises.

Thus, it is premature to extrapolate the future losses in this crisis from the credit losses so far. And, therefore, it is imperative that banks maintain prudent capital positions to maintain their resilience and to ensure that this crisis will not become a banking crisis.

Because of this, it is a bit disappointing to see that few banks are not heeding the supervisors' recommendation to restrict dividends for the time being.

This behaviour is unfortunate for two reasons. Firstly, it dilutes the banks' capital buffers, thus making them more susceptible to any future deterioration in economic conditions. This will increase the risks to financial stability.

Secondly, such behaviour may even seem like profiteering from the crisis. A better than expected situation in any bank now is not due to the excellent business skills or risk management at the bank, but is more of a windfall from the multi-trillion euro of public support.

In future, the capital markets will play a role in sustainable finance by complementing bank lending

Once again, this crisis has shown the extent of Europe's dependency on banks to provide funding for the real economy. Now, don't get me wrong, we need banks and their role will still be critical in the future. But it is time to turbocharge the development of the Capital Markets Union, the CMU.

The CMU would provide complementary funding sources for companies, especially in turbulent times when banks are not able to lend as much as needed. Furthermore, the capital markets could allow riskier companies to attain funding, as bank loans are not suited for all.

The CMU would also allow banks to attain funding, securitize their loans and sell them to investors. This could have the potential to distribute risks more evenly across countries, thus absorbing future shocks. Furthermore, active capital markets require banks to act as intermediaries, thus it could provide stable or even a countercyclical source of revenue for banks.

It is also critical that we build back better after COVID-19, focusing on environmental sustainability and helping the EU and Member States to transition to climate neutrality by 2050. The capital markets would enable different types of green instruments to be developed to help towards this goal.

And, as the current crisis has shown, there are ample opportunities for Member States and the EU to issue social bonds that can help to build more inclusive and equitable societies. Efficient and liquid capital markets could provide a solid foundation for extending this.

To conclude

The public authorities' role in helping society cope with the economic impacts of the COVID-19 pandemic has been significant.

Most EU banks have understood the gravity of the situation and have continued to provide funding to households and companies while at the same time preserving prudent capital positions.

Going forward, we need to increase the role of the capital markets to enhance the resilience of our economies. For this we need the CMU, which could help the EU to become socially, environmentally and economically more sustainable. I think it is a goal worth pursuing.