COVID-19: Key measures taken by governments and central banks

Economic Research

How Global Central Banks are Responding to COVID-19

When times get tough, central banks typically act as the first line of defense. However, modern economies are incredibly complex—and mishaps like the 2008 financial crisis have already pushed traditional policy tools to their limits. In response, some central banks have turned to newer, more unconventional strategies such as *quantitative easing* and *negative interest rates* to do their work. In response to the COVID-19 pandemic, central banks are once again taking decisive action. To understand what's being done, this analysis is referring to the International Monetary Fund (IMF) latest webinars and other relevant sources to compare the policy responses of 29 systemically important economies and also Armenia's current situation and the action plan.

The Central Bank Toolkit

To begin, here are brief descriptions of each policy, which the IMF sorts into four categories:

1. Monetary Policies

Policies designed to control the money supply and promote stable economic growth.

Policy Name	Intended Effect
Policy rate cuts	Stimulates economic activity by decreasing the cost of borrowing
Central bank liquidity support	Provides distressed markets with additional liquidity, often in the form of loans
Central bank swap lines	Agreements between the U.S. Fed and foreign central banks to enhance the provision of U.S. dollar liquidity
Central bank asset purchase schemes	Uses newly-created currency to buy large quantities of financial assets, such as government bonds. This increases the money supply and decreases longer-term rates

2. External Policies

Policies designed to mitigate the effects of external economic shocks.

Policy Name	Intended Effect
Foreign currency intervention	Stabilizes the national currency by intervening in the foreign exchange market

Capital flow measures	Restrictions, such as tariffs and volume limits, on the flow of foreign capital in and out of a country

3. Financial Policies for Banks

Policies designed to support the banking system in times of distress.

Policy Name	Intended Effect
Easing of the countercyclical capital buffer	A reduction in the amount of liquid assets required to protect banks against cyclical risks
Easing of systemic risk or domestic capital buffer	A reduction in the amount of liquid assets required to protect banks against unforeseen risks
Use of capital buffers	Allows banks to use their capital buffers to enhance relief measures
Use of liquidity buffers	Allows banks to use their liquidity buffers to meet unexpected cash flow needs
Adjustments to loan loss provision requirements	The level of provisions required to protect banks against borrower defaults are eased

4. Financial Policies for Borrowers

Policies designed to improve access to capital as well as provide relief for borrowers.

Policy Name	Intended Effect
State loans or credit guarantees	Ensures businesses of all sizes have adequate access to capital
Restructuring of loan terms or moratorium on payments	Provides borrowers with financial assistance by altering terms or deferring payments

1. Monetary Policies

So far, many central banks have enacted expansionary monetary policies to boost slowing economies throughout the pandemic.

One widely used tool has been policy rate cuts, or cuts to interest rates. The theory behind rate cuts is relatively straightforward—a central bank places downward pressure on short-term interest rates, decreasing the overall cost of borrowing. This ideally stimulates business investment and consumer spending.

If short-term rates are already near zero, reducing them further may have little to no effect. For this reason, central banks have leaned on asset purchase schemes (*quantitative easing*) to place downward pressure on longer-term rates. This policy has been a cornerstone of the U.S. Federal Reserve's (Fed) COVID-19 response, in which newly created currency is used to buy hundreds of billions of dollars of assets such as government bonds.

When the media says the Fed is "printing money", this is what they are actually referring to.

2. External Policies

External policies were less relied upon by the systemically important central banks.
That is because foreign currency interventions, central bank operations designed to influence exchange rates, are typically used by developing economies only. This is likely due to the higher exchange rate volatility experienced by these types of economies.

For example, as investors flee emerging markets, Brazil has seen its exchange rate (BRL/USD) tumble 30% this year.

In an attempt to prevent further depreciation, the Central Bank of Brazil has used its foreign currency reserves to increase the supply of USD in the open market. These measures include purchases of **$8.8B** in USD-denominated Brazilian government bonds.

3. Financial Policies for Banks

Central banks are often tasked with regulating the commercial banking industry, meaning they have the authority to ease restrictions during economic crises.

One option is to ease the countercyclical capital buffer. During periods of economic growth (and increased lending), banks must accumulate reserves as a safety net for when the economy eventually contracts. Easing this restriction can allow them to increase their lending capacity.
The European Central Bank (ECB) is a large proponent of these policies. In March, it also allowed its supervised banks to make use of their **liquidity buffers**—liquid assets held by a bank to protect against unexpected cash flow needs.

4. Financial Policies for Borrowers

Borrowers have also received significant support. In the U.S., government-sponsored mortgage companies Fannie Mae and Freddie Mac have announced several COVID-19 relief measures:

- Deferred payments for 12 months
- Late fees waived
- Suspended foreclosures and evictions for 60 days

The U.S. Fed has also created a number of facilities to support the flow of credit, including:

- Primary Market Corporate Credit Facility: Purchasing bonds directly from highly-rated corporations to help them sustain their operations.

- Main Street Lending: Purchasing new or expanded loans from small and mid-sized businesses. Businesses with up to 15,000 employees or up to $5B in annual revenue are eligible.
- Municipal Liquidity Facility: Purchasing short-term debt directly from state and municipal governments. Counties with at least 500,000 residents and cities with at least 250,000 residents are eligible.

Longer-term Implications

Central bank responses to COVID-19 have been wide-reaching, to say the least. Yet, some of these policies come at the cost of burgeoning debt-levels, and critics are alarmed.
In Europe, the ECB has come under scrutiny for its asset purchases since 2015. A ruling from Germany's highest court labeled the program illegal, claiming it disadvantages German taxpayers (Germany makes larger contributions to the ECB than other member states). This ruling is not concerned with pandemic-related asset purchases, but it does present implications for future use.

The U.S. Fed, which runs a similar program, has seen its balance sheet swell to nearly $7 Trillion since the outbreak. Implications include a growing reliance on the Fed to fund government programs, and the high difficulty associated with safely reducing these holdings.

Where does Armenia stand

Armenia

Background. The first confirmed case was reported on March 1, 2020. Armenia is currently facing a steep increase in COVID-19 cases with a high infection rate per capita. The government extended a national state of emergency to August 12, and imposed strict containment measures, including school closures, travel bans on foreign citizens from high risk countries, and imposed fines to those who violate isolation orders during the state of emergency.
The government announced an assistance package with a headline amount of $300 million (2 percent of GDP) to mitigate the socio-economic issues related to the pandemic, although this includes a variety of direct spending, state-sponsored loans, and increased investment.
Reopening of the economy. Since May, the movement restrictions were removed, and containment measures were eased, allowing for resumption of public transport, retail businesses, and restaurants. Since early June, the government declared wearing a face mask in all open public spaces mandatory and imposed fine on those not doing so.

Policy Name	Intended Effect
Fiscal	(i) subsidized 2-3-year loans to provide short-term support to affected businesses and SMEs;
	(ii) direct subsidies to SMEs and businesses to help maintain their employees;
	(iii) grants to entrepreneurs and firms;
	(iv) lump-sum transfers to the vulnerable including individuals who were unemployed after the COVID-19 outbreak, families with or expecting children, micro-businesses, general population who needed help with utility bills, and temporary part-time employment.
	So far, the authorities have adopted 21 support packages and allocated over 73 billion AMD ($137.9m) to those.

Policy Name	Intended Effect
Monetary and Macro-Financial	The Central Bank of Armenia (CBA) reduced the policy rate by another **100** bps to **4.5** percent in three phases. The interbank market has been active, and the central bank has easily met liquidity needs so far and provided a few FX swap operations to assure sufficient liquidity in dram and in FX. The CBA undertook few foreign exchange sales to limit excessive dram volatility around the beginning of April, although since then the dram has strengthened, and the CBA has been able buy some FX.

Policy Name	Intended Effect
Macroprudential	The CBA's authorities are supervising banks' liquidity positions and will act swiftly if required to safeguard financial stability. The CBA has allowed banks to use their capital and liquidity buffers also postponed the application of LCR and NSFR standards. The CBA did not apply LTV and DSTI standards and has reduced the capital adequacy ratio from 10 to 9. The opportunity to review loans without creating additional capital burden for customers of good faith was granted to banks by the Central banking authority.

Policy Name	Intended Effect
Exchange Rate and Balance of Payments	The exchange rate has been allowed to adjust flexibly and has appreciated to pre-pandemic level against the US$. No balance of payment or capital control measures have been adopted.