ARTICLE – The central banks' measures

Like other central banks, the Riksbank has taken extensive measures to alleviate the economic effects of the coronavirus pandemic. These measures concern helping companies to survive the shut-down to counteract loss of production and avoid too many jobs being lost. Many central banks are therefore focusing on stimulating the credit supply to companies, on providing the financial system with liquidity and on keeping borrowing costs down. Following the policy rate cuts by some central banks, policy rates are now close to zero in all developed economies, which contributes to making monetary policy more expansionary.

Acute stress on the financial markets

At the end of February and the first weeks in March, the realisation of the scope of the pandemic hit the financial markets in Europe and North America with full force. Companies' borrowing costs then rose rapidly and it became more expensive for banks and other financial agents to borrow in particular US dollars on the international financial markets. In several countries it also became more expensive for municipalities and regions to get loans. The interest rates charged to companies, banks and authorities rose, despite several central banks cutting their policy rates at a rapid pace, or alternatively holding them close to zero. The situation worsened further in mid-March, when the corporate bond markets in several countries showed signs of acute stress. Many investors then wanted to sell their debt instruments and it became difficult or impossible to find buyers at prices the sellers could accept. During a few days, yields on government bonds with long maturities also rose, even in countries such as the United States and Germany, which are normally regarded as having very good credit ratings.

Central banks are focusing on crisis management

To prevent the economic shut-down ultimately leading to a financial crisis, the Riksbank and other central banks have taken extensive measures over a short period of time (see Table 2:2).[8] In many cases, these concern decisions and promises of measures that are unprecedented in modern times. For instance, in the United States the Federal Reserve has cut its policy rate by 1.5 percentage points to almost zero in a short space of time and has opened ten or so different programmes and facilities to help credit granting. In addition, they announced on 23 March, that they intended to purchase US government securities and covered bonds in the amounts needed to support the smooth functioning of markets. The European Central bank, ECB, and the United Kingdom's central bank, the Bank of England, has also decided to carry out extensive purchases of financial assets.

To counteract the increased demand for liquid fund, and especially US dollars, many central banks have offered loans both in their country's own currency and in US dollars.

The Riksbank has for instance decided to lend up to SEK 500 billion to the banks for onward lending to companies, has extended its purchases of government bonds, cut its lending rate to monetary policy counterparties and begun to purchase covered bonds and debt instruments issued by individual companies. The Riksbank has also announced that purchases of bonds issued by municipalities and regions in Sweden will be initiated on 28 April.

Large-scale purchases of financial assets

Large increases in purchases of government bonds have been made by many central banks. One purpose of these purchases is to keep interest rates down. Government bonds play an important role in the financial system, as in most developed economies they are associated with a low level of risk. They are therefore used regularly as collateral when banks and other financial institutions are to borrow money and the yield on government bonds often forms a benchmark when determining other interest rates. Smoothly-functioning markets for, and low yields on, government bonds in this way create the conditions for banks and non-financial companies to be able to finance themselves at low borrowing costs via the financial markets.

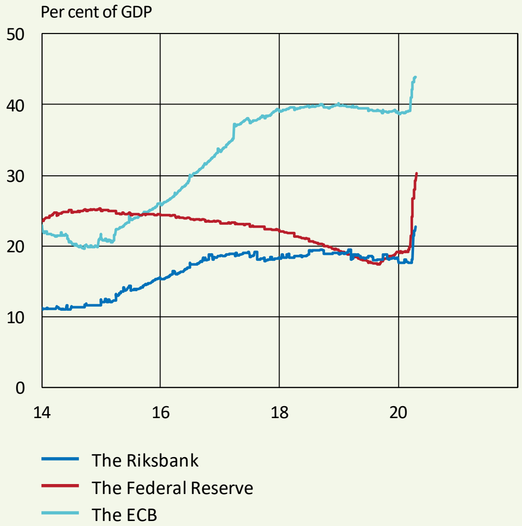
The pandemic and its economic consequences have already caused several states to substantially increase their expenditure. As tax revenue is falling at the same time, sovereign debt will rise and the supply of government bonds will increase rapidly. Within the euro area, expectations of poorer public finances have led to larger differences in yields on government bonds issued by different states in the

[8] In addition, governments and financial supervisory authorities have taken extensive measures. For a discussion of the fiscal policy measures, see the boxes "The Swedish Government's crisis measures" in Chapter 1 and "Fiscal policy support measures abroad" in Chapter 3.

monetary union. The difference in government borrowing rates between on the one hand Germany and on the other hand Greece, Italy, Portugal and Spain, rose substantially during the first weeks in March. On 18 March, the ECB announced a new and extensive programme of measures including purchases of government bonds and securities issued by the private sector. Within the framework for the *Pandemic Emergency Purchase Program* the ECB is intending to buy assets for EUR 750 billion this year, which corresponds to more than 6 per cent of the monetary union's total GDP. Following the announcement, government borrowing rates in the euro area fell and the downturns were particularly large for the most heavily indebted countries. But yields on bonds issued by Greece, Italy, Portugal and Spain are still relatively high. This has led to an intensive discussion in the euro area on potential jointly-financed economic policy measures to supplement the ECB's purchases.[9]

The central banks' decisions on extensive asset purchases have already had a clear impact on their balance sheets, which are now expanding at a rapid pace (see Figure 2:12).

Figure 2:12. Central banks' balance sheet totals
Per cent of GDP



Note. Observations after 31 December 2019 are expressed as a percentage of GDP per 2019 Q4.

Sources: Macrobond and the Riksbank

Easing for credit supply to companies

One of the most acute economic problems caused by the coronavirus pandemic is that robust companies risk being knocked out when they no longer receive income they can use for their payments. This risk increases the longer the virus and the restrictions to prevent the spread of the virus are preventing households from consuming and companies from conducting their normal operations. There is thus a growing need to borrow money in the corporate sector to weather the turbulent period.

For small and medium-sized enterprises it is mostly a case of applying for loans from private banks. The unease on the financial markets and the uncertainty over companies' future prospects could, however, lead to the banks tightening their credit granting. This is why the Riksbank and other central banks have chosen to stimulate the banks' lending to non-financial companies in various ways.

Many large companies and banks also issue their own debt instruments to cover parts of their borrowing requirements. To make it easier for companies to obtain access to financing, several central banks have decided to extend their purchases of financial assets to also include debt instruments issued by non-financial companies and banks and by other financial institutions. The Riksbank, for instance, has begun to buy short-term debt instruments issued by non-financial companies and covered bonds, which comprise an important funding source for mortgages. One important purpose of this measure has been to ensure that the markets for these securities continue to function, despite the uncertainty. The central banks' purchases will keep down borrowing costs for companies and on the housing market and reduce the risk of companies experiencing difficulty in financing the debt instruments that fall due. This will encourage other investors to continue purchasing companies' debt instruments.

Debt instruments issued by companies and banks are linked to credit risks and purchases of these instruments are not usually included in most central banks' areas of activity. The governments in the United Kingdom and the United States have therefore decided on special measures to compensate for the possible credit losses that may arise. In the euro area and in Sweden, the central banks have decided on asset purchases without this type of loss guarantee. The differences between the countries partly reflect the differences in the framework regulating the central banks' operations and independence.

In recent weeks, the yields on corporate bonds have fallen somewhat and the markets have begun to function better (see Figures 2:3, 2:4 and 2:5). The difference between yields on covered bonds and government bonds has also fallen substantially, both in Sweden and abroad. This indicates that the measures that the Riksbank and other central banks have taken have had some effect. The situation on the global money markets has also improved since the Federal Reserve extended its swap agreements with other central banks and thus made US dollars more easily available on these markets. This has means that the cost for the banks to finance themselves in dollars has declined slightly.

[9] The ECB announced as early as 12 March that they had decided on extended purchases of net assets during 2020, to a value of EUR 120 billion. The total of the new asset purchases decided on 12 and 18 March thus amounts to EUR 870 billion, or just over 7 per cent of the euro area's GDP.

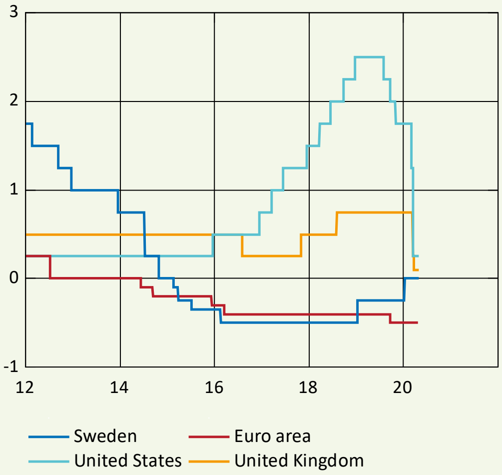
Policy rates abroad close to zero

As already mentioned, the Federal Reserve has reduced the interval for its policy rate by 1.50 percentage points to 0.00 – 0.25 per cent. The central banks in Canada, Norway and the United Kingdom have also cut their policy rates close to zero. Examples of other countries where the rates have been cut are Australia, Mexico, New Zealand, Poland and the Czech Republic.

The Riksbank and other central banks that already had policy rates close to zero have so far let them remain there. The ECB's deposit rate, for instance, has remained unchanged, at −0.50 per cent. All in all, policy rates in all of the developed economies are now close to zero and this will contribute to making monetary policy expansionary (see Figure 2:13).

Figure 2:13. Policy rates

Per cent



Sources: The national central banks, Reuters and the Riksbank

Table 2:2. The central banks' measures

Measures	Bank of England	The ECB	Federal Reserve	The Riksbank
Policy rate cut	Yes	No	Yes	No
Programme for corporate lending via banks	Yes	Yes	Yes	Yes
Purchases of bonds issued by public authorities, such as central or local governments	Yes	Yes	Yes	Yes
Purchases of bonds with mortgages as collateral	No	Yes	Yes	Yes
Purchases of commercial paper	Yes	Yes	Yes	Yes
Purchases of corporate bonds	Yes	Yes	Yes	Yes
Changed collateral requirements in steering system	No	Yes	No	Yes
Loans in US dollars via swap agreement with Fed	Yes	Yes	—	Yes

Note. The measures in the table do not necessarily cover all of the measures taken by central banks. Purchases of corporate bonds are included in the Riksbank's framework decision but no such purchases have yet been made.

Sources: Bank of England, ECB, Federal Reserve and the Riksbank