COVID Crisis Response: “Evergreening Proposal”

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<table>
<thead>
<tr>
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<th>2008</th>
<th>2020</th>
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<tbody>
<tr>
<td><strong>Pre-crisis</strong></td>
<td>Build-up of imbalances</td>
<td>Well balanced</td>
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<td></td>
<td>- run-up of credit</td>
<td>- US gov. debt expansion</td>
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<td>- Thinly capitalized (shadow) banks</td>
<td>- Corporate debt</td>
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<td><strong>Trigger</strong></td>
<td>Re-evaluation: real estate</td>
<td>Drop in corporate cash flow</td>
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<td></td>
<td>- correlation</td>
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<td><strong>Amplification</strong></td>
<td>HH &amp; banks’ balance sheets</td>
<td>Corporate sectors balance sheets</td>
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<td><strong>Fin- sector</strong></td>
<td>Shadow banks (part of banks)</td>
<td>FinTechs for mortgages</td>
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<td>Banks still for SMEs</td>
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<td><strong>Structured finance</strong></td>
<td>CDOs</td>
<td>CLOs</td>
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<td><strong>Policy objective</strong></td>
<td>Stimulus</td>
<td>Survival</td>
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The challenge

- **Stop clock** = total standstill of all debt/rent/wages/...

  - “Hibernation strategy” for whole economy

- **Not possible**
  - Essential sector: food, ...
  - Less essential sector

- **Shut down part** of economy
  - Supported by other part
Policy actions

- Firm vs. household focused

- Targeted vs. broad brush
  - Mankiw idea: ex-post targeting (precautionary savings)

- Loans vs. grants
  - Risk sharing/moral hazard – pick-up problem
  - Automatic stabilizers

- How to channel government support?
  - Direct to HH: CBDC-helicopter money
  - To HH via firms: “Kurzarbeit” (short-term work)
  - To firms via banks: SME lending (SBA)

- Purely crisis vs. long-term structural focused
Inverse Policy Description

- Dos-and-don'ts are reversed

- Usual recession:
  - Stimulus focused
    - interest rates to stimulate spending and investment

- COVID recession:
  - Survival focused
Inverse Policy Description

- Chapter 11 for large firms works ok, but
- SME need a pause

**Usual recession:**
Avoid evergreening is a problem b/c it crowds out credit to new firms/start-ups (Japan ...)

**COVID recession:**
Promote evergreening
offer banks cheap central bank refinancing for rolled-over loans
  • stabilize existing businesses
How to Promote Evergreening?

**Carrots:** positive incentives for banks to evergreen loans, e.g. central bank provided *cheap refinancing* for rolling over existing loans,

- eligible as collateral for financing at a rate that is x% less than the discount window rate
- Such loans include:
  1. existing callable loans (which could not be extended)
  2. loans that are coming due in the next 3 months
  3. credit line commitments
  4. current floating rate loans which are repaid/ refinanced with new debt

**Stick:** punish banks which do not rollover existing loans, e.g. by strictly *enforcing non-performing loan rules*.

- *act more strictly* in classifying loans as non-performing
- slow down bankruptcy proceedings