THE ROLE OF CENTRAL BANKS IN POST-PANDEMIC ECONOMIC RECOVERY: REALITIES AND PERSPECTIVES

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Abstract: *Romania's economy has honorably withstood the crisis caused by the covid-19 pandemic, given the limited budgetary space available to the authorities to intervene in support of companies and individuals affected by the virus and the restrictions imposed to limit its spread. The measures taken by the authorities to limit the effects of the pandemic have had mainly positive effects and the government's financing programs launched in this context have functioned largely due to the collaboration between the state and the banking system this time at the helm of the economy. Through this paper, we aim to highlight the support given by commercial banks to companies and individuals in order to recover the negative impact, through complex support policies that involved the mobilization and coordination of the authorities, especially the monetary and fiscal ones.*

Keywords*:* monetary policy, central banks, pandemic, economic recovery, covid-19

JEL Classification Codes: G21, O23

1. INTRODUCTION

With the onset of the pandemic, countries around the world have faced the challenge of finding solutions to protect the economy and their citizens, and central banks have played and will continue to play a crucial role in both the current and post-pandemic situation. Although their efforts have led to the avoidance of the worst-case scenario, and the economic recovery is on track, it is still uneven, with many countries facing high unemployment and low vaccination rates in population, that restrict what banks and the government can do to stabilize the economy.

In a state, central banks, money management institutions, and its monetary policy/monetary union have key roles in the economy, but Covid-19 has led to a shift in their short-term priority with a high likelihood of spillover into the longer term. Covid-19 is an extremely virulent and deadly coronavirus that spreads rapidly. Left to spread without government intervention, the pandemic would have overwhelmed health systems with people in need of medical care.

Crises are good reminders of the key role that banks play in the economic system. The efficiency of the process through which savings are channelled into productive activities is crucial for growth and welfare. Lenders of funds are primarily households and firms. These lenders can supply funds to the ultimate borrowers – who are mainly firms, governments and households – in two ways. The first is through financial markets (money markets, bond markets, and equity markets). The second is through banks and other financial intermediaries. Thus, banks are a crucial part of the saving/lending process, especially in banks. This section draws partly on Allen et al. (2019). Challenges to banks' business models 25 dominated financial systems such as Europe and

Japan. It is therefore important to analyse their main functions and business models to understand how the challenges that these institutions are currently facing may affect the sustainability of the industry and, ultimately, the economy. (Carletti, Claessens, Fatás and Vives, 2020)

2. ACTIONS TAKEN BY CENTRAL BANKS DURING THE PANDEMIC

The need for a partial or general lockdown has resulted in a significant reduction in economic activity, leading to increased risks of bankruptcy and a sharp rise in unemployment. Thus, the provision of additional and temporary liquidity to businesses and households proved essential. At the same time, investors, who are in constant need of liquidity, have led to increased volatility in financial markets, with banks having to intervene with monetary policy

In this context, the stability of the financial system becomes the main pillar around which central banks will gravitate. Injecting liquidity will be the first step taken by them, led by the Federal Reserve, to help alleviate the worrying dollar shortage affecting both businesses and developing countries, the main cause being the accumulation of massive debts in this currency in the rather loose monetary policies of recent years.

The next step was the purchase of commercial titles and corporate bonds to stabilise corporate finance markets, but also to support small and medium-sized enterprises hit hard by the pandemic with emergency financing.

Next, they implemented a series of tools using multidimensional strategies to address the challenges they faced:

- interest rate cuts and forward guidance in order to reduce tensions in financial markets but also to help aggregate demand in the economic recovery;
- asset purchases to address widespread dysfunctions in financial markets and subsequently for additional aggregate demand support;
- providing liquidity and credit support (loans to financial firms, purchases of corporate securities, loans to non-financial firms and Funding for Lending programmes to support bank lending), in most cases in collaboration with governments, ensuring that viable firms survive the crisis and increase production, ultimately helping to increase employment post-pandemic;
- finally, the relaxation of regulations (reduction of the countercyclical capital buffer, other measures to reduce liquidity requirements and capital buffers) to ensure that banks do not increase credit and liquidity constraints to meet regulatory standards.

3. THE ROLE OF CENTRAL BANKS IN POST-PANDEMIC ECONOMIC RECOVERY

Most developed economies are expected to recover fully by 2023, but unevenly. On the other hand, despite these expectations, most countries expect the recovery to be still weak. Over the next two years, the unemployment rate is expected to fall gradually in most countries.

The Organisation for Economic Co-operation and Development (OECD) forecasts strong global growth of 5.7% this year and 4.5% in 2022, slightly revised from its May 2021 outlook of 5.8% and 4.4%.

As demand patterns normalize, production capacity expands and more people return to work, supply-side constraints and shortages should gradually decline by 2022-2023. The global recovery is expected to continue, but overall GDP growth is projected to moderate over time, from 5.6% in 2021 to 4.5% in 2022 and 3.2% in 2023 (Table 1).

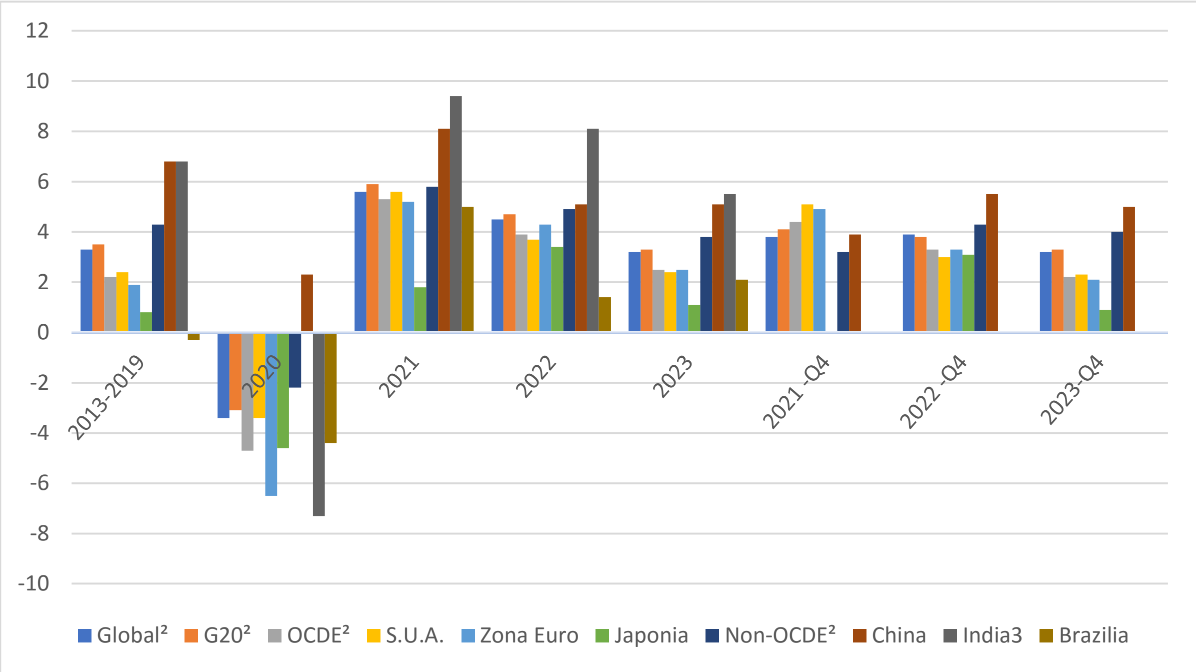
Table 1 Highlights of global economic recovery in percentages

Years	Average 2013-2019	2020	2021	2022	2023	2021 Q4	2022 Q4	2023 Q4
Real growth of GDP[1]								
Global[2]	3,3	-3,4	5,6	4,5	3,2	3,8	3,9	3,2
G20[2]	3,5	-3,1	5,9	4,7	3,3	4,1	3,8	3,3
OECD[2]	2,2	-4,7	5,3	3,9	2,5	4,4	3,3	2,2
USA	2,4	-3,4	5,6	3,7	2,4	5,1	3,0	2,3
Eurozone	1,9	-6,5	5,2	4,3	2,5	4,9	3,3	2,1
Japan	0,8	-4,6	1,8	3,4	1,1	0,0	3,1	0,9
Non-OECD[2]	4,3	-2,2	5,8	4,9	3,8	3,2	4,3	4,0
China	6,8	2,3	8,1	5,1	5,1	3,9	5,5	5,0
India[3]	6,8	-7,3	9,4	8,1	5,5			
Brazil	-0,3	-4,4	5,0	1,4	2,1			
Unemployment rate[4]	6,5	7,1	6,2	5,5	5,2	5,7	5,4	5,1
Inflation[1,5]	1,7	1,5	3,5	4,2	3,0	4,9	3,4	3,1
Fiscal balance[6]	-3,2	-10,4	-8,4	-5,2	-3,7			
Real growth in world trade[1]	3,4	-8,4	9,3	4,9	4,5	6,1	5,2	4,2
1. Percentage change; the last three columns show the change from one year earlier.								
2. Change in nominal GDP weights using purchasing power parities.								
3. Fiscal year.								
4. Percentage of labour force.								
5. Personal consumption deflator.								
6. Percentage of GDP								

Source: Table created by author based on OECD data

The Covid-19 crisis brings new challenges and opportunities for the banking industry. It will most likely mean that interest rates will remain low for much longer. Although in the short run banks are bound to benefit from being the channel of liquidity support in the crisis and having access to central bank reserves, the deep crisis hitting the real economy is likely to bring a new surge in non-performing loans and eventually threaten banks’ solvency once again. While providing at least temporary regulatory and supervisory relief for banks, the crisis may accentuate the digitalisation. (Carletti, Claessens, Fatás and Vives, 2020)

The pandemic will bring many changes in the banking sector, on one hand it will precipitate some changes in the banking sector, and on the other hand it will influence those private and public actors who carry out their activity in this sector. However, its greatest influence will be to precipitate the digitization and restructuring of the banking system.



Graphic no. 1 Real growth of

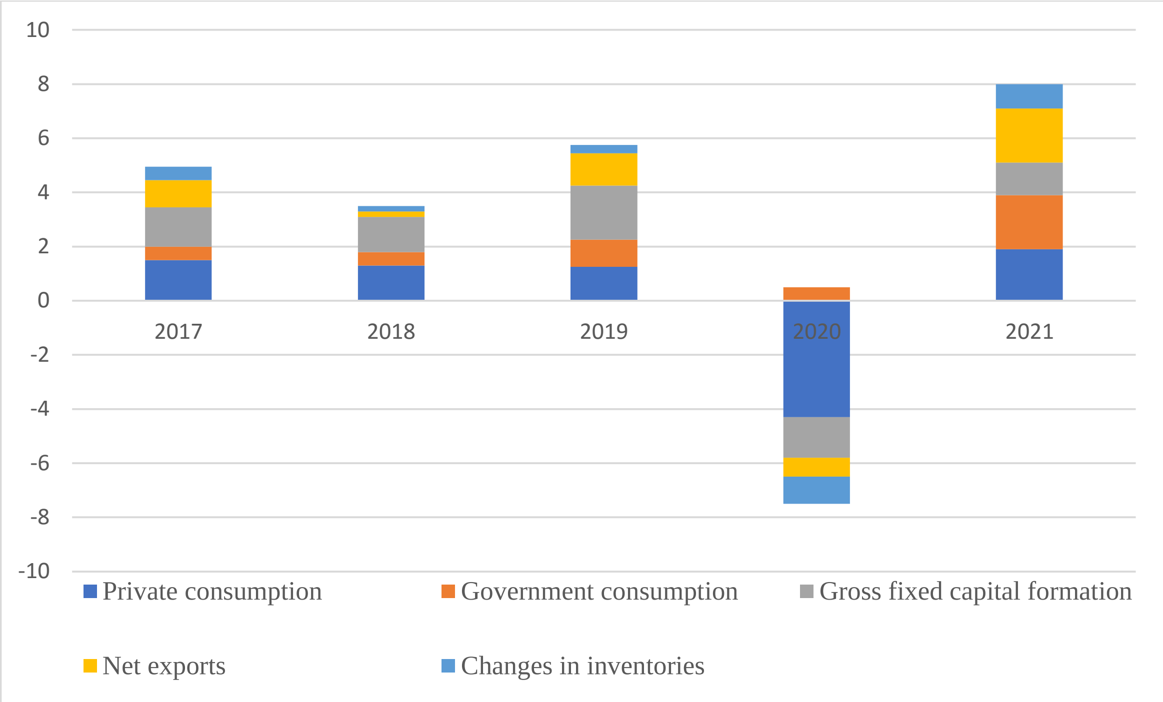
Source: ECB Annual Report 2021

Vaccination campaigns are proceeding at different pace around the world, and the extent of macroeconomic policy support and the ability to reopen contact-intensive activities differs considerably from one economy to another. Some specific restrictions on cross-border mobility continue to be necessary, and the Delta variant has led to the re-imposition of domestic containment measures in many countries with relatively low vaccination rates. This will affect the prospects for full recovery in all countries.

In the short term, central banks will continue to be concerned with balancing and supporting post-pandemic recoveries, considering the risk of rising inflation as policy stimulus is achieved. New challenges arise from the existence of the possibility of changing their mandates as well as the introduction of central bank digital currencies. At the same time, the high level of public debt will put the interaction between fiscal and monetary policy in the spotlight.

Monetary policy will continue to play an important role as there is still unused capacity in most economies, especially as fiscal support is set to expire. This stimulus is likely to favour asset prices rather than inflation (consumer prices). In any case, central banks will be more tolerant of consumer price inflation.

In 2021, after the biggest decline on record 6.4% in 2020, euro area real GDP grew by 5.3% (Graphic 2). The growth dynamics of that year were still influenced by the continuing COVID-19 virus, as well as elevated but decreasing uncertainty regarding the economy. The quarter between January and March was still affected by travel restrictions and lockdown measures, which negatively impacted the spending on services. The industrial sector grew very fast, while overall growth rates were still impacted by the COVID-19 virus. In the second and third quarters of the year, as economies started operating more freely again and restrictions were loosened, the services sector started to improve. This then helped create a more solid recovery. However, during the second half of the year, demand was exceptionally high, which created supply-demand mismatches in many markets.



Graphic no. 2 Euro area real GDP and demand contributions

Source: ECB Annual Report 2021

In the euro area, the positive recovery of the economy in 2021 was supported by fast and decisive expansionary monetary and financial programs. Some measures also helped to acclimatize to ongoing structural changes caused by the epidemic. The European Central Bank has not stopped providing support through its policy in 2021 to mitigate the effects of the epidemic.

Loose monetary policy, including ample liquidity, ensured the flow of credit to the real economy. Through fiscal policy, eurozone states will continue to provide substantial fiscal aid in 2021 to mitigate the impact of the crisis through reduced working hours, increased funding to support health, forms of relief for businesses and households, and more loan guarantees. At EU level, the implementation of the Next Generation EU program started with the introduction of the Fit 55 package, to support a strong, green and unified recovery for all countries. Private consumption grew by 3.5% in 2021 with a particularly strong recovery in the second and third quarters, largely due to the easing of restrictions imposed by the COVID-19 pandemic. Since the spring, consumer confidence has risen rapidly as vaccination rates have increased and fears of infection have subsided, while household finances have improved, largely reflecting positive income growth.

Central banks may be under pressure to keep interest rates low to help governments finance their debt. As a result, so-called 'financial repression' will become more widespread. In the meantime, central bank digital currencies will probably be introduced in the next decade. This will present central banks with new challenges on how such currencies interact with monetary and fiscal policy. (Capital Economics, 2021)

Also, a new focus for central banks is to build, not just better, but greener, in the context of general concerns about the future of the global economy, there is a renewed emphasis on “green transformation” towards a sustainable, carbon-neutral economy and a socially responsible world - especially after a major health crisis.

4. CONCLUSIONS

Although the pandemic is still far from over, a preliminary assessment suggests that central banks have responded effectively to the initial phases of the Covid shock - through a combination of strong monetary policy that built on programmes first tried in response to the GFC, combined with an entirely new set of initiatives to directly support financial markets and provide credit to the economy. This response has involved an unprecedented expansion of coverage - well beyond the narrow focus of most central banks on inflation targeting. These programs have been crucial to stabilizing economies and financial markets when economies have been blocked and while vaccines have been developed and launched, but this expansion of coverage and responsibilities also raises many questions about monetary policy and the role of central banks in the future. In addition, the post-pandemic recovery is likely to have additional extraordinary features, and central banks will need to continue to be flexible and nimble to respond successfully.

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