The impact of Covid-19 on the financial system

The pandemic may inflict long-lasting damage on the global economy while impacting the financial systems in Asia and beyond in both positive and negative ways.

**THE BAD: RISKS TO THE BANKING SYSTEM**

On the negative side, the rising bankruptcy rates among businesses and households could lead to negative repercussions on the banking and financial system.

The economic turmoil has impacted so many central banks around the world have infused massive liquidity to keep their respective financial systems and businesses afloat and have also encouraged financial institutions to offer debt moratoriums and defer loan repayments for individuals and businesses.

In Singapore, the MAS too has offered temporary regulatory forbearance to financial institutions to assist domestic economic recovery.

**THE UGLY: COMPROMISING LONG-TERM MACROECONOMIC STABILITY**

Since the early 1990s, central bank independence has been widely accepted as one of the reasons behind the Great Moderation of non-inflationary global growth which came to an abrupt end with the GFC. The primary goals of central banks in most emerging economies have been to focus on (a) ensuring inflation is kept at the target rate; (b) maintaining financial stability including the smooth functioning of the national payments system; and (c) managing exchange rate volatility. By and large most Asian central banks have done so quite effectively since the 2000s, hence contributing to the economic successes of the region which has led global growth until the last few years.

While unconventional monetary policies during the GFC were limited to advanced economies, many emerging economies have also undertaken massive asset purchases this time around.

Some, like Indonesia and the Philippines, have already taken steps towards partial debt monetization (policy-makers in the former prefer using the diplomatic term ‘bureaucratic easing’).

While policy coordination to manage economic upheaval is positive, there is a risk of the central banks’ independence being compromised in the pursuit of macroeconomic stability.

Within Asean, the ratings agency S&P in an April 6, 2020 report has also highlighted financial stability concerns in Indonesia. Indeed, Finance Minister Sri Mulyani Indrawati, who chairs the Financial System Stability Committee (RSSK), has cautioned that given the acute slowdown in the domestic economy and expected deterioration in corporate credit quality and rising bad loans, the ‘coronavirus poses a serious threat to the economy and also to the financial system stability’.

**THE GOOD: DIGITAL TRANSFORMATION IN FINANCIAL SERVICES**

The containment and lockdown measures globally in response to Covid-19 has given a big impetus to payments and digital banking and financial services (lending, remittances, insurance, trade finance, etc) combined with new technologies such as AI, blockchain and cloud computing.

Digital functionality has been vital in ensuring that the financial system has remained resilient and that financial services have operated fairly smoothly in many countries.

For instance, in Singapore with financial services having grown 5.9 per cent year-on-year in the first half of 2020, the sector has been one of the few bright spots in an otherwise gloomy economic environment which contracted 6.7 per cent in the same period.

As Covid-19 has been a major catalyst that has caused a massive shift in consumer behaviour towards the digital world which is likely to be permanent, on the supply side the Monetary Authority of Singapore (MAS) has shown a strong commitment to scaling up digital finance in Singapore to prepare for a post-Covid-19 world while taking care to put in place safeguards to ensure the very real risks such as operational resilience, fraud, money laundering, privacy and data protection violations, cyber-attacks are effectively managed.

For instance, apart from offering attractive Digital Acceleration Grants to promote digital adoption by smaller financial institutions and fintech firms in Singapore, the MAS has established the ASEAN Institute of Digital Finance (AIDF), which is a joint research institute among the MAS, the National Research Foundation (NRF) and the National University of Singapore (NUS) to promote and augment research and entrepreneurship, and develop and deepen local skills in digital financial services and fintech.

Singapore is operating on offering up to five virtual banking licences – two bank licences and three wholesale banking licences (WBLs). These virtual banks, along with the digital transformation ongoing in more traditional brick-and-mortar banks, ought to give a further impetus to the financial sector.

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