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ARAB MONETARY FUND

Financial Sector Policy Responses to COVID-19

Statement by

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I would like first to thank the G24 Secretariat for having extended the invitation to attend this virtual meeting. My special appreciation goes also to the organizers for having set the appropriate arrangements to maintain and hold this important meeting under the particular circumstance of global COVID 19 pandemic, which has taken the world by surprise and poses significant challenges to all economies across the globe.

This unforeseen situation has put national leaders and global bodies under additional pressures to, firstly stopping and addressing the extremely rapid spread of coronavirus, and secondly to fighting the forecasted substantial economic impact. In this regard, I would like to direct my statement at this time towards economic and financial challenges originated by the critical COVID-19 pandemic, where we should all be focused on, as the virus may in fact be as contagious economically as it is medically.

Indeed, the COVID-19 pandemic continues to scramble across the globe, with the epicentre having moved from one region to another, with a foremost risk for another massive move towards the rest of the World. Beyond the devastating toll on human health, the COVID-19 pandemic is expected to cause, significant economic turmoil across the Arab region through simultaneous shocks; as the very measures that are crucial to slowing the spread of the virus will likely to have a direct cost on local economies. The disruption to people's daily lives means less income, less spending, and fewer jobs, and with borders closed, travel and tourism are quickly drying up, and shipping and trade are suffering.

Moreover, tighter global financial conditions will limit access to finance and countries are more likely to also see delays in getting investment or development projects off the ground. Indeed, the rise in global risk aversion and capital flight to safe assets have led to a decline in portfolio flows into the Arab region by near $2 billion since mid-February, with significant outflows observed in recent weeks, coupled with falling share prices and rising bond spreads. Such a tightening in financial conditions is likely to prove to be a major challenge and the intertwined shocks are expected to impact economic activity in the region, at least in the first half of this year; with that in mind, additional challenges are expected to be faced by the financial system.

In response to the above challenges, what options do Arab countries have to maintain the financial health of their societies and economies? what risk-response options do they have at their disposal to protect people from mass defaults? financial institutions from drying up liquidity? and MSMEs from financial exclusion? In the midst of this rapid development, how can technology help?

Globally, a range of risk-responses have been implemented by central banks and the wider financial services industry including fiscal stimulus measures, interest rate cuts, liquidity measures, and relaxation of capital rules to soften the impact of COVID-19. However, the attention will turn to effective economic recovery later this spring and early summer where there will be a clearer picture of the magnitude of the losses in the financial system. Then, addressing the situation will require further global action with a strong public–private coordination where banks, nothing like the 2008 financial crisis, are not the source of the problem but part of the solution as they will play a crucial role for their customers, their employees, and for the economy at large. Cash and deposit services, credit extension, payment facilities, and market making are all essential services.

To this end, mitigation measures have to allow banks to keep providing financial support to viable households, small businesses and corporates that are hardest hit by the current economic fallout. Regulatory risk-responses should be engaged to keep precious capital resources within the banking system in these difficult times. These resources are expected to enhance banks capacity to lend to the real economy and to support other segments of the financial sector as they come under stress. The regulatory reforms of the past ten years, including bank resolution frameworks, will then be put to their first massive test.

While there is a high degree of uncertainty and limited information, lessons from previous crises can come in useful to define possible policy actions. The following will focus on the main proposed policy steps and actions:

Proactive measures are needed

COVID-19 continues to cause an enormous shock to both the real economy and the financial sector, reflected in financial market distortions and funding concerns for many market participants, including banks. In this regard, banks are expected to plan for an acute period of multiple months and spanning their entire footprint to provide essential banking services to retail customers. Regardless of coronavirus containment measures, customers will need banking services and banks should therefore continue their operations through both branches and ATM where possible, particularly as the more vulnerable members of society such as the elderly may be less likely to use digital banking services. Despite this, banks should also encourage customers to use digital channels and mobile banking options where possible.

Importantly, banks should continue supporting households and businesses with credit as many workers live from paycheck to paycheck, illustrating the extent of the impact that prolonged periods without work due to coronavirus could have. Therefore, it is recommended that banks rapidly identify most affected sectors and customers to understand how they can provide the best support.

While banks can help overcome their clients' liquidity constraints, they have a limited ability to do so. Indeed, one of the defining characteristics of bank lending over the business cycle is its procyclicality where in a recession period, banks reduce lending rapidly, especially to MSMEs and riskier households where some of this lending retrenchment is demand-driven. Therefore, regulation can further exacerbate this procyclicality, requiring forward-looking loan classification and provisioning, as well as forcing an increase in risk weights and thus capital. Anticipating negative effects from the disruption of the real economy and financial sector and mitigating these negative effects is therefore critical and urgent.

To address these challenges, several initiatives have been taken by Arab Central Banks, such as unveiling financial support packages, collateralizing loans and supplying liquidity for banks, reducing compulsory reserve requirements, slashing interest rate and deferring periodic loan repayments to all borrowers can be helpful in this context. Considering the long-term impact of COVID-19, additional measures could be considered as well to mitigate lending retrenchment risks, such as: (i) reducing loan guarantee commissions and increasing the coverage of the local sales guarantee programs; (ii) lowering countercyclical buffers when it applies, (iii) reducing capital requirements that allow banks to operate temporarily below the defined level of capital requirements, and (vi) allowing banks to operate below 100% of the liquidity coverage ratio (LCR), among others. Moreover, it would be advisable to put temporarily on hold the process of implementing further capital increases under Basel reforms. In this regard, thanks to the Basel Committee's oversight body which announced that Basel III implementation will be deferred by one year to help banks and supervisors cope with the impact of the coronavirus disease.

Reinforcing the confidence in the financial sector:

Government is the ultimate backstop for absorbing losses in crisis situations like this one. One of the critical tasks for policymakers is to provide a maximum degree of certainty and inspire confidence. As much as this applies to the public policy response to the current health crisis, it also applies to the financial sector. Standing ready as lender and market-maker of last resort and providing clear signals that central banks will stand ready to avoid any price overshooting and market freezes is critical in such situation.

Turning Covid-19 crisis into an opportunity to push for further digitization of financial services

Indeed, consumers desire for digital banking services will most likely increase, forcing many traditional financial institutions to fast-track digital innovation efforts. As result, many banks and financial institutions may look to Fintech firms for assistance in bringing better digital banking solutions to the marketplace.

This potential increase in demand for digital solutions could provide a lifeline to Fintech firms at a time when venture capital funding may not be an option. In addition, weakening economies may force government organizations and regulators to stimulate the expansion of Fintech solutions. For instance, the World Health Organization has encouraged contactless payments.

Finally, for those Fintech, RegTech and advanced data and analytic firms that can weather the current coronavirus storm, more venture funding will most likely be available. According to many reports, private equity and venture capital firms have significant cash available once the market stabilizes.

AMF's support to member countries

The Arab Monetary Fund (AMF) stands ready to support member countries in reducing the risks of the COVID-19 on financial sector. Indeed, and since the outbreak of COVID-19, the AMF has been in continuous interaction with the authorities in our region to offer advice and assistance. The AMF has several tools at its disposal to help its members surmount this crisis and limit its human and economic costs. In addition to the financing arrangements and lending programmes, AMF stands ready to provide a proper technical support to member countries through its ongoing Financial Sector Development Initiatives, such as Financial Inclusion for the Arab Region Initiative (FIARI) and Arab Debt Market Development Initiative (ADMDI) as well as through committees and task forces established under the umbrella of the Council of Arab Central Banks Governors and the Council of Arab Finance Ministers, including analytical work and studies to find out the impacts of the COVID-19 on financial stability and long term responses.

Beyond the region, now, more than ever, cooperation among all development partners is vital to prevent lasting economic effects across the world.

Thank you!

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