The Covid-19 crisis in historical perspective

• The economic crisis induced by the Covid-19 pandemic stands out in terms of its global scale, scope, and severity.

• In 2020, 95 percent of all countries experienced negative output growth. More than in the Great Depression or both World Wars.

• The crisis is unique in its nature: unlike previous crises, it did not originate as a crisis in the government or financial sector. Self-induced supply shock that affects households and firms.

• Poverty increased for the first time in a generation, generating 100 million new poor in 2020.

• Impacts of the crisis highly regressive within and between countries.

World Development Report 2022: Finance for an Equitable Recovery

A research agenda to promote an inclusive recovery

January 12, 2022
COVID-19 caused a massive shock to output and income

In 2020, economic output contracted in 95% of countries

The economic impact of COVID-19: A historical perspective

Percentage of countries experiencing negative per capita annual GDP growth

Regulators implemented unprecedented measures
Which helped mitigate short-term impacts, yet also revealed longer-term risks

Fiscal, monetary, and financial sector policy responses to the pandemic, By country income group

Note: The figure shows the percentage of countries in which each of the listed policies were implemented in response to the pandemic.
Economic risks accumulate due to interconnections between sectors.

Well-designed fiscal, monetary, and financial sector policies can counteract and reduce these risks to support an equitable recovery.
Why finance?

As governments around the world phase out COVID-19 support programs, they face a dual challenge – made more difficult by the lack of transparency:

1. **Ensure inclusive access to finance** to help households and businesses weather economic uncertainty and invest in opportunities

2. **Manage the interconnected financial risks** in a way that preserves the ability to address adverse events in the future and restore economic growth

Recommended: Timely action in four key policy areas
Policy areas 1 & 2: Identifying and resolving loan distress and restructuring private debt

Equipping the financial sector to continue lending and to protect viable businesses

Businesses expecting to fall into arrears (percent)

Source: Apedo-Amah et al. (2020) based on Covid-19 Business Pulse Survey
Resolving Loan Distress

Unprecedented challenge:

- Government interventions to alleviate the economic and financial impact of the pandemic have created a lack of transparency about the health of bank balance sheets & degree of exposure to problem loans

Risks:

- High ratio of non-performing loans impair credit intermediation
- Delayed action increases costs and compromises the capacity of banks to finance the recovery

Recommendations:

- Swift intervention before distressed loan levels rise:
  - Ensure banks identify and report problem loans accurately and manage exposures effectively
  - Encourage banks to set up dedicated workout units and adapt their credit risk methodologies
  - Address distress of problem banks to preserve financial stability and support credit intermediation
  - Support the Microfinance sector
Improving insolvency frameworks

Unprecedented problem:

• The economic shock has led to an increase in firm distress, especially for small businesses

Risks:

• High NPL rates that lead to widespread debt distress, “zombie firms”, mass bankruptcy filings, government interference in debt resolution

• Delayed action can cut off access to credit, destroy jobs, and discourage entrepreneurship

Recommendations:

• Strengthen formal insolvency mechanisms

• Facilitate conciliation and mediation, including accessible and cheap out-of-court procedures for MSMEs

• Promote debt forgiveness and discharge of loans for private individuals/sole proprietors
Policy area 3: Ensuring continued access to finance

Encouraging financial innovation in a context of consumer and market protection

Trends in Credit Conditions

Net percentage of countries changing credit conditions, compared to the previous quarter

Source: Author’s calculations from Central Bank Loan Officer Surveys from Albania, Argentina, Austria, Belgium, Canada, Chile, Cyprus, Czechia, Estonia, France, Germany, Ghana, Greece, Hungary, India, Indonesia, Ireland, Italy, Latvia, Lithuania, Japan, Mexico, Netherlands, North Macedonia, Philippines, Poland, Portugal, Romania, Russia, Serbia, Spain, Thailand, Turkey, Uganda, Ukraine, United Kingdom, United States, and Zambia. Note: The Net Percentage is the difference between the share of countries that report easing in credit conditions and the share of countries that report a tightening of credit conditions relative to the previous quarter. A negative Net Percentage value indicates a tightening of credit conditions among the sample of markets covered.
Ensuring continued access to finance

Unprecedented problems:

• The real-sector shock has impaired lender visibility into credit risk

• Lenders struggle to distinguish between borrowers facing short term vs. long-term impacts

Risk:

• Lenders stop issuing credit – especially for perceived higher-risk groups – because traditional ways to measure risk and establish recourse in the event of default are less effective

Recommendations:

• Innovate to improve visibility into risk and to improve recourse

• Adapt the regulatory and supervisory system to enable innovation in a context of consumer and market protection
Policy area 4: Managing high levels of government debt

Protecting the ability of governments to access resources for the recovery

Public and publicly guaranteed debt, LICs

<table>
<thead>
<tr>
<th>Year</th>
<th>Percentage of GDP</th>
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<tbody>
<tr>
<td>2010</td>
<td>36.7%</td>
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<tr>
<td>2012</td>
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<tr>
<td>2014</td>
<td></td>
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<tr>
<td>2016</td>
<td></td>
</tr>
<tr>
<td>2018</td>
<td>60.9%</td>
</tr>
<tr>
<td>2020</td>
<td>67.0%</td>
</tr>
</tbody>
</table>

Source: WDR 2022 team using data from IMF World Economic Outlook (April 2021) and World Development Indicators.

Note: The figure shows the average public debt stock as a share of GDP by World Bank income classification.

Risk of external debt distress, LICs

Source: Joint Bank-Fund LIC DSF database, June 2021.

Note: The figure shows the risk of debt distress for low-income countries with a debt sustainability analysis (DSA).
Managing high levels of sovereign debt

Unprecedented problem:

• Average total debt burdens among low- and middle-income countries has surged

Risk:

• On average, it has taken two debt restructurings to successfully cure a default spell
• Delays in addressing elevated sovereign debt are associated with protracted recessions and high inflation, which have disproportionate negative effects on the poor

Recommendations:

• Prompt recognition of the problem & coordination and transparency in approaching resolution
• Resolution of distressed debt through: Debt reprofiling; Pre-emptive negotiations; Post-default or in-distress restructurings
• Improved resource mobilization
Evaluating unprecedented fiscal policies

Such as tax relief and credit, cash transfers to individuals and income support for businesses

- The distributional impacts of fiscal support policies, e.g., if relief payments reach the most vulnerable populations and benefit productive and sustainable sectors
- Impact on household welfare, spending behavior and balances, borrowing and repayment, and financial resilience
- Impact on entrepreneurship and jobs (attrition, hours worked, etc.), especially for women
- Impact of digital/electronic relief payments on financial inclusion and digital adoption by households and businesses
- Impact of relief payments on government budgets—and whether these caused increases in government debt and/or unequitable distributions of spending cuts across the population
- Impact of tax systems on inclusive economic growth
Evaluating unprecedented monetary policies
Resulting in increased liquidity to financial institutions

• Impact on bank lending portfolios to small businesses and households
• Impact on bank performance and financial stability, especially in countries with state-owned banks
• The success of monetary policies to promote lending to sustainable firms and sectors
• Spillover risks of advanced economies monetary policy on developing countries
Evaluating unprecedented financial sector policies
That hide the true loan quality on financial institution balance sheets

• As true NPL rates are revealed, the impact of weak financial institution balance sheets on the supply of credit to small businesses and households

• Because of the difficulties in measuring credit risk during and post-pandemic, the success of innovations in financial technology and lending models, including algorithmic lending, to ensure continued access to credit for underserved borrowers

• Identifying ways financial regulators and supervisors should respond to new risks posed by digital innovations

• How should debt relief policies be designed to minimize moral hazard, threats to credit market transparency, and the risk of hidden debts
Evaluating the impact of COVID-19 policy responses
Requires the collection of new data

For example:
• Financial inclusion of households and firms
• Lending portfolios of banks, fintechs, and nonbank lenders (including MFIs)
  • How much credit is allocated to small businesses and low-income households?
  • How much credit is allocated to sustainable sectors?
• National and sub-national government budgets
• Structure and size of sovereign debt
• Digitization of government and private sector payments
Thank you.

Further questions or comments are welcome - please email lklapper@worldbank.org