IMPACT OF COVID-19 ON THE GLOBAL BANKING SECTOR

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Abstract. *This article discusses the consequence of Covid-19 crisis on the global banking system. The main challenges that banks have faced during this time are analyzed. Even if the pandemic did not have the projected negative financial consequences for the global banking industry, it had plenty of other consequences. The recent trends boosted by Covid-19 such as acceleration of digital banking, decrease of cash and authorities concern about the sustainability are discussed. Moreover, perspectives of recovery and long-term outlook for banking industry are identified.*

Keywords: *banking industry, Covid-19, bank regulatory framework, bank profitability, digitalization, Basel III, non-performing loans.*

Although COVID hasn't been a solvency event for the banking industry, we have seen material profit compression that has reordered banks' priorities. Leading institutions have witnessed double-digit net income declines of 7% in Asia-Pacific, 37% in North America and 51% in Europe in 2020. The pandemic also created a credit crisis. The immediate impact was a substantial increase in the cost of risk for global banks during the first half of 2020. Bad loans also increased again in the second half of 2020, although more moderately given the unprecedented levels of public-sector fiscal support. Despite the size of the provisions, the truth is that, from a capital perspective, banks were better prepared to handle this crisis than they were going into the 2008 Great Recession. Covid-19 crises one more time proved the importance of banking system. Not only were banks instrumental in delivering government aid and ensuring financial stability through their continuous daily operations, but they also opened their balance sheets to lend: loans grew at 11% in 2020, five times more than the consensus prediction, boosted by China (20%) and Europe (9%).

Bank crashes are littered across economic history and remain the single most dangerous risk to the industry. However, it is believed that Covid-19 crisis was much less likely because of the policy measures in the wake of the 2008-09 meltdown sparked by defaults on US mortgages and related securities. The extensive implementation of Basel III international rules for capital and liquidity, as well as national measures such as ring fencing of investment banks in Europe, have made banks more resilient. Global regulations also include stricter rules for systemically important banks. The Covid-19 crisis put those safeguards to the test, and they worked.

One important consequence of the crisis in most markets was a surge in deposits (and, to lesser extent, in securities investment accounts), which according to EIU grew by 13.6% in nominal US dollar terms in 2020. With the exception of those most severely hurt by the disease outbreak and economic lockdown, households and firms set aside emergency funds drawn from their savings on consumption, government assistance, credit lines and capital-raising. Most savers kept funds in highly liquid forms, such as demand deposits, despite a sharp fall in interest rates. Certain middle-income economies experienced an increase in the stock of physical currency as a result, even as the rising popularity of digital payments meant that cash fell out of favour as a medium of exchange.

Despite the abundant, inexpensive resources available to banks, lenders faced difficulties in recycling these deposits into credit for businesses and households. Falls in both deposits and lending rates led to a compression in interest margins, banks' primary source of revenue. This made the extension of many types of credit unappealing in the ab-

sence of state guarantees, which many developed countries offered to ensure the survival of enterprises. Overall, lending to businesses, often backed by official guarantees, grew modestly in most economies, at an estimated 9.7% in US dollar terms. Credit to households was less positive, with loans generally expanding for house purchases or improvements but dropping for consumption (which at any rate was curtailed by lockdowns and quarantines).

Net interest income, a major source of revenue for most banks worldwide, remained stagnant or declined altogether in 2020. Increasing numbers of beleaguered businesses and households were unable to service their debt, leading to heavier bad loans at banks, although the true level of distress was often unclear because of forbearance and moratoria on loan repayments adopted in many economies. However, a robust recovery in most advanced economies and the resulting strong demand for goods, services and labour will avert a deterioration in loan portfolios. The best-performing banks in 2020 were those that were focused on fee-generating activities, a second major source of revenue. Although fees include such diverse activities as loan origination, transaction charges and penalties, the most lucrative in 2020-2021 have concerned capital markets. Rising share prices from April 2020 led to a boom in trading, market fundraising, and mergers and acquisition activity. Low interest rates and a desire to build up emergency cash spurred firms to secure credit lines and raise funds via debt issues. The ability to shift to digital transactions is one reason why banks have outperformed other industries in the coronavirus-afflicted economy. Lenders in most markets have deployed online and mobile services steadily over recent years to meet customer expectations and to compete with alternative financial technology providers. Banks started delivering an additional number of services via digital channels in 2020, primarily as a result of public health concerns during the pandemic, although some more complex operations still require in-person interaction. Increased use of 3G, 4G and now 5G mobile handsets and the decline in cash transactions have facilitated this digital shift.

Recovery in the global banking industry is expected to be uneven across regions. US banks had built up substantial reserves in 2020. But buoyed by government stimulus programs and a strong recovery, the top 100 US banks released 24 billion dollars in loan loss reserves in the first half of 2021 alone, and their counterparts in Canada are doing the same. Unlike European and Asia Pacific banks, which continued to add to their reserves, the top 100 European banks have added 25 billion dollars to their reserves. And those in European and Asia Pacific have provisioned for 125 billion dollars' worth of credit losses in the same period. The brighter outlook for loan loss provisions is helping drive profitability for US and Canadian banks. But sluggish loan growth and modest interest income are likely to dampen growth in both countries. In contrast, because of overexposure to the sectors hardest hit by the pandemic, most European banks have yet to recover to pre-pandemic profitability levels. And they continue to face other challenges: negative rates, fragmentation of the regulatory system, high levels of inefficiency, and the less robust capital markets in Europe. Continued strengthening of Chinese banks are a bright spot in Asia, and banks in Singapore and Australia also remain relatively sound. Otherwise, the region is beset with a k-shaped recovery since many Southeast Asian banks are dealing with asset quality concerns.

Over the longer term the banking industry is likely to tread water in developed economies and in middle-income markets with already extensive banking networks. In such places the majority of the population and businesses are already served by formal financial firms, although there will be some scope to attract customers with more sophisticated credit, payment and investment products. In countries with weak banking networks, which is the case in most developing economies, there will be ample scope to reach new customers, both among unbanked households and businesses. Many governments will continue to promote financial inclusion to reduce poverty, improve distribution of aid and spur collection of taxes. The push will be facilitated by the adoption of mobile devices,

the spread of the internet and the decline in use of cash.

All in all, the world's financial industry will recovery gradually and unevenly in the coming years as the global economy rebounds from the health and economic crises caused by the Covid-19 pandemic. The coronavirus pandemic has boosted some subsectors in the broader financial services industry, while weighing heavily on others. Certain activities, such as digital payments and capital-markets fundraising, have been bolstered, and corporate lending has advanced, primarily because governments have promoted it as part of their relief programmes. The sector as a whole, and banks in particular, have historically been susceptible to crashes in times of economic turmoil, but there were few signs of such instability in this latest crisis, as authorities stepped in to stabilise certain markets, and financial institutions have relied on reform-driven improvements to their own balance-sheet positions over the past decade, which have proven to be largely resilient. Stung by recent financial crises, in the coming years banks will generally shift to safer business models focused on deposit-taking, simple commercial and household lending, and asset management. A smaller number of firms will dominate risky, sophisticated capital markets activities, which will be increasingly walled off from traditional banking and government-guaranteed deposits.

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ВЛИЯНИЕ COVID-19 НА МИРОВОЙ БАНКОВСКИЙ СЕКТОР

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Аннотация. *В этой статье обсуждаются последствия кризиса Covid-19 для мировой банковской системы. Анализируются основные вызовы, с которыми столкнулись банки за это время. Даже если пандемия не имела прогнозируемых негативных финансовых последствий для мировой банковской индустрии, она имела множество других последствий. Обсуждаются недавние тенденции, вызванные Covid-19, такие как ускорение цифрового банкинга, сокращение наличных денег и озабоченность властей по поводу устойчивости. Кроме того, исследуются перспективы восстановления и долгосрочные перспективы банковской отрасли.*

Ключевые слова: *банковская отрасль, Covid-19, банковская нормативная база, прибыльность банков, цифровизация, Базель III, проблемные кредиты.*