CAREC High-Level Virtual Policy Dialogue

on

COVID-19 Pandemic – Financial Stability; Implications and Regional Cooperation

14 December 2020, 7.30 pm Manila time; Virtual meeting

SUMMARY

The CAREC Secretariat organized a virtual high-level dialogue discussing lessons learned on maintaining financial stability in the wake of the COVID-19 pandemic on 14 December 2020. The webinar saw participation from senior central bank officials, financial regulatory authorities, finance ministries and other officials from CAREC countries, together with senior representatives from the ADB, International Monetary Fund (IMF), World Bank, and ASEAN+3 Macroeconomic Research Office (AMRO).

Mr. Ajmal Ahmady (Governor of Central Bank of Afghanistan) chaired the event and provided opening remarks. They focused on the importance of ensuring financial stability during and after the pandemic and the Afghan government's focused policy responses in the health sector, and regarding food security and the trade and transit mechanisms that ensured the flow of essential goods and commodities. He also emphasized the role of IFIs and partnership that has helped Afghanistan quickly respond to the risks to the economy and the financial system. Mr. Werner Liepach, Director General of Central and West Asia Department (CWRD) at ADB offered welcome remarks and described the context for this event, noting the exposed vulnerabilities of the highly interconnected global and regional financial systems to the impact of the COVID-19 pandemic, and highlighting the importance of sharing lessons and knowledge across the various stakeholders to build resilience of the financial systems with collective efforts.

Mr. Tobias Adrian (the IMF's Financial Counselor and Director of the Monetary and Capital Markets Department) gave a keynote presentation, discussing the impact of the pandemic on financial systems and the unprecedented policy responses from CAREC countries to keep markets functioning, maintain the flow of credit and alleviate the adverse macro-financial feedback loops. However, the recovery faces challenges owing to still high funding costs, subdued bond flows, and elevated vulnerabilities in the financial and corporate sectors. Important intertemporal trade-offs exist, whereby greater liquidity support provided to the corporate sector may merely postpone the materialization of solvency problems, and the increased use of capital buffers by banks during the pandemic may limit their capacity to lend during the recovery. Careful balancing of near- and medium term considerations requires maintaining monetary accommodation until its policy objectives are achieved, continuing liquidity support while incentivizing exit, and transitioning to rebuilding buffers and dealing with debt overhang when the recovery takes hold.

A panel discussion on CAREC DMCs experiences and the IFI's perspective on financial stability during the pandemic was moderated by Ms. Asli Demirgüç-Kunt (Chief Economist, Europe and Central Asia, World Bank). The panel started off with a discussion on the unique challenges for financial stability posed by the pandemic and the country-specific policy responses that have been adopted.

Azerbaijan: Mr. Rustam Tahirov (Deputy Head of Financial Stability Department, Central Bank of Azerbaijan) stated that Azerbaijan was exposed to a double shock: from the pandemic and the decline in oil prices. The authorities quickly and successfully responded with fiscal support, monetary easing, and initiatives in the banking sector, including reduction of capital adequacy requirements and liquidity injections, amongst other measures. Measures taken after the previous crisis helped strengthen the banking sector before the pandemic unfolded.

Afghanistan: Mr. Ahmady stated that to deal with risks posed to the economy and the financial system, the central bank quickly eased the reserve requirements in the banking sector, provided liquidity in the financial systems, and extended loan guarantee programs. The IFIs, including the IMF, World Bank, and ADB provided financial support and policy advice to Afghanistan, which helped the authorities respond quickly and effectively to the pandemic.

Mongolia: Mr Ganbold Enkhtaivan (Deputy Governor, Bank of Mongolia) stated that the government and central bank worked together seamlessly and quickly introduced emergency regulatory and fiscal measures. The fiscal measures included tax exemptions on high priority goods, support for rent payments, and distribution of food stamps for households. The monetary policy rate was reduced significantly and reserve requirements were eased, supporting the flow of credit to the economy.

Uzbekistan: Mr. Botir Zakhidov (First Deputy Chairman, Central Bank of Uzbekistan) explained measures that the central bank took to respond to the crisis, including extending credit repayment period, injecting liquidity, and modifying capital buffers for banks. Non-performing loans increased, but gradual resumption in economic activity improved the loan repayment ratio. The government recognized the importance of establishing proper risk identification and response mechanism for shocks to the financial system.

Kyrgyz Republic: Ms. Altynai Aidarova (Director of Economic Department, National Bank of the Kyrgyz Republic) mentioned the various steps taken by the central bank, which included injecting liquidity to commercial banks for an extended period of time, introducing a credit auction system, and supporting loan restructuring undertaken by banks. Digital finance and services were actively adopted to support better functioning of the payment system and to enhance access to financial services during the pandemic.

The panel also discussed lessons CAREC countries learned from the previous global financial crisis and their responses to the current pandemic.

Kazakhstan: Mr.Oleg Smolyakov (First Deputy Chairman, the Agency of the Republic of Kazakhstan for Regulation and Development of Financial Market) stated that the previous financial crisis prompted overall improvements in the corporate and banking systems and practices: enhancements in transparency, better management of non-performing loans, and increases in capital buffers. The key lesson from Kazakhstan's policy responses to the crisis was how to balance temporary measures aimed at easing financing conditions and supporting corporate lending with improvements in risk management.

Georgia: Mr. David Utiashvili (Head of Financial Stability Department, National Bank of Georgia) stated that the government, learning lessons from the previous shocks, took measures to increase the quality and quantity of capital and liquidity buffers, strengthen the regulatory framework, establish crisis response funds, and temporarily relax capital adequacy requirements for banks, among other steps. An important factor that needs to be considered in the pandemic context is the use of fintech and digital finance, which can help the under-served sectors of the economy, including SMEs and the poor, to gain easier access to credit and financial services.

Tajikistan: Ms. Nigina Kurbonalieva (Head Department of Financial Stability, National Bank of Tajikistan) stated that commercial banks' performance was moderate amid ample liquidity. However, risks of exchange rate instability and weakening asset quality in the banking system require careful consideration. The central bank responded to the pandemic by reducing the refinancing rate and the requirement for mandatory reserves, among other steps. IFIs' policy advice and sharing of international experiences is helping improve the resilience of the financial system in the wake of the unexpected and unprecedented global shocks.

Mr. Subir Lall (Deputy Director, Middle East and Central Asia Department, IMF) stated that risks to the financial systems should be analyzed in the broader economic context. Ensuring resilience of the financial system and the economy to shocks requires sufficient capital and fiscal buffers, healthy balance sheets of the private sector, and economic diversification. Providing sufficient credit to SMEs and the informal sector is important, not only for job creation but also for achieving economic diversification.

Mr. Martin Melecky (Lead Financial Economist on Central Asia, World Bank) mentioned that Europe and Central Asian (ECA) countries entered the pandemic with better liquidity and capital positions than during the previous financial crises. However, there is variation in performance among countries depending on progress made on improving the regulatory framework, insolvency regimes, and broader financial sector reforms. While each country has a wide array of policy options to respond to the crisis, the success of the implementing those policies depends on the fundamental strength of the financial sector. It is also important that all countries consider how to accelerate reform efforts after the crisis and how to exit crisis policies in an orderly manner, with a view to normalizing the situation in the financial sector.

Mr. Jun-Kyu Lee (Head of Financial Sector Group, ADB) discussed the risks the pandemic poses to financial stability. He highlighted the significant impact of decreases in remittances, which are large relative to the size of the economy in many CAREC countries and have a direct impact on household incomes. Mr. lee emphasized the importance of a forward-looking approach and robust monitoring systems when assessing possible channels of transmission between the financial system and the rest of the economy. He also discussed other important issues, including sudden capital flight caused by shifts in investment sentiment, disaster risk financing, fintech and cyber-security.

The panel also focused on experiences in regional cooperation in dealing with the pandemic.

Mr. Han Beomhee (Group Head, Chiang Mai Initiative Multilateralization Support, AMRO) presented on ASEAN+3's response to the COVID-19 pandemic. The ASEAN+3 economies entered the pandemic crisis in a relatively healthy shape during the pandemic. This was due to a large domestic build-up of foreign exchange reserves, capital flow management, regional financing arrangements, standby arrangements, crisis prevention facilities, short and long-term financing instruments, and other instruments, such as bilateral swap agreements amongst central banks.

Pakistan: Mr. Muhammad Javaid Ismail (Director, Financial Stability Department, State Bank of Pakistan) stated that Pakistan's central bank quickly eased monetary policy and introduced measures such as increasing capital buffers, extending existing loan maturity, supporting consumer financing, and promoting digital payment systems. The key lessons learnt included the importance of a proactive and swift central bank engagement, coordination among all stakeholders, and the need for a well-designed monitoring and surveillance system to assess risks in the economy. The current pandemic crisis can be an important opportunity for all countries to promote digitalization of financial system and fintech for better outreach and services.

Turkmenistan: Mr. Rovshen Nuryagdyyev (Deputy Minister of Finance and Economy) stated that given higher budget deficits and increased tax burden in most CAREC countries, IFIs can consider supporting the member countries by extending loan periods to ease fiscal burden and support financial stability.

Mr. Jun-Kyu Lee (Head of Financial Sector Group, ADB) discussed contagion effects of the crisis and high loan dependence. He stated that coordinated regional efforts need to be made to improve financial access for the under-served, including poor households and SMEs, to build resilience of the financial system, and to deal with large capital outflows.

Mr. Peter Rosenkranz (Economist, ERCI, ADB) mentioned that despite the provision of liquidity support thus far, the risk of an increase in non-performing loans remains, which may have an adverse impact on bank stability and jeopardize credit flow to SMEs. Regional efforts to promote the sharing of knowledge about best practices to resolve non-performing loans could be valuable. Further, fluctuations in the commodity price cycle as well as deteriorating remittances can lead to greater risks and current account deterioration, especially in the dollarized economies. This in turn could transmit risks to other countries through contagion and negative cross-border impacts.

Ms. Asli Demirgüç-Kunt (Chief Economist, Europe and Central Asia, World Bank) closed the panel discussion with her own reflections on the what to do in order to prevent a widespread financial crisis as a result of this pandemic. She noted that rising non-performing loans will require a proactive and coordinated policy response and the effective resolution of non-performing loans starts with clarity about banks' exposures to problem assets. She also noted that while debt relief and repayment moratoriums made sense when COVID-19 struck, a timely and orderly exit strategy from these measures should be prioritized. Finally, distressed but potentially viable firms may need loan restructuring.