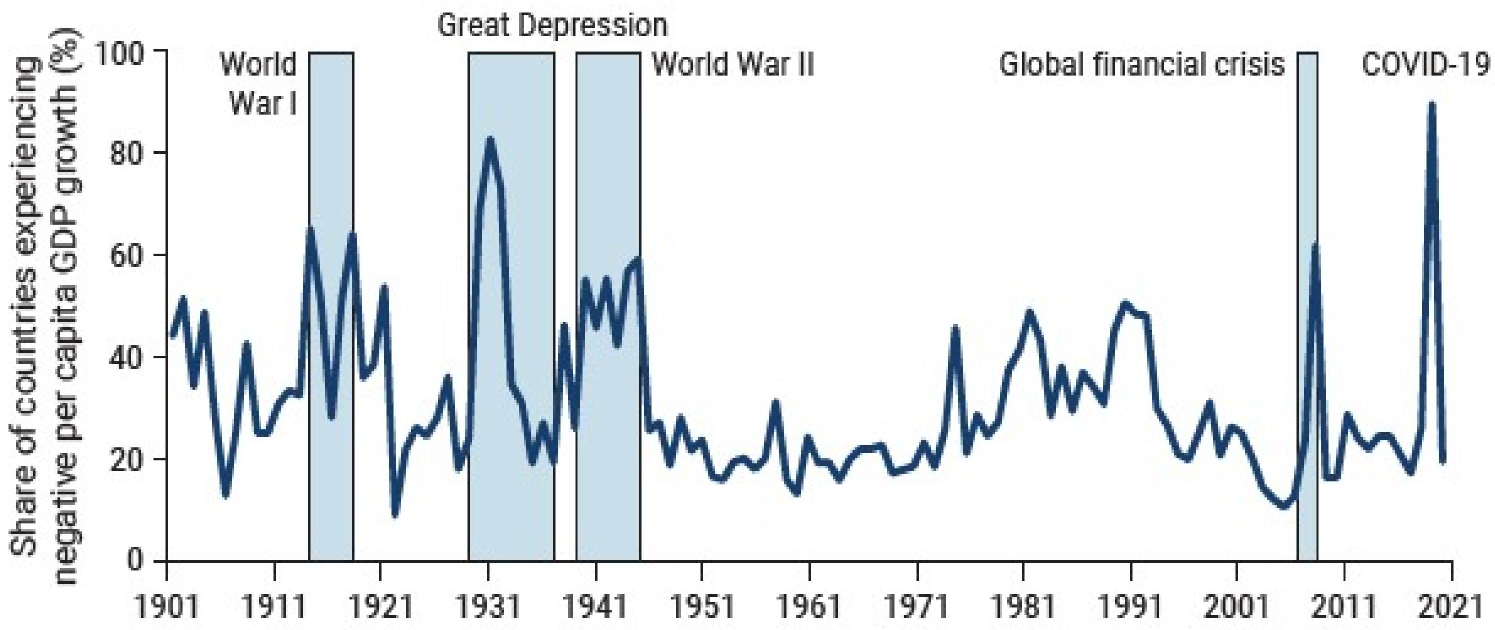
Japan International Cooperation Agency (JICA)

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



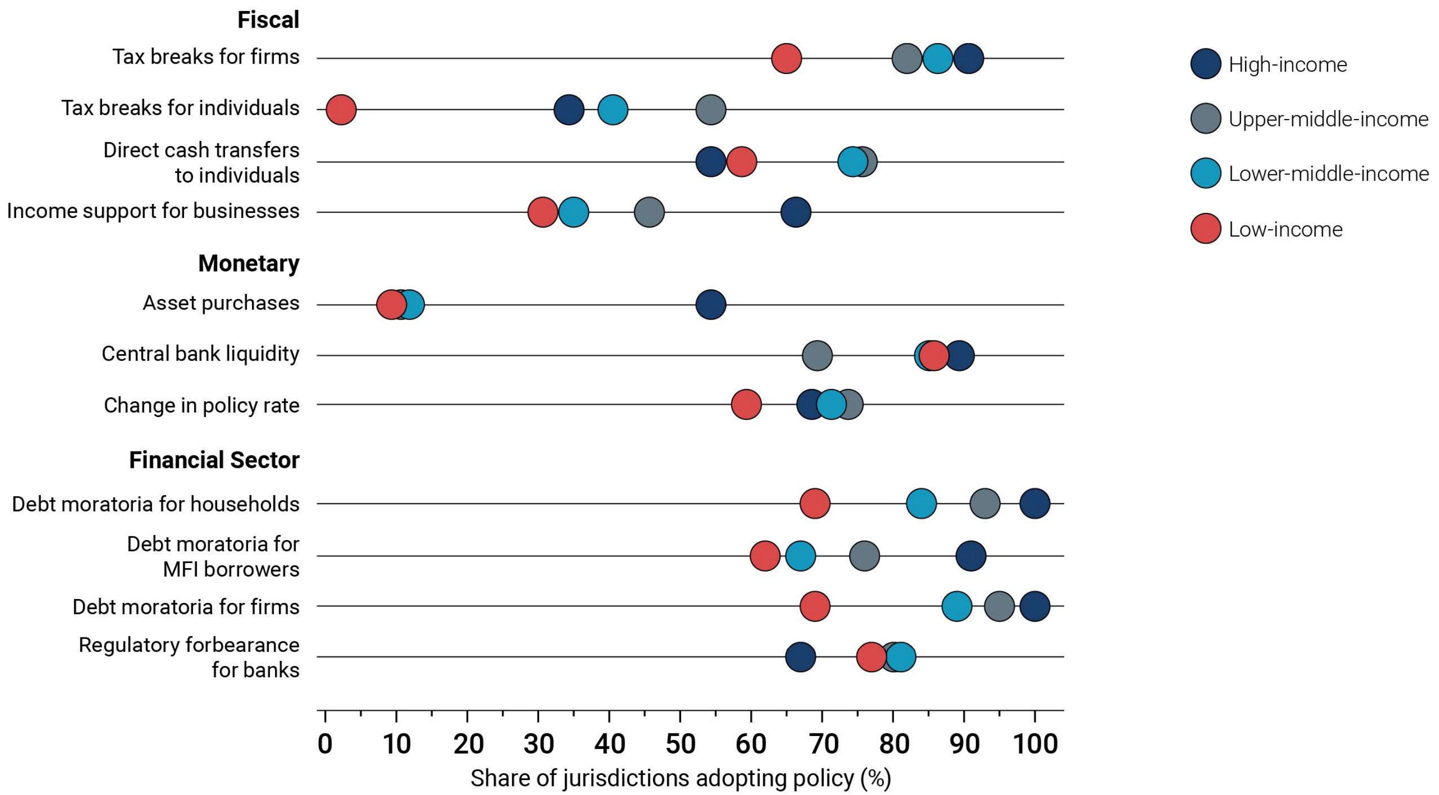
Source: Holston, Kaminsky, and Reinhart (2021) based on data from the IMF World Economic Outlook and the Maddison Project Database (2020).

In East Asia and Pacific, **11 of 14 countries** experienced a drop in GDP growth in 2020 in 2020

Regulators implemented unprecedented measures

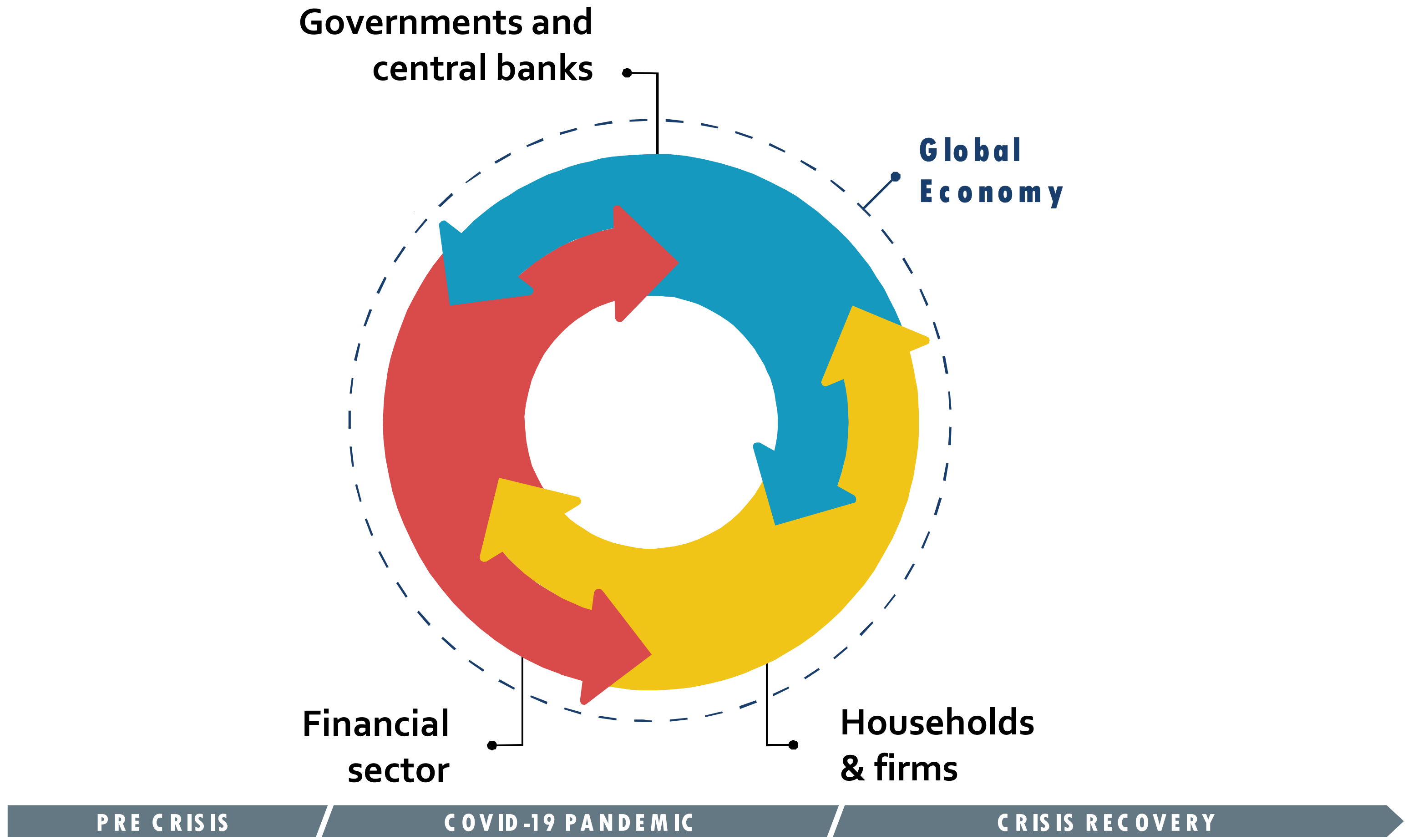
Which helped mitigate short-term impacts, yet also revealed longer-term risks

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



Source: WDR22 World Bank Crisis Response Survey, 2021.
Note: The figure shows the percentage of countries in which each of the listed policies were implemented in response to the pandemic.

Economic risks – and strengths – accumulate due to interconnections between sectors



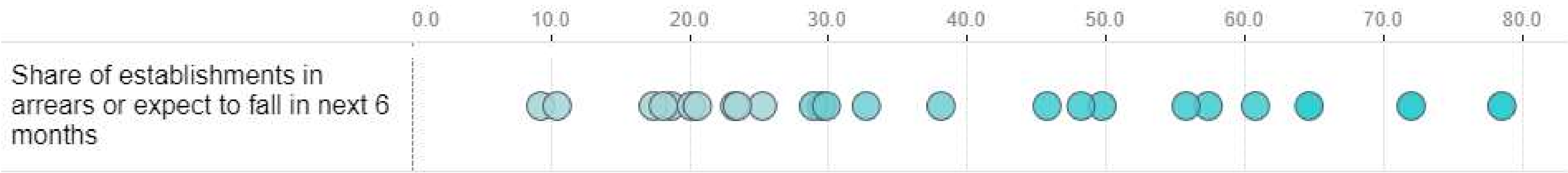
Recommended:
Timely action in four key policy areas

- Managing and reducing loan distress
- Improving the legal insolvency framework
- Ensuring continued access to finance
- Managing increased levels of sovereign debt

Risk: Rising nonperforming loans

- Increasing transparency and reducing the share of non-performing loans enables financial institutions to remain stable, well-capitalized, and able to provide credit, especially to low-income households and small businesses

Firms in emerging markets report financial vulnerability



Source: World Bank COVID-19 Business Pulse Survey Dashboard, March, 2022; Data includes 26 middle- and low-income countries.

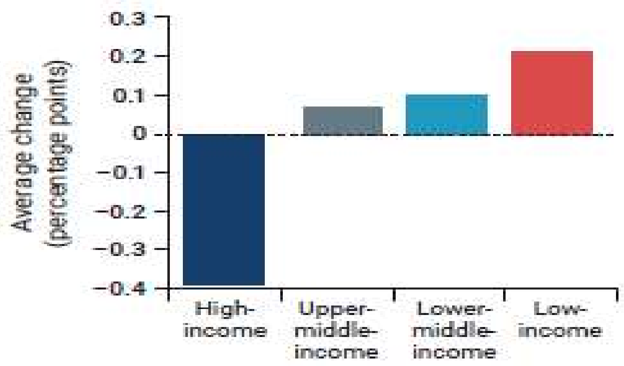
Managing and Reducing Financial Distress

The importance of timely NPL management

- High NPL levels:
    - Burden all levels of an economy
    - Depress economic growth, as for example in the case of Japan or countries in Central, Eastern, and Southeastern Europe in the aftermath of the 2007-2009 Global Financial Crisis
    - Are associated with capital misallocation, translating into lower economic output, investment, and employment

- **The negative cycle of high NPLs leading to low economic growth is not inevitable**

Changes in nonperforming loan ratios, by country income group, 2020–21



Source: WDR 2022 team, based on data from International Monetary Fund, FSIs (Financial Soundness Indicators) (dashboard), https://data.imf.org/?sk=51B096FA-2CD2-40C2-8D09-0699CC1764DA.

Risk: Rising Non-Performing Loans

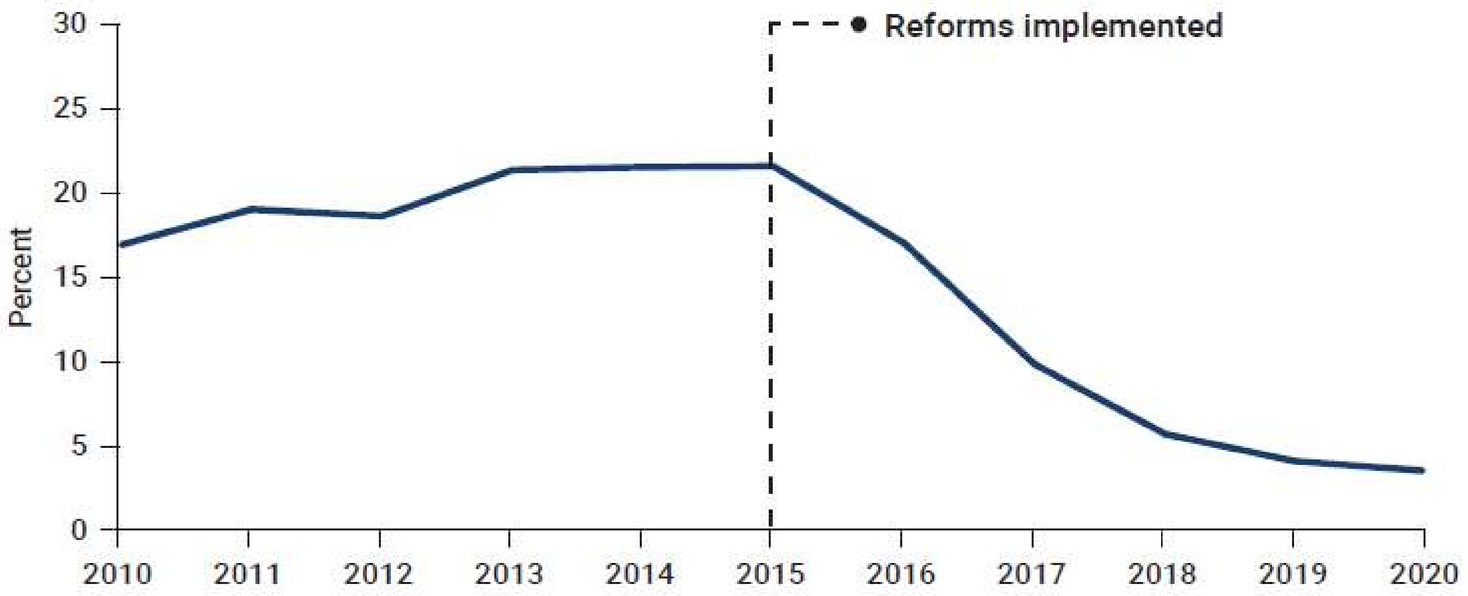
Policy Priorities:

- Ensuring clear, consistent practices for reporting on asset quality
- Developing the capacity to manage nonperforming loans
- Dealing with problem banks swiftly

Managing and Reducing Financial Distress

Banks, when left to their own devices, are slow to reduce elevated NPLs

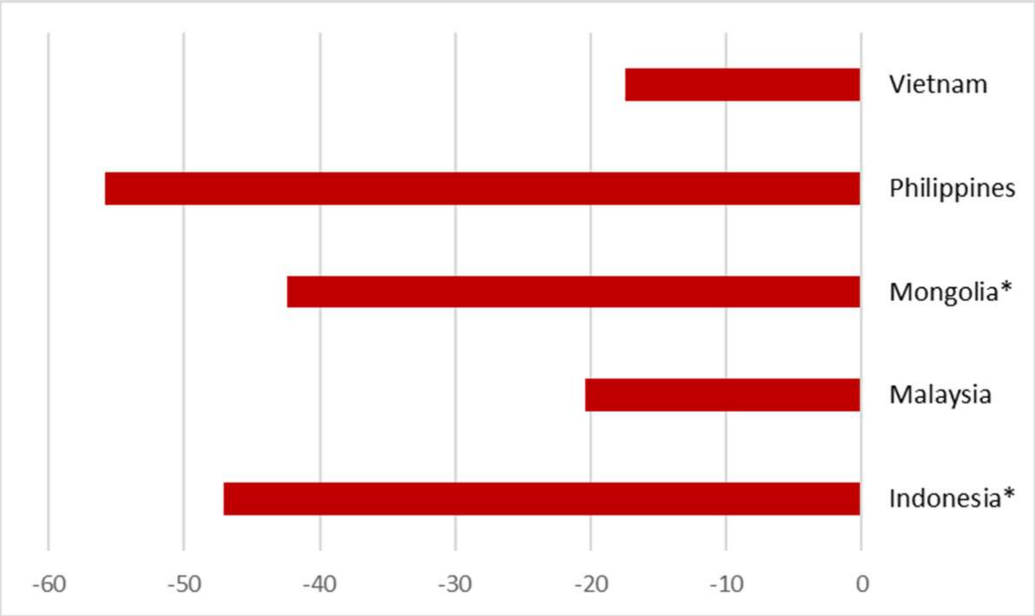
Ratio of nonperforming loans to total loans, Serbia, 2010–20



Source: WDR 2022 team, based on data from National Bank of Serbia, https://www.nbs.rs/export/sites/NBS_site/documents-eng/finansijska-stabilnost/pregled_grafikona_e.pdf.

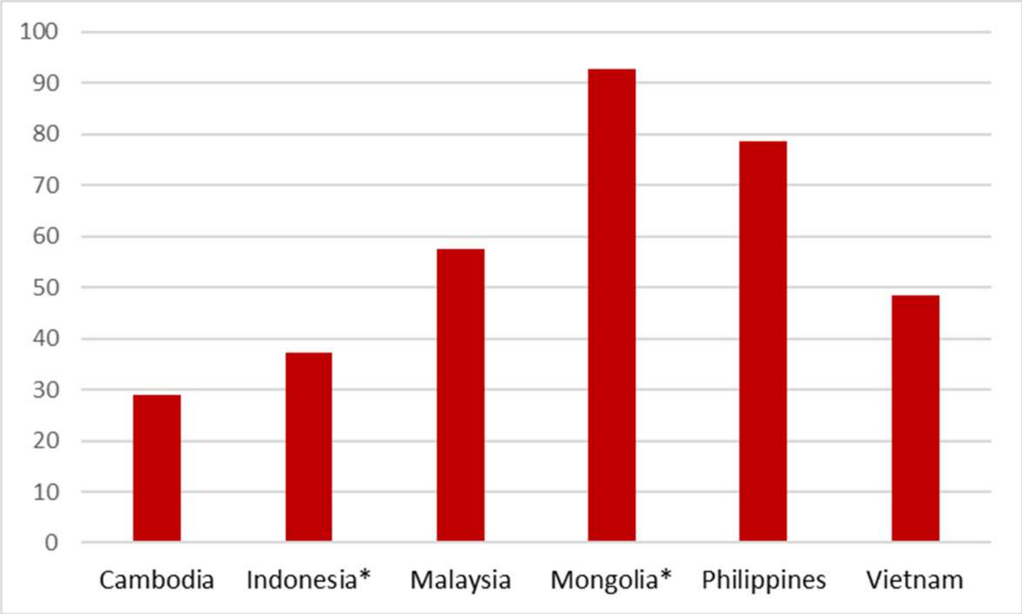
Risk: Delayed Resolution of Distressed Loans

Average percentage change in monthly sales compared to previous year



Source: World Bank "COVID-19 Business Pulse Surveys Dashboard".
*Note: Data is from Wave 3; * indicates Wave 2.*

Share of establishments in arrears or expecting to fall into arrears in next 6 months



Source: World Bank "COVID-19 Business Pulse Surveys Dashboard".
*Note: Data is from Wave 3; * indicates Wave 2.*

Risk: Delayed Resolution of Distressed Loans

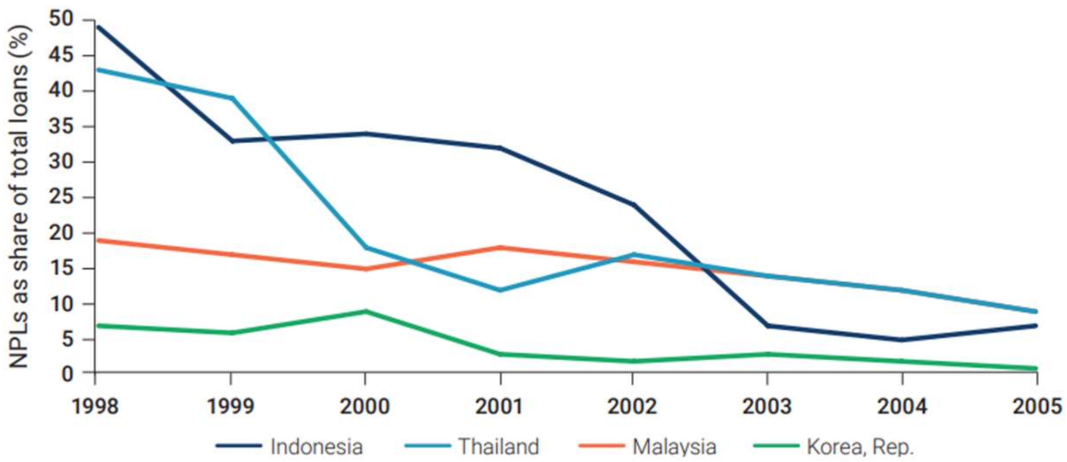
Policy Priorities:

- Strengthening formal insolvency mechanisms
- Facilitating alternative dispute resolution systems such as conciliation and mediation
- Establishing accessible and inexpensive in-court and out-of-court debt resolution procedures for micro-, small, and medium enterprises
  - Myanmar implemented a MSME-specific insolvency regime in February 2020
- Promoting debt forgiveness and discharge of natural person debtors

Risk: Delayed Resolution of Distressed Loans

MSME Insolvency reform during the Asian Financial Crisis

In the late 1990's and early 2000's, NPL ratio in Southeast Asia exceeded 40% and in response, many countries adopted various reform measures:



Source: Lee and Rosenkranz 2019.
Note: NPLs = nonperforming loans.

- Malaysia took an approach that was segmented by firm size and characterized by a (relatively) interventionist regulator.
- The Republic of Korea deployed a segmented approach as well in which the restructuring framework was effectively reserved for large debtors in the early phase of their crisis.
- Thailand's approach went through stages, beginning with a consensual debt resolution scheme involving creditors and debtors and subsequently turning to more targeted and intrusive measures.

Risk: Delayed Resolution of Distressed Loans

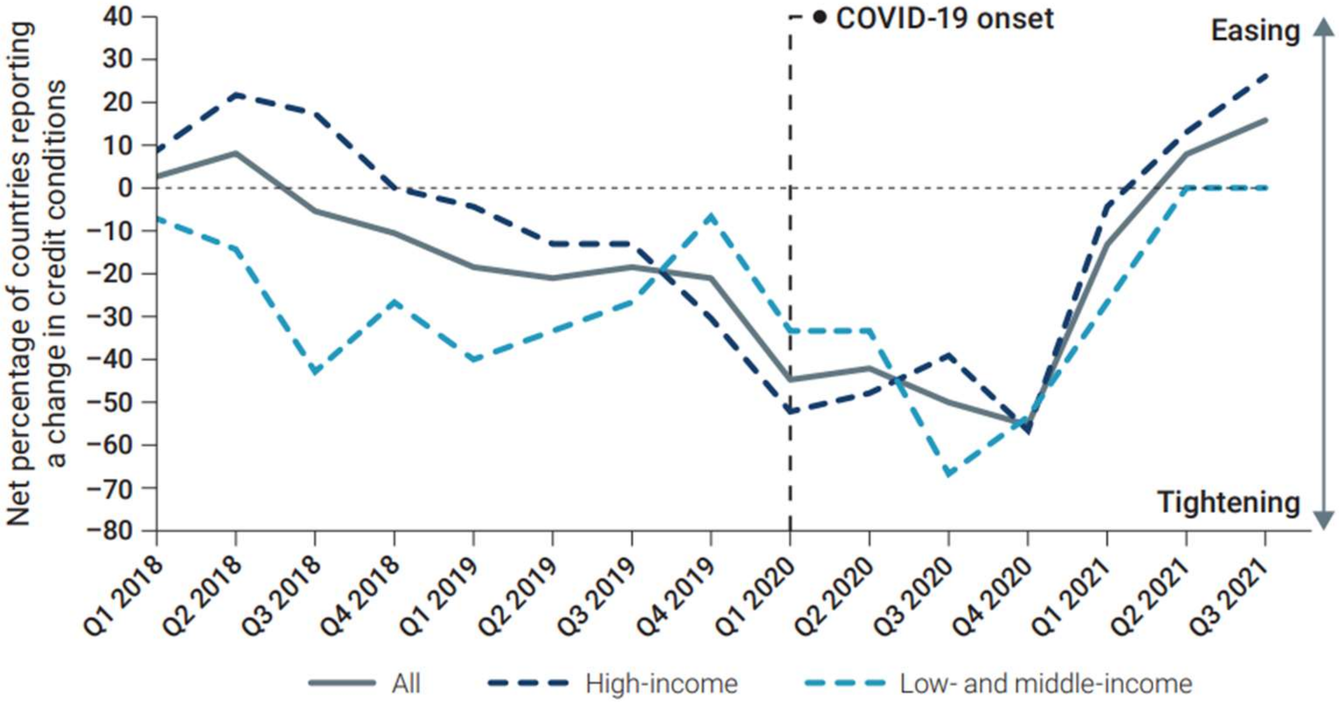
Poland’s Act of Financial Restructuring of Enterprises and Banks

How out-of-court restructuring can quickly help deal with rising NPLs

- Financial institutions brokered conciliation agreements with debtors and divested NPLs on the secondary market which resulted in banks receiving an influx of capital to facilitate the restructuring process
- By mid-1995, about 85% of the conciliation agreement had been finalize, features included debt write-offs, extensions of the payment period, more favorable trms for small creditors, debt-for-equity swaps.
- The NPL rates fell from 31% in 1993 to 9% in 1996.

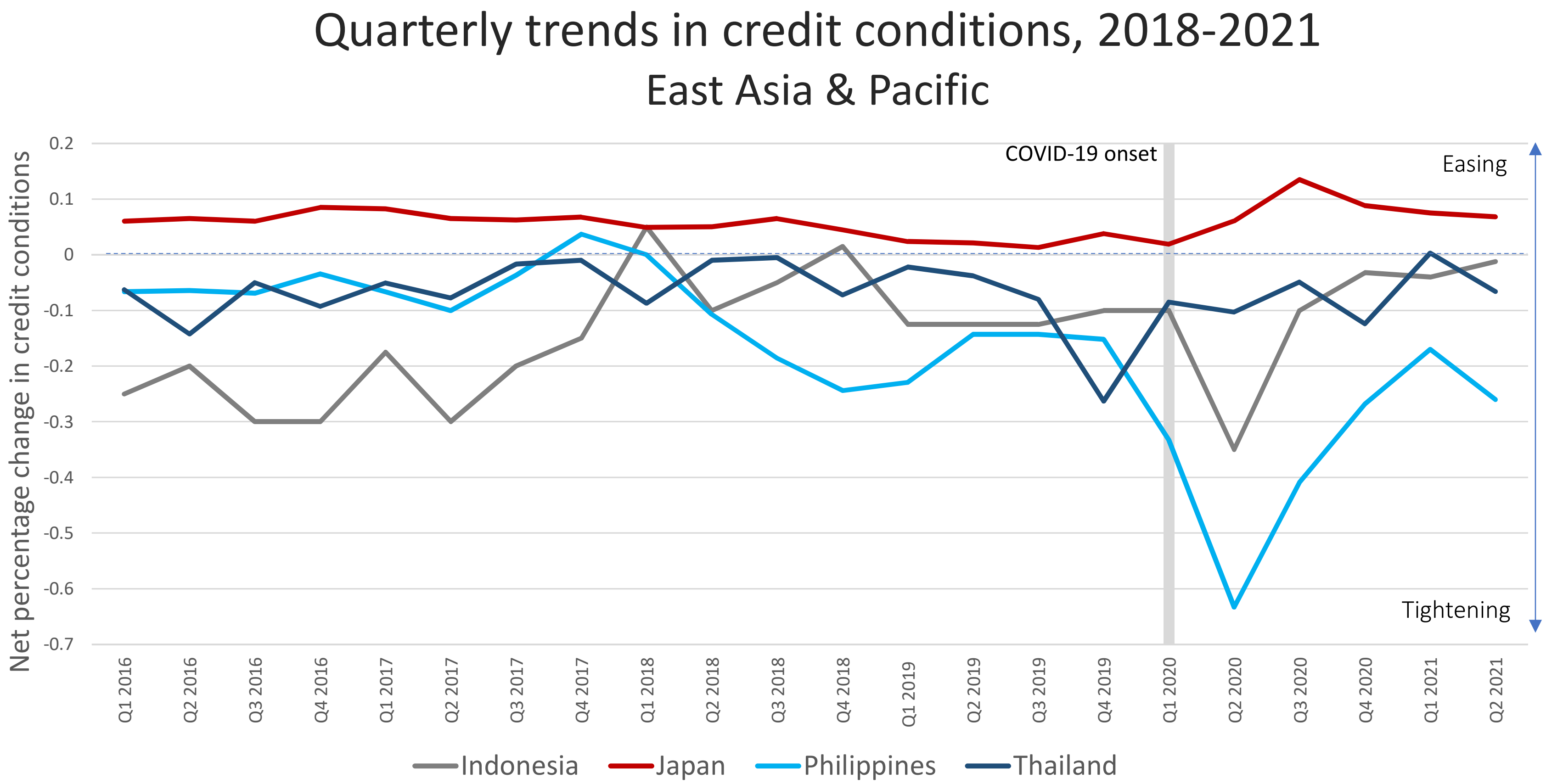
Risk: Tighter Access to Credit

Quarterly trends in credit conditions, by country income group, 2018–21



Source: WDR 2022 team calculations, based on data from survey reports by the central banks of 38 countries published or accessed as of December 15, 2021: Albania, Argentina, Austria, Belgium, Canada, Chile, Cyprus, Czech Republic, Estonia, France, Germany, Ghana, Greece, Hungary, India, Indonesia, Ireland, Italy, Japan, Latvia, Lithuania, Mexico, the Netherlands, North Macedonia, the Philippines, Poland, Portugal, Romania, the Russian Federation, Serbia, Spain, Thailand, Turkey, Uganda, Ukraine, the United Kingdom, the United States, and Zambia.

Risk: Tighter Access to Credit



Source: based on data from survey reports by the central banks of Indonesia, Japan, Philippines and Thailand, published or accessed as of December 15, 2021.

Risk: Tighter Access to Credit

Financial sector showing signs of recovery but credit for MSMEs remains tight

Insights from survey of 197 IFC client financial institutions – Nov/Dec 2021

Impacts (Q4 2021)		Outlook 2022	
34%	Operate below pre-crisis levels	2/3	reach full recovery
51%	Collection levels still affected		
1.2p	Avg. increase in NPL (+25%, Jun 19-Jun 21)	84%	Expect asset quality stable (33%) or improved (51%)
61%	Lending returned to pre-crisis levels	+7%	Demand is above pre-crisis levels
46%	Tighter credit standards for MSMEs	=	No expected change in overall credit standards (1/4 tighten, 1/4 ease, 1/2 no change)

Source: IFC Financial Institutions COVID-19 Impact Survey (public report forthcoming)

Opportunity: Leverage Tech to Improve Access to Credit

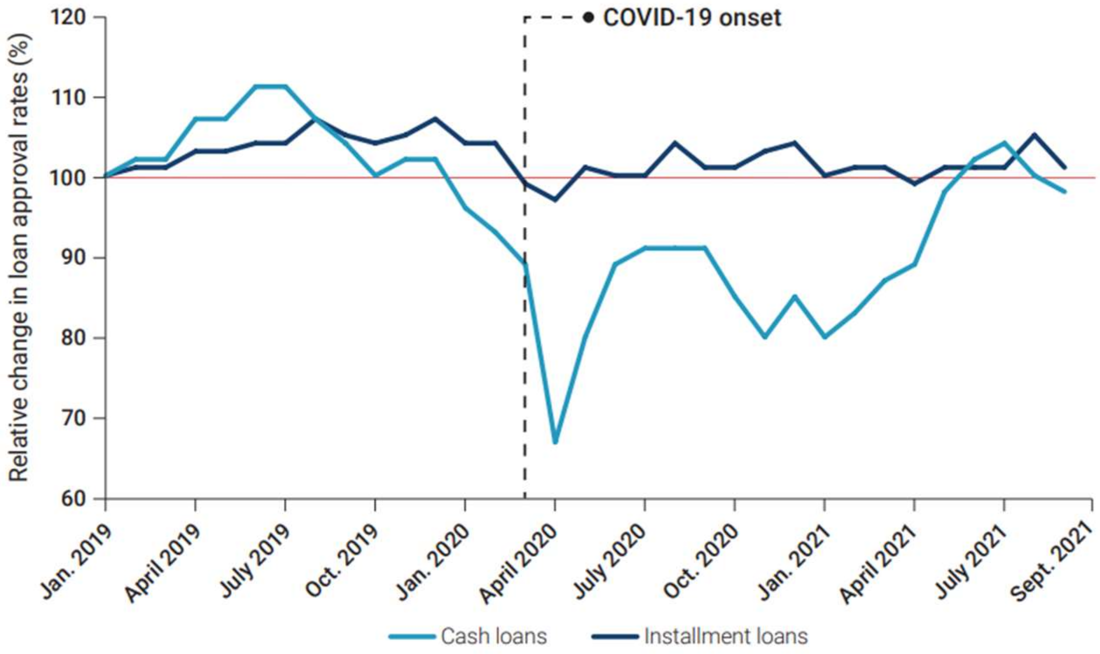
	Improve visibility	Strengthen recourse	Reduce risk
Risk measurement			
Alternative data	●	○	○
Enhanced analytics	●	○	○
Product choice and design			
Loan tenor	●	○	○
Secured credit	◑	◑	○
Embedded finance	●	◑	◑
Supply chain finance	◕	◔	◑
Insuring risk			
Credit guarantees	○	●	●

Source: WDR 2022 team.

Note: Shaded circles indicate the increasing relevance of each solution for the respective challenge, from not applicable (○) to degrees of relevance (◔◑◕) to highly relevant (●).

Risk: Tighter Access to Credit

Impact of the COVID-19 pandemic on consumers' loan approval rates, by product type, Poland, 2019–21



Source: Biuro Informacji Kredytowej S.A. (Credit Information Bureau) analysis based on proprietary data.

Note: The figure shows for Poland the relative change in approval rates for cash and installment consumer loan products from January 2019 to September 2021, compared with their respective approval rates as of January 2019. Approval rates are defined as the share of customers who applied for a cash or installment loan during a two-week period and were granted the respective loan product by any Polish lender.

Opportunity: Leverage Tech to Improve Access to Credit

MSE financing throughout the pandemic: The case of China’s MYbank

- MYbank, an online bank serving mostly micro- and small enterprises (MSEs) in China, nearly doubled its reach during the pandemic, from 21 million MSEs in 2019 to 40 million MSEs as of June 2021.

- MYbank’s credit underwriting uses machine learning techniques to integrate payments and transaction data, as well as other user information from these platforms to inform its risk profiles. As of June 2021, MYbank’s nonperforming loan ratio was 1.52 percent.

- It used real time data to adjust credit underwriting models and strategies and expand its reach within China.

- In March 2020, Mybank initiated a partnership with the All-China Federation of Industry and Commerce to collaborate with over 100 banks to offer a jointly financed and administered loan product. Banks were able to provide access to finance for MSEs by leveraging MYbank’s loan processing facility and its transaction data

Opportunity: Leverage Tech to Improve Access to Credit

Policy Priorities:

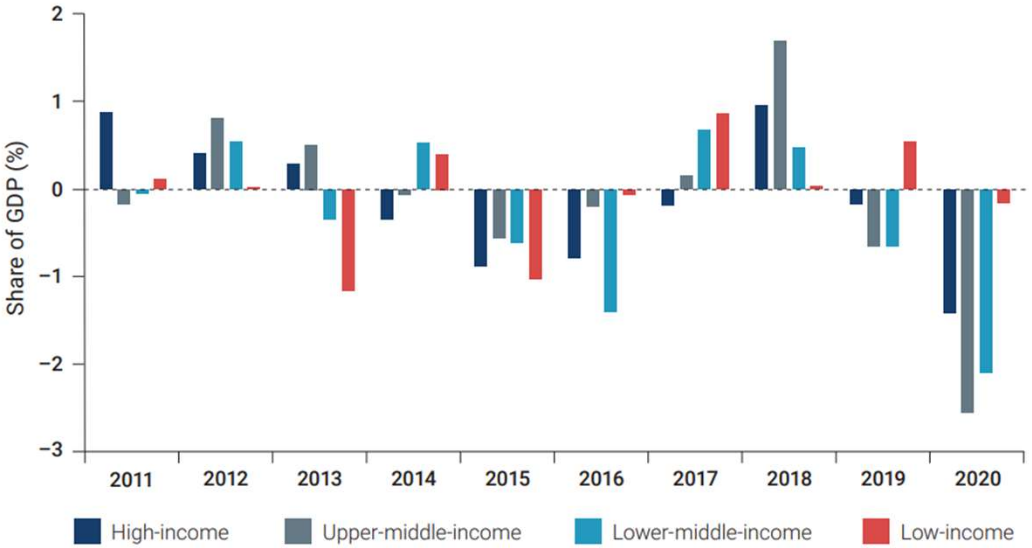
- Creating an enabling environment to leverage alternative data
- Embracing innovations in product design and embedded finance
- Providing well-tuned guarantee programs
- Advancing the regulatory framework and financial infrastructure

Spotlights: Focus on inclusive and sustainable finance

- Financial inclusion and financial resilience
- Strengthening the regulation and supervision of microfinance
- Supporting MSMEs and informal businesses through recovery requires concerted efforts to support MFIs
- Public credit guarantees to support MSME's, designed to mitigate the risks of moral hazard, politicization
- **Greening of capital markets: Issuance of sovereign sustainable bonds**

Risk: Elevated Levels of Sovereign Debt

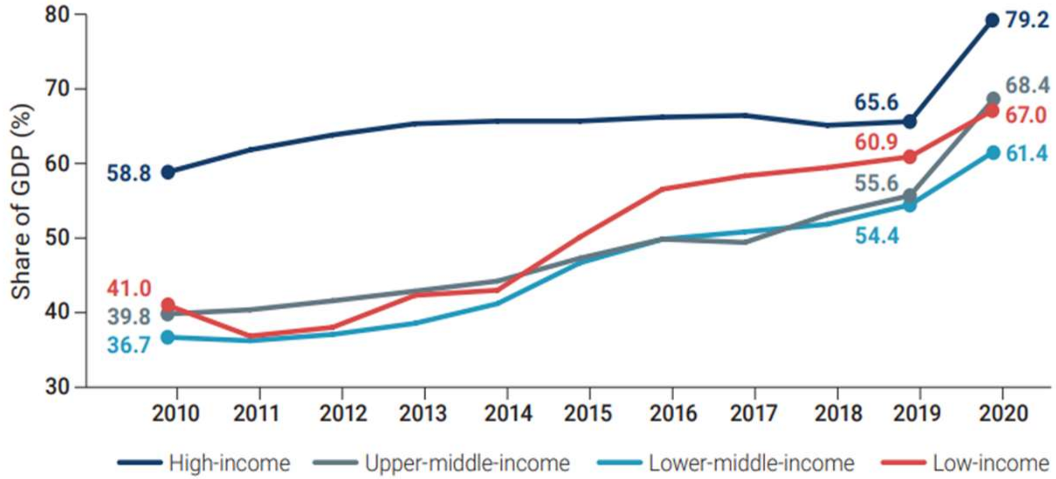
Change in average government revenue, by country income group, 2011–20



Source: WDR 2022 team, based on data from IMF (2021b).

Note: The figure shows the difference relative to the prior year in average revenue as a share of the gross domestic product (GDP) for each country group.

General government gross debt, by country income group, 2010–20



Source: WDR 2022 team, based on data from IMF (2021b); World Bank, World Development Indicators (database), https://datatopics.worldbank.org/world-development-indicators/.

Risk: Elevated Levels of Sovereign Debt

Policy Priorities:

- Governments at high risk of debt distress can pursue proactive debt management approaches
- Governments in debt distress must coordinate with creditors to restructure debt
- Governments and their creditors can benefit from improvements in sovereign debt transparency
- Contractual innovations can help overcome coordination problems and speed up the resolution of unsustainable debts
- Well-developed tax policy and investments in tax administration can support debt sustainability in the longer run

Risk: Elevated Levels of Sovereign Debt

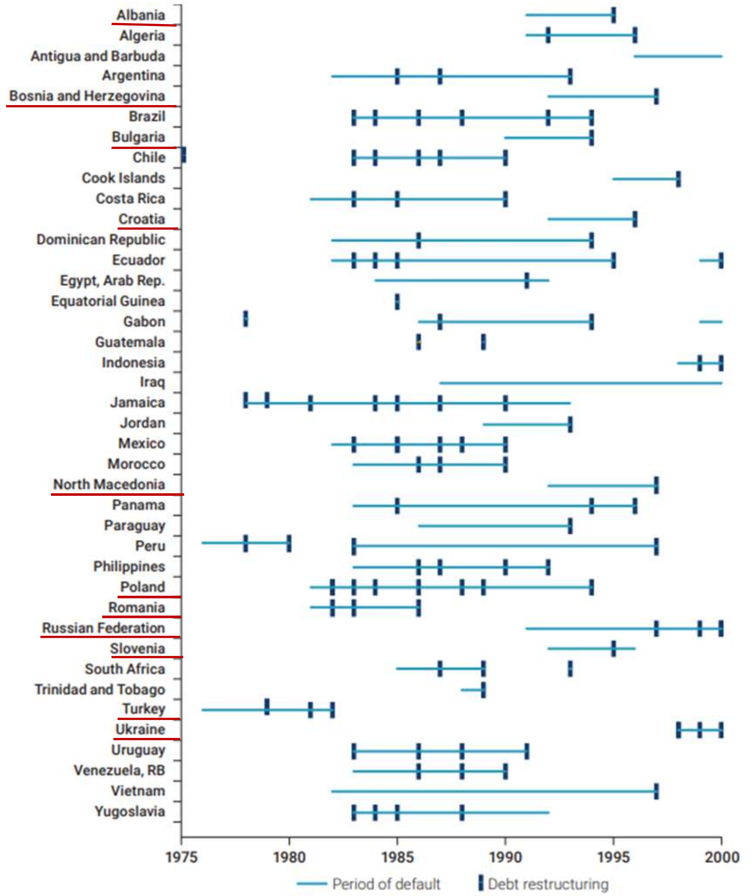
The importance of timely sovereign debt restructuring

- Evidence from past debt crises shows that the average default spell lasts eight years, and the indebted country typically goes through two debt restructurings before it emerges from default
  - Poland engaged in seven debt restructuring deals with private external creditors before resolving their default spell

- Postponing debt resolution efforts until economic conditions improve can deepen and prolong an economic downturn having a far-reaching social and economic consequences in which development goals suffer significant setbacks, delaying an equitable recovery

- Creditors and debtor governments should thus view debt restructuring as part of the initial resolution and recovery plan rather than as a subsequent step

Sovereign debt restructuring and time spent in default, selected countries, 1975–2000



Source: WDR 2022 team, based on Cruces and Trebesch (2013); Farah-Yacoub, Graf von Luckner, and Reinhart (2021); Meyer, Reinhart, and Trebesch (2019); Reinhart and Rogoff (2009).

Note: The figure shows a timeline of sovereign defaults and debt restructuring from 1975 to 2000. The figure excludes countries covered by the International Development Association (IDA) and the Heavily Indebted Poor Countries (HIPC) Initiative.

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