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THE IMPACT OF COVID-19 ON ACTIVITIES OF BANKS

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Abstract

The COVID-19 pandemic is causing unpredictable disruption in the global economy. The pandemic affects every sector of the economy. As a result of this virus, the world economy is weakening, and this is also happening in Bulgaria.

The banking sector is an important component of every economy. The banks have a fundamental role as providers of payment services, liquidity, and funding to businesses and individuals during the COVID-19 crisis.

This paper aims to examine the impact of COVID-19 on bank liabilities and assets during the crisis and their role in the recovery of the economy. During the COVID-19 crisis, the business reduces its deposits because it does not have enough purchases and receivables. Firms need lending to cover inequality between in- and outflows, decide their liquidity problems, and ensure the working capital to restart business. The risk during the COVID-19 crisis rises and the quality of credit portfolio will deteriorate, by increasing non-performing loans.

Keywords: COVID-19, banks, credit

JEL: G21, E32, E51

Introduction

The COVID-19 pandemic is causing unpredictable disruption in the global economy. The pandemic affects every sector of the economy.

The main goal of economic policy after the pandemic of COVID-19 is the recovery of the economy. The banking sector will play a key role in these activities.

The banks have a fundamental role as providers of payment services, liquidity, and funding to businesses and individuals in the time of the COVID-19 crisis. On the one hand, during the COVID-19 crisis, most of the governments designed schemes for recovery, based on easy access to credit for businesses and households, guaranteed by the state and low interest. It has made it possible to pass more easily through the crisis. On the other hand, the banking sector will play an important role in the recovery of the economy.

This is true for a small and open economy such as Bulgarian.

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Problem Statement

Theoretical approach

The banks play an important role for the main part of businesses in Bulgaria. For this, banks have to dispose of liquidity resources. Mainly they come from deposits and credit lines from other parents banks abroad.

Most of these funds go to businesses through credit. The credit transmission channel includes bank's and balance sheet types. The bank credit channel is based on the understanding that banks play a special role in the financial system. Large companies can attract resources by selling commercial papers and other forms of credit thus increasing their debt. Small and medium-sized businesses have limited access to financial markets. They are not able to attract funds from there. The gap between large and small firms becomes larger mainly during a recession. Less access to other forms of credit markets than to banks makes small businesses extremely dependent on the activities of banks.

The balance sheet channel focuses on the potential impact of changes in monetary policy on borrowers' balance sheets and their incomes, including their net wealth, liquid assets and cash flows. The firms often finance investments and current expenses by borrowing, and sometimes by increasing their loans earlier during the economic cycle. The households also reduce their incoming cash flow due to the close-down of essential businesses and unemployment. However, their outgoing cash flow does not fall at the same pace as the in-coming cash flow. The consumers also want to borrow at a time when their income is declining and when credit conditions are poor, which leads to an increase in the volume of credit.

Literature review – COVID-19 and its impact on the economy

Lots of resources in the literature examine the role of policy initiatives during financial crisis (Claessens et al., 2005; Reinhart & Rogoff, 2009; Taylor & Williams, 2009). Ait-Sahalia et al. (2012) examine the effects of policy measures on liquidity risk premia and interbank credit during global financial crises. Asli Demirguc-Kunt et al. (2020) study the market response of banks to policy initiatives and the differences between the COVID-19 shock versus the previous events of financial and economic stress. Since the shock is truly exogenous to the financial sector, the irresistible reaction from policymakers has been to decrease regulatory requirements and use capital buffers. Acharya & Steffen (2020) credit market conditions have tightened in response to the COVID-19 pandemic.

Aims of the Research

All countries in the world have taken measures, which, if implemented successfully, are aimed at minimizing losses during the COVID-19 crisis and lead to the recovery of economies afterwards. The impact of COVID-19 on the banking sector depends on:

- deterioration of the financial situation in the firms. It is due to the restrictions on activity, as a result of the dramatic fall in consumption, especially services, and in net exports. At the same time, prices changed on commodity markets, mainly those of raw materials. This led to a decrease of incoming cash flow and a delay of local and foreign payments;
- deterioration of the financial situation for the households. They lost part of their incomes due to unemployment or earned reduced wages. All measures of banks were aimed the reducing the negative impact of COVID-19 on the financial conditions in the short term and at supporting the flow of credit to firms and households.

The recovery of the economy also will require active participation of banks. The firms will need working capital to restart the business. At the same time, business models will change after the pandemic and they will need new investments. The changes in businesses will improve the financial situation of households, too. The instruments used for recovery could be monetary and fiscal. This paper aims to examine the impact of COVID-19 on bank liabilities and assets during the crisis and their role in the recovery of the economy.

Research Methods

The achievement of key targets and accomplishment of the main aim of the study are done by systematic theoretical – empirical approach. In particular, this approach is realized as follows:

- Induction and deduction in the research of the facts characterizing bank activities before and during the pandemic of COVID-19.
- Empirical study of the situation in the banking sector before and during the COVID-19crisis.
- Comparative analysis of all main variables before and during the pandemic of COVID-19.

The chosen instruments for achieving the main objectives of the study use extensive statistical data. The data are illustrated using graphics and tables.

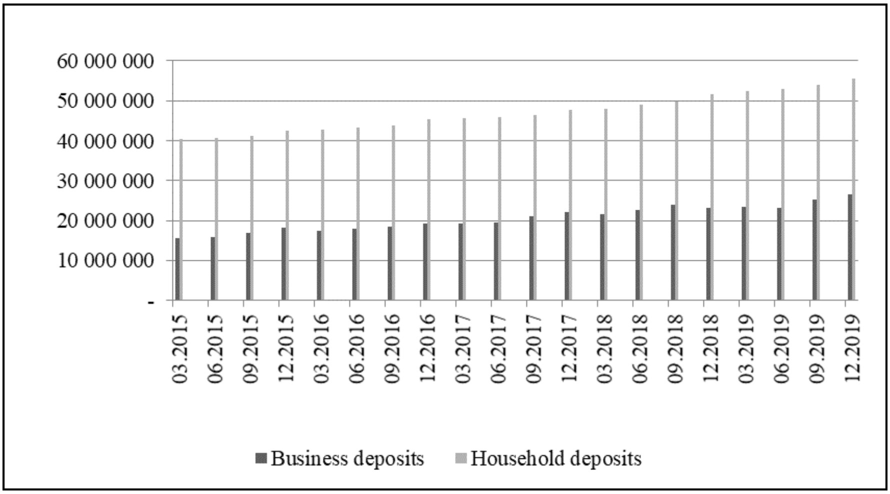
The conclusions of the research are based on the results of the calculation of the main variables before and during the pandemic and on feedback analysis.

Findings

The banks are being called to play an important countercyclical role to support the real sector. These actions also have a series of implications for the future resilience of the banking sector. It requires investigating the situation in the banking sector before and during the COVID-19 pandemic.

Bank liabilities and assets before the pandemic

The dynamic of deposits for the investigated period depends on the current account balances and term deposits. The corporate deposits during the whole period changed, following positive trend. This is a result of continued and sustainable development of the economy in Bulgaria, and of the economic growth achieved before the crises. But most of the resources attracted by banks come from households. The deposits from individuals increased during the period 2015 – 2019 by 73%, from businesses – by 59%, and the total increase was by 68%. During the period 2015 – 2019, it can be noticed that the wealth in the economy increased. According to the theory of demand of assets, it will increase investments in different ways, including deposits. From the bank's point of view, the level of deposits in the banking system ensures sustainable disposable resources for the active operations. The changes of business and household deposits are shown on Figure 1.

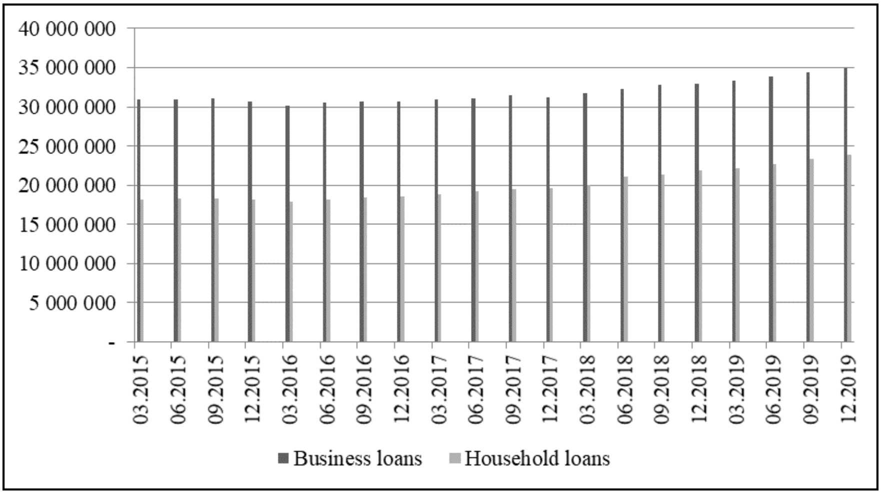


Source: Bulgarian National Bank

Figure 1: Business and households deposits for the period 2015 – 2019 (thousand BGN)

Before the health crisis, the overall economic and financial stability in Bulgaria led to a strong increase of lending (Assenova, 2019).

The crisis in the second half of the 1990s led to the suspension of any financial intermediation for some time. The policy followed, aimed at reducing inflation, increasing GDP and rapidly growing incomes and profits, it exacerbated the need for credit, and changed banks 'views on borrowers' requirements. The entry of foreign banks into the market, as well as the strengthening of commercial banks' audit in the sector, led to return the confidence of the public in banks, and hence to an increase in deposits. On the other hand, improved economic conditions pre-determined the growth of foreign cash flows, mainly coming from foreign banks in Bulgaria. All factors led to a strong need to find ways to invest the accumulated funds to generate income (Assenova, 2009, 2018). The business loans increased during the investigated period 2015 – 2019. This is shown in Figure 2.



Source: Bulgarian National Bank

Figure 2: Business and households loans for the period 2015 – 2019 (thousand BGN)

Banks' liabilities and assets after the pandemic

After the onset of the health crisis in China, before the coronavirus crisis became evident, GDP sharply declined during the first stage of the pandemic (Farboodi, Jarosch, Shimer, 2020; Alfani, 2020). It made it difficult for the supply chain to function in other parts of the world. As it is known, the world economy depends on China for delivery. As a result, supply in other parts of the world declined. In the second stage, after the lockdown in more countries, many sectors of economy were closed and this additionally reduced GDP in those countries. The Bulgarian economy, a small and open economy, is very sensitive to outside conditions. The lockdown in the many countries in the world influenced the Bulgarian net exports, orientated mainly to the countries of the EU. Their GDP declined and it directly reduced the Bulgarian GDP. During the pandemic, investments in Bulgaria collapsed due to expected recession all over the world. The third part of the GDP – consumption – also fell. More consumers were temporarily unemployed or unemployed, and the incomes were reduced due to the uncertain situation. All efforts forced a sharp reduction in consumption. The last part of the GDP – public spending – does not compensate the loss from the other three components of GDP.

The Bulgarian National Bank introduced several measures, including following:

- "temporary moratorium on bank loans repayment, following the EBA Guidelines on legislative and non-legislative moratoria on loan repayments applied in the light of the COVID-19 crisis (EBA/GL/2020/02);
- The state Fund Manager for Financial Instruments in Bulgaria announced a new package of measures to support various business and public groups through financial instruments. The Fund will provide bank guarantees in the amount of BGN 170 million (EUR 87 million), which should serve to secure a loan portfolio of up to BGN 850 million. Loans under the scheme will have a term of up to 10 years and the possibility of interest-free loans" (European Commission, 2020).

Also an opportunity for borrowers to renegotiate the terms of bank loans related to the timing of repayment of agreed principal and/or interest. Debtors, who have suffered financial difficulties due to the impact of COVID-19 and have difficulty repaying were be able to negotiate with their banks a deferment of their debts for up to 6 months, but no later than 31 December 2020.On postponement may be amounts due or only the principal.

The scope of application of the Moratorium covers the widest possible range of subjects, both business and households. The Moratorium applies to all bank loans concluded before 31 March 2020, irrespective of their type, size, purpose and without the collateral provided.

In turn, debtors who have been irregular in servicing of their debts prior to the pandemic were not be able to benefit from the relief provided for in the Moratorium. They used other restructuring options will be sought, with specific measures will be assessed on a case-by-case basis by the respective bank.

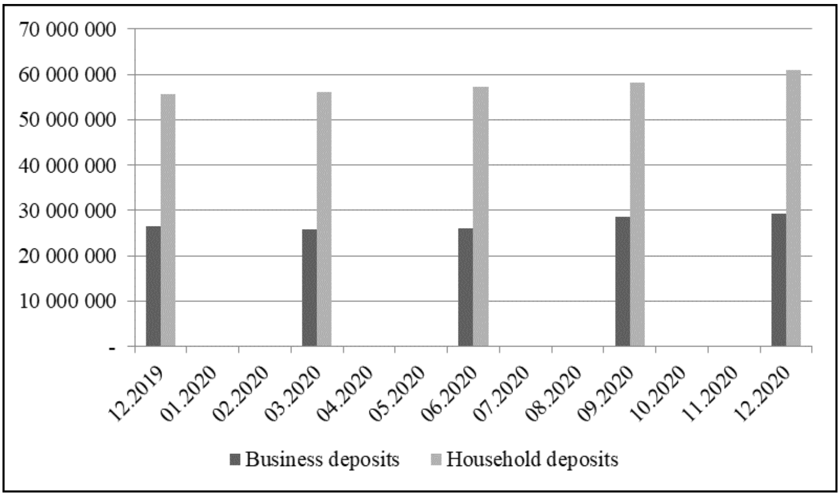
The bank activities are developed under these conditions. The changes of deposits during the period of lockdown are insignificant.

Table 1: Changes of Deposits after pandemic of COVID-19

Period	Δ Business Deposits %	Δ Households Deposits %
12/2019 – 3/2020	Minus 2.56	0.85
3/2020 – 6/2020	0.74	1.87
6/2020 – 9/2020	9.70	1.71
9/2020 – 12/2020	2.63	4.97

Source: BNB and own calculation

Business deposits decreased only during the first lockdown and after it they recovered to reach the pre-crisis level. Nevertheless, local consumption remained at the same level, and the external market went down, with more sectors continuing the work, excluding services – transport, tourism. Households kept their saving for the prudential motive. During crises, the situation is unpredictable and they keep savings for more bad days ahead. From the bank's point of view, they stayed on a sustainable liability position. Because the Bulgarian National Bank works as per requirements of the Currency Board, it lost some of the monetary instruments as creditor of last resort and open market operations. For these reasons, the Bulgarian government delivered additional liquidity resources though state Bulgarian Bank of Development. This financing for the banking system was enough to ensure the measures taken by the government for supporting businesses and households.



Source: Bulgarian National Bank

Figure 3: Business and households deposits for the period January 2020 – December 2020 (thousand BGN)

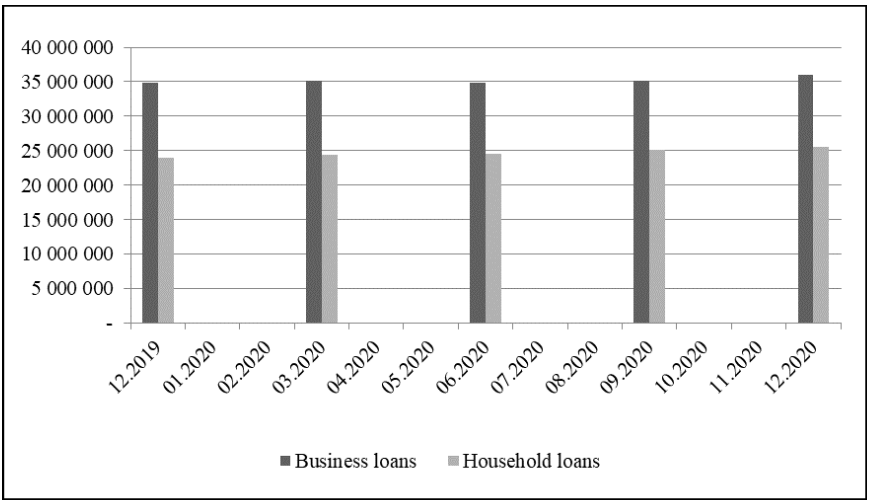
On the other hand, businesses that have to hire workers, needed to start operating again and to see the demand for their products and services rebound quickly, if indeed they had survived the downturn. The new stimulus package from the Government perhaps catalysis the change of the credit cycle. The companies may redirect payment installments for later periods after the lockdown and take new loans to cover differences between in- and out-flows. They could take credit for the recovery the business (Beck, 2020).

Table 2: Changes in Credit after COVID-19 pandemic

Period	Δ Business Loans %	Δ Households Loans %
12/2019 – 3/2020	0.74	1.89
3/2020 – 6/2020	Minus 1.04	0.81
6/2020 – 9/2020	1.06	2.36
9/2020 – 12/2020	2.33	1.40

Source: BNB and own calculation

The credit cycle went into a new stage after the lockdown. The answer of businesses after the lockdown took place later, in the second quarter of 2020 and after it the firms recovered through credit. The loans for households remained at similar levels to those before the pandemic.



Source: Bulgarian National Bank

Figure 4: Business and households loans for the period January 2020 – December 2020 (thousand BGN)

The credit cycle went into a new stage after the lockdown. During this period, the factors affecting demand were:

- Income fell or remained at the same level;
- Unemployment;
- Companies reduced their investments due to the stage of market;
- Negative trend in Bulgarian net export;
- Financing negative cash flows.

The factors influencing the supply were:

- Reducing part of business deposits by banks during the crisis;
- Increasing risk in the economy;
- Economic activity froze for several months. The return on projects was reduced. Therefore, companies financed their negative cash flows.

The interest rate of bank loans was highly volatile in the beginning of 2020. After the COVID-19 pandemic, the rates decreased sharply.

In the short term, banks saved some costs during the pandemic, such as lower interest on deposits, lower operation cost, lower HR cost. At the same time, they increased their cost for usage of IT technology.

The banks received lending assistance from the government, including instruments facilitating supply of funds to firms and households due to the loss of revenue or income during the lockdown. The banks improved liabilities though the Bulgarian Bank for Development. Moreover, the government directly financed the working capital of firms, provided direct funding to strategic sectors and ensured state support for interest-free loans. The measures to provide liquidity or financing delivered to businesses and households did not bring the expected results.

Due to the moratorium on repayment and to keep the profit and stock prices at the same level, banks increased the fees and commissions for all services and this had a negative impact on business activities and households' expenses for financial services.

The banks' activity during the pandemic could stimulate changes in their functioning in the long term as following:

- new business models;
- ongoing development of on-line banking;
- expansion of non-cash trade;
- strengthening and further development of remote communication with customers;
- reduction of the number of branches of every bank;
- reduction in the operating cost.

Conclusions

The COVID-19 pandemic has dramatically affected almost every aspect of the economy. The credit cycle transformed into a stressful one. This paper seeks to analyze the accumulated deposits and access to credit before the unexpected global health crisis and its immediate and extended impact, as well as the performance of several key indicators of deposits and credits.

The Bulgarian economy, as a small and open economy, is very sensitive to outside conditions. During the COVID-19 pandemic, the national economy depended on them. They affected all sectors. The new stimulus package of the Government perhaps catalyzed the change in the credit conditions. The deposits in banking system did not change sharply during the lockdown. The credit cycle during the pandemic went into new stage, with reduced loans for businesses for two months in the second quarter of 2020 when the COVID-19 pandemic started. The economic activities slowly recovered and household credits covered the liquidity gap and supported the recovery of the economy.

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