

ECA RESEARCH NOTES

Office of the Chief Economist

EUROPE AND CENTRAL ASIA

Financial Stability after COVID-19

November 2020



Hi Everyone,

Hope you are having a productive Fall. As we continue to consider the impact of the COVID-19 pandemic, this month we are looking at its impact on the Financial Sector.

The economic impact of shutdowns and continued interruptions in normal business operations have placed a significant strain on the global economy. It has fallen to the financial sector to take action to supply vital credit to the corporate sector and to households. To enable this, central banks and governments have enacted a wide range of policies. While these can help increase the flow of credit in the short run, how will they affect the future stability of the financial sector? Are the banking systems adequately

capitalized to absorb the COVID shock? Did we learn enough during the Global Financial Crisis to prepare the financial sector to manage these shocks?

If you missed the ECA Talk we hosted on this topic last week, you can watch the video below. We also include a round-up of related research.

If you are in the United States, I wish you a Happy Thanksgiving as you celebrate safely with your loved ones. We have a full agenda with exciting events as we approach the holidays and in the new year, so stay tuned.

Happy Reading!

Asli

FEATURE STORY



Clockwise from upper left corner: Thorsten Beck, Asli Demirgüç-Kunt, Mario Guadamillas, Viral V. Acharya

Zombie Lending, Fiscal Dominance and Financial Stability - Some Implications for the Post-Pandemic World

How has the pandemic affected financial stability in advanced and emerging markets? What do the stabilization policies adopted during the pandemic imply for the post-pandemic financial sectors? In a recent ECA Talk, professor Viral V. Acharya discussed these and other questions through the lens of zombie lending by under-capitalized banks and its implications for economic growth, inflation, and financial stability.

[Video and event information](#)

[Presentation by Viral V. Acharya](#)

[Presentation by Thorsten Beck](#)

RELATED RESEARCH

[Banking Sector Performance During the COVID-19 Crisis](#)

Asli Demirgüç-Kunt, Alvaro Pedraza, Claudia Ruiz-Ortega, World Bank Policy Research Working Paper 9363 – August 2020

This paper analyzes bank stock prices around the world to assess the impact of the COVID-19 pandemic on the banking sector. The crisis and the countercyclical lending role that banks are expected to play have put banking systems under significant stress, with bank stocks underperforming their domestic markets and other non-bank financial firms. The effectiveness of policy interventions has been mixed.

[Which Firms Benefit from Corporate QE during the COVID-19 Crisis? The Case of the ECB's Pandemic Emergency Purchase Program](#)

Asli Demirgüç-Kunt, Bálint L. Horváth, Harry Huizinga, World Bank Policy Research Working Paper 9379 – September 2020

This study examines how European firms have been affected by the announcement of the European Central Bank's Pandemic Emergency Purchase Program (PEPP). While firms with an investment grade rating benefit relatively more, as evidenced by higher share prices and lower credit default swap spreads, firms that are more heavily impacted by the pandemic benefit relatively little from the PEPP.

[Cross-Border Banking in EMDEs: Trends, Scale, and Policy Implications](#)

Erik Feyen, Norbert Fiess, Ata Can Bertay, Igor Zuccardi Huertas, World Bank Policy Research Working Paper 9393 – September 2020

Based on the analysis of the ownership structure and recent trends of bank activities of prominent financial groups headquartered in emerging markets and developing economies, the data suggest that cross-border groups in most regions have grown in size, geographical reach, and range of activities. The increasing relevance and complexity of cross-border banking pose challenges for policy makers and for the groups themselves to maximize the benefits of international financial integration while mitigating the risks.

[Recent Trends in Bank Privatization](#)

Ata Can Bertay, Pietro Calice, Federico Alfonso Diaz Kalan, Oliver Masetti, World Bank Policy Research Working Paper 9318 – July 2020

Bank privatization became more frequent since the Global Financial Crisis, especially in emerging markets such as China and India, but also smaller in that the fraction of a bank's ownership relinquished during privatization events declined. The banks that were chosen to be privatized tended to underperform their peers and had weaker asset quality pre-privatization. The authors argue that privatized banks turn toward more traditional banking models and increase credit extension with no apparent negative distributional implications.

[Interest Rate Repression: A New Database](#)

Pietro Calice, Federico Diaz Kalan, Oliver Masetti, World Bank Policy Research Working Paper 9457 – October 2020

Financial repression resurfaced in the wake of the global financial crisis and might become a common feature in the post Covid-19 world. To advance knowledge and inform policy advice, this paper presents a new database on interest rate controls, a popular form of financial repression, based on a survey of 108 countries, representing 88 percent of global gross domestic product. It also provides a preliminary estimate of the degree of bindingness of the interest rate control regime in a country and presents simple correlations with other financial repression policies.

[COVID-19 and EMDE Corporate Balance Sheet Vulnerabilities: A Simple Stress-Test Approach](#)

Erik Feyen, Fernando Dancausa, Bryan Gurhy, Owen Nie, World Bank Policy Research Working Paper 9424 – July 2020

The authors conduct a simple stress test to gauge the ability of listed nonfinancial corporates to withstand shocks to earnings and receivables. It targets two basic accounting ratios that capture a firm's ability to cover its short-term

liabilities and interest expenses. The findings show that , prior to the pandemic, almost 60 percent of the debt was associated with firms that already exhibited vulnerabilities according to at least one ratio.

BLOGS

A banking sector pandemic

Asli Demirgüç-Kunt, Alvaro Pedraza, & Claudia Ruiz-Ortega, August 21, 2020

The spread of COVID-19 represents an unprecedented global shock. The financial sector, particularly banks, were expected to play an important role in absorbing this shock by supplying vital credit to the corporate sector and households. In an effort to facilitate this, central banks and governments around the world enacted a wide range of policy measures to provide greater liquidity and support the flow of credit. An important policy question is the potential impact of these countercyclical lending policies on the future stability of banking systems and to what extent their strengthened capital positions since the global financial crisis will allow them to absorb this shock without undermining their resilience. In a [recent paper](#), the authors use daily stock prices and other balance sheet information for a sample of banks in 53 countries to take a first look at this issue.

[Read the blog »](#)

Cross-border banking in developing economies: Trends and policy implications

Erik Feyen, Norbert Fiess, Ata Can Bertay, & Igor Zuccardi, October 13, 2020

Cross-border banking in emerging markets and developing economies (EMDEs) has expanded across most regions and become large relative to some home and host economies. Especially in the wake of the global financial crisis (GFC), financial groups headquartered in EMDEs have increased their regional and even global footprints. The [recent study](#) shows that EMDE groups have grown in size, geographical reach, range of activities in the financial and real sectors, and group complexity

[Read the blog »](#)

CALENDAR OF EVENTS

- **December 7, 2020, 10AM:** ECA Talk featuring Mary Hallward-Driemeier, Senior Economic Adviser at the World Bank, on "Europe 4.0 and Digital Divide"
- **January 20, 2021, 10AM:** ECA Talk featuring Sergei Guriev, Professor of Economics at Sciences Po, on "Mobile Broadband Internet and Confidence in Government"

Check [ECA Lectures](#) and [ECA Talks](#) to learn more about our past and future events.

The ECA Research Notes newsletter is produced by the Europe and Central Asia (ECA) Chief Economist's Office. Please send comments, suggestions, and feedback to ECACEoffice@worldbank.org.

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