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A STUDY ON IMPACT OF COVID-19 ON BANKING SECTOR: AN INDIAN PERSPECTIVE

KEY WORDS: Baking Sector, COVID-19, Impact on Banking

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ABSTRACT

Decreased productivity and lockdowns have already started to take a toll on the financials of the corporate sector. Supply chain disruptions, manufacturing hindrances and crippled health systems need a hefty public fund/stimulus to continue operations smoothly. With economic growth poised to slow down — the International Monetary Fund has cut India's GDP growth estimate to 1.9 per cent for 2020-21 — the banking and financial sector, whose prospects are tied closely to the economy's, is bound to bear the brunt. There could be a spike in bad loans. "The slowdown could lead to potential job losses, which could cause stress in banks' retail loan books. Income from tourism, entertainment sectors among many others has already crippled the economic situation. Factors like these are all adding up to strain the global economy which might also have its repercussions in the year ahead. Asia-Pacific governments, central banks, and supervisory authorities have rolled out diverse measures to address COVID-19. These include liquidity injections, targeted loans to affected industries and regions, and policy rate cuts. It also includes support for banks to provide forbearance to otherwise economically viable households and businesses sideswiped by COVID-19.

INTRODUCTION

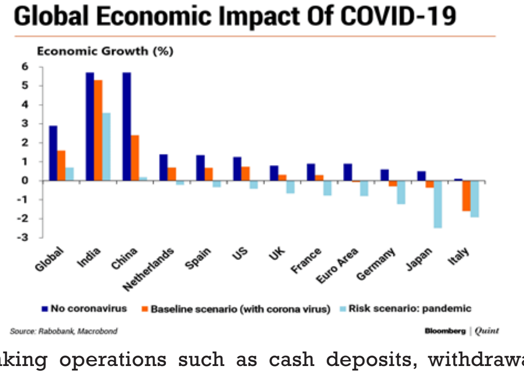
The financial markets of up to Rs 56.22 trillion in the month due to this pandemic. Investor sentiments are at an all time low and it is also becoming evident how difficult it is going to be for banks all over the world to maintain good assets and good earnings. Due to the shutdowns and income slowdown, many repayments of loans, especially in Europe, may cease leaving the banks dry. Europe can already be seen as the emerging epic centre after China started to recover from this economic shock. Italy, the world's second best health services country, is in a socio-economic disaster since Corona virus hit the country. The situation has continued to escalate even after total lockdowns and borders being completely shut down. The Fitch ratings agency already warned of Italian Banking System coping mechanism with COVID 19'. Bank shares have been seeing a sharp decline showing the shaking confidence in the global financial system. Banks in the country are likely to witness a spike in their non-performing assets ratio by 1.9 per cent and credit cost ratios by 130 basis point in 2020, following the economic slowdown on account of COVID-19 crisis, says a report. In its report titled "For Asia-Pacific Banks, COVID-19 Crisis Could Add USD 300 Billion To Credit Costs" S&P Global Ratings said, it expects the non-performing assets (NPA) ratio for the Chinese banking sector to increase by about 2 per cent in 2020. The report said the economic storm created by COVID-19 will test the ratings resilience of the region's 20 banking sectors. "The resilience of banks' asset quality in 2020 hinges in part on the success of governments' and regulators' policy responses. One of the many roles of credit is to act as a temporary insurance to tide over shocks like the pandemic and the subsequent lockdown, and help smooth consumption. Thus, a market for financial products that help hedge against future crises will develop. These products could build on the need for precaution and risk aversion among both households and firms.

The Coronavirus quite literally makes money 'dirty' in that the surface of banknotes and coins could carry the virus. The fear of infection will thus drive the next wave of digitalization and a flight from cash. This will buttress the rapid digitalization that India has seen over the last few years. (Retail digital payments saw a compounded average growth of 30 per cent since December, taking the value of digital payments up to Rs 26,82,000 crores at the end of 2019.) However, with the prospect of a prolonged slowdown in the economy in the medium term, both the volume and value of transactions is likely to decline. Growth in the penetration of digital transactions will be tempered by slowing transaction activity. The pandemic could have an impact on the choice of the mode of delivery of finance, and the nature and structure of financial products. However, COVID-19 or not, financial penetration in India is here to stay

LITERATURE REVIEW

- Many private banks were trading at rich valuations prior to the downturn. "Since credit growth is likely to slow down and gross non-performing assets could spike, investors are unwilling to accord rich valuations to them," says Jaikishan Parmar, senior equity analyst-BFSI, Angel Broking. This sector, which tends to be heavily owned by foreign institutional investors, has also been hit by their pull-out.
- Luigi Wewege, Senior Vice President and Head of Private Banking at Caye International Bank, in a commentary said, "Overall, United States and European based banks have showed reasonable improvement since the last financial crisis around 2008 however Europeans in particular do remember what happened with bail-ins and bailouts so you do see a lot of investor concern with what the European Central Bank might do next."
- "It is almost certain that the industry will see a big spike in bad loans. A number of companies are feeling the heat. This stress is not reflecting so far because of the present RBI relaxations such as moratorium on loan payments. But, once this is lifted, the real picture will emerge," said Siddarth Purohit, analyst at SMC Global Securities.

IMPACT AREAS OF COVID-19



Banking operations such as cash deposits, withdrawals, clearing of cheques and other traditional teller services had to be executed by maintaining a safe distance of at-least a meter. Social media was abuzz with a bank employee's effort to handle cheques with tongs and sanitize them with a steam iron.

The operational and technical challenges for both the customers and employees highlighted a lacuna and the general lack of agility in our banking systems when faced with an emergency situation. The immediate learning's from the current COVID-19 situation will add the much-needed rigor towards digitizing and optimizing the bank's backend operations. This will eliminate the dependency on manual entries, person led reviews i.e. paper and employee intervention within banks.

The COVID-19 situation will not only accelerate the adoption of technology, but will renew focus on the following four key areas of banking:

Embracing Neo Technologies – In the aftermath of the pandemic and economic uncertainties, emerging technologies will play a key role in speeding up transactions and reducing costs for banks. Indian banking sector has already realized the role of technology in achieving the reach and scale.

It foresee higher rates of adoption of micro service architecture by dropping vertically integrated stacks, APIs, containerization, cloud computing, AI and block chain. These technologies will play critical roles in digital transformation of Banks and Financial Institutions and re-imagine digital delivery of services.

Channels of Digitization – As per the 2017 global findex report by the World Bank, India is home to the world's second largest unbanked population at 190 million adults without access to a bank account. With increased penetration of mobile and Internet, the primary focus would to accelerate technology enabled digital financial inclusion. The business focus would also be to create a gradual shift in customer preference from visiting bank branches to using digital channels. Banks will enable its customers to interact over multiple automated and digital channels to offer the optimal channel mix. Banks will consider important factors such as demographics, access to internet, last mile connectivity, customer banking behavior patterns etc. to enable effective adoption by the Indian banking consumers.

Security, Privacy and Customer Trust – According to RBI, for the financial year 2017-18, India's banking sector witnessed a spike in cyber frauds and pegged the losses at $ 13.7 million. With increased use of cashless and digital economy, it will be imperative for the banks to implement secure frameworks and systems. Some of the obvious cyber risks include financial frauds, money laundering, data loss, identity thefts and privacy breaches. Banks need to take stringent steps to identify both internal and external system vulnerabilities. They should be technically strengthened by rigorous KYC, strong customer authentication (SCA), financial grade APIs, firewalls, smart networks, etc., for secure and seamless transactions. Robust banking solutions and cyber security initiatives help safeguard against malicious attacks.

Policy and Compliance – The focus should be on increased digital payment infrastructure, especially in rural India, with an intention to create a financial ecosystem for the unbanked and under-banked population of our country. From a security and privacy standpoint, India is already on its path to introduce the Personal Data Protection bill (PDP) on the lines of GDPR in the EU. This India's banking revolution can be further catalyzed by the introduction of the open banking directive on the lines of the UK and the EU.

OTHER IMPACT

- COVID-19 is likely to lead to a major shift in precautionary savings and risk aversion for households. This increase could lead to an enhanced flow of savings into bank deposits often considered to be the safest among savings instruments. On the other hand, households' propensity to borrow to spend will diminish.
- Retail bankers could end up with a bounty of deposits but with limited demand for loans. However, even if the demand for loans rises, banks will be extremely cautious about their exposures. Thus it is quite likely that unsecured (not backed by collateral) lending like personal loans or credit cards will slow down and banks will look for safe and liquid collateral to extend credit.
- Retail borrowers will have to find ways of gauging risk better and dive deep into the risk profiles of borrowers –both retail and corporate-- to enhance lending. This calls for a major upgrade in analytical tools and data that build more 'complete' risk profiles of borrowers.
- The banking and financial sector is among the worst hit in the current downturn. While the Nifty50 has declined 27.7 per cent, the Nifty Bank index has nosedived 40.1 per cent over the past three months.
- Insurers may also be considered, as the fear generated by the pandemic could lead to people purchasing more policies.
- Investors with at least a seven-year horizon may invest in a banking and financial sector fund having a consistent track record. Avoid those with exposure to the more vulnerable segments mentioned above. Allocation to a sector fund should not exceed 5 per cent of the equity portfolio.

CONCLUSION

Two implications follow for the future of banking. First, banks will operate in a financial system that is awash with liquidity and interest rates are extremely low. Second, the government will be a key player in the financial sector, both as a borrower (to fund its deficit) and as a "risk absorber" providing guarantees, back-stops and more direct fiscal support for borrowers whose businesses and cash flows bear the brunt of the virus. This brings us to the related issue of how banks' loan books are likely to look in the future since major economic upheavals invariably lead to an escalation in risk perception and a flight to quality. This means that banks will prefer to give loans to borrowers whose cash flows are visible and strong, while avoiding borrowers whose cash flows and incomes run the risk of being disrupted. A thumb rule that banks often follow is that size matters. Bigger companies on average are less likely to default than smaller ones and the flight to quality could translate to into flight to size. Banks remain highly risk averse and the consensus among industry leaders is that most companies in consumer-oriented sectors at the moment are now operating with less than 70 percent of their capacity. The banking sector's health depends on how soon the economy recovers. All eyes are now on the government's upcoming fiscal stimulus package.

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