THE BANKING SYSTEM OF EMERGING ECONOMIES IN ASIA AGAINST THE BACKGROUND OF COVID-19. CASE STUDY – THE ASEAN AREA

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Abstract

The importance of the banking system for the economy has been intensely debated in specialized works and numerous studies and articles highlight the connection between banks and economic development. The article analyzes the banking system in Asian emergent economies, particularly in the ASEAN area, in the context of the coronavirus pandemic and it highlights the importance of financial and banking institutions in implementing the initial batch of measures authorities have enforced in order to limit the impact of COVID-19 on the economies in the region.

The financial-banking system in the ASEAN area was quick in reacting to the pandemic and it showed flexibility and adaptability to the new economic context. Banks in that region are the main source of funding for the economy; in addition, they are open to new technologies and cooperation with fintechs, so that the new context, where consumer behavior is changing as a result of lockdowns and medical restrictions, favors digitalization, and financial institutions are accelerating their strategies for digital transformation.

The evolution of the economy depends on the evolution of the medical crisis, but the manner the pandemic will evolve is uncertain. The sole certainty is if the manner banks are currently reacting to the crisis will determine the manner they will rebuild themselves for the future**.**

Keywords: banking system, emerging economies, ASEAN banking system, digital banking, economic development

JEL codes: E02, F63, G21, G23, F34

Introduction

COVID-19's spreading across the world has had a negative impact on both households and companies and it has harmed global economy. The feeling of uncertainty and the breakdown of the supply chain brought about by the COVID-19 pandemic have

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driven companies to be more cautious, to revise strategies and to postpone major investments or expansion plans.

The ASEAN member countries were among the first countries to be impacted by the pandemic that broke out in China, and many companies ceased operations because they were deemed non-essential or they simply did not have the resources to continue operations. However, going beyond companies and industries, the pandemic has directly impacted households and individuals, as the shutdown of enterprises resulted in massive layoffs.

Like other countries in the world, ASEAN member states have immediately come up with packages of defensive measures against the pandemic and measures meant to alleviate the effects of COVID-19 on their economies. Monetary policy was used in order to ensure adequate liquidity levels and to boost confidence in the economy, when the initial concerns arose over the breakdown of supply chains and travel restrictions. However, as the virus spread and the economic impact grew worse, governments implemented stronger fiscal incentives in order to aid the economy, particularly in severely hit sectors such as tourism and SMEs.

The measures taken by authorities, not only those measures pertaining to monetary policy, but the financial-incentive packages as well, were implemented by way of the banks. It was financial institutions that supported companies, extended loans to entrepreneurs who needed working capital to keep their businesses running and implemented moratoria for the loans taken by retail customers.

Banks in the ASEAN area have been open to new technologies, and the changes in consumer behavior as a result of the measures brought about in the wake of COVID-19 – self-isolation, social distancing, travel restrictions, as well as the risk of infection – raised the level of interest in the products and services offered by fintechs, they made digital channels more attractive and they accelerated the digital transformation strategy of the financial institutions in the region. This is a global trend, rather than a trend limited to the ASEAN member countries. According to estimates, the number of financial app downloads to mobile phones a day rose by 24%-32% starting February 2020, which means an average daily increase of 5.2 million to 6.3 million in 74 countries (Fu and Mishra 2020).

1. Literature review

Banks are the engine of the economy, and the connection between the banking system and economic development has been carefully examined and analysed in specialized literature. Joseph A. Schumpeter (1912) demonstrated the importance of financial institutions and argued that financial intermediation accelerates technological progress by redistributing funds to companies that focus on using new and more efficient technologies and on innovation. In turn, Raymond W. Goldsmith (1969) highlighted the importance of funding for economic development. He carried out an extensive study that monitored the evolution of 35 states during 1860-1963 and emphasized the connection between the development of the financial system and economic growth.

At the same time, the importance of the connection between banks and economic growth is worth examining because the problems faced by banks are reflected in the stability of the banking system and in the evolution of the economy. Luc Laeven and Valencia Fabián (2018) highlight the manner crises in the financial system influence macroeconomic stability, the costs of the instability being borne by everybody.

Bogdan Căpraru (2014) demonstrates that emerging economies have a major influence on the level of global economy, and banking systems in those states are characterized by fragility, with the banks undergoing major changes in the past few decades as a result of: deregulation, banking internationalization, political regime change, an increase in financial and banking competition, the development of technology and, last but not least, international financial crises.

Abu Hanifa Md. Noman (2017) analyses the financial and banking system of ASEAN member states during 1990 – 2014 and demonstrates how encouraging competition among merchant banks resulted in increased operational efficiency and improved stability.

Wahyoe Soedarmono (2013) indicates that authorities in Asia encouraged the consolidation of the banking system by means of mergers and acquisitions in order to increase stability.

As far as the digitalization of the banking system is concerned, recent studies indicate that the pandemic has brought an acceleration of digital transformation strategies of financial institutions and it boosted the degree of fintech adoption. Fu and Mishra (2020) indicate that the mobility restrictions, the fear of contagion and the periods of isolation have led to an increase in interest in the products and services offered by fintechs.

The studies that analyze the manner how the decisions to use financial services and products offered by fintechs are taken at the individual level reveal the importance of financial education and of getting acquainted with the new technologies and the connection with demographics. For instance, Bruce Carlin (2017) analyzed the introduction of a personal finance management app on smartphones and demonstrated that easier access to financial information by way of new technologies influences the use of consumer loans and ultimately influences financial health. The analysis highlights the role of demographics and demonstrates that gender and age determine differences in both the probability of adopting various financial services, and in the economic results. In turn, Brown (2020) inquired into the introduction of contactless card technology at customer level and concluded thar young people in urban areas make up the specific group that boosts the adoption rate of that type of payment.

The article analyzes the banking system in South-Eastern Asia, particularly in the ASEAN area, and the way it reacted in the context of the evolution of the pandemic and the widening medical crisis.

The work examines the measures taken by authorities in order to diminish the effects of the pandemic on the economy and the manner these packages of incentives were implemented by way of the banking system in order to support the industries impacted by COVID-19. It examines the measures taken during the first stage, analysing the available data, in the context where the evolution of the medical crisis was call-center study analyses the measures taken by monetary authorities in ASEAN countries and the way banking systems participated in the projects launched by governments in order to implement measures to alleviate the effects of the pandemic.

In addition, it analyses the degree of account ownership in ASEAN countries, reviewing data on account ownership and the ratio of people who used the internet in order to pay bills in each of the ASEAN member countries, in order to highlight the potential for development of the banking system in the region, against the new context generated by COVID-19, which has accelerated digitalization of banking products and services.

The analysis is limited to the data available during the first stage of implementation of the measures to alleviate the effects of the pandemic, in the context where the estimates on the impact of COVID-19 on the economy are being constantly revised as new statistical data emerge.

The work examined the macroeconomic indicators, indicators on the levels of the population's account ownership, using databases and official reports issued by the Asian Development Bank (ADB), rating agency Fitch, the International Monetary Fund (IMF), the World Bank (WB) and data published by national regulatory authorities such as central banks and associations of merchant banks in the region.

2. The first measures meant to alleviate the effects of the pandemic

Most countries in South-East Asia have had the means to enforce monetary and fiscal policies meant to limit the effects of the pandemic, and almost all ASEAN countries have relaxed their respective monetary policy. Some of the central banks have stepped in as soon as the pandemic broke out, by cutting back the monetary policy interest rate (Indonesia, Malaysia, the Philippines, Thailand and Vietnam) and banks' minimal mandatory reserves, allocating funds to be used to offer loans to impacted companies, moratoria for loan repayments and the exclusion of loans related to COVID-19 from the calculation of non-performing loan levels or monetary market operations (Indonesia).

In addition to the measures pertaining to monetary policy, packages of fiscal incentives have been implemented in order to support companies and the population (Table 1). The composition of those packages varied from one country to the next, but it included, in varying proportions, financial subsidies and the deferral or waiving of taxes, with many countries implementing specific policies to support vulnerable sectors such as SMEs.

In Cambodia, Malaysia and Myanmar, for instance, access to funds for SMEs was facilitated by means of low-interest loans, and in Malaysia and Thailand authorities deferred or waived the payment of loan instalments. In Malaysia, authorities implemented adjustments of prudential regulations in order to allow additional loans to SMEs, governmental guarantees for loans, and in Indonesia, authorities enforced looser lending regulations and other adjustments of prudential regulations, backed by special funds meant to support SMEs. In addition, grants and subsidies were offered, for instance in the shape of payroll subsidies (in Brunei and Thailand) or facilitating rent payments (in Malaysia).

COVID-19 has had a global impact, and the economic shockwave was intense and severe, and the banking industry has faced unprecedented challenges ever since the outbreak of the pandemic. Banks are the entities that have to keep the economy running and they continued to serve that role even during the periods of lockdown and medical restrictions. Governments and central banks acted rapidly, deploying a whole arsenal of packages of fiscal and monetary incentives in order to support companies short of cash, in order to supply liquidity to financial markets and in order to help millions of people who lost their jobs.

Table no. 1. The value of the first packages of measures meant to limit the impact of the pandemic, implemented in ASEAN member states

State	Package value in US$ (billions)	Date
Brunei	0.319	March 30, 2020
Cambodia	0.1 2.0	April 13, 2020 April 14, 2020
Indonesia	0.742 8.1 1.5 3.9 24.6 43.0	February 25, 2020 March 13, 2020 March 16, 2020 March 18, 2020 March 31, 2020 May 19, 2020
Laos	0.005	April 2, 2020
Malaysia	4.8 55.2 2.4	February 27, 2020 March 27, 2020 April 6, 2020
Myanmar	0.1	April 27, 2020
The Philippines	0.5 3.8	March 16, 2020 March 31, 2020
Singapore	4.6 33.7 3.4 23.3	February 18, 2020 March 26, 2020 April 6, 2020 May 26, 2020
Thailand	3.2 3.6 82.0	March 4, 2020 March 24, 2020 April 7, 2020
Vietnam	10.8 2.6	March 6, 2020 April 10, 2020

Source: Muhamed Zulkhibri, M., Sinay, J.B., 2020, p. 4.

All of these packages of measures were implemented by way of the banking system, and banks are aware that the manner they react to the crisis will determine the manner they would rebuild themselves for the future. Supporting governments and customers is crucial during the pandemic, but this will require a coherent response and a balance from banks in order to respond to challenges they had not faced before, despite the experience of previous crises.

Central banks were the first to step in and take measures to support the economy, because monetary policy was used first of all in order to ensure adequate liquidity levels and in order to enhance confidence in the economy when the initial concerns arose concerning the breakdown of supply chains and the isolation and quarantine measures. As the pandemic spread and the impact on the economy grew more severe, governments implemented, still by way of the banks, packages with fiscal measures in order to support the medical sector and in order to alleviate the effects on companies, particularly on SMEs.

Muhamed Zulkhibri and Joy Blessilda Sinay (2020) indicate, in the "ASEAN Policy Brief" report, that ASEAN member states had implemented, by May 2020, fiscal packages worth a total US$ 318.2 billion, the equivalent of 10.1% of the GDP of the region in 2019, with Thailand the country with the biggest package, worth US$ 88.8 billion.

During the early stage of the pandemic, banks have faced an intense activity and a low in-person presence, because at the same time they respected medical restrictions and implemented work-from-home policies. Nevertheless, they adapted quickly in order to efficiently respond to the increase in the number of loan applications and call-center queries.

Moreover, COVID-19 has had a sizeable impact on the way people work and consume so that certain countries, for instance, Brunei Darussalam, Malaysia and Singapore, proceeded to help SMEs to adapt to this changing environment, by adapting to electronic commerce and to digitalization in general.

3. The challenges of digitalization

ASEAN is a region encompassing a total of 643 million people in 10 countries, with different characteristics, ranging from Laos, an agricultural country, to Singapore, a city-state with one of the highest living standards in the world. Nevertheless, studies indicate that the banking system in that region is homogeneous (Banna, et al. 2019), and banks in that region are the main source of funding for the economy and they own more than 80% of the financial assets of the region.

The differences between countries are reflected in the banking system and in the use of financial services. In the ASEAN 5 group (Indonesia, Malaysia, the Philippines, Singapore and Thailand) the banking industry is better developed, with complex financial services, unlike the countries in the BCMLV group (Brunei, Cambodia, Myanmar, Laos and Vietnam). The level of development of the banking system is reflected in account ownership levels, too. For instance, by 2017, Singapore had the highest account ownership rate, with 98% of the adult population having bank accounts, followed by Malaysia and Thailand, with 85% and 82% account ownership rate, respectively. The countries with the lowest account ownership rate are Myanmar and Cambodia, with 26% and 22%, respectively, according to data from the World Bank. (Table no. 2).

Table no. 2. Account ownership rates in the ASEAN region, adults who have a bank account

Country	Account ownership rate
Singapore	98%
Malaysia	85%
Thailand	82%
Indonesia	49%
The Philippines	34%
Vietnam	31%
Laos	29%
Myanmar	26%
Cambodia	22%
Brunei	-

Source: The World Bank, The Global Findex Database 2017

The Global Findex study analyses the reasons for the low account ownership rates, too; in the ASEAN countries the most frequently mentioned obstacle in the way of getting a bank account is the shortage of money (respondents could select several reasons). The answers vary from one country to another. In the Philippines, unbanked adults said that they do not have bank accounts because financial services are expensive (38%), they do not have the documents needed to open an account (32%) or the bank is too far (29%). In Cambodia, the main reason is the absence of funds (63%), as well as the absence of the necessary documents (28%) (Table no. 3).

In Laos, 26% of the respondents declared that the bank is too far away; the same reason was mentioned by 27% of the respondents in Cambogia and 29% of the respondents in the Philippines, respectively. The new technologies bring bank products and services to smartphones, so that they are just a click away.

Table no. 3. Reasons why people in the ASEAN area do not have bank accounts

Country/ Reason	The financial institution is too far	Financial services are too expensive	They lack the necessary documents	They do not trust financial institutions	Religious reasons	They do not have sufficient funds	A family member already has a bank account	They do not need financial services
Malaysia	6%	7%	5%	5%	2%	9%	10%	-
Thailand	7%	3%	2%	2%	1%	11%	12%	1%
Indonesia	19%	19%	15%	5%	3%	42%	17%	1%
Philippines	29%	38%	32%	15%	10%	49%	20%	1%
Vietnam	9%	8%	10%	5%	0%	32%	16%	10%
Laos	26%	13%	17%	5%	3%	56%	12%	2%
Myanmar	17%	7%	24%	1%	2%	57%	7%	5%
Cambodia	27%	23%	28%	16%	12%	63%	11%	2%
Singapore	-	-	-	-	-	-	-	-
Brunei	-	-	-	-	-	-	-	-

Source: The World Bank, The Global Findex Database 2017

In terms of online bill payment, Singapore has the highest rate of people who pay bills online (50%). In Cambodia, Myanmar, Laos, the Philippines and Indonesia, the ratio of people who pay bills online is very low (Table no. 4.). These figures indicate the potential of the market and the fact that, in the new context of the pandemic, when consumer behaviours changed, banks will be able to use digital channels more.

In the past few years, Asia was the main driver of innovation in banking services, and Asian banks have been leaders in terms of digitalization. Authorities in the financial and banking sector have promoted the use of the newest technologies for the digitalization of financial services and as a way to increase financial inclusion.

The ASEAN Bankers Association, made up of the banks' associations of all 10 ASEAN member countries, promotes new technologies and active collaboration between banking institutions and fintechs. At the same time, the ASEAN Bankers Association, alongside the Monetary Authority of Singapore and the International Finance Corporation, developed the ASEAN Financial Innovation Network (AFIN), a platform that supports innovation in the region, by way of fintechs and their partnership with banks and non-banking financial institutions (Mortimer-Schutts 2017).

Table no. 4. The ratio of people who used the internet in order to pay bills

	People older than 15	People aged 15-24	People older than 25
Singapore	50%	27%	54%
Malaysia	25%	24%	25%

Thailand	10%	17%	9%
Indonesia	4%	6%	4%
The Philippines	3%	3%	4%
Vietnam	7%	11%	5%
Laos	3%	5%	2%
Myanmar	1%	3%	0%
Cambodia	1%	1%	1%

Source: The World Bank, The Global Findex Database 2017

In Malaysia, for instance, the Malaysia Digital Economy Corporation (MDEC) supports the country's digital economy by raising awareness levels concerning the importance of the new technologies; in addition, it brings together tech-sector entrepreneurs, public-authority representative officials, investors and specialists in order to provide resources and professional training workshops to both companies and start-ups and to the population.

Digital transformation stimulates innovation, it generates efficiency and improves services, while - at the same time - stimulating a more inclusive and more sustainable growth. At the same time, the scale and the speed of this change bring about challenges in numerous fields, including the financial-banking sector. The measures to enforce lockdowns and social distancing enforced in the wake of the coronavirus pandemic have accelerated digitalization in the region and modified the strategies of banks in South-East Asia. In order to cope with the challenges, banks have to reinvent themselves, to think like fintechs – which are ready to win over bank customers when the opportunity emerges, capitalizing on their agility and flexibility in order to rapidly release products and services.

Rating agency Fitch predicts that stable banks, advanced in terms of digitalization, would profit as customers, like during any other time of crisis, would seek security, while they would simultaneously benefit from an increase in productivity as a result of the shutdown of brick-and-mortar branches.

Numerous important banks in the region have reported an increase in online banking operations since the beginning of the pandemic. For instance, Bank Rakyat Indonesia announced an around 88% year-on-year increase in internet banking activity in the first quarter of 2020, with similar growth rates posted by important banks in the Philippines and Malaysia. At the same time, during the same time span, DBS Group Holdings, Oversea-Chinese Banking Corp. and United Overseas Bank, the three biggest banks in Singapore, reported, in addition to increased digital transactions, a significant increase in the opening of digital accounts and the use of financial-planning service platforms and chatbots (Fitch, 2020). The rating agency expects this trend would endure after the pandemic ends, and that customers used with cash-based transactions would preserve their newly-acquired habits. The change in customer behaviour and the competition with fintechs will force banks to innovate faster in other to be able to cope on an increasingly dynamic market. Banks will be even more actively pursuing growth by way of digital channels, with extant branches to be further streamlined and used for services with higher added value and cross-sales. However, with the exception of Filipino banks, banks in the region did not rely, as a rule, on the expansion of brick-and-mortar distribution channels to generate revenue, before the pandemic. Fitch calculated that banks in the major ASEAN markets saw an average 8% increase in compound annual growth rate (CAGR), during 2014-2019, while their branch networks registered a 1% drop in that rate.

Banks will modify their strategy and use digital channels more, taking into consideration that the pandemic has changed consumer behaviour as soon as the use of technology is concerned. Before the pandemic, DBS Bank Ltd. announced that the cost-income ratio of its digital customers was around 20 percentage points lower than in the case of its non-digital banking customers, which indicates that there exists the potential to increase productivity in the longer run if the trend persists. However, in the short term, investments in technology might be tempered because of the very uncertainty of business conditions.

The high rate of adoption of digital channels will give an extra advantage to banks that are well positioned on the market and are already using digital channels and new technologies and it will boost their competitive edge over less agile banks or new digital banks on the market. Regulatory authorities in the region have already extended the deadline for issuing licenses to digital banks as a result of the pandemic, but there remains the possibility that some of the companies, particularly those that do not originate in a traditional banking environment, would re-examine their strategy and focus on managing extant operations.

For instance, Bank Negara Malaysia has shown its support for the use of technology and digitalization of the banking sector, and in March, it announced that up to five licenses would be issued to digital banks and it published the criteria the applicants for the licenses should meet. The licensing framework for the digital banks is part of a series of measures used by the National Bank of Malaysia to support the use of the latest technologies in the banking sector.

Digital banks would be able to provide consumers with easy access to banking products and services, and they will add dynamism to the banking sector and support the economy, but the Central Bank mentioned that a well-balanced approach is necessary and that regulations that would protect depositors are necessary. Subsequently, digital banks will undergo a multi-stages process before receiving their licenses. The initial stage (the first 3-5 years), the foundational phase, is the stage when banks will have to prove their viability and integrity, and the Central Bank will assess results and the accompanying risks. During this stage, banks will have to comply with a simplified set of banking regulations, while a bank’s assets should not exceed 2 billion Malaysian Ringgit (RM).

At the same time, because the respective banks may adopt new and untested business patterns, the Central Bank mentioned that applicants need to have drawn up not just a business plan, but an exit plan as well, in case those business patterns prove to be unsustainable or inefficient.

Conclusions

ASEAN member countries were among the first states to be impacted by COVID-19. The effects were severe, and the banking industry has faced unprecedented challenges since the very outbreak of the pandemic. Banks are the entities that keep the economy running and they did that, even during the periods of lockdown and medical restrictions. Authorities acted rapidly, deploying a whole arsenal of packages of fiscal and monetary incentives in order to support companies, in order to supply liquidity to financial markets and in order to help the people who had lost their jobs. All of these packages of measures were implemented by way of the banking system.

Central banks took the measures to support the economy, and the cutback of monetary policy interest rates, minimal mandatory reserves and monetary market operations have preserved financial stability, they supplied liquidity into the system and brought about a drop in the cost of loans. As the pandemic escalated and the impact on the economy grew worse, governments implemented, still by means of the banks, packages of fiscal measures in order to support the medical sector and to alleviate the effects on companies, particularly on SMEs.

The banking system in the ASEAN area was quick in reacting to the pandemic and it showed flexibility and adaptability to the new economic context created by the pandemic. Access to quick and cheap loans, including the restructuring of loans, moratoria for loan repayments have offered companies in the region the support that should allow them to come out of the crisis.

Banks in the ASEAN region are the main source of funding for the economy, they are open to new technologies and to cooperation with fintechs, so that the new context, where consumer behavior is changing, as a result of self-isolation and medical restrictions, favors digitalization, and financial institutions are accelerating their digital transformation strategies. The challenge is enormous, because flexibility and adaptation have to be accompanied by efficiency, responsibility and balance.

The banking system in Asia is more open than ever before to collaborate with fintechs and other companies that provide financial services, it is flexible, but this openness entails the taking of risks, as well. Fintechs and digital banks come with new business patterns. New regulations are necessary, as well as new business patterns, in order to adapt to the new context generated by the pandemic, to the new consumer habits of people impacted by isolation and restrictions meant to prevent the virus from spreading, to a new style of working, work from home, to a world in a constant and rapid change.

The overview of the account ownership rates in ASEAN member countries highlights the potential for growth of the banking system in those countries. The differences in account ownership rates brought about differences in the role of banking institutions in the government programs to stimulate the economy, with the measures meant to aid the population easier to implement in those countries where account ownership rates are higher.

The analysis of the causes for the low account ownership levels reveals that one of the barriers against having a bank account, most frequently mentioned, was the big distance from a bank, for instance in Laos, Cambodia and the Philippines. Digitalization, accelerated by restrictions and the isolation enforced by the measures to prevent the virus from spreading, will facilitate access to bank products and services. The new technologies eliminate this geographical-distance barrier because they bring bank products and services onto phones, a mere click away.

Stable and advanced-digitalization banks will benefit from the situation where, in any time of crisis, customers will want security, and they will register an increase in productivity as a result of closing down brock-and-mortar branches. Many important banks in the region have reported an increase in online banking operations since the onset of the pandemic. For instance, Bank Rakyat Indonesia reported around 88% year-on-year increase of online banking operations in the first quarter of 2020, with similar growth rates posted by important banks in the Philippines and Malaysia. In turn, the three biggest banks in Singapore posted, in addition to a bigger volume of digital transactions, in the same time span, a significant increase in digital account opening and the use of financial planning service platforms and chatbots.

Banks are currently stepping up their use of digital channels in order to reach the consumers whose consumer behavior has changed against the background of travel restrictions and the periods of lockdown. At the same time, the digital transformation stimulates a more inclusive and more sustainable growth of banking systems in the region.

It is uncertain what the future course of the pandemic would be, and the sole certainty is that the way banks are now reacting to the crisis will determine the manner they would rebuild themselves for the future.

For the moment we are in the stage of the first analyses of the effects of COVID-19, but, as more statistical data concerning the evolution of the economy and the impact of the pandemic on the banking system become available, the analyses will grow more detailed. In addition, the investigation can be expanded to include an analysis of other regions and a comparison of the nature of the reactions to the crisis and the measures taken in order to alleviate the effects of COVID-19.

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