



IMPACTS OF THE COVID-19 OUTBREAK ON ISLAMIC FINANCE IN THE OIC COUNTRIES

EDITED BY:

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PRODUCED BY:

KNEKS
Komite Nasional Ekonomi dan Keuangan Syariah

IN PARTNERSHIP WITH:

DinarStandard
GROWTH STRATEGY RESEARCH & ADVISORY

 **Salaam
Gateway**

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FOREWORD



Executive Director
**National Committee for Islamic
Economy & Finance (KNEKS),
Indonesia**

*Assalamu'alaikum Warahmatullahi Wabarakatuh
Bismillahirrahmanirrahim*

All praises to God Almighty Allah SWT, the One who always showers us His mercy and blessings so we can complete the book on "Impacts of COVID-19 Outbreak on Islamic Finance in the OIC Countries". Peace be upon the Prophet Muhammad SAW, the greatest role model of all time for humankind.

Most countries in the world are currently battling the COVID-19 pandemic. This disease has caused the global economy to slow down and its impact is different from the global financial crisis of 2008 as it attacks public health systems and results in multi-dimensional implications.

The Economist Intelligence Unit (EIU) predicted that the global economic growth will only be 1.9 percent in 2020, the lowest since the global financial crisis. As the growth of the economy plunges, the Islamic finance industry will also be impacted. This decrease consequently will reduce revenue sharing or margins of the banks which will also reduce their profits.

Some countries, including OIC states, will decide to take on debt to boost their economies. Expanding debt may create economic growth but too much of it will put the economy at risk as it leads to higher borrowing costs. Alternatively, optimizing the role of Islamic social finance such as zakat, infaq, and sadaqah, as well as instruments of Islamic investment such as sukuk, can be used as solutions. The value of sukuk outstanding globally increased from \$454.5 billion in 2018 to \$574.1 billion in 2019 (RAM Ratings). This is a positive indication that sukuk can be used as an alternative form of financing to reduce the impact of the COVID-19 crisis.

I hope this book can provide valuable information about the impact and possible solutions from Islamic finance to mitigate the impacts of the COVID-19 crisis. This book could also be used as policy recommendation for governments or the Islamic Development Bank (IsDB) to fight the impacts of the financial and economic fallouts from the pandemic.

Wabillahitaufik Walhidayah

Wassalamualaikum Warahmatullahi Wabarakaaatuh

Jakarta, April 2020

Executive Director KNEKS
Ventje Rahardjo



FOREWORD

Director of education and research
**National Committee for Islamic
Economy and Finance (KNEKS)
Indonesia**

Assalamu'alaikum Warahmatullahi Wabarakaaatuh
Bismillahirrahmanirrahim

All praises to Allah SWT, the Most Gracious and Merciful, that because of His Mercy we can complete this book "Impacts of COVID-19 Outbreak on Islamic Finance in the OIC Countries." May peace be upon the Prophet Muhammad SAW, the one who had brought us from the darkness to the lightness.

We are facing the inconvenient truth that the COVID-19 outbreak affects all aspects of our lives and we cannot deny that the financial sector is one of the worst hit. The Islamic financial industry is no exception. It is interesting to see the regional impacts of the COVID-19 pandemic on Islamic finance in the OIC countries since the OIC is the second largest inter-governmental organization after the United Nations. Moreover, the global supply chain disruptions, demand compression, and macroeconomic instability has definitely also affected OIC member countries.

The global financial and economic crisis of 2008 has highlighted that the Islamic finance industry remains vulnerable to the similar systemic risks as its conventional counterpart. Economic recovery, especially in Islamic countries, will be accelerated by increasing the exchange of information in the fields of finance, banking, microfinance, and capital market. Sharing experiences from affected countries is invaluable for us. Therefore, this book becomes essential in addressing how far and how fast the novel coronavirus pandemic affects the Islamic financial industry in the OIC countries. This book also considers how long the damage will last and elaborates some recommended solutions to minimize adverse impacts.

The researchers in this book have attempted a comprehensive overview of the impacts of the COVID-19 outbreak on Islamic finance in the OIC countries. I hope this book can be a reference for governments and practitioners in the Islamic finance sector, especially in the OIC countries. Finally, I would like to express my sincere gratitude to all contributors and editors who have helped make this book possible. Hopefully, we will reach an end to this pandemic and economic crisis. May Allah SWT always protect us wherever and whenever we are. Thank you

Wabillahitaufik Walhidayah

Wassalamualaikum Warahmatullahi Wabarakaaatuh

Jakarta, April 2020

Director of Education and Research KNEKS
Sutan Emir Hidayat



FOREWORD

CEO / Managing Director
Dinarstandard

Assalamu'alaikum Warahmatullahi Wabarakaaatuh

Bismillahirrahmanirrahim

The modern-day Islamic finance industry is approximately 45-years mature with total assets estimated at \$2.5 trillion in 2018, represented by almost 1,500 institutions worldwide (IFDI Report 2019). The industry's leaders know the tools and levers to steer the growth and success of their institutions. However, this COVID-19 pandemic has thrown the known levers into uncertainty like never before. The severity of negative economic and human impacts with far-reaching implications on consumer, corporate, and global trade finance dynamics is indeed unprecedented.

The urgency to respond is a matter of survival for Islamic financial institutions (IFIs). Complacency is not an option. It is in such times of uncertainty that the torch of knowledge-driven insights can navigate us towards an efficient response--enabling industry's resilience, financial success and underlying mission.

This book presents important initial perspectives from well-respected industry scholars and thought leaders, sharing their analysis of COVID-19 impact and responses so far from 12 leading Islamic finance

jurisdictions globally. The 12 countries covered in this publication represent 87% of the world's Islamic finance assets that stretch through the GCC, Southeast Asia, South Asia, Africa, and Central Asia.

Some key mission critical questions industry leadership will be grappling with are: How will the prolonged economic collapse affect structural stability of Islamic financial institutions? How long can government agencies and financial institutions sustain supporting deferment of loan repayments and other support measures? Will further digital transformation urgency disrupt business models? What are areas of social finance leadership that IFIs can drive?

These and other key questions will need constant monitoring in the shifting-sand state that we are in with COVID-19. I congratulate KNEKS for taking a leadership role in galvanizing research-based insights from industry scholars around COVID-19 response for the Islamic finance industry. Finally, given the underlying ethos of Islamic finance, we heed to the guidance of our beloved prophet Mohammad (peace be upon him) who instructed us to, "tie our camel, and trust in Allah." So as we scientifically evaluate our course of actions, we cannot forget the power of 'dua' and also seek to be grounded in God consciousness in our response to this pandemic. May Allah swt make this test easy on all of us and, may the Islamic finance industry rise to the occasion in addressing this global socio-economic challenge.

Wassalamualaikum Warahmatullahi Wabarakatuh

Dubai, April 2020

CEO / Managing Director
Rafi-uddin Ahmed Shikoh

IMPACTS OF THE COVID-19 OUTBREAK ON ISLAMIC FINANCE



The 12 countries covered in this book represent 87% of the world's Islamic finance assets and stretches across the GCC, Southeast Asia, South Asia, Africa, and Central Asia.

2020 GDP GROWTH IMPACT & COVID-19 IMPACT SEVERITY

From the latest adjusted GDP growth projections for 2020, Bangladesh and Indonesia remain the only OIC economies in green. Turkey, Malaysia and Oman had the biggest net drop in projection.

OIC COUNTRIES	PROJECTED GDP GROWTH 2020 (JAN)	ADJUSTED GDP GROWTH 2020 (APR)
Turkey	3	-5
Saudi Arabia	1.9	-2.3
Pakistan	2.4	-1.5
Iran	0	-6
UAE	2.6	-3.5
Bangladesh	7.2	2
Indonesia	5.1	0.5
Nigeria	2.1	-3.4
Bahrain	2.1	-3.6
Oman	3.7	-2.8
Malaysia	4.5	-1.7
Brunei	-	1.3
BENCHMARKS		
USA	1.8	-5.9
Germany	0.44	-7
China	5.9	1.2

Source: IMF World Economic Outlook (WEO); Jan 2020; April 2020



GLOBAL EQUITIES INDEX

During Q1 2020, global equities fell 22.3 percent, as measured by the S&P Global BMI, with COVID-19 taking center stage and cases growing worldwide.



BMI Sharia outperformed its conventional benchmark markedly by more than 500 bps, marking its largest quarterly outperformance since its inception

Dow Jones Islamic Market (DJIM) Europe and DJIM Emerging Markets each outperformed their conventional benchmarks by more than 8.0%.

Source S&P May 12th 2020 data download; DowJones Indexes for DJI data

OIC EQUITIES IMPACT

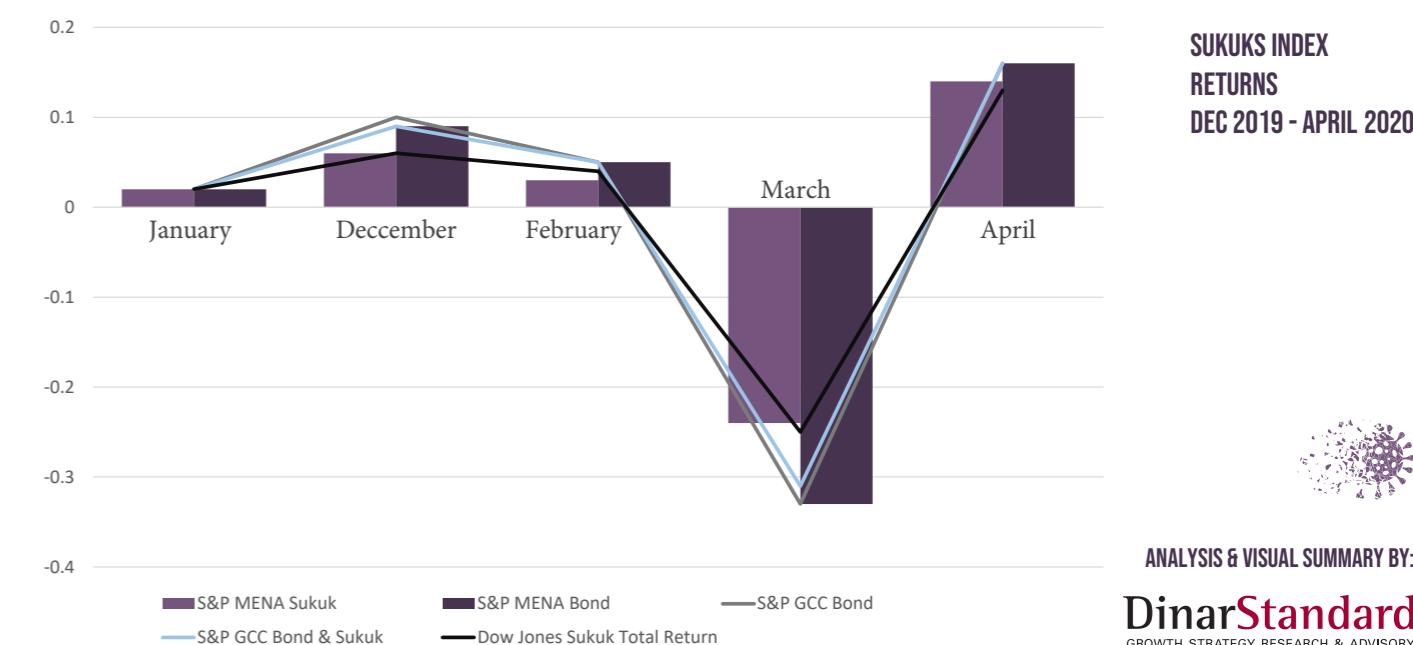
From the 11 OIC equity markets shown below, stock exchange of Indonesia, followed by Bahrain and Bangladesh were best performing (average 5-month during the COVID-19 period December 2019 to April 2020)

OIC EXCHANGES	DECEMBER	JANUARY	FEBRUARY	MARCH	<th>5 MONTH AVERAGE</th>	5 MONTH AVERAGE
Malaysia: KLCI	-0.06	0.18	0.16	0.46	-0.18	0.11
Oman: Muscat Securities	0.11	-0.09	-0.14	1.43	-0.2	0.22
Nigerian Stock Exchange	0.03	-0.32	0.48	0.96	-0.38	0.15
Saudi Arabia: Tadawul	-0.27	0.08	0.39	0.76	-0.39	0.11
Indonesia: Jakarta	-0.15	0.27	0.43	0.96	-0.16	0.27
Turkey: Borsa Istanbul	-0.23	-0.1	0.57	0.92	-0.64	0.10
Bahrain Stock Index	-0.18	0.01	0.39	1.16	-0.11	0.25
UAE: DFM	-0.05	0.03	0.19	1.08	-0.55	0.14
Pakistan: Karachi Stock Exchange	-0.07	-0.09	0.49	1.31	-0.68	0.19
Bangladesh: Dhaka Exchange	0.35	0	0	0.65	-	0.25
Iran: Tehran Stock Exchange	-0.76	-0.59	-1.5	-0.42	-2.33	-1.12
BENCHMARK EXCHANGES						
NYSE	-0.17	0.11	0.51	1.01	-0.44	0.20
Shanghai	0.32	-0.70	0.40	-0.36	0.25	-0.02

Source: Data from respective stock exchanges

SUKUK IMPACT

Returns from five sukuk and bond indexes (Dec 2019-April 2020) show the COVID-19 impact realized in March. S&P Ratings projected sukuk issuance is expected to drop from \$162 billion in 2019 to \$100 billion in 2020.



ANALYSIS & VISUAL SUMMARY BY:

DinarStandard
GROWTH STRATEGY RESEARCH & ADVISORY

PREFACE AND ACKNOWLEDGMENT

Since the world economy's recovery from the 2008 global financial crisis, we experienced a Goldilocks, or almost ideal, scenario. The world also thought that there was no more Black Swan, or improbable event or crisis, and that things were once again on the rise. U.S. financial markets went through the roof, with unprecedented tax cuts favoring the rich, the economy was boosted while unemployment rates fell to the lowest in decades.

While going through periodic recurrent crises, we try to learn and improve ourselves, as almost all economic and financial crises present paradigm-shifting opportunities. The 2008 global crisis was not an exception. However, it was treated primarily as an economic or financial crisis, not as an ethico-moral crisis, let alone anything deeper. Nothing more than policy changes and politicking were involved in dealing with the crisis.

In the broader spectrum of life during the post-crisis period it was business as usual. Major powers like USA, China, Russia and India all were engaged in the pursuit of how to become more powerful on two particular fronts: economic and military. The existential threat of environmental challenges has been inadequately prioritized. Poverty and deprivation around the world continue to grow and remain unchecked. Great powers use their military prowess to engage in or engineer conflicts that not only devastate some nations, but also contribute to an unprecedented refugee problem. In the name of fighting terrorism and external threats, already extreme levels of military spending by major nations continues to grow as if there is no better way to seek peace, security and stability. The global conglomerates of the weapons industry continue to thrive and it is not farfetched to make the case that they need and do engineer conflicts for their own survival and growth. Indeed, the "defense" industry might be more aptly called "war" industry.

It is in this context of the world where war and conflict, greed and corruption, poverty and deprivation, pollution and environmental degradation are rampant, who could have thought a few months ago that an invisible virus, whose source is not even known, would bring the world to its knees, and as the Economist magazine's cover page displayed the earth: Closed?

A tiny, invisible adversary rendered all the most powerful and destructive weapons useless. The country with the highest military spending as a superpower scrambled to breathe as a few hundred thousand ventilators and other medical supplies were in critical shortage to the extent that medical professionals are still struggling to fulfill their essential duty often without the desired protection. The boasting about reducing unemployment in USA to a historical level within the first three years of the Trump presidency evaporated within a few months. The skyrocketing stock market once again found that the law of gravity still works in the financial market and "irrational exuberance" still has its relevance.

This COVID-19-induced crisis is a whole new breed that is much darker than a "black swan" that we

have become somewhat used to. In light of the disorientation the entire world is facing in this fast-unfolding crisis, to understand and assess its nature and consequences is much too premature. Yet, as economists or social scientists, we have a responsibility to have a head start.

That's where this work fits in. While this is another global crisis, although of a different breed, the broader impact on the global economy would be a much bigger to deal with. Regardless, this work has a much narrower focus and less ambitious objective. In the Muslim world, one out of not-too-many dynamic agendas and projects involves Islamic finance. Since the launching of the first full-fledged commercial bank, Dubai Islamic Bank, in 1975, the industry has come a long way. It is now a multi-trillion dollar industry, with presence of Islamic finance activities of varying scale in almost all the Muslim-majority countries and beyond. It has been registering steady growth in more and more countries, especially those that are somewhat latecomers.

It is important to point out that this emerging industry has some fundamental constraints, as it exists and operates within both domestic and global economic and financial systems that are broadly conventional and un-Islamic in various respects. Thus, the industry has its existence essentially at the institutional and transactional level, not at the system level. Those countries that have good governance and well-articulated development plans and frameworks have benefited better and more distinctively from the presence and growth of the industry. In many other contexts, the industry has grown primarily based on religious rationales without necessary changes at the system level. It is claimed that Islamic finance focuses on the real economy as all of its transactions must be asset-linked (asset-based or asset-backed). However, being asset-linked, especially in the form of asset-based, is hardly adequate to be considered as focused on the real economy.

Islamic finance industry had a silver lining during the 2008 crisis that while it did suffer as the global economy suffered, it was resilient on the downside and the negative consequence it suffered was less severe than its conventional counterpart. This book is an early start to try to understand and assess the impact of this 2020 virus-induced crisis on the Islamic finance industry.

A good number of countries, consisting of Muslim-majority countries with major and some minor presence of Islamic finance industry, are covered in this book. The subject is fresh and exciting enough to elicit interest of a number of academics and scholars on such a short notice to contribute a chapter each on countries they have expertise about.

We are deeply grateful to these contributors for taking on this challenge and making their contribution in less than three weeks. The countries covered in this book are (in alphabetical order): Bahrain, Bangladesh, Brunei, Indonesia, Iran, Malaysia, Nigeria, Oman, Pakistan, Saudi Arabia, Turkey and United Arab Emirates. These chapters as specific to those countries explore the especial ways they might be impacted and the ways these countries are gearing up to the meet the challenges arising out of this crisis.

This publication project has been fundamentally facilitated by the patronage of National Committee of

Islamic Economy and Finance, the Republic of Indonesia (Komite Nasional Economi dan Keuangan Syariah, KNEKS), Dinar Standard, and Salaam Gateway and we are deeply grateful to them.

Given the extraordinary nature of the crisis, an invisible non-economic, non-financial, non-political adversary, it is fair to say that the global community is in a largely uncharted territory. The same is true about the Islamic financial industry. What is most interesting about this crisis is that unlike the previous crises where the problems were diagnosed and sought mainly in the policy arena, this crisis has categorically forced us to change our lifestyles. Indeed, quite notably the world is recognizing the simple and clear teaching of the Prophet Muhammad (pbuh) regarding epidemics as fundamentally important from health and the lifestyle viewpoint. As this crisis is more than just an economic or financial crisis, The Islamic financial industry might also, being largely a part of the conventional global financial system, be entrapped into limiting itself to the policy arena. Here Islamic finance, being rooted in and connected to Islam, might have an extraordinary opportunity to move beyond merely policies and tools but also present a better vision for the future within which Islamic finance might be able to prove its greater relevance in coping with the challenges not just in the Muslim world but also beyond. It is our hope and prayer that Islamic financial industry would recognize the relevant challenge as well as the opportunities and rise to the occasion.

Dr. Sutan Emir Hidayat

Dr. Mohammad Omar Farooq

April 2020

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COVID-19 AND ITS IMPACTS ON THE ISLAMIC FINANCIAL INDUSTRY IN THE OIC COUNTRIES

Sutan Emir Hidayat; Mohammad Omar Farooq; Atiqoh Nasution; Citra Atrina Sari

The novel coronavirus COVID-19 was first reported on December 31, 2019 in Wuhan, China, a city with a population of over 11 million. The virus went on to spread to nearly every country in the world. As of May 1, 2020, the disease infected at least 3,175,207 people with fatalities of more

than 224,172 globally, according to the World Health Organization (WHO)¹. This global pandemic has already had a dramatic impact on global economic activities. This introductory chapter is an attempt to examine the impact of COVID-19 on the Islamic financial industry particularly among the Organization of Islamic Cooperation (OIC) countries.

The first incidences of COVID-19 in the OIC countries were reported by Malaysia with three cases on January 25, 2020. Consequently, the virus spread throughout the OIC countries at exponential rates. As of May 5, 2020, there were at least 408,113 recorded confirmed cases, 13,896 (3.4%) fatalities and 202,835 recovered cases in the OIC countries, with 202,835 recoveries (49.7%), according to the Statistical, Economic and Social Research Training Center for Islamic Countries (SESRIC). The highest number of fatalities among the OIC countries has been reported in Iran, followed by Turkey and Indonesia.²

Figure 1 Total Number Confirmed COVID-19 Cases

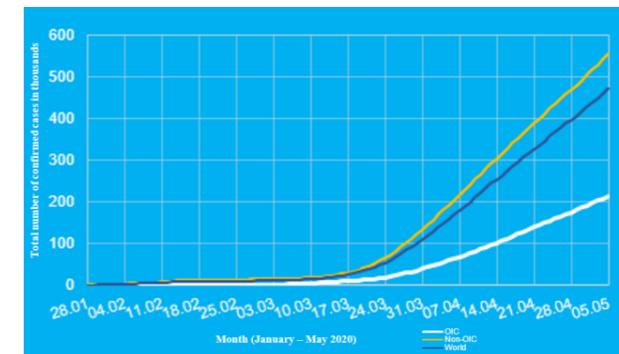


Figure 2 Case Fatality Rate of COVID-19

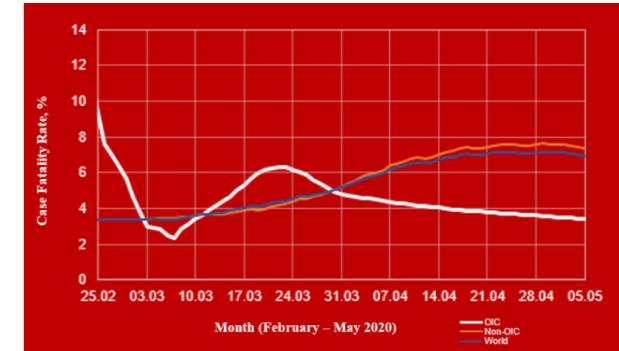
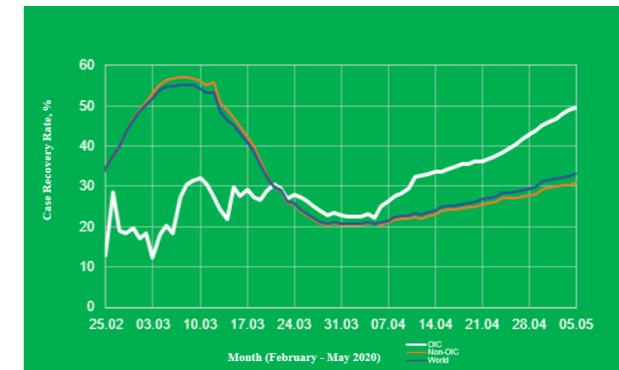


Figure 3 Recovery Rate



Source: Statistical, Economic, and Social Research Training Center for Islamic Countries

1 WHO coronavirus Disease (COVID-19) Dashboard, (2020, May 1st). Retrieved from <https://covid19.who.int/>

2 SESRIC COVID-19 Pandemic Database for OIC Member Countries. (2020, April 10th). Retrieved from https://www.sesric.org/sesric_covid_19.php

ECONOMIC DOWNTURN LEADING TO DEBT

The uncertainties caused by the pandemic have put the global economy in jeopardy and global recession seems inevitable for all countries including those of the OIC. In just a few weeks of COVID-19's outbreak and spread, the fallouts and impact on the world's economy surpassed that of the global financial crisis in 2008. Those who can work from home mostly have stable incomes, but non-permanent or daily workers are at risk of losing their earnings, particularly in the most affected industries such as property, construction, tourism, retail, and food and beverages. With countries shutting down industries and sectors, the economic impacts have amplified and spilled over to most of the global economy, the effects of which are seen in the short-term and will continue to be felt in the long-term.

Various measures have already been taken by governments in OIC countries to reduce the economic impact of the crisis caused by COVID-19. Some countries, predominantly emerging markets, are turning to debt, which was already prevalent among OIC countries pre-COVID crisis. The total external debt of the OIC countries increased by 139.5% from 2005 to 2019 and 58.5% from 2010 to 2019 (SESRIC, 2019)³. With the onset of the crisis, in the beginning of April, Iran – the hardest hit country in the OIC – requested \$5 billion from the International Monetary Fund (IMF) to fight the COVID-19 outbreak.⁴ It was the Islamic Republic's first request for an IMF loan since its Islamic Revolution in 1979. Iran isn't the only OIC country asking for loans. As of April 16, 2020, Pakistan welcomed debt relief measures for an additional \$1.4 billion from the IMF to cope with its increasing number of COVID-19 cases despite a lockdown. The government previously announced an \$8 billion stimulus to feed the poor as well as to extend relief to businesses.⁵ Nigeria also took on similar relief measures at the end of April. The IMF approved \$3.4 billion in emergency financial assistance to support Nigerian authorities' efforts in addressing the severe economic impact of the COVID-19 and the sharp fall in oil prices.

⁶The COVID-19 outbreak has magnified existing vulnerabilities, leading to large external and fiscal financing needs.

3 SESRIC. (2019). OIC Economic Outlook 2019: Mobilizing Financial Resources for Development.

4 Iran Presses IMF Emergency Loan to Fight coronavirus (2020, April 08). Retrieved from <https://www.aljazeera.com/ajimpact/iran-presses-imf-emergency-loan-fight-coronavirus-200408112104881.html>

5 COVID-19: Pakistan gets US\$1.4 billion relief financing to combat coronavirus as death toll rises to 128 (2020, April 16th). Retrieved from <https://gulfnews.com/world/asia/pakistan/COVID-19-pakistan-gets-us14-billion-relief-financing-to-combat-coronavirus-as-death-toll-rises-to-128-1.71011751>

6 IMF Executive Board Approves US\$ 3.4 Billion in Emergency Support to Nigeria to address the COVID-19 Pandemic (2020, April 28th). Retrieved from <https://www.imf.org/en/News/Articles/2020/04/28/pr20191-nigeria-imf-executive-board-approves-emergency-support-to-address-COVID-19>

The Islamic Development Bank (IsDB) has also made a contribution to support its member countries. So far, a total of \$2.3 billion has been approved to be channelled towards preventing, mitigating and recovering from the COVID-19 pandemic.⁷ The latest contribution made by IsDB is to support innovation in minimizing the adverse impact of COVID-19 on its member countries.⁸

THE IMPACTS ON AND RESPONSES FROM THE ISLAMIC BANKING INDUSTRY

Domestic consumer demands have dropped mainly due to travel and movement restrictions, curfews, quarantines, and lockdown imposed by most countries. This has disrupted global supply chains and consequently pushed many companies to lower production and shrink employment. A large number of people have already lost their jobs and global unemployment will rise. In particular, the micro, small and medium-sized enterprises (MSMEs) sector is significantly disrupted by the pandemic. MSMEs are struggling to survive, at the same time that many are obliged to pay expenses such as installments on their financings from financial institutions. Consequently, the disruptions also spread to the financial industry.

Central banks have been quick to respond to the needs of the financial industry. Measures taken by various central banks include reducing banks' capital buffers in order to finance rescheduling of loans/financings and to allow a temporary deferment of financing repayments of customers affected by the economic fallouts of the COVID-19.

For example, the Saudi Arabian Monetary Authority (SAMA) announced the Private Sector Financing Support Program with a total value of 50 billion riyals (\$13.29 billion) and has directed banks to provide concessional loans aimed at helping businesses maintain their employment levels.⁹ SAMA has also helped banks by postponing the implementation of outstanding BASEL III standards.¹⁰ The Central Bank of Bahrain (CBB) reduced the reserve requirements for banks from 5% to 3% while the Central Bank of UAE (CBUAE) cut the reserve requirement by 50% from

7 The Islamic Development Bank Group Strategic Preparedness and Response Programme for the COVID-19 Pandemic Allocates US 23 billion to Member Countries. (2020, April 04th). Retrieved from <https://www.isdb.org/news/the-islamic-development-bank-group-strategic-preparedness-and-response-programme-for-the-COVID-19-pandemic-allocates-us-23-billion-to-member-countries>

8 Islamic Development Bank to Support Pioneering Ideas in the Fight Against COVID-19 via 500m Transform Fund (2020, April 1st). Retrieved from <https://www.isdb.org/news/islamic-development-bank-to-support-pioneering-ideas-in-the-fight-against-coronavirus-via-500m-transform-fund>

9 Saudi central bank announces 50 bln riyal coronavirus financing package (2020, April 15th). Retrieved from <https://www.reuters.com/article/health-COVID-19-saudi-cenbank/saudi-central-bank-announces-50-bln-riyal-coronavirus-financing-package-idUSL8N2B70RT>

10 Saudi tells banks to support businesses to avoid job cuts (2020, March 30th). Retrieved from <https://gulfbusiness.com/saudi-tells-banks-support-businesses-avoid-job-cuts/>

14% to 7%.¹¹ Banks are allowed to give temporary deferment on monthly loan payments for a six-month period in Bahrain while in the UAE the deferral is extended until December 31, 2020.¹²

Bank Negara Malaysia (BNM) released a robust set of measures. The central bank cut the statutory reserve requirement from 3% to 2% to inject over 30 billion ringgit of liquidity into the banking system. BNM is also allowing banks to draw down 2.5% capital conservation buffer, run the liquidity coverage ratio below 100% and utilize accumulated regulatory reserves.¹³ Meanwhile, Indonesia's Financial Services Authority (OJK) issued a stimulus policy that includes credit restructuring for affected borrowers and leniency for banks in determining the quality assessment of financing to affected borrowers as well as relaxation of periodic report submissions by financial institutions.¹⁴

A number of Islamic financial institutions have also pledged to provide relief packages for their customers amidst the COVID-19 pandemic. In Malaysia, banks including RHB Islamic Bank, Maybank Islamic, Public Islamic Bank, and Hong Leong Islamic Bank have pledged to provide relief packages for their customers.¹⁵ The measures taken include flexibility to defer financing repayments as well as restructuring and rescheduling of financing payments. In Indonesia, some private Islamic banks such as Permata Islamic Bank, Bukopin Islamic Bank, Mega Islamic Bank, and Muamalat Bank enacted loan repayment delays and granted relief of rent payments.¹⁶ Turkish private lenders and Islamic banks, namely IsBank, Akbank, Ziraat Katilim and Vakif Katilim are also allowing clients to postpone loan repayments until June 30, 2020¹⁷ in order to ease their financial burdens. In Saudi Arabia, Al-Ahli Bank announced that it will defer the payment of personal, real estate, and leasing financing instalments for public and private health workers for a period of three months.¹⁸

¹¹ UAE Central Bank cuts reserve requirements and boosts stimulus to Dh256bn (2020, April 5th). Retrieved from <https://www.thenational.ae/business/economy/uae-central-bank-cuts-reserve-requirements-and-boosts-stimulus-to-dh256bn-1.1001634>

¹² Central Bank of Bahrain Regulatory Measures as Part of Precautionary Efforts to Contain COVID-19. (2020, March 18th). Retrieved from <https://www.cbb.gov.bh/media-center/central-bank-of-bahrain-s-regulatory-measures-as-part-of-precautionary-efforts-to-contain-COVID-19/>

¹³ Malaysia's central bank cuts statutory reserve ratio to 2% (2020, March 19th). Retrieved from <https://www.businesstimes.com.sg/banking-finance/malaysias-central-bank-cuts-statutory-reserve-ratio-to-2>

¹⁴ Kebijakan Stimulus OJK pada Sektor Jasa Keuangan Antisipasi Dampak Virus Corona (2020, March 31st). Retrieved from <https://www.ojk.go.id/id/berita-dan-kegiatan/info-terkini/Pages/Kebijakan-Stimulus-OJK-pada-Sektor-Jasa-Keuangan-Antisipasi-Dampak-Virus-Corona.aspx>

¹⁵ Banks step up measures to help customers amidst COVID-19 crisis. (2020, March 20th). Retrieved from <https://www.thestar.com.my/business/business-news/2020/03/20/banks-step-up-measures-to-help-customers-amidst-COVID-19-crisis>

¹⁶ Islamic Bank, Rural Development Bank (BPR), and Regional Development Bank (BPD) are giving Credit Repayment Delays (2020, March 31st). Retrieved from <https://www.cnnindonesia.com/ekonomi/20200331202117-78-488887/bank-syariah-bpr-bpd-mulai-beri-penundaan-cicilan-kredit>

¹⁷ Turkish Banks Delay Loan Payments to Ease the Impact of COVID-19 (2020, March 24th). Retrieved from <https://www.cpifinancial.net/bme/news/turkish-banks-delay-loan-payments-to-ease-the-impact-of-COVID-19>

¹⁸ Saudi Banks Postpone Payments for Health Workers (2020, March 23rd). Retrieved from <https://aawsat.com/english/home/article/2195126/saudi-banks-postpone-payments-health-workers>

MARKET REACTIONS

The spread of COVID-19 has shaken the global stock markets, and the OIC countries are no exception. Islamic indexes have dropped a few times since the beginning of the pandemic at the end of 2019. Since the beginning of 2020, the net return of the MSCI Saudi Arabia Domestic IMI Custom Min Vol declined by 18.33% as the markets struggled with the spread of COVID-19 as well as the oil price war between Saudi Arabia and Russia initiated by Saudi Arabia in early March 2020.¹⁹

Figure 4 MSCI Saudi Arabia Domestic IMI Islamic Custom Volatility Index



Source: MSCI Emerging Market Islamic Index (USD)

The Jakarta Islamic Index took a hard hit in March 2020 since the announcement of the first confirmed case of COVID-19 in the country. The stock market sharply declined by 6.44% on March 19 alone.²⁰ The FTSE Bursa Malaysia Sharia fell 4.9% on March 13, 2020 then started recovering with a gain of 2.41% on April 7, 2020.²¹

Figure 5 Jakarta Islamic Index Shariah



Source: Investing.com

Figure 6 FTSE Bursa Malaysia Shariah



Source: Investing.com

¹⁹ MSCI Saudi Arabia Domestic IMI Islamic Custom Minimum Volatility Index (USD) (2020, April 30th). Retrieved from <https://www.msci.com/documents/10199/4c316ea8-7161-47f5-843a-be64c11c73c2>

²⁰ IDX Islamic. (2020, April 09th). Retrieved from <https://www.investing.com/indices/idx-islamic>

²¹ FTSE Malaysia Hijrah Shariah. (2020, April 09th). Retrieved from <https://www.investing.com/indices/ftse-malaysia-hijrah-shariah>

ISLAMIC NON-BANKING INDUSTRY

The non-banking sectors are not spared, including takaful. Although the insurance and takaful sector is considered to be one of the most important economic sectors in Kuwait, it is also one of the weakest because it does not enjoy any significant support from the government. Gulf Takaful Insurance claimed that the insurance sector is currently suffering from a lack of new business in light of the interruption of government and private projects as well as a decline in collections. Moreover, the suspension of business activities in Kuwait will affect the ability of companies to pay insurance premiums or cause them to defer premium payments to insurers, which will lead to a decreased liquidity for the latter and affect their cash flows²². This will affect the ability of insurers to continue to pay compensation and benefits. A Supreme Committee for Insurance was established on February 1, 2020 by the Ministry of Commerce and Industry of Kuwait that aims to regulate and supervise the insurance business in the country²³. It will be difficult for such a new body to introduce any immediate solutions to the crisis. The United Arab Emirates appears to be more ready to address the impact of the COVID-19 outbreak on its takaful sector. On April 27, Abu Dhabi National Takaful, which is listed on the Abu Dhabi Securities Exchange, announced a 40% discount on car insurance renewal premiums for the period of April and May, to be effective on May 1, 2020 until the end of the year. The announcement comes simultaneously with another initiative launched by the company in its effort to support the physical distancing policy. The company has also had to turn to digital options and social platforms such as WhatsApp to respond to customers²⁴.

The extent and severity of the damage caused by the COVID-19 pandemic on our economies may not be clear amidst the health crisis we are currently fighting. But the initial indicators discussed in this chapter suggest that we; governments, financial institutions, policy makers, investors, individuals and down to the smallest social units of our economies, should come together to look for solutions to face the economic storm that we might be heading towards as the dust of the pandemic storm settles. As Prophet Muhammad SAW taught us: "The believers, in their mutual kindness, mercy, and compassion, are like one body. When any limb of it aches, the whole-body aches, because of sleeplessness and fever." (Bukhari and Muslim)

²² Kuwait: Insurance companies' liquidity affected by COVID-19 (2020, April, 16th). Retrieved from <https://www.meinsurancereview.com/News/View-NewsLetter-Article?id=61240&Type=MiddleEast>

²³ MOCI to Form Panel to Regulate Insurance Business (2020, February 2nd). Retrieved from <http://www.arabtimesonline.com/news/moci-to-form-panel-to-regulate-insurance-business/>

²⁴ UAE: Abu Dhabi National Takaful offers 40% discount on motor renewals to support stay-at-home directives (2020, April 27th). Retrieved from <https://www.meinsurancereview.com/News/View-NewsLetter-Article?id=61421&Type=MiddleEast>

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THE IMPACTS OF COVID-19 ON THE ISLAMIC FINANCE INDUSTRY IN THE KINGDOM OF BAHRAIN

Muhammad Rizky Prima Sakti; Rizwan Malik

The novel coronavirus COVID-19 whose first case was reported in China at the end of 2019 has since spread to the rest of the world. Bahrain saw its first reported case on February 21, 2020, that of a school bus driver who returned from overseas. As a result, the government of Bahrain took an active step to close academic institutions, including schools and universities, immediately throughout the Kingdom first for two weeks and then for an indefinite period. All new cases were imported, that is to say that they came from overseas and were brought into the Kingdom from abroad. As a result, Bahraini authorities acted promptly to limit incoming flights, introducing scanning at the airport and suspending flight operations.

Since then, cases related to COVID-19 have steadily increased to 3,356 including 8 deaths as of May 3, 2020.

On a positive note, Bahrain is among the countries with the highest recovery rate of the COVID-19, with more than 51% as of May 3, 2020.

Bahrain was among the last countries within the GCC to introduce a partial shutdown of non-essential businesses. In addition, various precautionary steps have been introduced, including 14 days compulsory quarantine for incoming travelers, social distancing and stay-at-home measures imposed by authorities, closing educational institutions, retail shops, restaurants and cinemas; suspending flights to infected areas; suspending prayers in mosques; rescheduling major events (including the annual Formula 1 race); restricting gatherings to a maximum of 5 people; and switching to remote working at public entities and introducing mobile applications that allow residents of the country to monitor proximity of recovered COVID-19 patients.

COVID-19 AND BAHRAIN'S ECONOMY: SOME POLICY RESPONSES

The outbreak of the COVID-19 has already and will continue to disrupt economic activities of the global economy after having experienced a 2.9% GDP growth in 2019. While the IMF earlier forecasted a growth of 3.3% in the global GDP in the year 2020, it has now revised its forecast to 3% decline in the GDP for the year 2020. Most businesses and companies in services, tourism, retail, transportation, and industrial sectors have been interrupted since the viral outbreak emerged.

In the Middle East and North Africa (MENA) countries, the COVID-19 pandemic has increased stress in the markets as reflected in a downward revision of MENA economic growth in 2020. Table 2 shows the declining projections of GDP growth in MENA countries due to COVID-19.

Table 2 Projections of GDP growth (%) in MENA countries in 2020

	2019	2020f (Previous, Oct 2019 forecast)	2020f (Current, Apr 2020 forecast)	Difference (PP Change)
MENA Region	0.6	2.6	-1.1	-3.7
Algeria	1.3	1.9	-3.0	-4.9
Bahrain	1.8	2.1	-2.5	-4.6
Egypt	5.6	5.8	3.7	-2.1
Iran	-8.7	0.1	-3.7	-3.8
Iraq	4.8	5.1	-5.0	-10.1
Jordan	2.2	2.3	-3.5	-5.8
Kuwait	1.5	2.5	0.0	-2.5
Lebanon	-0.2	0.3	-10.9	-5.1
Libya	3.8	2.7	-8.1	-11.2
Morocco	2.7	3.5	-1.7	-5.2
Oman	0.3	3.5	-3.5	-7.0
Qatar	2.0	3.0	0.4	-2.6
Saudi Arabia	0.5	1.6	0.2	-1.4
Tunisia	1.6	2.2	-4.0	-6.2
UAE	1.8	2.6	-1.1	-3.7

Data source: World Bank, 2020

According to the World Bank (2020), the economic growth of MENA countries in 2020 would be revised down from 2.6% to -1.1% due to coronavirus pandemic. The COVID-19 outbreak may severely hit economic activities and trade across MENA countries to varying degrees for 2020 and accordingly Bahrain will also face pressure on its economy as the coronavirus spreads.

Bahrain's economy is expected to grow in 2020 by -2.5%, down by 4.6 percentage points as compared with the earlier forecast (World Bank, 2020). Moreover, as a regional oil producer, Bahrain will also face fiscal pressures from lower oil prices, limiting government spending and hence dragging on non-oil economic activities.

The government response with restrictions on travel, events, and business activities will certainly hit hard domestic consumption, businesses, and investment in the Kingdom. Bahrain's economy after oil and gas (17.8%) is dependent on financial services (16.5%) based on the Bahrain Economic Report 2019, followed by the manufacturing sector (14.5%).

Nevertheless, it is important to highlight that Bahrain has been leading on economic stimulus packages in combating the impacts of COVID-19¹. The Kingdom has launched economic relief packages of almost 30% of GDP in response to impact of the pandemic. The huge stimulus packages of \$11.4 billion (4.3 billion Bahraini dinars) will play a crucial part in cushioning the fall in economic activities². Under this relief package several important commitments are made by the government for residents and nationals of the country. Among others, they include:

1. Postponement of all loan payments for six months – both principal and profit;
2. Paying the salaries of all private sector employees for three months from April 2020 from the unemployment fund, this adds up to \$ 570 million (BHD 215 million);
3. Paying individuals' and businesses' electricity and water bills for three months from April 2020 (up to the costs incurred during the same period in 2019);
4. Exempting all individuals and businesses from municipal fees for three months from April 2020;
5. Exempting all businesses from industrial land rental fees for three months from April 2020;
6. Exempting all tourism-related industry from tourism levies for three months from April 2020;
7. Doubling the Liquidity Support Fund to \$530 million (BHD 200 million);
8. Increasing the Central Bank of Bahrain's loan facilities to \$9.8 bn (BHD 3.7 billion) to allow debt instalments to be deferred and extra credit to be extended;
9. The redirection of all Tamkeen programmes (semi-autonomous government agency that provides loans and assistance to businesses) to support adversely affected companies, as well as the restructuring of all debts issued by Tamkeen.

The above measures introduced by the Government of Bahrain are very timely and may have a short-term positive impact on residents and the Bahraini economy in general.

¹ The advanced economies announced economic stimulus packages in response to coronavirus spreads in their economy. US has provided the economic stimulus packages worth 10% of their GDP, and about 5% in UK and Germany. Source: <https://www.fitchratings.com/research/sovereigns/deep-global-recession-in-2020-as-coronavirus-crisis-escalates-02-04-2020>

² Source: <https://bahainedb.com/key-updates-on-covid-19/>

IMPACTS ON ISLAMIC BANKING AND FINANCE

The COVID-19 pandemic has undeniably increased stress on the banking and financial sectors in many jurisdictions. One of the key questions yet to be assessed is how and to what extent the Islamic financial services industry will be impacted by the coronavirus pandemic.

The banking sectors in Bahrain, both conventional and Islamic, have already taken a series of actions as a result of the spread of COVID-19 to meet the needs of customers. Among the initiatives, inter alia, are encouraging customers to use digital or online banking to manage their accounts, and retail customers who have received financing in the form of personal, mortgage, and car financing will receive six months' postponements of instalments without incurring any fees. The Central Bank of Bahrain (CBB) has cut the interest rate by 1.55% from 4% to 2.45% in response to economic repercussions of the pandemic in the Kingdom³.

Nevertheless, we anticipate that COVID-19 could potentially impact Islamic banks in several dimensions, including revenue, fee-based income, asset quality, and liquidity coverage.

- Profitability:** The profitability levels of Islamic retail banks remain stable at 0.3% while the profitability of Islamic wholesale banks slightly decreased from 0.6% in June 2018 to 0.4% in June 2019, according to the central bank's Financial Stability Report 2019. However, credit ratings agencies such as S&P Global Ratings project that the Islamic banking sector will experience a dramatic drop in revenue for 2020. A lower interest rate environment with the CBB cutting the lending rate by 1.55%⁴ will potentially lift funding costs if liquidity shrinks, and margins are likely to come under pressure.
- Fee-based income:** The coronavirus crisis will weaken customer spending in retail, and force investors to hold cash due to economic instability, a move that may lower assets under management in asset management divisions. The pandemic looks likely to slow down Islamic investment banking activities. The crisis could put pressure on fee-based services offered by Islamic banks, such as fees/commissions for providing a bank transfer service (outside the country), commissions for issuing Islamic credits, and safe custody services. The diversification of revenue that includes fee-based income is of utmost importance. This could be challenging for Islamic banks if the outbreak deepens further or carries on, leading to prolonged disruptions. With reduced economic activities in the country and an expected increase in unemployment, especially for the expatriate community, it is expected that annual remittances, which were around \$3.3 billion in 2018 will be affected.

³ Source: <https://www.cbb.gov.bh/media-center/cbb-cuts-lending-interest-rate/>

⁴ Central Bank of Bahrain, CBB. (2020). CBB Cuts Lending Interest Rate. Retrieved from <https://www.cbb.gov.bh/media-center/cbb-cuts-lending-interest-rate/>

The extent of the impact will be known in due course.

- Asset quality :** The deadly coronavirus, coupled with the oil price drop might raise asset quality risks for Islamic banks in Bahrain. This could lead to pressure on capital adequacy. The asset quality ratio for Islamic retail banks deteriorated as their non-performing facilities (NPF) ratio increased from 9.5% in the fourth quarter of 2018 to 10.4% in the last quarter of 2019, according to the CBB Statistical Bulletin. For the Islamic banking and finance industry, there is a greater probability that the deferment of loan payments will have a positive impact on the asset quality (NPF) of banks in the short run as it will shield against the involuntary defaults owing to COVID-19. In addition, the government's initiative to pay salaries of the private sector, land rental exemptions and tourism-related organizations will assist in reducing the operational costs for the Islamic banks and financial institutions and their clients by lowering their operational expenses. This may also indirectly lower the overdue / default probability. However, in the long-term, it is anticipated that Islamic banks in Bahrain are likely to witness an increase in NPF (% gross facilities) if the virus continues to disrupt the economic activities as the crisis could affect the ability of companies to meet their financial obligations due to subdued demand, that could elevate their NPF levels. The wider benefits from huge economic policy stimulus launched by the government are unlikely to be seen until the health crisis subsides.

Moreover, the pressure on asset quality could worsen Islamic banks that have higher impairment on transportation (34.6%), construction (30.7%), and trade (19.5%) (CBB Financial Stability Report, 2019). Islamic banks with high proportion of financing facilities in these sectors are likely to have substantial asset quality deterioration. The government introduction of the financial relief packages by giving six months credit extension will not suffice if pressure on those sectors persists for a prolonged period.

- Liquidity coverage:** Doubling the liquidity support fund will most probably enable the banking industry, including Islamic financial institutions, to enhance their financing capacity, which may contribute towards economic growth by stimulating demand in the short-term. Bahraini banks are among the most active issuers of Islamic fixed-income instruments (sukuk) in the GCC region. According to Refinitiv data (2019), Bahrain recorded a \$2.2 billion increase in sukuk issuance from \$6.4 billion in 2018 to \$8.6 billion in 2019. Islamic banks in Bahrain are also dependent on non-domestic funding, accounting for around 26% of total funding and 38% of deposits⁵ (CBB Statistical Bulletin, 2020). The obligations on foreign exchanges will put Islamic banks in Bahrain in a riskier situation. In addition, global markets volatility and concerns over liquidity tightening could hamper Islamic banks to access global markets and would also drive non-domestic deposits withdrawals. In this situation, the liquidity coverage would be deteriorated if investor confidence is not restored and non-domestic deposits are withdrawn and not replaced. Aside from that, Islamic banks should reassess the risk profiles of their customers, typically by classifying cus-

⁵ Total foreign assets of Islamic banks in Bahrain for year 2019 is \$8,530 million (overall Islamic bank's assets \$32,082 million). Meanwhile, total foreign liabilities recorded at \$11,139 million

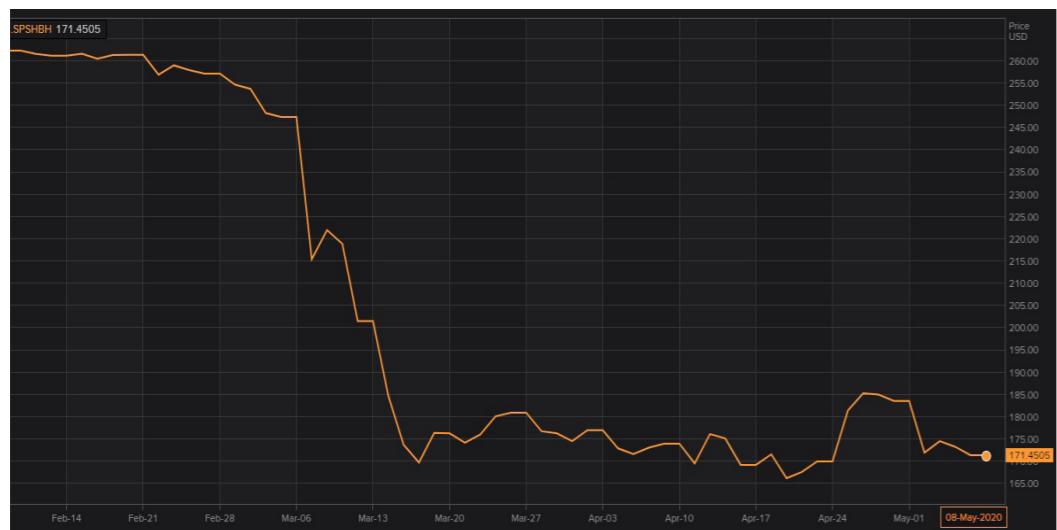
tomers who are impacted by the COVID-19 as high risk.

- Credit Ratings:** As a result of low oil prices and COVID-19, credit ratings agency Moody's downgraded⁶ the GCC banking system from a stable outlook to negative for all countries except Oman. In the case of Bahrain, additional factors include the government's weakening fiscal position and lower activity in the real estate sector⁷ as well as frequent travelers and freight movement between Saudi Arabia and Bahrain, both of which have significant impact on banking firms in Bahrain.

Furthermore, the COVID-19 pandemic has caused stock market indices to plummet around the globe. On March 12, 2020, the Dow Jones, S&P 500 and FTSE 100 saw their biggest one-day decline since 1987⁸. According to Baker et al.⁹, the stock market reaction is an early signal of economic repercussions of the COVID-19 outbreak. The disruption on global supply chains, the temporary halt in manufacturing, and the fears of getting infected by the deadly COVID-19 could reduce the volume of stock market activities.

In Bahrain, the main index BAX decreased by about 20.52% to close at 1,279 points as of May 7, 2020. Meanwhile, the Islamic indices of S&P Bahrain Shariah Index fell about 32.14% to close at 171.45 points, as of May 8, 2020). It was evidenced that the S&P Bahrain Shariah Index started to fall as the COVID-19 emerged in the Kingdom at the end of February 2020, and since then, the Bahrain Islamic

Figure 8 S&P Bahrain Shariah Index During the COVID-19 Pandemic



Source: Thomson Reuters Eikon, 2020

⁶ Fitzpatrick, Nick. (2020, April 03). Moody's downgrade GCC banking system. Retrieved from <http://www.fundsglobalmena.com/news/moody-s-downgrades-gcc-banking-systems>

⁷ Source: <http://www.fundsglobalmena.com/news/moody-s-downgrades-gcc-banking-systems>

⁸ Source: <https://www.bbc.com/news/business-51829852>

⁹ Baker, S. R., Bloom, N., Davis, S. J., Kost, K., Sammon, M., & Viratyosin, T. (2020). The unprecedented stock market reaction to COVID-19. *White paper-Becker Friedman Institute for economics at UChicago*.

stock market witnessed sharp declines.

STILL UNFOLDING

The COVID-19 pandemic is still unfolding. It is expected that the world post COVID-19 will be a different one.

Many businesses are likely to face severe challenges in the coming weeks and months as they get used to a new norm. In line with the reduction in economic activities, it is expected that the affiliated industries like Islamic banking and finance will experience lower than expected growth.

However, the COVID-19 crisis coupled with low oil prices may be a blessing in disguise for the Islamic finance industry, in particular in the GCC and Bahrain, which is historically a hub for Islamic finance in the region. This is due to the fact that lower profit rates might be an opportunity for investors, sovereigns and corporates to tap into the market and raise funds by issuing sukuk, thereby growing assets under management of the Islamic finance industry in the country.

RECOMMENDED MEASURES TO BE TAKEN BY THE ISLAMIC FINANCE INDUSTRY

A weak demand and prolonged disruption due to the fragile situation would impose a shock to Bahrain's economy. Nevertheless, it is important to appreciate the extraordinary economic packages that the government has introduced for extraordinary times.

When it comes to the Islamic banking and finance industry in Bahrain, we believe the following measures can be introduced by the industry to play its part in the development of the economy in Bahrain:

- Islamic banks in the county can jointly set up a waqf fund to support the families affected by the coronavirus as part of their CSR activities. This may include:
 - Families of the deceased, who have died due to this virus. The fund may support the education, healthcare and other living expenses indefinitely or until other means are available.
 - Support the families of the sick by paying salaries until they have recovered completely.
 - A large number of expats have been affected, these are the people who are from developing countries and send funds to their families on a regular basis. The waqf fund can provide sustenance to these people as well as their monthly salaries, if not covered by the employer.
 - At a time when public health has become of utmost priority due to the outbreak, the waqf fund can also be utilized to boost healthcare services, by way of increasing hospital capacity such as hospital beds, ventilators, and medical staff (doctors, nurses), in order to cushion

the detrimental impacts of further pandemic.

- In addition, providing temporary credit relief to both expats and locals could lead to fewer lay-offs of people affected by the pandemic.
- Small and medium-sized enterprises must also be supported with relaxed working capital and financing terms to ensure continuity of their businesses in these difficult times.
- Lastly, it is expected that default rates of the underlying companies will go up; hence it is important for Islamic banks and financial institutions to work with their clients both on the assets side and the liability side to ensure an optimum solution is reached to ensure NPFs and investors' expectations are managed well.

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THE IMPACT OF COVID-19 ON THE ISLAMIC FINANCIAL SECTOR IN BANGLADESH

Mohammad Dulal Miah; Norizan Binti Mohd Kassim

There is a general consensus that the novel coronavirus COVID-19 is gradually leading the global economy into an unprecedented economic recession, second only to the Great Depression. The decline of world GDP is estimated to be 3% in 2020, and an accumulated loss of \$9 trillion in 2020 and 2021¹. The crisis is likely to cripple business enterprises by its recurrent wave of bankruptcies and layoffs². Many industries, including tourism, aviation, catering services, sports, and entertainment, are steadily moving toward an uncharted danger zone. The world's major stock markets have lost their value significantly³, which is merely an indication of what the global economy would look like in the coming days.

The financial sector is likely to receive a blow worse than the 2008/9 global financial crisis (GFC) that was triggered by the financial sector and penetrated the real economy gradually. Back then, regulatory authorities had enough tools to fight the crisis but this current one is utterly different in terms of its genesis, nature, and magnitude of effects. Hence, it is difficult to predict the future effect of the pandemic on financial institutions. Especially, the demand (credit) and supply (deposit) sides of financial institutions are expected to be disrupted seriously. The impact is going to be worse for developing countries like Bangladesh, due to limited available tools to fight the crisis.

COVID-19 struck Bangladesh at a time when the financial system of the country was undergoing a critical phase due to some issues in the banking sector accumulated over the years including liquidity crunch, substantial accumulation of non-performing loans (NPLs), and operational inefficiency. While the credits and deposits of the banking system were starting to show a recovery from an earlier collapse, the pandemic turned the trajectory downward again. Figure 2 shows the latest available monthly data on loans and deposits of the banking system. Compared to December 2019, both credits

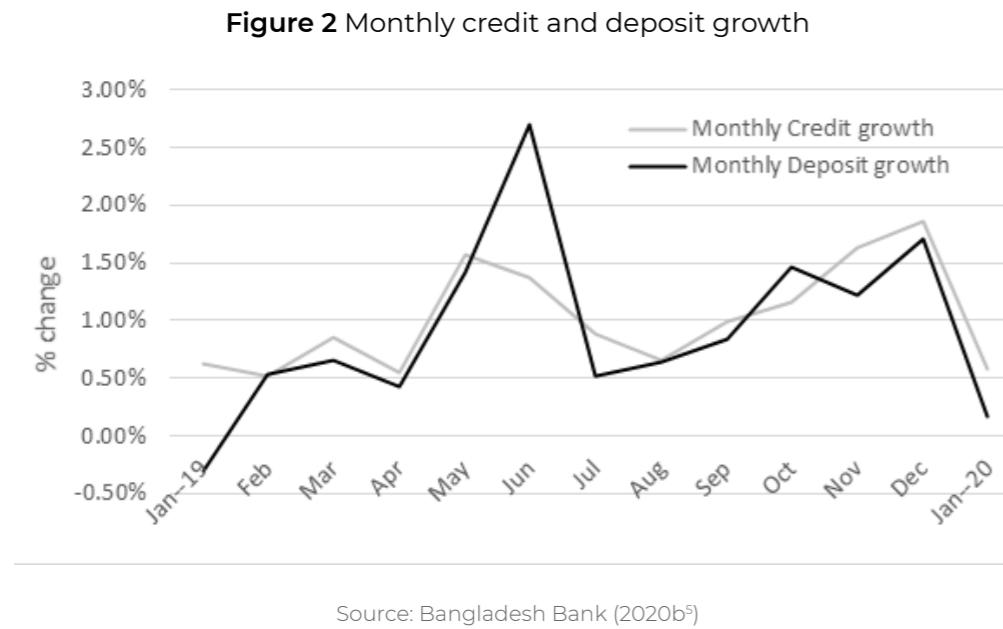
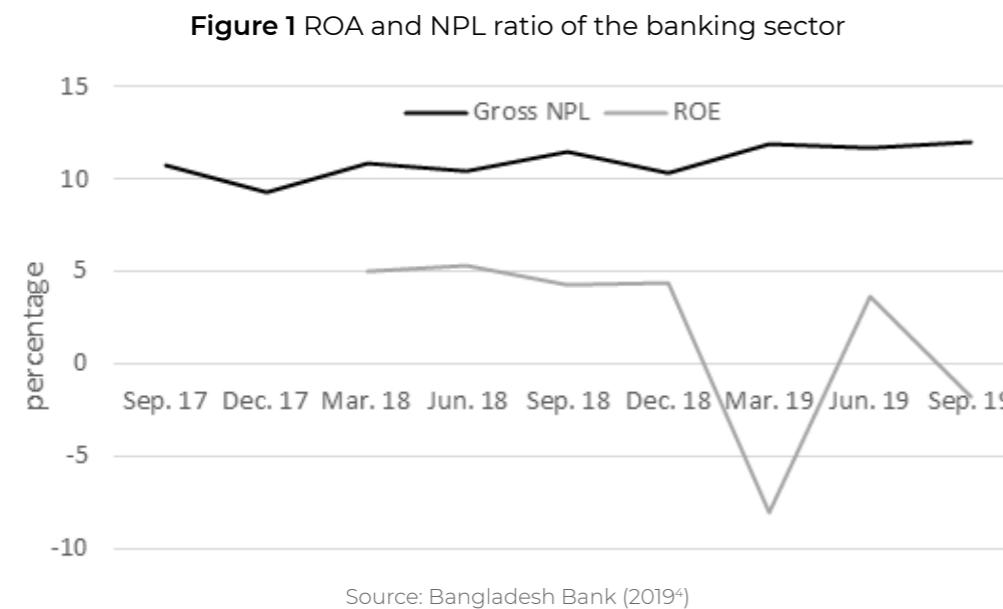
1 IMF. (2020). The Great Lockdown: Worst Economic Downturn Since the Great Depression, retrieved from <https://blogs.imf.org/2020/04/14/the-great-lockdown-worst-economic-downturn-since-the-great-depression/> on April 15, 2020.

2 Cochrane, J. H. (2020.) coronavirus monetary policy, in Baldwin, R., and de-Mauro, B. (eds.), Economics in the Time of COVID-19, Centre for Economic Policy Research, London. Pp, 105-108

3 Al-Awadhi, A. M., Al-Saifi, K., Al-Awadhi, A., & Alhamadi, S. (2020). Death and contagious infectious diseases: Impact of the COVID-19 virus on stock market returns. Journal of Behavioral and Experimental Finance, vol. 27, doi: <https://doi.org/10.1016/j.jbef.2020.100326>

and deposits declined by 1.28% and 1.53%, respectively, in January 2020.

A similar trend was noted in the leading capital market of Bangladesh. The general index of the Dhaka Stock Exchange (DSE) plunged from its top 5,952 points in January 2019 to its lowest, 4,068 points in January 2020, a loss of more than 31% in just one year. This shows that the financial vulnerability of Bangladesh was already exposed even before the COVID-19 pandemic escalated. The crisis added more damage to the system. For example, between February and March, the DSE general index lost 1,130 points (23%) in just one month.



⁴ Bangladesh Bank. (2019), Financial Stability Assessment Report, Issue: 19, (III) July-September, Dhaka, Bangladesh

⁵ Bangladesh Bank. (2020b), Monthly Economic Trend (March 2020), Dhaka, Bangladesh

PROBABLE IMPACT ON THE ISLAMIC FINANCE INDUSTRY

The Islamic finance industry in Bangladesh comprises of banking and non-banking financial institutions. Major non-banking financial institutions include insurance companies and a few other financial service providers. Although the banking sector has absolute dominance over the Islamic finance industry, Shariah-based insurance companies are growing rapidly.

STOCK MARKET

Realizing the importance of Islamic finance in Bangladesh, the DSE decided to launch a separate index comprising of only Shariah-compliant listed firms. The index, the DSE Shariah Index (DSES), was officially launched on January 20, 2014, with the base value of 1,000. About 70 listed companies are included in the index. DSE keeps the names of these confidential but can be purchased.

COVID-19 has affected all sorts of Shariah-compliant firms regardless of sectors. This is reflected in the DSES Index, as illustrated in Figure 3. The graph depicts a one-year daily data of both DSE General and Shariah Indices. DSES index was declining before the COVID-19 affected the market. However, the index was moving upwards at the beginning of 2020 before the virus crushed its recovery. As per the latest available data, DSES tumbled in the first three months of 2020. Between February and March, the index lost 15% of its value.

Figure 3 DSE General Index (left axis) and Shariah Index (right axis)



INSURANCE

As mentioned earlier, banks and insurance companies are the major firms constituting the Islamic finance industry in Bangladesh. There are 11 full-fledged takaful companies of which 8 are life and 3 are non-life insurance companies that account for less than 2% of the Islamic financial sector of the country.

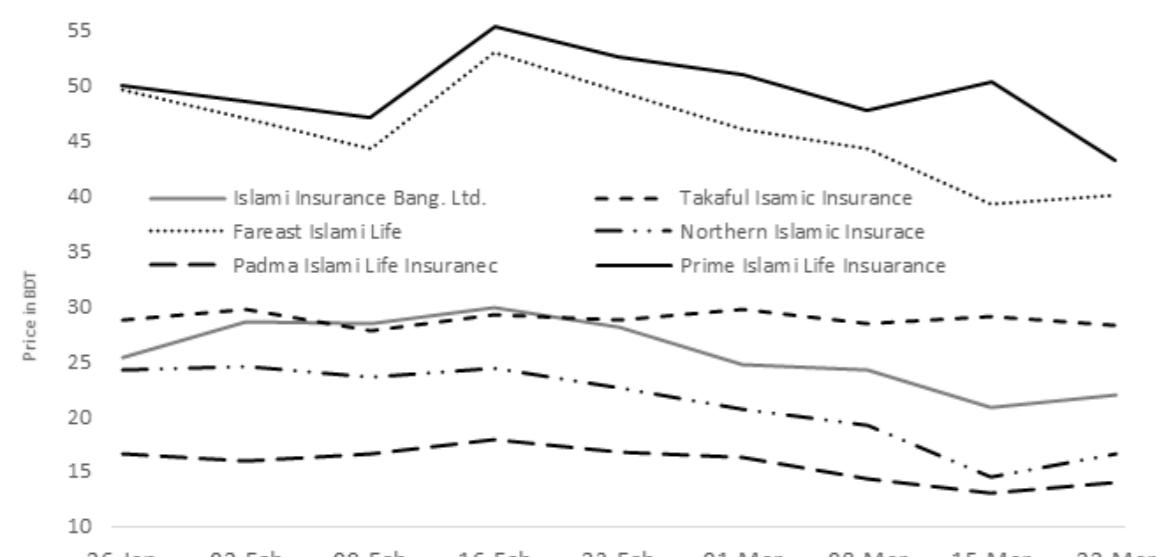
No doubt, the insurance sector is expected to suffer a loss of business during the COVID-19 crisis due to the absence of operations. Specifically, property and other insurance, particularly related to businesses such as import and export, will plummet substantially.

Second, the investment value of insurance firms is likely to plunge considerably as most security markets are continuously falling.

Third, due to increased disease and loss of properties, insurance claims will rise rampantly although it is uncertain if COVID-19 will be covered by the general terms and conditions of insurance contracts. Thus, the effect of the pandemic on the liability side remains uncertain.

This sums up what insurance companies are going to suffer, and it appears that the market has already started to adjust to the looming future as reflected in the stock price of listed takaful companies, as seen in figure 4.

Figure 4 Stock Price Movement of Six Takaful Firms



Source: Dhaka Stock Exchange

BANKING

However, as the major partner of the Islamic finance industry in Bangladesh, the banking sector should brace itself to face the worst blow.

The pandemic will, first, undermine the current growing trend of the Islamic banking sector of the country, which consists of 11 full-fledged Islamic banks, 19 Islamic banking branches of 9 conventional commercial banks, and 88 Islamic banking windows of 8 conventional commercial banks. The Islamic banking sector constitutes a quarter of the total banking sector of the country in terms of deposits and investments, as illustrated in Table 1.

Table 1 Share of Islamic banks in the total banking sector of Bangladesh as of Dec. 2019.

	Total Banking Sector (in ML BDT)	Islamic Banking sector (in ML BDT)	(%)
Total Deposits	11369796	2802278	24.65
Total Investments	10587073	2627520	24.82
Total Excess Liquidity	1056460	97326	9.21
Investment to Deposit Ratio			94

Source: Bangladesh Bank (2020a⁶)

Since takaful accounts for only a tiny fraction (less than 2%) of the total assets of the Islamic financial sector, the impact assessment and recommendations thereof, reflect mainly the banking sector.

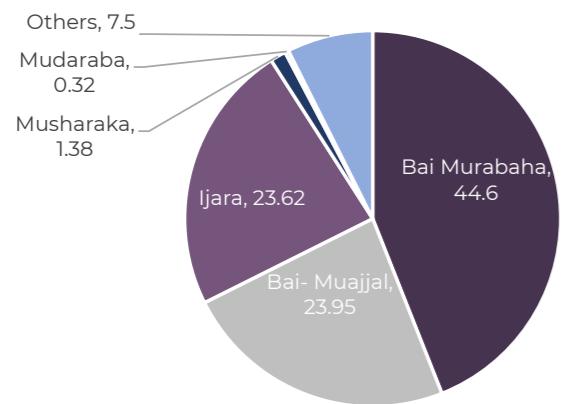
For the banking sector, the impact of COVID-19 can be assessed through balance sheets. The balance sheet approach, although it tells the inside story of a bank, provides the necessary clues to signal the future trajectory⁷. For instance, the quality lending capacity, operational efficiency, liquidity position, and equity capital strength signal the buffer a bank possesses to fight adverse economic conditions. Islamic banks in Bangladesh are going to be affected almost in the same fashion as their conventional counterparts because of their similar exposure to risk.

Figure 5 shows that more than 90% of the investment of Islamic banks takes the form of murabahah (mark-up or cost-plus investment) which includes bai murabahah, bai muajjal, and ijarah. Profit and loss sharing modes of finance such as musharakah and mudarabah constitute only a small percentage of total investments.

6 Bangladesh Bank. (2020a), Developments of Islamic Banking in Bangladesh, Dhaka, Bangladesh.

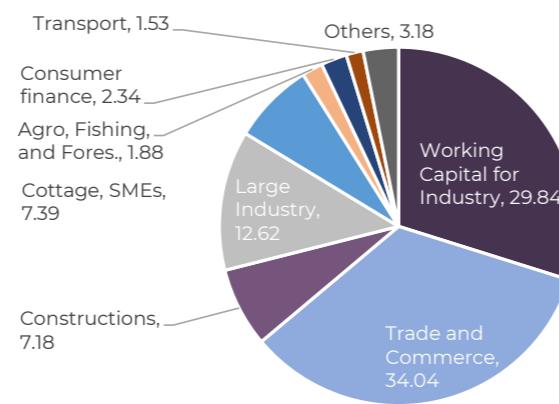
7 Setser, M. B., Roubini, N., Keller, M. C., Allen, M. M., & Rosenberg, M. C. B. (2002). A balance sheet approach to financial crisis (No. 2-210). IMF Working Paper #WP/02/210

Figure 5 Types of investment of Islamic Banks as of Dec. 2019 (in %)



Source: Bangladesh Bank (2020a⁸)

Figure 6 Sectoral share of Investment as of 2019 (in %)



THE DEMAND-SIDE VIEW OF THE IMPACT

Let us turn to where Islamic banks might be hit hard by the COVID-19 outbreak.

Figure 6 shows the sectoral distribution of investment of Islamic banks. About two-thirds of Islamic banking sector assets are concentrated in trade and commerce and working capital for industries. The majority of them are invested in the ready-made garments industry, which is severely disrupted by the pandemic. According to Bangladesh Garment Manufacturers and Exporters Association (BGMEA), work orders of about 634.8 million pieces of garment items from 729 registered garment factories, with an estimated value of \$1.51 billion, were cancelled as of March 23, 2020⁹. Islamic banks should be ready to embrace a serious financial blow from this sector.

On the other hand, 7.39% of the banks' portfolios are doled to the cottage, small, and medium enterprises (CSMEs) while 1.53% is disbursed to the transport sector. These two sectors combine to make up about 10% of Islamic banks' investment and are likely to be hit hard by the upcoming recession. Their operations have been completely shut down and cash inflows dwindled to almost zero. Islamic banks are likely to receive another blow from these sectors.

HIT TO FUTURE INVESTMENTS

The setbacks for Islamic banks resulting from COVID-19 are not limited to the assets which are already invested. Their future investment is also in jeopardy. For instance, about 30% of Islamic banks' investments are allocated to meet the working capital needs of industries. The ongoing lockdown of major cities and the suspension of industrial production for an uncertain period result in limited demand for bank finance at present (figure 1) and the future.

On the other hand, banks' operations have been reduced through closures of branches in high-risk areas, limiting operating hours, and restricting service provision. Moreover, neither the banks' infrastructure nor their customer base is equipped with advanced technologies so that a significant portion of operations can be kept running. These constraints seriously diminish Bangladesh's bank's current and future earnings. Since banks cannot adjust their operating expenses temporarily in commensuration with the declining revenue, their bottom line is expected to turn red.

THE SUPPLY-SIDE VIEW OF THE IMPACT

While the demand (asset) side remains a great concern, banks are also not immune from supply (liability) side shock.

In general, the saving capacity of the people of Bangladesh, like in other developing countries, is very limited due to low per capita income. The current crisis will narrow the existing low savings capacity further down. Households will hardly find savings to deposit in the banking system. Also, during the time of crisis households and businesses tend to turn their short-term and marketable assets (securities) into cash for a precautionary purpose¹⁰. These scenarios, along with banks limited deposit collection infrastructure are likely to create a negative pressure on banks' deposits.

HOW FAST AND HOW FAR?

It is thus obvious that the Islamic financial sector is going to be badly affected. However, the questions are: how fast and how far?

Any sensible prediction at this point is not feasible as the effect of the pandemic depends clearly on how fast the virus can be exterminated.

8 Bangladesh Bank. (2020a), Developments of Islamic Banking in Bangladesh, Dhaka, Bangladesh.

9 Mirdha, R. F. (2020). Garment order cancellations coming thick and fast. *The Daily Star*, March 24.

10 Lozano, M. B., & Yaman, S. (2020). The European Financial Crisis and Firms' Cash Holding Policy: An Analysis of the Precautionary Motive. *Global Policy*, Vol. 11, 84-94.

On a positive note it can be said that unlike other business entities, the strike in the banking system is not likely to be immediate. The banks' real scenario is expected to be revealed during the second quarter of the year. On the other hand, banks' internal capacity, as well as the external regulatory and policy environment in which banks operate, will determine how far COVID-19 can damage the Islamic finance industry in Bangladesh.

WAYS TO WEATHER THE STORM

Unlike the 2008/9 global financial crisis, the financial sector has neither triggered the economic crisis nor can it do a lot to ameliorate the current worrisome situation. Still, it has to prompt some actions from within and then wait for suitable policy interventions from the state. Also, banks can appeal by their institutional capacity or with the cooperation of the state for international assistance.

EFFORTS FROM WITHIN

First, banks, as well as insurance companies, shall continue their normal operation as much as possible. However, the scope for insurance companies to operate during the crisis is much smaller than the banking sector because insurance in Bangladesh is still not extensively utilized as a risk-socializing strategy. As a result, the size of this sector is still very small.

Tech

These sectors have the opportunity to serve their customers without coming into physical contact. Here comes the role of technology.

Many service organizations are increasingly relying on technology for delivering their services. Banks can try to capitalize on this opportunity. In particular, mobile banking technology shall be highly encouraged. The mobile phone is widely used even in developing countries. Bangladesh can mobilize this particular device to render banking services. In so doing, they can request the government to increase the internet infrastructure to facilitate enough technological enablement. On a positive note, Islamic banks' investment to deposit ratio is about 94% (table 1), which exceeds the allowable limit of 90%. Thus, a temporary halt of investment will drop the investment-deposit ratio to a recommended level.

Regulatory buffers

Second, banks' internal determinants such as equity capital, liquidity buffer, and the quality of assets are going to provide a lifeline for their survival during this tough time.

Bangladesh Bank, the central bank, has revised the statutory reserves requirements for both conventional and Islamic banks. According to the revised policy, Islamic banks are required to maintain an 11% statutory liquidity ratio (SLR) and cash reserve requirement (CRR). As of December 2019, the excess liquidity (total liquid assets – provision for SLR and CRR) of Islamic banks accounted for 48% of the required provision. On the other hand, the capital adequacy ratio (CAR) of six Islamic banks, which account for 90% of Islamic market share, averages 12.3%, which is close to 12.5% required by Bangladesh Bank to meet the BASEL III requirement.

These statistics show that the overall liquidity conditions of the Islamic banking sector in Bangladesh would provide it some buffer to absorb a short to medium-term shock of moderate level. Of course, not all Islamic banks are equally strong, and smaller banks are more fragile than larger ones. However, a long-term crisis will drain income away and seriously impair the asset side of balance sheets that may trigger a systemic bank run.

THE ROLE OF NATIONAL GOVERNMENT

Appropriate policy responses by the national government are considered the preconditions for mitigating the effect of the current uncertain economic situation.

Regulatory intervention, as far as the banking sector is concerned, should focus primarily on the asset side of the banks. The reduced economic activities have led to a substantial drop in income for households and businesses. For banks, this may mean an abnormal level of their investment may turn non-performing due to customers' inability to pay their dues in time or not paying at all. Since banks only have adequate provisions for managing the average level of non-performing assets (NPA), the abnormal rise in NPA will create a tremendous burden.

Moreover, banks are unlikely to receive their regular income owing to the potential failure of many businesses or reduced scope of business activities. Until the normal flow of economic activities is restored, banks are certainly going to suffer.

Hence, government intervention should focus on returning to business-as-usual for business entities. In particular, business enterprises, especially SMEs, manufacturing, and export-oriented industries, should receive loans from the state at a substantially reduced rate and flexible terms. As the data shows, Islamic banks' health is tightly tied to the ready-made garment industry, which is basically export-dependent.

In addition, the government should devise policies so that banks can adjust their balance sheets for unusual changes in assets. For example, a new NPA means that banks should maintain an additional amount with the central bank as a statutory reserve. This, in turn, will create a negative pressure on banks' liquidity as well as their capacity to invest. In this circumstance, the central bank can allow Is-

lamic banks with the privilege to reschedule the NPA until the crisis subsides.

Also, it is important for banks' smooth operations that they hold enough liquidity and flow of funds. When households are left with barely any income during the time of COVID-19, they tend to exhaust deposit balances. Depository institutions are going to experience the squeeze of household deposits. Thus, to avoid a total disruption of the deposit channel, fiscal policy is likely to play a critical role. The government should earmark funds for households in dire need of cash. Also, the government should sponsor other developmental activities, especially where it is safe to work, so that circulation of money increases in the economy.

SEEKING ASSISTANCE FROM INTERNATIONAL DEVELOPMENT AGENCIES

We may prescribe various initiatives to be undertaken by the national government. However, the government's capacity is constrained by limited available resources.

Fiscal deficit accounts for about 5% of the annual budget of Bangladesh. The deficit is financed through borrowing nationally and internationally. As per the recent statistics, the debt to GDP ratio of Bangladesh is not alarming, about 34%. Of the total debt, about 20% comes from domestic sources, mostly from the national banking system. The remaining 14% is borrowed from external sources.

For the fiscal year 2019-2020, a borrowing target of 773.63 billion takas (\$9.1 billion) was set, of which 490.20 billion takas (\$5.8 billion) (63%) was borrowed during the first half of the fiscal year, mostly from commercial banks. This proves that the local market is incapable of supplying huge resources required for tackling the impact of COVID-19.

Thus, the government should convince bilateral partners and international development organizations and donor agencies to extend their help. The International Monetary Fund, the World Bank, the Islamic Development Bank, and the Asian Development Bank can provide loans at zero or near-zero rates to developing nations to fight COVID-19 together. Also, some development assistance would be highly appreciated. It is to be noted that the crisis is global, not local; hence global coordination is quite essential.

CONCLUSION

The coronavirus outbreak is an extraordinary situation that has already affected economic activities so much that the resulting economic recession is 'similar to none'.

It is almost impossible to predict the economic consequences of the pandemic because of its sheer uncertainty. Like other sectors in the economy, the Islamic financial sector is also going to be affected seriously, and the concern is more for banks because they are highly leveraged. Thus, regulatory authorities and policymakers should adopt necessary policies to alleviate the gravity of the impact. This article has attempted to project, in the context of the Islamic financial sector in Bangladesh, the possible ways and means available to financial institutions, regulatory authorities, and the international community that can be furnished for taming the impact of the crisis. Based on the discussion, the following recommendations can be offered:

- (1) Islamic banks and takaful should keep rendering their valuable services as much as the on-going circumstance permits. Of course, this will require to draw a cautionary line of safety for employees and customers. As mentioned earlier, banks and insurance companies should utilize the available technology and infrastructure to materialize their full benefits. If the additional infrastructure is required that can be provided in the short run, in particular strengthening internet facilities, banks can appeal to the government to provide the required infrastructure.
- (2) Due to some issues that had plagued the financial sector before the pandemic hit Bangladesh, some regulatory changes and banks' efforts facilitated the building up of Islamic banks' capital buffers and liquidity cushions that will surely help banks to withstand the storm to some extent. However, banks have to be very cautious in utilizing these assets. They have to properly preserve liquid assets as new NPAs are expected to rise. If necessary, they should suspend paying cash dividends for the recent accounting year.
- (3) The immediate asset-side impact for insurance companies will be the loss of investment value due to the decline of major securities markets. An early assessment of potential risk-exposure will help them to strategize future moves. Like banks, insurance companies should also think of deferring cash dividends because failure to honor the policyholders, in case the stated incident happens, will create a ripple effect in the economy and lead to bankruptcy.
- (4) Given the nature of the problem, the government's monetary and fiscal incentives are very essential. Since the impact is not confined to any specific sector or area, monetary and fiscal policies are the prerequisite for fighting the crisis. Among monetary policies, conventional tools including a rate cut, quantitative easing, and tax rebate are to be put in place. At the same time, fiscal stimulus, to increase the circulation of money in the economy, should be planned.

- (5) Banks should be allowed to reschedule impaired investments until the situation becomes normal. This will reduce the pressure from banks, in particular, from classifying new NPA and maintaining additional risk-adjusted reserves. At the same time, it will buy additional time for banks' customers to repay their dues.
- (6) In a dire situation, if depositors flock to withdraw their savings from the banking system that may leave a bank in a liquidity crunch, the central bank can buy bonds to increase liquidity. As a first step, the central bank can purchase commercial banks' liquid assets excess of SLR and CRR. Moreover, SLR and CRR can be reduced so that banks' investment capacity is enhanced. Besides, the government should act to convince people that any sort of financial panic is uncalled for. Depositors need to be assured that there is no shortage of liquidity in the banking system and appropriate measures are already put in place to keep the health of financial system sound. This confidence is highly essential in a situation like the current one to ensure that citizens behave rationally. An irrational panic, once it engulfs the society, can turn deadlier than the pandemic itself.
- (7) Given the limited capacity of the national government in terms of fiscal spending, development organizations such as the Islamic Development Bank, IMF, and World Bank can extend their direct assistance to increase the financial strength of developing countries. These organizations can offer loans at zero or near-zero rates to national governments.

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BRUNEI DARUSSALAM'S RESPONSE TO MITIGATE COVID-19 ECONOMIC FALLOUTS

Abdurrahman Raden Aji Haqqi; Nadiah Hidayati

Brunei Darussalam has been hit by two shocks—the spread of COVID-19 and the sharp decline in global oil prices. The first confirmed case of the novel coronavirus in the country was detected on March 9, 2020, and infections have since increased to 139 as of May 6, 2020. Similar to many other countries, Brunei's government is actively responding to the risks of the pandemic from further spreading by implementing a range of measures, including strict inbound and outbound travel restrictions and banning all mass gatherings, including weddings and sporting events.

As a result of these restrictions, there has been a significantly lower demand for travel and tourism, as well as energy, all of which impacts oil-exporting countries such as Brunei. A projection by the Asian Development Bank says Brunei's tourism revenue will decline by 0.086%¹ of GDP as a best case scenario. This is equivalent to a reduction of \$11.7 million. On the other end of the scale, ADB estimates a worse case scenario of a decline of 0.192% of GDP, equivalent to a loss of \$26.1 million in tourism revenues for Brunei.

Oil and gas accounts for nearly 90% of Brunei's exports and the shock of historic low oil prices has led to the government expecting a budget deficit of about 1.81 billion Bruneian dollars (\$1.28 billion).² However the government warns that GDP forecasts and estimated revenue for the financial year did not consider the current situation of declining oil prices. As such, the country's economic position will be affected and government revenue will be lower than the estimated amount, which can cause a bigger deficit.³

GOVERNMENT STIMULUS AND FINANCIAL SUPPORT

First State-led Measure

With regards monetary and macro-financial policy, the Autoriti Monetari Brunei Darussalam (AMBD), the central bank, the Ministry of Finance and Economy (MOFE), and the Brunei Association of Banks (BAB), agreed on the following measures effective April 1, 2020 for a period of six months:

1. To support the business sectors in the form of a six-month deferment of principal repayments of financing / loan for the following sectors: (a) tourism; (b) hospitality / event management; (c) restaurant / cafes (food and beverages); (d) air transport
2. This deferment will also be extended to food and medical supplies importers to support the higher cash flow requirements to meet the surge in demand
3. All bank fees and charges, except third party charges, related to trade and payment transactions for companies in these sectors will be waived for a period of six months. This will help businesses to self-sustain, and banks are encouraged to transfer these savings to the public.⁴

Second State-led Measure

The second set of measures centered on tax, utility and social security deductions and deferments to help Brunei's private sector mitigate the fallouts from the COVID-19 crisis. This was announced on March 21.

It was also clarified that the deferring of loan repayments would be extended to the wider business community, subject to case-by-case review by the lending institutions.

The new measures effective April 1, 2020 for six months are:

1. A six-month deferment on Employees Trust Fund (TAP) and Supplementary Contributory Pension (SCP) for micro, small and medium enterprises (MSMEs) with employees earning less than \$1,500. The government will continue monthly contributions to ensure that the annual dividend payments to employees are not affected. MSMEs need to apply for the deferment and are to repay the contributions within a year after the final month of deferment.
2. The government will provide the full SCP contribution for the self-employed. The self-employed SCP scheme carries a survivorship benefit which includes a \$400 monthly payout to dependents for up to 15 years – in addition to receiving the SCP already paid up – if the participant passes away before 60-years-old.
3. For tourism, hospitality, including hotels and registered lodging houses, food and beverage as well as air and water transport, 30% discount on rental rates for government buildings for MSMEs, 50% discount on corporate tax for companies (private/public limited or sendirian

berhad/berhad) for 2020 and 15% discount on water and electric bills.

4. Up to six months extension for i-Ready apprentices for trainees whose contracts are ending before September 2020.
5. Temporary exemption of customs and excise duties on personal hygiene products to help retailers and consumers manage prices amidst increasing demand. Pricing of essential items will continue to be monitored and regulated under the Consumer Protection Order and Price Control Act.
6. Business matching by Darussalam Enterprise (DARe) for MSMEs to onboard e-commerce platforms to help market their services/products online more effectively to mitigate challenges in offline retail⁵.

Third State-led Measure

On March 31, the government announced additional steps to the interim measures in supporting various micro, small and medium enterprises (MSMEs) and individuals affected by the crisis.

These steps include an additional economic relief package amounting to approximately 250 million Bruneian dollars in the form of deferment of principal or loan repayment and exemption of fees and charges.

This measure, combined with previously announced fiscal assistance, including business productivity, will boost the economic stimulus package for Brunei Darussalam for COVID-19, totaling 450 million Bruneian dollars.

The packages announced are specific to all business sectors in the country and individuals, including those who are self-employed. The additional assistance hopes to ease the financial burden on businesses and affected individuals.

The packages are deferment of principal payment of loans or financing for all sectors; restructuring and deferring principal amounts on personal loans and hire purchase facilities such as car loans or financing for not more than 10 years; provision of deferment of principal amount or financing for real estate; restructuring outstanding credit card balance to loans for a period of not more than three years for individuals affected in the private sector only including the self-employed, but this measure will not increase the credit card limit amount during the three-year period; and all bank fees and charges, except for third party charges, will not be applied.

The postponement will begin from the date of application approval until March 31, 2021. Companies and individuals may apply for suspension and restructuring at their banks or financial institutions

⁵ See <https://www.bizbrunei.com/2020/03/mofe-introduces-new-measures-to-support-businesses-during-COVID-19-outbreak/>

between April 1 and Dec 30, 2020.

AMBD assured that the banking sector in Brunei Darussalam remains resilient, stable and has sufficient capital funds. At the same time, AMBD will continue to monitor the development of the situation, along with financial institutions⁶.

With the introduction of several financial aid packages in view of the COVID-19 pandemic Brunei's packages are broken down into certain broad categories.

The first category: Brunei Darussalam has a welfare system where the Community Development Department (JAPEM) and the Brunei Islamic Religious Council (MUIB) financially help those in need, on top of the subsidies provided by the government on a monthly basis. In Brunei Darussalam, the management of zakat and other Islamic social finance are governed by MUIB, a statutory body that has the force of law, under the Laws of Brunei 1/1984, Religious Council and Kadi Courts, Chapter 77, Section 114.

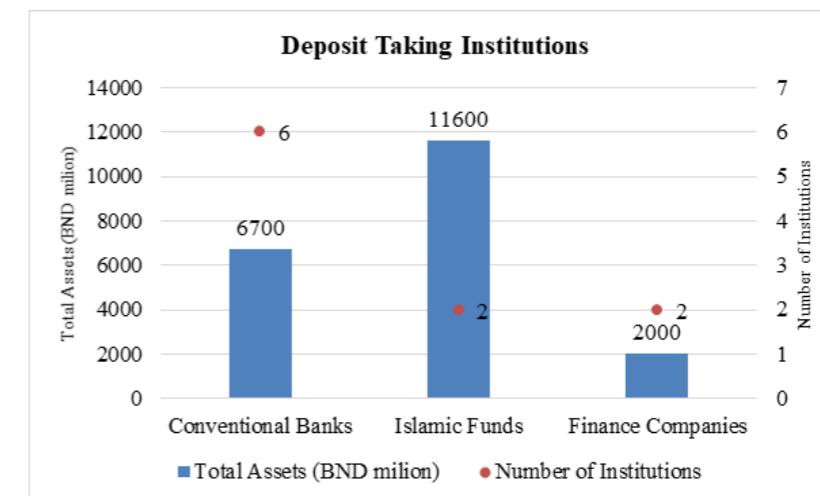
The second category covers people who have lost jobs. The government is trying to protect jobs through the introduction of various measures including paying 25% of salaries, along with TAP and SCP contributions, and negotiating with banks for the restructuring or deferments of loans or financings for a period of time.

The above measures are to ensure that financial burdens of businesses will be reduced so they may continue to hire and not terminate workers, as well as take the opportunity to train their employees, and possibly rethink hiring foreign labour, so that in the future post-COVID-19 people are trained to take over the jobs of foreign workers. To this effect, on March 20 new regulations were announced to say that applications to recruit new foreign workers into Brunei were suspended until further notice. However foreign manpower required for critical operations of certain sectors in Brunei will be still assessed.

ISLAMIC FINANCE SECTOR

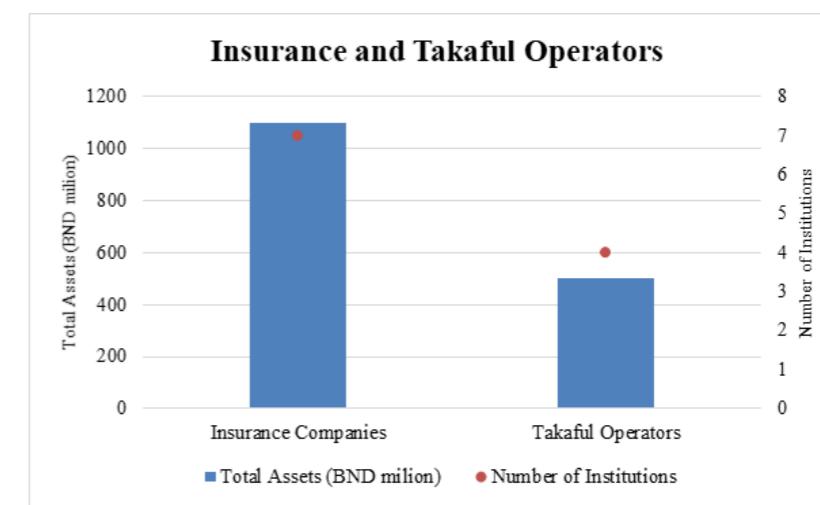
The financial aid packages also pertain to the Islamic financial sector.

Figure 4 Deposit Taking Institutions – Total Assets (2018)



Source: AMBD Annual Report 2018

Figure 5 Insurance and Takaful Institutions – Total Assets (2018)



Source: AMBD Annual Report 2018

There are four deferments or eligible delays in the new packages including for the Islamic finance sector: deferment on repayment for financing for all business sectors; restructuring and deferment of repayments for personal financings and hire purchase facilities including car financings for up to ten years for businesses and working individuals, including the self-employed; delaying repayment of

⁶ See <https://www.thestar.com.my/news/regional/2020/03/31/brunei-rolls-out-added-stimulus-package-for-those-affected-by-COVID-19>

property/real estate financings for businesses and working individuals, including the self-employed; and restructuring outstanding credit card debt into financings not longer than three years for private sector employees and the self-employed. However, credit card limit will not be raised within these three years.

The deferments and the waiver of bank fees would cost the financial sector approximately \$250 million. When factoring previous COVID-19 related economic relief measures – including deferred TAP/SCP payments, 25% salary contribution for MSME's Bruneian employees and sponsored training programmes for graduates, employees and businesses – the total government-led contribution is worth \$450 million.

With the addition of these assistance measures, banks are expected to be able to provide support to MSMEs and individuals. Hopefully, it can ease their financial burden during this difficult time. AMBD wants to provide assurance that the banking sector in Brunei remains strong, and has sufficient capital funds. In the same period, AMBD will continue to monitor the development of this situation together with financial institutions.⁷

CONCLUSION

His Majesty the Sultan and Yang Di-Pertuan of Darussalam, in his 2016 New Year's Titah (speech), emphasized that in light of economic headwinds, citizens must double efforts to increase the Sultanate's domestic productivity, particularly in the non-oil and gas sector. Sectors identified with high growth potential include: agriculture and fisheries, manufacturing, services sector including financial services sector, transportation, logistic, telecommunication, trade and tourism. His Majesty also pointed out that enterprises must aim to grow their business to not only cater for the domestic market but also to export their products and services to other countries. Productivity in this respect can be enhanced through continuous research and application of new technology.

Based on the Sultan's directions in 2016, Brunei Darussalam is on track to implement and apply them. Hence, although the coronavirus crisis affects the Islamic financial industry, the government's initiatives may minimize the effects for the country.

⁷ Siaran Akhbar Kementerian Kewangan dan Ekonomi. Langkah – Langkah tambahan bagi membantu semua sektor perniagaan termasuk individu yang bekerja di sektor swasta dan bekerja sendiri semasa COVID-19

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THE IMPACT OF COVID-19 OUTBREAK ON THE ISLAMIC FINANCIAL INDUSTRY: INDONESIA

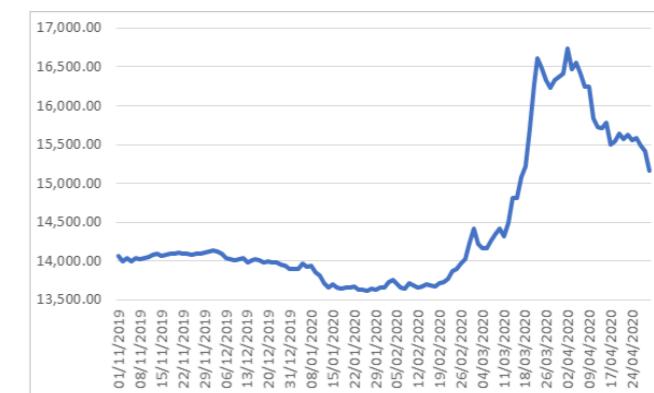
Raditya Sukmana; Imam Wahyudi Indrawan; Shochrul Rohmatul Ajija

The novel coronavirus COVID-19 started in the city of Wuhan in China in December 2019 and reached Indonesia on March 2, 2020 with the first two confirmed cases in the city of Depok, Greater Jakarta¹. Since then, the virus has spread quickly. According to the Health Ministry, as of May 1, 2020, there were 10,551 confirmed cases with 800 deaths and 1,591 recovered patients. This means Indonesia has a 7.58% fatality rate, one of the highest in the world².

HIT ON MACRO-ECONOMY

The impact of COVID-19 on the Indonesian economy was inevitable, at least in the financial market as shown by two main indicators. First, the exchange rate of the Indonesian Rupiah against the U.S. Dollar reached 16,575 rupiah per U.S. Dollar on March 23, the weakest since the Asian financial crisis of 1998, despite Bank Indonesia's best efforts to control the local currency.

Graphic 1 Exchange Rate of Indonesian Rupiah Against U.S. Dollar, November 2019 to April 2020



1 CNN Indonesia (2020) *Jokowi Umumkan Dua WNI Positif Corona di Indonesia*. Available at: <https://www.cnnindonesia.com/nasional/20200302111534-20-479660/jokowi-umumkan-dua-wni-positif-corona-di-indonesia> (Accessed: 10 April 2020).

2 Tim detikcom. (2020). *Tembus 10.551, Ini Sebaran Kasus Positif Corona di Indonesia 1 Mei 2020*. Available at: <https://news.detik.com/berita/d-4998765/tembus-10551-ini-sebaran-kasus-positif-corona-di-indonesia-1-meい-2020> (Accessed: 4 May 2020).

Data source: Bank Indonesia (2020b), Modified by authors

Secondly, the Indonesia Stock Exchange (IDX) is also hit by the outbreak. The Jakarta Composite Index (JKSE) value that was steady around 6,200 until late January 2020 saw a huge decline to 4,000 in the last week of March before rebounding to around 4,500 in early April, thanks to positive sentiments from pharmaceutical manufacturers such as Sidomuncul, Indo Farma, Kimia Farma, and Kalbe Farma due to demand for more health products³.

In the real sector represented by the Gross Domestic Product (GDP), the official figure has not been revealed for the first quarter of 2020. However, Bank Indonesia revised its economic growth projection to be in the range of 4.2 - 4.6% in 2020, lower than 2019's growth rate of 5.02%. Recovery is expected to take place in 2021, which will be around 5.2-5.6%⁴.

A policy brief from the Asian Development Bank (ADB) outlines the channels by which this global pandemic will affect Asian economies, including Indonesia. They include, among others: decline in domestic consumption and international trade; future investment decision; lower tourism and business travel due to restrictions; and effects from the health emergency situation such as increasing confirmed cases, higher mortality rates and shifts in expenditure in healthcare. In the Indonesian context, the potential loss of revenue due to COVID-19 from the tourism sector alone is estimated to be between \$ 1.7 billion and \$ 3.4 billion.⁵

The crisis will also affect the workforce, particularly those who are seeking their livelihoods in the informal sectors. In Indonesia, more than 80% of employment lies in these sectors, such as daily-paid workers and ride-hailing drivers. An economic slowdown such as the crisis from the COVID-19 outbreak will plunge these workers into unemployment and poverty⁶. Formal sector employment is also affected. The Ministry of Workforce said unemployment in Indonesia is likely to rise by 1.2 million people due to lay-offs⁷.

In addition, since the Indonesian economy is dominated by Micro and Small Enterprises (MSEs), the

³ CNBC Indonesia (2020) *Top! 4 Saham Farmasi Cuan Terus, Ada yang Hampir 100% Nih.* Available at: <https://www.cnbcindonesia.com/market/20200331100706-17-148664/top-4-saham-farmasi-cuan-terus-ada-yang-hampir-100-nih> (Accessed: 9 April 2020).

⁴ Bank Indonesia (2020a) 'Indonesia's Recent Economic Updates, Prospect, and Bank Indonesia's Policy Mix'. doi: 10.1017/CBO9781107415324.004.

⁵ Abiad, A. et al. (2020) *The Economic Impact of the COVID-19 Outbreak on Developing Asia.* Available at: <https://www.adb.org/sites/default/files/publication/571536/adb-brief-128-economic-impact-covid19-developing-asia.pdf>.

⁶ International Labour Organization (2020) *ILO Monitor 2nd edition: COVID-19 and the world of work, Updated estimates and analysis.*

⁷ Sandi, F. (2020) *Alert! 1,2 Juta Pekerja RI Kena PHK & Dirumahkan Imbas Corona.* Available at: <https://www.cnbcindonesia.com/news/20200408174050-4-150695/alert-12-juta-pekerja-ri-kena-phk-dirumahkan-imbas-corona> (Accessed: 9 April 2020).

COVID-19 attack in early 2020 was certainly very pronounced for them. According to Statistics Indonesia (BPS), the contribution of MSEs to the country's GDP amounted to 23.89% in 2018 and this sector contributed 99.90% of total business units and 93.87% of total employment.⁸

GOVERNMENT STIMULUS

During the outbreak, the central government and many local governments have imposed massive social and physical distancing in the forms of school closures, limitation of activities in offices and stores, all of which reduce economic activities. The government's stimulus packages are expected to help the poor and businesses to survive during the crisis.

The new Government Regulation in Lieu of Acts (*Peraturan Pemerintah Pengganti Undang-Undang/Perppu*) No. 1 year 2020 regulates the State's Finance and Financial System Stability during the COVID-19 outbreak. This regulation is the basis of economic stimulus from the government, including⁹:

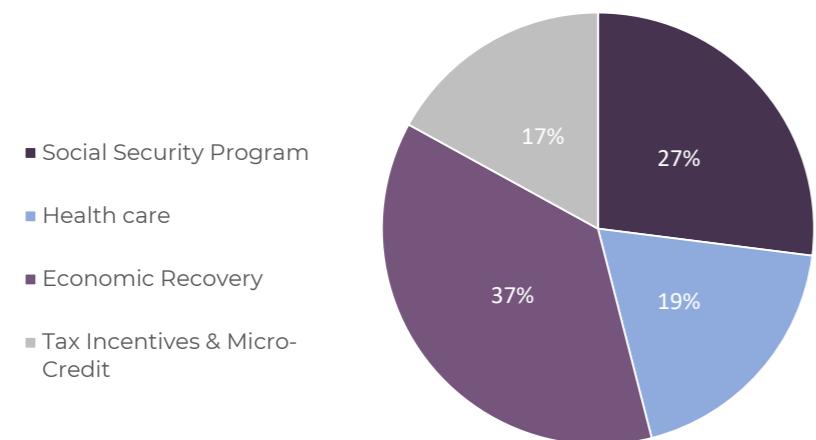
- i) The government has loosened its fiscal deficit restriction that previously was set at a maximum 3% of GDP. This regulation gives the government the ability to ease the fiscal deficit to more than 3% of the GDP until 2022.
- ii) Income tax rates for firms are cut from 25% to 22% for 2020 and 2021, and 20% for 2022. If a firm is a public company in which 40% of its shares are traded on the IDX, it may receive additional tax cuts up to 3% below the aforementioned rate.
- iii) Bank Indonesia, the central bank, is authorized to purchase sovereign bonds and sukuk directly in the primary market. Previously, purchases were only possible in the secondary market to conduct monetary policy.

The government has offered stimulus worth 405.1 trillion rupiah (around \$25.8 billion), comprising 110 trillion rupiah for social security programs, 75 trillion rupiah for healthcare, 150 trillion rupiah for economic recovery, and 70.1 trillion rupiah for tax incentives and stimulus in the form of micro and small credits (*Kredit Usaha Rakyat/KUR*)¹⁰.

⁸ Ministry of Cooperatives and Small and Medium Enterprises. (2019). *Perkembangan Data Usaha Mikro, Kecil, Menengah (UMKM) dan Usaha Besar (UB) Tahun 2017-2018.* Retrieved from <http://www.depkop.go.id/data-umkm>

⁹ Republic of Indonesia (2020a). *Peraturan Pemerintah Pengganti Undang-Undang Republik Indonesia Nomor 1 tahun 2020 Tentang Kebijakan Keuangan Negara dan Stabilitas Sistem Keuangan untuk Penanganan Pandemi coronavirus Disease 2019 (COVID-19) Dan/Atau Dalam Rangka Menghadapi Ancaman yang .* Indonesia. Available at: https://www.pajak.go.id/sites/default/files/2020-04/Perpu_Nomor_1_Tahun_2020.pdf.

¹⁰ Tobing, S. (2020) *Sisi Minus Stimulus Rp 405 Triliun dalam Penanganan Virus Corona.* Available at: <https://kata-data.co.id/telaah/2020/04/03/sisi-minus-stimulus-rp-405-triliun-dalam-penanganan-virus-corona> (Accessed: 9 April 2020).

Figure 1 Indonesia's COVID-19 Stimulus Allocation

Source: Kementerian Keuangan RI (with author's modification)

In addition, Indonesia's Financial Services Authority (OJK) issued OJK Regulation No. 11 year 2020 enabling banks and financial institutions, including Islamic ones, to restructure their loans/financing, especially for Micro, Small, and Medium Enterprises (MSMEs) that have outstanding credit/financing of no more than 10 billion rupiah (\$640,000), including a one-year grace period but still maintaining prudent banking practices¹¹.

Bank Indonesia in the middle of March lowered its policy rates, the BI 7-day reverse repo rate, to 4.5% and placed its Deposit Facility and Lending Facility rates at 3.75% and 5.25% respectively, indicating a loosening of monetary policy¹².

ISLAMIC FINANCIAL IN INDONESIA PRIOR TO THE OUTBREAK

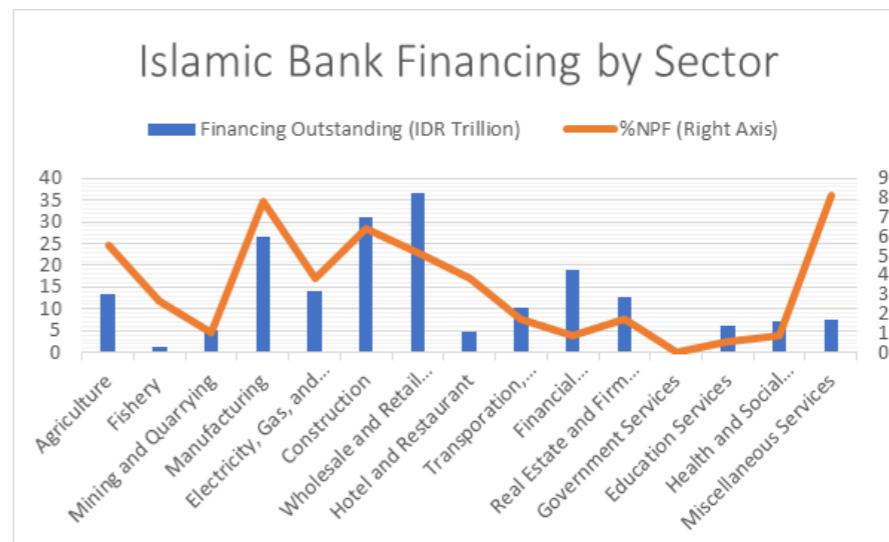
Banking

Indonesia's Islamic finance industry maintained stable performance prior to the emergence of COVID-19. Islamic banks until January 2020 showed some good performance with the following indicators¹³:

1. Capital Adequacy Ratio (CAR) at 20.27%

2. Return on Assets (ROA) at 1.88% (Islamic commercial banks) and 2.44% (Islamic services unit)
3. Gross Non-Performing Financing (NPF) at 3.46% (Islamic commercial banks) and 3% (Islamic business units)

On the assets side, financing for businesses in January 2020 was recorded at 195.3 trillion rupiah with top three sectors being wholesale and retail trade (18.7%), construction (15.8%), and manufacturing (13.6%). The NPF on businesses financing stood at 4.5%, with highest NPF rate recorded in the miscellaneous services (8%), manufacturing (7.8%), construction (6.4%), and agriculture (5.6%)¹⁴.

Graphic 2 Share of Islamic Bank Financing to Economic Sectors in Indonesia

Data source: Otoritas Jasa Keuangan (with author's modification)

Capital market

In the capital market, OJK reported that three Islamic indices, the Jakarta Islamic Index (JII), JII-70 and Indonesia Islamic Index, recorded market capitalization in February 2020 at 1,876.6 trillion rupiah, 2,283.8 trillion rupiah and 3,139.1 trillion rupiah, respectively¹⁵. In the corporate sukuk market, OJK recorded that until February 2020, there were 146 outstanding corporate sukuk with market capitalization of 29.6 trillion rupiah.¹⁶

11 Otoritas Jasa Keuangan (2020c) *Peraturan Otoritas Jasa Keuangan Republik Indonesia Nomor 11/POJK.03/2020 Tentang Stimulus Perekonomian Nasional sebagai Kebijakan Countercyclical Dampak Penyebaran coronavirus Disease 2019*. Indonesia. Available at: https://www.ojk.go.id/regulasi/Documents/Pages/Stimulus-Perekonomian-Nasional-Sebagai-Kebijakan-Countercyclical-Dampak-Penyebaran-coronavirus-Disease-2019/pojk_11-2020.pdf.

12 Bank Indonesia (2020) 'Indonesia's Recent Economic Updates, Prospect, and Bank Indonesia's Policy Mix'. doi: 10.1017/CBO9781107415324.004.

13 Otoritas Jasa Keuangan (2020a) *Sharia Banking Statistics*. Jakarta. doi: 10.1017/CBO9781107415324.004.

14 Otoritas Jasa Keuangan (2020a) *Sharia Banking Statistics*. Jakarta. doi: 10.1017/CBO9781107415324.004.

15 Otoritas Jasa Keuangan (2020d) *Statistik Saham Syariah Februari 2020*. doi: 10.1098/rspa.2008.0142.

16 Otoritas Jasa Keuangan (2020e) *Statistik Sukuk Februari 2020*. Jakarta. Available at: https://www.ojk.go.id/kanal/syariah/data-dan-statistik/data-produk-obligasi-syariah/Documents/-Statistik-Sukuk-Syariah---Februari-2020/Statistik_Sukuk_Februari_2020.pdf.

Non-banking

For Islamic Non-Banking Institutions (INBIs) in December 2019, a report by OJK shows that the number of INBIs in Indonesia was 92, dominated by takaful (45) and Islamic financing institutions (32). In terms of assets, OJK reported INBIs' assets valued at 105.6 trillion rupiah, dominated by takaful (45.5 trillion rupiah), Islamic specialized financial institutions (comprising Islamic pawnshops and Islamic guarantor companies, at 28.5 trillion rupiah) and Islamic financing institutions (27.2 trillion rupiah)¹⁷.

CRISIS-HIT

Stock market

The Islamic indexes showed a declining trend during the early stages of the outbreak. The JII was stable above 650 from October 2019 until early February 2020 when it started to decline. The JII even recorded below 400 at the end of March 2020 before rebounding to around 500 in early April 2020¹⁸, thanks to good performance from pharmaceutical manufacturers that are also part of the JII and the composite index JKSE¹⁹.

There is a need to increase the share of domestic investors in the Islamic capital market in order to avoid risks related to withdrawal of funds by foreign investors that will harm the capital market and foreign exchange market. Stability and steady growth of Indonesia's Islamic capital market is needed to support development and recovery of other Islamic financial institutions, particularly the takaful industry. This industry extensively invests its funds in the Islamic capital market, with 82.3% out of their 39.8 trillion rupiah funds in Islamic capital market instruments, such as Islamic stocks, sukuk and mutual funds.²⁰

17 Otoritas Jasa Keuangan (2020) 'Statistik IKNB Syariah Desember 2019'. Jakarta: Otoritas Jasa Keuangan. Available at: [https://www.ojk.go.id/kanal/syariah/data-dan-statistik/iknb-syariah/Documents/STATISTIK BULANAN IKNB SYARIAH DESEMBER 2019.xlsx](https://www.ojk.go.id/kanal/syariah/data-dan-statistik/iknb-syariah/Documents/STATISTIK%20BULANAN%20IKNB%20SYARIAH%20DESEMBER%2019.xlsx).

18 Investing.com (2020) *Jakarta Islamic (JII)*. Available at: <https://in.investing.com/indices/idx-islamic> (Accessed: 9 April 2020).

19 CNBC Indonesia (2020) *Top! 4 Saham Farmasi Cuan Terus, Ada yang Hampir 100% Nih*. Available at: <https://www.cnbcindonesia.com/market/20200331100706-17-148664/top-4-saham-farmasi-cuan-terus-ada-yang-hampir-100-nih> (Accessed: 9 April 2020).

20 Otoritas Jasa Keuangan (2020) 'Statistik IKNB Syariah Desember 2019'. Jakarta: Otoritas Jasa Keuangan. Available at: [https://www.ojk.go.id/kanal/syariah/data-dan-statistik/iknb-syariah/Documents/STATISTIK BULANAN IKNB SYARIAH DESEMBER 2019.xlsx](https://www.ojk.go.id/kanal/syariah/data-dan-statistik/iknb-syariah/Documents/STATISTIK%20BULANAN%20IKNB%20SYARIAH%20DESEMBER%2019.xlsx).

Banking

In the banking sector, it is expected that Islamic banks will potentially face higher NPF rates. COVID-19 causes lower production in manufacturing, delays or cancellations on construction projects and lower demand for non-digital wholesale and retail markets which may eventually fail to meet their repayment obligations.

Following instructions from OJK, restructuring financing is required in order to ensure consumers affected by the outbreak will not suffer additional financial burdens due to their inability to repay instalments during the economic slowdown.

Moreover, the current pandemic and crisis situation reveals the need for Islamic banks to reform their business operations. Currently, it is dominated by *murabahah* on the financing side. Islamic banks can think of utilizing more risk-sharing mechanisms such as *mudarabah* and *musharakah* that may better help them absorb risks.

Microfinance

The shock to the MSEs sector due to the pandemic has a direct bearing on the performance of microfinance institutions in Indonesia in the form of banks or non-banks such as Islamic cooperatives.

According to data from the Ministry of Cooperatives and Small and Medium Enterprises (2019), the number of Shariah-compliant cooperatives in Indonesia is around 4,046 units or 3.29% of the 123,048 cooperative units in Indonesia. Based on the location, the majority of Islamic cooperatives are located in East Java Province, which is around 1,952 units or 48.25% of all Islamic cooperatives in the country.

In East Java, up to the end of March 2020, Islamic cooperatives were still surviving with an average NPF of around 3.46% as in previous periods (sample data of 8 Islamic cooperatives). The shock was felt in April 2020 especially for the cooperative member businesses dominated by the secondary and tertiary product trade sector. This was when they began to experience a sharp turnover decline. Conversely, the business of trading in primary products experienced an improved business performance. Business members in the fisheries sector also declined. Fishermen and fish farmers cannot sell their products because many hotels and restaurants are closed due to the pandemic.

In contrast, member businesses in the agricultural sector are not too affected by the pandemic. Agricultural production is more influenced by weather changes, while demand for agricultural products rose sharply along with the increasing demand for basic necessities for distribution of zakat and alms. Islamic cooperative associations incorporated in the East Java Islamic Cooperative Forum (FKS) undertook several strategies to minimize the negative influence of the pandemic. Those are the realization

of financing restructuring with banks, proposing liquidity assistance to the Ministry of Cooperatives and SMEs or national secondary cooperatives such as the *Induk Koperasi Syariah (Inkopsyah)*, and mutual assistance programs for liquidity among primary Islamic cooperatives. Distribution of funding to members engaged in vulnerable sectors affected by COVID-19 was temporarily minimized. This is important to reduce the impact of increasing NPF. For members whose businesses are affected by COVID-19, Islamic cooperatives also provide easy installment payment procedures in accordance with the agreement between the two parties.

SOLUTIONS FROM ISLAMIC SOCIAL FINANCE

The unprecedeted global pandemic will force the Islamic finance industry to adapt in order to sustain its presence in the global economic and financial system.

Islamic financial institutions must integrate Islamic social finance such as zakat and waqf into their operations in order to provide a community-based social security system that will help to maintain livelihoods, basic needs, and purchasing power of the society. According to a study conducted by IPB University and IRTI-IsDB, Indonesia's zakat potential is up to 217 trillion rupiah (about \$ 13.8 billion)²¹. If this potential is materialized, it could significantly help to take care of those in need as a result of this crisis.

Meanwhile, waqf potential in Indonesia is equally big, with assets in the form of land alone reaching up to 510 km² about a quarter of Tokyo Metropolitan area²². If waqf lands are utilized productively for agriculture, it could support basic needs provision in Indonesia during times of crises.

Cash waqf in Indonesia could also play a significant role in Indonesia. Islamic financial institutions, including Islamic cooperatives throughout the country can mobilise cash waqf from waqif to support the purchase of medical equipment within such as ventilators that are urgently needed at this time. If this integration can be done optimally, economic recovery can be achieved immediately and the Islamic financial institutions can operate in normal conditions again.

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21 Firdaus, M. et al. (2012) *Economic Estimation and Determinations of Zakat Potential in Indonesia*.

THE SEVERITY & MAGNITUDE OF THE IMPACT OF THE CORONAVIRUS CRISIS ON THE ISLAMIC FINANCIAL INDUSTRY IN IRAN

Hojjat Izadkhasti

The novel coronavirus COVID-19 that was first reported in the Chinese city of Wuhan in December 2019 arrived in Iran on February 20, 2020. The crisis is hitting Iran's economy in the short-term and in the medium-term by creating shocks in demand and supply.

In the short-term, the virus has already led to a reduction in production, an increase in the number of unemployed, weaker stock market indexes, lower oil prices, a shattered tourism industry, and lower non-oil exports.

The Iranian government's decision to restrict traffic in cities in the first phase and implement social distancing in the second phase to limit the spread of the virus has required banks to provide banking and financial services using one-third of employees. There have been layoffs at a lot of production units, leading to an increase in unemployment. This will result in a rise in the number of bounced checks in the medium term. In addition, reduced work shifts or temporary closures of production units push down production and profits.

In the long-run, the crisis will lead to a rise in deferred non-current claims of banks, more bounced checks, and the financing system of companies will be disrupted due to the bank-centered nature of manufacturing firms leading to a recession in the economy. Further, the reduced profits of manufacturing firms and the economic recession will leave negative effects on the capital market.

In line with reducing the consequences of the coronavirus outbreak, based on the decision of the government's economic headquarters, commercial banks are required to pay 750,000 billion rials in facilities at a rate of 12 percent to units and businesses affected by the outbreak of the corona virus. The 12% facility is available to 11 job categories from different production units in the country that have been directly or indirectly affected by the outbreak of the coronavirus.

In order to support the families, 19 million and 500 thousand people from the Iranian households have been included in the 10 million Rials Gharz al-Hasna facility. Also, three million families with the lowest incomes and expenses in the country have been covered by the subsidies of 2000 to 6000 thousand Rials for government subsidies per single family, five people and above. This amount will be paid in March and April and will be doubled during the holy month of Ramadan. It is obvious that in May and June of this year, these three million families will receive subsidies of 2,000 to 6,000 thousand Rials from the government.

THE EFFECT OF THE COVID-19 CRISIS ON THE ISLAMIC FINANCIAL INDUSTRY IN IRAN

The outbreak and continued spread of the COVID-19 has hit Iran's real economy in production, trade, and tourism, all of which have a knock-on effect on the financial markets.

Banking

The financing of firms can be seriously affected due to the bank-centered nature of Iran's financial system. The banking system is expected to be significantly affected but how badly it will be hit will depend greatly on how long the crisis goes on for.

If the crisis is not played out for too long, it will only cause a slight shock to the demand and supply chain in the economy. As a result, the role of the banking system is expected to be limited to supportive measures.

In the middle of March, the act of the Supreme Economic Coordination Council aimed at deferring bank loans, tax debts, and social security payments for manufacturing firms for three months has been approved in this regard. Taxable pardons for March 2020, which ended in March, will be extended until the end of June 2020. In addition, to support the country's economic sectors, the deadline for submitting VAT returns for all taxpayers by the end of April 2020, as well as the deadline for VAT payments for some economic groups, has been extended until the end of May this year.

As the crisis continues, in the medium term the economy will fall into a recession. In this case, a lot of firms will face problems and even the bankruptcy rate is expected to increase, particularly among small and medium enterprises. The rate of returns on loans, including those related to working capital, will go down. Considering the high share of these loans, significant changes are expected in the balance sheet of Iran's banking network (66% share of facilities related to the creation and provision of working capital from the total facilities of the banking system).

Adding non-current claims can increase problems as banks face loan default shocks under the current conditions. Reducing the liquidity ratio, increasing demand in the interbank market, and reducing the amount of new loans (which can deepen the recession) are the least effects which can cause the spread of coronavirus and these are the least of the banking system's worries. On the other hand, since businesses will need more financing, policymakers will pressure the banking network to grant more loans and this could lead to a new wave of non-performing loans that will ultimately put pressure on Central Bank resources and money creation.

Based on the decision of the government's economic headquarters, the Commercial banks are required to pay a loan of 230 trillion rials to subsidise recipients and 520 trillion rials to affected firms

and jobs which have not laid off their human resources at 12 % rate¹.

Policymakers pressure on the banking system to grant more facilities is a mandatory facility in the first three months of 2020, the volume of liquidity and monetary base in 2019 has increased and the growth of liquidity and monetary base has been more than 28%, that being more than its long-term trend. Based on statistics, the main cause for the growth of monetary base was the increased debt of commercial banks, the government to the Central Bank and the net increase of foreign assets of the Central Bank. Accordingly, individuals have turned their bank deposits into alternative assets, or are they withdrawing money from banks and buying gold, for example. Table 1 indicates the effects of the COVID-19 outbreak on the banking system.

Table 1 The Effects the Coronavirus Outbreak on Iran's Banking System

The Status of the Banking System After the Coronavirus Outbreak	The Status of the Banking System Before the Coronavirus Outbreak
The intensified increasing trend of liquidity volume more than the long-term trend	The increasing trend of liquidity volume more than the long-term trend
The intensified increasing trend of monetary base more than the long term trend	The increasing trend of monetary base more than the long-term trend
Imposing the granting of non-operating loans to the banking system	Increased speed of liquidity
Increasing the deferred non-current claims of the banking system	41% inflation and formation of inflationary expectations

THE EFFECT ON THE CAPITAL MARKET

The Tehran Stock Exchange index increased regardless of the volatility of the global stock market and Iran's economic parameters. However, the index had a declining trend since March 4 in reaction to the disagreement between OPEC and Russia, oil price crash, and the COVID-19 outbreak. Thus, the effectiveness of the outbreak of the virus on the Tehran Stock Exchange has been deferred because of high liquidity in the stock market. The descending trend of the total index has continued by March 24, 2020 and after that the trend had an ascending trend again. So this is the crux of the message about the Tehran Stock Exchange.

¹ In Iran, the interest rate on loans is 18 percent, and the government pays the difference between 18 percent and 12 percent.

Table 2 The Effects of the Coronavirus Outbreak on the Stock Market

The status of the stock market after the Coronavirus outbreak	The status of the stock market before the Coronavirus outbreak
Unprecedented crash of international and global stock exchanges	Relative stability of international and global stock exchanges
One-month prohibition on the travel of Europeans to the US due to the coronavirus outbreak and the intensification of the intensified crash of European and American stock exchanges	Significant growth of stock index on Tehran Stock Exchange
Relative reduction of the Tehran Stock Exchange index in the short term	Dependence of the growth of Tehran Stock Exchange index on dollar price
Returned positive trend of the total index of the Tehran Stock Exchange	The cross-sectional effect of sanctions and oil price crash on Tehran Stock Exchange index

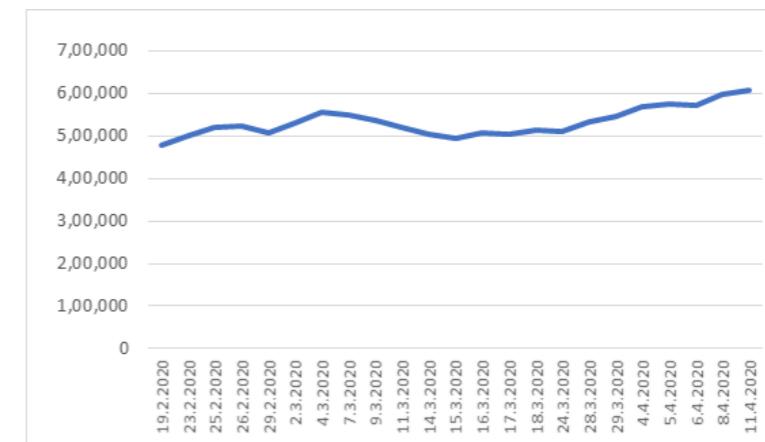
In general, the effects of the COVID-19 outbreak on the capital market based on its severity in Iran and other countries are considered in two dimensions including those affecting the economic-financial parameters of the firms in the stock market including sales, production, and profitability of the firms, as well as those influencing the stock trading of the firms.

The outbreak of COVID-19 was initially expected to have little effect on the capital market in the short term before it would resume its normal course. But as the crisis persisted, the main parameters of determining the stock price value, such as future cash flow and profitability, have been affected due to the continuing crisis.

The reduction or cessation of exports because of the closure of borders and prohibition of the import of raw materials have led to a reduction in production and income of some production units. In addition, the reduction of work shifts or temporary closure of production units resulted in reducing production and profits of companies. Ultimately, it led to a reduction in stock market prices and the capital market index.

Nevertheless, the crisis has had a different effect on the pharmaceutical and food industries, which are significant components of the capital market. Further, the profitability of the pharmaceutical and health industries increased due to the increasing market demand for disinfectants and health products. In addition, market demand for food has increased due to fears of the outbreak and the possibility of quarantine in some cities.

Additionally, the strengthening of the U.S. dollar against the Iranian rial, inflationary expectations, recession in other parallel markets for example, the housing market, and reduced oil sales due to economic sanctions have had the biggest impact on the growth of the stock market index.

Figure 1 The total index of Tehran Stock Exchange during the Coronavirus Outbreak in Iran

The main growth of the Tehran Stock Exchange in the last 12 months is related to the increased price of the U.S. dollar and inflation which affected the stock market with a slight delay. Accordingly, the Rial value of companies from the revaluation and increase of capital of companies has led to profitability, which is considered as the main reason for the rising trend of the stock market in Iran. The number of trading codes increased from about one million in 2019 to about 1.7 million on March 10, 2020. The adverse impact of the outbreak of this virus on the Tehran Stock Exchange has been deferred because of high liquidity in the stock market. The descending trend of the total index has continued by March 24, 2020 and after that the trend had an ascending trend again.

THE GOVERNMENT'S ACTIONS FOR REDUCING THE EFFECTS OF THE CORONAVIRUS CRISIS ON THE ISLAMIC FINANCIAL INDUSTRY IN IRAN

The government has used various strategies for minimizing the effects of the COVID-19 outbreak to reduce the negative effects of the outbreak to businesses, economic actors, and households. As a result, a reduction occurs in the negative effects of the outbreak on the monetary and banking system and the capital market. Thus, the government can prioritize the repayment of private sector debts in the 2020 budget bill and its financial management system to support the private sector and prevent the collapse for economic actors of the private sector especially micro-service firms through clearing the debts of the government in the private sector. It is planned that some support will be provided in the period from April to June 2020.

The crisis caused by the COVID-19 outbreak caused a big shock to the financial turnover of the service sector which will turn into a credit crisis if such conditions continue. Thus, policy makers of the monetary and financial system should develop a comprehensive program for the role-playing of the monetary, financial and credit system to control the economic consequences of the crisis with an active approach and the participation of the private sector. In this regard, the banking system is required to grant loans to the households and firms affected. Approval of the payment of 230 trillion rials in loans to subsidy recipients and 520 trillion rials in loans to businesses with lower interest rates are some of the policies that are being implemented. The government obligated commercial banks to grant loans at 4% interest rates to households and 12% interest rates to the firms destroyed by coronavirus.

THE SUGGESTED SOLUTIONS OF REDUCING THE EFFECTS OF CORONAVIRUS ON THE ISLAMIC FINANCIAL INDUSTRY IN IRAN

It is suggested to grant the loans according to the wages paid of the human resources, last year's tax, social security insurance, as well as water, electricity, gas expenses by the firm directly to the employees of these firms, the Social Security Organization, the Ministry of Energy, and National Gas Company. Using the banking transaction information available to the banking system separately for job categories and the province is considered as one of the tools for identifying the impacted manufacturing firms. Another complementary method is using field observations and feedbacks from various guilds and jobs.

Cash relief packages for households and deferring the repayment of loans for three months can prevent increasing bounced checks and deferred claims of commercial banks. Furthermore, supporting manufacturing activities by deferring tax debts, deferring the payments of social security and manufacturing firms, and granting loans to affected manufacturing units can prevent from reducing the profitability of manufacturing firms in the medium term and minimizing the negative effects of the supply sector on the capital market.

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THE ECONOMIC COSTS OF THE COVID-19 OUTBREAK FOR MALAYSIA: A PRELIMINARY CRUDE ESTIMATE AND SUGGESTION FOR SOLUTIONS

Ahamed Kameel Mydin Meera; Yosita Nur Wirdayanti

Today, May 3, 2020 is the 46th since the movement control order (MCO) was put into effect by the Malaysian government to contain the spread of the COVID-19. Apart from China that claims it has succeeded in containing the virus outbreak that first started on its shores in December, the rest of the world is still actively fighting it at different levels of severity. Hence, most other governments have imposed “lockdowns”, or restrictions on movements, on their peoples. As of May 3, Malaysia registered a total of 6,298 cases, 1,780 under treatment (out of which 27 are in ICU), 4,413 recovered and total 105 deaths (Table 1).

Table 1 COVID-19 Cases as per 3 May 2020

Cases	Number	%
Total Infected	6,298	100.00
Under Treatment (non ICU)	1,753	27.83
ICU Care	27	0.43
Recovered	4,413	70.07
Died	105	1.67

Data source: Ministry of Health Malaysia

Accordingly, many employees and professionals work from home as a response to the MCO but businesses are either closed or operate below capacity, restaurants sell only takeaways and all forms of public gatherings are either cancelled or postponed, including religious activities like congregational prayers. Many individuals are out of work or underemployed. Hospitals handling the COVID-19 cases seem overwhelmed and hence medical and health workers are stressed out. While it is necessary

to slow the spread of the disease, the lockdowns, imposed by governments for four to six weeks simultaneously, have numerous and grave implications for the domestic and global economy. The trade-off is between health and economy.

GREAT CONCERN

There have been pandemics in the past; SARS and MERS are also forms of coronaviruses, but COVID-19 is of a greater concern to the world due to its faster and higher rates of infections, and deaths.

The timing of COVID-19 coincides with a severe global recession already expected for the year 2020, to emerge from the financial sector. However, this pandemic coming from the real sector is likely to accelerate the recession, making it larger, deeper and more pronounced.

THE ENSUING ECONOMIC IMPACT

The first initial disruption from the lockdown is to jolt the economy with simultaneous supply and demand shocks. This is because most of the labor force becomes either underemployed or unemployed. At the same time, income to the labor force also shrinks, causing a demand shock. The economy therefore shrinks by a multiplier effect, finding a new equilibrium at a lower quantity of output. This is a huge cost to the economy and can potentially devastate many small and medium-sized enterprises (SMEs) and households. The dynamics of the economic effects of a nationwide lockdown may be summarized as follows:

1. Supply and demand shocks that shrink the economy by a multiplier effect. Economy reaches new equilibrium at a much lower quantity of output. The effect on price level depends on the relative size of the respective shocks.
2. The aviation, tourism and hospitality industry is hard hit.
3. Domestic and global supply chains are severely disrupted.
4. Businesses and individuals would be hard-pressed for cash, hence LIQUIDITY crisis creeps in.
5. Businesses and households default on loans – further crunching liquidity. Bankruptcies and foreclosures ensue.
6. Liquidity injection needed to turn around the situation. This amount would be huge and the government's concern is how to finance this.

Bank Negara Malaysia, the central bank, estimates real GDP to grow at between -2.0% to +0.5%¹ for 2020, after taking into consideration the stimulus package from the government. However, the Malaysian Institute of Economic Research (MIER) expects that the real GDP growth of Malaysia in 2020 will

¹ Bank Negara Malaysia Economic and Monetary Review, Financial Stability Review. (2020). Retrieved from https://www.bnm.gov.my/?rp=ar2019_en_slides

drop from the initially projected 4.0% to -2.9%². The unemployment rate is expected to rise to 3.5%, that is about 2.4 million³ workers, mostly from the unskilled category (67%). Exports, Investment and Consumption growths are all expected to fall.

The disruption to aggregate supply is likely to cause shortages in some essential items and thereby cause panic-buying and hoarding among households. With people's income dwindling, and SMEs failing, it can spell disaster for the country.

Therefore, while it is important to address the COVID-19 health crisis, it is equally important the economy is kept working as much as possible. Health is a priority but people have other needs too, such as food and shelter, all of which, including health, people can enjoy only if they WORK. We need to note that many in the world today live on meagre daily wages and many also rent their homes. Without income these people can be devastated. So saving households and the SMEs that employ almost 70% of the nation's labor force is crucial. We cannot afford to let the SMEs fail due to this pandemic. The MCO for just two months can destroy 10% to 15% of GDP, some potentially permanently. In economic terms, it destroys LIQUIDITY in the economy. So the main concern for the government now is how to solve the health crisis and at the same time inject the lost liquidity back into the economy, as soon as possible.

This is indeed a "war time" crisis whose focus is first to secure the people and then the economy, national security, resources and sovereignty.

THE SOCIO-ECONOMIC COST OF MCO

A crude estimate of the total loss to Malaysian GDP due to a partial lockdown from March 18 to April 28 (40 days) is about 10% of GDP. The actual loss of economic output is likely to be more because productions may not resume immediately after the MCO is lifted. In fact, some production processes would be lost forever. 10% of expected 2020 GDP will be lost. The 2019 real GDP (2015 prices) was 1,420,492 million ringgit EAA: Please confirm this number is correct – it becomes 1.4 trillion ringgit, with the relative size of Agriculture, Industry and Services being 7.1%, 36.8% and 56.1% respectively (Table 2).

² "MIER projects job losses could be 2.4 million", The Star online, 25 March 2020. Retrieved from <https://www.thestar.com.my/business/business-news/2020/03/25/COVID-19-to-shrink-growth>

³ "MIER projects job losses could be 2.4 million", The Star online, 25 March 2020. Retrieved from <https://www.thestar.com.my/business/business-news/2020/03/25/COVID-19-to-shrink-growth>

Table 2 2019 GDP at 2015 Prices by Sector

Sector	Real Output (million ringgit)	Percentage (%)	Real Output due to Pandemic (million ringgit)
1. Agriculture	101,287	7.1	91,158
2. Industry	522,366	36.8	470,129
3. Services	796,839	56.1	717,155
TOTAL	1,420,492	100	1,278,442

Source: Computed from Bank Negara Malaysia Statistics

We assume that every sector would produce 10% less even though there are sure to be differences in the subsectors. The sectors expected to be hard-hit are Tourism and Hospitality, Aviation and Logistics, Oil and Gas, and Agricultural exports, particularly palm oil. In 2018, Tourism brought in a revenue of 83.44 billion ringgit and Aviation 24.3 billion ringgit, but now these two industries are completely grounded by the pandemic. However, delivery services and online businesses have started to pick up.

The sectors that contribute to the above costs include:

1. **Healthcare management** is foremost to the government in handling this crisis. These include:
 - The healthcare capacity threshold needs to be enhanced. Critical items needed include hospital beds, ICU beds, ventilators, test kits, medicines, PPE (personal protective equipment), sanitizing retired doctors and nurses.
 - Quarantining those arriving into the country and those just recovered from the disease.
 - Additional immigration resources for screening, sanitizers etc.
 - Deploying police and army to enforce MCO.
2. **Tourism and hospitality industry** has been severely hit and brought almost to zero. The effects may continue for many months even after the MCO is lifted.
3. **Aviation Industry** is another that has been practically grounded.
4. Other transportation and logistics services have also been hit severely. However due to the MCO, food delivery business like Grab Food has seen substantial rise. The e-hailing service drivers are included in the Prihatin stimulus package given by the government.
5. **Restaurants**. The ban on social gatherings and movement restrictions have severely hit restaurants. Only takeaways are allowed.
6. Many **SMEs and micro businesses** have faced severe loss of business. Without government intervention, many of these businesses will go bust, bankrupt, foreclosed and so on. Some may never recover or resume business after the crisis is over.
7. **Unemployment and underemployment** have been rising. Many people have been forced to

take unpaid leave and would remain unemployed even after the crisis is over.

8. **Plantation and farms** have also been operating under capacity. Many workers have been laid-off. There is a possibility the country would face food scarcity in certain items, particularly imported food. The price of food item might rise, but the lower demand due to restricted movement should check that a bit. Accordingly, due to low global demand, palm oil exports have fallen significantly.
9. **Stock market collapses**. The stock market being a major indicator of future economy has collapsed since businesses fare poorly.
10. **Banking and Finance**. Many banks, including Islamic banking, would be severely affected due to the expected loan defaults by SMEs and individuals. Therefore, bank failures are likely to happen, followed by bank mergers. However, banks will gain back from confiscation of collaterals and foreclosures.
11. Sales of **durables** have fallen. People tend to postpone purchase of vehicles like cars, electrical items etc.
12. **Supply chains disrupted**. Domestic and international supply chains are being disrupted and altered tremendously.
13. **Oil and gas**. This industry has been severely hit since much lowered economic activity worldwide from the lockdowns requires much less energy.

EFFECTS ON ISLAMIC BANKING AND FINANCE

The COVID-19 crisis is expected to affect the banking sector severely, both Islamic and conventional. But this would only be a “paper” loss. As mentioned earlier, banking will gain back by confiscating collaterals and from foreclosures. The dynamics of bank “failure” will be as follows:

1. Due to the shifts in aggregate demand and aggregate supply, liquidity in the country would shrink first. This would bring about loan defaults by businesses and individuals, causing further liquidity and credit crunch. Banks with NPLs will cut lending. The economy shrinks further by a multiplier effect.
2. Bankruptcies and foreclosures would rise.
3. Banking failures and mergers are likely to ensue.

The above scenarios are expected to happen to both conventional and Islamic banking and finance, since both are operating under a similar environment, regulated by Bank Negara Malaysia. However, being risk-free institutions (note that interest rate is indeed the risk-free rate) banks do not really lose even in recessions. In fact they gain.

Nonetheless the effects on the banking sector are of grave importance to the economy because the liquidity destroyed must be replenished. Hence government intervention is needed to solve the banking “crisis” too.

As expected, stock markets throughout the world plummeted due to the COVID-19 pandemic. For the first quarter of the year 2020 the KLCI index fell a whopping 15% while the Emas Index dropped 18.4% (Diagram 1). Accordingly, the Shariah indices also plummeted, but less than their conventional counterparts. The Emas Shariah Index fell 3% lower, i.e. 15.4%. Clearly the markets are at their five-year low due to the pandemic.

Diagram 1 Performance of Shariah Indices in Bursa Malaysia



As for the growth of Islamic banking and finance per se, one credit rating agency, Fitch Ratings, nevertheless, expects Islamic financing to still grow faster than its conventional counterpart but likely to fall short of Bank Negara Malaysia's 40% market share target of total banking assets for 2020.

GOVERNMENT ECONOMIC STIMULUS

In order to rejuvenate the economy it is essential for government intervention. The government must inject back into the economy lost liquidity so that there is enough liquidity for corporations, SMEs, small businesses and individuals to transact comfortably in the economy.

The Malaysian government was quick to come up with its Prihatin stimulus package to the size of 250 billion ringgit. However, the direct fiscal injection is only 22 billion ringgit.

From May 4, 2020 the MCO was gradually lifted allowing people to go to work. This is great news because we need to produce goods and services for life to continue. Malaysia responded with a Movement Control Order effective from March 18, 2020 in order to contain the spread of the COVID-19 pandemic. We started to test people entering the country, contact tracing people who were confirmed to have the disease, testing, quarantining, and monitoring treatments and those in ICU.

In the meantime people were basically confined indoors at home while social distancing and masks were required for those outdoors.

We are particularly thankful to our government authorities for correctly doing what had to be done and after realizing the true nature of the disease have decided to open the economy. This is very important and urgent in order to avert numerous socioeconomic and health problems that would otherwise ensue.

However, in our opinion the direct fiscal injection of 22 billion ringgit is not enough. Since about 10% of the GDP is expected to be "destroyed", the government should inject as much as that amount, i.e. about 150 billion ringgit (about 10% of GDP).

A natural question that arises is how to finance the stimulus package. Our suggestion is that the government should never borrow the needed funds at interest, domestic or worse internationally, particularly from IMF, World Bank, JP Morgan etc. If funds are borrowed, it will have to be serviced later, i.e. paid back principal plus interest. The rakyat (people) will have to pay for this through higher taxes, GST etc. Therefore, in our opinion, in present circumstances countries should use Quantitative Easing (QE), i.e. printing new money (physically or electronically). Both borrowing and QE would create inflation but under QE it need not be paid back. However, the inflation created might not be big since the new money also compensates for the lost liquidity. The government should also consider crowdfunding to source funds from the wealthy in the country. Since this is a common crisis, countries should also consider counter-trades to boost trade and mitigate liquidity shortage, without having to borrow.

OPPORTUNE TIME FOR ISLAMIC FINANCE

The COVID-19 crisis provides an opportune time for Islamic finance to shift from credit-based financing to an equity-based one, i.e. a tectonic shift chance to move into true Islamic finance, basically a move from risk-free financing to risk-sharing modes. Fintech applications like digital money and crowdfunding would accelerate this. Hence real money payment systems, cryptocurrencies, mutual credit netting, Islamic micro-finance, waqf including family-waqf, sadaqah, agent-banking and cooperatives will become popular and grow in size. In particular non-bank Islamic finance like peer-to-peer financing will rise tremendously post COVID-19.

OTHER OPPORTUNITIES POST-COVID-19

The following are other areas that provide great opportunities post-COVID-19. Islamic finance should take advantage of these.

1. **Health Products.** Countries will be encouraged to domestically produce health-related products so as to become as self-sufficient as possible. At least things like masks (home-made and reusable), hospital beds, ventilators, PPE (personal protective equipment), skin

protection, eye protection, gloves, sanitizers, herbs, traditional medicines etc. can be produced locally. Traditional medicines and practices will rise in popularity. Neem, black seed and honey have been said to help COVID-19 patients recover. Hydroxychloroquine which is said to be a cure, is derived from the barks of the Cinchona tree that grows very well in the hot tropical Malaysian climate. It should be noted that these traditional medicines have not been clinically proven to help the current COVID-19 patients. However, it has been a common belief for generations that these traditional medicines can improve health. Hence traditional medicines could be scientifically studied vis-à-vis modern medicine.

2. **Agriculture** will be given its due importance, i.e. to target food security and self-sufficiency. Hence modern, automated farming, like vertical farming will rise. The production of herbs, traditional medicines and supplements too will provide abundant opportunities.
3. **Technology.** Digital learning, e-businesses, e-meetings and conferences (like using Zoom), home schooling, e-education, selling online, home-based e-businesses, blockchain-based management for increased security, transparency, supply chain tracking, digital marketing etc. will all rise. So will applications of AI, robotics and 5G.
4. **Halal Industry.** Halal industry is also poised to rise in tandem. Post-COVID-19 people are bound to become more health conscious, eat more healthy and wholesome food. The halal food industry is precisely about that and hence can be expected to rise in popularity. Exotic animals that carry coronaviruses are not promoted by the halal industry. Also, post-COVID-19 economic crisis, Muslims are likely to engage more in non-bank Islamic financial activities to solve their common problems. Muslim retail outlets, like ASEAN Mall (Thailand) and Malakat Mall, will rise in number and popularity. In order to minimize the effects of the interest-based fiat money system, the rakyat (people) is likely to take the opportunity to free and enhance themselves through “People-Help-People” concepts using waqf, crowdfunding, peer-to-peer lending etc.

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IMPACTS OF COVID-19 ON THE ISLAMIC FINANCE INDUSTRY IN NIGERIA

Aliyu Dahiru Muhammad; Amina Abubakar Ismail

Unlike the 2008 financial meltdown which affected mainly the financial sector, the COVID-19 crisis has hampered real economic activities such as farming, trading, manufacturing and other businesses. It also affects households.

In Nigeria, the government has taken several measures to mitigate the negative consequences of the crisis. The government projected its budget on \$57 per barrel and 2.18 million barrels per day. Upon the outbreak of the disease, it reviewed its budget and quickly offered stimulus to Lagos State, the epicentre of the disease, 10 billion nairas (\$25.6 million) and additional 5 billion nairas (\$12.8 million) to the Nigeria Centre for Disease Control (NCDC). Various stimulus packages of about 3.5 trillion nairas (\$9 billion) were later announced by the Central Bank of Nigeria (CBN). These were targeted at households, businesses, manufacturers and healthcare providers to support efforts to fight COVID-19 and to build a more resilient and more self-reliant Nigerian economy¹.

The disease affected 2,170 people in Nigeria, with 68 deaths, as of May 1. However, 351 persons were discharged after full recovery, also as of May 1.

OVERVIEW OF ISLAMIC FINANCE IN NIGERIA

Nigeria is Africa's largest economy and most populous country with more than 55% of its total population of over 200 million being Muslims. The majority of Nigerians live below the poverty line of \$1.90 a day, mainly due to the problem of financial inclusion². Though the effort to establish Islamic banking in Nigeria has a long history of struggle, the industry started with the first full-fledged Islamic bank opening in 2011 with the approval of a regional license by the Central Bank of Nigeria.

In Nigeria, Islamic banking is relatively new in the country's financial system. The release of the Bank and Other Financial Institutions Act 1991 as (amended 1997, 1998, 1999 and 2000) provided a legal

¹ Emeifiele, G. (2020). Turning The COVID-19 Tragedy into an Opportunity for a New Nigeria, Central Bank of Nigeria.

impetus for the evolution of Islamic banking in the country's financial system. Nigeria's Islamic finance industry largely depends on constitutional provision and guidelines from relevant regulators. The Central Bank of Nigeria, National Insurance Commission (NAICOM) Securities and Exchange Commission (SEC), Nigeria Deposit Insurance Corporation (NDIC) and Pension Commission (Pen-Com) have been issuing related guidelines on the modalities and operations of Non-Interest Financial Institutions in the country.

In April 2003, Jaiz International Plc was registered as a Special Purpose Vehicle (SPV) to offer Islamic financial services in Nigeria. Jaiz Bank was established as a full-fledged non-interest bank, after increasing its capital base from 2 billion nairas to 25 billion nairas in December 31, 2005. By November 2011, the bank received its final approval and license granted by the CBN, in order to operate as a regional full-fledged bank. The bank started full operations on January 6, 2012 and has been growing ever since. In 2019, the second full-fledged Islamic bank, Taj Bank, was also issued a regional license. With regards to Islamic windows, the CBN required that all conventional banks with Islamic windows establish a separate and self-accounting Islamic banking department, with designated management as contained in the CBN Guidelines for the Regulation and Supervision of Institutions Offering Non-Interest Financial Services in Nigeria. Subsequently, Islamic windows of conventional banks were opened by Stanbic IBTC (albeit reversed its decision few years later), Sterling Bank Islamic Window and more recently, Zenith Bank Non-Interest window.

Takaful companies started to spring up such as Niger Insurance, Halal Takaful, Cornerstone Takaful, Noor Takaful, the first full-fledged Takaful Company, Jaiz Takaful and recently Salam Takaful Insurance.

IMPACT ON ISLAMIC BANKS

Islamic finance has significant market potential in Nigeria but in spite of the increasing patronage of Islamic financial products, the bulk of small businesses are not being effectively served.

The recent initiative by Jaiz Bank to establish a dedicated department targeting micro, small and medium enterprises (MSMEs) will go a long way to contain the difficult situations faced by the sector. Jaiz Bank through its MSME department has disbursed over 4 billion nairas from May 2019 to December 2019 with average of 500 million nairas monthly. This promotes equitable distribution of wealth and income in the society. The existing level of non-performing loans (NPLs) stands at barely 1%, far below the CBN threshold of 5%.

Jaiz Bank's success in this sector prompted the Bank of Industry (BoI) and Development Bank of Nigeria (DBN) to approach it with more funds on a non-interest based arrangement. In fact, during and post COVID-19, this MSME product would remain unique and give a cutting-edge advantage to the bank in promoting small-scale businesses.

The operation of Islamic banks is adversely affected by the crisis. In the first place, the financial system

and money markets are allowed to operate amid lockdowns in major cities, albeit on a skeletal setup³. According to the President of the Federal Republic of Nigeria, the sectors that are exempted are food processing, distribution and retail companies; petroleum distribution and retail entities; power generation, transmission and distribution companies; and private security companies⁴.

The banks were required to identify pharmaceutical firms for onward distribution of loans worth 1 billion nairas for the supply of medical equipment. The central bank has given a one-year moratorium for repayment effective from March 1, 2020. The Commercial Agricultural Credit Scheme (CACS) and Paddy Agricultural Scheme (PAS) with the loan of 100, 000 nairas to 500 million nairas are among the affected schemes. According to the regulator, the moratorium is only for loans made in the health sector or through the central bank or BoI interventions as in the case of CACS and PAS. Yet Islamic banks, particularly Jaiz Bank, has given the facility based on *murabahah* at 13% profit. The contract is now concluded. The lending has Shariah implications on the transactions. First, the bank is not allowed by Shariah to change the concluded transactions. Secondly, if there is a need to give subsidies to customers and to avoid falling into Shariah risk, it has to be unilaterally done by the bank perhaps through rebate.

Customer services have become difficult in all banks, as crowds are not allowed in the banking hall, yet, outside the banking hall there are still crowds where restrictions for movement policies are not made. Profitability and business development have been negatively affected as all the marketers were asked to work from home especially at the Head Office where there is total lockdown. This gives room also for business risk as what is projected by the bank in terms of profits and cash flow could not be attained. Moreover, there is default issue as those with facilities without salary or markets for their businesses could automatically default the repayment.

Through its corporate social responsibility and under the Coalition against COVID-19, a private sector initiative, Jaiz Bank supports government efforts with 100 million nairas during the pandemic while Taj Bank, though new, donated the sum of 50 million nairas. Jaiz Bank also took out radio jingles advising the public on safety measures against COVID-19. Other non-interest windows were required to donate in order to mitigate the crisis. This is necessary because according to the Central Bank Governor, "to procure all needed equipment, material, and all infrastructure needed to fight this pandemic, over 120 billion nairas need to be raised."⁵ A total of 37 donors comprised of individuals and institutions have contributed 15 billion nairas as at April 2, 2020 as reported by the CBN.

³ Zainab, S. Emeifie, G. (2020). Notice to Affected Stakeholders And General Public Regarding COVID-19 and Restrictions In Movement Of Person, Federal Ministry Of Budget And Planning And Central Bank Of Nigeria Joint Announcement.

⁴ Buhari, M. (2020).Address by Muhammadu Buhari, President of The Federal Republic of Nigeria On the COVID-19 Pandemic Sunday 29th March, 2020, State House.

⁵ Emeifie, G. (2020).Speech by Godwin, i. Emeifie, Governor of the Central Bank of Nigeria, March 26, 2020.

IMPACT ON MICROFINANCE BANKS

With a total of 898 microfinance banks, out of which 20 were granted national licences, 40 were given state licences, and the rest operating as units, the country stands a good chance to achieve financial inclusion. However, these banks are quite unevenly distributed across the country with the northern part where Muslims are in majority, having a lower number compared to the south. This is particularly due to the dealing in riba by the microfinance institutions and nonchalant attitude of the central bank to consider the need of the majority of the people in providing timely alternatives to interest-based microfinance banks.

With the emergence of the COVID-19 crisis, like the banking sector, the microfinance banks are allowed to operate on a skeletal level to offer essential services. The sector has not received proportionate support despite its being close to the people. For instance, the government injected 950 billion nairas to deposit banking to mitigate the crisis. At the same time the central bank, through its Nirsal Microfinance Bank, provides 50 billion nairas in stimulus packages to micro and small entrepreneurs at 5% interest rate. The same was not provided to other commercial microfinance banks in the country. This unequal opportunity has a long-term effect on the sector in particular and the economy in general.

In fact, the Nigerian Association of Microfinance Banks has requested 50 billion nairas. This is in addition to the need for relaxing the conditions of restructuring microfinance banks. Previously the government raised the capital of national microfinance banks from 2 billion nairas to 5 billion nairas, state microfinance from 100 million nairas to 1 billion nairas and unit microfinance banks from 20 million nairas to 200 million nairas. The deadline for meeting these requirements was put at April, 2021.

However, the Association has now requested the central bank to extend the deadline to April 2023 when businesses are expected to be fully recovered from the COVID-19 crisis. The Development Finance Unit of the central bank was said to review all the guidelines for the central bank interventions to include Islamic options. Unfortunately, this is taking a much longer time than expected.

Luckily, many microfinance banks are using technology to offer their products and services. With the total lockdown, and skeletal operations, internet windows, point of sales terminals (POS), and other electronic services can still serve customers. This is widely applied between Islamic and conventional microfinance banks except some state microfinance banks that are operating manually and to some extent inefficiently.

However, what is becoming a challenge for Islamic microfinance banks is physical recovery. For instance, according to the MD of Tijarah Microfinance Bank, the first Islamic microfinance in Nigeria, every Friday they used to go out to the field to recover financing before the pandemic. However, when the pandemic hit the country, this became difficult. According to him, without close monitoring,

many customers are likely to default. The money would even be diverted to another sector. Thus, at the moment, no funds mobilization and no investment can be made. Unlike conventional microfinance banks that can buy treasury bills, Islamic microfinance banks cannot do so.

IMPACT ON ISLAMIC CAPITAL MARKETS

Before the emergence of COVID-19, Nigeria's capital market was performing moderately well in terms of volume of transactions and returns on equity and shares' dividends.

However, the market is largely interest-based with the Securities and Exchange Commission (SEC) targeting to increase the total market share of Islamic capital market to 25% by the year 2025. The ten-year master plan is intended to boost the development of the Non-interest Capital Market master plan by providing clarity of vision and set objectives that can positively impact on market capitalization. It is also aimed at ensuring that the market is well-positioned to support Nigeria's economic development by providing alternative sources of long-term financing⁶.

Currently, new issues approved by SEC have been suspended. There is panic in the market which caused investors to develop negative sentiments and trigger sell-off since February, 2020. Some investors have shifted to Forex as the central bank further devalues the naira, while many others migrate to BitCoin, despite a lack of concrete legal and regulatory framework for cryptocurrencies. The market closed the first-quarter of 2020 with a loss of 2 trillion nairas in market capitalization.

Specifically, in the Islamic capital market, the much expected Federal Government Sovereign Sukuk for the third tranche has been suspended indefinitely. Issuance now strictly depends on the new structured Year 2020 budget. However, there was timely payment of the rentals in March, 2020, amidst the COVID-19 crisis for the first tranche of sukuk issued in 2017. This is commendable from the part of the government and this, of course, has been part of the characteristics of Islamic finance i.e. fulfillment of promise.

In addition, the pandemic also necessitates the indefinite suspension of discussion on a Sub-national Sukuk issuance by one of the states of the federation. Previously, in 2013, Osun State issued the first sukuk worth 11.4 billion nairas for construction of 27 ultra-modern schools. The issue was oversubscribed. The Osun sukuk will soon mature and the last tranche of payment is due in October, 2020. Since the Osun sukuk, there has not been much attempt by other states with regards sukuk issuance. The two sovereign sukuk serve as benchmarks for sub-national sukuk.

⁶ Muazu, M. (2019). Appraisal of Nigeria Capital Market Master Plan, unpublished Masters dissertation, submitted to the School of Postgraduate Studies, Bayero University, Kano.

Also affected by the COVID-19 pandemic is the suspension of the regular engagements among stakeholders in the sector through the Nigerian Association of Islamic Financial Institutions (NAIFI). Some of these players include non-interest based mutual funds such as Lotus Capital, Buraq Capital, Metropolitan Skills, and LCM Consult Nigeria Limited. The central bank allows Non-Interest Financial Institutions to open their pension funds based on guidelines available from the regulator.

The aforementioned developments negate the effort to the Islamic capital market sector in Nigeria in terms of products and services and the quest to increase financial inclusion.

IMPACT ON NON-BANK FINANCIAL INSTITUTIONS

The crisis has affected institutions such as pension funds, takaful, zakat, waqf and other non-bank financial institutions.

Takaful

There are currently five full-fledged takaful companies, and the sector has an exceptionally low penetration rate. This crisis perhaps provides opportunities for organizations to mitigate their different risks. Post COVID-19, there would be an increase in subscriptions, particularly in the health sector and businesses. On April 12, 2020, Salam Takaful, as part of its CSR, donated 10 million nairas to Kano State Government and instituted 40million nairas takaful coverage to health workers on the front line in the fight against the virus.

Pension fund assets are basically domiciled in either retirement savings accounts (for contributions under the Contributory Pension Scheme) or legacy funds (for employers who maintain Contributory Defined Benefit Scheme). The global outbreak of COVID-19 since December 2019 and more recently in Nigeria around February 2020 has eroded the values of the funds in both RSAs and Legacy Funds accounts due to negative returns and inability of some employers to continue regular remittance. The erosion in the balance is simply attributed to the effect of the pandemic on the global financial markets and hence Nigeria's financial market is not immune from the shock and its subsequent adverse effect on the market. Pension assets are all invested in different portfolios in the market and the yields have drastically dropped on bonds, rates are being cut, stock prices have crashed, and the value of pension assets is facing the heat.

With regard to Islamic financial instruments, despite the long existence of guidelines for investment of pension fund assets in non-interest financial instruments in Nigeria, the limited number of investment vehicles has restricted the ability of pension fund administrators to channel some portion of the funds. In 2019, the National Pension Commission added an asset class to the multi-fund structure named

“Fund 6”. This class is to enable contributors with ethical concerns to have their pension contribution invested in a non-interest financial instruments. However, the asset class is yet to start functioning as PFAs await further guidelines from the commission.

As at December 31, 2019, the total pension fund asset stood at 10.2 trillion nairas, with investment in sukuk representing 0.82%. Investment in domestic ordinary shares amounts to 5.41% of the funds. There is no clear filter as to which stock in the portfolio can be regarded as fully ethical or Shariyah-compliant, there exist stocks of companies whose activities and line of operations do not violate provisions of the Shariah.

Zakat and waqf

With regard to zakat and waqf institutions, states and NGOs are making efforts to contain the crisis with limited mobilized funds at their disposal.

For instance, Zakat and Sadaqat Foundation, in addition to other measures, produced hand sanitizers for distribution, Kazaure Zakat Committee distributed zakat worth 34 million nairas, Sokoto State Zakat and Endowment Fund continue to support the poor virtually every day with full support of the government. The recently approved Association of Zakat and Waqf Operators in Nigeria (AZAWON) headed by the Sadaukin Sakkwato, Muhammad Lawal Maidoki, the Executive Chairman, Sokoto State Zakat and Endowment Commission has been working hard to provide direction and reposition zakat and waqf before, during and post-pandemic period through awareness creation, advocacy and leading by example.

Some foundations have generously donated to federal and state response funds. For instance, Dangote Foundations, owned by the richest man in Africa, Aliko Dangote, donated 1 billion nairas at the national level and set up 600 beds in isolation centres in Kano State, the largest Muslim population state in West Africa. Many other individuals and companies have also contributed to the fund as stated earlier.

RECOMMENDATIONS

1. The Federal Government should collaborate with reputable financial institutions and grassroots organizations to distribute palliatives to people especially at lower level in a transparent manner.
2. The Central Bank of Nigeria (CBN) should appreciate the sizable number of Muslims and provide adequate facilities to serve their needs and deepen the financial sector in the country.
3. The CBN should evaluate its interventions to ensure fairness and effectiveness among all citizens. Currently, the CBN’s circular on 1-year moratorium on principal repayment of loans, interest rates reduction on all its intervention facilities (from 9% to 5%), 50 billion nairas credit to affected households and SMEs and the 1 trillion nairas stimulus advanced to boost manufacturing, are mainly advantageous to conventional financial institutions, thus leaving the non-interest financial institutions behind. There is therefore the need for the CBN to further consider the Islamic financial institution in its intervention programmes, giving their peculiar nature and modes of operations.
4. In the capital market, there is currently a move to restructure especially mid-term bonds from 7 to 10 years, given the current economic realities. This is to avoid default. Similar attention should also be given to the sovereign sukuk issued, given the current realities on the ground.
5. Regulators in the capital market sector should further resume engagement with the federal government on the proposed third tranche of the sovereign sukuk. This will further strengthen investors’ confidence in the market.
6. The legislatures – both Federal and States - should enact a comprehensive law for robust Islamic finance in Nigeria.
7. Educational institutions should collaborate and offer training and capacity building on non-interest finance to various categories of people in society to promote wider application of Islamic finance thereby increasing wealth circulation in the society.
8. The Federal Government, through the Ministry of Finance should work with the multilateral Saudi-based Islamic Development Bank to address infrastructure needs such as housing, electricity, and jobs creations post COVID-19.
9. Zakat and waqf agencies should come up with programs and projects to support low income households and their businesses for sustainable development.

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COVID-19 IMPACT ON ISLAMIC BANKING AND FINANCE IN OMAN

Muhammad Iman Sastra Mihajat

The first reported case of the COVID-19 in Oman was on February 24, 2020¹ and as of May 3, 2020, the Sultanate recorded 2,568 cases, including 750 recoveries and 12 deaths, according to the Ministry of Health (MOH).

The crisis caused by the spread of COVID-19 is expected to disrupt the development of Islamic finance in the Gulf Cooperation Council (GCC) countries, including in Oman.

THE ISLAMIC BANKING AND FINANCE INDUSTRY IN OMAN

The Islamic finance industry is still in its infancy in Oman and it is not easy for it to compete with the same zeal as its conventional counterpart while adhering to Islamic injunctions. The Islamic finance industry started in early 2013 after the issuance of Royal Decree 69/2012 of December 6, 2012. The main purpose of the Royal Decree was to add six additional articles, 120-126, in the Banking Law of Oman under a new section for Islamic banking. These articles cover the general provisions of the legal framework, supervision and advisory of Islamic banking, the jurisdiction of the Board of Governors of the Central Bank of Oman (CBO) to set regulations and guidelines as well as its authority to license Islamic banks and Islamic windows.

Banking

Currently, Oman has two full-fledged Islamic banks, Bank Nizwa and Alizz Islamic Bank, and six Islamic windows: Al Yusr Islamic Banking (under Oman Arab Bank), Meethaq Islamic Banking (under Bank Muscat), Muzn Islamic Banking (under National Bank of Oman), Sohar Islamic Bank, Maysarah Islamic Bank (under Bank Dhofar), and Al Hilal Islamic Bank (under Bank Al Ahli). However, after the merger of Oman Arab Bank and Alizz Islamic Bank, the number of Islamic windows in Oman will decrease to five, as OAB's Al Yusr merges with Alizz to become a full-fledged Islamic bank and a subsidiary of Oman Arab Bank. Oman Arab Bank will become a parent company of a new Alizz Islamic

¹ Pharmaceutical-Technology. (2020). *COVID-19 in the Middle East: coronavirus-affected countries*, retrieved April 2, 2020, from <https://www.pharmaceutical-technology.com/features/coronavirus-affected-countries-middle-east-covid-19/>

Bank noting that these two entities have their own BODs and Managements. Alizz Islamic Bank will have its own Shariah Supervisory Board that has no relationship with Oman Arab Bank.

Although Oman was the last country in the Middle East to introduce Islamic finance, all sectors - Islamic banking, takaful, sukuk - have managed to maintain healthy double digit growth since inception. The future for Islamic banks in Oman is promising as compared to many other countries. The market share of assets held by Islamic banks jumped from 7.75% in 2015 to 10.3% in 2016 to 13% in 2018 to 13.9% in 2019, when it reached 4.9 billion Omani rials (\$12,78 billion).

This rapid growth is partially due to learning from the experiences of other jurisdictions. The central bank still does not allow Islamic banking institutions to use the contract of *bai' al-'inah* and *tawarruq* because these contracts are still being debated among some Shariah scholars.

Table 1 Figure in millions Omani rials

	December 2015	December 2016	December 2017	December 2018	December 2019
Total Assets	2,253	3,100	3,570	4,300	4,900
Total Deposits	1,539	2,170	2,970	3,260	3,600
Total Financing	1,781	2,420	3,030	3,604	4,000
Islamic Banking Market Share	7.45%	10.3%	12.9%	13%	13.9%

Data source: Central Bank of Oman (CBO) and modified from multiple sources.

Takaful

Like the Islamic banking segment, takaful is also burgeoning apace. The sector has been able to record double digit growth in 2018 by 17% and in 2019 by 20%, according to the Annual Report of the Capital Market Authority (CMA) for the years 2018 and 2019. This is because Shariah-compliant insurance appeals to more customers in the Sultanate, whereby the total gross contributions reached over 64 million rials (\$164.1 million) during 2019 as compared to 53.6 billion rials in 2018. As of end 2019, the total market share of takaful companies in Oman increased from 12% to 13.2% of total gross direct premiums.

Sukuk issuance represents 57% of the total volume of the capital market within the Sultanate, according to data from the Capital Market Authority.

Unlike the Islamic banking and takaful sector, the Shariah-compliant MSM index is declining. As at the end of 2018, the Sharia MSM index closed the year at 591.9 points, a yearly decrease of 17%. The Shariah-compliant index comprises 15 companies in which the performance measures of the shares is

reviewed on a quarterly basis in accordance with Shariah rules and principles issued by the Accounting and Auditing Organization of Islamic Financial Institutions (AAOIFI). However, according to the Capital Market Authority, as at the end of 2018, the value of the Islamic capital market reached approximately 1.91 billion rials (comprising of Shariah-compliant shares, investment funds and sukuk), representing 10.37% of the total market market value. This figure does not include the additional sovereign sukuk issuance issued outside of Oman by the government of Oman through the Ministry of Finance, totalling \$2.5 billion thus far, and the latest Meethaq Sukuk issuance of 44.61 million rials (\$ 115.49 million) that was issued in 2017.

Before the COVID-19 pandemic spread throughout the world, Islamic banking and finance entities in Oman were expected to continue a record of remarkable achievement. However, the crisis adds its own challenges to the ones already faced by the sector within the Sultanate. These include the lack of awareness about Islamic banking and finance transactions and activities, a limited supply of qualified human capital, insufficient liquidity instruments in the Islamic money market, and lack of sukuk issuance and its availability in the secondary market. Shariah governance also needs to be incorporated into the sector's corporate governance frameworks².

These challenges need to be addressed collectively by stakeholders of the Islamic finance industry in order to achieve sustainable growth for the industry amid the COVID-19 crisis.

COVID-19 IMPACT ON THE CORPORATE AND SME SECTOR

The impact of the outbreak of COVID-19 especially pertains to supply disruption and demand shocks that have already had global repercussions. Boone³ identifies at least three main channels through which these measures spill over globally:

1. **Supply:** significant disruptions in the global supply chain, factory closures, cutbacks in many service sector activities;
2. **Demand:** a decline in business travel and tourism, declines in education services, a decline in entertainment and leisure services;
3. **Confidence:** uncertainty leading to reduced or delayed consumption of goods and services, delayed or foregone investment.

However, the sector that will experience the biggest and the greatest losses is the small and medium enterprises (SMEs), not only in Oman but also in other countries that are affected directly or indirectly by the outbreak. However, SMEs in Oman contribute only 15% to the national GDP.

2 Mihajat, MIS. (2019). "Shari'ah Governance Framework in IFIs in Oman: Issues and Challenges», Azid, T., Al-nodel, A. and Qureshi, M. (Ed.) *Research in Corporate and Shari'ah Governance in the Muslim World: Theory and Practice*, Emerald Publishing Limited, pp. 249-26.

3 Boone, L. (2020). "Tackling the fallout from COVID-19", Richard Baldwin and Beatrice

SMES AND THE ROLE OF ISLAMIC BANKING AND FINANCE

Businesses have been given some reprieve during the downturn caused by the pandemic. The Central Bank of Oman (CBO) through its circular BSD/CB/2020/1 dated March 18, 2020, allowed for financial institutions, including banks and financing leasing companies, to defer up to six months the repayments of financing facilities, rental as well as profit for customers affected by the COVID-19 crisis. This especially pertains to SME customers. This could be a lifeline for SMEs facing cashflow challenges.

There are several advantages that can be seen from the circular, such as to support business continuity and jobs sustainability as well as to overcome the ensuing impacts of large-scale bankruptcy and unemployment.

In addition, Islamic banks could take a role with the support from the government and concerned authorities to provide COVID-19 financing programmes that encourage the financial institutions to expand their businesses amid the pandemic.

In this case, Islamic banking and finance can play a pivotal role by supporting the government to strengthen economic activities within the Sultanate. Islamic banks have already taken on some measures to help businesses mitigate the crisis by:

- a. deferring monthly installments and upcoming repayments for a period of 6 months from the existing respective due dates,
- b. offering a grace period or repayment holiday until September 30, 2020, and offering rescheduling and restructuring of financing,
- c. reducing existing fees related to various banking services and not introducing new ones during 2020.
- d. On the takaful side, takaful companies may provide a discount to premium contribution on a certain percentage.

In addition, the Central Bank of Oman in March unveiled an economic stimulus package of 8 billion rials⁴ (\$20 billion). The package is aimed at tackling the outbreak and to combat the impact of COVID-19 on the local economy as an additional channel of liquidity to the country's financial institutions. The stimulus includes a reduction of capital conservation buffers (CCB) for banks, from 2.5% to 1.25%. CBO also increased the Financing Ratio for Islamic banking entities by 5% from 87.5% to 92.5% with the condition that the additional financing portfolio be channeled to productive sectors of economy, including healthcare and food security.

⁴ Oman Observer. (2020). *Central Bank of Oman unveils RO 8 bn stimulus package to fight downturn, accessed 3 May 2020, <https://www.omanoobserver.om/central-bank-of-oman-unveils-ro-8-bn-stimulus-package-to-fight-downturn/>.*

PROSPECTS, OPPORTUNITIES AND CHALLENGES

Oil⁵

Oman and its neighbouring GCC countries depend on oil to support their economies. Therefore, oil prices will remain a main factor for the development of Islamic banking and finance in Oman and the overall GCC market.

2019 has been an interesting year for the political environment and volatility of oil prices especially after the September 2019 drone attack on Saudi Arabia's largest oil field and oil infrastructure. 2020 will become the toughest challenge for Oman's Islamic banking and finance sector and other GCC countries as the coronavirus pandemic has severely disrupted the demand for energy. These disruptions have left the Islamic banking and finance sector on a very cautious footing because oil prices will remain the main factor for growth of the industry in the region.

Tech

Another challenge faced by the Islamic banking and finance industry in Oman is how to digitalize services and payments. Especially during the coronavirus pandemic, banknotes have become a burden because they facilitate transmission of the virus. Therefore, the World Health Organization (WHO) recommends the use of contactless payments, that will make Islamic banks rely on digital technologies and minimize use of physical branches. Oman's Islamic banking and finance entities should take advantage of this opportunity to leverage a new operating business model in order to adapt to the changes in market reality.

Therefore, it is time for players in the Islamic finance industry in Oman to change their strategy, and revise their budgets to meet new targets. The Islamic banking and finance industry should focus on two main categories for financing: the health sector, and agriculture and the food sector.

In the short run, Oman's Islamic banks should shift a big part of their financing portfolio to health as this sector contributes a lot to the current economic activities. Therefore, this sector should be given a lot of focus and emphasis.

In particular, the focus should be given to medical-related manufacturing and services that can be made locally by domestic companies, such as production of hospital beds, masks, ventilators, test kits, hospital equipment, medicines, and vaccines as these are of paramount importance to tackle the current pandemic and any future outbreaks.

⁵ International Energy Agency. (2020). *Oil Market Report – March 2020, accessed 3 April 2020, retrieved from <https://www.iea.org/reports/oil-market-report-march-2020>.*

The current outbreak also shows that food security is given a lot of priority by the government. The government should ensure adequate stocks of food and consumable items in the Sultanate for a long period of time so that people will not panic buy.

CONCLUSION

Amid the pandemic, Islamic banking and finance can seize a major role. The question is whether the industry is able to evolve its business models, transform its processes, and if organizations can adapt. Despite all the challenges faced by the Islamic banking and finance institutions amid COVID-19, we still expect the industry to continue to grow albeit at a slower pace than previously expected.

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COPING WITH COVID-19 IN PAKISTAN

Salman Ahmed Shaikh

The outbreak of COVID-19 amidst an already precarious economic situation has amplified challenges for Pakistan, a developing country with a per capita GDP of around \$5,872 in 2019 (PPP Adjusted). The gross national income per capita remains at \$1,590 as per World Bank data for 2018. Absolute poverty level has gone down in Pakistan during the first decade of the 21st century. Nonetheless, multi-dimensional poverty taking into account income as well as non-income indicators remains high at 38%, according to the United Nations Development Program (2016). With a meagre tax to GDP ratio at 12% and high current expenditures in defence and debt servicing, the government finds itself short of resources to fund development and welfare projects. The size of the financial sector is also small. Insurance penetration is less than 1% of GDP while only 23% of people are formally served with banking services through commercial banks and other institutions.

Pakistan's external debt accounted for 37.5% of the country's nominal GDP in 2019. External debt servicing and negative balance of trade put pressure on the country's foreign reserves and exchange rate from time to time. In moving towards the recent IMF program to source \$6 billion in 2019, the country had to face stringent guidelines to increase tax collection, reduce subsidies, keep tight monetary policy and let the exchange rate float freely in the market. High interest rates together with the drive for increasing tax net has put pressure on domestic businesses that were already finding it hard to deal with more than 30% depreciation in local currency and rise in cost of utilities since 2018. The balance of payment crisis was managed through increasing import duties and depreciating the local currency since 2018. However, with possible decline in exports, remittances and investment, the country faces another impending balance of payment crisis if external debt servicing and the import bill do not decline significantly.

CORONAVIRUS CASES IN PAKISTAN

The first case of COVID-19 in Pakistan was reported on February 26, 2020. It took some time to mobilize resources and increase testing capacity. Table 1 summarizes the incidence of COVID-19 cases by May 5, 2020, in different regions along with the details of deaths and recovery. COVID-19 has reached almost 90% of Pakistan as on May 5, 2020.

Table 1 COVID-19 in numbers

Indicators	Count (In Numbers) – As on May 05, 2020
First Case Reported	26 February 2020
Confirmed Cases	22.049
Total Tests	222.404
Tests to Cases Ratio	1 confirmed case from every 10.08 tests
Daily Average Cases	315 average cases daily from the date of first case
Deaths	514
Recovered	5.801
Recovery to Deaths Ratio	11.28
Cases in Punjab Province	8.133
Cases in Sindh Province	8.189
Cases in KPK Province	3.499
Cases in Balochistan Province	1.321
Cases in Islamabad (Capital City)	464
Cases in Azad Jammu Kashmir	71
Cases in Gilgit Baltistan	372

Data source: Government of Pakistan official website covid.gov.pk

ECONOMIC POLICY RESPONSE TO FIGHT COVID-19

Following the outbreak of COVID-19, the government cut interest rates by 4.25% in three phases, introduced a relief package of 1.2 trillion rupees including the Ehsaas Cash Relief Program of 144 billion rupees, and announced investment incentives for the construction sector.

Export refunds are expedited to help businesses manage working capital shortfall and meet wage bills without layoffs during the second quarter of 2020. The construction sector was specifically targeted since it has a significant potential to provide employment to masons, electricians, plumbers, painters, welders, carpenters and retail and wholesale businesses that sell tools and accessories related to construction. A lot of other industries are connected with the construction sector including, steel, cement, paint and varnishing, brick, cables, pipes, aluminium, marble, tiles, ceramics, electric lighting, fan, electronics, furniture, curtain, carpet and rugs, plastic, spare parts, transport, electricity, gas, banking and insurance.

Going forward, on the macroeconomic front, the government faces the challenge of a decrease in economic growth, rise in fiscal deficit, decrease in tax revenues and worsening balance of payment situation.

DEALING WITH FOOD PRICES

Inflation, for now, is not a potent problem. Consumer spending is now centred on essentials and the government has assured that there is enough stock for essential food items such as wheat, rice, sugar and pulses.

A drop in international oil prices has allowed the government some room to slash the domestic price of petroleum products. Since global oil prices are not expected to rebound anytime soon, the cost of transportation is not going to be higher than before.

The government has warned against hoarding and artificial price increases. On a limited scale in urban areas, efforts are made to actively monitor the prices of essential items. Right now, the prices of milk, vegetables and fruits have actually dropped from the previous months. If food supplies and distribution is adequately handled together with a limited ban on export and strong check on smuggling, food prices are under control at least for the time being.

DEALING WITH FISCAL DEFICIT

The real challenge lies in arresting the expected rise in the fiscal deficit. This can be achieved by further lowering the interest rate. The key policy interest rate in India and Bangladesh was slashed to 5.15% and 5.75%, respectively. Total domestic debt of Pakistan is around 20 trillion rupees. Every 1% reduction in the policy rate can save the government a significant amount of money.

The government's domestic borrowing is in different forms, including Treasury-bills of different maturities, Pakistan Investment Bonds, National Savings Scheme instruments and sukuk to name a few. To get a rough estimate, let us assume that domestic borrowing is carried out at the current policy rate of 9%. In such a scenario, every 1% reduction in policy rate can save the government up to 200 billion rupees a year going forward. If the policy rate is brought down to 6% from 9%, then it will save the government roughly up to 600 billion rupees. Thus, a decrease in interest rates can help revive production, employment and ease the state's budgetary position. So far, the government has taken the route of financing its budget deficit together with slashing the policy rate from 13.25% to 9%. Sukuk instruments of 700 billion rupees are being issued to meet the budgetary needs.

DEALING WITH DECLINE IN ECONOMIC GROWTH

Another big challenge is the inevitable decline in economic growth.

The size of Pakistan's GDP is around \$300 billion. If the informal economy size is about 30%, then the total economy size would be around \$390 billion.

A month-long lockdown will take out \$32.5 billion if there is zero economic activity. But during the period of lockdown, not all economic activities are halted. Productive sectors, albeit at a reduced rate include telecoms, utilities, banking, e-commerce, the freelance sector, work from home by content writers, advertisers, programmers, teachers and graphic designers, the wholesale and retail trade of fast moving consumer goods and activities in rural farms. As such, we can expect the loss to be about 60% to 75% of when there is zero economic activity.

So, by rough estimates, a month-long lockdown would have trimmed GDP growth by 1% at least. A prolonged lockdown or slowdown in economy for another two months may very well push overall economic growth into negative territory as feared by the International Monetary Fund (IMF) in its latest economic assessment for the country as released on April 15, 2020. A further decrease in interest rates amidst lower expected inflation and lower international oil prices can help in meeting the challenge of worsening fiscal deficit and decline in economic growth.

DEALING WITH BALANCE OF PAYMENT DIFFICULTIES

Going forward, the balance of payment situation is also going to present a big threat to our policy-makers. A drop in oil prices will result in a loss of jobs to overseas workers in the Middle East. Most of our workforce in the Middle East are employed in blue collar jobs in construction and energy sectors. Since these sectors are going to be hit badly, the overseas workers will face layoffs and it will decrease remittances back to Pakistan.

In addition, Pakistan also has many of its overseas workers engaged in blue collar jobs in countries like Italy, Spain, UK, Germany and France. Many of them have activity-based work and earn their livelihood on a daily basis. Even if they are engaged in small businesses like in East Asia, their businesses are in retail which is badly hit during the lockdown period.

On the other hand, attracting foreign investment in a short period is difficult even with policy incentives. Foreign portfolio investment could potentially come to the stock market at the current attractive valuations, but very few people are convinced that markets have bottomed out and hence investors wait unless they have lucrative incentives like significant decrease in capital gains tax.

Exports could have had a cushion in a scenario where the pandemic had remained in China. But the epicentre is now Europe and America where most of Pakistan's exports end up.

In such a scenario, it is important to seek reprieve from foreign lenders to provide debt relief in the form of deferment, if not waivers.

Secondly, it is important to look inward and mobilize local resources to produce goods previously imported. Pakistan has a workforce hungry for work even at lower wages and businesses that are anxiously looking to survive. Falling oil prices have provided an opportunity to become competitive. A further decrease in tax cuts and interest rates can help revive local industries to meet at least the domestic demand of goods which we can produce locally and which we were not producing previously only because of a lack of competitiveness due to high cost of production.

Common people in urban areas are responding to the crisis through generous donations. They can also play a role by spending on local goods.

The lockdown has affected approximately 50 million poor people in Pakistan as well as the daily earners who were non-poor before. The non-poor daily earners bring in no incomes during lockdown. Hence, they are effectively in as much a vulnerable position as the poor themselves. For the safety of these poor people and others, we asked these poor people to sacrifice their right to earn to feed themselves. But, we need to also think about ourselves who or for whom \$1,187 million or 8.6 billion rupees worth of the following goods were imported last year. These are reported and documented figures for FY19 retrieved from the Pakistan Bureau of Statistics. Actual figures including the undocumented imports might be many times over.

- Coffee, Tea, Mate and Spices \$635 million
- Dairy, Eggs, Honey and Edible Products \$133 million
- Furniture; Bedding, Mattresses, Lamps and lighting \$129 million
- Cereals \$89 million
- Cutlery, Spoons & Forks of Base \$67 million
- Toys, Games and Sports Requisites \$45 million
- Sugars and Sugar confectionery \$39 million
- Articles of Leather, Travel Goods and Handbags \$31 million
- Tobacco \$19 million

Thus, tighter import controls on non-essential goods, further decrease in interest rates, decrease in capital gains tax on shares trading, tax cuts for labour intensive manufacturing industries other than construction, lobbying for external debt deferment, appeal for foreign aid, mobilizing donations from overseas Pakistanis and incentivizing flow of remittances through formal banking channels are some of the steps that can help in mitigating the impending balance of payment challenge.

MONETARY POLICY RESPONSE

On the monetary side, the usual policy options include interest rate cuts and easing credit availability by relaxing the credit controls and stability checks. The policy rate has been slashed by 425 basis points in three phases to 9% from 13.25%. Keeping in view the interest rate cuts globally, some economists feel there is more room for decreasing the policy rate further. India has cut its base rate to 5.15% and Bangladesh has slashed its repo rate to 5.75%.

It has been found in many intertemporal consumption studies that savings are significantly related to income, but not with interest rate in developing countries. The sensitivity of savings to interest rates measured through intertemporal elasticity of substitution is either found to be insignificant or not positive in many studies¹. Thus, savings would not be affected by much with the cut in policy rate. In recession, a bigger concern for most people is income, especially for those who face liquidity constraints. In Pakistan, about 30% of people are poor, fewer than 10% have access to bank credit and not more than 30% have formal employment contracts. On the other hand, the government also has low tax revenues. In this scenario, a further decrease in interest rates would support both the private sector and government.

The State Bank of Pakistan, the central bank, has taken other steps to support the economy. These include i) relaxing the Debt Burden Ratio (DBR) requirement from 50% to 60%, ii) reducing the Capital Conservation Buffer (CCB) from its existing level of 2.50% to 1.50%, iii) deferring the payment of principal on loans and advances by one year and iv) introducing refinance scheme for financing wage bill. Islamic banks are also beneficiaries of these steps.

These measures are beneficial. However, few suggestions are given to further improve their effects. First, it is better to apply Debt Burden Ratio (DBR) relaxation on smaller loans first. Those eligible for smaller loans are going to be in a more vulnerable position. A person borrowing 1 million rupees for five years having a monthly income of 100,000 rupees and a person borrowing 200,000 rupees for five years having a monthly income of 35,000 rupees differ in their capacity to withstand a decrease in income or increase in medical and other expenses.

To achieve economies of scale, banks prefer to lend big and hence are less inclined to lend to small borrowers, SMEs and microfinance clients. Hence, a policy guideline from the central bank could achieve prioritized access of loanable funds to small borrowers.

It is good to relax the capital conservation buffer. Furthermore, relaxation in reserves can also enhance the capacity to lend directly and swiftly since capital conservation buffer primarily looks at stability.

Deferment of principal payment by one year is a good step. But, people having to pay interest payment would still find themselves in a troublesome position. Banks usually revise the instalment schedule on a yearly basis. The effect of policy rate cut may not reflect in upcoming monthly payments for those who had just taken loans or whose instalments had been revised few months prior. The central bank is well advised to ask commercial banks to revise instalment schedules immediately on the basis of the current lower interest rates.

Finally, the central bank's refinance scheme for financing the wage bill is very generous and perhaps a little broad. As per SMEDA, a company having up to 250 employees, paid-up capital of up to 25 million rupees and sales of up to 250 million rupees is classified as an SME. As per the scheme, for up to 200 million rupees wage bill for 3 months, the company can avail finance up to 100% of the wage bill. For total wage bill between 200 million rupees to 500 million rupees for 3 months, the company can avail finance up to 75% of the wage bill. For example, a company with a monthly wage bill of 160 million rupees can still borrow 360 million rupees at 5%.

Some tweaks can make this scheme robust and allocate loanable funds among the most deserving candidates first. Adding a filter for number of employees would be good. Priority shall be given to those firms employing the greater number of unskilled or low skilled workers.

A cascaded interest rate structure at the end user level is going to ease the burden on smaller firms. Currently, it is 5% for all scale of businesses, small, medium or big. Addressing the issue of activity-based workers is tricky. What if they are genuinely underemployed or not given work? What if the firms genuinely do not have enough work for them and hence under employ them? What if firms over report the wage bill to finance other expenses as well at subsidised rate?

The central bank would refinance banks at 0%, but why are there no burdens to be taken up by senior management of private sector corporations? At least, executive salaries should be excluded from the wage bill to determine financing limit. It will ensure access to subsidised loans to a maximum number of companies. Furthermore, since there is a 2% lower rate on financing for active taxpayers at the end-user level, banks are going to have a lower spread when financing to taxpayers at 3% as compared to non-taxpayers at 5%. Lastly, in providing relief to borrowers, it would have been better to also include microfinance borrowers.

¹ Shaikh, S. A., Ismail, M. A., Ismail, A. G., Shahimi, S., & Shafai, M. H. M. (2018). Intertemporal Consumption Behaviour in OIC Countries. *International Journal of Islamic and Middle Eastern Finance and Management*, 11(4), 529 – 552.

ROLE OF PRIVATE SECTOR BUSINESSES

Realignment in product mix can help the textile, pharmaceutical, surgical goods, cement, processed food and hygiene industry. The textile industry can produce goods that are used in hospitals and medical care, such as towels, bed sheets, face masks, handkerchiefs, and suits worn by medical practitioners and patients, for instance. Pharmaceutical companies can meet the demand of antibiotics, anti-viral and other medicines not only for the local market, but also for neighbouring countries. The surgical goods industry can also join the global value chain and supply the surgical instruments used in intensive medical care.

Just like Pakistan, other countries will also have to deal with massive unemployment by supporting labour intensive sectors like construction. Pakistani cement companies have an opportunity to benefit from the construction package announced for Pakistan and also tap global markets when post-development construction activities surge.

In Ramadan and after, the market for dates, mangoes and citrus fruits can also be tapped. Finally, the demand for anti-bacterial and anti-malaria sprays, sanitizers and anti-bacterial soaps can also be tapped locally and internationally as consciousness for pre-emptive hygiene care is being taken seriously.

As social distancing increases, people may increasingly use e-commerce which can increase the demand for motorcycles as well as create employment in the delivery segment, but it will take time.

Tapping these segments is vital to stay afloat and avoid massive unemployment that can be contained if private sector business owners also play their part. Formal sector businesses can initiate work from home if the lockdown persists further. In Ramadan, work hours are usually curtailed in the country. Work in multiple shifts and a rotation policy among employees and industries can also be used to have balance between work and social distancing. The government can give a daily schedule as to which industries and types of businesses can be opened on which days.

Since most utility companies are owned and operated by the government, authorities can use scheduling of utilities access like electricity and gas to ensure smart lockdown with smart work. Instead of layoffs, avoidable expenses need to be curtailed like advertising, organizing corporate events and deferring bonuses of senior executives.

Industries that cannot operate for the time being can give employees leave if they have in balance or give leave on account. When the lockdown ends and work resumes, the employees can be asked to provide work in lieu of leave on account.

Finally, companies can also avail refinance schemes to manage their wage bills. The government can also introduce a similar scheme to finance overhead expenses at subsidized rates or by providing deferment of utility bills. A strong message and commitment from the government to support local industries in the post lockdown period will encourage industrialists to hold onto their businesses.

IMPLICATIONS OF COVID-19 FOR THE ISLAMIC FINANCE INDUSTRY

Islamic finance is a growing industry in Pakistan. Islamic banks have 15% market share in the overall banking industry at the end of December 2019.

There are 5 full-fledged Islamic banks and 17 conventional banks with Islamic banking windows. The total branch network in Islamic banking reached 3,226 in 2019.

Islamic banks face the issue of a small number of liquid instruments for short-term investments in the money market. The recent sukuk issue of 700 billion rupees by the government would enable Islamic banks to place their liquidity in sukuk. Islamic banks are relatively less risky with smaller value of gross non-performing financing to total financing ratio (4.3%) as compared to the overall industry (8.6%) as at the end of December 2019.

However, since the lockdown which started from mid-March is extended to at least May 9, 2020 and given the expected slowdown in economic activity in the remaining months of 2020, Islamic banks are going to face challenges in maintaining a quality portfolio of financing assets. Additionally, Islamic banks cannot rollover loans nor charge penalties on late payment as their income. Finally, the exchange rate and mark-up rate fluctuation will pressurise their margins in short-term sale based financing contracts, such as in *murabahah*.

On the other hand, takaful companies have a minuscule presence. Given the lower levels of per capita income and lower private savings rate, insurance penetration in the country is 0.85% of GDP. Takaful companies rely on banks for their business, such as general insurance for underlying assets in financing contracts. Falling equity market returns, mutual fund returns and lack of activity in the real estate sector will also put pressure on their portfolio returns in long-term savings plans which they offer to individual clients.

The Islamic capital market comprising Shariah-compliant stocks, sukuk and Islamic mutual funds will also not be immune to systemic risks. Most of the Shariah-compliant stocks are in the manufacturing sector which is going to face challenges. Just before the outbreak of COVID-19, the halal stock index, i.e. Karachi Al-Meezan 30 Index started to recover from a prolonged slump over the last two years. However, the outbreak of COVID-19 has resulted in a steep decline in the index. In the first quarter of 2020, the Halal index KMI-30 lost one-third of its value.

Figure 2 KMI-30 (April 02, 2018 to May 5, 2020)

Nonetheless, some steps, such as the announcement of the construction package, release of sales tax refunds, tax cuts, interest rate cuts and an ease in the banking sector's lending capacity has been taken positively by market participants in the recent trading days. It remains to be seen whether this will be short-lived or not.

Islamic mutual funds also rely on Shariah-compliant stocks and sukuk in their portfolio. Income funds like cash funds, sovereign funds and money market funds as well as balanced funds, commodity funds and asset allocation funds will not face steep decline as they can cling on to sukuk. However, they will have increased appetite to invest in new sukuk if they are issued. On the other hand, equity funds will face a hard time coping with systematic risk. They would still look towards cement, fertilizer and pharmaceutical stocks which can still manage to keep their sales safe from decline and benefit from different investment incentives that are offered in these sectors.

ROLE OF ISLAMIC SOCIAL FINANCE IN RESOURCE REDISTRIBUTION DURING LOCKDOWN

There are approximately 50 million poor people in Pakistan. If the poverty line is defined at \$1.30 a day, 10 billion rupees is needed to feed them daily. The total federal Public Sector Development Program (PSDP) size is 675 billion rupees for the whole year and it is allocated for all development spending for the country. If total PSDP is allocated to feed the poor only, it would be enough for roughly 2 months.

After the lockdown, which started in the third week of March 2020, millions of poor people fell out of work. If the government or the third sector does not intervene, then these people do not have the purchasing power to afford essential items.

In poor countries like Pakistan, people with surplus resources engage in charity, donations, and volunteering. Within a few days, 800,000 people voluntarily registered themselves for the volunteer work in the 'tiger force' constituted for relief efforts. Empirical evidence in Pakistan in multiple research studies has found that faith is the biggest motivation behind charitable donations and it encapsulates and is associated with other humane motives².

Zakat

In most countries where data is retrieved, the wealth to income ratio ranges from 4 to 7 as per the data from the World Inequality Database (2019). Let us assume this ratio to be 5 for Pakistan. Pakistan's GDP is around \$300 billion. Conservative estimates put the size of the informal economy at one-third of total GDP³. Adding both the value of production in the formal and informal economy, we get \$400 billion. Five times the sum of aggregate GDP in documented economy plus the value of production in the informal sector will be around \$2,000 billion. If one-fifth of that national wealth comprises assets that are eligible for zakat, then 2.5% rate of zakat on that portion of wealth will be \$10 billion. It roughly equals 2.5% of aggregate value of production in the formal and undocumented economy. Estimates using disaggregated data of income and wealth subject to zakat in a study published in Pakistan Development Review in 2015 also confirm such estimates.

It is important to put this money mobilized through philanthropy to effective use. Islamic scholars have come forward and explained that people can pay zakat in advance to people suffering from lock-

2 Shaikh, S. A., & Ismail, M. A. (2019). Exploring Dynamics of Private Giving as Income Support Institution for Endowment Deficient Consumers. In Revitalization of Waqf for Socio-Economic Development, Volume II (pp. 91-114). Palgrave Macmillan, Cham.

3 Gulzar, A., Junaid, N., & Haider, A. (2010). What is Hidden, in the Hidden Economy of Pakistan? Size, Causes, Issues, and Implications. *The Pakistan Development Review*, 49(4), 665 – 704.

down. Lockdown has not affected only the poor, but the daily wagers and earners who are non-poor in normal circumstances if they get daily work. The Pakistan Institute of Development Economics estimates that a prolonged lockdown can bring short-term unemployment to as many as 20 million people⁴. Many of them would be looking after 2 or 3 dependents on average in their families.

In response, the government launched the Ehsaas Emergency Cash programme to extend one-time cash support of 12,000 rupees to 12 million families benefitting 78 million individuals. 17,000 payment points are being established across the country with special protective measures to facilitate payment of cash assistance.

Philanthropic sources

The role of non-market philanthropic activity can also not be undermined. An important goal is to reach the right targets efficiently. If the food ration packs or cash support does not reach rural areas, then it may create panic and bring a lot of people to urban areas in the hope of help and work. Private welfare institutions like Al-Khidmat, Alamgir Welfare Trust, Saylani, JDC, Edhi and others can collect most of their donations in the urban areas. It is important that the funds are also allocated widely across the country. That is where planning and coordination is vital.

Private NGOs also need to cooperate with government. They have the trust capital, but lack infrastructure to reach masses across the length and breadth of the country. The government has a trust deficit, but it has profiled data and government machinery to mobilize activities and human resource. It is hoped that a close and collaborative effort between non-market institutions and government will leverage the philanthropic impulse and provide a social safety net to affected people.

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SAUDI ARABIA'S ECONOMIC STIMULUS AND FINANCIAL STABILITY RESPONSE TO THE COVID-19 CRISIS

Faleel Jamaldeen

The novel coronavirus COVID-19 hit China in December and outbreaks have since spread worldwide. Saudi Arabia saw its first case on March 2, 2020 and on May 1 registered 1,344 new coronavirus cases, raising the total number of COVID-19 infections in the country to 24,097, according to the Ministry of Health.

Since the identification of the first case in the country, the Kingdom of Saudi Arabia is working hard to combat the spread of the virus. Initially, some parts of the eastern province were put on lockdown followed by other parts of the country. As of this writing, the country's border has been closed with restricted movement internally. Most private sector and government employees are working from home. The government took measures to ensure uninterrupted education for schools and higher educational institutions by introducing virtual learning platforms. During the holy month of Ramadan curfew was partially lifted and most commercial establishments, including shopping malls, were re-opened with restricted access and social distancing.

The present COVID-19 pandemic has affected the financial market in Saudi Arabia, with effects seen in the banking and capital market. Saudi Arabia as the regional leader and powerhouse of Islamic finance is also facing challenges in its Islamic finance market.

GOVERNMENT MEASURES TO STIMULATE THE ECONOMY

Saudi Arabia introduced various economic packages to mitigate fallouts from the COVID-19 outbreak. Stimulus packages include tax benefits, temporarily amending banking regulations and regulating the labor market to support spending and reduce unemployment.

In March, authorities announced measures exceeding 120 billion riyals (\$31.93 billion) to mitigate the impact of the coronavirus outbreak on the economy. The package includes 50 billion riyals to support banks, financial institutions, and small and medium enterprises, and includes other initiatives to support the economy exceeding 70 billion riyals.

The General Authority for Zakat and Tax (GAZT) introduced a general extension of three months for filing tax returns and payments of related tax for registered taxpayers. The extensions apply for zakat, income tax, withholding tax, value added tax (VAT), and excise tax due for the period from March 18 to June 30 2020. These measures will provide relief for corporations and SMEs to carry on their regular business activities and save on working capital.

In April, the government implemented additional tax relief measures—including those to ease, for a limited time, the filing and payment obligations for taxpayers. Relief from certain penalties and the postponement of zakat, tax, and withholding tax return filings and payment for the period 18 March 2020 to 30 June 2020 (KPMG).

Further, the Saudi Monetary Agency (SAMA), the central bank, introduced numerous economic stimulus packages including revising the interest or profit rate of credit cards, restructuring financing for individuals affected by the crisis , waiving minimum deposit and digital channel fees for six months and new rules to protect financial technology (fintech) companies.

STIMULUS PACKAGES TO STABILIZE THE FINANCIAL INDUSTRY

The total assets of Saudi Arabia's Islamic finance industry was \$541 billion in 2018, according to an ICD-Refinitiv report on Islamic finance development. This is equal to 21% of the world's aggregate Islamic financial assets. The kingdom holds around 48% of the Gulf Cooperative Council's (GCC) Islamic finance assets and 45% of the GCC's total Islamic banking assets. Further, the kingdom has a lion's share of 79% of the total GCC takaful market. In 2018, the outstanding sukuk issue was \$98 billion.

The present pandemic situation has hit the kingdom's Islamic financial market. The government is taking serious steps to minimize the impact of the COVID-19 crisis in the finance industry and to stimulate the economy post-pandemic.

The central bank has directed lenders to provide concessional loans to businesses to help companies through the crisis. Banks are urged to extend financing to businesses at least for six months. These instructions also cover relief for debt repayment. These measures minimize the unemployment level in the kingdom during an ongoing pandemic situation.

The implementation of Basel III standards will also be postponed by SAMA to help banks through the crisis. Most banks in Saudi Arabia offer trade financing products such as export and import letters of credit, letters of guarantee, import and export financing using *murabahah* and *tawarruq* contracts. The instructions from SAMA to the banks can increase loans for trade financing for businesses and

eventually, benefits could trickle down to the Saudi economy.

Five other incentives and measures have been introduced by SAMA to protect the banking industry and all measures are expected to be followed by banks for six months.

1. Firstly, banks should waive all digital channel charges for six months. This can assist customers and drive the use of digital banking so that customers don't need to visit the banks physically during the lockdown.
2. Secondly, the minimum balance to be maintained by the bank should be waived. These measures help customers channel more of their income or savings to spending during this difficult time and to assist SMEs to increase capital or manage working capital requirements.
3. The third incentive is that no fee should be charged to break an existing loan or refinance existing facilities. The businesses hit by the present pandemic situation can benefit by refinancing their existing *murabahah* or *tawarruq* trade facilities with Islamic banks.
4. The fourth incentive is to assist credit card users. Credit card interest or profit rates and other fees need to be reviewed according to SAMA guidelines. Most credit cards and personal loans are offered based on Islamic contracts such as *ujrah*, *murabahah* and *tawarruq*. Revising the rates of these cards would help customers settle their debts without default during the economic hardship.
5. A refund of travel booking to the customer's debit, credit or prepaid card is the fifth incentive.

SUPPORT FOR FRONTLINE HEALTHCARE WORKERS

Healthcare sector employees take on the most risk during this pandemic by risking their lives and their loved ones. They are one of the most respected professionals who serve the country along with law enforcement agencies. As a token of appreciation, the Saudi Arabia Monetary Agency (SAMA) instructed banks to defer the repayment of loan instalments for three months for healthcare workers. This announcement was made in the third week of March.

FINTECH

In the second week of April, the central bank introduced new rules to protect the fintech industry in the kingdom. SAMA said the rules will also introduce two new financing activities: digital finance intermediation and collection of financing agencies debts.

Overall, these new measures announced by the Kingdom will reduce the risk of defaults of sukuk outstanding and support Islamic funds to minimize losses. The measures are to protect businesses and make the Saudi Stock Exchange (Tadawul) stable. Further, these measures would also protect the banking sector.

CONCLUSION

The present pandemic situation has severely hit developed and developing economies. The economic impact because of the ongoing pandemic is common across all Islamic countries. The kingdom of Saudi Arabia, as a powerhouse of Islamic finance has taken maximum measures to stabilize its finance industry. These general measures of safeguarding financial institutions and business organizations can help the kingdom to minimize the impact of the crisis on the Islamic finance industry in general. These new stimulus packages and new measures can stabilize the Islamic capital market, Islamic banking industries and takaful industries.

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THE CONSEQUENCES OF THE COVID-19 PANDEMIC ON THE TURKISH ECONOMY

Saban Çelik; Bora Aktan

The first reported case of COVID-19 in Turkey was March 11, 2020, some two and a half months since the first reported incident on December 31, 2019 out of Wuhan in China. Between those two milestones, the outbreak became a crisis affecting the world economy.

Crises in economies generally arise from either supply-side or demand-side reasons¹ but in the case of the COVID-19, the world economy is experiencing both at the same time.

Governments, Turkey's included, are taking various measures to contain the spread of COVID-19 within borders. As a result the first negative impact is on employment in the service sector due to lock-down measures that have closed commercial interests including tourism sites, entertainment venues, and shopping malls. Other disruptions will also manifest themselves on macroeconomic indicators such as growth, interest rates, inflation and public finance.

In Turkey, administrative, legal and political measures have been taken to mitigate the impact of the crisis, with economic stability packages at the top of the list. Despite these, there will be short, medium and long-term negative effects on Turkey's economy.

Turkey has a liberal economy, offering a combination of both the conventional and Islamic banking system. Islamic banks are referred to as participation banks in the country. The overall share of participation banking in the banking system is about 5%. Because of this composition, the general economic outlook in the evaluation of the impact of the COVID-19 outbreak in the context of Turkey's economy must also be addressed.

If the stock market BIST100 Index, which is one of the leading indices in Istanbul is examined, between December 31, 2019, the date China officially announced the outbreak and March 11, 2020, the first case seen in Turkey, we can make two inferences. First, Turkey's financial markets did not immediately react to the announcement of the first outbreak. Financial markets were able to react as a result of the transmission of COVID-19 virus to other countries after a 20-day delay.

¹ Cochrane, J.H. (2020). *Coronavirus Monetary Policy*, Economics in the Time of COVID-19, Edited by Richard Baldwin and Beatrice Weder di Mauro, Centre for Economic Policy Research.

The second important point is that on January 22, 2020 (Index value: 123180), the BIST100 Index reached its highest value. Following this, the markets dipped until March 12. After this date, the markets fluctuated but largely saw a horizontal trend. For this reason, it can be said that the financial markets in Turkey responded seriously to the epidemic in the short-term. In addition, we can expect the markets to fluctuate and remain unstable in the short-term following to the course of the COVID-19 outbreak.

Turkey has six participation banks, of which only Al Baraka Turk is traded on Borsa Istanbul. Therefore, inferences made regarding Turkey's economy are also true for the price of this participation bank. Overall, the effects of the COVID-19 outbreak will be felt in both the conventional and Islamic banking sectors.

Turkey's Islamic finance sector in recent years has sustained growth through state-supported initiatives. The market share of Islamic funds collected was 8.38% in 2019; 5.46% for funds used; 6.33% for total asset size; 4.42% for total equity and 3.05% for total net profit. In addition, the sector's 5.1% NPL (Non-Performing Loan) ratio is lower than the overall banking sector average, which is good news for the participation banks in Turkey.

Table 1 Share of Participation (Islamic) Banks in Turkish Banking System

	2020/January	2019
Collected Funds	8.50%	8.38%
Used Funds	5.55%	5.46%
Total Assets	6.40%	6.33%
Total Equity	4.38%	4.42%
Net Income	2.74%	3.05%
Non-Performing Loans/ Total Loans		
Participation (Islamic) Banks	Banking Sector	
5.1%	5.5%	

Data source: Banking Regulation and Supervision Agency, Association of Turkish Participation (Islamic) Banks.

Table 2 Participation (Islamic) Banks And Banking Sector (million TL - January 2020)

Variables	Participants Banks			Banking Sector			
	January 2020	Dec-20	Monthly Increase (%)	January 2020	Dec-20	Monthly Increase (%)	
Collected Funds	Turkish Lira	92.785	91.145	1.80%	1.281.448	1.267.073	1.10%
	Foreign Currency	108.116	106.533	1,5%	1.226.604	1.226.609	0.00%
	Precious Metal	20.061	18.305	9,6%	92.205	82.722	11.50%
	Total	220.962	215.983	2,3%	2.600.257	2.576.404	0.90%
Used Funds		153.704	149.475	2,8%	2.769.844	2.739.736	1.10%
Non-Performing Loans (Gross)		7.912	7.763	1,9%	151.866	150.108	1.20%
Total Assets		289.994	284.45	1,9%	4.533.530	4.491.708	0.90%
Total Equity		22.117	21.762	1,6%	505.043	492.384	2.60%
Net Income		217	98	121,4%	7.921	3.208	146.90%
Number of Personnel		16.12	16.04	0,5%	204.588	204.626	0.00%
Branches	National	1.18	1.176	0,3%	11.304	11.3	0.00%
	International	3	3	0,0%	74	74	0.00%
	Total	1.183	1.179	0,3%	11.378	11.374	0.00%

Data source: Banking Regulation and Supervision Agency, Association of Turkish Participation (Islamic) Banks.

There is no sufficient data published for a fundamental analysis to examine the impact of the COVID-19 outbreak on the participation banks in Turkey. The most up-to-date data of official databases is January 2020. The effects of the COVID-19 outbreak were not felt more severely this month (January). Therefore, within the framework of the indicators given in Table 1 and Table 2, the negative effects of the COVID-19 outbreak on participation banks were very limited as of January 2020.

We anticipate that if the COVID-19 pandemic continues, there will be devastating effects on the economy. We see the overall effects of the COVID-19 outbreak in the current situation as follows:

1. The devastating effect of COVID-19 outbreak on supply and demand structures in the global economy is felt.
2. The measures of the central banks are insufficient in solving the economic problems coming from both supply-side and demand-side shocks.

3. As a general rule, the longer the COVID-19 outbreak lasts, the more drawn-out will be the recession.
4. Although quarantine practices are yielding positive results in terms of health, they have negative results for the economy.
5. The difficulties seen in the production and supply chain processes for enterprises are causing liquidity problems in a short time.
6. It is essential that the unemployed be funded by unemployment insurance fund or an alternative source.
7. Many small and medium-sized enterprises (SMEs), especially service companies, have started to experience liquidity problems.
8. It is essential that future supportive measures taken by the government and the banks should continue to support the economy.
9. COVID-19 did not only affect the world banking system, it negatively affected the Turkish banking system, which is integrated into this system. In the Turkish banking system, there were problems before COVID-19 such as macroeconomic pressures on asset quality, losses from lowering interest rates, unfavorable policies on fees and commissions charged for banking services. The possible initial effects of the COVID-19 outbreak on the Turkish banking system will address the liquidity problems of businesses and households.
10. There will be an increase in cost of capital on the funds provided in international capital markets due mainly to the low rate of savings in Turkey.
11. Turkey can borrow from international markets in the current crisis in at least three ways. The first is to get a share of \$1 trillion of funds created by the IMF. Due to the negative perception of the IMF in Turkish society, it is very difficult to use this alternative. IMF's suggestions for the solution of economic problems during the last standby agreement are the main reasons behind this negative perception. The second possibility is the DOLLAR-TL SWAP agreements which could be made with the U.S. Federal Reserve Bank. This is also difficult due to the recent political sparrings between USA and Turkey. There are many disagreements between the U.S. and Turkey with regards Mediterranean and Middle East policy. These include the political situation in Syria and Libya, taking the S-400 defense systems from Russia, and seeking natural gas in the Mediterranean. The third alternative is the EURO-TL SWAP agreement with the Central Bank of the European Union. This alternative is more attractive and plausible.

During the COVID-19 outbreak, an increase was observed in Dollar / TL, Euro / TL and gold prices. The Turkish Lira depreciated by about 15% against the dollar and euro during this process. In addition, gold prices also increased by approximately 15%. In this process, the most important good news for Turkey's economy is the nearly 60% decline in oil prices. This decrease is seen as an important cost reducing factor due to the fact that Turkey is a net importer of energy.

GOVERNMENT AND NGO RESPONSES TO CRISIS

The government's first economic stimulus was a \$15.4 billion economic stability package on March 18, 2020. In addition, various taxes were deferred. Firms and household bank debt and tax payments were deferred for three months. A number of tax practices specific to the service sector have also been deferred.

As the effects of the COVID-19 outbreak persisted, different economic and financial aid packages were announced. One of these was to give approximately 4.3 million needy checks of 1,000 liras each. One of the most important support initiatives for businesses is to provide employment support so that companies do not lay off workers. This initiative involves two phases. In the first phase, firms can apply for support if they do not lay off workers. In the second phase, workers can apply for support if they are given a temporary leave (which is not considered a lay off). In addition, the size of the loan guarantee fund operated in bank loans used by businesses has been increased to \$50 billion.

Turkey's government launched an aid campaign across the country and was able to collect donations of about 2 billion liras. However, this figure is far below the required amount. This aid campaign is specifically designed for helping people who need support due to the COVID-19 outbreak. The government announced this campaign to everyone and institutions in Turkey. According to our estimate, there is a need of approximately \$100 billion in order to compensate the negative effects of COVID-19 outbreak for a one-year period.

WHAT'S NEXT? RECOMMENDATIONS

The damage caused by the COVID-19 crisis depends to a large extent on how long the outbreak will persist. From this perspective, it is necessary to predict exactly when the COVID-19 outbreak will be brought under control. Two prominent dates are suggested in this regard.

First, China and South Korea brought their outbreaks under control in about 3 months. However, these two examples can only give an idea to other countries where the COVID-19 outbreak has occurred. China and South Korea were able to control the COVID-19 outbreak in a 3-month period using different quarantine systems. However, these countries have had previous experience dealing with similar crises such as SARS. As a result, 3 months is a very optimistic benchmark for the United States, European countries and Turkey. The end of 2020 is perhaps a more realistic expectation that the outbreak can be brought fully under control.

The impact of COVID-19 on the economy and Islamic financial markets in Turkey can only be investigated with more time span and data. In addition to this, according to Taymaz², given the total size of the markets affected negatively in this crisis and the size of the markets affected or positively affected, it is possible to make the following conclusions:

- a. In the case of Turkey, the value added in the affected markets in the COVID-19 outbreak is approximately \$204 billion. There are approximately 7.3 million jobs in this market. In the COVID-19 outbreak, the depreciation of this market is expected to be approximately \$93 billion. This means a 46% shrinkage. The amount of unemployment in this market is about 3.4 million. This means a 46% shrinkage.
- b. The depreciation in markets that are not directly affected by the COVID-19 outbreak is also estimated at \$107 billion in Turkey. This depreciation also brings an additional 3.3 million in unemployment in Turkey.
- c. In summary, the recession in all markets is about 17% in Turkey. The unemployment rate also rises to about 28% in Turkey.

Thanks to the economic support packages made so far as a result of the COVID-19 outbreak, the unfavorable conditions faced by the unemployed and small businesses can be partially compensated. Due to the fact that Turkey has an open economy, there should be consumption-based activities in order to facilitate a way out of the crisis.

According to simulation results made on real data of 2017, it is reported that half of damages due to the outbreak will be offset.

According to our forecasts, there is a need of \$100 billion aid package for the short-term. We suggest two alternatives for gathering this required funds:

- a. The EURO-TL SWAP agreement with the Central Bank of the European Union.
- b. The introduction of the “Epidemic Sukuk”. In case of increasing uncertainty, this product can be linked to gold prices.

We hope humanity will find a way to overcome this and similar outbreaks.

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² Taymaz, E. (2020). COVID-19 tedbirlerinin Türkiye ekonomisine etkisi ve çözüm önerileri, retrieved from <https://sarkac.org/2020/04/covid19-tedbirlerinin-turkiye-ekonomisine-etkisi-cozum-onerileri/>

ISLAMIC FINANCE CAN SUPPLEMENT THE FINANCIAL RESPONSE TO THE CORONAVIRUS IN THE UNITED ARAB EMIRATES USING ESG TO PRUDENTLY MANAGE RISKS AND RETURN THE ECONOMY TO GROWTH

Blake Goud, Sayd Farook and Hanife Ymer

The United Arab Emirates has avoided many of the direct impacts caused by the spread of the coronavirus, such as overwhelmed hospitals, seen in other countries through a focused and proactive response to containing the virus' spread. According to data from the UAE Ministry of Health & Community Protection, there were 13,038 cases as of May 1 with 111 confirmed deaths.¹ One of the most challenging elements of grappling with the outbreak of COVID-19 is understanding the true scope of infection.

During the beginning months of the spread of COVID-19, there was a perception from markets that the virus' economic impact would be contained to China with some minor global ripples being driven primarily by supply chain disruptions. As the virus spread across Asia through the end of February, global equity markets as well as those in the UAE, began a sharp decline reflecting a reassessment of the anticipated economic impact of COVID-19. During the first half of March, the decline in equity markets in Dubai and Abu Dhabi intensified along with a global market crash.

The seriousness of the decline was reflected across equity markets, and even spread across credit markets up to and including US Treasuries. Central banks, including the Central Bank of the UAE

¹ @UAEGov. "The Ministry of Health and Prevention conducted additional 28,000 COVID-19 tests, which revealed 462 new cases, bringing the total number of cases to 15,192. The new cases identified are undergoing treatment, @mohapuae announced today. #uaegov," Twitter, 1 May 2020, 3:36a.m. <https://twitter.com/uaegov/status/1257620217594773504>

@UAEGov. "Also, @mohapuae announced that nine people of different nationalities who tested positive for COVID-19 died due to complications. This brings the total death toll to 146. The Ministry of Health and Prevention expressed sincere condolences to the families of the deceased," Twitter, 1 May 2020, 3:36a.m. <https://twitter.com/uaegov/status/1257620223802343424>.

(CBUAE), took action to stabilize banks and financial markets, and their efforts stabilized markets starting around the third week of March. As COVID-19 cases continued to increase into early April, CBUAE brought additional stimulus that continued to support recovery of equity markets.

Equity markets will continue to be vulnerable to the level of new cases and uncertainty about the degree to which COVID-19 has spread locally. Although measures implemented to date have been successful at stabilizing markets, the UAE is susceptible as are most countries to a lack of data. It has taken efforts to improve data using measures such as opening 14 drive-through testing centers, as well as using existing hospitals and specialist health centres, starting from the end of March and by prioritizing testing for those most at-risk including the elderly and pregnant women.² By April 1, the UAE had the capacity to perform tens of thousands of tests per day, and by the beginning of May, approximately 1.2 million tests had been performed, equivalent to about 12% of the population.³

In relative terms, this testing success means the outbreak is more likely to remain contained relative to harder hit countries where testing is not as widely available. Within the UAE, the containment measures have varied across the seven emirates, with particularly strong measures such as a 24-hour per day curfew and lockdowns for two commercial districts in Dubai with significant residential concentrations of foreign laborers. The first day of Ramadan saw easing to allow greater freedom during the holy month. These easing measures included the opening of malls across the country with physical distancing measures still in place to protect public health including a requirement for residents to stay at home from 10pm to 6am, and similar easing was undertaken in other emirates, to allow opening of public transportation of businesses as long as they limited their capacity to 30%.⁴

From the perspective of all banks in the UAE, Islamic banks included, the direct impact from COVID-19 on earnings has been limited. Many of the cases of COVID-19 have occurred among the migrant worker populations that were generally financially excluded before the pandemic and did not represent a significant customer base for UAE banks.

Among the UAE's banks, including Islamic banks, the indirect financial impact is more severe as many customers, whether as employees or businesses, have seen a sharp hit to their incomes during the lockdown. The duration of that impact, its severity and the relative impact it has on Islamic versus

² Staff writer. "Coronavirus: UAE opens state of the art drive-through testing facility," *Middle East Eye*, 29 March 2020. <https://www.middleeasteye.net/news/coronavirus-uae-opens-state-art-drive-through-testing-facility>
Bashir, Hassan. "UAE conducts 1.3 million coronavirus tests," *Emirates News Agency (WAM)*, 5 May 2020. <http://wam.ae/en/details/1395302840869>

³ Bashir op. cit. <https://covid19.ncema.gov.ae/en/News/Details/1230> Al Amir, Khitam. "COVID-19: 300 new coronavirus cases reported in UAE on Wednesday," *Gulf News*, <https://gulfnews.com/uae/health/covid-19-300-new-coronavirus-cases-reported-in-uae-on-wednesday-1.1586343767143>

⁴ Staff Writer. "Dubai relaxes its coronavirus lockdown for Ramadan," *Al-Monitor*, 23 April 2020. <https://www.al-monitor.com/pulse/originals/2020/04/dubai-relaxes-coronavirus-lockdown-ramadan.html#ixzz6Lh1WAP1h>

conventional banks depends on how much exposure each has to the sources of this indirect impact. Banks are also able to gain some mitigation of the adverse impacts of the lockdown as a result of the effectiveness of the central bank and regulatory policies that have been adopted since mid-March.

At a time when the financial stability issues have been largely contained, the attention of Islamic banks should focus on their ability to do more to respond to the social and economic issues that will face the UAE and ensure a strong recovery. Islamic finance is unique because it brings an explicitly ethical approach to the conduct of financial services to facilitate activity in the real economy. In the past, the real economy impact has been derived from its provision of financing.

There is a potential opportunity in this time of global need for Islamic finance to create a positive social return by recognizing the environmental, social and governance (ESG) issues that are relevant to their customers. By working with customers on these issues, Islamic banks will ensure better risk management during a challenging time.

UAE QUICK TO MINIMIZE COVID-19 IMPACT ON ISLAMIC BANKS

The CBUAE announced two rounds of support for the banks which did not differentiate between conventional and Islamic banks. The first supporting measures were adopted on March 15 in a 100 billion dirhams (\$27.2 billion) package aiming to address the most acute concerns at the time. This support package offered 50 billion dirhams in a Zero-Cost Funding (ZCF) Support Facility and allowed banks to use their Capital Conservation Buffer, freeing up an additional capacity to respond of 50 billion dirhams. The ZCF funding is liquidity support to the banks in exchange for eligible collateral under the Collateralized Murabaha Facility (CMF).⁵

In order to be eligible for the ZCF facility, banks must offer a full payment pause (principal plus profit), called a Targeted Economic Support Scheme (TESS) for customers for 6 months (later extended through the end of 2020). The Higher Shariah Authority reviewed and approved the conditions of the TESS for Islamic banks at the end of April, including the operational guidance for how to postpone payments for different transaction structures.⁶ This payment pause will have a negative impact on banks by reducing their income, which will lower their capital levels. The combination of these effects motivated the CBUAE to allow banks to use of the Capital Conservation Buffer (CCB) to avoid creating retrenchment in new financing at a time when demand for it is heightened. The CCB is an

⁵ Central Bank of the UAE. *Standards for The Central Bank of the UAE's Targeted Economic Support Scheme (TESS)*. 15 March 2020. Abu Dhabi: CBUAE.

⁶ Augustine, Babu Das. "Higher Shariah Authority at Central Bank issues guidelines for COVID-19 relief," *Gulf News*, 3 May 2020. <https://gulfnews.com/business/banking/higher-shariah-authority-at-central-bank-issues-guidelines-for-COVID-19-relief-1.71306705>

added capital requirement of 2.5% of risk-weighted assets that is in addition to their 12% minimum capital levels. The UAE Central Bank's action allowed all banks to draw up to 60% of the buffer with additional flexibility for Domestic Systemically-Important Banks (D-SIBs) that are able to draw down 100% of their CCB buffer.

On April 5, the CBUAE extended these policies with the aforementioned extension of the payment pause for customers through the end of 2020.⁷ In addition, the second phase of support measures for banks includes additional support for bank liquidity. The CBUAE relaxed the reserve requirement for demand deposits from 14% to 7%, freeing up 61 billion dirhams (\$16.6 billion).

The central bank also allowed banks to draw down their liquidity by another 95 billion dirhams (\$25.9 billion) such that their liquidity coverage ratio drops to 70% and their Eligible Liquid Asset Ratio (ELAR) falls to 7%. The former measures High Quality Liquid Assets (HQLA) to projected net 30-day outflows, while the latter reflects a range of assets deemed to be liquid by the CBUAE relative to the bank's total assets.

Apart from the measures to expand the capital and liquidity, the Central Bank eased requirements for funding real estate and SMEs. For real estate, the requirements allowed for higher loan-to-value by 5% for first-time home buyers, and banks have their real estate exposure cap relaxed from 20% to 30%, but they must hold more capital. To encourage SME financing, the CBUAE reduced the risk-weighting on SME financing from 25% to 15%.⁸

In total, these measures accounted for 256 billion dirhams (\$69.7 billion), which was about 17% of estimated GDP in 2019, and they provide a backdrop of stability for the financial system, including the Islamic banks in the UAE. They also pass through some of the relief to consumers and businesses through the TESS, although there are notable gaps because the debt relief will be of limited help for those who have lost their jobs who will struggle to meet their financial obligations even with their debt repayments paused.

In addition to the capital and liquidity relief offered to banks in the UAE, the central bank, together in coordination with the Dubai Financial Services Authority (DFSA) and Abu Dhabi Global Market (ADGM) issued guidance on how the banks should treat their financing impairments to give banks

more flexibility during the pandemic.⁹ In short, the banks were given an extended time to update macroeconomic models to calculate the expected credit loss (ECL) of their assets.

Each bank participating in TESS will report about the total volume of financing for which repayment is paused and indicate how significantly their financing portfolio has been affected using a two-group classification system. One classification indicates that customers' business is likely to be mildly and temporarily affected while the other indicates a more significant and lasting impact from the coronavirus crisis. The status of financing for clients making use of TESS would be unchanged in how they are classified for the purpose of measuring expected credit loss under IFRS 9. The exception to this policy comes anytime the bank actually incurs a credit loss (such as if the customer faces insolvency). This reverts treatment to pre-IFRS 9 requirements and treats the impact of the lockdown as purely a liquidity issue, and not an impairment of the creditworthiness of the customer. As a part of this change, banks were able to avoid late payment triggering a negative impact based on changes to expected credit loss (ECL) that change based on the number of days for which a payment is due. This trigger would otherwise increase the level of losses required to be counted against financing asset value.

As outlined above, the response within the UAE to the coronavirus crisis from the perspective of Islamic banks is likely sufficient for the time being to stabilize the financing sector. Islamic banks may find some elements more difficult than conventional banks as a result of having a different mix of financing assets. To take one example, there may be greater haircuts involved in the ZCF funding because Islamic banks have less financing to the government and government-related entities than conventional banks.

As of the end of February, their assets included 50% financing assets to the private sector compared with 34% for conventional banks. The corresponding asset share for government and GRE financing assets was 3.1% and 5.5% for Islamic banks, respectively, and 8.4% and 6.1% for conventional banks. At the same time, their liquid asset position is healthier, with 12.8% of assets in cash and central bank deposits, plus 2.6% with other UAE banks. The corresponding liquid asset position for conventional banks is 10.2% in cash and central bank deposits and 1.4% due from other UAE banks. From the perspective of stability, the Islamic banks are likely to be in at least as strong a position as their conventional counterparts.

⁷ Central Bank of the UAE. "The Central Bank of the UAE Reduces Reserves Requirement for Demand Deposit by 50 percent and Announces Further Measures to Support the UAE Economy During the COVID-19 Pandemic," Press Release, 5 April 2020.

⁸ Staff Writer. "A Guide To The Relief And Stimulus Measures Offered For Businesses In Dubai Amid The COVID-19 Crisis," *Entrepreneur Middle East*, 4 May 2020. <https://www.entrepreneur.com/article/349230>

⁹ Central Bank of the UAE, DFSA and ADGM. *Joint Guidance Note to Banks and Finance Companies on the Treatment of IFRS 9 Expected Credit Loss*. Abu Dhabi: CBUAE.

HOW CAN BANKS MITIGATE THE IMPACTS OF COVID-19 AND LOCKDOWNS USED TO CURB ITS SPREAD?

The current central bank policies are largely defensive. It is focused on easing the acute pain facing those currently affected by the COVID-19 lockdown. Providing financial stability, as the CBUAE's actions are likely to do, is a necessary but not sufficient outcome for the banks.

As their customers face significant economic damage, they face an opportunity to support their customers now that the central bank has provided them with support. For Islamic finance in particular, the ethical principles that guide the industry would both offer them a framework to implement support for their customers as the economy rebuilds following the crisis and also increases reputational risk that they would face if customers believe their efforts were insufficient. The Higher Shariah Authority reiterated this sentiment as it urged Islamic financial institutions to support the most affected customers and economic sectors.¹⁰ The efforts to think about rebuilding damaged economic sectors is important because the duration and severity of the economic contraction that has already begun is only partially within banks' control. Continuing to maintain a robust response to the coronavirus will influence the epidemiological progression of the coronavirus, but there are significant unknowns about treatment and vaccines, as well as the form that social preferences change as the economy is reopened. This phase of the recovery could last as long as through 2022 under conditions that require moderate or severe physical distancing.¹¹

In addition to the financing needed for the immediate response, the economic transformation that is required to recover from this crisis needs new investment. Postponement of existing financing is a useful short-term tool, but it needs to be supplemented with new financing as well. As banks work to extend this new financing, it will be especially important for them to make their risk management process robust.

One element that will be critical is to recognize the heightened importance of environmental, social and governance (ESG) issues as a tool to understand and evaluate the material financial risks that they face. These risks have always existed, and have sometimes been evaluated, but not in the systematic way that is required today and into the future.

The world has been transformed by the coronavirus. The environmental, social and governance – especially social issues – will be pivotal for how well businesses are able to re-engage employees and

¹⁰ Augustine *op. cit.*

¹¹ Branswell, Helen. "Some social distancing may be needed into 2022 to keep coronavirus in check, new study says," STAT, 14 April 2020. <https://www.statnews.com/2020/04/14/some-social-distancing-may-be-needed-into-2022-to-keep-coronavirus-in-check-new-study-says/>

customers or lose them to their competitors. From the perspective of a bank extending new financing to businesses that have been disrupted so much, an analysis of their ESG issues will be as important as their pre-crisis financials in understanding how resilient they will be.

Operationalizing ESG will benefit from digitization, and be amplified by the digitization trends within the financial industry that are being accelerated by COVID-19. One of the most common ways that these trends are interacting in the UAE's banks to date is with promotion of greater social inclusion through digital financial inclusion. For example, Emirates NBD launched a digital bank Liv in 2017 which allowed for financial inclusion for those living in remote areas and supported the bank's corporate social responsibility efforts promoting inclusion of people with disabilities.¹²

These types of digital services provided accessibility for some types of financially excluded people while also reaching out to younger consumers, but also had the side benefit of preparing the bank better for unprecedented changes that are occurring today. As a new normal develops during and after the lockdown as the economy continues to rely on physical distancing, this technology will support the banks' effort to support businesses that are reliant on some degree of physical interaction as they become contactless. Having already made the technological development and invested in the infrastructure needed to operate digitally can enable these banks to more effective in understanding and responding to changing customer expectations.

Islamic banking represents a sizeable share of the market in the UAE, particularly banks with Islamic banking services ('Islamic windows') and their share of the market has increased during the recent consolidation of the banking sector in the UAE. These Islamic windows are at a relative advantage compared with standalone Islamic banks when it comes to adopting new technology. For example, Islamic windows connected to conventional banks that have developed their own neo bank, that offers services without any branch network, will be in the strongest position for growth by adapting their offering for the Islamic windows.

The Islamic windows will be able to leverage on their parent banks' neo bank infrastructure already offering non-interest-bearing deposits. Using this as a starting point, they will be able to integrate their existing Islamic financing products, with minimal additional effort to automate processes compared to banks starting from scratch. The neo bank infrastructure being used to offer existing Islamic financing products could be leveraged to deliver services 'at speed' to market compared to standalone Islamic banks.

Standalone Islamic banks will need to respond quickly in order to maintain their competitive posi-

¹² Emirates NBD. "Press release, 14 May 2018. <https://www.emiratesnbd.com/en/media-centre/media-centre-infos/?mcid=en=611>

Emirates NBD. "#TogetherLimitless," <https://www.emiratesnbd.com/en/corporate-social-responsibility/together-limitless/about/> (Accessed 8 May 2020).

tioning, which could have further impacts on the UAE banking sector post-COVID-19. The natural alignment that standalone Islamic banks could otherwise use to their benefit in the post-COVID world between ethical underpinnings and broader ESG trends could be eroded. For example, if their focus is consumed by the shift to digital banking to meet current realities while the Islamic windows and conventional banks are able to use their digitization lead to implement ESG, including with the use of digital tools which follow the UAE's Guiding Principles on Sustainable Finance, it would put standalone Islamic banks at a significant competitive disadvantage in a market where they otherwise could have an advantage.¹³

CONCLUSION

The UAE's response to the coronavirus crisis has been well designed with the objective of containing the spread of the virus. It has also now deployed the type of infrastructure that will allow to test and trace the level of infections and support the gradual reopening of businesses and the economy. The UAE has expanded its testing and healthcare response while also introducing measures to support its banking sector, including Islamic banks.

These banks are facing customers' repayment worries that stresses both capital and liquidity and the central bank's response to the financial strain has been effective in stabilizing interbank rates, which often provide indications of financial strain. Within the Islamic banking market, there will also be challenges facing individual banks, such as competitive pressures caused by accelerating trends in digitization, that they will need to address simultaneously.

Although governments and Islamic banks each require financial stability in order to act, they each have a duty to do more, and can benefit themselves in the process. The development of ESG practices in banking provides a better way for these banks to understand risks and opportunity. By becoming more resilient, they are able to unlock more resources to support to businesses that can thrive post-COVID but are facing severe constraints in the current environment. In addition to contributing to solid risk management in a time when traditional methods may be less effective, an ESG approach can provide Shariah-compliant financial institutions with more data to enable them to support the recovery of the real economy for the benefit of all of their stakeholders including customers, employees, regulators, and society at large. These stakeholders will want to know how Islamic banks are able to be creative while working within their regulatory framework to prudently direct financing to those who need it to support the recovery from the coronavirus crisis. It will provide a tangible example for how Islamic finance can maintain a focus on its own commercial objectives while at the same time also support a positive impact, particularly in relation to social impacts. This is a critical element to support society during a time of acute need on a scale when the needs of society are far larger than what can be addressed by governments or philanthropic activities.

13 Abu Dhabi Global Market. 2020. UAE Guiding Principles on Sustainable Finance. Abu Dhabi, UAE: ADGM. <https://www.adgm.com/documents/fsra/sustainable-finance/abu-dhabi-sustainable-finance-guiding-principles.pdf>.

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