IFC Insights Research

MAY 2022

WWW.IFC.ORG/INSIGHTS

SIGNS OF RECOVERY AMID STUBBORN UNCERTAINTY

INSIGHTS FROM IFC FINANCIAL INSTITUTIONS SURVEYS ON THE IMPACT OF COVID-19

By Khondoker Haider, Sephooko Motelle, Beniamino Savonitto, Sandeep Singh, Shengnan Wang and Jeyul Yang[1]

The COVID-19 pandemic exacted a severe toll on financial sectors around the globe. Financial institutions faced concerns for the safety of their employees and clients, while their liquidity and asset quality were tested. At the same time, the financial sector played a critical role in mitigating the immediate economic impacts of the pandemic and can support economic recovery. This report contributes to the growing body of analysis on the impact of COVID-19 on the financial sector in the developing world using data from two rounds of surveys of IFC clients, conducted in the final months of 2020 and again in late 2021. Responses to these surveys paint a promising picture, with the majority of financial institutions returning to pre-crisis levels of operations and lending while maintaining sound liquidity and contending with a seemingly manageable increase in nonperforming loans. While most institutions had a positive outlook on their operations and portfolios by late 2021, the lingering effects of debt moratoria, regulatory forbearance and other policy measures may be masking the true impact of the pandemic on asset quality. In addition, persisting uncertainty and mounting instability that were not visible to survey respondents in late 2021 have already begun to affect the pace of economic recovery.

EXECUTIVE SUMMARY

The COVID-19 pandemic brought severe economic contractions across the world that triggered soaring unemployment and sharp increases in poverty and inequality, particularly in emerging economies. The financial sector experienced significant challenges and uncertainty that resulted from mobility restrictions and unprecedented policy interventions.

In the early months of the crisis, lagging financial industry data failed to provide an accurate picture of the unfolding impacts of the pandemic on the sector. To address this gap, in October 2020 IFC launched an online survey of its extensive network of client financial institutions to produce one of the first accounts of the early impact of the pandemic on financial institutions in emerging markets. As the crisis continued to unravel, in October 2021 IFC reached out again to clients to capture the evolving impacts of the pandemic on their portfolios, operations, and lending, and to assess their pathway to recovery. This latest survey round gathered data from 197 institutions across 76 emerging and developing economies.

A comparison of the results of these two surveys suggests that in 2021 IFC financial institution clients experienced a strong recovery in operations, lending, and client demand over 2020 levels; they saw a marked improvement in loan collection levels, though few have returned to pre-crisis levels; they expected to have passed the peak of crisis-induced loan deterioration; and they had a positive outlook on future performance.

In late 2020, most financial institutions were reporting sharp and persistent drops in loan collection and disbursement levels since the onset of the pandemic. Government moratoria and deferrals affected over half of outstanding loan portfolios, while nonperforming loans (NPLs) had begun

to rise. Liquidity, a major concern in the early months of the pandemic, was substantially preserved due to growing deposit levels and high levels of market liquidity supported by unprecedented policy support.

A year later, **IFC clients reported a strong recovery for operations, lending, and credit demand.** Two-thirds indicated they were operating at or above pre-crisis capacity by the end of 2021, up from just one-fifth a year before. On average, loan disbursements levels returned to pre-crisis levels due to a recovery in demand for credit among businesses and consumers. Lenders remained cautious, however, especially with loans to segments perceived as riskier, such as small businesses, due to the severe contraction in business revenues during the crisis and ongoing uncertainty about the recovery.

Financial institutions faced no liquidity crunch, but liquidity pressures were widespread. Nearly 60 percent of institutions experienced liquidity pressures since the onset of the crisis as loan collections dropped. **While loan collection levels improved markedly by the end of 2021, only about half of institutions had returned to pre-crisis levels.** Liquidity was bolstered by deposits, which increased for most deposit-taking institutions compared to before the crisis. Wholesale debt levels also increased on average, albeit not for all. Among microfinance institutions and non-bank financial institutions that rely heavily on debt funding for their operations, one in four reported funding below pre-crisis levels.

The pandemic impacted most financial institutions' asset quality, with nine in 10 respondents reporting some level of portfolio quality deterioration due to the crisis. Over half, however, assessed the impact as minor. **By late 2021, financial institutions expected the impact of the COVID-19 crisis on asset quality to have peaked, and fewer than two in 10 expected a further deterioration in portfolio quality.** As the share of portfolios affected by loan moratoria and restructurings decreased compared to 2020, survey respondents reported only a minor increase in NPLs in 2021 compared to pre-crisis levels. Data on NPLs show significant variation, however, with the impact greater for institutions in low- and lower middle-income economies and among non-bank lenders.

By the end of 2021, **financial institutions were generally optimistic about their operations, liquidity, asset quality, and loan demand. Nearly 90 percent of survey respondents expected to have fully recovered operationally in 2022,** while very few foresaw further liquidity challenges. On the portfolio side, most expected to recover a significant share of outstanding NPLs, while less than one in six institutions anticipated a further deterioration in asset quality.

Importantly, data from the two surveys show that while financial institutions' performance indicators were mostly at or above pre-crisis levels in 2021, **institutions in low- and lower middle-income markets were disproportionally impacted by the crisis in 2020, and they continued to lag in most metrics at the end of 2021.**

While not necessarily representative of the entire financial industry in emerging markets, **these data show that by the end of 2021 the sector had largely withstood the COVID-19 shock and was on the road to recovery.** However, it is distinctly possible that lingering effects of the extraordinary policy support, debt moratoria, and forbearances have been masking further impacts on asset quality for financial institutions. If so, these reports from financial institutions may be overly optimistic, especially considering that the outlook captured by these surveys does not factor in the full extent of the Omicron variant (which had not yet peaked when the survey was conducted), the impact of the war in Ukraine and associated trade and economic sanctions, the impact of recent spikes in commodity prices, or the effect of monetary policy responses to elevated inflation.

INTRODUCTION

The COVID-19 pandemic has been and continues to be an extraordinary public health and economic crisis. It created a severe contraction of economic activity across the world, leading to soaring unemployment and a sharp increase in poverty and inequality, particularly in emerging economies. The economic and social disruptions caused by the pandemic continue to be felt across the globe more than two years after its outbreak. These effects are more severe for low- and lower middle-income countries, and within countries, lower-income households and micro, small, and medium enterprises (MSMEs) were disproportionally affected.[2]

As the pandemic unfolded, the risks to the financial sector escalated rapidly. Financial institutions were directly affected by mobility restrictions, closed workplaces, and stay-at-home directives—and the resulting contraction in economic activity. In addition, a range of policy interventions aimed at mitigating the effects of the pandemic on households had a significant impact on the financial industry. Moratoria on loan repayments and regulatory forbearance—which were critical to preventing defaults the crisis could have caused—had not been tested at scale before. These threats to financial institutions' liquidity, solvency, asset quality, and risk appetite also raised the risk of a financial sector crisis, which would only risk further deepening the economic wounds of the pandemic.[3]

Because of the unprecedented nature of the pandemic and policy responses to it, the impact on the financial sector was highly unpredictable. Thus, data and information about the damage financial institutions sustained during

the crisis was lagging. Yet due to a dearth of accurate and timely industry data, regulators, policymakers, and development institutions could not get a clear picture of the unfolding impact of the crisis on the sector. This was particularly true in emerging markets.

To fill this gap, in October 2020 IFC launched an online survey of over 300 financial institutions in its outstanding client portfolio with lending operations, excluding fund investments and clients exclusively engaged in short-term trade finance transactions. With 149 responses across 57 markets, the survey resulted in one of the first and most comprehensive accounts of the early impacts of the pandemic on financial institutions in emerging markets.[4]

After the sharp decline in economic activity in 2020, the year 2021 was characterized by a strong economic recovery across many countries and substantial progress in vaccinations in many advanced and middle-income economies. Still, the effects of the pandemic continued to unravel. The rise of new virus variants in 2021—with more than 200 million new cases[5] that contributed to persisting economic uncertainty[6]—led to marked changes in the economic and financial industry landscape over a year. In October 2021, IFC again reached out to clients to capture the impacts—direct and indirect—of the pandemic and extraordinary policy measures on their portfolios, lending, and operations, as well as to assess barriers to and progress toward recovery for the sector. The second survey was conducted between October 27 and December 14, 2021, and collected data from 197 IFC FI clients—including 99 respondents to the first survey—representing approximately 41 percent of FIG's outstanding portfolio in long-term finance across 76 markets.

While not perfectly representative of the industry in each of these markets, the surveys aggregate data from a diverse pool of financial institutions, the majority of which (66 percent in the first survey and 72 percent in the second) are regulated banks. Among the remaining non-bank finance and microfinance institutions, 73 percent are non-deposit taking institutions that rely primarily on wholesale debt to fund their portfolios. Approximately 43 percent of survey respondents in the two surveys are located in high-income and upper middle-income countries, the majority of them in Latin America and Europe, while about 57 percent of responding institutions were located in lower middle-income and low-income countries, primarily in the Sub-Saharan Africa, South Asia, and East Asia Pacific regions.

Although respondents in the two surveys are not identical, Table 1 shows that across key characteristics respondents in the two surveys are comparable, confirming that systemic bias between the two surveys is unlikely.

TABLE 1 Comparison of Survey Respondents from 2020 Survey and 2021 Survey

KEY CHARACTERISTICS	2020 SURVEY	2021 SURVEY
Low-Income & Lower Middle-Income Countries (%)	57.0%	58.4%
Regulated Banks (%)	65.8%	71.6%
Deposit Taking Institutions (%)	78.5%	79.2%
Loan Portfolio Outstanding (2019 USD, millions)	3,481	3,985
Sample (N)	*149*	*197*

Notes: The table compares the two key descriptive characteristics of respondent financial institutions for the 2020 and 2021 survey rounds. The t-tests comparing means for key variables between these two samples produced p-values > 0.05, confirming that the two samples are comparable across those characteristics.

The remainder of this report presents averages and statistics for each survey round in order to highlight trends in the data where these trends are confirmed by the review of the data for the sample 99 respondents that answered to both rounds of surveys. These confirmed trends provide what we hope are valuable insights as to how financial institutions in emerging markets are recovering from the impacts of the COVID-19 pandemic and what they expect going forward.

THE IMPACT OF THE CRISIS

Operations and Lending

Operational recovery is underway. As mobility restrictions were relaxed or lifted and economic activity rebounded across most markets, so did the operations of financial institutions. Two-thirds of respondents indicated they were operating at or above pre-crisis capacity by the end of 2021, compared to only 21 percent a year before. Among those that recovered, half reported some growth compared to pre-crisis levels. Among respondents, 86 percent indicated that the crisis had significantly accelerated the digital transformation of their operations.

Demand for credit is growing faster than disbursement levels. After a sharp decline in demand for credit at the onset of the pandemic, 2021 was characterized by a rapid recovery. After dropping between 15 and 22 percent in 2020, respondents indicated that demand for credit increased 7 percent above pre-crisis levels by the end of 2021. The supply of credit—which averaged 20 percent below pre-crisis levels in 2020—had also largely recovered by the second survey. However, survey data also suggest that the recovery for loan disbursements was slower and more heterogeneous

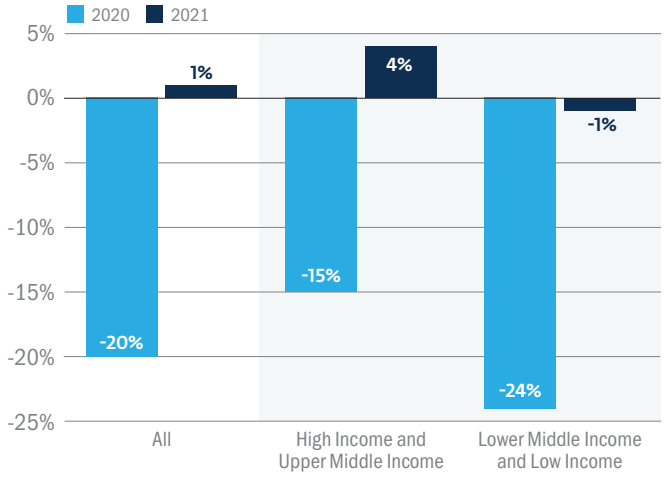

FIGURE 1 Change in average loan disbursement levels across institutions (2019–2021)

Notes: The figure shows the relative change in loan disbursement levels compared to pre-crisis. Data from the end of 2021 indicates that, on average, survey respondents had returned loan disbursements to pre-crisis levels. A comparison on average institution performance across country income groups shows that institutions in lower middle-income and low-income markets contracted loan disbursement levels more in 2020 but had nearly returned to pre-crisis levels by late 2021.

compared to estimates of loan demand. More specifically, loan disbursements have matched or even outpaced demand in high-income and upper middle-income markets, while institutions in low-income and lower middle-income markets registered a significant gap between the average estimated levels of demand for credit and loan disbursements compared to pre-crisis levels.

Credit conditions for MSMEs remain tighter compared to pre-crisis levels. A closer look at micro, small, and medium enterprise (MSME) lending practices reveals that 46 percent of financial institutions maintained tighter credit standards for these businesses compared to pre-crisis, as of late 2021. The higher threshold for MSME lending echoes findings from a firm-level study indicating that the recovery from the initial COVID-19 shocks for MSMEs was slower relative to larger firms.[7] Significant variation in credit conditions for MSMEs is observed across countries, with 53 percent of respondents in low- and lower middle-income markets reporting tighter standards compared to pre-crisis levels, compared to 36 percent in high- and upper middle-income markets.

Tighter credit conditions took the form of increased collateral and application requirements, reduced loan amounts, and less unsecured lending—reflecting concerns about the impact of the lockdowns on business health and collateral quality, a lack of reliable data on businesses, and uncertainty on future performance outlook for MSMEs. To improve their ability to assess and manage risk, about six in 10 institutions reported having made significant updates to their credit models, primarily in the forms of updates to sector risk profiles and revisions of their statistical models. However, only 14 percent of respondents reported having invested in new capabilities to integrate alternative data or machine learning in their risk assessments since the onset of the crisis.

Liquidity and Funding

While nearly 60 percent of institutions experienced liquidity pressures during the crisis, among these just a quarter rated these pressures as significant. From the 2021 survey, 35 percent said a key source of liquidity pressure came from delays in collections, while 39 percent indicated pressure came from an increase in provisioning and collection costs. A much smaller group—18 percent—indicated that wholesale funding levels were a source of pressure since the crisis began.

Deposits continued to grow, with three-quarters of institutions reporting deposits above pre-crisis levels, largely due to reduced spending by businesses and households. On average, deposit levels increased by 16 percent since the crisis, continuing the growth trend observed in 2020. This increment was seen, with some variations, across all regions and types of institution. Just 14 percent of institutions reported a reduction in deposit levels, the majority of which are from lower-income markets.

Wholesale debt markets remain liquid and continue to be an important source of funding, particularly for microfinance

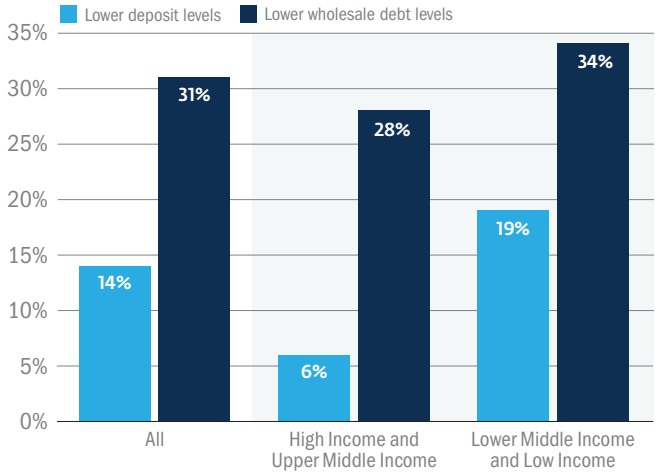

FIGURE 2 Share of institutions with deposit or wholesale funding below pre-crisis levels (Q4 2021)

Notes: The figure shows the share of financial institutions that responded to the 2021 survey that reported deposit or wholesale funding below pre-crisis levels. Data on deposit levels is limited to deposit-taking institutions. A comparison across income groups shows that a greater share of institutions in low- and lower middle-income countries reported funding levels below pre-crisis.

institutions (MFIs) and non-bank financial institutions (NBFIs).[8] On average, financial institutions reported wholesale debt funding levels 12 percent above pre-crisis levels. While this growth is relatively consistent across regions and institution types, nearly a third of institutions borrowing from the market reported a decrease in debt levels compared to pre-crisis. Notably, about one in four non-bank lenders, which rely on borrowing for over two-thirds of their funding, reported debt levels below pre-crisis. While the most common drivers of reduced debt funding among respondents are lower need due to growth of deposits or reduced lending operations, 40 percent of affected institutions identify the higher cost, limited availability, or short tenor of funding in the market as reasons for the reduction in wholesale funding levels. By the end of 2021, about a quarter of financial institutions lending to MSMEs, and nearly half of microfinance institutions, identified cost of funding as a top challenge for lending to MSMEs.

Portfolio Quality

Loan collections improved significantly from 2020 to 2021, but more than half of financial institutions remain below pre-crisis levels. Banks, which saw relatively larger drops in collections in the first months of the crisis, experienced a swifter recovery than other institutions. In line with findings on operations and new business, a correlation between recovery in collections and country income is observed: Just over a third of institutions in low- and lower middle-income markets indicated having recovered collections, compared to two thirds in high- and upper middle-income markets. The impact of moratoria on collection levels was acknowledged by 86 percent of respondents, half of whom attributed to these policies a significant or very significant impact.

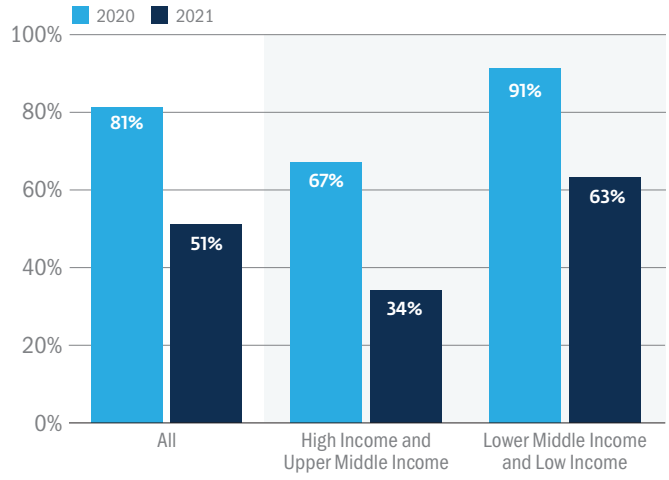

FIGURE 3 Change in the share of institutions with collections below pre-crisis levels (2019–2021)

Notes: The figure shows the change in the share of financial institutions that reported collections below pre-crisis levels. Data on deposit levels is limited to deposit-taking institutions. A comparison across income groups shows that while the share of institutions reporting collections below pre-crisis levels has decreased from the first survey to the second, institutions in low- and lower middle-income countries continue to be significantly more impacted.

The impact of COVID-19 on asset quality was ubiquitous, but survey respondents report a moderate increase in their stock of NPLs. While 91 percent of respondents confirmed some level of portfolio quality deterioration from the crisis, 53 percent considered the impact to be minor, 32 percent significant, and just 6 percent assigned a very significant rating to the crisis's impact on portfolio quality. Between June 2019 and June 2021, NPL-90/PAR-90 rates increased by 1.2 percentage points (a 25 percent increase) on average among survey respondents. The hike has been more prominent in mortgage portfolios and less marked for corporate loans. When comparing the NPL ratios for the 67 institutions (38 percent of respondents) that attributed to the pandemic at least a significant impact on their portfolio quality, the average estimated increment increased to 3.4 percentage points, representing a 60 percent increase from 2019.

Nonperforming loans data reveals significant heterogeneities across markets. When comparing NPL-90/PAR-90 trends across countries, institutions in high- and upper middle-income markets reported on average a slight reduction of their NPL rates over the crisis, likely due to the impact of more extensive fiscal support and policy interventions. Conversely, institutions in lower-income markets average a 2.2 percentage point (or 44 percent) increase in NPL-90/PAR-90 rates.

Policy Measures

Government moratoria on loan repayments continue to impact collection levels. Thirty-seven percent of respondents rate the impact of active or recently lifted moratoria on collection levels as significant. While pandemic-related policy support measures had been lifted in several markets,[9] as of June 2021 over one-third of institutions reported that their portfolios were still being affected by active government moratoria, covering an average of almost 20 percent of their outstanding loan portfolios. In addition, voluntary deferrals and loan restructurings were reported by two-thirds of respondents, affecting on average 12 percent of the outstanding portfolios of these institutions.

Most countries offered policy measures to support the financial sector,[10] but not all financial institutions reported having leveraged or benefitted from these policies. In the 66 countries where public credit guarantee programs were in place during the crisis, only 32 percent of lenders reported taking advantage of these policies. The data collected does not allow us to determine the main reasons behind the

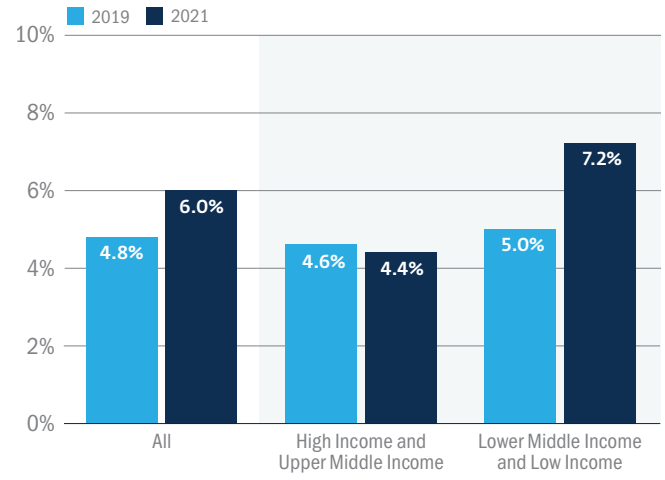

FIGURE 4 Change in average nonperforming loan rates across institutions (2019–2021)

Notes: The figure shows the relative change in NPL-90 day rates and PAR-90 day rates reported by respondents in the 2021 survey. The data reflects self-reported NPL rates across the FI portfolio for June 2019 and June 2021. The data shows that, on average, nonperforming loan rates increased compared to pre-crisis levels by 1.2 percentage points. A comparison on average portfolio performance across country income groups shows, however, that institutions in high- and upper middle-income countries saw on average a slight reduction in NPL/PAR-90 rates, while the average respondent from low- and lower middle-income markets experienced an increase by 2.2 percentage points.

limited use of these measures. However, deposit-taking institutions (38 percent) were more than three times more likely than non-deposit-taking ones (11 percent) to leverage guarantees, suggesting that eligibility was a significant driver of uptake. This finding is consistent with firm-level data showing that only one in four firms had received some type of policy support as of March 2021.[11] Similarly, liquidity facilities offered by governments or monetary authorities were leveraged by 28 percent of financial institutions in countries where such facilities were established, while 41 percent of institutions confirmed having benefitted from some level of regulatory forbearance and other policy support.[12]

Differences Across Income Groups and Geographies

As shown in the data and figures above, every metric looked at in the survey indicates that financial institutions in low- and lower middle-income markets were disproportionally impacted by the crisis in 2020, and continued to lag behind at the end of 2021.

For example, while many institutions in high-income and upper middle-income countries saw nonperforming loan rates in 2021 that were lower than their 2019 NPL rates, institutions in low- and lower middle-income countries continued to experience NPL rates significantly higher than in 2019 (Figure 4).

And while the share of institutions reporting collections below pre-crisis levels decreased significantly from the first survey to the second, the share of institutions in low-income and lower middle-income countries with collections below pre-crisis levels was nearly twice as high as high- and upper middle-income countries at the end of 2021 (Figure 3).

Similar differences across country income levels were seen for deposits and wholesale funding levels (Figure 2) and changes in disbursement levels (Figure 1).

Financial institutions in Eastern Europe and Central Asia experienced a stronger recovery in collections through the end of 2021, while those in the South Asia and the East Asia and the Pacific regions lagged the most. Operational recovery among regions was more uniform, with between 60 and 80 percent of institutions in most regions reporting they had recovered to pre-crisis levels. The East Asia and the Pacific region was the outlier with less than half of institutions there reporting a full recovery.

As for nonperforming loans, the average institution from Eastern Europe and Central Asia, the Middle East region reported a reduction in NPL/PAR-90 rates from June 2019 to June 2021. All other regions saw an increase. And a higher percentage of institutions in Central Asia and Turkey and the Middle East region reported that liquidity pressures during the crisis were minor.

LOOKING AHEAD

Lending and Portfolio Quality

Despite persistent uncertainty, financial institutions are optimistic about their operations, lending, and liquidity. By the end of 2022, 87 percent of client financial institutions expect to have fully recovered operationally. Lending levels have returned to and even surpassed pre-crisis benchmarks, while the outlook on liquidity is largely positive, with just one in five respondents anticipating a possible deterioration.

Lenders remain cautious about lending to MSMEs in the current environment, while most of them expect demand for credit to grow significantly in the coming year. Tight credit conditions for this segment are expected to continue through 2022. While half of respondents do not expect to make any changes to their credit standards, a quarter of financial institutions expect a further tightening. Conversely three in four lenders expect demand for credit to grow further in 2022.

Lenders expect to be able to recover a substantial share of their outstanding nonperforming loans. While financial institutions registered marked increases in nonperforming loans, they remain optimistic about their ability to recover

a significant share of these loans. About half of institutions anticipate portfolio quality improvements in 2022, while at the same time respondents expect approximately half of their June 2021 nonperforming portfolio stock to either become performing or be restructured, before moving to collection. Less than 20 percent of June 2021 nonperforming loans was expected to be written off or sold at the time of the more recent survey. While the rate of write-offs will likely grow over time, survey data indicates continued confidence by lenders in their ability to recover distressed assets, either by offering clients more time, or in collection by realizing collaterals or leveraging guarantees.

The widespread implementation of debt moratoria, government support, and forbearance may be masking a deeper impact on asset quality, disincentivizing write-offs. The gradual withdrawal of these policy measures and improved transparency in the financial sector are likely to uncover more nonperforming assets,[13] though the IFC survey reveals that financial institutions are optimistic about the outlook on portfolio quality. Among institutions that experienced a significant deterioration in portfolio quality, 69 percent expect an improvement in 2022. Only 15 percent anticipated a further, minor deterioration. Similarly, among institutions that registered only a minor impact on portfolio quality by late 2021, most expect NPL rates to remain stable or reduce over the next 12 months. The data suggest that the majority of financial institution expect NPL rates to have peaked in 2020-2021, with asset quality stabilizing or improving in 2022.

The recent deterioration of the political and macroeconomic environment is likely to introduce new risks, particularly for financial institutions in more fragile markets. Beyond the impacts on portfolios and operations, the balance sheet exposure to sovereign risk has increased, with government debt averaging 21 percent of total assets for respondents in low- and lower middle-income countries, a 16 percent increase compared to pre-crisis levels. The Omicron variant was a stark reminder that pandemic risks and uncertainty can retard or even halt economic recovery, as can global value chain bottlenecks, spikes in commodity prices and inflation, and the war in Ukraine.[14] An increase in interest rates to contain inflationary pressures may pose further challenges to financial institutions' liquidity, while also constraining borrowers' ability to refinance or afford new loans.

Strategic Directions and Needs

The importance of digital transformation continues to grow. The digitalization wave induced by the pandemic has led to 86 percent of institutions ramping up digital transformation efforts. From an initial focus on operational resilience and employee and customer safety, digital transformation continues to be a strategic priority for virtually all financial institutions through 2022. Nine in 10 institutions say the pandemic increased the priority or urgency of at least one aspect of their digital transformation. The expansion of digital channels such as mobile or internet banking, and the digitalization of internal processes, are the two areas of digital transformation most prioritized by institutions.

A growing focus on MSMEs, women entrepreneurs, and climate finance suggests more room for strategy development. Compared to a year earlier, in late 2021 a greater share of financial institutions indicated that COVID-19 led to increased focus on the development of lending programs to reach certain priority segments and objectives. For the financial institutions, 45 percent cited lending to MSMEs as a growing priority area and 36 percent signaled more support for women-owned enterprises, possibly reflecting greater readiness and ambition by lenders to target these segments as soon the uncertainty abates. Finally, 42 percent cited an increasing focus on developing climate or green finance programs, confirming the growing awareness and readiness of the financial sector of the role it can play in supporting a sustainable economic recovery.

BOX 1 Market Demand for External Support

Three out of four lenders prioritize access to medium- to long-term financing to support their operations and strategy, preferably in local currency. Working capital financing is a top priority for 47 percent of respondents, followed by capital investments (equity and subordinated debt) at 44 percent. Credit enhancements for target client segments, such as guarantees and first-loss, are indicated as a priority by 36 percent of respondents, while only 16 percent indicated interest in NPL purchasing programs at the end of 2021.

Demand for advisory services and technical assistance for digital transformation was raised by 69 percent of respondents, with the highest share of respondents seeking external support for the development of data analytics and automated credit scoring capabilities (45 percent), the development of digital channels (30 percent), and the digitalization of internal processes (27 percent). Risk management is identified as the next area of support by 25 percent of respondents, followed by green and climate finance (22 percent).

CONCLUSION

The COVID-19 pandemic inflicted significant damage to financial institutions across emerging and developing economies. Yet reports from IFC client financial institutions draw a picture of a resilient sector capable of maintaining liquidity despite a deep and prolonged drop in loan collections and several months of subdued lending and operations. While lending has returned to pre-crisis levels on average, institutions face significant challenges in lending to riskier segments such as low-income households and MSMEs, and in several cases maintain more conservative credit standards compared to pre-pandemic levels because of heightened risk, reduced visibility into borrower viability, and limited recourse in case of default. Firm-level research confirms that smaller firms were disproportionally affected by the crisis and remain more vulnerable. MSMEs benefitted less from policy support compared to larger firms and were relatively less able to adjust to the crisis by digitalizing their operations.[15] Access to finance for these businesses will be essential for their ability to take part in the economic recovery.

The effects of the crisis on portfolio quality have continued to unfold with significant variance across regions and country income levels, with institutions in low- and lower middle-income markets disproportionally impacted by the crisis in 2020 and continuing to lag at the end of 2021. As of this writing, while moratoria on loan repayments were lifted for most respondents by the end of 2021, the growth of nonperforming loans appears to have remained within range. Possible improvement: By the end of 2021, financial institutions did not expect the materialization of 'hidden debts' following the scale-back of regulatory forbearance. Most respondents expected the impacts of the crisis on nonperforming loans to have peaked in 2020–2021, maintaining a positive outlook on portfolios for 2022.

Despite the positive outlook depicted by the survey data, the recently published *World Development Report 2022: Finance for an Equitable Recovery* concludes that the resilience of financial institutions and economies may again be tested as policy support is scaled back. Furthermore, mounting inflationary pressures, developed economy central bank policy normalizations, rising exposure of financial institutions to sovereign risk, a potentially weakening macroeconomic climate, persistent challenges with global value chains, and war in Ukraine are casting more clouds on the outlook of the financial sector and its central role in supporting the economic recovery.[16]

---

1 This report was prepared with guidance from Dan Goldblum and under the leadership of Issa Faye. The authors would like to thank the management and staff of IFC's portfolio financial institutions for their contribution to the surveys, as well as the many IFC Financial Institutions Group colleagues that contributed to this research. In particular we would like to acknowledge inputs and support from: Paulo De Bolle, Andres Felipe Gomez, Martin Holtmann, Vladimir Hrkac, Etleva Koka, Mehmet Mumcuoglu, Alain Nounke, Joon Young Park, Matthew Saal, Eugenia Vargas, Laura Vecvagare, and Matt Benjamin.

2 World Bank (2022), World Development Report 2022: Finance for an Equitable Recovery.

3 Ibid.

4 Haider et al. (2021), The Early Impact of Covid-19 on Financial Institutions, IFC.

5 Dong E, Du H, Gardner L. An interactive web-based dashboard to track COVID-19 in real-time. Lancet Inf Dis. 20(5):533-534. DOI: 10.1016/S1473-3099(20)30120-1

6 World Bank (2022), Global Economic Prospects, January 2022.

7 Cirera et al. (2021), Firm Recovery during COVID-19: Six Stylized Facts.

8 Debt—including senior loans, sub-debt, and bonds—accounts on average for more than two-thirds of overall funding for MFIs and NBFIs in the sample.

9 World Bank Database, COVID-19 Finance Sector Related Policy Responses. https://datacatalog.worldbank.org/search/dataset/0037999

10 Ibid.

11 Cirera et al. (2021), Firm Recovery during COVID-19: Six Stylized Facts.

12 For example, relaxation of reporting requirements, capital buffers, liquidity requirements, foreign currency reserves, caps on loan-to-value ratios.

13 World Bank, 2022, World Development Report 2022: Finance for an Equitable Recovery.

14 IMF (2022), World Economic Outlook April 2022: War sets back the global recovery.

15 Cirera et al. (2021), Firm Recovery during COVID-19: Six Stylized Facts.

16 IMF (2022), World Economic Outlook April 2022: War sets back the global recovery.