
POTENTIAL SYSTEMIC RISK EFFECTS OF CREDIT RELAXATION IN THE FINANCIAL INDUSTRY AS THE EFFECT THE COVID-19

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Abstract : The granting of credit relaxation has caused polemics in the early days of the spread of COVID-19 in Indonesia. As a result of the spread of COVID-19, several industrial sectors have experienced unworkable conditions. Companies in this industry are not able to pay off their financial obligations to the Banking or Financing Company. The government asked financial industry players to provide credit relaxation. This was conveyed by the government, however, without being included with fixed procedures and direct communication with business players. In addition to this relaxation, there is a systemic risk. This research is in the form of qualitative research. This research focuses on the effect of credit relaxation on the finance and banking industries. This research proposes that the government determines the overall policy. Businesses, finance companies, and banks focus on the implementation procedures controlled by the Financial Services Authority. The government needs to take a more aggressive and comprehensive policy towards relaxation policies so that this relaxation policy can be carried out correctly to support the economy of small and medium enterprises again. If this policy is not comprehensive, it is feared that it will create higher new risks to the financial sector and the national economy.

Keywords : COVID-19; Credit relaxation; Economics; Pandemic; Systemic risk

Introduction

The COVID-19 pandemic has vast implications on the economy. The policy to reduce the transmission of the coronavirus has forced the government to take several policies that are also related to economic activities. Policies such as staying at home, keeping distance, studying at home to large-scale social restrictions have reduced economic activity. McKibbin and Fernando (2020) stated that the outbreak of coronavirus named COVID-19 has disrupted the Chinese economy and is spreading globally. The evolution of the disease and its economic impact is highly uncertain, which makes it difficult for policymakers to formulate an appropriate macroeconomic policy response.

As the number of Covid-19 cases grew, households began to radically alter their typical spending across some significant categories. Initially, spending increased sharply, particularly in retail, credit card spending, and food items. This was followed by a sharp decrease in overall spending. Households responded most strongly in states with shelter-in-place orders in place by March 29th, 2020. Higher levels of social distancing are associated with drops in spending, particularly in restaurants and retail. (Baker et al., 2020)

President Joko Widodo has also asked the Bank and Financing Company to provide credit relaxation to medium and small enterprises affected by Covid-19. The President asked to provide relief in installments for 12 months. The Financial Services Authority (OJK) has also issued a regulation on the Financial Services Authority (POJK) No 11 / POJK.03 / 2020, which states that the mechanism of credit restructuring to the Bank. The regional government has also issued the same statement to the public so that finance companies will provide credit relaxation.

An economy can move if there is a flow of funds that drives the economic or financial system. The function that channels the flow of funds is carried out by financial institutions. Financial institutions in the form of banks, finance companies, insurance, securities, venture capital, and others. Relations between financial institutions have interrelated relationships. The problems that financial company experiences affect other financial companies. This relationship is called the systemic effect. Betz et al. (2016) provide evidence on how banking sector fragmentation and sovereign-bank linkages evolved over the European sovereign debt crisis, and how they are reflected in estimated network statistics and systemic risk measures.

In December 2019, the number of finance companies in Indonesia totaled 246 companies with total assets of 625 Trillion IDR. Funding obtained was 442 Trillion IDR, with most significant contribution coming from the banking industry. Banks control directly, through ownership of 37.39% shares. Finance companies finance 21 productive sectors and two consumptive sectors, including households. Financing companies spread in 34 provinces with financing contracts totaling 22,414,360 customers as of December 2018.

Banks contribute to the financing of finance companies by 71%. The remaining 29% consists of capital market loans in the form of bonds, medium term-notes, and others. If finance companies have obstacles in returning loans to banks, banks will also experience difficulties in returning public savings. If this happens, then the financial industry might have systemic risks.

If systemic risk happens in the financial industry, the government will rescue it. The financial industry plays an essential role in a country's economy. Financial services play an essential role in modern free-market economies. Therefore, governments often do not have a choice but to provide support to failing financial institutions in order to protect the broader economy. (Brunnermeier and Cheridito, 2019).

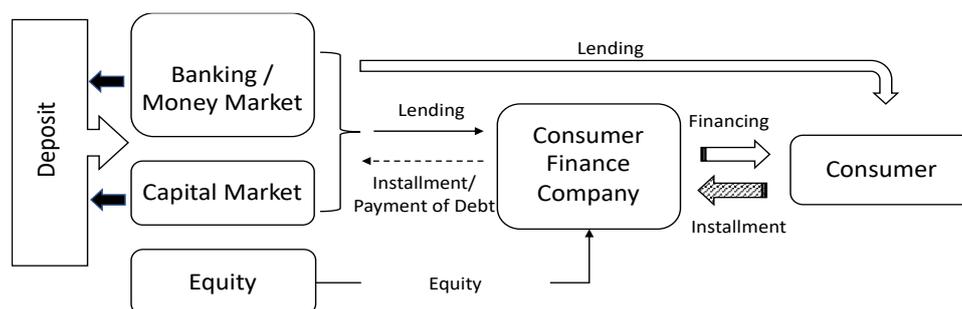


Fig 1. Funding industry funding mechanism

This can be seen in Figure 1, where public funds are stored in banks or invested in the capital market, then the funds are lent to the finance company industry. The finance company industry issues bonds in the capital market or issues medium term-notes to investors. After obtaining funds, the finance company provides financing to consumers in order to purchase goods or services. In general, those goods are motorized vehicles or heavy equipment.

Literature review

According to Zhao et al. (2017), the risk spillover from the diversified financial industry and insurance industry to other financial industries is greater than their commitment to China. In the financial crisis and "crash" period, the systemic risk contribution, and the risk-taking of financial institutions are greater than the sample mean, especially during the financial crisis. The risk spillover between each financial industry, and the financial system is positive and asymmetry. The order of systemic risk contribution from big to small is banking, insurance, securities, real estate, and multiple financial.

Barrios and Hochberg (2020) found that political partisanship may play a role in determining risk perceptions in a pandemic, with potentially significant externalities for public health outcomes. Relying solely on compliance with voluntary suggested measures in the

presence of different political views on the crisis may have limited effectiveness; instead, enforcement may be required to successfully flatten the curve.

Systemic risk arises when shocks lead to states where a disruption in financial intermediation adversely affects the economy and feeds back into further disrupting financial intermediation. (He and Krishnamurthy, 2019). Acharya et al. (2016) investigated the role of leverage (measured as the ratio of assets to common equity) in determining the systemic risk of firms. Even though deposits are in principle demandable and thus, short-term too, the presence of deposit insurance meant that commercial banks with access to insured deposits were fact, relatively stable in the crisis. It seems important, therefore, to empirically understand how short-term leverage contributes to market-based measures of systemic risk of financial firms.

Nagy et al. (2016) stated that the authorities and financial supervisors recognized, following the financial and economic crises, that the process of identification of systemic risks should receive more attention. The research obtained the composite indicator with the aggregation of five market-specific subindices created from individual financial stress measures (foreign exchange market, bond market, equity market, money market, and banking sector). The systemic nature of stress is captured by the time-varying correlations between market segments.

The COVID-19 crisis spread rapidly throughout the world last week. They were combined with a Saudi Arabia vs. Russia oil-price war, plus travel bans, this has led stock markets to their worst day since 1987, and valuations are now 30% (or more) below their previous highs. A global recession now seems inevitable. However, how deep and long the downturn will be depending on the success of measures taken to prevent the spread of COVID-19, the effects of government policies to alleviate liquidity problems in SMEs, to support families under financial distress, and to secure jobs. It also depends upon how companies react and how long the current lockdowns will last. (Fernandes, 2020).

Based on the background above, this study has the following research problems:

- a. What is the effect of loan relaxation on the finance company industry?
- b. What must be done to anticipate systemic financial risks?
- c. How to implement credit relaxation?

Research method

This type of research used in this study is a type of qualitative research. The type of data used in this study is primary data obtained directly from the field as the main source. Primary data is then supported by secondary data obtained by examining the literature material in the form of primary legal materials, secondary legal materials, and tertiary legal materials. Data collection techniques are done through observation and interview techniques. Data analysis was carried out qualitatively, that is, an analysis describing the state or status of phenomena with words or sentences, then separated according to their categories to reach conclusions. Conclusions are drawn inductively, namely by describing everything in detail and ending with data or general facts as the core problem. (Lie et al., 2019).

Results and Discussion

4.1 The effects of credit relaxation on the financing company industry

Provision of credit relaxation by finance companies needs to be included with the same policies for the upstream industry. The primary source of funding for finance companies comes from banks. Finance companies provide relaxation, but debt to banks still has to be paid. Then, the finance company will have difficulty in funding.

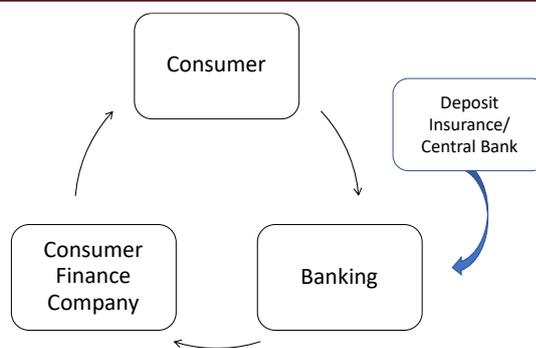


Fig 2. Relationship of the banking triangle, financing, and society

However, if relaxation is provided by a finance company, and banks provide it to a finance company, then banks also need the same policy towards their creditors, the people who deposit their money in banks. If there is no government policy towards the people who save their money, banks will experience liquidity problems, if the public withdraws significant amounts of funds. The triangle of society, banking, and financing is illustrated in Figure 2.

If the government wants to provide relaxation, then the government needs to do it, starting from the upstream industry. Where the government can go through the policies of the Financial Services Authority, Bank Indonesia, Ministry of Finance, and the Indonesian Deposit Insurance Corporation. Relaxation policies must be comprehensive policies and incorporate systemic risks into this policy.

The Ministry of Finance needs to determine the value of guarantees at the Deposit Insurance Corporation (LPS) as in the Century Bank case or the 2008 Global Crisis. If the Ministry of Finance can provide guarantees and support LPS policies, the public will feel calm and confident about the government.

Bank Indonesia and the Ministry of Finance as The Lender of the Last Resort, need to convince banking players that the government supports banking, if there is an unwanted event so that the banks will be able to make decisions in giving the credit relaxation. When banks dare to provide credit relaxation, then finance companies that obtain funds from banks will also give credit relaxation to their customers. If the customer is trusted, and can delay the payment of installments, then the customer will be able to focus more on his business. By focusing on its business, the economy will begin recover again. Thus, in the aggregate the economy will be able to move.

In addition, banks and finance companies will revive the economy by being able to extend credit or financing to sectors that have prospects so that certain sectors of the economy can move again.

Thus, the relaxation of credit by banks and financing needs to be legalized by a comprehensive policy from the government and involving many decision makers. Credit relaxation cannot be done by the finance company itself or by the banking industry itself.

4.2 Anticipating systemic financial risks

If relaxation is provided without a comprehensive policy, there is a potential for systemic risk. If there is a finance or banking company that provides significant amounts of relaxation, then this relaxation will put a burden on the company's revenue. In addition to expenses, relaxation will also affect the company's cash flow.

If the finance or banking company, is considered default due to this relaxation, thereby affecting its ability to pay its obligations, then it can cause systemic effects. If there is one finance or banking company that gets the implication, then it will give effect to banks and banks will give effect to other banks.

This will continue until the public becomes distrustful of the financial industry. People will rush their funds in banks by withdrawing them. With the rush happening, banks will

experience liquidity problems. If one finance company experiences this, then a group of finance companies or the finance industry will be considered to have the same potential. The same thing will happen to banks.

If one bank is considered to suffer from liquidity difficulties, then there is the potential for a whole industry liquidity problem to occur. This was experienced by Indonesian banks in 1998 and almost experienced in 2008.

The government needs to take a comprehensive policy in relaxing credit. Decision making that is not comprehensive, will have broad implications on the economy. Credit relaxation policies can have worse implications for the economy, if the policies are not carried out thoroughly and systemically.

4.3 Implementing credit relaxation

Credit relaxation can be done with several schemes, namely:

- a. Provide a longer financing tenure so that the number of liabilities becomes smaller.
- b. Reduce the number of obligations or installments to be smaller for some time, for example for 3 to 12 months during the recovery of a pandemic.
- c. Not applying for any installments for a while, for example during the large-scale social restrictions period, because the business does not work, so there is no funds. This type is usually mentioned by Grace Period. However, they type will also extend the installment tenure.

Banks or finance companies need to verify individual and small and medium enterprises' customers before agreeing to provide relaxation. Financial companies also need to determine the standardization of approval.

Standardization of approval covers which industry will be given what policy and for how long. This standardization will depend on the conditions in each region and the business conditions of each customer. The COVID-19 incident did not occur in Indonesia at the same time and there were no national policies like the lockdown policy in Italy. Almost all countries in the world choose local policies that differ depending on the conditions of the spread of COVID-19. So that banks and finance companies in Indonesia also cannot provide policies that apply nationwide.

Table 1

Industry and types of relaxation

Industry	Type of Relaxation
Tourism industry (hospitality)	Installments are given Grace Period, if there are no other sources of income. Installments with a minimum amount, if there are other sources of income.
Culinary Industry	Lower installments for large-scale social restrictions or Pandemic
Intercity Transportation Industry	Installments are given Grace Period with certain tenures
Automotive Industry (workshop, spare parts and others)	Installments are given Grace Period with certain tenures

Relaxation programs will also differ from one customer to another. The business of one customer will be different from the business of other customers. The location of the business and also the speed at which the business runs normally again will differ between customers so that the relaxation program cannot be comprehensive even in the same area. This is explained in Table 1 regarding the types of industries and types of relaxation that are given.

The relaxation program is highly dependent on the conditions of the spread of COVID-19, the existing conditions of the economy, the condition of the customer's cash flow, the

condition of the existing credit tenure, and also the different characters of the customers so that relaxation is not as easy as saying that it could be 12 months do not need to make installment payments.

Application for the credit relaxation will also be different in each area. Application can be done online or offline. Application can be done online if the customer has the internet to fill out the relaxation submission form and sign in from their mobile phones. If there is none, then the customer must print a letter or form for credit relaxation, then scan it and download it again to be sent. Access to school children to learn online is still experiencing obstacles in several cities in Indonesia. The credit relaxation application will also experience obstacles.

Therefore, it would be nice, if the government focuses on a comprehensive policy and for fixed procedures in the credit relaxation can be done by the businesses controlled by the Financial Services Authority. Thus, each party will focus on their respective duties and responsibilities.

Conclusion

The credit relaxation given to the people affected by COVID-19 must be a comprehensive policy in other sectors. This policy is in order not to cause systemic effects on the financial industry. In providing relaxation, financial institutions need to do detailed verification from one customer to another. This is caused by different customer conditions. The credit relaxation policy cannot apply nationally and cannot generalize all customers. The government should focus on macro and overall policies. Sectoral policies are left to industry players and controlled by the relevant authorities.

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