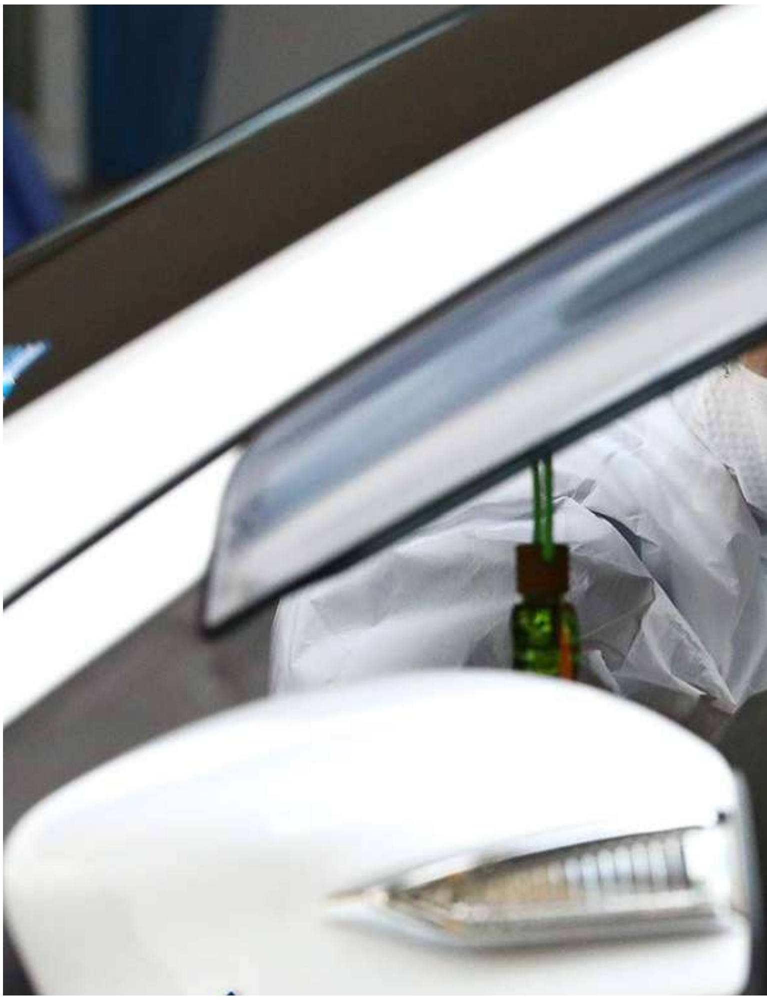
The Impact of COVID-19 on Islamic Finance:

IN THE MIDST OF EVERY CRISIS, **LIES GREAT OPPORTUNITY**

By Assoc. Prof. Dr. Aishath Muneeza
INCEIF

COVID-19 is a pandemic that has overturned the world including the whole mankind. Never in the wildest dreams, one would have anticipated that a health crisis would lead to a multi-dimensional crisis where trade and transportation activities has been stopped; creating domino effect where many have become jobless overnight and is stuck at home unable to find alternatives to ease their personal situation. It is not only the individuals who were affected, but starting from small businesses to big giant corporations, COVID-19 has hit hard. As a result, there is no way individuals or private sector could survive unless and until the government saves them by providing a helping hand. The helping hand extended by the government costs a lot to them as there is no way to receive revenue during the time of unprecedented pandemic and it is being forced to find alternative source of funding to save themselves from getting into a fiscal deficit crisis.



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The hurricane effect of COVID-19 is unique to each country depending on the political, social and economic situation of the country. For countries relying on oil trade and tourism to earn revenue, it is described as a dual shock and this is the situation in all GCC countries as the price of oil has fell to their lowest levels in 17 years (Strategy&, 2020). Since it is a health crisis, the allocation of money to health sector to purchase COVID-19 test kits, medicines required to treat patients and increase in the number of ventilators. To control the pandemic from spreading, countries have adopted lock down approach where movement of people except for essential needs are introducing resulting in companies to close down and suffer loss resulting in terminating the employees.

Even the self-employed like taxi drivers are unable to operate business resulting in loss of income. The panic created in this situation increased demand for food stuffs spiking up the prices for some goods based on demand and supply. Some individuals and corporations did not have enough savings or savings at all to last this unprecedented pandemic resulting in situations where they did not have money in hand to buy food nor pay bills or rent or loans/financing facilities or financial commitments.

The only one to bail out individuals and corporations in this lack of cash flow and liquidity crisis the government. As a result, not only the policies of the government have been shaped to satisfy the needs of its citizens; but some governments have been distributing food to the population.

Photo: Universiti Malaysia Sarawak

For instance, in Afghanistan, it was reported that on 29th April 2020, the government started providing free bread to about 2.5 million needy and poor people in Kabul, and plan to extend to other cities (IMF, 2020).

COVID-19 has brought unprecedented policy responses by countries of the world by changing fiscal policies such as providing relief packages or stimulus packages by postponing or reducing taxes, monetary and macro-financial policies such as reducing minimum reserve requirements and providing moratoriums for loans/ financial facilities granted by financial institutions, and exchange rate and balance of payment policies such as by providing flexibility to exercise floating exchange rates (IMF, 2020).

For instance, in Malaysia, it is said that the country had not only been in shock due to COVID-19 alone; but the sharp reduction in the oil prices also has created shockwaves in the country (IMF, 2020). A Movement Control Order (MCO) was introduced closing non-essential businesses, schools, universities banning all public gatherings since 18th March 2020. The MCO has been extended with variations and on 4th May 2020, the authorities allowed opening most businesses though 7 states out of 14 chose to delay this. As a fiscal response: on 27th February 2020, a fiscal stimulus package of RM 6 billion (0.4 percent of GDP) was approved including increased health spending; temporary tax and social security relief; cash transfers to affected sectors;

and rural infrastructure spending and additional measures such as electricity discounts and temporary pay leave for RM 0.62 billion (less than 0.1 percent of GDP) were announced on 16th March 2020; some investment spending planned for 2020 is being frontloaded; a second stimulus package of RM 25 billion (1.7 percent of GDP) was released on 27th March 2020, including additional health spending; cash transfers to low income households; wage subsidies to help employers retain workers; and infrastructure spending in East Malaysia; the government also setup a RM 50 billion fund for working capital loan guarantees for all COVID-19 affected businesses; employees will be allowed special withdrawals from their Employment Provident Fund (EPF) account for a 12-month period and businesses will be allowed to reschedule their EPF payments.; and on 6th April 2020, the authorities announced a third stimulus package of RM 10 billion (0.7 percent of GDP), including grants for micro SMEs, scaled-up wage subsidies, and a 25 percent discount on foreign workers' fee (IMF, 2020). As a monetary and macro-financial response: on 3rd March 2020, Bank Negara Malaysia (BNM) lowered the Overnight Policy Rate (OPR) by 25 basis points to 2.50 percent, citing market disruptions, greater risk aversion and financial market volatility, and tighter financial conditions due to COVID-19; on 5th May 2020, the BNM lowered the OPR again to 2 percent, citing weakening global economic conditions and subdued inflationary pressures; BNM lowered the Statutory Reserve Requirement (SRR) Ratio by 100 basis points to 2 percent effective March 20; on 5th May 2020, the BNM announced that banking institutions can use MGS and MGII to fully meet the SRR compliance until May 2021; on 27th March 2020, BNM increased its Financing Facilities by RM4 billion to RM13.1 billion (0.9 percent of GDP); on 25th March 2020, BNM announced temporary easing of regulatory and supervisory compliance on banks to help support loan deferment and restructuring; BNM also announced relief measures for insurance policy holders and takaful participants; on 23rd March 2020, the Securities Commission Malaysia (SC) and Bursa Malaysia suspended short-selling until April 30; on 28th April 2020, the suspension was extended through 30th June 2020; SC also waived annual licensing fees for capital market licensed entities; on 16th April 2020, SC announced regulatory relief measures for public listed companies; and on 10th April 2020, the Companies Commission of Malaysia announced measures to enhance protection of distressed companies against liquidation (IMF, 2020). There is no notice published for change of exchange rate and balance of payment (IMF, 2020).

Against this backdrop, this article highlights the opportunities COVID-19 has created for Islamic finance from an optimistic perspective. Below discussed are five significant opportunities in this regard.

- **Opportunity # 1- Islamic Finance can be Compatible with Technology**

  Before COVID-19, Islamic finance has been criticized for being backward as complex processes and multiple layers of documents are required to execute even a single transaction consuming time and requiring labor to eliminate errors and perfect the transactions. As a result, when compared with conventional finance transactions, Islamic finance has been considered as a slow mover and having virtual Islamic finance transactions and merging it with technology was thought to be impractical.

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The reason for the existence of this view is due to the fact that money is not used as a commodity in Islamic finance and it is structures based on the sale or lease of an underlying asset or providing a shariah compliant service by charging a fee or by forming a partnership without guaranteeing profit where the profit generated shall be directly linked to a shariah compliant real economic activity. Not only this, but Fintech has also been viewed as a threat to Islamic finance industry (Raghu, 2017). At the midst of COVID-19, the opportunity to "experience" Islamic finance transactions virtually has been provided and as a result it has been practically understood that using innovation even Islamic finance has the flexibility of merging it with technology and offering virtual products and services.

- **Opportunity # 2- Islamic Social Finance is the Champion to Rise from Crisis**

  With COVID-19, modes of Islamic social finance have begun to be relevant more than ever. As the result, the opportunity feels the just wealth redistributive system in Islam has received the limelight and how the system helps to rise from crisis has forced to believe in humanitarian agencies the practical strength and benefit of the system. For instance, UNDP has published an article on "Islamic finance takes on COVID-19" in their official website where Rahman (2020) has expressed that zakat could be used as an emergency short term support; the impact investing and financing of equipment, vehicles, and other sources of livelihood and trade finance via Islamic finance institutions can support recovery; and SDG-aligned sukuk and waqf can be used for long term recovery and resilience from COVID-19.

- **Opportunity # 3- Islamic Finance Really Shares Risk**

  Since the institutionalization of Islamic finance, it has been always criticized for replicating conventional finance and practically it does not share risk. However, COVID-19 has provided the opportunity to truly feel this difference. For instance, the sukuk yet to mature which has been issued before COVID-19 that is structured on equity based contracts does not automatically get defaulted if the sukuk holders are not paid due to loss in the economic activity that is supposed to generate return. The sukuk in this case will be saved as the sukuk issuer and the sukuk holders are supposed to share risk in profit and loss as per the nature of the shariah compliant equity contract they enter into. However, if it was a conventional bond, no matter what, mere lapse in payment of return on the due date will legally tantamount to a default. Therefore, in this regard, COVID-19 has provided the chance to know the differences in different commercial contracts used in Islamic finance and the effect of it.

- **Opportunity # 4- Islamic Finance does not have Compound Interest Effect**

  Islamic finance has been said to be an exact replica of conventional finance. "Apple to apple" comparison between Islamic finance and conventional finance is made and said that Islamic finance is different only in textbooks and in practice, it is one and the same forgetting that if one is an apple, the other is an orange which simply means that it cannot be compared side by side. As a monetary and macro-financial measure, some countries have granted moratorium for conventional loans and Islamic financing facilities granted to the economically affected customers. In this situation, the conventional financial institutions can charge interest for the extension of time granted; but Islamic finance products cannot charge anything extra than what has been stipulated as the price as the contract whether it is a fixed or floating price mechanism which is followed. This shows that Islamic finance is not just a mere change of name and it is definitely a system that delivers what it promises and it does not take advantage of one's helpless situation to make money.

- **Opportunity # 5- Islamic Finance is a Mercy to Mankind providing Human Financing**

  COVID-19 has provided with the opportunity to understand and appreciate the rational of Islamic principles applicable to Islamic finance and how fair and equitable the maqasid al shariah approach adopted in it is. Islamic commercial modes of financing operate with a view of making profit while at times in need there is always opportunity to switch to Islamic social finance mechanisms to seek appropriate help. For years, Islamic finance has been blamed for making profit without distinguishing Islamic commercial finance with Islamic social finance. Islamic financial institutions were "expected" to be social financial institutions where it was thought that it is not Islamic to charge profit and it was blamed for only catering for rich and wealthy neglecting the needs of poor and needy. With COVID-19, the distinction between Islamic commercial finance and Islamic social finance has become vivid and the equitable nature of Islamic finance as a mercy to mankind has been understood.

For instance, Qatar Islamic Bank is providing interest free loans to private companies under the National Guarantee Program funds of QAR 3 billion ($815,000) (IMF, 2020) to ease those affected to rise from COVID-19 economic situation. This initiative shows that commercial financial institutions can switch to offer social services in unprecedented situations.

It is evident from above discussion that Islamic finance is a resilient system that has untapped potential that could be deployed even at times of crisis like unprecedented COVID-19. It is anticipated that with these on-going developments in Islamic finance due to COVID-19, there will be a growth in virtual use of Islamic financial products and services; the crypto asset market will flourish; sukuk will be digitized; and different modes of Islamic social finance will be institutionalized with international humanitarian agencies and technology will be merged to enhance the collection and out-reach of recipients.

Despite the disruptions caused by COVID-19, it is reported that sukuk issuance is set to remain stable at around $180 billion this year (Moody's, 2020). Furthermore, the leadership role of Islamic Development Bank (IsDB) to assist sovereigns to fight against COVID-19 providing not only assistance, but via Islamic financing facilities is also praiseworthy. In this regard, for example, on 9th April 2020, IsDB was reported to provide $35 million to Sudan (IMF, 2020). IsDB also announced that as part of the US$ 2.3 Billion Package, IsDB Provides US$ 1.86 Billion to 27 Member Countries to Contain COVID-19 (IsDB, 2020). There is no doubt that COVID-19 has provided the opportunity to do stress-testing and so far, the result shown is very promising and it indicates that Islamic finance is here to stay with a brighter tomorrow.

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