

# CAREC INSTITUTE RESEARCH CONFERENCE

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## Session Two

Regional Integration and Macroeconomic Dynamics Beyond COVID-19  
Pandemic

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## Abstract:

The COVID-19 pandemic produced many different challenges for the economy and financial stability of many countries and Pakistan is no different. The wide-natured and quick policy response of Pakistan's central bank with measures such as monetary easing, facilitating new investment, macro-prudential relief, loan extension and restructuring package, salary & wages financing, support to health sector and promotion of digital payments etc. not only provided pivotal liquidity support to small businesses and the wider economy but also enhanced resilience of the banking system. This confidence is reflected in the steady improvement in performance of the banking system and its impacts are also being carried over to the broader economy. The response of Pakistan's central bank to the COVID-19 crisis provides a good policy blueprint to developing economies for any future crises of this nature.

# IMPACT OF COVID-19 PANDEMIC ON PAKISTAN & CENTRAL BANK RESPONSE

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(State Bank of Pakistan)

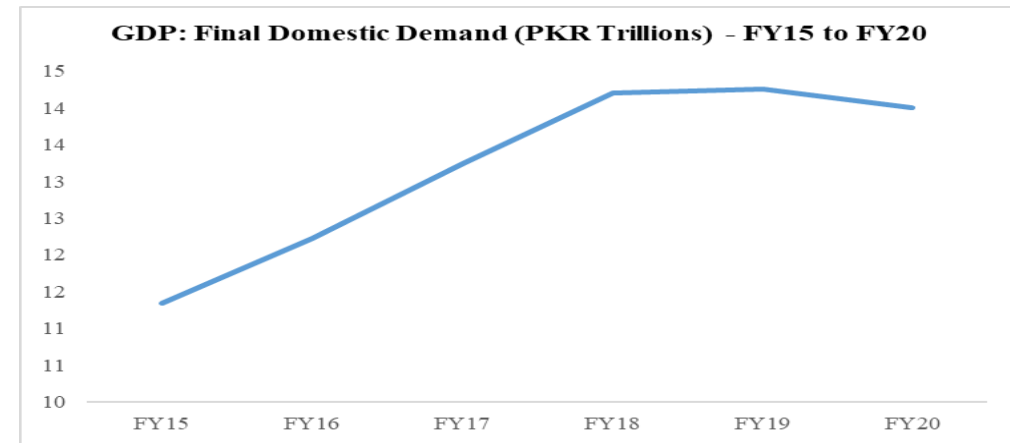
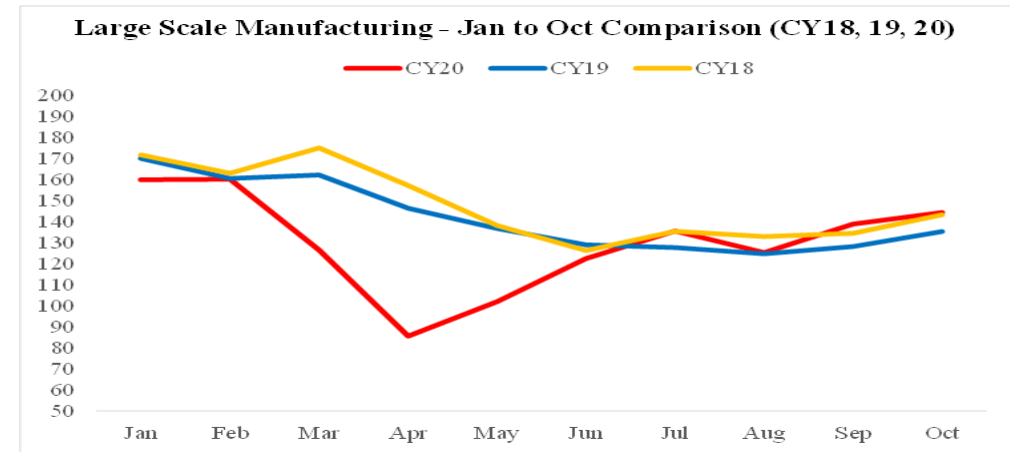
\* All views expressed are of the author and may not be considered official policy of SBP

# LITERATURE REVIEW

- Eichenbaum, Rebelo & Trabandt, 2020: COVID-19 both supply and demand shock. Both effects work together, to generate large, persistent recession.
- Fornaro & Wolf (2020): propose monetary easing, aggressive fiscal interventions.
- Gourinchas (2020): argues for strict public health measures despite recessionary impact
- Wali ullah (2020): firms in Pakistan operating at less than 50% of normal capacities (March-April, 2020). Aggregate demand declined more than 2008.
- Qazi Masood (2020): credit channel most effective channel for monetary policy transmission; works best setting targets for allocation of credit in each sector.
- Caballero & Simsek (2021): LSAP policies can be highly effective.
- Cochrane (2020): targeted bailouts for firms/ consumers in absence of pandemic insurance.
- Thorsten Beck (2020): banks can provide support for struggling firms in case of a temporary disruption to supply chains or a mild-demand side shock resulting in delay in consumption
- Cechetti & Schoenholtz (2020): most effective mechanism to arrest financial contagion driven by solvency concerns is an extraordinary disclosure mechanism.

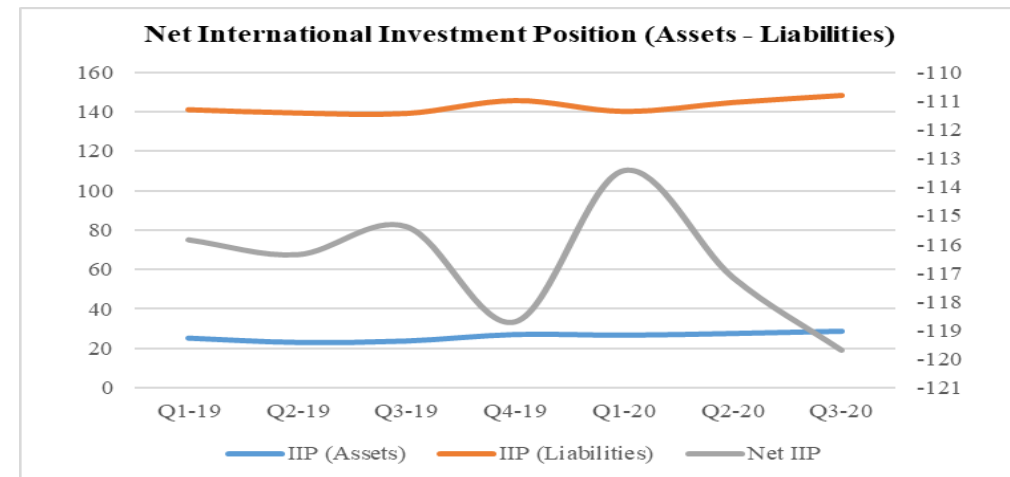
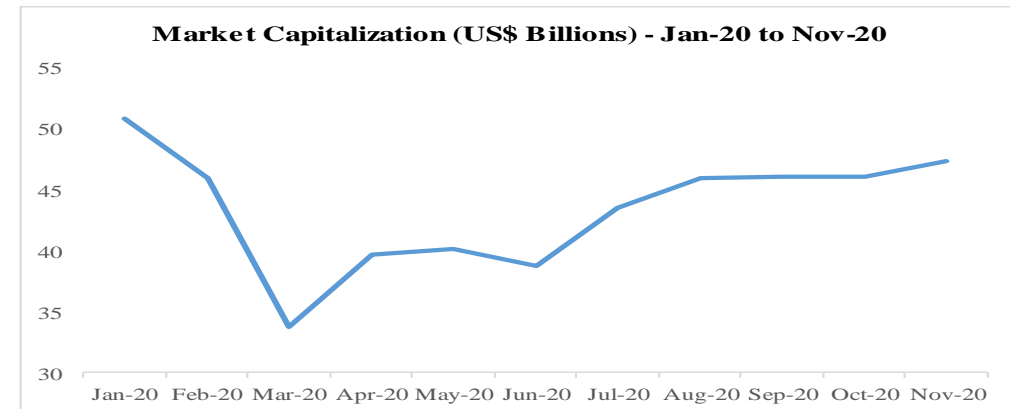
# COVID-19 SHOCK

- Shutdown of large scale manufacturing, textiles, construction, automobile, transportation, leather & allied goods
- Drastic reduction in aggregate demand for goods & services
- Telecommunication and pharmaceutical sector boomed
- Government ensured supply chain of food and other essential items remained intact.



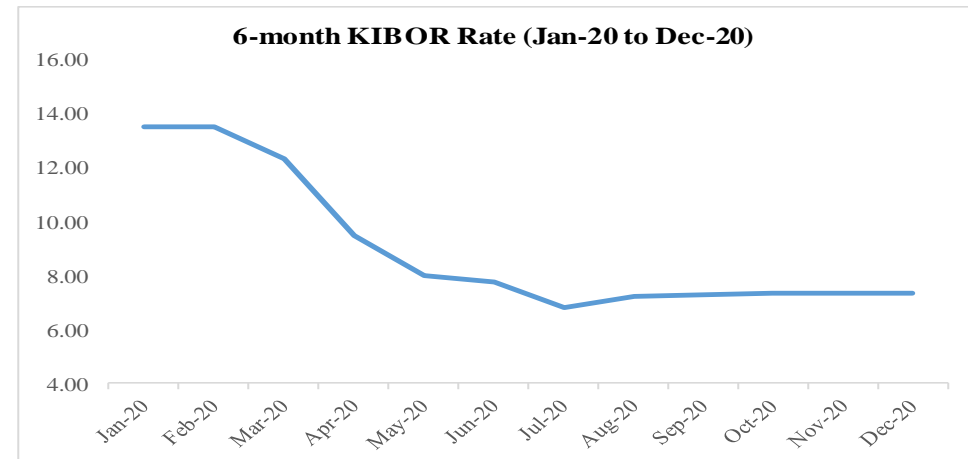
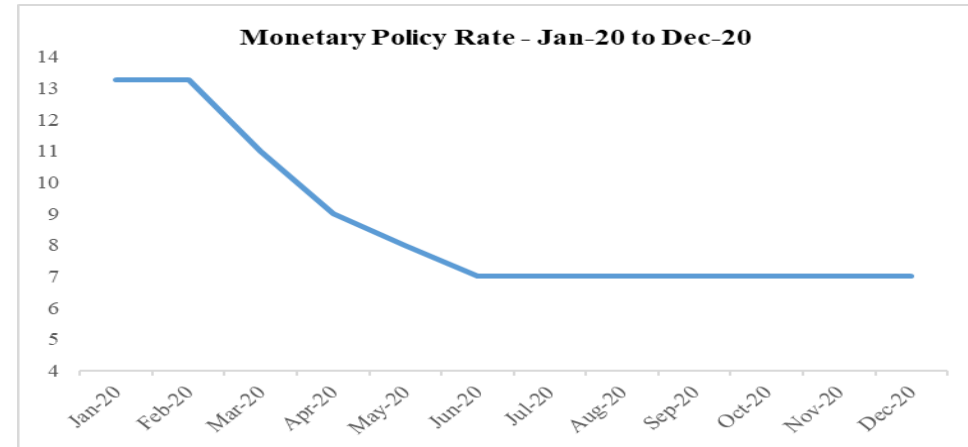
# COVID-19 SHOCK

- Pakistan Stock Exchange (PSX) witnessed 30% overall decline (31-Jan-20: 41,630 points to 29,231 points/; 31-Mar-20)
- Market cap reduced from US\$ 50.8 billion (Jan-20) to US\$33.8 billion (Mar-20)
- Foreign investors also rushed to safer avenues as net International Investment Position (IIP) deteriorated during the first 6 months of CY20



# MONETARY EASING

- Monetary Policy rate cut from 13.25% (Feb-2020) to 7% (June-2020)
- Other market interest rates followed suit (Overnight Call Money Rate, KIBOR etc.)
- Rate cuts improved liquidity of banks and eased day-to-day operations.
- Latest Monetary Policy Statement (Jan-2021): “... In the absence of unforeseen developments, the MPC expects monetary policy settings to remain unchanged in the near term.”



# TERF & MACROPRUDENTIAL POLICY MEASURES

## ➤ Temporary Economic Refinance Facility:

- SBP launched TERF aimed at boosting new investment, expansion of existing projects and BMR.
- Banks / DFIs can provide financing to all sectors under this facility except power sector where SBP is already providing financing through another facility.
- Tenor of the loan is 10 years; grace period: 2 years.
- As of January 28, 2021, PKR 374.3 billion worth of loans approved under TERF.

## ➤ MACROPRUDENTIAL POLICY MEASURES:

- SBP announced certain relaxations (Basel Capital Adequacy measures): 1% reduction in Capital Conservation Buffer (CCB) from 2.5% to 1.5% and enhancement of regulatory limit of retail portfolio from PKR 125 million to PKR 180 million.
- Reduction in CCB created space for banks to lend an additional amount of PKR 800 billion (equivalent to 10% of their current outstanding loans in March 2020).
- Enhancement of retail portfolio limit (allowing banks to increase funding to SMEs from PKR 125 million to PKR 180 million).



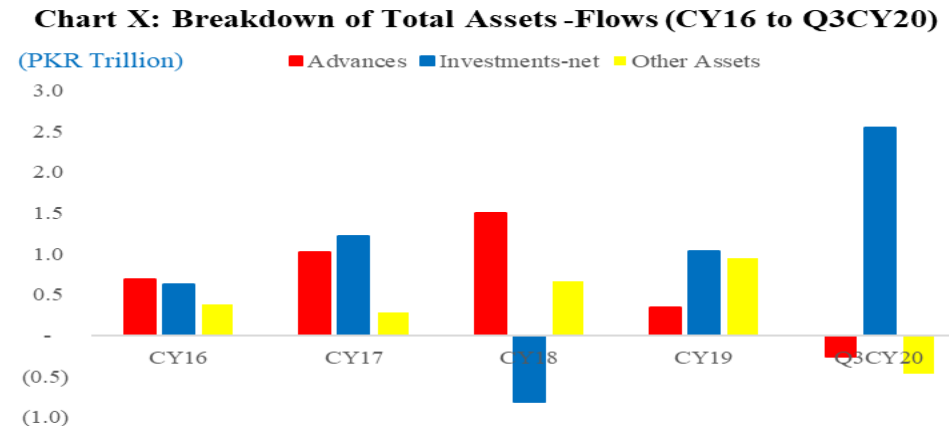
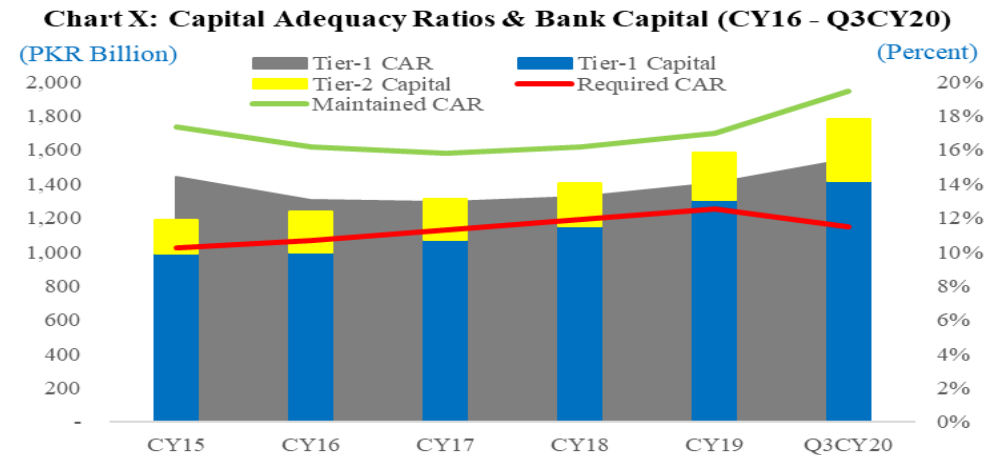
# LOAN RESTRUCTURING & OTHER MEASURES

- Banks allowed to defer principal repayment of loans for up to one year.
- Borrowers unable to service mark-up or requiring deferment beyond one year may have loans rescheduled / restructured
- As on Feb 12, 2021 loans deferred (PKR 657 billion) loans restructured (PKR 234 billion).
- **SBP Employment Scheme:** The central bank also announced a scheme to prevent layoff of workers by the private sector by financing wages and salaries of their employees
- **Refinance Facility for Combating COVID-19:** Under this facility, SBP will refinance banks to provide financing of up to PKR 500 million
- **Promoting Digital Payments:** SBP waived bank charges for online fund transfers for all banks, introduced Direct Cheque Deposit Facility which provided an opportunity to customers to avail fund transfer facility through SBP operated RTGS.



# PAKISTAN BANKING SECTOR POSITION POST COVID-19 SHOCK

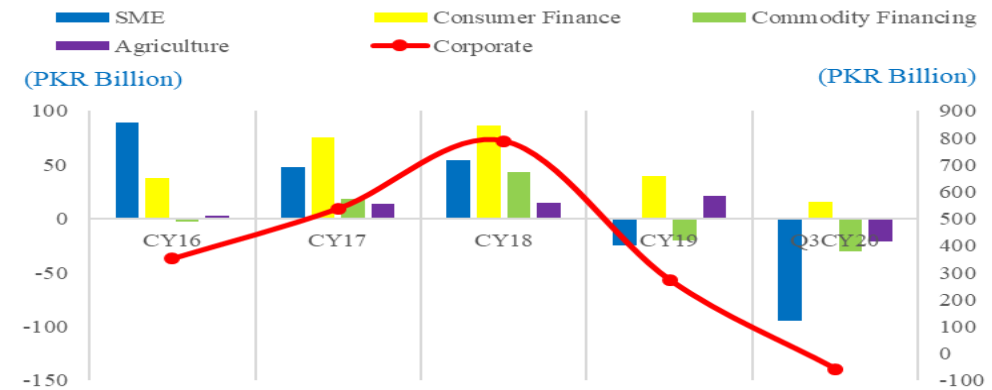
- SBP reduced CCB thereby reducing minimum CAR for banks from 12.5% to 11.5%
- As a result, CAR of banking system increased from 17% (Dec-19) to 19.5% (Sep-20)
- COVID-19 lockdowns in March, 2020 lead banks to consolidate their balance sheets (drastic increase in investment in govt. bonds; advances further lowered)
- Banks have opted for investment in zero-risk govt. bonds by reducing advances to weak borrowers



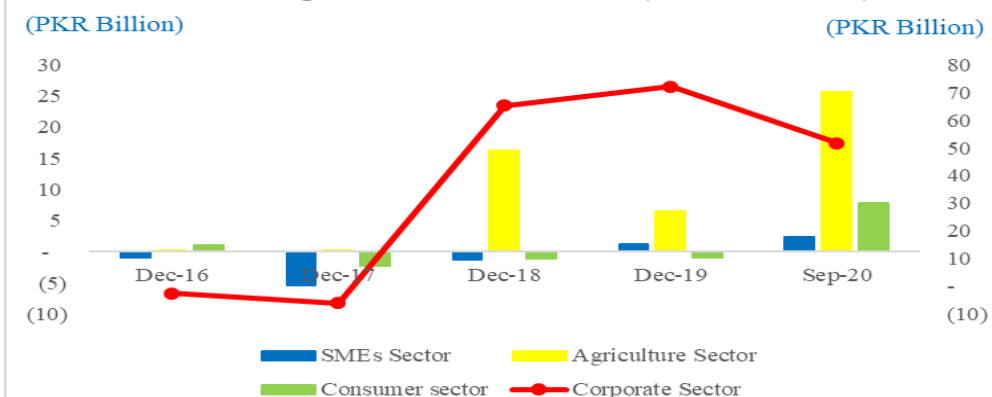
# PAKISTAN BANKING SECTOR POSITION POST COVID-19 SHOCK

- Net flow of advances to Corporate sector has been negative in CY20 i.e. borrowing to Corporate lower than CY19
- Net flow of advances for SME, Agri has been negative while Consumer is slightly positive
- Ratio of NPLs to total loans in CY20 is still low because of SBP's aggressive COVID-19 policy package to provide relief to businesses.

**Chart X: Segment-wise Flow of Advances (CY16 - Q3CY20)**



**Chart X: Segment-wise Flow of NPLs (CY16 - Q3CY20)**



# CONCLUSION

- The banking and financial system of Pakistan led by the central bank has shown a lot of resilience in meeting financial needs of the economy during COVID-19 crisis.
- The range of policy responses adopted by the central bank along with swift implementation of policy provided confidence to commercial banks, financial markets and the wider economy, that the government and central bank are ready to meet the challenges in this difficult situation.
- This confidence is reflected in the steady improvement in performance of the banking system and its impacts are also being carried over to the wider economy.
- The response of Pakistan's central bank to the COVID-19 crisis provides a good policy blueprint to developing economies for any future crises of this nature.