PERSPECTIVES

A quick note on SBP announcement

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The State Bank of Pakistan (SBP) announces three measures in its monetary policy statements to address the economic and recent health challenges in the backdrop of spread of COVID-19. First, cut its policy rate by 75 basis points. Second, announced a “Temporary Economic Refinance Facility (TERF)” to encourage new investment in manufacturing. Third, announced a “Refinance Facility for Combating COVID-19 (RFCC)” to support hospitals and medical centres in combating the spread of COVID-19.

The cut in policy rate was expected due to four important domestic and international reasons. First, the recent deceleration in domestic food prices owing to the arrival of domestic supplies of food commodities. Second, a significant decline in consumer price expectations based of expectation surveys of SBP. Third, a sharp fall in global oil prices. Fourth, last but not the least, the slowdown in external and domestic demand due to the coronavirus pandemic.

Therefore, lowering the policy rate was inevitable but there is a discussion on the size of
The current cut in policy rate is minimal as compared to the other regional economies th
announced their monetary policy decisions recently (see Table 1). Therefore, a major ch
of private sector investor was expecting a much more aggressive response from the SBI

The average of percentage change of all cuts is around 30 percent (see table 1). Therefore, one may argue that the SBP should give a cut of 400 basis points, which is 30 percent of 13.25. However, the current SBP decision is very conservative due to uncertain situation domestic and globally.

Table 1: The Interest rate change in the recent monetary policies (mostly March 2020)

Country	Previous Policy Rate	Current Policy Rate	Cut in Policy Rate	Percentage change
Australia	0.75	0.50	0.25	33.33
Hong Kong	1.50	0.90	0.60	40.00
Indonesia	5.00	4.75	0.25	5.00
Malaysia	3.00	2.50	0.50	16.67
New Zealand	1.00	0.25	0.75	75.00
Philippines	4.00	3.75	0.25	6.25
South Korea	1.25	0.75	0.50	40.00
Thailand	1.25	1.00	0.25	20.00
Average	—	—	—	29.53
Pakistan	13.25	12.50	0.75	5.66

> *It is important to disseminate the message that the SBP is standing ready for mitigating the risk of the coronavirus pandemic*

SBP ismanaging the monetary policy amid fiscal rigidities and (in)stability of external accounts. For example, the portfolio investment (hot money) flows have become uncertain in the backdrop of interest rate risk and currency risk. Similarly, the worker remittances will get a sizeable dip due to lower economic activities globally. In nutshell, the external account will remain vulnerable in coming days. Furthermore, the magnitude of the damage of Covid-19 is not clear.

However, the initial projections and anecdotal analyses show that the domestic demand, domestic supply and economic growth will be lower in FY 20. Therefore, the SBP announces that it"stood ready to take further actions if and when needed as more information becomes available on the outlook for inflation and growth." The sketchy analysis suggests that the time is not too far. We may expect 100 to 150 basis points in the next policy review(s). However, it is overwhelmingly dependent on the trajectory of external accounts in the coming weeks.

The second important thing is TERF to new investment in manufacturing. Under this scheme, the SBP will refinance banks to provide financing at a maximum end-user rate of 7 percent for 10 years for setting up of new industrial units. This scheme is available for the next one year; that is, the letter of credit must be opened by the end of March 2021. Apparently, it is out-of-box thinking but seems to have been done in hurry in apanic situation. It will create more confusion and uncertainty, at least, for one year.

The existing industrial units are getting finance at around 13 percent and new industrial units are offered 7 percent. Then how is it possible that the existing units get finance on a higher rate?Furthermore, it is a long-term policy. At this crucial point of time, the economy needs short term impetus. Therefore, the SBP should think and disseminate in a clearer way.

The SBP and government must move proactively to mitigate the damage towards the economy.It is important to disseminate the message that the SBP is standing ready for mitigating the risk of the coronavirus pandemic. Several steps can be taken. For example, lower the interest rates by 300 to 400 bps. Make a clearer and a short-term policy for financing to industrial units, both for the existing and new industrial units. Immediately, rethink the tax policy and the documentation policy to avoid the stoppage of transactions in the economy.

Furthermore, the government should immediately approach the International Monetary Fundfor its share in the recently created "concessionary funding pool" and to adjust targets of the extended facility programme. Indeed, all these steps are not easy, but a proactive approach will give confidence to the economic agents of the country.

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