



External Relations Department

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SBP introduces incentive and penalty mechanism for banks to promote housing and construction financing

Building upon its earlier measure of setting mandatory target for banks to extend mortgage loans and financing for developers and builders, State Bank of Pakistan (SBP) has introduced a mechanism to incentivize meeting these targets. The mechanism also penalizes the banks for any shortfall in meeting the target.

According to this mechanism, commencing from December 31, 2020, banks will find an incentive of maintaining reduced Cash Reserve Requirement (CRR) with SBP, in the next quarter, in case they achieve or exceed the target of financing for housing and construction of buildings set for the quarter. The amount of CRR to be maintained for the forthcoming quarter will be reduced by an amount equal to increase in housing and construction finance from 30th June 2020 to the end of the relevant quarter. This incentive, however, will be subject to a ceiling of 1 percent of the total demand and time liabilities based on which CRR is calculated. Further, the banks shall continue to maintain daily minimum CRR, which is currently at 3 percent.

Conversely, if the banks fail to meet the target, they will be penalized by requiring to maintain extra CRR by an amount equal to the shortage from the target. It would be pertinent to mention here that banks do not earn any return on the amount of CRR maintained. Therefore, a decrease in amount of CRR works as an incentive for banks, whereas an increase in amount of CRR serves as a penalty for banks. Further details of the incentive mechanism are provided in the circular issued to banks and available at: <https://www.sbp.org.pk/dmmd/2020/CL3.htm>

SBP has been actively working with banks to support finance for the promotion of housing and construction of building activities in the country. The growth of the housing and construction sector is vital for the economy, due to its linkages with a number of allied industries and potential for jobs creation and Pakistan has lower private sector credit to GDP than many comparable countries. In order to enhance the flow of financing towards this sector, SBP has required banks to achieve mandatory targets, equivalent to 5 percent of their domestic private sector credit by December 31, 2021, to finance the housing and construction activities. Accordingly, quarterly targets from December 31, 2020 till December 31, 2021 have been agreed with the banks.

SBP expects that this incentive mechanism, through changes in the CRR structure, will result in banks increasing their emphasis on housing and construction finance.
