**ERD/M&PRD/PR/01/2020-59** **June 15, 2020**

# Financial Stability Review CY-19 suggests resilience of the banking sector to the COVID-19 pandemic

The State Bank of Pakistan (SBP) has issued its flagship annual publication, the Financial Stability Review (FSR) for CY19. The Review presents performance and risk assessment of various segments of the financial sector including banks, non-banking financial institutions, financial markets, non-financial corporates and financial market infrastructures.

The FSR notes that the outbreak of COVID-19, the trigger for the Global Health Crisis (GHC), has had significant consequences for the global and domestic economy. As elsewhere, the dismal impact of COVID-19 on Pakistan is still unfolding. The country, after imposing lockdowns, has moved towards easing some of the restrictions, amid rising levels of infection. This should help provide support to economic activity.

In order to limit risks and facilitate stakeholders, SBP has taken a host of policy measures. These measures include substantial monetary easing, release of capital buffers, deferment of the repayment of principal loan amount for corporate, SMEs, and household borrowers, restructuring/rescheduling of loans, concessionary financing to save jobs and boost health care to combat COVID-19, ensuring availability and continuity of financial services, and reduction in payment system related costs. These measures have started bearing results as banks have approved debt deferment of around PKR 495 billion and rescheduling/restructuring of PKR 70 billion to around seven hundred thousand borrowers. Under the refinance scheme to avoid layoffs, around PKR 93 billion have been approved for 1172 companies covering about eight hundred and fifty thousand employees. A complete list of the measures taken so far and the outcomes are available on SBP's website (http://www.sbp.org.pk/corona.asp).

Going forward, the pace and extent of global and domestic economic revival are inextricably tied to the trajectory of Covid-19. Against this backdrop, SBP is keeping a close watch on developments and stands ready to take all policy actions in its domain to safeguard the economic and financial stability.

Overall, it is encouraging that the strong capital buffers built over the years have significantly enhanced the resilience of Pakistan's banking sector. Stress tests conducted in the FSR suggests that the banking sector should remain resilient to the Covid-19 shock under most reasonable shock scenarios, reflecting the strong capital and liquidity positions of the majority of banks as discussed below.

In terms of performance last year, the FSR suggests that after some strains due to sluggish growth during the early part of the year, financial sector stability started to improve towards the end of CY19. Owing to necessary stabilization measures, macroeconomic vulnerabilities emanating from Pakistan's external and fiscal imbalances along with the uncertainty prevailing amongst market participants began to recede by year-end. There were early signs of an economic revival as foreign exchange reserves increased, the market-based exchange rate stabilized, the fiscal deficit contracted, and economic activity, particularly the Large Scale Manufacturing, revived. Due to better sentiment, both local and foreign investors started taking positions in the equity and bond markets of the country. As macroeconomic stress declined, the stability of the financial sector improved.

The consolidated asset base of the financial sector expanded by 11.74 percent during CY19; higher than the 7.46 percent growth recorded in the previous year. The major contribution in this growth came from the banking sector, the largest segment of the financial sector. Financial markets—after remaining volatile in the first half of CY19—observed stability in the second half as operations in the foreign exchange market smoothed after the transition to a market-based exchange rate system. The equity market also showed a significant recovery towards the end of CY19, after having been quite volatile earlier in the year.

A key highlight of the FSR is that the banking sector has remained resilient, with robust solvency backed by healthy profitability. The Capital Adequacy Ratio (CAR) improved to 17 percent, well above global and domestic minimum regulatory requirements of 10.5 percent and 11.5 percent, respectively. Earnings of the banking sector surged by 14.3 percent to PKR 170 billion in CY19, a turn around after the contraction of the previous few years. The higher interest income of the sector improved the Net Interest Margin (NIM) to 4 percent, a 60 bps rise over the last year. Accordingly, profitability indicators like the return on assets and equity also increased. While demand for financing weakened—amid sluggish economic conditions—bank assets expanded by 11.73 percent in CY19, primarily, due to a surge in investment in treasury instruments. Though asset quality saw some deterioration, most of the Non-Performing Loans (NPLs) continued to be fully provisioned. Encouragingly, the deposit base also exhibited a marked recovery, expanding by 11.92 percent, and provided the resources to support asset growth.

The FSR suggests that the performance of the Islamic Banking Institutions (IBIs) also remained remarkable during CY19. Not only did their assets surge by 23.52 percent but their profitability also increased, bolstering the overall earnings of the banking sector. Nevertheless, healthy inflow into their deposits further complicated the liquidity deployment challenges for the IBIs as they continued to face limited Sharia-compliant investment opportunities.

The FSR observes that the performance of the Non-Bank Financial sector as well as Non-Financial Corporate sector also remained stable during the year under review. Further, the Financial Market Infrastructures efficiently and effectively handled a growing volume and value of electronic and paper based transactions.

The FSR is accessible at SBP website at: http://www.sbp.org.pk/FSR/2019/index.htm

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