Box 1: COVID-19 Pandemic and the Policy Response

(a) Global Perspective

The Coronavirus (**COVID-19**) outbreak that began in Wuhan, China at the end of 2019, spread across the globe within months. Given its alarming level of infection and severity, World Health Organization (**WHO**) declared it as a pandemic on Mar 11, 2020.[24] Until May 29, 2020, it has penetrated into more than 200 countries, infecting 5,724,342 persons and causing 359,151 deaths worldwide.[25] USA, Brazil, Russia, and U.K. have remained the most affected countries in terms of infection, while USA has experienced the biggest death toll so far.[26]

The speed of infection and the non-availability of a cure has resulted in rising numbers of fatalities across the globe and has instilled fear among the 7.8 billion inhabitants of the world. Consequently, from social norms and movement of people to consumer preferences and availability of goods and services, COVID-19 has affected all aspects of human life. To contain the outbreak, on the recommendations of WHO, authorities have introduced strict social distancing rules and various degrees of restrictions on mobility. The necessary quarantines and social distancing practices to contain the pandemic across the globe have resulted in a Great Lockdown, bringing large segments of the global economy to a complete halt and putting basic societal functions on hold.

In this environment of anxiety and uncertainty, industry after industry is facing dim prospects. With the sharp decline in passenger traffic and cancellation of flights, the travel industry is under severe stress. Similarly, the suspension of mass gatherings and events (such as sports, religious, academic, and entertainment) is adversely affecting not only the relevant industries but all its horizontal and vertical linkages as well. Academia has moved from physical classroom based learning to virtual classes. According to the United Nations Educational, Scientific and Cultural Organization (**UNESCO**), over 156 countries have implemented nationwide closures, affecting over 70 percent of the world's student population.[27] This may result in loss of human capital and diminished economic opportunities.[28] With the rising intensity of the disease, offices and factories were initially shuttered, though restriction are being eased more recently.

The global health crisis (**GHC**) due to COVID-19 outbreak is thus influencing the world economy through supply, demand, and financial channels. On the one hand, aggregate supply has shrunk as the containment efforts (such as restricted mobility and plant closures) intensified, resulting in severe disruptions in supply chains and international trade. On the other hand, aggregate demand has also waned as firms' investment stutter and consumer spending decline because of increased precautionary behavior and restricted mobility.[29] This combination of supply and demand disruptions, caused by the GHC, is likely to dent the cash flows of the corporate sector, which may lead to higher NPLs and pose financial stability concerns.

The available data illustrates the adverse impact of COVID-19 on the Chinese economy. Industrial production in China declined by 13 percent in the first two months of 2020—the largest contraction

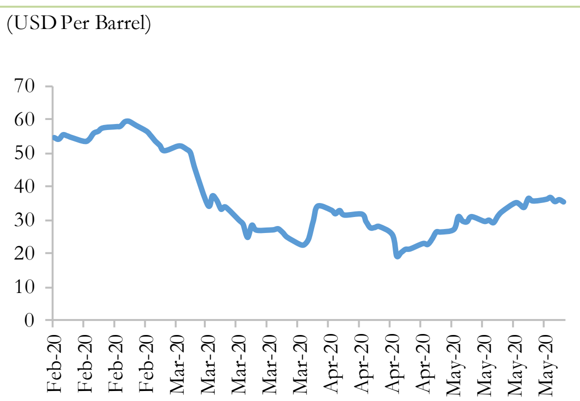
[24] https://www.who.int/dg/speeches/detail/who-director-general-s-opening-remarks-at-the-media-briefing-on-covid-19---11-march-2020
[25] World Health Organization
[26] Ibid
[27] As of May 18, 2020
Source:https://en.unesco.org/themes/education-emergencies/coronavirus-school-closures
[28] https://blogs.worldbank.org/education/managing-impact-covid-19-education-systems-around-world-how-countries-are-preparing
[29] Consumer contact industries are most likely to be affected such as Traveling and Tourism.

on record.[30] The services sector contracted by 13.5 percent during the same period. Marked slowdown in retail sales and automobiles sales of 20.5 percent and 80 percent, respectively, is a candid manifestation of ebbing demand. Moreover, exports were down by 17.2 percent during Jan-Feb 2020, reflecting disruption in supply chains as well as abating external demand.

In the USA, jobless claims have exceeded 6.6 million in the final week of Mar-2020 as compared to 280,000 two weeks earlier. Also, a survey of purchasing managers indexes reveal that the USA, euro area and Japan have experienced a major dip in economic activity during Mar-2020.[31]

As the infection spread, economic activity in China and the rest of the world slackened, and travelling and transportation slowed down, the demand for oil fell that has brought the oil prices down by 30.07 percent[32] (**Chart B1.1**) and turned the oil futures into negative territory. Also, from mid Jan to end Mar-2020, base metal and natural gas prices have fallen by 15 percent and 38 percent, respectively. According to International Air Transport Association (IATA), global air carriers could suffer 55 percent decline in revenue in 2020.

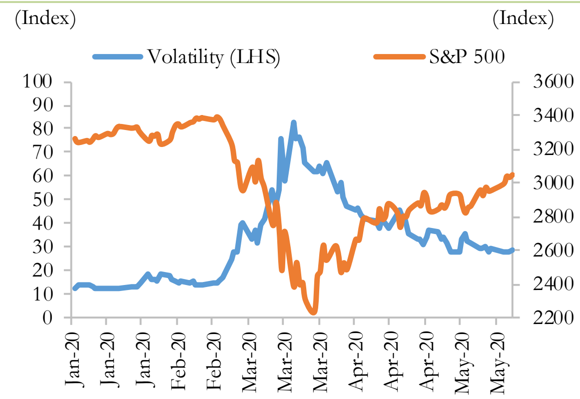
Chart B1.1: Brent Crude Oil Prices



Source: Bloomberg; oilprice.com

In response to the GHC, global financial markets have experienced notable anxiety. Amid diminished risk appetite and flight to safety, global investors have retreated and massive sell-offs have been witnessed in financial markets worldwide. S&P 500 index, for example, fell by 28.66 percent since end Dec-2019 to Mar 20, 2020 and its volatility increased significantly. However, it recovered later on (**Chart B1.2**). As a result of investors' rush to safe assets[33] amid intensifying virus fears, government bond yields of safe haven countries have moved downward. Concurrently, massive capital outflows of USD 100 billion from emerging markets since the start of the GHC is another evidence of the shifting risk sentiment of investors.[34]

Chart B1.2: S&P 500 equity index and its volatility



Source: Fedral Reserve Bank of St.Louis

Looking ahead, global economic activity in 2020 is likely to contract. The IMF predicts a contraction of 3 percent for the global economy in 2020 – the worst economic downturn since the Great

[30] Financial Times (Mar 21, 2020). Chinese economy suffers record blow from coronavirus.
[31] IMF(2020). World Economic Outlook. April
[32] From end February to May 29, 2020

[33] In times of crisis, investors tend to pile into government bonds for their apparent safety.
[34] IMF (2020). Global Financial Stability Report. *April*

Depression.[35] Further, UN's trade and development agency (**UNCTAD**) suggests that the spike in uncertainty owing to the outbreak is likely to cost USD 1 trillion to the global economy in 2020.[36] The costly impact of COVID-19 is also evident from the fact that it has wiped out USD 50 billion of global exports in Feb-2020 alone.[37] The impact of lost tourism revenues, falling remittances and travel and other restrictions linked to the coronavirus pandemic are expected to leave about 130 million more people hungry in CY20, in addition to 135 million already in that category.[38]

The heightened downside risks to economic growth emanating from this hybrid demand-supply-financial shock has prompted international institutions to enact aggressive policy measures in order to shield the global economy from the COVID-19 outbreak. The IMF announced financing of USD 50 billion for EMDEs. Of this, USD 10 billion is available at zero interest for the poorest members through the Rapid Credit Facility.[39] Moreover, the IMF has approved debt service relief for 25 low-income countries through a reformed Catastrophe Containment and Relief Trust (**CCRT**), and has established a new instrument – the Short-Term Liquidity Line – to provide quick-disbursing financing to strengthen buffers and help in managing liquidity pressures for countries with strong economic policies.[40]

Similarly, the World Bank has made USD 14 billion fast track financing available to its members to respond to the global coronavirus. Moreover, the World Bank will deploy up to USD 160 billion over 15 months to protect the poor and vulnerable, support businesses, and bolster economic recovery. The initial response to COVID-19 pandemic from ADB amounts to USD 6.5 billion[41], with an additional USD 13.5 billion to respond to COVID-19 outbreak.[42] Moreover, the Basel Committee on Banking Supervision (**BCBS**)—on Mar 20, 2020—suspended consultation on all policy initiatives and postponed all outstanding jurisdictional assessments planned in 2020 under its Regulatory Consistency Assessment Program.[43] To give further support to the global financial system, BCBS has taken a number of policy measures including amendment in regulatory capital treatment of Expected Credit Loss (**ECL**) accounting, deferment of the final two implementation phases of the framework for margin requirements by one year, and postponement of the implementation of the revised G-SIB framework by one year.[44]

Besides the multilateral responses to the crisis, central banks and the governments across the globe have also taken various potent policy measures. These include cutting interest rates, providing liquidity to the market, supporting SMEs and relaxing macroprudential policy levers etc. (**Annexure A**). An analysis of 54 countries indicates that most of them have enacted macroprudential polices to fight the repercussions of COVID-19 outbreak, while quite a few deployed policies directly targeting households

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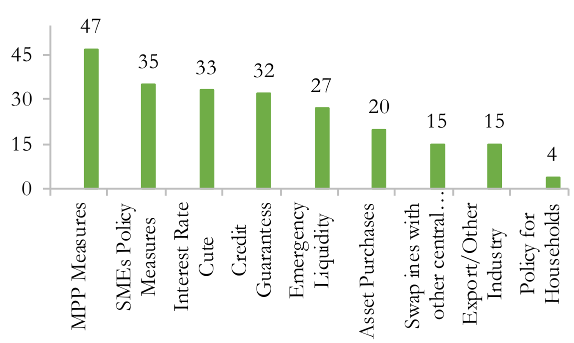
35 https://blogs.imf.org/2020/04/14/the-great-lockdown-worst-economic-downturn-since-the-great-depression/
36 https://news.un.org/en/story/2020/03/1059011
37 Source: United Nations
38 http://www.fightfoodcrises.net/fileadmin/user_upload/fightfoodcrises/doc/Global_Network_Flyer_EN.pdf
39 https://www.imf.org/en/News/Articles/2020/03/04/sp030420-imf-makes-available-50-billion-to-help-address-coronavirus
40 https://www.imf.org/en/News/Articles/2020/04/21/pr20177-imf-managing-director-heads-rfa-readiness-cooperate-mitigate-impact-covid-19-global-economy
41 https://www.adb.org/news/adb-announces-6-5-billion-initial-response-covid-19-pandemic
42 https://www.adb.org/news/videos/adb-president-masatsugu-asakawa-announces-covid-19-response-package-triple-20-billion
43 https://www.bis.org/press/p200320.htm
44 https://www.bis.org/press/p200403.htm

(**Chart B1.3**).

Chart B1.3: Number of countries that have developed various policies to contain Covid-19 risks



Source: Yale University

Among the central banks, the Federal Reserve has not only cut its federal funds rate by 150 basis points[45] but has also introduced a number of liquidity measures including the purchase of Treasury Bills (worth USD 500 billion) and mortgage backed securities (worth USD 200 billion) over the coming months. Moreover, the Federal Reserve—in order to ensure sufficient US dollar liquidity around the world—has announced swap line arrangements with the central banks in Europe, Japan, U.K, and Canada.

Other central banks such as the Bank of England and Hong Kong Monetary Authority –besides reducing interest rates—have relaxed countercyclical buffers. The People's Bank of China has taken several policy measures to support the economy including interest rate cuts, injecting 400 billion yuan into the banking system, lowering reserve ratios, and approving delayed repayments to qualified SMEs. The ECB has moved to contain the risks from COVID-19 by introducing a combination of liquidity and macroprudential policy measures. For instance, it has provided liquidity to the euro area financial system via additional long-term refinancing operations (**LTROs**) along with allowing banks to operate temporarily below the level of capital defined by the Pillar 2 Guidance (**P2G**), the capital conservation buffer (**CCB**) and the liquidity coverage ratio (**LCR**).

Besides aiding the financial system, various countries have taken a number of policy measures to ease SME finance and liquidity constraints. These include

- Temporary tax relief such as deferral of tax payments (e.g. Australia, Belgium, France), tax cuts, and tax credits (Italy).
- Opening up the Disaster Relief Loan Program (US).
- Direct financial support to SMEs, such as new credits granted by public investment banks (France).
- Zero-interest loans with no collateral (Japan).
- Sectoral support, especially for the tourism industry (e.g. Australia, Chile, Italy).
- New public guarantees (Austria, Japan, Korea),
- Account receivable insurance (Korea)

(b) Domestic Perspective

In Pakistan, Covid-19 has infected 66,457 persons, causing 1,395 deaths as of May 29, 2020.[46] Heightened global risk aversion has led to portfolio investment outflows of USD 2.8 billion since end February 2020, causing a depreciation of 5.90 percent in the PKR.[47] Also, the equity market is down by 10.67 percent since end February-2020.[48] Going forward, the partial lockdown in the country and intensification in health care issues are likely to drive down domestic economic activity.

Survey on "Impact of Corona Virus on the Banking Industry" (March 2020)

SBP conducted an "Impact of Corona Virus on Banking Industry" survey in March 2020 to gauge

[45] by end Feb 2020 to April 29,2020
[46] http://covid.gov.pk/stats/pakistan
[47] Until May 29, 2020.
[48] Until May 29,2020

the perceptions and views about the risk arising for the banking industry in the virus hit environment. The target respondents for this survey included 52 financial institutions.[49] The responses were received from 49 financial institutions.

The survey captured the respondent's general views about the implications of the outbreak of COVID-19 for the banking sector and the economy, as well as possible preventive measures to safeguard against adverse financial implications. The detailed responses involved information about the banking sector exposure, implications for profitability, and their views about key economic sectors most likely to be affected by the spread of Covid-19. Further, assuming the worst-case scenario, respondents were asked about their Business Continuity Plans (**BCP**) including availability of alternative delivery channels. The survey results showed that:

1. Most respondents were concerned about the adverse implications of the corona virus outbreak for the economy and the banking sector of Pakistan. **(Chart B1.4)**
2. The key economic sectors most likely to be affected by the pandemic include electronics, textile and travel-tourism & transport (**Chart B1.5**).
3. Most of the banks foresaw a limited impact on profitability in H1CY20 but a stronger impact for the whole year in case the episode prolongs.
4. Majority of the banks have put in place effective plans to counter any contingencies, to ensure uninterrupted provision of financial services.

Chart B1.4: Extent of concern that Corona Virus may adversely impact the:

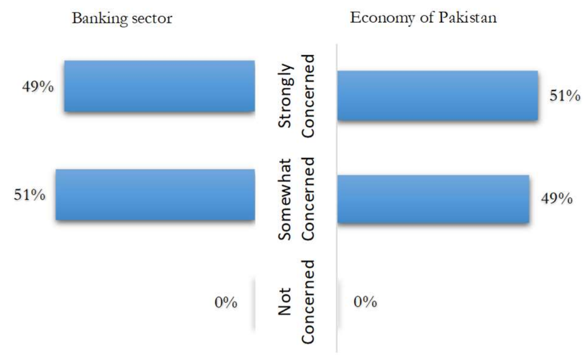
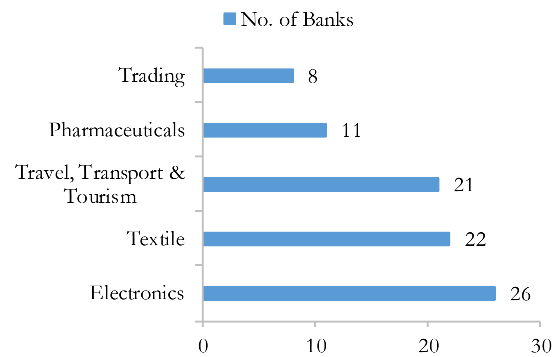


Chart B1.5: Affected Sectors Ranked by Bank



SBP's policy response to counter COVID-19

In response, the SBP has adopted the following comprehensive set of policy measures to limit the risks of the COVID-19 outbreak:

a) Monetary Easing

SBP reduced policy rate by 75 basis points to 12.50 percent on Mar 17, 2020.[50] In the wake of increased risk to growth and anticipated sharp slowdown in domestic demand amid COVID-19 outbreak in Pakistan, SBP moved to reduce policy rate by another 150 basis points to 11 percent on Mar 24, 2020.[51] The policy rate was further reduced by 200 basis points and 100 basis points on April 16, 2020 and May 15, 2020, respectively.

[49] Including 32 commercial banks, 9 Development Finance institutions (**DFIs**) and 11 Micro Finance Banks (**MFBs**).
[50] http://www.sbp.org.pk/m_policy/2020/MPS-Mar-2020-Eng.pdf
[51] http://www.sbp.org.pk/m_policy/2020/MPS-Mar-24--03-2020-Eng.pdf

In aggregate, SBP has cut the policy rate by a cumulative 525 bps within a span of two months.

b) Macroprudential Policy Measures

To allow the banking sector to supply additional loans to businesses and households, SBP has reduced the Capital Conservation Buffer (**CCB**) from its existing level of 2.50% to 1.50%. This will enable banks to lend an additional amount of around PKR 800 billion, an amount equivalent to about 10% of their current outstanding loans.[52]

Further the existing regulatory retail portfolio limit of PKR. 125 million for treatment as SME under the Basel capital requirements has been enhanced to PKR 180 million.[53]

Also, the SBP has relaxed the margin requirement [from 30 percent to 20 percent] and margin calls [from 30 percent to 10 percent] for exposure against shares of listed companies due to prevailing volatility on the Pakistan Stock Exchange. Moreover, SBP has relaxed the criteria for classification of Trade Bills by six months.[54]

In addition, SBP has instructed banks/DFIs to defer the repayment of principal loan amount for households and businesses (microfinance, SMEs, corporates, commercial, retail, and agriculture) upon written request by borrower(s) by one year.[55,56, 57,58 ,59] Also, SBP has relaxed the regulatory criteria for restructuring/rescheduling of loans for borrowers whose financial conditions require relief beyond extension of principal repayment for one year. For consumer financing, SBP has also relaxed the Debt Burden Ratio (**DBR**) for consumer loans from 50% to 60%.[60]

In terms of data received from banks up till May 29, 2020, various segments of borrowers have availed deferment relief to the tune of PKR 495 billion and rescheduling/ restructuring of PKR 71 billion.

c) Support for the Health Sector

SBP has announced cheap loans for hospitals and medical centers through "Refinance Facility for Combating COVID-19" (**RFCC**). Under this policy, the SBP will refinance banks to provide financing of up to PKR 500 million at a maximum end-user rate of 3 percent for 5 years for the purchase of equipment to detect, contain and treat the Coronavirus.[61] [62] Further, banks are allowed to use RFCC to finance up to 100 percent of the cost of entire civil works for setting up of isolation wards.[63] Also, SBP has allowed all federal and provincial government departments, hospitals in public and private sectors, charitable organizations, manufacturers and commercial importers to make Advance Payment and import on Open Account, without any limit, for the import of medical equipment, medicines and other ancillary items for the treatment of COVID-19.[64]

Till May 21, 2020 banks have approved PKR 5 billion for 24 hospitals, while requests from 17 hospitals for PKR 2 billion are under process.

d) Refinance Scheme to Support Employment and Prevent Layoff of Workers

SBP has announced refinance scheme to prevent layoffs through financing of wages and salaries of all types of workers and employees like the permanent, contractual, daily wagers as well as outsourced workers. Financing under the scheme will be available to those borrowers, who

52 http://www.sbp.org.pk/bprd/2020/CL12.htm
53 http://www.sbp.org.pk/bprd/2020/CL12.htm
54 http://www.sbp.org.pk/bprd/2020/CL13.htm
55 http://www.sbp.org.pk/bprd/2020/CL13.htm
56 http://www.sbp.org.pk/bprd/2020/CL14.htm
57 http://www.sbp.org.pk/acd/2020/CL2.htm
58 http://www.sbp.org.pk/acd/2020/CL1.htm
59 http://www.sbp.org.pk/smefd/circulars/2020/CL3.htm
60 http://www.sbp.org.pk/bprd/2020/CL14.htm
61 1. http://www.sbp.org.pk/smefd/circulars/2020/C3.htm
2. http://www.sbp.org.pk/smefd/circulars/2020/C4.htm
62 http://www.sbp.org.pk/smefd/circulars/2020/CL8.htm
63 http://www.sbp.org.pk/smefd/circulars/2020/CL6.htm
64 http://www.sbp.org.pk/epd/2020/FECL9.htm

undertake not to lay off their employees at least for the next three months. Loans under the scheme will be available to finance 3 months of wages, i.e., April to June 2020.[65] Various categories of business can avail maximum financing of up to PKR 1000 million.[66] The end user rate of up to 3% will be charged from the borrowers on active taxpayers list, while others will be charged up to 5%. Repayment of the loan under the scheme will start from January 2021 after a grace period of 6 months and will be payable with within 2 years. Under the scheme, Banks have also been encouraged to provide loans without any collateral i.e. take a clean exposure of up to PKR 5 million.[67] To facilitate employees for receiving wages under the scheme directly in their accounts, banks have been allowed to open accounts on information & documents provided by the employers. Banks will ensure NADRA verifies before activation of accounts, which will solely be used for salary disbursement and withdrawal.

To incentivize banks to extend loans to collateral deficient SMEs and small corporates with sales turnover of up to PKR 2 billion under the SBP refinance scheme, Federal Government has introduced a credit risk sharing facility. For the purpose, PKR 30 billion has been allocated for the risk sharing for banks spread over the four years to share the burden of any future loan losses from SMEs and small corporates.[68]

To facilitate financing to SMEs under the scheme, SBP has prescribed a simplified loan application form. Also, banks' exposure under the scheme has been exempted from per-party exposure limits, to allow banks to lend to borrowers that have exhausted their exposure limits.

Since the launch of the scheme till May 29, 2020, around PKR 93 billion have been approved for 1,172 companies having 864,637 employees. Applications of 837 companies having 384,490 employees for PKR 36 billion are under process.

e) Ensure Availability and Continuity of Financial Services

SBP has advised Banks to adopt practices necessary to fight the spread of COVID-19 and ensure availability of uninterrupted financial services. This includes enhanced usage of cash counting machines, encouraging customers to use Alternate Delivery Channels (**ADCs**), reassessing Business Continuity Plans, and carrying out an impact analysis to assess the consequences on business and operations and enhance the monitoring frequency of key risk areas like credit, capital market and foreign exchange exposures etc. SBP has also instructed banks to keep bare minimum staff for ensuring the continuity of essential banking services.[69]

Moreover, in a bid to limit person-to-person interactions and to provide ease of services to the customers, SBP has advised banks to provide Direct Cheque Deposit Facility.[70] In addition, in view of the possible rise in cyber security concerns owing to teleworking/work from home, SBP has issued specific instructions to bank to exercise due diligence and implement stronger and robust cybersecurity measures to counter cyber risks associated with remote access functionality.[71]

f) Promote Digital Payments

To contain the spread of COVID-19 by limiting the physical interaction of citizens at bank branches, SBP has instructed banks to waive all charges on fund transfers through online banking channels such as Inter Bank Fund Transfer (**IBFT**).

[65] http://www.sbp.org.pk/smefd/circulars/2020/C6.htm
[66] The refinancing limit has been further extended up to PKR 1 billion: (http://www.sbp.org.pk/smefd/circulars/2020/CL10.htm)
[67] http://www.sbp.org.pk/smefd/circulars/2020/CL7.htm
[68] http://www.sbp.org.pk/smefd/circulars/2020/C9.htm
[69]
1. http://www.sbp.org.pk/bprd/2020/CL6.htm
2. http://www.sbp.org.pk/bprd/2020/CL8.htm

[70] http://www.sbp.org.pk/psd/2020/C4.htm
[71] http://www.sbp.org.pk/psd/2020/C3.htm

Annexure A: Policy Measures across the Globe to Contain Covid-19 Outbreak Risks (Updated Until April 25, 2020)

Countries	**Interest Rate Cut**	**Emergency Liquidity**	**SMEs Policy Measures**	**Credit Guarantees**	**Export/Other Industry**	**Macroprudential Policy Measures**	**Asset Purchase**	**Swap Lines with other Central Banks**	**Policy for Households**
Argentina						✓			
Australia	✓	✓				✓	✓	✓	
Belgium						✓	✓		
Brazil	✓	✓	✓	✓				✓	
Canada	✓	✓	✓		✓	✓	✓	✓	
Chile		✓	✓	✓		✓	✓		✓
Colombia		✓	✓	✓		✓	✓		
China	✓	✓	✓	✓		✓			
Denmark	✓	✓	✓	✓	✓			✓	
Egypt	✓					✓			
Estonia			✓	✓	✓				
European Union		✓	✓	✓		✓	✓	✓	
Finland				✓		✓	✓		
France			✓	✓		✓			
Germany			✓	✓	✓	✓			
Greece				✓		✓			
Hong Kong	✓	✓	✓	✓	✓	✓			
Hungry			✓		✓	✓			✓
Iceland	✓	✓	✓	✓	✓	✓	✓		
India	✓	✓	✓	✓	✓	✓	✓		
Indonesia	✓					✓			
Ireland						✓			
Israel	✓	✓	✓	✓	✓	✓	✓		
Italy			✓	✓		✓			✓
Japan		✓	✓			✓		✓	
Kenya	✓					✓			
Malaysia	✓		✓		✓	✓			
Mexico	✓	✓				✓		✓	

Countries	Interest Rate Cut	Emergency Liquidity	SMEs Policy Measures	Credit Guarantees	Export/Other Industry	Macroprudential Policy Measures	Asset Purchase	Swap Lines with other Central Banks	Policy for Households
Netherlands			✓	✓		✓			
New Zealand	✓	✓	✓	✓		✓	✓	✓	
Nigeria	✓		✓	✓	✓	✓			✓
Norway	✓	✓	✓	✓		✓	✓	✓	
Oman	✓					✓			
Pakistan	✓		✓		✓	✓			
Peru		✓		✓		✓			
Philippines	✓	✓		✓		✓	✓		
Romania						✓			
Republic of Korea	✓	✓	✓	✓	✓	✓	✓		
Russia		✓	✓			✓			
Saudi Arabia	✓		✓	✓		✓			
Singapore	✓		✓	✓	✓	✓		✓	
South Africa	✓	✓				✓	✓		
Spain			✓	✓		✓			
Sri Lanka	✓					✓			
Sweden	✓	✓	✓	✓	✓	✓	✓		
Switzerland		✓				✓		✓	
Taiwan	✓		✓						
Thailand	✓		✓					✓	
Turkey	✓	✓				✓	✓		
Ukraine	✓		✓			✓	✓		
UAE	✓	✓			✓	✓			
U.K	✓	✓	✓	✓		✓	✓	✓	
USA	✓	✓	✓	✓		✓	✓	✓	
Vietnam	✓			✓					

Source: Yale University