Governor's Message

This edition of the Financial Stability Review (**FSR**) is being released at a time when the COVID-19 pandemic has triggered global health and economic crises at a scale unmatched in recent history. All over the world, authorities are battling to save lives and protect the economic well-being of their population. Pakistan's case is no exception.

Prior to the pandemic, CY19 ended with green shoots of economic recovery becoming visible. The stabilization measures adopted helped rein in Pakistan's external and fiscal imbalances and lowered uncertainty among the market participants. As a result, the exchange rate stabilized, foreign exchange reserves surged, the fiscal deficit improved, and economic activity, especially Large Scale Manufacturing, revived. Both local and foreign investors confidently took positions in the equity and bond markets.

The stability of the financial sector improved over the year. The banking sector observed a healthy rise in profitability that further improved its solvency and resilience to shocks. Deposit growth recovered, enabling banks to expand their earning asset base. The non-bank financial sector also demonstrated a reasonable performance, with mutual funds witnessing net inflows. Likewise, the non-financial corporate sector—despite a dip in domestic sales and higher financial charges—preserved its profitability by improving operational efficiency. Thus, not only the economy but also the financial sector was in a much better position by the end of CY19.

The COVID-19 outbreak, however, changed the scenario altogether. In order to contain the pandemic, the world moved towards a Great Lockdown, bringing large segments of the global economy to a halt. According to the IMF, the world output is likely to contract by 3 percent in 2020, making this economic downturn the worst since the Great Depression. As in other countries, the impact of COVID-19 on Pakistan is still unfolding. The country initially moved towards a partial lockdown, amid rising levels of infection. As a result, economic activity experienced slowdown. However, recent easing of restrictions could provide some respite.

In order to limit risks and facilitate stakeholders, State Bank of Pakistan has taken a host of policy measures. Among others, these include substantial monetary easing, offering concessionary financing to save jobs, as well as for health care, SMEs and the export industry, deferring debt servicing, releasing macroprudential buffers, and reducing payment system related costs. A complete list of the measures taken is available on SBP's website.

Going forward, the recovery in the domestic economy will depend upon the severity and duration of the pandemic at home and abroad, as well as the efficacy of containment and revival measures adopted. In such fluid times, it gives us some comfort that capital buffers built over the years have enhanced the resilience of the banking sector, such that stress test results suggest the sector is relatively well-placed to absorb the adverse shocks that could emanate from COVID-19. Nevertheless, there remains considerable uncertainty about the future trajectory of the pandemic and its spillover effects on the economy and financial systems worldwide. As a result, SBP is keeping a close watch on developments and stands ready to take all policy actions necessary to safeguard the economy and financial stability.

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