Reduction in refinance rates

EDITORIAL (January 04, 2013) : In order to finance credit requirements of the priority sectors, central banks usually devise a system to encourage banks to extend sufficient credit to these sectors at relatively lower rates. The State Bank, like other central banks, has also instituted a mechanism, called refinance facilities, under which it has arranged to provide adequate credit for expansion of exports, long-term investment and setting up of power plants using renewable energy sources at concessional rates. Rates under various schemes for these sectors are periodically adjusted according to the money market conditions, in particular in accordance with the changes in the policy rate prescribed by the State Bank. After the discount rate cut by 50 basis points in the second week of December, 2012, it was expected that the SBP would also revise downward the rates applicable on these schemes and such a move was made through circulars 1, 2 and 3 of the new year (on 1st January, 2013), stipulating a reduction in the refinance rate and service charges on its various financing schemes with the exception of financing for over five years and up to 10 years. The rate of refinance under the Export Finance Scheme (EFS) was reduced by 0.20 percent to 8.30 percent per annum. Exporters will now get the export financing facility from banks at 9.30 percent per annum while service charges under the Long-Term Financing Facility (LTFF) have been reduced by 0.70 percent for financing up to three years and by 0.20 percent for financing upto five years. However, service charges for financing up to 10 years have been raised by 0.20 percent. Service charges under the Scheme of Financing Power Plants (FPP) using renewable energy sources have also been reduced by 0.25 percent for financing up to five years while service charges for financing up to 10 years have been raised by 0.20 percent. The revised reduced mark-up rate would also be applicable on outstanding loans already granted under EFS. Banks were, therefore, advised to immediately re-price their outstanding loans under this category, keeping in view the revised reduced mark-up. The adjustment in the refinance rate and service charges as announced by the State Bank on 1st January, 2013 is, more or less, a reflection of its current monetary stance and its expectation about the long-term trends in the interest rate structure of the economy. Though the size of the recent reduction in the policy rate and on various concessionary lending schemes is not the same, yet the trend in downward adjustment as announced by the SBP is similar. This is understandable because changes in the policy rate indicate monetary policy stance of the central bank at a particular point of time which is generally followed by the money market in terms of movement of the overall interest rate structure. The State Bank could actually dictate the borrowing rates under EFS, LTFF and FPP due to the refinance facility provided directly to the banks under these schemes on a concessionary rate. The rates on LTFF and FPP for advances extending beyond five years have been raised slightly due to the expectation of the SBP for the rise in interest rates on longer-term basis. However, while slight adjustment in interest rates under these schemes could be a routine matter for the State Bank in the overall monetary policy context, the real issue is whether such changes could meet the intended objectives or at least are able to provide the necessary incentives to the productive agents in the economy in the desired fields. In our view, the answer to this question could be only in the negative due to the reason that a small downward adjustment of about 0.20 percent in the lending rates under these schemes would not be enough to change the credit and investment behaviour of the borrowers. As such, exports and long-term investment is not likely to pick up as a result of recent changes in the lending rates. Secondly, and definitely more importantly, the trend in exports or investment in

the country is presently less influenced or dictated by changes in the interest rates as other factors have come to play a much more domineering role in these areas. For instance, slightly better monetary incentives would not make much difference if acute energy shortages continue to persist and law and order situation does not improve in the country. According to Chief Co-ordinator, Pakistan Readymade Garments Association, gas and power crisis in Punjab would not only result in a steep fall in exports of textiles by $3 billion or 30 percent, but would also render thousands of people jobless. Obviously, a reduction of 20 basis points in lending rates would not be enough to compensate for these losses. Only a brave soul could consider investing in the country when it is faced with so much militancy and political uncertainty. All said and done, while the State Bank's decision to reduce interest rates under certain schemes by a small margin could be the right signal to the market, there would hardly be any entrepreneur who would take the signal seriously, and readjust his business plans according the fresh incentive provided by the SBP. ***Copyright Business Recorder, 2013***