Twitter Thread by Do Marlay Ka Moonh

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@2paisay

After needlessly arguing over the effect of discount rate and inflation, I decided to analyze its impact on the credit market myself. I used SBP monthly data from its website (stock). Flow data would have been better but I worked with what was available.

A thread.

Government borrowing was impacted by the discount rate. At 13.25%, GoP borrowed appears to have stopped increasing. As the size of private-sector borrowing is smaller than GoP borrowing, we will look at private-sector borrowing separately.

Private sector borrowing: stand-alone and starting the left axis from Rs.3 trillion so that changes are visible. It appears private sector borrowing kept increasing till Dec 18 when the discount rate was raised to 10%.

SBP started decreasing discount rate in March 2020 along with some other initiatives to spur growth. But now it was too late. Pandemic had struck. Private sector borrowing continued to fall. You can read about SBP initiatives here https://t.co/3s6w4UtbMq

The impact of SBP discount rate is obvious here if we look at it YoY. Credit to Private sector continued to grow till Dec 2018. Growth in credit clocked at 16% and 21% in 2017 and 2018. After that SBP's moves up or down stopped having any impact. 4% growth in 2019 and 0% in 2020

Looking at the overall credit masks the underlying different type of facilities i.e. short term, long term, fixed or subsidized, floating rate.

Unsurprisingly, the discount rate had no impact on the fixed rate facilities or the subsidized facilities offered by SBP i.e. export refinance and TERF/LTFF which continued to gradually increase regardless of the discount rate

We are left with unsubsidized long-term loans, working capital loans and others (such as bill purchase, import financing etc). Long term loans (LTLs) by their nature can't be increased or decreased and usually repaid as per terms. Others also appear stable.

Hence we are left with working capital loans. Zooming in, we see that credit was going down in 2018 (not significantly but noticeably. Index on left starts from 2.1 trillion) but then it started increasing. However, decreasing discount rate in Mar 2020 could not spark borrowing.

The above chart goes against the theory that almost everyone preaches over here. The discount rate almost halved from 13.25% to 7% yet private sector borrowing continues to fall if we exclude export refinance and subsidized TERF/LTFF.

Going from 6.5% in Jun 2018 to 13.5% in Jun 2019 would have doubled the financing cost of non-export oriented industries.

Banks would have made good profit. Working capital borrowing was 46% of total borrowing in Jan 2019 and had decreased slightly to 42% of the total borrowing of private sector businesses by Nov 2020. Private sector isn't making most of decrease in discount rate.

It turns out the working capital borrowing by sectors that are in the news the most i.e. wheat, sugar, power or textile remain unaffected by discount rate. Borrowing for grains (wheat, rice) in 2020 is even less than 2019. Textile has increased but from a very low base.

It's the others (sectors not included in above) that were affected by high discount rate. (Note the index on LHS does not start from zero). What I classify as Others comprise consistently of 65% of the working capital borrowing and 28% of overall private sector borrowing.

The significant increase in discount rate decreased the working capital borrowing of Others in July 2019. the decrease of discount rate back to the previous level by Mar 2020 was too late and had absolutely no impact. Rather private sector borrowing continued to fall.

On consumer loans, car loans appear to be impacted by the discount rate. Car loans outstanding became stable when discount rate peaked and have since started increasing when the rate fell. Personal loans continued to increase gradually regardless of discount rate

Discount rate may or may not have affected the private sector credit but it definitely has a hand in recovery of the automotive sector as consumers have started to borrow for car loans.

To summarize: The increase in discount rate had the effect of decreasing private sector borrowing. Yet decreasing the discount rate has absolutely no impact. Borrowing has continued to decrease with exception of fixed/subsidized Export RF, TERF, LTFF.

No conclusion.

Note: Borrowers borrow based on KIBOR which more or less would have followed the discount rate during this period (I didn't verify).