

**Welcome speech by Shahid Kardar  
Governor, State Bank of Pakistan  
Developing Monetary Policy in an Islamic financial system  
May 19, 2011**

I am delighted in welcoming Professor Humayon Dar to State Bank of Pakistan and would like to thank him for accepting our invitation to give a talk on Developing Monetary Policy in an Islamic financial system. Professor Dar is an Islamic economist, a transformational thinker, Shariah advisor and an Islamic banking expert. He has authored various articles and books and has a special focus on product innovation for the industry. I am confident that today's talk will be a stimulating experience for all of us in finding new directions for the industry.

**Ladies & Gentleman**, the significant growth of Islamic finance extending its outreach even beyond the Muslim countries is reflective of its increasing acceptability as a viable and competitive system having inherent strengths to absorb both endogenous and exogenous shocks. The resilience of Islamic financial institutions during the recent financial crisis has given further credence to its claim of being a sound and prudent financial system, which if adopted in total and in true spirit could save us from the oft recurring crisis in financial markets and its subsequent fallouts on the real economy. With a network of more than 600 institutions operative in more than 75 countries and an asset base of over US \$ 1.2 trillion, the industry is all set to significantly improve its footprint in global financial markets during next few years.

Pakistan having a large Muslim population of about 170 million has even bright prospects for growth and development of Islamic finance industry as a major component of mainstream financial system. It has maintained a sustained growth trajectory during last 7-8 years and now constitutes about 7 percent of the country's banking system with an assets base of about Rs 500 billion and a network of more than 750 branches of both full-fledged Islamic banks and conventional banks having Islamic banking branches/windows. The growth momentum is likely to gather further strength with the increasing awareness levels and expansion of Islamic banking branches and windows in second/third cities.

This optimism however, should not be construed as complacency; the industry despite making significant strides both globally and locally is still faced with some major challenges including development of liquidity management instruments, Shariah Islamic money and capital markets, low product diversification and differentiation and unavailability of adequate human capital which will have to be addressed to sustain the growth momentum.

State Bank of Pakistan has remained committed in facilitating the industry by providing a conducive growth environment; it is one of the few regulators which introduced comprehensive legal, regulatory and Shariah compliance framework for Islamic banking industry. In its supportive role the central bank has been actively conducting targeted seminars, conferences and certified courses to create awareness and for capacity building of the industry.

To promote product diversification with a special focus on participatory financial mechanisms like Musharaka and Mudaraba, the State Bank working with the industry to develop an incentive framework. This framework will be aimed at encouraging Islamic banks to offer participatory modes while minimizing issues of moral hazard and adverse selection, information asymmetries and trust deficit between Islamic banking institutions (IBIs) and entrepreneurs.

On the liquidity management front, while issuance of Government of Pakistan's Ijara Sukuk of about Rs.190 billion during the last 6 months has provided big relief to the industry in deploying the excess liquidity, however issues like absence of Islamic money market and short term liquidity management instruments, non-tradability of Sukuk largely due uncertainty about future Sukuk issuances still needs to be addressed. The Central Bank is engaged with the industry to bridge such gaps and I am confident about their early resolution through collaborative efforts by all the stakeholders.

Today's topic is very relevant to our efforts for development of a comprehensive liquidity management mechanism for the industry. While we are already working towards having Islamic liquidity management instruments, I am sure that Prof Dar's talk on "Developing Monetary Policy in an Islamic financial system" will further help us in understanding and resolving issues faced in the development of Monetary Policy in an Islamic Financial System.

In the end, I would like to thank Professor Dar again for accepting our invitation and wish him a pleasant stay.

Thank you