

STATE BANK OF PAKISTAN
AGRICULTURAL CREDIT DEPARTMENT
(PSCAC Secretariat)

**MINUTES OF THE 3rd MEETING OF PRIVATE SECTOR CREDIT
ADVISORY COUNCIL (PSCAC) HELD ON 21st June, 2008 AT SBP, KARACHI**

The 3rd meeting of Private Sector Credit Advisory Council (PSCAC) was held at State Bank of Pakistan under the chairperson of Governor, SBP on 21st June, 2008. The meeting was attended by senior officials of SBP, representatives of federal and provincial governments, heads / representatives of commercial banks, Federation of Pakistan Chambers of Commerce and Industry, Agriculture Chambers and other trade bodies. Agenda items discussed in the meeting and list of participants are appended at Annexure A & B respectively.

The meeting started with recitation of the Holy Quran. At the outset, Governor welcomed the participants and briefly explained that the objective of restructuring and renaming of NCCC is to make the new body more effective and meaningful. PSCAC is not only responsible for identifying impediments to credit availability for various segments of the economy including project finance, working capital finance, agriculture finance, infrastructure & housing finance, consumer finance, SMEs finance, trade finance, Islamic finance and other sectors but will also review the related credit availability to these sectors by suggesting workable proposals to promote sector-wise financing on sustainable basis. She also emphasized upon the members to actively participate in this important forum and make suggestions / proposals for the economic development of the country.

Overview of Private Sector Credit

Governor gave an overview of the recent trends and credit availed by various segments of the private sector. Details thereof are as under:-

- Overall private sector credit remained strong in FY-08 up to May 31, 2008 despite a challenging economic year. Expansion in private sector recorded a higher growth of around 16% in FY08 at Rs 384 billion compared with Rs 287 billion in FY07 (14%). On annualized basis, growth in private sector credit is 19% in FY 08 which is higher than 17% last year.
- Distribution of credit was broad-based and almost all the sectors of the economy have availed credit. Large proportion of the credit (59%) was availed by manufacturing sector including textile. Massive increase in working capital loans was registered, which increased from Rs 152 billion in FY07 to Rs 311 billion in FY08 (July-April). Its share in total credit improved from 73% to 88%. Inflationary pressure and higher cost of inputs are the main reasons for higher credit flow for working capital

needs in current year. Some slowdown was witnessed in demand for fixed investment loans as it declined from Rs 56 billion to Rs 42 billion. This was mainly due to the slowdown in overall economic growth in FY 08 and gestation of previously undertaken BMR initiatives.

- Private domestic banks are playing a key role in meeting private sector credit demand. These banks have improved their share in PSC from 72% to 84% while public sector and foreign banks have lost their shares, coming down to 14% and 1% from 22% and 5%, respectively.
- Disbursement to the agri. sector through banking system in first 11 months of the financial year showed growth of 30% year-on-year (July-May) FY08. Banks have disbursed a combined total of Rs 185 billion to the agriculture sector as compared to Rs 142 billion in the same period last year, showing an absolute increase of Rs 43 billion.
- Credit to SMEs up to April 2008 expanded by Rs 3 billion or 1%. Growth in flow of credit showed an expansion in commerce & trade by Rs 10 billion and contraction in manufacturing, construction, transport & communication and services sector.
- Consumer loan, increased by Rs 17 billion or 5% during 10 months of FY07-08 compared to a growth of 13% during the same period last year. Within the consumer financing, highest share was in personal loans at 39% followed by car financing 30%, housing loans 18%, and credit cards at 12% as at end April, 2008. Growth in consumer finance remained slow as compared to last year mainly because of high interest rate, slow pace of recovery, strict risk management system of banks etc.
- Disbursement to housing sector by banks and DFIs up to March 2008 stood at Rs 133 billion compared to Rs 117 billion at end FY-07.
- Disbursement by MFBs & MFIs showed considerable growth during last 4 years which stood at Rs 15 billion as of December 2007 serving 1.5 million borrowers compared to Rs 2.6 billion and 0.3 million borrowers as of December, 2003.
- Financing by Islamic modes grew from Rs 3.5 billion in 2002 to Rs 122 billion as of April, 2008.

Governor, SBP also informed the participants that in addition to PSCAC, focused working groups and task forces had also been formulated including Agricultural Credit Advisory Committee, SME Credit Advisory Committee, Task Force on infrastructure & housing, etc. with specific task on improving access to development finance. She also urged upon the foreign banks to arrest their declining share in private sector credit.

While discussing the development of Islamic banking, Governor stated that SBP is playing a pivotal role in drawing a parallel between the Islamic banking and conventional banking with the sole aim of building a broad-based financial system enabling all segments of the population to have access to financial services. She further stated that the private sector credit is the major portion of Islamic financial institutions and currently six full-fledged Islamic banks and twelve conventional banks are operating throughout the

country with the network of 300 plus branches as compared to 162 branches in June 2005. She also urged upon the banks for the implementation of true spirit of Islamic financing to get the optimum benefit of the Islamic banking system.

Implementation Status of Previous Meeting Decisions

Director, ACD briefed about the implementation status of previous PSCAC meetings' decisions and sought approval of minutes of the last meeting. The members while giving approval stressed upon the need for early circulation of implementation status report of PSCAC meetings, preferably along with the working papers to enable them to review and provide feedback in advance.

Presentation by FPCCI

In compliance with the decision of the last PSCAC meeting, President, Federation of Pakistan Chambers of Commerce & Industry (FPCCI) made a detailed presentation on the major issues being faced by the industry in Pakistan especially with regard to the availability of credit to the private sector.

- In presentation, President FPCCI appreciated the initiatives of SBP and banks in facilitating the flow of credit to different sectors of the economy. However, they were of the view that due to high fixed cost to the industry which, inter alia, included cost of energy, high rate of interest, wages & high cost of funds made it difficult for the sector, particularly the textile to maintain the growth of the sector. Resultantly deceleration has been seen in all major sectors of the industry. He mentioned that the decision of imposing 35% cash margin on imports has further increased the burden on the industry as their major expense is based on the imported raw materials. They suggested that to reduce the import burden instead of imposing cash margin across the board, exclusion should be provided to such imports which are critical for the export-oriented / value added industry. They also presented some country-wise comparison on interest rate disadvantage to Pakistani industries compared with other regional countries.
- On the issue of 35% cash margin on import LCs, SBP Governor informed the participants that SBP would issue a circular today exempting a number of additional essential items from the requirement of 35% cash margin with a view to facilitate the trade & industry to meet their raw material requirements and to ensure timely delivery of export orders. However, cooperation is needed from the industry that they should not go for excessive forward import bookings. In addition, the exporters should bring back their export proceeds before the scheduled time.
- Commenting on FPCCI's assertion on interest rate disadvantage as compared to its regional competitors, Governor said that the empirical evidence shows that the country has the lowest real interest rate in the region. Therefore, the industry should evaluate its business propositions keeping in view the real interest rate for sustainable growth and to ensure competitiveness. She stressed

upon banks that while making project appraisals the banks should have sensitivity analysis based on real interest rate. Governor also urged upon FPCCI to formulate a code of corporate governance for its members to improve the governance structure and transparency.

- Special Secretary, Ministry of Finance raised the issue of slow growth in industrial sector, particularly the textile despite of giving heavy subsidy to this sector by the Government. In this regard, representative of FPCCI responded that the main reasons for current slow growth in textile sector are low utilization of bulk capacity on account of high cost of doing the business, shortage of cotton / raw material, power crisis, multiplicity of taxes etc.
- Banks showed their concerns over the statistics regarding cost of credit given in the presentation. They explained that markup rate being charged is based on the risk profile of individual borrowers and the good clients are offered relatively lower rate of markup even below the KIBOR and high risk borrowers are being charged at a higher rate.
- To ascertain the factual position about the share of cost of credit / interest in total production cost, Governor constituted a committee comprising of Mr. Ali Sameer (UBL / PBA), Mr. Mohammad Mansoor Ali, Economic Analysis Department, SBP and representatives of FPCCI viz. Dr. Mirza Ikhtiar Beig, and Dr. Shahzad Arshad.
- One of the representatives of FPCCI raised the issue that under the revised export refinance procedures, exporters are facing problem in getting finance from banks. Therefore, SBP needs to look into it. On this, Director, Microfinance Department, SBP replied that they are monitoring the position of export refinance on regular basis and whatever complaints received in this respect are either looked into by SBP or they are sent to its field offices to ensure the availability of refinance to the eligible / legitimate exporters. He further stated that the data shows that more credit has been availed by the exporters under the revised procedures as compared to last year which clearly depicts that exporters are not facing any problem in obtaining export refinance facility. However, if still there are complaints, the same may either be referred to SBP or to its field offices for resolution.

Thereafter, the floor was opened for detailed discussion on ways and means to enhance flow of credit to various sectors of the economy including agriculture, small and medium enterprises (SMEs), microfinance and housing sector.

Agriculture Financing

The Director, ACD, briefly explained the current initiatives taken by SBP in increasing flow of credit to agriculture sector which, inter alia, include guidelines on poultry & horticulture financing, group based lending scheme for small farmers, crop loan insurance scheme developed by SBP Task Force, guidelines on Islamic financing for agriculture, etc. He mentioned that the banks have disbursed Rs 185 billion up to May, 2008 and hopefully the annual target of Rs 200 billion for FY08 will be met by end June, 2008.

- The Secretary, MINFAL gave an overview of the initiatives being taken by the Government for the development of agriculture and emphasized on banks to provide credit to the farming community especially small and landless farmers on fast track basis. He said that there are issues of the valuation of collateral and the amount of credit due to sharp increase in the prices of agriculture inputs. He further said that banks should create charge on proportion of the land holdings instead of mortgaging the whole pass book with them. He also suggested that deposits of rural areas should be lent in the rural areas.
- In reply, President, Saudi Pak Commercial Bank mentioned that the existing land revenue system does not facilitate multiple charge by banks. Moreover, there are issues of fake pass books and delays in verification / authentication by the Revenue Authorities. However, with the computerization of revenue record which is being carried out as pilot in some of the provinces the banks would be able to create multiple charge by banks simultaneously.
- Governor informed the participants that SBP has arranged a funding from Asian Development Bank for the automation of revenue record of the Sindh province which if utilized effectively would address the issues of pass books and will facilitate banks & farming community in availing of agri. credit.
- The Governor emphasized on MINFAL & Provincial Agriculture Departments to learn from the experience of green revolution in Pakistan and reactivate the role of extension services and collaborative efforts to educate the farming community with mechanization, good quality of seed and best cultivation practices to make farming community viable for getting finance from banks. She further said that though the credit to agriculture has increased many fold, the impact of it on the real sector growth i.e. productivity, GDP ratio etc. has not been reflected significantly. Therefore, there is a need that Planning Commission and MINFAL should analyze the situation.
- The representatives of farming community, federal and provincial Governments appreciated the increase in flow of credit to agriculture by the banks. However, they emphasized on banks to develop more innovative products to meet the growing credit requirements of farmers especially the livestock which form about 50% of Agri. GDP.
- The Secretary Agriculture, Balochistan pointed out that livestock and fisheries sectors have completely been neglected in the Province while disbursing agri. credit. Similarly, the loaning should be more broad-based covering credit for storage facilities and farm implements also. Besides, due to lack of rural branches, the access to financial services in Balochistan is restricted. In reply, Governor said that to ensure the provision of financial services to the rural community SBP has now made it mandatory to banks to open at least 20% of their new branches in the rural areas.
- Banks raised the issue of non-cooperation by the revenue authorities, non-availability of pass books & one window operation, particularly in Sindh which have made it difficult to increase the flow of

credit to the farming community. Moreover, due to improper marketing system, the farming community does not get right price for their produce resultantly the repayment of bank loans is affected.

- President, Federation of Chambers of Agriculture Pakistan pointed out that in Sindh the matter of obtaining of pass books is still a major issue and it should be resolved on the highest priority. He emphasized the need to start one window operation in Sindh on the same lines as it is being done in Punjab. He also called for the implementation of Crop Loan Insurance Scheme developed by the SBP task force.
- In reply, Governor said that SBP task force has developed a commercially viable and sustainable scheme after detailed deliberations and analysis of various agri. credit data and on the basis of which, National Insurance Corporation Ltd. and other major insurance companies have also developed their products and are in the process of negotiating their arrangements with banks. Thus the objective of the task force has been accomplished, however, a concluding meeting of the task force would be held soon to finalize its report for implementation.
- Governor emphasized on integrated efforts among the federal and provincial agricultural ministries, planning departments, farming communities, banks and SBP to introduce specific projects like corporate farming or other mechanics of bulk lending by banks for onward lending to small farmers and also monitor the impact of increased credit flow vis-à-vis productivity.

SMEs Financing

Director, SME Department gave an overview of the initiatives taken by SBP to increase the flow of credit to SMEs sector. He said that there are approximately 3.2 million business enterprises and SMEs constitute almost 99% of them. SMEs sector in terms of banks exposure is the second largest sector after corporate. Overall growth within SMEs sector is encouraging. The outreach of SMEs has increased from 67,520 to 184,000 borrowers during the period December 2002 to December 2007. The market potential for SMEs finance is still huge but due to many issues / impediments, banks are reluctant to get into SMEs lending in a big way. The major constraints in lending include lack of collaterals to meet banks requirements, absence of proper information about business, lack of awareness, lack of credit history, lack of innovative cash flow based products, high management cost, etc. To overcome these issues, SBP is taking several initiatives and under DFID program it would establish a credit guarantee scheme in addition to capacity building program for banks.

- CEO, SMEDA said that inspite of SBP's various initiatives, banks are still not meeting credit needs of SMEs due to lack of their capacity, non-availability of cash flow based financing products, and traditional mindset. Therefore, he urged upon banks to develop innovative and targeted products to meet the credit requirements of this segment especially the small enterprises. He further said that

SMEDA has developed accounting manuals and also facilitates SMEs in preparation of loan proposals and feasibility report for obtaining loans from banks. On this, Governor advised him to provide the list of SMEs benefited from their services.

- Representative of SME Association complained that small enterprises are still unable to get credit from banks because of lengthy & cumbersome lending procedures, collateral and financial requirements. He urged upon banks to develop collateral free / cash flow based lending product to meet the requirements of this large segment of SMEs.
- Representatives of banks explained that as far as medium enterprises are concerned, the credit flow had increased significantly. However, due to non-disclosure and lack of information on cash flows and inadequate collaterals, financing to small enterprises is the biggest challenge. The setting up of SME Credit Guarantee Scheme by the SBP is expected to resolve this issue to a great extent. They further said that financing to small enterprises is more challenging and costly one, therefore, program based techniques / products need to be developed by banks.

Microfinance

About microfinance, Governor said that the sector has made impressive progress in terms of enabling policy environment & outreach and the future growth is enormous with the estimated target market size of 30 to 40 million clients. SBP has developed a strategy for expansion of microfinance outreach to 3 million borrowers by 2010 and to raise this number to 10 million borrowers in next five years. In this regard, various initiatives including branchless banking, transformation of Khushhali Bank and NRSP, entry of international successful players in microfinance sector, using post offices as delivery channel for microfinance, trade union development plan, Islamic microfinance products, and development of financial literacy plan are also being undertaken. The growth in microfinance sector can pick significantly if commercial banks with extensive branch network and low cost of funds may develop microfinance products or collaborate with microfinance institutions for provision of the financial services to the poor.

Housing Finance

Governor said that housing finance is one of the emerging profitable avenues for banks as the country has been facing shortage of housing units like other developing countries. The recent housing data shows the substantial growth but still lacks behind the desired level. According to the latest statistics, the share of HBFC in housing finance is continuously declining as compared to commercial banks and it is expected that commercial banks will continue to maintain this trend in future. For the development of housing finance, SBP has constituted Housing Advisory Group with representation from all the stakeholders with the objective to review the existing regulatory & policy framework and prepare the recommendations for promotion and development of housing finance. The Group has made several recommendations relating

to banks provincial and federal governments and the same are being examined at concerned quarters. In addition, for the capacity building of banks on mortgage lending training programs in collaboration with IFC have also been arranged by SBP and efforts are also being made for establishment of mortgage refinance company for development of schemes for rural and low cost housing. It is expected that as a result of these initiatives, housing finance will grow at a faster rate in future.

Decisions / Follow up Actions:

Following decisions were taken:-

1. PBA Chairman shall make a presentation on "Corporate lending trends and issues in corporate financing" in the next PSCAC meeting which was deferred due to his non-availability.
2. To ascertain the factual position about the share of cost of credit / interest in total production cost of the Industry, a committee comprising of Mr. Ali Sameer, UBL & PBA, Mr. Mohammad Mansoor Ali, Economic Analysis Department, SBP and representatives of FPCCI Dr. Mirza Ikhtiar Beig, and Dr. Shahzad Arshad was constituted.
3. To facilitate agri. lending, ACD will take up the issue of commencement of one window operation with the Provincial / Federal government.
4. SMEDA will furnish the list of SMEs which benefited from their Business Development Services.
5. SBP will arrange posting of minutes / proceedings of focused working groups on SBP web for the information of members of PSCAC.
6. PSCAC Secretariat, in future, shall furnish the implementation status report of the decisions of PSCAC and minutes of last meeting along with working paper for the members.
7. All Presidents / CEOs of member banks shall ensure their personal participation in future PSCAC meetings.

The meeting ended with a vote of thanks to the chair.
