



Annual Credit Plan

Fiscal Year 07

Economic Policy Department

State Bank of Pakistan

Contents

Title	Page No.
1. Review of Credit Plan for FY06	2
2. Review of Monetary and Credit Developments	3
3. Bank Credit to Government	5
4. Bank Credit to Private Sector	6
5. Distribution of Credit to Private Sector	8
6. Credit to SME Sector	10
7. Credit to Agriculture Sector	11
8. Monetary Outlook for FY07	12
9. Table –1: Monetary Indicators	14

1. Review of Credit Plan for FY06

The credit plan for FY06 projected broad money expansion at 12.8 percent (Rs.380 billion) by the end of the year. This projection was based on the consideration that the real GDP would grow at 7 percent and consumer prices would increase at 8 percent (**Table 1**). Monetary expansion was kept marginally below the projected nominal GDP growth of around 15 percent in view of the presence of monetary overhang that had stemmed from massive yearly monetary expansion since FY03, and its consequent fallout in terms of rising inflation,

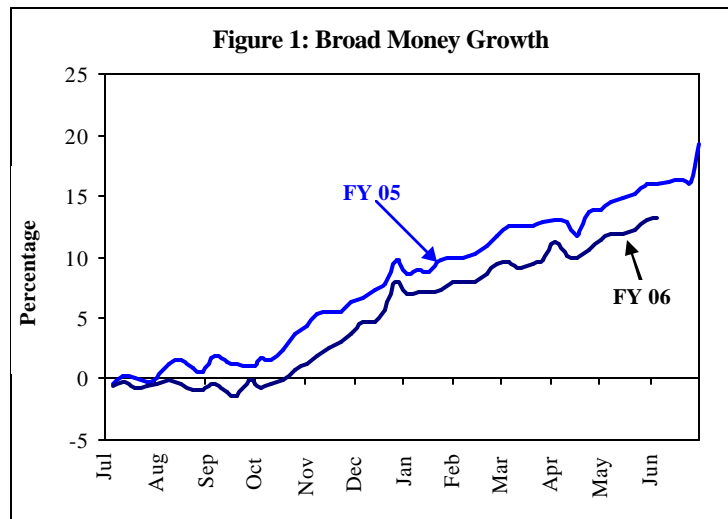
The projected monetary expansion was expected to result primarily from the buildup in net domestic assets (NDA) of the banking system which were anticipated to accumulate by Rs.365 billion owing primarily to considerable absorption of bank credit by the private sector. Net foreign assets (NFA) of the banking system were projected to rise moderately by Rs.15 billion on account of dwindling net foreign inflows. One of the assumptions used in projecting NFA of the banking system was that about 90 percent privatization proceeds of PTCL would be utilized to retire foreign debt during FY06. However, if these proceeds were not utilized fully during the year then NFA of the banking system would be expansionary and NDA of the banking system would be contractionary to the extent of unused privatization proceeds and therefore the degree of monetary expansion would remain unchanged.

Within NDA, the government sector was estimated to absorb bank credit to the extent of Rs.120 billion with budgetary borrowings at Rs.98 billion and borrowings for commodity operations at Rs.20 billion. Credit to

non-government sector was estimated at Rs.320 billion with private sector to absorb Rs.330 billion and PSEs to retire Rs.10 billion. Credit allocation of Rs.330 billion to the private sector was made to adequately meet the genuine credit demand of the corporate and business community and thereby ensuring the achievement of key macroeconomic targets set for FY06.

2. Review of Monetary and Credit Developments

The rate of yearly monetary expansion that had averaged at around 18 percent in the last four years came down considerably to 13.33 percent towards the end of FY06. SBP continued



to exercise tight monetary policy through frequent interventions in the inter-bank money market to delimit the supply of loan-able funds to contain inflation. Therefore, the rate of monetary expansion remained below 5 percent until the third week of December 2006 (**Figure 1**). However, it picked up momentum in the second half of the year. In consequence, broad money showed a growth of 13.33 percent during July-10 June FY06 against an expansion of 16.18 percent in the corresponding period of last year. Full-year broad money growth in FY06 is expected to be around 14.8 percent compared with 19.3 percent growth experienced in FY05.

Correspondingly, reserve Money (RM) expanded by 12.60 percent (Rs.114.49 billion) during July-10 June FY06 compared with an expansion

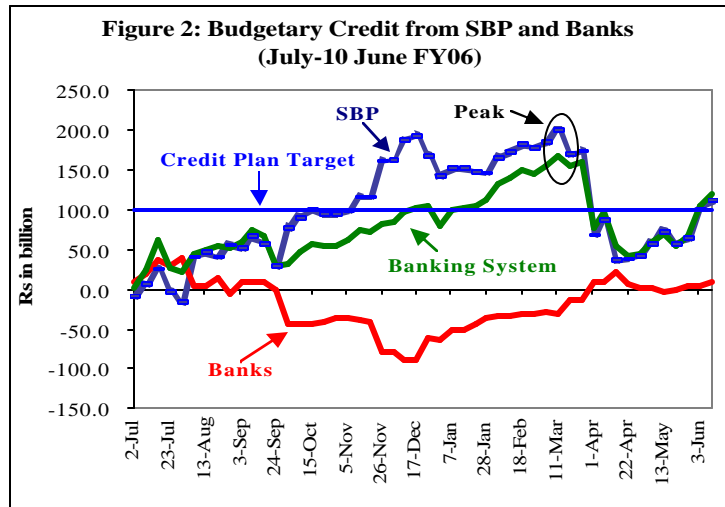
of 19.36 percent (Rs.149.65 billion) in the same period of last year. The growth in RM remained relatively moderate primarily on account of massive trade deficit that constrained the buildup in NFA of SBP despite realization of significant privatization proceeds and inflow of foreign exchange owing to the floatation of bonds in the international financial market. However, despite huge trade deficit of \$6.53 billion (exchange-based) during July-April FY06, the base of NFA of SBP during July-10 June FY06 expanded by Rs.46.67 billion whereas buildup in NDA of SBP was restricted to Rs.67.82 billion due to realization of privatization proceeds and foreign bond related inflows and consequent reduction in government borrowings for budgetary support.

As projected in the credit plan, monetary expansion primarily occurred on account of buildup in NDA of the banking system which expanded by Rs.373.12 billion during July-10 June FY06. The buildup in NDA occurred on account of more-than-targeted expansion in credit to both the government and the non-government sector. Credit to government amounted to Rs.131.86 billion during July-10 June FY06 against the credit plan target of Rs.120 billion while credit to the non-government sector totaled Rs.335.12 billion against the credit plan target of Rs.320 billion (**Table 1**). The government's heavy reliance on bank credit came from the absence of borrowing from non-bank sources against the target of Rs.55.4 billion (in fact, government was constrained to retire Rs.12.8 billion to the non-banks during July-March Y06) and additional demand for funds to finance earthquake related initiatives (Rs.51 billion have already been spent to date) and commodity operations to ensure adequate supplies of essential inputs and food items. Buildup in NFA of the banking system, on the other

hand, was moderately high at Rs.22.4 billion during July-10 June FY06 against the credit plan target of Rs.15 billion. It was the rising trade deficit which completely offset the expansionary impact of privatization and other foreign inflows on the NFA.

3. Bank Credit to Government

The credit to government for budgetary purposes continued to rise (primarily from SBP) until the receipt of funds on account of both privatization of PTCL



(\$1.12 billion) and issuance of foreign bonds (\$0.8 billion) between 31 March and 13 April (**Figure 2**). The net credit to government for budgetary purposes which had peaked at Rs.162.2 billion during July-11 March 2006 (credit to government from SBP had also peaked at Rs.168.2 billion during the same period) quickly came down to the lowest level of Rs.43.3 billion during July-22 April 2006. Since then it has been rising and during July-10 June FY06 it expanded by Rs.120.41 billion. Had privatization and bond receipts not been realized, government borrowing for budgetary support would have been around Rs.235 billion as on 10 June 2006. It may be noted from **Exhibit 1** that during the first two quarters of FY06 the government completely relied on borrowing from SBP for its budgetary needs. In the third quarter, TB holdings of SBP declined partly due to transfer of the government debt to scheduled banks and partly due to government's ability

to retire its debt from the SBP through the utilization of privatization and other foreign proceeds (\$1.92 billion). In the fourth quarter, borrowings from SBP showed a significant expansion once again due to distribution of grant to the provinces and shifting of government debt away from banks to SBP. All factors considered, it is expected that budgetary credit to government from the banking system would be close to the credit plan target of Rs.98 billion.

Credit to government for commodity operations continued to show net retirement up to the third quarter; total retirements amounted to Rs.33.04 billion. However, government

Exhibit 1: Profile of TB Holdings		
<i>(Rs. in million)</i>		
FY06	Flows	
	Banks	SBP
Q1	-29,927	73,194
Q2	-11,763	117,500
Q3	60,526	-78,600
Q4 up to 22 June (estimated)	-33,022	59,006
Total	-14,186	171,100

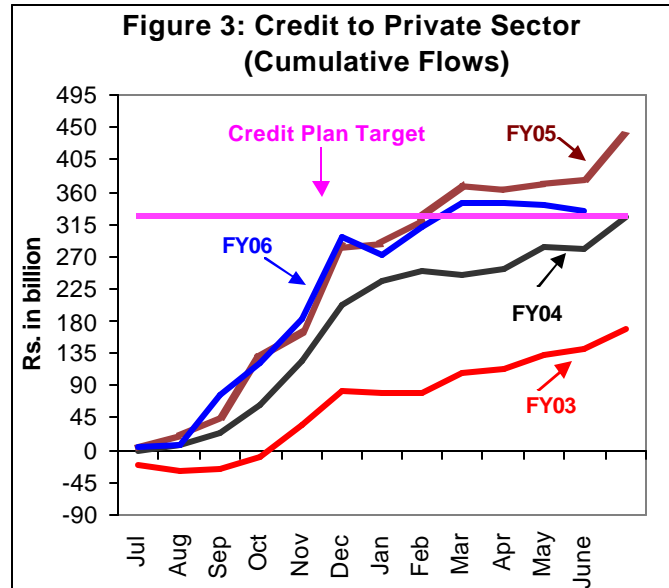
borrowings picked up strongly in the fourth quarter and showed a massive expansion of Rs.44.46 billion (Rs.3.36 billion in April, Rs.36.45 in May and Rs.4.65 billion up to 10 June 2006). Most of the funds were utilized to procure wheat (Rs.35.90 billion), sugar (Rs.7 billion) and fertilizer (Rs.3.33 billion) to improve supply-side management. Although net commodity-related borrowings by the government amount to Rs.11.42 billion during July-10 June FY06, they are expected to surpass the credit plan target of Rs.20 billion by Rs.5 to Rs.10 billion in view of additional credit allocations made in recent months.

4. Bank Credit to Private Sector

The enormity of bank credit consumption by the private sector that had started to unfold in FY03 continued through FY06. Bank credit to the

private sector during July-10 June FY06 grew by 19.49 percent against the 3-year average annual credit growth of 29.7 percent (21 percent in FY03, 34.3 percent in FY04 and 34.4 percent in FY05). Such a significant growth of credit to the private sector persisted despite tight monetary policy stance of the SBP. Key factors accounting for such a phenomenon appeared to include broad basing of credit structure; strong inter-bank liquidity on the back of considerable flows of workers' remittances, expectation of further rise in interest rates and the consumer belief in the future strength of the economy.

Despite the fact that credit to the private sector grew quite significantly at 19.49 percent during July-10 June FY06 it did show visible deceleration against the credit growth of 29.66 percent experienced in the corresponding period of last year (**Figure 3**). This could

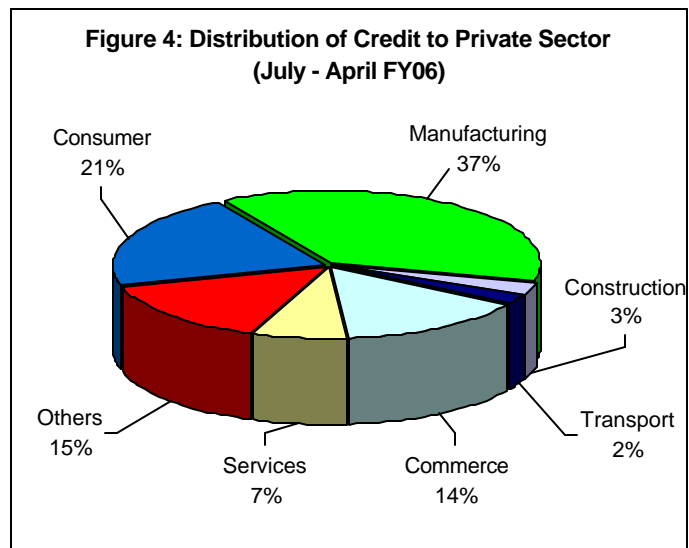


be attributed to tight monetary policy stance that pushed 6-month KIBOR rate by 42 bps to 8.88 percent, 12-month KIBOR rate by 70 bps to 9.78 percent and weighted average lending rate by about 2 percentage points to 10.25 percent (as on April 2006) since the end of June 2005. The recent trend of credit to the private sector indicates that credit absorption by the private sector by the end of the year may be around Rs.370 billion against the annual credit plan target of Rs.330 billion.

5. Distribution of Credit to Private Sector

The utilization of bank credit by various segments of the private sector during July-April FY06 remained broad-based (**Figure 4**). The *manufacturing sector* as usual continued to dominate the consumption of bank credit as its credit consumption grew by 17 percent (Rs.128.9 billion) against its consumption growth of 20 percent (Rs.146.8 billion) in the corresponding period of the last year. The deceleration in credit consumption by the *manufacturing sector* primarily resulted from a significant decline in credit consumption by the *textile industry* (presumably due to strong profit margin and rising credit cost) to Rs.68.8 billion from Rs.94.7 billion in the corresponding period of last year.

Textile industry despite experiencing a deceleration in credit consumption continued to be the largest recipient of bank loans; it used loans to finance mainstream operations and on-going BMR initiatives as the



import of textile machinery continued unabated and totaled \$693.3 million during July-April FY06. The textile industry contributed quite significantly to overall exports (customs based) which grew by 17.8 percent to \$13.5 billion during July-April FY06. The share of *textile industry* in exports during July-April FY06 increased to 60 percent (\$8.1 billion) from 59 percent (\$6.8 billion) in the comparable period of last year. Within the

exports of textile industry, the export of bed-wear grew by 51.4 percent (\$1.66 billion) followed by cotton yarn (35.3 percent (\$1.15 billion)), ready-made garments (28.3 percent (\$1.09 billion)) and cotton fabrics (16.7 percent (\$1.75 billion)).

The performance of *cement industry* also improved significantly as its credit consumption expanded by 46.9 percent (Rs.15.25 billion) while *fertilizer industry* which had retired Rs.4.71 billion last year showed a net credit consumption of Rs.1.8 billion. The *construction industry* remained buoyant as its credit off-take exhibited a growth of 30 percent (Rs.9.4 billion) against the growth rate of 52.5 percent last year. *Commerce-related* activities picked up strongly as their credit absorption rose by 34.4 percent (Rs.49.8 billion). Credit absorption by exporters (Rs.11.09 billion), by importers (Rs.5.80 billion) and by wholesalers and retail traders (Rs.26.03 billion) seems consistent with the export growth of 17.8 percent and import growth of 40.4 percent during July -April FY06.

Consumer loans continued to register strong growth as they showed an expansion of 29.4 percent (Rs.73.3 billion) during July-April FY06. *Consumer loans* comprised of auto loans (Rs.25.8 billion), personal loans (Rs.22 billion), loans via credit cards (Rs.11.7 billion) and loans for house building (Rs.11.1 billion). Major sources of growth of consumer loans were: (i) increased demand for cars both domestically assembled and imported ones; (ii) increased demand for house building well supported by rising production of *cement industry*; and (iii) aggressive strategies of commercial banks to market consumer loans.

It is quite encouraging to see that the private sector has utilized bank credit to the extent of Rs.300-plus annually in recent years. However, the

distribution of credit to the private sector is still heavily skewed towards capital-intensive sectors and hence the flow of credit to priority sectors like SME and agriculture is still low. Therefore, it is highly desirable that more bank credit goes to these sectors for greater job creation and poverty alleviation.

6. Credit to SME Sector

The importance of *SME sector* in Pakistan has been appreciated in recent years because of its ability to create employment opportunities and thereby reducing poverty through potentially strong forward and backward linkages that exist among various economic activities.

There is no denying the fact that *SME sector* has the potential to foster entrepreneurial culture, serve as training ground for managerial skills, offer a wide range of working opportunities to entrepreneurs and low-income individuals, help improve the economic profile of the country and ensure allocative efficiency from a social point of view. Based on these realizations, both *SBP* and *Government* took a number of initiatives to promote credit to the *SME sector*. *SBP* provided adequate level playing field to SMEs by opening up credit facilities and ensuring capacity enhancement and other promotional activities. Similarly *Government* took a number of fiscal measures (e.g. tax relaxation for SMEs) to facilitate operations of the SMEs. It is because of all these initiatives that credit to SMEs has picked up strongly in the last few years.

Credit from scheduled banks and DFIs to SMEs expanded by 13.3 percent (Rs.42.2 billion) during July-April FY06 compared with an

expansion of 25.6 percent (Rs.62.6 billion) in the same period of last year. However, credit to SMEs remained concentrated towards *Commerce and trade sector*; its credit absorption amounted to Rs.23.5 billion during July-April FY06 compared with the absorption of Rs.32.6 billion in the corresponding period of last year. The credit consumption of the *manufacturing sector* totaled Rs.8.8 billion compared with Rs.9.9 billion consumed in the corresponding period of last year; bulk of the credit was consumed as working capital to support downstream businesses related to textile, cement, automobile and chemicals. *Commerce and manufacturing sectors* combined together accounted for 76.6 percent share in total advances to SMEs compared to 67.8 percent during the same period of last year. The reason for persistent relative concentration of bank credit in these sectors is that these are relatively well organized sectors with superior entrepreneurship. The credit shares of other sectors included: *Services*: 13.5 percent (Rs.5.7 billion), *Mining and Quarrying*: 11.3 percent (Rs.4.8 billion) and *Transport and Communications*: 2 percent (Rs.0.8 billion).

7. Credit to Agriculture Sector

Bank credit to the *agriculture sector* comprises of loans termed as *production* loans and *development* loans. *Production* loans are extended for the procurement of inputs like seeds, fertilizer, and pesticides while *developmental* loans are granted to increase and modernize the fixed assets base of *agriculture sector* through the acquisition of tractors, threshers, and tube wells. Historically, distribution of credit to the *agriculture sector* has remained concentrated towards *production* loans. This is also evident from the recent credit data as share of *production* loans further increased by three percentage points to 84 percent during July-May FY06 over the

corresponding period of last year.

Bank credit to *agriculture sector* (on a gross disbursement basis) grew by 25.7 percent (Rs.116.9 billion) during July-May FY06 compared with an expansion of 50 percent (Rs.93.02 billion) during the same period of last year. *Production loans* rose by 30.8 percent to Rs.98.6 billion while *development loans* registered an expansion of 3.7 percent to Rs.18.3 billion. *Commercial banks* deepened their dominance over the traditional credit leader *ZTBL* as their share in gross disbursements further rose to 63 percent (Rs.73.6 billion) from 58.6 percent (Rs.54.5 billion) in the corresponding period of last year. However, their gross disbursements grew by 35 percent to Rs.73.6 billion.

The credit performance of five major commercial banks continued to improve. However, *National Bank of Pakistan* continued to play a lead role and its gross disbursements amounted to Rs.21.4 billion followed by *Habib Bank Limited* (Rs.20.2 billion), *United Bank Limited* (Rs.8.1 billion), *Muslim Commercial Bank limited* (Rs.5.5 billion) and *Allied Bank of Pakistan Limited* (Rs.4.5 billion). The credit performance of *small private domestic banks* also improved significantly as their credit share rose to 11.8 percent (Rs.13.8 billion) from 10.6 percent (Rs.9.9 billion) last year.

8. Monetary Outlook for FY07

The tight monetary policy stance of the SBP is expected to continue through FY07. Therefore, broad money expansion for FY07 is projected at 13.5 percent (**Table 1**). This projection is supportive of real GDP growth target of 7 percent and inflation target of 6.5 percent. The projected monetary expansion is expected to emanate mainly from accumulation in

NDA of the banking system due to the persistence of strong demand for credit by the private sector. However NFA of the banking system is anticipated to accumulate moderately despite the expectation of large trade deficit in FY07.

Table 1
Monetary Indicators (Targets and Actual)

(Rs. in million)

SECTORS	Credit Plan		Cumulative Flows	
	FY06	FY07	01-Jul-05 to	01-Jul-04 to
			10-Jun-06 ^P	11-Jun-05
1. GOVERNMENT SECTOR BORROWINGS (Net)	120,000	130,100	131,857	101,110
i. Net Budgetary Borrowing	98,000	120,100	120,407	77,153
ii. For Commodity Operations	20,000	10,000	11,424	22,093
iii. Net effect of Zakat Fund/Privatization	2,000	0	26	1,864
2. NON-GOVERNMENT SECTOR (A+B+C)	320,000	395,000	335,123	355,500
A. Credit to Private Sector (i + ii)	330,000	390,000	333,725	377,957
i. Commercial Banks			349,904	374,779
ii. Specialized Banks (a+b+c)			-16,179	3,178
a. ZTBL/PPCB			-12,987	4,198
b. IDBP			-2,767	-2,661
c. SME			-424	1,641
B. Credit to Public Sector Enterprises (PSEs)	-10,000	5,000	2,663	-16,394
C. Other Financial Institutions (SBP credit to NBFIs)			-1,266	-6,064
3. OTHER ITEMS (Net)	-75,000	-75,000	-93,859	-84,223
4. NET DOMESTIC ASSETS (1+2+3)	365,000 (15.67%)	450,100 (13.20%)	373,121 (16.02%)	372,387 (19.56%)
5. NET FOREIGN ASSETS	15,000	9,800	22,409	29,970
6. MONETARY ASSETS (4+5)	380,000 (12.81%)	459,900 (13.50%)	395,530 (13.33%)	402,357 (16.18%)

P = Provisional

Figures in parenthesis are growth rates

Source: State Bank of Pakistan (Economic Policy Department)