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## State Bank's Significant Role in Textile Industry's Development

The State Bank of Pakistan has consistently lent a helping hand to the textile industry due to its strategic significance and contribution to the overall industrial output, exports and employment generation.

In the post-quota regime, the State Bank's support for the textile industry has been extensive and substantive recognizing the intense international competition faced by the industry.

Latest SBP exchange figures indicate that textile exports for July-March FY07 have grown by 10.3%. While in the first few months of FY07 textile exports grew somewhat slowly, it seems to have gained momentum in the last 5 months when the average growth recorded was 11.63%. The composition of exports reflects that exports of yarn, knitwear, towels, synthetic textiles and made-up articles have picked up but few other categories such as cotton cloth, bed wear, and ready-made garments are growing slowly.

At the start of FY07, based on the suggestions from different textile bodies, the State Bank agreed to provide higher level of interest rate subsidy on export financing and long-term financing for exports. Currently, the financing facilities to exporters under the Export Finance Scheme (EFS) are being offered for a six-month period at 7.5% which is around 3% below six-month Karachi Inter Bank Offered Rate (KIBOR), and facilities for import of eligible machinery for a period of up to 3 years under SBP's Scheme for Long Term Financing for Export Oriented Projects (LTF-EOP) are being offered to exporters in the range of 5% below the KIBOR of relevant maturities. Similarly, financing facilities under LTF-EOP for up to 7-1/2 years are available to exporters at 7.0%.

Total gross disbursement from refinancing facility allowed to banks during July 2006 to April 21, 2007 under EFS and LTF-EOP is estimated to be Rs 328 billion of which EFS flows were Rs 284 billion.

It may be pointed out that while providing these incentives, the State Bank has always underscored that the country's financial sector offers fairly competitive financing to textile industry and real interest rates in the country are lower than its regional and competitive partners. This has been further confirmed by an independent report of a consultant hired by the Government.

It is significant to note that FY07 reflects record high-level refinancing support ever provided by the State Bank. This refinancing has had few consequences:

First, refinancing being a creation of new money has an impact on growth of high-powered money. Growth in textile refinancing (LTF-EOP) of Rs 43.8 billion for July-April 07 (relative to Rs.6.7 billion for preceding year)

has as such accounted for 29% of the reserve money growth, which along with exceptionally high government borrowing for budgetary support from the banking system to the tune of Rs.173 billion in July-April 07 (relative to Rs.43.3 billion in comparative period of FY06) has resulted in money supply growth of 16.5% on an annualized basis. This exceeds the annual money supply target of 13.5%.

Second, refinancing has resulted in central bank paying approximately Rs2.0 billion interest rate subsidy to commercial banks, which along with Rs16.4 billion subsidy on textile sector as Research & Development (R&D) support will reduce SBP's profit transfer by an equivalent amount. The State Bank's profits lately have been an important source of revenue for the Government.

Third, excessive refinancing in the current fiscal year has diluted the SBP's monetary tightening stance and the excess liquidity, which could not be retailed by banks, is now finding its way back to the Government securities in different Treasury Bills auctions/Open Market Operations and distorting the overall monetary policy implementation.

Fourth, the excessive refinancing and liquidity generated by it is distorting incentives for commercial banks' deposit mobilization effort. The State Bank's moral suasion and enhanced cash-reserve requirement for current and saving deposits (which are low yielding relative to long-term deposits) and a rise in deposit rates on margin have resulted in growth in deposits. The State Bank contends that this growth would have been still higher but for the refinancing.

It is reiterated that the State Bank's support for textile industry has been extensive and substantive over the last many years. In regular interface with the International Financial Institutions and other stakeholders, SBP has been regularly advocating for improved market access in the United States and Europe. The SBP has been closely following issues of the industry with the commercial banks and within the macroeconomic and fiscal limitations, the funding provided for the textile sector has been large and significant.

There is a widespread recognition that Pakistan's textile industry has made its mark particularly those textile industry operators who have been able to develop their niche markets and continue to compete in international markets.

There is a lot of scope for textile industry to further grow as it improves its productivity and competitiveness.

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