Governor's Message

State Bank of Pakistan is the apex financial institution of the country. It is responsible for regulating the monetary and credit system of Pakistan to foster its economic growth, by fuller utilisation of country's productive resources, while securing monetary stability. During the fiscal year 2013, as in the previous years, the Bank continued to endeavour to achieve its goal of economic growth with low inflation environment despite internal and external shocks and amid difficult trade-offs. Though economic growth remained slightly below the target, SBP succeeded in bringing inflation down to single digit level in FY13.

Noteworthy policy decisions and other developments during FY13 are summarized below:

- The monetary policy easing, which started in FY12, continued in FY13 as well. SBP reduced its policy rate by 300 basis points (bps) in FY13, with a cumulative reduction of 500 bps in the last two years, bringing the SBP reverse repo rate to 9.0 percent. The key drivers of these policy decisions were a sharper than anticipated decline in inflation and attempt to promote dwindling private investment in the country. With the objective to have a forward-looking view while deciding on monetary policy stance, consumer confidence and inflation expectations indices are built by the Bank. These micro level survey based indices are useful in explaining inflation dynamics in Pakistan. For the benefit of external stakeholders as well, SBP has published the survey results, the indices of the consumer confidence and inflation expectations, and the background research on its website.

- SBP provided banks more flexibility in their liquidity management by extending reserve maintenance period from one week to two weeks (for CRR) and reducing the daily minimum CRR from 4 percent to 3 percent. SBP also guided banks to improve their liquidity management practices by dissuading their frequent access to SBP overnight reverse repo or repo facilities by introducing a spread of plus/minus 50bps for an eligible institution visiting said window more than seven times in a given quarter. Dissemination of bank-wise data on excess cash reserves and banks' use of SBP's standing facilities has brought transparency and efficiency in our money market.

- With the introduction of an interest rate corridor of 300bps, in August 2009, volatility in the short-term interest rates reduced significantly that helped in strengthening the transmission mechanism of the monetary policy. In order to improve the transmission mechanism by further reducing the interest rate volatility in the short-term interest rates; SBP narrowed the interest rate corridor by 50 bps, effective February 11, 2013, to 250 bps.

- Most of the banks in Pakistan were used to pay profit to saving depositors on minimum monthly balances. To promote savings by rationalizing the deposit rates, and to reduce high banking spreads by bringing compatibility between the return on loans and the payment of profit on saving deposits; banks are now, effective from April 01, 2013, directed to pay profit to depositors on average monthly balances. Furthermore, instead of following a discretionary policy to fix the minimum deposit rate, SBP has recently made a rule for it by linking the same to the floor of the interest rate corridor. The minimum profit rate to be paid on all PKR saving deposits will now be 50 bps below the prevailing SBP repo rate.

- In order to improve transparency and bring standardization in Islamic banking institutions' profit and loss distribution policies and practices, SBP issued instructions for 'Profit & Loss Distribution and Pool Management for Islamic Banking Institutions' on November 19, 2012. The instructions were well received by domestic and international stakeholders, which are likely to improve perception and understanding of the masses generally and Islamic banking clients particularly.

- The exchange rate policy in Pakistan continued during FY13 to aim at ensuring smooth functioning of the foreign exchange market and optimizing foreign currency reserves of the country. Considering the increasing volume of transactions and enabling banks to manage large flows without adding excessive volatility in the market, SBP raised the cap on aggregate foreign exchange exposure limit (FEEL) of individual authorized dealers (ADs) from PKR 2.5 billion to PKR 3.5 billion and increased the overall FEEL of the market by 9.7 percent. During FY13, PKR exhibited a modest depreciation of 5.1 percent against US$ in the interbank market, compared to 9.1 percent depreciation in FY12. Proactive approach of SBP to market regulation and management not only led to stability in the foreign exchange market, but also enhanced the depth of the market. Though the deficit in the balance of payments and IMF debt servicing resulted into a fall in the country's foreign exchange reserves during FY13; the decline in the reserves was gradual due to prudent SBP management that helped to avoid any undue negative impact on the market sentiment.

- In consonance with the policy to organize and facilitate the foreign exchange companies (ECs), the SBP issued comprehensive network expansion policy for the ECs. Through this policy, ECs have been provided with detailed set of instructions regarding network expansion that has been linked with capital and compliance ratings of ECs. Further, in order to protect the interests of the buyers/sellers of foreign exchange, SBP made it mandatory for ECs that the spread between buying and selling rates of foreign currencies should not exceed 25 paisas.

- In order to facilitate the foreign currency depositors/borrowers and to increase liquidity in the foreign exchange market; regulations related to foreign currency accounts and trade loans (under FE-25 scheme) have been further clarified during FY13. ADs have been allowed to open foreign currency accounts and extend trade loans in US Dollar, UK Pound Sterling, Euro, Japanese Yen, Canadian Dollar, UAE Dirham, Saudi Riyal, Chinese Yuan, Swiss Franc and Turkish Lira. Furthermore, the interbank placements and interbank SWAPs or any other source of foreign currency liquidity, permitted under SBP regulations, are now allowed to be used for trade loans (in the currency of the underlying LC/Firm Trade Contract) in the above foreign currencies.

- In order to facilitate and support efficient flow of workers' remittances and to provide domestic investment opportunities to overseas Pakistanis; a joint initiative, called Pakistan Remittance Initiative (PRI), was launched by SBP, Ministry of Overseas Pakistanis, and Ministry of Finance in early 2009. The establishment of PRI has contributed significantly in enhancing the flow of workers' remittances to Pakistan, which emerged as a major source to finance the trade deficit of the country. Remittances financed over two-third of Pakistan's trade deficit during FY13 compared to less than one-third of the trade deficit financed by the remittances during FY08.

- One of the core responsibilities of SBP is to regulate and supervise the financial system (comprising banking institutions/DFI's and ECs) to ensure its soundness and stability. As part of enhanced surveillance, SBP has been assessing the resilience of banking system towards shocks arising from both the financial and macroeconomic risk factors. The Bank has also been preparing and publishing quarterly Financial Soundness Indicators (FSIs) of the banking industry for the benefit of stakeholders. Through enforcement of consumer protection framework; current regime of banking regulation and supervision in the country is effectively protecting the rights of financial consumers as well.

- Consequent to changes in the international capital standards and to strengthen SBP's regulations on banks' capital adequacy, Quantitative Impact Assessment was carried out to evaluate the impact of newly proposed Basel-III capital regime on capital adequacy of Pakistani banks. The assessment indicated that, with the exception of a few small-size banks, banking industry was well placed to comfortably meet the capital requirements as prescribed under Basel III capital accord.

- During FY13, SBP made developments on its plan for the consolidated supervision of banking groups and financial conglomerates in collaboration with SECP. Objective is to monitor and mitigate the contagion risk and address the challenges which may arise from conglomeration in the financial sector. In order to strengthen the ongoing monitoring framework, the BPRD of the Bank, in collaboration with SECP, devised and issued regulatory returns (in September 2012) to collect key information from banks and NBFIs on half yearly basis.

- Bank branches and ATMs reflect access to finance. During FY13 banks were allowed to open 772 new branches which included 527 conventional banking branches, 172 Islamic banking branches and 73 microfinance branches. Accordingly, total number of bank branches in the country increased to 11,699. Keeping in view the low ratio of ATMs per branch in Pakistan; banks have been advised to add one ATM in their network against each new branch to be opened in CY13 and onwards. Banks, having ATM per branch ratio less than 1, are advised to cover their existing gap linearly in 5 years starting CY13. During FY13, SBP also allowed Pakistani banks to further expand their overseas operations in Afghanistan, Bangladesh, Mauritius, Bahrain, Sri Lanka, Seychelles, Malaysia and China. Presently, 8 Pakistani banks are operating in 36 countries of the world to serve Pakistanis there and the host countries.

- Given the importance of SMEs to the country's economic growth and employment prospects; SBP rationalized SME Regulations, during FY13, to encourage lending to such enterprises. These regulations focused more on Small Enterprises, by defining them separately (from the Medium Enterprises) and formulating more specific and simpler regulations for them. SBP also put in place a Credit Guarantee Scheme for Small and Rural Enterprises, which allowed banks to develop a portfolio of fresh borrowers who are creditworthy, but could not fit into the usual credit parameters of banks, especially when collaterals were required.

- During FY13, microfinance banking sector has gained traction, marked by fresh equity investments, growing deposits, and rising profitability. Pakistan's microfinance and branchless banking market has become one of the fastest growing and innovative markets in the world. SBP's role, to foster a thriving environment for microfinance and branchless banking in the country, has garnered esteem and acclamation from financial inclusion experts and organizations across the globe.

- A pilot Nationwide Financial Literacy Programme (NFLP) was launched by SBP in FY12 in collaboration with and support from Asian Development Bank, Pakistan Banks Association (PBA) and Pakistan Poverty Alleviation Fund; to assist financial inclusion and poverty alleviation efforts across the country. It was completed in FY13 by reaching around 50,000 beneficiaries. The programme focused on disseminating basic education about financial concepts, products and services to masses; explaining budgeting, saving, investment, debt management and consumer right and responsibilities. We intend to scale up this programme in coming year, to 500,000 poor and low income Pakistanis, which are more prone to financial fraud/victimization.

- Successful upgrade of core Enterprise Resource Planning system was a major achievement of IT in SBP during FY13. To align with the developments on business systems, technological infrastructure of the Bank has also been augmented this year. Similarly, the protection of information assets of the Bank was beefed up during the year. Another achievement was consolidation of country-wide Globus related support mechanism into a central workflow solution using the SBP Service Desk system. SBP also strengthened and upgraded IT setup for SWIFT international payments system. Furthermore, keeping in view the risks associated with clear text emails and to address ever increasing phishing threats, SBP (in collaboration with PBA) issued a circular for banking industry to implement industry standard protocol which ensures bank to bank email communication will be authenticated first at the email gateway level and later, contents of the message exchange will be encrypted.

- The SBP Banking Services Corporation (SBP-BSC), established in 2002, is one of the two subsidiaries launched by State Bank of Pakistan, the other one being National Institute of Banking and Finance (NIBAF). SBP-BSC is an operational arm of the SBP. Since its inception, it has shown unswerving advancement in its activities. Voyage of the Corporation witnessed an era of success on different fronts including timely and quality services to Government, banking industry, and the general public. Over time, it strengthened its role as an extended arm of the Development Finance Group of SBP. A visible improvement was observed during FY13 in the area of currency management. It has been made mandatory upon the banks to use good quality notes for ATM operations. SBP-BSC ensured availability of Bank notes (and coins) across the country, particularly on special occasions like Eid ul Fitr.

- NIBAF, being the training arm of SBP, continued to play its role effectively in the development of human capital of the Bank, its subsidiaries and other financial institutions, both local as well as regional. The Institute offered a variety of programmes to 3229 participants from banking and financial sector by delivering 140 weeks of training during FY13. As part of priority for SBP & SBP-BSC, the Institute also launched some programmes to instill new skills critical for job competency and to enhance managerial capacities of staff besides other function specific training programmes.

In the end, I am proud to mention here that a survey, carried out in 2013 by Pakistan's most popular financial daily, of treasury bosses at banks and brokerage houses, showed that SBP's communication is ranked at an average of 6 on a scale of 1-10. It is improved, over the past (2007) perception, as a result of detailed monetary policy statements, data compendiums and higher frequency of policy decisions. Importantly, this improvement is achieved over the period when such skills of the central banks of some developed countries deteriorated in the eyes of the international financial markets, according to another survey.

It is heartening to note that all 7 vacant positions on the Board of Directors of the Bank were filled through appointments by the Federal Government during February-March 2013. Fourteen meetings of the Central Board were held in FY13, during which the Board took various decisions on matters related to corporate governance, monetary policy, banking regulation, financial markets & reserve management, and corporate services. In line with best practices, the Board initiated the practice of formally declaring conflict of interest, if any, with the agenda of each meeting from March 21, 2013 onwards, which is now recorded as part of the Board's proceedings.

During this year, Government also appointed Kazi Abdul Muktadir and me as Deputy Governors of the Bank. Recently Mr. Saeed Ahmad has also been appointed as Deputy Governor of the Bank (on January 21, 2014). After resignation of Mr. Yaseen Anwar as SBP Governor on January 31, 2014, I have been given the responsibility of Acting Governor of SBP by the Government.

I would like to express my gratitude to SBP's Central Board of Directors for their support and cooperation towards discharging the statutory responsibilities. I also extend my appreciation to the staff of SBP for their dedicated efforts to ensure the effective functioning of the Bank.

Ashraf Mahmood Wathra
Acting Governor
State Bank of Pakistan.