



Governor's Review

State Bank of Pakistan (SBP), being a statutory body and central bank of the country, is entrusted with number of policy, regulatory, and fiduciary responsibilities that primarily aim at ensuring monetary and financial stability and supporting growth in the best national interest of the country. During the year under review, the State Bank made headways to achieve its objectives. Following is a summary of key developments and initiatives taken by the Bank during the year:

After monetary easing in the last two fiscal years that witnessed policy rate going down from 14.0 percent to 9.0 percent, SBP changed its policy stance in September 2013. This was primarily based on growing inflation concerns and external sector vulnerabilities; although a healthy expansion in credit to private sector was recorded after nearly four years of slow growth. Thus, during H1-FY14, SBP increased its policy rate to 10.0 percent and since then, SBP has kept the policy rate unchanged. This policy stance proved conducive in keeping inflation close to the target for FY14, providing stability in foreign exchange market and anchoring inflation expectations.

During the year, Central Board of Directors of SBP proposed critical amendments to SBP Act, 1956, with the objective of bringing it in conformity with international best practices of a modern central bank. These amendments include constituting an independent monetary policy committee with external experts, enabling SBP to establish depositor's protection fund in future and allowing SBP to hold properties for the purposes of use of Shariah compliant instrument. These amendments have already been tabled in parliament and their legislation will further enhance the autonomy of State Bank.

IMF Safeguard Mission visited SBP in September 2013 for getting assurance on the adequacy of SBP's controls, accounting, reporting and auditing systems and to ensure integrity of operations. Pursuant to IMF mission's recommendation, the Bank decided to adopt IFRS as its financial reporting framework. Bank's financial statements for FY14 are fully compliant with IFRS, making SBP amongst the selected few in the Central Banks which have achieved this status.

SBP's reserve management strategy for FY14 was shaped to ensure the security and liquidity of foreign exchange reserves. This helped SBP manage its debt obligations despite a sharp deterioration of reserve position at the start of FY14. Foreign exchange reserves have bounced back from the middle of the year and are expected to improve further in FY15. SBP continued to invest in the Chinese domestic bond market, after its agreement with the People's Bank of China in FY13. Foreign exchange reserves yielded a gross return of more than 1.3 percent during FY14, which is quite high under the prevailing zero yield levels in the global financial markets.

During FY14, the bank took a number of initiatives to further strengthen the banking supervision, which adequately complies with internationally recognized Core Principles. After due assessment and modifications for local environment, Basel-III as developed by Basel Committee on Banking Supervision, was issued for implementation in Pakistan over 2013-2019. Moreover, the Prudential Regulations were revised to address emergent risks and assist institutions in better addressing their

unique risks by allowing more discretion in business decisions. To bring improvements in industry's risk management practices, the bank issued guidelines for operational risk management and incentivized the large borrowers to get them externally rated. Further, to ensure the integrity of the banking system against Money Laundering and Terrorist Financing, AML/CFT regulations were further strengthened.

Pakistan has seen substantial progress in financial inclusion, marked by supportive policy framework, a consistent positive growth in microfinance and branchless banking, greater private investment, development of vibrant market infrastructure, and increased use of innovative technologies. During FY14, SBP revised prudential regulations and guidelines for agricultural, micro and housing finance, and continued implementation of market development initiatives including risk sharing guarantees for SMEs and microfinance sectors, encouraging innovation in agri and rural financing, livestock loan insurance scheme, capacity building and awareness programs for banks and consumers. FY14 also witnessed deepening of our relationship and collaboration with international development partners. SBP initiated formulation of a National Financial Inclusion Strategy in collaboration with the World Bank to address financial exclusion in a structured and well coordinated manner.

To foster a viable alternate banking system, Islamic Banking remained a top priority for the central bank. A medium term strategic plan for Islamic Banking was launched during the year. Other key initiatives include issuance of Shariah Governance Framework, adoption of Shariah Standard on Investment Sukuk and issuance of instructions for free-of-cost priority banking services to harmonize Islamic banking industry.

Over the past 5 years, consistent growth has been witnessed in both Large Value and Retail Payment Systems owing to the increase in economic and financial activities, changing market dynamics and the proactive efforts of SBP. SBP, as current Secretariat of SAARC Payment Council (SPC), is playing an active role in developing and promoting cooperation among member countries and reforming their national Payment and Settlement Systems (PSS). A number of policy initiatives are in pipeline to improve the Financial Market Infrastructure.

State Bank continued its efforts to inculcate a culture of treating customers fairly and took a number of initiatives to strengthen the consumer protection regime. Moreover, to assist the social welfare initiatives of the government, due regulatory guidance and support was extended to facilitate disbursement of financial assistance to affectees of natural disasters and Internally Displaced Persons (IDPs).

The National Institute of Banking and Finance (NIBAF), being the training wing of the Bank, imparted training and development programs of 115 weeks of course work that were attended by 2,823 participants from local and foreign institutions during FY14. NIBAF continued to offer regional and international programs in the areas of central banking and commercial banking.

The SBP Banking Services Corporation (SBP-BSC), established in 2002 as an operational arm of the SBP, continued to perform various operational activities assigned to it, albeit there is a need to realign some of the operational activities with the changing market trends. It continued to manage currency operations, acted as banker to the Government and scheduled banks, implemented various policies on behalf of the development finance group of the State Bank and managed foreign exchange operations and adjudication. It witnessed a large number of attrition in its work force mainly due to early retirement scheme. The Management of BSC, therefore, embarked upon a major initiative to induct entry-level batches, not only to fill the HR gap in terms of head count but also to improve the skill

mix of its work force. It is in the process of gearing itself to meet the emerging challenges especially in the areas of automated handling of currency and e-banking to provide better quality services to its stakeholders besides substantially improving internal controls.

Subsequent to year end, certain significant developments have taken place which requires a brief mention. The Bank has now constituted an advisory committee on monetary policy to strengthen the process of monetary policy formulation. The Bank has also been able to resolve a longstanding issue of restructuring of Zarai Taraqiati Bank Limited and House Building Finance Company Limited, the implementation of which is underway.

At the end, I am pleased to report that twelve meetings of the Central Board were held during FY14, out of which five meetings were to decide the Monetary Policy stance. During the year, I took charge as Governor, SBP subsequent to the resignation of Mr. Yaseen Anwar, ex-Governor on January 31, 2014. Further, Mr. Saeed Ahmad was also appointed as a Deputy Governor, to join the existing DG Mr. Kazi Abdul Muktadir.

To conclude, I acknowledge the support extended by SBP's Central Board of Directors to address the challenges entrusted to me as Governor. I am confident that with competent and dedicated human resource, the Bank will be able to capitalize on the successes gained in the areas of monetary management, financial stability, and governance. I also expect that the employees of the Bank will continue to uphold the traditions of hard work, dignity, and professionalism towards achieving the strategic goals of the Bank.

Ashraf Mahmood Wathra
Governor
State Bank of Pakistan.

Dated: 25-10-2014