

Governor's Review



I am pleased to present the performance review of SBP for FY16 which was another promising year in the recent economic history of the country. Macroeconomic indicators continued to improve during the year with average annual headline CPI inflation declining to a historic low of 2.9 percent, the real GDP growing by 4.7 percent, the highest level in the last eight years and foreign exchange reserves touching an all time high of USD 23.1 billion. The credit to private sector almost doubled and the net Foreign Direct Investment increased to USD 1.9 billion during the year as compared to USD 0.9 billion in the previous year, largely due to the ongoing CPEC related projects.

The low inflation environment also provided space to further reduce the policy rate by 75bps to 5.75 percent to facilitate investment and business activities, while keeping the real rate of return on deposits positive. During the year, Pakistan became the first major country in the South Asian region to have an independent Monetary Policy Committee (MPC) after requisite amendments in the SBP Act, 1956 were promulgated in November, 2015. The MPC has three external economists, three SBP Board members and three SBP executives, with the Governor as its chairperson. It has been mandated to independently formulate monetary policy. The minutes of the MPC meetings are also publicly disclosed to ensure transparency and to allow the public and the concerned stakeholders to better appreciate the MPC's decisions-making process.

The foreign exchange market also remained stable after witnessing some volatility in the first quarter of the year. After depreciating by about 3 percent against the USD in the first quarter, the Rupee-USD parity stabilized at around 105/USD in the last three quarters. While exports declined by 8.8 percent, remittances grew by 6.4 percent to reach USD19.92 billion by the year end. The market also remained liquid which not only helped in maintaining exchange rate stability but also enabled SBP to strengthen the FX reserves that reached a record high level, equivalent to the country's over five months import bill. These reserves have been invested in well-diversified instruments, managed both internally and externally, keeping in view the overall guiding principles of safety, liquidity and return.

During the year, the banking industry experienced some pressure on its profits due to declining interest rates and spreads, however, the outlook remained stable with high solvency levels, a strong capital base, contained Non Performing Loans and improving risk management systems. The banking industry grew by 16.1 percent during the year. The doubling of private sector credit was the most encouraging development during the year that contributed significantly in achieving the 4.7 percent growth in real GDP. This was despite a major setback in the agriculture sector due to the 27 percent decline in the cotton crop. The sharp surge in private sector credit is a reflection of increasing trust and confidence of the business community in the overall improvement in the investment climate of the country.

The year also witnessed continued double digit growth of Islamic banking with 16.8 percent and 14.1 percent growth in its assets and deposits respectively. As of end June 2016, its asset base grew to Rs 1,745 billion, representing 11.4 percent of the banking system assets, whereas deposits at Rs 1,461 billion were equivalent to 13.2 percent of the banking industry's deposit base. The outreach of the Islamic banking industry has also expanded considerably with its branch network increasing to 2146 branches in 98 districts across the country. This is well above the target of 2000 branches set in the second Strategic Plan 2014-18 of Islamic Banking Industry.

In line with “SBP Vision 2020”, SBP has initiated work on strengthening the Financial System Stability Framework. A separate ‘*Financial Stability Department*’ was established during the year to focus and steer all financial stability related issues and initiatives including crises management, consolidated supervision and identification and supervision of D-SIBs in the country. A Financial Stability Executive Committee has also been constituted to serve as an internal forum for discussion and coordination of financial stability issues, while the constitution of National level Financial Stability Council is in process.

The regulatory and supervisory framework for banks is reviewed on an ongoing basis to ensure its conformity with the internationally recognized Core Principles and Standards. During the year two regulatory liquidity standards i.e. Liquidity Coverage Ratio (LCR) and Net Stable Funding Ratio (NSFR) along with a set of five risk monitoring tools were issued for implementation from 2017. This would enable banks to objectively measure liquidity risk and take necessary corrective actions. A Risk Based Supervision project has also been initiated, to graduate to the next level of risk based supervision. This would help in prioritizing resources, improving responses to financial stress conditions and enhancing our understanding of the risks at the institution level. The long awaited deposit insurance scheme is also planned to be launched in the near future, as both the National Assembly and the Senate approved the proposed Deposit Protection Corporation Act, 2015 during the year. The law is in line with International Association of Deposit Insurers’ (IADI) Core Principles for an effective deposit insurance system. It envisages the establishment of the Deposit Protection Corporation (DPC) as a subsidiary of SBP to provide coverage to all the depositors up to a certain limit, to be decided by the DPC Board. The membership of DPC will be mandatory for all banks operating in the country. With the establishment of DPC, a major gap in the financial stability infrastructure will be filled and would serve to further enhance the confidence and trust of the general public in the banking system.

Consumer protection and ensuring fair treatment of consumers has been a major focus of SBP’s regulatory and supervisory policies and initiatives. A number of guidelines and regulations were issued during the year to ensure fair treatment of consumers by banks. Further, to facilitate banks in having a reliable mechanism to assess their conduct with customers, a Conduct Assessment Framework (CAF) was developed and shared with the banks. The CAF, besides enabling the banks to objectively assess their conduct, will also serve as the conduct monitoring tool for SBP. The campaign for improving financial literacy has also been intensified, as better consumer awareness about financial products and services would serve as the first line of defense against any unfair treatment of consumers by banks.

The development of a modern and robust Payment System in the country is one of the key Strategic Goals of SBP’s Vision 2020 which includes: i) development of the National Payment System Strategy ii) modernizing and expanding payments, clearing and settlements infrastructure to improve efficiency, security, costs and access, iii) implementing a robust regulatory and supervisory framework for Financial Markets Infrastructure and iv) maintaining the quality, security and adequate supply of banknotes and coins in circulation. To promote usage of PRISM by banks’ customers, banks were advised to ensure availability of PRISM funds transfer facility at their branches and create awareness among general public about its usage. In order to ensure timely interbank transfer of home remittances, the use of PRISM system has been allowed free of charges. Further, to enhance the capacity of PRISM and address systemic risks inherent in the Large Value Payment System, the PRISM System upgradation project was initiated during the year, which will be completed during FY17. SBP also facilitated the launch of the first domestic payment card PayPak by 1-Link to provide a low cost card-based payment solution to customers in the country. This is expected to boost the use

of cards as an important payment instrument in the country and will thus be instrumental in modernizing the payment system.

The implementation of the National Financial Inclusion Strategy (NFIS), developed last year in collaboration with the World Bank, continued with full vigor during the year. The introduction of Low Risk "Asaan Account" with simplified due diligence requirements brought 1.13 million more people in the banking system. Branchless banking has been another key instrument for increasing financial inclusion. The industry added about one million mobile wallets during the year thus increasing the total mobile wallets to 14.6 million spread across the country. Further, 55,000 biometric devices have been installed at agent locations to facilitate paperless and hassle-free account opening for customers, which will help in achieving the goal of developing an inclusive financial system. The expansion of agriculture and rural finance has also been an important component of the financial inclusion strategy. Despite negative growth in the agricultural sector during the year, agri-finance continued its growth momentum, increasing by 16 percent to Rs599 billion. Encouragingly, the agri-finance sector added over 200,000 new borrowers during the year, thus increasing the total outreach of the sector to 2.4 million active borrowers from 2.2 million in the previous year.

Some encouraging activity has been seen in the housing finance sector, which grew by almost 17 percent during the year with all time high disbursements of Rs 20.13 billion. This could be attributed to the low interest rate environment prevailing in the country. During the year, SBP also succeeded in getting the Financial Institutions Recovery Ordinance, 2001 amended to provide legal cover to banks to take legal action against housing finance defaulters. This has addressed one of the key concerns of banks and would thus give a boost to the housing finance market. SBP is also promoting 'Green Banking', which would help to address energy shortages and environment degradation issues being faced by the country. A special unit has been created in the Development Finance Group to work as a focal point for all Green Banking initiatives.

Progress on strategic goals is not possible without building the necessary institutional capacity. As envisaged in Vision 2020, SBP made focused efforts to strengthen HR and IT systems' capacity and improve organizational efficiency. To attract quality human resources from the market particularly at entry level, the Bank's HR team visited reputed business and management schools across the country to promote 'SBP' as an 'Employer of first choice'. Further, being a knowledge based organization, SBP is investing heavily on training and development to ensure compatibility of the skills mix of its HR with the industry dynamics. During the year, 8058 man-days of in-house trainings were completed, besides sending 170 officers on foreign training to reputed international institutions and central banks. To sharpen the leadership skills of middle and senior management officers, several iterations of the world renowned 'Management Grid' program were completed, enabling around 125 officers of middle to senior management level to enhance their leadership skills. Further, 35 officers completed the International Certification of Enterprise Risk Management, from the faculty of George Washington University.

Besides HR development, continuous improvement and strengthening of IT systems is also an important component of SBP's institutional development strategy. During the year, several major projects were initiated to upgrade IT systems, including up-gradation of core Banking System (Globus G11) to its latest version Temenos-T24 R15, replacement of underlying servers, storage area network systems and operating systems for catering to the requirements of hosting new / upgraded Business Systems and Applications. Further, in view of incidents of high profile regional cyber attacks, a detailed review of IT Security infrastructure and SWIFT systems was undertaken and adjustments in technology and business processes were made.

In conclusion, I would like to express my gratitude to the SBP Board of Directors for their continuous support and guidance. I would also like to place on record my deepest appreciation of the senior management team members and the staff of SBP who work tirelessly to achieve the organizational objectives.

Ashraf Mahmood Wathra
Governor/Chairman

October 31, 2016