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STATE BANK COMMITTED TO DEVELOP & DIVERSIFY FINANCIAL SECTOR TO SPUR ECONOMIC GROWTH: SYED SALIM RAZA

The State Bank of Pakistan is committed to develop and diversify the financial sector in order to enhance its role in supporting the country's economic growth. This was stated by the Governor, State Bank of Pakistan, Syed Salim Raza while delivering his keynote address at a Prize Award Ceremony of the Institute of Bankers, Pakistan in Karachi today.

'Pakistan is currently standing at a juncture where long-term investment in infrastructure is crucially needed to facilitate the process of economic growth', the SBP Governor added.

Stressing the need for the development of capital markets, Mr Raza said that developing bond markets and enhancing the capacity of public- and private-sector borrowers to issue long-dated local currency denominated debt securities is high on the country's policy agenda. Among other factors, the presence of the requisite investor base is crucial for the development of both the primary and the secondary markets in debt securities, he said and added that the regulatory environment should provide the right incentive framework to encourage both individual and institutional investors to invest and trade in debt instruments.

The Governor opined that the banking sector, which enjoys virtual monopoly in providing financing to all sectors of the economy, can play a contributing role in the development of the debt market. He said the central bank has a crucial role in promoting secondary market trading of debt securities by improving the effectiveness of monetary policy implementation.

'Development of the term structure of interest rates depends on regular issues in the primary market, increased trading activity in the secondary market, and providing ease of entry and exit to both the issuers and the investors. Regular auctions of Pakistan Investment Bonds (PIBs) since May 2006 is a step in this direction', Mr Raza observed.

Referring to sustainability of the banking sector, Mr Raza observed that banks in Pakistan have been able to withstand the headwinds from the weakening macroeconomic fundamentals since FY07. 'Now that the economy is poised for a remarkable turnaround, the banking sector has an even greater role to play in supporting the real sector by meeting its financing needs', the SBP Governor added.

He said that Non Performing Loans (NPLs) of country's banking system are expected to stabilize with the improvement in macroeconomic fundamentals as the recent macroeconomic pressures which eventually led to a slowdown in economic growth in FY09, indicate that the increase in NPLs of the banking system is largely of a cyclical nature. 'The sensitivity analysis undertaken at SBP suggests that the banking sector is well placed to withstand credit risk shocks of a modest nature', Mr Raza said and added that the provisioning coverage ratio of around 70 percent at end March 2009 also shows a prudent and proactive approach towards credit risk management.

He said that in response to the emerging dynamics in the macro-financial environment, SBP has rationalized the Minimum Capital Requirement (MCR) and the time period in which it needs to be implemented, thus providing the much required breathing space to the banking industry in this difficult macroeconomic environment.

Mr Raza emphasized that banks need to make concerted efforts to ensure a sustained deposit growth by tapping the unbanked market, increasing financial penetration and facilitating the process of financial intermediation.

The SBP Governor observed that banks' loan portfolio is highly skewed towards big sized loans. Classification on loans by account size indicates that only 0.5 percent of total bank borrowers with loans size of more than Rs 10.0 million are using 71.7 percent of banks' loan portfolio, Mr Raza said and added this indicates high concentration risk in the banking sector.

'Sensitivity analysis of concentration risk in banking sector suggests that the default of the three largest fund- based exposures can cause the aggregate Capital Adequacy Ratio (CAR) to fall below the minimum requirements. These risks can be easily managed in the presence of well developed capital markets,' he added.

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