November 23, 2009

SBP ensures sound financial system in challenging economic times: Salim Raza

Syed Salim Raza, Governor State Bank of Pakistan has said that the central bank strived to strike a balance between price stability and growth in a challenging economic environment and ensured a stable financial system by proactively responding to emerging risks and challenges to the banking system and taking appropriate corrective measures timely.

In his message embodied in the Annual Report (Vol. II) on State Bank's Performance Review for the year 2008-09 (FY09) which was released today, Mr. Raza said that the implementation of the macroeconomic stabilization program was primarily driven by tightening monetary and fiscal conditions to facilitate the resolution of structural problems. "These measures yielded results in subsequent months: fiscal deficit was substantially contained, from Rs777.2 billion in FY08 to Rs680.4 billion in FY09, at 5.2 percent of GDP (down from 7.4 percent in FY08), on the back of elimination of subsidies as well as a cut in development expenditure," he added.

He said that monetary tightening had a visible impact on CPI inflation which fell from its peak of 25.3 percent in August FY09 to 13.1 percent by June FY09; giving SBP the much needed breathing space to switch the direction of its policy stance. Furthermore, after unabated expansion in the last four years, the current account deficit contracted considerably to 5.3 percent of GDP during FY09, from 8.4 percent in FY08. "These positive developments need to be viewed with caution, however, given that the economy continues to be fragile, and an assessment of the balance of risks continues to present a mixed picture," he added.

Mr. Raza said that as inflationary pressures began to ease SBP reduced its policy rate by 100 bps each in April FY09 and August FY10, to 13 percent. Notably, it was the consistent approach to curbing excessive demand pressures which helped subdue inflation. In FY09, SBP issued three monetary policy statements (MPS), i.e., for the first half and then one each for the last two quarters of the year. In November FY09, SBP also announced interim monetary policy measures. Cognizant of the uncertain and rapidly changing macroeconomic environment, and to enhance the effectiveness of monetary policy, SBP decided in January FY09 to increase the frequency of its monetary policy statements; first to quarterly basis, and from August FY10, the frequency was further increased to six times in a fiscal year, he added. Similarly, to further enhance the transparency and credibility of the monetary policy formulation process, SBP constituted an independent Monetary Policy Committee (MPC) consisting of both internal and external members.

He said that segregation of debt and monetary management with an objective of strengthening the monetary policy framework was the highlight of FY09. In January FY09, the responsibility of deciding the cut-off yields in the primary auctions of Treasury Bills (T-bills) and Pakistan Investment Bonds (PIBs) was shifted to the Ministry of Finance, while SBP's role was to manage the operational aspect of the auctions. "This measure was taken to communicate that changes in the cut-off rate are not reflective of the monetary policy stance, while allowing SBP to focus on liquidity management consistent with the requirements of monetary policy implementation," he added.

SBP Governor said that in response to the changing economic and business cycle, the central bank also stepped in to facilitate the banking sector by rationalizing the minimum capital requirements to Rs10 billion, to be implemented in a phased manner by December 2010, and allowing the use of 30 percent of the Forced-Sale Value (FSV) of collateral in calculating provisioning requirements for the rising base of Non Performing Loans (NPLs). In view of the complex regulatory requirements of large financial conglomerates, SBP also signed a Memorandum of Understanding with the SECP to undertake consolidated supervision. Similarly, progress on modernization of the legislative framework including the revamping of SBP Act, 1956, and the Banking Companies' Ordinance 1962 is underway, while efforts are also underway to introduce a Deposit Protection Scheme and a Consumer Protection Act.

Mr. Raza said that first half of FY09 was characterized by a continuation of pressures in the foreign exchange market. During Jul-Oct FY09, the trend of deterioration in current account deficit seen in FY08 accelerated further, mainly owing to higher import prices and a sharp fall in financial inflows. This led to a rapid depletion of foreign exchange reserves along with substantial pressure on the exchange rate. However, subsequent implementation of a macroeconomic stabilization program led to a marked improvement in the external account position in the ensuing months. This also helped SBP build up foreign exchange reserves which had dropped to US$ 6.7 billion in October FY09, back to the almost end June FY08 level of US$ 11.4 billion, he added.

He said that in continuation of SBP's efforts to strengthen its reserve management capabilities, substantial value were added to its profitability through active management of the investment portfolio in FY09. On gross return basis, SBP managed to earn a return of 2.31 percent, which while less than the 4.9 percent return in FY08, is still significant given the situation in the global financial markets, he added.

Referring to several initiatives taken by SBP to broaden access to financial services to the marginalized sectors of the economy, Mr. Raza said that SBP in partnership with the UK Department for International Development launched the Financial Inclusion Program in July FY09. The Financial Inclusion Program worth UK £50 million is being implemented by the State Bank of Pakistan and the program was designed and developed through broader consultations with the stakeholders. This will help SBP implement Pakistan's Microfinance Strategy which was approved by the Prime Minister.

The detailed Annual Report Vol. II can be accessed at SBP website www.sbp.org.pk.

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