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Pakistan's financial system size increases to Rs 9.2 trillion by June 2010: SBP Report

Pakistan's financial system size, in terms of assets, increased to Rs 9.2 trillion by end-June 2010 showing a robust growth of 20 percent from December 2008 level of Rs 7.71 trillion, says State Bank's Financial Stability Review 2009-10, which was released today.

The Report, which presents an assessment of financial stability for 2009 (CY09) and the first half of 2010 (H1-CY10), is based on the theme of "Role of Government in the Financial Sector" and assesses the government's developmental role in enhancing the financial development in the country. The Report said that stability of the financial system is largely derived from the pre-dominant position of the banking sector, as other components of the financial system continue to grow at a more gradual pace. "Domestic banking sector assets constitute 73.2 percent of total financial system assets", the Report added.

It said the bank deposits, which have a key contribution in maintaining financial stability, grew by 13.5 percent in CY09, and 8.2 percent in H1-CY10, bringing the total deposit of the banking system to Rs. 5.1 trillion by end-June CY10. "This bodes well for enhancing prospects of financial stability, especially keeping in view the slowdown in deposits growth in CY08," the Report added.

The deposit growth is largely driven by the growth in home remittances of 23.9 percent (in USD terms), gradual economic recovery, and the substantial increase in government borrowing, a portion of which flows back into the banking system in the form of deposits, it added.

The Report opined that healthy deposit growth is indicative of banks' resilience to the competition from the National Savings Schemes (NSS), which generally offer a higher rate of return than bank deposits. It said that the pace of deterioration in the quality of advances slowed down considerably as in CY09 Non Performing Loans (NPLs) increased by 24.2 percent to Rs 432 billion and further by 6.4 percent to Rs 460 billion by end-June CY10. 'Going forward, NPLs remain a key cause of concern for the banking sector,' it added.

However, the Report noted that structural weaknesses in the process of revenue generation, significant rigidities in government spending, expansion in quasi-fiscal operations have added to the fiscal burden, which is increasingly financed from the financial system.

It pointed out that the banks' exposure to the government increased significantly during 2009 and in the first half of 2010, with particular concentration in the power sector due to the ongoing issue of circular debt, and continued increase in lending to public sector enterprises and commodity finance in general. Finding the government to be a captive client, banks' behaviour to lend more to the government and to public sector agencies impedes the process of productive activity in the economy, it said. This causes crowding out of the private sector, to the extent that demand for credit exists, which in turn carries long term implications for economic growth, with feedback impact on banks' asset quality and hence on financial stability, it added.

"In the current circumstances, while it may be prudent for banks to allocate their loan and investment portfolio in favour of public sector to maximize profits in the short run and minimize risks, a long term strategy requires an allocation of their portfolio in favour of the private sector, which is the main engine of growth and productivity," the Report added. At the moment, the flow of bank credit to the private sector remains hampered and the basic objective of financial intermediation i.e. efficient allocation of resources is not being met, the Report opined and stressed upon the need to reverse this trend on a priority basis.

Referring to other components of the financial system, the Report said that the dormant element of funding risk in case of Non-Bank Financial Institutions (NBFIs), which emerged as a strong threat to their commercial viability in CY08, continues to be a source of systemic risk. Whereas, insurance sector, on the other hand, continues to provide requisite support to the economy, despite its small size and low penetration.

With regard to financial markets, the Report said that in contrast to the volatility in global financial markets since the inception of the global financial crisis, financial markets in Pakistan have continued to strengthen, primarily due to the low level of integration with global financial markets, and in response to the ongoing reform process, domestic financial markets continue to provide requisite support to the financial system in performing its function of financial intermediation.

The detailed Report is available at State Bank's website www.sbp.org.pk.

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