Conclusion

The financial sector has not only become more resilient in recent years to withstand any negative external macroeconomic shock, but also better equipped to serve the burgeoning credit needs of the economy. Overall macroeconomic scenario also remained supportive to financial sector stability. Most of the indicators like high real GDP growth, low inflation, narrower fiscal deficit, improved debt and debt servicing, surplus current account balance, and stable exchange rate suggest that financial sector vulnerability has decreased significantly as a result of broad-based improvement in the economy. However, phenomenal growth in private sector credit, steep rise in equity and real-estate prices and existing monetary overhang are some areas which have the potential to increase various risks that can affect the performance of financial sector.

Cognizant of above mentioned risks, the apex regulatory institutions, both SBP and SECP have taken several measures to safeguard the financial system from any adverse shock. Regulations and guidelines are continuously being refined through an actively-sought feedback form stakeholders. A recently introduced system of Institutional Risk Assessment Framework (IRAF) by SBP will go a long way in promptly correcting any creeping weakness in banks and DFIs. This together with NBFC Prudential Regulations and other guidelines by SECP has made the financial system adequately capable to manage various financial risks.

The outreach of financial sector has significantly expanded, as banking with SME sector and consumers has witnessed a visible rise in recent years. The outreach to these areas is likely to grow further in coming years due to: (1) a number of banks have developed human resource expertise to tailor products according to specific targeted markets and to manage the related risks; (2) this area is largely untapped, except for making of beginning inroads, and as such it has a great potential; and (3) legal infrastructure has been developed by the regulatory authorities allowing financial institutions to mobilize matching funds and launch risk-mitigating products.

Besides consumer finance, increasing activities of the microfinance institutions (MFIs) are not only helping to fight poverty, but also promoting banking with poor. These microfinance activities are envisaged to surge in future due to emergence of new institutions in this market segment. SBP has already issued a separate set of Prudential Regulations for these institutions. Moreover, under Microfinance Sector Development Program (MSDP) various funds have been created with the help of Asian Development Bank to mitigate risks as well as to provide microfinance facilities on sustainable basis. In addition, this sector has great potential to grow, as the existing MFIs are currently catering only to the needs of a small segment of a large population.

Another important development in financial sector is the emergence of Islamic banks. Although efforts to Islamization of the banking system date back to early 1980s, it is the recent past when the full-fledged Islamic Banks started their operations parallel to the conventional interest-based banks. The SBP has constituted a Shariah Board and established a separate department to deal with the rules and regulations of Islamic Banking. Although present activities of the financial institutions focusing on Islamic modes of financing form only a miniscule portion of overall finance sector, these are likely to grow at greater pace in future as the extent of prospective users is quite large.

Financial markets, which performed impressively to cater to the needs of the market players, are likely to deepen further in coming years. While money market is likely to benefit from the establishment of money market funds and the opening up of the avenue to issue commercial papers, foreign exchange market will experience the establishment of foreign exchange companies. Capital

market, which performed exceptionally in recent years with respect to various yardsticks, is expected to sustain the existing momentum. The replacement of Badla financing with the Margin financing and numerous steps taken by SECP will help to further strengthen the capital market.
Although rapid credit expansion to the non-traditional areas has raised concerns about the asset-quality of the financial sector, the non-performing loans continued to decline. While declining burden of NPLs is a welcome development for the financial sector in aggregate, the financial institutions must tighten their internal administrative and management controls to keep an eye on expanding credit portfolios. This is of utmost importance, as aggressive credit expansion particularly against highly inflated equity and real-estate values has the potential to impair the asset quality of the financial sector. However, the likelihood of such possibility is minimal due to strengthened SBP supervisory mechanism and capacity building within the financial sector.

Furthermore, the SBP has recently increased its minimum capital requirements for both the banks and DFIs largely in line with the Basel Capital Accord II (Basel II) to further strengthen the shock absorbing capacity of these institutions. The increased minimum paid-up capital (net of losses) will not only help to expand their financial activities in an increasingly competitive business environment, but may also aid the process of on-going mergers/acquisitions in coming years.

Although structure of financial sector remained highly skewed towards the banking system, the ownership structure has significantly changed towards the private sector. The later is envisaged to change further due to increasing activities of the private financial sector institutions and on-going privatization.

Despite a visible improvement in overall financial sector of Pakistan in recent years, it needs to be still emphasized that further development is necessary to catch up with other countries in the region with similar economic characteristics. Recent structural changes, for example developments in the financial sector, economic revival, and the relatively stable rupee will make it possible for Pakistan to substantially improve its position at least in relation to most of the countries with a comparable per capita income.