

# Governor's Review

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I am pleased to present the performance report of State Bank of Pakistan (SBP) for FY15. The year witnessed some major developments including steep fall in international oil prices to six years low and its benign impact on our external sector and domestic inflation, which at 4.5 percent was the lowest in last ten years. The other key macroeconomic indicators including fiscal deficit, balance of payments, current account deficit, real sector growth also showed positive and encouraging trends during the year. The investment to GDP ratio though improved marginally, however, remained modest at 15.2 percent. SBP, during the year, while keeping vigilance on developments on various fronts, vigorously pursued its strategic objectives and continued to enhance and improve its institutional capacity to align it with the strategic direction. This report reviews and examines the progress on strategic objectives as well as the management strategies adopted.

The favorable inflation environment and outlook and stability in the exchange rate during the year, gave us the space to shift the focus of our monetary policy towards catalyzing growth and investment in the country; the SBP policy rate was thus reduced by a total 300 bps during the year. This coupled with improving law and order situation and relatively better energy availability would be instrumental in catalyzing growth in fixed capital investment in the country. The external sector barring exports, which reduced marginally during the year, also registered significant improvement with stable foreign exchange rate and reserves reaching US\$18.7 billion by the close of the fiscal year from US\$14 billion as at end June last year. Further, to improve the monetary policy transmission mechanism the Interest Rate Corridor was revised and SBP Target Rate was introduced. The main purpose of this change was to keep the overnight money market rate close to the target rate. This has now become the main policy rate of SBP distinct from Reverse Repo Rate (ceiling rate). SBP is now signaling its monetary policy stance through changes in the policy rate. We are also very near to establishment of a statutory Monetary Policy Committee in SBP through amendments in the SBP Act that have already been approved by National Assembly and are likely to be approved soon by the Senate.

The banking system closed the year on a strong note with significantly enhanced capital base and solvency levels, declining trend in NPLs, enhanced coverage against NPLs and remarkable profitability levels. While maintaining adequate supervisory oversight on individual banks and financial institutions, we have increased our focus on macro prudential oversight to ensure safety and soundness of overall banking system. The resilience of the system towards both historical and hypothetical single/multi factor shocks is being assessed on regular basis. Similarly to assess the resilience of individual banks against various shocks, each bank/DFI is required to carry out quarterly stress testing exercise as per our *Stress Testing Guidelines*. The stress test results both at the banking system and individual institution level, are encouraging. To further strengthen our capacity to monitor and manage systemic risks we have developed a comprehensive financial stability framework wherein Financial System Stability Council at national level and Financial Stability Executive Committee and Department at SBP level will be created. This would enable SBP to better preempt the systemic risks and take prompt and well coordinated measures to manage the systemic shocks.

Consumer protection is another key focus of our banking supervision policy, which is aimed at ensuring provision of banking services to the consumers in fair and transparent manner. To promote truth, transparency and fairness in banking services, guidelines on *Fair Treatment of Customer* and

*Conduct of Business in Banks* were issued during the year. We have also intensified our efforts for educating consumers about banking and financial services and their rights and responsibilities. The enhanced consumer awareness about banking and financial services will ensure them fairer deal from banks and will help us in increasing financial inclusion.

Payment System being the main artery of the financial system has also remained amongst our key focus areas. During the year, we continued strengthening and modernizing our Payment System Infrastructure, revamping the regulatory framework and enhancing payment options for Federal and Provincial governments, general public, and corporate sector. Considering the dominance of cash in our payment system, a comprehensive strategy was introduced to reform the cash management function from manual to fully automated environment. The process for automation of SBP cash management function and installation of high end banknote processing machine was also initiated. This will help us in checking currency counterfeiting, improving quality of banknotes in circulation and enhancing the efficiency of cash management function in the banking industry. We have also initiated the process for reforming the government payments and receipts system to diversify tax payment options for the tax payers and gradually move towards electronic transfers for all government payments. Further, to optimally leverage the developments in retail payments technology, we are encouraging electronic processing of retail payments. Over the last five years, the volume of e-banking transactions has almost doubled to 469 million valuing Rs 35.8 trillion. Similarly payments worth Rs 179.6 trillion were processed through Pakistan Real-time Interbank Settlement Mechanism (PRISM) during the year, which is approximately 8 times of Pakistan's GDP at current basic prices.

Financial inclusion since the beginning of last decade has emerged as a key strategic objectives of central banks in developing countries. SBP has also been pursuing it as one of the key focus areas of its financial sector policy. It has been at the forefront of all major initiatives, public or private, taken during last 15 years for increasing financial inclusion. During the year we steered the development of a consensus *National Financial Inclusion Strategy* in consultation with all stakeholders. The strategy approved by National Financial Inclusion Council headed by Finance Minister will guide our efforts to promote financial inclusion over the next five years. We also introduced 'Asaan Accounts' during the year with reduced KYC requirements to enable low end clientele to use banking services.

The year also witnessed stellar growth of over 32 percent in disbursements to agriculture sector, which increased to Rs516 billion. A significant feature of the recent credit growth is the increased diversification of agricultural credit into non-crop and non-conventional agribusiness segments. Similarly our flagship initiative of branchless banking has started making massive impact on financial inclusion levels. During the year the number of depositors of microfinance banks increased by over 7 million to 11.5 million primarily due to M-wallet accounts introduced during the year. I strongly believe that the success of microfinance and other financial inclusion policies is highly dependent on optimum use of technology, and as such will remain a key focus area of our financial inclusion strategy. Encouragingly the housing finance market has also started responding to our policy, regulatory and promotional initiatives. The disbursements to the housing sector during the year increased to Rs14.25 billion which is the highest in last 5 years. The long outstanding issue of establishing a Mortgage Refinance Company also saw resolution during the year as Pakistan Mortgage Refinance Company was incorporated and its Board constituted. This is a key milestone achieved which will go a long way in developing a robust housing finance sector in the country.

Islamic banking has also been amongst our key focus areas and we have been playing a leading role in development of this segment of our financial system on sound footings. During the year, we launched

Bai Muajjal of Sukuk as an important instrument for managing liquidity in Islamic banking industry. Further, to encourage graduation of Islamic banking branches of conventional banks into Islamic banking subsidiaries, the MCR for Islamic banking subsidiaries was reduced to Rs 6 billion to be increased to Rs 10 billion within five years from the date of commencement of operations. We have also been working extensively to enhance HR capacity of the Islamic banking industry. During the year, we signed agreements with IBA Karachi, LUMS Lahore, and IMS Peshawar for establishing Centers of Excellence in Islamic Finance in these cities. The centers will produce Islamic finance professionals not only for the domestic industry but also for Middle East, particularly GCC and other far eastern countries.

The development of SBP Vision 2020 was another key task completed during the year. The vision developed through a consultative process identifies the key focus areas of our policy, regulatory, supervisory and promotional initiatives during next five years. The strategic objectives of the vision 2020 are:

- Enhancing effectiveness of monetary policy
- Strengthening the financial system stability
- Improving efficiency, effectiveness, and fairness of the banking system
- Increasing financial inclusion
- Developing modern and robust payment systems; and
- Strengthening SBP's organizational efficiency and effectiveness

The performance achieved in almost all the strategic objectives was not possible without improving the institutional capacity. We continued investing in our human resources and IT and physical infrastructure to have adequate capacity to undertake our strategic objectives. We also reviewed the HR policies to better align them with our strategic goals, enhance transparency and improve employees' motivation. The clarity in the direction and objectives and their full ownership by the Board and the senior management has given a new vigor, energy, and motivation to my team and staff to perform. This gives me optimism for further improvement in our performance on all the strategic objectives.

Lastly, I would like to acknowledge the professional and commendable guidance provided by members of the Central Board of Directors for improvement in the performance of SBP. The commitment and hard work of SBP employees is also appreciable and I expect them to take the same to next levels with the objective of making SBP a model central bank.

**Mr. Ashraf Mahmood Wathra**  
Governor/Chairman

October 26, 2015