Governor's Review

I am pleased to present the SBP Performance Review for FY19, during which the economy faced challenges despite recording healthy growth in FY18 and FY17. The growth was primarily consumption driven which resulted in increase in twin deficits i.e., fiscal and current account deficits. The latest estimates of National Income Accounts indicate that the real GDP grew by 3.3 percent in FY19 as compared to 5.5 percent in preceding period. Owing to high domestic demand, inflation remained above its target in FY19. The current high frequency indicators point towards a marked slowdown in domestic demand along with overall economic activity. However, a modest recovery is expected on account of improvement in agriculture sector and its impact on industry and services sectors.

SBP, being cognizant of the emerging risks to macroeconomic stability, proactively increased its policy rate by a cumulative 575 bps. In the same vein, the SBP raised the policy rate by 100 bps to 13.25 percent with effect from July 17, 2019. The monetary tightening has been supported by greater exchange rate flexibility and administrative measures to contain imports. The government supported the policy adjustments by increasing regulatory duties on consumer and luxury items and arranging external funding to contain deterioration in external buffers (foreign exchange reserves).

The policy actions have led to visible improvement in the country's external accounts and helped in containing domestic demand. Specifically, external conditions continued to improve with a 31.7 percent reduction in the current account deficit (CAD) to USD 13.6 billion in FY19 from USD 19.9 billion deficit in preceding year. The consolidation is likely to gain momentum going forward with CAD to contract further on account of import compression, anticipation of moderate growth in exports and prospects of increase in remittances. Further, the country's financial account is going to benefit from the IMF Extended Fund Facility (EFF), activation of the Saudi oil facility and other multilateral and bilateral commitments.

Both the demand and supply side factors pushed the headline inflation to 7.3 percent in FY19, above the medium term target of 6 percent. Year on year CPI inflation increased by 10.3 and 11.6 percent in July and August 2019, respectively. Accordingly, the Monetary Policy Committee expects average headline inflation (old base of 2007-08) for FY20 to remain in the range of 11-12 percent. This notable increase in FY20 inflation is largely stemming from the one-off impact of adjustment in utilities prices, rationalization of taxation structure and the unfolding impact of depreciation of the PKR in the last few months. However, the lagged impact of stabilization measures and weakening impact of one-off adjustments would significantly reduce headline inflation in FY21.

The Government of Pakistan (GoP) and the IMF have signed a 39-month EFF arrangement amounting USD 6 billion. The program would help strengthening macroeconomic stability and facilitating the implementation of much-needed structural reforms. The GoP in consultation with all stakeholders has developed a well-thought set of economic and financial policies to contain macroeconomic imbalances to manageable levels and to pave the way for sustainable economic growth in the medium to long run.

SBP, considering the importance of financial stability, is working towards formulating and implementing a comprehensive and well-structured Macroprudential Policy Framework (MPPF) to ensure system-wide stability of the financial sector. SBP has substantially improved its macro stress-testing regime to capture the macro-financial interlinkages to enhance its assessment of pro-cyclical systemic risk capabilities. In the same vein, SBP is in the final stage of forming a National Financial Stability Council (NFSC) with the coordination of Finance Division and Securities & Exchange Commission of Pakistan (SECP) for establishing a setup for MPPF. SBP and SECP have also setup a Joint Task Force to monitor and manage the risks posed by the financial conglomerates and address the changing dynamics of the financial industry and the system.

On the supervisory front, SBP is smoothly progressing towards implementing a targeted and forward looking Risk Based Supervision (RBS) framework to strengthen its role. This would help SBP in structured risk profiling of financial institutions, allocating limited resources appropriately and determining responses/ regulatory actions suitably. Similarly, SBP aligned its inspection methodology for Exchange Companies (ECs) with RBS framework to assess risk factors particularly related to terrorist financing (TF) and to evaluate related controls.

On regulatory front, SBP issued guidelines on ‘Governance Framework’ for banks’ overseas operations. The framework is aimed at strengthening banks’ capacity to understand, identify and manage various risks posed by its foreign operations. SBP also issued guidelines on ‘Internal Audit Function’ to provide a standardized framework for establishment and implementation of robust internal audit governance structure, in line with international standards and best practices. Similarly, SBP updated its instructions to further enhance the understanding of Targeted Financial Sanctions regime for TF and Proliferation Financing under UNSC Resolutions.

SBP is pursuing financial inclusion as one of its key strategic objectives under SBP Vision 2020 to promote inclusive economic growth. It adopted National Financial Inclusion Strategy to achieve universal financial inclusion by boosting digital financial services and encouraging priority sector lending in areas including agriculture, SME, Islamic and Microfinance Banking and low cost housing sector. SBP took various initiatives under NFIS including scheme for Asaan Mobile Accounts, Extension of Digital Financial Services, Interoperability of Branchless Banking (BB) Agents and launch of financial literacy programs.

SBP has been encouraging banks to facilitate the agriculture sector, being a priority area. The financial institutions were able to achieve 94 percent of their annual indicative disbursement target of Rs 1,250 billion, assigned by Agricultural Credit Advisory Council for FY19. SBP also remained cognizant of the needs of SME sector. Accordingly, Pakistan Credit Guarantee Company has been established to provide risk-sharing facility to banks for extension of financing facilities to SMEs, which would be operational by end December 2019. Similarly, SBP is assisting Finance Division in establishing a ‘Secured Electronic Collateral Registry’ to facilitate SME sector to secure lending by using their moveable assets as collateral. Encouragingly, the financial institutions met 51.7 percent target of SME financing of Rs 898 billion for CY19 by end June 2019. Similarly, Pakistan Mortgage Refinance Company has been established to provide long term funding to primary mortgage lenders to promote housing sector. In order to facilitate 'Low Cost Housing Scheme' SBP has allowed regulatory relaxations and provided incentives to financial institutions to promote the sector.

Islamic Banking, being an important area under SBP Vision 2020, continued its growth momentum during FY19 due to supportive measures of SBP. These include Shariah compliant alternatives of conventional financing for Renewable Energy, Modernization of SMEs, Storage of Agricultural Produce and Low Cost Housing for Special Segments based on principles of Mudarabah. Similarly, SBP supported Islamic Banking industry by arranging training sessions for government servants, Shariah scholars, businessmen/ traders and students. As a result of various measures, Islamic Banking Industry showed impressive growth. Accordingly, total assets and deposits increased by 20.6 percent and 18.8 percent to Rs 2,992 billion and Rs 2,415 billion respectively by end June 2019.

Being cognizant of the value of a robust payment system for the economy, SBP acted prudently to develop a landscape mutually beneficial for banking industry, businesses, government agencies and the masses. SBP started implementation of Micro Payment Gateway in collaboration of Bill & Melinda Gates Foundation to ensure faster retail payments. SBP expects rapid digitization of public and private sectors' collections and payments particularly of salaries and pensions with the completion of the project. Further, SBP issued instructions on 'Electronic Money Institutions' to address the needs of financially excluded masses and provide suitable environment to technology enabled entities (Fintechs) for provision of cost effective, innovative and user friendly payment services. Similarly, comprehensive instructions were issued to avoid financial losses from cyber-attacks and on-line frauds. Substantial progress has also been recorded on issuance of Euro Visa Master (EMV) chip based cards and adoption of standards like Payment Card Industry Data Security Standard and 3D Secure.

After successful implementation of the project for collection of FBR duties and taxes through Alternate Delivery Channels in FY18, SBP extended the facility for collection of Government of Punjab tax and non-tax receipts. The said facility will be extended to other provincial governments.

Considering the importance of HR, SBP is providing excellent opportunities in terms of developing skill set of its officers due to diverse nature of institutional activities in line with SBP Vision 2020. Further, as an equal opportunity employer, SBP recognizes and encourages the evolving role of women and the strategic significance of their inclusion in the workforce. Presently, 10 percent of SBP's workforce comprises females working at various levels of hierarchy.

IT remained an important area under SBP Vision 2020 to provide seamless services to all business groups of SBP and SBP-BSC. Three new data warehouse systems were implemented to support business activities during FY19. A web API Server for optimizing data integration across IT systems was also developed. The bank realizing the criticality of information security has put in place a robust, state of the art cybersecurity program to secure its IT and information assets by employing market acclaimed information security framework. Further, the Business Continuity Management function provided full support to all critical/ support services departments and offices. Business Continuity exercises were regularly conducted to test the resilience and the readiness level of the institution to respond to disruptions if any, for continuation of critical time sensitive functions of SBP and SBP-BSC.

Enterprise Risk Management Framework has been fully implemented at SBP and SBP-BSC. It has also been introduced in two other subsidiaries i.e. Deposit Protection Corporation and Pakistan Security Printing Corporation. SBP also developed Expected Credit Loss (ECL) models for its investment portfolio in line with the requirements of IFRS 9. The bank also developed a state-of-the art software 'ECL Application' considering the complexities involved in modeling to maintain quality of data, ensure its accuracy and meet compliance requirements of IFRS 9.

SBP's four subsidiaries continued to provide their support and related services to banking industry, government agencies and masses to enable SBP to meet its responsibilities.

Lastly, I would like to express my gratitude to SBP Board for their unflinching support to enable us to meet important milestones. I also extend my appreciation to SBP staff for their continuous efforts and resolve towards enhancing the effectiveness of the institution.

Dr. Reza Baqir
Governor

October 30, 2019