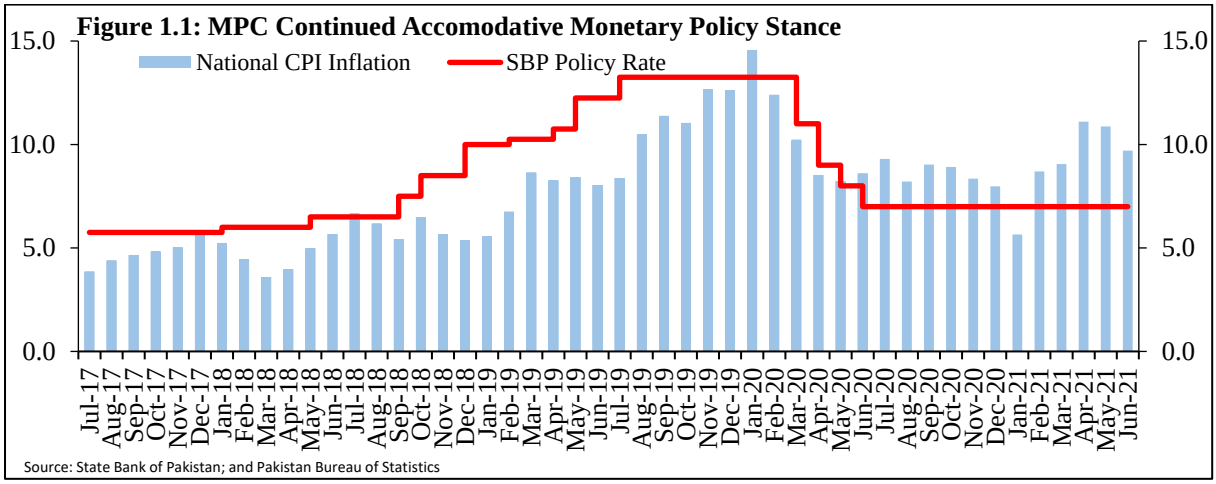
1 Enhancing Effectiveness of Monetary Policy

The domestic and global economic environment remained plagued with uncertainties due to the global spread of COVID-19 pandemic in FY21. While large stimuli packages and introduction and widespread distribution of vaccines, particularly in the advanced economies, raised hopes of a positive global economic outlook, but the emergence of new variants, lower access to vaccines and limited resources in low-income economies created significant downside risks. At the domestic front, emergence of new strains and multiple waves of COVID-19 required a balanced approach that involved both targeted containment measures to slowdown the spread of the virus and a focus on policy measures that would protect employment while leading to a sustainable economic recovery. Accordingly, the Monetary Policy Committee (MPC) maintained its accommodative monetary policy stance and kept the policy rate unchanged at 7.0 percent throughout FY21. The accommodative monetary policy was backed by well-anchored inflation expectations, a strong external position, a continuous build-up in foreign exchange reserves, an active communication and a continuous outreach to the stakeholders (including via effective forward guidance), and data-driven policymaking by the SBP. As a result, the domestic GDP growth clocked in at 3.94 percent, supported by strong private sector credit off-take and growth in both industrial and services sectors. Meanwhile, CPI inflation remained moderate and within the forecasted range of 7-9 percent, despite significant uncertainties and rise in international commodity prices.

1.1 Monetary Policy Stance in FY21

During FY21, the monetary policy stance continued to be accommodative due to uncertainty prevailing in the economy amid the second and third waves of COVID-19 pandemic. In the five meetings held in FY21,[7] the Monetary Policy Committee (MPC) of SBP decided to keep the policy rate unchanged at 7 percent. The accommodative monetary policy stance was backed by well-anchored inflation expectations, moderate inflation within the forecasted range of 7-9 percent, strong external position, buildup in foreign exchange reserves and an effective forward guidance by the SBP. **(Figure 1.1)**.

Figure 1.1: MPC Continued Accomodative Monetary Policy Stance



Source: State Bank of Pakistan; and Pakistan Bureau of Statistics

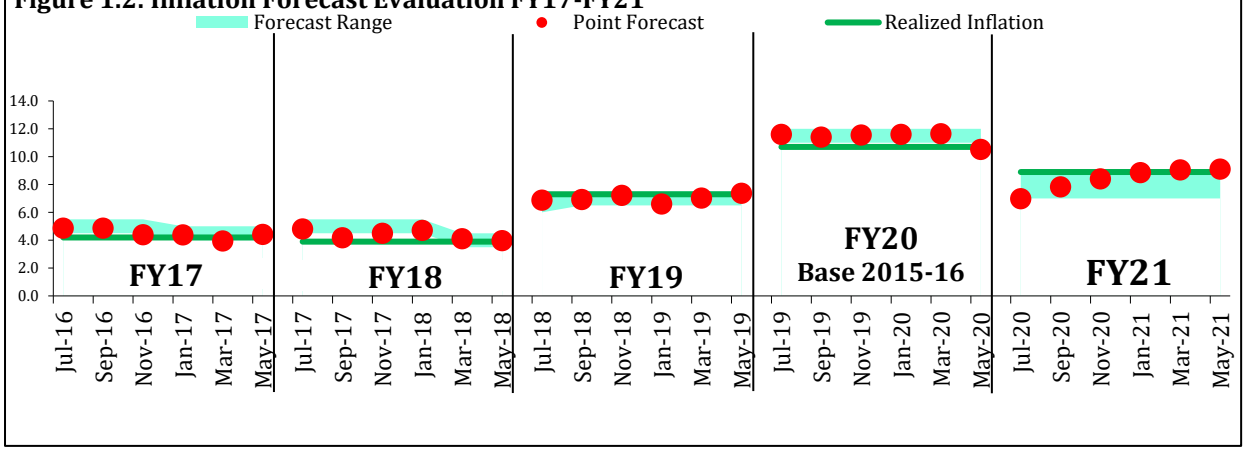
[7] MPC meetings during FY21 were held in September 2020, November 2020, January 2021, March 2021 and May 2021.

During FY20, the MPC proactively reduced the policy rate by a cumulative 625 bps from 13.25 percent to 7.0 percent within a short period i.e., from mid-March to June 2020, in order to effectively respond to the fast-evolving COVID-19 pandemic shock. The accommodative monetary policy was supplemented by various well-targeted yet time-bound liquidity-enhancing schemes by SBP. To improve the cash flows of businesses and households, SBP allowed both the deferment of principal amount and restructuring of loans. In addition, the SBP introduced refinance schemes to prevent unemployment, encourage investment activities, and support the healthcare sector to upscale their facilities to provide services to combat COVID-19. In aggregate, SBP's measures provided liquidity support of over Rs 2 trillion (or around 5 percent of GDP) to the businesses and households.[8]

During September 2020, the MPC observed that since its meeting in June 2020 business confidence and the outlook for economic growth had improved in line with the decline in domestic COVID-19 cases, easing of lockdowns, and timely stimulus from the government and SBP. At the same time, the forecast for inflation had risen slightly, primarily due to supply-side shocks to food prices; nonetheless, the average inflation was expected to fall within the range of 7-9 percent during FY21.

In subsequent MPC meeting held in November 2020, it was noted that the rise in COVID-19 cases in Pakistan and many other countries during the second wave of the pandemic was posing considerable downside risks to economic growth. Domestically, inflation remained high primarily due to temporary increases in food prices. However, SBP's projection for average inflation during FY21 remained unchanged at 7-9 percent, despite significant uncertainty surrounding the trajectory of global economic growth and international commodity prices **(Figure 1.2).**

Figure 1.2: Inflation Forecast Evaluation FY17-FY21



By January 2021, the domestic economic recovery gradually gained traction, with further improvement in business sentiments. During its meeting in March 2021, the MPC observed that employment continued to recover while prospects of economic growth had enhanced further. Expected improvements in the manufacturing sector, particularly due to the provision of loans under the Temporary Economic Refinance Scheme (TERF), led to an upward revision in growth projections of about 3 percent for GDP during FY21, the first agency to revise growth forecasts for FY21, as compared to an earlier forecast of around 2 percent. However, an increase in electricity prices would

[8] https://www.sbp.org.pk/COVID/index.html

continue to manifest in headline inflation in the coming months, keeping average inflation in FY21 close to the upper end of the projected range of 7-9 percent.

Finally, in May 2021, the MPC noted that the annual GDP growth estimate of 3.94 percent announced by the Pakistan Bureau of Statistics (PBS) confirmed the strength of the broad-based economic recovery on the back of targeted fiscal measures and appropriate monetary stimulus. It also acknowledged that average CPI inflation projection for FY22 was remarkable given the uncertainties, in line with the earlier anticipation of it remaining close to the upper end of the range of 7-9 percent.

1.1.1 Effective Communication

Central bank communication is key for transparency and effective transmission of monetary policy decisions. Over the years, SBP has strived to modernize and increase transparency in monetary policy formulation and communication in line with international best practices. The need for timely and clear communication of the policy stance gained more prominence during the pandemic, so as to facilitate decision-making by firms and households during an uncertain environment.

During FY21, SBP moved forward to implement a well-articulated and transparent communication strategy to further anchor inflation expectations and strengthen the effectiveness of monetary policy. The MPC provided forward guidance in the Monetary Policy Statement (MPS) for the first time to facilitate policy predictability and decision-making by economic agents. Reducing economic uncertainty and improving policy predictability were the main objectives behind adoption of forward guidance.

Subsequent to its first iteration in the January 2021 MPS that read, "*In the absence of unforeseen developments, the MPC expects monetary policy settings to remain unchanged in the near term*", term premiums witnessed a marked decline. The term premium between the 10-year and 3-year bonds decreased from 147 bps (as of January 21, 2021) to 93 bps (as of June 29, 2021). The investment in the government securities shifted from three-month Market Treasury Bills (MTBs) to six-month instruments, while participation in Pakistan Investment Bonds (PIBs) also improved.

SBP also started releasing the half-yearly schedule of MPC meetings in advance to make monetary policy formulation process more structured and to enhance transparency. This also reduced the uncertainty regarding the timeline of monetary policy decisions.

Moreover, SBP started to conduct regular post-MPC analyst briefings as well as sessions with academia, media (both print and electronic) and the business community to discuss key macroeconomic developments in more detail. These sessions and briefings are aimed at better articulating the role of the underlying economic trends that lead to monetary policy decision-making.

1.1.2 Policy Coordination

The coordination among domestic policymaking entities remained an important component of an overall economic policy strategy. Accommodative monetary stance of SBP during FY21 was aligned with the targeted fiscal support to the economy in the wake of COVID-19 pandemic. SBP's refinance schemes also continued to complement the targeted fiscal stimulus to combat COVID-19 by providing social security and support to corporate sector. These schemes encouraged employment and

sustainable growth, without compromising financial stability and the medium-term inflation targets of the government.

Coordination with International Financial Institutions

During FY21, SBP maintained closed coordination with the government and multinational financial institutions. The IMF's Extended Fund Facility (EFF) program was delayed from March 2020 till December 2020, mainly due to the COVID-related disruptions. Nonetheless, discussions picked up from the second half of the fiscal year and culminated in the successful completion of the combined 2nd-5th reviews and the release of a USD 500 million tranche, bringing cumulative disbursements under the EFF to around USD 2.0 billion. Meanwhile, Pakistan had also successfully negotiated purchases under the IMF's Rapid Financing Instrument (RFI) for disbursement of USD 1.386 billion in April 2020. This, along with close coordination with the World Bank, Asian Development Bank and the Asian Infrastructure Investment Bank, paved way for further sizable multilateral disbursements during FY21.

1.1.3 Strengthening Monetary Policy Formulation

The conduct of monetary policy also improved in Pakistan, in line with international best practices by taking following measures:

Exchange Rate Reforms

SBP has adopted the market-determined exchange rate regime since June 2019 to act as an automatic stabilizer and help correct the macroeconomic imbalances that had developed over the previous few years. The regime change supplemented SBP's efforts of data-driven approach to monetary policymaking and proactive management of potential macroeconomic risks. The regime remained in place during FY21, as reflected in the two-way movement in the exchange rate, in line with market conditions. Due to the encouraging trend in workers' remittances, exports and much lower level of services trade deficit, the current account improved significantly during FY21. After recording surpluses in the earlier months of the year, the current account deficit for full-year FY21 reached a 10-year low of USD 1.8 billion or 0.6 percent of GDP. Accordingly, the PKR appreciated against USD, from Rs.168.05 on June 30, 2020 to Rs.157.25 on June 30, 2021.

Emphasize on Prices Stability

To preserve the value of the currency, it is imperative that price stability is considered as the overriding objective of the monetary policy. In this regard, the medium-term inflation target is now determined and explicitly announced by the government, while SBP strives to achieve the target with the conduct of monetary policy. During FY21, SBP remained vigilant of rising pressures on urban and rural inflation arising from supply-side factors related to major food items and administered prices. All monetary policy statements and annual and quarterly reports on the State of the Pakistan's Economy analyzed the situation upfront, especially with emphasis on determining the impact of economic activities on inflation.

Elimination of monetization of fiscal deficit through zero borrowing from the SBP

In order to keep the supply of relatively more inflationary reserve money under control, amendment was proposed in SBP Act 1956 to curb deficit monetization. Cognizant of the inflationary impact, the

government did not borrow any money from SBP during FY21. SBP continued to monitor market position and managed liquidity accordingly.

Trends and developments

For its decision-making, the MPC requires latest trends and developments of domestic and global economic indicators. SBP staff provides a detailed analysis of the real, external, monetary and fiscal sectors, along with discussion of trends in international economic conditions and an information compendium of detailed statistics. SBP staff also shared the outlook of major sectors of the economy, along with projections on inflation, growth, trade deficit, remittances, money supply, etc. This high-quality background material on the full macroeconomic framework and unbiased forecasts of key variables facilitates the MPC make informed decisions about the policy rate.

Economic models

SBP employs Dynamic Stochastic General Equilibrium (DSGE) and Forecasting and Policy Analysis System (FPAS) models to forecast the future paths of macroeconomic variables and to perform policy scenario analysis. Cognizant of the risks posed by climate change to a developing economy like Pakistan, SBP initiated a development project in FY21 to analyze short- to medium-term impact of a climate change shock on the agriculture sector and its dynamics effects on the rest of the economy. For this purpose, SBP has formulated a multi-sector DSGE model for Pakistan's economy, in which the agriculture sector has been embedded with a climate change-induced damage function, to be used extensively in integrated assessment models. Once developed, the model would provide some quantitative assessment of the macroeconomic dynamics of the recurrent spells of extreme weather events, such as floods, droughts, heatwaves and heavy rainfall, on Pakistan's economy.

Perception surveys

Expectations and perceptions of various economic agents about the economic conditions and outlook remained an important input for monetary policy formulation in FY21. The perceptions of consumers, businesses and banking professionals were collected by SBP through surveys for consumer and business confidence, and for bank lending. During the COVID-19 pandemic, new questions were added in all the surveys, about the respondents' perception of the impact of the pandemic on their living and business conditions. Moreover, the SBP, in collaboration with the Ministry of Planning, Development and Special Initiatives, also conducted a unique survey on the perceptions of overseas Pakistanis with respect to their remittance-sending patterns during the pandemic. This survey served as a useful input for understanding the much higher than expected inflow of remittances during FY21; the realized inflows were contrary to projections from multilateral agencies of a substantial decline. Likewise, surveys on financial exclusion, savings behavior, and real estate investment & housing finance needs of the Roshan Digital Account holders provided valuable input to streamline RDA-related regulations.

Market Based Exchange Rate Regime

The transition to the flexible, market-determined exchange rate regime, successfully implemented in end of FY19, continued to benefit the economy. Serving as the first line of defense, the exchange rate acted as a shock absorber against external shocks and buildup of external imbalances. The interbank foreign exchange market had also adjusted relatively well to the market-based exchange rate, with the

PKR/USD exchange rate parity showing a healthy two-way movement.

As a result of stabilization measures taken by SBP during the last couple of years and adoption of flexible exchange rate regime, SBP's FX reserves depicted strong growth during FY21. SBP's FX reserves increased by USD 5.2 billion in FY21, from USD 12.1 billion at end-June 2020 to USD 17.3 billion at end-June 2021. The strengthening of FX buffers helped in improving the import coverage ratio, building confidence of market participants and turning the overall sentiments positive by keeping demand and supply conditions orderly in the foreign exchange market.

1.2 Money and Debt Market

1.2.1 Reforming the Primary Dealers System

SBP further strengthen the Rules governing the Primary Dealer (PD) system aimed at widening the investor base of government securities, enhance liquidity, transparency and promote market development. These revisions in PD rules were made after a comprehensive review of international best practices and experiences of other countries, and detailed consultations with financial market stakeholders.

The revised PD rules provide for expansion of the eligible list of institutions that can work as primary dealers, including security depositories and clearing institutions. This would cater to the needs of a diverse group of investors, including capital market clients, corporates and individuals, and attract new clientele to the government securities market. Further, SBP has also relaxed the selection and performance criteria for DFIs, Investment banks and Brokerage Houses to encourage them to become part of the PD system. Hence, a larger and more diverse group of institutions will now have direct access to primary auctions, among other privileges offered to the PDs.

The other key changes to the PD Rules focus on tightening the responsibilities, increasing ownership and commitment of primary dealers towards the objectives of the PD system, striking a balance between their privileges and obligations, and utilizing the strength of each individual dealer institution in the development of the government securities market.

The changes in the PD Rules would also ensure participation and competitive pricing in the auctions of government securities, reduce the cost of borrowing for the government, encourage savings in the economy, and allow a diverse group of investors to benefit from attractive returns offered on these instruments.

1.2.2 Floating Rate Pakistan Investment Bonds (PFLs) – Introduction of Quarterly Coupon Instruments and Changes in Auction Pricing Mechanism

In order to further diversify the product suite of Government securities, lengthen the maturity profile and improve sustainability of public debt, SBP, in coordination with GoP, introduced new variants of PFLs with quarterly coupon payment frequency, in addition to existing semi-annual coupon PFLs. These quarterly coupon PFLs are offered with quarterly coupon re-fixing and fortnightly coupon re-fixing variants.

1.2.3 Introduction of Re-opening Auction and Abolishing Holding Limit on GoP Ijara Sukuk (GIS)

SBP, in coordination with Finance Division, introduced a mechanism for re-opening auctions of GoP Ijara Sukuk (GIS)[9]. Previously, due to absence of re-openings, each issue of GIS would be a separate security, which resulted in fragmentation and limited liquidity of each instrument. Further, SBP also abolished holding limits on all existing and new issues of GIS[10]. Previously, Islamic banks and commercial banks with Islamic branches had a holding limit of 35 percent, while commercial banks with no Islamic branches had a limit of 25 percent, of the cumulative target or issued amount, whichever was higher. Accordingly, now GoP Ijara Sukuk may be held by institutions without any restriction of holding limit.

Introducing re-opening auctions and eliminating holding limits on GIS would improve participation in GIS auctions and secondary market trading, and support development of Islamic financial markets in Pakistan.

1.2.4 Enhancing Single Investor NCB Limit for MTB and PIB

SBP, in coordination with Finance Division, increased the single investor Non-Competitive Bid (NCB) Limit from 0.25 percent to 0.50 percent of the auction target for both MTBs and PIBs[11]. The enhanced limit would help to (i) diversify the investor-base of government securities; (ii) cater needs of institutions that mobilize retail investments; and (iii) promote participation in the auctions at competitive rates to promote savings.

1.2.5 Abolishing Limits on PIB Holding and SLR Eligibility

SBP withdrew the holding limit applicable on PIBs[12]. Previously, a PD's holding in a particular issue with days to maturity greater than 1-year could not exceed 30 percent of the cumulative target or issued amount, whichever was higher, in each tenor. For Non-PDs, this limit was set at 15 percent. Further, the PDs had to run down their issue-wise holding limit of 30percent to 15percent on expiry of 90 days from the last auction date of that particular issue.

In a similar perspective, SBP also abolished the limit of 15 percent of liabilities (subject to SLR) for banks and 5percent for DFIs on counting their holding of PIBs towards maintenance of SLR[13]. Accordingly, now the holdings of PIBs by banks and DFIs are fully counted towards maintenance of SLR.

These measures will help improve participation in auctions and improve secondary market trading of long-term paper.

1.3 Foreign Exchange Reserve Management

The fiscal year 2021 started with the COVID-19 pandemic in full swing, wherein authorities globally were implementing movement restrictions, lockdowns and at the same time providing monetary and

[9] DMMD Circular No. 19 dated August 18, 2020
[10] DMMD Circular No. 03 dated February 18, 2021
[11] DMMD Circular No. 28 dated December 02, 2020
[12] DMMD Circular No. 02 dated February 18, 2021
[13] DMMD Circular No. 04 dated February 18, 2021

fiscal stimuli to their economies. During this period, the global economy witnessed the sharpest slowdown in decades, with commodity and asset prices declining and safe-haven asset prices surging. The pandemic-related disruptions induced a worldwide economic slowdown, and the measures adopted to curb the ensuing impact on the global economy dominated market sentiment. Most notably, the Federal Reserve re-engaged in expansionary measures, after having initiated a tapering down of the GFC-era stimuli, resulting in the doubling of the Fed balance sheet from the already inflated post-GFC levels. In coordination, central banks of other major developed nations also provided support to their national economies, followed by emerging economy central banks. Quantitative easing, targeted asset purchase programs, bilateral swap lines, and yield curve control programs comprised the primary monetary measures deployed by central banks. Meanwhile, tax reliefs, job retention schemes, unemployment insurance, direct benefit checks and targeted support for particular segments comprised fiscal measures deployed by the governments.

The second half of FY21 brought some respite for the global economy, as COVID-19 vaccines began to roll out, providing hope for an economic recovery. With encouraging vaccine administrations, national lockdowns and travel restrictions were gradually eased. As these measures buoyed market sentiment and global growth picked up, the same was reflected in improving economic indicators and recovering commodity prices. Major central banks, including the Federal Reserve and the European Central Bank (ECB), resisted the temptation to hike interest rates, despite unhinging inflation expectations, in favor of their commitment to keep interest rates ‘lower for longer’ and to maintain an overall accommodative monetary stance. While the outlook for the global economy has improved, notable risks remain. Any future waves of the virus or new variants can lead to re-imposition of lockdowns, hampering the re-opening of businesses that remain at the heart of the global recovery. Also, authorities will closely monitor the risks of inflation, considering the massive monetary and fiscal stimuli provided after the COVID-19 outbreak.

SBP’s FX Reserves recorded a notable increase of USD 5.2 billion; and the enhanced reserve position was utilized through investment strategies formulated under the broad investment guidelines of safety, liquidity and optimal return, as approved by the SBP Board, which allow SBP to maintain returns and high-quality credit profile of overall portfolio. Going forward, FX reserve position is expected to remain favorable and SBP would continue to deploy reserve assets with the objective of optimizing returns while adhering to the approved risk parameters.

1.4 Supporting Ease of Doing Business and Enhancing Effectiveness of Foreign Exchange Regime

SBP has been taking initiatives in collaboration with different stakeholders to face the challenge of balancing / fulfilling the needs of stakeholders on one hand and ensuring a stable foreign exchange position on the other by way of taking steps to enhance ease of doing business, improve investment climate in the country, increase home remittances, and provide efficient / effective framework for trade settlements including e-commerce framework.

The important initiatives taken by SBP during FY21 to improve the efficiency and effectiveness of Foreign Exchange regime of Pakistan are outlined below.

1.4.1 Connecting Overseas Pakistanis with Banking System of Pakistan

One of the major initiatives undertaken by SBP was the launch of Roshan Digital Account (RDA) scheme in September 2020 in collaboration with GoP and the banking industry. Under RDA, millions of non-resident Pakistanis as well as non-resident Pakistan origin card holders can now remotely open and operate their bank accounts with RDA banks in Pakistan from the comfort of their homes without any need to visit a bank branch. RDA will allow non-resident Pakistanis (NRPs) living abroad to integrate with Pakistan's banking system and easily access a wide suite of banking and investment services, and support their families in their home country. The account can be opened within 48 hours through an entirely digital process without compromising the customer due diligence. The account can be opened in foreign currencies (USD, GBP, EUR, etc.) as well as PKR.

The RDA not only fulfils the banking needs in Pakistan for the overseas Pakistanis but also provides lucrative investment opportunities in government securities including Government debt Securities i.e., Naya Pakistan Certificate, shares listed on Pakistan Stock Exchange, Mutual Funds, commercial & residential Real Estate and term/ Remunerative deposits of banks. The accounts can also be used to avail different types of liability products from the banks, including credit cards, auto loans, and mortgage financing.

The RDAs are fully repatriable, i.e., the funds can be remitted back to the overseas Pakistanis' bank account abroad any time, without any approval from SBP. While the profits/return earned on the investments made from the account are subject to applicable taxes, the RDA is subject to simplified tax regime, where the account holder is not required to file income tax return, if he/she has no other tax obligation in Pakistan.

The RDAs have been an outstanding success, leading to valuable foreign exchange inflows into the country. To further encourage their adoption by the vast Pakistani diaspora across the world, SBP has defined minimum service standards for RDAs to ensure confidence within the NRP population.

1.4.2 Ease of Doing Business

To improve ease of doing business for the industry, SBP took a number of regulatory measures to facilitate cross border trade and investment. Key measures taken during FY21 are given below:

- Policy of Equity Investment Abroad was revised to simplify the process for residents to boost country's export and to attract FDI. Under the revised policy, transactions have been divided into four categories (A, B, C & D). Except transactions falling under Category-C, the rest of the transactions pertaining to: (i) establishing subsidiary / branch office by exporters (category A), (ii) establishing holding company abroad by resident start-ups to channelize investment to Pakistan (category B) and (iii) investment by individuals to a certain limit (category D) would be approved by the banks without seeking any approval from SBP.
- Framework has been introduced for acquisition of services from a whitelist digital service providers on the concept of "Payment vs Receipt", with an annual limit of USD 400,000/- per entity. This would help our start-ups as well as export-oriented entities to use these platforms for bringing efficiency in their business processes and extending services to more customers worldwide.

- SBP allowed startup companies to avail loans as "Convertible Debt" to facilitate them in raising financing from abroad. This would attract more foreign investment by providing another investment option to international investors in startup companies operating in Pakistan. The foreign investors, hesitant to invest in equity of startup company at initial stage, may provide financing under this category.
- Developed mechanism of valuation and remittance of disinvestment proceeds exceeding market/breakup value of shares and delegated remittance of disinvestment proceeds to authorized dealers.
- Exporters were allowed to retain a certain portion of their export proceeds in their special foreign currency accounts, to be used for limited purposes. To facilitate the exporters, the permissible uses of the exporters' retention account were broadened in consultation with the exporters, enabling them to use funds for all legitimate needs to boost the exports of the country.
- Special foreign exchange regulations were issued for entities operating in Special Technology Zones (STZA) in Pakistan, in terms of sub-section 5 of Section 19 of the STZA Ordinance, 2020.
- Statutory Liquidity Requirement (SLR) for Exchange Companies (ECs) has been revised to 15 percent from 25 percent. This would enable Exchange Companies to increase their business and profitability.
- The exposure limits for ECs and ECs – B were revised to 70 percent and 50 percent (of the paid-up capital) from earlier 50 percent and 25 percent respectively. This measure was taken due to decrease in demand of FCY in KERB market because of COVID-19 pandemic, which increased FCY exposure of ECs.
- ECs were allowed for five days forward purchase contracts after reviewing the requisite policy and procedure.
- SBP extended time for settlement of foreign currency loans amid COVID-19 pandemic to facilitate the exporters and importers by allowing extension up to 180 days in settlement of their export and import loans under FE-25 foreign exchange loan Scheme.
- SBP engaged with provincial governments for continuity of business of ECs, while complying with the COVID guidelines, to facilitate the foreign remittances. Reportedly, ECs have facilitated USD 2.1 billion of remittances while USD 4.12 billion has been surrendered/sold in the interbank market.

1.4.3 E-Commerce

To promote Business-to-Consumer (B2C) e-Commerce exports from Pakistan, SBP revised instructions of FE Manual to align it with the changing business dynamics of e-commerce exports. A comprehensive regulatory framework was issued for current business needs of e-commerce exports, along with facilitation for developing a separate Module in WeBOC in collaboration with Pakistan Customs and other relevant stakeholders.

1.4.4 Home Remittances

Despite challenges due to COVID-19, home remittances of Pakistan rose to USD 29.4 billion during FY21 compared to USD 23.13 billion in the corresponding period of FY20, witnessing robust growth of 27.11 percent. This rise in remittances is mainly attributed to supportive Government policies, pro-active strategy of SBP/PRI and positive response of banks and exchange companies to implement SBP/PRI strategy. Some major steps taken during FY21 to boost remittances through formal channels are as follows:

- Reintroduced incentive scheme for marketing of home remittances to further encourage domestic financial institutions to increase marketing of home remittances for remitters and beneficiaries.
- Media/Awareness campaign launched by FIs under the incentive scheme for marketing and promotion of Home Remittance Products and Services both locally and abroad;
- Timely disbursement of rebate under reimbursement of TT charges scheme with pending claims lag of just two months compared to previous lag of six months, motivating home remittance channel partners for mobilizing funds for Pakistan.
- Increase in outreach by allowing domestic financial institutions to enter new agency arrangements with overseas tie ups.
- End to end digital integration of remittances by encouraging domestic financial institutions to bring forth more digitally enabled Fintech and Money Service Businesses (MSBs) for swift disbursement of funds in Pakistan.
- Arrangement of webinars in coordination with Pakistani Embassies and High Commissions, to increase awareness and outreach of initiatives of GoP for home remittances for Pakistani communities.
- SBP/ PRI conducted orientation sessions of Community Welfare Attaches (CWAs), Pakistani missions abroad and embassies in Pakistan to train them regarding remittance markets, available products for home remittance segment and modes to send remittances through formal channels.
- Banks and exchange companies celebrated “International Day for Family Remittances” (IDFR) on June 16, 2021, an official day for IDFR as conveyed by UNO, to recognize the contribution of migrants to improve the lives of their family members back home and create a future of hope for their children.

1.4.5 Digitalization of FX Regulatory Approval System (RAS)

SBP launched an online platform i.e., Regulatory Approval System (RAS), to facilitate online submission of foreign exchange (FX) related cases to SBP. The SBP-RAS became operational on March 24, 2020 whereby manual case submission by banks was discontinued in SBP-BSC. After successful parallel run, paper-based case submission to SBP by banks was also discontinued with effect from August 28, 2020. The objective of this initiative was to provide a fully digitalized platform to the business community and individuals in approaching banks for their foreign exchange related requests. This initiative will transform FX operations by replacing the paper-based requests with electronic submissions, which is not only efficient but also cost-effective. Till date, 28 banks

have developed their portals to receive cases digitally. Further, it has been made mandatory for all customers to submit all FX related cases digitally to banks from July 2021 onwards.

1.5 Research

In-house research at SBP has been a key element of the toolkit, aimed at providing strong empirical and conceptual foundation for policymaking. Research work at SBP covers monetary policy, exchange rate, trade and other relevant macroeconomic issues. The research is published in SBP publications including the Working Paper Series, Staff Notes and SBP Research Bulletin. These publications are available online on SBP's website, as well as at other sources. During FY21, SBP researchers contributed to a range of topical issues, which broadly aimed at improving existing economic models used for monetary policy formulation at SBP, understanding the evolving dynamics of inflation, impact of IMF program and government borrowing.

Research on incorporation of climate change in the FPAS model has been a key contribution towards strengthening and modernizing monetary policy formulation at SBP. Similarly, other research studies on exploring the dependency structure of CPI basket items using Vine Copulas, role of transitory shocks and structural determinants of inflation in Pakistan, spillovers from global and regional shocks, and role of imported inputs in exchange rate pass through in Pakistan yielded valuable insights regarding inflation dynamics in Pakistan. Short studies were also conducted to gauge the impact of COVID-19 on real GDP growth, inflation and financial markets.

Evidence-based research also increased in SBP, with the objective to improve policy formulation and effectiveness. SBP conducted numerous surveys, including two flagship surveys in the areas of consumer and business confidence. The following surveys are some of the examples portraying SBP's efforts in line with a broader central bank vision:

- Remittance behavior survey of overseas Pakistanis to gauge the impact of COVID-19 on remitting behaviors
- Perception Survey for Assessing Quality and Usage of Security Features of Banknotes
- Real Estate Investment and Housing Finance Needs of RDA holders

Research support was also extended for various in-house surveys in SBP that have contributed to strengthening of internal controls, standards and procedures to provide a conducive working environment in the bank.

SBP also organized multiple discussions with academics, policymakers and other stakeholders, to foster a better understanding of the evolving research areas. These included lectures, conferences, seminars and webinars. In particular, a webinar series was conducted during the COVID-19 lockdowns, and provided an effective way of promoting and sharing research ideas. SBP's webinar series covered the following topics:

- Allocative Inefficiencies and Growth
- Export Competitiveness: Perspectives from Mid-sized Firms
- The Volatility in Stock Markets with Geographical Perspective
- Foreign Aid and Public Sector Capacity in Pakistan
- Transmission of Asset Prices into Goods Prices - the Moderating Role of Monetary Policy

- Economic Modeling in The Post-COVID Era
- Closing Yield Gap in the Dairy Farms in Punjab, Pakistan
- Digitization and Development: Property Rights Security, and Land and Labor Markets
- Taxation of Agricultural Income: Conceptual Issues, Practical Challenges and Potential Revenue Estimates in Pakistan
- An Analysis of Pakistan's Agricultural Commodities Based on Effective Protection Rate and its Decomposition
- Household Debt and Indebtedness: Estimates and Implications
- Financial Markets Lessons from the COVID-19 Crisis: A Practitioner Perspective
- Economic Modeling and Forecasting: Practice in Central Banks

Moreover, a virtual SAARC-FINANCE seminar was organized on *"Economic Modeling and Forecasting in Central Banks".* The seminar was attended by delegates from SAARC central banks, including Afghanistan, Bangladesh, Bhutan, Sri Lanka and Nepal.

SBP also collaborated with other central banks, especially those in the SAARC region, to conduct joint research. During COVID-19, central banks around the world have been playing critical roles to provide economic stimulus and ensure financial soundness. In this regard, SBP initiated a joint study titled *"The use of Unconventional Policy Instruments by South Asian Central Banks: A Study on Refinance Schemes"* to assess policies and their effectiveness of various refinance facilities provided by the regional central banks.

SBP has been contributing to strengthen research at national level by establishing SBP Memorial Chairs at various public sector universities and by participating in meetings and other related forum to provide input regarding policy formulation at national level.

1.6 Economic Analyses and Publications

SBP publishes its quarterly and annual reports on the "State of Pakistan's Economy", which review the recent economic developments and challenges and provide policy recommendations where applicable. During FY21, the coverage of these reports was enhanced with the introduction of a new section on the labor market, which adds value to the discussion of real sector developments. The section utilized alternative official data sources with higher frequency than the Labor Force Survey: these data sources include monthly surveys of industrial performance and employment conducted by the provincial statistical bureaus; the employment index from the SBP's Business Confidence Survey; and CPI wage rate data. The set of proxy indicators to track activity in the services sector was also expanded.

Besides the sectoral coverage, the flagship reports of FY21 documented the policy measures taken to mitigate the impact of the COVID-19 pandemic on the economy. The publications highlighted the importance of the highly accommodative monetary policy environment, SBP's liquidity support via refinance schemes, and targeted fiscal support from the government, including for the agriculture sector, as essential for facilitating the economic rebound after the ease in the lockdown conditions. Furthermore, a special section in the FY20 Annual Report, titled '*COVID-19 and the Need to Boost Digital Connectivity in Pakistan*', underscored the significance of digitization during COVID-19 through digital cash transfers, telehealth, e-learning and e-commerce. The special section also

recommended measures to tackle the remaining demand- and supply-side constraints for inclusive and equitable access to digital services. Moreover, a box item in the first quarterly report of FY21 (*COVID Impacts on Domestic Production*) summarized the findings of an ADB survey on the impact of COVID-19 on the production and marketing of certain crops. Similarly, a box item in the second quarterly report (*Special Survey on Evaluating the Impact of COVID-19*) reported the findings of a PBS survey, which revealed that total employment – which amounted to 55.7 million workers prior to the first COVID-19 lockdown – fell to 35 million when the restrictions peaked, before recovering to 52.5 million workers once they were eased.

In addition, SBP publications shed light on various topical issues. A special chapter in the FY20 Annual Report, titled '*Understanding Low Private Credit Penetration in Pakistan: Contextualizing Recent Policy Reforms*', analyzed the reasons behind low credit penetration in Pakistan's economy over time. The findings included the risk aversion of commercial banks amid information asymmetries, high borrowing appetite of the government, and declining role of specialized lending institutions. The chapter also highlighted the coordinated efforts by SBP and government to promote low-cost housing finance, creation of a secured transactions registry, development of private credit bureaus and growing use of digital financial services and their potential to improve credit penetration.

A special section in the first quarterly report of FY21 (*Public Pension Expenditures in Pakistan - The Need for Reforms*) flagged the rapid growth in public pension expenditures in the country and highlighted the parametric and systemic reforms, including proper indexation of increments, elimination of retrospective increases and rationalization of survivorship benefits, which may result in a more sustainable pension structure. The second quarterly report contained a special section on the LNG sector (*LNG Sector in Pakistan - Attaining Sustainability through Deregulation and Structural Reforms*), which explored multiple operational and structural bottlenecks in the current framework, highlighted some international best practices, and suggested reforms for deregulating the LNG market. Similarly, a special section in the third quarterly report (*Private Credit Bureaus in Pakistan – Enhancing Credit Penetration by Addressing Information Asymmetries*) identified the legal, operational and policy level challenges faced by private credit bureaus in the country and made recommendations to address the same.

The overall analysis in the reports was further enriched by box items on diverse topics. Some of these are mentioned below, along with their key takeaways:

- ***Introduction of ultra-low-sulfur-fuel*** (Q1-FY21 report): The government's decision to move to a new emissions standard is expected to affect domestic automobile and crude oil refining industries in the short-to medium-term. The measure would also improve urban air quality and modernize these industries over the long term.
- ***Rising global food prices*** (Q1-FY21 report): A wide range of factors, mostly related to the COVID-19 pandemic, are responsible for the broad-based surge in global commodity prices. These factors include supply disruptions and unfavorable grain production outlook; stockpiling of key commodities by some major importers; increasing protectionism; and limited food exports. These challenges are likely to keep the global food inflation at an elevated level for some time.

- ***Implementation of Public Financial Management Rules and data reclassification in Q1-FY21*** (Q1-FY21 report): The major amendments to the fiscal accounts pertained to tax refunds through the Finance Division, deduction of refunds from the divisible pool, reclassification of federal taxes (not collected by FBR) as non-tax revenues, PSDP allocation in compliance with PFM, and adjustment in provincial expenditures to reflect statistical discrepancy.
- ***Recent changes in the floating-rate bond market*** (Q2-FY21 report): New PIBs-Floating rate (PFLs) were introduced in October 2020 for 3, 5 and 10 years, with quarterly coupon and quarterly resets. A 2-year PFL with fortnightly coupon resets and quarterly coupon payments was also introduced, bringing the total number floaters available in the market to seven.
- ***Implications of geographical indications (GI) tagging for exports*** (Q2-FY21 report): Pakistan needs to expedite the domestic registration of exportable and GI-worthy products (besides basmati rice) to increase the country's exports earnings. The GI tagging would benefit the fetching premium prices and from increased market access and endorsements by international companies and brands.
- ***The state of internet inclusiveness*** (Q3-FY21 report): The Economist Intelligence Unit's Inclusive Internet Index 2021 report showed that Pakistan lags behind regional peers on internet inclusiveness. In particular, the country ranked low on the dimensions of 'availability' (linked to low level of literacy and digital skills, and gender gaps in internet usage) and 'relevance' (due to non-availability of public sector open data policy and e-government services in local language).
- ***Implications of the Debt Service Suspension Initiative (DSSI) for Pakistan's fiscal sector and debt sustainability indicators*** (Q3-FY21 report): The positive implications of the DSSI include a reduction in the fiscal deficit and public debt burden during H1-FY21 and FY22, and improvements in the 'external debt servicing to exports' and 'external debt servicing to FX earnings' ratios.

1.7 Data Management System

The statistics compiled by SBP largely follow international standards. The statistics on balance of payments, monetary and financial variables, external and domestic debt, and flow of funds accounts are compiled in accordance with the guidelines provided in the manuals of international organizations, such as the IMF, UN and World Bank. Various stakeholders both within and outside SBP use these compiled statistics for analysis, research and policy formulation.

1.7.1 Initiatives including adoption of International Standard Classification

A number of initiatives were taken for data compilation and dissemination during FY21. Details are given below:

- ***Compilation of data on Roshan Digital Accounts (RDA):*** RDAs remained a big success by attracting over USD 1.5 billion through more than 180,000 accounts in FY21. SBP initiated acquisition of data on RDAs for utilization in balance of payments, external debt and liabilities and domestic debt. Furthermore, a note titled "Tracing RDA impact in Balance of Payments" was prepared to highlight the positioning of RDA inflows and their utilization in the balance of payments data.

- ***Survey of CIF Margin on Import Payments:*** Manual on Balance of Payments and International Investment Position, sixth Edition (BPM6) recommends: *"the principle for valuation of general merchandise is the market value of goods at the point of uniform valuation. The point of uniform valuation is at the customs frontier of the economy from which the goods are first exported, that is, free on board (FOB)"*. Import payments recorded through the International Transactions Reporting System (ITRS) is on mixed basis (e.g. CFR, CIF and FOB). To calculate the FOB value, the cost of insurance and freight (CIF) component is deducted from import payments. To update this estimate/coefficient periodically, a survey of importers is conducted every three years. The fourth iteration of the survey was undertaken during FY21 to update the coefficient of CIF margin on import payments.
- ***Monetary Survey compilation based on revised format of SBP Statement of Affairs:*** In terms of Section 40(1) of SBP Act 1956, SBP Board has approved revised format of Weekly Statement of Affairs, effective from week ending on July 3, 2020. Accordingly, working procedure manual and the back-end compilation methods of weekly monetary survey were revised to realign them with the revised format of SBP Statement of Affairs.
- ***Implementation of the IMF methodology for splicing the new CPI series (base 2015-16=100) into base year 2010 for compilation of REER index:*** The CPI index base of 2007-08 was used for the compilation of the relative price index (RPI) up to June 2020 after rebasing it to year 2010. The Pakistan Bureau of Statistics shifted the CPI base to 2015-16 and discontinued the dissemination of price statistics on the 2007-08 base from July 2020. Therefore, the CPI based on 2015-16 was spliced backward up to January 2010 by using the ratio of the CPI series base 2007-08 (old base) for the following month in the first step and rebased to 2010 for the compilation of REER index in the second step. This method has also been used by the IMF for rebasing.
- ***Revamped code guide for weekly ITRS data reporting of exchange companies:*** A developmental project was completed on *"Enhancing the scope of data acquired from exchange companies"* to develop an improved reporting mechanism for exchange companies, according to the guidelines in the exchange companies' manual.
- ***Implementation of classification of Balance of Payments and International Investment Position Manual Sixth Edition (BPM6) in Rest of the World (ROW) sector of Flow of Funds Accounts:*** Pakistan's flow of funds accounts is prepared by using data of the Sectoral Balance Sheets (SBS) of all sectors of the economy, as per the definitions in the System of National Accounts (SNA, 2008), except for those related to the Rest of World (ROW). The classification and guidelines of the IMF's Manual on Balance of Payments and International Investment Position Sixth Edition (BMP-6) has been implemented in preparation of the ROW sector to synchronize it with SNA-2008.

1.7.2 Improvements in statistical publications

Monthly, quarterly, half-yearly and annual publications are compiled to provide a warehouse of statistical information, pertaining to a broad spectrum of economic sectors. Some of the major achievements include the release of the fourth edition of the Handbook of Statistics on Pakistan Economy 2020; addition of regional statistics on disbursement of loans to textile sector; province-

wise scheduled banks branches annexures; and merging basic banking accounts in deposits with respect to type of accounts table in the half-yearly publication of the 'Statistics on Scheduled Banks in Pakistan'

Besides, SBP also initiated a pre-publication of its annual publication "Financial Statement Analysis of Non-Financial Companies listed at PSX". It covers data of 70 percent of the companies and would be released six months ahead of the regular publication. The early availability of this data would facilitate the users in general and market analysts in particular for carrying out their assessments.

1.7.3 Internal support

To provide formal housing finance at affordable rates, the government introduced the Markup Subsidy for Housing Finance (MPMG) and assigned monthly mandatory targets for housing units and amount of disbursements to banks, in proportion to their share in total banking assets. Accordingly, weekly data was compiled on "construction and housing finance" for monitoring the mandatory credit target scheme for the banks.

Furthermore, SBP also started data collection on closed government deposit accounts from banks, DFIs and MFBs, for the implementation of the government's Treasury Single Account policy.

1.7.4 User-friendly data dissemination system

SBP made consistent efforts to enhance its economic data coverage and present the data in a user-friendly manner to stakeholders. In this regard, SBP developed "SBP Asaan Adaad (SAAD)", a new website with a user-friendly and intuitive interface. SAAD displays interactive charts of economic indicators with useful chart controls to understand the evolving trend in the economy. It allows users to easily create a data basket of frequently used variables for later retrieval. It also compiles public time series data from other, disparate sources, on a single platform, and makes this data available for download. SAAD is expected to go live soon.

1.7.5 Ensuring timely dissemination of data during the pandemic

SBP ensured timely dissemination of important statistics during the COVID-related mobility restrictions and the consequent remote-working model. To this end, remote access to data compilation modules was implemented with robust security controls.

1.7.6 Implementation of new data compilation modules

SBP endeavors to improve its data compilation by persistently automating manual processes. During FY21, the following modules were implemented:

a) Data acquisition of daily cash flows from commercial banks
b) Data acquisition of Crop Loan Insurance Scheme
c) TAT Monitoring Portal for SME Financing
d) Compilation of CRR, SLR, CRA & SCRA modules
e) Data acquisition on the National Financial Literacy Program

Besides, detailed analysis of the requirements of the following data compilation modules was completed with the development of System Requirements Specifications (SRS) during FY21:

a) Revamping of Foreign Exchange Computerized Reporting System
b) Electronic Credit Information Bureau - version 2
c) Automation of data collection of hourly FX Net Open Position
d) Non-residents' shareholding registration systems