Governor's Review

I am pleased to present the State Bank of Pakistan's Annual Performance Review for FY21. As we all know, this was a particularly challenging year, as the global economy adjusted to a once-in-a-life time healthcare pandemic. Notwithstanding the human toll of the COVID-19 outbreak, the economic and financial challenges posed by the containment measures, including lockdowns and limited movability, were also quite significant and required a timely, well-coordinated and data-driven policy response. Amid such testing times, which included multiple waves of the virus outbreak, I am pleased to note that Pakistan's economy and financial sector performed considerably well. The economic growth rebounded to 3.94 percent during the year, against a COVID-induced contraction of 0.47 percent last fiscal year and an original target of 2.1 percent set for FY21. At the same time, average inflation also moderated to 8.9 percent in FY21, within the SBP's previously announced target range of 7 – 9 percent, and down from 10.8 percent last year. In addition, other key macroeconomic balances also improved during FY21 over the previous year: the current account deficit fell from 1.7 to 0.6 percent of GDP and the overall fiscal balance improved from -8.1 to -7.1 percent of GDP.

This improvement was enabled by timely, aggressive, and targeted policy measures to provide financial support to address the imminent liquidity and solvency concerns that had emerged immediately after the outbreak in March 2020. The SBP's monetary policy stance, including quantitative measures, remained supportive and was supplemented by targeted fiscal support, especially for the economically vulnerable segments of the society, and the agriculture and industrial sectors. This turnaround in growth while improving macroeconomic balances was also striking from a cross-country perspective, where emerging and developing economies on average contracted by -2.1 percent and developing Asian economies contracted by -0.8 percent on average in CY2020.[1]

At the outset of the virus outbreak, SBP had realized the critical role of ensuring liquidity flows to both firms and households amidst the unfolding national lockdowns. In this regard, SBP introduced concessional refinance schemes to prevent layoffs (Rozgar Scheme); facilitate healthcare institutions to upscale their facilities (Refinance Scheme to Combat COVID); and encourage firms to undertake long-term investments (under the Temporary Economic Refinance Facility). The export-oriented firms, which were faced with an extremely challenging global business environment, were facilitated by time-bound relaxations in export-related procedural requirements, and an expansion in the eligibility criteria for the concessionary Export Finance Scheme (EFS). In addition to the refinance schemes, SBP also allowed banks to temporarily defer principal repayments of loans for firms,

[1] Source: IMF, World Economic Outlook – October 2021 update

including SMEs, and households, and to restructure loans where appropriate. In aggregate, SBP measures provided liquidity support of around 5.0 percent of GDP.

These measures were well distributed across the beneficiaries. Approximately 73 percent of the beneficiaries of the Rozgar scheme to prevent layoffs were small corporates (defined as businesses with turnover of less than Rs. 2 billion) and SMEs. Similarly, approximately 94 percent of the beneficiaries of the principal extension scheme were clients of micro finance banks which are small borrowers. The major share of TERF offtake (for new investment, expansion and BMR) is in textiles (42 percent), food and FMCG (11.9 percent) and plastic manufacturing firms (7.9 percent).

These measures were also well targeted and temporary in nature; of the Rs.691.7 billion approved quantitative measures, approximately Rs. 64.9 billion worth of measures have been unwound by end-FY21. The Rozgar scheme, Loan principal deferment scheme and Refinance Facility for Combating COVID-19 (RFCC)[2] expired on September 30, 2020, whereas Temporary Economic Refinance Facility (TERF) and Loan restructuring schemes, expired on March 31, 2021. Such normalization of support provided during COVID has been an important goal of central banks around the globe and I am pleased to share that SBP was able make concrete progress in this regard.

Furthermore, the anchoring of inflation expectations, despite some upward pressures from supply management issues in food items and the surge in international commodity prices, allowed the Monetary Policy Committee (MPC) to keep the policy rate unchanged throughout the year. The adoption of forward guidance on Monetary Policy by SBP since January 2021, played a major role in reducing short-term policy uncertainty for stakeholders. Moreover, the temporary nature of the stimulus measures also ensured that the overall financial stability was not compromised.

FY 2021 also witnessed an improvement in Pakistan's external indicators. SBP's FX reserves depicted strong annual growth of more than 40 percent during FY21, with an increase of USD 5.2 billion to USD 17.3 billion. The increase was largely attributed to reduction in the current account deficit to a 10-year low, on the back of record-high workers' remittances and export receipts, as well as much lower services and primary income deficits. The market-based exchange rate facilitated this improvement in increasing export competitiveness, and by encouraging emigrants to remit funds back to their home country via the formal banking channel. Furthermore, the financial incentives announced by the SBP and the government for remittance processors under the Pakistan Remittance Initiative (PRI) also played an important role in increasing remittance flows to USD 29.4 billion during the year.

Being the regulator of the payment infrastructure in the country, SBP undertook two major policy measures that are likely to have a lasting impact on the country's banking landscape and external accounts. First, SBP, in collaboration with the government and commercial banks, launched a landmark initiative to engage the millions of Pakistanis living abroad with Pakistan's banking system. This objective was achieved by introducing Roshan Digital Accounts (RDA) in September 2020, which allowed non-resident Pakistanis to open and operate their bank accounts remotely with banks in

[2] For existing hospitals, the scheme expired on September 30, 2020, however, validity of this scheme for new hospitals is June 30, 2021. (details: https://www.sbp.org.pk/COVID/index.html)

Pakistan. The RDA facilitates non-resident Pakistanis to make a wide range of payments to support their families; invest their savings in the newly launched Naya Pakistan Certificates (NPCs), as well as in the stock market, mutual funds and real estate; and to purchase cars for their family members (under Roshan Apni Car). The RDAs have been immensely popular among the Pakistani diaspora, as evident in the rapid increase in number of RDAs open during FY21; by end June 2021, a total of 181,556 accounts have been opened and funds amounting to USD 1.56 billion have been received. From the policy perspective, the RDAs have provided another avenue to the country to diversify the sources of its foreign exchange earnings, by more actively tapping the savings of the millions of Pakistanis living and working abroad.

The second major payments-related undertaking by SBP was the launch of the first use-case of Raast - a state-of-the-art, interoperable and secure payment platform that enables consumers, merchants and government entities to exchange funds in a seamless, instant and cost-effective manner. The implementation of Raast would transform the payment landscape of Pakistan by allowing multiple partners and stakeholders to swiftly process funds and payments.

Financial inclusion remained the top strategic priority at SBP, in line with the vision of the National Financial Inclusion Strategy. To achieve its underlying objectives, SBP issued 706 licenses for new branches and offices to commercial banks and microfinance banks during FY21. Around 19 percent of these new branches, were opened in the rural, underserved, and unbanked areas. Special focus remained on the priority areas of Balochistan, Khyber Pakhtunkhwa, Azad Jammu and Kashmir and Gilgit Baltistan; 135 new branches were approved for these areas under the Annual Branch Expansion Plan 2021.

In terms of credit disbursement, there was a renewed focus during FY21 on the relatively underserved economic segments, especially housing and construction finance, agriculture finance, and finance for micro, small and medium enterprises. To develop a cohesive and facilitative environment for housing finance, various measures and initiatives were taken by the government and SBP. These included the Government Mera Pakistan Mera Ghar (MPMG) Scheme for housing finance, mandatory housing and construction finance targets for banks, incentive and penalty structure, digitization of land records at the provincial level for online land transfers and development of framework for new channels. Resultantly, the housing and construction finance portfolio witnessed a growth of 74 percent during FY21 with the outstanding loan portfolio reaching to Rs.259 billion by end June 2021, from Rs.149 billion at end June 2020. Moreover, the third five-year strategic plan for the Islamic banking industry was issued by SBP in April 2021 to set a strategic direction and strengthen the existing growth momentum of industry. The strategic plan has set headline targets for Islamic banking industry to be achieved by 2025.

Another major initiative of the SBP during FY21 was the implementation of the Risk Based Supervision (RBS) framework for supervision of regulated entities. The RBS is a forward-looking supervision framework that would allow the SBP to pursue a coherent risk-based approach through proactive identification of risks, and take timely mitigation measures to ensure financial stability in the country.

To achieve the broad strategic goals, organizational efficiency of SBP was further strengthened during the year. Key initiatives included workforce rationalization, automation of process workflows, strengthening the cyber security and risk management framework, improvements in the bank's resilience against shocks and disruptions and enhancing communications with the stakeholders. On the communications front, in addition to the issuance of forward guidance, the SBP increased its engagements with economic agents, including via post-MPC analyst briefings, interactions with industrial groups and media organizations across the country, and an active presence on social media. The SBP is also cognizant of the importance of gender diversity, and undertook efforts to encourage the hiring of more female employees across the wider financial services industry. Around 11 percent of the SBP's workforce consists of female employees, who serve in diverse roles at various level of hierarchy, ranging from entry level to senior management.

Lastly, I would like to express my gratitude to the SBP Board for their firm support and guidance, which enabled us to pursue the central bank's strategic objectives with persistence and vigor. I also extend my appreciation to SBP staff for their unwavering efforts and dedication in helping the institution to actively contribute to the country's growth prospects.

Dr. Reza Baqir
Governor

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