Chapter 5

Money and Credit

An effective monetary policy plays a significant role in managing and sustaining financial stability because it promotes monetary and financial conditions which in turn support to achieve low and stable prices. Accordingly, stable inflation directs to strong and robust economy which itself not only a key stabilizing force for financial markets but also contributes towards achieving monetary policy objectives.

In the aftermath of financial crisis during 2007-09, monetary policy has progressed into a key policy tool to attain the twin objectives of macroeconomic and financial stability. In response to global financial crisis, central banks around the world adopted extremely accommodative monetary policy as they kept policy rate very low. Notwithstanding, this policy stance successfully navigated the crisis and its immediate repercussions, still there are concerns about prolonged monetary accommodation.

Presently, in advanced countries the financial stability has largely reinforced while on the other hand, global financial conditions are tightening on account of U.S transitions to a less accommodative monetary policy stance. Resultantly, the challenge is to make a successful transition from policy accommodation to investment-driven growth while minimizing spillovers that threaten financial stability.[*]

Pakistan has also pursued an accommodative monetary policy to reinvigorate the economy amid weak private investment and considerable deceleration in inflation. It is well-known that over the years Pakistan's financial sector remained resilient in the face of uncertainties at domestic and external front. Nevertheless, fragile global economic recovery, persistently high fiscal deficit, energy related issues and security concerns brought plethora of challenges and risks to financial stability. The risks further elevated when insufficient external inflows resulted in heavy reliance on banking sector and continuous fall in foreign exchange reserves due to heavy debt payments. Furthermore, rising pressure on banking sector constricted the growth in private sector credit. All these issues collectively exerted pressure on money and foreign exchange markets and posed certain risks to financial markets.

When present government assumed the charge in June, 2013, they took all these issues on board and immediately developed a comprehensive agenda of reforms with an aim to address the structural issues particularly in energy sector, restructuring PSEs and raising tax revenues in order to put the economy on the path of sustainable economic growth.

Consequently, these initiatives instantly helped in easing off the pressures on the economy. During first nine months of current fiscal year, 2013-14 all the major indicators have shown significant improvement particularly, real GDP grew by 4.14 percent during current fiscal year 2013-14 against 3.70 percent recorded in the same period of 2012-13, fiscal deficit reduced to 3.2 percent of GDP during July-March, 2013-14, against 4.7 percent in the same period of 2012-13, and growth in Large Scale Manufacturing (LSM) has been strong. On the other hand rupee also appreciated and exchange rate is now moving towards the stability and market sentiments are giving positive signal for the economy. Above all, foreign exchange reserves which were under significant pressure on account of payments to international agencies have also been increased noticeably.

Going forward, inflationary pressures have tapered since December 2013 after remaining at 10.9 percent in November, 2013. In April, 2014 it stood at 9.2 percent. Similarly, credit to private sector accelerated as it posted a growth of 8.8 percent during July-09 May, 2013-14 against 2.7 percent in the same period of 2012-13. On the other hand, in banking sector improvement in asset quality indicators have been witnessed on account of decline in infection ratio adequate provisioning against non performing loans and improved capital adequacy position of the banking system. NPLs to loans ratio reduced from 15.8 percent in March 2013 to 13.3 percent in March, 2014; while overall

[*] Global Financial Stability Report: April, 2014

Capital Adequacy Ratio recorded at 14.8 percent as of end March 2014, much higher than the minimum required level of 10 percent.

Furthermore, entering into 3-year arrangement under the Extended Fund Facility (EFF) with IMF (Box-1), successful launch of Pakistan Sovereign bonds worth $2.0 billion and auction of 3G/4G license during 2013-14 were the major developments, which will not only be helpful in strengthening the financial and external sector while reducing short term risks but it will also address Pakistan's underlying medium term problems to sustain higher and more inclusive growth. Moreover, expected issuance of international Sukuk bonds worth $500 million in first and second quarter of next fiscal year will further support the improvement in external sector.

Box-1: Extended Fund Facility (EFF)

Pakistan entered into an Extended Fund Facility (EFF) program with IMF on September 4, 2013. It is a 36-month extended arrangement under the Extended Fund Facility (EFF) for SDR 4.393 billion (US$6.64 billion, 425 percent of quota) with an aim to support the country' s economic reform program as well as to address Pakistan's underlying medium term problems to sustain higher and more inclusive growth. To date, Pakistan has received three tranches totaling about $ 1.65 billion.

Three reviews have been completed till now and it is pertinent to mention that EFF program with IMF is on track and Pakistan has achieved almost all performance criteria till March, 2014 under IMF's condition on account of reducing budget deficit, limiting borrowing from SBP and providing cash transfers to beneficiaries of BISP. Furthermore, on the basis of improved economic performance, IMF has raised the growth projection from 3.1 percent to 3.3 percent for fiscal year 2013-14 and lower down end June inflation estimates to 9.5 percent and for end period 8.8 percent. While for fiscal year 2014-15, for end June target is 7.5 percent and 8.1 percent for end period. For fiscal year 2014-15, IMF has scaled up projected growth from 3.7 percent to 4.0 percent.

Monetary Policy Stance

Monetary policy is primarily focused on stimulating and sustaining economic growth through containment of inflationary pressures. Over the past few years, monetary management in Pakistan remained quite difficult due to long standing structural issues particularly in confluence with law and order situation, continuous decline in foreign and domestic investment and insufficient external inflows. At the same time, high government borrowing for budgetary purpose significantly affected the balance sheet of scheduled banks. During fiscal year 2012-13, budgetary borrowings from the banking system stood at Rs1446 billion which was even higher than the total expansion in M2. Consequently, it has posed serious implications for effective monetary management and financial stability. Equally, it has severely hampered government's ability to extend the credit to private sector. It is pertinent to mention that government successfully met the target of borrowing from SBP by end March, 2014[*]. In net terms, government gradually reduced its borrowing from SBP with an aim to adhere the zero limit borrowing.

During fiscal year 2012-13, SBP adopted accommodative policy stance keeping in view the considerable decline in inflationary pressures and to reinforce the growth in private sector credit. Since June, 2012, overall policy rate was slashed by 300 bps points to 9.0 percent in June, 2013. Consequently, the declining interest rate environment and improvement in electricity contributed in a marginal pickup in loans to some sector of private businesses during 2012-13.

Table:5.1- Policy Rate

w.e.f	Policy rate
Oct-11	12.0
Nov-11	12.0
Feb-12	12.0
Apr-12	12.0
Jun-12	12.0
Aug-12	10.5
Oct-12	10.0
Dec-12	9.5
Feb-13	9.5
Apr-13	9.5
Jun-13	9.0
Sep-13	9.5
Nov-13 till date	10.0

Source: State Bank of Pakistan

During the first half of current fiscal year, SBP reversed its stance from accommodative to tight policy as the rate was increased by cumulative 100 bps, staggered in two stages of 50 bps each. This policy stance was largely a reflection of expected inflationary pressures in the medium term on account of high growth in monetary aggregates and upward adjustment in administered prices of

[*] Borrowing from SBP(on cash basis) stood at Rs.2,226.8 billion against the target of Rs.2,390 billion under IMF condition.

electricity and gas. Similarly, in September 2013, the SBP linked the minimum rate of return on average balances held in saving deposits with the floor of the interest rate corridor with an aim to ensure that deposit rates respond more strongly to policy rate changes.

During the first nine months of current fiscal year, almost all major economic indicators improved, which in turn ensures the revival of confidence in Pakistan's economy. However, due to likely resurgence in inflationary pressures in the remaining months of current fiscal year, SBP adopted a cautious stance by maintaining the policy rate at 10.0 percent in latest monetary policy announced on 16th May, 2014.

Recent Monetary and Credit Developments

During July – 9th May, 2013-14, growth in money supply (M_2) remained below than the previous level recorded in the same period of 2012-13 as it increased by 7.32 percent (Rs.648.2 billion) against the expansion of 10.32 percent (Rs.788.8 billion) in the comparable period last year on account of contained net government borrowing in particular for budgetary purpose as compared to the previous level.

Table: 5.2- Profile of Monetary Indicators (Rs in billion)

	Jul-09 May 2013-14	Jul-10 May 2012-13
1.Net government sector Borrowing(a+b+c)	199.6	992.9
a .Borrowing for budgetary support	264.7	1,075.8
b.Commodity operations	-65.0	-84.2
c.Others	-0.18	1.3
2.Credit to Non-government Sector(d+e+f+g)	351.6	141.2
d.Credit to Private Sector	296.4	92.5
e.Credit to Public Sector Enterprises (PSEs)	55.1	48.9
f. PSEs Special Account-Debt repayment with SBP	0.0	-0.2
g.Other Financial Institutions(SBP credit to NBFIs)	0.1	-0.1
3.Other Items(net)	-139.9	-163.9
4.Net Domestic assets (NDA)	411.3 (4.79%)	970.2 (13.65%)
5.Net Foreign Assets (NFA)	236.9	-181.4
6.Monetary Assets(M2)	648.2 (7.32%)	788.8 (10.32 %)

Source: Weekly Profile of Broad Money, State Bank of Pakistan

Net Foreign Assets (NFA) which remained under a tremendous pressure during most of the current fiscal year, has recently started to improve on account of availability of external financing from International financial institutions (IFIs) and immediate efforts of SBP to increase liquid reserves. Recent data reveals this fact as it has increased to Rs.236.9 billion during July-9th May, 2013-14 as compared to the net contraction of Rs.181.4 billion in the comparable period last year. Earlier pressure on NFA was largely attributed to decline in foreign exchange reserves on account of debt repayment to IMF since July, 2011. To date, Pakistan has repaid $ 7.0 billion to IMF. As Pakistan has already made significantly large payments to IMF and has also successfully launched Pakistan Sovereign bonds, thus the position will likely to improve further.

Fig: 5.1 - Net Foreign Assets (Flows)

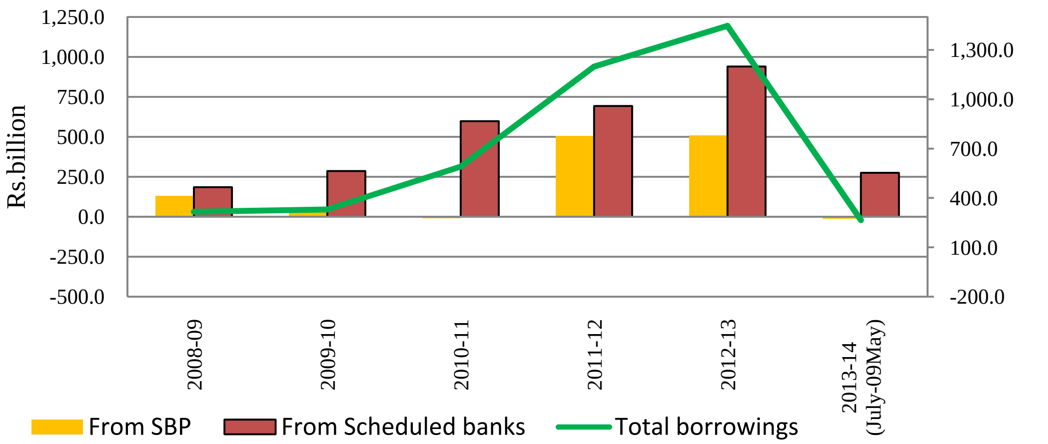
On the other hand, NDA of the banking sector contained at 4.79 percent (Rs.411.3 billion) during July-9th May, 2013-14 as compared to net expansion of 13.65 percent (Rs.970.2 billion) in the same period last year. Containment in NDA can be attributed to decline in government borrowing for budgetary finance.

During July-9th May, 2013-14, credit to public sector enterprises (PSEs) borrowed Rs.55.1 billion against Rs.48.9 billion in the same period of fiscal year 2012-13. Credit extension to PSEs was considerable in energy sector as they borrowed considerably from the banking sector to enhance capacity utilization after the settlement of circular debt in June 2013.

Government Bank Borrowing

During July-9th May, 2013-14, economy witnessed a significant decline in government borrowing from the banking system due to contained borrowing for budgetary support which is largely a reflection of improved fiscal accounts. During the period under review, government sector borrowing for budgetary support amounted to Rs.264.7 billion against Rs.1,075.8 billion in the same period of fiscal year 2012-13. Within the banking system, government retired Rs.10.5 billion to SBP against the borrowing of Rs.416.8 billion in the same period last year. On the other hand government has borrowed Rs.275.2 billion from Scheduled banks during July- 9th May, 2013-14 against the borrowing of Rs.659.0 billion last year. Consequently, net government borrowing from the banking system reduced significantly to Rs.199.6 billion during July-9th May, 2013-14 from Rs.992.9 billion recorded in the same period of fiscal year 2012-13.

Fig: 5.2-Government Borrowings (Flows)



Quarter wise break indicates that government borrowed Rs.271.7 billion for budgetary purpose from the banking system during the second quarter of current fiscal year, in addition to Rs.200.0 billion borrowing in the first quarter of the year*. Whereas, in the third quarter of fiscal year 2013-14, government successfully retired Rs.56.7 billion to the banking system. On the other hand, second quarter of current fiscal year witnessed a reverse trend in borrowing from the SBP, as government borrowing was declined to Rs.83.7 billion in the second quarter of fiscal year 2013-14 from Rs.379.2 billion in first quarter. Whereas, government successfully retired an amount of Rs.397.8 billion to SBP during the third quarter of current fiscal year 2013-14. As mentioned earlier, at the end of third quarter, government was able to contain its borrowing from SBP within the limit agreed with IMF.

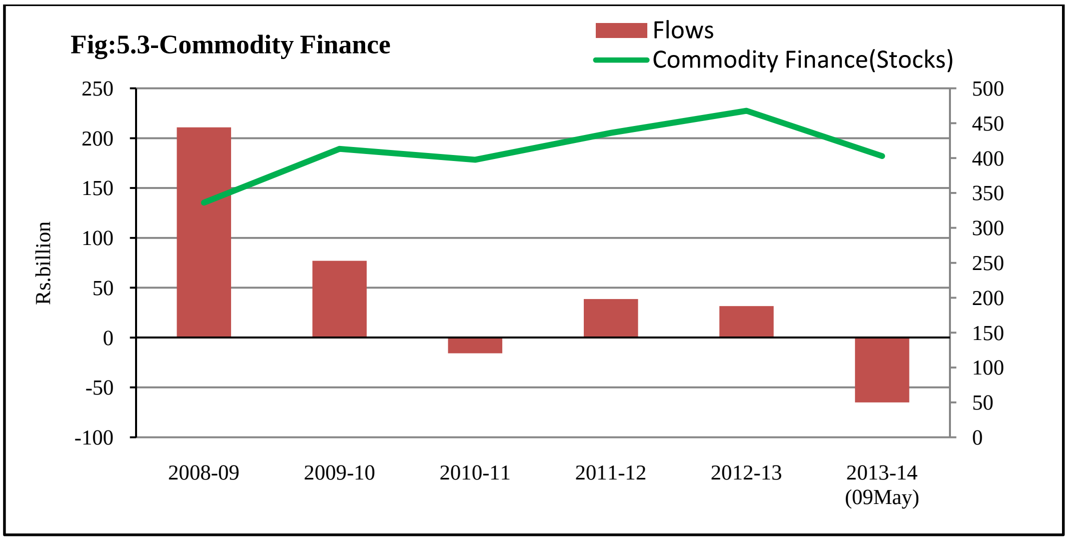
Commodity Finance

To support domestic agriculture prices, particularly of wheat, caused a significant rise in commodity financing over the past few year, which resulted in crowding out of private sector credit. Rise in commodity financing over the years is largely attributed to higher support price for major food crops.

During fiscal year 2012-13, outstanding loans for commodity financing amounted to Rs. 467.7 billion against 436.1 billion in 2011-12, posting a growth of 7.2 percent. Rise in loans during fiscal year 2012-13 was largely attributed to fresh borrowing for the procurement of sugar, fertilizer and wheat. Whereas, during July-9th May, 2013-14 loans for commodity

* SBP 2nd Quarterly Report

operations registered a net retirement of Rs.65.0 billion against the retirement of Rs.84.2billion in the comparable period of fiscal year 2012-13, hence outstanding loans for commodity financing reduced to Rs.402.8 billion.



While commodity wise breakup shows that during July-March, 2013-14 with net retirement of Rs.133.6 billion, the outstanding loans for commodity finance reached to Rs.334.1billion. Of which, loans for wheat finance registered a net retirement of Rs.146.0 billion against Rs.144.9 billion of retirement in the comparable period of 2012-13. Significant amount of retirement during the period was mainly due to aggressive off loading of wheat stocks by the provincial food departments to stabilize wheat price in second quarter of current fiscal year.

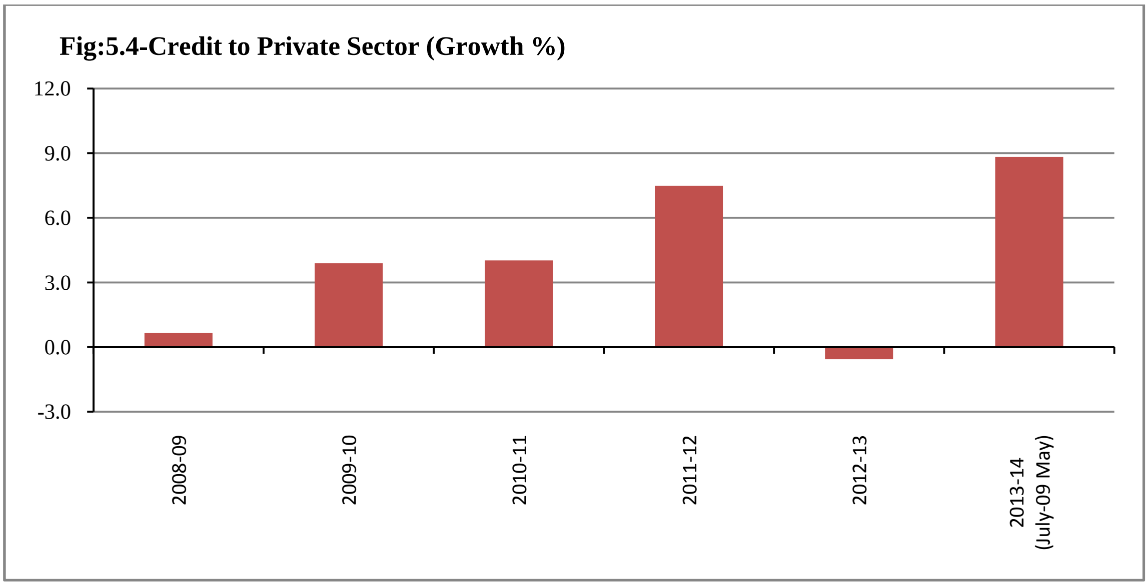
On the other hand, borrowing for fertilizer finance amounted to Rs.9.3 billion during July-March, 2013-14 against Rs.17.9 billion in the same period of 2012-13. Due to rise in domestic production, lower imports helped in reducing the borrowing requirement for fertilizer import. Similarly, borrowing for sugar finance has also witnessed sluggish growth as TCP aggressively offloaded its sugar stock. It reached to Rs.3.0 billion during July-March, 2013-14 against the borrowing of Rs.14.5 billion in the same period of last fiscal year.

Credit to Private Sector

Over the years, Pakistan's private sector has faced multifaceted challenges on various fronts like finance, infrastructure, employee skills and the investment climate. Moreover, less external inflows, low tax to GDP ratio, expenditure overrun due to unplanned expenditure on account of war against extremism and unprecedented floods and consequently rapidly rising public borrowing to finance the budget deficit resulted in crowding out of private sector. The situation further aggravated due to energy crisis, resultantly, the banks were reluctant to extend the credit for private businesses rather they were more comfortable to invest in government papers. All these factors resulted in a muted growth of private sector. However, current fiscal year 2013-14 has witnessed significant improvement in credit to private sector growth as a result of positive developments on structural reforms in order to promote competitive business environment with an aim to boost the private sector rather managing the businesses.

Fig 5.4 reflects a significant decline in credit to private sector during fiscal year 2012-13 despite the accommodative monetary policy, as credit to the private sector posted a net retirement of Rs 19.0 billion in 2012-13, against the expansion of Rs 235.2 billion in 2011-12, thus posting a decline by 0.6 percent. However, recent data indicates that the credit to private sector has improved and increased to Rs.296.4 billion during July- 9th May, 2013-14 against the expansion of Rs.92.5 billion in the comparable period last year, thus posted a growth of 8.8 percent against 2.7 percent in the same period last year. While on year on year basis it grew by 5.3 percent as on 9th May, 2013-14 against 2.7 percent recorded in the same period of fiscal year 2012-13.

This positive development is mainly attributed to improved financial conditions of the corporate sector partly due to decrease in interest rates during 2011-12 and 2012-13, improved supply of electricity after settlement of energy sector circular debt by the government and better business sentiments after May 2013 elections.



Sectoral Analysis

Sector wise growth in credit to private sector shows that during fiscal year 2012-13, Loans to private sector business witnessed a growth of 0.7 percent. Whereas, during July-March, 2013-14 it grew considerably to 10.2 percent against 6.5 percent recorded in the comparable period of 2012-13.

Table: 5.3 - Credit to Private Sector (Rs. in billion)

Sectors	End June Stocks				July-March (Flows)		Growth Rates	
	Jun-12	Jun-13	March-13	March-14	2012-13	2013-14	2012-13	2013-14
Overall Credit (1 to 5)	2,922.0	2,976.3	3,110.7	3,281.3	188.7	305.0	6.5	10.2
1. Loans to Private Sector Business	2,450.1	2,467.2	2,615.2	2,738.9	165.1	271.7	6.7	11.0
A. Agriculture	198.4	222.0	212.8	238.6	14.3	16.6	7.2	7.5
B. Mining and Quarrying	15.9	20.8	21.9	23.0	5.9	2.3	37.1	10.9
C. Manufacturing	1,389.9	1,448.9	1,535.4	1,664.0	145.5	215.1	10.5	14.8
Textiles	491.0	514.9	565.9	583.5	74.9	68.6	15.3	13.3
D. Electricity, gas and water supply	278.1	228.9	277.3	255.6	-0.8	26.8	-0.3	11.7
E. Construction	53.5	53.4	52.4	51.7	-1.2	-1.6	-2.2	-3.1
F. Commerce and Trade	210.0	206.9	211.8	227.2	1.8	20.3	0.8	9.8
G. Transport, storage and communications	111.3	89.8	102.6	85.8	-8.7	-4.0	-7.8	-4.4
I. Other private business n.e.c	30.0	42.1	38.7	43.1	8.8	1.0	29.2	2.3
2. Trust Funds and NPOs	18.0	17.0	17.1	7.3	-0.9	-9.7	-5.0	-56.9
3. Personal	285.0	305.8	298.0	327.5	13.0	21.7	4.6	7.1
4. Others	15.6	14.2	11.6	20.6	-4.0	6.4	-25.7	45.3
5. Investment in Security & Shares of Private Sector	153.2	172.2	168.8	187.0	15.6	14.8	10.2	8.6

Due to significant increase in credit off take in various sectors and subsector during July-March, 2013-14, credit to private business witnessed broad-based improvement. As discussed earlier, that revival of business confidence due to government's efforts to address long standing structural issues along with expansion in production capacities, product diversification, investment in alternate energy sources etc contributed to this significant expansion in loans to private sector.

Similarly, loans to private business by type (trade financing and working capital) have also witnessed an increase during the period under review on account of increased business activity in textiles, power and trade. During third quarter of current fiscal year, textiles, commerce and trade, and energy witnessed a net retirement which was largely offset by net credit uptake by sugar (mostly for working capital), refined petroleum and manufacturing machinery.

In flow terms, credit expansion to private business increased to Rs.271.7 billion during July-March, 2013-14 against Rs.165.1 billion in the same period of 2012-13. Among all major sectors, credit off take in Manufacturing remained high at 14.8 percent, of which textile sector received 13.3 percent of credit. Manufacturing sector availed 79.2 percent of private sector loan (Rs.215.1 billion), followed by textile (25.2 percent or Rs.68.6 billion), electricity, gas and water (9.9 percent or Rs.26.8 billion), and mining and quarrying (0.8 percent or Rs.2.3 billion).

Table 5.4: Consumer Financing (Rs. in billion)

	July-March (Flows)		Growth (%)	
Description	**2012-13**	**2013-14**	**2012-13**	**2013-14**
Consumer Financing	8.5	21.5	4.2	9.8
1) For house building	-2.4	-0.1	-5.7	-0.3
2) For transport i.e. purchase of car	2.3	9.0	5.1	17.8
3) Credit cards	-1.9	-0.5	-8.2	-2.1
4) Consumers durable	-0.1	0.2	-40.3	88.2
5) Personal loans	10.2	13.9	11.5	13.9
6) Other	0.4	-0.9	7.0	-11.1

Significant growth has also been witnessed in consumer loans during July-March, 2013-14 , as it increased to 9.8 percent against 4.2 percent recorded in the same period of fiscal year 2012-13. Consumer financing start gaining momentum since November 2012 and continued its upward trend during July-March, 2013-14. Consumer durables registered a tremendous growth of 88.2 percent in credit expansion followed by 17.8 percent growth in auto and 13.9 percent in personal loans. It is pertinent to mention that increased growth in auto finance is largely attributed to the auto finance facility actively marketed by leading Islamic banks. Additionally, one of the public sector commercial banks advertised its Salary Loan Scheme and Cash and Gold scheme which attributed to significant rise in personal loans.

Table-5.5: Targets and Actual Disbursement of Agriculture Loans

	Target		Flows (July-March)	
Name Of Banks	**2012-13**	**2013-14**	**2012-13**	**2013-14**
5 Big Commercial Banks	153.5	188.0	123.7	133.5
ZTBL	72.0	69.5	38.0	45.9
DPBs	66.7	90.4	51.0	54.2
PPCBL	9.0	10.0	5.4	5.4
MFBs	13.8	21.6	13.0	16.2
Islamic Banks		0.5	0.0	0.5
Total	315.0	380.0	231.0	255.7

In agriculture, against the credit disbursement target of Rs.380 billion for fiscal year 2013-14, overall disbursement increased to Rs.255.7 billion during July-March 2013-14 against Rs.231.0 billion in the same period of fiscal year 2012-13, posting an increase of 10.7 percent. Whereas, during July-March of current fiscal year, credit disbursement accounted 67.3 percent of the annual target. Five major commercial banks disbursed agri loans of Rs.133.5 billion or 71.0 percent of its annual target which is 8.0 percent higher from Rs.123.7 billion during the same period of last fiscal year.

Monetary Assets

Monetary assets (M2) consist of currency in circulation, demand deposits, time deposit and resident's foreign currency. Monetary expansion during July-9th May, 2013-14 recorded at 7.3 percent against 10.3 percent in the same period of fiscal year 2012-13, whereas y-o-y basis it stood at 12.8 percent as on 9th May. Lower growth in M2 is mainly stemmed from decline in currency in circulation (CIC) and deposit money.

Currency in Circulation

Growth in currency in circulation has decelerated as it reduced to 9.0 percent during July-9th May, 2013-14.2 against the growth of 19.7 percent recorded in the same period last year, while y-o-y growth stood at 10.5 percent as on 9th May, 2013-14. Decline in CIC is largely a reflection of contained government borrowing from banking system for budgetary purpose. Similarly, during the same period currency in circulation (CIC) as percent of money supply (M2) has also reduced to 23.3 percent from 23.8 percent recorded a year earlier.

Table 5.6: Monetary Aggregates (Rs Million)

Items	End June		July-09 May	
	2012	2013	2012-13	2013-14
A.Currency in Circulation	1,673,746	1,938,222	2,003,617	2,213,406
Deposit of which:				
B. Other Deposits with SBP	8,899	10,523	10,736	13,982
C.Total Demand &Time Deposits incl.RFCDs	5,959,150	6,909,066	6,416,258	7,278,640
of which RFCDs	440,130	514,988	508,070	562,130
Monetary Assets Stock (M2) A+B+C	7,641,795	8,857,812	8,430,611	9,506,029
Memorandum Items				
Currency/Money Ratio	21.9	21.9	23.8	23.3
Other Deposits/Money ratio	0.1	0.1	0.1	0.1
Total Deposits/Money ratio	78.0	78.0	76.1	76.6
RFCD/Money ratio	5.8	5.8	6.0	5.9
Income Velocity of Money	2.9	2.9	2.7	2.7

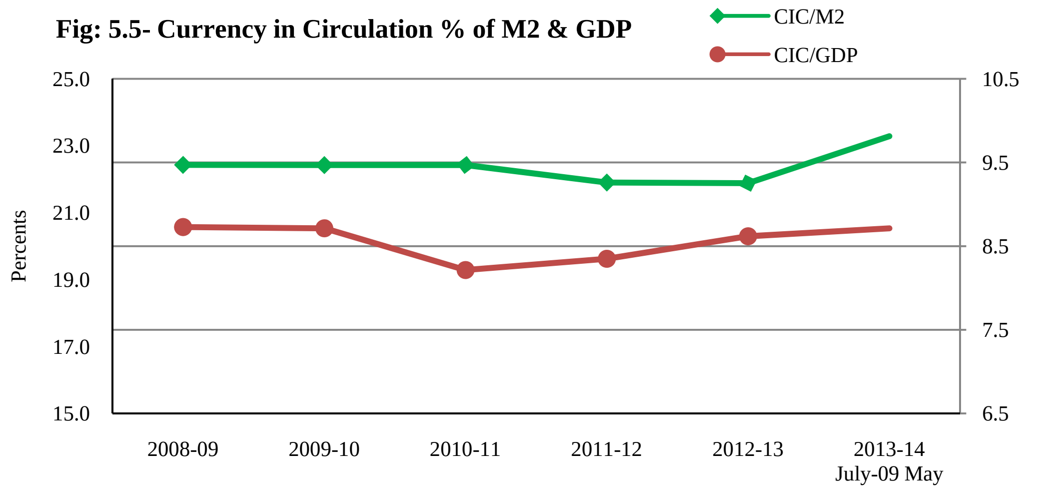
Source: State Bank of Pakistan

Deposits

During July-9th May, 2013-14 demand and time deposits stood at Rs.369.6 billion against Rs.457.1 billion during the same period last year, posting a growth of 5.3 percent against 7.7 percent during the same period of fiscal year 2012-13. This deceleration in deposit growth is largely attributed to lower real interest rates due to higher expected inflation, relatively better returns on other assets such as equity and real estate and increase in withholding tax on cash withdrawals.

Particularly, time deposits witnessed a persistent reduction since the start of fiscal year 2013-14, as it remained negative and declined to Rs.96.0 billion against an increase of Rs.38.0 billion in the same period. Similarly, decline in Resident Foreign Currency Deposits (RFCDs) have also contributed to overall deposit growth as it reduced to Rs.47.1 billion during July-9th May, 2013-14 from Rs.67.9 billion in the same period of fiscal year 2012-13. Impact of rupee appreciation during the current fiscal year has been translated into this decline in RFCD.

Fig: 5.5- Currency in Circulation % of M2 & GDP



Monetary Management

During the initial months of current fiscal year 2013-14, monetary management remained under tremendous pressure on account of volatility in market liquidity conditions, resurgence in inflationary pressures, prevailing uncertainty over foreign financial inflows and pressure on exchange rate. Financial market witnessed the volatility in liquidity conditions on account of government borrowing from the central bank, which in turn made liquidity management more difficult. However, the pattern of borrowing changed to commercial banks significantly since September, 2013, when SBP increased the policy rate by 50 basis points successively in September and November 2013 to deal with balance of payments position, and stabilizing the inflationary outlook.

Table 5.7: Summary of Open Market Operations (Rs. in billion)

	Injections		Absorptions	
	2012-13	**2013-14**	**2012-13**	**2013-14**
July	1,058.6	631.3	-	142.4
August	2,090.1	-	-	725.2
September	2,095.6	-	-	689.8
October	2,505.1	136.25	-	54.0
November	2,633.2	121.5	-	668.0
December	2,404.4	241.1	39.5	-
January	2,480.2	262.95	107.0	-
February	2,231.6	348.1	-	129.1
March	2,322.5	520.05	-	69.0
Total	**19,821.1**	**2,261.3**	**146.5**	**2,477.4**

Source: State Bank of Pakistan

It is pertinent to mention that during the current fiscal year, reduced borrowing for budgetary support from the banking system helped SBP to mop-up liquidity after an extended period of monetary injections. SBP's purchases from the FX market to support falling FX reserves and commercial bank's reluctance to invest in government securities, created excess liquidity in the interbank market[*]. SBP mopped up a significant amount through Open Market Operations (OMOs) in order to drain this excess liquidity. SBP mopped up Rs. 2,477.4 billion during July-March 2013-14 against the injections of Rs 2,261.3 billion whereas in the comparable period of last year absorption of Rs 146.5 billion against the injection of Rs 19,821.1billion has taken place.

Table 5.8 Market Treasury bills Auctions (Rs.in million)

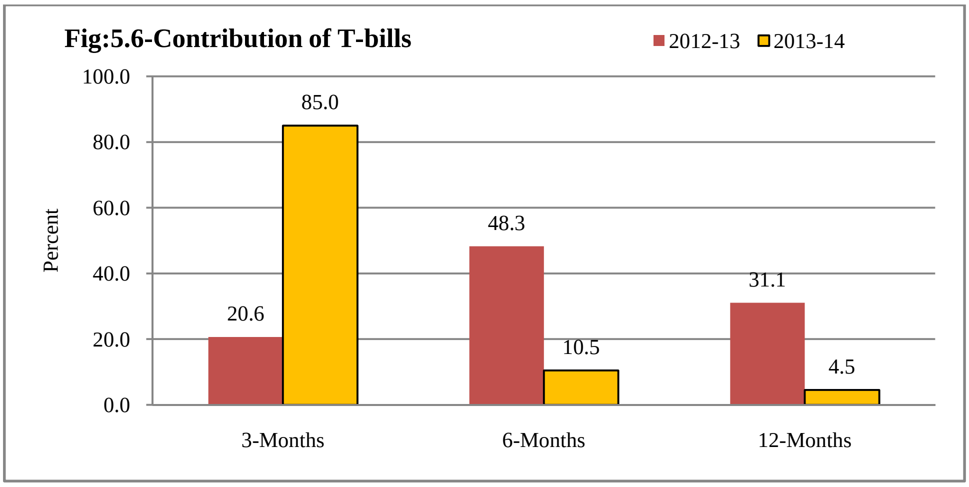
	JUL-JUN			Jul-March					
	2012-13			Offered		Accepted		W.A.Rate*	
	Offered	**Accepted**	**W.A Rate***	**2012-13**	**2013-14**	**2012-13**	**2013-14**	**2012-13**	**2013-14**
3-Months	1,592,616	1,155,404	10.4	1,266,989	5,248,579	878,175	4,730,455	10.5	9.4
6-Months	3,597,169	2,434,463	10.4	3,147,453	650,866	2,053,367	583,060	10.5	9.5
12-Months	2,963,751	2,017,987	10.4	2,095,012	273,557	1,321,928	252,939	10.6	9.5
Total	8,153,536	5,607,854	-	6,509,454	6,173,002	4,253,470	5,566,454	-	-

Source: State Bank of Pakistan
*Average of maximum and minimum rates

During July-March, 2013-14 market offered the total amount of Rs.6,173.0 billion against Rs.6,509.5 billion in the same period of fiscal year 2012-13. Since September, 2013 monetary policy decision, 85.0 percent of total bids under T bills auction were on average for 3-month tenure.

In the T-bills auction held in fourth quarter of fiscal year 2013-14 so far government has raised less than the targeted amount, which shows that bank's appetite for PIBs are increasing as in the PIBs auction held in the same period so far, government has raised higher amount than the target amount.

[*] SBP, Second quarterly report, 2013-14

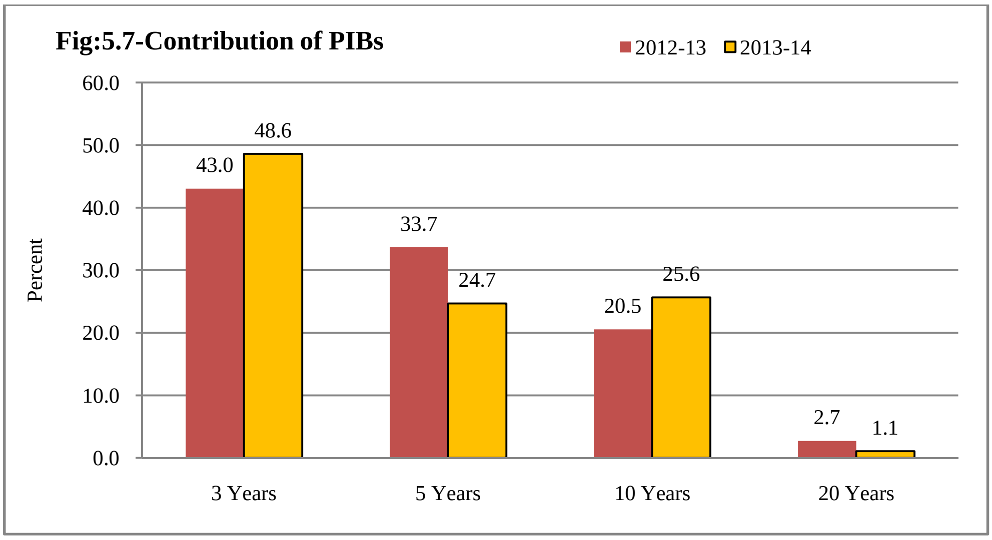


Market offered total amount of Rs. 1,336.3 billion during the first nine months of current fiscal year 2013-14 under PIB auction as compared to Rs. 459.5 billion in the same period of last fiscal year. Heavy investment was seen in 3 years PIBs which constituted 48.6 percent of total accepted amount.

Table 5.9: Pakistan Investment Bonds Auctions (Rs. in million)

PIBs	July-June			July-March				W.A. Rate	
	Offered	Accepted	W.A Rate	Offered		Accepted			
	2012-13			2012-13	2013-14	2012-13	2013-14	2012-13	2013-14
3 Years	319,735	139,300	11.1	206,729	615,509.0	82,224	560,908	11.4	11.2
5 Years	173,909	80,492	11.6	128,227	321,945.0	64,362	285,020	11.9	11.7
10 Years	147,403	53,368	12.1	118,349	385,532.0	39,239	296,012	12.4	12.2
15 Years	-	-	-	-	-	-	-	-	-
20 Years	6,210	5,197	13.4	6,211	13,333.0	5,197	12,323	13.4	13.1
30 Years	-	-	-	-	-	-	-	-	-
Total	647,257	278,357	-	459,516	1,336,319.0	191,023	1,154,263	-	-

Source: State Bank of Pakistan
Note: Accepted amount include non-competitive bids as well as short sell accomodation.



During the first nine months of current fiscal year, following a rise in policy rate by 100 bps, weighted average lending rate (including zero mark-up) on gross lending has also increased from 10.46 percent in March, 2013 to 10.53 percent in March, 2014, thus increased by 7 bps during the period. On the other hand, weighted average deposit rate have declined by 23 bps to 5.80 percent in March, 2014 from 6.03 percent in the same period last year.

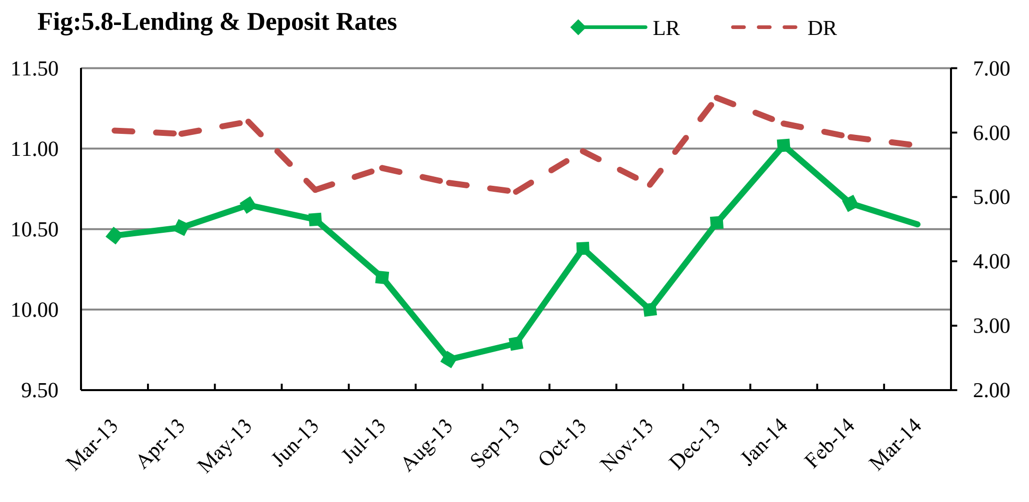
Banking spread which generally refers to the cost of channeling funds through intermediaries and is the difference of lending and deposit rates has increased by 30 bps to 4.73 percent in March 2014 against 4.43 percent witnessed in March 2013.

However, since January, 2014 it registered a decline from 4.88 percent to 4.73 percent in March 2014 after gross advances registered a decline of 49 bps to 10.53 percent whereas fresh deposits have also declined by 34 bps to 5.80 percent.

Table-5.10 Lending & Deposit Rates(W.A.)

	LR	DR	Spread
Mar-13	10.46	6.03	4.43
Apr-13	10.51	5.98	4.53
May-13	10.65	6.17	4.48
Jun-13	10.56	5.11	5.45
Jul-13	10.20	5.45	4.75
Aug-13	9.69	5.22	4.47
Sep-13	9.79	5.08	4.71
Oct-13	10.38	5.71	4.67
Nov-13	10.00	5.19	4.81
Dec-13	10.54	6.54	4.00
Jan-14	11.02	6.14	4.88
Feb-14	10.66	5.93	4.73
Mar-14	10.53	5.80	4.73

Fig:5.8-Lending & Deposit Rates



Pakistan's Financial Sector

The role of financial sector stability in the process of economic development has increased manifold, particularly, stable banking sector is considered to be a paramount for economic growth.

Pakistan's banking sector remained extremely strong and resilient, despite immense pressures stemming from fragile macroeconomic environment over the past few years. Remarkable performance of banking system was mainly due to improved capital adequacy and solvency indicators, contributed by higher level of profits and equity injections.

Overall performance of the banking sector has remained encouraging. In December, 2013, the asset base of the banking sector and its key elements registered a modest growth as it grew by 8.5 percent year on year basis to reach at Rs.10.5 trillion. However, this modest increase was duly supported by 14.0 percent growth in deposits. In 2013, asset base reached to Rs.165 billion, whereas it amounted to Rs.10.8 trillion by end March, 2014 and YTD profit before tax reached at Rs.51 billion.

Table 5.11: Banking System: Key variables of Balance Sheet and Profit & Loss Statement* (Rs. in billion)

	2009	2010	2011	2012	2013	Mar-14
Total Assets	6,516	7,117	8,171	9,711	10,537	10,752
Investments (net)	1,737	2,157	3,055	4,013	4,305	4,662
Advances (net)	3,240	3,358	3,349	3,804	4,047	4,014
Deposits	4,786	5,451	6,244	7,294	8,318	8,151
Equity	660	695	784	882	939	956
Profit Before Tax (ytd)	81	105	170	179	165	51
Profit After Tax (ytd)	54	65	112	178	111	33
Non-Performing Loans	446	556	592	615	585	602

Table 5.11: Banking System: Key variables of Balance Sheet and Profit & Loss Statement* (Rs. in billion)

	2009	2010	2011	2012	2013	Mar-14
Non-Performing Loans (net)	134	185	182	176	126	134
Capital Adequacy Ratio (all banks)	14.0	13.9	15.1	15.6	14.9	14.8

Source: State Bank of Pakistan
*: On the basis of calendar year
Note: Statistics of profits are on year-to-date (ytd) basis.

Moreover, Capital Adequacy position of the banking system has also improved significantly on the basis of improved capital position of the banking sector. SBP regularly monitors banks capital adequacy ratios (CAR) in accordance with Basel requirements. The steady profits and a gradual increase in Minimum Capital Requirements (MCR) prescribed by SBP assisted banks in increasing their common equity capital significantly in the recent years and facilitated Pakistani Banks in converging to new Basel III capital requirements comfortably. The CAR under Basel-III as reported by banks for Dec-13 quarter stood at 14.9 percent (15.1 percent under Basel II). While it stood at 14.8 percent as of end March, 2014. Hence it remained strong and well above the prescribed benchmark of 10 percent. It is also worth mentioning that the CAR of the banking industry has remained well above this benchmark during the last six years.

Similarly, with broad-based improvements in macroeconomic performance and recent revival in credit demand both for working capital and fixed capital needs, the assets quality has also witnessed gradual improvement after observing deterioration over the last five years. NPLs to loans ratio came down from 4.6 percent to 3.1 percent year on year basis. While it came down to 13.3 percent in March, 2014 from 15.8 percent in March 2013. Significant performance in banking sector is achieved on account of prompt regulatory measures and proactive policy initiatives.

Financial Development

It is a well known fact that financial depth has a positive effect on economic development. In this perspective, role of well structured and efficient financial sector is integral as it ensures efficient use of financial resources and facilitates large investments and more productive allocation of capital, which directs to higher income growth.

Table: 5.12 Key Indicator of Financial Development

Years	M2/GDP
2008-09	38.9
2009-10	38.9
2010-11	36.6
2011-12	38.1
2012-13	39.4
July-09 May	
2012-13	37.5
2013-14	37.4

Financial depth or deepening is generally a measure of the size of financial intermediaries. There are several proxies, which can be used to measure the financial depth, but M2-to-GDP ratio is regarded as the most comprehensive and commonly used measure. Increasing M2/GDP ratio mainly refers to more developed and efficient financial sector. Additionally, it also indicates that growth in financial assets is more than non financial assets. In case of Pakistan this ratio is not only low but also remained stagnant for the past few years. Monetary assets which were 38.9 percent of GDP in fiscal year 2008-09 increased to 39.4 percent in 2012-13. While during July-9th May, 2013-14, it reduced slightly to 37.4 percent from 37.5 percent recorded in the same period last year. However, the ratio is expected to rise on account of ongoing reforms in financial sector with an aim to strengthen and widen its scope in the economy. In this context, SBP is working to achieve its multipronged objectives including efficiency, soundness and stability of financial system, financial inclusion, development finance, customer protection and improvement in payment system etc.

Box-2: Financial Reforms

- State Bank has been striving for ‘financial inclusion’ in the country through sound policy advocacy, market & infrastructure development, and proportionate regulatory frameworks. Promotion of microfinance through Micro Finance Banks (MFBs) is key component of this overall “financial inclusion” strategy.
- Numerous initiatives have also been taken to address market bottlenecks that restrict access to and outreach of financial services in the rural areas. Some of these programs include (a) Issuance of revised Prudential Regulations (PRs) for agriculture financing, (b) Livestock Insurance Scheme for Borrowers, (c) Farmers’ Financial Literacy and

Awareness Program (FFAP), (d) Capacity Building of banks, (e) facilitating post harvest financing to farmers, traders and exporters, etc

- Measures have been taken for strengthening the SME sector and promotion of financing to this key segment. The measures already in place including (a) SBP Finance and Refinance Schemes, (b) Export Finance Scheme and Long Term Finance Facility (LTFF), (c) Export Finance Facility for Locally Manufactured Machinery (EFF-LMM), (d) Credit Guarantee Scheme. In order to promote the financing to this important segment and improve the capacity of the related human resources, SBP is conducting Primary Survey of 21 SMEs, and conducting SME Finance Grass Root Cluster Training Programs.
- SBP is also supervising and monitoring the recently launched Prime Ministers Youth Business Loans Program, which is meant for providing loans to unemployed youth, especially educated youth for establishing or extending business enterprises in order to promote self-employment in the country. The program is currently being implemented through National Bank and First Women Bank. Other banks are also gearing up their systems for participation in PM Youth Business Loans Program.
- To promote housing finance in the country, SBP is facilitating in establishment of Mortgage Refinance Company (MRC). The creation of a MRC would help to address the long term funding constraint hindering the growth of the primary mortgage market.
- In May 2014, SBP has issued separate Prudential Regulations (PRs) for Housing Finance to encourage banks to follow housing finance more rigorously and prudently. Further, in April 2014, SBP issued Developer Finance Guidelines, which are expected to work as bridge between builders and banks.
- Keeping in view the importance of financial consumer’s protection, a dedicated Consumer Protection Department (CPD) is functioning at SBP, which ensure that banks have put in place an adequate consumer protection framework, introduce efficient delivery channels and adopt more customer centric practices.
- During the last five years, SBP introduced policy of setting minimum rate on deposits to protect the depositor’ interest. In May 2008, the SBP set the minimum saving rate floor of 5 percent which was raised to 6 percent in April 2012 that was further strengthen in March 2013 by instructing banks to calculate on monthly average balance. In Sep-13, SBP further raised the minimum rate to 6.5 percent while tagging it with 50 bps below the lower bound of interest rate corridor w.e.f. Oct-13. Since the current SBP’s repo rate is 7.5 percent, effectively, the existing minimum saving rate is 7 percent which is the highest ever till date since the introduction of minimum saving rate.
- The SBP has continuously enhanced Minimum Capital Requirements (MCR)-paid up capital (free of losses)- of the financial institutions regulated by it in a phased manner, which facilitated in improving the capital adequacy and solvency of the banking system. It not only attracted the worthy investors to enter the market but also ensured stability by setting a threshold for minimum size of a bank.
- In order to evaluate trading of government securities on the stock exchanges of Pakistan, a committee was formed in August 2013 consisting of all stakeholders i.e. SBP, SECP, KSE and CDC. Objective of the committee was to put up an appropriate regulatory and operational framework to launch the trading of Government securities on the stock exchange by the end of January 2014. It was agreed that trading of Government Securities at the stock exchange will be an additional platform and will not replace the existing OTC market (Bloomberg, Reuters and money market brokers).
- Robust payment mechanisms are a pre-requisite for improving financial inclusion in the country. SBP has taken a number of initiatives to bring about efficiency and reliability in the existing payment system of the country. It has introduced International Bank Account Number (IBAN) in 2012, for identification of standardized bank account across the national as well as international borders. It has also issued various guidelines for enhancing the number of ATMs for making their usage more ubiquitous with safety and security.
- Further, several projects are underway, which are expected to further strengthen the financial infrastructure and improve efficiency of the existing system. Few projects in progress include (a) rules related to various Electronic Payment Gateways and services providers, (b) Regulation on prevention of E-banking fraudulent transactions, (c) standardization and security of financial articles, (d) implementation of cheque truncation system for faster image based cheque clearing, (e) guidelines for pre-paid card, (f) upgrading the existing Real Time Gross Settlement (RTGS) system and its membership extension to MFBs, and (g) ADCs compliant management system.
- Further, SBP is currently managing the Secretariat for SAARC Payment Council (SPC), which is a forum for Central Banks/Monetary Authorities of SAARC countries to collectively develop strategies and roadmaps for the improvement of payment systems in the SAARC region. The Payment Systems Department (PSD) is playing an active role in developing and promoting cooperation among member countries.

Source: State Bank of Pakistan

Islamic Banking

Islamic Banking industry in Pakistan is currently spread across 80 districts of the country constituting nearly 10 percent share in overall banking industry with 19 banking institutions offering Shariah compliant products and services. In terms of branch network, more than 1300 branches of the Islamic banking industry are currently operational in 87 districts across the country. Keeping in view the huge potential of Islamic Banking, several initiatives have been taken in order to provide necessary legal, regulatory and supervisory infrastructure.

During the past few years, Islamic banking posted an exceptional growth in financial sector of Pakistan with both assets and deposits contributing in this growth. Share of Islamic banking assets in overall banking system rose from 4.90 percent in 2008 to 9.60 percent in 2013. while in terms of deposits the share increased from 4.78 percent in 2008 to 10.40 percent in 2013.

During 2013, asset base of Islamic banking industry (IBI) reached to Rs.1,014 billion against Rs.837.0 billion in 2012, thus posted a growth of 21.1 percent (YoY). Similarly, deposits of Islamic banking industry stood at Rs. 868.0 billion in 2013 against Rs. 706.5 billion during 2012, hence registered a growth of 22.9 percent. As of March 2014, the assets base of the Islamic Banking Industry reached to Rs.1,016 billion while deposits reach to Rs.872 billion. Consequently, the market share of Islamic Banking assets and deposits in overall banking industry stood at 9.40 and 10.70 percent by end march 2014.

Table 5.13 Islamic Banks* (Rs. in billion)

	2009	**2010**	**2011**	**2012**	**Dec-13**	Mar-14
Assets of the Islamic banks	366.3	477.0	641.0	837.0	1,014.0	1,016.0
Deposits of the Islamic Banks	282.6	390.1	521.0	706.5	868.0	872.0
Share in Banks Assets	5.60%	6.70%	7.80%	8.60%	9.60%	9.40%
Share in Bank Deposits	5.90%	7.20%	8.40%	9.70%	10.40%	10.70%

*: On the basis of calendar year

Source: Islamic Banking Department, State Bank of Pakistan

In terms of profitability, there was an increase of Rs.2.61 billion in profit in the quarter end Dec 2013, however remained lower compared to the profit (Rs.9.9 billion) earned by the industry by the end Dec, 2012. Similarly, the Islamic banking industry witnessed an increase in Return On Equity (ROE) during the last quarter of 2013, however, Return On Assets (ROA) remained unchanged compared to the previous quarter. As a positive development, Non-Performing Financing (NPF) of Islamic banking industry decreased during October to December 2013 quarter and reached to Rs.18.9 billion showing quarterly (QoQ) decline of 4.0 percent. Similarly non-performing assets (NPA) of Islamic banking industry also decreased during the October to December 2013 quarter.

Box-3: Key initiatives for the promotion of Islamic Banking Industry

a. Issuance of Shariah Governance Framework

To further strengthen the Shariah compliance environment in Islamic banks, Shariah overnance Framework (SGF) has been issued, which will be effective from 1st October 2014. It explicitly defines the Shariah related roles and responsibilities of all key organs of IBIs including Board of Directors, the executive management, Shariah Boards and internal and external auditors.

b. Issuance of Five year Strategic Plan for Islamic Banking Industry of Pakistan

State Bank of Pakistan has developed a five year Strategic Plan (2014-18) for the Islamic Banking industry in consultation with all key stakeholders which gives a consensus agenda and strategy to take the industry to next level of growth and development. It focuses on improving public perception of Islamic banking as a distinct and viable system capable of catering to the financial services needs of various segments of the society. It envisages intensifying the awareness creation efforts, strengthening consultation mechanism with stakeholders, removing confusion and inconsistencies in legal, regulatory and taxation environment, deepening and broadening of product offerings by Islamic Banks, doubling the outreach of Islamic Banks during the next five years and increasing the market share to 15 percent of the banking system.

c. Completion of Knowledge, Attitude and Perception Study

State Bank of Pakistan completed a survey based study to estimate demand for Islamic Banking in the country. The main objectives of the survey based Project; “Knowledge, Attitude and Practices of Islamic Banking in Pakistan” are (a) quantification of the demand for Islamic Banking and its nature in the country, (b) incidence of Financial Exclusion based on religious beliefs and (c) identification of critical areas requiring financing. The study is based on first hand information collected through survey from both banked (Islamic and conventional) & un-banked sectors of the country. The findings of this study are not only expected to benefit SBP in policy formulation but also be of interest to both incumbent and potential entrants to the market.

d. Awareness Creation

State Bank of Pakistan launched a nationwide media campaign in collaboration with the industry to improve Islamic finance literacy. The first phase focused on creating awareness and improving visibility of Islamic banking in the country, while the second phase is focused on improving the understanding of the masses about Islamic banking.

e. Constitution of Steering Committee for Promotion of Islamic Banking

The Government of Pakistan (GOP) has demonstrated its strong commitment for supporting development of Islamic finance in the country and has constituted a high level Steering Committee for promotion of Islamic banking. The steering committee comprises of renowned Shariah scholars, senior government officials, industry experts and business leaders aiming to develop proposals and recommendations for transforming the financial system in conformity with Shariah principles.

Table 5.13 (a) Financing Products by Islamic banks (%age)*

Mode of Financing	2009	2010	2011	2012	Dec-13
Murabaha	36.5	40.8	43.8	97.5	134.2
Ijara	15.1	8.9	10.4	22.5	25.4
Musharaka	3.4	1.9	2.4	1.9	22
Mudaraba	0.4	0.2	0.1	0.6	0.5
Diminishing Muskaraka	29.7	29.7	32	87.7	101.8
Salam	1.2	1.5	2.4	7.3	13.3
Istisna	6	6.1	4.4	17.7	18.5
Others	7.8	10.9	4.4	10.5	14.5

*: on the basis of calendar year
Source: State bank of Pakistan

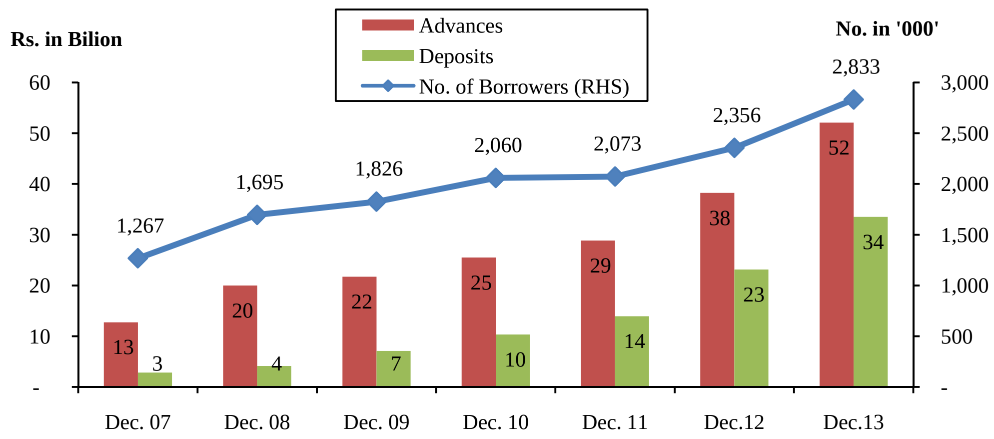
In terms of financing mix, all modes of financing registered increase during the last quarter of 2013. However, Murabaha and Diminishing Musharaka remained the most concentrated modes as these collectively contributed more than 70 percent in overall financing mix followed by Ijarah, Musharaka, Istisna, others and Salam etc..

Microfinance

The Microfinance sector has continued its positive long-term growth as a result of greater private investment, supportive policy environment, vibrant market infrastructure, increased use of innovative technologies, and improved operational performance. Current performance of microfinance is marked by growth in all key areas including outreach, loan portfolio, deposit base, profitability, and equities. In particular, the sector is currently serving more than 2.8 million active borrowers.

The microfinance sector (MFBs and MFIs) witnessed a 36 percent growth in its aggregate loan portfolio which grew by Rs.13.8 billion; reaching to Rs.52.1 billion against a total of 2.8 million borrowers as at end December, 2013 compared to loans worth Rs.38.2 billion to 2.4 million borrowers in the corresponding period last year. At the close of 2nd quarter of fiscal year 2013-14, the total loan portfolio of MFBs grew by 42 percent, reaching to Rs 28.3 billion as compared to Rs 20 billion in the corresponding period last year. The number of borrowers served also registered a growth of 21.3 percent, increasing from 803,096 in December, 2012 to 974,352 in December, 2013. The asset base of MFBs also registered an impressive growth of 31 percent rising to Rs.58 billion in December, 2013 from Rs.44.3 billion in the corresponding period last year. The NPLs of MFBs were restricted to around 1 percent as of end December, 2013, which points to prudent lending practices by MFBs. The deposits' growth also remained impressive with a total of Rs 10.3 billion (44.7 percent) added to the MFBs' deposit base which stood at Rs 33.5 billion as of end December, 2013, compared to Rs 23.1 billion in corresponding period last year. The progress of the industry remained satisfactory despite macroeconomic challenges and law & order situation, facing the country. The sector was able to expand its branch/service centre network to 2,157 as of December, 2013 adding 239 new business locations across the country compared to position of December, 2012.

Fig: 5.9 Growth of Microfinance Industry



In line with the impressive growth in microfinance banking, the coverage of the branchless banking network is also expanding significantly with persistent double-digit growth, as nearly 110,214 agents are now spread out across more than 90 per cent of the country's districts. Branchless banking transactions crossed 52 million mark during July-September 2013, which led total value of transactions to reach Rs 224 billion (around $ 2.1 billion) showing 16 percent growth in numbers and a notable 29 percent growth in value during the quarter. During the period under review, 355,574 new accounts were opened and the cumulative BB accounts grew to 2.97 million. Currently, the average size of transaction is Rs 4,315, up 11 percent from Rs 3,870 during the preceeding quarter. This demonstrates that this innovative technology is now increasingly becoming accesssible for the poor.

SBP Policy Initiatives during the Year 2013-14

Key policy developments during fiscal year 2013-14 so far are;

- After Tameer MFB, Advans Pakistan MFB and Khushhali Bank Ltd. have also been allowed to undertake microenterprise lending on a pilot basis. The development came after SBP allowed higher loan limits to MFBs for undertaking microenterprise lending in March, 2012 with prior approval of SBP.
- The Consultative Group to Assist the Poor (CGAP) and SBP have jointly completed an I-SIP research in Pakistan to study the linkages between financial inclusion (I) and central banks' traditionally core objectives of Financial Stability (S), Financial Integrity (I), and Consumer Protection (P). Sharing the findings of I-SIP research, the CGAP testified in a workshop held at SBP in December, 2013 that SBP's policy framework for BB and financial inclusion is in sync with the best approach for optimally managing linkages between financial inclusion and central banks' traditionally core objectives of financial stability, financial integrity, and consumer protection.
- A four member delegation of Bank of Zambia (BoZ) visited SBP in September, 2013 to learn about innovative approaches of Pakistan for financial identification system. Meetings of the delegation were arranged with relevant stakeholders at SBP and NADRA to share Pakistan's experience in branchless banking, IT infrastructure, consumer protection, computerized national ID card system for identification and verification procedures under KYC requirements, etc.
- APNA Microfinance Bank, a Karachi-based district MFB, has been granted in principle approval to become a provincial MFB, subject to meeting the prescribed capital requirement.
- Three new players i.e. U-paisa by U MFB, Mobile-paisa by Alfalah, and MCB-lite by MCB Bank Ltd. have commenced their branchless banking operations after approval from SBP.

Insurance Sector

The insurance industry in Pakistan is relatively small compared to other developing and regional countries; however, the sector possesses huge potential for expansion and growth. During the calendar year, 2012, the industry's total premium revenue was over Rs.145 billion compared to Rs.124 billion (US$ 1.29 billion) as of 2011; insurance penetration and density have also witnessed an upward trend to 0.93 percent and US$ 7.70 for 2012, compared with 0.82 percent and US$ 7.22 for 2011.

The non-life insurance sector comprises 40 insurers, including three general Takaful operators and one state-owned insurer, the National Insurance Company Limited (NICL), with the exclusive mandate to underwrite public property. During the period under review, the non life insurance market remained dominated by top three players with over 65 percent of the market share, while the remaining 35 percent market was shared among the 37 insurers. The sector witnessed a growth of 6 percent during 2012 with total premium underwritten of over Rs.57 billion. In the life insurance sector, there are nine life insurance companies, including two, “family Takaful operators” and one state-owned corporation having a dominant market share of 64 percent. In 2012, the life insurance sector grew by 26 percent, with total premium of Rs.88 billion. The only reinsurer of the industry-the government-owned Pakistan Reinsurance Company Limited (PRCL) continues to enjoy the mandatory minimum 35 percent share in the area of non-life Treat Reinsurance.

Box: 5.5- Achievements

SECP has taken number of initiatives in order to protect the interest of policyholders and to facilitate orderly development of the insurance industry:

Micro Insurance Rules 2014

The SECP has recently notified the Micro insurance Rules in February, 2014 which put special focus on the consumer protection, adequate disclosure requirements and transparent regulatory reporting by insurers so as to enable growth of the micro sector in a disciplined manner.

Insurance Industry Reform Committee

SECP has constituted an Insurance Industry Reform Committee, comprising of industry experts, professionals and members from SECP, which has prepared a comprehensive report recommending a roadmap for increasing insurance penetration and developing a sound insurance sector in Pakistan.

Third Party Administrators (TPA) for Health Insurance Regulations, 2014

The insurers in Pakistan have been experiencing higher management cost due to lack of modernized technological infrastructure, low business volume and lack of expertise. To address these issues SECP has issued Third Party Administrators (TPA) for Health Insurance regulations, 2014; TPAs specialize in processing medical insurance claims, and carrying out administrative duties which are not core competencies of an insurance company and can be outsourced.

Draft Bancassurance Regulation, 2013

SECP framed the draft Bancassurance regulations by aligning the long term interests of the policy holder, insurer and agent (i.e. bank in this case). The draft regulations propose various regulatory measures such as rationalization of bank’s remuneration structure, minimum financial protection, introduction of commission claw-back provisions, minimum surrender values, minimum financial underwriting parameters, mandatory after sale call-back requirements and introduction of a need analysis document.

Revised Legal Framework for the Direct Insurance Brokers

In order to evolve insurance broker’s regime in line with the best international practices, SECP has proposed draft amendments in the Insurance Rules, 2002 affecting the licensing of direct insurance brokers. The proposed amendments encompass exclusivity of insurance broking license, paid-up capital requirements, requirement to maintain net asset value, registration and renewal fees, statutory deposit requirements, professional indemnity insurance requirements and fit and proper criteria for the directors and chief executive of the insurance brokers; these are expected to be finalized during 2014.

Life Insurance Product Submission Mechanism

SECP has issued a regulatory directive in November, 2013 through which detailed product submission requirements have been prescribed after taking a holistic view of the entire legal and regulatory framework pertaining to the life Insurance sector.

Development of Crop and Livestock Insurance

SECP strives to develop comprehensive guidelines for the Crop insurance industry to cater to the huge demand in the market. During the year, the pilot projects launched by the Pakistan Poverty Alleviation fund and the State Bank of Pakistan are being executed under SECP’s supervisory advice, and are expected to provide effective learning outcomes for developing guidelines for the market to pursue this product actively.

Licensing and Registration of Insurance Companies and Brokers

SECP issued license to the Sahara Insurance Company Limited (SICL), a wholly-owned subsidiary of the Employees Old age Benefits Institution (EOBI), to transact the non life insurance business in the country bringing the total number of active non life insurers in Pakistan to 40; while the total number of active insurance companies (life and non life) including Pakistan Reinsurance Company Limited is 50. During the period under review, the SECP renewed the licenses of nine direct insurance brokers.

Money Laundering (ML) Compliance by the Insurers

While taking appropriate steps to address the gaps related to the threat of money laundering in the insurance industry, SECP has issued a directive for the insurers on the Anti-money Laundering (AML) regime redefining the Customer Due Diligence/Know Your Customer (CDD/KYC) requirements. SECP regularly monitors the compliance of AML/CFT regulatory requirements by the insurers.

Conclusion

Despite difficult monetary management due to longstanding structural issues, positive development in most of the economic indicators, particularly improved fiscal accounts helped the government to limit its borrowing from SBP for budgetary support. Most encouragingly, government successfully managed to achieve borrowing target set under IMF conditions. One of the major development during current fiscal year was improvement in credit to private sector on account of improved supply of electricity and better business sentiments after May 2013 elections. Similarly, with broad-based improvements in macroeconomic performance and recent revival in credit demand both for working capital and fixed capital needs, the assets quality has also witnessed gradual improvement with a decrease in Non Performing Loans.

During the current fiscal year, SBP reversed its stance from accommodative to tight policy and increased the policy rate by cumulative 100 bps during first half of 2013-14 on the basis of expected inflationary pressures in the medium term due to high growth in monetary aggregates and upward adjustment in administered prices of electricity and gas. However, during the second half of current fiscal year, SBP maintained the policy rate at 10.0 percent keeping in view the positive development of almost all major economic indicators.