Money and Credit

Money and Credit

Monetary Policy is an influential tool to attain medium term objectives for macroeconomic developments. Furthermore, it ensures financial stability which is in fact a key foundation for long-term economic growth and stability. It has not only a broad effect on financing conditions in the economy but it additionally affects the cost and accessibility of credit by controlling inflation.

Since the start of the global financial crisis in 2008, central banks around the globe especially in major advanced economies have followed accommodative monetary policy to support the economic recovery. Recent growth estimates suggests that world economic growth is projected to increase from 3.4 percent in 2014 to 3.5 percent in 2015 and further to 3.8 percent in 2016 on the basis of rebound in advance economies supported by the decline in oil prices.[1] On the other hand growth in emerging market and developing economies is projected to be lower at 4.3 percent in 2015 owing to weaker prospects for some large emerging market economies and oil-exporting countries.

In the wake of rapid decline in international oil and commodity prices, international economic developments have important ramifications for Pakistan, particularly, with the significant reduction in oil prices, trade balance is expected to improve on account of reducing import bill. Additionally, it will be helpful to further stabilize the exchange rate.

Over the past few years, Pakistan's economy has gone through many ups and down as the economic strategies were concentrated on short term measures to spur growth. In fact, economic reforms which were imperative for sustainable economic growth particularly in the wake of multifaceted challenges owing to security and energy related issues and global economic downturn were not given due care. Consequently, the growth rate remained significantly below our potential. When present government came into power, there was plethora of challenges due to long standing structural and security related issues whose immediate solution was the top priority. Therefore, soon after assuming the charge government embarked on a wide-ranging agenda of economic reforms focusing on energy reforms, better resource mobilization, eliminating militancy, PSEs reforms, bridging fiscal deficits and price stability.

Consequently, better strategies started to garner benefits as Pakistan achieved 4.03 percent GDP growth in fiscal year 2013-14, whereas the growth for fiscal year 2014-15 stood at 4.24 percent which is the highest level during last 7 years. Current economic conditions are indicating noticeable improvement as inflation indicators are on descending direction, remittances are showing momentous performance, FBR revenue collections are on track, stock exchange is performing excellent, foreign exchange reserves have been improved, and fiscal deficit is contained through prudent expenditure management. Similarly, in net terms government gradually reduced its borrowing from SBP with an aim to adhere the zero limit borrowing at the end of each quarter.

Moreover, financial system indicators also remained robust as asset quality has slightly improved with a decline in the non performing loan (NPL) ratio to 12.3 percent and the capital adequacy ratio (CAR) increased to 17.1 percent by end-December 2014 due to accumulation of

[1] World Economic Outlook, IMF. April,2015

profits and fresh equity injection by some banks. While CAR increased to 17.4 percent as of end March,2015. Keeping in view the improvement in key macroeconomic indicators, SBP has adopted an accommodative policy stance during the current fiscal year.

Monetary Policy Stance

Accommodative monetary policy stance during current fiscal year continues to signal improved key macroeconomic indicators like contained fiscal deficit, contracted current account deficit, low inflationary pressure, improvement in FX market sentiments as issuance of Sukuk Bond contributed to improvement in overall Balance of Payment (BOP) position and external accounts. Furthermore, receipts of Coalition Support Fund (CSF) during current fiscal year and successful completion of 7th review with the IMF in May 2015 has also helped in improving the market sentiments.

On the back of these developments, international agencies have upgraded outlook for Pakistan's economy from stable to positive which in turn will further improve the investor's confidence.

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	10.0
Nov-14	9.5
Jan-15	8.5
Mar-15	8.0
May-15	7.0

Source: State Bank of Pakistan

SBP adopted easy monetary policy stance during fiscal year 2012-13 keeping in view the significant decline in inflationary pressures and to stimulate the growth in credit to private sector. However, fiscal year 2013-14 witnessed a gradual shift in monetary policy stance from easy to tight keeping in view the resurgence of inflationary pressures in the medium term. Policy rate was increased by a cumulative 100 bps from 9.0 percent in June 2013 to 10.0 percent in November, 2013. While it remained unchanged at 10 percent during second half of fiscal year 2013-14 till November, 2014 due to improvement in some of the major macroeconomic indicators.

In November 2014, SBP reversed its stance from tight to accommodative due to improved economic environment and stable outlook. It reduced the policy rate by 50 bps to 9.5 percent in the second quarter of current fiscal year, further cut in policy rate by 100bps to 8.5 percent in January, 2015 and then by 50 bps to 8.0 percent in March 2015. Recently, Policy rate has been reduced further by 100 bps to 7.0 percent w.e.f 25th May,2015 which is the lowest rate in last 42 years reflecting improved macroeconomic conditions towards the end of fiscal year 2014-15. In this way, SBP has reduced the policy rate by a cumulative 300 basis points since the start of current fiscal year.

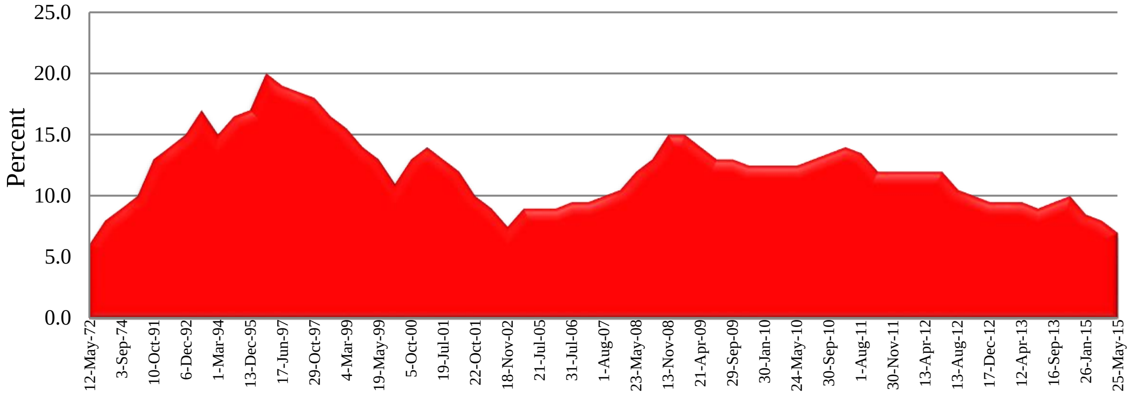
In February, 2015 SBP announced its time-bound plan to improve its interest rate corridor with an objective to enhance the effectiveness of monetary policy, better manage liquidity in the interbank market, and conduct open market operations rate of the corridor. In this regard, SBP has decided to introduce a "Target Rate" for overnight money market repo rate as a new "Policy Rate" to unambiguously signal SBP's stance of monetary policy. A new "SBP target rate" is set at 50 bps below ceiling rate. SBP will ensure that the overnight rate remains close to this target rate. This will be the main Policy Rate of SBP. Moreover, width of the interest rate corridor is reduced by 50 bps from 250 to 200 bps. Consequently, the floor rate is set at 5.0 percent[2].

Similarly, SBP has recently started conducting OMOs through GOP Ijara Sukkuk (GIS) to manage liquidity of the Islamic Banks, which will also help in improving monetary policy

[2]Monetary Policy Statement. May 23,2015

transmission along with keeping SBP's NDA target under IMF program.

Fig: 5.1 SBP Reverse Repo Rate



Recent Monetary and Credit Developments

Broad Money (M2) witnessed an increase of 7.33 percent during July-8th May, 2014-15 to stand at Rs. 730.5 billion against the expansion of 7.05 percent (Rs. 624.3 billion) in the comparable period last year mainly due to increase in net government borrowing specially from scheduled banks. While year on year growth in M2 was recorded at 12.8 percent as on May 8, 2015.

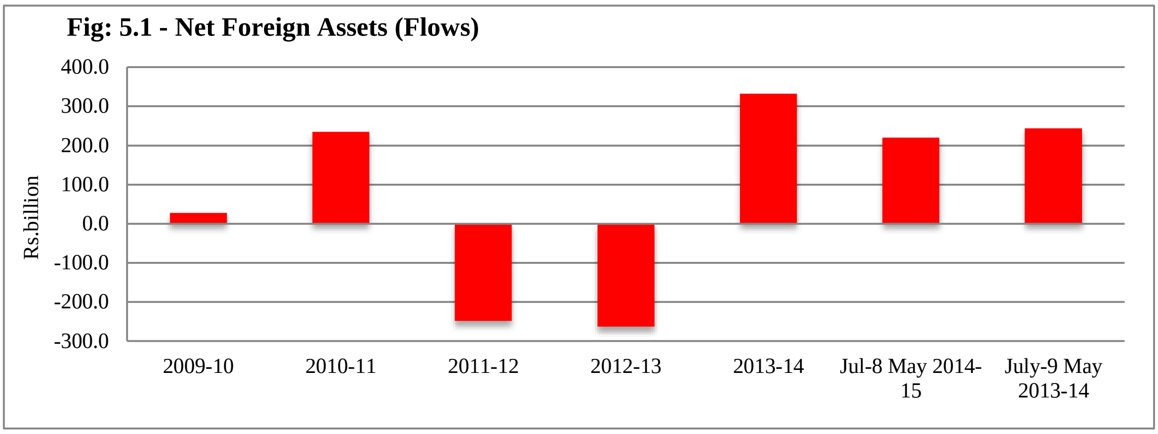
Table: 5.2- Profile of Monetary Indicators (Rs Billion)

	Jul-8 May 2014-15	Jul-9 May 2013-14
1.Net government sector Borrowing(a+b+c)	**579.7**	**175.1**
a .Borrowing for budgetary support	601.1	240.2
b.Commodity operations	-20.8	-65.0
c.Others	-0.70	-0.2
2.Credit to Non-government Sector (d+e+f+g)	**223.8**	**348.1**
d.Credit to Private Sector	161.7	292.9
e.Credit to Public Sector Enterprises (PSEs)	62.1	55.1
f. PSEs Special Account-Debt repayment with SBP	0.0	0.0
g.Other Financial Institutions(SBP credit to NBFIs)	0.0	0.0
3.Other Items(net)	**-293.0**	**-142.5**
4.Net Domestic assets (NDA)	**510.5 (5.45%)**	**380.6(4.43%)**
5.Net Foreign Assets (NFA)	**220.1**	**243.7**
6.Monetary Assets(M2)	**730.5(7.33%)**	**624.3 (7.05 %)**

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

On the other hand Reserve Money (RM) grew at 11.51 percent during July-8th May, 2014-15 against the growth of 9.84 percent in the comparable period last year. Net Foreign Assets (NFA) of SBP remained the main driver of reserve money growth during the current fiscal year.

Within Broad Money, Net Foreign Assets (NFA) of the banking sector witnessed an increase and reached to Rs. 220.1 billion during July-8th May, 2014-15 as against the net expansion of Rs. 243.7 billion in the comparable period of fiscal year 2013-14. There is a substantial contribution of NFA in the expansion of M2 during the period under review. NFA started to improve during second quarter of current fiscal year when it saw an expansion of Rs. 78.7 billion against the net contraction of Rs. 31.1 billion during first quarter of current fiscal year. While third quarter has witnessed further improvement when it expanded by Rs. 86.8 billion. This turnaround in NFA during the current fiscal year was mainly due to official financial inflows, divesture of ABL, HBL and UBL and issuance of Sukuk bonds in the international market.



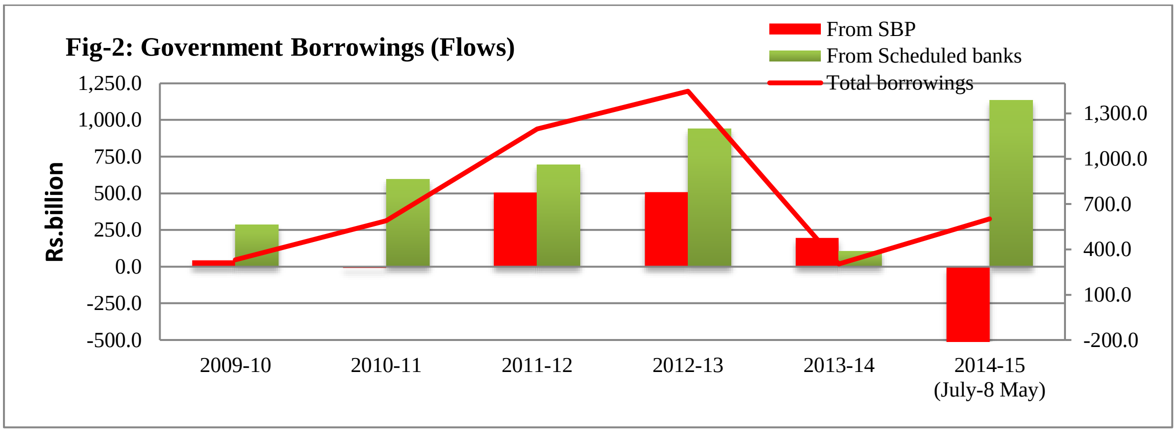
On the other hand growth in Net Domestic Asset (NDA) had increased due to increase in government borrowing from the banking system. NDA of the banking sector grew at 5.45 percent (Rs. 510.5 billion) during July-8th May, 2014-15 as compared to net expansion of 4.43 percent (Rs. 380.6 billion) in the same period last year. It is encouraging to note that SBP's NDA target for end-March 2015, limit agreed with the IMF was met due to government's efforts to improve financing mix of budget deficit and lower its reliance on SBP borrowing. It shows government's commitment with the IMF under its EFF program to meet its end quarter quantitative target of budgetary borrowing from SBP.

During July-8th May, 2014-15, credit to public sector enterprises (PSEs) witnessed an expansion of Rs. 62.1 billion against the expansion of Rs. 55.1 billion in the comparable period of fiscal year 2013-14.

Government Bank Borrowing

The government borrowing from the banking system for budgetary support and commodity operations stood at Rs. 579.7 billion during July-8thMay, 2014-15 as compared to Rs. 175.1 billion in the comparable period last year. Government borrowing for budgetary support stood at Rs. 601.1 billion during July-8thMay, 2014-15 against Rs. 240.2 billion in the same period of fiscal year 2013-14. Within banking system, large part was financed by commercial banks as it amounted to Rs. 1,133.6 billion as compared to Rs. 250.6 billion last year.

Significant borrowing from scheduled banks for budgetary support during the current fiscal year reflects a major shift from the central bank to scheduled banks because of State Bank of Pakistan (SBP) Amendment Act 2012, which required net zero government borrowing from the SBP at the end of each quarter. Therefore, net government borrowing from the banking system reached to Rs. 579.7 billion from Rs. 175.1 billion over the previous year. However, encouraging consideration occurred in government borrowing from SBP as government retired Rs. 532.4 billion to SBP during July-8thMay, 2014-15 against the retirement of Rs. 10.5 billion in the same period last year.



Commodity Finance

Despite the considerable rise in loans for commodity finance over the previous years, government borrowing for commodity finance recorded a net retirement of Rs.20.8 billion during July-8thMay, 2014-15 which were lower against the retirement of Rs. 65.0 billion witnessed in the same period last year, hence the outstanding stock of commodity financing amounted to Rs. 471.7 billion against Rs. 402.8 billion.

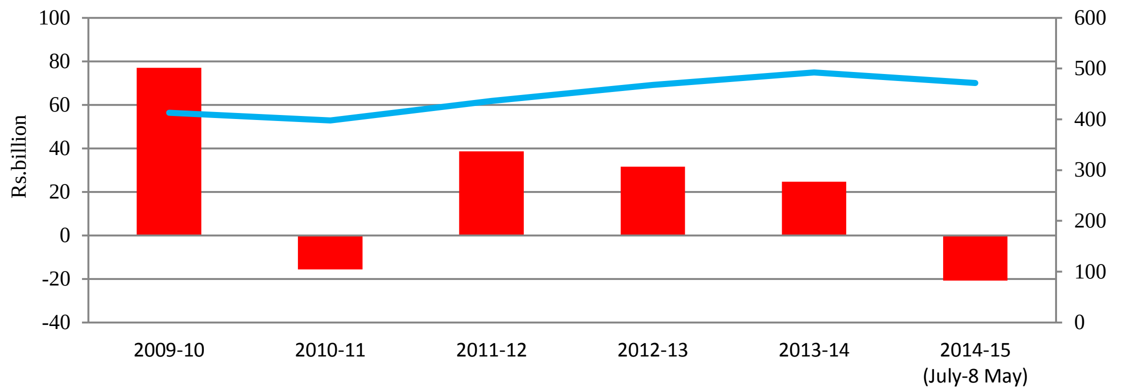
The outstanding stock of commodity financing has increased considerably to Rs.492.4 billion in fiscal year 2013-14 from Rs.467.7 billion in the comparable period of fiscal year 2012-13, posting a growth of 5.3 percent.

The commodity wise breakup reveals that during July-March, 2014-15 with net retirement of Rs. 55.7 billion, the outstanding loans for commodity finance reached to Rs. 492.4billion. Of which, loans for wheat finance witnessed a net retirement of Rs. 47.6 billion against the retirement of Rs. 146.0 billion during the same period of 2013-14. Higher amount of retirement during fiscal year 2013-14 was due to aggressive offloading of wheat stocks by the provincial food departments to stabilize wheat prices.

During the first half of current fiscal year, the private sector imported 0.7 million tons of wheat despite the available stocks with public procurement agencies with an aim to reap the benefits from lower global prices. Consequently, due to inability to offload additional wheat stock by these agencies, seasonal retirement of loan to commercial banks was reduced.

On the other hand loans for fertilizer finance registered a net retirement of Rs.8.9 billion during July-March, 2014-15 against the borrowing of Rs. 9.3 billion in the same period last year. While borrowing for sugar finance has also witnessed a retirement of Rs. 0.8 billion against the borrowing of Rs. 3.0 billion in the comparable period last year.

Fig-3: Commodity Finance



Credit to Private Sector

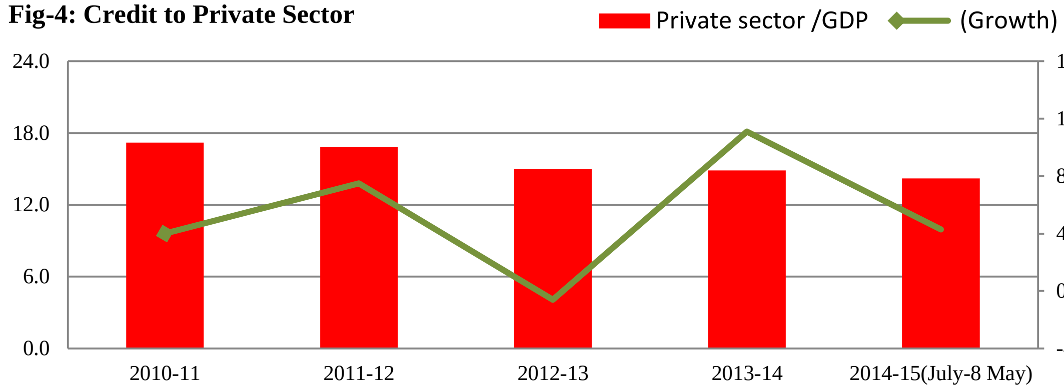
Private sector in Pakistan has been recognized as the key player in economic development due to its contribution to investment, employment and business creation. Usually, public resources are not enough to address the development challenges alone, therefore private sector investment is imperative to supplement the public resources in order to fuel the economic growth along with providing better employment opportunities.

Fiscal year 2013-14 has witnessed a momentous increase in credit to private sector despite the tight monetary policy stance, as it registered a net expansion of Rs. 371.4 billion in 2013-14, against the net retirement of Rs. 19.0 billion in 2012-13. On year on year basis, it posted a growth of 11.1 percent which is the highest level in past five years.

In contrast, recent data specified that credit to private sector increased to Rs. 161.7 billion during July-8th May, 2014-15 against the expansion of Rs. 292.9 billion in the same period of last year, thus posted a growth of 4.3 percent as compared to 8.7 percent in the comparable period of last year. However, despite low expansion, credit to private sector posted a growth of 6.6 percent on year on year basis as on 8th May, 2014-15 against the growth of 5.2 percent recorded in the same period last year.

Slow pace in credit to private sector during the current fiscal year 2014-15 may be attributed to change in trend of government borrowing from SBP to commercial banks that constricted the quantum of loanable funds with the banks. Additionally, shortage of energy and decline in international commodity prices also restricted the demand for bank credit. However, demand for credit to private sector is likely to pick up with lagged impact of cutting in cumulative discount rate by 300 bps in coming months.

Fig-4: Credit to Private Sector



Ratio of credit to private sector to GDP is one of important indications of economic development and prosperity. Higher ratio implies not only increased financing to the private sector but it also reflects greater opportunity and space for the private sector to develop and grow. Considering Pakistan, credit to private sector as percentage of GDP has not been significant and stood at 14.2 percent during July-8th May, 2014-15. Historically, the private sector in Pakistan 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, higher expenditure and consequently rapidly rising public borrowing to finance the budget deficit resulted in crowding out of private sector. Hence, the flow of money or credit diverted away from the most productive sectors. The situation further aggravated due to energy crisis, resultantly the private sector could not gain the momentum as it was required to boost the economic growth.

However, recognizing the private sector as the engine of economic growth, Pakistan is striving to tap private sector initiatives and investment in order to achieve the potential growth and alleviating poverty. In this context, the present government is taking all possible efforts to create a conducive business environment by removing major bottlenecks like energy shortages, bleeding PSEs along with creating conducive investment climate to boost exports and tax revenues. In this perspective, recently Pakistan and China has signed agreements of worth $ 45billion with an aim to build a China-Pakistan Economic Corridor (CPEC) - a network of roads, railway and pipelines between the long-time allies, which will go a long way to build better infrastructure and will create conducive environment to facilitate the private sector.

Sectoral Analysis

Sector wise growth demonstrates that loans to private sector business recorded a significant growth of 12.1 percent during fiscal year 2013-14 as compared to 0.7 percent in 2013-14. Whereas, overall credit grew by 6.9 percent during July-March, 2014-15 as compared to 10.2 percent in the same period of last year. Despite an increase in absolute term, lower growth in credit to private sector and various subsectors can be attributed to lower demand from the manufacturing sector, agriculture sector and commerce and trade. Specifically textiles, food and beverages and the sugar sector which were the main contributors in the credit off take last year, have witnessed less demand this year.

In flow terms, credit expansion to private business increased to Rs. 185.1 billion during July-March, 2014-15 as against Rs. 271.7 billion in the same period of fiscal year 2013-14. Among all major sectors, credit off take remained high in Construction (21.1 percent), followed by Mining and Quarrying (21.0 percent) and Transport, Storage and Communication (8.4 percent). Manufacturing sector received share 56.5 percent of private sector loan (Rs. 104.6 billion), followed by textile (15.93 percent or Rs. 29.5 billion), agriculture (7.73 percent or Rs. 14.3 billion), commerce and trade (6.0 percent or Rs. 11.1 billion), construction (5.94 percent or Rs. 11.0 billion) and transport, storage and communication (5.34 percent or Rs. 9.9 billion).

Table: 5.3 - Credit to Private Sector (Rs Billion)

Sectors	End June Stocks		March-14	March-15	July-March (Flows)		Growth Rates	
	Jun-13	Jun-14			2013-14	2014-15	2013-14	2014-15
Overall Credit (1 to 5)	**2,976.3**	**3,313.8**	**3,281.3**	**3,542.0**	305.0	228.2	10.2	6.9
1. Loans to Private Sector Business	**2,467.2**	**2,765.2**	2,738.9	2,950.3	271.7	185.1	11.0	6.7
A. Agriculture	222.0	252.7	238.6	267.0	16.6	14.3	7.5	5.7
B. Mining and Quarrying	20.8	18.9	23.0	22.9	2.3	4.0	10.9	21.0
C. Manufacturing	1,448.9	1,636.0	1,664.0	1,740.6	215.1	104.6	14.8	6.4
Textiles	514.9	558.1	583.5	587.6	68.6	29.5	13.3	5.3
D. Electricity, gas and water supply	228.9	278.6	255.6	275.5	26.8	-3.2	11.7	-1.1
E. Construction	53.4	52.3	51.7	63.3	-1.6	11.0	-3.1	21.1
F. Commerce and Trade	206.9	223.3	227.2	234.4	20.3	11.1	9.8	5.0
G. Transport, storage and communications	89.9	117.1	85.8	126.9	-4.1	9.9	-4.5	8.4
H. Other private business n.e.c	42.1	36.2	43.1	37.0	1.0	0.7	2.3	2.1
2. Trust Funds and NPOs	**17.0**	**8.2**	7.3	9.0	-9.7	0.8	-56.9	9.6
3. Personal	**305.8**	**337.6**	327.5	361.5	21.7	23.9	7.1	7.1
4. Others	**14.2**	**15.3**	20.6	13.5	6.4	-1.8	45.3	-12.1
5. Investment in Security & Shares of Private Sector	**172.2**	**187.5**	187.0	207.8	14.8	20.3	8.6	10.8

Source: State Bank of Pakistan

Notwithstanding, a well-diversified growth in credit has witnessed during July-March, 2014-15 in its type of finance. As major sectors of the economy like agriculture, manufacturing and services availed credit both for working capital and for fixed investment. Advances to private sector businesses in fixed investment expanded to Rs. 84.4 billion in July-March, 2014-15 from Rs. 50.3 billion in the same time of a year ago. While working capital requirement credit declined to Rs. 90.3 billion in July-March, 2014-15 from Rs. 223.8 billion in the same period of fiscal year 2013-14 owing primarily to decrease in commodity prices.

Fig: 5.4- Consumer Financing (Rs. Billion)

	July-March (Flows)		Growth(%)	
Description	**2013-14**	**2014-15**	**2013-14**	**2014-15**
Consumer Financing	21.5	16.0	9.8	6.4
1) For house building	-0.1	0.1	-0.3	0.2
2) For transport i.e. purchase of car	9.0	12.7	17.8	20.0
3) Credit cards	-0.5	-0.5	-2.1	-2.0
4) Consumers durable	0.2	-0.1	88.1	-14.5
5) Personal loans	13.9	4.9	13.9	4.2
6) Other	-0.9	-1.1	-11.1	-13.8

Source: State Bank of Pakistan

During July-March, 2014-15 consumer financing posted a growth of 6.4 percent (Rs. 16.0 billion) as compared to 9.8 percent (Rs. 21.5 billion) in the same period of last year. Within consumer financing, auto loans increased by 20.0 percent as compared to 17.8 percent in same period of last year. Increase in auto financing is largely due to amendment in regulations for car financing, which allowed banks to finance cars up to 9 years old and high demand for the new model of car. Contrary to it, the decreasing trend in personal loans has been witnessed owing to high base impact of "introduced innovative personal loans products, especially designed to cater to the need of the middle and high income groups in previous years like Salary Loan Scheme, Cash for Gold scheme and Enhanced-gold Scheme, etc.

Table-5.5: Targets and Actual Disbursement of Agriculture Loans

	Target		Flows (July-March)	
Name Of Banks	2013-14	2014-15	2013-14	2014-15
5 Big Commercial Banks	188.0	252.5	133.5	167.4
ZTBL	69.5	90.0	45.9	56.2
DPBs	90.4	115.6	54.2	72.1
PPCBL	10.0	11.5	5.4	5.9
MFBs	21.6	28.2	16.2	20.7
Islamic Banks	0.5	2.3	0.5	3.7
Total	380.0	500.0	255.7	326.0

Source: State Bank of Pakistan

For fiscal year 2014-15, agriculture credit disbursement target is set at Rs. 500.0 billion against the target of Rs. 380.0 billion in fiscal year 2013-14 which actually disbursed at higher than target i.e Rs. 391.4 billion. During July-March, 2014-15, overall credit disbursement increased to Rs. 326.0 billion as compared to Rs. 255.7 billion in the corresponding period of last year, thus posting a growth of 27.5 percent against the growth of 10.7 percent. While, agri credit disbursement accounted for 65.2 percent of the annual indicative target during July-March of current fiscal year. Five major commercial banks disbursed agri loans of Rs. 167.4 billion or 66.3 percent of its annual target which is 25.4 percent higher from Rs. 133.5 billion during the same period of last fiscal year.

Monetary Assets

Monetary assets (M2) include currency in circulation, demand deposits, time deposits and resident's foreign currency. Monetary aggregate have started to increase in the fourth quarter of current fiscal year. Money supply (M2) posted a growth of 7.33 percent during 1st July – 8th May 2014-15 against the growth of 7.05 percent in the comparable period last year, while y-o-y basis it stood at 12.8 percent as on 8th May, 2014-15. Higher growth in M2 is largely stemmed from increase in currency in circulation and total time and demand deposits.

Currency in Circulation (CIC)

Currency in circulation (CIC) accelerated by 15.1 percent during July-8th May, 2014-15 against the growth of 14.2 percent during the same period of fiscal year 2013-14, whereas y-o-y growth recorded at 13.3 percent as on 8th May, 2014-15.

Despite a persistent decline in inflation and lower credit expansion, increase in currency in circulation may be attributed to higher government borrowing from scheduled banks. Similarly, during July-8th May, 2014-15 currency in circulation (CIC) as percent of money supply has also been increased to 23.4 percent from 23.3 percent in the same period last year.

Table-5.6 Monetary Aggregates (Rs Million)

Items	End June		July-8 May	
	2013	2014	2013-14	2014-15
A. Currency in Circulation	1,938,222	2,177,873	2,213,406	2,506,695
Deposit of which:				
B. Other Deposits with SBP	10,523	13,147	13,982	15,620
C. Total Demand &Time Deposits incl. RFCDs	6,909,066	7,777,021	7,254,746	8,176,268
of which RFCDs	514,988	590,384	578,312	593,963
Monetary Assets Stock (M2) A+B+C	8,857,812	9,968,041	9,482,136	10,698,584
Memorandum Items				
Currency/Money Ratio	21.9	21.8	23.3	23.4
Other Deposits/Money ratio	0.1	0.1	0.1	0.1
Total Deposits/Money ratio	78.0	78.0	76.5	76.4
RFCD/Money ratio	5.8	5.9	6.1	5.6
Income Velocity of Money	2.9	2.9	2.7	2.7

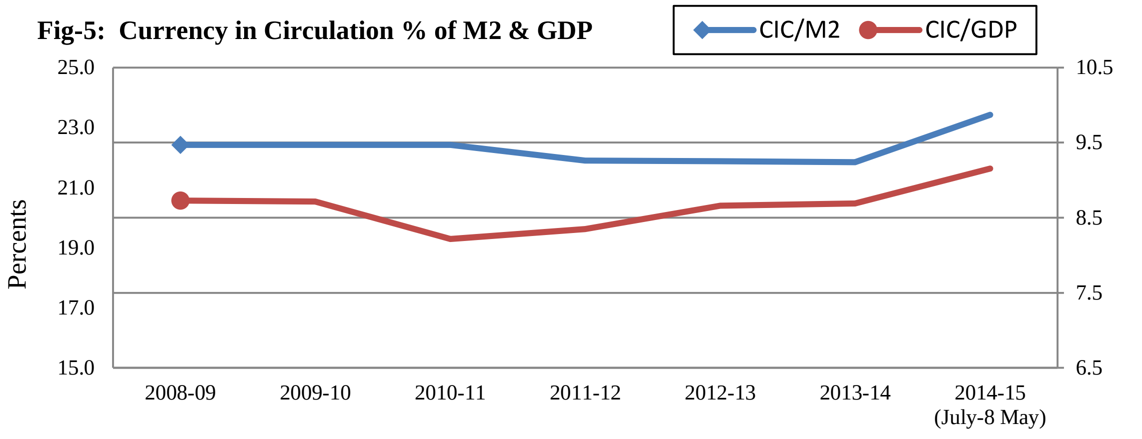
Source: State Bank of Pakistan

Deposits

During July-8th May, 2014-15 demand and time deposits stood at Rs. 399.2 billion against Rs. 345.7 billion in the same period last year. Thus it witnessed a slight increase as it grew by 5.1 percent during July-8th May, 2014-15 against the growth of 5.0 percent in the same period last year. However, during July-8th May, 2014-15 demand deposits stood at Rs. 357.5 billion against Rs. 379.4 billion in the same period last year. On the other hand, time deposits increased to Rs. 38.2 billion during July-8th May,2014-15 against the contraction of Rs.97.3 billion in the comparable period last year.

While Resident Foreign Currency Deposits (RFCD) has reduced to Rs. 3.6 billion during July-8th May, 2014-15 from Rs.63.6 billion in the same period last year. Impact of Rupee appreciation during the current fiscal year has been translated into this decline in RFCD.

Fig-5: Currency in Circulation % of M2 & GDP



Monetary Management

SBP conducts its liquidity management operations with an aim to contain the monetary expansion within the safe limits in order to achieve the objective of price stability.

Table :- 5.7 Summary of OMO's (Rs. billion)

	Injections		Absorptions	
	2013-14	**2014-15**	**2013-14**	**2014-15**
July	631.3	342.65	142.4	166.7
August	-	183.3	725.2	-
September	-	414.7	689.8	-
October	136.25	603.75	54.0	-
November	121.5	1,161.05	668.0	-
December	241.1	2,147.73	-	-
January	262.95	3,007.4	-	-
February	348.1	2,850.7	129.1	122.6
March	520.05	4,290.6	69.0	-
Total	**2,261.3**	**15,001.8**	**2,477.4**	**289.3**

Source: State Bank of Pakistan

Recently, due to change in composition of government borrowing from SBP to scheduled banks resulted in considerable liquidity shortage in the system[3]. Thus in order to overcome liquidity shortage, SBP has been injecting

[3] Government has retired significant amount of its borrowing from SBP during the current fiscal year.

liquidity through its open market operations in accordance with its policy stance. During July-March, 2014-15, SBP mopped up Rs. 289.3 billion against the injections of Rs. 15,001.8 billion. While in the same period of fiscal year 2013-14, it mopped up Rs. 2,477.4 billion against the injections of Rs. 2,261.3 billion.

Liquidity conditions have improved considerably towards the end of current fiscal year on account of overall improvement in balance of payments. Money market overnight repo rate on average remained 49 bps lower than the SBP's policy rate in the post March 2015 policy decision as against 33 BPS in the post January decision. Other market interest rates, such as KIBOR and the weighted average lending rate (WALR), have largely followed the policy rate reductions. Consequently, these developments augur well for smooth transmission of changes in policy rate to other market interest rates along with implementation of the revised interest rate corridor framework.[4]

During July-March, 2014-15 market offered the total amount of Rs. 4,430.6 billion against Rs. 6,173.0 billion in the comparable period last year. In the T-bill's auction during current fiscal year, so far the government has raised less than the targeted amount which implies an increase appetite for PIBs.

Table 5.8 Market Treasury bills Auctions (Rs. Million)

	JUL-JUN			Jul-March					
	2013-14			Offered		Accepted		W.A.Rate	
	Offered	Accepted	W.A Rate	2013-14	2014-15	2013-14	2014-15	2013-14	2014-15
3-Months	5,555,952	5,031,692	9.4	5,248,579	1,041,500	4,730,455	986,557	9.4	9.1
6-Months	1,024,910	950,189	9.5	650,866	1,250,739	583,060	855,834	9.5	8.9
12-Months	915,273	894,465	9.5	273,557	2,138,389	252,939	954,892	9.5	8.9
Total	**7,496,135**	**6,876,346**		**6,173,002**	**4,430,628**	**5,566,454**	**2,797,283**		

Source: State Bank of Pakistan

During the first nine months of current fiscal year, T-bills accounted for 35.3 percent of the total accepted amount in 3 months followed by 34.1 percent in 12-months.

Market offered total amount of Rs.1,837.5 billion during July-March, 2014-15 under PIB auctions as compared to Rs. 1,336.3 billion in the same period last year. PIBs witnessed heavy investment in 3 years as it contributed 46.1 percent of total accepted amount followed by 29.4 percent in 5 years. In the PIBs auction held so far in fiscal year 2014-15, government has raised greater amount than the target.

Fig-6: Contribution of T-bills

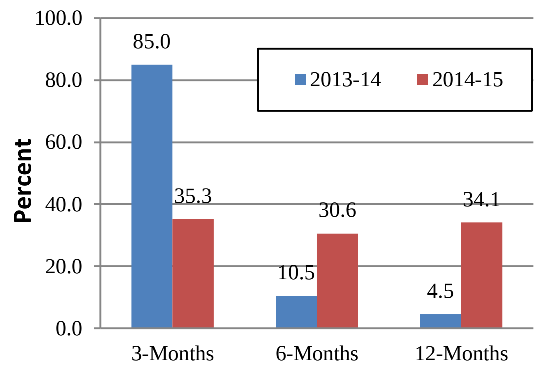


Table-5.9 Pakistan Investment Bonds Auctions (Rs Million)

PIBs	July-June			July-March				W.A Rate	
	Offered	Accepted	W.A Rate	Offered		Accepted			
	2013-14			2013-14	2014-15	2013-14	2014-15	2013-14	2014-15
3 Years	1,231,992	1,171,806	11.2	615,509	936,316	560,908	396,809	11.2	10.4
5 Years	465,286	426,111	11.7	321,945	462,036	285,020	252,760	11.7	10.8
10 Years	512,925	420,755	12.2	385,532	430,328	296,012	202,572	12.2	11.4
15 Years				-	-	-	-	-	-
20 Years	22,368	20,323	13.1	13,333	8,775	12,323	8,000	13.1	12.3
30 Years	-	-	-	-	-	-	-	-	-
Total	**2,232,571**	**2,038,995**		**1,336,319**	**1,837,455**	**1,154,263**	**860,141**		

Source: State Bank of Pakistan

[4] Monetary Policy Statement, May 23,2015

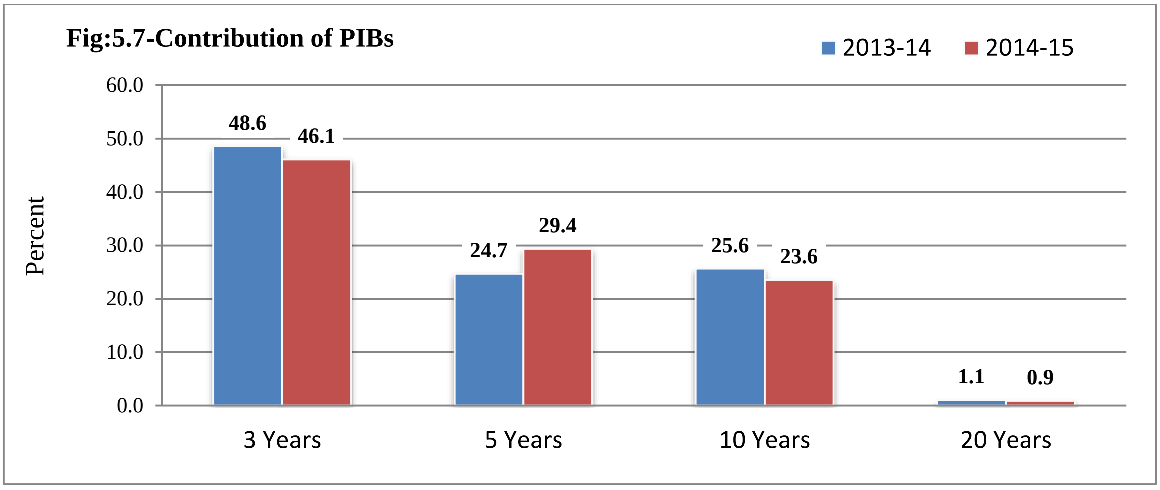
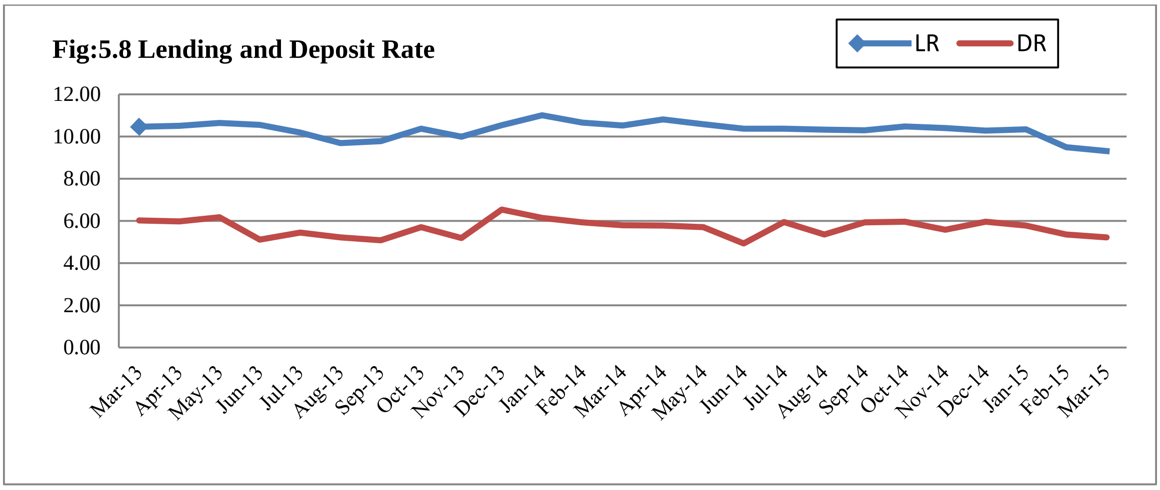


Table-5.10 Lending & Deposit Rates(W.A)			
	LR	DR	Spread
Mar-14	10.53	5.80	4.73
Apr-14	10.81	5.78	5.03
May-14	10.59	5.70	4.89
Jun-14	10.37	4.93	5.44
Jul-14	10.38	5.95	4.43
Aug-14	10.33	5.36	4.97
Sep-14	10.30	5.93	4.37
Oct-14	10.48	5.96	4.52
Nov-14	10.41	5.59	4.82
Dec-14	10.28	5.97	4.31
Jan-15	10.35	5.78	4.57
Feb-15	9.50	5.36	4.14
Mar-15	9.31	5.22	4.09

Following a decline in policy rate, weighted average lending rate on gross disbursements has also reduced from 10.53 percent in March, 2014 to 9.31 percent in March, 2015. Similarly, weighted average deposit rate offered on fresh deposits also reduced from 5.80 percent in March, 2014 to 5.22 percent in March, 2015. Resultantly, banking spread which is the difference between the lending and deposit rates fell to 4.09 per cent in March 2015 from 4.73 percent in March 2014.

Likewise, the average lending rate on outstanding loans also reduced to 10.47 in March,2015 from 11.10 percent recorded in March,2014. Weighted average deposit rate reduced from 5.05 percent in March,2014 to 4.55 percent in March,2015.



Financial Sector

The fragile global financial system, sovereign debt crises in Euro Zone and non-conducive economic conditions during end of last decade affected different countries of the world directly or indirectly. The economy of Pakistan also faced numerous challenges during last few years on account of BOP crises, energy shortfall, law & order concerns, mounting fiscal deficit and high inflationary pressures. However, various macroeconomic challenges and structural issues in, the banking and financial sector of Pakistan performed remarkably well and emerged as a highly profitable financial backbone of the country. Significant improvement of banking system and financial sector was mainly due to conducive macroeconomic condition since last one and half year due to better energy supply, increase in manufacturing activities, low inflation and reduced pressure on external front which translated into unprecedented profits before tax of Rs. 80 billion during first quarter of CY15 (Rs. 247 billion during CY14).

Further, the alignment of regulatory capital requirements in Pakistan with best international practices coupled with high profitability helped banking sector in achieving strong solvency with an overall Capital Adequacy Ratio (CAR) of 17.1 percent as of end December 2014. While it increased to 17.4 percent during first quarter of CY15, hence it remained strong and much higher than minimum required level of 10 percent. It is pertinent to mention that the CAR of the banking sector has remained well above this benchmark during the last seven years.

Similarly, asset quality has also improved and NPLs to loans ratio gradually came down from 16.7 percent in September 2011 to 12.3 percent in December 2014. Net NPLs to loans ratio reduced from 3.4 percent to 2.7 percent year on year basis. While Gross NPLs to loans ratio recorded at 12.3 percent in December, 2014 against 13.3 percent in same period of last year. However, the asset quality observed a marginal setback during first quarter of CY15 as NPLs to Loans ratio increased by 50 bps to reach 12.8 percent and net NPLs to Net Loans by 9 bps to 2.8 percent.

Table 5.11: Highlights of the Banking Industry* (Rs. in billion)

	2010	2011	2012	2013	2014	Mar-15
Total Assets	7,117	8,171	9,720	10,487	12,106	12,528
Investments (net)	2,157	3,055	4,013	4,313	5,310	5,954
Advances (net)	3,358	3,349	3,805	4,110	4,447	4,336
Deposits	5,451	6,244	7,291	8,311	9,230	9,236
Equity	695	784	873	943	1,207	1,248
Profit Before Tax (ytd)	105	170	176	162	247	80
Profit After Tax (ytd)	65	112	117	112	163	52
Non-Performing Loans	556	592	618	607	605	620
Non-Performing Loans (net)	185	182	176	139	122	123
In percent						
Capital Adequacy Ratio (all banks)	13.9	15.1	15.6	14.9	17.1	17.4

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

The asset base of the banking sector and its key components recorded significant growth, as it grew by 15.4 percent in 2014 and amounted to Rs.12.1 trillion. However, significant increase in asset base was duly supported by 11.0 percent growth in deposits. Whereas, asset base reached to Rs.12.5 trillion by end March, 2015.

Financial Development

Well-functioning financial system is a fundamental feature of economic development because it effectively channelizes the resources to their best productive use in order to enhance the aggregate saving and investment rate. Additionally, it prompts higher degree of financial development through wider availability of financial services which in turn bolsters economic growth and reduces poverty and inequality.

Financial depth or deepening is generally a measure of the health and soundness of financial institutions in a country. When it comes to measuring financial development, it can be usefully examined through the ratio of broad money to GDP as it captures the overall size of the financial sector. Increasing M2/GDP ratio is defined as more developed and efficient financial sector and also a benchmark for the position of financial development.

Table: 5.12 Financial Depth	
Years	M2/GDP
2008-09	38.9
2009-10	38.9
2010-11	36.6
2011-12	38.1
2012-13	39.6
2013-14	39.8
July-8 May	
2013-14	37.8
2014-15	39.1

In Pakistan the ratio M2/GDP remained low however, the ratio has shown increasing trend since 2010-11 due to several policy initiatives and financial reforms initiated by SBP to reshape the financial sector. A cursory look at Table 5.12 indicates that monetary assets which were at 36.6 percent of GDP in fiscal year 2010-11 rose to 39.8 percent in 2013-14. Whereas, during July-8thMay, 2014-15, it increased to 39.1 percent against 37.8 percent during the corresponding period of last year. The ratio is expected to increase further in coming years on account of ongoing financial reforms with an aim to attain more financial depth. Recently, National Financial Inclusion Strategy (NFIS) has been approved which will not only help in achieving optimal economic growth and financial stability but it will also serve as a critical pathway for millions of unserved poor people to rise out of poverty. The strategy is consistent with the Government of Pakistan's Vision 2025 which requires enhancing access to credit for Small and Medium Enterprises and focuses on financial inclusion and deepening.

Furthermore, SBP has also been striving for attaining many targets in financial sector including financial inclusion, SME finance, housing finance, infrastructure finance, consumer protection, regulatory development and strengthening of financial market infrastructure etc (Box-II).

Box-II: Financial Reforms

- Measures have been taken by SBP for the development of SME finance through its various initiatives some of which are; (a) Flexible Regulatory Framework for SME Financing, (b) Credit Guarantee Scheme, (c) Development of Secured Transaction Framework, (d) SBP Finance and Refinance Schemes, (e) Export Finance Scheme and Long Term Finance Facility (LTFF), (f) Export Finance Facility for Locally Manufactured Machinery (EFF-LMM), etc. Moreover, 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 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. In first year of the Program, loans amounting to Rs 100 billion would be extended to 100,000 borrowers. As of February 28, 2015 more than 60,000 applications were received by both public sector banks, while 15,275 applications have been approved.
- With the support and initiatives taken by SBP, Housing Finance has been increasing since July 2014 which is contributing towards growth of 40 allied industries. Housing finance portfolio of banks/ DFIs with an increase of 5.62 percent on Y-o-Y basis stood at Rs.54.5 billion as of March,2015. NPLs has also reduced from Rs.16.21 billion in March 2014 to Rs.14.16 billion in March 2015.
- To promote housing finance in the country, SBP is facilitating an establishment of Mortgage Refinance Company (MRC) to develop secondary mortgage market through securitization and Mortgage Backed Securities, Bond Market and creating long term funding facility for mortgage lenders. The creation of a MRC would help to address the long term funding constraint hindering the growth of the primary mortgage market.
- Cognizant of the pivotal role of infrastructure in economic development, State Bank is continuing with its efforts to improve financing of banks/ DFI for infrastructure. In view of the ongoing energy crisis, State Bank has picked up its efforts for promotion of green banking & finance, which broadly includes concepts like renewable energy/ energy efficiency financing, resource efficiency & sustainable development. SBP has held consultations with various stakeholders including multilateral agencies to design and implement policies on green banking. With simultaneous development of human capital through trainings and other awareness/capacity building measures.
- For financial consumer's protection, a dedicated Consumer Protection Department (CPD) is functioning at SBP. In order to provide for the incorporation, functioning and regulation of the existing and new credit

bureaus in private sector, enactment of Credit Bureau Act is presently under process.

- In order to strengthen the financial sector, SBP implement the regulatory development like (a) Privatization transactions/merger/acquisition transactions, (b) Strengthening the AML/CFT regime in Pakistan, (c) Macro Prudential Reforms, (d) Capital Adequacy, and (e) Computerized Reporting System for Derivatives Market
- The coverage of the Branchless Banking (BB) network, consisting of 8 players, is also expanding with persistent double-digit growth, as nearly 204,073 agents are now spread across the country. BB transactions crossed 71 million during Oct-Dec 2014 showing a rise of 8 percent and transaction value has reaching Rs 372 billion with average size of transaction of Rs 5,181.
- During the period under review, 701,510 new accounts were opened and the cumulative BB accounts have reached to 5.4 million with Rs.6.6 billion deposits, showing strong role of the segment in broader digital financial inclusion.
- In order to enhance the growth of Branchless Banking, agreement was signed between SBP and NADRA for reducing biometric verification cost to Rs 10 for each m-wallet account opening to reduce transaction costs and strengthen customer identification & verification procedure in opening of mobile accounts.
- As things stand; two banks have been given approval to pilot test their branchless banking services. Hence the number of banks who have SBP's approval has reached to twelve. Eight banks are commercially live in the market currently and the rest are on pilot test phase. In line with country's requirements and global trends, SBP has been collaborating with the World Bank (WB) Group to develop a broader National Financial Inclusion Strategy (NFIS) for Pakistan.
- Robust payment mechanisms are a pre-requisite for improving financial inclusion in the country. SBP is ensuring safety and efficiency of payment systems using the following three essential roles in the payments industry: (a) Cheque Truncation, (b) International Bank Account Number (IBAN), (c) Rules for Payment System Operators and Payment Service Providers.

Source: State Bank of Pakistan

Islamic Banking

Islamic Banking industry in Pakistan is currently spread across 89 districts of the country comprising more than 10 percent share in overall banking industry. 22 Islamic banking institutions (IBIs) (5 full-fledged Islamic banks and 17 Islamic banking branches of conventional banks) are operating in the country with a network of nearly 1,600 branches. Owing to its vibrant outlooks, SBP 5 year's strategic plan (2014-18) forecasts 15 percent market share of Islamic banking in total banking industry in next five years. The future outlook of the industry is also very positive with bright prospects of doubling its market share by 2020.

Keeping in view the huge potential of Islamic Banking, several initiatives have been taken by SBP in order to provide necessary legal, regulatory and supervisory infrastructure and awareness & capacity building programs.

The Islamic banking industry witnessed significant growth in CY14 with both assets and deposits contributing in this expansion. As of March 2015, the asset base of the Islamic banking industry reached to Rs.1.3 trillion while deposits reached to Rs. 1.1 trillion. Consequently, the market share of Islamic banking assets and deposits in the overall banking industry increased to 10.4 percent and 12.2 percent, respectively by end March 2015.

Table 5.13: Islamic Banking Industry

	CY 10	CY 11	CY 12	CY 13	CY 14	15-Mar
Total Assets (Rs. billion)	477	641	837	1,014	1,259	1,302
Total Deposits (Rs. billion)	390	521	706	868	1,070	1,122
Share in Banks' Assets (percent)	6.7	7.8	8.6	9.6	10.4	10.4
Share in Banks' Deposits (percent)	7.2	8.4	9.7	10.4	11.6	12.2

Source: State Bank of Pakistan

Net Investments of Islamic Banking institutions stood at Rs. 357 billion by end December 2014 from Rs 354 billion by end September 2014. However, on year on year (YoY) basis, net investments of the Islamic banking industry declined by 9.5 percent which can be associated with fall in investment in federal government securities by 1.6 percent compared to the previous quarter and by 9.8 percent compared to December 2013 owing to maturity of GoP Sukuk of Rs. 90 billion while the availability of new GoP Ijara Sukuk was only of Rs. 49.5 billion during CY14. In terms of profitability, an increase of Rs. 3.95 billion has been witnessed in the last quarter of CY14 to reach above Rs. 15 billion as against Rs. 9.4 billion profit earned by end December 2013. High profit earned during the quarter is also reflected in improving both Return on Assets (ROA) and Return on Equity (ROE) compared to the same quarter last year. ROA has seen marginal improvement while ROE showed significant increase. Keeping with the usual trend, ROA of Islamic banking industry is less than that of overall banking industry while ROE is higher than the overall industry average[5].

All mode of financing except Murabaha witnessed increase during CY14. Gross financing of Islamic banking industry grew from Rs. 330.2 billion by end December 2013 to Rs. 422.1 billion by end December 2014, reflecting y-o-y growth of 27.8 percent.

Table 5.14 Financing Products by Islamic banks %age

Mode of Financing	CY10	CY11	CY12	CY13	CY14
Murabaha	44.9	43.8	39.7	40.6	30.1
Ijara	12.7	10.4	9.2	7.7	7.7
Musharaka	2.9	2.4	0.8	6.7	11
Mudaraba	0.2	0.1	0.2	0.2	0.1
Diminishing Musharaka	29.3	32	35.7	30.8	32.6
Salam	1.4	2.4	3	4	4.5
Istisna	5.8	4.4	7.2	5.6	8.3
Others	2.6	4.4	4.3	4.4	5.6

Source: State Bank of Pakistan

Despite 63 percent collective contribution by Murabaha and Diminishing Musharaka, share of both in overall financing declined during the quarter ending December 2014 mainly due to relatively higher growth in financing modes like Musharaka, Salam and Istisna.

Box-III: Key initiatives for the promotion of Islamic Banking Industry in Pakistan

a. Constitution of Steering Committee for Promotion of Islamic Banking

The Government of Pakistan (GOP) has demonstrated strong commitment for supporting development of Islamic finance in the country. To this end, a high level Steering Committee for promotion of Islamic banking was set up in December 2013 which is chaired by Deputy Governor SBP. The Steering Committee comprises renowned Shariah scholars, senior government officials, industry experts (local and international) and business leaders aiming to develop proposals and recommendations for transforming the financial system in conformity with Shariah principles.

b. Establishment of Centre of Excellence for Islamic Finance:

The SBP in collaboration with Government of Pakistan (GOP), industry and other stakeholders is planning to develop a Centre of Excellence for Islamic Banking and Finance education to ensure adequate supply of trained human resources to the industry. Moreover, the Center will also act as an incubator for research on contemporary issues.

c. Rationalization of Minimum Capital Requirement (MCR) for Islamic banking subsidiary:

With the objective of encouraging banks to move towards a subsidiary based model, SBP has revised the initial MCR for an Islamic banking subsidiary from Rs. 10 billion to Rs. 6 billion in October, 2014.

[5] Islamic Banking Bulletin Oct-Dec 2014

d. Commencement of Open Market Operations for IBIs:

In order to facilitate Islamic Banking industry in their liquidity management and more effective transmission of monetary policy, SBP decided to conduct outright purchase or sale Government of Pakistan IjaraSukuk (GIS) either on deferred payment basis (Bai-Muajjal) or on ready payment basis through Open Market Operations (OMOs) based on a price competitive auction process.

e. 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.

f. Completion of Knowledge, Attitude and Practices (KAP) Study:

SBP launched a survey based study to estimate demand for Islamic banking in the country. The main objectives of the project; "Knowledge, Attitude and Practices of Islamic Banking in Pakistan" were (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 was based on first hand information collected from both banked (Islamic and conventional) and un-banked sectors of the country. According to the study there is an overwhelming demand for Islamic banking in Pakistan in both retail and corporate sectors.

g. Collaboration between SBP and SECP

To promote Islamic finance in the country, SBP is collaborating with Securities and Exchange Commission of Pakistan (SECP), the capital markets regulator. Both the regulators are working on developing proposals for facilitating development of an Islamic capital market. SECP has also created a dedicated Islamic Finance Department and has started taking initiatives for development of necessary infrastructure for an Islamic capital market. These initiatives include:

(a). Review of Modaraba guidelines to align those with overall regulatory framework of Islamic finance in the country, (b). Issuance of Sukuk guidelines, (c).Issuance of Takaful rules.

Source: State Bank of Pakistan

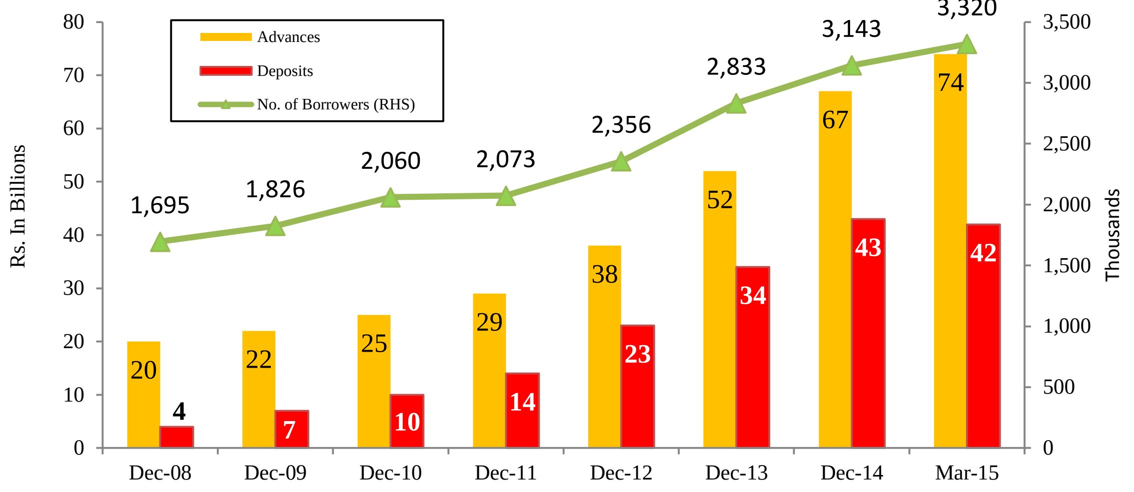
Microfinance

The State Bank of Pakistan (SBP) has been encouraging microfinance banks (MFBs) to increase their outreach for greater usage of micro-banking services by financially under privileged segments especially those living in the rural and remote areas. The microfinance banking sector is expanding fast with ten privately-owned MFBs operating in the country. Eight of them are operating at national level, while two at the provincial level (Sindh province). All the MFBs are privately owned with both foreign and national investors.

The microfinance sector (MFBs and MFIs) witnessed a 29.2 percent growth in its aggregate loan portfolio which grew by Rs. 16.7 billion; reaching to Rs. 73.7 billion against a total of 3.3 million borrowers as of March, 2015 compared to loans worth Rs. 57 billion to 2.9 million borrowers in the corresponding period last year.

At the close of 3rd quarter of fiscal year 2014-15, the total loan portfolio of MFBs grew by 30.3 percent, reaching to Rs. 41.2 billion as compared to Rs. 31.6 billion in the corresponding period last year. The number of borrowers served also registered a growth of 17.5 percent, increasing from 1,063,571 in March, 2014 to 1,249,857 in March, 2015. The asset base of MFBs also registered an impressive growth of 24.1 percent rising to Rs.71.4 billion in March, 2015 from Rs.57.5 billion in the corresponding period last year. The NPLs of MFBs were restricted to around 1.9 percent as of end March, 2015, which points to prudent lending practices by MFBs. The deposits' growth also remained impressive with a total of Rs. 9.3 billion (28.0 percent) added to the MFBs' deposit base which stood at Rs 42.4 billion as of end March, 2015, compared to Rs. 33.1 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 center network to 2,587 as of March, 2015 adding 274 new business locations across the country compared to position of March, 2014.

Fig-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 204,073 agents are now spread out across most of the country's districts. Branchless banking transactions crossed 71.8 million mark during July-December 2014, which led total value of transactions to reach Rs 372 billion. During the period under review, 701,510 new accounts were opened and the cumulative BB accounts grew to 5.4 million.

SBP Policy Initiatives during the Year 204-15

Key policy developments during fiscal year 2014-15 so far are;

- The Consultative Group to Assist the Poor (CGAP) and SBP have jointly organized a one day workshop on "Inclusion-Effective Interoperability" on October 22, 2014 at Mariot Hotel, Karachi. The conference aimed to share the findings of the global research study conducted by CGAP on topics like: solution relating to account interoperability, how agent interoperability might assist financial inclusion, effective use of national payment infrastructure, priority use case and key impediments.
- SBP in collaboration with CGAP and DFID organized a one day International Branchless Banking Conference on November 17, 2014 at Serena Hotel, Islamabad. During the BB conference, the following two MOUs were signed to advance the digital financial inclusion in Pakistan.
  i. Between Governor SBP and Chairman NADRA for reducing the biometric verification cost to Rs.10 for each m-wallet account opening at industry level.
  ii. Between Gates Foundation and DFID to set up a Digital Financial Inclusion Unit in Karandaaz which is a newly incorporated company to support small and growing businesses in Pakistan.
- SBP has been collaborating with the World Bank (WB) Group for a broader National Financial Inclusion Strategy (NFIS) for Pakistan. The NFIS covers priority areas like Branchless Banking, Digital Payment Systems, Agri. & MSME Finance, Housing Finance, Islamic Finance, Consumer Protection and Financial Literacy, Insurance and Pensions etc. Based on an exhaustive and comprehensive exercise including in-depth consultation with all the stakeholders, the strategy has now been finalized and its implementation will start soon.
- SBP has recently launched 3rd Financial Innovation Challenge Fund (FICF) Round on promoting Excellence in Islamic Finance. FICF designed under Financial Inclusion Programme (FIP) for promoting Islamic Financial services to meet the growing demands for Shariah compliant products and services in Pakistan.

Insurance Sector

The insurance industry in Pakistan is relatively small compared to other developing countries and economies in the region. However, the sector possesses huge potential for expansion and growth but remained underdeveloped relative to its prospects. For the calendar year, 2013, the industry's total premium revenue was over Rs.174 billion (USD 1.74 billion) as compared to Rs.145 billion (US$ 1.45 billion) as of CY12. The insurance penetration and density have also witnessed an upward trend to 0.73 percent and US$ 9.26 for CY13, compared with 0.67 percent and US$ 7.64 for CY12.

The non-life insurance sector comprises 42 insurers, including three general Takaful operators and one state-owned insurer, the National Insurance Company Limited (NICL), with an exclusive mandate to underwrite public property and one state-owned reinsurer, the Pakistan Reinsurance Company Limited (PRCL). During the period under review, the non-life insurance market remained dominated by top four players with over 62 percent of the market share, while the remaining 38 percent market was shared among the 36 insurers. The sector witnessed a growth of 13 percent during CY13 with total premium underwritten of over Rs. 62 billion.

Conversely, in the life insurance sector, there are nine life insurance companies, including two, "Family Takaful Operators" and one state-owned insurer, the State Life Insurance Corporation of Pakistan (SLIC). The SLIC having a dominant market share of 62 percent while the remaining 38 percent of the market is shared among the private life insurers. In CY13, the life insurance sector grew by 30 percent, with total premium of Rs.112 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.

Achievements:

SECP aiming to protect the interests of policyholders and facilitating orderly development of the insurance industry has undertaken a number of initiatives which include:

- A comprehensive project for review and revision of the existing insurance regulatory framework has been initiated, with technical assistance from the World Bank and FIRST Initiative.
- Takaful rules were introduced in 2012, allowing the conventional insurers to obtain authorization under these rules before commencing their window takaful operations, enabling the conventional insurers to offer Sharia complaint products through these windows in addition to the conventional products, subject to the conditions that window operations are segregated in all respects including the capital. However, with resolution of the dispute in May 2014, SECP granted Window Takaful authorization to 5 entities during the current fiscal year.
- Bancassurance business has shown tremendous growth in last couple of years. SECP has carried out a survey of bancassurance business in 2012 to assess the bancassurance market, to provide a sustainable regulatory framework. Recently the SECP has completed the consultation process including consultation with the State Bank of Pakistan and the final Bancassurance regulation, shall be issued in the forthcoming financial year after the due legal process of approval.
- During the financial year, the SECP renewed the licenses of 8 direct insurance brokers and issued fresh licenses to two insurance brokers, which raised the total number of registered direct insurance brokers to 11.
- During the period under review, SECP has initiated rulemaking process in order to streamline and standardize the course outline for all insurance agents as well as a testing mechanism to be conducted by an institution duly approved and accredited by the SECP. The testing mechanism has been introduced to assess the agents' basic level of competence to act as the insurance agents.
- During the period under consideration, SECP has initiated process to prescribe increase in the minimum paid up capital requirements for the insurers, as Rs. 500 million for non-life insurers and Rs. 700 million for life insurers.

- The SECP specified growth rate scenarios for life insurance and family takaful illustration for year 2014 whereby the life insurers and family takaful operators use three growth rate scenarios to demonstrate projected benefits to the potential life insurance or family takaful policyholders. The SECP specifies these scenarios based on long-term interest rate outlook prevalent in Pakistan after consultation with the Pakistan Society of Actuaries (PSOA).
- The SECP, upon the advice of the Ministry of Finance, worked on the course of implementation of provisions of Foreign Account Tax Compliance Act (FATCA) so as to avoid the negative repercussions of its non-compliance, which essentially include the withholding of 30 percent of payment from US-source income resulting in financial losses to the financial institution along with the reputational damages.
- A Circular has recently been issued guiding the insurers about FATCA, its requirements, implications and directing them to assess the status of their entities on their own or through formal consulting services, as deemed appropriate.
- During the period under review, with the addition of wholly-owned subsidiary of provincial government, the total number of active non-life insurers in Pakistan will reach 41, while the total number of active insurers (life and non-life), including Pakistan Reinsurance Company Limited (PRCL), will reach 50. The applications for licenses by 2 insurers consecutively for the last 2 years indicate an encouraging trend for the non-life insurance industry.

Conclusion

Currently, Pakistan is following an accommodative monetary policy stance in order to reinvigorate the economy. During the current fiscal year, SBP slashed the policy rate by cumulative 300 bps to 7.0 percent which is the lowest in 42 years. Current policy stance is the reflection of improved macroeconomic conditions on the basis of which international agencies have upgraded outlook for Pakistan’s economy which in turn will further improve the investor’s confidence.

Liquidity conditions have improved considerably during the second half of current fiscal year on account of overall improvement in balance of payments. Other market interest rates, such as KIBOR and the weighted average lending rate (WALR), have largely followed the policy rate reductions. Consequently, these developments augur well for smooth transmission of changes in policy rate to other market interest rates along with implementation of the revised interest rate corridor framework.