Chapter 5

Money & Credit

The outbreak of COVID pandemic in 2019 has led to a global macroeconomic shock of unprecedented magnitude. The central banks responded aggressively to avoid deep recession in the economies. Short-term interest rates, which were already low in most advanced economies, quickly fell to around zero in all advanced economies, outpacing their responses to Global Financial Crisis (GFC) in terms of both speed and scope.[1] Emerging markets also experienced sharp declines in short-term interest rates, approaching zero in several countries.

The central banks supported national government's expansionary fiscal policy measures in the form of tax cuts and higher government spending to boost aggregate demand and employment. The GFC and the COVID-19 pandemic have shifted the focus of monetary policy, which involves significant budgetary expansion even if it requires using the money-creation capacity of the central bank.

The global recovery was expected in 2021 after contraction in 2020, but the momentum slowed and fueled by the highly transmissible Delta and Omicron variant, along with emerging price pressures, due to unusual pandemic-related developments, soaring global commodity prices and pandemic-induced supply-demand imbalances during second half of 2021. Further, the Russia-Ukraine conflict raises immediate financial stability risks and questions about the longer-term impact on markets early in the 2022.

In a nutshell, the sharp rise in commodity prices combined with long-term supply disruptions, has exacerbated pre-existing inflationary pressures and shifted inflation risks to the upside. In many countries, inflation has become a central concern. In some advanced economies, including the United States and some European countries, it has reached its highest level in more than 40 years.

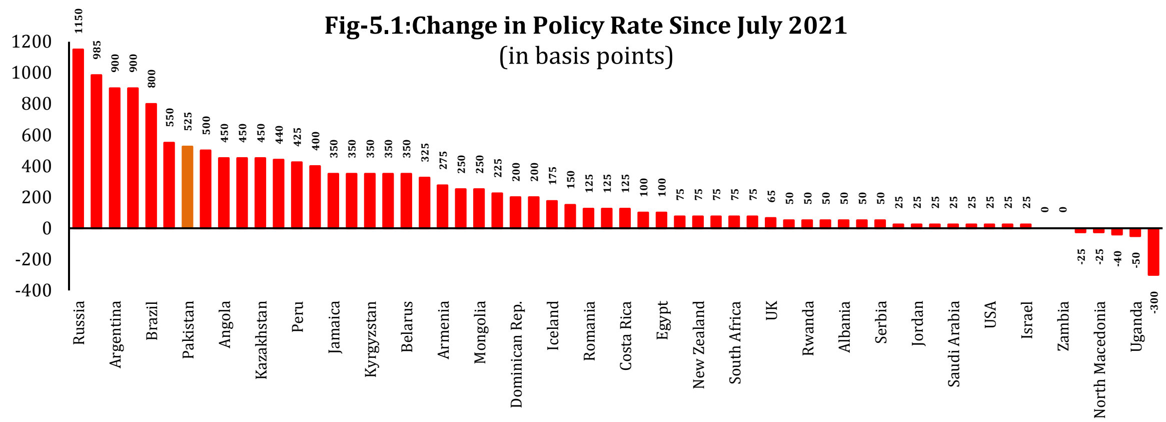
War-related supply shortages are expected to amplify these pressures, notably through increases in the price of energy, metals, and food. As a result, inflation is projected to remain elevated for longer than previously expected, in both advanced and emerging market and developing economies.[2]

In response, central banks around the world began to tighten monetary policy to keep inflationary expectations well anchored. Since July 2021, 53 central banks have

[1]https://voxeu.org/article/monetary-policy-and-central-banking-COVID-era-new-ebook
[2] Global Financial Stability Report, April 2022, IMF

increased their policy rates. The changes in policy rate in some selected countries is shown in Fig-5.1.

Fig-5.1:Change in Policy Rate Since July 2021
(in basis points)



Source: tradingeconomics.com; cbrates.com; upto April 15, 2022

In emerging and developing economies, increases in food and fuel prices can significantly increase the risk of poverty. A wider range of emerging market economies can come under pressure if the pace of global monetary tightening accelerates further, especially in the United States, or if financial markets start to reprice more aggressively, which would further weigh on the global outlook.

Global economic challenges like monetary tightening, high international commodity prices, and the Russia-Ukraine conflict have posed a potential risk for Pakistan's economy which is already struggling to maintain the Post COVID recovery. The impact of global challenges on the domestic economy has been transmitted through higher inflation, deterioration in external accounts, depletion of foreign reserves, which eventually exerts significant pressure on the exchange rate. Accordingly, SBP has moved to monetary policy tightening at the end of the first quarter of FY2022, which was kept unchanged since June 2020.

Monetary Policy Stance in Pakistan

Pakistan's economy has witnessed a V-shaped recovery in FY2021 after witnessing a contraction of 0.9 percent in FY2020. After the COVID outbreak, the policy rate was reduced by 625 bps within short span of less than three months, during Mar-Jun, 2020. This was the largest policy rate cut in emerging market economies. During FY2021, State Bank of Pakistan maintained an accommodative monetary policy stance, by keeping the policy rate unchanged at 7.0 percent throughout FY2021. Besides, SBP provided liquidity and regulatory support to businesses and households during the challenging times. The economic policy was implemented with a prudent mix which supported the economic recovery without putting any pressure on macroeconomic imbalances.

With heightened uncertainty due to COVID-19, the Monetary Policy Committee for the first time considered it appropriate to provide some forward guidance on monetary policy in its January 2021 meeting[3], to facilitate policy predictability and decision-

[3] The central bank communication is an important aspect of the monetary policy that aims to reduce economic and financial uncertainty. During unusual economic conditions, some central banks also communicate the future monetary policy stance which is referred to as

making by economic agents. In the absence of unforeseen developments, the MPC expected monetary policy settings to remain unchanged in the near term. Moreover, in the subsequent monetary policy decisions during FY2021, the MPC has maintained the policy rate of 7.0 percent to nurture the economic recovery.

Table-5.1:Policy Rate

w.e.f	Policy rate
21/5/2016	5.75
26/1/2018	6.0
25/5/2018	6.5
14/7/2018	7.5
1/10/2018	8.5
3/12/2018	10.0
1/2/2019	10.25
1/4/2019	10.75
21/5/2019	12.25
16/07/2019	13.25
18/03/2020	12.50
25/03/2020	11.00
16/04/2020	9.00
16/05/2020	8.00
26/06/2020	7.00
20/09/2021	7.25
22/11/2021	8.75
15/12/2021	9.75
7/4/2022	12.25
24/5/2022	13.75

Source: State Bank of Pakistan

At the end of first quarter FY2022, policy rate has increased by 25 bps to 7.25 percent. The decision was primarily based on observation of excess aggregate demand and more than expected economic recovery as reflected by rising high import bill and increasing current account deficit. The objective of monetary policy was shifted to ensuring the appropriate policy mix to protect the longevity of growth, keep inflation expectations anchored, and control the current account deficit.

In subsequent Monetary Policy decisions announced in November and December, 2021, policy rate was increased by 150 bps and 100 bps to 8.75 percent and 9.75 percent, respectively. The decision was made due to heightened risks associated with inflation and balances of payments, which stemmed from both global and domestic factors.

In Pakistan, high import prices have contributed to higher-than-expected inflation outturns. At the same time, there were also emerging signs of demand-side pressures on inflation from domestic administered prices.

In December, 2021 Monetary policy decision, MPC explained that the goal of mildly positive real interest rates was now close to being achieved. Looking ahead, the MPC expected monetary policy settings to remain broadly unchanged in the near-term. Resultantly, policy rate has kept unchanged at 9.75 percent in two successive decisions held on January and March, 2022.

However, policy rate was increased by 250 bps to 12.25 percent from 9.75 percent in an unscheduled meeting on 07th April 2022, to address significant uncertainty amidst rising global commodity prices and domestic political situation. The inflation outlook had deteriorated and risks to external stability had increased for FY2022. Externally, futures market suggests that global commodity prices, including oil, are likely to remain elevated for longer and the Federal Reserve is likely to increase interest rates more quickly than previously anticipated, likely leading to a sharper tightening of global

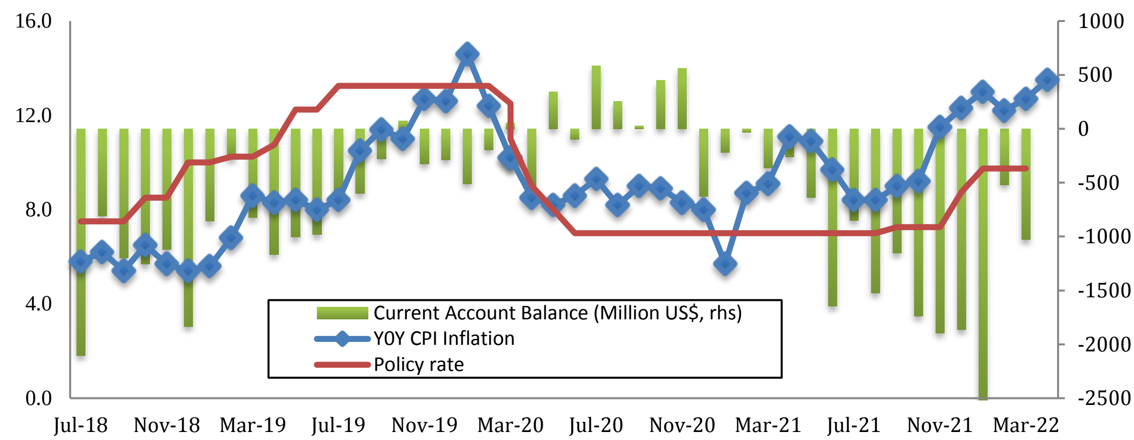
forward guidance. It is an unconventional monetary policy tool that is used by the central banks to minimize interest rate volatility and to manage interest rate expectations. In the aftermath of COVID-19 outbreak, some developed and emerging market central banks (included US Federal Reserve, Reserve Bank of Australia, Bank of Canada, Reserve Bank of India, Central Bank of Sri Lanka and Central Bank of Brazil) adopted this approach to give confidence to investors and other economic agents in the forward-looking decisions given heightened uncertainties (SBP Annual Report, FY2021).

financial conditions. Domestically, some macroeconomic indicators have deteriorated, as have SBP reserves as a result of debt repayment and political uncertainty. Fig-5.2 presents the trend in policy rate, CPI inflation and current account balance.

In monetary policy decision held on 23rd May, 2022 the MPC decided to raise the policy rate by 150 basis points to 13.75 percent. The decision was based on outcome of provisional growth estimates for FY2022 more than target, shows excess aggregate demand, elevated external sector pressure and the higher inflation outlook due to domestic and international factors.

In addition to policy rate increase, the interest rates on EFS and LTFF loans are also being raised. The MPC has informed that in future, these rates will be linked to the policy rate and will adjust automatically, while continuing to remain below the policy rate in order to incentivize exports.

Fig-5.2: Monetary Policy Performance



Box-I: Salient Changes in SBP Act[4]

- The role of the SBP as defined in the State Bank of Pakistan Act 1956 has undergone several changes over the years.[5] These legislative changes were carried out to bring the central bank functions in line with the international best practices so as to enable it to deal with the evolving challenges and issues effectively. In the similar manner, recent amendments in the SBP Act 2022 mainly clarifies the objectives of the SBP, along with enhancing operational and financial autonomy, accountability, and transparency.
- Overall, the amendments balance the provision of necessary operational and financial autonomy to the State Bank while enhancing transparency in decision making and strengthening accountability. More specifically, the amendments have six key purposes:
  1. to clearly define the objectives of the SBP to improve its accountability;
  2. to outline the SBP's functions in line with these objectives;
  3. to provide the SBP necessary financial resources to help achieve its objectives;
  4. to strengthen the functional and administrative autonomy of the SBP;
  5. to increase transparency in the operations of the SBP and strengthen its governance;

[4] https://www.sbp.org.pk/about/pdf/LF/Brief-1.pdf
[5] Major revisions in the SBP Act were introduced in 1994, 1997, 2012 and 2015

6. to enhance the SBP's accountability by strengthening oversight functions and increasing reporting requirements.

Key Amendments in SBP Act 2022

Scope of Amendment	Rationale
Definition of Objectives: The amendments identify domestic price stability as the primary objective of the SBP, followed by financial stability and support of the general economic policies of the Government. [6]	There is strong international evidence that countries with an independent, accountable and transparent central bank have lower and more stable inflation over long periods of time, which in turn, lays the foundation for sustainable growth. Across the world, the majority of central banks have price stability as their primary objective and these include emerging and developing economies like Indonesia, Malaysia, Philippines, Colombia, Mongolia, Bhutan, and Jordan.
SBP's Functions: The amendments suitably align the SBP's functions and collate them under a new section in order to achieve objectives.[7]	Given the inflationary nature of government borrowing from the Central Bank, the amendments propose to exclude provisions related to Government borrowing[8] as well as the quasi-fiscal operations of the State Bank. The State Bank would, however, continue to extend refinance facilities to financial institutions with appropriate checks and balances. Further, the lender of last resort function of the central bank has been further strengthened to enable it to provide temporary liquidity facility to banks against appropriate collateral.[9]
Provision of Resources: The amendments seek to provide the SBP with sufficient financial resources to achieve its objectives.[10]	If a central bank cannot continually avail for itself sufficient financial resources to fulfill its mandate, its autonomy remains vulnerable. The amendments allow SBP to be sufficiently capitalized and prescribe the necessary mechanism to achieve the desired level of capital over time, through both statutory reserves as well as retained earnings.[11]
Strengthening the Autonomy: The amendments strengthen the functional and administrative autonomy of the SBP.[12]	A key element of the functional independence of Central Banks is the protection of its officials for actions taken in good faith. Provisions for protection are not only a common practice in other central banks but also exist in other domestic laws. The amendments, therefore, propose to add a provision for a general protection to SBP officials for all actions undertaken in good faith.[13] In addition, the Monetary and Fiscal Policies Coordination Board has been abolished, as its terms of reference overlap with the work that has been assigned to the Monetary Policy Committee under the existing Act and such a mechanism for coordination goes beyond provisions in the acts of other central banks. Instead, a new mechanism for coordination is being proposed between the Finance Minister and the Governor, under which they would establish a close liaison and keep each other

[6] "Whereas it is necessary to provide for the constitution of State Bank to achieve domestic price stability by way of regulating the monetary and credit system of Pakistan and, without prejudice to said primary objective, contribute to the stability of the financial system of Pakistan and supporting the general economic policies of the Federal Government to foster development and fuller utilization of the country's productive resources;"

[7] Section 4C. Functions of the Bank

[8] Section 9C. Prohibition on the Government borrowing

[9] Section 17G. Lender of last resort

[10] Share capital. (1) The authorized capital of the Bank shall be five hundred billion Rupees, divided into five billion shares of one hundred Rupees each. The authorized capital may be increased by the resolution of the Board, subject to the approval of the Federal Government.

[11] Section 4A. Re-capitalization

[12] Section 52A, Section 9G

[13] Section 52A. Protection of action taken in good faith and indemnity

	informed of matters that jointly concern the Ministry of Finance and the State Bank.[14]
Increasing Transparency: The amendments increase transparency in the operations of the SBP and strengthen its governance.[15]	The amendments prescribe qualification and experience requirements,[16] tenure,[17] conflict of interest[18] and disqualification criteria[19] for all appointments[20], including the directors of the Board of State Bank, members of the Monetary Policy Committee, the Governor and the Deputy Governors. In addition, to introduce a collegial decision-making process, the amendments propose to establish an Executive Committee at State Bank consisting of the Governor, Deputy Governors, and Executive Directors.[21] This committee will be responsible for formulating policies related to the Bank's core functions as well as those related to administration and management matters, excluding those matters falling in the purview of the Monetary Policy Committee or the Board of Directors. All policy decisions will be taken by the Executive Committee.
Enhancing Accountability: The amendments enhance the SBP's accountability by strengthening oversight functions and increasing reporting requirements[22].	The amendments strengthen provisions related to accountability of the State Bank to the Parliament, constitution of an Audit Committee,[23] designation of a Chief Internal Auditor[24] and appointment of External Auditors.[25] In addition, it is proposed that the oversight role of the Board of Directors of State Bank be strengthened and its scope broadened, including by giving them explicit oversight over the affairs and functions of the Bank; the power to supervise the management, Bank's administration, operations; and right of access to all activities of the Bank.[26]
Source: https://www.sbp.org.pk/about/pdf/LF/Brief-1.pdf	

Recent Monetary and Credit Developments

Broad Money (M2) has increased by Rs 1,457.2 billion during the period 01st July-29th April, FY2022 as compared to Rs 1,632.7 billion during same period of last year, showing the growth of 6.0 percent. Contained growth in M2 has been observed mainly due to decrease in Net Foreign Assets (NFA) of banking system. NFA's point contribution has decreased to 5.5 percent as compared to positive contribution of 4.7 percent last year. Whereas Net Domestic Assets (NDA) point contribution stood at 11.5 percent as compared to 3.1 percent during same period last year. As a result, M2 growth reached at 6.0 percent during the period under review as compared 7.8 percent during same period last year (Table-5.2).

14 9G. Governor and Minister of Finance to establish liaison
15 9F. Executive Committee. (1) An Executive Committee shall be established with the power to formulate policies related to the Bank's core functions as well as those related to administration and management matters, excluding those matters falling in the purview of the Monetary Policy Committee, or the Board of Directors.
16 Section 9(5) Board of Directors
17 Section 14. Terms of Office
18 Section16A. Conflict of interest
19 Section 13. Disqualifications of the Governor, Deputy Governors, Directors and members
20 Section 11A. Appointments
21 Section 9F. Executive Committee
22 Section 39. Accountability (1) The Governor shall submit annual report before the Majlis-e-Shoora (Parliament) regarding the achievement of the Bank's objectives, conduct of monetary policy, state of the economy and the financial system.
23 Section 45. Audit committee.
24 Section 45A. Chief internal auditor
25 43. External Audit
26 Section 9. Board of Directors and 9(A). Powers of the Board

Table-5.2: Profile of Monetary Indicators Rs billion

	FY21 (Stocks)	29/04/2022	30/04/2021
Net Foreign Assets (NFA)	724.7	-1327.7	980.6
Net Domestic Assets (NDA)	23,573.0	2784.8	652.1
Net Government Borrowing	16,265.1	1795.6	619.7
Borrowing for budgetary support	15,373.5	1586.8	642.6
From SBP	5,332.5	133.5	-1164.3
from Scheduled banks	10,041.0	1453.3	1807.0
Credit to Private Sector	7,629.1	1312.9	454.4
Credit to PSEs	1,436.7	14.6	-26.6
Broad Money	24,297.7	1457.2	1632.7
Reserve Money	8,663.5	1171.0	550.8
Growth in M2 (%)	16.2	6.0	7.8
Reserve Money Growth (%)	12.8	13.5	7.2

Source: Weekly Profile of Monetary Aggregates, State Bank of Pakistan

Within Broad Money, the NFA of the banking sector contracted by Rs 1,327.7 billion against expansion of Rs 980.6 billion in last year.

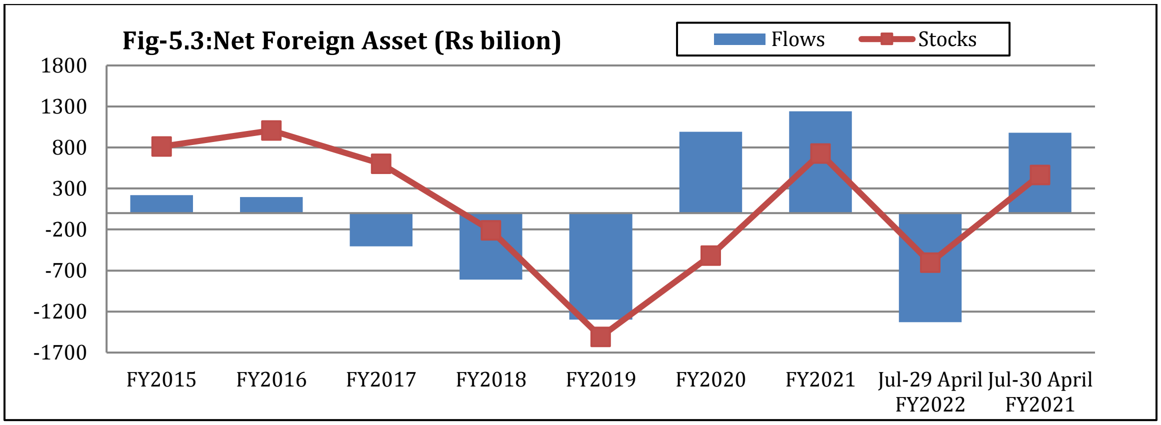
The NFA of SBP witnessed contraction of Rs 1,360.1 billion during the period under review against expansion of Rs 782 billion in last year. This was contained due to pressure on external front on account of high international commodity prices and expansion in domestic activities, transfers pressure on import bill and current account deficit. The higher foreign currencies outflows on account of debt repayment and foreign exchange operations more than offset the impact of inflows from issuance of Eurobonds and higher remittances received under Roshan Digital account during the period under review. Meanwhile, the allocation of SDRs amounting to US$ 2.75 billion under IMF's general SDR allocation had no effect on the NFA of SBP.[27] Whereas, NFA of scheduled bank increased by Rs 32.4 billion as compared Rs 198.4 billion in last year.

Conversely, NDA of banking sector observed expansion of Rs 2,784.8 billion against Rs 652.1 billion in last year. Within NDA, NDA of SBP increased by Rs 2,267.5 billion compared to contraction of Rs 557.1 billion in last year. On the other hand, NDA of scheduled banks increased by Rs 517.3 billion against expansion of Rs 1,209.3 billion in last year. The expansion in NDA on account of significant expansion in private sector credit, increased lending to Public Sector Enterprises (PSEs) and lending to government commodity procurement agencies.

Reserve Money (RM) grew by 13.5 percent (Rs 1,171.0 billion) during 1st Jul- 29th April, FY2022 as compared to growth of 7.2 percent (Rs 550.8 billion) during same period last year. High growth in RM is entirely stemmed from NDA of SBP which partially counter by negative NFA of SBP.

Therefore, M2 growth remained 6.0 percent, after expansion of 7.8 percent during same period last year. Contrary to last year, M2 growth totally emanated from growth in NDA which partially offset by contraction in NFA growth.

[27] First Quarterly Report, FY2022, SBP

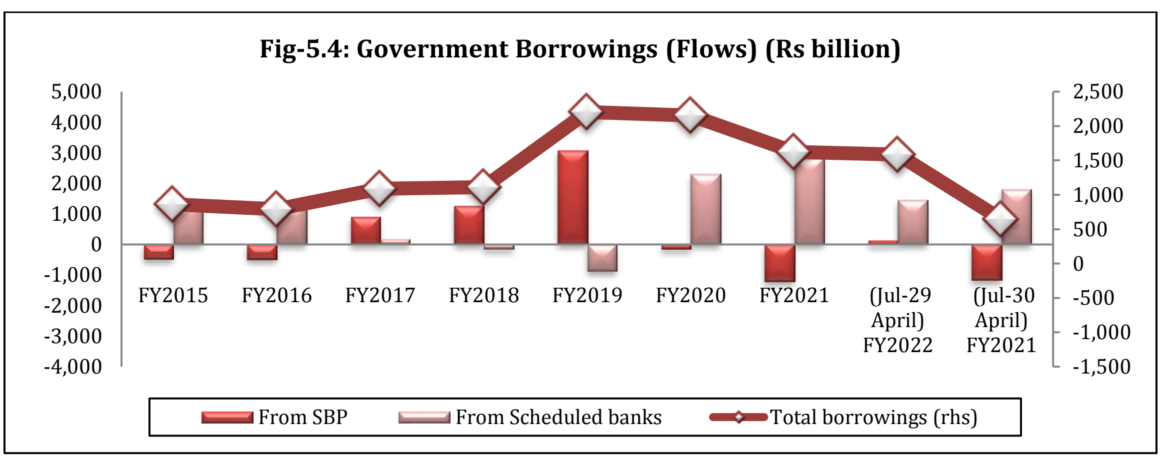


Credit to Public Sector Enterprises (PSEs) witnessed expansion of Rs 14.6 billion as compared to retirement of Rs 26.6 billion during same period last year.

Government Borrowing

The Government sector borrowing increased to Rs 1,586.8 billion for budgetary support during the period 01stJuly-29th April, FY2022 as compared to Rs 642.6 billion during same period last year. Domestic borrowing for budgetary support remained higher than last year due to pressure on the external front for high payments. Within budgetary support, Government has borrowed Rs 133.5 billion from SBP as compared to retirement of Rs 1,164.3 billion in the same period last year. On the other hand, Government has borrowed Rs 1,453.3 billion from scheduled banks as compared to borrowing of Rs 1,807.0 billion last year. As a result, net Government sector borrowing amounted to Rs 1,795.6 billion against the borrowing of Rs 619.7 billion during same period last year.

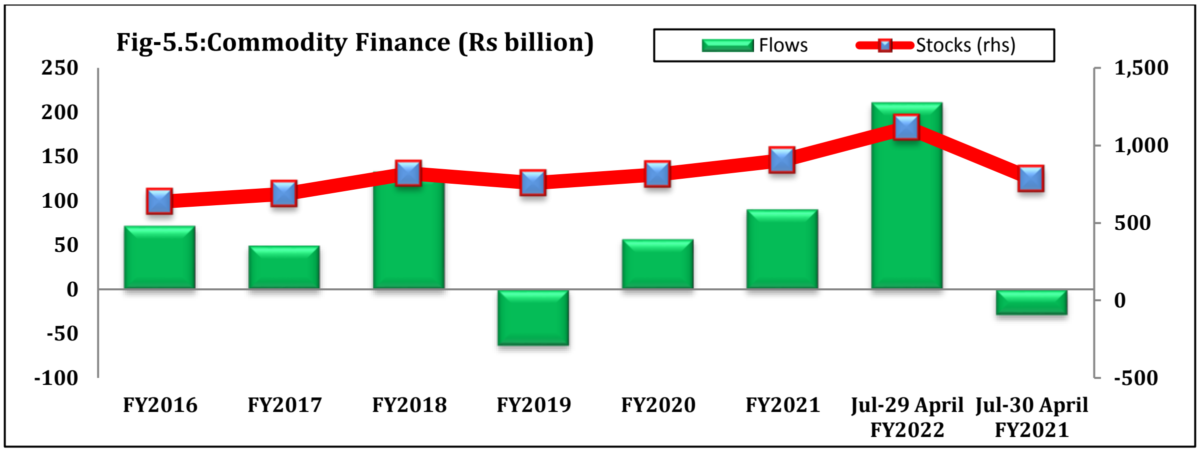
During first nine months of FY2022, Government has financed around 62 percent of fiscal deficit from domestic sources. Within domestic sources, bank and non-bank financing share remained 66 and 34 percent, respectively.



Commodity Finance

Commodity operation means advances provided either to Government, public sector corporations or private sector for the procurement of commodities such as cotton, rice, wheat, sugar, fertilizer, etc. Both federal and provincial governments borrow from scheduled banks to finance their purchases of commodities.[28] The proceeds from the sale of such commodities are subsequently used to retire commodity borrowing.

During FY2021, commodity finance observed net borrowing of Rs 90.6 billion (posted growth of 11.1 percent) against borrowing of Rs 57 billion (growth of 7.5 percent) in FY2020. The outstanding stock of commodity finance amounted to Rs 904.0 billion in FY2021 as compared Rs 813.4 billion in FY2020. The amount has been borrowed for commodity finance during FY2021 mainly reflected the borrowing of Rs 90.9 billion by wheat procurement agencies from banking system as compared to Rs 43.1 billion in FY2020.



Loans for commodity finance observed a net borrowing of Rs 210.9 billion during 01st Jul-29th April, FY2022 as compared to net retirement of Rs 28.8 billion during same period last year. The outstanding stock of commodity finance reached at Rs 1,115 billion as on 29th April, FY2022, against Rs 785 billion during the same period last year.

During July-March, FY2022, loans for wheat financing observed a net retirement of Rs 45.6 billion against the retirement of Rs 110.8 billion during same period last year. Loans for sugar financing witnessed net retirement of Rs 8.6 billion during the period under review, before borrowing of Rs 1.1 billion in last year. Fertilizer financing observed net retirement of Rs 5.1 billion as compared to net retirement of Rs 2.9 billion last year. Fertilizer sector has paid its loans due to better liquidity situation on account of increased in sales revenues. Cotton financing witnessed net borrowing of Rs 82.0 million as compared to net borrowing of Rs 94.0 million last year. Rice financing shows net retirement of Rs 15 million against the net borrowing of Rs 8.0 million in last year.

Credit to Private Sector[29]

Private sector credit increased significantly to Rs 766.2 billion during FY2021 as compared to Rs 196.4 billion in last year. This unprecedented expansion was primarily due to an accommodative monetary policy stance throughout FY2021, with the policy

[28] Glossary, Monthly Statistical Bulletin, SBP

[29] Islamic Financing, Advances (against Murabaha etc), Inventories and other related Items previously reported under Other Assets have been reclassified as credit to private sector.

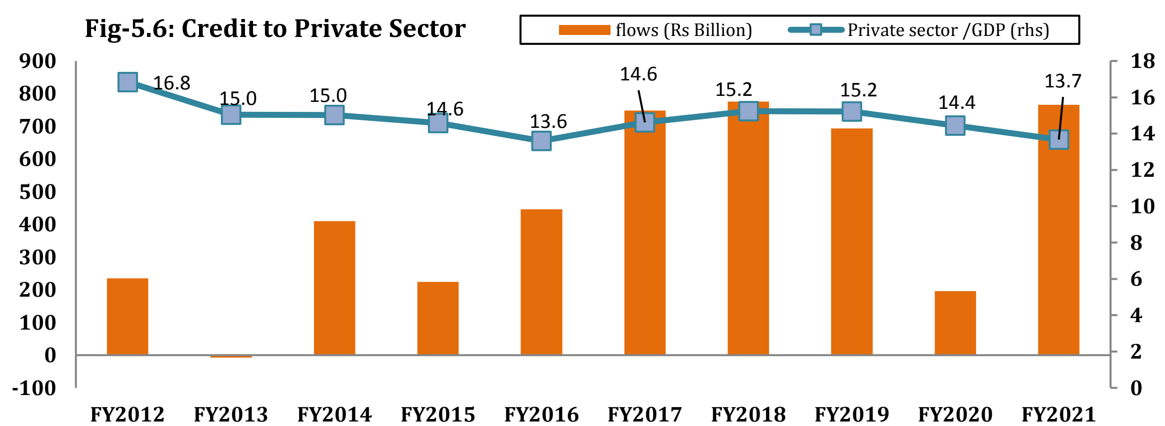
rate remaining unchanged at 7.0 percent, as well as the availability of SBP concessional finance schemes such as the Long-Term Finance Facility (LTFF) and the Temporary Economic Refinance Facility (TERF). Within loans to private sector businesses, fixed investment loans increased significantly during FY2021 to Rs 203.5 billion as compared retirement of Rs 27.9 billion in FY2020. On the other hand, working capital loans observed expansion of Rs 169.5 billion as compared Rs 23.3 billion in FY2020.

During the period 1st July-29th April, FY2022 private sector credit witnessed significant expansion of Rs 1,312.9 billion against Rs 454.4 billion during comparable period of last year, posted significant growth of 189.0 percent. On average, it has posted growth of 17.2 percent as compared to growth of 6.0 percent in last year. On Year on Year (YoY) basis, it has posted growth of 22.2 percent as on 29thApril, 2022.

Quarter-wise data revealed that the first quarter of FY2022 witnessed net expansion of Rs 177.4 billion credit to businesses as compared usual seasonal loan retirement of Rs 101.4 billion in last year. Factors contribute to this unusual expansion include continuation of accommodative policy environment, availability of concessionary financing schemes (mainly TERF), significant growth in LSM and increase in industrial activity and improved business confidence. Policy stance has been changed from accommodative to contractionary during second quarter of FY2022, it increased by 275 bps during second quarter, but high WALR cost has not been transmitted on borrowing pattern. Therefore, it has increased significantly to Rs 682.8 billion during second quarter of FY2022 against the expansion of Rs 320.9 billion during same quarter of last year.

Private Sector business loans increased to Rs 142.0 billion during third quarter of FY2022 against expansion of Rs 60.5 billion during comparable period last year.

Fig-5.6: Credit to Private Sector



Sectoral Analysis

Overall, private sector credit observed an expansion of Rs 1,162.6 billion (growth of 17.0 percent) during Jul-Mar, FY2022 against an increase of Rs 441.5 billion (growth of 7.1 percent) last year. Within private sector credit, loans to private sector businesses increased to Rs 1,002.2 billion (receive 86 percent share of total credit) compared Rs 280.0 billion (63.4 percent of credit) during same period last year. Sectors which posted higher credit expansion included Manufacturing Rs 789.0 billion (78.7 percent of business loans) of which Textile Rs 334.1 billion (42.3 percent of Manufacturing sector loans), followed by manufacturing of food products Rs 148.7 billion of which Rice processing Rs 62.4 billion and manufacturing of sugar Rs 98.6 billion. Information and Communication sector observed expansion of Rs 66.8 billion, followed by Wholesale and Retail trade Rs 46.1 billon, Construction Rs 31.0 billion and Transport and Storage availed Rs 14.0 billion.

Table- 5.3 : Credit to Private Sector Rs billion

Sectors	End Month Stocks				Jul-Mar (Flows)		Average Growth Rates	
	June-20	March-21	June-21	March-22	2020-21	2021-22	2020-21	2021-22
Overall Credit (1 to 5)	**6,180.2**	**6,621.7**	**6,827.6**	**7,990.1**	**441.5**	**1,162.6**	**7.1**	**17.0**
1. Loans to Private Sector Business	**5,271.0**	**5,551.1**	**5,712.4**	**6,714.6**	**280.0**	**1,002.2**	**5.3**	**17.5**
Agriculture	280.2	281.8	292.3	314.6	**1.6**	**22.4**	**0.6**	**7.7**
Mining and Quarrying	83.0	84.6	67.2	68.3	**1.6**	**1.1**	**2.0**	**1.7**
Manufacturing	3,290.3	3,454.1	3,548.5	4,337.5	**163.8**	**789.0**	**5.0**	**22.2**
Textiles	1,088.4	1,126.3	1,114.7	1,448.8	**37.9**	**334.1**	**3.5**	**30.0**
Electricity, gas, steam and air conditioning supply	491.8	548.9	558.7	588.7	**57.0**	**30.0**	**11.6**	**5.4**
Water supply, sewerage, waste management and remediation activities	15.1	22.1	24.2	25.0	**7.0**	**0.8**	**46.3**	**3.5**
Construction	129.6	138.5	154.4	185.4	**8.9**	**31.0**	**6.9**	**20.0**
Wholesale and retail trade; repair of motor vehicles and motorcycles	429.3	442.9	452.6	498.6	**13.6**	**46.1**	**3.2**	**10.2**
Transportation and Storage	119.6	119.4	113.7	127.7	**-0.2**	**14.0**	**-0.1**	**12.3**
Accommodation and food service activities	37.0	43.3	42.9	41.3	**6.3**	**-1.6**	**17.0**	**-3.8**
Information and Communication	159.2	162.0	185.4	252.2	**2.7**	**66.8**	**1.7**	**36.0**
Real estate activities	29.4	26.9	30.9	36.8	**-2.6**	**5.9**	**-8.8**	**19.0**
Administrative and support service activities	62.2	59.6	64.6	60.6	**-2.6**	**-3.9**	**-4.2**	**-6.1**
Education	22.5	29.0	32.3	36.7	**6.5**	**4.4**	**29.0**	**13.7**
Human health and social work activities	14.6	18.1	19.9	19.1	**3.5**	**-0.8**	**23.7**	**-4.2**
Arts, entertainment, and recreation	2.5	3.4	3.1	2.9	**0.9**	**-0.2**	**34.8**	**-6.6**
Other service activities	53.5	62.8	71.1	69.1	**9.3**	**-2.0**	**17.5**	**-2.9**
2. Trust Funds and Non Profit Organizations	**17.9**	**15.7**	**15.0**	**14.6**	**-2.2**	**-0.4**	**-12.2**	**-2.8**
3. Personal	**675.7**	**836.3**	**885.9**	**1,057.7**	**160.6**	**171.8**	**23.8**	**19.4**
4. Others	**1.5**	**4.3**	**3.1**	**2.8**	**2.8**	**-0.3**	**178.3**	**-9.9**
5. Investment in Security & Shares of Private Sector	**214.0**	**214.3**	**211.1**	**200.4**	**0.3**	**-10.7**	**0.1**	**-5.1**

Source: State Bank of Pakistan

Sizeable increase in credit offtake has been observed during first nine months of current fiscal year, credit demand increased both for fixed investment and working capital loans. Businesses took advantage of SBP concessionary financing schemes, particularly TERF. As a result, fixed investment loans witnessed significant expansion of Rs 333.1 billion during Jul-Mar FY2022 as compared Rs 137.0 billion during same period last year. Sector-wise distribution shows that Manufacturing sector dominated the overall fixed investment loans to Rs 213.9 billion (share of 64%), of which textile sector borrowed major share to Rs 94.6 billion during Jul-Mar FY2022 as compared Rs 45.9 billion during same period last year. The sector availed long term loans facility and benefitted from SBP concessionary schemes as evident from data of textile machinery which posted significant growth of 65 percent during Jul-Mar, FY2022.

Within non-manufacturing sectors, information and communication has borrowed long term loans amounted to Rs 72.5 billion as compared to retirement of Rs 1.5 billion during same period last year. The sector has availed long term loans for expansion and up-gradation. Similarly, Electricity and Gas sector has availed fixed investment loans to Rs 26.4 billion, albeit lower than last year of Rs 41.3 billion.

Table-5.4: Loans Classified by Borrowers (By Type of Finance) P (Rs billion)

Data based on ISIC 4 Classifications of Private Sector Businesses	Total Credit		Working Capital		Fixed Investment		LTFF		EFS	
	Jul-Mar FY2021	Jul-Mar FY2022	Jul-Mar FY2021	Jul-Mar FY2022	Jul-Mar FY2021	Jul-Mar FY2022	Jul-Mar FY2021	Jul-Mar FY2022	Jul-Mar FY2021	Jul-Mar FY2022
Loans to Private Sector Business	280.0	1002.2	110.8	608.7	137.0	333.1	120.0	202.9	68.7	101.1
Agriculture, forestry and fishing	1.6	22.4	6.5	12.9	-4.9	8.5	0.2	0.6	0.3	0.1
Mining and quarrying	1.6	1.1	-3.6	-4.3	5.2	5.4	0.0	0.0	-0.2	-0.1
Manufacturing	163.8	789.0	60.9	566.3	99.9	213.9	102.8	194.9	64.1	99.4
Manufacture of food products	125.4	148.7	97.8	134.1	27.0	13.9	7.8	15.1	7.3	15.3
Manufacture of grain mill products	42.8	29.4	41.6	24.3	1.1	4.9	1.0	1.1	10.2	10.7
Wheat Processing	-1.9	-20.7	-2.4	-21.1	0.4	0.4	0.4	0.2	0.0	-0.1
Rice Processing	36.7	62.4	35.4	57.1	1.3	5.1	0.5	0.8	8.3	10.4
Manufacture of sugar	73.0	98.6	63.1	100.6	9.7	-2.1	1.2	3.4	-2.3	3.3
Manufacture of beverages	2.4	17.3	0.8	13.8	1.5	3.5	0.5	0.2	-0.4	0.2
Manufacture of textiles	37.9	334.1	-9.8	235.3	45.9	94.6	60.8	94.6	44.8	64.8
Manufacture of coke and refined petroleum products	2.4	25.5	1.3	21.1	1.1	4.5	0.4	1.4	0.3	0.0
Manufacture of refined petroleum products	2.2	25.9	1.1	21.3	1.1	4.6	0.4	1.4	0.3	0.0
Manufacture of chemicals and chemical products	-28.9	24.5	-8.6	3.9	-20.2	20.5	4.1	16.5	0.2	5.0
Electricity, gas, steam and air conditioning supply	57.0	30.0	16.0	3.7	41.3	26.4	1.1	-1.7	-0.1	-0.3
Electric power generation, transmission and distribution	56.4	29.3	14.6	3.6	42.1	25.8	0.9	-2.3	-0.1	0.0
Water supply; sewerage, waste management and remediation activities	7.0	0.8	5.7	1.4	1.3	-0.6	0.0	0.0	0.0	0.0
Construction	8.9	31.0	4.7	-1.2	-12.3	-5.7	3.5	-5.3	0.1	0.0
Wholesale and retail trade; repair of motor vehicles and motorcycles	13.6	46.1	7.0	38.2	6.2	6.0	4.2	0.1	0.6	0.7
Transportation and storage	-0.2	14.0	0.4	10.2	-0.6	3.1	0.9	1.8	0.0	0.0
Accommodation and food service activities	6.3	-1.6	0.8	-2.4	4.1	0.8	0.8	1.4	0.0	0.1
Information and communication	2.7	66.8	4.1	-5.7	-1.5	72.5	5.0	9.2	1.0	2.8
Telecommunications	-0.3	66.1	2.4	-3.8	-2.7	69.9	4.7	6.7	0.0	2.5
Real estate activities	-2.6	5.9	-0.9	0.8	-5.6	-0.2	0.0	0.1	0.0	0.0

Table-5.4: Loans Classified by Borrowers (By Type of Finance) P (Rs billion)

Data based on ISIC 4 Classifications of Private Sector Businesses	Total Credit		Working Capital		Fixed Investment		LTFF		EFS	
	Jul-Mar FY2021	Jul-Mar FY2022	Jul-Mar FY2021	Jul-Mar FY2022	Jul-Mar FY2021	Jul-Mar FY2022	Jul-Mar FY2021	Jul-Mar FY2022	Jul-Mar FY2021	Jul-Mar FY2022
Education	6.5	4.4	4.8	-1.4	-1.6	0.5	0.1	-0.2	0.0	0.0
Human health and social work activities	3.5	-0.8	1.4	-1.0	0.6	0.1	0.2	0.6	0.0	0.0

P : Provisional

Notes:

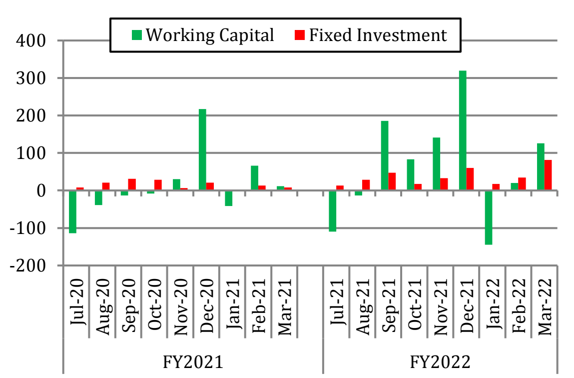
1. Classification of Private Sector - Business based on International Standard Industrial Classification (ISIC), Rev. 4 of United Nation adopted from June 2019.
2. Islamic Financings, Advances (against Murabaha etc) and Other related items previously reported under Other Assets has been reclassified as credit to private sector w.e.f June 2014.
3. With reference to Infrastructure, Housing & SME Finance Department Circular No. 10 of 2020 dated 15th July 2020 and Statistics & Data Warehouse Department circular No. DS.MFS. 013814/20 dated 4th December, 2020, a new category "Construction Finance" has been added to "Loans Classified (By Type of Finance)" from June 2020 onwards. This type of finance includes working capital and fixed investment loans provided by scheduled banks to private sector for construction purposes. Accordingly, release amount under construction financing increased to Rs 60.5 billion during Jul-Mar, FY2022 as compared to Rs 32.2 billion during same period last year.

Source: SBP

Working Capital loans observed expansion of Rs 608.7 billion during Jul-Mar, FY2022 as compared expansion of Rs 110.8 billion during same period last year. Demand for short term loans has increased on account of high exports proceed particularly in textile sector, expansion of economic activities and higher commodity prices at global level which transfers pressure on domestic prices. Accordingly, manufacturing sector credit offtake amounted to Rs 566.3 billion against the borrowing of Rs 60.9 billion during same period last year. Of which, textile sector is the dominant sector, credit demand increased to Rs 235.3 billion against retirement of Rs 9.8 billion during last year. The textile sector also benefitted from SBP Export Finance Scheme (EFS) at a concessional rate of 3.0 percent, being the major exporter and availed Rs 64.8 billion against Rs 44.8 billion in last year.

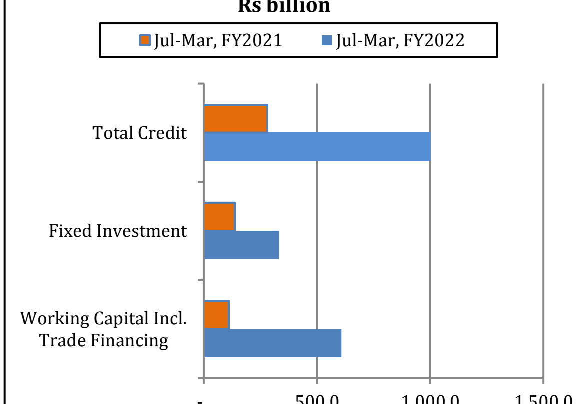
Higher international fuel prices and domestic demand on account of expansion in economic activities also reflects in petroleum sector credit demand for working capital loans, which increased to Rs 21.3 billion compared Rs 1.1 billion during same period last year. This also evident from 77.0 percent increase in Brent crude prices in March, 2022 on YoY basis and total oil sales by 23.0 percent.

Fig-5.7:Loans to Private Sector Businesses, Rs billion



Source: SBP

Fig-5.8:Loans to Private Sector Businesses, Rs billion



Source: SBP

Consumer financing continued to accelerate and major impetus came from housing and automobile sector (Table 5.5). Consumer financing increased to Rs 143.6 billion (growth of 20.3 percent) during Jul-Mar, FY2022 as compared to Rs 131.7 billion (growth of 24.7 percent) during same period last year. Banks consumer loans demand primarily stemmed from automobile sector, with dominant share of 39 percent in total portfolio. Increasing demand also evident from cars sales which increased by 54.0 percent during Jul-Mar, FY2022.

Table-5.5: Consumer Financing Rs billion

	July-March (Flows)		Growth(%)*	
Description	**FY2021**	**FY2022**	**FY2021**	**FY2022**
Consumer Financing	131.7	143.6	24.7	20.3
1) For house building	13.8	66.6	17.2	64.3
2) For transport i.e. purchase of car	73.6	55.5	34.9	18.0
3) Credit cards	10.0	13.9	23.1	25.2
4) Consumers durable	-2.7	1.4	-33.6	23.5
5) Personal loans	37.2	6.2	19.4	2.6
6) Other	-0.1	0.2	-16.7	24.0

* Growth is calculated on the basis of Stocks.

Source: State Bank of Pakistan

House building sector has witnessed unprecedented growth of 64.3 percent (Rs 66.6 billion) during Jul-Mar FY2022 as compared growth of 17.2 percent (Rs 13.8 billion) in last year. This surge in house building loans demand primarily due to measures taken by Government and SBP to promote housing and construction financing in the country.

In October 2020, the Government of Pakistan augmented these efforts by introducing the Government Markup Subsidy Scheme (G-MSS) wherein, now commonly known as Mera Pakistan Mera Ghar (MPMG) Scheme. This scheme enables banks to provide financing for the construction and purchase of houses at very low financing rates for low to middle income segments of the population.

SBP also instructed banks to target housing and construction finance on July 15, 2020. Banks were required to increase their housing and construction finance portfolio to 5 percent of their domestic private sector advances by the end of 2021. As a result, banks' financing to housing and construction sector increased to Rs 367 billion as of December 31, 2021 from Rs148 billion as of June 30, 2020. For 2022, Banks have been directed to increase their housing and construction portfolio to 7 percent of their domestic private sector advances, i.e. up to Rs 560 billion[30].

Monetary Liabilities

Monetary Liabilities include currency in circulation, demand deposits, time deposits and Resident Foreign Currency Deposits.

[30]https://www.sbp.org.pk/press/2022/Pr1-14-Apr-2022.pdf

Currency in Circulation (CiC)

During the period 01st July-29th April, FY2022 CiC witnessed an expansion of Rs 991.7 billion (growth of 14.4 percent) as compared to expansion of Rs 673.0 billion (growth of 11.0 percent) during same period last year. Currency-to-M2 ratio reached 30.7 as on 29th April, 2022 against 30.2 percent during same period last year. Significant growth in CiC has been observed particularly in the month of April, 2022 on account of cash demand during Ramzan and Eid Festive.

Table-5.6: Monetary Aggregates Rs million

Items	**End June**		**29th April**	
	2020	**2021**	**2020-21**	**2021-22**
A.Currency in Circulation	6,142,016	6,909,937	6,814,968	7,901,646
Deposit of which:				
B. Other Deposits with SBP	41,218	68,004	61,403	95,272
C. Total Demand &Time Deposits incl.RFCDs	14,724,770	17,319,755	15,664,377	17,757,930
of which RFCDs	1,074,511	1,046,150	1,018,992	1,122,176
Monetary Assets Stock (M2) A+B+C	20,908,004	24,297,696	22,540,748	25,754,848
Memorandum Items				
Currency/Money Ratio	29.4	28.4	30.2	30.7
Other Deposits/Money ratio	0.2	0.3	0.3	0.4
Total Deposits/Money ratio	70.4	71.3	69.5	68.9
RFCD/Money ratio	5.1	4.3	4.5	4.4
Income Velocity of Money	2.3	2.5	_	_

Source: State Bank of Pakistan

Deposits

Bank deposits (including demand, time and Resident Foreign Currency Deposits (RFCD)) increased by Rs 438.2 billion (growth of 2.5 percent) during the period 01st July-29th April, FY2022 as compared Rs 939.6 billion (growth of 6.4 percent) during same period last year. Within deposits, demand deposits witnessed expansion of Rs 363.8 billion against Rs 1,172.1 billion in last year.

This slowdown in deposit growth was partly due to high base effect of deposits at end-June 2021. Accordingly, demand deposit increased by Rs 2,686.4 billion in FY2021 as compared Rs 1,494.0 billion in FY2020. On the other hand, time deposits decreased by Rs 1.6 billion as compared decline of Rs 177.0 billion in last year. On the contrary, RFCDs increased by Rs 76.0 billion as compared to contraction of Rs 55.5 billion last year, on account of massive PKR depreciation around 15.3 percent during Jul-Apr, FY2022 as compared appreciation of 8.0 percent during same period last year, reversing the position of foreign currency deposits. Resultantly, significant increase in CiC and reduction of deposits has led to increase in currency-to-deposits ratio to 44.5 percent as of 29th April, 2022 compared 43.5 during same period last year.

Monetary Management

During the period July-March, FY2022, average Open Market Operations (OMOs) stepup almost double to Rs 2,214.6 billion as compared Rs 1,291.1 billion during same period last year. Net injections have increased on account of increase in liquidity requirement, which primarily stem from significant increase in private sector credit offtake, increase in government budgetary borrowing and SBP's foreign exchange operations cumulatively increased the Rupee liquidity requirements of commercial banks. Meanwhile, deposit mobilization was not sufficient to bridge this short-term liquidity gap. In response to these requirements, SBP has increased its OMOs injections. Accordingly, the outstanding net injections has rose an average in each of first three quarters.

Table-5.7: Average Outstanding Open Market Operations1 Rs billion

	FY18	FY19	FY20	FY21	FY22
Full Year	**1,228.7**	**(23.8)**	**1,103.2**	**1,291.1**	**2,214.6**
Q1	1,440.9	1,035.2	1,337.7	1,048.3	2,127.2
Q2	1,530.5	-257.6	912.8	822.8	1,875.0
Q3	1,123.5	-641.2	892.4	1,158.0	2,641.8
Q4	813.1	-247.4	1,270.0	2,135.2	

1: The data does not include the impact of outright OMOs.

Note: (+) amount means net Injections. (-) amount means net mop-up.

Source: State Bank of Pakistan

Table-5.8: Market Treasury bills Auctions Rs million

	Jul-Jun			Jul-Mar					
	FY2021			Offered		Accepted		W.A.Rate*	
	Offered	Accepted	W.A Rate*	FY2021	FY2022	FY2021	FY2022	FY2021	FY2022
3-Months	15,505,232	8,698,476	6.9	11,269,020	12,095,938	6,985,123	7,450,156	12.5	9.5
6-Months	9,989,084	5,585,878	7.1	4,341,280	10,515,444	2,608,950	4,661,527	12.6	9.8
12-Months	2,462,402	580,918	7.2	1,795,065	3,827,187	528,226	847,815	12.4	10.0
Total	**27,956,718**	**14,865,272**		**17,405,365**	**26,438,569**	**10,122,299**	**12,959,498**		

Source: State Bank of Pakistan

*Average of maximum and minimum rates

Market offered the total amount of Rs 26,438.6 billion for T-Bills during Jul-Mar, FY2022 as compared Rs 17,405.4 billion during same period last year. During current fiscal year, the Government has raised Rs 12,959.5 billion (49.0 percent of the offered amount) in the T-bill's auction compared to last year accepted amount of Rs 10,122.3 billion (58 percent of the offered amount). The acceptance for the tenors under T-Bills almost remained same during current fiscal year as compared to last year. During Jul-Mar FY2022, around 57.5 percent of outstanding T-bills comprised of 3 months, followed by 36.0 percent for 6.0 months and just 6.5 percent under 12 months, indicating market's expectation of bottoming out of interest rates.

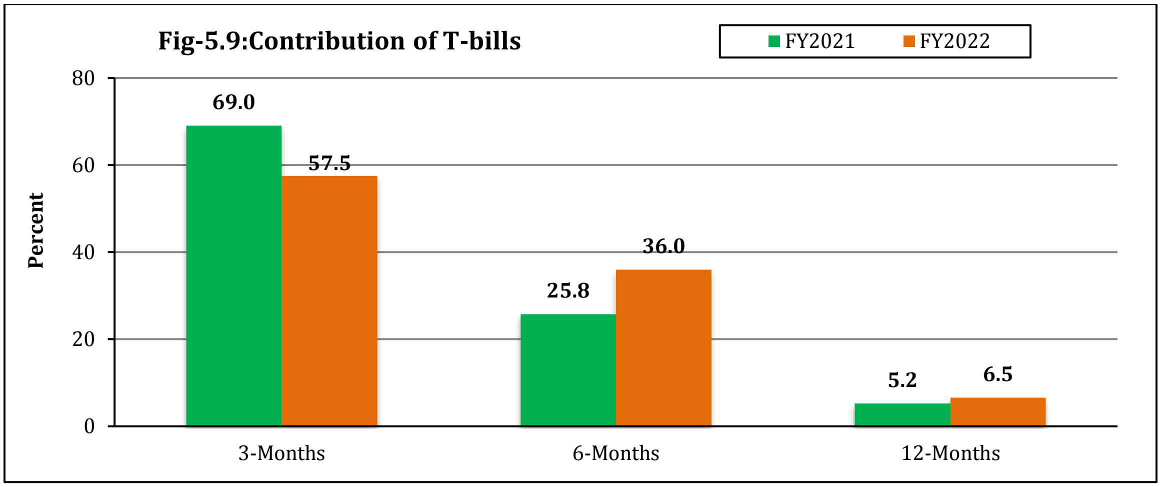


Table-5.9: Pakistan Investment Bonds Auctions Rs million

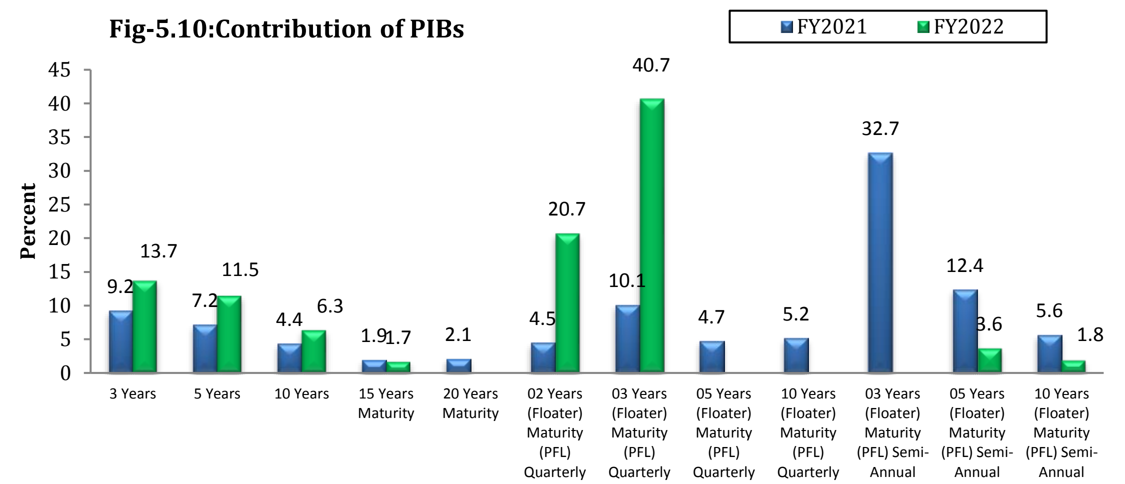
PIBs	July-June			Jul-Mar				W.A Rate	
	Offered	Accepted	W.A Rate	Offered		Accepted			
	FY2021			FY2021	FY2022	FY2021	FY2022	FY2021	FY2022
3 Years	1,181,021	479,261	8.3	337,420	1,436,991	176,740	488,929	8.3	10.2
5 Years	866,330	301,239	9.0	450,548	1,316,745	136,716	408,456	9.0	10.4
10 Years	445,052	149,729	9.5	243,752	1,077,606	83,405	225,451	9.5	10.8
15 Years Maturity	96,589	64,000	9.9	54,549	73,978	37,000	59,000	9.9	10.4
20 Years Maturity	72,061	62,061	10.5	50,061	10,529	40,061		10.5	
02 Years (Floater) Maturity (PFL) Quarterly	213423	175664	99.5853	120,025	1,067,462	86,282	738,404	99.6 Cut off price	99.4 Cut off price
03 Years (Floater) Maturity (PFL) Quarterly	365,931	228,976	99.1	287,756	1,948,458	193,776	1,449,403	99.1 cut off price	98.6 cut off price
05 Years (Floater) Maturity (PFL) Quarterly	107,600	90,500	98.0	107,600		90,500		98.0 cut off price	
10 Years (Floater) Maturity (PFL) Quarterly	130,050	98,542	95.3	130,050		98,542		95.3 cut off price	
03 Years (Floater) Maturity (PFL) Semi-Annual**	1,193,302	624,763	99.6	1,193,302		624,763		99.6 cut off price	
05 Years (Floater) Maturity (PFL) Semi-Annual**	776,785	306,271	99.3	577,020	318,000	236,261	129,562	100.3 cut off price	98.24 cut off price
10 Years (Floater) Maturity (PFL) Semi-Annual**	384,124	136,707	100.5	384,124	63,150	107,802	64,553	100.1 cut of price	100.0 cut of price
Total	**5,832,268**	**2,661,913**		**3,936,207**	**7,312,919**	**1,911,848**	**3,563,758**		

Note: Accepted amount include non-competitive bids as well as short sale accommodation.
* The banchmark for coupon rate is defined in clause 'B' of DMMD Circular No. 9 dated May 07, 2018.
** Margins quoted ober benchmark rate in fresh auctions of floating rate PIB (PFL)

Source: State Bank of Pakistan

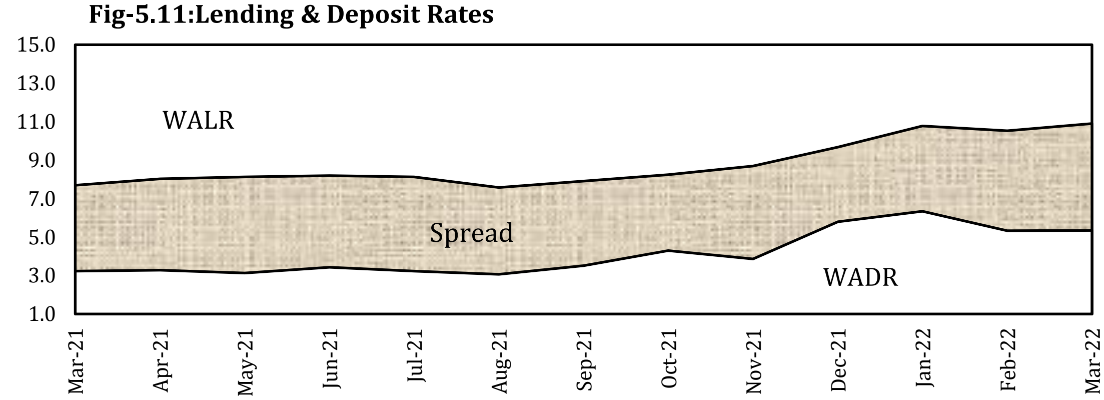
During Jul-Mar, FY2022, Government remained inclined towards floating rate long-term debt instrument PIBs. Market offers Rs 3,915.8 billion under fixed rate PIBS which is 53.5 percent of offered amount, while for floaters, the market offered Rs 3,397.1 billion, 46 percent of the offered amount. Keeping in view higher yields demanded by the market compared to the prevailing cut- offs, the Government accepted only Rs 1,181 billion from fixed coupon PIBs (33 percent of the accepted amount). In this backdrop, floaters helped the Government to raise medium-to-long term debt. Given these favorable traits of floaters, the Government was able to raise Rs 2,382 billion via issuances of floating rate PIBs (67 percent of accepted amount). Moreover, 3Y quarterly coupon PIBs remained the market's most favored instrument floaters which contribute around 61 percent of floaters accepted amount.

Fig-5.10:Contribution of PIBs



Monetary policy has changed its direction from accommodating to tightening, the impact has been transferred on Weighted Average Lending Rate (WALR), which was 7.7 percent on gross disbursement in March, 2021 increased to 10.59 percent in March, 2022. Similarly, Weighted Average Deposit Rate (WADR) offered on fresh deposits also increased to 5.1 percent in March, 2022 from 3.2 percent in March, 2021. Accordingly, banking spread, which is the difference between the lending and deposit rates and the cost of channeling funds through intermediaries, increased from 4.5 percent in March, 2021 to 5.5 percent in March, 2022.

Fig-5.11:Lending & Deposit Rates



Financial Sector

To create conducive and thriving environment for the banking industry, the SBP continued to play its role within its regulatory and supervisory ambit during FY2022.

Financial Performance and Standing of Banking Sector

The banking sector performed reasonably well during CY21. The asset base of the banking sector expanded by 19.6 percent in CY21 (14.2 percent in CY20). The expansion was mostly driven by growth in advances and investments.

Advances (net) increased by 22.1 percent (YoY) in CY21 as compared to the COVID-induced minimal growth of 0.5 percent in CY20. The growth in advances was broad based, however, textile sector availed highest financing during CY21.

Banks' investments rose by 22.0 percent over the year to reach Rs 14.5 trillion by end Dec-2021. Around 95 percent of the expansion in total investments came from investments in Government securities, reflecting the increased needs of the government for bank credit.

Deposits of the banking sector surged by 17.3 percent over the year to Rs 21.7 trillion by end CY21 (16.1 percent increase in CY20). Current and Savings deposits together contributed 70.9 percent rise in total deposits in CY21. A number of factors, such as revival of economic activities, upbeat momentum of workers' remittances, sizeable increase in Roshan Digital Accounts (RDAs), increased use of digital payment modes and improvement in rate of return on deposits contributed to the rise in deposits during CY21.

Asset Quality indicators of the lending portfolio improved due to contained growth in NPLs as well as better provisioning. The infection ratios, on both gross as well as net basis declined over the year CY21. With high provisions coverage (provisions to NPLs) of 91.2 percent, net NPLs to net loans ratio declined to 0.7 percent by end Dec-2021 from 1.2 percent as of end Dec-2020.

Solvency indicators such as Capital Adequacy Ratio (CAR) moderated to 16.7 percent by end Dec-2021 (18.6 percent at end Dec-2020), largely due to healthy growth in advances. However, the prevailing CAR level remains well above the local and international minimum benchmarks of 11.5 percent and 10.5 percent, respectively.

Table-5.10: Highlights of the Banking Sector Industry

	CY15	CY16	CY17	CY18	CY19	CY20	CY21
Key Variables (Rs billion)							
Total Assets	14,143	15,831	18,342	19,682	21,991	25,124	30,058
Investments (net)	6,881	7,509	8,729	7,914	8,939	11,935	14,554
Advances (net)	4,816	5,499	6,512	7,955	8,249	8,292	10,121
Deposits	10,389	11,798	13,012	14,254	15,953	18,519	21,720
Equity	1,323	1,353	1,381	1,406	1,658	1,862	1,942
Profit Before Tax (ytd)	329	314	267	243	304	411	451
Profit After Tax (ytd)	199	190	158	149	171	244	264
Non-Performing Loans	605	605	593	680	761	829	860
Non-Performing Loans (net)	91	90	76	110	141	97	75

Table-5.10: Highlights of the Banking Sector Industry

	CY15	CY16	CY17	CY18	CY19	CY20	CY21
Key FSIs (Percent)							
NPLs to Loans (Gross)	11.4	10.1	8.4	8	8.6	9.2	7.9
Net NPLs to Net Loans	1.9	1.6	1.2	1.4	1.7	1.2	0.7
Net NPLs to Capital	7.7	7.3	5.8	7.8	8.9	5.3	4
Capital Adequacy Ratio (all banks)	17.3	16.2	15.8	16.2	17	18.6	16.7
Advances to Deposit Ratio	46.4	46.6	50.1	55.8	51.7	44.8	46.6

Source: State Bank of Pakistan

Note: Statistics of profits are on year-to-date (ytd) basis.

Financial Development

The relationship between financial development and economic growth has remained an important issue of debate. A well-developed financial system performs several critical functions to enhance the efficiency of intermediation by reducing information, transaction, and monitoring costs. A modern financial system promotes investment by identifying and funding good business opportunities, mobilizes savings, enables the trading, hedging, and diversification of risk, and facilitates the exchange of goods and services. These functions result in a more efficient allocation of resources, in a more rapid accumulation of physical and human capital.

Financial development (i.e. financial depth) can be measured by different macroeconomic variables such as domestic credit to the private sector as a percentage of GDP, money supply measures, and stock market indicators. In table 5.11, financial depth is measured by M2/GDP ratio, which is widely used as an indicator of financial sector deepening, where higher values represent a more developed financial sector. This ratio has witnessed substantial rise and increased from 36.6 percent in FY2011 to 43.5 percent in FY2021, indicating more developed and efficient financial sector due to SBP various initiatives for financial sector development. The increasing trend is continued in current fiscal year and the ratio stood at 38.5 percent as on 29thApril FY2022.

Table- 5.11: Financial Depth

Years	M2/GDP
2010-11	36.6
2011-12	38.1
2012-13	39.6
2013-14	39.6
2014-15	41.0
2015-16	44.1
2016-17	45.7
2017-18	46.2
2018-19	40.6
2019-20	44.0
2020-21	43.5
29th April	
2020-21	40.4
2021-22	38.5

Source: EA Wing Calculation, Finance Division

Box-II: Financial Sector Reforms during July-March FY2022

To enhance financial soundness and robust performance of the banking sector, SBP has taken various regulatory and policy reforms. The key policy reforms are highlighted below.

Strengthening of Regulatory and Supervisory Environment

SBP, in line with the international best practices, introduced a comprehensive set of reforms to enhance supervision and resilience of the banking system.

➢ **Supervisory Reforms**

1. **Supervisory Transition to Risk Based Supervisory Regime**

   SBP accomplished successful supervisory transition with the implementation of "Risk Based Supervisory (RBS) Framework" in order to improve the supervisory regime and align it with international best practices. Being a forward-looking framework, it will help better understand the risk profiles of regulated entities with respect to both external & internal risks and controls.

2. National Money Laundering/Terror Financing (ML/TF) Risk Assessment of Pakistan

The National ML/TF Risk Assessment of Pakistan – 2022 (NRA-22) is currently underway and SBP is member of a national level core committee for review and guidance on NRA-22. With respect to NRA-22, SBP conducted a comprehensive assessment of inherent ML/TF vulnerabilities of SBP regulated entities, i.e. Banks, Microfinance Banks, Exchange Companies and Development Finance Institutions.

3. Guidance and Technical Support to Central Directorate of National Savings (CDNS) and Pakistan Post

SBP has been providing guidance and support to CDNS and Pakistan Post to bridge gaps identified by Asia Pacific Group (APG) in Pakistan's Mutual Evaluation Report (MER). Senior officers of SBP are member of Supervisory Boards constituted for both the institutions.

- **Regulatory Reforms**

1. SBP has developed a licensing and regulatory framework for setting up digital banks in Pakistan. The primary aim of the framework, inter alia, include enhancement of financial inclusion, provision of affordable/cost effective digital financial services especially to unserved and underserved segments of the society and fostering a new set of customer experience.

2. Revision of Corporate Governance Regime

SBP has comprehensively updated the Corporate Governance Regulatory Framework (CGRF) for banks/DFIs (vide BPRD Circular No. 05 of 2021). The revised framework aims to align with the international standards and principles. The framework covers Fit and Proper Test (FPT) criteria and other corporate governance regulatory requirements for the sponsor shareholders **Issuance of Licensing and Regulatory Framework for Digital Banks** /beneficial owners, members of the Board of Directors (BoDs), Presidents/CEOs and key executives of banks/DFIs.

3. Customers' Digital On Boarding Framework

SBP has developed a "Customers' Digital on Boarding Framework" for banks/ MFBs which inter alia elaborates basic parameters for opening of bank accounts for Resident Pakistanis through digital channels.

4. Implementation of Regulatory Approval System (RAS)

In order to further strengthen the organizational efficiency, effectiveness and turnaround time of regulatory approval process, SBP has implemented Regulatory Approval System to digitize the end-to-end process of various request letters/ proposals received from banks/DFIs/MFBs, their approval process and dissemination of regulatory decisions there against.

5. Revised Prudential Regulations for Consumer Financing to Moderate Import Growth

SBP has revised Prudential Regulations (PRs) for Consumer Financing (vide BPRD Circular Letter No. 29 of 2021), to moderate the demand for imported items, particularly the automobiles and address associated prudential risks to the banks. The changes in the PRs effectively prohibit financing for imported vehicles, and tighten regulatory requirements for financing of domestically manufactured/ assembled vehicles of more than 1000 cc engine capacity and rationalize other Consumer Finance Facilities like personal loans and credit cards.

6. Women Branchless Banking Agents under Banking on Equality Policy

The introduction of Women Branchless Banking (BB) agents will facilitate women's adoption of digital financial services, especially in rural areas.

7. SBP Imposed 100 percent Cash Margin Requirement on Import of Additional 114 Items

SBP imposed 100 percent Cash Margin Requirements (CMR) on import of 114 items vide BPRD Circular Letter No. 30 of 2021, taking the total number of items subject to CMR to 525. In view of the building current account deficit in the context of fast economic growth, SBP has decided to adjust its policy by imposing CMR on additional import items. This will complement SBP's other policy measures to ease the pressure on import bill and help contain the current account deficit at sustainable levels.

- **Foreign Exchange (FX) Regime**

1. **International Trade**

SBP has taken following measures to facilitate E-Commerce, foreign trade, exporters of SME sectors and export proceeds realization. These measures will not only improve the foreign exchange flows into the country but also enhance the ease of doing business in Pakistan.

a. To promote e-Commerce exports from Pakistan and facilitate Pakistani exporters/entrepreneurs to sell their products through international digital market places including Amazon, e-Bay, Ali Baba, another framework of Business–to-Business-to-Consumer (B2B2C) e-Commerce has been introduced.

b. SBP in collaboration with Pakistan Single Window (PSW) project has developed Electronic Data interchange with Banks. PSW system allows parties involved in trade and transport to lodge standardized information and documents with a single-entry point to fulfil all import, export, and transit-related regulatory requirements. It will help reduce the time and cost of doing business by making trade related business processes more efficient, transparent and consistent.

c. With an objective to improve the timely inflow of foreign exchange from exports proceeds in the market, SBP amended foreign exchange regulations now require exporters to bring export proceeds within a maximum period of 120 days from date of shipment instead of earlier 180 days.

Financial Inclusion

SBP is pursuing financial inclusion as one of its strategic objectives to promote inclusive economic growth in the country by improving the access and usage of quality financial services among individuals and firms. In this connection, SBP is implementing National Financial Inclusion Strategy (NFIS) and pursuing headline targets to be achieved by end 2023.

Under NFIS, a total of 96 actions/sub-actions are being implemented by more than 30 partners envisaged in this multi-focal strategy to be completed by 2023. As of FY21-22 (upto March 2022), 52 actions/sub-actions have been completed while other tasks are in progress. In terms of progress under headline target of active accounts, as of December 2020, overall number of unique active accounts stood at 53.2 million of which 14.5 million were held by women.

Key Initiatives taken under NFIS are listed below:

- **Gender Mainstreaming Policy**: SBP launched a landmark gender mainstreaming Policy i.e. "Banking on Equality: Reducing the Gender Gap in Financial Inclusion" on September 17, 2021. The Policy aims to introduce a gender lens within the financial sector through five identified pillars and specific measures, to bring a shift towards women friendly business practices. Under the policy, actions are targeted towards improving institutional readiness, product diversification and development capability, customer acquisition and facilitation approaches towards women segments, robust collection of gender disaggregated data, and prioritizing gender focus in SBP's policies. The Policy is in implementation phase and most banks have already submitted board approved plans for ensuring compliance of BOE Policy, while actions plans are being implemented to achieve the below headline targets:

    i. 20 million women owned active accounts by 2023.

    ii. 20% of banks' workforce to be women by 2024.

    iii. 10% of Branchless Banking agents to be women by 2024.

    iv. 75% of bank access points to have trained women champions in place.

- **Asaan Mobile Account (AMA) Scheme**: In Dec. 2021, SBP launched the Asaan Mobile Account (AMA) Scheme to cater to the needs of those men and women who don't have access to a smart phone or internet facility. Under this scheme, anyone with a basic feature phone can open and use an account simply by dialing *2262# and following the steps on their screen. As of March 18, 2022 around 2.7 million AMA accounts have been opened.

- **Asaan Digital Accounts:** SBP has launched Asaan Digital Accounts as a revolutionary account category that can break barriers, for digital financial inclusion of men and women. The end-to-end digitized solution allows people to open a bank account digitally with a CNIC and no other documentation requirements, from anywhere using their phone or computer through the web portals/apps of banks/MFBs. This account is specifically useful for the female segments who find it challenging to visit bank branches. The account has a maximum balance limit of Rs 1 million, making it a smart choice for freelancers, and home-based workers.

Source: State Bank of Pakistan

Islamic Banking

During CY21, assets of Islamic banking Industry (IBI) witnessed significant YoY increase of Rs 1,308 billion to Rs 5,577.0 billion (growth of 30.6 percent) compared to growth of 30.3 percent in CY20. Deposits of IBI increased by Rs 822 billion to Rs 4,211 billion (growth of 24.2 percent) in CY21. It is pertinent to mention that this is the highest ever increase in assets and deposits of IBI in a year. Accordingly, market share of Islamic banking assets and deposits in the overall banking industry jumped to 18.6 percent and 19.4 percent, respectively by end December 2021 compared 17.0 and 18.3 percent, respectively in CY20. (Table-5.12).

Table- 5.12: Islamic Banking Industry

	CY16	CY17	CY18	CY19	CY20	CY21
Total Assets (Rs billion)	1,853.0	2,272.0	2,658.0	3,284	4,269	5,577
Total Deposits (Rs billion)	1,573.0	1,885.0	2,203.0	2,652	3,389	4,211
Share in Banks' Assets (Percent)	11.7	12.4	13.5	14.9	17	18.6
Share in Banks' Deposits (Percent)	13.3	14.5	15.5	16.6	18.3	19.4

* Provisional

Source: State Bank of Pakistan

Currently, 22 Islamic Banking Institutions (IBIs) (5 full-fledged Islamic banks, 17 conventional banks having Islamic Banking Branches) are providing Shariah compliant products and services through their network of 3,956 branches spread across 125 districts of the country. Further, the number of Islamic Banking windows (dedicated counters at conventional branches) operated by conventional banks having standalone Islamic Banking Branches stood at 1,442 as of December 31, 2021. Breakup of the data between IBs and IBBs shows that assets of IBs posted an annual rise of 21.2 percent (Rs 529 billion), while IBBs observed significant increase of 44.0 percent (Rs 779 billion).

Table -5.12 (a): Financing Products by Islamic banks — **Percent share**

Mode of Financing	CY16	CY17	CY18	CY19	CY20	CY21
Murabaha	15.8	13.2	13.6	12.9	13.7	13.6
Ijara	6.8	6.4	6.2	5.7	4.8	4.4
Musharaka	15.6	22.0	19.9	19.8	22.7	24.9
Mudaraba	0.0	0.0	0.0	0.0	0.0	0.0
Diminishing Muskaraka	34.7	30.7	33.3	34.1	33.6	33.8
Salam	4.4	2.8	2.4	2.6	1.9	2.0
Istisna	8.4	8.2	9.1	9.5	8.3	8.3
Qarz/Qarz-e-Hasna	0.0	0.1	0.0	0.0	0.0	0.0
Others	14.3	16.7	15.5	15.4	15.0	13.0
Total	100.0	100.1	100.0	100.0	100.0	100.0

Source: State Bank of Pakistan

Investments (net) made by IBI registered significant increase of 46.7 percent (Rs 589 billion) in CY21 and reached to Rs 1,852 billion in CY21. This increase in investments (net) was mainly due to funds invested by IBIs in multiple Government of Pakistan (GoP) domestic Ijarah Sukuk (GIS).

Mode-wise financing breakup in CY21 revealed that Diminishing Musharaka has highest share in overall financing of IBI followed by Musharaka and Murabaha.

Microfinance

The Microfinance Banks (MFBs) are set to conclude on a positive note by registering all-round growth in FY2022; although a significant number of microcredit borrowers continue to struggle and recover from the adversities inflicted by the COVID-19 pandemic. Many of these borrowers were unable to honor their debt obligations, which in turn placed MFBs under considerable financial stress owing to escalated loan loss provisioning and charging off overdue facilities.

The GoP and SBP worked in tandem to provide support to vulnerable groups. SBP remained proactive to respond to emerging challenges by actively engaging the microfinance industry. To this end, a number of policy interventions were made to support both MFBs and their vulnerable clients.

Table-5.13: Microfinance Industry Major Indicators (Rs billions)

Indicators	FY21	FY22*	Annual Growth
Number of Branches	3,782	3,823	1.1%
No. of Borrowers	8,031,941	8,122,085	1.1%
Gross loan portfolio	355.7	392.6	10.4%
Average Loan Balance (in Rs)	44,286	48,335	9.1%
*up to December 2021			

Source: PMN MicroWatch , various issues

As of December-2021, around 36 institutions reported provision of microfinance services. These included eleven deposits taking MFBs, one Islamic Banking Institution, while the rest were non-bank microfinance providers.[31]

Altogether, the microfinance industry witnessed 10.4 percent growth in its aggregate microcredit portfolio, but the number of borrowers increased by just over 1.1 percent to register 8.1 million at end of the reporting period.

As of December 2021, the microfinance industry players operated through 3,823 branches spread in 138 districts across the country. The course of microfinance industry performance is presented in Figure-5.12 which depicts an increasing trend in number of borrowers and gross loan portfolio over the past few years apart from the impact of prevailing pandemic.

As of March 2022, eleven MFBs and MCB – Islamic Bank[32] were involved in extending micro-banking services to the low-income segments of the country.

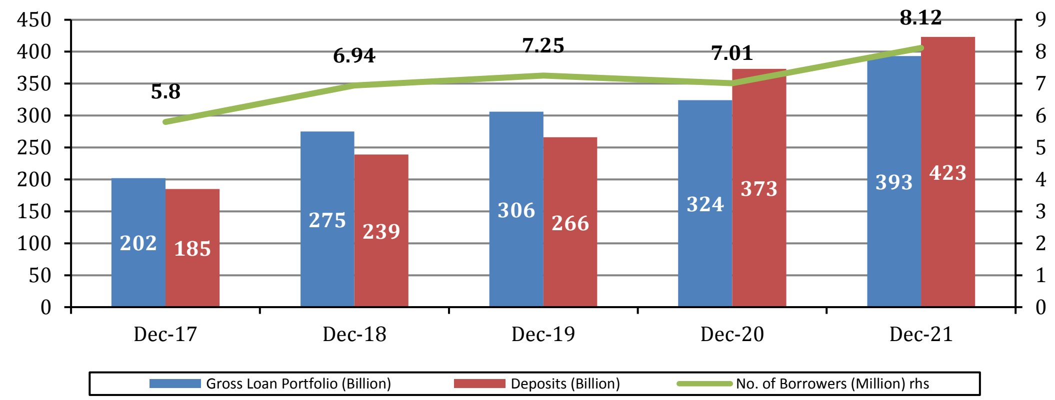
In 3rd quarter of FY22, the combined asset base of MFBs, witnessed a growth of 14.9 percent (Rs 76 billion) since June 30, 2021. MFBs reported an increase in Non-

[31] Include Non-Bank Microfinance Companies (NB-MFCs), specialized microfinance institutions, rural support programs besides organizations running microfinance, as a part of their multi-dimensional service offering.

[32] Since October/November 2017, MCB Islamic Bank is extending microfinance banking services by establishing counters at its existing branches in line with IBD Circular No. 5 of 2007.

Performing Loans (NPLs) from 5.4 percent to around 6.0 percent. Among other factors that underpin the current rise in portfolio infection, the lack of credit discipline of borrowers remains primary challenge faced by the sector. The deposit base of MFBs registered an impressive growth of 13.7 percent to reach Rs 430.3 billion, compared to Rs 378.4 billion over June 30, 2021.

Fig-5.12: Microfinance Industry Performance



Key Initiatives for promotion of Microfinance in the Country

SBP promotes microfinance as a tool for financial inclusion and poverty reduction by making formal financial services accessible to low income segments in order to facilitate asset creation and investments primarily in income generating activities at the bottom of the pyramid. In this regard, SBP took the following measure during FY2022:

Table -5.14: Microfinance Banking Indicators (Rs billions)

Indicators	FY21	FY22 (Mar '22P)	Annual Growth
No. of Borrowers	4,630,716	4,763,310	2.9%
Gross Loan Portfolio	262.5	305.5	16.4%
Average Loan Balance (in Rs)	56,693	64,126	13.1%
Deposits	378.4	430.3	13.7%
No. of Depositors	66,687,601	81,055,082	21.5%
Equity	54.7	54.9	0.4%
Assets	513.8	590.2	14.9%
Borrowings	33.9	60.1	77.3%
NPL	5.4%	6.0%	10.4%

Source: Financial Soundness Indicators, SBP.

1. Relaxation on COVID-19 Relief Portfolio

Enabling MFBs in extending relief to the beneficiaries, criteria for classification of assets and provisioning requirements was relaxed for Deferred and Restructured Portfolio (DRP) up to March 31, 2022.[33] As a result of this relief:

- DRP loans were classified if overdue by 60 days instead of 30 days,
- Outstanding DRP was re-classified as per the extended timelines,

[33]Circular Letter No. 1/December 1, 2021

- Interest/profit/mark-up/service charges already suspended were reversed for the extended period.

2. **Simplified Documentation and Requirements to Report & Obtain Credit Information**

   To streamline requirement for obtaining Credit Information Report (CIR) and simplifying documentary requirements, following changes have been made;

   - Obligations to obtain written declaration about existing facilities has been withdrawn.
   - MFBs' obligation towards reporting to SBP's eCIB has also been simplified.
   - Mandatory requirement to obtain credit report from SBP's eCIB for credit facilities exceeding Rs 30,000 has been withdrawn.[34]

   These regulatory updates correspond to the developments that have taken place after promulgation of Credit Bureau Act (CBA) 2015 and establishment of Licensed Credit Bureaus that are offering comprehensive CIRs to financial institutions on individuals/borrowers to make informed decisions about borrowers' credit worthiness and debt carrying capacity.

3. **Promotion of Micro Housing and Enterprise Financing**

   To encourage financing for low cost housing finance and microenterprise lending, following instructions were issued:

   - Guidance for MFBs to underwrite housing loans.
   - Detailed guidance in respect of property assessment, mortgage creation, risk management, etc. to ensure prudent housing and microenterprise financing.
   - Separate requirements for classification/provisioning and charging-off non-performing loans for each loan category.
   - Extension in classification cycle from 180 DPDs to 2 years.
   - Extension in time to charge-off overdue facilities from 210 DPDs to 5 years.[35]

   These revisions are expected to play a crucial role in enabling MFBs to reach out to the low-income segments of the economy that generally remain financially underserved.

Branchless Banking (BB) Performance

During the period under review, all key indicators of Branchless Banking (BB) exhibited an encouraging growth following the COVID-19 pandemic and ensuing lockdowns. SBP's measures regarding limiting the spread of COVID-19 virus by promoting the use of Digital Payment Services have further pushed the growth trajectory. The number of agents, mobile wallets and deposits witnessed a boost in numbers. Notable growth was witnessed in the number and value of transactions during the period.

[34] Circular Letter No. 2/December 11, 2021
[35] Circular No. 2/March 16, 2022

Table -5.15: Branchless Banking Indicators			
BB Indicators	**CY20**	**CY21**	**Growth**
Number of Agents	481,837	587,547	22%
Number of Accounts	62,755,479	78,809,751	26%
Deposits (Rs In millions)	51,671	65,580	27%
No. of transactions ('000')	1,819,184	2,501,293	37%
Value of transactions (Rs in millions)	6,785,764	8,971,352	32%

Source: Agricultural Credit & Microfinance Department, SBP.

Conclusion

SBP had initiated to tighten monetary policy stance from September 2021 after keeping the policy rate unchanged at 7 percent in all the MPC meetings held in FY2021. The monetary policy in Pakistan shifted direction in Q1-FY2022 in accordance with the changing economic outlook owing to recovery in domestic demand, higher commodity prices and persistent inflationary pressures. Consequently, policy rate had increased by cumulative 275 bps to 9.75 percent during consecutive three monetary policy decision, within a span of three months.

The outlook for inflation improved following the reduction in fuel prices and electricity tariffs announced by the Government's relief package, while data also suggest a moderation in growth. As a result, MPC kept the policy rate unchanged in January and March 2022 meetings.

However, the Russia-Ukraine conflict has created significant uncertainty about the outlook for international commodity prices and global financial conditions. Consequently, the outlook for inflation worsened. Accordingly, the MPC in an unscheduled meeting on April 7, 2022, raised policy rate by 250 basis points to 12.25 percent. The MPC was of the view that this action would help to safeguard external and price stability.

In monetary policy decision held on 23rd May, 2022 the MPC decided to raise the policy rate by 150 basis points to 13.75 percent. The decision was based on outcome of elevated external sector pressure and the higher inflation outlook due to domestic and international factors.

Notwithstanding of monetary policy decisions, private sector credit witnessed unprecedented expansion. On positive note, credit demand increased both for fixed investment and working capital loans. Businesses took advantage of SBP concessionary financing schemes, particularly TERF. As a result, fixed investment and working capital loans witnessed significant expansion. The expansion is a signal for both continuation and expansion of economic activities, which is evident from significant growth of 5.97 percent economic growth for FY2022, surpass the target of 4.8 percent.