CHAPTER 5

Money and Credit

Monetary policy is an important tool to achieve price stability and manage economic fluctuations. Inflation targeting has emerged as the leading framework for monetary policy over recent decades in many advanced and in low income economies. Monetary policy role after global financial crises has extended as macro prudential policy which required strong institutional framework for financial stability and to achieve twin objectives of price and output stabilization.

Pakistan's economy witnessed a consumption led growth of 5.53 percent during preceding year FY2018. The incumbent government has inherited the economy facing multiple challenges including unsustainable twin deficits that pose serious risks to the economy. Hence, to correct the imbalances in the economy, authorities have taken steps to curtail the fiscal deficits and tighten monetary policy to contain demand. SBP has significantly tightened monetary policy, and allowed greater flexibility in the exchange rate adjustments to curb excessive aggregate demand and move towards macroeconomic stabilization.

This trend is in line with the global trends. The global economic expansion has weakened and projected to slow down from 3.6 percent in 2018 to 3.3 in 2019, before returning to 3.6 percent in 2020. Following a notable tightening of global financial conditions during second half of 2018, conditions have eased in early 2019 as the US Federal Reserve signaled a more accommodative monetary policy stance and markets became more optimistic about a US–China trade deal. The US federal funds rate is expected to increase to about 2.75 percent by the end of 2019. Policy rates are assumed to remain at close to zero in Japan through 2020 and negative in the Euro area until mid-2020[1].

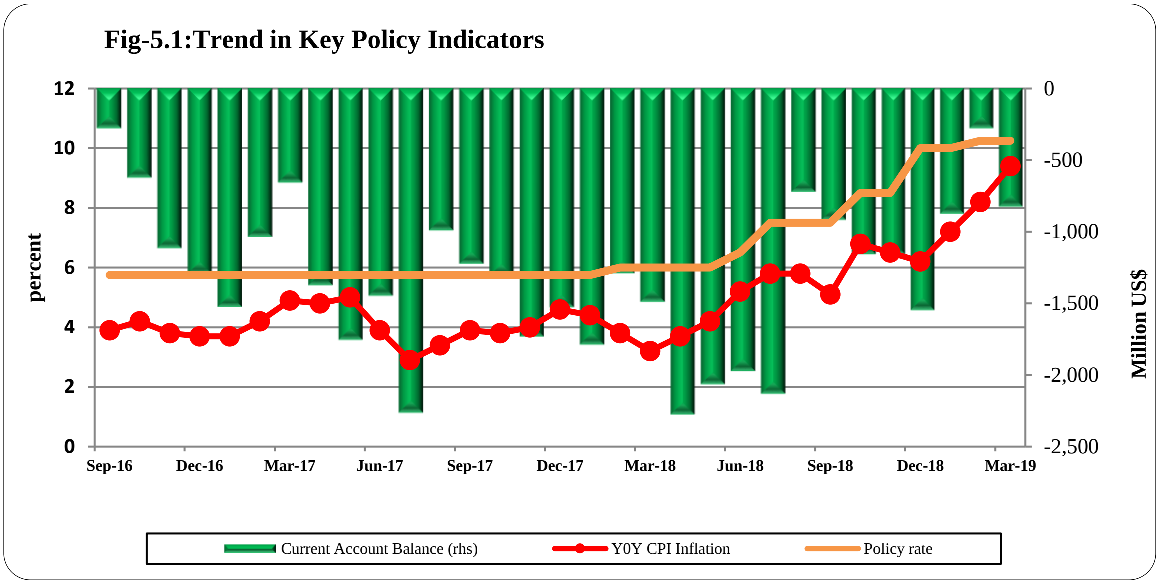
SBP has adopted policy rate reversal and gradually increased it by a cumulative 650 bps since January, 2018. Despite increase in policy rate, Weighted Average Lending Rate (WALR) remained stable which translated into healthy private sector credit demand. Credit to private sector (CPS) increased to Rs 775.5 billion during FY2018 against Rs 747.9 billion last year. Significant increase in credit demand primarily came from working capital and fixed investment in the preceding year. During the period July-March, FY2019 CPS increased to Rs 554.7 billion compared with Rs 401.1 billion during same period of last year. Of which working capital loans received the major share and stood at Rs 369.0 billion compared to Rs 215.3 billion last year. While, fixed investment decelerated to Rs 83.1 billion against Rs 148.1 billion in the comparable period last year.

Table-5.1: Policy Rate

w.e.f	Policy rate
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	6.5
Sep-15	6.0
May-16	5.75
Jan-18	6.0
May-18	6.5
Jul-18	7.5
Oct-18	8.5
Dec-18	10.0
Feb-19	10.25
Apr-19	10.75
21st May-19 till date	12.25

Source: State Bank of Pakistan

[1]World Economic Outlook IMF, April 2019



Recent Monetary and Credit Developments

During the period 01 Jul-26 Apr, FY2019 money supply (M2) increased by Rs 625.3 billion (growth of 3.9 percent) compared with Rs 601.8 billion (4.1 percent) in comparable period of last year. Net Domestic Assets (NDA) is the main contributor to M2 growth. Net Foreign Assets (NFA) point contribution is negative and stood at (-5.5 percent) during the period under review compared with (-3.3 percent) in the same period last year. NDA point contribution has increased to 9.4 percent compared with 7.4 percent last year. NDA point contribution growth partially offset by NFA negative growth, thus overall money supply grew by 3.9 percent during the period under review.

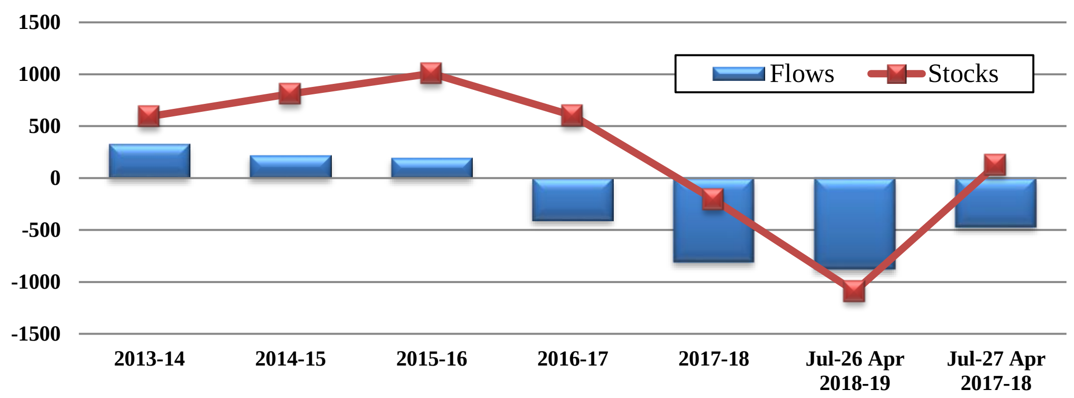
Table-5.2: Profile of Monetary Indicators **Rs Billion**

	FY18 (Stocks) R	26-Apr-19	27-Apr-18
Net Foreign Assets (NFA)	-208.4	-882.4	-475.4
Net Domestic Assets (NDA)	16,205.6	1,507.7	1,077.2
Net Government Borrowing	10,199.7	908.0	813.6
Borrowing for budgetary support	9,393.0	1,073.0	850.0
From SBP	3,613.4	3,204.7	1,316.1
from Scheduled banks	5,779.6	-2,131.7	-466.1
Credit to Private Sector (R)	5,973.0	580.9	498.5
Credit to PSEs	1,068.2	312.1	153.2
Broad Money	15,997.2	625.3	601.8
Reserve Money	5,484.6	488.0	260.5
Growth in M2 (%)	9.7	3.9	4.1
Reserve Money Growth (%)	12.7	8.9	5.4

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

On the other hand, reserve money posted an expansion of Rs 488.0 billion (growth of 8.9 percent) during 01 Jul-26 Apr, FY2019 against Rs 260.5 billion (5.4 percent) last year. SBP's NDA posted a growth of 22.5 percent compared with 18.18 percent during the same period last year. whereas, SBP's NFA decreased by Rs 743.8 billion compared with contraction of Rs 473.7 billion in the comparable period last year. Therefore, reserve money growth stemmed from NDA of the SBP whereas NFA outstanding stock remained negative during the period under review.

Fig-5.2:Net Foreign Asset



Within Broad Money, NFA of the banking sector further contracted to Rs 882.4 billion during 01 Jul-26 Apr, FY2019. During same period last year, it was contracted by Rs 475.4 billion. Therefore, SBA and scheduled bank's NFA remained negative during the period under review.

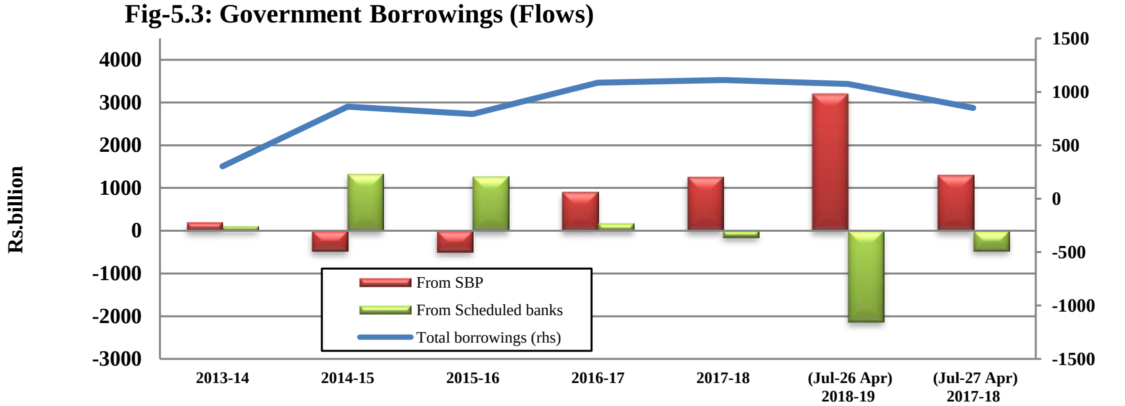
During the period 01 Jul-26 Apr, FY2019 NDA of the banking sector registered an expansion of Rs 1,507.7 billion (growth of 9.3 percent) compared with Rs 1,077.2 billion (7.7 percent) during the comparable period last year. NDA of SBP increased by Rs 1,132.5 billion as compared with Rs 661.5 billion during same period last year. The NDA of scheduled banks witnessed an expansion of Rs 375.1 billion compared to expansion of Rs 415.7 billion in the same period of last year. Government sector borrowing and private sector credit mutually impacted NDA growth of the banking system, which was more than offset the contraction in NFA of the banking system. Consequently, broad money growth increased to 3.9 percent during 01 Jul-26 Apr, FY2019 as compared to 4.1 percent during the comparable period last year.

Credit to Public Sector Enterprises (PSEs) increased by Rs 312.1 billion during the period 01 Jul-26 Apr, FY2019 against Rs 153.2 billion during the same period of last year.

Government Bank Borrowing

During 01 Jul-26 Apr, FY2019 government borrowed Rs 1,073.0 billion for budgetary support compared to Rs 850.0 billion in the same period last year, of which, government has borrowed from SBP Rs 3,204.7 billion as compared to Rs 1,316.1 billion last year. On the other hand, government retired Rs 2,131.7 billion to scheduled banks against retirement of Rs 466.1 billion in last year. Net government sector borrowing thus remained at Rs 908.0 billion during the period under review compared with Rs 813.6 billion last year.

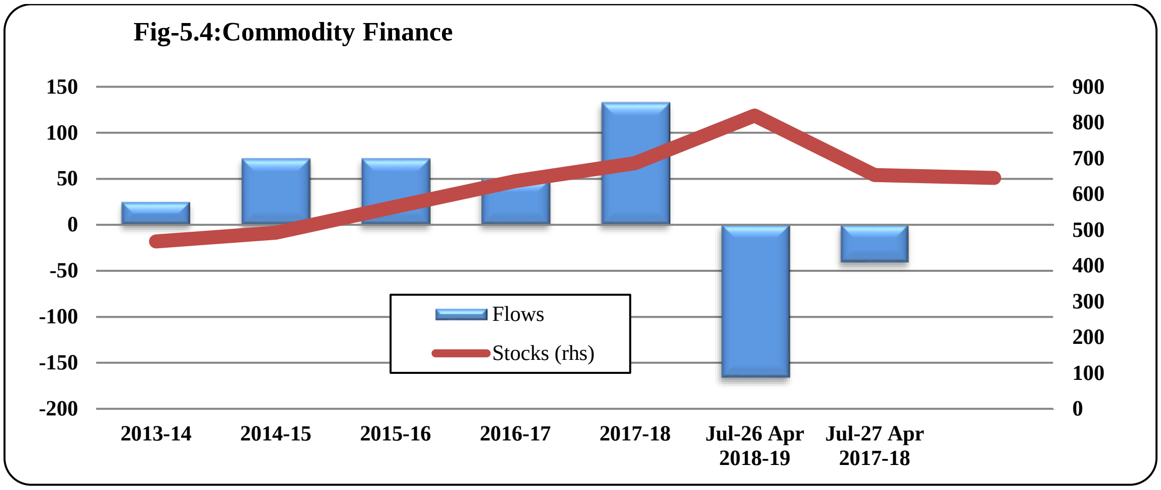
Fig-5.3: Government Borrowings (Flows)



Commodity Finance

The outstanding stock of commodity finance recorded a growth of 19.4 percent in FY2018 to Rs 819.7 billion compared with Rs 686.5 billion (growth of 7.8 percent) last year. In flows term, loan for commodity finance increased from Rs 49.9 billion in FY2017 to Rs 133.2 billion during FY2018.

During the period 01 Jul-26 Apr, FY2019 loans for commodity finance observed a net retirement of Rs 166.7 billion compared to the net retirement of Rs 40.9 billion during the same period of last year. The outstanding stock of commodity financing stood at Rs 652.9 billion as compared to Rs 645.6 billion last year.



Loans for wheat financing witnessed a net retirement of Rs 174.1 billion during the period 01 Jul-31 Mar, FY2019 compared with the retirement of Rs 55.4 billion in the comparable period of last year. The outstanding stock of wheat increased to Rs 553.24 billion compared with Rs 536.8 billion in the same period of last year.

The fertilizer financing observed net borrowing of Rs 5.1 billion during 01 Jul-31 Mar, FY2019 compared to the retirement of Rs 1.4 billion in the corresponding period of last year. Whereas, financing for sugar sector stood at Rs 2.75 billion against retirement of Rs 1.8 billion in the same period of last year.

Retirement of wheat loans are the sole contributor for net contraction in loans for commodity finance, whereas other commodities witnessed net borrowing during the period under review. Momentous increase in wheat loans retirement was due to significant offloading of wheat stocks to international markets on the back of recovery in global prices[2].

Credit to Private Sector3

Sufficient liquidity in interbank market with low and stable WALR remained instrumental for private sector credit cycle during FY 2018 as it touched to 8 years high credit to GDP ratio to 17.3 percent in FY2018. Private sector credit increased to Rs 775.5 billion in FY2018 compared with Rs 747.9 billion in FY2017. Significant increase in credit demand primarily stemmed from increase economic activities and industrial expansion requirement. Financing requirement for fixed investment grew but at slower pace. Credit demand for fixed investment reached to Rs 227.9 billion in FY2018 against Rs 253.0 billion in FY2017. Textile, sugar, cement and power sectors availed fixed investment loans

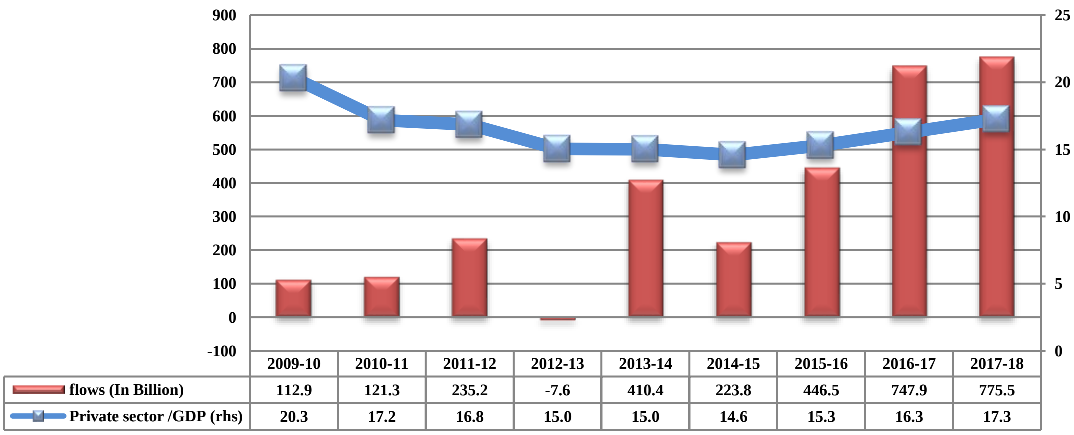
[2]Wheat price has been increased from $166.6/mt in 2016 to $205.8/mt in March 2019.

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

due to unchanged end users mark-up Long Term Financing Facility Rate (LTFF) and Export Finance Scheme Rate (EFS) during FY2018 despite increase in policy rate[4]. Working capital credit amounted to Rs 471.7 billion compared to Rs 367.4 billion during FY2017. Manufacturing sector remained the active borrower for working capital requirement.

During the period 01 Jul-26 Apr, FY2019, flows of private sector credit has seen expansion of Rs 580.9 billion compared with Rs 498.5 billion during same period last year, witnessing average growth of 9.7 percent during the period under review against 9.6 percent last year. YoY CPS growth increased to 15.1 percent as on 26th April, FY2019 against 14.7 percent during same period of last year.

Fig-5.5: Credit to Private Sector



Sectoral Analysis

Table-5.3: Credit to Private Sector — Rs Billion

Sectors	End Month Stocks				Jul-Mar (Flows)		Average (Jul-Mar) Growth Rates		YoY Growth	
	June-17	March-18	June-18	March-19	2017-18	2018-19	2017-18	2018-19	Jun-18	Mar-19
Overall Credit (1 to 5)	**4,728.9**	**5,188.8**	**5,481.9**	**6,069.8**	**459.9**	**587.8**	**9.7**	**10.7**	**15.9**	**17.0**
1. Loans to Private Sector Business	**3,936.8**	**4,337.9**	**4,594.7**	**5,149.4**	**401.1**	**554.7**	**10.2**	**12.1**	**16.7**	**18.7**
A. Agriculture	297.5	303.8	305.5	295.8	6.3	-9.7	2.1	-3.2	2.7	-2.6
B. Mining and Quarrying	40.3	46.5	42.7	55.3	6.2	12.6	15.4	29.4	6.1	19.0
C. Manufacturing	2,287.9	2,532.2	2,707.6	3,159.6	244.3	452.0	10.7	16.7	18.3	24.8
Textiles	689.1	807.7	807.0	980.8	118.6	173.9	17.2	21.5	17.1	21.4
D. Electricity, gas and water supply	352.4	402.4	399.5	458.7	50.0	59.1	14.2	14.8	13.4	14.0
E. Construction	136.8	150.6	164.4	152.6	13.8	-11.8	10.1	-7.1	20.2	1.3
F. Commerce and Trade	307.9	346.7	377.0	434.1	38.8	57.1	12.6	15.2	22.4	25.2
G. Transport, storage and communications	210.8	230.5	234.2	230.9	19.7	-3.2	9.3	-1.4	11.1	0.2
I. Other private business n.e.c	54.5	44.6	45.0	49.9	-9.9	5.0	-18.2	11.0	-17.5	12.0
2. Trust Funds and NPOs	**16.8**	**18.0**	**19.3**	**18.0**	**1.1**	**-1.3**	**6.6**	**-6.7**	**14.6**	**0.4**
3. Personal	**504.5**	**574.7**	**606.2**	**655.7**	**70.2**	**49.5**	**13.9**	**8.2**	**20.2**	**14.1**
4. Others	**6.2**	**2.4**	**4.0**	**5.0**	**-3.8**	**1.0**	**-61.8**	**24.5**	**-35.1**	**111.6**
5. Investment in Security & Shares of Private Sector	**264.6**	**255.8**	**257.7**	**241.6**	**-8.7**	**-16.0**	**-3.3**	**-6.2**	**-2.6**	**-5.5**

Source: State Bank of Pakistan

[4]End-user rate for (LTFF) was 6 percent (5 percent for textile) while for (EFS) it was 3 percent during FY18, SBP.

During Jul-Mar, FY2019 overall credit posted growth of 10.7 percent compared to 9.7 percent during corresponding period of last year. Loans to private sector businesses grew by 12.1 percent during first nine month of CFY against 10.2 percent during comparable period of last year.

Private Sector Businesses (PSBs), received 94.4 percent of CPS amounted to Rs 554.7 billion during Jul-Mar FY2019 against Rs 401.1 billion (87 percent of CPS) during same period of last year. Sectors which posted the higher credit expansion include Mining and Quarrying grew by (29.4 percent), followed by Manufacturing (16.7 percent) of which textile (21.5 percent), Commerce and trade (15.2 percent) and Electricity, Gas and Water Supply (14.8 percent). Sectors which remained the major beneficiaries of PSBs during first nine months of CFY include Manufacturing sector which received share of 81.5 percent (Rs 452.0 billion), followed by textile (31.3 percent or Rs 173.9 billion), Electricity, Gas and Water supply (10.7 percent or Rs 59.1 billion) and Commerce and Trade (10.3 percent or Rs 57.1 billion).

Table 5.4: Loans* to Private Sector Businesses — **Billion Rupees**

Description	Total credit		Working capital		Fixed investment		Trade financing	
	(Jul-Mar) FY18	(Jul-Mar) FY19	(Jul-Mar) FY18	(Jul-Mar) FY19	(Jul-Mar) FY18	(Jul-Mar) FY19	(Jul-Mar) FY18	(Jul-Mar) FY19
Total loans to private businesses	401.1	554.7	215.3	369.0	148.1	83.1	37.7	102.5
of which								
1) Manufacturing	244.3	452.0	123.4	290.8	83.0	51.6	38.0	109.6
i) Textiles	118.6	173.9	73.7	101.8	29.2	19.0	15.8	53.1
Spinning, weaving and finishing	104.8	147.9	69.9	93.1	30.7	13.5	4.2	41.3
ii) Chemicals	(55.9)	21.1	(33.9)	16.0	(11.8)	(0.1)	(10.2)	5.1
Fertilizer	(69.2)	3.5	(47.4)	7.7	(14.0)	(6.4)	(7.7)	2.2
iii) Food products & beverages	64.2	95.0	4.7	54.5	35.5	12.3	23.9	28.2
Rice processing	31.1	41.4	22.8	30.4	0.8	0.1	7.5	11.0
Edible oil and ghee	16.3	19.4	11.7	15.3	2.4	(3.2)	2.3	7.3
Sugar	25.2	34.9	7.3	9.0	11.2	14.1	6.7	11.9
iv) Basic and fabricated metal	15.7	22.1	17.4	18.1	(2.5)	2.6	0.8	1.4
v) Rubber, plastics and paper	4.1	3.9	3.6	2.2	(1.2)	(2.3)	1.7	3.9
vi) Electrical equipment	28.2	(0.4)	25.2	0.5	2.6	1.0	0.3	(1.9)
vii) Cement	35.9	33.4	10.0	4.7	24.2	20.8	1.7	8.0
2) Electricity, gas & water supply	50.0	59.1	49.5	15.8	(1.1)	48.2	1.5	(5.0)
3) Transport, storage & communications	19.7	(3.2)	(0.4)	8.7	21.5	(16.7)	(1.4)	4.8
Road transport	4.3	(3.9)	(0.7)	0.1	5.0	(4.1)	(0.0)	(0.0)
4) Construction	13.8	(11.8)	8.4	9.2	5.4	(20.7)	0.0	(0.3)
Road infrastructure	(1.9)	(0.1)	(0.6)	3.2	(1.3)	(3.6)	0.0	0.3
5) Real estate activities	24.9	22.1	9.4	12.6	13.7	9.6	1.8	(0.1)
6) Agriculture	6.3	(9.7)	0.8	(1.5)	6.5	(9.2)	(1.0)	1.0

*: Loans include advances plus bills purchased & discounted excluding foreign bills.

Source: State Bank of Pakistan

By type of finance, total loans to private sector businesses increased from Rs 401.1 billion to Rs 554.7 billion during Jul-Mar, FY2019. Of which working capital credit received share of 66.5 percent of total private businesses loans to Rs 369.0 billion against Rs 215.3 billion in the same period of last year. Strong credit demand for working capital stemmed from manufacturing sector of which major contributors are textiles, food products & beverages, rice processing, refined petroleum, edible oil and ghee, fertilizer and motor vehicles manufacturers. Export oriented industries of textile and basmati rice availed higher credit due to higher raw material prices amid currency depreciation. Furthermore, firms expand their input purchases required to meet strong domestic and exports demand to EU. Significant increase in global crude oil prices also impacted on working capital financing.

Automobile sector's working capital increased largely owing to higher cost of components and accessories due to exchange rate depreciation, imposition of regulatory duties as well as cash margin requirements on the import of completely- and semi-knocked down units[5].

Fertilizer sector borrowed Rs 7.7 billion for working capital compared to the retirement of Rs 47.4 billion in the same period last year. Significant increase in fertilizer sector loans is due to revival in production and high input cost during the period under review.

Loans for fixed investment decelerated to Rs 83.1 billion during Jul-Mar FY2019 compared to Rs 148.1 billion during the same period last year. Manufacturing related sectors include textile, food product and beverages, electrical equipment and cement alongwith electricity, gas and water supply and real estate activities continued to increase their long term borrowing during the period under review. On the contrary, transport, storage and communication, construction and agriculture sector retired their long term loans during the period under review.

Table 5.5: Consumer Financing **Rs Billion**

	July-March (Flows)		Growth (%)	
Description	**2017-18**	**2018-19**	**2017-18**	**2018-19**
Consumer Financing	57.2	43.0	14.7	9.0
1) For house building	15.1	8.3	24.9	10.0
2) For transport i.e. purchase of car	34.6	17.7	23.0	9.1
3) Credit cards	4.7	4.0	15.7	10.6
4) Consumers durable	1.0	3.2	56.9	116.9
5) Personal loans	1.8	9.8	1.2	6.1
6) Other	6.8	1.5	165.0	19.7

Source: State Bank of Pakistan

Consumer financing credit demand contained to Rs 43.0 billion during Jul-Mar FY2019 (growth of 9.0 percent) compared to Rs 57.2 billion (growth of 14.7 billion) during same period of last year. Loans for auto financing usually had highest share in consumer loans decelerated to Rs 17.7 billion during the period under review against Rs 34.6 billion in the comparable period of last year. Similarly, the pace of house building loans slow down and stood at Rs 8.3 billion compared to Rs 15.1 billion in the comparable period of last year. Decelerated financing in house building and auto sector was observed due to government policies of banning on non-filers for purchase/registration on these two sectors through Finance Act, 2018. The restriction was relaxed to locally manufactured motor vehicle having engine capacity not exceeding 1,300 cc through finance supplementary (second Amendment) Bill, 2019.

On the contrary, personal loans increased by Rs 9.8 billion compared to Rs 1.8 billion during same period last year. Expansion in personal loans significantly outpaced the deceleration impact of auto and housing financing on overall consumer financing.

Monetary Assets

Monetary asset (M2) includes currency in circulation, demand deposits, time deposits and resident's foreign currency deposits. Money supply witnessed a growth of 3.9 percent during 01 Jul-26 Apr, FY2019 compared to 4.13 percent during same period last year. On YoY basis, it posted growth of 9.5 percent as on 26th April 2019.

Currency in Circulation (CIC)

CIC has seen expansion of Rs 389.5 billion (growth of 8.9 percent) during 01 Jul-26 Apr, FY2019 against Rs 279.0 billion (growth of 7.1 percent) during corresponding period of last year. Currency-

[5] Second Quarterly Report FY2019, SBP

to-M2 ratio increased to 28.7 percent as on 26th April 2019 against 27.6 percent in the same period last year.

Table 5.6: Monetary Aggregates **Rs Million**

Items	End June		26 April	
	2017	2018	2017-18	2018-19
A. Currency in Circulation	3,911,315	4,387,828	4,190,278	4,777,295
Deposit of which:				
B. Other Deposits with SBP	22,692	26,962	23,732	34,101
C. Total Demand &Time Deposits incl. RFCDs	10,646,875	11,582,372	10,968,673	11,811,023
of which RFCDs	655,340	829,355	768,196	938,268
Monetary Assets Stock (M2) A+B+C	14,580,882	15,997,162	15,182,684	16,622,420
Memorandum Items				
Currency/Money Ratio	26.8	27.4	27.6	28.7
Other Deposits/Money ratio	0.2	0.2	0.2	0.2
Total Deposits/Money ratio	73.0	72.4	72.2	71.1
RFCD/Money ratio	4.5	5.2	5.1	5.6
Income Velocity of Money	2.3	2.3	-	-

Source: State Bank of Pakistan

Deposits

During the period 01 Jul-26 Apr, FY2019 bank deposits (including demand, time and Resident Foreign Currency Deposits (RFCD) increased to Rs 228.7 billion (growth of 2.0 percent) compared with Rs 321.8 billion (growth of 3.0 percent) during the same period last year. Of which, RFCD amounted to Rs 108.9 billion during the period under review compared to Rs 112.9 billion during the comparable period last year. This expansion in banks deposits supports the interbank liquidity.

Table 5.7: Average Outstanding Open Market Operations[1] **Rs Billion**

	FY16	FY17	FY18	FY19*
Full Year	**1,268.9**	**1,045.8**	**1,228.7**	**136.5**
Q1	1,082.9	1,094.0	1,440.9	1,035.2
Q2	1,287.6	861.3	1,530.5	(257.6)
Q3	1,323.8	961.1	1,123.5	(641.2)
Q4	1,383.3	1,267.2	813.1	-

1: The data does not include the impact of outright OMOs.
*: Updated up to End-March 2018
Note: (+) amount means net Injections.(-) amount means net mop-up.

Monetary Management

Net liquidity conditions remained comfortable during first quarter of CFY and net injections increase to Rs 1.04 trillion compared with Rs 1.4 trillion during same period last year. In fact, government retired Rs 1.4 trillion to scheduled banks on account of sizable amount of government's paper maturity during the period under review. Excess liquidity and stable WALR reflects in healthy flows of private sector credit.

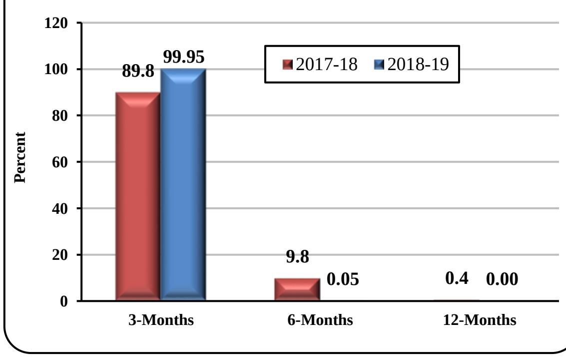
This trend continued during second and third quarter of this fiscal year. The government retired to scheduled banks which more than offset the liquidity requirement derived from both private sector and public sector enterprises. SBP continued with OMOs net absorption to keep the weighted average overnights rate close to policy rate. Accordingly, average outstanding OMOs remained negative by Rs 257.6 billion and Rs 641.2 billion (net absorption) during second and third quarter, respectively against net injection of Rs 1.5 trillion and Rs 1.1 trillion respectively, during the comparable period last year.

Table 5.8: Market Treasury bills Auctions										Rs Million
	Jul-Jun			Jul-Mar						
	2017-18			Offered		Accepted		W.A.Rate*		
	Offered	Accepted	W.A Rate*	2017-18	2018-19	2017-18	2018-19	2017-18	2018-19	
3-Months	19,826,420	16,231,950	6.4	13,339,720	14,960,868	10,976,213	13,802,533	6.1	8.7	
6-Months	1,620,207	1,271,001	6.4	1,371,631	111,444	1,198,292	6,527	6.0	9.2	
12-Months	86,406	47,687	6.0	86,054	8,870	47,687	0	6.0	0.0	
Total	**21,533,033**	**17,550,638**		**14,797,405**	**15,081,182**	**12,222,192**	**13,809,060**			

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

During Jul-Mar, FY2019 market offered the total amount of Rs. 15,081.182 billion for T-Bills against Rs. 14,797.405 billion in the comparable period last year. In the T-bill's auction during current fiscal year, so far, the government has raised Rs 13,809.060 billion (91.6 percent of the offered amount) compared to last year accepted amount of Rs 12,222.2 billion (82.6 percent of offered amount). During the first nine months of current fiscal year, T-bills accounted 99.95 percent of the total accepted amount in 3 months followed by 0.05 percent in 06-months.

Fig-5.6: Contribution of T-bills



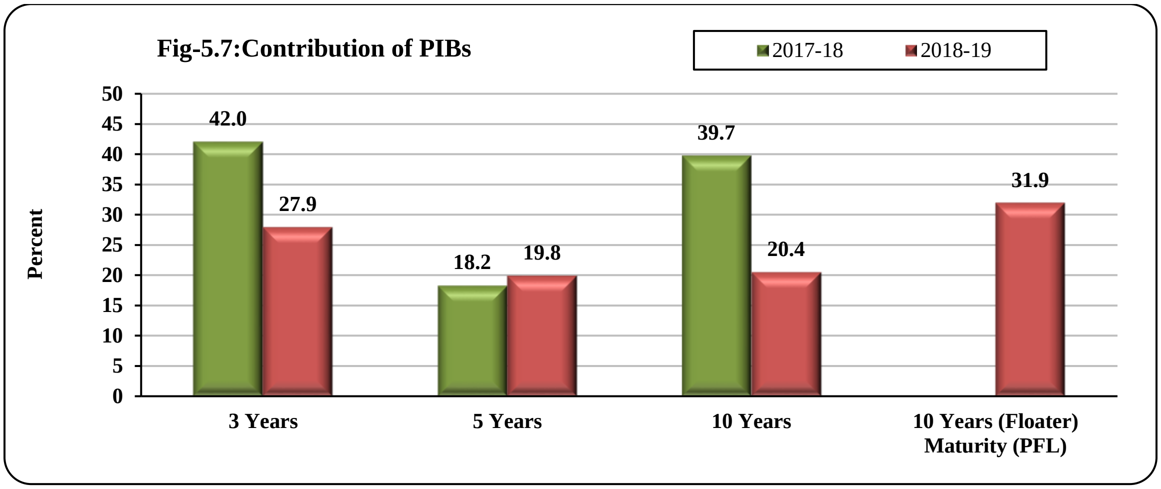
Almost the entire amount of Rs 13.8 trillion T-Bills comprised 3 months papers reflects the banks expectations of further policy rate hike in short run.

Market offered total amount of Rs.1.6 trillion during Jul-Mar, FY2019 under PIB auctions as compared to Rs. 218.8 billion in the same period last year. However, fixed rate PIBS accepted amount stood at Rs 441.0 billion against offered amount of Rs 1,123.1 billion. Fixed rate PIBs witnessed heavy investment in 3 years as it contributed 41 percent of accepted amount followed by 30 percent in 10 years and 29 percent in 5 years. On the other hand, floating rate PIBS accepted amount remained at Rs 206.4 billion under 10 years maturity or 43.2 percent of Rs 477.6 billion offered amount. Importantly, banks' bidding pattern in this auction clearly indicated that despite a 500 bps increase in policy rates between January 2018 and March 2019, medium term expectations regarding inflation and interest rates were quite entrenched[6].

Table 5.9: Pakistan Investment Bonds Auctions									Rs Million
PIBs	**July-June**			**Jul-Mar**				**W.A Rate**	
	Offered	**Accepted**	**W.A Rate**	**Offered**		**Accepted**			
	2017-18			**2017-18**	**2018-19**	**2017-18**	**2018-19**	**2017-18**	**2018-19**
3 Years	235,367	37,915	6.9	157,928	520,617	23,376	180,322	6.4	12.1
5 Years	48,467	14,932	7.7	24,085	268,914	10,150	128,451	6.9	11.0
10 Years	65,101	48,885	8.3	36,761	328,538	22,095	132,237	7.9	13.0
10 Years (Floater) Maturity (PFL)*	-	-	-	-	477,574	-	206,434	-	Benchmark + 70 bps
15 Years	-	-	-	-	-	-	-	-	-
20 Years	-	-	-	-	5,000	-	-	-	-
30 Years	-	-	-	-	-	-	-	-	-
Total	**348,935**	**101,732**		**218,774**	**1,600,643**	**55,621**	**647,443**		

*: The benchmark for coupon rate is defined in clause 'B' of DMMD Circular No. 9 dated May 07, 2018.
Note: Accepted amount include non-competitive bids as well as short sell accommodation.
Source: State Bank of Pakistan

[6]Second quarterly Report, FY2019 SBP

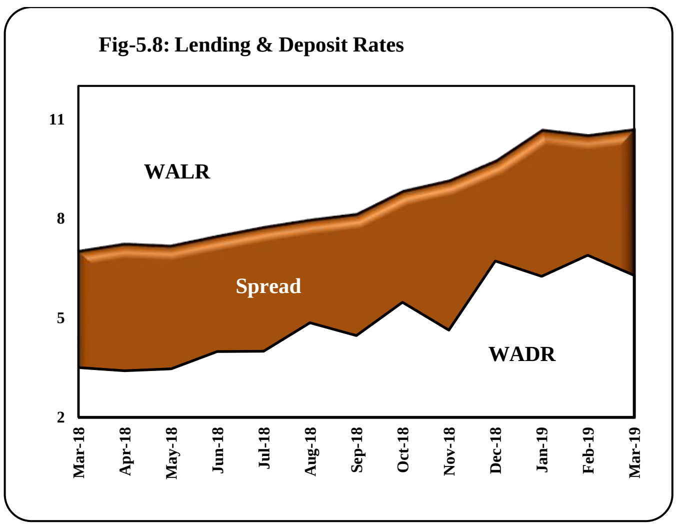


Following an increase in policy rate, WALR on gross disbursements also increased from 7.00 percent in March 2018 to 10.7 percent in March 2019. Similarly, Weighted Average Deposit Rate (WADR) offered on fresh deposits also increased from 3.5 percent in March 2018 to 6.3 percent in March 2019. Resultantly, banking spread which is the difference between the lending and deposit rates increased to 4.4 percent in March 2019 from 3.5 percent in March 2018. Easy liquidity conditions in the interbank market did not allow a complete transmission of the policy rate hike on the WALR helped the private sector maintained its borrowing momentum during the period under review.

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

	LR	DR	Spread
Mar-18	7.0	3.5	3.5
Apr-18	7.2	3.4	3.8
May-18	7.2	3.5	3.7
Jun-18	7.5	4.0	3.5
Jul-18	7.7	4.0	3.7
Aug-18	7.9	4.9	3.1
Sep-18	8.1	4.5	3.7
Oct-18	8.8	5.5	3.33
Nov-18	9.1	4.6	4.5
Dec-18	9.7	6.7	3.0
Jan-19	10.7	6.3	4.4
Feb-19	10.5	6.9	3.6
Mar-19	10.7	6.3	4.4

Source: State Bank of Pakistan



Similarly, the average lending rate on outstanding loans also increased to 10.69 in March 2019 from 7.6 percent recorded in March 2018. The average deposit rate increased from 2.95 percent in March 2018 to 5.01 percent in March 2019.

Financial Sector

During FY2019, finance and insurance sector posted growth of 5.14 percent. The banking sector has performed well despite some challenges during the CY18. Asset growth of banking sector moderated to 7.3 percent in CY18 compared with 15.9 percent in CY17. This deceleration is primarily stemmed from negative growth in net-investment (mainly in govt. securities) by 9.3 percent due to shift in government's borrowing from commercial banks to SBP. On the contrary, the net-advances registered a healthy and broad-based growth of 22.1 percent during CY18 (18.4 percent in CY17).

The key thrust came from the textile, energy, chemical and food sectors as well as individuals. The deposits, with a growth of 9.6 percent, provided the main funding support to the asset expansion. The deposit growth was mainly contributed by relatively more stable Current Account – Saving Account (CASA) deposits.

The asset quality has also improved further with Non-Performing Loans (NPLs) to Advances ratio sliding to 8.0 percent as of end December 2018 (8.4 percent in CY17). Prudent risk-based regulations have also helped the banking sector to maintain a strong solvency profile. Capital Adequacy Ratio (CAR) improved to 16.2 percent as of end December-2018; well above the minimum required level of 11.90 percent and global benchmark of 10.5 percent.

Table 5.11: Highlights of the Banking Sector Industry

	CY14	CY15	CY16	CY17	CY18
Key Variables (Rs. billion)					
Total Assets	12,106	14,143	15,831	18,342	19,682
Investments (net)	5,310	6,881	7,509	8,729	7,914
Advances (net)	4,447	4,816	5,499	6,513	7,955
Deposits	9,230	10,389	11,798	13,012	14,254
Equity	1,207	1,323	1,353	1,381	1,406
Profit Before Tax (ytd)	247	329	314	267	243
Profit After Tax (ytd)	163	199	190	158	150
Non-Performing Loans	605	605	605	593	680
Non-Performing Loans (net)	122	91	90	76	110
Key FSIs (Percent)					
NPLs to Loans (Gross)	12.3	11.4	10.1	8.4	8
Net NPLs to Net Loans	2.7	1.9	1.6	1.2	1.4
Net NPLs to Capital	10.1	7.7	7.3	5.8	7.8
Provision to NPL	79.8	84.9	85.0	87.2	83.8
ROA (Before Tax)	2.2	2.5	2.1	1.6	1.3
Capital Adequacy Ratio (all banks)	17.1	17.3	16.2	15.8	16.2
Advances to Deposit Ratio	48.2	46.4	46.6	50.1	55.8

Source: State Bank of Pakistan

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

Financial Development

A well-functioning financial system is considered as one of the key foundations for sustainable economic development. Many empirical studies indicate that there is a long-run positive relationship between financial development and economic growth. Financial depth or deepening can be measured through many proxies, but M2-to-GDP ratio is considered as the most comprehensive and commonly used measure. Increasing M2/GDP ratio mainly indicates more developed and efficient financial sector.

Table 5.12: Financial Depth

Years	M2/GDP
2009-10	38.9
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
26th April	
2017-18	43.9
2018-19	39.4

Source: EA Wing Calculation, Finance Division

This ratio is gradually increasing in Pakistan since FY2012 and reached at 46.2 percent in FY2018 as compared 38.1 percent in FY2012 on account of SBP financial sector reforms. Whereas, monetary assets/GDP ratio stood at 39.4 percent as on 26th April, 2019 against 43.9 percent last year.

State Bank of Pakistan (SBP) continued to strengthen its regulatory and supervisory regime during the FY2019. Further, SBP continued to align its regulatory and supervisory structure with the international best practices to strength the financial depth.

Box-I: Financial Reforms

During July-March FY2019, various regulatory and policy reforms were undertaken by SBP have been highlighted: -

- **Strengthening of Regulatory and Supervisory Environment**

  A conducive regulatory and supervisory environment is essential for the development of financial industry and overall financial stability. SBP remains committed to ensuring up to date regulatory and policy settings. In this regard, the key reforms introduced by SBP are given below:

- **Regulatory Reforms**

1. SBP has initiated various regulatory changes to align Anti Money laundering (AML) and Combating the Financing of Terrorism (CFT) regulations with the Financial Action Task Force (FATF) recommendations. The following measures were taken in this regard:

- SBP advised all banks/DFIs to conduct biometric verification of all existing accounts till 30th June 2019. Further, it has been reiterated that banks/DFIs must ensure strict observance of all applicable instructions including identification and verification of customers and their beneficial owner(s) and obtain information on the purpose and intended nature of business relationship[7].
- SBP has made various amendments in the existing AML/CFT regulations to cover potential risk areas. These amendments will ensure better understanding for implementation of AML/CFT requirements by banks/ DFIs in areas, including customer due diligence (CDD), correspondent banking, wire transfers/ funds transfers and minimum documents required for opening of accounts by the customers. Further, the existing Prudential Regulations on AML/CFT for MFBs were also strengthened.
- In terms of changes made in Fit & Proper Test (FPT) criteria, bank's sponsor shareholders/beneficial owners, directors, presidents and key executives (appointments subject to FPT) would stand disqualified if they are designated/proscribed or associated directly or indirectly with designated/proscribed entities/persons under United Nations Security Council Resolution or Anti-Terrorism Act 1997.
- In order to ensure strict compliance of Statutory Regulatory Orders (SROs) and Notifications issued by the Government of Pakistan under the United Nations (Security Council) Act, 1948 and the Anti-Terrorism Act (ATA), 1997, detailed guidelines for Exchange Companies were issued on Targeted Financial Sanctions (TFS).

2. SBP has issued a comprehensive Governance Framework for Bank's overseas operations in 2018. The framework will be helpful for the improvement in governance structure and risk management in the overseas operations of banks.

3. To promote mortgage financing, Pakistan Mortgage Refinance Company (PMRC) commenced its operations in 2018. To facilitate mobilization of low cost housing finance in Pakistan, all banks, MFBs and DFIs have been exempted from maintenance of Cash Reserve Requirements (CRR) and Statutory Liquidity Requirements (SLR) on funds borrowed from PMRC[8].

4. Following improvements have been made in the **foreign exchange regime**:

   - Keeping in view the changing dynamics of the foreign exchange market, SBP has revised the Foreign Exchange (FE) Manual in consultation with different stakeholders. The revisions were introduced in areas related to instructions regarding Authorized Dealers, Foreign Currency Loans, Overdrafts and Guarantees, Forward Exchange Facilities etc.
   - The facility allowed the importers to make advance payments for imports against letters of credit and invoices which was withdrawn in July 2018. However, the Authorized Dealers (Banks) were allowed to approach SBP for special permission on case to case basis where the matter merits consideration. Moreover, SBP relaxed the above restrictions and allowed import advance payments up to USD 50,000 for import of life saving medicines and devices.

[7] BPRD Circular Letter No.18 of 2018
[8] DMMD Circular No. 08 & No. 09 of 2019

- Subsequently, on the basis of recommendation of Ministry of Commerce and in light of requests received from various industry stakeholders, SBP has further relaxed the import advance payment restrictions and has allowed the Authorized Dealers (Banks) to effect advance payments up to USD 10,000 per invoice on behalf of importers cum exporters for import of raw materials, accessories and spares.
- In order to ensure that all outlets of Exchange Companies and Exchange Companies of 'B' Category carry out business activities as per their terms of authorization and public is also made aware of the same, all Exchange Companies were advised to display signboards, stating their names and type of outlet i.e. Head Office, Branch, Franchise, Payment Booth, Currency Exchange Booth etc. Moreover, to ensure efficient and transparent services to customers, instructions have been issued to display updated and detailed Schedule of Charges in their outlets.

➢ **Supervisory Reforms**

- Branchless banking (BB) has emerged as a significant part of the wider banking system. Considering its increasing importance in the banking system, relevant inspection framework has been devised to improve supervision effectiveness and identification of risks.
- SBP has made strides in development of Risk Based Supervision (RBS) framework. Under the umbrella of RBS, a comprehensive assessment of IT systems of the supervised financial institutions, Information Systems' Inspection Framework (ISIF) was developed. Moreover, for institutional capacity building, SBP has entered in a Long Term Country Engagement Program (LTCE) with Toronto Centre (TC), Canada from July 2018- December 2020.

➢ **Reinforcing Measures for Financial Stability and Systemic Risk Assessment**

- Strengthening Institutional Framework: SBP has established a Financial Stability Executive Committee (FSEC) to discuss financial stability developments and consider formulating policy responses to address relevant issues. In addition, a proposal for creation of a National Financial Stability Council comprising of SBP, SECP and Ministry of Finance is also under consideration.
- Systemically important banks are critical for financial stability & overall economy. Owing to their large-scale interconnectedness, their failure can result in heavy losses to the real economy. SBP introduced the Framework for Domestic Systemically Important Banks (D-SIBs) in Pakistan in April 2018, for enhanced regulation and supervision, consistent with international standards and practices and dynamics of the domestic financial sector. Based on the designation criteria outlined in the framework, SBP has designated Habib Bank Limited (HBL), National Bank of Pakistan (NBP) and United Bank Limited (UBL) as D-SIBs. These banks are required to meet enhanced supervisory and regulatory requirements, including the Higher Loss Absorbency Capital surcharge in the form of additional core equity tier-1 capital (CET1) ranging from 1.5-2%.[9]
- To operationalize the working of deposit protection and to promote consumer's confidence in the banking system, the Deposit Protection Corporation (DPC) rolled out a deposit protection mechanism for banking companies (including Islamic Banks) effective from July 01, 2018. The mechanism is in compliance with its statute (DPC Act, 2016) and generally aligned with Core Principles for Effective Deposit Insurance Systems issued by International Association of Deposit Insurers (IADI).The guarantee amount has been determined by the Corporation at Rs. 250,000 per depositor per bank. The protected depositors shall be paid up to the guarantee amount in an unlikely event of a bank failure[10].

➢ **National Financial Inclusion Strategy (NFIS) - Implementation progress:**

- Under NFIS, Pakistan is pursuing a target of ensuring 50% adult population is financially included by 2020 from the level of 23 percent measured under Access to finance Survey 2015, whereas the broader objective remains to achieve universal financial inclusion by promoting digital financial services and increasing priority sector lending like agriculture, SME, Islamic Banking & low cost housing finance.

➢ Following initiatives have been taken for the NFIS implementation:

- Under the NFIS platform, SBP has developed the Asaan Mobile Account (AMA) Scheme, which provides an integrated platform allowing any person with a basic mobile phone to open a digital

[9]The designated D-SIBs will be required to meet enhanced supervisory and regulatory requirements by end of March 2019.
[10] DPC Circular No. 04 of 2018

transaction account swiftly through a Unified Unstructured Supplementary Service Data (USSD) code from anywhere, at any time.

- In order to foster innovations for adoption of digital financial services, an Innovation Challenge Facility (ICF) was launched. The facility aimed to provide support to financial service providers, financial technology providers and institutions to develop new or expand on existing digital financial products, services and delivery platforms that will increase financial access for people living at the bottom of the pyramid. The facility has been widely advertised in leading newspapers to invite proposals. Total 11 proposals were received till December 2018, which have been reviewed by the Evaluation Committee that draws representation from SBP, Pakistan Telecommunication Authority (PTA), Department for International Development (DFID) UK and private sector.

- **NFIS Extended Action Plan 2023:**

Recently, Government of Pakistan has prioritized NFIS as part of its 100 days agenda to achieve inclusive economic growth through enhance access to finance & deposit base, promotion of small & medium enterprises, easy & affordable access to finance to farmers, facilitation in low cost housing finance and provision of Shariah compliant banking solutions.

In this connection, the government has set following headline targets to be achieved by 2023:

- Enhance usage of Digital Payments (65 million active digital transaction accounts, with gender segregation of 20 million accounts by Women)
- Enhance Deposit Base (Deposit to GDP ratio to 55%)
- Promote SME Finance (Extend finance to 700,000 SMEs; 17% of the private sector credit)
- Increase Agricultural Finance (Serve 6 million farmers through digitalized solutions; enhance annual disbursement to Rs.1.8 trillion)
- Enhance share of Islamic Banking (25 percent of the banking industry; increase branches of Islamic banks to 30 percent of the banking industry)

The plan has been developed after comprehensive industry wide consultation and analysis, while specific timelines and responsibilities have been allocated against each target.

Source: State Bank of Pakistan

Islamic Banking

Islamic Banking Industry (IBI) has grown considerably since re-launched in 2001-02. Assets of IBI posted growth of 17.0 percent and stood at Rs 2,658.0 billion in CY18 compared with Rs 2,272.0 billion (growth of 22.6 percent) in CY17. On the other hand, deposits of IBI increased by 16.9 percent and reached to Rs 2,203.0 billion in CY18 against Rs 1,885 billion(19.8 growth) in CY17. Market share of Islamic Banking assets and deposits in the overall banking industry was recorded at 13.5 percent and 15.5 percent, respectively in CY 18 compared with 12.4 and 14.5 percent, respectively in last year.

Table 5.13: Islamic Banking Industry

	CY14	CY15	CY16	CY17	CY18
Total Assets (Rs. Billion)	1,259.0	1,610.0	1,853.0	2,272.0	2,658.0
Total Deposits (Rs billion)	1,070.0	1,375.0	1,573.0	1,885.0	2,203.0
Share in Banks' Assets(Percent)	10.4	11.4	11.7	12.4	13.5
Share in Banks' Deposits (Percent)	11.6	13.2	13.3	14.5	15.5

Source: State Bank of Pakistan

In terms of number of providers, 22 Islamic Banking Institutions (IBIs) (5 full-fledged Islamic banks, 16 conventional and one specialized bank (Zarai Taraqiati Bank Limited) are providing Shariah compliant products and services through their network of 2,851 branches spread across 113 districts of the country. During CY18, 270 branches were added to branch network of Islamic banking industry. Further, Islamic Banking branches operated by conventional banks were recorded at 1,288 by end December 2018.

Investments (net) of IBI reduced by Rs 20 billion (-3.7 percent) during the period under review and recorded at Rs 515 billion by end December 2018 compared to Rs 535 billion in the previous quarter. Financing and related assets (net) of IBI witnessed expansion of Rs 146 billion (10.7 percent) during the last quarter of CY18 and stood at Rs 1,511 billion compared to Rs 1,365 billion in the previous quarter. Of which full-fledged IBs and IBBs of conventional banks registered growth of 11.3 and 9.7 percent, respectively for financing and other related assets.

Profit before tax of IBI was recorded at Rs. 34 billion by end December 2018 against Rs. 23 billion in the same quarter last year. Profitability ratios like return on assets and return on equity (before tax) were recorded at 1.4 percent and 22.3 percent, respectively by end December 2018 compared to 1.1 and 17.1 percent, respectively during the same period last year.

In terms of mode wise financing breakup, the share of Diminishing Musharaka remained highest in overall financing of IBI followed by Musharaka and Murabaha.

Table 5.14: Financing Products by Islamic banks

Percent Share

Mode of Financing	CY14	CY15	CY16	CY17	CY18
Murabaha	30.1	24.5	15.8	13.2	13.6
Ijara	7.7	6.6	6.8	6.4	6.2
Musharaka	11	14	15.6	22	19.9
Mudaraba	0.1	0	0	0	0
Diminishing Muskaraka	32.6	31.7	34.7	30.7	33.3
Salam	4.5	5.3	4.4	2.8	2.4
Istisna	8.3	8.6	8.4	8.2	9.1
Qarz/Qarz-e-Hasna	0.0	0.0	0.02	0.1	0.0
Others	5.6	9.3	14.3	16.7	15.5
Total	100	100	100	100	100

Source: State Bank of Pakistan

Microfinance

During FY 2019, besides initiatives aimed at enhancing financial inclusion. State Bank provided active guidance to Microfinance Banks (MFBs) to further strengthen their internal controls and deterrence towards Money Laundering, Terrorist Finance and other related unlawful activities.

At the close of quarter ended December 2018, around 44 institutions reported provision of microfinance services. These included eleven deposit taking microfinance banks (MFBs), one Islamic Banking Institution (MCB Islamic Bank while others were Non-Bank Microfinance Companies (NB-MFCs)[11].

On a YoY basis, the sector was able to expand its retail business network to 4,239 adding 566 new business locations as of December 2018 compared to last year. Performance of the microfinance industry is presented in following table, which depicts increasing trend in all major indicators over the period.

Table 5.15: Microfinance Industry Indicators

Indicators	Dec-17	Dec-18	YoY Growth	
			Absolute change	%
Number of Branches	3,673	4,239	566	15.4
Total No. of Borrowers	5,800,457	6,936,554	1,136,097	19.6
Gross Loan Portfolio (Rs billion)	202.70	274.70	72	35.5
Average Loan Balance	48,695	55,173	6,478	13.3

Source: State Bank of Pakistan

At the fall of CY2018 (i.e. 2nd quarter of FY19), eleven MFBs and MCB-Islamic Bank were involved in extending complete range of micro-banking services.

[11] Include specialized microfinance institutions, rural support programs besides organizations running microfinance as a part of their multi-dimensional service offering.

Table 5.16: Microfinance Banking Indicators Rs Billion

Indicators	Mar-18	Mar-19	Growth in (%)
No. of Branches	916	1,087	18.67
Number of Borrowers	2,777,164	3,371,695	21.41
Gross Loan Portfolio	152	201.27	32.70
Deposits	189	236.02	25.10
Number of Depositors	25,492,075	36,111,999	41.66
Equity	36	48.44	35.36
Assets	255.03	325.22	27.52
Borrowings	14.05	19.95	41.98
NPLs	1.80%	3.28%	-

Source: State Bank of Pakistan

Initiatives for Promotion of Microfinance

SBP has allowed MFBs to open accounts of Afghan refugees holding Proof of Registration (PoR) Cards, issued by NADRA as acceptable identity document.

SBP has enhanced the lending limits under 'Housing Finance' for MFBs by increasing the maximum loan size from Rs. 500,000 to Rs. 1,000,000. Moreover, the restriction to maintain 60% of housing portfolio within the loan limit of Rs. 250,000/- is also being removed.

The federal government vide Second Supplementary Finance Bill FY2019, has announced that with effect from 1st July 2019, reduced rate of taxation @ 20% (instead of 35%) on interest income of Banking Companies from additional advances to micro, small and medium enterprises; low cost housing finance and farm credits for four years (from Tax Year 2020 to Tax Year 2023) subject to fulfilment of certain conditions. This would further encourage MFBs to extend credit to priority sectors.

To provide relief to adversely affected borrowers in eight calamity affected districts of Sindh namely Tharparkar, Umer Kot, Sanghar, Thatta, Jamshoro, Dadu. Badin and Kamber Shahdad Kot, microfinance banks were advised to undertake all possible measures in line with Prudential Regulation R-9; 'Rescheduling/Restructuring of Loans.'

Branchless Banking (BB) Performance

All key indicators of Branchless Banking exhibited promising growth during the FY 2019, which shows that the digital channel is gradually paving its way in the previously excluded masses to provide them an easier access to the basic financial services.

Table 5.17: Performance of BB Indicators

Indicators	Mar-18	Mar-19	Growth (in %)
Number of Agents	403,100	408,980	1.5
Number of Accounts	38,507,887	51,809,393	34.5
Deposits (Rs Million)	17,051	30,263	77.5
No. of Transaction (in Thousands)	532,743	842,267	58.1
Value of Transactions (Rs Million)	2,269,482	2,980,743	31.3

Source: State Bank of Pakistan

Conclusion

The overall macroeconomic environment remained challenging towards the end of FY2018. Twin deficits on fiscal and external front, emerging inflationary pressure and excessive aggregate demand contributed challenges for the economy. The government has started homegrown macroeconomic stabilization program. The thrust of stabilization efforts is on monetary and fiscal tightening to control aggregate demand and inflation targeting. This allowed SBP to take a cautionary stance on changing the policy direction by increasing the policy rate by a cumulative 650 bps since January, 2018.

Economy is responding to stabilization measure on external front but near term challenges suggests more macroeconomic adjustments for some time. Efficacy of monetary policy required prudent fiscal management, balance of payment support in coming years.