Chapter 5

Money and Credit

Central banks across the world are responsible for maintaining price stability as their prime objective, along with safeguarding the stability of the financial system. The ultimate objective of an effective monetary policy is low and stable inflation, which is prerequisite for sustainable economic growth. It ensures confidence of the individuals and businesses to make rational economic decisions relating to consumption, saving and investment, which have spillover effect on economic growth and employment opportunities in long run, thus improving overall economic welfare of the country.

The COVID-19 pandemic has created unprecedented recessionary impact on global GDP in 2020. Following the COVID-19 outbreak, central banks around the world have pursued highly accommodative monetary policy to ease financial conditions in order to maintain the flow of credit to households and firms and thus support aggregate demand. At the same time, fiscal authorities provided relief through cash transfers, targeted social safety net programmes and wage subsidies. In response to these timely and unprecedented policy supports, global outlook has improved. After an estimated contraction of 3.3 percent in 2020, the global economy is projected to grow at 6 percent in 2021 before moderating to 4.4 percent in 2022. In sum, the COVID-19 recessionary impact is likely to lower than the 2008 Global Financial Crisis (GFC).

However, the recovery is expected to be unsynchronized and uneven across advanced, emerging market and developing economies. There is a risk that financial conditions in emerging market economies may tighten, especially if policymakers in advanced economies take steps toward policy normalization[1].

The outlook of the appropriate policy stance may vary by country, stage of pandemic, strength of recovery and structural characteristics of an economy. If pandemic continues, policies should first focus on escaping the crisis, prioritizing health care spending, providing well-targeted fiscal support and maintain accommodative monetary policy while monitoring financial stability risks[2]. Then, as the recovery takes hold, policymakers may think about policy normalization, with focus on boosting productive capacity and incentivizing efficient allocation of productive resources.

[1] Global Financial Stability Report, April 2021, IMF
[2] World Economic Outlook, April 2021, IMF

Monetary Policy Stance in Pakistan

In January 2018, State Bank of Pakistan (SBP) has changed its monetary policy stance from accommodative to contractionary to correct the macroeconomic imbalances accumulated during the past years. Policy rate was cumulative increased by 750 bps from 5.75 to 13.25 percent till July 2019. This combined with fiscal consolidation efforts and exchange rate adjustment, helped to contain demand pressures and improve overall country's external position during first eight months of FY2020.

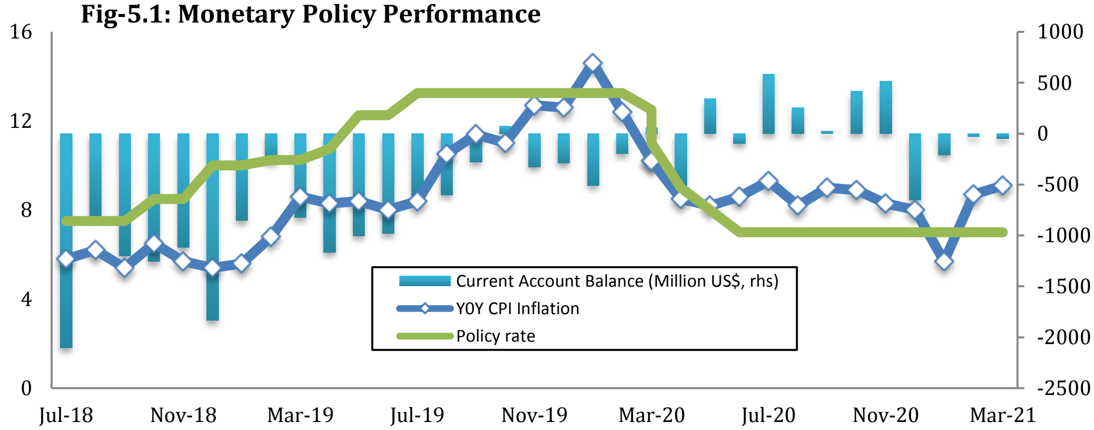
Table-5.1: Policy Rate

w.e.f	Policy rate
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
May-19	12.25
Jul-19	13.25
12/03/2020	12.50
25/03/2020	11.00
16/04/2020	9.00
16/05/2020	8.00
26/06/2020 till date	7.00

Source: State Bank of Pakistan

After COVID-19 outbreak in February 2020, SBP proactively changed its policy stance, reducing the policy rate by a cumulative 625 bps from 13.25 to 7.0 percent, within almost 3 months between March and June 2020, largest policy rate cut among emerging market economies **(Fig - 5.2)**.The emergency monetary policy decisions were supported by significant reduction in inflation momentum and marked slowdown in domestic demand, softening food prices, decades low global oil prices and noticeable decline in inflation expectations. The target of monetary policy was shifted towards supporting growth and employment during the pandemic.

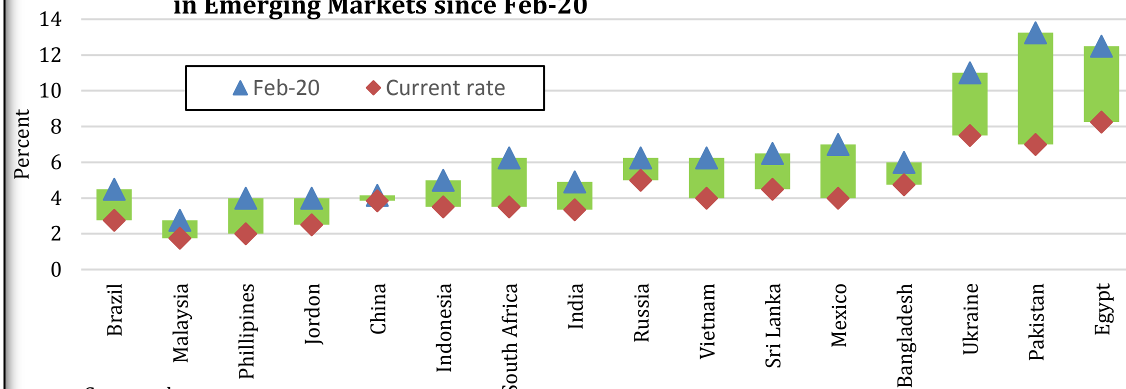
Fig-5.1: Monetary Policy Performance



During FY2021, SBP has continued with accommodative monetary policy stance with 7.0 percent policy rate which supports the economic recovery while keeping inflation expectations under-control and safeguarding financial stability.

Besides sharply lowering of the borrowing cost, SBP introduced a host of measures aimed at supporting the businesses and household during the challenging times. The objective of these time bound, targeted measures was to keep the business afloat and avoid insolvencies, support export oriented industries, incentivise investment and provide uninterrupted financial services (**Box-I**). These measures, along with fiscal stimulus package especially for revival of construction, led to a quick turnaround in economic activity in the country.

Fig-5.2: Monetary Policy Response to COVID-19 in Emerging Markets since Feb-20



Source: cbrates.com

Box-I: SBP's Policy Response during the Coronavirus Pandemic

- The first COVID-19 case was detected in Pakistan on February 26 and by March 19, domestic lockdowns had come into effect; countries across the world were also adopting similar mobility restrictions. At this point, the SBP recognized the acute disruptions in business activity and supply chains, which was severely impacting sales and cash flows of both local and export-oriented firms. These challenges necessitated an immediate and forceful policy response to address the developing liquidity constraints as well as prevent large-scale insolvencies and layoffs.
- To counter the negative fallout of COVID-19 pandemic on the economy, SBP took a number of measures.

Policy Matrix for COVID-19

Purpose	Measure	Brief Summary
Facilitate Healthcare Sector	Refinance Facility to Combat COVID (RFCC)	1. Financing made available by SBP at 0% to banks, with maximum end-user rate of 3 percent, for hospitals to purchase equipment to detect, contain and treat COVID patients. RFCC subsequently expanded to allow purchases to treat non-COVID patients too and for local manufacturers of PPE. Per-party limit=Rs 500 million, 5 year tenor
	Ease in Import Procedures for Medical Equipment	2. Advance payment and open account imports allowed, without any limit, to purchase medical equipment, medicines & related items for COVID-19
Facilitate Exporters	Relaxation under EFS & LTFF Performance & Eligibility Criteria	1. Exporters availing EFS allowed 12 months to export goods, from 6 months. Performance requirement of 2X of credit availed is reduced to 1.5X for FY2020 and FY2021
		2. Eligibility criteria for LTFF reduced from exports worth 50%, or \$5 million, of total sales, to 40% or

		$4 million, from January 1, 2020 to September 30, 2020. Also, the projected exports performance will be measured in 5 years, instead of 4
		3. Eligibility criteria for LTFF was extended to all exporting sectors (in January 2020) and per project limit was doubled to Rs 5 billion. LTFF end-user rate was reduced from 6% to 5% for all sectors
	Extension in realization period of export proceeds	4. Time period for realization of exports proceeds extended from 180 days to 270 days, where the delay is related to COVID-19, for receipts falling due between January - June 2020
	Dispatch of shipping documents by exporters	5. Exporters can directly dispatch shipping documents of consignment to foreign buyers without any limit, subject to some conditions, against earlier limit of consignments of up to $100,000
	Ease in advance payment restrictions for importers	6. Existing limit of $ 10,000 per invoice for advance payment extended to $ 25,000 for manufacturing & industrial concerns and commercial importers for import of raw material, spare parts and machinery
		7. Time period for imports against advance payment extended from 120 days to 210 days
Liquidity Support for Firms & Individuals	Refinance schemes for wage support (Rozgar Scheme) and capital investment (TERF)	1. Rozgar Scheme provided (from April 2020 till September 2020, with disbursements till November 2020) loans at maximum end-user rate of 3% to businesses for wages expenses, provided they commit to not lay off workers
		2. The government introduced a Risk Sharing Facility (RSF) for the Rozgar Scheme, under which it will bear 60% first loss on disbursed portfolio (principal portion only) for SMEs and small corporates (turnover of <Rs 2bn)
		3. TERF provides loans at maximum end user rate of 5% to businesses to purchase locally manufactured or imported machinery for new investment and BMR. Maximum loan size of Rs 5 billion and tenor of 10 years. Scheme valid from March 2020 to March 2021.
	Policy rate cuts	4. The SBP cut the policy rate by a cumulative 625 bps in less than 3 months, during March to May 2020. This led to downward re-pricing of significant amount of loans
	Increase in Loan Limits	5. Limits for housing finance and microenterprise loans from MFBs revised up to Rs 3 million from Rs 1 million and for general loans to Rs 0.35 million from Rs 0.15 million. Annual income eligibility for

		general loans and housing loans increased up to Rs 1.2 million and Rs 1.5 million. Portfolio limit for lending against gold collateral increased to 50% from 35%. Per party limit for SME loans permanently raised to Rs 180 million from Rs 125 million
	Principal Deferments & Loan Rescheduling	6. Banks told to defer principal repayment for up to 1 year of consumer financing for borrowers that request so, w/o charging additional fee or mark-up. Loans for borrowers needing more help were to be restructured
Industry-Specific Support Measures	Construction industry	1. Banks to ensure that housing and construction financing shall be at least 5 percent of their domestic private sector credit by December 2021
	Banking industry	2. Ease in regulations related to housing & consumer finance, capital ratios, margin requirements & booking of capital losses (equities), digital on-boarding of merchants, biometric verification, adoption of IFRS-9

Impact of SBP's major relief measures

	Approved Financing Rs billion	Cumulative position as of
SBP's Rozgar Scheme	238.2	13-Nov-20
Loan Deferrals & Restructuring after COVID Outbreak	910.8	16-Apr-21
Refinance Scheme to Combat COVID (RFCC)	12.6	22-Apr-21
Temporary Economic Relief Facility (TERF)	435.7	31-Mar-21

Source: State Bank of Pakistan

- It is important to note that the SBP's COVID-related support measures are temporary and targeted and their implementation is being closely monitored. The refinance schemes are being implemented through banks and aimed at directly supporting businesses and encouraging capital investments. Microfinance and SME borrowers have also benefitted from these schemes.

Source: State Bank of Pakistan

Recent Monetary and Credit Developments

During the period 01st July-30th April, FY2021 Broad Money (M2) witnessed expansion of Rs 1,664.8 billion (growth of 8.0 percent) against Rs 1,698.1 billion (growth of 9.5 percent) during same period last year. Growth in M2 mainly contributed by Net Foreign Assets (NFA) of banking system. NFA's point contribution stood at 4.5 percent compared to 5.2 percent last year. Whereas, Net Domestic Assets (NDA) point contribution remained 3.4 percent as compared to 4.3 percent in last year.

Table-5.2: Profile of Monetary Indicators			Rs billion
	FY2020 (Stocks)	**30-April-21**	**01-May-20**
Net Foreign Assets(NFA)	-516.2	950.2	931.1
Net Domestic Assets(NDA)	21,424.2	714.6	767.0
Net Government Borrowing	14,547.2	653.0	1,092.2
Borrowing for budgetary support	13,748.3	675.9	1,171.3
From SBP	6,538.8	-1,164.7	-642.2
from Scheduled banks	7,209.5	1,840.6	1,813.4
Credit to Private Sector	6,862.9	454.5	318.5
Credit to PSEs	1,490.5	-26.6	-5.3
Broad Money	20,908.0	1,664.8	1,698.1
Reserve Money	7,679.8	550.4	582.4
Growth in M2 (%)	17.5	8.0	9.5
Reserve Money Growth (%)	16.8	7.2	8.9
Source: Weekly Profile of Monetary Aggregates, State Bank of Pakistan			

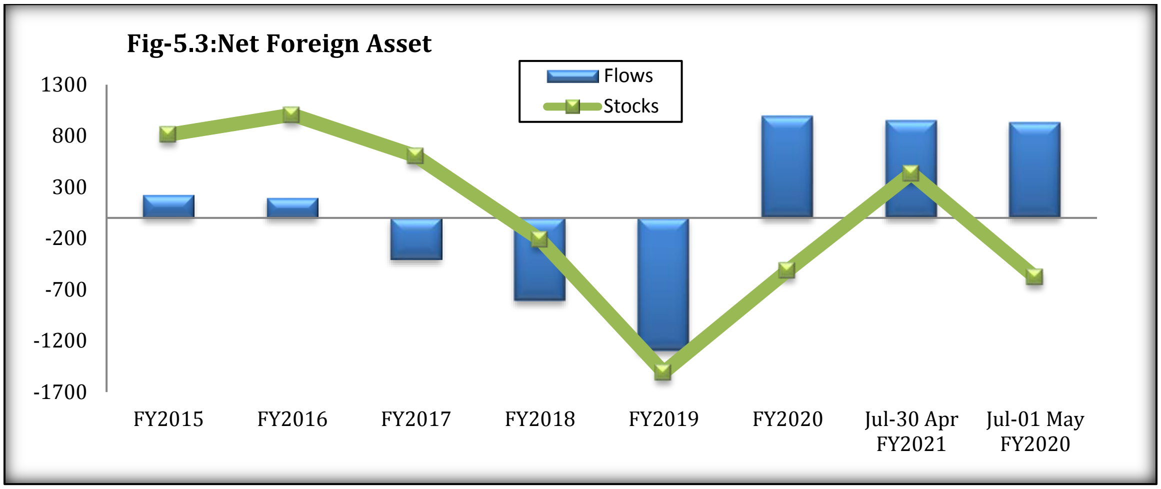
Within Broad Money, the NFA of the banking system increased by Rs 950.2 billion against expansion of Rs 931.1 billion last year, shows improved balance of payment position.

Within NFA, NFA of SBP increased by Rs 782.2 billion against expansion of Rs 966.5 billion last year. The increase in SBP's NFA was mainly on the back of increase in bilateral inflows from China, other multilateral loans and grants, decrease in foreign liabilities and build in Foreign Exchange (FXs) reserves. On the other hand, NFA of scheduled bank witnessed significant expansion of Rs 168.0 billion against contraction of Rs 35.4 billion last year, higher inflows in NFA of banks primarily contributed by surplus in current account balance.

On the other hand, NDA of banking system increased by Rs 714.6 billion compared to expansion of Rs 767.0 billion last year. NDA of SBP decreased by Rs 557.5 billion compared to contraction of Rs 527.5 billion last year, reflect significant retirement by government to SBP under budgetary borrowing. This shows continuation of government adherence to zero borrowing from central bank.

NDA of scheduled banks increased by Rs 1,272.1 billion against expansion of Rs 1,294.5 billion last year, on the back of higher private sector credit offtake from scheduled banks, which more than offset the impact of increase in retirement under commodity operations and other items on the NDA of the banking system.

Reserve Money increased by Rs 550.4 billion (growth of 7.2 percent) during the period under review against Rs 582.4 billion (growth of 8.9 percent) in comparable period last year. Reserve Money growth remained low during CFY on account of decline in SBP's NDA. This was due to budgetary retirement to SBP which more than offset the considerable increase in the SBP' claims on scheduled banks on accounts of refinance schemes.



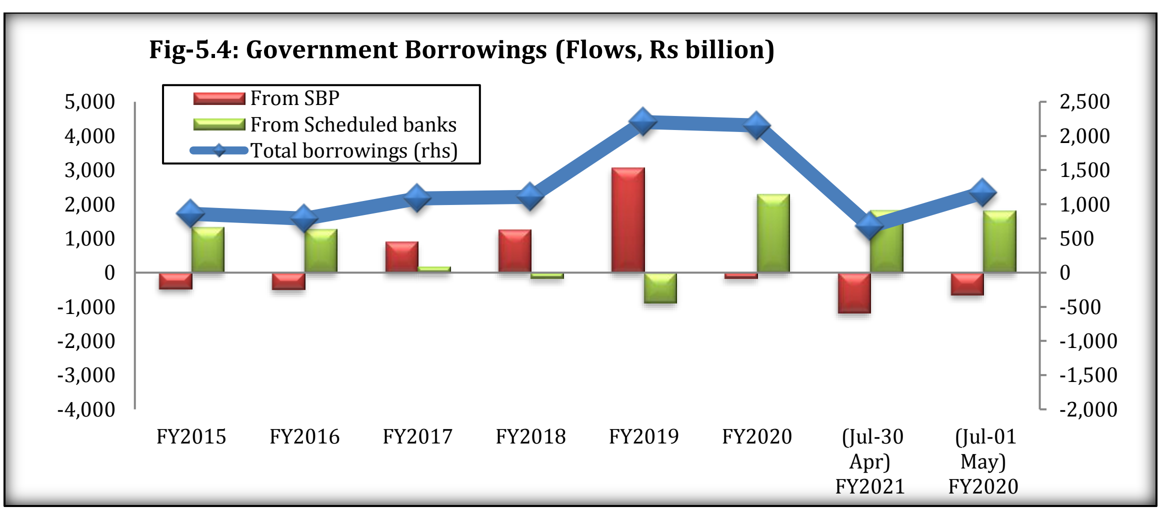
Credit to Public Sector Enterprises (PSEs) observed retirement of Rs 26.6 billion compared to retirement of Rs 5.3 billion during comparable period last year.

Government Bank Borrowing

During the period 01st July-30th April, FY2021 net government sector borrowing stood at Rs 653.0 billion against the borrowing of Rs 1,092.2 billion last year. Government has borrowed Rs 675.9 billion for budgetary support compared to Rs 1,171.3 billion during corresponding period last year.

Within budgetary support, government has retired Rs 1,164.7 billion to SBP as compared retirement of Rs 642.2 billion in the same period last year. On the contrary, government has borrowed Rs 1,840.6 billion from scheduled banks as compared to borrowing of Rs 1,813.4 billion last year. As the government adhered to its commitment of zero fresh borrowing from the central bank and relied on scheduled banks and non-banks for its financing needs.

During July-March, FY2021 Government has financed around 67 percent of fiscal deficit from domestic sources. Within domestic sources, bank and non-bank financing share remained 58 and 42, percent respectively.

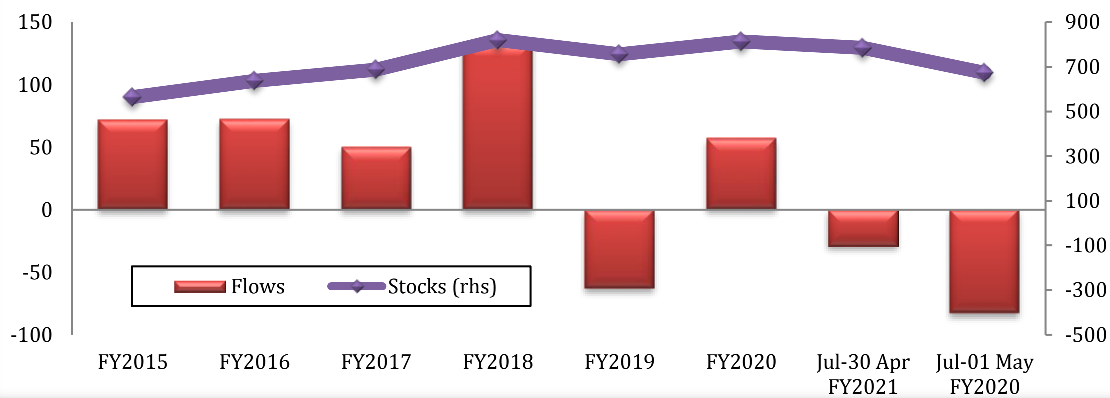


Commodity Finance

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[3]. The proceeds from the sale of such commodities are subsequently used to retire commodity borrowing.

The outstanding stock of commodity finance posted growth of 7.5 percent in FY2020 and reached to Rs 813.4 billion against Rs 756 billion (negative growth of 7.7 percent) last year. In terms of flows, commodity finance observed a net borrowing of Rs 57.0 billion in FY2020 against retirement of Rs 63.3 billion in FY2019. Commodity financing borrowed amount during FY2020 primarily reflected the borrowing of Rs 43.1 billion by wheat procurement agencies from banking system as compared to retirement of Rs 73.1 billion in FY2019.

Fig-5.5: Commodity Finance



During the period 01 July-30th April, FY2021 loans for commodity finance observed a net retirement of Rs 28.8 billion as compared to net retirement of Rs 82.9 billion last year. The outstanding stock of commodity finance stood at Rs 785 billion as on 30th April, FY2021 as compared to Rs 674 billion in same period last year.

During 01st July-31st March, FY2021, loans for wheat financing witnessed a net retirement of Rs 110.8 billion against the retirement of Rs 139.4 billion during same period last year. The outstanding stock of wheat increased to Rs 586.5 billion as compared to Rs 514.8 billion in comparable period last year. Significant retirement of wheat loans are the major contributor in commodity financing loans retirement.

Loans for sugar financing stood at Rs 1.1 billion against borrowing of Rs 6.2 billion last year. Fertilizer financing observed net retirement of Rs 2.9 billion during the period under review as compared to net retirement of Rs 3.3 billion last year. On the contrary, the rice financing observed net borrowing of Rs 8 million against the net retirement of

[3] Glossary, Monthly Statistical Bulletin, SBP

Rs 835 million last year. Cotton financing shows net borrowing of Rs 94 million as compared to net borrowing of Rs 130 million last year.

Credit to Private Sector[4]

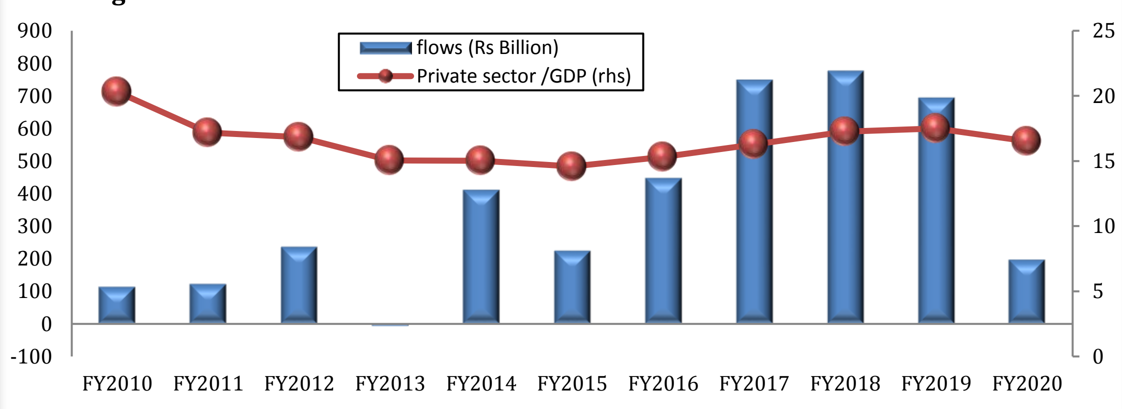
During FY2020, credit to private sector reduced significantly to Rs 196.4 billion as compared to Rs 693.5 billion in FY2019. Private sector credit plummeted in FY2020 on account of high cost of borrowing, surplus inventories, low industrial production, business closures due to COVID related smart lockdown strategy, slow economic activities and uncertainty about COVID trajectory.

During fourth quarter of FY2020, SBP has announced number of concessionary refinancing schemes, despite this, net addition in the outstanding amount of credit is not large and higher net retirement has been observed, thus overall credit remained decelerated during FY2020.

During the period 01st July-30th April, FY2021, overall private sector credit observed expansion of Rs 454.5 billion against Rs 318.5 billion last year, posted growth of 42.7 percent in flow terms. On average, it has posted growth of 6.6 percent compared to growth of 4.8 percent last year. On Year on Year (YoY) basis, it has posted growth of 4.8 percent as on 30th April, 2021.

During FY2021, host of positive factors plays significant role in credit expansion: accommodative policy environment, number of concessionary refinancing schemes introduced by SBP, overall improved business environment, negative real interest rate and significant growth in LSM.

Fig-5.6: Credit to Private Sector



Sectoral Analysis

Overall credit witnessed expansion of Rs 441.5 billion (growth of 7.1 percent) during July-March, FY2021 compared to Rs 204.9 billion (growth of 3.4 percent) last year. Loans to private sector businesses receive 63 percent share of total credit and stood at Rs 280.0

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

billion. Sectors which received major share of total loans included manufacturing, which received 58.5 percent share of total loans (Rs 163.8 billion), of which textile 13.5 percent (Rs 37.9 billion) followed by electricity, gas steam & air condition supply 20.4 percent (Rs 57.0 billion), wholesale & retail trade 4.9 percent (Rs 13.6 billion), construction 3.4 percent (Rs 8.9 billion) and water supply, sewerage, waste management and remediation activities 2.5 percent (Rs 7.0 billion).

Quarter wise distribution revealed that private sector credit observed net retirement during first quarter on account of higher retirement under working capital loans on the back of sales tax refunds by the government, debt relief measures (loan deferment and restructuring), availability of surplus carry-over stocks and muted input costs helped businesses in retiring their short-term loans[5].

Table- 5.3: Credit to Private Sector Rs billion

Sectors	End Month Stocks				Jul-Mar (Flows)		Average Growth Rates		YoY Growth	
	Jun-19	Mar-20	Jun-20	Mar-21	2019-20	2020-21	2019-20	2020-21	Jun-20	Mar-21
Overall Credit (1 to 5)	6,086.6	6,291.5	6,180.2	6,621.7	204.9	441.5	3.4	7.1	1.5	5.2
1. Loans to Private Sector Business	5,173.5	5,360.8	5,271.0	5,551.1	187.3	280.0	3.6	5.3	1.9	3.5
A. Agriculture	301.5	286.3	280.2	281.8	-15.2	1.6	-5.0	0.6	-7.1	-1.6
B. Mining and Quarrying	68.0	75.9	83.0	84.6	7.9	1.6	11.7	2.0	22.1	11.5
C. Manufacturing	3,128.9	3,366.6	3,290.3	3,454.1	237.7	163.8	7.6	5.0	5.2	2.6
Textiles	919.6	1,111.1	1,088.4	1,126.3	191.5	37.9	20.8	3.5	18.4	1.4
D. Electricity, gas, steam and air conditioning supply	484.0	531.4	491.8	548.9	47.4	57.0	9.8	11.6	1.6	3.3
E. Water supply, sewerage, waste management and remediation activities	20.3	13.7	15.1	22.1	-6.6	7.0	-32.6	46.3	-25.6	61.5
F. Construction	153.7	124.3	129.6	138.5	-29.4	8.9	-19.1	6.9	-15.7	11.4
G. Wholesale and retail trade; repair of motor vehicles and motorcycles	477.3	433.8	429.3	442.9	-43.5	13.6	-9.1	3.2	-10.0	2.1
H. Transportation and Storage	106.6	118.8	119.6	119.4	12.2	-0.2	11.4	-0.1	12.2	0.5
I. Accommodation and food service activities	34.5	43.5	37.0	43.3	9.1	6.3	26.4	17.0	7.5	-0.5
J. Information and Communication	140.6	140.1	159.2	162.0	-0.5	2.7	-0.3	1.7	13.2	15.6
K. Real estate activities	28.3	31.0	29.4	26.9	2.7	-2.6	9.4	-8.8	4.0	-13.3
L. Adminstrative and support service activities	75.4	59.7	62.2	59.6	-15.7	-2.6	-20.8	-4.2	-17.5	-0.2
M. Education	20.7	18.8	22.5	29.0	-1.9	6.5	-9.3	29.0	8.8	54.7
N. Human health and social work activities	11.3	12.1	14.6	18.1	0.8	3.5	7.3	23.7	29.3	49.0
O. Arts, entertainment and recreation	0.8	2.6	2.5	3.4	1.8	0.9	223.9	34.8	215.3	31.2
P. Other service activities	69.2	50.4	53.5	62.8	-18.8	9.3	-27.2	17.5	-22.7	24.7
2. Trust Funds and Non Profit Organizations	18.5	18.4	17.9	15.7	-0.1	-2.2	-0.5	-12.2	-2.8	-14.2
3. Personal	674.3	708.1	675.7	836.3	33.8	160.6	5.0	23.8	0.2	18.1
4. Others	3.2	1.5	1.5	4.3	-1.7	2.8	-53.2	178.3	-52.0	185.9
5. Investment in Security & Shares of Private Sector	217.2	202.8	214.0	214.3	-14.4	0.3	-6.6	0.2	-1.5	5.7

Source: State Bank of Pakistan

[5] First Quarterly Report FY2021, SBP

During second and third quarter of CFY, considerable higher credit offtake has been observed which more than offset the net loan retirements in the first quarter. Higher credit demand mainly driven for fixed investment loans under subsidized Long Term Finance Facility (LTFF) and Temporary Economic Refinance Facility (TERF) reflects increase in economic activities.

Table-5.4: Loans Classified by Borrowers (By Type of Finance)[P] based on ISIC 4 Classifications of Private Sector Businesses

Rs billion

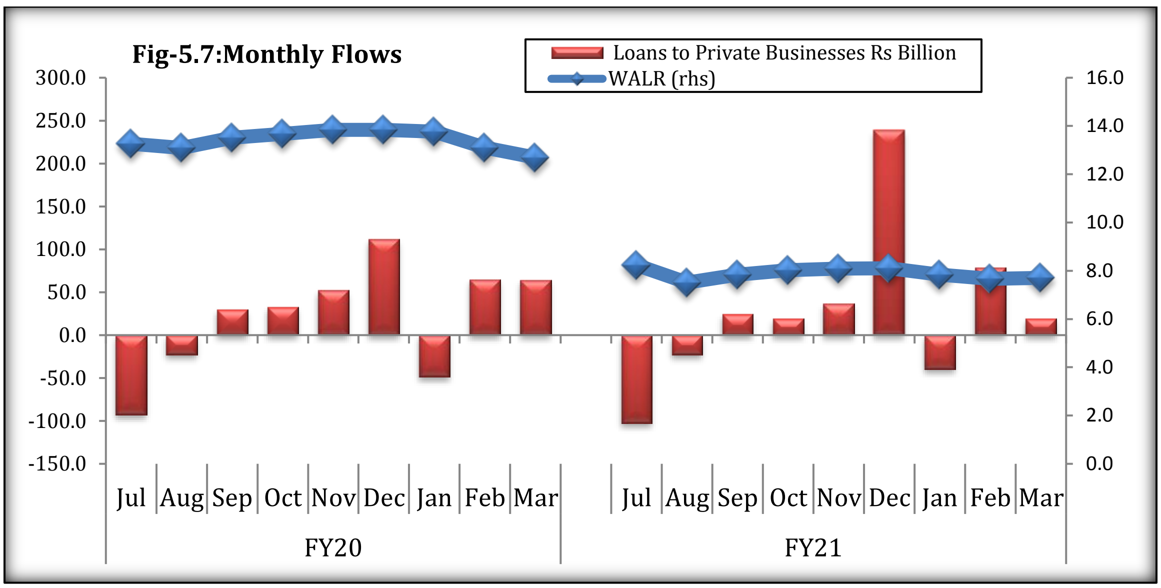
	Total credit		Working capital		Fixed investment		Trade financing	
	Jul-Mar FY2020	Jul-Mar FY2021	Jul-Mar FY2020	Jul-Mar FY2021	Jul-Mar FY2020	Jul-Mar FY2021	Jul-Mar FY2020	Jul-Mar FY2021
Loans to Private Sector Business	187.3	280.2	28.8	65.1	(5.2)	127.4	163.8	55.3
o/w: EFS	109.2	68.7	109.2	68.7	_	_	_	_
LTFF (including TERF)	37.0	110.4	_	_	37.0	110.4	_	_
Agriculture, forestry and fishing	(15.2)	1.6	(6.6)	5.9	(7.7)	(4.9)	(1.0)	0.6
Mining and quarrying	7.9	1.6	(0.1)	(1.3)	4.7	5.2	3.3	(2.3)
Manufacturing	237.7	160.8	42.9	24.7	19.1	90.6	175.7	45.5
Manufacture of food products	21.1	124.8	15.8	89.2	(9.9)	25.7	15.3	9.9
Manufacture of grain mill products	(27.2)	42.7	(36.4)	28.3	(0.6)	1.1	9.8	13.3
Wheat Processing	(30.4)	(1.9)	(29.1)	(2.4)	(0.0)	0.4	(1.2)	(0.0)
Rice Processing	19.1	36.7	8.4	24.2	0.2	1.3	10.5	11.2
Manufacture of sugar	49.4	72.7	48.7	61.0	(3.4)	9.7	4.1	2.1
Manufacture of textiles	191.5	36.1	42.3	(45.0)	26.2	41.3	123.0	39.8
Manufacture of basic pharmaceutical products and pharmaceutical preparations	2.3	19.9	(1.2)	5.9	2.9	12.3	0.6	1.7
Electricity, gas, steam and air conditioning supply	47.4	57.3	45.6	16.4	3.8	41.3	(2.0)	(0.4)
Water supply; sewerage, waste management and remediation activities	(6.6)	7.0	(1.9)	3.8	(0.6)	1.3	(4.1)	1.9
Construction	(29.4)	(7.6)	(18.5)	5.1	(9.6)	(12.3)	(1.3)	(0.4)
Wholesale and retail trade; repair of motor vehicles and motorcycles	(43.5)	13.3	(33.0)	5.7	(5.8)	6.2	(4.7)	1.4
Transportation and storage	12.2	(0.2)	19.0	0.0	(6.9)	(0.6)	0.1	0.4
Accommodation and food service activities	9.1	4.9	7.7	0.6	(0.2)	4.1	1.5	0.2
Information and communication	(0.5)	2.6	(11.0)	4.6	9.8	(1.7)	0.7	(0.3)
Real estate activities	2.7	(6.5)	3.5	(0.9)	(0.8)	(5.6)	-	-
Professional, scientific and technical activities	(0.7)	3.4	1.0	(0.7)	(0.2)	0.3	(1.5)	3.9
Administrative and support service activities	(15.7)	(3.0)	(6.5)	(5.1)	(6.9)	2.7	(2.3)	(0.6)
Education	(1.9)	3.2	(2.0)	4.7	0.1	(1.6)	-	0.1
Human health and social work activities	0.8	2.0	(0.6)	1.5	1.6	0.6	(0.2)	(0.1)
Arts, entertainment and recreation	1.8	0.9	1.9	(1.5)	(0.1)	2.3	-	-
Other service activities	(18.8)	6.4	(12.7)	1.6	(5.7)	(0.5)	(0.5)	5.4

*Total loans during Jul-Mar, FY2021 include Rs 32.2 billion in construction financing after the revision in data on credit/loans from June 2020 onwards due to the inter-sectoral adjustment in private sector business. Construction finance includes both working capital and fixed investment loans provided by banks to private sector for construction purposes. See S&DWD Circular Letter No. DS.MFS. 013814/2020 and IH&SMEFD Circular Letter No. 28 of 2020 for details.

Source: State Bank of Pakistan

By type of finance, working capital loans observed net borrowing of Rs 65.1 billion during July-March, FY2021 against borrowing of Rs 28.8 billion during same period last year. Sector wise distribution revealed that under working capital loans, manufacturing sector has borrowed Rs 24.7 billion against the borrowing of Rs 42.9 billion last year. Within manufacturing, textile sector retired Rs 45.0 billion against the borrowing of Rs 42.3 billion last year. Textile sector has retired higher short term loans on account of 13 percent higher export proceeds in rupee terms and weak credit demand on account of surplus carry-over stock. Under Export Finance Scheme (EFS), textile sector has borrowed Rs 44.5 billion as compared to Rs 71.0 billion last year.

Under working capital loans, usually higher credit offtake is observed during second quarter, primarily explained as seasonal factor - rice and sugar sectors usually retired their short term loans during first quarter and borrowed in second quarter, mainly to procure inputs and raw materials.



Fixed investment loans increased by Rs 127.4 billion during July-March, FY2021 against the retirement of Rs 5.2 billion last year. Within fixed investment loans, manufacturing sector availed long term loans of Rs 90.6 billion compared to Rs 19.1 billion last year. Higher credit demand for manufacturing sector was mainly driven by sub-sectors including food products, textile and pharmaceutical. Quadrupled borrowing under fixed investment loans borne from LTFF and TERF schemes. Under non-manufacturing sector, electricity, gas steam and air condition supply availed higher credit during the period under review.

Under LTFF and TERF schemes, loans disbursement increased to Rs 110.4 billion during July-March, FY2021 as compared to Rs 37.0 billion during corresponding period last year. Loans to manufacturing sector increased by Rs 93.6 billion compared to Rs 34.2 billion last year. Within Manufacturing, textile sector has availed Rs 56.3 billion against Rs 26.5 billion last year, to pursue capacity expansions and Balancing, Modernization and Replacement (BMR) activities. Accordingly, import of textile machinery posted significant growth of 58.2 percent on YoY basis in March, 2021.

Table-5.5: Consumer Financing Rs billion

Description	July-March (Flows)		Growth (%)*	
	FY2020	FY2021	FY2020	FY2021
Consumer Financing	15.3	131.7	2.8	24.6
1) For house building	-5.6	13.8	-6.1	17.2
2) For transport i.e. purchase of car	3.2	73.6	1.5	34.9
3) Credit cards	2.4	10.0	5.5	23.1
4) Consumers durable	1.1	-2.7	17.1	-33.6
5) Personal loans	14.4	37.2	7.9	19.4
6) Other	-0.2	-0.1	-19.7	-16.7

* Growth is calculated on the basis of Stocks.

Source: State Bank of Pakistan

Consumer financing flows increased by Rs 131.7 billion (growth of 24.6 percent) during July-March, FY2021 as compared to Rs 15.3 billion (growth of 2.8 percent) last year. Significant demand for consumer loans primarily driven by house building, auto and personal loans. Higher offtake remained attractive due to low cost of borrowing as Weighted Average Lending Rate (WALR) reduced from 13 percent in March, 2020 to 7.7 percent in March, 2021 and SBP initiatives for housing and construction. Accordingly, house building loans posted growth of 17.2 percent as compared to negative growth of 6.1 percent last year. This higher growth is likely due to the mandatory targets set by the SBP for banks to increase their housing and construction loans to 5 percent of their overall private sector credit portfolio by December 31, 2021.

SBP has taken various initiatives for promotion of housing finance in line with the government agenda to provide affordable access to housing in the country in FY2021.

- **Mandatory Targets for Housing Finance**

SBP has assigned mandatory targets to banks to extend mortgage loans and financing for developers and builders. Banks will be required to increase their housing finance portfolio to at least 5 percent of their private sector advances by the end of December 2021. Banks that fulfill or exceed their quarterly financing target are incentivized to maintain a lower Cash Reserve Requirement (CRR), in the next quarter, by an amount equivalent to incremental outstanding financing as of relevant quarter end. Those that do not meet the target will have to maintain additional CRR in the next quarter equivalent to the shortfall.

- **Mark-up Subsidy Scheme for Housing Finance**

To promote affordable housing and home ownership among low to middle-income group, SBP has introduced Government's Mark-Up Subsidy Scheme (G-MSS) wherein subsidized financing is provided to individuals who currently do not own a house for construction or purchase of a new house. The government has allocated Rs 36 billion for payment of mark-up subsidy for financing over a period of 10 years.

The government of Pakistan has revised and reduced mark-up subsidy scheme rates for housing finance[6] as follows:

Table-5.6: Pricing for Housing Loans[7]

Loan Tiers	Amount	Customer Pricing	Bank Pricing
Tier 0	Rs 2.0 million	5% for first 5 years & 7% for next 5 years	KIBOR + 700 BPS
Tier 1	Rs 2.7 million	3% for first 5 years & 5% for next 5 years	KIBOR + 250 BPS
Tier 2	Rs 6.0 million	5% for first 5 years & 7% for next 5 years	KIBOR + 400 BPS (Spread may vary)
Tier 3	Rs 10.0 million	7% for first 5 years & 9% for next 5 years	

For loan tenors exceeding 10 years, market rate i.e. bank pricing will be applicable for the period exceeding 10 years.

Source: State Bank of Pakistan

Monetary Liabilities

Monetary Liabilities include currency in circulation, demand deposits, time deposits and Resident Foreign Currency Deposits. During the period 01st July-30th April, FY2021, Money supply witnessed expansion of 8.0 percent as compared to 9.5 percent in comparable period last year. On YoY basis, it posted a growth of 15.8 percent as on 30th April, 2021.

Currency in Circulation (CiC)

During 01st July-30th April, FY2021 CiC increased by Rs 672.6 billion (growth of 11.0 percent) as compared to expansion of Rs 996.4 billion (growth of 20.1 percent) during corresponding period last year. Currency-to-M2 ratio stood at 30.2 percent as on 30th April, 2021 as compared to 30.5 percent in comparable period last year, due to enhanced uses of digital modes of payments, have contributed towards the lower demand for holding cash. It is important to mention that the comparable period of FY2020 has observed relatively higher withdrawals of deposits after witnessing higher growth at the end of FY2019 due to Asset Declaration Scheme (ADS)[8]. These higher withdrawals of deposits had translated into higher growth in CiC in last year.

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[6] In October 2020, the GoP started providing markup subsidy facility for the construction and purchase of new homes in a bid to promote housing finance to first time home buyers at subsidized and affordable markup rates. This facility is being provided with the administrative support of Naya Pakistan Housing and Development Authority (NAPHDA) and implemented by State Bank of Pakistan through banks. https://www.sbp.org.pk/smefd/circulars/2020/C11.htm

[7] IH&SMEFD Circular No. 03 of 2021, SBP

[8] The ADS 2019 required the declares to deposits their cash-like assets into their respective bank accounts. That had led to a massive increase in bank deposits.

Table-5.7: Monetary Aggregates				Rs million
Items	**End June**		**30th April**	
	2019	**2020**	**2019-20**	**2020-21**
A. Currency in Circulation	4,950,039	6,142,016	5,946,464	6,814,580
Deposit of which:				
B. Other Deposits with SBP	33,636	41,218	34,923	61,404
C. Total Demand &Time Deposits incl.RFCDs	12,814,820	14,724,770	13,515,228	15,696,812
of which RFCDs	1,109,780	1,074,511	1,023,351	1,006,058
Monetary Assets Stock (M2) A+B+C	17,798,494	20,908,004	19,496,614	22,572,796
Memorandum Items				
Currency/Money Ratio	27.8	29.4	30.5	30.2
Other Deposits/Money ratio	0.2	0.2	0.2	0.3
Total Deposits/Money ratio	72.0	70.4	69.3	69.5
RFCD/Money ratio	6.2	5.1	5.2	4.5
Income Velocity of Money	2.3	2.2	-	-

Source: State Bank of Pakistan

Deposits

Bank deposits (including demand, time and Resident Foreign Currency Deposits (RFCD) observed expansion of Rs 972.0 billion (growth of 6.6 percent) during the period 01st July-30th April, FY2021 against Rs 700.4 billion (growth of 5.5 percent) in the same period last year. Within deposits, demand deposits increased by Rs 1,158.3 billion as compared to Rs 338.8 billion last year. Significant increase in demand deposits despite lower interest rate reflects increasing inclination towards digital payments, higher remittances inflows, personal savings due to restriction on leisure and religious travel and business deposits on account of higher refunds. On the other hand, time deposits decreased by Rs 117.8 billion against expansion of Rs 448.0 billion last year, due to reduction in returns on time deposits. Similarly, RFCDs declined by Rs 68.5 billion as compared to contraction of Rs 86.4 billion last year, on account of PKR appreciation around 10.0 percent during July-March, FY2021, which lowered incentive for savings of foreign currency. Therefore, strong growth in total deposits combined with substantial lower CiC has led to reduction in currency-to-deposits ratio to 43.0 percent as of 30th April, 2021 compared 44.0 percent during same period last year.

Monetary Management

The average outstanding OMOs size fell to Rs 1,048.3 billion during Q1-FY2021 compared Rs 1,337.7 billion during same quarter last year. The liquidity requirement of the commercial banks comfortably met from higher bank deposits, SBP FX's management, retirement from the private sector, PSEs and the government commodity operation agencies. Cumulatively, these higher inflows offset the liquidity requirement to meet government borrowings needs. As a result, OMOs remained lower during Q1-FY2021 compared during same period last year.

Table-5.8: Average Outstanding Open Market Operations1					Rs billion
Full Year	FY2017	FY2018	FY2019	FY2020	FY2021
	1,045.8	**1,228.7**	**(23.8)**	**1,103.2**	**935.6**
Q1	1,094.0	1,440.9	1,035.2	1,337.7	1048.3
Q2	861.3	1,530.5	(257.6)	912.8	822.8
Q3	961.1	1,123.5	(641.2)	892.4	1,158.0
Q4	1,267.2	813.1	(247.4)	1,270.0	
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					

During second and third quarter FY2021, the higher inflows remained persistent and provided liquidity support in interbank market to manage the liquidity demand emanated from both government and private sector credit demand. As a result, liquidity requirements eased up further and net injections reached to Rs 822.8 billion and Rs 1,158.0 billion respectively during Q2 and Q3 compared to Rs 912.8 billion and Rs 892.4 billion, respectively in corresponding quarter last year.

During first nine months of CFY, interbank market remained relatively more volatile, but on multiple instances the SBP either completely refrained from intervening in the market to let the market settle on its own or made interventions of lower volumes than was demanded by the market, which also led to heightened volatility in the overnight rates.

Table-5.9: Market Treasury Bills Auctions										Rs million
	July-June			July-March						
	FY2020			Offered		Accepted		W.A.Rate*		
	Offered	Accepted	W.A Rate*	FY2020	FY2021	FY2020	FY2021	FY2020	FY2021	
3-Months	14,913,709	8,811,853	10.7	12,790,718	11,269,020	8,122,054	6,985,123	12.5	6.9	
6-Months	4,345,673	1,705,828	10.7	2,420,952	4,341,280	1,133,167	2,608,950	12.6	7.1	
12-Months	14,210,931	4,649,744	10.8	11,467,044	1,795,065	3,966,446	528,226	12.4	7.2	
Total	**33,470,313**	**15,167,425**		**26,678,714**	**17,405,365**	**13,221,667**	**10,122,299**			
Source: State Bank of Pakistan										
*Average of maximum and minimum rates										

Under T-bills, government has received higher offered amount in T-Bills during July-March, FY2021. With no change in interest rates during first nine months of FY2021, the market is concentrating its offers in the 3-month T-bills. Market offered Rs 17,405 billion of T-bills compared Rs 26,678.7 billion during same period last year. However, given the government's inclination towards raising debt through long term papers, the government largely adhered to its auction plan. Consequently, T-bills accepted amount remained lower compared to last year during the period under review. The accepted amount stood at Rs 10,122 billion, which remained 58 percent of offered amount during the period under review. Within accepted amount, market has preferred to invest particularly in 03-months T-Bills and contribute around 69 percent followed by 25.8 and 5.2 percent under 6 and 12 Months, respectively.

Fig-5.8: Contribution of T-Bills

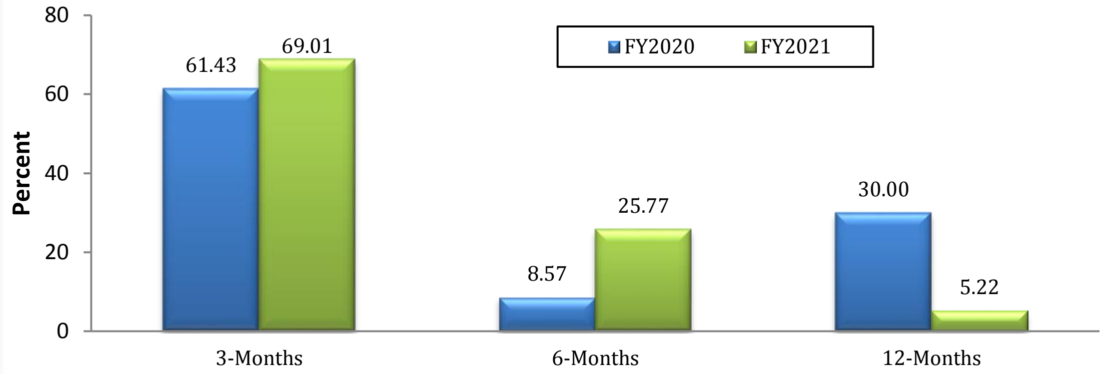


Table-5.10: Pakistan Investment Bonds Auctions Rs million

PIBs	July-June			July-March				W.A Rate	
	Offered	Accepted	W.A Rate	Offered		Accepted			
	FY2020			FY2020	FY2021	FY2020	FY2021	FY2020	FY2021
3 Years	2,389,228	1,102,152	10.8	1,872,240	337,420	900,059	176,740	12.8	8.3
5 Years	1,643,278	612,849	10.8	1,467,540	450,548	494,899	136,716	12.4	9.0
10 Years	1,216,358	332,797	11.0	1,145,149	243,752	275,183	83,405	12.1	9.5
15 Years Maturity	22,925	16,800	10.1	-	54,549	-	37,000	-	9.9
20 Years Maturity	22,659	6,113	11.2	15,259	50,061	1,000	40,061	-	10.5
02 Years (Floater) Maturity (PFL) Quarterly					120,025		86,282		99.6 Cut off price
03 Years (Floater) Maturity (PFL) Quarterly					287,756		193,776		99.1 cut off price
05 Years (Floater) Maturity (PFL) Quarterly					107,600		90,500		98.0 cut off price
10 Years (Floater) Maturity (PFL) Quarterly					130,050		98,542		95.3 cut off price
03 Years (Floater) Maturity (PFL) Semi-Annual**	84,100	60,552	45bps		1,193,302		624,763		99.6 cut off price
05 Years (Floater) Maturity (PFL) Semi-Annual**	48,500	34,500	49bps		577,020		236,261		100.3 cut off price
10 Years (Floater) Maturity (PFL) Semi-Annual**	1,445,471	723,417	72.5 bps	1,233,051	384,124	577,292	107,802	14.3	100.1 cut of price
Total	**6,872,519**	**2,889,180**		**5,733,328**	**3,936,207**	**2,248,433**	**1,911,848**		

Note: Accepted amount include non-competitive bids as well as short sell accommodation.
* The benchmark 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

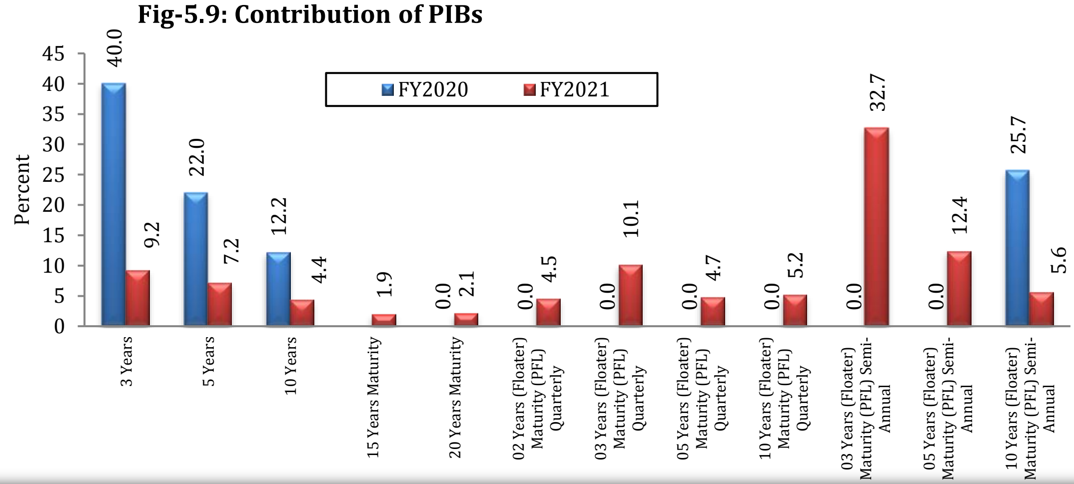
In May 2018, Pakistan's first floating rate PIBS (PFL) government bonds were introduced under Pakistan Investment Bonds Rules.

- The 10-years PFL instrument was launched primarily to provide an avenue to the market to invest in long-term bonds without taking exposure of the duration risk.
- 3 and 5 year PFL have been introduced in June, 2020 to provide the investors with suitable substitutes to T-bills and to lengthen the average maturity of domestic debt.
- Government started issuance of 3, 5 and 10 Year PFL with quarterly coupon payment frequency from October, 2020; and
- Government also introduced 2-Year PFL in November, 2020 with quarterly coupon payment frequency and fortnightly interest rate re-setting.

During FY2021, the government leveraged on the floating rate PIBs (PFL) that not only offer a longer maturity period but also provide a flexible return in line with the interest rate cycle. Keeping in view the relatively low level of interest rates, the government preferred to issue floating rate PIBs, more than double that of fixed rate PIBs and also introduced new PFLs, with quarterly coupons. Currently, there are seven floaters available in the market, with maturities ranging from 2 years to 10 years.

Government has set target for floating rate PIBs, more than double of fixed rate PIBs for FY2021. For fixed rate PIBs, market offers remained significantly lower to Rs 1,136 billion during July-March, FY2021 compared to Rs 4,500 billion in same period last year. The government also remained reluctant to accept higher cut-offs, therefore, government accepted amount against fixed rate PIBs stood at Rs 473.9 billion (42 percent of offered amount) compared to Rs 1,671 billion in last year. Within accepted amount, market has preferred to invest in 3 years as it contributed 37 percent of the fixed rate PIBs accepted amount followed by 29 percent in 5 years, 17.6 percent in 10 years, 8.5 percent in 20 years and 7.8 percent in 15 years.

Fig-5.9: Contribution of PIBs



With a tough situation in mobilizing financing for longer tenor at fixed rates, the PFLs plays instrumental role for the government to maintain its maturity profile. Government has accepted Rs 1,438 billion under PFLs which remained 51 percent of offered amount of Rs 2,799 billion for PFLs. Around 75 percent of the consolidated PIBs accepted amount was concentrated in the floating rate PIBs of various tenors during July-March, FY2021.

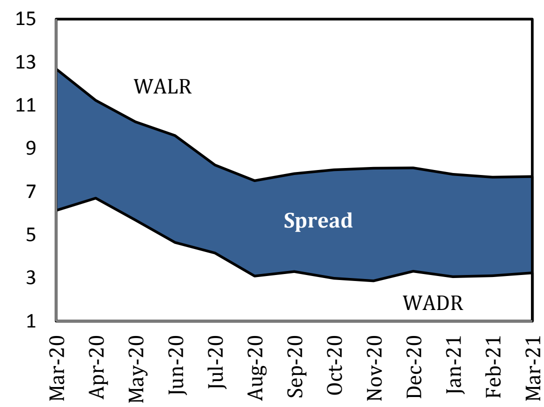
Impact of policy rate reduction after COVID-19 outbreak has translated on Weighted Average Lending Rate (WALR), which was 12.7 percent on gross disbursement in March, 2020 has decreased to 7.7 percent in March, 2021. Similarly, Weighted Average Deposit Rate (WADR) offered on fresh deposits also decreased from 6.1 percent in March, 2020 to 3.2 percent in March, 2021. Resultantly, banking spread which is the difference between the lending and deposit rates and the cost of channeling funds through intermediaries decreased from 6.6 percent in March, 2020 to 4.5 percent in March, 2021.

Table-5.11: Lending & Deposit Rates(W.A)

	LR	DR	Spread
March-20	12.7	6.1	6.6
April-20	11.2	6.7	4.5
May-20	10.2	5.7	4.6
June-20	9.6	4.7	5.0
July-20	8.2	4.2	4.1
August-20	7.5	3.1	4.4
September-20	7.8	3.3	4.6
October-20	8.0	3.0	5.0
November-20	8.1	2.9	5.2
December-20	8.1	3.3	4.8
January-21	7.8	3.1	4.8
February-21	7.7	3.1	4.6
March-21	7.7	3.2	4.5

Source: State Bank of Pakistan

Fig-5.10:Lending & Deposit Rates



Financial Sector

Despite pandemic-induced vulnerabilities, the banking sector performed reasonably well during CY2020. The asset base of the banking sector expanded by 14.2 percent in CY20 on YoY basis, higher than 11.7 percent expansion in CY19. Robust rise in assets was primarily driven by surge in investments (mainly in Government securities) which increased by 33.5 percent. Advances growth, however, remained weak owing to economic slowdown triggered by COVID-19.

Deposits of the banking sector increased by 16.1 percent to Rs 18.5 trillion during CY20 as compared to 11.9 percent growth in CY19. Acceleration in deposits was primarily on account of halt in business activities and restrained consumer spending due to mobility restrictions caused by the pandemic.

The after-tax profit of the banking sector increased by 42.9 percent to reach Rs 244 billion in CY20 against Rs 171 billion in CY19. As a result of higher earnings, Return on Assets (ROA-after tax) and Return on Equity (ROE-after tax) improved to 1.0 percent (0.8 percent for CY19) and 13.8 percent (11.3 percent for CY19), respectively.

The solvency of the banking sector continued to strengthen, indicating elevated capacity of the banks to sustain stress from unexpected shocks. Capital Adequacy Ratio (CAR) of the banking sector was at 18.6 percent by end Dec-20—was well above the local and international minimum benchmarks of 11.5 percent and 10.5 percent, respectively.

Table-5.12: Highlights of the Banking Sector Industry

	CY15	CY16	CY17	CY18	CY19	CY20
Key Variables (Rs. billion)						
Total Assets	14,143	15,831	18,342	19,682	21,991	25,124
Investments (net)	6,881	7,509	8,729	7,914	8,939	11,935
Advances (net)	4,816	5,499	6,512	7,955	8,249	8,292
Deposits	10,389	11,798	13,012	14,254	15,953	18,519
Equity	1,323	1,353	1,381	1,406	1,658	1,862
Profit Before Tax (ytd)	329	314	267	243	304	411
Profit After Tax (ytd)	199	190	158	149	171	244
Non-Performing Loans	605	605	593	680	761	829
Non-Performing Loans (net)	91	90	76	110	141	97
Key FSIs (Percent)						
NPLs to Loans (Gross)	11.4	10.1	8.4	8	8.6	9.2
Net NPLs to Net Loans	1.9	1.6	1.2	1.4	1.7	1.2
Net NPLs to Capital	7.7	7.3	5.8	7.8	8.9	5.3
Provision to NPL	84.9	85.0	87.2	83.8	81.4	88.3
ROA (Before Tax)	2.5	2.1	1.6	1.3	1.5	1.8
Capital Adequacy Ratio (all banks)	17.3	16.2	15.8	16.2	17	18.6
Advances to Deposit Ratio	46.4	46.6	50.1	55.8	51.7	44.8

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

Source: State Bank of Pakistan

Financial Development

A well-developed financial sector plays an important role in the overall economic development. The financial sector liberalization in Pakistan is being pursued since late 1980s. The financial sector reforms were primarily aimed to promote economic development of the country in general and the financial intermediation in particular.

Table -5.13: 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	46.7
2019-20	50.3
30th April	
2019-20	46.9
2020-21	47.3

Source: EA Wing Calculation, Finance Division

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 5.13, financial depth is measured by M2/GDP ratio, which is widely used as an indicator for 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 50.3 percent in FY2020, 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 has increased to 47.3 percent as on 30th April FY2021 as compared 46.9 percent during same period last year.

Box-II: Financial Sector Reforms during July-March FY2021

To create conducive and thriving environment for the banking industry, SBP continued to play its role within its regulatory and supervisory ambit during FY2021.

The key policy reforms are highlighted below.

1. **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 while balancing the need to dampen the effects of COVID-19 (Box-I:).

Some of the other measures that were taken by SBP to facilitate banks, depositors and borrowers of all segments to withstand the economic shocks of COVID-19 include:

- The requirements of the Basel III capital framework were relaxed, whereby the Capital Conservation Buffer was reduced by 1 percent from 2.50% to 1.50%; Similarly, the limit of retail portfolio was also enhanced from Rs 125 million to Rs 180 million to support the growth of credit to the retail sector and small & medium enterprises
- The margin requirement for exposure against shares was reduced from 30 percent to 20 percent and margin calls from 30 percent to 10 percent.
- The borrowers who were 'performing' as of December 31, 2020 were allowed deferral of principle payment for 1 year.
- The banks/DFIs were allowed to recognize impairment loss, if any, resulting from the valuation of listed equity securities in phased manner equally on quarterly basis during CY2020.
- The Debt Burden Ratio limit for borrowers was increased temporarily from 50 percent to 60 percent.
- Clean and secured limits under Prudential Regulations for Consumer Finance were revised to facilitate consumer spending.
- The Banks/DFIs were allowed, subject to certain conditions, to release and use the general provision maintained against consumer finance portfolio as per SBP regulation against the secured and unsecured consumer finance portfolio until December 31, 2020, enabling banks to withstand negative shocks of COVID-19 on their balance sheets.
- To minimize the risk of COVID-19 transmission, biometric verification and other relevant requirements of Branchless Banking and Merchant on boarding Framework were relaxed in March 2020. These relaxations were extended until June 2021.

➢ **Regulatory Reforms**

Strengthening of the Regulatory Framework

1. **Compliance with SBP related points of the Financial Action Task Force (FATF) Action Plan**

   - Pakistan achieved compliance with regard to all 9 action items related to the banking and financial sector in the 27 points FATF Action Plan in October 2020, by addressing all gaps identified by FATF and demonstrating its effectiveness.

2. **Revamping of AML/CFT Regulatory Regime to Align with FATF Recommendations**

   - To further align Anti-Money Laundering and Counter Financing of Terrorism (AML/CFT) Regulations with the recommendations of FATF and to bridge the gaps identified in Pakistan's Mutual Evaluation Report, SBP has made some important amendments in its regulatory framework, which will provide further clarity on implementation of AML/ CFT requirements.

3. **Enhanced Disclosure Requirements for Banks in Financial Statement**

- SBP revised the format of interim financial statements (quarterly and half-yearly) of banks, with the best international practices of disclosures, which will present banks' business performance and value in a clear and concise manner.

4. **Expansion of Cloud Servicing Guidelines**

- To allow utilization of the innovative and cost effective services being provided by Cloud Service Providers (CSPs), the scope of outsourcing to cloud service providers for Banks/DFIs/Microfinance Banks has been enhanced in September 2020.

5. **Allowing Banks, DFIs and MFBs to Raise Foreign Currency (FCY) Subordinated Additional Tier 1 Capital from Sponsors**

- SBP allowed banks, DFIs and MFBs to have majority foreign shareholding (Greater than 50%) to raise Additional Tier 1 capital in the form of FCY subordinated debt/loan from their existing foreign sponsors.

6. **Establishment of Pakistan Corporate Restructuring Company Limited (PCRCL)**

- Securities and Exchange Commission of Pakistan (SECP) licensed Pakistan's first Corporate Restructuring Company (CRC) under the Corporate Restructuring Companies Act, 2016. Accordingly, SBP issued guidelines to the banks/DFIs for transfer and assignment of their Non-Performing Assets (NPA) to the CRCs.

7. **Revised Security requirements under R-4 to facilitate the Government of Pakistan (GoP)**

- To facilitate the Government in acquiring financing facilities from commercial banks, SBP revised instructions contained in Regulation R-4 of Prudential Regulations for Corporate/ Commercial Banking, allowing financing against a letter of Comfort issued by the Government, with the condition that the Government issues the required guarantee within a period of 90 days.

8. **Enhancement of Banks Investments Limits in Real Estate Investment Trusts (REITs)**

- In order to promote the Real Estate Investment Trust (REIT) sector, SBP has enhanced the investment limit of banks and DFIs to 5% of equity of the institution or 15% of paid up capital of Investee Company, whichever is lower.

9. **Development of Digital Bank Regulatory Framework Draft for Public Consultation**

- SBP has developed a draft Digital Bank Regulatory Framework, which has been placed on the SBP's website for public consultation. Through this framework, SBP's goal is to provide an appropriate framework for the operation of Digital Banks in Pakistan.

- **<u>Foreign Exchange Regime</u>**

1. **Connecting Overseas Pakistanis with the Banking System of Pakistan:**

SBP allowed Non-Resident Pakistanis (NRPs) and Pakistan Origin Card (POC) holders to open Roshan Digital Accounts (Foreign Currency Value Account (FCVA) and NRP Rupee Value Account (NRVA)). In addition, resident Pakistanis having assets abroad, duly declared with FBR, have also been allowed to open Roshan Digital Account (FCVA only).

The NRPs can now open and operate these accounts digitally, spend money in Pakistan for meeting their family needs, invest in Government of Pakistan (GOP) securities (including Naya Pakistan Certificates -NPCs), shares/units quoted on stock exchange, unit of mutual funds (Open Ended Schemes), residential/commercial real estate and deposit products of the banks. The disinvestment proceeds, profits thereon and balances in these accounts are fully repatriable.

2. **FX liberalization/ Regulatory Permissions to bring operational efficiency:**

SBP, over time, has eased the restrictions on foreign exchange related transactions, making these transactions effective and efficient while also improving the Ease of Doing Business. A brief of these measures is given hereafter:

a) Policy of Equity Investment Abroad has been revised to simplify the process for residents to boost country's exports and to attract FDI. Under the revised Equity Investment Abroad Policy, transactions pertaining to: (i) establishing subsidiary / branch office by exporters, (ii) establishing holding company abroad by resident start-ups to channelize investment to Pakistan; and (iii) investment by individuals to a certain limit, would be approved by the banks without seeking any approval from SBP.

b) Framework for acquisition of services from a whitelist of digital service providers on the concept of "Payment vs Receipt" has been developed, with an annual limit of USD 200,000/- per entity that is acquiring the services.

c) Issuance of business-to-consumer (B2C) e-Commerce regulatory framework to facilitate exporters to export goods up to the value of USD 5,000 without the requirement of E-Form through WeBOC.

d) Development of mechanism of valuation and remittance of disinvestment proceeds exceeding market/breakup value of shares while delegating this function to Authorized Dealers.

e) The exporters were allowed to retain a certain portion of their export proceeds in their special foreign currency accounts. The funds retained were to be used for specific purposes, include advertisement, promotion and marketing abroad, subscription fee for participation in foreign exhibitions and fairs, foreign consultants fee, travel expenses abroad, among others.

3. Digitalization of FX Regulatory Approval System (RAS)

SBP launched an online platform i.e. Regulatory Approval System (RAS) to facilitate online submission of foreign exchange (FX) related cases to SBP. The SBP-RAS became operational on March 24, 2020 whereby manual case submission by banks was discontinued in respect of Foreign Exchange Operations Department of SBP-BSC. Later on, after successful parallel run, paper based case submission to Exchange Policy Department by banks was also discontinued with effect from August 28, 2020. It is envisaged that all FX related cases would be submitted digitally to the banks by their customer from July 2021 onwards.

4. Review and Updation of Foreign Exchange Manual:

In order to align the foreign exchange regulations with the changing business dynamics and best international practices, SBP initiated the project of review of entire Foreign Exchange Manual.

- **Supervisory Reforms**

1. Improvements in AML/CFT Sanctions Regime:

- During 2020-21, AML/CFT penalty scale was aligned to make it proportionate and dissuasive. Moreover, penalty scale was further refined in the light of amendments made in the Anti-Money Laundering Act (AMLA) 2010 in September 2020.

2. Strengthen SBP's supervisory role and enhance effectiveness of enforcement actions

- During FY2021, SBP has developed and implemented a new penalty scale for exchange companies, rationalized by enhancing the focus on administrative actions under Section 3AA(5) of the Foreign Exchange Regulation Act 1947 so as to make enforcement actions dissuasive especially for serious violations.

3. Risk Based Supervision (RBS) Framework

- SBP is at final stages of implementation of forward- looking **"Risk Based Supervisory (RBS) Framework**" to improve the supervisory regime and align it with good international practices, understand the risk profiles(external & internal) of regulated entities, facilitate supervisors in early identification of problems, efficient deployment of supervisory resources and initiating prompt corrective actions. Currently, pilot testing of the framework is being conducted.

4. AML/CFT Inspection Framework and Manual

- Since June 2018, Pakistan has been under Financial Action Task Force (FATF) Action Plan. Therefore, SBP developed an internal plan, inter alia, to update existing ML/TF and

Proliferation Financing (PF) risk assessment methodology on the premise of Risk Based Supervision.

5. **Risk Based Cyber security Inspection Framework**

- Realizing the significance of cyber security risk, SBP has developed Risk Based Cyber security Inspection Framework to improve cyber resilience of the regulated entities.

6. **Framework for Supervision of Credit Bureaus**

- The SBP, under the Credit Bureaus Act, 2015, is empowered to grant license and supervise the credit bureaus. Therefore, SBP has developed a risk-based framework for assessment of key risks, corresponding control functions and governance framework in Credit Bureaus.

7. **Digitization of supervisory process**

- SBP has launched parallel run of system based inspection workflow system that digitizes end-to-end process of conducting on-site inspections of regulated entities as well as initiation of subsequent enforcement actions.

2. **Broadening of Financial Net:**

Following are the key developments in the financial inclusion during FY2021 :

- **National Financial Inclusion Strategy (NFIS)**

SBP is pursuing financial inclusion as one of its strategic objectives to promote inclusive economic growth in the country. In this connection, SBP is implementing National Financial Inclusion Strategy (NFIS) and pursuing headline targets to be achieved by 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. During H1 of FY2021, 15 actions/sub-actions have been completed, thus increasing the number of completed actions/sub-action to 35. In terms of progress under headline target of active account, as of June 2020, overall number of unique active accounts stood at 45.9 million of which 11.7 million were held by women.

Key Initiatives taken under NFIS are listed below:

a. **Gender Mainstreaming Policy**: SBP has developed a Policy i.e. “Banking on Equality: Policy to Reduce the Gender Gap in Financial Inclusion”. It aims to introduce a gender lens within the financial sector, the policy is currently under consultation process with domestic/ international stakeholders.

b. **Automation of Central Directorate of National Savings (CDNS)**: The project was initiated to enable CDNS to (i) reduce the cost of funds by at least 25%; and (ii) develop HR capability and digitalization capacity. As of February 2021, 165 branches have been computerized.

c. **Asaan Mobile Account (AMA) Scheme**: SBP in collaboration with PTA and NADRA is implementing the Asaan Mobile Account (AMA) Scheme to develop an interoperable USSD (Unstructured Supplementary Service Data) platform by third party service provider (TPSP) for accessing and usage of digital financial services from anywhere, at any time. After meeting the licensing formalities by TPSP, the scheme is expected to be launched shortly.

Source: State Bank of Pakistan

Islamic Banking

Assets of Islamic banking Industry (IBI) has posted growth of 30.0 percent, which is the highest growth in asset base since December 2012 and stood at Rs 4,269 billion in CY20 as compared to growth of 23.6 percent, Rs 3,284 billion in CY19. On the other hand, deposits of IBI has grown by 27.8 percent, the highest growth since December 2015 and reached Rs 3,389 billion against growth of 20.4 percent to Rs 2,652 billion in CY19.

Market share of Islamic Banking assets and deposits in the overall banking industry stood at 17.0 and 18.3 percent, respectively during CY20 as compared to 14.9 and 16.6 percent, respectively in CY19.

Table- 5.14: Islamic Banking Industry

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

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 3,456 branches spread across 124 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 1,638 as of December 31, 2020. In addition, NRSP Microfinance Bank and MCB-Islamic Bank are also offering Shariah compliant microfinance services.

Breakup of the data between IBs and IBBs revealed that assets of IBs saw an annual rise of 29.7 percent (Rs. 572 billion), while IBBs experienced a sharp rise of 30.4 percent (Rs. 413 billion).

Table -5.14 (a): Financing Products by Islamic banks **Percent Share**

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

Source: State Bank of Pakistan

Investments (net) made by IBI registered considerable increase of 17.9 percent (Rs. 191 billion) in CY20 and were recorded at Rs. 1,261.2 billion compared to rise of 0.3 percent in corresponding period of 2019. This increase is mainly attributed to investments made by IBI in GoP Sukuk during the period under review.

Profit before tax of IBI was recorded at Rs. 88.4 billion by end December 2020. While, earnings ratios like ‘Return on Assets (ROA)’ and ‘Return on Equity (ROE)’ (before tax) stood at 2.4 percent and 36.4 percent, respectively by end December, 2020 as compared to 2.2 and 34.4 percent, respectively in CY19.

In terms of mode wise financing breakup in CY20, Diminishing Musharaka has highest share in overall financing of IBI followed by Musharaka and Murabaha.

Box-III: SBP unveils ambitious Third Five-year Strategic Plan for Islamic Banking Industry

State Bank of Pakistan (SBP) has unveiled in April-2021 its third five-year Strategic Plan for the Islamic Banking Industry. The strategic plan has set headline targets for Islamic banking industry to be achieved by 2025. These include:

(i) 30 percent share in both assets and deposits of overall banking industry,
(ii) 35 percent share in branch network of overall banking industry and
(iii) 10 percent and 8 percent share of SMEs and Agriculture financing respectively, in private sector financing of Islamic Banking Industry.

In order to steer the growth of Islamic banking on sound footings, this third Strategic Plan for Islamic banking industry (2021-25) aims to set a strategic direction for the industry to strengthen the existing progressive momentum and lead the industry to the next level of growth. The plan has been developed in close coordination and consultation with all key relevant stakeholders.

The strategic plan envisages achieving the aforementioned specified targets by focusing on six strategic pillars namely:

(i) strengthening legal landscape,
(ii) enhancing conduciveness of regulatory framework,
(iii) reinforcing comprehensive Shariah governance framework,
(iv) improving liquidity management framework,
(v) expanding outreach & market development and
(vi) bolstering human capital & raising awareness.

The Islamic banking industry is expected to fully capitalize on the potential of Islamic finance to attain the shared vision of a vibrant and sustainable Islamic banking sector in Pakistan.

Source: State Bank of Pakistan

Microfinance

The FY2021 remained challenging for the microfinance industry as economic issues, amidst COVID-19 pandemic, adversely impacted the repayment capacity of MF borrowers who belong to low income segments. To counter the adverse impacts of COVID-19 pandemic and to address issues efficiently, SBP remained proactive since the emergence of the disease in the country.

Table-5.15: Microfinance Industry Indicators

Indicators	December-19	December-20	YoY Growth
Number of Branches	4,036	3,828	-5.15%
Total No. of Borrowers	7,249,943	7,005,885	-3.37%
Gross Loan Portfolio (Rs. in millions)	305,753	324,155	6.02%
Avg. Loan Balance (Rs.)	42,173	46,269	9.71%

Source: State Bank of Pakistan

As of December 2020, the microfinance industry players operated through 3,828 branches spread in 138 districts across the country. Industry's retail network decreased marginally owing to a number of business and cost considerations. Performance of the microfinance industry depicts increasing trend in gross loan portfolio over last year apart from the impact of prevailing pandemic.

Table -5.16: Microfinance Banking Indicators (Rs. in millions)

Indicators	March-20	March-21	Growth
No. of Branches	1,212	1,195	-1.4%
No. of Borrowers	3,713,374	4,234,502	14.0%
Gross Loan Portfolio	219,345	256,173	16.8%
Average Loan (in Rs.)	59,069	60,497	2.4%
Deposits	239,641	371,656	55.1%
No. of Depositors	45,800,637	63,781,970	39.3%
Equity	47,398	56,535.61	19.3%
Assets	373,649	493,425	32.1%
Borrowings	26,343	24,084	-8.6%
NPLs	6.33%	3.72%	-41.2%

Source: State Bank of Pakistan

As of March 2021, eleven MFBs and MCB – Islamic Bank[9] were involved in extending complete range of micro-banking services to the low-income populace of the country.

During the period under review, the combined asset base of MFBs, witnessed a YoY growth of 32.1 percent and deposit base of MFBs registered an impressive growth of 55.1 percent. Concurrent growth was also witnessed in number of depositors which grew by 39.3 percent to over 63.7 million. As of March 2021, MFBs were operating through a network of over 1,195 retail outlets.

Similarly, aggregate loan portfolio of MFBs registered a growth of 16.8 percent and the number of borrowers registered increase of 14 percent from 3.71 million to 4.2 million. Concurrently, the average loan balance increased by 2.4 percent to Rs 60,497. MFBs reported reduction in Non-Performing Loans (NPLs) from 6.33 percent to around 3.7 percent. This decline in NPLs is consequent to the regulatory relief extended to the borrowers as MFBs were been advised not to classify their financing facilities until March 31, 2021.[10]

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.

[9] Since October/November 2017, MCB Islamic Bank is extending microfinance banking services by establishing counters at its existing branches in line with IBD Circular Mo. 5 of 2007.

[10] Para 2-iii of AC&MFD Circular Letter No. 1 of 2020

Table-5.17: Performance of BB Indicators

BB Indicators	March-20	March-21	Growth
Number of Agents	434,192	509,720	17%
Number of Accounts	48,345,517	66,542,098	38%
Deposits (Rs In millions)	31,935	56,442	77%
No. of transactions ('000')	1,420,501	2,006,299	41%
Value of transactions (Rs in millions)	4,784,845	7,355,595	54%

Source: State Bank of Pakistan

Conclusion

At the start of FY2020, SBP has continued with tight monetary policy stance as stabilization tool. Coordinated monetary and fiscal policies have reflected in the form of sustained improvement in the country's fiscal and external accounts, a revival in the real economy and positive business and consumer sentiment. The unprecedented shock of COVID-19 required an unprecedented monetary and fiscal response. Aiming to this, SBP has cut the policy rate by cumulative 625 bps during short tenor of three months, supported by a number of targeted and temporary interventions in the credit market through refinance schemes that provided much needed cash flow relief to households and businesses.

During FY2021, SBP has continued with accommodative monetary policy stance with 7.0 percent policy rate and the target of monetary policy was shifted towards supporting growth and employment during the pandemic. As a result, accommodative monetary policy environment, targeted fiscal intervention to counter the COVID-19 impact, led to a pick-up in the economic activity during first nine months of FY2021.

Correspondingly, credit to the private sector posted an encouraging recovery amid the revival in economic activity and the availability of SBP's concessionary refinancing schemes. Fixed investment loans increased significantly by Rs 127.4 billion during July-March, FY2021 against the retirement of Rs 5.2 billion last year, which augurs well for sustainable growth in coming years.