Governor : Mr. Tariq Bajwa
Title : Keynote Address
Date : March 18, 2019
Event : Bloomberg Pakistan Economic Forum
Venue : Movenpick Hotel Karachi.

Ladies and Gentlemen,

Assalam-o-Alaikum and Good morning!

First of all, I would like to thank the organizers for inviting me to this forum. I'm pleased to have the opportunity to address you today.

As you are all aware, Pakistan's economy is going through a phase of transition. On the one hand, stabilization policies are in place to ensure a stable macroeconomic environment which is vital for economic development; and on the other, the government is pursuing wide-ranging reforms to improve the ease of doing business in the country and minimize the cost of stabilization measures

After experiencing a spell of rising GDP growth between FY14 and FY17, Pakistan's economy is set for a calibrated moderation. This is a result of the high fiscal and CAD which was registered in FY 18. Unless we are able to grapple the three core macroeconomic issues i.e. low savings, low revenue generation and high trade gap, sustainable high growth will continue to be a challenge.

The twin objectives of macroeconomic policies are growth and stability. With the twin deficit moving to unsustainable territory, stability became a priority over growth.

In view of the pressures building in the economy we had begun to take policy measures. In December 2017, there was an adjustment in the exchange rate. A month later, SBP's Monetary Policy Committee initiated the tightening cycle, which to date has resulted in a cumulative upward revision of 450 basis points in the policy rate i.e. to 10.25 percent. And the Rupee has moved 31% against the dollar during the same period.

However, it has been hard to shift the focus of fiscal policy. While the economic growth is slowing down - which in turn is hurting the revenue growth - many of the government's expenditures are non-discretionary in nature, especially debt servicing, and increase in defense expenditure under the existing tension with India. On the other hand, Government receipts both tax and non-tax are below target. Therefore, the deficit in the fiscal accounts has persisted at a high level. The need for taking the tax to GDP ratio to atleast 15% cannot be overemphasized. Without this a primary and revenue surplus will be a mirage.

On the external front, the foremost step required is to arrange external funding to meet the financing gap. You are all well aware of the government's efforts in this regard to arrange timely inflows from China, Saudi Arabia, UAE and other friendly countries, alongside the finalization of deferred oil payment arrangements from Saudi Arabia. In addition, the most encouraging aspect is the investment commitments that our friendly countries have recently made. Certainly, these have given the country some cushion to withstand external headwinds, and also bode well for growth and employment opportunities.

As for the IMF, the government is continuously negotiating to get a program that can avoid a hard landing for the economy. There is a general agreement regarding the policy direction between us and the IMF; the differences are only on the timing and pace of stabilization policies.

In the meantime, we have already laid the foundations of a homegrown stabilization program, which hopefully would deliver good results. As I've mentioned before, tight monetary policy is in place, and the government is committed to reduce fiscal deficit. Importantly, the focus is on narrowing external imbalances to a sustainable level by allowing greater exchange rate flexibility and incentivizing savings in the economy. Finally, the government has been pursuing wide-ranging reforms to improve the investment climate in the country.

The policy mix has already started to bring the desired results in the external front. The current account deficit has declined by 22.6 percent on a YoY basis during the first eight months of FY19 and was only $ 356 mio in Feb 2019. It is likely to narrow further on the back of a deceleration in imports of goods and services and robust workers' remittances. FX reserves are also expected to improve further in the coming months. Taken together, these favorable developments have helped reduce the level of uncertainty in the domestic FX market. Furthermore, the early-harvest CPEC projects aimed at eliminating structural bottlenecks in the economy are near completion, and the next stage of the corridor pertaining to Special Economic Zones, agricultural advancement and technology upgradation is about to begin. Thus, the overall business environment in the country stands ready to experience significant improvement in the next few years.

Like any stabilization exercise, the economy must brace for an initial slowdown before it gets back on the recovery track. I understand that raw material costs for businesses have moved up because of higher oil prices and exchange rate depreciation, and financing cost has also escalated. At the same time, prices of consumer goods have also increased as the year-on-year CPI inflation for February 2019 has reached 8.2 percent, with Jul-Feb average inflation at 6.5 percent. However, it is encouraging to note that the burden of this rising inflation was considerably lower for low income segment of the society as the food inflation remained considerably low. Going forward, average CPI inflation for FY19 is likely to fall in the range of 6.5 to 7.5 percent. Having said this, let me say that these are short-term challenges, and I hope that our economy's inherent resilience will meet these challenges successfully.

Even during this stabilization period, we are trying to protect our export-oriented businesses. Importantly, the mark up rates on the export finance scheme (EFS) and long-term financing facility (LTFF) have been left unchanged to keep incentivizing the export-oriented sectors of the economy. Currently, the EFF and LTFF rates are at ten years' low. To further incentivize the financing under EFS, the rates are linked with performance, wherein lower rates are charged from exporters who achieve higher level of export performance. Similarly, the market-driven PKR depreciation has allowed the domestic goods and services to compete more favorably in the international markets.

While there are challenges in the Pakistan's economy, there are opportunities also. The correction in the exchange rate shall make production in many sectors more competitive and encourage new ventures in import substitution. Let me assure you that State Bank will continue to provide, through its regulatory and policy initiatives, a conducive financial system that is able to contribute in the growth of Pakistani businesses through the provision of adequate banking facilities. Furthermore, our banking industry shall also play an effective role when it comes to financial intermediation. In particular, beyond the encouraging growth in private sector credit numbers, banks are now being asked to extend their services to the underserved, unbanked and disadvantaged segments as well. I appreciate that the government has offered a lower tax rate of 20 percent to the banks on their income derived from incremental financing to the SME, Agriculture, and low cost housing borrowers (via the Finance Supplementary [Second Amendment] Act, 2019). As I have emphasized before at other forums, the State Bank's key focus is on three priority sectors, namely SMEs, Agriculture, and Low Cost Housing, with financial inclusion and Islamic Banking as cross cutting themes.

Let me first expand on SMEs. The SME sector makes a prominent contribution towards the country's GDP, exports and generation of employment opportunities. In this context, SBP had launched a Policy for Promotion of SME Finance in December 2017, aimed at enhancing SME access to finance by addressing the key challenges faced by the sector. There are nine key pillars of the SME Finance Policy, which include (i) improving the regulatory framework, (ii) upscaling of micro finance banks, (iii) risk mitigation strategy, (iv) simplified procedures for SME financing, (v) program based lending & value chain financing, (vi) capacity building & awareness creation, (vii) handholding of SMEs, (viii) leveraging technology and (ix) simplification of taxation regime. The detailed policy is available on SBP's website, and I would simply encourage those of you who have an interest to review it there at your convenience. It is encouraging to note that SME Financing of banks has, for the first time, crossed the nominal milestone of Rs. 500 billion, as of December 2018. The target that has been given to the commercial banks is that by 2020 SME credit should be equal to 17% of their lending.

Let me add that State Bank is keeping close coordination with federal and provincial governments as well as the Chamber of Commerce & SME Associations for timely implementation of all the initiatives identified under this policy. Moreover, under the enhanced National Financial Inclusion Strategy approved by the Prime Minister as part of the government's 100 days agenda, some immediate measures that need to be taken for SME sector development have also been identified. These measures include strengthening of specialized banking institutions and SMEDA. It also includes formation of a National SME policy on a fast track basis.

SBP is also offering concessional refinance facilities, like the Refinance Scheme for Working Capital financing for Small and Low-end Medium Enterprises. The end-user markup rate on such facilities is 6 percent. The Refinance and Credit Guarantee Scheme for Women Entrepreneurs in Underserved areas is even more attractive at 5 percent end-user rate, with up to 60 percent risk coverage facility.

Our second priority area is the agriculture sector, which contributes around 19 percent to GDP, 20 percent to overall export of the country and, importantly, employs around 38 percent of the labor force. SBP has been proactively promoting credit to agriculture sectors, primarily through the enhancement in production loans to small farmers to improve their productivity. I am pleased to share that banks have disbursed Rs. 606.1 billion up to January 2019, which is around 50 % of the total assigned target of Rs. 1,250 billion for FY19. Moreover, the number of outstanding borrowers has also increased to 3.92 million as of end-January 2019 from 3.50 million a year earlier, with a growth of 12 percent. Going forward, I believe there is a need to develop stronger linkages between the agriculture sector and SME/large-scale processing and manufacturing sectors. This would help achieve the dual objective of making the country self-sufficient in terms of industrial raw material, while also providing incentives to farmers to grow non-traditional high value crops.

Finally, I will move to the third priority area, i.e. low-cost housing finance. Pakistan is facing a shortage of 10 million housing units and this number is growing. This basic human need is felt more profoundly at the bottom-of-the-pyramid comprising of the poor and financially under-served segments of the society. To this end, SBP has undertaken various initiatives to promote and develop housing finance in Pakistan. Key initiatives include separate Prudential Regulations, setting up of the Pakistan Mortgage Refinance Company, capacity-building measures, and creating an enabling regulatory framework.

In order to address the issue of affordability, the SBP in the presence of Prime Minister has launched a low-cost housing finance policy last week that encompasses important measures taken by the SBP including regulatory relaxations to banks/DFIs, as well as a subsidized fixed rate financial facility for low cost housing for special segments. Firstly, to give you some examples of regulatory relaxations, the existing 0.5 – 1.5 percent general reserve requirement against classified housing finance portfolio will not be applicable on low-cost housing finance. In addition, the Loan to Value ratio of 85:15 has been relaxed to 90:10 for low cost housing finance. Also, the bank or DFI's exposure in low cost housing is not to be included for calculating the real estate exposure limit (i.e. 10percentof advances and investments).

The Financing Facility for Low Cost Housing for Special Segments is a scheme designed to benefit widows, children of martyrs, special persons, transgender persons, and persons in areas severely affected by terrorism. Under this facility, SBP shall provide refinance against subsidized low-cost housing financing extended by banks and DFIs. Among its salient features, the scheme will have a 5 percent borrower rate, including the bank's spread of up to 4 percent. Loan amounts up to Rs. 2.7 million, for tenors up to 12.5 years, will be eligible, with up to 100 percent refinancing provided by SBP.

Moreover, SBP will also assign targets for housing finance to banks. It is expected that introduction of targets will contribute in achieving the policy objective of increasing the housing finance portfolio from 1.7 percent currently to 6 percent of total private sector credit by December 2023.

Now I move to the first cross-cutting theme that is financial inclusion. Financial inclusion is an important instrument for inclusive economic growth and therefore, is also a high priority for the government. We all know that majority of people in our country fall in lower income groups who strive each day to make their ends meet. Financial inclusion can empower these segments to not only meet their financial needs but also improve their livelihoods through better financial management and investment in micro and small businesses.

In this regard, the GoP has adopted the National Financial Inclusion Strategy (NFIS) as one of its priorities. The NFIS targets and time-line have been enhanced until 2023 from its earlier end-date of 2020. We now have an agenda set for us for the next 5 years and some ambitious targets to meet, through which we aim to enlarge the strategy's scope and deepen its impact for the country's socio economic growth.

Besides promotion of digital payments, the strategy also aims to:

a. Enhance deposit to GDP ratio to 55%,
b. Promote SME Finance to 700,000 Small and Medium Enterprises,
c. Increase Agricultural Finance disbursements to Rs.1.8 trillion, and serve 6 million farmers through digitalized solutions; and
d. Enhance share of Islamic Banking to 25 percent of the banking industry.

Here I would like to stress that the most critical difference in the previous headline targets versus the new targets is emphasis on usage of financial services. I believe that mere account opening is not enough. It is essential that we permeate a culture of using digital financial services, to spur activity in accounts. Secondly, we have a clear priority to ensure that a gender-segregated target for account usage is incorporated as well. I am confident that we can meet all of the targets, based on the progress I have seen so far. By reaching these targets, we hope to create at least 3 million new jobs, and additional exports of US$ 5.5 billion.

The Government's ownership in NFIS can also be determined by the fact that an NFIS Transformation Office will be established in the PM Office:

a. To ensure 100% digitalization of Govt. payments, along with providing necessary technical services to provincial government, so they can possess or identify the pool of expertise in this regard.
b. To act as Trouble-shooter in resolving Implementation Agencies issues.

Second cross cutting theme is Islamic finance. Islamic Banking industry now accounts for 13.6 percent of the country's overall banking system in terms of assets while in terms of deposits the share is 14.7 percent (as of September 30, 2018). The focus on Islamic Banking is not only a question of faith but an important plank to increase the savings rate. In a survey undertaken in 2015 over 78% of these surveyed had stated that if they have access to Islamic Banking they will use Islamic banking. This is the vast segment of the populace that we want to tap by promoting Islamic Banking.

Today we have one of the most robust Shariah governance framework in the world in place that is regularly revised to address the needs of this evolving and dynamic industry. To address the needs of faith sensitive clients Shariah compliant alternatives of existing refinance schemes have been introduced. Our policies aim at not only providing a level playing field for the Islamic Banks but also facilitate them.

Why are these initiatives important? Because growth in Agriculture, SME and low cost housing can be a catalyst for the growth in the economy in a short period. Furthermore, growth in these areas would not be a burden on the current account and hence would not only be sustainable but also generate employment.

Having highlighted the steps taken by the State Bank of Pakistan to further the agenda of sustainable and inclusive economic growth in the country. Furthermore, the central bank fully supports the agenda of the business community and is always open for discussion and support. I remain very much confident that the new policies and programs being ushered in would prove conducive to our economy and bring about improvements in our economic development.

Thank you for your time!