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Speech by Deputy Governor, SBP on
“Monetary Policy and Digitization of Payment Systems”
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بسم الله الرحمن الرحيم

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Distinguished Speakers

Ladies and Gentlemen!

Assalam o Alaikum and a very Good Morning!

It is a privilege for me to be here to deliver a keynote address on “Monetary Policy and Digitization of Payment Systems”. These areas are the key policy pillars of every forward-looking Central Bank in the world today and has therefore attracted a lot of interest of the academia, business community and the public in our country as well.

In my talk today, I would first like to draw your attention to the challenges our economy is facing and how the recent structural and policy changes by SBP, especially through monetary policy, will help stabilize it. Then, I will share my thoughts on the issue of digitization and technological developments, which is massively changing the payment and banking industry around the globe as well as in Pakistan. Finally, I will talk about the strategy of SBP on digitization and use of technology to not only bring efficiency in the payment but help in documentation of economy while also supporting our efforts of financial inclusion.

Ladies and Gentlemen!

1. As most of you may be aware that Pakistan's economy is passing through a stabilization phase, as structural deficiencies have accentuated the twin deficits during FY17 and FY18. The situation was further complicated by the uncertainty prevalent in the global economy mostly due to trade disputes among major economies. These trade wars are unsettling the capital and commodities markets and affecting the export performance of emerging markets.
2. To effectively tackle domestic structural bottlenecks and enhance our economy's resilience in line with the evolving global dynamics, Pakistan has made some tough but necessary adjustments in the monetary and exchange rate policies. These measures have already helped contain domestic demand pressures and led to a progressive improvement in the country's external account. Supported by a healthy growth in workers' remittances and external financing from multilateral and bilateral sources, the country's foreign exchange reserves have now stabilized.
3. Encouragingly, the current account deficit decreased by a substantial 32.1 percent during FY19 and the July 2019 figures of a 72.8 percent decline are also encouraging. However, inflation has been on an upward trajectory mainly due to the pass-through of the exchange rate depreciation and adjustment in energy prices. Cognizant of the building up of inflationary pressures, SBP has been pursuing a tight monetary policy stance since early 2018. However, the impact of this tightening is going to reflect in the headline inflation with a certain lag.

4. At present, barring any sudden shock, the Monetary Policy Committee (MPC) of SBP is of the view, as stated in the last monetary policy statement, that the adjustment related to interest rate and the exchange rate from previously accumulated imbalances has already taken place. The recent monetary policy statement has explicitly stated that the MPC decision has inbuilt the impact of following 3 important developments:

- First, the outlook for external financing has further strengthened with the disbursement of the first tranche associated with the IMF Extended Fund Facility, activation of the Saudi oil facility, and other commitments of support from multilateral and bilateral partners;
- Second, the Government of Pakistan has passed FY20 budget that seeks to improve fiscal sustainability by focusing on revenue measures to widen the tax base. The government has also committed to cease borrowing from the SBP that would qualitatively improve the inflation outlook;
- Finally, on the international front, the sentiment towards emerging markets has improved as expectations of further policy rate cut in the United States have grown stronger and with all the conducive policies Pakistan has the capacity to attract foreign investment.

5. As we know, the effectiveness of monetary policy critically depends on the level of financial sector development, including financial access. Therefore, countries with low financial inclusion and financial development may have a weaker monetary policy transmission mechanism as opposed to countries with higher financial inclusion and developed financial markets. Globally, financial inclusion is considered

an effective tool for achieving sustainable and inclusive economic growth, as it is a prerequisite for equitable distribution of the economic opportunities, poverty reduction, and financial stability. Pakistan is committed towards broadening access to financial services and implementing development finance reforms and policies that can empower individuals and firms to access a well-functioning financial system, which cultivates opportunities for enhanced socio-economic outcomes, improved livelihoods and protection against economic shocks. The stated vision for financial inclusion in Pakistan is to improve the access and usage of quality financial services among individuals and firms, with dignity and fairness.

6. With this vision, and being cognizant of high financial exclusion in the country, SBP in 2015 launched the first National Financial Inclusion Strategy. This strategy sets the vision and outlines an action plan for achieving certain targets like ensuring that at least 50% of adults have a bank account in Pakistan by 2020. The NFIS has progressed well, and I am happy to share that as of June 2018, SBP's data shows that unique account ownership in Pakistan has reached to 63.9 million, representing more than 50% of adults having a bank account in the country well before the deadline of Year 2020.

7. Since we reached the headline targets well before our deadline of 2020, the Government adopted an enhanced NFIS, which sets the vision to improve financial inclusion through further 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. Accordingly, the GoP has set the following headline targets to be achieved by 2023:

- **Enhancing the usage of Digital Payments to 65 million** active digital transaction accounts, with gender segregation of **20 million** accounts by Women
- **Enhancement of Deposit to GDP ratio to 55%**
- **Promotion of SME Finance** by extending finance to **700,000** SMEs which is **17%** of the private sector credit
- **Increase in Agricultural Finance** by serve **6 million** farmers through digitalized solutions and extending annual disbursements to **Rs.1.8** trillion
- **And finally enhancing the share of Islamic Banking assets and its number of branches to 25 percent and 30 percent** of the banking industry respectively

8. The NFIS action plan expects to contribute in achieving sustainable development through creation of 3 million new jobs, generate additional exports of US\$ 5 billion and enhance banks' deposits to GDP ratio to 55% by 2023 through measures adopted under NFIS-2023. I must mention that the NFIS strategy also includes digitization of payment systems and adoption of technology as an effective method to improve financial access and inclusion. This leads me to my next topic which is the digitization of payment systems and SBP's policy on it.

Ladies and Gentlemen!

9. Throughout history, technological innovations and advancements in payment methods have continually reshaped monetary systems. However, since the last decade we have witnessed the emergence of a plethora of exciting innovations especially in the areas of banking and payments, which has resulted in enabling open business models based on entirely new and disruptive ideas. I would like to briefly mention some of the most prevalent trends:

- First is the rise of open platforms, such as e-commerce marketplaces, which allows anyone to buy, sell, and share in real time without considerable investments in infrastructure;
- Second: cloud based hosting enables quick deployment of complex systems using tools that are open source and easily available to anyone;
- Third is the pervasive adoption of mobile devices where everyone regardless of their social or financial stature owns a mobile phone;
- Fourth: advancements in big data analytics that provides deep insights about customer behavior, needs and wants;
- Fifth: advancements in artificial intelligence using big data and complex algorithms are being put to use in ways that were unimaginable a few years ago;
- Finally, the emergence of distributed ledger technologies like the Block Chain is set to transform entire industries by removing the need for intermediaries.

Ladies and Gentlemen!

10. These technologies are now threatening to disrupt the financial sector by creating new forms of money and removing the need to intermediate, which has traditionally been the forte of banks. Since this has implications for central banks especially with regard to monetary policy execution and transmission, SBP has adopted a comprehensive strategy to further its agenda of digitizing payments in the country. This includes promoting and developing interoperable payments Infrastructure, issuing enabling regulations especially for retail payment providers, ensuring the trust and security of digital payment channels in the country and finally promoting and experimenting with new fintechs players.

Let me now talk about each of these areas one by one:

11. As most of you may be aware that payment systems are usually categorized as wholesale and retail payment systems. Like the rest of the world, SBP upgraded its wholesale payments infrastructure to a Real Time Gross Settlement system, over a decade ago. The RTGS system has made our monetary policy operations more effective and efficient.

12. Now with the emergence of new enabling technologies, the retail payment systems are being transformed into the so-called “faster payments” that enables the public to pay and receive money in almost real time. Consumers accustomed to instant communication via email and social media expect to be able to make payments instantly. Therefore it is not surprising that these faster payments are rapidly gaining acceptance and popularity.

13. To remain abreast with these trends, SBP has already started work on the implementation of a Micro Payment Gateway in partnership with Bill & Melinda Gates Foundation and its representatives in Pakistan. This Gateway will offer faster retail payments with advanced Application Programming Interfaces and directory services, which will simplify the requesting, receiving and sending of payments in the country.
14. SBP is also closely working on digitizing government collections and payments, which includes digitization of government salaries, pensions and government collections. Recently, SBP, FBR and the provincial revenue authority of Punjab have successfully completed the project for digital collection of taxes and duties using alternate delivery channels.
15. On the regulatory front, realizing the emerging and critical role of non-banks in digitization and payments, SBP, back in 2007 issued Regulations for Branchless Banking that disrupted the retail payments space by introducing agent based banking and payments services. Then in 2014, SBP issued the Rules for Payment System Operators and Service Providers. These Rules garnered significant interest in the payments industry and signaled a changed direction in SBP's policy towards payments and digitization. Further, these Rules not only enabled SBP to regulate the payment systems operators in the market but also helped us in interacting with the new tech-oriented service providers and understand their needs and requirements.
16. In April this year, SBP issued the Regulations for Electronic Money Institutions that signify the resolve of SBP to promote digitization and innovative solutions for payments in the country. Since the initiation of

the licensing process, we have received very exciting applications from a variety of service providers who intend to offer innovative, user-friendly and cost-effective low value digital payment products in the country. We expect that with the potential to innovate, these non-banking entities can play a critical role in digitizing different types of payments in the country.

17. For ensuring trust and security of digital payments, SBP being cognizant of the risks inherent in digital payment is strengthening the oversight frameworks and capability. Let me say that enhancing cyber resilience is our number one priority and our recent regulatory instructions and enforcements are just first steps in that direction. I must mention that we have already issued various guidelines encompassing frameworks for Enterprise Technology Governance and Risk Management, Payment Systems' Designation, Security of Internet Banking and card based transactions, guidelines for prevention against cyber-attack, Risk Management in Outsourcing Arrangements by Financial Institutions, etc.

Ladies and Gentlemen!

18. During the past few years, SBP has adopted an open door policy for Fintechs innovators by facilitating and encouraging dialogue and discussions. Our teams from the policy group meet perspective providers especially from payments, remittances and banking and help them assess the appropriateness of their proposals against the existing regulations.
19. To promote Fintechs and nurture innovative ideas, SBP has already established an **Innovative Challenge Fund** facility, which provides funding facility to companies and Start-ups for innovative products and

services in the area of digital payments. Further, we are contemplating the development of a fintechs facilitation mechanism that would enable smaller fintechs to work with SBP in assessing the feasibility of their ideas in a controlled environment while at the same time giving SBP an opportunity to identify and address potential risks.

20. To sum it up, while central banks seem to be primarily concerned with the formulation and implementation of monetary policy, their domain has now expanded towards increasing the financial inclusion as well. This is necessary not only from financial deepening purposes but also from the perspective of poverty reduction. Enhanced financial inclusion ensures economic efficiency, maximum participation of its population in the overall economic process and thus maximizing growth and development. Technology on the other hand is rapidly enabling the policy makers to take effective action and leapfrog economies into new progressive eras. SBP is not only aware of the importance of these trends but is also continuously adapting itself in all areas of policymaking including monetary policy, financial inclusion and adoption of new technologies. I am sure that Insha'Allah; together we will overcome our problems and drive our country on the path of progress and development.

21. In the end, I would like to thank the Management Association of Pakistan for inviting me to deliver this Keynote Address.

Thank you for your attention. *****