State Bank of Pakistan

GOVERNOR'S ANNUAL REPORT
2023 - 2024

Governor's Annual Report

2023-2024

October 18, 2024

State Bank of Pakistan

Governor's Annual Report

2023-2024

The analyses presented in this report were prepared on data outturns for fiscal year 2024 (July 2023 - June 2024). These were finalized in September 2024, using data and developments as of then.

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This Report has been prepared in accordance with section 39(1) of the *SBP Act 1956* (as amended up to January 2022), which states that the Governor shall submit annual report before the Majlis-e-Shoora (Parliament) regarding the achievement of the Bank's objectives, conduct of monetary policy, state of the economy and the financial system.

Objectives of the State Bank of Pakistan

Objectives

The objectives of the State Bank of Pakistan are set out in section 4(B) of the *SBP Act 1956* (as amended up to January 2022), which states:

1. The primary objective of the Bank shall be to achieve and maintain domestic price stability.

2. Without prejudice to the Bank's primary objective, the Bank shall contribute to the stability of the financial system of Pakistan.

3. Subject to sub-sections (1) and (2), the Bank shall support the Government's general economic policies with a view to contributing to fostering the development and fuller utilization of Pakistan's productive resources.

Definition of Price Stability

Price stability means the maintenance of low and stable inflation guided by the government's medium-term inflation target. (section 2 (kb) of the *SBP Act 1956* (as amended up to January 2022))

Board of Directors

Mr. Jameel Ahmad (Chairperson)	Governor, SBP
Mr. Imdad Ullah Bosal	Secretary, Finance Division, Government of Pakistan
Dr. Ali Cheema	Non – Executive Director
Dr. Syed Akbar Zaidi	Non – Executive Director
Mr. Najaf Yawar Khan	Non – Executive Director
Mr. Fawad Anwar	Non – Executive Director
Mr. Zahid Ebrahim	Non – Executive Director
Mr. Mahfooz Ali Khan	Non – Executive Director
Mr. Muhammad Ali Latif	Non – Executive Director

Monetary Policy Committee

Mr. Jameel Ahmad (Chairperson)	Governor, SBP
Dr. Inayat Hussain	Deputy Governor, SBP
Mr. Saleem Ullah	Deputy Governor, SBP
Mr. Muhammad Ali Malik	Executive Director, SBP
Dr. Naved Hamid	External Member
Dr. Hanid Mukhtar	External Member
Dr. S. M. Turab Hussain	External Member
Mr. Najaf Yawar Khan	Non-Executive Director, SBP Board
Mr. Muhammad Ali Latif	Non-Executive Director, SBP Board
Mr. Fawad Anwar	Non-Executive Director, SBP Board

LETTER OF TRANSMITTAL

State Bank of Pakistan
Karachi.
October 18, 2024

Dear Mr. Chairman,

In terms of Section 39 (1) of the State Bank of Pakistan Act, 1956, Governor's Annual Report on the achievement of the Bank's objectives, conduct of monetary policy, state of the economy and the financial system for the year 2023-2024 is hereby enclosed for submission to the Majlis-e-Shoora (Parliament).

With warm regards,

Yours sincerely,

(Jameel Ahmad)
Governor
Chairperson, Board of Directors

Syed Yousaf Raza Gilani
Chairman
Senate of Pakistan
Islamabad

LETTER OF TRANSMITTAL

State Bank of Pakistan
Karachi.
October 18, 2024

Dear Mr. Speaker,

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With warm regards,

Yours sincerely,

(Jameel Ahmad)
Governor
Chairperson, Board of Directors

Sardar Ayaz Sadiq
Speaker
National Assembly of Pakistan
Islamabad

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Governor’s Remarks

Pakistan’s macroeconomic conditions improved in fiscal year 2024. With continued tight monetary policy stance, supported by fiscal consolidation, and relatively benign global economic conditions, inflation turned a corner after two challenging years. External account pressures also waned, contributing to a build-up of foreign exchange reserves, which together with reforms in foreign exchange companies, instilled stability in foreign exchange market. These improvements were accompanied with continued stability in financial sector, amid a moderate agriculture-led economic growth that was also supported by a small but gradual recovery in large scale manufacturing (LSM) against a sharp contraction in FY23.

The early signs of improvement in macroeconomic conditions were visible since the first quarter of FY24, reflecting that the various difficult decisions taken by the SBP and the government in the battle against inflation were indeed paying off. However, the SBP remained cautious against a premature monetary easing. It maintained the tight monetary stance by keeping the policy rate unchanged at 22 percent until nearly the end of FY24, to eliminate the risks of deep entrenchment of inflationary pressures. The year also saw fiscal policy being aligned with the tight monetary stance by recording the first primary surplus in 17 years, which also led to a notable decline in public debt in terms of GDP.

As result, the headline and core inflation witnessed a consistent downtrend in the second half of the fiscal year, falling sharply to 12.6 percent in June 2024 from 29.4 percent in June 2023. This provided room for the SBP’s Monetary Policy Committee (MPC) to reduce the policy rate by 150 basis points (bps) to 20.5 percent in June 2024. The reduction was the first in 33-months, marking the gradual softening of the tight monetary policy stance.

The exchange rate stability also helped the deceleration of inflation in H2-FY24. The PKR’s stability came on the back of a number of factors, including the narrowing current account deficit (CAD) to a 13-year low of 0.2 percent of GDP on account of growth in exports and remittances amid muted increase in imports. The trends in foreign exchange market were also facilitated by the inflows under the US$ 3 billion Stand-By Agreement (SBA) with the International Monetary Fund (IMF) in June 2023, and ensuing official inflows from multilateral and bilateral external creditors. In addition, the government’s decision to approach the IMF for Extended Fund Facility (EFF) program; FX market reforms including in exchange companies; and mobilization of deposits from friendly countries supported the build-up in FX reserves and the stability in exchange rate.

The fiscal year 2024 also witnessed a respite from the multitude of shocks faced by global economy in recent years. Despite the geo-political tensions emerging in the Red Sea region during the year and continued Russia-Ukraine conflict, the global economy performed relatively well. Global GDP growth was marginally higher, whereas world trade also improved as the year progressed. Moreover, global inflation declined with both headline and core inflation falling meaningfully in advanced economies (AEs) as well as emerging market and developing economies (EMDEs). The trends in inflation were supported by continued softening of global commodity prices that began in FY23. In light of these developments, EMDEs unwound monetary tightening, while AEs adopted a cautious stance due to relatively sticky core inflation. In addition to macroeconomic stabilization policies, this conducive global environment, coupled with relatively lower economic and political uncertainty, also had multifaceted positive spillovers on domestic economy.

On the financial stability front, the banking sector continued to perform well. The total deposits of banking sector grew strongly on the back of elevated interest rates and SBP’s efforts towards financial inclusion and digitalization of payments. This contributed to a decline in currency-in-circulation to deposit ratio. Owing to government's increased reliance on domestic banks to finance the budget deficit amid shortfall in external financing, banks invested these deposits in government securities as demand for private sector credit remained low in FY24.

In addition to increase in deposits, banking sector's capital adequacy ratio (CAR), assets quality, and liquidity indicators also improved, enabling the country's financial sector to maintain overall financial soundness. Despite the tight monetary policy stance, the growth in banking sector's loan delinquencies remained relatively contained compared to FY23, while the provisioning coverage improved substantially. However, relative to commercial banks, growth in asset base of microfinance banks (MFBs) more than halved in FY24. MFBs' borrowers, being more vulnerable to economic shocks, were hit hard by the Covid-19 pandemic, unprecedented floods in FY23 as well as the recent high inflationary environment and economic slowdown, resulting in a significant increase in MFBs' losses. These factors led to a further decline in MFBs' aggregate CAR. However, excluding the non-compliant MFBs, the sector's CAR improved in FY24.

Complementing the efforts to ensure price and financial stability, the SBP continued to support the government's general economic policies, as part of its tertiary objective. These measures are also well aligned with the SBP's Vision 2028, which includes goals to facilitate exports and remittances; further develop an innovative digital financial services ecosystem; promote financial inclusion, and transforming to Shariah-compliant banking system. Accordingly, the SBP undertook measures and initiatives to support exports and remittances, such as increase in retention limit in foreign currency accounts for IT companies, freelancers and exporters; and launched awareness programs to boost remittance inflows through formal channels.

From the perspective of digital financial services, the SBP also achieved significant progress during the year, particularly the launch of Raast 'Person-to-Merchant' (P2M) service. The Raast P2M service is set to accelerate the digitization of business transactions across Pakistan, by enabling payments via QR Codes, Raast Alias, IBAN and Request to Pay. Moreover, the SBP also granted license to an Electronic Money Institution to enable digitization of agri-business. In terms of cross-border digital financial integration, the SBP signed an MoU to integrate SBP's Raast with Arab Monetary Fund's Buna, its cross-border payment system, where the inclusion of PKR as a settlement currency in Buna is a key milestone. In addition, the SBP approved a cross-border partnership between Pakistani and Chinese financial services companies that would enable e-wallet users in Pakistan to make cross-border payments in China.

During FY24, the SBP also implemented the National Financial Inclusion Strategy (NFIS) 2018-2023, successfully achieving its headline targets of increase in account ownership and a reduction in gender gap. The SBP is in process of finalizing the next version of the NFIS to further enhance financial inclusion and digital financial services by 2028. In other measures towards increasing financial inclusion, the SBP's Banking on Equality policy has achieved notable success in terms of women's financial inclusion by introducing women-centric products and gender mainstreaming policies. Moreover, the SBP is developing a Financial Inclusion index based on access, usage and quality to better assess the progress and inform evidence-based policy making.

Meanwhile, progress on the development of Islamic banking continues, with the sector experiencing significant growth, in terms of asset and deposits in FY24. During the year, the SBP adopted 12 additional Shariah standards to strengthen compliance framework and harmonize Shariah practices in domestic Islamic banking sector. To further advance Islamic banking, the SBP is collaborating with the stakeholders to promote understanding and develop skilled human capital through appropriately formulated strategic goals. Moreover, in line with the Federal Shariat Court's ruling on Riba, the SBP has granted in-principle approval for establishing a digital retail Islamic bank and Shariah compliant digital banking through Islamic window operations.

These complementing measures will help towards Pakistan's long term economic growth and development. At the same time, there is a need to address supply side constraints, and other policy, governance and administration related challenges. In this context, while the scaling back of energy subsidies poses an upside risk to inflation, it is an important step towards energy reforms. This needs to be accompanied by reforms in energy policy and governance to ensure energy inflation risks are tempered in the medium term. Similarly, there is a need for continued fiscal consolidation to reduce debt and help bring down inflation sustainably. This also entails reducing fiscal leakages, such as by reforming state-owned enterprises, and better fiscal planning, including through public pension reforms. In addition, it also requires addressing the issues of informal economy and documentation that will not only help raise revenues but also have lasting impact on access to credit.

In this regard, the ongoing fiscal consolidation is encouraging. With budgeted increase in direct and indirect taxes amid plans to widen tax net, the fiscal deficit in FY25 is projected to be lower than FY24, despite government's plans for higher development spending aimed at boosting economic growth. Although the pace of agriculture growth may soften in FY25, the slow but consistent recovery in LSM since December 2023, and the bottoming out of high-frequency demand indicators reflects steady improvements in real economic activities. This momentum, supported by lower borrowing costs and fall in global commodity prices, is expected to continue in the remaining period of FY25.

While moderate economic growth is expected to increase import volumes, its impact on trade balance may be muted by benign trends in global commodity prices. At the same time, both the exports and workers' remittances are projected to grow in continuation of the trends in FY24, leading to a sustainable CAD. This, coupled with the approval of the IMF's US$ 7 billion EFF program, which typically paves way for other external inflows from multilateral and bilateral sources, is expected to further strengthen foreign exchange buffers.

In this backdrop, inflation is projected to remain significantly contained in FY25, particularly due to the lagged impact of tight monetary policy stance and continued fiscal consolidation. The headline inflation has already been on a downward trajectory since June 2023 falling to 6.9 percent in September 2024; global commodity prices continue to be low; whereas core inflation is also softening. These are indeed encouraging signs. However, upside risks could still emanate from global and domestic economic and political uncertainties, such as from slippages from envisaged fiscal consolidation, unplanned energy subsidies, or volatile global commodity prices in the wake of growing geo-political tensions.

Reflecting its confidence over receding inflationary pressures, the SBP's MPC further reduced the policy rate by 350 bps in July and September 2024, taking the cumulative reduction to 450 bps since June 2024. Despite this reduction, the real policy rate remains significantly positive, which the MPC considers appropriate to guide inflation towards the medium term target of 5.0 – 7.0 percent. The SBP will remain on guard to counter any threat to price and financial stability, which are critical for sustaining higher growth over the medium to long term.

1 The State of Pakistan's Economy and Financial System

Supported by stabilization policies and softer global commodity prices, the fiscal year 2024 witnessed improvements across key macroeconomic indicators. The combined impact of tight monetary policy and more-than-budgeted fiscal consolidation, coupled with lower global commodity prices, led to a decline in inflation, particularly in the second half of the fiscal year. The year witnessed moderate agriculture-led GDP growth, supported by a gradual recovery in large scale manufacturing (LSM). The current account deficit narrowed significantly amid somewhat easing of external financing conditions. As a result, the FX reserves improved and pressures in foreign exchange market also subsided as the year progressed. The financial sector, which remained stable and resilient, also posted steady growth amid high government borrowing from scheduled banks. However, the financial sector's depth fell for the second consecutive year mainly owing to elevated level of inflation.

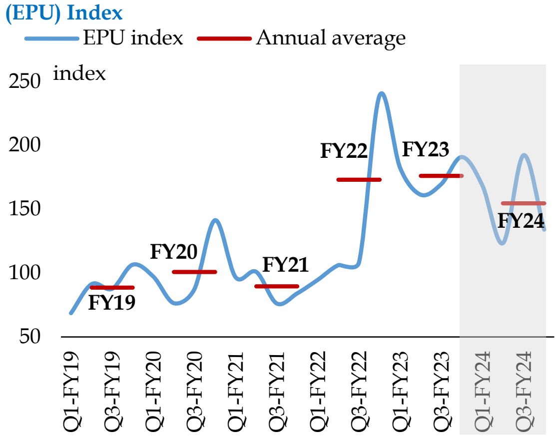
1.1 The State of Pakistan's Economy

Pakistan's macroeconomic conditions improved during FY24 after two volatile and challenging years. With the economic situation becoming relatively sanguine in the second half of the fiscal year across key indicators —including the external account, national CPI (NCPI) inflation, exchange rate, and large scale manufacturing— real GDP moderately recovered in FY24 from a slight contraction in the year before. These developments emerged amid the continuation of the central bank's tight monetary policy stance, and fiscal consolidation where the government achieved a primary surplus for the first time in seventeen years. These stabilization policies also translated into a significant reduction in public debt in terms of GDP.

The fiscal year 2024 had begun in the backdrop of an elevated inflation and challenging external account position, responding to which the SBP had increased the policy rate by 600 basis points (bps) in H2-FY23 alone. However, early signs of improvement in economic conditions appeared soon as FY24 progressed, with the narrowing of twin deficits; and inflation turning a corner in Q1-FY24 from the peak in Q4-FY23. This reflected the cumulative impact of policy rate hikes since September 2021; various administrative measures introduced by the SBP and the government in the preceding two years; fiscal consolidation; and softening global commodity prices. Nonetheless, awaiting confirmation of early signals of improvement, the Monetary Policy Committee (MPC) remained cautious and maintained the tight monetary policy stance until nearly the end of FY24, when it reduced the policy rate by 150 basis points (bps) to 20.5 percent in June 2024. The reduction was the first in 33-months, marking the gradual softening of the tight monetary policy stance.

While the government's decision to increase tax rates and reduce energy subsidies impacted inflation outturns, the overall economic environment started to markedly improve, following the US$ 3.0 billion Stand-by Agreement (SBA) with the International Monetary Fund (IMF) in June 2023, accompanied by the reversal of import prioritisation measures in the same month. During the year, the government also approached the IMF for an Extended Fund Facility program that somewhat buoyed market sentiments. Moreover, the elevated economic policy uncertainty that did weigh on industrial activities, tapered off in FY24, on account of relative stability in domestic political arena compared to the previous two years **(Figure 1.1)**. The economy in FY24 also benefitted from post-flood accelerated growth in agriculture sector,

Trends in Economic Policy Uncertainty (EPU) Index **Figure 1.1**



Source: State Bank of Pakistan

and an encouraging global economic environment.

International Developments

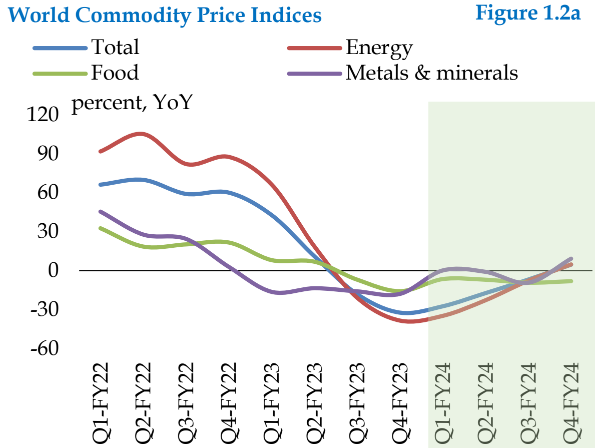
Global economic growth was only marginally higher in FY24, with more-than-expected output in the US and emerging market and developing economies (EMDEs) slightly offsetting slower growth in EU and UK. Both the headline and core inflation returned within the target ranges in EMDEs. It also fell noticeably in advanced economies (AEs), but remained above their target range due to sticky core inflation. Accordingly, while central banks in EMDEs slashed their policy rates, those in AEs adopted a cautious stance.

Modest global growth and persistent core inflation in AEs had a three-pronged impact on international trade and markets. First, while it enabled a corresponding increase in world trade, its pace of growth was slow amid a stiff price competition, such as in textile, steel and automobile industries. Second, it contributed to almost persistent decline in global commodity prices, particularly that of energy and food, with some exceptions such as rice **(Figure 1.2a & 1.2b)**. This was despite geo-political tensions in the Red Sea region and the continuation of Russia-Ukraine conflict. Third, with interest rates still relatively high in AEs, EMDEs' currencies and capital markets remained under pressure.

Real Sector

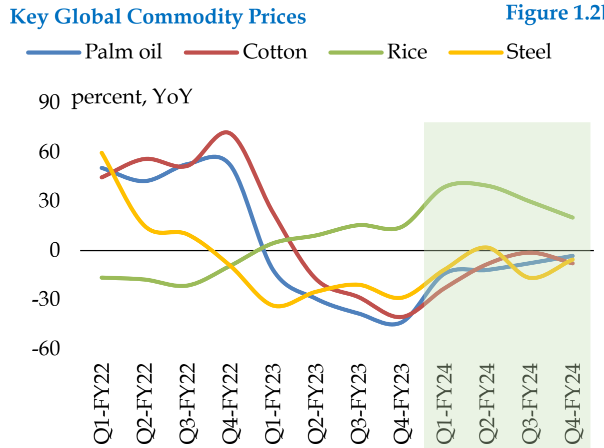
In the backdrop of improving domestic and global environment, real GDP grew moderately by 2.5 percent in FY24, against a contraction of 0.2 percent in the year before. This growth was mainly led by agriculture sector that contributed 1.5 percentage points to real GDP growth. Higher agricultural production also helped drive the increase in services sector output, which was mainly led by wholesale and retail trade. Industrial GDP, however, contracted during FY24, albeit lower compared to FY23, as mining & quarrying and manufacturing sub-sectors recovered.

World Commodity Price Indices **Figure 1.2a**



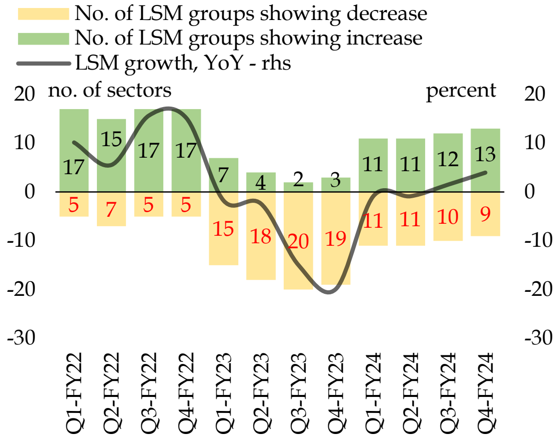
Source: World Bank

Key Global Commodity Prices **Figure 1.2b**



Sources: World Bank and Bloomberg

Large Scale Manufacturing (LSM) Growth **Figure 1.3**



Source: Pakistan Bureau of Statistics

Within the agriculture sector, *Kharif* crop output and improved input availability for *Rabi* season signalled positive crop outlook since the start of the year. The output of important crops alone jumped by 17 percent in FY24 compared to growth of a mere 0.5 percent in FY23. This was mainly driven by significant improvement in yields resulting from post-diluvial soil enrichment, favourable weather conditions, and better availability of inputs.

The increase in crop output was led by record production of wheat and rice, as well as a rebound in cotton production. While a timely announcement of support prices helped more than doubling of cotton output in FY24, better exports prospects incentivised increase in area under rice cultivation. Both crops witnessed an improvement in yield as well as area under cultivation, owing to which famers allocated lesser area for sugarcane leading to slight decline in production. Maize output also fell due to lower price prospects amid a decline in demand from poultry sector that discouraged farmers who instead preferred cotton and rice in FY24.

The recovery in manufacturing sub-sector was supported by a modest growth in LSM, despite subdued domestic demand and high cost of production stemming from successive increases in domestic energy prices amid the declining but still elevated level of inflation. With better availability of domestic and imported raw materials following the removal of import guidance in June 2023 and the decline in global commodity prices, the LSM posted a gradual recovery in FY24. The recovery became visible in the first quarter, but was more pronounced in H2-FY24, leading to a full year growth of 1.1 percent as against a 9.8 percent contraction in FY23. While this was not a broad-based recovery, the number of LSM sub-sectors posting growth was much higher in FY24, having eked out gains sequentially during the year **(Figure 1.3)**.

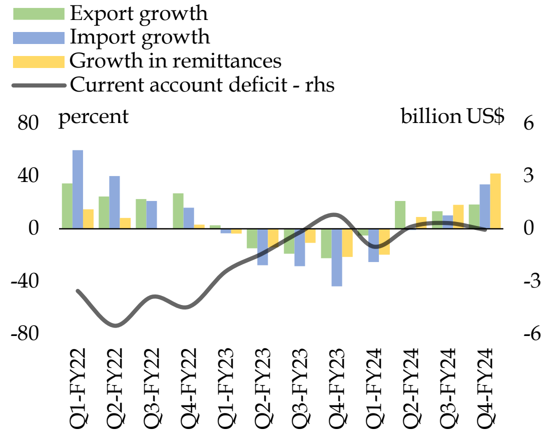
The factors underlying the performance of LSM sub-sectors varied. For instance, the pharmaceuticals benefited from increased availability of raw materials and export growth, whereas sugar production rose despite a decline in sugarcane output due to higher sucrose recovery on account of delayed start of crushing. The automobile production declined 25 percent in FY24. However, it witnessed a whopping jump of 28 percent in H2-FY24, which reflected recovery in demand. Similarly, cooking oil industry benefited from lower global palm oil prices. Moreover, while steel and cement production decreased in FY24, the pace of decline slowed with both sectors showing an uptick near the end of FY24.

The major drag to industrial GDP, nevertheless, came from electricity, gas and water supply sub-sector, while construction also posted a slight decline. The former was due to low energy demand amid rising electricity and gas prices, reduced gas distribution, and a growing shift towards production of off-grid solar electricity. The latter was due to tight monetary policy and fiscal consolidation, especially the deceleration in development spending.

External Sector

The external account pressures eased considerably in FY24 amid further narrowing of the current account deficit (CAD) to a 13-year

Key Drivers of Pakistan's Current Account **Figure 1.4**



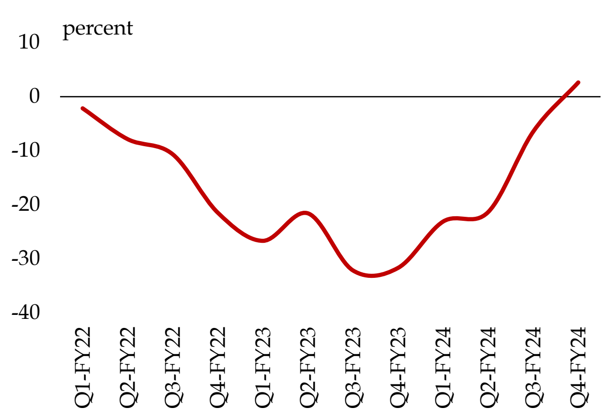
Source: State Bank of Pakistan

low. The improvement in CAD became prominent from Q2-FY24 onwards, as export growth outpaced the growth in imports, and workers' remittances witnessed a broad-based increase **(Figure 1.4)**. The latter rose on account of steady growth in AEs and the Middle East economies; reforms in exchange companies; and ensuing reduction in kerb premiums that redirected remittance inflows to formal channels. The growth in workers' remittances may also be attributed to elevated domestic inflation that squeezed household incomes, and resulted in higher transfers from overseas workers.

Exports rose nearly 12 percent in FY24 compared to a 14 percent fall in the previous year. This growth was mainly driven by food commodities, particularly rice that alone contributed nearly half of the increase in exports in dollar terms. Rice exports benefitted from India's ban on rice exports last year that enabled Pakistani exporters to increase their share in existing markets, tap new markets, and fetch higher prices. By comparison, exports of all other commodities increased by only 6 percent, as textile exports decreased about 2 percent despite a low base i.e. a 10 percent decline last year. However, this is mainly attributed to low unit prices in international markets driven by China's low pricing strategy, as export volumes of key textile products — apparel, home textile and cotton yarn—rose during FY24.[1]

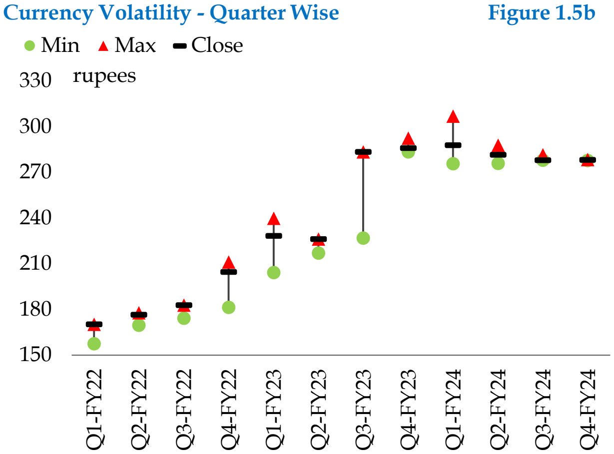
Import growth was contained at 0.9 percent during FY24 as a nearly 20 percent contraction in energy imports almost offset the 12 percent jump in non-energy imports. The decrease in energy imports is attributed to low unit prices as import volumes increased slightly during the year. While total imports had contracted nearly 15 percent in H1-FY24, it jumped sharply by 21 percent in the second half of the fiscal year. This reflected the increase in global energy prices in Q4-FY24; the surge in demand for solar panels

Trends in PKR Exchange Rate - app(+)/dep(-) **Figure 1.5a**



Source: State Bank of Pakistan

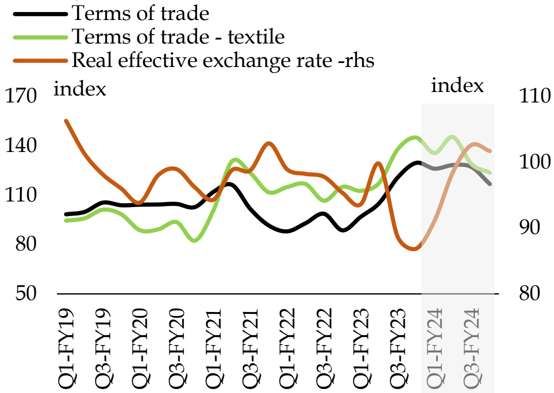
Currency Volatility - Quarter Wise **Figure 1.5b**



Source: State Bank of Pakistan

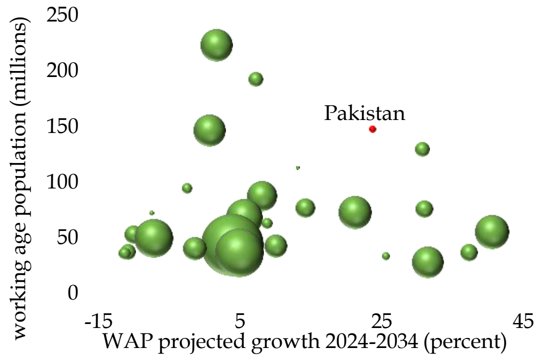
[1] Trade numbers in this report are based on SBP's BOP (payments) data. However, discussions on volume and unit price of exports/imports of commodities are based on customs data (on value and volume) as reported by Pakistan Bureau of Statistics.

Terms of Trade and Real Effective Exchange Rate **Figure 1.6**



Sources: Pakistan Bureau of Statistics and State Bank of Pakistan

FDI Stock - Top 30* Populated Countries **Figure 1.7**



*India & China are excluded due to their very large population. Bubble size represents FDI stock as percentage of GDP.

Sources: UN Population Division and UNCTAD

amid rising electricity costs; and a notable increase in import of mobile phones, iron/steel, and automobiles amid gradual recovery in the LSM.

The improvement in external account was also supported by an increase in net financial inflows, mainly due to the disbursement of US$ 3.0 billion in three tranches under the 9-month SBA with the IMF. The SBA catalyzed inflows from other external creditors, thereby diffusing external account pressures experienced in FY23. As a result, the SBP's gross FX reserves more than doubled during the year, and pressures on exchange rate decreased as the year progressed, culminating in PKR appreciation in Q4-FY24 **(Figure 1.5a & 1.5b).** However, the real effective exchange rate appreciated, mainly due to domestic inflation being higher than that in major trading partners. **(Figure 1.6)**.

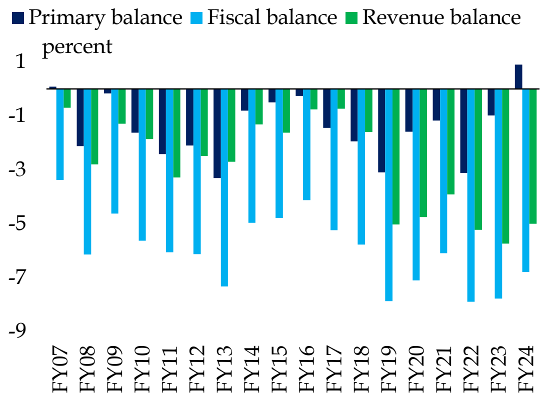
The private inflows in FY24 also witnessed improvement, where foreign portfolio investments, excluding Eurobond, inched up on account of relatively higher returns. Moreover, foreign direct investments (FDI) inflows rose nearly 17 percent to US$1.9 billion. However, in terms of GDP, the inflow was only marginally (0.02 percent) higher over last year. Pakistan's FDI stock remains considerably low in relation to the size and growth of its working age population (WAP). Typically, a large WAP helps attract FDI **(Figure 1.7)**. This is because high WAP either offers big market size, or potentially lower labour costs, or both. The country's inability to sufficiently attract this important non-debt creating external financial inflows reflects deep underlying structural problems faced by the economy, including low skilled labour, weak productivity, and a myriad of challenges to sectoral policies and governance.

Fiscal Policy and Public Debt

The key fiscal indicators improved during the year, with fiscal restraint becoming apparent since the first quarter. Fiscal consolidation in FY24 was more than envisaged, with primary surplus closing at 0.9 percent of the GDP compared to the budgeted target of 0.4 percent. While fiscal deficit was slightly higher than the budget target, it was lower than last year. Revenue deficit also decreased compared to FY23. These improvements came mainly on the back of phenomenal growth in non-tax revenues (NTR), supported by higher tax revenues, and lower non-interest expenditure in terms of GDP **(Figure 1.8)**.

The NTR surged by a whopping 75 percent, contributing to four-fifths of the increase in total revenue in terms of GDP that rose by 1 percent to 12.5 percent during FY24. This increase mainly stemmed from higher SBP profits that

Key Fiscal Indicators (as a Percent of GDP) **Figure 1.8**



Sources: State Bank of Pakistan and Pakistan Bureau of Statistics

more than doubled in terms of GDP on account of considerable increase in net interest income from large liquidity injections in money market amid elevated interest rates as well as revaluation gains due to PKR appreciation.[2] While 44 percent of the increase in NTR came from SBP profit, about one-third came from rate-driven growth in collection of petroleum development levy (PDL) that more than offset the impact of decline in POL sales volume.

In comparison to NTR, tax revenue accounted for only one-fifth of the increase in total revenue in terms of GDP, despite accelerated growth that helped increase FBR tax to GDP ratio to 8.8 percent from 8.5 percent in FY23. The growth in tax collection was visibly strong from Q1-FY24 onward, led by direct taxes that surged about 39 percent in FY24 compared to nearly 23 percent increase in indirect taxes. In relation to the expected buoyancy-led growth automatically driven by growth in tax bases (without tax new measures), direct tax collection rose much higher compared to indirect taxes **(Table 1.1)**. As a result, in terms of GDP, direct taxes rose by 0.4 percent whereas indirect taxes edged lower by 0.1 percent. These trends were driven by moderate GDP growth, high interest rates, inflation, as well as revenue mobilization measures, including the widening scope of super tax; increase in withholding tax and general sales tax rates; and rationalization of some of the tax expenditure.

On the expenditure side, total non-interest expenditure decreased by about 1 percent of GDP, despite a 16 percent increase in absolute terms. The rationalization of these expenses was visible since Q1-FY24, particularly in federal development spending and subsidies that cumulatively decreased by 0.7 percent of GDP during the year. Moreover, spending on defence affairs and provincial current expenditure also declined.

Actual and Expected Revenue Growth without New Measures - FY24 **Table 1.1**

Base	(A) Base Growth[a] (percent)	(B) Buoyancy Metric[b]	Tax Head*	Potential Buoyancy-led Growth (without new measures) (A*B)[c] (percent)	Actual Growth in FBR Taxes** (percent)
Nominal GDP	26.43	1.0	Direct taxes (d)	26.43	38.6
Import (in PKR terms)	14.95	1.2	Direct taxes (m)	17.94	37.2
Nominal LSM	17.87	1.1	Sales tax (d)	19.69	23.7
Import (in PKR terms)	14.95	1.0	Sales tax (m)	14.95	17.0
Import (in PKR terms)	14.95	1.0	Customs duty	14.95	18.5
Nominal LSM	17.87	0.8	FED (d)	14.30	51.9
Import (in PKR terms)	14.95	0.8	FED (m)	11.96	164.2

*(d) domestic; (m) import; ** Provisional data
Sources: [a] Pakistan Bureau of Statistics, [b] FBR's Evidence-based Revenue Forecasting FY24 (Table-9), [c] based on FBR's formula for buoyancy-led growth

[2] Low base affect is another reason behind higher SBP profits received by the government in FY24. Following the changes to the SBP Act in January 2022, the transfer mechanism of SBP's surplus profits to the government was changed from quarterly to annual basis; accordingly, SBP's surplus profits were transferred on quarterly basis only up to Q3-FY22. In comparison to SBP's profits received for a single-quarter in FY23, the government received full year SBP profits for FY23 in FY24.

In contrast to non-interest expenditure, interest payments overshot the budget estimate for the second year in a row. Interest expenses surged by 0.9 percent of GDP, even as its year-on-year growth slowed to 43 percent in FY24 from 79 percent in the year before. This is mainly attributed to large fiscal deficit in recent years that has led to increasing debt stock and higher debt servicing costs in the wake of rising interest rates. Mark-up payments in FY24 equalled about 88 percent of FBR taxes compared to an average of 62 percent between FY19-FY23. In fact, as percent of net federal taxes—i.e. federal taxes net off transfers to provinces—mark-up payments equalled about 202 percent in FY24 compared to about 155 percent in the preceding five years.

Nonetheless, as a result of lower fiscal deficit in FY24, the pace of domestic debt accumulation slowed during the year, leading to a decline in domestic debt to 44.6 percent of GDP from 46 percent in FY23. Most of the domestic debt during FY24 was sourced from commercial banks, unlike in recent years when its growth was mainly driven by debt raised from non-bank sources. The maturity profile of domestic debt lengthened as the government relied mainly on floating long-term securities in FY24. This change in domestic debt profile helps reduce the rollover risk, and also potentially benefit the government in falling interest rate environment through repricing at lower rates.

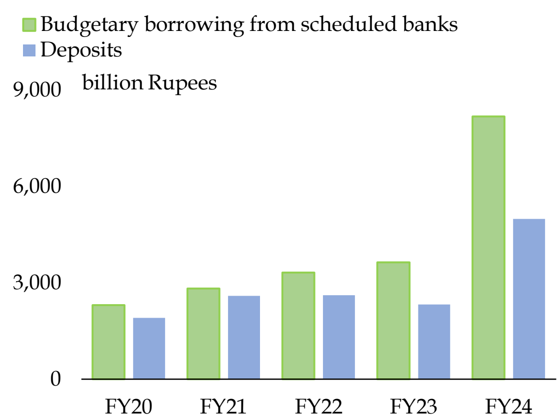
The stock of public external debt expanded by US$ 2.5 in FY24 compared to a contraction of US$ 4.8 billion in the year before, on account of multilateral and bilateral inflows following the SBA with the IMF. However, on net basis, external debt benefited from the impact of favourable revaluation stemming from PKR appreciation, reflecting the impact of macroeconomic stabilization measures. The revaluation gains more than offset the increase in external debt in dollar terms, which enabled a notable 5.6 percentage point decrease in external debt to GDP in FY24. Consequently, growth in total public debt almost halved to 13.3 percent during FY24, and public debt to GDP ratio dropped to 67.4 percent in FY24, the lowest since FY18.

Money and Credit Developments

Supported by the increase in external buffers on account of inflows from bilateral and multilateral lenders, Net Foreign Assets (NFA) of the banking system rose significantly in FY24, against a large contraction in FY23. The jump in NFA mainly drove the increase in broad money (M2) growth as Net Domestic Assets (NDA) of the banking system rose at a much slower pace compared to FY23. The M2 growth inched up to 16.1 percent in FY24 from 14.2 percent in the year before. However, it remained noticeably lower than the nominal GDP growth, easing to 34.5 percent of GDP, as against 37.6 percent in FY23.

The pace of growth in NDA slowed mainly due to large contraction in other items net—that reflects Open Market Operations (OMOs) entries of Development Finance Institutions — alongside net retirements in commodity financing, and sharp slowdown in borrowings by public sector enterprises. These substantially offset the surge in budgetary borrowing from commercial banks, as non-banks parked a major chunk of their funds in bank deposits instead of investing in government securities **(Figure 1.9)**. Accordingly, deposit growth in nominal terms

Budgetary Borrowing from Scheduled Banks and Deposits **Figure 1.9**



Source: State Bank of Pakistan

nearly doubled to 22.5 percent in FY24 amid lucrative interest rates.

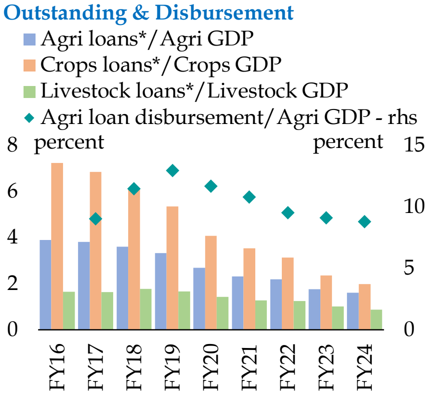
The NDA growth was also supported by modest uptick in private sector credit. This mainly stemmed from moderate recovery in economic activity and high input costs due to elevated domestic inflation, as working capital loans rose to Rs364 billion compared to a net retirement of Rs145 billion in FY23, whereas loans for fixed investment fell by 31 percent during the year. Owing to slow credit growth, the country's credit to GDP decreased further to 9 percent in FY24 from 10.9 percent in FY23. Pakistan credit penetration compares unfavourably with other lower middle income countries and has witnessed a consistent decline across key economic sectors **(Figure 1.10)**. From the central bank's perspective, these trends pose a challenge in terms of effective monetary policy transmission, and accordingly warrants several reforms, including addressing the issues of inadequate documentation of economy, lack of collateral, and improved availability of various credit information to strengthen credit reporting system.

On the liabilities side, currency-in-circulation (CiC) barely changed while deposits grew sharply, leading to notable improvement in currency to deposit ratio to nearly 34 percent in FY24 compared to 41 percent in the preceding year. In addition to high rate of return on deposits, this trend reflects SBP's continuous efforts towards digitalization of payments; crackdown on speculative activities in FX market; and somewhat elevated but receding inflation. Despite the slowdown in CiC, increase in NFA, and greater deposit mobilisation, liquidity pressures in the interbank market increased in FY24 as government borrowing from scheduled bank rose faster than the growth in banks' deposit base. Nonetheless, average deviation in overnight repo rate from the policy rate in FY24 remained lower compared to the year before, amid increase in the number of SBP's total OMO injections and their average size by 6.2 percent and 55 percent respectively.

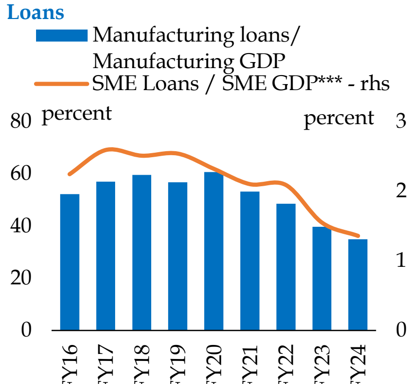
Inflation

Headline NCPI inflation decreased significantly in FY24, with sharp deceleration in the second half that more-than-offset a rather stubborn inflationary trend in H1-FY24. The decline, which was visible since January 2024, can be attributed to the lagged impact of monetary tightening and fiscal consolidation; higher agricultural production; the government's administrative efforts; and falling global commodity prices. While food inflation turned a corner from Q1-FY24 onward, the decrease in

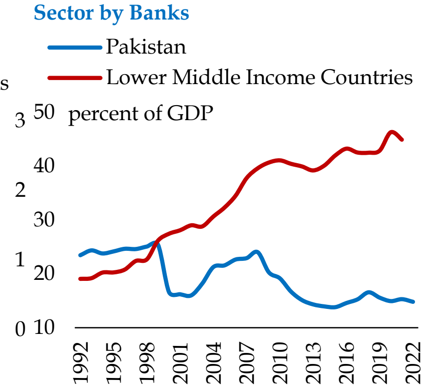
Agriculture Loans Outstanding & Disbursement — **Figure 1.10a**



Manufacturing [**] **& SME Loans** — **Figure 1.10b**



Domestic credit to Private Sector by Banks — **Figure 1.10c**



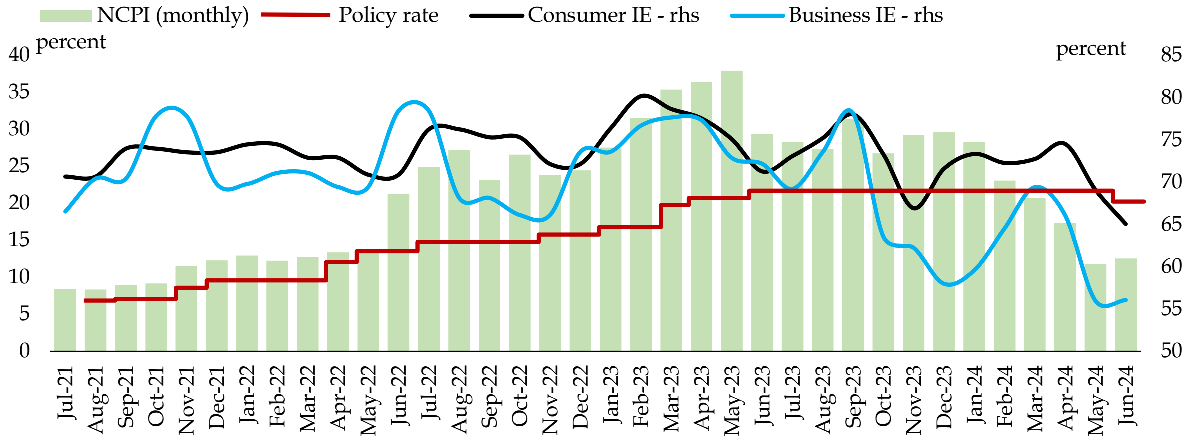
*outstanding loans based on ISIC-4 classification, **based on ISIC-4 classification, ***based on estimated SME contribution to GDP at 40 percent.

Source: SBP Staff Calculation

Source: SBP Staff Calculation

Source: World Development Indicators

NCPI Inflation, Inflation Expectations (IE) and Policy Rate **Figure 1.11**



Sources: State Bank of Pakistan and Pakistan Bureau of Statistics

core inflation was more pronounced in the last quarter. Energy inflation, on the other hand, ballooned in Q2-FY24 onward in urban areas that has a 60 percent share in the NCPI basket.

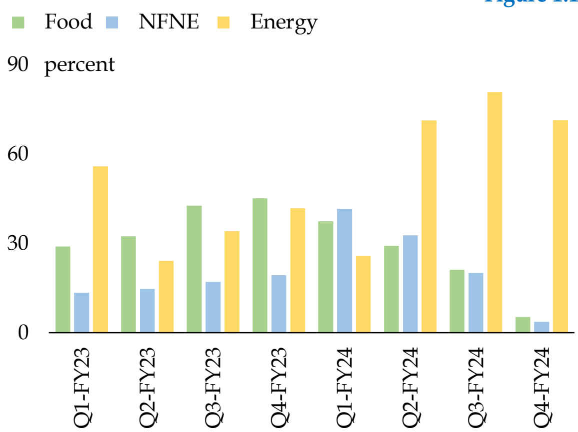
Food inflation benefitted from improved supply, lower input costs, and decline in global commodity prices. Wheat prices softened on the back of imports, and record wheat production. Similarly, milk prices—that has been one of the leading drivers of inflation in recent past — tapered off in FY24 due to reduction in feed costs, while vegetable oil prices eased due to lower palm oil prices in international markets.

Energy inflation in urban areas surged to about 63 percent in FY24 from 38.4 percent in the year before, due to upward revisions to gas and electricity prices as well as higher PDL rates on domestic POL products. By comparison, energy inflation in rural areas softened, because unlike the urban basket, the rural energy basket has much larger share of solid fuel instead of gas, and a reduced share of electricity.

Gas prices have been periodically increased from January 2023 onward as part of the government's plan to align gas charges with cost recovery and check the flow of gas circular debt. Similarly, electricity tariffs have been on the rise since FY23 on account of higher capacity payments in the wake of growing under-utilization of capacity of independent power producers. Exchange rate depreciation in H1-FY24 also contributed to increase in electricity tariffs, both on account of higher fuel cost in terms of local currency and as part of US dollar-index guaranteed returns that feed into power tariff calculations. While rationalization of energy subsidies is important for fiscal prudence, it presents the challenge of potentially reducing electricity demand, which in turn raises tariffs given the unique nature of tariffs structure mentioned above. Therefore, in addition to tariff revisions, a host of structural, policy, and regulatory reforms are also needed to check energy inflation in the medium term. This includes opening up the power market and fostering competition and efficiency by replacing the existing arrangement of single buyer model with a competitive, multiple buyer model.

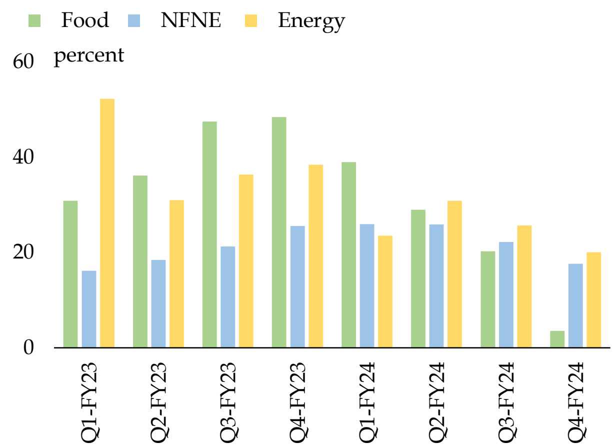
The combined effect of the second round impact of rising energy inflation; the lagged impact of PKR depreciation until the Q3-FY24; and higher tax rates kept the core inflation unchanged over last year. However, owing to lagged impact of monetary tightening and fiscal consolidation, coupled with exchange rate appreciation amid sustained improvement in external account and easing inflation expectations of business and consumers, the core inflation softened towards the end FY24 **(Figure 1.11 and 1.12a & 1.12b)**.

Average Inflation - Urban **Figure 1.12a**



Source: State Bank of Pakistan

Average Inflation - Rural **Figure 1.12b**



1.2 The State of the Financial System

The financial sector exhibited a steady performance, and continued the provision of credit and financial services amid moderate economic recovery in an environment marked by declining but elevated inflation. The asset base of the financial sector grew by 21.6 percent to Rs 65.2 trillion by the end of FY24. However, the financial depth — the financial sector assets to GDP ratio — fell to 61.5 percent from 64.0 percent in FY23. This was the second consecutive year when the country's financial depth declined, as elevated inflation usually hampers the financial intermediation in the economy (**Table 1.2**).[3]

Trends in Key Financial Sector Indicators

Total assets of the banking sector, which holds the biggest share of country's financial sector, grew by 26.7 percent during FY24, higher than 17.0 percent increase in FY23 (**Table 1.2**).[4] Investments in government securities was the major driver, which mainly reflects the rising financing needs of the government. In particular, amidst a shortfall in budgeted external and non-bank financing, the government's reliance on domestic banking sector remained high. This has been affecting the supply of credit to private sector.[5] However, from demand side, advances recorded muted increase amid subdued economic activities and tight financial conditions during the year.

Deposits and borrowings together financed around 91 percent of the increase in banks' asset base during FY24 (**Table 1.3**). Profitability remained steady on the back of expanding earning assets and higher lending rates, though the interest/mark-up payments to depositors and tax charges also increased substantially. The after-tax profit of the banking sector increased by 30.4 percent in FY24 to Rs 645.2 billion. Accordingly, the sector's key profitability indicators improved during the year: the after tax Return on Assets (ROA) rose to 1.4 percent in FY24 from 1.3 percent in last year, whereas

[3] Empirical evidence also suggests that inflation impedes financial depth. For instance, see Khan M.S, Senhadji A.S, Smith B.D. Inflation and Financial Depth. *Macroeconomic Dynamics*. 2006;10(2):165-182. doi:10.1017/S1365100506050152

[4] Among financial institutions, the SBP regulated entities represent more than 80 percent of the assets of financial sector. As such, the financial performance and standing of these entities is crucial for the financial system and overall economy. The banking sector holds key significance in the financial sector due to its large market share as well as the crucial role that it plays in financial intermediation and payment systems.

[5] For details see Monetary Policy Statement July 2024 available at: https://www.sbp.org.pk/press/2024/Pr-29-Jul-2024.pdf

Assets Composition of the Financial Sector **Table 1.2**

	Jun-22	Jun-23	Jun-24
Assets (billion Rupees)			
MFBs	604	721	782
DFIs	807	3,224	2,460
NBFIs	2,171	2,922	3,978
Insurance*	2,380	2,740	3,194
CDNS	3,630	3,248	3,140
Banks	34,861	40,797	51,687
Total	**44,450**	**53,651**	**65,242**
Asset growth (percent)			
MFBs	17.6	19.3	8.6
DFIs	50.8	299.5	-23.7
NBFIs	18.1	34.6	36.2
Insurance	11.8	15.1	16.6
CDNS	-7.9	-10.5	-3.3
Banks	23.7	17.0	26.7
Overall financial sector	19.7	20.7	21.6
Share in total assets (percent)			
MFBs	1.1	1.3	1.2
DFIs	1.5	6.0	3.8
NBFIs	4.0	5.4	6.1
Insurance	4.4	5.1	4.9
CDNS	6.8	6.1	4.8
Banks	65.0	76.0	79.2
Assets as percent of GDP*			
MFBs	0.9	0.9	0.7
DFIs	1.2	3.8	2.3
NBFIs	3.3	3.5	3.8
Insurance	3.6	3.3	3.0
CDNS	5.4	3.9	3.0
Banks	52.3	48.6	48.7
Overall assets	**66.7**	**64.0**	**61.5**

*For FY24, Insurance data is as of March 2024

Sources: SBP, SECP, CDNS, and PBS

the Return on Equity (ROE) increased to 24.3 percent in FY24 from 23.5 percent in FY23.[6]

However, taxation charges are on a rising trend in recent years that lop a significant part of financial institutions' pre-tax profits; especially in the case of banks, taxation charges were about 52 percent of their pre-tax profits in FY24 (**Figure 1.13**). From financial stability perspective, the rising taxation has implications for the banking sector's ability to build buffers necessary to withstand unforeseen macro-

Key Balance Sheet Variables of Banks, DFIs and MFBs **Table 1.3**

billion Rupees

	Jun-22	Jun-23	Jun-24
Banks			
Total assets	34,861	40,797	51,687
Investments (net)	17,829	21,504	30,973
Advances (net)	10,890	12,060	12,083
Deposits	23,730	26,785	32,538
Development Finance Institutions (DFIs)			
Total assets	807	3,224	2,460
Investments (net)	584	2,944	2,134
Advances (net)	160	188	191
Deposits	31	36	58
Microfinance Banks (MFBs)			
Total assets	604	721	782
Investments (net)	133	157	164
Advances (net)	310	360	376
Deposits	447	520	640

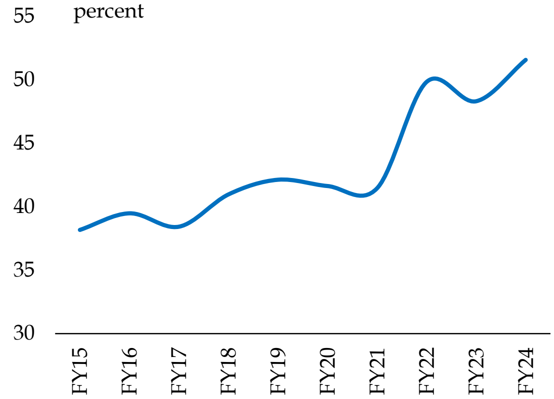
Source: State Bank of Pakistan (unaudited quarterly returns of the institutions)

financial shocks; take risks and continue lending during situations when economic growth is low; and undertake capital expenditures, such as investments in technology to improve efficiency.

In sharp contrast to the banks, the asset base of Development Finance Institutions (DFIs) shrank by 23.7 percent to Rs 2,460 billion by the end of FY24. The fall in assets was driven by contraction in the portfolio of government securities, which had substantially increased during FY23. Since these investments were mainly financed from borrowings, some DFIs faced lower spreads, especially in the latter half of FY24, when market interest rates decreased in the wake of receding inflation and increasing expectations of monetary policy easing. This impact was also reflected in higher interest expenses that surpassed interest earnings in H2-FY24 and dragged DFIs' overall earnings in FY24. The after tax profit of DFIs thus fell by 37.0 percent to Rs 13.2 billion from Rs 21 billion in FY23. Nonetheless, the major support to the earnings came from non-interest income (mainly

[6] RoA and RoE ratios are calculated on the basis of fiscal year (July to June). Usually, these are calculated on calendar year basis.

Taxation Charges to Profit Before Taxes of Banking Sector **Figure 1.13**



Source: SBP staff calculations

dividend income), though net interest income also contributed to profits.

In Microfinance Banks (MFBs), the pace of growth in asset base decelerated to 8.6 percent in FY24, compared to 19.3 percent growth in FY23. Both advances and investments grew at a slower pace, reflecting a relatively difficult operating environment for MFBs as compared to banks and DFIs. Nonetheless, advances remained a major part of MFBs' balance sheet, constituting around 48 percent of the asset base at the end of FY24. This asset composition reflects MFBs' traditional business model of extending microcredit and their important role in providing low-income groups an access to finance.

The MFBs in general have been facing strains since the Covid-19 pandemic, which were further compounded by the catastrophic floods in FY23, and the ensuing challenging macroeconomic environment. As MFBs' borrowers have relatively low shock absorbing capacity, the recent high inflationary environment and economic slowdown contributed, inter alia, in rising delinquencies in MFBs. Thus, aggregate losses of MFBs increased to Rs 18.0 billion in FY24 from Rs 13.5 billion in FY23. Operating expenses, which were already at elevated levels as compared to the earnings, rose further and contributed to losses in FY24.

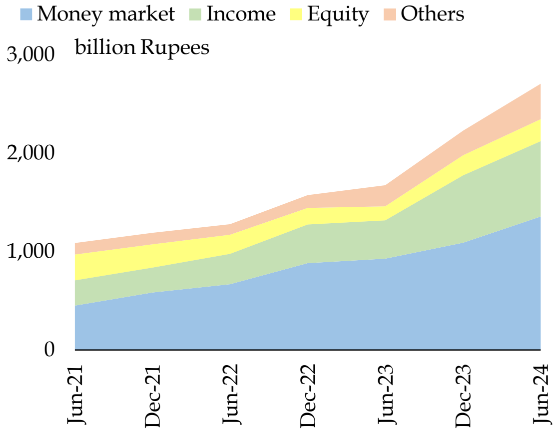
The asset base of Non-Bank Financial Institutions (NBFIs) grew by 36.2 percent in FY24 to reach Rs 3,978 billion. Asset management segment,[7] which dominates the NBFIs, saw 41.5 percent increase in assets. The asset base of the lending segment,[8] however, contracted by 0.5 percent in FY24 as higher interest rates and slowdown in economic activities contained demand for credit. This resulted in further increase in the share of asset management segment to 90.7 percent by the end of FY24 (from 87.3 percent in June 2023), while the share of lending segment further fell to 9.3 percent in June 2024 (12.7 percent in June 2023).

Within the asset management segment, mutual funds and portfolios were the major drivers of growth.[9] Though all the categories of mutual funds exhibited growth, the expansion in income and money market funds was prominent (**Figure 1.14**). While the returns on equity funds sharply rose from October 2023 onwards till end FY24, investors remained tilted towards relatively low risk money and income funds. These two fund categories contributed around 78 percent of the total increase in mutual funds' assets during the year. The asset base of the lending segment of the NBFIs, however, contracted marginally as higher interest rates and subdued economic activities contained demand for credit.

The insurance sector remained resilient in the face of high inflationary environment and tight macro-financial conditions. The asset base of the

[7] The Asset Management (AM) segment includes: Asset Management Companies (AMCs), Investment Advisors (IAs), Real Estate Investment Trusts (REITs), Mutual Funds, Pension Funds, Private Equity (PE) Funds, and Discretionary/ Non-discretionary Portfolios.
[8] Lending NBFIs (also referred to as the non-AM segment) include Leasing Companies, Modarabas, Investment Finance Companies, Housing Finance Companies, Non-Bank Microfinance Companies (NBMFCs), etc.
[9] Mutual funds and portfolios constitute 68.1 percent and 14.5 percent of the asset base of the NBFIs respectively.

Composition of Mutual Fund Assets **Figure 1.14**



Source: Securities and Exchange Commission of Pakistan

sector grew by 16.4 percent in the first nine months of FY24 to reach Rs 3,194 billion. Pakistan's insurance sector is dominated by life insurance segment with 84.6 percent market share as of March 2024, while the non-life insurance segment constitutes 15.4 percent. The life and non-life segments grew by 16.9 percent and 13.8 percent, respectively. Preliminary data shows debt and equity investments as the main source of expansion in insurance sector's assets.

Trends in Financial Intermediation by SBP- Regulated Entities

Deposit mobilization and promotion of savings

Branch network of SBP-regulated entities (REs) i.e., Banks, MFBs, and DFIs expanded to 18,355 in FY24 from 17,751 branches in FY23. These branches along with increasing alternate delivery channels (ADCs)[10] helped financial institutions in carrying out the financial intermediation process and facilitated a large number of customers during FY24. Despite the recent high inflation and challenging operating environment, the increase in branch network of banking sector is encouraging, and is expected to help in expanding outreach of banking as well as financial inclusion in the economy. Due to these initiatives and the use of ADCs, the expansion in total accounts of these regulated entities maintained the double-digit growth, up 18.0 percent to reach 215 million accounts by the end of FY24.[11] This fast growth is conducive for raising the financial inclusion in the country (for details, see **Chapter 4**).

Total deposits mobilized by banks, DFIs and MFBs rose by 21.6 percent in FY24 to Rs 33,236 billion in FY24. Consistent with its share in the overall financial sector, the banking sector mainly drove deposit mobilization efforts, whose deposits increased by 21.5 percent to Rs 32,538 billion in FY24. The major increase in deposits was witnessed in saving and fixed categories in an elevated interest rate environment.[12] The rising trend of saving accounts bodes well for reducing cash preference and improving the saving rate in the economy, which is quite low in Pakistan compared to the regional peers. Reflecting the growth in saving deposits, the banking sector's higher mark-up/interest expenses on deposits rose to Rs 3,236 billion in FY24 up from Rs 2,011 billion in FY23.[13]

Meeting credit needs of the economy

After contraction in FY23, real GDP growth moderately recovered in FY24, and inflationary pressures eased[14], particularly in H2-FY24. This create room for the MPC to reduce its policy rate by 150 bps in June 2024. However, macro-financial conditions continued to remain tight during the year.

[10] ADCs include various channels such as ATM, Internet banking, Agent/ merchant banking, Mobile banking, e-Wallet, Call center
[11] https://www.sbp.org.pk/publications/Quarterly/Jun-2024.htm
[12] The share of savings and fixed deposits rose to 53.4 percent in FY24 from 52.3 percent on FY23, while share of current accounts fell to 38.7 percent from 40.5 percent.
[13] For details on the state of financial sector development in Pakistan and its comparison with peers, see chapter 1 of Governor Annual Report for 2021-22 available at: https://www.sbp.org.pk/reports/annual/Gov-AR/pdf/2022/Dec/Gov-AR.pdf
[14] Average CPI inflation fell to 23.4 percent in FY24 from 29.2 percent in FY23

The growth in overall advances of the SBP-regulated institutions remained subdued at 0.3 percent in FY24 and the outstanding quantum of loans stood at Rs 12,650 billion by the end of FY24.[15] Nonetheless, investments, mainly in government securities, increased by 35.2 percent to Rs 33,271 billion. This was the second consecutive year after FY22, when investments have recorded a significant rise. The strong growth in investments reflects, in part, a weaker demand for credit by the private sector as well as heavy reliance of government on banks to finance fiscal deficit amid less-than-budgeted external finance and fall in non-bank financing. With substantial investments in government securities, banks' exposure (advances *plus* investments) to public sector increased to 63.9 percent of their asset base by the end of June 2024, up from 58.8 percent in June 2023. The situation demands earnest measures by the government to reduce its reliance on banks for deficit financing and make space for lending to the private sector.

Banks being the major providers of credit, accounted for around 56 percent of the expansion in combined advances of the SBP-regulated entities during FY24. Total advances of the banking sector rose by only Rs 226 billion in FY24, much lower than the increase of Rs 1,310 billion in the year before.[16] In FY23, around 90 percent of the increase was due to public sector entities and credit to private sector remained muted.[17] During FY24, however, there was some revival in private sector credit, which rose by Rs 369 billion compared to Rs 118 billion increase in the year before. Nonetheless, the credit off-take was concentrated in few sectors such as sugar, agribusinesses, chemical & pharma and textiles.

Public sector entities, on the other hand, made a net retirement during FY24, which was largely driven by commodity operations financing (mainly wheat). During Q4-FY23, the commodity procurement agencies increased their borrowing by around Rs 361 billion, which was quite higher than their last three years' average borrowing during the fourth quarter of fiscal year, a period when commodity financing rises on account of seasonality. However, during FY24, provincial food departments received some of the pending payments (subsidies) from the federal government, which enabled them to make higher net retirements during H1-FY24.[18] These net retirements more than offset the increase in commodity financing in H2-FY24.

With the slowdown in credit expansion, combined with higher nominal GDP amid elevated inflation, the private sector credit to GDP ratio declined further to 9.0 percent in FY24 from 10.9 percent in FY23 and 13.4 percent in FY22. The advances to deposits ratio (of banks, DFIs and MFBs) also fell to 38.1 percent in FY24 from 46.1 percent in FY23.

Though credit off-take remained muted, the total number of borrowers of banks and the MFBs grew by 13.1 percent to 10.8 million in FY24. The major contribution to the borrowers' base emanated from MFBs, which are leveraging on use of technology in extending microcredit.

A few MFBs have recently started offering nano-loans of short maturities to eligible borrowers, through mobile applications. One of the MFBs has also obtained in-principle approval under digital bank licensing framework to prepare itself operationally to launch digital financial services.[19] With the increased use of technology,

[15] Overall advances of banking sector, DFIs and MFBs grew 11.0 percent in FY23 and 23.8 percent in FY22
[16] Outstanding advances of banks' domestic operations.
[17] Share of domestic public sector advances is 28.1 percent and that of domestic private sector is 71.9 percent in total advances of banking sector at end June 2024
[18] For details see, chapter 3 of The State of Pakistan's Economy Half Year Report 2023-2024
[19] For details see SBP press release available at: https://www.sbp.org.pk/press/2023/Pr-20-Sep-2023.pdf

Performance of Islamic Banking — Table 1.4

	IBIs		Conventional Banks	
	FY23	FY24	FY23	FY24
billion Rupees				
Total assets	8,118	9,689	32,679	41,998
Investments (net)	3,472	4,489	18,032	26,484
Financing (net)	3,324	3,449	8,736	8,634
Deposits	5,870	7,363	20,915	25,175
Growth (percent)				
Total assets	19.7	19.4	16.4	28.5
Investments (net)	30.0	29.3	19.0	46.9
Financing (net)	12.3	3.8	10.2	-1.2
Deposits	20.9	25.4	10.8	20.4
Share in Total Assets (percent)				
Investments (net)	42.8	46.3	55.2	63.1
Financing (net)	40.9	35.6	26.7	20.6
FDR/ADR (percent)*	56.6	46.8	41.8	34.3

* FDR= Financing to Deposits ratio for IBIs and ADR=Advances to Deposits ratio for Conventional banks
Source: State Bank of Pakistan

the MFBs targeted extending microcredit via digital modes, leading to a significant growth in borrower base. This development further improved the share of MFBs in combined borrower base (of banks and MFBs) to around 65 percent by the end of FY24 from 58.6 percent in FY23. Though banks provide the major chunk of credit in absolute terms, MFBs continue to serve a large number of small borrowers. The fast penetration of small-sized loans can help in improving the access to finance for low income individuals, thus contributing to the achievement of financial inclusion goals outlined in SBP's Vision 2028.

Islamic Banking Institutions (IBIs), which offer Shariah-compliant financial services to businesses and households, performed well during FY24. However, as compared to their conventional counterparts, IBIs' assets recorded slower growth during FY24. This was because of much higher expansion in assets of conventional banks on the back of substantial rise in investments, mainly government securities. The growth in deposits of IBIs, however, accelerated and outpaced the increase in deposits of conventional banks (**Table 1.4**). These developments also reflected in relative share of IBIs in the banking sector, which, in terms of asset base, fell to 18.7 percent in FY24 from 19.9 percent in FY23, though IBI's share in deposit base rose to 22.6 percent in FY24 from 21.9 percent in FY23.

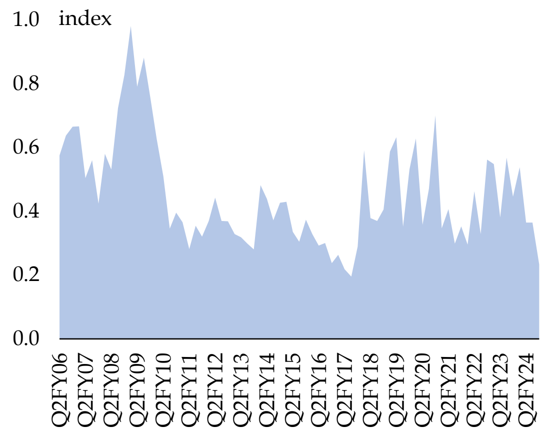
With six full-fledged Islamic banks and Islamic banking branches of 16 conventional banks, total number of institutions offering Islamic banking services remained unchanged at 22. Branch network of IBIs, however, rose to 5,196 by June 2024 from 4,534 in June 2023. This fast growth reflects SBP's emphasis on extending Islamic banking branches across the country. This will not only help in tapping the vast potential of Shariah-compliant banking products and services but will also help in raising the share of IBIs in overall banking sector.

The IBIs have a vast potential for growth as a result of an enabling environment created through SBP's consistent efforts. The Federal Shariat Court's judgement on Riba provides a clear direction, for which SBP is collaborating with the government and other stakeholders, and is actively working for the implementation of the judgment. In this regard, a multi-pronged approach has been adopted under the guidance of a high-level 'Committee for Transformation of Conventional Banking into Islamic'. This includes a review of existing domestic laws and comparison with international best practices, assessment of existing regulatory framework, awareness sessions on Islamic banking and finance, and capacity building of stakeholders.[20]

The composition of domestic advances portfolio of banking sector shows that the corporate sector continued to dominate with around 66 percent share, whereas the share of SMEs at 3.7 percent and agriculture sector at 4.1 percent remained on lower side in FY24. Financing to these priority sectors is low due to a number

[20] For details see, Box 3.2: SBP's Strategy to transform the banking sector to Islamic mode – key challenges and opportunities available at (www.sbp.org.pk/FSR/2022/Box-3.2.pdf)

Trends in Financial Market Stress Index **Figure 1.15**



Source: SBP staff calculations

structural issues, such as low saving rate and a limited pool of loanable funds; weak and insufficient collateral; informal economy; and underdeveloped credit reporting system.

Nevertheless, the supply of credit to these sectors remains a key priority of SBP. For this purpose, the SBP has taken various steps over time. On policy front, separate sets of prudential regulations have been prescribed for financing to SMEs, consumer, housing, and agriculture segments. These regulations duly take into account the unique dynamics of these sectors and, in line with the principle of proportionality, prescribe the prudential standards that are relatively relaxed compared to regulations for financing to large corporate firms. Nonetheless, as the second biggest borrower after the government, the corporate sector utilizes a major portion of total bank credit.

It has been a policy preference of the SBP that the financing needs of large corporate firms and government should ideally be met from the capital market. For this purpose, SBP's policy framework provides different incentives. For instance, prudential regulations prescribe a conservative exposure limits on banks' lending to single and group borrowers and also ensure diversity and diffusion in the banks' portfolios by putting limit on the aggregate amount of large borrowers. Moreover, to improve the corporate governance standards of large corporate borrowers and prepare them for tapping the capital market funding, these borrowers are required to prepare and submit audited financials, while risk-based capital regulations incentivizes the large borrowers to get themselves rated by the credit rating agencies. In addition, the SBP cooperates with the relevant stakeholders to develop the capital market and remove the bottlenecks in the demand and supply of credit to priority sectors.

Financial markets

Domestic financial markets remained relatively calm during FY24 compared to FY23. As the macroeconomic conditions started improving during FY24, the stress in domestic financial markets subsided (**Figure 1.15**). The FX market primarily contributed to lower volatility in financial markets during FY24, as PKR remained stable, appreciating 2.7 percent as against depreciation of 28.4 percent and 23.1 percent in FY23 and FY22, respectively (**Table 1.5**).

The stability in the FX market was due to a number of factors. First, current account deficit further narrowed to US$ 0.7 billion in FY24 from a deficit of US$ 3.3 billion in FY23 (US$ 17.5 billion in FY22). Higher exports as well as increase in workers' remittances and muted growth in imports helped improve the current account balance.[21] Second, the revival of net financial inflows helped in the build-up of SBP's FX reserves.[22] Third, administrative and regulatory measures[23] in the FX market along

[21] Exports increased to US$ 31.1 billion in FY24 against US$ 27.9 billion in FY23. Moreover, workers' remittances increased to US$ 30.3 billion as compared to US$ 27.3 billion in FY23. Data source: SBP

[22] Financial Account in Balance of Payments shows net inflows of US$ 4,654 million in FY24 compared to net outflow of US$ 468 million in FY23.

[23] Administrative measures refer to the actions by law enforcement agencies while regulatory measures refer to the reforms introduced by SBP in exchange companies

Movements in Key Variables of Financial Markets **Table 1.5**

		FY22	FY23	FY24
PKR vs. USD	Level (end of period)	204.8	286.0	278.3
	Depreciation (-)/ Appreciation (+) (%)	-23.1	-28.4	2.7
	Volatility*	0.37	0.96	0.28
Weighted Average Overnight Repo rate	Level (end of period)	13.8	22.5	20.5
	Change (bps)	631	869	-198
	Volatility*	0.04	0.03	0.02
KSE-100 Index	Level (end of period)	41,541	41,453	78,445
	YoY change (%)	-12.3	-0.2	89.2
	Volatility*	0.94	0.88	1.07

*Volatility is measured using Exponential Weighted Moving Average (EWMA) method

Sources: SBP, PSX, and SBP staff estimates

with IMF-SBA program in June 2023 positively influenced sentiments in FX market. Backed by these developments, the SBP's FX reserves more than doubled to US$ 9.4 billion by end June 2024 from US$ 4.4 billion at end FY23.[24] Moreover, SBP reduced its forward position by US$ 1.1 billion to US$ -3.4 billion by end June 2024.

The average volatility in overnight repo rate remained lower during FY24, as the policy rate remained unchanged at 22.0 percent until the MPC decided to lower it by 150 bps in June 2024, compared to a cumulative 825 bps increase during FY23. Despite weak growth in private sector advances and healthy deposit mobilization, the average size of SBP's OMO injections went up significantly during FY24,[25] as the borrowing needs of the government outpaced the expansion in banks' deposit base.[26]

KSE-100 index rebounded notably and rose to 78,445 by end June-2024, resulting in 89.2 percent growth in FY24, as compared to a decline of 0.21 percent in FY23. A moderate recovery in economic activity, softening inflationary pressures, exchange rate stability, decrease in political uncertainty, and progress over IMF program revived investor confidence. Overall, financial markets continued to function smoothly and the financial institutions exhibited reasonable resilience to the fluctuations in market conditions.

Payment Systems and Financial Market Infrastructure (FMI)

The payment systems and institutions are providing systemically essential services for the functioning of the economy and financial markets mainly by facilitating the settlement and clearing of payments and securities.[27] The functioning of the FMI is also crucial for the efficiency and stability of the financial system, as well as effective transmission of the monetary policy.

The FMI performed without confronting any major disruption in flow of financial services and posted increased activity during FY24. For instance, the PRISM, the large value payments and settlement system in the interbank, processed 5.8 million transactions in FY24, which is 18.8 percent higher than the same period last year. In terms of values, PRISM handled Rs 1,043 trillion worth of transactions in FY24, which is 62.9 percent higher than last year. The growth was primarily driven by government securities, which reflects increased investments of banks in treasuries and higher volume of OMO injections that use these securities.

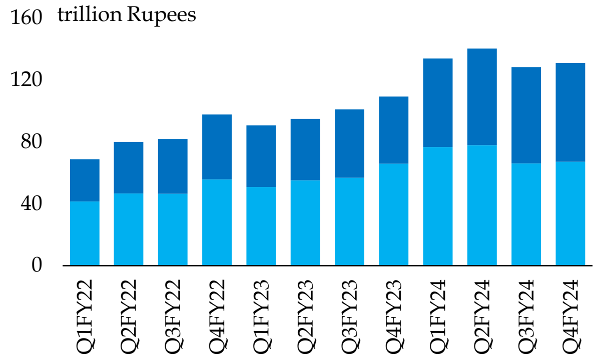
[24] The country's FX reserves rose 52.8 percent in FY24 to reach at US$ 14.0 billion at end June 2024

[25] Average OMOs' injections amounted to Rs 974.7 billion in FY24 – higher than Rs 346.1 billion in FY23. Moreover, SBP conducted 188 injections in FY24 as compared to 177 injections in FY23.

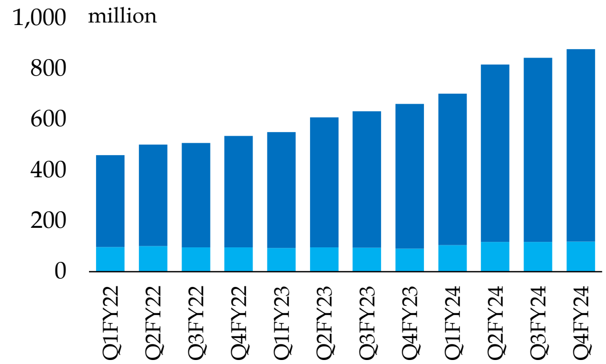
[26] The stock of government borrowing from the banking sector reached Rs 25.2 trillion by end June 2024 from Rs 17.0 trillion in June 2023.

[27] The FMI is a multilateral system among participating institutions that is used for clearing, settling, or recording of payments, securities, derivatives, or other financial transactions. The FMI of Pakistan comprises of: (i) a Large Value Payment System i.e. Pakistan Real-Time Interbank Settlement Mechanism (PRISM); (ii) a Retail Value Payment System or Instant Payment System i.e. Raast; (iii) an inter-bank switch facilitating various banking services i.e. 1-Link; (iv) a clearing house for paper-based instruments i.e., National Institutional Facilitation Technologies (NIFT); (v) National Clearing Company of Pakistan Limited (NCCPL), a corporate securities settlement company; and (vi) a corporate securities depository, i.e. Central Depository Company (CDC).

Composition of Retail Banking Transactions: Values **Figure 1.16a**



Composition of Retail Banking Transactions: Volume **Figure 1.16b**



Source: State Bank of Pakistan

Similarly, the retail value payments also showed robust growth of 32.1 percent and 34.7 percent, respectively, in volume and value terms in FY24. The share of paper-based transactions in total retail payments is consistently on a decline, which shows increasing consumer preference for digital modes of payment (**Figure 1.16a & 1.16b**). Moreover, *e*-banking transactions continued their upward trajectory, rising by 33.8 percent and 46.9 percent in volume and value terms, respectively, during FY24. The growth in volume was primarily driven by mobile banking and the ATMs, followed by Point of Sale (POS) and internet banking transactions. In terms of value, however, real time online banking (RTOB) dominated the mobile banking transactions, which reflects relatively large size transactions within e-banking modes (**Table 1.6**).

It is worth mentioning that the PRISM's real-time gross settlement approach mitigates systemic risk associated with large-value payments by eliminating the end-of-day settlement. The security settlements through Delivery versus Payment (DvP) or Payment versus Payment (PvP) ensures that securities are transferred only after payment is made, further reducing counterparty risk. To enhance participant efficiency, PRISM offers queuing and prioritizing facilities. The system remained seamlessly available throughout the review period, with disaster recovery sites in place as part of SBP's business continuity plan. Further, PRISM operating rules are aligned with international standards, and robust security measures, including multi-level network encryption and firewalls, protect the large-value payments against emerging threats like cybersecurity.

The transactions via Raast — SBP's instant payment system for retail transactions—witnessed exponential growth in transactions both in term of volume and value (**Figure 1.17**). The number of transactions processed through Raast jumped to 496 million in FY24 from 147 million in the same period last year. Major

E-Banking Transaction Channels **Table 1.6**

transactions volume in million; value in billion Rupees

	FY23		FY24	
	Volume	**Value**	**Volume**	**Value**
RTOB	200	113,942	192	159,314
ATM	810	12,154	932	15,018
POS	201	1,074	271	1,502
Internet banking	172	16,343	223	23,518
Mobile phone banking	661	23,793	1,123	46,344
Call centers/ IVR banking	0	8	0	8
E-Commerce	35	127	40	194
Total	**2,079**	**167,440**	**2,781**	**245,900**

Note: RTOB: Real-Time Online Branches; ATM: Automated Teller Machine; POS: Point of Sale

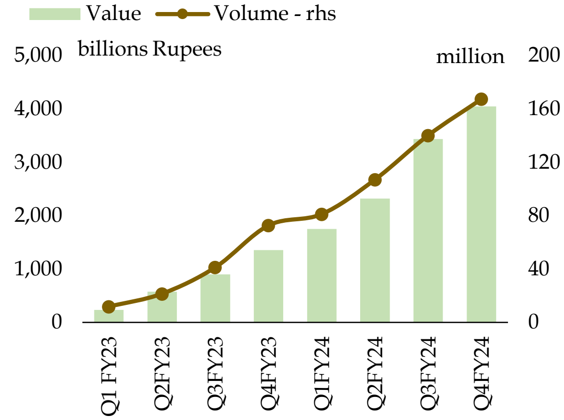
Source: State Bank of Pakistan

impetus to volumetric growth came from Person-to-Person (P2P) module, which was launched in February 2022. In value terms, transactions more than tripled to Rs 11,558 billion in FY24, as compared to Rs 3,074 billion in same period last year.

The country's digital payments and financial markets are undergoing constant improvements. This includes the SBP's introduction of Person-to- Merchant (P2M) module in Raast, which allows businesses to accept payments using QR codes, Raast IDs, bank account numbers, and request-to-pay options, thus expanding the payment choices for customers and boosting digital payments.[28] This initiative is expected to create further increase the convenience for businesses in carrying out their transactions (for details, see **Chapter 4**).

Another significant development was the signing of a Memorandum of Understanding (MoU) to integrate Raast with Buna—the cross border payment system owned by The Arab Monetary Fund.[29] This would pave the way for facilitation of cross-border transactions, specifically workers' remittances, between the Arab region and Pakistan, by providing instant, safe and cost-effective cross border payments (for details, see **Chapter 4**).

Trends in Raast Transactions **Figure 1.17**



Source: State Bank of Pakistan

[28] PSP&OD Circular No.04 2023 available at: https://www.sbp.org.pk/psd/2023/C4.htm
[29] Buna is the cross-border payment system operated by Arab Regional Payments Clearing and Settlement Organization "ARPCSO", owned by Arab Monetary Fund (AMF). For details see SBP press release: https://www.sbp.org.pk/press/2023/Pr-03-Nov-2023.pdf

2 Price Stability and the Conduct of Monetary Policy

2.1 Inflation Projections and Outcomes

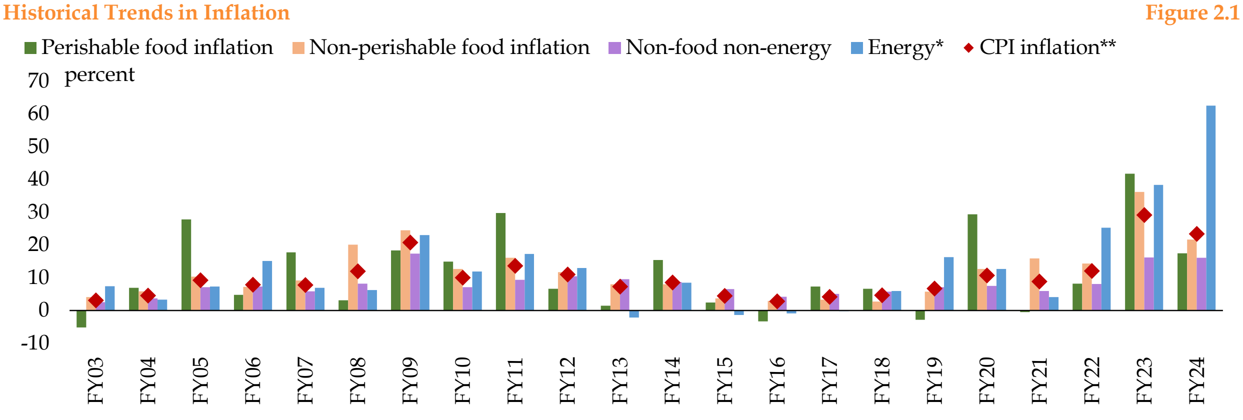
The average national CPI (NCPI) inflation declined to 23.4 percent in FY24, close to the lower bound of the SBP's revised projection range of 23.0 – 25.0 percent, and significantly lower compared to 29.2 percent a year before. The monthly trend reveals that inflation remained on a downward trajectory throughout the year, except for slight upticks in September, November, and December 2023, and June 2024, driven by adjustments in energy tariffs. The pace of disinflation, however, quickened as the year progressed, with year-on-year (YoY) inflation falling to 12.6 percent in June 2024 from 29.4 percent in June 2023.

Amid increased crop output and the government's administrative efforts, the food supply situation improved, leading to a considerable decline in food inflation during FY24. On the other hand, energy inflation jumped to its highest level in two decades due to adjustments in power and gas tariffs to contain energy sector circular debt (**Figure 2.1**). The core inflation remained almost unchanged at preceding year's level, as gradual decline in the latter half of FY24 offset the elevated levels in the first half (**Table 2.1**).

During H1-FY24, the upward adjustments in energy prices, combined with the artificial shortages of key food commodities and PKR depreciation that trimmed the gains from softening global commodity prices, kept the inflation high in the range of 26.8 to 31.4 percent. However, the government's decision to allow wheat import, coupled with increase in domestic agriculture output, eased the supply situation of food commodities during the second half of the year. In overall terms, waning food price pressures trimmed around 6.0 percentage points from the average NCPI inflation in FY24. In addition, continued tight monetary policy stance and budgeted fiscal consolidation that kept domestic demand in check (**Figure 2.2**), declining global commodity prices, and exchange rate appreciation since September 2023 (**Figure 2.3**) further attenuated inflationary pressures during H2-FY24.

As the year progressed, hikes in energy prices turned out to be the dominant factor shaping inflation outcomes and its outlook. To put things into the perspective, the contribution of the

Historical Trends in Inflation Figure 2.1



Note: The base year for inflation indices is as follows: FY00 for FY02-09 NCPI; FY08 for FY09-17; and FY16 for FY7-23. *includes firewood, kerosene oil, bulbs, match box. **inflation indices for urban areas are used from FY17 onwards.
Source: Pakistan Bureau of Statistics

Average Inflation **Table 2.1**

percent

	FY20	FY21	FY22	FY23	FY24
National CPI	10.8	8.9	12.1	29.2	23.4
Urban inflation	10.2	8.1	11.8	26.8	24.1
NFNE	7.5	6.0	8.1	16.2	16.1
Food	13.6	12.4	13.4	37.6	22.1
Energy	12.7	4.1	25.3	38.4	62.6
Rural inflation	11.6	10.0	12.6	32.6	22.4
NFNE	8.7	7.6	9.0	20.6	22.7
Food	15.9	13.1	13.0	41.1	21.6
Energy	6.2	6.6	24.8	39.1	24.9

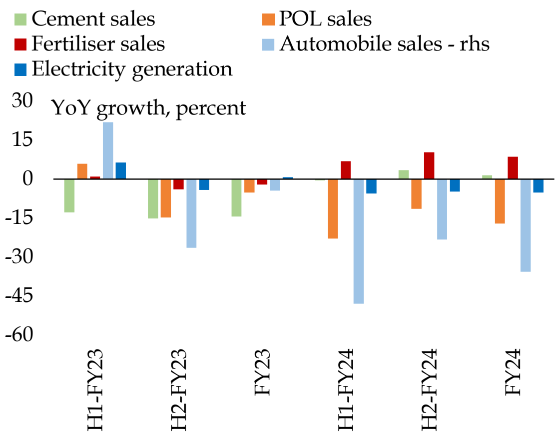
Source: Pakistan Bureau of Statistics

energy group in urban inflation progressively increased from around one-tenth in the first quarter to nearly one-half in the fourth quarter of FY24 **(Figure 2.4a & 2.4b)**.[1]

This mainly reflected the impact of long-standing inefficiencies in the energy sector. Specifically, untargeted energy subsidies and prolonged delays in tariff adjustments have stoked energy demand in the country, supported mainly through unsustainable fiscal subsidies. At the same time, limited fiscal space constrained timely disbursement of subsidies by successive governments. This, together with the rising transmission and distribution losses has led to piling up of a large stock of circular debt that rose to around Rs 4.7 trillion early 2024, amounting to 4.5 percent of GDP.[2]

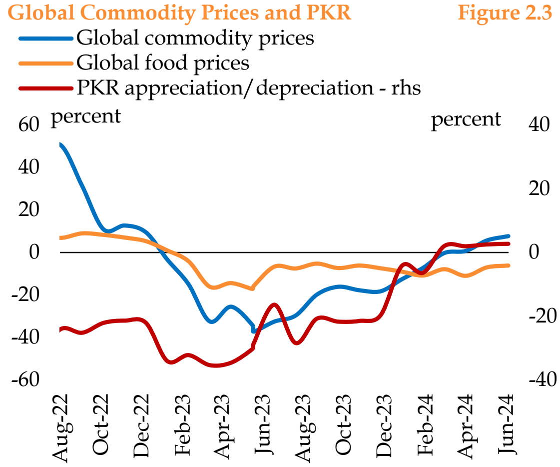
To correct these imbalances, the government initiated adjustments in electricity prices from FY19 to align power tariffs with the cost recovery levels as a primary tool to stem the increase in circular debt.[3] The scope of these efforts was broadened by initiating adjustments in gas tariffs for both household and industrial consumers from January 2023. Continuing these measures, the government introduced substantial increases in gas tariffs for protected and non-protected domestic consumers, non-domestic sectors, including commercial and captive users, and CNG stations during

Trends in High Frequency Indicators **Figure 2.2**



Sources: APCMA, OCAC, NFDC, PAMA, and NEPRA

Global Commodity Prices and PKR **Figure 2.3**



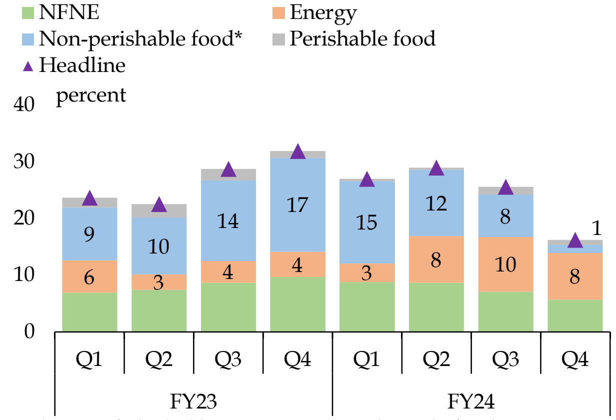
Source: World Bank and State Bank of Pakistan

[1] Similarly, the contribution of housing, water, electricity, gas and other fuels in NCPI rose from around one-tenth in Q1-FY24 to nearly one-half in Q4-FY24. Rural energy inflation, however, decreased to 24.9 in FY24, compared to 39.1 percent in FY23. This is mainly because of absence of gas charges from the rural basket.

[2] IMF (2024). Second and Final Review under Stand-By Arrangement, published in May 2024.

[3] IMF (2019). Staff Report under Request for an Extended Arrangement under the Extended Fund Facility, published in July 2019

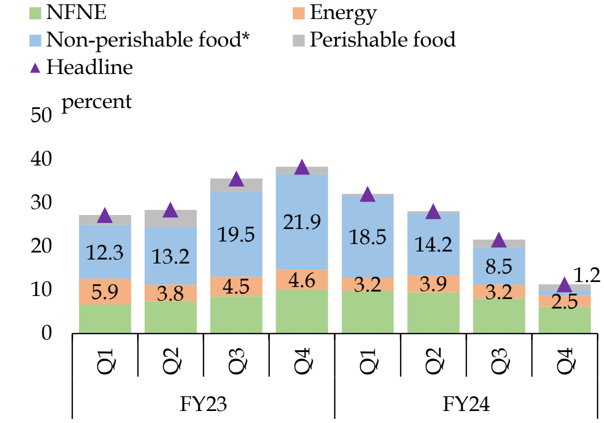
Composition of CPI Inflation (Urban) **Figure 2.4a**



*inclusive of alcohol beverages and readymade food

Sources: Pakistan Bureau of Statistics and SBP calculations

Composition of CPI Inflation (Rural) **Figure 2.4b**

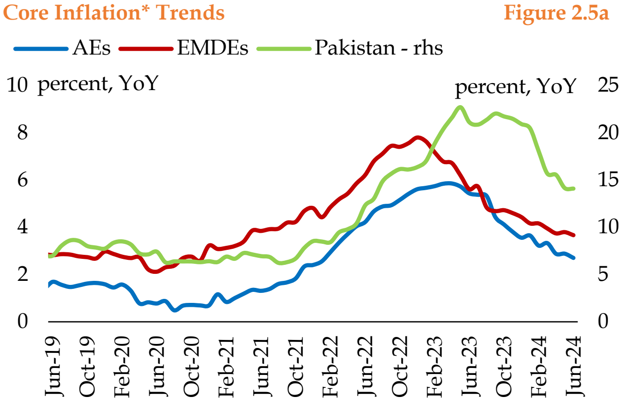


November 2023 and February 2024, which significantly exacerbated inflationary pressures in the energy group during FY24.[4]

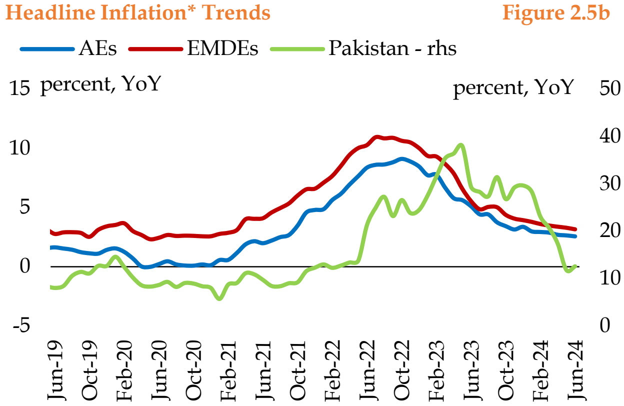
The impact of soaring energy prices also intensified underlying inflationary pressures in early part of the year by seeping into core services prices and inflation expectations. The confluence of the second-round effects of frequent adjustments in energy prices, hikes in tax rates, levies, wages, and PKR depreciation kept core inflation at elevated levels during H1-FY24. However, the lagged impact of continued tight monetary stance, complemented by fiscal consolidation, a beneficial base effect, and exchange rate appreciation, induced moderation in core inflation during H2-FY24. Nonetheless, it remained higher than the headline inflation towards the end of FY24.

These trends were not much different from the experiences of many advanced economies (AEs) and emerging market and developing economies (EMDEs). During the year, AEs and EMDEs saw inflation nearly returning to the pre-pandemic levels due to the fading impact of price shocks, dampening demand, and easing supply disruptions (**Figure 2.5a & 2.5b**). In response to the softening price trends, many central banks in EMDEs transitioned to

Core Inflation* Trends **Figure 2.5a**



Headline Inflation* Trends **Figure 2.5b**



Note: The sample comprises 30 AEs and 43 EMDEs

*median inflation.

Source: Haver Analytics and PBS

[4] The upward adjustment in gas administered prices began in FY23. Subsequent revisions made in November 2023 and February 2024 kept the gas prices at elevated levels in FY24. Source: OGRA

monetary easing during FY24. However, central banks in AEs maintained a tight monetary stance during the year because of a slower-than-expected decline in core inflation (**Figure 2.6**).

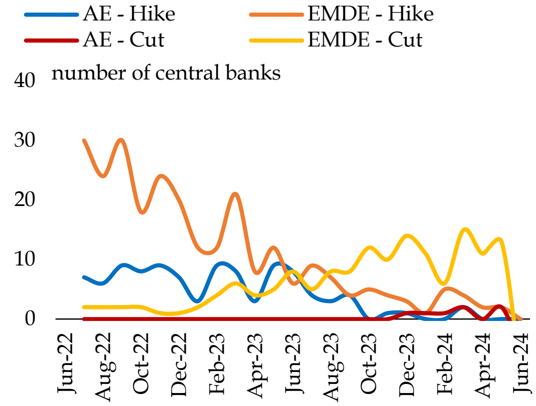
In view of the elevated inflation levels, the SBP also followed a cautious approach by keeping the policy rate unchanged until the end of FY24. The second half of FY24 saw a consistent decline in headline inflation, subsiding underlying inflationary pressures, and easing inflation expectations. This, coupled with improved external account, created room for the MPC to reduce the policy rate by 150 bps to 20.5 percent, which marked the gradual softening of the tight monetary policy stance.

Energy inflation, global commodity prices and external account developments weighed on inflation outcomes and its outlook during FY24

A number of positive developments improved the inflation outlook when the economy entered FY24. Particularly, the US$3.0 billion Stand-by Agreement (SBA) with the IMF in June 2023 paved the way for inflows from other external creditors and investors, addressing the near-term challenges to the external account. Similarly, falling global commodity prices and reduction in uncertainties also reflected positively on the inflation outlook.

In addition, the lagged impact of continued monetary tightening since 2021 and budgeted fiscal consolidation in FY24 was expected to keep domestic demand in check. Confirming these trends, inflation posted a ten percentage point decline in June 2023 after touching a multi-year high in May 2023. Based on these

Central Banks' Response in AEs and EMDEs — Figure 2.6



Note: The sample comprises 30 AEs and 43 EMDEs.
Source: Haver Analytics

developments, in its July 2023 meeting, the Monetary Policy Committee (MPC) anticipated inflation to generally follow a downward trajectory during FY24, falling in the range of 20.0 – 22.0 percent, down from 29.2 percent in FY23. This projection was subject to upside risks emerging from adverse impact of climate change, adjustments in gas prices and any unfavourable external development.

Further, the MPC expected the real GDP growth to witness a modest agriculture-led recovery in the range of 2.0 – 3.0 percent in FY24 (**Table 2.2**). The easing of import restrictions, along with the improvement in business sentiments, was expected to moderately support economic activity. At the same time, the continued contractionary policies were likely to keep the growth range-bound. Consequently, with the limited expansion in economic activity, the current account deficit (CAD) was anticipated to remain in the range of 0.5 to 1.5 percent of GDP during FY24.

SBP Macroeconomic Projections* in FY24 — Table 2.2

percent

	Jul-23	Sep-23	Oct-23	Dec-23	Jan-24	Mar-24	Apr-24	Jun-24
				Growth				
Real GDP	2.0 – 3.0	2.0 – 3.0	2.0 – 3.0	2.0 – 3.0	2.0 – 3.0	2.0 – 3.0	2.0 – 3.0	2.0 – 3.0
				Percent of GDP				
CAD	0.5 - 1.5	0.5 - 1.5	0.5 - 1.5	0.5 - 1.5	0.5 - 1.5	0.5 - 1.5	0.0 - 1.0	0.0 - 1.0
Fiscal deficit	7.0 – 8.0	7.0 – 8.0	7.0 – 8.0	7.0 – 8.0	7.0 – 8.0	7.0 – 8.0	7.0 – 8.0	7.0 – 8.0

* At the time of MPC meetings
Sources: SBP staff estimates, PBS, MoF, Bloomberg

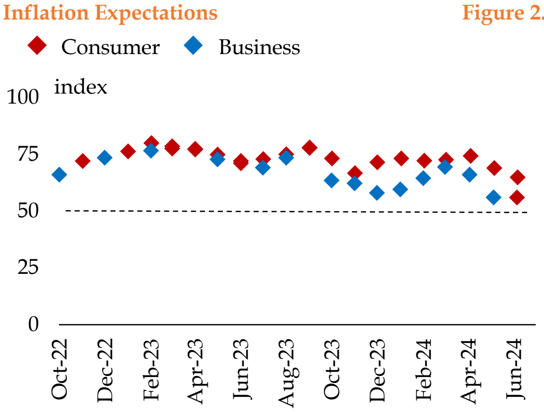
Moreover, the government envisaged significant fiscal consolidation in the FY24 budget, targeting to generate a primary surplus of 0.4 percent of GDP against a deficit of 1.0 percent of GDP in FY23. Finally, global commodity prices were expected to slightly recover in H2-FY24 after maintaining a downtrend trajectory during the first half of FY24.

However, as the year progressed, frequent and higher-than-anticipated adjustments in energy tariffs hampered the pace of disinflation. Moreover, the decline in global commodity prices, witnessed in H1-FY24, did not translate into a concomitant decrease in energy inflation due to the ongoing energy price adjustments to contain circular debt. Taking stock of these trends and the evolving risks, the MPC raised its inflation projection range for FY24 to 23.0 – 25.0 percent, in its meeting held in January 2024.

2.2 Monetary Policy Stance

The MPC, following a data-driven approach, continued to closely monitor the incoming information on key macroeconomic indicators and assess their impact on inflation outlook and its expectations. Accordingly, the MPC stayed the course in maintaining a tight monetary stance and kept the policy rate unchanged at 22 percent, in all its meetings held during FY24, with the exception of June 2024 meeting, when the policy rate was cut by 150 bps. The committee viewed that this policy stance was appropriate to keep the real interest rates in positive territory on a forward looking (12-month) basis, which was needed to bring inflation down to the medium-term target of 5.0 – 7.0 percent.

Inflation Expectations **Figure 2.7**



Note: values exceeding 50 indicate that high inflation views outnumber low inflation views.
Source: State Bank of Pakistan

Persistently elevated core inflation alongside the volatility in global commodity prices led the MPC to keep the policy rate unchanged at 22 percent, in July, September and October 2023 meetings

The macroeconomic trends were mostly in line with the MPC's expectations in the initial months of FY24. Reflecting improved supply of food commodities, the headline inflation saw almost a consistent decline during June to October 2023,[5] after a sharp increase during the period of Jan-May 2023. Notwithstanding its declining trend, inflation was still considerably above the average seen in the past five years, as well as the previous peak of 20.8 percent in FY09.[6]

Moreover, core inflation remained at elevated levels, which indicated the second round effects of earlier shocks to food and energy prices. This could also be seen in the declining but still elevated inflation expectations of households and businesses (**Figure 2.7**). The MPC also assessed the impact of fiscal policy measures and global developments on expected inflation path during FY24. The additional tax measures and increase in electricity tariffs notified at the time of approval of the FY24 budget, presented upside risks to inflation. In addition, the rising geo-political tensions in Middle East induced volatility in oil prices, that could have

[5] However, the headline inflation surged in September 2023 due to base effect in previous corresponding month (September 2022) as the government provided relief in energy prices during floods.
[6] The figure (20.8) is based on SBP staff calculations of annual NCPI inflation for the years FY03 - FY24; the calculations have used FY00 inflation index as the base year.

potentially fuelled increase in global commodity prices.

The MPC weighed the impact of these developments against the lagged impact of cumulative monetary tightening since September 2021, budgeted fiscal consolidation, expected moderate economic growth in FY24 and beneficial base effect from the last year. As anticipated, the real GDP posted a modest 2.1 percent agriculture-led recovery in Q1-FY24, against a 0.1 percent expansion in the same period last year, whereas, the large scale manufacturing (LSM) exhibited a tepid improvement in the first three months of FY24.[7]

Encompassing the combined impact of the moderate uptick in economic activity and withdrawal of priority guidance on imports in June 2023, the current account balance turned into a small deficit during Jul-Nov 2023, after recording a surplus in the last four months of FY23. At the same time, in line with the budgeted consolidation, fiscal indicators improved during Q1-FY24.

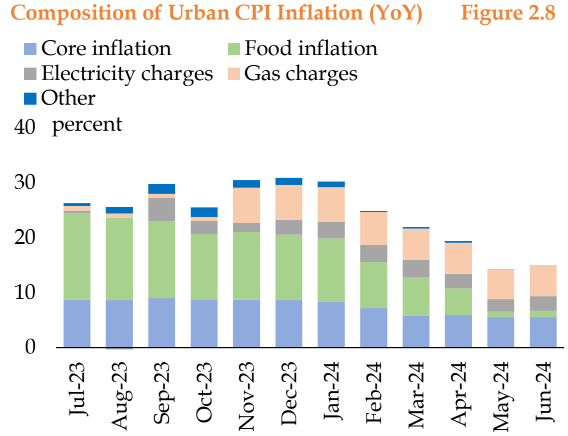
These trends alongside increase in crop production and government's administrative efforts to address artificial shortages of food commodities, and curb speculation in FX market also contributed positively to inflation outlook in FY24. Taking stock of these developments and still strong underlying inflationary pressures, the MPC decided in favour of maintaining the policy rate at 22 percent at the time of its reviews in July, September and October 2023. The MPC noted that this tightening stance was adequate to keep inflation at the projected downward trajectory during FY24, particularly from the second half of the year, and to achieve the medium term target of 5.0 – 7.0 percent by the end of FY25.

As frequent and unanticipated adjustments in energy prices impaired the pace of decline in inflation, the MPC maintained the policy rate at 22 percent in all its meetings from December 2023 till April 2024[8]

A greater-than-expected increase in gas tariffs pushed the headline inflation to 29.2 percent in November 2023, from 26.8 percent in October 2023. In a bid to slow the accumulation of circular debt in the energy sector by aligning energy tariffs with cost recovery levels, the governments had initiated price adjustments in the energy sector since FY19. Continuing these efforts, the authorities introduced significant hikes in gas tariffs, which slowed the pace of decline in inflation from November 2023 onwards **(Figure 2.8)** and weighed heavily on near-term inflation outlook.

In addition to its direct contribution to inflation, the impact of the increase in energy tariffs also seeped into core inflation, via higher cost of production, as well as elevated inflation expectations. Specifically, inflation expectations of businesses saw a steady increase during December 2023 till March 2024, while expectations of consumers also remained sticky

Composition of Urban CPI Inflation (YoY) Figure 2.8



Note: Gas charges are not a part of rural CPI basket.
Sources: Pakistan Bureau of Statistics and SBP calculations

[7] According to the updated revised estimates released in September 2024, the real GDP grew by 2.7 percent during Q1-FY24, against 1.5 percent expansion in Q1-FY23.
[8] The MPC convened four meetings during this period in the following months: December 2023, January, March and April 2024.

at elevated level during this period.[9] The MPC viewed that these large adjustments in administered energy prices had partly offset the beneficial effect of contractionary monetary and fiscal policies, easing global commodity prices and better agriculture produce on inflation.

In line with the MPC's anticipation, the quarterly data on national income accounts showed a continuation of moderate expansion in economic activity, with a 1.7 percent increase in real GDP growth during H1-FY24.[10] This was mainly led by agriculture sector, whereas industry showed a lower contraction compared to the same period last year, and services growth remained lacklustre on account of subdued domestic demand and higher operational costs.

Amid continued contractionary policies, lower global commodity prices, and better agriculture output, the CAD dipped by 85.1 percent to US$ 603 million during Jul-Mar 2024, compared to US$ 4.1 billion in the same period last year. This large and greater-than-anticipated contraction in the CAD helped stabilize FX buffers despite weak financial inflows. These favourable developments underpinned 2.3 percent appreciation in PKR during Mar- June 2024, after a consistent depreciation since August 2021, which contributed positively to inflation outlook.

Considering these developments, alongside the emergent risks to global commodity prices from geo-political tension in the Red Sea and fiscal measures in the upcoming budget for FY25, the MPC decided to continue with a cautious approach and kept the policy rate unchanged at 22 percent to bring inflation down to medium-term range by September 2025. While reaching this decision, the committee also took into account the cautious monetary policy stance adopted by central banks in major AEs and EMDEs in the face of the rising uncertainties in the global inflation outlook.

Moreover, in view of the pronounced contribution of the energy group in inflation, the MPC underscored the need for introducing fast-paced reforms to address structural bottlenecks in the energy sector. The committee also stressed the importance of fiscal reforms aiming at widening the tax base and reducing losses of public sector enterprises (PSEs) as an important precondition to achieve price stability.

Better than anticipated inflation outturns in May 2024 and softening underlying inflation led MPC to cut the policy rate by 150 bps to 20.5 percent in June 2024

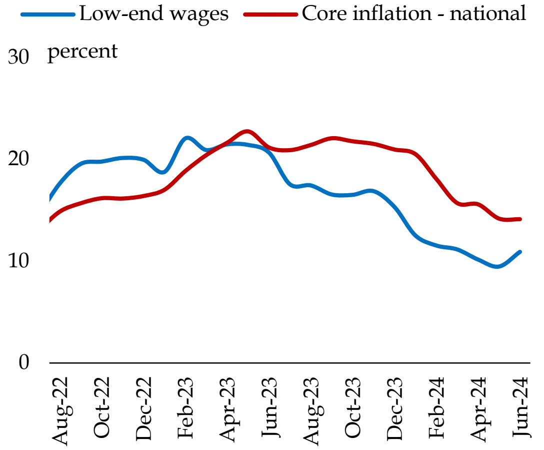
Continuing the downtrend since January 2024, the NCPI inflation saw a steep 5.6 percentage points drop in May 2024 to a 30-month low of 11.8 percent, from 17.3 percent in April 2024. Aside from a significant decline in food prices, softening underlying inflation was also behind this decrease.

After remaining at elevated levels, core inflation showed a gradual decline almost throughout H2-FY24. The fading second-round effects of commodity price shocks somewhat lowered inflation expectations of businesses and households, which translated into weaker growth in lower end-wages during this period **(Figure 2.9)**.[11] In addition, lower cost pressures due to strengthening PKR and policy-induced slowdown in domestic demand that helped stem the rise in input costs also played a role in waning core inflation.

At this point, the macroeconomic trends were broadly in line with the MPC's expectations. According to the provisional estimates released by the PBS, the real GDP showed a moderate

[9] The business expectations index remained around 60 from December 2023 till March 2024. Similarly, consumer price index remained above 70 from December 2023 till April 2024.
[10] According to the revised estimates released in September 2024, the real GDP grew by 2.3 percent in H1-FY24.
[11] The low-end wages include wages for personal grooming services, mechanical services, household servant, garbage collection, cleaning and laundering, construction wage rate, and tailoring. Source: Pakistan Bureau of Statistics

Trends in Low-end Wages **Figure 2.9**



Source: Pakistan Bureau of Statistics

increase of 2.4 percent in FY24, against a 0.2 percent contraction in FY23.[12] This was mainly led by agriculture, whereas the performance of industry and services sectors remained sluggish, amid the impact of contractionary policies. Benefitting from increased agriculture production, current account witnessed a surplus during February to April 2024, after posting a deficit of $ 1.2 billion during Jul-Jan 2024. Moreover, fiscal indicators, also showed continuation of consolidation, with a higher primary surplus of 0.9 percent of GDP compared to a deficit of 1.0 percent in the same period last year.

The growth in money supply though ticked up to 16.1 percent in FY24, against a 14.2 percent expansion in FY23, it was significantly lower compared to nominal GDP growth. A significant expansion in NFA, supported by improvement in external account, and increased government budgetary borrowing from commercial banks mainly underpinned this expansion. Moreover, reflecting the modest recovery in economic activity and higher cost of production, the growth in private sector credit also edged up in FY24 compared to last year. However, currency in circulation remained almost at preceding year's level, whereas bank deposits saw a notable expansion. These trends were in line with the tight monetary policy stance pursued in FY24.

Taking stock of these favourable macroeconomic developments, consistent decline in inflation during Jan-May 2024 and subsiding core inflation, the MPC decided to reduce the policy rate by 150 bps to 20.5 percent. Nevertheless, besides stressing on fiscal reforms to complement monetary policy to attain price stability, the MPC underscored the need of timely mobilization of external inflows and further strengthening of FX reserves to meet external financing requirements and ward off the negative effects of external shocks.

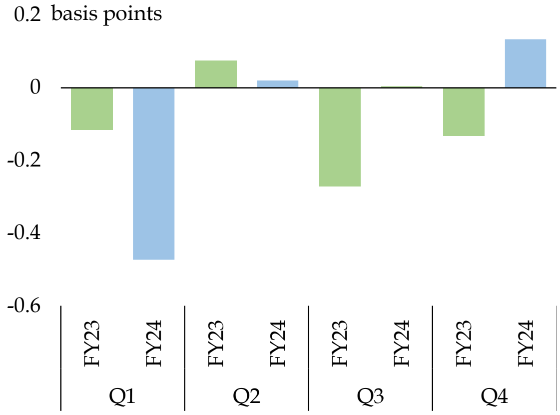
2.3 Monetary Policy Implementation

The SBP manages day-to-day liquidity in the money market with an objective to keep the overnight rate (ONR) stable and aligned with the policy (target) rate. In FY24, SBP operations helped to keep the ONR aligned with the policy rate with the exception of Q1-FY24, when, the ONR dropped 47 bps below the policy rate on average, compared to 12 bps in the same period last year. However, in the subsequent three quarters, the ONR moved relatively closer to the policy rate with an average deviation of 5 bps compared to the same period last year, when it remained 11 bps below the policy rate on average (**Figure 2.10**).

A significant increase in the government's budgetary borrowing requirements from commercial banks kept liquidity conditions of the market stressed compared to last year. The average outstanding stock of OMOs rose to Rs 9,433.3 billion in FY24, compared to Rs 5,829.2 billion in FY23 (**Figure 2.11**). This was despite a notable expansion in deposit mobilization during the year amid lucrative interest rates and lower economic uncertainty, which also subdued the increase in currency-in-circulation (CiC), compared to last year. Moreover, a

[12] According to the revised estimates released in September 2024, the real GDP grew by 2.5 percent in FY24.

Average Deviation of ONR from Policy Rate **Figure 2.10**



Source: State Bank of Pakistan

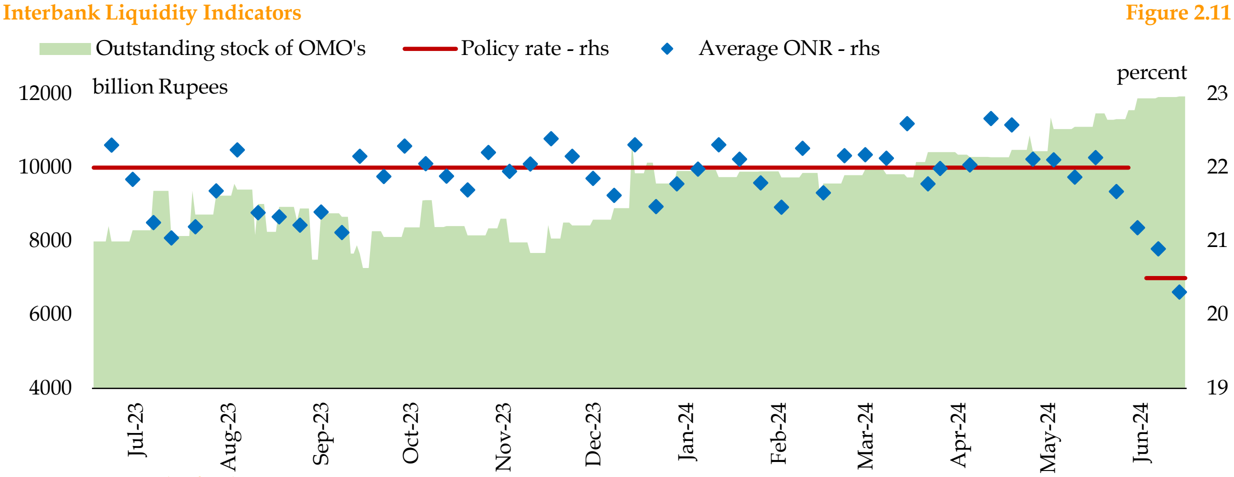
sluggish increase in loans to PSEs and private sector and net retirements in commodity financing somewhat cushioned liquidity situation in the interbank market. However, less than anticipated external financing and retirements in non-bank financing underscored an increased reliance on commercial banks for the government's deficit financing.

To meet the market's growing requirements, the SBP managed liquidity through shorter-tenor OMOs (less than 30 days) during FY24, with the exception of first quarter. This is in contrast to FY23, when longer-term OMOs were employed to meet liquidity needs due to market's expectation of increase in policy rate amid inflationary pressures. The market's expectation about the policy rate remained unchanged in Q1-FY24, which maintained its interest in longer-tenor OMOs.[13] However, more than sufficient liquidity in the system, at times pushed ONR below the policy rate during Q1-FY24 compared to the same period last year.[14]

However, in the subsequent three quarters of FY24, some moderation in inflationary pressures led to a reversal in market's sentiments about the monetary policy stance. Hence, the SBP provided liquidity through shorter-tenor OMOs during this period, which improved the alignment of ONR with the policy rate.

Similarly, liquidity requirements of the Islamic Banking Institutions were met through shorter-tenor OMOs in FY24 as compared to longer-tenor OMOs in FY23. Overall, 73 injections were conducted and the total amount injected into the market rose to 7.5 trillion in FY24 as compared to 4.1 trillion in FY23. Overall, the SBP's objective to strengthen the transmission mechanism of monetary policy was achieved by aligning the ONR more closely with the policy rate.

Interbank Liquidity Indicators **Figure 2.11**



Source: State Bank of Pakistan

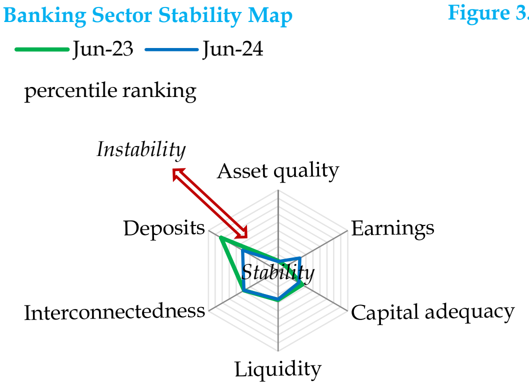
[13] During Q1-FY24, the SBP injected Rs 12 trillion in the interbank market through OMOs, around three-fourth of which had long-term maturity of 60 days and above (70, and 77 days).
[14] The ONR slipped below the policy rate on 48 days during Q1-FY24, compared to 30 days in the same period last year.

3 Financial Stability

The macroeconomic environment, which remained challenging during FY23, improved in FY24. After posting a slight contraction in FY23, the real GDP grew by 2.5 percent in FY24. Amid a tight monetary policy stance, inflation fell from its peak of 38.0 percent in May 2023 to 12.6 percent in June 2024, while current account deficit narrowed. Though SBP reduced the policy rate by 150 bps towards the end of FY24, the overall macro-financial conditions continued to remain tight throughout the fiscal year. Nevertheless, Pakistan's financial sector maintained its soundness and continued to meet its obligations, while providing credit and uninterrupted financial services to firms, households, and the government.

The banking sector stability map (BSSM),[1] which tracks the trends of key financial soundness indicators along various dimensions, shows that the indicators on capital adequacy, assets quality, liquidity, and deposits witnessed improvement. This is encouraging considering that the sector's performance and soundness is crucial for the stability of the entire financial system.[2] The sector's earnings, however, showed some moderation (**Figure 3.1**). Nonetheless, the slight decline in earnings did not pose imminent stability concerns, as the profitability and solvency of the sector remained steady during FY24.

Banking Sector Stability Map **Figure 3.1**



Source: State Bank of Pakistan

Asset Quality and Credit Risk

The asset quality indicators improved on an overall basis during FY24. The ratio of non-performing loans (NPLs) to total loans marginally inched up from the last year's level in case of banking sector and Development Finance Institutions (DFIs). However, provisioning against NPLs also increased substantially amid implementation of IFRS-9, which requires the provision of allowances for any prospective losses in performing loans that may occur in the future. Accordingly, the provisioning coverage for NPLs of banks and DFIs further improved over the year, and the additional cushions available in the form of General Provisions also added to the buffers against delinquencies in loan portfolio.

The increase in loan infection in banking sector has remained relatively contained despite the difficult operating environment during the last couple of years. The banks have been following risk management practices that target borrowers with better credit worthiness, especially in case of large exposures. For instance, corporate lending constitutes a major part (around 66 percent) of banking sector's domestic loan portfolio at end June 2024. This portfolio mostly

[1] BSSM ranks the Financial Soundness Indicators of the current period vis-à-vis their historical level. It is based on percentile rankings (scaled from 1 to 10) of various indicators, and the summary score of these indicators in a particular dimension e.g. asset quality. A ranking close to 10 value on the summary statistic suggests increased risks but not necessarily immediate stability concern. This is because the summary statistic is based on percentile rankings of historical series and the actual indicators for the quarter may still be in comfortable position or above the minimum regulatory requirement. Methodology of BSSM is based on Dattels, P., McCaughrin, R., Miyajima, K., & Puig, J. (2010). "Can you map global financial stability?" *IMF Working Papers*, 1-42

[2] See **Chapter 1** for share and role of banking sector in the country's financial system.

Key Financial Soundness Indicators of Banks, DFIs and MFBs* — **Table 3.1**

Description	Jun-22	Jun-23	Jun-24
Asset Quality Indicators			
NPLs to Total Loans			
Banks	7.5	7.4	7.6
DFIs	8.6	7.2	7.4
MFBs	6.5	7.8	10.5
Provision to NPLs#			
Banks	91.6	94.4	105.3
DFIs	86.1	107.3	107.9
MFBs	73.4	89.5	96.4
Specific Provisions to NPLs			
Banks	83.5	83.6	85.5
DFIs	78.4	84.4	87.4
MFBs	35.0	62.0	73.2
Net NPLs to Capital			
Banks	3.8	2.4	-1.9
DFIs	1.5	-0.7	-0.8
MFBs	11.0	9.1	7.2
Solvency Indicators			
Eligible Capital to Risk Weighted Assets (RWA)^			
Banks	16.1	17.8	20.0
DFIs	36.4	36.0	48.9
MFBs	14.9	9.3	5.7
Tier 1 Capital to RWA			
Banks	13.4	14.8	16.2
DFIs	35.7	35.2	47.2
MFBs	11.4	6.3	3.0
Earnings Indicators			
ROA (after Tax)*			
Banks	0.9	1.3	1.4
DFIs	1.8	1.3	0.5
MFBs	-2.1	-2.0	-2.4
ROE (after Tax)*			
Banks	13.9	23.5	24.3
DFIs	7.8	14.4	8.8
MFBs	-21.4	-30.3	-51.6
Liquidity Indicators			
Liquid Assets/Total Assets			
Banks	58.5	59.9	66.8
DFIs	66.4	89.2	85.5
MFBs	27.8	28.5	29.0
Liquid Assets/Total Deposits			
Banks	86.0	91.2	106.1
DFIs	1,745.8	8,098.2	3,618.3
MFBs	37.6	39.6	35.5
Liquid Assets/Short term liabilities			
Banks	105.2	107.9	111.5
DFIs	99.1	97.2	94.8
MFBs	35.3	38.8	40.1

*Share in Total Financial Sector Assets at end June 2024: Banks=79.2%, DFIs=3.8% and MFBs=1.2% ^ CAR Requirement = For Banks/ DFIs = 11.5 percent; For MFBs = 15 percent, #Provisioning against NPLs contain specific as well as general provisions including provisions under IFRS-9, ***ROA and ROE are calculated on fiscal year basis
Source: State Bank of Pakistan

comprises lending to rated borrowers, which have a better credit history, strong financial health and resilience to economic shocks, thereby positively impacting the credit risk profile of the banking sector. The implementation of IFRS-9 from January, 2024 is expected to further strengthen the credit risk assessment practices of banks.

On net basis, therefore, there are relatively muted residual credit risks to the solvency of banks and DFIs from their delinquent loan portfolio (**Table 3.1**). The results of the latest stress testing exercise (sensitivity analysis) also show that the banking sector has adequate resilience to severe hypothetical shocks to the credit risk factors.

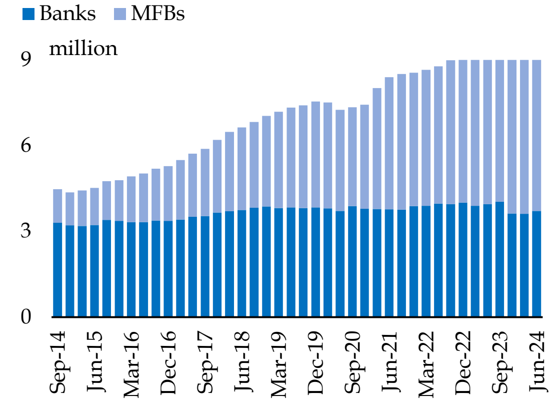
In comparison to banking sector and the DFIs, gross NPLs-to-loans ratio of the MFBs, slightly deteriorated in FY24. The increase in NPLs mainly emanated from livestock portfolio followed by agriculture, and was concentrated in a few MFBs in the sector. The lagged impact of floods in FY23 and elevated inflation seem to have dented the repayment capacity of the borrowers in this segment, which have low resilience to economic shocks.

Given the importance of MFBs in enhancing the outreach of financial services to underserved and low income segment (micro-borrowers), SBP continued with its enhanced supervision of these institutions. During the year, a few institutions have injected equity to improve their capital position (**Figure 3.2**). The MFBs have been facing a difficult situation for the last few years. However, due to their low share in overall assets of the financial sector, MFBs pose relatively muted risks to the overall stability of the system.

Market Risk

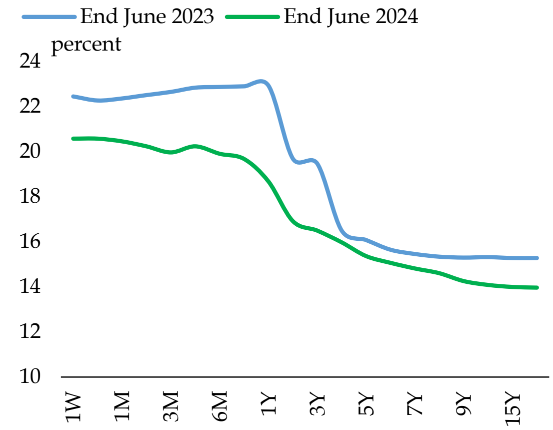
The market risk for banks, given its large share in the financial sector, is relatively more important from the perspective of the stability of overall financial sector. Within the market risk, interest rate risk is particularly important for banks due to high proportion of rate sensitive assets. For instance, investments in government

Composition of Banks' and MFBs' Borrowers **Figure 3.2**



Source: State Bank of Pakistan

Yield Curve at end FY23 and FY24 **Figure 3.3**



Source: Mutual Fund Association of Pakistan

securities constituted 56.9 percent of total assets of the banking sector at end June 2024, up from 49.6 percent in June 2023. Around 90 percent of these government securities were held in Available for Sale (AFS) and Held for Trading (HFT) categories, which are regularly marked-to-market for any changes in interest rate to reflect their fair value. Towards the end of FY24, the yield curve shifted downward, compared to end June 2023, as the market factored in the falling inflation into their expectations about the policy rate (**Figure 3.3**). The fall in yield curve translated into revaluation gains on HFT securities;[3] accordingly, the accumulated revaluation deficit on AFS securities also came down.[4] Nevertheless, banks in general were able to smoothly sail through the period of rising interest rates that started in September 2021.

Cognizant of the impact of interest rates on their fixed-income securities, banks raised the share of floating rate papers in total government securities. The share of floating rate instruments in AFS and HFT categories stood at around 55 percent of the total AFS and HFT portfolio of government securities of banks, which bodes well for banks in reducing their sensitivity to interest rate changes.

The other two major market risk factors i.e., currency and equity price movements do not have material impact on financial health of banks. The banking sector does not have large exposure to FX, which helps them in containing the impact of exchange rate volatility.[5] The equity market, whose performance remained dull in FY22 and FY23, witnessed a notable growth of 89.2 percent in FY24, which also translated into gains on quoted shares during the year. The volatility in equity market posed low risk to banks' solvency due to their limited exposure to equities. The contained sensitivity of the banking sector to the FX and equity price movements stems, in part, from a prudent regulatory regime of the SBP, which prescribes conservative limits on banks' exposures to these market segments.[6] The resilience to FX and equity prices shocks was also reflected in results of the latest stress testing exercise, which show that the banking sector in general remained resilient to hypothetical severe shocks related to various market risk factors (**Figure 3.4**).

[3] Gains on sale of government securities of banking sector amounted to Rs 30.2 billion in FY24, compared to Rs 1.0 billion losses in FY23.
[4] Revaluation losses on the AFS government securities, which were Rs 372.8 billion (1.8 percent of total value government securities) at end of FY23, reduced to Rs 40.6 billion (0.1 percent of total value of government securities) by end June 2024.
[5] For instance, investment in equities to capital ratio of banking sector is 5.6 percent in June 2024 (6.8 percent in June 2023).
[6] The aggregate equity investment limit for banks and DFIs, which are mobilizing funds as deposits/COIs from general public/individuals, shall be 30 percent of their respective equity. For details see https://www.sbp.org.pk/publications/prudential/PRs-IPF-June-24.pdf

In case of DFIs, investments comprised of around 86 percent of assets base at end June 2024. Investments predominantly consisted of government securities (97.6 percent), where, similar to banks, the share of floating rate securities increased during FY24. The share of floating rate government securities was around 59 percent of total AFS and HFT portfolio of government securities of DFIs at end June 2024. The floaters help reduce the weighted durations of AFS and HFT portfolios, and thus its sensitivity to interest rate changes. The stress testing results for DFIs suggest that these institutions are resilient to both a sharp upward shift in the yield curve (interest rate), and a severe fall of up to 36.1 percent in equity prices. The MFBs, on the other hand, have low exposure to market risk, given their business model: investments constituted just 21.0 percent of total assets at end June 2024. Thus, their sensitivity to market risk is relatively low.

Earnings

Profitability is an essential dimension of financial stability, which is important for building buffers against unforeseen shocks, creating incentives for business expansion and carrying out capital expenditures.

The earnings of the banking sector are particularly important for building resilience against shocks, given its large share and critical role in the financial system. The after-tax profit of the sector grew by 30.4 percent to reach Rs 645.2 billion in FY24. The pace of increase in profits, however, decelerated from 84.9 percent in FY23, as interest expenses on deposits and borrowing were higher compared to interest income, which can be mainly traced to subdued expansion in advances. Non-interest income provided some support, where besides higher fee and FX income, trading gains on government securities contributed notably.[7]

On the other hand, growth in operational expenses remained elevated in FY24 as well.[8] This sharp rise reflects branch expansion and impact of inflation (such as higher cost of utilities and operating expenses). Moreover, higher taxation charges (in terms of profit before tax) also suppressed after tax earnings during FY24. It is worth emphasizing that taxation charges as percent of profit before tax rose to 51.6 percent in FY24 as compared to 48.3 percent in FY23.[9] The profitability indicators, such as after-tax ROE, improved to 24.3 percent in FY24 (23.5 percent in FY23) and after-tax ROA improved to 1.4 percent in FY24 (1.3 percent in FY23).[10]

The after-tax profit of DFIs fell to Rs 13.2 billion in FY24, from Rs 21 billion in FY23. This was because of lower net interest income, which fell to Rs 11.4 billion in FY24 compared to Rs 20.2 billion in FY23. Few DFIs, having around 60 percent market share, incurred higher interest expenses on funding that outpaced interest earnings in last two quarters of FY24 amid falling yields, which dragged the net interest earning of the sector. However, the higher dividend income supported the earnings of DFIs suggesting better performance of their associates in FY24. The fall in after-tax profit resulted in a decline in after-tax ROA to 0.5 percent in FY24 from 1.3 percent in FY23. Similarly, the after-tax ROE of DFIs dropped sharply to 8.8 percent in FY24 from 14.4 percent in FY23.

In case of MFBs, the FY24 marked the fifth consecutive year, when the sector faced losses (before tax) on aggregate basis. The losses

[7] Gains on sale of government securities of banking sector amounted to Rs 30.2 billion in FY24, compared to Rs 1.0 billion losses in FY23.
[8] Operating expenses rose by 31.5 percent growth in FY24 and 30.2 percent in FY23.
[9] The rising taxation charges reduces the sector's ability to build buffers against unforeseen macroeconomic shocks and the resilience of overall financial sector, of which banking sector is a major part
[10] These profitability ratios (ROA and ROE) are calculated on fiscal year (July to June) basis. Usually, these ratios are calculated on calendar year basis.

emanated from two major factors i.e., rising NPLs, which necessitated provisioning expenses, and higher cost of operations relative to their income.[11] This is because MFBs and their borrowers have low resilience to macroeconomic shocks (e.g., COVID-19, floods of 2022, and challenging macroeconomic conditions such as elevated inflation). The persistent occurrence of these shocks has weakened repayment capacity of borrowers. The after-tax loss of the MFBs rose to Rs 18.0 billion in FY24, up from Rs 13.5 billion in FY23. Moreover, the cost-to-income ratio deteriorated to 101.6 percent in FY24 from 95.4 percent in FY23.[12] The losses have lowered the equity of MFBs. Profitability indicators, such as the ROA and ROE, of the MFBs remained negative and deteriorated further in FY24 (**Table 3.1**).

Liquidity

The liquidity related financial soundness indicators (FSIs) of banks showed improvement, when compared to the same period last year. As of end June 2024, liquid assets fully covered total deposits and more than fully covered short-term liabilities. The improvement reflects the increased investments in liquid government securities by banks. The treasury instruments have a reasonably developed secondary market that helps banks in managing their liquidity needs.

Liquidity indicators of DFIs in terms of covering short-term liabilities declined in FY24 when compared to FY23. This was due to a fall in investments in government securities. However, the reduction in investments helped DFIs to reduce short-term borrowings during FY24. This was unlike FY23 when borrowings rose substantially.

Liquidity ratios of MFBs, though improved during FY24, were still lower compared to banking sector and DFIs. This is because the business model of MFBs is skewed towards advances, and investments formed around one-fifth of the balance sheet at end June 2024. This translated into relatively lower liquidity ratios. However, due to their small share in the financial sector, the likelihood of MFBs posing liquidity risks for the overall financial sector is low.

The Basel-III standard liquidity ratios — Liquidity Coverage Ratio (LCR) and Net Stable Funding Ratio (NSFR) —that comprehensively cover different aspects of the FIs' overall liquidity profile and are prescribed by SBP for banks and DFIs, showed that the banking sector and DFIs complied with the prescribed benchmarks. The LCR ratio of the banking sector remained at 234.0 percent in June 2024, well above the regulatory requirement of 100 percent (244.2 percent in June 2023). Similarly, the NSFR also remained at comfortable level of 192.0 percent in June 2024, (206.4 percent in June 2023), suggesting a satisfactory liquidity profile.[13]

However, despite comfortable liquidity profile, the market liquidity conditions were tighter in FY24 compared to last year. Therefore, in order to keep money market rate closer to the policy rate, the SBP had to inject liquidity in the market, which was also reflected in a high average size of the OMO injections for both conventional as well as Shariah-compliant modes.[14] Nonetheless, financial institutions also used floor facility, especially in the first half of FY24, which reflects surplus liquidity on certain occasions. Banks preferred to place funds for short-term in line with their expectations about

[11] The small loan size and scattered borrowers contribute to higher cost per borrower.
[12] These ratios are calculated on fiscal year basis
[13] For detail explanation of LCR and NSFR ratios, please see chapter 3 of the Governor Annual Report FY23 available at: https://www.sbp.org.pk/reports/annual/Gov-AR/pdf/2023/Dec/Gov-AR.pdf
[14] Average size of OMO injections rose to Rs 1,528 billion in FY24 from Rs 534 billion in FY23 in conventional modes, while in case of Shariah-compliant mode, it rose to Rs 103 billion in FY24 from Rs 58 billion in FY23.

interest rates.[15] The open market operations and standing facilities are important for keeping the overnight rate close to the SBP policy rate, which is crucial for effective transmission of monetary policy and achieving price stability.

The stress testing exercise (sensitivity analysis) of hypothetical liquidity shocks suggests that most of the banks can survive withdrawal of up to 10 percent of customer deposits beyond fifth day. However, in a severe hypothetical shock of withdrawal of up to 50 percent wholesale deposits and unsecured borrowings, a few non-systemic banks (with low market share) may face liquidity constraints beyond three days.[16]

Solvency and Capital Adequacy

Solvency indicators of the banking sector improved further in FY24. Headline solvency indicators such as capital adequacy ratio (CAR), rose to 20.0 percent by end June 2024 from 17.8 percent in June 2023, which was well above the minimum regulatory capital requirement of 11.5 percent. This improvement mainly emanated from higher earnings in FY24, which augmented Tier-I capital, and revaluation gains on AFS securities that improved Tier-II capital. The solvency profile of DFIs also remained strong, as their aggregate CAR improved to 48.9 percent by end June 2024 from around 36 percent at the end of FY23, well above the minimum regulatory requirement. Besides the fundamental factors, such as revaluation gains on AFS securities, the addition of a new DFI (which has low risk weighted assets) also boosted the CAR of the DFI sector.

Over the last few years, banking sector's exposure in government securities has significantly increased, which requires no capital charge (involving zero risk weighted treasuries) for credit risk, and relatively low capital charge in respect of market risk. In order to avoid the excessive leverage that banks can build in the operating environment, banks are also subject to a minimum leverage ratio requirement of 3.0 percent as per Basel-III standards. This ratio acts as non-risk based 'backstop'[17] to CAR requirement to address, inter alia, any issues in calculating the risk weights and address the issues of excessive leveraging.[18] In this regard, the leverage ratio of Pakistan's banking sector at 4.0 percent and DFIs at 5.5 percent remained above the minimum requirement.

In case of MFBs, the aggregate CAR has consistently declined from June 2022 and fell short of minimum regulatory requirement of 15.0 percent, as applicable on the institutions on individual basis. The overall CAR ratio of the sector fell to 5.7 percent in June 2024 from 9.3 percent in same period last year. However, within the MFBs, institutions with a combined market share of around 53 percent complied with the minimum regulatory capital requirement. Excluding the CAR-non compliant MFBs, the sector's aggregate CAR improves to 21.3 percent at end June 2024.

While the MFBs have a low share in the overall asset base of the financial sector, these institutions play a significant role in financial inclusion and provision of financial services to underserved segments of the society. The sector is facing challenging operating environment since FY20. The severity of various shocks (Covid-19 pandemic and consequent challenging operating environment and mobility restrictions, heavy floods in 2022, and the prolonged stressed macro-financial conditions) weakened the repayment capacity of MFBs' borrowers who have relatively limited shock

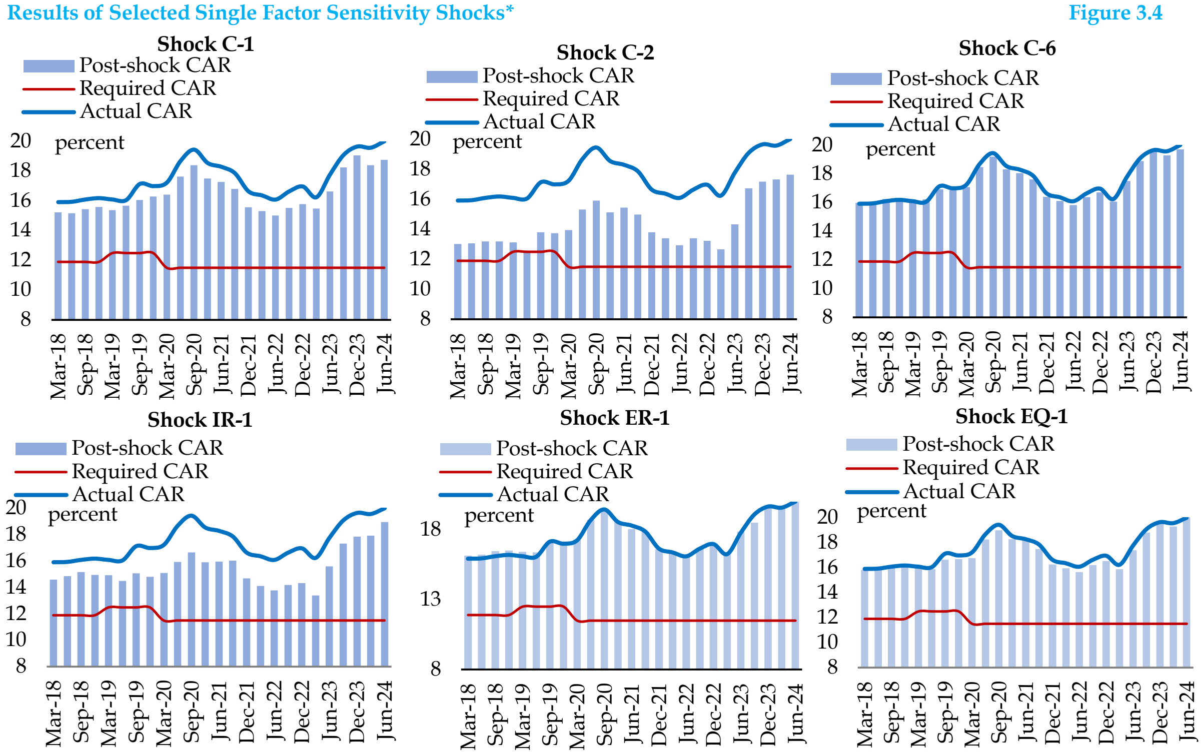
[15] For details see chapter 3 'Banking Sector' of the Financial Stability Review (2023) available at: https://www.sbp.org.pk/FSR/2023/FSR%202023.pdf
[16] Detailed results are available at: https://www.sbp.org.pk/ecodata/fsi/qc/2024/Jun.pdf
[17] The Basel III Leverage Ratio (LR) is designed to restrict the build-up of leverage in the banking sector, and to backstop the existing risk-weighted capital requirements (RWRs) with a simple, non-risk-weighted measure. In this context, it is often referred as non-risk backstop measure.
[18] Details are available at: https://www.bis.org/publ/bcbs270.htm

absorbing capacity against exogenous shocks. In this backdrop, the deterioration in assets quality of a few MFBs was expected. The SBP has not only provided necessary support to the sector, but also continued enhanced supervision to improve solvency position. The SBP is also proactively engaged with the management and sponsors of respective MFBs to ensure compliance with the minimum regulatory requirements and solvency of viable institutions.

Macroeconomic conditions started to improve during FY24. The real GDP moderately grew in FY24, after showing a contraction in FY23. Elevated inflationary pressures have subsided amid a tight monetary policy stance.[19] With easing inflation, the SBP reduced the policy rate by 150 bps in June, followed by a further 100 bps cut in July and 200 bps in September 2024. External account position also improved during FY24. Though financial conditions in general remain tight, they are gradually easing and are expected to positively impact the borrowers' debt servicing capacity and credit demand.

Keeping in view the soundness of financial institutions in the evolving environment, the SBP regularly conducts sensitivity analysis and macro stress testing (scenario analysis) exercises to assess its regulated institutions' capacity to

Results of Selected Single Factor Sensitivity Shocks* **Figure 3.4**



Shock C-1: 10% of performing loans become non-performing, 50% of substandard loans downgrade to doubtful, 50% of doubtful to loss.
Shock C-2: Default of top 3 private sector borrowers/Groups (fund based) exposures.
Shock C-6: Increase in NPLs to Loan Ratio equivalent to the historical maximum quarterly increase in the ratio of individual banks.
Shock IR-1: Parallel upward shift in the yield curve - increase in interest rates by 300 basis points on all the maturities.
Shock ER-1: Depreciation of Pak Rupee by 30%.
Shock EQ-1: Fall in general equity prices equivalent to maximum decline in KSE-100 index.
*these selected shocks are part of a set of single factor sensitivity analysis that SBP conducts and publishes regularly
Source: State Bank of Pakistan

[19] Inflation fell from its peak of 38.0 percent in May 2023 to 12.6 percent by end June 2024.

withstand hypothetical severe macro-financial shocks.[20] The results of the latest sensitivity analysis suggest that the banking sector, in general, has adequate resilience to withstand severe hypothetical shocks to credit, market, and liquidity risks (**Figure 3.4**).

The scenario analysis, which complements the sensitivity analysis, shows that the CAR of the banking sector is likely to remain above the minimum regulatory requirement under both business-as-usual and stressed macroeconomic scenarios —the latter add hypothetical shocks to the economic conditions—over the projected period of two years (**Figure 3.5**). Particularly, the large sized banks, which are crucial for overall financial stability in the economy, exhibit relatively higher resilience.

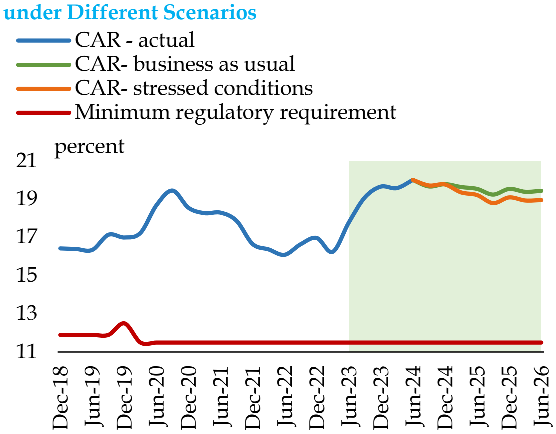
The soundness of individual FIs in general, and the systemically important banks in particular, is the cornerstone of the overall financial stability. The ratings assigned by independent credit rating agencies to SBP-regulated FIs also suggest that these institutions in general have satisfactory credit worthiness, indicating that they have adequate ability to honor their financial obligations.[21]

The SBP regularly assesses the financial performance and soundness of its regulated entities and communicates the analyses through various publications, such as the Quarterly Compendium on Banking Statistics and Financial Soundness Indicators; Mid-Year Performance Review of Banking Sector (January to June period); and the annual Financial Stability Review. The analytical reports of Mid-Year Performance Review of Banking Sector and Financial Stability Review also include results of Systemic Risk Survey (SRS), which gauge the views of market participants and independent experts about various existing and emerging risks to the stability of the financial system. The results of the latest SRS survey conducted in July 2024 suggest that the respondents seem to repose confidence in the stability of the financial system, particularly the banking system. Moreover, the participants of the survey also showed confidence on the ability of regulators to ensure the stability of the financial system.

Strengthening Institutional Arrangements on Financial Stability and Current Priorities of the SBP

The financial sector landscape is rapidly evolving around the world, especially owing to continuous technological advancements. These advancements offer numerous opportunities as well as challenges for the financial institutions and their regulators. Cognizant of these facts, the SBP strives to continuously assess and improve its regulatory and supervisory frameworks, in line with international best practices, to effectively manage the risks arising from these developments. In this context, the SBP undertook various initiatives to ensure stability and development of the financial sector of Pakistan during FY24.

Projected Capital Adequacy Ratio under Different Scenarios — **Figure 3.5**



Source: SBP staff calculations

[20] As part of its stress testing exercise, SBP conducts sensitivity and scenario analyses on quarterly basis. The summary results of sensitivity analyses are also published in Quarterly Compendium of Banking Statistics and FSIs, and results of scenario analysis are published in Mid-Year Performance Review of Banking Sector.

[21] Detailed ratings are available at: https://www.sbp.org.pk/publications/c_rating/2023/Ratings-26-Oct-2023.pdf

National Risk Assessment (NRA) 2023 on Money Laundering & Terrorist Financing

The SBP conducted the inherent vulnerability assessment of the SBP-regulated sectors i.e., Banks, MFBs, DFIs and Exchange Companies, as part of the National Risk Assessment (NRA) 2023. The NRA was approved in August 2023 and has been shared with the relevant stakeholders for necessary actions.

Strengthening AML and CFT Regime

SBP has been continually striving to strengthen the AML and CFT regime, including processes for Know Your Customer (KYC) and Customer Due Diligence (CDD). To streamline these processes further, the Pakistan Banks Association (PBA) is developing a shared e-KYC platform under SBP's guidance. This platform, built on Distributed Ledger Technology (DLT), will enable secure exchange and updating of KYC/CDD information among banks; enhancing customer onboarding; standardizing data; and ensuring data privacy through explicit customer consent. Banks were also advised to join, and allocate necessary resources for the timely implementation of this platform.[22]

In addition, banks and Microfinance Banks (MFBs) offering Branchless Banking (BB) services were instructed to enhance measures against money laundering and terrorist financing (TF) risks by implementing Biometric Verification (BV) for account and wallet holders during cash transactions at BB agents' locations starting January 31, 2024. They were also advised to prioritize BV device deployment in high TF risk areas and upgrade their Automated Transaction Monitoring Systems (ATMS) to flag suspicious transactions and facilitate evidence gathering for criminal investigations.[23]

Deposit Protection Corporation (DPC) Provided its First Support to Depositors and Financial System

On the advice of SBP, the Federal Government approved a winding down plan for the SME Bank, which was facing weak capital and operating performance, to ensure that no depositor is adversely affected due to closure of the bank. In terms of the SBP's proposed plan, payout to all the depositors of the SME Bank was initiated on priority basis in order to maintain depositors' confidence in the banking system. Consequently, the DPC made a public announcement informing eligible depositors of the SME Bank to approach the bank for receiving their due balances, following which the DPC commenced periodic reimbursements to the SME Bank against its payouts to the eligible depositors and has smoothly paid around 93 percent of total protected deposits by the end of FY24.

Enhancement in Implementation of Regulatory Approval System

To allow enhanced tracking of the cases of FCY Cross Border Payments and Transfers[24] through SBP Nostros, banks will now be able to submit these cases through SBP's Regulatory Approval System (RAS).[25] Previously, such cases were submitted to the banks through Data Access Portal of the SBP.

Digital Banks

In a bid to foster innovations, financial inclusion and availability of affordable digital financial services, the SBP granted In-Principle Approval, in September 2023, for establishing five digital retail banks, namely: HugoBank Limited, KT Bank Pakistan Limited, Mashreq Bank Pakistan

[22] BPRD Circular Letter No. 22 of 2023
[23] BPRD Circular Letter No. 20 of 2023
[24] These FCY transactions include ACU dollars payment / receipt cases, CRR & SCRR deposits & withdrawal cases/ instruction letters (FE25), and Local US Dollar Instrument Collection & Settlement Account Deposit & withdrawals cases.
[25] TOD Circular Letter No. 01 of 2024

Limited, Raqami Islamic Digital Bank Limited and Telenor Microfinance Bank Limited.[26] Further, in order to ensure effective supervision of digital banks, the SBP also developed a Digital Banks Supervision Framework.

Structural Reforms in the Exchange Companies Sector

During the last few years, frequent regulatory challenges were observed in the Exchange Companies sector, particularly in the operations of Exchange Companies of "B" Category and franchises of Exchange Companies. Therefore, to strengthen the solvency of exchange companies – enabling them to have robust infrastructure and systems, the minimum paid-up capital requirement was increased from PKR 200 million to PKR 500 million.[27] Further, the Exchange Companies of "B" category and franchisees of Exchange Companies were offered the following options to transform into the mainstream Exchange Companies:

a. Exchange Companies of "B" category may graduate to single category Exchange Companies after meeting all regulatory requirements.

b. Franchisees of Exchange Companies may either merge with or sell operations to the concerned franchiser company, after meeting all regulatory requirements.[28]

In addition, the leading banks actively engaged in foreign exchange business, have also been encouraged to establish wholly owned Exchange Companies to cater to the legitimate foreign exchange needs of general public.

Introduction of Electronic FX Trading Platform for Interbank Trading

The development of a forward looking, innovative and inclusive digital financial ecosystem is a key objective outlined in SBP Vision 2028. Aligned with this vision, the SBP launched a Centralized Foreign Exchange (FX) Trading Platform named 'FX Matching' for the interbank FX market in January 2024.[29] The aim of introducing FX Matching is to furnish interbank market participants with a centralized trading platform that enables FX trading anonymously and provides real-time price visibility. The FX Matching platform is operational since January 29, 2024 and interbank participants are regularly quoting prices.

The implementation of the FX Matching is instrumental in furthering SBP's objective to fully automate the processing of FX transactions, enhancing market efficiency through automation, improved processes, accuracy, and timeliness of data received. The adoption and integration of the FX Matching platform is a key step for enhancing the depth and transparency of the interbank FX market, ultimately fostering a more robust financial landscape.

Dissemination of End of Day Open Market Exchange Rates

In order to further enhance transparency and depth of the foreign exchange market, the SBP has started disseminating end of day open market exchange rates on its website on a daily basis. The SBP, in collaboration with Exchange Companies Association of Pakistan (ECAP) streamlined the mechanism for determining the end of day open market exchange rates for this purpose. Previously, only the interbank closing exchange rates were disseminated by SBP.[30]

[26] External Communications Department | Press Release September 20, 2023
[27] EPD Circular Letter No. 13 of 2023
[28] FE Circular No. 03 of 2023
[29] DMMD Circular No. 01 of 2024
[30] ECAP Open Market Daily Rates

4 Measures to Support the Government's Economic Policies

The fiscal year 2024 marked a period when the central bank achieved several key milestones, as part of its tertiary objective to support government's overall economic policies. These milestones —that also complement the SBP's efforts to effectively implement the monetary policy and maintain financial system stability—included achieving significant progress in financial inclusion, as well as paving the way for its future growth through digitalization.

Similarly, the SBP has taken a variety of initiatives, including reforms in foreign exchange regulatory framework, and incentive schemes encouraging the use of formal channels of sending remittances. These initiatives would not only support growth in exports, particularly the ICT exports, and home remittances, but also mitigate exchange rate pressures, and thus contribute to price and financial stability.

These supportive measures are also well aligned with three of the six strategic goals under SBP's Vision 2028, i.e. promoting inclusive and sustainable access to financial services; transforming to a Shariah-compliant banking system; and building an innovative and inclusive digital financial services ecosystem.

The main measures and initiatives taken during the year under review can be grouped into four major categories: financial inclusion; payment systems and digitalization of financial services; promotion of sustainable finance; promotion of home remittances and reforms in the Foreign Exchange (FX) regulatory framework.

4.1 Measures to Promote Financial Inclusion

In recognition of financial inclusion as a key element in supporting inclusive economic growth and financial development, the SBP has been mandated to promote financial inclusion as one of its functions under the SBP Act 1956 (as amended up to January 2022). The policy aims to enhance access to and use of quality financial services for individuals and businesses, with a strong emphasis on delivering these services with dignity and fairness.

Accordingly, the SBP had launched the National Financial Inclusion Strategy (NFIS) 2018 – 2023 in 2018. The NFIS 2018-2023 had set a headline target of reaching 65 million unique active bank accounts, including 20 million active women-owned accounts, by December 2023. That target was not only met, but also surpassed during FY24. Between December 2018 to 2023, total active unique accounts grew from 37.5 million to 69.5 million, from which active women depositors grew from 8.4 million to 23.5 million. Moreover, during this period, the total number of bank accounts surged from 99 million to 203 million showing a growth of 105 percent. As a result, the overall financial inclusion grew from 47 percent in 2018 to 64 percent in 2023.

The SBP continued to ensure implementation of sector and segment specific guidelines and regulations for banks in a bid to achieve overall financial inclusion targets. Specifically, these guidelines and regulations were focused on: reducing gender disparity across the financial services landscape (both as customers and bank employees); increasing the share of Islamic banking; making housing finance —especially for low income segments —an important part of banks' lending portfolios; facilitating traditionally underserved business segments, such as SMEs and agriculture; and rolling out modern (i.e. digitalization-centric) policy interventions. Moreover, the SBP is in the process of finalizing the third version of NFIS to tackle the remaining financially excluded businesses and individuals, and further improve the usage and quality of digital financial services by 2028.

(i) NFIS 2023

The NFIS 2023 had set the vision to achieve inclusive economic growth through enhanced deposits and access to finance; promotion of small and medium enterprises; easy and affordable access to finance for farmers; facilitation in low cost housing finance; and provision of Shariah compliant banking solutions. In terms of headline targets, it set the milestone of reaching 65 million active digital unique accounts, with gender segregation of 20 million accounts by women, by 2023. Moreover, it also set targets to increase share of Islamic banking, deposit to GDP ratio, and financing for SME and agriculture sectors.

In terms of progress, it is worthwhile to note the following two key stylized facts as of December 2023:

- The number of unique active accounts has increased to 69.55 million from 64.34 million in December 2022, reflecting 8.2 percent annual growth, and exceeding NFIS headline target by 4.55 million well before the deadline.

- Women's active account ownership stood at 23.5 million, up from 21.8 million accounts, reflecting 7.8 percent annual growth.

Similarly, the headline target to enhance the share of Islamic Banking Institutions (IBIs) in overall banking sector was also met with share in deposits standing at 23 percent; share in assets at 19 percent; and share in branch network at 29 percent. In contrast, the targets for deposit to GDP ratio, SME finance and agricultural finance were partially achieved due to an elevated interest rate environment and modest economic growth.

In terms of NFIS 2023 action plan, 38 main actions and 96 sub-actions were assigned to more than 28 lead implementing agencies, including regulators, federal ministries and departments, provincial departments, banks and private sector. In terms of institutional performance, regulators comprising of the SBP, the Securities Exchange Commission of Pakistan (SECP) and the Pakistan Telecommunication Authority (PTA) have completed all 25 actions/sub-actions assigned to them.

Out of 96 actions/sub-actions, 72 have been completed, while 4 actions/sub-actions have been dropped as they required government intervention. Moreover, 8 actions/sub-actions have been transformed into operational activities after achieving the underlying objectives, and 12 actions/sub-actions have been carried forward to be part of the upcoming NFIS 2028.

Some key initiatives launched under NFIS 2023 include: i) National Payment Systems Strategy, ii) Asaan Mobile Account, iii) Raast, iv) Banking on Equality Policy, v) National SME Policy 2021, vi) Secured Transactions Registry, vii) Electronic Land Record Management Information System (eLRMS), and viii) Electronic Warehouse Receipt (EWR) Financing Mechanism. These initiatives have collectively fostered financial inclusion by promoting digital financial services in the unserved/underserved areas, supporting innovation in products and services, and embedding a gender lens in policies and practices of banking sector.

(ii) Banking on Equality (BoE)

Women in Pakistan remain disproportionately under-served by the country's financial system, which has led to a large gender gap in financial inclusion. In an attempt to reduce the gender gap in financial inclusion by bringing a shift towards women friendly business practices in the financial sector, the SBP launched Banking on Equality Policy in 2021. The policy is based on five key pillars: improving institutional readiness; product diversification and capability development; customer acquisition and facilitation of women; robust collection of gender disaggregated data; and prioritizing gender focus in SBP's policies.

The progress made against the policy actions and headline targets, as of June 2024, is as follows:

- All SBP-regulated financial institutions (FIs) have developed gender mainstreaming policies with the approval of their Boards that adds an emphasis and focus on implementation of BoE across their institutions.
- A total of 9,622 women staff members have been added to SBP-regulated FIs work force, which has improved the overall ratio of female staff from 14.6 percent last year to 16 percent. Further, an annual growth of 85 percent was witnessed in women's hiring.
- All the BoE implementing FIs have developed women-centric asset and liability side products and services, compared to 95 percent banks last year.
- All BoE implementing FIs have established dedicated women's financial services departments/teams, as compared to 89 percent last year. However, the ratio of women in branchless banking (BB) agents remained at 3 percent compared to the baseline of 1 percent.
- As compared to 56 percent till June 2023, 70 percent of all FIs staff have been imparted with gender sensitivity trainings.
- 69 percent of branches have appointed dedicated women champions to serve women customers as compared to 51 percent till June 2023.
- So far, a total of 8.2 million active women owned accounts have been added to the baseline of 20 million in December 2021, showing an 11 percent annual growth since June 2023.

Further, the implementation of BoE policy actions has spurred progress on women's access to bank accounts. Since the policy's launch in 2021, women's unique accounts and active accounts have grown by 27 percent and 18 percent respectively, while during the same time, men's unique accounts and active accounts have grown by 12 percent and 8 percent respectively. Due to this, the gender gap in terms of access to account reduced to 34 percent in 2023, from 39 percent in 2021. In order to review the progress of BoE implementation, the SBP has developed a BoE Scorecard to annually rank the performance of FIs against their assigned targets and their relative position against the top-performers, and the results are shared with relevant FIs.

(iii) Islamic Banking

Pakistan's Islamic banking has experienced considerable growth since its inception. Assets of IBIs expanded by 19.3 percent (i.e. Rs 1,571 billion) during FY24, reaching Rs 9,689 billion by end June, 2024. IBIs' deposits also witnessed a significant increase of 25.4 percent to Rs 7,363 billion by end June 2024.

This growth in deposits of IBIs was the highest ever in a particular fiscal year. The substantial rise in deposits may be attributed to record expansion in IBIs' branch network during the period under review. Moreover, there has been a general trend among banks to open new Islamic branches and convert conventional branches into Islamic, especially after Federal Shariat Court (FSC) judgment dated April 28, 2022 on 'Riba' case. While the share of Islamic banking assets fell to 18.8 percent by end June 2024 from 19.9 percent at end June 2023, IBIs' market share in deposits in the overall banking industry rose to 22.7 percent compared to 21.9 percent by end June 2023.

IBIs' network consists of 22 Islamic banking institutions (six full-fledged Islamic banks and sixteen conventional banks having standalone Islamic banking branches). During FY24, 662 stand-alone branches were added to the overall branch network of IBIs bringing the total to 5,196 branches (dispersed over 131 districts of the country). This is the largest increase in the number of branches in a single fiscal year. The increase was due to opening of 417 new Islamic banking branches and conversion of 245 conventional banking branches into Islamic. In addition to branches, 2,066 Islamic banking windows (dedicated counters at conventional branches) were also providing Shariah compliant Islamic banking services in the country by end June 2024.

Apart from the above, NRSP Microfinance Bank Limited and U-Microfinance Bank Limited were offering Shariah compliant microfinance services in the country through a branch network of 127 Islamic banking branches by end June 2024. Assets and deposits of these institutions were recorded at Rs 24.7 billion and Rs 15.4 billion, respectively by end June 2024 compared to Rs 15.8 billion and Rs 8.4 billion, respectively by end June 2023.

Efforts to implement the Federal Shariat Court's (FSC) Judgement

In pursuance of Federal Shariat Court's (FSC) April 2022 judgement on 'Riba' case, the federal government constituted a high-level steering committee in December 2022, entrusted with the task of providing strategic guidance for the effective implementation of the judgment. The SBP also established a high-level committee for transformation of conventional banking into Islamic. Under the committee for transformation, 07 working groups and their 33 work streams are actively engaged and meeting frequently to perform their assigned tasks.

Working groups and work streams have made major progress in their respective areas. These include assessment of legal and regulatory framework to ensure its alignment with the Shariah principles; preparation of proposals for development of asset-light Sukuk structure(s);[1] formulation of comprehensive strategies for awareness creation and capacity building to address issue of perceptions about Islamic banking & finance; and build a skilled workforce for the IBIs.

The SBP is dedicated to fulfil its statutory obligation for the elimination of Riba from the country's banking system. Accordingly, the central bank's fourth strategic plan, "SBP Vision 2028" in November, 2023, includes "Transforming to a Shariah-Compliant Banking System (SG-4)" as one of the strategic goals.

Guidelines for Conversion of Conventional Banks into Islamic - Broad Parameters

In line with the SBP Vison 2028 and to facilitate banks in their conversion process from conventional to Islamic, the SBP has issued broad guiding parameters to local private banks in June 2024, which could be used to devise their own conversion plans.

Adoption of AAOIFI Shariah Standards and Review of Shariah Governance Framework

With a view to further strengthen Shariah compliance framework and harmonize Shariah practices in the IBIs, the SBP adopted 12 additional Shariah standards of Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) during FY24. In addition, SBP has also reviewed the existing Shariah governance framework in light of international best practices during the period.

Facilitation in Commencement of Islamic Operations

The SBP has been supporting financial institutions to start Islamic operations. During the first nine months of FY24, Pakistan Kuwait Investment Company[2] commenced Shariah compliant business and operations. Moreover, the SBP granted in-principle approval to Raqami Islamic Digital Bank for establishing a digital

[1] A Sukuk structure that involves intangible assets as underlying, or in which the requirement of tangible assets is minimal.
[2] A development finance institution

retail Islamic bank in the country. Furthermore, another proposed digital retail bank, Mashreq Bank Pakistan Limited, has been allowed to commence Shariah compliant digital banking through Islamic window operations. The SBP has also been engaged with a few other financial institutions, which are interested in starting Islamic operations. It is expected that the number of financial institutions providing Islamic products and services would increase further in coming years.

Facilitation in Issuance of Domestic Sovereign Sukuk

The SBP has been playing an active role in facilitating Government of Pakistan in issuing Ijarah Sukuk. The Government of Pakistan issued 31 domestic Sukuks amounting to Rs 1,238 billion through SBP during FY24, compared to Rs 872 billion in the last year.

Awareness and Capacity Building Initiatives

The SBP has been making efforts, in coordination with the IBIs and other related stakeholders, to promote understanding about Islamic banking & finance, as well as to ensure the availability of highly-skilled staff to meet demands of IBIs. Two major strategies have been put in place: awareness creation strategy and capacity building strategy. Each of these include detailed set of activities for dedicated stakeholders and segments. The execution of activities under these strategies has been started in a planned and phased manner in collaboration with the relevant stakeholders.

During FY24, the SBP sustained its efforts and organized different awareness creation and capacity building programs to meet the diverse needs of stakeholders such as banking industry, Shariah scholars, legal fraternity, government officials, academia, students, and general public. It is pertinent to highlight that 124 iterations of awareness and capacity building programs were conducted in FY24 compared to 42 iterations in FY23.

(iv) NFIS 2028

After the successful conclusion of NFIS 2018-2023 in December 2023, the SBP is now planning to launch the 3rd edition of NFIS (2024-28) to tackle persisting challenges in digital financial inclusion. NFIS 2028 aims to capitalize on digital means to enhance the access, usage, and quality of financial services. The strategy will focus on leveraging the progress made under the past two NFIS strategies of 2020 and 2023, to not only tackle persisting bottlenecks, but to also foster innovations for improving usage and quality of formal financial services.

The NFIS 2028 will prioritize enhanced availability and usage of secure and easy digital financial services, improved ecosystem for priority sector financing, and strengthening capabilities of both financial institutions, and consumers. In terms of segments, the focus will be on improving financial inclusion of women, youth and disabled persons in un-served and under-served areas. Moreover, in order to catalyse inclusive growth and economic development in the country, specific actions have been outlined to revolutionize priority sector financing in the areas of SME, housing, agriculture, microfinance and sustainable finance, with the ultimate aim to enhance the wellbeing of the low income/under-privileged population.

Based on these priorities and actions, NFIS 2028 will be launched in FY25, with a headline target to improve the level of financial inclusion in Pakistan from 60 percent to 75 percent and reduce the gender gap to 25 percent, by 2028. Moreover, the SBP is currently in the process of developing a financial inclusion index for Pakistan to gauge the true level of financial inclusion in the country and aid evidence-based policy making. The index will be computed on three parameters -- access, usage and quality, thereby ensuring a 360-degree analysis and an accurate reflection of the financial inclusion level in Pakistan. Prior to that, the SBP used to measure FI level on a single measure, i.e.

number of depositors, as practiced by the World Bank and some other Central Banks. Once the index is calculated, its results will be publically available on annual basis.

(v) Measures to Promote Agriculture Credit

The agriculture sector has been the key driver of economic growth during FY24. The sector grew by 6.4 percent on the back of robust crop output. The sector contributes 24.0 percent to the overall GDP, and 37.4 percent towards employment in the country.[3] In recognition of this, the SBP plays a leading role in meeting the financing needs of agriculture sector due to its significance for economic growth, employment and food security in the country.

In this regard, the SBP took a number of initiatives to facilitate financing to the sector, and enabled better access to credit for farmers. As a result of these initiatives, agriculture credit disbursement increased by over 24.8 percent to Rs 2,215.7 billion during FY24 compared to Rs 1,776 billion last year. Moreover, the outstanding agriculture credit also recorded a growth of 15.1 percent, reaching Rs 875 billion by end June 2024. In this regard, following initiatives have played a key role in terms of improvement in performance of agriculture finance in the country and achievement of the assigned targets during FY24.

PM Kissan Package

The SBP implemented PM's Kissan Package with the financial support from the Government of Pakistan (GoP) to provide relief and rehabilitation to farmers in the flood-affected regions. A summary of the initiatives undertaken to support agriculture-based economic activities under PM's Kissan Package is as follows;

- **Waiver of mark-up on outstanding loans for subsistence farmers in flood affected areas**:[4] With the support of GoP, the banks waived Rs 2.96 billion in mark-up on agricultural loans, benefiting subsistence farmers in flood-affected regions, having outstanding loan amount of up to Rs 500,000. The GoP covered half of this amount, totalling Rs 1.48 billion.

- **Provision of subsidy for interest-free loans to** subsistence **farmers in flood affected areas:** Under this scheme, banks provided loans of up to Rs 500,000 on zero percent mark-up to the subsistence farmers for the revival of agriculture and livestock sectors in flood affected districts. The banks collectively disbursed Rs 10.05 billion to 43,465 borrowers under the scheme, till its closure as of December 31, 2023.

- **Interest free loans to landless farmers in flood affected areas:** Under this scheme, the banks provided loans of up to Rs 200,000 with risk coverage of 50 percent, to small and marginalized landless farmers and tenants in the flood affected areas. The banks collectively disbursed an amount of Rs 5.802 billion to 47,425 borrowers under the scheme, till its closure on December 31, 2023.

- **Mark-up Subsidy and Risk Sharing Scheme for Farm Mechanization (MSRSSFM):** Under this GoP subsidy scheme, banks are providing subsidized loans of up to Rs 30 million to farmers and corporates for purchase of tractor, thresher, combined harvester, planter, mobile grain dryer and solar tube-well, etc. The scheme was initially valid till December 31, 2023, however, it was extended till June 30, 2024. Under the scheme, an amount of Rs 46.6 billion has been disbursed to the farmers till end June 2024.

[3] Ministry of Finance, Economic Survey of Pakistan 2023-24; Pakistan Bureau of Statistics, Labour Force Survey 2020-21
[4] ACFID circular No. 3 of 2022 dated December 21, 2022 which can be accessed at :https://www.sbp.org.pk/acd/2022/C3.htm

Adoption of Agriculture Credit Scoring Model

The SBP has introduced a scoring model for agriculture credit performance of banks in 2022 to promote fairness and transparency in gauging the individual performances of agriculture lending banks. The scoring model uses multi-dimensional criteria based on various indicators, such as disbursement, outstanding portfolio, number of borrowers and sectoral and regional performance to calculate numerical reflection of each bank's performance on agriculture credit.

The objective of the scoring model is to increase banks' focus on key areas that must be catered for enhancing agriculture financing in the country. Through this model, the SBP is able to monitor the performance of banks in relation to their categories: large banks, mid-size banks, small banks, and microfinance banks. The model has been useful in identifying specific areas to shift banks' focus on each area, where improvement is needed, in order to increase agriculture financing. The results of scoring model are periodically updated on the SBP's website.[5]

Champion Bank Model

The SBP initiated Champion Bank Model in 2022 with an objective to enhance banks' focus on regional agricultural financing needs and address allied issues with coordinated efforts of the key stakeholders. In this regard, six (06) Champion Banks (CBs) were nominated for 6 regions/provinces, each mandated to establish their respective Regional Agriculture Coordination Committees (RACCs) in consultation with SBP-Banking Services Corporation (BSC), with their respective CEO as chairman.[6]

The RACCs hold regular quarterly meetings comprising of officials from banks, SBP, SBP-BSC and provincial agriculture departments. In these meetings, the performance of banks and issues pertaining to agriculture are discussed, and important decisions regarding resolution of the issues are made. The RACCs have made many important developments so far, involving the removal of incorrect stamp duty on charge creation on Passbook in KPK, training of agriculture field teams, removal of the requirement of Khasra Girdawri in Balochistan, development of sugarcane and dairy value chain product guidelines and organization/facilitation of agriculture financial literacy programs.

As of June 2024, there has been positive growth in agriculture credit in all the regions of the country: 20.5 percent in Punjab, 36.9 percent in Sindh, 86.9 percent in KPK, 134.6 percent in Balochistan, 11.6 percent in AJK and 19.1 percent in GB. The initiative is also expected to bring positive structural changes over the medium to long term.

Electronic Warehouse Receipt Financing (EWRF)

The SBP formally rolled out the EWRF in February 2022 for maize and rice crops to enable farmers, traders and processors to avail financing from banks against physical commodities stored in accredited warehouses without the need for conventional collateral. Banks continued to finance under the EWRF and against the EWRF target of Rs 1,741 million for FY24, the banks have disbursed Rs 1,891 million to 637 borrowers in FY 2024 compared to a disbursement of Rs 1,125 million to 411 borrowers in FY23.

Crop Loan Insurance Scheme (CLIS)

With the aim to reduce the impact of natural calamities on agriculture, the GoP, provides the cost of insurance premium, per crop, per season to the eligible agriculture borrowers. The scheme is applicable and mandatory for agriculture production loans of banks/MFBs for

[5] https://www.sbp.org.pk/ACS/Index.html
[6] SBP press release on recent initiatives to boost agriculture financing dated June 15, 2022.

wheat, cotton, rice, sugarcane, and maize. Between July 2008 and December 2023, banks submitted insurance premium claims of Rs 11.3 billion against 7.0 million beneficiaries under the CLIS.

Livestock Insurance Scheme for Borrowers (LISB)

The scheme offers insurance coverage for livestock losses due to diseases, natural occurrences, accidents, and various natural disasters like floods, droughts, windstorms, and heavy rains. The insurance premium cost is covered by the federal government for eligible borrower. This scheme is applicable to loans provided by banks/MFBs for the purchase of cows, buffalos, and bulls. It is particularly intended for small livestock farmers, allowing them to purchase up to 10 animals. Under the LISB, during the period from July 2014 to December 2023, banks submitted insurance premium claims of Rs 3.22 billion against 0.954 million beneficiaries.

(vi) SME Finance

Given the significant potential of the SME sector in driving economic growth, creating jobs, and reducing poverty, the SBP has implemented various measures to improve SME's access to finance. At the end of June 2024, outstanding SME finance has risen to Rs 491 billion, from Rs 457 billion in the corresponding period of last year, exhibiting an increase of 7.2 percent. The key initiatives to promote SME finance are as follows:

Prime Minister's Youth Business and Agriculture Loan Scheme (PMYB&ALS)

In collaboration with the SBP, the GoP launched the PMYB&ALS in January 2023. The scheme aims to foster youth entrepreneurship and self-employment by providing business and agriculture loans to young people at concessional rates ranging from 0 to 7 percent. The GoP provides mark-up subsidy for the scheme and offers a partial credit guarantee to cover the risk associated with the financing to young entrepreneurs. For FY24, the SBP set a disbursement target of Rs 80 billion for banks, split equally between the SME and agriculture sectors. As of end June, 2024, banks met this target, disbursing Rs 80 billion to approximately 166,072 borrowers under the PMYB&ALS. Since the scheme's inception in January 2023 until June 2024, a total of Rs 110 billion has been disbursed to around 227,759 borrowers.

SME Asaan Finance (SAAF) Scheme

The SBP, in collaboration with GoP, launched 'SME Asaan Finance' (SAAF) scheme on August 16, 2021. The scheme offered both refinance and risk coverage to participating banks for financing to SMEs that lacked collateral, or did not have sufficient collateral. The financing of up to Rs 10 million was available to the SMEs at end user rate of up to 9 percent. Scheme successfully concluded in June 30, 2024. From August 2021 till June 2024, banks disbursed a total of Rs 60 billion to 12,300 SME borrowers under the scheme by end June, 2024.

(vii) SBP Initiatives for Financial Inclusion of Persons with Disabilities (PWDs)

The SBP has issued extensive guidelines for banks to promote financial inclusion for all categories of persons with disabilities (PWDs), including those who are physically handicapped, visually impaired, or have hearing and speech disabilities.[7] Banks are advised to ensure the availability of necessary physical and assistive technological infrastructure, prioritize service availability, and offer products and services that meet the special needs of PWDs. To this end, the SBP requires banks to develop a policy framework and ensure its implementation through periodic monitoring.

[7] SBP press release dated June 21, 2021 on SBP's Policy for Financial Inclusion of Persons with Disabilities (PWDs)

The main components of the banks' policy framework should include: i) availability of physical infrastructure to increase accessibility to bank branches; ii) accessibility of banking products and services; iii) accessibility audits of bank premises; iv) capacity building of staff to facilitate the PWDs; v) employment, retention, and career development of the PWDs; vi) capacity building of the PWDs for their financial inclusion; and vii) general guidelines for visually impaired/blind persons.

In this context, the SBP undertook the initiative for establishment of a dedicated network of model branches across the country, including AJK and GB. This resulted in an industry-wide plan to establish a total of 389 model branches in 108 districts. These model branches are required to ensure the availability of all necessary physical, technological and facilitative infrastructure and services at one place. By end June 2024, 376 out of the planned 389 branches have been operationalized.

Furthermore, the SBP under a 2-year time-bound action plan covering CY2021 and CY2022 had advised banks to construct 11,081 ramps at the entrance of their ATM cabins and business places to facilitate the PWDs. Accordingly, around 90 percent of the target has been achieved while for the remaining business places/ATMs, the construction of ramps was not possible due to different reasons, such as local municipal laws, narrow lanes of bazars, proximity to roads, and business places inside shopping malls.

(viii) Facilitation for Exports

The SBP has been facilitating industries and exports aiming to drive the country's overall economic development through various strategies, including refinance facilities. The major schemes include Export Finance Scheme (EFS) for meeting short-term working capital requirements of the exporters, and the Long-term Financing Facility (LTFF) to encourage capacity expansion in the export-oriented industries.

However, to strengthen governance and allow the SBP to focus on its core objectives, the central bank has planned to gradually phase-out refinance facilities and transfer the remaining balance to a dedicated development finance institution, namely Export-Import Bank of Pakistan (EXIM Bank). This plan outlines a transition period of up to 5 years, during which commercial banks will extend credit to export industries at preferential rates, with subsidies transparently allocated from the federal budget and administered by the EXIM Bank. Commercial banks will no longer access dedicated liquidity facilities from the SBP at below-market rates but will instead obtain liquidity at market rates through the SBP's standard open market operations.

This is aimed at improving the monetary policy transmission mechanism. The EXIM Bank will be allowed to participate in subsidized lending schemes using its own financial resources. Following the introduction of phasing out plan, the outstanding amount under Export Finance Scheme administered by EXIM Bank stood at Rs 89.7 billion as of end June, 2024.

Export Finance Scheme (EFS)

The EFS, operational since 1973, is a short-term financing facility for value-added exports with a loan duration of up to 180 days. Additionally, a Shariah compliant alternate, Islamic Export Refinance Scheme (IERS), is also available. In line with the aforementioned phasing out plan, the total outstanding amount under the EFS, including the IERS and Rupee-based discounting facility, decreased to Rs 605.5 billion as of June 2024, compared to Rs 745.4 billion as of June 2023.

Long Term Financing Facility (LTFF) for Plant and Machinery

Under the LTFF scheme, financing is offered for export-oriented ventures aiming to procure both imported and locally manufactured new plants and machinery. Each project has a maximum limit of up to Rs 5 billion. A Shariah compliant alternate is also available. Similar to the EFS, the total outstanding amount of the LTFF including Islamic Long Term Financing Facility (ILTFF) decreased to Rs 254.0 billion as of end June 2024, compared to Rs 302.6 billion as of end June 2023.

4.2 Payment Systems and Digitalization of Financial Services

Payment Systems

Payment systems enable smooth, efficient and secure transactions between individuals, businesses, and government entities and therefore is an important pillar for efficient functioning of a country's economy. Effective payment systems reduce transaction costs, enhance transparency, and boost consumer confidence, thereby driving economic growth and development. Pakistan's payments eco-system primarily comprises of Real-Time Gross Settlement (RTGS) System known as, Pakistan Real-Time Interbank Settlement Mechanism (PRISM); Instant Payment System – Raast; Banks and Microfinance Banks; Payment System Operators/ Payment Service Providers (PSOs/PSPs); Electronic Money Institutions (EMIs); payment schemes; and third-party service providers.

PRISM, operated by the SBP, provides a central platform for the settlement of large-value interbank funds transfers, government securities, retail clearing and customer transfers. PRISM also contributes in reducing settlement risk in government securities transactions through its delivery versus payment (DVP) mechanism. During FY24, PRISM handled 5.8 million transactions amounting to Rs 1043.1 trillion as compared to 4.9 million transactions amounting to Rs 640.4 trillion in the previous fiscal year FY23. In terms of value, PRISM transactions have increased by 63 percent.

Digital payments processed by banks, MFBs and EMIs continued their momentum during FY24, providing an uninterrupted flow of financial services. The share of digital payments in total payments processed by Banks, MFBs and EMIs grew from 77 percent in FY23 to 82 percent in FY24. However, in terms of value, digital payments during FY24 constituted only 16 percent of total payments, showing an increase of 2 percent compared to 14 percent in FY23.

The rise in digital payments came from the adoption of banking mobile apps and internet banking, increasingly being used for fund transfers, bill payments and mobile top-ups. The average share of internet and mobile banking transactions in digital retail transactions has increased to an average of 50 percent in FY24

Transactions Processed by Banks, MFBs and EMIs **Table 4.1**

transactions volume in million; value in billion Rupees, growth in percent

	FY23		FY24		Growth	
	Volume	Value	Volume	Value	Volume	Value
Digital Payments	**1,907**	**53,561**	**2,674**	**86,779**	**40**	**62**
of which;					0	0
ATM	810	12,154	932	15,018	15	24
Point-of-Sale (POS)	199	1,064	271	1,502	36	41
Internet banking	172	16,330	223	23,486	30	44
Mobile phone banking	661	23,791	1,123	46,344	70	95
Call center /IVR banking	0.1	8	0.3	8	95	-3
E-Commerce gateway	32	142	40	194	26	37
E-Wallet	33	72	85	226	156	215
OTC payments	**574**	**342,689**	**571**	**447,675**	**-1**	**31**
Total	**2,481**	**396,250**	**3,245**	**534,454**	**31**	**35**

ATM: Automated Teller Machine; POS: Point-of-Sale IVR: Interactive Voice Response; CNP: Card-not-present

Source: State Bank of Pakistan

from 44 percent in FY23. In value terms, last year's share stood at an average of 75 percent that has increased to 80 percent in FY24. In addition to internet and mobile banking channels, ATMs, Point of Sale (POS), e-commerce, call center/IVR banking and e-wallet also contributed to expanding the share of digital payments. On the other hand, number of transactions conducted over-the-counter (OTC) at bank branches appear to follow a declining trend (**Table 4.1**).

It is pertinent to mention that Raast, which is an instant payment system, is paving the way to further increase the adoption of digital payments. Raast person-to-person (P2P) use case offers a free-of-cost facility for fund transfers between individuals, enabling them to transfer funds using mobile banking apps or internet banking portals. During FY24, a total of 496 million transactions were processed through Raast amounting to Rs 11,558 billion. In FY23, the number of transactions stood at 147 million with the value of Rs 3,074 billion. In just 2 years of inception, Raast has successfully on boarded all banks, PSOs and EMIs. This shows an accelerated growth of 237 percent of transactions. Similarly, in terms of value, the increase is around 4 times **(Table 4.2)**.

As part of Raast implementation project, the SBP has now launched an interoperable Raast Person-to-Merchant (P2M) service to facilitate digital payment acceptance for merchants and businesses. The P2M service will enable payment acceptance by businesses using Quick Response (QR) Codes, Raast Alias, IBAN and Request to Pay (RTP). The Raast P2M service is set to accelerate the pace of digitization of merchant and business transactions in Pakistan. Accordingly, the SBP advised its regulated entities to enable necessary capabilities for processing P2M transactions via their delivery channels and take necessary measures for creating awareness about Raast Merchant Services and promoting its adoption.[8]

The SBP issued a circular letter in November 2023 on the standardization of the purpose list for domestic Electronic Fund Transfers (EFT) in order to have uniformity and streamline the list of purposes across the industry to bring convenience to the customers.

Rise in Digital Payments

Over the last decade, Pakistan's digital payments landscape has seen remarkable growth due to enabling regulations and technology-driven market participants. This progress has led to the introduction of innovative digital products and services, making digital payments more convenient, secure, and efficient for customers.

During FY24, digital transactions processed by banks, MFBs and EMIs expanded by 40 percent (**Figure 4.1**). The same pattern was observed in the value of transactions with an annual growth of 62 percent (**Figure 4.2**). As mentioned earlier, internet and mobile banking contribute a major share in digital payments with a total of 1,345.9 million transactions amounting to Rs 69.8 trillion during FY24. The second largest contributor was the ATM channel, with 931.6 million transactions of Rs 15.0 trillion. Despite being

Raast Transactions — **Table 4.2**

transactions volume in million; value in billion Rupees

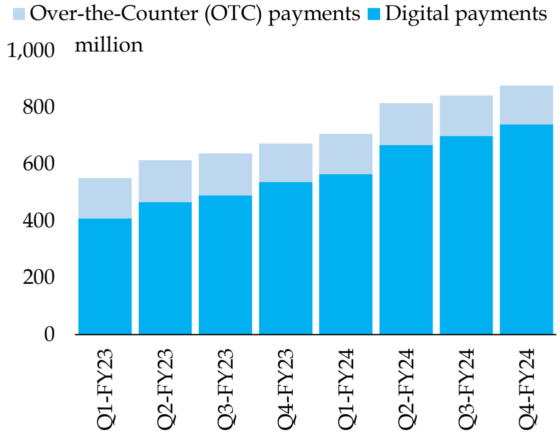
Raast	FY23		FY24^{P}		Growth YoY	
	Volume	Value	Volume	Value	Volume	Value
Bulk Payments	0.4	88	1.7	280	337.2	218.9
P2P Payments	147	2,987	494	11,278	236.7	277.6
Total	**147**	**3,074**	**496**	**11,558**	236.9	276.0

P: Provisional

Source: State Bank of Pakistan

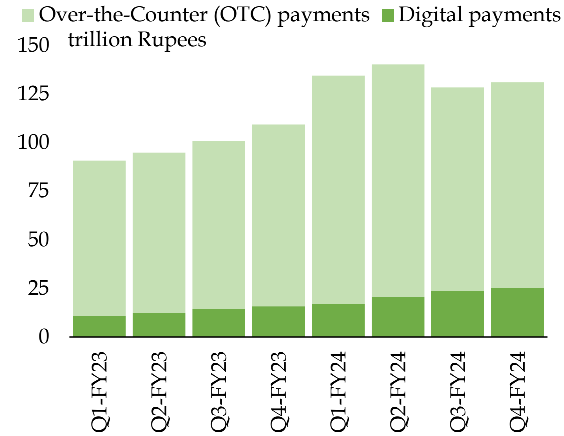
[8] PSP&OD Circular No 04 of 2023

Volume of Retail Transactions Figure 4.1



Source: State Bank of Pakistan

Value of Retail Transactions Figure 4.2



Source: State Bank of Pakistan

relatively new in the country's payments ecosystem, EMIs have also promoted digital payments, accounting for 3 percent of transactions through e-wallets.

Card-based payments, either at POS terminals for in-store purchases or e-commerce platforms, also witnessed an increase in comparison to the previous year. The number of POS transactions and e-commerce transactions increased by 36 percent and 26 percent reaching 271.4 million and 39.9 million respectively. Almost identical growth was observed in the value of transactions with POS transactions reaching Rs 1,502.4 billion (41 percent growth) and e-commerce transactions reaching Rs 194.3 billion (37 percent growth).

Increasing adoption of digital channels

The adoption of digital channels for financial transactions has been on a steady rise, driven by the ease in use of digital channels, accessibility, enhanced security, and affordability. As of end-June 2023, there were 16.1 million users of mobile banking apps, 9.6 million users of internet banking portals, and around 2.0 million e-wallet holders. By the end of FY24, internet and mobile banking users have increased to 18.7 million and 12.0 million respectively while e-wallet holders have increased by 82 percent to 3.7 million.

Payments infrastructure of Pakistan

In Pakistan, there are 18,450 banks and MFBs branches, 18,957 ATMs, 125,593 POS machines and 7,816 e-commerce merchants as of FY24. Further, Raast, an instant payment system, which is being operated by SBP, is offering free-of-cost instant Person-to-Person (P2P) funds transfer facility. Raast has 3 use cases, (i) Raast Bulk, (ii) Raast P2P, and (iii) Raast P2M (Person-to-Merchant).

Enablement of digital payments at cattle markets on Eid-ul-Azha

In order to address the hassle and overheads of keeping cash for both the cattle sellers and the buyers, there was a need for digital acceptance at cattle markets. Accordingly, the SBP and the banks/MFBs deployed digital solutions nationwide on the occasion of Eid-ul-Azha 2024 for the first time in the country's history. The SBP encouraged the financial institutions to establish their presence in major cattle markets across the country through stalls, kiosks, mobile vans etc. Banks and MFBs on-boarded merchants by opening their accounts and built their capacity to receive payments digitally, including but not limited to Raast QR-based payments.

To further promote this initiative, the SBP launched an electronic & digital marketing campaign through electronic media. One of the notable achievement of this initiative was the onboarding of cattle sellers into the formal financial system. A total of 4,067 cattle seller accounts were opened in 48 cattle markets across the country during the activity. Around 13,000 transactions worth Rs 560 million were conducted through digital channels including IBANs, Raast QRs and Cash Deposit Machines.

Licensing and approvals to new EMIs

During FY24, M/s Akhtar Fuiou Technologies Pvt. Ltd. (AFT) was granted a license for commercial operations having a special use case of digitization of agi-business. As of year-end, AFT had on-boarded more than 50,000 farmers on their platform facilitating them to get financing in collaboration with a microfinance bank. M/S Cerisma Pvt. Ltd. was granted in-principle approval (IPA).

Enablement of cross-border payments through e-wallet

NayaPay, after obtaining necessary approval has partnered with M/s Alipay Hong Kong Ltd. under which the NayaPay's users would be able to use their e-money wallets for in-store payments through QR Codes in mainland China. Through this arrangement, NayaPay's customers traveling to China will gain access to a vast merchant network of Alipay and will be able to make in-store payments in China. NayaPay's e-wallet users in Pakistan now have alternate options, in addition to card payments, for making cross-border payments in China.

Raast-Buna integration for settlement of cross-border payments in Arab region

FY24 marks an important milestone in the area of cross-border payments. The SBP in partnership with the Arab Monetary Fund (AMF) signed an MoU to establish a framework of cooperation between Raast, Pakistan's Instant Payment System, and Buna, the cross-border payment system operated by Arab Regional Payments Clearing and Settlement Organization (ARPCSO), owned by AMF.

The year also saw the signing of key agreements between the SBP and the AMF, marking the end of the feasibility and design phase, and start of the project's implementation phase. This development has also enabled the inclusion of PKR as a settlement currency in Buna, in addition to the existing international and Arab currencies.

The Buna-Raast interlinking and the inclusion of PKR as a currency for cross-border instant payments will enhance accessibility and convenience for banks and their customers, while supporting financial integration between the Arab region and Pakistan. The project is envisioned to bring more flows to the formal channels by addressing the critical challenges faced in cross-border remittances which are often affected by inefficiencies and high costs. The Buna-Raast project will offer a transparent and secure solution that will support the economic well-being of families and support greater financial inclusion.

4.3 Measures for Promoting Sustainable Finance

Financing for sustainable development has become imperative for Pakistan, especially given its vulnerability to climate change. To this end, the role of financial sector in facilitating the establishment of a resilient and sustainable economy is critical. Recognizing the sensitivity of the issue, the SBP has incorporated climate change as one of the crosscutting themes in its Strategic Plan for the next five years. This integration reflects the SBP's commitment to enhancing climate risk mitigation and management capabilities, recognizing the urgent need to address the challenges posed by climate change and promote sustainable development.

In this regard, the SBP has undertaken a number of green initiatives to promote sustainability considerations in the financial sector, which are aligned with the international best practices. These measures mainly include Green Banking Guidelines (2017), the ESRM Implementation Manual (2022) and Financing Scheme for Renewable Energy (2019).

Development of National Green Finance Taxonomy for Pakistan:

To scale up green financing in the country and to enhance the financial system's resilience to climate-related financial risks, 'Green Taxonomy' for Pakistan is being developed in collaboration with the World Bank. The Green Taxonomy serves as a common reference for market players to identify and assess environmentally and socially sustainable projects and economic activities. In this regard, a working group has been formulated of all relevant stakeholders from federal and provincial governments for their inputs.

The Green Taxonomy will support to further streamline green product development within the banking industry. On the investment side, taxonomy will attract investments towards environment friendly projects and minimise the risk of green washing. Hence, the taxonomy will provide a clear and consistent framework that will aid in climate risk mitigation and adaptation by supporting the transition to a low-carbon economy and promoting sustainable finance practices.

4.4 Promotion of Home Remittances & Reforms in FX Regulatory Framework

(i) Addition of Diamond Category in Sohni Dharti Remittance Program (SDRP)

The SDRP is a point-based loyalty program through which remitters earn and accumulate reward points by sending remittances via formal channels (i.e. through SBP regulated entities). Reward points can be redeemed at select public service entities by the remitters and their beneficiaries for availing free of cost products & services.[9] In order to further incentivize Overseas Pakistanis to remit through formal channels, a new 'Diamond' category has been added to the SDRP; in addition to the existing 'Green', 'Gold' and 'Platinum' categories. Under the Diamond category, the remitters sending remittances exceeding US$ 50,000 can earn highest percentage (i.e. 1.75 percent) of reward points.[10]

(ii) Pre-departure Briefings Program for Emigrants

The SBP and Pakistan Remittance Initiative (PRI), in collaboration with banks and the Bureau of Emigration & Overseas Employment, launched a pre-departure briefing program in August 2023. Under this initiative, briefing sessions are held at all Protectorate of Emigrants Offices across the country for awareness of the outgoing workers. The program aims to educate the workers about efficient and secure channels for sending remittances, highlight the risks of using informal channels, facilitate workers in opening their bank accounts; and update about the government's incentive schemes as well as banks' products related to home remittances. During FY24, more than 4,500 briefing sessions were held wherein over 200,000 workers were briefed and a large number of accounts of emigrant workers have been opened.[11]

(iii) Enhancement in Reimbursement of Telegraphic Transfer (TT) Charges Scheme

Reimbursement of TT Charges Scheme enables overseas Pakistanis and their beneficiaries to send and receive free of cost remittances for transactions of equivalent US$ 100 and above.

[9] Currently, reward points can be redeemed against selected products and services of Pakistan International Airlines, Federal Board of Revenue, National Database and Registration Authority, State Life Insurance Corporation of Pakistan, Oversees Pakistanis Foundation School, Utility Stores Corporation, Bureau of Emigration and Overseas Employment and Directorate General of Immigration and Passports.

[10] Reward points for Green, Gold and Platinum categories are 1, 1.25 and 1.5 percent of remittance amount, respectively.

[11] This accounts for approximately 27 percent of registered workers went abroad between August 2023 and June 2024.

Keeping in view the increasing cost of sending remittances, the rate of reimbursement of TT charges was increased from SAR 20 to SAR 30 to facilitate overseas Pakistanis and global Money Transfer Operators (MTOs).[12] This made Pakistan an attractive corridor for global players and more MTOs have signed agreements with Pakistani banks for home remittance business.

(iv) Incentive Scheme for Marketing of Home Remittances

To encourage banks and exchange companies to initiate marketing/promotional campaigns for the senders and recipients of home remittances, the "Incentive Scheme for marketing of Home Remittances" was launched in 2018-19. In FY24, the rate of cash incentive offered to the financial institutions against growth over previous year was increased to enhance its effectiveness.[13]

(v) Pakistan Remittance Summit at Malaysia

Under the auspices of the SBP and the PRI, the 3rd Pakistan Remittance Summit was organized in Kuala Lumpur - Malaysia, in collaboration with the top remittance-mobilizing banks. For the first time, the PRI Awards were introduced at the Summit; aimed at recognizing the performance of banks and partner MTOs in home remittances during the fiscal year 2022-23.

(vi) Facilitation in Export of Software, Information Technology (IT) & IT Enabled Services (ITeS) and Freelance Services

A number of regulatory measures have been taken by the SBP to encourage exporters of IT, IT enabled Service (ITeS) companies and freelancers to boost their export earnings and bring additional foreign exchange into the country. To this end, the retention limit in Exporters' Special Foreign Currency Account (ESFCA) was enhanced from 35 percent to 50 percent of the export proceeds and the utilization of retained funds was further liberalized. The exporters can freely make payments of current account nature from these accounts, without prior approval of the SBP. Besides, the authorized dealers have been advised to offer FCY denominated debit cards against the ESFCAs to the exporters.[14]

(vii) Awareness and Capacity Building Sessions

The SBP has organized a number of awareness sessions across Pakistan for IT Companies & Freelancers and also arranged capacity building programs for banks. In addition, the SBP has been engaged with trade bodies, and associations on a regular basis for knowledge-dissemination programs and gaining insights in terms of challenges faced by exporters and freelancers, in its endeavour towards ease of doing business. Moreover, dedicated helpdesks have been established within the Exchange Policy Department of the SBP, for the swift resolution of banking related issues of exporters as well as IT exporters & Freelancers.

(viii) Export Facilitation Scheme

A procedure of International Toll Manufacturing within the FBR's Export Facilitation Scheme has been formally rolled out for the import of input goods from foreign principals without any payment of foreign exchange. At the time of export, banks will provide the financial instrument at Pakistan Single Window equivalent to the service charges (or value) added to the goods imported. The service charges will be received as foreign remittances from abroad. The implementation of this import-cum-export arrangement will encourage local manufactures to enhance their outreach and expand services to the global customers.[15]

[12] EPD Circular Letter No. 14 of 2023
[13] EPD Circular Letter No. 15 of 2023
[14] EPD Circular Letter No. 17 of 2023
[15] EPD Circular Letter No. 18 of 2023

List of Abbreviations

A

AAOIFI	Accounting and Auditing Organization for Islamic Finance Institutions
ACFID	Agriculture Credit & Financial inclusion Department
ACU	Asian Clearing Union
ADCs	Alternate Delivery Channels
ADR	Advances to Deposit Ratio
AEs	Advanced Economies
AFS	Available for Sale
AFT	Akhtar Fuiou Technologies Private Limited
AJK	Azad Jammu and Kashmir
AM	Asset Management
AMC	Asset Management Companies
AMF	Arab Monetary Fund
AML	Anti-Money Laundering
ARPCSO	Arab Regional Payments Clearing and Settlement Organization
ATM	Automated Teller Machine
ATMS	Automated Transaction Monitoring Systems

B

BB	Branchless Banking
BoE	Banking on Equality
BPRD	Banking Policy and Regulations Department
bps	Basis Points
BSSM	Banking Sector Stability Map
BV	Biometric Verification

C

CAD	Current Account Deficit
CAR	Capital Adequacy Ratio
CBs	Champion Banks
CDC	Central Depository Company
CDD	Customer Due Diligence
CDNS	Central Directorate of National Savings
CEO	Chief Executive Officer
CFT	Combating the Financing of Terrorism
CiC	Currency in Circulation
CLIS	Crop Loan Insurance Scheme
CNG	Compressed Natural Gas
CNP	Card-not-present
COI	Certificate of Investment
COVID	Coronavirus Disease
CPI	Consumer Price Index
CRR	Cash Reserve Requirement

	CY	Calendar Year
D		
	DFIs	Development Finance Institutions
	DLT	Distributed Ledger Technology
	DMMD	Domestic Markets & Monetary Management Department
	DPC	Deposit Protection Corporation
E		
	e-Banking	Electronic Banking
	ECAP	Exchange Companies Association of Pakistan
	e-Commerce	Electronic Commerce
	EFF	Extended Fund Facility
	EFS	Export Finance Scheme
	EFT	Electronic Fund Transfer
	eLRMS	Electronic Land Record Management Information System
	EMDEs	Emerging Market and Developing Economies
	EMIs	Electronic Money Institutions
	EPD	Exchange Policy Department
	EPU	Economic Policy Uncertainty
	ESFCA	Exporters' Special Foreign Currency Accounts
	ESRM	Environmental and Social Risk Management
	EU	European Union
	e-Wallet	Electronic Wallet
	EWMA	Exponential Weighted Moving Average
	EWRF	Electronic Warehouse Receipt Financing
	EXIM Bank	Export-Import Bank of Pakistan
F		
	FBR	Federal Board of Revenue
	FCY	Foreign Currency
	FDI	Foreign Direct Investment
	FDR	Financing to Deposits Ratio
	FED	Federal Excise Duty
	FI	Financial Inclusion
	FIs	Financial Institutions
	FMI	Financial Market Infrastructure
	FSC	Federal Shariat Court
	FSI	Financial Soundness Indicator
	FX	Foreign Exchange
	FY	Fiscal Year
G		
	GB	Gilgit-Baltistan
	GBGs	Green Banking Guidelines
	GDP	Gross Domestic Product

	GoP	Government of Pakistan
H		
	H1	First half of the fiscal year/financial year
	H2	Second half of the fiscal year/financial year
	HFT	Held for Trading
I		
	IAs	Investment Advisors
	IBAN	International Bank Account Number
	IBIs	Islamic Banking Institutions
	ICT	Information and Communication Technology
	ID	Identification
	IE	Inflation Expectation
	IERS	Islamic Export Refinance Scheme
	IFRS	International Financial Reporting Standards
	ILTFF	Islamic Long Term Financing Facility
	IMF	International Monetary Fund
	IPA	In-principle Approval
	ISIC	International Standard Industrial Classification of All Economic Activities
	IT	Information Technology
	ITeS	Information Technology Enabled Services
	ITM	International Toll Manufacturing
	IVR	Interactive Voice Response
K		
	KPK	Khyber Pakhtunkhwa
	KSE	Karachi Stock Exchange
	KYC	Know Your Customer
L		
	LCR	Liquidity Coverage Ratio
	LISB	Livestock Insurance Scheme for Borrowers
	LR	Leverage Ratio
	LSM	Large Scale Manufacturing
	LTFF	Long Term Financing Facility
	LVPS	Large Value Payment System
M		
	M2	Money Supply (Broad Money)
	MFBs	Microfinance Banks
	MoF	Ministry of Finance
	MoU	Memorandum of Understanding
	MPC	Monetary Policy Committee
	MSRSSFM	Markup Subsidy and Risk Sharing Scheme for Farm Mechanization
	MTOs	Money Transfer Operators
N		
	NBFIs	Non-Bank Financial Institutions
	NBMFCs	Non-Bank Microfinance Companies

NCCPL	National Clearing Company of Pakistan Limited
NCPI	National Consumer Price Index
NDA	Net Domestic Assets
NEPRA	National Electric Power Regulatory Authority
NFA	Net Foreign Assets
NFDC	National Fertilizer Development Centre
NFIS	National Financial Inclusion Strategy
NFNE	Non-Food Non-Energy
NIFT	National Institutional Facilitation Technologies
NPLs	Non-Performing Loans
NRA	National Risk Assessment
NRSP	National Rural Support Programme
NSFR	Net Stable Funding Ratio
NTR	Non-tax Revenue

O

OCAC	Oil Companies Advisory Council
OMOs	Open Market Operations
ONR	Overnight Rate
OTC	Over-the-Counter

P

P2M	Person-to-Merchant
P2P	Person-to-Person
PAMA	Pakistan Automotive Manufacturers Association
PBA	Pakistan Banks' Association
PBS	Pakistan Bureau of Statistics
PDL	Petroleum Development Levy
PE	Protectorate of Emigrants
PE	Private Equity
PKR	Pakistani Rupee
PM	Prime Minister
PMYB&ALS	Prime Minister's Youth Business and Agriculture Loan Scheme
POL	Petroleum, Oil and Lubricants
POS	Point of Sale
PRI	Pakistan Remittance Initiative
PRISM	Pakistan Real-Time Interbank Settlement Mechanism
PSEs	Public Sector Enterprises
PSOs	Payment System Operators
PSP&OD	Payment Systems Policy & Oversight Department
PSPs	Payment Service Providers
PSX	Pakistan Stock Exchange
PTA	Pakistan Telecommunication Authority
PWDs	Persons with Disabilities

Q		
	QR	Quick Response
	Q1	First Quarter
	Q2	Second Quarter
	Q3	Third Quarter
	Q4	Fourth Quarter
R		
	RACCs	Regional Agriculture Coordination Committees
	RAS	Regulatory Approval System
	REs	Regulated Entities
	REIT	Real Estate Investment Trust
	ROA	Return on Assets
	ROE	Return on Equity
	RTGS	Real Time Gross Settlement
	RTOB	Real-Time Online Branches
	RTP	Request to Pay
	RWAs	Risk Weighted Assets
	RWRs	Risk-Weighted Capital Requirements
S		
	SAAF	SME Asaan Finance
	SAR	Saudi Riyal
	SBA	Stand-By Agreement
	SBP	State Bank of Pakistan
	SBP-BSC	State Bank of Pakistan - Banking Services Corporation
	SCRR	Special Cash Reserve Requirement
	SDRP	Sohni Dharti Remittance Program
	SECP	Securities and Exchange Commission of Pakistan
	SG-4	Strategic Goal no. 4
	SME	Small and Medium Enterprise
	SRS	Systemic Risk Survey
T		
	TT	Telegraphic Transfer
	TF	Terrorist Financing
	TOD	Treasury Operations Department
U		
	UK	United Kingdom
	UN	United Nations
	UNCTAD	United Nations Conference on Trade And Development
	US	United States
	USD/US$	United States Dollar
W		
	WAP	Working Age Population
Y		
	YoY	Year on Year