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NBP Performance at a Glance

## Editor's Corner

Dear Readers,

The world economy is engulfed in an economic crisis, being described as the worst since the Great Depression. The world stock markets have fallen, major banking institutions have collapsed or been bought out and governments have had to come up with rescue packages to bail out some large banks and financial institutions; and commodity prices which had risen sharply have fallen with the slowdown in the global economy precipitated by the financial crisis. As of late November 2008, the dollar price of crude oil had fallen more than 60 percent and food prices were also much lower, but still higher than in January 2003. These developments have now triggered a full-fledged economic crisis, with most advanced countries already slowing down and the outlook for emerging and other developing economies deteriorating rapidly.

The global financial crisis started showing its effects in the middle of 2007, which continued into 2008. It has its roots in the subprime mortgage crisis in the US. The later was triggered by a dramatic rise in mortgage delinquencies in the US, with major adverse consequences for banks and financial markets around the globe. Wikipedia describes the crisis, "many US mortgages issued in recent years were made to subprime borrowers, defined as those with lesser ability to repay the loans based on various criteria. When US house prices began to decline in 2006-07, mortgage delinquencies soared and securities backed with subprime mortgages, widely held by financial firms, lost most of their value. The result has been a large decline in the capital of many banks and USA government sponsored enterprises, tightening credit around the world."

The crisis gained prominence in September 2008, when two firms Fannie Mae and Freddie Mac were nationalised, Lehman Brothers filed for bankruptcy, Bank of America announced that it would be purchasing Merrill Lynch, Bear Stearns was sold to JP Morgan Chase, and two investment banks – Goldman Sachs and Morgan Stanley – opted to become commercial banks, thereby subjecting themselves to more stringent regulation.

The financial crisis has had repercussions on the growth prospects of the world economies, both advanced and developing. Recent forecasts are lower than those made six months earlier. The IMF expects the world economy to grow at 2.2 percent in 2009, down from the earlier projection of 3 percent. Meanwhile, the United Nations forecast world GDP to grow a mere 1.0 percent in 2009, a sharp slowdown from the 2.5 percent growth estimated for 2008, while World Bank's Global Economic Prospects predicts that global GDP growth will fall from 2.5 percent in 2008 to 0.9 percent in 2009. Developing countries' growth is expected to decline from 7.9 percent in 2007 to 4.5 percent. In its latest economic outlook, the Organization for Economic Cooperation and Development expects economic output to shrink to 0.3 percent in 2009 for its members, against the 1.4 percent growth predicted for 2008.

The World Bank has projected the world trade volume to decline by 2.1 percent in 2009, the first fall since 1982. This is driven by the global financial crisis, which has hit the high income countries and led to sharp slowdown across the developing world. Weaker foreign demand, tighter credit conditions have led to worsening external accounts.

The World Bank's Global Economic Prospects says that the commodity boom has come to an end. Prices in all commodity markets have fallen sharply since July 2008 and with a much weaker GDP growth projected, commodity prices are expected to ease further.

The crisis has led governments to take measures to stabilize their economies. The US, Japan, Europe and China have announced stimulus plans to revive their economies. For some countries there is the risk of unrest, as many have been affected by the downturn. Some countries are seeking assistance from the IMF and more countries are expected to go to the IMF for help to get them through the crisis.

2008 has been a grim year for the Pakistan economy. Oil and food price shocks, security concerns, acute power shortages and political transition impacted the macroeconomic situation. Major economic indicators deteriorated; the economy slowed down, overall inflation went above 25 percent year-on-year in August, from 8.8 percent in December 2007, fiscal and current account deficits shot up to 7.4 percent and 8.4 percent of GDP respectively. The Pak Rupee weakened against the US dollar and by October 17, it had fallen to Rs85.75 against Rs62.75 to the dollar in January, a drop of nearly 27 percent. Foreign exchange reserves had dropped to \$6.5 billion by November compared to \$15 billion at the beginning of the year.

Economic uncertainties, political developments and the deteriorating law & order affected investor sentiments and contributed to a decline in investment inflows and the stock market witnessed a flight of capital. The Karachi Stock index dropped by more than 35 percent during April-July 2008. Standard and Poor downgraded Pakistan's debt rating from B+ to B in May 2008 followed by Moody's. The year also saw a decline in portfolio investment, while foreign direct investment growth stagnated.

The government has taken measures to address some of the problems confronting the economy. It entered into a 23-month Stand-By loan agreement with the IMF so to implement a stabilization programme that envisages a significant tightening of fiscal and monetary policies, which would help bring down inflation and reduce the current account deficit to more manageable levels. The signing of this agreement implied that any immediate risk of default on external obligation has receded and there was some improvement in the foreign exchange reserve position.

The government and the State Bank of Pakistan have taken steps to resolve some of the other issues. The economic indicators which had remained under stress because of the impact of global commodity prices alongwith a rise in domestic demand had resulted in rising fiscal and external account deficits. This in turn had generated inflationary pressures. State Bank of Pakistan has taken timely measures during the year, like increase in SBP discount rate, changes in CRR and SLR, encouraging resource mobilization by banks, etc for proper liquidity management.

Subsidies are being gradually reduced so to contain the fiscal deficit and the government has acknowledged the dangers to macroeconomic stability resulting from heavy recourse to borrowings from the central bank. In FY09 the government would adhere to a desirable borrowing programme and has committed to zero additional budgetary borrowings from the central bank, which has now been incorporated into the IMF supported macroeconomic stabilization programme.

The government plans to give relief to the domestic consumers who suffered when international commodity prices were rising. Downward adjustments have been made in the price of petrol, diesel, kerosene and LPG. Better prices and credit availability to the farmers has encouraged them to increase investment in crops and the poor are being provided support under the Benazir Income Support Programme.

Looking towards 2009, the State Bank of Pakistan first quarterly report FY09 states, "Pakistan's economy needs effective policies and implementation of reforms in FY09 to regain macroeconomic stability in the midst of a challenging year."

*Ayesha Mahmood*

## Pakistan and the IMF

IMF loan for Pakistan

In November 2008, the International Monetary Fund (IMF) approved a US\$7.6 billion loan to Pakistan to support the country's stabilization programme. The government had sought support from the Fund to help finance its economic programme devised to deal with the difficult economic and financial challenges confronting it. IMF support will help fill the external financing gap and is a signal to the other donors about the country's improved macroeconomic prospects.

In fiscal 2007-08, Pakistan faced a very difficult economic situation, as major macroeconomic indicators showed a deterioration. Adverse security developments, alongwith policy inaction during political transition to the new government compounded the existing problems.

IMF programme is based on the following objectives: -

- Restore macroeconomic stability through tightening of macroeconomic policies,
- Ensure social stability for the poor.

Recent economic developments

Pakistan's economy which had shown good economic performance in recent years saw deterioration in the macroeconomic situation in FY08, because of adverse security developments, oil and food price hikes in the

international market, global financial crisis and uncertainty during the election period.

In earlier years, economic growth averaged 7 percent, foreign exchange reserves had risen to a record level of \$16.4 billion by October 2007, there was an improvement in sovereign rating to B+, external debt declined to 27 percent of GDP, there was higher foreign direct investment and large capital inflows financed the current account deficit, per capita income rose and government's policies had helped in some reduction in poverty.

However, internal security concerns, low investor confidence, large price increases in oil and food imports, reduced foreign exchange inflows, policy inaction during the election period, fiscal management weaknesses, energy shortages, adversely impacted the economic gains made earlier.

As a consequence of these developments economic growth slowed down in FY08, investors were cautious in investing in the economy, food shortages occurred, rising fuel and raw material prices and energy shortages slowed down industrial activities, inflationary pressures strengthened, fiscal performance indicators deteriorated, domestic and external debt grew, current account deficit deteriorated, and the Pak Rupee US dollar exchange rate and SBP foreign exchange reserves remained under pressure, trade deficit widened and there was an increase in the rich-poor divide.

Macro-economic indicators deteriorated

Pakistan: Main Economic Indicators

	2006-2007	2007-2008
GDP (%)	6.8	5.8
CPI (%)	7.8	12.0
National Savings as % of GDP	17.8	13.3
Aggregate Market Capitalization (Rs bn)	3980.8	3744.1
Turnover of Shares at KSE (Total)	54042.4	63316.1
Total External Debt (\$ bn)	39.0	44.5
Total Debt Servicing (\$ mn)	531.6	669.2
Debt as % of GDP	56.8	60.2
Workers' Remittances (\$ bn)	5.5	6.5
Gold & Foreign Exchange Reserves (\$ mn)	17924	13275
Net Inflow of Foreign Private Investment (\$ mn)	6960.0	5172.2
Portfolio Investment (\$ mn)	1820.4	19.3
Trade Deficit (\$ mn)	(-)13.4	20.2
Fiscal Deficit as % of GDP	4.3	7.4
Domestic Debt (Rs trillion)	2.6	3.26
Current Account Balance (\$ bn)	(-)7.4	(-)14.0

Source: Annual Report 2007-08, State Bank of Pakistan

Programme for 2008-10

Realizing the gravity of the prevailing economic conditions, the government has a programme in place for 2008-09-2009-10, which with donor support would help improve the situation and bring stability in the economy. The Programme highlights are:-

- Restore the confidence of international and domestic investors by correcting the macroeconomic imbalances;
- Strengthen the international reserve position, check portfolio outflows;
- A better external position is expected as a result of lower commodity prices, increase in donor financing, and tighter financial policies;

- Further gains in macroeconomic stabilization because of fiscal adjustment, continuation of tight monetary policy and falling oil and food import prices;
- Macroeconomic conditions to improve over the medium term;
- Fiscal consolidation to be supported by strong tax policy and administrative measures;
- Higher spending in infrastructure and the social sectors;
- The programme envisages tightening of monetary policy;
- Expenditure on social safety net to be increased to protect the poor;
- Steps to be taken to improve liquidity;
- SBP is preparing a plan for dealing with problems of private banks.

During FY09 and FY10, the Programme seeks to achieve the following targets: -

- Inflation to decline to 20 percent by June '09 and to 6 percent by June '10;
- Current account deficit to fall to 6.5 percent of GDP in 2008-09, and to 5.7 percent by 2010;
- Real GDP to grow by 4.5–5 percent in FY10 and will increase gradually to 6.5–7.0 percent by 2012-13.
- Need to rebuild international reserves to at least \$8.6 billion in FY09 and increase it to \$11.3 billion by end June 2010.
- Fiscal deficit to be reduced to 4.2 percent in FY09 from 7.4 percent in FY08, and further to 3.3 percent in 2009-10.
- The programme envisages an increase in disbursements to the government by multilateral and bilateral creditors.
- Tax revenue to increase because of better tax administrative measures.
- Expenditure measures include the phasing out of energy subsidies and a better prioritization of development spending.
- The elimination of energy subsidies will create resources for social sectors.
- Social safety net spending to increase to 0.9 percent of GDP in order to protect the poor.

The programme is based on the targets set by the government for the next two years.

Financing from the IMF will help fill the external financing gap and help to catalyze other donor support.

The Fund programme has certain conditionalities. There are some quarterly targets on variables like the budget deficit, budget borrowing from the State Bank of Pakistan, international reserves, the domestic assets of SBP, contracting or guaranteeing of non-concessional loans by the public sector. Then there are some specific commitments for improvements in banking and tax legislation, phasing out electricity subsidies, reducing foreign exchange market intervention by the SBP, strengthening the social safety net for poor households, working toward elimination of inter-corporate circular debt.

In line with the fiscal adjustments in 2008-09, the government has implemented a number of measures: -

- Petroleum prices have been adjusted three times since June 2008, which has led to the complete elimination of petroleum subsidies.
- Electricity subsidies were adjusted in September '08 and will be eliminated by June 2009.
- Domestically financed development spending will be reduced by about one percentage point of GDP through better project prioritization.
- Steps have been taken to slow down the pace of development spending, and the general sales tax rate has been raised by one percentage point to 16 percent.
- Electricity tariff differential subsidies will be fully eliminated by end June 2009.
- Fuel prices will continue to be adjusted to pass through changes in international prices.
- A well targeted social safety net is a key priority under the programme, for which the government will prepare a set of specific measures and the first programme review will assess progress in this area.
- A plan would be prepared by end March 2009 for eliminating the inter-corporate circular debt within the fiscal deficit target.
- A reduction in fiscal deficit will help eliminate SBP financing of the budget, which would be financed through available external assistance, privatisation proceeds, issuance of treasury bills and other domestic financing instruments.

Condi-  
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Target for  
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*Interim Report on  
Economic Stabilization with a Human Face  
Planning Commission Pakistan*

Given the economic challenges facing the country, the Planning Commission had constituted a panel of eminent economists to frame policy measures to address the issues facing the economy. The group published an Interim Report '*Economic Stabilization with a Human Face.*'

We give below excerpts from the Report.

- The current crisis reflects both adverse short-term developments caused by an unprecedented increase in global oil and food prices and the festering structural economic weaknesses that have resulted in bursts of stop-go cyclical growth (viz a fragile budget, loss of international competitiveness and fragmented social protection). A difficult domestic political transition and taking the fight to the militants has heightened these challenges.
- The global economic situation has taken a dramatic turn for the worse starting with the implosion of the so-called 'sub-prime' mortgage market in the US, which has led to the collapse of major US investment banks such as Merrill Lynch, Lehman Brothers and Bear Stearns, the insurance giant AIG, and the government sponsored mortgage lenders and guarantors Freddie Mac and Fannie Mae, all since August 2008.
- Given the severity and likely duration of the stresses facing the world economy, it is clear that, on balance, there could be adverse consequences for developing countries such as Pakistan. The different channels via which any potential impact may be transmitted include the following:
  - *Impact on Exports:* With nearly 60 percent of its exports directed to the advanced economies, a significant and protracted downturn in these markets could adversely impact Pakistan's export earnings.
  - *Availability of Financing:* Over the past few years, in particular between 2004 and 2007, a significant feature of Pakistan's balance of payments position has been the 'financing' of its rising current account imbalance, mainly in the form of strong private capital inflows such as FDI and portfolio investment. A potential downturn in FDI inflows could have significant negative implications for investment as well as growth over the medium-term and put additional pressure on the balance of payments.
- *Remittances:* Touching nearly US\$6.5 billion in FY08, worker remittances are not only substantial but are critical in 'financing' the external account. As such, any adverse impact of global economic developments on remittance inflows to Pakistan could have serious implications not just for the BOP, but for growth, investment and employment-generation as well.
- *Global Commodity Prices:* A decline in global commodity prices, especially of oil and food, could have a significant positive impact on Pakistan's balance of payments situation.
- Pakistan's economic situation further worsened in the first quarter of the current fiscal year, 2008-09. The high rate of inflation continues unabated.
- The situation has also further worsened in external sector in the current fiscal year. The trade deficit for July-August 2008 reached US\$2.9 billion as compared to US\$1.6 billion in July-August 2007. This has resulted in rapid depletion of foreign exchange reserves and depreciation of the Rupee.
- However, there are some positive indications also. First, the inflation rate which was rising by over 2 percent monthly from May 2008 onwards, due primarily to the large upward adjustment in prices of petroleum products, has increased by about 1 percent in September 2008. Second, exports have shown some buoyancy in the first two months of the current financial year with a growth rate of 18.7 percent while home remittances continue to demonstrate rapid increase of 21 percent. Third, foreign direct investment has almost doubled, although this may be a reflection of past agreements.
- The Panel has examined in depth the budgetary projections for 2008-09. The basic conclusion is that the reduction in deficit from 7.4 percent of the GDP in 2007-08 to 4.7 percent in 2008-09 is unlikely to be achieved under present assumptions. In particular, the assumptions that the inflation rate will be 12 percent only and the GDP growth rate will reach 5.5 percent are unlikely to materialize.
- The target of tax revenues will probably be achieved even though the tax-to-GDP ratio is unlikely to demonstrate any rise, due primarily to the higher rate of inflation.

Box

- The emergence of very large and unsustainable macroeconomic imbalances coupled with a high and rising rate of inflation necessitate the resort to a strong stabilization programme in the short run if the country is to avoid a default eventually on its international obligations and to prevent inflation from acquiring a runaway character, leading to a social breakdown in an already difficult security situation.
- The principles underlying a ‘home-grown’ stabilization strategy with a human face are as follows:
  - a) Preserve the growth momentum by protecting levels of public and private investment to the extent possible and aiming for pro-poor growth.
  - b) The policy actions and reforms should be designed in such a manner as to insulate the poor to the extent possible from negative impacts.
  - c) A strong social protection strategy needs to be put in place to reach out to particularly vulnerable groups at this time.

The stabilization strategy will have the following components:

- *Strong Fiscal Policy:* The emphasis in fiscal policy has to be more on current expenditure containment and resource mobilization, rather than cutting development outlays. Protection of the core investment programme is important for expansion of infrastructure to sustain the process of growth and for increasing the coverage of services to the poorer segments of the population. Within the resource mobilization strategy, the primary thrust has to be on broad basing the taxation system through withdrawal of exemptions or taxing more the undertaxed sectors.
- *Moderate Monetary Policy:* given the recent crisis in the financial sector in developed countries and the possibility of ‘contagion’ effects via a loss in confidence in the banking system of developing countries and the liquidity shortage that has emerged in the commercial banks of the country, there is need at this time to avoid disruption of the financial sector. An aggressive monetary policy is not recommended in the short-run.
- *Strong exchange rate and import containment policies.* There is need also for major downward adjustment in the real effective exchange rate.
- *Strong Policy on Administered Prices:* the policy must be one of transferring higher costs into higher prices as

soon as possible, unless the impact is disproportionately on lower income groups.

- *Adjusting the PSDP:* adjustment in the Public Sector Development Programme will be needed to achieve the macroeconomic stabilization objectives.

The criteria for restructuring the current year’s PSDP are:

- Give priority to projects that have incurred at least 50 percent of total cost.
- Protect the refined and fine-tune Benazir Income Support Programme.
- Give priority to projects for special regions and national security concerns.
- *Strong Social Protection Strategy:* the ‘fiscal space’ has somehow to be found through expenditure-switching for launching an expanded programme of social safety nets either in the form of cash transfers and or employment generation to enable vulnerable and marginalized groups, especially in the backward areas, to face up to the problems of rising prices and worsening employment prospects.
- *Institutional reforms.*
- The stabilization programme will need to be announced simultaneously for maximum impact on market confidence. It will include detailed announcements on cut in current expenditure and PSDP; package of taxation measures; levy of a more broad-based regulatory duty on imports; regulation of defense and public sector imports, enhancement in the SBP discount rate and in the return on National Saving Schemes; future policy on administered prices and subsidies (especially if international commodity prices continue to fall) and an expanded programme of social safety nets.
- By the end of the two-year stabilization programme the incidence of poverty in the country may have risen significantly and employment is expected to grow.
- The Panel recommends a three pronged strategy to lower the budget deficit to about 4.5 percent of GDP in 2008-09.
- Budget deficit reduction should be achieved through: higher resource mobilization, cuts in current expenditure and development expenditure rationalization.

Box

- Following the implementation of the stabilization programme, imports are projected to fall to \$31.6 billion from \$35.4 billion in 2007-08.
  - Export growth in FY09 is limited by the prospects of a severe downturn in the global economy.
  - The trade deficit is expected fall from \$15.3 billion to \$10.5 billion in 2008-09, and further to \$9.5 billion in 2009-10.
  - Prospects for inflow in the capital account may worsen considerably for Pakistan in 2008-09, due to the continued erosion of market confidence and adverse global developments in the form of a 'credit crunch.'
  - The total external financing needs of Pakistan in 2008-09 are \$9.5 billion.
  - At the time when high inflation and balance of payments crisis calls for stabilization of the economy, its human and social consequences have to be necessarily addressed. High inflation continues to erode real incomes and policies to reduce the budget deficit and aggregate demand will result in reducing employment opportunities. Poverty and unemployment, therefore, is expected to increase.
  - It is, therefore, imperative that the most disadvantaged and vulnerable sections of society are protected in these adverse conditions.
- The Government of Pakistan has made an important policy shift in moving away from general subsidies to targeted ones. The fiscal and policy commitment of the federal and provincial governments is explicitly in the direction of targeted subsidies directed towards the poorest and most vulnerable sections of society.
- Untargeted subsidies are also inequitable. In a country where incomes are low and the taxation structure is far from progressive, there is no justification to subsidize the rich through petroleum and electricity subsidies. But this is only one side of the coin. For a responsible democratic government, its imperative that the poor are protected through targeted subsidies.
- Currently the state machinery does not have such a targeting system in place.
- Since independence, Pakistan has experienced numerous growth episodes which have always ended in a balance of payments crisis. The underlying reason is that economic policies and resulting incentive structure have always favored consumption and production for the domestic market over exports.
  - Another major weakness in the growth strategy has been the neglect of the less developed regions of the country. The growing regional inequalities have contributed to the instability and internal conflicts evident today.
  - The current crisis is also an opportunity to correct endemic distortions. We recommend that a more comprehensive framework be adopted for the prioritization of projects in the PSDP. The guiding principles for restructuring and inclusion of new projects in the PSDP should be: High growth impact, Employment intensity, Social protection and human development, Export intensity, Regional equity and inter-sectoral harmony.
  - Laying the Foundations for Sustainable and Equitable Growth
    - The present crisis be seen as an opportunity to address the chronic overvaluation of the exchange rate and its implications for international competitiveness.
    - Other relative prices also be reviewed comprehensively to remove systemic discrimination against industry, especially those with export potential.
    - Focus of the Panel is on promoting agricultural growth.
    - Encourage investment by China.
  - Establish institutional framework necessary for sustained growth with rapid poverty reduction.
  - The final issue which must be addressed, in our view, in any growth strategy relates to coordination between the Federal and provincial planning agencies. In the development of any provincial strategies, greater ownership of the concerned province must be ensured.
  - Pakistan's slow export growth and the consequent perennial pressures on the balance of payments constitute a structural constraint to sustaining high GDP growth.
  - A number of changes in the institutional structure can be suggested which can lower the cost of business and facilitate export growth and diversification. These include; targeted development, rebates, marketing support framework, private sector link up for outsourced production for exports to new markets, infrastructure support for export production, import of raw materials from India, and capturing China's export markets.

- Significant tightening of monetary policy and steps to be taken to avoid central bank financing of the budget.
- SBP will intervene in the foreign exchange market to meet the programme's reserve targets. Gradually SBP's provision of foreign exchange for oil imports will be phased out.
- Effectiveness of SBP enforcement powers to be strengthened.

Pakistan's long association with the IMF

Pakistan joined the IMF in 1950 and has since had a long relationship with the institution. It has lent support to the country whenever faced with macroeconomic imbalances. The first time that the government asked for a loan was in 1958, a Stand-by Arrangement worth SDR25 million, which however, remained unutilised. Two more SBAs were made in 1965 and 1968, both of one year duration. In earlier years, until the late 1970s, Fund arrangements for Pakistan were infrequent and mostly short term in nature.

However, in the 1980s as growth fluctuated and persistent fiscal and external imbalances produced an unsustainable debt burden, Pakistan became more heavily dependent on Fund financial support. It entered into a long term Extended Fund Facility (EFF) in Nov

IMF's funding pattern changes in the late 70s & 80s

1980 for a period of 3 years and it was worth SDR1.27 billion, nearly three times the amount lent between 1947-1980. From a high of about SDR1.3 billion Fund credit to Pakistan following its 1980 EFF, it fell to less than SDR0.5 billion in 1988, but increased gradually in the years between 1988-2001. The last arrangement with the Fund was a Poverty Reduction Growth Facility which was completed in 2004.

Pakistan has had a checkered record with the IMF. From 1988 to 1999 many of the programmes approved by the IMF were not completed as planned. They were either extended to accommodate delays in the completion of reviews, or cancelled and replaced by new arrangements. At times certain developments at home, like the nuclear tests in May 1988, or change in government in October '99 did not allow for the completion of the programmes.

Dependent on Fund support

As growth faltered in the later half of the 1980s, and the fiscal and external imbalances posed problems resulting in unsustainable debt burden, Pakistan became more heavily dependent on Fund Support. Between 1988-2001, Pakistan had nine different

## Pakistan: History of Lending Arrangements, 1958-2004

Facility	Date of arrangement	Initial date of expiration	Actual date of expiration	Length of arrangement (years)	Amount agreed (thousands of SDRs)	Amount drawn	Percent undrawn
1 SBA	08-Dec-58	07-Dec-59	22-Sep-59	0.8	25000	0	100
2 SBA	16-Mar-65	15-Mar-66		1.0	37500	37500	0
3 SBA	17-Oct-68	16-Oct-69		1.0	75000	75000	0
4 SBA	18-May-72	17-May-73		1.0	100000	84000	16
5 SBA	11-Aug-73	10-Aug-74		1.0	75000	75000	0
6 SBA	11-Nov-74	10-Nov-75		1.0	75000	75000	0
7 SBA	09-Mar-77	08-Mar-78		1.0	80000	80000	0
8 EFF	24-Nov-80	23-Nov-83		3.0	1268000	1079000	15
9 SAF	28-Dec-88	27-Dec-91	15-Dec-92	4.0	382410	382410	0
9 SBA	28-Dec-88	07-Mar-90	30-Nov-90	1.9	273150	194480	29
10 SBA	16-Sep-93	15-Sep-94	22-Feb-94	0.4	265400	88000	67
11 ESAF	22-Feb-94	21-Feb-97	13-Dec-95	1.8	606600	172200	72
11 EFF	22-Feb-94	21-Feb-97	13-Dec-95	1.8	379100	123200	68
12 SBA	13-Dec-95	31-Mar-97	30-Sep-97	1.8	562590	294690	48
13 PRGF	20-Oct-97	19-Oct-00		3.0	682380	265370	61
13 EFF	20-Oct-97	19-Oct-00		3.0	454920	113740	75
14 SBA	29-Nov-00	30-Sep-01		0.8	465000	465000	0
15 PRGF	06-Dec-01	05-Dec-04		3.0	1033700	861420	17
<b>Total</b>		<b>46.0</b>		<b>24.6</b>	<b>6840750</b>	<b>4466010</b>	<b>35</b>

SBA- Stand-by Arrangements, EFF- Extended Fund Facility

ESAF- Enhanced Structural Adjustment Facility, PRGF- Poverty Reduction Growth Fund

Source: International Monetary Fund

arrangements with the Fund (4 SBAs, 2 EFFs, 3 ESAF/PRGFs). During this period, economic growth slowed, poverty increased and governance problems became increasingly evident.

Pakistan's last Fund arrangement was a three arrangement worth \$1.3 billion under the Poverty Reduction and Growth Facility (PRGF) in 2001 and the 2000 Stand-by Arrangement, which were successfully completed without any extensions. The fourth and last tranche of 2000 SBA was released on September 26, 2001, exactly after 10 months from the approval by the IMF Board. The PRGF was successfully completed and all disbursements were made available on completion of programme reviews, but the authorities did not draw the last tranche under the PRGF arrangement.

#### Latest Financial Arrangements with IMF

Type	Approval Date	Expiration Date	Amount Approved (SDR Mn)	Amount Drawn (SDR Mn)
PRGF	06.12.2001	05.12.2004	1033.70	861.42
Stand-By	29.11.2000	30.09.2001	465.00	465.00
EFF	20.10.1997	19.10.2000	454.92	113.74

Pakistan has received the first tranche of \$3.1 billion assistance from the IMF and the remaining amount would be given, subject to quarterly reviews. The regular monitoring of the economy by the IMF will show how the macroeconomic objectives set by the Government are being met. Some difficult steps have already been taken by the Pakistan authorities and a number of additional steps are envisaged for the coming two years.

Over the years, conditionality in Pakistan's Fund-supported programmes have become increasingly extensive after 1999. In the 1990s programmes included fairly standard quantitative conditionality: a floor on the net foreign assets and ceilings on the net domestic assets of SBP, the overall budget balance, government bank borrowing, and net banking sector claims on public sector enterprises, as well as on government external borrowing and the accumulation of external arrears. The quantitative conditionality was augmented in

the 2000 SBA and 2001 PRGF by a floor on CBR revenues and a ceiling on the accumulation of budgetary arrears to WAPDA among few others.

In the 1990s as implementation of broad commitments or structural benchmarks were often weak, the staff tried to close as many loopholes as possible, through an increase in the number of both macroeconomic and structural conditions. While structural conditionality peaked in 2000 SBA, it was gradually reduced thereafter because of Pakistan's improved performance, as the government of the day generally delivered on its commitments and the number of structural conditions was steadily reduced during the 2001-04 PRGF arrangement. These conditionalities became more focused, for instance during the PRGF arrangement it focused on improving the tax system, financial sector reforms and public enterprise reforms.

Under the 23 month Stand-by Arrangement reached with the IMF in November 2008, Pakistan has already taken some actions, which have been mentioned above, other measures are to be taken during the course of the next two years. Quarterly performance criteria have been set out, which will be subject to quarterly reviews, and there are some quantitative targets which have to be met.

Benchmarks have been set with regard to the plans for handling problem private banks, tax administration, electricity tariff adjustments, adopting of specific measures to strengthen the social safety net and improve targeting of the poor, eliminating the inter-corporate circular debt and the transition to a single treasury account.

#### Total External Debt, 2005/06 – 2008/09 1

	2006/07	2007/08	2008/09
Total External Debt	38.7	44.5	51.3
of which : Public	36.7	41.6	48.1
Multilateral	20.1	22.9	30.0
IMF	1.4	1.3	5.8
Other Multilateral	18.7	21.6	24.2
Bilateral & Commercial	16.6	18.7	18.1
Private	2.0	2.9	3.2

Sources: IMF Country Report, December 2008

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Pakistan  
receives  
first  
tranche

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**Quarterly Performance of Selected Banks – 2008**

(Rs. Bn)

	Major Banks							Provincial Banks	
	National Bank of Pakistan	Habib Bank	United Bank	MCB Bank	Allied Bank	Bank Al-Falah	Standard Chartered Bank	Bank of Punjab	Bank of Khyber
<b>Assets</b>									
2007 December	764.6	692.0	530.3	412.9	320.1	329.0	259.1	235.0	29.7
<b>2008</b>									
Q1 March	738.3	702.8	538.1	399.2	332.7	308.7	273.4	226.6	32.4
Q2 June	798.1	735.7	576.0	453.2	344.7	333.0	279.3	217.8	34.4
Q3 September	740.4	742.7	600.7	456.3	333.9	333.2	274.7	200.4	33.6
<b>Deposits</b>									
2007 December	591.8	531.3	401.6	292.1	263.5	273.2	177.0	192.0	21.4
<b>2008</b>									
Q1 March	564.5	537.7	407.5	301.7	277.9	263.5	177.7	187.4	22.8
Q2 June	621.5	584.8	465.5	350.7	294.0	287.8	173.8	180.8	24.4
Q3 September	561.7	587.3	455.4	324.0	279.3	280.7	180.0	163.4	23.6
<b>Advances</b>									
2007 December	340.4	382.2	299.4	219.0	168.4	171.2	122.8	133.9	10.1
<b>2008</b>									
Q1 March	361.6	386.9	319.9	229.8	176.4	169.5	127.6	139.5	10.7
Q2 June	373.0	411.4	328.6	229.0	168.4	180.0	129.1	142.8	11.1
Q3 September	388.4	435.1	364.9	248.8	181.0	187.9	133.4	137.6	11.6
<b>Investment</b>									
2007 December	212.1	177.9	115.6	115.4	83.5	88.5	40.7	73.5	8.9
<b>2008</b>									
Q1 March	188.8	185.0	107.7	88.1	87.0	74.6	38.9	56.1	11.1
Q2 June	173.4	171.7	112.6	102.1	80.8	72.6	38.8	38.4	9.3
Q3 September	155.6	131.6	111.7	93.1	82.6	66.6	30.5	30.0	8.7
<b>Equity</b>									
2007 December	70.8	55.1	34.0	47.3	18.4	13.8	43.5	15.1	5.6
<b>2008</b>									
Q1 March	68.0	56.9	34.7	48.2	19.0	13.8	44.3	12.0	5.6
Q2 June	74.2	62.9	38.8	51.0	20.1	15.8	44.8	12.5	5.6
Q3 September	80.3	68.9	43.0	53.2	20.4	15.8	45.6	10.8	5.9
<b>Interest Income</b>									
2007 December	50.6	50.5	41.0	31.8	21.2	25.8	22.9	17.5	2.4
<b>2008</b>									
Q1 March	13.6	14.0	11.2	8.2	6.4	6.8	5.5	4.8	0.6
Q2 June	14.5	14.6	12.0	8.7	6.7	7.0	5.9	4.9	0.7
Q3 September	15.2	16.9	13.8	11.1	8.0	8.1	6.0	4.6	0.8
<b>Interest Expense</b>									
2007 December	16.9	19.2	16.9	7.9	10.0	16.6	6.6	13.9	1.8
<b>2008</b>									
Q1 March	4.5	5.4	4.8	2.0	3.5	4.1	1.6	4.0	0.4
Q2 June	4.6	6.1	5.2	2.3	3.6	4.3	1.7	3.7	0.4
Q3 September	7.2	7.2	6.2	3.4	4.2	5.3	1.6	4.4	0.5
<b>Net Interest Income</b>									
2007 December	33.6	31.3	24.1	23.9	11.2	9.2	16.3	3.6	0.5
<b>2008</b>									
Q1 March	9.0	8.6	6.4	6.2	2.9	2.7	3.9	0.8	0.2
Q2 June	9.9	8.4	6.8	6.4	3.1	2.7	4.2	1.2	0.3
Q3 September	8.0	9.7	7.6	7.7	3.8	2.8	4.4	0.2	0.3
<b>Non Interest Income</b>									
2007 December	13.5	10.0	9.0	6.0	3.9	6.0	6.1	5.4	0.7
<b>2008</b>									
Q1 March	4.1	3.0	3.0	1.9	1.1	1.2	1.9	1.0	0.05
Q2 June	3.6	2.9	3.1	1.0	0.8	1.7	1.9	0.9	0.06
Q3 September	5.1	3.4	2.8	1.7	1.1	1.3	1.9	1.8	0.2
<b>Admn. Expense</b>									
2007 December	14.2	18.3	13.4	5.0	6.0	8.3	12.2	2.2	0.5
<b>2008</b>									
Q1 March	4.1	4.7	3.5	1.7	1.6	2.3	3.2	0.5	0.1
Q2 June	4.0	5.3	3.9	1.5	2.0	2.6	2.7	0.6	0.2
Q3 September	5.1	5.8	4.2	2.8	2.1	2.7	3.3	0.7	0.2
<b>Profit/(Loss) B.T</b>									
2007 December	28.1	15.1	13.0	21.3	6.0	4.5	4.1	4.8	0.09
<b>2008</b>									
Q1 March	7.0	6.4	4.4	5.7	2.0	1.5	1.2	-4.0	0.1
Q2 June	5.8	5.2	4.5	5.7	1.8	1.0	0.9	-1.0	0.05
Q3 September	6.3	5.7	4.8	5.7	1.9	0.9	1.2	-3.1	0.4
<b>Profit/(Loss) A.T</b>									
2007 December	19.0	10.1	4.6	15.3	4.1	3.1	2.8	4.4	0.2
<b>2008</b>									
Q1 March	4.6	4.3	2.9	4.0	1.4	1.0	0.8	-3.0	0.08
Q2 June	3.5	3.2	2.7	4.5	1.1	0.7	0.6	0.5	0.02
Q3 September	4.8	3.6	3.2	4.0	1.2	0.6	0.8	-1.7	0.3

		Domestic Private Banks										
		Askari Commercial Bank	Soneri Bank	Bank Al-Habib	Mybank	Habib Metropolitan Bank	Faysal Bank	KASB Bank	Saudi Pak Commercial Bank	Samba Bank*	NIB	Meezan Bank
<b>Assets</b>												
2007	December	182.2	76.9	141.2	40.6	172.9	141.3	40.9	53.7	20.7	177.8	67.2
2008												
Q1	March	177.5	80.6	152.9	41.3	188.6	146.1	45.8	49.5	19.0	183.2	67.4
Q2	June	194.2	81.6	167.4	45.5	192.5	137.3	53.7	50.8	18.5	178.0	71.7
Q3	September	202.9	83.2	170.2	43.4	186.6	135.4	57.5	53.6	18.1	178.8	76.4
<b>Deposits</b>												
2007	December	143.0	60.1	114.8	30.2	121.1	102.1	33.1	42.4	12.6	116.7	54.6
2008												
Q1	March	134.9	63.6	123.4	28.6	131.9	101.3	38.0	41.4	11.3	115.1	54.3
Q2	June	153.3	64.7	136.7	32.0	129.0	99.6	44.3	42.3	10.2	112.1	57.8
Q3	September	161.1	62.6	136.9	30.3	128.1	92.5	47.0	42.9	9.3	113.1	61.4
<b>Advances</b>												
2007	December	100.8	40.2	79.2	20.8	89.8	87.3	25.1	25.9	4.7	81.9	34.6
2008												
Q1	March	102.1	44.8	87.7	21.5	95.6	83.4	29.1	25.0	4.6	85.3	38.4
Q2	June	114.0	45.8	93.2	23.0	101.2	87.6	32.6	27.6	5.7	85.4	38.3
Q3	September	124.6	48.8	101.2	22.2	105.1	91.3	35.5	29.5	6.0	86.0	40.0
<b>Investment</b>												
2007	December	39.4	19.2	35.3	11.6	61.7	31.6	7.3	17.9	3.9	39.0	10.5
2008												
Q1	March	39.8	17.7	41.8	12.2	65.5	31.2	7.0	11.0	3.7	34.7	10.8
Q2	June	40.8	15.0	31.3	11.6	61.0	28.5	8.8	10.2	3.9	30.0	11.0
Q3	September	36.7	13.6	39.3	11.2	49.2	23.7	9.7	10.8	2.6	31.2	13.6
<b>Equity</b>												
2007	December	12.1	6.2	8.0	5.1	13.5	10.3	4.2	1.1	6.2	37.6	5.7
2008												
Q1	March	11.8	6.6	8.0	5.1	13.6	9.5	4.3	0.9	6.1	36.8	6.0
Q2	June	12.1	6.7	8.7	5.5	14.5	9.8	4.2	0.3	6.1	37.3	6.2
Q3	September	12.1	7.0	9.4	5.6	15.4	10.8	4.5	2.9	5.9	36.3	6.2
<b>Interest Income</b>												
2007	December	15.1	6.3	9.9	2.9	12.0	11.6	2.9	4.8	1.2	7.0	4.6
2008												
Q1	March	4.0	1.6	2.9	0.8	3.4	3.1	1.1	1.1	0.4	3.5	1.4
Q2	June	3.9	1.8	3.1	0.9	3.7	3.2	1.1	1.0	0.4	3.7	1.5
Q3	September	5.0	2.1	9.9	1.0	4.3	3.4	1.6	1.2	0.5	4.2	1.7
<b>Interest Expense</b>												
2007	December	8.7	4.3	5.8	2.2	8.3	7.5	2.3	4.4	0.8	5.0	2.5
2008												
Q1	March	2.2	1.1	1.6	0.6	2.4	1.9	0.8	1.0	0.3	2.4	0.7
Q2	June	2.3	1.2	1.8	0.7	2.7	1.9	0.9	0.9	0.2	2.3	0.7
Q3	September	3.0	1.3	5.4	0.7	2.9	2.1	1.4	1.1	0.3	2.9	0.8
<b>Net Interest Income</b>												
2007	December	6.5	1.9	4.2	0.7	3.7	4.2	0.6	0.4	0.3	2.0	2.1
2008												
Q1	March	1.8	0.5	1.3	0.2	1.0	1.1	0.3	0.1	0.2	1.0	0.8
Q2	June	1.6	0.6	1.4	0.2	1.1	1.3	0.1	0.1	0.2	1.4	0.8
Q3	September	2.0	0.8	4.4	0.3	1.4	1.3	0.2	0.1	0.2	1.3	0.9
<b>Non Interest Income</b>												
2007	December	4.6	1.1	2.1	0.9	3.2	3.4	0.8	0.8	0.1	0.9	1.3
2008												
Q1	March	0.6	0.3	0.5	0.2	0.7	0.3	0.1	0.09	0.05	0.7	0.2
Q2	June	0.9	0.3	0.8	0.3	1.3	0.3	0.4	0.09	0.02	0.6	0.1
Q3	September	0.8	0.3	2.0	0.2	1.0	1.3	0.09	0.1	0.02	0.3	0.02
<b>Admn. Expense</b>												
2007	December	4.8	1.3	3.2	0.7	2.3	2.8	1.2	1.3	0.9	2.1	1.8
2008												
Q1	March	1.3	0.4	0.9	0.2	0.7	0.7	0.3	0.4	0.3	1.2	0.6
Q2	June	1.4	0.4	1.1	0.2	0.8	0.8	0.4	0.4	0.3	1.4	0.6
Q3	September	1.6	0.4	3.2	0.2	0.8	0.9	0.3	0.5	0.3	1.6	0.6
<b>Profit/(Loss) B.T</b>												
2007	December	2.3	1.5	3.1	0.2	4.2	2.7	0.06	-0.4	-1.4	-0.2	1.3
2008												
Q1	March	0.2	0.5	0.8	0.2	1.0	0.7	0.1	-0.3	-0.05	0.2	0.4
Q2	June	0.3	0.2	1.0	0.4	1.3	0.5	0.01	-0.5	-0.2	-0.9	0.3
Q3	September	0.01	0.4	2.7	-0.1	1.3	1.3	-0.08	-1.4	-0.2	-1.3	0.1
<b>Profit/(Loss) A.T</b>												
2007	December	2.7	1.0	2.2	0.3	2.8	2.2	0.2	-3.3	-1.3	-0.1	1.0
2008												
Q1	March	0.2	0.3	0.5	0.08	0.7	0.4	0.09	-0.2	-0.05	0.2	0.2
Q2	June	0.2	0.1	0.7	0.4	0.9	0.3	-0.01	-0.5	-0.07	-0.4	0.2
Q3	September	0.02	0.3	1.8	0.07	0.9	1.0	-0.06	-1.4	-0.2	-1.0	0.08

\* Crescent Commercial Bank was renamed Samba Bank, which is now a subsidiary of SAMBA Financial Group of Saudi Arabia.

		Foreign Banks				
		Citibank	RBS*	HSBC	Deutsche Bank AG	Oman International Bank
<b>Assets</b>						
2007	December	92.5	107.5	32.4	17.6	2.7
<b>2008</b>						
Q1	March	100.3	112.2	38.1	19.7	2.6
Q2	June	104.5	117.6	45.7	15.3	2.7
Q3	September	107.5	112.4	52.9	17.2	3.5
<b>Deposits</b>						
2007	December	68.6	90.3	25.4	5.1	0.5
<b>2008</b>						
Q1	March	78.2	86.2	29.0	9.5	0.6
Q2	June	72.7	89.5	37.2	7.4	0.5
Q3	September	68.6	86.7	38.3	7.2	0.5
<b>Advances</b>						
2007	December	49.1	64.5	19.3	4.7	0.2
<b>2008</b>						
Q1	March	47.9	67.4	20.7	4.5	0.1
Q2	June	45.4	70.9	21.9	6.2	0.2
Q3	September	44.8	69.9	26.5	6.5	0.3
<b>Investment</b>						
2007	December	21.3	16.4	0.3	3.7	-
<b>2008</b>						
Q1	March	16.3	15.8	1.1	2.3	-
Q2	June	15.4	15.1	1.0	0.7	-
Q3	September	15.3	13.2	1.0	-	-
<b>Equity</b>						
2007	December	6.4	5.1	2.5	3.6	2.0
<b>2008</b>						
Q1	March	6.4	5.2	2.6	3.8	2.0
Q2	June	6.7	5.2	4.0	3.7	2.1
Q3	September	6.4	4.8	5.0	4.7	2.7
<b>Interest Income</b>						
2007	December	10.6	13.0	2.1	0.7	0.004
<b>2008</b>						
Q1	March	2.5	3.2	0.7	0.3	0.007
Q2	June	2.5	3.2	0.4	0.2	0.006
Q3	September	2.5	3.3	1.2	0.3	0.011
<b>Interest Expense</b>						
2007	December	5.0	6.8	1.3	0.4	0.05
<b>2008</b>						
Q1	March	1.0	1.5	0.4	0.1	0.01
Q2	June	1.0	1.5	0.2	0.1	0.010
Q3	September	1.1	2.0	0.7	0.1	0.014
<b>Net Interest Income</b>						
2007	December	5.5	6.2	0.8	0.3	-0.0009
<b>2008</b>						
Q1	March	1.5	1.7	0.3	0.1	0.004
Q2	June	1.4	1.7	0.2	0.1	0.008
Q3	September	1.4	1.3	0.5	0.2	0.003
<b>Non Interest Income</b>						
2007	December	3.1	2.2	0.4	1.0	0.0004
<b>2008</b>						
Q1	March	0.8	0.9	0.1	0.6	0.001
Q2	June	1.7	1.0	0.1	0.2	0.003
Q3	September	0.6	0.3	0.3	0.4	0.005
<b>Admn. Expense</b>						
2007	December	4.7	5.8	1.0	0.6	0.04
<b>2008</b>						
Q1	March	1.2	1.5	0.4	0.2	0.001
Q2	June	1.3	1.5	0.2	0.2	0.01
Q3	September	1.3	1.6	0.5	0.2	0.015
<b>Profit/(Loss) B.T</b>						
2007	December	1.2	-1.4	0.2	0.8	-0.009
<b>2008</b>						
Q1	March	0.2	0.2	0.07	0.4	-0.02
Q2	June	0.9	0.1	0.07	0.1	-0.011
Q3	September	-0.2	-0.1	0.1	0.4	-0.014
<b>Profit/(Loss) A.T</b>						
2007	December	0.3	-1.6	0.1	0.5	-0.009
<b>2008</b>						
Q1	March	-0.003	0.1	0.04	0.3	-0.02
Q2	June	0.3	-0.06	0.04	-0.04	-0.011
Q3	September	-0.3	-0.2	0.09	0.2	-0.014

\* ABN Amro Bank's Pakistan branches were acquired by Royal Bank of Scotland and renamed as RBS.

## Market Analysis

### *Market Review*

The KSE-100 index during the year under review was volatile to say the least mainly due to gradual deterioration of the macro-economic scenario and various political developments subsequent to the February 18, 2008 general elections. Overall, the KSE-100 Index plunged by 58% or 8,210 points for the year ended December 31, 2008 to 5,865 on an average daily volume of 132.91m shares. The KSE-30 Index declined by 67% or 11,231 points to close the year at 5,485. Looking back at the last 12 months, the market can be segmented into 3 distinct phases: 1) positive start; 2) major bear attack; and 3) floor.

In the immediate aftermath of the tragic demise of Ms. Bhutto on December 27, 2007, the KSE-100 Index shed over 1,300 points from December 31, 2007 to January 2, 2008 to touch 13,353. There was selling pressure from all quarters especially from foreign investors, as the political scenario appeared shaky, as there were incidents of looting and rioting reported across the country during the 3-day mourning period, as there was a breakdown in law and order. Fortunately, the market staged a minor rebound that saw the Index climb back above the 14,000 plateau, which remained at this level till the middle of the month because of institutional buying in oil and banking stocks as well as punter buying interest in second and third tier scrips. The postponement of the election to February 18 and the positive response by the major political parties to participate helped to improve investor confidence.

Despite further tightening in the monetary policy by the SBP in its Monetary Policy Statement for 2HFY08 that was announced on January 31, the market reaction was quite muted as the Index traded in a narrow band the day after the announcement. For the first 11 days of February, the Index was range bound as it shed 132 points to touch 13,884.

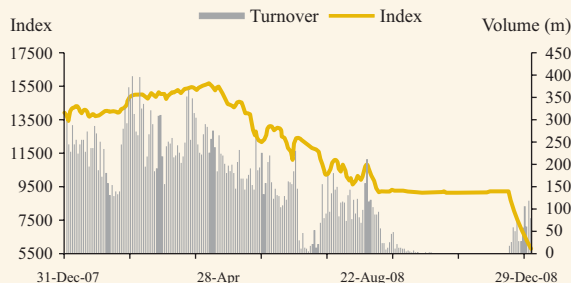
During this period, the activity was mostly dominated by punting activity in second and third tier stocks while there was a lack of interest in major large cap scrips.

However, the market experienced a moderate rebound in the final week before the elections because of institutional buying interest in selective major Index stocks. There was buying interest in oil stocks such as OGDC, POL and PSO due to rising international crude oil prices and expectations of good quarterly results, which was also the reason for buying activity witnessed in some banking scrips. In addition, the inflow of foreign funds in the post-election period served as an impetus for the continuation of the rally as the SCRA's posted a net inflow of around US\$183m from February 19 to the end of the month. From February 11 to the end of the month, the Index jumped by 1,049 points on average daily turnover of 323m shares and also crossed the 15,000-mark a few times depicting the strong momentum of the time. February 26 was an historic day as the KSE-100 Index finally closed above 15,000 for the first time.

During the month of March, the KSE-100 Index went into a sideways pattern, trading within a consistent band of 14,700 to 15,300. At the end of 1QCY08, the KSE-100 Index was one of the best performing indices in the region as well as the world. Also, the formation of a new government in the end of March led to new hope that the economy would get back on track with renewed vigor and policy by the government. There were positive sentiments that the market would continue its ascent from the last quarter, but this did not come to fruition due to the economic and political issues that arose at the beginning of April that adversely impacted investor sentiments and thus, resulted in the market being flat and lackluster for the first 3 weeks of 2QCY08. From April 10 to 18, the KSE-100 Index gained 371 points to peak at 15,676. The KSE-100 Index jumped by 1,600 points or 11.4% from January to April 18 while the average daily turnover was 253.31m shares.

Positive  
start

The Market - January - December 2008



Major bear attack

The market experienced a major bear attack for the next 6 weeks from April 18 to August 27 because of speculation regarding the imposition of capital gains tax on shares and further tightening in the monetary policy by the SBP. The KSE-100 plunged by over 6,500 points or about 42% from its all-time peak on April 18 to 9,144 on August 27 while the average daily volume during this period slumped to 138.71m shares.

On May 22, the SBP Governor announced an interim monetary policy statement that further tightened monetary policy in the wake of added inflationary pressure in the economy due to higher food and energy prices as well as massive Pak Rupee devaluation of 15% (July 2007 to May 21, 2008) against the U.S. dollar despite the greenback weakening against other world currencies. At the beginning of June, the market staged a slight recovery ahead of the budget due to the announcement by the Finance Minister Syed Naveed Qamar that the capital gains tax (CGT) exemption would be extended for a further 2 years till June 30, 2010 and that the rate of CVT would remain unchanged for 1 year.

The resignation of Pervez Musharraf from the presidency on August 18 led to a short-lived spike as political uncertainty gripped the country again due to the judges' restoration issue as well as Moody's warning of a ratings downgrade 3 days after his resignation if the government fails to focus on economic issues immediately.

Floor

The market remained dull and lackluster since August 27 due to the flooring of stock prices,

as it has caused volumes to shrink dramatically making it hard for most investors to exit.

The deteriorating external accounts situation eventually forced the GoP to approach the IMF for assistance. On November 24, the IMF executive board approved the US\$7.6bn bailout package for Pakistan. The initial disbursement is US\$3.1bn, while the remainder would be disbursed in six equal installments. There would be a positive impact on the Pak Rupee/USD parity, as we would expect some strengthening of the Rupee. It is expected that the total soft loans received by Pakistan during the current fiscal year would be around US\$9bn, which includes US\$4.6bn from the IMF; US\$1bn from World Bank; US\$1.5bn from ADB; US\$500m from both China and the Islamic Development Bank.

From the removal of the floor on December 15 to the end of the year, the KSE-100 Index shed 36% or 3,322 points, reflecting the selling pressure that was built-up during the flooring period.

Looking ahead to 2009

Since forming the government back in the end of March 2008, the PPP-led coalition has underwhelmed most Pakistanis with its performance. However, the current deterioration of the macroeconomic conditions may be linked to the previous administration's policies that placed more emphasis on consumerism rather than building the real economy to achieve sustainable growth.

By entering into the Standby Agreement with the IMF, the government must focus on good governance and transparency. The achievement of these objectives would go a long way towards improving the credibility of the government both domestically and internationally. Currently, there remains a bit of skepticism regarding the government's commitment to governance and fiscal discipline.

The beginning of FY09 has been quite turbulent on the economic front with the

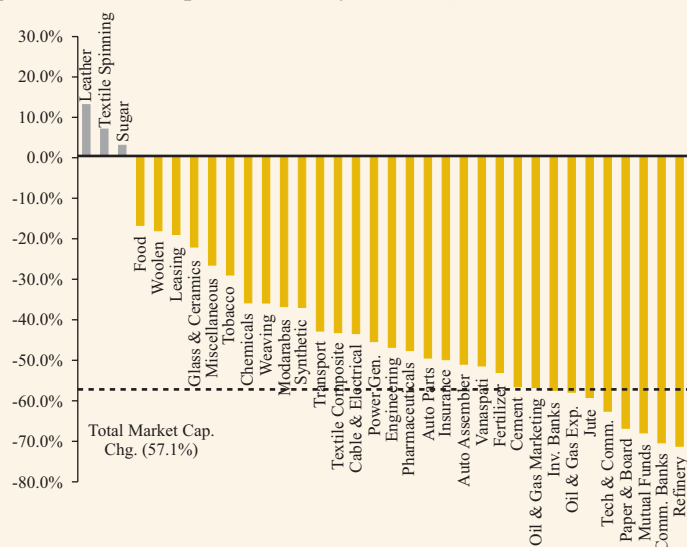
problems of widening external accounts deficit and high inflationary pressure still persisting from the previous fiscal year. Besides the rising international commodity prices, inflation in Pakistan has been exacerbated by the alarming rise in government budgetary borrowings from the SBP that stood at PKR 378.9bn from July to mid-November as against PKR74.7bn for the same period last year. The current account deficit during 4mFY09 has surged by 98% YoY to around PKR6bn.

The continuing deterioration in the balance of payments situation led to the government to request financial assistance from the IMF. The economic focus has now shifted from

growth to stabilization in the immediate term in order to overcome the major problems discussed above. The original real GDP growth target of 5.5% will not be achieved and according to the SBP, the growth rate will likely be around 3.5% to 4.5% while the IMF estimates it to be 3.4% and may improve to around 5% in FY10.

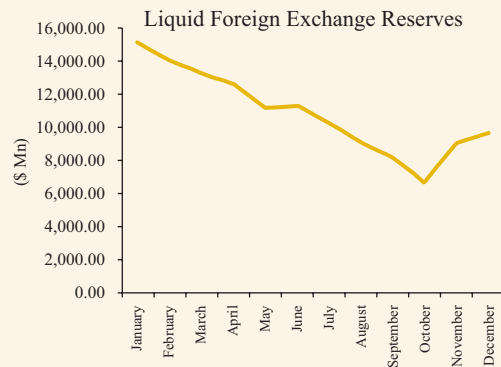
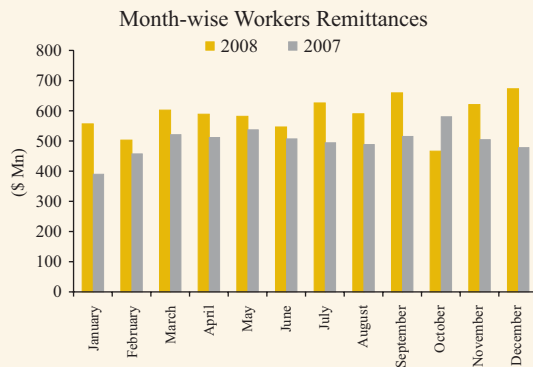
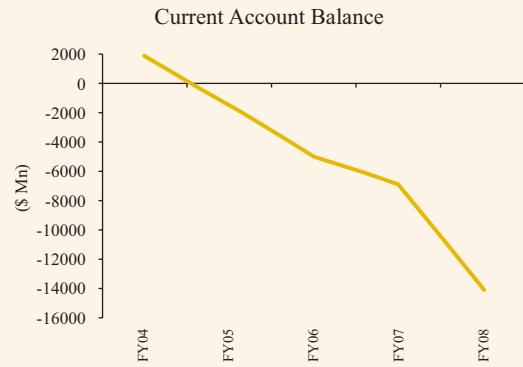
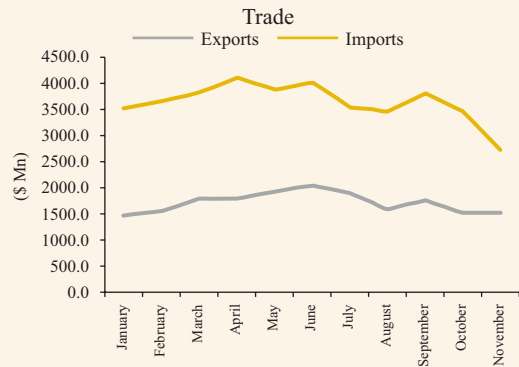
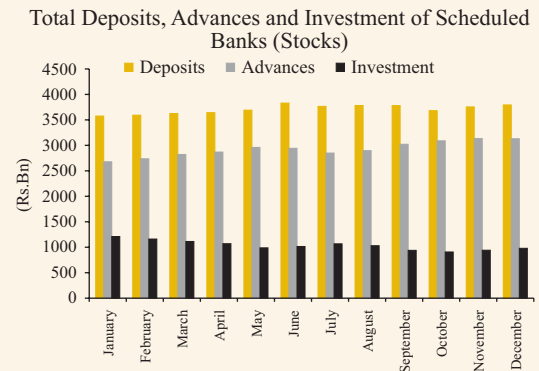
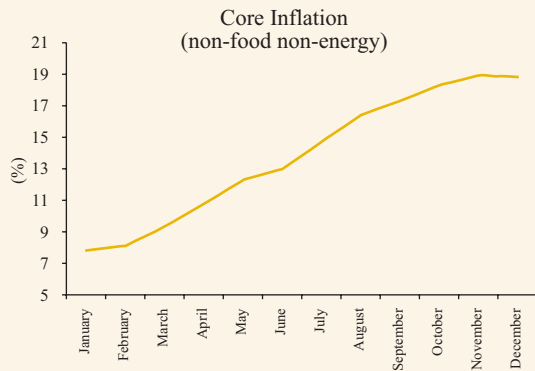
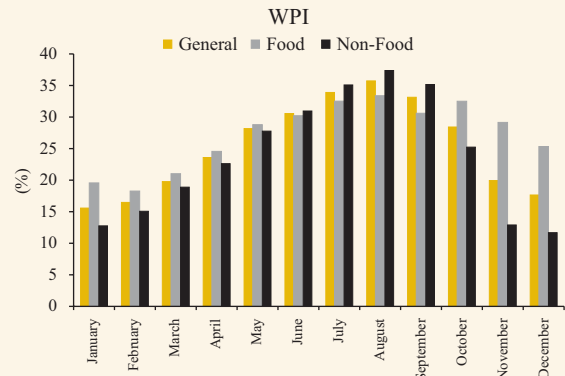
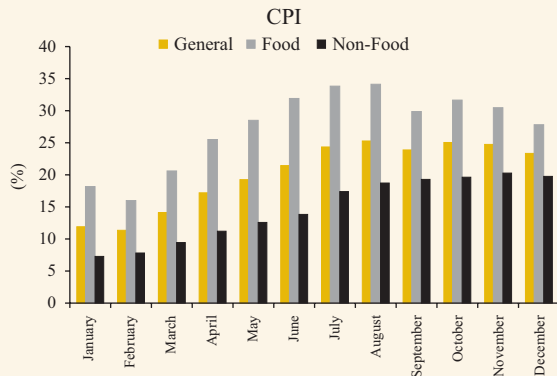
In January 2009, it is expected that the government will create a market support fund that would be funded by different public sector organizations to the tune of Rs20 billion. This fund will be managed by NIT, which would buy stock in government owned enterprises such as PSO, OGDC, PPL, Kapco, PTCL, SNGP, SSGC and NBP.

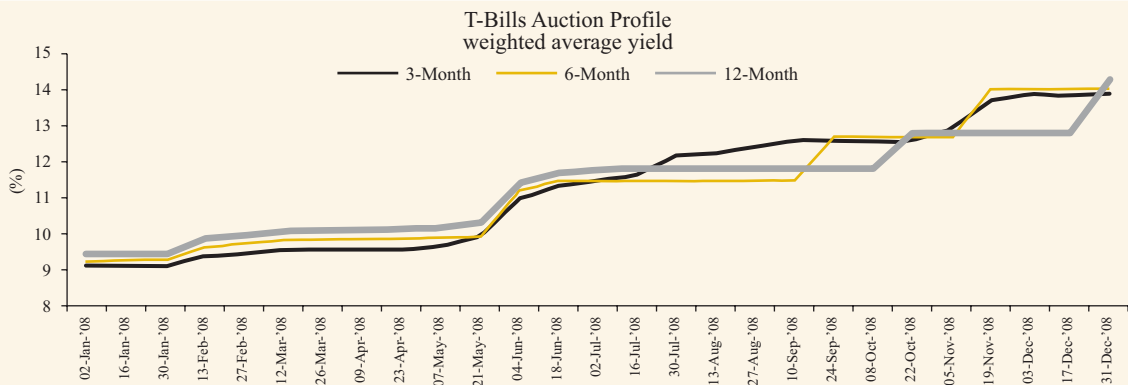
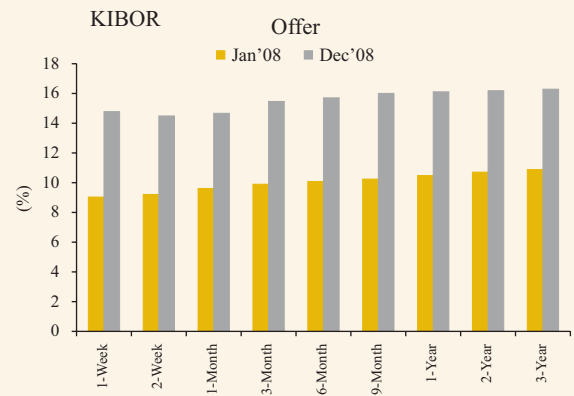
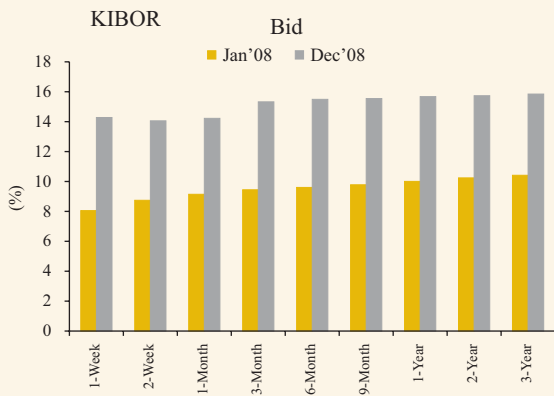
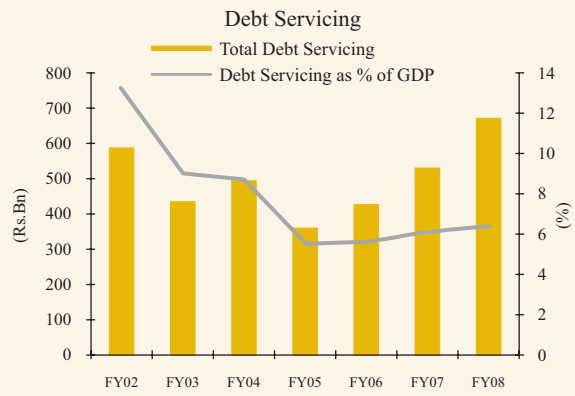
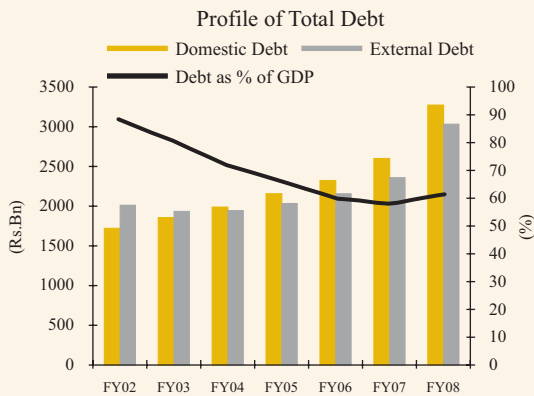
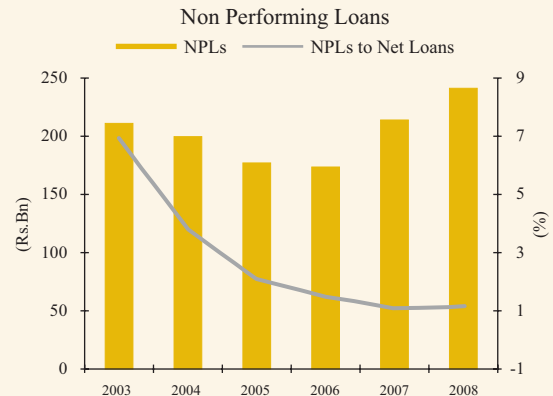
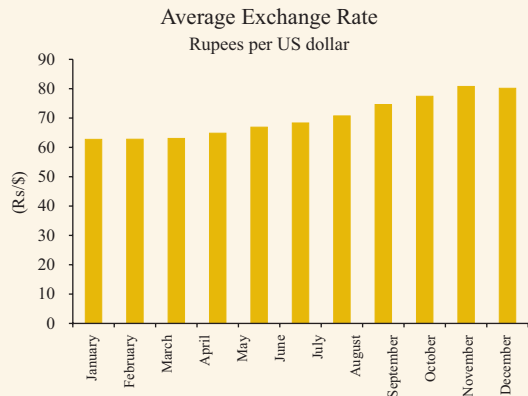
Change in Market Capitalization by Sector (Dec 31, 07 - Dec 31, 08)



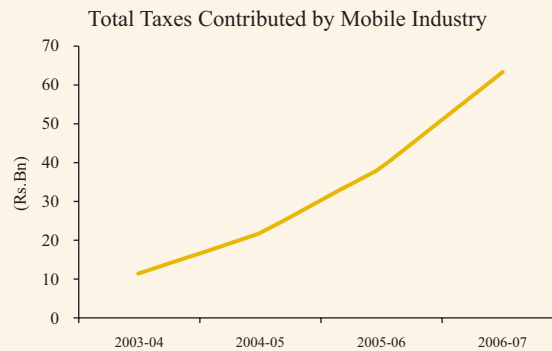
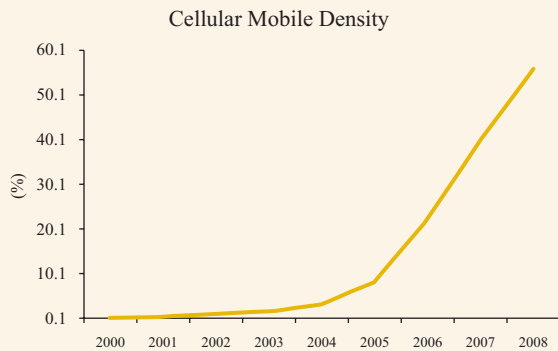
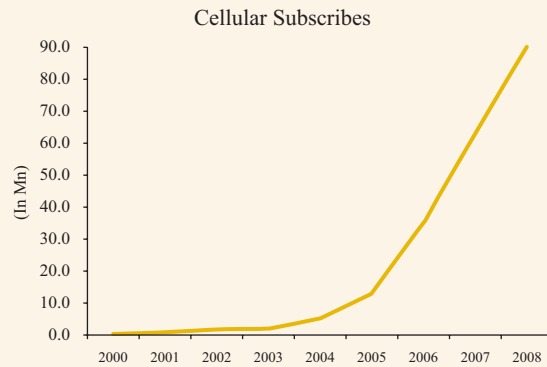
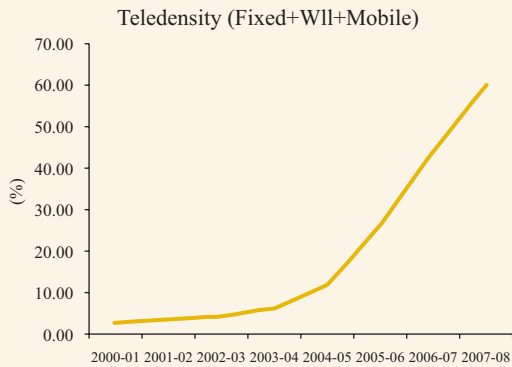
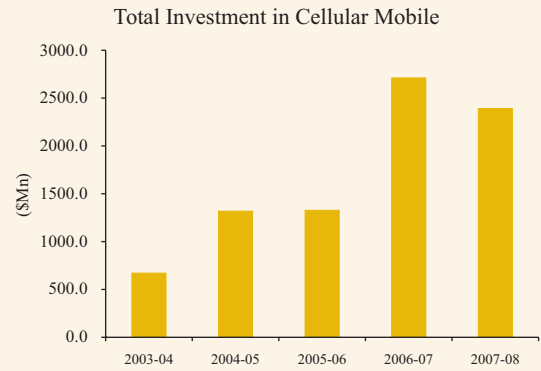
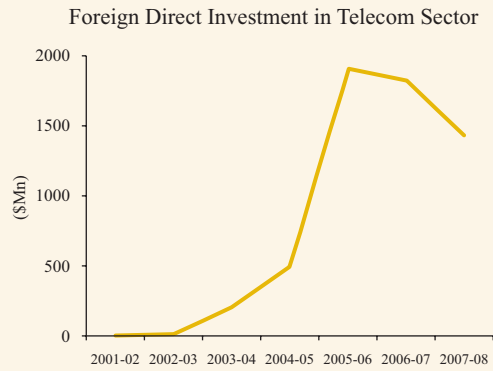
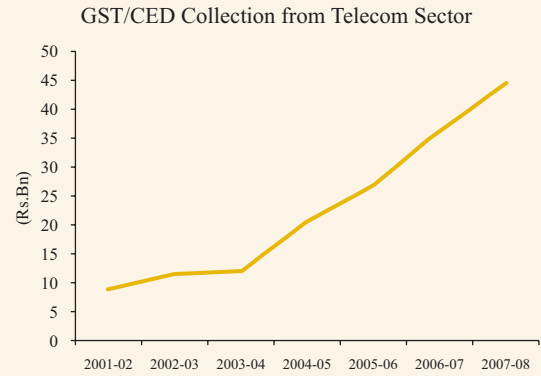
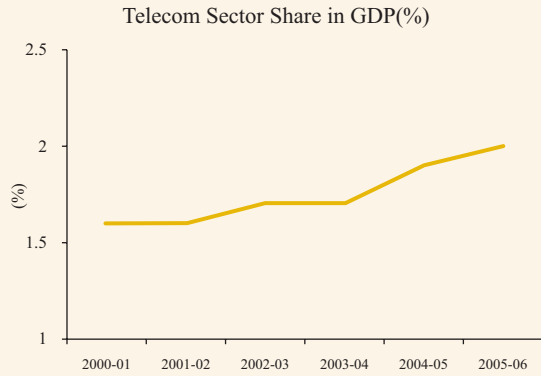
(Contributed by Taurus Securities Ltd, a subsidiary of National Bank of Pakistan)

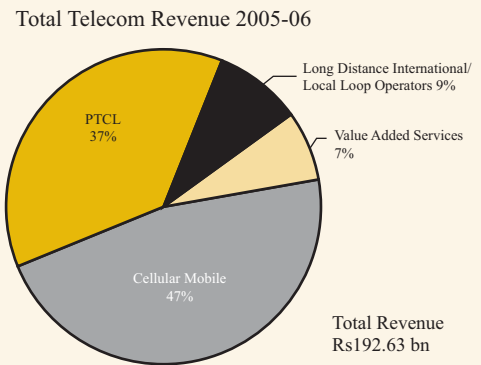
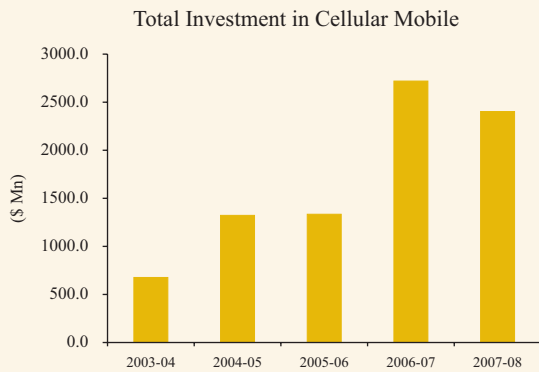
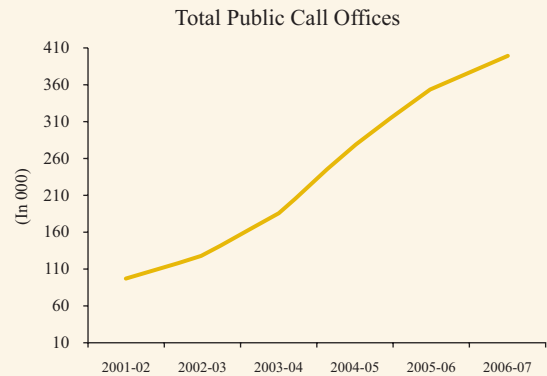
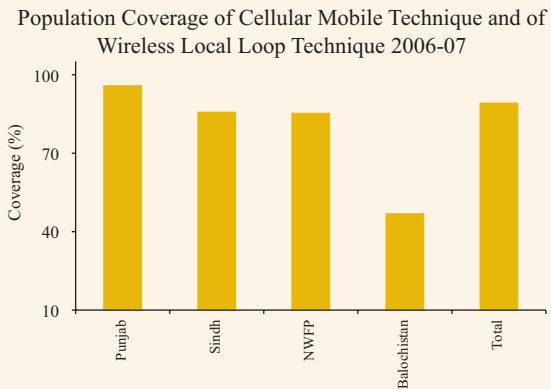
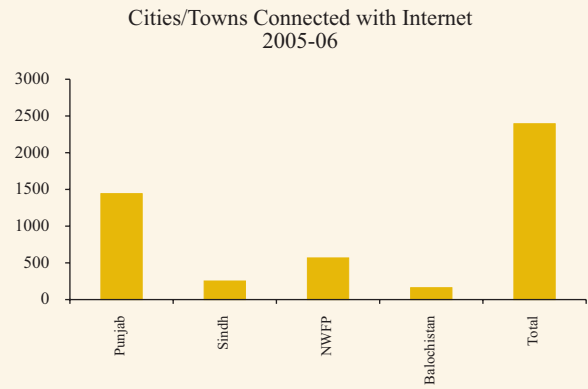
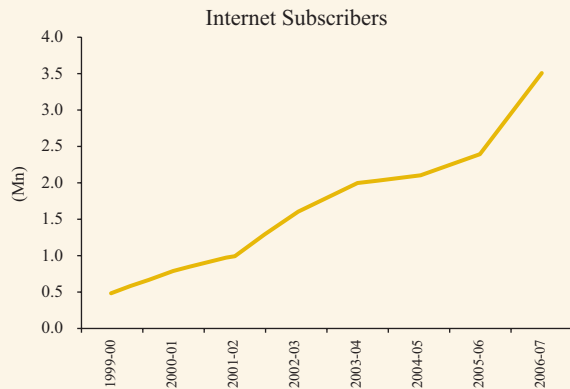
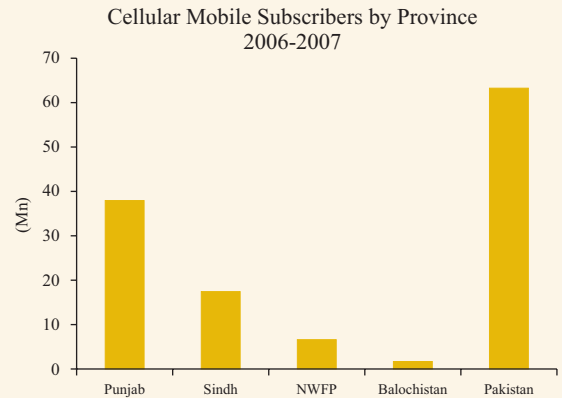
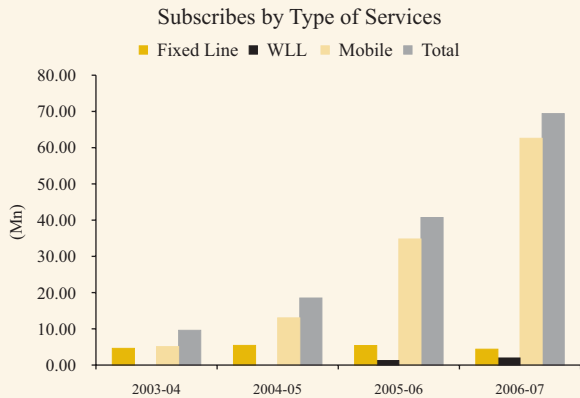
## The Year 2008





## Growth of Pakistan's Telecom Sector





**Report/Book Reviews**

*Devolution and Governance  
Reforms in Pakistan  
Syed Mubashir Ali  
Muhammad Amjad Saqib  
LUMS-McGill Social Enterprise  
Development Centre  
Oxford University Press*

The book is a compilation of case studies written at the Lahore University of Management Sciences under the LUMS-McGill Social Enterprise Development Centre. These fourteen case studies have been contributed by the LUMS faculty during their research and by government officers and consultants who are actively involved in governance.

Many developing countries worldwide are experimenting with various forms of decentralisation. Pakistan has also initiated the process of devolution and announced an ambitious Devolution Plan in 2001. The objective is improved local government representation; accountability and efficiency, resulting in improved service delivery.

The authors have through the case studies analysed how decentralisation can contribute to local development, and how it can improve the provision and maintenance of public services and infrastructure. Some of the various aspects of decentralisation like, the planning process in a decentralised system, the resource mobilisation in local governments, police reforms, pro-poor health service delivery, institutional change for poverty reduction, gender and devolution, decentralisation and inequality, the non-profit sector etc have been discussed.

The programme of reform that has been underway in Pakistan for the last seven years now, has brought a major change in the system of government, especially at the local level. Divisions have been abolished, and a three tier local government structure comprising of three categories of local government – districts, tehsils and unions has been brought in.

There has been a shift of power and responsibility to the elected officials with wide

acceptance of the restructuring of the local government system. The concluding chapter of the book states, “all vital elements of Pakistani society have supported this restructuring. Even the political parties that initially opposed the local government plan and were sceptical about its relevance and adequacy jumped on the bandwagon and decided to participate in the elections of District and Tehsil Nazims by fielding proxy candidates.”

There is a general perception that local governments can lay the foundation stone for the development of genuine democracy in the future. There are some initial problems but as the system finds wider support the process initiated will help in the evolution of democratic institutions.

*Education Problems of Pakistan  
with special reference to SINDH  
Dr. Habibullah Siddiqui  
Pakistan Study Centre  
University of Sindh, Jamshoro*

The Pakistan Study Centre in the University of Sindh undertook the study and Dr. Habibullah Siddiqui was assigned the project, which was subsequently published.

The first chapter of the book gives a brief account of development of education from the Indus Valley Civilization period to the present day system. Immediately after the creation of Pakistan, an All Pakistan Educational Conference was held in Karachi (Nov '47) to review the educational situation and to consider the needed reforms. Subsequently, the Five Year Plan chalked out strategies for the sector, earmarked expenditures and strived for its improvement. The various programmes initiated from time to time and the setting up of non-governmental organizations have been mentioned.

The second chapter deals with the status of Education. The National Educational Policy has been discussed. Measures taken to reform and develop the existing education system has been discussed in chapter III. It shows the

problems encountered while reforming the existing education system to meet the national requirement of providing a viable modern education. Government measures taken to reform the system forms part of the chapter.

Chapter IV talks about the areas where problems are encountered because of wrong policies pursued. In the area of teacher training it states, “the teacher training curriculum is a decade old document without syllabi and textbooks, orally delivered in the government elementary colleges of education.”

The existing system of education in Pakistan is class-based. Quality education is exclusive and elitist, and it is as costly as the parents can afford. It is imperative to restructure the system.

Analysis and Interpretation of Educational Data is the theme of chapter V, while the role of public-private partnership in providing education is discussed in chapter VI.

Chapter VII discusses the goals of Education for All. The capacity and resources of the existing education system in physical and human terms is discussed in chapter VIII.

Conclusion derived is discussed in the last chapter, which also offers and give suggestions to improve the system.

*Annual Report 2007-08*  
*State Bank of Pakistan*

The State Bank of Pakistan has published the Annual Report for fiscal 2007-08, in two volumes. Volume I is a Review of the Economy, while Volume II is the Performance Review.

Volume I assesses the performance of the economy in the outgoing fiscal year 2007-08 in the various areas – prices, money & banking, public finance, domestic & external debt, trade & exchange rate, social sectors, agriculture, industry, services sector, savings/ investment etc. The mentioned chapters discuss the related issues in detail. The statistical tables are spread over 118 pages and give vital data on the economy.

The Review begins with the Governor’s assessment of the Pakistan economy, which after showing strength for the past few years, faced a difficult fiscal year in FY08 as the growth was disrupted because of exogenous and endogenous factors. The rise in international oil and food prices hit Pakistan the most, as the country is heavily dependent on oil imports. This coupled with higher commodity prices adversely affected the import bill and contributed to the worsening of the current account deficit which widened to 8.4 percent of GDP.

The government’s reluctance to pass on the increase oil prices to the consumers led to rising fiscal deficit, drawdown of foreign exchange reserves. Inflationary pressures intensified, hitting the common man’s pocket.

The government has developed a macro-economic stabilization package, which forms the cornerstone of the Stand-by Arrangement negotiated with the IMF, which has agreed to provide \$7.6 billion assistance to Pakistan.

Volume II of the Report sets out with the Governor’s message which talks about the policies adopted by the State Bank to meet the challenges Pakistan was faced with in FY-08.

The strategic objectives of SBP; maintaining price stability, broadening access of financial sector, ensuring soundness of financial sector, exchange management and strengthening payment systems have been discussed in detail in the subsequent chapters.

The following section is about Management Strategy of SBP, where the Human Resource, and Information Technology developments that have taken place at SBP have been discussed. This is followed by a section on SBP Subsidiaries – State Bank of Pakistan Banking Services Corporation and National Institute of Banking & Finance. Finance of SBP and Subsidiaries are given in a detailed section, while the Annexures at the end gives the chronology of policy announcements, the major decisions taken during the year etc.

## Pakistan Economy – Key Economic Indicators

	Unit	2000-01	2001-02	2002-03	2003-04	2004-05	2005-06	2006-07	2007-08
<b>Output and Prices</b>									
GNP Size	\$ bn	70.3	72.1	85.0	100.1	111.7	129.8	146.6	171.4
GDP Size	\$ bn	71.3	71.7	82.4	97.9	109.4	127.3	143.9	167.6
Income Per Capita	\$	501	504	579	669	732	835	927	1065
<b>Real Growth</b>									
	(%)								
GNP		1.9	5.1	7.9	6.4	8.3	5.6	6.7	6.1
GDP		1.8	3.1	4.7	7.5	8.6	5.8	6.8	5.8
Agriculture		-2.2	0.1	4.1	2.4	6.7	6.3	3.7	1.5
Manufacturing		9.3	4.5	6.9	14.0	12.6	8.7	8.2	5.4
Services Sector		3.1	4.8	5.2	5.8	8.0	6.5	7.6	8.2
<b>Prices</b>									
Consumer Price Inflation*	(%)	4.4	3.5	3.1	4.6	9.3	7.9	7.8	12.0
Wholesale Price Inflation*	(%)	6.2	2.1	5.6	7.9	6.8	10.1	6.9	16.4
Food Inflation*	(%)	3.6	2.5	2.8	6.0	12.5	6.9	10.3	17.6
Non Food Inflation*	(%)	5.1	4.2	3.3	3.6	7.1	8.6	6.0	7.9
Core Inflation*	(%)	4.2	2.0	2.5	3.8	7.2	7.5	5.9	8.4
Gold Tezabi	\$/10 grams	91.8	95.5	109.0	127.2	138.3	172.2	208.2	267.1
Motor Gasoline Premium	Rs/Ltr	29.34	31.60	33.08	33.91	40.75	55.21	56.09	57.83
Kerosene oil	Rs/Ltr	16.84	18.58	22.48	24.95	29.11	36.19	39.09	43.44
Light Speed Diesel	Rs/Ltr	13.50	16.70	21.15	22.72	26.50	36.45	38.40	40.97
GDP Deflator	%	8.02	2.49	4.42	7.74	7.02	9.20	7.80	13.41
<b>Savings and Investment</b>									
National Savings	% GDP	16.5	18.4	20.6	17.9	17.5	17.7	17.8	13.3
Domestic Savings	% GDP	17.8	17.9	17.4	15.7	15.4	15.3	16.0	11.0
Gross Capital Formation	% GDP	15.8	15.3	15.1	15.0	17.5	20.5	21.3	20.0
Public	% Gross Capital	5.7	4.1	3.9	4.0	4.3	4.8	5.7	5.7
Private		10.2	11.2	11.2	10.9	13.1	15.7	15.6	14.2
<b>Public Finance</b>									
Revenue Receipts	% GDP	13.3	14.1	14.5	13.8	13.5	13.4	13.9	18.47
Tax Revenue	% GDP	9.9	9.2	9.5	9.2	9.1	9.2	9.6	9.6
Total Expenditure	% GDP	17.2	17.9	16.2	13.9	15.4	15.4	15.6	18.3
Fiscal Deficit	% GDP	4.3	4.3	3.7	2.4	3.3	4.3	4.3	7.4
<b>Domestic Debt</b>									
	Rs.bn	1731	1718	1854	1979	2150	2322	2601	3266
Funded	% Domestic Debt	58.9	53.9	51.0	54.6	59.4	62.0	63.9	68.8
Non Funded	% Domestic Debt	41.1	46.1	49.0	45.4	40.6	38.0	36.1	31.2
<b>FBR Tax Collection</b>									
	Rs.bn	392	404	461	521	590	713	847	1001
Direct Taxes	% share	31.9	34.9	33.0	31.7	31.0	31.6	39.4	38.3
Indirect Taxes	% share	68.1	65.1	67.0	68.3	69.0	68.4	60.6	61.7
<b>Monetary Sector</b>									
Net Domestic Assets (NDA)**	Rs.bn	1498	1531	1539	1903	2329	2697	3080	4022
Net Foreign Assets (NFA)**	Rs.bn	28.3	231	540	583	637	710	985	667

\* Period Average \*\* End-June Stocks

	Unit	2000-01	2001-02	2002-03	2003-04	2004-05	2005-06	2006-07	2007-08
Credit to Private Sector	Rs.bn	750	841	949	1274	1712	2114	2480	2888
Net Credit to Government	Rs.bn	602	677	599	657	753	834	927	1510
Borrowings for Budgetary Support	Rs.bn	4999*	567	511	575	647	708	810	1365
Broad Money (M2)	growth %	9.0	15.4	18.0	19.6	19.1	15.1	19.3	15.3
Reserve Money (Mo)	growth %	7.1	9.6	14.5	15.4	17.6	10.2	20.9	22.3
<b>Capital Market</b>									
SBP General Index	2000-01=100	118.7	106.7	204.1	323.3	362.8	427.0	547.5	455.4
KSE 100 Index	1991=1000	1366	1770	3402	5279	7450	9989	13772	12289
Market Capitalisation	\$ bn	5.8	6.6	12.8	24.4	34.3	46.2	65.7	59.9
National Saving Scheme**	\$ bn	13.0	13.8	16.8	17.1	15.8	15.6	16.5	17.4
<b>Banking Sector</b>									
Scheduled Banks Deposits	\$ bn	21.9	23.1	28.7	34.8	40.9	47.0	55.7	61.0
Scheduled Banks Advances	\$ bn	13.6	14.4	16.6	21.6	28.5	34.5	39.2	45.0
Scheduled Banks Assets	\$ bn	34.0	37.5	43.4	52.1	62.9	61.3	77.6	80.7
Lending and Deposit Rates	weighted average								
Deposits Outstanding	% pa	5.0	4.17	1.90	1.61	2.55	4.01	5.30	6.94
Advances Outstanding	% pa	13.97	12.03	7.58	7.20	8.98	10.90	11.80	12.42
<b>Open Market Operation</b>									
SBP 3-Day Repo	% pa	14.00	9.00	7.50	7.50	9.00	9.00	9.50	12.00
Treasury Bills Yield - 6 Months	% pa	12.88	6.28	1.66	2.08	7.96	8.49	8.90	11.47
KIBOR - 6 Months	% pa	-	6.21	2.12	2.69	8.46	9.36	9.77	13.94
Pakistan Investment Bonds - 5 yrs	% pa	12.99	9.39	4.16	5.27	7.50	9.65	9.53	-
Overnight Call Money Rate	%	8.96	6.74	4.23	1.86	4.34	8.46	9.37	13.55
SBP Export Finance Rate	%	9.00	6.50	2.00	1.50	6.50	7.50	6.50	6.50
<b>External Sector</b>									
Exports	\$ bn	8.93	9.14	10.97	12.46	14.48	16.55	17.28	20.12
Imports	\$ bn	10.20	9.43	11.33	13.74	19.00	24.99	26.99	35.42
Trade Balance	\$ bn	-1.27	-0.29	-0.36	-1.28	-4.52	-8.44	-9.71	-15.70
Current Account	\$ bn	-1.95	0.09	3.16	1.30	-1.78	-5.70	-7.40	-14.46
	% GDP	-2.9	0.1	3.7	1.3	-1.6	-6.6	-5.1	-8.6
Worker Remittances	\$ mn	1087	2389	4237	3872	4168	4600	5494	6451
Foreign Private Investment	\$ mn	182	475	816	922	1677	3872	6960	5172
Direct		322	485	798	950	1524	3521	5140	5153
Portfolio		-140	-10	18	-28	153	351	1820	19
External Debt and Liabilities	\$ bn	37.2	36.5	35.5	35.3	35.8	37.6	40.5	46.3
	% GDP	52.2	50.9	42.6	36.1	32.7	29.5	28.1	27.6
External Debt Servicing	\$ mn	3395	4095	3150	4969	2716	2805	2769	2923
Gold & Forex Reserves	\$ mn	3810	7065	11472	13155	13338	14590	17924	11828
Gold		566	667	725	831	917	1288	1366	1931
Cash		3244	6398	10747	12324	12421	13302	16558	9897
Crude Oil Spot Prices (Brent)	\$/barrel	26.1	25.5	28.2	33.0	55.4	73.3	71.9	141.0
Exchange Rate (Average)	Rs/US\$	58.4	61.4	58.5	57.6	59.4	59.9	60.6	62.5

\* Special Account-Debt Repayment Adjusted \*\* Outstanding Amount