Contents

Editor's Corner

Dear readers,

In today's competitive business environment, worldwide experience confirms that countries with well developed financial systems grow faster and more consistently than those with weaker systems.

In Pakistan, over the years, the banks particularly those in the public sector had begun to suffer from mismanagement, lack of professionalism, and political interference both in their day to day operations as well as policy formulation. This resulted in poor performance, manifest through infected investment portfolios, non-performing loans, debt write-offs for considerations other than commercial and non-adherence to Prudential Regulations and fiduciary responsibilities.

In the mid 1990s, the situation reached a zenith of poor performance, with large operational losses and capital erosion. The process of reforming the banking sector started in 1997 and driven by the restructuring of nationalised commercial banks/development financial institutions is still in the process, being assisted through loans and technical assistance from the World Bank.

Like other nationalised commercial banks, National Bank of Pakistan also initiated the process of major restructuring of its operations. It redefined its role and is moving from a public service organisation into a modern commercial bank. This is being brought about by the process of structural changes initiated at the Bank, whereby focus is on seeking out customers and not just responding to their needs. The main emphasis is on service standards and better management of the bank's business. While focusing on service standards, Relationship Managers have been inducted who will look after the Bank's corporate clients.

A major initiative of the Bank to grow into a more modern, responsive and skilled institution necessitated substantial changes in both staffing and branch network. The voluntary handshake scheme offered twice over the last five years has resulted in a reduction of over 10,000 employees and currently the permanent workforce has reduced to 12,500.

Rationalisation of branch network has to date resulted in closure of 209 unprofitable/close proximity branches. Closure has reduced the total number of branches from 1405 at end December 2000 to 1196 by end March 2002. This has resulted in reducing the losses by about Rs.225 million.

Overseas operations have seen consolidation. The UN Plaza Branch was merged with the Wall Street Branch, while in UK, National Bank was merged with United Bank Ltd to form a new bank called Pakistan International Bank Ltd.

To optimize employment of resources for gaining a competitive edge over the peer group competitors in the domestic financial market, it was felt that restructuring be undertaken. Concurrently structural reorganisation is taking place through the reduction in layers of authority and decision making and the introduction of focused groups, each responsible for one particular aspect of operations. Zones and Regions are being reorganized into more cost effective structures. It is expected to yield better operational/business control and efficiency with greater focus on customer services.

National Bank has recently established an Investment Banking Department to undertake corporate finance, advisory and investment banking activities. Various tasks performed by the Department include Corporate Advisory; structuring of transactions; analysis and floatation of Term Finance Certificates, equity, and quasi equity instruments; syndication of debt and TFCs; and financial modelling and forecasting.

It is aggressively pursing a program to develop its Retail & Commercial Banking to meet the growing demand of its clientele in a highly competitive environment. It will soon be coming up with new products and services like expanded ATM network, utility bill payment kiosks, credit cards, auto loans, home loans (mortgage) among others.

The Bank has signed an agreement with Information Technology Commission to install 18 ATMs in Islamabad and Rawalpindi. These would be located in some of the low income areas, primarily to facilitate low rank government employees to draw their salaries any time of the day. The Bank is also looking into providing a similar service for the pensioners.

These and other reforms like strengthening its position in equity market, improving treasury services, training existing staff are being undertaken as part of a program to facilitate the bank for privatisation. In a move towards partial privatisation of NBP, the GoP decided to offload 5% NBP shares owned by it, with a green shoe option for additional 18.652 million shares owned by the State Bank of Pakistan, in case of over subscription. As the bank received an overwhelming response, additional 5% shares have also been offloaded. Total subscription offer received was over Rs.1 billion, with overseas Pakistanis showing keen interest.

One of the major focus of the Bank is also to develop its professional skills. This is being achieved through hiring of qualified professional staff with skills in management, marketing, Treasury.

Reengineering process is also underway; whereby the Bank is developing a strong IT platform, strengthening internal controls, initiating various HR reforms, among others.

NBP has over the last year progressed into a modern commercial Bank, competing efficiently with other private banks. It was awarded the Prestigious Bank of Year 2001 award by the Banker, a publication of the Financial Times London. The success story does not end here, for given its strength of 8.5 million customers, large domestic and international branch network, substantial asset/deposit base, a prudent lending policy, it is now moving towards diversification of its revenue sources, increasing non-interest revenues, streamlining organizational structure, bringing about institutional changes, and thus striving to meet the challenges of modern banking. In other words making National Bank a truly Universal Bank.

Ayesha Mahmud

Abstract of the Bulletin

Foreign Banks in Pakistan Performance 2001

- There are 18 foreign banks operating in Pakistan, with a network of 78 branches.
- Foreign banks' performance for 2001, reveals a growth in deposits, fall in advances to various sectors, rise in investment portfolio, rising interest expense and modest increase in non fund based income.
- Of the foreign banks operating in Pakistan, ABN Amro, Standard Chartered & Grindlays and Citibank are among the banks who performed well in 2001.

Banking Sector Restructuring in Pakistan

- The government of Pakistan has embarked upon a banking sector reform program.
- Nationalised commercial banks faced with large non-performing loans, lack of financial discipline, excess manpower, a large branch network, outside pressures were performing poorly. In 1997, the process of restructuring/reorganisation, initiated to achieve better results continues to date.
- World Bank is helping finance the restructuring costs of these banks.
- Various reform measures undertaken by the banks have started to show positive results.

Pakistan's Development Priorities

- Today, Pakistan faces a number of challenges; slow economic growth, high debt, rising poverty, poor social indicators, law and order, poor investor confidence, deterioration in institutions of governance etc.
- A comprehensive reform program has been launched which addresses the key issues.

Pre-Budget 2002-03

- The forthcoming Federal Budget 2002-03 is expected by mid June.
- The Budget is expected to pursue the government's structural reform agenda.
- The Budget is expected to emphasize besides other issues, rising levels of poverty, higher allocations for development expenditure, infrastructure, agriculture especially water management, fiscal reforms etc.

Banking and Finance

- Key monetary indicators, deposits, advances, investment in central government securities, notes in circulation and approved foreign exchange have risen at end April compared to last year's level.
- The real cost of domestic government borrowing has risen in the last three years.
- The government has decided to rationalize interest rate structure.

Market Analysis

- The KSE-100 Index gained 30.84 points (MoM) in April to close at 1897. Average trading volume declined to 136m shares from 195m shares in March.
- The rise in the index (MoM) was due to a short spurt on the second last day of April, which saw an increase of 45 points on the eve of the referendum. In fact, the referendum was the key factor that did not allow the market to decline.
- With the referendum over, we believe the market will witness a correction which has been due for some time; there is no foreseeable strong fundamental development that could prompt a major upside move.

Foreign Banks in Pakistan - Performance 2001

Foreign banks face competition

Financial reforms introduced in 1990 liberalized Pakistan's banking sector, which had long been dominated by state-owned banks. The sector is now open to private banks, both local and foreign. A process of restructuring is underway in the nationalized commercial banks as they prepare for privatisation. The increasing number of domestic private banks pose a new challenge for foreign banks operating in Pakistan.

At present, there are 18 foreign banks operating in Pakistan, with a network of 78 branches having a strong presence in major cities. Their target has been high net worth individuals and blue chip companies.

In the past, foreign banks had also flourished due to foreign currency accounts (FCAs) and swap dollar funds. The withdrawals from the resident FCAs resulting from freezing of FCAs in May 1998, adversely affected foreign banks operation. With the loss of these deposits, profitability of foreign banks came under pressure.

New strategy being adopted

Bank of America was the first to decide to close its operations in Pakistan, while ANZ Grindlays Bank Asia's operations were undertaken by the Standard Chartered Bank as a result of global merger of the two banks. The number of foreign banks came down from 21 to 18 and their branch network was reduced to 78 from 82. These banks are redefining their policies and have adopted new strategy to remain competitive in resource mobilization. As there is stiff competition between local and foreign banks in getting a larger share of Pakistan's consumer market, the later have come up with innovative financial products. They have also made substantial investment in upgrading technology.

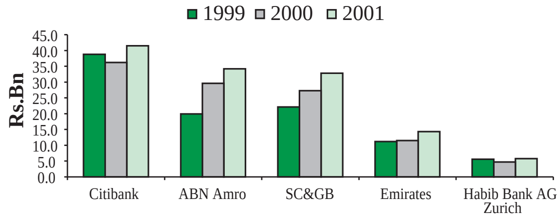
Performance 2001 analysed

This paper has made an attempt to analyse the performance of foreign banks on the basis of financial data available for 15 out of 18 banks operating in Pakistan as of December 31, 2001.

Slow growth in deposits

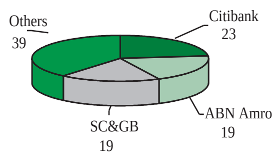
The key to success for commercial banks is their deposit base. When compared with 2000, cumulative growth in deposits of 15 foreign banks recorded a modest slowdown in 2001. Of these, nine banks recorded a rise, while six banks posted declines in their deposits. Oman Bank International with under Rs2 billion deposits recorded the highest growth of 59.3%, while the largest decline of 82.9% was recorded by Doha Bank.

Deposits

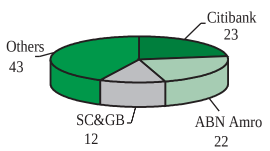


However, Citibank continued to enjoy the highest deposit base amongst foreign banks operating in Pakistan. It recorded a spectacular turnaround from a decline of 6.8% in 2000 to a rise of 14.7% in 2001. ABN Amro, and Standard Chartered & Grindlays posted a double-digit growth, but slower than the preceding year. These three banks account for over 61% of foreign banks total deposits. Among the other banks, Hong Kong & Shanghai Banking Corporation managed to enlarge its deposits following three years of decline.

Deposits % Share



Advances & Investments % Share



Advances fall

In 2001, total advances of 15 foreign banks operating in Pakistan shrank by 16.9%, after expanding 14.4% a year earlier. Oman International recorded the highest growth, while Doha Bank suffered the largest fall. These two banks have a smaller share, accounting for only 1.6% of foreign banks' total advances. Citibank, Standard Chartered & Grindlays and ABN Amro cumulatively lent 60% of total advances last year.

Fall in advances was, however, compensated by a sharp rise in foreign banks' investments, which surged 108.7%. Nine banks posted decline in investments with the Deutsche Bank suffering the largest fall. Increase in total investments is, however, attributable to ABN Amro which enjoyed the largest investment portfolio, followed by Citibank, Emirates International and Habib Bank A.G. Zurich, with a combined share of 78.6% in total investment portfolio. The investment was nil at Societe Generale, while at Oman International it rose from negligible to Rs136 million. Hongkong & Shanghai also saw a sharp turnaround.

Invest-ments increase

The sharp rise in investment portfolio, partially offset the decline in advances and contributed to an increase of 14.4% in assets of foreign banks. Nine banks shared this increase. While Citibank enjoyed the largest assets base, the highest growth in assets came from Hongkong & Shanghai Banking Corporation. ABN Amro, Citibank, Standard Chartered & Grindlays and Emirates International share over 65% of foreign banks' assets.

Assets growth slows

Six banks, accounting for 17% of foreign banks' total assets, suffered decline in 2001. Doha Bank with assets of under Rs2 billion posted the highest fall. Among the others, American Express, Societe Generale, Deutsche Bank and Mashreq Bank also recorded falls.

Interest income

Interest income was higher by 19.4%, as Citibank continued to generate highest income through interest, ABN Amro posted the highest growth amongst the 15 banks. Alongwith Standard Chartered & Grindlays these three banks share 60% of the total interest income. Four banks saw a decline in their interest income, with Doha Bank registering the highest decline.

Interest expense

Interest expense was largely higher, with ABN Amro posting the highest increase. Alongwith Citibank, Standard Chartered & Grindlays, Habib Bank A.G. Zurich and Emirates International they accounted for over 71% of total interest expenses. Some banks like Doha, Bank of Tokyo managed to curtail their interest expense.

Net interest income rises

Net interest income registered a double digit growth of 22.1%. Citibank emerged as the largest net interest income earner amongst the 15 foreign banks. Oman International with the smallest net interest income shared the highest growth, against a negative net interest income in 2000.

Of the seven banks recording a decline in their net interest income, Deutsche Bank's was the largest. Mashreq Bank, Societe Generale and Standard Chartered & Grindlays also registered double digit decline. Despite the fall in net interest income of Standard Chartered & Grindlays, it is amongst the three larger banks (two other being ABN Amro and Citibank) who together contribute 75% of the total net interest income of foreign banks.

Modest growth in non-fund based income

Aggregate non-fund based income of all foreign banks recorded less than 1% growth. Nearly 42% of revenue accrued from non-fund based income in 2001, which was less than preceding year's share of 46%. While highest increase was recorded by the Emirates International, in quantum terms, Citibank remains the topmost; nearly 60% of the total non-fund based income is shared by ABN Amro, Standard Chartered & Grindlays and Citibank.

Net revenue rises

Total revenue consisting of net interest income and non-fund based income recorded an 11.5% growth, with the highest increase contributed by Oman International. Citibank has the largest revenue base, followed by Standard Chartered & Grindlays and ABN Amro. These three banks account for 68.5% of total revenue. Of the six banks, which recorded decline in revenue, Societe Generale recorded the highest.

In contrast to an 11.5% growth in revenue, the 15 foreign banks managed to keep operating expenses relatively low, growing at 4.8%.

Admn expenses low

While administrative expenses account for nearly 85% of total operating expenses, foreign banks were able to restrict growth under this head to only 1.4%.It was the highest at Citibank and lowest at Oman International.

Administrative expenses have declined for some of the larger foreign banks, like Hongkong & Shanghai Banking Corporation (53.9%) and Standard Chartered & Grindlays (1.9%). Citibank recorded nearly 11% growth and ABN Amro showed a 24.6% rise.

Key Performance Indicators – Foreign Banks

(Rs. Million)

Banks	Assets		Deposits		Advances		Investments	
	2000	2001	2000	2001	2000	2001	2000	2001
ABN Amro	39239.7	52798.5	29578.7	34191.9	21526.0	23860.8	511.1	9317.3
Standard Chartered & Grindlays	35097.1	38171.7	27337.2	32809.3	22557.2	16598.6	2616.6	1149.5
Citibank	49022.1	61573.8	36176.7	41505.6	24296.3	27118.6	2600.6	6798.6
American Express	15133.2	13990.6	6322.3	5956.5	5880.0	4978.5	2076.7	3118.4
Credit Agricole Indosuez	8592.4	10406.0	3983.6	5306.6	4493.6	4267.3	1363.8	1236.3
Societe Generale	9201.0	7056.4	5015.4	2959.1	3263.3	2901.7	189.2	-
Hongkong & Shanghai Banking Corporation	6594.4	10690.7	4732.8	5832.8	4094.3	4348.1	135.7	570.8
Deutsche Bank	8790.9	7032.5	5232.9	3994.4	3265.8	3169.3	184.1	44.1
Mashreq Bank	9729.5	7643.8	5608.8	3756.4	2125.3	2221.0	781.5	393.9
Doha Bank	2886.5	1890.0	1021.5	175.1	1354.9	639.2	19.8	9.8
Oman International	1982.4	3117.4	1144.4	1823.4	952.2	1131.0	-	135.7
Bank of Tokyo	10363.0	8594.2	8401.2	6517	1273.7	916.1	988.0	808.1
Habib Bank AG Zurich	19592.4	21426.1	12965.9	16679.2	10666.6	10651.2	2238.8	4118.4
Emirates International	19132.3	24879.1	11489.4	14326.1	8066.0	9028.5	3078.8	7351.0
IFIC Bank	1843.7	2044.4	1151.9	1362.2	1169.5	1213.8	25.0	25.0
Total	**237200.6**	**271315.2**	**160162.7**	**17795.6**	**114984.7**	**113043.7**	**16809.7**	**35076.9**

Banks	Interest Income		Interest Expense		Net Income		Non-Fund Based Income	
	2000	2001	2000	2001	2000	2001	2000	2001
ABN Amro	3453.2	4988.7	2663.8	3708.0	789.4	1280.7	699.0	759.4
Standard Chartered & Grindlays	3394.1	3520.7	2005.6	2292.1	1388.5	1228.6	849.4	761.9
Citibank	4783.5	6526.4	3307.7	4219.1	1475.8	2307.3	1201.8	1254.4
American Express	1129.7	1112.1	966.9	948.3	162.8	163.8	311.6	295.6
Credit Agricole Indosuez	779.3	902.0	692.3	803.5	87.0	98.5	120.1	125.6
Societe Generale	888.5	938.1	809.3	879.1	79.2	59.0	96.1	63.6
Hongkong & Shanghai Banking Corporation	551.7	625.4	432.1	514.8	119.6	110.6	142.4	156.5
Deutsche Bank	612.6	619.4	411.8	472.2	200.8	147.2	151.8	166.5
Mashreq Bank	815.6	790.2	739.4	725.0	76.2	65.2	196.1	131.2
Doha Bank	147.4	26.2	312.9	139.9	-165.5	-113.7	54.1	10.1
Oman International	148.0	168.7	153.1	160.8	-5.1	7.9	24.0	24.7
Bank of Tokyo	925.3	864.4	684.7	632.2	240.6	232.2	81.0	94.4
Habib Bank AG Zurich	1811.0	2044.1	1462.5	1700.0	348.5	344.1	356.2	427.8
Emirates International	1467.2	1836.5	1051.1	1395.3	416.1	441.2	245.6	296.1
IFIC Bank	146.2	169.8	103.0	122.5	43.2	47.3	61.5	64.0
Total	**21053.3**	**25132.7**	**15796.2**	**18712.8**	**5257.1**	**6419.9**	**4590.7**	**4631.8**

Banks	Revenue		Admn Expense		Operating Expense		Profit/Loss (BT)	
	2000	2001	2000	2001	2000	2001	2000	2001
ABN Amro	1488.4	2040.1	688.4	858.0	731.9	870.0	756.5	1170.1
Standard Chartered & Grindlays	2237.9	1990.5	942.1	923.8	1463.0	1484.0	774.9	506.5
Citibank	2677.6	3561.7	1488.4	1651.1	1645.3	1793.9	1032.3	1767.8
American Express	474.4	459.4	414.0	396.7	434.1	470.7	40.3	-11.3
Credit Agricole Indosuez	210.0	250.0	146.6	182.9	147.6	183.1	62.4	66.9
Societe Generale	180.1	122.6	184.9	154.7	186.9	213.6	-6.8	-91.0
Hongkong & Shanghai Banking Corporation	262	267.1	328.9	151.6	394.8	165.3	-132.8	101.8
Deutsche Bank	352.6	313.7	513.0	319.7	519.9	332.9	-167.3	-19.2
Mashreq Bank	272.3	196.4	123.8	102.1	128.5	123.3	143.8	73.1
Doha Bank	-111.4	-103.6	56.1	74.3	86.1	102.3	-197.5	-205.9
Oman International	18.9	32.6	43.9	44.0	59.0	44.4	-40.1	-11.8
Bank of Tokyo	321.6	326.9	94.8	99.2	98.4	99.5	223.2	227.4
Habib Bank AG Zurich	704.7	771.9	283.7	325.5	297.6	365.4	407.1	406.5
Emirates International	735.4	737.3	464.1	563.1	464.8	723.6	270.6	13.7
IFIC Bank	107.5	111.6	44.9	50.7	45.1	50.8	62.4	60.8
Total	**9932.0**	**11078.2**	**5817.6**	**5897.4**	**6703.0**	**7022.8**	**3629.7**	**4394.6**

Growth Rates

(%)

Banks	Assets		Deposits		Advances		Investments	
	2000	2001	2000	2001	2000	2001	2000	2001
ABN Amro	40.60	34.55	48.36	15.60	26.45	10.85	-83.08	1722.99
Standard Chartered & Grindlays	10.95	8.76	23.84	20.02	24.38	-26.42	-30.75	-56.0
Citibank	4.20	25.60	-6.76	14.73	13.00	11.62	-79.16	161.42
American Express	45.53	-7.55	14.23	-5.79	18.39	-15.33	450.56	50.16
Credit Agricole Indosuez	21.38	21.11	12.24	33.21	22.00	-5.04	72.31	-9.35
Societe Generale	22.36	-23.31	20.20	-41.00	-13.41	-11.08	-50.17	-
Hongkong & Shanghai Banking Corporation	-18.12	62.12	-15.14	23.24	-6.19	6.20	-85.19	320.63
Deutsche Bank	23.23	-20.00	9.66	-23.67	9.53	-2.95	-73.88	-76.05
Mashreq Bank	39.08	-21.44	37.06	-33.03	-16.51	4.50	483.21	-49.60
Doha Bank	-7.83	-34.52	-56.31	-82.86	-17.46	-52.82	102.04	-50.51
Oman International	-2.56	57.25	-14.96	59.33	-8.02	18.78	-	100.0
Bank of Tokyo	-0.61	-17.07	1.88	-22.43	13.90	-28.08	-68.79	-18.21
Habib Bank AG Zurich	17.02	9.36	8.80	28.64	13.47	-0.14	142.29	83.96
Emirates International	27.86	30.04	2.50	24.69	10.92	11.93	96.46	138.76
IFIC Bank	4.85	10.89	8.45	18.26	9.16	3.79	-78.13	-

Banks	Interest Income		Interest Expense		Net Int. Income		Non-Fund Based Income	
	2000	2001	2000	2001	2000	2001	2000	2001
ABN Amro	6.23	44.47	2.96	39.20	18.99	62.24	9.49	8.64
Standard Chartered & Grindlays	-12.10	3.73	-23.65	14.29	12.47	-11.52	15.71	-10.30
Citibank	-11.41	36.44	-18.21	27.55	8.87	56.34	14.80	4.38
American Express	15.58	-1.56	10.36	-1.92	60.71	0.61	10.22	-5.13
Credit Agricole Indosuez	-7.70	15.74	-6.00	16.06	-19.29	13.22	-18.58	4.58
Societe Generale	-10.59	5.58	-14.43	8.62	65.34	-25.51	-13.58	-33.82
Hongkong & Shanghai Banking Corporation	-46.85	13.36	-52.09	19.14	-12.19	-7.53	-34.47	9.90
Deutsche Bank	-14.38	1.11	-20.75	14.67	2.50	-26.69	-59.07	9.68
Mashreq Bank	5.09	-3.11	2.51	-1.95	39.05	-14.44	-53.21	-33.10
Doha Bank	-22.71	-82.23	1.62	-55.29	41.21	-31.30	36.62	-81.33
Oman International	-12.27	13.99	0.07	5.03	-132.48	-254.90	23.71	2.92
Bank of Tokyo	-5.98	-6.58	-2.74	-7.67	-14.10	-3.49	-29.13	16.54
Habib Bank AG Zurich	3.41	12.87	5.81	16.24	-5.58	-1.26	-1.74	20.10
Emirates International	-15.48	25.17	-21.64	32.75	5.45	6.03	-6.37	20.56
IFIC Bank	-9.31	16.14	-17.40	18.93	18.36	9.49	36.36	4.07

Banks	Revenue		Admn Expense		Operating Expense		Profit/Loss (BT)	
	2000	2001	2000	2001	2000	2001	2000	2001
ABN Amro	11.72	37.07	9.58	24.64	9.63	25.86	7.44	54.67
Standard Chartered & Grindlays	13.67	-11.06	13.07	-1.94	-1.66	38.50	-12.63	-34.64
Citibank	11.41	33.02	-4.53	10.93	-5.11	9.09	99.94	71.25
American Express	23.54	-3.16	-3.74	-4.18	-3.09	11.88	-186.85	-128.04
Credit Agricole Indosuez	-26.83	19.05	3.02	24.76	3.72	24.05	-56.88	7.21
Societe Generale	13.20	-31.93	3.59	-16.33	4.71	-17.23	-87.05	1238.24
Hongkong & Shanghai Banking Corporation	-25.88	1.95	23.23	-53.91	24.47	-54.33	-334.28	-176.77
Deutsche Bank	-41.81	-11.03	-8.00	-37.68	-7.66	-37.91	-459.78	-88.52
Mashreq Bank	-42.54	-27.87	0.65	-17.53	0.81	-17.66	-53.40	-49.17
Doha Bank	43.56	-7.00	14.26	32.44	54.99	34.17	53.01	3.94
Oman International	-46.15	72.49	2.33	2.33	2.56	0.23	414.10	-70.57
Bank of Tokyo	-18.46	1.65	-2.47	4.64	-2.47	4.96	-24.90	1.88
Habib Bank AG Zurich	-3.68	9.54	4.61	14.73	4.61	14.73	0.20	-0.15
Emirates International	12.0	0.26	6.08	21.33	4.76	21.19	26.92	-94.94
IFIC Bank	31.74	3.81	16.02	12.92	16.54	12.64	79.83	-2.56

Profit improves

Cumulative profits of 10 foreign banks recorded a 21.1% rise in 2001. While Citibank continued to earn the highest profit, a significant jump by ABN Amro enabled the bank to cross the Rs1 billion mark. Hongkong & Shanghai Banking Corporation, which had registered a decline in profit (BT) since 1998 and a loss in 2000, was able to convert this loss into profit in2001. Over 78% of the foreign banks' total profit was earned by Citibank, ABN Amro and Standard Chartered. Profit at Emirates International was the lowest.

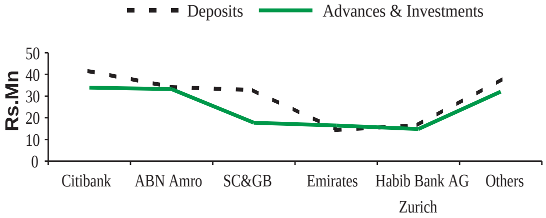
Of the five banks that incurred losses, Doha's continued to rise. Oman International was able to reduce its loss, whereas earlier profit at American Express was converted into loss. However, foreign banks were able to reduce their cumulative losses by 38% in 2001.

Ratio Analysis

Liquidity in a bank is difficult to measure because a bank's liquidity position changes daily. By the time the bank's financial data is processed, the ratios may not represent the current position. Nevertheless an attempt has been made to measure liquidity by looking at two ratios. These are advances to deposits and earning assets to total assets.

Advances / Deposits ratio

In 2001 the advances to deposits ratio averaged 76.6% for the 15 banks, only slightly higher over 2000. The ratio varied considerably with the size of the banks; small banks registering higher ratio on average, than the larger banks.



This ratio ranges from as low as 14.7% for Bank of Tokyo to as high as 166.6% for Doha Bank. Among the big banks, ABN Amro and Standard Chartered & Grindlays recorded a decline, while Citibank showed an increase in its advances to deposits ratio. However, the ratio was 65.1% for Standard Chartered & Grindlays, 66.2% for Citibank and 71.2% for ABN Amro. This was below the foreign banks average of 76.67%.

Earning assets / total assets ratio

Earning Assets to Total Assets ratio averaged 68.3% for all banks, almost the same as that of the preceding year. The ratio ranged from 85.5% for ABN Amro to 45.0% for Doha Bank. Citibank and Standard Chartered & Grindlays were among the three big banks, which recorded an above average ratio.

Cost of deposits rises for 9 banks

During 2001 the average cost of deposits for all banks has come down to 8.71% from 8.92%. Banks recording increase in their cost of deposits include Citibank, ABN Amro and Standard Chartered & Grindlays. At 12.71% the cost of deposits ratio for Societe Generale continues to be the highest. Hongkong & Shanghai Banking Corporation on the other hand, has the lowest cost of deposits at 6.84%.

Low intermed-iation cost

Intermediation cost has been further reduced, as the ratio averaged 2.78% in 2001 against 3.13% in 2000. While ABN Amro, Citibank and Standard Chartered & Grindlays have managed to curtail their intermediation costs, Doha Bank incurred the highest cost at 5.84%, a big increase over 2000. Though Hongkong & Shanghai Banking Corporation has drastically reduced its cost of intermediation by 300 basis points, the ratio is the lowest at 1.30% for Bank of Tokyo.

Spread shrinking

The average spread of foreign banks, except Doha, showed a marginal fall from 4.52% in 2000 to 4.43% in 2001. Doha Bank however, recorded a rising negative spread. Mashreq Bank has the highest spread at 8.2%, while it was the lowest at 2.2% for Hongkong & Shanghai Banking Corporation. Among the bigger banks, Citibank registered a rising spread, while ABN Amro and Standard Chartered & Grindlays recorded lower spread.

Net interest margin

Fewer banks saw an increase in their net interest margin (NIM) as most recorded a fall in their yield on average earning assets. Citibank recorded the highest yield on earning assets at 10.33%. while it was the lowest at 0.60% for Oman International. It continued to be negative for Doha Bank.

Key Ratios

(%)

	ABN Amro		Standard Chartered Grindlays		Citibank		American Express		Credit Agricole Indosuez	
	2000	2001	2000	2001	2000	2001	2000	2001	2000	2001
Cost of Deposit	8.77	8.80	6.83	7.01	8.01	8.99	8.58	7.25	9.86	9.23
Intermediation Cost	2.27	2.04	3.21	2.82	3.60	3.52	3.68	3.03	2.09	2.10
Pre-Tax Margin	50.83	57.36	34.63	25.45	38.55	49.63	8.49	-2.46	29.71	26.76
Return on Assets	2.25	2.54	2.32	1.38	2.15	3.20	0.32	-0.08	0.80	0.70
Return on Deposits	3.06	3.67	3.14	1.68	2.75	4.55	0.68	-0.18	1.66	1.44
Spread	3.88	3.87	6.88	5.59	5.42	6.99	4.39	2.62	2.73	2.78
Advances to Deposits	77.85	71.17	82.36	65.10	61.08	66.19	91.48	88.43	108.55	94.30
Earn. Assets to T. Assets	81.29	85.54	74.19	76.29	74.19	73.84	68.19	77.37	78.99	79.07
Net Interest Margin	2.89	3.25	5.61	4.40	9.28	10.33	1.87	1.45	1.41	1.31
Revenue to Expense Ratio	216.21	237.77	237.54	215.47	162.17	828.11	114.6	115.8	143.25	136.69

	Societe Generale		Hong Kong & Shanghai Bank		Deutsche Bank		Mashreq Bank		Doha Bank	
	2000	2001	2000	2001	2000	2001	2000	2001	2000	2001
Cost of Deposit	11.21	12.71	6.84	6.84	6.36	7.57	11.0	9.9	14.4	10.99
Intermediation Cost	2.56	2.24	5.21	2.01	7.92	5.13	1.84	1.39	2.58	5.84
Pre-Tax Margin	-3.78	-74.23	-50.61	38.11	-47.45	-6.12	52.81	37.22	-	-
Return on Assets	-0.08	-1.12	-1.81	1.18	-2.10	-0.24	1.72	0.84	-6.58	-8.62
Return on Deposits	-0.15	-2.28	-2.57	1.93	-3.34	-0.42	2.96	1.56	-11.79	-34.4
Spread	4.01	5.43	3.09	2.22	7.65	6.70	8.27	8.19	-4.92	-8.55
Advances to Deposits	76.53	77.31	82.04	79.90	62.45	69.74	48.15	46.41	89.20	166.65
Earn. Assets to T. Asstes	69.81	63.65	75.87	79.90	54.93	54.86	50.63	50.35	51.70	45.00
Net Interest Margin	1.36	1.14	2.15	1.60	4.59	3.39	1.80	1.49	-10.64	-10.58
Revenue to Expense Ratio	97.40	79.25	79.66	176.19	68.73	98.12	219.95	192.95	-198.57	-139.43

	Oman International		Bank of Tokyo		Habib Bank AG Zurich		Emirates International		IFIC Bank	
	2000	2001	2000	2001	2000	2001	2000	2001	2000	2001
Cost of Deposit	11.01	8.86	8.21	8.31	8.95	9.38	7.03	7.05	6.69	7.82
Intermediation Cost	3.16	2.42	1.14	1.30	1.74	1.80	3.10	2.84	2.91	3.24
Pre-Tax Margin	-212.17	-36.2	69.40	69.56	57.77	52.66	36.80	1.86	58.05	54.48
Return on Assets	-2.00	-0.46	2.15	2.40	2.24	1.98	1.59	0.06	3.46	3.13
Return on Deposits	-3.22	-0.80	2.68	3.05	3.27	2.74	2.38	0.11	5.64	4.84
Spread	2.37	3.90	5.88	5.77	4.23	2.90	4.94	4.12	4.05	5.33
Advances to Deposits	79.81	70.19	14.37	14.68	80.64	71.91	67.57	66.22	101.215	94.8
Earn. Assets to T. Asstes	55.08	51.86	63.15	64.74	75.61	81.17	71.92	74.75	75.64	66.42
Net Interest Margin	-0.46	0.60	3.67	3.78	2.54	2.07	3.4	2.68	3.17	3.66
Revenue to Expense Ratio	43.05	74.09	339.24	329.54	248.40	237.14	158.46	130.94	239.42	220.12

Pre-tax profit margin

The analysis further shows that of the foreign banks under review, pre-tax profit margin for five banks was in negative. Societe Generale recorded the highest negative ratio, followed by American Express, Oman International, Deutsche Bank and Doha Bank. Doha Bank had suffered a loss and its revenue was in negative due to high interest expenses.

Among the remaining ten banks, the Bank of Tokyo posted the highest pre-tax profit margin at 69.6% while the ratio was at its lowest for Emirates International after drastic reduction in pre-tax margin to only 1.9% from 36.8% a year earlier. Citibank, ABN Amro and Standard Chartered & Grindlays recorded positive pre-tax profit margins in the range of 25.4% to 57.4%.

Return on assets

Return on assets ratio shows how efficiently total net assets have been employed by the bank. The analysis revealed that this ratio declined for most of the banks. American Express, Societe Generale, Deutsche Bank, Oman International and Doha Bank were among the group which recorded negative return. Only four banks recorded increase in the ratio. Hongkong & Shanghai Banking Corporation showed substantial improvement from negative to positive return. The highest ratio was 3.2% for Citibank, while Emirates International posted the lowest ratio at 0.06%. Doha Bank suffered 300 basis point increase in its negative return.

Return on deposits

High return on deposits attracts customers. Banks like Citibank, Hongkong & Shanghai Banking Corporation and IFIC have recorded increase in the ratio. The highest return on deposits amongst the 15 banks was 4.84% offered by IFIC Bank, followed by Citibank (4.55%) and ABN Amro (3.67%). The Standard Chartered & Grindlays recorded a lower ratio at 1.38%. Citibank registered nearly 200 basis point increase in the ratio.

Hongkong & Shanghai Banking Corporation recorded a substantial improvement as it was able to convert its negative ratio to a positive in 2001. Emirates International and Mashreq Bank registered significant decline in the ratio. Four banks recorded negative return on deposits. Among these, Doha Bank posted the highest (34.4%) while American Express suffered the lowest negative return of 0.18% in 2001.

Conclusion

The above analysis reveals that foreign banks are operating in a competitive environment. The three-banks, ABN Amro, Standard Chartered & Grindlays and Citibank continue to dominate the market. These banks showed improved performance last year despite a few set backs.

Among the other banks, American Express is facing some difficulties. However, Hongkong & Shanghai Banking Corporation has improved its performance, while Emirates International is gradually emerging as a sound bank. Habib Bank A.G. Zurich and Bank of Tokyo are also doing well. Mashreq Bank has shown mixed performance. Oman International and Doha Bank need to put extra efforts to improve their performance.

Foreign banks have enjoyed robust profitability in the past. Generally foreign banks are selective in their clientele and offer personalized services by targeting reputable established companies and individuals. However to survive in the changed scenario, foreign banks in Pakistan need to identify new clients other than multinational companies and blue chip corporations, and come up with new innovative products. As some domestic banks have also come up with innovative products and are targeting the market, which had previously been the exclusive domain of foreign banks, competition among banks is likely to get tougher with the passage of time.

Banking Sector Restructuring in Pakistan

Need for reforms

In 1997, the Government of Pakistan embarked upon a banking sector reform programme. The nationalised commercial banks (NCBs) were in need of structural changes and the central bank's autonomy had to be strengthened, empowering it to play a more effective role as regulator over the financial sector without outside interference. NCBs were faced with, high level of loan defaults which remained unresolved in an effective court system, poor management, distortion in expenditure, political interference, credit ceilings, lack of financial discipline, overstaffing, over branching and at times undue pressures by labour unions resulted in large operating losses. They needed reforms to improve institutional working.

It is only when financial institutions are run prudently and efficiently with greater credit discipline, free from the interference of vested interests and operating under a strong regulatory framework can a healthy system evolve and contribute in improving the country's prospects for growth. It also improves the poor's access to financial services.

It was with this objective that banking sector structural reforms were undertaken and which continues to date, with much progress having been achieved.

Objective of reforms

In early 1997, the State Bank of Pakistan and the Ministry of Finance designed and started to implement the banking reform program.

These reforms aimed to: -

- strengthen financial discipline,
- enhance the authority and the ability of the central bank to supervise banks and enforce regulations,
- improve the legal and judicial process for enforcing financial contracts,
- initiate corporate governance reforms in the NCBs and development financial institutions (DFIs).
- bring prudential regulations and financial disclosure standards to international levels to increase transparency,
- improve corporate governance by appointing professionals to the management and boards of the NCBs and DFIs.
- initiate a comprehensive privatisation program.

Major initiatives

As part of the reform program, the State Bank of Pakistan Act 1956, the Banking Companies Ordinance 1962 and the Banks Nationalisation Act 1974 were amended to strengthen autonomy of the State Bank. These amendments empowered the Central Bank to enforce the financial discipline and supervise and control the financial sector without outside interference.

SBP initiatives

The State Bank of Pakistan (SBP) also strengthened its supervision over the financial sector, with the view to devise a system of continuous surveillance, including providing early warning and hence timely action to correct adverse developments.

It is carrying out continuous offsite monitoring through periodic reports submitted by banks/ non-bank financial institutions to identify those institutions which reflect a high probability of financial difficulty so that policies and corrective actions can be designed and implemented.

The Central Bank has improved its on site inspection reports prepared under the newly introduced CAMELS rating system. It has recruited young professionals who have received training and their reports are more specific and focused than before, facilitating specific remedial actions.

To strengthen the capital base of banks, the SBP has moved to the Basle system of defining minimum capital requirements for banks. All banks are now required to maintain capital and unencumbered general reserves, the value of which is not less than 8% of the risk weighted assets. Also the minimum paid up capital requirement for banks was raised.

Among other measures taken by the State Bank, was strengthening of prudential regulations of banks, enhancing recovery efforts of defaulted loans and restructuring of public sector banks in terms of staff strength and branch network. Banks have also been asked to prepare their financial statements according to international accounting standards and improve public disclosure by the introduction of credit rating.

Non-core activities of the SBP have been separated out so that the central bank can concentrate on monetary policy and financial sector regulation. As mentioned, the capacity of SBP in supervision and regulations of banks have been upgraded significantly, primarily through a change in the supervisory methodology.

NCBs initiatives

The process of restructuring/reorganisation is in progress in the NCBs. The three large public sector banks, National Bank of Pakistan, Habib Bank Ltd and United Bank Ltd have drawn up major restructuring plans, which are being pursued to check the deterioration and achieve better results.

To improve loan recovery and facilitate banks' privatisation, the Corporate & Industrial Restructuring Corporation (CIRC) has been set up, which helps in the restructuring of the balance sheets of NCBs and DFIs by assuming from them all private sector non-performing loans of over Rs.10 million, starting with those that already have court order for execution.

Box 1 — Corporate & Industrial Restructuring Corporation

- Established as an autonomous body under the Ministry of Finance, Government of Pakistan.
- To play a pivotal role for Pakistan's financial sector restructuring; acquisition and resolution of non-performing assets of financial institutions; and management & arrangement of sales of non-performing loans of government owned banks.
- Assist banks in dealing with distressed enterprises, clearing up their balance sheets and to make them ready for privatisation by removing the NPA.
- Assumed non-performing assets worth Rs.59 billion during the first year of its operation since May 2001.
- Sold 45 units with an outstanding amount of Rs.6.5 billion.
- 139 units with an outstanding amount of Rs.33 billion returned to respective financial institutions for assisted resolution.
- It will initiate second phase of its operations for disposal of sick units or non-performing assets in the first week of May.

Experience of public sector banks

In the pre-structural reform era, the large public sector banks were characterized by: -

- large non-performing loans,
- excess manpower,
- large branch network,
- absence of business focus,
- poor customer service,
- limited products/services offered,
- high intermediation costs,
- outside pressure,
- ineffective court procedures for recovery of loan defaults,
- poor disclosure standards.

These large public sector banks have initiated:-

- manpower rightsizing
- branch rationalisation
- enhanced recovery effort
- hiring of professionals
- restructuring the organizational structure
- improving credit organizational structure
- automation of branches

SBP lends support

Two public sector banks, United Bank Ltd and Habib Bank Ltd suffering from an inadequate capital base, approached the SBP for bailout packages. Before allowing for equity support, certain pre-conditions had to be met, which included among others: -

- action plan that should support the policy objectives of re-capitalisation,
- improve their recovery position,
- guarantee expansion of their resource base,

- improve the internal generation of earning on self sustained basis,
- settle their outstanding dues with CBR,
- commit themselves to freeze their establishment expenditures and working strength.

It was only after receipt of these action plans, with the approval of the government, that equity support amounting to Rs.21 billion was released for UBL and Rs.9.7 billion for HBL in 1998.

World Bank supports reforms

In December 1997, the World Bank lent support to the initial stages of Pakistan's banking reform program and announced a $250 million loan for the sector (co-financed with another $250 million by Japan).

The reform program initiated by the banks started to show positive results as performance indicators improved. In October 2001, the World Bank approved another $300 million for the banking sector to assist it with its on-going reform program.

The focus was on: -

- reduce the cost structure of state owned banks for efficiency,
- reduce the tax on banks to attract private capital to the sector,
- reform national savings schemes,
- facilitate loan collateral foreclosure to reduce cost of default,
- strengthen the central bank.

The World Bank is helping finance the restructuring cost of NCBs and also providing technical assistance to the Privatisation Commission for its banks privatisation program and to the central bank for strengthening its regulatory and supervisory role.

Reforms show results

Various measures undertaken by the banks as part of the structural reform strategy has started to show positive results.

As mentioned above, the State Bank, in a move to protect the interest of depositors had asked banks to maintain 8% capital to risk weighted assets ratio (CRWA).

They were also required to achieve a minimum paid up capital of Rs.500 million, which was later raised to Rs.1 billion as on January 1, 2003.

Capital adequacy improves

The CRWA ratio of 4.5% in 1997 for all banks was less than the required level, mainly due to poor performance of NCBs. In later years however, the ratio improved and is now above the required level, which has helped the banks divert their investment towards more productive private sector advances.

Recovery efforts shows visible improvements

A major irritant affecting the balance sheet of nationalised commercial banks has been the large quantum of non-performing loans. These were manifestations of poor financial discipline, political interference, at times collusion between the bankers and the borrowers at the expense of poor savers etc. Problem of NPLs remains the most dominant factor, affecting the earning capacity of the banks and hence the returns they offer to depositors.

Ratio of gross non-performing loans to total loans was 23.5% in 1997, being as high as 50.6% for specialized banks and 31.3% for nationalised commercial banks. The NCBs and DFIs were the major sources of bad loans, accounting for 90% of the bad loans in the entire system and were the main loss makers.

The concerted efforts of the State Bank and the government's comprehensive accountability drive brought about positive response. Cash recovery in the three year period totaled Rs.70 billion, or a third of the stock of loan defaults.

While the quantum figure of gross NPLs have risen from Rs.173 billion in 1997 to Rs.236.7 billion in 2000, it reflects the change in the basis of reporting. In recent years, SBP has adopted more vigorous standards for classifying loans, improved the reporting and disclosure requirements. The proportion of net NPLs to net advances ratio shows improvement. It however, still remains the major factor affecting the earning capacity of banks.

The gross NPLs to gross advances ratio has declined marginally to 23.3% for all banks in 2000. In case of NCBs, this improvement is much more pronounced, (from 31.3% in 1997 to 26.5% in 2000) given their share in total NPLs. This shows that fresh loans are being extended much more prudently than was the case earlier.

Earnings & profit-ability better

Measures undertaken by the banks have helped improve the sector's earning and profitability. The SBP Annual Report 2000-01, shows that return on assets (ROA) (after tax) and net interest margin showed an improvement in 2000 over 1997.

The ROA ratio of the banking industry remained negative during 1997-99, primarily on account of losses suffered by NCBs and specialized banks. As NCBs have a large share in the banking industry, their performance overshadows other banks. Profit earned by this group in 2000 resulted in a positive value of ROA of the banking industry.

Net interest margin has risen for NCBs from 1.5% in 1997 to 3.4% in 2000, while for all banks it rose from 2.8% to 3.3%.

Manage-ment indicators

The SBP Annual Report 2000-01, has through some indicators gauged the change in management quality of the banking institutions in the last four years. The expenditure to income ratio, for NCBs has declined from 104.5% in 1999 to 95.4% in 2000. The ratio of provisioning to total expenditure has also come down. There is however, an across the board increase in administrative expenses to total expenditure.

There were also more stringent disclosure standards imposed by the Central Bank. Legal and judicial reforms implemented in the past three years have facilitated financial contract dispute resolution. Implementation of court judgements is still ineffective partly due to remaining weaknesses in the law.

With regard to NCBs, the staff and branch rationalisation program is expected to bring down their cost/income ratios closer to international benchmark of 0.50.

The reduction in the branch network would enable the banks to upgrade the technology needed and improve the quality of financial services offered. The reduction in branches would lead to organizational transformation, fewer layers of hierarchy would reduce head office bureaucracy, have stronger controls and improved internal communications.

However, certain reform processes have to be strengthened further, with focus on bank privatisation as the next step in the process.

Pakistan's Development Priorities

Pakistan today faces multi-dimensional challenges; slow economic growth, high debt burden, more and more people slipping below the poverty line, social indicators deteriorating, law and order and corruption thwarting the investment climate, investor confidence at low ebb and deterioration in institutions of governance.

Weak-nesses in the economy

While Pakistan has witnessed long periods of sustained economic growth, it has failed to trickle down and translate into the betterment of lives of the vast majority. Today, one in every three families is poor, having concomitant implications on law and order. The problem worsened in the 1990s with declining economic growth, which resulted in shrinking employment opportunities and widespread poverty. Against an average growth of 6% per annum in the 1980s, the real GDP growth slowed to an average of 5%, in the first half and 4% in the second half of the 90s.

Poor governance

While the 1990s experienced slow economic growth, it also witnessed significant deterioration in institutions of governance, and the state's capacity to deliver social and economic services markedly eroded. Weak governance contributed to slowing economic growth, reducing the effectiveness of public expenditure undermined investor confidence, encouraged tax evasion, loan defaults, and non-payment of utility bills.

Lagging social indicators

Pakistan under performs other countries with similar per capita income in most social indicators, with a large gender gap. A large percentage of the population is afflicted by illiteracy and ill-health, severely limiting the possibilities of economic growth. In today's world no country can make much progress without an educated and healthy workforce.

In Pakistan, an adult literacy rate of 45% compares poorly with Sri Lanka's 91% or a weighted average of 54% for South Asia. The gender disparity is much higher (59% males, 30% females). Public expenditure on education is 2.7% in Pakistan as against 3.2% in India and Nepal, 3.4% in Sri Lanka, 4.1% in Bhutan and 6.4% in Maldives. On health, Pakistan spends 0.9% of GDP against 1.67% by Bangladesh, 1.4% in Sri Lanka and Nepal each, and 5.3% in Maldives.

Burden of public debt

A major challenge facing the economy today is the burden of domestic and external debt. The problem has reached a crisis proportion with rising debt servicing, constraining government's ability to spend on key development activities.

Large and persistent fiscal and current account deficits, imprudent use of borrowed resources, such as wasteful government spending, undertaking low economic priority development projects and poor implementation of foreign aided projects, weakening of debt servicing capacity in terms of stagnation or decline in real government revenues and exports and rising real cost of government borrowing, both domestic and foreign has resulted in a large debt burden.

Low investment

Investment which plays a key role in the growth potential of a country has decelerated in recent years. A number of factors like, continuing effect of the tax survey, weakening Rupee, excess capacity in industries like cement, sugar, in the face of sluggish demand, problems of law & order, inadequate infrastructure have acted as impediments towards any new investment by private sector.

Development Policy

The Government of Pakistan has chalked out a detailed reform agenda, prioritizing the weak areas and giving a direction to be pursued, to improve and better the many weaknesses that prevail in the economy.

Poverty reduction & human develop-ment

Governments have in the past tackled the problem of illiteracy and ill-health and the plight of the poor in Pakistan without much results. The poor are not only deprived of income and resources, but they also lack such basic needs like education, health and clean drinking water. The problem is further accentuated by institutions of governance that tend to exclude the most vulnerable from the decision making process.

Pakistan has grown much more than many other low-income countries, but failed to achieve social progress commensurate with its economic growth. It faces major problems regarding both social and gender gaps. Given that human capital is critical in achieving long term economic growth, the widening social gaps acts as a constraint to faster growth.

It was because of under-achievement in human development, that the Social Action Program was launched by the government in 1992-93 with the aid of donor financing and technical assistance. It was aimed at increasing public spending on social development and improving the institutional and policy framework for service delivery.

A World Bank Report *'Pakistan Development Policy Review: A New Dawn?'*, states, "the record of SAP in terms of improving outcomes in the target sectors was generally disappointing. While improvements did occur in some health and population indicators, the gains were at best marginal in education. It appears that the first phase of SAP succeeded to some extent in terms of creating more physical facilities, but quality enhancement by improving accountability among service providers made little headway."

The government has placed social development on the centre stage and has committed to expanding social expenditure. The Human Development Strategy developed by GoP is articulated in the Interim Poverty Reduction Strategy Paper (I-PRSP), published late last year.

The strategy for Poverty Reduction centers on unleashing growth, improving indicators of human development and reforming the institutions of governance. Ongoing reforms focus on the education and health sector, involves investments in school rehabilitation, teacher training, adult literacy campaign, mainstreaming the madrassas, a pilot school nutrition program, technical education in secondary schools etc.

In the health sector, the government plans to raise public sector health expenditures, with a focus on prevention and control programs, reproductive health, child health and nutrient deficiencies and communicable diseases. The focus is to address these issues via devolution. Over the long term the plan is to give more responsibility for health delivery mechanism, to the district level and increasing cost recovery, with subsidies focused only on the poor through zakat.

Improving governance

A major challenge confronting policy makers is the issue of governance – political, institutional and economic. In the structural reform program being pursued by the government, governance is an integral part of economic policy. It is felt that the increase in the incidence of poverty in the 90s was not solely attributable to slow growth, for the decade also experienced significant deterioration in institutions of governance and the state's capacity to deliver social and economic service had markedly eroded.

Improving governance is the key to a conducive investment climate and the delivery of basic services. The government has developed a program that addresses all three concerns of governance.

Political governance initiative

Pakistan is pursing a policy of decentralization or devolution of political and fiscal powers to new local governments. This initiative would make the locally elected governments more accountable, and would help improve the delivery of local services like education, health, water supply and sanitation.

After political decentralisation the next step is fiscal decentralisation and empowerment given in preparation of budgets, selection of projects and allocation of funds by district governments.

Institut-ional governance initiatives

A National Accountability Bureau (NAB) has been established for effectively enforcing accountability. It would investigate and prosecute matters relating to abuse of public office and wilful default.

At the Pakistan Development Forum meeting in April, the World Bank highlighted governance improvement as the key to improving the investment climate and the delivery of basic services. It stated "Reforms of a few institutions hold the key to the country's development. These are the reforms of Central Board of Revenue, Water & Power Development Authority and Karachi Electric Supply Corporation, unanimously seen as most corrupt institutions and responsible for most of the harassment of the private sector."

The government is also pursing Pay & Pension Reforms, improvements in policy making for a more efficient and citizen oriented judicial and legal sector, reforming the civil service, where recruitment and promotion will be on merit.

Economic governance initiatives

In this category, measures have been taken to improve economic governance. It means pursing the privatisation and deregulation agenda. Government's regulatory role is being strengthened and the private sector is being encouraged to play a more active role. State Bank of Pakistan has been given greater autonomy and nationalised commercial banks/development financial institutions are being restructured to be privatised, while some DFIs will be dissolved/ merged. Operational efficiency of public sector corporations is being looked into by positioning of professional corporate management, alongwith restructuring of big corporations. Debt management is being emphasised and so also fiscal reforms.

Debt overhang & GoP initiatives

A key challenge being addressed by the authorities is the large public and external debt. The rigidity of budgetary expenditures and the lack of buoyancy in revenues have generated persistently large fiscal deficits over the last two decades, resulting in accumulation of public debt.

The country has incurred large current account deficits, the financing of which has created an unsustainable external debt problem. This has greater immediacy because of the concentration of large external debt service payments, which cannot be met without financing from IMF and other multilateral institutions and further debt rescheduling from the Paris Club.

The present government constituted a Committee to design a strategy to reduce debt burden and to suggest an efficient debt management system. The Report has shown that growing debt burden has been a fundamental cause of many of Pakistan's problems, including the slowdown of overall economic growth, increase in poverty incidence, the low levels of social welfare indicators, among others.

The Report shows the links between high debt burden and slow economic growth — reduced net external resources constrains investments, large government domestic borrowings keeps real interest rates high and discourages private investment. The later is also constrained by shortage of complementary infrastructure due to inadequate fiscal resources.

Debt reduction strategy

The Debt Reduction Strategy plans to improve debt payment capacity through reduction in the debt burden and a significant increase in the rate of economic growth. The elements of the strategy include, reducing fiscal deficits, increasing government revenues, expanding exports, accelerating privatisation, and strengthening the oil & gas and information technology sectors.

Achieving government revenue targets is to be pursued through a combination of eliminating exemptions, fundamental institutional changes in the CBR and with devolution and increased responsibilities at the district level among other steps.

Some changes have also been made to lower domestic debt costs. Return on National Savings Schemes were subject to three cuts after May 1999 and in early 2000 were linked to the market based yields on PIBs launched in December 2000.

If Pakistan is able to implement the fiscal, structural and social reforms it has embarked upon, there is a good chance of putting the debt ratios at a favourable level.

Low investments levels

Pakistan has not succeeded in raising investment levels to take the economy to a higher growth path, essential for fighting poverty. Total investment as a share of GDP fell from around 18% of GDP at the beginning of the 1990s to about 13% by 2000-01, reflecting declines both in the public sector and in private investment.

Unanticipated policy changes by successive governments, regional political instability, cumbersome labour laws, plethora of regulations and procedures, lack of proper infrastructure, problems of law & order adversely affect the inflow investment. The problem is basically one of governance, involving the decay of law enforcement institutions.

Continuity of reforms and steps taken to address issues of governance - assess existing regulation and procedures so to eliminate red tapism; judicial reforms aimed at strengthening the rule of law and enhancing the accessibility of the legal system; and improving infrastructure i.e. uninterrupted power supply, efficient port operations, rail and telecommunication network should help improve the investment climate.

Initiatives have been taken to address major areas of priority which deserve government attention - consolidation of macroeconomic stability, revival of economic growth, reduction of the public debt burden and change in the composition of public expenditures towards poverty reduction and social sector development. Hopefully it will be more pro-poor than in the past. The World Bank in a recent report said "the main message to Pakistani policymakers is to stay the course, maintaining a balance between the competing priorities of increasing development spending and exiting the debt trap."

Pre-Budget 2002-03

The forthcoming Federal Budget 2002-03 is expected to be announced by mid-June. The government's structural reform program being pursued is expected to be reflected in the Budget. Past efforts to rectify some of the macroeconomic imbalances have been fairly successful. Prudent fiscal and monetary policies succeeded in reducing the budget deficit significantly and in containing inflation. However, the reduction in the deficit was achieved at the expense of development spending.

Encouraging developments

Financial sector reforms were responsible for strengthening the banking system, public sector banks cut operating losses by reducing staff and closing branches. The share of non-performing loans started to stabilize due to intensified recovery and better quality new loans.

The government's stabilisation policy has largely succeeded in restoring macroeconomic stability and the reform program has laid the foundation for sustained high economic growth in the long run. While some key economic fundamentals have improved, certain areas continue to be weak and are a source of concern.

Debt (both external & domestic) is a serious problem for Pakistan's economic management. It pre-empts a large chunk of budgetary revenues necessitating cut backs on essential public expenditure for promoting growth and poverty reduction. It also consumes large parts of export earnings and government has to borrow to meet the non-development expenditures.

Rising domestic debt has generated persistently large fiscal deficits over the past two decades.

While a Debt Management Strategy has been designed and appropriate policies are being pursued, its success would depend on the performance of Pakistan's macroeconomic policies particularly with regard to fiscal consolidation backed by a strong structural adjustment program.

Poverty

The Budget is expected to address the high and rising levels of poverty. Poverty has increased from 21% in 1990-91 to 35% in 1998-99, largely attributed to macro level factors, such as decrease in overseas remittances high unemployment rate and low growth. Worsening employment situation during the 1990s explains the rapid rise in poverty during this period. Real wages of the employees in public sector have fallen due to inadequate adjustment to the cost of living in the nominal wages. The workforce in the informal sector has experienced a decline in their real wages.

Pakistan's major failure in the 1990s has been the continuing macro instability, slowdown of growth and rising poverty. Lack of attention to governance issues and institutional reforms have also played a major role in the backsliding of the reform process.

The I-PRSP promises a new priority in spending commitments toward the social sectors, and is also hoping that the devolved local authorities will increase the effectiveness of service delivery. The focus of efforts will be to reduce the proportion of population living in deprivation. The key driven sectors emerge as education, health and nutrition.

The Report on *"Human Development in South Asia 2001"*, states "Pakistan needs to continue with the ongoing reform programs, but it must make sure that the poor are protected from short-term costs and the social sector expenditure, particularly on education and skill training, is increased to improve the quality of its labour."

Development expenditure

In the forthcoming Budget, allocations for development expenditures are expected to be higher, as more resources are made available because of Paris Club rescheduling and economic relief packages received. As costs of debt servicing will be lower, the government will have more to spend on development projects and also increase spending in areas of elementary education, primary health, drinking water and sanitation schemes, as well as on labour intensive projects which generate employment.

At times, development expenditures utilised during the year fall short of allocations to the various departments, which clearly indicates that the departments themselves have not been able to effectively utilise the money. One cannot emphasise enough on the need to improve the management of public expenditure.

Infras-tructure

As the economic program being pursued by the government seeks to improve the investment climate, infrastructure is expected to receive priority. Burdened with an inadequate infrastructure, where supply shortages from under investment in transmission and distribution capacity, power outages for hours, poorly maintained roads, poor services of railways and telephone act as major deterrents to any investment. Weaknesses in telecommunications has recently begun to be addressed, as the government wants to bring Pakistan in the mainstream of Global IT development through providing an enabling telecommunications infrastructure.

Agriculture

Agriculture is the other area, expected to receive due priority, given its contribution to the economy and the role it can play in poverty reduction in rural areas where 80% of the poor live.

In recent years, water has become the major factor limiting growth. Last year alone, in addition to losses in major crops, performance of fisheries also remained subdued due to lower water levels in rivers, lakes, reservoirs and dams. In absolute terms, the loss on account of a decline in value addition by agriculture stood at Rs.4.2 billion during the year, which limited the increase in value addition in GDP to Rs.16.6 billion.

Water management program is expected to play a key role to enhance water availability, thereby raising cropped area. Any renovation work involving irrigation canals and water courses would help raise the incomes of the poor in areas covered by the program.

Additional storage is needed to compensate for the capacity lost due to sedimentation and to increase the water delivered by the canal system. Improved water use efficiency requires rehabilitation, modernisation and efficient maintenance of the irrigation and drainage systems.

Fiscal reforms

The Budget is expected to continue with ongoing efforts to widen the tax base and meet the fiscal deficit target. A fiscal responsibility law is expected to be promulgated to put in place a mechanism to ensure prudent fiscal discipline from next year. The reform of CBR continues and the government is expected to announce an interim plan shortly.

Falling government revenues have severely compressed the fiscal space needed for poverty reduction initiatives. The stagnant taxes to GDP ratios in Pakistan are a result of a narrow tax base, weak tax administration, widespread corruption and tax evasion.

The reforms introduced focus on documentation aimed at improving tax compliance, restructuring of CBR and providing the tax payer a friendly environment. While the government is planning to increase its revenue it must not lose sight of the fact that a large portion of the economy remains untapped. There is a need to make progress toward putting agricultural income at par with other sources of income for income tax purposes. These and other steps should help promote fiscal discipline and correct macroeconomic imbalances.

Banking and Finance

Key Monetary Indicators

(Rs. Bn)

	April 27, 2002	*April 27, 2001*
Scheduled Banks Deposits	1392.6	1215.5
Scheduled Banks Advances	883.9	843.4
Scheduled Banks Investment in Securities & Shares	390.8	289.4
Notes in Circulation	450.8	395.7
Approved Foreign Exchange (Incl. Balances held outside Pakistan in approved foreign exchange)	237.7	67.9

Source: State Bank of Pakistan

Deposits grow

Scheduled banks deposits grew by 14.6% to Rs.1392.6 billion in the last week of April compared to the corresponding period a year ago, when deposits amounted to Rs.1215.5 billion.

Advances grow by 4.8%

Scheduled banks advances grew by 4.8% on April 27 to total Rs.883.9 billion, against the figure of Rs.843.4 billion a year ago.

Investment in securities show substantial gains

Scheduled banks investment in central government securities and shares has showed a gain of 35% over the corresponding period a year earlier. These investments rose to Rs.390.8 billion in the week ended April 27, over last year's corresponding figure of Rs.289.4 billion.

Meanwhile, the State Bank of Pakistan has kept the cut off yields on six month and one year Treasury Bills almost unchanged at around 6.43% and 6.99% respectively. By keeping rates unchanged, the Central Bank reinforces its earlier signal of maintaining interest rates stability.

Notes in circulation

Notes in circulation rose by 13% to Rs.450.8 billion in the week ended April 27, 2002 against last year's corresponding figure of Rs.395.7 billion.

Approved foreign exchange rises substantially

Pakistan's approved foreign exchange including balances held outside Pakistan showed a substantial rise of three and a half times to stand at Rs.237.7 billion against last year's corresponding figure of Rs.67.9 billion.

Real Cost of Domestic Debt

The government's growing indebtedness has become the gravest problem faced by the economy. Of the total domestic debt aggregating Rs.1708.5 billion, 40% is unfunded debt largely comprising of National Saving Schemes.

In the 1980s the government was paying high nominal interest rates on these instruments, while inflation was still relatively low. This was however, initially not having an impact on government interest payments, because the weight of unfunded debt was small and bulk of NSS is in the form of zero coupon five or ten year certificates, the interest of which is recorded when they are encashed.

In the late 1980s and early 1990s the attractive returns on NSS instruments led to a rise in interest payments on domestic debt, making the fiscal deficit reduction difficult. The government had to resort to large borrowings from the banking system to finance the deficit.

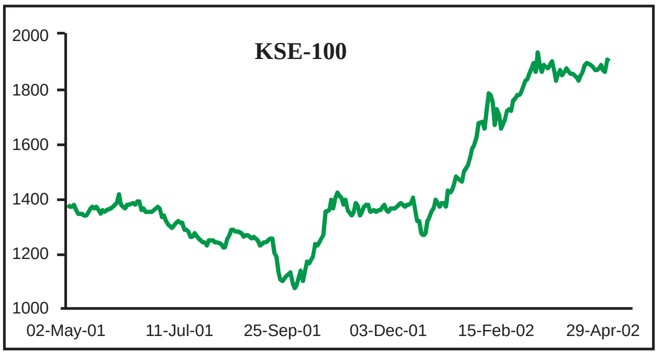
The real cost of domestic borrowings has risen upto an average of 9% per annum over 1998-2000, as inflation rate dropped and nominal interest rates stayed high.

It was in 1999 when the government decided to rationalize interest rate structures. Returns on NSS instruments were reduced, there was a ban on institutional investment, and the government decided to use the yield structure on Pakistan Investment Bonds as a benchmark to determine the profit structure on NSS instruments, especially Defence Saving Certificates.

Even after a reduction in the rates of return on NSS since May 1999, the average interest rate paid on these schemes will remain high for some years because of the substantial time lags between purchase date and encashment (3-10 years). The Debt Reduction Strategy assumes that real cost of government domestic borrowings can be brought down to 3-4% in the coming years, through a reduction in rates offered for fresh borrowings.

Market Analysis

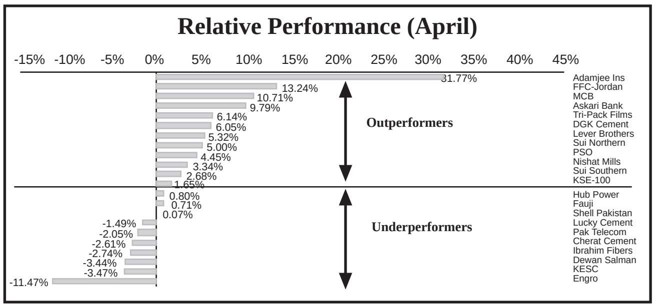
KSE Performance in April and Outlook



Performance

The KSE-100 Index gained 30.84 points (MoM) in April to close at 1897. Average trading volume declined to 136m shares from 195m shares in March. The rise in the index (MoM) was due to a short spurt on the second last day of the month, which saw an increase of 45 points on the eve of the referendum. In fact, the referendum was the key factor that did not allow the market to decline.

The other factors that kept the market stable were: a strong earnings report, and a surprise second interim dividend, from PSO; low *badla* rates (in line with lower money market rates); and stable prices of second tier stocks.



Outlook - depressed

With the referendum over, we believe the market will witness a correction which has been due for some time; there is no foreseeable strong fundamental development that could prompt a major upside move. The low trading volumes also indicate the wavering interest of investors and traders in the market. In our view, the market has a relatively greater downside risk than upside potential at the moment. We think the second tier stocks that have appreciated on speculative factors may also witness declines.

Pivotal Stocks

PSO - keep an eye on developments

PSO continued its role of *market driver* for this month as well. The expectation of significantly improved results made it a pick for investors as well as traders. The stock witnessed a month low of Rs153.4 on the first day of the month, and ended the month on Rs164.15.

The results were in line with market expectations, however, the market had already incorporated the increased profits in the stock price. Hence, after seeing a high of Rs167.8 the price declined, as investors and traders booked profits.

We believe the stock will witness a temporary decline in the coming month in line with the overall market. However, the full year results are expected to improve further on the back of the margin increase. Any tangible development on the privatization front can also rejuvenate the stock price.

Hubco - neutral outlook

Hubco's nil dividend announcement this quarter ended any chance of speculative trading in the stock. The stock moved in a narrow band of Rs23.7 to Rs25.2 for the whole month.

The stock is a stable dividend paying stock; however with two big dividends still in store, the stock attracts considerable interest. It is also a good stock for longer-term investment with respect to dividend yield. We believe the stock price will be stable in the coming month, with slight movements in line with the overall market trend.

PTCL - depressed outlook

PTCL has not played the market driver role in the *bull run*, which started on October 01. The stock moved in a narrow band of Rs18.25 and Rs19.4 this month.

We believe the stock will continue its second fiddle role in the coming month as well. There has been no development on the privatization front for the company, which could have increased market interest in the stock. Hence we believe the stock will decline in line with the overall market.

ICI - short term weakness

ICI had an eventful month: the month started with accumulation of the stock by a leading broker to win a seat on the board of directors; ICI management successfully fended off the challenge, causing traders to dump the stock in the wake of the failed attempt; as a result, the stock began surrendering its recent gains.

The second event that affected the stock was the low PAT in the first quarter for the company, thus reinforcing the down-trend that had already begun.

The third bombshell was dropped at the end of the month, when the company's board of directors announced that ICI would be subscribing to the huge rights issue announced by Pakistan PTA (although the decision is subject to approval by the shareholders, given ICI PLC's overwhelming majority, shareholder approval ought to be a formality). However, that investment would not result in additional funds being injected into Pakistan PTA; through the rights issue, ICI Pakistan will convert Rs1.5b of the Rs1.8b existing subordinated loan to Pakistan PTA into equity. To the extent of the conversion, however, this swap will result in lower *other income* to ICI, since the company will not earn any return on its equity investment to compensate it for the loss of the interest income it was booking on the loan.

The decision by ICI to continue carrying the burden of Pakistan PTA will have a negative impact on investors' perception of the stock, which effect will be visible in the future short-term price performance. We believe the stock price will see further erosion in the coming month.

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

Key Economic Indicators

Economy Size & Growth		1997-98	1998-99	1999-00	2000-01P
GNP - Market Prices	Rs bn	2653.3	2912.8	3138.1	3411.3
GDP - Market Prices	Rs bn	2677.7	2938.4	3182.8	3472.1
Per Capita Income	Market Prices Rs	20415	21899	23073	24528
	Market Prices US $	473	438	446	429
Growth					
GDP	%	3.50	4.18	3.89	2.55
Agriculture	%	4.52	1.95	6.14	-2.49
Manufacturing	%	6.93	4.07	1.42	7.05
Services	%	1.64	4.99	4.79	4.38
Rate of Inflation	%				
Consumer Price Index		7.8	5.7	3.6	4.4
GDP Deflator		7.7	6.0	3.1	5.4
Balance of Payments	$ mn				
Exports (f.o.b.)		8434	7528	8190	8926
Imports (f.o.b.)		10301	9613	9602	10195
Trade Balance		-1867	-2085	-1412	-1269
Services Account (Net)^		-3264	-2618	-2794	-3137
Private Transfers (Net)^		3210	2274	3063	3898
Current Account Balance		-1911	-2429	-1143	-508
Fiscal Balance	% of GDP				
Total Revenue (Net)		16.0	15.9	17.0	16.3
Total Expenditure		23.7	22.0	23.4	21.7
Overall Deficit		7.7	6.1	6.4	5.3
Domestic & Foreign Debt					
Domestic Debt	Rs bn	1176.2	1375.9	1559.9	1708.5
As % GDP		43.9	46.8	49.0	49.2
Total External Debt[a]	$ bn	32.1	32.9	34.3	34.7
As % GDP		51.7	56.1	55.8	58.4
External Debt Servicing	$ bn	4.67	2.66	2.98	3.33
Investment & Savings	% of GNP				
Gross Investment		17.9	15.7	15.8	14.9
Fixed Investment		15.2	14.1	14.2	13.3
National Savings		14.8	11.8	13.9	12.9
Domestic Savings	% of GDP	16.0	12.9	15.4	14.5
Foreign Investment	$ mn	822.6	499.6	543.4	182.0
Portfolio		221.3	27.3	73.5	-140.4
Direct		601.3	472.3	469.9	322.4
Monetary Aggregates	%				
M1		8.3	33.9	14.9	3.1
M2		14.5	6.2	9.4	8.9
Interest Rates (Weighted Average)	%				
Deposits*		8.38	7.96	6.62	6.58
Advances		15.64	14.80	13.52	13.61
Gold & Foreign Exchange Reserves	$ mn	1737	2371	2150	2666
Exchange Rate+	Rs./$				
Official Rate		46.23	51.60	52.16	64.40
Open Market Rate		54.20	54.40	54.82	66.70

P Provisional
^ Excluding official transfers
a Excludes foreign exchange liabilities
* PLS & Interest bearing
+ End-June Buying Rate

Source: Annual Report 2000-01, State Bank of Pakistan

NBP Performance at a Glance

(Rs. Bn)

Items	1996	1997	1998	1999	2000
Income	28.2	34.2	34.5	35.3	33.7
Expenditure	29.5	33.2	32.4	34.8	32.7
Pre-Tax Profit/(Loss)	(1.26)	0.995	2.14	0.52	1.03
Total Assets	274.1	310.6	325.9	350.4	370.7
Deposits	235.9	254.9	273.4	294.8	316.5
Advances	85.9	105.6	109.5	122.6	140.3
Investments	108.2	109.5	102.9	91.5	80.4
Number of Branches	1555	1445	1434	1431	1428
Number of Employees	23730	18096	15785	15541	15351