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NBP Performance at a Glance

## Editor's Corner

Dear Readers,

Pakistan's banking industry has largely remained unscathed from the direct impact of the world financial crisis. This was mainly because of strong resilience built over the years to a variety of shocks due to prudent regulatory and supervisory environment, strengthening of risk management and governance standards, and no direct exposure to securitized instruments. In contrast to the liberalized financial system in the west, which cost their financial industry heavily, the risk absorption capacity of the banking system in Pakistan has developed, as the State Bank of Pakistan has in a place strong regulatory policy and stringent loan provisioning requirement.

However, there have been indirect implications of the international financial crisis. With a slowdown in economic growth in leading developed countries, its spill over effects has impacted other economies. It is manifested in the slowdown in demand for exports, reduced inflows of foreign investment, and external financing, deterioration in the current account deficit, ability to tap international capital markets severely impaired, sovereign debt issues postponed, among others. Coupled with domestic political uncertainty, power outages, loss of investor confidence, and other adverse developments in the macro economic environment started to have an effect on the country's banking industry.

While the domestic banking industry has withstood the shocks it faced in the last year and a half, the economic slowdown and pressures from the macro economic environment has put pressures on the balance sheet of corporates, which in turn has impacted the asset quality ratios of the banking system.

The deterioration in the operating environment of the banking system, built due to both domestic and external factors affected the asset quality of the banking system which showed considerable worsening last year, as banks' total non-performing loans increased sharply by 52.2 percent (i.e. Rs107.6 billion) over the December 2007 level to reach Rs313.7 billion by end December 2008. The NPLs to loan ratio has risen from 7.44 percent at end December 2007 to reach 9.13 percent by December 2008.

Banks' group wise data shows that both public and private banks are facing the rising burden of bad loans. With an increase in the NPLs of the banking system, more banks are now facing rising NPLs. It is the relatively larger banks that were facing greater increase in NPLs in 2008. The NPLs to loan ratio has increased across all banking groups, with a significant rise for local private banks and foreign banks. The infection ratio for public sector banks at 2.88 percent is higher than industry average. The industry average ratio has risen from 1.9 percent by the end of 2007 to 2.5 percent by end December 2008.

During the year 2008, sector-wise NPLs to loan ratio increased for the corporate sector (where textiles, sugar, and auto sector face rising NPLs – advance ratio) for SMEs, consumer financing and commodity financing. For SMEs the ratio had risen to a high of 15.79 over a year earlier figure of 9.25 percent, for textiles to 14.6 percent from 10.74 percent, for consumer sector to 6.93 percent from 4.37 percent, where all sub-sectors, credit cards, auto loans, consumer durables and mortgage loans showed increases. For the agriculture sector while the ratio is still high at 15.77 percent, it has declined from 18.68 percent a year earlier.

*Ayesha Mahmood*

## Pre-Budget Economic Scenario

The forthcoming Federal Budget 2009-10 is being presented at a time when the government is confronted with economic, political and formidable security challenges. This is indeed a test for the new democratic government and its capacity for handling such gigantic issues together. On the economic front, there is a need to correct serious imbalances in fiscal and external accounts, improve the investment climate, develop programmes of social protection focusing on skill development for the young, provide employment opportunities, pursue a pro-poor growth strategy, so to check the maldistribution of income and deprivation with its concomitant social consequences, develop the power sector so to reduce power outages which adversely impacts industrial production, and other sectors, include the poor in the process of investment and economic growth so to make a substantial dent into the poverty problem. Any revival of growth to a sustained level, would require narrowing the saving – investment gap and reducing the high dependence on external resources and develop a contingency plan against external risks.

Challenges for the government

To bring any meaningful improvement in the economy and take forward the process of recovery which is necessary to stimulate economic growth, the government will have to address the problem posed by the continuing deterioration in the state of security and most of all priority to be given to the welfare of the people, for if they are happy and have confidence in the state institutions they would not resort to street politics, which negatively impacts the investment climate.

Pakistan has in place an IMF supported programme to address the macroeconomic imbalances. It was in October 2008, that the government embarked on a stabilisation programme, supported by a Standby Arrangement (SBA) to correct the deteriorating macroeconomic situation.

IMF programme

In FY08, both fiscal and current account balances widened significantly, foreign exchange reserves showed a declining trend, inflationary pressures picked up, stock market

showed a drastic fall as foreign capital fled, inflow of foreign direct investment slowed, private investment declined, government borrowings from the central bank rose significantly, and Pak Rupee came under pressure.

### Trend in Selected Indicators

Year	GDP Growth	Fiscal Deficit	Current Account % of GDP	Trade Balance % of GDP	Total Foreign Exchange Reserves (\$ Bn)	Debt Indicators % of GDP	
						Total	External
2004	7.4	(-2.9)	1.3	(-1.2)	12.4	71.2	34.1
2005	7.7	(-3.3)	(-1.6)	(-4.0)	12.6	65.8	31.1
2006	6.2	(-4.3)	(-4.0)	(-6.6)	13.1	60.0	28.2
2007	6.0	(-4.3)	(-4.8)	(-6.8)	15.6	57.9	27.1
2008	6.0	(-7.4)	(-8.4)	(-9.1)	11.4	58.8	26.5

Source: ADB Outlook 2009

The prevailing economic condition of Pakistan in FY08 can be gauged from the following excerpts from the *Asian Development Outlook 2009*: -

- During FY08, the economic situation deteriorated significantly after 5 years of respectable growth that averaged around 7 percent.
- Growth dropped to 5.8 percent in FY08. Significant factors constraining growth have been the sharp decline in the growth of private investment resulting from political uncertainty, the worsening security situation, and the impact of high international oil prices and frequent power shortages.
- Aggravated by unprecedented oil and food price shocks in FY08, though, the economy started having problems attracting inflows, and its economic fundamentals worsened.
- The contribution of investment to growth fell to only 0.7 percentage points in FY08 compared to 2.7 percentage points in the preceding fiscal year.
- On the supply side, growth in agriculture and industry was less than half the respective targets for FY08.
- Industrial growth remained subdued.

Economic conditions in 2008

Box

***Pakistan: 2009 Article IV Consultation and  
First Review Under the Stand-By Arrangement  
Staff Report, April 2009, IMF Country Report No.09/123***

In October 2008, the Government embarked on a stabilization program for 2008/09-2009/10 aimed at restoring financial stability while protecting the poor. This program, supported by the SBA approved on November 24, envisages a significant tightening of fiscal and monetary policies to bring down inflation and strengthen the external position, as well as several structural measures in the fiscal and financial sectors. Strengthening the social safety net is a key priority under the program.

The first review of Pakistan's economic performance under the Stand-by Arrangement was completed on March 16, 2009. We give below excerpts from the mentioned report.

- Initial developments since the approval of the program have been generally positive. The exchange rate has been broadly stable, enabling the SBP to buy foreign exchange on a net basis. As a result, gross reserves have strengthened from \$3.5 billion at end-October to \$6.7 billion as of February 20.
- Domestic activity has weakened while inflation has been falling more rapidly than expected, and the external current account deficit has been narrowing. A combination of domestic factors (energy shortages, high interest rates) and external factors (weakening global demand for textiles) resulted in a decline of nearly 6 percent in large-scale manufacturing output during the first half of 2008-09 and a sharp drop in exports in recent months. On the positive side, agricultural output will benefit from a bumper wheat crop in 2008-09, and significant increases in the rice and cotton crops should more than compensate for the decline in sugarcane production. With falling food and energy prices and lower economic activity, headline inflation has dropped faster than expected.
- In mid-December, the authorities removed the stock market price floor which has been in place for 3 ½ months. The feared massive capital outflows did not materialize. After the initial sharp drop, the Karachi Stock Exchange (KSE) 100 Index bottomed out in late January, following a cumulative decline of nearly 70 percent from its April 2008 peak. The stock market has since rebounded by about 20 percent but, like most other capital markets, is volatile.
- All structural benchmarks for the first program review have been met.
- The global economic and financial environment has deteriorated significantly since the SBA approval.
- The outlook for the remainder of 2008-09 remains difficult, in particular for the manufacturing sector. As a result, the growth projection for 2008-09 was revised downwards to 2.5 percent, from 3.4 percent in the original program. With a continued strong performance in agriculture and electricity sector reforms, which are expected to improve supply conditions in the large-scale manufacturing, growth is projected to pick up to 4 percent in 2009-10. Under conservative assumptions for the remainder of 2008-09 (food and energy prices remaining flat, and core inflation of one percent per month), year-on-year headline inflation would decline to 10 percent by June 2009 (compared with 20 percent in the program), and to 6.5 percent by June 2010.
- The external current account deficit is projected to narrow in 2008-09 and 2009-10, but there are downside risks. The projected external current account in 2008-09 is slightly better than originally envisaged, with lower imports expected to outweigh a weaker export performance. A further improvement is expected in 2009-10, mainly on account of the full-year effect of lower oil prices. However, the projected improvement in the current account may not materialize if exports drop sharply or private transfers decline.
- The financial account surplus is now expected to be slightly lower than originally projected, due mainly to the worsening environment for foreign direct investment (FDI) and privatization-related inflows. Disbursements of official budget support from China, a commodity support loan from Saudi Arabia, and higher disbursements under short term oil import facility from the Islamic Development Bank would offset delays in disbursements from the World Bank and the ADB. In addition, net private capital flows would be better than envisaged as the expected sharp outflow of foreign capital from the stock market did not materialize. Consequently, the overall external balance for 2008-09 is now projected to be better than programmed by about \$500 million.
- In the near term, fiscal policy will be challenged by the shortfalls of revenue and external financing. The slowdown in economic activity is affecting the revenue base and is likely to result in a shortfall in the Federal Board of Revenue (FBR) collections relative to the original 2008-09 program target. To help increase the revenue-to-GDP ratio by 0.6 percentage points in 2009-10, the authorities are also planning to broaden the tax base across all sectors of the economy, including by reducing the scope of tax exemptions and zero-rating.

## Box

- The fiscal deficit target for 2009-10 has been set at 3.4 percent of GDP, consistent with the fiscal effort of 0.9 percentage point of GDP envisaged in the original program.
- Cash transfers to the poor are projected to increase from 0.4 percent of GDP in 2008-09 to 0.6 percent in 2009-10.
- Real GDP growth is projected to recover to 4 percent next year, and to 7 percent a year by 2013-14. Headline inflation is expected to decline rapidly to 6 by 2009-10. The current account deficit is envisaged to narrow to more sustainable levels as fiscal consolidation continues and the real effective exchange rate adjusts gradually to its equilibrium level. This, together with improved market access, a recovery in foreign direct investment, and increased financing from official sources would enable the SBP to maintain the reserve cover of about three months of imports over the medium term.
- Growth will be sustained by structural reforms and increased public investment, especially in the energy sector, and improved access to water for agriculture.
- A significant increase in revenue as a share of GDP remains the cornerstone of the medium-term framework. In this regard, the introduction of a broad-based VAT, which constitutes the most important tax policy reform, is scheduled for 2010-11. An increase in the revenue-to-GDP ratio to above 14 percent of GDP by 2013-14, together with a sharp reduction in subsidies and ill-targeted development spending, would be needed to create fiscal space for high quality public investment and an adequate increase in outlays on poverty reduction.
- Pakistan's stabilization program is on track. Fiscal consolidation and improved coherence between fiscal and monetary policies are bringing under control the factors that led to large imbalances in recent years.
- Structural reforms have progressed broadly as envisaged. A contingency plan for handling problem banks has been prepared and is being strengthened; an action plan to reform tax policy and administration has been adopted and will be implemented with technical assistance from the IMF and the World Bank; and tariff differential electricity subsidies will be fully eliminated by the end of June 2009.
- Looking ahead, with the weaker global outlook and slower domestic activity, the risks to Pakistan's economic and financial prospects have risen notably. While Pakistan is benefiting from the decline in petroleum prices and the external current account deficit is narrowing, the decline in the demand for exports and uncertainty about workers' remittances are important risks to the external outlook. Weakening bank credit to the private sector and dimmer prospects for external private finance are also constraining growth. Political risk is also higher.
- Fiscal policy has come along well, but remains under pressure. The fiscal targets for December 2008-09 were met with great effort under difficult circumstances. Staff commends the authorities for adhering to the program's fiscal target for 2008-09 and the fiscal adjustment for 2009-10. The fiscal program for these two years, however, contains ambitious revenue targets in the context of slowing economic activity. The widening revenue shortfall in the third quarter of 2008-09 suggests that meeting the revised revenue target for 2008-09 will be challenging.
- There is a pressing need to strengthen the social safety net. Social protection is a key element of the authorities' programme.
- Over the medium term, higher budget revenues are critical for creating fiscal space for development and social spending. Government revenue are low by international standards, which constrains capital accumulation, spending on maintenance, and social outlays. Against this background, a vigorous implementation of the government's ambitious tax reform agenda is essential. Specifically, the replacement of the General Sales Tax with a broad-based VAT in 2010-11 is a key reform.
- The SBP's monetary policy stance is appropriate, and needs to remain flexible to address risks. Looking ahead, there should be scope for lowering interest rates, provided that inflation continues to decline, international reserves are further strengthened, and the government avoids recourse to SBP financing.
- The envisaged strengthening of the SBP's policy framework is welcome.
- Pakistan's financial system has weathered the crisis thus far, but needs to be monitored carefully. With the slowing in economic activity and rising NPLs, the risks to the system are rising. In this connection, the recent formulation of plans for dealing with problem banks is welcome.
- Pakistan needs additional external assistance to reduce risks and provide some scope for countercyclical policies by allowing greater development and social spending.

- The oil price shock and the high wheat import price led to a massive buildup of unbudgeted subsidies and resulted in a high fiscal deficit of 7.4 percent of GDP in FY08 – the highest in 9 years.
- In the absence of foreign inflows, the deficit had to be financed mainly through domestic borrowings from the central bank.
- Development expenditure planned in the budget had to be cut to accommodate the untargeted subsidies.
- The tax-to-GDP ratio remained at a low 10 percent.
- The steep depreciation of the Pak Rupee stoked inflation pressures. The consumer price index on a year-on-year basis climbed to 21.5 percent in June 2008 and to 25.3 percent in August – the highest in 30 years.
- The current account deficit widened to \$14.0 billion (8.4 percent of GDP) in FY08, from \$6.9 billion (4.8 percent) in FY07, as the trade balance recorded its highest-ever deficit of \$15.3 billion. Imports expanded almost twice as fast as exports. The oil import bill jumped by 43 percent and food imports by 46 percent in FY08 relative to FY07.
- Portfolio investment declined to just \$41 million from \$3.3 billion the prior year. Foreign direct investment in FY08 showed no change, at \$5.1 billion. The Government's privatization program stalled. Multilateral disbursements, however, recorded a 14 percent increase in FY08.
- Foreign exchange reserves dropped by almost one third, to end FY08 at \$11.0 billion.
- The financing burden of the fiscal and current accounts led to large accumulation of debt, both domestic and foreign. The debt-to-GDP ratio increased for the first time in 3 years to 58.8 percent.

The pressures on the different sectors of the economy was a result of the sharp rise in international prices of oil and other commodities in 2007-08, combined with internal political uncertainty and security concerns. It was to avoid a balance of payments crisis and default on foreign debt payments that the government developed a stabilization programme supported by the IMF.

Objective  
of IMF  
prog-  
ramme

Under this medium term stabilization programme, the objective is to restore macroeconomic stability and confidence through a tightening of macroeconomic policies and to provide support to the marginalized segment of society who have been hit by the crisis.

The areas that are targeted in the programme to meet the basic aim are: -

- External balance.
- Tightening of fiscal deficit, through phasing out of energy subsidies, prioritizing development spending and better administrative measures.
- Monetary tightening.
- Financial institution reform.
- Foreign exchange intervention by the State Bank, directed towards achieving the programmes reserve targets.
- Spending on social safety programme to be raised.

Since the implementation of the stabilization programme there has been a modest improvement in the macroeconomic situation, though substantial challenges persist. Growth in CPI inflation has softened, foreign exchange reserves have increased, which would allow for easing of monetary policy, and an improvement by the external sector and a narrowing of the fiscal deficit.

Due to the sharper than anticipated economic slowdown, GDP is projected to grow by between 2.5–3.5 percent in FY09, against the Annual Plan target of 5.5 percent and last year's growth of 5.8 percent. The domestic industry, especially the large scale manufacturing sector saw a decline in growth due to a host of factors; acute power and gas shortages, rise in input cost, deterioration in the law and order situation, weakening external demand adversely hit the export led industries, while high interest rates on consumer financing and reluctance shown by commercial banks in providing consumer financing had direct consequences for the automobile and electronic industries. Metal industry suffered due to high international commodity prices and sluggishness in domestic construction activity.

LSM  
shows  
sluggish-  
ness

CPI  
inflation  
comes  
down

Inflationary pressures have started to ease after touching historic highs of 25.3 percent in August 2008, which had led the State Bank to tighten credit. By end April '09, year-on-year general CPI had fallen to 17.2 percent, with food inflation at 17.0 percent against 34.1 percent in August '08, and non-food at 17.3 percent against 18.7 percent, due to falling food and energy prices and lower economic activity.

Foreign  
exchange  
reserves  
rise

The exchange rate has been broadly stable after having fallen steeply in the first four months of FY09. It owes its recovery to an improvement in Pakistan's external accounts. Foreign exchange reserves which had fallen early FY09, increased considerably in the later months. Net reserves with SBP have risen from \$3.5 billion at end December '08 to \$7.1 billion by end April '09, while total liquid reserves have risen in the corresponding period from \$6.7 billion to \$10.5 billion.

Trade  
balance  
improves

The trade deficit showed a contraction of 16 percent during July-April FY09, as the gap shrank to \$14.1 billion against \$16.8 billion in the comparable period of FY08. Imports at \$28.9 billion were 9.8 percent smaller over \$32.1 billion in the comparable period of FY08, while exports fell by 3.0 percent to \$14.76 billion against the earnings of \$15.2 billion in the corresponding period.

### Unit Value – Major Import Items

Items	(\$/MT)	
	July-April 2008-09	July-April 2007-08
Wheat	358.8	471.6
Palm Oil	800.0	856.5
Pulses	600.0	576.3
Petroleum Crude & Products	550.6	570.7
Raw Cotton	1621.5	1430.2
Fertilizer	494.5	425.7
Plastic Materials	1790.3	1605.0
Iron & Steel Scrap	307.8	281.0
Iron & Steel	716.3	586.0
Paper & Paper Board	855.6	792.0

Source: Federal Bureau of Statistics

Unit value of items like wheat, palm oil, petroleum crude and products has fallen, while it has increased for plastic material, iron & steel, paper & paper board etc.

The decline in import growth due to a decrease in international commodity and oil prices and a slowdown in economic activity has outweighed the 3 percent fall in export earnings, leading to an improvement in the trade balance. However, the slow growth in exports mainly because of shrinking demand in Pakistan's major markets and a fall in textiles exports is worrisome. Unit prices of major export items has fallen as seen in the Table below: -

### Unit Value – Major Export Items

Items	Unit	July-April 2008-09	July-April 2007-08
Rice	\$/MT	810.5	546.2
Raw Cotton	\$/MT	1077.4	1231.5
Cotton Yarn	\$/MT	2120.1	2324.7
Cotton Cloth	\$/SQM	1.00	1.00
Knitwear	\$/Dozen	16.75	18.52
Bedwear	\$/MT	5282.8	5736.2
Towels	\$/MT	3674.1	4074.0
Readymade Garments	\$/Dozen	41.57	37.1
Cement	\$/MT	58.23	53.82
Leather Tanned	\$/SQM	15.70	17.14
Leather Garments	\$/Dozen	479.0	467.0
Plastic Material	\$/MT	1196.7	1338.0

Source: Federal Bureau of Statistics

During the year, the balance of payments is expected to show an improvement, primarily due to a fall in import prices and an increase in remittances. The current account deficit is expected to be lower at 6.0 percent of GDP, compared to 8.4 percent of GDP last fiscal year.

BoP

In the next fiscal year, if import prices especially oil remain at current levels and the inflow of home remittances and FDI persist, then there could be a further moderation in the current account deficit. However, if the demand for exports decline, as the global crisis persist, and FDI suffers because of security concerns and home remittances drop if recessionary conditions in labour importing countries persist, the balance of payment could be adversely impacted.

Fiscal consolidation remains the conerstone of the medium term framework. The IMF programme envisages a significant tightening

of fiscal policy, as in the past years, one witnessed growing fiscal deficits, owing in large part to increasing energy subsidies and financed by the central bank it fuelled inflation. A fiscal deficit target of 4.2 percent has been set for the current fiscal year, against 7.4 percent in FY08, as the government has undertaken rationalisation of subsidies and a curtailment of development expenditure.

In the first half of the current fiscal year, the fiscal deficit dropped to 1.9 percent of projected GDP, compared to 3.4 percent in the first half of FY08. "There will be a reduction in fiscal deficit from 7.4 percent of GDP in 2007-08 to about 5 percent in 2008-09. Some slippage in the IMF suggested target is likely due particularly to the loss of momentum in tax revenues in the second half of the year. It is a good thing that the government has recently moved to retire circular debt of Rs80 billion related to the oil payments and energy. But it has involved additional borrowing equal to about 0.6 percent of GDP. Meanwhile, other public enterprise losses have continued to mount. In other words, the underlying fiscal deficit is significantly higher than the deficit on a cash flow basis", states the *Institute of Public Policy* second annual report entitled *State of the Economy: Emerging from the Crises*.

With few more weeks to go before the Federal Budget 2009-10 is announced, there are a number of considerations before the policy makers. Given the resource constraint they have to prioritize areas for development in all sectors of the economy, tackle issues like energy shortages, and water shortages which constrains growth of various sectors of the economy and has far reaching implications for exports, employment and poverty. Water shortages for example, have cost the country as much as Rs70 billion in 2007-08 and overall costs of load shedding to the industrial sector is about Rs157 billion, with a loss of industrial employment of 300,000 workers. Further, power load shedding has cost the country Rs210 billion, and over \$1 billion of export earnings. (*Second Annual Report 2009, Institute of Public Policy, Lahore*).

Development of the power sector with better management of electricity distribution is the

need of the hour and one hopes that policy makers when they prepare the Federal Budget would focus on this sector, as it has implications for all sectors of the economy.

Investing in enhancing power generation capacity in the country and upgrading existing power generation facilities, alongwith an improvement in the distribution system would go a long way in bringing about an end to the energy problems faced by the various economic sectors and would pave way for improved performance in the future.

Energy shortages and upward adjustments in their prices has raised the cost of production in local industry, and alongwith lower demand, particularly for consumer durables it contributed to the sluggish performance of the large scale industry. It is to be seen what the Budget has in store for this sector. To move forward, the small and medium sized enterprises in the informal sector would need focus of public policy. This sector employs large numbers, and if it is developed, it would not only contribute to increasing the rate of growth of GDP, but help reduce poverty and narrow income distribution in the country.

An issue that begs for government focus is providing employment to a rapidly growing workforce. The agricultural sector still remains the dominant source of employment in Pakistan. Targeting of the livestock and dairy sectors which are labour intensive can be an important strategy for employment augmentation in rural areas. The growth of the SME sector, could in part meet the challenge. The government has in practice a number of employment promotion measures, and by providing employment to large numbers, it could make a positive contribution towards reducing poverty.

A major thrust of the forthcoming Budget is expected to be on broadbasing of taxes, withdrawal of tax exemptions and improvement in tax administration, curtailment of current expenditure, raising PSDP, curtailing borrowings from the SBP, continuing with social protection initiatives and improving the law and order situation in the country.

Some slippages in tax revenues

Cost of water shortages and power outages

Enhanced power generation essential

Generate employment



## Economy's Health Before the Budget - A Private Sector Perspective

*Engr. M. A. Jabbar\**

The manufacturing sector with an 18 percent share in GDP, is a major contributor to the taxes collected in the country. The taxation system focuses on gathering a substantial part of the taxes from particular regions, while other sectors/regions of the economy have been given relaxation. The rate of sales tax 16%, 18.5% and 21% at import stage on raw materials for use in industrial sector adds to their financial cost, is another misplacement one that requires the needful correction. The output tax is 16% + 1% Special Excise Duty on manufactured produced. The collection of major part of direct taxes again accrues from LSM, Oil exploration, refining and distribution and presumptive tax related to allied industrial activities.

The indirect taxes also depict a similar trend, where major taxes are paid by LSM, (beverages, tobacco, cement, sugar), oil and gas exploration, refining and distribution. The sales tax on imports of capital goods and machinery is the first slot of taxation on investments. The 1% SED on these imports is also non adjustable from the output tax of SED at manufacturing. The custom duties are also levied on import on plant and machinery items.

The net result of taxation measures on manufacturing sector results in contribution of about three times of its share in the GDP of the country. In simple, one can say that the proportionate sharing of taxes of other sectors against their share in the GDP is not maintained for all the segments' of the economy and the tax burden is carried by the industrial sector. The manufacturing sector looks forward for re-grouping in the upcoming budget. This re-grouping in my opinion may be possible if the new venues and wide ranging exemptions and evasion are checked and brought in the tax net. This can release some pressure on the manufacturing sector. Some tax relief to the manufacturing sector will create a better climate for existing industrial units which will facilitate competing against imports and diversify surplus produce to the overseas market. The strength of expenditures charged

on quality improvements for compliance with technical barriers to trade will also be available through reduced burden of taxes on the industrial sector. The requirement of the technical compliances and the compliances to improve the hygiene requirements more appropriately abbreviated as TBT and SPS are the packaged deal of WTO. We have to live in the new world trading system where our industry has to adhere to all the requirements which countries impose as TBTs and as mandatory compliances of sanitary and phyto-sanitary. There is now no escape from these compliances for access to the markets of developed countries and emerging markets.

The industrial sector of Pakistan needs market access domestically as it is impeded by unfair traded values of similar imports. These imports land in the country under organized group under invoiced clearances combined with mis-declarations. The cost of finish goods by manufacturers in Pakistan faces difficulty in competing with the costs of such unfair traded similar goods in the market. The situation can only be corrected by the government by giving preference to the locally manufactured produce without violation of liberalization promises we have made in the WTO. Support to the domestic market through providing market access for local industrial produce may be based on grant of preferences for purchase by public sector organizations on the justified basis of realities existing on account of differential and higher costs of gas, electricity and petroleum.

The balance between domestic prices and the international prices of industrial inputs could be traded off with the preferences for domestic produce provided by policy supports. The weak infrastructure, high cost of financing, non correction of many areas due to restrains by IMF on account of meeting the fiscal deficits targets may constitute a reason for providing the considered preferential market access for locally produce industrial merchandise. No country can challenge such differential treatment on account of given differential

adjustment on the basis of justified reasons for manufacturing sector in the country.

The manufacturing sector in Pakistan is also a victim of inconsistency in policies due to change of governments. The past governments have taken different approaches towards policy formulation. Consistency may be achieved by some legislative approaches, example of which would be to continue with the benefits of certain statutory order for growth of certain industries. The inconsistency can be eliminated by making policies time bound for atleast 10 years or marking any bench mark of period from the time of the commercial production of certain manufacturing sector through SRO. The adhoc decisions which bring the changes in the tax structure on imports or exports may be avoided as much as possible, however, certain compromises have to be struck in the general interest of industry at large.

The industrial sector's demand from the budget is based on protection and the demand by the trade is for liberalization; as such budgetary measures must balance conflicting demands. At the time of budgetary exercise, the frame work for development of the manufacturing sector should be based on cascading of duties structures more minutely. The country should prefer promoting industrial sector and it is a choice between employment and instability as the industrial economy can absorb the available labour force which is growing yearly at a faster rate than the rate of growth of industrial economy. The abuse of Afghan transit trade has also been the root cause of under-capacity utilization and cross bordering from one financially stable industry to new industry due to menace created by rebounding cargoes from Afghanistan for consumption in Pakistan. The tax compliant manufacturing sector contributing about 60% of the total taxes in Pakistan cannot compete with the cost of zero rated imports which rebound from Afghanistan to the local market.

The trade policy also plays a big role in promoting manufacturing sector. One part is the direction for budgetary tariff measures and the other part is the direction for different facilitating ministries to support the industrial

growth in an environment in which industrial policy becomes the guide book for investments of future by locals and helps in inflows of FDI in the green field. The state of art laboratories in the industrial estates maybe developed out of the trade policy initiatives, with budgetary allocation support. The laboratories in the individual manufacturing units may be subsidized on the cost of borrowing so that needful correction for productive utilization is ensured with ownership of the industry. The state and public sector supported laboratories uptil now have not responded to the level of supported funds and resources invested uptil now. The skill development centers in the industrial estates with a board, chaired by private sector may prepare the industry for productivity gains which at present is 160 percent lower than China.

The manufacturing units in the industrial estates may be allowed relaxation in the national power policy, to allow setting-up of the power plants upto 50 MW, preferably through subsidized industrial loans. The industries can share the outages and load shedding and will thus acquire the entrepreneurship of managing a small distribution network. They should also be allowed to pool in money for forming companies to help themselves in the upcoming power scenario which appears to be still uncomfortable despite the ongoing efforts of the Government for creating power contingencies for assuring reliable and uninterrupted power. We have hydro which cannot work at full load all year, we have gas powered plants which however, cannot ensure meeting the entire electricity demand when gas pressure is low in winters and when residential gas demand rises. This situation may be taken care by liberalizing and relaxing the present power policies to provide reserve power from industrial estates for meeting rising demand for the power generation.

The manufacturing is facing tremendous pressure on account of inspection by more-than 22 agencies. The inspections generate corrupt practices than seek end results for the purpose these inspections are made. Some of the inspections relate to labour levies. The

manufacturing should be liberated from this counting procedure of labour in matter of arithmetics of labour levies. To reduce the windows of inspections, percentage of turnover of the manufacturing unit should suffice for avoiding the hassle of inspections in matter of labour levies.

The economy is set to post economic growth in the range of 2.5 percent to 3.5 percent which is much lower than its historical average, thus affecting the manufacturing performance, as shrinking demand affects the performance of industries. We have to consider contingencies for creating market access for domestic industry in the public sector development programmes, and where we have surplus, we should endeavour to export with intervening support of public sector. After all when the private sector becomes weak, the support of government becomes inevitable. What is happening in the west is an example for us. In a country like ours it may be considered as subsidy for employment generation or a subsidy to discontinue the decrease in employment. The example would be a case study which shows that due to power outages, more than 100,000 labour force has been laid off and one can say that 2 hours on average outages for small industrial units disturbs its competitive cost in the market which is flooded with imports of similar products. It also serves to lower the production and productivity, and SMEs would find it difficult to find a niche in the export markets.

Large-scale manufacturing depicted a decline of 5.73% during July-February 2008-09 as against 5.27% positive growth in the comparable period of last year. This would reduce the share of manufacturing in GDP as well as the opportunities for gainful employment. Employment opportunities are needed for the increasing workforce, which is rising with the increase in population. The configuration of population shows young force available for work in industrial sector. They can be absorbed subject to growth of manufacturing sector, in which LSM has a relatively large share. The revenues contributed by LSM growth can assist the socio economy uplift of the economy.

Main items showing positive growth included; fertilizer (24.29%), glass sheets & plates (17.38%), cement (6.52%), chemicals (4.39%), leather products (3.83%), paper & paper board (3.80%) and engineering products (2.54%). Despite a slowdown in the economy some sectors are still showing positive growth trends, sustaining of which should be considered in the budgetary measures, especially by reducing the burden of taxes on these industries. Reduction or withdrawal of taxes on petroleum, gas, electricity and fertilizer would be more appropriate. The revenue loss could be compensated possibly by bringing the service sectors into the tax net with a 50 percent share in GDP.

Major items showing decline in production includes, automobiles (-38.22%), electronics (-22.21%), petroleum products (-8.40%), food & beverages (-6.38%), rubber products (-5.35%), and iron & steel products (-4.65%). These manufacturing sub-sectors need to be supported by budgetary measures, by considering containing the cost of inputs which has risen sharply. The automobile sector has been grouped with auto industrial development programme, approved by the cabinet which must ensure the elimination of inconsistency in the policy with respect to its development as promised through tariff based system.

The domestic electronics sub-sector needs market access against similar imports. This can be facilitated through policy support out of the budgetary decisions legislated as statutory order support for tariff cascading which helps in competing the cost of imports as finished products. With the other manufacturing sub-sector like iron and steel, as development takes place the use of iron and steel will always pickup, and budgetary adjustments drive the manufacturing sector to support the iron and steel sector. Pakistan has been identified as the market available for iron and steel, as private sector parties are in the process of establishing iron and steel manufacturing units near Port Qasim and are selecting other areas for setting up of similar facilities.

The inflation rate as measured by the changes in Consumer Price Index (CPI) reached

19.1% in March 2009 after reaching a record level of 25.5% in August 2008. As this trend is expected to decline further, it would envisage the need for a policy that addresses the markup issues. Perhaps KIBOR plus few hundred basis points for short term and higher basis points for long term financing can make any drive for a good financial statement in manufacturing sector. It is proposed that 100 basis points plus KIBOR should be reduced by banks on average for short term financing and 150 to 200 basis points to the KIBOR should be reduced by banks for long term financing on the basis of appraisal of level of risks.

SBP while giving relaxation in CRR and SLR has mandated the banks to improve their liquidity position for making reasonable lending sustainable. This needs to be reciprocated by banks through their lending to the customers, as banks take care of their customers. The overall policy in matters of markup needs to be considered in the larger national interest, in which SBP can be a force of advice as being custodian of policy for helping the industrial economy to expand. The government also has earmarked sectors for development, including manufacturing which is to receive priority. The government's objectives should be implemented through adopting some of the suggestions as given here-above but not limited to. SBP with its strength of research can manage a lot of options to implement the desire of GOP to see that manufacturing sector is investing, seeking joint ventures and improving the health of the sector so that the wealth generated is re-employed for meeting the objectives of socio economic improvement in the economy of the country.

Food inflation is estimated at 28 percent during July-March 2008-09 as against 13.8 percent in the comparable period of last year. Non-food inflation stood at 19.2 percent, against 6.3 percent in the corresponding period of last year. The value added manufacturing sector needs to be also brought in the industrial economy as the necessary segment for increasing the unit value of our agriculture produce. The question is as how the policy and budgetary supports should assist the

achievement of the idea. This needs a comprehensively worked out policy which may be in the shape of public private sector partnership. The present government could arrange money for agro value addition by private sector at subsidized rates out of either trade policy initiative or budgetary support may trigger this virgin sector, unexplored in a country, which is agriculture country.

The tight monetary policy resulted in a slow expansion of money supply, growing by only 1.6% against the target of 8.0% and last year's expansion of 8.1%. The private sector borrowings have been less than the level of the preceding year. The lending for the private sector needs to be given consideration through budgetary support. The industrial borrowings may need institutions like the Industrial Development Bank of Pakistan and other such appropriate institution. This could be announced in the budget as an institution set up for the purpose. The industrial loans must be at a leg behind the commercial loan rates. This is the budgetary support provision, I am suggesting for providing cover for the differential amount on cost of borrowings between commercial and industrial loan.

Credit to Private Sector witnessed a net increase of Rs.55.4 billion during July 01, 2008-April 18, 2009 as compared to Rs.359.7 billion in the comparable period of last year. The stocks still went up by 9.1%.

Since January 2009 exports started to face the impact of global financial crisis and the contraction of global demand, has exacerbated export contraction. Exports witnessed fractionally negative growth of 0.1 percent - declining from \$ 13.432 billion last year to \$13.414 billion in July-March 2008-09. However, exports fell by 25.9 percent in March 2009 over March 2008 which is really worrying for the economy. The budget must provide for the improvement in the supply side costs. Product diversification is taking place, as the share of textiles has fallen and other products have shown some increase. The diversification taking place needs to be better managed through budgetary support for the products whose share in total exports

has risen. Some of the tax credits and other measures which augment market developments, need to be undertaken to lend support to the product diversification in exports already taking place.

Imports registered a negative growth of 6.6 percent in July-March 2009. The imports stood at \$26.1 billion as against \$28.0 billion in the comparable period of last year. The imports of finished products needs to be corrected by imposing LC margins of some values for discouraging the speculative trading, in which LCs are opened and the imports are made as and when it will be more in the interest of the individuals than in the interest of the manufacturing economy.

The imports of raw materials lend support to manufacturing, especially those which are not manufactured locally. This needs to be maximized for exemption towards possible zero rated duties. The imports of finished products against the competing domestic products may improve its price competitiveness if the LC margins are imposed on similar imports. The surveillance of quality of imports by standards notified by Pakistan Standard Quality Control Authority (PSQCA), making them subject to technical barriers to trade and taking these out of the present available tax policy support to remain under presumptive tax regime of 2 percent of sales tax are few of the budgetary measures to help the formation of more share for domestic industrial produce. Further sales of imports may be excluded from the presumptive regime of 0.75 percent as final liability towards all the direct and in direct taxes in the wholesale, retail business dealing with the imported merchandise.

Some of above suggested measures may be necessary to increase the cost competitiveness of similar local produce. This will improve market access within the country and affect improvements in the sales. The surplus of domestic produce will become part of the product diversification available for exports. The necessary changes in the trade policy will drive the tariff policy on imports which will sufficiently take care of technical barriers to

trade by Pakistan. All other countries are taking care of their domestic industrial produce on the measurement scale of filtering the imports through technical barriers to trade. Further, the TBT is allowed for all the members of WTO to exercise without impeding the trade un-necessarily amongst the members of the world trade organization, which we are not doing properly.

The competitiveness of domestic industrial produce more appropriately coming under the mandate of non agriculture access markets, better known as NAMA needs to be loaded for protection in the trade policy which will drive the tariff policy of the budgetary measures 09-10. The suggestions that may be considered are the following: -

PSQCA being responsible for developing of standards, and quality control/ quality assurance in the country has been reiterating time and again that the provisions of paragraph 16(B)(ix) of Import Policy Order, 2007 must be adhered to in respect of all the imports in the country especially those which are mandatory for conformity with national standards. The said provision subjects imported goods to the same national quality standards or regulations as are prescribed in respect of similar domestically produced goods. Its stance is more important since WTO agreement on TBT encourage the development of international standards and conformity assessment systems while giving right to its member countries to take necessary measures for standardization and procedures for assessment of conformity with national standards. Additionally, the Import Policy provision is in complete harmony with the basic paradigm of multilateral trading regime to grant same treatment to imports as if these are local goods.

The Federal Government through Ministry of Science & Technology has so far notified 78 articles that have to meet the criterion of national standards called as technical regulations. The enforcement of quality as per national standards on imports needs to be enforced so that the similar domestic produce has better market access within the country.

Suggestions on improving the image of made in Pakistan: It has been reported many a times in the press that Pakistan's exports face rejection in the EU markets due to non compliance with the product specification as allowed under the WTO regime. During 2008, the rejection problem of agro based products had reached alarming level and the Planning Commission had to take up the matter with the concerned departments including PSQCA. The Planning Commission therefore, decided to enhance the role of Inspection Agencies to pre-inspect the export consignments. However, the decision taken in May 2008, was not incorporated in the Trade Policy 2008-09 announced in September, 2008. Since the problem of rejection on one count or the other persists, it has been proposed that pre-shipment inspection mechanism be incorporated in the forth coming export policy. The sources believe that proper legislative framework through PSQCA Act, 1996 and Inspection Agencies (Registration & Regulation) Rules, 1981; is already on the statute books; the only thing is to incorporate appropriate provisions in the Export Policy Order under which export is regulated by the Ministry of Commerce.

The above suggested measures, may be resisted initially but with its bilateral agreement between industrial goods producers and regulators it will serve the country, the exports of goods and industrial manufacturer as this will accredit our name for mutual recognition by the countries. The mutually recognition agreements better known as MRAs between countries will help us to have non questionable entry of our manufactured merchandise in the importing countries. In the large dimension, it will also encompass the area of intellectual property rights. The reasons for the encroachment upon rights of genuine manufacturers with brand names facing the counterfeit products taking their share is another supplementary area to be improved. The budgetary measures may provide more strength to the institutions concerned with these jobs, herein PSQCA and the IPR offices. The budget may provide some tax credit for the persons who will under go the exercise of making investments to seek their rights under IPR and as appropriate to the working of PSQCA for acquiring quality certification.

**Trade Balance** The merchandise trade deficit improved by 12.5 percent as the gap narrowed from \$14.5 billion in July-March 2007-08 to \$12.7 billion in July-March 2008-09. The budgetary measures, some of which are suggested as above and some of which may be left to the wisdom of policy makers would constitute the necessary measures to be adopted to reduce the trade gap. However, the most critical is to reduce the taxes on investments which in the form of taxes on imports of capital goods and machinery attract taxes. The discrimination between imports for foreign investors and domestic investors should be done away with. The example is import of prefabricated building and materials by foreign sponsors of chain stores at 5% against 25% for imports of the same by domestic investor in industry. The trade balance can improve also through increase in exports and decreasing of imports.

Government should have budgetary incentives cascaded in such a way that FDI flows in the industrial sector in anticipation of better profits and markets. The foreign investors should find the industrial setup as more attractive than the other sectors based on budgetary support priorities.

Industrial policy pursued is the true determinant of foreign investment as well as domestic investment. Objective of the Industrial policy should be for bringing higher growth and bringing prosperity for a country. The industrial policy is under preparation. The following points may be considered as the policy features of the national industrial policy:-

- Maintaining a sustained growth in productivity;
- Enhancing gainful employment;
- Achieving optimal utilisation of human resources;
- Attaining international competitiveness and
- Transforming the country into a major partner and player in the global arena.
- Deregulating Pakistan industry;
- Allowing the industry freedom and flexibility in responding to market forces and providing a policy regime that facilitates and fosters growth of industry.



Non Performing Loans -- All Banks & DFIs

(Rs. Bn)

Banks	2002		2003		2004		2005		2006		2007		2008	
	NPLs	Net NPLs	NPLs	Net NPLs	NPLs	Net NPLs	NPLs	Net NPLs	NPLs	Net NPLs	NPLs	Net NPLs	NPLs	Net NPLs
Public Sector Banks	95.50	41.00	85.90	29.40	40.10	9.2	38.0	5.0	40.5	6.3	43.7	4.61	77.61	16.42
<i>Growth %</i>	-26.31	-27.05	-10.05	-28.29	-53.32	-68.71	-5.2	-45.7	6.58	26.00	7.90	-26.83	77.60	256.27
<i>Share %</i>	39.09	42.57	38.35	37.17	18.97	14.62	20.93	10.62	21.78	14.03	19.65	14.46	23.85	19.84
Domestic Private Banks	66.90	27.70	67.40	25.10	103.40	31.1	95.6	22.5	92.3	17.6	136.53	15.7	203.91	54.68
<i>Growth %</i>	46.39	1.84	0.75	-9.39	53.41	23.90	-7.54	-27.65	-3.45	-21.78	47.92	-10.80	49.35	248.30
<i>Share %</i>	27.38	28.76	30.09	31.74	48.92	49.41	52.67	47.81	49.65	39.20	61.41	49.23	62.67	66.05
Foreign Banks	5.20	1.40	4.00	0.80	2.50	0.005	2.10	-0.998	1.20	-1.20	1.18	-0.76	3.00	0.18
<i>Growth %</i>	-14.75	-12.50	-23.08	-42.86	-37.50	-99.38	-16.00	-20060	-42.86	20.24	-1.67	-36.67	154.24	-123.03
<i>Share %</i>	2.13	1.45	1.79	1.01	1.18	0.01	1.16	-2.12	0.65	-2.67	0.53	-2.38	0.92	0.21
Commercial Banks	167.60	70.10	157.30	55.30	146.00	40.31	135.70	26.50	134.00	22.70	181.41	19.55	284.52	71.28
<i>Growth %</i>	-7.61	-17.53	-6.15	-21.11	-7.18	-27.12	-7.05	-34.25	-1.25	-14.35	35.38	-13.88	56.84	264.61
<i>Share %</i>	68.60	72.79	70.23	69.92	69.07	64.03	74.76	56.31	72.07	50.56	81.59	61.30	87.44	86.10
Specialised Banks	63.90	21.20	54.10	21.20	53.70	20.8	41.7	18.8	38.7	13.8	32.75	9.99	29.14	8.15
<i>Growth %</i>	1.91	-17.19	-15.34	0.00	-0.74	-1.89	-22.35	-9.62	-7.19	-26.60	-15.37	-27.61	-11.02	-18.47
<i>Share %</i>	26.15	22.01	24.16	26.80	25.40	33.04	22.97	39.95	20.82	30.73	14.73	31.33	8.96	9.84
All Banks	231.50	91.30	211.40	76.50	199.70	61.11	177.40	45.30	172.70	36.50	214.16	29.54	313.66	79.43
<i>Growth %</i>	-5.16	-17.45	-8.68	-16.21	-5.53	-20.12	-11.17	-25.86	-2.65	-19.43	24.01	-19.07	46.46	168.88
<i>Share %</i>	94.75	94.80	94.39	96.73	94.47	97.08	97.73	96.26	92.89	81.29	96.32	92.63	96.40	95.94
DFIs	12.83	5.01	12.57	2.59	11.68	1.84	4.12	1.76	13.22	8.40	8.18	2.35	11.72	3.36
<i>Growth %</i>	-	-	-2.03	-48.30	-7.08	-28.96	-64.73	-4.35	220.87	377.27	-38.12	-72.02	43.28	42.94
<i>Share %</i>	5.25	5.20	5.61	3.27	5.53	2.92	2.27	3.74	7.11	18.71	3.68	7.37	3.60	4.06
Banks & DFIs Total	244.33	96.31	223.97	79.09	211.38	62.95	181.52	47.06	185.92	44.90	222.34	31.89	325.38	82.79
<i>Growth %</i>	0.09	-16.97	-8.33	-17.88	-5.62	-20.41	-14.13	-25.23	2.42	-4.59	19.59	-28.98	46.34	159.60

Source: Annual Reports of Various Banks



**Non Performing Loans by Business Segments - Selected Banks**

(Rs. Mn)

Type of Business	National Bank of Pakistan			Habib Bank			United Bank			MCB Bank		
	2006	2007	2008	2006	2007	2008	2006	2007	2008	2006	2007	2008
Chemicals & Pharmaceuticals	1554	1528	3884	104	99	240	752	780	165	33	22	118
Agribusness	1103	1698	1602	1865	4806	6322	913	1356	1625	320	268	912
Textiles	11884	14556	17965	10373	8718	11034	4804	5540	7898	1088	1279	2912
Cement	2183	1193	2506	201	15	500	25	20	32	1	1	0
Sugar	1524	1340	1721	434	0	615	37	35	35	36	21	388
Rice Processing	321	819	1806	0	0	0	0	0	0	0	0	0
Shoe & Leather Garments	178	108	264	517	487	499	147	8	97	93	71	107
Automobile & Transport Equipment	318	362	935	232	525	935	145	150	783	45	3	116
Transportation & Telecommunication	223	70	1300	0	0	0	0	3	14	27	35	73
Real Estate/Construction	138	335	271	0	0	0	451	2270	3059	160	85	80
Electronics & Electrical Appliances	146	168	2716	172	178	2825	119	150	240	303	133	558
Food & Tobacco	1074	969	377	953	1519	687	770	786	714	0	0	0
Fertilizers	192	211	256	0	0	0	0	71	37	0	0	0
Metal Products	1922	1994	2535	120	118	36	272	258	398	0	0	0
Oil, Gas, Petroleum & Energy	978	1216	130	0	27	29	154	-	154	2	2	4
Hotel & Services	9	57	417	0	0	0	246	127	202	167	288	296
Individuals	355	896	2999	383	630	956	3156	6601	8206	262	784	1444
General Traders	3880	1662	2338	875	1821	1824	551	848	964	4371	5178	3465
Public/Govt	0	0	0	667	101	1160	0	0	0	0	0	0
Financial	66	60	105	2304	2338	2969	138	133	20	65	53	2094
Others	8212	9076	12335	10833	6311	9422	3575	2876	3196	1598	2502	5702
Total	36260	38318	56462	30033	27693	40053	16255	22012	27839	8571	10725	18269

**Non Performing Loans by Business Segments - Selected Banks**

(Rs. Mn)

Type of Business	Allied Bank		Bank Al Falah		Standard Chartered Bank Pakistan		NIB		Saudi Pak Commercial Bank		
	2006	2007	2006	2007	2006	2007	2006	2007	2006	2007	2008
Chemicals & Pharmaceuticals	236	192	26	33	157	144	4	644	46	146	612
Agribusiness	366	335	104	210	318	477	0	45	131	63	34
Textiles	3123	1591	495	717	2095	3166	376	6419	882	1484	3815
Cement	0	0	15	11	0	0	0	130	43	200	255
Sugar	0	0	0	0	0	0	8	747	22	21	219
Rice Processing	0	0	0	0	0	0	0	0	0	0	0
Shoe & Leather Garments	0	0	0	0	15	15	0	61	15	12	8
Automobile & Transport Equipment	0	0	7	77	36	30	1	902	8	8	519
Transportation & Telecommunication	301	946	0	0	0	0	59	119	0	0	0
Real Estate/Construction	0	0	0	0	0	0	52	341	4	0	0
Electronics & Electrical Appliances	0	0	0	0	0	275	3	171	143	455	865
Food & Tobacco	437	351	0	0	0	0	0	45	0	0	0
Fertilizers	0	0	0	0	0	0	0	0	0	0	0
Metal Products	0	0	0	0	0	0	0	32	0	0	0
Oil, Gas, Petroleum & Energy	0	0	0	0	200	0	95	27	203	0	0
Hotel & Services	0	0	0	0	0	0	12	16	1	0	0
Individuals	121	169	839	1749	2593	3068	131	1400	37	40	232
General Traders	802	624	341	797	0	0	0	448	0	0	0
Public/Govt	0	0	0	0	0	0	0	0	0	0	0
Financial	0	0	0	0	5	64	0	0	148	112	52
Others	5093	7147	482	1111	3477	3751	283	1705	2952	3595	6234
Total	10479	11355	2309	4705	8896	10990	1024	13252	4635	6136	12845

Source: Annual Reports of Various Banks

Write-Offs & Financial Relief Allowed  
By Selected Banks 2000 – 2008

(Rs. Mn)

Banks		2000	2001	2002	2003	2004	2005	2006	2007	2008	Total* 2000-2008
Allied Bank Limited	Principal Written-off	26.814	28.249	5.774	7.754	455.873	2472.697	1706.61	268.83	824.199	5796.8
	Mark-up Written-off	0	16.524	12.013	26.045	176.598	13.204	77.88	0	0	322.264
	Other Financial Relief	0	7.897	34.735	32.100	562.882	2856.092	1420.27	306.61	837.469	6058.055
	<b>Total</b>	<b>26.814</b>	<b>52.670</b>	<b>52.522</b>	<b>65.899</b>	<b>1195.353</b>	<b>5341.993</b>	<b>3204.76</b>	<b>575.44</b>	<b>1661.668</b>	<b>12177.119</b>
Habib Bank Limited	Principal Written-off	208.436	436.878	742.172	816.631	2127.425	2699.872	8505.50	3881.30	1029.93	20448.144
	Mark-up Written-off & other Financial Relief	781.771	493.772	2634.948	1311.091	6560.408	4788.415	6906.53	3587.93	3473.04	30537.905
	<b>Total</b>	<b>990.207</b>	<b>930.650</b>	<b>3377.120</b>	<b>2127.722</b>	<b>8687.833</b>	<b>7488.287</b>	<b>15412.03</b>	<b>7469.23</b>	<b>4502.97</b>	<b>50986.049</b>
United Bank Limited	Principal Written-off	555.541	511.950	865.498	695.488	535.490	2739.934	3205.53	2719.42	4234.514	16063.365
	Mark-up Written-off	0	105.634	120.425	154.422	63.614	452.460	377.480	604.120	611.660	2489.815
	Other Financial Relief	141.951	141.880	1416.111	837.119	792.090	3082.322	10150.490	4149.49	3655.736	24367.189
	<b>Total</b>	<b>697.492</b>	<b>759.646</b>	<b>2402.034</b>	<b>1687.029</b>	<b>13191.194</b>	<b>6274.716</b>	<b>13733.500</b>	<b>7473.030</b>	<b>8501.910</b>	<b>42920.369</b>
National Bank of Pakistan	Principal Written-off	128.356	96.544	1600.449	288.716	800.730	918.233	710.409	1564.19	614.444	6722.071
	Mark-up Written-off	0	67.898	229.985	104.332	208.414	112.37	209.75	600.78	22.341	1555.87
	Other Financial Relief	216.855	762.561	2205.992	2194.709	3641.029	3697.174	2000.00	2076.64	1875.20	18670.16
	<b>Total</b>	<b>345.211</b>	<b>927.033</b>	<b>4036.426</b>	<b>2587.757</b>	<b>4650.173</b>	<b>4727.777</b>	<b>2920.159</b>	<b>4241.61</b>	<b>2511.985</b>	<b>26948.101</b>
MCB Bank	Principal Written-off	659.622	507.308	737.213	322.699	601.208	167.31	287.28	788.12	1599.649	5660.409
	Mark-up Written-off	0	7.787	247.475	43.893	50.173	6.267	6.00	101.4	47.213	510.208
	Other Financial Relief	28.122	526.046	558.966	729.489	370.07	861.523	506.29	504.63	1121.613	5206.749
	<b>Total</b>	<b>687.742</b>	<b>1041.141</b>	<b>1543.654</b>	<b>1096.081</b>	<b>1021.451</b>	<b>1035.110</b>	<b>799.570</b>	<b>1384.15</b>	<b>2768.475</b>	<b>11377.366</b>
Bank Al-Falah	Principal Written-off	22.582	13.031	25.154	49.405	166.613	250.939	14.172	128.800	467.630	1138.326
	Mark-up Written-off	0	0.726	11.793	17.673	15.118	4.818	18.425	5.951	3.61	78.114
	Other Financial Relief	3.475	0	0	0	0	0	0	0	0	3.475
	<b>Total</b>	<b>26.057</b>	<b>13.757</b>	<b>36.947</b>	<b>67.078</b>	<b>181.731</b>	<b>255.757</b>	<b>32.597</b>	<b>134.751</b>	<b>471.240</b>	<b>1219.915</b>
Standard Chartered Bank of Pakistan	Principal Written-off	215.086	55.401	31.181	56.417	166.642	400.918	835.991	3734.85	741.34	6237.826
	Mark-up Written-off	0	8.477	0.265	1.972	174.643	154.706	19.124	51.540	90.500	501.227
	Other Financial Relief	3.475	0	0	0	0	0	1.676	0.562	0	5.713
	<b>Total</b>	<b>218.561</b>	<b>63.878</b>	<b>31.446</b>	<b>58.389</b>	<b>341.285</b>	<b>555.624</b>	<b>856.791</b>	<b>3786.952</b>	<b>831.84</b>	<b>6744.766</b>
Bank of Punjab	Principal Written-off	0	4.042	2.956	10.815	15.448	17.378	19.764	377.638	0	448.041
	Mark-up Written-off	0	5.506	18.16	1.626	3.377	11.608	12.687	20.595	0	73.859
	Other Financial Relief	14.158	0.115	0	0	51.781	0	0.033	0.087	0	66.174
	<b>Total</b>	<b>14.158</b>	<b>9.663</b>	<b>21.416</b>	<b>12.441</b>	<b>70.606</b>	<b>28.986</b>	<b>32.484</b>	<b>398.32</b>	<b>0</b>	<b>588.074</b>
Faysal Bank	Principal Written-off	149.057	281.933	133.427	17.814	127.683	0.013	0.067	17.446	1.09	728.55
	Mark-up Written-off	0	21.912	9.106	0	328.77	0	0	0	0	359.788
	Other Financial Relief	0	0	0	1.662	704.436	0	0	30.247	1.92	738.265
	<b>Total</b>	<b>149.057</b>	<b>303.845</b>	<b>142.533</b>	<b>19.476</b>	<b>1160.889</b>	<b>0.013</b>	<b>0.067</b>	<b>47.693</b>	<b>3.01</b>	<b>1826.603</b>
Askari Commercial Bank	Principal Written-off	1.287	5.242	0	51.360	60.488	0.031	1.597	34.325	467.963	622.293
	Mark-up Written-off	0.775	20.938	10.764	0	21.503	9.941	0.864	12.754	155.854	233.393
	Other Financial Relief	0	0	0	109.56	0	0	0	0	0	109.56
	<b>Total</b>	<b>2.062</b>	<b>26.18</b>	<b>10.764</b>	<b>160.920</b>	<b>81.991</b>	<b>9.972</b>	<b>2.461</b>	<b>47.079</b>	<b>623.817</b>	<b>965.246</b>
Selected Banks Combined	Principal Written-off	1966.781	1940.578	4143.824	2317.099	5057.600	9667.325	15286.92	13504.919	9980.759	63865.825
	Mark-up Written-off	0.775	255.402	660.286	349.963	1042.21	765.374	722.210	1397.140	931.178	6124.538
	Other Financial Relief	1189.807	1932.271	6850.752	5215.730	12682.696	15285.526	20985.289	10656.196	10964.978	85763.245
	<b>Total</b>	<b>3157.363</b>	<b>4128.251</b>	<b>11654.862</b>	<b>7882.792</b>	<b>18782.506</b>	<b>25718.225</b>	<b>36994.419</b>	<b>25558.255</b>	<b>21876.916</b>	<b>155753.608</b>

\* Accumulated Total 2000 to 2008

Source: Annual Reports of the Various Banks

Commercial Banks Registered in Pakistan  
Financial Position - at a Glance

(Rs. Bn)

Banks	Date of Incorporation/ Commencement of Business	As of December 2008									
		Paid up Capital	Reserves	Assets	Deposits	Advances	Profit After Tax	Earning Per Share	Branch Network Nos	Credit Rating	
										Short term	Long term
Habib Bank	25-08-1941	7.59	24.24	757.93	597.09	456.36	15.61	20.47	1508	A-1+	AA+
Allied Bank	3-12-1942	6.46	5.80	366.68	297.46	212.97	4.16	6.43	766	A1+	AA
MCB Bank	9-7-1947	6.28	36.77	443.62	330.27	262.51	15.37	24.47	1040	A1+	AA+
National Bank of Pakistan	8-11-1949	8.97	19.94	817.76	624.94	412.99	15.46	17.23	1276	A-1+	AAA
United Bank	24-07-1959	10.12	15.50	576.02	605.07	371.14	8.33	8.24	1119	A-1+	AA+
First Women Bank	21-11-1989	0.28	0.23	7.30	5.94	3.30	0.11	3.74	38	A2	BBB+
Bank of Punjab	30-07-1989	5.29	7.43	217.85	180.82	142.85	-2.63	-4.97	272	A1+	AA-
Soneri Bank	28-09-1991	4.11	2.02	80.98	61.63	47.58	0.70	1.70	117	A1+	AA-
Askari Bank	9-10-1991	4.06	7.67	206.19	167.68	128.82	0.39	0.95	200	A1+	AA
Bank Al-Habib	15-10-1991	4.79	3.06	177.32	144.39	100.20	2.43	5.07	225	A1+	AA
Bank of Khyber	17-09-1991	4.00	1.44	31.34	24.73	12.64	0.14	0.27	34	A-2	BBB+
Bank Al-Falah	21-06-1992	8.00	3.17	348.99	300.73	192.67	1.30	1.63	226	A1+	AA
Saudi Pak Commercial Bank	5-4-1994	9.00	0.22	55.65	41.06	31.09	-2.83	-2.83	65	A-3	A-
Faysal Bank	3-10-1994	5.30	3.79	138.24	102.78	89.76	1.12	2.11	129	A1+	AA
KASB Bank	13-10-1994	4.02	0.15	51.80	35.09	32.24	-1.85	-2.43	73	A1	A
Meezan Bank	31-01-2002	4.93	0.85	85.28	70.23	39.77	0.62	1.26	166	A1	A+
NIB Bank	2-10-2003	28.44	8.33	178.91	104.59	80.34	-7.47	-2.63	244	A1+	AA-
Samba Bank*	31-03-2004	8.77	0.04	16.49	9.86	6.16	-0.74	-0.85	28	A-1	A
Bank Islami Pakistan	7-4-2006	5.28	-	19.09	12.48	6.53	-0.23	-0.120	102	A2	A-
mybank	26-04-2005	5.30	0.32	39.80	28.03	20.94	-0.76	-0.79	80	A-1	A
Dubai Islamic Bank of Pakistan	28-03-2006	6.02	-	32.05	25.46	18.07	-0.27	-0.35	25	A-2	A
Arif Habib Rupali Bank	9-12-2005	5.00	1.32	24.80	16.62	15.76	0.21	-0.35	33	A-2	A
Atlas Bank	25-03-2004	5.00	0.58	28.97	18.65	20.55	-1.59	-2.02	40	A2	A-
Standard Chartered Pakistan	19-05-2006	38.72	1.81	264.62	174.55	125.60	0.63	0.16	174	A-1+	AA+
JS Bank	15-03-2006	5.70	0.02	21.63	15.29	9.70	0.06	0.11	39	A2	A-
Habib Metropolitan Bank	16-10-2006	6.02	7.04	182.36	128.37	108.26	3.28	5.44	110	A1+	AA+
Emirates Global Islamic Bank	13-02-2007	4.50	-	16.54	10.89	9.97	-0.39	-0.60	40	A2	A-
Dawood Islamic Bank	10-04-2007	4.00	0.02	9.57	5.06	5.64	0.03	0.084	21	A-2	A
RBS Bank**	30-08-2007	13.47	-6.40	108.09	79.10	67.91	-0.52	-0.38	79	A1+	AA

\* The Crescent Commercial Bank now operates as a subsidiary of SAMBA Financial Group of Saudi Arabia, which acquired 68.42% shares of the bank and was renamed as Samba Bank Limited effective October 21, 2008

\*\* Following amalgamation of ABN Amro Bank's Pakistan branches with the Royal Bank of Scotland (RBS) Limited in October 2007, the bank has been renamed as RBS Bank effective August 1, 2008.

## Market Analysis

### *Market Review*

The market performance was mainly positive for the period under review. The KSE-100 Index during the two-month period of March and April 2009 surged by 1,474 points to close at 7,202 on April 30, 2009. The average daily turnover during the period under review was 236.83m shares exchanging hands.

The first two weeks of March, the Index movement was mainly sideways with thin volumes averaging 98m shares a day due to the political uncertainty, as the long march to Islamabad and sit-in called by the lawyers and the political parties such as the PML-N supporting them in their demands to restore the deposed Chief Justice Iftikhar Muhammad Chaudhry was beginning their mobilization on March 12 in order to reach the capital on March 16. The long march was reaching its crescendo from March 14-15 in Lahore as both the government and the marchers were ready for a showdown.

The turning point came on March 15, as former PM Nawaz Sharif alongwith tens of thousands of his supporters came out on the streets to show support. This forced the Prime Minister and the President to restore the deposed Chief Justice in order to avoid a serious political and law and order crisis in the country. The Prime Minister in his address to the nation informed the public of the government's decision to restore the Chief Justice along with 10 other deposed justices of the Supreme Court and various High Courts. The market reaction was euphoric as the KSE-100 Index surged by 313 points on March 16 and the turnover broke the 200m shares barrier for the first time in a month. From March 11 to 31, the KSE-100 Index surged by 1,302 points to 6,860 on an average daily turnover of 230m shares traded.

During the first week of April, the market experienced a moderate rally due to across the board buying activity from all investor classes. The KSE-100 Index gained 775 points or 11 percent from the beginning of the month

to April 7 to reach 7,635 on average daily turnover of 338m shares traded.

The major drivers of this rally were:

- The settlement of PKR80bn of circular debt of the various oil and gas companies and IPPs;
- The receipt of the second tranche of US\$848m from the IMF and;
- The SBP 2QFY09 Review of the Economy reported improvements in key macroeconomic variables such as fiscal deficit, inflation and external account scenario led to optimism among investors that the discount rate would be cut soon by the central bank.

However, the market witnessed a 5percent slump for the next two days on April 8 and 9 because of the abolition of CFS Mk-II and deliverable futures products until new products are developed and the higher than expected rise in T-bill yields across all tenors in the April 8 auction. Fortunately, the slump was short and the market rebounded for the next week. The Index received a boost due to buying interest in banking and second tier scrips. Investors reacted positively to the news of acquisition interest in Royal Bank of Scotland's Pakistani operation expressed by HBL, MCB Bank and JSCL.

Also, the SBP announced on April 15 that it was slashing the minimum capital requirement for commercial banks from Rs23 billion by December 31, 2013 to Rs10 billion. There was strong expectations in the market that the central bank would slash the discount rate in the April 20 Monetary Policy Statement. The Index reacted positively to the US\$ 5.28 billion aid pledged by the Friends of Democratic Pakistan Group on April 17 in Tokyo. Also, as expected by most analysts and investors, the SBP on April 20 in its 4QFY09 Monetary Statement cut the policy rate by 100bps to 14 percent.

From April 9 to 20, the KSE-100 Index gained 606 points or 8.3percent to reach 7,902 mainly on the back of positive developments on the macroeconomic front such as the slash in the

policy rate and improvement in the current account deficit. Yet, for the next 3 sessions, the market experienced a mini-slump due to the anxiety over the Nizam-e-Adl regulation being implemented in Swat and the march of the militants into Buner in violation of the peace deal.

The Index staged a recovery on April 24 as it was reported that the militants retreated from Buner as the Pakistani security forces threatened to start operations there and good quarterly results reported by banks and petroleum companies. During the last week of the month, the market movement could be described as eclectic, as there was no sense of direction and investors were reacting to the news flow rather than to the fundamentals that were heading in the right direction. The KSE-100 Index shaved off 418 points or 5.5 percent from April 24 to the end of the month due to the precarious law and order situation throughout the country.

The Pakistan market PE at 7.39x is trading at a 45 percent discount to the regional average of 13.45x. Since the beginning of the year, the discount has been gradually declining, which is a good sign. Based on dividend yield, Thailand is the most attractive at 10.39 percent as compared to the regional average of 4.70 percent.

Regional Valuation

### Regional Valuation Comparison

Country	12m F	
	PEx	Dividend Yield (%)
China	16.33	1.49
Hong Kong	12.38	3.43
India	11.62	1.86
Indonesia	10.08	3.79
Malaysia	12.57	4.94
Pakistan	7.39	7.85
Philippines	10.05	4.68
Singapore	11.59	7.57
South Korea	12.68	1.51
Taiwan	28.55	4.21
Thailand	8.61	10.39

Source: Thomson One Analytics, Date: April 16, 2009

We expect that next month's market activity will be dominated by speculation about the possible budgetary measures to be introduced by the federal government in the upcoming budget for FY10 some time in early June. There has been much discussion in the public by the Adviser to the Prime Minister on

Looking Ahead

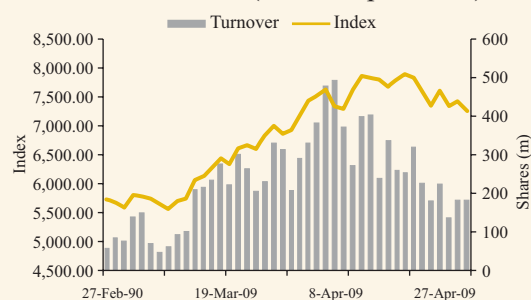
Finance Shaukat Tarin regarding the expansion of the tax base by including non-taxed sectors such as real estate. In regards to the equity markets, capital gains tax exemption is valid till June 30, 2010 but most investors would welcome some relief on CVT.

On the macroeconomic front, it will be interesting to see if there is further easing in both headline and core inflation that has shown such signs in the March figures. Additional downward movement will lead to heightened expectations of the capital markets for another cut in the discount rate by the SBP that could sustain positive market sentiments for the next couple of months.

The law and order situation in the country has caused apprehension for both the GoP and foreign governments. Further capitulation will cause some strain on the societal fabric of the country and a major law and order situation might arise especially in the Punjab and Karachi. The government at all levels will have to be vigilant and try to build a national consensus policy to try to tackle this internal militancy as it will have dire consequences on the economy if not properly addressed.

For Pakistan, the geopolitical scenario could become more contentious in the immediate term due to both the militancy in Swat and the pressure applied by the U.S and other foreign governments to tackle this issue head on. Also, the results of the Indian general elections will be known next month and whoever forms the government there is unlikely to restart dialogue with Pakistan immediately and so tensions in the region will remain high.

### KSE-100 Index (March-April 2009)



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

## Book Reviews

*Pakistan: The Political Economy of Lawlessness*  
Azhar Hassan Nadeem  
Oxford University Press, 2007

The book attempts to assess the economic impact of lawlessness, widespread corruption, financial mismanagement on Pakistan's economic development, with special reference to the period 1969–1996, though other critical periods have also been touched upon. This period has been a disturbed period of Pakistan's history, in terms of frequency, intensity and violence of disorders and crimes and it has also been a period of lost opportunities of development of Pakistan. This situation continues to persist even today with the intensity of violence having increased manifold.

This first seven chapters of the book discuss the issues in lawlessness, socio economic developments and crimes, nature of violent crime, magnitude of lawlessness, the pattern of lawlessness and one chapter gives a historical overview of law and order in Pakistan. The later chapters examine the impact of lawlessness on the economy, and how an effective strategy can be put in place for crime prevention.

Rapid urbanisation, rising growth of population has added to the urban chaos. Increase in the number of squatter settlements, housing shortages, rising unemployment, poverty, juvenile delinquency, poor health and literacy coverages explain in part the pattern of crimes and law and order situation prevailing in the country.

In the chapter *Patterns of Lawlessness in Pakistan*, the author has discussed the socio-economic aspects of lawlessness with reference to corruption and white collar crimes such as written off loans, cooperative scandals, the rip off investment companies, other financial irregularities, and the economic policies adopted by the successive regimes have contributed to the debt burden of the country and set up a course of dependence and living beyond means. Institutions have

been flouted. These and other factors have given birth to the present situation of lawlessness.

The impact of lawlessness on the economy has been discussed in chapter 8. It shows the relationship between conditions of law and order and economic indicators with reference to various periods of Pakistan's history. It shows how essential peace and security are for general economic development, particularly for encouraging mobility of factors of production. The economy has suffered serious setbacks due to lawlessness. For example, the breakdown of law and order during late 1960s led to a fall of annual growth rate to 1.4 percent from the average annual growth rate of 5.5 percent during early 1960s. The more recent example is that of Sindh where process of development has slowed down because of ethnic riots and kidnappings.

Economic policies, the influence of domestic/external factors, is shown to have influenced the performance of the Pakistan economy. During the period 1986-89, due to a number of factors like the influx of Afghan refugees, introduction of drug culture, sectarian strife, political turmoil, violence and other crime affected the performance of the economy. GDP growth declined from 6.3 percent in 1985-86 to 4.81 percent in 1988-89, while manufacturing sector growth fell to 3.9 percent per annum in 1988-89 from 7.6 percent in 1985-86. The quantum of capital outflow, the level of foreign private investment has been impacted by the internal political conflicts, and other factors.

Given the impact of lawlessness on economic development, there exists a need for ensuring a system of law enforcement commensurate with the requirements of self sustained economic growth. One chapter explains the strategy of policing in Pakistan, as part of an effective strategy of crime prevention. A chapter suggests short term and long term measures for improving general criminal administration system. The last chapter in the book draws conclusion and gives recommendations for the resolution of the problems.

*Transforming Schools in Pakistan  
Towards the Learning Community  
Edited by John Retallick & Iffat Farah  
Oxford University Press, 2007*

The authors of the various chapters of the book present their research on the idea of the school as a learning community. There has been lot of interest towards learning communities in the west and it is now being increasingly felt that it is time to consider the usefulness of the idea in a developing country such as Pakistan

The editors in the introductory chapter have pointed out three reasons why they decided to focus on the learning community idea. Those contributing to the book have a deep commitment to improving schools and schooling in Pakistan, improvements in both quality and quantity of school education are desperately required in Pakistan, and an increase in the number of schools and teachers is required throughout the country to provide access for all children of school going age.

The book attempts to answer the question, how can the quality of schooling in Pakistan be transformed? It has long been felt that there exists major problems in the quality of schooling, which needs to be improved and this can happen to a significant extent if the ideas outlined in the book are adopted on a widespread basis.

The first chapter in the book sets out the concept of learning organization, by analysing the available literature. The various approaches offer useful ideas for transforming schools into learning communities, where not only students, but also teachers, administrators, and parents will take on various learning related roles.

The next four chapters talk about teachers as learners. Teachers should become researchers in their own classrooms and contribute to self development and school improvement. Teacher development has to be ensured and they need a support system with the collaboration of school and university to sustain their growth.

After writing about the different aspects of teacher training, the remaining chapters are about the other participants in the learning community, students, school teachers and parents.

*Water Supply in Karachi  
Issues and Prospects  
Noman Ahmed  
Oxford University Press, 2008*

The book under review is based on extensive research, which studies the procedures of urban water supply in the city of Karachi. The case studies mentioned focus on the dominant procedures of water supply. It also shows the working of formal and informal alternatives arrangements in the water supply services.

The main aspects of the study are the status of water supply service, factors affecting water supply modes, machinery and equipment as well as the linkages of piped water with alternative arrangements.

The first two chapters give a general overview of the arrangements of water supply in developing countries, and the alternative arrangements in water supply. The third chapter identifies the three case studies; water supply in Karachi's planned and unplanned urban areas, retail beneficiaries of bulk water supply arrangements and awami tanks – an emerging arrangement of water supply in the informal settlements of Karachi. Chapter 7 presents the analysis of the findings drawn from the case studies.

The consumers have been found to obtain water supply through a variety of arrangements. The case studies have shown that in planned areas, consumers obtained water supply through a piped mode which largely functioned with the help of a suction pump.

The other alternatives that were commonly resorted to by consumers included commercial water tankers and boreholes. In unplanned areas, the supply was facilitated to a limited extent by piped water and augmented through boreholes, commercial water tankers vending supply through donkey carts and in remote areas, people relied on awami tankers.