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Editor's Corner

Dear Readers,

The recently released *Annual Report 2011-12, The State of Pakistan's Economy, State Bank of Pakistan* shows that national savings declined in FY12 to 10.5 percent of GDP against 13.2 percent a year earlier. The domestic savings rate too has been on a declining trend and as a proportion of GDP it has fallen from 11.5 percent in FY08 to 5.6 percent in FY12. This compares unfavourably with other regional countries at the same income level who have a higher savings rate.

National savings comprise of public and private sector savings. Public sector savings include government savings and savings produced by public sector enterprises (public corporations, public enterprises, self financing by financial institutions of public and general government). Public sector savings has been low over the years as the government has been a dissaver and the savings that have accrued is from public sector enterprises. The savings largely originate from the private sector, which includes savings of households and the corporate sector. The household sector, which constitutes the largest portion in national savings has shown a varying trend over the past five years. From 12.7 percent in FY08 it fell to 7.1 percent in FY10, rose in the following year to 10.2 percent, but again declined to 6.2 percent in FY12. On the other hand, savings trend in the corporate sector has been largely stagnant over the years.

The low savings rate has negative implications for the sustainability of economic growth. To sustain annual rate of growth of 6-8 percent per annum, an investment level of 20-25 percentof GDP is needed. During the last 3 years however, GDP growth has averaged 3.3 percent, as investment levels in the economy remained sluggish. From a high of 22.1 percent in FY08, gross investment as a proportion of GDP has come down to 12.5 percent (FY12). This is worrisome as it essentially means a decline in future productive capacity of the economy.

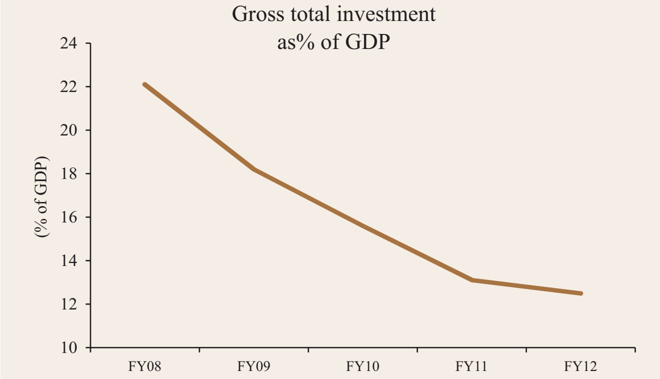
Despite its critical significance, savings rate has remained low and cannot meet the investment levels needed for sustained growth of the economy. Little has been done to enhance domestic resource mobilization efforts in the economy. There are a number of factors which are responsible for low savings. These include among others; increasing disparity in incomes have promoted consumption rather than savings, lack of employment opportunities and thereby absence of income, persistent inflation has resulted in a fall in household income's purchasing power, lack of saving instruments in the market, lack of financial literacy, emergence of credit fostering consumption boom, fall in real interest rates because of inflation.

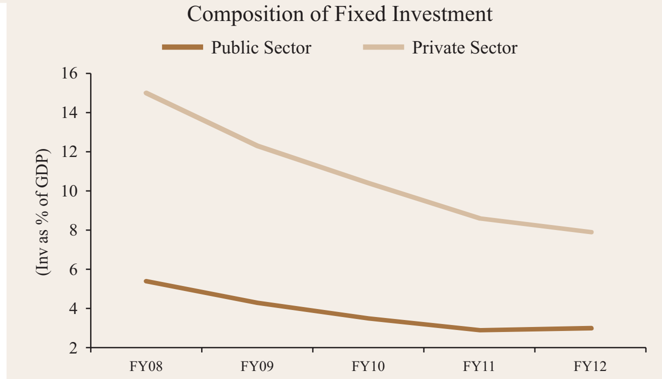
When savings are not forthcoming, the government's dependence on borrowed funds both internal and external rises, resulting in a buildup of debts, with its adverse consequences for the economy. The pressure of this debt on the country's exchequer can be gauged by the fact that debt servicing alone constitutes 32 percent of current expenditures and 33 percent of federal government revenues. Pakistan's total debt now stands at Rs12.9 trillion; domestic debt alone is Rs7.6 trillion, where unfunded debt (primarily made up of saving schemes) constitutes 23.5 percent.

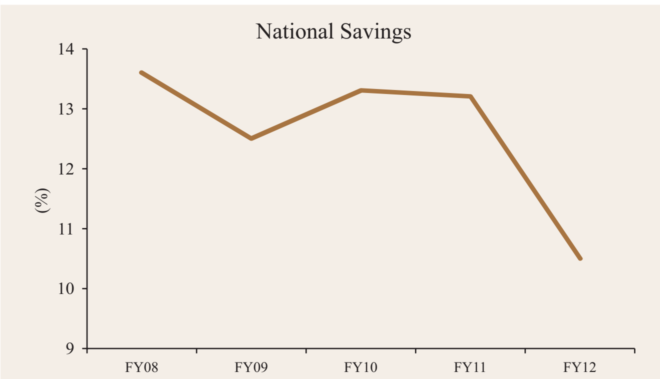
Every effort needs to be made to raise the savings rate so to get a desirable investment level and hence sustained growth in the economy. Without concerted efforts to raise domestic savings, the country will not be able to get out of its debt trap, moderate inflationary pressures and achieve self sustaining growth. The financial sector would need to focus on providing innovative liability products so the investors have various options to chose from, also efforts should be made to enhance accessibility of financial services to excluded areas including rural areas, containing inflation would enhance rates of return on saving products, thereby encouraging savings.

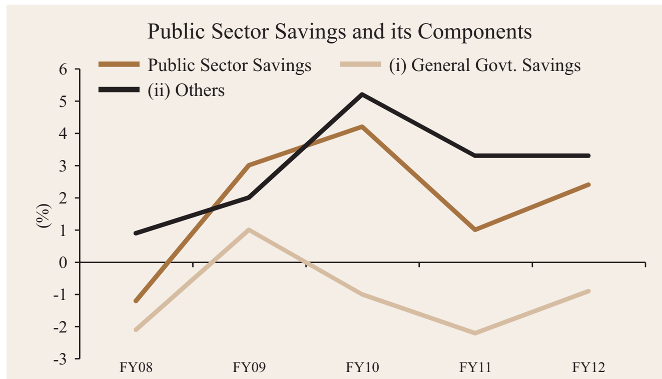
Ayesha Mahmud

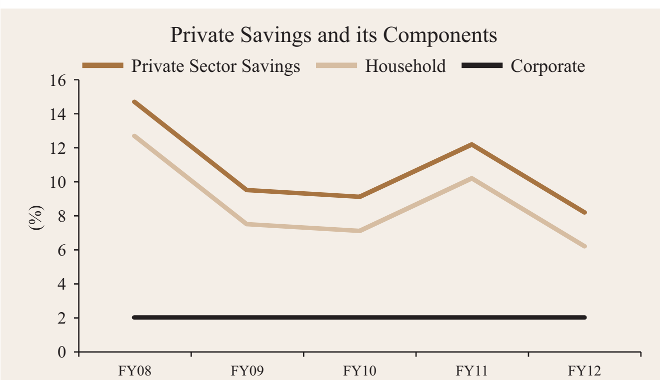
Investment and Savings

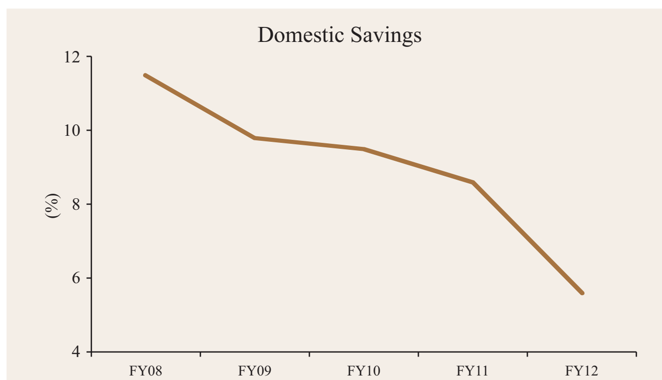


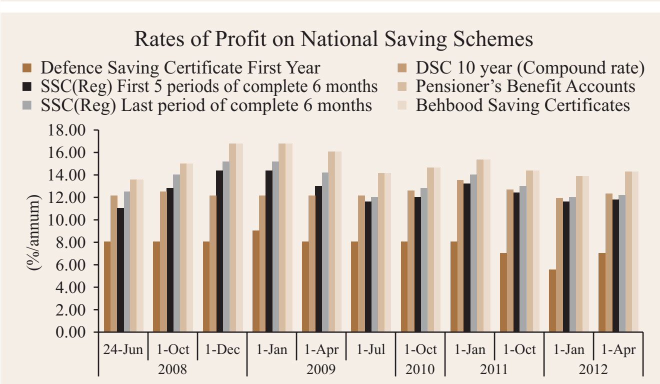


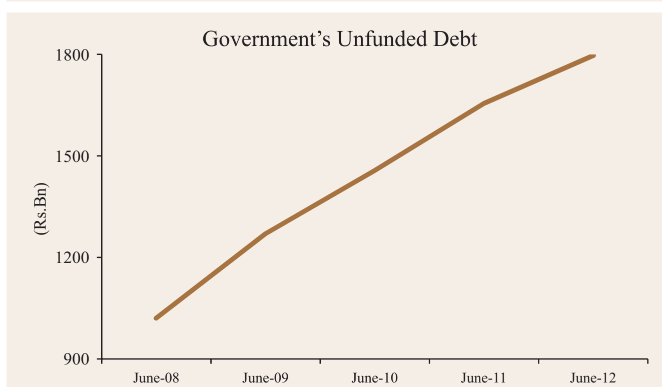










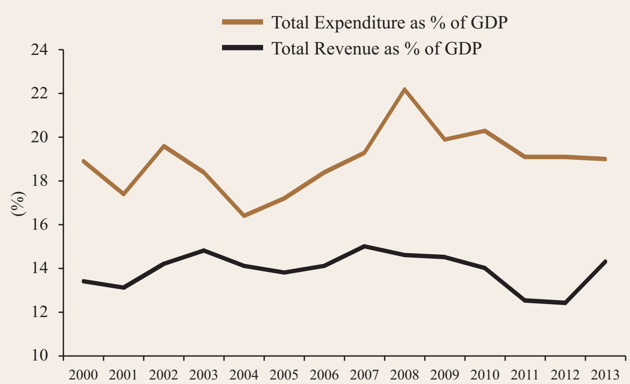


Pakistan's Public Debt

Revenue shortfalls

Over the years, Pakistan has failed to collect enough revenues to finance its budget. Large and growing budget deficits and the concomitant need for borrowing has resulted in high levels of public debt. While total expenditure as percent of GDP has ranged between 17-22 percent in the last 10-12 years, total revenue as percent of GDP has been lower at between 13-15 percent. This is because revenues have remained largely stagnant. Tax revenues have not been able to commensurately grow with expenditures because of a number of factors; narrow tax bases, revenue leakages, evasion and corruption. In recent years, the heavy burden of debt servicing on the budget has emerged as the biggest claimant of public resources. In 2011-12, interest payments on domestic and foreign debt claimed nearly 34 percent of current expenditure; this leads to a cut in expenditures on social development, infrastructure and other development expenditure.

Trend in Revenue / Expenditure



Public debt as a means of financing gaps

Governments worldwide faced with budget deficits mobilize revenue by increasing taxes or resorting to domestic or external borrowing. When the government decides to borrow instead of introducing additional tax measures to finance the budget deficit, it creates a liability on itself known as public debt. It is an important means of meeting government financing gaps. In debt financing the government can borrow either directly from the central bank, domestic commercial banks, or from domestic non-bank sectors or from external sources. Government usually utilizes a number of options at the same time.

Borrowing to be used wisely

Borrowings whether domestic or from external sources has different macroeconomic implications. Borrowing from the central bank, leads to monetary expansion and is highly inflationary. Borrowing from domestic commercial banks is less inflationary, but it may crowd out private investment. Borrowing from external sources taps into foreign capital surplus, increases resource availability and is conducive for economic growth. However, excessive reliance on foreign borrowing and its improper use generates severe debt service obligations. Borrowed funds when properly managed and utilized can benefit a country's long term development. Beyond a certain level, debt is a drag on growth. If used wisely, it clearly improves welfare and enhances growth, but when it is used imprudently it can have disastrous consequences. It is the country's debt management strategy which not only needs to explore new and cheap sources of finance, but also to consider the proper use of borrowed funds.

Studies have shown that high level of accumulated debt has an adverse effect on rate of investment and economic growth. If there is some likelihood that in future, debt will be larger than the country's repayment ability than the expected debt service costs will depress investment. Debt obligations can affect economic growth through the 'crowding out' effect. When resources are utilized for servicing debt, little is available for investment and growth.

The South Asia region has the largest fiscal deficit among developing countries with the region-wide deficit estimated at 8.2 percent in 2010. At the country level, fiscal deficits as a share of GDP range significantly from 2.5 percent for Bangladesh to 22.4 percent for Maldives. India was 9.6 percent, Sri Lanka 8 percent, Pakistan 6.3 percent and Bhutan 6.1 percent. Tax mobilization in the region is low, leading to high fiscal deficits. Government tax revenues averaged 14.3 percent as a share of GDP in 2009 – compared with Europe and Central Asia (21.4%), Sub-Saharan Africa (16.5%) and Latin America and Caribbean (16.4%).

South Asia region has large fiscal deficits

Meanwhile on the expenditure side, the region carries a heavy burden in the form of high interest payments. These averaged at 18.2 percent in 2009, by far the highest share among developing regions. The Report *Global Economic Prospects, January 2011* states, 'this reflects elevated interest payments as a share of total outlays in Bangladesh, (17.3%, as of 2009), India (17.7%), Pakistan (25.5%) and Sri Lanka (25.8%)'.

Global Economic Prospects Report for *2012* shows that 'in the region subsidy outlays have exceeded the targets. In India, subsidy outlays rose particularly due to an upsurge in oil subsidies. With a slowdown in activity, tax receipts failed to meet expected levels. The shortfall prompted the government to announce an increase in borrowing, which in turn led to a rise in government bond yields, raising the burden of interest payments. Slower revenue growth has contributed to larger fiscal deficits in Bhutan, Nepal and Pakistan.

On the expenditure side, fertilizer, food and fuel subsidies (on and off-budget) remain a significant burden on regional fiscal coffers. In Bhutan, a rise in capital expenditures was a key factor behind the expansion of the fiscal deficit. Other structural factors are at play across the region, including rising debt-servicing charges in a number of countries, while the region's low tax base makes consolidation especially challenging'.

Subsidy a burden on the budget

Large fiscal deficits in South Asia compared with other developing regions remain a source of concern, as government borrowing requirements may be crowding out private investment, while associated spending may be contributing to inflationary pressures. India's general government deficit is estimated at over 9 percent of GDP, significantly higher than the 1.7 percent average deficit for the emerging market economies belonging to the Group of 20, according to the *IMF's Fiscal Monitor*.

Despite efforts at consolidation, fiscal deficits are 6 percent or higher in Pakistan and Sri Lanka, and above 4 percent in Bangladesh. Subsidies, mainly for fuel and to a lesser extent for food, contribute to the overall deficits – subsidies account for over 2 percent of GDP in India and Pakistan, and over 3.5 percent of GDP in Bangladesh, according to the recent World Bank and IMF estimates. Moreover, losses of public sector firms in the petroleum and electricity sectors have been substantial in South Asian countries, implying a *'quasi-fiscal'* burden for governments.

Subsidies contribute to deficits

Government across South Asia have taken steps to redress these subsidies, in particular by raising administered prices for fuel, and in some cases, of electricity. For instance, Sri Lanka raised administered fuel prices in early 2012 as part of fiscal reforms, and again later in the year. Bangladesh has raised fuel prices to reduce the burden of subsidies. The Indian government raised regulated diesel prices by 14 percent in September 2012.

Efforts to bring deficits under control will also need to involve efforts to broaden the tax base, which is extremely narrow in some countries and to improve compliance – in particular, in Pakistan where a very small percentage of citizens pay income tax, states the *Global Economic Prospects 2013* Report.

Over the years, Pakistan has faced persistent fiscal deficits, because revenues have fallen short of meeting rising expenditures. Expenditure as a proportion of GDP has been higher than revenue generation as a proportion of GDP. The later suffers from narrow tax

South Asia: Selected Debt Indicators

	Afghanistan			Bangladesh			Bhutan			India		
	2000	2008	2011	2000	2008	2011	2000	2008	2011	2000	2008	2011
Summary external debt data												
External debt stocks	–	2134	2623	15596	22952	27043	212	695	1035	101130	227043	334331
Long-term external debt	–	1985	2023	14985	20300	22350	202	678	1021	96781	182173	250171
Public & publically guaranteed	–	1985	2023	14985	20300	22350	202	678	1021	81195	76248	107857
Private non-guaranteed	–	0	0	0	0	0	0	0	0	15586	105925	142314
Use of IMF credit	0	131	373	277	758	1271	8	9	9	888	1049	6108
Short-term external debt	–	17	228	334	1894	3422	2	8	5	3462	43821	78052
External debt flows												
Disbursements	–	132	81	861	1939	1469	35	32.0	267	10556	38690	42727
Long-terms external debt	–	96	62	861	1732	1469	35	32.0	267	10556	38690	72727
IMF purchases	0	36	19	0	206	0	0	0	0	0	0	0
Principal repayments	–	1	1	572	640	1181	5	43	47	6728	23685	22138
Long-terms external debt	–	1	1	487	632	1050	5	43	47	6702	23685	22138
IMF purchases	0	0	0	86	8	131	0	0	0	25	0	0
Interest payments	–	7	10	197	249	312	2	38	38	4232	7287	7039
Long-terms external debt	–	6	9	165	203	258	2	38	38	4007	5716	6192
IMF purchases	2	1	0	10	8	4	0	0	0	40	9	7
Short-term external debt	–	0	1	22	39	50	0	0	0	185	1563	841
Currency composition of public and publically guaranteed debt (%)												
Euro	–	0.0	0.0	–	0.7	0.5	–	11.6	8.9	–	5.4	3.6
Japanese yen	–	0.0	0.0	20.3	10.0	9.6	0.0	0.0	3.6	12.6	23.0	19.6
Pound Sterling	–	0.0	0.0	3.0	1.5	1.1	0.0	0.0	0.0	3.8	2.1	1.1
Swiss franc	–	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.3	0.2	0.2
US dollars	–	82.6	73.7	44.3	52.4	50.5	17.7	22.9	23.4	66.3	64.4	70.5
Average terms of new commitments												
Official creditors												
Interest (%)	–	0.5	0.0	2.4	1.2	0.9	3.6	0.8	0.5	5.6	2.0	1.0
Maturity (years)	–	34.6	0.0	28.4	37.5	34.7	32.1	38.9	31.2	23.7	26.4	25.2
Grace period (years)	–	10.0	0.0	7.4	9.5	3.6	10.5	9.4	9.6	6.5	5.3	5.0
Private creditors												
Interest (%)	–	0.0	0.0	3.0	0.0	0.0	0.0	0.0	0.0	4.2	4.4	2.8
Maturity (years)	–	0.0	0.0	12.7	0.0	0.0	0.0	0.0	0.0	5.0	8.7	7.5
Grace period (years)	–	0.0	0.0	3.2	0.0	0.0	0.0	0.0	0.0	4.8	2.5	5.8
Major economic aggregates												
Gross national income (GNI)	–	10810	–	48857	86607	119788	419	1073	1594	469716	1216938	1830516
Exports of goods, services & primary income	–	–	–	7293	17594	27334	–	686	761	62453	320713	446750
Imports of goods, services & primary income	–	–	–	10018	26286	39397	–	832	1399	80489	400437	568362
Current account balance	–	–	–	-306	840	244	–	-28	-355	-4601	-30.972	-60038
International reserves	–	2431	5268	1486	5689	8510	318	765	790	37902	247419	271285
Ratios												
External debt stocks to exports (%)	–	–	–	213.9	130.5	98.9	–	101.2	136.1	161.9	70.8	74.8
External debt stocks to GNI (%)	–	19.7	–	31.9	26.5	22.6	50.5	64.7	65.0	21.5	18.7	18.3
Debt service to exports (%)	–	–	–	10.5	5.1	5.5	–	11.9	11.1	17.5	9.7	6.5
Reserves to imports (months)	–	113.9	200.8	1.8	2.6	2.6	–	11.0	6.8	5.7	7.4	5.7

(US$ million, unless otherwise indicated)

	Maldives			Nepal			Pakistan			Sri Lanka		
	2000	2008	2011	2000	2008	2011	2000	2008	2011	2000	2008	2011
Summary external debt data												
External debt stocks	206.4	917.3	983.0	2878	3698	3956	32954	49505	60182	9173	15723	23984
Long-term external debt	184.7	697.1	726.3	2826	3551	3661	29684	43522	47685	8236	13345	19746
Public & publically guaranteed	184.7	488.6	684.4	2826	3551	3661	27124	40338	45122	7868	12611	18733
Private non-guaranteed	0.0	208.5	41.9	0	0	0	2560	3184	2563	368	734	1013
Use of IMF credit	0.4	4.4	27.5	23	89	214	1751	4614	9962	253	278	2325
Short-term external debt	21.4	215.9	229.2	29	57	81	1519	1370	2535	685	2100	1913
External debt flows												
Disbursements	13.6	144.9	124.5	154	103	306	1838	6802	2875	732	1238	3411
Long-terms external debt	13.6	144.9	124.5	154	103	306	1644	3601	2875	732	1238	2976
IMF purchases	0	0.0	0.0	0	0	0	195	3201	0	0	0	435
Principal repayments	13.9	67.2	73.6	71	127	167	1870	1943	1936	539	882	811
Long-terms external debt	13.9	64.7	73.6	67	127	162	1587	1763	1664	453	804	798
IMF purchases	0	2.4	0	4	0	4	282	180	272	86	78	12
Interest payments	5.9	29.3	20.3	31	35	36	995	1069	1023	252	350	503
Long-terms external debt	4.7	20.5	11.4	28	34	35	857	1026	805	213	286	446
IMF purchases	0.0	0.3	0.2	1	0	0	59	9	178	5	9	24
Short-term external debt	1.2	8.6	8.6	3	1	1	78	33	39	34	56	33
Currency composition of public and publically guaranteed debt (%)												
Euro	–	22.7	19.0	–	1.7	1.2	–	10.0	8.2	–	9.2	6.9
Japanese yen	0.0	0.3	4.9	9.2	8.0	10.2	16.9	17.7	19.5	30.0	31.4	26.6
Pound Sterling	0.2	0.0	0.0	0.1	0.0	0.0	0.7	0.2	0.1	0.5	0.1	0.0
Swiss franc	0.0	0.0	0.0	0.0	0.0	0.0	0.3	0.2	0.2	0.2	0.0	0.0
US dollars	53.3	47.0	43.9	38.6	42.5	40.5	41.6	44.3	45.7	38.4	40.4	51.7
Average terms of new commitments												
Official creditors												
Interest (%)	2.5	0.9	0.6	1.4	0.6	1.0	6.2	2.2	1.1	2.4	2.1	1.7
Maturity (years)	34.7	12.9	12.6	31.4	30.7	36.2	12.8	22.9	28.9	32.0	21.0	25.0
Grace period (years)	9.3	4.0	2.9	8.1	9.8	4.8	3.1	5.9	6.4	8.5	7.6	4.4
Private creditors												
Interest (%)	6.6	0.0	0.0	0.0	0.0	0.0	8.0	0.0	0.0	6.6	3.1	5.9
Maturity (years)	8.8	0.0	0.0	0.0	0.0	0.0	5.3	0.0	0.0	10.4	9.9	9.9
Grace period (years)	1.1	0.0	0.0	0.0	0.0	0.0	1.0	0.0	0.0	1.3	3.4	9.3
Major economic aggregates												
Gross national income (GNI)	594.3	1805.6	1959.6	5514	12695	18989	73025	167234	220252	16016	39746	58521
Exports of goods, services & primary income	467.5	1063.1	–	1354	1946	2150	10237	26756	32173	6527	10338	14109
Imports of goods, services & primary income	492.0	1646.9	–	1825	4456	6588	14484	53546	50838	8554	16889	23368
Current account balance	-51.5	-647.3	-490.1	-131	733	289	-85	-15655	-2234	-1044	-3885	-4615
International reserves	122.8	243.6	348.7	945	2458	3631	1513	7194	14528	1039	2469	6248
Ratios												
External debt stocks to exports (%)	44.1	86.3	–	212.5	190.0	184.0	321.9	185.0	187.1	140.5	152.1	170.0
External debt stocks to GNI (%)	34.7	50.8	50.2	52.2	29.1	20.8	45.1	29.6	27.3	57.3	39.6	41.0
Debt service to exports (%)	4.2	9.1	–	7.5	8.3	9.5	28.0	11.3	9.2	12.1	11.9	9.3
Reserves to imports (months)	3.0	1.8	–	6.2	6.6	6.6	1.3	1.6	3.4	1.5	1.8	3.2

Source: International Debt Statistics, The World Bank

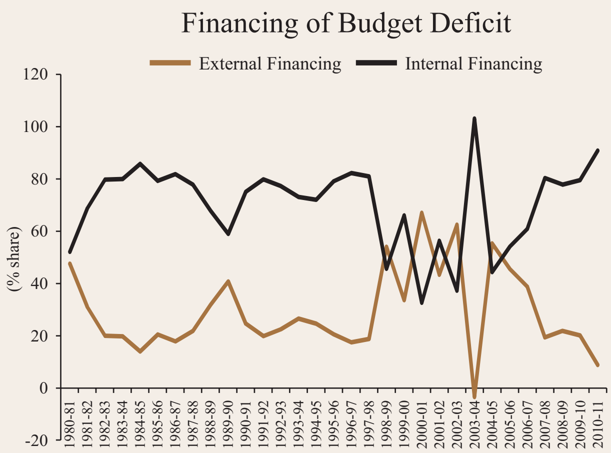
South Asia: Key Indebtedness Indicators, 2009-2011

Country	Total external debt, 2011 ($ Mn)	Ratio of total external debt to exports (%)	Ratio of total external debt to GNI (%)	Composition of Total External Debt Stocks for 2011 (US$ Mn)										
				Total long-term external debt	Public and publicly guaranteed, multilateral	Public and publicly guaranteed, bilateral	Public and publicly guaranteed, bonds	Public and publicly guaranteed, commercial banks and other	Private non guaranteed, bonds	Private non guaranteed, commercial banks and other	IBRD *(memo)*	IDA *(memo)*	Use of IMF credit	Short-term debt
Afghanistan	2623	84	17	2023	1073	950	0	0	0	0	0	413	373	228
Bangladesh	27043	123	25	22350	18690	3594	0	66	0	0	0	10712	1271	3422
Bhutan	1035	157	75	1021	385	636	0	0	0	0	0	138	9	5
India	334331	93	21	250171	48841	26870	16517	15630	10861	131453	11524	26605	6108	78052
Maldives	983	73	51	726	301	274	0	110	0	42	0	103	28	229
Nepal	3956	209	25	3661	3153	505	0	2	0	0	0	1426	214	81
Pakistan	60182	215	32	47685	25427	17927	1550	218	250	2313	1610	10772	9962	2535
Sri Lanka	23984	208	48	19746	6331	8459	3000	943	0	1013	0	2652	2325	1913

Source: International Debt Statistics – 2013, The World Bank

Pakistan appears to be a relatively highly indebted country compared to other South Asian countries. The ratio of external debt to exports at 215 percent is higher compared to others in the region. Maldives with external debt of $983 million has a ratio of 73 percent. Long term external debt primarily makes up for 79 percent of Pakistan's external debt.

base, revenue leakages, evasion and corruption and low level of fiscal effort. In the face of rising public expenditures and little effort at enhancing revenues, the government has resorted to borrowings both domestically and from external sources to finance the budget deficit.



The accompanying graph shows the financing of the budget deficit. The persistence of large fiscal deficit, financed by borrowing has resulted in the accumulation of public debt (domestic & foreign) in Pakistan, giving rise to the heavy burden of debt servicing. This has emerged as the biggest claimant of public resources and weighs down many development efforts, as resources are used to service the borrowed cost of the debt, rather than enable the country to break out of poverty and other economic and social injustices in society.

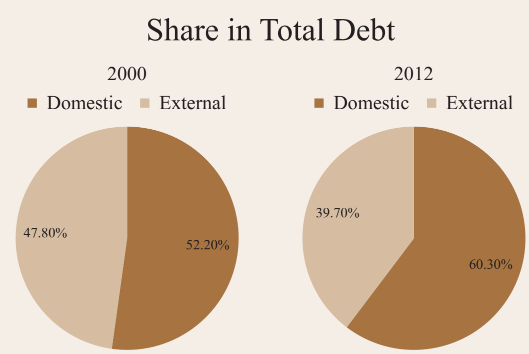
Growing public debt

Pakistan's total public debt stood at Rs12,924.3 billion as of end June 2012, equivalent to 62.6 percent of the GDP, with Rs7638.3 billion as domestic debt, Rs4364.5 billion as external debt, Rs694.3 billion as debt from IMF and Rs227.3 billion as external liabilities. In 2000-01 public debt was as high as 93 percent of GDP and accounted for nearly 600 percent of annual revenues. In 2001, Pakistan was the only country in South Asia to be classified as a severely indebted country by the World Bank. However, economic growth accelerated and as many macroeconomic indicators improved, public debt indicators also showed improvement. Modest growth in public debt, coupled with a strong growth in GDP led to a significant fall in public debt to GDP ratio from 82.8 percent in 2001-02 to nearly 56 percent in 2006-07. It has since risen.

External debt has grown less rapidly than domestic debt. In 1990, external debt was nearly 50 percent of GDP and internal debt 42.8 percent. By 2012 external debt stood at 29.1 percent and domestic debt at 37.0 percent. This reflects some limits to external borrowing and heavy reliance on domestic debt.

Composition of debt has changed

The composition of domestic and foreign debt has also undergone a change over the decades. In the 1990s the major share, 51 percent of total public debt was accounted by external debt, which has since fallen and the share of domestic debt has risen. Reliance on domestic borrowing has increased substantially in recent years as donors curtailed support due to failure of the government to implement the agreed power sector and taxation reforms under the IMF's Standy Arrangement 2008.



The government's domestic debt has increased from Rs3275 billion at the end of June 2008 to Rs7638 billion by June 2012 or by 133 percent. Meanwhile, the external debt has grown from Rs2780 billion to Rs4364.5 billion over the same period, or by nearly 57 percent.

External debt was 64 percent of GDP in 1970. However, this ratio has declined to 29 percent by FY12. Pakistan historically had higher access to concessional aid than it does in recent times. In the late 1980s and early 1990s, short term debt as a percent of total debt ranged between 12-18 percent. This has since come down to about 3-5 percent.

External debt

External debt of Pakistan consists primarily of medium and long term debt (more than one year) of the government with multilaterals (ADB, World Bank and the IMF) and bilaterals who are members of the Paris Club. On September 30, 2012 long term debt stood at $46.4 billion or 70 percent of total external debt, constituting the largest component of external debt. Debt from bilateral sources includes loan contracted with Paris Club countries and other countries outside the Paris Club. It is the second largest component of external debt. Private sector debt has a small share of 6 percent in total debt. On September 30, 2012 Pakistan owed to IMF a sum of $7.0 billion.

Composition of Pakistan's External Debt Outstanding
as of 30 September, 2012

($ Mn)

	30-Sept-2012
Public debt (1+2+3)	56285.6
1. Government debt	46854.7
i) Long term (>1 year)	46445.0
Paris Club	15328.5
Multilateral	25660.0
Other bilateral	2603.3
Euro/Sukuk global bonds	1550.0
Others	1303.1
ii) Short term (>1 year)	409.7
2. From IMF	7004.0
a) Federal government	1855.0
b) Central bank	5149.0
3. Foreign exchange liabilities	2426.9
4. Public sector enterprises (PSEs)	1585.9
a) Guaranteed debt	220.0
b) Non guaranteed debt	1365.9
5. Banks	1808.5
6. Private Sector	4495.8
7. Debt liabilities to direct investors - Intercompany debt	2067.0
Total external debt (1+2+3+4+5+6+7)	66242.8

Source: Monthly Statistical Bulletin, February 2013, SBP

The other components of external debt are, debts of public sector enterprises, banks and debts of private sector. Among the Paris Club members, Pakistan owes the largest debt to Japan ($8.1 billion) followed by France ($2.0 billion). Among the non-Paris Club countries Pakistan owes $3.2 billion to China. As of June 30, 2012 the country owed Rs25.2 billion to multilateral and others.

Medium and Long Term Debt Major Creditors
30-06-2012

($ Mn)

	Amount
I BILATERAL	
a) Paris Club Countries	
France	2033
Germany	1683
Japan	8066
United States	1472
Others	1760
Sub Total I.a. Paris Club Countries	15014
b) Non-Paris Club Countries	
China	3224
Kuwait	118
Saudi Arabia	437
Others	80
Sub Total I.b. Non-Paris Club Countries	3859
Total I. (a+b)	18873
II MULTILATERAL & Others	
ABD	11868
IBRD	1578
IDA	10967
IDB	570
Others	307
Total II: Multilateral & Other	25290
III BONDS	1550
IV COMMERCIAL BANKS	-
Grand Total (I+II+III+IV)	45713

Source: Economic Survey, 2011-12, GoP

Terms of loans contracted

The terms at which new loans are being contracted by Pakistan has changed over the years. The concessional element was higher in the earlier decades at almost 60 percent, but fell sharply in the 1990s and earlier part of the last decade. In recent years there has been some change, due to grants from the UK. The average interest rate has also changed. The table shows the maturity period of loans has fallen from 33 years to 22 years by 2010.

Terms of New Loans Contracted

	1970	1980	1990	2000	2010
Average Grant Element (%)	59.0	62.2	35.5	20.7	55.1
Average Interest Rate (%)	2.7	2.5	5.2	6.2	2.3
Average Maturity Period (Year)	33.5	35.5	22.9	12.8	22.0
Share of Concessional Debt (%)	68.9	71.2	58.4	55.0	59.1

Source: Review of External Debt in Pakistan, August 2012

Domestic debt

Pakistan's domestic debt is classified as, permanent debt (medium and long term), floating (short term) and unfunded debt (non-bank or direct public borrowing, having shares of 21.6 percent, 54.5 percent and 23.9 percent respectively in total domestic debt. Permanent debt mainly consists of medium to long term instruments like Pakistan Investment Bonds and Ijara Sukuk Bonds, Prize Bonds etc. Floating debt is short term debt, raised through domestic borrowings instruments such as treasury bills and State Bank borrowing through the purchase of market related treasury bills. Treasury bills are issued in tenors of 3 months, 6 months and 12 months. Unfunded debt is made up of various schemes available under the National Saving Schemes. The Central Directorate of National Savings mobilizes savings in the economy through the various schemes such as Defence Saving Certificates, Special Saving Certificates, Behbood Saving Certificates, Pensioners Benefit Account, Regular Income Scheme among others.

The outstanding amount under the various heads of domestic debt is given below.

Outstanding Domestic Debt

(Rs Bn)

	2008	2009	2010	2011	2012[P]	2013*
Permanent Debt	**616.8**	**685.9**	**797.7**	**1125.6**	**1696.9**	**1846.9**
Market Loans	2.9	2.9	2.9	2.9	2.9	2.9
Government Bonds	9.4	7.3	7.2	0.7	0.7	0.7
Prize Bonds	182.8	197.4	236.0	277.1	333.4	350.5
Foreign Exchange Bearer Certificates	0.2	0.2	0.1	0.1	0.1	0.1
Special US Dollar Bonds	8.3	7.7	2.7	1.0	0.9	0.9
Government Bonds Issued to SLIC	0.6	0.6	0.6	0.6	0.6	0.6
Pakistan Investment Bonds (PIB)	411.6	441.0	505.9	618.5	974.7	1075.0
GoP Ijara Sukuk	0.0	27.8	42.2	224.6	383.5	416.2
Floating Debt	**1637.4**	**1904.0**	**2399.1**	**3235.4**	**4143.1**	**4339.0**
Treasury Bills through Auction	536.4	796.1	1274.1	1817.6	2383.4	2759.6
Rollover of Treasury Bills discounted SBP	0.6	0.5	0.5	0.5	0.5	0.5
Treasury Bills purchased by SBP (MRTBs)	1100.4	1107.3	1124.4	1417.3	1759.2	1578.9
Unfunded Debt	**1020.4**	**1270.5**	**1457.5**	**1655.8**	**1798.0**	**1935.8**
Defence Saving Certificates	284.6	257.2	224.7	234.5	241.8	259.7
Savings Accounts	27.7	16.8	17.8	17.2	21.2	19.1
Mahana Amadni Account	2.5	2.4	2.2	2.1	2.0	2.0
Postal Life Insurance	67.1	67.1	67.1	67.1	67.1	67.1
Special Saving Certificates and Accounts	227.6	377.7	470.9	529.1	537.4	624.2
Regular Income Scheme	51.0	91.1	135.6	182.6	226.6	238.7
Pensioners' Benefit Account	87.7	109.9	128.0	146.0	162.3	167.0
Bahbood Savings Certificates	229.0	307.5	366.8	428.5	480.8	496.6
National Savings Bonds	-	-	3.6	3.6	3.6	3.6
G. P. Fund	42.5	40.1	39.9	44.3	54.5	55.0
Short Terms Savings Certificates	-	-	-	-	-	2.2
Total Domestic Debt	**3274.5**	**3860.4**	**4654.3**	**6016.7**	**7638.1**	**8121.7**

[P] Provisional
* end September, 2012

Source: Debt Policy Statement 2012

The composition of domestic debt has undergone considerable changes over the years.

Composition of Domestic Debt
% Share in Total Debt

	1990-00	2002-03	2004-05	2008-09	2010-11	2011-12
Permanent	19.8	24.1	24.0	17.7	19.0	22.2
Floating	39.4	27.5	36.0	49.3	54.0	54.2
Unfunded	40.7	48.4	40.0	33.0	27.0	23.5

Source: Economic Survey, various issues

Composition of domestic debt

The share of unfunded debt in domestic debt increased from 40.7 percent in 1999-00 to 48.4 percent in 2002-03, and thereafter its share has gradually declined. This was mainly because of the rationalization of interest rates of various instruments of the national saving schemes. In the 1990s, attractive real rate of return on the National Saving Schemes (NSS) with the added advantage of being tax exempt had resulted in a sharp rise in unfunded debt. Later, however, with the increase in the inflation rate and boom in property prices, NSS certificates became less attractive to investors to a large extent. Though the rate of return has fallen, NSS have remained popular and support the government in financing its budgetary requirements.

Share of floating debt rises

The share of floating debt in total domestic debt has considerably increased. It consists of treasury bills and central bank borrowing through the purchase of market related treasury bills. The share of floating debt has recorded a sharp increase. Increased holdings of T-bills by scheduled banks have been an important source of deficit finance in recent years. Government borrowings from the State Bank of Pakistan recorded a slower rise in FY10. The IMF has imposed limits on government borrowings from the State Bank. Consequently, government's budgetary borrowing through the banking system rose.

In addition, falling spread between various NSS instruments and T-bill yields have diverted non-banks institution's demand to T-bills. In FY10 the share of permanent debt has also risen, because of higher receipts in PIBs and the rise in the stock of prize bonds due to keen public interest in the newly introduced Rs25,000 denominated bond in FY12.

Interest payments

Interest payments on domestic debt have risen to Rs811.2 billion by end of FY12, against Rs440.2 billion in FY08. In these five years there has been a change in the structure of interest payments made under the various heads of domestic debt. Upto FY10 interest payments on unfunded debt constituted the single largest component of total domestic debt servicing, but in the following year interest payment on floating debt rose due to the sharp increase in the short term government borrowings, and a re-pricing of the accumulated stock of floating debt as of end FY10. The entire stock of Rs2.4 trillion at the beginning of the year was rolled over during FY11 on higher interest rates, as the SBP policy rate rose by 150 basis points during the first half of FY11, states the SBP Annual Report 2010-11.

Interest payments on permanent debt also grew. Interest payments on unfunded debt grew by 51 percent in FY12, and nearly one-third of the total increase (Rs811.2 billion) was due to encashment by institutional investors from National Saving Schemes, specifically Special Saving Certificates. Earlier, institutional investors were reinvesting interest payments on these certificates, but due to the ban on their participation, large withdrawals were seen during the year.

Interest Payments
(Rs Bn)

	FY08	FY09	FY10	FY11	FY12
Permanent debt	51.2	57.0	74.3	91.8	136.0
Floating debt	116.5	227.2	241.1	361.4	377.1
Market Treasury bills	59.1	71.8	101.1	191.9	202.8
Market Related Treasury bills	57.5	155.4	140.0	169.5	174.4
Unfunded debt	272.5	286.0	262.1	197.0	298.0
of which					
Defence Saving Certificates	217.5	207.1	146.9	55.9	70.8
Total Domestic Debt	440.2	570.6	577.7	650.3	811.2

Source: SBP Annual Reports

Pakistan external debt servicing have risen from $2.68 billion in FY07 to $4.29 billion by FY12. While interest payments on external loans saw a decline, repayments of principal rose, due to repayment to the IMF.

External Debt Servicing

($ Mn)

	FY07	FY09	FY10	FY11	FY12
Principal	1593.1	2837.4	3123.6	2439.0	3276.3
Interest	1090.9	1158.8	1007.1	1067.5	1014.7
Total	2684.0	3966.2	4130.8	3506.5	4291.0

Source: SBP Annual Report, 2011-12

Debt sustain-ability indicators

The debt sustainability indicators have shown a mixed trend. There are various such indicators; external debt liabilities to GDP, external debt to reserves, external debt servicing to total revenue, and debt servicing to exports of goods and services. The evaluation of a country's external debt sustainability includes an assessment of its debt carrying capacity as indicated by various solvency and liquidity indicators.

Pakistan's external debt burden as measured by external debt to GDP ratio declined to 28.5 percent in FY12 against 31.5 percent in FY09. There was also some improvement in the debt carrying capacity of the economy as measured by indicators, as interest payments to foreign exchange earnings (FEE) and external debt servicing to FEE. Both these ratios improved in FY11 because workers' remittances and export proceeds improved, resulting in a growth in FEE. However, in FY12, as debt servicing ratios to foreign exchange earnings and export earnings deteriorated it was reflected in the debt servicing burden which did not show an improvement. Foreign exchange reserves remained under pressure and the ratio short term debt plus current account balance to reserves deteriorated.

Indicators of External Debt Sustainability

(%)

	FY08	FY09	FY10	FY11	FY12
Solvency indicators					
TED/GDP*	--	--	33.4	30.3	27.4
EDL/GDP*	--	--	34.9	31.5	28.5
IP/FEE	3.4	3.3	2.7	2.3	2.2
EDS/FEE	8.7	13.5	12.2	7.5	9.0
IP/XE	6.1	6.1	5.2	4.2	5.5
EDS/XE	15.6	24.8	23.3	13.9	23.3
Liquidity indicators					
STD/TED*	--	--	3.3	2.6	2.0
RES/STD*	--	--	8.7	11.7	12.0
(STD+CAB)/RES*	--	--	34.9	7.5	38.8
WoM (Number)	17	21.1	28.2	27.8	19.9

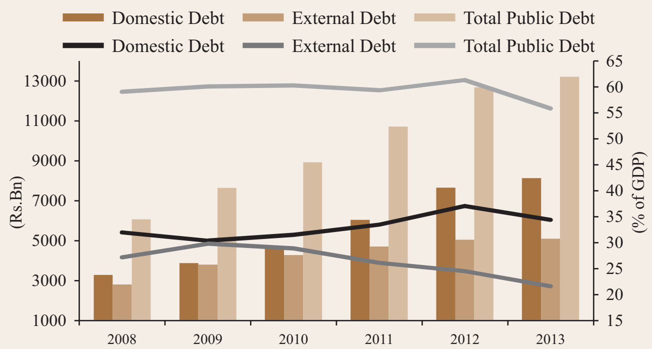
TED: Total External Debt; EDL: External Debt and Liabilities; IP: Interest Payments; EDS: External Debt Servicing; STD: Short Term Debt; CAB: Current Account Balance; WoM: Weeks of Imports; FEE: Foreign Exchange Earnings; XE: Exports Earnings; RES: Overall Reserves

* Debt data according to new coverage, not available before FY10.

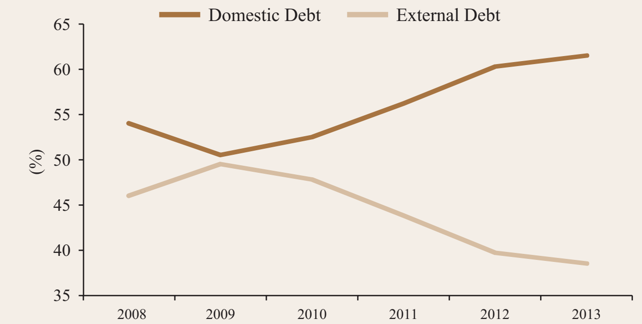
Source: SBP Annual Report, 2011-12

Selected Debt Indicators

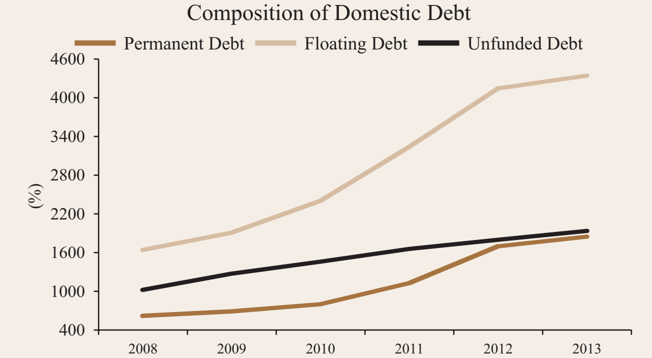
Public Debt



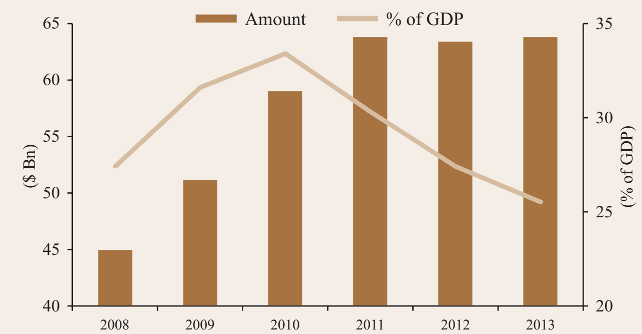
Domestic/External Debt as % of Total Debt



Composition of Domestic Debt

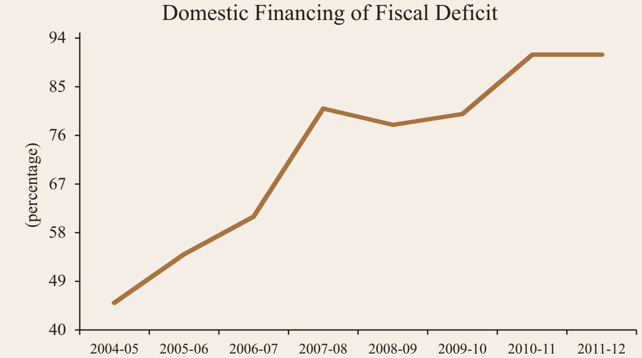


Pakistan's External Debt

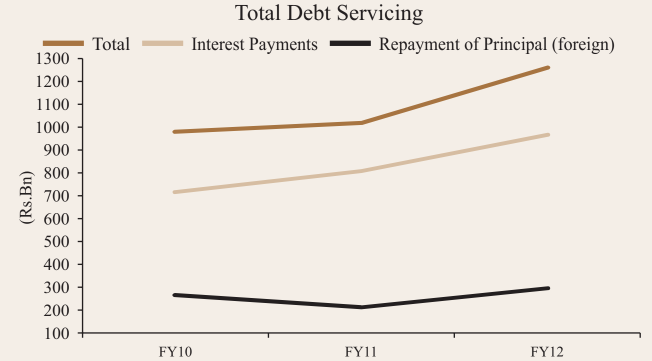


Pakistan's External Debt Servicing

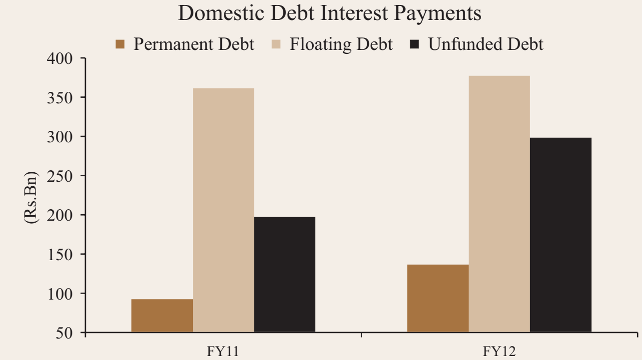
Domestic Financing of Fiscal Deficit



Total Debt Servicing



Domestic Debt Interest Payments



Pakistan's Economy — 2012

The Annual Report 2011-12, *The State of Pakistan's Economy, State Bank of Pakistan* has recently been released. We give below highlights of the Report: -

- The economy showed modest improvement in 2011-12. Gross domestic product (GDP) grew by 3.7 percent during the year, compared with 3.0 percent in FY11. The growth was however, lower against the target of 4.2 percent.
- Commodity producing sectors (agriculture plus industrial sector) posted a growth of 3.3 percent against 1.5 percent in FY11.
- The growth in the agriculture sector came from major crops and livestock sector.
- The industrial sector grew by 3.4 percent in FY12, higher than 0.7 percent in the previous year.
- Modest growth in large scale manufacturing was concentrated in a few sectors. Many industries suffered declines, these include steel, chemicals, tractors, trucks/buses, bicycles. Growth of cotton yarn, cotton cloth, cooking oil, sugar was slower over the previous year. Cement, fertilizer, paper & paper board, showed higher output.
- Services sector showed a sluggish growth of 4.0 percent against 4.4 percent a year earlier.
- Investment rate has been falling. During FY12, the investment-to-GDP ratio reached a low of 12.5 percent, due to security concerns, energy constraints, excess capacity with the manufacturing sector etc.
- Domestic savings have declined over the years. As a proportion of GDP it fell to 5.6 percent in FY12 against 8.6 percent a year earlier and from 11.5 percent in FY08.
- Inflation for FY12 was 11.0 percent, which is lower than the government's target of 12 percent and is also lower than the 13.7 percent posted in FY11.
- The State Bank of Pakistan lowered policy rate by a cumulative 200 basis points during the fiscal year. Policy rate was reduced by 50 bps to 13.5 percent in July 2011 and by 150 bps to 12 percent in October 2011.
- Following the cut in the policy rate, weighted average lending rates of commercial banks saw a reduction of 112 bps to 13.1 percent by June 2012, against 14.1 percent in June 2011.
- Budgetary borrowing from the banking system doubled in FY12 compared to the year earlier. The government borrowed Rs1198.3 billion during FY12, compared to Rs590.2 billion during FY11.
- Loans to the manufacturing sector grew by only 0.3 percent in FY12, compared to 9.6 percent in FY11. The decline was broad-based, as a large number of industries, either paid off existing loans, and/or reduced their fresh credit demand. The textile sector, one of the biggest users of bank credit, saw a net contraction of Rs23.7 billion in FY12, cement sector saw a contraction of 20.74 percent and sugar 1.2 percent. Fertilizer sector however, saw credit expansion of Rs8.9 billion compared to Rs2.3 billion in FY11.
- In FY12, the budget deficit rose to 8.5 percent of GDP, driven by strong growth in expenditures primarily increase in debt servicing, subsidies and development spending.
- Non-realization of envisaged receipts from the auction of 3G licenses and Coalition Support Fund overshadowed the growth in tax collections. As the external sources of funding dried up, the burden of financing the deficit fell on domestic sources. This has unfavourable implications for the sustainability of Pakistan's public debt.
- Domestic banking system has become the major source of deficit financing, which is

not only costly, but also carries a high opportunity cost, in terms of crowding out the private sector. Within the banking system, financing from the central bank increased sharply during the year.

- During FY12, net lending to private sector businesses was only Rs18.3 billion, against Rs692.3 billion that commercial banks lent (in net terms) to finance the budget deficit and the circular debt settlement.

- As of June 2012, just the deficit financing by commercial banks (ie their holdings of government securities) accounted for 34.4 percent of their aggregate balance sheet, while total private sector lending was only 39 percent; in June 2008, the stock of government securities was only 16.4 percent, while lending to the private sector was 52.4 percent of their total assets.

- FBR's tax-to-GDP ratio increased from 8.6 percent in FY11 to 9.1 percent in FY12.

- Currently, 1 percent of Pakistan's population pays income tax, compared to 3 percent in India and 40 percent in the US.

- Domestic debt servicing and pensions increased significantly. The increase in debt servicing is the result of excessive borrowing from banks, pension increases of 15 to 20 percent was announced in the FY12 budget.

- Public debt-to-GDP increased to 62.6 percent in FY12 compared with 60.9 percent in FY11.

- Pakistan's total public debt stands at Rs12.9 trillion, showing an increase of Rs1.9 trillion during the year. The sharp rise was due to a large fiscal deficit and exchange losses stemming from the depreciation of the Pak Rupee.

- Most of the increase in public debt was contributed by domestic debt, its share increased from 54.7 percent in FY11 to 59.1 percent in FY12.

- The stock of external debt and liabilities fell by $569 million to reach $65.8 billion by end June 2012.

- Pakistan's external debt burden fell from 31.5 percent of GDP in FY11 to 28.5 percent in FY12.

- The country's foreign exchange reserves came under pressure in FY12. During the year, as external loan inflows were not forthcoming, the current account deficit along with payments of external debt, led to a fall in the country's foreign exchange reserves from 27.8 weeks at end June 2011, to 19.9 weeks at end June 2012.

- Gross receipts in National Saving Schemes were higher despite two downward revisions in the rates in October 2011 and January 2012.

- The Central Directorate of National Savings launched certificates of shorter maturities, i.e. 3 month, 6 month and 12 month from July 1, 2012.

- For FY12, exports are estimated at $24.7 billion, a fall of 2.75 percent over the preceding year, and imports at $40.1 billion are 11.7 percent higher over $35.4 billion in FY11. Hence the trade deficit widened to $15.5 billion from $10.5 billion.

- Workers' remittances rose to $13.2 billion.

- Current account reverted to a deficit ($4.6 billion) after the surplus ($0.2 billion) seen in FY11.

- Foreign direct investment declined to $812 million in FY12 from $1.6 billion a year earlier.

- Pakistan was not the only country to experience a worsening external position. In the backdrop of the global recession, a number of emerging economies have experienced a deteriorating external position.

- Pakistan's liquid foreign exchange reserves declined to $15.3 billion by the end of FY12, compared with $18.2 billion a year earlier.

Strategic Trade Policy Framework 2012–15
Salient Features

The strategic trade policy announced for a three year period 2012-15 seeks to strengthen Pakistan's export competitiveness. The Policy focuses on regional trade, strengthening of the institutional framework for promotion of exports, creation of regulatory efficiencies, export development initiatives, promotion of domestic commerce and increasing exports from less developed regions of the country and strengthening the monitoring and evaluation mechanism.

- A domestic commerce wing is being set up in the Ministry of Commerce to establish necessary institutional and legal mechanism and business processes that facilitate domestic commerce regulations.
- Rationalize tariff protection policy. The Ministry of Commerce would adopt certain initiatives so to create a competitive environment.
- Pakistan Land Port Authority would be established to strengthen regional trade.
- Export Import Bank would be set up to provide export credit, suppliers credit and export credit guarantees.
- To promote services sector exports, a Services Trade Development Council is being established in collaboration with the relevant sectors.
- National Tariff Commission to be strengthened. A Resource Management Unit in the Ministry of Commerce and an International Trade Dispute Arbitration Council will be established.
- The Training and Product Development Institute would be strengthened.
- Export Promotion Agencies to be strengthened.
- Sector specific export development initiatives announced.
- Mark up support of 2 percent on existing LTFF to leather, engineering goods including auto parts, horticulture, processed food, marble & granite, sports goods and computer related services sectors announced.
- Mark up support of 1.5 percent on export finance scheme to selected export sectors.
- Services Export Development Council to be set up in collaboration with the private sector, to promote export of services.
- Ad hoc relief of 3 percent to selected non-textile exporting sectors to offset the impact of increasing cost of utilities.
- Retail outlets to be set up in major importing countries.
- The government to provide 50 percent subsidy on cost of setting up processing plants and machinery for meat, fruits, vegetables, dates & olives in Balochistan, Gilgit Baltistan, FATA and Khyber-Pakhtunkhwa.
- Rice inspection labs to be upgraded so to ensure that quality rice is exported.
- 100 percent mark up subsidy and 50 percent subsidy would be provided for the installation of wire saw cutting machines in Khyber-Pakhtunkhwa, FATA, Gilgit Baltistan and Balochistan.
- Leather Export Promotion Council would be established to promote export of leather sector.
- Amendments being introduced in trade regulations to simplify the procedures and strengthen the regulatory process.
- Regulate import of non-hazardous plastic scrap.
- Certain concessions allowed to facilitate Pakistani construction companies working abroad.

NBP, HBL and MCB Bank – Key Financial Indicators

(Rs. Mn)

Heads	NBP			HBL			MCB		
	Dec-11	Dec-12	% change	Dec-11	Dec-12	%	Dec-11	Dec-12	% change
Investments	319,653	344,400	8	399,939	777,185	94	316,652	402,069	27
Advances	525,046	655,891	25	416,261	460,071	11	227,580	239,583	5
Deposits	927,421	1,037,785	12	875,309	1,141,165	30	491,189	545,061	11
Total Assets	1,149,657	1,309,339	14	1,063,854	1,517,840	43	653,233	765,899	17
Total NPLs	88,161	88,742	1	64,954	69,289	7	26,665	25,562	-4
Provision against NPLs	63,476	69,451	9	57,343	60,313	5	21,869	22,380	2
NPL / Total Advances	15.0%	12.2%	-18	13.7%	13.3%	-3	10.7%	9.8%	-9
Net NPL / Net Advances	4.7%	2.9%	-37	1.8%	2.0%	7	2.1%	1.3%	-37
Specific Provision Coverage	72.0%	78.3%	9	88.3%	87.0%	-1	82.0%	87.6%	7

(Rs. Mn)

Heads	NBP			HBL			MCB		
	Dec-11	Dec-12	% change	Dec-11	Dec-12	%	Dec-11	Dec-12	% change
Gross Interest Revenue	95,325	99,611	4	96,447	114,400	19	68,147	68,356	0
Cost of Funds	48,516	55,937	15	41,563	58,324	40	23,620	27,500	16
Net Interest Revenue	46,810	43,674	-7	54,884	56,076	2	44,526	40,856	-8
Non-Interest Revenue	19,337	23,849	23	12,088	12,390	2	8,112	9,153	13
Total Revenues	66,147	67,524	2	66,972	68,466	2	52,639	50,010	-5
Provisions	9,880	8,367	-15	7,134	5,506	-23	4,168	291	-93
Administrative Expenses	30,255	35,899	19	27,806	29,334	5	16,987	17,665	4
Pre-tax profit	26,011	23,258	-11	32,032	33,626	5	31,483	32,054	2
After-tax profit	17,605	16,163	-8	20,742	21,564	4	19,425	20,941	8
EPS	9.5	8.7	-8	17.1	17.8	4	21.1	22.8	8

Key Ratios

(In %)

Heads	NBP		HBL		MCB	
	Dec-11	Dec-12	Dec-11	Dec-12	Dec-11	Dec-12
Return on Assets (pre-tax)	2.4	2.0	3.3	2.6	5.2	4.5
Return on Assets (After-tax)	1.6	1.4	2.1	1.7	3.2	3.0
Return on Equity (pre-tax)	24.3	20.5	36.6	33.0	42.5	38.4
Return on Equity (After-tax)	16.4	14.3	23.7	21.1	26.2	25.1
Yield on Earning Assets	9.7	9.2	10.6	9.4	12.4	10.7
CASA Ratio (excluding FI deposits)	67.2	73.1	71.4	68.4	81.0	85.0
Cost of Funds	5.9	6.1	5.0	5.2	4.8	4.8
Expense / Revenue	0.46	0.53	0.40	0.42	0.30	0.34
Non-Int.inc. as % of total income	34.0	40.1	20.2	19.6	16.6	18.5

NBP – National Bank of Pakistan
HBL – Habib Bank Limited

Source: NBP – Financial Control Division

Market Analysis

Market Review – January-February 2013

The market remained volatile during the month of January with KSE-100 index first dipping to a month low of 16,108 points on January 15th, but subsequently increased to close at 17,243 points showing a gain of 2 percent MoM. Political drama over long march as well as rental power case led to the market declining by around 800 points during the first half of the month. IMF mission's concern over economic numbers also added to apprehensions on the macro front. Tactful handling of the long march issue by the government and the opposition parties eased market concerns. As result season started from mid January, the market again started to focus on the corporate earnings, with political temperature also receding.

Average	Nov-12	Dec-12	Jan-13	MoM
Volumes (mn)	216	165	160	-3%
Value Traded (PKR mn)	4,982	4,127	4,061	-2%

On a MoM basis, average volumes of All Share index dipped by 3 percent, while value traded also declined by 2 percent. Looking at the indices return shows that KSE-30 increased by 2.3 percent MoM, which was slightly higher than 2 percent return for All Share index.

A closer analysis of monthly data shows that activity remained skewed towards the second half of month, with major uptick witnessed in volumes. Following the decline in political noise, investors again focused on corporate results during the second half of January. After declining by around 800 points in the first half, KSE-100 index jumped by a remarkable 1,135 points in latter half of the month to close at yet another all time high level.

Adjusted for the one off intergroup trade, Banks/DFIs were the biggest buyers during the month of January, as low yields on the fixed income side resulted in increased buying from them (especially in high dividend yielding companies), plus fresh allocation after year end would have also enticed them in increasing their participation on the equities side. Individuals and companies (adjusting for one off trade) were the main sellers during the month. Individuals were the biggest buyers during the previous month. Foreigners after remaining net seller during the month of December, again turned back positive in January.

Adjusting for one off deals, Banks/DFIs were the biggest buyers

Among the key sectors, Fixed Line Telecom sector provided the highest return in January after being the biggest underperformer in the previous month. PTCL's share price got a boost from Warid/Singtel deal as it provided a proxy for Ufone's valuation. Overall the telecom sector also outperformed due to rumors of hefty earnings expectations for the 2QFY13. Cement stocks also continued their rally due to elevated earnings being witnessed in current result season and change in sector dynamics. Portfolio allocation towards smaller cement scripts is also said to have increased, which resulted in the sector again outperforming the market. IPP's provided the third best sector return during the month as compelling double digit yields attracted interest towards regular dividend paying companies like Kapco and Hubco (especially from Banks/DFI's).

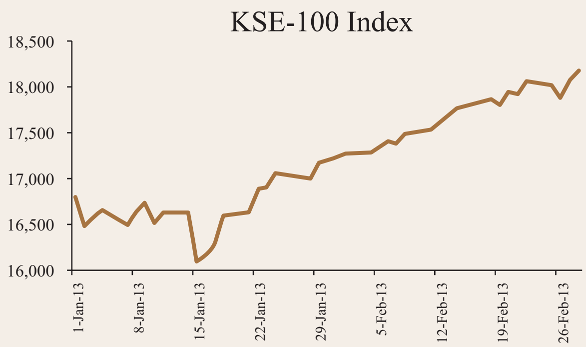
Telecom, Cements & IPPs remained the star

After witnessing a fair bit of volatility in the month of January, the market showed a straight upward trajectory in the month of February despite issues on the economic, political and law & order front intensifying. KSE100 index gained a hefty 932 points (5.4 percent) in February to continue its monthly gain streak, which is ongoing since June 2012.

As bulk of the corporate earnings was announced in this month, investor's interest remained tilted towards this side while ignoring the other political/economic issues. On a MoM basis, average volumes of All

Share index increased by a hefty 78 percent, while value traded also improved by the same percentage.

Average	Dec-12	Jan-13	Feb-13	MoM
Volumes (mn)	165	160	286	78%
Value Traded (PKR mn)	4,127	4,061	7,231	78%



In what is becoming a usual sight in NCCPL figures, foreigners continued to remain on the buying side, with net inflow of USD29mn witnessed in February. CYTD net inflow figures have now reached higher than USD50mn versus a mere USD11mn seen in the corresponding period last year. Companies & NBFC's were also on the buying side, but of smaller proportion. The biggest sellers during the month remained Mutual funds with net outflow of USD22mn. Mutual funds have consistently remained towards the selling side in the recent quarters. Banks/DFIs after being the biggest buyers in the previous month went on to report a net outflow of USD11mn in February.

Among the key sectors, Fixed Line Telecom sector provided the highest return for a second consecutive month, but this time it outperformed by an even bigger margin.

Telecom outperforms the market by a big margin

Telecom sector gave an outstanding return of 27 percent in February (versus KSE-100 index return of 5.4 percent) due to turnaround in sector earnings as they continued to book higher international call charges during the 2QFY13, as well as due to one off's in PTCL's results. Autos and Oil and Gas sector also outperformed the market due to improvement in volumes, and margin revision news in the case of OMC's.

Among the laggards, Banks unperformed the market due to lower spreads being witnessed by the industry, despite decent results/payout under the circumstance. Chemical sector also underperformed despite Engro's share price surge as overall sector uncertainty continued.

Future Outlook

With result season almost over and market at an even higher level, we advice investors to start booking profits as economic/ political/law & order issues are expected to take centre stage in the coming weeks. Foreign inflows remain the key factor propelling the market to new highs and likewise keeping the locals enthusiastic. However, we maintain our cautious stance especially at such high levels and advice exposure in top picks only. It now seems that we will not be entering the IMF program any time soon. While this seems good for keeping CPI low (election purpose), but this will ultimately have a negative impact on fiscal deficit and external account. This is a dangerous game that the government is playing, fallout of which will borne by the next government. Our top picks at current level are PPL, HUBC, NML, DGKC & PSO.

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

Book/Report Reviews

Rethinking the Role of the State in Finance
Global Financial Development Report 2013
The World Bank

The Report discusses the role of the state in the financial sector. It focuses on a broad range of stakeholders, including governments, international financial institutions, non-governmental organizations, academics, private sector participants and the development community. The report offers policy advice based on research and lessons from operational work.

The global financial crisis has shown that active state involvement in the financial sector can help maintain economic stability, drive growth and create jobs. The state has an important role, especially in providing supervision, ensuring healthy competition, and strengthening financial infrastructure. Financial sector policies need to be so designed so to better align private incentives with public interest without taxing or subsidizing private risk-taking.

The Report has five chapters. Chapter 1 introduces measures of different characteristics of financial systems that are useful in benchmarking financial systems around the world. It introduces a major new database, the Global Financial Development Database. Chapter 2–5 examine the various aspects of the role of the state as regulator and supervisor. It also reviews international regulatory and supervisory reforms and discusses proposals for further reforms. Chapter 3 focuses on the role of the state in competition policy.

Chapter 3 focuses on the role of the state in competition policy, while chapter 4 examines direct state interventions, particularly the experience with state-owned banks during the financial crisis. Chapter 5 relates to the role of the state in financial infrastructure. The report concentrates on banks. There are some references to and data on financial markets and non-bank financial institutions.

Report of the National Commission for Government Reforms on
Reforming the Government in Pakistan
Ishrat Hussain

In 2006, the National Commission for Government Reforms was given the task of analysising and recommending on how government, its institutions, and infrastructure can become more effective to meet the social, economic and political challenges that Pakistan faces in the 21st century. The Report covers the restructuring of Government at the Federal, Provincial levels, strengthening of the district government, reorganizing of civil services, improving human resource management policies and practices, with focus on recruitment, training, strengthening key institutions of governance, has addressed issues of compensation and benefits, performance appraisal, promotion policy and career management.

Chapter 7 Simplifying Rules, Processes Procedures shows that the rules and procedures in practice in public sector have adversely affected its working. The Commission has simplified rules and procedures to achieve the objective of efficiency and effectiveness.

Given the importance of education and the need to make quality education accessible to all the Commission has made recommendations for the consideration of Federal and Provincial Governments in Chapter 8. The recommendations are expected to improve governance in public sector education and would also involve the private sector in a more meaningful way.

The Commission has recommended reforms in a few selected areas of the health sector so to improve provision of better health facilities to the people of Pakistan. One of the chapters deal with police reforms, another with land revenue administration reforms, another chapter with reforms of selected key institutions.

The Millennium Development Goals
And the Road to 2015
Building on Progress and Responding to Crisis
The World Bank (2012)

The Report seeks to show the progress made in achieving the Millennium Development Goals target by 2015. It shows the achievements of the past 20 years and the challenges ahead. The eight MDGs are supported by 18 quantified targets and 60 indicators. Over the past decade, global progress has been made on the MDGs.

Progress on reducing poverty has been strong. Good progress has also been made on achieving universal primary education, eliminating gender disparities in primary and secondary education, and increasing access to safe drinking water. As a result, many countries have achieved or are likely to achieve the MDG targets set for 2015 in these areas. Progress on other MDGs — especially those related to health has been less encouraging. It has been slower in reducing child mortality and malnutrition. Progress on improving sanitation has been much slower – indeed, some of the slowest progress among the MDG target.

Progress on the MDGs has been particularly slow in low income countries. Lower middle income countries have done much better, though they still face serious challenges. A third are expected to achieve the poverty reduction target, and 38 percent have attained universal primary school completion, with another 7 percent on track to do so. Two thirds of lower middle-income countries have attained or are expected to attain gender equality in secondary schools. And 43 percent are expected to achieve the safe drinking water target. Two areas where lower middle income countries have done poorly are child mortality and sanitation access. Progress has been fastest among upper middle income countries.

Among regions, Sub-Saharan Africa lags on all the MDGs, including poverty reduction. The impact of global financial crisis on the MDGs would have been far worse but for the policy responses adopted by many countries which helped mitigate the effects of the crisis.

Gender and Urban Poverty in South Asia
Proceedings Report of the 2012
Subregional Workshop
Asian Development Bank

A subregional workshop on gender and urban poverty in South Asia was held in March 2012 in Colombo, Sri Lanka. It was attended by participants from Bangladesh, Bhutan, India, the Maldives, Nepal and Sri Lanka, who shared their experiences in addressing gender and social inclusion issues in urban sector policies and projects in their respective countries. They also suggested approaches on how to achieve equitable and sustainable growth with poverty reduction in South Asia.

The urban population of these countries is growing rapidly, and urban poverty and social exclusion are recognized as growing problems in South Asia, where 35 percent of the urban population lives in slums and informal settlements without access to secure housing, affordable basic services, and regular income earning opportunities. These countries face enormous challenges with urbanization. There is lack of affordable land in urban areas giving rise to slums and lack of security of tenure is the key constraint to improvements in basic services.

Legal and regulatory reforms are needed to ensure security of tenure, lack of formal employment and regulatory framework have led to the growth of the informal sector in urban areas. Labour and financial sector policies need to be addressed for poor urban people need opportunities for employment generation so that they can improve their livelihoods, legal reforms are necessary and need to be enforced, gender issues to be addressed. To meet the demands of growing urban population a strong partnership between government, private sector and civil society is needed. Pro poor and gender inclusive targets/features are integrated which would improve outreach to the poor.

Pakistan Economy – Key Economic Indicators

	Unit	2005-06	2006-07	2007-08	2008-09	2009-10	2010-11	2011-12[P]
Output and Prices								
GNP Size	Rs.bn	7773	8831	10452	13070	15370	18853	21679
GDP Size	Rs.bn	7158	8235	9922	12110	14034	17093	19437
Income Per Capita	$	823	904	1015	990	1068	1258	1372
Real Growth	(%)							
GNP		5.6	6.7	3.7	2.1	4.1	3.5	4.0
GDP		5.8	6.8	3.7	1.7	3.1	3.0	3.7
Agriculture		6.3	4.1	1.0	4.0	0.6	2.4	3.1
Manufacturing		8.7	8.3	4.8	-3.6	5.5	3.1	3.6
Services Sector		6.5	7.0	6.0	1.7	2.6	4.4	4.0
Prices*	(%)							
Consumer Price Inflation		7.9	7.8	12.0	17.0	10.1	13.7	11.0
Wholesale Price Inflation		10.1	6.9	16.4	18.9	13.8	21.2	10.4
Food Inflation CPI		6.9	10.3	17.6	23.7	12.6	18.3	11.0
Non Food Inflation CPI		8.6	6.0	7.9	18.4	8.3	10.7	11.0
Core Inflation†		7.5	5.9	8.4	11.4	7.6	9.4	10.6
GDP Deflator		10.5	7.7	16.2	20.0	12.4	18.2	9.7
Gold Tezabi (Karachi)	Rs./10 grams	10317	12619	16695	22195	29587	37658	48444
Petrol Super	Rs/Ltr	55.12	56.00	57.83	67.68	67.56	75.70	91.33
Kerosene Oil	Rs/Ltr	36.19	39.09	43.44	66.79	72.65	84.89	103.09
Wheat Flour (Avg. Quality)	Rs/Kg	13.06	13.64	18.07	25.64	28.77	29.56	30.15
Savings and Investment	% GDP							
National Savings		18.2	17.4	13.6	12.5	13.3	13.2	10.5
Domestic Savings		16.3	15.6	11.5	9.8	9.5	8.6	5.6
Gross Fixed Investment		20.5	20.9	20.5	16.6	14.0	11.5	10.9
Public Sector		4.8	5.6	5.4	4.3	3.5	2.9	3.0
Private Sector		15.7	15.4	15.0	12.3	10.4	8.6	7.9
Public Finance								
Revenue Receipts (Fed Govt)	% GDP	14.1	15.0	14.6	13.2	13.9	12.4	11.7
Tax Revenue	% GDP	10.5	10.2	10.3	9.8	10.0	9.3	9.4
Total Expenditure	% GDP	18.4	20.8	22.2	16.5	17.4	14.9	13.5
Overall Budget Deficit	% GDP	4.3	4.4	7.6	5.3	6.3	6.6	8.5
FBR Tax Collection (Fed Govt)	Rs.bn	713.5	847.2	1008.1	1161.1	1327.4	1558.2	1881.5
Direct Taxes	% share	31.5	39.4	38.4	38.2	39.6	38.6	38.9
Indirect Taxes	% share	68.5	60.6	61.6	61.8	60.4	61.3	61.1
Internal Debt Outstanding	Rs.bn	2337	2610	3275	3861	4651	6012	7638
Funded Debt	% of Internal Debt	62.3	64.0	68.8	67.1	68.7	72.5	76.5
Unfunded Debt	% of Internal Debt	37.7	36.0	31.2	32.9	31.3	27.5	23.5
Monetary Sector								
Growth of Broad Money (M2)	%	15.1	19.3	15.3	9.6	12.5	15.9	14.1
Currency in Circulation	Rs.bn	740.4	840.2	982.3	1152.2	1295.4	1501.4	1673.7

[P] *Provisional.* [*] *The base for price indices have been changed as 2007-08 new base year.* [†]*non-food non-energy.*

	Unit	2005-06	2006-07	2007-08	2008-09	2009-10	2010-11	2011-12[P]
Credit to Public Sector	Rs.bn	834	927	1510	2034	2441	3020	4258
Borrowings for Budgetary Support	Rs.bn	708	810	1365	1681	2011	2602	3800
Credit to Private Sector	Rs.bn	2114	2480	2890	2907	3020	3141	3376
Credit to Private Sector Enterprises	Rs.bn	196	207	114	266	351	388	257
Social Sector								
Population	Mn	155.37	162.91	166.41	169.94	171.73	175.31	178.91
Education Expenditure	as % of GNP	2.2	2.4	2.4	2.1	2.0	1.8	0.9[a]
Literacy Rate	(%)	54	55	56	57	58	58	58[b]
Health Expenditure	as % of GNP	0.5	0.6	0.6	0.6	0.6	0.6	0.3
Capital Market								
KSE 100 Index		9989	13772	12289	7162	9722	12496	13801
Market Capitalisation of								
Ordinary Shares	Rs.bn	2801.2	4019.4	3777.7	2120.7	2732.4	3288.7	3518.1
Banking Sector								
Scheduled Banks Deposits	Rs.bn	2817	3373	3812	4138	4693	5489	6219
Scheduled Banks Advances	Rs.bn	2071	2376	2816	3080	3174	3311	3530
Non-Performing Loans All Banks	Rs.bn	173	214	314	432	548	607	636
Lending and Deposit Rates	weighted average							
Deposits	% per annum	1.96	2.60	4.13	4.44	4.29	4.53	4.56
Advances	% per annum	10.61	11.55	12.49	14.25	13.63	13.46	12.81
Open Market Operation								
SBP Reverse Repo Rate	% end period	9.00	9.50	12.00	14.00	12.50	14.00	12.00
Treasury Bills Yield - 6 Months	% end period	8.49	8.90	11.48	12.00	12.30	13.70	11.90
KIBOR - 6 Months	% end period	9.36	9.75	13.95	12.65	12.25	13.65	11.94
Yield on 5 Years PIBs	weighted average	9.65	10.00	10.80	12.40	12.50	14.03	13.08
Interbank Call Rates (Overnight)	%	8.80	8.90	9.90	13.20	11.60	12.40	11.70
SBP Export Finance Rate	%	7.50	6.50	6.50	6.50	8.00	10.00	10.00
External Sector								
Exports*	$ bn	16.45	16.98	19.05	17.69	19.29	24.81	23.62
Imports*	$ bn	28.58	30.54	39.97	34.82	34.71	40.41	44.91
Balance	$ bn	-12.01	-13.56	-20.92	-17.13	-15.42	-15.60	-21.27
Current Account Balance	$ mn	-4990	-6878	-13874	-9261	-3946	214	4634
Workers' Remittances	$ mn	4588	5491	6449	7811	8905	11201	13187
Foreign Investment in Pakistan	$ mn	3872	6960	5454	3210	2739	2000	741.5
Direct	$ mn	3521	5140	5410	3720	2151	1635	812.6
Portfolio	$ mn	351	1820	44.3	-510	588	365	-71.1
Debts								
External Debt and Liabilities	$ bn	37.6	40.5	46.2	52.3	61.6	66.4	65.8
Domestic Debt Outstanding	Rs.bn	2337	2610	3275	3861	4654	6012	7638
Internal Debt as % of GDP	%	30.7	30.1	32.0	30.3	31.4	33.4	37.0
National Saving Schemes (Outstanding)	Rs.bn	936	1004	1094	1361	1586	1821	2010
Gold & Foreign Exchange Reserves	$ mn	14354	18890	13436	13971	17921	20941	16489
Exchange Rate (Average for year)	Rs/US$	59.8566	60.6342	62.5465	78.4983	83.8017	85.5017	89.235

** Trade data compiled by Pakistan Bureau of Statistics*
[a] as % of GDP [b] as of FY11

Source: Pakistan Economic Survey 2011-12
Annual Report 2011-12, State Bank of Pakistan